

ECONOMIC REVIEW

EXECUTIVE SUMMARY

The year 2005 has been tremendous in that Malawi qualified for a new Poverty Reduction and growth facility (PRGF) by the IMF in August after establishing a good economic track record under the Staff Monitored Programme (SMP). After securing the positive relations with the IMF, other bilateral and multilateral donors resumed their funding to the country.

Malawi's real economic growth for 2005 stood at 2.1 percent down from 5.0 percent registered last year. The slump in economic growth was attributed to a dismal performance of the agricultural sector in 2005 which shrunk by 9.1 percent compared to a positive growth rate of 2.7 percent in 2004. Significant growths were recorded in the distribution, transportation, manufacturing, water and electricity, mining and construction sectors.

The local currency's 2005 performance was less than satisfactory as it came under pressure and depreciated against other major trading currencies across the year. The dismal production of Malawi foreign exchange earner, tobacco, contributed largely to this cause and it was not surprising that Malawi's total gross foreign exchange reserves averaged 2.7 months in 2005 compared to an average import cover of 3.0 months in the previous year.

The Malawi's interest rate regime remained relatively stable in the year 2005 compared to the previous year. The ruling rate, the Bank Rate remained stable at 25.0 percent and consequently commercial banks minimum lending and savings rates averaged 27.0 percent and 7.75 percent, respectively. Treasury bill, RBM bill average yields and mortgage rates also remained relatively stable in the year under review.

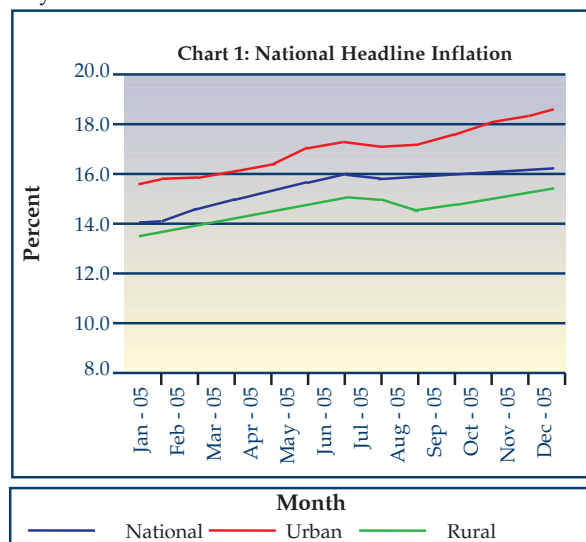
Annual average inflation rate for 2005 at 15.4 percent was 3.9 percentage points higher than last

year. Both urban and rural inflation also registered increases in the year 2005. The main force behind inflation acceleration in the year under review was the scarcity of food which has a large weighting on the inflation index. Increase in domestic oil prices and exchange rate depreciation also contributed to the increase in inflation.

Trading on the Malawi stock exchange increased by 44.3 percent in terms of share volume while at the same time it increased by 37.2 percent in terms of share value. Market capitalisation also registered an increase of 50.3 percent and it's not surprising that the Malawi All Share Index closed off at 906.85 points compared to 583.48 in January 2005.

NATIONAL INFLATION

Annual average inflation rate for the year 2005 stood at 15.4 percent compared to 11.5 percent registered in 2004. The respective urban and rural average annual inflation rates increased to 17.1 percent and 14.6 percent from 12.7 percent and 10.9 percent, in 2004 respectively. The food component of the national inflation index averaged 17.2 percent in 2005 compared to 7.5 percent in 2004. This was the main driving force behind continued National inflation acceleration in year 2005.



source: National Statistics Office

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Other categories of National inflation index (clothing & footwear, housing, household operations and transport) on average decelerated apart from beverages and tobacco category which registered an average of 19.8 percent last year to 22.4 percent increase in the year under review.

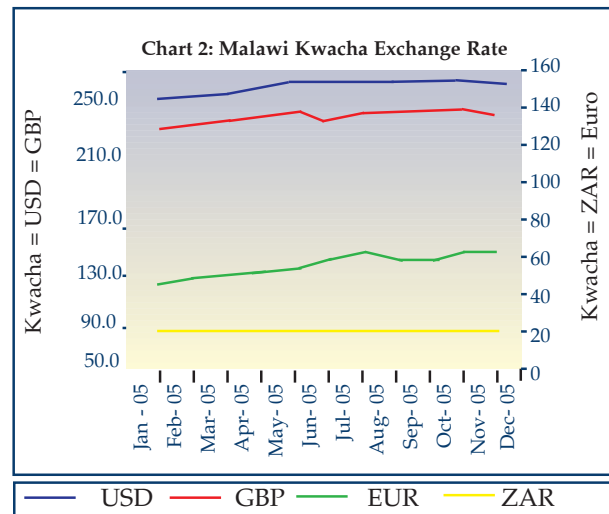
The inflation trend for this year went against the normal trend as it continued rising throughout the year except for a one month marginal drop in August. Normally period covering September to March, inflation tend to rise while inflation subsides in the periods between April to August.

The main driving force behind a continuous upward movement in the inflation index in 2005 was the increase in food prices particularly cereals which were in short supply due to insufficient harvest in the 2004/2005 farming season. In addition, the continued depreciation of the local currency throughout the year also had a negative effect on the inflation through increased fuel prices and increase in prices of other imported commodities.

EXCHANGE RATE

Unlike in the year 2004 in which the domestic currency remained relatively stable against the other major trading currencies, the Malawi Kwacha depreciated in the year under review after remaining stable during the first quarter. The local unit depreciated to close the year at an official middle rate of K123.7806 to the Dollar from K108.9432 as at end December 2004. It also weakened against the Great Britain Pound (GBP), South African Rand (ZAR) and EURO to trade at a middle rates of K215.4865, K19.9643 and K147.9834 at the end of the year from K211.4865, K19.0667 and K146.5287 in December 2004, respectively.

The weakening of the local currency in the year 2005 was due to low reserve position, which averaged 2.7 months of import cover compared to



source: Reserve Bank of Malawi

3.0 months in the previous year. The Kwacha also lost its value due to the strengthening of the other major trading currencies in the year under review.

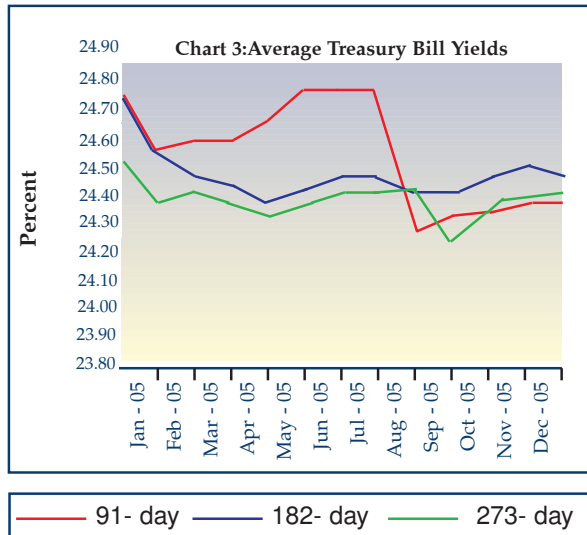
Though the country enjoyed the resumption of donor support from bilateral and multilateral donors who supported the Government social and economic programmes, pressure on the local currency emanated from the huge demand for foreign exchange to meet payment obligations, for example, the importation of subsidized fertilizer and maize which was in short supply.

MONEY MARKET RATES

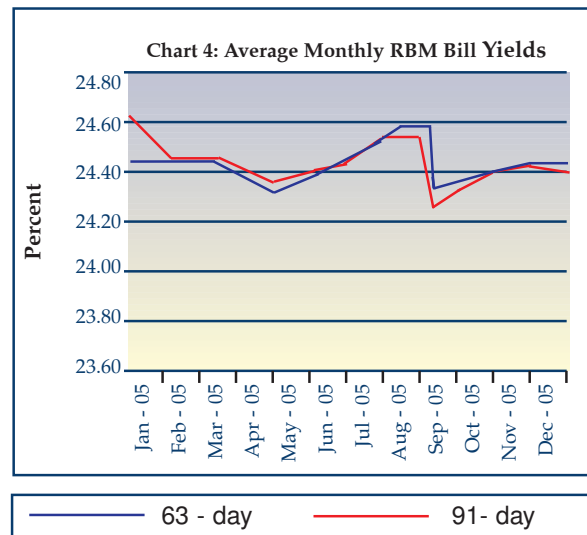
Treasury and RBM bill yields in the year were relatively stable owing to the fact that the benchmark rate, the Bank rate remained at 25.0 percent during the entire year. Primary market 91 day Treasury bill monthly average yields fluctuated within the range of 24.57 percent to 24.18 percent. The annual average for the 91 day Treasury bill yield for 2005 was 24.40 percent compared to an average of 34.25 percent for the period January 2004 to May 2004 and 24.86 percent for the period June 2004 to December 2004 after the bank rate was reduced from 35.0 percent to 25.0 percent. The 182 day annual average yield for 2005 was 24.51 percent and the monthly yields fluctuated within the ranges of 24.78 percent and 24.39

ECONOMIC REVIEW (CONT.)

percent across the year. In 2004, the average monthly yield for the period January to May 2004 was 34.48 percent but was reduced to 24.79 percent period between June to December 2005.



source: Reserve Bnk of Malawi



source: Reserve Bnk of Malawi

The annual average yield for the longer dated tenor, 273 days, for 2005 was 24.56 percent and the monthly yields fluctuated within the range of 24.25 percent to 24.80 percent across the year. In 2004, the monthly yield averaged 34.63 percent between January and May and averaged 24.86 percent between June to December 2004.

A similar pattern to the Treasury bill yields was observed in the movement of the RBM bill yields in the year 2005. The annual average yield for a 63 day RBM bill was 24.36 percent and the monthly yields fluctuated within the ranges of 24.71 percent and 24.11 percent. In the previous year the 63 day monthly average yield for the period January to May was 34.42 percent and it moved down to 24.13 percent in the remainder of the year.

The 91 day annual average yield for 2005 was 24.34 percent and monthly yields fluctuated within the range of 24.47 percent and 24.05 percent. In the previous year the monthly average yields for the period January to May 2004 averaged 34.44 percent and they later averaged to 24.39 percent for the remaining part of the year.

Having left the Bank Rate at 25.0 percent for the year 2005, the money market rates remain almost unchanged throughout the year. The commercial bank base lending rate averaged 27.0 percent while savings rates averaged 7.75 percent. Mortgage rates in the year 2005 averaged 25.0 percent. Only inter bank rates remained unstable during the year owing to levels of liquidity in the market. The rates fluctuated within the ranges of 5.0 percent to 33.98 percent in the year under review.

MONEY MARKET LIQUIDITY AND MONEY SUPPLY

Open market operations and foreign exchange operation resulted in an overall net withdrawal of liquidity amounting to K26.1 billion from the money market in the year 2005. Total foreign exchange sales for the entire year amounted to K21.8 billion while purchases only amounted to K7.7 billion. This resulted in a withdrawal of liquidity from the money market amounting to K14.1 billion.

Open market operations on aggregate mopped out K145.2 billion from the money market against

ECONOMIC REVIEW (CONT.)

an injection of K133.3 billion and this resulted in a net withdrawal of about K12.0 billion. From the available statistics, it is evident that monetary policy for the year 2005 was contractionary. It is

GOVERNMENT BUDGETARY OPERATIONS

In the period January to December 2005, Government operations resulted in an overall deficit of K3.1 billion. Total revenues for the

2005 Foreign Exchange and Open Market Operations (K'bn)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Net Forex Operations	-3.6	-1.7	1.1	0.0	0.0	0.1	1.7	-1.3	1.5	-8.1	-1.8	-2.0
Sales	3.6	1.7	0.8	0.0	0.0	1.8	0.4	1.3	0.3	8.1	1.8	2.0
Purchases	0.0	0.0	1.9	0.0	0.0	1.9	2.1	0.0	1.8	0.0	0.0	0.0
Net OMO	-0.9	-1.5	-7.1	2.9	0.9	-5.4	-4.7	0.2	1.0	2.4	0.5	-0.3
Injections	9.8	3.8	4.0	12.0	13.7	10.6	18.9	10.9	8.4	19.2	4.0	18.0
Withdrawals	10.7	5.3	11.0	9.1	12.8	16.0	23.6	10.7	7.4	16.8	3.5	18.3
Net OMO & Forex	-4.5	-3.2	-6.0	2.9	0.9	-5.3	-3.0	-1.1	2.5	-5.7	-1.3	-2.3

+ means injection & - means withdrawal

Source: Reserve Bank of Malawi

not surprising that money supply on an annual basis only grew by 14.3 percent in the year under review compared to 29.8 percent in the previous year.

period under review amounted to K102.0 billion while its corresponding expenditure amounted to K105.1 billion. The deficit was mainly financed by both domestic and foreign borrowing, and open

2005 Money Supply (K'bn)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Money Supply (M2)	43.1	43.7	44.6	47.4	50.4	51.5	51.3	51.9	51.1	51.3	52.7	52.2
Narrow Money (M1)*	24.0	25.2	24.4	26.2	28.6	29.1	28.1	27.6	29.2	29.7	29.3	30.2
Quasi Money	18.7	18.6	20.2	21.2	21.7	22.5	23.2	24.3	21.9	21.5	23.3	22.0
M2 growth-Annual %	22.1	26.2	24.5	22.2	24.3	20.5	20.6	18.6	17.6	18.9	22.1	14.3
M2 growth-Monthly%	-5.5	1.4	1.8	6.3	4.4	2.3	-0.7	3.2	-1.6	0.4	2.7	-0.9

* Excludes encumbered reserves at RBM

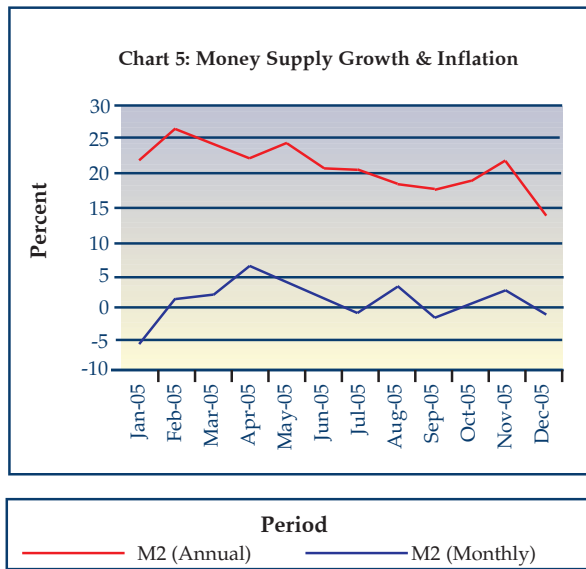
Source: Reserve Bank of Malawi

Growth in money supply in the year 2005 largely emanated from increase in net domestic credit, net domestic assets and net foreign assets. Net domestic assets increased by 10.1 % from the December 2004 level while Net foreign assets and net domestic credit increased by 9.3 percent and 42.5 percent, respectively.

market operations and ways and means advances.

Surpluses realized in the months of January, April, June, August, September and December were used to reduce both domestic and foreign debt stock.

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Total market capitalisation for the ten listed stocks closed the year at K1, 120,358.45 (US\$9,051.16 million) reflecting an increase of 50.33 percent and 39.56 percent in Malawi Kwacha and US Dollar terms. The increase in capitalisation was mainly due to increase in share prices of ILLOVO, NBM, NICO, NITL, PCL, PIM and OML plc.

The Malawi All Share Index (MASI), the barometer that measures the average price movement of all counters at the Malawi Stock Exchange increased from 583.48 points in January to 906.85 points in December, 2005 giving a return on Index of 55.42 percent (36.56% in US\$ terms). The Domestic Share Index (DSI) that measures the average price movement of only domestic

2005 Central Government Budgetary Operations (K'bn)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Revenues	6.1	5.4	7.4	8.1	6.4	8.4	7.2	11.7	9.3	9.4	10.5	12.1
Expenditure	5.9	7.9	9.7	7.3	9.3	8.2	6.7	8.9	8.1	11.8	11.2	10.1
Surplus/Deficit	0.2	-2.5	-2.3	0.8	-2.9	0.2	-0.5	2.8	1.2	-2.4	-0.7	2.0

Source: Reserve Bank of Malawi

MALAWI STOCK EXCHANGE

A total of 61,564,967 shares were traded for a total turnover of K917.8 million (US\$7.594 million) in 480 deals. In the same period last year, 110,592,066 shares were traded at a total consideration of K669.103 million (US\$6.15 million) in 282 deals. Thus, in the year 2005 there was a 44.33 percent decrease in term of share volume which were transacted through the exchange while a 37.17 percent increase was recorded in terms of share value.

The highest sales of share trades in terms of share volume were transacted in the month of March 2005 amounting to 10,633,271 shares while in terms of share value the month of July recorded a total turnover of K196.58 million. Least shares were traded in the month of April with 1,490,097 shares with a total turnover of K11.78 million (US\$0.104 million).

counters yielded a return of 61.26% (41.89% in US\$ terms) from 426.03 points to 687.00points during the year 2005.

The market recorded trading activity on all counters but one, Blantyre Hotels Limited which, did not register any trade during the year 2005. NICO Holdings Limited registered the biggest trading volume of 16,650,571 shares representing 27.05 percent of the total volume of shares traded.

The highest capital gainer through a share price rise during the period under review was Press Corporation Limited by 150.0 percent from an opening price of MK20.00 to MK50.00 per share, seconded by National Bank of Malawi by 110.0 percent from an opening price of MK10.00 to a closing price of MK21.00 per share. Other price gainers were NICO (68.75 percent), PIM (66.67

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percent), OML plc (50.0 percent), NITL (37.74 percent) and ILLOVO (18.82 percent). STANBIC and SUNBIRD registered capital loss of 4.15 % and 10.00 %, respectively, during the review period.

THE REAL SECTOR INDICATORS

Domestic Production - The authorities revised the 2005 real economic growth to 2.1 percent from an earlier estimate of 1.9 percent. The revision was mainly attributed to a 9.1 percent projected shrink in the agricultural sector compared to an annual growth of 2.7 percent in 2004. The small-scale agriculture sub sector declined by 11.6 percent whereas the large scale agriculture sub sector shrunk by 0.2 percent mainly due to the decline in tobacco production. Though the agricultural

decline in production was due to adverse climatic conditions that prevailed during the growing season. In the year 2005, the quantity of tea sold was lower by 30.3 percent at 11.9 million kilograms compared to 17.1 million kilograms, which were sold in 2004. Prices averaged US\$1.04 per Kilogram in 2005, 3.7 percent lower than US\$1.08 per Kilogram which was fetched in 2004. Sales of tea in 2005 were poor compared to the previous year, due to low production of the commodity as well as a low demand on the international market.

Tobacco - After the closure of the tobacco auction on 17th October 2005, a total of 146.1 million kilograms were sold across all the auction floors in

Company Trading Statistics

Company	Opening Price (MK)	Closing Price (MK)	Change in Price (MK)	% Price Change	Share Vol. Trade	Percentage of total % Traded
BHL	3.70	3.70	0.00	0.00	0	0.00
ILLOVO	8.50	10.10	1.60	18.82	1,276,949	2.07
NBM	10.00	21.00	11.00	110.00	10,910,000	17.72
NICO	1.60	2.70	1.10	68.75	16,650,571	27.05
NITL	2.65	3.65	1.00	37.74	15,465,939	25.12
PCL	20.00	50.00	30.00	150.00	12,564,793	20.41
PIM	1.65	2.75	1.10	66.67	168,060	0.27
STANBIC	9.65	9.25	-0.40	-4.15	4,397,155	7.14
SUNBIRD	2.00	1.80	-0.20	-10.00	3,000	0.00
OML	190.00	285.00	95.00	50.00	128,500	0.21
					61,564,967	100.00

Source: Malawi Stock Exchange

sector recorded declining growth, significant growths were recorded in the distribution, transportation, manufacturing, water and electricity, mining and construction sectors.

Tea - For the period January to december 2005, a total of 38.0 million kilograms were produced in 2005 representing a 24.2 percent decline on the amount produced during 2004. The substantial

the country. This represents an 18.9 percent drop in production compared to the 180.0 million kilograms which were sold in 2004. The tobacco prices at the auction floor averaged US\$1.11 per kilogram compared to US\$1.14 per kilogram in the previous year. Total realization in 2005 amounted to US\$162.7 million compared to a realization of about US\$ 205.0 million in 2004. Several factors affected the production of the crop in the year

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under review among them are; low prices in 2004 increased cross-boarder trade with neighboring countries and poor leaf quality due to lack of fertilizers and also poor weather conditions. In addition, world tobacco prices have been falling due to falling demand, high taxes, litigation as well as anti-smoking lobbies. In the year 2005 the tobacco market was without controversies as the market was closed a couple of times due to price disagreements between buyers and growers.

Sugar - Though the full cane yield potential was not realized due to unseasonal periods of wet weather at Dwangwa and power supply interruptions during periods of peak cane growth, both Dwangwa and Ntchalo performed very well in the year under review. Overall cane harvest amounted to 2,064,380 tons of which 187,711 tons were produced by smallholder farmers. From the quoted cane harvest, a total of 256,706 tones of sugar were produced by both Dwangwa and Nchalo sugar factories compared to 259,878 tons in 2004.

Maize - The last round of crop estimates indicated that total maize production declined by 29.3 percent to 1.2 million metric tonnes from 1.7 million metric tonnes recorded in 2004. This was far well below the national requirement of about 2.0 million metric tonnes. The lower harvest for the year was as a result of the scarcity and inaffordability fertilizer prices, in addition to the insufficient rains which the country received in 2005. As was the case with maize production, other smallholder crops recorded low yields; Ground nuts, rice, pulses and cassava production declined by 12.5 percent, 17.0 percent, 11.9 percent and 12.8 percent, respectively.

Petroleum Products - Unlike in 2004 in which there were two price adjustments, 2005 recorded three petroleum products adjustments in the months of June, August and November. The changes in the fuel prices mainly emanated from

increases in fuel prices on the world market and depreciation of the local currency. The pump price per litre of petrol, diesel and paraffin moved from K102.70, K95.40 and K74.45 in January 2005 and closed the year selling at K134.80, K132.70 and K106.30 per litre.

WORLD ECONOMIC OUTLOOK

The world economy has broadly withstood the volatile increases in oil prices, but despite a slowdown reaching virtually every economic region in 2005, it is expected that expansion will continue in 2006, with Asia and North America at the forefront. Growth is expected to be stable in 2006, before strengthening somewhat in 2007. Growth will continue to be solid for the world economy and major economies are expected to push ahead with their stimulative economic policies and this will go well with the favorable financial market conditions, such as low long-term interest rates; such policies may counter the impact of rising oil prices. Industrialized economies are set for an overall growth of 2.9 percent in 2006.

At the same time, China, India and some other major developing countries are set to keep the trend of rapid growth going in 2006. Developing nations are expected to gain an economic growth of 5.9 percent in 2006. Economic growth in East Asia and the Pacific region will hit 7.8 percent, while the growth rate will reach 6.9 percent in South Asia, 4.5 percent in Latin America and the Caribbean and 4.6 percent in sub-Saharan countries.

However, threats remain to the world economy and at the top of all the disturbing factors are the high oil prices. The possibility of continuous surging of oil prices in 2006 are likely, prolonged high oil prices might hurt consumer confidence, thus multiplying its negative impacts on the world economy. Moreover, increases in official short-term interest rates in some rich nations might also

affect the world economy, especially the developing countries. Potential threats to the world economy also include a deteriorating current account balance in the United States and consequent dollar fluctuation, an increase in long-term interest rates, falls in property prices, and outbreak of bird flu.

MALAWI'S ECONOMIC OUTLOOK

On the back of an anticipated good agricultural output, due to favorable weather and Government intervention as regards the provision of subsidies for agricultural inputs, economic growth for the country is expected to improve from the decimal growth of 2.1 percent in 2005.

Expected recovery in agriculture and improved fiscal discipline may result in a slow down in food and non food inflation though currency depreciation and high international oil prices will still exert some pressure through imported inflation. With contained inflationary pressure and anticipated tight monetary policy stance in 2006, authorities are likely to effect a downward revision in the bank rate which will in turn trigger an automatic downward revision of commercial banks lending rates and yields on Treasury and RBM securities. This will be done in order to deliberately encourage private sector led growth.

The expected good fiscal discipline and improved governance under PRGF may boost Malawi's chances of qualifying for debt relief under the IMF-World Bank heavily indebted poor countries (HIPC) initiative in 2006. With anticipated Government reforms remaining on track with the PRGF targets, the Malawi Kwacha exchange rate is expected to follow its normal seasonal pattern, stabilizing in the second and third quarter (during tobacco auction) and depreciating in the first and last quarter, this being the lean period in foreign exchange supply.



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