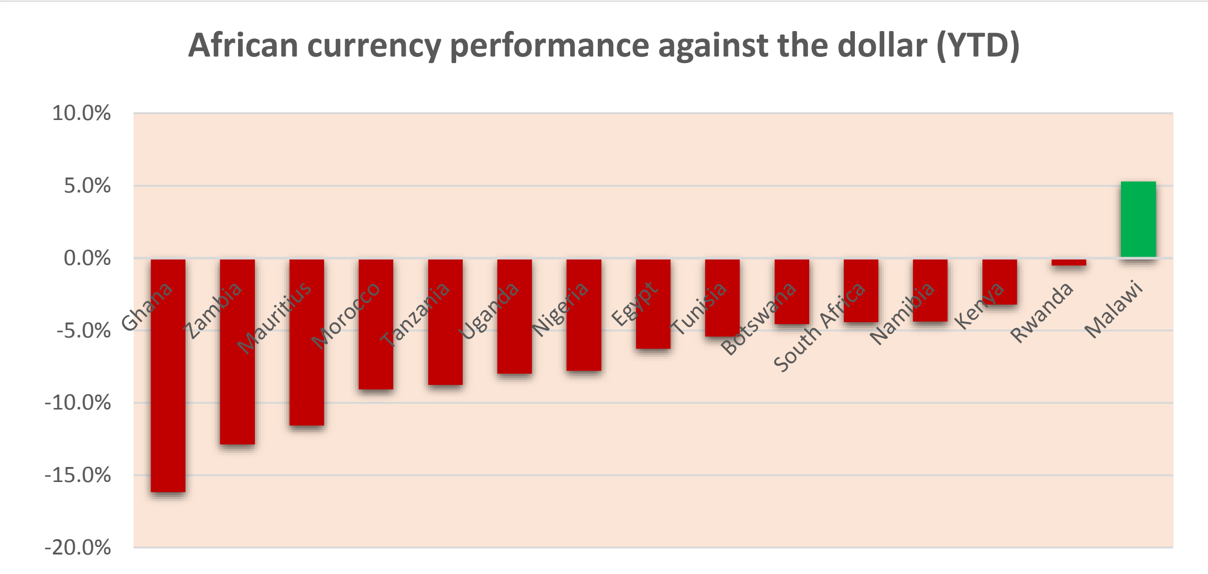
24 April 2015

Malawian Kwacha bucking the trend…for now.

In the last six to eight months, most Emerging and Frontier currencies have weakened against the greenback. A possible explanation of this weakness is the likelihood of the Fed raising rates in its September meeting thereby making US assets comparatively attractive. Moreover, the possibility of a 'Grexit' is exacerbating the need for investors to buy safe haven assets of which dollar assets are amongst the most sought after.

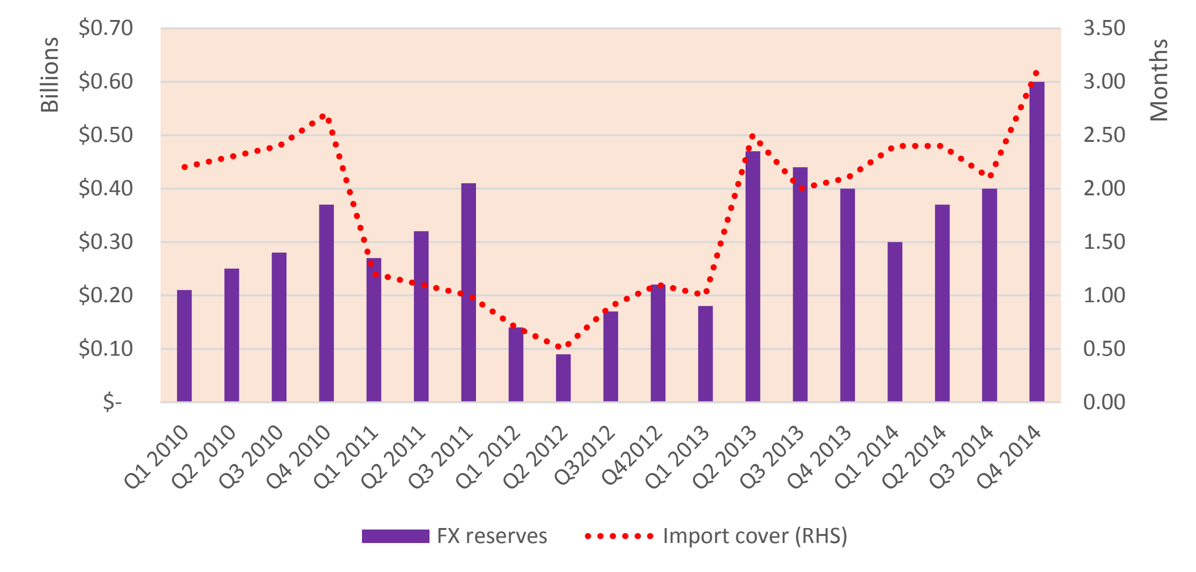
However, there have been some currencies that have bucked this trend. The Malawian Kwacha is one of them, and the only African currency that has strengthened, as shown in the bar chart below:



Data source: Capital IQ

For a country that is largely dependent on tobacco as its main export, one has to wonder why the Malawian Kwacha has strengthened versus the US Dollar.

Late last year the Reserve Bank of Malawi (RBM) took some very aggressive steps to address what had been a persistent weakening of the Kwacha. Firstly, it sold government securities to the Preferential Trade Area (PTA) Bank, a regional development institution, for US$200 million to help them shore up their international reserve base. The details of the loan, in terms of tenure and interest rate are largely unknown. However, the loan will be paid back in local currency.



Data source: Standard Bank.

The jump in reserves to US$646 million in Q4 2014 represents an almost 50% increase from the previous quarter therefore giving the RBM greater ability to supply the market with dollars. Unfortunately, this represents a one-off increase and reserves will subsequently reduce when the loan becomes due. Going forward, it is likely that reserves will settle back to US$350 million mark and import cover to two months.

The second measure adopted by the RBM was allowing local banks to hold their reserve requirements in local currency compared to holding them in dollars as was previously the case, thus freeing up dollars within the system.

In addition, export proceeds associated with tobacco sales alongside a relatively tight monetary policy will provide support for the Kwacha. However, we ask ourselves if this strength is likely to persist given the liquidity available in global markets.

We believe that when the inevitable finally happens, most currencies will gyrate in the short term and despite the efforts of the RBM, the Kwacha will feel the pinch. With limited options to fight the pending tidal wave of capital outflows, the sensible option would be for the RBM to maintain its tight monetary stance to at least limit the bleeding. However, this will be particularly challenging given the delayed start to the rains and the floods that will likely weigh down on growth. It would be interesting to see if it loosens the reins now in anticipation of a hike in the last quarter of the year.

Comment piece by the Macroeconomic Strategy Team at Atria Africa, an asset management and corporate advisory firm, focused on Sub-Saharan Africa.

www.atria-africa.com