



**Economic Review
22 June 2005
Decision Time for the National Assembly**

The 2005/06 budget is currently being debated in the National Assembly. The future social and economic welfare of the nation hinges on whether this budget is passed without substantive amendment or delay. A budget acceptable to the IMF must be approved in good time to enable the IMF board meeting of 18 July 2005 to consider resumption of a formal PRGF facility. Failing that, something approaching a complete economic meltdown is inevitable and the kwacha can be expected to go into free fall and interest rates can be expected to soar back to historic levels. The social consequences of such economic chaos occurring at a time when the country faces a significant food deficit cannot be underestimated.

Now is the time for statesmanship, not political point scoring. The most vulnerable of our society are potentially the innocent victims to be sacrificed on the altar of our politicians' egos.

The 2005/2006 Budget Statement

Like the curate's egg it was good in parts:

- The fiscal out-turn for 2004/2005 was commendable given the immense domestic debt stock inherited as a result of the wanton over-expenditure of the previous government. One need only compare the 2004/2005 domestic interest bill of K16 billion with the 2004/2005 deficit of K8 billion. In very simplistic terms, had government borrowing not doubled over the period January 2003 to June 2004, government would now be living within its means.
- Looking forward, the 2005/2006 budget estimates a further reduction in the fiscal deficit to K2.6 billion or 1% of GDP. This projection is, however, predicated on an ambitious K12 billion or 22% forecast increase in domestic revenues and the receipt of grants of K50 billion (2004/05 K30 billion).

Without doubt, allocations to individual expenditure votes can and will be criticized as excessive or disproportionate but it is encouraging to see the proposed increased allocations to key sectors including health, education and agriculture.

- It is worrying to note that, in addition to the official domestic debt stock, government had built up arrears or unpaid bills in excess of K10 billion by 30 June 2004. It is also of concern that the current government's commitment to good governance does not include a commitment to settle these arrears immediately. It is proposed that some K8 billion will be deferred for payment until at least beyond 2006. Although these bills were incurred by a previous government, failure to pay constitutes an unauthorized expropriation of the rightful assets of citizens. Even the undoubtedly significant utility bills arrears due to parastatals result in increased costs for private sector consumers. As a minimum these arrears should be substituted by interest bearing and tradable official debt instruments.
- Certain fiscal measures including individual tax rate reductions are welcome. Less welcome will be the somewhat opaque interest income deeming provisions and the punitive changes to the capital gains tax legislation. The latter, being a wholly reprehensible tax on inflation, seems to be at direct variance with the numerous references in the Minister's speech to the need to increase domestic savings/capital. In the same vein, the tinkering with the basis of taxation of pension funds and pension income will do little to encourage savings by way of pension plans.

An economy at the cross roads

The government has demonstrated a commitment to fiscal discipline and good governance and gone a considerable way towards restoring donor and private sector confidence in Malawi. The final piece in the jigsaw is the 2005/2006 budget which will provide the framework for a resumed PRGF facility unlocking in turn enhanced levels of multilateral and bi-lateral support.

There is no escaping the current parlous condition of the economy

- Malawi's foreign exchange reserves are virtually depleted and there is a significant pipeline of unpaid foreign remittances. Current forex inflows are insufficient to meet demand, despite now being the peak tobacco selling season. The supply and demand equation cannot be ignored for much longer and, without an alternative source of forex in the form of balance of payments support, the value of the kwacha will plummet. Government is relying on grants to fund 40% of its proposed expenditure for 2005/2006. If these grants are not forthcoming, the alternatives are to reduce expenditure or to raise further domestic debt.

The former option would likely see an impairment in the level of basic services that Government can afford its citizens and the latter option puts the Government back in the vicious circle of spiraling domestic debt and debt service costs from which it desperately needs to escape. Interest rates could also be expected to rise once again.

- The country's maize import requirements are not as yet fully funded by the donor community. Government may require significant sums of money, a considerable portion of which will be foreign exchange in order to fund the shortfall. Additionally, if the private sector is expected to participate in the importation and distribution of maize on a commercial basis it will require access to foreign exchange which is not available at present.
- Private sector investors and potential investors in Malawi are extremely nervous over the outcome of the budget debate as they are fully aware of its critical importance to the economy. Investment decisions are being postponed and defensive strategies adopted which does not bode well for short term economic growth prospects. A speedy resolution of the uncertainty is required.

Frankly, there is no solution to the problems facing the nation other than a resumption of the PRGF facility in the very near term. In turn this appears to be dependent on the outcome of the budget debate. There is an imminent danger of an economic collapse and, unfortunately, there is no longer a window for prolonged debate and horse-trading.

Let us hope that the honourable members of the National Assembly recognize the national economic imperatives ahead of their individual or collective political imperatives and engage in reasoned and constructive debate that results in an approved budget in the interests of all Malawi citizens irrespective of political allegiance. In this process the executive wing of Government must also exhibit tolerance and a willingness to modify its budget proposals in light of any justified and practicable amendments put forward by the National Assembly.

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