

# ECAMA NEWSLETTER

## NOVEMBER 2021 ISSUE

*The official monthly newsletter of the Economics Association of Malawi*



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## Economic Insight

### DOES THE INTRODUCTION OF HIGHER BANK NOTES LEAD TO AN INCREASE IN INFLATION?

Since the inception of currency as a medium of exchange, the largest denomination banknote ever issued was the Z\$100 trillion note by the Reserve Bank of Zimbabwe. In the United States of America, the largest denomination banknote ever issued was the \$100,000 banknote which was circulated in 1934<sup>1</sup>.

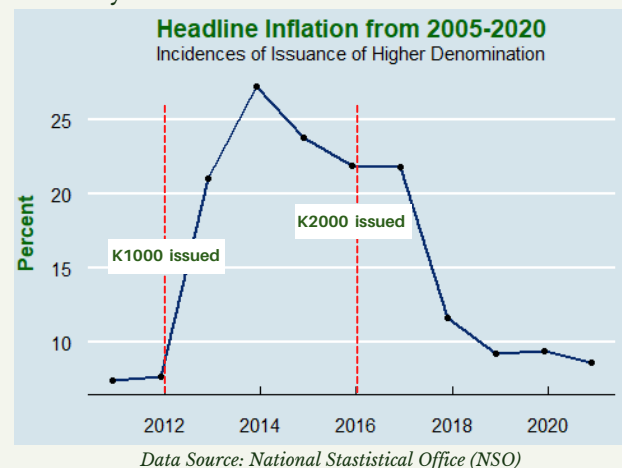
A central bank may carry out a currency reform to normalize monetary circulation and strengthen the entire monetary system. Currency reforms, whether redenomination of existing currency or introducing an entirely new currency, may be a useful step in obtaining or retaining macroeconomic stability but are typically complex and risky. Successful implementation of a currency reform is never guaranteed, for instance, Zimbabwe in its disinflationary stabilization efforts. According to Lönnberg (2013), currency reforms require that sound macroeconomic policies and strong financial sector regulations should be in place and the success of a currency reform is dependent on successful civic education of the public.

The Reserve Bank of Malawi (RBM) has in the past nine years carried out Currency Management Reforms which included introduction of three higher denomination bank notes and changing the design of existing bank notes. RBM first introduced the K1000 note in May 2012. The K2000 note was introduced in December 2016 in the Bank's efforts to minimize costs of printing currency, save foreign exchange for importing currency notes, and increase operational efficiency in transactions (Reserve Bank of Malawi, 2016). In February 2021, RBM circulated a new K1000 note with new security features to curb production of fake notes.

During a Press Briefing on 23<sup>rd</sup> November 2021, the Governor of RBM, Dr Wilson T. Banda, announced plans to issue a higher banknote with a face value of K5000 and a new K2000 note to be circulated from 24<sup>th</sup> February 2022. According to the Governor, the issuance of the K5000 banknote is in line with the RBM's Currency Management Policy which

stipulates that the highest bank note in circulation should not be above 60 percent. He highlighted that issuance of the MK5000 will minimize currency issuance costs, save foreign exchange, and increase operational efficiency. The introduction of an upgraded K2000 note is aimed at protecting the currency from counterfeiting to maintain public confidence.

The question that has lingered following the RBM's announcement of plans to issue a higher denomination bank note is *what would be the effect of this on inflation?* Many people believe that introduction of a higher bank note leads to higher inflation. *Does the introduction of higher bank notes lead to higher inflation?* This depends on how the public interprets the central bank's action and what the central bank does to manage the expectations. When the issuance of higher denomination notes is interpreted by the public as an over issue of currency by the central bank, inflation expectations are elevated which could push prices up even though the money supply has not increased. To mitigate such an effect, the central bank needs to manage these expectations by properly educating the masses on the rationale of issuing the higher denomination currency.



A quick analysis of the recent issuances of higher denomination bank notes in Malawi, as illustrated in the figure above, shows no discernible relationship between the issuance of a higher bank note and higher inflation. In 2012, when the K1000 note was introduced, inflation continued to rise, and this was mainly a result of the devaluation of the currency in that year. In

<sup>1</sup>US Currency Education Program. The History of US currency. <https://www.uscurrency.gov/history?period=1900s>

fact, the higher denomination currency was introduced to manage the effects of the inflation emanating from the devaluation. In contrast, when the K2000 note was introduced in 2016, inflation continued on a downward trend.

Moyo & Dunga (2020) conducted a study using monthly time series data from 1990 to 2017 for Malawi with the main objective of determining the relationship between the issuance of higher bank notes and inflation in Malawi. They found bi-directional causal relationship between inflation and higher banknotes. They concluded that a change in the currency mix can have an impact on inflation even where the money supply has not changed. Therefore, they recommended strategic issuance of higher denomination notes by the RBM to manage inflation expectations.

Psychologically, the "*denomination effect*", a term coined by Raghubir & Srivastava (2009), occurs when consumers use smaller denominations in their transactions while holding on to the higher denominations which are perceived as of high value and less exchangeable. Franses (2006) analysed 40 years data on inflation and denominations for 59 countries and found a uni-directional causality from inflation to banknotes. This finding is intuitive, because

issuances of higher denominations of bank notes are normally motivated by the need to manage higher levels of nominal transactions caused by inflation. Egbuna and Obikili (2013) used five different measures of inflation for Nigeria from 1973 to 2011 to examine the effects of the introduction of new notes on inflation in Nigeria and found no impact on inflation for all the currency restructuring events.

In conclusion, issuance of higher denomination bank notes may have an impact on inflation through its effect on expectations even when the level of money supply has not changed. Central banks, therefore, need to be strategic when issuing higher denomination bank notes so that they manage inflation expectations. Civic education on the factors underlying the introduction of a higher bank note can be used to manage inflationary expectations and avoid an increase in inflation. Empirical studies have found a positive causal relationship spanning from inflation to higher bank notes and this has been attributed to the fact that issuance of higher denomination bank notes is triggered by the need to finance larger nominal transactions stemming from higher inflation and not vice versa. Currency reforms should, therefore, not lead to an increase in inflation when strategically done.

## References

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*The importance of money flows  
from it being a link between the  
present and the future.*



**– John Maynard Keynes**



# HIGHLIGHTS FOR THE MONTH

## 2021 ECAMA ANNUAL ECONOMIC CONFERENCE

The 2021 ECAMA economic conference was held on 11<sup>th</sup> and 12<sup>th</sup> November 2021 and drew participants from the public and private sector, civil society organizations and development partners. ECAMA has been holding the economic conferences annually since 2012. In our efforts to promote inclusivity, this year's conference also included youth participation. Student representatives from the universities that participated in the 2021 University Students' Debates took part in the conference deliberations.



The Guest of Honour His Excellency Dr. Lazarus McCarthy Chakwera, The First Lady Her Excellency Madame Monica Chakwera, and The Right Honourable Dr. Saulos Klaus Chilima pose for a photo with ECAMA Board of Trustees and Executive Committee.

Photo credit: ECAMA

The official opening of the 2021 conference was presided over by His Excellency Dr Lazarus McCarthy Chakwera, President of the Republic of Malawi as Guest of Honour. The First Lady, Her Excellency Madame Monica Chakwera also graced the official opening ceremony. In his opening address the President challenged the gathering and economists in the country to come up with practical solutions to the economic malaise that has inflicted the country.

The Right Honorable Dr Saulos Klaus Chilima, Vice President of the Republic Malawi and Minister of Economic Planning and Development and Public Sector Reforms, who was also in attendance, delivered the keynote address. He observed the need for policy issues in Malawi to be addressed to ensure that the financial sector plays its role in promoting industrial development. He sparked debate on the interest spread that continues to widen and set the tone for policy

dialogue at the conference.

ECAMA has consolidated the proceedings and produced a Communique and Action Matrix. The Communique will be shared with all members for their appreciation and comments. The Action Matrix will be presented to all stakeholders so that we can combine effort in its implementation. ECAMA will follow through the implementation of the Action Matrix.



An aerial view of the 2021 ECAMA Annual Conference Proceedings.  
Photo credit: ECAMA

ECAMA would like to express its sincere gratitude to JTI Leaf Malawi, Tobacco Commission, Malawi Revenue Authority, Malawi Communications Regulatory Authority, and the Delegation of the European Union to Malawi for partnering with us to make the event a success. ECAMA would also like to extend its sincere gratitude to the presenters, panelists, and participants for engaging in such fruitful, constructive, and open exchange of ideas throughout the conference. This contributed to the overall success of the conference.

## 2021 PUBLIC FINANCE MANAGEMENT (PFM) RESEARCH SYMPOSIUM

As part of the activities under the "Enhanced evidence-based research to inform policy decision making in PFM" project which ECAMA is implementing in collaboration with Oxfam in Malawi and LUANAR, ECAMA organized the country's first ever research symposium fully dedicated to address Public Finance Management (PFM) issues.

The 2021 PFM research symposium was held on the 30<sup>th</sup> of November 2021 at the Bingu Wa Mutharika International Convention Centre in

Lilongwe under the theme: **"Improved Policy Decision Making in PFM, Enabled by Evidence-Based Research and Sharing of Best Practice Models".**



PFM Research Symposium Group Photo

Photo credit: ECAMA

The symposium attracted participation from research experts, policy analysts and university students. It was organized as an academic-style conference where research papers were presented on a specific theme and PFM experts and participants engaged in a plenary session on the chosen theme.

The symposium provided a platform for sharing well researched evidence of best practices, alternative and viable policy options on PFM with the aim of influencing policy decision making in the country. The suggested solutions and actions points will contribute to the overall objective of the

project the consortium is implementing on PFM.

## REMINDER 2021 MEMBERSHIP SUBSCRIPTION

ECAMA would like to encourage its esteemed members to renew their membership and pay subscription fees for 2021.

The corporate membership categories and their annual fees are as follows:

Platinum Members	K3,000,000
Gold Members	K1,500,000
Silver Members	K500,000

Individual membership annual fees are at K50,000 per member and K5,000 each for students.

The membership form can be downloaded from the following link:  
<http://www.ecamamw.com/about-us/membership>

ECAMA would like to notify its members that **from 2022, the Association will introduce a premium on late payment of membership fees.** The deadline for payment of membership fees will be announced in due course.

## KNOW YOUR MEMBER (KYM) FORMS

ECAMA would like to notify its members that it will circulate Know Your Member forms through its members' emails to build a credible membership database. An improved membership database is one of ECAMA's way to stay in contact with its members in its drive to ensure its members derive benefits from their membership.

## 2021 ECAMA ANNUAL CONFERENCE SUPER PLATINUM SPONSORS



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## UPCOMING EVENTS

Date	Activity	Venue
TBA	ECAMA Executive Committee Meeting	TBA
TBA	ECAMA Board of Trustees Meeting	TBA
24/12/2021	Office closes for Christmas Break	
04/1/2022	Office resumes	

## OFFICIAL COMMUNICATION CHANNELS

Any update on activities being undertaken by the Secretariat in collaboration with the Executive Committee is officially communicated through the following:



[www.ecamamw.com](http://www.ecamamw.com)



[facebook.com/ECAMA4](https://facebook.com/ECAMA4)



[twitter.com/ECAMA\\_official](https://twitter.com/ECAMA_official)



[linkedin.com/in/ecama2019/](https://linkedin.com/in/ecama2019/)

### FEEDBACK

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