Annual economic review 2017

Investment banking

25th January 2018

Reviewed: 20th February 2018

http://www.cdh-malawi.com

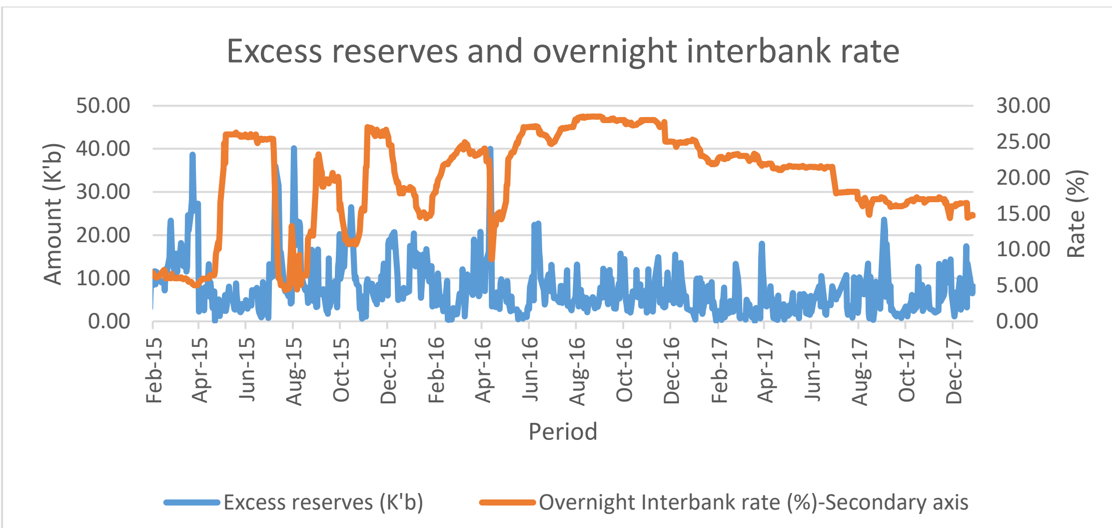
1. INTERBANK MARKET AND INTEREST RATES

1.1 Liquidity conditions on the interbank market were generally tight in 2017. Excess reserves averaged K5.54 billion per day compared to K7.33 billion per day in 2016. Excess reserves were lowest at negative K0.79 billion in April and were the highest at K23.58 billion in September 2017 towards the close of the tobacco auction season. As a result of Policy Rate cuts which were triggered mainly by decelerating inflation and exchange rate stability during the year, the overnight interbank rate declined, averaging 18.52% in 2017 from 24.46% in 2016 despite persistent tight monetary conditions.

1.2 Overnight interbank borrowing increased to a daily average of K6.76 billion from an average of K5.12 billion in 2016. Access on the Lombard Facility of the Reserve Bank of Malawi (RBM) (also known as the discount window) increased to a daily average of K7.01 billion compared to a daily average of K6.94 billion in 2016.

1.3 The central bank withdrew a daily average of K6.38 billion (total: K898.88 billion) from the market at an average rate of 18.68% through open market operations (OMO) during the period under review.

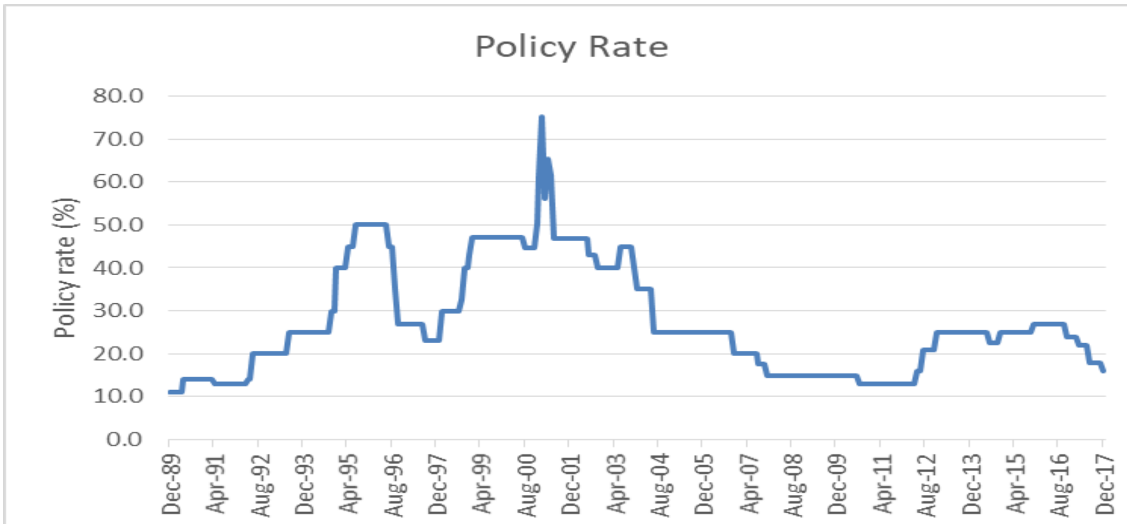
1.4 The chart below summarizes the movement of excess reserves and overnight interbank rate in the last three years.



Source: Reserve Bank of Malawi

1.5 The Monetary Policy Committee (MPC) revised the Policy Rate downwards three times in 2017. The first adjustment was by 200 basis points from 24% to 22% in March 2017. The second adjustment was by 400 basis points to 18% in July 2017 and the last adjustment was by 200 basis points to 16% in December 2017. On all the three occasions that the Policy Rate was revised, the decision was made after considering developments in the local economy especially the drop in inflation and the stability of the exchange rate that prevailed throughout the year as well as the outlook on inflation and developments in the global economy. The downward revisions in the Policy Rate were triggered by the need to maintain a tight monetary policy to keep inflation on a downward trend. Low inflation in turn was expected to guarantee low interest rates and prolonged stability of the exchange rate. The committee, however, maintained the Liquidity Reserve Requirement (LRR) at 7.5 percent.

1.6 The chart below depicts the historical trend of the Policy Rate.



Source: RBM

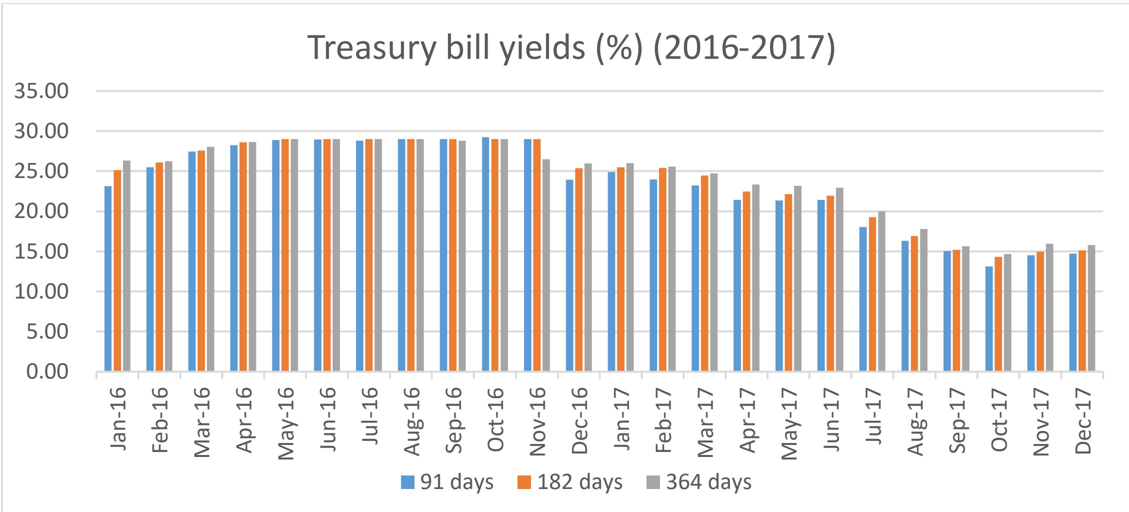
1.7 In response to the Policy Rate cuts, all other interest rates on the market declined during the year. The Lombard rate declined from 26.00% as at the beginning of the year to 16.00% at the end of the year. The overnight interbank rate decelerated from 25.1% as at 3rd January 2017 to 14.72% as at 28th December 2017. Consequently base lending rates for commercial banks also declined in the year 2017. They ranged between 32.00% and 35.00% at the beginning of the year to the currently range of between 23.00% and 25.50%.

1.8 Looking forward, interest rates are likely to continue the downward trend in the short to medium term as no significant negative shocks to underlying macroeconomic fundamentals are immediately expected. In 2018, if inflation remains in the single digit and shocks to the exchange rate continue to be contained, backed by sufficient foreign reserves, the MPC could cut the Policy Rate further, leading to an across- the- board deceleration of interest rates. The interbank rate will most likely remain close to the Policy Rate amid continued tight liquidity conditions as authorities intensify mop up operations to withdraw liquidity injected from expansionary operations. The RBM has clearly stated their intention to keep the interbank rate within the band of ±200 basis points around the policy rate.

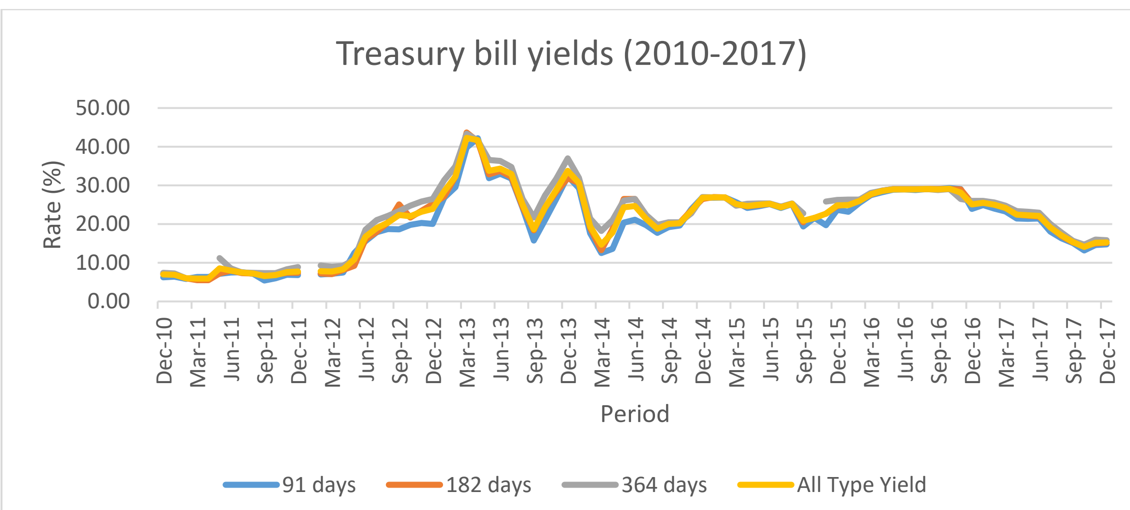
2. TREASURY BILLS

2.1 During the year under review, government raised K243.67 billion through Treasury bill auctions compared to K367 billion raised in 2016. Total applications for Treasury bills stood at K444.13 billion, representing a 45.14% rejection rate (2016: 14%). In response to Policy Rate cuts, Treasury bill yields declined during the year, with the all-type Treasury bill yield averaging 19.76% from 27.87% in 2016 and closing the year 2017 at 14.53%.

2.2 The following two charts depict the movement of the Treasury bill yields in the last seven years.



Source: Reserve Bank of Malawi



Source: Reserve Bank of Malawi

2.3 Looking ahead, the Treasury bill yields are expected to stabilize around the Policy Rate as the authorities work to consolidate the gains made in stabilizing the economy in 2017. In the short to medium term, Treasury bill yields may face a downward pressure as the authorities target cheaper funds due to high government debt levels.

3. EXCHANGE RATES

3.1 The Kwacha was broadly stable in 2017, registering a marginal depreciation of 0.08% against the USD and depreciations of 9.78%, 9.67% and 13.51% against the ZAR, GBP and EUR, respectively, between 30th December 2016 and 29th December 2017. As at 29th December 2017, the Kwacha was trading at USD/MWK725.5840, ZAR/MWK58.4941, GBP/MWK976.4909/ and EUR/MWK866.7101, compared to USD/MWK725.0093, ZAR/MWK53.2829, GBP/MWK890.3839 and EUR/MWK763.5798 as at 30th December 2016.

3.2 The relative stability of the Kwacha in 2017 can be attributed to the tobacco marketing season which brought in USD212.5 million, the resumption of aid and credit facilities from development partners which ensured consistent availability of forex in the country, as well as tight monetary conditions which mitigated the impact of a wide current account deficit.

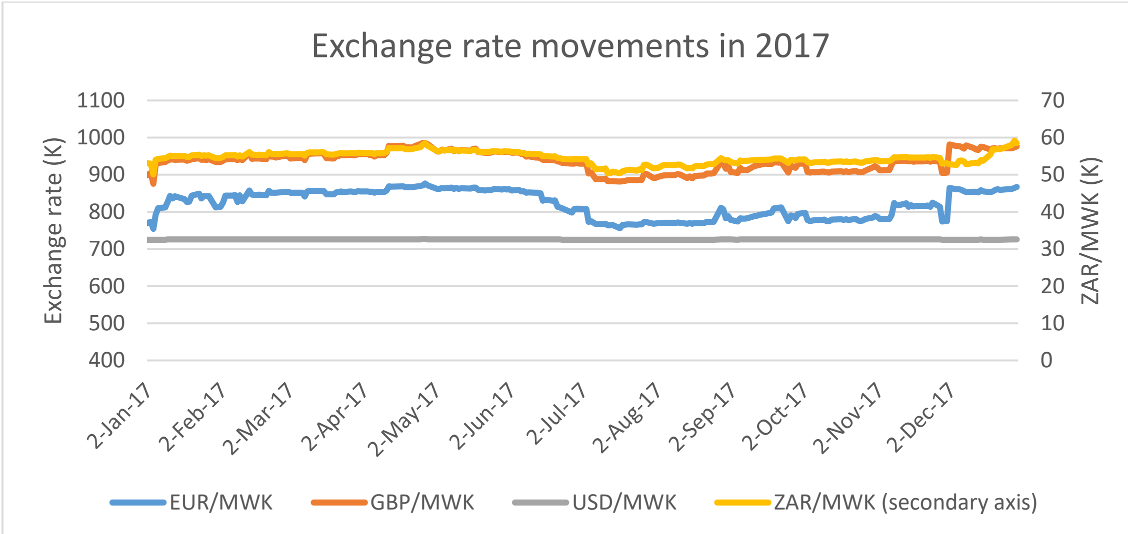
3.3 The table below provides an annual overview of how the Kwacha fared against the four major trading currencies in the last three years.

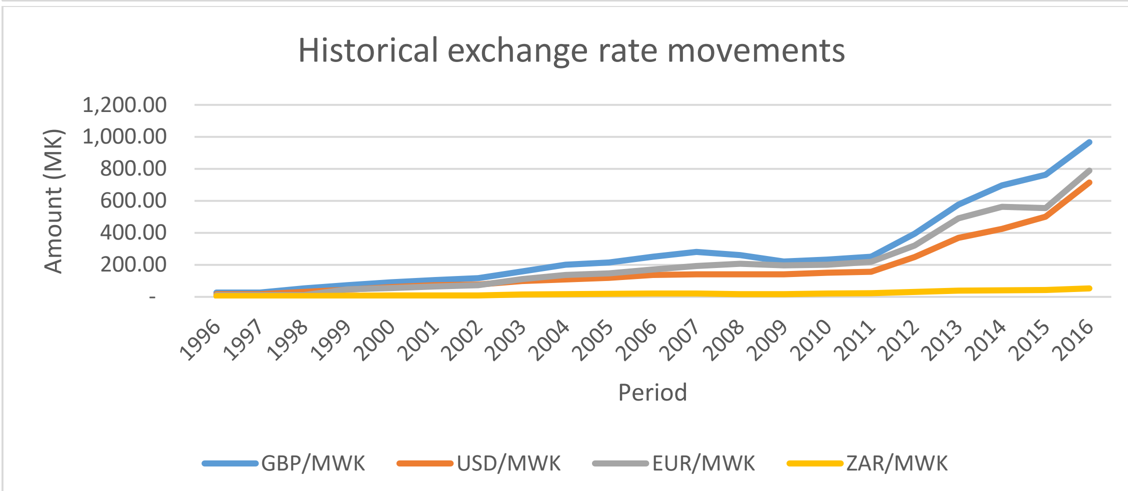
Kwacha exchange rate movement against major trading currencies

Currency	29-Dec-17	30-Dec-16	31-Dec-15	2017 Change	2016 Change
USD	725.584	725.0093	664.365	0.08%	9.13%
GBP	976.4909	890.3839	984.3232	9.67%	-9.54%
EUR	866.7101	763.5798	726.3503	13.51%	5.13%
ZAR	58.4941	53.2829	42.6975	9.78%	24.79%

Source: Reserve Bank of Malawi

3.4 The following charts provide a historical pictorial view of the trend of the exchange rates.



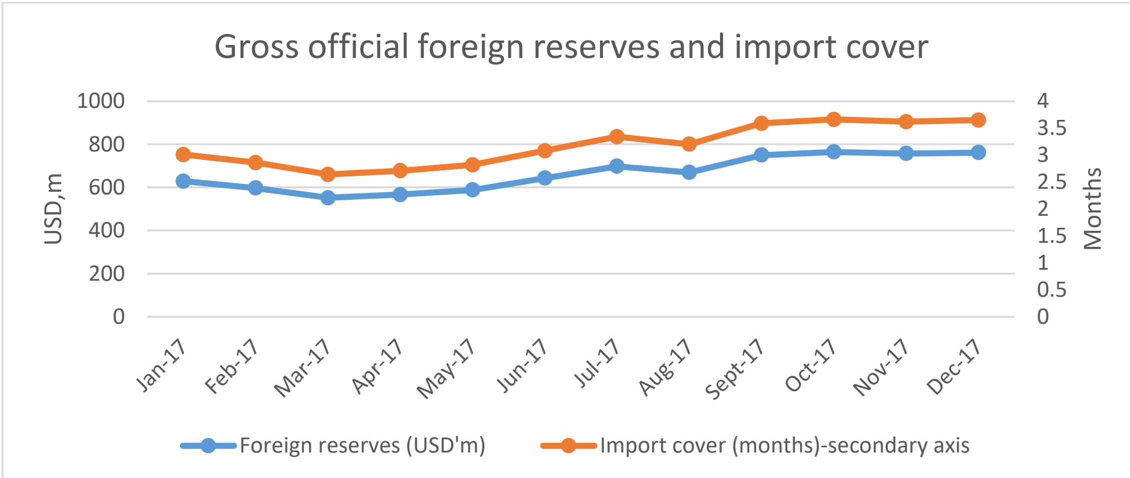


Source: Reserve Bank of Malawi

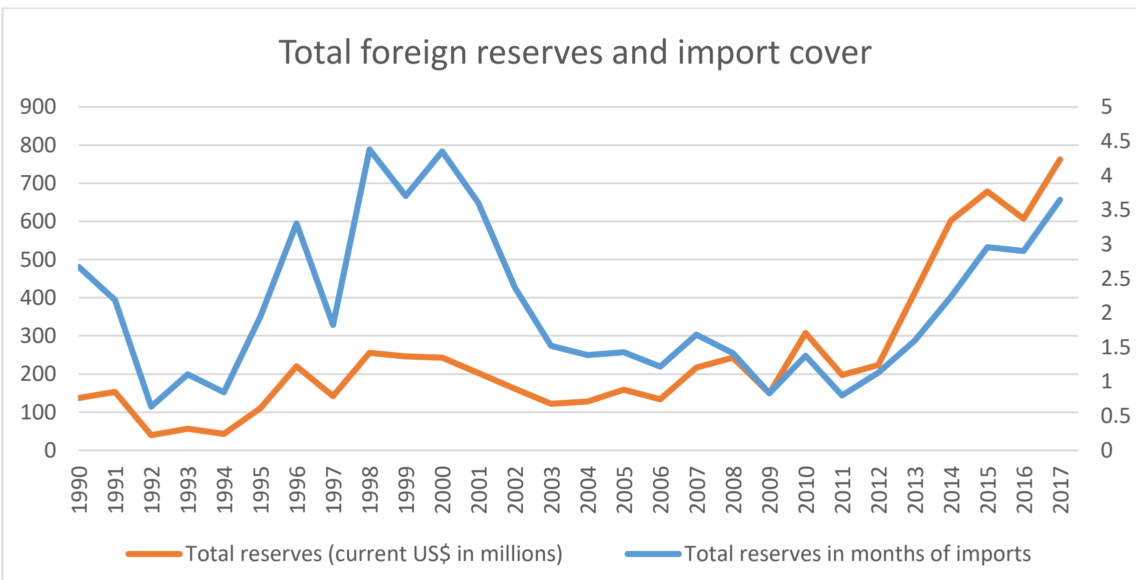
3.5 The Kwacha is expected to remain broadly stable in the short to medium term as the country currently has sufficient foreign exchange reserves. In the long term, however, the local currency could depreciate further due to trade imbalances and exogenous shocks such as rising international fuel prices.

3.6 Gross official foreign reserves were observed at USD761.97 million (3.65 months of imports) on 29 December 2017, 25.54% higher than USD606.93 million (2.90 months of imports) observed at the end of 2016. Private foreign reserves were observed at USD414.03 million (1.98 months of imports) from USD336.61 million (1.61 months of imports).

3.7 The following charts depict the trend of total foreign reserves position and import cover movement in 2017 and since 1990.



Source: Reserve Bank of Malawi



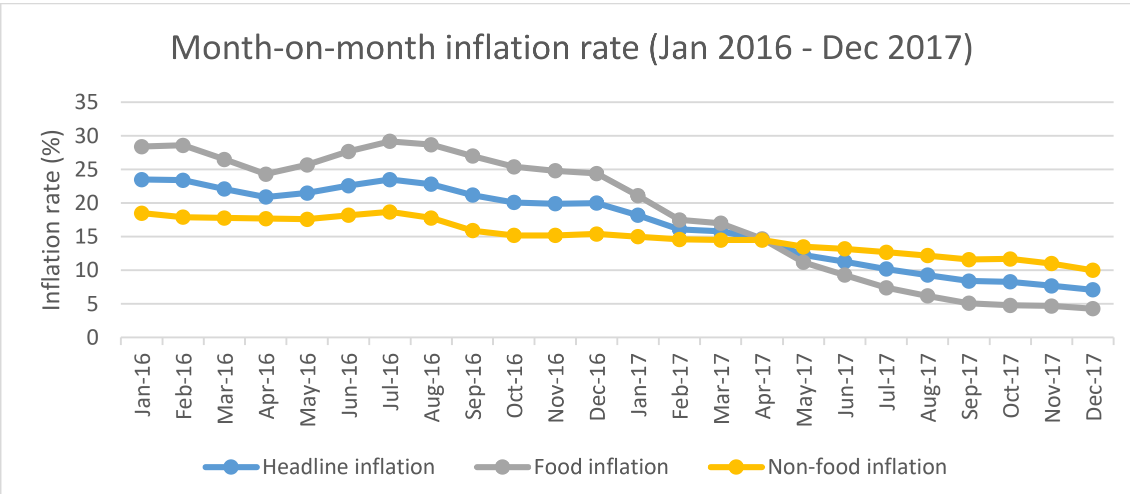
Source: World Bank-World development indicators database

3.8 The Reserve Bank of Malawi has stated in its 2018 strategic plan that it aims to maintain the import cover above 3 months throughout the year. Among its efforts to ensure that the goal is realized, the RBM will aim to generate an extra USD600 million (K440 billion) in export earnings through the Export Development Fund (EDF) and increase diaspora remittances to USD200 million from USD38 million.

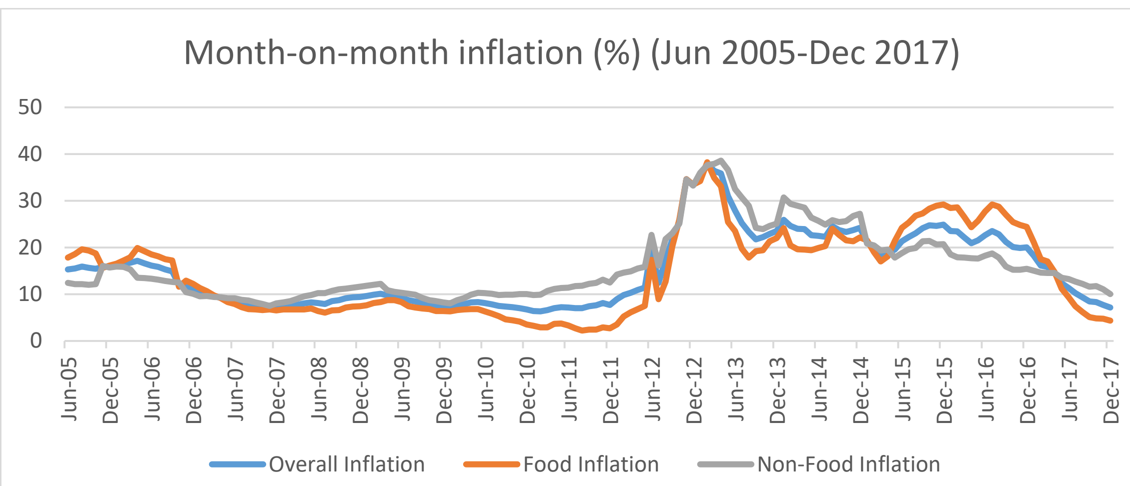
4. INFLATION

4.1 Annual headline inflation decreased to 11.5% in 2017 from 21.7% in 2016 due to a slowdown in both food and non-food inflation. Annual food inflation decreased to 10.3% in 2017 from 26.6% in 2016, whereas annual non-food inflation decreased to 12.8% from 17.1%.

4.2 As at end December 2017, month-on-month headline inflation was at 7.1%, compared to 20.0% in December 2016. Month-on-month food inflation stood at 4.3% in December 2017, compared to 24.4% in December 2016, whereas month-on-month non-food inflation stood at 10.0% in December 2017, compared to 15.45% in December 2016.



Source: National Statistics Office (NSO)



Source: National Statistics Office (NSO)

4.3 The decline in inflation in 2017 is largely attributed to low agricultural food prices (especially maize) necessitated by a bumper harvest in the 2016/2017 growing season, a stable exchange rate backed by sufficient availability of forex, stable fuel prices, a tight monetary policy and a tight fiscal stance which saw the government spending within its budget.

4.4 Looking ahead, in 2018, the inflation rate could remain in the single digit territory. RBM projects that inflation will average 8.5% in 2018 and end the year at 7.0%. The continued drop in inflation could give room for a further reduction in interest rates. However, upside risks to inflation remain rising global oil prices, power challenges, government missing some public finance targets and a possible rebound in high maize prices. The 2018 maize harvest is threatened by the occurrence of the fall armyworm and a dry spell that hit some parts of the country in December 2017 and January 2018.

5. STOCK MARKET

5.1 The stock market was buoyant in 2017 as it registered a positive return on investment of 62.14% compared to a negative return of 8.53% in 2016. The market registered a 70.09% increase in share volume traded of 698,894,283 shares compared to a traded volume of 410,895,390 shares in 2016. Traded share value amounted K13.52 billion in 2017, compared to K6.20 billion in 2016, representing a 118.14% increase. Top gainers for the year were FMB, TNM, NICO, MPICO and NITL, with registered share price gains of 182.35%, 139.67%, 100.00%, 99.36% and 76.65%, respectively.

5.2 The following table summarizes stock price movements on the Malawi Stock Exchange in 2017.

Trading summary				
	29-Dec-17	3-Jan-17		Capital gain
Market indices				
MASI	21598.07	13320.51	⇧	62.14%
DSI	16272.64	10456.92	⇧	55.62%
FSI	3519.43	2026.07	⇧	73.71%
Gainers (price in K)				
FMB	48.00	17.00	⇧	182.35%
TNM	14.50	6.05	⇧	139.67%
NICO	34.00	17.00	⇧	100.00%
MPICO	15.61	7.83	⇧	99.36%
NITL	60.06	34.00	⇧	76.65%
Sunbird	96.00	58.50	⇧	64.10%
ILLOVO	240.00	160.00	⇧	50.00%
FMBCH	67.00	45.01	⇧	48.86%
NBS	8.50	6.00	⇧	41.67%
BHL	28.00	20.10	⇧	39.30%
Standard Bank	610.00	500.00	⇧	22.00%
Old Mutual	1960.00	1612.00	⇧	21.59%
NBM	270.08	237.12	⇧	13.90%
PCL	600.00	540.00	⇧	11.11%

Source: Malawi Stock Exchange (MSE)

5.3 Corporate news

5.3.1 The Malawi Stock Exchange MSE) listed NBS rights issue shares on 17th July 2017, FMB Capital Holdings (FMBCH) through a corporate restructuring on 18th September 2017 and a 2 year Treasury note on 9th October 2017. FMB was officially delisted from the Exchange on 18th December 2017. In its place FMB Capital Holdings was listed on the MSE.

5.3.2 FMB issued a cautionary statement on a corporate restructuring and acquisition of a controlling shareholding in Barclays Bank Zimbabwe.

5.3.3 Telekom Networks Malawi Plc (TNM) released a statement advising that it expected its profits for the year ended December 2017 to be more than 60% higher than the previous corresponding period. In 2016, TNM made a profit of K8.21 billion.

5.3.4 Sunbird Tourism Plc released a statement advising that it expected its profits for the year ended December 2017 to be more than 70% higher than the previous corresponding period. In 2016, Sunbird made a profit of K1.34 billion.

5.3.5 Standard Bank Malawi Plc released a statement advising that it expected its profits for the year ended December 2017 to be more than 30% lower than the previous corresponding period. In 2016, Standard Bank made a profit of K19.43 billion.

5.3.6 MPICO Plc released a statement advising that it expected its trading results for the year ended December 2017 to be more than 100% higher than the previous corresponding period. In 2016, MPICO made a profit of K1.99 billion.

5.3.7 Press Corporation Plc (PCL) released a statement advising that it expected the profit for the year ended December 2017 to be more than 90% higher than the previous corresponding period. In 2016, PCL made a profit of K17.21 billion.

5.3.8 NBS Bank Plc released a statement advising that it projected the loss for the year ended 31st December 2017 to be at least 70% lower than the previous corresponding period. In 2016, NBS made a loss of K4.33 billion.

5.3.9 National Investment Trust PLC (NITL) released a statement advising that it expects the profit for the year ended 31st December 2017 to be more than 100% higher than the previous corresponding period. In 2016, NITL made a loss of K1.07 billion.

5.3.10 NICO Holdings PLC released a statement advising that it forecast the profit for the year ended 31st December 2017 to be more than 180% higher than the previous corresponding period. In 2016, NICO made a net profit of K2.74 billion.

(Source: MSE)

6. ECONOMIC GROWTH

6.1 Malawi is projected to register a real economic growth rate of 4.50% in 2017 by the World Bank and the International Monetary Fund (IMF) from the rate of 2.50% recorded in 2016. Economic growth in the previous two consecutive years (2015 and 2016) was largely crippled by regional adverse weather conditions which led to contraction of the agricultural sector. Higher economic growth is expected in 2017 following favorable weather conditions which facilitated a rebound in agricultural production. The World Bank estimates a growth of 5.00% in 2017 for the agricultural sector, up from 2.30% in

2016, led by increased production of the country's staple crop, maize, which is estimated at 3.5 million tons in 2017, representing a 46.20% increase from the output of 2.4 million tons recorded in 2016.

6.2 Despite high growth rates in the agriculture sector, growth rates for the industry and services sectors are expected to be modest. According to the World Bank Economic Monitor for November 2017, the services sector is expected to register a growth rate of 0.2 percentage points higher than that recorded in 2016 and the industry sector a growth rate of 0.8 percentage points higher than that of 2016. Within these sectors, however, the transportation and storage services and manufacturing sub-sectors are expected to register significant growth rates due to increased availability of agricultural goods. Wholesale and retail trade and financial and insurance services are also expected to register higher than average growth rates. Despite the expected rebound in manufacturing, the sector's growth remains weak, mainly due to structural constraints in the supply of energy and water which continue to adversely affect production.

6.3 The structural constraints in the supply of energy and water was the major risk to economic growth in 2017. Production in the manufacturing sector, especially, might have been adversely affected by the continued power outages.

6.4 Growth forecasts for 2018 are more optimistic on the back of better performance of the agricultural sector and general macroeconomic fundamentals. The IMF, World Bank, and the EIU, project that real economic growth will reach 5.00%, 5.00% and 4.10%, respectively, in 2018.

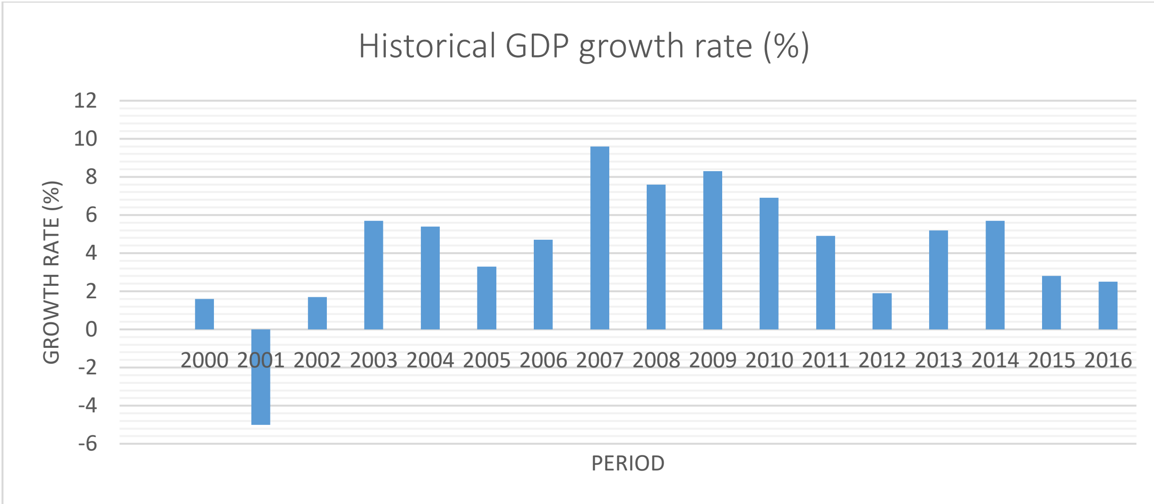
6.5 Risks to economic growth in 2018 include insufficient power supply which could slow down economic growth by reducing private sector activity, and high government debt levels which might keep interest rates high and crowd out private sector funding for growth. The fall armyworm outbreak and a dry spell that hit some parts of the country in January 2018 also threaten agricultural output in 2018.

6.6 The table below shows real economic growth projections to 2018

Real economic growth projections

	2015	2016	2017	2018	2019
EIU	2.90%	2.90%	4.40%	4.10%	4.80%
IMF	2.95%	2.30%	4.50%	5.00%	
World Bank	2.80%	2.50%	4.50%	5.00%	5.40%
Malawi Government	3.30%	2.70%	5.00%		

6.7 The following chart depicts the Malawi's GDP growth rate from 2000 to 2016.



Source: World Bank-World development indicators database

7. COMMODITIES

7.1 Tobacco

7.1.1 The 2017 tobacco market season registered better performance in terms of prices compared to the previous season. The all-type tobacco price averaged USD1.99 per kilogram, 40.1% higher than USD1.42 per kilogram recorded at the close of the 2016 season. However, total volume of tobacco sales in 2017 decreased by 45.4% to 106.5 million kilograms, compared to 195.1 million kilograms in 2016. Consequently, the total realization from tobacco sales in 2017, amounting USD212.5 million, was 23.1% lower than USD276.4 million realized in 2016.

7.1.2 The decline in tobacco production in 2017 was on account of poor prices that farmers were offered in 2016 and high rejection rates due to overproduction.

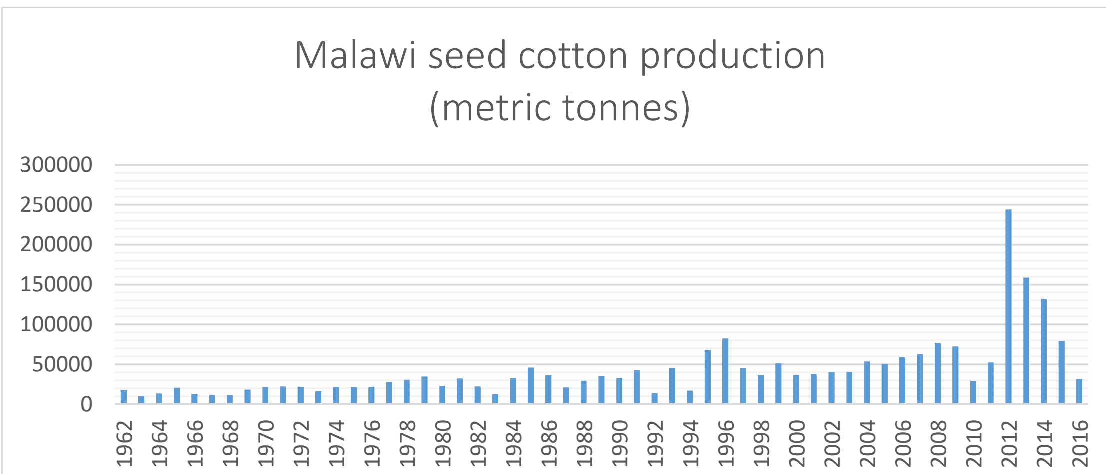
	2017	2016	Change
Volume (kg)	106.5 million	195.1 million	(45.4%)
Average price (USD/kg)	1.99	1.42	40.1%
Turnover (USD)	212.5 million	U276.4 million	(23.1%)

Source: Tobacco Control Commission (TCC)

7.1.3 In 2018 season, farmers could make better margins if they grow good tobacco as the gap between demand for the crop from international buyers and production quota has narrowed. The Tobacco Control Commission (TCC) indicated that the 2018 international buyer demand stands at 171 million kilograms against 162 million kilograms to be grown by 41,784 registered farmers. In 2017, the international buyer demand was 158 million kilograms against 106 million kilograms that were sold through the auction market. However, the dry spell that persisted in January 2018 in some parts of the country could affect the output.

7.2 Cotton

7.2.1 Cotton production levels are still relatively low in Malawi, averaging 24.03 thousand metric tonnes 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 31,439 metric tonnes in 2016.



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

7.3 Fuel

7.3.1 Fuel prices were steady in 2017 at K824.70 per litre of petrol, K815.80 per litre of diesel and K648.70 per litre of paraffin after being adjusted three times in 2016, the last adjustment being in November 2016.

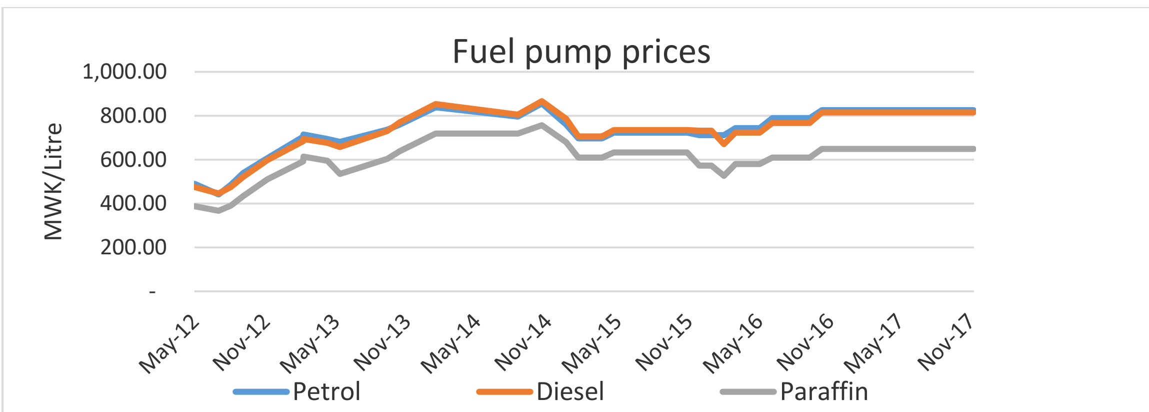
7.3.2 The Malawi Energy Regulatory Authority (MERA), however, reviewed the fuel prices a number of times during the year to determine if price adjustments were needed. The last review was in December 2017 when MERA assessed the combined effect of the movement of FOB prices and the Kwacha to US Dollar exchange rate, as well as, changes in local factors that determine the maximum pump prices. It was observed that the landed costs of petrol, diesel and paraffin had increased by 15.35%,23.51% and 23.28%, respectively, which combined are beyond the ±5% trigger limit which qualifies petrol, diesel and paraffin for an upward pump price adjustment. The MERA Board, however, resolved not to change the pump prices for all the three products but instead apply the accumulated funds in the Price Stabilization Funds (PSF) to cover the increased landed costs.

7.3.3 The table and graph below show the recent trend in prices of the three petroleum products.

Fuel pump prices (Kwacha/litre)

Product	Jan - Dec 2017	Nov-16	Jun-16	Mar-16	Dec-15
Petrol	824.70	824.70	788.30	743.30	711.90
Diesel	815.80	815.80	766.90	722.80	732.70
Paraffin	648.70	648.70	609.80	580.40	573.10

Source: MERA



Source: MERA

7.3.4 In 2018, local fuel prices could face an upward pressure from rising international oil prices following the decision made by oil producers in November 2017 to extend the oil output cut until end 2018.

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