ASSESSMENT OF THE BUSINESS ENVIRONMENT IN 2023: THE PRIVATE SECTOR PERSPECTIVE

By

MALAWI CONFEDERATION OF CHAMBERS OF COMMERCE & INDUSTRY CHAMBER HOUSE,
CHICHIRI TRADE FAIR GROUNDS,
P.O BOX 258, BLANTYRE.
Tel. 01871988.
Email: mccci@mccci.org

DECEMBER 2023

Contents

Introduction.

The Malawi Confederation of Chambers of Commerce and Industry (MCCCI), on behalf of its members, would like to provide an assessment of the business environment as perceived by its members in 2023.

The economic environment in Malawi continued to be unfavorable in 2023 due to a number of shocks that have been hitting the country in the past 3 years. Since 2020, the economy has been hit by a COVID-19-induced economic slowdown, disruption in the global economy due to geopolitical tensions in Ukraine (2022), and Cyclone Anna (2022), just to mention a few. As the economy was recovering from these shocks in 2023, it was also hit by Cyclone Freddy, which compounded the effects of all the previous shocks. The shocks have worsened the macroeconomic imbalance, as evidenced by the scarcity of foreign exchange, high levels of inflation and the high cost of loanable funds.

General overview of the business environment in 2023

The past three years have been particularly difficult, with stagnating growth and widening macroeconomic imbalances due to unsustainable debt and the lingering effects of multiple shocks. Malawi's balance of payment crisis became more acute over the course of 2023, with foreign exchange widely unavailable. This is mainly attributed to the relative increase in appetite for imported goods against dwindling levels of exports. The scarcity of foreign exchange led to ongoing shortages of imported goods, illustrated by long queues at filling stations and difficulties for manufacturers to obtain raw materials and machinery for production. To make matters worse, a significant share of the meagre foreign exchange found its way into parallel markets creating a huge disparity between the official and parallel market rates. Prior to the 44 percent devaluation in November 2023, the Malawi kwacha exchange rate to the United States dollar was highly misaligned, with the official rate standing at K1,180 while on the parallel market, a dollar was fetching as high as K1,900.00 representing a 61 percent difference.

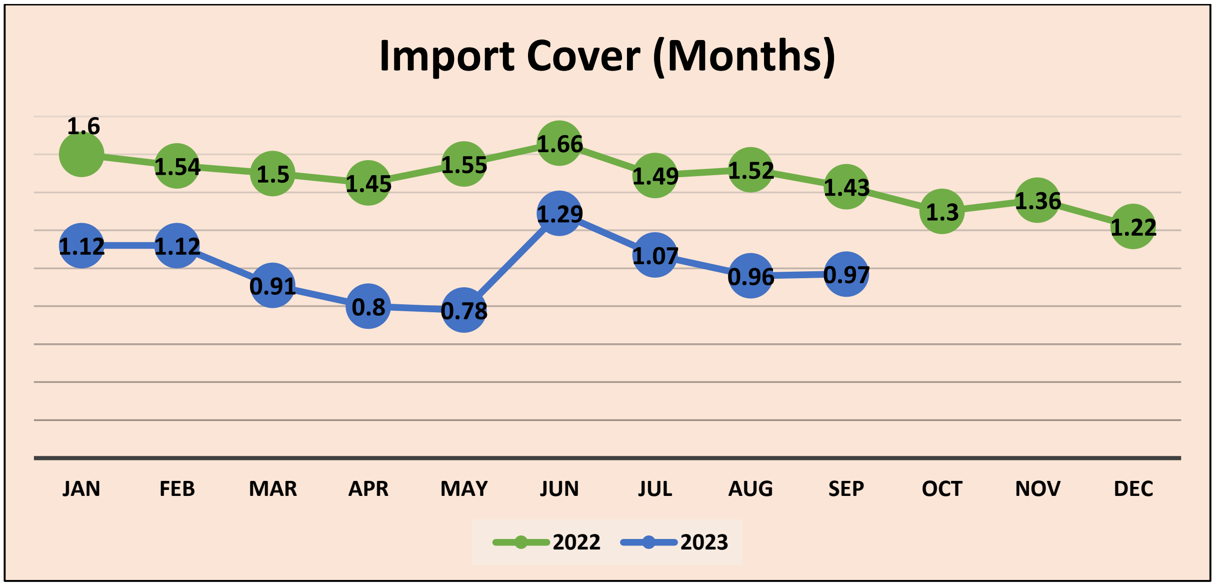
Inflation rate in the year was very high reaching 33.1 percent in November 2023, the highest in the last 10 years. The high rates affected costs of production and reduced spending power for consumer income.

As a way of curbing the rising inflation, the Monetary Policy Committee (MPC) of the Reserve Bank of Malawi (RBM) raised the policy rate from 18 percent to 24 percent. The tight monetary stance by RBM resulted in increased cost of loanable funds from commercial banks. This affected most businesses especially SMEs, which face challenges in obtaining patient capital.

Challenges faced by businesses in 2023.

Businesses faced a number of challenges that made it difficult for them to thrive during the year. Some of the major challenges were as follows:

1. **Shortage of Foreign Exchange**



Source: RBM ***(Note: data for September, October, November and December 2023 is yet to be released)***

Malawi's balance of payment crisis became more acute over the course of 2023, with foreign exchange widely unavailable. The problem was largely structural, emanating from imbalances between the country's limited capacities in generating foreign exchange against insatiable appetite for imports. The supply-demand imbalance manifested in the domestic foreign exchange market in a number of ways, including low foreign exchange supply and declining official foreign reserves.

The situation negatively affected the operations of both local and international cross-border businesses. During the year 2023, the highest recorded import cover was 1.29 months which is way below the recommended target of 3 months. In the year 2022, 1.66 months of import cover was recorded as the highest with the lowest being 1.22 months. Exports as a share of GDP have been declining over the decades, driven by weak demand for tobacco and an overvalued exchange rate, which resulted in low foreign exchange reserves and a rising spread between the official and parallel market rates. The foreign exchange scarcity made it hard for businesses to import raw materials and essential goods.

The shortage of foreign exchange led to two main problems which impeded business performance namely misaligned currency and scarcity of fuel.

I. Misalignment of the Currency

The shortage of foreign exchange led to development of a parallel market and this brought in the misalignment of the value of the currency between the official and parallel markets**.** In response to the foreign exchange liquidity challenges, misalignment of foreign exchange between parallel and official markets, and its effects on exchange rate developments, the Reserve Bank of Malawi instituted short-term measures including foreign exchange auctions. The auctions resulted in minor devaluations totaling to 14.2 % from January to October. However, in November, the Reserve Bank of Malawi announced an adjustment of the exchange rate from the selling rate of K1,180.29 to a selling rate of K1,700 to the United States dollar, representing a 44 percent devaluation of the kwacha. In the statement from the Bank, it was indicated that the devaluation of the Kwacha followed an assessment conducted by the Bank that, among other factors, indicated that "supply-demand imbalances remained in the market despite adjustments of the exchange rate through the auction system. The Bank swayed to devaluation by the prospect of Malawi receiving an Extended Credit Facility, a form of financial assistance, from the International Monetary Fund (IMF).

The exchange rate adjustment was needed because there were still supply-demand imbalances in the currency market. This was the second time in 18 months that Malawi significantly decreased the value of the kwacha in relation to the US currency. It first did so in May last year in order to prop up dwindling foreign currency reserves, pressured by rising commodity prices and declining dollar revenue from tobacco exports.

Malawi being a predominantly importing country, the devaluation of the currency had more negative impact than the intended purpose of the devaluation both on consumers as well as businesses. On the consumer side, the devaluation led to sky rocketing of prices for goods and services as a result the demand on certain goods and services which are not essential to human lives declined. This is due to constraint on the budget as in the short run, income does not immediately respond to devaluation. On the business front, the devaluation made importation of raw materials and other goods more expensive since most businesses import raw materials from other countries, resulting in increased production costs. The devaluation also affected preparation for the agricultural season. There was also an immediate rise of prices in the energy sector which is crucial to production. For instance, the Malawi Energy Regulatory Authority (MERA) increased fuel prices with petrol fetching K2, 530 per litre from K1746 (a 44.9 percent rise); diesel at K2, 734 per litre, up from K1, 930 (42.4 percent increase), while paraffin is at K1910 from K1261, up by 51.47 percent.

II. Scarcity of Fuel

According to the 2023 Malawi Business Climate Survey that was conducted by the Malawi Confederation of Chambers of Commerce and Industry, fuel scarcity was the major challenge that undermined business activity, with a rating of 9.4 out of 10. The scarcity of fuel in the country was caused by the scarcity of foreign exchange, which made it difficult to import fuel into the country. This impediment affected all the businesses as fuel is used for transportation and production, which is the bloodline for every business.

2. **High Inflation**

Higher inflation levels affected businesses negatively by raising production costs and reducing aggregate demand through the erosion of consumers' disposable income. The cost of production increased in the year due to skyrocketing prices of raw materials and the massive impacts on wages. This created a situation whereby the businesses were producing at higher cost but could not substantially raise prices fearing reduced demand for their products or services. Businesses in the construction sector complained that they had existing contracts with fixed prices which did do not account for inflation. In an inflationary environment, meeting these contractual obligations became more challenging, leading to financial strain. Inflation created a volatile environment that made most businesses uncertain to increase their investment.

3. **Weather shocks**

Early in January 2023, the country experienced cyclones that destroyed infrastructure, fields, human lives, and properties. According to the World Bank, Cyclone Freddy alone is estimated to have caused production losses equivalent to $36.4 million, which translates to a real GDP loss of 0.5 percent for 2023. Further analysis has also shown that without significant investments in climate adaptation, the impacts of climate change will lead to GDP loss of 3 percent to 9 percent in Malawi by the end of this decade.

The agricultural sector, which is the biggest contributor to the economy, faced a number of challenges in 2023 that affected production. The cyclone caused massive damage in the agriculture sector, with an estimated 204,800 hectares of crops destroyed, mostly in the southern region of the country. In contrast, the northern region was affected by drought, which had negative effects on maize and rice production. The impact of the weather shocks was exacerbated by higher fertilizer prices on a global scale due to the Russian-Ukraine war, the ban on fertilizer exports by China, and, on the domestic scene, the inefficiencies of the Affordable Input Program (AIP). All these led to low agricultural production for the 2022–2023 season.

Selected macroeconomic indicators

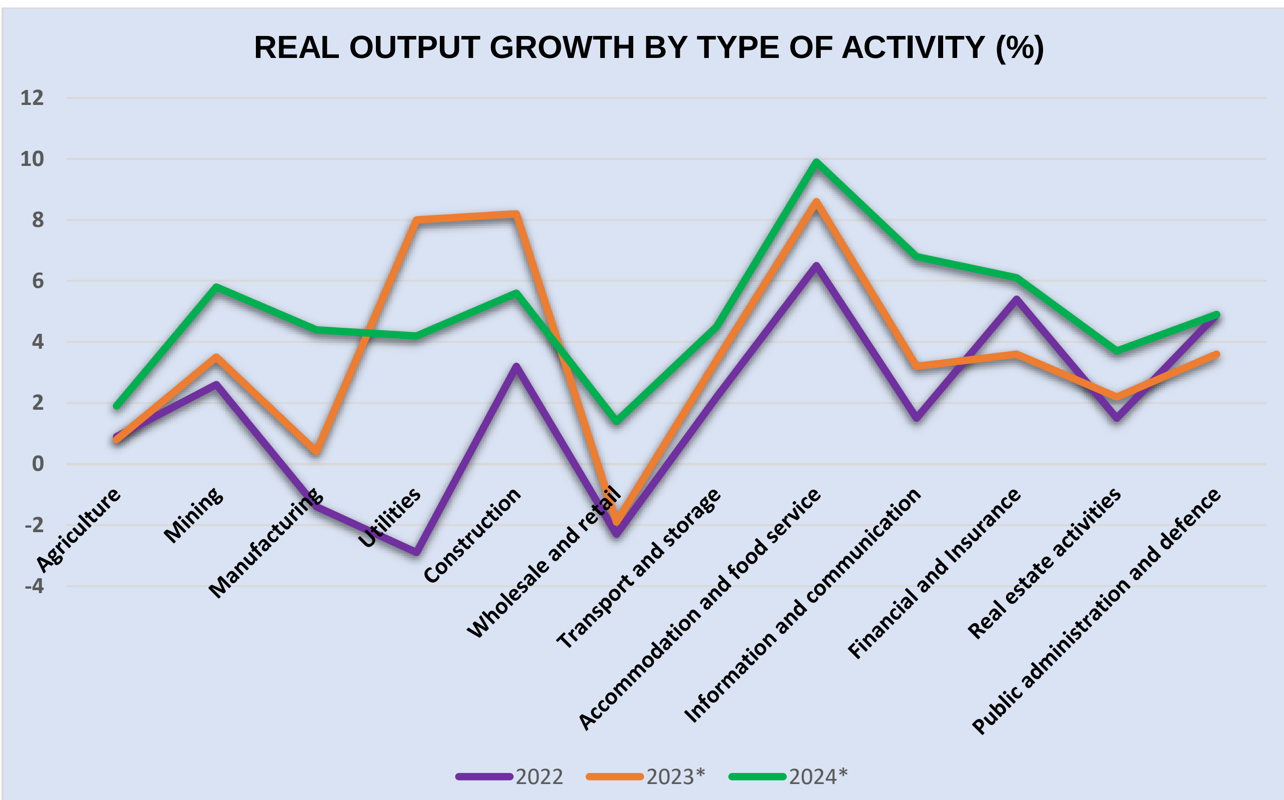
The economic recovery in 2023 was met with a number of shocks that undermined growth prospect for the year. Malawi's balance of payments crisis became more acute over the course of 2023, with foreign exchange widely unavailable.

On the other hand, inflation continued to be on a rising trend even during harvesting season, when food prices are expected to be generally low because of the increase in supply on the market.

Weather shocks, especially the impact of cyclone Freddy caused a lot of damage to infrastructure and fields, droughts in the southern region, and dry spells in the northern region, respectively which put pressure on food inflation. These risks, in addition to the impact of limited access to fertilizers, negatively impacted the 2022–23 agricultural production season. The inflation pressure led to a tightening of monetary policy, especially the policy rate, which further increased the cost of borrowing.

1. Real Economic Activity

Domestically, real GDP growth projection for 2023 was revised downwards to 1.5 percent, from the earlier estimate of 1.9 percent following the November 2023 Business Interviews conducted by NSO and Ministry of Finance and Economic Planning. The revision was attributed to lower than anticipated growth in the agriculture, wholesale and retail, and manufacturing sectors, stemming from persistent shortages of foreign exchange, weather shocks, high inflation, and increased episodes of fuel shortages. Meanwhile, stronger growth is expected from the electricity, construction, mining and quarrying and accommodation and food services sectors.



Source: National Statistical Office & Ministry of Finance and Economic Affairs

* Projections

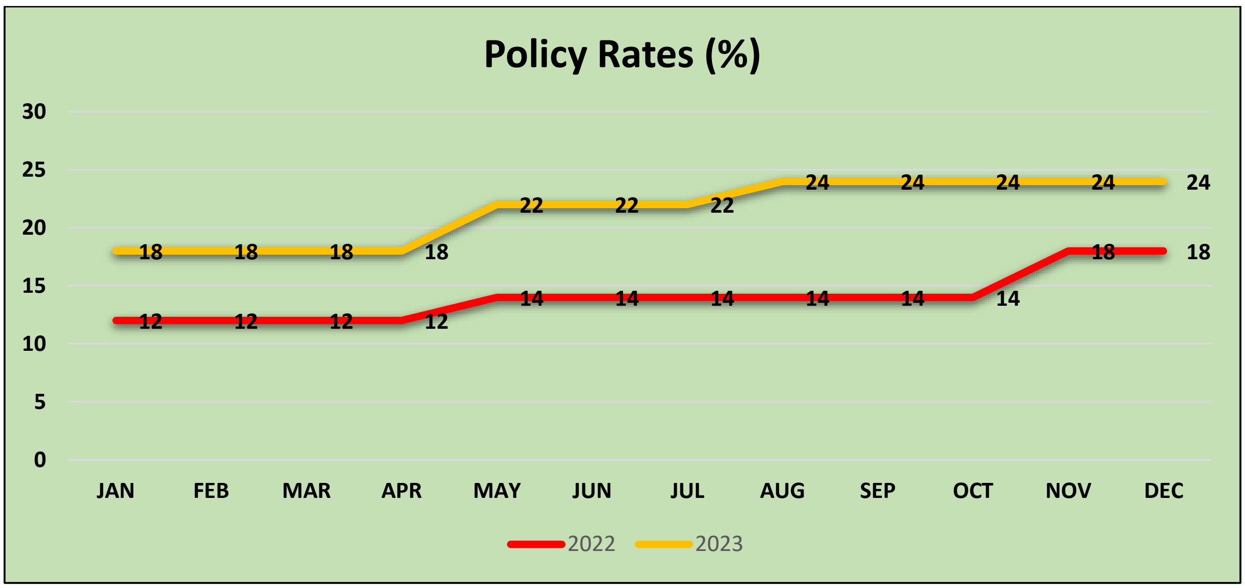
Following revision to the projection of 1.5 percent real GDP growth rate for 2023, the growth prospects according to NSO are as follows

- Growth in the agriculture, forestry, and fisheries sub-sector was revised downward to 0.8 percent in November 2023 from 1.1 percent estimated in May 2023, and from a growth of 0.9 percent in 2022. The slight downward revision was driven by the unfavorable weather conditions in the northern and southern regions.
- Estimated growth for 2023 in the mining and quarrying subsector was adjusted upwards from 3.3 percent during the May 2023 estimates, to 3.5 percent during the November 2023 estimates, and from a growth of 2.6 percent in 2022. The improved 2023 growth estimate is due to improved electricity production in 2023, and the effect of the ongoing construction projects that have increased demand for the industry's products.
- In the manufacturing sector, the growth forecast for 2023 was adjusted down from 1.0 percent to 0.4 percent during the November 2023 estimates. The downward revision was primarily attributed 5 to challenges associated with the availability of foreign exchange, which continued to compromise the industry’s ability to import necessary raw materials.
- Growth for 2023 in the utilities sub-sector was revised upwards from 5.1 percent to 8.0 percent during the November 2023 estimates, from a contraction of 2.9 percent in 2022. The positive outlook banks on the rehabilitation of the Kapichira power plant, which has significantly improved electricity supply in 2023, in addition to the Nkhotakota Solar Power Station.
- The growth outlook for the construction sector was revised upwards from 4.0 percent to 8.2 percent in the November 2023 estimates, compared to a growth of 3.1 percent in 2022. This positive adjustment can be attributed to several road infrastructure development projects.
- The growth forecast for 2023 was revised further downwards from the May estimate of 0.6 percent to minus 1.9 percent. The expected negative growth in 2023 is attributed to the persistent challenges such as foreign exchange shortages and the slow growth in the agriculture and manufacturing sectors, which are suppliers of inputs to the wholesale and retail trade sector. Further, the rise in inflation experienced in 2023 has reduced disposable incomes of households and other economic agents, who are key players in the industry.
- The transportation and storage services growth in 2023 was marginally revised upward by 0.2 percentage points to 3.4 percent, from a growth of 2.2 percent in 2022. Despite the damage caused by cyclone Freddy to the sector’s infrastructure, and acute fuel shortages experienced in 2023, there was still significant improvement in the performance of railway, airline and road transport.
- The growth rate for 2023 in the sector was revised from 3.3 percent to 8.6 percent, from a growth of 6.5 percent in 2022. The faster growth in the industry

is premised on increased number of arts, entertainment, and recreational activities, which created a demand for accommodation and food services.

- The growth rate for the information and communication sector in 2023 is estimated at 3.2 percent from 1.5 percent in 2022. The improvement in the industry is attributed to the revision of data prices by leading companies in the communication industry, and the introduction of different innovations and promotions.
- Growth in the financial and insurance services sector is expected to moderate to 3.6 percent, from a growth estimate of 5.4 percent in 2022. The estimated slowdown is on account of contractionary monetary policy stance through raising of the policy rate.

2. Policy Rate

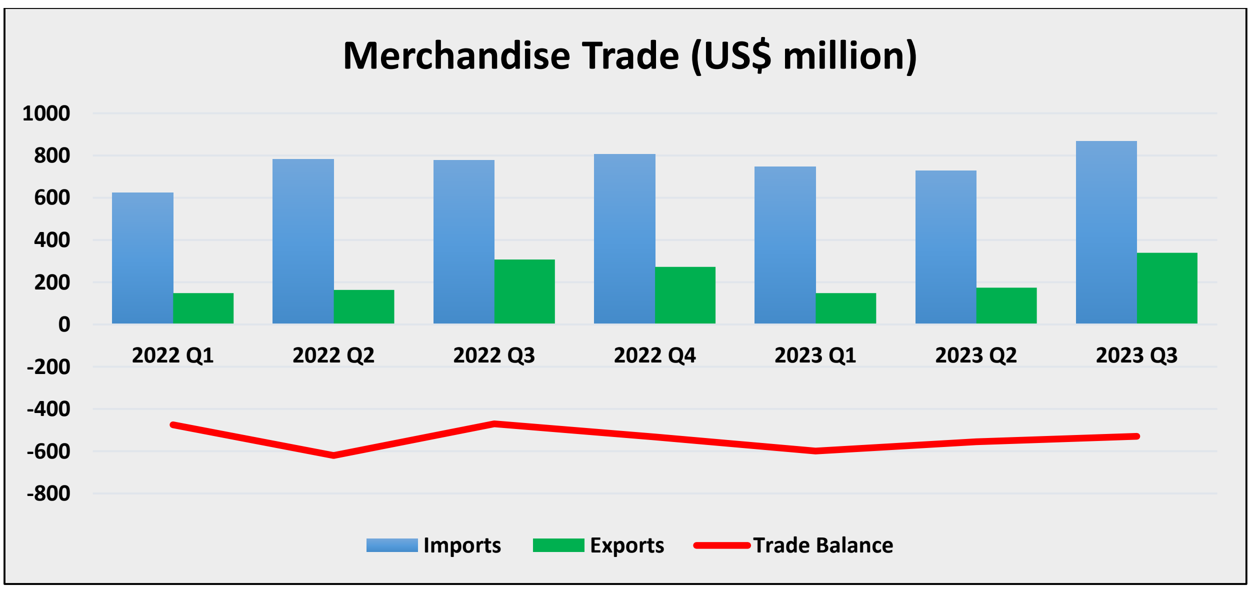


Source: RBM

The year 2023 finishes with a policy rate of 24 percent, up from 18 percent at the end of 2022, representing a 6 percent increase. The increase has been there due to the continued inflation pressure that was experienced during the year. In April 2023, the Monetary Policy Committee (MPC) noted that the inflation outlook had worsened since their last meeting, mainly due to unforeseen domestic shocks. In particular, the occurrence of cyclone Freddy in southern Malawi and localized drought in northern Malawi had worsened the food supply prospects and strengthened adverse supply-side inflationary pressures. It was also observed that the need to rehabilitate the infrastructure damaged by the cyclone had the adverse impact of amplifying aggregate demand and fueling inflation, requiring further tightening of monetary policy to dampen the demand effects. In view of these developments, it was resolved to increase the policy rate by 400 basis points to 22.0 percent and the LRR ratio on domestic currency deposits by 200 basis points to 5.75 percent in May 2023. However, the LRR ratio on foreign currency deposits and the Lombard rate were maintained at 3.75 percent and 20 basis points above the policy rate, respectively.

Furthermore, in July 2023, the MPC decided to increase the policy rate by 200 basis points to 24.0 percent and the Liquidity Reserve Requirement (LRR) ratio on domestic deposits by 200 basis points to 7.75 percent. The decision was made as price pressures intensified, such that inflation was projected to remain substantially above the medium-term target for longer. Nevertheless, the decision was made mindful that the impact of the previous monetary policy decisions may not have been fully transmitted into the economy. However, it was resolved that taking further action was necessary to continue dampening the rising inflationary pressures and re-anchoring inflation expectations while supporting the economic recovery process.

3. Merchandise Trade



Source: NSO and MRA

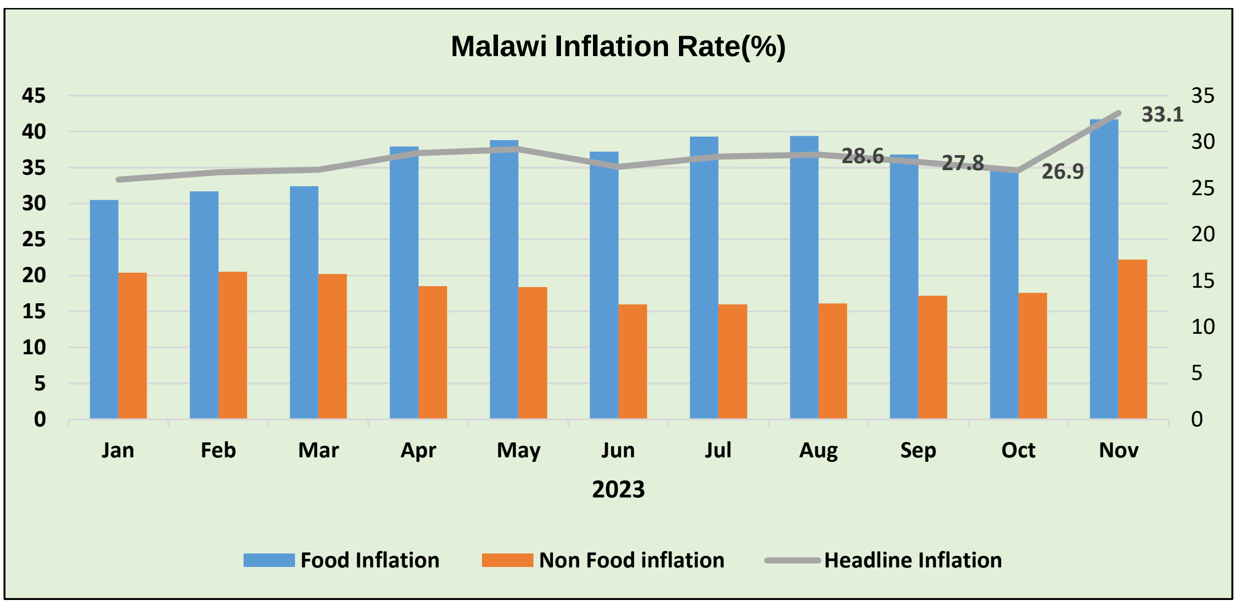
The trade balance of Malawi continued to linger on the negative side as imports outweighed exports in 2023. Exports as a share of GDP have been declining over decades, driven by weak demand for tobacco. The performance of merchandise trade during the first 3 quarters of 2023 indicated that trade balance worsened to minus US$1.7 billion compared to minus US$1.6 billion reported in the corresponding period in 2022.

Preliminary statistics indicated that the merchandise trade balance marginally improved to a deficit of US$528.8 million in the third quarter of 2023 from a shortfall of US$555.0 million recorded in the previous quarter and compared to minus US$470.0 million registered in the third quarter of 2022. The narrower deficit was a result of a typical seasonal growth in exports which outweighed the growth in imports in the quarter. Specifically, exports and imports increased by US$166.2 million and US$139.9 million, respectively, in the review quarter.

During the second quarter of 2023, merchandise trade balance was estimated at a deficit of US$555 million from minus US$598 million during the preceding quarter and compared to a shortfall of US$619.3 million recorded in a similar period of 2022. The wider deficit was a result of growth in import demand while exports remained relatively stable. Specifically, the quarter registered US$174.1 million of exports and a surge in imports of US$729.1 million.

For the first quarter, the merchandise trade balance widened to a deficit of US$598 million from minus million and compared to a deficit of US$474.9 million recorded in the first quarter of 2022. The outturn largely reflected seasonal factors, being at the peak of a lean period where exports are low against elevated imports. Specifically, the quarter registered a drop of exports to US$149.4 million and imports were registered at US$747.4 million.

4. Inflation Rate



Source: RBM

In 2023, inflation rate remained high throughout the year. The highest inflation rate was 33.1 percent in November 2023, while the lowest was 25.90 percent in January 2023. Headline inflation averaged higher at 26.5 percent in the first quarter of 2023, compared to 12.1 percent in the first quarter of 2022. Food inflation declined to 31.5 percent in the first quarter of 2023, partly reflecting the impact of the opening of some of ADMARC's maize markets, which helped to stabilize prices during the period. In addition, the seasonal increase in the supply of vegetables during the first quarter of 2023, which constitutes about 12.0 percent of the food basket, further contributed to the moderating food price pressures. Furthermore, pressure mounted on non-food inflation, as evidenced by the average of 20.4 percent in the first quarter of 2023. The sources were the high costs of items under transportation and hospitality services, as well as the alcohol and tobacco categories.

The inflationary pressures persisted during the second quarter of 2023, as evidenced by a surge in headline inflation to an average of 28.4 percent, a 1.9 percent increase from the first quarter. The outturn was driven by an acceleration in food inflation, which rose to an average of 38.0 percent in the second quarter of 2023, 6.3 percent up from the first quarter. The rise in food inflation, which reflected the impact of high farm input costs, was sustained by the ongoing Russia-Ukraine war. The impact of unfavorable weather conditions experienced earlier this year exacerbated the situation. Meanwhile, non-food inflation moderated to 17.6 percent in the second quarter, down by 2.8 percent from the first quarter. The slowdown partly reflected the impact of tightening the monetary policy stance during the second quarter, in addition to the continued weakening of global demand, which helped to suppress imported non-food inflation pressures.

During the third quarter of 2023, inflationary pressures abated, resulting in a marginal slowdown in average headline inflation to 28.2 percent, a 0.2 percent drop from the second quarter. The outcome was explained by developments in non-food inflation, which decelerated to an average of 16.4 percent in the third quarter of 2023, a 1.2 percent drop in the second quarter, an outcome that was attributed to a relatively tight monetary policy environment and lower imported inflation. In contrast, food inflation edged up to 38.5 percent in the third quarter of 2023, 0.5 percent up from the second quarter. The moderation in food prices was partly attributed to maize sales in some selected ADMARC depots. However, upside risks to the inflation outlook include exchange rate movements, increases in crude oil prices, and adverse weather conditions.

The fourth quarter started with a slight decline in the inflation rate. In October 2023, the headline inflation rate declined to 26.9 percent from 27.8 percent in the previous month, food inflation rate declined to 34.5 percent from 36.7 percent in the previous month, and non-food inflation increased to 17.6 percent from 17.2 percent recorded in September 2023. However following the 44 percent devaluation in November, the year on year inflation rate for November 2023 was 33.1 percent, an increase from the 26.9 percent recorded in October 2023. Food and Non-Food Inflation rates were at 41.7 percent and 22.2 percent, respectively. The national month to month Inflation rate for November 2023 stood at 7.6 percent. Food inflation rate was at 9.3 percent while Non-Food Inflation rate was at 5.2 percent.

Consistent with the aforementioned factors, the 2023 headline inflation is projected at 28.2 percent, 1.3 percentage points lower than the 29.5 percent forecast during the previous Monetary Policy Committee round, according to RBM projections. This is still higher than the average of 20.9 percent recorded in 2022. Food inflation is now projected to moderate to 36.2 percent from an earlier forecast of 37.2 percent, nevertheless higher than an outturn of 26.8 percent in 2022. Similarly, non-food inflation is forecast to average 18.1 percent from a forecast of 20.4 percent made in July 2023, compared to 15.1 percent for 2022.

Forecast into 2024

There are a lot of opportunities and threats that are likely to influence economic performance in 2024. There is a window for the economy to perform better depending on the policy pathway to be undertaken post-devaluation. The economic performance in 2024 will depend on the availability of foreign exchange amongst many other factors. If the country does not embark on new foreign exchange generating endeavors, then the macroeconomic imbalance will persist or even worsen n 2024. Most of the strategies that were used to ease the scarcity of foreign exchange in 2023, are short-term strategies. However, there is a need to have long term solutions. The establishment of mega farms for commercialization and value addition, if implemented successfully, has a huge potential in the generation of the much needed foreign exchange. The country needs to diversify the foreign exchange generating activities like labour exports and reduce the overreliance on the agriculture sector as a major export earner. There is a need to utilize the export deals that the country has with other countries as such deals are quick and simple solutions to our problems.

Mitigation of post-devaluation impacts will be crucial to the growth of the economy in 2024. This notwithstanding, the approval of the IMF-supported ECF program is expected to unlock foreign exchange inflows, which will, in turn, support the importation of raw materials and promote economic activity. According to the Ministry of Finance and Economic Planning, the country secured support through the Extended Credit Facility amounting to USD174 million covering the next four years. Foreign support is expected to help us stabilize the economy, thereby putting our economy on a growth trajectory. The risk is in the timing of the devaluation. In the third quarter of the year, businesses in agriculture prepare for the agricultural season. The rise in fertilizer prices due to devaluation has a negative impact on crop production and may worsen the existing food insecurity in the country as the majority of farmers will not access fertilizer on the market. This will lead to increased pressure on food prices.

Redevelopment of parallel market for foreign exchange if foreign exchange liquidity is low on the official market is another potential risk that could arise in 2024. If the liquidity is low on the market, the value of the local currency will just increase further which shall affect business operation hence undermining growth.

The rainfall pattern for the 2023/24 farming season is projected to be unreliable. From January to March 2024, most areas should anticipate normal to below-normal total rainfall amounts, with the possibility of above-normal rainfall in January. There is also a high chance of prolonged dry spells in the month of February. This poses a threat to the economy as there is a possibility of low agriculture productivity in 2024.

Nevertheless, the IMF-supported ECF program and support from other development partners brings in optimism with the real GDP projected to grow by 3.8 percent in 2024 according to RBM.

Lekani Katandula	**Chancellor Kaferapanjira**
PRESIDENT	**CHIEF EXECUTIVE**