Economic review for 2018 and outlook for 2019

Investment Banking

22nd February 2019

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1. Interbank market

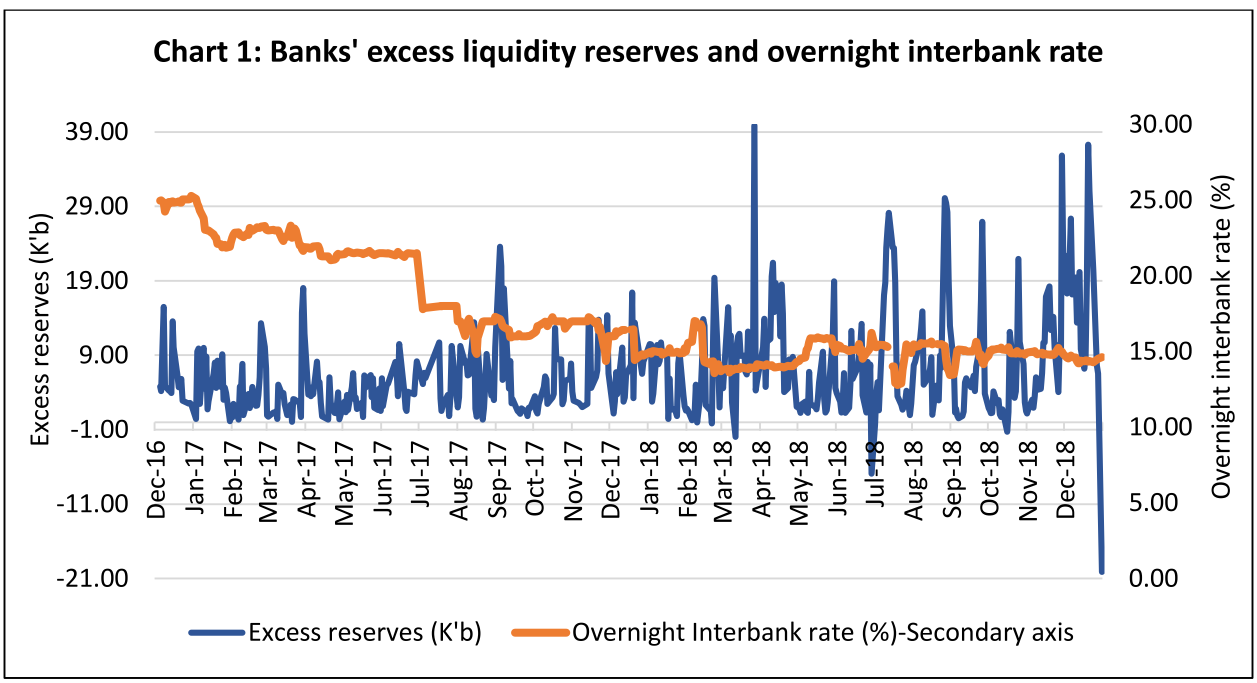
1.1 Liquidity levels on the interbank market were higher in 2018 relative to 2017. Excess liquidity reserves averaged K9.11 billion per day compared to K5.54 billion per day in 2017, representing a 65% increase. Liquidity levels were highest in December 2018 when excess liquidity reserves averaged K16.05 billion per day and were lowest in May 2018 when excess liquidity reserves averaged K4.53 billion per day.

1.2 With high liquidity levels, coupled with persistent downward pressure on the general level of interest rates emanating mainly from the interest rate capping bill, the overnight interbank rate declined, averaging 14.79% during the year compared to the average of 18.52% in 2017.

1.3 Banks borrowed more from each other than they resorted to the Reserve Bank of Malawi (RBM) during the year as indicated by an increase in overnight interbank borrowing to a daily average of K8.24 billion from an average of K6.76 billion in 2017, while access on the Lombard Facility of the Reserve Bank (also known as the discount window) decreased to a daily average of K6.64 billion compared to a daily average of K7.01 billion in 2017.

1.4 The central bank withdrew a total of K337.60 billion from the market at an average rate of 15.00% through open market operations (OMO) during the year, compared to a total of K898.88 billion at an average rate of 18.68% in the previous year.

1.5 Chart 1 provides a summary of excess liquidity reserves and overnight interbank rate movements over the last two years. The chart shows that the interbank rate remained within the RBM target band of +2/-4 percentage points of the Policy rate which was stable at 16.00% throughout the year.



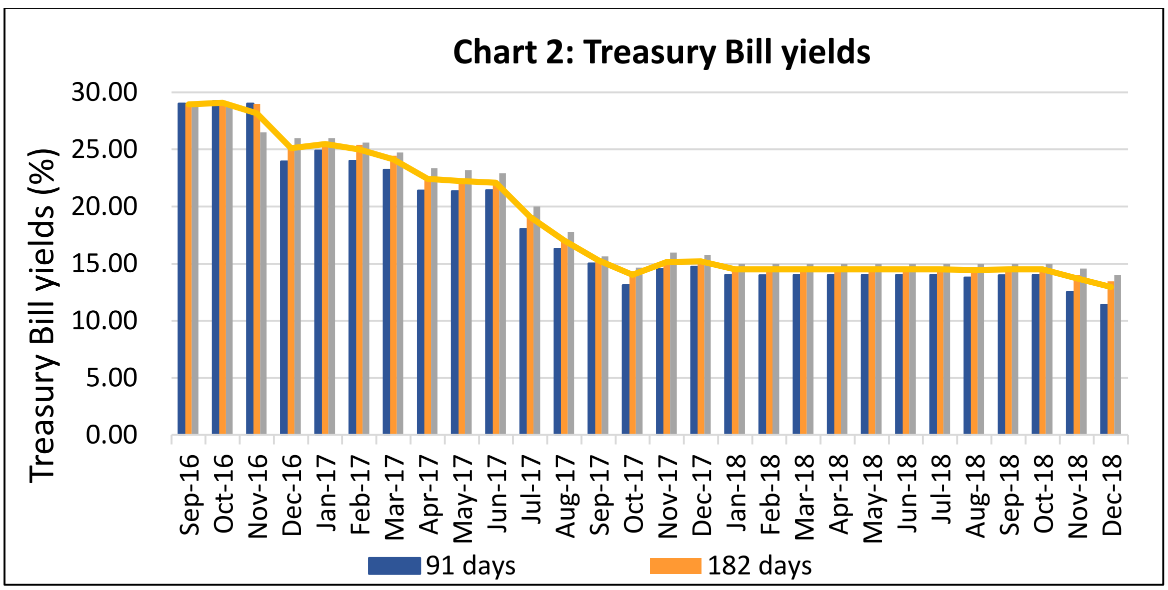
(Source: Reserve Bank of Malawi)

2. Government securities

2.1 In 2018 Government raised a total of K490.41 billion through auctions for Treasury Bills (TB) compared to K243.67 billion raised in 2017, representing a 102% increase. Total applications for Treasury bills for the year amounted to K569.55 billion (2017: K444.13 billion), representing a 7.22% rejection rate (2017: 45.14%).

2.2 Treasury Bill yields were broadly stable in 2018. They only started to decline in the last two months of the year. The 91-day TB yield averaged 13.64%, the 182-day TB yield averaged 14.37% and the 364-day TB yield averaged 14.88%, resulting in an all-type (average) yield of 14.30% which is lower than the all-type yield of 19.76% recorded in 2017.

2.3 Chart 2 shows that TB yields declined between November 2016 and September 2017 before stabilizing in 2018. Towards the end of the year 2018, however, the yields started to decline again, largely due to mounting downward pressure on the general level of interest rates as the interest rate capping bill gained prominence.



(Source: Reserve Bank of Malawi)

2.4 In 2018 the Government also embarked on a debt restructuring programme which saw the issuing of 2-year, 3-year, 5-year and 7-year Treasury Notes (TN) through auctions conducted by RBM. A total of K104.56 billion was raised through these auctions at the average yield of 18.08% for the 2-year TN, 19.53% for the 3-year TN, 20.42% for the 5-year TN and 24.00% for the 7-year TN. The Government will continue to issue TNs in 2019.

2.5 Looking ahead, following the significant monetary policy changes that RBM made in January 2019, which include:- the reduction of the Policy rate from 16% to 14.5%; the reduction of the Lombard rate from 18.0% to 14.9%; the reduction of the Liquidity Reserve Requirement (LRR) from 7.5% to 5.0% for domestic currency deposits and to 3.5% for foreign currency deposits; and the pegging of the base lending rate for commercial to the Lombard rate 14.9%, yields on Government securities like other interest rates in the market are expected to decline in the near term before stabilizing later in the year when the market fully responds the policy changes.

3. Foreign exchange market

3.1 The Kwacha remained broadly stable in 2018, registering a marginal depreciation of 0.23% against the USD and appreciations of 5.38%, 13.69% and 3.72% against the GBP, ZAR and EUR, respectively, between 29th December 2017 and 31st December 2018. This is an improvement from the previous year when the Kwacha registered depreciations of 0.47%, 9.59%, 11.79% and 13.45% against the USD, GBP, ZAR and EUR.

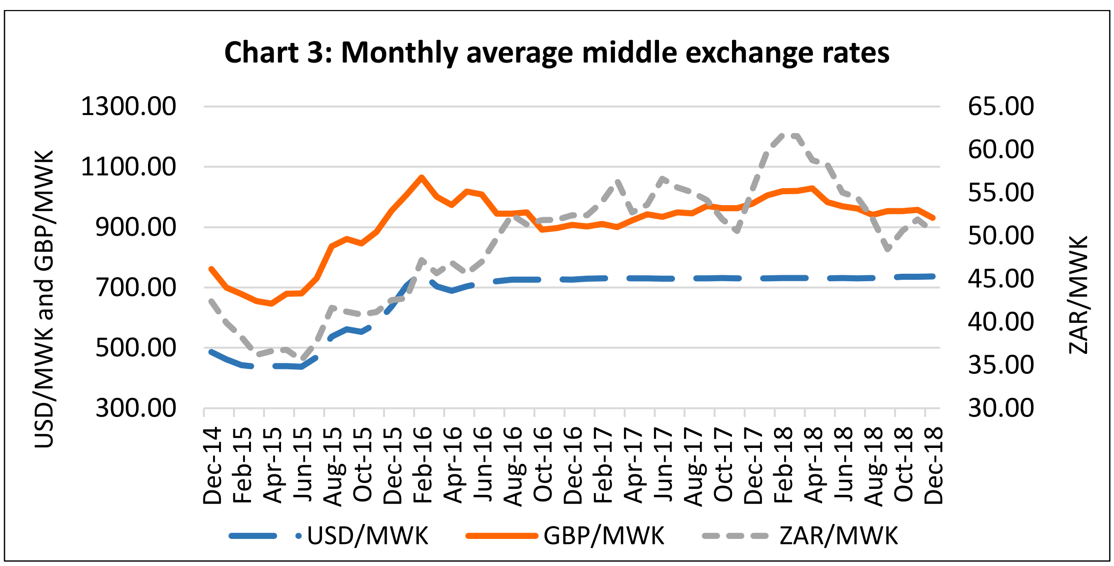
3.2 Table 1 and Chart 3 below provide an overview of how the Kwacha has fared against the four major trading currencies in the last three years.

Table 1: End of year middle exchange rates

Currency	31-Dec-18	29-Dec-17	30-Dec-16	2018 Change	2017 Change
USD	733.69	732.03	728.62	▼ 0.23%	▼ 0.47%
GBP	926.83	979.53	893.83	▲ -5.38%	▼ 9.59%
ZAR	50.96	59.04	52.81	▲ -13.69%	▼ 11.79%
EUR	836.75	869.07	766.03	▲ -3.72%	▼ 13.45%

Source: Reserve Bank of Malawi

Note: Upward arrow represents appreciation and downward arrow represent depreciation of the Kwacha.

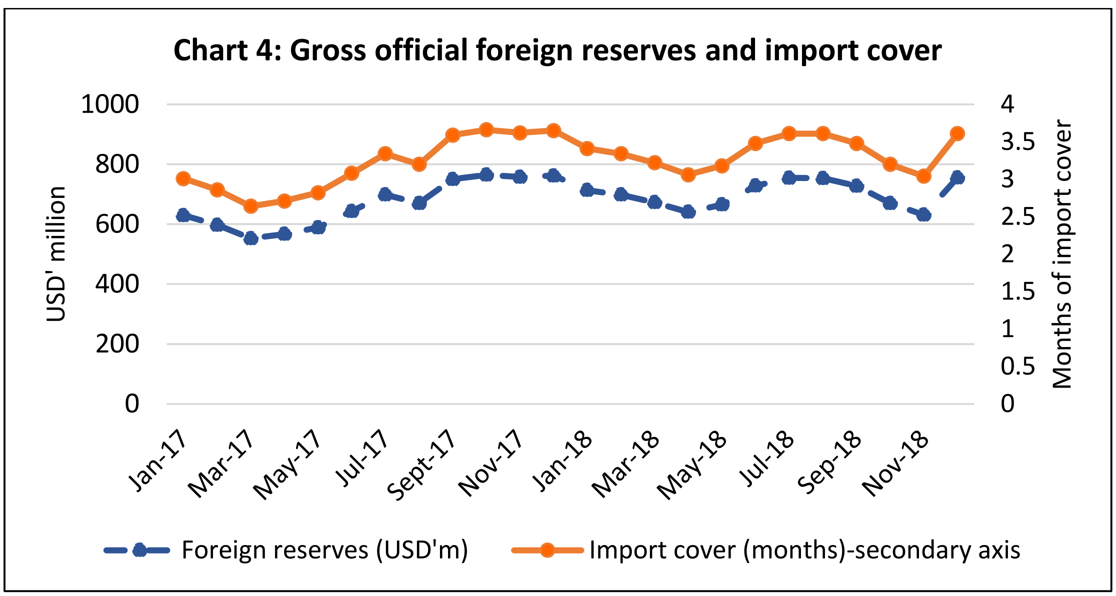


(Source: Reserve Bank of Malawi)

3.3 The continued stability of the Kwacha against the USD despite the general strengthening of the USD during the year, could be attributed to stronger confidence in the Kwacha from market players, robust forex reserves which ensured consistent availability of forex on the market, and tight monetary conditions which resulted in weak demand for imports. Besides these factors, the appreciation of the Kwacha against the other major trading currencies in 2018 was on account of pressures on these currencies on the international market, partly due to uncertainty in the UK regarding Brexit negotiations and political uncertainty in the Euro area.

3.4 With regard to forex reserves, the RBM managed to keep official reserves at or above 3.0 months of import cover throughout the year, as depicted in Chart 4 below, largely due to an increase in forex inflows from tobacco exports - in 2018 Malawi realised a total of USD337.50m from tobacco auction sales, a 58.82% increase when compared to USD212.51m realized during the 2017 season.

3.5 Gross official foreign reserves stood at USD755.22 million (3.61 months of import cover) on 31st December 2018, slightly lower than USD761.97 million (3.65 months of import cover) recorded on 29th December 2017. Private foreign reserves were observed at USD330.84 million (1.58 months of import cover) as at the end of December 2018, compared to USD414.03 million (1.98 months of import cover) during the same period the previous year.

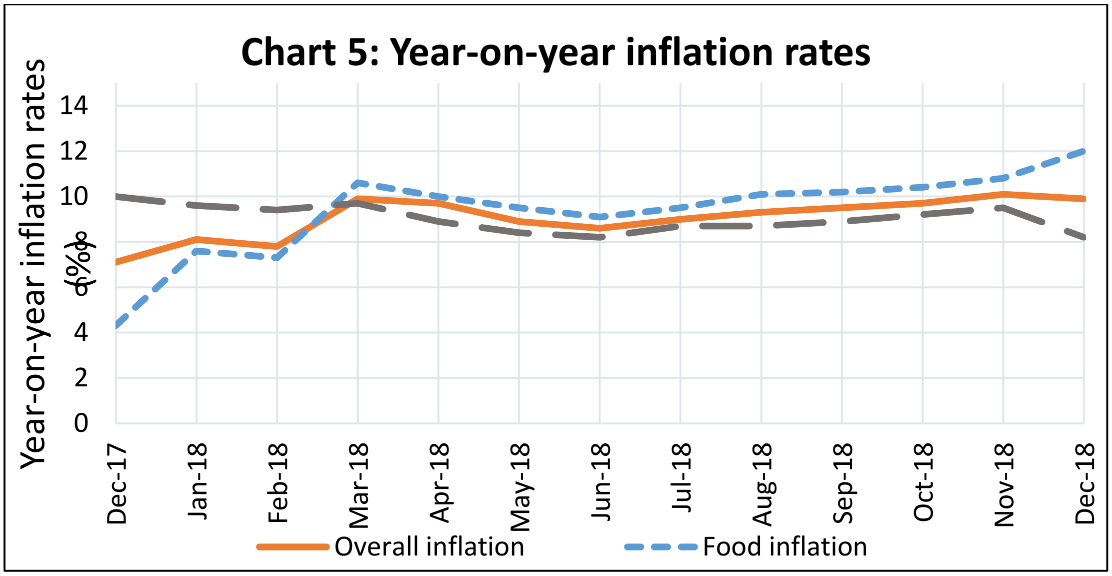


(Source: Reserve Bank of Malawi)

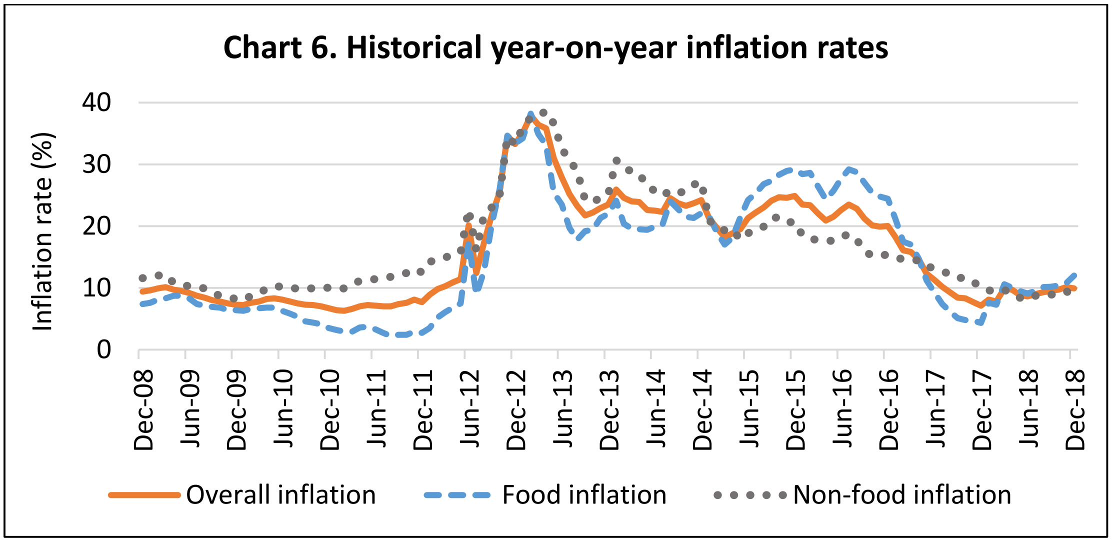
3.6 Looking ahead, the Kwacha is expected to remain broadly stable in the short to medium term, supported by a robust forex reserves position. In the long term, however, depreciation risks could emanate from trade imbalances due the country's weak and less diversified export base and from exogenous shocks such as rising international oil prices.

4. Inflation

4.1 2018 registered a relatively stable inflation rate despite unwavering pressures from upward adjustments in utility prices and rising maize prices. Headline inflation rate remained within a single digit throughout the year, expect in November 2018. It averaged 9.2%, down from the average of 11.5% in 2017 on account of a decline in both food and non-food inflation rates which averaged 9.8% and 9.0%, respectively, compared to 10.3% and 12.9% in 2017.



(Source: National Statistical Office)



(Source: National Statistical Office)

4.2 The decline in inflation in 2018 relative to the previous years could largely be attributed to a relatively stable macroeconomic environment during the year, including stable exchange rate and interest rates which could have improved confidence in the economy.

4.3 The inflation rate, however, faced consistent pressures from elevated maize prices and upward adjustments in utility prices. Maize price rose by over 60% in 2018 compared to 2017 levels on account of lower than average harvest in the 2017/2018 season as most parts of the country experienced dry spells and fall army worm attacks. The Malawi Energy Regulatory Authority (MERA) approved two price hikes for electricity in 2018 (in February 2018 and October 2018). As at the end of the year, electricity tariff stood at K88.02/Kwh, up by 53.00% from K57.72/Kwh as at the end of the previous year. Further, MERA approved three upward adjustments in fuel prices during the year (in July, October and November) which were later adjusted downwards in December 2018. As of December 2018, prices for petrol, diesel and paraffin stood at K923.50 per litre, K949.60 per litre and K781.80 per litre, respectively, representing increases of 11.98%, 16.40% and 20.52% when compared to K824.70 per litre, K815.80 per litre and K648.70 per litre as of December 2017.

4.4 Looking forward, headline inflation is expected to continue to decline in 2019, partly supported by continued stability in the exchange rate and expected improvement in agricultural output following a normal rainfall pattern so far experienced in the 2018/2019 season which could lessen the impact of any further upward adjustments in utility prices. RBM projects an average headline inflation rate of 8.5% in 2019 and targets an average annual rate of 5% by 2021.

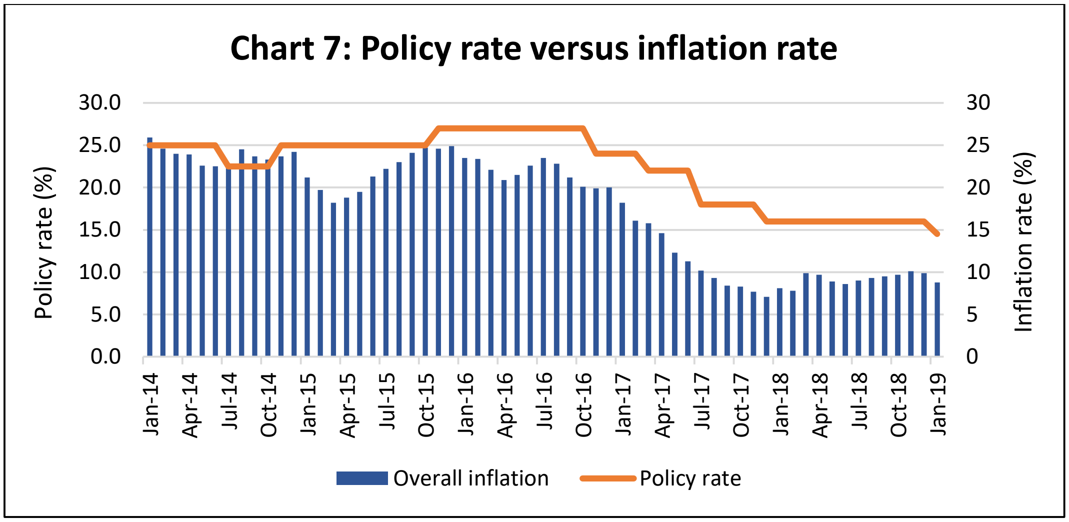
4.5 Risks to this inflation outlook include significant shocks to this year's agricultural output, unfavourable shocks to international oil prices and possible increase in Government expenditure especially during the elections period, among other factors.

5. Monetary policy

5.1 The Monetary Policy Committee (MPC) of the Reserve Bank of Malawi (RBM) met three times in 2018 (in March, July and September) to review developments in the local and global economy that inform monetary policy decisions. On all three occasions the Committee decided to maintain the monetary policy stance and so kept the Policy rate unchanged at 16.00%, the Lombard rate at 18.00% and the Liquidity Reserve Requirement (LRR) at 7.50%. The cautious stance of monetary policy was on account of persistent upward inflationary pressures that prevailed during the most part of the year. The decision was thus aimed at containing risks and supporting disinflation towards the RBM medium term objective of 5.00%. The RBM committed to complementing this policy stance with consistent mop-up operations to maintain tight liquidity conditions in the market.

5.2 In 2017 the MPC revised the Policy rate downwards three times which saw the Policy rate decline from 24.00% as at the beginning of the year to 16.00% as at the end of the year.

5.3 The chart below depicts the historical trend of the Policy rate relative to inflation rate. The chart shows that the Policy rate has been on a declining trend since November 2016.



(Source: RBM, NSO)

5.4 Going into 2019, on 29th and 30th January 2019, the MPC met for their first meeting of 2019. After taking into consideration developments in the domestic and global economy and macroeconomic outlook, the Committee observed that risks to inflation experienced in 2018 had started to dissipate and that the macroeconomic outlook for 2019 looked favourable. The Committee thus decided to loosen monetary policy as follows:

5.4.1 reduce the Policy rate (PR) from 16.0% to 14.5%;

5.4.2 reduce the Liquidity Reserve Requirement (LRR) ratio from 7.5% to 5.0% for domestic currency deposits and from 7.5% to 3.75% for foreign currency deposits;

5.4.3 reduce the Lombard rate from 18.0% to 14.9%; and

5.4.4 peg the Base lending rate for commercial banks at the Lombard rate.

5.5 These policy changes were aimed at assisting the financial sector and the private sector to harness synergies and effectively contribute to economic growth.

5.6 In response to the monetary policy changes, commercial banks reduced their maximum lending rates which now range from 25.80% to 26.9%, compared to the range of 32.00% to 39.00% before the revision.

5.7 Looking forward, we expect the MPC to take a cautious stance in the short to medium term to allow the market to fully respond to the recent changes. All other interest rates in the market could continue to decline in the near term and then stabilise later in the year. In the long term, we expect further interest rate cuts if shocks to inflation and the exchange rate continue to be contained.

6. Economic growth

6.1 RBM and the World Bank estimate that economic activity moderated to around 4.0% and 3.7%, respectively, in 2018 from around 5.2% in 2017, owing to a decline in agricultural production as erratic rains and a fall army worm infestation negatively impacted crop output. Structural challenges related to the intermittent supply of power and water were also a significant constraint on production in 2018.

6.2 In 2019 economic growth is expected to be slightly better than in 2018 largely on account of a rebound in agriculture following an expected normal rainfall pattern and a favourable macroeconomic environment. RBM and the Government project a real GDP growth rate of 4.1% for 2019 driven by good performance in the following economic activities: agriculture; wholesale and retail trade; transportation and storage; information and communication; and professional, scientific and technical services, among others. Agriculture output in 2019 is expected to recover to 2.0% from 0.6% in 2018, the wholesale and retail trade sector is estimated to grow by 4.9%, transport and storage by 5.4% and information and communication by 7.5%.

Table 2: Government estimates and forecasts of growth rates

	2017^{e}	**2018^{f}**	**2019^{f}**
Agriculture, forestry and fishing	6.1	0.6	2.0
Mining and Quarrying	1.6	1.9	1.5
Manufacturing	2.0	3.8	3.5
Utilities	2.6	4.4	3.1
Construction	4.4	4.9	3.7
Wholesale and retail	5.0	4.4	4.9
Transport and storage	6.0	5.2	5.4
Accommodation and food service activities	4.2	5.9	4.0
Information and communication	6.5	7.0	7.5
Financial and Insurance activities	5.5	7.1	3.9
Real estate activities	4.4	3.9	2.8
Professional, scientific and technical services, Administrative and support service activities	4.0	5.2	5.9
Public administration and defense	5.7	7.2	6.1
Education	6.6	9.4	7.6
Human health and social work activities	5.3	6.0	5.7
Other services	4.3	5.2	5.0
Sum of all industries	**5.0**	**3.8**	**3.9**
Plus taxes less subsidies on products	*7.7*	*7.1*	*7.7*
GDP in 2010 constant prices	**5.2**	**4.0**	**4.1**

(Source: Business Interviews Summary Report, September 2018 - compiled by National Accounts and Balance of Payments Technical Committee)

Table 3: World Bank growth rate estimates for Malawi			
	2016	2017	2018[f]
Real GDP	**2.5**	**4.0**	**3.7**
Agriculture	-2.3	5.0	2.5
Industry	2.4	2.2	3.0
Services	4.4	4.0	4.5

(Source: World Bank's Malawi Systematic Country Diagnostic: Breaking the Cycle of Low Growth and Slow Poverty Reduction - December 2018)

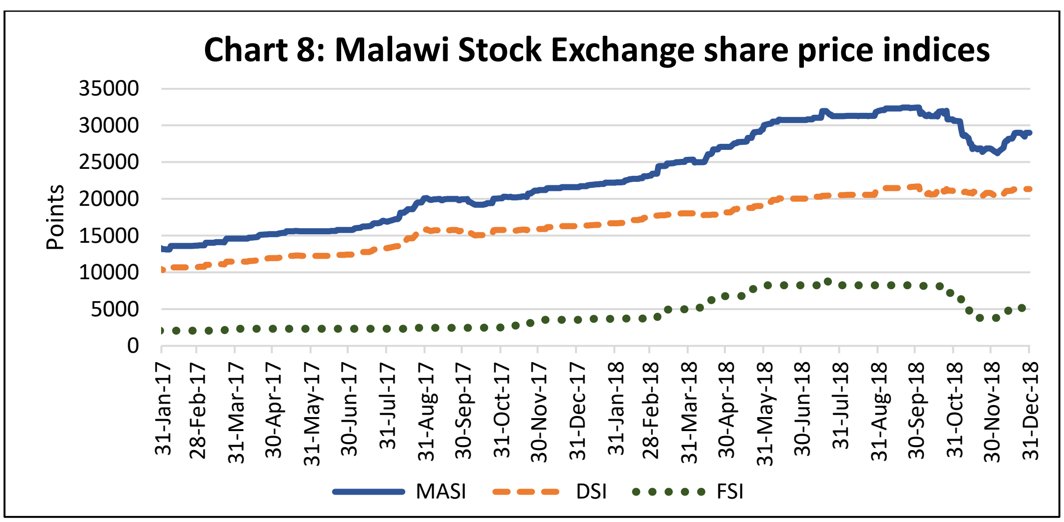
7. Stock market performance

7.1 The Malawi Stock Exchange (MSE) was buoyant for the second consecutive year as it registered a positive return on investment of 34.19% compared to 62.14% in 2017. The Malawi All Share Index (MASI) closed the year at 28,983.53 points compared to 21,598.07 as at the beginning of the year.

7.2 The market registered significant improvements in both the volume and value of shares traded. The volume of traded shares increased by 37.11% to 958,247,064 and the value of traded shares increased by 260.28% to K48.70 billion.

7.3 11 counters registered capital gains while 2 counters registered losses. Top gainers were BHL (141.64%), TNM (93.10%), PCL (90.00%), OML (52.04%) and SUNBIRD (51.04%) and top losers were ILLOVO (-16.67%) and MPICO (-15.44%).

7.4 During the year, MSE listed the first corporate bond by New Finance Bank and 6 Government of Malawi Treasury Notes with tenors ranging from 2-3 years. However, there was no trade in the listed debt securities as was the case in the previous year.



(Source: Malawi Stock Exchange)

Table 4: Share trading summary			
	Dec-18	Dec-17	% Price change
Market indices			
MASI	28,983.53	21,598.07	34.19%
DSI	21,318.07	16,272.64	31.01%
FSI	5,265.12	3,519.43	49.60%
Gainers			
BHL	13.00	5.38	141.64%
TNM	28.00	14.50	93.10%
PCL	1,140.00	600.00	90.00%
OML	2,980.00	1,960.00	52.04%
SUNBIRD	145.00	96.00	51.04%
FMBCH	100.00	67.00	49.25%
NICO	43.00	34.00	26.47%
NITL	75.00	60.06	24.88%
NBM	332.02	270.08	22.93%
NBS	10.00	8.50	17.65%
STANDARD	670.00	610.00	9.84%
Flat			
OMU	2,513.25	2,513.25	0.00%
Losers			
MPICO	13.20	15.61	-15.44%
ILLOVO	200.00	240.00	-16.67%

(Source: Malawi Stock Exchange)

8. Financial results for the half year ended 30th June 2018

8.1 During the year, listed companies and some financial institutions published their financial results for the half year ended 30th June 2018. All companies listed in Table 7 below, except Nedbank, posted profits and most companies registered improvements in profits compared to a corresponding period in the previous year. A relatively stable macroeconomic environment, especially with regard to interest rates, exchange rate and inflation rate, was mentioned by some companies as one of the contributing factors to good performance during the period.

8.2 Most banks reported lower profits than the previous corresponding period due to among other factors, reduced interest income, an increase in loan impairments and weak response on the supply side to macroeconomic gains experienced during the period partly owing to infrastructural challenges in the power sector.

Table 5: Published financial results for the half year ended 30th June 2018

	H1 2018 PAT (K'm)	Movement	H1 2017 PAT (K'm)
Listed companies			
FMB Bank (Malawi only)	6,580	31%	5,035
FMB Capital Holdings PLC (USD'm)	20		
MPICO PLC	3,799	38%	2,760
National Bank fo Malawi PLC	8,541	-10%	9,527
NBS Bank	479	142%	(1,136)
NICO Holdings PLC	5,973	39%	4,303
National Investment Trust PLC	1,429	42%	1,009
Press Corporation PLC	23,079	227%	7,061
Standard Bank	5,532	-32%	8,163
Sunbird	1,173	9%	1,072
TNM	6,942	46%	4,750
Unlisted banks			
CDH Investment Bank	672	34%	503
Ecobank	2,120	-1%	2,134
FDH Bank	1,342	-26%	1,820
Nedbank	(1,053)	-15%	(912)
New Finance Bank	820	180%	(1,022)
Discount house			
First Discount House	157	-75%	634

(Sources: MSE and The Nation and Daily Times newspapers)

9. Commodities

9.1 Tobacco

9.1.1 The 2018 tobacco auction market lasted 26 weeks and closed in September 2018, by which a total of USD337.50m had been realized, compared to USD212.51m realized during the 2017 season, representing a 58.82% increase. The increase in proceeds from tobacco sales in 2018 relative to the previous year is on account of an increase in volumes sold. In the 2018 season the total volume of tobacco sold amounted to 202.00 million kilograms, 89.60% higher than 106.54 million kilograms sold during the 2017 season. The increase in volumes is on account of higher production for 2018 and also an influx of leaf imports from Zambia and Mozambique sold in Malawi.

9.1.2 The increase in volumes, however, led to a decline in prices. The all-type tobacco price averaged USD1.67 per kilogram, 16.08% lower than USD1.99 per kilogram recorded at the close of the 2017 season.

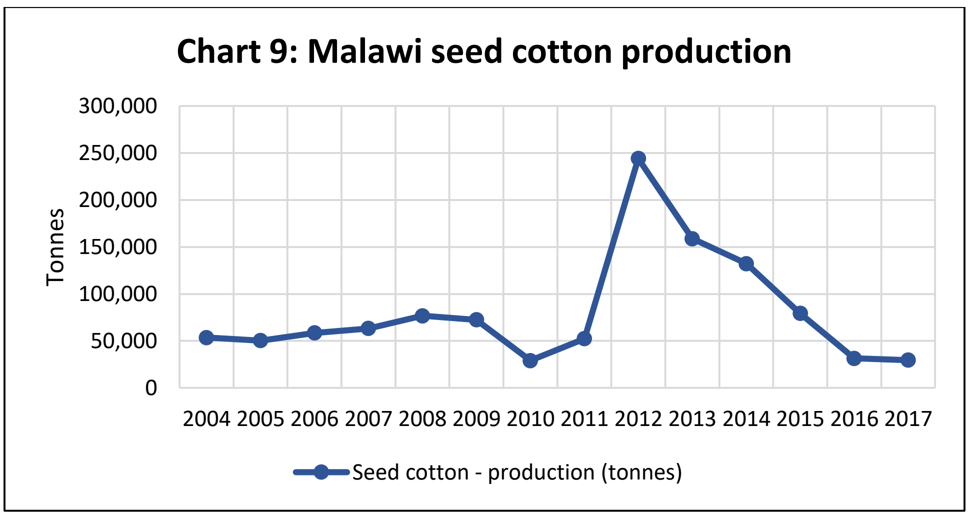
9.1.3 Below is a summary of how the tobacco market fared in 2018 relative to the previous year.

	2018	2017	Change
Volume (kg)	202.00 million	106.54 million	89.60%
Average price (USD/kg)	1.67	1.99	(16.08%)
Turnover (USD)	337.50 million	212.51 million	58.82%

Source: Tobacco Control Commission (TCC)

9.2 Cotton

9.2.1 Cotton production remains low in Malawi, averaging 90,654 metric tonnes per year in the last decade. It is only in 2012 and 2013 that the country produced relatively significant amounts (244,154 metric tonnes in 2012 and 158,826 metric tonnes respectively). Since then cotton production has been declining, reaching 29,545 metric tonnes in 2017.



Source: Food and Agricultural Organization of the United Nations (FAO)

10. Interest rate capping bill

10.1 A member of parliament moved a motion in parliament on 8th December 2016 to cap interest rates on loans obtained from banks and other lending institutions with an aim of protecting consumers from exorbitant loan prices. The issue sparked debate in 2018 as members of parliament held consultations with various stakeholders on the issue to inform decisions regarding a bill that was being drafted. The RBM also organized a conference on the same.

10.2 The general consensus from the debate was that lending rates in Malawi are too high compared to other countries in the Sub-Saharan African region but the debaters deferred on whether capping interest rates by law was the way to go to bring down the lending rates.

10.3 The first draft of the bill was presented in Parliament on 13th December 2018. The members of parliament, however, resolved that there was need for further consultations on the bill and so referred the matter to a Joint Parliamentary Committee comprised of the Public Accounts Committee, the Government Assurances Committee and the Women's Caucus.