Economic review, fourth quarter to November 2017

Investment banking

5th December 2017

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1. Interbank market and interest rates

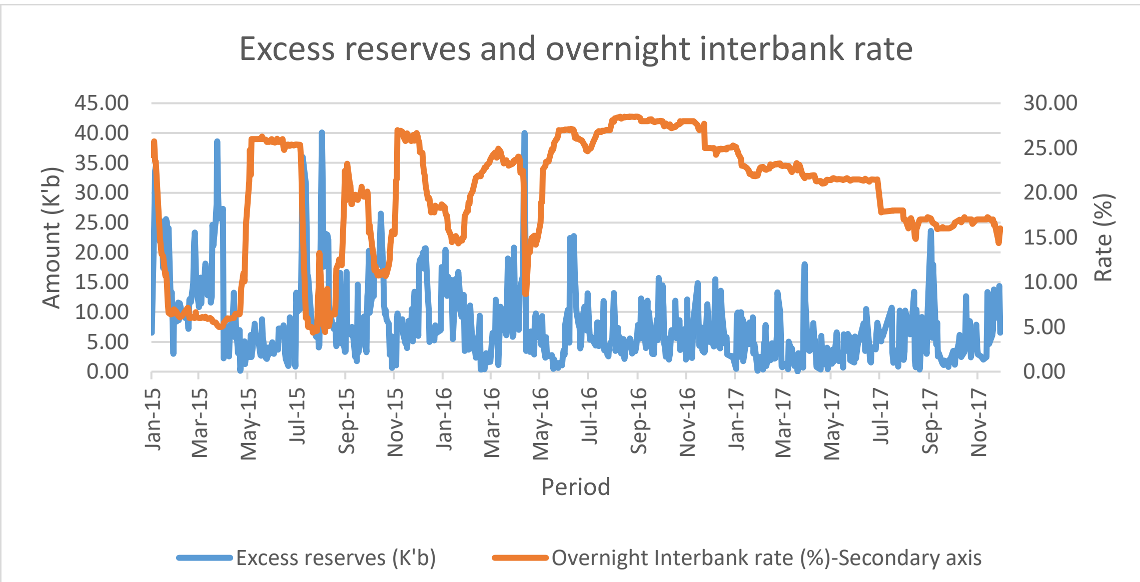
1.1 Liquidity levels fluctuated along an upward trend in the two months of the fourth quarter of 2017 (Q4), departing from trendless fluctuations in the third quarter of 2017 (Q3). Excess reserves averaged K6.06b per day, increasing from K5.61b in Q3, K4.13b in Q2 and K5.69b in Q1 of 2017. Consequently, the overnight interbank rates decreased to a daily average of 16.70% from 16.81% in Q3, 21.48% in Q2 and 22.93% in Q1.

1.2 Overnight interbank borrowing increased in October and November 2017 to a daily average of K7.87b from an average of K6.69b in Q3, K5.13b in Q2 and K4.96b in Q1 of 2017. Access on the Lombard Facility during the review period also increased, averaging K15.94b per day compared to K3.65b in Q3, K4.81b in Q2 and K3.72b in Q1.

1.3 The central bank withdrew a total of K65.00b (daily average: K1.81b) from the market at an average rate of 16.00% through open market repurchase agreements (OMO) in the two months of Q4 of 2017, compared to K560.56b (K11.93b per day) at an average rate of 17.09% in Q2, K116.65b (K3.89b per day) at an average rate of 21.32% in Q2 and K95.74b (K4.56b per day) at an average rate of 24.41% in Q1.

1.4 Figure 1 below gives a summary of excess reserves and overnight interbank rate movements from January 2015 to November 2017.

Figure 1: Excess reserves and overnight interbank rate movement



Source: Reserve Bank of Malawi

1.5 The policy rate during the two months under review stood at 18.00% after the monetary policy committee resolved to maintain the rate at that level during their meeting held on 27 and 28 September 2017. The decision to maintain the policy rate at 18.00% was made after consideration of local economic developments and the need to maintain a tight monetary policy to keep inflation on a downward trend and at single digit. Low inflation in turn was expected to guarantee low interest rates and prolong stability of the exchange rate. The policy rate was last revised on 5 July 2017 from 22% as a reaction to the decrease in the headline inflation.

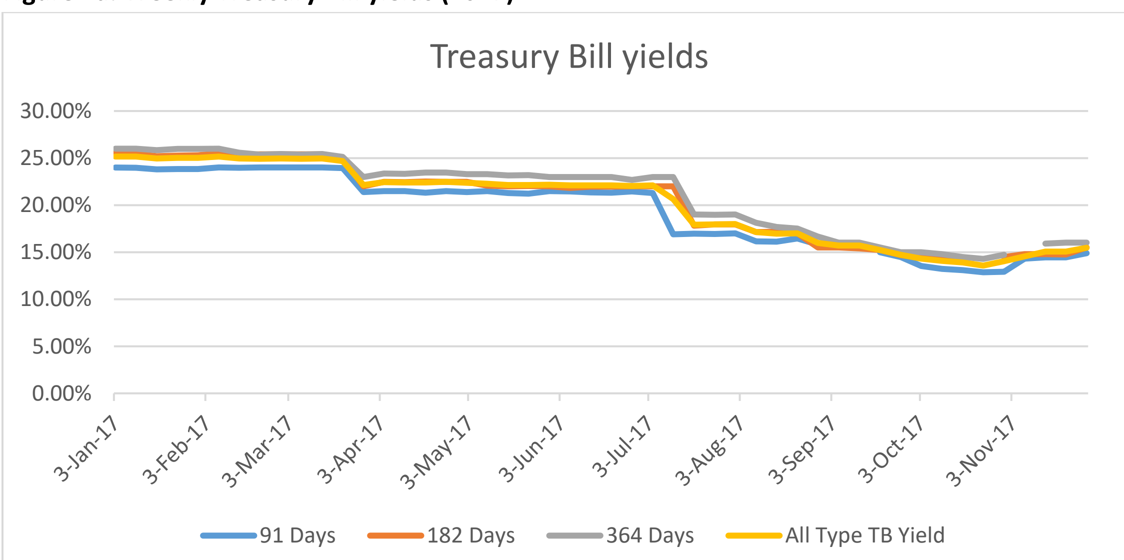
1.6 In the short to medium term, the policy rate could still be maintained at 18.00% on account of the same reason that monetary authorities want to keep inflation within a single digit and interest rates on a downward trend. In the long term, most likely after the lean period, the policy rate could be reduced further in order to encourage an across the board reduction in interest rates.

2. Treasury Bills

2.1 During the 9 auctions held in October and November 2017, authorities managed to raise K21.68b compared to K54.97b raised in 12 auctions in Q3 and K41.89b raised in 10 auctions in Q2. Total applications stood at K45.95b, representing a rejection rate of 52.83%. This is compared to K158.43b that was applied in Q3 (65% rejection rate).

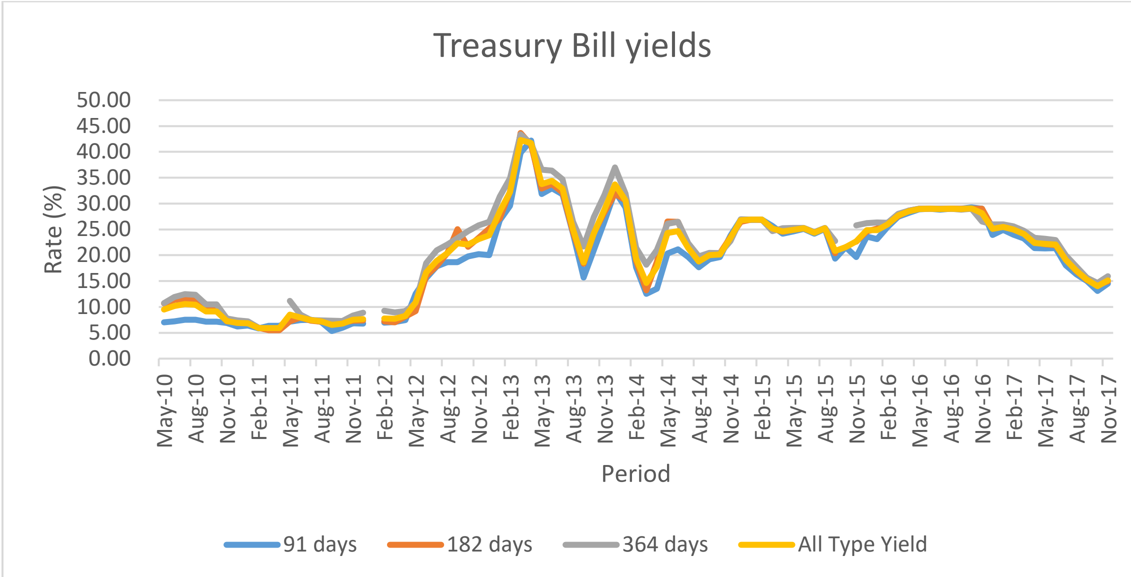
2.2 Treasury Bill yields continued the downward trend during the review period with the all-type Treasury Bill yield averaging 14.51% from 17.34% in Q3, 22.25% in Q2 and 24.77% in Q1. Figure 2a depicts the weekly movement of the Treasury Bill yields this year and Figure 2b depicts the monthly movement from May 2010.

Figure 2a: Weekly Treasury Bill yields (2017)



Source: Reserve Bank of Malawi

Figure 2b: Monthly Treasury Bill yields (2010 - 2017)



Source: Reserve Bank of Malawi

2.3 Looking forward, in the short term Treasury Bill yields are expected to inch upwards owing to market expectations of a possible rise in inflation in December due to high consumer demand during the festive season and the ongoing power challenges. In the medium to long term, Treasury Bill yields may face a downward pressure due to improved liquidity in the market and as the authorities target cheaper funds due to high government debt levels.

3. Exchange rates

3.1 The Kwacha remained stable in the period under review, registering marginal appreciations of 0.01% against the USD and 0.95% against the ZAR, and marginal depreciations of 0.37% and 0.70% against the GBP and the EUR, respectively, between 30th November 2017 and 29th September 2017. As at end November 2017, the Kwacha was trading at K725.4142/USD, K53.1007/ZAR, K976.9153/GDP and K860.5589/EUR, compared to K725.5001/USD, K53.6038/ZAR, K973.2584/GBP and K854.5666/EUR as at the end of Q3.

3.2 Year-to-date figures indicate that the Kwacha has marginally appreciated against the ZAR by 0.34% and has depreciated against the USD, GBP and EUR by 0.06%, 8.86% and 11.27%, respectively. The depreciation of the Kwacha against the GBP and the EUR was due to the strengthening of these currencies on global markets, particularly in the case of the EURO, with increased investor confidence due to improved political certainty.

3.3 The relative stability of the Kwacha against the USD this year has been attributed to the tobacco marketing season which raked in USD212m, the resumption of aid and credit facilities from development partners which have ensured consistent availability of forex in the country, as well as tight monetary conditions which have mitigated the impact of a wide current account deficit.

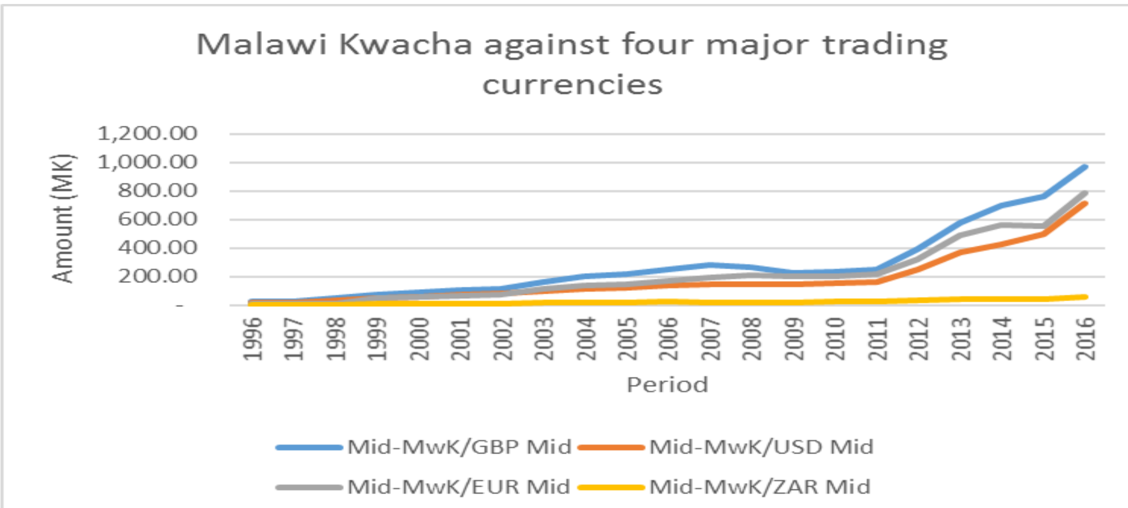
3.4 Table 1 provides a summary of how the Kwacha has fared against the four major trading currencies this year and Figure 3 depicts the Kwacha exchange rate movement since 1996.

Table 1: Kwacha exchange rate movement against major trading currencies

Currency	30-Dec-16	31-Mar-17	30-Jun-17	29-Sep-17	30-Nov-17	Q4 Change	Q3 Change	Q2 Change	Q1 Change	YTD Change-2017
USD	725.0093	725.7323	725.4452	725.5001	725.4142	0.01%	-0.01%	0.04%	-0.10%	-0.06%
GBP	890.3839	906.2945	944.0944	973.2584	976.9153	-0.37%	-3.00%	-4.00%	-1.76%	-8.86%
EUR	763.5798	774.6467	829.9093	854.5666	860.5589	-0.70%	-2.89%	-6.66%	-1.43%	-11.27%
ZAR	53.2829	53.6431	55.7345	53.6038	53.1007	0.95%	3.97%	-3.75%	-0.67%	0.34%

Source: Reserve Bank of Malawi

Figure 3: Kwacha exchange rate movement

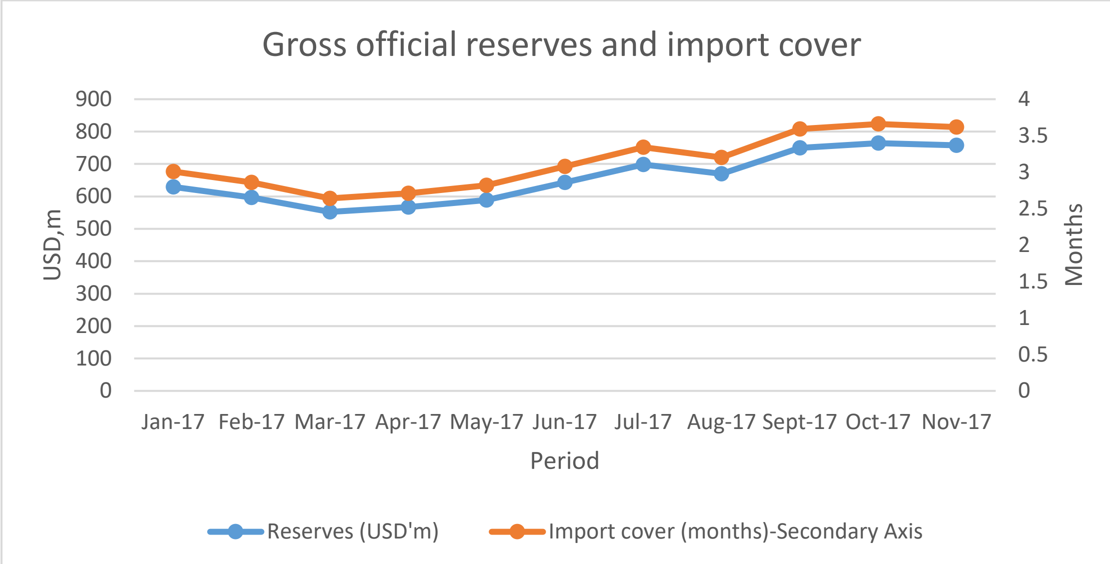


Source: Reserve Bank of Malawi

3.5 The Kwacha is expected to remain stable in the short to medium term as there are currently no indicators of unfavorable shocks to the exchange rate. In the long term, however, the local currency could depreciate further due to trade imbalances and exogenous shocks such as rising international fuel prices.

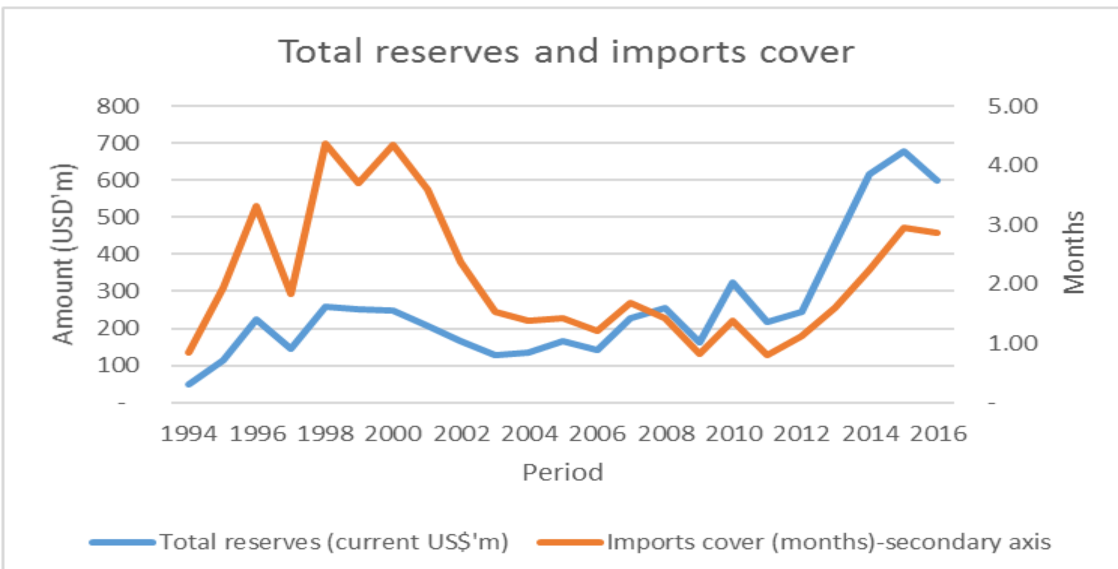
3.6 Gross official reserves were observed at USD757.40m (3.62 months of imports) on 30th November 2017, 0.96% higher than USD750.23m (3.59 months of imports) observed at the end of September 2017. Figures 4a and 4b give a summary of total reserves and import cover movement this year and since 1994.

Figure 4a: Monthly import cover movement (2017)



Source: Reserve Bank of Malawi

Figure 4b: Annual import cover movement (1994-2016)

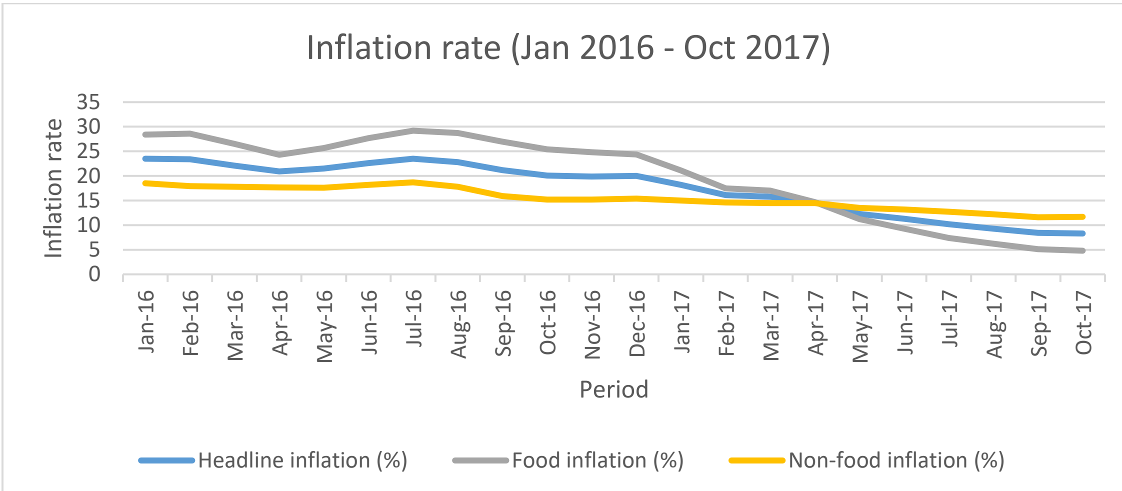


Source: World Bank-World development indicators database

4. Inflation

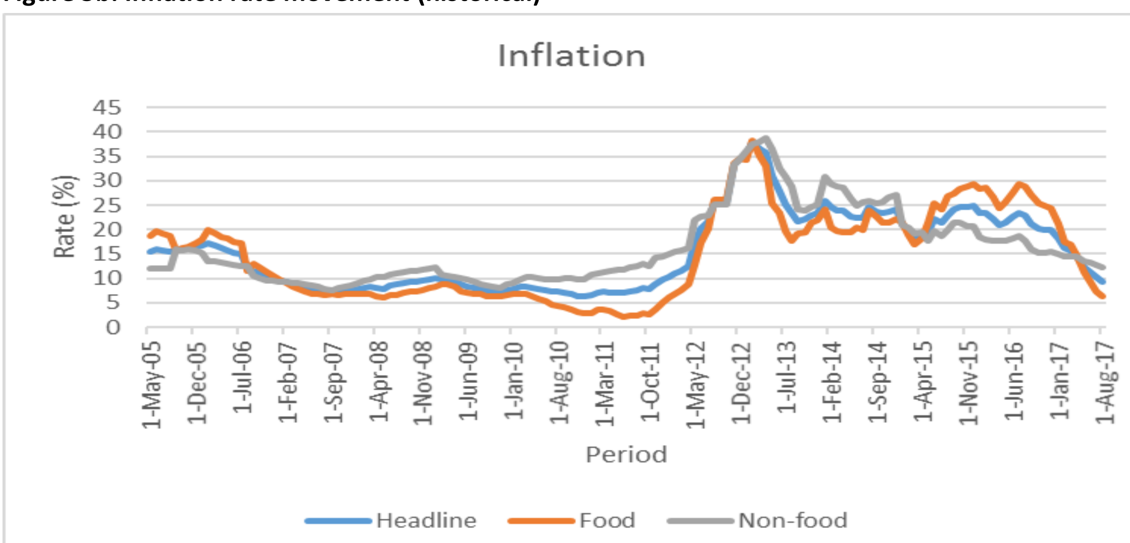
4.1 Headline inflation stood at 8.3% in October 2017, slightly dropping from 8.4% in September 2017, 9.30% in August 2017, 10.20% in July 2017 and 11.30% in June 2017. Headline inflation for the same period last year (October 2016) was 20.10%. The decline is largely attributed to a slowdown in both food and non-food inflation. Food inflation for October 2017 dropped to 4.80% from 5.10% in September 2017 while nonfood inflation increased marginally to 11.7% from 11.6%. Food and non-food inflation for the same period last year (October 2016) was 25.37% and 15.17% respectively.

Figure 5a: Inflation rate movement (2017)



Source: National Statistics Office (NSO)

Figure 5b: Inflation rate movement (historical)



Source: National Statistics Office (NSO)

4.2 Looking ahead, in the short term inflationary pressures are expected to mount in December 2017 and early 2018 due to increased consumer demand during the festive season. In the medium term, inflation will continue to decelerate due to better availability of food and stability of the exchange rate should there be no significant unfavorable shocks to forex inflows in the country. It is expected that weather conditions in the 2017/2018 agricultural season will be favorable. The Department of Meteorology forecasted that the country will receive normal rainfall during this agricultural season. Risks on the inflation outlook, however, remain on non-food inflation which could potentially increase due to insufficient power supply which could adversely affect production.

5. Stock market and other corporate news

5.1 The Malawi Stock Exchange was generally bullish during the review period, with the MASI gaining 6.03%, driven by price gains on 7 counters. There were 3 losers while 4 counters registered no price movement. Table 2 provides a summary of stock movements at the Malawi Stock Exchange for the period between end September 2017 and end November 2017.

Table 2: Malawi Stock Exchange share movement

Market indices				
	30-Nov-17		**% pts Δ**	**29-Sep-17**
MASI	21122.43	↑	6.03%	19920.42
DSI	15850.21	↓	1.04%	15687.31
FSI	3516.49	↑	44.97%	2425.75
Gainers	**Current price (K)**		**Δ**	**Previous price (K)**
BHL	28.00	↑	12.00%	25.00
FMB	48.00	↑	6.64%	45.01
ILLOVO	240.00	↑	2.21%	234.81
NBM	270.05	↑	0.02%	270.00
Standard Bank	610.00	↑	1.67%	600.00
Sunbird	96.00	↑	37.14%	70.00
FMBCH	67.00	↑	48.86%	45.01
Losers	**Current price (K)**		**Δ**	**Previous price (K)**
NBS	7.00	↓	-6.67%	7.50
NITL	60.06	↓	-0.03%	60.08
TNM	13.03	↓	-6.93%	14.00
Flat	**Price (K)**		**Δ**	**Previous price (K)**
MPICO	15.61	→	0.00%	15.61
NICO	34.00	→	0.00%	34.00
Old Mutual	1930.00	→	0.00%	1930.00
PCL	570.00	→	0.00%	570.00

Source: Malawi Stock Exchange (MSE)

5.2 FMBCH released a notice to shareholders of FMB Plc advising them that all the remaining 49,342,803 FMB shares will be transferred to FMBCH. One FMBCH ordinary share will be issued in exchange for every one FMB ordinary share (Source: The Nation, 1st December 2017).

5.3 TNM released a trading statement advising that profit after tax for year ending December 2017 is expected to be more than 60% higher than the previous corresponding period. In 2016, the company made K8.2bn in profit after tax (Source: MSE). At a minimum of 60% growth, this translates to K13.13b in profit after tax. The rise in profit could translate into higher dividends for the company's shareholders. The news could also increase demand for TNM shares, pushing up prices in the process, especially in the short to medium term. However, the immediate response of the share price may not be as expected since the news has come at almost the peak of the lean period during which monetary conditions are usually tight.

6. Economic growth

6.1 Malawi's real economic growth is projected to accelerate to 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 last 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 have facilitated a rebound in agricultural production. The World Bank estimates that the agricultural sector will grow by 5.00% in 2017, up from 2.30% in 2016, led by increased production of the country's staple crop, maize, which is expected to reach 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, the industry and services sectors are expected to grow by modest rates. According to the World Bank Economic Monitor for November 2017, the services sector is expected to grow by 0.2 percentage points higher than that recorded in 2016 and the industry sector by only 0.8 percentage points higher. Within these sectors, however, the transportation and storage services and manufacturing subsectors 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 is the major risk to economic growth in 2017. Production in the manufacturing sector, especially, might be adversely affected by the continued power outages.

6.4 Growth forecasts for 2018 are even more optimistic on the back of better performance of the agricultural sector and general macroeconomic fundamentals. The IMF, the EIU and the Malawi

Government, project that real economic growth will reach 5.00%, 4.70% and 4.90%, respectively, in 2018.

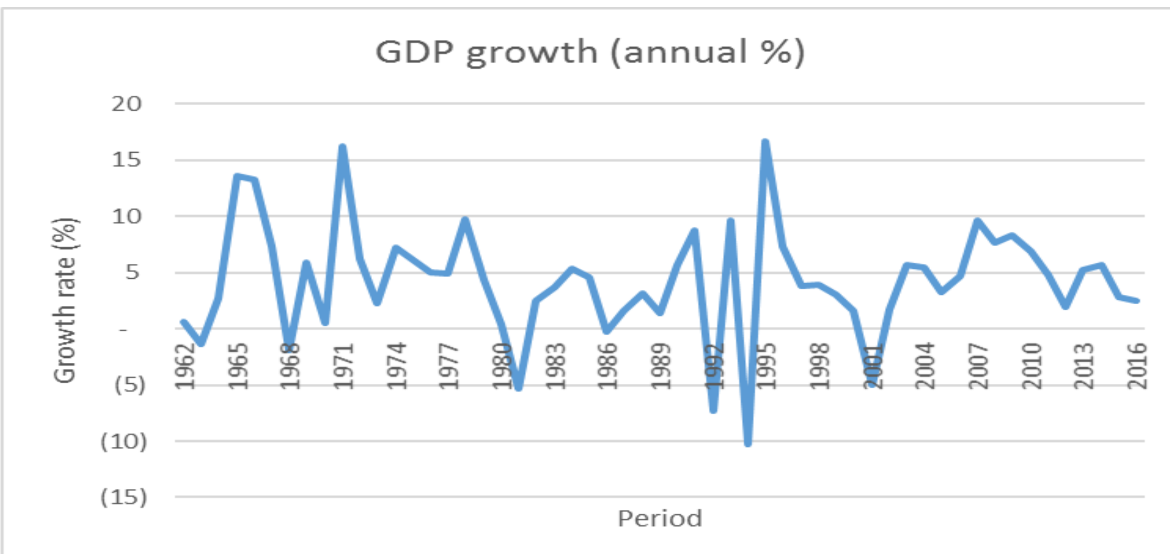
6.5 Risks to economic growth in 2018 include insufficient power supply which could slow down economic growth by reducing private sector activity. High government debt levels might also keep interest rates high and crowd out private sector funding for growth.

Table 3: Real economic growth projections to 2018

	2015	**2016**	**2017**	**2018**
EIU	2.90%	2.50%	3.80%	4.70%
IMF	2.95%	2.95%	4.50%	5.00%
World Bank	2.80%	2.50%	4.50%	
Malawi Government	3.30%	2.90%	4.40%	4.90%

6.6 Figure 6 depicts the Malawi's GDP growth rate from 1962 to 2016.

Figure 6: GDP growth rate (%) from 2000 to 2016



Source: World Bank-World development indicators database

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