Charles S R Chuka: Financial and economic challenges for Malawi

Address by Mr Charles S R Chuka, Governor of the Reserve Bank of Malawi, at the Bankers Association Dinner and Dance, Blantyre, 8 September 2012.

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The President, Bankers Association of Malawi, Mr. William Chatsala and your Executive Committee

Chief Executive and Management of Banks and Other Financial Institutions

The Vice Chancellor, Dr Emmanuel Fabiano

The Principal of Polytechnic, Dr Grant Kululanga

The CEO, Bankers Association of Malawi, Mrs. Nkungula,

Distinguished Guests

Ladies and Gentlemen

I am very delighted to be part of this colourful occasion. And so I want to thank you, Mr President, for the invitation to partake in the dinner that is soon to be served. It is the dining and wining part that I came for but I can also well appreciate why you would want me to say something, albeit short. I therefore intend to be very brief in my remarks.

Mr president, ladies and gentlemen

Let me start by applauding BAM executive management for being foresighted in fostering discussions and debate on issues that affect the banking industry and thus the entire economy. It is through occasions like this one that the financial and banking experts in this country can make enormous contribution to the policy making process. I can assure you that we – the Reserve Bank of Malawi team – do carefully listen to sentiments expressed in our consultations as well as the media.

I must admit there are public sentiments that we prefer to ignore. Allow me to give you some examples. First, on August 14 The Nation carried a story "Banks Borrow K0.8 trillion from RBM". That was for the month of July, meaning the RBM went away with K1.4 billion in interest. Obviously, the so called banking liquidity crisis was going to get worse with borrowing from the Discount Window. Well, the truth of the matter is that the K25.9 billion daily average was a rolling figure and not to be treated as separate borrowings.

Today it was the turn of Daily Times which carried the title "Scrap off floating exchange regime", the argument being it makes planning difficult. Well, I hope that IBAM members made more money when the Kwacha was fixed. My sense is that planning meant nothing then in the absence of hard currency in the banks. I think that IBAM members stand a greater chance than hitherto to make more money.

At the same time, however, I want to agree that achieving stability remains the overarching goal for the Reserve Bank of Malawi. I am referring to stability that will be sustained and not temporary – so businesses can plan better with much longer time horizons than was possible before the floatation of the Kwacha.

Mr president, ladies and gentlemen

As a listening organization, there is something we must clarify though. The 49% devaluation and the subsequent (15%) depreciation of the Kwacha has increased prices but not by 64 per cent. The real effect of currency adjustments comes through the rate of inflation – that's what measures the average change in prices and thus the loss in purchasing power for the nation as a whole. This explains the acceleration of inflation from 12.4% in April to 21.7% in July. By the way, urban inflation rose from 15.5% to 25.1% during the period. We estimate inflation to be between 21% and 24% by end-year with an average of between 17.5% and 19.8% for the year. Thus, when all companies come to review salaries in January 2013, adjustments in salaries will not exceed the average inflation unless that particular company has made huge profits. Adjustments effected during this year will be taken into account accordingly.

It is therefore quite instructive of the nature of and motivations in our public discourse to hear the kind of salary increases that some of our esteemed institutions and social advocates are calling for. I very much hope that the employers will be standing and the workers will still have their jobs when all the demands are met. Ask the person who has no job how life is like.

If in its wisdom the government succumbs to the demands of our public institutions, the results are not hard to contemplate. First of all, there is a limit to the ratio of wages and salaries to the total recurrent budget. Anything beyond that limit is unsustainable and the government will one day be forced to reduce its establishment. Unless substantial cuts are made in other budgetary lines to cutter for the unplanned salary adjustments, the 2012/2013 budget will become very difficult to implement, domestic borrowing will increase, and with that pressure will mount on the Kwacha exchange rate and interest rates. The result will be higher inflation and continuous loss of purchasing power for wage earners. The country could enter into a vicious circle which could be even harder to break. Of course few people would believe that – after all things in Malawi have never become that bad, except to remember that we remain among the poorest of nations after nearly 50 years of independence.

Mr president, ladies and gentlemen

I very much hope that in our life time we will all manage to build an economy in which all citizens will have the opportunity to fully participate in the generation of income and enjoyment of fruits of their labour. Public discourse will be about how to sustain development and the welfare of all citizens.

We will have dispensed with windy and inconclusive debates on the negative impacts of devaluations and high interest rates on the man in the street. Labour relations will be more constructive than destructive – employers and employees will be discussing how to improve productivity so that their company can beat the competition and all staff can get bonuses.

The economic environment that I am describing is quite possible with a floating exchange rate, and a government that is totally committed to fiscal prudence. The Kwacha exchange rate will have – for all practical purposes – adjusted fully to economic fundamentals and fluctuations will reflect inflation differentials with our major trading partners and the impact of exogenous shocks.

In such a scenario I believe the level of foreign exchange reserves could exceed six months of imports. In today's terms, that is almost equivalent to 100% foreign exchange cover for the total money supply.

Mr president, ladies and gentlemen

Way before that, there will be no need for exchange controls that have hitherto crippled the ability of the citizens to protect the purchasing power of their savings and thus their ability to increase investments in productivity capacity. For instance, if you got your pension commutation on April 30, your plans to build a house or invest in a small business are now a pipe dream because the 49% devaluation plus the 15% depreciation since then have cut the purchasing power of your pension by over 60%. Perhaps you should be satisfied with an investment in a bicycle.

However, for those Malawians that have access to hard currency all the time, their story is totally different. By holding onto some dollars which they sold after the devaluation, they have become relatively richer. In others words, for most of us, exchange controls inhibit active risk management and foster social inequalities.

Instead of being a temporary measure to manage the oil price shock in late 1970's, exchange controls have become a permanent feature of our economy. We are now scared to remove them as exogenous shocks – fuel price increase increases, unfavourable terms of trade, global financial crises and so forth – have never given Malawi a breathing space.

Our neighbours in Zambia were wiser: they abolished exchange controls in the 1980's. At that time both Malawi kwacha and Zambian kwacha were about 2 to US$1. Today Malawi's is approaching K300 and Zambia's about K5, 000. Until recently, Zambians were completely free to choose between holding, quoting or transacting in US dollars. The job of defending the Zambian Kwacha's role as legal tender fell on the fiscal authorities and not the central bank or man in the street. Indeed, the Bank of Zambia became more of a central bank as the conduct of monetary policy became much easier and credible.

Recent changes are raising questions not about the efficacy of removal of exchange controls but government's resolve to sustain fiscal prudence.

Mr president, ladies and gentlemen

I refer to the Zambia only to underscore the fact that the Kwacha has been floated within a constrained framework – it is still strongly supported by exchange controls on capital transactions – that is movements of funds across the border for investment, savings or good old speculation is prohibited. You are even prohibited from holding onto dollars without permission. It is currently illegal to quote or make payments in hard currency.

In the circumstances, therefore, there is a limit to which the Kwacha can depreciate. While it is difficult to estimate that limit, it is definitely the amount of money to purchase hard currency that matters most. This is where the Reserve Bank of Malawi comes in – to balance the supply of money to economic activity and in so doing contain inflation and exchange rate stability. That work is made extremely difficult when the government of the day is forced to print money. That is why the government has committed itself to zero domestic borrowing in order to ensure early attainment of macroeconomic stability and thereby help Malawians to have a chance to improve their lives. Growth and job creation requires a stable environment; we are not yet there, and please do not rock the boat.

Mr president, ladies and gentlemen

Analysing the on-going labour disputes and to suggest a solution is obviously beyond my pay-grade. I am, however, comforted in the knowledge that all concerned citizens understand the risks ahead of us and the need to stabilise the economy, enhance growth and create jobs.

For that, we also need strong banks, banks that can facility investment. Banks that can afford to set aside some capital to cover loans or investments in junk bonds. By junk bonds I mean loans to investors who have minimal resources or just good ideas – very risky borrowers. It is only strong banks – well capitalised and solvent – that can afford to take on such risks. It is strong banks that can facilitate access to finance by the SME's that are so critical for Malawi's growth and job creation – not banks that are likely to lose shareholder value by lending carelessly.

Ensuring a strong financial system is one of the major roles of the Reserve Bank of Malawi. In this task, we will be as professional as possible. We will do everything in our power and capacity to protect the savings of the man on the street whether such savings are placed in banks, pension funds or insurance and assurance companies. The days for financial institutions that can't pay up or run away with people's savings have since passed.

Financial institutions should at all times represent a beacon of hope and prudence, underwriting good business and facilitating maintenance of sound macroeconomic fundamentals. In other words, financial institutions must champion financial deepening and access to finance in a sustainable manner. Financial soundness calls for a focus on long-term profitability and not on short-term profit taking.

Mr president, ladies and gentlemen

I have taken too much of your time and now it's time to wish you an enjoyable evening.

I thank you for your attention and may God bless you.