Charles S R Chuka: Looking at Malawi's future

Address by Mr Charles S R Chuka, Governor of the Reserve Bank of Malawi, at the Economics Association of Malawi (ECAMA) business dinner, Blantyre, 20 July 2012.

* * *

The Patron, Economics Association of Malawi, Mr Thom Mpinganjira;

CEO of FDH Financial Holdings;

Acting President of ECAMA, Mr Edward Chilima

Distinguished Guests;

Ladies and Gentlemen;

It gives me enormous pleasure to be amongst you tonight and so I do want to say, thank you, for inviting me to this annual dinner.

I have been reminded this evening that, by virtue of being Governor of the country's "dreaded" central bank, I also assumed the position of Chairman of the Board of Trustees of the Economics Association of Malawi. While I am yet to fully appreciate my new role in the Association, I am most grateful to whoever came up with the idea of honouring a Governor with such responsibility. Allow me for a moment only to count my luck that many of the stones that will be thrown upon me will not come from this highly cultured group.

In such turbulent waters, it is always worthwhile to take time off to interact and share hopes and fears with others equally stressed by the unwelcome costs of adjustment to such an acute macroeconomic misalignment as that Malawi went through in last five years.

I do not intend to recap what happened since 2004 – well that is a year after I took an early retirement – a well-deserved one. Suffice to ask a few questions: when fate has placed upon you responsibility for monetary policy, what do you do if you find yourself siting on less than one month import cover, money stock is growing consistently at above 30 percent a year and inflation that used to be in single digits for a while – thanks to cash transfers to farmers – is accelerating fast.

But hold on, a few clarifications are in order here: first, what I called one month import cover should be adjusted by the fact that the banking system was holding payments arrears of about $400 million, and you have no idea what was kept outside that system. Second, the increase in money stock was being pushed by credit expansion to both the private sector and government. And this despite the fact that you had a zero fiscal budget.

Yes, I heard you saying to me, Mr. Governor, get to the point. How do you justify the excruciating pain being experienced by industry and the man on the street? You devalued by a whole 49 percent to K250 and the currency has depreciated since then by another 14 percent to K285. Then from nowhere you increased interest rates by an ugly 5 percentage points! That's not all, Mr. Governor; you have done nothing when the banks raised lending rates not by 5 but by 10 percentage points!

Give me a chance to respond albeit briefly. As we are dining here tonight, the IMF team working on Malawi's request for a new Fund- supported economic recovery program, and Malawi's Executive Board member in the Fund, are putting together a strong case that Malawi deserves to be supported in its recovery program. I can envisage the way the case will be laid out.

Let me try to put the argument before the IMF Board: In sharp contrast to the political impasse to effectively deal with the country's problems under the Bingu regime, indeed departing sharply from the country's history of stop-go policies, the new government of H.E. Mrs. Joyce Banda has undertaken bold measures to correct long- standing macroeconomic imbalances and to set the stage for an economic recovery in the months ahead.

The local currency has depreciated by 63 percent in the last two months and interest rates have been hiked with the Bank Rate jumping from 13% to 23% to tame underlying inflation pressures and support the Kwacha exchange rate which now floats freely. Indications are that the pace of reforms will be sustained consistent with the agreed program in view of the President's demonstrated passion to transform Malawi and improve the welfare of her people. The President has also taken clear steps to allow the central bank policy independence which Malawi badly needs. We therefore recommend approval of Malawi's reform program with a doubling in access to Fund resources.

Well, I believe I can afford to be presumptuous here, if this story line is true, then the chances are that come Tuesday morning Malawi will wake up to realize that the IMF program has been approved and if the government can adhere to its stated policy of zero borrowing, then Malawi's future is on the right path.

You can imagine what some of us feel when we read in the papers and hear on the radio, and indeed hear in some circles "amenewa ndiye sakutithandiza". Dumbani Mzale in an article in today's The Nation tried to produce a balanced article by putting together the comments by World Bank's Country Manager, and those by Ben Kalua, with a rejoinder from an unnamed economist arguing that "recent monetary policy developments have triggered a high cost of borrowing by the private sector which could essentially retard Malawi's gross domestic product (GDP) of 4.3 percent manufactures .will incur huge cost of production which could force them to pass on to consumers; hence exerting pressure on the headline inflation rate."

I wish I was in a position to determine how many economists agree with which side of the story. I will never know of course. But my sense is that even learned economists and experienced businessmen share the sentiments of the unnamed economist.

Fortunately, the IMF Board will not say to the staff team, hold on, what we hear in Malawi is that people are hurting, companies are closing down, the government has no will or capacity to see through this complex reform program. No, they will not say that, not because it cannot be said but because we are not a special case. Many people around the world are going through the same thing. Not because the IMF says so. But because when you mess up you pay the price. We all messed up. We all consumed beyond our means, thanks to an over- valued exchange rate. We all praised the government for single digit inflation and we agreed with the measures being put in place to generate foreign exchange.

To justify an over-valued currency, we called upon government to force every exporter to repatriate our hard won foreign exchange – I am yet to fathom how a country can claim hard currency it has not earned – the government only owns what it earns through taxes and the hard currency earned through sales of its local currency. The government does not own anybody's assets, and that's by Constitution.

The short of the story is that we have all become Indigenous Economists – we recall that we have lived on subsistence farming all our lives, we will make it. Global rules of the game do not apply to us – we have our own rules. The man on the street is entitled to undiminished income. He is entitled to zero inflation. If the government has devalued the currency, it must increase salaries by as much. I am not even sure that the ailing companies have the resources to fully compensate for the lost purchasing power without passing on the cost to the same consumer.

We want to live comfortably as before, forget the fact that others are unemployed because we are busy exporting jobs through an overvalued exchange rate, through negative interest rates that undermine the savings culture and encourage low productivity. Forget the many hours spent out of the office in search of fuel that never came or that finished just before we got there.

Allow me to conclude on the following note. If we had a choice, we would have left the Kwacha and interest rates alone. However, the extent of economic malaise was unprecedented in our short history and it will take a lot more work and sacrifice by the man on the street before things get better. This is not the time for growth. It is the time for correction. Hopefully by this time next year, so I believe, this country will be different.

The key to successful recovery will be the patience of the man on the street and the political will to implement the 2012/2013 Budget as passed. With that the currency will stabilize; interest rates will begin to come down; foreign exchange reserves will be built up and investors will start looking at Malawi again.

Inflation should be contained within an average of 18.5 percent in 2012, coming down slightly to about 16 percent in 2013 but with a much lower rate at year-end. Growth will pick up as projected at 5.9 percent and payments arrears will be history. We will forget that fuel used to be scarce. With increased reserves, we will open up trade more so that Malawians can enjoy the economic freedoms so enshrined in our Constitution.

That will be the time for the central bank to watch carefully growth prospects and prevent a runaway inflation – single digit inflation will come but in a sustainable way. I can foresee increasing investment in both export and import-substitution industries.

That's what a free float supported by appropriate other monetary and fiscal policies brings about. Obviously, that brings about some instability but not forex shortages. By the way, with a free float you do not need 3 months import cover every time. But we must build up reserves even beyond three month because this is a country and we face many exogenous shocks which require reserves to be addressed expeditiously.

Well, we do not have the luxury of the counter-factual – what would have been the situation had the government – as two journalists have put it this week – through the Reserve bank of Malawi, taken the policy actions to-date. We will never know.

As I close, I believe commendations are in order for your continued participation and contributions towards ECAMA, its mission, as well as for the way you have championed economics. Now everyone wants to be known as such. You have more work to do ahead of us. Keep the torch burning.

Oh, yes, perhaps I should remind us that ECAMA's sole existence depends on our resources, time, and dedication. Your gathering here tonight in such large numbers to dine and share economic experiences is clear evidence of your willingness to enhance the economic profession and progress in the country for the benefit of the state and its citizens. Please do make sure you are a registered member and to pay any dues. You get from ECAMA what you put in – ideas for strengthening the Association.

With these remarks, it is now my pleasure and privilege to wish you a great dinner and fruitful discussions, bon appetite.

I thank you for your attention.