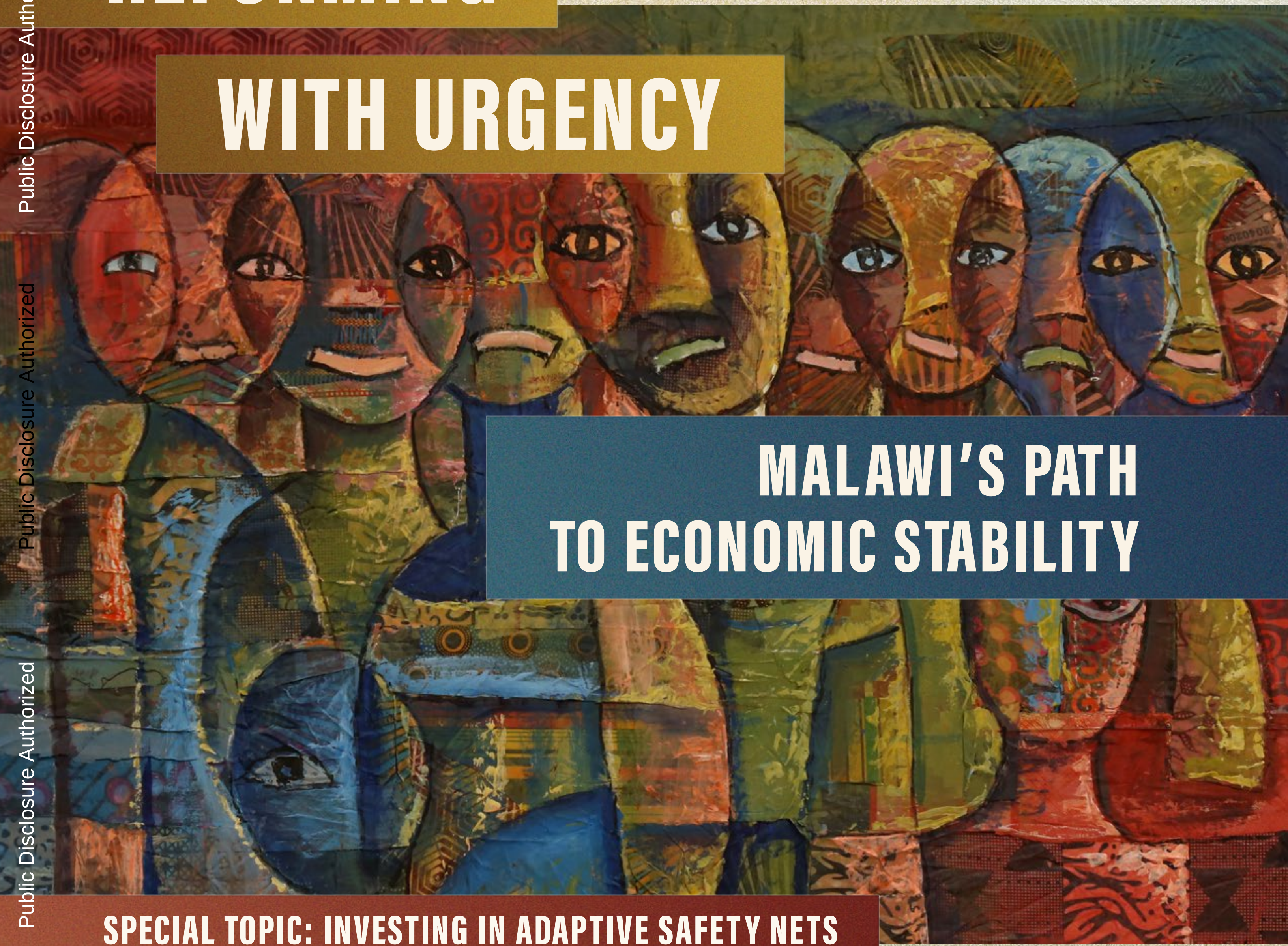
Malawi Economic Monitor

JULY 2024

REFORMING WITH URGENCY

MALAWI'S PATH TO ECONOMIC STABILITY



SPECIAL TOPIC: INVESTING IN ADAPTIVE SAFETY NETS

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ABBREVIATIONS

AIP	Affordable Inputs Programme
ARC	African Risk Capacity Group
CCT	Conditional Cash Transfer
CS-EPWP	Climate Smart Enhanced Public Works Program
CUCI	COVID-19 Urban Cash Initiative
DFS	Digital Financial Services
DODMA	Department of Disaster Management Affairs
EFT	Electronic Funds Transfer
EMDEs	Emerging Markets and Developing Economies
EU	European Union
FY	Fiscal Year
GDP	Gross Domestic Product
IMF	International Monetary Fund
MDTF	Multi-Donor Trust Fund
MEM	Malawi Economic Monitor
MITASS	Malawi Interbank Transfer and Settlement System
MITC	Malawi Investment and Trade Centre
MoFEA	Ministry of Finance and Economic Affairs
MPC	Monetary Policy Committee
MPO	Macro Poverty Outlook
MK	Malawian Kwacha
NCG	Net Credit to Government
NePG	National Electronic Payment Gateway
NLGFC	National Local Government Finance Committee
NPLs	Non-Performing Loans
NSO	National Statistics Office
PSIP	Public Sector Investment Programme
RBM	Reserve Bank of Malawi
ROA	Return on Assets
ROE	Return on Equity
SADC	Southern African Development Community
SCTP	Social Cash Transfer Program
SEZ	Special Economic Zone
SSRLP	Social Support for Resilient Livelihoods Project
UBR	Unified Beneficiary Registry
UCT	Unconditional Cash Transfer
UNICEF	United Nations International Children’s Emergency Fund
UNCTAD	United Nations Trade and Development
US$	United States Dollar
WEO	World Economic Outlook
WFP	World Food Programme

OVERVIEW

A drought and an incomplete reform agenda undermine prospects for a rapid economic recovery

Economic growth in Malawi fell short of expectations in 2023 and is projected to remain subdued in 2024. While implementation of planned macroeconomic and structural reforms is expected to boost Gross Domestic Product (GDP) growth over the medium term, an El Niño-induced drought has worsened the near-term growth outlook. The drought has compounded longstanding macroeconomic imbalances, with large fiscal deficits, balance-of-payments challenges, unsustainable debt, and price instability weighing on economic activity since 2020. As a result, the growth projection for 2024 has been revised downward to 2.0 percent. With average population growth at 2.6 percent, GDP is expected to decline in per capita terms.

A weak harvest has intensified food insecurity. The production of staple foods has fallen behind national needs, preventing a large share of households from accessing sufficient nutrition. Many households are expected to enter the 2024/25 lean season with limited food stocks, depleted finances, and precarious health conditions. The success of Malawi's El Niño response will hinge on timely action and the effective prioritization of interventions. Given the grain deficit in the country, limited food stocks in the region, and little recent progress in expanding irrigated maize production, increased grain imports are urgently needed.

A difficult business environment and the persistent underperformance of the Malawian economy compound the challenges facing households and the private sector. Many businesses must contend with foreign-exchange shortages and exchange-rate policy uncertainty, which discourages investment and results in slow job creation. As a result, the private sector is unable to generate sufficient high-quality jobs to sustainably improve the welfare of most Malawians.

Efforts to balance the external accounts have been slow and uneven, putting additional pressure on the exchange rate, driving foreign-exchange shortages and leading to further debt accumulation. The country's terms of trade, however, have improved and now exceed pre-pandemic levels, driven by moderating international fuel and fertilizer prices and continued demand for Malawi's key exports. Malawi's reliance on tobacco exports increased in 2023, and diversification remains elusive. Official exports of products other than tobacco fell by 4 percent as prices for macadamia nuts fell and groundnut export volumes declined. Mining, especially the production of materials necessary for the green energy transition, continues to hold great potential in the medium term, but large pipeline projects have yet to start production.

Despite interventions by the Reserve Bank of Malawi (RBM), foreign-exchange liquidity remains low, with the spread between the official and parallel exchange widening. Recent inflows from international financial institutions notwithstanding, official foreign-exchange reserves stand at less than one month of import coverage, significantly below the more than 3 months deemed adequate by the authorities. This situation highlights the scale of the country's external imbalances and the inadequacy of its buffers. Total reserves, including those held by authorized dealer banks, are approximately 2.5 months. While international fuel prices have fallen and domestic prices have increased, fuel imports continue to erode foreign-exchange reserves. In the context of an inflexible official exchange rate, declining reserves have resulted in foreign-exchange rationing. This policy reduces incentives for banks, exporters, and investors to convert their foreign-exchange holdings into Malawian kwacha (MK) and pushes some foreign exchange into the informal sector. Sustaining ongoing efforts by the RBM to significantly reduce sales of foreign exchange to the market will be critical to rebuild official reserves.

Fiscal deficits, supply-side factors following a weak harvest, and monetary policy risks are increasing inflationary pressures

After spiking in the wake of the November 2023 devaluation, inflation has remained consistently above 30 percent, and food-price inflation is particularly high. Inflation peaked at 35.0 percent in January before edging down to 31.8 percent in March, and again rising to 32.7 percent in May. Food prices have driven this trend, with rising prices for maize pushing food-price inflation to a high of 44.9 percent in January. The rapid growth of the money supply, fiscal indiscipline and limited supply following a weak harvest continue to intensify price pressures.

The fiscal deficit for FY2023/24 exceeded the approved and revised budgets, and the FY2024/25 budget again risks deviating from the planned fiscal consolidation path. After accounting for the statutory recapitalization of the RBM totaling 4.4 percent of GDP, the overall deficit reached 12.4 percent of GDP in FY2023/24. Malawi is on a path toward having one of the highest fiscal deficits relative to GDP in Sub-Saharan Africa in 2024. Moreover, the approved budget for FY2024/25 rests on optimistic revenue assumptions, and revenue underperformance may necessitate further borrowing, which could undermine monetary policy efforts.

As the domestic debt stock rises, interest payments have become the largest single expenditure item in the budget, crowding out productive investment and social spending. Debt service consumes 32 percent of revenue or 6.7 percent of GDP. Fiscal consolidation and a negotiated debt restructuring are vital to restore fiscal and external sustainability. While the government continues to pursue external debt restructuring, margins for error are becoming smaller, and the country's reliance on high-interest external debt has significantly worsened its debt profile. Delays in reaching agreements with external creditors and continued fiscal slippages could derail the needed fiscal adjustment. In this context, it will be critical for bilateral and commercial creditors to reach an agreement with the authorities that ensures Malawi's medium-term debt sustainability. The recently signed supplemental loan agreement to restructure US$ 206 million of outstanding debt to China is an important step in this direction.

Fiscal imbalances weaken the ability of monetary policy to mitigate inflationary pressures, though in recent months there have been improvements in bond markets sentiment. The RBM has raised the policy rate by 200 basis points to 26 percent and increased liquidity reserve requirements to contain second-round inflationary effects following the devaluation in November 2023. However, money growth remained elevated at 47 percent year-on-year in April, driven in part by RBM financing of the fiscal deficit. The limited impact of higher policy rates on monetary and external imbalances reflects the extent to which high fiscal deficits diminish the effectiveness of monetary policy. Recent data showing a decline in monetary financing and improved bond market sentiment may herald a gradual shift in these dynamics.

While Malawi's banking sector has maintained solid capital and liquidity positions, its main role as a financial intermediator for investment has weakened. Driven by a significant increase in domestic borrowing by the public sector, almost 80 percent of the banking system's total credit is towards financing the fiscal deficit. The resulting crowding out of private investment has negative long-term implications for growth and job creation.

A sustained recovery requires urgently implementing planned reforms

Addressing Malawi's difficult economic situation requires a combination of immediate emergency-response efforts and the implementation of structural reforms. While expected GDP growth for 2024 is higher than in 2022 and 2023, per capita GDP will likely experience its third consecutive contraction in 2024. Growth could improve if the winter cropping season boosts agricultural output beyond current expectations. Other potential upside risks include rapid progress on debt restructuring, the accelerated development of the mining sector, and an increase in grants to ease fiscal pressures.

However, downside risks continue to dominate the outlook. The impact of climate-related shocks during the current El Niño year could be larger than anticipated, while fiscal slippages, delays in debt restructuring, or the slow implementation of public financial management reforms could further increase macro-fiscal instability. The continued lack of foreign-exchange availability could result in shortages of critical imports, which would reduce economic activity.

The coming months will be critical to ensure that planned macroeconomic reforms are implemented and that the external and fiscal adjustment process remains on track. At the end of 2023, the government reached an agreement with the IMF on a four-year program under the Extended Credit Facility (ECF), and the resumption of budget support from the World Bank and African Development Bank will support important reforms designed to accelerate long-term growth. These achievements have bolstered confidence in the reform process, but success is far from assured. Rebalancing the economy and enabling faster, more inclusive growth, while strengthening resilience against shocks will require accelerating reform efforts.

The 19th edition of the Malawi Economic Monitor (MEM) outlines urgent policy measures required to stabilize the economy, protect vulnerable households, and enhance long-term growth (Table O.1). Its key recommendations focus on:

i) ***Restoring macroeconomic stability:*** Planned macro-fiscal reforms must be implemented and sustained to achieve fiscal consolidation, ensure the success of external debt restructuring, and contain the growth of domestic borrowing. Exchange-rate flexibility will be vital to support reserve accumulation, while controlling inflation will hinge on both addressing supply-side factors and limiting the growth of the money supply.

ii) ***Bolstering food security, building resilience and protecting the poor:*** Given the food deficit in the upcoming lean season, it will be essential to import maize to alleviate food insecurity while also advancing policy measures to build resilience, including the implementation of the Disaster Risk Management Act. As described in the Special Topic of this edition of the MEM, the existing social protection infrastructure must be effectively leveraged to provide targeted and adaptable support to poor and vulnerable households.

iii) ***Strengthening productive capacity and diversifying exports:*** With climate-induced natural disasters and extreme weather events likely to intensify, promoting sustainable farming practices and investing in irrigation systems will be essential to build resilience. Reforming the system of price controls will be necessary to alleviate distortions that discourage production and exports. Finally, given the government's limited resources, public investments must focus on the most productive development projects and must be built around a carefully considered cost-benefit analysis.

TABLE O.1 Priority policy areas and key actions

1. Restoring macroeconomic stability			
Adhere to fiscal targets	Meet ECF-supported fiscal targets by exerting greater control over public spending and ensuring revenue forecasts are supported by credible tax policy and administration measures.	Short	Strengthen
Moving toward debt sustainability	Accelerate restructuring negotiations with external creditors, while limiting domestic borrowing in line with targets	Medium	Sustain
Increase foreign-exchange reserves	Consistently implement exchange-rate reforms announced in the November 2023 RBM circular by enabling authorized dealer banks to set rates, increasing the frequency of auctions and reducing net sales to the market.	Short	Strengthen
Control inflation	Maintain a tight monetary stance and refrain from further monetary financing of the fiscal deficit.	Medium	Strengthen
2. Bolstering food security, building resilience, and protecting poor households			
Import maize	Use the limited funds available for disaster response to import maize and mitigate the risk of severe food insecurity.	Short	Initiate
Prepare for future disasters	Implement key policy measures to build resilience, including through a new Social Protection Policy and implementation of the Disaster Risk Management Act.	Medium	Strengthen
Leverage social protection systems	Use existing social protection infrastructure to deliver government services to poor and vulnerable households in a targeted and adaptable way.	Medium	Sustain
3. Increasing production and exports			
Make agriculture more resilient and adaptive	Draw lessons from the El Niño-induced drought to encourage more resilient farming practices and develop sustainable irrigation systems.	Medium	Strengthen
Focus public investment on the most productive projects	Prioritize investment projects that are shown to generate the highest economic returns and ensure that all PSIP projects are subject to rigorous screening.	Short	Strengthen
Reform price controls	Frequently update administrative prices to reflect market conditions (e.g. for fuel) and phase out those that have no market-determined component (e.g. for timber).	Short	Initiate

Initiate Strengthen Sustain

Investing in adaptive safety nets to protect poor households from shocks

Malawi is exceptionally vulnerable to climate change and other shocks, with the world's highest incidence of extreme dry events since 1980. Over the last five years, extreme weather events such as cyclones, floods, and droughts, combined with weather-related cholera outbreaks, have inflicted immense social and economic damage. These disasters have compounded the impact of the COVID-19 pandemic and prolonged macroeconomic instability, with significant negative effects on agricultural output, housing and living conditions, purchasing power, and food security. Even transitory shocks can significantly exacerbate rural poverty, as an estimated 40 percent of nonpoor rural households are highly vulnerable to poverty.

A lack of savings and other coping mechanisms increases the burden of climate-related shocks. For every three Malawians who escaped poverty between 2010 and 2019, four others fell into poverty due to weather-related shocks. Malawi's social protection system, the focus of this MEM's Special Topic, is the country's main policy framework for building long-term resilience to climate and weather-related shocks at the household level.

The social protection system has evolved dramatically over the last two decades. Beginning as a collection of fragmented, small, and exclusively donor-financed initiatives, the social protection system is now a coherent set of programs, some of which cover large sections of the population. The system is centrally coordinated, with programs implemented jointly by the central and local governments, and it is supported by a well-functioning and swiftly expanding digital infrastructure. While Malawi's social protection system has played a key role in shielding households from the impacts of recent shocks, further efforts will be needed to ensure that it can meet the challenges presented by rapid population growth and the intensifying effects of climate change.

In recent years, investments in improving the social protection system have highlighted its capacity to protect a larger share of households more effectively against a broader range of shocks. Beyond providing immediate relief to households in a crisis, Malawi's social protection system is becoming a key policy tool for building resilience among poor and vulnerable households and among the communities most affected by climate shocks. The main components of the country's increasingly sophisticated adaptive social protection system include: (i) comprehensive programs; (ii) innovative digital infrastructure and delivery mechanisms; and (iii) a cutting-edge policy and programmatic framework that allows for a rapid response to shocks.

Implemented under the umbrella of the Social Support for Resilient Livelihoods Project (SSRLP), and with the support of the recently established Malawi Social Protection Multi-Donor Trust Fund (MDTF), the social protection system's three core programs are:

1. The **Social Cash Transfer Program** (SCTP), *Mtukula Pakhomo,* which provides unconditional financial support to the most vulnerable and extremely poor households with the objective of lifting them out of poverty while building human capital at the household level.

2. The **Climate Smart Enhanced Public Works Program** (CS-EPWP), *Mbwezera Chilengedwe,* which provides income support and strengthens food security among the poorest households while creating durable, climate-resilient community-owned assets.

3. The **Livelihoods Support Program,** which promotes economic opportunities through a "cash plus" approach designed to enhance the skill level, nutritional profile, and financial inclusion of households eligible for safety-net programs. These core programs are supported by innovative digital infrastructure and delivery mechanisms, including:

- The **Unified Beneficiary Registry** (UBR), a rapidly expanding centralized digital platform that enables the targeting of poor and vulnerable households across different programs. The UBR currently includes demographic and socioeconomic information for 3.9 million households (about 16 million individuals or approximately 77 percent of the total population). As the UBR plays a central role in targeting social protection benefits, the government can monitor which programs and services benefit various households and identify redundancies across programs.

- **Digital payments,** the uptake of which has increased significantly over the last years. Over 440,000 households across 10 districts receive benefits or wages electronically. The use of digital payments is contributing to the efficient and timely delivery of benefits, reducing the delays, errors, and fraud typically associated with manual processes. Digital payments have enabled rapid transfers during emergencies, including the COVID-19 pandemic, as well as recent cyclones and droughts.

Over the last four years, the policy and programmatic framework has been adapted to make Malawi's social protection system more responsive and better able to support households in the face of climate shocks.

- **A comprehensive package of earmarked contingent resources augmented by parametric risk insurance coverage is available to quickly finance emergency programs.** By earmarking contingency funds to be used in response to shocks and by establishing a sovereign drought-related insurance policy triggered under predetermined conditions, Malawi in effect pre-emptively finances emergency programs.

- **The "Scalable Safety Nets" mechanism provides cash to vulnerable households following a drought.** Leveraging the UBR data, and building on the SSRLP's core programs, the government can quickly identify and provide support to beneficiary and non-beneficiary households that are affected by droughts.

By leveraging the programs, systems, and policy framework described above, Malawi was able to respond to recent shocks more effectively than many regional peers.

- **The first major shock-responsive cash transfer program was the COVID-19 Urban Cash Initiative (CUCI).** The program was also Malawi's first cash transfer targeting urban areas. Building on the targeting methodology and implementation arrangements of SCTP, the intervention used a mix of geographic and household-level characteristics to rapidly identify 199,000 households in Lilongwe, Blantyre, Zomba, and Mzuzu and extended cash support equivalent to the monthly minimum wage for three months.

- **In response to the 2019 floods caused by Cyclone Ida, SCTP scaled up its support by providing top-ups to 31,587 SCTP beneficiary households affected by the flooding in five districts.**

- **Shortly after Cyclone Freddy hit Malawi in March 2023, the government approved the Early Recovery and Food Insecurity Response.** By March 2024, close to 195,000 SCTP and CS-EPWP beneficiaries across nine districts had received MK 150,000 to support their recovery.

- **In March 2024, the government implemented the Urban Price Shock Emergency Response intervention to protect poor and vulnerable urban households from the impacts of the currency devaluation and rising inflation.** Building once again on the SCTP, the measure provided support to about 105,000 households in Blantyre, Lilongwe, Mzuzu, and Zomba.

Despite these achievements, institutional fragmentation remains a challenge. The creation of the MDTF marked a significant step toward improving donor coordination, but the social protection sector remains divided among several different line ministries tasked with various aspects of program implementation, which complicates coordination.

The policy framework is also incomplete. The National Social Protection Policy has yet to be approved, and there is no sustainable financing strategy for the sector. The budget for social protection remains low, with donors providing over 95 percent of its resources.[1] The country's severe macro-fiscal imbalances will continue to inhibit the allocation of additional domestic resources to the sector, at least in the near term. The policy uncertainty facing the sector, and the lack of a clear financing plan both for the system as a whole and for existing programs beyond a five-year horizon, makes it difficult to establish feasible long-term objectives, including goals for strengthening climate resilience.

1. This figure does not include the budget for the Affordable Inputs Program.

The MEM Special Topic highlights sweeping improvements in the performance of Malawi's social protection system, including cutting-edge innovations in climate adaptation and household-level support. Further reforms to the sector should emphasize sustainable financing and prioritize the progressive expansion of coverage and benefit levels. As climate risks continue to intensify, Malawi will increasingly face multiple successive and overlapping shocks. Greater investment in social protection, building on the strong foundations laid over the last two decades, will enable Malawi to respond swiftly and effectively to a more volatile global environment.

1

ECONOMIC DEVELOPMENTS

1.1

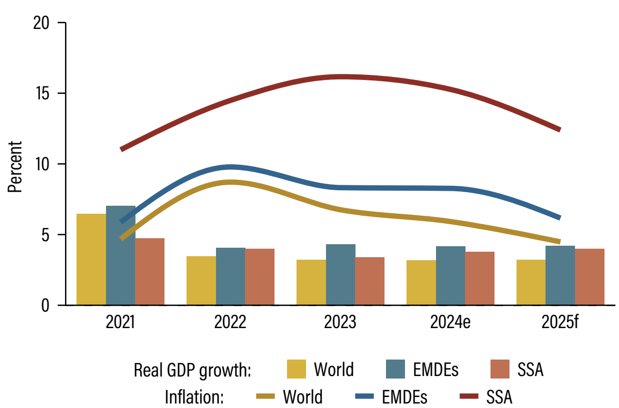
GLOBAL AND REGIONAL CONTEXT

Global growth conditions have remained steady despite challenges

Global growth has proven surprisingly robust, and inflation has begun to decline (Figure 1.1). To contain the post-pandemic surge in inflation, central banks across the world hiked interest rates (Figure 1.2). Tightening global financial conditions have raised concerns that more stable prices may come at the cost of economic output and could even precipitate a global recession. However, growth has remained robust in most major economies, especially those that implemented aggressive stimulus spending, while pandemic-era savings have helped shore up consumption. The timing of a prospective loosening cycle remains uncertain amid tight labor markets and expansionary fiscal policy in many advanced economies, and central banks remain vigilant against resurgent inflation.[2] The growth trajectories among high-income countries and emerging markets and developing economies (EMDES) continue to diverge.

FIGURE 1.1 Global growth has held up despite simultaneous monetary tightening, and inflation is declining

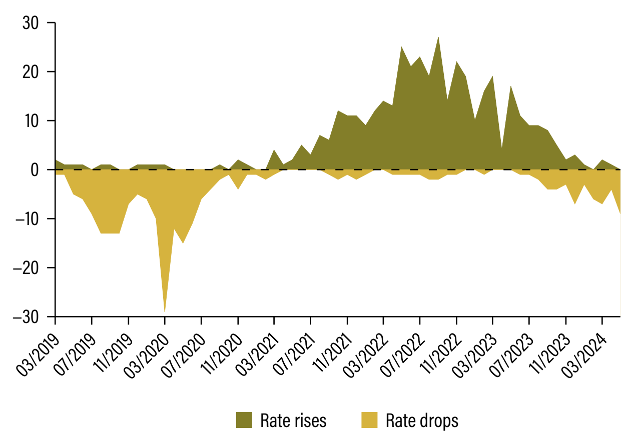
Real GDP growth and inflation



Source: IMF WEO 04/2024.
Note: e indicates estimate, f indicates forecast.

FIGURE 1.2 Interest rate cuts have recently started exceeding rate hikes

Number of central banks increasing and decreasing policy rates by month



Source: World Bank based on Bank for International Settlement data.

The effects of El Niño on global grain yields have resulted in abundant harvests in some countries and severe droughts in others, heightening the risk of food insecurity in Malawi and across the Southern African region. El Niño is a climate phenomenon characterized by the periodic warming of surface temperatures in the central and eastern Pacific Ocean, which significantly impacts global weather patterns

2. Some countries that raised rates aggressively in 2021 have already begun loosening their monetary stance as inflation has slowed, including Brazil, Colombia, Hungary, among others.

and economic activity. While the El Niño phenomenon is associated with drier weather in Southern Africa, Central America, and East Asia, it tends to boost rainfall and thus crop yields among some of the most productive cereal producers in North America, Eastern Europe, Central Asia, and East Africa. However, redistributing surplus harvests to those in deficit regions poses a challenge. The number of people worldwide in need of food assistance has increased due to conflicts, and the resources available to relief agencies like the World Food Programme (WFP) are stretched thin. In 2023, WFP reported a funding gap of 60 percent against its operational requirements (WFP 2023).

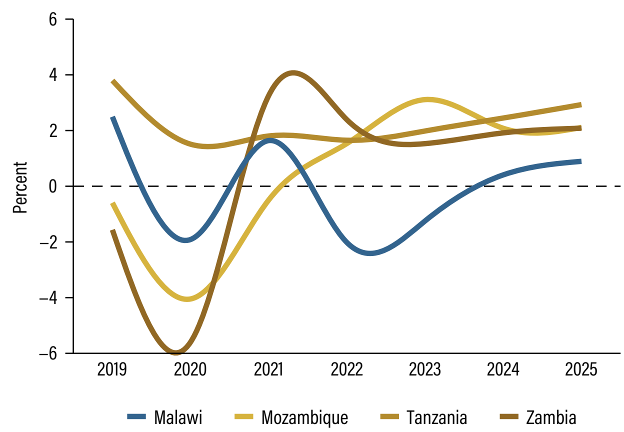
While GDP growth in Sub-Saharan Africa in 2023 was consistent with global trends, rapid population growth continued to undercut gains in per capita income. Sub-Saharan Africa is the only region where fertility rates remain substantially above replacement levels. An average population growth rate of 2.6 percent reduced real per capita GDP growth to just 0.8 percent in 2023, the lowest rate of any region. Moreover, a significant share of growth is concentrated in just a few economies, with Nigeria alone accounting for more than one-fifth of the region's GDP growth.

Due to high levels of inequality, economic growth has had a weaker impact on poverty in Sub-Saharan Africa than in other regions. In Sub-Saharan Africa, a 1 percent increase in per capita GDP is associated with a 1 percent decrease in poverty, compared to a 2.5 percent decrease in the rest of the world (World Bank 2024). The link between growth and poverty reduction is especially tenuous in southern Africa, which includes seven of the world's ten most unequal countries.[3] Low tax revenues, regressive tax structures, poorly targeted subsidies, and limited social assistance programs all perpetuate inequality.

Malawi is set to have the weakest macroeconomic fundamentals and experience the smallest improvement in living standards among its neighbors for the foreseeable future. In Zambia, the government continues to stabilize the economy through fiscal consolidation and debt restructuring. Mozambique's economy is growing steadily, driven by a booming mining sector, while the adoption of a single civil service salary scale has contributed to an ongoing fiscal adjustment. Tanzania continues to have strong macroeconomic fundamentals, though a shortage of foreign exchange prompted a 10 percent depreciation of the shilling against the US dollar between January and April 2024. Malawi, by contrast, continues to have the weakest macroeconomic fundamentals among these countries, with only modest and inconsistent efforts at reform (Figure 1.3). In 2023, it had the highest inflation rate among its neighbors, the highest fiscal deficit, the second highest debt-to-GDP ratio, the second widest current-account deficit, and the lowest real per capita growth rate.

FIGURE 1.3 Malawi's economy continues to lag the performance of its neighbors'

Real per capita GDP growth in Malawi and among its neighbors



Source: World Bank Macro Poverty Outlook (MPO) (4/2024).

3. Inequality is measured by the Gini coefficient inequality index.

1.2

RECENT ECONOMIC DEVELOPMENTS

Economic growth failed to meet expectations in 2023 and will likely remain subdued in 2024

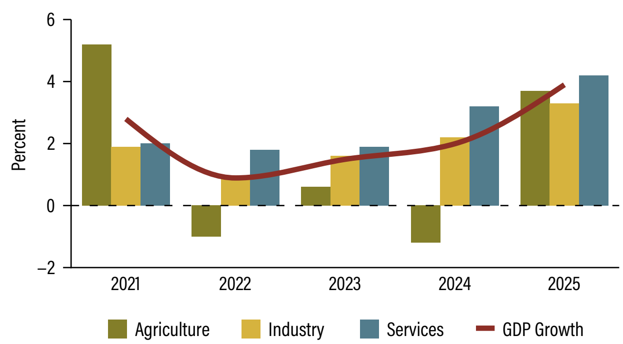
In 2023, economic growth failed to keep pace with population growth, resulting in a decline in per capita GDP. Compounding its longstanding development challenges, Malawi entered a comprehensive macroeconomic crisis in 2020 (World Bank 2023a). Wide fiscal and current-account deficits, unsustainable debt dynamics, and price instability all have contributed to weak growth. The resumption of electricity production at the Kapichira hydroelectric plant realigned national supply with current demand levels and contributed to a slight acceleration in economic growth, which rose from 0.9 percent in 2022 to 1.5 percent in 2023 (Figure 1.4). However, lack of productive inputs and the impact of Tropical Cyclone Freddy in 2023 continue to constrain a broad-based recovery.

While macroeconomic reforms have increased the medium-term potential growth rate, a prolonged dry spell is already affecting agricultural output and will likely constrain growth in 2024. In addition to continued macro-fiscal challenges, spillovers from the contraction in the agriculture sector reduce the availability of inputs in industrial subsectors. Output growth in services is expected to be broadly in line with population growth and will make only a modest contribution to economic activity. In per capita terms, GDP growth is expected to contract for a third consecutive year.

El Niño-induced droughts led to weak harvests in many parts of the country (Figure 1.5). As was expected prior to the farming season (World Bank 2023b), drought conditions and crop losses were especially severe in the southern and eastern parts of the country. Second-round production estimates, which are typically close to final estimates, show a 16.6 percent reduction in maize harvests compared to 2022/23. With an expected maize harvest of 2.9 million metric tons, this represents a shortfall relative to the national requirements of approximately 3.5 million metric tons. There are also likely to be a lower millet and sorghum harvest, a 12.1 percent reduction in groundnuts, and a 24 percent reduction in soybean production. Rice (+11.6 percent) and cassava (-3.8 percent) are the only important staples not to experience double-digit crop losses, as

FIGURE 1.4 Growth for 2024 is expected to increase relative to previous years but is still expected to be lower than anticipated due to the impacts of the drought on agriculture GDP

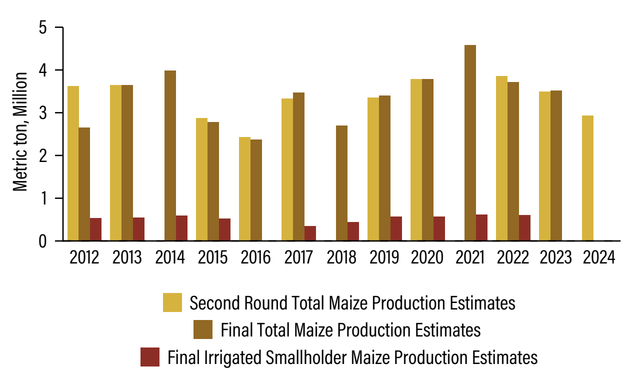
Real GDP growth in Malawi across sectors and across forecast publication dates



Source: World Bank MPO (April 2024 or indicated publication date).

FIGURE 1.5 Malawi has experienced its third consecutive decline in annual maize production in 2023

National official maize production estimates by round and irrigation status



Source: Ministry of Agriculture.

they are less vulnerable to drought, and their production is concentrated in northern Malawi. In this context, reducing the government budget for input subsidies provided through the Affordable Inputs Programme (AIP) from an estimated MK 151 billion in FY23 to MK 103 billion in FY24 was a prudent fiscal choice, as drought conditions make it more difficult to convert subsidized fertilizer into increased yields (Box 1.1). Crop losses are a major channel through which climate change affects the Malawian economy (World Bank 2022a). However, unless additional resources are devoted to strengthening climate resilience, climate change could reduce Malawi's economic output by as much as 20 percent by 2040.

BOX 1.1 Further AIP reforms can strengthen climate resilience

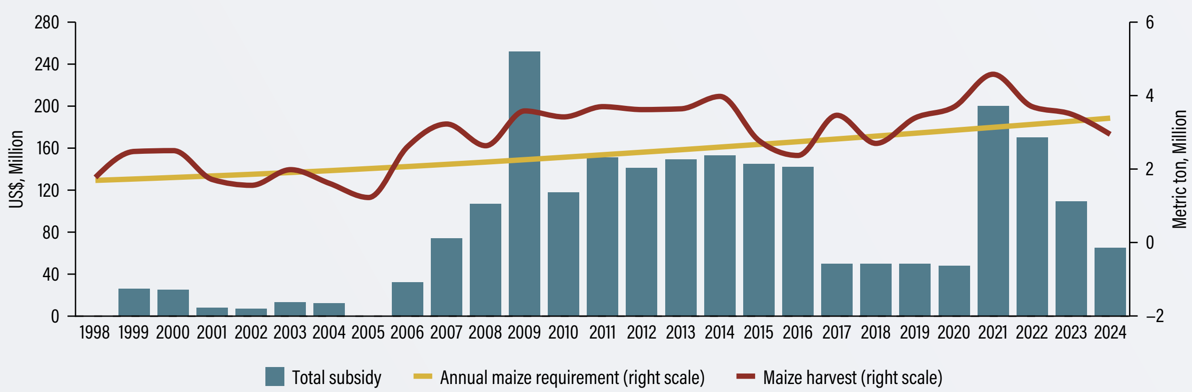
Achieving sustained agricultural growth and rural transformation in Malawi will require systemic reforms to current agricultural support programs to increase the efficiency and effectiveness of public spending, improve productivity, encourage diversification, and promote sustainable, climate-resilient production practices. Malawi's AIP, which subsidizes maize seed, fertilizer, and other agricultural inputs, has come at a high fiscal cost while doing little to enhance food security, climate resilience, or productivity. Instead, the program has trapped many rural households in poverty by perpetuating a maize-based agricultural system and discouraging responsible land management. An estimated 16 percent of the agricultural households currently targeted by AIP are not economically productive and sell subsidized fertilizer for cash to meet their basic needs.

The AIP consumes about 40 percent of the agricultural sector's limited budget, reducing the scope for productive investments in irrigation, research, extension services, skills development, and soil and water conservation. The program also consumes a large share of available foreign exchange. Like previous agricultural subsidy policies, the AIP has largely failed to stimulate the agricultural transformation necessary to accelerate economic growth and job creation, and public spending on the program is only weakly correlated with total maize production, due both to sup-optimal targeting and the greater significance of other factors, like weather.

Recognizing these deficiencies, the government has launched an effort to reform the AIP to reduce costs and improve targeting. The government is evaluating the effectiveness and efficiency of its agricultural policies and expenditures to strengthen climate resilience, productivity, and commercialization. Through a pilot program undertaken as part of the Malawi Food Systems Resilience Program, the World Bank is supporting the design, implementation, and assessment of alternative input-subsidy schemes designed to generate greater value for money while accelerating the transition towards sustainable food systems. Particular attention is being devoted to improving beneficiary targeting and promoting private-sector engagement in input procurement and distribution. The new interventions will leverage alternate means of supporting food security with a focus on agricultural commercialization and climate resilience, improving the impact of AIP funds going forward. Support will also be provided to enhance the institutional capacity of the Policy and Planning Department of the Ministry of Agriculture to identify, track, and evaluate public expenditures, determine whether public policies are aligned with strategic development objectives, and recommend and implement appropriate reforms.

FIGURE B1.1.1 Increased spending on fertilizer subsidies does not necessarily lead to increased maize production

Subsidy spending and maize production



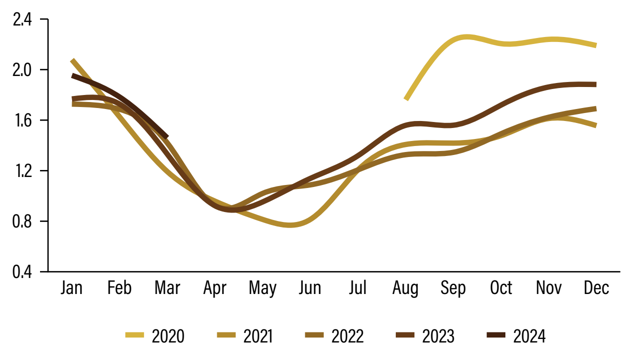
Source: World Bank 2023b.

The success of Malawi's El Niño response hinges on timely action and effective prioritization. Following the declaration of a state of emergency by President Lazarus Chakwera, the Department of Disaster Management Affairs (DODMA) published an appeal for US$447 million in emergency support. While the government was able to mobilize US$265 million in response to the last El Niño-related drought in 2016/17 (Duchoslav et al. 2024), at the time the government's finances were more solvent and international assistance was more forthcoming. The US$57.6 million grant provided by the World Bank in April 2024, which the government can use immediately and with significant flexibility, may ultimately constitute a large share of external funds available for the current response. To minimize suffering and prevent the loss of human capital, DODMA will need to prioritize its response activities carefully to address the food-security crisis. Given the acute lack of grain in the country and the limited success of increasing irrigated maize production in recent years, grain imports are urgently needed, and given the limited stocks available in the region, most will likely be sourced from overseas. Distributing grain nationwide before the onset of the 2024/25 lean season while preempting shortages in neighboring markets due to the regional nature of the drought requires rapid procurement.

Food insecurity in Malawi is highly seasonal and typically peaks in January (Figure 1.6). Indicators of the prevalence and severity of food insecurity were already higher towards the end of 2023 than in either 2022 or 2021. Data from the first quarter of 2024 show a troubling increase in food insecurity, which reached its highest level in three years. The new assessment of the Malawi Vulnerability Assessment Committee estimates that the number of food-insecure Malawians will increase to 5.7 million in the coming lean season, compared to 4.4 million in 2023/24. The production of staple foods has likely fallen behind national needs, and broader economic challenges have prevented many families from sourcing sufficient and nutritious food. As a result, many families will go into the 2024/25 lean season facing precarious food, financial, and health conditions. Households also remain exceptionally reliant on food markets rather than their own production (World Bank 2023b).

FIGURE 1.6 Food insecurity is already worse than in previous years

Mean Household Hunger Scale



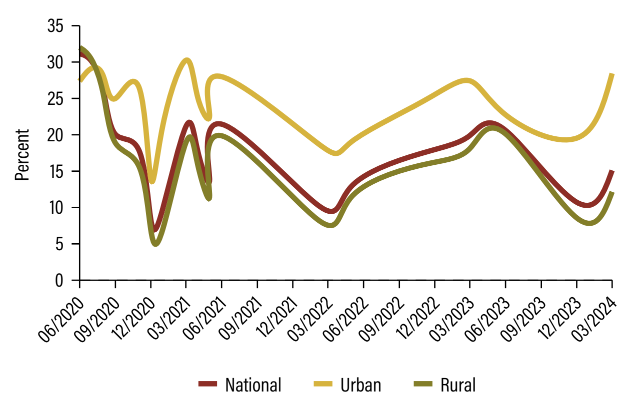
Source: World Bank based on Rapid Feedback Monitoring System 2024.

Note: The Household Hunger Scale is an internationally validated survey with scores ranging from 0 (no hunger in the household) to 6 (high severe hunger) and a score above 2 indicating at least moderate hunger. It is based on six questions related to food consumption and food security. These estimations are based on the Rapid Frequent Monitoring System. The system collects monthly household-level data to provide real-time tracking of food security, coping strategies, and shocks experienced over time, which are linked to household characteristics associated with resilience. The system now surveys approximately 5,500 households, mainly in the country's southern region. Estimations are based on this sample, which is representative for rural Zomba, rural Mangochi, Chiradzulu, Phalombe, Chikwawa, and Balaka throughout the survey period beginning in 2020. Thyolo, Nsanje, Machinga, and Mulanje are represented from July 2021. The urban districts of Blantyre and Zomba and the northern district of Karonga have also been added to the survey but are omitted from the estimation to ensure comparability across time.

The share of economically inactive Malawians in urban areas has increased considerably over time. In the nationally representative High Frequency Phone Survey conducted in March 2024, 3 out of 10 respondents from urban areas stated that they had not worked during the past week (Figure 1.7). This is a higher percentage than was observed in May 2023 and is almost the same level observed in February 2021, one year after the outbreak of COVID-19. Furthermore, the share of people in urban areas who are not working is double the share in rural areas, and the gap between rural and urban areas has widened over the past year. According to World Bank estimates, the poverty rate measured at the international poverty line is expected to increase to 71.9 percent in 2024.[4]

FIGURE 1.7 The share of economically inactive people has increased in 2024, especially in urban areas

Share of respondents who reported not working in the past week



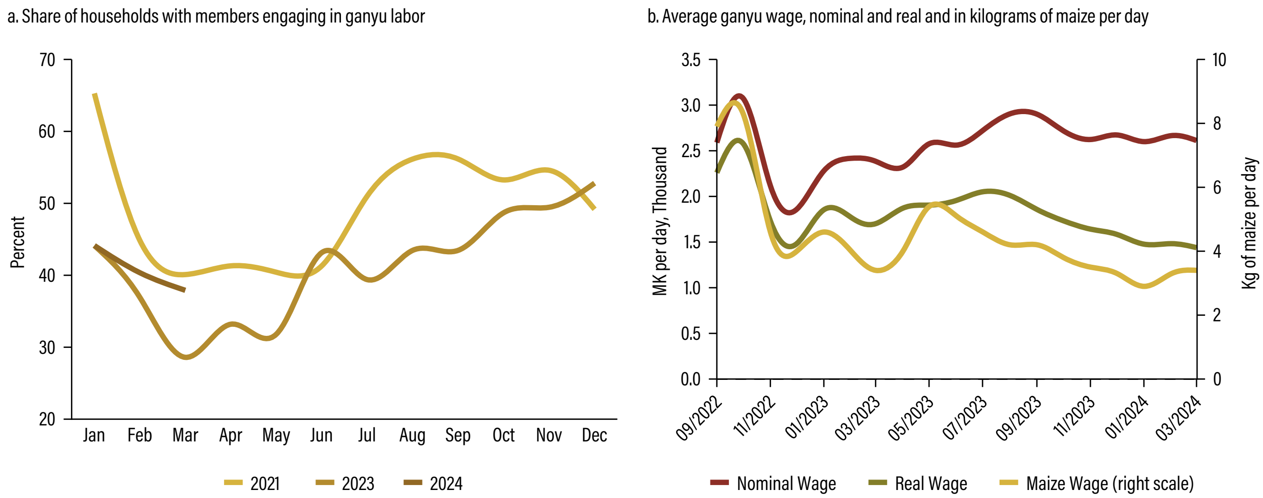
Source: World Bank based on High-Frequency Phone Survey 2024.

The share of Malawians engaging in low-paid temporary labor, known as "ganyu," increased during 2023, but real wages deteriorated. *Ganyu,* one of the main sources of income among poor households (World Bank 2022b), was less available in the early months of 2023 than it had been two years prior. However, the share of Malawian households engaging in *ganyu* surpassed 2021 levels in the final month of 2023 at 42 percent. The share of households participating in *ganyu* rose

4. The international poverty line is US$2.15 in 2017 purchasing-power-parity terms or MK 656 at 2019/20 prices.

from just under 20 percent in March 2023 to almost 30 percent in March 2024 (Figure 1.8). Nominal wages trended upward in 2023 and remained high in 2024, but rising prices caused real wages to decline. In March 2024, the average wage was MK 2,612 per day, just enough to buy 3.4 kilograms of maize at the average national price.

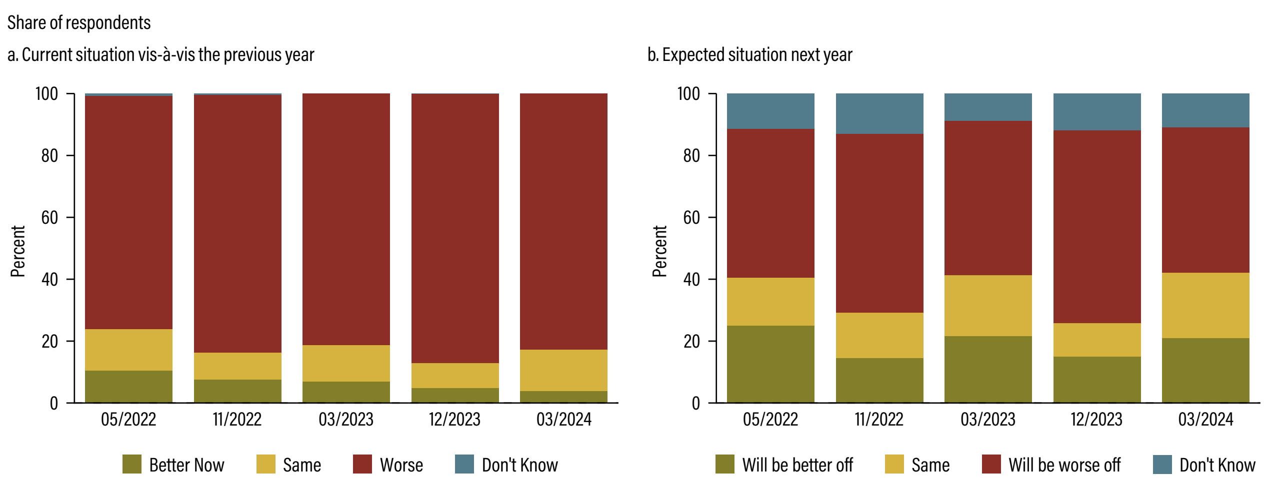
FIGURE 1.8 Despite declining wages, rural southern Malawians are becoming more likely to engage in temporary labor



Sources: World Bank calculations based on Rapid Feedback Monitoring System 2024, Reserve Bank of Malawi 2023, and IFPRI 2023.

Household welfare has deteriorated over the last two years, and survey respondents are increasingly pessimistic about their future wellbeing. In May 2022, respondents from about 7 in 10 households perceived their economic situation as being worse than in the previous year. Two years later, in March 2024, the share had increased to 8 in 10 (Figure 1.9). Most Malawians are pessimistic about their future, with 7 in 10 households expecting their situation to remain the same or to worsen further.

FIGURE 1.9 Most Malawians believe that their current situation is worse than it was a year ago, while 68 percent think that their future will be the same or even worse



Source: World Bank based on High Frequency Phone Survey 2024.

Many households face challenges rooted in Malawi's difficult business climate, which is not sufficiently conducive to investment and entrepreneurship. As a result, the private sector is unable to produce enough high-quality jobs to sustainably improve household welfare. In the short term, many businesses must contend with rising financing costs and increased prices for key inputs, including electricity,[5] water, and fuel—all of which have been negatively influenced by the deteriorating exchange rate and the declining availability of foreign exchange. In a difficult macroeconomic environment, many businesses are pessimistic about their growth prospects. The spread of digital payment systems has facilitated transaction flows, but this is one of relatively few recent innovations to have significantly improved the business climate (Box 1.2).

BOX 1.2 New national electronics payment gateway will support e-commerce transactions, social cash transfers, and revenue collection

Digital transaction flows in Malawi have increased, with customers increasingly turning to convenient and flexible digital payment channels such as mobile banking and mobile money. Digital payment channels have become more popular with customers since December 2022, when Malawi launched an instant Electronic Funds Transfer (EFT) feature to enable real-time processing of digital transactions. Although the volume of transactions in Malawi's Interbank Transfer and Settlement System (MITASS) fell by 7.7 percent between 2022 and 2023, the total value of transactions increased by 84.5 percent. Activity in all three interbank transfer and settlement channels—checks, large-value transactions, and EFT payments—declined in volume but increased in value. Similarly, the volume of cash withdrawals is slowing, due in part to a reduction in the number of ATM transactions. MITASS flows account for less than 5 percent of total transaction volumes, while digital financial services (DFS) transactions make up over 95 percent. The volume of retail DFS transactions increased by 31.2 percent in 2022 and by 51.8 percent in 2023. Point-of-sale transactions, internet banking, and mobile-money services contributed the most to the overall growth of DFS transactions, increasing by 67.9 percent, 31.8 percent, and 31.0 percent, respectively. Mobile money remains the most popular and widely used service, accounting for the majority of all transactions in 2023.

To facilitate the continued uptake of digital financial services, the government is establishing a national electronic payment gateway (NePG) with support from the World Bank. With robust security features such as encryption and fraud-prevention mechanisms, the payment gateway will make online transactions seamless, secure, and convenient, eliminating the need for cash transactions that are more vulnerable to theft and fraud. Various payment methods will be supported, including credit cards, mobile money, and digital wallets, with QR codes making the gateway accessible to a wide clientele. The gateway will support e-commerce transactions, social cash transfers, and the collection of tax and non-tax revenue:

- *E-commerce:* The gateway will facilitate person-to-person, person-to-business, and business-to-business transactions, enabling individuals and firms to do business safely and conveniently online. Businesses will have access to new markets, customers, and sources of liquidity, as well as the capacity to track sales and customer interactions more efficiently.
- *Social cash transfers:* Financial institutions and social assistance programs will be able to securely share payment data through the gateway, enhancing the efficiency of their operations by improving targeting and reducing administrative costs. Increased accountability and oversight will also help reduce fraud, as all beneficiaries will be required to show proof of identity.
- *Government revenue:* Using the gateway, citizens will be able to make tax and non-tax payments and receive funds securely and reliably, without the need for paper forms and manual calculations. The government will have real-time access to payment data, allowing it to better monitor cash flows, detect fraud, and identify discrepancies in payments. As well as providing a secure platform for tax payments, the gateway will reduce opportunities for fraud and corruption among institutions that collect non-tax revenue.

Source: RBM 2023.

The government has identified three priority sectors—agriculture, tourism, and mining. While agriculture is set to contract in 2024, tourism has performed well, with a 23 percent increase in air-passenger arrivals in the 12 months to March 2024. However, Malawi still received 8.0 percent fewer air passengers between April 2023 and March 2024 than it did in the immediate pre-COVID period (April 2019–March 2020). Among Southern African Development Community (SADC) members with available data, the tourism sectors in only three countries (Namibia, Zimbabwe, and Botswana) achieved positive growth in the same period, and only three countries (Tanzania, Mozambique, and Madagascar) experienced a larger contraction than Malawi relative to the pre-COVID period. Mining holds considerable medium-term potential (World Bank 2023b), but the largest projects in the pipeline have yet to start production, though progress is being made in finalizing negotiations.

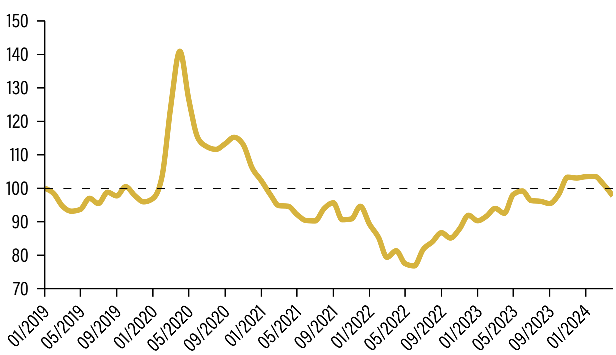
5. An equivalent 51 percent increase for private customers was initially suspended until April 2024, but as of June 2024, the adjustment had not occurred.

Foreign-exchange inflows continue to fall short of demand

Malawi's efforts to shore up the balance of payments have been modest and uneven. With international fuel and fertilizer prices stabilizing and demand for Malawi's key exports remaining strong, the country's terms of trade have improved and now exceed pre-pandemic levels (Figure 1.10). Nevertheless, financing imports has required the continued sale of foreign exchange, mainly from project loans and grants from external partners. As a result, imports declined by just 2 percent year-on-year during the 12 months ending in March 2024 (Figure 1.11). Imports contracted further in the four months following the depreciation of the kwacha, decreasing by 11 percent year-on-year (Figure 1.12). This trend was driven by a sharp decline in imports of medical and pharmaceutical supplies (-US$41 million) and fertilizer (-US$31 million), which had been procured earlier in the year. Consumer-goods imports have declined more modestly, due largely to a drop in price rather than volume. Key consumer goods include plastics, paper, printed products, and textiles (-US$21 million in value, +14 percent in tonnage), fuel (-US$10 million in value, +9 percent in liters), and vehicles (-US$6 million in value, +5 percent in units).

FIGURE 1.10 Malawi's terms of trade have improved...

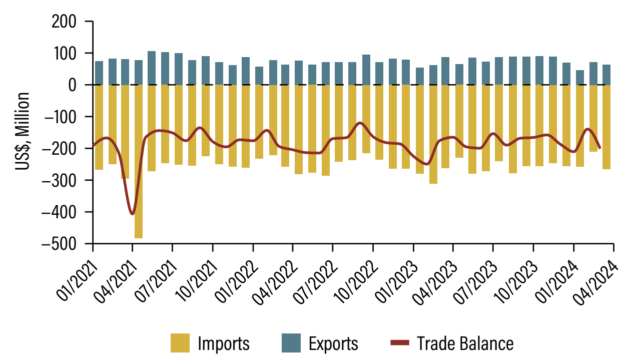
Commodity terms-of-trade index (January 2019 =100)



Source: IMF Commodity Terms of Trade.

FIGURE 1.11 ...but imports continue to exceed exports

Malawi's monthly exports, imports and trade balance (seasonally adjusted)

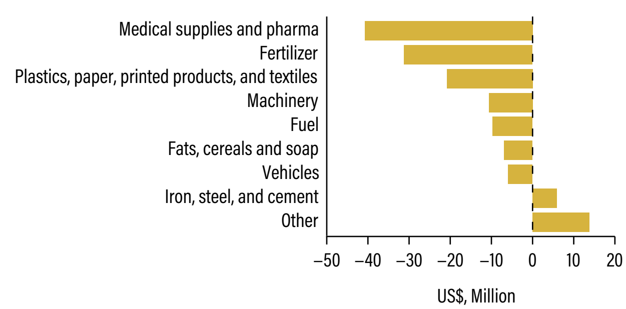


Source: World Bank based on NSO and RBM data.

The past 12 months have been a strong year for the tobacco sector by recent standards, though Malawi's continued reliance on tobacco exports results in volatility of export proceeds. Over the past decade, tobacco exports have brought in approximately US$458 million per year and contributed 46 percent to official merchandise exports. After falling to US$343 million in the 12 months to March 2023, the nominal value of tobacco exports rebounded to historical averages in the 12 months to March 2024, reaching US$428 million. Larger export volumes and rising prices both contributed to the recovery. However, export concentration remains a challenge as fluctuations in global demand or prices result in significant volatility. Official non-tobacco exports decreased by 4 percent, as prices for macadamia nuts fell along with groundnut export volumes, and rising exports of pulses and sugar were unable to compensate. Tobacco has continued to constitute 45 percent of merchandise exports in the past 12 months, unchanged from historical averages. Between 2013 and 2023, Malawi's population grew by 28 percent, while imports rose by 12 percent, underscoring the long-term pressure on the balance of payments.

FIGURE 1.12 Since the devaluation of the kwacha in November 2023, most imports have declined in value terms

12/2023 – 03/2024 year-on-year change in merchandise imports by product category

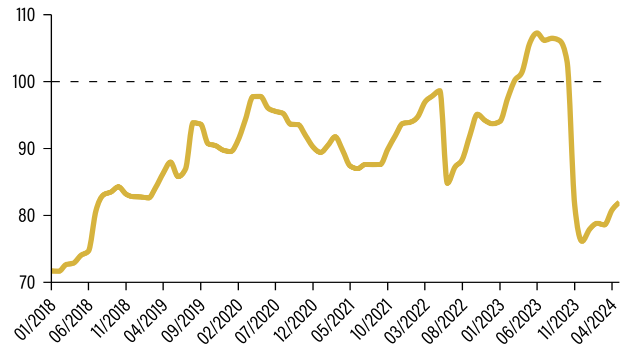


Source: World Bank based on NSO data.

Malawi's real exchange rate has appreciated since the start of 2024, but foreign-exchange liquidity has remained low. After the rapid depreciation that followed the devaluation of the kwacha in November 2023, the real exchange rate appreciated again since the start of 2024 (Figure 1.13). Inflation in excess of 30 percent, coupled with a stable official exchange rate, has made it challenging to increase the supply of foreign exchange. Banks, exporters, and investors continue to be reluctant to convert their foreign-exchange holdings into kwacha. There are many factors that could explain this, including on the supply side (uncertainty about being able to access foreign exchange holdings when needed) as well as the higher rates offered in informal parallel markets. As a result, foreign-exchange liquidity among Malawian banks has been stagnant in recent months and foreign-exchange sales to authorized dealer banks by the RBM since early 2023 have been unable to satisfy demand (Figure 1.14). Cumulatively, the RBM has sold an additional US$1.1 billion to banks in the past five years (Figure 1.15). Sustaining ongoing efforts by the RBM to significantly reduce sales of foreign exchange to the market will be critical to rebuild official reserves.

FIGURE 1.13 After a substantial depreciation in November, Malawi's real exchange rate is appreciating again

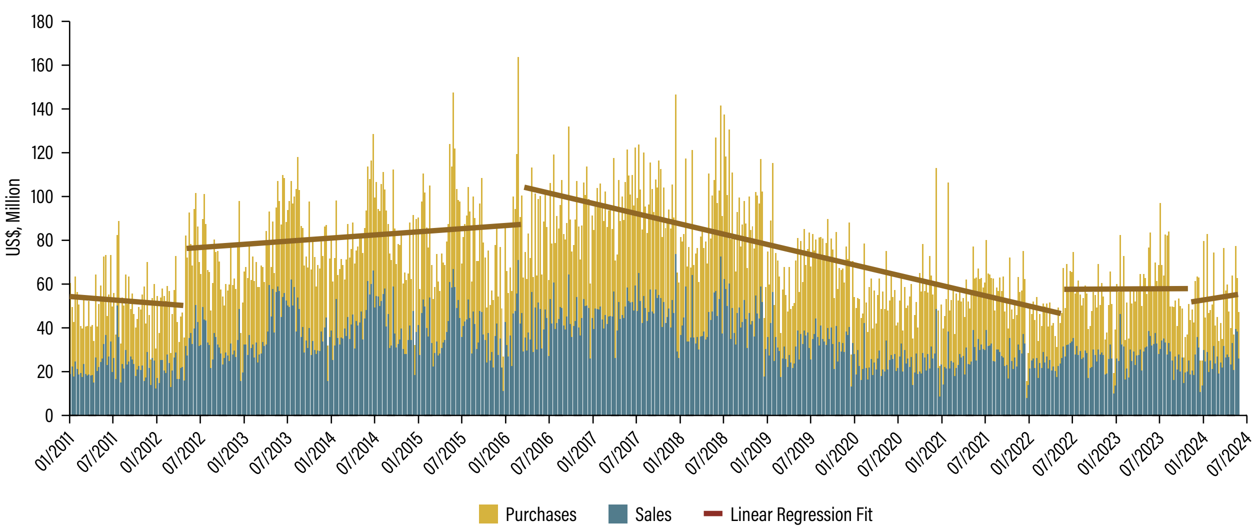
Real effective exchange rate (2012=100)



Source: IMF International Finance Statistics.

FIGURE 1.14 Foreign-exchange liquidity remains very low

Weekly foreign-exchange purchases, sales, and trends in total market liquidity

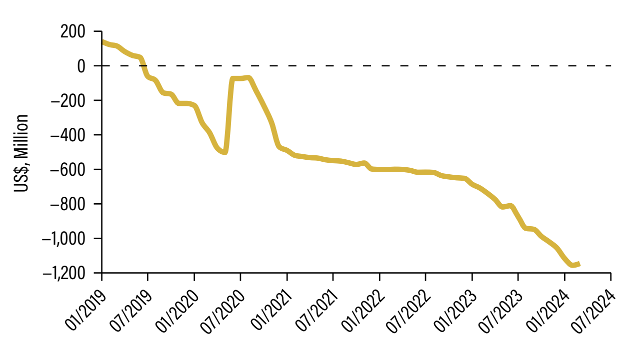


Source: World Bank based on RBM data.

Fuel imports are consuming an increasing share of Malawi's foreign-exchange reserves. Despite historically low fuel prices, the share of fuel in total imports increased in 2020 and then climbed rapidly as fuel prices rose amid rebounding demand and heightened geopolitical instability (Figure 1.16). Malawi has also continued to import large amounts of diesel for electricity generation. In 2022, fuel accounted for 18 percent of total merchandise imports. Real prices for fuel on the domestic market trended downward between 2010 and 2020 but recently returned to their 2015 level. Fuel imports are high relative to Malawi's per capita GDP, which may be due in part to underpriced fuel. Lower effective tax rates make used cars in Malawi cheaper than in peer countries (IMF 2023), and alternative modes of public transportation are scarce.

FIGURE 1.15 Substantial foreign-exchange sales were not able to meet market demand

Cumulative RBM net foreign-exchange sales to authorized dealer banks

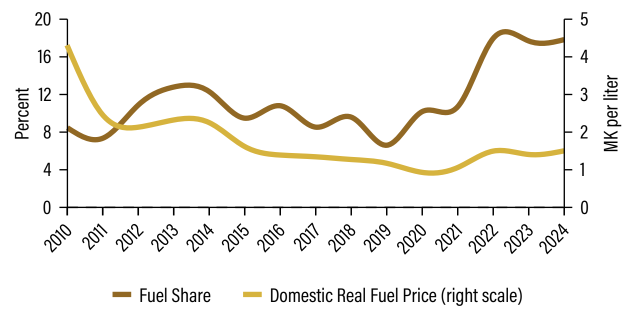


Source: World Bank based on RBM data.

Malawi's fuel pricing policies are costly and regressive. The Automatic Fuel Price Mechanism, which was developed in response to Malawi's previous foreign-exchange and fuel crisis in 2012, was designed to stabilize fuel prices while keeping them market-reflective. However, the calculated fuel price has long relied on the official exchange rate and on discretionary pricing policies, which ultimately reflect non-commercial considerations. The cost of the effective underpricing of fuel—an implicit subsidy—is borne by: (i) the RBM and other parties that have historically supplied foreign exchange at the undervalued official exchange rate; (ii) the energy regulator, which is obligated to reimburse importers for losses due to underpricing and which claims to have exhausted the financial buffers accumulated during previous episodes of overpricing; and (iii) parastatals and private importers that have accumulated large claims against the energy regulator. The country has also experienced occasional fuel shortages at retail outlets. The bias toward underpricing has led to an additional increase in fuel consumption. Over the past 14 years, a 10 percent price decrease in the fuel price has been associated with an immediate 2.8 percent increase in the amount of petrol consumed and a 2.1 percent increase in the amount of diesel consumed (Figure 1.17).[6] This implicit subsidy of fuel imports also hampers Malawi's economic development by reducing the availability of foreign exchange, which reduces the supply of other imports needed for growth and household welfare. Recently, fuel demand appears to have declined slightly since the increase in prices in November 2023 following the devaluation, which in turn reduced the size of the implicit subsidy.

FIGURE 1.16 As domestic fuel prices fell, the share of fuel in total imports increased

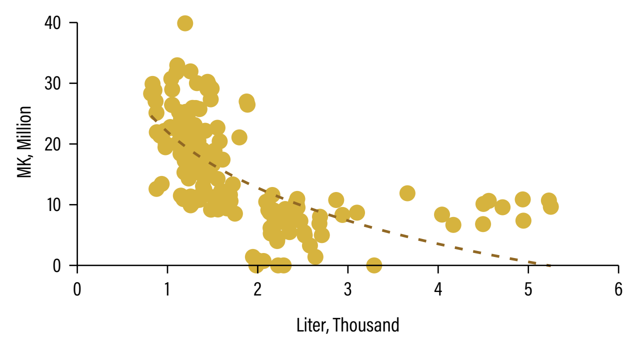
Share of fuel in merchandise imports by year and real average fuel price in 01/2022



Source: World Bank based on NSO and MERA data.

FIGURE 1.17 Lower real petrol prices are associated with higher imports

Real petrol prices in 01/2022



Source: World Bank based on MERA and RBM data.

BOX 1.3 A new effort to develop Special Economic Zones calls for close oversight and learning lessons from past experiences

In 2023, the government approved the Special Economic Zones (SEZ) Act, which aims to establish SEZs in the country. While SEZs can be a useful tool for policy experimentation and to concentrate expensive infrastructure in strategic areas, the international experience shows that they require significant public investment and often reduce tax revenue. SEZs may also fail to attract firms or investors that would not have established operations in the country without them.

Malawi's disappointing experience with SEZs in the 1990s was consistent with that of many other developing economies and underscores the extent to which the success or failure of SEZs hinges on their design and implementation. Malawi's first SEZs, known as Export Processing Zones, were established in 1993 as part of a wide-ranging effort at trade liberalization. Offering exemptions from constraints on capital mobility, import restrictions, and policies favoring "indigenous" Malawian entrepreneurs, these SEZs attracted about 40 firms. However, broader economic challenges undermined the initiative, and by 2023 the number of firms had fallen to 15 (Phiri 2023).

The international experience with SEZs is mixed. On average, they tend to exhibit the same economic trajectory as the countries in which they are located. Incentive packages, relaxed ownership rules, tax breaks, and other ostensible advantages enjoyed by SEZ firms tend to have at best a marginal impact on their performance (World Bank 2017). SEZs appear to be most successful when they address a specific market failure that cannot be alleviated nationwide. These market failures include a dearth of secure land for foreign investors, limited access to power, water, and other infrastructure, and specific regulatory hurdles (Zeng 2021). Since SEZs tend to be expensive to establish, policymakers must carefully select the right location, target key constraints on doing business, appeal to industries and firms most likely to succeed in the SEZ, and maximize spillovers onto the broader economy.

6. A simple autoregressive model was fitted separately for diesel and petrol based on monthly data between 01/2010 and 03/2024. The model equation is $ln\ ln(Qt) = \beta 0 + \beta 1\ ln\ (Pt) + \beta 2\ ln\ (Qt - 1) + \varepsilon t$ with Q being the quantity of fuel imported and P being the price. The coefficients for $\beta 1$ were -0.277 (0.083) for petrol and -0.205 (0.110) for diesel. These values are in line with estimates elsewhere (Amaglobeli et al. 2022).

Malawi's new SEZ Act of 2023 could address some key market failures. The Malawi Investment and Trade Centre (MITC) is designated as the SEZ Authority and can grant licenses as a one-stop shop. While foreign businesses are still unable to acquire land outright, they can lease land for up to 50 years from the MITC. While the SEZ Act alleviates some burdensome non-tariff barriers and capital controls, the tax incentives granted to SEZ firms may be overly generous. They would also not necessarily attract businesses that are more focused on generating profits at scale rather than limiting their tax liability. The law gives officials considerable discretion to provide taxes and other incentives, which raises the risk that SEZ firms will receive additional favorable treatment regardless of their economic contribution.

Malawi has found an experienced developer, ARISE IIP, to establish its newest SEZ in Kanengo, Lilongwe, with financing provided by Afreximbank. However, many details of the project remain unclear, and greater transparency regarding the financial and risk-sharing arrangements and the scale of the tax and regulatory exemptions granted would enable an assessment of the project's likelihood of success. Moreover, as Malawi remains in debt distress and Afreximbank is its largest external commercial creditor, it will be critical to ensure that ongoing negotiations on medium-term debt restructuring can proceed in the context of this new arrangement.

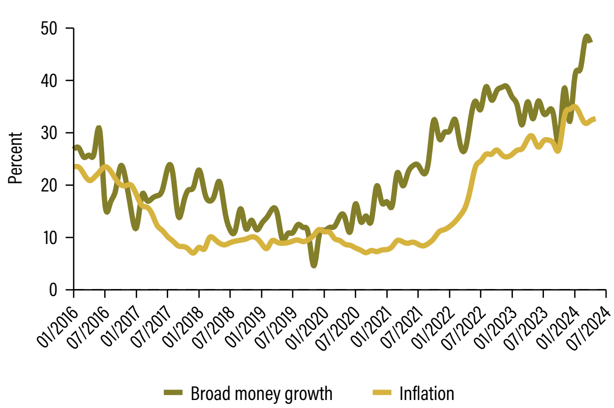
Inflation has moderated slightly, but risks remain elevated

Following a spike after the November 2023 devaluation, inflation has remained consistently above 30 percent, driven by a surge in food prices. Headline inflation peaked at 35.0 percent in January 2024 before edging down to 31.8 percent in March and then rising to 32.7 percent in May. Food inflation reached a high of 44.9 percent in January, led by rising maize prices, but has declined slightly to 40.7 percent in May. Non-food inflation has been somewhat lower and more stable at around 22 percent since the start of the year. Urban consumers have experienced higher overall inflation due to their greater consumption of non-food items affected by the pass-through effect of exchange-rate depreciation. However, the pass-through effect has been weaker than in past episodes of devaluation, due in part to more prudent monetary policies and in part to the parallel market rate already being priced in before the devaluation for many goods without price controls.

The risk of a renewed surge in inflation is significant amid the rapid growth of the money supply and insufficient fiscal discipline. The RBM has tightened its stance, raising the policy rate by 200 basis points since November 2023 to 26 percent in an effort to contain second-round inflationary effects following the devaluation of the kwacha and increasing liquidity reserve requirements. The growth of money supply remained elevated at 47 percent year-on-year in April, driven by central-bank financing of the fiscal deficit (Figure 1.18). Further monetary financing of the deficit could intensify inflationary pressures, and the recent drought could cause a supply shock that increases food prices, especially for staples like maize (Figure 1.19). Recent data showing a decline in monetary financing and improved bond market sentiment may herald a gradual shift in these dynamics.

FIGURE 1.18 Inflation continues to increase broadly in line with the growth of the money supply

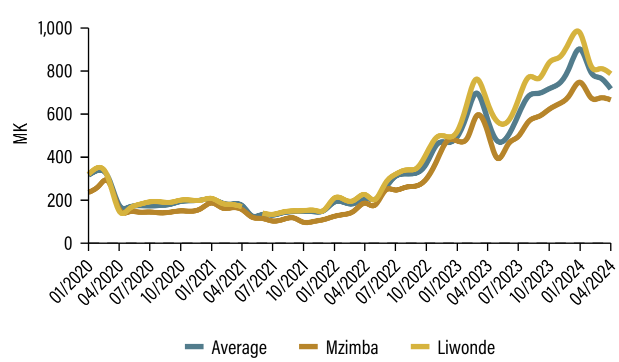
Year-on-year inflation and the growth of broad money



Source: World Bank based on NSO and RBM data.

FIGURE 1.19 Maize prices have been a key factor in rising inflation

Nominal maize prices, national average and averages in Mzimba and Liwonde districts



Source: World Bank based on FAO data.

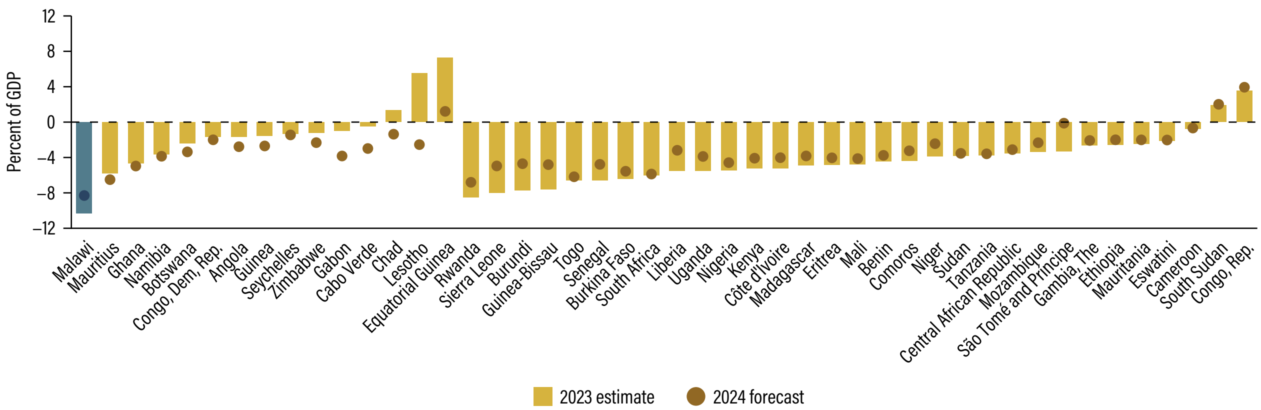
Note: Data for Mzimba and Liwonde districts included as they are the northern- and southern-most districts in the FAO dataset.

Persistent fiscal slippages jeopardize Malawi's economic recovery

The fiscal deficit for FY2023/24 significantly exceeded the levels anticipated both in the approved budget and in the mid-year revised budget. When the statutory 4.4 percent of GDP recapitalization of the RBM is included, the overall fiscal deficit reached 12.4 percent of GDP, up 2 percentage points from FY2022/23. As a result, Malawi is once again on the path toward having one of the highest fiscal deficits in Sub-Saharan Africa during the 2024 calendar year (Figure 1.20). Expenditure overruns drove the widening of the deficit, with spending levels exceeding the approved budget by 10.6 percentage points of GDP due to the RBM recapitalization and overspending on the wage bill, subsidies, and other recurrent costs. Rising expenditures more than offset a strong revenue performance, as the 44 percent adjustment of the kwacha in November 2023 increased the cost of many goods and services, but also boosted customs revenue through higher import tax intake and by increasing effective tariff rates on price-controlled goods like fuel. Financing the deficit necessitated greater domestic borrowing from the RBM and commercial lenders.

FIGURE 1.20 Malawi is again on the path to have one of the highest fiscal deficits in Sub-Saharan Africa

Fiscal deficits of countries in Sub-Saharan Africa

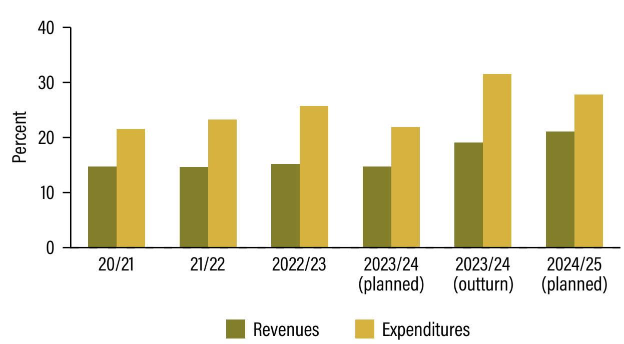


Source: World Bank 2024.
Note: Deficit estimates adjusted from fiscal year to calendar year for comparability across countries. These have been updated for Malawi to include the FY2024/25 approved budget. e indicates estimate, f indicates forecast.

The approved budget for FY2024/25 rests on optimistic revenue assumptions related to budget support and tax collection. Total expenditures are projected to decline by 3.7 percent of GDP, while tax reforms, improvements in revenue administration, and rising budget support are expected to yield a 0.8 percentage-point increase in revenues (Figure 1.21). The budget targets a primary surplus in line with the IMF ECF program, but fiscal discipline must be strengthened to avoid further slippages. These expectations are also subject to significant downside risks. The budget includes few specified sources of increased revenue beyond anticipated efficiency gains from the implementation of the new "Msonkho Online" integrated tax-administration system. Slowing economic activity also poses a major risk to revenue projections. Underperformance on the revenue side could necessitate further borrowing and potentially monetary financing, impeding efforts to rein in inflation.

FIGURE 1.21 Reduced expenditures and higher revenues are anticipated in the approved FY2024/25 budget

Revenues and expenditures as a share of GDP



Source: World Bank based on MoFEA and IMF data.

As the domestic debt stock rises, interest payments have become the single largest expenditure item. Successive fiscal deficits have contributed to the sustained accumulation of domestic debt, with outstanding balances reaching 31.9 percent of GDP at end-2023. Debt service consumes 32 percent of revenue (6.5 percent of GDP), narrowing the scope for productive investment and social spending. The Constituency Development Fund, which lacks the oversight mechanisms of other local-government financing instruments, and the AIP are sources of expenditure inefficiency, and the socioeconomic impact of the drought is increasing expenditure pressures. Implementing lessons learned from past projects under the Public Sector Investment Programme could help improve oversight and efficiency (Box 1.4).

BOX 1.4 The importance of transparency in the prioritization of the Public Sector Investment Programme

The FY2024/25 budget increased the resources allocated to the Public Sector Investment Programme (PSIP). The development budget increased to 30 percent of total spending, a key benchmark for the government. However, given that the FY2024/25 PSIP contains 297 projects with a total estimated cost of MK 14.5 trillion (of which MK 5.4 trillion is to be government-funded), even the targeted MK 1.77 trillion (of which the government optimistically expects to cover MK 1.3 trillion) will likely not go far enough in advancing the implementation of the broader portfolio.

Given the need to focus scarce public funds on the most effective projects, the government could leverage its increased transparency in the PSIP to promote effective prioritization by incorporating input from the public. Starting with the FY2020/21 budget, the government has begun producing increasingly granular details on public investment projects, and since FY2023/24 it has published the PSIP Document, which presents an analysis of ongoing projects, tracks their physical progress, and offers recommendations for addressing challenges involving the most costly projects.

The PSIP Document confirms that many projects face similar problems. These include low readiness when they enter the portfolio, funding and procurement delays, shortages, and escalating costs. However, some projects proceed on schedule and remain within budget, such as the Lilongwe Water and Sanitation Project. Such projects should receive priority when allocating funds, and lessons learned from their implementation could significantly improve the quality of the entire PSIP portfolio.

FIGURE B1.1.4 While some public investment projects struggle, others deliver on time and on budget

Water infrastructure delivered by the Lilongwe Water and Sanitation Project

Source: Government of Malawi 2023b.

The government has implemented important fiscal and public financial management reforms, but these efforts have been gradual and uneven. These measures include steps to improve budget execution by expanding the Integrated Financial Management Information System across the public sector, enforcing adherence to quarterly expenditure allotments, and conducting regular reconciliations between banking and accounting data. However, prescribed processes are not always followed, and public investment management often suffers from weaknesses in implementation.

The new budget reaffirms the government's commitment to the controversial Lilongwe-Salima Water Project. With the government pre-financing 50 percent of the total estimated cost of MK 350 billion, the project constitutes a major explicit liability for the government. If liability-management measures are not implemented stringently, the project may also generate additional contingent liabilities for the government. Further policy action is urgently needed to enhance transparency and accountability in public financial management.

TABLE 1.1 Fiscal Accounts

Percent of GDP

						23/24	24/25
	20/21	21/22	22/23	Approved Budget	Revised Budget	Budget Outturn	Approved Budget
Revenue	14.7	14.6	15.2	14.7	17.5	19.1	21.1
Domestic Revenue	12.8	12.8	12.1	12.9	13.8	13.1	15.7
Taxes	12	12.1	11.6	12.2	12.6	12.7	15.1
Taxes on Income, Profits and Capital Gains	5.6	5.5	5.5	5.7	5.9	6.2	7.3
Taxes on Goods and Services	5.4	5.6	5	5.2	5.3	5.2	6.0
Taxes on International Trade and Transactions	1.0	1.0	1.1	1.4	1.4	1.3	1.8
Other Taxes	0	0	0	0.0	0.0	0.0	0.0
Grants	1.9	1.8	3.1	1.8	3.6	6.0	5.4
From Foreign Governments	0	0	0.2	0.1	0.1	0.0	0.3
From International Organizations	1.9	1.8	2.9	1.7	3.5	6.0	5.1
Other Revenue	0.7	0.7	0.5	0.7	1.2	0.4	0.6
Expenditure	21.5	23.2	25.7	21.8	24.9	31.5	27.8
Expense	17.8	18.5	18.6	17.0	18.7	22.4	19.6
Compensation of Employees	5.8	6	5.6	5.3	5.9	5.9	5.2
Goods and Services	3.6	3.8	3.1	3.1	3.5	3.5	3.9
Generic Goods and Services	2.2	2.2	1.9	1.9	2.1	2.2	2.3
Interest	3.6	3.3	4.6	5.3	5.4	5.0	6.7
To Non-Residents	0.2	0.2	0.3	0.2	0.5	0.3	0.4
To Residents other than the General Government	3.4	3.1	4.3	5.1	4.8	4.7	6.4
Grants	1.9	2.1	3.3	1.7	1.9	5.9	1.9
Social Benefits	2.5	3	1.9	1.4	1.7	1.7	1.7
Fertilizer Payments	1.3	1.9	1.1	0.6	0.6	0.6	0.7
Other Expenses	0.3	0.4	0.1	0.1	0.3	0.5	0.2
Acquisition of Non-Financial Assets	3.7	4.7	7	4.8	6.2	9.1	8.2
Foreign Financed	2.7	3	5.4	3.5	4.6	7.4	6.4
Domestically Financed	1.0	1.7	1.7	1.3	1.6	1.7	1.8
Fiscal Deficit	−6.8	−8.6	−10.4	−7.1	−7.4	−12.4	−6.7
Primary Balance	−3.2	−5.3	−5.9	−1.8	−2.1	−7.4	0.0
Net Financing	6.8	8.6	10.4	7.1	7.4	12.4	6.7
Net Incurrence of Liabilities	6.9	10.3	7	7.1	7.4	7.6	6.7
Foreign Liabilities	1	2.6	1.9	0.8	1.1	0.5	0.7
Borrowing	1	0.7	1.9	1.7	2.1	2.1	1.7
Amortization	−0.4	−0.4	−0.6	−0.9	−1.0	−1.7	−1.0
Domestic Liabilities	5.9	7.7	5.1	6.3	6.3	7.0	6.0
Statistical Adjustment (underfinancing if positive)	−0.1	−1.7	3.4	0.0	0.0	4.9	0.0

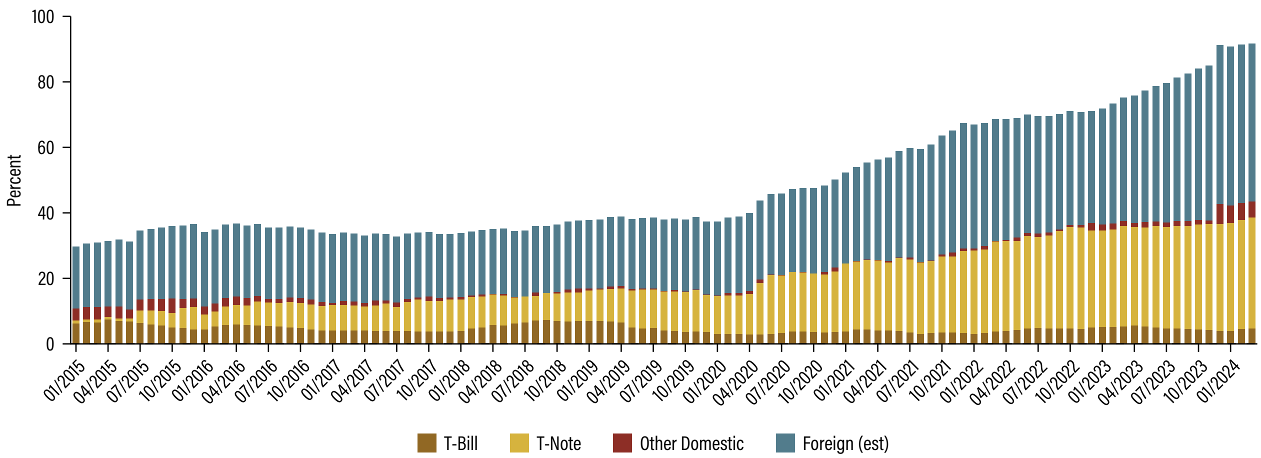
Source: World Bank calculations based on data from MoFEA and IMF.

Debt sustainability hinges on successful restructuring and fiscal adjustment

Persistently large fiscal and external deficits and the deprecation of the kwacha have pushed the debt stock to 91.3 percent of GDP. The fiscal deficit reached 12.4 percent of GDP in FY2023/24, necessitating large-scale domestic and external borrowing while the depreciation of the kwacha added approximately MK 2 trillion to the debt stock. The current account deficit has widened to more than 15 percent of GDP in recent years due to the overvaluation of the exchange rate over many years, significant explicit and implicit import subsidies, higher global prices for fuel and fertilizer and subdued export performance. Although increased grant financing provided some relief, the twin fiscal and external deficits contributed to a mounting debt stock. Negative real interest rates eroded the real value of domestic debt, but this was outweighed by substantial new issuances, especially of medium-term Treasury notes (Figure 1.22). Meanwhile, the kwacha's depreciation pushed the external debt burden to 48.5 percent of GDP, and it now exceeds the domestic debt stock of 42.8 percent of GDP.

FIGURE 1.22 The share of Treasury securities in total debt is increasing

Debt as a share of GDP by instrument



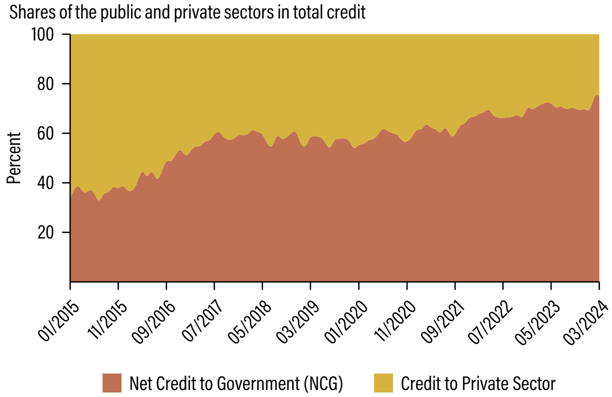
Source: World Bank based on RBM data.

Malawi continues to pursue external debt restructuring, but the margin for error is narrowing. The latest World Bank Debt Sustainability Analysis confirms that the restructuring strategy—if fully implemented alongside a successful fiscal consolidation under the IMF program and complemented by increased grant financing—could restore debt sustainability over the medium term (IMF/World Bank 2023). In this context, it will be critical for bilateral and commercial creditors to reach an agreement with the authorities that ensures Malawi's medium term debt sustainability. The recently signed supplemental loan agreement to restructure US$ 206 million of outstanding debt to China is an important step in this direction. There is limited flexibility to accommodate further shocks, and delays in restructuring negotiations with creditors or domestic reform slippages could derail the adjustment. External risks include a potential deterioration in the terms of trade or a further tightening of global financing conditions.

While bond market sentiment appears to be improving slightly, the financing of deficits from the domestic market is becoming increasingly expensive. Domestic borrowing by the public sector has surged and accounted for almost 80 percent of total credit to the economy at end-2023 (Figure 1.23). Sovereign risk has pushed up yields on government securities, with the 364-day Treasury bill rate exceeding 25 percent and the 10-year Treasury note rate reaching 35 percent in June. Despite higher rates, there is limited scope to expand domestic financing, and the share of outstanding debt held by the RBM will likely increase (Figure 1.24). In this context, fiscal consolidation and successful external debt restructuring will be vital to restore fiscal and external sustainability.

FIGURE 1.23 Increased government borrowing since 2016 is crowding out private-sector credit

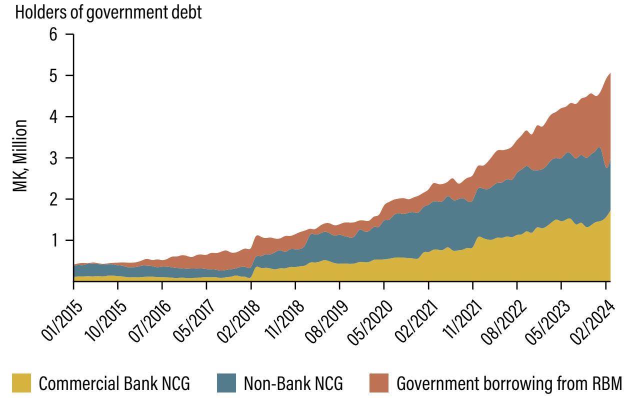
Shares of the public and private sectors in total credit



Source: World Bank based on RBM data.

FIGURE 1.24 Government borrowing is increasing from all domestic sources

Holders of government debt



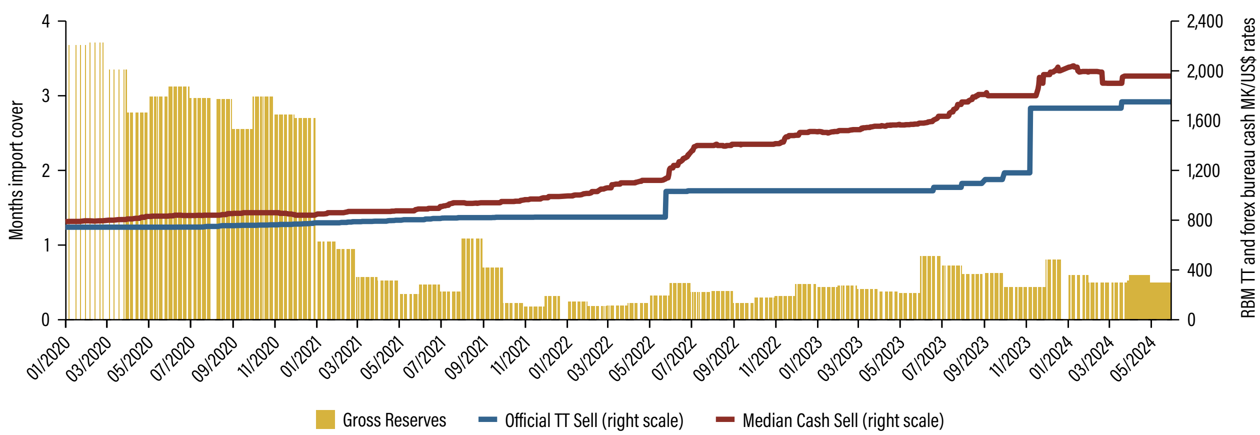
Source: World Bank based on RBM data.

The exchange-rate spread has narrowed following the devaluation, but planned reforms to increase flexibility have yet to be fully implemented

Following the kwacha's 44 percent adjustment against the US dollar in November, the spread between the official and bureau exchange rates narrowed substantially. The spread declined from a high of over 60 percent to about 10 percent at end-April (Figure 1.25). Despite significant inflows from development partners, foreign-exchange liquidity remains very low, with reserves equal to less than one month of import cover. Total reserves, including those held by authorized dealer banks, are approximately 2.5 months. The RBM has struggled to step up foreign-exchange purchases and reduce sales for most of this year, but May 2024 data shows a first significant reduction of sales to the market. If sustained, this would be an important contributor to the accumulation of necessary reserves.

FIGURE 1.25 The exchange-rate spread stabilized after the November 2023 devaluation but have since begun widening again as reserves remain low

Telegraphic transfer and forex bureau cash MK/US$ rates and spreads through May 31 and gross official reserves in months of import coverage



Source: World Bank based on RBM data.

The incomplete implementation of exchange-rate reforms announced in November 2023 is a key factor in the current shortage of foreign-exchange liquidity. The RBM has kept the official exchange rate stable since the November 2023 devaluation, and some key liberalization measures announced in November 2023 have yet to be fully implemented. Rather than setting rates freely, authorized dealer banks continue to transact exclusively at the official exchange rate in the spot market. While foreign-exchange auctions are held monthly, volumes remain very low and have so far resulted in only a single 3 percent adjustment of the exchange rate in late February 2024. Furthermore, the bureau exchange rate has become a less useful guide for assessing the market-clearing rate as the spread between the official and parallel market rates is likely higher than reported bureau rates would indicate.

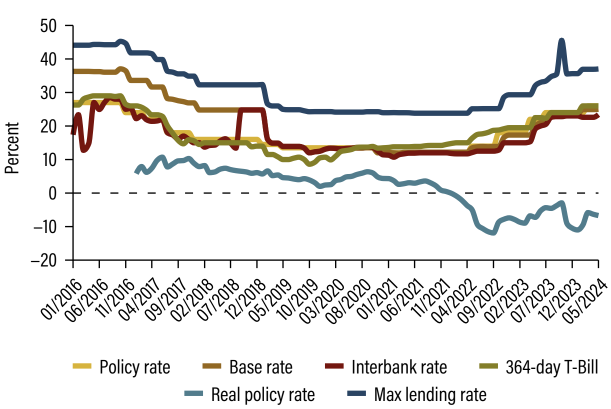
Monetary tightening has been insufficient to contain inflationary pressures

Following the devaluation, the policy rate has been tightened further, but sustained money growth paired with continued supply constraints have undercut efforts to control inflation. Since January 2023, the Monetary Policy Committee (MPC) has increased the policy rate by a cumulative 800 basis points to 26 percent, with the most recent hike of 200 basis points occurring in February 2024. Nevertheless, the real policy rate (calculated as the difference between the nominal rate and inflation) remains negative. Rates for Treasury bills, interbank rates, and base rates have all moved in lockstep with the policy rate (Figure 1.26). Despite the tighter monetary stance, continued central-bank financing of the fiscal deficit has resulted in a continuous expansion of the money supply, which is contributing to inflation.

Yields on Treasury bills and notes increased over the past year in line with rising interest rates. The mounting cost of debt service further complicates fiscal management. The exchange-rate depreciation, high inflation, and high levels of money growth also weakened the RBM's balance sheet, requiring a statutory recapitalization of MK 704 billion (4.4 percent of GDP) to offset valuation losses.

FIGURE 1.26 The real policy rate remains negative, but base lending and interbank rates have increased...

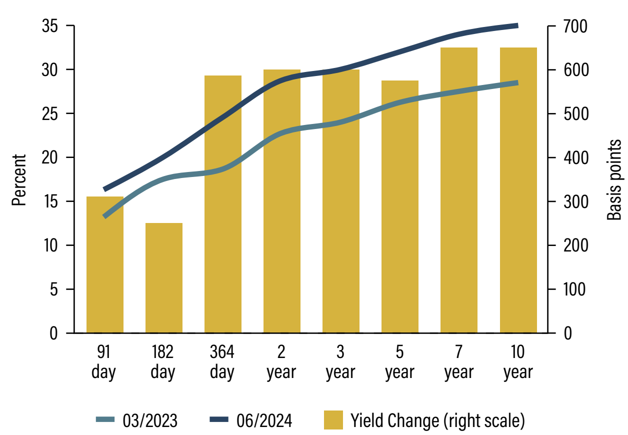
Government and private sector shares of total credit



Source: World Bank based on RBM data.
Note: Real policy rate calculated as difference between nominal rate and inflation.

FIGURE 1.27 ...and government borrowing yields have risen substantially over the last year

Treasury bill and note interest rates and yield change



Source: World Bank based on RBM data.

The financial sector remains stable, with commercial banks reporting a very strong performance in 2023

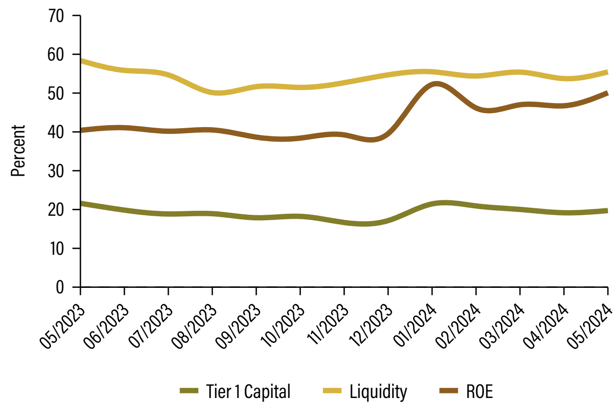
Malawi's banking sector has maintained a solid capital and liquidity position despite the economic challenges facing the country. As of March 2024, the overall capital ratio and the tier 1 capital ratio were 22.3 percent and 20.0 percent respectively, down slightly from 25.5 percent and 22.2 percent in March 2023 but still well above the regulatory minimums of 10.0 percent and 15.0 percent (Figure 1.28). The drop in capital adequacy was mainly due to a 27.6 percent increase in private-sector credit during the period. Meanwhile, the liquidity coverage ratio rose from 56.4 percent in March 2023 to 66.2 percent.

While ample liquidity is a positive sign, it reflects the concentration of bank resources in short-term assets, and in particular government securities that are unlikely to support capital investment by the private sector. As a result, the share of total loans and advances fell from 26.2 percent of total assets in March 2023 to 24.6 percent in March 2024. Supported by profitable government securities, the banking sector maintained an impressive return on assets (ROA), which rose from 5.2 percent in March 2023 to 5.6 percent in March 2024, while return on equity (ROE) increased from 39.3 percent to 47.0 percent, the highest in southern Africa.

Credit to the private sector increased in nominal terms, by 28.3 percent to MK 1.22 trillion in March 2024 from MK 939.0 billion in March 2023. A 51.7 percent increase in credit to the agriculture, forestry, fishing, and a 38.3 percent increase in credit to the community, social and personal services sector drove this trend (Figure 1.29). As of March 2024, these two sectors accounted for a combined 57.5 percent of credit to the private sector. The community, social, and personal services sector's share in total private-sector credit rose from an average of 28.3 percent in January 2022 to 37.5 percent in April 2024. The share of agriculture, forestry, fishing, and hunting increased from 14.7 percent to 19.0 percent over the same period, while the wholesale and retail trade sector's share fell from 18.7 percent to 14.3 percent. The increase in the share of credit to the agriculture sector is encouraging, as it reflects greater financing of productive activities, though the level of concentration remains a concern. However, the steady increase in the share of credit to the community, social, and personal services sector may be economically regressive if a large proportion of those resources is devoted to consumption. Moreover, the dominance of these three sectors—which together accounted for an average of 75.0 percent of total private-sector credit in the first quarter of 2024—poses a significant risk to the financial system, as a downturn in one or more of these sectors could strain bank balance sheets.

FIGURE 1.28 Financial stability indicators have proven resilient

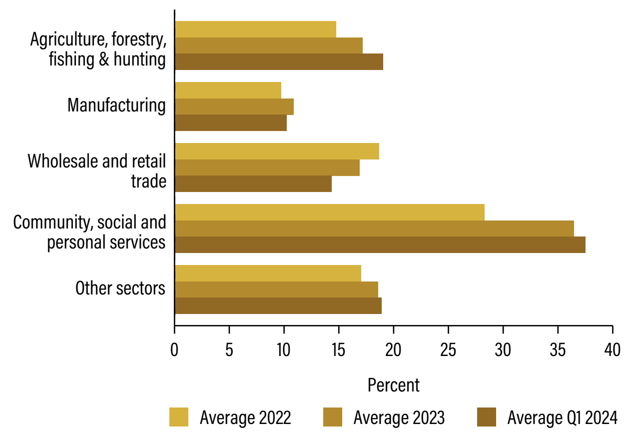
Tier 1 capital and liquidity coverage ratios as share of total exposure and ROE as share of total equity



Source: World Bank staff calculations based on RBM data.

FIGURE 1.29 Community, social, and personal services remain the focus of private credit

Lending by sector as a share of total lending



Source: World Bank staff based on RBM data.

By the end of March 2024, non-performing loans (NPLS) stood at 7.2 percent of total loans. NPLS as a ratio of gross loans declined to 7.2 percent in March 2024 from 6.3 percent in March 2023, and remained above the regulatory benchmark of 5.0 percent. While some banks have generally maintained NPL ratios below the benchmark, others have consistently registered higher NPL ratios. Despite the high NPL ratio of some banks, the regulator considers the banking sector to be resilient to risks, including default risk.

Overall, as of December 2023, the rest of the financial sector remained sound. The microfinance sector, the general insurance sector, and the life insurance sector all maintained capital ratios well above the regulatory benchmarks. In the microfinance sector, some monetary financial institutions and financial cooperatives have low levels of capital adequacy, while the life insurance sector faces important risks related to the concentration of investments in government bonds and a narrow range of listed equities.

1.3

MEDIUM-TERM ECONOMIC OUTLOOK

Malawi's economy is in a difficult position, with macroeconomic policy choices and the recent drought worsening an already challenging situation. The approval of the ECF in November 2023 enabled the resumption of budget support by the World Bank and the African Development Bank, but the macroeconomic adjustment necessary for the economy to recover is proceeding slowly. Meanwhile, significant fiscal slippages, the RBM's continued difficulty to accumulate foreign reserves, and mounting debt challenges cloud the outlook. Further progress on the reform agenda will only become more challenging as spending pressures related to the 2025 presidential election approaches.

Malawi's economy is projected to grow by 2.0 percent in 2024, an improvement on the past two years but below the population growth rate of 2.6 percent, leading to a contraction in per capita terms. The limited availability of agricultural inputs and the impact of prolonged dry spells during the growing season are expected to reduce agricultural output. Continued liquidity challenges in foreign-exchange markets are expected to continue affecting the importation of raw materials and productive inputs, constraining economic activity in the industrial and services sectors. However, the implementation of planned macroeconomic and structural reforms to support private investment is expected to boost the potential growth rate to about 4 percent in the medium term, also leading to a reduction in the poverty rate. As rising prices and declining output contribute to heightened food insecurity, poverty is expected to worsen in 2024, and the share of people living below the international poverty line of US$2.15 a day is projected to rise to 71.9 percent in 2024.

Headline inflation is expected to remain elevated at an average of about 30 percent in 2024. The disinflationary impact of tighter monetary policy will likely be offset by diminished agricultural output and continued upward pressure on food prices. In addition, further increases in energy and other utility prices in line with pricing formulas could compound inflationary pressures in 2024, and additional monetary financing of the fiscal deficit poses inflationary risks.

The fiscal deficit is expected to moderate to 7.0 percent of GDP, but this forecast is subject to several downside risks. Revenue is projected to reach 21.1 percent of GDP in FY2024/25, assuming the government achieves its ambitious targets for tax collection, and grants increase to 5.4 percent of GDP—the highest level in a decade. In parallel, spending is expected to moderate slightly to 27.8 percent of GDP, resulting in a fiscal deficit of 6.7 percent of GDP in FY2024/25 if buget targets are achieved. Revenue underperformance and/or overspending would widen the deficit further, adding to an already unsustainable public debt burden.

Malawi's economic outlook is vulnerable to numerous downside risks, but also could benefit from upside risks materializing. The impact of El Niño-related droughts could worsen, while further fiscal slippages and delays in debt restructuring and public finance management reforms could increase macroeconomic instability. A failure to increase adequate foreign-exchange liquidity could result in shortages of critical imports, which would have negative implications for economic activity and could impact social cohesion. On the upside, an unusually successful winter cropping season could bolster agricultural output and alleviate food insecurity. Further upside risks include a swiftly negotiated debt-restructuring agreement, the faster-than-expected development of the mining sector, and an increase in grants (and especially on-budget grants).

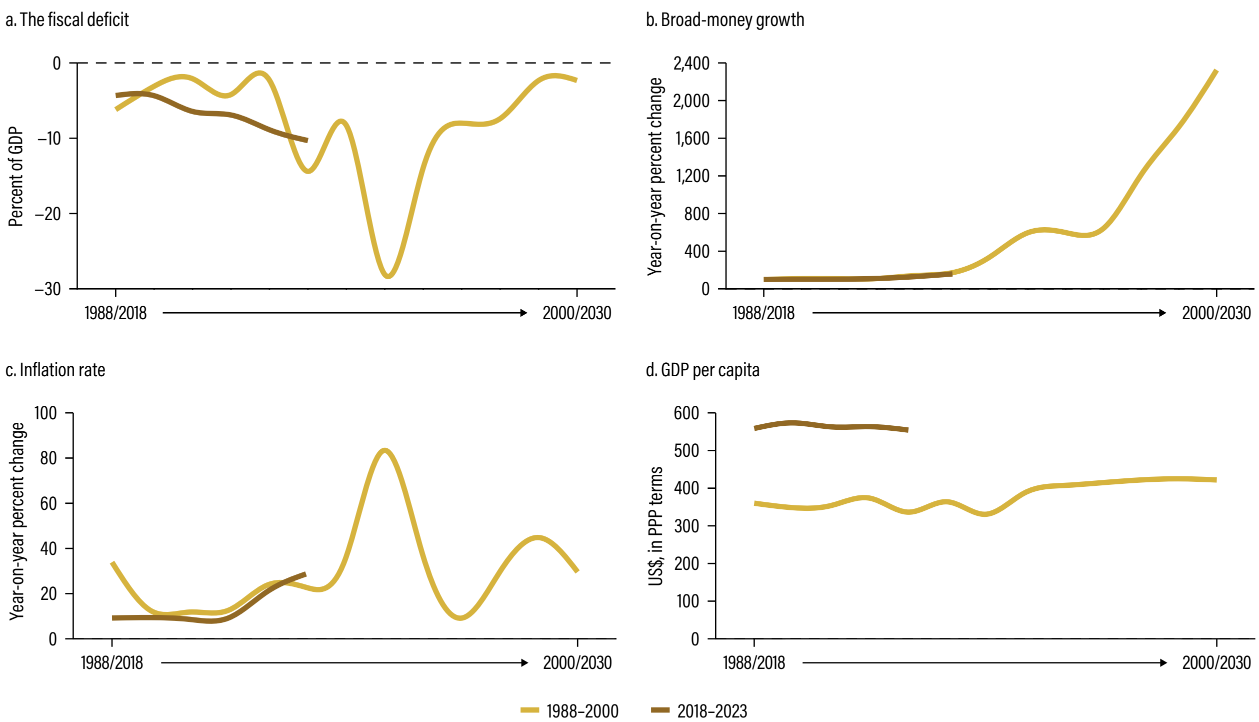
Policy Priorities: restoring macroeconomic stability, protecting vulnerable households against shocks, and increasing production and exports

Malawi's macroeconomic adjustment effort will face critical challenges in the coming months. Agreement on a four-year ECF-supported program at the end of 2023 was a significant milestone, but it represents the start of a reform process, not its conclusion. To rebalance the economy toward faster, more inclusive, and more resilient growth, policymakers will need to focus on advancing key structural reforms to increase investment in priority sectors, including agriculture, energy, mining, and tourism.

Lessons from the early 1990s underscore the risks of failing to address macroeconomic imbalances. At that time, Malawi's fiscal deficit steadily widened, with fiscal restraint deteriorating in the run-up to the 1994 election. Left with few options, the government resorted to monetary financing of the fiscal deficit, and between 1988 and 1993 the money supply increased by 260 percent. In 1995, inflation peaked at close to 100 percent. The result was a decade of economic stagnation that only ended following painful adjustment reforms and debt relief in the early 2000s (Figure 1.30). A key lesson from this period is the importance of prioritizing fiscal discipline and addressing macroeconomic imbalances proactively.

FIGURE 1.30 Recent trends echo those of the early 1990s

Key economic indicators, 2018-2023 and 1988-2000



Source: World Bank staff calculations based on WDI, MoFEA and RBM data.

Urgent actions and sustained reforms are required to restore macroeconomic stability, protect the most vulnerable households, and enhance growth (Table 1.2). Key objectives include:

i) ***Restoring macroeconomic stability:*** Planned macro-fiscal reforms must be fully implemented and sustained over time. Key objectives include fiscal consolidation in line with the ECF targets, progress on external debt restructuring while containing the growth of domestic borrowing, accumulating reserves by moving forward with increased exchange-rate flexibility, and controlling inflation by limiting the growth of the money supply and refraining from further monetary financing of the fiscal deficit.

ii) ***Bolstering food security, building resilience, and protecting poor households:*** Given the significant food deficit in the coming lean season relative to the national requirement, maize imports will be vital to mitigate widespread food insecurity. Meanwhile, the authorities must prepare for the next disaster by implementing the Disaster Risk Management Act along with additional policy reforms to build ex-ante resilience. As described in the MEM's Special Topic, the government can leverage its existing social protection infrastructure to provide targeted and adaptable support to poor and vulnerable households.

iii) ***Increasing production and exports:*** With climate-induced natural disasters and extreme weather events likely to intensify, promoting sustainable farming practices and investing in irrigation systems will be essential to build resilience. Moreover, reforming the system of price controls will be necessary to alleviate distortions that discourage production and exports. Finally, given the government's limited resources, public investment must focus on the most productive projects and reflect a careful analysis of likely costs and benefits.

TABLE 1.2 Priority policy areas and key actions

1. Restoring macroeconomic stability			
Adhere to fiscal targets	Meet ECF-supported fiscal targets by exerting greater control over public spending and ensuring revenue forecasts are supported by credible tax policy and administration measures.	Short	Strengthen
Moving toward debt sustainability	Accelerate restructuring negotiations with external creditors, while limiting domestic borrowing in line with targets.	Medium	Sustain
Increase foreign-exchange reserves	Consistently implement exchange-rate reforms announced in the November 2023 RBM circular by enabling authorized dealer banks to set rates, increasing the frequency of auctions, and reducing net sales to the market.	Short	Strengthen
Control inflation	Maintain a tight monetary stance and refrain from further monetary financing of the fiscal deficit.	Medium	Strengthen
2. Bolstering food security, building resilience, and protecting poor households			
Import maize	Use the limited funds available for disaster response to import maize and mitigate the risk of severe food insecurity.	Short	Initiate
Prepare for future disasters	Implement key policy measures to build resilience, including through a new Social Protection Policy and implementation of the Disaster Risk Management Act.	Medium	Strengthen
Leverage social protection systems	Use existing social protection infrastructure to deliver government services to poor and vulnerable households in a targeted and adaptable way.	Medium	Sustain
3. Increasing production and exports			
Make agriculture more resilient and adaptive	Draw lessons from the El Niño-induced drought to encourage more resilient farming practices and develop sustainable irrigation systems.	Medium	Strengthen
Focus public investment on the most productive projects	Prioritize investment projects that are shown to generate the highest economic returns and ensure that all PSIP projects are subject to rigorous screening.	Short	Strengthen
Reform price controls	Frequently update administrative prices to reflect market conditions (e.g. for fuel) and phase out those that have no market-determined component (e.g. for timber).	Short	Initiate

Initiate Strengthen Sustain

2

MALAWI'S SOCIAL PROTECTION SYSTEM ADAPTS TO MOUNTING RISKS

Introduction

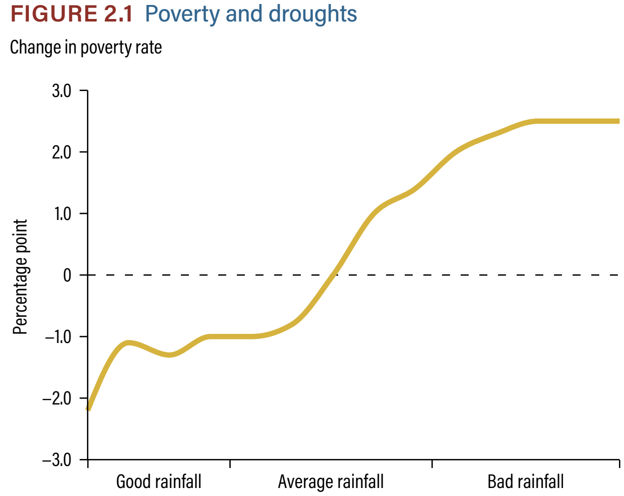
In Malawi, decades of modest economic growth have resulted in stubbornly high poverty rates. While the annual GDP growth rate has averaged 4 percent over the last 30 years, 71.9 percent of Malawi's population remains below the international poverty line, and about 46 percent of national income accrues to the richest 20 percent of the population (UNCTAD 2023). In 2019, the official poverty rate remained close to 51 percent, virtually unchanged from 10 years earlier (World Bank 2022b). Moreover, the growth elasticity of poverty is very low, and growth has a weaker impact on poverty in Malawi than it does in countries with similar economic structures, growth rates, and levels of private-sector development such as Rwanda, Tanzania, Uganda, and Mali.[7] With an average population growth rate of close to 3 percent per year during the 2010s, the number of people living below the poverty line increased by 2 million over the decade, resulting in over 9 million people living in poverty by 2019. Moreover, the poverty gap increased between 2010 and 2019,[8] indicating that the average poor household had fallen even deeper into poverty over the period.

Inequality declined between 2010 and 2019, but this was mainly due to wealthier households reducing their consumption, further highlighting the lack of inclusive economic growth. Inequality stagnated during 2016–19, with consumption among the poorest 40 percent of households falling slightly, while consumption among the top 60 percent ticked up. While most of the poor live in rural areas, urban poverty and inequality both increased during 2010–2019, raising doubts about the poverty-reduction potential of Malawi's ongoing urbanization (World Bank 2022a).

Malawi is exceptionally vulnerable to climate change and other shocks. From 1980 to 2014, Malawi exhibited the greatest sensitivity to extreme dry events of any country. Even transitory shocks have the potential to exacerbate rural poverty and may push an additional two out of every five nonpoor households below the poverty line (World Bank 2022b). Between 2015 and 2017, floods and droughts inflicted economic losses equal to an estimated 5 percent of GDP. Over the last five years, extreme weather events such as cyclones, floods, and droughts, compounded by weather-related cholera outbreaks and the impact of the COVID-19 pandemic, substantially reduced agricultural output, worsened living conditions, and led to rising inflation and food shortages. Accelerated by rapid population growth and environmental degradation and exacerbated by severe macroeconomic imbalances and years of underinvestment in climate adaptation, the impact of increasingly frequent weather shocks on Malawi's economy and population is expected to worsen over time.

Due to their greater direct exposure to shocks and limited coping mechanisms, poor households have been shouldering much of the burden of climate change. For every three Malawians that escaped poverty between 2010 and 2019, four fell into poverty due to weather-related shocks (World Bank 2022b). Around 60 percent of Malawians lived below the poverty line either in 2010, 2019, or both, underscoring the persistent nature of poverty. Moreover, a climate shock increased the probability of a household being poor by 14 percentage points. Poverty in Malawi is closely linked to rainfall, with a year of good rainfall being associated with a 2 percentage-point decrease in the poverty rate and a year of bad rainfall associated with a 2.5 percentage-point increase (Gascoigne et al. 2023) (Figure 2.1).

FIGURE 2.1 Poverty and droughts



Source: Gascoigne et al. 2023.

7. Many factors may lie behind this low elasticity, including the low return of human and physical household assets and the migration of poor households to areas with undynamic labor markets, the incidence of shocks, and the lack of income diversification for poor households.

8. The poverty gap is an indicator of the severity of poverty rather than its prevalence. It measures the distance between the average income of the poor and the poverty line.

Evidence from the last two decades shows that Malawi's social protection programs have played a key role in shielding households from shocks. The Social Cash Transfer Program (SCTP) has had an especially positive impact on equity, resilience, and long-term opportunities, and it compares favorably against 27 similar programs in 14 African countries. Among other achievements, the SCTP has led to a 23 percent increase in food consumption and health-seeking behavior among beneficiaries. The program has also helped households become more resilient to shocks by fostering investments in productive assets (World Bank 2022d). As macroeconomic risks increase and Malawi continues to face multiple successive and overlapping shocks, the government must continue to build on the foundation laid over the last two decades by making social protection programs even more shock-responsive and better able to adapt to change.

BOX 2.1 A brief overview of social protection

Social protection systems help individuals and societies manage risk and volatility, mitigate the impact of shocks on poverty, and access economic opportunity. Clear evidence shows that social protection programs deliver critical support that helps reduce poverty and promote long-term economic growth. Social protection includes instruments ranging from social insurance to labor-market programs, social assistance, food aid, and targeted healthcare support, with multiple forms of assistance often contributing to more than one goal. Malawi's first and second National Social Protection Programs set forth three key objectives:

- *Foster equity by reducing poverty and inequality, promoting equality of opportunity, and minimizing exclusion.* Many social assistance programs, including cash and in-kind transfers, are designed to directly reduce poverty by shoring up household welfare. By helping poor households access basic nutrition, health, and education services, these programs protect human capital and contribute to equality of opportunity. Malawi has developed a range of social assistance programs that provide direct support to poor and vulnerable households.
- *Build the resilience of individuals and households by providing them with insurance against shocks and reinforcing their capacity to manage shocks.* Social insurance and social assistance programs can build the resilience of individuals and households by attenuating the negative impact of shocks, enabling them to more effectively protect their human capital. These types of programs include unemployment and disability insurance, old-age pensions, and adaptable and scalable social assistance programs. Many labor regulations aim to manage the risks faced by workers—for example, by mandating safety standards, sick leave, parental leave, or severance pay. In Malawi, as in many countries with a large informal sector, these programs cover a relatively small share of workers, especially public employees.
- *Promote opportunity by supporting household investments in human capital and helping men and women to access more productive employment.* By providing income support to individuals and households living in poverty, social assistance bolsters demand for education, health, and nutrition, all of which build human capital. Labor programs help beneficiaries build their skills and acquire work experience to enhance their productivity and job prospects while helping them find better employment opportunities. They also help micro and small enterprises expand and grow. Programs that enhance opportunity are increasingly important as new technologies, evolving demographics, and climate change continue to transform Malawi's economy.

Source: Replicated and adapted from World Bank 2022c.

Social Protection in Malawi: An Expanding and Innovative System Able to Respond to Shocks

The social protection system has evolved dramatically over the last two decades. Beginning as a collection of fragmented, small, and exclusively donor-financed initiatives, the social protection system is now a coherent set of programs, some of which cover large sections of the population. The system is centrally coordinated, with programs implemented jointly by the central and local governments, and it is supported by a well-functioning and swiftly expanding digital infrastructure. Over the years, the country's social protection system has become more efficient, and the coverage of households in the poorest quintile has steadily increased.[9]

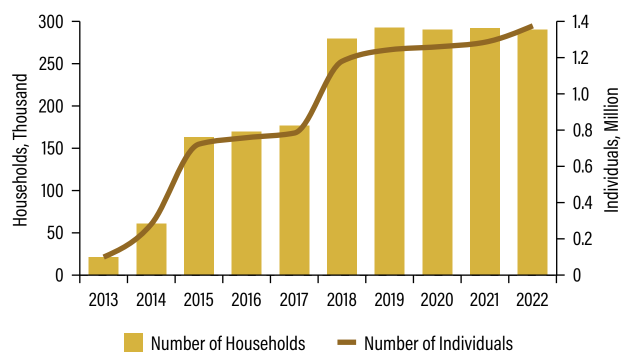
9. According to the World Bank's ASPIRE database, while in 2010/11, 19.4 percent of beneficiaries of social safety net programs belonged to the poorest quintile, in 2013, it was 21.5 percent, and in 2016/17, it was 27 percent.

Dynamic and Shock-Sensitive Core Social Assistance Programs

Since 2020, Malawi's main social protection initiatives and delivery systems have been developed under the Social Support for Resilient Livelihoods Project (SSRLP) as part of the National Social Protection Strategy. The SSRLP is a six-year initiative designed to improve resilience among poor and vulnerable households and strengthen social protection at the national level. The program is implemented by the National Local Government Finance Committee (NLGFC) and by the Ministry of Gender, Community Development and Social Welfare, with financing from the World Bank, the Government of Germany, Malawi's Social Protection MDTF,[10] and the Government of Malawi. The SSRLP includes three core social assistance programs, all of which have been significantly expanded over the last five years: the Social Cash Transfer Program (SCTP), the Climate Smart Enhanced Public Works Program (CS-EPWP), and the Livelihood Support program.[11]

The SCTP, known locally as *Mtukula Pakhomo,* provides unconditional monthly financial support to the poorest and most vulnerable households. It aims to lift them out of poverty while building human capital and resilience at the household level. The program is financed by the World Bank, the European Union, the Government of Germany, the Government of Ireland, and the Government of Malawi, and it currently covers all districts in the country. The SCTP supports about 300,000 extremely poor households, covering roughly 6 percent of all households in the country and almost 1.3 million people (Government of Malawi 2022) (Figure 2.2).

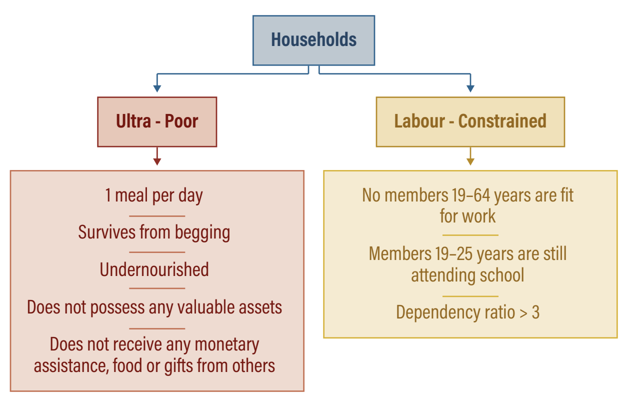
FIGURE 2.2 The number of SCTP beneficiaries



Source: SCTP Administrative Records.

The SCTP's positive impact on beneficiary households and communities is well established. A 2016 evaluation by the University of North Carolina found that the STCP was associated with significant improvement in the welfare of beneficiaries. Consistent with the international experience, the evaluation uncovered further proof that households tend to use the cash they receive wisely, as transfers were used to purchase food and to invest in education, health services and productive assets. Relative to non-beneficiaries, SCTP households displayed a 21 percent increase in the ownership of livestock, a 60 percent increase in crop value, and an 86 percent increase in spending on productive tools such as agriculture assets and livestock. SCTP beneficiaries were also more likely to delay sexual debut and had a higher average age of first pregnancy. Children in SCTP beneficiary households were 12 percent and 16 percent more likely to be enrolled in primary and secondary school, respectively, indicating a greater likelihood of escaping the cycle of poverty. Finally, every dollar disbursed by SCTP generated US$1.69 for the local economy, a powerful multiplier effect showing that investments in social protection generate a highly positive economic return (University of North Carolina at Chapel Hill 2016).

FIGURE 2.3 SCTP eligibility criteria



Source: Replicated from SSRLP Operational Manual.
Note: According to STCP's strategy, the program will gradually revise its targeting criteria to include more categorical elements (i.e., to prioritize specific groups of society based on demographics or vulnerability profile).

In recent years, rising inflation and currency depreciation have eroded the real value of the average SCTP transfer, jeopardizing the achievements of the program. The international experience

10. Malawi Social Protection MDTF donors are the European Union, the United States Agency for International Development, Ireland, Iceland, Norway and the United Kingdom's Foreign Commonwealth Development Office.

11. The School Meals Program, targeting about 600,000 children as of 2021 in seven districts (Chikwawa, Dedza Mangochi, Phalombe, Nsanje, Salima and Zomba), funded by the European Union and implemented by WFP in partnership with local governments, is the country's largest safety net, though it focuses on children and in-kind benefits. Because it is implemented mostly by non-state actors, the program is not considered in this section.

indicates that a transfer equal to about 20 percent of household consumption can have a transformative effect on beneficiaries. Currently, transfers to just 30 percent of households reach this level. The last nominal increase in benefits was in October 2023, and a further increase in 2025 may be necessary to maintain the program's impact (Government of Malawi 2024).

BOX 2.2 Conditional and unconditional cash transfers

Transfers provided through the SCTP are unconditional, meaning that beneficiaries are not required to take any specified action in order to qualify for benefits. In other countries, similar programs impose conditions such as obtaining reproductive health care or enrolling children in school. Almost three decades of evidence shows that while conditional cash transfers (CCTs) appear to have a greater short-term impact on human capital than unconditional cash transfers (UCTs), the latter do more to improve psychological wellbeing and reduce teen pregnancy and child marriage. In low-income settings, where public services are of limited availability and quality, imposing conditions may further marginalize the poorest and most vulnerable, who are typically those least able to comply. CCTs can also create opportunities for abuse of power by those responsible for monitoring and enforcing them, exacerbating unequal power dynamics at the local level. Ultimately, the relative merits of UCTs and CCTs hinge on the types of outcomes policymakers are trying to achieve, as well as their capacity to monitor compliance among beneficiaries. For programs covering remote areas or sectors with limited reporting infrastructure, imposing conditions may be infeasible.[a]

a. For a summary of this debate, see https://blogs.worldbank.org/en/developmenttalk/how-should-we-design-cash-transfer-programs

The Climate-Smart Enhanced Public Works Program (CS-EPWP), also known as *Mbwezera Chilengedwe,* provides income support and increases food security while building resilience to climate shocks by creating durable community-owned assets. Poor households, which often depend on subsistence agriculture, are highly vulnerable to climate change and environmental degradation. Building on the success of previous public works programs in Malawi, the World Bank and other donors have been supporting CS-EPWP since its inception in 2020, including through a recently established multi-donor trust fund.[12] Over the last four years, the CS-EPWP has significantly expanded its coverage, and by May 2024 close to 520,000 extremely poor households had been enrolled in CS-EPWP across all of the country's 28 rural districts.

Implemented through district councils with support from NLGFC and the Department of Land Resource Conservation, the CS-EPWP targets extremely poor households with adequate labor capacity. Prospective beneficiaries are identified through the UBR. The local projects financed through the program contribute to climate-change adaptation and mitigation and reduce households' exposure to climate-related risks and shocks. Many projects focus on soil and water conservation, agro-forestry, and similar areas.

In line with the National Social Support Program's objective of building resilient livelihoods through a "cash plus" approach, the Livelihood Support component of SSRLP provides households with ancillary assistance aimed at enhancing their productive capacity. This component concentrates on fostering the development of income-generating activities by offering small grants aimed at self-employment or microenterprise creation and supporting the formation of savings' groups; skills development through trainings on topics like business planning, bookkeeping, and group mobilization; as well as financial literacy and inclusion through the promotion of digital payments and the use of mobile money and other financial technologies.

The Social Protection System and Infrastructure

Institutional Arrangements and Donor Dependence

The institutional fragmentation of the social protection sector complicates coordination among stakeholders. While a lot of planning and implementation capacity has been built within Government over the last decade around social protection, several different line ministries are tasked with implementing various aspects of the different programs. The Ministry of Gender, Community Development and Social Welfare implements the SCTP, while NLGFC and the Ministry of Local Government implement the CS-EPWP. The Poverty Reduction and Social Protection Division of the Ministry of Finance and Economic Affairs (MoFEA) oversees the implementation of the National Social Protection Policy and coordinates the sector, but constraints related to ICT and continuous training limit the ability to

12. Other donors to the MDTF that finances the CS-EPWP include the European Union, Iceland, Norway, the UK's Foreign Commonwealth Development Office, and the United States Agency for International Development

fulfill its role. The National Social Support Steering Committee and its Technical Committees have limited capacity to provide strategic guidance to line ministries and agencies. Malawi's 2018 National Social Support Programme II called for establishing thematic working groups on shock-sensitive programs and other aspects of social protection, but these groups have yet to be established. However, the creation of the MDTF is a positive step towards improving donor coordination.

The budget for social protection remains low and heavily donor-dependent, which could jeopardize the system's overall effectiveness in supporting climate-change adaptation among poor and vulnerable households.[13] Only 3.4 percent of the national budget is allocated to safety nets, which include SCTP and CS-EPWP transfers and a few smaller emergency-related measures that were temporarily incorporated into the SCTP. Total spending on social safety nets averaged 0.8 percent of GDP between 2011 and 2019 and reached 0.9 percent in 2023, still well below the Sub-Saharan Africa average of 1.2 percent. Development partners provide over 95 percent of the SCTP budget and almost all CS-EPWP resources (World Bank 2022a, and UNICEF 2023). The country's challenging fiscal position and debt dynamics prevent a significant increase in social protection spending in the short term, even though greater investments in the social protection sector would likely yield a highly positive return.

Innovative Shock-Responsive Financing

To address the sector's financing challenges, a comprehensive package of earmarked contingent funding was adopted, with additional parametric risk insurance, to respond to multidimensional crises, particularly droughts, and to provide support to affected households through the SSRLP. By linking disaster risk financing and social protection programs, the government allocated financing for shock-responsive cash transfers in advance. Under the project, various instruments to respond to disasters and shocks have been established, including: (i) disaster risk financing instruments such as parametric insurance and flexible contingency funds to financially prepare for timely shock-responsive cash transfers, and (ii) measures embedding adaptable shock response in the design of the SCTP and CS-EPWP.

Harmonized Digital Delivery Systems

The UBR is a vital component of the SSRLP and other shock-response mechanisms. In 2016, the government envisioned the UBR as a single repository of household-level information to assist in harmonizing beneficiary outreach and registration for social protection and other government programs. The UBR has since evolved to include information both on current beneficiaries and potential beneficiaries.

The UBR serves as a central platform to support the targeting of poor and vulnerable households across different programs. The UBR identifies households based on their socioeconomic status using information on asset ownership and other household characteristics. The data included in the UBR enables the government to monitor which programs different households are enrolled in and identify redundancies across programs.

The UBR currently includes demographic and socioeconomic data on a total of 3.9 million households (16,102,922 individuals), representing approximately 77 percent of the total population and 95 percent of the rural population. Housed in MOFEA's Directorate for Poverty Reduction and Social Protection, UBR data is collected every four years using the "census sweep" approach and a harmonized data-collection tool. Five programs currently use the UBR data for targeting,[14] and many different institutions have

13. The figures in this paragraph do not include the budget for the AIP program, which is a subsidy linked to agricultural inputs.

14. These programs include the SCTP, CS-EPWP, and Shock Responsive Social Protection programs (Lean Season/Food Insecurity/Price Shock Responses and Scalable safety nets). The UBR also supports targeting across other small-scale interventions implemented by various agencies such as WFP, UNICEF, and nongovernmental organizations. This has enabled the UBR to attain some key attributes of a good social registry i.e., cost saving, efficiency, coordination, reduced targeting errors, and improved response to shocks.

access to the data for various purposes, helping to streamline services and program delivery across the country and allowing for better coordination among line ministries, agencies, and donors (Table 2.1).

TABLE 2.1 Institutions currently using UBR data

Name of Institution	Purpose	Coverage
Ministry of Gender	Targeting SCTP beneficiaries	All councils
District Councils	Targeting CS-EPWP beneficiaries	All 28 councils
Ministry of Agriculture	Targeting for AIP	18 Councils
Red Cross	Rapid disaster assessment	Mulanje, Machinga, Phalombe, Zomba
DODMA -Mulanje and Thyolo	Humanitarian response	Mulanje and Thyolo
ENDEV – GIZ	Targeting for the Demand Side Subsidy Program	Balaka, Nkhatabay, Dedza and Salima
NLGFC – Scalable Safety Nets	Targeting beneficiaries	Karonga
SOS Mzuzu	Targeting orphans and vulnerable children	TA Kampingo SIbande (Mzimba)
Care Malawi International	Targeting households	Mangochi
UNDP	Tracking indicators for the Sustainable Development Goals	Nsanje
National Planning Commission	Developing the New Malawi Vision	12 Districts
Concern WorldWide	Preparing a pilot graduation package	Chikwawa
Give Directly	Triangulating data for poverty mapping	Lilongwe District – TA Khongoni
The World Bank	Monitoring poverty	All Councils
NRB	Validating national IDs	Selected Councils
UMEA Universidad	Academic research	Nsanje & Chikwawa

Source: Author's representation.

The UBR is partially integrated with the management information systems of the SCTP and the CS-EPWP, and data is shared through a one-way Application Program Interface. A 2022 memorandum of understanding between the MoFEA and the National Registration Bureau enabled the integration of the UBR and National Identification System, as the latter is used to uniquely identify social protection beneficiaries. The UBR is one of the databases that will be linked through a government data-exchange platform ("Boma Lathu") to the National Identification System and other government databases to enhance data exchange and improve timeliness and data quality.

UBR data are critical to make effective policy decisions and support targeted crisis-response efforts. The UBR's georeferenced data are close to achieving full population coverage in the most disaster-prone districts. Information on households' vulnerabilities, location, enrollment in different programs, and other characteristics is referenced against indicators of shock exposure in different parts of the country, informing preparedness and response measures.

Under the SSRLP, the use of digital payments has increased significantly, with about 440,000 households across 10 districts currently being paid STCP benefits or CS-EPWP wages electronically. Digital payments contribute to the efficient and timely delivery of benefits. Traceability, payment reports, and reconciliation processes are automatic and reliable, avoiding the errors, delays, and increased risk of fraud associated with manual processes. Digital payments are also much more convenient for beneficiaries, as funds are delivered directly to the intended recipient (subject to authentication) and may be withdrawn as needed rather than all at once. Digital payments have allowed for rapid transfers during emergencies, when support is especially urgent. The digital payments infrastructure developed under the SSRLP can also be used across government departments and by donors and humanitarian organizations to rapidly scale up their support and quickly reach affected populations.

Digital payments have encouraged financial inclusion by increasing access to formal financial services among beneficiaries. Beneficiaries are currently being paid through mobile-money platforms and banks, enabling them to save, borrow, and build financial resilience. Introducing digital payments in areas underserved by the financial sector, where many beneficiaries reside, gives financial-service providers the opportunity to reach new customers, prompting them to make complementary investments in infrastructure or tailor-made products for poor households.

Social Protection as an Adaptive Crisis Response Tool

The COVID-19 Urban Cash Initiative (CUCI)

Malawi's first major shock-responsive cash-transfer program was the COVID-19 Urban Cash Initiative (CUCI) implemented as part of the 2020 National COVID-19 Preparedness and Response Plan (World Bank 2021 and Government of Malawi 2023). The initiative aimed at mitigating the adverse impacts of the pandemic on livelihoods, human capital accumulation, and basic consumption among poor households in the cities of Lilongwe, Blantyre, Zomba, and Mzuzu. It targeted 35 percent of each city's population. In 2021, about 199,000 households received the equivalent of the minimum wage at the time, MK 35,000 (about US$45), per month for three months. CUCI was the first cash-transfer program in urban centers and in a number of areas where no regular social safety net had previously existed.

A rigorous evaluation of the CUCI documented its positive effects, particularly in terms of increasing resilience and mitigating the economic and social impact of the pandemic (Government of Malawi 2023). Close to 70 percent of CUCI beneficiaries spent at least part of their benefit on food, with an average of 30 percent of the total payment devoted to food purchases. The second largest share of CUCI benefits went to protecting businesses, with about 45 percent of beneficiaries using an average of 40 percent of the provided benefits for this purpose. About one-third of CUCI recipients used about 25 percent of the funds to support their children's education. The intervention increased both the quality and quantity of food consumed among beneficiaries relative to non-beneficiaries. Crucially, CUCI beneficiaries were less likely to resort to negative coping mechanisms such as selling productive assets or incurring debt.

Emergency Cash Transfers in Response to Floods, Tropical Cyclones, and Price Shocks

By leveraging the information compiled in the UBR and utilizing the targeting methodology and geographical coverage of SCTP and CS-EPWP, the government was able to provide rapid support to poor and vulnerable households in response to multiple shocks. The response effort included a temporary increase in support to existing program beneficiaries, the expansion of programs to new households, or through a combination of both.

- **In response to the 2019 floods caused by Cyclone Ida, SCTP support was scaled up by providing additional transfers to 31,587 beneficiary households in five affected districts.**

- **Shortly after Cyclone Freddy hit Malawi in March 2023, killing over 1,200 people and destroying livelihoods and infrastructure, the government approved the Early Recovery and Food Insecurity Response.** Under the SSRLP, close to 195,000 households (about 875,000 people or 4 percent of the population) across nine districts received MK 150,000 to bolster their resilience. Another 67,000 households in five additional districts received a combination of support to mitigate the impact of Cyclone Freddy, inflation, and food insecurity.

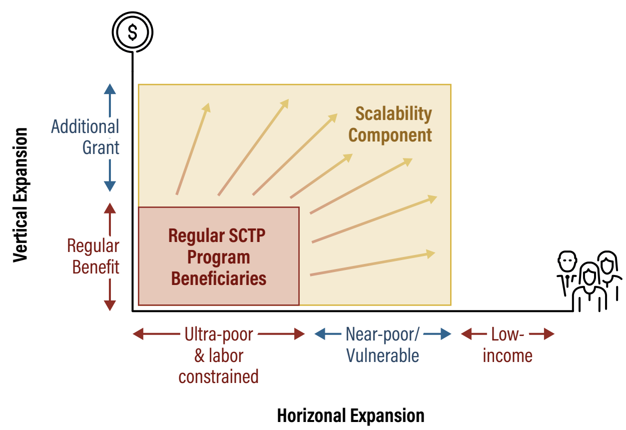
- **The government has implemented temporary measures to support the urban poor and vulnerable from the effects of the recent currency devaluation and subsequent increase in inflation.** Building once again on the SCTP, the Urban Price Shock Emergency Response intervention was launched in March 2024. A scheme similar to the Early Recovery and Food Insecurity Response, the Urban Price Shock Emergency Response provided support to about 105,000 households (about 470,000 people) in the cities of Blantyre, Lilongwe, Mzuzu, and Zomba.

- **In October 2023, benefit levels for regular SCTP payments were permanently increased by over 65 percent, from MK 9,000 to MK 15,000, to compensate for the rising cost of living.** Digital payments facilitated a swift transition to the new benefit level.

The Future of Adaptive Social Protection in Malawi: Scalable Safety Nets

Climate-related events such as floods and droughts disproportionally affect poor and vulnerable households, and Malawi as a whole is highly exposed to climate shocks. The Disaster Risk Financing Strategy for 2018–2024 outlines strategic priorities and financial instruments designed to enhance Malawi's financial resilience to disasters. The main pillars of the strategy are sound risk assessments, adequate disaster risk finance mechanisms, and clear implementation rules. In line with the strategy, the Scalable Safety Nets effort was incorporated into the SCTP to provide cash to vulnerable households following a drought (Figure 2.4). The mechanism uses existing SCTP systems to provide additional benefits to existing beneficiaries and to temporarily include additional households, selected from among the CS-EPWP beneficiaries, that have become vulnerable because of a drought. The benefit amount is MK 50,000 per household per month for three months.

FIGURE 2.4 The scalability mechanism



Source: Author's representation.

Under the Scalable Safety Nets program, about 151,000 households currently enrolled in SCTP and CS-EPWP are eligible for additional cash when drought conditions materialize across the six districts.[15] These districts were selected for the initial phase of the program based on a review of drought vulnerability, food insecurity, poverty levels, and the readiness of the delivery systems to enable a timely response. The mechanism is triggered using satellite data on rainfall in the six districts[16] and is managed by a cross-departmental task force led by the MoFEA and NLGFC. Over the last two years, nearly 85,000 households have benefited from additional transfers in the pilot district of Karonga.

The program's scalable component is funded by an innovative risk-financing package that combines flexible contingent financing and disaster-risk insurance. The SSRLP includes US$20 million in contingent World Bank financing, as well as a sovereign parametric insurance package issued by the African Risk Capacity (ARC) with a US$10 million-dollar premium funded by a grant from the Global Shield Financing Facility.[17] The funding is released to the government to finance cash transfers once the specified drought conditions have been met. Based on the preliminary information available for the 2023/24 season, disbursements will be triggered in at least four districts, and funds will be released from both instruments to meet the cost of the additional cash transfers. Payments to households are expected to be made in early July 2024, but the envisioned amount of MK 25,000 per month for three months is currently being reviewed in light of the recent devaluation and the support being provided under other programs. A total of about 151,000 households are set to receive support through the scalable component, with roughly US$6 million coming from the ARC insurance policy (Table 2.2).

15. Blantyre, Chiradzulu, Ntcheu, Nkhotakota, Thyolo, and Karonga.

16. A secondary trigger (called "evidence review") is also defined. This is a soft trigger to be used as a failsafe to capture the impact of droughts, which may not be captured by the primary trigger.

17. The African Risk Capacity (ARC) Group is a Specialized Agency of the African Union established to help African governments improve their capacities to better plan, prepare, and respond to extreme weather events and natural disasters.

TABLE 2.2 Scaled-up coverage for SCTs
as of February 2024

District	Regular SCTP households selected to receive additional benefit	Non-SCTP households selected to receive support	Total number of households to be covered by the scalable component
Blantyre	7,815	10,879	18,694
Ntcheu	14,355	11,991	26,346
Thyolo	19,000	10,598	29,598
Karonga	7,483	5,259	12,742
Chiradzulu	6,453	8,941	15,394
Nkhotakota	7,701	5,882	13,583
Balaka	10,070		10,070
Mwanza	3,384		3,384
Chikwawa	14,263		14,263
Nsanje	7,074		7,074
TOTALS	**97,598**	**53,550**	**151,148**

Source: Unified Beneficiary Registry.

The Scalable Safety Nets component of the SSRLP is among the world's most innovative social safety net programs. Several countries have joined risk pools or use parametric insurance via mechanisms such as ARC or the Caribbean Catastrophe Risk Insurance Facility, and some have operational plans specifying that a given share of the payouts must be devoted to shock-responsive social protection programs. However, most lack clear criteria for identifying beneficiaries or predetermined rules for payouts, which delays response times. Other countries, such as Uganda, have set up contingent funding for climate shocks using World Bank funds. However, Malawi is the only country to have implemented a financing plan backed by multiple instruments (risk financing plus contingent financing) with predefined triggers for funds that routinely flow through the public sector. While Malawi is building one of the world's most advanced shock-responsive social protection systems, the country's intense climate vulnerability requires further investments in safety nets that can support households amid multiple successive and overlapping shocks.

Building on a Strong Foundation: The Future of Malawi's Shock-Responsive Social Protection System

Recent efforts to make Malawi's social protection system more responsive to shocks have demonstrated the system's potential both to provide immediate relief to households in the face of crises and to build long-term resilience among the households and communities most affected by climate change. These achievements provide a strong foundation for continued investments in social protection. Despite the sophistication of Malawi's social protection system, low coverage and benefit levels limit its impact on poverty and inequality. As the government and donors launch the next phase of the SSRLP program, drawing on lessons learned from the SCTP program and a forthcoming evaluation of the CS-EPWP could enable stakeholders to assess how the current mix of programs can be improved to strengthen its contribution to poverty reduction in a context of accelerating climate change.

Programs and Institutions

Most of Malawi's social protection programs have relatively modest coverage levels, and their benefits continue to be eroded by inflation and currency depreciation. In the short term, consolidating programs that have similar objectives and target the same type of households, such as the small humanitarian programs operating in a limited number of districts, would rationalize the overall system and reduce administrative costs. At the same time, stakeholders must review the benefits provided by the different programs to ensure that the support provided is adequate to meet household needs while preserving fiscal sustainability.

The government has yet to approve the updated National Social Support Policy and the new National Social Protection Strategy—the successor to the Malawi National Social Support Program, which closed in June 2023. The social protection sector currently lacks an overall vision for shock-sensitive social protection. In the near term, reforming the sector's institutional framework would help formalize the recent changes and achievements. Strengthening the capacity of MoFEA's Poverty Reduction and Social Protection Division to oversee the implementation of the policy by onboarding additional staff and conducting trainings on strategic planning, budgeting, and monitoring could improve sectoral coordination.

Financing

Malawi's spending on safety net programs remains below the regional average. The recent introduction of contingent funding for shock response, the use of parametric insurance, the leveraging of funds from the Global Shield Financing Facility to hedge against extreme weather events, and the use of multi-donor financing for social cash transfers are innovative and forward-looking developments. Going forward, strengthening the links between the country's adaptive safety nets and the various forms of disaster and climate-risk financing available at the global level could increase the financial resources available to support Malawi's social protection system.

Donors provide over 95 percent of the resources going to the social protection system. Tight fiscal constraints continue to inhibit the allocation of additional domestic resources to the sector, and the lack of a clear financing plan beyond a five-year horizon complicates long term-strategic decisions. The resulting uncertainty may jeopardize the overall system's effectiveness in supporting climate resilience among poor and vulnerable households. In the medium term, policymakers must implement the National Social Protection Strategy and establish a financing framework designed to gradually formalize social protection as a standard expenditure item in the national budget.

In the near term, shifting budget allocations away from the AIP and other subsidy programs could free up additional resources for programs such as the SSRLP. The AIP imposes a significant fiscal burden, but its targeting mechanism does not focus on the poorest households, and its impact on agricultural output appears marginal at best. Tightening enforcement of AIP eligibility criteria and consolidating beneficiaries of multiple support programs could generate an estimated US$40 million in savings. These resources could be reallocated to expand the coverage of the SSRLP and shield poor households from the loss of the benefits they had been receiving through AIP.

Shock Responsiveness and Adaptation

The SSRLP's Scalable Safety Nets component is unique and places Malawi at the forefront of the world's adaptive and climate-responsive social protection systems. After considerable delays, the approval of the Disaster Risk Management Act is more closely integrating Malawi's disaster risk financing strategy into the social protection system. Further leveraging global financing for climate adaptation and disaster risks mitigation could increase the resources available for social protection.

Over the longer term, the government should pivot away from relying on donors and humanitarian agencies to support disaster response efforts and strengthen the capacity of the domestic social protection system to respond to shocks. Humanitarian assistance, which remains a crucial part of crisis response in Malawi, mainly operates outside the government's systems. In-kind support, such as food aid, is non-fungible and may distort local prices. Building on the shock-responsive systems already in place, the government should consider further integrating emergency support into the Scalable Safety Nets program.

Beneficiary Registration and Management

The 2022–2026 UBR strategy sets forth objectives for the system's development. The strategy aims to expand the coverage of the UBR, tighten its linkages with other programs and institutions, improve the timeliness of the data, and provide real-time information on programs and beneficiaries. Expanding the coverage of the UBR to urban areas would support improved targeting and implementation of urban safety nets. Fully integrating the UBR with the National Identification System would help verify beneficiaries and ensure their unique identification, while continuing to strengthen data-security protocols will help to ensure privacy.

Connecting the UBR with other national databases would enable the exchange of data across ministries and agencies. Integrating the UBR with the AIP database and other information systems would help rationalize the overall provision of government support. Further developing the linkages between early warning systems for floods and droughts and shock-responsive social protection programs would increase the speed of response efforts.

Digitalization

Expanding the use of digital payments would further strengthen the efficiency and integrity of the social protection system. The government should gradually roll out digital payments in the remaining districts. Developing a choice model that allows beneficiaries to select the payment service provider would result in greater financial inclusion, better connectivity, and increased competition among mobile network operators and commercial banks. Finally, linking the digital payment system for social protection to the government's e-payment gateway would help consolidate the management of public resources while fostering transparency and accountability.

APPENDIX A

Macroeconomic Indicators

	2019	2020	2021	2022	2023e	2024p	2025p
National Accounts and Prices							
GDP at constant market prices (% change)	5.4	0.8	2.8	0.9	1.5	2.0	3.9
Agriculture	5.9	3.4	5.2	-1.0	0.6	-1.2	3.7
Industry	7.7	1.2	1.9	0.9	1.6	2.2	3.3
Services	5.5	-0.5	2.0	1.8	1.9	3.2	4.2
Consumer prices (annual average)	9.4	8.6	9.3	20.9	28.7	30	20.8
Central Government (FY % of GDP)							
Revenue and grants	14.6	14.6	14.7	14.6	15.2	19.1	21.1
Domestic revenue (tax and non-tax)	13.2	13.1	12.8	12.8	12.1	13.1	15.7
Grants	1.4	1.5	1.9	1.8	3.1	6.0	3.9
Expenditure	19.1	20.9	21.5	23.2	25.7	31.5	27.8
Overall balance (excluding grants)	-5.9	-7.8	-8.7	-10.4	-13.6	-18.4	-12.1
Overall balance (including grants)	-4.5	-6.3	-6.8	-8.6	-10.5	-12.4	-6.7
Foreign financing	0.8	0.8	1.0	2.6	1.9	0.5	0.7
Domestic financing	3.8	4.9	5.9	7.7	5.1	7.0	6.0
Money and Credit							
Broad money (% change)	10.2	16.7	30	38.8	32.2	35.3	18.8
Credit to the private sector (% change)	27.3	16.1	17.8	23.2	17.6	10.2	5.8
External Sector (US$ millions)							
Exports (goods and services)	1148.0	1314.0	1591.0	1490.0	1563.0	1563.0	1819.0
Imports (goods and services)	3268.0	3376.0	3770.0	3707.0	3945.0	3949.0	4152.0
Gross official reserves	825.0	799.0	910.0	575.0	749.0	1112.0	1604.0
(months of imports)	3.0	2.8	2.9	1.9	2.3	3.4	4.6
Current account (percent of GDP)	-11.6	-13.6	-15.2	-17.3	-16.1	-20.0	-19.6
Exchange rate (MK per US$ average)	745.9	749.5	805.9	949.0	1161.0	—	
Debt Stock							
External debt (public sector, % of GDP)	27.8	32.9	31.5	34.8	48.5	47.4	46.8
Domestic public debt (percentage of GDP)	17.5	21.9	30	40.8	42.8	38.1	36.5
Total public debt (percentage of GDP)	45.3	54.8	61.5	75.7	91.3	85.5	83.3
Poverty							
Poverty rate (US$ 1.90 in 2017 PPP terms)	70.1	70.7	70.6	71.3	71.7	72	71.4
Poverty rate (US$ 3.20 in 2017 PPP terms)	89.1	89.4	89.4	89.5	89.7	89.8	89.6
Poverty rate (US$ 5.50 in 2017 PPP terms)	97.3	97.4	97.4	97.5	97.5	97.5	97.5

Note: Indicators from April 2024 World Bank Macro Poverty Outlook based on data as of March 1.
e indicates estimates and p indicates projections.

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