ASSESSMENT OF THE BUSINESS ENVIRONMENT IN 2024

DECEMBER 2024

Preamble

The Malawi Confederation of Chambers of Commerce and Industry (MCCCI) presents its report on the business environment for 2024. This comprehensive assessment evaluates the macroeconomic fundamentals of the year, offering a snapshot of the current economic environment and projections for the upcoming year. Insights gathered from the private sector regarding these crucial macroeconomic factors form the basis of the findings.

The year 2024 started with a sense of optimism, anticipating a recovery from prior economic challenges. This positive sentiment was bolstered by a series of structural reforms, among them the approval of the $175 million Extended Credit Facility (ECF) on 21 September 2023 from the International Monetary Fund (IMF). This financial support boosted confidence in the Malawi economy and was expected to facilitate an influx of foreign exchange through increased Foreign Direct Investment and donor inflows, thereby alleviating the ongoing foreign exchange shortages. Consequently, projections indicated an economic growth rate of 3.2 percent for 2024, a significant improvement from the 1.5 percent recorded in 2023. However, as the year ended, growth is now pegged at 1.8 percent.

Furthermore, the year 2024 started and closed with a promising tobacco sales season, with 133.3 million kilograms (120.5 million kilograms in 2023) sold for a total value of USD 396.8 million (USD 283.8 million in 2023) at an average price of USD 2.98 per kilogram (USD 2.35 per kilogram in 2023).

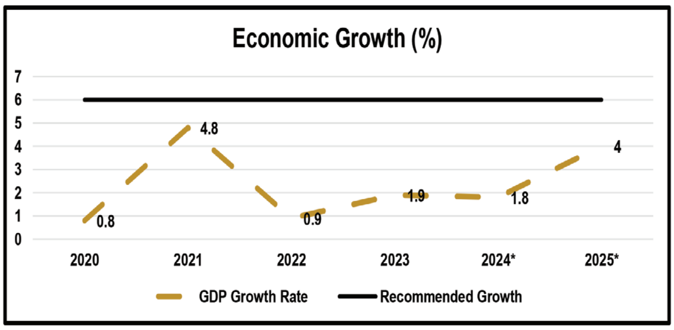
A. General Overview of the Business Environment in 2024

Malawi has encountered a series of shocks in recent years, prompting the country to implement a range of macroeconomic and structural reforms aimed at fostering medium- and long-term growth through the Agriculture, Tourism, and Mining (ATM) Strategy. However, the implementation of these reforms has faced significant challenges in 2024, including an El Niño-induced drought that has intensified the impact of previous shocks. This drought has worsened existing macroeconomic imbalances, contributing to substantial fiscal deficits, balance-of payments challenges, unsustainable debt levels, and price instability, all of which have impeded economic activities.

Private sector productivity remains below its potential, with most businesses, particularly micro, small, and medium enterprises (MSMEs) struggling with stagnation or even facing closure. Throughout the year, businesses grappled with a myriad of macroeconomic challenges, including escalating production costs, high interest rates, foreign-exchange shortages, and uncertainty surrounding exchange-rate policies. These factors have deterred investment, resulting in subdued job creation, diminished revenue, and a relative decline in exports.

The Reserve Bank of Malawi (RBM) has revised its real GDP growth projection for 2024 downward to 1.8 percent, a significant drop from the initial estimate of 3.2 percent, signifying the underperformance of the private sector. This downward adjustment is attributed to the adverse effects of El Niño on agricultural output and its spillover effects on the broader economy, including reduced exports and an increased need for social spending. The revised projection for the growth rate also represents a slowdown from the 1.9 percent growth recorded in 2023. Given an average population growth rate of 2.6 percent, this projected GDP growth is expected to reduce per capita income. Moreover, the anticipated growth rate of 1.8 percent falls short of the 6.0 percent target outlined in the Malawi 2063 First 10 Year Implementation Plan 1 (MIP-1).

Despite these macroeconomic challenges, there has been an improvement in power supply, with only minor planned and unplanned blackouts reported in the third quarter. The political environment has also been relatively stable for the business community, despite several developments that could have led to disruptions. Furthermore, the government has introduced essential policies and initiatives aimed at creating a more conducive business environment and address some of the issues facing the economy. However, some of these policies may inadvertently pose risks to private sector growth and innovation.



Government Initiatives in 2024

During the year under review, the government implemented several initiatives. These actions aimed to address various economic and social challenges, focusing on promoting development and stability. The initiatives included the following:

- Introduction of bills, policies, and strategies aimed at fostering a conducive business environment.
  1. 2024 Micro, Small and Medium Enterprises Bill
  2. National Agriculture Policy (NAP II)
  3. National Irrigation Policy
  4. The 2024 Competition and Fair-Trade Bill
- On the infrastructure front, the government made progress on several road and rail projects that will significantly help reduce landing costs. In addition, government struck a deal with Mozambique to develop the Nacala port, which, if successfully implemented, will have a substantial impact on landing costs.
- Government successfully finalized the SADC Simplified Trade Regime (STR) agreement with Mozambique, a move that is set to significantly boost trade, particularly for micro, small, and medium-sized enterprises (MSMEs), between the two nations.
- The Public Procurement and Disposal of Public Assets Bill, 2024, is likely to have significant impact on private sector players in Malawi. By introducing enhanced transparency, accountability, and competitive standards in public procurement, private businesses, particularly suppliers, contractors, and consultants, will face a more regulated and structured environment. The emphasis on open and competitive bidding, sustainable procurement, and participation by micro, small, and medium enterprises (MSMEs) could foster fairness and inclusivity but might also increase competition, potentially disadvantaging smaller firms that lack capacity or resources to compete effectively.

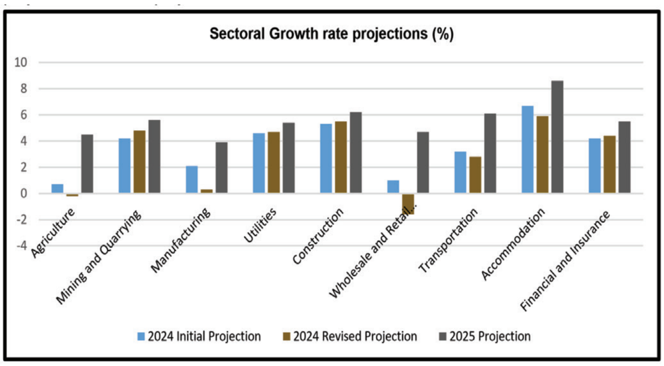
Furthermore, greater transparency and reduced corruption risks could level the playing field, ensuring that qualified businesses have equal opportunities. The focus on sustainable practices and innovation could also encourage private players to adopt environmentally friendly and socially responsible strategies, enhancing their market competitiveness and long-term viability.

Despite the positive initiatives, the government has also introduced some measures that could negatively affect businesses and deter investment. These include:

- The implementation of the Tax Stamp initiative without adequate consultations, which has adversely affected many businesses. Additionally, the decision to suspend the initiative for a subset of traders has significantly affected domestic manufacturers.
- The new government-to-government (G2G) arrangement for importing fuel, which designates the National Oil Company of Malawi (NOCMA) as the sole importer, is poised to significantly affect private sector fuel-importing firms by effectively excluding them from the market. While this arrangement aims to stabilize fuel supply in the short term, it raises concerns about its broader economic implications. Malawi is already grappling with limited foreign exchange reserves and high public debt. Therefore, relying on a centralized system could exacerbate debt accumulation during periods of foreign exchange scarcity, further straining the country's fiscal position. Although the arrangement may ensure a more consistent fuel supply, it risks distorting market competition, potentially leading to inefficiencies, reduced innovation, and a lack of cost-effectiveness in the long run. Additionally, the dependency on government-led imports could create vulnerabilities, particularly if there are delays or mismanagement in procurement. A more sustainable and long-term solution would involve prioritizing policies that boost foreign currency generation, such as supporting export-oriented industries, improving the business environment for foreign investment, and enhancing value addition in key sectors like agriculture and mining.
- In the 2024/25 National Budget, the government introduced a 10 percent corporate tax on businesses declaring profits exceeding MK10 billion. This decision may discourage investment, particularly in capital-intensive sectors such as mining and manufacturing, potentially hindering economic growth and development in these critical areas.
- The introduced Foreign Exchange Control (2024) regulation is likely to have negative impact on foreign exchange availability for the private sector. The regulation requires public institutions to hold foreign currency reserves at the Reserve Bank of Malawi (RBM) with mandatory conversion of 80 percent and Commercial Banks to convert, within 48 hours, 70 percent of NGOs foreign exchange receipts into Malawi kwacha and immediately transfer the proceeds to the Reserve Bank of Malawi. Whilst the intention remains to curb illegal forex trading, this will reduce the volume of forex circulating in commercial banks, making it harder for private businesses to access the forex they need for imports or international transactions.
- The Insurance Bill, 2024, introduces a range of regulatory changes that will significantly affect private sector players in Malawi's insurance industry. Stricter licensing requirements, corporate governance standards, and solvency margins will increase operational and administrative costs, especially for smaller insurers, potentially leading to market consolidation as some firms may struggle to meet the new obligations. The mandate to place insurance business within Malawi and transact in local currency could boost local economic activity but may limit insurers' flexibility to manage risks through international reinsurance arrangements. Higher compliance costs may also drive-up premiums, potentially reducing the affordability of insurance products. However, improved governance, risk management, and faster claims settlements could enhance consumer trust and encourage greater insurance uptake. The Bill's focus on inclusive insurance for low-income households may foster innovation as insurers develop products tailored to underserved markets. Despite the opportunities for growth and improved sector stability, private players face potential legal and financial risks due to strict penalties for non-compliance, making it essential to carefully navigate the new regulatory landscape.

B. Sectoral Performance and 2024 Projections

Initial analysis per sector projections had most sectors projecting growth. However, challenges faced by the economy led to a decline of the projections, whilst others were able to capitalize on the opportunities that emerged. Figure 2 below illustrates the initial projections, revised projections, and forecasts for 2025.



1. Agriculture, Forestry, and Fishing Sector

The sectoral growth rate for 2024 has been revised downwards to -0.2 percent, a significant adjustment from the earlier projection of 0.7 percent made in May 2024. This revision reflects a decline from the 0.5 percent growth recorded in 2023. The decrease is primarily attributed to poor agricultural output during the 2023/24 growing season, which has been exacerbated by unfavorable El Niño weather conditions. Both small- and medium-scale farmers, as well as large-scale agricultural producers, have been adversely affected.

The El Niño weather conditions have severely impacted the production of key crops such as maize, groundnuts, soya beans, sorghum, and beans across 23 out of 28 districts in the country. For instance, the Third Round Agriculture Production Estimation Survey (APES), conducted by the Ministry of Agriculture, indicated a staggering 22.7 percent decline in maize production during the 2023/24 season compared to the previous growing season, contributing significantly to the overall lower agricultural output.

The sector is projected to rebound with a growth rate of 4.5 percent in 2025, thanks to anticipated favorable weather conditions for the 2024/25 farming season and the government's strategic focus on scaling up Mega Farms. With a strong commitment to implementing the Agriculture, Tourism, Mining, and Manufacturing (ATM) strategy, it is expected that resources will be effectively channeled toward agricultural commercialization and various irrigation initiatives.

2. Mining and Quarrying Sector

The Mining and Quarrying sector is anticipated to witness robust growth of 4.8 percent in 2024, an increase from 3.1 percent in 2023. This growth is largely attributed to a stable electricity supply and the government's expedited road construction initiatives for the 2024/25 fiscal year, which have significantly increased the demand for quarry materials. Furthermore, the implementation of the Artisanal and Small-scale Miners (ASMs) Act is expected to bolster gemstone and mineral production in both 2024 and 2025, further contributing to the sector's expansion.

Looking ahead, the growth forecast for 2025 is an impressive 5.6 percent. This optimistic outlook is bolstered by the planned implementation of the Artisanal and Small-scale Mining strategy, which includes projects focused on rare earth elements, graphite, and uranium, as well as increased construction activity during the election period. Moreover, the signing of development agreements with Lotus Resources and Mkango Resources Limited is set to further enhance prospects for growth in 2025.

3. Manufacturing Sector

The growth forecast for the manufacturing sector has been revised down by 1.8 percentage points to 0.3 percent in October 2024, a decrease from the previously estimated 2.1 percent in May 2024. Nevertheless, this marks an improvement compared to last year's growth of 0.1 percent. The downward revision primarily results from ongoing foreign exchange shortages, which have significantly hindered the importation of essential raw materials for production. Additionally, the sector's performance has been adversely affected by the underperformance of the agriculture sector, attributed to lower than-expected production during the 2023/24 season. The manufacturing sector's heavy reliance on agricultural raw materials has further contributed to its decline, though the current growth projection for 2025 is pegged at 3.9 percent. This anticipated recovery is largely attributed to expected positive developments in the agricultural sector, driven by favorable weather conditions in 2025 and the successful implementation of the ATM strategy. Furthermore, improvements in the foreign exchange situation, reliable power supply, and consistent fuel availability are expected to bolster production within the manufacturing sector.

4. Utilities (Electricity, Gas, and Water) Sector

The growth rate for this sector in 2024 has been revised slightly upward to 4.7 percent, up from the previously estimated 4.6 percent in May 2024. This follows a robust growth rate of 7.4 percent in 2023. The modest increase in the 2024 growth forecast is attributed to ongoing advancements in electricity and water projects aimed at enhancing production capacity. Notably, the Salima Solar Power Plant, with a total capacity of 50 megawatts divided into three phases (10MW, 10MW, and 30MW), has contributed to this growth, particularly with the successful completion of the initial 10MW phase in July 2024.

Furthermore, the commissioning of the Nkhunzi Bay Scheme by the Southern Region Water Board, along with various ongoing water and sanitation initiatives, has significantly bolstered the industry's growth prospects for 2024. The growth rate for 2025 is projected to reach 5.4 percent, driven by the implementation of major projects such as the 300MW Kam'mwamba Thermal Power Plant and the 50MW Nanjoka Solar Power Plant in Salima, among others.

5. Construction Sector

The growth rate projection for the construction sector in 2024 has been revised upward from 5.3 percent in May 2024 to 5.5 percent in October 2024. This adjustment reflects an increased pace of ongoing construction activities across the country. Notably, there has been a surge in projects such as road construction, the development of learning complexes at public universities, and the establishment of District Council offices

The positive trajectory of the industry is expected to persist into 2025, buoyed by the continuation of these projects during the campaign and election period. The growth forecast for 2025 is set at 6.2 percent, a downward revision from the previous estimate of 7.2 percent. This adjustment is primarily due to ongoing foreign exchange shortages, which negatively impact the sector. Nevertheless, robust growth is anticipated, driven by key projects in the pipeline, including the rehabilitation of the Balaka-Nkhotakota Dwangwa-Nkhata Bay M6 road, the Nsipe-Liwonde road, the Nacala Corridor Project Phase V, and the Southern Africa Trade and Transport Facilitation Project, among others.

However, delayed payments to contractors and the recent increase in tax rates for contractors and subcontractors from 4 percent to 10 percent pose significant risks to cash flow and operational viability. This hike in tax rates is likely to escalate operational costs, reducing profitability for construction firms. It is further assumed that fuel shortages will be curtailed in 2025; otherwise, this could further derail progress of these projects. As contractors may pass these increased costs onto clients, the overall cost of projects could rise, potentially leading to a slowdown in construction activities.

6. Wholesale and Retail Trade Sector

The growth of the wholesale and retail trade sector was revised downwards by 2.5 percentage points, from an estimated 1.0 percent in May 2024 to -1.6 percent in October 2024. This estimate still represents an improvement from the growth of -2.4 percent recorded in 2023. The outcome was due to continued foreign exchange challenges that affected the supply chains of goods and services in the markets. Additionally, the prevailing high inflation during the period led to the erosion of consumers' disposable income, thereby lowering aggregate demand in the sector. However, the industry is expected to grow by 4.7 percent in 2025. This positive outlook is supported by the anticipated moderation of inflation, driven by the expected good performance of the agriculture, manufacturing, mining, and tourism sectors. However, there is a risk regarding the ongoing availability of foreign exchange, as it plays a crucial role in the operations of this sector.

7. Transportation and Storage Services Sector.

The growth outlook for the transportation and storage services sector in 2024 has been revised downward from the 3.2 percent projected in May to 2.8 percent in October, compared to a growth rate of 2.5 percent in 2023. This adjustment is primarily attributed to underwhelming performance in the agriculture, manufacturing, wholesale, and retail trade sectors, which are significant users of transportation services.

On a positive note, the outlook for the industry has improved, largely due to the rehabilitation of railway lines by the Central Eastern African Railway (CEAR), which has significantly enhanced railway services. Looking ahead, the sector is expected to experience robust growth of 6.1 percent in 2025. This anticipated surge is driven by the ongoing road and railway construction and rehabilitation projects, which are expected to improve service delivery. Additionally, the upcoming election period is likely to boost demand for transportation services, further contributing to the industry's growth.

8. Accommodation and Food Services Sector

In 2024, the Accommodation and Food Services sector is expected to grow by 5.9 percent, a downward revision from the previously estimated 6.7 percent in May 2024, but an improvement from the 5.3 percent growth recorded in 2023. This growth is largely fueled by an increase in arts and entertainment activities this year, which has heightened demand for accommodation and dining services. However, the downward revision is attributed to the ongoing high inflation and a decline in recreational activities along the shores of Lake Malawi due to rising water levels. The growth rate for 2025 is projected to be 8.6 percent, driven by anticipated boosts in arts, entertainment, and recreational activities during the upcoming campaign and election period.

9. Financial and Insurance Services Sector

The Financial and Insurance Services sector is projected to grow by 4.4 percent in 2024, an upward revision from the earlier estimate of 4.2 percent made in May 2023. This projection marks a significant increase of 1.3 percentage points compared to the 3.1 percent growth recorded in 2023. The revised forecast for 2024 is largely driven by a surge in demand for products and services within the sector, as indicated by a rise in credit. The public sector's indebtedness to the banking system increased by 30.2 percent, rising from K4.3 trillion at the end of the first quarter of 2024 to K5.6 trillion at the end of October 2024, while credit to the private sector increased by 15.4 percent, from K1.3 trillion at the end of the first quarter of 2024 to K1.5 trillion at the end of October 2024. Furthermore, the growing adoption of digital banking and increased demand for insurance services have positively impacted the industry's performance, contributing to a higher growth rate than the previous year. Looking ahead, the sector's growth is anticipated to accelerate further, reaching 5.5 percent in 2025, a notable upward revision from the previous estimate of 4.5 percent.

C. Agricultural Commodity market

1. Tea Production

In the year under review, tea production saw a notable increase compared to 2023. From January to November 2024, a total of 44,771,344 kilograms of tea was produced, up from 39,324,610 kilograms during the same period in 2023, representing an impressive growth of 13.9 percent. The increase in production is attributed to the favorable rainfall patterns observed between June and August 2024.

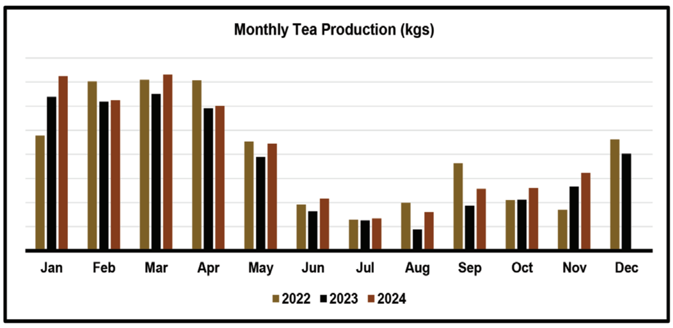


Figure 3: Average monthly tea production (2024 excludes December) source: Tea Association of Malawi

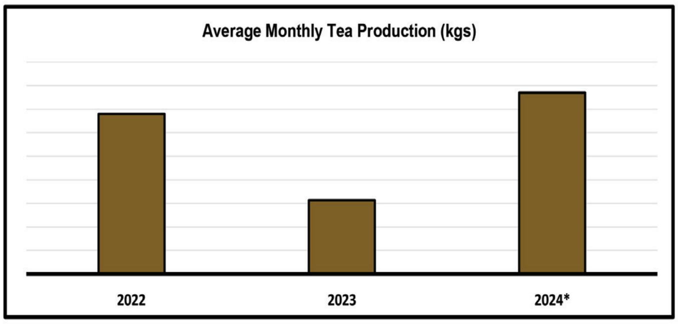


Figure 4: Average monthly tea productivity (2024 excludes December) source: Tea Association of Malawi

2. Tobacco Production and Market

Tobacco markets performed well in 2024 with a total volume of 133.3 million volumes sold marking a 10 percent increase from the previous season. On prices, the market also registered an increase in the average prices to US$2.98/kg from US$2.35/kg recorded in 2023. The increase in both volume and average prices saw an increase in the total earnings to US$396.8 million from the US$283.8 million in 2023. This projected improvement is attributed to increased hectarage due to good prices offered in 2023, an increase in the number of growers, more sponsorship, and better availability of inputs. As of October 18, 2024, with just two weeks remaining in the grower licensing period for the 2024/2025 farming season, licensed tobacco volumes were on an upward trend, bolstering confidence in the country's dedication to meeting market demand. Licensed tobacco volumes reached 223 million kilograms, reflecting a substantial 24.7 percent increase from the 178.9 million kilograms licensed at the same point in the 2023/2024 farming season.

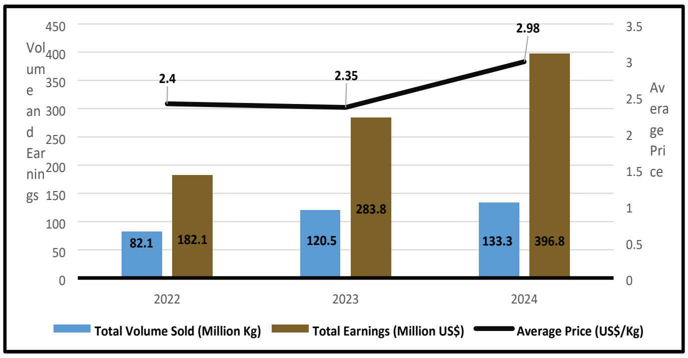


Figure 5: Volume Sold, Total Earnings and Average Prices source: RBM

3. Maize Market

The delayed onset of rains and extended dry spells during the 2023/24 agricultural season, exacerbated by El Niño and rising agricultural input costs, have led to low maize production, resulting in a significant increase in staple food prices in 2024. The Ministry of Agriculture's 2024 Third Round Agriculture Production Estimation Survey (APES) revealed that production of maize, the main staple, was estimated to be 2,926,190 MT, which is a 17 percent decrease from the previous year.

This reduction in productivity necessitated maize imports from neighboring Tanzania, which experienced a surplus due to its relatively mild impact from El Niño. However, high transportation costs and elevated foreign exchange rates on the parallel market significantly increased the landing costs of imported maize, resulting in even higher retail prices in Malawian markets.

Data from the International Food Policy Research Institute (IFPRI) indicates that the average price of maize in 2024 reached MK 769.0 per kilogram (from January to mid December 2024), marking an increase from the 2023 average of MK 633.61 per kilogram. The lowest monthly average prices were recorded in April and May 2024 at MK 592 per kilogram, while the highest monthly average price peaked at MK 930 per kilogram in January 2024. As we went to press the price of maize was at close to MK1000 per kg.

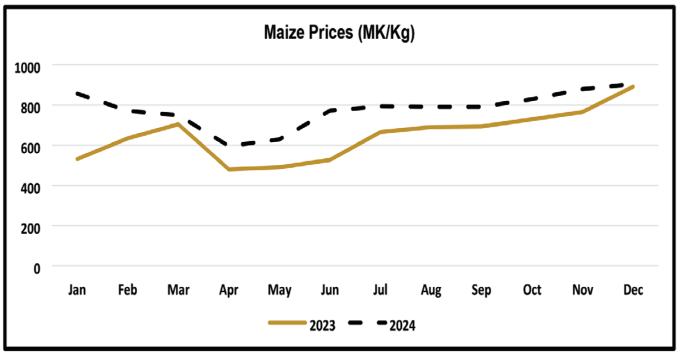
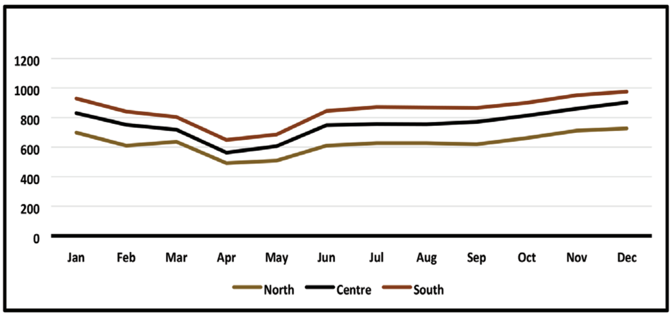


Figure 6: Maize prices in 2023 and 2024
Source: IFPRI

When comparing the three regions, the Southern region recorded the highest average price at MK 837.5 per kilogram, followed by the Central region at MK 744.8 per kilogram, and the Northern region at MK 620.08 per kilogram. This pattern aligns with typical trends, as the Southern region often experiences elevated maize prices due to its increased vulnerability to weather shocks that reduce supply. Additionally, the transportation costs associated with moving maize from the Central region to the Southern region also contribute to the increased prices.



Maize Prices in 2024 in the three Regions (MK/Kg)
Figure 7: Maize prices in the three regions
Source: IFPRI

D. Selected Macroeconomic Indicators

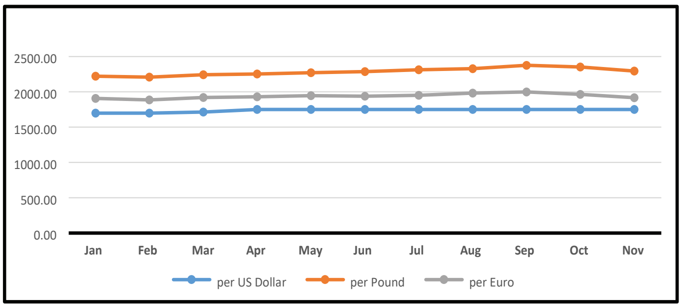
The business environment remains challenging for the private sector, primarily due to significant macroeconomic imbalances driven by low productivity. This persistent low productivity results in diminished revenue, declining exports, negative balance of payment and limited job creation, which in turn heightens the demand for social spending.

Consequently, the economy is caught in a cycle where increased social expenditures coincide with reduced government revenue, complicating the ability of both the government and private sector to fulfill their respective roles effectively.

1. Foreign Exchange Rates

During the review period, Malawi Kwacha experienced relatively stable performance on the official market, particularly against major trading currencies. By the end of November, the kwacha had a monthly average exchange rate of MK1, 750.29 per US Dollar, a slight decline from MK1, 697.82 per Dollar recorded in January 2024, reflecting a devaluation of 3.1 percent against the US Dollar. Concurrently, the Malawi Kwacha also depreciated by 0.6 percent against the Euro and 3.3 percent against the British Pound, closing November at MK1, 916.22 per Euro and MK2, 294.65 per Pound, respectively.

The performance of the Malawi Kwacha against neighboring currencies during the review period was varied. Malawi Kwacha depreciated by 11 percent against the South African Rand, while it experienced slight gains of 0.8 percent against the Zambian Kwacha and 2.5 percent against the Tanzanian Shilling. In the Asian market, Malawi Kwacha appreciated by 2.1 percent against the Japanese Yen, but it weakened against the Chinese Yuan and Indian Rupee, losing 2.5 percent and 1.5 percent, respectively. However, a persistent negative balance of payments places significant pressure on the local currency by increasing demand for foreign exchange to finance imports and service external debt. When a country imports more goods, services, and capital than it exports, the resulting deficit depletes foreign exchange reserves, weakening the currency.

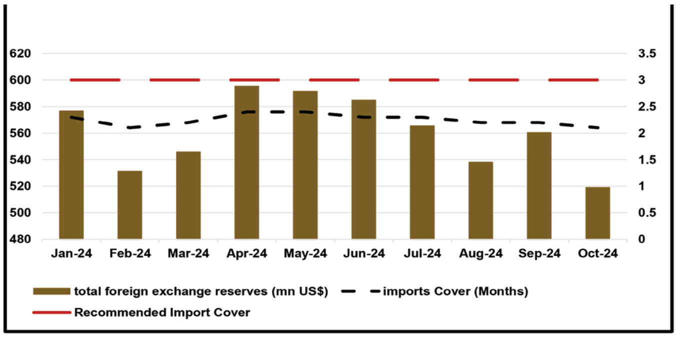


Malawi Kwacha against Major Trading Currencies
Figure 8: Kwacha against major trading Currencies
Source: RBM

2. Foreign Exchange Reserves

Malawi's balance of payments crisis intensified throughout 2024, marked by a severe shortage of foreign exchange. This issue is primarily structural, stemming from a significant mismatch between the country's limited capacity to generate foreign exchange and its overwhelming demand for imports. This supply-demand imbalance became evident in the domestic foreign exchange market in several ways, including businesses' inability to import essential raw materials, a decline in official foreign reserves, and an escalating gap between official and parallel market exchange rates, which peaked at MK3, 000/US$ in December 2024.

The situation continues to deteriorate further in the fourth quarter of 2024, as the country faced challenges in importing fuel, leading to additional disruptions in production and logistics. Throughout the review period, Malawi's foreign exchange reserves consistently fell below the recommended level of three months' import coverage. The highest recorded reserves were US$ 595.2 million in April 2024, sufficient to cover only 2.4 months of imports. Conversely, the lowest reserves were recorded in October, when the total fell to US$ 519 million, providing just 2.1 months of coverage.



Total Reserves (mn US$) and Import Cover (months)
Figure 9: Foreign Exchange Reserves Source: RBM

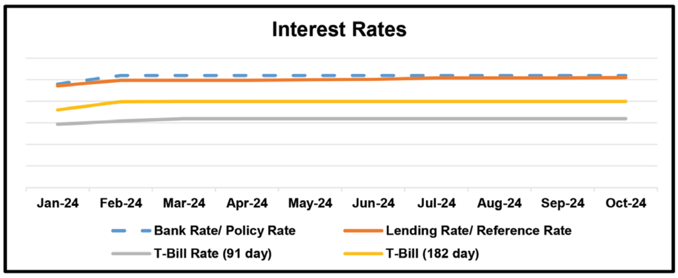


Figure 10: Interest Rates Source: RBM

In February 2024, the Reserve Bank of Malawi (RBM) increased the policy rate by 200 basis points to 26 percent. Concurrently, the Monetary Policy Committee decided to keep the Lombard rate at 20 basis points above the policy rate and maintained the Liquidity Reserve Requirement (LRR) ratio at 7.75 percent for domestic currency deposits and 3.75 percent for foreign currency deposits. This decision was aimed at mitigating second round inflationary effects stemming from the devaluation that occurred in November 2023. Throughout the year, the policy rate remained steady at 26 percent; however, in the fourth quarter, the RBM raised the LRR ratio for domestic currency deposits by 125 basis points to 10 percent.

The elevated interest rates and increased government borrowing continue to burden private sector credit, exacerbating the challenge of securing long-term financing. Despite monetary policy efforts, the impact of the higher policy rates on inflation has been mixed, primarily due to unfavorable fiscal pressures and external factors. While monetary policy has managed to stabilize non-food inflation, it has had little impact on food inflation. Current inflationary pressures are largely driven by food inflation due to poor agricultural productivity, particularly in maize production.

3. Merchandise Trade

Malawi's trade balance remains firmly in the negative, with imports consistently outpacing exports. Over the past several decades, exports as a percentage of GDP have been on a downward trajectory, largely due to a lack of diversification in the export base. Data from the first ten months of 2024 reveals a significant deterioration in the trade balance, which fell to a deficit of US$1.9 billion, compared to a deficit of US$1.4 billion for the entirety of 2023. In response to declining agricultural production levels, the government has implemented a ban on soybean exports to bolster local manufacturing requirements for raw materials. This decision, along with a drop in exports of other commodities, has further exacerbated the trade deficit.

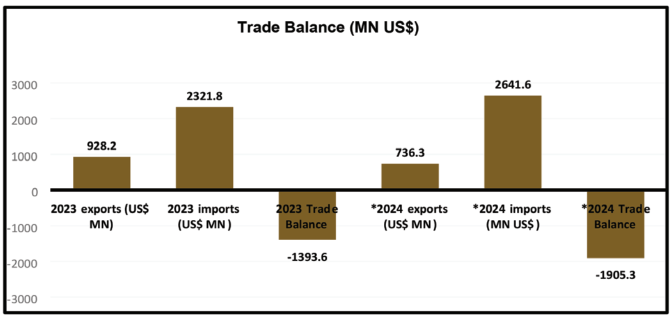


Figure 11: Trade Balance (2020 figure excludes Nov and Dec) Source: RBM

The Government has made strides in facilitating access to markets for Malawian producers at both regional and international levels. This includes agreements under SADC and COMESA protocols, bilateral agreements with the governments of South Korea and bilateral agreements with the People's Republic of China on groundnuts and soybeans. Additionally, Malawi has entered a Simplified Trade Regime with Mozambique, Zambia, and Zimbabwe, signed a Memorandum of Understanding (MoU) with India to facilitate trade in pigeon peas and has also ratified the upcoming African Continental Free Trade Area (AfCFTA), among other agreements.

However, access to these markets is affected by various Non-Tariff Barriers (NTBs). These include stringent import and export controls, compliance with standards and certification requirements, and high transit fees along corridors, such as escort, scanning, and tracking charges. Recent unrest in Mozambique has further impacted the smooth transportation of exports to the port, posing additional challenges to market access.

4. Inflation Rate

The rising fiscal deficit, coupled with supply-side challenges resulting from a poor agricultural harvest, is intensifying inflationary pressures. Following a sharp increase in inflation after the November 2023 devaluation, the rate has consistently exceeded 30 percent, with food inflation averaging a staggering 40 percent in 2024. From January to November 2024, the average headline inflation rate stood at 32.7 percent, significantly higher than the annual average of 28.8 percent recorded in 2023.

In response to soaring inflation, the government has primarily leaned on tightening monetary policy. However, the effectiveness of higher policy rates in curbing inflation has been mixed due to persistent fiscal pressures and external factors. Given that the inflationary pressures are largely driven by inadequate agricultural productivity particularly in maize, a more integrated approach combining monetary policy, fiscal measures, and supply-side initiatives, such as winter cropping, would likely have yielded better results.

In 2024, inflation peaked at 35.0 percent in January, marking the highest level since April

2013, before gradually declining to 27 percent in November 2024, the lowest since March 2024. This decline in November can be largely attributed to government efforts to alleviate food shortages through the distribution of maize to affected households. However, inflation is expected to remain elevated until food supply issues are fully resolved in the upcoming 2024/2025 harvest season.

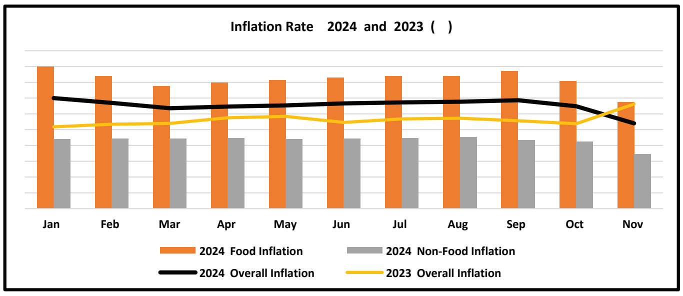


Figure 12: Inflation Rate Source: RBM

E. Forecast into 2025

The Ministry of Finance and Economic Planning projects a real economic growth rate of 4.0 percent for 2025, primarily driven by anticipated improvements in agricultural output during the 2024/25 growing season. However, this optimistic outlook is not without its challenges, as several potential risks could impact economic performance in 2025.

The 2024/25 agricultural season has begun on a challenging note, with many districts experiencing rainfall levels that fall short of expectations. Furthermore, inefficiencies in the Affordable Input Programme (AIP) are likely to further hinder agricultural productivity due to the challenges posed by foreign exchange scarcity in importing farm inputs.

As Malawi approaches its general election, the potential for political instability remains significant. Should disruptions occur, there is a substantial risk of economic activities being adversely affected.

Inflation in 2025 is expected to remain elevated due to anticipated increases in government social spending as we approach the election cycle.

In 2024, discussions emerged regarding the potential review of rising fuel prices to better align them with the actual costs of petroleum products. This consideration is expected to remain a significant focus in 2025. The positive impact of aligning fuel prices with the actual costs of petroleum products includes reducing the financial burden on governments caused by subsidies. However, this consideration is likely to exert upward pressure on inflation, as adjustments in fuel prices directly affect transportation, production costs, and the overall cost of goods and services.

On a global scale, several political tensions, including the ongoing war in Ukraine and conflicts in Israel, pose significant risks to the energy sector and could disrupt the logistics supply chain.

The ongoing forex shortage will likely remain an impediment in 2025, especially with the new gazetted Supplementary Exchange Control Regulations for public institutions which now mandates them to keep their forex with RBM rather than commercial banks. The regulation requires public institutions to hold foreign currency reserves at the Reserve Bank of Malawi (RBM), with mandatory conversion of 80 percentage into Malawi kwacha. Further, the regulation mandates Commercial Banks to convert, within 48 hours, 70 percent of NGOs foreign exchange inflows and immediately transfer the same to RBM. This will reduce the volume of forex circulating in commercial banks, making it harder for private businesses to access the forex they need for imports or international transactions there by reducing economic activities.

Given the economic challenges in recent years and the persistent risks and shocks, Malawi's vulnerability remains high, and achieving economic stability will likely take longer than anticipated. However, 2025 presents an opportunity for businesses to transform the economic landscape by building enterprises that are not only resilient but also anti-fragile, capable of thriving amidst disruptions. It is crucial for the Private Sector to focus on creating much-needed forex and fostering robust domestic supply chains to reduce the import bill.

Despite the myriad of challenges, businesses must prioritize innovation and embrace digitalization to enhance competitiveness for both export markets and import substitution. With the changing trade landscape ushered in by the African Continental Free Trade Area (AFCFTA), there is a pressing need to seize these new opportunities to expand market access, boost exports, and integrate into regional value chains. By doing so, businesses can drive growth and contribute to a more stable and self-sufficient economy.

F. Areas to consider for Private Sector Growth

The government should consider reviewing certain tax policies to create a more conducive environment for private sector growth and investment. For example, the introduction of a 10 percent corporate income tax surcharge on profits exceeding MK10 billion, as outlined in the 2024/2025 budget, could have unintended consequences. While it aims to increase revenue collection, such a policy risks discouraging investment, particularly from large corporations that play a crucial role in driving economic growth, job creation, and innovation. High tax burdens on profits may reduce the attractiveness of Malawi as an investment destination, prompting companies to either relocate operations to more tax-friendly jurisdictions or limit expansion plans. To foster a vibrant private sector, the government could explore alternative strategies, such as incentivizing reinvestment of profits into the local economy, offering tax breaks for specific growth sectors, or implementing a more progressive tax structure that balances revenue needs with the goal of stimulating private sector development.

There is a critical need to establish a structured mechanism for prioritizing the allocation of limited foreign exchange to forex-generating sectors to maximize their production capacity and export potential. While ensuring adequate foreign exchange for essential public sector imports, such as medicine and fuel, remains vital, it is equally important to prioritize forex-generating industries, such as agriculture, manufacturing, and mining. Allocating forex to these sectors will enable them to procure necessary inputs, maintain operations, and expand production, ultimately increasing exports and boosting forex inflows.

In addition, a targeted approach could involve identifying high-potential industries and businesses that demonstrate significant capacity to generate forex and providing them with prioritized access. This strategy would not only address the current forex shortage but also create a multiplier effect by enhancing production, creating jobs, and fostering economic growth.

Effective implementation of policies in the agriculture sector, such as the National Agriculture Policy (NAP II) and the National Irrigation Policy, is critical to enhancing agricultural productivity and building resilience against the vulnerabilities of traditional rain-fed agriculture, especially in the face of climate change. These policies are designed to promote sustainable practices, improve irrigation infrastructure, and encourage the adoption of climate-smart technologies. However, successful implementation will require robust coordination among stakeholders, including government agencies, private sector actors, and local communities.

Key steps include ensuring adequate funding, building technical capacity, and providing timely access to inputs such as seeds, fertilizers, and irrigation equipment. Additionally, regular monitoring and evaluation of policy outcomes are necessary to identify challenges and make data-driven adjustments.

Addressing the fiscal deficit is a crucial step toward achieving economic recovery and stability. One effective approach is to formulate a budget that aligns closely with actual revenue collection, thereby minimizing reliance on borrowing to finance expenditures. By narrowing the fiscal deficit, the government can reduce its dependence on domestic borrowing, which often crowds out the private sector's access to credit. This would create more opportunities for private businesses to obtain affordable financing, enabling them to invest, expand, and drive economic growth.

Furthermore, reducing the fiscal deficit would ease inflationary pressures, as excessive government borrowing can lead to an oversupply of money in the economy, driving up prices.

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