Considerations for devaluation and depreciation of Malawi Kwacha against major trading currencies in National Development Agendas – Litmus Test for Malawi Vision 2063

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Considerations for devaluation and depreciation of Malawi Kwacha against major trading currencies in National Development Agendas – Litmus Test for Malawi Vision 2063

By

Brian Phiri Kampanje

Abstract

This paper strived to evaluate the impact of exchange rate of Malawi Kwacha more specifically as result of devaluation and depreciation against major currencies in the attainment of the country’s developmental agendas. The results indicate that the country has failed to achieve meaningful gains in its developmental agendas in view of significant adverse movement in the exchange rate. There was however one exception with Malawi Growth and Development Strategy (2006-2011) when the exchange rate was stable. National Planning Commission should consider safeguards in the Vision 2063 by curbing illegal externalisation of forex as sustainable tool to avoid depreciation and devaluation of the Malawi Kwacha.

Type of Paper: Research

Key words: Devaluation; Development; Depreciation
1.0 Introduction

The study is premised on published data to evaluate the impact of the adverse foreign currency exchange rate movement on Malawi’s development agendas. The country is known to tout the introduction of each development agenda at the implementation stage but the euphoria thereof wanes as time passes by due to realisation that the objectives might not be achieved after all. This could be one of the pioneer studies regarding the relationship between foreign currency exchange rate movement and the attainment of country’s developmental agendas.

2.0 Literature review

This section looks at events between 1994 and first half of 2022.

2.1 Devaluation of the Malawi Kwacha

Reserve Bank of Malawi devalued Malawi Kwacha by twenty five percent at the end of May 2022 in an effort to control forex shortage in the country. It further issued out Exchange Control (Repatriation of Export Proceed and Operations of Foreign Currency Denominated Accounts) Regulations, 2022 which compels authorised dealer banks to convert thirty percent of the export proceeds upon receipt of funds in the domiciled foreign currency
denominated accounts (FCDAs). The immediate adverse impact of such action has been substantial increase in fuel and maize prices which should sharply increase inflation.

The Malawi Kwacha was devalued by ten percent in August 2011 such that the exchange rate with United States Dollar moved from MWK150.80 in March 2011 to MWK166.00 in September 2011 – Financial Stability Report (2011). The Reserve Bank of Malawi devalued the Kwacha on 7th May 2012 from MWK168.00/USD to MWK250.00/USD – Reserve Bank of Malawi Bank Supervision Annual Report (2012). This translated to 48.8 percent. The Malawi Kwacha however depreciated sharply by end of 2012 as a result of the free flow of the Kwacha in a liberalised forex market resulting in depreciation of the Kwacha by 104.7 percent to USD – Reserve Bank of Malawi Bank Supervision Annual Report (2012).

2.2 Depreciation of Malawi Kwacha

Simwaka (2007) stipulated that exchange rate was around MWK4.50/US$ in February 1994 but depreciated to MWK15.00/US$ by September 1994. Simwaka (2007) further annotated that there was a sharp fall of Malawi Kwacha between 1997 and 1998 with an adverse exchange rate trend from MWK15.00/US$ to MWK38.00/US$, it further dropped by 4.1 percent in
1999 and again by 38.0 percent in 2000 when compared to 1999 but registered a gain in 2001 to close at MWK67.29/US$ compared to MWK80.08/US$ in 2000.

The depreciation of the Kwacha against major trading currencies does not appear to be a result of trade imbalances only but also a result of availability of credit lines from donors as noted by Malawi Economic Growth Strategy (2003:17/18):

[... This drop in capital inflows was caused mainly by the reduction in Government foreign borrowing by half from K9.8 billion in 2001 to K4.9 billion in 2002. Because Government’s main foreign lenders are the multilateral institutions including the IMF and World Bank, these institutions were not willing to lend Government any more money until Government restores its economic programme with the IMF.

... This led to the depreciation of the average exchange rate by 6.2 per cent from K72.2 to US$1 in 2001 to K76.7 to US$1 in 2002. The slow rate of depreciation of the currency was a result of the intervention in the domestic foreign exchange market by the Reserve Bank through sales of foreign exchange to Authorised Dealer Banks (ADBs).]


Financial Stability Report (2014:6) noted that the exchange rate movements of MWK/USD

Table 1: Exchange Rate for USD Sep 2012 to Mar 2014

<table>
<thead>
<tr>
<th>Period</th>
<th>Sep 2012</th>
<th>Mar 2013</th>
<th>Sep 2013</th>
<th>Mar 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>299.00</td>
<td>405.2</td>
<td>371.5</td>
<td>410.2</td>
</tr>
</tbody>
</table>

Financial Stability Report (2015:4) postulated:

[Risks to the banking sector from the foreign exchange market remained low. Despite depreciating in November 2014, the Kwacha appreciated in December 2014. The Kwacha continued to appreciate until March 2015. In addition, between February and March 2015, the Kwacha remained relatively stable.

… Appreciation of the Kwacha was partly aided by issuance of three directives by the RBM and the swap debt facility with Preferential Trade Area Bank, (PTA) …].
The exchange rate at the end of December 2014 and 2015 was MWK475.80/USD and MWK664.4/USD respectively - Press Corporation Plc Annual Report (2015). Financial Stability Report (2016:5) provides data regarding the percentage of movement of the MWK/USD as follows:

Table 2: Exchange rate for US$ Apr 2015 to Mar 2016

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>% age</td>
<td>0.6</td>
<td>-0.4</td>
<td>0.6</td>
<td>16.1</td>
<td>8.95</td>
<td>-0.5</td>
<td>0.84</td>
<td>8.1</td>
<td>9.8</td>
<td>9.7</td>
<td>2.1</td>
<td>-8</td>
</tr>
</tbody>
</table>

Press Corporation Plc Annual Report (2020:4) provides exchange rate for USD data for period between 2016 and 2020 as follows:

Table 3: Closing USD Rate – 2016 to 2020

<table>
<thead>
<tr>
<th>Year</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Mean</td>
<td>694.90</td>
<td>725.50</td>
<td>727.70</td>
<td>733.25</td>
<td>754.22</td>
</tr>
<tr>
<td>Closing Rate</td>
<td>725.40</td>
<td>725.60</td>
<td>729.80</td>
<td>736.70</td>
<td>771.73</td>
</tr>
</tbody>
</table>

The exchange rate was MWK817.30 as at 31<sup>st</sup> December 2021 and MWK817.31 as at 31<sup>st</sup> March 2022 – MPICO Plc Annual Report (2021:93). The Reserve Bank of Malawi devalued Malawi Kwacha by twenty five percent on 27<sup>th</sup> May 2022 – Reuters (2022). The exchange rate as 31<sup>st</sup> May 2022 was MWK1,021.66/USD. The exchange
rate of Malawi Kwacha to USD has moved from MWK4.5 in February 1994 to around MWK140.50 in 2010 and shot sharply to MWK1,021.66./USD as at 31st May 2022. Reuters (2022) purported that lack of IMF Credit Facility might have partly contributed to the acute shortage of forex in Malawi.

### 2.3 Development agendas in Malawi

Malawi has undertaken number of developmental agendas since 1994 in the quest to uplift the lives of millions of Malawians. Kampanje (2017) noted that Malawi rolled out several development agendas such as Vision 2020 in 1998 supported by Malawi Poverty Reduction Strategy Paper in 2002; Malawi Economic Growth Strategy in 2003; Malawi Growth and Development Strategy - MGDS (2006-2011) in 2006 and Malawi Growth and Development Strategy II (2011-2016) dubbed MGDS II in 2012. These development strategies did not however have effective mechanism of managing adverse foreign currency exchange rate movement. Devaluation of the Malawi Kwacha was never mentioned in those development strategies while depreciation of the same was said in passing like in the MGDS and none in MGDS II.

The MGDS III (2017-2022) did not cover matters of foreign currency exchange rate risks and possible mitigation factors either. This is despite quoting US$ in several key areas of health which required annual
investment of about US$2.8 billion to meet SADC targets. Section 5.1.1 of MGDS III set a target of increasing public expenditure by US$1.2 billion to act as catalyst for doubling Malawi’s income per capita of US$380.00. There was need to instil foreign currency exchange rate risks hedging mechanisms for the attainability of those ambitious targets.

2.4 Depreciation of MWK on development agendas

It appears the depreciation of the Malawi Kwacha was more severe than the devaluation itself as noted by Malawi Poverty Reduction Strategy Paper (2002:13):

[The depreciation of the Kwacha in August 1998 led to cost-push inflationary pressure resulting in annual inflation rates of 29.8 percent and 44.7 percent in 1998 and 1999, respectively.]

There are a lot of proponents for a weaker Malawi Kwacha as a tool for export growth. Sadly, this is a view of the majority of the donors and bilateral partners. This is however quashed by other quarters that argue that in a predominantly importing economy, devaluing or depreciating the local currency does not provide significant benefits as noted by Malawi Economic Growth Strategy (2003:17):

[As a result of the above developments, export earnings, in dollar terms, declined by 27.7 per cent over the period 1998-2002. In Kwacha terms, however, total value of exports more]
than doubled from K14.8 billion in 1998 to K30.3 billion in 2002 mainly on account of the depreciation of the Kwacha by twofold, which improved export prices although they fell in dollar terms. Of the total export earnings; domestic exports rose by 1.3 per cent from K29.9 billion in 2001 to K30.3 billion in 2002 while re-exports grew impressively at 17.4 per cent in 2002.]

There are no known studies of the impact of the foreign currency exchange rate movement on the Malawi’s quest to fulfil its several developmental agendas. For example, the Vision 2020 was the long-term strategy which set an ambitious per capita target of US$1,000 when the exchange rate was about MWK15.00/USD in March 1998. The exchange rate was around MWK772/USD by end of 2020. The actual rate for USD cash in the market was much higher than the telegraphic transfer (TT) rate. Attainability of the US$1,000.00 was unsurmountable task considering the fact that local income did not rise at the same pace with the adverse trend in the exchange rate.

2.4.1 Malawi Poverty Reduction Strategy Paper

Rolled out in 2002 when exchange rate was MWK76.7/USD - Malawi Economic Growth Strategy (2003). This was terminated in 2005 – Kambewa et al (2005) and Kampanje (2017) when the rate was MWK118.4171/USD in 2005 - Reserve Bank of Malawi Bank Supervision Annual Report (2005:9). There was 54.4 percent adverse movement of the local currency
which meant that poverty reduction mechanisms were off-track as depreciation of the local currency meant more people especially in the rural areas descended into poverty as a result of cost-push inflation arising out of increased cost of living.

2.4.2 Malawi Economic Growth Strategy

This development plan was rolled in 2004. It was however foreclosed in 2005 – Kambewa et al (2005) and Kampanje (2017). The exchange rate marginally depreciated by 8.74 percent but the timeframe of less than two years was shorter to evaluate the real impact of that adverse exchange rate movement as it hardly operate in full cycle of a fiscal year.

2.4.3 Malawi Growth and Development Strategy

This development plan was rolled between 2006 and 2011. The exchange rate in 2006 was MWK140.20. There was 10 percent devaluation of the currency in 2011 in September 2011 as noted above to close around MWK166/USD. This was a period of stable exchange rate leading to accomplishment of the majority of the objectives under the development strategy as noted by Reserve Bank of Malawi Bank Supervision Annual Report (2010:13) as follows:

[The foreign exchange market was characterized by lower supply against a background of higher demand, thereby
exerting pressure on the local currency. The increased demand for foreign currency largely emanated from the robust economic growth the country has registered over the past six years.

This notwithstanding, the Malawi kwacha remained relatively stable against the US dollar throughout 2010, at K150.8009 per US dollar.]

Reserve Bank of Malawi Bank Supervision Annual Report (2011:13) continued to tout economic growth but also acknowledged shortage of forex and petroleum products in the country as follows:

[During 2011, the Malawi economy continued to grow at a reasonable pace in an environment of relatively stable inflation and low interest rates. However, sustainability of these aggregates became undermined by acute influences in the external sector which resulted in shortage of critical inputs including petroleum products. External payments arrears accumulated against the background of a fixed exchange rate regime.]

The problems of dry pumps were not well captured in government’s official documents although major economic activities were disrupted resulting in downward revision of Malawi’s economic growth from 6.9 percent to 4.1 percent in 2011 – Kampanje (2012). Kampanje (2012) further stipulated that scarcity of petroleum products from 2009 which reached its peak in 2011 affected manufacturing sector making Malawian exports less
competitive on the international stage and also affected activities of international organisations in assisting the local poor masses.

Malawi Growth and Development Strategy (2006:261) set a target of per capita of US$450.00 by 2011. This was surpassed at the end of 2011 as Malawi’s per capita was estimated at US$534.95 – The World Bank Data (2020). This was by far no mean achievement. The scarcity of forex did not have material impact on the rural poor masses as inflation was contained.

2.4.4 Malawi Growth and Development Strategy II

MGDS II (2011-2016) was operationalised in 2012 by the new regime ushered in following the death of the incumbent President of the Republic in April 2012 amidst forex and fuel shortage in Malawi. The new regime took drastic measures to devalue the Malawi Kwacha as stated in 2.1 above. From exchange rate of MWK168/USD in May 2012, it depreciated by over 100 percent by close of 2012 and this caused massive inflation and pain on the local masses as noted by World Bank (2013:5):

[Since April 2012, major economic and political reforms have been initiated but the poorest have been hit hard by the Malawi Kwacha depreciation and economic recovery remains fragile due to the risk of social unrest and policy reversal, the constrained supply side response of the economy and exogenous threats. … the 49% devaluation and the introduction
of a floating exchange rate in May 2012 have since then translated into an over 100% depreciation of the Malawi Kwacha and generated a surge in inflationary pressures that is hitting hard the poorest groups of the population, creating a high risk of social unrest that would slow down economic recovery.]

Malawi rolled out Malawi Recovery Plan in 2012 to counter the negative effects of the massive depreciation of the Malawi Kwacha and removal of price controls on petroleum products and utilities resulting in increase of inflation from 7.6 percent in 2011 to 18.4 percent in 2012 – Kampanje (2017). Malawi introduced National Export Strategy in December 2012 as a five year plan (2013 – 2018) to support Malawi Recovery Plan to generate more forex to address significant trade imbalances as Malawi was a predominantly importing country – Kampanje (2017). This would have sorted out forex shortage and probably stabilise the exchange rate.

Forex through donor inflows which were promised in exchange for liberalisation of the forex market and removal of price controls in the petroleum products and utilities were short-lived due to suspension of donor aid amidst the revelation of massive plunder of government resources at Capital Hill in September 2013 termed Cashgate Scandal forced Malawi to borrow heavily and this caused further pressure on the Malawi Kwacha which depreciated substantially between 2013 and 2016 and therefore more Malawians descended into poverty as
result of it. The exchange rate moved from MWK371.50 in September 2013 to MWK725.40 by end of 2016 representing local currency depreciation rate of 95.3 percent thereby failing to achieve the target of income per capita of US$726.6 set out in Malawi Growth and Development Strategy II (2012:315) as actual income per capita was US$340.00 – World Bank (2016). World Bank (2020) noted that poverty and inequality remain stubbornly high and stated that the latest poverty figures showed the national poverty rate increased slightly from 50.7% in 2010 to 51.5% in 2016.

The substantial reduction of per capita in Malawi between 2010 and 2015 is substantially attributed to massive devaluation of the Malawi Kwacha and hence Malawi’s failure to achieve the target in that aspect in MGDS II (2011-2016) despite doing so under MGDS (2006-2011)

2.4.5 Malawi Growth and Development Strategy III

MGDS III (2017-2022) was supposed to have been rolled out in 2016 but delayed because National Planning Bill was passed in Parliament in December 2016 to oversee that medium development agenda – Kampanje (2017). Malawi’s economy experienced some shocks from nature with Cyclone Idai in Southern Region in 2019 and Covid-19 Effects in 2020 which affected the economy but the exchange rate stabilised between 2017 and 2020 as shown in Table 3 above. Reserve Bank of Malawi (2021) stated
that GDP per capita for Malawi was US$318.1 for 2016, US$365.1 in 2017, US$401.0 in 2018, US$592.2 in 2019 and US$615.8 in 2020. One might think that Malawi missed the per capita by US$385.00 in 2020 from the target of US$1,000.00 stipulated in the Vision 2020. There are however concerns that economic figures for 2019 and part of 2020 might have been altered to show a better performance than what was actually the case such that exchange rate might have been worse off than reported in the official statistics as noted by International Monetary Fund (2021:4):

[The authorities reported the possible provision of inaccurate information by the previous administration to the Fund; and have been working closely with staff to resolve this legacy issue. RBM has started submitting appropriate data of higher frequency and improved quality, with measures to avoid similar occurrences in the future. The authorities are undertaking actions more broadly to address legacy issues related to weak governance, including a special audit of foreign exchange reserves of the RBM to be completed before the end of the first half of 2022. The RBM and the Ministry of Finance have also scaled up internal reconciliation exercises and increased the frequency of reporting to the Fund.]

The global economy shrunk in 2020 and international trade was significantly disturbed. Several business ventures significantly curtailed their operations in 2020 and therefore believability of the Malawi’s economic data for 2020 needs further testing. Whatever the case might
be, significant depreciation of the MWK against USD between 2012 and 2020 played a crucial in increasing poverty in the general populace through high inflationary factors leading to failure to attain income per capita of US$1,000.00.

2.4.6 Vision 2063 and MIP-1 Development agenda

Vision 2063 through its medium term plan known as MIP-1 replaced MGDS III (2017-2022) in 2021 – Government of Malawi (2021). MIP-1 strives to make Malawi a lower middle income country with US$1,000.00 per capita by 2030. In an effort to accomplish that, several capital and operational projects have to be undertaken. Under Creation of Enabling Business Environment on page 191, the Exchange Rate used was MWK749.53 for five years between 2021 and 2025 but the current rate is over MWK1,100.00 indicating a adverse disparity of 46.76 percent this will have significant impact on completion of Bankable and Flagship Projects as well as cost of pillars and enablers were estimated at MWK17.580 trillion as cost overruns would be quite substantial.

Government of Malawi has introduced austerity measures as one way of reducing expenditures and that includes banning conferences at the lake which has brought serious debates on the negative effect of tourism industry in Malawi which was targeted to contribute about 11 percent
of Malawi’s GDP by 2030 from 6.7 percent in 2021. Other negative spill-over effects on contractionary fiscal expenditures will be known in due course.

The reduction of power supply from end January 2022 as a result of structural damage at Kapachira Hydro Power Station due to effects of Cyclone Ana has reduced the country’s productivity in view of prolonged load shedding and this might affect exports. There is however hope for boosted exports as Malawi has secured a loan for US$60 million from World Bank for rehabilitation works and on the other hand, Malawi National Export Strategy II is being implemented with new markets for products such as maize flour, cooking oil, sugar etc to South Sudan and this can bring in substantial forex.

2.5 Depreciation of MWK on NEPAD and MDGs

Kampanje (2017) also noted that Malawi adopted New Africa for Partnership Development – NEPAD. It is an economic philosophical considerations developed by Africans for African Continent unlike the traditional economic methodologies developed by the Bretton Woods Institutions. NEPAD was incorporated in the Malawi Economic Growth Strategy in January 2004.

NEPAD promised flagship projects in Agriculture in joint programmes with Food and Agriculture Organisation from 2005. Much is not known about success of such projects.
NEPAD was involved with energy sector financing feasibility studies for Malawi interconnection with Mozambique and Zambia under NEPAD Infrastructure Project Preparation Fund in 2017.

Malawi also adopted Millennium Development Goals (MDGs) which expired in 2014. Much is not known about the successes of MDGs but Kampanje (2017:40) annotated as follows:

"[Regarding MDGs, Ministry of Finance, Economic Planning and Development (2014:9), attested the following:

“This 2014 report shows progress that has been achieved in attaining the eight MDGs. Four of the goals are likely to be achieved, and significant progress has been made on the other four, where the country had a much lower starting base compared to other countries. The four MDGs that are likely to be achieved are: Reducing Child Mortality; Combating HIV and AIDS, Malaria and other diseases; Ensuring Environmental Sustainability; and Developing Global Partnership for Development. The four that are in doubt are: Eradicating Extreme Poverty and Hunger; Achieving Universal Primary Education; Promoting Gender Equality and Women Empowerment and Improving Maternal Health”."]

The acute depreciation of the MWK against USD is certainly one of the major factors for increasing extreme poverty and hunger as depreciation of the MWK leads to cost push inflation and slows economic development. Malawi adopted the Sustainable Development Goals
Devaluation and Development Strategy

(SDGs) in 2015 to run up to 2030 developed by United Nations which include instituting deliberate policies for eradicating extreme poverty. The recent devaluation of the Malawi Kwacha against the USD and subsequent depreciation of the local currency can impinge attainability of the SDGs in Malawi.

3 Plausible reason for depreciation of Kwacha

While this paper has explored trade imbalances and lack of credit facilities as major drivers for acute shortage of forex in Malawi, there is another dark side regarding the illegal externalisation of forex in Malawi.

It is very often stipulated that Malawi’s import bill greatly surpasses the export earnings and that Malawi should become more productive to export more goods and services to earn more forex to adequately cover its import bills. What is not discussed though is that the import bills seem to be inflated by unscrupulous traders who illegally externalise forex assisted by local banks. Mtonga (2018) noted that Malawi loses at least MWK200 billion annually through illegal externalisation of forex. Chimjeka (2022) stated that Reserve Bank of Malawi acknowledged that at least MWK500 billion might have been illegally externalised out of Malawi in 2018. That amount translates to USD685 million and is by no means a small sum of money as it would have been adequate to fully pay
for fuel, inorganic fertilizer and pharmaceuticals bills.

It can therefore be deduced that about USD5 billion has been externalised illegally between 2011 and 2021 putting Malawi’s Vision 2020 off-track by sending millions of Malawians into abject poverty in view of cost-push inflation associated with depreciation and devaluation of the Malawi Kwacha.

Worst still, there are a lot of companies which are either under declaring exports or conceal them altogether. The forex reserves would have otherwise improved and contain the inflationary pressures affecting Malawi.

4 Conclusions and recommendations

There is undoubted evidence that foreign currency exchange rate has significant impact on inflation in Malawi and has been responsible for sending more people into abject poverty in the country. There appears to be no deliberate policies to protect the economy from massive local currency devaluation and depreciation. The national development agendas have been prepared in Malawi Kwacha with projected exchange rates which have proved to be too ambitious such that actual cost of implementing budgeted activities has either been double or more on any given five year cycle. This paper recommends that the National Planning Commission should seriously consider rolling out measures which government ministries,
departments and agencies must consider to use less forex while implementing their core functions without compromising quality. Malawi’s think tanks must not only talk of import substitution but practice it so that the country can save forex, otherwise, majority of Malawians will remain in poverty. But more importantly, National Planning Commission must work hand in hand with appropriate authorities to curb legal externalisation of forex estimated at about USD5 billion between 2011 and 2021. Significant underreporting of export proceeds is also a problem which must be sorted out with urgency and ruthlessly.

References


Malawi Poverty Reduction Strategy Paper (2022)

MPICO Plc Annual Report (2021)


Reserve Bank of Malawi Bank Supervision Annual Report (2005); (2007); (2008); (2009); (2010); (2012)
Devaluation and Development Strategy


