



REPUBLIC OF MALAWI

MINISTRY OF FINANCE

**ANNUAL PUBLIC DEBT REPORT
FOR THE
2019/2020 FINANCIAL YEAR**

SEPTEMBER 2020

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EXECUTIVE SUMMARY

This annual report on public debt provides a comprehensive analysis of Malawi's sovereign debt situation as of June 30th 2020. It is part of a series of semi-annual public debt reports published by the Ministry of Finance. At the end of the 2019/20 Financial Year (FY), Total Public Debt (TPD) stood at MK 4.13 trillion or 65 percent of Gross Domestic Product (GDP). This is an increase of MK 458 billion over the same statistic a year earlier. Of the TPD stock, MK 2.37 trillion (or 57 percent) were Domestic Debt and USD 2.39 billion were External Debt.

Domestic Debt grew by 20 percent in the 2019/20 FY, significantly faster than External Debt. The Domestic Debt portfolio consisted of 89 percent of medium- to long-term Treasury Notes, eleven percent of short-term Treasury Bills and less than one percent of Promissory Notes. The Reserve Bank of Malawi (RBM) is no longer the largest holder of Domestic Debt with 26 percent of the government portfolio, surpassed by commercial banks, which hold 34 percent and only narrowly behind the Foreign Sector, which holds 24 percent. Yields on Domestic Debt were high, especially on longer-term securities when compared to External Debt and peer-countries.

External Debt was primarily owed to multilateral creditors (83 percent), with the rest repayable to bilateral creditors (17 percent). The International Development Association (IDA) is the largest creditor by volume, being owed USD 1.01 billion by the Malawian government, followed by the African Development Fund (ADF) and the International Monetary Fund with USD 364 million and USD 323 million, respectively. In terms of currency composition, 46 percent of External Debt is in USD, 24 percent in EUR and 30 percent in other currencies, this is after the decomposition of Special Drawing Rights. Eight new loans were contracted in the 2019/20 FY with commitments amounting to USD 661 million.

As for guarantees, there were no called guarantees in the reporting period however Government guaranteed MK 159 billion in debt held by state-owned enterprises.

Major risks concerning the Malawian public debt status include the high stock of domestic debt, refinancing risk, and exposure to exchange rate risk. According to the latest Debt Sustainability Analyses, Malawi is at moderate risk of external debt distress but high overall risk of debt distress due to large amounts of high-interest domestic debt being owed. The Average Time to Maturity (ATM), an indicator of refinancing risk, decreased from 9.7 years to 8.3 years in the course of the 2019/20 FY due to the increased share of Domestic Debt, which has a lower ATM of 2.7 years. 40 percent of the present value of debt was denominated in foreign currency, introducing significant exchange rate risk. The management of debt became more proactive in the course of the 2019/20 FY, with increased active communication, the execution of Liquidity Management Operations (LMOs) and refined debt governance.

PREFACE

The Debt and Aid Management Division in the Ministry of Finance is the primary agent of the Government of Malawi that is responsible for contracting and managing the country's public debt. It is responsible for the compilation and dissemination of public debt statistics. Comprehensive and timely public sector debt statistics allow the government and other stakeholders to monitor the evolution of the public sector's debt liabilities and its debt-service obligations over time. Debt statistics provide early warning signals of possible debt-servicing problems and serve as an indicator of the sustainability of government and public corporations' policies. In addition, public debt statistics serve as essential inputs for government budget preparation, for approval by parliament, for execution, for forecasting, and for compiling other macroeconomic statistics.

This report covers loans and debt securities under budgetary central government debt. It also covers publicly guaranteed debt to state-owned enterprises (on-lending) and debt owed to the International Monetary Fund. In terms of valuation, domestic debt is reported at Face Value and external debt is Disbursed Outstanding Debt. For future debt reports, the Government aims at adopting nominal valuation and extending coverage to Special Drawing Rights. This is in line with international standards as stipulated in the Public Sector Debt Statistics Guide.

This edition highlights debt management operations issues, Malawi's external and domestic debt portfolios, risk analysis for the period July 2019-June 2020. The public debt portfolio review provides analysis on the public debt composition, debt sustainability analysis and debt dynamics analysis. The external debt portfolio review focuses on the evolution and composition of debt by creditor and currency. The domestic debt portfolio review focuses on the main instruments and holders of debt. The risk analysis assesses the risks associated with the external and domestic debt portfolios.

An electronic version of this report is available on the Ministry's website:
www.finance.gov.mw .

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ACRONYMS AND ABBREVIATIONS

| | |
|--------|---|
| ADF | African Development Fund |
| ADMARC | Agricultural Development and Marketing Corporation |
| AfDB | African Development Bank |
| ATM | Average time to maturity |
| ATR | Average time to re-fixing |
| CNY | Renminbi, official currency of the People's Republic of China |
| CSDRMS | Commonwealth Secretariat Debt Recording and Management System |
| DAD | Debt and Aid Management Division |
| DMTC | Debt Management Technical Committee |
| DSA | Debt Sustainability Analysis |
| EIB | European Investment Bank |
| EUR | Euro, official currency of 19 European Union member states |
| FX | Foreign Exchange, currencies other than the Malawi Kwacha |
| FY | Financial Year of Malawi (July 1 st to June 30 th) |
| GBP | Pound sterling, official currency of the United Kingdom |
| GDP | Gross Domestic Product |
| IDA | International Development Association |
| IFAD | International Fund for Agricultural Development |
| IFMIS | Integrated Financial Management Information System |
| IMF | International Monetary Fund |
| IR | Interest Rate |
| JPY | Japanese Yen, official currency of Japan |
| LMO | Liquidity Management Operation |
| MK | Malawi Kwacha, official currency of Malawi |
| MTDS | Medium-Term Debt Management Strategy |
| PV | Present Value |
| RBM | Reserve Bank of Malawi |
| SBR | Sub-committee on Short Term Borrowing Requirements of the Debt Management Technical Committee |
| SDR | Special Drawing Rights, unit of account of the International Monetary Fund |
| TPD | Total Public Debt |
| USD | United States Dollar, official currency of the United States of America |

SECTION I: RECENT PUBLIC DEBT MANAGEMENT OPERATIONS ISSUES

1.1 Debt Management Policy Objective

The primary objective of debt management is to ensure that financing needs and debt service obligations of the Government are met adequately and at the lowest possible cost and a reasonable level of risk. The secondary objective is to support the development of a vibrant domestic debt market. To that end, the Government remains committed to containing and controlling public expenditure to avoid unsustainable debt trajectory. The Government shall continue with its policies of contracting external loans on concessional terms and restructuring of the domestic debt from predominantly short-term treasury bills to medium to long term papers. These policies will ensure that debt remains at sustainable levels.

1.2 Macro-economic Developments

Despite political uncertainty and the onset of the COVID-19 pandemic, the economy enjoyed relative macroeconomic stability. GDP growth in the 2019/20 FY stood at 3.4 percent. The inflation rate remained low and relatively stable, oscillating between double and single digits. The pandemic and its attendant uncertainty are also reflected in the all-type yield for Treasury Bills. It declined steadily from 9.6 percent in June 2019 to 8.1 percent in November 2019, before increasing again to levels last seen in January 2019 (13.1 percent) with 12.4 percent in June 2020. In terms of the foreign exchange, the Malawi Kwacha was stable against the United States Dollar and consequently appreciated in real terms relative to most other currencies.

1.3 Medium-Term Debt Management Strategy

While an updated MTDS is in progress, the reporting period is still based on the MTDS approved by the Minister of Finance in December 2018 covering the FYs 2018/19 to 2021/22. The MTDS has a provision for annual updates. To reduce re-financing and re-fixing risks of the public domestic debt stock, four strategies were considered as follows:

- Strategy 1 – status quo whereby Government will continue borrowing from concessional and, where necessary, semi-concessional external sources and maintain the current composition of domestic debt;
- Strategy 2 – lengthening of the domestic debt maturities through the issuance of 2- and 3-year Treasury Notes;
- Strategy 3 – lengthening of the domestic debt maturities by issuing 2- and 3-year Treasury Notes while increasing the proportion of 5- and 7-Year Treasury Notes (T-Notes); and
- Strategy 4 – increased net domestic borrowing to substitute slow or non-disbursing amounts of concessional and non-concessional loans.

Out of the four strategies, Strategy 3 was the most preferred as it provides the lowest debt maturing in one year, thus demonstrating the lower re-financing and re-fixing risks relative to the other strategies. Strategy 1 yielded higher debt maturing in one year. Likewise, Strategy 2 had a higher proportion of debt that requires re-fixing within a year thus exposing the debt portfolio to risks emanating from fluctuations of interest rates. Strategy 4 yielded the highest interest payments as a percentage of GDP. The choice of Strategy 3 is based on its relative costs and risks. It was supplemented by the issuance of small amounts of 10-year Treasury Notes to test the acceptability of longer tenors in the market.

The MTDS is strictly being implemented. Table 1 below shows the proportions of the two main instruments as per strategy. This translated into the exact same proportions of 35 percent Treasury Bills and 65 percent Treasury Notes in the published issuance calendars. The actual issuances over-allocated slightly on Treasury Bills, but maintained the same order of magnitude. The main reason for over-allocation on Treasury Bills was that the Issuance Calendar was only published in August 2019, while Treasury Bill issuances commenced in July 2019.

Table 1: Debt Issuances in the 2019/20 FY by Instrument according to Strategy, Indicative Amounts and Actual

| | MTDS | Issuance Calendar | Actual |
|---|-------------|--------------------------|---------------|
| Treasury Bill Amount (MK millions) | N/A | 277,349 | 334,189 |
| Treasury Note Amount (MK millions) | N/A | 523,789 | 534,890 |
| Treasury Bill Share | 35% | 35% | 38% |
| Treasury Note Share | 65% | 65% | 62% |

Source: Ministry of Finance

1.4 Debt Sustainability Analysis

The Debt Sustainability Analysis (DSA) conducted in May 2019 remains relevant for the reporting period. Its results were vindicated by a DSA conducted by the World Bank and International Monetary Fund (IMF) in May 2020, which largely attested the same results. The DSA aimed at updating policymakers on Malawi's debt portfolio and assess the risks and vulnerabilities associated with planned future borrowing to ensure long-term debt sustainability. The DSA was done using the revised standardised joint World Bank/IMF Debt Sustainability Framework for Low-Income Countries analytical tool. The analysis informed the overall space available to the Government to absorb shocks given additional borrowing. It was conducted and concluded in a timely manner to inform the 2019/20 and 2020/21 FYs national budgets.

The DSA results indicate that Malawi's external debt portfolio remains sustainable over the medium term with all sustainability indicators, such as the ones presented in Table 2, falling below their recommended thresholds. Both projected stock expressed in Present Value (PV) and projected debt service payments for external debt are moderate with them remaining below the relevant benchmarks for the entire forecast period. However, the country faces a moderate risk of external debt distress with limited space to absorb

shocks as it is highly vulnerable to export-related shocks. Considering domestic debt, however, the country is at high risk of debt distress.

Table 2: External Debt Burden Indicators

| Indicator | Threshold | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|------------------------------------|-----------|------|------|------|------|------|------|
| PV of debt (% of GDP) | 30% | 19% | 21% | 24% | 25% | 25% | 26% |
| PV of Debt (% of exports) | 140% | 88% | 99% | 109% | 112% | 114% | 118% |
| Debt service (% of exports) | 10% | 5% | 5% | 6% | 6% | 6% | 7% |
| Debt service (% of revenue) | 14% | 6% | 6% | 7% | 7% | 7% | 8% |

Source: Ministry of Finance

1.5 Newly Signed Loans

Eight loans were contracted in 2019/20FY with commitments amounting to USD661 million. The loans were mainly contracted from the IDA of the World Bank, the ADF of the African Development Bank (AfDB), International Fund for Agricultural Development (IFAD), European Investment Bank (EIB) and Export-Import Bank of India Exim Bank. The loans will finance energy, roads, infrastructure, water and agriculture sectors (Refer to Annex 1).

Of the eight newly signed loans, Government on-lent two loans from IDA, namely Malawi Electricity Access and Mozambique –Malawi Interconnector to the Electricity Supply Corporation of Malawi and one loan for drinking water supply schemes from India Exim Bank to Blantyre Water Board and Southern Region Water Board. The on-lent loans bear the same financing terms as per the creditors’ terms.

1.6 Strengthening Debt Management

Government is committed to strengthening debt management. The Debt Management Technical Committee (DMTC) was held monthly. The DMTC plays an advisory role on public debt management issues.

Another initiative is the sub-committee on Short Term Borrowing Requirements (SBR), to which the Debt and Aid Management Division (DAD) is the Secretariat. The SBR meets every week to consider the liquidity and possible financing requirements for the week and overall impact on debt. Besides, good coordination between Debt Management and Cash Management was realized through monthly Cash Management Committee meetings, which has led to improved cash flow forecasting.

1.7 Communication and Investor Awareness

In the 2019/20 FY, DAD introduced a new activity to strengthen debt management. Together with Cash Management Unit, DAD held two meetings with participants in the domestic debt market. While the RBM, the government's advisor on domestic debt issues, has been in close exchange with those participants for some time, this was the first time a structured exchange directly between investors and government debt managers took place.

Furthermore, DAD officials participated in workshops on Valuation of Capital Markets and Symposium on Leveraging Pension Funds for Infrastructure Development. Both events were organised by RBM. These meetings provided a platform for interacting with market players in order to enhance public awareness on government securities and on deliberate measures towards Local Currency Bond Markets development. Going forward, DAD plans to have a harmonised communication strategy.

1.8 Liquidity Management Operations

During 2019/20FY, Government in collaboration with the RBM undertook LMOs in form of government securities buy-backs. The LMOs were aimed at reducing bulky maturities. To reduce considerable maturities in September 2020, the Government bought back two Treasury Notes with a total face value of MK 29 billion in three reverse auctions between January and March 2020.

1.9 Debt Securities Issuance Calendar

During the year under review, Government in collaboration with the RBM also developed an Issuance Calendar, which was published regularly, included indicative amounts and guided issuances of debt securities. The Issuance

Calendar was developed in line with the 2019-2022 MTDS. The Issuance Calendar was successfully implemented as evidenced by a continued ATM of 2.7 years despite large maturities in the 2020/21 FY. This confirms the lengthening the maturities of the domestic debt securities portfolio (more discussion in Section 5.1).

The year under review saw the maiden issuance of a development bond. This bond was issued on 14th April 2020, denominated in MK and had a 5-year tenor. The government fully raised the MK 21 billion it targeted in an oversubscribed auction. The funds were ring-fenced and dedicated to the construction of new houses for personnel of public security institutions.

1.10 Public Financial Management Issues

During 2018/19 FY, Government embarked on activities that will enhance the Integrated Financial Management Information System (IFMIS) in order to improve public financial management. One of the activities was incorporation of Public Debt accounts into IFMIS. Data on public debt is managed in the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS). Since CS-DRMS is not interfaced with IFMIS, information on debt transactions, in particular principal repayments, was not incorporated in IFMIS. To that end, Government has resolved to incorporate public debt transactions into IFMIS. Government is now testing a new IFMIS with a functionality for integration with the debt recording system. It is envisaged once full integration is achieved, it will enhance reconciliation of Government Accounts and improve Government debt operations reporting.

1.11 Limits of Borrowing

Government borrowing continues to be guided by the Public Financial Management Act of 2003 and the RBM Act of 2018. Together, the Acts limit central bank financing, the stock of Treasury Bills and various other debt management procedures. Furthermore, Malawi continued to be on the IMF's Extended Credit Facility programme which restricts non-concessional borrowing. Where Government intends to contract non-concessional loans, Government is expected to seek a waiver from the IMF. The Government fully

observed all legal stipulations and successfully met all benchmarks in the IMF programme review in December 2019.

SECTION II: TOTAL PUBLIC DEBT PORTFOLIO AS AT 30 JUNE 2020

2.1 Composition of Total Public Debt

As at end-June 2020, TPD stock amounted to MK 4.1 trillion or 65 percent of Gross Domestic Product (GDP), up from MK 3.7 trillion or 65 percent of GDP, in June 2019. This means debt and GDP grew in unison over the period. The nominal change in TPD translates into an increase of 12 percent between the two periods.

Table 3: Evolution of Public Debt (in Millions)

| | 2005 | 2006 (HIPC) | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|-------------------------------|---------|----------------|-----------|-----------|-----------|-----------|
| Total Public Debt (MK) | 426,592 | 130,846 | 2,628,777 | 3,058,238 | 3,669,238 | 4,127,736 |
| External (USD) | 2,969 | 452 | 1,921 | 2,132 | 2,190 | 2,388 |
| Domestic (MK) | 73,337 | 68,957 | 1,235,037 | 1,511,176 | 1,971,910 | 2,367,221 |
| GDP | 326,957 | 430,522 | 4,224,062 | 4,950,925 | 5,618,192 | 6,372,145 |
| Domestic Revenue | 62,082 | 75,805 | 871,160 | 971,740 | 1,050,338 | 1,144,698 |
| Percent of GDP | | | | | | |
| Total (%) | 130 | 30 | 62 | 62 | 65 | 65 |
| External (%) | 108 | 14 | 33 | 31 | 30 | 28 |
| Domestic (%) | 22 | 16 | 29 | 31 | 35 | 37 |

Source: Ministry of Finance

The increase in the 2019/20 FY can be predominantly traced to the domestic component of TPD, which increased by MK 395 billion to MK 2.4 trillion (37 percent of GDP), while external debt increased by USD 198 million to USD 2.4 billion (28 percent of GDP).

2.2 Analysis of Interest rates

Loans and Debt securities in Malawi's public debt portfolio are on fixed rates. However, Treasury Bills rates reset when rolled over. In terms of implied interest rates, external loans registered a maximum of 1.98 percent and securities rates ranged between 9.77 to 19.01 percent as per Table 4 below. With 0.6 percent inflation on the USD and 9.8 percent on the MK, this translates to real interest rates of 0.14 to 1.38 percent on external debt and -0.03 and 9.21 percent on domestic debt.

Table 4: Interest rates

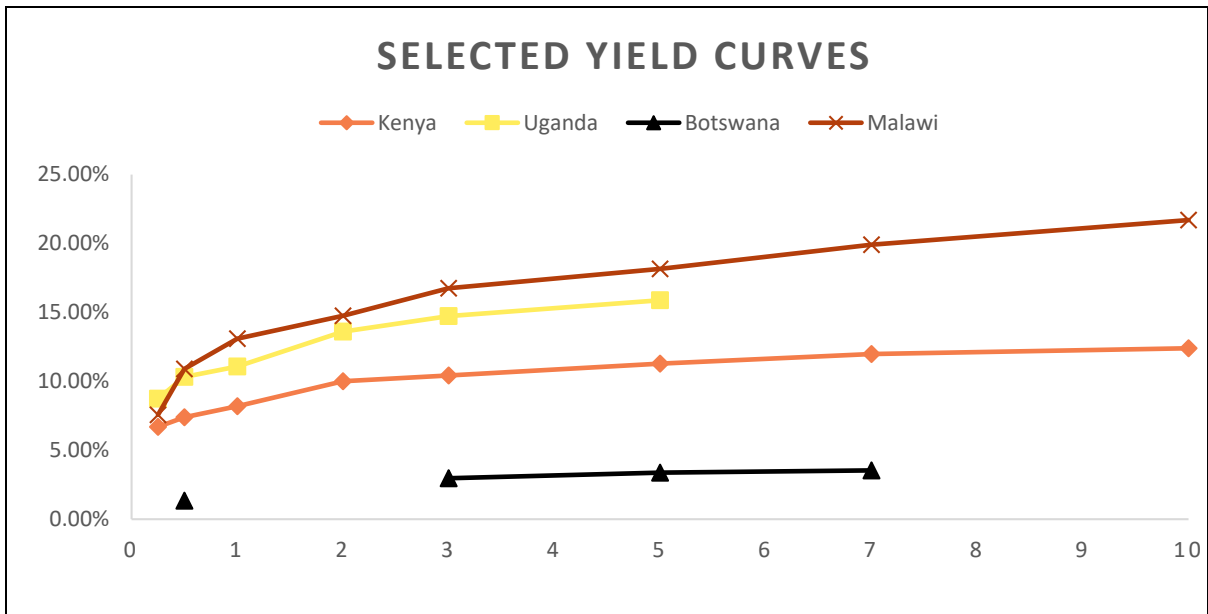
| Loan | Implied Interest rate | Securities | Implied Interest rate |
|----------------------------------|------------------------------|-------------------|------------------------------|
| Existing and New ADF/ IDA | 0.74% | T-bills | 9.77% |
| Concessional-Others | 1.31% | 2-Year TN | 12.75% |
| Semi-concessional (USD) | 1.08% | 3-Year TN | 13.29% |
| Semi-concessional (CNY) | 1.98% | 5-Year TN | 16.73% |
| | | 7-Year TN | 19.01% |
| | | 10-Year TN | 18.76% |

Source: Ministry of Finance

A comparison between Malawi and peer countries in the region shows that Malawi's short-term yields remain moderate. This is despite relatively high inflation and a high-risk rating in the DSA. Outliers in the region are Botswana, which through fiscal and monetary prudence achieves exceptionally low yields. Zambia (not included on the chart), on the other hand, with its recent debt distress situation records yields of 38 percent on its 10-year bonds.

What remains particular about Malawi's yield curve is the high term-premium. This means that Malawi pays a much higher yield on longer-term debt than it does on short-term debt.

Figure 2: Yield over Tenor in Years as of end-June 2020 of Malawi and Selected Peer Countries



Source: Reserve Bank of Malawi and World Government Bonds

SECTION III: EXTERNAL PUBLIC DEBT PORTFOLIO REVIEW

3.1 External Debt by Creditor Composition

At approximately 83 percent (USD 1,981 million) of total external debt, multilateral creditors continue to account for the largest proportion of Malawi's external debt. Bilateral creditors accounted for 17 percent of all external debt (USD 407 million).

3.2 External Debt by Holder

For the past ten years, the International Development Association (IDA) has remained the largest creditor to the Government of Malawi. As of end June 2020, the IDA, which is part of the World Bank Group, accounted for 42 percent of total external debt. The second-largest creditor is the African Development Fund (ADF) at 15 percent followed by the International Monetary Fund at 14 percent. The Export-Import Bank of China and Export-Import Bank of India accounted for 8 percent and 6 percent, respectively.

Table 5: Total External Debt by Holder as at End-June 2020

| Creditor | Debt outstanding (USD millions) | Percent of total external debt |
|---|--|---------------------------------------|
| International Development Association | 1,014.85 | 42% |
| African Development Fund | 364.37 | 15% |
| International Monetary Fund | 323.36 | 14% |
| Export-Import Bank of China (Main-Land) | 197.07 | 8% |
| Export Import Bank of India | 139.35 | 6% |
| International Fund for Agricultural Development | 85.30 | 4% |
| OPEC Fund for International Development | 70.48 | 3% |
| Arab Bank for Economic Development in Africa | 60.38 | 3% |
| Kuwait Fund for Arab Economic Development | 43.08 | 2% |
| European Investment Bank | 43.05 | 2% |
| Saudi Fund for Development | 21.84 | 1% |
| Nordic Development Fund | 19.57 | 1% |
| Abu Dhabi Fund for Development | 4.14 | 0% |
| Government of Belgium | 1.34 | 0% |
| TOTAL | 2,388.18 | 100% |

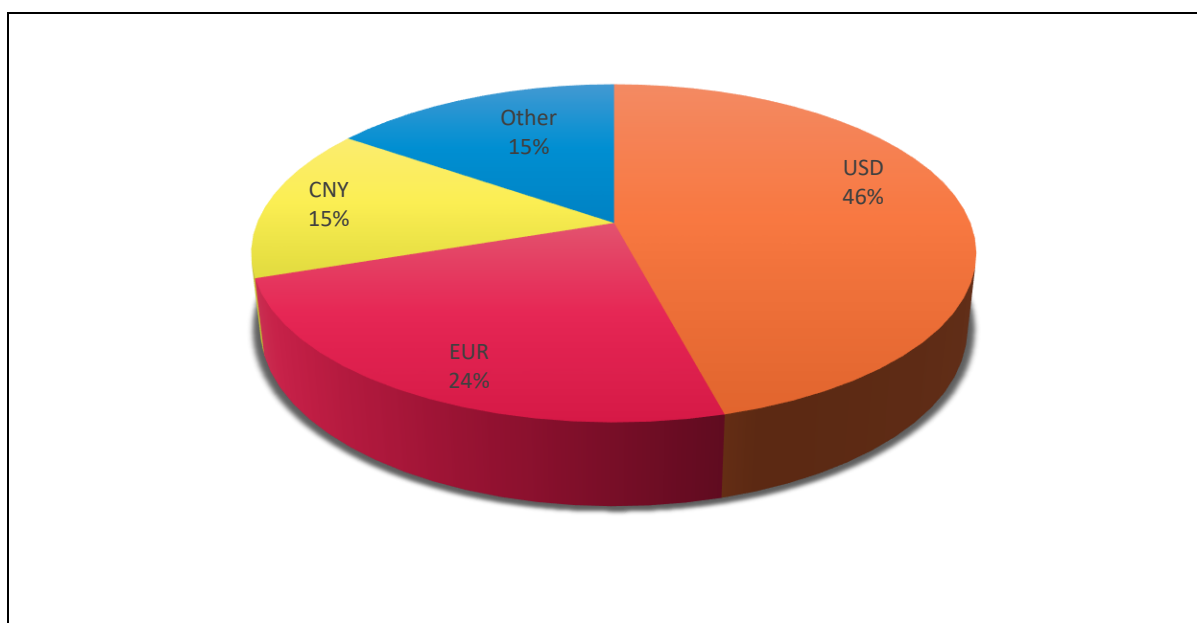
Source: Ministry of Finance

3.3 External Public Debt by Currency

Special Drawing Rights accounted for 60 percent of the total external public debt (EPD). Since SDRs is a basket of currency and is not a tradable currency, SDRs are decomposed into tradable currencies namely USD, EUR, CNY, JPY and GBP. Decomposition is done using the following proportions; USD 41.73%, EUR 30.93%, CNY 10.92%, JPY 8.33% and GBP 8.09%.

After decomposing the SDRs, the USD accounted for the largest proportion of total EPD at 46 percent followed by the EUR and CNY at 24 percent and 15 percent, respectively. This implies that fluctuations of the USD will enormously affect Malawi's EPD. However, since the majority of Malawi's foreign reserves are denominated in USD, EPD does not face currency mismatches.

Figure 2: External Debt Stock by Currency as at end-June 2020¹



Source: Ministry of Finance

3.3 Debt flows

In terms of debt flows, amortisation (principal repayment) during the period under review amounted to USD 69.5 million (equivalent to MK 51.0 billion)

¹ Other currencies in the external public debt which include British Pound, Kuwait Dinar, Saudi Riyal and Dirham accounted for 15 percent

and interest payment amounted to USD 19.6 million (equivalent of MK 15.3 billion). Without payments to the IMF, amortisation amounted to USD 46.1 million, equivalent of MK 33.9 billion. Comparing with the approved budget, interest costs were within the approved budget of MK 15.4 billion and amortisation was below the approved budget of MK 46.7 billion. This is attributed to the exchange rate which was stable during the period under review.

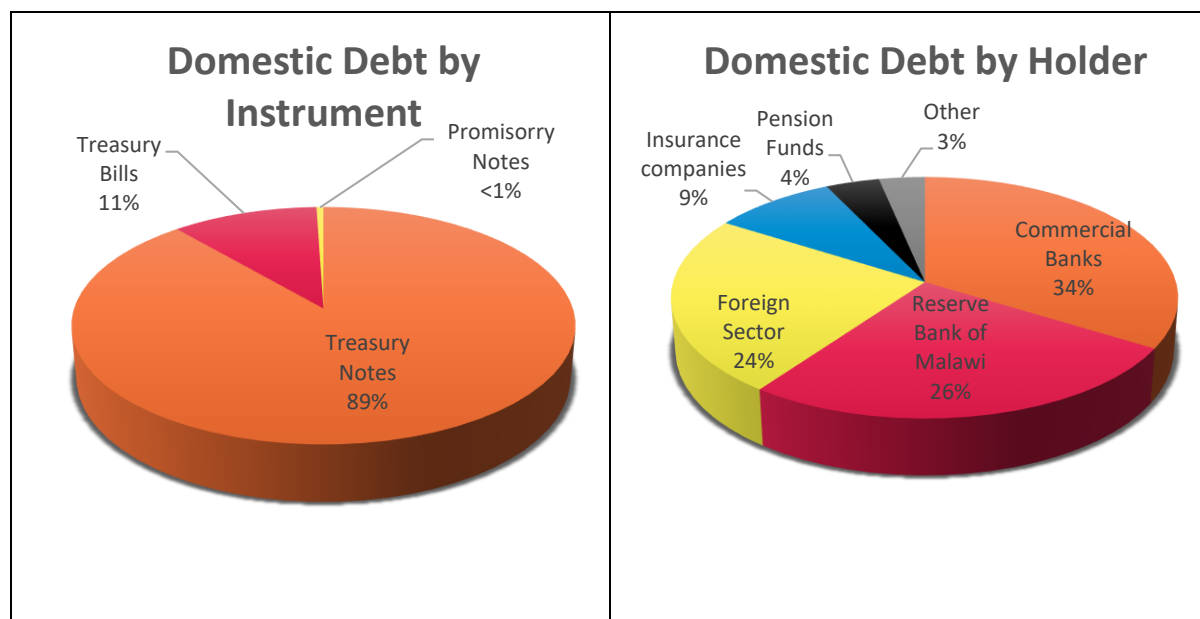
Net flows as represented by disbursements minus principal repayment during 2019/20FY were USD212.8million. These net flows take into account disbursements and debt repayment under the IMF. Without IMF, net flows were USD103.1million.

SECTION IV: DOMESTIC PUBLIC DEBT PORTFOLIO REVIEW

4.1 Domestic Debt by Instrument

As of end June 2020, total domestic public debt amounted to MK 2.37 trillion. Of this domestic debt stock, 89 percent were Treasury Notes, 11 percent Treasury Bills, and less than 1 percent Promissory Notes.

Figure 4: Domestic Debt Stock by Instrument and Holder as at end-June 2020



Source: Ministry of Finance

4.2 Domestic Debt by Holder

In the 2019/20 FY, commercial banks overtook the RBM as the largest holder of domestic debt with holdings at 34 percent of Malawi's domestic debt, followed by the RBM at 26 percent. The foreign sector also saw a large increase in its holdings, which amounted to 24 percent of the total. Insurance companies and pension funds continue to play a minor but increasing role, with holdings of 9 percent and 4 percent, respectively.

4.3 Domestic Contingent Liabilities

Contingent liabilities are potential obligations that could arise from Government guarantees for non-sovereign borrowings, including liabilities of local governments and public and private sector enterprises, Government insurance schemes, payments of arrears arising from goods and services rendered to Government but not yet paid, and bank failures and other financial sector bail-outs. Contingent liabilities are a potential risk to the

Government. Our key contingent liabilities arise from Government issuing guarantees and consent letters that are issued to state-owned enterprises that provide social and essential services to the society.

During the period under review, the stock of guarantees issued amounted to MK 159 billion, thus representing more than 2.5 percent of GDP. Some of the guaranteed amounts were not fully drawn, for instance guarantees to Agricultural Development and Marketing Corporation (ADMARC) and Malawi Enterprise Development Fund Limited. Almost all the guarantees were issued in favour of local commercial banks namely CDH Investment Bank, FDH Bank, National Bank of Malawi and NBS Bank. One guarantee was issued to the Export Development Fund.

Table 6: Government Guaranteed Debt as of end-June 2020 (in currency millions)

| Guaranteed entity | MK amount | USD amount | MK Total |
|--|------------------|-------------------|-------------------|
| Agricultural Development and Marketing Corporation | 12,000.00 | | |
| Electricity Supply Corporation of Malawi | 33,600.00 | | |
| Electricity Generation Company Malawi | 8,400.00 | | |
| Malawi Enterprise Development Fund | 13,000.00 | | |
| Salima Sugar Company Limited | 25,000.00 | | |
| SF International Limited | 4,000.00 | | |
| Auction Holdings Limited | | 15.00 | |
| Lilongwe Water Board | | 17.00 | |
| Umodzi Park | | 3.11 | |
| Green Belt Initiative | | 6.00 | |
| National Oil Company of Malawi | | 45.00 | |
| Total | 96,000.00 | 86.11 | 159,478.00 |

Source: Ministry of Finance

The Government continues to closely monitor the performance of the beneficiaries of the guarantees and in the 2019/20 FY no guarantees were called. However, some institutions restructured their facilities. For example, ADMARC and Salima Sugar Company Limited.

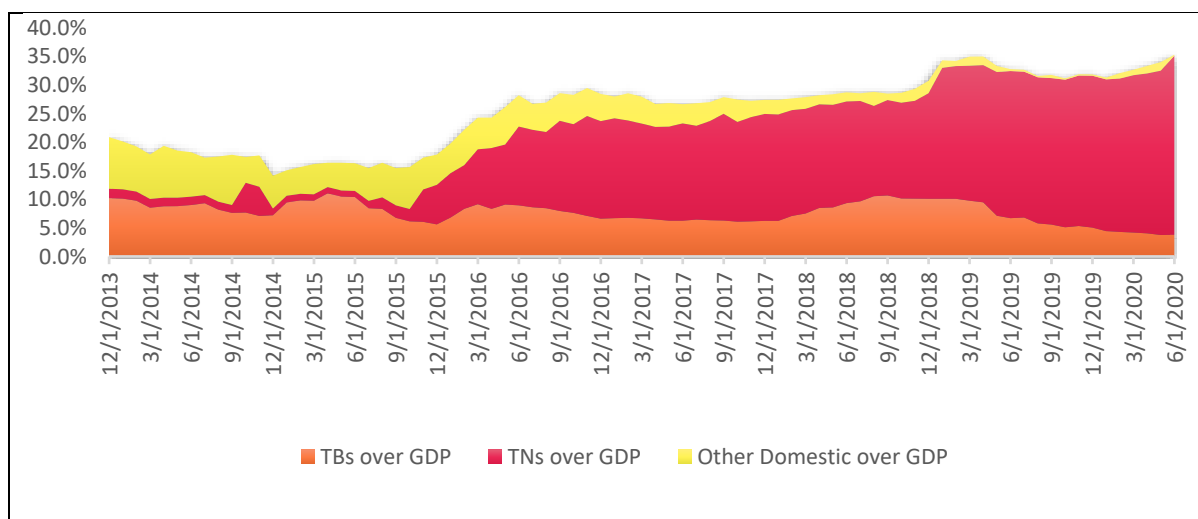
4.4 Domestic Debt Absorbing Shocks

Traditionally, domestic debt has had an important role in absorbing shocks. The last major such shock event was in the 2015/16 FY when major flooding in Malawi coincided with a food security crisis and a currency crisis. Figure 5 illustrates how the Government was able to smooth this crisis by quickly expanding domestic debt to generate the necessary financing volumes. Domestic debt over GDP almost doubled within the space of a year. This financing space was especially crucial in an environment where there was limited support from development partners in the wake of the Cashgate scandal.

In the subsequent years, however, domestic debt did not revert to the previous low levels. Instead of decreasing from the 29 percent level at the end of 2016 to the 16 percent seen before the crisis, domestic debt crept up to 33 percent in March 2020, the time of the onset of the current pandemic.

This means that the Government will have substantially less room to borrow, as a renewed doubling of domestic debt is likely to be unsustainable. This is supported by the “high risk of overall debt distress” rating in the last DSA. Thus, unprepared for the current crisis, the Government will have to find different financing mechanisms to overcome the current crisis induced by COVID-19.

Figure 5: Domestic Debt at Face Value over GDP by Instrument



Source: Ministry of Finance

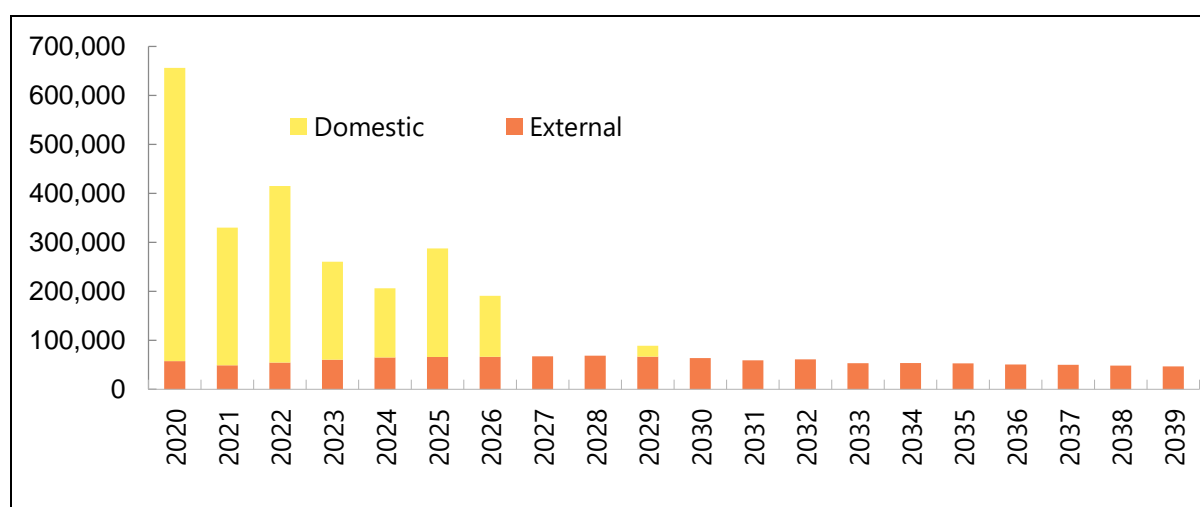
SECTION V: RISK ANALYSIS

In terms of risk, Malawi's public debt is exposed to refinancing, interest and exchange rate risks. The refinancing (and/or roll-over) risk and interest rate risk are largely on account of the short- to medium-term nature of most of the domestic debt portfolio. While significant progress has been made towards lengthening the maturity profile, 30.7 percent of Malawi's domestic debt still matures within one year.

5.1 Refinancing Risk Analysis using Redemption Profile

The redemption profile refers to the outstanding debt stock or the amount of debt that is falling due in a given period. This indicator shows the specific points of a country's vulnerability which is manifested by high debt service payments in the debt repayment schedule. As of end June 2020, 31 percent of total domestic debt matures within one year. With large maturities in September 2020, which are being addressed with Liquidity Management Operations, this is worse than the 25 percent recorded in June 2019.

Figure 6: Malawi's debt redemption profile in MK millions by FY



Source: Ministry of Finance

5.2 Refinancing Risk Using Average Time Maturity

The ATM of the debt portfolio indicates that the average holding needs to be repaid in 8.3 years. This decrease from the 9.7 years recorded in June 2019 is predominantly on the account of the increasing prominence of domestic debt, which typically has a shorter tenor based on remaining maturity. While the ATM within the external debt portfolio increased slightly from 14.7 to 14.8 years and the ATM within the domestic debt portfolio remained stable at 2.7

years, the now higher share of domestic debt in the total portfolio translates to a decreased ATM. The constant ATM in the domestic debt portfolio is an achievement of the well-implemented MTDS, as a significant share maturing in September 2020 has a low residual maturity.

5.3 Interest Rate Risk

With all of Malawi's debt being fixed interest rate debt, all interest charges are updated upon roll-over. Thus, the Average Time to Refixing (ATR) is the same as the ATM, 8.3 years.

Table 7: Cost and Risk Indicators for existing debt (end-June 2020)

| Risk Indicators | | External debt | Domestic debt | Total debt |
|--------------------------------|---|---------------|--------------------------|-------------|
| Amount (in millions of MWK) | | 1,522,176.0 | 1,949,411.1 ² | 3,471,587.1 |
| Amount (in millions of USD) | | 2,064.8 | 2,644.4 | 4,709.2 |
| Nominal debt as percent of GDP | | 23.9 | 30.6 | 54.5 |
| PV as percent of GDP | | 14.6 | 30.6 | 45.2 |
| Cost of debt | Interest payment as percent of GDP | 0.3 | 5.5 | 5.7 |
| | Weighted Av. IR (percent) | 1.0 | 17.9 | 10.5 |
| Refinancing risk | ATM (years) | 14.8 | 2.7 | 8.3 |
| | Debt maturing in 1yr (percent of total) | 3.5 | 30.7 | 18.2 |
| | Debt maturing in 1yr (percent of GDP) | 0.9 | 9.4 | 10.3 |
| Interest rate risk | ATR (years) | 14.8 | 2.7 | 8.3 |
| | Debt refixing in 1yr (percent of total) | 3.5 | 30.7 | 18.2 |
| | Fixed rate debt incl T-bills (percent of total) | 100.0 | 100.0 | 100.0 |
| | T-bills (percent of total) | 0.0 | 11.9 | 6.4 |
| FX risk | FX debt (percent of total debt) | | | 43.8 |
| | ST FX debt (percent of reserves) | | | 15.9 |

Source: Ministry of Finance

² In this table, domestic debt is presented at Cost Value

5.4 Exchange Rate Risk

As for foreign exchange risk, 40 percent of the debt stock was denominated in foreign currency at the end of June 2020. This implies that over one-third of the debt is susceptible to exchange rate movements. Exchange rate shocks can substantially contribute to higher debt service payments in local currency terms, thereby leading to higher payments in the budget than projected.

Annex 1: Newly Signed Loans

| LOAN | CREDITOR | SIGNING DATE | GRACE PERIOD (YEARS) | REPAYMENT PERIOD (YEARS) | INTEREST RATE/ANNUAL (%) | OTHER LOAN TERMS | LOAN AMOUNT | EQUIV IN USD | GRANT ELEMENT |
|---|-----------------|--------------|----------------------|--------------------------|--------------------------|----------------------|-------------|--------------|---------------|
| Line of Credit for Drinking Water Supply Schemes and Other Development Projects | India Exim Bank | 12/06/2020 | 5 | 20 | 1.5 | | 215.68 | 215.68 | 35 |
| Malawi Resilience and Disaster Risk Management (Additional Financing) | IDA | 22/05/2020 | 6 | 32 | 0.75 | Commitment fees 0.5% | 60 | 83.4 | 53.3 |
| Transforming Agriculture through Diversification | IFAD | 20/12/2019 | 10 | 30 | 1.54 | | 51.1 | 51.1 | 47.1 |

| | | | | | | | | | |
|--|------|------------|----|----|------|----------------------|------|-------|----|
| and Entrepreneurship | | | | | | | | | |
| Sustainable Fisheries, Aquaculture Development and Watershed Management | AfDB | 25/11/2019 | 10 | 30 | 0.75 | Commitment fees 0.5% | 6.5 | 9.0 | 51 |
| Multinational Nacala Road Corridor Development Project Phase V – Liwonde-Nsipe Road and One stop border post | AfDB | 25/11/2019 | 10 | 30 | 0.75 | Commitment fees 0.5% | 26.6 | 36.8 | 51 |
| M1 Rehabilitation | EIB | 03/10/2019 | 5 | 20 | 1.15 | | 95 | 106.4 | 39 |

| | | | | | | | | | |
|----------------------------------|-----|------------|---|----|------|----------------------|-----|-----|-------|
| Mozambique-Malawi Interconnector | IDA | 18/10/2019 | 6 | 32 | 0.75 | Commitment fees 0.5% | 15 | 15 | 53.3 |
| Malawi Electricity Access | IDA | 18/10/2019 | 6 | 32 | 1.4 | Commitment fees 0.5% | 144 | 144 | 45.12 |