@#&OPS~Doctype~OPS^blank@pidaprcoverpage#doctemplate

Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 26-Oct-2023 | Report No: PIDA0127

BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Region	Operation ID	Operation Name
Malawi	EASTERN AND SOUTHERN AFRICA	P500589	De-risking Importation of Strategic Commodities
Financing Instrument	**Estimated Appraisal Date**	**Estimated Approval Date**	**Practice Area (Lead)**
Investment Project Financing (IPF)	20-Oct-2023	20-Nov-2023	Finance, Competitiveness and Innovation
Borrower(s)	**Implementing Agency**		
Ministry of Finance and Economic Affairs	Reserve Bank of Malawi		

Proposed Development Objective(s)

The development objective of this project is to increase supply of trade finance for importation of essential commodities to Malawi.

Definition: For the purpose of this Project Appraisal Document (PAD), essential commodities refers to fertilizer, pharmaceuticals and potentially more strategically important commodities which will be selected by the client, subject to a 'No Objection' from the World Bank.

Components

Foreign Currency (FX) Backstopping Facility

PROJECT FINANCING DATA (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Operation Cost	**75.00**
Total Financing	**75.00**
of which IBRD/IDA	**60.00**

Financing Gap	**0.00**

DETAILS

World Bank Group Financing

International Development Association (IDA)	60.00
IDA Grant	60.00

Non-World Bank Group Financing

Commercial Financing	15.00
Unguaranteed Commercial Financing	15.00

Environmental And Social Risk Classification

Moderate

Decision

The review did authorize the team to appraise and negotiate

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Malawi is a low-income country with one of the highest incidences of poverty, food insecurity and frequent climate shocks.** Malawi's population stands at 20.4 million with a gross domestic product (GDP) per capita of US$645 in 2022[1], making it one of the poorest countries in the world. In the last two decades, real per-capita gross domestic product (GDP) has remained largely flat. The internationally comparable poverty headcount ratio - US$ 2.15 a day - for Malawi stands at 71percent, one of the highest globally.

2. **Malawi relies on subsistence, rainfed agriculture, which limits its growth potential, increases its susceptibility to climate shocks, and creates food insecurity.** About 84 percent of the country's population lives in rural areas, where they primarily engage in, or are dependent upon, smallholder, rain-fed subsistence agriculture. The agricultural sector contributes to more than 80 percent of total export earnings and total employment. Recurrent climate shocks, particularly the recent Cyclone-Freddy, inflicted severe damage on Malawi's economy, particularly on the agricultural sector. Cyclone-Freddy was the most destructive in a series of increasingly frequent extreme weather events

[1] World Bank, World Development Indicators. 2022

affecting Malawi, causing US$505 million material loss and damage, as well as production losses equivalent to a real gross domestic product (GDP) loss of 0.5 percent for 2023[2]. The effects of the cyclone have particularly impacted the outlook for the agriculture sector in the coming season, with potentially grave consequences for the poorest. According to Integrated Food Security Phase Classification (IPC), 3.3 million people in Malawi are currently experiencing high acute food insecurity (IPC Phase 3)[3]. This number is projected to increase to 4.4 million (22percent of the population) by October 2023.

3. **Malawi is one of the most vulnerable and least ready country to respond to climate change, ranking 161 (out of 185 countries) in ND-GAIN's index.**[4] As described in this project's climate and disaster risk screening, Malawi is already exposed to various natural hazards, such as flood, cyclone, and extreme heat, which will worsen with climate change. Malawi's Country Climate and Development Report (CCDR) suggest that the average projected increase in temperature is 1.03°C by 2040 and 1.34°C by 2050. Globally and in southeastern Africa in particular, extreme precipitation events are expected to intensify and become more frequent. Warming will intensify very wet and dry weather, with implications for flooding and drought.[5] In addition, Malawi is exposed to non-climate related disaster risks. ThinkHazard rates volcano hazard level as "high", especially in the northern region of the country. Earthquake hazard level is rated "medium", meaning that there is a 10percent chance of potentially damaging earthquake in Malawi in the next 50 years.[6] Climate change and geophysical hazards could exacerbate the health and food insecurity crisis in Malawi. For example, rising temperatures could lead to an increase in outbreaks of vector- and water-borne diseases (e.g., malaria and cholera). Increased dry spells and floods could reduce maize yields and earthquakes could trigger landslides, leading to further disruptions in agricultural supply chains and increasing food insecurity. As an example, according to the CCDR, the first year of the devastating drought in 2015–2017 left 6.5 million people food-insecure, including 3.5 million children. The Tropical Storm Ana in 2022 also destroyed 71,700 hectares of crops and killed or injuring tens of thousands of livestock. Women and girls are particularly vulnerable to these risks. The CCDR pointed to women having inadequate access to healthcare and family planning. The CCDR also shows that women are more vulnerable to climate shocks to food consumption, partly due to their lack of access to land-tenure security.[7]

4. **Currently, Malawi's economy is struggling with a toxic cocktail of forex shortage, high inflation, and large current account and fiscal deficits.** These macroeconomic challenges are reflected in a parallel market premium of above 50 percent, low forex reserves of less than three months of import cover, annual inflation of around 28 percent, and large current account and fiscal deficits equivalent to around 12 percent and 10.9 percent of GDP, respectively. Gross reserves decreased from US$805 million in June 2022 to US$714.1 million in June 2023 (around 2.9 months of import cover). The Government tried to ensure fuel and fertilizer importation by providing prioritized access to official financing by the RBM. But as the official reserve dwindles further, RBM and the banking sector in Malawi are finding it difficult to finance these strategic imports. An acute lack of foreign currency is impeding businesses and is increasingly reflected in the shortage of critical and lifesaving imports such as fertilizer and pharmaceuticals.

5. **Cognizant of the macroeconomic challenges, Malawi's authorities have reached out to the World Bank and International Monetary Fund (IMF) seeking support to restore a stable and sustainable macroeconomic position**. In September 2023, Malawian authorities and IMF reached a staff-level agreement on macroeconomic and financial

[2] World Bank. 2023. Malawi Economic Monitor

3 Integrated Food Security Phase Classification, Acute Food Insecurity Analysis for Malawi. 2023.

[4] *The ND-GAIN Country Index summarizes a country's vulnerability to climate change in combination with its readiness to improve resilience. A lower country ranking means that the country is more vulnerable and/or less ready to respond to climate change.*

[5] *World Bank (2022). Malawi Country Climate and Development Report.*

[6] *ThinkHazard. Malawi.*

[7] *World Bank (2022). Malawi Country Climate and Development Report.*

policies and reforms to be supported by a new 48-month financing arrangement under the Extended Credit Facility (ECF) of about US$174.00 million[8]. In parallel, Malawian authorities are in discussion with the World Bank towards preparation of a new development policy operation (DPO). These envisaged WB & IMF operations will support the authorities' ongoing efforts to restore a stable and sustainable macroeconomic position consistent with strong and durable poverty reduction and growth envisaged under Malawi 2063. Moreover, the authorities are working towards securing debt restructuring with bilateral official and external commercial creditors which is key to restore medium-term debt sustainability.

6. **As the envisaged macroeconomic reforms take time to take effect, a bridging solution is required to avoid disruption of critical economic functions**. In light of this, the Government of Malawi has made an official request to the World Bank requesting the latter to support the financing of imports of essential commodities, particularly fertilizer and pharmaceuticals. This project responds to the urgent needs of Malawi and is part of a package of WB&IMF programs aimed at tackling the country's macroeconomic challenges.

Sectoral and Institutional Context

7. **Malawi's financial sector is small, shallow, and dominated by banks.** The financial sector consists of banks, microfinance institutions, a nascent capital market and a small number of institutional investors (insurance and pension markets). As of December 2021, 59.5 percent of total financial sector assets were held in the country's eight commercial banks. The banking sector in Malawi is comprised of eight banks. The two largest banks held 46.2 percent of the total assets and 50.1 percent of the loans in 2021. Four of the banks are privately owned, and they represent 59.5 percent of total net assets, while the remaining four are foreign-owned, and they represent 40.5 percent of total net assets (RBM, 2021).

8. **The Financial Sector is sound despite the economic challenges facing the country.** While other sectors of the economy have grappled with the effects of a series of macroeconomic shocks that have hit the economy, the financial sector has remained resilient. The macroeconomic environment has weakened following adverse global conditions, from COVID-19 to the recent global commodity price shock, and their spillover to the domestic market. Nonetheless, the financial system in Malawi remains well capitalized, liquid, and profitable.

[8] *The agreement is subject to IMF Management and Executive Board approval and receipt of the necessary financing assurances*

Figure 1.32 Bank resilience reflected in financial stability indicators
Percent

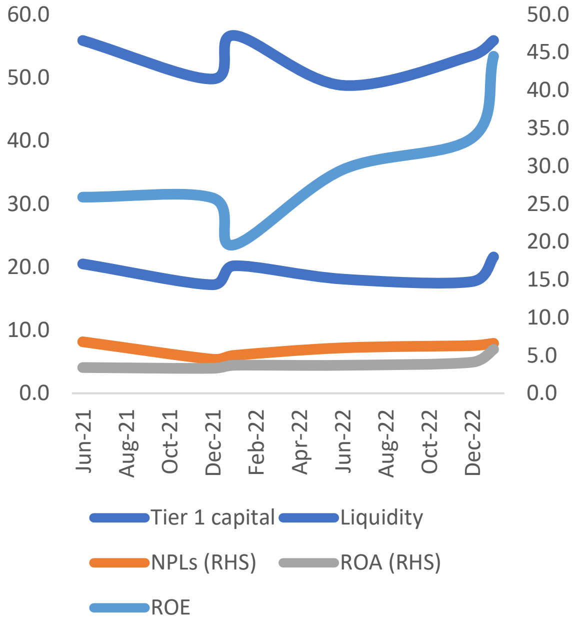
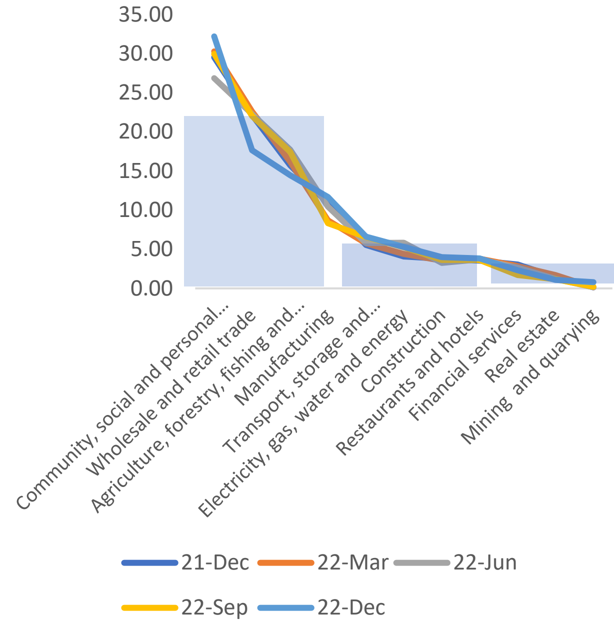


Figure 1.3.3 Bank lending predominant in three sectors
Monthly share to total lending in selected sectors



9. **Goods and services to Malawi are imported through open account, advance payments, payment guarantees as well as conventional letters of credit with or without paying cash up front.** Advance payments are rarely used by importers that source goods from their regular suppliers but are common for importers who are unable to establish credibility with their suppliers. Recently, there has been an increased reliance on LCs for import transactions due to foreign exchange scarcity which inhibits open account transaction.

10. **Banks' main sources of forex are their exporting clients, clients receiving donor funds, diplomatic missions who sell forex when they have financial obligations in local currency, and remittances.**[9] Commercial banks get forex to sell to importers when the central bank sell forex in the market or when their customers with forex deposits sell part of their deposits. The Reserve Bank of Malawi (RBM) intervenes periodically by selling forex to banks to enable them to meet demand for payment of strategic import commodities. However, the RBM has not been able to do so in the recent past due to forex shortages and a new regulation that was introduced towards the end of 2021 requiring all forex earners to convert 30 percent of their forex earning into local currency and to remit forex to the central bank. Thus, banks must continue to meet all demand from meagre export proceeds, donor aid projects, and remittances. Occasionally, commercial banks may run short currency positions (i.e., borrow forex from their clients) to cover import bills.

11. **This lack of depth in the forex market implies that banks would not open LCs with forex amounts beyond what they think they can mobilize by the time the LC matures**. As a result, importers are no longer able to secure the foreign currency needed to bring in products into the country. Some importers have indicated that they have not managed to get their banks to issue LCs, even at a premium price. Some international banks are not willing to confirm

[9] Net remittance reduced to an average of about US$12 million in 2021 from US$20.6 million in 2019.

LCs while some are willing to confirm them but want to see the cash in the account upfront, which is a departure from normal working procedures.

12. **Malawi's terms of trade have improved after declining for more than two years through June 2022.** The prices of many of the key commodities that Malawi imports such as petroleum fuel have decreased in recent months while the prices of Malawi's core export commodities have stabilized at a high level (Figure 1). This is reflected in improved terms of trade since the second half or 2022 (Figure 2). The prices of Malawi's commodity exports relative to its commodity imports are approximately at the level they were in late 2021, before the recent commodity price shock, and early 2019, before the onset of pandemic-induced disruptions.

Figure 3: Fertilizer and oil have been getting cheaper recently while Malawi's main exports have held their value
Price indices for select commodities (01/2022 = 1)

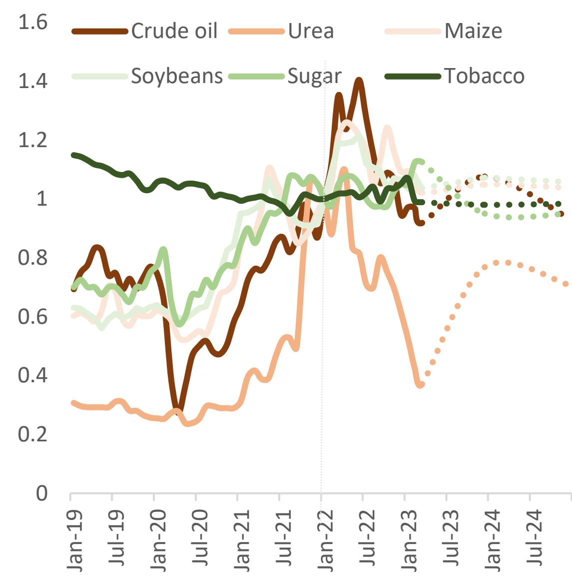


Figure 4: After a long decline, Malawi's terms of trade are looking up
Commodity terms of trade (01/2022 = 1)

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

13. The development objective of this project is to increase supply of trade finance for importation of essential commodities to Malawi.

Definition: For the purpose of this Project Appraisal Document (PAD), essential commodities refers to fertilizer, pharmaceuticals and potentially one more strategically important commodity which will be selected by the client, subject to a 'No Objection' from the World Bank.

Key Results

14. The achievement of the PDO would be measured by the result indicators below.

a. Total value of imports backstopped through this operation as a percentage of total imports of essential commodities to Malawi
b. Total value of import supported by the backstopping facility.
c. Number of trade finance transactions supported by the facility.

15. The intermediate results are measured by the result indicators below:

a. Number of local issuing bank participating in the scheme
b. Default rate on payment obligations of local issuing banks
c. Percentage increase on the LC limits from confirming banks to local issuing banks

D. Project Description

16. The proposed operation will de-risk importation of essential commodities to Malawi by backstopping the payment obligations of local issuing banks to their correspondent confirming banks. In effect, the project would assume the payment risk of local issuing banks to their correspondent confirming banks. Currently, correspondent banks lack confidence to extend letter of credit (LC) lines to Malawian banks due to the high-risk profile of local banks, which largely emanates from country risk. As a result, Malawi is witnessing a huge deficit in the supply of essential commodities such as fertilizers and pharmaceuticals. The proposed facility will provide correspondent banks with the assurance that the WB will assume the payment obligations of the local issuing banks in the unlikely event that local banks default on their payment obligations, thereby increasing correspondent banks' confidence to extend LC lines to local issuing banks. The facility is akin to a credit guarantee facility in its intent to make markets work by enhancing confidence.

17. This project aims to expand the supply of trade finance by restoring confidence to the market and mitigating risks that would otherwise inhibit the activity of local issuing banks. The relevance of this trade finance facility lies in its structure to make markets work, without undermining market solutions. The proposed operation offers an opportunity to enhance supply of trade finance through a market-driven solution that focuses on the private sector and leverages banking sector resources. The facility aims to support commercial banks in facilitating LC for private importers while leveraging a portion of their forex liquidity to achieve a multiplier effect and provide time for the market to correct itself. The program will also help local banks develop relationships with correspondent banks and enhance their trade finance capabilities. The additionality of this operation lies in the extent to which it helps enable viable trade transactions that would otherwise not occur because of the inadequate supply of trade finance for essential commodities.

18. The Project is expected to leverage the IFC's GTFP to enhance the impact of the intervention. Two windows are envisioned under the proposed operation: 1) working via GTFP and 2) working directly with corresponding banks. GTFP will work with local issuing banks and correspondent banks to support the import of select commodities into the country. This will be done by the onboarding of selected issuing banks in phase 1 and later expand to include additional banks in Malawi. GTFP already has relationships with more than 300 corresponding and the expertise to help manage the facility effectively.

19. **This operation will only support importation of essential commodities by the private sector.** Supporting a program of imports through the private sector is a more efficient approach that complements a set of reforms on the macro-fiscal front. This includes reducing the pervasive role of the State in imports of commodities through a graduated pathway and enabling markets to function. The proposed operation through the private sector is consistent and closely linked with the broader reform agenda with less reliance of the import of strategic goods on the state budget.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Area OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

E. Implementation

Institutional and Implementation Arrangements

20. **MoFEA will represent the GoM in signing the financing agreement with a deferred drawdown option while RBM will be the main implementing agency for this operation**. As this trade finance operation falls under RBM's mandate of ensuring price and financial stability, RBM is best positioned to implement the project.

21. **Implementation arrangement for this Project is expected to be fairly straightforward as it does not involve procurement of goods or services, and disbursements will only take place upon the occurrence of pre-defined trigger events.** To manage the reporting, safeguard and (light) supervision functions, Reserve Bank of Malawi (RBM) will assign focal persons who will work closely with the FINES PIU. The principal activities of the implementing agency will comprise: (a) preparing environmental and social safeguard instruments, particularly ESMS and SEP, (b) gathering required documentation for verification of trigger events- in case they occur - and use of funds - in case withdrawal(s) are requested - in accordance with protocols agreed with the World Bank; and (c) reporting on trade finance transactions supported by the project.

CONTACT POINT

World Bank

Isfandyar Zaman Khan
Lead Financial Sector Specialist

Mengistu Bessir Achew
Senior Financial Sector Specialist

Qursum Qasim
Private Sector Specialist

Qursum Qasim
Private Sector Specialist

Borrower/Client/Recipient

Ministry of Finance and Economic Affairs

Implementing Agencies

Reserve Bank of Malawi
Chakudza Linje, Director, chakubanda@rbm.mw

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Isfandyar Zaman Khan, Mengistu Bessir Achew, Qursum Qasim

Approved By

Practice Manager/Manager:		
Country Director:		