Economic update – Q1 2019

Investment Banking

23rd April 2019

http://www.cdh-malawi.com

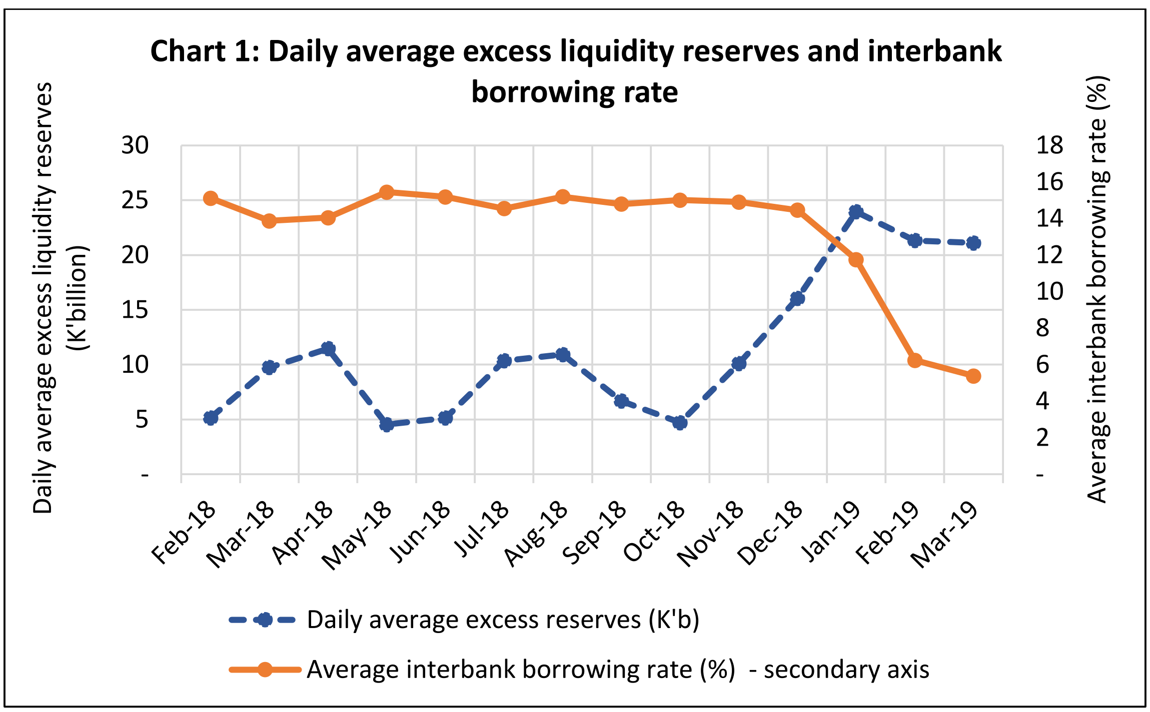
1. Interbank market

1.1 The Reserve Bank of Malawi (RBM) made significant monetary policy changes in January 2019, including the reduction of the Policy Rate (PR) from 16.0% to 14.5%; the reduction of 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; the reduction of the Lombard rate from 18.0% to 14.9%; and the pegging of the Base lending rate for commercial banks to the Lombard rate. These policy changes led to a significant increase in the level of liquidity on the interbank market and a decrease in various market interest rates during the first quarter of 2019 under review. The policy changes are discussed in detail in Section 5 of this report.

1.2 Excess liquidity reserves for banks increased from an average of K10.29b per day in the fourth quarter (Q4) of 2018 to K22.13b per day in the first quarter (Q1) of 2019, which were much higher compared the average volume of K9.79b per day recorded in Q1 of 2018.

1.3 On account of high liquidity levels, coupled with the reduction in the Policy and Lombard rates, the interbank borrowing rate decreased from the average of 14.79% in Q4 of 2018 to the average of 7.79% in Q1 of 2019. In 2018, the interbank borrowing rate averaged 14.65% in Q1.

1.4 Chart 1 provides a summary of excess liquidity reserves and overnight interbank rate movements over the past year.



Source: Reserve Bank of Malawi

1.5 The volume traded among banks on the interbank market increased by 2.90% from the average of K8.27b per day in Q4 of 2018 to the average of K8.51b per day in Q1 of 2019.

1.6 Further, in line with higher liquidity levels, access to the Lombard facility decreased from a total of K245.94b in Q4 of 2018 to a total of K55.90b in Q1 of 2019. In the previous year, access to the Lombard facility totaled K233.63b in Q1.

1.7 The Lombard rate decreased from 18.00% in Q4 of 2018 to the average of 15.73% in Q1 of 2019. The Lombard rate was at 18.00% in the previous corresponding period, namely Q1 of 2018.

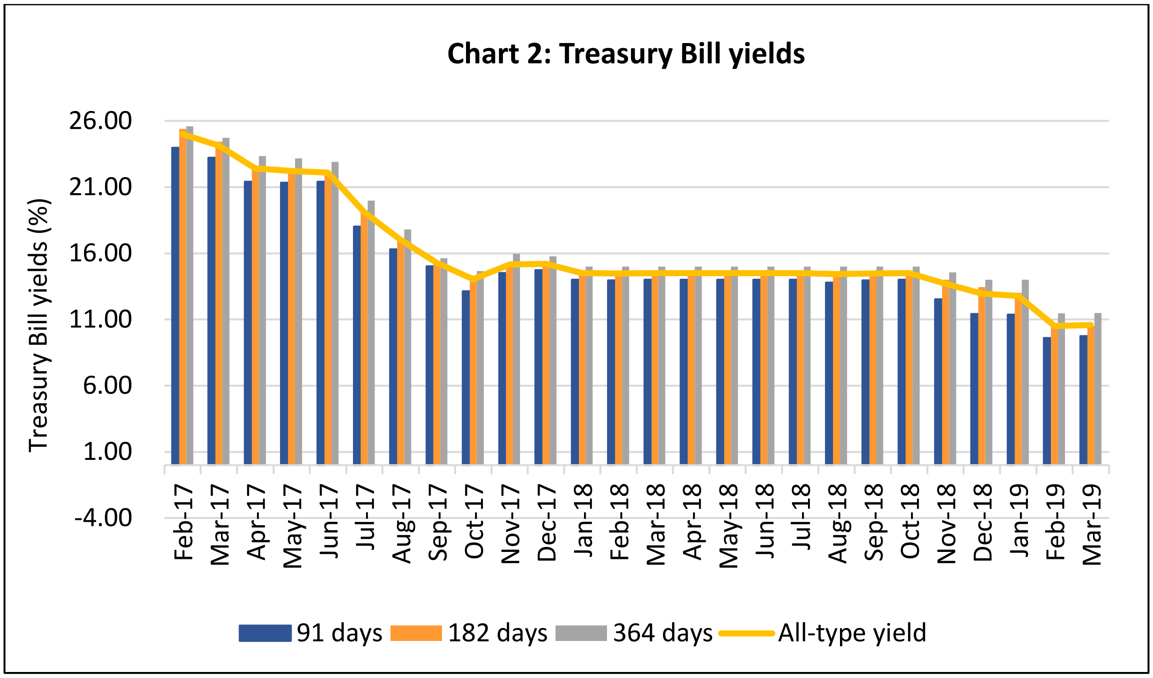
1.8 While there were no Open Market Operations (OMOs) in Q4 of 2018, RBM withdrew from the market a total of K47.64b at the average rate of 11.46% in Q1 of 2019. In Q1 of 2018, OMOs amounted to K250.71b at the average rate of 15.00%.

2. Government securities

2.1 Government raised a total of K179.22b in Q1 of 2019 through auctions for Treasury Bills (TB), registering a significant increase when compared to a total of K59.95b raised in Q4 of 2018. Total applications for TBs for Q1 of 2019 amounted to K289.53b, representing a rejection rate of 38.10%, which is slightly lower than a rejection rate of 38.82% recorded in Q4 of 2018. In Q1 of 2018, Government raised a total of K128.27b in TB auctions with a rejection rate of 1.31%.

2.2 TB yields declined in the period under review following the reduction of the Policy rate and the Lombard rate by RBM on 30th January 2019. The 91-day TB yield decreased from the average of 12.65% in Q4 of 2018 to the average of 10.24% in Q1 of 2019; the 182-day yield decreased from the average of 13.98% in Q4 of 2018 to the average of 11.34% in Q1 of 2019; and the 364-day yield decreased from the average of 14.53% in Q4 of 2018 to the average of 12.32% in Q1 of 2019. Consequently the all-type (average) TB yield decreased from 13.72% in Q4 of 2018 to 11.30% in Q1 of 2019. During Q1 in the previous year, TB yields were higher, with the 91-day average yield at 13.99%, the 182-day average yield at 14.50% and the 364-day average yield at 15.00%; resulting in an all-type yield of 14.50%.

2.3 Chart 2 shows that after remaining broadly stable in 2018, TB yields resumed the declining trend towards the end of the year- a phenomenon that has been registered since 2017. The decline has been influenced by reductions in the Policy rate, the most recent on 30th January 2019.



Source: Reserve Bank of Malawi

2.4 In the period under review, there were also auctions for Treasury Notes (TN), particularly 2-year, 3-year, 5-year and 7-year TNs. Through these auctions, the Government raised a total of K82.09b during Q1 of 2019 at the average yield of 17.32% for the 2 year TN, 14.77% for the 3-year TN, 16.27% for the 5-year TN and 24.00% for the 7-year TN. In the previous quarter (Q4 of 2018), the Government raised a total of K36.61b through auctions for 3-year, 5-year and 7-year TNs at the average yield of 20.00%, 20.42% and 24.00%, respectively. In Q1 of 2018, the Government raised a total of K6.10b during auctions for 2-year and 3-year TNs at the average yield of 17.79% and 18.53%, respectively.

2.5 Looking ahead, yields on Government securities are expected to continue to decline in the near term before stabilizing later in the year when the market fully responds to the policy changes.

3. Foreign exchange market

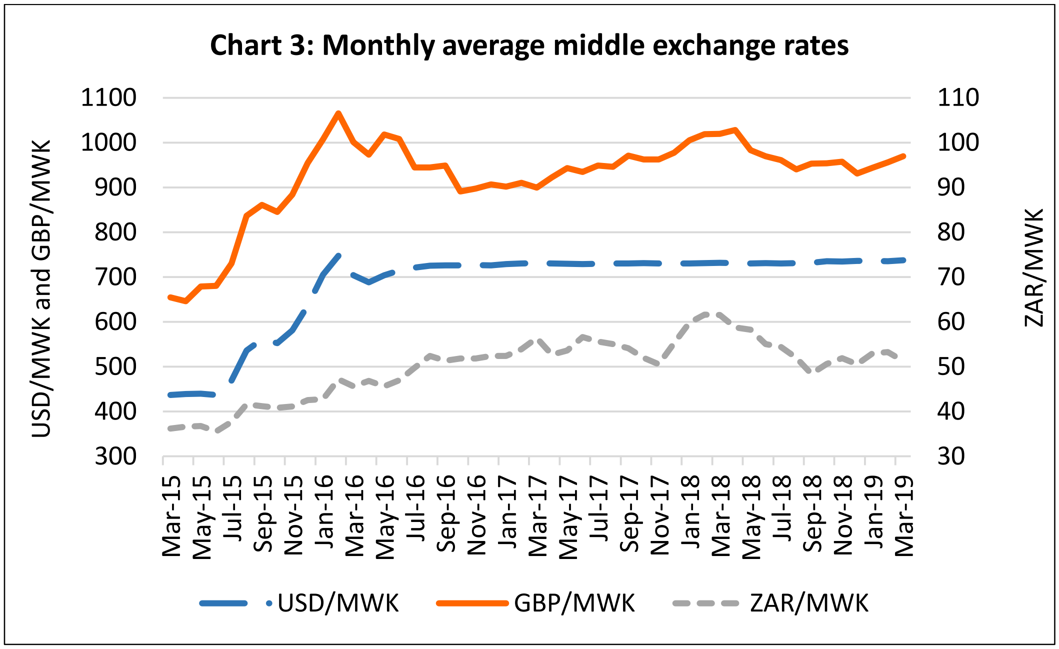
3.1 The Kwacha marginally depreciated against most major trading currencies in Q1 of 2019 relative to the previous quarter, mainly on account of seasonal factors. The USD/MWK middle exchange rate increased by 0.11% to the average of 736.39 in Q1 of 2019, the GBP/MWK average middle exchange rate increased by 0.98% to 956.64 and the ZAR/MWK average middle exchange rate increased by 2.95% to 52.52. On a year-on-year basis, the Kwacha depreciated by 0.59% against the USD and appreciated by 6.64% and 16.39% against GBP and ZAR, respectively.

3.2 Table 1 and Chart 3 below provide an overview of how the Kwacha has fared against the three major trading currencies in the last four years. **(Note:** Upward arrow represents appreciation and downward arrow represents depreciation of the Kwacha).

Table 1: Average middle exchange rates

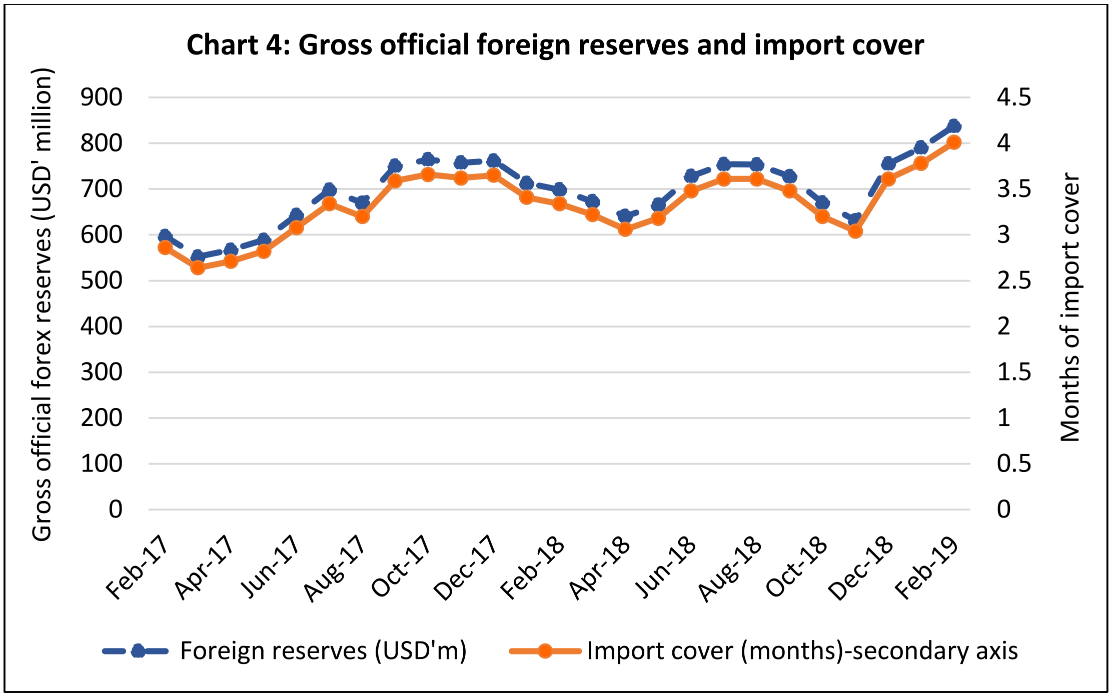
Currency	Q1 2019	Q4 2018	Q1 2018	Q-O-Q Change	Y-O-Y Change
USD	736.39	735.57	731.27	▼ 0.11%	▼ 0.59%
GBP	956.64	947.36	1014.74	▼ 0.98%	▲ -6.64%
ZAR	52.52	51.01	61.01	▼ 2.95%	▲ -16.39%

Source: Reserve Bank of Malawi



Source: Reserve Bank of Malawi

3.3 With regard to forex reserves, gross official foreign reserves increased to USD837.49m (4.01 months of import cover) as at the end of February 2019 from USD755.22m (3.61 months of import cover) as at end December 2018 and USD698.51m (3.34 months of import cover) as at end February 2018. According to the RBM, the foreign exchange position has improved since Q4 of 2018 when reserves were under intense pressure, mainly due to purchases of foreign exchange inflows resulting from portfolio investments.



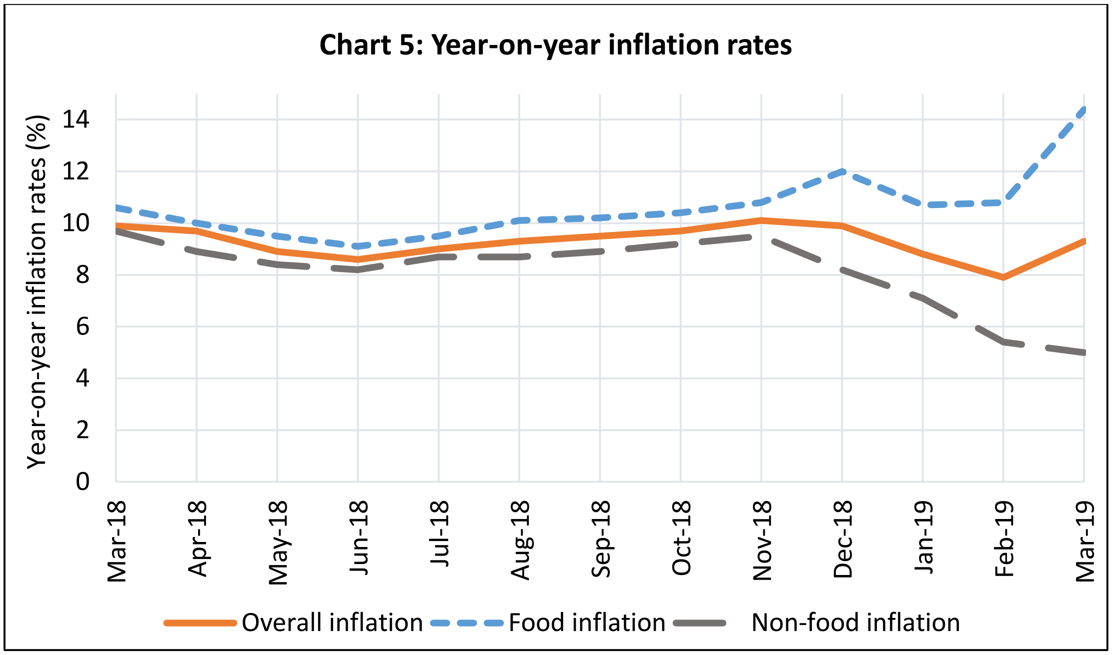
(Source: Reserve Bank of Malawi)

3.4 Looking ahead, the forex reserves position is expected to continue to improve in the ensuing months, especially with the commencement of the agricultural marketing season in April 2019. The robust forex reserves position is expected to continue to prevent excessive volatility of the Kwacha in the short term. 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. Political and policy uncertainties during the elections period could also add pressure on the Kwacha.

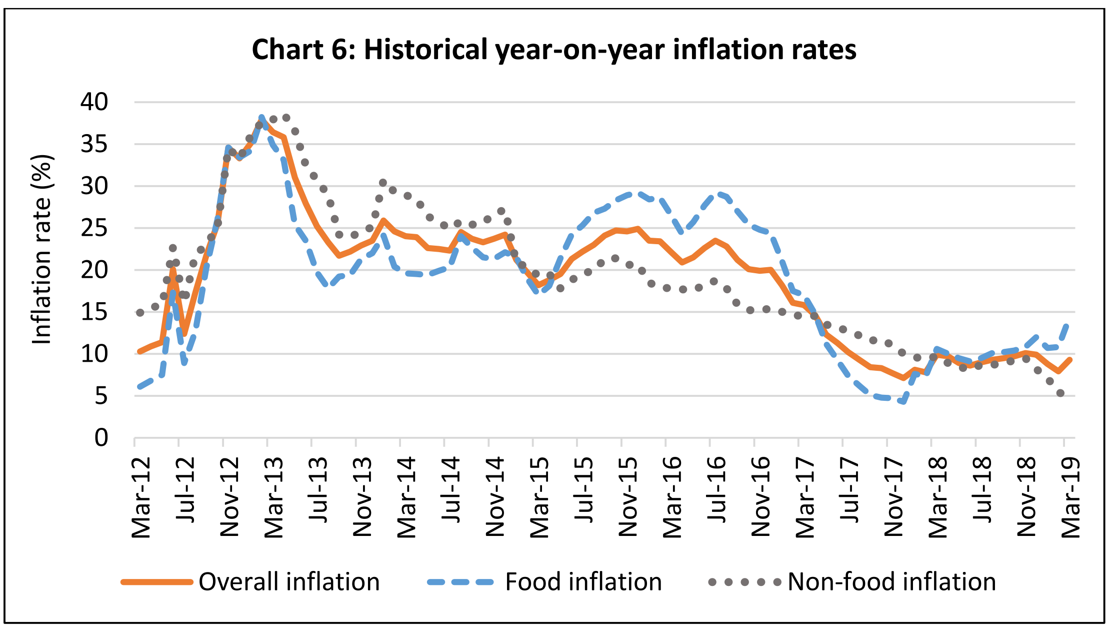
4. Inflation

4.1 Year-on-year headline inflation rate stood at 9.3% in March 2019, declining from 9.9% in December 2019 largely on account of a decrease in non-food inflation rate. Year-on-year non-food inflation rate decreased to 5.0% in March 2019 from 8.2% in December 2018 while year-on-year food inflation rate increased to 14.4% in March 2019 from 12.0% in December 2019. In March 2018, year-on-year headline inflation rate and non-food inflation rate were higher at 9.9% and 9.7%, respectively, while year-on-year food inflation rate was lower at 10.6%.

4.2 Chart 5 depicts the trend of inflation rate in the past year and Chart 6 depicts a longer period trend.



(Source: National Statistical Office)



(Source: National Statistical Office

4.3 Looking forward, inflation is expected to remain relatively low in 2019, partly supported by a relatively stable exchange rate and expected improvement in agricultural output as a result of a better rainfall pattern in the 2018/2019 season compared to the previous season, despite the recent floods experienced in the southern part of the country. The second round of the 2018/2019 agricultural production estimates survey that was conducted from February to March 2019 by the Ministry of Agriculture, Irrigation and Water Development, has indicated that crop production for the 2018/2019 season will increase significantly over the 2017/2018 season and five year average on all commodities except cotton and wheat. Maize production, Malawi's stable food, is expected to increase by 24.36%. However, risks to this inflation outlook could emanate from increased Government and consumer expenditure especially during the elections period, increased Government borrowing in the second half of the 2018/2019 fiscal year due to an increase in the budget deficit as some development partners delayed disbursement of budget support and rising oil prices on the international market.

4.4 RBM earlier in January 2019 projected an average headline inflation rate of 8.5% for 2019 and targets an average annual inflation rate of 5% by 2021.

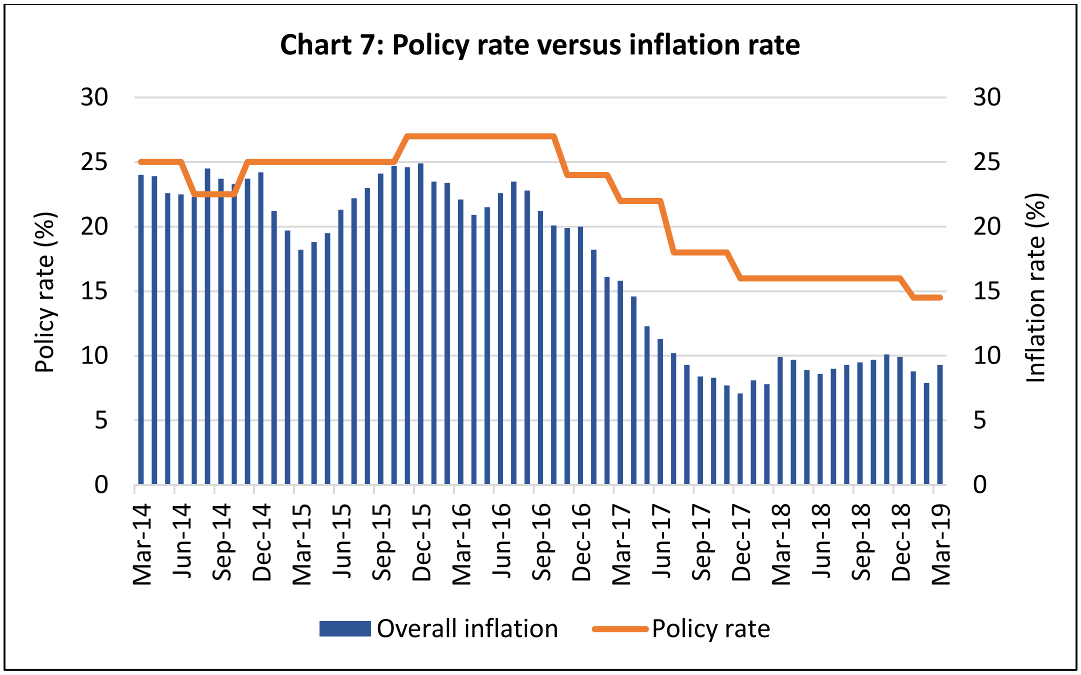
5. Monetary policy

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

- 5.1.1 reduce the Policy rate (PR) from 16.0% to 14.5%;
- 5.1.2 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;
- 5.1.3 reduce the Lombard rate from 18.0% to 14.9%; and
- 5.1.4 peg the Base lending rate for commercial banks at the Lombard rate.

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

5.3 Chart 7 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 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. Details are shown in the table below:-

Table 2: Commercial banks' lending rates

	Revised (February 2019)				Previous rates		
Bank	**Base rate**	**Maximum rate**	**Maximum premium**	**Effective date**	**Base rate**	**Maximum rate**	**Maximum premium**
CDHIB	14.90%	25.80%	10.90%	18-Feb-19	24.50%	27.50%	3.00%
Ecobank	14.90%	26.75%	11.85%	11-Feb-19	25.00%	31.00%	6.00%
FDH	14.90%	26.00%	11.10%	1-Mar-19	25.00%	32.50%	7.50%
First Capital	14.90%	26.00%	11.10%	11-Feb-19	23.00%	33.00%	10.00%
NBM	14.90%	25.90%	11.00%	11-Feb-19	23.00%	33.00%	10.00%
NBS	14.90%	26.90%	12.00%	11-Feb-19	25.50%	34.50%	9.00%
Nedbank	14.90%	26.50%	11.60%	13-Feb-19	25.00%	31.00%	6.00%
NFB	14.90%	26.50%	11.60%	11-Feb-19	29.00%	39.00%	10.00%
Standard	14.90%	25.90%	11.00%	13-Feb-19	23.00%	32.00%	9.00%
Average	14.90%	26.25%	11.35%		24.78%	32.61%	7.83%

Source: Various banks. (Note: NFB is now called MyBucks Banking Corporation (MBC))

5.5 Looking forward, following the policy rate cut we expect all other interest rates in the market to continue to decline in the near term before stabilizing 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 3.5%, respectively, in 2018 from 5.2% and 4.0% 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 better than in 2018 largely on account of an increase in agricultural production following a better rainfall pattern and a favourable macroeconomic environment. Improvements in power supply is also expected to improve production in 2019. The World Bank project a real GDP growth of 4.3%[1], whereas the RBM and the Government project a real GDP growth rate of 4.1% 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.

Table 3: 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

[1] Source: World Bank Global Economic Prospects, January 2019

7. Stock market performance

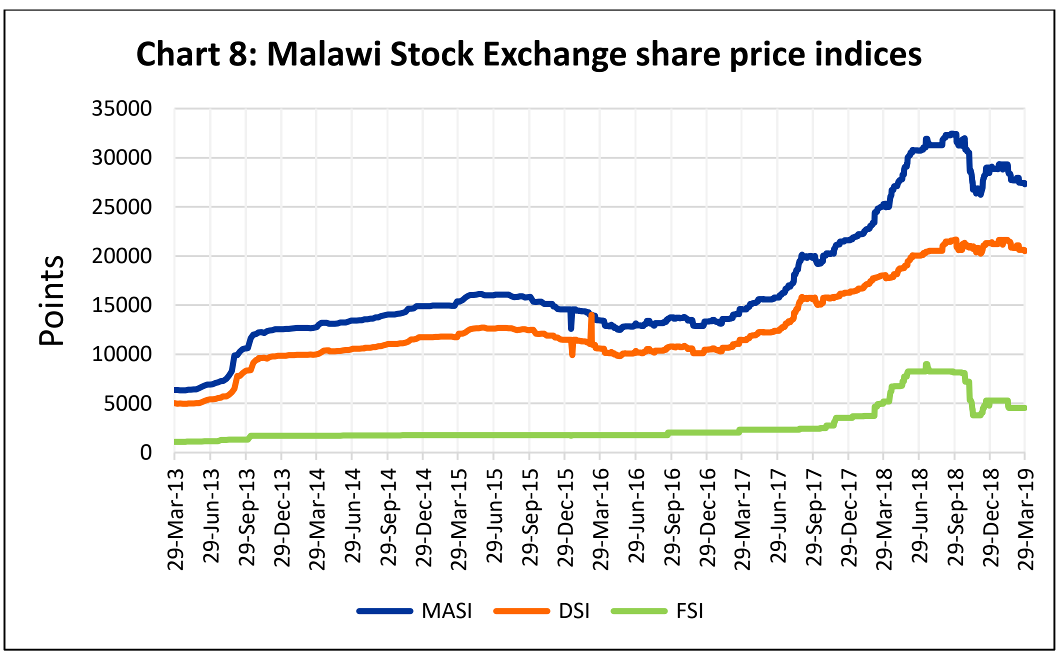
7.1 The Malawi Stock Exchange (MSE) was bearish in Q1 of 2019 as it registered a negative return on investment of -5.8% as at the end of the quarter when compared to the end of the previous quarter. The Malawi All Share Index (MASI) stood at 27,303.65 points on 31st March 2019, down from 28,983.53 on 31st December 2019. However, on a year-on-year basis, the MASI gained by 7.98%.

7.2 The market transacted a total of 420,679,180 shares at a total consideration of K14.16b in Q1 of 2019 compared to a total of 199,158,922 shares transacted in Q4 of 2018 at a total consideration of K16.67b, and a total of 321,380,401 shares transacted in Q1 of 2018 at a consideration of K10.15b. This represents a 111.23% increase quarter-on-quarter and a 30.90% increase year- on-year in terms of transacted volume of shares; and a 15.11% decrease quarter-on-quarter and a 39.58% increase year-on-year in terms of the value of shares traded.

7.3 Two counters, ICON and PCL, registered capital gains in Q1 of 2019, three counters registered no share price movement while the rest registered losses, as shown in Table 4 below.

7.4 ICON Properties, a property development and management firm, was officially listed for the first time on the Malawi Stock Exchange on Monday, 21st January 2018. A total of 6,680,000,000 shares were listed at the unit price of K8.75. During the listing day, ICON share price gained by 37.14% and closed at K12.00.

7.5 On the debt market, three Treasury Notes were listed in Q1 of 2019, bringing the total number of listed debt securities to twelve. There was no trade on the debt market during the quarter.

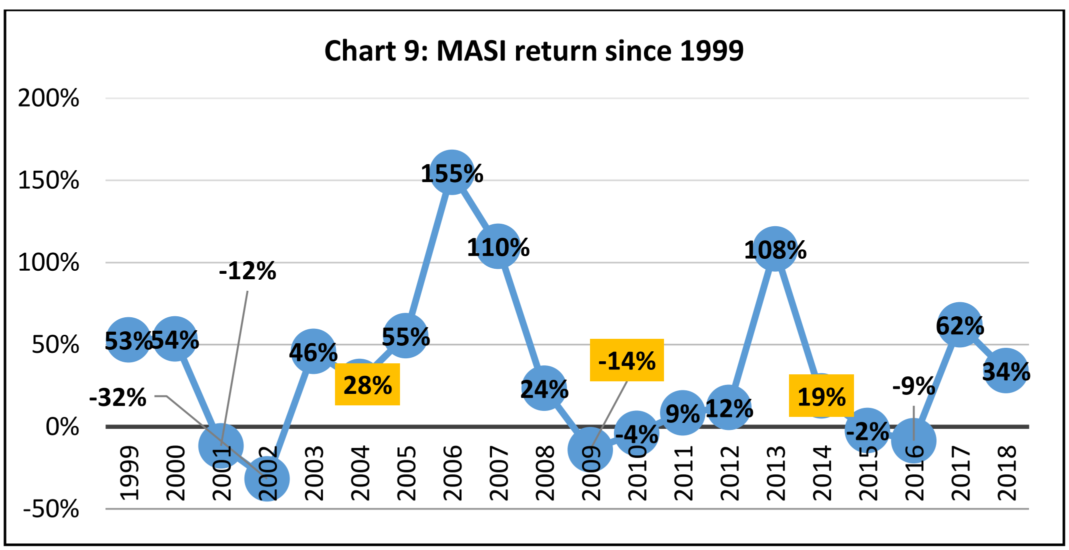


Source: MSE

Table 5: Share trading summary							
	29-Mar-19	31-Dec-18	29-Mar-18	29-Dec-17	Q1 2019 Δ	Y-O-Y Δ	Q1 2018 Δ
Market indices							
MASI	27,303.65	28,983.53	25,286.79	21,598.07	-5.80%	7.98%	17.08%
DSI	20,483.29	21,318.07	18,009.73	16,272.64	-3.92%	13.73%	10.67%
FSI	4,521.94	5,265.12	5,197.43	3,519.43	-14.12%	-13.00%	47.68%
Gainers (Q-O-Q)							
ICON	11.00	8.75			25.71%		
PCL	1,200.00	1,140.00	602.00	600.00	5.26%	99.34%	0.33%
Flat (Q-O-Q)							
ILLOVO	200.00	200.00	240.00	240.00	0.00%	-16.67%	0.00%
NITL	75.00	75.00	55.00	60.06	0.00%	36.36%	-8.42%
Loosers (Q-O-Q)							
STANDARD	569.00	670.00	610.00	610.00	-15.07%	-6.72%	0.00%
FMBCH	85.00	100.00	100.00	67.00	-15.00%	-15.00%	49.25%
TNM	25.05	28.00	20.00	14.50	-10.54%	25.25%	37.93%
NBM	315.01	332.02	280.00	270.08	-5.12%	12.50%	3.67%
SUNBIRD	138.00	145.00	110.05	96.00	-4.83%	25.40%	14.64%
NICO	41.97	43.00	48.00	34.00	-2.40%	-12.56%	41.18%
NBS	9.90	10.00	8.70	8.50	-1.00%	13.79%	2.35%
MPICO	13.07	13.20	18.30	15.61	-0.98%	-28.58%	17.23%
BHL	12.96	13.00	28.00	28.00	-0.31%		0.00%
OMU/OML	2,513.23	2,513.25	2,360.00	1,960.00	0.00%	6.49%	20.41%

Source: MSE

7.6 The first half of 2019 does not look promising for the stock market largely due to increased uncertainty with regards to the May 2019 general elections results. As shown in Chart 9 below, MSE has a history of a decline in return on investment in election years.



Source: MSE

8. Financial results for 2018

8.1 A number of listed companies and financial institutions published their financial results for 2018. The reported profits and expected profit movements are summarized in Table 5 and Table 6 below:

Table 6: Published annual financial results for 2018

	2018 PAT (K'b)	Movement	2017 PAT (K'b)
Listed companies			
Blantyre Hotels Plc	0.352 ↓	-31%	0.507
First Capital Bank Plc	10.775 ↑	7%	10.064
ILLOVO Sugar Malawi Plc	16.449 ↑	113%	7.735
Mpico Plc	6.782 ↑	33%	5.093
National Bank of Malawi Plc	15.965 ↓	-17%	19.147
National Investment Trust Plc	1.422 ↓	-39%	2.326
NBS Bank Plc	1.699 ↑	256%	(1.092)
NICO Holdings Plc	12.774 ↑	15%	11.123
Old Mutual Malawi Ltd	21.030 ↑	74%	12.096
Press Corporation Plc	36.713 ↓	-7%	39.673
Standard Bank Malawi Plc	10.582 ↓	-13%	12.162
Sunbird Tourism Plc	2.562 ↑	5%	2.434
Telekom Networks Malawi Plc	16.666 ↑	27%	13.108
Unlisted financial institutions			
Britam Insurance Company Ltd	0.227 ↑	237%	(0.166)
CDH Investment Bank Ltd	0.965 ↑	293%	0.246
Continental Asset Management Ltd	0.608 ↑	8%	0.562
Continental Capital Ltd	0.025 ↑	414%	0.005
Ecobank Ltd	5.011 ↑	30%	3.856
FDH Bank Ltd	5.965 ↑	694%	(1.004)
FDH Financial Holdings Ltd	7.820 ↑	8166%	0.095
First Discount House Ltd	1.125 ↓	-17%	1.352
NBM Capital Markets Ltd	0.411 ↓	-24%	0.540
NBM Pensions Administration Ltd	0.078 ↓	-16%	0.067
New Finance Bank Ltd	0.769 ↑	140%	(1.918)
NICO Asset Managers Ltd	0.798 ↑	43%	0.558
NICO General Insurance Company Ltd	1.403 ↓	-36%	2.190
NICO Life Insurance Company Ltd	9.420 ↑	0%	9.378
Old Mutual Life Assurance Company Ltd	9.467 ↑	57%	6.036
Old Mutual Unit Trust Company Ltd	(0.013) ↓	-138%	0.035

Sources: MSE and The Nation and Daily Times newspapers.

(Note: New Finance Bank (NFB) is now called MyBucks Banking Corporation (MBC)).

9. Interest rate capping bill

9.1 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.

9.2 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.

9.3 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.

9.4 The Joint Committee conducted consultations with various domestic stakeholders on the bill, including:-

- 9.4.1 Ministry of Finance, Economic Planning and Development
- 9.4.2 Reserve Bank of Malawi (RBM)
- 9.4.3 Bankers Association of Malawi (BAM)
- 9.4.4 Malawi Union of Savings and Credit Cooperatives (MUSCCO), and
- 9.4.5 Microfinance Network and Human Rights Defenders Coalition (HRDC).

9.5 The Joint Committee also conducted study tours in Ghana and Zambia where they met the following institutions:

- 9.5.1 The Parliamentary Committee on Finance
- 9.5.2 Officials from Ministry Finance in Ghana and Zambia
- 9.5.3 Officials from the Central Banks
- 9.5.4 Microfinance networks, and
- 9.5.5 Centre for Economic and Business Research in Ghana

9.6 From these consultations, study tours and other research, the Joint Committee gathered that the unintended consequences of interest rate capping outweigh the benefits. Therefore, in their report released in March 2019, the Committee recommended that Malawi should not legislate but rather regulate the issues of interest rates in order to protect the borrower.