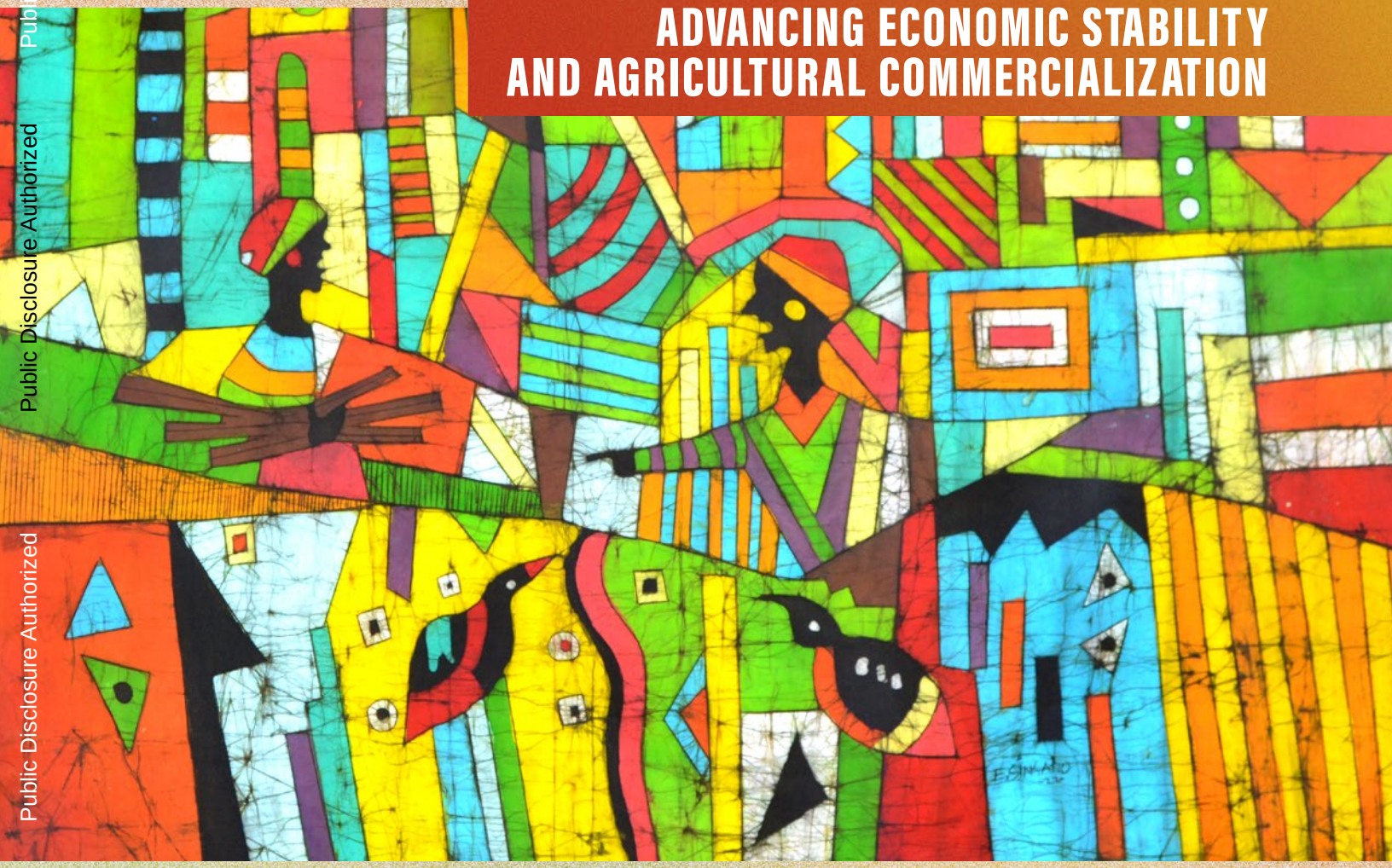
Malawi Economic Monitor

DECEMBER 2022

PLANNING BEYOND THE NEXT HARVEST

ADVANCING ECONOMIC STABILITY AND AGRICULTURAL COMMERCIALIZATION



THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

Malawi Economic Monitor

DECEMBER 2022

PLANNING BEYOND THE NEXT HARVEST

ADVANCING ECONOMIC STABILITY AND AGRICULTURAL COMMERCIALIZATION

THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

Cover Art Work Credit:
Ellis Singano

Cover design, interior design:
Piotr Ruczynski, London, United Kingdom
Typesetting:
Piotr Ruczynski, London, United Kingdom
Wojciech Wolocznik, Cambridge, United Kingdom

CONTENTS

BOXES

FIGURES

TABLES

ACKNOWLEDGEMENTS

The Malawi Economic Monitor (MEM) provides an analysis of economic and structural development issues in Malawi. This 16th edition was published in December 2022 and is part of an ongoing series, with future editions to follow twice each year. The publication intends to foster better-informed policy analysis and debate regarding the key challenges that Malawi faces in its endeavor to achieve inclusive and sustainable economic growth.

This edition of the Malawi Economic Monitor was prepared by Jakob Engel (Senior Country Economist, Task Team Leader), Yumeka Hirano (Economist, co-Task Team Leader), Yalenga Nyirenda (Country Economist), Hayaan Nur (Consultant), Efrem Chilima (Senior Private Sector Specialist), Dipti Thapa (Agriculture Economist), Blessings Botha (Senior Agriculture Economist), and Paavo Eliste (Lead Agriculture Economist). Chapter 2 benefitted from close collaboration with Todd Benson and Joachim De Weerdt from the International Food Policy Research Institute and draws on the forthcoming Background Paper for the new Malawi Country Economic Memorandum, "Employment options and challenges for rural households in Malawi". Contributions were also made by William Mwanza (Consultant), Innocent Njati Banda (Consultant), Lina Marcela Cardona (Economist), Nobuo Yoshida (Lead Economist), Besart Avdiu (Economist), Trust Chamukuwa Chimaliro (Senior Financial Management Specialist), Michael Roscitt (Senior Public Sector Specialist), and Paul Welton (Senior Financial Management Specialist).

Vivek Suri (Practice Manager, Macroeconomics, Trade and Investment), Hugh Riddell (Country Manager, Malawi), Preeti Arora (Operations Manager, Malawi), and Nathan M. Belete (Country Director, Malawi) provided overall guidance. The team wishes to thank Holger Kray (Practice Manger, Agriculture and Food) and William Battaile (Lead Country Economist), as well as the peer reviewers Sashana Whyte (Senior Economist) and Francisco Obreque (Senior Agriculture Specialist) for their constructive inputs.

This report benefited from fruitful discussions, comments and information provided by representatives of the Ministry of Finance and Economic Affairs; the Reserve Bank of Malawi; the National Statistical Office; and a number of other Government ministries, departments and agencies. The team would also like to thank representatives of the private sector in Lilongwe and Blantyre for their helpful contributions.

Henry Chimbali (External Affairs Officer), Elizabeth Mangani (Team Assistant), and Tinyade Neffie Kumsinda (Team Assistant) provided assistance with external communications, design and additional production support. Peter Kjaer Milne (Consultant) provided editorial support.

The findings, interpretations, and conclusions expressed in this publication do not necessarily reflect the views of the World Bank's Executive Directors or the countries they represent. The report is based on information current as of November 25, 2022.

The World Bank team welcomes feedback on the structure and content of the Malawi Economic Monitor. Please send comments to Jakob Engel (jengel@wordlbank.org), Yumeka Hirano (yhirano@worldbank.org) or Yalenga Nyirenda (ynyirenda@worldbank.org).

ABBREVIATIONS

AIP	Affordable Input Programme
AGCOM	Agricultural Commercialization Project
DRM	Disaster Risk Management
ECF	Extended Credit Facility
EMDEs	Emerging Markets and Developing Economies
EU	European Union
FDI	Foreign Direct Investment
FXB	Foreign Exchange Bureau
GDP	Gross Domestic Product
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IFPRI	International Food Policy Research Institute
IHS	Integrated Household Survey
IMF	International Monetary Fund
MEM	Malawi Economic Monitor
MDA	Ministry, Department, and Agency
MoFEA	Ministry of Finance and Economic Affairs
MSME	Micro, Small & Medium Enterprises
MTDS	Medium-Term Debt Strategy
NPLs	Non-Performing Loans
NSO	National Statistical Office
PDU	Presidential Delivery Unit
PFM	Public Finance Management
PFMA	Public Finance Management Act
POs	Producer Organizations
RBM	Reserve Bank of Malawi
ROA	Return on Assets
ROE	Return on Equity
TT	Telegraphic Transfers
US$	United States Dollar
VAT	Value-Added Tax

OVERVIEW

Malawi's macroeconomic crisis is worsening, severely impacting households and the private sector

After a tepid rebound in 2021, Malawi's economy entered another slowdown this year. World Bank estimates suggest that Gross Domestic Product (GDP) growth has slowed to 0.9 percent in 2022, a decline from 2.8 percent in 2021. This constitutes a per-capita GDP contraction of 1.8 percent given annual average population growth of 2.7 percent. External shocks, and in particular the impacts of the Russia-Ukraine war, as well as a worsening balance-of-payments crisis caused by sustained fiscal and external imbalances, are at the core of this recent economic slowdown.

Due to adverse weather conditions, agriculture became a drag on growth rather than its principal driver, declining by 1.0 percent relative to 2021. The late onset of the 2021/22 rainy season followed by multiple tropical storms have led to decreased yields for both smallholders and commercial farmers. Seasonal production estimates indicate that Malawian farmers harvested 5 percent less maize and 37 percent less tobacco than the average for the three preceding growing seasons. The storms also damaged the infrastructure supporting production, including the Kapichira hydroelectrical power plant, which provided about one-third of national capacity and remains offline as of late 2022. Industry in particular has been suffering from pervasive electricity shortages, growing at just 0.9 percent in 2022, while services growth in 2022 is estimated at 1.8 percent.

The worsening balance-of-payments crisis has led to an acute foreign exchange shortage, affecting all those producers that import inputs, and causing shortages of fuel and other essential goods. The effects on the retail fuel sector are only the most visible symptom of much wider challenges. The latest World Bank Business Pulse Survey found that, in October 2022, two-thirds of businesses reported a decrease in sales compared with one year earlier and more than three-quarters of businesses consider the unavailability of foreign exchange as a threat to profitability. In addition, there are reports of organizations that import essential commodities, such as the Central Medical Stores Trust, facing shortages of medical supplies.

Headline inflation rose to 26.7 percent in October 2022, the highest level since June 2013. The invasion of Ukraine by the Russian Federation in February 2022 and the subsequent further rise in global commodity prices contributed to an increase in domestic prices for fuel, fertilizer, cereals and cooking oil. The domestic price of fuel has more than doubled since February 2022, while food inflation soared to 34.5 percent in October 2022. The World Bank's Macro-Poverty Outlook (October, 2022) estimates that poverty based on the international poverty line of US$2.15/day will increase by 0.5 of a percentage point in 2022, to 71.2 percent.

Lower yields and high global and domestic prices are pushing many Malawian families into food insecurity. According to the joint assessment of the IPC Working Group, one in three Malawians is prone to food insecurity and, for the 2022/23 lean season, one in five Malawians will face crisis levels of acute food insecurity.

Despite some progress toward fiscal consolidation and debt sustainability, budget discipline remains a challenge

Higher government spending during the first half of FY2022/23 widened the fiscal deficit, exerting pressure on the Government's fiscal consolidation plans announced in the FY2022/23 budget.

Through the first half of the fiscal year, the fiscal deficit totaled 4.3 percent of GDP, compared to the mid-year target of 3.5 percent of GDP. Despite strong performance on tax collection, revenues overall slightly underperformed the approved target, and together with higher recurrent spending contributed to the widened fiscal deficit. Part of these spending overruns, especially for goods and services, have been caused by external factors such as commodity price increases and the devaluation of the Malawi kwacha, but some are due to a continued lack of budget discipline despite fiscal consolidation efforts. The Government has revised the fiscal deficit for FY2022/23 to 7.0 percent of GDP. If the performance for the first half of the fiscal year is maintained, the fiscal deficit for FY2022/23 is expected to widen further to 8.6 percent. However, planned expenditure reductions in the mid-year budget could still significantly narrow the gap between the current fiscal trajectory and the target.

Malawi's public debt is currently assessed to be in distress, but the ongoing implementation of the Government's debt restructuring strategy means that debt is sustainable on a forward-looking basis. Public debt increased to 64.0 percent of GDP in 2021, up from 54.8 percent of GDP in 2020, and is expected to increase further to 76.6 percent in 2022. Financing of fiscal deficits through domestic resources has led to the accumulation of domestic debt, which increased from 21.9 percent of GDP in 2020 to 31.2 percent of GDP in 2021. A shift in the composition of external debt toward commercial creditors at non-concessional terms has increased debt-servicing costs significantly. However, the Government is implementing a debt-restructuring strategy with its debt advisors to bring debt onto a sustainable path over the medium term by reducing debt-servicing commitments to commercial creditors.

Following a 25 percent devaluation of the Malawi kwacha in May, the spread between the official and market exchange rates has widened once again, while foreign reserves remain low. To align the official rate with market rates and address foreign exchange shortages, the Reserve Bank of Malawi (RBM) adjusted the official Malawi kwacha-US dollar exchange rate downward by 25 percent in May 2022. However, a divergence between the official rate and foreign exchange bureau cash rates has reemerged and grown to 46 percent by mid-November, surpassing the pre-devaluation level of late May. Gross reserves decreased by more than one-third over the year from US$605 million in August 2021 to US$326 million in October 2022, equivalent to just 1.3 months of import cover. Net reserves have been negative over the past year, and gross reserves have been mainly supported by swaps and medium-term borrowing facilities at non-concessional terms.

Monetary conditions have been tightened but, in light of the supply-driven nature of inflation, this has not resulted in increased price stability. The RBM raised the policy rate further to 18 percent in October 2022, following an earlier increase from 12 to 14 percent in April 2022. This has contributed to a rise in bank lending rates and monthly average Treasury Bill and Note yields. However, with the real policy rate remaining negative since March, the monetary policy stance has failed to achieve price stability, also reflecting the supply-driven nature of inflation.

The banking sector has maintained a strong performance despite the economic challenges facing the country, though this is in part due to its heavy reliance on borrowing by the Government. The main financial stability indicators for the banking sector have mostly been adequate and sufficiently liquid in the first part of 2022. However, especially small and medium enterprises (SMEs) still face significant constraints in accessing credit and many are unaware of key government support programs.

From stabilization to growth: key policy priorities to weather the current crisis and build resilience

Amid headwinds in the global economy, Malawi's economy is projected to show subdued growth and faces considerable downside risks. The economy is projected to grow at 2.2 percent in 2023, an increase relative to 2022 but still significantly lower than its pre-pandemic trajectory. This rate of growth is expected to be driven by a significantly better agricultural season, as well as a gradual recovery in the

services and industry sectors. A rapid deterioration of global growth, higher-than-anticipated energy prices, and tighter financing conditions are the primary external risks. Natural disasters and intensifying climate-related shocks continue to pose major downside risks to the economic outlook. Other risks include the persistent unavailability of foreign exchange, increasing corporate bankruptcies, inability to access affordable agricultural inputs, and rising poverty and food insecurity in the face of high inflation and weak job creation.

The lack of sustained economic growth, along with continued inflationary pressures and recurrent weather shocks, will make it more difficult to reduce poverty. Meanwhile, any further external shocks and sustained inflation are likely to result in increased poverty and cause rising food insecurity. The increased frequency and severity of shocks related to climate change create additional downside risks and will require a sustained focus on adaptation investments. The World Bank *Country Climate Development Report* for Malawi finds that climate change shocks could reduce GDP by up to 9 percent by 2030. It could also push another 2 million people into poverty by 2030. However, these impacts can be significantly mitigated by policies and investments supporting adaptation, including in land and forest restoration and management, in improving the country's stock of infrastructure to better withstand extreme weather, and by supporting the resilience of households and the private sector.

The 16th edition of the Malawi Economic Monitor (MEM) calls for urgent actions to stabilize the economy and enhance growth. As in the previous MEM, this includes addressing three key areas:

i) *Stabilizing the economy:* While some progress is being made, there remains an urgent need for the implementation of the announced macroeconomic reforms, including building foreign reserves, achieving fiscal consolidation goals for the current fiscal year, returning debt to a sustainable path through restructuring, implementing key fiscal governance and public financial management (PFM) reforms, and continuing the shift toward a more flexible exchange rate regime.

ii) *Stimulating agricultural export competitiveness and market-driven growth in the economy:* In the context of an ongoing macroeconomic crisis, it will be essential to focus on reforms to catalyze growth. This includes a sustained emphasis on advancing agricultural commercialization, improving the productivity of firms, and increasing and diversifying exports. It will also be important to deliver on the planned reform of expensive and poorly targeted subsidies, such as those for the Affordable Input Programme (AIP), and remove distortions that constrain firms' growth.

iii) *Protecting the poor and strengthening resilience:* As another difficult lean season approaches, including the heightened risk of extreme weather events, it will be essential to advance implementation of the significantly expanded Social Cash Transfer Program and other assistance programs. In the context of fiscal pressures, it will also be important to continue prioritizing the delivery of essential services to the most vulnerable, while improving the efficiency and effectiveness of social sector expenditure.

Strengthening rural labor markets and the scope for agricultural commercialization

In light of the current economic difficulties highlighted in Chapter 1, there is an urgent need to sustainably increase growth and improve the employment potential of the rural economy. Chapter 2 of this MEM highlights the growing importance of advancing structural transformation in rural areas, in particular through agricultural commercialization. In past years, agriculture has contributed more than 40 percent to overall economic growth. Over three-quarters of all Malawian adults work in agriculture. The rural economy, which captures the breadth of economic activities through which households in rural areas obtain incomes, accounts for a significant share of employment and output in Malawi. However, the rural economy is characterized by a lack of formal and more remunerative job

opportunities. At the same time, high poverty rates show that there are few opportunities to increase rural incomes. Ninety-four percent of all poor households in Malawi are in rural communities and the rural poverty headcount ratio at the national poverty line (57 percent) is almost three times that found in urban areas (19 percent).

Even for farming households, own farm income is not the main income source, highlighting the diversity of livelihood strategies that are already a reality in rural Malawi. The median farming household only derives 21 percent of its annual per capita income from own farm income. As a result, even if all farming households were able to reach the agricultural productivity levels of the top 10 percent most productive households, the impact on household incomes and the poverty rate would be limited. According to new analysis in Chapter 2, even such enormous productivity improvements would only reduce the poverty rate by between 1.9 and 9.7 percent, depending on the main crop that a farming household depends on. As such, the current structure of household agricultural production in Malawi offers no pathway to sustained poverty reduction for many, if not most, farming households. This in turn informs the focus on the potential of agricultural commercialization to transform the rural economy.

The evolution of the agriculture sector and the rural economy more broadly holds enormous sway over the economy as a whole. Agriculture has many deep links with other sectors, as well as with the overall macroeconomic performance of the country. However, the design of current major agricultural support programs, such as the AIP, not only impacts agriculture directly. Such programs also limit fiscal space and consume a significant share of available foreign exchange, in turn reverberating across the overall economy. Moreover, agricultural support programs have done little to stimulate the agricultural transformation process that Malawi urgently needs to generate economic growth and create jobs. Conversely, a vibrant rural economy, stimulated by improved policies and better-targeted investment, could lift the economy as a whole out of its current low-growth equilibrium. The recent announcement by President Chakwera of significant reforms to the AIP in particular, provide an opportunity to rethink the direction of agricultural policy toward an increased focus on advancing commercialization and creating rural employment opportunities for smallholders.

To assess the potential for increased commercialization, we categorize households into four groups: commercial smallholders, other productive rural households, not economically productive households, and urban households. At 64 percent, other productive rural households comprise the majority of Malawian households, while 16 percent of households are found in urban areas, and not economically productive households comprise 13 percent of households. The remaining 7 percent of households are commercial smallholders and can play a key role in driving the transformation of the agriculture sector.[1]

Other than farming, rural Malawians are engaged in three types of economic activities: *ganyu*, commercial household enterprises, and longer-term employment. *Ganyu*—a type of short-term casual employment—is by far the most common type of work, with 70 percent of Malawian households having at least one member engaged in it. Income from *ganyu* employment is especially important for poor households, where the income generated through it makes up just over half of total household income. Household enterprises are led by a member of 38 percent of Malawian households. However, household enterprises are predominantly concentrated in low-skilled activities and often do not pay well, even by local standards. The least common type of labor is in longer-term wage employment. Only one in five Malawian households has a member working for a stable wage, with the ratio dropping to 15 percent for farming households. For those households that have a member in formal wage employment, the income from this source often contributes a large share to total household income, but such jobs are rare.

1. Commercializing farmers are defined as those households which sell at least 25 percent of their maize production. While it presents a rather narrow definition of commercializing farmers, it is determined by the limitations of the IHS dataset used in this analysis, it nonetheless serves as a suitable proxy for commercialization. As demonstrated in Chapter 2, commercialization opportunities in Malawi go well beyond maize sub-sector. We therefore consider the above definition of commercializing farmers as a conservative lower bound estimate.

Seasonality is a key characteristic of rural labor markets. Farming households face a conundrum: relatively remunerative jobs, especially those in longer-term employment, can be an impediment to tending to one's own farm. *Ganyu*, too, is most remunerative and sought-after when farming households need to look after their own fields. Nevertheless, farming households are more likely than others to engage in *ganyu*. Less than one-third of household enterprises operate throughout the year and they are especially attractive to commercial smallholders who can concentrate on their businesses when their farms need less attention. Often these household enterprises process or trade produce from household farms, with non-agricultural trade and food- and drink-related businesses also common.

Even with own farm income only delivering a small share of incomes, commercially successful farmers are extraordinarily important for the rural economy. The *Malawi Vision 2063* identifies agricultural commercialization as one of its three pillars to drive the country's long-term growth. A vibrant commercial smallholder sector would give rise to better non-farm livelihood opportunities, sparking rural economic transformation.

Chapter 2 argues for an approach to rural economic transformation that focuses on fostering commercially successful smallholders and creating on- and off-farm employment opportunities for smallholders. These can both generate jobs in downstream agro-processing and services sectors and also increase demand for an increasing amount of locally-produced services. This increases the employment opportunities for rural Malawians who, in turn, give up farming to specialize in better paying industry and services sector jobs, eventually freeing up land for the most productive farmers who specialize in commercial agriculture. There is growing evidence from the region that emerging commercially-oriented, small- and medium-size farmers can be a significant source of demand for innovation, capital investment, and service provision, which together drive productivity growth and job creation. For example, in Tanzania, medium-scale commercializing farms, which control roughly 20 percent of total farmland, have generated about 13 million labor days per year through local employment.

Different forms of agricultural commercialization can be observed in Malawi. Historically, the most traditional pathway for commercialization in Malawi has been through outgrower schemes. In these schemes, an entrepreneur contracts smallholders to produce commodities of high value to be marketed, in turn, by the entrepreneur. The next generation of commercial arrangements between farmers and agribusinesses has been supported through productive alliances. Finally, there are independent commercially-oriented farmers. However, widespread rural economic transformation from the dominance of subsistence agriculture has not yet started, as is evidenced by a stagnant and low share of commercial smallholders. Nonetheless, pockets of emerging transformation do exist in Malawi.

The productive alliances model of agricultural commercialization has been shown to help foster rural economic transformation in Malawi. This model is characterized by strong producer organizations building deep links with commercial off-takers of farm produce. Productive alliances are farmer-led, recognizing their needs, promoting ownership by farmers, and linking farmers to adapted financing solutions. Productive alliances can be particularly beneficial to the most vulnerable population groups, including the poor, women, and the youth.

The Malawi Agricultural Commercialization Project (AGCOM) has been supporting agricultural commercialization through the productive alliance model. In these productive alliances, smallholder farmers organize themselves into groups or cooperatives, empowered and supported by matching grants to bolster their production, and integrate them into value chains by improving their capacity to finance and execute productivity-enhancing investments and respond to the requirements of buyers and off-takers. High and increasing farmer demand to participate in productive alliances supports the approach of the project. A total of 255 productive alliances have been signed, half of which deal in soya or dairy. Examples such as the ACADES Youth Farmer Cooperative and the Nsanama Cassava Producers and Marketing Cooperative show that catalyzing agricultural commercialization at the local level is possible.

Three areas of action can enable the more rapid propagation of such pockets of economic transformation, leading to a more robust and vibrant rural economy in general. First, a broad convergence of interests and incentives between agribusiness, commercializing farmers, and smallholders around commercialization objectives should be promoted. Examples above illustrate how this can be successful at the local level and the AGCOM model shows how this can spark wider change. Second, rural populations should be recognized for the diverse constituent groups that they already are. This will improve targeting for commercial opportunities and social safety nets. Lastly, addressing rural economic growth requires holistic, targeted solutions aimed at productive rural communities, which go beyond the narrow domain of agriculture sector. While commercial smallholders play a critical role in rural economies, there is need for safety nets and non-agricultural livelihood options for those rural households that lack productive capacity or resources.

The Government of Malawi can contribute decisively to strengthening rural economies:

First, there is a need to strengthen existing commercialization mechanisms, including medium-sized family farms, farmer organizations, and anchor farm models. Regardless of the specific commercialization pathway, support for agricultural commercialization calls for targeted programs for farming households and organizations that can generate significantly more production through increased productivity.

Second, Malawian agricultural businesses will benefit from a positive business environment and investment climate. Coordinated business-friendly policy reforms, for example in the legislation of fertilizer, seeds, irrigation, and trade, have the potential to pay off both inside and outside agriculture. Reducing uncertainty should be a key goal of such reforms.

Third, investments in productive infrastructure will catalyze rural economic transformation. The Government should focus on high-return investments in public goods that create new economic activity, such as irrigation schemes, post-harvest facilities, or transport linkages.

1

ECONOMIC DEVELOPMENTS

1.1

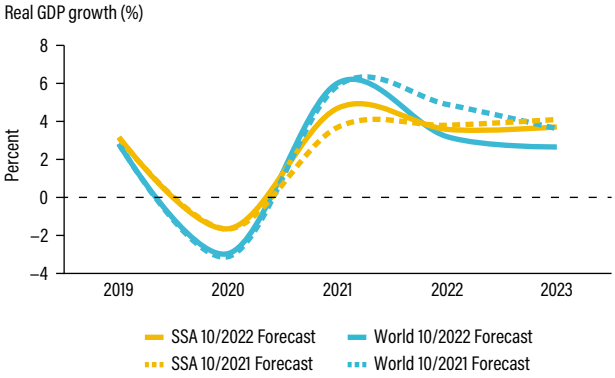
GLOBAL AND REGIONAL CONTEXTS

Major economies are experiencing a marked economic slowdown, giving rise to worries of a global recession

Driven by the sustained impacts of the Russia-Ukraine war and monetary tightening, global economic growth is now lower than recent estimates had suggested. The October 2022 International Monetary Fund (IMF) estimates of global annualized Gross Domestic Product (GDP) growth for 2022 lag 1.7 percentage points behind those from October 2021 (Figure 1.1). Economic growth in the United States, China, and the European Union (EU) has been especially slow, with the United States and China recording 1.0 and 1.6 percent GDP growth, respectively, for the first three quarters of 2022. The EU is among the areas most affected by the war in Ukraine, especially through natural gas shortages. Together, these economies represent about half of total global GDP. In turn, slow economic growth in these three economies lowers the demand for goods and services produced elsewhere, and can lead to lower international investment and trade. In addition, other major emerging markets are slowing. In the past, a sharp slowdown of global growth led by economic distress in major economies was normally a precursor a global recession[2] (Guenette, Kose and Sugawara, 2022).

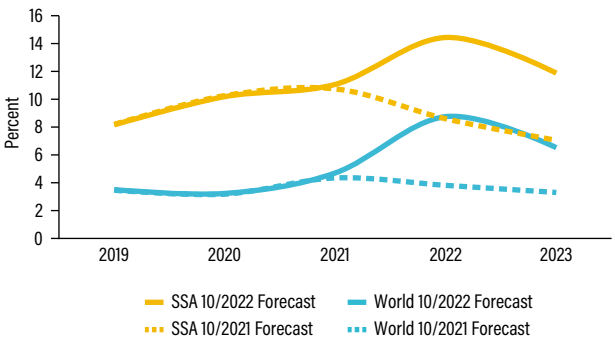
With inflation exceeding expectations in almost all economies, central banks around the world have resorted to rapid monetary tightening. Inflation is accelerating to a global average of 8.8 percent and 14.4 percent in sub-Sahara Africa in 2022 (Figure 1.2). This is against an expectation of 3.8 and 8.6 percent, respectively, one year ago. The current inflationary wave was initiated by over-extended global supply chains during the COVID-19 pandemic, which have since eased. However, the Russian Federation's invasion of Ukraine pushed energy and food prices up further and, over time, price pressures have

FIGURE 1.1 Economic growth prospects have weakened substantially...



Sources: IMF World Economic Outlook 10/2021 and 10/2022.

FIGURE 1.2 ... while inflation has continued to exceed expectations everywhere



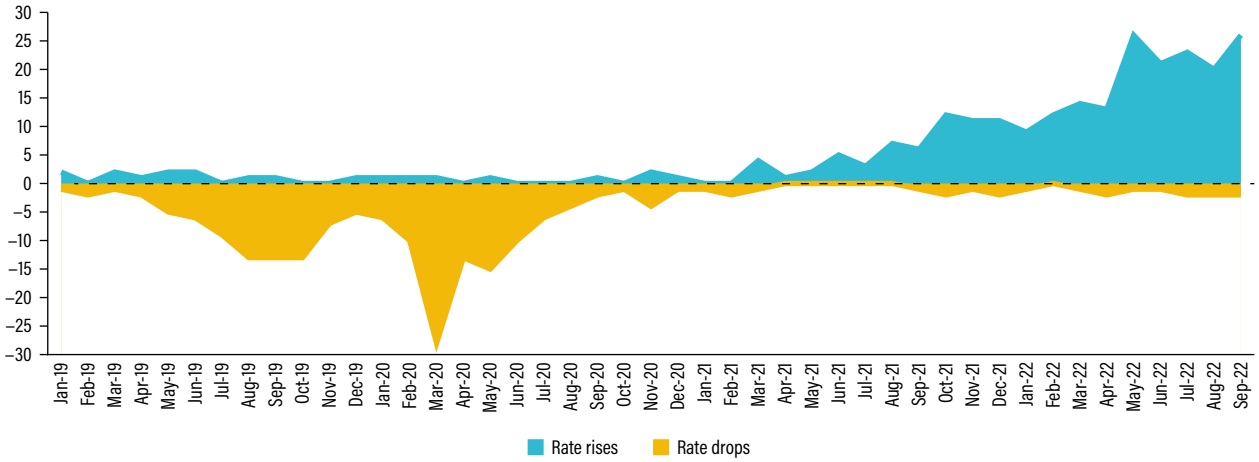
Sources: IMF World Economic Outlook 10/2021 and 10/2022.

2. A global recession is an extended period of economic decline synchronized around the world. The IMF dates global recessions based on broad-based weakening of macroeconomic indicators with per capita GDP typically serving as the primary anchor.

become increasingly broad-based, signified by price increases in excess of central bank targets for goods other than commodities and those affected by shipping bottlenecks. These developments have sparked fears that more rapid price increases will become entrenched through heightened inflation expectations. Central banks, in turn, have resorted to rapid monetary tightening. Thirty-five out of 38 central banks tracked by the Bank for International Settlements have raised policy rates at some point between January and October 2022 (Figure 1.3).

FIGURE 1.3 ... leading to a global wave of monetary tightening

Number of major central banks changing their respective policy rates



Sources: World Bank staff calculations based on Bank for International Settlements data.

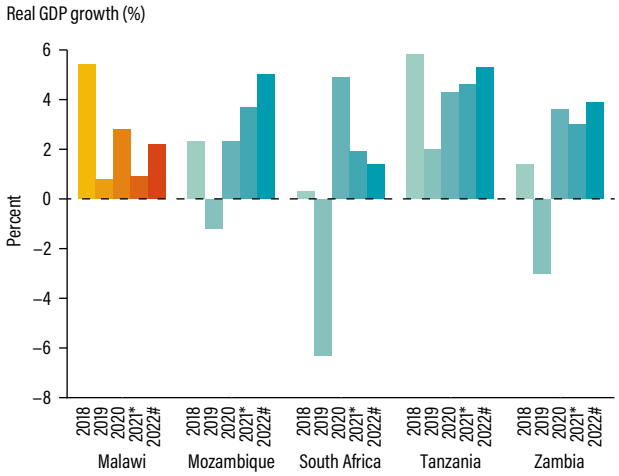
Aggressive monetary policy responses to increased inflation can become self-reinforcing and have particularly adverse effects on emerging markets and developing economies (EMDEs). Tighter monetary policy has a slowing effect on economic activity. In addition, rapid interest rate increases by the U.S. Federal Reserve, resulting in a cumulative 375 basis points increase between March and November 2022, make it more profitable to hold US assets. Together with a "flight to safety", where investors seek relatively resilient US$-denominated assets, this led to a sharp appreciation of the US dollar by 14 percent between January and mid-November 2022 against a set of six other major currencies (the euro, the Swiss franc, the Japanese yen, the Canadian dollar, the British pound, and the Swedish krona). This makes US$-denominated debt more expensive to repay and other central banks may have to raise interest rates beyond the point that would be ideal to protect exchange rates. Moreover, the boost to EMDEs' export competitiveness from their depreciating currencies is often outweighed by the short-term frictions caused by exchange rate volatility in the domestic value of US$-denominated trade.

Extreme weather events, as well as the war in Ukraine, have led to high global food prices, resulting in widespread food insecurity. Many countries have responded to increasing global food price pressures with trade restrictions which, in turn, have increased price pressures in other countries (World Bank, 2022b). The Global Report on Food Crises estimates the number of people needing urgent humanitarian assistance between October 2022 and January 2023 at 205 million, an increase of 30 million from 2021/22 (GNAFC, 2022). Large year-on-year (y-o-y) increases are clustered in sub-Saharan Africa, including Malawi, as well as some conflict-affected countries such as Yemen. Rising food prices have exacerbated existing vulnerabilities, including conflict and extreme weather. Several East African countries have been affected by a sustained drought, leading to the risk of a fifth poor harvest in a row.

Countries in Malawi's region are experiencing varied rates of growth and diverse economic challenges. South Africa's economy was severely impacted by widespread load-shedding, as well as by floods in KwaZulu Natal and the Eastern Cape. Manufacturing was especially badly affected, with a decrease in output of 5.9 percent in the second quarter of 2022 relative to the first quarter. Meanwhile, Zambia

has performed better, with growth for 2022 estimated at 3 percent (Figure 1.4). The Government of Zambia's commitment to addressing sustained macroeconomic imbalances and a new US$1.3 billion IMF Extended Credit Facility (ECF) is central to this development. The facility supports what the Government of Zambia calls a "homegrown"[3] program of strict fiscal consolidation and comprehensive reforms aimed at improving economic governance. Tanzania continues to experience general macroeconomic stability and robust economic growth of 4.6 percent in 2022, although this is still slightly below pre-COVID-19 levels. It has also recently agreed a new US$1 billion ECF focused on reforms to create fiscal space for social spending and high-yield investments. Mozambique's economic growth continues to be subdued at 3.7 percent in 2022, despite high natural gas prices. The country faces governance challenges and the ongoing fallout from its 2013 hidden debt scandal,[4] as well as a continuing insurgency in Cabo Delgado. This is limiting the gains from its substantial liquified natural gas (LNG) wealth, which represent the world's 14th largest LNG reserves.

FIGURE 1.4 Different post-pandemic trajectories in Southern Africa



Notes: * estimates, # forecasts.
Source: World Bank Macro Poverty Outlook (World Bank, 2022c).

3. As termed by President Hakainde Hichilema (IMF, 2022c).

4. Transgressions relating to hidden public debt, dubbed the 2013 Tuna Bond Scandal, continue to be uncovered ,with Credit Suisse ordered to pay a US$22.6 million fine in July 2022, following other fines and write-downs related to the scandal amounting to US$675 million. However, it is likely that most of the costs of this fraud will remain with the Mozambiquan people. The Center for Public Integrity estimates the economic costs for the Mozambican Government of the Tuna Bond Scandal at US$11 billion (Cortez et al., 2021).

1.2

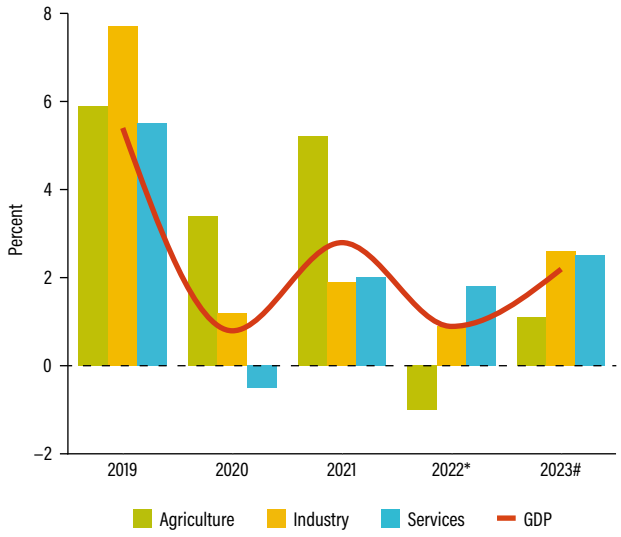
RECENT ECONOMIC DEVELOPMENTS

Malawi's macroeconomic crisis is worsening, as sustained imbalances are exacerbated by external shocks

After a tepid rebound in 2021, Malawi's economy entered another economic slowdown this year. World Bank modeling suggests that GDP growth has slowed to 0.9 percent in 2022, a decline from 2.8 percent in 2021 (Figure 1.5). This constitutes a per-capita GDP contraction of 1.8 percent given population growth of 2.7 percent. Three factors have driven this development: first, through adverse weather conditions and significant problems in the implementation of the Affordable Inputs Programme (AIP) last season, agriculture became a drag on growth rather than its principal driver, declining by 1.0 percent in 2022 compared with 5.2 percent growth in 2021. Second, the industry sector in particular has been suffering from pervasive electricity shortages and is expected to grow at only 0.9 percent in 2022. Third, the services sector achieved modest growth at 1.8 percent. Services continue to benefit from the subsiding of COVID-19 effects, in particular benefiting the tourism and retail segments. However, services growth in 2022 has declined relative to 2021 and the sector continues to face low demand, suffering from challenges in the wider macroeconomic environment, including foreign exchange shortages and high inflation.

FIGURE 1.5 Overall economic growth remains weak

Real GDP growth by sector (%)



Note: * estimates, # forecasts.
Source: World Bank Macro Poverty Outlook (2022e).

Adverse weather events and a balance-of-payments crisis are at the core of the recent economic slowdown. The late onset of the 2021/22 rainy season followed by multiple tropical storms have led to lower yields for both smallholders and commercial farmers. Crops that are heavily dependent on predictable weather patterns fared particularly poorly. Seasonal production estimates indicate that Malawian farmers harvested 5 percent less maize and 37 percent less tobacco than the average for the three preceding growing seasons. In addition, tropical storms Ana and Gombe in January 2022 have led to direct damage to crops, submerging farmland across many parts of Southern Malawi, and damaging the infrastructure supporting agricultural production. The Kapichira hydroelectrical power plant, which provides about one-third of national capacity, was especially badly hit and will remain offline through the end of the year. The impact of severe weather events and climate-related shocks is likely to increase over time (see Box 1.1). Furthermore, a balance-of-payments crisis has led to widespread foreign exchange shortages, affecting access to fuel, fertilizer and other imported inputs.

BOX 1.1 Climate change is exacerbating vulnerabilities in the Malawian economy

Malawi's economic growth continues to be affected by a series of climate-related shocks, with the frequency and severity of these shocks increasing over recent years. In the past five years, the country has suffered from a prolonged dry spell and an armyworm infestation in 2018; floods from heavy rainfall induced by Tropical Cyclone Idai in 2019; dry spells in the southern regions and localized floods in the northern region in 2020; and flooding in all regions from heavy rainfall caused by Tropical Cyclones Ana and Gombe in 2022. Total damage from the latter alone were equivalent to 1.5 to 2.7 percent of GDP, severely damaging the Kapichira hydroelectricity generation plant and reducing the country's power supply by one-third.

An analysis in the World Bank *Country Climate Development Report* (World Bank, 2022d) focusing on Malawi finds that the increased impacts of climate change would reduce GDP by up to 9 percent in 2030. It would also push another 2 million people into poverty by 2030 and 4 million by 2050. As climate change impacts intensify, GDP would further decline by 8 to 16 percent by 2050 (Figure B1.1.1). The analysis considers five climate scenarios and six types of climate change-related impacts on the economy, including impacts on crop productivity, labor productivity, damage to roads and bridges, and damage to hydropower plants. These impacts vary depending on the climate scenario and the damage channel, with the largest impacts projected to come from damage to roads and bridges.

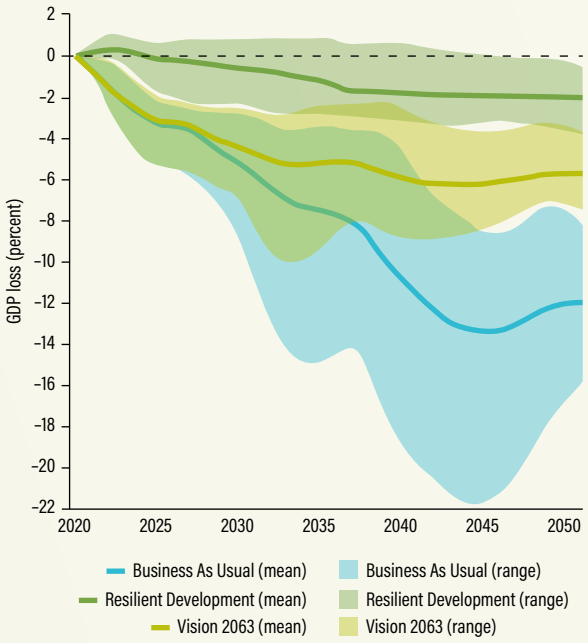
A higher growth path in line with *Malawi Vision 2063* would contribute to a significant reduction in annual GDP loss. This would support higher-quality infrastructure and a more diversified economy. The analysis shows that the magnitude and variability of the potential reduction in GDP from impacts of climate change would reduce to 3–7 percent by 2030, and then 4–7 percent by 2050. However, transitioning to a higher-growth economy alone will not be enough and building greater resilience to climate change will require investments in adaptation, which would greatly diminish the likely impact of climate change on the economy.

To adapt from climate change impacts, the Government could focus on three areas that support "resilient development": (i) halt and reverse widespread land degradation through investments in land and forest restoration and management; (ii) build, upgrade and rehabilitate infrastructure (roads and bridges, dams, water and sewerage networks, urban infrastructure) to withstand climate change shocks; and (iii) address climate impacts on households and labor productivity by protecting people against climate-related damage.

Source: World Bank (2022d).

These priorities will require policy and institutional reforms, new financing arrangements, and the increased use of digital technologies, as well as more private sector investment. However, chronic fiscal imbalances and high levels of external and public debt will impede Malawi's ability to invest in climate change adaptation priorities. Thus, optimization of public sector resources and greater access to international public finance, as well as increased private sector involvement, will be required to support climate change-resilient and low-carbon growth. Institutional and legal frameworks will need to be strengthened to address governance challenges that could impede climate change adaptation. Central to this would be passage of the Disaster Risk Management (DRM) Bill, which was introduced in 2018 but has yet to be voted on by Parliament.

FIGURE B1.1.1 Losses from climate change can be mitigated through investments in growth and adaptation

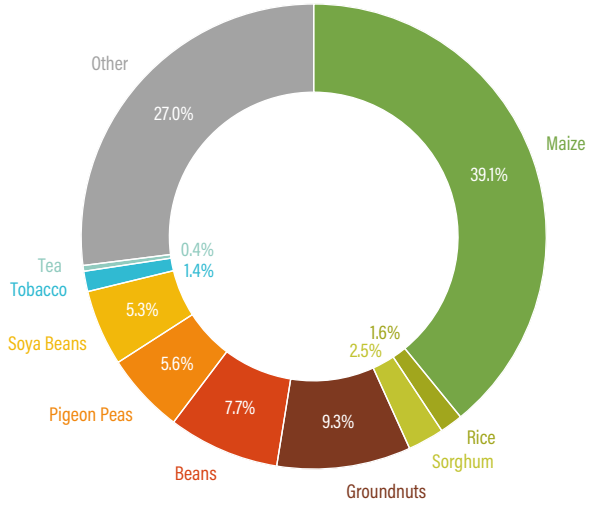


Notes: The analysis includes major sector and considers main pathways of climate change impact.
Source: World Bank (2022d).

Due to rapidly rising prices, farmers are likely to have harvested a higher total value of crops despite generally lower yields. In the 2021/22 agricultural season, Malawian farmers grew field crops on about 4.3 million hectares (ha), slightly less than half its total land area. Reliable production and yield estimates exist for nine of the most important crops, representing 73 percent of the planted area (Figure 1.6). According to these estimates, Malawian growers harvested about MWK 2.5 trillion worth of crops at May 2022 market prices. This is an 18-percent increase compared with the MWK 2.1 trillion valued at May 2021 prices but adjusted for overall inflation. Soybeans and pigeon peas saw some of the largest increases in volumes and prices. Growers realized higher earnings from soya beans (MWK 303 billion) than from tobacco (MWK 85 billion) and tea (MWK 49 billion) combined. But even for crops such as maize, the 65 percent increase in price more than made up for the drop in yield and headline inflation (Figure 1.7). The value of chicken and goat production has increased, as well.

FIGURE 1.6 More than half of all cropland is maize, groundnuts, and beans...

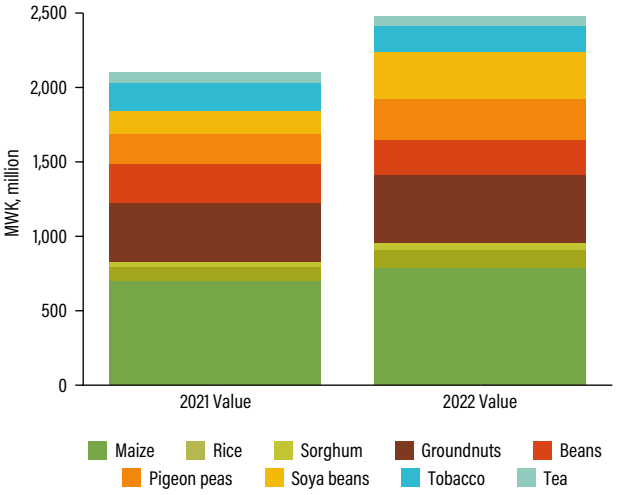
Hectarage allocated to various field crops in the 2021/22 farming season (%)



Sources: Ministry of Agriculture, Irrigation and Water Development, Crop Production Estimates; Tea Association of Malawi.

FIGURE 1.7 ... but soya bean and pigeon pea farmers have seen large gains due to high global prices

Value of select harvested crops at end-May prices in real 05/2022 (MWK million)

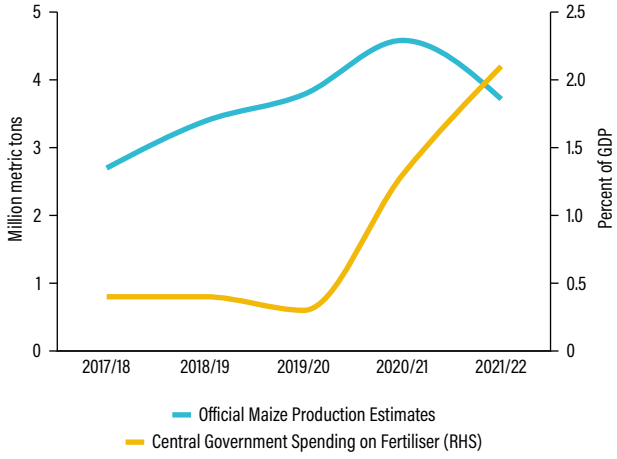


Sources: Ministry of Agriculture, Irrigation and Water Development, Crop Production Estimates; Tea Association of Malawi; Tobacco Commission; IFPRI, Maize Market Reports and Price Bulletin for Selected Legumes, Roots, Tubers, and Other Cereals.

In response to persistent challenges, the President of Malawi has announced significant reforms to the AIP, the country's largest agriculture support program. Key reforms central to a so-called "AIP 2.0" announced in the President's national address on October 25 include the wider use of a Unified Beneficiary Register to improve efficiencies and targeting across a streamlined but differentiated package of support, including social cash transfers, a scaled-up climate-smart public works program for those with limited land, and a scaled up Agricultural Commercialization Project (AGCOM) for more market-ready farmers. He also announced a fixed government contribution to limit fiscal risk, while reiterating the Government's commitment to the MWK 109 billion budget target during this fiscal year. The stipulated changes also include market-based pricing for fertilizer procurement. Fertilizer subsidy schemes, including past years' AIPs, have long been criticized on the grounds of limited efficiency, suboptimal targeting, and a lack of fiscal sustainability (see Chapter 2). In 2021/22, adverse weather events also meant that a significant proportion of the subsidized fertilizer that was applied was ineffective, especially in areas where crops were destroyed by flooding. In addition, implementation faced challenges relating to procurement practices and execution arrangements, as evidenced by several monitoring reports (ACB, 2022; EU, 2022).[5] Consequently, despite increasing budgets, maize yields have not increased commensurately (Figure 1.8).

FIGURE 1.8 The cost of fertilizer subsidies has increased significantly, but maize production has not

Central government spending on fertilizer in percent of GDP and official maize production estimates (million metric tons).



Sources: Ministry of Agriculture, Irrigation and Water Development; Ministry of Finance and Economic Development; Integrated Food Security Phase Classification.

5. Fixing the price that suppliers receive at significantly below commercial prices and limited oversight by the authorities meant that fertilizer was often unavailable and that many clerks demanded extra payments by farmers. Some selling points had intermittent network connectivity and often no checks were performed on whether the ID submitted through the network was that of the registered beneficiary, opening opportunities for third parties to redeem subsidized inputs. Evidence also points toward significant shares of total subsidized fertilizer having been of low quality and diluted with other substances.

Lower yields and high global and domestic prices are pushing many Malawian families into food insecurity. Through its chronic food security analysis, the IPC (2022) estimates that one in three Malawians is generally prone to food insecurity. For the 2022/23 lean season, according to the IPC Acute Food Insecurity classification, one in five Malawians will face crisis-level acute food insecurity (IPC, 2022b). This is against the backdrop of rapidly rising prices for staple foods and a lower maize harvest. Food insecurity is concentrated in the Southern Region, where weather shocks have had the most severe impact on livelihoods and food production. The Government has prepared a Food Insecurity Response Plan, currently costed at MWK 76 billion. The plan will coordinate resources from various partners and the Government for the delivery of cash and in-kind food assistance.

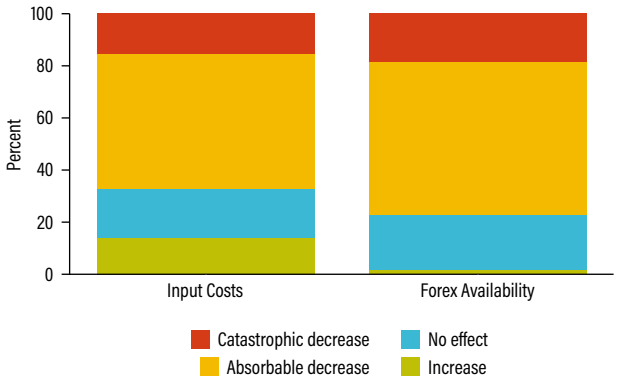
On the back of economic underperformance, poverty levels are increasing further. The World Bank's Macro-Poverty Outlook (2022e) estimated that poverty at the international poverty line of US$2.15 in 2017 purchasing power parity (PPP) prices will increase by 0.5 of a percentage point to 71.2 percent in 2022. This is likely to be an underestimate as the economic environment has worsened since these estimates were published. Low yields affect farming households, while inflation is increasingly burdening urban households.

The Government's commitment to large-scale commercialized agriculture has not been reflected in recent policy initiatives. The Land Amendment Bill, passed in March 2022, is seen by many producers as introducing additional obstacles to operating a commercial farm, without significantly improving the security of land tenure. This could also impact the Government's plans to establish "mega farms", i.e., government-owned but privately-run farms of at least 5,000 ha with a high degree of mechanization and value addition.[6] It is unclear how such farms could assimilate competing customary claims on the land. Other recent developments may hold back existing large, commercialized farms. The recent draft Crops Bill is seen by many as not compatible with promoting agricultural commercialization. It would expand already wide-ranging ministerial powers that many farmers already see as impeding investment and growth in the sector (Duchoslav et al., 2022).

Escalating foreign exchange shortages and rising input costs put pressure on already strained enterprises. Micro- and small enterprises have been especially affected, with few buffers and limited access to finance to bridge episodes of pressure. The World Bank Business Pulse Survey (BPS) interviewed 1,200 small enterprises in October 2022 and found that two-thirds of businesses report a decrease in sales compared with a year earlier (World Bank, 2022a). Sales declined by 21 percent on average. Many enterprises are on the brink of financial unviability, with one-quarter reporting existing or imminent arrears and 14 percent insolvent or on the brink of insolvency. Two-thirds of surveyed businesses believe that increased non-labor input costs negatively affected their profits, while foreign exchange unavailability is seen as a threat to profitability by more than three-quarters (Figure 1.9). Three-quarters also report difficulties in accessing finance, which could be used to overcome such impasses. However, small businesses are optimistic about their future, with half of BPS interviewees expecting a sales increase during the next year.

FIGURE 1.9 Rising input costs and foreign exchange shortages are a strain for businesses

Share of BPS respondents estimating the effect of increased non-labor input costs and decreased foreign exchange availability since the beginning of 2022 on their businesses' net operating profits*



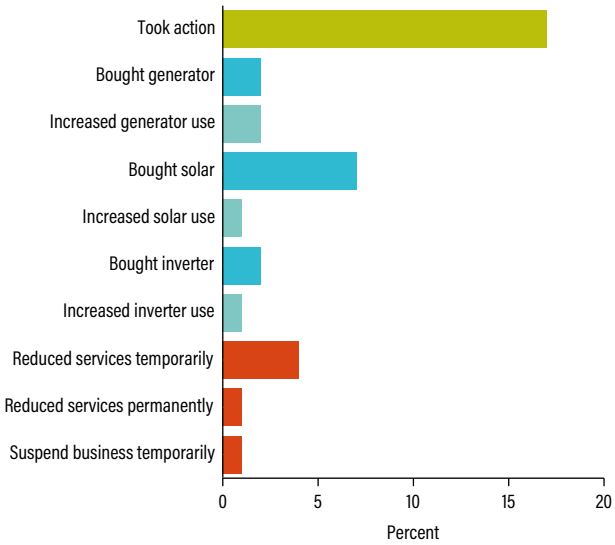
Note: * Catastrophic decrease is defined as a decrease that prompts the discontinuation of some business activity.
Source: World Bank BPS (2022a).

6. While still in its early stages, the Government's Mega Farm Project aims at facilitating the establishment of large-scale production units that will also anchor willing surrounding smallholder farmers through an out-grower system that will be premised on contract farming arrangements. Through the anchor farm model, mega farms will provide productivity enhancing support to the anchored smallholder farmers. This support will include the provision of extension and advisory services, provision of high-quality inputs (on loan), provision of warehousing facilities, farm equipment hiring services and the implied linkage to markets.

Electricity shortages have added further pressure to the fuel sector and have become an impediment to businesses. The Malawi Confederation of Chambers of Commerce and Industry—a representative body of mostly large enterprises—has estimated that frequent load-shedding costs businesses MWK 94 billion annually (Nation Online, 2022). About 17 percent of small businesses in the BPS survey have taken new remedial actions in the past year in response to increased blackouts, with the most common response being the purchase of solar-powered electricity backup systems, ahead of generator purchases (Figure 1.10). Even critical infrastructure such as hospitals has been affected at times. Running generators is not only significantly more expensive, but also requires imported diesel, which is scarce, and further saps revenues from an underfunded electricity supply system.

FIGURE 1.10 Load-shedding has increased the popularity of solar power systems

Share of BPS respondents taking remedial action to increased blackouts since the beginning of 2022



Source: World Bank BPS (2022a).

Foreign exchange shortages have led to the current fuel crisis. Long queues at fuel stations have become a regular occurrence in the second half of 2022. The supply of fuel is only intermittently normalized through credit facilities to support fuel imports. Large businesses were among the first to experience shortages with unmet demand reported as far back as 2021.

Foreign exchange shortages have also had adverse effects on public services and the wider economy. The effects on the retail fuel sector are only the most visible symptom of much wider challenges. In a context where many businesses are unable to access foreign exchange allocations from commercial banks, a black market for US dollars and other foreign currencies has emerged. However, organizations importing essential commodities, such as the Central Medical Stores Trust, must rely on official channels. Despite efforts to prioritize these essential imports in foreign exchange allocations, there have been widespread reports of shortages.[7] These concerns have also been central to recent discussions between the Government and the private sector in the context of the Private Sector Labs organized by the Presidential Delivery Unit (see Box 1.2).

BOX 1.2 The Private Sector Lab: A new approach to driving agro-industrial transformation in Malawi and addressing business concerns

The absence of structured public-private dialogue for investment facilitation and the generation of investible opportunities in Malawi has been widely acknowledged. To address this, the Malawian Government held its first ever Private Sector Lab from June 17 to 24, 2022, in Lilongwe. The Lab was hosted by the Presidential Delivery Unit (PDU), in collaboration with the Ministry of Trade and Industry and the Malawi Investment and Trade Centre, and with support from the International Finance Corporation (IFC).

The focus of the Labs was to resolve issues hindering large-scale local and international investment. This should help create a platform to convene high-level exchange between government and private sector to jointly identify and address bottlenecks impeding the operations and expansion of the private sector in Malawi. The PDU also invited various investors and is continually working with the Malawi Investment and Trade Centre to facilitate investment into key sectors and projects.

Prior to the Lab, the PDU surveyed 168 private sector firms, asking respondents to identify key issues impeding private sector growth in Malawi. These included:

- **Taxation:** Delays in tax refunds and enhancing consistency and clarity in tax administration.
- **Access to Energy:** Load-shedding, on-site generation, maximum demand tariff and independent power producer engagement.
- **Forex and Exports:** The efficiency of export corridors, export quality standards, efficiency and clarity of export procedures, access to export markets, and access to foreign exchange.
- **Access to Finance:** High interest rates, stringent collateral requirements, and onerous documentation requirements.

7. One striking example of reported shortages is the frequent lack of intravenous drip fluids (VOA, 2022).

Ministerial presentations were also made on issues related to agriculture, immigration, labor, and land. While these concerns also largely mirror binding constraints identified in the recent World Bank *Country Private Sector Diagnostic* (IFC, 2021) and other publications, the focus of these labs was on identifying and prioritizing feasible solutions, each assigned to a responsible ministry, department, and agency (MDA) for implementation.

The PDU has put in place a tracking mechanism, with quarterly progress reports compiled and reported directly to the President. There have been significant achievements across numerous MDAs. This includes implementing a Business Development Service unit to support SME investor readiness, launching the Mchinji one-stop border post, sensitizing workshops on business incentives and tax compliance for smaller businesses, and the initiation of a credit referencing system. The continued focus on delivery across MDAs will be critical to ensure that the process initiated by the Private Sector Labs can further address challenges faced by businesses, and instill a culture of delivery across MDAs.

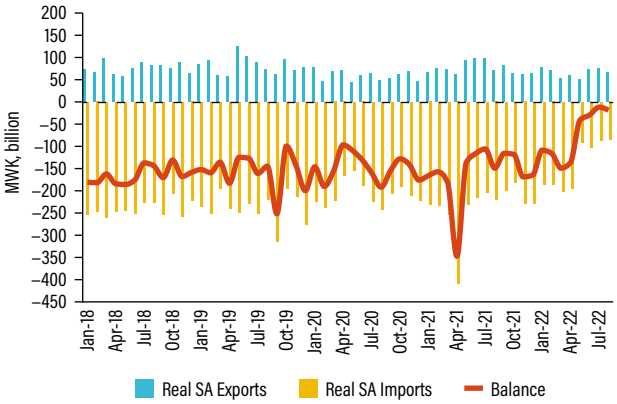
Source: PDU (2022).

The ongoing balance-of-payments crisis has led to a sharp contraction of imports

Imports began declining in early 2022 and collapsed in May 2022, reflecting the impact of foreign exchange shortages. Officially reported imports, already slightly below longer-term trends, dropped by 46 percent to 10.0 percent of GDP in May 2022 (Figure 1.11). The trade deficit continued to contract, eventually leading to a small trade surplus of MWK 0.1 billion (less than 0.1 percent of GDP) in August 2022. There has only been one other month (April 2016) where a trade surplus has been recorded since the start of detailed records in 2010. The timing of the contraction suggests that acute foreign exchange shortages, rather than price and exchange rate movements, underlie this trend. The timing also coincides with widespread fuel unavailability and the Reserve Bank of Malawi's (RBM) move to become a net buyer of foreign exchange.

FIGURE 1.11 In the face of severe foreign exchange shortages, imports have declined dramatically

Seasonally adjusted trade balance (real 01/2022 MWK billion)

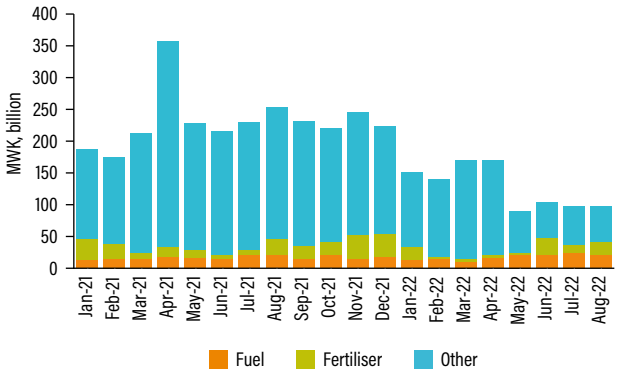


Note: SA = seasonally adjusted.
Source: World Bank staff calculations based on NSO data.

Protected through RBM-supported credit facilities, fuel imports were stable through August but have declined since then. Cumulatively, Malawi imported 192 million liters of fuel in the year through August 2022 . This is only 3 percent less than from January to August 2021 but is likely to have dropped since August with fuel shortages proliferating. This stability in imports has been achieved through RBM-supported import credit facilities to the National Oil Company of Malawi (NOCMA). The overall reduction in imports is primarily a result of a decline in imports for goods other than fuel and fertilizer, for example intermediate inputs required for producers, or consumer goods (Figure 1.12). Currently, the system of foreign exchange allocation prioritizes ad-hoc support for selected essential imports, such as recent interventions in fuel import financing. This uncertainty creates challenges for the private sector, as many firms require imported goods and services as inputs to production.

FIGURE 1.12 The recent import collapse has in particular impacted non-fuel imports

Monthly import values (real 01/2022 MWK billion)



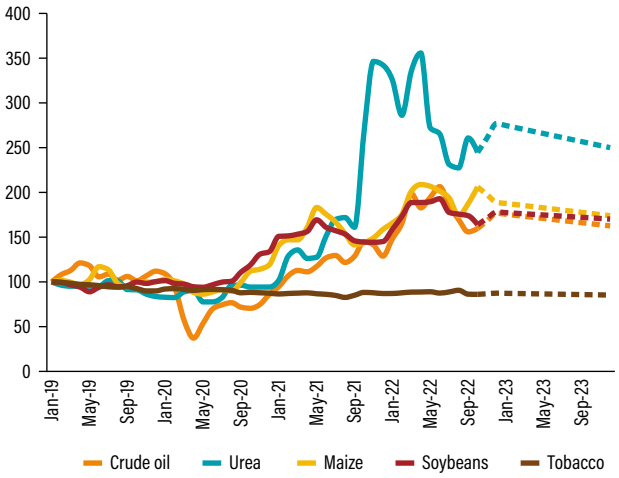
Source: World Bank staff calculations based on NSO data.

In light of declining commodity prices, Malawi's terms of trade have improved marginally in recent months. International oil prices decreased by 13 percent between April and October 2022, while the price of urea plummeted by 31 percent (Figure 1.13). Combined with relatively stable prices for Malawi's export basket, this price drop in Malawi's two most common imports means that terms of trade have improved (Fig-

ure 1.14).[8] However, Malawi can still buy less than half of its commodity imports with its commodity exports at today's prices. Fertilizer imports are recovering from a four-month drop through May 2022, which is seasonal but also deeper than those recorded since 2018.

FIGURE 1.13 Commodity prices are stabilizing at a high level...

Select commodity prices, indexed, 01/2019=100



Source: World Bank Monthly Commodity Prices and World Bank Commodities Market Outlook, 10/2022.

FIGURE 1.14 ...leading to a decline in Malawi's terms of trade

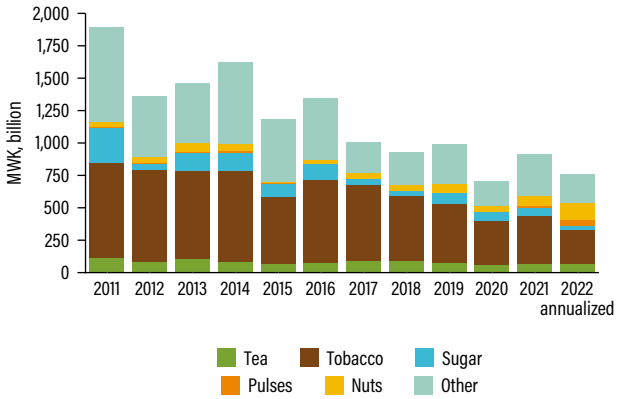
Malawi's net barter terms of trade and Pink Sheet terms of trade on reported commodities, 2015 = 100

Sources: World Bank Commodity Markets and Data, UNCTAD Handbook of Statistics, IMF IFS, National Statistics Office.

Tobacco exports have consistently declined, and other leading export sectors have not been able to provide sufficient inflows of foreign exchange. Official tobacco exports in real terms declined by 42 percent between 2016 and 2021 (Figure 1.15). Tobacco exports through August 2022 were only worth MWK 149 billion in nominal terms, compared with MWK 183 billion in the same period in 2021. Although record amounts of soya beans and pigeon peas have been harvested in recent years, rising exports in these goods have not been reflected in official statistics. MWK 312 billion worth of soya beans (303,000 MT) and MWK 279 billion worth of pigeon peas (429,000 MT) were harvested. However, only MWK 28 billion (57,000 MT) in pulses between January and August 2022 were officially exported.

FIGURE 1.15 The long decline in exports

Annual exports by category (real 01/2022 MWK billion)



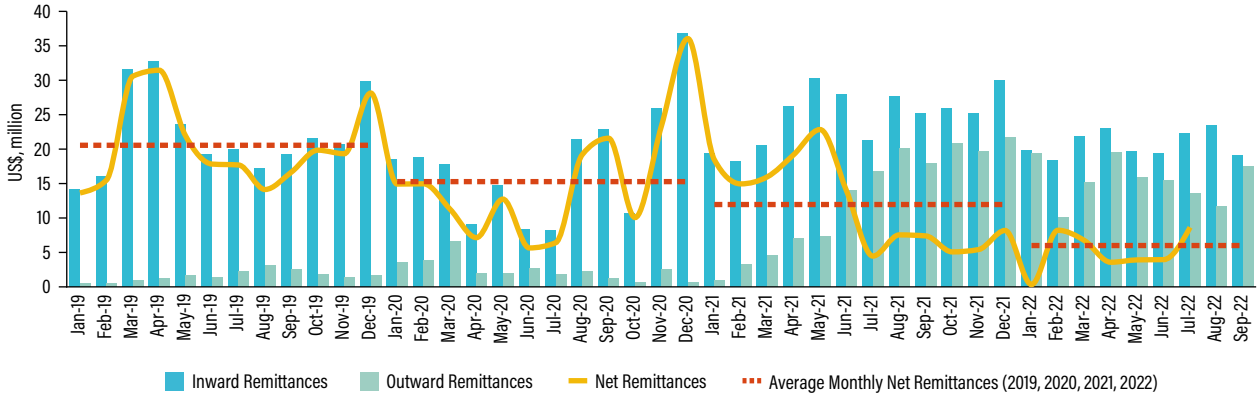
Source: World Bank staff calculations based on RBM data.

Remittances are still declining in their relevance as a foreign exchange earner. With recently declining inflows and the emergence of high outflows, the net position—the money that remains as foreign exchange that can be used to finance imports—has been in a steady decline in recent years (Figure 1.16). Historically, net remittances have been about 8.5 percent of current account credits, covering about the same share of the trade deficit. Incoming personal remittances can also be more reliable than other transfers. Building foreign currency reserves through increasing financial flows including remittances is critical to managing shocks (see Box 1.3).

8. Terms of trade show the relative price of exports versus imports. They are calculated as the percentage change in the price of typical exports over the percentage change in the price of typical imports. The index here is normalized to 2015 being 100. While the terms of trade reported by the World Bank include all trade reported to United Nations Conference on Trade and Development (UNCTAD) that fulfills certain quality standards at actual prices, the Pink Sheet terms of trade are calculated based on a more limited set of products, including tea, tobacco, cotton, sugar, soybeans, rice, coffee, oil, urea, and coal, that have the international price of a related commodity tracked in the World Bank monthly commodity markets data. Thus, both measures are expected to follow the same trend representing terms of trade, but while Pink Sheet terms of trade are more timely, they are also more volatile.

FIGURE 1.16 Outward remittances have increased significantly in the past two years

Inward, outward, and net remittances in Malawi (US$ million)



Source: World Bank staff calculations based on RBM data.

BOX 1.3 What can Malawi do to bolster its reserves?

The current balance-of-payments crisis has shown the importance of building foreign reserves to ensure sufficient liquidity to meet obligations and manage shocks. Sources of foreign reserves include earnings from exports, remittances, foreign direct investment (FDI) and foreign assistance, including loans.

Key drivers of reserve accumulation include:

- **Enhancing exports.** A country could accumulate foreign reserves when its earnings from the export of goods and services exceed payments against imports. For example, a key driver of successful foreign reserve accumulation in Asian economies was through sustained export-led growth, following the large exchange rate depreciation in the region as a result of the 1997/98 financial crisis. Services exports, for example through tourism, can also be a major contributor of foreign exchange earnings. Malawi's tourism industry has achieved moderate growth in recent years, despite the impacts of the COVID-19 pandemic (MoFEA, 2021).
- **Increasing financial flows, especially:**
  - **Official development assistance.** While aid is the largest inflow for Malawi, most of this support, especially from bilateral development partners, is off-budget. Off-budget aid is retained by commercial banks and thus does not become part of official reserves.
  - **FDI** can increase reserves directly through the inflow of foreign capital, without creating any repayment burden. FDI can also help earn foreign exchange by increasing export receipts indirectly. FDI to Malawi has been volatile in recent years, driven primarily by individual large investments rather than consistent inflows (IFC, 2021).
  - **Remittances** are now a greater source of foreign exchange for Malawi than FDI and portfolio investment flows (Figure B1.3.1).

Unlike for most developing countries, in Malawi, aid inflows are still by far the most significant source of foreign exchange. On average for developing countries, FDI net inflows are three times larger than net aid flows in 2020. This indicates that there is a room for Malawi to enhance private financial flows, especially from FDI and remittances, while gradually reducing aid dependance.

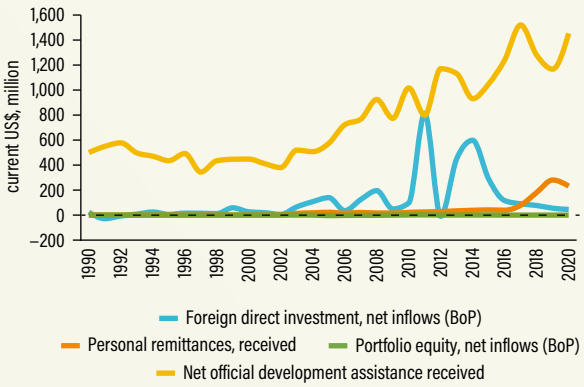
Sources: IFC (2021), IMF (2022b), and ECB (2006).

There are several policy options for increasing reserves:

- **Greater exchange rate flexibility.** The misalignment of the real exchange rate can reduce exports and creates uncertainty for businesses. In addition, greater flexibility in the exchange rate is needed to enable convertibility and increase liquidity in the market.
- **Developing the foreign exchange interbank market.** This allows for transparent currency exchange, facilitates price discovery, and helps current account adjustments. The mandatory retention of export proceeds of 30 percent enforced by the RBM since August 2021 should be phased out as soon as macroeconomic circumstances recover.
- **Strengthening the RBM's reserve management.** Key priorities include establishing a reserve management strategy, establishing a registry to ensure consolidating records of all liabilities and contracted facilities, timely reporting, and enhancing transparency and accountability.

FIGURE B1.3.1 In Malawi, aid inflows are still by far the most significant source of foreign exchange

Financial flows to Malawi (current US$ million)



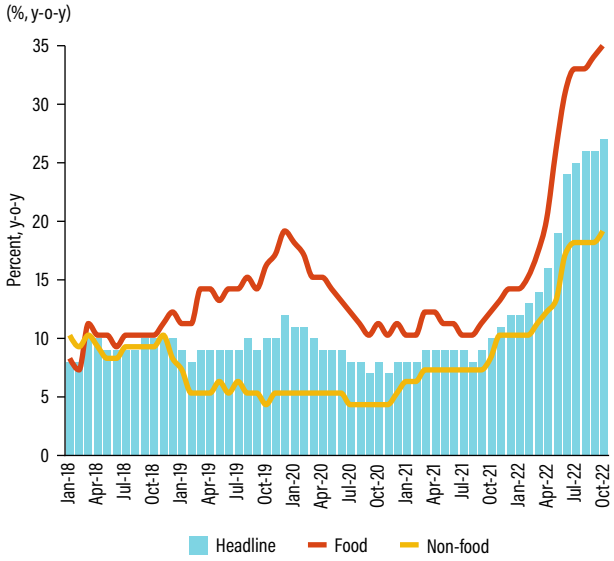
Source: World Development Indicators (World Bank, 2022e)

A clear strategy by the authorities on how external economy challenges will be overcome is still emerging, though there has been recent progress. In November, the IMF Executive Board approved a US$88 million Rapid Credit Facility and a Staff Monitored Program with Executive Board Involvement. While this is not yet equivalent to an Extended Credit Facility in terms of its overall assessment of the soundness of the country's macroeconomic situation and its debt sustainability, these funds can be used to bolster foreign currency reserves, support critical imports and contribute to debt servicing, while the authorities work out a more comprehensive plan to address the balance-of-payments crisis under the Staff Monitored Program. The ongoing debt-restructuring process offers a pathway to external economic stability that would also enable Malawi to transition to a fully-fledged IMF program supported by an Extended Credit Facility.

Headline inflation has risen to its highest level since June 2013

Upward inflationary pressures, largely induced by rising commodity prices from the impact of the Russia-Ukraine war and downward adjustment of the Malawi kwacha, have resulted in high and rising headline inflation. Headline inflation started picking up in October 2021, as COVID-19 pandemic restrictions were eased and global commodity prices started rising. However, the invasion of Ukraine by the Russian Federation and the resultant supply-related shocks have added an additional strain on commodity prices, which induced a jump in domestic prices. The devaluation of the Malawi kwacha and resultant price increases of imported commodities exerted additional upward pressure on prices. Consequently, headline inflation rose and has remained elevated, peaking at 26.7 percent in October 2022—the highest level since June 2013 (Figure 1.17). This has been driven by an upward push on both food and non-food inflation. The impact of the Russia-Ukraine war has had direct effects on oil, fertilizer, cereals and cooking oil prices, which contributed to food inflation soaring to 34.5 percent in October 2022. Non-food inflation has also risen to 18.6 percent.

FIGURE 1.17 Inflation has reached the highest levels since 2014



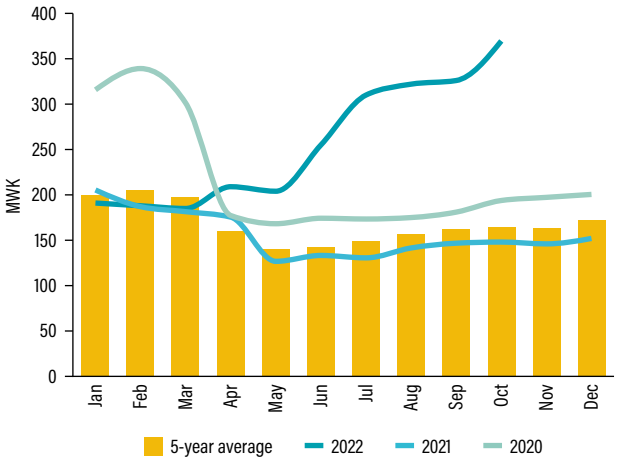
Source: World Bank with data from NSO.

Global oil prices are moderating, contributing to a decline in domestic fuel prices, but non-food inflation pressures remain elevated. Crude oil prices (Brent) have declined to US$93 per barrel as of October 2022, from US$120 per barrel in June 2022, and this induced the Government to decrease the domestic price of petrol by 10 percent, to a still historically high rate of MWK 1,746 per liter on September 16, 2022. Nonetheless, domestic fuel prices are still high and are contributing to a rise in transportation costs. With the erratic supply of electricity, most companies are relying on diesel-operated generators to supplement their energy requirements, contributing to increased costs of production. The subsequent passthrough to consumers is also contributing to elevated domestic prices.

Rising domestic food prices due to lower supply following lower yields is exerting pressure on food inflation. This has induced an upward push on domestic food prices, already strained by high global food prices of certain food products, as well as the higher costs of imported food following the 25 percent devaluation of the Malawi kwacha in May. Prices of maize and rice have increased even during the harvest period, defying typical seasonality dynamics. Maize prices have more than doubled in 2022, reaching MWK 370 per kilogram in October, against MWK 148 per kilogram during the same period in 2021 (Figure 1.18). Increased demand for maize and maize products in all of Malawi's three regions has also contributed to rising maize prices. The price of rice has also escalated, reaching MWK 1,303 per kilogram in October 2022, compared with MWK 736 per kilogram during the same period in 2021 (Figure 1.19).

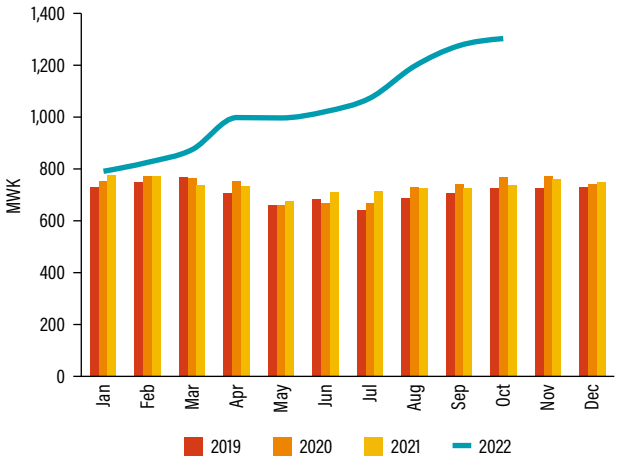
Domestic food prices of legumes and meat have also increased during the reported period. The survival minimum expenditure basket[9] (WFP, 2022) also increased by 3.1 percent in urban areas, 2.0 percent in the rural Northern region, 1.7 percent in rural Central region, and 1.1 percent in rural Southern region in August 2022, over the previous month. Consequently, nearly 22 percent of households are employing severe consumption-based coping strategies (WFP, 2022).

FIGURE 1.18 Maize price trends (MWK)



Source: World Bank, with data from FMPA tool.

FIGURE 1.19 Rice price trends (MWK)

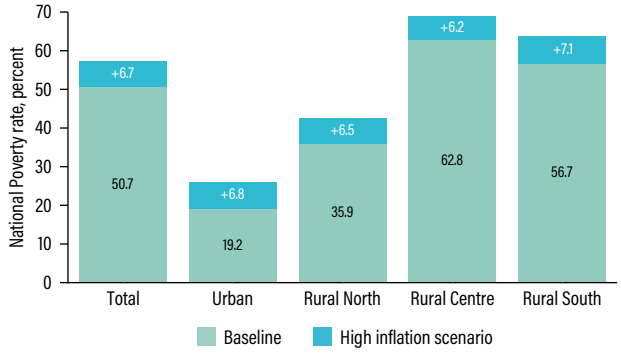


Source: World Bank, with data from Ministry of Agriculture.

Rising food inflation is pushing more people into poverty. New World Bank simulations of the poverty impact of rising food prices find that sustained price increases of 32 percent (the rate of food inflation in September), in the absence of rising incomes, will push an additional 7 percent of the population into poverty (Cardona, 2022).[10] The magnitude of the effect depends on whether households are net food consumers or net producers.[11] The impact of food inflation on poverty differs depending on where people live, with those in the rural south hit hardest. However, in relative terms increasing food prices affects people in cities the most (Figure 1.20).

The Government has introduced various measures to address the cost-of-living crisis. This includes the temporary suspension of one fuel levy and reductions in three fuel levies. In addition, the Government reduced the pump price of petrol by 10 percent on September 16, reflecting lower global prices. However, these measures have not benefited consumers much amidst fuel scarcity throughout the country. Other measures include the removal of value-added tax (VAT) on cooking oil and bottled water, and maize price interventions.

FIGURE 1.20 Changes in poverty rate due to food inflation of 32 percent



Note: Assumes impacts through affecting food purchases and income from food sales.
Source: World Bank calculation with data from NSO.

9. The survival minimum expenditure basket comprises the bare minimum amount required to maintain existence and cover lifesaving needs.

10. The analysis relies on the following assumptions: (i) households do not change their consumption patterns; (ii) food inflation affects all households equally; (iii) changes in food prices do not affect the share of food produced by families to be consumed in house: (iv) the increase in food prices translates into an equivalent reduction of households' consumption; and (v) the increase in own farm income translates into an equivalent increase in consumption for producers' households.

11. Net consumers refers to households whose net consumption decreases with higher prices as their expenditure on food is higher than their income earned from food sales, while net producers encompasses households whose net consumption increases with higher prices as their income from food sales is higher than their food expenditure.

Despite some progress toward fiscal consolidation, budget discipline remains a challenge

Higher government spending during the first half of FY2022/23 widened the fiscal deficit, exerting pressure on the Government's fiscal consolidation plans announced in the FY2022/23 budget. The Government expressed its commitment to implement fiscal consolidation during the budget process of FY2022/23. Through the first half of the fiscal year, from April to September, the fiscal deficit totaled 4.3 percent of GDP, wider than the mid-year target of 3.5 percent of GDP. Revenue collection slightly underperformed the approved target, and together with higher recurrent spending resulted in an above-target fiscal deficit. While some of these spending overruns (especially for goods and services) have been caused by external factors, including recent increases in commodity prices, others are due to a continued lack of budget discipline. If the performance for the first half is maintained, the fiscal deficit for FY2022/23 may widen further to 8.6 percent of GDP However, in line with the new IMF Staff Monitoring Program, the Government will further enhance revenue collection and implement expenditure reductions. Taking these into consideration, the Government could still significantly narrow the gap between the current fiscal trajectory and the target.

All major tax categories have performed well, contributing to a good performance of domestic revenues by mid-year. Domestic revenues totaled 6.7 percent of GDP, largely driven by a strong performance in international trade taxes, which were supported by rising global commodity prices and their impact on the value of imports, high-value imports for the telecommunication sector, as well as the devaluation of the Kwacha. Taxes on income, profits, and capital gains[12] performed well and contributed to taxes totaling 6.3 percent of GDP against their mid-year target of 6.2 percent of GDP. Grants totaled 1.1 percent of GDP supported by frontloading of resources for project spending, but still underperformed their mid-year target of 1.5 percent of GDP. An unsatisfactory performance in other revenues, due to lower remittance of dividends, exerted a downward pressure on total revenue. By mid-year, revenue collection totaled to 7.7 percent of GDP, below the target of 8.3 percent of GDP.

The Government exceeded spending targets in almost all expense categories during the first half of FY2022/23. Expenditures totaled 12.1 percent of GDP, higher than the mid-year target of 11.8 percent of GDP. Overruns were reported in all expense categories, other than social benefits and other expenses. These categories in particular were impacted by the high rates of inflation and increased global commodity prices. Use of goods and services totaled 2.1 percent of GDP, largely driven by higher spending on generic goods and services, which totaled 1.3 percent of GDP by mid-year. The Government also spent more on employee compensation, which amounted to 3.2 percent of GDP against a mid-year target of 2.8 percent of GDP. Higher spending was also reported on interest expenses, which totaled 2.2 percent of GDP, missing its mid-year target by 1.7 percent of GDP. This calls for improved expenditure and fiscal risk management by strengthening public finance management (PFM) systems and the management of commitments (see Box 1.4). Spending on social benefits (including the AIP) was mostly in line with plans, with a performance of 0.9 percent of GDP, compared with the mid-year target.

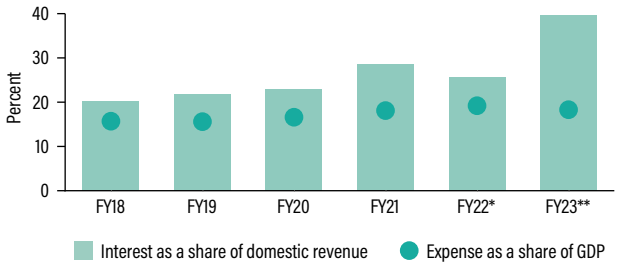
Spending on debt servicing had been increasing significantly in recent years, taking up resources for government discretionary fiscal policy. In FY2022/23, debt servicing is projected to take up more than one-third of domestic revenue, increasing by 50 percent relative to FY2021/22 (Figure 1.21). However, ongoing debt-restructuring negotiations are likely to contribute to increased debt sustainability and significantly reduce interest payments, especially for external debt servicing.

12. This was driven by a strong performance in taxes payable by corporations and other enterprises from higher remittance of provisional taxes, and personal income taxes from gains of the revised PAYE structure.

Frontloading of project financing contributed to the strong performance of development spending. Spending under the foreign-financed development component improved due to the frontloading of grant disbursements for on-budget development projects. Nonetheless, by mid-year, the Government had spent 2.1 percent of GDP on foreign-financed development expenditure, below the mid-year target of 2.6 percent of GDP. The Government had less under the domestically financed component, totaling 0.5 percent of GDP by mid-year, below the target of 0.9 percent of GDP. Cumulatively, the Government intends to spend up to 5.2 percent of GDP on development projects (Figure 1.22).

FIGURE 1.21 Debt-servicing costs have been on an upward trajectory

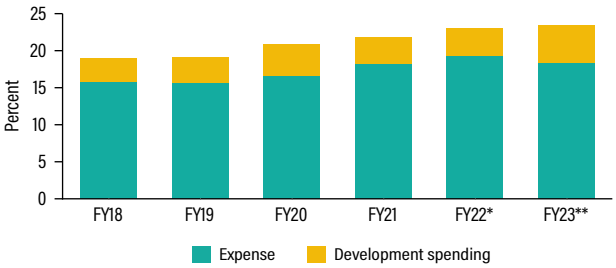
Interest as a share of domestic revenue (rhs) and expense as a share of GDP



Note: *Interpolated data to a full fiscal year based on nine months of data for FY21/22. **Approved Budget.
Source: World Bank, with data from MoFEA.

FIGURE 1.22 Development spending is expected to increase in FY2022/23

Expenses and development spending as a share of GDP



Note: *Interpolated data to a full fiscal year based on nine months of data for FY21/22. **Approved Budget.
Source: World Bank, with data from MoFEA.

BOX 1.4 Recent PFM reforms could help improve management of expenditures and fiscal risk, but will require political will for successful implementation

Inadequate PFM systems and weak management of commitments have contributed to the deterioration of Malawi's fiscal situation, causing budget overruns and posing fiscal risks in Malawi. In FY2021/22, the Government reported large overruns in most expenditure categories, most notably in compensation for government employees, social benefits (which include higher-than-targeted spending on fertilizer payments under the AIP), and use of goods and services (Table B1.4.1).

TABLE B1.4.1 Government expenditure heatmap

(%, actual against approved target)

	FY17/18	FY18/19	FY19/20	FY20/21	FY21/22
Compensation of employees	2.64	-1.45	-0.93	1.98	10.41
Use of goods and services	3.37	-10.14	-0.68-	-0.62-	12.72
Interest	13.62	23.49	7.25	-7.37	-9.42
Grants	30.50	59.87	33.83	0.88	13.40
Social benefits	1.09	-0.08	-1.24	-1.54	15.31
Domestic financed projects (Part II)	-24.53	-5.53	15.18	-11.60	-34.69

<-10 >-10<-5 >-5<0 >0<5 >5<10 >10

Source: World Bank, with data from the Ministry of Finance and Economic Affairs.

In turn, the Government has committed to addressing these consistent PFM problems through two major reforms: the amendment of the Public Finance Management Act (PFMA) 2003 and the implementation of a new Integrated Financial Management Information System (IFMIS).* The objectives of these reforms are: (i) to maintain a sustainable fiscal position; (ii) a more effective allocation of resources; and (iii) the efficient delivery of public goods and services.

The Government has taken an important step to amend the PFMA to ensure that public resources are used with due regard to economy, efficiency, and effectiveness. The PFMA is the principal legislation in the management of public resources. The Government enacted a revised PFMA in March 2022, which provides greater clarity in terms of responsibilities of controlling and other officers in the management of public funds. The PFMA emphasizes improved management of commitments and arrears. For instance, one of the provisions for controlling officers include restrictions against over-expenditure and over-commitment of funds.

Central to the implementation of the PFMA is the new IFMIS, which was rolled out from July 2020 and is central to supporting budgetary execution. The IFMIS allows the MDAs to commit annual expenditure against approved budgets when contracts are signed, or local purchase orders are issued. Annual portions of multiyear contracts can also be committed as budgeted. Some of the benefits of using IFMIS include:

- Making expenditure commitments against approved budgets on a real-time basis;
- Managing arrears, as real-time commitments will ensure that arrears are within approved budgets subject to funding; and
- Avoiding over-commitment, as reports generation required under the Act will be facilitated.

While these reforms have generated optimism for improved PFM in the country, implementation will be key. There will be a need for strict application of the provisions of the PFMA to ensure effective compliance, including effective deterrence and entrenchment of responsibility and integrity. The IFMIS, which has full commitment control functionality at present, needs to be fully implemented as an effective tool to address consistent overruns and insufficient budget discipline.

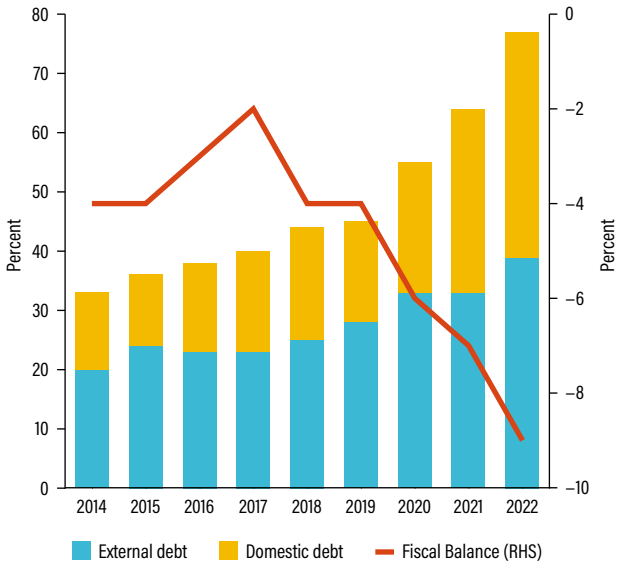
Notes: *IFMIS is a SAP-based software systems to support management of public sector budgetary, financial, and accounting operations and promote better PFM with a centralized registry of public sector revenues and expenditures.
Source: World Bank, with data from MoFEA.

Malawi's public debt is in distress, but the Government is restructuring some debt to ensure medium-term sustainability

While debt is sustainable on a forward-looking basis, Malawi is assessed to be in debt distress, with both external and public debt considered unsustainable under current polices. The November 2022 Joint IMF-World Bank Debt Sustainability Analysis reports that Malawi's public debt is unsustainable, with the heaviest burden arising from liquidity ratios against exports. Public debt increased to 64.0 percent of GDP by end of 2021, up from 54.8 percent of GDP in 2020. This was largely driven by accumulation of domestic debt from 21.9 percent of GDP in 2020 to 31.2 percent of GDP in 2022. The Government has mostly been implementing an expansionary fiscal policy, and related financing of fiscal deficits with domestic resources (Figure 1.23) has contributed to the large uptake of domestic debt. External debt slightly decreased from 32.9 percent of GDP in 2020 to 32.8 percent of GDP in 2021. While the Government has taken measures toward fiscal consolidation, fiscal deficits remain high and will contribute to continued accumulation of public debt in the short term. Public debt is estimated to reach 76.6 percent of GDP by end of 2022.

FIGURE 1.23 Malawi's public debt has grown as fiscal deficits have increased

As a share of GDP

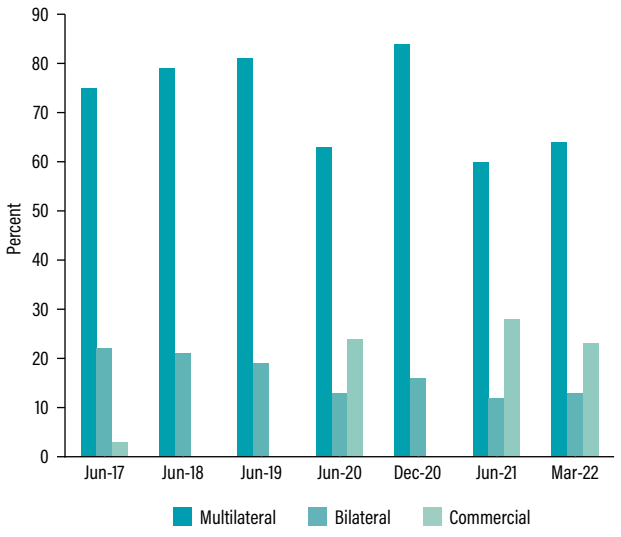


Source: World Bank calculations, with data from RBM and MoFEA.

The composition of external debt has shifted toward commercial creditors at non-concessional terms, increasing debt-servicing costs (Figure 1.24). As part of exchange rate management, the RBM had contracted short-term exchange-rate swaps. However, amid dwindling foreign exchange reserves and thus liquidity challenges, these were converted into medium-term facilities and contributed to the jump in external debt from 25 percent at the end of 2018 to 33 percent at the end of 2020. Some of the medium-term facilities matured in 2021, and external debt moderated. However, foreign currency liquidity challenges are still paramount, and public institutions have been contracting foreign exchange facilities for the importation of strategic commodities. This may further strain the country's external debt position, especially if the current shortage of foreign exchange in the country persists. As of March 2022, commercial lenders held 23 percent of external debt (equivalent to 9.8 percent of GDP), while multilateral and bilateral creditors held 64 and 13 percent of external debt (equivalent to 27.0 and 5.4 percent of GDP), respectively. Terms of borrowing from commercial creditors are highly non-concessional and external debt servicing is concentrated on these commercial lenders. As of end FY2021/22, debt service to the two major commercial lenders (AFREXIM and TDB) comprised 64 percent of the total external debt service.

FIGURE 1.24 Commercial debt has increased in significance, especially since 2020

As a share of total external debt

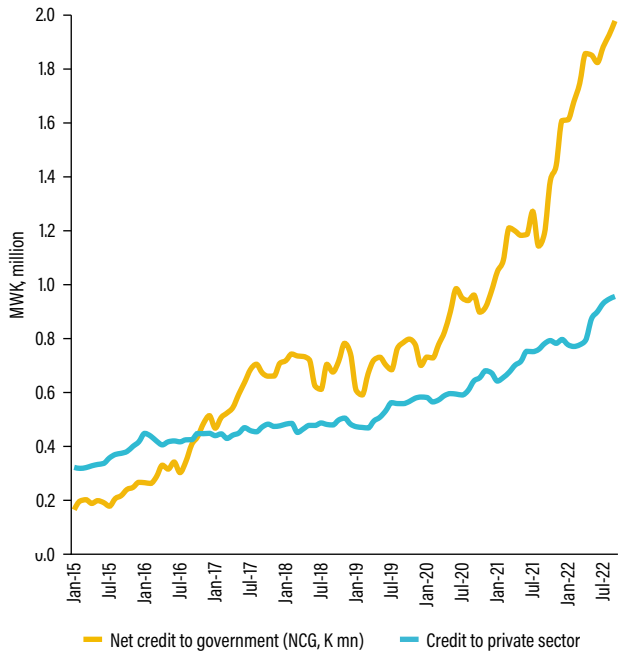


Source: World Bank calculations, with data from MoFEA

Domestic government debt uptake by the banking sector remains high, crowding out resources for private sector investment. With the Government still recording high fiscal deficits, uptake of domestic debt to finance the gap is still rising. Domestic debt has increased by 11 percent in FY2022/23 to MWK 4.3 trillion (equivalent to 37.4 percent of GDP) as of August 2022, 67 percent of which is held by the banking sector. Broad money supply is increasing by 36.3 percent y-o-y as of September 2022,

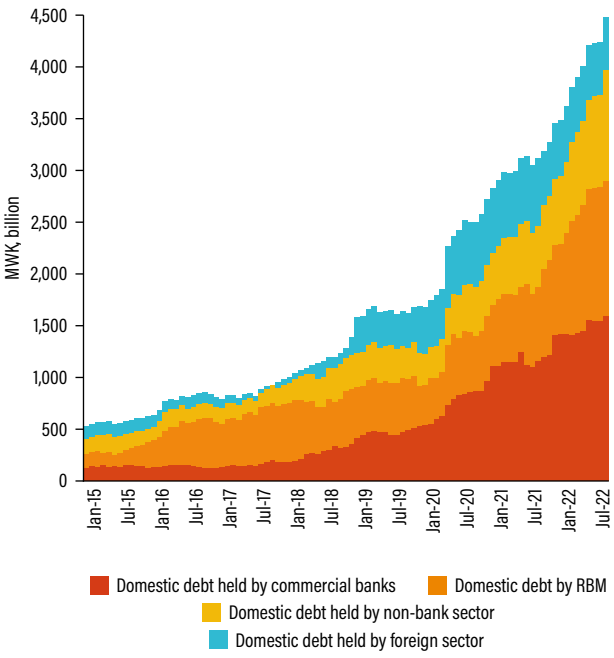
in turn exerting additional inflationary pressures. At the same time, increased credit to government is eroding resources for private sector investment. As of September 2022, net credit from the banking sector to the private sector had increased by 22.4 percent y-o-y, while net credit to government had increased by 66.3 percent over the same period (Figure 1.25). Uptake of government domestic debt by the non-bank[13] sector is rising rapidly by 79 percent y-o-y over September 2021. On the other hand, domestic debt held by the foreign sector has declined by 21.2 percent y-o-y over the same period (Figure 1.26).

FIGURE 1.25 Credit to the Government and the private sector



Source: World Bank, with data from the RBM.

FIGURE 1.26 Domestic debt by holder



Source: World Bank, with data from the RBM.

The share of domestic debt held in longer-term instruments reduced slightly relative to FY2021/22, but remains high. In line with the Medium-Term Debt Strategy (MTDS) 2018–2022, the Government has shifted its borrowing strategy toward longer-term instruments to address the debt rollover risk associated with short-term instruments. This has contributed to the share of the Government's domestic debt held in Treasury notes increasing over the period of implementation of the MTDS, from 66 percent of total domestic debt in June 2017, peaking at 89 percent in March 2022. As of September 2022, the share of domestic debt held in Treasury notes had slightly reduced to 87 percent. Interest rates associated with these longer-term instruments have also been increasing, increasing the debt-servicing burden (Figure 1.21). The share of domestic debt held in Treasury bills has slightly increased, from 11 percent in March 2022 to 12 percent in September 2022.

The Government has taken initial steps to bring debt down to a more sustainable path, both through restricting additional debt and the initiation of PFM reforms. Currently, the Government is engaging its external creditors to implement a debt strategy that involves significant restructuring, in particular to reduce debt-servicing costs. PFM reforms may contribute to reduced pressure on public debt from arrears. However, efforts toward fiscal consolidation are being challenged by the current macroeconomic environment, including rising domestic prices from the effects of Russia-Ukraine war.

13. This excludes debt taken up by the foreign sector.

TABLE 1.1 Fiscal accounts

(% GDP)

	2018/19	2019/20	2020/21	2021/22	2022/23	
					Mid-Year Actual	Revised Budget
Revenue	**14.7**	**14.6**	**14.5**	**14.9**	**7.7**	**16.6**
Domestic Revenue	**13.2**	**13.1**	**13.0**	**13.7**	**6.7**	**13.4**
Taxes	**12.8**	**12.3**	**12.2**	**13.0**	**6.3**	**12.7**
Taxes on Income, Profits and Capital Gains	6.0	5.8	5.7	5.8	3.0	5.9
Taxes on Goods and Services	5.7	5.5	5.5	6.0	2.7	5.5
Taxes on International Trade and Transactions	1.1	1.0	1.0	1.1	0.7	1.2
Other Taxes	0.0	0.0	0.0	0.0	0.0	0.0
Grants	**1.4**	**1.5**	**1.5**	**1.2**	**1.1**	**3.1**
From Foreign Governments	-	-	-	-	0.1	0.2
From International Organizations	1.4	1.5	1.5	1.2	1.0	2.9
Other Revenue	**0.5**	**0.8**	**0.7**	**0.8**	**0.3**	**0.8**
Property Income	0.1	0.3	0.4	0.1	0.1	0.4
Sale of Goods and Services	0.4	0.5	0.3	0.6	0.2	0.3
Fines, Penalties and Forfeits	0.0	0.0	0.1	0.0	0.0	0.0
Expenditure	**19.1**	**20.9**	**21.7**	**23.7**	**12.1**	**23.5**
Expense (with arrears)	**15.6**	**16.6**	**18.1**	**19.7**	**9.5**	**18.3**
Compensation of Employees	5.2	5.5	5.9	6.4	3.2	5.8
Goods and Services	3.4	4.0	3.7	3.9	2.1	3.3
Generic goods and services	2.1	2.5	2.2	2.3	1.3	2.0
Maize purchases	0.1	0.1	0.1	0.2	0.1	0.1
Interest	2.9	3.0	3.7	3.5	2.2	5.3
To non-residents	0.2	0.2	0.2	0.2	0.2	0.3
To residents other than general government	2.7	2.8	3.5	3.3	2.0	5.1
Grants	2.7	2.7	2.0	2.2	1.1	1.9
Social Benefits	1.4	1.4	2.6	3.3	0.9	1.9
Fertilizer payments	0.4	0.3	1.3	2.1	0.3	0.8
Other Expenses	0.1	0.1	0.3	0.4	0.1	0.1
Non-Financial Assets	**3.5**	**4.2**	**3.6**	**4.0**	**2.6**	**5.2**
Foreign financed	2.2	2.4	2.7	2.2	2.1	4.2
Domestically financed	1.4	1.8	1.0	1.8	0.5	1.0
Deficit	**-4.5**	**-6.3**	**-7.2**	**-8.8**	**-4.3**	**-7.0**
Primary Balance	**-1.6**	**-3.3**	**-3.5**	**-5.3**	**-2.2**	**-1.6**
Net Financing	**4.5**	**5.7**	**7.1**	**9.1**	**2.9**	**7.0**
Foreign Liabilities	**0.8**	**0.8**	**1.0**	**0.9**	**0.6**	**2.2**
Program Borrowing	0.1	0.0	0.3	0.0	0.0	0.8
Project Loans	1.0	1.2	1.2	0.9	1.0	2.6
Amortization	-0.4	-0.4	-0.4	0.0	-0.4	-1.3
Domestic Liabilities	**3.8**	**4.9**	**6.0**	**8.2**	**3.7**	**4.8**

* FY2021/22 figures as a percent of GDP represent a nine-month fiscal year, to enable comparison with previous fiscal years.

Note: Figures are a share of rebased GDP figures.

Source: World Bank calculations, with data from the RBM and MoF

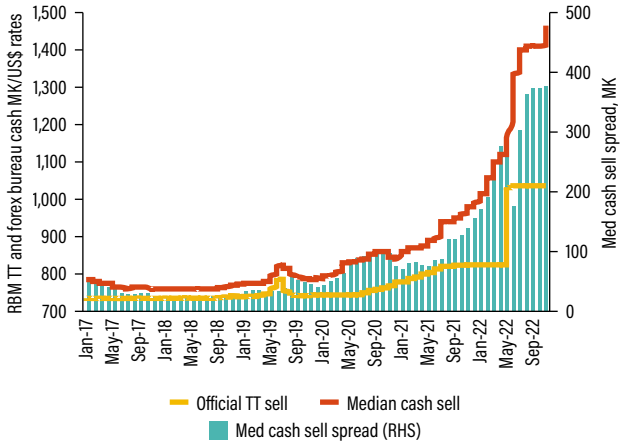
The spread between the official and market exchange rates has widened again, while foreign reserves remain low

The spread between the official telegraphic transfer rates and cash rates has reemerged after the RBM devalued the official MWK-US$ exchange rate by 25 percent in May 2022. Between July 2021 and May 2022, the official Malawi kwacha exchange rate for telegraphic transfers (TT), through which most foreign exchange transactions are carried out, had only marginally depreciated by 1.4 percent. Meanwhile, foreign exchange bureau (FXB) cash exchange rates depreciated by 25.6 percent, widening the spread against the TT rate to 42 percent (Figure 1.27). To align official rates with market rates and address foreign exchange shortages, the RBM devalued the official Malawi kwacha-US dollar exchange rate by 25 percent. However, the spread between the official TT rates and foreign exchange bureau cash rates now has surpassed the pre-devaluation level. Increases in current money supply in the domestic economy and inflation differentials (i.e., a rise in domestic prices relative to foreign prices) are considered to have a depreciating impact on exchange rate movements.

The exchange rate adjustment has had a limited impact in addressing foreign exchange shortages. This comes after a number of measures, including the re-introduction of the mandatory sale of export proceeds in August 2021,[14] which did not sufficiently support the foreign exchange supply to eradicate imbalances in the interbank market. The exchange rate adjustment was aimed at improving external sector competitiveness and building up official reserves, aligning the exchange rate with market fundamentals, as well as improving the circulation of foreign exchange in the market. While imports and other international foreign exchange transactions have declined, banks and other businesses continue to hoard foreign exchange despite the devaluation in May (IMF, 2022b).

FIGURE 1.27 Spreads between TT and bureau MWK-US$ exchange rates continue to widen...

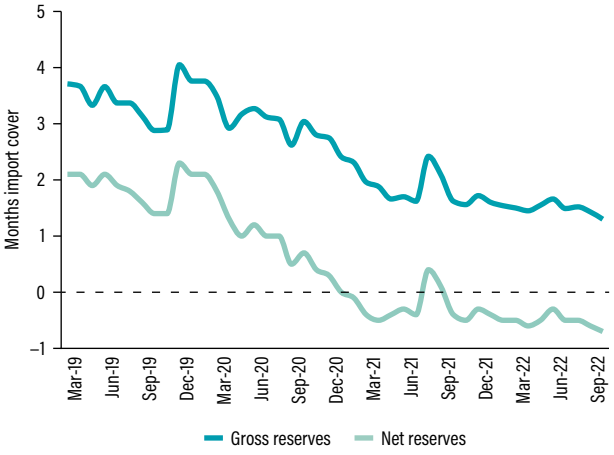
RBM telegraphic transfer (TT) and forex bureau cash MWK/US$ rates and spreads through Nov 17



Source: World Bank staff calculations based on RBM data.

FIGURE 1.28 ...while reserves remain low

Official gross and net reserves, months import cover



Notes: Net reserves subtract predetermined short-term drains, such as short-term swaps

Source: World Bank staff calculations based on RBM data.

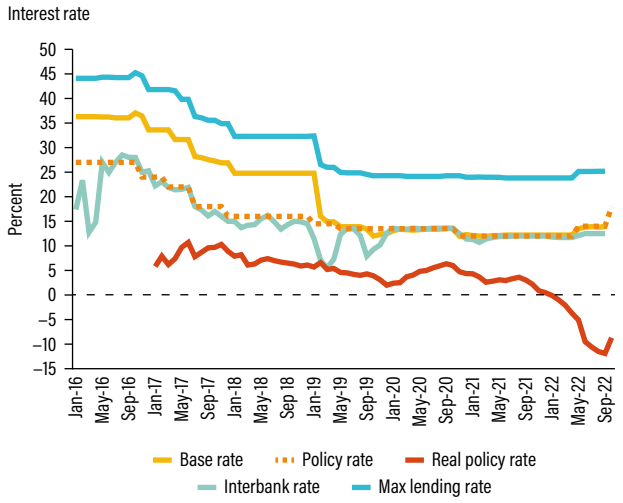
Official foreign exchange reserves remain low, caused by a structural trade deficit and rising debt-servicing payments to external commercial creditors. Gross reserves decreased by more than half, from US$847 million in December 2019 and one-third over the year from US$605 million in August 2021 to US$326 million in October 2022, or around 1.3 months of import cover (Figure 1.28). This is much lower than the recommended adequacy level of 3.9 months of import coverage for a credit-constrained economy (IMF, 2022b). Net reserves have been negative, and gross reserves have been mainly supported by substantial swaps (both new and rollovers) and medium-term borrowing facilities at non-concessional terms.

14. It requires exporters to liquidate 30 percent of their proceeds held in Foreign Currency Denominated Accounts. The requirement was supposed to be on a temporary basis but has continued to date.

The rise in the policy rate has not resulted in lower inflation, which remains primarily supply-driven

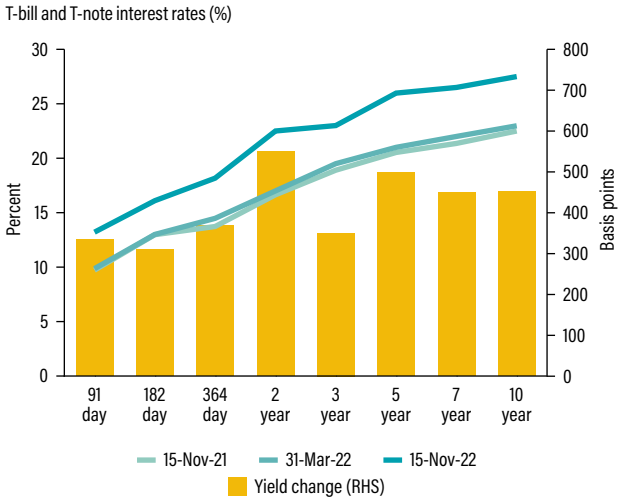
Monetary conditions have tightened. Since the policy rate was increased to 14 percent from 12 percent in April 2022, the base lending rate and interbank rate have increased in response. The policy rate increase and strong government demand led to a rise in monthly average Treasury bill and note yields across all the tenors (Figure 1.29). For example, the yields of two-year and seven-year Treasury notes increased by 550 and 450 basis points, respectively, between the March and mid-November 2022 position (Figure 1.30). Furthermore, in October 2022, the Monetary Policy Committee increased its key policy rate to 18 percent from 14 percent to restore price stability, noting that high inflation could frustrate the country's economic recovery process and diminish the welfare of households (RBM, 2022). The 6.5 percentage point increase in the policy rate this year is an effort by the RBM to address rising inflation by anchoring inflation expectations.

FIGURE 1.29 The real policy rate has been negative since January 2022



Source: World Bank staff calculations based on RBM data.

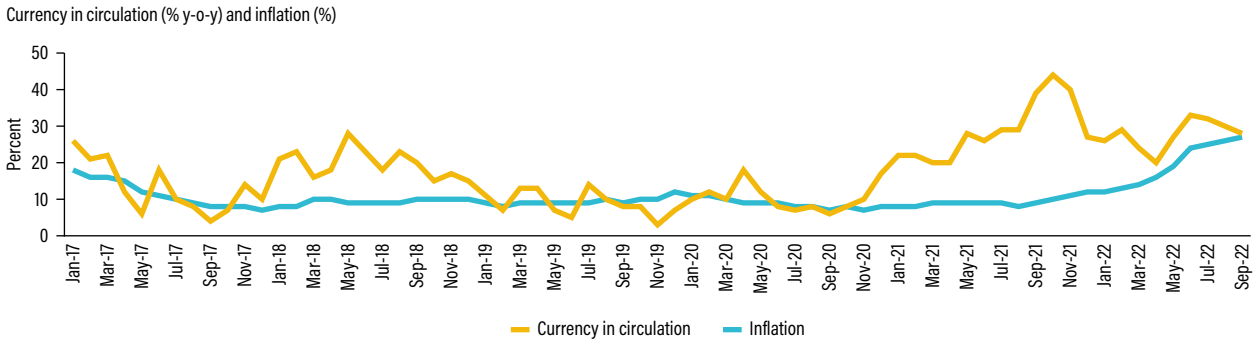
FIGURE 1.30 Government borrowing yields have increased since March 2022



Source: World Bank staff calculations based on RBM data.

However, the real policy rate has been negative amid heightened inflationary pressure. Following the October 2022 rate increase, the real policy rate stands at –8.7 percent, 2022 with headline inflation at 26.7 percent. Despite the recent increase in the policy rate, the monetary policy stance has tended to be accommodative, expanding the money supply to boost the economy during a slowdown and reflecting its supply-driven nature (Figure 1.31).

FIGURE 1.31 Monetary supply has expanded

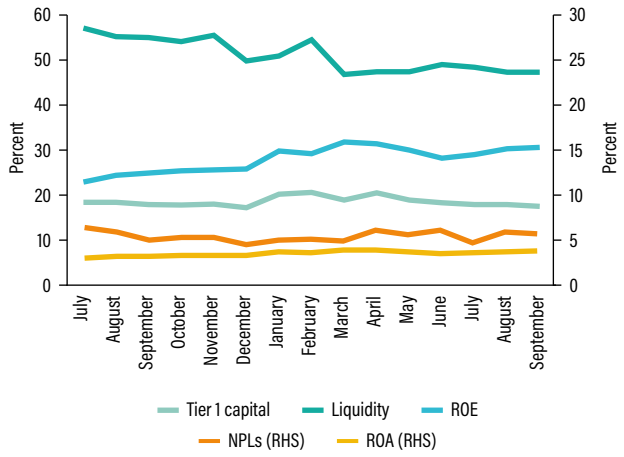


Source: World Bank staff calculations based on RBM data.

Bolstered by high levels of government borrowing, the banking sector has performed well despite wider macroeconomic challenges

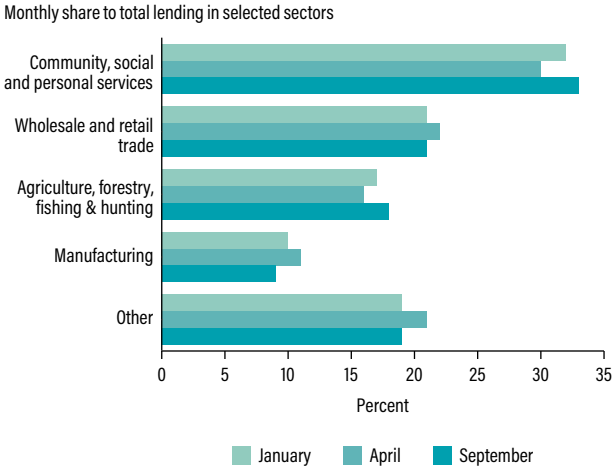
The banking sector has maintained high profits and a strong overall financial performance, but trends show declining buffers in 2022 compared with the position in 2021. The banking sector's overall capital adequacy ratio and tier 1 capital adequacy ratio were well above the regulatory thresholds of 15 and 10 percent, respectively, as of September 2022 (Figure 1.32). Nonetheless, there has been evidence of slight deterioration in 2022. A similar trend was observed in the liquidity coverage, which stood at 47.3 percent. While this is above the 25 percent regulatory threshold, it is lower than the 55 percent recorded in September 2021. While the sector is still maintaining a healthy asset quality position, non-performing loans (NPLs) to gross loans and advances deteriorated as compared with the end of 2021, mostly remaining above the prudential limit of 5.0 percent in 2022. The wholesale and retail trade; electricity, gas, water and energy; community, social and personal services sector; and agriculture, forestry, fishing and hunting continue to account for a significant proportion of NPLs. On the other hand, the overall profitability for the banking sector is healthy, with return on equity (ROE) and return on assets (ROA) increasing by 22.8 percent (to 30.6 percent) and 17.1 percent (to 3.8 percent), respectively, over the positions at the same period in 2021. Profitability in the sector was a result of increases both in interest and non-interest income, against slower growth in expenses (Figure 1.33).

FIGURE 1.32 Financial stability indicators show resilience against economic decline



Source: World Bank staff calculations based on RBM data.

FIGURE 1.33 Private sector credit is dominated by personal loans and trading services



Source: World Bank staff calculations based on RBM data.

The banking sector is showing resilience, but facing a challenging environment characterized by a slowdown in the economy, rising inflation and a scarcity of foreign exchange. These conditions would typically adversely affect the performance of the banking industry. However, lending to the Government has mitigated such challenges, complemented by lending to low-risk businesses deemed most likely to be capable of servicing loans, explaining the low NPLs. Sentiments from the industry indicate that banks are strengthening due diligence procedures and lending to trusted clients only. This performance is also reflected in the performance of shares of major banks, which have outperformed on the Malawi Stock Exchange this year, contributing to the Malawi All Shares Index, which covers 16 stocks, reaching an all-time high in November 2022.[15]

15. This, however, is likely to be a function of the shallowness of Malawian financial markets rather than underlying business performance. The Pensions Act of 2011 makes it mandatory for businesses and employees to contribute at least 7.5 and 5 percent of pensionable emoluments, respectively, to a pension fund. This leads to rapid growth in assets in a market with few alternatives, government bonds and real estate being among the few notable ones.

The pattern of lending to the private sector has not changed much in the year. While growing modestly in nominal terms, most lending went to just three sectors, namely community, social and personal services; wholesale and retail trade; and the agriculture, forestry, fishing and hunting sector (Figure 1.33). Collectively, these accounted for 71.9 percent of the total loan portfolio in September 2022, an increase from 67.7 percent in September 2021. Lending to the manufacturing sector remains low at 9.3 percent, down from 13.2 percent in 2021. Analyzing this further, it is notable that most of the lending is directed at activities associated with personal loans, pay day loans, loans associated with state-owned enterprise activities and mostly for consumption, and for trading and agriculture-related activities. As Micro, Small and Medium Enterprises (MSMEs) struggle to grow with limited access to financing, financial institutions are implementing lending programs to support this sector (see Box 1.5).

BOX 1.5 As MSMEs struggle to grow, financial institutions are implementing lending programs to support this sector with support from the RBM and the World Bank

The RBM, with support from the World Bank, commissioned an MSME survey, which identified characteristics of micro, small and medium enterprises in Malawi. The survey identified several characteristics of the MSMEs and owners, including the following:

- Forty-five percent of MSME owners in Malawi are financially illiterate, and they acquired business skills by themselves and mostly through trial and error, rather than through a training program.
- The majority (71 percent) of business owners did not register with the Registrar of Companies. Among the minority that did, more than three-quarters (79 percent) had registered as sole proprietors, 11 percent as a private company and 7 percent as partnerships.
- The majority (55 percent) kept records of business finances. However, of those who kept records, the majority (82 percent) used a standardized manual recording system.

The survey identified a number of challenges for MSMEs, especially when it comes to access to finance. With regard to access to finance, 27 percent of survey respondents indicated access to finance as a major obstacle. The National Economic Empowerment Fund Limited is seen as the most popular micro-finance institutions for accessing loans (54 percent), followed by FINCA (19 percent), and the Microloan Foundation (5 percent). About 74 percent are aware of know-your-customer standards, but only 34 percent are aware of the credit reference system in Malawi. Digital financial uptake is dominated by mobile money accounts (54 percent). 11 percent reported having either a registered debit or credit card, and internet banking is used by only 4 percent.

Interventions will be required to increase knowledge and utilization of institutions that provide business management, entrepreneurial skills and access to credit. Most MSMEs are unable to access formal credit for several reasons, including a failure to meet collateral requirements set by lenders, weak management structures, and the high cost of credit. These challenges cause MSMEs to struggle in their efforts to survive and scale up.

Study findings revealed that most MSMEs were not aware of the existence of public institutions or bodies that provide support for MSME development in Malawi. For example, awareness of the Malawi Investment and Trade Centre, Small and Medium Enterprises Development Institute, and the Malawi Confederation of Chambers of Commerce and Industry remains low at 24, 29 and 34 percent, respectively, and use of the services of these three institutions remains at or below 10 percent of surveyed firms.

To help address this challenge, the Government initiated the Financial Inclusion and Entrepreneurship Scaling project. Through this project, which is supported by a US$86 million credit from the World Bank, the commercial banks, microfinance institutions and development finance institutions have partnered with the RBM to provide low-cost loans to innovative enterprises, support high-potential start-ups, and establish capable and well-supervised investments, while enabling them to adopt digital financial services. In addition, capacity building programs are being offered to innovative MSMEs.

Source: Preliminary Report of the Baseline Survey from the Financial Inclusion and Entrepreneurship Scaling project to be published in December, 2022.

1.3

MEDIUM-TERM ECONOMIC OUTLOOK

Malawi's economy is projected to post subdued growth over the coming year, with per capita income stagnating. GDP growth is projected to slow to 0.9 percent in 2022. This is driven by a lower-than-anticipated performance in agriculture, the ongoing balance-of-payments crisis and its impact on production, as well as the cumulative impact of external shocks. The industry and services sectors continue to be impacted by erratic electricity supply. Recovery from the COVID-19 pandemic continues to be hampered by the sustained impacts of cyclones in early 2022, as well as persistent economic imbalances. Economic growth is projected to pick up to 2.2 percent in 2023, driven in particular by a recovery of the agriculture sector. A full recovery of the economy to a pre-COVID-19 growth path is not expected in the near term.

Prolonged foreign exchange shortages can have severe and long-lasting effects on the real economy. Businesses have to forego potentially profitable investment opportunities because imported investment items are unavailable, limiting economic growth in the medium term. When a market price is replaced by government interventions, it is often done on a per-good- or per-business-basis. This may deepen the crisis by limiting the capacity of businesses to generate foreign exchange.

The poor performance of exports, amid elevated global prices for most key commodities, will result in a further weakened external sector and a high current account deficit. While a more flexible exchange rate regime has some negative consequences in the short term, such as an increase in the cost of imports, it should gradually help increase export competitiveness and improve the trade balance in the medium term. However, limited diversification and declining global demand for tobacco will contribute to sustained difficulties in reducing the current account deficit. As such, increasing exports in identifying new potential export sectors, most notably in agribusiness and mining, will be essential.

Inflation is expected to remain high. Malawian businesses and consumers will likely have to expect higher Malawi kwacha prices for imported products, especially fuel, fertilizer and cooking oil. In addition to rising inflation, there is a possibility of energy prices rising, which will increase electricity prices and further strain the costs of production.

Pressures on the macroeconomy could create further challenges for the achievement of the Government's fiscal consolidation aims. There is a risk that the FY2022/23 fiscal deficit may widen further to 8.6 percent of GPD, beyond the revised target of 7.0 percent of GDP in the absence of significant reforms. Despite consolidation efforts planned for this fiscal year, expenditure will likely further rise owing to increased recurrent spending due in part to elevated commodity prices and the recent devaluation. Due to the scarcity of fuel and erratic availability of electricity and increasing costs of production from high and rising input costs, several companies are reducing their scale of operations, which could result in reduced mobilization of domestic revenue. These factors could cumulatively result in a higher-than-projected fiscal deficit. As most foreign financing is dedicated or ringfenced to specific spending items, this may result in increased domestic borrowing, which could heighten inflationary pressures and contribute to crowding out resources for private sector investment.

In the absence of significant restructuring, public debt is projected to increase further due to high fiscal deficits financed through high-cost domestic borrowing. Non-concessional external debt incurred to support foreign currency reserves is currently being restructured but remains a concern. In addition, restructuring with bilateral lenders is being sought. Financing assurances from creditors, as well as fiscal, monetary, and exchange rate policies, could bring Malawi to a sustainable debt path needed for a full IMF program supported by an ECF. Such an ECF would in turn engender trust by private investors and crowd in further budget support from development partners. If this process is adequately supported with sustained fiscal consolidation that progressively lowers expenditure, and additional measures to reduce debt vulnerabilities, especially through improved PFM systems, this could give rise to increased investor confidence and private sector investment.

The lack of sustained economic growth, along with the continuous inflationary pressures and recurrent weather shocks, will make it more difficult for Malawi to find a way to reduce poverty. The share of people living with less than US$2.15 per day is projected to remain at 71 percent in 2022 and 2023. However, further external shocks may result in increasing poverty rates and push more people into food insecurity.

These economic prospects are subject to considerable uncertainty with several downside risks. Persistent foreign exchange unavailability, a wave of corporate bankruptcies, financial stress, delays in the AIP implementation and reform process, rising poverty and food insecurity, and a worsening of the current cholera outbreak could derail the recovery. A rapid deterioration of global growth, higher-than-anticipated energy prices, and tighter financing conditions are the primary external risks. Natural disasters and intensifying climate change impacts, especially on agriculture production, continue to pose a major downside risk to the economic outlook.

Policy Options: Reducing macroeconomic imbalances, supporting the recovery of growth and protecting the poor against shocks

The Government has taken important steps to address the ongoing crisis over the course of 2022. This includes measures to reduce the fiscal and external deficit, including initiating discussions on debt restructuring, the announcement of a less expensive and better targeted "AIP 2.0", and the ongoing implementation of the 2022 PFM Act. In parallel, support to the poorest has been enhanced significantly through an expansion of cash transfer programs and climate-smart public works. However, the prospects for Malawi's economy depend on an improvement in external conditions, as well as the materialization of the Government's plans to improve expenditure management and debt sustainability. In turn, implementing announced policy reforms and strategies has become more important than ever to overcome the interlinked fiscal, balance of payments, and food security crises, and create the foundations for sustained economic growth.

This 16th edition of the Malawi Economic Monitor (MEM) calls for urgent actions to stabilize the economy and enhance growth. As in the previous MEM, this edition includes addressing three key areas:

i) *Stabilizing the economy:* While some progress is being made, there remains an urgent need for the implementation of the announced macroeconomic reforms, including building foreign reserves, achieving fiscal consolidation goals for the current fiscal year, returning debt to a sustainable path through restructuring, implementing key fiscal governance and PFM reforms, and continuing the shift toward a more flexible exchange rate regime.

ii) *Stimulating export competitiveness and overall market-driven growth in the economy:* In the context of an ongoing macroeconomic crisis, it will be essential to focus on reforms for growth. This includes a sustained emphasis on advancing agricultural commercialization, improving the pro-

ductivity of firms, and increasing and diversifying exports. It will also be important to deliver on the planned reform of unaffordable and poorly targeted subsidies, such as those for the Affordable Input Programme (AIP), and remove distortions that constrain firms' growth.

iii) *Protecting the poor and strengthening resilience:* As another difficult lean season approaches, including the heightened risk of extreme climatic events, it will be essential to advance implementation of the significantly expanded Social Cash Transfer Program and other assistance programs. In the context of fiscal pressures, it will also be important to continue prioritizing the delivery of essential services to the most vulnerable, while improving the efficiency and effectiveness of social sector expenditure.

TABLE 1.2 Priority policy areas and key actions

1. Restoring macroeconomic stability			
Building foreign reserves	Continue the progression towards a sustainable, well-supported, and market-based exchange rate regime.	short	
	Gradually increase foreign exchange purchases	medium	
	Strengthen the RBM's reserve management by developing reserve management strategies and practices, including a registry to ensure the consolidation of records of all liabilities and contracted facilities, timely reporting, and enhancing transparency and accountability.	medium	
Addressing fiscal pressures	Strengthen fiscal consolidation efforts, in particular by continuing the process of scaling back AIP expenditures through improved targeting.	short	
	Increase domestic revenue by implementing policies to support private sector growth, improving the Government's tax collection capacity, as well as increasing taxpayer compliance.	medium	
	Strengthen budget planning and prioritize expenditures in a sustainable medium-term fiscal framework.	medium	
Achieving debt sustainability	Finalize debt restructuring negotiations and proceed with implementation of new debt strategy.	short	
	Develop and adhere to an annual borrowing plan to contain the increase in domestic debt and non-concessional external borrowing.	short	
	Enhance public debt transparency by expanding the coverage of public debt reports to include comprehensive information on contingent liabilities and outstanding payments.	short	
Improving public finance management and investment	End overspending on budget allocations by implementing commitment controls and a framework for cash management that supports more efficient service delivery and increases public trust.	short	
	Continue improving the prioritization and transparency of the Public Sector Investment Program through investments in its technical infrastructure and timely publication of key analyses.	medium	
2. Enhancing export competitiveness and market-oriented growth			
Boosting private-sector development and trade	Ensure that any legislation under discussion such as the Crops Bill, and export licensing procedures, supports implementation of the Control of Goods Act.	short	
	Implement Malawi's National Export Strategy, promoting access to key regional and global markets, such as the African Continental Free Trade Area.	medium	
Improve the efficiency and sustainability of infrastructure	Increase access to reliable power by ensuring the financial sustainability of ESCOM, advancing the realization of the Mpatamanga Hydropower Project, and improving the infrastructure for off-grid systems.	medium	
	Build, upgrade and rehabilitate infrastructure to withstand climate change shocks through improved use of public sector resources and greater access to international climate finance and private sector investment.	medium	
Increasing access to finance and ensuring the stability of the financial sector	Promote longer-term and affordable financing options for the private sector, and particularly smaller enterprises.	medium	
	Strengthen the monitoring of the performance of the banking sector, while slowly phasing out single exposure limit waivers and reducing lending to the public sector.	short	

3. Protecting the poor and strengthening resilience		
Improve efficiency and effectiveness of public expenditure at the sub-national level to increase access to essential basic services among the most vulnerable.	short	
Implement emergency cash transfers across both urban and rural areas to help vulnerable households access food and other necessities in response to acute food insecurity and price shocks.	medium	
Expedite national roll-out of climate smart public works programs as a complementary social safety net to cash transfers for the poorest and most vulnerable in rural areas.	medium	
Halt and reverse widespread land degradation through investments in land and forest restoration and management	medium	
Submit to parliament the DRM Bill to provide clarity on the functional mandates of MDAs working on climate and DRM programs and improve the monitoring and coordination of resource allocation and execution.	short	

Initiate Phase out Sustain Strengthen

2

STRENGTHENING AGRICULTURAL COMMERCIALIZATION AND RURAL LABOR MARKETS

Improving rural labor market outcomes is key to reducing poverty

A more robust and vibrant rural economy is needed to address Malawi's economic difficulties. In 2021, over three-quarters of all adults worked in agriculture and the sector contributed 43 percent to the country's overall economic growth. In addition, agriculture has many deep links with other sectors, and has an important impact on Malawi's overall macroeconomic performance. As discussed in the previous chapter, the design of current major agricultural support programs, such as the AIP, not only has direct impacts on the agriculture sector, but also limits fiscal space and consumes a significant share of available foreign exchange, thus reverberating across the overall economy. While the AIP takes up a significant share of scarce agriculture budget resources—around 40 percent on average in recent years—it has done little to stimulate the process of agricultural transformation that Malawi desperately needs to generate higher economic growth and create more jobs. In fact, if anything, it has contributed to the status quo of the current low-return maize-based farming systems that have trapped many rural households in perpetual poverty. Conversely, a vibrant rural economy, stimulated by improved policies and better-targeted investments, could catalyze the economy as a whole, alleviating many of the macro-fiscal imbalances discussed in Chapter 1.

As urbanization is progressing slowly, rural labor markets hold the key to sustained poverty reduction in Malawi. Malawi's population remains mostly rural—the 2018 census classified 84 percent of the population as rural residents (NSO of Malawi, 2019)—and largely pursues small-scale, rainfed agriculture. For most rural residents, farming remains the foundation of their livelihood—over 93 percent of rural workers (aged 15 to 64 years) are employed in the sector and three in four working Malawians are estimated to derive their livelihoods from agriculture (IFPRI, 2022). Many people spend most of their lives working in agriculture and there are few signs of labor mobility to other sectors (Baulch et al., 2019). In fact, in Africa more people shifted into farming when the COVID-19 pandemic arrived, with agriculture cushioning the economic contraction (Amankwah and Gourlay, 2020).

The high level of subsistence farming has been a key factor in Malawi's persistent poverty, which remains predominantly a rural phenomenon. Ninety-four percent of all poor households are found in rural communities, with the rural poverty headcount ratio for Malawi at 57 percent, three times higher than in urban centers, at 19 percent (Caruso and Cardona Sosa, 2022). This is partly related to the low productivity of farming systems in Malawi in terms of crop yields, and partly due to the small average farm size of only 0.7 hectares (ha) in land, which is considerably less than in other countries in the region. For example, whereas per capita arable land for Malawi's rural population was 0.19 ha in 2020, this figure was 0.34 ha in Tanzania, 0.37 ha in Zambia and 0.39 in Zimbabwe (World Bank, 2022). Such small landholdings, especially when the majority of farming is limited to a single rainfed cropping season, does not offer sufficient returns to enable farming households to meet their basic needs.[16] According to the most recent (2019/20) Integrated Household Survey (IHS), the typical farming household only derived MWK 16,190 (about US$20 in nominal terms) in value per capita annually from their efforts. Meanwhile, the share of rural households with a member engaged in waged employment has steadily dropped to fewer than one in five.

While agriculture will remain Malawi's largest employer for the next decade, farming only provides 21 percent of total income for the typical Malawian farming household. The rest is made up of casual labor, longer-term wage employment, household enterprises and, to a lesser degree, regular income payments such as pensions, as well as social protection and similar transfers. Despite these diversified livelihood strategies that have enabled households to generate incomes from non-farm activities, some 54 percent of farming households are still not able to meet their basic needs.

Rural households will increasingly need to turn to other types of employment outside agriculture to avoid or to escape poverty. However, non-farm rural employment does not necessarily provide

16. Productivity is low, especially for smallholders, due to constraints that range from weather variations (floods and dry spells), limited use of improved agricultural technologies, inputs, and practices, as well as poor access to credit and markets. The scarcity of land and fragmentation of holdings compound these problems. The availability of water is another concern.

sufficiently high incomes to lift households out of poverty and many households do not have the resources or skills needed to create or find employment that pays well. New analysis in Benson and De Weerdt (2023, forthcoming) shows that even if all farming households were able to reach the agricultural productivity levels of the top 10 percent most productive households, the impact on household incomes and the poverty rate would be limited, ranging from a reduction of 1.9 to 9.7 percentage points, depending on the main crop planted. As such, the current structure of household agricultural production in Malawi offers no pathway to sustained poverty reduction for many, if not most, farming households.

Understanding the full diversity of income-generating activities that rural Malawians engage in is crucial to developing viable strategies that can enhance incomes and reduce poverty. In contrast to perceptions, which depict rural households as a relatively undifferentiated mass, Malawian farming households are highly heterogenous. Households across the rural-urban divide can be categorized into four groups based on economic, residential and demographic characteristics. These are: (i) commercially-oriented smallholder farmers (see Box 2.1); (ii) other productive rural households; (iii) households that are not economically productive; and (iv) productive urban households (Figure 2.1). The analysis in this chapter illustrates how each of these types of households plays a dedicated role in rural economies and how agricultural and non-agricultural labor markets interact. Interaction between local and national economies is also important in shaping rural labor market dynamics, as is the level of skill required for higher returns. To develop viable strategies to boost rural incomes, it is essential to both understand the appropriate policy options to enhance what households reap from farming, and to pay attention to increasing the returns that these households receive from their non-farm work.

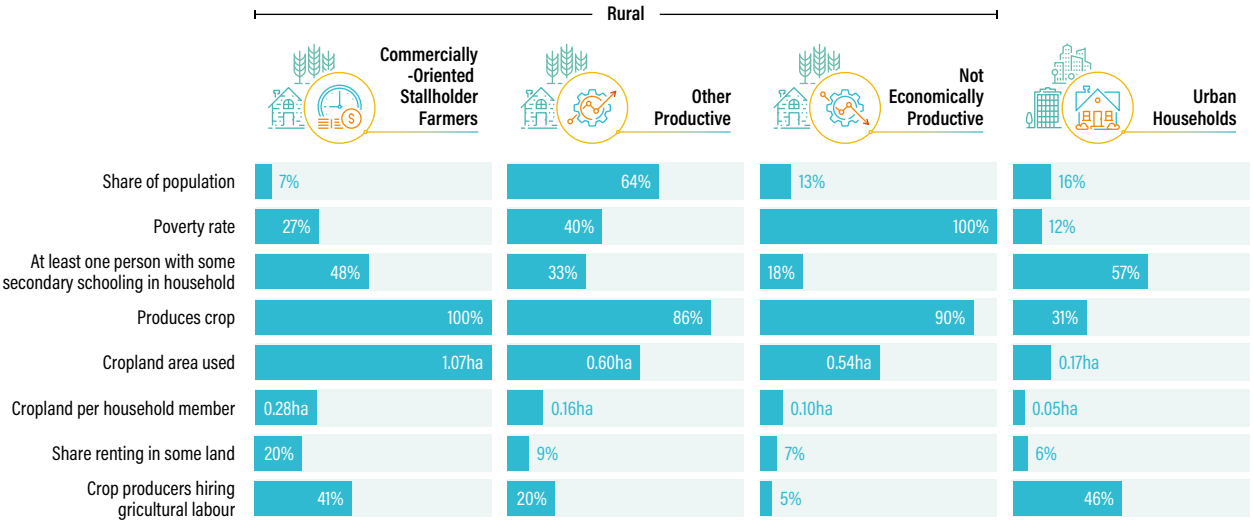
BOX 2.1 What is a Commercial Farmer?

A commercial farmer is broadly engaged in agricultural production for the market. These farmers are typically net sellers, i.e., able to meet food consumption needs while also producing a surplus to sell.

For the purposes of this report, households are categorized as commercially-oriented if their consumption level is above the food poverty line and they reported selling more than one-quarter of their harvested maize annually. Although the total value of crop production that was sold could have been used to define households in this category, maize was used for analytical simplicity. Eighty-eight percent of farming household in Malawi produce maize and the crop is planted on over 70 percent of the cropland of farming households. In addition, gross sales as a share of maize harvested was used, given that information on food crop sales and consumption is not sufficiently harmonized in the IHS to determine annually whether a household is a net maize seller or a net maize purchaser. Information on crop sales is collected on a seasonal basis, while information on food purchases is based on food consumption recall over the previous seven days.

FIGURE 2.1 Typology of Malawian households

Shares calculated as percentage of overall population covered in the 2019/20 IHS 5 survey. Poverty rate defined as the share of households falling under the national per-capita basic needs poverty line.



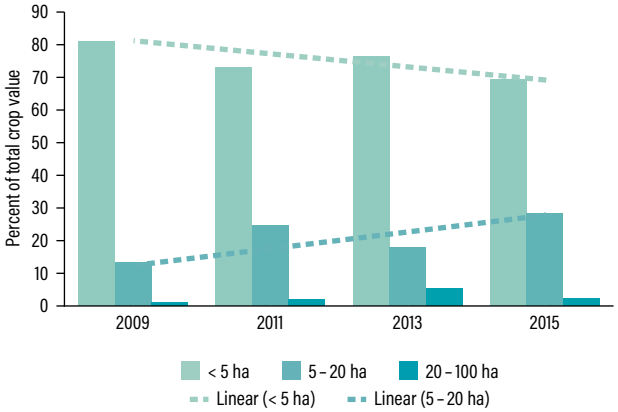
Note: Commercially-Oriented Smallholder Farmers are defined as those households that are not ultra-poor (i.e., consumption below the food poverty line) and that sell more than one-quarter of the maize they harvested. Not Economically Productive Households are ultra-poor and more than half of their members are not working age (aged 15 to 64). Urban Households are residents of urban centers and rural towns. Other Productive Households are rural households that do not fall into the Commercial Smallholder or the Not Economically Productive Household categories.

Source: World Bank staff compilation based on Benson and De Weerdt (2023, forthcoming) .

In this context, a move toward commercial livelihood strategies is needed in order to sustainably reduce poverty levels. Successful commercial farming creates demand for labor, thus serving a pivotal role in rural markets. Commercializing smallholders create local demand for services and labor on their productive plots. This, in turn, stimulates rural off-farm labor markets, which are already where most rural economic activity takes place. There is growing evidence from the region that emerging commercially-oriented, small- and medium-size farmers can become a significant source of demand for innovation, capital investment, and service provision, which together can drive productivity growth and job creation. For example, such medium-scale commercializing farms (5–100 ha) now control roughly 20 percent of total farmland in Kenya, 32 percent in Ghana, 39 percent in Tanzania, and over 50 percent in Zambia. In Tanzania, medium-sized farms generate 13 million labor days per year. This trend in most cases reflects increased interest in land by urban-based professionals or influential rural people. About half of these farmers obtained their land later in life, financed by non-farm income. A greater share of savings in urban areas is being re-invested in farming and agribusiness (Jayne et al., 2019) (Figure 2.2).

FIGURE 2.2 Medium-sized farms' share of total crop value in Tanzania increased from 14 to 30 percent in six years

Share of total crop value by scale of farms



Sources: Tanzania National Bureau of Statistics, National Panel Survey and Wineman, Jayne, Modamba, and Kray (2020).

Rural Malawians engage in a wide range non-farm economic activities both on and off the farm

Slow structural transformation, accompanied by stagnant per-capita production levels, has left Malawians working in less-productive agricultural jobs, with adverse effects on poverty levels. Services sector employment is growing more slowly in Malawi than among its peers, while the employment share in the industry sector has been decreasing for the past decade. Consequently, Malawi's progress in addressing poverty and vulnerability has stalled, with the poverty rate virtually unchanged over the past two decades, leading to a significant increase in the absolute number of poor Malawians. At the same time, progress in increasing non-farm employment in Malawi has been among the slowest in the region.

Rural Malawians engage in a wide range of economic activities in search of better economic prospects. Particularly due to small cropland holdings of many households, even at much higher levels of productivity, many would not be able to meet their basic needs through farming alone (Figure 2.3). Moreover, the incomes that farming households obtain from the crops that they produce from their small cropland holdings are generally too low. Crop prices, particularly for food crops, are also volatile from year to year. Consequently, even households farming larger cropland holdings cannot be confident that they will always be able to generate sufficient income from farming. To meet the basic needs of their members, most farming households, whether poor or non-poor, need to pursue additional economic activities to farming, as agriculture alone is insufficient.

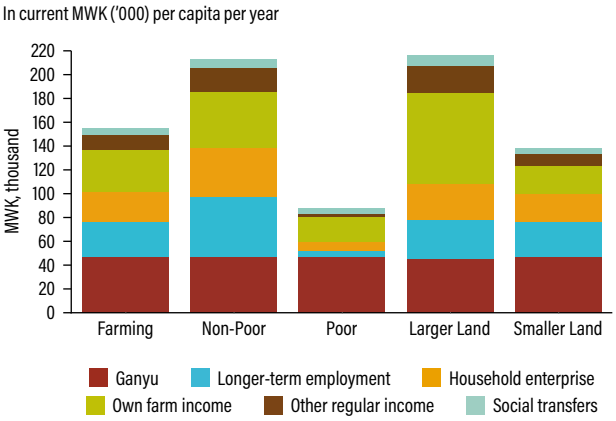
FIGURE 2.3 Households reporting any member engaged in various economic activities or receiving regular income

Percentage of overall population covered in the 2019/20 IHS5 survey in respective household categories

Source: World Bank staff calculations based on Benson and De Weerdt (2023, forthcoming).

Workers in farming households have three principal options for off-farm employment—(i) casual short-term *ganyu* employment; (ii) more formal longer-term wage employment; and (iii) operating commercial household enterprises. The average farming household is heavily dependent on such off-farm employment to supplement their farm income (Figure 2.4). Around two-thirds of the income of farming households comes from off-farm labor. All three types of off-farm employment available to workers in farming households come with their own advantages and challenges:

FIGURE 2.4 Average farming household reported income by source



Source: World Bank staff calculations based on Benson and De Weerdt (2023, forthcoming).

- *Ganyu employment* and seasonally-operated household enterprises allow workers in farming households to focus on farming during the rainy season and then pick up temporary work or reengage in a household enterprise after the harvest. However, the income that households can obtain from such unskilled work is uncertain. Demand for short-term workers in farming communities in the dry season is lower than during the cropping season, while the supply of workers competing for *ganyu* labor opportunities at that time of year is large, suppressing wages.

- The returns to *household commercial enterprises* depend to a large degree on the nature of the enterprise—offering relatively more skilled services to other households typically provides a household with a larger income stream than small-scale trading of local agricultural produce. However, many households do not have the capital or skill sets needed to create enterprises that can generate returns to labor that exceed those from subsistence farming.

- In contrast, *longer-term wage employment* can provide a more assured income stream for households. However, such wage employment opportunities are rare. Moreover, if a member of a farming household in successful in finding wage employment, the household then also faces a reduction in the labor that it can call on for farming.

Casual short-term or *ganyu* employment—which typically pays less than one-third of earnings in business or waged employment—is as central to the livelihoods of most farming households as is farming on their own cropland. During the dry season, *ganyu* labor is the main coping strategy used by poor Malawian households to meet their food security needs (Whiteside, 2000). *Ganyu* labor is therefore a necessary component of the annual income stream of growing numbers of farming households in Malawi and acts as a complement to farming activities (Caruso and Cardona, 2022).[17] Most *ganyu* labor is linked directly or indirectly to agriculture, both on-farm and off-farm, such as working on other people's fields, and engaging in processing and trade, and working in the rural retail sector. *Ganyu* labor is occupying an increasing share in household incomes, rising from 18 to 37 percent between 2010 and 2019. The share of income from *household businesses* and *wage jobs* has also increased, from 3 to 11 percent since 2010, although this remains low.

Overall, farming households are considerably more likely than non-farming households to have members engaging in *ganyu* employment—almost three-quarters of farming households in Malawi reported a member having engaged in *ganyu* in the past year, compared with only about half of non-farming households.[18] Farming households are more constrained by seasonal factors in their ability either

17. Trend analysis presented in Benson and de Weerdt (2023, forthcoming) comparing 2010/11 (IHS3) with 2019/20 (IHS5), showed that participation among all Malawian households in *ganyu* has increased significantly over this period.

18. The share of all individuals who reported engaging in some *ganyu* in the past year is much higher among farming households—over one-third, compared with one-quarter of all individuals aged five years and above in non-farming households.

to take on or to find *ganyu* employment.[19] Unlike for many workers in non-farming households, *ganyu* labor does not appear to be a transitional form of employment for smallholders. Although non-farming households engage in *ganyu* labor while they seek to secure more remunerative longer-term wage employment, farming households primarily rely on this income source to meet their food security needs, especially during the dry season when there is a labor surplus. As such, *ganyu* labor is not a way out of poverty. Most of the literature points to the fact that smallholder farmers engaged in *ganyu* might sacrifice productivity on their own farm while working on other people's fields, because this is when the demand for labor is at its highest. Poor farming households are almost 40 percent more likely to engage in *ganyu* labor than members of non-poor farming households, while those with smaller landholdings are 20 percent more likely to do so than those with larger cropland holdings.

In contrast, relatively few farming households have members in permanent wage employment[20] and the overall share of working age individuals with salaried work appears to be declining over time. Only about 10 percent of all those of working age in Malawi receive a salary for their work, which suggests that there are significant barriers to expanding formal labor markets across the country. These barriers are particularly challenging for members of farming households—while 24 percent of those of working age in non-farming households have wage employment, only 7 percent of those in farming households do. Surprisingly, despite most agricultural production in Malawi being undertaken at the smallholder farmer level, the most common type of wage employment[21] in Malawi is in the agri-food sector, which involves everything from on-farm production to trade, processing and marketing.[22] In addition to this, there is an almost limitless supply of potential workers for employers offering wage employment for the sector, resulting in strong downward pressure on rural wage levels.

In part because wage employment opportunities are rare, more than one-third of farming households have members that operate at least one commercial enterprise. Meanwhile, 45 percent of non-farming households have some form of household enterprise. Farming households with relatively small cropland holdings are more likely to operate such enterprises, possibly to diversify how their labor is employed to generate sufficient income. The enterprises that members of farming households operate are often only available during the dry season, reflecting the strong seasonality of agricultural production. Less than one-third of household enterprises operate 12 months a year. Moreover, the risk of commercial losses is relatively high, particularly for enterprises involving trade in non-agricultural commodities.

Enterprises centered on processing, sales, and trade of agricultural products are the most commonly reported enterprises (Figure 2.5). Many farming households that have such enterprises simply sell their own production in local markets. While operating such enterprises is certainly an option for households to increase their income and to diversify their income sources, successfully doing so is not assured. Such enterprises generally do not provide sufficient income to cover the basic needs of their households. The more remunerative types of enterprises may need to be located in areas where there is sufficient demand for the products or services (mostly near urban centers), and may not be viable in more remote rural communities with low purchasing power. Other enterprises may require specialized skills or public services to be commercially successful—notably electricity, but also transportation, com-

19. Those that engaged in *ganyu* labor in non-farming households reported relying on such work for considerably more days in the previous year than did *ganyu* laborers in farming households—106 days on average, compared with 64 days for *ganyu* laborers in farming households. Moreover, the average number of months in which those in non-farming households reported pursuing such short-term employment was just over seven months, while those in farming households reported doing so for 5.7 months, on average.

20. While over one-third of non-farming households have a member with wage employment, only 15 percent of farming households do (IHS5 dataset). Farming households with smaller cropland holdings are significantly more likely than those with larger landholdings to have a member with wage employment. However, non-poor farming households are more likely than poor farming households to have a member with wage employment.

21. Such employment includes agricultural estate managers and employees, tenant farmers on tobacco estates, agricultural extension agents, staff at Agricultural Development and Marketing Corporation depots, and staff of food-processing firms, including local grain mills.

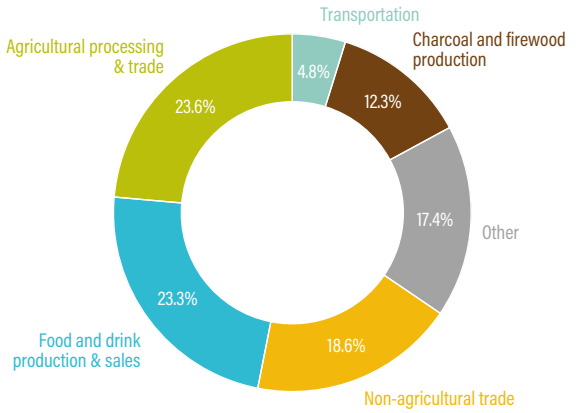
22. Wage employment in education sector, as well as primary production occupations, including agriculture, is primarily found among members of farming households.

munication, and information services. All household enterprises that require significant capital to launch will be constrained by the poor access that Malawian households have to credit.

The relatively high level of entrepreneurship should prove to be an important resource to draw upon as the Malawian economy continues to evolve. Some 38 percent of Malawian households own or engage in some form of commercial enterprise despite the daunting challenges that households face in doing so. This reflects positively on the entrepreneurial spirit of many Malawians, even as it also shows the challenges that they face in terms of limited wage employment options and seasonal agricultural production. Nonetheless, if the process of agricultural transformation strengthens and, in parallel, more wage employment opportunities emerge, there will be a need for a large cohort of entrepreneurs to exploit new opportunities, respond to new demands, and propel needed adaptations in the structure of the economy.

FIGURE 2.5 Types of activities household enterprises are engaged in

Percentage share of all household enterprises



Source: World Bank staff compilation based on Benson and De Weerdt (2023, forthcoming).

Commercialized smallholder agriculture is an important source of economic growth and job creation

An increasing share of households will either need to commercialize or find more remunerative off-farm employment in order to escape poverty. The relatively low wages that rural workers are likely to obtain if they find secure wage employment in agricultural production, processing, or sales[23] reflects oversupply of such unskilled labor. In this regard, increasing household income flows from commercially-oriented farming households through increased agricultural productivity levels could result in greater demand for non-agricultural products and services, including those produced or provided through formal/permanent wage employment, in rural communities across Malawi. This increased demand could also help to expand opportunities for off-farm employment.

Transitioning from smallholder subsistence farming is imperative to longer-term rural economic development. A vibrant commercial smallholder sector would give rise to better non-farm livelihood opportunities, sparking rural economic transformation. As the productivity of commercial smallholder farmers rises, their farm production expands, and their incomes increase. With increased incomes, they will demand more of the goods and services that their less agriculture-focused neighbors produce. These goods and services are those that are labor-intensive, require limited capital in their production, and typically are not marketed outside of the local community—construction and building repair services; transport; education, health, and other social services; furniture and handicraft-making; and food and beverage processing, among others. This consumption linkage spreads many of the economic gains that commercial smallholders make from more productive farming to those other rural households. In the process, local markets are deepened, local economic activities accelerated, and access to food for economically active households in these communities improved, including the poor. Commercialization thereby also has a tremendous employment-generating effect, not just due to growth in terms of increased wage labor employment, but also due to substantial downstream/multiplier effects owing to job generation in sectors beyond on-farm work.[24]

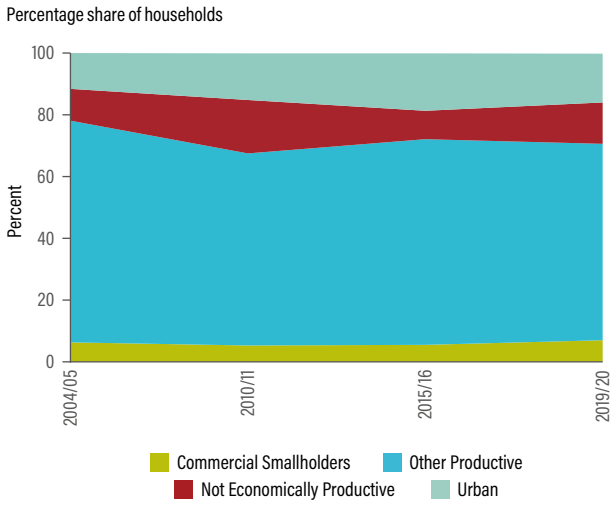
23. These are the largest wage employment industry sub-category in terms of number of workers.

24. This is supported by evidence going back several decades. For example, Mellor (1966) argued that agricultural growth focused on small- and medium-sized farms would generate rapid, equitable, geographically-dispersed growth owing to agriculture's substantial labor-intensive linkages with the non-farm economy. Bell et al. (1982) highlighted how smallholders spend substantial portions of increased income on employment-intensive, non-tradable goods and services produced by the rural non-farm sector. Hazell and Roell (1983) showed similar indirect income-transfer mechanisms for a comparative analysis of Malaysia and Nigeria.

As this pattern of rural economic development continues, the returns that the less agriculture-focused rural households obtain from their non-farm activities begin surpassing those that they can obtain from their low-productivity farming. Many of the households producing goods and services for the local market will expand their activities to serve wider markets, propelling some specialization in local rural employment patterns and further increasing their income. In so doing, many will transition from being poor, subsistence-oriented households that engage in some farming to become non-farming households specializing in livelihoods outside farm production. Moreover, potentially large shares of the cropland that these less agriculture-focused rural households currently use will increasingly be made available for more productive use by commercial smallholder farming households, further accelerating agricultural and rural economic growth. Thus, the structural transformation process involves the movement of labor out of the farming sector and into the non-farm sectors, including downstream segments of food value chains and rural-urban migration for employment in urban areas (Haggblade, Hazell and Reardon, 2007). Accelerating this process and the overall structural transformation in Malawi essentially entails targeting this group and helping it to access other non-farm economic activities, which would include skills development for more remunerative employment opportunities.

Commercial farming trends in Malawi have strong spatial and temporal characteristics. While nationally the share of commercializing smallholders is low at 7 percent and has not changed significantly since FY2004/05 (Figure 2.6), there are significant spatial trends that give hope that commercialization at more localized levels is taking place in Malawi. While similar numbers of rural households live in the rural central region compared with the rural south, at 35 vs. 38 percent, the share in commercially-oriented households in FY2019/20 was almost three times higher in the Central region than in the Southern region (11.8 vs. 4.6 percent). The share of commercially-oriented farmers is also higher than the national average in the Northern region, at 10.6 percent. More importantly, the share of commercially-oriented farmers in the Central region increased steadily from 8.2 percent in FY2004/05 to 11.8 percent in FY2019/20. Similarly, this share increased from 7.5 to 10.6 percent in the Northern region over the same time period (Figure 2.7). However, the share of commercializing farmers in the Southern region declined from 6.1 to 4.6 percent between FY2004/05 and FY2019/20, and this has been the main reason behind the stagnant national-level statistics. These trends highlight that successful rates of agricultural commercialization exist in Malawi at localized levels, most likely in areas where farmers have better access to land and irrigation, and that are located closer to urban markets and major trade and logistics routes.

FIGURE 2.6 Share of household types by IHS wave



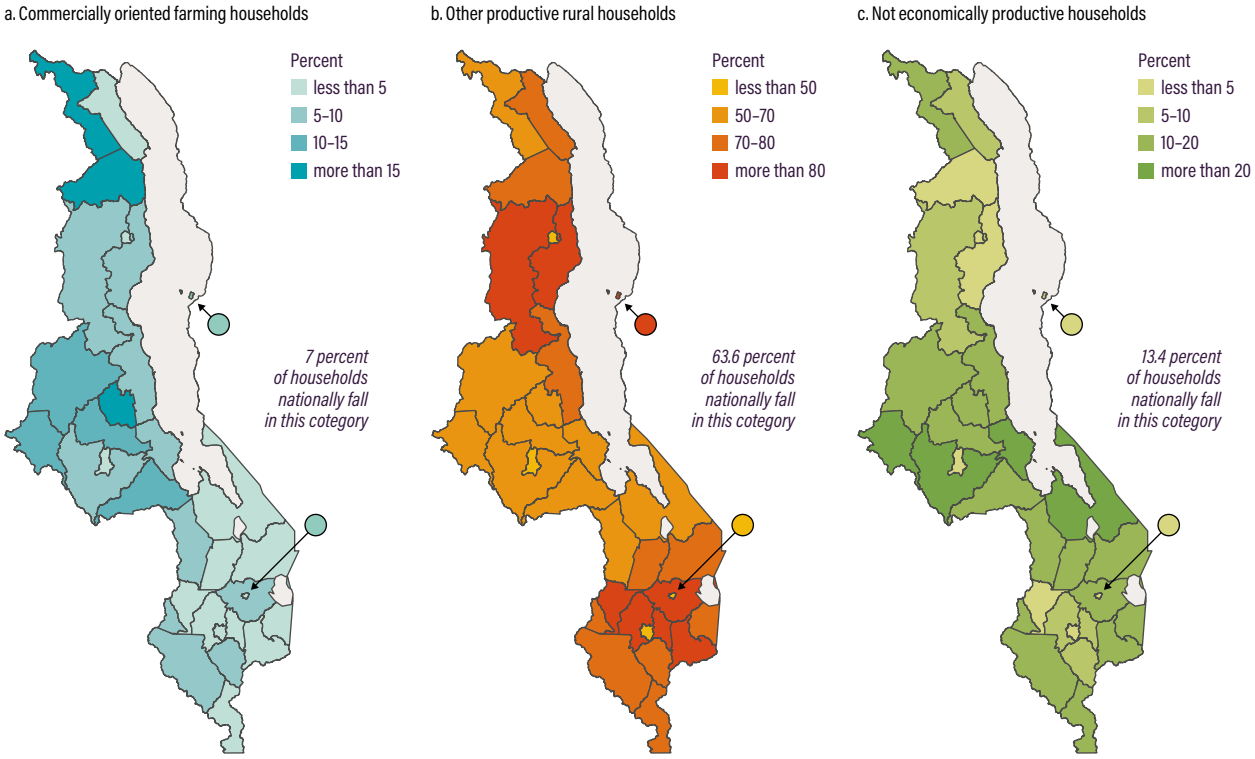
Source: World Bank staff compilation based on Benson and De Weerdt (2022).

Different forms of agricultural commercialization can be observed in Malawi. Historically, the most traditional pathway for commercialization in Malawi has been through out-grower schemes. In these schemes, an entrepreneur (e.g., commercial farm or an agribusiness entity) contracts smallholders to produce commodities of high value to be marketed, in turn, by the entrepreneur (tobacco, paprika, cotton, to mention a few crops). The entrepreneur provides smallholders with the necessary technical advice and inputs to produce the agreed product and also provides a guaranteed market outlet for the produce. The next generation of commercial arrangements between farmers and agribusinesses has been supported through productive alliances, such as those supported by the Agricultural Commercialization Project (AGCOM) (see next section). Finally, there are independent commercially-oriented farmers, similar to the emerging mid-sized farms observed in neighboring countries, who engage directly in the marketing of their produce. While the share of this segment of farmers is still small at the national level, there are significant growth trends at the national level. This provides optimism that

this model of agricultural commercialization is possible in the Malawian context. Demand for services from such commercial farmers would be a critical element in creating off-farm jobs in the future.

FIGURE 2.7 Commercial farming households are heavily concentrated in the North and Central region

Maps by district and major urban centers of households that fall into rural households



Source: Benson and De Weerdt (2023, forthcoming).

While structural transformation is not yet happening at scale, there are nonetheless pockets of agricultural commercialization in Malawi. Select commercialized farmers produce much of Malawi's main exports: tobacco, sugar, tea, and soya. This suggests that there are pockets of productive commercialized farmers across the country, but they are just still too small to be visible in nationally representative data. Further research in this area is needed to identify the spatial growth centers of agricultural commercialization in order to determine the specific drivers. The anecdotal evidence from AGCOM in the next section provides some hints as to how and where such commercialization trends emerge. It is particularly important to identify the precise policy and business environment that has enabled these enterprises to experience episodes of growth to extract broader lessons for Malawian agriculture at large.

Productive alliances play important roles in advancing agricultural commercialization

Productive alliances are helping to make markets work for smallholders who operate commercially or are in transition to becoming commercial. This has been shown through the World Bank-financed AGCOM, which has been operational in Malawi for almost five years and has a financing volume of close to US$100 million. Through its "Productive Alliance" model, it has reached over 60,000 farmers operating in more than 20 value chains nationwide.

Productive alliances are characterized by strong farmer organizations, links to offtake markets, improved access to finance and an enabling environment. The productive alliance model starts with strengthening or building Producer Organizations (POs) to allow smallholders to seize market oppor-

tunities. Forming POs is a way for smallholders to have their voices heard, receive more information, reduce costs, and reap the rewards that come from selling in volume. Second, productive alliances link POs with off-takers to assure access to markets and partnerships. "Off-takers"—companies that buy produce and refine it, such as commercial-scale oil mills and the dairy industry—are operating at low capacity because of inconsistent supplies. If farmer POs orientate their production to meet this demand, this results in a mutually beneficial, commercial relationship between the farmers and the buyers. Third, productive alliances put farmers in the driver's seat where POs respond to competitive calls for proposals. In the case of AGCOM, farmers must contribute at least 10 percent cash contributions and 20 percent in-kind contributions before matching grants are awarded. This boosts production levels and promotes ownership by the farmers. Fourth, productive alliances connect farmers to finance. In the case of AGCOM, this includes a Partial Credit Guarantee Facility, which provides access to finance through commercial banks to boost the production capacity of farmer POs. To date, the project has signed 255 sub-projects valued at US$24.6 million, with US$2.5 million own-cash contributions from farmers. Six POs have benefited through a Partial Credit Guarantee Facility, receiving loans of about MWK 125 million to boost the production operations of their sub-projects. And, lastly, productive alliances' efforts to improve the enabling environment, including reforms, land tenure security, standards and certifications, are all geared toward improving agricultural commercialization.

Productive alliances can promote greater inclusion, especially for women. The most vulnerable members of the farmer POs are the ones profiting the most from commercial partnerships with buyers. In AGCOM, the farmer POs are made up of a diverse mix of men and women, and among them, the youth. Based on over 60,000 beneficiaries reached, 54 percent of them are women (see Box 2.2). The collaborative partnerships will allow women to match and compete on levels of productivity with men by providing them with access to inputs, technologies, and markets. The project includes women-only calls and, so far, 25 POs have benefited from the matching grants. Support targeting the youth is gradually increasing, with special youth-only calls included, in addition to the general calls (see Box 2.3). Currently, 12 youth-only sub-projects have received support from the project.

Increasing farmer demand for AGCOM shows that pockets of structural transformation can propagate. The demand for AGCOM sub-projects has greatly increased, from 79 concepts received in 2019 to 2,064 in 2022. A total of 255 productive alliances are currently signed and financed by the project, an increase from 85 in September 2022. Such efforts have increased the volume and value of sales commercialized with improved farmer access to finance and markets. The types of value chains also spur the hopes for a virtuous cycle of economic transformation: while some value chains are in traditional export goods, others predominantly serve a local market, creating local economic feedback effects (Figure 2.8).

BOX 2.2 The importance of adequate finance: the Nsanama Cassava Producers and Marketing Cooperative example

The Nsanama Cassava Producers and Marketing Cooperative is a women-only group that produces cassava and processes it into high-quality cassava flour and other bakery products. To achieve the quality standards that its customers, such as confectionery companies and consumers in Machinga, Zomba, and Blantyre demand, modern processing facilities and equipment are necessary.

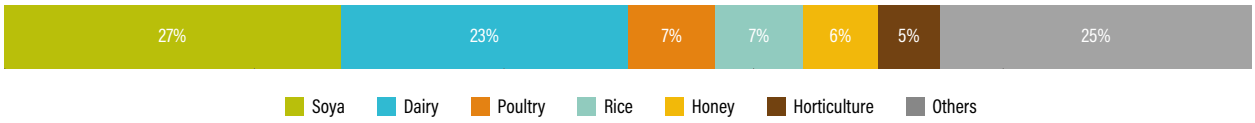
The contribution of MWK 18 million to fund these activities was matched by a grant of MWK 41.5 million (US$55,000) under the AGCOM project. Through this investment, the Nsanama Cassava Producers and Marketing Cooperative was able to improve cassava production volumes from 104 to 169 metric tons, with sales increasing by 63 percent within just one year of grant support. New products emerged, including cassava starch, which boosted income for the cooperative members, while also stimulating increased production of cassava in the surrounding area by at least 20 percent.

BOX 2.3 The importance of market access: The ACADES Youth Farmer Cooperative example

Conceptualized by graduates from Lilongwe University of Agriculture and Natural Resources, the group with an average age of 27 is already proving to be the leader among the youth in agribusiness. ACADES' substantial investment of nearly MWK 200 million was also supported by the AGCOM project. This financed a solar-powered irrigation system and water plant, which enabled an increase in sales by 176 percent in the first year and a projected 492 percent in the second year. However, investments and production were only made feasible through partnerships with reliable off-takers. These guarantee to purchase agreed volumes and thereby secure markets for the produced commodities. Already more than 3,000 farmers have benefited through jobs, illustrating the importance of access to profitable markets.

FIGURE 2.8 AGCOM supported value chains

Percentage share of all AGCOM supported value chains



Source: World Bank staff calculations.

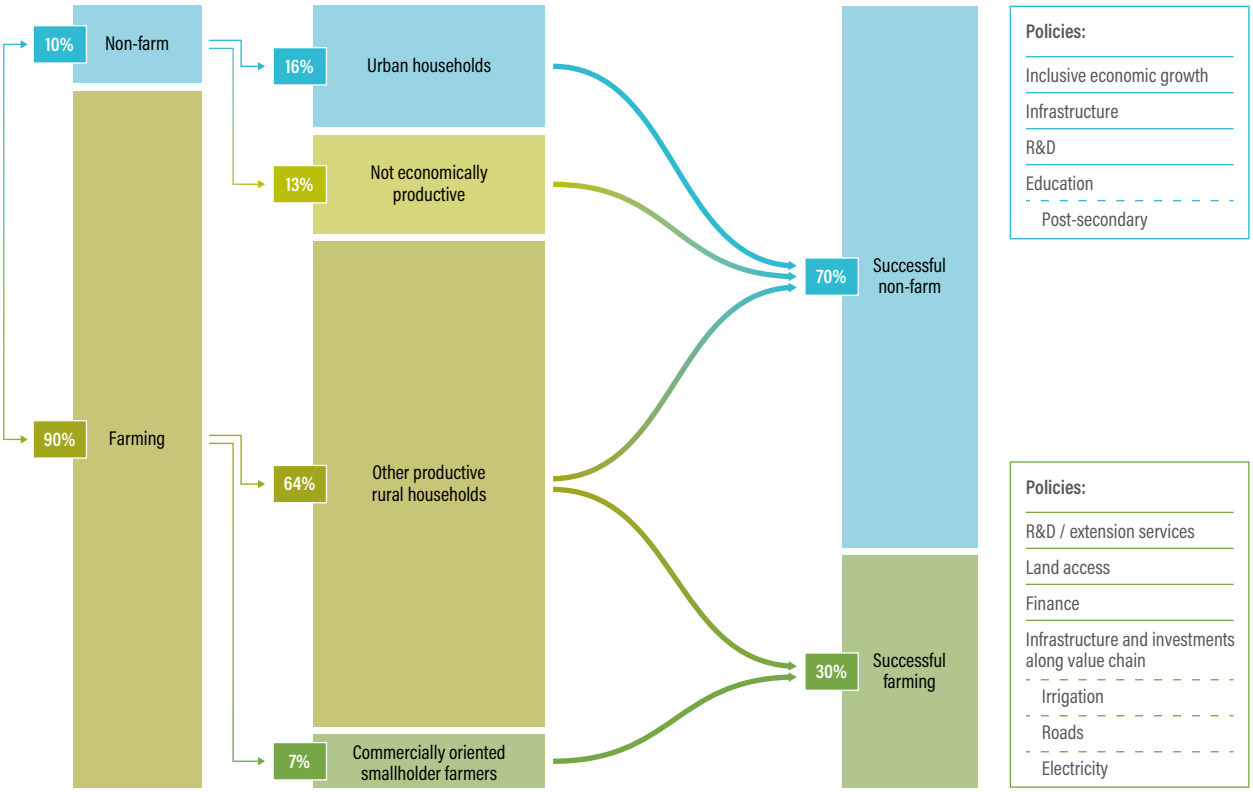
Pathways Forward: Recommendations and considerations for prioritization

Commercial smallholder farmers need to be placed at the center of any policies and strategic programs that seek to foster rural economic transformation in Malawi. The *Malawi Vision 2063* Development Strategy features agricultural commercialization as one of its three pillars. This subset of farmers is uniquely positioned within rural communities to serve as an engine of local economic growth (Benson, 2021). Viewing all farming households as having a similar role in contributing to the performance of the agriculture sector—something that is enforced by one-size-fits-all agricultural support programs, such as the AIP—is misguided and results in missed opportunities for promoting longer-term rural economic development and for sustainably improving the welfare of rural communities. That said, an opportunity exists to capitalize on a reformed AIP, should the political will exist, that would involve segmentation of the beneficiaries according to their needs, such as targeting market-ready farmers to transition toward commercialization opportunities, along with a range of integrated social protection measures for resource-poor farm households.[25] Following a rural development strategy based on the expansion of agricultural commercialization opportunities is crucial to create demand and the related service provision. Three major themes emerge from the analysis in this chapter that could lead to a broader rethinking toward fostering a thriving commercialized smallholder farming sector in Malawi—one that can stimulate rural economies and expand the participation of farmers in agriculture value chains. These three themes can help guide the design of public support programs for smallholder commercialization. Below, Figure 2.9 presents the possible vision for structural transformation that is driven by agricultural commercialization.

First, there is a strong convergence of interests between agribusinesses, commercializing farmers, and more subsistence-oriented smallholders. This is evident in the thriving productive partnership models, discussed above, that could involve both commercially-oriented and other productive rural households. The majority of smallholders in Malawi will not be able to access on their own increasingly sophisticated domestic and international value chains (regardless of their individual or organizational capacity) without the support of agribusinesses or off-takers. Agribusiness off-takers are therefore likely to remain the main drivers of growth for agriculture, as well as the main source of credit through various value-chain financing arrangements. However, the comparative advantage of Malawian agri-food value chains will continue to rely on the relatively low production costs of smallholder producers. This has important policy implications in terms of the legal and regulatory framework. Addressing constraints for smallholder commercialization will therefore require actions that benefit smallholders, as well as both agricultural and non-agricultural enterprises in rural areas. This means that the greatest potential for smallholder commercialization lies not so much in addressing smallholder or commodity-specific constraints (as suggested by the draft Crops Bill currently being drafted by the Ministry of Agriculture), but in overall increases in the efficiency of value chains arising from the removal of economy- and sector-wide constraints, together with the strengthening of institutional mechanisms by which key stakeholders and their service providers can effectively link to each other by forming partnerships and alliances.

25. This vision has been reflected in President Chakwera's national address on October 2022.

FIGURE 2.9 Possible pathways for structural transformation in Malawi



Source: Figure adapted from Thomas Jayne (2018) using data from Malawi (2019/20 IHS5) on farm/non-farm population shares and farmer typology in this chapter.

Second, there is a pronounced variation among smallholders in Malawi in terms of the potential for commercialization that requires different targeting strategies. This heterogeneity of smallholder households with different potential, already demonstrated in this chapter, also has implications for the design and targeting of government support programs. It is most likely that farmers already involved in commercial activity—those located closer to urban or trade logistics centers, and who already possess necessary productive and social assets, such as land and labor, human capital (education and health), social capital (e.g., functioning farmer organizations), and access to financial assets—will be the vanguard of commercialization efforts. Most of these smallholder households are still relatively poor, so there is potential for poverty reduction in the short term, as demonstrated by the success of productive partnerships under AGCOM. In the longer term, with new investments in transport, communication infrastructure, and irrigation, some poor rural households in what are currently considered remote or lower potential areas might benefit from agricultural commercialization.

Third, addressing the issues of rural poverty, and household risks and vulnerabilities, including managing the risks to household food insecurity are the largest hurdles to overcome to accelerate agricultural growth in Malawi, and requires holistic solutions that go beyond the agriculture sector. Overcoming these hurdles will require making markets more reliable for both sellers and buyers, particularly through efforts to reduce price volatility, including through increased crop productivity and expanded trade. It would also require a consideration of social safety nets to support those seeking to obtain their livelihoods outside of subsistence farming. If farming households perceive that they cannot rely on the market to supply adequate food for their families, low-productivity subsistence farming will continue to be dominant in smallholder farming systems across Malawi. Therefore the risk of food insecurity at the household level is what makes commercial agricultural development particularly challenging in Malawi. Yet as discussed in this chapter, commercialization of smallholder agriculture still has the potential to create local economic development linkages that can benefit non-commercializing

smallholders in their communities. Smallholder agricultural production systems will continue to remain important from a household food-security perspective, especially for those smallholders that do not have commercial potential. However, there will still be a need for safety nets as well as off-farm and non-agricultural livelihood options for more vulnerable groups. This will require more realistic expectations about the short- and medium-term potential of moving smallholders to higher levels of commercialization. For commercialization to take place, agricultural support programs should simultaneously address both smallholder-specific and broader sector-wide issues that limit development of agri-food value chains, as opposed to direct commodity-specific interventions. There is a need for flexible investment approaches to accommodate changes in demand-side factors and to support the development of emerging-market opportunities. It is also equally important to recognize that many of the key constraints for smallholder commercialization are multi-sectoral in nature, and lie largely outside the domain of agriculture sector.

The opportunities for the Government to support smallholder commercialization in Malawi can be organized around the following three pillars:

Pillar 1: ***Strengthen Existing Commercialization Mechanisms.*** A range of agricultural commercialization pathways exist in Malawi. These could include: (i) medium-sized family farms, as evidenced in neighboring countries; (ii) the development of appropriate farmer organizations and strengthening their access to markets through productive partnership models, such as those supported under the AGCOM project; or (iii) through the development of anchor farm models where large commercial farms will partner with smallholders to provide them with access to agricultural inputs, training and markets. Regardless of the specific commercialization pathway, support for agricultural commercialization would call for targeted support programs for those farming households and their organizations that can generate significantly more production through increased productivity. These include farmers with relatively larger cropland holdings concentrated in the mid-altitude plateau areas of the Central and Northern regions, those living in the vicinity of large irrigation and anchor farm schemes, particularly in the Southern region, or those aiming to achieve economies of scale by joining farmer organizations. Specific recommendations under this pillar include the following:

- **Increase farm-level productivity** by encouraging the adoption of innovative farming technologies and skills that have been seen to work in Malawian farming systems. Here, the particular focus should be on those technologies and practices that, in parallel to enhancing productivity, also improve resilience against climate-related shocks, and related risk management practices. Realignment of public extension programs to support technology transfer, adoption and skills development could go long way toward supporting agricultural commercialization in Malawi.

- **Develop functional farmer organizations** to overcome constraints facing the development of more dynamic crop or livestock sub-sectors through productive partnership arrangements. Supporting development of strong farmers' organizations is critical for the emergence of vibrant productive partnership arrangements as it makes smallholders more attractive business partners for agri-businesses and off-takers. Support programs could include facilitation of business development services to viable and commercially-oriented farmers' organizations addressing group formation, group governance skills, farm planning skills, market intelligence training, and business skills and training on contracts and understanding contractual obligations.

- **Support local economic development through anchor farms.** While the analysis in this chapter provides little direct insight on the anchor farm (or megafarm) commercialization model, it is nevertheless an important element of the Government's agricultural strategy. Anchor farms control a significant share of cropland in Malawi and thus have an important role in the development of the sector. The constraints that anchor farms face are not so different from those of commercializing farming households. The conceptual framework of commercialization presented in the chapter suggests that the anchor farm model could energize local economic activity if its design is based on close engagement with nearby communities. Agricultural support programs here could help to build stronger linkages between the larger farms, nearby farmers and local communities.

Pillar 2: ***Reform and Strengthen the Implementation of Sectoral, Multi-sectoral and Macro Policies.*** Many issues that are critical for smallholder commercialization are part and parcel of broader "investment climate" issues, which could be addressed through coordinated policy reforms. Opportunities exist for sectoral policy interventions that are relatively low cost and have potentially significant impacts and high returns. Sectoral policies for agri-food systems need to reflect a strong growth orientation, with attention also focused on food security and safety-net issues. This includes the following priorities:

- **Carry out policy reforms that improve the business-enabling environment**, especially as these relate to weaknesses in legal and judiciary systems in Malawi, and that enhance the sustainability of commercialization pathways. These include: (i) enactment of the Fertilizer Bill; (ii) implementation of the Seed Act, including the drafting of related regulations; and (iii) approving the pending Irrigation Bill.

- **Take actions to reduce the uncertainty of the government policy-making process**, which has a negative impact on developing private sector-led markets and appropriate market institutions. The Government's commitment to the full implementation of the Control of Goods Act would go a long way toward this end, along with a careful review and revision of the draft Crops Bill and the Land Amendment Bill. This would help to conserve the recent achievements of agribusiness investments in agricultural commercialization and improve the relative cost-competitiveness of smallholder production systems in Malawi.

- **Improve the efficiency and effectiveness of agricultural public expenditure programs.** Increasing debt levels and shrinking fiscal space mean that public agricultural expenditure programs need to be able to deliver more and better results with less. This means better rationalization of the budget allocations for input subsidy programs, such as the AIP, which currently absorbs almost 40 percent of agriculture budget, and rebalancing scarce public resources toward genuine growth and job-enhancing investments, such as extension for better farm management skills. In order to improve the targeting of these programs by differentiated farmer typology, there is a need to develop a robust (i.e., biometric) farmers' registry.

Pillar 3: ***Investments in Productive Infrastructure.*** This strategy would focus on investments in public goods that have the potential to generate new economic opportunities, improve accessibility, and facilitate forward and backward linkages to other sectors in the economy. There is a need to support the development of new approaches and partnerships for the delivery of productive infrastructure assets (i.e. irrigation infrastructure, and storage and post-harvesting facilities, among others) to improve the competitiveness of value chains. Priorities in this regard include:

- **Invest in sustainable irrigation development.** Irrigated farming is key for intensifying farming systems and generating employment opportunities. In addition to significantly expanding farmers' access to irrigation infrastructure, there is also a need to improve water management to transform farming practices. There is a need for support programs and approaches that enhance profitability of small-scale irrigated farming, such as farmer-led irrigation development approaches.

- **Develop more efficient logistics and trade corridors** to bring produce to regional and global markets. Access in terms of road and rail linkages would enable commercialization of agriculture in both directions: farmers can be reached through the local network and their produce can access regional/international markets through regional corridors, especially using cheaper long-term modes of rail and inland waters.

- **Prioritize investments in productive rural infrastructure through geographically targeted approaches.** The strategic focus should be on those rural areas that have the highest potential for agricultural growth.

TABLE 2.1 Macroeconomic Indicators

	2018	2019	2020	2021 (Est.)	2022 (Proj.)	2023 (Proj.)
National Accounts and Prices						
GDP at constant market prices (% change)	4.4	5.4	0.8	2.8	0.9	2.2
Agriculture	0.3	5.9	3.4	5.2	-1.0	1.1
Industry	7.2	7.7	1.2	1.9	0.9	2.6
Services	4.5	5.5	-0.5	2.0	1.8	2.5
Consumer prices (annual average)	9.2	9.4	8.6	9.3	22.5	22.7
Central Government (FY % of GDP)						
Revenue and grants	14.6	14.7	14.6	14.5	14.9	16.6
Domestic revenue (tax and non-tax)	13.6	13.2	13.1	13.0	13.7	13.4
Grants	1.0	1.4	1.5	1.5	1.2	3.1
Expenditure and net lending	19.0	19.1	20.9	21.7	23.7	23.5
Overall balance (excluding grants)	-5.4	-5.9	-7.8	-8.7	-10.0	-10.1
Overall balance (including grants)	-4.4	-4.5	-6.3	-7.2	-8.8	-7.0
Foreign financing	1.8	0.8	0.8	1.0	0.9	2.2
Domestic financing	3.0	3.8	4.9	6.0	8.2	4.8
Money and Credit						
Money and quasi-money (% change)	11.2	10.2	16.7	30.0	27.5	23.5
Credit to the private sector (% change)	10.6	27.3	16.1	17.8	27.9	14.7
External Sector (US$ millions)						
Exports (goods and services)	1112	1238	1202	1262	1294	1421
Imports (goods and services)	2927	3031	3088	3255	3406	3173
Gross official reserves	750.1	815	566	429	172	409
(months of imports)	3.6	3.9	2.1	0.3	0.6	1.5
Current account (percent of GDP)	-17	-13.8	-11.7	-14.6	-16.4	-13.6
Exchange rate (MWK per US$ average)	732.3	745.9	780.8	827.0	--	--
Debt Stock						
External debt (public sector, % of GDP)	25.0	27.8	32.9	32.8	38.9	37.1
Domestic public debt (percentage of GDP)	18.9	17.5	21.9	31.2	37.7	37.5
Total public debt (percentage of GDP)	43.9	45.3	54.8	64.0	76.6	74.6
Poverty						
Poverty rate (US$ 2.15 in 2017 PPP terms)	70.1	70.7	70.7	71.2	71.1	
Poverty rate (US$ 3.65 in 2017 PPP terms)	89.1	89.4	89.4	89.5	89.5	
Poverty rate (US$ 6.85 in 2017 PPP terms)		97.3	97.4	97.4	97.4	97.4

Sources: World Bank staff calculations based on MFMod, MoF, RBM and IMF data.

REFERENCES

ACB (Anti-Corruption Bureau). 2022. Report on 2021/22 Affordable Input Programme Monitoring Exercise. Lilongwe: Anti-Corruption Bureau.

Amankwah, A., and Gourlay, S. 2021. Impact of COVID-19 Crisis on Agriculture : Evidence from Five Sub-Saharan African Countries. Washington DC: World Bank. https://documents1.worldbank.org/curated/en/304561611294945287/pdf/Impact-of-COVID-19-Crisis-on-Agriculture-Evidence-from-Five-Sub-Saharan-African-Countries.pdf

Baulch, B., Benson, T., Erman, A., Lifeyo, Y., and Mkweta, P. 2019. Malawi's Challenging Employment Landscape. MASSP Working Paper. Washington, DC: IFPRI. https://ebrary.ifpri.org/digital/collection/p15738coll2/id/133058

Bell, C.L., Hazell, P.B., and Slade, R. 1982. "Project Evaluation in Eegional Perspective: A Study of an Irrigation Project in Northwest Malaysia." Johns Baltimore: Hopkins University Press. https://www.cabdirect.org/cabdirect/abstract/19826746168

Benson, T.D. 2021. Disentangling Food Security from Subsistence Agriculture in Malawi. Washington, DC: IFPRI. doi:https://doi.org/10.2499/9780896294059.

Benson, T. and Weerdt, J.D. 2023 (forthcoming). "Employment Options and Challenges for Rural Households in Malawi.' Background Paper for the Malawi Ecounty Economic memorandum. Lilongwe: IFPRI Malawi.

Caruso, G.D., and L.M. Cardona Sosa. 2022. Poverty Persistence in Malawi: Climate Shocks, Low Agricultural Productivity, and Slow Structural Transformation. Washington, DC: World Bank Group. http://documents.worldbank.org/curated/en/099920006302215250/P174948072f3880690afb70c20973fe214d

Cortez, Edson; Orre, Aslak; Fael, Baltazar; Nhamirre, Borges; Banze, Celeste; Mapisse, Inocencia; Harnack, Kim; and Reite, Torun. 2021. *Costs and Consequences of the Hidden Debt Scandal of Mozambique*. Maputo and Bergen: Centro de Integridade Publica and Chr. Michelsen Institute https://www.cmi.no/file/4442-Costs-and-consequences-of-the-Hidden-Debt-FINAL.pdf

Duchoslav, Jan; Nyondo, Christone; Comstock, Andrew; Benson, Todd. 2022. *Regulation of Agricultural Markets in Malawi*. Strategy Support Program Policy Note No. 45. Lilongwe: IFPRI Malawi. https://ebrary.ifpri.org/utils/getfile/collection/p15738coll2/id/135939/filename/136148.pdf

EU. 2022. Monitoring and Evaluation of the New Malawi Affordable Input Programme for Season 2021/22. Lilongwe: Delegation of the European Union Malawi.

Guenette, Justin Damien; Kose; M. Ayhan; and Sugarara, Naotaka. 2022. *Is a Global Recession Imminent?* EFI Policy Note No. 4. Washington, DC: World Bank. https://openknowledge.worldbank.org/bitstream/handle/10986/38019/Global-Recession.pdf

Haggblade, S., P.B.R. Hazell, and T.A. Reardon. 2007. Transforming the Rural Nonfarm Economy: Opportunities and Threats in the Developing World. Baltimore: Johns Hopkins University Press.

Hazell, P.B.R., and Roell, A. 1983. "Rural growth linkages: Household expenditures patterns in Malaysia and Nigeria" Research report No. 41. Washington, DC: IFPRI.

IFPRI. 2022. Key Facts Sheet on Employment. IFPRI Malawi Strategy Support Program (MASSP) Key Facts series. Washington, DC: IFPRI. https://ebrary.ifpri.org/digital/collection/p15738coll2/id/135920

IFC. 2021. Creating Markets in Malawi: Country Private Sector Diagnostic. Washington, DC: IFC.

IMF. 2020. Annual Report on Exchange Arrangements and Exchange Restrictions. Washington, DC: IMF. https://www.elibrary.imf.org/downloadpdf/books/012/29310-9781513556567-en/29310-9781513556567-en-book.pdf

IMF. 2022a. Global Financial Stability Report. Shockwaves from the War in Ukraine Test the Financial System's Resilience. April 2022. Washington, DC: IMF. https://www.imf.org/-/media/Files/Publications/GFSR/2022/April/English/text.ashx

IMF. 2022b. Malawi. Request for an Arrangement under the Rapid Credit Facility And Staff Monitored Program with Executive Board Involvement. Washington, DC: IMF.

IMF. 2022c. World Economic Outlook April 2022: War Sets Back the Global Recovery. Washington, DC: IMF.

IMF. 2022d. Zambia. Request for an Arrangement under the Extended Credit Facility—Press Release; Staff Report; Staff Supplement; Staff Statement; and Statement by the Executive Director for Zambia. Washington, DC: IMF. https://www.imf.org/-/media/Files/Publications/CR/2022/English/1ZMBEA2022001.ashx

Jayne, T.S., M. Muyanga, A. Wineman, H. Ghebru, C. Stevens, M. Stickler, A. Chapoto, W. Anseeuw, D. van der Westhuizen, and D. Nyange. 2019. "Are medium-scale farms driving agricultural transformation in sub-Saharan Africa?" *Agricultural Economics* 50(S1): 75–95.

John W. Mellor, J.W. 1966. "The Economics of Agricultural Development." Ithaca: Cornell University Press. https://www.cabdirect.org/cabdirect/abstract/19671801080

MOFEA. 2021. Annual Economic Report. Lilongwe: MOFEA.

Nation Online. 2022. Power Blackouts Suffocating Industries. Lilongwe: Nation Publications Limited. https://mwnation.com/power-blackouts-suffocating-industries/

NSO. 2019. 2018 Population and Housing Census: Main Report. Zomba: National Statistical Office, Government of Malawi.

RBM. 2022. Monetary Policy Report October 2022. Lilongwe: RBM.

VOA (Voice of America). 2022. Malawi Faces Shortages of Foreign Exchange Currency. Washington, DC: Voice of America. https://www.voanews.com/a/malawi-faces-shortages-of-foreign-exchange-currency/6584639.html

Whiteside, M. 2000. "Ganyu Labour in Malawi and Its Implications for Livelihood Security Interventions—an Analysis of Recent Literature and Implications for Poverty Alleviation." Agricultural Research and Extension Network Paper No.99.

Wineman, A., Jayne T. Modamba E. I. and Kray H. 2020. "The Changing Face of Agriculture in Tanzania: Indicators of Transformation." *Development Policy Review*. 38: 685–709.

WFP (World Food Programme). 2022. Minimum Expenditure Basket in Malawi. A look at food and non-food prices and availability in times of COVID-19. Rome: World Food Programme.

World Bank. 2022a. COVID-19—Business Pulse Survey 5th Wave. Washington, DC: World Bank.

World Bank. 2022b. Food Security Update. Update September 15, 2022. Washington, DC: World Bank. https://thedocs.worldbank.org/en/doc/40ebbf38f5a6b68bfc11e5273e1405d4-0090012022/related/Food-Security-Update-LXIX-September-15-2022.pdf

World Bank. 2022c. Macro Poverty Outlook. Washington, DC: World Bank.

World Bank. 2022d. Malawi Country Climate Development Report. Washington, DC: World Bank.

World Bank. 2022e. World Development Indicators. Washington, DC: World Bank.

World Bank (forthcoming). Country Economic Memorandum. Washington, DC: World Bank.

World Bank Office Malawi
Mulanje House
Capital City, PO Box 30557
Lilongwe 3, Malawi

+265 (0) 1 770 611

www.worldbank.org/mw

The World Bank
1818 H Street, NW
Wahington, D.C. 20433
USA
Tel: +1 202 473 1000
Fax: +1 202 477 6391
www.worldbank.org

WORLD BANK GROUP