Victor Mbewe: Positive financial and economic developments in Malawi

Speech by Mr Victor Mbewe, Governor of the Reserve Bank of Malawi, at the Sovereign Credit Rating Dissemination Conference, Lilongwe, 16 March 2007.

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The Minister of Finance, Hon. Goodall Gondwe, M.P.
The Minister of Trade, Industry and Private Sector Development, Hon. Ken Lipenga, M.P.
His Excellency, the US Ambassador to Malawi, Mr Alan Eastham
Members of the Diplomatic Corp
Heads of Missions (Development Partners)
Members of Parliament
The Chief Secretary to the President and Cabinet
Secretary to the Treasury
Principal Secretaries
Heads of Parastatal Organisations
Heads of Private Sector Industries
Mr Charles Seville and Veronica Kalema from Fitch Rating Agency
Representatives of the Civil Society
Distinguished Invited Guests
Representatives of Electronic and Print Media
Ladies and Gentlemen

I feel greatly honoured and happy to stand here today at this very important dissemination conference where Malawi has attained yet another economic development milestone indicating an improvement in the country's creditworthiness. Credit rating is one of the areas where Malawi was considered lagging behind under the Millennium Challenge Account.

Honourable Minister, distinguished ladies and gentlemen, since the last credit rating in December 2005, where Malawi was rated at CCC, a lot of progress has been made and it was therefore imperative that a fresh rating exercise be conducted to determine our current status. To this effect, Fitch Rating Agency was engaged by Millennium Challenge Corporation to conduct the rating between 4th and 8th December 2006. Reserve Bank of Malawi as an implementing agency for Credit Rating for the country, successfully coordinated this exercise.

To begin with, it is worthwhile to mention that credit rating is an indication of the ability and willingness of a country to pay its external debt on the original terms. With a sovereign credit rating, the country is signalling to the rest of the world especially international investors its readiness to participate in the global economy by opening itself for public scrutiny and foster transparency in the collection and dissemination of information. A credit rating also helps to promote realistic monetary and fiscal policies and adherence to liberalization policies and reform efforts in keeping up with peer group countries and the global economy. Furthermore, the business world uses a sovereign credit rating as the benchmark to evaluate current and potential risks in a nation's economic environment they desire to invest in.

As alluded to earlier, many positive developments have taken place in Malawi since the last rating in 2005. Among these are cancellation of Malawi's debt by both multilateral and bilateral creditors, the decrease in inflation rate and a reduction in interest rates.

The IMF and World Bank Boards on 30th and 31st August 2006, respectively, approved that Malawi had reached the HIPC Completion Point after making satisfactory progress in implementing its Poverty Reduction Strategy Paper (PRSP) for at least one year, and maintained satisfactory macroeconomic policies as evidenced by its performance under the PRGF. Furthermore, Malawi also met all the completion point targets in the area of economic governance and public expenditure management, safety nets, and microfinance.

Apart from receiving HIPC debt relief, Malawi also qualified for the Multilateral Debt relief Initiative (MDRI) which cancelled all pre-2004 debt to the World Bank and African Development Bank, and pre-2003 debt to the IMF. In October 2006, Paris Club creditors also agreed to cancel almost 100% of Malawi's debt owed to them.

These developments, distinguished ladies and gentlemen, reduced Malawi's external debt from 142% of GDP at the end of 2005 to 23% of GDP at the end of 2006. Other external debt indicators also improved significantly.

Distinguished ladies and gentlemen, let me now turn to the monetary policy stance that was pursued in 2006. Monetary developments in 2006 were generally expansionary. The increase in money supply mainly arose from net foreign reserves on account of receipts for balance of payments support. The increase in money stock was also partly a reflection of an expansion in credit to the private sector. It should be noted that since March 2006, credit to the private sector has been increasing steadily, implying that the February 2006 reduction in the Liquidity Reserve Requirement (LRR) was bearing fruit. This is in line with the economic program which allows for more credit to the private sector to boost economic growth. The Bank Rate was adjusted downwards from 25.0 percent to 20.0 percent on 13th November 2006. As a result, commercial banks followed suit by adjusting both their savings and deposit rates. The reduction in interest rates should, therefore, give an opportunity to the private sector to participate in borrowing capital, thereby generating economic growth.

It is also pleasing to note that the rate of inflation has been declining since February 2006. By December 2006, the annual rate of inflation declined to 13.6 % from 17.1% realised in 2005.

This was mainly due to:

- slowdown in food inflation as a result of a good crop.
- relative stability of the Malawi kwacha against other major currencies.
- lagged effects of a decline in money supply observed earlier in the year.

On the external sector, it is pleasing to note that foreign exchange reserves have been building up rapidly since the attainment of the HIPC Completion Point in August 2006. Between September 2006 and January 2007, the country has been benefiting from inflows from various donor partners, including the IMF, the British & Norwegian Governments, the European Union and DFID because of good performance. As a result of these inflows, the country's gross official reserves improved significantly.

Prospects for 2007

Let me now give you a picture of our expected outcome for 2007. GDP growth in 2007 is projected to grow by 5.6%, a slower growth from 8.5% in 2006. The agricultural sector is expected to continue leading this growth due to the on-going fertilizer subsidy program coupled with the current favourable rains.

By December 2006, inflation rate had decelerated to 10.1 percent. In January 2007, the rate of inflation dropped to a single digit of 9.6 percent and it is expected that it would continue dropping further. This is mainly premised on the high food supply situation in the country (especially maize), that is expected to have a restraining effect on food inflation, which normally accelerates during this time of the year. The favourable outlook for inflation is based on the continued stability in food prices, the stable kwacha exchange rate and the easing of pressures on international oil prices.

In 2007, growth in money supply will be closely monitored to safeguard and consolidate the declining rate of inflation and the overall financial system stability.

The stability of the local currency will continue to depend on the flow of foreign exchange from the tobacco auction floors and the donor community, prices of petroleum products, as well as government's fiscal discipline.

Distinguished ladies and gentlemen, this favourable outlook which I have outlined would assist the country to attain a higher rating at the end of 2007 compared to that of 2006.

The improvement in credit rating being officially announced today will assist in enhancing pricing and access to international capital markets. This would in turn enhance the inflows of private capital and hence increased investment. The goodwill that we have built with the international community will be further strengthened and this will ultimately signal that Malawi is a better place for doing business.

In conclusion, distinguished ladies and gentlemen, I would like to acknowledge the collective efforts played by all stakeholders for the success of the credit rating exercise. These include the Minister of Finance, Members of Parliament, Government officials, members of the private sector, the donor community and Non-Governmental Organisations. These officials spared their time to grant interviews to Fitch Rating Agency. Let me also applaud my staff at RBM for compiling quality data used by Fitch in the rating exercise, some of which was supplied by National Statistical Office and Ministry of Finance.

Finally, let me thank Casals and Associates through the Millenuim Challenge Corporation, for their financial as well as logistical support they have provided to make this Conference a success.

Thank you for your attention and God bless you.