Exchange and Interest Rate Determination in Malawi:
Past and Present

1.0 Introduction

1.1 Since independence, Malawi has adopted various policies to ensure, among other things price stability, a sustainable external position and faster economic growth and development. To achieve this, Malawi has used various policy instruments which have included exchange rate and interest rate adjustments. The choice of an exchange rate policy in any country has an important role to play in creating the proper environment for economic growth. The exchange rate policy chosen affects the country's relative price structure between tradable and non-tradable goods and ultimately the overall level of domestic prices. Thus, a particular exchange rate system chosen does have far-reaching effects on the entire economy.

1.2 The management of the exchange rate in Malawi can be traced from the year the country got its independence. At that time, the country's currency was fixed at par to the British pound sterling. From that period onwards, the determination of the country's exchange rate has evolved over time, having been pegged to the weighted average of the pound sterling and the US dollar; to the IMF's Special Drawing Rights (SDR); to the weighted basket of seven currencies; and, recently the currency has been allowed to move according to the forces of demand and supply.

1.3 Regarding interest rates, until the late 1970's Malawi experienced a high degree of financial repression, with administered interest rates, credit ceilings, segmented capital markets and excessive intermediation costs. As part of structural adjustment programs supported by the World Bank and the IMF, Malawi has been implementing structural reforms in the financial system for close to two decades now. The main objective of these reforms has been more efficient mobilization of resources and optimal resource allocation. One of the most important aspects of financial reforms was interest rate liberalization.

1.4 The paper is organized as follows: Section 2 deals with exchange rate arrangements. It briefly outlines types of exchange rate arrangements commonly used by countries. Section 3 describes the evolution of exchange rate determination in Malawi and briefly explains recent developments in the Malawi kwacha exchange rate. Section 4 covers interest rate determination in Malawi. In this section, the evolution of interest rates in Malawi is analyzed in two parts. First, is the pre-July 1987 period, when interest rates were administratively set by the Reserve Bank of Malawi and the second period is the post-July 1987 when the process of interest rate liberalization started. The section also describes movements in interest rates before and after liberalization and the final section is the conclusion.

1.5 Before we delve into the next section, we need to look at some of the most commonly used terms in exchange rate analysis.The first one is the definition of the exchange rate itself. There are two commonly used definitions of exchange rate. First, the so called *direct quotation*, expresses exchange rate as the price of foreign currency in terms of the domestic currency. For example, the kwacha / US dollar exchange rate would be K46.4377 = US$1.00 as of December-end, 1999. The second is the *indirect quotation* which expresses the exchange rate as the price of the domestic currency in terms of the foreign currency. Defined thus, the example given above would be stated as, as at December-end, 1999, the exchange rate of one Malawi kwacha was equivalent to US$0.0215. This means that when a country quotes its exchange rate, it has to specify which of the two definitions it uses. Malawi uses the first definition, while other countries (Botswana and the United Kingdom for example) use the second one. In both definitions of the exchange rate, demand and supply in the foreign exchange market interact to establish a nominal exchange rate at a particular point in time. The exchange rate is affected by changes in demand and supply, of course depending on the type of exchange arrangement being pursued. The following definitions may also assist in understanding some of the concepts and principles discussed in this paper:-

(i) Spot and Forward Exchange Rates: The spot exchange rate is the domestic currency price of a unit of foreign currency for immediate delivery (usually within three days). Forward or future exchange rate, on the other hand, is the exchange rate used for the purchase or sale of foreign currency at some future date, ranging from 30 to 90 days or more ahead. Both spot and forward exchange rates are determined daily in the foreign exchange markets.1[1]

(**ii)** Nominal Effective Exchange Rate:This refers to the average relationship between a currency and a set of other currencies. It is expressed as an index, being an average of bilateral exchange rates. Swings in this index are an indication of either appreciation or depreciation of the domestic currency against a set of other currencies.

(iii) Real Effective Exchange Rate:This is the nominal effective exchange rate adjusted for movements in domestic prices relative to foreign prices. It is useful for measuring a country's external competitiveness and assessing the need to adjust the exchange rate.

2.0 Exchange Rate Arrangements

In the literature on exchange rates, a distinction between major forms of exchange rate arrangements is based on their degree of flexibility, that is, how often the rate is allowed to adjust. Two extreme cases are currency pegs and independent floats.

2.1 Currency Pegs

These vary from pegging to a single currency to pegging to a trade-weighted basket of currencies. In a single currency peg, the currency to which a country pegs is usually that of its major trading partner. The peg to a set of currencies involves maintaining the peg on a weighted average of a number of currencies. The advantage of this arrangement includes ability of the pegging country to avoid large movements in its exchange rate vis-à-vis trading partners' currencies thereby minimizing price movements arising from exchange rate changes.

Under a pegged exchange rate system, monetary authorities stand ready to buy or sell foreign exchange at a predetermined fixed exchange rate. When there is a threat that the market exchange rate may depart from this fixed level, the monetary authorities buy or sell foreign exchange in exchange for the local currency to ensure that the rate remains at the fixed level. Therefore, when authorities adopt a fixed exchange rate regime, they dedicate the conduct of monetary policy to ensuring that the officially fixed exchange rate is also the equilibrium level. The central bank is committed to altering the money supply to a level that clears the exchange rate market at the predetermined exchange rate.

Malawi has experimented with all these arrangements. Although currency pegs enabled the maintenance of stability of the Malawi kwacha in the 1970s, they failed to do so in 1980s. Besides economic difficulties experienced in the 1980s, currency pegs were unable to prevent exchange rate volatility because first they had to be adjusted often in line with movements in currencies to which they were pegged; and second currencies in the basket had to float against currencies outside the peg whose movements tended to interfere with domestic policy objectives. Furthermore, experience showed that pegging to a basket of currencies was difficult to implement, and caused uncertainties concerning the future value of the currency.

2.2 Independent Float

Under this arrangement, the exchange rate is determined by forces of supply and demand in the foreign exchange market. The exchange rate moves to equate demand for and supply of foreign exchange. In addition, independent floating allows for automatic adjustment to changes in foreign exchange markets. There are two main forms of exchange rate arrangement under the floating system, namely:

(i) *The Auction Arrangement* in which receipts from specified exports of goods and services are surrendered to the Central Bank at the ruling exchange rate. They are then auctioned on regular sessions during which the new exchange rate is determined.

(ii) *Inter-bank Spot Exchange Arrangement*. In this arrangement participants are mainly commercial banks and other authorized foreign exchange dealers. The exchange rate is determined from negotiations between the authorized dealers and their clients and from transactions between banks.

2.3 Managed Floating Arrangement

Under this arrangement, the Central Bank sets the rate, varying it frequently with regard to such factors as the real effective exchange rate, developments in the balance of payments, in international reserves, etc. Unlike currency pegs and independent floating systems, broad judgmental factors are used in setting the rate.

2.4 Exchange Control System

This is another exchange rate management system which Malawi has used in the past. Under this system, authorities set the exchange rate and they do not let individuals carry out their transactions. Monetary authorities sell foreign exchange only under certain conditions. Individuals are also required to sell any foreign exchange they have to the government. The currency is essentially inconvertible.2[2] Exchange controls are often practiced in fixed exchange rate systems where rationing of the available foreign exchange is considered necessary. In addition exchange controls are generally needed for the purpose of managing capital account flows given the scarcity of foreign exchange and the shallowness of financial markets in most less developed economies.

3.0 Evolution of Exchange Rate Determination in Malawi: Past and Present

The management of exchange rate in Malawi has been pursued with three major policy objectives in mind. These include:

(i) attainment of growth in real income;

(ii) maintenance of a viable balance of payments position; and

(iii) attainment of stable domestic prices.

These objectives were attained to some extent in the 1970s; but, owing to both external and internal factors, they were difficult to achieve in the 1980s. In this section, we look at the evolution of the exchange rate in Malawi by focusing on periods identified as first the par value peg to the British pound sterling; second, the peg to the trade-weighted basket of the US dollar and the British pound; third, the peg to the SDR; fourth, the peg to a basket of currencies; and finally the floating regime. The analysis of recent developments will follow.

3.1 British Pound Sterling/Malawi pound par value system (1965-1973)

The use of the exchange rate as an instrument of monetary policy began as early as 1965 when the Reserve Bank of Malawi became fully operational. Soon after attaining self rule from Britain in 1964, Malawi introduced its own Malawi pound which later became known as the Malawi kwacha in early 1971. At that time the Malawi currency was pegged at par to the British pound sterling and this continued until November 1973. During this period (1965-1973), the Malawi pound moved in tandem with movements in the British sterling, such that when the latter was devalued by some 14 percent in November 1967, the Malawi pound was

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also devalued by the same magnitude. During that time the Malawi pound was floating against the US dollar and commercial banks calculated rates for other currencies with reference to London Inter-bank Market rates. During this exchange rate regime, the Malawi economy enjoyed buoyant economic growth and had a healthy balance of payments position.

During this period, many developed countries including the United Kingdom, maintained a fixed exchange rate system with the gold or the US dollar.3[3] 4[4] By 1971 problems arising from limited gold supply5[5] began to surface; and, by 1973 this system completely collapsed as most major countries renounced the par value system. This was followed by the generalized floating of exchange rates by several countries which caused large volatilities in currency markets. The Malawi currency, as was expected, depreciated along with the depreciation of the British pound to which it was pegged. Authorities, thus, began to think of other ways of managing the exchange rate.

3.2 Peg to weighted Basket of British Pound and the US dollar (1973-1975)

From November 19, 1973, Malawi authorities responded to the movements in the international currencies by de-linking the Malawi kwacha from the British pound, and pegging it to a trade-weighted basket of the British pound and the US dollar. In this system, the Reserve Bank determined the exchange rate by setting daily buying and selling rates for the US dollar and the British pound in the light of foreign exchange market developments. During this period, which ended in June 1975, authorities started pursuing an active exchange rate policy which involved overt (announced) devaluations of the kwacha when a need arose. However, the continued instability in the major international currencies forced authorities to look for a permanent peg, preferably to a currency which was considered less liable to violent movements. Authorities thought the SDR was suitable for this purpose.

3.3 The Peg to the IMF SDR (1975-1984)

With effect from 9 June, 1975, the Malawi kwacha was pegged to the IMF's Special Drawing Rights (SDR) initially at the rate of MK1.0540 to one SDR. The middle rate for the US dollar was determined on the basis of the IMF's daily calculations of the US dollar-SDR rate; rates for other currencies were determined on the basis of cross rates on the London inter-bank market. This time the US dollar was used as the intervention currency.

For a time, the peg to the SDR seemed to have worked better for the economy as evidenced by the temporary stability achieved with the new peg at a time when major international currencies were experiencing violent movements. These benefits, however, proved to be only short-lived as the SDR began to appreciate in chorus with the US dollar6[6] in the early 1980s. The Malawi kwacha responded by appreciating along with the SDR. This did not go well with Malawi authorities as it constrained export development.

It must also be recalled that at the beginning of the 1980s, Malawi's sound economic performance was seriously disrupted by several shocks, both from external and internal sources. One of the external factors was a deterioration in the country's terms of trade which resulted largely from weak external demand for the country's primary products in world markets. As the SDR continued to appreciate, Malawi authorities had to take active exchange rate actions with the view to restraining the terms of trade from further deterioration. Hence on April 24, 1982 the kwacha was devalued by 15 percent. This was followed by another devaluation of 12 percent on 17 September, 1983. These actions, however, failed to redress the situation as the country was also severely affected by a drought which curtailed agricultural production, thereby adding pressure on the country's balance of payments.

3.43.4 Peg to the Weighted-Basket of Seven Currencies (1984-1994)

Despite the devaluations carried out in 1982 and 1983, the country's external situation continued to deteriorate, which was made even worse by the disruption of the traditional transport routes to the maritime ports of Beira and Nacala due to political conflicts in Mozambique. On 17 January, 1984 authorities de-linked the Malawi kwacha from the SDR and pegged it to a trade weighted-basket of seven currencies7[7] representing the geographical composition of Malawi's trade and the currencies used in settling the country's international transactions. During this regime, the middle rate of the Malawi kwacha exchange rate as quoted by the Reserve Bank was determined on the basis of the daily calculations of the exchange rate of the US dollar in terms of the SDR. Rates of other currencies were quoted by the Reserve Bank on the basis of the appropriate daily cross rates as communicated by the IMF. Frequent adjustments were made with the view to realigning the kwacha with the basket taking into account inflation differentials.

Although the peg to the trade-weighted basket of currencies managed to improve the current account balance from -11.8 percent of GDP in 1983 to a low of -1.7 percent in 1984 (Table 1 appended), problems on the international trading routes intensified when Beira and Nacala routes were completely closed to Malawi traffic in 1984. This forced the country to rely on long overland routes to the ports of Durban in South Africa and Dar-es-Salaam in Tanzania, a change which significantly increased the country's c.i.f. / f.o.b.8[8] margin from only 22 percent in the 1970s to over 40 percent since 1984. This worsened the country's terms of trade. Authorities had to take active exchange rate changes. Thus on April 2, 1985 the kwacha was devalued by 15 percent; it was devalued by 10 percent on August 16, 1986; by 20 percent on February 7, 1987; by 15 percent on 16 January 1988; by 7 percent on 24 March 1990; and twice in 1992, by 15 percent on March 28 and 22 percent July 11.

3.5 Floatation of the Malawi kwacha (February, 1994)

In 1988, the Malawi government embarked on a three-year structural adjustment program supported by the IMF's Structural Adjustment Facility (SAF), the World Bank's Industrial and Trade Policy Adjustment Credit (ITPAC) and the Agricultural Sector Adjustment Credit (ASAC). Among other things, this program involved a phased liberalization of imports, that is the removal of restrictions on the approval and availability of foreign exchange for private sector imports, as well as a move towards adoption of a more flexible exchange rate policy.

On February 7, 1994 the foreign exchange market was completely liberalized and the kwacha was allowed to float freely. Several factors led to this change, including: fundamental disequilibrium as revealed by balance of payments pressures emanating from the 1992/93 drought; the withdrawal of non-humanitarian development assistance by the international community on account of "good governance" issues; and by the fact that several member countries of the then Preferential Trade Area (PTA) now COMESA had already adopted various types of market-determined exchange rates.

To support the liberalization, other measures were also implemented in 1994. A foreign exchange retention scheme whereby exporters of non-traditional exports were allowed to retain a major portion of their export earnings was instituted. Further more, exporters of traditional exports , i. e. tobacco, tea and sugar were allowed to open interest earning foreign denominated accounts with domestic banks. These measures were meant to encourage production for export. In addition, restrictions on capital movements by non-residents were also removed, and foreigners were permitted to make direct investments and buy market traded paper and repatriate investment proceeds without any restrictions.

The switch from the fixed regime to the floating one was meant to achieve certain objectives which can be summed up as:

(a) improvement of the country's export competitiveness;

(b) provision of an efficient foreign exchange allocation mechanism;

(c) dampening speculative attacks on the kwacha; and

(d) restoration of both investor and donor confidence; among other objectives.

The following features were also put in place to support the foreign exchange market liberalization:

(a) authorized dealer banks were free to buy and sell foreign exchange at freely determined market exchange rates;

(b) foreign exchange bureaus were authorized to engage in spot transactions with the general public on the basis of exchange rates arrived at with their clients;

(c) foreign exchange brokers9[9] were authorized to match orders from buyers and sellers of foreign exchange on agency basis only;

(d) to determine the exchange rate, the Reserve Bank convened weekly fixing sessions at which offers to buy and sell foreign exchange from authorized participants were matched to arrive at a clearing exchange rate. Thus the type of the free float adopted was the auctioning system; and

(e) exchange rates of other currencies were determined on the basis of the cross rates of the US dollar for the concerned currencies.

There are many advantages for floating a currency. One is that a floating currency ensures that movements of the exchange rate are in line with the market forces of demand for and supply of foreign exchange. In this case, the foreign exchange value of the domestic currency settles at a price which equates the quantity of foreign exchange demanded to the quantity supplied. Just like in any other free market, if the amount of foreign exchange supplied in the foreign exchange market falls short of the amount demanded, the price of the foreign exchange rises until the quantity demanded is equal to the quantity supplied. The reverse occurs when the quantity supplied exceeds the quantity demanded.

3.6 Recent Developments in the Malawi Kwacha Exchange Rates

When authorities floated the Malawi kwacha on 7 February 1994, the currency immediately plummeted, from its level of K6.70 per US$1.0 on Friday, 4 February to K9.88 per US$1.0 on 28 February 1994, a loss of 32.2 percent within a period of one month. This resulted from a combination of factors, such as the liberalization of the foreign exchange market and the 1992/93 drought. By end-November of that year, the kwacha had depreciated in nominal terms by over 290 percent against the US dollar; 300 percent against the British pound; 279 percent against the South African rand; and 335 percent against the German mark, reflecting spending overruns which led to loss of confidence in the kwacha. Initially, such massive depreciations were viewed as excessive. In fact the general consensus was that the depreciation was more than what was implied by the economic fundamentals.

Increased government expenditures following the 1994 general elections triggered a rapid acceleration in inflation which reached critical levels in 1995 and 1996. During this period exchange rate policy focused on reducing price increases. Although authorities managed to curb inflationary pressures during the last half of 1996, there were indications that the real exchange rate was appreciating, which was not in the best interest of the country's long term growth prospective. Besides the fact that foreign exchange was readily available during most of 1996, the appreciation of the real exchange rate was caused by domestic developments in the South African economy that saw the rand nose-diving against the US dollar. This affected the Malawi kwacha since Malawi has strong trade links with South Africa.

Despite these developments, the nominal value of the kwacha remained relatively stable, especially vis-à-vis the US dollar during most of 1996 and the first half of 1997. However, this stability also meant that the real exchange rate strengthened over the same period and became excessively overvalued, mainly reflecting huge inflation differentials between Malawi and its trading partners. This, combined with pressures on the currency arising from huge fiscal deficits in the second half of 1997, led to the devaluation of the kwacha in July 1997. At the same time, authorized dealers (except bureaus) were now required to maintain the by-sell spread of not more than 2 percent.

The devaluation of the kwacha in July of 1997 had the effect of improving its competitiveness vis-à-vis currencies of the country's regional trading partners, but this was only temporary. The currency began to appreciate in real terms against the Zimbabwe dollar and the South African rand. This trend continued into the second half of 1998.

South Africa and Zimbabwe account for a considerable proportion (about 60 percent) of Malawi's trade (mainly imports); hence the fall in value of the rand and the Zimbabwe dollar in 1997 and 1998 rendered the kwacha uncompetitive. Furthermore, pressures on the kwacha intensified at the beginning of the second half of 1998 as indicators revealed that tobacco exports and donor-related inflows were going to be much lower than expected at the beginning of the year. As a result the reserves target could hardly be attained. To make matters worse, demand on official reserves which normally emerges in October, began as early as August and this was a clear indication that reserves management thereafter would become increasingly difficult.

It was against this background that authorities decided to take appropriate exchange rate action. Consequently, the kwacha was devalued by 28 percent and 23 percent on 21 and 24 August, respectively. This action resulted in a real depreciation of the kwacha and the demand on official reserves appreciably decreased.

Towards the end of August 1998, the kwacha was allowed to be market determined again and intervention by the Bank was only guided by preset reserves target. However, over this period, the exchange rate system was more of a managed float with banks trading with few limitations. The Reserve Bank remained the main dealer.

From August 1998 to December 1999, the nominal exchange value of the kwacha ranged between K42 to a US dollar and K46.

In the final analysis, it must be mentioned that the maintenance of a stable exchange rate in the short-term requires many things, including first the maintenance of adequate foreign reserves for currency stabilization. Second, fiscal discipline is critical in order to avoid domestically financed deficits. Third a steady inflow of donor support or other capital flows is also fundamental in maintaining a stable exchange rate. Finally, interest rates must be managed flexibly with a view to maintaining demand for local currency. In the long-term, the diversification of the export base, increased investment to meet domestic demand for consumption goods, reduction of external debt and maintenance of a realistic exchange rate will be critical.

4.0 Interest Rate Policy in Malawi: Past and Present

The Pre- July 1987 Period

Prior to July 1987, the basic structure of interest rates was directly administered by the Reserve Bank (RBM) of Malawi. As a result, interest rates were infrequently adjusted during the period before July 1987. Less attention was paid to underlying macroeconomic conditions, especially inflation (See Table 1) as well as the demand and supply of funds. The main preoccupation was to keep interest rates low in order to reduce government expenditures and to promote private investment. During the regime of administered interest rates, deposit rates were set by Reserve Bank of Malawi while lending rates were set by commercial banks, but subject to a ceiling rate. In March 1980, however, interest rates which were in favour of the agricultural sector were introduced for the first time. The sector was given a preferential rate of 1 to 2 percentage points below the prime rate.

4.2 Post-July 1987 Period (Liberalization)

4.2.1 Rationale for Liberalization

The deregulation or liberalization of interest rates started in earnest in July 1987 when lending rates were freed. The advocates of interest rate liberalization and financial development as growth enhancing economic policies in developing countries have based their arguments on the theoretical works of Mckinnon (1973) and Shaw (1973). The policy of low interest rates was considered an important avenue for promoting investment by keeping interest costs low. Mckinnon and Shaw, however, showed that the policy of controlled or administered interest rates was tantamount to “financial repression”, which is a general distortion in financial prices like interest rates that reduces the real value of financial assets. Thus, the overall volume of savings decreases and investment is naturally adversely affected. The policy prescription for the financially repressed economy in the Mckinnon Shaw models is then to raise institutional interest rates or reduce inflation.

In line with this thinking and in order to support the adjustment program, it was decided to gradually deregulate interest rates. This was done as follows:-

(a) In July 1987, commercial banks were given the freedom to set their own lending interest rates.

(b) In April 1988, deposit rates were deregulated.

(c) In August, 1988 preferential interest rates to the agricultural sector were abolished.

(d) By May 1990 all rates became fully liberalized.

Since complete interest rate liberalization was launched, the Bank rate (the rate at which commercial banks borrow from the central bank) has played a more important role in the financial system. The role of the bank rate has been enhanced by the development of the money market and the frequent use of open market operations as a tool of monetary policy. The Reserve Bank of Malawi now uses the Bank Rate as an indicator of the stance of monetary policy. Many times, the adjustment of the Bank Rate has led to adjustment of interest rates in the financial system. The Bank rate is set on the basis of interest rates on the Treasury Bill market as well as developments in inflation rates.

4.2.2 **Interest Rate Movements Before and After Liberalization**.

During the period 1985 to 1990, the bank rate and the savings rate hovered around 10.0 percent with hardly any changes while the minimum lending rate remained at 13.0 percent. As noted earlier, the full liberalization of interest rates in 1990 meant that commercial banks could set their own interest rates. However, in practice during the period 1990 to 1992 the commercial banks moved their own rates only after the central bank moved its bank rate. The bank rate was adjusted at least seven times by monetary authorities mainly to reduce excess demand for cash, particularly during the period 1994-1995. This is also the period when Malawi experienced high levels of inflation. From end 1994, to curb inflationary expectations, the bank rate was raised to 50.0 percent by May 1995. This was also in line with Treasury Bill (TB) yield which soared during this period. From 1996, however, the bank rate has been steadily adjusted downwards and currently stands at 47.0 percent (as of October 1999). This downward adjustment resulted from developments in the economy as both TB yield and inflation followed a downward trend (See Table 1).

5.0 Conclusion

It is clear from the preceding arguments, facts and figures that Malawi has and continues to have an active exchange rate policy whereby regimes are changed in response to both internal and external circumstances. The point to note is that in our view there is no such thing as "the" optimal or best exchange rate policy. It all depends on the underlying fundamentals, which may be both domestic and external, as well as perceptions of policy credibility. How countries react to them will not be the same at all. Floating the currency would, of course, be deemed to be better than the other approaches but questions need to be answered as to, among others, whether the country has sufficient reserves to intervene in the market at all times when it is necessary. In the case of Malawi, this has proved to be very difficult since the availability of foreign exchange is highly seasonal. Malawi also faces another problem in that public confidence in the floating regime is taking rather long to stabilize with the consequence that the kwacha is constantly under speculative attacks.

On a regional level, the kwacha is also very sensitive to developments in Zambia, Zimbabwe and South Africa. Thus, when the Zimbabwe Dollar and the Rand took a dip recently the kwacha was likewise affected.

On the interest rate front, complete liberalization has not brought about what we thought should happen in the market. As stated above, the Bank rate is now being used as an indicator of where the Reserve Bank wishes the interest rates to move. Indeed, when it was adjusted downwards, the banks adjusted the lending and deposit rates as well. The problem, however, is that the major banks, until of late, would collude and reduce their rates by identical magnitudes, reflecting structural rigidities. This perhaps could be ascribed to the fact that with only two major banks, competition would not be expected to emerge from the deregulation in the short-run. Another problem is that the spreads have not narrowed at all. The solution as we see it is to introduce more players into the market to encourage more competition, but it looks as if major international banks are taking a wait and see attitude so far.

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[1] The forward foreign exchange market in Malawi is minimal and underdeveloped. Most traders are not familiar with this kind of market. To a lesser extent, the market is used by fertilizer importers, tea producers and ADMARC.

[2] See A. O. Krueger (1983) p. 22.

[3] During this Bretton Woods System, member states were asked to state the par values for their currencies in line with the Bretton Woods rules. They intervened in the foreign exchange market in order to keep the market exchange rate within one percent of the par value, by adding or reducing their foreign Reserves (Hallwood, P., and MacDonald, R. (1989): **International Money: Theory, Evidence and Institutions**; Basil Blackwell, Oxford.

[4] Up to the late 1930s, countries were operating under the 'Gold Standard' . This entailed the requirement that domestic currencies be fully backed by gold reserves. This system ended in the 1930s and between 1971 and 1973 countries were operating under the Bretton Woods System in which domestic currencies had an adjustable peg to the US dollar or other currency such as the pound sterling or French franc.

[5] The United States was mandated to maintain gold reserves which were to be exchanged for national currencies of member states in the case of intervention to realign their currencies.

[6] From 1974 the SDR was calculated in reference to a basket made up of major international currencies with the US dollar having the largest weight of over 40 percent in 1981. Other currencies composing the SDR in 1981 were Deutsche Mark (19%); Japanese Yen (13%); French franc (13%); and the British Pound Sterling (13%).

[7] Currencies in the basket and their weights were as follows: US dollar (27 %); Pound Sterling (27 %); South Africa rand (18 %); German Deutsche mark (7 %); Japanese yen (7 %); French franc (7 %); and the Netherlands Guilder (7 %).

[8] c.i.f. /f.o.b. in full is cost, insurance and freight and free on board, respectively, of cost of transportation.

[9] Foreign exchange Brokers were suspended in November, 1994.