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MADAGASCAR ECONOMIC UPDATE

Setting a course for recovery

December 2020

Economic activity in Madagascar has been severely impacted by the COVID-19 pandemic, resulting in a recession comparable to that of the 2009 constitutional crisis and the reversal of close to a decade of progress in poverty reduction. While conditions are expected to stabilize in 2021, the impact of the pandemic will cast a long shadow on economic and social prospects and could be compounded by other shocks, including droughts and other climatic events affecting already vulnerable populations. To set the country on a course for recovery, the government will have to extend emergency measures aimed at preserving livelihoods and preventing a resurgence of the pandemic, but also combine them with structural reforms aimed at accelerating Madagascar's economic transformation, strengthening its resilience to shocks, and increase food security.

FOREWORDS

Gains in income per capita and poverty reduction accumulated over the last decade were abruptly reversed in 2020, as the COVID-19 pandemic triggered a sharp economic slowdown. The sudden contraction in activity has had a severe impact on vulnerable populations, while reducing fiscal resources available for priority investments and social programs. Beyond the knock-on effect of the crisis, growth remains structurally constrained by inadequate human capital, a high prevalence of informality and self-subsistence agriculture, insufficient and poorly maintained infrastructures, and governance and institutional weaknesses. In the absence of ambitious reforms, the crisis risks exacerbating these constraints with the effect of durably hindering the country's growth potential.

Madagascar was able to reduce the propagation of the pandemic but the government must remain vigilant and be prepared to respond to new outbreaks. A second wave of the pandemic in major economies during the final quarter of 2020 highlights the risk of resurgence in Madagascar and the need to strengthen preparedness. Key priorities in the short term include boosting testing and contact tracing capacities, developing capacity to distribute and administer vaccines when they become available, preparing for the possible extension of social protection programs for existing and new beneficiaries, and implementing additional measures to safeguard viable businesses and protect workers. More generally, health and social protection systems will need to be bolstered to improve livelihoods, inclusiveness and resilience to future shocks.

A new reform momentum is key to rebuilding back better and stronger after the crisis. Beyond short-term mitigation measures, delivering a sustained economic revival after the crisis will largely depend on the government's ability to mobilize domestic resources to sustain priority investments, implement far-reaching reforms to accelerate economic transformation, and address large gaps in infrastructure and human capital development with well targeted programs. To accelerate this economic transformation, the business environment will need to improve to boost market access and contestability, leapfrog the digitalization of the economy, reinforce the selectivity and management of public investments, and stimulate agricultural productivity to support living standards and food security.

Marie-Chantal Uwanyiligira
Country manager

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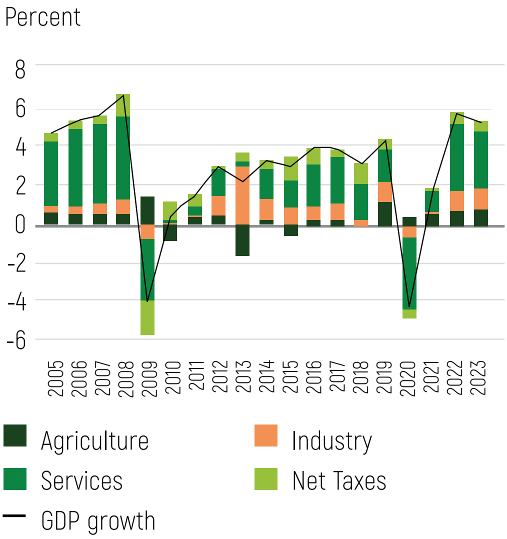
PART ONE

RECENT ECONOMIC DEVELOPMENTS

1 The COVID-19 crisis triggered a sudden contraction in global and domestic activity

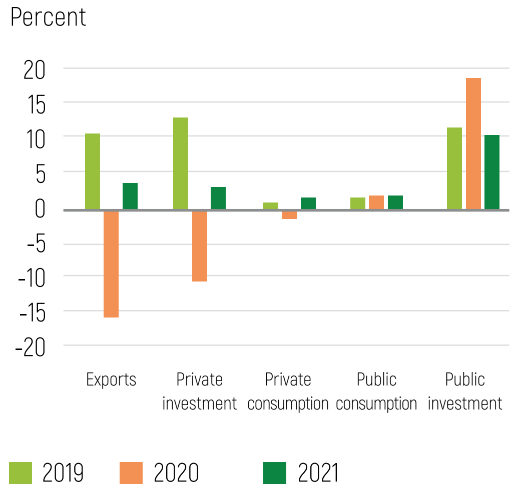
1. Prior to the pandemic, Madagascar was on sustained recovery path and achieved progress in poverty reduction. The economic revival in the period leading up to the COVID-19 crisis was supported by political and economic stability, renewed investor confidence, rising integration in key export markets, growing flows of concessional financing and structural reforms. Activity continued to gain strength up until 2019, as public and private sector investments accelerated, while moderate inflation helped support real income and consumer spending. At the same time, budget and current account deficits remained moderate and the currency stabilized in real effective terms. In this context, growth reached 4.4 percent in 2019, its fastest pace in over a decade, with export-oriented sectors such as textiles, mining, and tourism performing particularly well in the run-up to the crisis. Tourism revenues were bolstered by a 19 percent increase in visitor arrivals, reaching a decade high of 375.000. In the primary sector, favorable weather conditions have contributed to a bumper rice harvest and significant gains in agricultural production more generally.

Figure 1: Contribution to GDP growth by sector



Source: National Institute of Statistics, World Bank staff calculations.
Note: Contribution of sectors to GDP growth. Based on national accounts in 2007 prices. Data for 2019 are estimates and those for 2020-2023 are forecast.

Figure 2: Main demand components



Source: National Institute of Statistics, World Bank staff calculations.
Note: Based on national accounts in 2007 prices. Figures for 2019 are estimates and those for 2020-2023 are forecast.

2. The COVID-19 pandemic triggered a sudden and deep recession, reversing nearly a decade of prior income per capita gains. The combined impact of global trade disruptions and domestic containment measures is estimated to have resulted in a GDP contraction of -4.2 percent in 2020, similar to that observed during the devastating 2009 constitutional crisis (Figure 1). Considering a pre-crisis projection of 5.2 percent in 2020, this means that income per capita would be 9.4 percent lower than expected at the start of the year, erasing all gains achieved since the return to constitutional order in 2013 (Table 1). On the demand side, a sharp drop in exports was the key driver of the decline in activity, while public consumption and investment played a buffeting role (Figure 2).

Table 1: Madagascar: Selected Economic Indicators

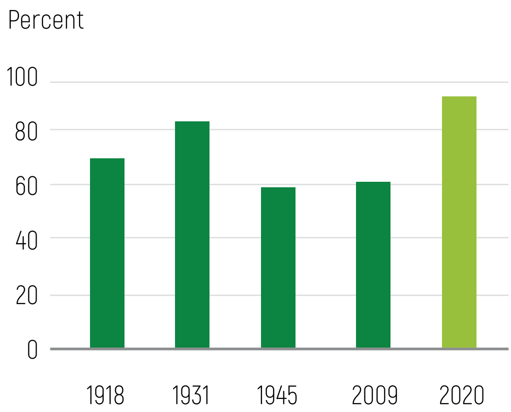
	2018	2019	2020	2021	2022	2023	2020	2021
	Actual	Estimates	Current Baseline Projections				Revisions from Feb.	
Annual percent change								
Real GDP	3.2	4.4	-4.2	2.0	5.8	5.4	-9.4	-3.4
GDP deflator	7.1	8.3	5.6	5.9	5.7	5.9	-1.1	0.1
Consumer price index (end of period)	7.3	5.6	4.3	5.9	6.1	6.1	-1.4	0.0
Fiscal accounts, % of GDP								
Revenues	13.2	13.3	11.4	12.0	13.1	14.2	-2.0	-1.6
Expenditures	14.4	14.7	16.5	17.4	17.7	18.0	0.9	0.8
Overall balance (commitment basis)	-1.3	-1.4	-5.2	-5.4	-4.6	-3.8	-3.0	-2.5
Primary balance	-0.5	-0.7	-4.4	-4.5	-3.6	-2.7	-3.0	-2.5
General government debt	39.5	37.4	45.1	49.7	51.2	51.9	4.8	3.9
Balance of payments, % of GDP								
Current account balance	0.7	-2.3	-4.0	-4.4	-4.3	-4.3	-0.3	-0.2
Exports, goods, and services	34.7	30.8	25.3	26.0	26.6	27.3	-8.1	-4.7
Imports, goods, and services	37.8	35.0	31.2	32.2	32.8	33.3	-8.0	-4.6
Net income	3.8	1.9	2.0	1.9	1.9	1.8	-0.2	-0.1
Net foreign direct investment	2.6	2.6	1.9	2.5	2.5	2.5	-0.6	-0.1

Sources: World Bank Group and IMF.

3. The COVID-19 crisis was an external shock of unprecedented magnitude. The contraction in global activity in 2020, currently estimated at -4.4 percent, would be by far the most severe and broad-based on records, with output shrinking in more than 90 percent of countries around the world, against 83 percent during the great depression in 1930, and 60 percent during the great recession 2009 (Figure 3). In the Euro Area—Madagascar's largest export destination—output is estimated to contract by 7.4 percent. As the global toll of the pandemic continues to increase, millions of people are suffering from diminished prospects and disrupted livelihoods. In the developing world, falling income per capita in the vast majority of countries will interrupt poverty reduction trends and could tip over more than 100 million people into extreme poverty.[1]

1 (Lakner et al. 2020; World Bank forthcoming)

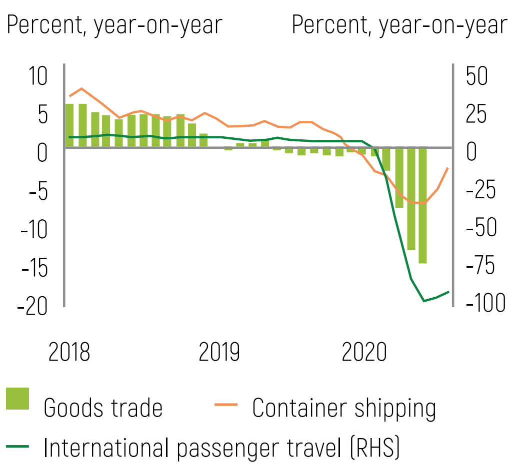
Figure 3: **Share of countries in the world experiencing a recession**



Source: World Bank
Note: Sample includes 183 countries

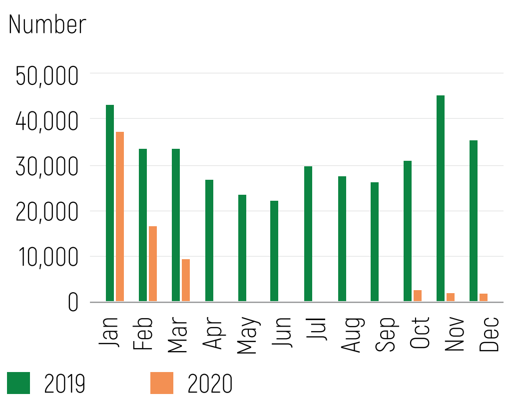
4. Global trade and travel disruptions had a severe impact on previously high-performing sectors in Madagascar. In the first semester of 2020, global goods trade volumes were down 15 percent from a year earlier, and passenger air travel down 98 percent (Figure 4). This was reflected in a sharp contraction in export revenues in Madagascar, particularly from textiles, mining, and tourism, which were key sources of growth and job creation prior to the crisis (Figure 5). Overall, in the first half of 2020, goods export values fell at an annual rate of 15 percent, reflecting a drop in both volume and prices amid weakening external demand. Although there were no specific limitations to air and sea cargo, supply chains and access to raw materials were disrupted, further dampening activity in trade-oriented sectors.

Figure 4: **Global trade and air passenger travel**



Source: Haver Analytics; IATA Passenger Traffic Report; Institute of Shipping Economics and Logistics.
Note: Figure shows 3-month moving averages. Last observation is July 2020. International passenger travel reflects revenue passenger kilometers, i.e. the number of paying passengers time kilometers flown.

Figure 5: **Tourism arrivals in Madagascar**



Source: Ministry of Transport, Tourism and Meteorology, World Bank staff calculations.
Note: Data from October 2020 to December 2020 are World Bank's staff projections.

5. Domestic containment measures contributed to a relatively short outbreak in Madagascar. First COVID-19 cases were reported in Madagascar on March 20, 2020, leading to a period of rapid but short-lived propagation of the pandemic from May to July. Since then, containment measures contributed to significantly reduce the number of active cases, with hospitalizations stabilizing at low levels in October and November (Figure 6). As of end November, there were less than 17.500 confirmed cases and 250 deaths, putting Madagascar in the category of moderately affected countries when considering the size of its population. Several periods of lockdown were implemented in parts of the country, including the capital Antananarivo, complemented by the closure of borders (except for cargo), quarantine and systematic testing of all travelers, and limits to business operations and movements between regions. To organize its policy response, the government set up a multi-task Command Center led by the Minister of Interior and Decentralization and put in place a Multisectoral Emergency Plan, comprising health and safety measures, cash transfer programs, tax relief for the private sector and the supply of exceptional liquidity to the financial system. Details about the government response to the crisis are presented in Box 1.

Box 1: Government response to the COVID-19 crisis

The government has taken action to slow the propagation of the disease and limit its social and economic impacts. From the confirmation of the first COVID cases in March to end October, a state of emergency was declared, which was complemented by regulatory measures such as the closure of borders except for cargo, quarantine and systematic testing of all travelers, a lockdown of the cities where cases have been detected, the treatment of patients at the government's charge, and a limitation of business operations. The government also introduced social protection, and fiscal and monetary measures to support livelihoods and businesses during the lockdown. To limit the burden on private operators, the limitation of business activity has been progressively released. The government has set up the *Centre de Commandement Opérationel*, a multi-task Command Center led by the Minister of Interior and Decentralization/BNGRC to coordinate its response.

In an effort to consolidate different sectoral interventions and to prepare the medium-term response, a multisectoral emergency plan has been developed. The development of the multisectoral emergency plan (PMDU) was formulated based on an analysis of priority needs for the period running up to the end of 2020. Its objectives were to (i) control the spread of the virus and stem the pandemic; (ii) help vulnerable populations and respond effectively to their needs and (iii) protect the economy, maintain human capital and facilitate the recovery. The Plan is steered by the Prime Minister Office and will implement a range of measures and actions funded by the state budget and the donor community. Actual implementation was delayed by the late nomination of the steering committee for the PMDU and the slow execution of emergency measures. Regarding transparency initiatives, the government made significant headways in November by producing two public dashboards: the first focusing on the monitoring of COVID-related public spending, including information on public contracts, and the second on the annual budget execution by ministry, program, and nature of spending.

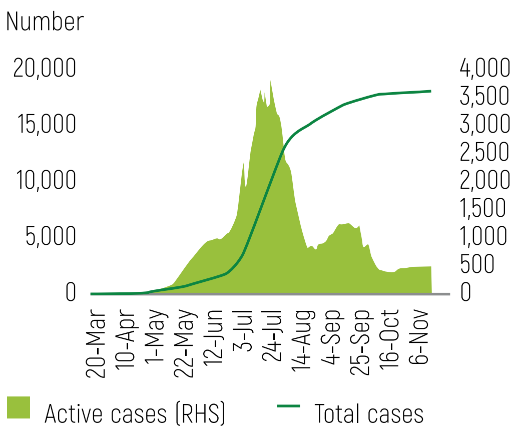
Several social safety net measures have been launched to support vulnerable households. The government has launched a targeted unconditional cash transfer program in the cities of Antananarivo, Fianarantsoa, and Toamasina to support households directly affected by the lockdown. In addition, the government supported the distribution of food and staple products to selected vulnerable households; the operation of subsidized rice and edible oil sales at the fokontany level; and the rescheduling of electricity bill payments to the utility company JIRAMA.

Measures for the private sector focus on support to business continuity and job protection. Actions decided by the government to support the private sector in the multi-sectoral emergency plan included (i) the provision of vocational training for employees; (ii) support inter-company medical services so that they can ensure the continuity of the provision of care services to employees and advise and train companies to better protect employees in the workplace; (iii) loans to support the cash flow of entrepreneurs and small and medium-sized enterprises; (iv) communication and promotion actions to develop national and international markets. The tourism and transport sectors will benefit from specific support and health protocols necessary for international travel. Finally, the company Tsaradia will receive financial support to enable it to maintain domestic air service. In addition, several tax relief measures were effective since March, including the suspension of payment of installments and postponement of payment declarations for the tourism sector, air transport and enterprises benefiting from the free-processing regime.

On the monetary side, the Central Bank of Madagascar has injected liquidity in the form of main injection operations and marginal loan facilities. To alleviate pressure on SMEs and household cashflows, banks were encouraged to reschedule loan repayments and will be able to deduct a similar amount from their reserve requirements. Exceptional liquidity is also provided to the financial system, conditioned on an increase in credit to companies.

6. The impact of a sudden stop in activity on companies and households has been far-reaching. An abrupt slowdown in almost all sectors of the economy led to a 20 percent contraction in GDP in the second quarter (from a year earlier), by far the sharpest decline since the start quarterly national accounts data in 2007. On average, 97 percent of surveyed companies reported a decline in the demand for their products and services in the first semester. SMEs that have micro-enterprises or households as clients have reported stronger declines in revenues than the ones trading with larger companies. In response, businesses in Madagascar have cut wages, reduced working hours and laid-off workers or in some cases have been forced to exit the market altogether. Around 32 percent of formal companies surveyed are estimated to have closed their doors (46 percent in the tourism sector), 7 percent permanently. Households surveys illustrate the impact on the labor market, with an estimated contraction in total employment of 7.7 percent in the first semester. Hardest hit sectors were in restaurants, hotels and transportation (Figure 7). In

Figure 6: Number of COVID-19 cases in Madagascar

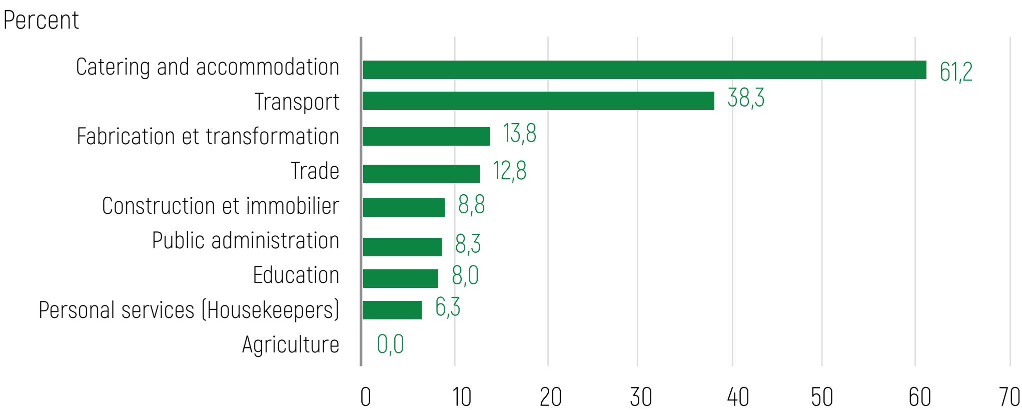


Source: Johns Hopkins University Center for Systems Science and Engineering (JHU CSSE)

Note: Last updated on November 18, 2020. Total cases recorded.

total, 64.4 percent of households reported a loss of revenue since the start of the crisis. Reducing food consumption was cited among the responses to lower income, thereby threatening long-term health for more vulnerable households. Food insecurity in Madagascar ranks among the highest in Sub-Saharan Africa.

Figure 7: Share of employment affected by COVID-19

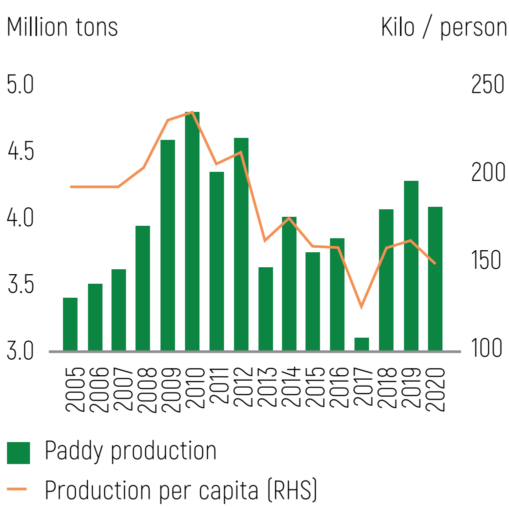


Source: WB Households survey
Note: Survey conducted in June 2020.

2 Poverty has increased, disproportionately impacting urban populations

7. Extreme poverty is predicted to increase significantly in 2020, with vulnerable populations in urban areas particularly affected. Job losses in key manufacturing and service sectors, as well as the sudden loss of income for informal workers affected by lockdowns in major cities contributed to pushing a large number of people into extreme poverty this year. Under baseline assumptions, the poverty rate (at $1.9/day) is estimated to rise to 77.4 percent in 2020, up from 74.3 percent in 2019, corresponding to an increase of 1.38 million people in one year. Given the outsize impact of the pandemic on urban populations as well as the projection of an expected increase in extreme poverty in 2020, there is a significant risk that this crisis could widen existing inequalities and societal divides, contributing to heightened fragility.

Figure 8: Paddy production



Source: Ministry of Agriculture, World Bank staff calculations.
Note: Data for 2020 is estimated based on FAO reports.

8. Rural households were impacted as well, but resilient agricultural output helped reduce the blow. Crop production levels in 2020 are estimated to be near to the country's average in previous years, despite disruptions in intra-regional trade and slowing demand from urban and peri-urban areas (Figure 8). This contributed to maintain income and livelihoods in more remote rural areas where extreme poverty concentrate. However, paddy production slowed somewhat in 2020 and non-farm income are expected to be severely impacted by crisis this year. This effect could be significant as about half of rural households have at least one working age member participating in off-farm activities for compensation. Contracting demand for off-farm activities are likely to have substantial adverse effects by lowering income for a vast swath of the country's population. The decline in vanilla prices combined with importers' reluctance to make longer-term commitments in this context of high uncertainty are also likely to generate a larger volume of unsold vanilla stocks. Such situation will increase the vulnerability of the less resilient rural producers. The COVID-19 crisis also coincided with severe droughts in the Southern part of Madagascar, hampering livelihoods of at least 1,5 million people so far.

Table 2: Madagascar: Key Fiscal Indicators

	2018	2019e	2020f	2021f	2022f	2023f
Percent of GDP						
Total Revenues and Grants	13.2	13.3	11.4	12.0	13.1	14.2
Tax Revenues	10.1	10.5	8.8	9.6	10.5	11.5
Tax on goods and services	2.2	2.3	2.0	2.5	2.6	2.7
Direct taxes	2.7	2.9	2.3	2.4	2.8	3.4
Taxes on International Trade	5.2	5.3	4.5	4.7	5.1	5.4
Non-Tax Revenues	0.7	0.2	0.2	0.2	0.2	0.3
Grants	2.4	2.6	2.4	2.2	2.4	2.4
Expenditures	14.4	14.7	16.5	17.4	17.7	18.0
Wages and Compensation	5.0	4.9	5.7	5.7	5.6	5.6
Goods and Services	0.8	0.6	1.2	1.0	1.2	1.4
Interest Payments	0.8	0.7	0.8	0.9	1.0	1.1
Transfers and subsidies	2.3	3.1	3.5	2.1	2.0	2.0
Capital Expenditures	4.9	5.6	6.8	7.3	7.6	8.0
Overall balance (commitment basis)	-1.3	-1.4	-5.2	-5.4	-4.6	-3.8
Primary balance	-0.5	-0.7	-4.4	-4.5	-3.6	-2.7
Overall Balance (cash basis)	-1.9	-1.3	-5.2	-5.4	-4.6	-3.8
Debt amortization (gross)	6.4	5.9	5.7	6.3	6.3	5.9
Gross financing needs	8.4	7.2	10.9	11.7	10.9	9.7
Change in GFN since February 2020	0.0	0.0	2.8	2.0	n.a	n.a

Sources: World Bank Group and IMF.

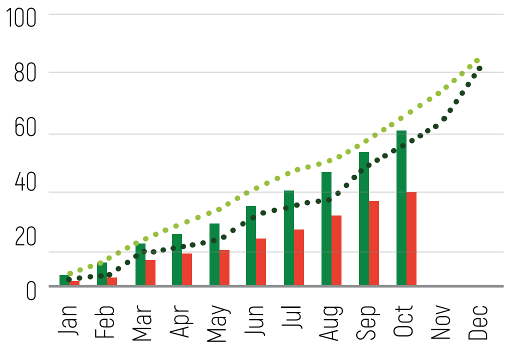
Note: GFN = Gross Financing Needs. Following the GoM's classification, externally financed programs are reported as capital spending. COVID-related expenditures are those reported in the revised budget law for domestically financed spending and by donors for externally financed spending.

3 Macroeconomic and financial stability has been maintained through difficult times

9. The budget deficit increased sharply in 2020 but was mostly financed by additional concessional financing. The sudden loss of fiscal revenues was a major driver of rising budget deficits in 2020, with the tax-to-GDP ratio falling back to 9 percent in 2020, its lowest level since 2012. On the spending side, government expenditures increased to reach 16.5 percent of GDP in 2020, notably driven by higher staff costs as salary adjustments were implemented and rising public investment. On the other hand, budget execution rates were low in the first three quarters of the year and are only expected to partially catch up in the final quarter of 2020 (Figure 9). This low execution rate reflected capacity constraints during the lockdown period and delays in processing public procurement and payments. Overall, the fiscal deficit is estimated to have widened to 5.2 percent of GDP in 2020 (Figure 10). The increase in fiscal financing needs from pre-outbreak expectations was entirely covered by emergency budget support operations from donors, which amounted to 3.1 percent of GDP in 2020 (Table 2). Madagascar is also participating in the G20's Debt Service Suspension Initiative, although it only stopped debt service payments to bilateral official creditors from the G20 in the course of November due to administrative delays. The suspension is effective from June 2020 to June 2021, potentially representing about US$ 35.5 million in savings for the government. These various support measures and interventions are expected to help create fiscal space to address the economic and social consequences of the crisis.

Figure 9: Budget execution rate

Percent

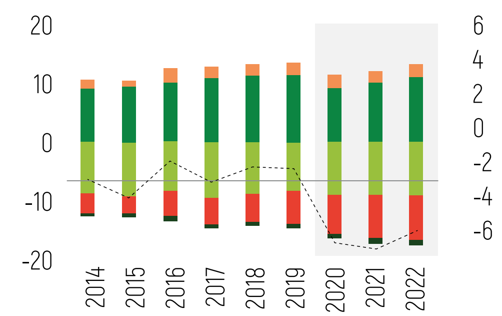


Budget execution rate in 2020
Public investment execution rate in 2020
Budget execution rate (average 2014-19)
Public investment execution rate (average 2014-19)

Source: Ministry of Economy and Finance, World Bank.
Note: The execution rate is the share of expenditures committed as of the end of each month over the revised annual budget. The underlying data is from the Treasury's Global Operations table.

Figure 10: Public expenditures, revenues, and budget balance

Percent of GDP | Percent of GDP



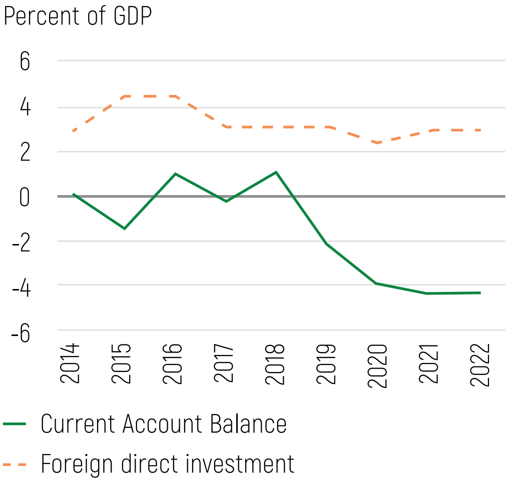
Interest payment
Capital expenditures
Primary current expenditures
Foreign grants
Domestic resources
Fiscal balance (RHS)

Source: Malagasy authorities, World Bank.
Note: Data for 2020-2022 are forecasts.

10. The financial sector has been affected by rising credit risks, but solvency remains generally sound. Prior to the crisis, all banks fulfilled the minimum capital adequacy requirement, with a capital to risk-weighted assets ratio of 13 percent on aggregate, well above a minimum of 8 percent. The impact of the pandemic has led to deterioration in liquidity and solvency indicators, particularly for microfinance institutions (MFIs), which serve most exposed sectors of society including MSMEs, informal businesses and households. MFIs experienced cash flow difficulties due to delay in loan repayment and deposit withdrawals at the beginning of the containment, though the situation has stabilized since mid-2020. The Banking sector has generally been more resilient but was also significantly affected by rising credit default rates. Proactive interventions of the Central Bank ensured the availability of adequate levels of liquidity, while banks were allowed to deduct loans to SME that have been restructured from regulatory reserve requirements. The extension of the existing Partial Portfolio Credit Guarantee Schemes (PPGS) for firms affected by the crisis has also helped.

11. Currency pressures have been manageable and foreign exchange reserves remain adequate. Adverse impacts of lower export revenues on the trade balance were partially offset by a drop in import values reflecting lower demand for investment goods and a sharp decline in oil prices (oil imports account for 18 percent of total imports). The current account deficit nevertheless increased to 4 percent of GDP in 2020, while foreign direct investments weakened as well (Figure 11; Table 3). Currency pressures increased amid rising external financing needs, with the central bank more than doubling its net foreign exchange purchases compared with 2019. However, comfortable reserves were maintained, bolstered by emergency budget and balance of payment support operations from donors. The Central Bank operates under a flexible exchange rate regime but aims at preserving currency stability with targeted interventions.

Figure 11: Evolution of current account balance and FDI



Source: Malagasy authorities, World Bank staff calculations.
Note: The current account measures net flows of goods, services and income between the residents of a country and non-residents. A negative figure means that payments to non-residents exceed receipts. Data for 2020-2022 are forecasts.

12. Inflation was stable in 2020, at levels consistent with price stability. Despite moderate currency pressures and supply chain disruptions due to the impact of lockdowns in some large cities, consumer price inflation remained subdued, hovering around 4 percent during 2020. The government took advantage of significantly lower international oil prices to reduce its liabilities towards oil distributors, maintaining gas prices at the pump unchanged. Core inflation, excluding rice and energy prices, remained moderate, at around 5 percent throughout 2020. This allowed the Central Bank to keep an accommodative monetary policy stance throughout the year. So far, the monetary policy response has consisted of providing liquidity to commercial banks and the relaxation of some mandatory deposit limits to encourage banks to reschedule repayment on existing loans and boost credit to corporates. The operational framework of the Central Bank is currently in transition from a monetary aggregates-based framework to one based on interest rates.

Table 3: Madagascar: Key Balance of Payment Indicators

	2018	2019e	2020f	2021f	2022f	2023f
Percent of GDP						
Current account balance	0.7	-2.3	-4.0	-4.4	-4.3	-4.3
Trade balance	-3.1	-4.2	-5.9	-6.3	-6.2	-6.1
Net income balance	3.8	1.9	2.0	1.9	1.9	1.8
Capital account balance	1.7	2.3	2.3	2.1	2.3	2.4
Financial account balance	-1.1	-0.5	-1.9	1.0	1.0	1.0
Net FDI and portfolio investment	2.6	2.6	1.9	2.5	2.5	2.5
Debt amortization	0.7	1.8	2.1	2.1	2.2	2.2
External financing needs	0.0	4.1	6.0	6.6	n.a	n.a
Change in EFN since February 2020	0.0	0.0	1.9	1.9	n.a	n.a

Sources: World Bank Group and IMF.
Note: FDI = foreign direct investment; EFN = External Financing Needs.

Currency pressures increased amid rising external financing needs, with the central bank more than doubling its net foreign exchange purchases compared with 2019.

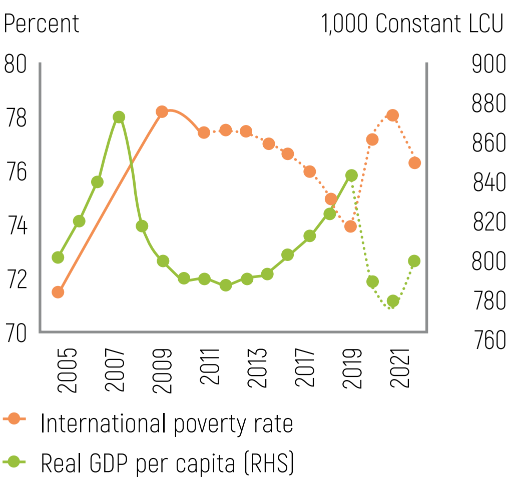
PART TWO

OUTLOOK AND RISKS

1 Activity is expected to recover in 2021, but prospects remain uncertain

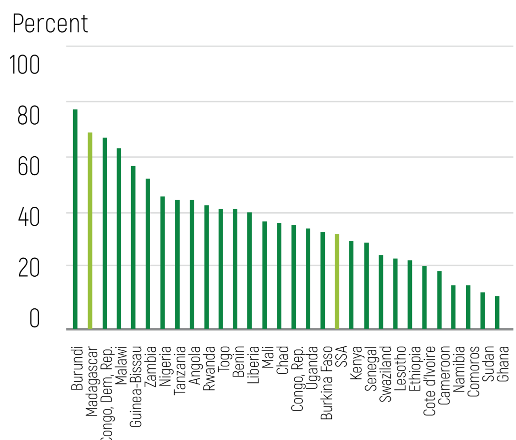
1. The global economic impact of the pandemic will persist in 2021 amid a resurgence in cases in many countries. Governments and central banks around the world have pledged trillions of dollars of stimulus, leading to expectations of a modest global economic recovery in 2021. However, a second wave of the pandemic in many of the countries where lockdowns were eased in previous months will adversely affect this expected rebound, aggravating an already dire situation due to historically high unemployment and indebtedness. Assuming that new policy restrictions are able to contain community spread and can be gradually lifted during the first quarter of 2021, global growth is predicted to reach 4.0 percent in 2021, and 3.7 percent in 2022. The baseline scenario assumes that new vaccines will be distributed starting in the first quarter of 2021, reaching peak coverage in the course of 2022. However, the pace of distribution and uptake by the population remains importance sources of uncertainty at the present juncture. This vaccination campaign is expected to underpin a pickup in consumer and business confidence during 2021, supporting a gradual upturn in global demand, travel and tourism.

Figure 12: Actual and projected poverty rates and real GDP per capita



Source: National Institute of Statistics, World Bank.
Actual data: 2012. Nowcast: 2013-2019. Forecast are for 2020-2022.

Figure 13: Poverty rate in 2019



Source: World Bank.
Note: Poverty measured at USD 1.90 per day in 2011 PPP. SSA stands for Sub-Saharan Africa.

2. Growth in Madagascar will recover in 2021-23, but at a gradual pace and will continue to face underlying constraints. As global demand picks up in 2021, export and investments should regain strength, but the 2020 recession will leave a long shadow for businesses and households. In this context, growth is expected to remain subdued in 2021, at around 2 percent, which is insufficient to increase average income per capita. This means that the crisis would have shaved over a two-year period about 13 percent to average income per capita when compared with pre-crisis expectations. In the baseline scenario, growth would bounce back to 5.8 percent in 2022 and 5.4 percent in 2023, but the crisis will likely exacerbate constraints to growth associated with a dualistic society, high exposure to shocks; and a lack of adequate human capital and infrastructures.

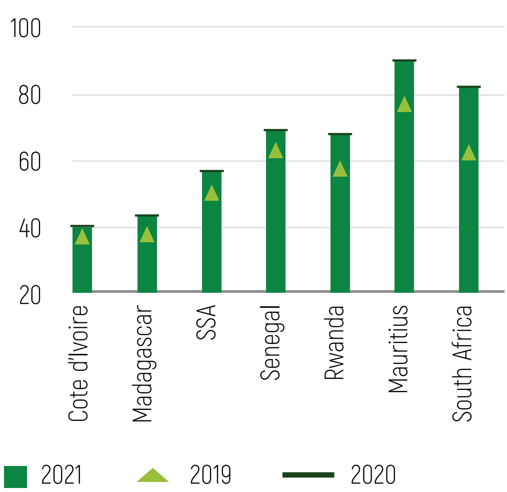
3. The poverty rate should resume its downward trend over the medium to long term, but vulnerable populations remain highly susceptible to shocks. A gradual economic recovery should allow poverty rates to return to a declining trend from 2022 onwards, but the crisis is expected to have set back the country's efforts in alleviating extreme poverty by a decade (Figure 12) and maintain it among the poorest countries in Sub-Saharan Africa (Figure 13). Over the medium to long term, the pace of poverty reduction will largely depend on the country's ability to facilitate formal job creation in off-farm employment, improve agricultural productivity and resilience to climate and other shocks.

2 A longer-lasting crisis could be a source of instability

4. Debt sustainability risks have increased but remain moderate. The projected economic recovery in 2022-23 should result in gradually declining budget deficits, from an estimated 5.2 percent of GDP in 2020 to 3.8 percent in 2023. The main driver of this decline will be a recovery in government revenues, offsetting accelerating public investments, particularly in infrastructure. In this context, public debt is projected to stabilize around 52 percent of GDP in 2023, following a sharp increase in 2020 and 2021 (Figure 14). External debt distress risks have increased in recent months from low to moderate, but baseline projections for key external debt and debt service ratios remain well clear of risk thresholds considered for Madagascar (Figure 15). The current debt risk profile for Madagascar still makes plans to scale up priority investments appropriate but calls for prudent borrowing policies and fast-track reforms to boost revenue mobilization and public spending efficiency.

Figure 14: General Government Debt (as % of GDP)

Percent of GDP

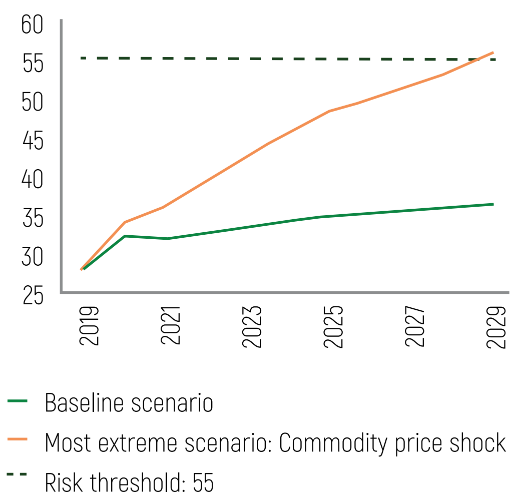


Source: World Bank.

Note: 2019 data are estimates, 2020 and 2021 are forecasts. SSA stands for Sud-Saharan Africa.

Figure 15: Present value of public debt-to-GDP ratio

Percent of GDP

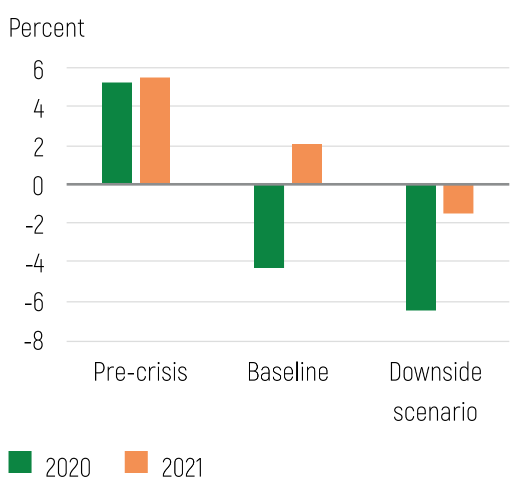


Source: IMF and World Bank.

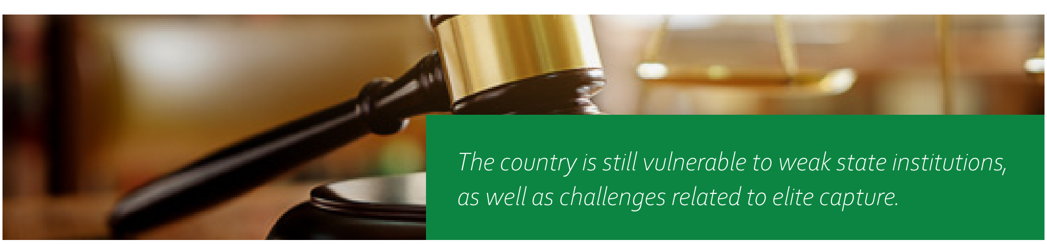
5. Macroeconomic imbalances are expected to remain limited. As export revenues gradually recover, the current account deficit is expected to stabilize around 4.3 percent of GDP in 2021-23, which will be covered by expected FDI and official financing flows. Inflation is projected to stabilize at about 6 percent over the period 2021-23, precluding major weather or commodity price shocks and assuming that domestic and global value chains gradually return to normal operations. In this context, the Central Bank is expected to keep its policy interest rates steady, while continuing to implement targeted liquidity and foreign exchange interventions to alleviate pressure on the banking sector. Solvency of the banking sector is expected to remain robust on the whole, but the adverse impact of growing non-performing loans and of credit payment rescheduling has significantly hampered balance sheets of more exposed banks.

6. Risks associated with a more prolonged crisis than currently envisioned could be significant. Projections are particularly uncertain in the face of a fast-evolving global and domestic pandemic. In particular, the resurgence of COVID-19 cases could linger in Europe and United States more than currently expected despite the recent discovery of vaccines, while a second wave could hit Madagascar. In such case, activity in Madagascar could continue to contract in 2021, leaving a cumulative impact after two years significantly larger than the constitutional crisis in 2009 (Figure 16). Such risk could be compounded by other shocks, including natural disaster and the risk of social unrest amid persistent economic hardship. Rural communities are highly vulnerable to the risks of cyclones and floods due to the dependence on rain-fed agriculture, poor infrastructure and the absence of affordable insurance mechanisms. Madagascar has historically experienced cycles of social and political instability and has only recently completed a peaceful democratic transition. Although it has made notable progress, the country is still vulnerable to weak state institutions, as well as challenges related to elite capture. These factors are at the heart of state fragility in Madagascar, and links to other sources and drivers of fragility, including regional imbalances and inequalities that have contributed to the historical neglect of the lagging regions such as the south, and that undermine social cohesion and compromise state-society relations. Fiscal risks are also significant, including those associated with exposures to SOEs facing growing financial pressures during the crisis such as the national utilities company JIRAMA and the airline company Air Madagascar. Both are in need a credible financial recovery plans in order to contain those risks and make them financially and operationally viable over the medium term.

Figure 16: GDP growth scenarios in 2020 - 2021



Source: World Bank.



PART THREE

POLICY PRIORITIES FOR THE RECOVERY

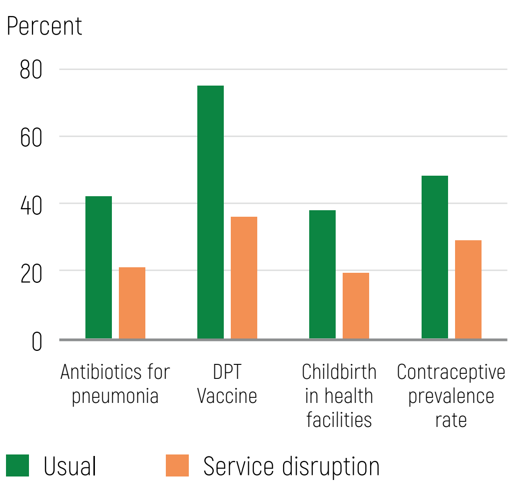
1. To put the country back on track, emergency measures to protect livelihoods and prevent a resurgence of the pandemic will need to scaled up, and combined with structural reforms aimed at accelerating economic transformation and creating opportunities for more and better jobs in the post-crisis period. This includes reforming the business environment to increase market access and contestability, accelerate the digitalization of the economy, mobilize additional domestic resources for priority infrastructure and human capital investments, and boost productivity in agriculture to support living standards and food security.

1 Preventing a resurgence of the pandemic and safeguarding livelihoods

2. Responding to the COVID-19 crisis with emergency measures to save lives, protect productive businesses and jobs remains the number one priority for the government in the short-term. Additional interventions will be needed to prevent a second wave of the pandemic in Madagascar while existing social protection and private sector support measures should be ramped up as the crisis persist longer than initially expected.

3. The health sector response will need to be scaled up to mitigate the risk of a second wave and accelerate the reopening of the economy. Additional measures are required to prevent a resurgence of the pandemic, including a mass testing and contact tracing strategy and improved coordination in the health sector response. With rapid progress on COVID-19 vaccines, Madagascar must reinforce its capacity to distribute and administer vaccines at scale, including institutional strengthening to ensure appropriate minimum standards for vaccine management, an allocation policy prioritizing vulnerable populations, as well as effective communication and community engagement campaigns. It also requires improved logistics infrastructure such as cold chain facilities and capacity to monitor vaccination progress. After the crisis abates, lessons will need to be drawn to reinforce the response and resilience of the health sector to future emergencies. Priorities include improved coordination of health and security-sector actors for outbreak response, increased attention to the continuity of basic health services, additional public resources for health from the national budget, and improved accountability and transparency of spending execution in the sector. Results of a preliminary analysis shows for instance a sharp drop in the number of children receiving third pentavalent vaccine doses during the earlier phase of COVID-19 crisis, which could have lasting adverse effects on children's livelihoods pandemic (Figure 17).

Figure 17: Coverage of basic health services



Source: GFF Secretariat Brief.

4. Social safety net programs will also need to be expanded to increase coverage and preparedness to future shocks. An unconditional cash transfer program, called Tosika Fameno, was implemented in coordination with donors, targeting nearly 345,000 vulnerable households spread across 14 districts affected by the lockdown measures (See Box 2 for details). A recovery program was also put in place to provide income support during a six-month period to 200,000 urban poor in urban/peri-urban areas (i.e. 58 percent of Tosika Fameno Beneficiaries) and 40.000 families affected by the drought in the Southern of Madagascar. This program should be expanded in case of a resurgence of the pandemic, in order to rapidly inject assistance to pre-targeted and enrolled poor households in affected areas (vertical expansion) and by including new vulnerable beneficiaries and possibly new localities (horizontal expansion). To ensure the sustainability of those programs beyond the lifetime of externally financed projects, a transparent and predictable budget allocation to national programs by the State paired with the identification of innovative sources of funding at the national level, in partnership with the private sector and donors would be crucial. Developing a more expansive social registry that covers rural and urban/peri-urban areas would also help further enhance social protection implementation capacities.

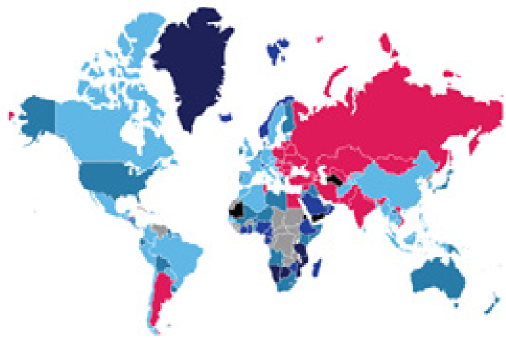
2 Building Back Better for a Sustained Economic Recovery

5. The prospects of a sustained economic and social revival will depend on the country's capacity to protect viable business and jobs during the crisis, while reinvigorate an agenda of structural reforms to accelerate economic transformation and create opportunities for more and better jobs.

6. A strategy to support the economic recovery will need to mix measures to address immediate impacts of the crisis on businesses and job creation and structural reforms. By avoiding the bankruptcy of otherwise productive businesses and the layoff of productive workers, measures to support firms and workers can enable a faster and more robust recovery. In the short term, these measures should address immediate liquidity challenges (i.e., "to keep the lights on") through a mix of grants, soft loans and credit guarantees. The provision of grants can be an important mean to safeguard job, support skills development and prepared businesses for the recovery including through the digitalization of the business operations, particularly for the most impacted sector such as tourism. In order to limit undue burdens on public finances and to avoid a persistent misallocation of resources and policy uncertainty, the government should establish a credible and transparent schedule for the removal of exceptional relief measures. Beyond short term mitigation measures, attracting new investments, supporting entrepreneurship, facilitating market access and contestability will be key elements of this recovery strategy. This includes opening up opportunities for investment and job creation through reforms in the areas of getting licenses, construction permits, getting electricity, registering property, access to credit, enforcing contracts, and resolving insolvency. An efficient insolvency regime, improved access to capital, including equity finance, and effective policies to support vocational training and entrepreneurship are also key priorities in the post-crisis period.

7. The COVID-19 crisis has also been a catalyst for digital solutions. Lockdowns and social distancing measures have accelerated the use of digital technologies for both public and private services, such as e-commerce offerings. This provides a unique opportunity to accelerate reforms towards e-governance and the digital economy, even though challenges remain daunting: currently, only 18 percent of the adult population has a bank account or uses mobile money (compared with 43 percent average for sub-Saharan Africa) and broadband connections are unaffordable for a majority of the population (Figure 18). Accelerating the digitalization of the economy requires measures that increase competition in the ICT sector to stimulate needed investments, provide training to raise the uptake of digital services, and expand public digital public service deliver. These include improving the telecommunication regulatory framework to reduce access costs; rolling out ambitious digital training programs to support digital transformation; accelerating the Government's digital transformation with the adoption of service standards, improved quality of service delivery, and digital identification systems, which would also create new opportunities for the private sector (G2B).

Figure 18: Cost of Fixed-Line Broadband
Average cost of broadband
(per month in USD)

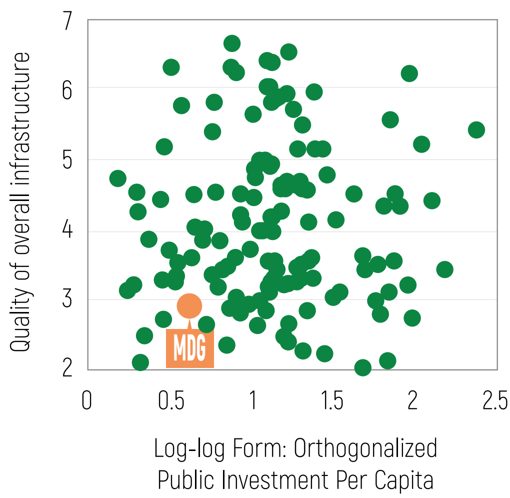


Source: cable.co.uk

8. Improving infrastructure quality and human capital will require adequate reforms and sufficient financing. Public investment in Madagascar is too low and ineffective to deliver the type of quality infrastructure that is needed for its development (Figure 19). This calls for wide-ranging reforms to improve the selection, evaluation and execution of public investments. This includes the use of objective socio-economic and spatial criteria for the selection of projects, effective multiannual planning, and improved coordination between various ministries and entities, and a PPP framework that encourages private sector participation while limiting contingent liability risks. Improving education outcomes is also a key priority to creating opportunities for more and better paying jobs in the face of a rapidly growing population. By improving absorptive capacity and strengthening financial management systems and efficiency, there is a strong case to increase the current budget allocation on education. Further reforms to ensure meritocratic recruitment of teachers, to improve flow of funds management for school grants, and ensure effective decentralization are key to enhance the quality and efficiency of public education and boost human capital. The mobilization of additional domestic resources to support priority investments in infrastructure and social sectors has become imperative. This requires focusing on tax reforms that bolster revenues while encouraging investment and job creation, such as the accelerated digitalization of tax declarations and payments, the removal of ineffective and costly tax expenditures, and the optimization of the tax regime applying to mining activities.

9. The crisis also highlighted the importance of boosting productivity in the agricultural sector in order to improve livelihoods and food security. Most rural households are engaged in low-productive subsistence farming with household food security being a consistent concern across the country. The rice sector has been the focus of government support for decades; however, paddy rice production is lower today than in 2010, farmed surfaces are insufficient or underexploited, and most of the rice surplus regions have difficult road access. This situation has led to rising imports, declining self-sufficiency and exposure to international food price shocks, making bold reforms critical. Improving rural feeder roads and developing regional mills could help significantly reduce transport costs, which represent a major burden and disincentive to commercialize production for most farmers. Partially removing tax exemptions on imported rice could also incentivize local production and encourage domestic producers to invest in quality inputs, higher-yielding production methods and operations and maintenance of irrigation and storage facilities. Greater reliance on domestic production and increased productivity in the rice sector could make a significant contribution towards lowering extreme poverty in rural areas and improving food security across the country. Reform to limit government interference in markets and efforts to promote value chain organization such as public-private governance platforms would be relevant for major agricultural exports, such as vanilla and food crops.

Figure 19: Public investment and infrastructure quality



Source: World Bank; World Economic Forum; Santiago Herrera and Abdoulaye Ouedraogo (2018)

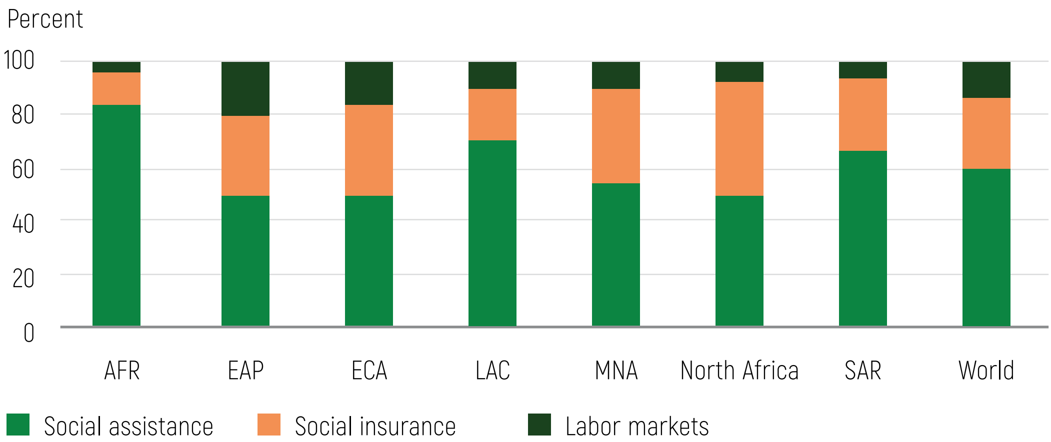
Box 2: Social Protection Response to COVID-19: an international perspective

At the outset of the COVID-19 crisis, the social safety net system in Madagascar focused mostly on rural poor, with a beneficiary registry under development but not yet operational. Yet, current programs had invested heavily in emergency response and coordination in response to cyclones and draughts. This enabled the Government and development partners to quickly design and implement an urban cash transfer response to COVID-19, called TOSIKA FAMENO in just a few weeks. Reaching up to 345,000 vulnerable households affected by confinement measures with unconditional cash transfers in a short period of time was made possible by: (a) using the national emergency response system and social protection coordination mechanisms; (b) moving registration and household targeting to the local level (commune, fokontany) with self-registration and community validation: (c) mobilizing existing implementation capacity, grievance and redress mechanisms, mainly through the *Fonds d'Intervention pour le Développement* (FID); and (d) prior experience with mobile payment methods that could quickly be scaled up. The partners have drawn lessons to strengthen future response and improve communication to the public. Future challenges remain in scaling up to a national social registry and financing a broader social protection system in both short and longer term. This box presents the experience of other countries in the region and globally, providing perspective on international good practices and guidance for future interventions in Madagascar.

i Social Protection Responses in Other Countries

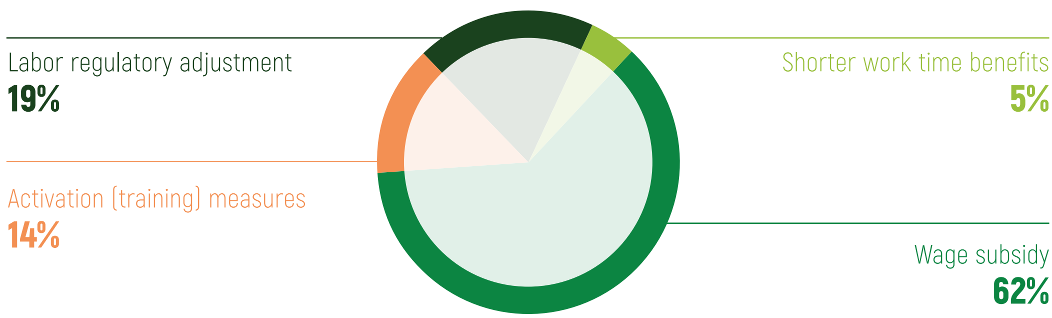
A vast majority of countries have introduced social protection and jobs measures in response to COVID-19. Among types of interventions, social assistance (or non-contributory transfers) is most widely used, followed by social insurance measures and supply-side labor market programs. Social assistance accounts for most of Africa's COVID-related response (Figure Box 2.1).

Figure Box 2.1: Type of social protection measures during COVID



Non-contributory social assistance was the most frequent measure adopted by governments. Social assistance programs account for 60.1 percent of responses, and include cash transfer, in-kind transfers, public works, and utility waivers. Among safety nets, cash transfer programs account for one third of total social protection programs and about 56 percent are new programs introduced as a response to the Covid-19. Wage subsidies continue to dominate labor market programs, accounting for 60 percent of them (Figure Box 2.2). There is considerable diversity in generosity and accompanying conditions.

Figure Box 2.2: Labor markets program type

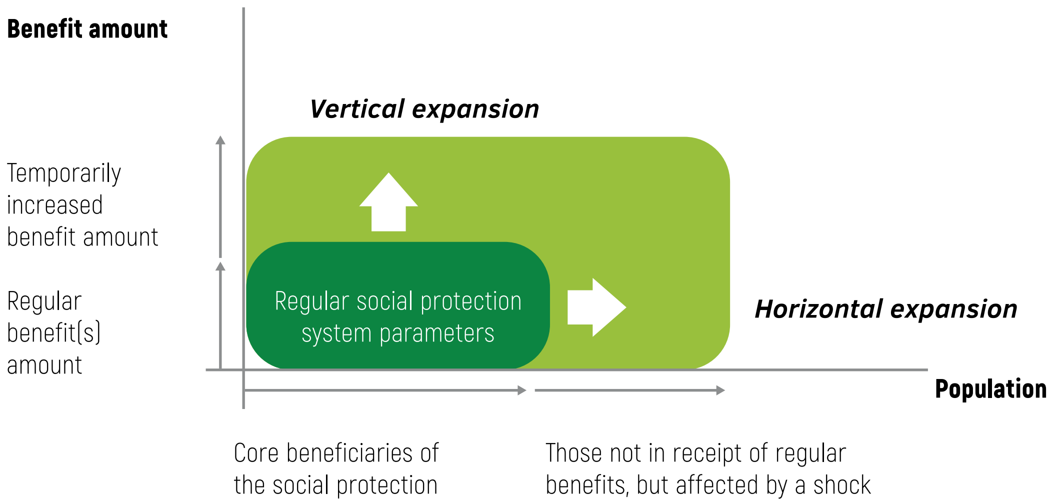


ii Typology of responses and design of cash transfer programs

Countries' COVID responses have used all five typologies for expanding social safety nets (Figure Box 2.3):

- Vertical expansion: increasing the benefit value or duration of an existing program for existing beneficiaries, increasing the frequency of payment.
- Horizontal expansion: adding new beneficiaries to an existing program. This may include (a) extension of geographical coverage, (b) an extraordinary enrolment campaign, (c) modifications of entitlement rules, and (d) relaxation of requirements or conditionality.
- Piggybacking: using a social protection program's administrative framework to deliver assistance, but running the shock-response program separately.
- Shadow alignment: running a parallel humanitarian system that aligns as best as possible with a current or possible future social protection program.
- Refocusing social safety nets by centering them on the people who are most vulnerable to shocks.

Figure Box 2.3: Type of social protection measures during COVID



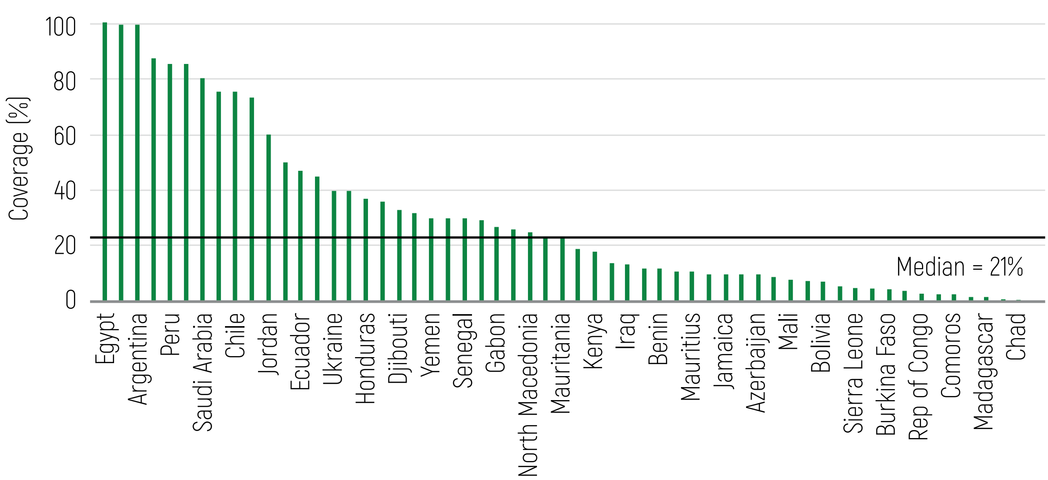
Source: World Bank.

Traditional or existing cash transfer programs have been customized by extending their duration, size, and scope. The duration of new programs ranges from 1 to 6 months, for an average of 3.1 months. In some cases, programs duration is undetermined as it tied to the uncertainty of the crisis (e.g. Morocco and Tuvalu). Current transfers account for an average 27 percent of monthly GDP per capita in respective countries (the highest increase, or 47 percent, is registered in low-income countries). On average, transfers have more than doubled (+134 percent) compared to average pre-COVID transfer levels. Increases in benefits among preexisting programs are implemented in 45 countries, including transfer value being increased in 45 programs (e.g., Egypt) and taking place in 18 programs (e.g., Chile). Various administrative adaptations are occurring in 41 countries. Coverage extension is underway in 157 countries.

The COVID-19 crisis has given new impetus to innovations in urban safety nets and support to the informal sector. The social distancing measures have had direct impacts on urban populations, while rural workers are also affected through the disruption of value chains. Urban poverty is generally substantially lower than rural poverty while most of urban poor work in the informal sector (domestic work, street vending, waste picking…). Yet, meeting the needs of informal sector workers affected by crises remains a challenge. They are excluded from social security and from most social assistance in low-income countries. COVID-19 is also impacting informal sector workers who were not among the extreme poor prior to the crisis but suffer large losses, whether in urban or rural areas. In response, many countries have introduced several innovations to reach informal workers including through new online platforms (Thailand), use of databases in health (Morocco) and energy (El Salvador) sectors; and cross-checking with taxation information (Colombia, Argentina).

Comprehensive social registries are key to help countries respond rapidly to crises and scale up programs. Expanded coverage of social registries facilitate expansion of transfers to people and households that may not usually be covered. Where functional registries and data-sharing protocols with other big data sources exist, programs can target and expand social protection quickly while avoiding lengthy new enrollment processes. Speed and digital enrollment are particularly important during pandemics. Social Registries can also be used to link and refer people to appropriate services or to qualify them automatically for subsidy/waiver programs. Yet, the coverage of social registries in Africa is low (Figure Box 2.4).

Figure Box 2.4: **Social Registry Coverage**



Source: GFF Secretariat Brief, Présenter les services de santé essentiels pendant la pandémie de COVID-19 à Madagascar, May 2020.

The COVID-19 outbreak has highlighted key requirements to improve social protection systems in the face of large-scale epidemics. These include improved digital services and procedures that are more 'human-centered' in order to improve availability and lower transaction costs; measures to allow continuous enrollment in programs or reassessments of needs rather than only rare 'survey sweep' based intakes; and labor protections that depends less on the form of employment contract.

iii Lessons for Madagascar

Safety net coverage and spending remain very low in Madagascar compared with peers. Whereas countries allocate on average 1.2% of GDP to social safety nets in sub-Saharan Africa, Madagascar devotes only 0.3% of GDP to these programs. Coverage of the extreme poor is low (5 percent) compared to other countries in the region (28 percent). So far, the main cash transfer social safety programs cover nine (of 22) regions, mainly in poor rural areas. The COVID-19 crisis yielded international and local lessons that provide a foundation for expanding and improving Madagascar's social protection system and propelled the extension of the safety net into urban zones.

A national system of social protection for the poor and vulnerable should build resilience ex-ante and provide effective counter-cyclical responses to large covariate shocks. An estimated 25 percent of the Malagasy population live in areas highly exposed to cyclones, floods and drought, and the pandemic lessons are equally applicable to such types of emergencies. The crisis demonstrated the ability of the Government and partners to mount a rapid response. Building on achievements of welfare impacts of the current models, the future expansion of the Madagascar social safety nets will depend on continued excellent coordination between development and humanitarian sectors; a broader and more sustainable financial base; scaling up implementation capacities; and constant enhancement of dynamic models for reaching different vulnerable groups efficiently and effectively. The consequences of the COVID-19 pandemic will be felt for some time to come, increasing the need for a robust social protection system.

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