



## **RESERVE BANK OF MALAWI**

### **TO ALL AUTHORISED DEALER BANKS**

#### **EXCHANGE RATE ALIGNMENT TO MARKET CLEARING LEVEL**

The Reserve Bank of Malawi (RBM), under the RBM Act of 2018 is mandated to manage foreign exchange transactions in the country. Authorized Dealer Banks (ADB) have faced liquidity challenges stemming from the impact of COVID-19 which saw deteriorating export earnings and increased import bills due to supply chain disruptions. Furthermore, the rising commodity prices following escalation of Russia-Ukraine geopolitical tensions coupled with cyclones Ana and Gombe have worsened the situation.

The supply-demand imbalance has manifested in the domestic foreign exchange market in a number of ways, including low foreign exchange supply, declining official foreign reserves, and widening spread between ADBs TT and Bureaux Cash exchange rates.

In response to the foreign exchange liquidity challenges and its effects on exchange rate developments, the RBM instituted several short-term measures including the following:

- Continuous interventions in the foreign exchange market in order to support importation of strategic commodities and avoid excessive volatility of the kwacha exchange rate;
- Temporarily re-introduced mandatory sale of 30 percent of export proceeds to the Bank within two working days from date of receipt;

- To close the arbitrage opportunity arising from the fact that only trades denominated in the US dollar were subject to the reasonable difference on spreads rule, effective 26<sup>th</sup> March 2022, the rule was revised to apply to all foreign currencies as well as Telegraphic Transfer (TT) and Cash markets for Authorized Dealer Banks (ADB's). Further, international brokers who capitalized on disproportionate application of the reasonable difference rule among currencies are now only allowed to transact with ADB's in US dollars;

These measures have done little to curb the arbitrage trading by international brokers and banks and inadvertently led to further declines in foreign currency supply in the market. The Bank is cognizant of the fact these opportunities arise due to the misalignment of the exchange rate to economic fundamentals. In order to curb the practice and dissuade hoarders of foreign currency from this practice, the Bank is informing ADB's to adjust the exchange rate by 25% from the midrate as of 26<sup>th</sup> May, 2022 to align to around the market clearing level with effect from 27<sup>th</sup> May, 2022. The Bank is aware that an exchange rate path cannot be predicted or determined without considering prevailing market factors. Further the Bank is aware that speculation can lead to excessive volatility in the foreign exchange market. As such, the Bank would like to inform ADB's of the following measures that will be taken going forward:

- The RBM will allow the exchange rate to adjust to a market clearing position with the view of endorsing a flexible exchange rate "managed float" regime that allows the exchange rate developments to reflect market fundamentals;
- The government will continue to meet most of its financing needs from the market and continue to work on initiatives that are aimed at widening the export base through diversification of the exports to the mining sector, establishment of structured markets for exports to increase receipts through formal channels; and implementation of policies that aim at improving the value of the exports.

- The Bank will aim to become a net buyer of foreign exchange in the market in order increase official foreign reserves; the procedures for the Bank's purchases will be announced in the coming weeks.
- The surrender requirements of both tobacco proceeds and export proceeds will remain in place for the short term until the foreign exchange market stabilizes.

In the short-term, the Kwacha exchange rate adjustment process may add pressure on inflation but we are committed to prudent monetary and fiscal policies in order to contain all inflationary pressures within manageable limits. Moreover, prices in the shops already reflect to a large extent the Bureaux Cash Rate; to that extent, aligning the ADB's TT rate with the Bureaux Cash Rate should not lead to further price increases.

In the short term, this move to a unified, market-clearing exchange rate should make it easier for companies to manage their businesses and so strengthen the economy. In the medium to long term, it is expected that the economy's structure of production and consumption will change towards increased exports and reduced imports resulting into favorable current account balance hence increased foreign exchange reserves. This, together with RBM's commitment to prudent monetary policy conduct should stabilize the Kwacha exchange rate and inflation in the medium term.

The Bank has confidence in the ability of ABDs to responsibly manage the exchange rate to avoid excessive volatility in the market.



Dr. Wilson T. Banda

**GOVERNOR**

*26<sup>th</sup> May 2022*