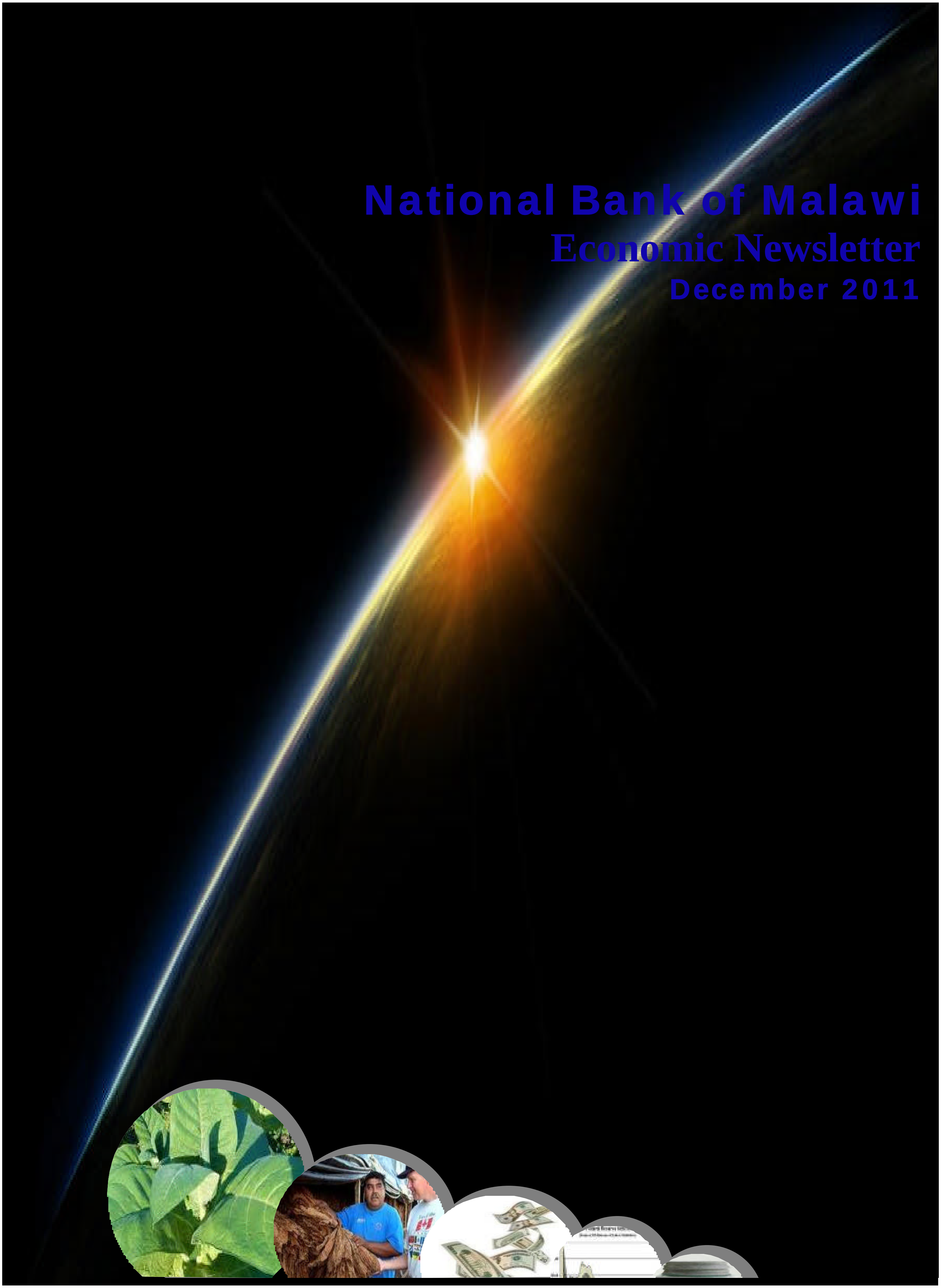
National Bank of Malawi

Economic Newsletter

December 2011



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Any opinion expressed in this news letter 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.

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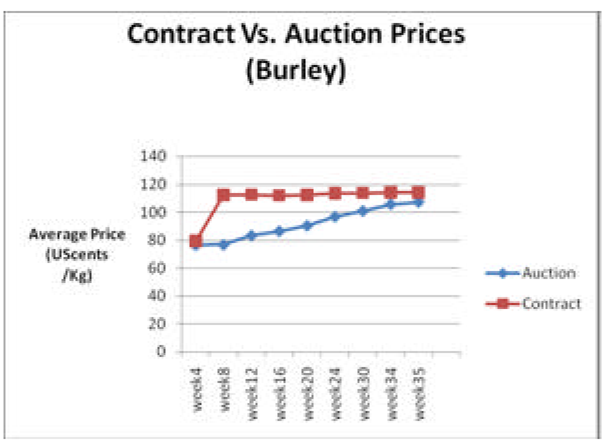
TOBACCO AUCTION UPDATE

35 weeks into the 2011 tobacco auction season (18 November 2011), revenues are at a mediocre US$259.446 million from 212.525 million kilograms of the crop implying an average price for the season thus far of US$122.08. This represents a reduction in sales value, quantities and prices of -36.99%, -2.03% and -35.68% respectively compared to the same review period in 2010.

The tobacco industry in Malawi continues to be negatively affected by overproduction and quality in recent years. This is in addition to reduction in demand due to the anti smoking lobby. This scenario has led to merchants only buying against confirmed orders, hence the frequent no sales and high rejection rate.

The sector has also been hit by logistical challenges as transporters are challenged in moving the commodity due to the prevailing fuel shortages. Third round estimates are projecting total production at over 245 million kilograms, partly due to diverted tobacco from Zambia and Mozambique where markets have closed. Incidentally, this may affect next year's sales as merchants may be compelled to reduce quantities bought by the same margin held as carryover stocks.



The above notwithstanding, there appears to be no light at the end of the tunnel as farmers are registering en masse with TAMA to grow the crop next season due to lack of clear alternatives. This is in spite of the introduction of production quotas in the coming season which are meant to reduce production by 11%. Tobacco merchants meanwhile are promoting the introduction of Integrated Production Systems where farmers will be required to grow under contract to ensure traceability of the crop, a fact demonstrated this year through better prices offered to contract farmers as seen above from TCC data.

INFLATION

Upward pressure on prices is showing no signs of abating with Inflation for October 2011estimated at 8.1%, up 0.4% from the previous month. For the first time this year, pressure on prices is emanating from both food and Non-food inflation as the effects of the recent the 10% devaluation, including the incorporation of the black market rate in pricing, and resultant fuel price hike take their toll on the typical consumer basket. As a result, urban inflation for October is now in double digits at 10.1% compared to rural inflation a t 7.0%.

Going forward, the main risk to further price increases is the inevitable further devaluation of the Malawi Kwacha which is expected to bring its own 'second round' price increases in fuel with knock-on effects on other prices as above. The potential for run-away cost-push inflation through an inflation-wage spiral is therefore high in 2012, especially if workers and labour unions, including Members of Parliament, succeed in bargaining for higher wages which do not match with improvements in productivity.

EXCHANGE RATE DEVELOPMENTS

The Kwacha was recently devalued against the US dollar by 10% on 8 August 2011 as the authorities yielded to pressure to re-align the exchange rate towards a marketing clearing level. However, this move has been deemed inadequate by the IMF within the context of the ECF Program. Recent directives on foreign exchange trading by commercial banks also go against previous commitments by the authorities to liberalize the exchange rate under the program hence the continued suspension of the program.

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The latest pronouncements by the Reserve Bank confirm the need for an exchange rate re-alignment, evidenced by the queues that continue to plague commercial banks.

This recent authoritative statement on devaluation has now created an impasse in the foreign exchange market. Those who have foreign exchange do not find it prudent to sell to the market while those who have bills to pay want it to be done as expeditiously as possible, worsening the already fragile situation of foreign exchange availability. The market is therefore expected to have little or no activity until the statement is confirmed by action on the ground. Waiting longer after the public statement (as is likely to be the case, since it will have to wait for an IMF Mission), may threaten growth prospects in a significant way. Paradoxically, the waiting may herald a dual currency economy and subsequent loss of control of monetary policy, the very thing authorities are guarding jealously.

MONEY MARKET & INTEREST RATES

The money markets have remained fairly liquid in 2H2011 with the 91days, 182 days and 273 days tenors yielding around 6.5%, 7.31% and 8.68% respectively during the week ended 22 November. Competition has been especially high for the 91 day tenor as investors were reluctant to invest for longer periods preferring instead to rollover maturities in order to take advantage of any foreign exchange allocations. The competition for the 91 day tenor resulted in yields of as low as 5% with at least 85% of applications and allotments going for this tenor.

Recent auctions also indicate increased appetite for liquidity to finance revenue gaps arising from the fiscal side. This is perhaps being indicated by the increasing prominence of ways and means advances and Open Market Operations (OMO) which are currently yielding 5.25%, 4.8%, 5.5% and 6.25% for the 7day, 14day, 30day and 60day tenors respectively. However, increased appetite for liquidity has not succeeded in dampening overall market liquidity which coupled with pressure on prices may force monetary authorities to adjust interest rates upwards in the short-medium term.

GROWTH PROSPECTS

Real GDP Growth is expected to be considerably lower than presented in the National Budget in June 2011. This due to continuing forex and fuel challenges which have created significant idle capacity. The lack of an IMF Program and resultant withdrawal of donor aid are expected to compound the situation.

The IMF forecasts Real GPD Growth in 2012 at around 4% compared to Ministry of Finance estimates that placed growth at 6.9%. Considering current forex challenges and poor revenue collection by the tax authorities which has constrained government expenditure programmes, it is reasonable to expect economic growth rates of less than 4% in 2011. Prospects of a negative growth rate may not be far-fetched.

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SELECTED ECONOMIC INDICATORS

INDICATOR	UNIT	2008	2009	2010	2011
GDP at current market prices	MK billion	600.3	702.3	819.4	942.9
GDP per capita	USD bn	312.8	356.4	366.5	389.5
Population	million	13.1			
Real GDP growth	%	9.8	7.7	6.0	4.0
Inflation (average)	%	8.7	8.4	10.1	8.3
Bank rate	%	15	15	13	13
Money supply (M 2)	% CHANGE	33.1	19.4	16.7	13.9
Import Cover	Months	3.4	1.4	2.1	2.1
Foreign debt	% GDP	16	19.1	21.8	23.3
Domestic debt	% GDP	19	20.3	14	11
Fiscal balance	% GDP	-1.0	-1.8	4.4	3.6
Current account	% GDP	-6.4	-8.6	-1.8	-2.2

Source: NSO, RBM, NBM, IMF

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