August Economic Review

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Commentary

While the COVID-19 crisis continues to send shockwaves around the globe, Malawi being a low-income developing country, is struggling to come up with effective fiscal response mechanisms to support its economy due to financial resource constraints.

At the moment, with no economic response plan in place, the question that needs to be answered is: ***Will the economy remain resilient in light of the multiple shocks that have hit the economy or is an economic crisis inevitable?***

I. Economic Growth Prospects

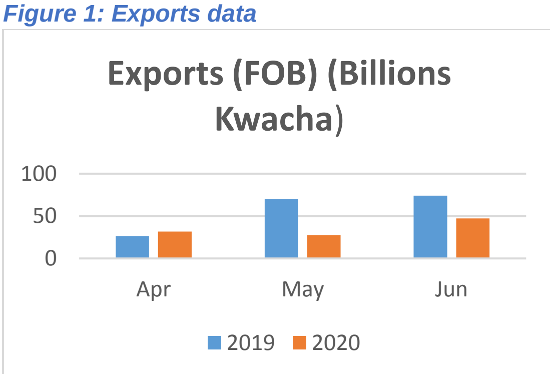
Since April, 2020, Malawi's economy has been hit hard by external shocks (both demand and supply side) caused by pandemic related lockdown measures instituted by most of the country's trade partners.

The external shocks have included: a sharp contraction in real exports, less capital and remittances inflows, reduced tourism receipts, increased prices of imported raw materials and consumer goods, shortage of imported raw materials and consumer goods as well as logistical challenges. Consequently, these shocks have not only led to severe business contractions for most export oriented businesses but to businesses that rely on imported raw materials and finished goods as well.

According to the Reserve Bank of Malawi (RBM) trade statistics, the impact of demand-side external shocks has had more severe impact on Malawi's economy compared to supply-side external shocks. As a result, Malawi's exports in terms of value have tremendously gone down in the months of May and June, 2020 relative to exports in the same period in 2019 (Figure 1). Specifically, in the months of May and June, 2020, the country's exports were worth K27.5 billion and K47.1 billion, respectively, compared to K70.1 billion and K74.2 billion achieved in 2019, respectively.

Manufactured exports like sugar were largely affected while traditional agricultural commodities like tea remained resilient.

Figure 1: Exports data

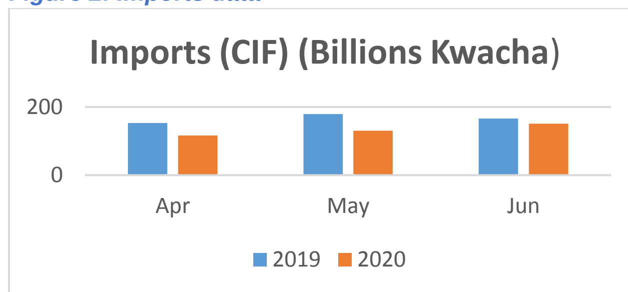


Source: Data from RBM

On the other hand, the impact of supply-side external shocks on the country's imports between the months of April to June, 2020 has not been too severe relative to the imports over the same period in 2019. Specifically, as Figure 2 below highlights, in the months of May and June, 2020, the country's imports were worth K130.6 billion and K151.1 billion, respectively, compared to K179.2 billion and K166.1 billion achieved in 2019, respectively.

Imports have not been significantly affected like exports due to the gradual lifting of restrictive COVID-19 measures in most of our major trading partner countries such as South Africa and China. As such, movement of cargo across the borders and ports has continued and therefore allowing imports to continue flowing into the country. As Figure 2 below shows, between April and June, 2020, the country registered month to month increase in import volumes on account of easing of restrictions by most of the country's trade partners.

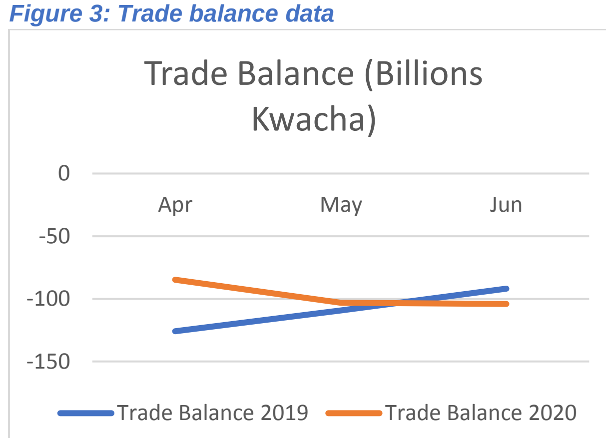
Figure 2: Imports data



Source: Data from RBM

Overall, due to the impact of the external shocks, Malawi recorded a worse trade balance of -K104.1 billion in June, 2020 compared to the figure of -K91.9 billion recorded in June, 2019. The worsening trade balance is mainly due to a drop in exports by 36.5 percent in the month of June, 2020 compared to June, 2019.

Figure 3: Trade balance data



Source: Data from RBM

Holding all other things constant, the decline in Malawi export earnings due to demand side external shocks caused by the COVID-19 pandemic has consequently triggered a new shock in the economy which is shortage of foreign currency. The shortage of foreign currency supply has in turn created a shortage of supply for some finished imported goods on the domestic markets. Consequently, the shortage of finished imported goods on the local markets is exerting upward pressure on nonfood inflation, hence the increase in prices of some manufactured products like cement.

Even though there is still pervasive uncertainty around the forecast of global output which creates demand for local exports, there is high probability that global output is going to contract severely in 2020. As such, global demand for Malawi’s export will likely remain subdued and ultimately our foreign earnings will potentially be less than in normal situations.

Therefore, in the short run, foreign exchange supply is expected to remain weak and this will continue to exert pressure on the Kwacha.

With this thought in mind, it would be wise therefore for the country to engage in import substitution for certain products in the short run in order to reduce imports. This will ease pressure on demand for foreign currency.

Successful import substitution can be achieved in the short run, by targeting industries that do not require a lot of investment and do not rely too much on imported raw materials. This can be effective to some extent while the country develops long-term solutions to foreign exchange supply deficits that come about due to heavy importing.

Overall, the subsequent external shocks that have hit the economy following the onset of the COVID-19 pandemic in Malawi, are exerting downward pressure on the growth prospects of the economy.

Specifically, the external shocks are threatening the stable macroeconomic fundamentals achieved in recent years such as declining inflation rates and stable exchange rate, by triggering internal shocks in the economy like shortage of foreign currency and shortage of supply of imported raw materials as well as finished goods.

II. Inflation

Headline inflation has been on a declining trend since January, 2020 owing to the continued decline in food inflation. As at July, 2020, it was recorded at 8.0 percent an improvement from the 9.3 percent figure that was recorded in July, 2019.

Similarly, food inflation has also been on a declining trend since the start of the year 2020. It moved from 17.6 percent in January, 2020 to 12.2 percent in July, 2020. The continued decline has been mainly due to low maize prices in the country, even though the prices have gradually been on an upward trend in recent months.

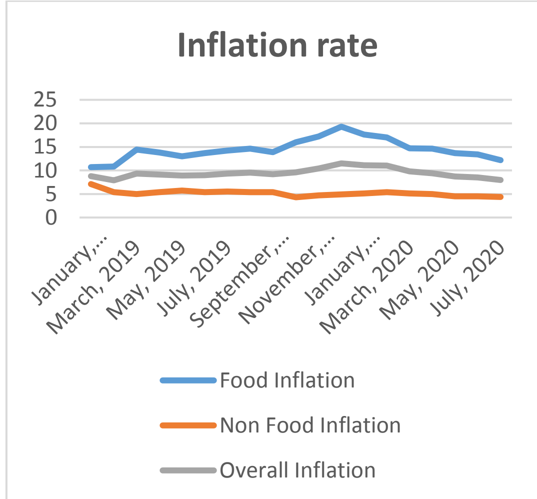
Conversely, the trend of nonfood inflation in Malawi has somewhat been stable with less fluctuations over the period between January and July, 2020. Price movements for manufactured goods have been oscillating between 5.4 percent and 4.4 percent throughout this period.

However, the current shortage in the supply of foreign currency in the economy is an emerging threat which will most likely cause a decline in the production and supply of manufactured goods on the domestic market since the country heavily relies on imported raw materials and consumer goods. This would inadvertently exert upward pressure on nonfood inflation, especially if the foreign currency shortage exist for a prolonged period.

For now, the upward pressure on prices for manufactured products is more significant in the cement industry. Thus, there has been an increase in the price of cement due to shortage of the product on domestic market caused by reduced cement imports.

Overall, there exist in the economy, significant inflationary pressures emanating from a gradual pick-up in food prices (largely maize) and increased short-term pressure on the exchange rate. These variables are likely to exert upward pressure on headline inflation which may result in a reversal to the downward trend in headline inflation in the coming months.

Figure 4: Inflation data



Source: Data from RBM

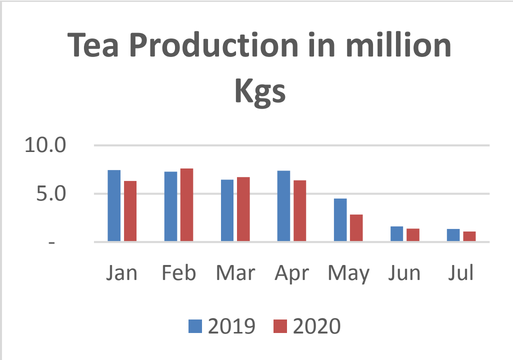
III. Domestic Production and Sale of selected commodities

A. Tea Production

Beginning April, 2020 to July, 2020, the country produced less quantity of tea relative to the quantity produced over the same period in 2019. Over this period, the country produced 11.7 million Kgs of tea in 2020 compared to 14.8 million Kgs produced in 2019 as shown in figure 4 below.

The period of the decline in tea production aligns to the period with which COVID-19 related restrictions were instituted in the country particular those to do with social distancing in public gatherings including work places. These restrictions have resulted in a decline in worker productivity since the number of laborers working in tea estates at a particular point had to be reduced. Subsequently, output has gone down in 2020 compared to 2019.

Figure 5: Tea production data

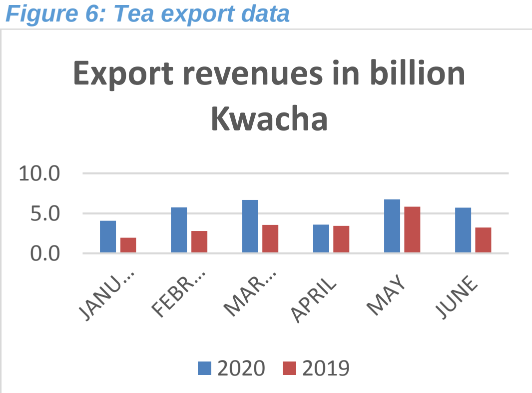


Source: Data from Tea Association of Malawi

In terms of export revenue from tea production, the crop fetched higher earnings between April and June, 2020 compared to 2019 over the same period. This is despite relatively lower production output levels in 2020 over this period compared to 2019.

Between April and June, 2020 the crop fetched a total of K16.0 billion compared to K12.5 billion realized over the same period in 2019.

Figure 6: Tea export data



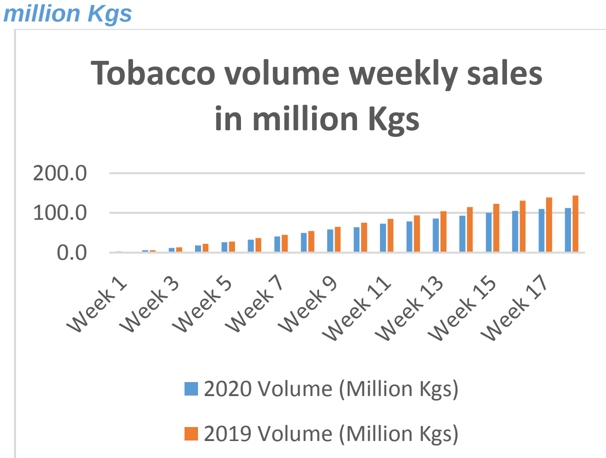
Source: Data from Tea Association of Malawi

B. Tobacco Sales

According to figures from the Tobacco Commission, cumulative volume of tobacco sales after 18 weeks of sales (as at 28th August, 2020) have decreased by 22 percent to 112.1 million kilograms compared to 144 million kilograms sold in the same period in 2019. The total sales comprised of Burley, Flue cured, NDDF and SDF tobacco of 93.7 million kilograms, 15.9 million kilograms, 1.9 million kilograms and 0.6 million kilograms, respectively.

Of the total volumes sold, 86.5 percent was sold under contract system whereas 13.5 percent was sold through the auction system.

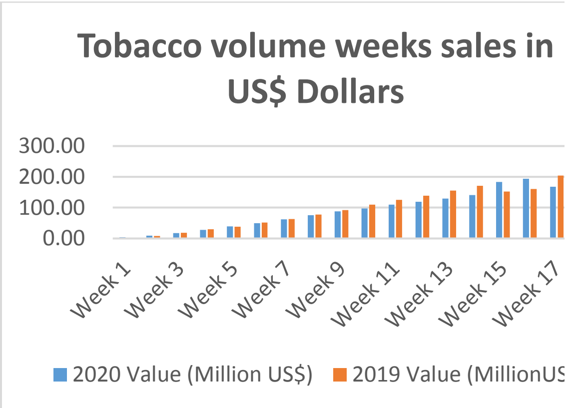
Figure 7: Cumulative tobacco weekly sales in million Kgs



Source: Data from Tobacco Commission

After 18 weeks of sales, the total proceeds from tobacco sales were US$172.2 million, 19 percent lower than US$211.5 million realized in the corresponding period of 2019. Of the total earnings, 90.0 percent was realized through contract system amounting to US$155.0 million whilst auction system sales totaled US$17 million representing 10.0 percent of total earnings.

Figure 8: Cumulative tobacco weekly sales in US$ Dollars



Source: Data from Tobacco Commission

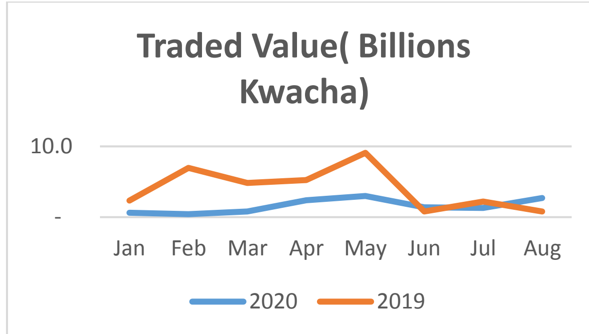
Meanwhile at the end of week 18, the tobacco prices for 2020 remained relatively higher at 1.54 US$/Kg compared to 2019 prices at 1.47 US$/Kg.

IV. Stock market developments

During the month of August, 2020, there was 1 new listed company on the primary market in the name of FDH Bank and as a result the number of listed companies increased to 16. On the secondary market, as at 31st August, 2020, the total volume of shares traded was 24.2 million at a total consideration of MK 2.7 billion in 320 trades.

This reflected an increase in the value of shares traded at the market during the month in review compared to the previous month; hence the total value of shares traded was MK 1.3 billion at a volume of 67.2 million in 195 trades. Thus, despite a low volume of shares sold in this month compared to the previous month, turnover increased tremendously. In this month, NBS Bank plc traded the most shares followed by Mpico plc and Telekom Networks Malawi plc, respectively.

Figure 9: Value of shares traded at the Malawi Stock Exchange



Source: Data from Malawi Stock Exchange

Figure 9 above shows that even prior to COVID-19, turnover at the Malawi Stock Exchange has been at lower levels for the most part in 2020 compared to 2019. However, for the month of August, the market has registered a higher turnover compared to 2019.

V. Interest rates

At the end of the previous month of July, 2020, the Monetary Policy Committee (MPC), decided to maintain the Policy Rate at 13.5 percent and the Lombard Rate at 0.2 percentage points above the Policy Rate. The MPC also maintained the Liquidity Reserve Requirement (LRR) ratio on both local currency and foreign currency deposits at 3.75 percent.

In arriving at this decision, MPC noted that although inflation developments were favorable in the first half of the year 2020, there are emerging upward risks to the medium-term inflation path. The MPC therefore, decided that a cautious approach, which would support economic activity amid the raging pandemic while safeguarding the economy against the risks ahead, is necessary.

Meanwhile, according to RBM statistics, as at 15th August, 2020, Treasury Bills average yields for 91-days, 182-days and 364-days were recorded at 9.97 percent, 12.55 percent and 13.24 percent, respectively. This meant that the only change in average yield took place in the 91-day Treasury Bills while for the other two, the average yield remained the same compared to figures recorded as at 31st July, 2020 as shown by Table 1 below:

Table 1: Treasury Bills Yields (%)

YEAR, 2020	**SECURITIES**		
	91-days	**182-days**	**364-days**
31-Jul	7.57	12.55	13.24
15-Aug	9.97	12.55	13.24
Change in yield	240	0	0

Source: Data from RBM

VI. Gross Official Reserves

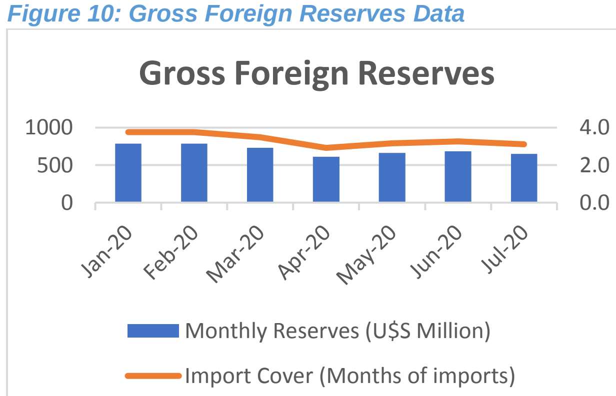
Gross official reserves slightly decreased to US$651.4 million (3.1 months of import coverage) at end July 2020, from US$682.7 million (3.3 months of import coverage) recorded in June 2020. Overall, between April to July 2020, Malawi has registered significantly low numbers of gross official reserves compared to the same period in 2019. This can be largely attributed to the decline in export revenue mostly for tobacco which continues to fetch lower revenue margins during this year's market compared to 2019.

The current declining pattern of the country's foreign reserves if not checked will exacerbate already existing supply-side shocks in the economy as the country is a heavy importer (so far the cement industry has already experienced supply deficits).

As the year drags on, it is expected that aggregate demand for local exports will remain subdued due to the decline in global output and overall our exports volumes will continue to decrease due to the seasonality nature of our exports.

As such export revenue that generates foreign reserves will most likely continue to go down. In view of this, the country must find ways to reduce demand for foreign currency by increasing domestic production to substitute foreign goods.

Figure 10: Gross Foreign Reserves Data



Source: Data from RBM

VII. Exchange rate

According to RBM statistics, in the month in review, the Kwacha weakened against the US Dollar with figures as at 31st August, 2020 showing that the local currency was trading at K756/Dollar compared to the figure of K749/Dollar recorded as at 31st July, 2020. Similarly, the Kwacha depreciated against the British Pound closing in at K1,008/Pound in the month of August compared to K1,006/Pound at the close of July, 2020.

On the other hand, the local currency appreciated against the Euro and South African Rand, respectively. According to the figures released at the close of the month of the August, 2020, the Kwacha was trading at K900/Euro compared to K908/Euro at the end of July, 2020. While against the Rand the local currency closed the month of August trading at K46/ Rand compared to K47/Rand.

Table 2: Selected Market Foreign Exchange Rates (End-Month)

	Malawi Kwacha Selling against the US Dollar	Malawi Kwacha Selling against the Pound	Malawi Kwacha Selling against the Euro	Malawi Kwacha Selling against the Rand
Apr-20	744.34	933.22	813.50	41.96
May-20	743.64	924.88	837.25	43.65
Jun-20	743.77	925.36	848.85	44.44
Jul-20	748.77	1005.90	908.32	46.87
Aug-20	755.93	1007.80	900.01	45.51

Source: Data from RBM

With demand for local exports continuing to be subdued, demand for the local currency will remain weak and this will cause shortage of foreign currency in the country holding all other things like demand for imports constant.

Taking into consideration the market behavior of foreign exchange markets like Malawi where currency price determination is on floating basis rather than a fixed peg. Furthermore, in light of the weakening demand of the local currency, the most probable market outcome for the Kwacha is that, holding all other things constant, it will depreciate against most of its major trading partners' currencies in the short term.

Even though the weakening of the Kwacha relative to its major trading partners' currencies, may make our exports cheaper in the short-term, our economy is unlikely to make short-term gains from the weak currency due to the seasonality of our agricultural exports. Malawi's exports usually pickup in volume in the second quarter of the year during the agricultural harvest period and diminish in third quarter of the year as the new agricultural season begins.

In a nutshell, Malawi's economic growth prospects remain weak and at risk of a recession, mainly due to downward pressures emanating from existing external and a number of emerging internal shocks. At the moment, with no economic response plan in place to offset the downward pressures, it is very unlikely that the economy will remain resilient in the short-term.

Therefore, there is a need for a strategic economic response plan to address the challenges pointed out that are currently threatening the economy before they exacerbate or trigger other threats.

Business News	
August 2020	
AfDB invests in tourism sector	The Department of Tourism in the Ministry of Tourism and Wildlife has secured a $10 million grant from the African Development Bank (AfDB) to implement a one and half year capacity building programme for Small and Medium Enterprises (SMEs) in the sector. The programme has been designed to capacitate indigenous SMEs who are failing to compete with companies owned by foreigners.
Scarcity of cement pushes prices up	Prices of cement increased by 33 percent in the last two weeks of the month August to K8, 000 per 50 kilogram (kg) bag, a development traders attributed to scarcity of the product on the market.
FMB Holding posts K10.5 billion profit in first half	FMB Capital Holdings plc (FMBCH) has registered a profit after tax of $14.29 million (about K10.5 billion) in the six months period ended June 30, 2020, a published financial statement has shown. This represents a 181 percent growth when compared to the $5.1 million (about K3.8 billion) posted in the same period last year. The statement further shows that during the period under review, the company's net interest grew by five percent to $29.06 million while non-funded income rose by 20 percent to $23.90 million from $19.95 million in June 2019.
MAIIC secures K10.3 billion funding for businesses	The Malawi Agriculture and Industry Investment Corporation (MAIIC) has indicated that it has mobilized funds in excess of K10.3 billion to help boost local businesses. The funds have come from resources from MAIIC capital of K2.8 billion and funding from external partners, amounting to $10 million (about K7.4 billion).