National Bank of Malawi
Economic Newsletter
September 2012

TOBACCO 2012 FINAL REPORT

The 2012 tobacco season has seen record low volumes with 79.822 million Kgs of tobacco produced and sold (py 237.171 million Kgs). As a result he auction season has been the shortest on record lasting only 20 weeks (py 41 weeks). However, prices recovered to a season average of USD2.2277/Kg (py USD1.2385/Kg) for all tobacco types, representing a 79.87% increase. Total revenue recorded at the close of the auction in 2012 was USD177.8 million (py 293.7 million). This turnout underscores the importance of prices to production as farmers shifted to production of other cash crops and away from tobacco due to the low prices and high rejection rates experienced in the 2010/11 auction season.

The forecast for 2013 is for production to rebound to at least 200 million Kgs as farmers are encouraged by the 2012 prices, although this in itself may cause prices to drop once again. There is uncertainty currently in the local tobacco industry as government has been quick to endorse Integrated Production Systems despite the absence of clear implementation guidelines. Major buyers of the leaf continue to push for 100% contract tobacco production while government seems to favour an 80/20 split contract vs. auction. The downside to Integrated Production Systems remains the inherent characteristic of buyers being able to control/determine farmer’s production margins since buyers control the whole chain.

2011/12 Average Prices for Various Tobacco Types (USD/kg)

	BURLEY	FLUE	NDDF
Contract 2012	2.0384	2.5842	1.9639
Contract 2011	1.1453	2.2780	1.5674
Auction 2012	2.0485	3.2216	2.1511
Auction 2011	1.1243	1.6143	1.5081

Source: Tobacco Control Commission

Recent evidence from the past two seasons shows little difference between the two seasons especially for the main type of tobacco, burley as can be seen from the table above. However, this debate is set to dominate discussion within the industry for some time.

FOREIGN EXCHANGE DEVELOPMENTS

The Kwacha which appeared to stabilize around the K278/1USD after the flotation of the currency on 7 May 2012, has depreciated further to around K285/1USD. The period September- February is traditionally a lean period for foreign exchange earnings for the country coming after the closure of tobacco sales, the main export earner for the country. However, the pressure on the currency has been compounded by late resumption of the IMF program which essentially resulted in most bi-lateral donors not participating in aid disbursements in the first fiscal quarter (July-Sept).

Going forward, pressure on the local currency is expected to continue as the country begins importation of crucial commodities like fertilizer and other agricultural inputs against weak earnings. Inevitably the black market has resurfaced and could get worse if the supply side does not improve. Although, bi-lateral aid is expected to pick up in the second fiscal quarter, part of the aid may be delayed in the wake of the audit scandal at the National Audit Office and failure to resolve the issue of minority rights, in particular, the decriminalization of homosexuality.

Further depreciation of the kwacha may therefore be expected as the year draws to a close.

MONEY MARKETS AND INTEREST RATES

Discount window accommodation by the central bank despite being a temporary measure is still a feature for most commercial banks. However, in the week ending 31 August 2012 there was a 42% reduction in amounts borrowed at K11billion down from approximately K19 billion. This perhaps is a sign that distressed banks are beginning to curb their appetite to lend, in response to the onerous requirements of the terms of the facility. This is presumably in line with the key monetary objective of the Reserve Bank to limit the growth in money supply and demand of foreign exchange.

From 11 July 2012, the Reserve Bank revised the rate for discount window accommodation from 18.5% to 23.5%. The central bank further advised that continued use of the non-collateralized window after 31 July 2012 will attract a charge of 4% above the prime lending rate of that particular bank. This scenario has resulted in high lending rates which are now ranging from 35.75% on the lower bracket to as high as 45% on personal loans, the segment hardest hit by these recent developments.

Reading in between the lines, there seems to be reluctance from the monetary authority to either to heed some commercial banks' plea to reduce the Liquidity Reserve Requirement (LRR) to improve the liquidity levels in commercial banks so as to facilitate credit expansion. This line of thinking may be understandable given the fact that any credit expansion will inevitably lead to increased money supply growth and foreign exchange demand which the country can ill afford hence leading to further depreciation of the local currency.

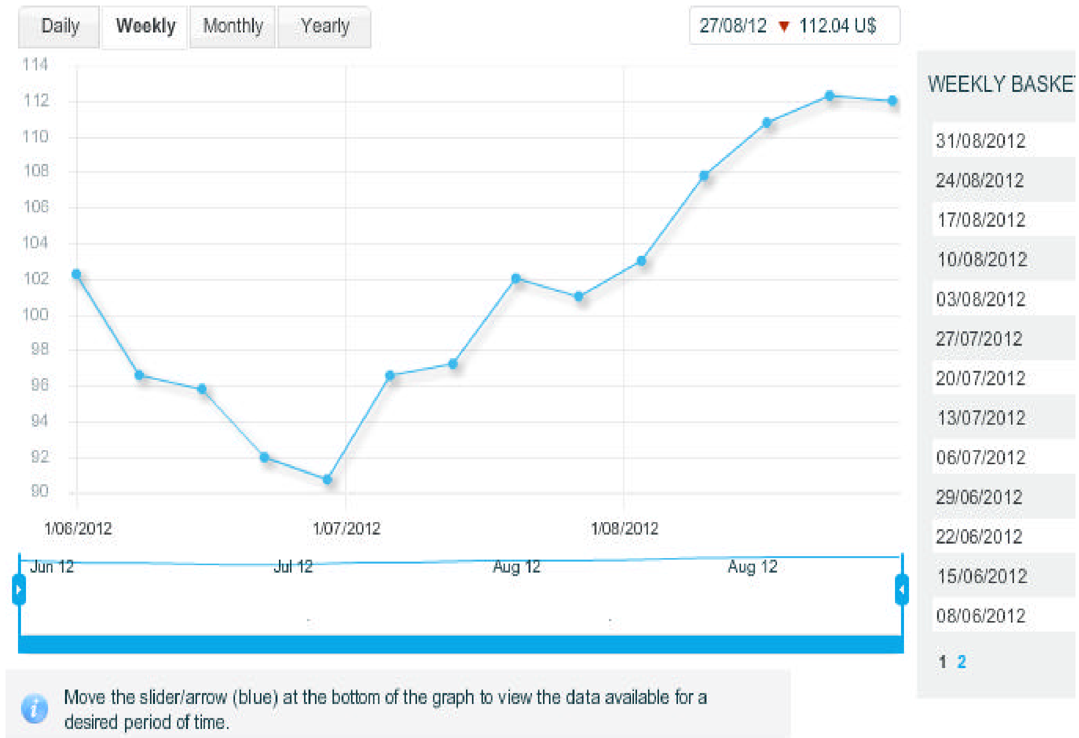
On the other hand, according to the Budget Statement delivered to the National Assembly on 8 June 2012, government guaranteed loans and overdrafts for Parastatal Organizations with commercial banks are at around K72bilion in arrears. This is apparently sufficient liquidity which could otherwise have gone a long way to ease the current liquidity crisis.

INFLATION PRESSURE AND WAGE DEMANDS

Pressure on prices abated slightly in the month of July due to a reduction in fuel prices. As a result inflation for July was at 21.7% up by 1.6% on the month before. Urban and rural rates for the month were at 21.5% and 19.6% respectively.

Currently, indications are for cost-push inflation to intensify given the concessions government is making for public sector organizations on wage increases. Even those that were already awarded are continuing to stage wild cat strikes demanding even more increases. These pay accommodations may result in a wage-inflation spiral which may derail government's austerity budget announced in June 2012. Restoration of the previous purchasing power of the kwacha through wage increases also may just result in the reversal of gains made, and the devaluation would then be meaningless.

The situation may be exacerbated if global fuel prices start to increase, which may then mean further local increases in the local pump prices. However, currently the OPEC global basket price is around USD112.05 which is within the 5% trigger point for the month of August 2012. However, a fuel price hike in the month of September cannot be ruled with rises in crude oil and if the authorities decide to clear the arrears in the stabilization fund, previously raided by central treasury to cover up for the then Zero Deficit Budget,. Arrears in the stabilization funds are currently at around K17billion.



Source: OPEC website

GROWTH PROSPECTS

Real GDP growth in 2012 is likely to be around 2-3% given the low tobacco revenues, relatively high inflationary environment and credit contraction due to high interest rates.

SELECTED ECONOMIC INDICATORS

INDICATOR	UNIT	2009	2010	2011	2012
GDP at current market prices	MK billion	710.2	812.4	879.8	1068.1
GDP at constant prices	%	9.0	6.5	4.3	4.3
Population	million	14			
GDP Deflator	%	8.4	7.4	3.8	16.4
Inflation (average)	%	8.4	7.4	7.6	18.4
Bank rate	%	15	15	13	21
Money supply (M 2)	% CHANGE	23.9	33.9	35.7	18.2
Import Cover	Months	1.4	1.4	2.1	2.8
Foreign debt	% GDP	19.1	21.8	23.3	20
Domestic debt	% GDP	20.3	14	11	2
Fiscal balance	% GDP	-2.0	-2.2	-7.0	-0.5
Current account	% GDP	-14.2	-17.2	-11.8	-15.7

Source: NSO, RBM, NBM, IMF

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