THE PERFORMANCE OF EXCHANGE RATE REGIMES IN THREE SADC COUNTRIES: AN OVERVIEW

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Abstract

This paper provides an overview of the real exchange rate and economic growth dynamics in three low-income Southern African countries, namely: the Democratic Republic of Congo (DRC), Malawi and Mozambique. Specifically, the paper investigates the nature of exchange rate regimes and the impact that they have on economic growth, as well as the movement of real exchange rates and real GDP from 1970−2010 in these countries. The paper identifies the following trends: Fixed exchange regimes were pursued from the 1960s until the late 1980s and early 1990s in these countries, which were growth-repressing; the countries pursued floating and managed-floating regimes from the 1990s to date, resulting in moderate-to-rapid economic growth. We conclude that liberalised exchange rates, which lead to undervalued currencies in these Southern African countries, were growth-enhancing.

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1. Introduction

Although the real exchange rate has played a crucial role in determining the direction of factor movements across countries and trade blocks, earlier growth models could not adequately account for these movements. As Eichengreen (2007) argued, this was perhaps due to the fact that pioneering growth models were derived from closed-economy conditions. However, this fundamental omission has been corrected in new growth theories such as the endogenous growth theory. The export-led growth theory, for example, has emphasized the competitive real exchange rate as a vital tool for engineering economic growth (Eichengreen, 2007).

According to this proposition, a mildly depreciated currency acts as a 'magic wand' for unlocking resources from idle sectors of the domestic economy into the more productive export sector, which is characterized by technological transfer. Through learning-by-doing, countries using this strategy have been able to maintain their growth momentum, and to grow into major economies (Gala, 2007; Freund & Pierola, 2008).[1]

Moreover, other theorists have advanced the essence of moderating the real exchange-rate volatility, since a volatile exchange rate inhibits economic growth. Corroborating this proposition, Calvo and Reinhart (2000) noted that most countries have hesitated to float their currencies – for fear of volatility consequences.[2] The thrust of the exchange-rate volatility concept is that real exchange-rate volatility could cause severe financial distress and balance-sheet mismatches, especially in emerging economies, whose assets are denominated in local currencies; but whose liabilities are denoted in foreign currencies (Eichengreen, 2007). The ensuing bankruptcies and financial crises, liquidity problems, and wealth transfer could seriously dampen any economic growth.

This basic discussion illuminates the importance of the real exchange rate in determining economic growth within and across countries. Dollar (1992), for instance, found that Eastern Asian countries, such as Japan, South Korea, Taiwan, Hong Kong, Singapore, and China have deliberately pursued undervalued exchange rates, in order to enhance their growth over the years. Besides, overvalued exchange rates have inhibited the growth prospects of several countries in Africa and Latin America (World Bank, 1984). In

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[1] The success story of the "Asian Tigers" and, more recently, China has been the main example highlighted by these economists.

[2] This reluctance to float is now known as the "fear of floating" in the literature.

Africa, in particular, the World Bank recounts that overvalued currencies have caused severe drops in agricultural output (World Bank, 1984).

The real exchange rate and economic growth nexus has been widely documented in the literature. Previous studies have concentrated on countries other than those in Africa (see Dollar, 1992; Razin and Collins, 1997; Acemoglu *et al.*, 2002; Fajnzylber *et al.*, 2002). This paper investigates the dynamics of the real exchange rate and economic growth over the years by focusing on exchange rate regimes and reforms, as well as growth policies and programmes implemented in low-income Southern African countries. The choice of these countries was purely motivated by the fact that they share common economic fundamentals and policies.

The rest of the paper is organized as follows: Section 2 examines the exchange rate regimes and policies pursued by these countries; section 3 examines the growth programmes and policies implemented by these countries; section 4 traces the movement of the real exchange rate and real GDP within these countries from 1970 to 2010; and section 5 draws conclusions from the preceding sections.

2. Exchange Rate Regimes and Policies

Right from independence, all the low-income Southern African countries examined were under a fixed exchange regime. Around the mid-1980s, these countries resorted to interim and adjustable peg regimes. At the turn of the 1990s and in the early 2000s, the countries shifted to managed float regimes. We present the country-based analysis of these regimes and policies as follows.

Congo DR

A few years after independence, in 1960, the Democratic Republic of the Congo adopted a fixed exchange regime, in which the Congolese Franc was pegged to the US Dollar. The Congolese franc was relatively stable, with occasional fluctuations, when government resorted to printing money. The Structural Adjustment Programme (SAP), which was introduced by the IMF and the World Bank into African countries, compelled countries involved to liberalise their exchange regimes; the DR Congo was affected too. Between 1980 and 1985 and in the period 1990 to 1995, the DR Congo adopted an interim exchange rate regime. However, in 2000, the country resorted once more to a floating regime (Fischer *et al.*, 2013).

The current regime is a managed, or so-called dirty-float regime. The currency is allowed to move along with major currencies in periods of smooth economic climate. However, when the currency begins to experience severe depreciation or appreciation, the central bank then steps in to peg it. Another distinguishing feature of the regime is the

high level of dollarization – with a weak institutional framework to accommodate it. Most transactions are done in foreign currencies, especially, in the US$ (Fischer *et al.*, 2013).

Moving forward to the new regime, the Economic Recovery Programme (ERP) paved the way for the initiation of flexible macro-economic and financial policies, leading to an improved performance of the economy. The independence of the central bank of the DR Congo was restored; the regular pattern of currency depreciation and hyperinflation was halted. The inflation rate, which stood at 511 per cent in 2000, fell drastically to 15 per cent by 2002. With this drastic decline in the rate of inflation and the introduction of a floating exchange rate regime in May 2001, the currency became stable (Fischer et al., 2013).

Economic activity now reflects transactions in US$, which have to some extent instilled credibility into the financial system. Monetary policy has primarily focused on stabilising the national currency, resolving budget overruns, and restoring the macro-economic balance (IMF, 2010).

Starting in 2007, the country's currency has suffered frequent misalignments, thereby leading to uncertainties and a loss of confidence in the economy. The Congolese franc experienced a depreciation of 10.5 per cent between January and February 2007. This was mainly due to the government's decision to print money (a sum of CDF 28 billion), in order to finance its widening government deficit. The main constraints of the exchange rate policy-management in the DR Congo have been attributed to fiscal dominance, the lack of capacity and credibility of the monetary authorities, institutional and administrative weaknesses, and the lack of well-functioning money and efficiently managed stock markets (OECD, 2008).

Malawi

The exchange rate policies in Malawi, like most countries in Africa, have been mixed. At some point, the country operated a controlled or peg system (1984-1994), a managed float (1994-1995), a de facto peg (1995-1997), a crawling peg (1997-1998), a float (1998-2003), and a de facto adjustable peg (2003 to date). Malawi has since moved back to a strictly controlled exchange rate regime, with periodic rationing and continually low foreign exchange reserve coverage; however, in spite of this, its official exchange rate been less overvalued than others (Maehle et al., 2013). Figure 1 shows the recent exchange regimes in Malawi.

It has been argued that the stop-and-go exchange rate policy that Malawi has been employing has not really provided a solution for its economic problems (Maehle *et al.*, 2013). If anything, this approach has rather worsened the economic situation in the country. The exchange rate experienced a high

nominal depreciation during the period from 1990 to 2012. In fact, the Malawian kwacha (MK) depreciated by 98 per cent between 1990 and 2010. At the same time, inflation rose steadily between 1990 and 2010; and consumer prices increased by almost 23 per cent on average each year.

According to reports (See Simwaka (2007), and Maehle et al. (2013) for further discussion), monetary policies in Malawi could be categorised into three distinct regimes: i) An era of financial repression (1964-1986); ii) an era of financial reforms (1987-1994); and iii) an era of financial liberalisation (after 1994). These regimes have bearings on the behaviour of the exchange rate. Under the repressed system, the exchange rate was unduly pegged; while the exchange rate experienced nominal depreciation under the reformed and liberalised regimes (Maehle *et al.*, 2013).

Figure 1. Exchange Rate-Regime History of Malawi (1990-2010)
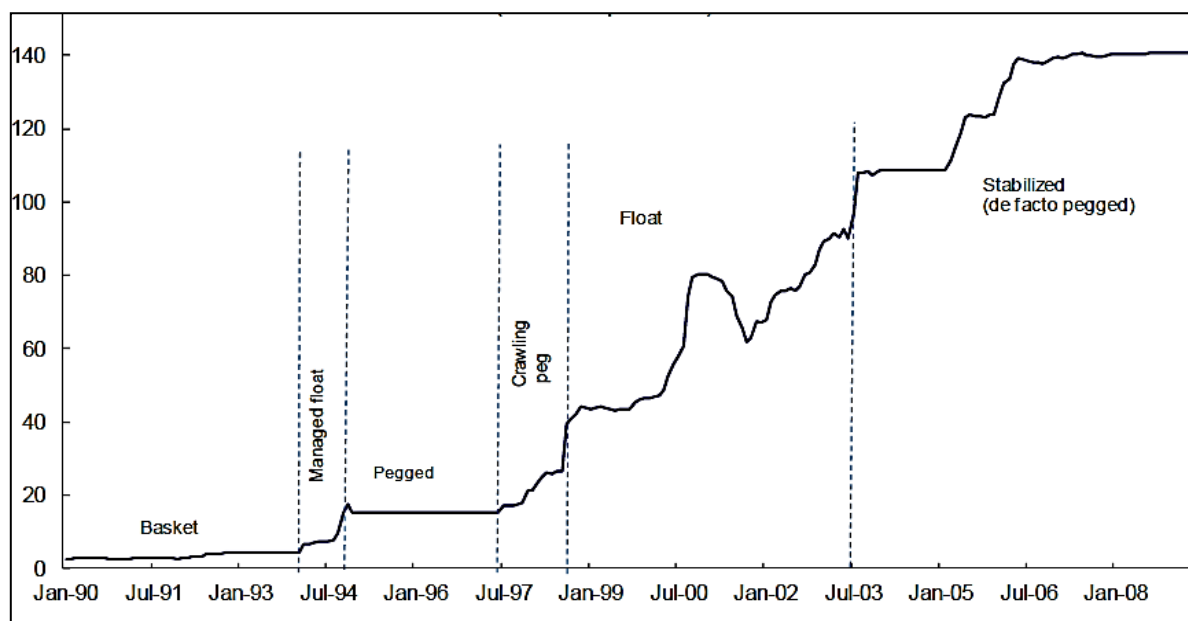
Source: Adapted from Maehle et al., 2013.

In the first phase (1964-1986), the monetary authorities imposed direct controls on credit; and the interest rates were, consequently, also controlled. Sectorial credit allocation was implemented, allowing credits to flow to preferred sectors of the economy. The exchange rate was pegged together with the imposition of price floors and ceilings. This led to a repressed economy, where the real exchange rate was misaligned and prices were distorted. The ultimate outcome was an economy that plunged into recession (see Reserve Bank of Malawi, 2003).

Facing severe recession, the monetary authorities were persuaded by the IMF staff to undertake financial reforms from 1987 onwards. The first step was a partial deregulation of the lending rates in July 1987; this was to be followed by a partial deregulation of the deposit rates in April 1988 (see Simwaka, 2007). In addition, preferential lending was completely abolished by 1990. The exchange rate was allowed to float in February 1994; this was accompanied by the establishment of forex bureaux, and the trading of foreign exchange options and currency swaps (Maehle *et al.*, 2013).

Mozambique

Since independence from Portugal in 1975, Mozambique has mostly operated a controlled economy. The exchange rate has been pegged over a considerable number of years. However, under pressure from severe hardships and economic instability, several reforms were introduced, including a gradual shift from a pegged exchange-rate regime to a relatively market-determined exchange regime (Fabrizio, 1998).

At the beginning of January 1987, the Mozambican currency, the metical, was devalued by 80.5 per cent from Mt 39 per dollar to Mt 202 per dollar; the exchange rate peg was adjusted from a basket of six currencies to the dollar. Later that year, in July 1987, the metical was devalued by 50 per cent from Mt 202 per dollar to Mt 404 per dollar. The devaluation at irregular intervals was said to have continued until April 1989, when a formal monthly devaluation was established (Fabrizio, 2001). The authorities, once again, changed the pegged exchange rate from a basket of six currencies to a dollar, and then to a basket of 10 currencies in December 1989.

Again, in October 1990, the monetary authorities of Mozambique introduced a market for foreign exchange – thereby, allowing commercial banks to transact business with the public. The metical was devalued in mid-1991, following pressures to discourage import; thus, foreign exchange transactions shifted closely to the official market (Fabrizio, 2001). In April 1992, the official central bank rate and the market rate were unified. Additionally, a special more appreciated rate was introduced in the form of a conditional aid.

Finally, the special appreciated rate was abolished in June 1993; and accordingly, the official exchange rate became fully market determined. In spite of this, there appeared a significant spread between the official and parallel rates, albeit transitory, in early 2000 – reaching a high of 10 per cent in March 2000. This was partly due to severe floods, which ravaged Mozambique at the beginning of that year. Official privatization of the financial sector started after 1995, leading to the establishment of forex bureaux and the establishment of foreign banks; steps were also taken to liberalize the current account (Fabrizio, 1998).

Following these financial sector and exchange rate reforms, it was reported that the economy of Mozambique responded positively and significantly (see Fabrizio, 2001). Economic growth reached a period high of 15 per cent in 1987; and over the last 27 years, growth has averaged 7 per cent or more. Exports grew by 18 per cent in 1987, remaining high over an extended period, and averaging 12.4 per cent between 1987 and 2010. Aid also increased over this period, speeding up imports of goods and services, and a significant rebuilding of the international reserves (Fabrizio, 2001; Tarp *et al.*, 2002).

3. Economic Growth Policies and Programmes

Low-income countries in Southern Africa have pursued various growth strategies and policies since independence. Most of the strategies and policies have been aimed at poverty-reduction and employment-creation. In particular, the Heavily Indebted Poor Countries (HIPC) initiatives have been implemented by some of these countries, in order to aid the reduction of their outstanding debts with the IMF and the World Bank. Moreover, various Poverty Reduction Programmes (PRSPs) have also been implemented. We present the country-based overview of the strategies, policies, and programmes as follows.

Congo DR

Since the beginning of independence, Congo DR has been ravaged by political uncertainties, which have inhibited the country's growth potential. The period between 1965 and 1997 was under an extreme dictatorial rule. Prior to that, the period between 1960 and 1965 was heavily characterised by a power struggle, culminating in a shift in power from one political leader to the other. Thus, this era merits no discussion, as far as our study is concerned.

Programme Relais de Consolidation (PRC) was launched in 2006 to implement stabilisation reforms; but it failed to achieve its objective – due to excessive government spending (African Economic Outlook, 2008). This led to a delay in reaching the completion point of the Heavily Indebted Poor Countries (HIPC) initiative. An IMF Staff-Monitored Programme (SMP) was set up to replace the PRC (African Economic Outlook, 2008). The conditions of the SMP were that public finance would be stabilised; while any necessary spending would go into poverty alleviation; non-prior expenses were also to be discouraged.

The DR Congo remains one of several sub-Saharan countries with the least development of human resources. The government implemented free basic education in 2010 to improve human-resource development. In 2011, the government of the DRC announced its interest to adopt new prudent macroeconomic policies aimed at limiting the amount of credit going to the State, maintaining the value of the DRC currency, and accommodating inflationary pressures. The commitment to this cause led the DRC to reach the completion point of its Heavily Indebted Poor Countries (HIPC) initiative in 2010. The remaining debt owed to the IMF was cancelled, thereby freeing the DRC from any pressures of debt servicing (African Economic Outlook, 2008).

In addition to participating in the HIPC initiative, in order to ease the negative impact of debt burden on the growth prospects of the economy, policymakers in the DR Congo have introduced planning instruments and budgetary programming in the provinces, with the objective of improving governance (African Economic Outlook, 2008). The country also put in place foundations to join the Organisation for Harmonisation of African Business Law (OHADA). Further to implementing various initiatives to enhance governance, the DR Congo has abolished redundant taxes and illegal levies – with the aim of boosting the business climate (African Economic Outlook, 2012).

Unemployment remains a particularly crucial issue, inhibiting the growth prospects of the DR Congo. To respond to this issue, the government recently introduced a youth employment programme under the second Poverty Reduction Strategy Document (DSCRP 2) – with the target of creating 900 000 jobs each year for the youth. Additionally, a steering group was created in 2011, in order to introduce a one-stop reform programme to simplify foreign trade operation, to stimulate growth, and to increase the rate of mobilisation of public revenues linked to foreign trade. The DR Congo joined the Common Market for Eastern and Southern Africa

(COMESA), and became a member of the COMESA's trade and development bank ZEP (preferential exchange zone) in December 1994.

The macro-economic policies implemented in recent times, coupled with the structural reforms advanced in the past, are believed to have had a positive impact on growth *via* resource allocation. Another source of optimism is the fact that the mining, energy, agriculture, and forestry sectors remain largely underexploited. A sustainable exploitation of these sectors should spur rapid growth of the economy of the DR Congo.

Malawi

Various growth strategies, policies and programmes have been implemented by the Malawian governments in the past. The Integrated Trade and Industry Policy was implemented in 1997, in order to galvanise growth in trade in six areas: i) to review and improve trade policy; ii) to provide a supportive trade infrastructure; iii) to expand export markets and diversify products; iv) to maintain and strengthen preferential non-reciprocal agreements; v) to negotiate new preferential agreements; and vi) the creation of competitive domestic markets.

Under the Integrated Trade and Industry Policy, the transport and telecommunication infrastructures were to be developed; and various export credit-financing mechanisms were revamped. Malawi entered into trade and growth agreements, such as African Growth Opportunity Act (AGOA) and Enterprise Bargaining Agreement (EBA) – with the aim of expanding its exports. As a member of Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC), Malawi has also negotiated with member countries, in order to trade and to do business with them.

As a step towards achieving economic emancipation, Malawi, like many other sub-Saharan African countries, entered into an agreement with the IMF as a Heavily Indebted Poor Country (HIPC). Under the HIPC initiative, Malawi agreed to undertake certain reforms, including cutting down on excessive government spending, and committing to transparent and accountable governance. Malawi reached the completion point of the HIPC initiative in 2006. Thus, the debts owed (estimated to be $646 million in net present value terms) to the IMF were cancelled; and a fund of $411 million was released to the Malawian government to support its budget (Kaluwa & Deraniyagala, 2011).

These benefits were estimated to have a long-term impact of reducing debt-servicing expenses to $5 million from 2006 to 2025, thereby increasing the average annual debt-servicing savings from $39 million to $110 million over this period (see Kaluwa & Deraniyagala, 2011). The action undertaken by the IMF had an immediate impact, as other donor institutions and countries reacted and cancelled Malawi's debts owed to them. Furthermore, Malawi signalled to prospective investors and donor institutions that it was committed to proper management of its economic affairs; the country's sovereign bond ratings quickly soured (Kaluwa & Deraniyagala, 2011).

Recently, Malawi received a one-year $77 million IMF Exogenous Shock Facility (ESF) to cushion the country against high world prices of crude oil and fertilizers (Malawi Government, 1998). The IMF cited the satisfactory review of Malawi's Poverty Reduction and Growth Facility (PRGF), as the reason for rewarding Malawi with such a facility (IMF, 2003). The full amount of the facility was not paid out; Malawi received $52 million out of the total $77 million because of the country's inability to meet its targets. In order to continue to improve economic performance, Malawi recently agreed to a new three-year medium-term macro-economic programme with the IMF in February 2010.

The key targets of the new programme include: a) restoring external equilibrium by liberalizing the foreign exchange regime for current account transactions, and by attaining foreign reserves to cover three months of imports; b) maintaining the country's internal equilibrium by prudent fiscal and monetary policies that contain aggregate demand and inflation; c) sustaining poverty-reduction by creating room in the budget for more pro-poor spending, and by creating safety nets to protect the poor from exogenous shocks; d) building competitiveness by encouraging public financial management, tax administration, and the efficiency of public enterprises (IMF, 2003).

Another significant growth initiative implemented by the Malawian government was the Malawi Growth and Development Strategy (MGDS). This strategy was a five-year growth strategy spanning the period of 2006—2011, which spelt out development priorities, proposed outcomes and budgetary allocations (Kaluwa & Deraniyagala, 2011). The ultimate goal of the MDGS was to transform the Malawian economy from a consuming and importing economy to a producing and exporting one.

The policy orientation was designed to attaining the medium-term development goals of sustainable growth and development in the infrastructure. The priority areas of the MDGS were agriculture and food security, irrigation and water development, transport infrastructure development, energy generation and supply, integrated rural development, and the prevention and management of nutritional disorders, HIV and AIDS; the areas were so chosen, with the aim of achieving the Millennium Development Goals (Kaluwa & Deraniyagala, 2011).

Mozambique

The growth story of Mozambique following independence was nothing to write home about under a strictly controlled system characterised by price distortion, misappropriation of funds, corruption, and persistent and irregular devaluation of the metical. A civil war broke out in the 1980s, leading to the severe loss of an active labour force, the destruction of the infrastructure, and the disarray of institutions, further adding a negative reverberating impact on the economy.

After the civil war was over, policy-makers in Mozambique began to gradually lay down programmes and strategies to arrest the economic deterioration. The main objective was to shift the economy from a controlled system to a market-based one. Supported by the IMF and the World Bank, the Economic Rehabilitation Programme (ERP) was launched in 1987. Under the ERP, Mozambique undertook reforms, such as the unification of the exchange rate, a reformation of import tariff structure, the liberalisation of external trade, the privatisation of various public enterprises, the elimination of price controls, financial sector reforms by partial privatisation and liberalisation of interest rates, and the establishment of an independent central bank (MacMillan *et al.*, 2003).

In addition to the ERP, the Structural Adjustment Programme (SAP) was also implemented to complement the economic-transformation process embedded in the ERP. The implementation of the SAP led to a transition from a socialist regime to a capitalist regime – culminating in a marked improvement in economic prospects, such as employment, a fall in inflation, stable exchange rates, and economic growth (MacMillan *et al.*, 2003). Later in 2001, the government introduced the Poverty Reduction Strategy (PRSP) known in Mozambique as Plano de Accao para a Reducao de Pobreza Absoluta, or PARPA), leading to further structural changes in subsequent years (MacMillan *et al.*, 2003).

The most recent growth initiative has been the Policy Support Instrument for Mozambique, a three-year programme designed by the government of Mozambique and supported by the IMF. The primary objectives of this instrument were to ensure economic stability, and the inflows of FDI, to speed up economic growth, to increase transparency and accountability, as well as to alleviate poverty. In a recent evaluation of the policy, the IMF claimed that the macro-economic performance of Mozambique remains strong, with a real GDP growth for 2013 of 7.1 per cent, and an inflation rate that remained moderate (IMF, 2014).

The IMF also claimed that the PSI-supported programme was on track, and that all assessment criteria were met; but some structural reforms could not be achieved (IMF, 2014). According to IMF officials, the macro-economic outlook of Mozambique remains favourable; and growth can be expected to be maintained in the medium term by way of a natural resource boom and infrastructural investment (IMF, 2014).

A programme to improve the performance of the agricultural sector, the National Agricultural Investment Plan (PNISA), is currently being implemented. The programme focuses on investment in hardware and technical assistance, and the expansion of cultivated areas. If successful, agriculture production could be expected to expand by 7 per cent in 2014. The Sena rail line has also been upgraded boosting the transport of coal. Following this rehabilitation, coal production reached 7.5 million tonnes/year (Mt/y) in 2013, 4.8 Mt/y more than 2012, barring heavy rains, which led to obstruction of the traffic (IMF, 2014).

The growth prospects of Mozambique could potentially be impeded by the deteriorating political situation. There have been increasing concerns over low-intensity confrontations between government and opposition. That aside, public financial management and economic governance have been on the decline in recent years, further casting doubt on the growth prospects of Mozambique. The Mozambican economy has been mostly capital-intensive, creating limited jobs; and, thus, it has had little impact on poverty-reduction (IMF, 2014).

4. Real Exchange Rate and Real GDP Movements (1970−2010)

It has been widely documented in the empirical literature that the real exchange rate misalignments have two different impacts on economic growth. The real exchange undervaluation tends to have a positive influence on economic growth; while the real exchange rate overvaluation tends to exert a negative impact on economic growth. We examine the various exchange regimes and their impact on economic growth between 1970 and 2010 in the country-based discussion that follows.

Congo DR

The fixed exchange regime from 1960 to 2000 adopted by the Congo DR was marked by mixed economic performance, as Figure 2 shows. The real GDP increased from 16475.88 million in 1970 to 20475.01 million in 1974. Real GDP then declined from 20475.01 million in 1974 to 16516.44 million in 1980. Following the monetary authority's decisions to devalue the exchange rate in 1982 and 1984, the real GDP responded, increasing from 16991.40 million in 1981 to 19671.34 million by 1988. From 1988 till 2001, the real GDP was on a free fall, declining by approximately 95.1 per cent.

In a desperate attempt to restore economic growth and to remove any distortions associated with the interim exchange regime, the Congo DR soon

abolished the pegged exchange in 2001. The interim pegged regime was replaced by a 'dirty' or managed-float regime. The real exchange rate depreciated substantially. The Real GDP responded to the new

exchange-rate policy, increasing from 10082.76 million in 2001 to 16644.71 million in 2010 (a percentage increment of approximately 39.42%).

Figure 2. Trends in Exchange Rate and Economic Growth in Congo DR (1970-2010)
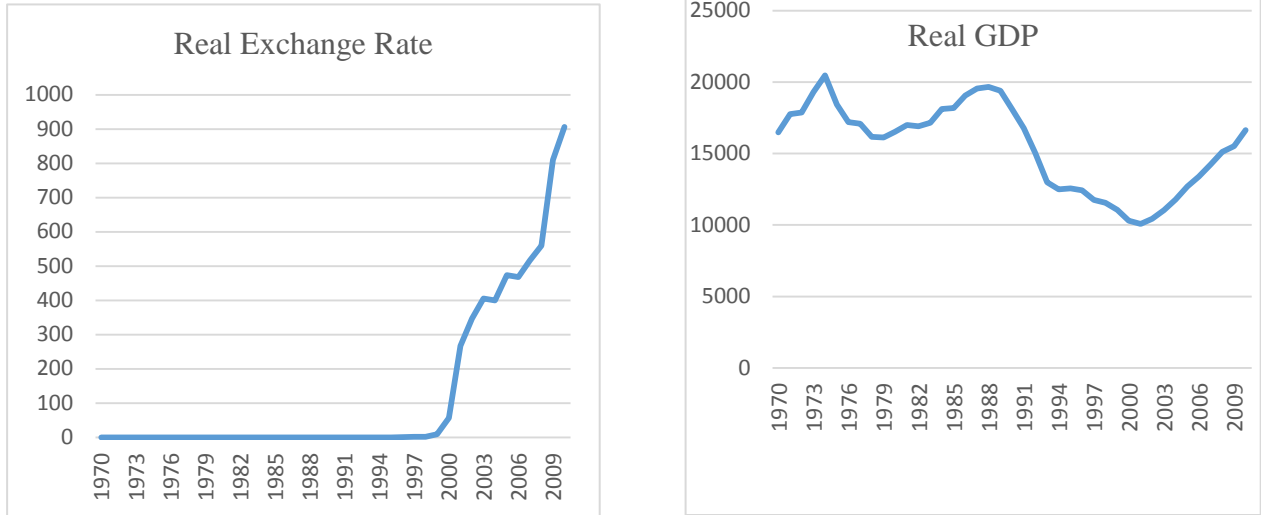
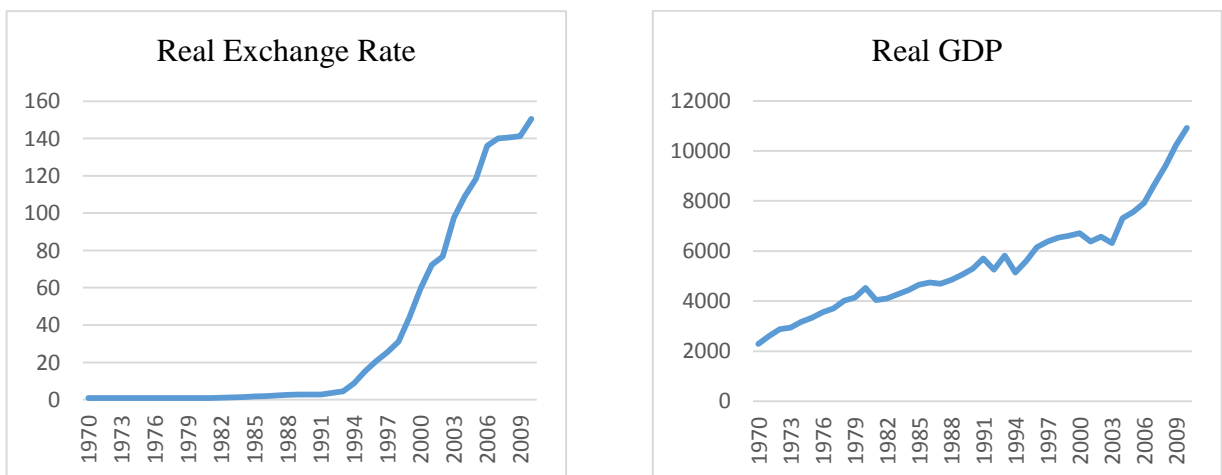*Source: Constructed from Feenstra et al. (2013)*

Malawi

From 1964 to 1986, Malawi maintained a fixed exchange regime (see Figure 3). Within this period, real gross domestic product rose from 2285.844 million in 1970 to 4532.894 million in 1980; and then it dipped suddenly to 4042.924 million in 1981. Even though the economy was said to have been repressed during this period, the growth in real gross domestic product was significant.

From 1987 to 1994, Malawi resorted to financial reforms; lending and deposit rates were partially

deregulated, easing pressures on exchange rates. The economy was partially stimulated – with real GDP rising from 4698.198 million in 1987 to 5817.511 million in 1993. The exchange rate was finally liberalised in February 1994, thereby allowing market forces to determine the rates. Real gross domestic product improved consequently from 5143.330 million in 1994 to 10917.499 million in 2010 (see Figure 3).

Figure 3. Trends in Exchange Rate and Economic Growth in Malawi (1970-2010)

Source: Constructed from Feenstra et al. (2013)

Mozambique

Mozambique has maintained a fixed exchange rate regime over a fairly long period of time, well before independence in 1975, and until 1993. The exchange rate was also devalued irregularly over this period. Real GDP was moderate over the period, with a relative increment from 3151.014 million in 1970 to a regime peak of 4496.182 million in 1982.

The controlled exchange regime was finally abolished in 1993, allowing for the market to determine the exchange rate, amid pressures from the decline in exports, the balance of payment problems, a decline in aid inflows, and the rapid development of parallel markets. Once the floating exchange regime was adopted, the economy responded. The real exchange rate began to reflect the economic fundamentals – leading to growth in exports, a decline in black market activities, increase in aid inflows, and increases in real gross domestic product from 4747.756 million in 1993 to 17455.298 million in 2010. In fact, the Mozambican real GDP has not dipped once under the flexible exchange rate regime, as Figure 4 shows.

Figure 4. Trends in Exchange Rate and Economic Growth in Mozambique (1970-2010)
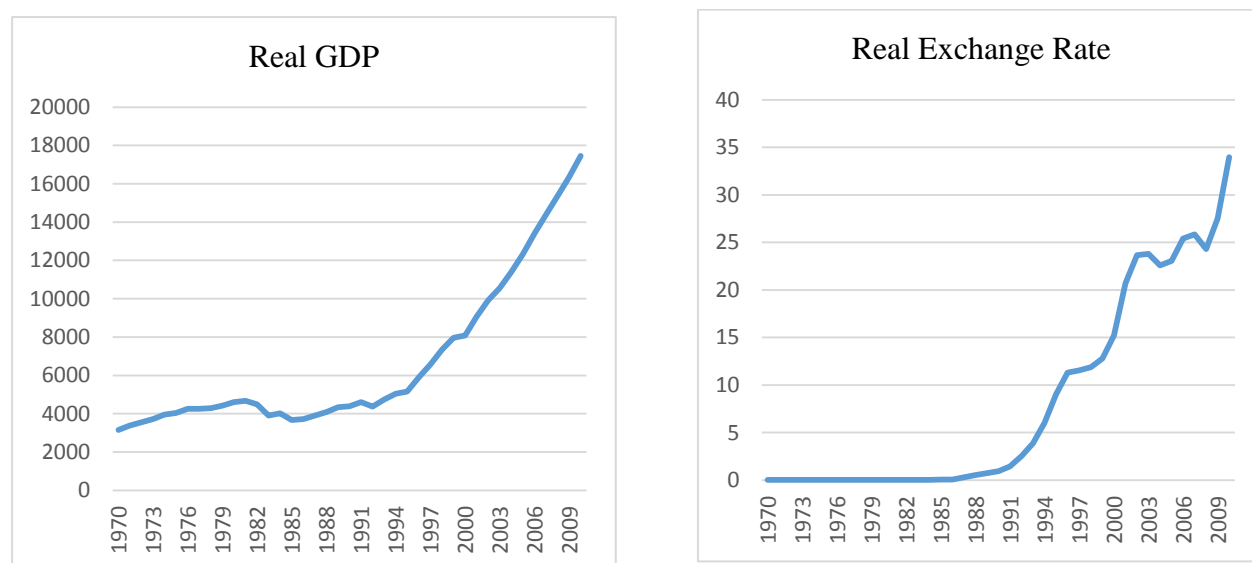
Source: Constructed from Feenstra et al. (2013)

5. Conclusions

The paper has provided an overview of the real exchange rate and the economic growth dynamics in three low-income Southern African countries, namely: the Democratic Republic of Congo, Malawi and Mozambique. The paper was motivated by the relatively scant nature of the literature on exchange rate and economic growth links in Southern Africa. The paper concentrated on these countries because they have mostly the same economic fundamentals. The paper identified common patterns of exchange rate regime adoption in these countries. For instance, these countries pursued a fixed exchange rate regime from the 1960s until the late 1980s, and into the early 1990s. Within that period, the countries undertook series of devaluation exercises, in order to keep their exchange rates aligned with those of the major currencies, such as the US dollar, and the British pound sterling. The fixed exchange rate regimes were usually characterised by, at best, slow increments in real GDP. The IMF/World Bank sponsored the economic recovery and structural adjustment programmes; the programmes paved the way for exchange-rate liberalisation later in the 1980s and early 1990s within these countries. As the exchange rates were liberalised, they rapidly moved upwards, increasing the real GDP concomitantly. One other conclusion is that, for those countries surveyed, the real exchange-rate undervaluation has been largely growth-enhancing. Finally, the common growth policies and strategies pursued by these countries were geared towards generating growth, alleviating poverty, and redistributing income. The experiences from these three countries show that policymakers should concentrate on liberalizing exchange rates rather than pegging them, since fixed exchange rate regimes are often featured by slow or stagnant growth.

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