



MALAWI GOVERNMENT

**Ministry of Economic Planning and
Development**



QUARTERLY ECONOMIC REVIEW

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OVERALL ECONOMIC PERFORMANCE DURING THE FIRST QUARTER OF 2005/06

1.0 INTRODUCTION

Malawi is implementing an Economic Programme under a Poverty Reduction Growth Facility (PRGF) supported by the IMF in the financial year 2005/06, and this is aimed at consolidating macroeconomic stability necessary for increasing economic growth, employment and wealth creation which is in line with the country's medium-term development strategy. Consistent with this overall objective, the macroeconomic program aimed at achieving a real GDP growth of around 2.1 percent in 2005 in view of the drought and around 8.2 percent in 2006 on account of a good economic recovery; an average inflation of 15.5 percent in 2005 and 9.4 percent in 2006; a decline in Central Government net domestic debt relative to GDP of about 2 percent. To this end, Government has implemented a number of activities in fiscal, monetary and real sectors.

Over all, the economic performance during the first quarter of 2005/06 fiscal year was not satisfactory due to the drought that hit the country in the 2004/05 fiscal year. The drought adversely affected maize production and necessitated the importation of maize to be a major element of the budget. The maize shortage was approximately 400,000 metric tonnes. Part of this amount was imported through the budget and the other part through donors, non-governmental organisations and the private sector. His Excellency the President also declared a state of national disaster that has also improved the amount of donor aid into the country. Since Malawi is an agro-based economy, the poor performance in the agriculture sector has contributed to poor economic growth that has been revised downwards to 1.9 per cent in 2005 from an earlier estimate of 2.1 percent made in April 2005.

Due to containment of government expenditure and pursuance of 'no borrowing policy', the base rate remained constant at 25 percent. The exchange rate has depreciated to K123.38 per US Dollar this year from K 108.95 per US Dollar during the same period last year. This is attributed to the low proceeds from tobacco sales, importation of maize and high cost of fuel into the country. Due to the shortage of maize and high cost of the petroleum products in the country, the inflation rate has moved from 15.6 per cent in July to 15.8 per cent in September, 2005.

1.1 ECONOMIC PROGRAMME

Perspectives of the 2005/06 budget as laid out in the 2005/06 Budget Statement, among others, highlight landmark of the budget which is the continuation of the strengthening of expenditure control mechanisms and reduction in the domestic borrowing by Government. In pursuance of this objective, Government is implementing the Integrated Financial Management and Information System (IFMIS), a public accounting computer system that allows centralization of government's payment system. It is expected that this system will contribute strongly to improved public financial management. Another landmark of the budget is the beginning of the repayments of domestic arrears that had accumulated up to 30th June 2004. Ministries are required to use their own resources to pay outstanding bills so that arrears are not carried over to the next year.

1.2 ECONOMIC AND FINANCIAL PROGRAMME WITH IMF

During the July 2004 IMF mission into the country, government and the IMF agreed to a 12 month Staff Monitored Programme (SMP) as a requirement for the country to resume borrowing arrangements with the IMF. Based on sound implementation of the programme by the Malawi Government, IMF approved a new Poverty Reduction and Growth Facility arrangement in August, 2005. The macroeconomic performance has remained satisfactory and the country met all the quantitative and structural performance criteria targets for the first quarter ending September 2005. This includes target on wages, as well as the indicative targets on discretionary expenditures and reserve money.

2.0 THE FISCAL SECTOR

This section reviews the fiscal performance during the first quarter of the 2005/06 financial year covering the period July to September 2005. The emphasis is put on reviews of the overall fiscal performance, highlighting performances in revenue, expenditure, the resultant overall balance and its financing. The fiscal performance is summarized in table 1, and is assessed against the quarterly targets of the PRGF.

2.1 FISCAL PERFORMANCE

Overall fiscal performance was good. Domestic revenues exceeded its PRGF target because of improved performance of tax revenue and adjustment of non-tax revenues in line with inflation. However, grants were below the target because of delays in disbursement of EU budget support and also exchange losses ensuing from the appreciation of the US dollar against other major trading currencies. With regard to expenditure it was within target. These developments led to the fiscal surplus, which was used to repay domestic debt amounting to K1,644.3 million

2.2 REVENUE

Domestic revenue performed satisfactorily because of strong performance of tax and non-tax revenues. Tax revenue exceeded its target by K149 million because of good performance of PAYE since measures from the tax review were effected. On the other hand, non-tax revenue increased by K570.5 million because of upward adjustment of departmental fees in line with inflation. Preliminary revenue outturn indicates that domestic revenues amounted to K16,177 million and this exceeded the budgeted level by K740.7 million. However, total revenues and grants fell short of the PRGF target. At K26,167 million, total revenue and grants were K4,958.4 million less than the budgeted figure of K31,125.4 million. This was as a result of delayed disbursement of Balance of Payments (BOP) support from EU and project grants.

2.3 EXPENDITURE

On the expenditure side, Government operated within the budget, reflecting the strong stance taken by Government on fiscal discipline and also delayed payments for maize purchases and fertilizer subsidy. From the 2005/06 budgeted expenditure of K119,499 million, K31,184.1 million was allocated to the first quarter. However preliminary expenditures and net lending for the quarter amounted to K24,994.3 million, which was K6,892.7 million below the target. Of this, current expenditure amounted to K18,621.1 million while development expenditure amounted to K5,670.3 million. Analysis of specific major expenditure items is presented below.

2.4 WAGES AND SALARIES

The budgetary allocation for wages and salaries is K20,722 million, of which the first quarter budget was K4,847.7 million. However, the quarterly outturn was K1,80.3 million below the quarterly target at K4,802.4 million. Salary expenditures for the remaining three quarters are expected to be higher than the first quarter as a result of the implementation of the new salary scale that will be effective from 1st October 2005.

2.5 INTEREST PAYMENTS

The budgetary allocation for interest payments is K16,628 million. During the first quarter, K4,427.8 million was spent compared to the budget of MK4,193 million. Of this amount, K754 million was on foreign debt which was K91 million higher than the target due to the depreciation of the Kwacha against major trading currencies. On the domestic front, interest payment amounted to K3,674.2 million which was K143.9 million more than the target due to a shortfall in the receipt of program grants which resulted in a modest increase in domestic borrowing.

2.6 DEVELOPMENT EXPENDITURE

Development expenditures were relatively lower by K2,285.9 million than the budgeted level of K7,956.3 million. This in part reflects the slow implementation of development projects due to capacity constraints. On the domestic front, a total amount of K832.8 million of project financing was funded. This was a reduction by K102.9 million from the budget of K935.7 million.

2.7 OVERALL BALANCE

The first quarter registered an overall surplus including grants of K1,172.7 million against a projected quarterly deficit figure of K58.7 million. There was also a primary surplus of K6,303.4 million against a projected surplus of MK348.8 million.

2.8 FINANCING

In view of the fiscal surplus, the Government repaid a total of K1,925 million of foreign and domestic debts. Of this amount, foreign loan repayment amounted to K280.7 million compared to a program net borrowing requirement of K841.8 million. Similarly, on the domestic front, a total amount of K1,664.3 million of domestic loans were repaid, which was more than twice the program net repayment figure of K782.8 million.

In summary, the fiscal outturn during the first quarter of the 2005/06 FY was good. Although total revenue and grants were below the PRGF target, low expenditures offset the adverse effect that emanated from low outturn on revenues and grants on the fiscal balance. This, therefore, led to an overall budget surplus which was used to retire both foreign and domestic debt.

Table 1: Selected Fiscal Indicators, for the First Quarter of 2005/06

Central Government				
(In MK' million)				
	2005/06 Approved Estimates	First Quarter Actual Performance	First Quarter Projections	Variance
Total Revenue and Grants	116796	26167	31125.4	-4958.4
Domestic Revenue	65385	16177	15456.6	720.4
Tax Revenue	57258	13891.9	13742	149.9
Non Tax Revenue	8127	2285.1	1714.6	570.5
Grants	51411	9990	15668.8	-5678.8
Program	13238	4416.3	7643.7	-3227.4
Project	15849	2381.5	3330.3	-948.8
Dedicated	14879	1930.3	3162.2	-1231.9
HIPC debt relief	7445	1261.8	1532.6	-270.8
Total Expenditure & Net Lending	119499	24291.4	31184.1	-6892.7
Current Expenditure	84394	18621.1	23227.8	-4606.7
Wages & Salaries	20722	4802.4	4847.7	-45.3
Interest Payments	16628	4427.8	4193.6	234.2
Foreign	3360	753.6	663.3	90.3
Domestic	13268	3674.2	3530.3	143.9
Other Current Expenditure	46844	9525.9	14186.5	-4660.6
Other Purchase of goods & services	27310	6229.9	8646.3	-2416.4
Generic Goods & Services	17258	4049.1	4330	-280.9
Subsidies and Current transfers	17534	2691.8	5040.2	-2348.4
Pensions & Gratuities	3208	716.4	802	-85.6
Fertiliser Subsidy	4757	0	2200	-2200
Other Subsidies & Transfers	9569	1976.4	2038	-61.6
Expenditure for Arrears	2000	604.2	500	104.2

Development	35105	5670.3	7956.3	-2286.0
Domestic (part II)	3819	832.8	935.7	-102.9
Foreign (part I)	31286	4837.6	7020.6	-2183.0
Net lending	0	702.8	0	702.8
Overall Balance (Including Grants)	-2703	1172.7	-58.7	1231.4
Primary Balance	1539.2	6303.4	384.8	5918.6
Total Financing	2703	-1925	59	-1984
Foreign (net)	4708	-280.7	841.8	-1122.5
Domestic (net)	-2005	-1644.3	-782.8	-861.5
Memorandum				
GDP (MK' million)	263,994	263,994	263,994	

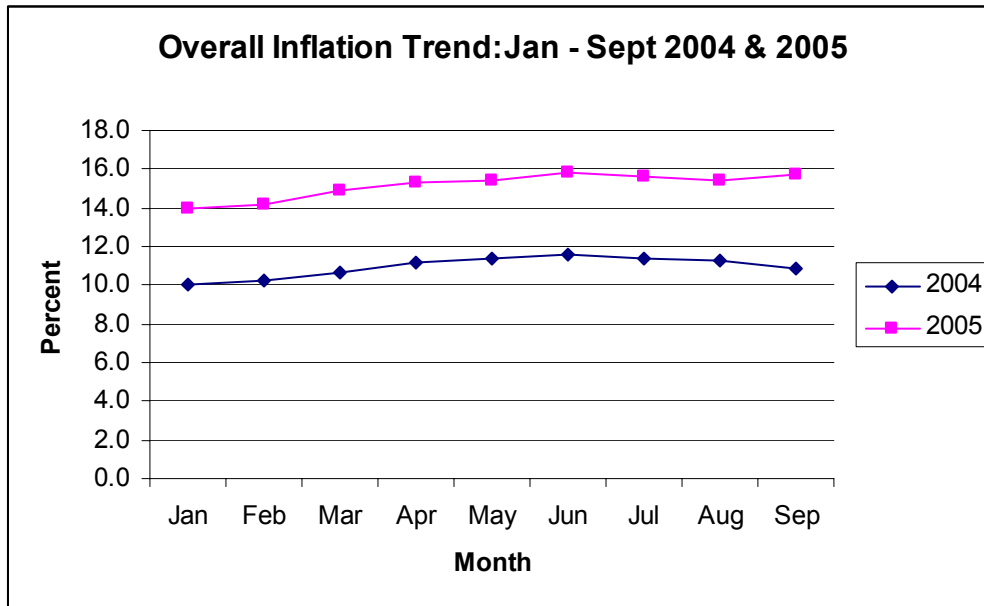
Source: Ministry of Finance

3.0 THE MONETARY SECTOR

3.1 INFLATION

Inflationary pressures in the year to September 2005 remained high as inflation rate was persistently above 14.0 percent. Overall inflation during the first quarter of 2005/06 stood at 15.8 percent in September 2005 compared to 15.9 in June 2005 and 10.9 percent in September 2004. Pressure on inflation is largely on account of low production of food crops as a result of unfavourable weather conditions. This was coupled by an increase in general non-food prices, which was triggered by upward adjustments in fuel prices that were effected during the quarter.

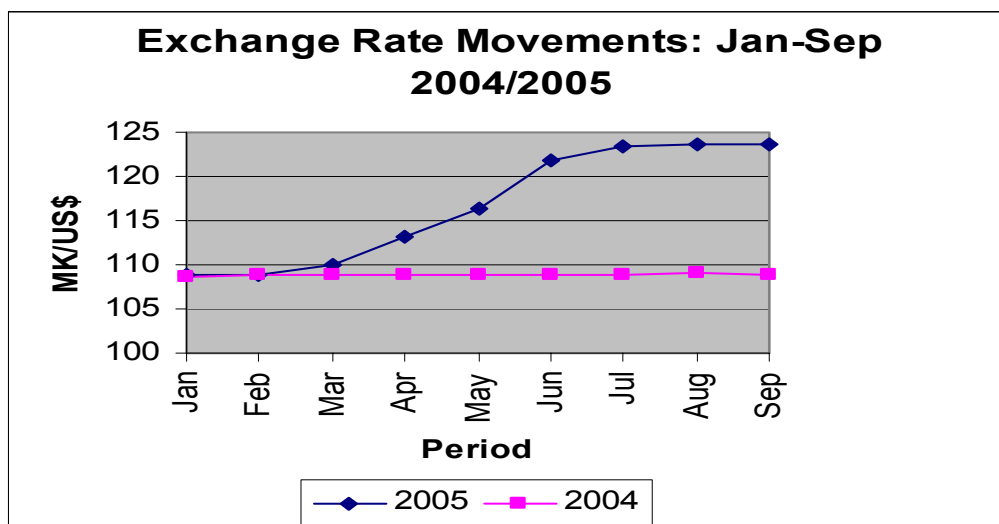
Table 2: Comparable Inflation Outturns for 2004 and 2005



3.2 FOREIGN EXCHANGE MARKET

During the first quarter of 2005/06, the Malawi Kwacha lost its value against all its major trading partners' currencies except against the British pound. The Kwacha slid despite proceeds from tobacco sales and the unlocking of donor support following the approval of the new PRGF program in August 2005. With regard to the US dollar, the Kwacha depreciated by 0.5 percent to close the quarter at K123.60 per US dollar. It also depreciated against the Euro by 0.4 percent. When viewed against the British pound and the Japanese yen, the Kwacha gained some ground by 1.5 percent and 1.4 percent to reach K218.74 per pound and K1.10 per yen, respectively. The stability is expected to be sustained in the months to come as more donors are expected to disburse according to their pledges.

Table 3: Exchange Rate Movements



In the region, the Malawi currency weakened against the South Africa rand by 4.8 percent to close the quarter at K19.47 per rand. The depreciation of the Kwacha to the rand has been a result of the rand gaining strength against some hard currencies, particularly as investors were switching from the US dollar to other countries. The Kwacha also slid by 2.6 percent against the Zambian Kwacha to close the quarter at K0.03 per Zambia Kwacha whereas it gained value against the Zimbabwe dollar by 61.6 percent to trade at K0.0048 per Zimbabwe dollar.

3.3 INTEREST RATES

During the period July to September, 2005, interest rates were unchanged except in the money market. The bank rate was maintained at 25.0 percent whilst commercial banks savings and prime lending rates were at 7.8 percent and 27.0 percent, respectively. On the money market, all tenors registered slight decreases. The average Treasury bill yield closed at an average of 24.3 percent from 24.6 percent in the quarter from April-June, 2004 whereas that of RBM bills closed at 24.1 from 24.5 percent.

3.4 MONETARY SURVEY

Developments in the monetary sector during the first quarter reflected a pick up in economic activity. Money supply (M2) stock rose by 1.3 percent or K647.7 million to K52.2 billion compared to increases of 13.4 percent and 17.1 percent in the previous quarter and during a similar period in 2004/05, respectively. The expansion in the quarter under review was on account of total net foreign assets of the banking system, which rose by K2.6 billion in the quarter following some donor inflows. Total net

domestic credit extended by the banking system, however, dropped by 15.8 percent to K38.8 billion.

3.5 MONETARY AGGREGATES

In terms of money demand, the increase in monetary growth was more pronounced in quasi money as narrow money rose moderately. Quasi money balances rose by 1.9 percent to K22.9 billion on account of an increase in time and savings deposits. Private sector holdings of time and savings deposits rose by K1.1 billion to K15.3 billion partly on account on income from agricultural proceeds as well as a shift in investors portfolio from financial instruments like Treasury bills to time and savings deposits. Residents' foreign currency deposits, however, registered a drop of K681.7 million to K7.6 billion as some holders converted their balances to meet their operational requirements during the quarter under review.

Narrow money, which comprises demand deposits and currency outside banks, rose by 0.8 percent to K29.3 billion compared to an increase of 18.6 percent at the end of the last quarter in 2004/05. Demand deposits explained the whole increase following a quarterly rise of K491.6 million while currency in circulation fell by K264.3 million. The overall increase in narrow money reflected a pick up in demand for transactional balances due to high consumption spending that usually characterises this quarter.

3.6 NET DOMESTIC CREDIT

Total net domestic credit extended by the banking system registered a decline by 15.8 percent to K38.8 billion due to a drop in net credit to the government and parastatals during the period. Gross credit to the private sector, however, recorded an increase in the quarter under review.

Net credit to government from the banking system decreased by 15.8 percent to K38.8 billion against an increase of K3.9 billion in the quarter ending June, 2005. The drop in net credit to government arose largely from the monetary authorities as reflected by a decrease of K10.2 billion in net government borrowing from the Reserve Bank. Following the approval of the PRGF by the IMF in August, 2005, Government received donors inflows for budgetary support totalling about US\$48.1

million during the quarter under review. This development improved government resource envelope such that government borrowing from the central bank reduced significantly. Net credit to government from commercial banks, however, increased by K1.4 billion and amounted to K9.5 billion mainly through Treasury bills uptake.

Gross credit to the private sector rose by K1.8 billion to K18.4 billion in this quarter compared to a rise of K3.3 billion recorded in the previous quarter. The increase reflected high financing requirements by most companies in order to augment their working capital coupled with the need by the agriculture sector to purchase farm inputs. Total net credit to statutory bodies decreased by K236.6 million to negative K1.1 billion compared to a decrease of K115.8 million during the previous quarter. The outcome in the net position reflected an increase in the entities deposits with the commercial banks coupled with a decline of 16.1 percent in the gross borrowing from the commercial banks.

3.7 COMMERCIAL BANKS: SOURCES AND USES OF FUNDS

Total resources of the commercial banks amounted to K58.6 billion, an increase of 6.4 percent from the level recorded at the end of the previous quarter. While private sector deposits, other liabilities and official deposits were the major sources of funding during the period, liabilities to non-residents topped the list of major sources of funding during the period under review.

Liabilities to non-residents in the form of deposits and Kwacha equivalent of foreign currency deposits contributed K1.3 billion to the increase in commercial banks resources compared to the contribution of K390.5 million in the preceding quarter. The increase was due to accumulation of uncleared foreign liabilities. In addition, the Kwacha value of the foreign liabilities rose on account of exchange rate movements.

Private sector deposits accounted for K912.0 million of the increase in commercial bank resources. The accumulation of these balances was attributed to agricultural incomes. Official sector deposits rose by K338.7 million due to accumulation of

deposits by both parastatals and government. Parastatals deposits with the commercial banks rose by K197.0 million whereas those of government increased by K141.7 million. All other unclassified liabilities of the commercial banks rose by K978.3 million to K5.9 billion largely because of an increase in liabilities with other domestic banks.

On the uses side, most of commercial banks funds were used to extend credit to the domestic sector. Total domestic credit by the commercial banks recorded an increase of 12.7 percent to K29.3 billion after a similar increase recorded during the preceding quarter. This was mainly attributed to the increases of K1.8 billion and K1.5 billion in gross credit to the private sector and government, respectively. Credit to the private sector increased through loans and advances whilst credit extended to the government sector was mainly through Treasury bills.

All other assets of commercial banks rose by K2.1 billion compared to an increase of K838.4 million in the preceding quarter. The rise was partly on account of an increase in inter-bank assets.

Foreign assets of the commercial banks, however, went down by K1.2 billion to K2.5 billion compared to an increase of K286.1 million in the second quarter. This was partly a result of the depletion in holdings of foreign currency denominated deposits as the need to procure agro-based and other necessary imports increased during the quarter.

3.8 RESERVE BANK OF MALAWI: SOURCES AND USES OF FUNDS

Total resources of the Reserve Bank of Malawi amounted to K49.3 billion following a drop of K8.3 billion from the amount realized in the preceding quarter. The rise was mainly attributable to a significant drop in all other liabilities of the Reserve Bank, which registered a decline of K8.3 billion to K12.0 billion from K20.3 billion recorded in the previous quarter. The drop was mainly due to a decline of K6.8 billion in open market operation liabilities of the Reserve Bank. Currency outside banks also

registered a decline of K264.3 million to K12.7 billion compared to an increase of K3.1 billion in the preceding quarter.

However, deposits of official sector rose by K812.0 million to K6.5 billion during the quarter under review. Government resources were boosted by balance of payment support facilities during the quarter and this enabled government to accumulate more deposits with the central bank.

Liabilities in the foreign sector rose by K877.5 million to K10.6 billion compared to a drop of K151.5 million in the previous quarter. This was due to an increase in IMF facilities following the disbursements of the first tranche under the new Poverty Reduction and Growth Facility.

Total uses fell by K6.1 billion to K49.3 billion compared to an increase of K7.1 billion in the preceding quarter. The central bank lending to government dropped by K9.4 billion to K18.1 billion compared to an increase of K1.9 billion in the last quarter in 2004/05. Government's recourse to central bank resources in the quarter was minimized by donor inflows, which were used to retire part of government debt with the RBM. Consequently, government offloaded part of its Treasury bills stock held by the RBM amounting to K7.7 billion and retired part of the outstanding Ways and Means advances by K1.7 billion.

All other assets of the Reserve Bank registered a drop of K2.6 billion to K11.1 billion compared to an increase of K1.7 billion in the preceding quarter. The outcome partly reflected a reduction in uncleared effects. During a similar period last fiscal year, all other assets dropped by K671.3 million.

The central bank's foreign reserves, however, recorded an increase of K5.9 billion to K20.2 billion following another increase of K3.5 billion in the preceding quarter. The increase was a result of some balance of payments inflows as well as substantial capital flows for government related projects.

4.0 THE REAL SECTOR

4.1 NATIONAL FOOD SECURITY

Malawi continues to experience food deficit as a result of low production in the 2004/05 crop season due to the dry spell that the country experienced in February 2005.

It is expected that the number of farm families without food will continue to increase as the months go by. The Malawi Vulnerability Assessment Committee's (MVAC), assessment in June 2005 estimated that from June 2005 to February 2006, 4.2 million people would be affected by the food shortfall. This necessitates a concerted effort to bring more food aid to the affected areas by government and its cooperating partners.

By the end of the first quarter (July-September 2005), 1,062,716 farm families out of the total 3,185,699 farm families did not have own produced food, representing 33 percent of the total and approximately twice the level of 16.9 percent recorded during the same time last year. The Southern Region had the highest percentage (49 percent) of farm families without food of their own, followed by Central (22.6 percent) and lastly Northern Region (6.8 percent).

4.2 MALAWI'S FOOD PRODUCTION, REQUIREMENT AND EXPECTED FOOD GAP

The 2004/05 Final National Agricultural Production Estimates released in June 2005 indicated a maize production estimate of 1,225,848 metric tonnes, representing a decrease of 30 percent from the previous season's final production of 1.73 million metric tonnes. For the 2005/06 marketing year, Malawi requires 2.1 million metric tonnes of maize and this figure is composed of maize for food use totalling 2.0 million metric tonnes; maize seed requirement totalling 38, 009 metric tonnes; and maize for the Strategic Grain Reserve totalling 60, 000 metric tonnes.

Taking into account the carry over stocks from ADMARC standing at 6,385 metric tonnes, NFRA – SGR stocks amounting to 27,000 metric tonnes and NFRA – Commercial stocks amounting to 20,000 metric tonnes, and on-farm stocks

approximated at 30,000 metric tonnes, there is a food shortfall in the country of approximately 389, 889 metric tonnes. The MVAC has, therefore, approximated 4.2 million people to be at risk requiring food aid amounting to 269,600 metric tonnes. As of end September, 2005 the food gap was at 133, 095mt.

4.3 INTERVENTIONS AND STRATEGIES BY THE GOVERNMENT AND MINISTRY OF AGRICULTURE AND FOOD SECURITY

The Government with donors (Department for International Development and European Union) through National Food Reserve Agency (NFRA) is procuring 90,000 metric tonnes of maize for both humanitarian and commercial purposes, that is, 62,000 metric tonnes (humanitarian maize) and 28,000 metric tonnes (commercial maize).

From June to September 2005, the WFP has distributed humanitarian food aid in Zomba, Phalombe, Machinga, Chiradzulu, Chikwawa, Nsanje and Mulanje whilst the Voucher System distributed food in Karonga, Blantyre, Mwanza, Neno and Balaka. The programme targeted 55 percent of those people requiring food aid during this period and 22,213 metric tonnes has been distributed to 1 million targeted people.

As part of reducing the food gap, ADMARC has purchased locally 2,993 metric tonnes of maize from the K100 million they got from government. This maize has already started being sold in some of the markets. ADMARC also has borrowed 5,000 metric tonnes from the SGR. This maize is to be repaid from commercial stocks which government is importing.

Government also launched 'Feed the Nation Fund', which is seeking donations from well-wishers. The donations to this fund will be used to purchase food for humanitarian purpose. The donations could be both in cash or kind.

4.4 FERTILIZER SUBSIDY PROGRAMME

The original orders of 137,000 under the Fertilizer Subsidy Programme have been adjusted upwards to 147,000 metric tonnes comprising 55,000 metric tonnes of UREA, 55,000 metric tonnes of 23:21:0 +4s, 15,000 metric tonnes of CAN and 22,000 metric tonnes of D-Compound. Out of the total tonnage, 20,000 metric tonnes of UREA, 20,000 metric tonnes of 23:21:0 +4s and 5,000 metric tonnes of CAN are to be sourced

locally while the rest will be imported. As regards imported fertilizer, 9,000 metric tonnes of 13,000 metric tonnes that docked at Beira port is in transit to Malawi.

As of end September 2005, 15,892 metric tonnes of UREA and 10,591 metric tonnes of 23:21:0, which were sourced locally had been received by the Smallholder Farmer Revolving Fund of Malawi (SFRFM) and distributed to ADMARC selling points.

In terms of implementation of the Programme, coupons are issued to the beneficiaries for the use when purchasing the subsidised fertilizer. The Government has planned to use coupons to track down those that might want to beat the system.

4.5 2005/06 AGRICULTURAL PRODUCTION ESTIMATES

The Ministry of Agriculture and Food Security (MoAFS) through the eight (8) Agricultural Development Divisions (ADD's) has started implementing /carrying out the Agricultural Production Estimates Survey. This covers both crops and livestock in preparation for the First Round 2005/06 Agricultural Production Estimates. Blocks and agricultural households to be involved in the survey were sampled during the month of September 2005.

5.0 CONCLUDING REMARKS

First quarter of 2005/06 fiscal year is characterised by a mix of performances in various sectors of the economy. With regard to fiscal and monetary sector, Government has scored highly in terms of management of finances and restraining domestic borrowing from the Reserve bank of Malawi. In terms of food security, the country has suffered a big setback emanating from low production of food crops in Malawi with particular reference to maize production. Others challenges facing the country in this quarter are the importation of maize to mitigate the effects of the drought, high petroleum prices on international and national markets and delays in disbursement of the budget support by some donors.

As stated in the introductory section, low crop production has had a far reaching impact on real GDP growth, which has been revised downwards from 2.1 percent as

estimated in April, 2005 to 1.9 percent in November, 2005 and average inflation is expected to be at 15.5 percent by the end of the year, December, 2005