



FOREIGN EXCHANGE DEVELOPMENTS

The Malawi Kwacha to the US Dollar exchange rate is showing signs of stabilization, at least for the time being, at around the MK420 mark. This is mainly due to weak demand for foreign exchange. Having almost cleared external arrears which had accumulated in the previous 3 years, the weak demand is also as a direct consequence of an effective monetary policy implementation strategy by the Reserve Bank notwithstanding the weak fiscal performance.

The tight monetary stance of relentlessly reducing Kwacha liquidity is being underpinned by very high interest rates and complemented by unorthodox administrative controls. Access to the RBM discount window for kwacha liquidity by commercial banks is now unpredictable and has been severely curtailed despite collateral and satisfying criteria.

The local foreign exchange interbank market is now exhibiting signs of some activity, bolstered by tobacco sales albeit with lack of off-takers. Due to the tight liquidity conditions within the economy and that of commercial banks in particular, tobacco dollars and other foreign currency proceeds are sometimes difficult to off-load for Kwacha into the market, thereby resulting into some semblance of exchange rate stabilisation.

If the above conditions persist, it could lead to some sort of appreciation of the Malawi Kwacha provided government spending appetite adjusts accordingly. Significant demand for the forex is now emanating from the public sector which has not shown any signs of adjustment unlike the adjustments in demand that have taken place in the private sector.

The expectation however is that since the monetary reforms of last year, this could be the first tipping point for the Malawi Kwacha to remain relatively stable at current levels especially during the tobacco auction season.

Despite the market showing signs of attainment of a near equilibrium position on forex, the down side risks remain the management of perceptions within the market of low levels of reserves, which may in reality be of little relevance for as long as the market can clear.

However, by far, the major downside risk remains the continuous unadjusted demand of imports by the public sector for as long as borrowing allows, whether through the issuance of Treasury Bills or through the RBM Ways and Means route. There is also the risk of dynamic inconsistency of abandoning the flexible exchange rate policy due to political pressures as the country approaches the general elections next year. This however, could plunge the country into a worse economic scenario than is current, since the IMF program would immediately go off track and consequently donors and other commercial creditors would once again pull the plug.

TOBACCO TRADING REPORT 2013

Five weeks into the 2013 tobacco sales season, 18.8 million kilograms (py 6.6 million Kilograms) has been sold raking in USD27.6 million (py USD8.4 million) implying an average price per kilogram of USD1.4681 (py USD1.2762) for all types of tobacco.

The market had initially planned for an 80/20 split between contract sales and auction sales respectively. However, after five weeks auction burley tobacco sales are 53% of total burley sales volume with average price at USD1.3705 (py USD1.2162). On the other hand, contract burley sales were 46% of total sales volume with average price USD1.5252 (py USD1.4937). At this early stage in the season, contract tobacco prices seem to be fairing slightly better than auction prices although farmers are still preferring the auction method of selling their tobacco.

MONETARY MEASURES, FISCAL PERFORMANCE AND INTEREST RATES

Day to day monetary policy conduct is signaling to commercial banks to exercise a lot of restraint in the provision of credit. To starve the market of liquidity, the monetary authorities are consistently introducing ad hoc

measures around the lender of last resort function to force commercial banks to tighten and significantly lower credit.

Although effective in achieving the objective, ad-hoc administrative limits on access to the discount window and the not so transparent changes of rules on a day to day basis is rendering liquidity management within commercial banks an almost impossible task. These ad hoc measures which can vary from day to day are imposing an inefficiency cost within the financial system including, mispricing of financial products.

Fiscal slippages and lack of adjustment on the part of government have led to an increase in Treasury Bills rates which are now over 40% for all tenors. Commercial banks have therefore been forced to increase their base lending rates from an average 35% to 40% to curb arbitrage profit opportunities whereby some customers can borrow from the bank and earn a decent margin by simply buying Treasury Bills.

The combined effect of the tight monetary policy and weak fiscal performance is likely to maintain the high interest rate and inflationary environment for some time. This is also resulting in the private sector being crowded out thereby stifling growth.

INFLATION

Year on year headline inflation for February 2013 stood at 37.9% up 2.8 percentage points on the previous month. Rural and urban rates stand at 33.7% and 39.6% respectively in the month. The rise in inflation is being attributed to increases in prices of maize and maize flour across the country as well as adjustment in the price of fuel and its derivatives.

The current inflation series, beginning January 2013, has been rebased to 2012 using updated data from recent household expenditure patterns from the 2010/11 Integrated Household Survey. Effectively prices have increased 35.1% from the base year to January 2013.

The main risks to further price increases remain the expansionary fiscal performance and to some extent, the continuing exchange rate depreciation pass through effects.

The expectation therefore is for inflation to peak in the month of March 2013 and start moderating thereafter as the maize harvest commences. Even with the weak public expenditure control environment, the fiscal

deficit is expected to narrow down marginally in Q2 due to programmed donor disbursements.

SELECTED ECONOMIC INDICATORS

INDICATOR	UNIT	2010	2011	2012	2013
GDP at current market prices	MK billion	812.4	879.8	1068.1	1298.6
GDP at constant prices	%	6.5	4.3	1.4	4
Population	million				13.1mio
GDP Deflator	%	7.4	3.8	16.4	17.3
Inflation (average)	%	7.4	7.6	21.4	20
Bank rate	%	15	13	25	25
Money supply (M 2)	% CHANGE	33.9	35.7	18.2	20
Import Cover	Months	1.4	2.1	1.8	2.8
Foreign debt	% GDP	21.8	23.3	20	20
Domestic debt	% GDP	14	11	2	2
Fiscal balance	% GDP	-2.2	-7.0	-0.5	-0.5
Current account	% GDP	-17.2	-11.8	-15.7	-15.7

Source: NSO, RBM, NBM, IMF

opinion expressed in this newsletter should be regarded as solely that of individual persons in our economics department and as such, inquiries and comments should be forwarded to that department. The Bank shall not be held liable for the consequences of any actions taken on the basis of this newsletter.

Shadreck Malenga
Economics Department
National Bank of Malawi
P.O. Box 945
BLANTYRE.

TEL: (265) 01 820 622/01 770 480
FAX: 01 820321
Email: smalenga@natbankmw.com
Website: www.natbank.co.mw
