



RESERVE BANK OF MALAWI
STATEMENT OF THE MONETARY POLICY COMMITTEE
1st MPC MEETING OF 2019
30TH JANUARY 2019

MPC reduces the Policy Rate by 150 basis points from 16 percent to 14.5 percent; adjusts downwards the Lombard rate from 200 basis points to 40 basis points above the Policy rate; and cuts the Liquidity Reserve Requirement (LRR) on foreign currency deposits by 375 basis points from 7.5 percent to 3.75 percent while the LRR on local currency deposits has been reduced by 250 basis points from 7.5 percent to 5.0 percent. In arriving at this decision, the Committee observed that risks to inflation experienced in 2018 are dissipating and that the macroeconomic outlook for 2019 is favourable.

Decisions based on a forward-looking monetary policy framework.

Monetary policy decisions are based on a Forecasting and Policy Analysis System (FPAS) which is an information-intensive forward-looking framework for structured and evidence based monetary policy decision making. At the core of this framework, is a Quarterly Projection Model (QPM) which describes dynamics of demand, supply and exchange rate. Monetary policy setting is endogenous and is aimed at minimising the deviation of aggregate demand, aggregate supply as well as the exchange rate from their equilibrium positions. In setting the monetary policy stance, emphasis is placed on closing the gaps between the Reserve Bank of Malawi's projected inflation and the target. While greater emphasis in this framework is on pre-empting risks to macroeconomic outlook, a careful balance is applied to ensure that historical as well as current developments also feed into the policy process. The approach of the MPC is to look through the first-round effects and focus on the possible second-round effects of supply side shocks. The current monetary policy decisions must therefore be viewed in the context of monetary policy reforms happening at the Reserve Bank of Malawi.

Risks to inflation have reduced in 2019

The year 2018 was characterised by several shocks to inflation. These shocks, which were envisaged by the Monetary Policy Committee, necessitated maintaining a relatively tight policy stance in 2018. The shocks included, electricity tariffs which were increased by around 50 percent and fuel prices which were increased by around 19 percent. Maize price rose by over 60 percent compared to 2017 levels owing to dry spells and fall army worm attacks experienced in some parts of the country. Inflation therefore mostly increased in the year, rising from 8.6 percent in 2018Q1 to 9.9 percent in 2018Q4.

Contrary to developments in 2018, risks to inflation are projected to subside in 2019. The favourable weather conditions experienced so far point to higher agricultural output than earlier projected. This is expected to significantly reduce food inflation. Furthermore, adequate foreign exchange reserves and favourable international crude oil price developments point to significantly reduced non-food inflation pressures. As a result, baseline inflation projections from the Reserve Bank of Malawi's Quarterly Projection model have shifted downwards. Inflation is now projected to average 8.5 percent in 2019, from an earlier projection of 10.1 percent. Though inflation expectations remain relatively high, they are likely to moderate on account of earlier than expected December 2018 downturn in inflation as well as favourable prospects for macroeconomic outturn.

Global and domestic oil prices stable

Brent crude oil prices which rose to as high as US\$86 per barrel in October 2018 significantly fell to about US\$50 per barrel in December 2018. Forecasts suggest that crude oil prices will average around US\$68.76 a barrel in 2019. Pummeled by concerns over the outlook for global demand, simmering trade tensions, increasing supply and rising inventories, crude oil prices are projected to remain relatively stable in the near term. These prospects necessitated the revision of this assumption in the Reserve Bank of Malawi's Quarterly Projection Model (QPM) which contributed to an overall downward shift in the baseline inflation forecasts. The stable international crude oil prices, together with the projected exchange rate stability point to relatively stable domestic pump fuel prices in 2019 and hence, subdued pressure on non-food inflation.

Global developments

Global growth is expected to remain broadly favourable over the near-term, but expected to moderate over the medium term while risks are tilted to the downside. Risks to the global economic developments include geo-political tensions and excessive financial market volatility. Recent communication from major central banks suggests a slower pace of monetary policy normalisation in advanced economies. In December 2018, the US Fed signalled a more gradual pace of rate hikes. Although the European Central Bank (ECB) ended its asset purchase programme in December 2018, it has indicated that monetary policy would remain largely accommodative. Closer to home in South Africa, the central bank maintained the monetary policy stance at its January 2019 Monetary Policy Committee meeting.

Exchange rate to remain stable in 2019

The nominal exchange rate continues to be stable. The Kwacha traded at K736 per US dollar at the end of December 2018, broadly unchanged since mid-2016. The stability of the Kwacha is expected to continue on the back of adequate foreign exchange reserves which at the end of December 2018 stood at 3.61 months of imports. The Kwacha's stability will as well be buoyed by the agriculture marketing season which is expected to commence in the next two to three months. It is therefore projected that the exchange rate stability witnessed in the past two years will also prevail in 2019.

Monetary policy eased

The MPC noted significant improvement in macroeconomic outlook, operations of the interbank market and the liquidity levels in the banking system. The improvement in this market have resulted in reduced recourse of commercial banks to RBM's Lombard facility. The Committee also noted with satisfaction that for the first time, since mid-2012, real private sector credit growth has turned positive over the past four months. The MPC therefore decided to reduce the:

1. Policy rate by 150 basis points from 16 percent to 14.5 percent;
2. Lombard Rate from 200 basis points to 40 basis points above the Policy rate;
3. Liquidity Reserve Requirement as follows:

- by 250 basis points from 7.5 percent to 5.0 percent on local currency deposits; and
- by 375 basis points from 7.5 percent to 3.75 percent on foreign currency deposits.

In addition to the above decisions, the MPC also created further room for LRR downward adjustment by resolving to incentivise commercial banks that invest in designated sectors and instruments. The detailed arrangements will be announced in due course. The changes in Liquidity Reserve Requirement will result in release of substantial investible funds into the productive sectors of the economy.

The Committee further noted that previously, policy rate adjustments were not fully transmitted to the rest of the economy. In this regard, going forward, all commercial banks are expected to use the Lombard rate as the base lending rate. The Committee therefore joins the rest of the economy in expecting corresponding responses from the commercial banks and other lending institutions. These policy initiatives are expected to assist the financial sector and the private sector to harness synergies and effectively contribute to economic growth.

The Committee's assessment is that the stance of monetary policy remains adequately tight and monetary policy actions will continue to gradually anchor inflation expectations towards the medium term inflation objective of 5 percent without necessarily jeopardising government's economic growth agenda.

Dalitso Kabambe, PhD

CHAIRMAN, MPC.

Information Note

The next scheduled date of the MPC meeting is on 29th and 30th April 2019. The decision will be announced on 30th April 2019 and the announcement will be accompanied by a news conference.