REPUBLIC OF MALAWI

MINISTRY OF FINANCE, ECONOMIC PLANNING AND DEVELOPMENT

ANNUAL PUBLIC DEBT REPORT FOR THE 2018/19 FINANCIAL YEAR

SEPTEMBER 2019

Table of Contents

PREFACE

The Debt and Aid Management Division in the Ministry of Finance, Economic Planning and Development 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 compilation and dissemination of public debt statistics. Comprehensive and timely public sector debt statistics allow 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 indicators of the sustainability of Government and public corporations' policies. In addition, public debt statistics serve as essential inputs into, among others, Government budget preparation, Parliamentary loan approvals, budget execution, and compilation of 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 IMF. In terms of valuation, domestic debt, unless otherwise indicated, is reported at face value and external debt is disbursed outstanding debt. For future debt reports, Government aims at adopting nominal valuation and extending coverage to special drawing rights and account payables. This is in line with international standards as stipulated in the IMF's Public Debt Statistics Guide for Compilers.

This edition highlights debt management operations issues, Malawi's external and domestic debt portfolios, risk analysis for the period July 2018-June 2019. 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 gives an assessment of the risks associated with the external and domestic debt portfolios.

This report was printed with support from UNDP and EU under Development Effectiveness Assistance Project. An electronic version of this report is available on the Ministry's website: www.finance.gov.mw.

All queries and comments on the contents of the report should be addressed to the Director of Debt and Aid Management in the Ministry of Finance, Economic Planning and Development on the address below:

Ministry of Finance, Economic Planning and Development,
Debt and Aid Management Division,
P.O. Box 30049, Lilongwe 3, Malawi
Tel No.: +265-1-789-355
Website: www.finance.gov.mw

ACCRONYMS AND ABBREVIATIONS

ADF	African Development Fund
ADMARC	Agricultural Development and Marketing Corporation
ATM	Average Time to Maturity
ATR	Average Time to Re-fixing
BADEA	Arab Bank for Economic Development in Africa
CMC	Cash Management Committee
CNY	Chinese Yuan
CS-DRMS	Commonwealth Secretariat Debt Recording Management System
DAD	Debt and Aid Management Division
DSA	Debt Sustainability Analysis
DSF-LICs	Debt Sustainability Framework for Low Income Countries
ECF	Extended Credit Facility
EPD	External Public Debt
EIB	European Investment Bank
FY	Fiscal Year
GBP	British Pound Sterling
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
MTDS	Medium Term Debt Management Strategy
NDF	Nordic Development Fund
NTF	Nigerian Trust Fund of the African Development Bank
OFID	OPEC Fund for International Development
PFM	Public Financial Management
RBM	Reserve Bank of Malawi
SDR	Special Drawing Rights
TPD	Total Public Debt (TPD)
US$	United States Dollar

SECTION I: RECENT PUBLIC DEBT MANAGEMENT OPERATIONS ISSUES

1.1 Debt Management Policy Objective

The primary objective of the debt management policy is to ensure that financing and debt service obligations of the Government are met timely and adequately, and at the lowest possible cost and reasonable level of risk. The second objective is to support the development of a vibrant domestic debt market. To that end, Government remains committed to containing budget deficits thereby avoiding a rapid buildup of public debt. Government shall continue with its policies of contracting external loans on concessional terms and restructuring of the domestic debt from the currently 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

In 2018/19 FY, the economy enjoyed macroeconomic stability with GDP growth at 4.2 percent. Inflation continued on downward trajectory and remained within single digits. As of end June 2019, inflation was recorded at 9 percent. Accordingly, within the year, RBM effected a combined 250 basis point reduction in the policy rate. Correspondingly, the average yield for treasury bills steadily declined from 14 percent in 2017/18 FY to 10 percent in 2018/19 FY. In terms of the foreign exchange rate, the Malawi Kwacha was stable against other currencies except for the fourth quarter of 2018/19 FY where the nominal exchange rate depreciated by 6 percent.

1.3 Medium Term Debt Management Strategy (MTDS)

The MTDS was approved by the Minister of Finance, Economic Planning and Development in December 2018. The MTDS covers 2018/19 FY to 2021/22 FY with 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:

- Strategy1- status quo whereby Government will continue borrowing from concessional and semi-concessional external sources and maintain the current composition of domestic debt;
- Strategy 2- lengthening of the domestic debt maturities through 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 Strategy 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 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.

1.4 Debt Sustainability Analysis

A Debt Sustainability Analysis (DSA) was conducted in May 2019. The aim of the DSA was to update policy makers on Malawi's debt portfolio and assess the risks and vulnerabilities associated with planned future borrowing with a view to ensuring long-term debt sustainability. The DSA was done using the revised standardised joint World Bank/ IMF Debt Sustainability Framework for Low Income Countries (DSF-LICs) 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 FY national budget.

The DSA results indicate that Malawi's external debt portfolio remains sustainable over the medium term with all sustainability indicators falling below their recommended thresholds. 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 faces a high risk of debt distress.

Table 1: 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, Economic Planning and Development

1.5 Newly Signed Loans

In 2018/19FY, Government contracted a total of six loans from OPEC Fund for International Development (OFID) Fund, the Kuwait Fund, Arab Bank for Economic Development in Africa(BADEA) and African Development Fund (ADF). The total commitment under these newly signed loans amount to US$90 million. The loans will finance water and agriculture sectors (Refer to Annex 1).

1.6 Strengthening Debt Management

Government is committed to strengthening debt management. The Debt Management Technical Committee (DMTC) meets on a monthly basis and plays an advisory role on public debt management issues. Another initiative is the Sub-Committee on Short Term Borrowing Requirements (SBR) which meets on a weekly basis to consider the liquidity requirements for the week and how any shortfall financing would impact the overall debt. DAD is the Secretariat to these two committees.

In addition, better 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 Debt Securities Issuance Calendar

During the year under review, Government in collaboration with the RBM developed an Issuance Calendar which was published 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 an improved Average Time to Maturity (ATM) of 2.7 years as compared to ATM of 0.5 years registered in the previous years. This confirms the lengthening the maturities of the domestic debt securities portfolio.

1.8 Public Finance Management Issues

During 2018/19 FY, Government embarked on activities that will enhance Integrated Financial Management Information System (IFMIS) in order to improve public finance 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 Management System (CS-DRMS). Since CS-DRMS is not interfaced with IFMIS, information on debt transactions, in particular principal repayments, were not previously incorporated into the IFMIS. To that end, Government has resolved to incorporate public debt transactions into IFMIS. It is envisaged that this will enhance reconciliation of Government Accounts and improve Government debt operations reporting.

1.9 Limits on Borrowing

Government borrowing continues to be guided by the PFM Act of 2003 and the revised RBM Act of 2018 (effected April 2019). The revised RBM Act limits Central Bank financing. Furthermore, during the period under review, Malawi continued to be on the IMF's ECF programme which restricts non concessional borrowing. When the Government intends to contract non concessional loans, it is expected to seek a waiver from the IMF. In addition, the MTDS aims to reduce domestic debt to the internationally recommended 20 percent of GDP in the medium term.

SECTION II: TOTAL PUBLIC DEBT PORTFOLIO AS AT 30 JUNE 2019

2.1 Composition of Total Public Debt

As at end-June 2019, Total Public Debt (TPD) stock amounted to MK 3.7 trillion or 65 percent of Gross Domestic Product (GDP, up from MK 3.1 trillion or 62 percent of GDP, recorded in June 2018. This translates into an increase of 20 percent between the two periods.

The end-June 2019 TPD stock comprised MK1.7 trillion (30 percent of GDP) external debt and MK 1.97 trillion (35 percent of GDP) domestic debt.

Table 2: Evolution of Public Debt (in Millions)

	2005	2006 (HIPC)	2015/16	2016/17	2017/18	2018/19
Total Public Debt (MK)	426,592	130,846	2,408,605	2,628,777	3,058,238	3,669,238
External (USD)	2,969	452	1,870	1,921	2,132	2189
Domestic (MK)[1]	73,337	68,957	1,076,423	1,235,037	1,511,176	1,971,910
GDP	326,957	430,522	3,512,870	4,224,062	4,950,925	5,618,192
Domestic Revenue	62,082	75,805	646,830	871,160	971,740	1,050,338
Percent of GDP						
Total (%)	130	30	69	62	62	65
External (%)	108	14	38	33	31	30
Domestic (%)	22	16	31	29	31	35

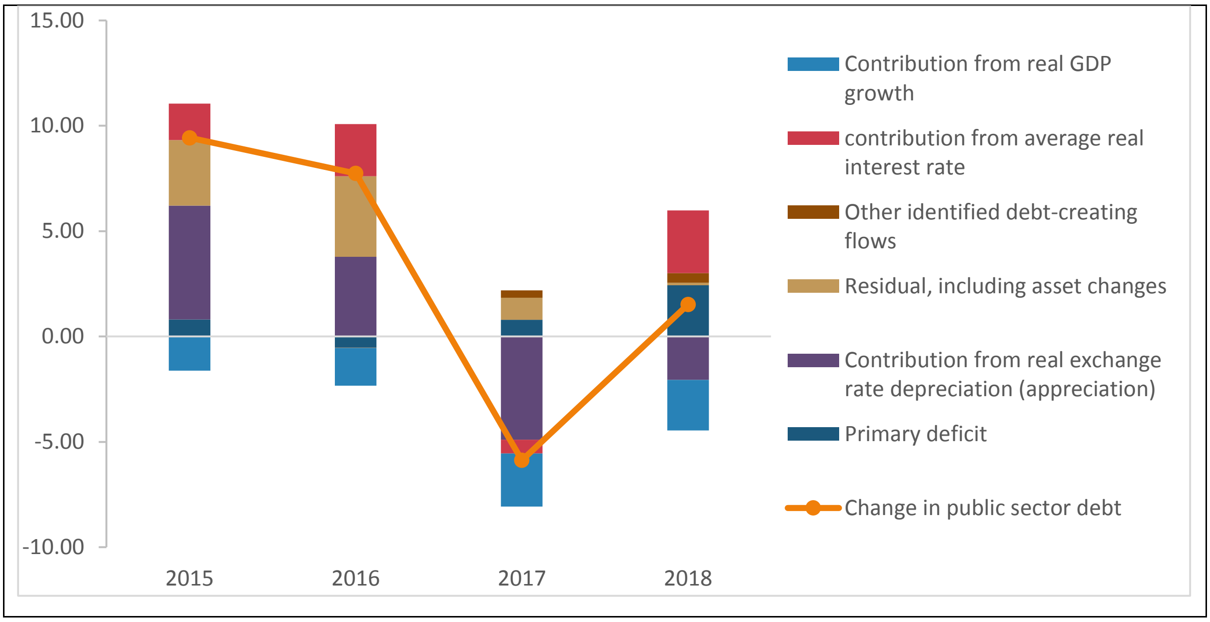
Source: Ministry of Finance, Economic Planning and Development

[1] Previous Financial Statements were reporting domestic debt stock at Cost Value. In keeping with international standards, figures will now be reported at Face Value which reflects the total liability (principal plus interest). Figures from 2015 have since been revised to reflect this change.

2.2 Drivers of debt dynamics

The main drivers of the increase in debt to GDP ratio in the past four years are high primary budget deficit, exchange rate depreciation and high interest rates largely emanating from domestic borrowing (refer to Figure 1 below).

Figure1: Drivers of debt dynamics (2015-2018)



Source: Ministry of Finance, Economic Planning and Development

2.3 Analysis of Interest rates

Loans and Debt securities in Malawi's public debt portfolio have fixed interest rates. However, the 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 10.42 to 16.12 percent as per table 3 below.

Table 3: Implied Interest rates

Loan	Implied Interest rate	Securities	Implied Interest rate
Existing and New ADF/ IDA	0.74%	T-bills	10.42%
Concessional-Others	1.31%	2-Year TN	14.53%
Semi-concessional (USD)	1.08%	3-Year TN	13.98%
Semi-concessional (CNY)	1.98%	5-Year TN	15.06%
Non-Concessional (Commercial)	0.00%	7-Year TN	16.12%

Source: Ministry of Finance, Economic Planning and Development

SECTION III: EXTERNAL PUBLIC DEBT PORTFOLIO REVIEW

3.1 External Debt by Creditor Composition

At approximately 81 percent (US$ 1,768 million) of total external debt, multilateral creditors continue to account for the largest proportion of Malawi's external debt. Bilateral creditors accounted for 19 percent of all external debt (US$421 million).

3.2 External Debt by Holder

The top five external creditors to Malawi are IDA of the World Bank at 44 percent of total external debt; the ADF at 16 percent; the IMF at 10 percent; the People's Republic of China and India at 10 percent and 7 percent, respectively.

Table 3: Total External Debt by Holder as at End-June 2019

Creditor	Debt Outstanding (Million USD)	Percent of total external debt
International Development Association	953	44%
African Development Fund	353	16%
People's Republic of China	214	10%
International Monetary Fund	214	10%
India	144	7%
International Fund for Agricultural Development	80	4%
OPEC Fund for International Development	69	3%
Arab Bank for Economic Development in Africa	53	2%
Kuwait Fund for Arab Economic Development	45	2%
European Investment Bank	25	1%
Nordic Development Fund	21	1%
Saudi Fund for Development	11	0%
Abu Dhabi Fund for Development	5	0%
Belgium	1	0%
TOTAL	**2,189**	**100%**

Source: Ministry of Finance, Economic Planning and Development

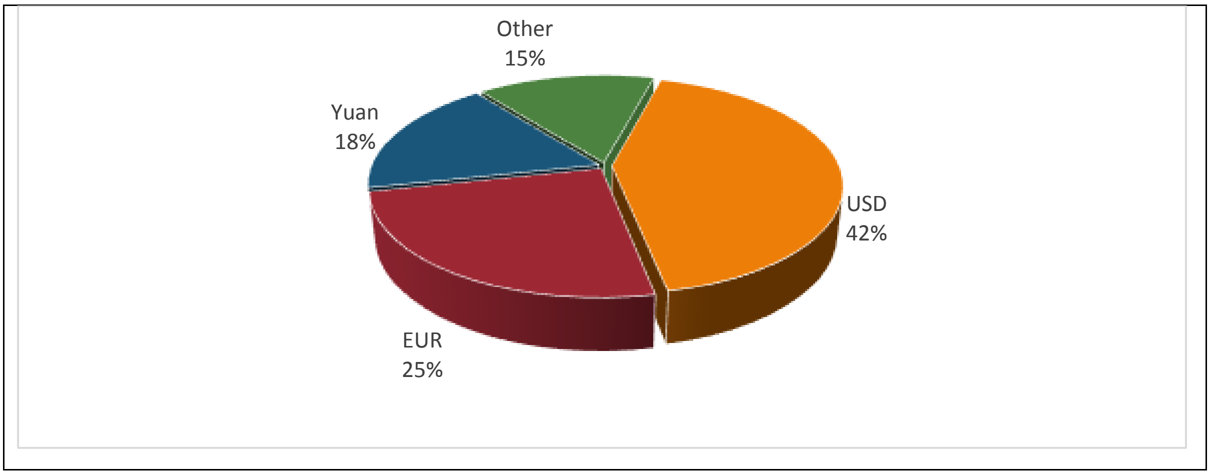
For the past ten years, the IDA has remained the largest creditor to the Government of Malawi. Nevertheless, India and China have increased their loans to Malawi in recent years.

3.3 External Public Debt by Currency

Special Drawing Rights (SDR) accounted for 73 percent of the total EPD. Since SDR is a basket of currencies and is not a tradable currency, it is decomposed into tradable currencies, namely USD, GBP, EURO, Japanese Yen and Chinese Yuan. Decomposition is done using the following proportions; USD 41.73%, euro 30.93%, Chinese Yuan 10.92% and Japanese Yen 8.33%.

After decomposing the SDR, the USD accounted for the largest proportion at 42 percent followed by the Euro, Chinese Yuan at 25 percent and 18 percent, respectively. This implies that fluctuations of the USD will enormously affect Malawi's EPD. However, since 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 2019[2]



Source: Ministry of Finance, Economic Planning and Development

3.3 Debt flows

In terms of debt flows, amortisation (principal repayment) during the period under review, amounted to USD 37.6 million equivalent to MK27.9 billion. Interest payments amounted to USD17.8 million equivalent to MK12.8 billion

---

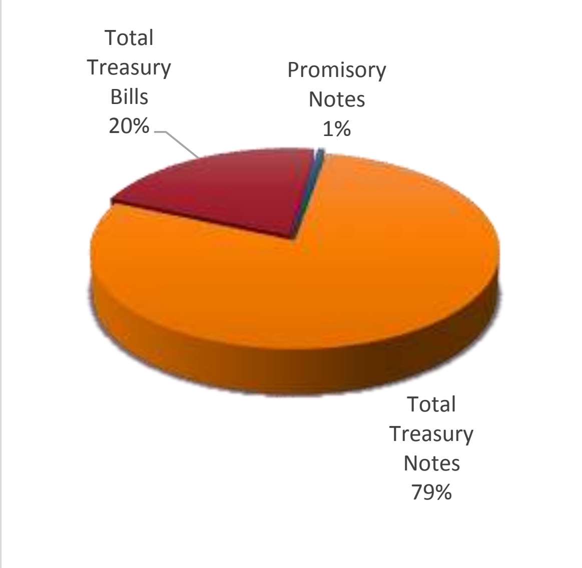
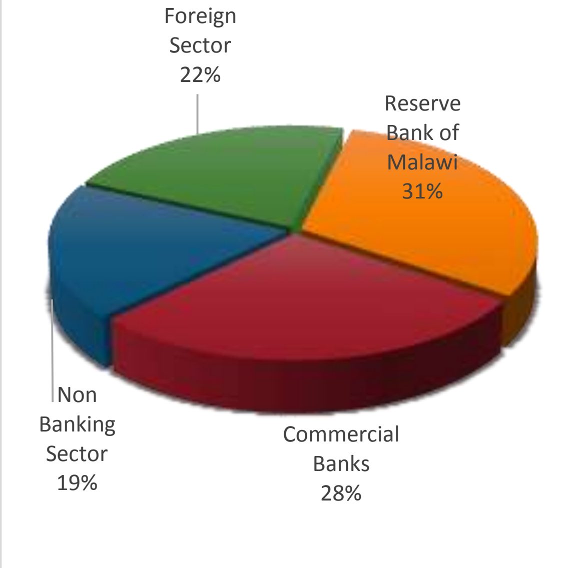
[2] Other currencies in the external public debt which include British Pound Sterling, Kuwait Dinar, and Saudi Riyal accounted for only 15 percent.

SECTION IV: DOMESTIC PUBLIC DEBT PORTFOLIO REVIEW

4.1 Domestic Debt by Instrument

As of end June 2019, total domestic public debt (DPD) amounted to MK 1.97 trillion. Of this domestic debt stock, 79 percent were Treasury Notes, 21 percent were Treasury Bills, and 1 percent were Promissory Notes.

Figure 4: Domestic Debt Stock by Instrument as at end-June 2019

Domestic stock by instrument	Domestic stock by holder
	

Source: Ministry of Finance, Economic Planning and Development

4.2 Domestic Debt by Holder

In terms of holders, the Reserve Bank of Malawi held 31 percent. Commercial banks also held significant amount of the domestic debt stock at 28 percent and was followed by the foreign sector at 22 percent. The non-banking sector held the least share at 19 percent.

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 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 to state owned enterprises that provide social and essential services to the society.

During the period under review, no contingent liabilities materialised. Nevertheless, Government has intensified efforts of monitoring contingent liabilities through periodic assessments of financial performance of the institutions that have guarantees. Of the previously guaranteed debt in 2017 and 2018, ADMARC was guaranteed MK12 billion, drew MK10 billion and managed to service MK9.3 billion leaving a balance of MK2.6 billion.

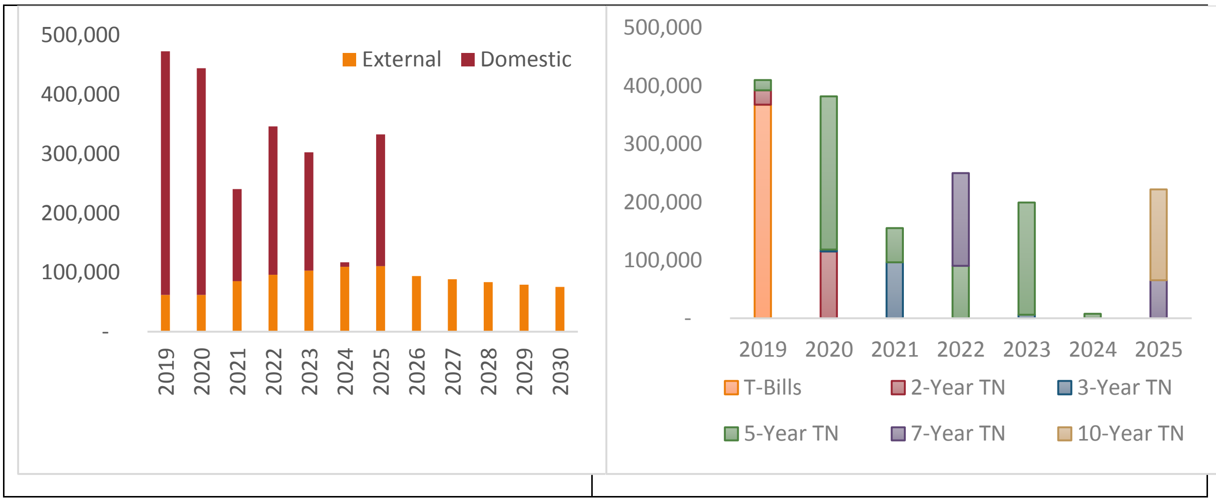
SECTION V: RISK AND COST ANALYSIS

In terms of risk, Malawi's public debt is exposed to significant re-financing, interest and exchange rate risks. The high refinancing (and/or roll-over) risk and interest rate risk are largely on account of short-term nature of the domestic debt portfolio.

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 of time. 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 2019, 25 percent of total domestic debt matures in 2019 (refer to Figure 5 below). This is an improvement from June 2018 where 44 percent of the domestic debt was projected to mature in 2018/19 FY. The short-term nature of domestic debt can be observed from the right chart of figure 5 where approximately 90 percent (MK 367, 654 million) of maturing domestic debt in 2019 are treasury bills. Moreover, whereas the maturity profile for domestic debt only goes up to 2025, external debt goes beyond 2030, despite the two portfolios approximately having equal shares of total debt[3].

Figure 5: Malawi's debt redemption profile



Source: Ministry of Finance, Economic Planning and Development

[3] It should be observed that analysis in this chapter is done using Cost Valueof domestic debt basis.

5.2 Refinancing Risk Using Average Time Maturity

The ATM of the debt portfolio indicates that it will take 9.7 years on average for Malawi's public debt to mature. This is an improvement of 1 year from the previous FY.

5.3 Interest Rate Risk

The public debt portfolio registers an ATR of 9.7 years. Again, an improvement of a year over the previous FY. The longer the maturity period of debt stock, the higher the ATR and the lower the risk. Conversely, the shorter maturity period, the lower the ATR.

5.4 Exchange risk

As for foreign exchange risk, 51 percent of the debt stock was denominated in foreign currency at the end June 2019. This implies that over half 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.

Table 4: Cost and Risk Indicators

		External Debt		Domestic Debt		Total Debt	
Risk Indicators		2018	2019	2018	2019	2018	2019
Amount(in billions of MWK)		1,502	1,697	1,497	1625	2,999	3,322
Amount (in billions of USD)		2,070	2,189	2063	2097	4,133	4,286
Nominal debt (% of GDP)		28.4	30.2	28.3	28.9	56.8	59.1
Cost of Debt	Interest payment (% of GDP)	0.3	0.3	2.0	3.8	2.3	4.2
	Weighted Av. IR (%)	1.1	1.0	6.9	13.3	4.1	7.0
Refinancing Risk	Average Time Maturity (ATM)	15.3	14.7	2.7	2.7	8.7	9.7
	Debt Maturing in 1 year (% of total)	3.1	2.8	43.8	25.2	24.3	12.2
	Debt Maturing in 1 year (% of GDP)	0.8	1.1	12.8	7.3	13.6	8.4
Interest Rate Risk	Average Time to Re-fixing(ATR) Years	15.3	14.7	2.7	2.7	8.7	9.7
	Debt Re-fixing in 1 year (% of total)	3.1	2.7	43.8	5.2	25.2	12.2
	Fixed rate Debt (% of total)	100.0	100.0	100.0	100.0	100.0	100.0

Foreign Currency(FX) Risk	FX Debt (% of total debt)					50.1	51.0
	ST FX Debt (% of reserves)					7.3	10.6

Annex 1: Newly Signed Loans

LOAN	CREDITOR	SIGNING DATE	GRACE PERIOD (YEARS)	REPAYMENT PERIOD (YEARS)	INTEREST RATE/ ANNUM (%)	OTHER LOAN TERMS	LOAN AMOUNT	EQUIV IN US$	GRANT ELEMENT
Shire Valley Transformation Programme	ADF	01/02/2019	10	30	0.75	Commitment fees 0.5%	20	28	**51**
Shire Valley Transformation Programme	NTF	01/02/2019	7	20	0.75	Commitment fees 0.5%	4.6	6.47	**36**
Shire Valley Transformation Programme	OFID	12/04/2019	5	15	1	Service Charges 1%	15	15	**31**
Mangochi water supply Project	KUWAIT	09/12/2018	4	24	1	0.5% on withdrawn and outstanding	5.0	15	**36.5**

						loan amount and commitment at 0.5% (applicable on special cases)			
Nkhata Bay water supply Project	OFID[4]	02/0/18	5	15	1	Service Charge 1%	15.0	15	**27.1**
Karonga water supply Project	BADEA	22/11/2018	10	25	1.5	None	10.0	10	**45.4**
Karonga water supply Project	OFID	02/08/2018	5	15	1	Service Charge 1%	15	15	**27.1**

Source: Ministry of Finance, Economic Planning and Development

[4] Considered individually, loans from OFID have a grant element of 27.1 percent which is lower than the recommended minimum concessionality threshold of 35 percent. However, it should be noted that at the project level, financing terms considered financing terms of co-financiers whose terms are highly concessional. Thus, in all cases, the resultant financing package concessional.