

# The Efficacy of Monetary and Fiscal Policy in Stimulating Economic Performance

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# OBJECTIVE OF THE PRESENTATION

- Understand the impact of external shocks on the economy
- Examine the effects of fiscal and monetary policy in stimulating economic activity
- Provide policy recommendation on how the fiscal and monetary policy can promote economic activity and provide resilience from external shocks



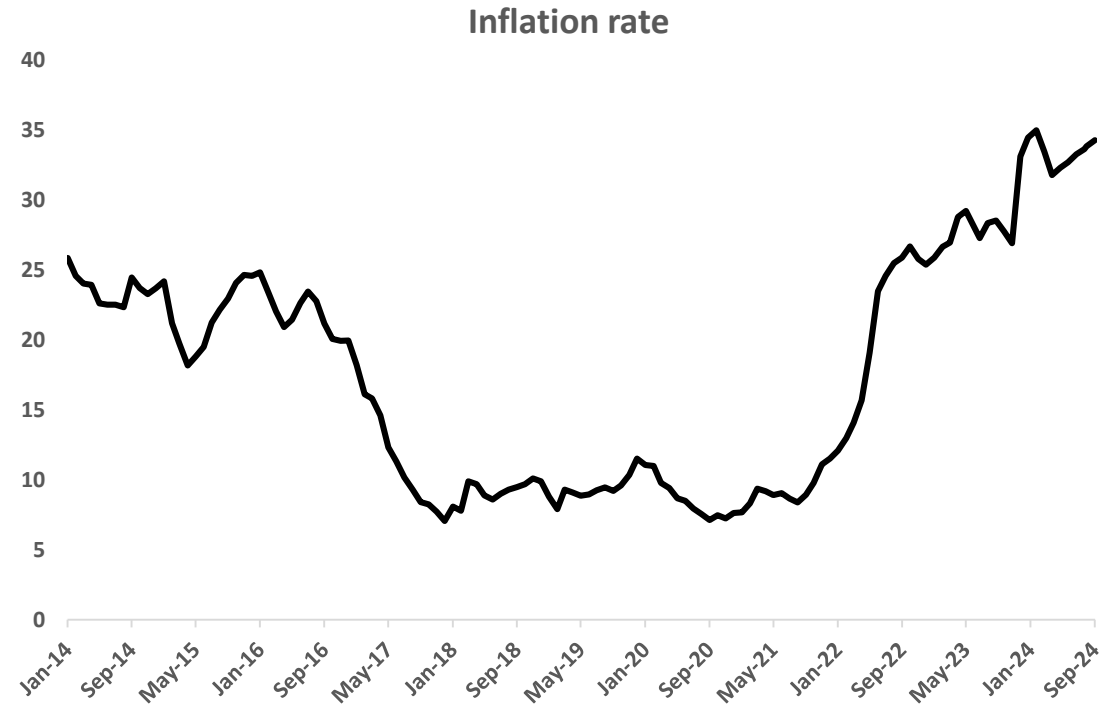
# OVERVIEW OF MALAWI'S ECONOMIC PERFORMANCE

- In recent years, GDP growth in the economy has declined from 4.6 percent in 2021 to 1.8 percent in 2024.
- Its growth was heavily affected by weather shocks related to climate change which has crippled the agriculture sector and exports (World Bank Group 2022).
- In addition, the recent external shocks from COVID-19 pandemic and war in Ukraine have further affected economic activity.

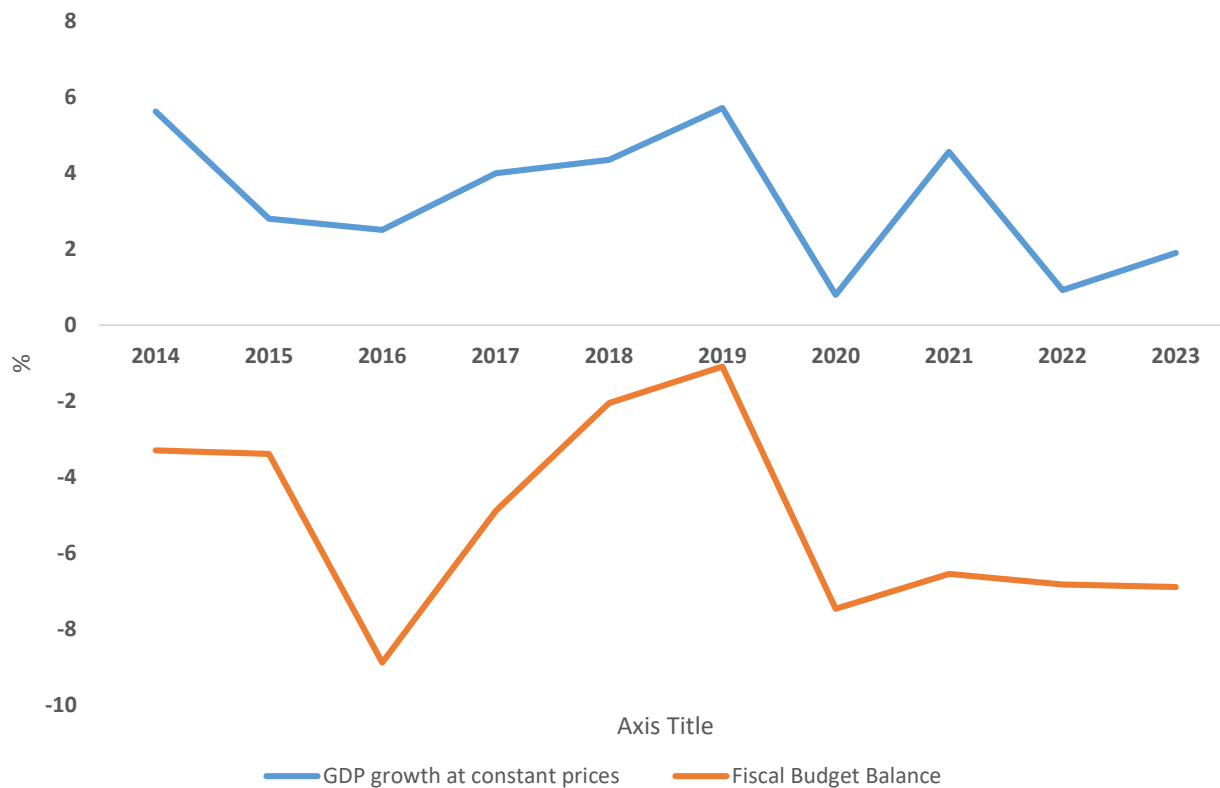


# OVERVIEW OF MALAWI'S ECONOMIC PERFORMANCE

- Apart from affecting economic growth, climate change and external shocks have heavily affected the inflation rate which had increased from the covid 19 era in 2020.
- In addition, this was worsened in 2022 by the Russia-Ukraine War.



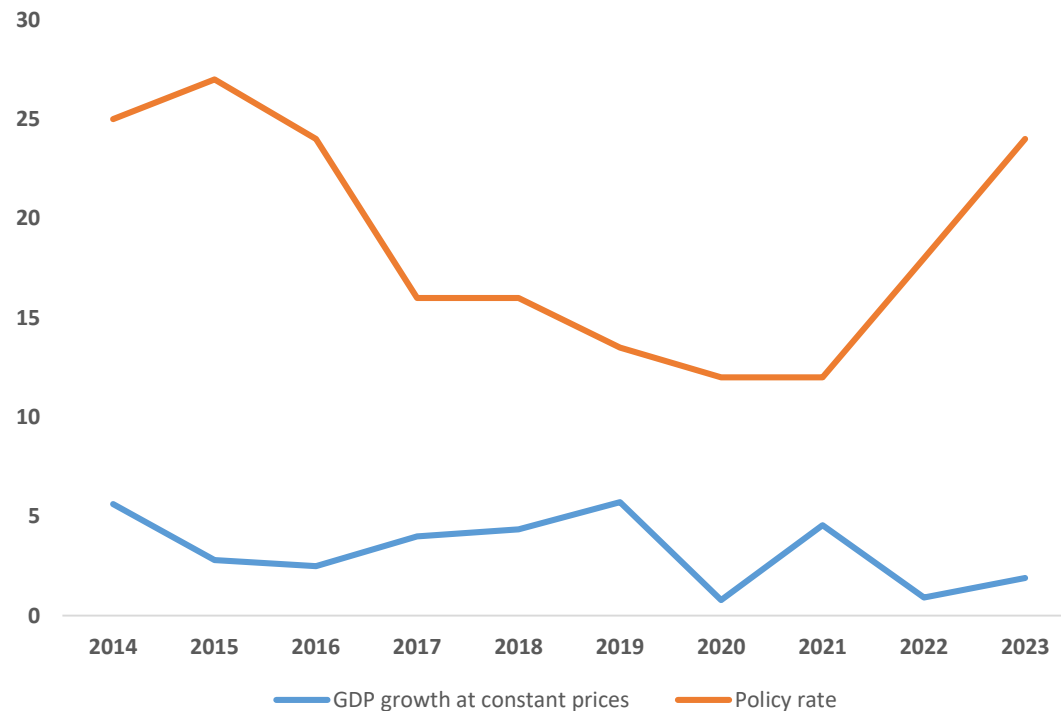
# Trends in Fiscal budget balance and Economic growth



- As the economy was affected by the COVID 19 pandemic in 2020, the Government had to embark on a counter cyclical fiscal policy in its humanitarian response.
- This together with the reduction in revenue attributed to the slowdown of economic activity amidst lockdown led to an expansionary fiscal position.



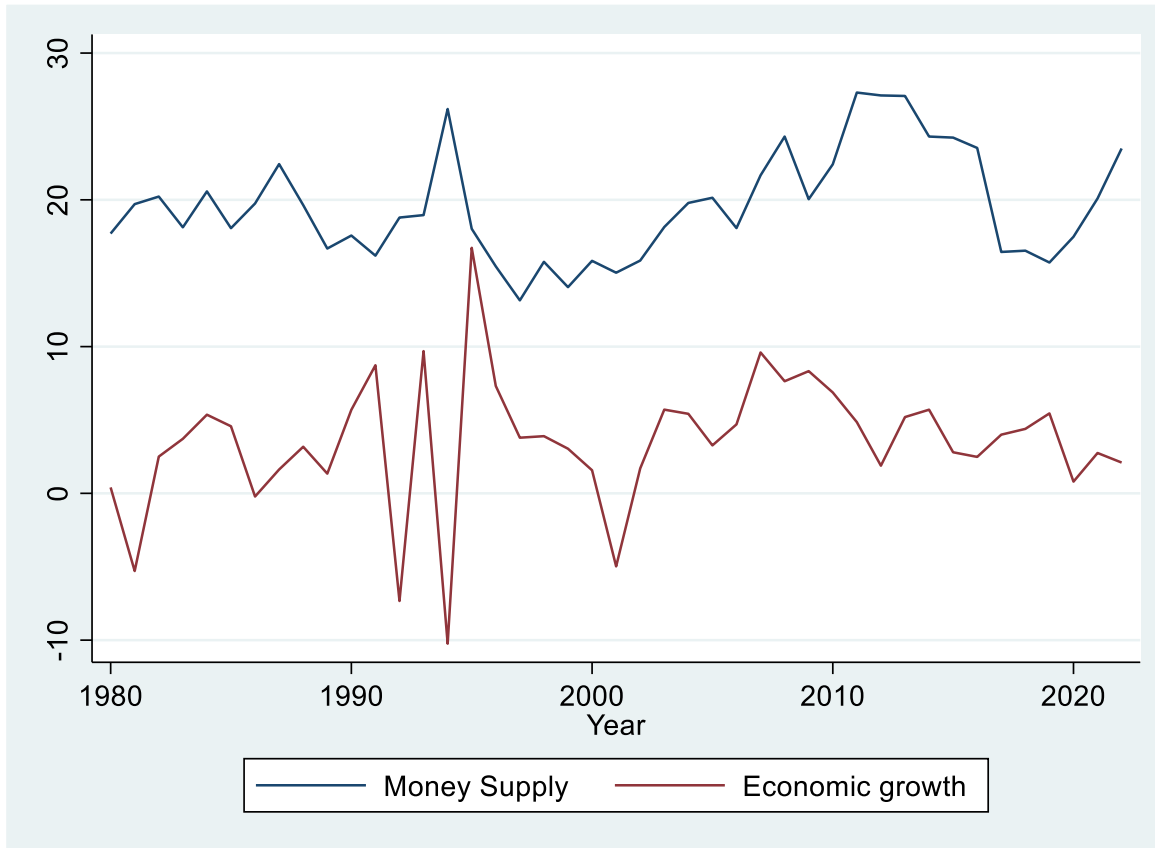
# Trends in Policy rate and Economic growth



- The Monetary Authority had to respond by implementing an accommodative monetary policy stance to promote economic recovery.
- But later, embarked on a monetary tightening by rising the policy rate by 200 basis points on 29<sup>th</sup> April 2022 after the increase in commodity and energy prices emanating from the Russia-Ukraine war



# Trends in Money Supply and Economic growth



- The outturns from these External shocks contributed to an increase in money supply in the economy.

**Examining the  
effects of fiscal and  
monetary policy in  
stimulating  
economic activity**



# Problem Statement

- What role does the fiscal budget balance have in influencing economic activity?
- Does Monetary Tightening Lead to Lower Economic Activity?
- What role does the Real effective rate have on influencing economic activity?
- Does the Neutrality of Money in the country exist?



# Methodology

- The VAR model used in this study uses the recursive identification approach, which is based on the Cholesky decomposition of innovations that allows for the identification of the monetary and fiscal budget balance shocks in stimulating economic growth from the 1980-2022.
- This method helps to solve the problem of the errors being correlated in the times series analysis.
- The method also helps in impulse response analysis as it helps examine the effect of a singular monetary policy and fiscal budget balance shock to economic growth whilst holding other variables constant.



# Variables used in the study

$$Y=f(K,L,M2,BD,REER,PR)$$

Where

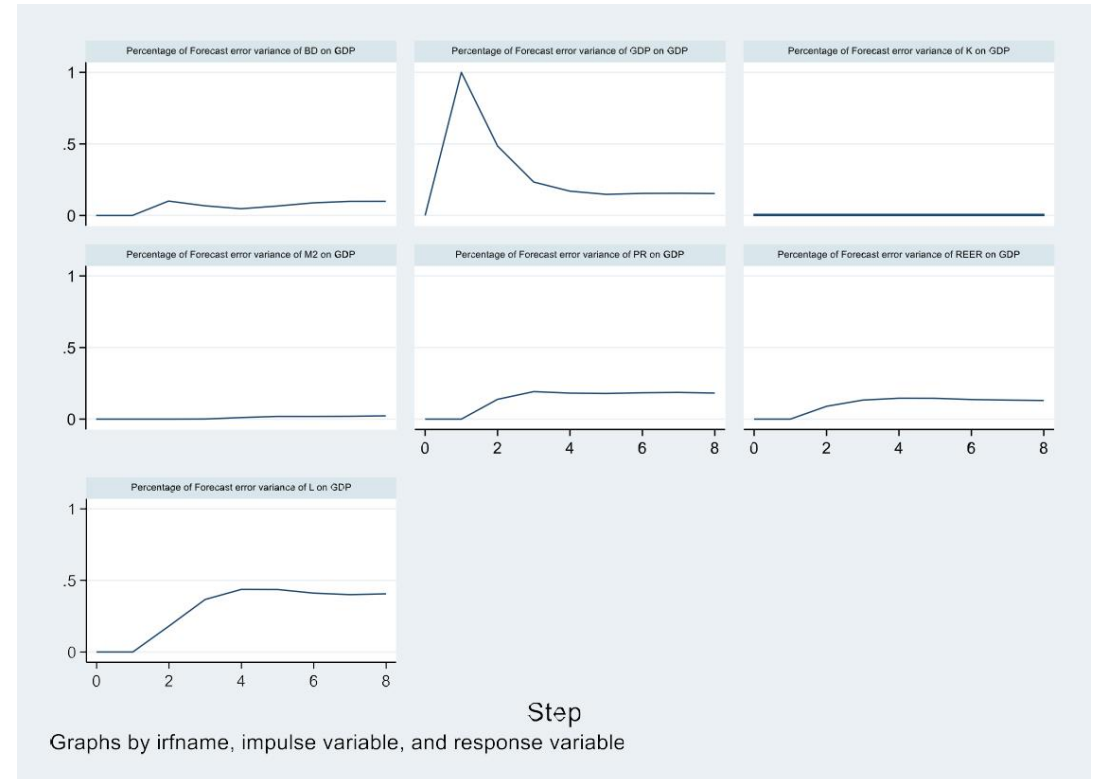
- Y is GDP growth at constant prices
- K\_ is capital,
- L is labour force,
- M2 is broad money,
- BD is Fiscal budget balance,
- REER is real effective exchange rate and
- PR is policy rate.



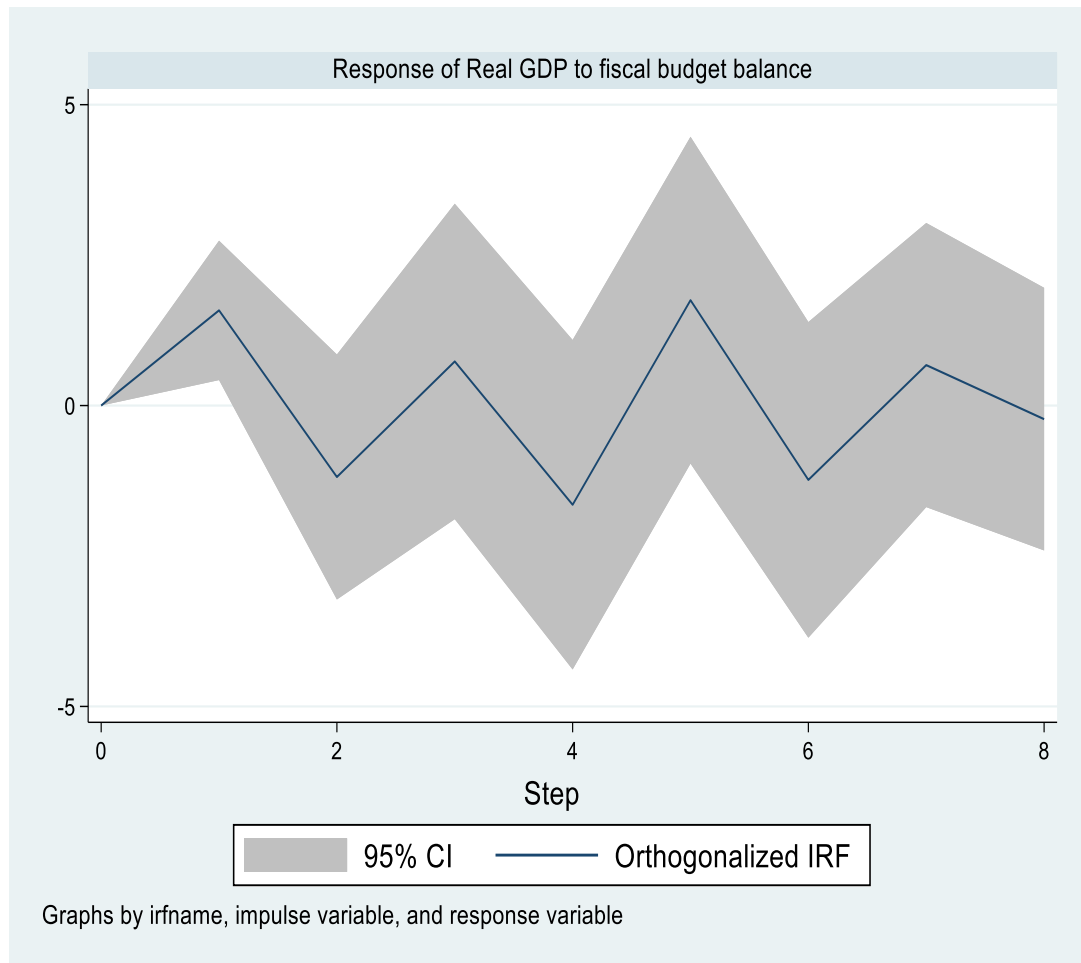
# Variance Decomposition

The variance decomposition coefficients of economic growth over 8 years showed most of the forecast error variances of economic growth is explained by Monetary policy variables.

For instance, the policy rate at 18.2% and the real effective exchange at 13.0 percent variability. Meanwhile, the Budget balance accounted for 10.0%.



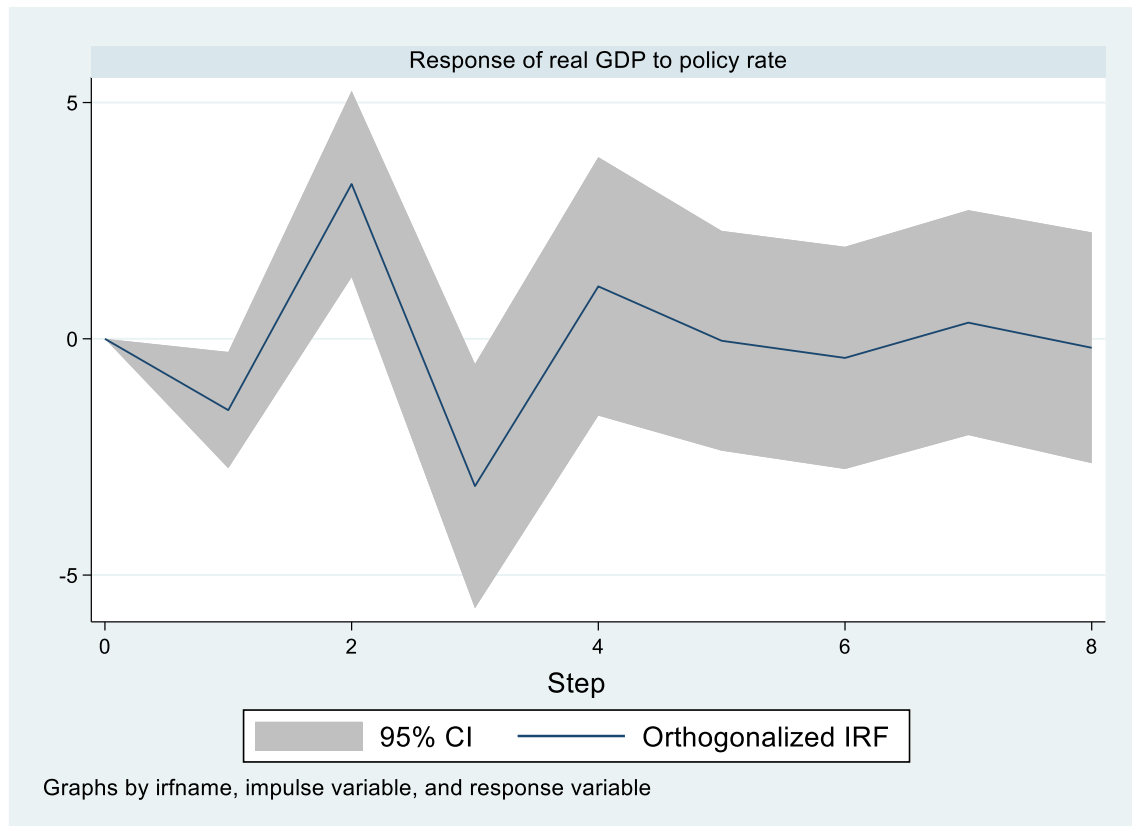
# Impulse response function



- An investigation of the impulse response function of fiscal budget balance to GDP shows that a one standard deviation positive shock to fiscal balance, as a percentage of GDP, has a substantial positive impact on economic growth in the first year by 1.6 percentage points. This shows that a contractionary fiscal stance either achieved by a reduction of government expenditure or an increase in the mobilization of resources has a positive impact on economic growth. This could be because a fiscal budget surplus reduces the need for the government to mobilize resources through borrowing which reduces crowding out in the economy.

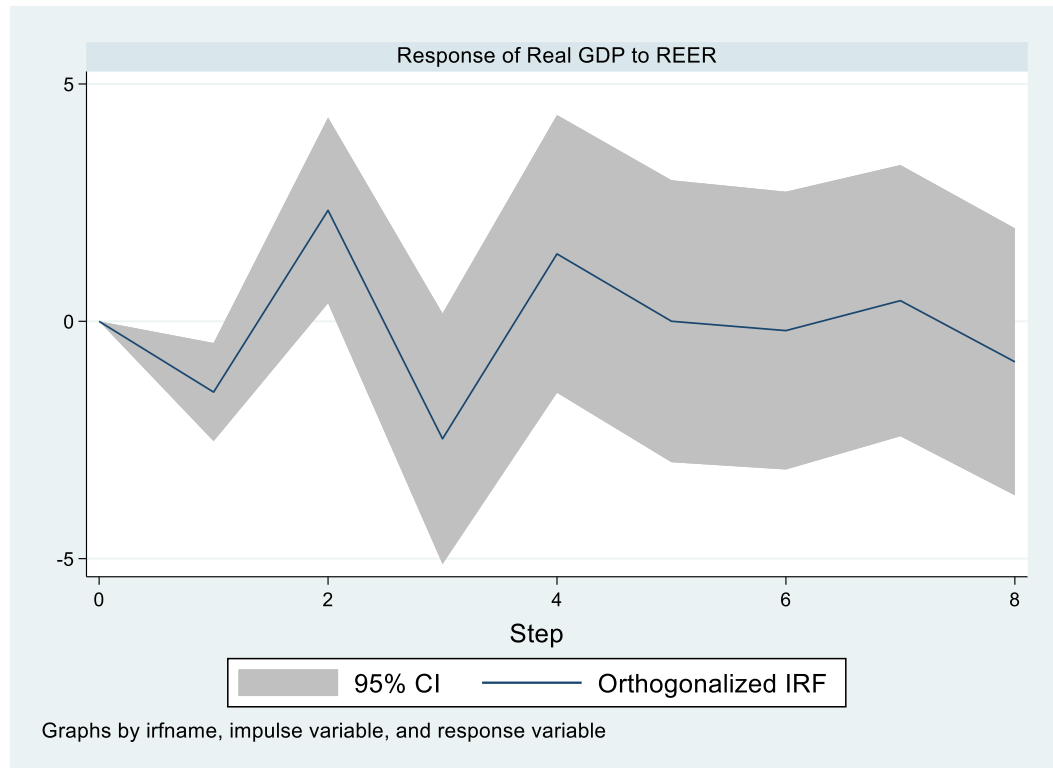


# Impulse response function



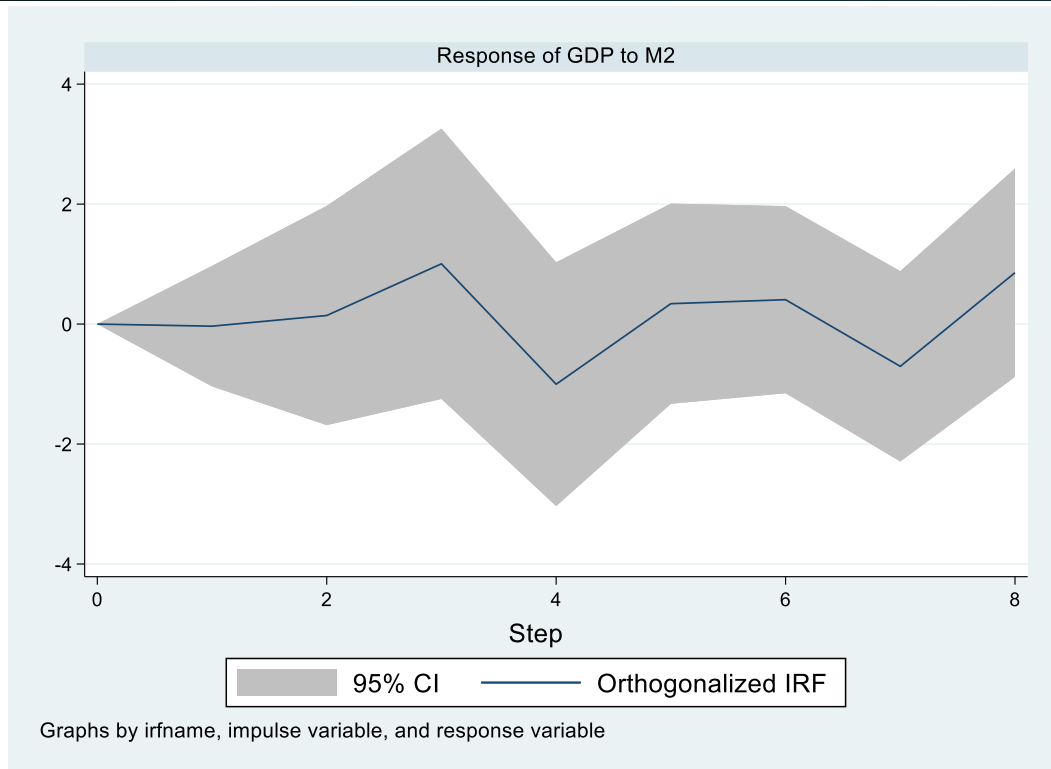
- It can be observed that the policy rate has a significant negative impact on real economic growth in the first year but eventually has a significant positive effect on real economic activity in the second year of up to minus 1.8 percentage points and 2.8 percentage points, respectively. This could be because a contractionary monetary policy stance has a constraining effect on economic activity through its impact of reducing money supply and aggregate spending but has positive effects on economic growth through its impact of reducing prices, capital inflows, government spending and eventually fiscal deficit.

# Impulse response function



- It can be shown that a one standard deviation positive shock to the logarithm of the real exchange rate has a negative impact on economic growth in the first year and eventually a positive effect on the second year of 1.5 percentage points and 2.3 percentage points, respectively.
- The impulse response analysis shows that real effective exchange rate appreciation either through net rising prices in the domestic economy than the international market or relative currency appreciation has a significant negative impact on economic growth in the first year but ultimately leads to an increase economic growth in the second year.

# Impulse response function



- The impulse response analysis shows that money supply has an insignificant impact on economic growth with the period up to the 2-year signaling neutral effect of Money supply on economic growth at constant prices.

# Policy recommendation from study

- The Government needs to improve its revenue mobilization in line with the domestic revenue mobilization strategy as most government expenditure is statutory. However, this should be combined with the reduction of inefficiencies to lower overall spending and fiscal slippages.
- Structural reforms should focus on long-term strategies that boost exports.
- Coordinate Monetary and Fiscal Policies for sustainable economic growth, both fiscal and monetary policies must work together to achieve economic growth.
- Maintain a contractionary monetary stance both through the policy stance and RBM market operations aimed at reducing inflationary pressures and promoting trade competitiveness.





THANK YOU

