Quarterly Economic and Business Perspectives

(April to June 2017)

Published by the Malawi Confederation of Chambers of Commerce and Industry - The Voice of the Private Sector

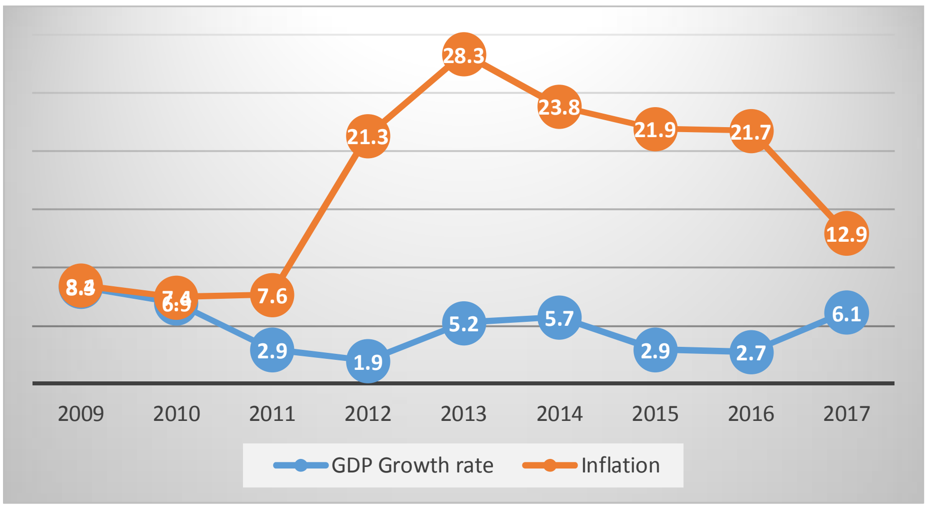
1. INTRODUCTION

During the second quarter of the year, economic and business performance has not registered significant improvements. The economic environment during the second quarter of the year is characterized by opening up of Auction Floors for tobacco in April, harvesting season of most agricultural products and policy prescription through presentation of the 2017/18 Fiscal budget. These determine to a great extent the economic and business perspectives of this report. Also taking into account emerging developments from the global economy, this report provide great insights in terms as how they affect business performance in Malawi.

2. ECONOMIC HIGHLIGHTS

2.1. Economic Growth

Figure 1: GDP Growth Rate and Inflation Trends (Percent)



Source: National Statistical Office & Reserve Bank

- The domestic economy is expected to grow from 2.7 percent in 2016 to 6.1 percent in 2017 on the premise of favourable weather conditions and stable macroeconomic environment. Good performance in agriculture and fishing which is estimated to grow by 6.8 percent, manufacturing, with a growth of 4.9 percent, construction, with a growth of 5.1 percent, wholesale and retail trade, with a growth of 6.6 percent, and financial and insurance activities with a growth of 7.3 percent.
- Looking further ahead to 2018, GDP growth is projected to remain strong with a growth of 5.0 percent. The growth will mainly be driven by stability of the macroeconomic environment which is expected to promote private sector investment. According to the June 2017 Monetary Policy Statement, continued economic recovery is expected over the medium to long-term horizon depending on sustained macroeconomic stability and addressing underlying structural constraints, especially on the supply side.
- At the Global level, economic growth is expected to strengthen marginally to 3.5 percent in 2017, from 3.1 percent in 2016 and prospects for 2018 is at 3.6 percent. The pickup in global activity is driven by developments in emerging and developing economies. This is primarily due to recovery in investment, manufacturing and trade.

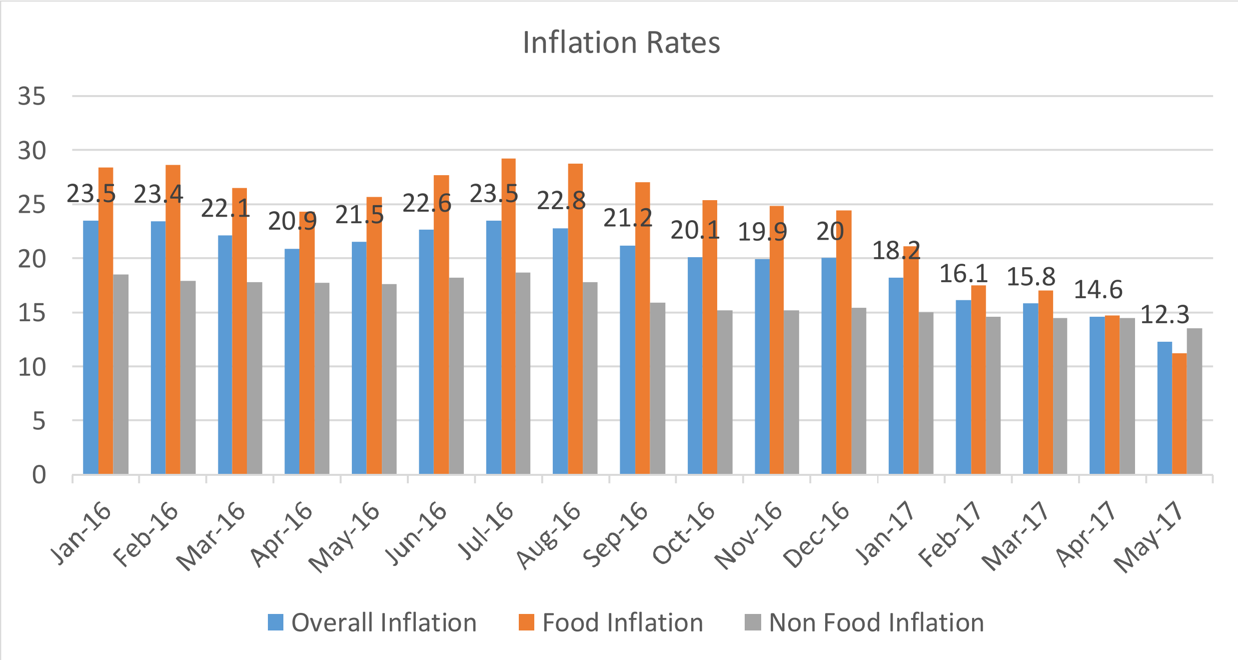
2.2. Inflation rates

Inflation has been rising in many economies over the past few years due to increase in commodity prices but in Malawi good agriculture performance has led to lowering of inflation rates to 12.3 percent as of May 2017. According to Reserve Bank of Malawi, the inflation rate is projected to a hit a single digit inflation rate of 8.5 percent by December 2017. In 2016 average inflation is at 21 percent and the projected average inflation for 2017 is 12.9 percent

In Sub-Saharan Africa economies, average inflation is projected to remain high in 2017 with a slight decline in 2018. In 2017 inflation is projected at 10.7 percent and is expected to slightly decline to 9.5 percent in 2018. The high inflation in the region is mainly due to the effects of currency depreciation. Inflation for selected neigbouring countries in April 2017 show Mozambique at 21.3%, Zambia at 6.7%, Tanzania at 6.4%, Republic of South Africa 6% against 14.6% for Malawi.

The figure 2 below shows the trend over the period (figures shown are for the headline inflation)

Figure 2 Inflation Rate Trends



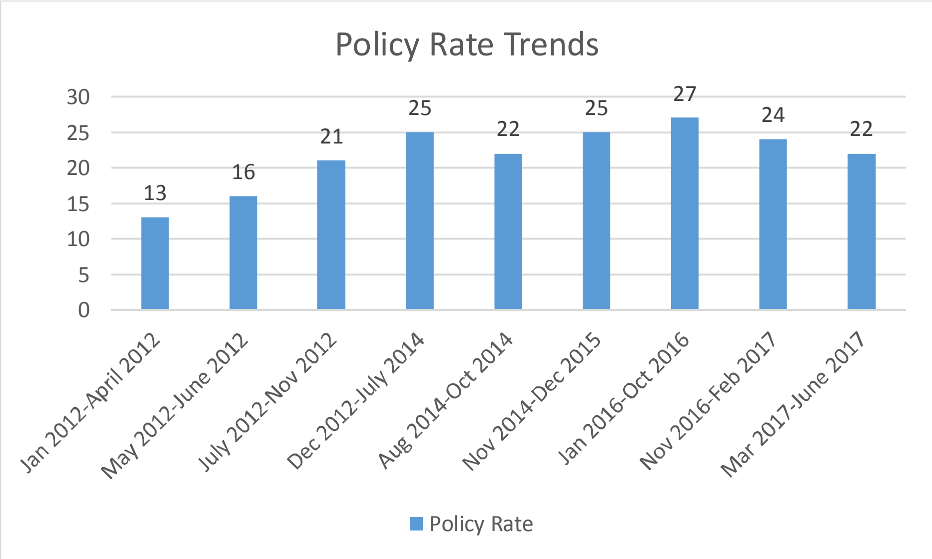
Source: National Statistical Office

2.3. Interest rates

The Central Bank of Malawi reduced the Policy Rate from 22 percent in March 2017 to 18 percent in June 2017. This continued reduction of the Policy rate is expected to trigger reduction of lending rates by the Commercial Banks as base lending rates now have reduced by same percentage points from 31.5 percent to 27.50 percent as reported by some commercial banks. However interest spreads still remain high for Malawi compared with other countries in the region. For example, in Mozambique the spread is 10 percent; Zambia is 21 percent; Tanzania is 15 percent and yet in Malawi the spread is 31 percent. This is attributed to the problem of repayment defaults which increases the risks associated with lending, among others.

The figure 3 below shows the Policy Rate trend since 2016. The rate has been reduced since November 2016 in line with inflation trends.

Figure 3: Policy Rate Trends



Source: Reserve Bank of Malawi

Up until late 1980s, monetary policy in Malawi was characterized by repressive procedures such as direct credit, interest rate ceilings, and strict controls on foreign exchange and capital flows. This has however changed during the recent periods and programmes include liberalization of the financial sector, which means that monetary policy had to shift from direct to indirect methods. Reserve Bank of Malawi therefore uses a number of instruments which include the policy rate, the Lombard rate, open market operations, foreign exchange transactions, Liquidity Reserve Requirement to communicate monetary policy decisions. Policy Rate is one of the instrument that forms the core of monetary policy in Malawi. This has facilitated the conduct of monetary policy in line with macroeconomic objectives of maintaining sustainable growth, viable balance of payments position and stable prices. The central bank therefore keeps watch on all indicators that would entail price developments including Consumer Price Index (CPI), growth in Gross Domestic Product (GDP), monetary growth and expansion of credit. This is the reason level of inflation rates influences the determination of lending rates in Malawi by way of policy rate changes.

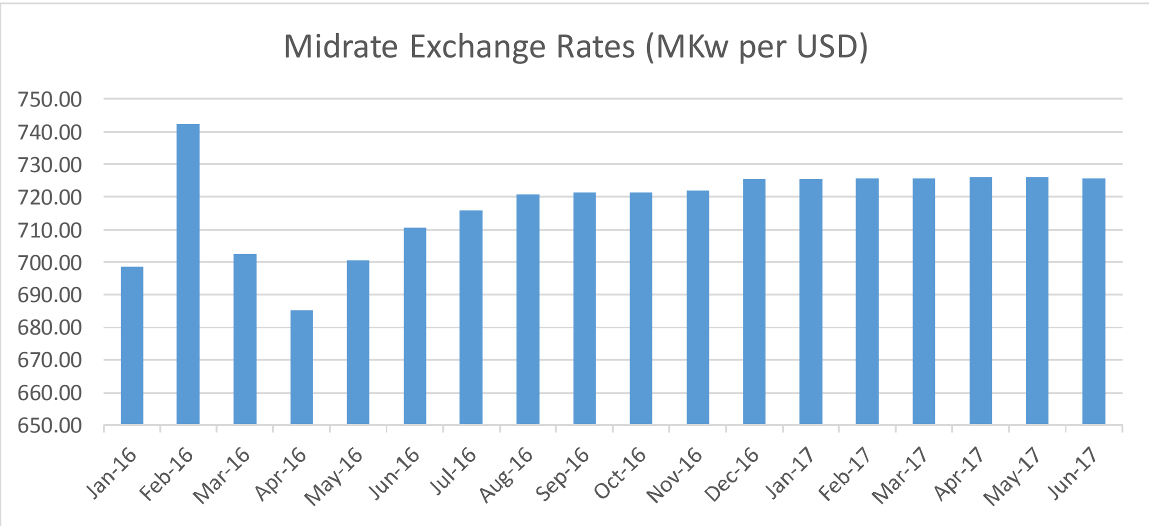
If the Central Bank cuts the policy rate, it is expected that commercial banks also cut their mortgage and lending rates and if the policy rate rises, the expectation is that banks will increase their lending rates. The mechanism is that by increasing policy rate, commercial banks find it more expensive to borrow from the Central Bank and they in turn increase their respective commercial lending rates at which they lend money to the borrowers. This further reduces supply of money in the system which helps sustain high lending rates. If it is cheaper to borrow from the Central Bank because of reduction in policy rate, commercial banks can reduce their lending rates and keep the same profit margin. However, banks sometimes retain part of reduction in policy rate to meet its internal expenses and pass on part of benefits to the borrowers. In the past especially after financial crises, banks did not reduce lending rates amidst policy rate reduction in order to earn higher profits to recover accumulated losses.

2.4. Exchange Rates and Foreign Exchange Reserves

The exchange rate has generally been stable since August 2016 as presented in the figure 4 below. However, the effectiveness of RBM intervention in the market is constrained by the amounts of foreign exchange reserves, which have historically been low in Malawi.

International reserves narrowly missed the 3 months of import cover as they stood at 2.9 months of imports in May 2017 but improved in June 2017 to 3.25 of imports as reported by the recent Monetary Policy Committee report. This was reflected in the improvements of Central Bank Official reserves for June 2017 to US$678.70 million, from US$610.25 million and compared to US$648.20 million (3.10 months of imports) in June 2016., The exchange rate has been relatively stable during the past twelve months supported by low kwacha liquidity and relatively subdued demand for foreign exchange. The Monetary Policy Committee noted that the stabilization of the Kwacha augers well for the disinflation process.

Figure 4: Monthly Exchange Rates



Source: Reserve Bank of Malawi

The period from April is characterized by inflows of foreign exchange due to sales of Tobacco. According to Tobacco Control Commission, 2017 production is projected at 124.5 million kilograms against the demand of 152 million kilograms. According to figures from AHL Group, about 46 percent of the 124.5 million kilograms of tobacco grown this year has been sold within the first nine weeks of the 2017/18 selling season.. The statistics show that the country had traded 57,162,979 kilograms of the leaf at the auction floors at an average price of $1.90 per kilogram. The AHL figures further show that within the first two months of this selling season, the country has realized over $108 million. This compares to 54,139,355 kilograms in 2016, which realized slightly over $78 million at an average price of $1.46 per kilogram during the same period in 2016.

2.5. General Economic Outlook

- Inflation outlook remains positive due to good agriculture season. However, the outlook is subject to some negative risks due to weaker global demand which could lead to lower prices for Malawi's export commodities.
- The tobacco season is marred by lower prices which can affect supply of foreign exchange.
- The demand for foreign exchange has remained subdued but is subject to change.
- OPEC and Non-OPEC member states have made a decision to cut crude oil production in a bid to stabilize international prices which can exert pressure on the domestic pump prices. This could also trigger inflation.
- The international oil prices are however currently below the trigger price of US$60 per barrel and the projections show it will remain at that level for the rest of the 2017. According to 2017 Annual Economic Report by Ministry of Finance, Economic Planning and Development, oil prices are projected at $55.23 per barrel in 2017 and $55.06 per barrel in 2018, respectively. Similarly, non-oil commodity prices are projected to increase in 2017.

3. PRIVATE SECTOR INSIGHTS FROM THE 2017/18 FISCAL BUDGET

3.1. What is the 2017/18 Plan?

Parliament on 30th June 2017 passed K1.3 trillion expenditure budget for the fiscal year 2017/18. The National Budget remains an important fiscal instrument as it provides an indication of how much revenue Government intends to raise, where the revenue will come from and how it will be spent. Businesses are the principal source of Government revenue, both tax and non-tax revenue for each year.

The table below shows a summary of Revenue and Expenditure plans for the 2017 fiscal year.

Table 1: Revenue and Expenditure

Category	2015/16 Outturn (MK, Billion)	2016/17 (Revised Estimates)	2017/18 Estimates	Growth as per revised figures
Total Revenue & Grants	765.30	999.16	1,107.89	11%
Total Domestic Revenue	634.31	840.46	980.16	17%
Tax Revenue	564.44	754.90	1,034.69	37%
Non Tax Revenue	69.87	85.55	96.13	12%
Grants	131.01	158.70	127.74	-20%
Total Expenditure and net Lending	895.91	1,132.93	1,301.23	15%
Overall Balance	-132.557	-133.773	-193.334	45%

Source: 2017/18 Budget Documents

The overall balance (deficit, including grants) as shown in the table at MK193.3 billion will be financed by Net Lending (borrowing). This is 45 percent higher than the 2016/17 revised estimate. The implication of this rise is that Government will be borrowing from the market and financial institutions have a risk free ready market. This deficit is likely to go up if grants do not come.

The deficit, excluding grants, represents 24.7 percent of the total Expenditure Budget and this is the extent to which the economy is leaving beyond its means.

Generally this deficit adds to the already growing Debt Stock as reflected in the amount of interest paid in the Fiscal Year 2016/17 (**K168.5 billion – domestic plus foreign interest)** and **K185.835 billion** to be paid in Fiscal Year 2017/18 as observed in the table 2 below. According to the Financial Statement (Budget Document No 3) as at end-December 2016, Total Public Debt (TPD) amounted to K2, 082.2 billion (accounting for 53.5 percent of GDP), of which US$1.7896 billion (K1, 276.0 billion or 32.8 percent of GDP) is foreign debt and K806.2 billion (or 20.7 percent of GDP) is domestic debt. This is huge for the country and domestic debt has significantly increased over the recent past due to lack of adequate donor support which in our view may continue to be the case.

Table 2: Expenditure Comparisons

	Total Expenditure & Net Lending	Recurrent	Wages & Salaries	Interest on Debt		Goods, Services &Transfers	Development Expend	Domestically Financed	Foreign Financed
				Domestic	Foreign				
2016/17 revised Estimates	1,132.9	868.9	270.8	156.2	12.3	252.7	260.5	42.7	217.8
2016/17 Revised Expenditure Share From Total Expenditure	100.0%	76.7%	23.9%	13.8%	1.1%	22.3%	23.0%	3.8%	19.2%
2017/18 Estimates	1301.227	948.876	303.576	170.955	14.88	258.207	348.351	132.212	216.139
2017/18 Expenditure Share From Total Expenditure	100%	73%	23%	13%	1%	20%	27%	10%	17%

Source: Budget Documents 2017/18

3.2. A critical look at how Government Plan to Raise Revenues to finance the budget?

3.2.1. Summary of Revenue Projections

Total revenue and grants in the 2017/18 fiscal year Fiscal Year is equivalent to 22.3% of GDP. This comprises domestic revenue estimated at 19.7% of GDP and 2.6% grants. The taxes are estimated to amount at 8.4% of GDP. This comprises K474.7 billion in taxes on income and profits, K364.2 billion in taxes on goods and services, and K78.8 billion in taxes on international trade. Non-tax revenue will total an equivalent of 1.6% of GDP, lower than the previous fiscal years on account of low remittances of dividends from Parastatals.

Grants are estimated to continue on the downward spiral, equivalent of 1.6% of GDP in 2017/18 fiscal year compared to 2.0% of GDP in 2016/17 Fiscal Year.

According to budget statement made by Minister of Finance, Economic Planning and Development, the main objectives of the 2017/18 tax measures are to improve administrative efficiency, encouraging tax compliance, and broadening tax base.

3.2.2. Specific Tax measures and their implication to businesses

Introduction of 10 percent excise tax on Fee based TV Services

Government uses excise tax to generate revenue, (re)distribute income, and influence consumption behavior.

The objective of this particular measure therefore is “to expand the revenue base as government attempts to shift from reliance, in the long term, on income and investment taxes to consumption taxes”

The Implication for business therefore is that providers of fee based TV services may face:

- Possible reduction in demand for services;
- Migration from higher to lower tiers by customers;
- Subscription only when there is something of interest to them.

Although the impact of the introduction of the tax may be thought to fall squarely on consumers, sometimes businesses reduce prices because of reduced demand, thus bearing part of the tax burden. In the end Government may not collect the revenue it is anticipating and therefore unable to meet the intended objectives. Furthermore, since businesses will be able to register less profits, Corporate tax income will eventually be reduced.

3.2.3. Deletion of Customs Procedure Code (CPC) 443 for Buses and Minibuses

- This CPC applied for 4 years to Buses and Minibuses that were up to 8 years old. According to the Minister, by operation of a sun-set clause, this CPC has expired.
- As such only Buses and Minibuses that are 5 years or less old will continue to benefit from duty free and excise free importation status.
- Buses and Minibuses older than 5 years now attract 15 percent duty and 16.5 percent VAT.
- Excise taxes will apply on a graduation or progressive basis.

The implication to business is that while sunset clauses are not unusual, Government should have informed businesses in advance in avoid surprises, which amount to inconsistencies in policy and regulatory policy implementation. This is one of the main challenges that businesses face has been expressed in numerous publications of the Malawi Business and Climate Survey yearly done by Malawi Confederation of Chambers of Commerce and Industry.

3.2.4. Value Added Tax Measures

Changes to VAT Act in FY2016/17 aimed to expand revenue base, remove economic distortions in production and supply chains, and “shift reliance of domestic revenue from taxes that fall on labour and investment to taxes that mainly fall on consumption.

3.2.4.1. VAT on Milk

- This was introduced in the FY2016/17, but has now been removed in the 2017/18 Budget, leaving it to be exempt as before.

Implication for business

- Input VAT will continue to apply and according to processors only a small proportion of inputs attract input VAT, generally less than 20 percent. Therefore the result appears more favourable to the industry compared to the situation when milk was subject to VAT.

3.2.4.2. VAT on Cooking Oil

- This has also been exempted for both Cooking Oil and Crude Oil. One of the main issue with this industry has been the surge of smuggling but since the prices will be reduced, the market share for the companies will relatively increase and therefore a favourable tax measure.

3.2.5. Income Tax Measures

3.2.5.1. An increase in the tax free threshold from K20,000 to K30,000 per month

- Tax free income bracket has been increased from K20,000 per month to K30,000 per month for salaried employees. The last expansion of the tax free bracket was effected in the fiscal year 2013/14.
- In order to maintain the real value of the tax free bracket amount, Government should have been expanding it by the inflation factor each year or compound the inflation factors in the 2017/18 fiscal Budget. This would have resulted in an increase in excess of 100 percent given the high inflation environment in Malawi.

3.2.5.2. A new tax bracket of 35% for wage income above K3,000,000 per month to enhance income distribution

- The introduction of a 35 percent tax bracket for salaried income in excess of K3 million per month is in direct contradiction to the claim that Government is shifting away from taxing production, labour, and investment. Higher tax rate on labour discourages hard work and therefore is counter to achieving the desired 7 percent annual GDP growth.

3.2.6. Other Miscellaneous Tax Measures

3.2.6.1. ***Harmonization of interest levied on overdue charges and penalties on late submission of returns and late payment of taxes is without dispute***.

It is nonetheless important for Government to appreciate the tough environment in which business is operating. No business would want to incur avoidable expenses whether through paying lower interest or less penalties

Government should also introduce interest and penalties on amounts it delays refunding to private sector to ensure fairness. Absence of interest and penalties on Government delays in settling dues is a clear incentive to it to continue defaulting.

3.2.6.2. *Changing the Description of Withholding Tax on "Bank Interest" to "Interest".*

- Government has imposed a withholding tax on interest from interest generating investments rather only on bank interest. This is tax broadening strategy because Government might have observed that companies are declaring less dividends and putting more money on interest notes.

3.3. Other Specific Interventions from the budget.

- Government will join the ***national contributory pension scheme*** on July 1 2017, migration for those employees below 35 years of age and new recruits. This will level the playing field with private sector in legal compliance and perhaps increase the funds that would be used for investments.

- Government will partner with Development partners in the energy sector by providing ***on - grid and off - grid power from both renewable and non-renewable energy sources.***

  Further the statement indicates that Government will put in place tax policies and incentives to achieve such objectives.

  The contentious issues surrounding power purchase agreements is the issue of tariffs where reasonable tariff has to be applied particularly for Independent Power Producers.

- Government with support of the World Bank and African Development Bank through institutions such as the Multilateral Investment Guarantee Agency (MIGA) will facilitate the signing of Power Purchase Agreements between ESCOM and other Independent Power Producers.

- Government will pursue irrigation farming for both small scale and large scale farming. This has been the talk for a long time. There is need to see a clearly irrigation plan that is implementable and particularly what will be implemented this year because it is not known yet about the weather in the next season.

  Further the budget statement has indicated that ***Green belt authority could extend its services to commercial farmers that could lease land in areas covered by the Shire River Basin program and this something privates sector may benefit from- what services***

ANNEX 1: SELECTED ECONOMIC AND BUSINESS INDICATORS

	Gross official		Private sector		Total	
	Reserves (millions)	Import Cover (months)	Reserves (millions)	Import Cover (months)	Reserves (millions)	Import Cover (months)
30-Jun -17	678.7	3.25				
31- May-17	610.25	2.92				
31-Mar-17	553	2.65	333	1.59	886	4.24
28-Feb-17	599	2.87	335	1.60	934	4.47
20-Jan-17	606.62	2.9	325.06	1.56	931.68	4.46
13-Jan-17	599.54	2.87	328.47	1.57	928.01	4.44
6-Jan-17	607.36	2.91	339.33	1.62	946.69	4.53
30-Dec-16	585.68	2.8	336.66	1.61	922.34	4.41
23-Dec-16	581.5	2.78	332.01	1.59	913.51	4.37
16-Dec-16	580.81	2.78	330.33	1.58	911.14	4.36
12/9/2016	574.41	2.75	333.83	1.6	908.24	4.35
12/2/2016	578.47	2.77	300.65	1.44	879.12	4.21
25-Nov-16	574.41	2.75	315.61	1.5	890.02	4.25
18-Nov-16	598.97	2.87	303.27	1.45	902.24	4.32
11-Nov-16	615.37	2.94	306.18	1.46	921.55	4.4
4/11/2016	621.59	2.97	322.68	1.54	944.27	4.51
28-Oct-16	610.32	2.92	332.62	1.59	942.94	4.51
21-Oct-16	616.98	2.95	332.53	1.59	949.51	4.54
14-Oct-16	614.04	2.94	330.41	1.58	944.45	4.52
7-Oct-16	618.39	2.96	327.13	1.57	945.52	4.53
30-Sep-16	598.17	2.86	332.51	1.59	930.68	4.45
23-Sep-16	593.49	2.84	338.95	1.62	932.44	4.46
16-Sep-16	605.77	2.9	338.14	1.62	943.91	4.52
9-Sep-16	612.47	2.93	330.18	1.58	942.65	4.51
2-Sep-16	609.39	2.92	332.07	1.59	941.46	4.51
26-Aug-16	612.71	2.93	336.61	1.61	949.32	4.54
19-Aug-16	631.71	2.93	343.42	1.64	975.13	4.57
12-Aug-16	621.2	2.97	332.07	1.73	953.27	4.7
5-Aug-16	603.82	2.89	333.34	1.59	937.16	4.48
29-Jul-16	629.14	3.01	337.05	1.61	966.19	4.62
22-Jul-16	630.96	3.02	323.59	1.55	954.55	4.57
15-Jul-16	606.63	2.9	350.51	1.68	957.14	4.58
8-Jul-16	626.29	3	339.32	1.62	965.61	4.62
1-Jul-16	602.44	2.88	359.06	1.72	961.5	4.6
19-Jan-16	610.19	2.92	330	1.58	940.19	4.5

	Interest rates and Inflation movements			
Month	**Policy rate (%)**	**Interbank rate (Average %)**	**Inflation rate (%)**	
February	24	22.88	16.1	
March	22	22.69	15.8	
April	22	21.6	14.6	
May	22	21.5	12.3	
June	22	21.42	NA	

	Stock Market Performances (2017)				
Index	**Feb**	**Mar**	**Apr**	**May**	**June**
MASI	13635.67	14577.62	15203.97	15573.68	15772.51
DSI	10707.55	11437.62	11935.73	12228.65	12386.77
FSI	2026.07	2308.87	2308.87	2325.21	2325.21

Trend of Classification of Central Budgetary Operations (% of GDP)- 2017 Annual Economic Report