« Madagascar’s performance under its economic program supported by the ECF has been strong » **– IMF’s David Lipton**

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IMF Executive Board Completes First Review under the ECF Arrangement, Approves US$86m Disbursement for Madagascar

June 28, 2017

- The program’s success hinges on building investment management capacity while safeguarding macroeconomic stability and debt sustainability.

- Reforms underway to promote the development and soundness of the financial sector, based on the 2016 Financial Sector Assessment Program, will contribute to a more inclusive and robust financial system that is responsive to Madagascar’s development needs.
- The authorities’ strategy to promote more inclusive and sustained economic growth by increasing investment in infrastructure and human capital, raising social spending, and advancing structural reforms is appropriate.

On June 28, 2017, the Executive Board of the International Monetary Fund (IMF) completed the first review of Madagascar’s economic performance under a program supported by an Extended Credit Facility (ECF) arrangement. It also approved the authorities’ request to augment access under the program for SDR 30.55 million (about US$42.39 million) or 12.5 percent of the country’s quota.

Completion of this review enables the immediate disbursement (including the augmentation) of SDR 61.978 million (about US$86 million). This brings total disbursements under the current arrangement to a total of SDR 93.41 million (about US$129.61 million).

In completing the review, the Executive Board approved the authorities’ request for waiver of the nonobservance of the continuous criterion on accumulation of new external payment arrears and the modification of the end-June 2017 performance criterion on the primary domestic balance.

The ECF arrangement for Madagascar was approved on July 27, 2016 (see Press Release No. 16/370).

After the Board meeting, Mr. David Lipton, First Deputy Managing Director and Acting Chair, stated:

“Madagascar’s performance under its economic program supported by the Extended Credit Facility (ECF) has been strong. The authorities’ strategy to promote more inclusive and sustained economic growth by scaling up investment in infrastructure and human capital, raising social spending, and advancing structural reforms—as outlined in the National Development Plan—is appropriate. The program’s success hinges on building investment management capacity while safeguarding macroeconomic stability and debt sustainability.

“Recent developments—particularly a drought, a severe cyclone, and financial weaknesses in state-owned enterprises—have created challenges. Additional resources are needed for relief and reconstruction work, as well as to support the public utility company JIRAMA, whose performance suffered from the drought. While Air Madagascar’s recent strategic partnership is expected to strengthen its operations, it will also require a costly recapitalization to offset past losses.

“Although the authorities have acted to mitigate the impact of these challenges, a temporary increase in the fiscal deficit is reasonable, provided that the deep-rooted problems of JIRAMA and Air Madagascar are addressed. The augmentation of access under the ECF and additional donor support will help offset the balance-of-payments impact of the natural disasters.

“The authorities’ efforts to strengthen governance and fight corruption are critical to their strategy. In addition to reinforcing the legal framework, it is vital to implement it effectively and to enhance judicial independence. Ongoing improvements in public financial management, particularly to improve transparency, also play a key role.

“Reforms underway to promote the development and soundness of the financial sector, based on the 2016 Financial Sector Assessment Program, will contribute to a more inclusive and robust financial system that is responsive to Madagascar’s development needs.”

The Executive Board also completed the 2017 Article IV Consultation with Madagascar. [1]

Madagascar is a fragile low-income country striving to recover from political instability. Madagascar has a long history of weak economic growth—barely keeping up with rapid population growth—and social welfare indicators have deteriorated. Recurrent political crises and natural disasters have aggravated these challenges. As a result, Madagascar has become one of the poorest countries in the world, and some of its education, health, and nutrition indicators rank among the lowest in the world. The government is aiming to break a cycle of low growth and investment by accelerating public investment and structural reforms under its 2014 National Development Plan.

Economic developments were encouraging in 2016. Driven by public investment, increasing textile exports, and accelerating activity in agroindustry, economic growth reached 4.2 percent in 2016—the highest level since 2008. The execution of the 2016 budget was in line with the government's objectives. Fiscal spending was under control, even though the financial performance of the public utility, JIRAMA, weakened toward the end of the year. Reforms continued in revenue administration, and fiscal revenue exceeded targets. Inflation was contained at 7.0 percent at end-2016. The external position strengthened significantly, benefitting from a positive shock to vanilla export prices and strong growth in manufacturing exports.

Budget execution has encountered challenges in 2017 however. In late 2016 and early 2017, Madagascar suffered a serious drought and a major cyclone—the worst in 13 years. The cyclone imposed total economic costs (damage plus lost production) estimated at about $400 million (4 percent of GDP). The drought reduced the supply of cheap hydropower for electricity generation, thereby increasing JIRAMA's needs for government transfers. In addition, the launch of a planned strategic partnership for Air Madagascar, will require a costly one-off recapitalization to offset past losses while it is expected to strengthen operations over the medium term.

In spite of current challenges, the medium term outlook is favorable. Growth is projected to accelerate, driven by the investment scaling up, tourism, garments and other light manufacturing, mining, and productivity gains in agriculture. Partly because of the recent disasters, average inflation is forecast to rise temporarily to about 8.5 percent in 2017, and then to fall back gradually to around 5 percent over the medium-term. Imports should increase with the scaling up of public investment and reconstruction efforts, although rising current account deficits are expected to be financed in a sustainable manner thanks to concessional official sector loans and foreign direct investment.

Executive Board Assessment [2]

Executive Directors welcomed Madagascar's strong performance under its Fund supported program despite recent challenges, including two weather related shocks, and noted that while the medium term outlook appears favorable, downside risks remain. Directors endorsed the authorities' strategy to promote more inclusive and sustained economic growth by scaling up investment in infrastructure and human capital, raising social spending, and advancing structural reforms. They stressed, however, that the strategy's success hinges on building investment management capacity and responding promptly to any signs of overheating so as to safeguard macroeconomic stability and debt sustainability.

To maintain progress toward Madagascar’s development objectives, Directors concurred that additional fiscal space is temporarily needed in 2017 in light of the costs posed by the impact of recent shocks and the financial weaknesses of state-owned enterprises. In this regard, they welcomed the measures undertaken to mitigate the impact of these shocks, including higher revenue targets for 2017 and reductions in lower-priority spending, and stressed the need to tackle the deep-rooted problems of the public utility company and Air Madagascar.

Directors welcomed the authorities’ strong emphasis on improving governance and fighting corruption, which is essential to improve the business climate. In addition to completing the legal framework to fight corruption, including with a new anti-money laundering law, Directors stressed the need for strengthening the framework’s implementation and enforcement as well as the independence of the judicial system. They also recommended further improvements in public financial management, particularly measures to enhance transparency.

Directors considered that the central bank’s conduct of monetary policy has been appropriate, and supported its efforts to continue upgrading the monetary policy operational framework. They also commended its continued efforts to develop the financial sector and reinforce its stability. Directors encouraged the authorities to continue implementing the recommendations of the 2016 Financial Sector Assessment Program, including to enhance the legal framework and the supervisory function, and to improve financial inclusion.

It is expected that the next Article IV consultation with the Republic of Madagascar will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board,

summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing ups can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm
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