National Bank of Malawi
Economic Newsletter
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FOREIGN EXCHANGE DEVELOPMENTS

Since the 49% devaluation of the Kwacha on 7th May 2012, the local currency has depreciated by a further 30% to stabilize around the MK330/1USD. In the quarter under review, the market saw a divergence between foreign exchange rates quoted by the smaller banks and the more established larger banks. In early November for instance, the weighted average selling exchange rate was around MK325/1USD but some of the smaller banks were quoting selling rates of as high as MK344/1USD.

Smaller banks faced with the challenge of small market share in the currency trading market could not compete with the larger banks that have significantly more dollar denominated accounts. As a result, they opted to protect their interests by bidding high on dollar sales leading to the classic dual exchange rate equilibrium situation.

In spite of the foregoing, there was convergence of exchange rates during early December 2012, conceivably due to peer pressure within the commercial banking sector. This was plausibly a sign of maturity on the part of commercial banks given their new responsibility to determine exchange rates depending on demand and supply conditions. However, recent evidence is pointing to further disparity in selling exchange rates which are currently averaging MK341/1USD with some banks quoting as high as MK350/1USD underscoring the fragility of the foreign exchange situation.

Paradoxically, further depreciation is occurring despite the injection of donor pledges of around USD200mio and SDR allocations from the IMF in the month of December 2012. This may be a manifestation of how strong the perceptions of low gross official reserves, which are currently at 0.5

months of imports, coupled with banks acting in their own self interest are having on the local currency pricing against the US dollar.

However, the depreciation appears to be having the desired effect of curbing foreign exchange demand with new imports of luxury goods and imported used cars as the biggest casualties. Overall, foreign exchange demand has reduced by at least 30% and is exhibiting trends of further decline. The forecast is therefore for the Malawi Kwacha/US dollar exchange rate to be around the current levels mainly anchored by reduced demand given the relatively expensive US dollar.

MONEY MARKETS AND INTEREST RATES

Accommodation by the Reserve Bank through the non-collateralized discount window officially expired on 30 November 2012. Although the liquidity conditions within the economy have improved significantly, there are still some commercial banks experiencing tight liquidity positions. At the time of expiry of the non-collateralized window, borrowing was at approximately MK8 billion per day with signs of an improved interbank borrowing market averaging MK 2 billion per day.

Although there is evidence that commercial banks have now started accommodating each other through provision of liquidity on the interbank market, there are still some distressed banks as evidenced by the statistics above. If this situation continues, the Reserve Bank may require distressed banks to present time-bound balance sheet restructuring plans which may entail securitization of some assets, curtailing lending levels and putting on hold expansion plans. This situation notwithstanding, commercial banks may take comfort from the recent conversion of government loan arrears of about MK72 billion into Promissory Notes which will be a source of much needed liquidity in due course as interest payments become due and the debt liquidated. The fact that these promissory notes may not be used as collateral to borrow on the discount window underscores the importance the monetary authorities are putting on stabilizing the exchange rate and containing inflationary expectations.

In the meantime, the Reserve Bank of Malawi raised the bank rate by 4 percentage points to 25% effective 3 December 2012. The move is designed to curb credit expansion to private sector thus stabilizing the exchange rate and arresting runaway inflation. The tight monetary stance is expected to remain for the time being until inflation is brought under control.

INFLATION

Year on year headline inflation for October stood at 30.6% up 2.3% on the previous month. Rural and urban inflation rates stand at 28.8% and 33.5% respectively in the month. The rise in inflation is being attributed to increases in prices of processed goods and seasonal products in some parts of the country.

The main risks to further price increases remain the perceptions within the country of foreign exchange scarcity based on the level of official international reserves, which may lead to further depreciation of the Kwacha and the dynamic inconsistency on policy. The fact that gross official reserves are approximately 0.5 months of imports has been a constant worry for many observers despite the reduced demand for imports and the clearance of external arrears estimated at USD500 million. The Malawi Energy Regulatory Authority also reversed an announced fuel price increase in the month of October 2012 based on a technicality which resulted in a larger than required fuel price adjustment in the following month. This reversal came only after a couple of months since the adoption of the automatic adjustment policy for energy prices.

The expectation therefore is for prices to increase further in the months of November and December 2012 due to the fuel and energy tariff increases of 15% and 41% respectively in November 2012, followed by increases in prices of beverages. The above notwithstanding, prices are expected to start moderating in Q2:2013 with the onset of the harvest and tobacco selling season, hence the official annual average inflation forecast of 18% for 2013.

GROWTH

The level of economic activity is expected to fall from 4.3% in 2011 to 1.9% in 2012 owing to contractions in agriculture and manufacturing sectors. Real GDP growth is, however, expected to rebound to 5.5% in 2013 as the two key sectors above recover coupled with good performance in services. The main risk to growth as we approach the general election due in May 2014 remains potential policy reversals as political realities may be prioritized ahead of economic considerations. There is therefore need for the fiscal and monetary authorities to develop robust communication strategies to inform the public and other key stakeholders to better understand policy actions. Otherwise looming signs of strikes due to misunderstanding in policy are already rife.

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	1.9	5.5
Population	million				
GDP Deflator	%	7.4	3.8	16.4	17.3
Inflation (average)	%	7.4	7.6	20.8	18
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	1.5	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	-7	-2
Current account	% GDP	-17.2	-11.8	-15.7	-10.7

Source: NSO, RBM, NBM, IMF

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