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# Does Malawi's exchange rate regime keep prices low?

## Evidence and policy implications

**Frederick Changaya, Andrew Comstock, Joachim De Weerdt, Jan Duchoslav, Andrew Jamali, Frank Kamanga, Grace Kumchulesi and Karl Pauw**

The current exchange rate regime in Malawi is untenable. It results in multiple effective parallel rates, which impose significant costs on the economy and the daily lives of citizens. A key concern underpinning the existence of the regime is that its removal would trigger rampant inflation and worsen livelihoods. However, the widespread importation of both food and nonfood products at informal exchange rates means that the average citizen derives little real benefit from the maintenance of the official rate. After two major fuel price hikes in recent months, pump prices have nearly converged with the cost that would prevail at market-determined exchange rates.

Drawing on a combination of price multiplier and food demand simulations, this policy note shows that an exchange rate regime rationalization – through devaluing the official exchange rate to eliminate the informal premium and allowing the Malawi kwacha to trade at market-clearing levels – would not lead to runaway inflation or harm household welfare. Recent fuel price increases – in October 2025 and January this year – have pre-emptively absorbed much of the inflationary impact that would have been associated with exchange rate reform.

Our analysis documents the direct, short-run effects of exchange rate unification on domestic prices and finds them to be relatively modest. Longer-term economic growth and sustained price stability will hinge on the effective execution of a coherent set of complementary reforms. Exchange rate unification is a necessary component of this package, but it is not sufficient. Implemented in isolation or treated as a one-off devaluation followed by business as usual, it will bring little relief. It must be accompanied by sound fiscal and monetary policy and sustained export growth to restore macroeconomic stability. We do not discuss the trade-offs inherent to these accompanying measures, as they have been addressed at length in AfDB et al. (2025) and Engel et al. (2025).

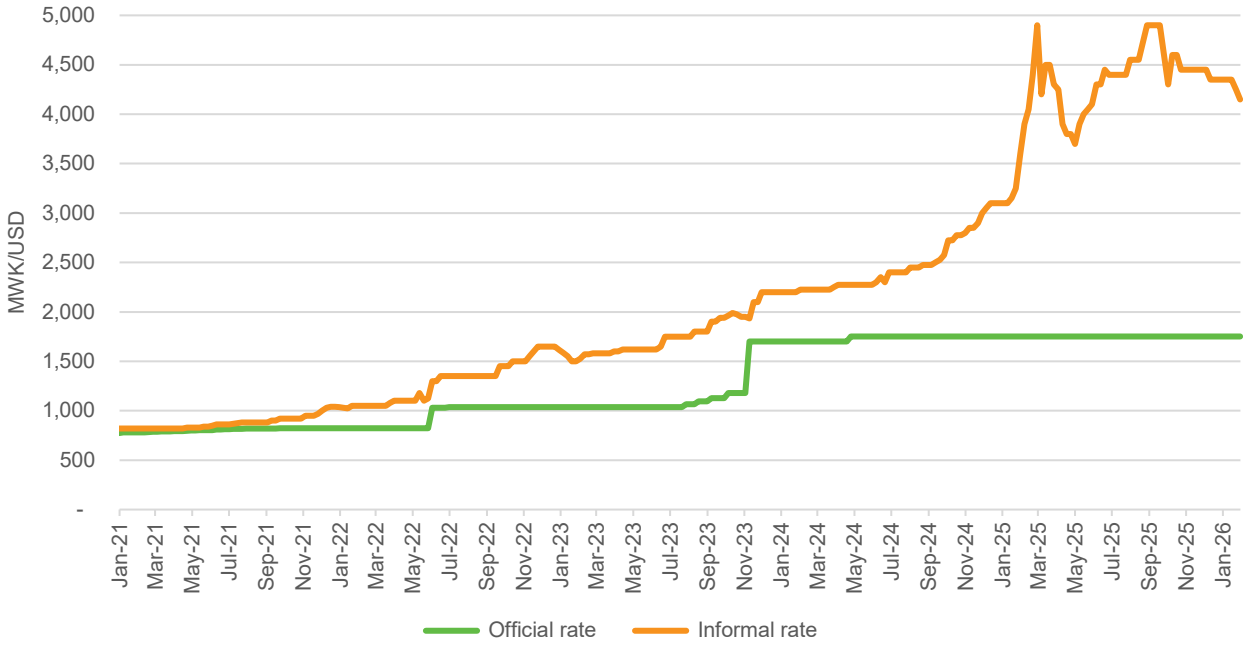
Critically, there must be a credible and durable switch toward a more flexible and transparent exchange rate regime. It will take time for exports and growth to pick up after a devaluation, and whether they do will depend on economic actors believing that macroeconomic conditions will remain stable over the lifetime of their investments. It will require careful preparation to get the cocktail right. Politically, the current administration might just have one shot at this: failure will make future reform attempts much harder.

## The promise of inflation control

The exchange rate is the price of a currency. Like with any good, when the price of a currency increases, sellers will supply more of it and buyers will demand less. When its price drops, sellers will supply less, and buyers will demand more. When traded freely, the price will adjust to a level where supply meets demand. But if the price is fixed too low (like the official price of a dollar in Malawi), demand will outstrip supply and there will be shortages. And if it is fixed too high, there will be an abundance of sellers who cannot find a buyer.

An important goal of any exchange rate policy is to ensure that supply matches demand, so that those in need of foreign currency can access it. Malawi's exchange rate does not meet this fundamental goal. The price of foreign currency, say the US dollar (USD), is set at an artificially low value, so that demand far outstrips supply. Anyone wishing to buy foreign currency must join a queue, but priority within this queue is determined through opaque and discretionary allocation mechanisms, with no guarantee of ultimately receiving foreign exchange. Since people and businesses with urgent need for foreign currency are willing to pay more than the official price to ensure immediate access, a parallel currency market, where supply meets demand, has developed. Figure 1 shows the evolution of this informal market over the past 5 years. Especially since the beginning of 2025 the spread has become very large, with economic actors willing to pay more than twice the official value of a dollar to access the currency.[1] Increasingly, the official rate is simply unavailable to most of the economy and has therefore become irrelevant to it.

### Figure 1 Malawi's dual exchange rate regime




**Source**: Reserve Bank of Malawi and Commodity Insights Africa

The harm that the dual exchange rate regime does to Malawi's economy is well documented. The need to transact informally creates uncertainty for businesses and households and reduces the tax base. Exporters are either driven into informality or out of business because they cannot compete in foreign markets at the official exchange rate. Similarly, hospitality operators – the backbone of the tourism sector which the government intends to support – are internationally uncompetitive at the official exchange rate and thus lose business to competitors in neighboring countries. Companies that continue to work formally struggle to source imports like spare parts and machinery as they cannot access foreign exchange. Malawians cannot use their bank cards abroad, which severely limits their ability to do business internationally. Knowing that they would be unable to repatriate

profits, foreign investors avoid Malawi. And Malawians who work abroad opt to keep their earnings out of Malawi or remit them through informal means, lest they lose value at the official exchange rate. Together, these distortions stifle economic activity and growth (IMF, 2025).

Why would any policy maker inflict such pain on a country's economy? In Malawi's case, the stated objective is twofold: to keep the cost of servicing Malawi's sovereign debt manageable and to combat inflation. Our note focuses primarily on the inflation objective, but a succinct discussion of the debt-related considerations is provided in Box 1.

### **Box 1:** Exchange rate unification and public debt: real risks, real trade-offs

A common concern is that exchange rate unification will raise the kwacha value of Malawi's external public debt. With close to USD5 billion in external liabilities, a move from K1,750/USD to a market-determined rate would indeed increase the kwacha cost of debt service. This fear is real. But focusing only on the cost of servicing debt risks overlooking the more binding constraint: policies that make it hard for Malawi to obtain USD in the first place.

Much of Malawi's scarce official reserves are used by government to meet external its obligations. Once these payments are made, very little forex remains for other government expenditures or for the private sector. Meanwhile, Malawi holds barely enough foreign reserves to cover its debt service obligations, a situation that leaves the country at risk of arrears.

One might argue that government can still buy dollars "cheaply" at the official exchange rate. But once the wider economic costs are considered, those dollars are anything but cheap. A policy that keeps prices of foreign exchange artificially low for government, while simultaneously throttling the country's ability to earn that foreign exchange, cannot be sustainable. The contrast between "cheap" and "expensive" debt service is therefore misleading: the current arrangement offers only temporary relief and becomes increasingly costly the longer it is maintained. That said, the short-run rise in debt-servicing costs is real and requires targeted measures, but it should not deter from the reforms needed to restore forex availability and support export-driven growth.

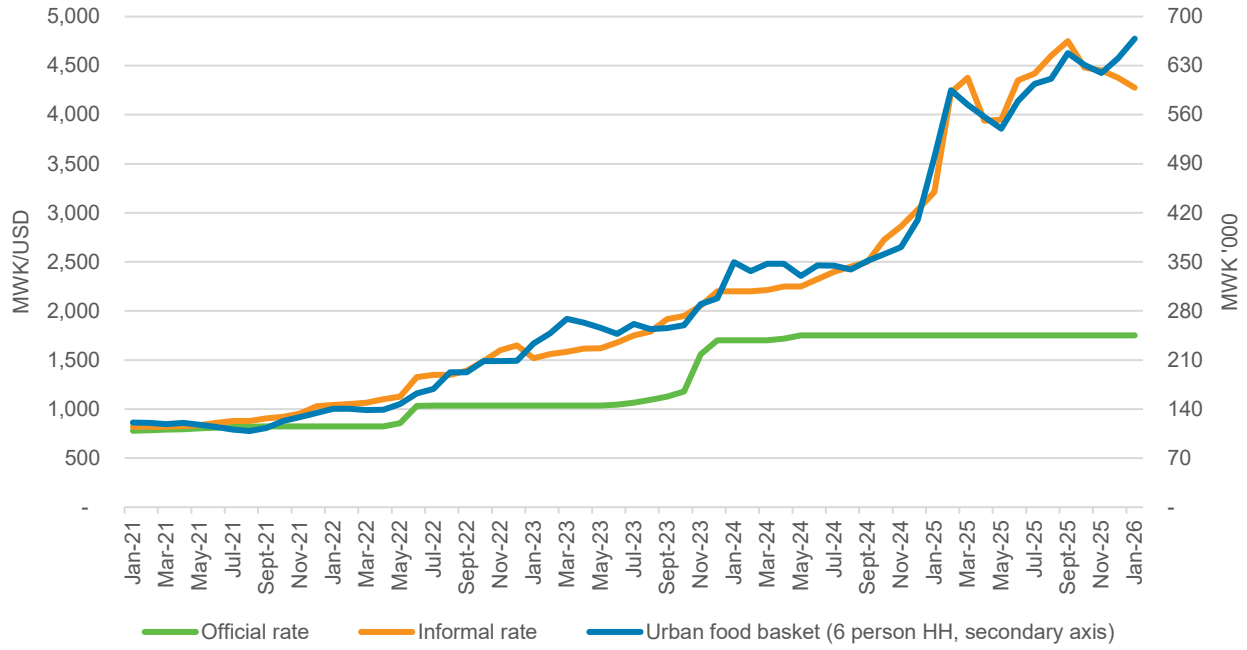
For the past four years, Malawians have had to endure double-digit inflation for the past four years, and government is *"concerned that exchange rate flexibility will lead to unchecked depreciation and pass-through inflation"* (IMF, 2025), further exacerbating the situation. By maintaining a fixed official exchange rate, it seeks to stabilize import prices and thereby protect food security and household welfare. There is some merit to the concerns about the effects of excessive exchange rate volatility on market stability and business confidence. Malawi's foreign exchange market is thin, with low trading volumes punctuated by seasonal spikes and irregular inflows, making the exchange rate sensitive to temporary supply–demand imbalances. However, this vulnerability does not justify maintaining a de facto peg, whose distortions and misalignments impose far greater economic costs. Instead, institutions such as the IMF are encouraging authorities to commit to a flexible, market-determined exchange rate as a long-term anchor, possibly using a managed float as a transitional arrangement to smooth excessive volatility and conditional on adequate reserve buffers.

In practice, the peg is failing to deliver the intended inflation control. As access to foreign exchange at the official rate has become increasingly rationed, most economic actors are effectively transacting at informal market-determined rates. Prices of many imported goods therefore already reflect the informal exchange rate.

Food markets provide a striking illustration of both the often-underappreciated importance of imports in Malawi and the irrelevance of the official exchange rate. Although Malawi grows much of its own food, it also relies heavily on imports – not just the exotic or high-end products commonly assumed, but also basic foodstuffs. Indeed, Malawi is structurally a net importer of maize, its primary staple crop. Since August 2024, IFPRI has monitored cross-border maize trade and has recorded consistent imports from all neighboring countries, with only sporadic exports (IFPRI, 2026).

Because food importers are generally unable to access foreign currency at the official exchange rate, they must procure it on the informal market. As a result, food prices track movements in the informal exchange rate. This is illustrated in Figure 2, which shows that the nominal value of a food basket closely follows the value of the Malawi kwacha (MWK) in informal markets. Changes in the official exchange rates have little explanatory power. Figure 2 therefore provides a compelling illustration of how the official exchange rate no longer anchors domestic prices for tradable goods.[2]

### Figure 2 Food prices follow the informal exchange rate




**Source**: Reserve Bank of Malawi, Commodity Insights Africa, Centre for Social Concern. **Note**: Daily official rates and weekly informal rates are averaged over each calendar month to align their frequency with that of food price data.

In sum, maintaining an overvalued official exchange rate and rationing access to foreign currency significantly harms Malawi's economy, while failing to deliver the advertised benefit of inflation control. The policy is very likely regressive too. The main beneficiaries are those with access to foreign exchange at the official rate, while everyone else – and particularly the poor and disenfranchised – operates in an environment where most imports are priced at the informal rate and exports are uncompetitive (Pauw et al., 2013). The regime generates significant pain for the economy, but no corresponding gain in terms of lower prices.

## Exchange rate unification and domestic prices

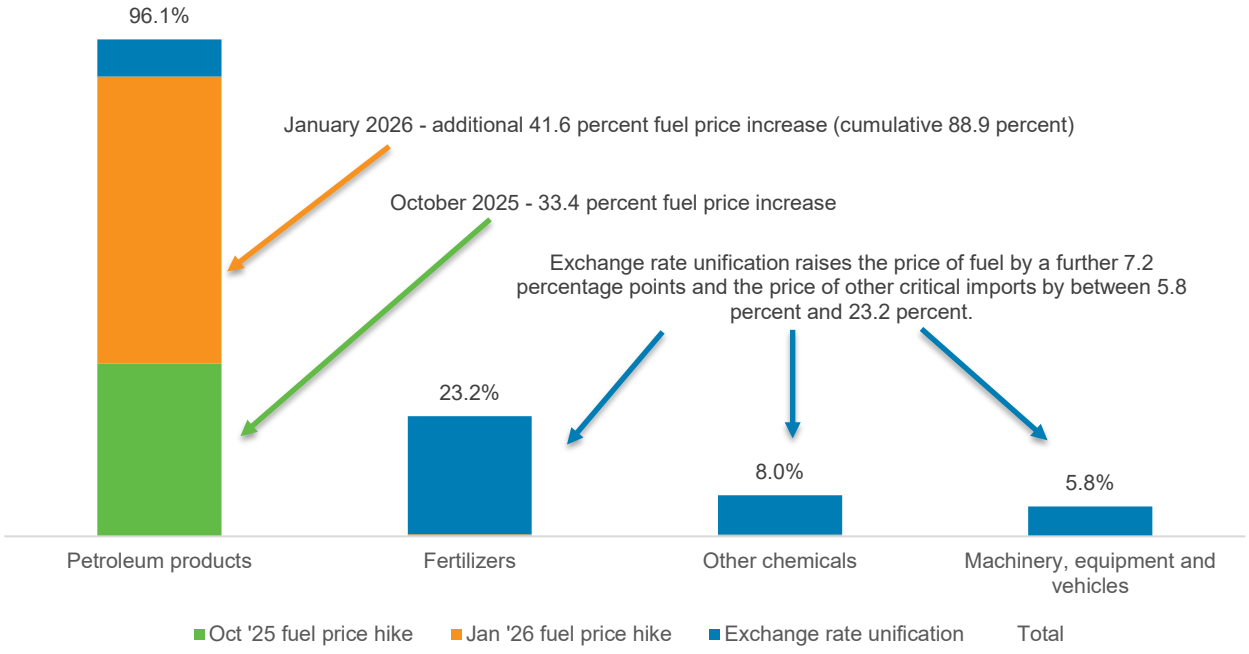
We estimate the short-run price effects of devaluing the Malawi kwacha from the current official rate of approximately MWK1,750/USD to MWK4,400/USD – the median informal market rate in 2025. This rate is lower than the peaks of MWK4,900/USD registered briefly in February and September 2025, but higher than the informal market rate at the time of writing (MWK4,050/USD). It is also higher than where some observers expect the market would settle under a coherent and well-implemented unification, and therefore provides an upper bound on the short-term inflationary effects.[3]

While an official devaluation would, in principle, raise the domestic price of imports by around 151 percent, the severe rationing of foreign exchange in Malawi has meant that most food and manufactured imports are already priced at the informal rate (see Figure 2). Unification would therefore have a more limited direct effect on food prices and thus food consumption than what is commonly assumed. What is true for food also applies to many other imported goods and services, be it general consumption goods, or production inputs such as machinery or spare parts (IMF, 2025).

Until recently, a notable exception was fuel, which was sold at a government-regulated price that reflected the official exchange rate. Some other goods – most notably fertilizer distributed under the Farm Input Subsidy Programme – are also procured at the official exchange rate. We assume that 30 percent of fertilizers, 10 percent of chemicals and pharmaceuticals, and 5 percent of equipment, machinery and vehicles are imported at the official exchange rate.[4,5] Major domestic fuel price hikes were announced in October 2025 and January 2026, despite the official exchange rate and international fuel prices showing little movement since 2023. With cumulative price increases of around 96 percent for petrol and 82 percent for diesel, domestic fuel prices now closely reflect the informal exchange rate, such that full alignment under exchange rate unification would require only a small additional adjustment.[6]

This is illustrated in Figure 3, which shows the direct domestic price effect of a 151 percent devaluation on those commodities assumed to still be partly imported at the official exchange rate. In the case of petroleum products, the effects of the October and January fuel price adjustments are also shown (in green and orange, respectively). With these earlier price adjustments, the devaluation would result in only a 7.2 percentage point further increase in petroleum prices, bringing the total price effect to 96.1 percent relative to pre-October 2025 levels. Much of the inflationary pressures of a devaluation on fuel prices have therefore already materialized. Increases in the prices of fertilizers, other chemicals, and equipment, machinery and vehicles are driven entirely by exchange rate unification, but these price increases range from only 6 to 23 percent since a large share of these goods are already imported at the parallel rate.

### Figure 3 Direct effects of fuel price hikes and exchange rate unification on key commodity prices, relative to pre-October 2025 levels




**Source**: Authors' estimates. **Note**: The 'fertilizers' category also includes, for 7% of its total value, insecticides, fungicides and herbicides. The 'other chemicals' category includes, among others, 20 percent industrial chemicals, 17 percent medicines, 15 percent soaps and detergents, 10 percent laboratory reagents and 10 percent vaccines.

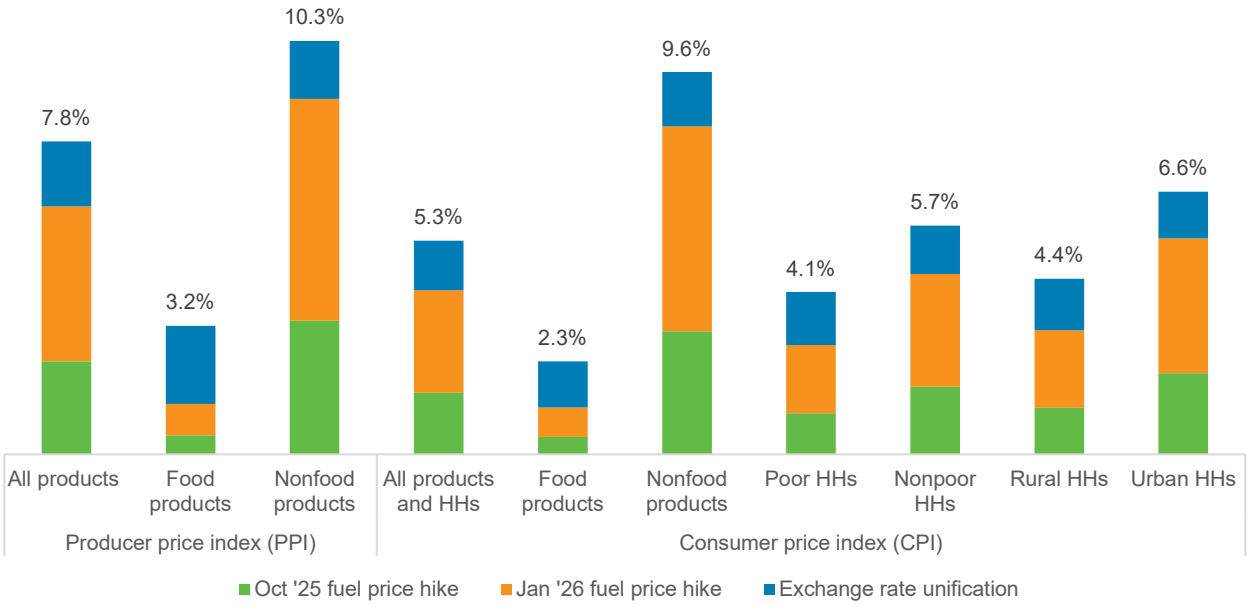
To gauge the pass-through effects of the two recent fuel price increases and model any remaining additional effect of an exchange rate unification on Malawi's economy and population, we implement a two-stage modelling framework. The first stage models the spillover effects of the direct price changes associated with exchange rate unification shown in Figure 3 on producer and consumer prices via inter-industry and consumption linkages in the economy. The consumer prices are then taken into the second stage, where we further unpack distributional impacts.

### *SAM price multiplier model*

We assess the effect of an exchange rate unification on food and nonfood prices using a fixed-coefficient price multiplier model for Malawi. The model is based on the latest Social Accounting Matrix (SAM) for Malawi (IFPRI, 2024) and is best described as a "cost-push price transmission" model which can be used to estimate the effect of fuel price hikes and further devaluation on (i) the production costs faced by different producers given their patterns of intermediate input use (these prices can be combined into a notional **producer price index**); and (ii) the average cost of different households' consumption baskets given their patterns of demand (akin to the concept of a **consumer price index**). Importantly, the model is designed to estimate only the short-run, first-order price effects of unification.[7] The longer-run trajectory of prices and economic activity will depend on the credibility and coherence of the unification process and its supporting reforms.

Figure 4 presents the impact of devaluation on producer and consumer prices. The overall producer price index (or PPI) increases by 7.8 percent, which can be broken down into nonfood (10.3 percent) and food (3.2 percent) components. The nonfood PPI includes the direct effect of rising costs of its components (such as imported petroleum and fertilizer) as well as the indirect effects on other nonfood sectors that use these goods as inputs. The increase in the food PPI is only because of indirect cost-push price transmission effects. The rising cost of fertilizer is an important factor driving price increases of primary foods, as is the cost of fuel used to transport agricultural commodities to markets. However, low use of fertilizer and limited market access generally means food producer prices are shielded from the worst inflationary effects.

**Figure 4 Impact of recent fuel price hikes and potential exchange rate unification on producer and consumer prices, relative to pre-October 2025 levels**

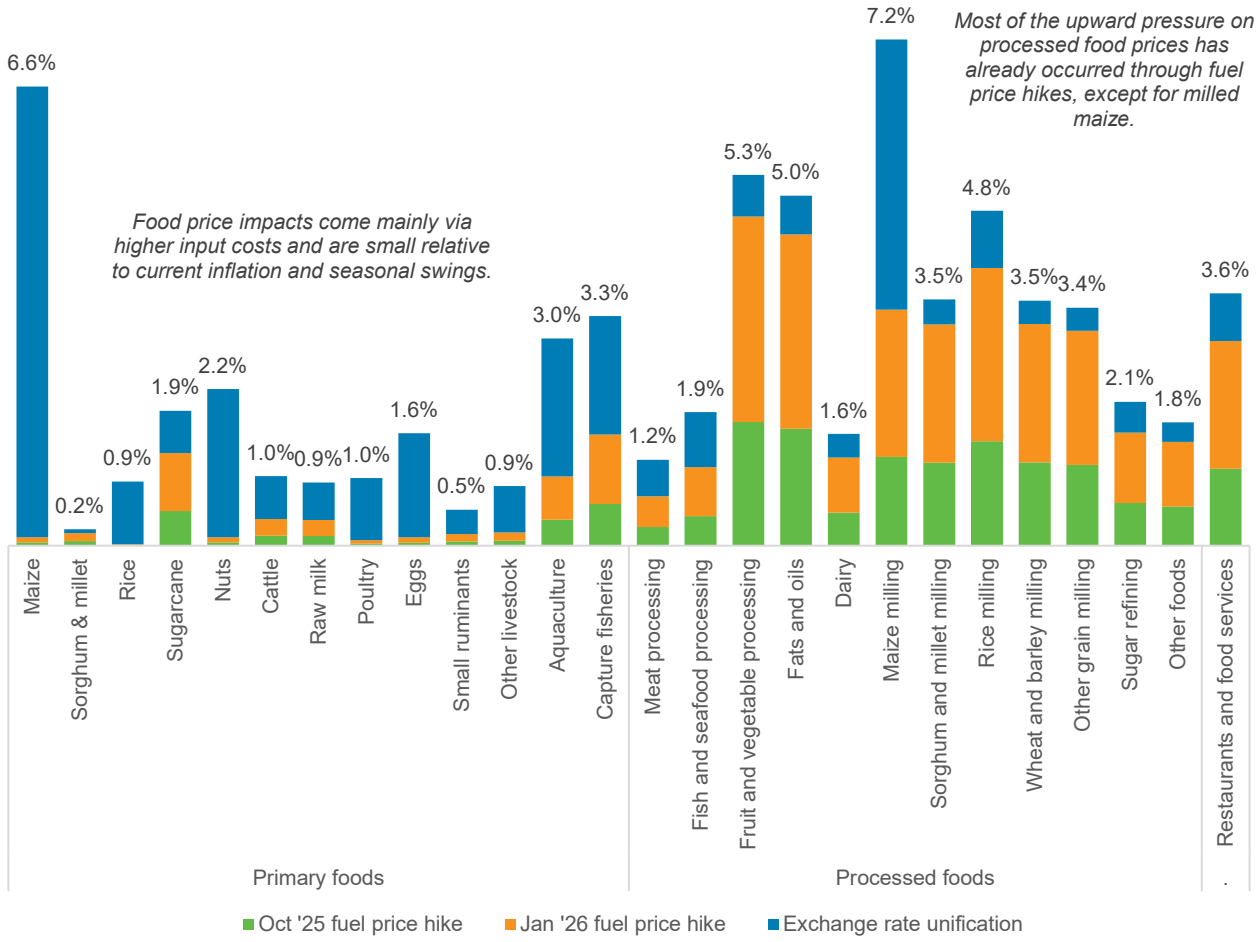



**Source**: SAM price multiplier model results.

The consumer price index (CPI) represents the cost of an average household consumption basket. Since the composition of households' consumption differs from producers' use of inputs, the CPI is expected to be different from the PPI. For instance, fuel accounts for only 0.7 percent of household consumption but 7.6 percent of all intermediate input-use by producers. Model results suggest that, on average, consumer prices increase by 5.3 percent through the combined effects of the two fuel price hikes (which have already happened) and a possible future unification of the exchange rate, with a much larger impact on nonfood (9.6 percent) than on food (2.3 percent). In aggregate, given differences in consumption patterns, prices will increase more for the non-poor (5.7 percent) than for the poor (4.1 percent) and more in urban areas (6.6 percent) than in rural areas (4.2 percent).

Critically, most of these producer and consumer price effects have already taken place after the fuel price increases in October 2025 and January 2026 and there is a relatively smaller residual effect (indicated in blue in Figure 4) on prices resulting from an ensuing exchange rate unification.

### Figure 5 Impact of recent fuel price hikes and potential exchange rate unification on primary and processed food prices, relative to pre-October 2025 levels




**Source**: SAM price multiplier model results.

Figure 5 unpacks changes in consumer prices for food products in more detail.[8] We distinguish between primary (unprocessed or raw) foods and foods that are sold after undergoing some processing. In general, primary food prices increase by less than processed foods. This mostly reflects the smaller trade and transport content of unprocessed foods. Primary foods that stand out include maize (6.6 percent) and wild-caught fish (3.3 percent), which respectively reflect high fertilizer use in the maize sector and high demand for fuel and equipment in the capture fisheries sector. The high maize grain price has a strong cost-push effect on maize flour (7.2 percent), one of the key processed foods in Malawi. Though certainly not negligible, these price increases are relatively small in

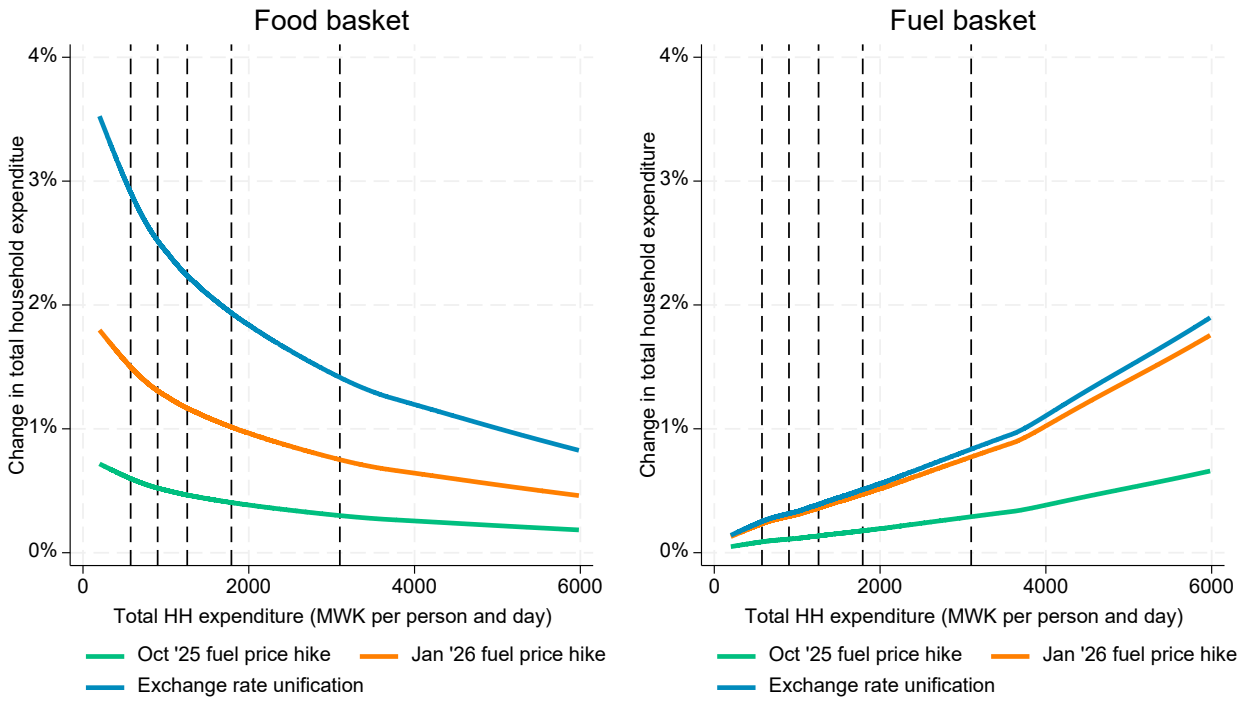
historical context. Over the past five years, maize prices have on average exhibited seasonal fluctuations of 127 percent within a single year and have increased on average by 44 percent per year.

It is important to acknowledge that past devaluations and fuel prices hikes were followed by immediate increases in domestic consumer prices often of a magnitude larger than the pass-through rates we estimate here. Following the November 2023 official devaluation of the kwacha, urban food prices increased by 21 percent, compared to a 13 percent increase in the price of the dollar at the informal market (Figure 2). And after the most recent fuel price hike of 42 percent in January 2026, many minibus operators increased their fares by as much as 67 percent. In the case of the November 2023 devaluation, the disproportionate reaction was likely a sign that sellers of goods and services interpreted it as a harbinger of similar measures in the future. When those did not materialize, prices converged back to the trend of the informal exchange rate (Figure 2). In other cases, disproportionate price increases might be a sign of lack of market competition, which would warrant close monitoring by the Competition and Fair Trading Commission to prevent price gouging.

### *Distributional impacts of price changes*

Next, we examine how consumer price changes differ across wealth quintiles by using two consumption baskets. The first is a **fuel basket**, comprising household purchases of diesel, petrol and motorized transport services such as buses and motorcycle taxis. The second is a **food basket**, reflecting Malawian dietary patterns. Figure 6 shows how much total household expenditure (vertical axis) would need to increase after the devaluation for households at different levels of total expenditure (horizontal axis) to continue consuming the same food and fuel baskets as before the devaluation.

**Figure 6 Distributional impacts**




**Source**: Authors' own calculations based on Malawi's 2019/20 Fifth Integrated Household Survey (IHS5). **Note**: The dashed vertical lines represent cut-off points for 5 wealth quintiles.

Several patterns stand out. First, the graphs have opposite slopes. Poorer households are primarily affected indirectly through pass-through to food prices, whereas wealthier households are more directly exposed through fuel and transport costs.

Second, recent policy changes that have brought prices of fuel closer to their cost at the market-determined exchange rate imply that exchange rate unification would not require an additional fuel price adjustment that is much smaller than the October 2025 and January 2026 increases. Reflecting this, the estimated impact of an exchange rate unification (blue line) lies only just above that of the January 2026 fuel price increase.

Third, the same does not hold for food prices. Pass-through from the October 2025 fuel price increase (green line) and the January 2026 adjustment (orange line) are evident. These arise mainly through higher prices of processed foods and non-food items. A full exchange rate unification is expected to generate additional price increases, particularly for primary foods (see Figure 5), through pass-through from higher costs of imported inputs – fuel, but also fertilizer, machinery, and equipment, to the extent that some of these imports now still occur at official exchange rates.

Finally, the bulk of the inflationary adjustment has already occurred. While some further increases in food and non-food prices are likely, their magnitudes are modest when weighed up against the substantial and ongoing economic costs imposed by the existing exchange rate regime.

## Conclusions

Malawi has already endured much of the inflationary adjustment that would ordinarily have accompanied a well-executed exchange rate reform: most imports already happen at the informal rate and recent fuel price adjustments have aligned fuel prices with those rates as well. The priority now is to complete exchange rate unification – decisively and transparently – so Malawi can put an end to opaque and uncertain access to foreign currency, allowing importers to source essential inputs, formal exporters to be rewarded at the true value of their outputs, and investors to plan and repatriate profits with confidence.

However, as we and others have argued before, exchange rate unification is a necessary but not sufficient condition for Malawi's economy to breathe and begin reaping the gains from the adjustment it has already made (Cockx et al., 2025, Engel et al., 2025). It is not a silver bullet, but rather an essential part of a broader reform package that must also include the adoption of sound fiscal and monetary policies and the establishment of a business environment that builds trust. Crucially, the transition must be towards a genuinely flexible and transparent exchange rate regime – one that is credible, rules-based, backed by adequate foreign exchange reserves and maintained for the foreseeable future. Empirical evidence shows that exports typically do not respond immediately to a depreciation but pick up only with a lag (Stojanov et al., 2024), explaining why one-off adjustments without sustained follow-through are ineffective (see Box 2). For a more complete discussion of the complementary reforms required, see AfDB et al. (2025) and Gray (2021).

We caution strongly against a one-off devaluation implemented in isolation of these necessary structural reforms. A hastily executed devaluation without credible follow-through would do more harm than good, not least because it would compromise the political feasibility of any future reforms. Politically, Malawi has only one real opportunity to get this right. It is therefore essential to plan carefully and deliberately, while paying full attention to the distributional consequences of the accompanying measures.

### **Box 2:** How imports and exports respond to currency depreciation

A common concern is that Malawi's exports "do not respond" to a weaker currency. Careful empirical analysis shows they do respond, but with a lag (Stojanov et al., 2024). The short run tells only part of the story. Exporters need time to adjust production, renegotiate contracts, secure inputs, and make new planting or investment decisions. Whether export volumes eventually rise therefore depends on firms believing that the macroeconomic environment will remain stable over the lifetime of these investments.

By contrast, losses from an overvalued or appreciating currency appear almost immediately: exporters become less competitive, and production contracts quickly. Malawi has repeatedly experienced this asymmetry. Because depreciations have typically been one-off and soon followed by a return to a peg, exporters have not had the confidence to expand capacity, so the medium-run benefits never materialized, even though the short-run costs did.

On the import side, Malawi's key imports (fuel, fertilizer, pharmaceuticals) have highly inelastic short-run demand. Their consumption cannot fall much in response to price changes, which is why import bills do not fall in dollar terms after a depreciation. This is not a violation of economic theory, but a reflection of limited short-run flexibility.

The implication is straightforward: exports will only respond to a credible and sustained move to a market-clearing exchange rate. The response will not be immediate, which makes it politically harder to implement but no less critical to closing Malawi's balance of payments gap.

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## ENDNOTES

[1] The sharp rise in the informal exchange rate in January 2025, shown in Figure 1, coincided with a substantial decline in dollar inflows after the United States cut much of its development assistance to Malawi in this same period. Cockx et al. (2025) examine the effect of this shock and argue that the fixed exchange rate regime impeded the economy's adjustment, thereby worsening the impact.

[2] Even if a small number of importers continue to have preferential access to foreign exchange at the official rate, this will have little effect on final prices faced by the Malawian consumer. These importers will rationally price their goods at the prevailing market-determined (informal) rate; and if they do not, then arbitrage will quickly eliminate any price gap. Consider the example of a mobile phone with a world price of US$100. At the official rate it would cost MWK 175,000, while at the informal rate it would cost MWK 440,000. An importer with preferential access to foreign exchange could acquire the phone at MWK 175,000, yet would still sell it at MWK 440,000, since that is the market-clearing price. If the importer instead priced the phone at MWK 175,000, an arbitrageur could purchase it and resell it at MWK 440,000. Such arbitrage would rapidly exhaust the small stock imported at the official rate and drive the retail price up to the informal market level.

[3] Although nobody knows exactly at what price the kwacha would clear under a unified exchange rate, there are two reasons to believe the price of K4,400/USD is best viewed as a worst-case scenario *under a well-executed unification exercise*. First, the kwacha recently appreciated against the dollar to around K4,050/USD in informal markets. Second, the parallel rate includes a black market premium, which would not be there under a unified regime. Should the unified exchange rate be lower than the 4,400 assumed in this note, then the estimated inflationary effects would also be lower.

[4] Petroleum products accounted for 22 percent of all imports into Malawi in 2023. Fertilizer accounted for 5%, other chemicals for 7% and equipment, machinery, and vehicles for 19 percent.

[5] It is hard to tell specifically how much of fertilizer has actually been imported at the official exchange rate – estimates vary widely. We have taken a relatively high percentage in our assumption of 30 percent to create an upper-bound for the potential pass-through effects.

[6] Although precise details of Malawi's fuel pricing formula are not publicly available, the Malawi Energy Regulatory Authority (MERA) justified the 33.4 percent price increase in October 2025 by explaining that fuel "importers were being quoted an average market exchange rate of MWK2,350/USD" (MERA, 2025), a premium of 44.6 percent over the official rate. The implication is that MERA introduced a shadow exchange rate into the pricing formula at the time. No similar statement was issued in January 2026 when fuel prices were increased by a further 41.6 percent. However, with no significant movements in global fuel prices between October 2025 and January 2026, our interpretation is that the shadow exchange rate was adjusted to MWK3,935/USD, bringing it much closer to the informal exchange rate.

[7] The model assumes that only prices adjust. Wages and profit rates are fixed in this short-term model. For a longer-term analysis a more flexible framework such as a Computable General Equilibrium (CGE) model is preferred.

[8] The figure omits nonfood commodities and food commodities with price increase of less than 0.5 percent.

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