The economy performed robustly in 2017, growing at 5.1% following an above average harvest. Services performed well; wholesale and retail in particular showed strong growth, driven by a stable kwacha and single-digit inflation. The short-term outlook is slightly less positive. Growth is projected to be 3.3% in 2018, reflecting a projected decline in agricultural production. For 2019, growth of 4.8% is projected, mainly driven by a rebound of agricultural output due to weather conditions that are expected to improve.

The Government was able to stabilize and reduce the fiscal deficit in 2016/17 with spending cuts. However, the deficit for 2017/18 is estimated to have widened as revenues have underperformed while unplanned spending increased.

Malawi continues to face large infrastructure deficits. This is most evident in the power sector which is highly dependent on hydro from the Shire River. Industry and commerce are both affected by power cuts, which curtail growth potential.

OVERVIEW

In recent years, Malawi’s economy has been adversely affected by the 2012 ‘Cashgate’ scandal, floods in 2014, a drought in 2015 and 2016 induced by El Nino that affected agricultural production and left millions of Malawians food insecure, and significant electricity supply deficits that have curtailed industrial production and increased macro-economic instability. In 2017, the harvest was good. Maize production was sufficient to meet domestic food needs, while a good tobacco harvest earned the country critical foreign exchange. Following a two year extension, the Stabilization Programme supported by the International Monetary Fund (IMF) had achieved its objectives: the currency had stabilized and inflation had returned to single digits. Economic growth of 5.1% was driven largely by strong agriculture growth of 6%. The services sector grew at 5.5%; wholesale trade and retail trade were both key drivers of growth.

The authorities maintained a tighter stance on fiscal policy and the deficit fell to 5.6% in 2016/17 compared to 6.8% in 2015/16. For 2017/18, the fiscal target is 3.9%, but slippages in the first half of the year will be difficult to reverse in the second half. Revenue in the first half of 2017/18 was lower than foreseen and this, combined with spending slippages, means that the fiscal deficit is expected to rise to 5%.

The Central Bank pursued a tight monetary policy into the beginning of 2017 but, motivated by positive macroeconomic indicators and declining inflation, it loosened its monetary policy stance during the year. Price pressures moderated throughout 2017 leading to further loosening. The policy rate had been adjusted downward by 8 percentage points to 16% by the end of 2017.

In 2018, GDP growth of 3.3% is projected, slightly lower than in 2017 because a prolonged dry spell in January affected large parts of the central and southern areas. The harvest is expected to be lower than in 2017. The kwacha (MWK) should remain stable, which will keep import prices steady, although some inflationary pressure is expected as a result of rising food prices. For 2019, growth is projected at 4.8%, mainly driven by a rebound in agricultural output due to weather conditions that are expected to improve.
RECENT DEVELOPMENTS AND PROSPECTS

In 2016, Malawi’s economy was affected by drought, electricity supply deficits, and macro-economic instability. About 31% of cultivated land was affected by the drought, creating food insecurity for more than six million people. Although tobacco production performed better, auction prices declined due to oversupply on the non-contract tobacco market. The combined effect of weather shocks and low commodity prices dampened business and consumer confidence. Consequently, real GDP growth remained subdued in 2016. Improved weather conditions and a good rainy season in 2017 revived the economy, generating a strong increase in agricultural production which substantially improved overall growth. Good performance in the wholesale and retail trade, financial and insurance services, and real estate services also helped growth in 2017. These sectors will remain key drivers of growth in the economy.

The Central Bank started to ease monetary policy in the last quarter of 2016 and throughout 2017, fortified by improving macro-economic indicators. Inflation continued to fall, thanks to tight monetary policy from 2015 into most of 2016, supported by fiscal consolidation and improvements in food production that will keep prices stable. The kwacha was stable, helped by liquidity tightening, which contributed to a fall in non-food inflation. Headline inflation fell to 7.1% (year on year) in December 2017, compared to headline inflation of 20% (year on year) one year earlier. In November 2016, the Central Bank of Malawi reduced the policy rate by 3 percentage points to 24% and made further gradual reductions during 2017. The latest reduction in December 2017 reduced the rate to 16%. As of January 2018, the consumer price basket was amended to reduce the overemphasis on food. The financial sector remained stable and well capitalized, though credit risks remain high because non-performing loans (NPL) are above the industry benchmark and credit is concentrated in two banks.

Fiscal consolidation was initiated in 2016/17, reducing the deficit by more than one percentage point. In 2015/16, expenditures increased in the context of the food crisis while revenues remained unchanged from the year before. The Government reduced subsidies, wages and arrears in 2016/17, diminishing overall expenditure. In addition, due to improvements in the overall economy, domestic tax revenues rose, reducing the deficit. The fiscal target for 2017/18 is 3.9% of GDP, but it is unlikely to be achieved after revenue targets slipped and the Agriculture Development and Marketing Corporation (ADMARC) required bailing out in the first half of the financial year. In the medium term, as the elections in 2019 approach, there is a risk of fiscal slippage.

Malawi expanded its debt rapidly up to 2015. Its external debt-to-GDP ratio rose from 20.1% in 2012 to 37.3% in 2015, easing in 2016 and reaching 32.6% in 2017. Domestic debt also rose significantly, from 13.8% in 2012 to 22.6% in 2017. The increase in borrowing was an effect of the “Cashgate” scandal, which reduced grant financing by development partners. Overall debt levels stabilized from 2015. In 2017, overall debt was estimated to have reached 55.1% of GDP (from 54.4% in 2016), driven by an increase in domestic debt. The IMF Extended Credit Facility (ECF), extended for a further two years in 2015, underpinned macroeconomic stability and slowed and eventually reduced external debt. The Government has agreed a new three year IMF programme to underpin the macroeconomic fundamentals. Although debt has stabilized, Malawi remains at moderate risk of debt distress. In the medium term, debt ratios are projected to decline steadily as the pace of fiscal consolidation increases and debt management capacity improves further.

### Table 1. Macroeconomic indicators

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017(e)</th>
<th>2018(p)</th>
<th>2019(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>2.3</td>
<td>5.1</td>
<td>3.3</td>
<td>4.8</td>
</tr>
<tr>
<td>Real GDP per capita growth</td>
<td>-0.8</td>
<td>1.9</td>
<td>0.2</td>
<td>1.7</td>
</tr>
<tr>
<td>CPI inflation</td>
<td>21.7</td>
<td>12.2</td>
<td>8.3</td>
<td>7.8</td>
</tr>
<tr>
<td>Budget balance (% of GDP)</td>
<td>-6.8</td>
<td>-5.6</td>
<td>-4.9</td>
<td>-4.1</td>
</tr>
<tr>
<td>Current account (% of GDP)</td>
<td>-13.5</td>
<td>-10.5</td>
<td>-9.0</td>
<td>-8.6</td>
</tr>
</tbody>
</table>

Note. The budget balance (on a commitment basis) showed a decrease in 2016 and 2017. The relatively large cash deficit was due to repayment of arrears from previous years.

Source. Data from domestic authorities; estimates (e) and predictions (p) are based on the authors’ calculations.
The external sector deteriorated between 2014 and 2016 after exports declined and imports increased as a result of the food crisis in 2016. The current account deficit increased from 8.5% of GDP to 9.4% in 2015, mainly due to declining tobacco exports. In 2016, the deficit increased significantly, driven by maize imports to fill gaps in domestic production. The deficit increased to 13.5% of GDP. The stabilization of the economy and improved production in 2017 led to a reduction in the current account. Stronger exports further supported an increase in gross international reserves, which increased import cover from 2.9 months in December 2016 to 3.6 months in December 2017. The Government supports growth through infrastructure and social programmes. These programmes underpin investment and consumption spending. The Government also has plans to continue to improve the business environment now that macroeconomic stability has been achieved, which will bring confidence to the economy and attract foreign direct investment. The importance of unlocking the private sector cannot be stressed enough. It is vital to attract investors to increase domestic investments and create jobs. Diversifying the economy will be a critical factor in reducing fragility and improving resilience to weather-induced shocks.

The outlook in the medium term looks positive, assuming that macroeconomic stability can be maintained. The run-up to the 2019 elections may cause investors to wait for the result before returning more strongly to the market. On the domestic front, macroeconomic risks to financial stability remain. Assuming that macroeconomic stability is maintained, interest rates are expected to continue to decline. Private sector lending should start to rebound as commercial lending rates fall, crowding out subsidies. Weather shocks remain an unpredictable factor and a critical source of vulnerability for the economy, which remains highly dependent on rain-fed agriculture and on hydro-generation for electricity supply. Growth is projected to be just short of 5% in the medium term.

In the near term, a prolonged dry spell occurred in the early part of the 2018 agricultural season which affected 270 000 hectares of land planted to maize. The Government has estimated that 210 000 tons of maize will be lost as a result. In addition, the fall armyworm (FAW) returned this year, causing losses of up to 100 000 tons according to the Ministry of Agriculture. Based on initial projections, it is estimated that production may fall by 8% to 12% compared to the harvest in 2017. Lower crop production is likely to increase food insecurity, particularly in the southern region. Estimates indicate that up to 130 000 households are vulnerable to food insecurity.

### TABLE 2. GDP by sector (percentage of GDP)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2011</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, fishing and hunting</td>
<td>31.2</td>
<td>30.2</td>
</tr>
<tr>
<td>of which fishing</td>
<td>1.6</td>
<td>1.1</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>1.1</td>
<td>0.9</td>
</tr>
<tr>
<td>of which oil</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>10.9</td>
<td>10.1</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>1.5</td>
<td>1.3</td>
</tr>
<tr>
<td>Construction</td>
<td>3.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of vehicles; household goods; restaurants and hotels</td>
<td>19.9</td>
<td>19.3</td>
</tr>
<tr>
<td>of which restaurants and hotels</td>
<td>1.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>6.5</td>
<td>7.6</td>
</tr>
<tr>
<td>Finance, real estate and business services</td>
<td>13.5</td>
<td>14.1</td>
</tr>
<tr>
<td>Public administration and defence, security</td>
<td>3.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Other services</td>
<td>8.7</td>
<td>11.3</td>
</tr>
<tr>
<td>Gross domestic product at basic prices / factor cost</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Data from domestic authorities.
MACROECONOMIC POLICY

Fiscal policy
Following a challenging period of high expenditure, caused by extraordinary food imports in 2014/15 and 2015/16, the Ministry of Finance with support from the IMF was able to moderate fiscal spending during 2016/17 while development partners maintained a reasonable level of grant aid. The good agricultural harvest reduced the need to import food to support vulnerable groups. The Government has maintained its infrastructure investments at an average 5% of GDP for the last four years. These investments are largely driven by development partners who have financed more than 80% of development needs. The fiscal deficit was reduced from 6.8% in 2015/16 to 5.6% of GDP in 2016/17. The lower deficit was made possible by lower recurrent spending, especially on subsidies and transfers, and a fall in arrears payments, improving the balance by 2.6% of GDP. This benefit was partially offset by domestic interest payments and goods and services which increased by 1.4%. The overall effect was an improvement in the fiscal balance of more than 1%.

Based on performance in the first half of 2017/18, the fiscal deficit is projected to miss the Government target of 3.9% of GDP. This is due to a combination of lower revenue collection and higher spending. The Government was obliged to bail out ADMARC because it was not able to service its commercial loans due to lower maize sales than expected. Tax revenues also fell short of their targets, in part because power outages hampered non-agricultural production, reducing economic activity.

Revenues are skewed towards income taxes, taxes on profits, and taxes on goods and services. These taxes alone account for 82% of revenues, while non-tax revenues account for 9% and trade taxes for 8%. The tax base is fairly narrow; less than 10% of the labour force works in formal tax-paying employment. The tax authorities will seek to broaden the tax base to ensure that public services can continue to be expanded.

Going forward, it will be important for the Government to remain disciplined on fiscal spending while strengthening revenue generation. Spending can be adjusted in the short term; initiatives to strengthen revenue generation will take longer to implement. To build confidence in the budget process and to improve the medium term fiscal framework, the Government has stated that it will strengthen transparency. To avoid overruns on spending, the Government will also need to continue to implement its reforms of cash management and control procedures.

Monetary policy
A rapid increase in inflation, which started in 2012, led the monetary authorities to pursue a tighter monetary policy. In the last four years the Reserve Bank of Malawi (RBM) managed to stabilize the exchange rate and bring inflation under control; inflation has returned to single figures. Starting in 2016 inflation was gradually curbed by tight monetary policy while an adequate food supply, sufficient to meet local demand, dampened price adjustments. Stabilization of the domestic currency on the back of liquidity tightening also contributed to a decline in non-food inflation. Headline inflation fell to 7.1% in December 2017 (20.0%...
one year earlier). Food inflation, in particular, declined from 24.4% in December 2016 to 4.3% in December 2017. Non-food inflation fell from 15.4% to 10.0% over the same period.

In 2017, the Central Bank reduced the policy rate several times in response to falling inflation and the improved macroeconomic environment. From March 2017, the RBM progressively reduced the policy rate, initially by 2 percentage points (from 24%), then by 4 percentage points in July, and finally by a further 2 percentage points in December 2017 (to 16%). Loosening the policy rate will have a positive effect on domestic consumption, as a result of increased short-term borrowing, and on investment once the base lending rate has fully adjusted. In the meantime, real interest rates remain high.

Average yields on treasury bills declined from 28% in 2016 to 20% in 2017 and are expected to decline further in 2018. Currently, the average yield rates on treasury bills (at 15%) will ease the Government’s domestic debt servicing burden. In an attempt to lower longer-term interest rates, the RBM issued a three year treasury note with a coupon rate of 11% in February 2018. Although it was oversubscribed, there were no successful bids as the bids came in at 20%, indicating that investors still see significant market risk.

Despite declining inflation and a more balanced budget, average commercial lending rates have remained high (at 30%), stifling borrowing for long term capital projects. Lending rates are expected to ease in the medium term, as a result of single digit inflation and lower returns on treasury bills. The spread between the base lending rate and three month deposit rate declined from 27.5% at its peak (in December 2014) to 17.8% at the end of 2017. Economic co-operation, regional integration and trade

In 2014, the current account deficit deteriorated, widening from 8.5% to 9.4% of GDP in one year, due to lower export revenues from tobacco. The current account deficit deteriorated further in 2016 (to 13.5% of GDP), reflecting the effect of maize imports and weak export growth. With an improved macro outlook, the current account is expected to strengthen; a deficit of 10.5% of GDP is estimated for the end of 2017. At that date, official foreign reserves stood at USD 545 million, equivalent to 3.6 months import cover, up from USD 439 million a year earlier. Import cover is expected to remain between 3 and 4 months in the medium term.

Malawi is a signatory to multilateral trade agreements of both the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC), and is also a signatory to the African Free Trade Zone of countries in the East African Community. Within the Southern African region, Malawi has signed bilateral trade agreements with South Africa, Zimbabwe, Botswana, and Mozambique. In the context of establishing a one stop border between Zambia and Malawi, in 2017, the two Governments signed a memorandum of understanding to start negotiations on establishing a bilateral trade agreement. These negotiations are expected to conclude in 2018.

Outside the region, Malawi has bilateral trade agreements under the Cotonou agreement and the African Growth and Opportunity Act. Bilateral agreements with India, Malaysia, and China have also been established.

<table>
<thead>
<tr>
<th>TABLE 4. Current account (percentage of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td>Trade balance</td>
</tr>
<tr>
<td>Export of goods (f.o.b)</td>
</tr>
<tr>
<td>Import of goods (f.o.b)</td>
</tr>
<tr>
<td>Services</td>
</tr>
<tr>
<td>Factor income</td>
</tr>
<tr>
<td>Current transfers</td>
</tr>
<tr>
<td>Current account balance</td>
</tr>
</tbody>
</table>

Source: Data from domestic authorities; estimates (e) and predictions (p) are based on the authors’ calculations.
Debt policy
Since 2006, following debt relief, public and publicly guaranteed debt has increased substantially. Between 2012 and 2017 total public debt increased from 33.9% to 55.1% of GDP. Despite its relatively high levels of debt, the IMF has classified Malawi as in moderate risk of debt distress, since all its baseline external debt burden indicators are below indicative thresholds. The rise in debt was driven by external debt uptake which increased from 20.1% of GDP in 2012 to 32.6% in 2017. Between 2015 and 2017, the Ministry of Finance, in the context of the Stabilisation Programme, successfully slowed the uptake of new external debt. External debt is predicted to remain at 32% of GDP at the end of 2018. Domestic debt also rose until 2017. In 2013, domestic debt stood at 13.8% of GDP. Food shortages in 2015, and 2016 made significant food imports necessary, while growing domestic investments in infrastructure expanded domestic debt. Domestic borrowing had risen to 21.2% of GDP by 2016 and rose further to 22.6% in 2017. Domestic debt is projected to ease in 2018, following a fall in the need for funding. In terms of interest payments, 92% of debt servicing is to meet domestic debt. With falling interest rates on Government securities, interest payments are expected to moderate in the medium term.

In the medium term, debt levels are expected to moderate, because Government borrowing will be limited under the 2018-2021 Stabilisation Programme agreed with the IMF. The IMF expects that debt will fall to 54.4% of GDP by 2019. The decline will be driven by expected higher economic growth. However, in the medium term, debt accumulation will remain vulnerable to shocks that affect export revenues and the exchange rate. In an effort to reduce roll-over risk, the RBM issued a three year treasury note in February 2018. It attracted considerable investor interest and was significantly oversubscribed. As average yields exceeded the coupon rate of 11%, however, the RBM closed the auction with no successful bids. The auction will be reopened at a later date.

The Central Bank has improved its in-house capacity to forecast and do policy analysis. The aim is to implement an inflation-targeting regime in the medium term. The Bank has also strengthened its communication with stakeholders in the financial and productive sectors. It briefs the media regularly to increase transparency and inform the public about its monetary policy decisions. Over time these initiatives will improve the credibility of the Bank and its policies, making it easier to manage inflation expectations.

ECONOMIC AND POLITICAL GOVERNANCE

Private sector
The performance of Malawi’s private sector has been improving since 2014, when the World Bank’s Doing Business ranked it 171 out of 190 countries. Since 2014, Malawi has implemented reforms to improve private sector development. In the 2018 Doing Business, Malawi improved its position to 110 (of 190 countries). Recent improvements in the macro-economic environment, including lowered inflation and exchange rate stability, will help to attract potential investors. Foreign direct investment (FDI) reached USD 600 million in 2014 but fell back to 288 million in 2015 because exchange rates were volatile and inflation was high. The stability of the kwacha in 2016 provided some encouragement to investors and FDI rose somewhat to USD 326 million.

In 2017, Malawi implemented several business reforms. It reduced the price of construction permits charged by city councils. In the financial sector, it improved access to credit, by adopting clear priority rules in bankruptcy procedures and establishing a new credit bureau to provide credit information. In addition, the authorities improved resolution of insolvency by introducing regulations for insolvency practitioners and a procedure that makes it easier for a debtor’s business to continue trading during insolvency proceedings. Finally, Malawi’s web-based customs data management platform was upgraded to facilitate trade across borders. These reforms complemented reforms in 2016 that strengthened investor protection. Minority shareholder rights were also improved by clarifying ownership and control structures; and subsidiary companies were prohibited from acquiring shares issued by their parent companies.

Although Malawi has over one million single-person businesses, entrepreneurship is an emerging area. The Global Entrepreneurship Index ranked Malawi 133 (out of 137 countries) with a score of 12.3 (out of 100). Malawi is in the absolute low end of factor-driven economies, followed by Burundi, Mauritania, and Chad on the African continent.

The private sector reforms that have been introduced, combined with a more stable macroeconomic environment, should cause investors to return to the market. However, corruption, inadequate access to finance, and high tax rates remain the three principal constraints affecting business.
Financial sector
The financial and insurance services sector in Malawi is developing, but remains relatively small, accounting for 5.3% of GDP. By contrast, real estate services account for 7.5% of GDP. The financial sector is stable and well capitalized, though credit risks have been aggravated by the high cost of borrowing and credit concentration. According to the latest financial stability assessment, commercial banks have adequate liquidity and are profitable at aggregate level. Capital adequacy ratios are all above the minimum benchmarks. However, a deeper look at the sector reveals several shortcomings, especially asset quality which continues to breach benchmarks. At the end of December 2017, 15.7% of all loans were non-performing (NPLs), an improvement on December 2016 (when the proportion was 17%).

The commercial banking sector remains highly concentrated: 51% of assets are held by two banks. Despite asset concentration the banking sector remained resilient to both domestic and external shocks during 2017. Credit risk sector concentration is a concern in the wholesale and retail trade sector, which holds 25.5% of loans; agriculture holds 20.2% and manufacturing 18.8%. Stress tests revealed that credit and liquidity shocks caused by growing NPLs would principally affect lenders in these three sectors. In addition, four banks out of ten would fail the regulatory capitalization benchmark in a moderate shock, and six in a major shock. Tests to assess the concentration risk to individual borrowers indicated that a default of the top five lenders would push the capital ratio below the benchmark level; only one bank passed the test. It should be noted that a few banks strongly influenced the overall results; the majority of banks failed the various stress tests.

The microfinance industry provides borrowing opportunities for those who are not able to access the commercial banking sector. The sector grew its asset base from MWK 28.8 billion in 2016 to MWK 35.3 billion in 2017, though this still represents less than 2.3% of commercial bank assets. Microfinance was able to make profits while liquidity levels remained above benchmarks. Microfinance NPLs remained above benchmark levels.

The pension system in Malawi remains generally sound. The major challenge is the build-up of contributors’ arrears. Between September 2016 and December 2018, arrears increased by MWK 6.7 billion to MWK 9.8 billion.

Public sector management, institutions and reforms
The Government established a Public Service Reform Management unit in 2007, a permanent structure to oversee reforms in the public service. The ‘Cashgate’ scandal marked a major setback in governance and revealed underlying weaknesses in public financial management. Following the election of President Mutharika in 2014, the Government increased its reform effort by establishing the Public Service Reform Commission. Its objective was to identify and recommend ways and means to improve the efficiency and effectiveness of public services and so raise the quality of services delivered to the public. Key areas of focus included improving accountability systems, increasing transparency, and reforms to strengthen the public financial management system.

In 2017, Parliament approved the Financial Crimes Bill, which addressed corruption, money laundering and other financial related crimes, and the Public Procurement and Disposal of Assets Bill, which increased the transparency and accountability of public procurement. A Public Audit Bill, enhancing the independence of the Auditor General, has not yet been enacted. The Government has established a National Planning Commission (created by Parliament in 2018) to facilitate development initiatives in the country. The Commission will be responsible for formulating medium- and long-term development strategies for Malawi and co-ordinating their implementation. Reforms are also under way to strengthen the electoral process ahead of the 2019 tri-partite elections, including legislation on political party financing.

Natural resource management and the environment
Malawi is endowed with considerable renewable and non-renewable resources, including minerals and forestry products. A major resource is Lake Malawi, which provides drinking water, water for agriculture, and fish. The climate changes that are affecting the southern Africa region are also having effects on the lake. The drought in 2016 and a prolonged dry spell in January 2018 reduced lake levels, particularly affecting Malawi’s electricity production which is 95% hydro-based on the Shire River.

A strategy is required to manage the impact of a larger human population on the country’s natural resources. The population is growing at a rate of 2.9% per year, implying a doubling of the population every 24 years. The combination of demographic growth and climate change is expected to increase environmental pressure. More volatile weather conditions are likely to affect future food security if productivity is not increased. In 2016, the Government prepared a national climate change management policy, which is designed to promote adaptation, mitigation and capacity building and ensure sustainable livelihoods in the future. An implementation strategy and an evaluation strategy were prepared at the same time, to support the policy. The Government also developed a series of nationally appropriate mitigation actions to strengthen its focus on mitigation. However, the institutional arrangements for managing and supervising the strategy’s implementation are not yet robust. One of the aims of
the policy is to formalize these institutional arrangements and strengthen co-ordination.

Political context
Malawi enjoys political stability and has made steady if slowing progress in governance and democracy since the restoration of multi-party democracy in 1994. The Mo Ibrahim Index of African Governance scored Malawi 18 (out of 54 countries) in overall governance in 2017 (compared with 17 in 2015). It noted that governance had stagnated, particularly in the last five years. Malawi’s overall governance score was 57 (maximum 100); in sub-categories, it scored 64 on ‘participation and human rights’, 63 on ‘safety and rule of law’, 55 on ‘human development’, and 46 on ‘sustainable economic opportunity’.

In 2014, the country elected a new Government led by President Peter Mutharika of the Democratic Progressive Party, which comfortably defeated the main opposition candidate Chakwera of the Malawi Congress Party. There is an informal coalition between the two main parties on which Government has relied to sustain a majority in Parliament. In preparation for the 2019 elections, Parliament is expected pass six electoral reform bills. These are the Constitutional Amendment Bill; the Electoral Commission Bill; the Presidential, Parliamentary and Local Government Elections Bill; the Assumption of the Office of the President (Transition Arrangements) Bill; the Referendum Bill; and the Political Parties Bill. These bills are expected to improve the electoral process in 2019; the administrative reforms envisaged by the Malawi Electoral Commission will be particularly important. Based on previous experience, the elections are expected to be held in a calm and peaceful manner. During the run-up to the election, there is a risk that fiscal spending may rise without a corresponding increase in revenue generation.

SOCIAL CONTEXT AND HUMAN DEVELOPMENT

Building human resources
Although it has improved since 2003, human resource development remains low in Malawi. UNDP’s 2016 Human Development Report ranked Malawi 170 (of 188 countries) with a score of 0.476. This score is below the average of both Sub-Saharan Africa (0.523) and least developed countries (0.508). There is significant scope for improvement. One of the most important factors in human development is education. Education underpins human, political and socioeconomic development and contributes to economic growth. Higher levels of education are associated with lower poverty because education empowers people, especially the poor and vulnerable. The quality of education is also an important factor in the overall quality of human development. The main cause of Malawi’s low score is the mean number of years in school (4.4 years), well below the expected number of years in school (10.8). Malawi’s low per capita income is also a major influence on its low human development ranking.

The Malawi Integrated Household Survey, released late in 2017, provides a snapshot of developments in education, health and wealth accumulation. According to the report, Malawians improved their literacy levels from 65% in 2011 to 73% in 2017. Unsurprisingly, literacy was higher in more densely populated areas. People in urban areas had literacy rates of 90%, compared to 60% in rural areas. Gender inequalities at national level were evident: only 66% of girls and women were literate compared with 81% of boys and men.

Malawi is a leader in the fight against HIV and AIDS. A new programme adopted in 2011 continues to provide antiretroviral (ARV) therapy to all pregnant women with HIV using a treat-all approach that removes the delays and hurdles associated with determining eligibility. Early treatment helps women stay healthy, protects subsequent pregnancies from infection, and reduces the risk of transmitting HIV to partners. It is estimated that about one million Malawians are living with HIV. In 2016, 70% of people were aware of their status, 89% of whom were on ARV treatment. Furthermore, 89% were virally suppressed meaning that the virus is less likely to transmit to others. New infections have been declining rapidly.

Poverty reduction, social protection and labour
Malawi, one of the world’s poorest countries, is classified as a low human development country. Poverty remains widespread, particularly in rural areas. Nationally, 50.7% of Malawians live below the national poverty line, including 57% of rural Malawians; 25% are estimated to live in extreme poverty. Poverty is driven by food insecurity, which in turn is due to erratic or poor rainfall and high farm input prices. Poverty analysis (based on the 2017 Integrated Household Survey) indicates that a large majority of Malawians feel poor or very poor when they assess themselves. According to the survey, 74% declared themselves to be poor or very poor, indicating that the national poverty...
line may underestimate actual poverty. The survey indicates a strong relationship between wealth and education. Households that are more educated tend to have more income, higher savings, and better access to social services, education and health. According to the survey, 14% of the population never attended school. About half cited lack of money as the main reason, while one in four said that their parents had not allowed them to go to school.

Income levels are very low and rank among the bottom 10 countries, with GNI per capita of USD 320 in 2016. Average income grew at a little more than 1.4% between 1995 and 2015. Inequalities are acute and rooted, with a Gini Coefficient of 46.1 in 2010 and 43.7 in 2014. The population is growing rapidly at 3% per annum, is young, and is urbanizing at a fast pace, posing major challenges for sustainable urban development, environmental sustainability, inclusive growth and services provision.

The majority of people (four out of five) still live in rural areas. The average household size is 4.3; 25% of households have six or more members. Most internal migration takes place within rural areas; half of all migration does so. However, rural to urban migration is increasing. A little under a third of all migration is to urban areas.

Malawi’s population of 17 million is very young. About 56% of Malawians are below the age of 20; a further 15% are between 20 and 30 years old. Youth unemployment is high and very few opportunities for employment are available. It is estimated that only 9% of youth have formal education beyond secondary school level. The 2014 Labour Force Survey estimated that 23% of the youth labour force in the age group 15-34 was unemployed, and that female unemployment rates were 10 percent higher than male. According to an ILO estimate in 2015, 5.2 million young adults aged between 18 and 24 will enter the labour market by 2040. In 2013, the Government adopted a youth employment policy to guide implementation of youth development and empowerment programmes. In 2017, a new national employment and labour policy was adopted by Cabinet.

**Gender equality**

Gender inequalities persist in Malawi and women continue to be marginalized. The Malawi Gender Index scored at a low 0.639. Only 16.2% of the executive, 12.8% of the judiciary, and 22.3% of the legislature are women; in city, municipal and district councils, women hold respectively 46%, 15% and 3.6% of decision-making posts. Improving educational and employment opportunities for women, eliminating harmful traditional practices and gender-based violence, and ensuring that women are able to make decisions about their sexual and reproductive health are key to achieving gender equity and equality, and overall socioeconomic development in Malawi.

To no surprise, the World Economic Forum’s Global Gender Gap report for 2017 placed Malawi in the bottom third of countries, below the global average. Malawi scored particularly poorly on ‘women’s representation in politics’; its score was also low on ‘women’s pay for equal work’, ‘income levels’ and ‘representation in senior management positions’.

The SADC Gender Barometer confirmed Malawi’s poor record on gender equality. It reported that 11% of representatives in local Government and the Cabinet were women. Their representation in economic decision-making was slightly higher at 13%. Women in Malawi are entitled to only 8 weeks of maternity leave, more than four weeks fewer than women in most SADC countries.

**THEMATIC ANALYSIS: INFRASTRUCTURE FINANCING**

Malawi’s infrastructure is growing but remains thin compared to neighbouring countries. The AfDB’s Africa Infrastructure Development Index ranked Malawi 28, in the lower half of the ranking. Water and sanitation were scored highest (14 of 54 countries). There remains huge scope to invest in infrastructure, especially in energy, transport, ICT and irrigation. Under the Malawi Growth and Development Strategy, the Government aims to strengthen domestic resource mobilization and attract more private investment by expanding the use of public-private partnership (PPP) arrangements. Energy, transport and ICT are among the Government’s five key priorities.

The road network in Malawi has 15 451 km of roads, classified as main (22%), secondary (20%), tertiary (27%), district (23%), and urban (9%). About a quarter of the roads are paved; 30% are classified as good, 53% as fair. The paved roads are primarily main roads and urban roads (89% of all paved roads). In addition to the above, Malawi has an estimated 10 000 km of nonstandard roads. Estimates indicate that roads carry 70% of domestic freight and over 90% of international freight. Generally, the extent of the road network is considered sufficient but certain parts have restricted capacity and are congested due to high traffic volumes, and overloaded vehicles threaten road conditions. Road maintenance is limited, due to lack of recurrent spending, and below the level needed to sustain the network.

Rail has historically been an important mode of transport for international freight. After independence, however, the network slowly deteriorated due to lack of maintenance and the absence.
of new investment. The network has 797 km of Cape gauge track, mainly in the southern and central parts of the country. Malawi rail was privatised in 1999 and, since the coal boom in Mozambique near the start of the century, interest in rail investment has revived, especially in the Nacala corridor that passes through Malawi.

The power sector in Malawi is relatively small compared to neighbouring countries. Generation capacity is about 370 MW, which is only enough to power about 250 000 of Malawi’s more than 3.7 million households. Electricity generation is 95% hydro-dependent on power generated by the Shire River. This entails considerable risk when rains are insufficient to maintain water levels on Lake Malawi, which functions as a reservoir. The poor state of energy infrastructure is a major constraint on returns to investment for both existing and new investors. The risk of low returns limits diversification into non-traditional exports and particularly undermines manufacturing output and investment.

The telecom sector in Malawi has two operators, one of which is wholly privately-owned while the other, Malawi Telecommunications Limited (the original fixed line operator), has a mix of Government and private sector Malawian shareholders. Although total telecom coverage exceeds 74% of the country, the mobile phone penetration rate is only 38%, among the lowest in the southern region. It is estimated that there are 5 million customers with a large potential to grow the sector and the customer base. The current market players are moving into high-speed services and stepping up efforts to develop mobile broadband. The cost of internet services remains one of the highest in the region, but a national fibre optic backbone will soon be completed as well as a link to the international submarine cable, and prices may therefore start to fall.

The country is frequently affected by droughts and flooding. Droughts affect agricultural productivity and floods damage agricultural land and crops. These adverse effects could be mitigated by increasing irrigation. It is estimated that 104 000 hectares out of a possible 410 000 hectares are currently irrigated.

Lake Malawi and the upper Shire River are connected and provide the main inland waterway transport system. However, lower water levels on Lake Malawi have affected the inland port system and only two of four ports are currently functional.

The water and sanitation sector has received considerable investments in the last 20 years. The sector has therefore reached a point where 86% of the population have access to improved drinking water sources and 95% to improved sanitation.

Building the infrastructure Malawi needs will require significant finance from Government, development banks and the private sector. The Malawi Growth and Development Strategy indicates that development activities, including infrastructure investments, will cost USD 5 billion. According to recent national budgets, the Government spends on average 19.7% of the budget on development activities, or about USD 2.4 billion. The strategy plans an additional allocation of USD 1.2 billion, to be financed by the private and public sector. This implies that a financing gap of USD 1.4 billion has still to be found.

In fact, the country’s infrastructure needs are even greater, according to the 2017 Transport Master Plan and the 2017 Integrated Resource Plan for Energy. Over the next 20 years these plans foresee transport investments of USD 9.2 billion and energy investments in generation and transmission of at least USD 3.4 billion. The limited public funding that is available and the limits on public borrowing indicate that more private sector involvement will be required. The Government should open the economy up to more private sector involvement by liberalizing certain key sectors, such as energy, the rail sector and water and sanitation, which can attract investment interest on a large scale.