# Economics

## Malawi: Annual economic outlook

### Buoyant growth expected to moderate marginally

7 April 2010

Anita Last

## Projections for 2010:

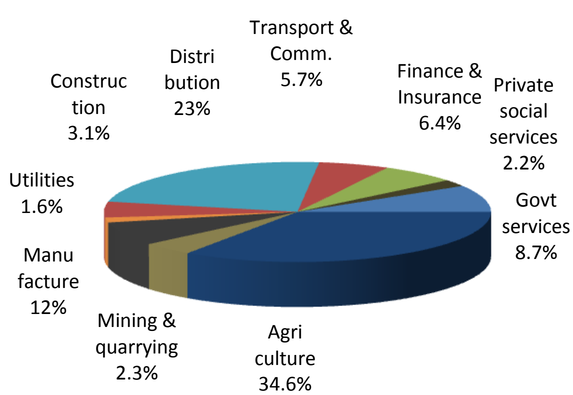
- Real GDP growth is expected to moderate to 6.6%
- Annual inflation to increase to an average of 8.8%
- Kwacha to depreciate and average MWK165/USD
- Fiscal deficit is expected to narrow to 1% of GDP in FY 2009/10

## Recent trends

### National accounts

The Malawi economy continued to grow at a fairly rapid, albeit slower, pace in 2009. It is estimated that GDP growth averaged 7.6% over the year, after reaching 9.8% in 2008. Agriculture, forestry and fishing, the largest sector of the economy, accounted for almost 35% of GDP in 2009 (see Figure 1). Maize and tobacco production continued to be the main drivers in this sector. The continued successful deployment of a national fertiliser subsidy, coupled with consistent rains across most of the country, resulted in the fourth consecutive bumper maize harvest, the most important staple crop. Maize production totalled 3.7 million tonnes compared to 3.4 million tonnes in 2008.

**Figure 1: Contribution to GDP (2009)**




*Source: IMF*

Tobacco, the country's biggest cash crop, increased by 15.5% in 2009 to 224.7 million kilograms from 195 million kilograms in the preceding year. However, despite solid growth in production, low commodity prices and weak global demand, suppressed exports and sales. Owing to the financial crisis, tobacco merchants were unable to access credit from international lenders to purchase tobacco. Tobacco prices were as low as US$1.22/kg, at the beginning of the season but steadily improved as the season progressed, reaching US$1.85/kg, representing a decrease of 23.4% over the 2008 average price of US$2.42/kg. As a result, overall growth in the agricultural sector slowed from 11.8% in 2008 to 10.4% in 2009.

The manufacturing sector accounted for about 7.7% of GDP in 2009, compared with 7.9% in 2008. Manufacturing grew at a preliminary 4.7% in 2009 from a growth rate of 9.9% in 2008. The deceleration is attributed to the foreign-exchange shortage, which was caused by lower-than-expected tobacco earnings and stronger than anticipated demand for foreign exchange that resulted in lower output than the sector envisaged as most of the raw materials and capital equipment required for production were not imported as planned.

Growth in the construction sector was supported by the continued construction of roads across the country, the new parliamentary building and the continued construction of residential property by private individuals, particularly in Lilongwe and Mzuzu. As a result of delays in some development projects due to the postponement of investments in the wake of the global slowdown and a shortage of foreign exchange reserves to import raw materials, expansion in the sector slowed to 7.3% in 2009 from 8.1% in 2008.

Growth in the wholesale and retail sector slowed to 5.6% in 2009 from 7.6% in the previous year on the back of lower domestic demand. This is probably as a result of the contraction in the largest sector, agriculture, which contributes about 64% of total income to the rural population and 87% of total employment.

Increased agricultural production accelerated growth in the transportation and storage sector, which grew by 6.9% in 2009 from 5.4% in 2008.

The information and communications sector continued to perform strongly and expanded by 15.4% in 2009 from 46.8% in the previous year. The high growth rate in 2008 is explained by massive promotion campaigns by mobile phone companies, and increased sales of phones and airtime.

The financial and insurance-services sector showed growth of 8.1% in 2009, compared with 11.8% previously, mainly on the back of lower economic activity and sluggish performance in the insurance sector due to increased operating costs. New entrants into the commercial banking subsector as well as increased products and the introduction of mortgage facilities by some of the commercial banks supported growth.

The mining and quarrying sector grew by more than 10% in 2009 from 7.2% in 2008. The growth is explained by the commencement of uranium mining at Kayelekera. Malawi granted Australia-based Paladin Energy Limited (TSX, ASX:PDN), formerly Paladin Resources Limited, a licence to mine uranium at Kayelekera in the country's northern region district of Karonga, which borders Tanzania. The US$200 million mine is expected to produce about 3.3 million pounds of uranium a year and is expected to become Malawi's top foreign currency earner in the coming years - contributing about 10% of the country's GDP and accounting for 20% of exports. The Malawian government has a 15% stake in the mine, which has an estimated lifespan of 12 years. The mine is expected to supply the nuclear industry and is the second largest uranium mine on the African continent after Langer Heinrich in Namibia. Apart from Paladin, other companies performing uranium prospecting or exploration in Malawi include Globe Uranium, Africa Energy Resources, Mantra Resources and Oropa Limited. Globe Uranium, of Australia, recently announced a 56 million ton mineral reserve in Kasungu, a district in central Malawi. The reserve includes niobium, tantalum, uranium and zirconium, of which niobium is the primary constituent. Promising discoveries of nickel deposits in southern Malawi, which are envisaged at 1.2 million tons a year, were also announced.

Increased exploitation of Malawi's mineral resources requires massive expansion in electricity-generating capacity. Although the rehabilitation of Malawi's hydropower plants is ongoing, the country still suffers from inadequate capacity for its current needs. A positive development in this regard was an agreement between the Government of Malawi, the Government of Mozambique and the World Bank on the construction of an inter-connector that will join Malawi's power grid to Cahora Bassa Hydro power plant in Northern Mozambique and the Southern African Power Pool.

## Domestic expenditure

Households are the largest spenders in Malawi's economy. Bumper harvests in the past three years imply that income for the bulk of the labour force increased, as agriculture is the biggest employer. Private consumption expenditure as a percentage of GDP is estimated to have increased to 8% in 2009, from 6% in 2008 and -10.8% in 2007. The purchasing power of Malawian households is also expected to have increased on account of record-low inflation rates in the past three years. Government spending has been largely facilitated by donor funding from the country's development partners. Despite 2009 being an election year, government consumption expenditure is estimated to have remained at 8.5% of GDP in 2009, the same as in 2008.

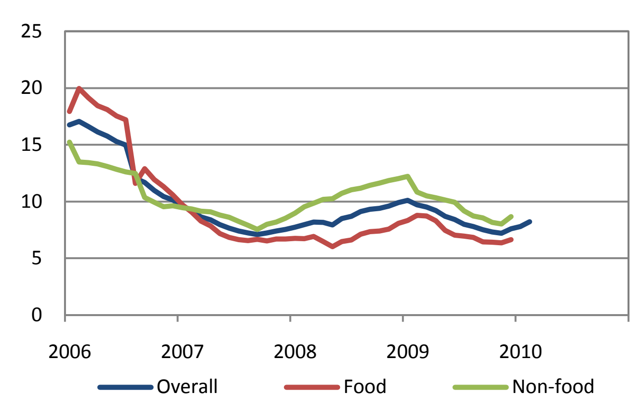
Being a landlocked country with a narrow resource base and a small domestic market, foreign direct investment (FDI) in Malawi is generally low. FDI centres mainly on the mining, manufacturing, agricultural, and tourism and services sectors. The main sources of new investments in recent years have been Asia, in particular China, and South Africa. Private sector investment has included ongoing construction of residential and office buildings while public investment has increased owing to infrastructure programmes, particularly in electricity and transport.

Net exports are negative in Malawi as the country imports more goods and services than it produces. A slowdown in external demand for the country's main export, tobacco, on the back of the global demand slump, caused an increase in the negative balance of net exports in 2009, which is negative for GDP growth.

## Monetary policy

Monetary policy conditions in Malawi remained prudent but accommodative enough to encourage private-sector development during 2009. The country's monetary policy is aimed at achieving low and stable inflation, and targets an inflation rate of below 7%. The Reserve Bank of Malawi (RBM) uses a combination of instruments to achieve its monetary policy objectives. These include the bank rate, the liquid reserve requirement (LRR), open market operations, and sales and purchases of foreign exchange. Following the implementation of the International Monetary Fund's Extended Credit Facility in the first quarter of 2010, the authorities have committed to move towards market liberalisation, a gradual depreciation of the exchange rate, and increased budgetary spending controls. Reserve accumulation nevertheless remains an important objective as a buffer against sharp short-term exchange rate movements.

**Figure 2: Consumer inflation**



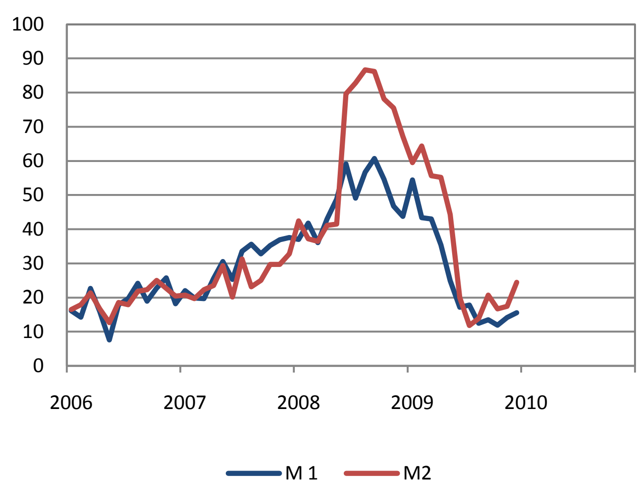

*Source: National Statistics Office*

With food accounting for 58% of the consumer price index, weather patterns tend to influence the inflation outcome. The bumper harvests in the past four years, and a stable exchange rate, helped to reduce inflation, to average 8% in 2007 (the first single-digit average in years) and 8.7% in 2008. From hitting a two-year peak of 10.1% y/y in January 2009, headline inflation slowed to 7.2% y/y in December 2009 as both food and non-food inflation maintained a downward trend. The slowdown in non-food inflation reflected the net effects of the downward adjustment in domestic fuel prices at the pump, which came into effect in the first quarter of 2009. Inflation averaged 8.4% y/y in 2009.

Inflation began to trend higher in November 2009. The period from November to March is traditionally known as the "hungry season" as this is the lean period for many foodstuffs. As a result, food inflation is on an incline. In addition, the continuous weakening of the exchange rate against the US dollar – trading at MWK150.80/US$ from MWK146/US$ at the end of December 2009 – exerted upward pressure on imported commodities and fuel prices, which pushed up non-food inflation. Pump prices for petrol increased by 20% and diesel prices by 16% on 12 February 2010.

Broad money (M2) growth was on average lower in 2009 than in 2008, as a result of dampened economic activity. After marginal expansion of 13% in the first quarter of 2009, money supply growth gained momentum during the second and third quarters of 2009 when it accelerated to 20% and 20.7% respectively. The expansion was on account of an increase in growth in net credit to government, the private sector and parastatals. Modest growth in net foreign assets was attributed to the proceeds realised from the sales of tobacco on the auction floors. Donor support also contributed to the increase in net foreign assets. During December 2009, annual growth of money supply accelerated to 24.4%, on the back of an increase in the precautionary motives for holding money, which outpaced the contractionary effects of reduced demand for transactional cash balances.

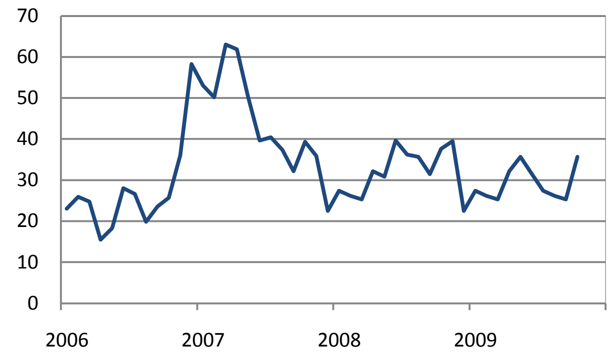
**Figure 3: Money supply (M2)**




*Source: Reserve Bank of Malawi*

Credit to the private sector rose mainly as a result of lending to the agricultural sector. Gross credit to the private sector rose by 26.6% y/y in the first quarter of 2009, 26.9% y/y in the second quarter and 29.8% y/y in the third quarter of 2009. The increase in lending to the private sector partly reflected a pick-up in economic activity during the cause of the year

**Figure 4: Private credit extension (%)**




*Source: Reserve Bank of Malawi*

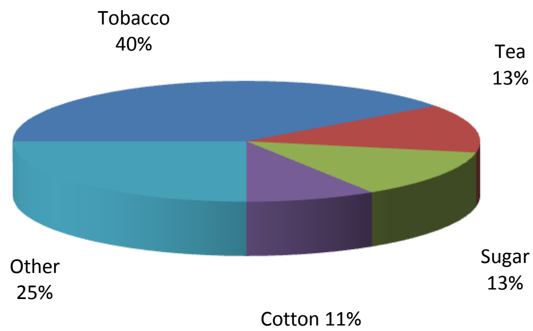
In view of accelerating money supply growth as well as inflationary pressures stemming from both food and non-food inflation, the Monetary Policy Committee (MPC) maintained a tight monetary stance at its meeting on 1 February 2010, and kept the bank rate at 15% and the liquidity reserve requirement at 15.5%.

### External sector

Malawi has very few commercially exploitable mineral resources in comparison with many of its sub-regional peers and therefore relies heavily on its agricultural sector, which accounts for around 80% of export revenue. Tobacco accounts for 40% (see Figure 5) of exports and a narrow range of agricultural commodities, including tea, sugar and cotton, currently makes up the bulk of annual foreign-exchange earnings.

After several years of relentless expansion, Malawi's current account deficit has shown signs of stabilising in recent years. One factor behind the improved performance is the government's investment in the agricultural sector for increasing food security, which has reduced the need to import staple foodstuffs. In fact, the implementation of the fertiliser subsidy programme as well as good rains in the past three marketing seasons boosted the agricultural sector to the extent that the country was able to export maize. Price support provided by the government in the form of a price floor at the tobacco auctions served as an incentive to increase tobacco production for farmers who were discouraged by lower prices a few years ago. This resulted in a noticeable increase in the production and sale of tobacco in recent years. Tea production also improved over the past three years resulting in greater export revenue. Malawi has continued to make progress in diversifying exports away from the traditional core products. Rice, coffee and pulses all realised strong export growth, albeit from a low base.

**Figure 5: Composition of exports (2008)**




*Source: IMF*

Terms of trade deteriorated in 2008 despite solid growth in tobacco prices and export volumes, which were countered by high fertiliser prices and other world market commodity prices for most of 2008. Besides higher fuel and food prices, fertiliser prices were almost 51% higher than was expected when the 2008/09 budget was prepared. The full impact had not been felt because reserves were largely held up by seasonal tobacco proceeds from April to September. Tobacco exports earnings may have almost doubled in 2008 but at the end of September 2008, gross reserves were only US$175 million, or 1.1 months of import cover. To help adjust the terms of trade shock, the authorities requested additional budget support, particularly to help finance the seed and fertiliser subsidy programme that was introduced in 2005, which is critical for sustaining agricultural production, exports and food security. They also requested a one-year Exogenous Shocks Facility (ESF) from the International Monetary Fund (IMF) which was approved in December 2008.

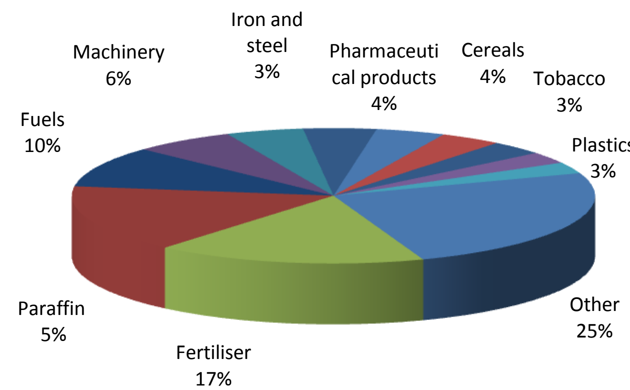
The main objective of the government for appealing for the ESF was to adjust the terms of trade shock and start rebuilding an international reserve buffer. The official reserve position improved on account of the disbursement from the IMF under the ESF facility, as well as allocations of Special Drawing Rights (SDR) early in 2009 to mitigate the impact of the global financial crisis.

The financial sector is small and is not very sophisticated. Moreover, foreign direct and portfolio investment levels are typically small, which implied that the impact of the financial crisis on Malawi was largely limited. The impact of the crisis was more pronounced on Malawi's real economy than on the external sector.

As a result of lower international commodity prices, tobacco sales, the main foreign exchange earner, performed dismally in 2009. Despite an increase in tobacco sales to 184.7 million kilograms as at the end of August 2009, compared to 172.2 million kilograms sold during the comparable period in 2008 (tobacco auctions begin in April and end in August), tobacco earnings fell by 24% to US$341.2 million, from US$421.5 million realised during the same period in 2008.

Seasonal demand for foreign exchange started to increase in August 2009, mainly on account of agricultural fertiliser imports, which account for 17% of total imports (see Figure 6). The current transfer account was unable to cover the trade deficit. As such, the current account has widened to 8.6% in 2009 from 6.4% of GDP in 2008.

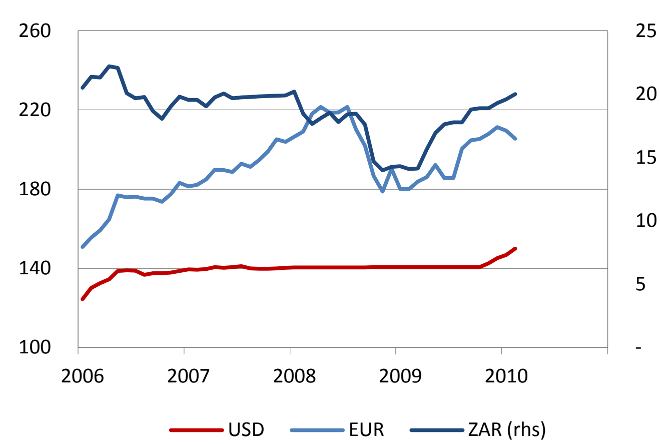
**Figure 6: Composition of imports (2008)**




*Source: Reserve bank of Malawi*

As a result of the terms of trade shock, official reserves in 2009 were well below the three months of import cover that is essential to reduce the country's vulnerability to exogenous shocks. Intervention in the foreign-exchange market, to keep the kwacha stable against the US dollar, compounded the low foreign exchange reserves position. The kwacha was kept relatively stable against the US dollar in 2008 and into 2009 at around MWK141/US$. At the end of December 2009, reserves had declined to US$205.2 billion (1.6 months of import cover), from US$243 billion a year earlier. The foreign exchange shortage led to the authorities adopting policy adjustments. In December 2009, the kwacha depreciated to MWK146/US$ and at the end of January 2010 the currency was trading at MWK147/US$. After further steady depreciation of 4.2%, the kwacha is now trading at MWK150.8/US$.

**Figure 7: Kwacha/US$**




*Source: Bloomberg*

The key effect of a weaker currency will be that Malawi's exports will become relatively less expensive for foreigners. Furthermore, the weaker kwacha would make foreign products relatively more expensive for domestic consumers, thus discouraging imports. This may help to increase the country's exports and decrease imports, and may therefore shore up the trade balance. However, by increasing the price of imports and stimulating greater demand for domestic products, a devalued currency can aggravate inflation. If this happens, the government may have to raise interest rates to control inflation, eventually slowing down economic growth.

In the longer term, sound economic policy, diversification of the economy and the export base, increased investment in domestically produced consumer goods, reduction of external debt, and maintenance of exchange rate that reflects fundamentals will be critical. To this end, the onset of uranium production in the northern parts of the country with exports expected to gain momentum soon, is encouraging. A flexible and competitive exchange rate will furthermore help to buffer the country against major exogenous shocks.

### Fiscal policy

Fiscal policy loosened in the run-up to the May 2009 presidential and parliamentary elections. Budget overruns on fertiliser and goods and services spending during fiscal year 2008/09 (June – July), combined with a modest shortfall in foreign financing, led to a high level of domestic borrowing and meant that the central government deficit was above the budget. The fiscal year 2009/10 budget plans to return to a more prudent fiscal stance.

The budget allocations for fiscal year 2009/10 recognise the fact that agriculture will remain a main driver of growth and that the government, in an effort to scale down the fertiliser subsidy programme, will promote irrigation and mechanised agriculture. Agriculture received the largest allocation, which represents 13% of total spending and equates to 4.4% of GDP. Education, science and technology received a 10% share of total spending, which represents 3.2% of GDP. A further 9% of total expenditure went to the Ministry of Health to help in the fight against tuberculosis and HIV/Aids. Around 12% of total spending will go to the funding of transport infrastructure. Development expenses are set at 26% of the budget. Recurrent expenditure includes a 15% increase in civil service salaries and will amount to K188.18 billion. Total expenditure and net lending is expected to rise by around 13% to K256.77 billion.

Revenue and grants are budgeted to increase by 17% from the previous fiscal year. This translates to K263.2 billion, up from K224.1 billion in the previous fiscal year. Tax revenues are projected to increase by around 41% from K105.0 billion to K139.9 billion. Non-tax revenues are also estimated to increase by K12.3 billion. The increase in tax revenues is premised on a projection of strong agriculture performance (especially tobacco production) and improved tax administration. Pledges for grants from mainly multinational financial institutions are expected to amount to K92.1 billion for the 2009/10 budget and consist of general budget support and dedicated grants to specific sectors and projects. A projected decline in grants of 9% over the previous fiscal year's figure comes mainly on the back of the completion of several one-off donor-funded projects in the previous year. Overall, the budget envisages that the fiscal deficit will be reduced to 1% of GDP from 1.5% of GDP in the previous financial year.

The preliminary results on the execution of the 2009/10 budget through the first half of the fiscal year to December 2009 are in line with the financial plan, adjusted for delays in donor support. In the mid-year review, domestic revenues for the first half of the financial year, at K77.8 billion, were 4.9% higher than anticipated. Government expenditure for the same period was K130.3 billion, K4.1 billion lower than target, due to capacity constraints. Domestic debt stood at K144.4 billion compared to K116.9 billion at 30 June 2009. Reducing domestic debt will be necessary to support the planned increase in reserves and lower the share of public expenditures devoted to debt service.

An extra K8 billion mid-year budget was presented to Parliament for the second half of the financial year. Allocations have been made to African Union (AU) activities, Karonga earthquake victims and the new Parliament building. There will be additional expenditures on road infrastructure and grain silos. The government will increase domestic debt repayment by about K6.0 billion. The decision was made to restructure domestic debt by converting more expensive short-term debt to cheaper medium- to long-term debt to reduce interest payments.

Donor aid makes up around 33% of Malawi's budgeted revenue in the 2009/2010 budget. The German government pledged to provide EUR10 million towards the budget. The EU and Irish governments pledged to provide the equivalent of K641 million and K669 million, respectively, to the subsidy programme. Other donors are DFID, India and Norway.

## National policy assumptions and the international environment

### Policy framework

As part of the UNDP-World Bank-sponsored African Futures project, the National Economic Council (NEC) of the Government of Malawi commissioned a national vision document, Malawi 2020 Vision, which details the country's economic and social aspirations to 2020. Vision 2020 reflects the long-term goals of Malawians and forms the basis for short- and medium-term policies and strategies. It defines national goals, policies and strategies that will help government, the private sector and society in general to improve development management:

- A united, secure and democratically mature nation;
- Access to quality health and education for all;
- Sustainable growth and development;
- Per capita income of US$1 000 – although there has been some progress towards the MDGs, poverty is still widespread. Per capita income is at around US$250;

- A manufacturing (science and technology) led economy generating 25% of GDP (currently around 10% of GDP);
- Fair and equitable distribution of wealth;
- A sustainably managed environment; and
- Food security: Malawi's food security was enhanced through increased agricultural output. For the past four years, the country was able to produce more than the domestically required 2.2 million/mt of maize, resulting in it becoming a net food exporter of maize, as opposed to a history of repeated famine.

Strategy elements include:

- Development of smallholder agriculture as the central element in the short to medium term;
- Reliance on private sector and competitive markets to provide incentives for growth;
- Elimination of primary school fees and school uniforms to promote universal primary education;
- Reorientation of public expenditures to social sectors and levels of service provision that benefit the poor; and
- All this to be carried out within a well-developed and maintained economic infrastructure

Given the current status of economic development in Malawi as well as implementation capacity, achievement of the objectives is likely to take longer than anticipated.

The objectives of fiscal policy are to support growth and reduce poverty in line with the country's Growth and Development Strategy. The authorities maintain a prudent fiscal policy stance. The intention is to uphold fiscal discipline, and thus build international reserves without crowding out credit to the private sector.

The government places substantial weight on a stable exchange rate against the US dollar. The authorities believe exchange rate stability has helped signal their commitment to economic stability and anchored inflation expectations and the prices of traded goods. In view of the current foreign-exchange shortages and following recent IMF consultations, the government is considering a more flexible foreign-exchange rate regime.

The country's monetary policy is aimed at achieving low and stable inflation. The desirable level of inflation is a rate below 7%. To achieve this, reserve money remains the tool of monetary policy. The Reserve Bank of Malawi (RBM) uses a combination of instruments to achieve its monetary policy objectives. These include the bank rate, the liquid reserve requirement (LRR), open market operations, and sales and purchases of foreign exchange. Rising inflationary pressure in 2010 will make interest rate cuts unlikely.

### International environment

The close of 2009 signalled the end of the global economic recession. The global economy shrank by 0.8% in 2009, following growth of 3.0% in 2008. The advanced economies were by far the worst affected by the recession; the collective of economies contracted by 3.2% in 2009. Of these economies, Japan, the Euro-area and the United Kingdom were the hardest hit by the global financial and economic crisis. Conversely, the emerging and developing economies showed positive growth of 2.1% in 2009, albeit significantly slower than the buoyant 6.1% in 2008.

Of the BRIC economies, Russia and Brazil were the laggard performers, with negative growth rates of 9.0% and 0.4% respectively in 2009. China and India's economies were a lot more resilient to the recession than expected. China's economy exhibited growth of 8.7% in 2009, which is less than a percentage point lower than its growth rate for 2008. In contrast, Africa's real economy was pummelled by the global economic slump and, in particular, the collapse in global trade. As a result, economic growth slowed to 1.9% in 2009, from 5.2% in 2008.

**Table 1: Global economic outlook**

| Real GDP growth (year-on-year) | | | | |
|---|---|---|---|---|
| | 2008 | 2009 | 2010p* | 2011p* |
| World | 3.0 | -0.8 | 3.9 | 4.3 |
| Advanced economies | 0.5 | -3.2 | 2.1 | 2.4 |
| United States | 0.4 | -2.5 | 2.7 | 2.4 |
| Euro-area | 0.6 | -3.9 | 1.0 | 1.6 |
| United Kingdom | 0.5 | -4.8 | 1.3 | 2.7 |
| Japan | -1.2 | -5.3 | 1.7 | 2.2 |
| Emerging and developing economies | 6.1 | 2.1 | 6.0 | 6.3 |
| China | 9.6 | 8.7 | 10.0 | 9.7 |
| India | 7.3 | 5.6 | 7.7 | 7.8 |
| Brazil | 5.1 | -0.4 | 4.7 | 3.7 |
| Russia | 5.6 | -9.0 | 3.6 | 3.4 |
| Africa | 5.2 | 1.9 | 4.3 | 5.3 |
| Sub-Saharan Africa | 5.6 | 1.6 | 4.3 | 5.5 |
| Developing Asia | 7.9 | 6.5 | 8.4 | 8.4 |

** p = projection*

*Source: IMF*

The resilience of the emerging and developing economies partly explains the bounce back in economic performance projected for 2010. The world economy is expected to grow at 3.9% in 2010, which is even stronger than its 2008 growth performance. This strong projection is largely based on an expectation that the advanced economies will exhibit a convincing recovery in 2010, with a growth rate of 2.1%. However, increasing concerns about a double-dip recovery, partly due to the rising risk of sovereign debt defaults, could mute the strength of the recovery. Stronger advanced economies are positive for providing a lift to consumer spending, which is supportive of a recovery in export-led emerging economies that will in turn support a recovery in demand for Africa's commodities.

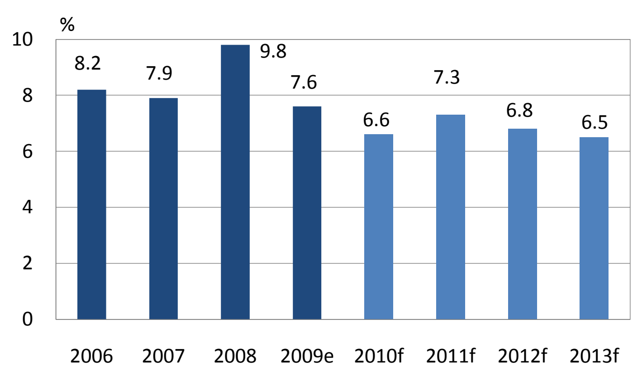
Higher commodity prices and an increase in economic activity are expected to spur an increase in inflation in 2010. Average inflation in the advanced economies is thus projected to increase to 1.3% in 2010, from 0.1% in 2009, while that of the emerging and developing world is expected to increase from 5.2% to 6.2%.

## Forecast summary

### Growth outlook

The level of economic growth activity is expected to remain strong, but moderate relative to the high growth of the recent past. We expect GDP growth in 2010 to meet the past six years' average of 6.6% (see Figure 8). Economic growth will be determined by growth in the agricultural sector, the largest contributor to GDP; a sustained global economic recovery, which underpins commodity prices and demand for Malawi's export products; and the government's sound management of the foreign exchange reserve position. A slower global recovery could dampen export demand, investor interest and access to foreign capital, while delays in relieving the foreign exchange shortage could threaten investor confidence and growth.

**Figure 8: Real GDP growth (%)**




*Source: Standard Bank*

Malawi's latest crop assessment results from all Agriculture Development Divisions (ADDs) show that production of the staple food, maize, and other food crops, such as rice and cassava, will drop by an average of 30% in 2010 compared to 2009, mainly on the back of drought conditions that hit the Shire Valley, Machinga and Karonga districts in January, which is normally the middle of the rainy season. Following successive years of bumper harvests, the government has a large stockpile of the staple food, maize. Therefore, we expect that food security will be sustained. Nevertheless, a dip in production has the potential to have a significant effect on real GDP growth.

Cotton production is estimated to decrease by 50% to 33 000 tonnes in 2010 compared to 67 000 tonnes produced in 2009. The decrease is attributed to the dry spell in the Lower Shire region that affected cotton-growing areas as well as reluctance by farmers to grow cotton. Besides cotton being the third-largest export earner, many farmers are reluctant to grow cotton as it is not as profitable as other crops because prices are low. The government, in an effort to stimulate and grow local cotton production, set a minimum price of 75 kwacha (US$0.54) per kilogram to be paid to farmers in 2009. Unfortunately, the move came in an environment of slumping world demand. Buying cotton at the government's recommended price was not commercially viable and cotton-buying and trading companies  withdraw from cotton-growing areas.

Growth in the manufacturing sector should increase in 2010 provided the foreign exchange problem is addressed. Manufacturing grew at 4.7% in 2009 from growth of 9.9% in 2008, owing to foreign exchange shortages that resulted in lower output than the sector envisaged as most of the raw materials and capital equipment required for production were not imported as planned. Downside risk to the sector is the limited supply of electricity. A positive development in this regard is an agreement between the governments of Malawi and Mozambique, and the World Bank on the construction of an inter-connector that will join Malawi's power grid to Cahora Bassa Hydro and the Southern African Power Pool.

Activity in the construction sector will continue to reflect ongoing mine development and private residential construction while the telecommunications sector will continue to grow fairly rapidly in response to the introduction of mobile banking in the country. Malawi also launched an international tender in February this year, for a fourth mobile operator. Zain Telekoms is currently the leading operator in Malawi with more than 1 million subscribers, followed by Telekom Networks Malawi, a wholly Malawian-owned company. The third operator, G-mobile, is a consortium of Malawian businessmen in partnership with South African Berry Telecoms.

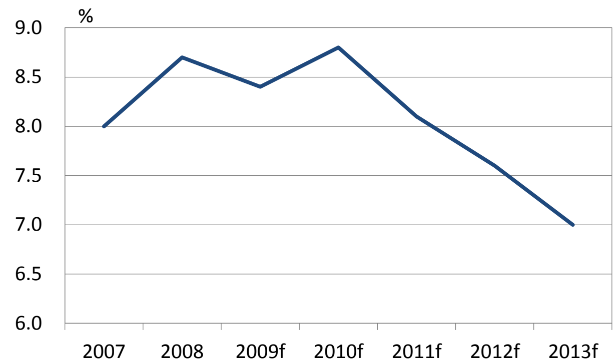
The mining and service sectors are likely to be highly influential in shaping the economic environment in Malawi in the future. Growth will register an accelerated growth rate and partly offset negative effects on the economy in 2010. Growth will be supported by production at the Kayelekera uranium mine and the exploitation of niobium, a niche mineral for steelmaking. The Kayelekera mine is expected to become Malawi's top foreign currency earner in the coming years, accounting for 20% of exports and contributing about 10% to the country's GDP.

Long-term positive growth depends heavily on the diversification of the economic base. The country relies heavily on agriculture, which is subject to adverse weather conditions. In addition, the country's transportation and manufacturing sectors, consisting of industries such as tobacco processing, tea factories, meat processing, and spinning and weaving, are to a large extent dependent on the agricultural sector for their inputs.

### Monetary policy

Monetary policy conditions in Malawi are expected to remain prudent but accommodative enough to encourage private-sector development during 2010. We expect annual inflation in 2010 to be higher than the average of 8.4% in 2009, and above the monetary policy target of 7%, at 8.8% in 2010 (see Figure 9). This projection is largely based on the expectation that maize prices, which have a considerable influence on domestic prices, might be marginally higher than prices a year ago, due to drought conditions that hit parts of the country.

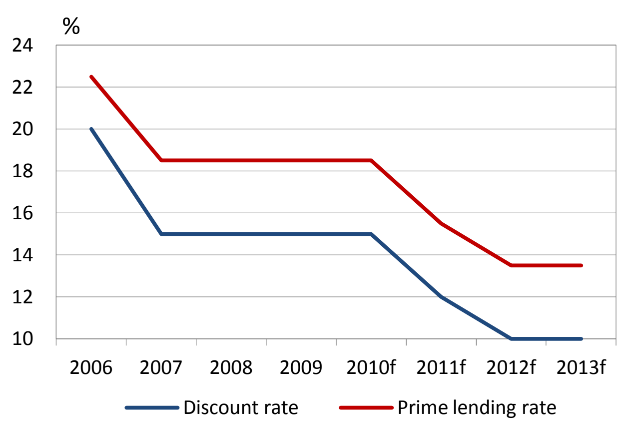
**Figure 9: Consumer inflation**




*Source: Standard Bank*

In addition, a weaker exchange rate against the US dollar, currently at MWK150.80/US$, against MWK140/US$ a year ago, will exert upward pressure on imported commodities and fuel prices, which will have a pass-through effect on domestic inflation. Given the upward bias on inflation, we expect the central bank to keep the interest rate at its current level of 15%, in line with a more accommodative stance that will support growth.

**Figure 10: Interest rate**

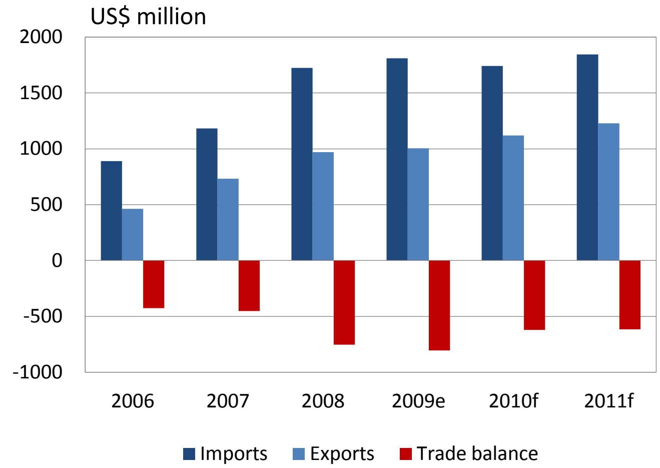



*Source: Standard Bank*

## External sector

The trade account deficit is forecast to narrow in 2010 (see Figure 11). Tobacco accounts for more than 60% of Malawi's export earnings and an expected improvement in global demand and prices will impact positively on the country's trade balance and foreign reserves. Furthermore, uranium production from the Kayelekera Mine will provide a much-needed boost to Malawi's exports. Uranium is expected to become an increasingly important source of export receipts through tax revenue that will help narrow the current account deficit, provide funds for the government to bolster infrastructure and reduce the economy's dependence on tobacco.

**Figure 11: Trade balance (US$ mn)**

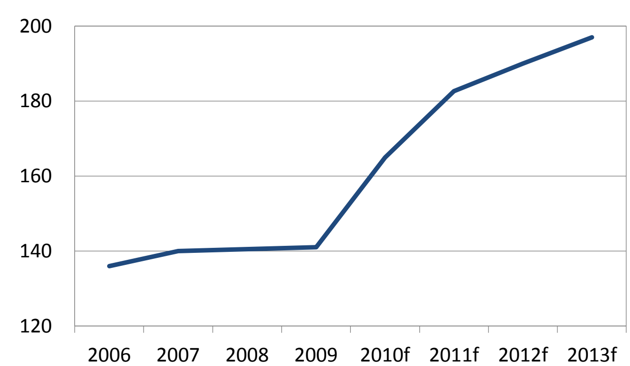



*Source: Standard Bank*

The import bill is expected to rise in 2010 owing to a weaker exchange rate as well as an increase in the oil import bill as the oil price trends upward on improved global growth.

In the longer term, we see a more diverse export earnings base, which will make the economy less vulnerable to external shocks. Promising discoveries of nickel deposits at Chimimbe Hill in southern Malawi were announced by Lisungwe, a UK-listed company. The company has carried out preliminary work for a scoping study and at this stage it envisages a 1.2 million tonnes/year operation, with production of ferrochrome by magnetic separation, followed by acid leaching to produce nickel hydroxide. In addition to this, Globe Uranium announced a 56 million ton mineral reserve in Kasungu. The reserve includes niobium, tantalum, uranium and zirconium, of which niobium is the primary constituent. This is believed to be the largest niobium reserve in the country, with the majority of the high-grade component at or near the surface. Niobium is primarily used in the steel industry, with 85% of the annual world production applied in high-strength, low-alloy steel and super alloys. The niobium market has grown by 20% y/y over the past five years.

**Figure 12: Kwacha/US$**




*Source: Standard Bank*

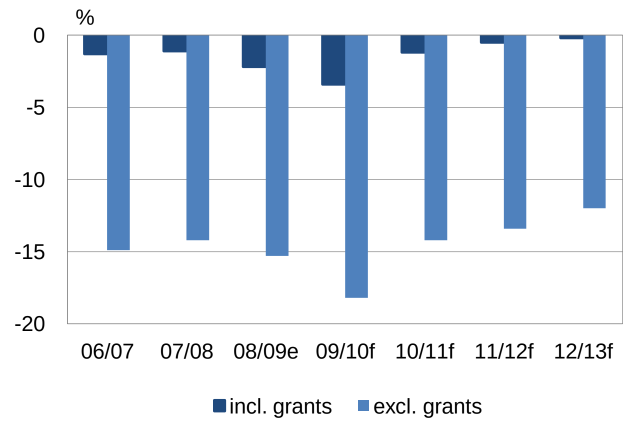
The exchange rate will largely be determined by the level of foreign reserves. Foreign reserves should rise as a result of expected inflows of donor assistance as well as seasonal export earnings when the new tobacco harvest season begins in April.

Nevertheless, we expect that the government will attempt to manage a gradual depreciation of the kwacha during 2010 to MWK190/US$ (see Figure 12), on the back of the large current-account deficit, which is critically dependent on the single-largest foreign currency earner, tobacco. Uranium exports, which are expected to gain momentum in April this year, will reduce dependence on agriculture and in particular tobacco proceeds as well as lessen the seasonality of foreign exchange, and will be an additional source of foreign exchange earnings.

### Fiscal sector

The fiscal year 2009/10 budget plans to return to a prudent fiscal stance, after fiscal policy loosened in the run-up to the May 2009 presidential and parliamentary elections. The budget envisages the fiscal deficit to narrow from 1.5% of GDP in FY2008 to 1% of GDP in FY2009 (see Figure 13).

**Figure 13: Budget balance (% of GDP)**




*Source: Standard Bank*

Despite the global economic turmoil and the impact it had on Malawi through weak demand for its export products and lower international prices, the preliminary results on the execution of the budget through the first half of the fiscal year June - December 2009 are in line with the financial plan. In the mid-year review, domestic revenues for the first half of the financial year, at K77.8 billion, were 4.9% higher than anticipated. Government expenditure for the same period was K130.3 billion, K4.1 billion lower than target. The budget allocations for fiscal year 2009/10 recognise the fact that agriculture will remain a main driver of growth. An extra K8 billion mid-year budget was presented to Parliament for the second half of the financial year. A decision was made to restructure domestic debt by converting more expensive short-term debt to cheaper medium- to long-term debt to reduce interest payments. This progress will add to private sector development. The authorities' commitment to return to a prudent fiscal stance and to continue reforms in public financial management are important to ensure that the budget remains on track. The steps taken to consolidate the fiscal position should help reduce pressure on the balance of payments and over the longer term, avoid the accumulation of debt.

## Conclusion

The economy continued to grow at a fairly rapid, albeit decelerating, pace in 2009. It is estimated that GDP growth averaged 7.6% over the year, after reaching 9.8% in 2008. Economic growth in 2010 will be determined by a sustained global economic recovery, which underpins commodity prices and demand for Malawi's export products; growth in the agricultural sector; and the government's management of the foreign reserve position. Economic growth will remain strong, but moderate relative to the high growth of the recent past. We expect GDP growth in 2010 to meet the past six years' average of 6.6%.

Annual inflation is expected to be higher in 2010 than the average of 8.4% in 2009, at 8.8%. This projection is largely based on the expectation that maize prices, which have a considerable influence on domestic prices, might be marginally higher than the prices a year ago. In addition, a weaker exchange rate against the US dollar, currently at MWK150.80/US$ against MWK140/US$ a year ago, will exert upward pressure on prices of imported commodities, which will have a pass-through effect on domestic inflation. Given the upward bias on inflation, we expect the central bank to keep the interest rate at its current level of 15%.

The foreign exchange rate will largely be determined by the level of foreign reserves. Foreign reserves should rise as a result of expected inflows of donor assistance as well as seasonal export earning inflows, once the new harvest season begins. Nevertheless, we expect that the government will attempt to manage a gradual depreciation of the kwacha during 2010 to MWK190/US$, on the back of the large current account deficit. Uranium exports, which are expected to gain momentum in April this year, will reduce the dependency on agriculture as well as lessen the seasonality of foreign exchange. This will stabilise the currency and improve the current account deficit. The trade account deficit is forecast to narrow from 8.6% of GDP in 2009 to below 4% of GDP in 2010.

The fiscal year 2009/10 budget plans to return to a prudent fiscal stance, after fiscal policy loosened in the run-up to the May 2009 presidential and parliamentary elections. The budget envisages the fiscal deficit to narrow from 1.5% of GDP in FY2008 to 1% of GDP in FY2009.

Notwithstanding the fairly positive outlook, the economy remains vulnerable to exogenous shocks. We expect economic policy to remain focused on boosting growth through developing the agro-processing and mining sectors, which will require continued improvement of national infrastructure, particularly roads, water and electricity. A slower global recovery could dampen export demand, investor interest and access to foreign capital, while delays in relieving the foreign-exchange shortage could threaten growth, fiscal revenues and investor confidence.

# Malawi

### Standard Bank forecasts of selected indicators

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|
| **National accounts** | | | | | | | | |
| Gross Domestic Product (billions of current LCU) | 430.3 | 501.9 | 592.7 | 683.3 | 780.1 | 876.2 | 962.0 | 997.8 |
| (% change) | 8.2 | 7.9 | 9.8 | 7.6 | 6.6 | 7.3 | 6.8 | 6.5 |
| **Prices** | | | | | | | | |
| Inflation (annual average, %) | 13.9 | 8.0 | 8.7 | 8.4 | 8.8 | 8.10 | 7.6 | 7.0 |
| **Monetary sector** | | | | | | | | |
| Interest rate, 3-month Treasury bill (annual average, %) | 17.1 | 10.16 | 13.38 | 13.62 | 10.10 | 10.04 | 9.8 | 8.9 |
| Exchange rate, annual average (LCU/USD) | 136.0 | 140.0 | 141.0 | 141.1 | 164.95 | 182.6 | 190.0 | 197.0 |
| **External sector** | | | | | | | | |
| Trade balance (millions of USD) | | -450.6 | -753.6 | -804.8 | -619.9 | -614.0 | -270.0 | -150.0 |
| (% of GDP) | -19.2 | -18.8 | -15.6 | -15.5 | -15.0 | -14.6 | -13.2 | -13.0 |
| **Public and external solvency indicators** | | | | | | | | |
| Gross external debt (% of GDP) | 14.3 | 14.5 | 17.0 | 16.5 | 17.4 | 19.4 | 18.6 | 18.2 |
| Fiscal balance, including grants (% of GDP)* | -1.31 | -2.1 | -3.3 | -3.0 | -1.6 | -1.2 | -0.5 | -0.2 |

*Sources: Bloomberg, Reserve Bank of Malawi, Malawi Statistical Office, IMF, Standard Bank est.*

# Group Economics


*Goolam Ballim – Group Economist*
+27-11-636-2910 goolam.ballim@standardbank.co.za

**International**

Jeremy Stevens
+27-11-631-7855
Jeremy.Stevens@standardbank.co.za

**South Africa**

| | | |
|---|---|---|
| Johan Botha | Shireen Darmalingam | Danelee van Dyk |
| +27-11-636-2463 | +27-11-636-2905 | +27-11-636-6242 |
| Johan.botha@standardbank.co.za | Shireen.darmalingam@standardbank.co.za | Danelee.vanDyk@standardbank.co.za |

**Rest of Africa**

| | | | |
|---|---|---|---|
| Jan Duvenage | Anita Last | Yvonne Mhango | |
| +27-11-636-4557 | +27-11-631-5990 | +27-11-631-2190 | |
| Jan.duvenage@standardbank.co.za | Anita.last@standardbank.co.za | Yvonne.Mhango@standardbank.co.za | |
| **Botswana** | **Angola** | **Kenya** | **DRC** |
| **Lesotho** | **Ghana** | **Mozambique** | **Nigeria** |
| **Namibia** | **Malawi** | **Uganda** | **Tanzania** |
| **Swaziland** | **Mauritius** | **Zambia** | **Zimbabwe** |

Simon Freemantle
+254 (20) 3269 027
Freemantles@stanbic.com

**Kenya**
**Uganda**
**Tanzania**


*All current research is available on the Standard Bank Group Economics home page. In order to receive Group Economics' research via email, all clients (new and existing) are required to register and select publications on the website. Click on http://ws9.standardbank.co.za/sbrp/LatestResearch.do, select **Register** and enter your email address. A username and password will then be emailed to you.*