Republic of Malawi	2014
The peer review based monitoring and surveillance of the SADC Macroeconomic Convergence (MEC) program was launched by the MEC Peer Review Panel at its first meeting in May 2013 in Maputo; to start the process, the Panel agreed that Lesotho and Malawi should be the Pilot countries to be reviewed on a voluntary basis. Angola and Namibia also on a voluntary basis agreed to constitute the Review Team of Macroeconomic experts to undertake the Lesotho and Malawi country Review Mission. The SADC Review Team comprised the following Macroeconomic experts: from Angola, Mr Joao Boa Quipipa and Mr Manuel Tiago Dias; from Namibia, Mr Gerson Kadhikwa the nominated Team leader and Mr James Seibeb. Ms Busi Dlamini from the SADC Secretariat coordinated the process. The Team visited Lilongwe from November 3 – 4, 2014 and is grateful to the Authorities for their demonstrated commitment to the review process and for giving the necessary support to the Country Review Mission to undertake an independent assessment of the Country MEC Self -Assessment Report and the National Plan of Action. The Team met with the Governor of the Reserve Bank of Malawi, Mr. C.Chuka, the Secretary to the Treasury Dr.R.Mangani and senior officials from the Reserve Bank of Malawi, Ministry of Finance, Economic Planning and Development as well as the National Statistics Office. The Review report contains information validated with the authorities of the Republic of Malawi and is for consideration by the Peer Review Panel, composed of Ministers of Finance and Central Bank Governors at its meeting in May/June 2015.	**Peer Review Report on recent economic developments and the SADCMacroeconomic Convergence Program**

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EXECUTIVE SUMMARY

Economic performance: **Malawi registered a relatively healthy growth in real GDP averaging 6.9 percent over 2008-2013 and weathered well the recent global financial market turbulence—but it has not yet reached its economic potential.** Real GDP growth remained below the SADC Macroeconomic convergence (MEC) target and poverty levels are still high. Growth is projected at 6.3 percent in 2014 and 5.8 percent in 2015. Growth in 2014 was underpinned by the improved harvest, particularly for tobacco. Looking ahead, growth is expected to remain solid, but modestly below the SADC target of 7 percent. The downside risk to growth remains continued reliance on rain-fed agriculture, which leaves the country vulnerable to drought and external shocks.

Challenges: Inflation has been on the upward trend averaging 27.3 percent in 2013. However, it was projected to average 19.6 percent for 2014 on the back of a slowdown in non-food inflation reflecting the pass through effects of the Kwacha appreciation observed since January 2014. This has resulted in the relative stability in prices of major non-food sub-components, such as fuel prices. Although the country undertook reforms to improve economic performance, policy challenges remains and entail: rapid growth of the economy, low levels of international reserves and the suspension of budget support, which could result in expenditure overruns and an increase debt levels.

SADC Review Team's views and overall assessment: Malawi has embarked on an ambitious and progressive reform programme reinforced by the Malawi Growth and Development Strategy. The government has made an impressive start in energizing the reform programme by implementing social-protection programmes, enhancing domestic revenue mobilization and strengthening public financial management. Moreover, the country adopted a floating exchange rate system and implemented policy efforts to ensure the operational independence of the Reserve Bank of Malawi (RBM). Other policy measures made were deepening the financial sector and improving the investment climate.

Overall, Malawi's performance against the primary and secondary SADC convergence target for 2013 was not satisfactory largely, due to the reforms undertaken. This was evident in high inflation, fiscal deficit, public debt and an elevated current account balance as a ratio of GDP. Given the high dependence on grants, it is critical for the country to move ahead with plans to strengthen tax administration and public expenditure management. Malawi should implement measures to rein in credit extension from the central bank to the government and government use of the overdraft facility at the Reserve Bank of Malawi should be regarded as a short term measure of last resort and should be discouraged, going forward. Generally, borrowing from the domestic market is advisable as it would contribute to the development of Malawi's financial markets. Also strong policy actions and bold structural reforms are needed to steer the economy through the challenges presented by adverse external conditions, and to lay the foundation for job-creating growth, low and stable inflation and sustainable development.

Authorities' views: The authorities broadly shared and concurred with the SADC review team's assessment. They were somewhat more optimistic on the near-term outlook for growth, while recognizing downside risks to the outlook stemming from reliance on rain-fed agriculture and a slower global recovery, which could dampen export demand, investor interest, remittances and access to foreign capital. Authorities were also cognisant of the inflationary pressures and are employing measures to stabilise prices, largely by not issuing new domestic and foreign debt and implementing the SADC target on Central Bank credit to Government in short to medium term.

1 INTRODUCTION AND OVERVIEW

The aim of the SADC macroeconomic convergence (MEC) programme is to promote macroeconomic stability, which is a necessary condition for financial sector development, attracting foreign direct investment and overall sustainable growth and poverty reduction in the region. Article 7 of Annex 2 to the Finance and Investment Protocol (FIP) provides that the Peer Review Panel shall establish a collective surveillance procedure to monitor MEC, determine specific targets, assess progress relative to those targets and provide advice on corrective actions, as set out in the Article. Against the above background, Malawi volunteered to be reviewed as a pilot country under the MEC programme.

On behalf of the MEC Peer Review Panel, a SADC Review Mission travelled to Malawi from 3 -4 November 2014. The objective of the mission was to evaluate Malawi's national self-assessment report against the MEC programme targets and determine whether the country was making progress towards the common convergence targets. Moreover, the review exercise was also aimed at encouraging reviewed countries, in this case Malawi, to improve its performance by undertaking appropriate policy actions aimed at satisfying and complying with the SADC MEC targets. The review focused on the following three areas:

(i) A review of recent economic developments in Malawi,

(ii) Progress and performance relative to MEC targets, and

(iii) Policy actions/program taken to address identified imbalances.

The evaluation team met with representatives of the Ministry of Finance, Planning and Economic Development, Reserve Bank of Malawi and the National Statistics Office. The delegation also met with the Secretary to the Treasury Dr. Ronald Mangani and the Governor of the Reserve Bank of Malawi, Mr. Charles Chuka and their senior officials.

Following the discussions with the authorities, the SADC review team was of the view that the Government of Malawi has an ambitious development programme as enunciated in Vision 2020, which envisages achieving sustainable economic growth, development of infrastructure, and poverty reduction. The main objective of macroeconomic policy in Malawi is to promote and maintain macroeconomic stability and inclusive economic growth.

To achieve the goals outlined in its development program, the Malawi Government has taken the following policy actions:

- Real Sector: Improving the investment climate,
- Fiscal Sector: strengthening the capacity of public financial management,
- Monetary Sector: Ensuring the operational independence of the Reserve Bank of Malawi and deepening the financial sector,
- External Sector: Adopting a floating exchange rate system.

2. RECENT ECONOMIC DEVELOPMENTS

Real GDP growth increased 6.1 percent in 2013 from 2.1 percent in 2012. There was vibrant performance in all sectors, due to availability of foreign exchange and raw materials. Notably, the agriculture and manufacturing sectors registered strong growth after poor performance in the previous year. The mining sector is however, expected to register negative growth rates owing to suspension of mining at the Kayelekera Mining Company as global uranium prices remained below the economically viable prices. Growth is expected to remain strong as output is projected to be 6.3 percent in 2014 on account of improved harvest. Growth is also expected to remain robust in the manufacturing, wholesale and retail trade, hotels and restaurants and the information and communication.

Inflation has been on the upward trend averaging 27.3 percent in 2013. However, it was projected to average 19.6 percent for 2014 on the back of a slowdown in non-food inflation reflecting the pass through effects of the Kwacha appreciation observed since January 2014. This has resulted in the relative stability in prices of major non-food sub-components such as fuel prices. In 2015, inflation is projected to decline significantly to 11.5 percent, due to a fall in food inflation as production improves. Non-food inflation will also fall in 2015, largely owing to greater expected stability of the Kwacha. The impact of the decline in world oil prices is also expected to impact price developments in Malawi significantly.

Budgetary operations resulted into an overall deficit of 1.6 percent of GDP in 2013, which was lower than the deficit of 6.9 percent of GDP witnessed in 2012. Total government revenues improved in 2014 largely, due to grants, which rose to 14.2 percent of GDP, compared to 4.2 percent of GDP in 2012. Total domestic resources rose by 2.0 percentage points on account of both tax and non-tax revenues. The rise in tax revenue was in tandem with increased efforts by the Malawi Revenue Authority of ensuring compliance and improving the efficacy of tax administration. The increase in non tax revenues was due to measures taken by government to increase non tax revenues such as upward revision of fees and user charges for the departments of Police, Registrar General and Road Traffic. Government has also put in place a system of paying the fees through banks in order to enhance compliance

The Reserve Bank of Malawi aims to build reserves to the level that will ensure macroeconomic stability and gross official reserve rose to 2.57 months of import in July 2014 from 2.1 months at the end of 2013 and 1.1 months of import in 2012. The main sources of foreign exchange have been purchases from the Authorised Dealer Banks. Following the reforms implemented in 2012 there was an increase in the availability of foreign exchange from private sources and the parallel market for foreign exchange virtually disappeared. Since January 2014, the Kwacha continued to register marginal gains against currencies of major trading partners. The appreciation pace has been stable for some time now and going forward, it is expected that the local currency will remain stable with a slight bias toward depreciation during the seasonal lean periods of foreign exchange. The RBM will continue to maintain a market based exchange rate regime in order to boost Malawi's export and international competitiveness.

3. ASSESSMENT OF MALAWI'S MACROECONOMIC PERFORMANCE AGAINST THE SADC BENCHMARKS

Malawi did not perform well against the SADC MEC primary benchmarks as reflected in Table 1.

Table 1: SADC Macroeconomic Indicators and Targets

	2008	2012	2018
Primary Indicators			
Inflation - annual rate percentage change	<10	<5	3-7
Fiscal Deficit - as a percentage of GDP	<5	<3	<3
Public Debt - as a percentage of GDP	<60	<60	<60
Secondary Indicators			
Current Account Balance - as a percentage GDP	<9	<9	<3
Economic Growth - annual rate in percent	7	7	7
Central Bank Credit to Government - as a	10	5	5

percentage of Revenue			
External Reserves - months of import cover	3	6	6
Domestic Savings - as a percentage of GDP	25	30	35
Domestic Investment - as a percentage of GDP	30	30	30

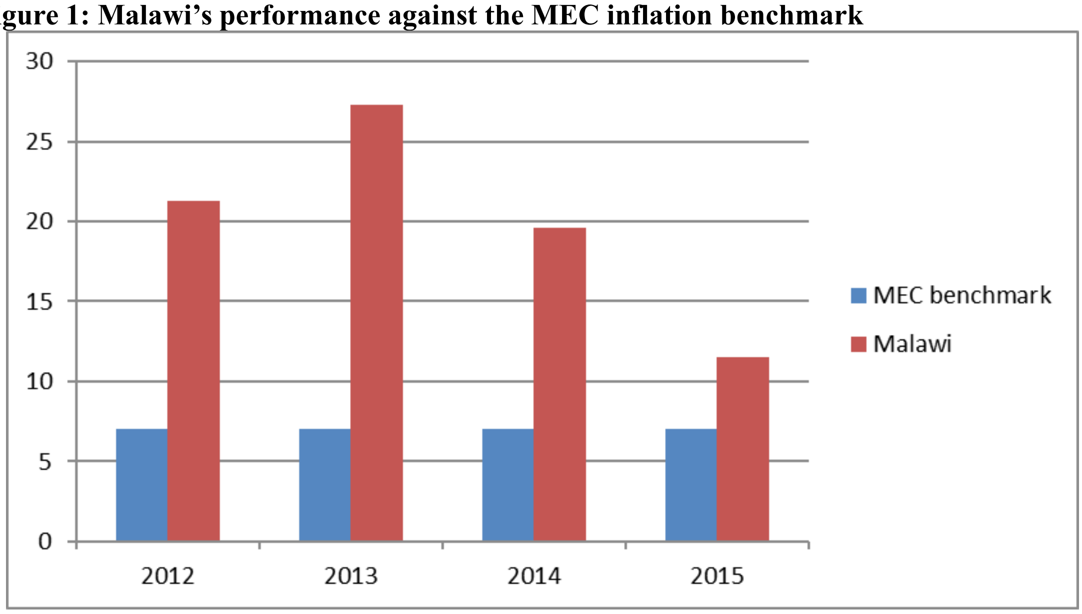
Source: SADC RISDP

3.1 Primary Benchmarks

3.1.1 Inflation (3-7 percent)

Notwithstanding the efforts made by the Government and the Reserve Bank of Malawi, the inflation rate remains significantly higher than the agreed SADC target. Inflation averaged 28.6 percent in 2013 and 23.8 percent for the first nine months of 2014. The main factors that have influenced inflation in Malawi are the exchange rate and domestic food production. Looking ahead, inflation is projected to decline to 19.6 percent in 2014 and subside to 11.5 percent in 2015 (Chart 1). The forecasted slowdown may result from non-food inflation, reflecting the pass through effects of the appreciation of the Kwacha and global developments particularly the slowdown in international oil prices. Going forward, the risks to the inflation outlook remains exchange rate volatility and a possible decline in food production, due to floods that occurred in January 2015.

Figure 1: Malawi's performance against the MEC inflation benchmark

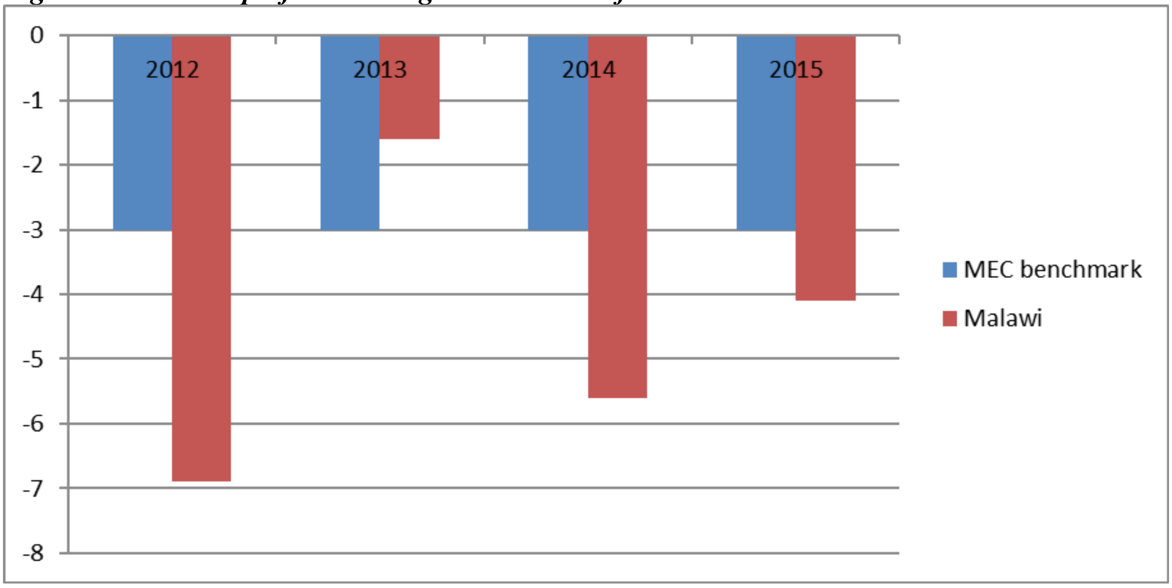


Source: SADC MEC Peer Review Team and Malawi Authorities, November 2014

3.1.2 Fiscal Balance /GDP (<3 percent)

Malawi's fiscal policy has been expansionary, although it registered a near balance budget in 2013, hence efforts are required to rebuild fiscal buffers. Such efforts should enable the country to comply with the agreed fiscal target. The fiscal deficit to GDP ratio was 6.9 percent in 2012 and 1.6 percent in 2013, before deteriorating to 5.6 percent in 2014, due to donor withdrawal of budgetary support (Chart 2). For 2015, it is expected to decline marginally to 4.1 percent of GDP. Despite the expected marginal decrease in the deficit, the fiscal accounts show some dependence on external grants. As a proportion of total revenue, grants constituted 14.8 percent during 2013/14 fiscal years. Moreover, the reliance on grants is estimated to increase to 17.4 percent of total revenue during the fiscal year 2014/15. Grants play a crucial role in containing the fiscal deficit and thus, when they are excluded the deficit is estimated at 8.2 percent in fiscal year 2014/15. For fiscal years 2015/16 and 2016/17, it is projected that the fiscal deficit excluding grants will hover around 5.1 percent and 5.3 percent of GDP, respectively.

Figure 2: Malawi's performance against the MEC fiscal balance benchmark

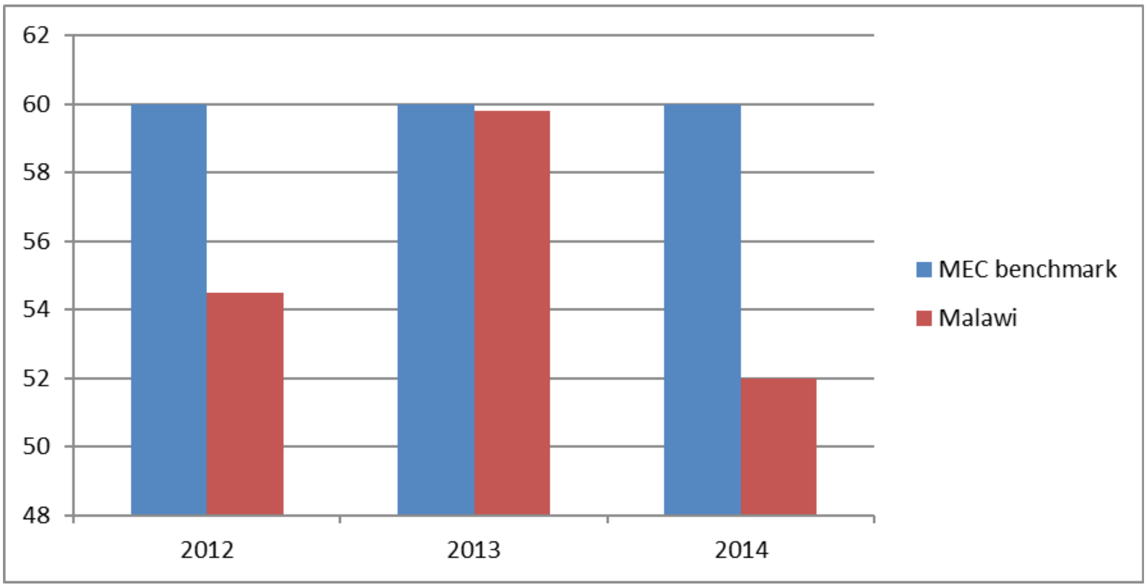


Source: SADC MEC Peer Review Team and Malawi Authorities, November 2014

3.1.3 Public Debt (< 60 percent of GDP)

The ratio of Public debt to GDP reached 59.8 percent in 2013, which is close to the threshold of SADC target of 60 percent of GDP. Public deficit has been financed with both internal and external resources. Public debt is estimated to slow to 52.0 percent of GDP in 2014 as government restructure its debt portfolio from short-term to long term and embark on a fiscal consolidation programme. These efforts were also complemented by clearance of domestic payment arrears, which started in 2013/2014.

Figure 3: Malawi's performance against the MEC public debt benchmark



Source: SADC MEC Peer Review Team and Malawi Authorities, November 2014

The primary deficit, which excludes interest payments was elevated at 10.5 percent of GDP in fiscal year 2013/14, but improved to 7.1 percent in 2014/15. It is projected that it will subside to 4.5 percent of GDP during fiscal years 2015/16 and 2016/17, respectively. The reduction in the primary deficit signals the impact of fiscal consolidation efforts implemented by the government in recent years. Going forward, it is however imperative for Malawi to strive towards achieving a primary surplus, given it is relatively large public debt ratio to GDP.

3.2 SECONDARY BENCHMARKS

Malawi's performance against the SADC MEC secondary indicator benchmarks is reflected in Table 2 below.

Table 2 Malawi's performance on the secondary SADC Benchmarks

	2012	2013	2014	2015 (Projections)

Real GDP growth in percent	2.1	6.1	6.3	5.8
CAB as a percentage of GDP	-4.4	-2.7	-6.0	-4.9
Reserves in months of Import Cover	1.1	2.1	2.5	
Domestic Savings as a percentage of GDP	12.5	13.5	13.6	15.1
Investment as a percentage of GDP	16.9	16.3	19.6	20.0
Central Bank Credit as a percentage of government Revenues	23.8	-8.9	9.4	

Source: SADC MEC Peer Review Team and Malawi Authorities, November 2014

3.2.1 Current Account Balance/ GDP (<3 percent)

In 2014, the current account deficit for Malawi is estimated to be 6.0 percent of GDP and therefore, remain above the target of convergence for SADC of less than 3 percent of GDP by 2018, which represented an increase from the 2012 ratio of 2.1 percent of GDP. In 2015, the deficit is expected to reach 4.9 percent of GDP, which is not compatible with SADC targets. Looking ahead, developments in the current account will be influenced by the exchange rate of the Kwacha against major trading currencies. Since January 2014, the Kwacha continued to register marginal gains against currencies of major trading partners. The appreciation pace has been stable for some time now and going forward, it is expected that the local currency will remain stable with a slight bias toward depreciation during the seasonal lean periods of foreign exchange. This could boost Malawi's exports and international competitiveness and thereby improve the current account balance.

3.2.2 Economic Growth (>= 7 percent)

Economic growth in Malawi shows a cyclical pattern and growth recorded in 2013 was 6.1 percent, below the target of convergence for SADC of 7 percent, however this represents a substantial improvement over the previous year when it was 2.1 percent. The acceleration of economic growth was influenced by the increased availability of foreign exchange resources and raw materials (Table 2). Real GDP growth is projected to increase by 6.3 percent in 2014, driven by agriculture and manufacturing, before slowing by 5.8 percent in 2015.

3.2.3 International Reserves (Import cover > = 6 months)

The RBM is committed to achieving a level of international reserves to ensure macro-economic stability. However, gross international reserves that reached a plateau represented

2.57 months of imports in July 2014 and fell short of meeting the goal of SADC convergence of 6 months of imports. The major source of increase in international reserves was tobacco exports and grants from development partners. Generally, Malawi's balance of payments has been characterized by a substantial imbalance in the current account as growth in imports has outstripped export growth. The government has therefore, developed the Malawi National Export Strategy with the objective of developing the export capacity and providing a road map for building Malawi's productive capacity. It is expected that this will contribute towards building reserves to the desired level.

3.2.4 Central Bank Credit to Government (less than 5 percent of revenue)

To finance the fiscal deficit recorded in 2012, the government used an overdraft facility at RBM amounting to 23.8 percent of revenues. However, in 2013 there were efforts to normalize the position of the government at the RBM, which was consolidated through the reimbursement of funds valued at 8.9 percent of government revenue for fiscal year 2012/13. The Government of Malawi is committed to ensuring that the financing of the fiscal deficit by RBM does not exceed 5 percent of government revenue as stipulated by SADC MEC benchmark.

3.2.5 Domestic Savings (> = 35 percent of GDP)

Domestic savings in Malawi is undesirably low, which require the Malawian authorities to institute efforts that would boost the appetite for the private sector and households to build up buffers. Domestic savings was 12.5 percent of GDP in 2013, which was less than half the target set by SADC at 30 percent of GDP. Going forward, the savings to GDP ratio is expected to be 13.6 percent in 2014 and 15.1 percent in 2015. It is expected that the proportion of domestic savings to GDP will improve, against the backdrop of an improvement in financial inclusion, which rose from 30 percent of the adult bankable population in 2013 to 40 percent in 2014. Looking ahead, it is commendable that the Government aims to increase domestic savings in the medium term through a reduction in domestic demand relative to output growth.

3.2.6 Domestic Investment (> = 30 percent of GDP)

Domestic investments were at 16.9 percent of GDP in 2013 against a target of 30.0 percent. The ratio of domestic investments to GDP is projected to improve to 19.6 percent of GDP in 2014, which is still below the SADC target. Malawi therefore, needs to implement policy measures to stimulate domestic investment. Such measures include improving the investment climate and ease of doing business in the country.

4. OUTLOOK AND POLICY INTERVENTIONS

Although inflation slowed in 2014, the most recent behaviour of prices of goods and services show that inflation will most likely continue to be above the SADC convergence in the near-term. Going forward, the inflation trend will be dependent on exchange rate stability, developments in crude oil prices and the performance of the agricultural sector, particularly increasing food production.

It is expected that the country will experience some fiscal challenges in the short to medium term. The fiscal deficits for 2014/15 and 2015/16 fiscal years are thus projected to remain in breach of the SADC targets. Moreover, public debt is forecasted to remain high and very close to the higher end of the SADC convergence targets. These developments call for concerted policy efforts to rebuild fiscal buffers and embark on a fiscal consolidation path.

The government has implemented austerity measures to avoid expenditure overruns and improve fiscal space. It is expected that the fiscal space created through the reduction of expenditures will be channelled towards restraining domestic debt and improve the fiscal balance. However, given that a major portion of country’s public debt is denominated in foreign currency, it is likely that the depreciation of the Kwacha against major international currencies will cause the country’s public external debt to be unsustainable in the medium term.

In order to contain inflation and reduce the high domestic debt, the government will cut lower priority expenditure or shore up revenues while protecting pro poor expenditure. Government will use the resultant surplus to reduce its domestic debt. The government will also strengthen tax and customs administration. Progress has also been made in improving fiscal accounting and reporting.

To stabilize the balance of payments, the authorities developed a national strategy for exports, since the current account deficit is largely characterised by high imports, which outweigh exports. This policy effort is a step in the right direction and will possibly reduce Malawi’s dependency on exporting primary products and build up reserves.

The government has put in place other policy measures to address the weakened balance of payment and bring about external balance. Initial steps include foreign exchange market liberalization and ensuring that the Kwacha is market determined to gain competitiveness. The central bank has also implemented the Foreign exchange Statistical Database System (FESDS) with the view to improving efficiency in the mobilization and tracking of foreign exchange proceeds from the country's exports.

5. CONCLUSION AND RECOMMENDATIONS

Malawi's economic performance has not been satisfactory when measured against the primary convergence benchmarks set by SADC for 2013 and projections for 2014, except for public debt. The country recorded a public debt to GDP ratio of 59.8 percent in 2013/14, which is within the parameters set by SADC, but warrants monitoring going forward.

Similar to the performance on the primary convergence benchmarks, Malawi did not do well on secondary convergence indicators in 2013. Real GDP growth was 6.1 percent in 2013 and is projected to reach 6.3 percent in 2014, which remains below the SADC target of 7 percent per annum. The current account balance as a share of GDP was negative 2.7 percent and thus, below the desired target of a surplus of 9 percent by 2018. Further, official reserves at 2.1 months of imports were below the SADC benchmark of 6 months of imports.

Against the above backdrop, the SADC review team therefore, makes the following recommendations:

5.1 The SADC MEC Review Team noted that the authorities formulated a remedial policy intervention strategy, namely, the Malawi Growth and Development Strategy II to ensure compliance with the SADC macroeconomic indicators, despite facing challenges such as dependence on rain fed agriculture, low international reserves, suspension of budget support by international co-operating partners and uncertainties in the global economic environment,

5.2 Thus, the SADC MEC Review Team recommends that the authorities of the Republic of Malawi implement the remedial policy interventions that are aimed at addressing the structural inadequacies of the economy to attain sustainable growth and development.