Realizing Safety Nets’ Potential

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Acknowledgements

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# TABLE OF CONTENTS

## Overview

1. Economic developments

   - Global economic growth accelerates, but subdued recovery in Sub-Saharan Africa
   - Real GDP growth picked up but is projected to moderate
   - Surplus food and a stable Kwacha drives inflation to below double-digit levels
   - Fiscal performance significantly deteriorated in the first half of the year
   - Tight fiscal space calls for careful expenditure control and investment prioritization
   - Increasing domestic debt is exacerbating risks
   - The Kwacha has been stable, aided by a weaker US Dollar
   - The Central Bank has lowered its policy rate, but real lending rates remain high
   - Export performance remained subdued with a marginal increase in tobacco earnings
   - Lower imports helped narrow the current account deficit
   - The banking sector has generally remained stable
   - The business environment has seen some modest improvements
   - Low productivity rain-fed agriculture contributes to slow pace of poverty reduction
   - Downside risks remain in the near term

2. Special topic: realizing the full potential of social safety nets

   - Safety nets have a critical role to promote resilience and long-term development
   - Cash transfers are an effective investment
   - Strengthening efficiency by reforming the mix of programs and links between them
   - Country systems can be improved through innovation and institutional reform
   - Fiscal space is available to devise sustainable financing for safety nets into the future
   - There is a clear path to transforming Malawi’s safety net

Data

References

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MALAWI ECONOMIC MONITOR MAY 2018
Box 1: Any end in sight to Malawi’s blackouts? ................................................................. 9
Box 2: The Unintended Consequences of Export Bans .......................................................... 19
Box 3: Is the Banking Sector in Malawi Resilient to Shocks? .................................................. 22
Box 4: Core Safety Net Programs ......................................................................................... 28
Box 5: Charting a Way Forward on the MASAF Public Works Program ................................... 31
Box 6: Lessons in Scaling Up Social Safety Nets across Africa ............................................... 35
Box 7: Case Study of Contingency Financing in the Northern Uganda Social Action Fund .......... 37

FIGURES

Figure 1: Malawi continues to face significant constraints in the short-term ................................. 6
Figure 2: ...but with positive medium-term growth prospects ..................................................... 6
Figure 3: Inflation eased in the last part of 2017 ......................................................................... 7
Figure 4: CPI rebased with significant weight changes for food and non-food items .................... 7
Figure 5: Lake Malawi mean water levels are dropping ............................................................... 9
Figure 6: ... and annual generation (GWh) is dropping .............................................................. 9
Figure 7: Recurrent overruns have been driven by the ADMARC bailout and securitization of arrears 11
Figure 8: Revenue collection has fallen below targets .............................................................. 11
Figure 9: Kwacha steady only against the dollar ....................................................................... 15
Figure 10: Growth in credit to the private sector remains unresponsive to declining policy rate .... 15
Figure 11: Although tobacco remains the main foreign exchange earner from commodity exports ...... 16
Figure 12: ... tobacco export prices are on a continual decline .................................................. 16
Figure 13: The current account balance has seen a slight improvement ..................................... 17
Figure 14: NPLs began to decline towards end of the year .......................................................... 18
Figure 15: Banks’ profitability is affected as capitalization takes place ..................................... 18
Figure 16: Malawi has had the most volatile maize prices in the region, apart from Zimbabwe ...... 19
Figure 17: An export ban in 2016/17 potentially cost Malawi an estimated MK 25 to 69 billion in revenue 19
Figure 18: Overall performance on the Doing Business indicators is improving .......................... 21
Figure 19: ... although the DB rankings for some indicators remain weak .................................... 21
Figure 20: Banks are resilient to liquidity, income and foreign shocks but vulnerable to credit and liquidity risks 22
Figure 21: The State of Safety Nets in Malawi ......................................................................... 29
Figure 22: Total Consumption and Food Consumption Estimates .............................................. 30
Figure 23: Spending on Safety Net Programs, the FISP, and Humanitarian Aid (Food Security and Nutrition) .... 33
Figure 24: Coverage of Safety Net Programs, the FISP, and Humanitarian Aid (Food Security and Nutrition) .... 33
Figure 25: Financing Sources for Social Safety Nets Across Africa ........................................... 36

TABLES

Table 1: Fiscal accounts ......................................................................................................... 12
Table 2: Selected macroeconomic indicators ..................................................................... 40
OVERVIEW

The Malawi Economic Monitor (MEM) provides an analysis of economic and structural development issues in Malawi. This edition was published in May 2018. It follows on from the six previous editions of the MEM and is part of an ongoing series, with future editions to follow twice per year.

The aim of the publication is to foster better-informed policy analysis and debate regarding the key challenges that Malawi faces in its endeavor to achieve high rates of stable, inclusive and sustainable economic growth.

The MEM consists of two parts: Part 1 presents a review of recent economic developments and a macroeconomic outlook. Part 2 focuses on a special selected topic relevant to Malawi’s development prospects.

In this edition, the special topic focuses on Social Safety Nets. This is a defining moment for Malawi to transform its safety net. The recently approved second Malawi National Social Support Program (MNSSP II) works towards the creation of a dynamic safety net system that is positioned to better respond to persistent poverty, recurrent shocks and a demographic dividend. There is now robust evidence showing how social safety nets can be an efficient way to break the cycle of poverty and vulnerability in Malawi. Despite the evidence, current expenditure trends are low in terms of needs and regional comparators. Strengthening the efficiency of safety nets is possible by reforming the mix of program interventions and the links between them. While the social safety net sector in Malawi has all the components necessary to facilitate transformative change, this will require critical shifts in policy, institutional and investment priorities.

ECONOMIC DEVELOPMENTS

The key messages of this edition of the MEM are about economic recovery and cautious optimism. Malawi’s GDP growth picked up in 2017, but is expected to moderate in 2018, tracking agricultural production. The Government is striving to achieve budgetary prudence, although it continues to face challenges in revenue collection. In the context of subdued inflation, the Government is continuing to cautiously ease monetary policy.

After two years of depressed economic activity, the real GDP growth picked up to 4 percent in 2017. With a rebound in agricultural production, the prospects for growth were generally positive. However, performance in the industrial and services sectors was much weaker than anticipated. Industry was adversely impacted by structural challenges related to erratic energy and water supply, which had a particularly negative impact on manufacturing. Within services, the performance of the wholesale and retail trade and distribution sub-sectors declined as a result of subdued domestic demand.

The prevalence of low-productivity rain-fed agriculture constrains poverty reduction. With most of the population engaged in subsistence rain-fed agriculture in rural areas, macroeconomic instability and the sub-optimal performance of the agricultural sector have contributed to the slow pace of poverty reduction. Current estimates using the international poverty line (US$1.90 per day) indicate that 69.4 percent of the population is classified as being poor in 2017.

With the fiscal deficit at around six percent of GDP over the past several years, in FY 2016/17 it declined to 4.8 percent. This was mainly due to strong revenue collection performance and controlled spending. The FY2017/18 budget envisioned an even stronger performance by lowering the deficit to 4 percent of GDP. The Government called for prudence in public expenditure, with a commitment to avoiding the recurrent slippages that have characterized fiscal performance in the past, and to continuing efforts to intensity revenue collection.

Despite the promising budget presentation, at mid-year, the deficit significantly deteriorated. This was due principally to three factors: a fall in revenue due to weaker economic activity; a one-off securitization of payment arrears dating back to FY2012/13 (1.2 percent of GDP); and an increase in expenditure associated with the Agricultural Development and Marketing Corporation (ADMARC) financing (about 1 percent of GDP).

Inflationary pressure subdued in the latter half of 2017, with the year-on-year headline rate falling to 7.1 percent in December. The decline was largely due to a fall in food inflation, from a high of 20 percent in December 2016 to 4.3 percent in December 2017. An interesting reversal in the factors driving inflation was noted in this period, with non-food inflation remaining sticky and slowing only marginally, from a peak of 15.4 percent in December 2016 to 10 percent a year later. In 2017, the decline in food inflation was due to the bumper harvest during the 2016/17 growing season, together with the maize export ban and carryover stock from the humanitarian food purchases. These factors led to an abundant food supply and subdued prices.
In the context of the significant decline in headline inflation, the RBM has continued to ease monetary policy. Since November 2016, the RBM has reduced the policy rate by 11 percentage points, with a reduction by 8 percentage points in 2017 alone.

In 2018, economic growth is projected to moderate to 3.7 percent due to an anticipated decline in agricultural production. Erratic rains and a Fall Army Warm infestation are expected to have a negative impact on agricultural output. The performance of industry and services is also projected to remain weak, with structural challenges related to the intermittent supply of power and water remaining a significant constraint on production.

The FY2017/18 fiscal deficit is expected to widen to around 7.1 percent of GDP. It will be necessary to contain the deficit to build up fiscal buffers that can be drawn on during a crisis. As part of its efforts to improve the fiscal position for the rest of the year amidst revenue shortfalls, the Government has reprioritized expenditures to avoid excessive recourse to domestic borrowing. To increase revenues, the Government is considering measures including repealing the industrial rebate scheme, discontinuing tax holidays, and strengthening of tax administration. The Government also aims to limit non-essential recurrent expenditures and allowances, to continue to reform FISP, and to reduce transfers to ADMARC.

In 2018, the current account balance is projected to narrow to 9.2 percent of GDP. This is due to an expected recovery of agricultural exports, especially tobacco, and a general decline in imports due to subdued economic activity. Internationally, it is expected that improved growth prospects in China and higher global commodity prices will also bolster Malawi’s exports. Domestically, it is expected that there will be a significant shift towards tobacco production and growth in other cash crops, with the latter driven by the collapse of the pigeon pea market.

Malawi needs to break the cycle of vulnerability and avoid repeated crises as a result of a changing climate. Difficult policy and institutional reforms should be implemented to reduce distortions in, and improve the performance of, the agricultural sector; and to restore basic public financial management and accountability systems.

Recommended measures include the following:

- **Significantly increased controls on expenditure to support macroeconomic recovery:** Prudent revenue assumptions, improving budget execution and stronger commitment controls would improve the credibility of the budget. This could be further improved through efforts to broaden the tax base and to strengthen public finance management.

- **Reforming agricultural market institutions to reduce the fiscal burden and market distortions**
  Most of Malawi’s poor remain locked in low productivity subsistence farming, with their poverty exacerbated by thin and distorted maize markets. Furthermore, the Government has periodically guaranteed ADMARC’s loans, providing funds when there is a default. Increased oversight and transparency of ADMARC would help reduce the fiscal burden imposed by the entity. These efforts could be complemented by the enactment of the Control of Goods Bill and related regulations by establishing a rules-based mechanism for commodity trade restrictions.

- **Simplify business regulations and address infrastructure constraints:** This would help to reduce the cost of doing business, to lower risk and to facilitate a decline in interest rates. Greater efforts are needed to simplify existing regulations, including tax and licensing requirements and to make them more accessible and easier to implement. Access to electricity and the reliability of the network are also major constraints to the growth of the private sector. To address this, the Government should improve the governance of utility suppliers and apply cost-reflective tariffs. This would encourage private sector investment to overcome Malawi’s infrastructure gaps.

**POTENTIAL OF SAFETY NETS**

This is a defining moment for Malawi to transform its safety net. The recently approved second Malawi National Social Support Program (MNSSP II) is intended to facilitate the creation of a dynamic safety net system that is better able to respond to persistent poverty, recurrent shocks and a demographic dividend.

Safety nets are playing an increasing role in promoting equity, strengthening resilience, and improving long-term human capital outcomes. Malawi implements five core safety net programs, including the Social Cash Transfer Program (SCTP), the School Meals Program (SMP), the Nutrition and Access to Primary Education (NAPE) program, the Malawi Social Action Fund Public Works Program (MASAF PWP), and the World Food Program Food for Assets (FFA) program. The MNSSP II puts a spotlight on the collective efficiency of these programs, and their broad sector linkages.
There is now robust evidence to demonstrate that social safety nets can be an efficient means to break the cycle of poverty and vulnerability in Malawi. The Social Cash Transfer Program (SCTP) has had one of the strongest and most consistent positive impacts on consumption, livelihood, earnings, and schooling outcomes of any such program implemented across Africa. There is a need to implement reforms to scale up targeted cash transfers to replace less effective interventions.

With the establishment of a strong evidence base, there has seen a significant shift towards cash transfers as a means to enhance resilience and to facilitate longer-term human development. In coming months, the SCTP will become fully operational at a national scale. This will increase the program’s total coverage to approximately 12 percent of the population and to almost 40 percent of the ultra-poor. By contrast, evidence regarding the effectiveness or otherwise of ongoing non-cash transfer programs, including SMP and FFA, could still be strengthened.

Ongoing reviews of the MASAF PWP need to be consolidated to establish a pathway for the program into the future. Recent technical assessments have demonstrated that some progress has been made in terms of improving the value of assets created under the program, the timing of the program across the seasonal cycle, and its potential linkages with other sectoral investments. At the same time, these assessments also demonstrate that there are underlying implementation and financing constraints, casting doubts on the effectiveness of Malawi’s longest running safety net intervention.

Malawi’s current level of expenditure on safety net programs is strikingly low in terms of the country’s needs and relative to regional comparators. Malawi’s average expenditure on safety net programs in the period from 2011 to 2016 was equivalent to 0.6 percent of GDP, a strikingly low figure compared to the average of 1.2 percent recorded across the African region. Malawi’s safety net coverage is significantly lower than that of its other priority poverty reduction and relief programs. In 2016, the coverage rate for FISP and humanitarian aid (food security and nutrition) stood at 37 percent and 32 percent of the population respectively, with expenditure on these programs standing at 1 percent and 6 percent of GDP, respectively.

Reforming the mix of safety net programs and strengthening the links between them will be critical to increasing efficiency. Although some progress has been made in terms of expanding safety net coverage, the poorest Malawians tend to receive a disproportionately low level of benefits from safety net programs compared to the poorest people in other countries. At the same time, there is increased demand for new program directions. For example, with growing humanitarian aid coverage and financing, the focus of policymakers has shifted to ensuring that the safety net system is more resilient to shocks.

Continued innovation will be required in the design and implementation of safety net programs. In particular, innovation is required to improve equity through improved targeting. Currently, the poor receive a disproportionately low level of benefits, placing Malawi in the bottom third of targeting performance across African countries. Investments in core delivery platforms such as the Unified Beneficiary Registry have the potential to improve the effectiveness of targeting.

The efficiency and effectiveness of Malawi’s social safety net is marred by institutional shortcomings at both the national and district levels. It is also hampered by a lack of coordination between development partners.

Ineffective coordination at the district level is one of the most significant constraints on the development of a more coherent system. Throughout the recent MNSSP consultation process, district-level stakeholders stressed that if safety net programs were better coordinated and integrated, it would result in a more efficient use of district officers’ time and resources.

There is fiscal space to devise a sustainable financing strategy for Malawi’s safety net program into the future. However, the financing of safety nets is not sustainable at current levels, given Malawi’s overwhelming dependence on development partner support. There are various options to support the establishment of a more sustainable financing strategy in the sector. First, there is scope to reallocate resources away from less effective poverty reduction initiatives, particularly the FISP. Second, there is scope to redirect humanitarian financing towards safety net initiatives. Third, there are opportunities to explore contingency or reserve financing mechanisms to make the safety net system more resilient and sensitive to shocks.

To transform Malawi safety net systems, policymakers need to consider the following:

- Commitment to a national financing strategy to support an adequate, sustainable social protection system: There is a critical need for the Government to
establish and meet domestic spending targets for basic safety net interventions, which are currently almost exclusively donor financed. In particular, the Government should consider re-channeling fiscal spending to a more progressive and effective mix of social protection programs.

- **Improved mix of safety net programs and linkages between them:** Malawi’s safety net system is inefficient compared to those of other countries. To improve efficiency, the Government should strive to identify the appropriate mix of programs over time. To inform this process, there is a need for stronger evidence, particularly related to the cost-effectiveness of longstanding programs such as the MASAF PWP and the SMP. As the example of the SCTP demonstrates, it is necessary to have rigorous evidence to ensure the effectiveness of interventions and to successfully scale.

- **Support for innovations to program design:** The Government should sustain its efforts to improve the targeting of support to the chronic and transitory poor. If the UBR can be successfully implemented on a national scale, it could serve as a best practice example for other African countries.

- **Prioritizing new directions in program design:** The Government must strive to strengthen the scalability of safety nets to promote resilience to shocks. Given Malawi’s vulnerability to shocks and the growing humanitarian presence, a better functioning safety net of last resort is required to meet the needs of the transitory poor. At the same time, a more systematic focus is required to improve and strengthen human capital in the long term.

- **The successful implementation of reforms to safety net programs are critically dependent on the strength of country systems and institutional capacity.** Sustained reforms must be implemented to address these issues, with due consideration given to the political economy challenges. These reforms need to be implemented at a wide range of levels and to involve all stakeholders, including development partners.
1. **ECONOMIC DEVELOPMENTS**

Global economic growth accelerates, but subdued recovery in Sub-Saharan Africa

1. **Following the slowdown in 2016, the global economy began to recover in the second half of 2017, with real growth projected to reach 3.1 percent in 2018.** The recovery was primarily due to an upsurge in investment and world trade following the recovery in commodity prices, consumer confidence and financing conditions. The result was a synchronized year-on-year growth in more than half of the world’s economies. In 2018, Emerging and Developing Economies (EMDEs) are expected to achieve higher levels of growth than advanced economies. The recovery in oil and commodity prices is expected to drive a growth rate of 4.5 percent for EMDEs in 2018, compared to 3.1 percent in Advanced Economies.

2. **Economic recovery in Sub-Saharan Africa (SSA) is projected to consolidate in 2018.** Growth in SSA economies is projected to continue to increase in 2018 up to 3.1 percent, a modest increase from 2.4 percent in 2017. Recovering growth in 2017 boosted SSA regional average growth from the low 2016 base. This growth emanated from the combined effect of strengthening external demand, recovering commodity prices, increasing agricultural production (except for countries in East Africa) and increasing oil production in the region’s newest oil producers, such as Ghana. However, this growth was driven primarily by the recovery in the region’s biggest economies, Angola, Nigeria and South Africa. By the end of 2016, these three economies cumulatively accounted for 58 percent of the region’s real GDP with Nigeria’s growth alone accounting for more than half of the region’s recovery in 2017.

3. In **2017, most economies across the region experienced low external buffers, receding inflationary pressure and destabilizing fiscal deficits.** Current account balances remained elevated, despite improved terms of trade. Resulting in low levels of foreign reserves, which stood at an average level of three months of import cover. Additionally, fiscal deficits narrowed only slightly, with many countries struggling to contain expenditure. Over-borrowing (Burundi, Equatorial Guinea and Ethiopia), mismanaged fiscal spending (South Africa) and revelations of previously undisclosed debt (Mozambique) kept Debt-to-GDP ratios across the region critically high, resulting in widespread fiscal unsustainability. However, the average regional headline inflation rate declined, while regional exchange rates stabilized. In addition, food prices fell in most countries following increased agricultural production due to the resumptions of rains in most Southern African countries.

4. **The regional outlook remains subject to both upward and downward risks.** Spillover effects from the anticipated strong growth in the United States and Euro Area could drive increased regional growth by generating increased export demand and investment flows. Unanticipated slowdown in China’s economy could result in lower-than-projects commodity prices and demand for SSA exports. Internal risks include those related to increasing fiscal indiscipline, which could further exacerbate debt dynamics and cause economic instability. At the same time, risks related to droughts in East Africa, political and policy uncertainty, and insecurity in the Sahel region remain significant. In addition, the projected economic growth of 3.2 percent in 2018 is only slightly higher than the region’s population growth of 2.5 percent, implying marginal gains in per capita growth and poverty reduction.

**Real GDP growth picked up but is projected to moderate**

5. **GDP growth in Malawi picked up to 4.0 percent in 2017, after two years of less than three percent GDP growth.** This was driven by a rebound in the growth of agricultural value added to 5 percent, following two previous years of drought driven contraction. However, the contribution of industry and services to growth was lower than in the previous year, at 2.2 percent and 4.0 percent respectively (see Figure 1). Industry was adversely impacted by structural challenges related to energy and water supply, which had a particularly negative impact on manufacturing. Within services, the performance of the wholesale and retail trade and distribution sub-sectors also declined as a result of subdued domestic demand. Consequently, the World
Bank’s estimate for Malawi’s GDP growth rate in 2017 has been revised downwards to 4.0 percent, from an earlier estimate of 4.5 percent (World Bank 2017b).

6. Prices for most agricultural commodities fell due to a good harvest and policy factors. In the case of maize, despite there being an adequate stock, an export ban constrained exports and kept prices low. As a result of these factors, given that most households rely on income from agriculture, low commodity prices resulted in an erosion of disposable incomes and purchasing power.

7. There was underproduction in tobacco as farmers switched to legumes. Despite an improvement in tobacco prices, production was significantly lower than that realized in the previous growing season. This was primarily due to farmers switching to legumes as a result of higher prices for this commodity in the preceding season. The production of burley alone, Malawi’s major tobacco product, fell by 53 percent. Thus, the average price increased significantly, by 41 percent, going up from US$ 1.42/Kg in 2016 to US$ 1.99/Kg. The depressed output resulted in a shorter than average sale season and despite fetching higher prices, the total value of tobacco sales in 2017 declined by 23 percent.

8. Prospects for tobacco production are better than last year, although prices are likely to be lower. The outlook for 2018 is promising, with most farmers switching back to tobacco from legumes after the depressed prices for legumes in 2017. However, it is anticipated than overproduction of tobacco will depress the average prices, further impacting farm incomes. It is further anticipated that implementation of production quotas in tobacco will rationalize the market and help protect farm incomes.

9. GDP growth is projected to moderate to 3.7 percent in 2018 due to an expected decline in agricultural production. Malawi’s maize crop has been under stress in 2017/18, affected by dry spells and fall army worm infestation. By the end of January 2018, dry spells were estimated to have affected 270,000 ha of maize fields, directly impacting 707,000 farming families, while the army worms had affected 379,000 ha of maize (about 22 percent of land under maize), directly impacting 1,029,000 farming families. Due to food security concerns, the Government re-imposed the maize export ban in January, after having lifted it in October 2017. While maize prices increased by 30 percent in the period from January to February, they
remained 43 percent lower than at the same time in the previous year and 37 percent lower than the three-year average.

10. The performance of industry and services is forecasted to remain weak. Structural challenges related to the intermittent supply of power and water remain a significant constraint on production. Planned investments in the energy sector will yield sustainable results only in the medium to long term (see Box 1). The poor prospects are further compounded by the projected low agricultural output, which is likely to reduce raw materials for agro-processing. Consequently, demand for imports and general consumer demand are also likely to be low. All these factors contribute to the lower growth rate projection.

Surplus food and a stable Kwacha drives inflation to below double-digit levels

11. Inflationary pressure eased in the latter half of 2017, with the year-on-year headline rate falling to 7.1 percent in December. The decline was largely due to a fall in food inflation, from a high of 20 percent in December 2016 to 4.3 percent in December 2017 (see Figure 3). Non-food inflation, on the other hand, remained sticky, slowing down only marginally from a peak of 15.4 percent in December 2016 to 10 percent a year later. In 2017, food inflation declined due to the bumper harvest during the 2016/17 growing season, the maize export ban and carryover stock from the humanitarian food purchases, all of which contributed to lower prices. For maize, Malawi’s staple food, prices averaged MK 90/kg in the period from June 2017 to January 2018, a decline of more than 60 percent from MK230/kg in the same period in 2016.

12. Non-food inflation remained relatively high, due primarily to the increasing costs of electricity and transport. The intermittent power supply kept production costs high, in some instances creating undersupply for items such as cement. This resulted in upward pressure on non-food prices. The relatively stable Kwacha against the United States Dollar (USD) and RBM monetary policy interventions also helped to keep non-food inflation stable. Since August 2016, the Kwacha has traded at an average of MK 730 to the USD.

13. The Consumer Price Index (CPI) was rebased in December 2017, with a significant reweighting of the food and non-food items. As a result of this exercise, the items were reweighted to reflect the household expenditure findings from the Fourth Integrated Household Survey (IHS4) conducted in 2016/17. The weight...
of food items in the CPI has been readjusted from 50.2 percent to 45.2 percent, while non-food items have increased in weight from 49.8 percent to 54.8 percent (see Figure 4). There was a significant increase in the weighting of non-food items associated with housing, electricity and water; household furnishings; health; transportation; and hotels and restaurants. The weighting of food, communication, education, clothing and footwear was reduced. As of April 2018, the year-on-year headline inflation rate stood at 9.7 percent.

**Fiscal performance significantly deteriorated in the first half of the year**

14. Following several years of deficits close to 6 percent of GDP, in FY2016/17, the budget deficit was contained at 4.8 percent of GDP. Despite the weather-related shocks that led to a food and humanitarian crisis, the Government managed to contain fiscal slippages. The deficit declined from 6.1 percent of GDP in FY 2015/16 to 4.8 percent in FY 2016/17, even lower than the revised target of 5.2 percent envisaged at mid-year. This was mainly due to strong revenue performance and controlled spending. Revenue collection was aided by migration to the Automated System for Customs Data (ASYCUDA) World, a series of new tax administrative measures and elimination of several exemptions, among other measures. Grants were also higher than expected, mainly due to increased financing to address the humanitarian and food crisis. The Government also managed to contain the pace of recurrent expenditure, despite the crisis. Measures that helped to achieve this included the continued implementation of reforms to the Farm Input Subsidy Program (FISP), which resulted in reduced expenditures on agricultural subsidies. Re-instituting the requirement by Controlling Officers to submit monthly reports of expenditure, revenues, commitments, payroll and bank reconciliations was also a key step in restoring basic controls to the country’s Public Finance Management (PFM) system.

15. The FY2017/18 budget envisioned that the budget deficit would be reduced to an even lower level, 4 percent of GDP. The Government called for prudence in public expenditure, with a commitment to avoiding the recurrent slippages that have characterized fiscal performance in the past, and for continued efforts to intensify revenue collection. Moreover, the budget was intended to allocate a relatively higher proportion of resources for development expenditure. After a four-year hiatus, the Government also benefitted from the proceeds of budget support provided by the World Bank.

16. Despite the promising budget presentation, at mid-year, the deficit significantly deteriorated. This was due principally to three factors: a fall in revenue due to weaker economic activity (about 1 percent of GDP); a one-off securitization of payment arrears dating back to FY2012/13 (1.2 percent of GDP); and an increase in expenditure associated with the Agricultural Development and Marketing Corporation (ADMARC) financing. Revenue and grants fell below mid-year targets, due both to lower than expected tax revenues, due to the impact of the intermittent power on economic activity, and lower-than-expected grants. Additionally, expenditure increased beyond budgeted levels with an unplanned public-sector spending on ADMARC (of 1 percent of GDP) in order to re-finance commercial borrowing undertaken by ADMARC in 2016 to finance largescale maize stocking during the food crisis. With ADMARC’s intervention price for sales remaining above market prices during the crisis (and acting as an effective cap on speculation), the bulk of the non-humanitarian food requirement was met by private traders, leaving ADMARC with large carry-over stocks (of approximately 90,000MT) at the end of the lean season and a loan maturity mismatch. Although some expenditure measures in the second half of the year are expected to constrain spending, the deficit is expected to reach 7.1 percent of GDP for the full fiscal year.
In 2016, electrification rates compared as follows: Sub-Saharan Africa 42%; Uganda 19%; Tanzania 33%; Cameroon 63%; Kenya 65%; and South Africa 88%.

Box 1: Any end in sight to Malawi’s blackouts?

In 2017, load shedding averaged 12 hours a day, with some areas experiencing more than 24 hours of load shedding by December 2017. A number of cases were also reported of loss of property and life, either as result of high power surges upon reconnection of electricity or due to alternative use of unsafe measures to electrify homes. Businesses of all sizes identified electricity shortages as the second-biggest constraint to doing business in Malawi, after access to finance. On average, firms reported losing 5.1 percent of their annual sales due to electricity outages, with 40.9 percent of firms owning a generator as a backup. Larger-sized enterprises were the most affected, especially in the manufacturing sector. Operating backup generating facilities can triple the marginal cost of electricity supply for the private sector, undermining competitiveness, and is only feasible in areas of business activity where margins can absorb such incremental costs (World Bank 2017). According to the World Bank’s Doing Business 2017, Malawi ranks 166 out of 190 countries for the indicator on “Getting Electricity”, with a significantly higher number of days to obtain connections than in neighboring Tanzania and Zambia, and at a significantly higher cost. The pace of electrification for Malawi has also been slower than regional comparators, with only around ten percent of the population having access to electricity in 2016.¹

Malawi’s energy mix is highly vulnerable to weather shocks. Malawi has a total installed generation capacity of 365MW, of which 98 percent is from hydropower resources along the Shire River. The country’s demand potential is estimated to be around 440MW, leading to a supply deficit. The hydropower sources are exposed to climate variability as demonstrated by the severe drought of 2015 and 2016, which resulted in record low water levels in Lake Malawi and in the Shire River. At the end of December 2017, generation was at less than half of full capacity, at 150MW, demonstrating a significant hydro risk (see Figure 5 and 6). It is noted that even with the commissioning of Kapichira II in 2012, annual generation declined in 2016 and 2017 due to the 2015/16 drought. The situation was also exacerbated by poor environmental management practices and subsequent high levels of siltation. According to ESCOM, Malawi requires five consecutive years of above-average rainfall to return to normal generating capacity, further underscoring the vulnerability of Malawi’s energy sector to weather shocks.

¹ In 2016, electrification rates compared as follows: Sub-Sahara Africa 42%; Uganda 19%; Tanzania 33%; Cameroon 63%; Kenya 65%; and South Africa 88%
Malawi urgently needs to diversify its energy sources. Neighboring countries outperform Malawi in terms of energy mix and capacity. Tanzania records a total installed electricity generation capacity of 1,352 MW, largely based on natural gas (43 percent), hydropower (43 percent), and heavy fuel oil (12 percent). Mozambique has a total installed generation capacity of 2,400MW, of which 56 percent is hydro and 42 percent is gas. Zambia’s total installed generation capacity is 2,411MW, entirely hydro, but supported by huge reservoir dams.

Malawi’s Integrated Resource Plan (2017-2037), is a least-cost investment plan in generation, transmission and distribution measure. The finance model of the IRP is that of Public Private Partnerships, as public resources are insufficient to finance energy sector investments. The IRP has identified renewable energy sources that can improve the energy mix in the medium term, including solar photo voltaic wind and biomass totaling 325MW and coal at 300MW. Another option is for Malawi to quickly tap into the regional grid, as Malawi’s electricity grid is currently not interconnected with the Southern Africa Power Pool (SAPP). This integration would help to ensure security of supply especially in the face of low hydrology and generation deficit. Establishing interconnections with Mozambique, Tanzania and Zambia should be prioritized, as these create opportunities to lower the cost of electricity supply and potential opportunities in the long run to sell surplus electricity to SAPP.

Although short term measures have been implemented to provide some relief, blackouts remain prevalent. Malawi’s planned investments will yield results, but only in the medium to longer term. At the same time, improving the overall performance of ESCOM, ensuring the implementation of cost reflective tariffs and attracting private investment are necessary to achieve sustainability. Cost reflective tariffs would not only enable the utility to meet its revenue requirements and to fund investment programs, but also attract Independent Power Producers (IPPs). At present, the average tariff stands at K57.72/kWh (US$ 0.08/kWh) which is not fully cost reflective and is considerably lower than the average for SSA (US$ 0.14/kWh). Addressing Malawi’s energy challenges will be a slow but necessary process. If these challenges remain unaddressed, severe load shedding will continue - adversely affecting production and further dampening the country’s growth prospects.

17. By the end of December, revenue and grants had fallen short of midyear targets by 18.9 percent, a gap of MK 112.4 billion, due to under-performance across categories. Tax revenues were 8.6 percent below target, falling below the targeted level in most months (see Figure 8). This shortfall was primarily due to lower than projected economic growth, which had led to overly optimistic revenue projections. Corporate provisional tax was also 9.0 percent lower than projected. Weak demand and high stock levels also led to a decrease in imports, which impacted the collection of import Value Added Tax (VAT), import excise, and import duties, which were between 14 to 15 percent below the targeted level. The introduction of a higher personal income tax bracket (35 percent) had a lower than expected impact, with Pay As You Earn (PAYE) tax collections falling below the targeted level by 12.1 percent. Domestic VAT exceeded the target by 6.8 percent, largely due to the improved implementation of Electronic Fiscal Devices (EFDs). Non-tax revenues also under-performed, falling MK 5.5 billion (11.9 percent) below target, largely due to the low parastatal dividends, which were MK 7.4 billion (72.0 percent) below target. Grants fell by MK 68.8 billion (64.5 percent) below target, largely due to the inclusion of MK 55.8 billion in budget support from the European Union, which was not realized. Dedicated grants also fell by MK 13.0 billion (61.0 percent) below the targeted levels, as some funds committed by development partners were not fully disbursed.
Expenditure at mid-year was about 3 percent in excess of the budgeted level, with an overrun in recurrent expenditure partially offset by lower than targeted development expenditure. Expenditure on maize purchases was nearly double the amount budgeted, at MK 69.9 billion, compared to the budgeted level of MK 35.0 billion, driven by a Government bailout of MK 48.2 billion (1.0 percent of GDP) for the ADMARC (see Figure 7). This occurred after ADMARC had purchased maize to avert a food crisis which did not materialize and after it called a Government guarantee to repay its loans, as it did not sell sufficient stock to meet its obligations. Additionally, the Government moved forward to address arrears accumulated since FY2012/13. It issued zero coupon promissory notes amounting to MK 33.8 billion. Moreover, expenditure on wages and salaries exceeded the budgeted level by about MK 2.4 billion (1.5 percent). This was largely due to unplanned expenditures on wages and salaries for the Malawi Police Service (MK 3.5 billion), which upgraded entry levels, and for the Malawi Defense Force (MK 2.2 billion) which, in addition to the upgrades, recruited a greater number of new entrants than budgeted. This over-expenditure was offset by under-spending on the Farm Input Subsidy Program (FISP), which was under-budget by 14.1 billion due to delayed payments to suppliers. Moreover, interest payments exceeded the budgeted level by MK 3.7 billion, due to the decline in inflation and the reduction of RBM policy rates. This reversed a pattern of going over-budget in this area in recent years. Although the lower interest bill created some fiscal space, this was offset by increased spending on wages and salaries and on goods and services. The development budget continued to underperform, falling 33.3 percent below the targeted level, mainly due to slow project implementation. Expenditure on domesticaly-financed and foreign financed projects was 24.6 percent and 37.3 percent below the targeted levels respectively.
Table 1: Fiscal accounts
Percentage of GDP (with rebased GDP)

<table>
<thead>
<tr>
<th></th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
<th>2017/18</th>
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<td>Revenue and grants</td>
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<td>Revenue</td>
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<td>Expenditure and net lending</td>
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<td>Foreign financed</td>
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<td>Overall balance (incl. grants) excl ZCPN</td>
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<td>(5.7)</td>
<td>(3.1)</td>
<td>(3.4)</td>
<td>(4.0)</td>
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<td>Overall balance (incl. grants)</td>
<td>(5.7)</td>
<td>(6.3)</td>
<td>(6.1)</td>
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<td>Financing</td>
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<td>Net foreign financing</td>
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<td>Gross foreign borrowing</td>
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<td>Project loans</td>
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<td>Amortization</td>
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<td>Net Domestic borrowing</td>
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<td>Securitization of domestic arrears</td>
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<td>0.0</td>
<td>0.3</td>
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</table>

Memorandum items:

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<th>2016/17</th>
<th>2017/18</th>
</tr>
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<tbody>
<tr>
<td>Primary balance including ZCPN</td>
<td>(1.3)</td>
<td>(1.7)</td>
<td>(2.1)</td>
<td>(0.5)</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Primary balance excluding ZCPN</td>
<td>(1.3)</td>
<td>(1.0)</td>
<td>0.9</td>
<td>0.9</td>
<td>(0.4)</td>
</tr>
</tbody>
</table>

Source: World Bank staff calculations based on MoFEPD data

1 Issuance of zero coupon promissory notes
2 Includes promissory notes issued for the repayment of domestic arrears accumulated since FY 2012/13
3 Excludes promissory notes issued for the repayment of domestic arrears accumulated since FY 2012/13
Tight fiscal space calls for careful expenditure control and investment prioritization

19. Following shortfalls in the first half of the fiscal year, total revenue and grant projections have been reduced by 1.3 percent of GDP below the level originally budgeted. Tax revenues are projected to decline from 18.4 to 17.1 percent of GDP, which more closely corresponds to previous years’ outturns (see Table 1). Weak economic activity in the first half of the year is expected to continue into the second half, with the dry spell and fall army worm infestation contributing to a modest harvest. Grants are also expected to continue to underperform, dropping from a budgeted level of 3.0 to 2.7 percent of GDP. Although the mid-year revised budget has reduced projected revenues to a more realistic level, expenditure overruns from the first half of the fiscal year are expected to lead to a substantial deficit.

20. Projected total expenditure has been revised slightly upwards from 27.3 to 28.9 percent of GDP, reflecting overruns from the first half of the year. Recurrent expenditure is projected to stand at 22.3 percent of GDP, in contrast to the budgeted level of 20.0 percent. Wages and salaries have been revised slightly upwards, by 0.1 percent of GDP. This reflects the upgrade of entry levels for the Malawi Police Service and Malawi Defense Force personnel, and several recruits to the latter in excess of the anticipated level. Interest on debt has been revised up by 0.3 percent of GDP, reflecting a larger volume of domestic treasury bills. Subsidies and transfers are expected to increase substantially, by 0.8 percent of GDP, due to the ADMARC bailout, although FISP is expected to come in within budget for a second year in a row. Expenditure control measures are expected to contain expenditure on goods and services. Finally, by the end of FY2017/18, the Government is further expected to fully clear accumulated arrears through securitization, the cost of which amounts to 1.2 percent of GDP. Despite the lapses in the first half of the fiscal year, the Government is maintaining its commitment to improving fiscal performance in the second half. Measures include tighter controls and monitoring of commitments to avoid the buildup of new arrears and the implementation of other expenditure control measures, including controls on travel, fuel and recruitment. These measures should help to contain expenditure on goods and services. In addition, expenditure on domestically-financed development will be reduced to historically low levels. In the context of the International Monetary Fund (IMF) program discussions, there is also a strong commitment for no additional monetization of deficits by the Central Bank.

21. Development expenditure is projected to fall by 0.7 percent of GDP, dropping to similar levels recorded in FY2016/17. While foreign-financed projects are expected to exceed budget projections, domestically-financed projects will fall short due to fiscal pressures. Critical projects, particularly in the transportation sector, have been prioritized for completion or to reach visibility stage by the end of the fiscal year, while other projects have been suspended. The revised budget projects that expenditure on domestically-financed projects will be reduced by 1 percent of GDP, while expenditure on foreign financed projects is expected to increase by 0.2 percentage points of GDP. Despite these reductions, this is expected to be the second year in which development expenditure exceeds 6.0 percent of GDP. These high levels are estimated to be driven by the highest domestically-financed development expenditure (1.8 percent compared to an average of less than 1 percent of GDP) in recent years.

22. The FY2017/18 fiscal deficit is expected to widen to around 7.1 percent of GDP. As discussed earlier, this is due to lower than expected revenue collection, the securitization of payment arrears, and expenditure overruns in the first half of the year. Net foreign financing is expected to reach 3.2 percent of GDP, while net domestic borrowing is projected to reach 4.6 percent, a substantial increase from the figure of 0.9 percent recorded in 2016/17. Thus, it will be necessary to contain the deficit to build up fiscal buffers that can be drawn on during a crisis. As part of efforts to improve the fiscal position for the rest of the year, amidst revenue shortfalls, the Government has reprioritized expenditure to avoid excessive recourse to domestic borrowing. Beyond FY2017/18, it is expected that there will be a faster pace of consolidation supported by the new IMF program. To increase revenues, the Government is considering a number of measures, including repealing the industrial rebate scheme, discontinuing tax holidays, and strengthening
tax administration, including through improved automation. To control expenditure, the Government aims to limit non-essential recurrent expenditures and allowances, to continue to reform FISP, and to reduce transfers to ADMARC.

23. The IMF Executive Board has approved US$112.3 Million under the Extended Credit Facility (ECF) Arrangement for Malawi. In April 2018, the IMF Executive Board approved a new three-year program supported by an arrangement under the ECF, and concluded the 2018 Article IV discussions. The economic program aims to entrench macroeconomic stability and foster higher, more inclusive, and resilient growth. As part of the program, following the slippages in FY2017/18, the Government has committed to shifting to a near zero primary balance in FY2018/19.

Increasing domestic debt is exacerbating risks

24. In recent years, the composition of debt has gradually shifted from external to domestic borrowing. Malawi’s public and publicly guaranteed (PPG) external debt stood at about US$ 2.0 billion (32.6 percent of GDP) in 2017, up from US$ 1.8 billion (33.2 percent of GDP) in 2016. Most of Malawi’s external debt (around 78 percent) has been contracted with multilateral creditors, principally the International Development Association (43 percent); the African Development Fund (14 percent); and the International Monetary Fund (11 percent), with all of this debt contracted on highly concessional terms. However, the proportion consisting of bilateral external debt has been increasing rapidly, although from a low base, with most of this debt contracted with China and India. Debt to China now accounts for about 12 percent of total debt. Gross domestic debt increased from MK 206.6 billion (13.8 percent of GDP) at the end of 2012 to MK 1,015 billion (22.6 percent of GDP) at the end of 2017. The increase reflects a progressive shift from external to domestic borrowing in recent years. This follows the increase in government net domestic financing after the decline in external financing in the wake of the “cash-gate” scandal; the securitization of domestic arrears; the issuance of Treasury notes for the conversion of ways and means; and maturing Treasury bills into longer-term government securities. While the stock of domestic debt is lower than that of external debt, the interest burden is substantially larger.

25. The most recent joint World Bank/IMF Debt Sustainability Analysis (DSA), conducted in April 2018, rates Malawi at a moderate risk of external debt distress. External debt burden indicators are projected to remain below their policy-dependent thresholds in the medium term, premised on a baseline scenario of a growth recovery and a continued moderate pace of borrowing, predominantly on highly concessional terms. However, stress tests indicate that a somewhat weaker debt outcome is possible under certain conditions. The strongest impact on the indicators arises under the scenario of one-time depreciation of the Kwacha by 30 percent, causing the present value of debt to GDP, the present value of debt to revenue, and the debt service to revenue ratio to breach thresholds. The risk of debt distress is heightened significantly if domestic public debt is added to external debt. Given Malawi’s historic vulnerability to shocks, careful macroeconomic management and difficult policy choices will be essential to maintaining macro-economic stability, particularly in the lead up to an election year. Limited space for borrowing increases the need for careful project prioritization, with close scrutiny to rates of return and financing terms and to ensure that new borrowing does not jeopardize debt sustainability. Therefore, it will be necessary to pay close attention to the financing terms of any proposed infrastructure investments.

The Kwacha has been stable, aided by a weaker US Dollar

26. The kwacha remained stable against the US Dollar for most of 2017. As of April 2018, it traded at MK 731 against the US Dollar, roughly the same as in April 2017. This is the lowest level of variation recorded for two years (see Figure 9). A weaker dollar and even weaker demand for imports have kept reserves and the MK/USD exchange stable over the past year. Structural constraints to growth, particularly the erratic supply of electricity, have resulted in a subdued demand for foreign exchange. Foreign reserves were sufficient for 3.06 months of import cover in April 2018.
27. The value of the Kwacha declined against the currencies of other major trading partners. These included the South African Rand (ZAR), Pound Sterling (GBP) and the Euro. The depreciation against the Rand was partly due to general optimism following the inauguration of new political leadership in the country.

**Figure 9: Kwacha steady only against the dollar.**
Exchange rate USD, Euro, GBP (LHS), ZAR (RHS)

![Graph showing exchange rate fluctuations](image)

**Figure 10: Growth in credit to the private sector remains unresponsive to declining policy rate**
Percentage change

![Graph showing credit growth and policy rate](image)

Source: World Bank staff calculations based on RBM Data

The Central Bank has lowered its policy rate, but real lending rates remain high

28. Despite the Reserve Bank of Malawi (RBM) reducing the policy rate, credit growth remains subdued. In the period from January 2017 to January 2018, the policy rate was reduced by a total of 8 percentage points as inflation declined. RBM reduced the rate by 2 percent in March; by 4 percent in July; and by 2 percent in December 2017. The yield on Treasury Bills (TBs) also declined over the period, from 25.0 to 14.5 percent. Commercial banks followed suit, reducing their nominal base lending rates from 33.6 percent to 24.8 percent in the period from January 2017 to 2018. Despite the drop in nominal rates, real base lending rates remained elevated at more than 15 percent as of January, weighing on private sector lending. During this 12-month period, credit to the private sector grew by only 0.3 percent, while government credit increased by 27.5 percent (see Figure 10). Nonetheless, the RBM has maintained its fight monetary stance, continuing to monitor and mop up excess liquidity to keep the interbank rate (IBR) close to the policy rate, and to ensure that inflation remains under control.

Export performance remained subdued with a marginal increase in tobacco earnings

29. The current account deficit is estimated to have narrowed to 11.3 percent of GDP in 2017, supported by a slightly improved tobacco export performance and a lower import bill. The growth in the nominal value of Malawi’s exports remained low, at only about 6 percent, due to the relatively weak performance of tobacco, the country’s largest export earner (see Figure 11). Despite the average national price going up by 41 percent in 2017, tobacco production fell by 45.5 percent, leading to a 23 percent decline in sales.
value. With some carry over stock, Malawi managed to export 134 million kilograms, recording annual export earnings of US$ 486 million in the 2017 season. This represents a modest increase of 0.8 percent from the preceding year. The average export price has continued on a downward trend, falling from US$ 3.70 per kilogram in 2016 to US$ 3.62 per kilogram in 2017 (see Figure 12).

30. **To prevent oversupply, which has severely suppressed earnings in the past, the Tobacco Control Commission has continued to implement the Integrated Production System.** This system is intended to keep output flat, thus supporting auction prices. This system is likely to be continued in the short to medium term as a means to protect export earnings from a crop that is in structural decline. Given the significant contribution of tobacco to the economy, the domino effect of stagnant or falling tobacco output will reverberate across other sectors of the economy, including coal, a large proportion of which is used to cure tobacco. In the long run, a decline in tobacco means that even reasonable investments in mining coal may be undermined, unless alternative markets are developed.

31. **Although tobacco remains the leading foreign exchange earner, other cash crops, including tea, sugar and edible nuts contributed to exports in 2017.** The drought in Kenya, the continent’s second largest tea producer resulted in a global decline in the production of tea. This boosted international prices and increased demand for tea from Malawi. Malawi also experienced earlier rains than expected, as a result of which total production of tea stood at 45 million kilograms, an increase of 12 percent year on year. Going forward, to achieve increased competitiveness, the Tea Association of Malawi has prioritized the mechanization of tea plucking and other technologies to boost quality of the crop. Exports of sugar and edible nuts (groundnuts, macadamia nuts and cashews) also increased in 2017.

32. **Malawi’s import bill declined in 2017, largely due to a fall in food imports due to higher domestic production as well depressed consumer demand and weak economic activity.** In 2017, a good harvest and the availability of carry over stock from the humanitarian response meant there was no importation of maize. The decline in the volume of food imports is estimated to have driven the total import bill down by 5.4 percent.
33. In addition, anecdotal evidence suggests that import demand for other imports grew weakly. Notably, the volume of imports of fertilizer and coal grew at low rates, at 2 percent and 5 percent respectively. Several manufacturing firms were reported to have scaled-down their activities as a result of power shortages, resulting in a consequent reduction in the import of production materials. A total of 63.2 percent of firms were producing at capacity levels below 70 percent, compared to 74 percent in the previous year. In addition, the Business Confidence Index (BCI)\(^2\) in 2017 stood at 67 percent, compared to 58.5 percent in 2016 (MCCCI Malawi Business Climate Survey, 2017). Lower maize earnings also resulted in a significant reduction to the purchasing power of households, with businesses suffering from considerably reduced consumer demand for their products.

34. The demand for petroleum products increased. In 2017, the average monthly import of diesel stood at 19 million liters, compared to 13.1 million liters in 2016. Similarly, the import of petrol stood at 15 million liters, compared to 13.4 million liters in the previous year. Demand for diesel decreased relative to petrol, reflecting the prevailing higher diesel pump prices compared to neighboring countries. This led to illegal imports and cross border trucks filling in the neighboring countries where prices were lower. While continuing influx of imported second hand cars, most of which use petrol, drove the demand for this fuel. The general increase in the demand for petroleum products has also been due to the increased use of thermal power generators to mitigate the power shortages Malawi is experiencing. On this backdrop, the Malawi Energy Regulatory Authority (MERA) envisages that fuel imports and consumption could reach 520 million liters in 2018. The FOB price for petrol stood at US$ 548.76/MT, an increase of 18.7 percent compared to the average price in 2016. For diesel, it stood at US$ 480.80/MT, an increase of 28.6 percent. However, pump prices have remained constant, in line with the Automatic Pricing Mechanism and through use of the Price Stabilization Fund.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure13.png}
\caption{The current account balance has seen a slight improvement}
\end{figure}

Figure 13: The current account balance has seen a slight improvement

35. In 2018, the current account balance is projected to narrow to 9.2 percent of GDP. This is due to an expected recovery of agricultural exports especially tobacco and a general decline in imports due to subdued economic activity. Internationally, improved growth prospects in China and higher global

\(^2\) The BCI is a qualitative index of scores of enterprises’ assessment of current as well as future expectations of business climate indicators. It is desirable to have a BCI of greater than 100 year-on-year
commodity prices are expected to boost Malawi’s exports. Domestically, a significant shift is expected towards tobacco production and growth in other cash crops, with the latter driven by the collapse of the pigeon peas market. Also on the backdrop of generally lower commodity prices in 2017, especially for maize. On the other hand, the total import bill is projected to increase modestly due to increased fuel imports for diesel generators. However, demand for other imports is estimated to continue to be subdued due to slow economic growth. This is forecasted to improve Malawi’s terms of trade and exert a downward influence on the overall current-account deficit (see Figure 13).

The banking sector has generally remained stable

36. The average ratio of non-performing loans to gross loans (NPLs) remains high, despite some recent improvement over the year. Three commercial banks were significantly vulnerable in the year, with their NPLs above their risk-weighted capital. In response to the RBM’s instructions for all commercial banks to develop and implement time bound NPL resolution strategies, key measures were implemented to resolve this issue. The banks intensified debt collection, increased provisioning for their loan books, and wrote off a significant amount of debts. As a result, the NPL ratio declined from 18.8 percent in September to 15.7 percent in December 2017 (see Figure 14). Industry wide provisioning, which stood at an average level of about 28 percent per month in 2017, increased to 72 percent in January 2018.

Figure 14: NPLs began to decline towards end of the year
Ratio of non-performing loans to gross loans, percentage

Figure 15: Banks’ profitability is affected as capitalization takes place
Capital adequacy, ratio of Tier 1 and total capital to risk weighted assets, percentage

37. In 2017, the banking sector’s overall capital adequacy ratio (CAR) improved. This ratio stood at 19.4 percent in December 2017, up from 16.8 percent at the same point in the previous year (see Figure 15). The statutory minimum level is 10 percent. The Tier 1 ratio stood at barely 15.3 percent in December 2017, up from 12.7 percent at the same point in the previous year. This was just above the minimum benchmark of 15.0 percent. Three previously undercapitalized banks had recapitalized by December 2017. In July 2017, one of the small banks, the Opportunity International Bank of Malawi, was acquired by a mid-sized bank - the First Merchant Bank. By January 2018, both Tier 1 and core capital adequacy ratios began to improve.
Since the 2000’s, the Government of Malawi (GoM) has implemented bans on the export of agricultural commodities, particularly maize and soya. Malawi’s crop production is heavily weighted towards maize, with 76 percent of farmland utilized for the production of this crop by smallholder farmers an average plot area of 0.8 acres (NSO 2017). Most Malawians derive a high proportion of their calorie intake from maize. Thus, policies related to maize have a significant impact on incomes and welfare at the household level, particularly in rural areas. This is the justification for the Government’s policy to control maize price levels and to ensure domestic supply. These policies include providing farm input subsidies and setting minimum farm gate prices to encourage maize production; supporting a parastatal grain marketing board designed to stabilize maize prices; implementing export bans on maize; maintaining a national reserve of maize to serve as a buffer when domestic supplies run low; and providing emergency food assistance to food insecure households (International Food Policy Research Institute, 2015).

Another crop on which trade restrictions have been imposed is soya. The Government argues that bans on the export of soya support the domestic poultry and cooking oil industries by ensuring lower input prices. However, only 6.8 percent of households utilize their land to produce this crop, on an average area of 0.8 acres (NSO 2017). It

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3 The estimates by the International Food Policy Research Institute (IFPRI) have the following caveats:

- Estimates are gross revenues minus transportation costs. They do not include the cost of buying or storing maize and other necessary costs incurred by maize exporters. Nonetheless, given that wholesale maize prices in Malawi were 45 to 70 percent lower in July 2017 than in the three East Africa markets, Malawian traders may have made substantial profits from exporting maize in August/September 2017 had they been permitted to do so.
- Trade taxes and other ‘facilitation’ fees were not considered. The Common Market for eastern and Southern Africa (COMESA) guidelines that maize imports into Kenya, Rwanda and Tanzania should be duty free. Nevertheless, it is common practice for traders to pay facilitation fees to customs officials and police at national border crossings, and these fees tend to be highly variable.
- The lifting of the maize export ban by 30 October 2017 is deliberately not taken into account. This is because no maize export licenses were granted by the Ministry of Industry, Trade and Tourism between then and the time of the analysis in December. [Needless to say, the export ban has since been reinstated in January 2018]
therefore constitutes a relatively small proportion of agricultural activities, with negligible effects on the economy as a whole (Edelman and Baulch 2016). Nonetheless, a simulation by USAID (2013) estimates that a soya ban could cost Malawi 12 percent of the overall economic activity generated by the soya bean sector and reduce soya bean farmer’s net revenue by 56 percent in a given year. The National Export Strategy identifies oil seed products as a priority to potentially drive export growth. However, an unstable soya market thwarts any prospects for diversification from traditional exports such as tobacco by smallholder farmers.

Discretionary policy interventions lead to market uncertainty, with long-term implications for food security and international trade. A cross-country analysis of seven countries in Eastern and Southern Africa, by Chapoto and Jayne (2009), revealed that, where government interventions are limited to regulation, infrastructure investment, crop diversification and financial markets improvement (Uganda, South Africa and Mozambique), staple food prices follow more consistent and regular seasonal price patterns. But where governments continue to engage actively in food markets through marketing board activities, discretionary trade policy tools such as export bans and domestic stock releases (Zambia, Ethiopia, Tanzania and Malawi), prices are more unpredictable. Of the seven countries studied, Malawi and Zambia exhibited the highest degree of price unpredictability. In more recent years, Malawi has continued to exhibit one of the most volatile maize prices in the region (see Figure 16).

Maize export bans have had a detrimental impact on prices and trade flows as well as on production and investment decisions. An export ban is in effect a non-tariff barrier to trade. Where the domestic price is lower than regional prices, it is more profitable for traders to export maize rather than sell it domestically (see Figure 17). Whilst low domestic prices benefit consumers, they adversely affect incomes of producers, and farmers are discouraged from growing maize. Depending on the elasticity of supply and demand, maize prices may end up being higher because of lower aggregate supply in subsequent years. Beyond price and trade flows, ad-hoc and impromptu policies affect private sector decision making processes. These factors make it difficult to plan, potentially impacting decisions related to investment and medium-term production (International Food Policy Research Institute 2015). At the firm level, this reduces the willingness of the banking sector to lend to the agriculture sector. Farmers’ incomes are affected by price volatility, in addition to the impact of weather shocks. As a result, the banking sector has seen a relative rise in NPLs, particularly involving loans to the agriculture sector. In general, investors lack the confidence to invest in agricultural products given the high level of uncertainty.

The Control of Goods Bill (2018) offers a policy alternative to ad hoc export bans and license restrictions. The current Control of Goods Act (1984) falls short of guaranteeing transparency and predictability in applying trade restrictions or licenses. This has affected the ability of the Government to support the commercialization of farming, value addition and increased trade. The new bill, which was recently submitted to Parliament, establishes a basis for a policy framework characterized by a higher degree of collaboration between the Government and the private sector. It recognizes the importance of protecting public interests and strives to ensure that bans/license restrictions are implemented in a manner that is transparent and predictable.

38. Overall, the banking sector recorded high levels of profitability throughout the year, with liquidity levels remaining healthy. Both Return on Equity (ROE) and Return on Assets (ROA) were positive in the year, although on a declining trend (see Figure 15). Both ROE and ROA were negative in January 2018, possibly reflecting the spike in the provisioning for the NPLs, and the recapitalization exercise that took place

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4 Using three potential export locations in East Africa, transportation costs to these locations Central Malawi, and two alternative estimates of Malawi’s likely surplus, IFPRI estimates that Malawi lost between MWK 25 billion and MWK 69 billion (approximately $ 34 to $ 95 million) from the export ban in the 2016/17 agricultural year. The findings show that Malawian traders could have earned between MWK 37 and 69 billion in gross revenues if they had been able to export to Kigali in August/September 2017. Similarly, if they had been able to export to Dar es salaam, they could have earned MWK 29 to MWK 54 billion. Exports to Nairobi would have been marginally less profitable than those to Dar es salaam, mainly due to higher road transportation costs to Nairobi, generating MWK 25 to 46 billion.
towards the end of the year. Improved liquidity, together with downward revision of the policy rate by 600 basis points from 22 percent in March to 18 percent in July and to 16 percent in December 2017, pushed the interbank market rate down from 21.9 percent in March to 15.0 percent in December 2017.

The business environment has seen some modest improvements

39. Positive macroeconomic conditions had a positive impact on private sector investment. Inflationary pressures subsided following the sustained deceleration in domestic price increases, with the headline inflation rate declining to single digit levels at the end of the year. Consequently, interest rates declined, particularly in the period from April to December 2017. Average base lending rates declined from 33.6 percent in March to 26.9 percent. Access to the Lombard Facility declined to an average of MK 5.57 billion per day, down from MK 6.27 billion in March 2017.

40. Overall, Malawi registered a strong performance in the Doing Business rankings in 2017, moving up 21 ranks from 133rd place in 2016 to 100th place in 2017 (see Figure 18). It achieved a distance to frontier (DTF) score of 6.33 points, the highest among the SSA countries. The DTF score demonstrates strong progress improving the business environment. Most of this strong performance reflects an improvement in terms of the Getting Credit indicator, with Malawi moving up from 152nd place to 6th place. However, Malawi continued to rank poorly in terms of Dealing with Construction Permits, Enforcing Contracts, and Getting Electricity indicators. In particular, it performed poorly in terms of the Dealing with Construction Permit indicator, moving down from 65th place to 144th place (see Figure 19).

41. Malawi’s improvement in the Doing Business rankings was driven by four positive reforms. These included: (i) implementation of a credit reference system that reduces credit risks; (ii) reduced fees to process building plans for business premises; (iii) clearer priority rules inside and outside bankruptcy procedures; and (iv) improved insolvency procedures by introducing reorganization procedures, and hence facilitating continuation of debtor’s business during insolvency proceedings and introducing regulations for insolvency practitioners. These were achieved, among other means, through the operationalization of the Companies Law, the Credit Reference Bureau Law, and the Insolvency Law over the year.
The Reserve Bank of Malawi (RBM) conducted a stress testing exercise in September 2017, based on the financial sector data from 10 banks in the country. At that point all banks except two were adequately capitalized. The overall sector posted healthy returns on assets (ROA) and return on equity (ROE). However, half of the banks individually posted cumulative losses, and only two registered NPL ratios below the maximum benchmark of 5.0 percent. The overall non-performing loans to gross loans ratio (NPLs) for the entire sector was high, at 18.8 percent. Credit sector concentration was high and favored a few sectors, namely agriculture, manufacturing and wholesale and retail trade sectors. The stress testing exercise focused on five areas namely; credit risk, liquidity risk, income risk, foreign exchange risk, and interest rate risk.

Figure 20: Banks are resilient to liquidity, income and foreign shocks but vulnerable to credit and liquidity risks

Banking industry capital adequacy seems somewhat resilient to credit shocks but vulnerable to concentration risk. RBM conducted two stress tests to assess effects of possible deterioration in asset quality in order to establish resilience to credit shocks. The first involved applying progressive growth in NPLs across economic sectors. The results revealed that banks in Malawi are resilient to sectoral credit shocks, with Tier 1 ratio remaining above the 10.0 percent minimum regulatory benchmark, falling from 15.9 percent to 12.1 percent after moderate shocks and 10.2 percent after major shocks (see Figure 20). However, four of the banks had core capital ratios below the regulatory benchmark after a moderate shock, and six banks after a major shock. The second test involved application of successive loan repayment defaults of top five borrowers in the banking industry. This test revealed serious vulnerability of the banking industry to single name concentration risk, reflected in a sharp drop in the core capital ratio (from 20.3) to 7.3 percent, arising from an assumed default of the top 5 largest exposures.

The industry is resilient to liquidity shock, but would not be able to withstand a bank run. A liquidity stress test was conducted by applying a reduction to the value of banks’ liquid asset portfolios to assess the resilience of the industry’s liquidity position. The results showed that the banking sector is sufficiently resilient. After the stress test, liquid asset to deposit and short-term liabilities

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5 The RBM conducts routine stress tests on a biannual basis, aimed at identifying potential sources of vulnerability to the financial sector.
6 The severity of the stress scenario was applied progressively from minor to moderate and major credit shocks in economic sectors such as Agriculture, mining, manufacturing, utilities, construction, trade, financial services, etc.
7 The shock assumed 50 percent provisioning on new NPLs.
8 Or 9.8 percent with assumed default of top three largest exposures
9 Only one bank would have core capital ratio above 5 percent in this scenario.
ratios declined to 50.7 percent and 53.7 percent\textsuperscript{10} respectively for both system wide and bank specific basis, following a major liquidity shock. A second simulation involved a sudden withdrawal of customers’ deposits to assess the ability of the banks to withstand such a run without recourse to external liquidity support. The results show that the banking industry is vulnerable, with their liquid assets unable to sustain even a moderate bank run, with such a run depleting these assets in less than five days.

Banks are resilient to moderate income shocks, but almost half of the banks were undercapitalized after a major income shock stress test. An income risk test involved assessing impact on banks’ earnings and profitability after the application of direct shock on the industry’s revenues. A range of scenarios to test the impact of shocks, ranging from minor, moderate to major,\textsuperscript{11} in terms of decline to interest income and foreign currency income for the sector was applied, together with an assessment on Tier 1 capital ratio and Return of Asset (ROA). The results indicate that the industry had a sufficiently high degree of resilience. A major shock scenario resulted in a Tier 1 ratio of 13.3 percent.\textsuperscript{12} However, further analysis revealed that four banks would be undercapitalized in the major shock scenario. The results also show that ROA would remain positive, at 1.7 percent, 1.2 percent and 0.5 percent respectively in the case of the minor, moderate and major shock scenarios (from 2.5 percent).

The banks are well positioned to withstand foreign exchange risks, as they are able to control losses emanating from currency shocks. A simulation of foreign exchange appreciation or depreciation of the Kwacha against major trading currencies was conducted, with an assessment of the possible effects of these on the banks’ capital position. A minor exchange rate shock test assumed an appreciation of the Kwacha of 20.0 percent, while moderate and major shocks assumed depreciations by 30 percent and 40 percent, respectively. The results of the test show that the banking industry is well cushioned against exchange rate volatilities, with currency shocks resulting in only minimal movement in the level of capital adequacy of the sector.

The industry is well positioned to withstand interest rate vulnerabilities. An interest rate shock test was conducted to assess the level of the banking system’s resilience to volatility in interest rates. Different scenarios assumed a 5.0 percentage points decline in interest rate in the case of a minor shock; a 7.0 percentage points increase in the case of a moderate shock; and a 10.0 percentage points increase in the case of a major shock. This test showed that the industry is resilient to interest rate shocks, with only minimal movements in Tier 1 ratio as a result of the simulated interest rate shocks. All individual banks are resilient to the shocks, except for the two which became undercapitalized in moderate and major shock scenarios.

The results of these stress tests show that the banking industry has a sufficient level of resilience except for credit risk shock and liquidity risk shock. Further analysis shows that the resilience of the entire sector is anchored on a few banks. The majority of the banks would fail to survive high stress shocks scenarios. Only four banks would survive major shocks with adequate capital ratios after a combined shock test. In such a scenario, about six banks would be highly undercapitalized, some with a Tier 1 capital ratio in a negative position.

These findings point to the need to resolve a number of issues, especially those relating to the banking sector’s asset quality and the low level of capitalization of Malawi’s weaker banks. While recent reduction to the level of NPLs should be applauded, banks should implement clearly defined NPL resolution strategies to improve their asset quality. Related to this, it is important that both the public and private sector’s repayment discipline to banks should improve. In particular, the level of Government payment arrears to private sector operators that have obtained financing from the banking sector should be controlled. The justice system should support debt collection efforts to a greater extent than it is currently the case, so that overall loan recovery rates improve. Loan concentration should be monitored and single lender exposures limits should be discouraged.


\textsuperscript{10} Remaining above the regulatory benchmark of 30.0 percent

\textsuperscript{11} The scenarios assume a combination of 5.0 percent and 20.0 percent declines for minor shock, 10.0 percent and 30 percent for moderate shock, and 15.0 percent and 50 percent decline in major shock, respectively in the interest income and foreign currency income for the banking sector

\textsuperscript{12} Which is still above the regulatory benchmark of 10.0 percent.
42. Malawi implemented measures to reduce accumulated arrears to the private sector. For some time, the growing payment of arrears for goods and services to government agencies negatively affected cash flows and investment decisions, especially by MSMEs. The Government has made some improvements to the public finance management system in relation to this matter, including in the area of auditing and verifying legitimate arrears. It has also issued zero coupon bonds with a maturation period of between one and three years to pay off outstanding debts. Nonetheless, the long payment terms and delays by the Government in clearing these arrears to the private sector continue to squeeze the working capital of this private sector. The Government increased the tax refunds threshold to 3 percent in July 2017, up from 2.5 percent earlier in the year. This has enabled the Malawi Revenue Authority (MRA) to collect sufficient resources to almost completely reduce the outstanding bills for VAT Refunds.

43. The low level of access to financing through the banking sector remains a significant constraint on the private sector. Delayed court decisions have contributed to high perceptions of risk, thus constraining access to credit from the banking system. Among other challenges, financial institutions have limited trust in the efficiency and impartiality of local courts when dealing with commercial disputes.

44. Reliable electric power is also a significant constraint to the private sector. Over the years, power rationing intensified, with power unavailable for periods of more than 24 hours in some cases. The national generation capacity stood at 343 MW, with most of this power deriving from hydropower located on the Shire River. Due to low water levels in Lake Malawi, the source of the river, generation output declined drastically to as low as 150 MW in December 2017 (see Box 1).

45. The pace of poverty reduction remains slow. The proportion of the population living below the international poverty line (US$ 1.90 per day) declined by less than 3 percentage points in the period from 2004 to 2010, going down from 73.6 percent to 70.9 percent. This means the poverty rate declined only at an annual rate of 0.6 percent. This is a considerably lower decrease than the average for Sub-Saharan Africa (SSA) at 2.1 percent and for neighboring countries such as Mozambique, Tanzania and Rwanda at 2.4 percent, 5.2 percent and 2.3 percent, respectively, during roughly the same period. Macroeconomic instability over the years and the predominantly agricultural economic structure, with most of the population engaged in subsistence rain-fed agriculture, have contributed to the slow pace of poverty reduction. Current estimates using the international poverty line of US$ 1.90 per day indicate that 69.2 percent of the population is classified as being poor in 2017.

46. Although the relative contribution of agriculture to GDP has almost halved since the early 1990s, nearly two thirds of the population continues to work in this sector. Thus, poor performance of the agricultural sector is likely to have an adverse impact on the poverty outlook. The uncertainty surrounding trade regulations could also discourage farmers from investing in agricultural inputs, further reducing production and possibly resulting in increased poverty. As a result, the poverty rate is projected to remain stagnant in 2017 and 2018. Given that tobacco is more likely produced by non-poor households than by poor households (World Bank 2017c), the projected growth in tobacco production for 2018, which would also result in a lower price level as discussed earlier, is not expected to have a significant implication on poverty.

47. Poverty trends highlight the importance of a dynamic social safety net to meet Malawi’s future needs. Over time national poverty has remained high and persistent in Malawi, declining only marginally from 52.4 percent to 50.7 percent between 2004 and 2010. While urban poverty reduced by 8 percent during this period, rural poverty increased marginally to 17 percent and 57 percent respectively. The rural economy

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13 The official poverty estimates for 2016/17 (based on the national poverty line) are being prepared using the Fourth Integrated Household Survey (IHS 4) and will provide the latest official national poverty rate.
relies heavily on the agriculture sector (employs 85 percent rural workforce) which has shown very modest growth vis-à-vis industry and services sectors. Compared to almost every other country in the region, Malawi faced the highest sensitivity to extreme dry events from 1980 to 2014 (Hallegate et al, 2017). One of the reasons for this sensitivity is the high dependence on maize in terms of production (about 90 percent of all land under cereal production being devoted to maize) and consumption (maize accounts for 54 percent of caloric intake by Malawian households). Most recent flood and drought events have exposed such vulnerabilities. It is therefore essential for the country to develop the systems and mechanisms needed to effectively manage persistent poverty, as well as shocks.

48. Evidence now shows that social safety nets are making a substantial contribution in the fight against poverty. They help people escape extreme poverty, close the poverty gap, and reduce inequality as well as build household resilience to respond to shocks across the life cycle, key to building human capital. The extent to which social safety nets SSN transfers have an impact on poverty and inequality depends on factors such as program coverage, transfer level, and the beneficiary or benefit incidence (World Bank 2018b). It is against such empirical evidence that policy makers are urged to pay attention to the interaction of these factors when designing poverty reduction policies.

49. The medium-term macroeconomic outlook appears positive, albeit with significant downside risks related to vulnerability to exogenous shocks. Malawi continues to face significant risks related to climatic shocks that have a potentially negative impact on the achievement of macroeconomic instability. The impact of these risks is manifested by Malawi’s volatile growth and stagnant poverty outcomes. Food security challenges have intensified the urgent need to implement reforms to ensure that Malawi can break out of the cycle of vulnerability and avoid crises associated with climate change. Despite signs of economic recovery, Malawi’s agriculture sector has been subject to fall armyworm infestations. Compounded by dry spells, these factors could result in lower than expected growth. A decline in agricultural output could also dampen the country’s export prospects, which could ultimately weaken the Kwacha and destabilize the exchange rate.

50. Adverse weather shocks, coupled with weak public financial management and distorted agricultural incentives, exacerbate fiscal pressure and constrain the Malawi’s capacity to respond to shocks. Pre-election spending pressure could also derail the reform agenda. These fiscal slippages could have a significant macroeconomic cost, necessitating painful adjustments to recalibrate the economy in the post-election period. This could derail progress towards the achievement of sustainable economic growth and poverty reduction in the medium to long term. Lower than expected development partner financing and/or shortfalls in revenue collection could also result in a deterioration in the fiscal balance. The risk of heightened pre-election spending could also exert an upward pressure on interest rates and thereby increasing the domestic debt burden and constraining access to finance.

51. Policy discipline and reform efforts are required to build a resilient and stable economy. Recommended measures include the following:

- Much stronger controls on spending to maintain macro stability, given revenue fluctuations and the need to build buffers to combat weather and other external shocks. Malawi’s fiscal position remains vulnerable to both internal and external shocks. Recurrence of natural shocks, especially weather events, have also perpetuated fiscal imbalance. Revenue shortfalls as well as recurrent expenditure overruns, compounded by rising pressure on domestic debt service and arrears repayment, leaves limited room for unplanned adjustment to shocks. Government expenditure has grown steadily even when revenues and grants have underperformed. Prudent revenue assumptions, improving budget execution and commitment controls, would help improve budget credibility. This can be further strengthened with efforts to broaden the tax base and stronger public finance management. Careful
Prioritization of expenditures and investment is also needed to ensure spending is aligned with development goals, but also to create fiscal space that would allow for responses to shocks without endangering macroeconomic stability. Together, these efforts would reduce fiscal risks, help achieve low and stable inflation and interest rates, thereby also improving the business environment.

- **Reforming agricultural market institutions to reduce the fiscal burden and distortions in maize markets.** The majority of the poor remain locked in low productivity subsistence farming, with their poverty exacerbated by thin and distorted maize markets. Interventions that were designed to ensure price stability have undermined incentives to commercialize agriculture, leaving Malawi overly dependent on a smallholder agricultural sector that is vulnerable to climatic shocks. Furthermore, the Government has periodically guaranteed ADMARC’s loans, providing funds when there is a default. Increased oversight and strengthened management of ADMARC would help to reduce the fiscal burden imposed by the entity. These efforts could be complemented by the enactment of the Control of Goods Bill and related regulations by establishing a rules-based mechanism for commodity trade restrictions, which would decrease uncertainty in agricultural markets (see Box 2).

- **Building on recent business environment reforms to simplify regulations and address infrastructure constraints.** This would help reduce the cost of doing business, to lower risk and to facilitate a decline in interest rates. The structural transformation of Malawi’s economy requires both the emergence of a more efficient agriculture sector and a more rapid development of the non-farm economic sector. This necessitates both removing policy barriers to investment and job creation and targeting investment to alleviate key infrastructure constraints. Much greater efforts are needed to make existing regulations, including tax and licensing requirements, simpler, more accessible, and easier to implement. Malawi has one of the lowest rates of access to electricity in the world (10 percent), with severe disparities between urban areas (38 percent) and rural areas (4 percent). Many rural households depend on biomass, which has led to severe deforestation in the country. The limited access to electricity and the low level of reliability of the network are also major constraints on the private sector. The Government should therefore implement measures to improve the governance of utility suppliers and to adopt cost reflective tariffs. This would encourage the private sector to invest in generation capacity, which would help Malawi’s address infrastructure gaps, particularly given the public sector’s limited resource.
2. SPECIAL TOPIC: REALIZING THE FULL POTENTIAL OF SOCIAL SAFETY NETS

The recently approved second Malawi National Social Support Program (MNSSP II) has created an opportunity to transform Malawi’s social safety net between now and 2023. Based on experiences from the first phase of this program, MNSSP II shifts focus from individual social safety net programs to ensuring coherence, integration, and harmonization between systems of interrelated interventions. The MNSSP II envisions the creation of a dynamic safety net system aimed at achieving equity, resilience, and long-term human capital development in Malawi. As such, the MNSSP II is the main vehicle for achieving Target 1.3 of the UN Sustainable Development Goals, which focuses on the implementation of a nationally appropriate social safety net system by 2030.

There is much robust evidence on how social safety nets can contribute to breaking the cycle of poverty and vulnerability in Malawi. The Social Cash Transfer Program (SCTP) has had one of the strongest and most consistent positive impacts on consumption, livelihood, earnings, and schooling outcomes of any such program implemented across the African region. Malawi’s recent drought response has yielded important lessons on the need to make safety nets more sensitive to shocks and on the need to strengthen links between safety nets and humanitarian programs. As discussed in Part 1, structural reform efforts are highlighting the need to scale up targeted safety net programs to complement or replace less effective interventions. These include the Farm Input Subsidy Program (FISP), maize purchases, bail-outs for public enterprises such as the Agricultural Development Market Corporation (ADMARC) which is inefficiently executing social functions, and imposing export bans in a manner that is not predictable and transparent.

There is a clear path to transforming Malawi’s safety net. Changing the mix of programs and strengthening coordination between them will be critical for increasing the efficiency and effectiveness of the safety net. Continued innovation is needed in program design and implementation, especially to strengthen core systems for program delivery. The Government will need to be prepared to commit itself to a national financing strategy that will support an adequate and sustainable safety net system over the long term. Currently, almost the entire safety net system in Malawi is financed by external development partners, but discussions about increasing public funding for safety nets tend to be politically contentious. Malawi’s limited institutional capacity is another major impediment to reforming the current system.

Safety nets have a critical role to promote resilience and long-term development

52. Trends in chronic and transitory poverty highlight the need for a safety net that promotes equity by reducing poverty and increasing food security and resilience in the face of shocks. Over time, Malawi’s poverty rate has remained persistently high, declining only marginally from 52.4 percent in 2004 to 50.7 percent in 2010. Transitory shocks have the potential to exacerbate rural poverty, pushing an additional two out of every five households below the poverty line (Dang and Dabalen, 2017). For example, severe floods generated by El Nino rains in late 2014 negatively affected more than 1 million people and displaced 200,000 (UNDAC, 2015), with the cost of the associated damage estimated to have been as high as US$ 335 million, or 5.2 percent of GDP (Government of Malawi, 2015). This suggests that Malawi will be able to sustain growth and poverty reduction in the medium term only by becoming more resilient to internal and external shocks. It is therefore essential to develop the systems and mechanisms needed to effectively manage shocks.

53. Demographic trends show that Malawi’s safety nets will need to evolve to meet the needs of current and future generations. Malawi’s population is expected to double in approximately two decades, increasing from 17.2 million in 2015 to 34.4 million in 2038 (UNDSA, 2015). At present, 58.2 percent of the population is under 19 years of age, with the working age population constituting a mere 38.8 percent of the total (World Bank, 2016). As Malawi positions itself to reap the potential growth that can come with its
first demographic dividend, there is scope for the safety net system to strengthen human capital and economic empowerment, for example, supporting business enterprise development, employment, and earnings. This recognizes the role of safety nets not just in the short term, but as part of a permanent system that also addresses the intergenerational cycle of poverty.

### Box 4: Core Safety Net Programs

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<thead>
<tr>
<th>Program</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Social Cash Transfer Program (SCTP)</strong></td>
<td>SCTP aims at improving access to basic needs, health, nutrition status and school enrolment of targeted households.</td>
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<tr>
<td><strong>School Meals Program (SMP)</strong></td>
<td>The program provides free and daily school meals to vulnerable primary schools. Objectives include promotion of regular attendance and learning among children.</td>
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<tr>
<td><strong>Nutrition &amp; Access to Primary Education (NAPE) Program</strong></td>
<td>This program complements SMP. Objective is to provide high-quality school meals to primary school-going pupils in 7 selected districts with aim to improve pupils’ participation in schools.</td>
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<tr>
<td><strong>Malawi Social Action Fund Public Works Program (MASAF PWP)</strong></td>
<td>Designed to provide conditional cash transfers to extremely to moderate poor households with labour capacity through participation in community-driven public works. Only safety net program that is fully operational across all districts.</td>
</tr>
<tr>
<td><strong>World Food Program Food for Assets (FFA) program</strong></td>
<td>Aims to reduce immediate need for food security, at the same time, building assets to improve long-term food security and resilience.</td>
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</table>

54. Safety nets are one of several priority poverty and relief responses that currently exist in Malawi, alongside the Farm Inputs Subsidy Program (FISP), ADMARC maize purchases, and humanitarian aid. The MNSSP II defines social safety nets (or social support) as “providing income and consumption transfers to the poor and food insecure, protecting the vulnerable against livelihood risks, and enhancing the social status and rights of the marginalized, with the overall objective of reducing ultra-poverty as well as reducing the economic and social vulnerability of poor and marginalized groups.” The MNSSP II prioritizes five thematic areas of support including: (i) consumption support (Pillar 1); (ii) support for resilient livelihoods (Pillar 2); (iii) shock-sensitive social protection (Pillar 3); (iv) links between safety nets and other programs (cross cutting); and (v) strengthening safety net systems (cross cutting).

55. Malawi has the foundation on which to build a strong safety net, as can be seen in Figure 21.14 Malawi implements five core safety net programs including the Social Cash Transfer Program (SCTP), the School Meals Program (SMP), the Nutrition and Access to Primary Education (NAPE) program, the Malawi Social Action Fund Public Works Program (MASAF PWP), and the World Food Program Food for Assets (FFA) program. Malawi’s core safety net programs are relatively highly concentrated, which is a contrast to the general pattern of program fragmentation across the region. The average number of programs in low-income Africans countries standing at 18 (Beegle et al, 2018). However, the average expenditure on safety net programs in the period from 2011 to 2016 in Malawi was equivalent to 0.6 percent of GDP, a strikingly low figure compared to the average of 1.2 percent across the Africa region.

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14 Analysis in this chapter focuses on core programs identified under an ongoing Social Protection Public Expenditure Review (MoFEPD, UNICEF and World Bank, forthcoming). Excluded from the analysis are any interventions managed by NGOs and non-state actors. This has likely resulted in underestimation of financing and coverage of School Meal Program, which receives considerable financing from an international NGO (Mary’s Meals). Requests for this data were not met.
Figure 21: The State of Safety Nets in Malawi

Sources: World Bank staff calculations based on data from National Authorities and Implementing Agencies, and Beegle et al (2018).
56. Safety net programs are estimated to cover 25 percent of the population, compared to the average of 10 percent covered by safety nets across the Africa region. While this is an encouraging trend, it should be stressed that most of the population is not covered by a safety net and, as discussed shortly, there are challenges in ensuring that existing programs reach the poorest. Finally, Malawi’s safety net coverage is noticeably lower than that of its other priority poverty reduction and relief programs. In 2016, FISP and humanitarian aid (food security and nutrition) coverage reached 37 percent and 33 percent of the population respectively, with an equivalent expenditure of 1 percent and 6 percent of GDP.

57. Although these coverage and financing trends reflect considerable success in scaling up safety nets, the efficiency of Malawi’s various safety net programs vary. An effective safety net system is more than just a collection of well-designed and well-implemented programs. It must also be appropriate, adequate, cost-effective, dynamic and sustainable enough to respond to changing needs and situations (Grosh et al, 2008). In this chapter, we examine whether these elements exist in the current safety net system in Malawi, and, if not, what key reforms will be needed going forward.

Cash transfers are an effective investment

58. There is a considerable technical and political debate about the role of safety nets in Malawi. In political terms, questions about the appropriateness and feasibility of safety nets often dominate the discourse. Several studies have highlighted a concern among technical and political elites in Malawi about the danger of creating a dependency culture/welfare trap by providing cash transfers (Kalebe-Nyamongo and Marquette, 2014 and Chisinga, 2009). In technical terms, there is a debate that has been ongoing since the first MNSSP about whether to target specific categories of beneficiaries (as the SCTP targets the poorest 10 percent for the population), whether to emphasize productivity or direct welfare interventions, and what the most accurate and efficient means are to target beneficiaries (Chisinga, 2009). Underpinning these debates are deep-rooted factors affecting the dynamics of development and institutional reform in Malawi, such as the country’s high dependence on donor financing (Bridges and Woolcock, 2017; Resnick, 2012; and Tambulasi, 2010).

Figure 22: Total Consumption and Food Consumption Estimates
Percentage of transfers

Source: Ralston et al (2017)
59. Malawi’s SCTP has had the strongest and most consistently positive impact of any such program implemented across Africa. Ralston et al (2017) reviewed 55 impact evaluations of 27 social safety net programs in 14 African countries implemented since 2005. They measured equity outcomes using total consumption and food consumption to find out whether households could cover their basic needs. They found that SCTP beneficiaries spent an equivalent of 179 percent of the transfer amount compared to an average of 74 percent across the region (see Figure 22). This points to the importance of community sharing and spillover effects within the program, which stimulated demand for retail, services, and agriculture goods. Overall, SCT beneficiaries increased total consumption by 24 percent and food consumption by 23 percent. This reflects the SCTP’s effective targeting of poor households. Evidence indicates that beneficiary households do not spend these SCTP transfers on temptation goods such as alcohol or tobacco. Critically, these impacts have been achieved at a very modest transfer level, estimated at 18 percent of mean household consumption expenditure (ibid, 2017). Going forward there remains an important policy discussion on the adequacy of this transfer, given food price volatility and inflation.

60. Across the Africa region, Malawi’s SCTP has also produced some of the strongest outcomes in measures related to resilience and long-term opportunities. The SCTP helps households to build up resilience to economic shocks through increased investments in productive assets, specifically livestock holdings, durable assets, and fertilizer. Evidence has also shown that the SCTP has encouraged the development of human capital by incorporating soft conditions and top-up benefits to encourage increased educational attainment in the household. Hoop et al (2017) found the program had contributed to increases in school enrollment rates, school attendance, and education-related expenditure for children. Finally, the SCTP has led to an increase in household micro-entrepreneurial activity and in the time spent on farm activities while also reducing the likelihood of household members engaging in ganyu (casual labor, outside the home) (de Hoop et al, 2017; Zezza et al, 2010; Covarrubias et al, 2017; and Boone et al, 2013).

Box 5: Charting a Way Forward on the MASAF Public Works Program

In 2017, the World Bank undertook a technical assessment to review the implementation of the MASAF PWP and to identify reform priorities for the future (World Bank, 2017). Priority areas for reform that have been identified include:

- **Fiduciary management:** Local procurement and financial management capacity are critical constraints and have triggered recent investigations about the misappropriation of MASAF PWP and other public funds. Project officers have been assigned to each District Council to support the implementation and planning of the program. Program fiduciary supervision and guidance have been strengthened at the national and district levels.

- **Asset creation:** There has been an increased focus on improving the quality of assets by incorporating a catchment management approach or, in other words, integrating nature conservation and livelihood promotion objectives into the criteria for selecting projects. This has required strong outreach by program staff into communities as well as improvements in quality control in the project selection process. Stricter adherence to the MASAF PWP Technical Manual, standards and norms therein is a critical priority.

- **Program timing and duration:** The timing and duration of MASAF PWs is not fully aligned with seasonal considerations or the needs of the beneficiary, and there are periodic delays in the predictability of the cash transfer. Going forward this is an area that will require continuous review and planning. Greater attention will also need to be paid to setting transfers at a level that will ensure that they can provide meaningful support in the face of food price volatility.

The MASAF PWP remains a relevant part of the overall safety net, but it requires some critical reforms. The Government now needs to consider how this program – in terms of its objective, coverage, and targeting – evolves within the overall safety net system.

61. Evaluative evidence has paved the way for modifications to the MASAF PWP. The MASAF PWP is Malawi’s most longstanding safety net and one of Africa’s largest public works programs. It has evolved
into a seasonal safety net program, reflecting the risks faced by Malawi’s poor during the annual agricultural cycle. An impact evaluation conducted in 2012-13 found no significant improvements in the food security of beneficiaries and highlighted several challenges related to the program’s design, such as poor targeting, significant rationing, the relatively small size of the transfers, and the infrequency of payments (Beegle, 2015). Since then, a series of design modifications have been made to the MASAF PWP with a view to improving program effectiveness, including a stronger focus on asset creation, enforcing multi-year employment for beneficiaries, and extending the number of working days offered each year.

62. To date, implementing these changes has been challenging and has raised questions on the future role of MASAF PWP as part of a comprehensive safety net for Malawi. The most recent beneficiary assessment of the program in 2017 found that about 60 percent of beneficiaries used the cash benefit to buy assets, 45 percent saved part of their public works earnings, and 40 percent invested their earnings in an income-generating activity (Local Development Fund, 2017). While this suggests that the MASAF PWP has a strong livelihood function, the data should be interpreted with some caution, as they cannot be as rigorous as the results of a robust impact evaluation would be. A recent round of technical assessments has identified a set of future reform priorities to improve MASAF PWP (see Box 5). Any future consensus on a reform agenda will need to include sustainable arrangements for financing the MASAF PWP, which is currently funded entirely by the World Bank.

63. The information and evidence base across non-cash transfer safety net programs is patchy and limited. For instance, the SMP is the only safety net program that is required by government directive to have universal coverage (MNSSP, 2016). Yet there is a lack of rigorous evidence on the program’s outcomes and on the impact of the different feeding modalities of the SMP (in-school feeding versus take-home rations) and of its procurement models (centralized procurement, grants, or community production). The most immediate effect of in-school feeding is the short-term alleviation of food insecurity. With expenditures of US$ 59 PPP per child per year, Malawi’s school meals were the second most expensive in a comparative study of World Food Program School Meal Programs in Africa, well above the average of US$ 40. Commodities make up 50 percent of the total costs of Malawi’s SMP (MNSSP, 2016).

Strengthening efficiency by reforming the mix of programs and links between them

64. Malawi is at a point where it must review the mix and scale of the programs that constitute its current safety net and the links between these programs and other poverty and relief programs. As noted earlier, Malawi currently implements a small set of safety net programs. From 2011 to 2016, total average expenditure on safety net interventions stood at an equivalent of 0.6 percent of GDP, peaking at 1.4 percent in 2016 at the height of the drought response. While safety nets in Malawi cover a high proportion of the poor relative to other countries, the majority of the population does not have access to a safety net. Individual program coverage varies significantly. In 2016, SCTP4 covered 4 percent of the total population, SMP12 covered 11 percent, and the MASAF PWP 17 covered 12 percent. However, both their coverage and financing are crowded out by the costlier provision of subsidies and humanitarian aid (see Figure 23 and Figure 24). The fiscal implications of these safety net programs are explored in the next section.

65. Although some progress has been made in expanding safety net coverage, the poorest Malawians receive a disproportionately low level of benefits from safety net programs compared to the poorest in other countries. The distribution of benefits across income quintiles in Malawi tends to be flat, which is partly a reflection of the country’s high poverty levels. However, Malawi’s safety net programs do not reach as many of its poorest citizens as those in many countries with a similar GDP per capita level. Safety net programs are estimated to cover 18 percent of those in Malawi’s lowest income quintile, compared with 29 percent in Mozambique, 28 percent in Zimbabwe, and 25 percent in Ethiopia (Beegle et al, 2018). Therefore, there is clearly a need to improve the targeting of Malawi’s safety net programs. There is a need to both expand program coverage and improving existing targeting approaches. For example, the SCTP is constrained by district threshold levels, with targeted upper limits of 10 percent of the population. This geographical uniform cut-off point may lead to significant inclusion and exclusion errors.
Figure 23: Spending on Safety Net Programs, the FISP, and Humanitarian Aid (Food Security and Nutrition)
Percent of GDP

Figure 24: Coverage of Safety Net Programs, the FISP, and Humanitarian Aid (Food Security and Nutrition)
Percent of population

Source: World Bank staff calculations based on data from National Authorities and Implementing Agencies.

Note: The number of covered individuals was calculated by multiplying the number of covered households by 4.5 (the average household size). The coverage of the FFA PWP and MVAC, while reported on a yearly basis, is seasonal and is spread out over two years. For the SMP and the NAPE, coverage is expressed as a share of the total population in the 0 to 14 age group. The figures for Humanitarian Aid/MVAC include only the food security and nutrition cluster.
66. Malawi can draw lessons from experiences in other countries on how best to scale up and refine its social safety net system (see Box 6). In recent years, one of the most notable trends in Malawi has been the expansion of targeted cash transfers under the MASAF PWP and the SCTP. Currently, 57 percent of safety net benefits in Malawi are paid in cash, compared to a regional average in low-income African countries of 42 percent (Beegle et al., 2018). This trend is set to increase in coming years, driven in large part by evaluative evidence of the success of this approach. At the time of writing, the SCTP is being scaled up nationwide, which will bring the program’s total coverage to approximately 12 percent of the population and almost 40 percent of the ultra-poor. Cash transfers have the potential to be even more effective if they are linked to other relief efforts (such as humanitarian responses) and are designed to encourage long-term human capital development.

67. Against a backdrop of growing humanitarian aid coverage and financing (see Figure 23 and Figure 24), the focus of policymakers has shifted to making the safety net system more resilient to shocks. As discussed under Pillar 3 of the MNSSP II, a shock-sensitive safety net should be designed to meet needs that vary by season, to prepare for and respond to unpredictable shocks together with the humanitarian sector, and to support recovery efforts and the return to regular programming. Becoming shock-sensitive will require Malawi’s safety net to meet the needs of what is often an unpredictable caseload of vulnerable beneficiaries. This will require fundamental reform of institutional arrangements, information systems, and transfer modalities (Holmes et al., 2017). It will also involve addressing underlying political economy factors such as incentives within both international agencies and across the Government to undertake reforms (O’Brien et al., 2017). Neither of these tasks will be easy. However, strengthening the shock sensitivity of safety nets is likely to yield cost efficiencies. Close to 35 percent of Malawi’s 2016 humanitarian aid expenditure (for food security and nutrition) was spent on administrative costs, the equivalent of 2 percent of GDP. This compares to administrative costs of 18 percent and 10 percent for the Government-led SCTP and MASAF PWP, respectively. There was wider variation in the administrative costs of WFP-led safety net interventions, with the highest being FFA with 35 percent in 2016.

68. The development of a shock sensitive safety net can help to sustain Malawi’s medium-term growth and poverty reduction efforts. As highlighted in Part 1, Malawi’s agricultural commodity prices are among the most volatile in the region. The negative impact of climate-induced shocks has been exacerbated by policy-induced distortions that contribute to market failures (e.g. export bans, natural shocks and weak performing grain markets continue to be the main impediments to reducing rural poverty). Recurring droughts also undermine improvements in crop production and poverty reduction efforts (World Bank, 2018). Making Malawi’s safety net shock sensitive would help to mitigate these problems and there are a number of important efforts now underway to work towards this, e.g. a pilot expansion of the SCTP, adaptation of core delivery systems for shock response (e.g. payments mechanisms) and, as discussed shortly, a review of financing mechanisms for crisis settings.

69. Malawi’s safety net should have a more systematic focus on building human capital and creating livelihood opportunities. Pillar 2 of the MNSSP II identifies two ways to do this: (i) livelihood enhancement interventions to help recipients to develop skills to access capital, and to build enterprises and (ii) human capital development interventions to increase access to education, health, and nutrition services, thus breaking the inter-generational cycle of poverty. Malawi already has several programs designed to enhance livelihoods, including the Community Savings and Investment Promotion (COMSIP) program, the Village Savings and Loan (VSL) program, MASAF PWP and various skills development programs, all of which have the potential to contribute to this aim. The MNSSP also emphasizes the importance of ensuring that interventions complement each other, which will require robust and regular communication between sectors. Global experience has shown that taking this approach to education, health, and nutrition interventions, for example, is likely to be much more effective than if the sectors operate independently (Ralston et al., 2017). An important future focus is the potential of safety nets to improve human capital outcomes for specific age cohorts e.g. a focus on investment in early childhood development through...
nutrition sensitive investments, and securing safe adolescent transition to adulthood through investments in secondary education, especially for girls.

**Box 6: Lessons in Scaling Up Social Safety Nets across Africa**

In recent years, the number of social safety net programs in Africa has exploded. Cash transfer programs are being implemented in almost all (46) countries, while public works programs are implemented in 33 countries and school feeding programs in 28. Important lessons have been learned during this process, especially in places where safety nets have been scaled up rapidly such as Ghana, Kenya, Senegal, and Tanzania.

- **The value and structure of a cash transfer matters.** The low initial value of Ghana’s LEAP transfer (4 percent of baseline consumption) was identified as an important constraint to the project’s success. The experience of Kenya’s GIVE program suggests that reducing the frequency of transfers while increasing their value by a corresponding amount might improve household resilience outcomes.

- **The impact of programs relies on their predictability.** In Zambia, 98 percent of households receiving the Social Cash Transfer received their payments on time, with this – combined with short walking distances to payment sites and low transaction costs – explaining the program’s high success rate.

- **Complementary programs:** Coordinating complementary programs is critical for maximizing the positive effects of the safety net system, for example, linking safety nets with agricultural sector programs (as is the case in Ethiopia and Lesotho) or with training and employment schemes (as in Uganda).

- **Role of conditionality:** Building in explicit design features to motivate beneficiaries to make positive changes in their behavior is critical. Many safety net programs feature ‘soft conditionality’ (i.e. conditions are not enforced but officially remain a responsibility of the beneficiary household). This can be achieved through program messaging, so that beneficiaries perceive the development intent of the program, as in Lesotho and Niger.

- **Preparing for recurrent crises:** It is critical to build the capacity of safety net programs during good times. In 2012, Tanzania’s TASAF program was scaled up from 275,000 to 1.1 million households, with a view to setting in place a permanent system of support for both chronic and transitory response.

Source: Ralston et al (2017)

**Country systems can be improved through innovation and institutional reform**

70. **Strengthening core delivery systems can increase the effectiveness of safety nets and other poverty reduction programs.** Across Africa, the expansion of safety net systems has arisen concomitantly with significant investments in core systems, including targeting, social registries, and payment mechanisms. In Malawi, the implementation of the Unified Beneficiary Registry (UBR) has been a key innovation. The UBR is a social registry that contains information on the key socioeconomic characteristics of all households in Malawi, with the aim of acting as a universal platform for the consolidated intake, enrollment and registration of eligible beneficiaries for all social support programs. So far, it has been applied in 11 districts in Malawi (with the poorest 50 percent of households being registered in 10 districts and 100 percent being registered in one district) and will expand to a further 14 districts during 2018. The current pilot is intended to: (i) reduce both financial and time costs in the beneficiary selection process for each program and (ii) facilitate better coordination and links between programs. A rapid assessment of the UBR system by the World Bank found that the registry’s institutional capacity and oversight were strong, its technology platform performed well, and the quality of the data was solid (World Bank, forthcoming). Thus, the UBR has significant potential to improve and streamline poverty targeting.

71. **The recent consultation process for MNSSP II highlighted several concerns regarding the governance and institutional structures behind Malawi’s safety net system (MoFEPD, 2016).** Currently, the provision of social safety net support is characterized by fragmentation at the national level. Several different line ministries are tasked with various aspects of implementing the programs, and the Ministry of Finance Economic and Planning Development does not have sufficient capacities to ensure that all stakeholders...
are held accountable or to enforce cross-ministerial coordination. A crucial problem is the absence of an adequate monitoring and evaluation system for the MNSSP. Therefore, if any links between programs exist, they are not guided by specific policies or through shared administrative systems.

72. The coordination of donor efforts is also a key issue. As noted during the MNSSP II consultation process (MoFEPD, 2016), Malawi’s social safety net programs consist largely of donor-funded programs, with only some of them using government systems. The SMP has hardly any government involvement, whereas the SCTP and MASAF PWP make considerable use of government systems. This raises concerns about the ownership and sustainability of the programs that exist almost independently of the Government. The donors that fund these programs contribute to this fragmentation by adopting different financing structures and implementation modalities, which makes it difficult to coordinate their initiatives, even those that exist within the same program, such as the SCTP.

73. Finally, ineffective coordination at the district level is one of the most significant constraints to the development of a more coherent system. Throughout the recent MNSSP II consultation process, district-level stakeholders stressed that better coordination and integration among safety net programs would result in more efficient use of district officers’ time and energy. Currently, each MNSSP II program requires district offices to participate in a range of meetings, often involving the same stakeholders. Efforts are now underway to create single social protection committees in every district to coordinate programs at the district level. However, coordination is only part of the problem, as programs must also contend with inadequate resourcing, infrastructure and staffing, which limit their ability to operate effectively at the district level.

Figure 25: Financing Sources for Social Safety Nets Across Africa

Fiscal space is available to devise sustainable financing for safety nets into the future

74. The financing of safety nets is not sustainable at current levels, given Malawi’s overwhelming dependence on development partner support. At present, only 6 percent of all safety net expenditure in Malawi is financed by the Government. In terms of the limited domestic resources available to finance the safety net, Malawi is in a comparable situation to many other African countries (see Figure 25). However,
experience across the region (particularly in Senegal and Kenya) suggests that it is possible to (i) increase the level and strengthen the sustainability of financial resources; (ii) identify the most appropriate mix of domestic, foreign, public, and nonpublic funding sources; and (iii) deploy a flexible financing strategy to respond to shocks and crises (Beegle et al., 2018). For most African countries this will require long-term incremental planning. For Malawi, there are three possible directions to follow.

75. First, there is scope to reallocate resources from less effective poverty reduction initiatives, particularly the FISP. In recent years, Malawi’s agriculture budget has focused disproportionately on the provision of fertilizer and seed subsidies, particularly subsidies for maize provided through the FISP. In the period from 2011 to 2016, the average expenditure on the FISP was equivalent to 2 percent of GDP. While the FISP is overseen by the Ministry of Agriculture, one of its key goals has been social protection for the rural poor. However, there have been longstanding concerns that the FISP crowds out more effective and productive interventions within the agriculture sector and that it is driven by political imperatives rather than evidence-based needs (World Bank, 2016; IFPRI, 2011; and Chibwana and Fisher, 2011).

76. As part of their recent prioritization of expenditures, the Government has piloted reforms to the FISP aimed at restricting its focus to agricultural objectives while simultaneously scaling up the provision of cash transfers (through the SCTP) to the poorest households. Analysis by the World Bank (2016) estimated that reallocating expenditure from the FISP to the SCTP would increase the income levels of those in the lowest decile of the population by 9 percent. There would also be far less leakage of benefits to households in the higher income deciles than is currently the case under the FISP. This conclusion was in line with an analysis conducted by the IMF (2015), which found that reforms to FISP need to be complemented by increased cash transfer programming and increased investments in agricultural research and development.

**Box 7: Case Study of Contingency Financing in the Northern Uganda Social Action Fund**

The World Bank–financed Northern Uganda Social Action Fund (NUSAF) III project has a US$ 12 million disaster risk finance (DRF) component. This component provides additional post-disaster support to vulnerable households by automatically scaling up the NUSAF III’s Labor Intensive Public Works (LIPW) activities during crises to build the resilience of beneficiary households.

The DRF component was initially piloted in Karamoja, where households are acutely vulnerable to drought. The World Bank Group team worked closely with the Government of Uganda to: (i) streamline data collection and analysis to develop an appropriate index to monitor drought; (ii) establish clear triggering rules for disbursing funds from the DRF mechanism; and (iii) establish a US$ 10 million reserve fund (using project resources) that can be drawn down to finance the expansion of the LIPW.

The 2016 El Niño caused widespread drought in the Karamoja region. The parametric index developed under the NUSAF project captured the drought and triggered a scaling up of the LIPW. As a result, US$4.1 million was disbursed to finance disaster assistance to approximately 30,000 households, or 150,000 people, in Karamoja. It is estimated that the DRF component of NUSAF III will finance the cost of scaling up LIPW to a total of 80,000 additional households (400,000 people) over the lifetime of the operation.


77. Second, there is scope to redirect humanitarian financing towards safety net responses. In the period from 2011 to 2016, the value of humanitarian aid (for food security and nutrition) averaged 2.2 percent of GDP, reaching a peak of 6 percent in 2016. The scale of humanitarian financing relative to GDP places Malawi with a small group of fragile and conflict-affected countries in Africa including Central African Republic (22 percent), South Sudan (11 percent), Somalia (9 percent), Liberia (9 percent), Sierra Leone (9 percent), and Mali (2.1 percent). The level in Malawi is significantly higher than the levels spent in
comparator countries such as Mozambique (0.15 percent), Rwanda (0.28 percent), Tanzania (0.09 percent), Uganda (0.38 percent), and Zambia (0.04 percent) (Beegle et al, 2018).

78. However, there are some serious constraints to redirecting humanitarian financing. Humanitarian aid is provided outside the Government system and is not fungible. There are critical questions regarding whether current donors would be prepared to make multi-year commitments to finance seasonal and scalable safety net interventions instead of providing shorter-term humanitarian aid to fill the annual hunger gap. This is a big challenge that policymakers will need to consider if a radical shift in the way Malawi handles seasonal food gaps is to be achieved (Holmes et al, 2017).

79. Third, there are opportunities to explore contingency or reserve financing mechanisms to make safety nets more shock sensitive. Contingency or reserve funds can be established to finance relief, rehabilitation, reconstruction, and prevention activities in emergencies. These are currently used in, for instance, Colombia, Costa Rica, India, Indonesia, the Marshall Islands, Mexico, the Philippines, the Lao People’s Democratic Republic, and Vietnam. Several African countries such as Kenya, Mozambique, and Madagascar are working on establishing similar funds, with a recent successful application in Uganda (see Box 7). These initiatives provide households with loans to increase their liquidity immediately following an exogenous shock. They have been used by multilateral development banks to create lines of credit that can be activated if a shock occurs.

80. Finally, improving the current funding structures for safety nets will be essential to underpin any new financing strategy. The current funding arrangements for the MNSSP are fragmented and inefficient. Concerns over fiduciary risks have led MNSSP donors to avoid using the Government financial systems, which has created a fragmented and inefficient funding system. Developing the right environment to enable funds to be harmonized and potentially pooled is a priority (MoFEPD, 2016). Recently the Government has set in place a Social Support Fund Task Force, which will play a critical role in advancing this discussion.

There is a clear path to transforming Malawi’s safety net

81. Momentum from the MNSSP II is creating an important opportunity to discuss long-term reforms to Malawi’s safety net system. As these discussions take place, there are several critical shifts that will need to take place to align the safety net system with the vision put forward in the MNSSP II. Based on our analysis of the problems facing the safety net system in Malawi, we make the following recommendations:

82. Program mix: Although coverage and financing trends are positive, gaps remain, and Malawi’s safety net remains inefficient compared to those of other countries. One considerable challenge is finding an appropriate mix of programs over time. Looking ahead, there is a need for more evidence, particularly about the cost-effectiveness of longstanding programs such as the MASAF PWP and the SMP. The example of the SCTP demonstrates the necessity of having rigorous evidence to ensure the effectiveness of interventions and to enable them to be successfully scaled up.

83. Financing strategy: A national financing strategy for an effective and sustainable safety net needs to be developed as soon as possible. The Government needs to establish and meet domestic spending budgets for safety net interventions, which are currently almost exclusively donor financed. A starting point may be to consider ways to reallocate fiscal spending with the aim of providing a more progressive and effective mix of safety net programs. The ongoing FISP reforms are an obvious starting point for discussing how this might be done. Policymakers should also consider establishing and funding contingency or reserve financing mechanisms to link safety net, humanitarian, and disaster responses more effectively.

84. Program Design (Targeting): Ongoing efforts to improve the targeting of support to the chronic and transitory poor should be sustained. This requires continued review of targeting practices and innovations, including geographic, community and means testing approaches. In supporting these efforts, an important step forward is the expansion of the UBR to administer the intake, enrollment, and registration of eligible
beneficiaries for all safety net programs and to establish links with other sectoral and humanitarian interventions. However, scale up of the UBR will only be successful if there is a predictable implementation and financing strategy in place and if key roles and responsibilities in the implementation of the UBR are established with sufficient flexibility to adapt to lessons learned along the way. If the UBR can be implemented nationwide successfully, then it can serve as a best practice example for other African countries that are currently taking initial steps towards creating their own unified registries.

85. Program Design (Public works): Ongoing efforts to review the MASAF PWP, Malawi’s longest running safety net intervention, need to be consolidated. Over time, many challenges have arisen regarding the implementation of this program, which have raised questions about its future. Recent technical assessments have recommended reforming the program’s fiduciary management asset creation and fitting the program more effectively around the seasonal cycle. Central to any future reform agenda will be deciding how to fund the program, which up until now has been entirely financed by the World Bank.

86. New program directions (Shock-sensitive safety nets): Safety nets need to be designed so that they can be scaled up during temporary crises to help households be resilient during those times and to reduce Malawi’s dependence on humanitarian aid. Currently, safety nets and humanitarian aid operate completely separately from each other, despite having many overlapping functions. The fact that shocks will occur is predictable, but their timing and scale is not so there will always be households that will repeatedly need periodic support at these times. Other households require assistance during certain seasons. Therefore, there is a need to improve the predictability and adequacy of the support provided to these households. There are different ways to achieve this. First, consideration should be given to moving away from the current system of identifying households through annual targeting exercises (though this system will remain relevant for households facing exceptional shocks). Second, sustainable financing mechanisms will be needed for these safety nets that are reliably resourced for several years at a time. Third, existing safety net programs will need to be redesigned to have the adaptive capacity to be scaled up according to needs that vary at different times.

87. New program directions (Human capital): Malawi’s safety net must take a more systematic approach to building the human capital of its beneficiaries and creating livelihood opportunities for them in the context of changing demographic patterns, skill requirements, and the political environment. One of the key lessons emerging from experience elsewhere in Africa is the importance of ensuring that interventions are complementary and coordinated and that all the relevant sectors cooperate. For example, taking this approach to education, health, and nutrition interventions is likely to be much more effective in breaking the inter-generational cycle of poverty than if the sectors operate independently. Two immediate areas where this approach could be taken is the promotion of early childhood development through nutrition-sensitive safety net interventions and the provision of livelihood enhancement interventions focusing on skills development, access to capital, and livelihood development.

88. Institutional arrangements: The efficiency and effectiveness of Malawi’s social safety net is marred by institutional shortcomings at both the national and district levels. It is also hampered by a lack of coordination between development partners. Sustained reforms must be implemented to address all these issues, with due consideration given to the broader political economy challenges noted at the outset of this review. The focus of these reforms needs to be at all levels of implementation and involve different stakeholders, including development partners.
### Data

#### Table 2: Selected macroeconomic indicators

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<td><strong>National Accounts and Prices</strong></td>
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<tr>
<td>GDP at constant market prices (percentage change)</td>
<td>5.7</td>
<td>2.8</td>
<td>2.5</td>
<td>4.0</td>
<td>3.7</td>
</tr>
<tr>
<td>Agriculture</td>
<td>5.9</td>
<td>-2.0</td>
<td>-2.3</td>
<td>5.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Industry</td>
<td>4.7</td>
<td>3.5</td>
<td>2.4</td>
<td>2.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Services</td>
<td>5.8</td>
<td>4.7</td>
<td>4.4</td>
<td>4.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Consumer prices (annual average)</td>
<td>23.8</td>
<td>21.9</td>
<td>21.7</td>
<td>11.5</td>
<td>10.9</td>
</tr>
<tr>
<td><strong>Central Government (percent of GDP on a fiscal year basis)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue and grants</td>
<td>23.2</td>
<td>21.4</td>
<td>21.6</td>
<td>23.5</td>
<td>21.7</td>
</tr>
<tr>
<td>Domestic revenue (tax and nontax)</td>
<td>19.7</td>
<td>18.6</td>
<td>17.8</td>
<td>20.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Grants</td>
<td>3.5</td>
<td>2.8</td>
<td>3.7</td>
<td>3.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Expenditure and net lending</td>
<td>28.9</td>
<td>27.1</td>
<td>27.6</td>
<td>28.2</td>
<td>28.9</td>
</tr>
<tr>
<td>Overall balance (excluding grants)</td>
<td>-9.2</td>
<td>-8.5</td>
<td>-9.8</td>
<td>-8.2</td>
<td>-9.9</td>
</tr>
<tr>
<td>Overall balance (including grants)</td>
<td>-5.7</td>
<td>-5.7</td>
<td>-6.1</td>
<td>-4.8</td>
<td>-7.1</td>
</tr>
<tr>
<td>Foreign financing</td>
<td>2.0</td>
<td>2.5</td>
<td>1.9</td>
<td>2.5</td>
<td>3.2</td>
</tr>
<tr>
<td>Domestic financing</td>
<td>4.2</td>
<td>3.3</td>
<td>1.7</td>
<td>0.9</td>
<td>4.6</td>
</tr>
<tr>
<td>Amortization (zero coupon bonds)</td>
<td>0.0</td>
<td>0.8</td>
<td>2.5</td>
<td>1.3</td>
<td>-0.9</td>
</tr>
<tr>
<td>Privatization Proceeds</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.3</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Money and Credit</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money and quasi money (percentage change)</td>
<td>20.7</td>
<td>23.7</td>
<td>15.2</td>
<td>19.7</td>
<td>12.6</td>
</tr>
<tr>
<td>Credit to the private sector (percentage change)</td>
<td>20.0</td>
<td>29.9</td>
<td>4.6</td>
<td>0.4</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>External Sector (US$ millions, unless otherwise indicated)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports (goods and services)</td>
<td>1,737</td>
<td>1,616</td>
<td>1,502</td>
<td>1,675</td>
<td>1,800</td>
</tr>
<tr>
<td>Imports (goods and services)</td>
<td>2,399</td>
<td>2,346</td>
<td>2,569</td>
<td>2,606</td>
<td>2,727</td>
</tr>
<tr>
<td>Gross official reserves</td>
<td>588</td>
<td>670</td>
<td>605</td>
<td>757</td>
<td>703</td>
</tr>
<tr>
<td>(months of imports)</td>
<td>3.1</td>
<td>3.4</td>
<td>2.9</td>
<td>3.3</td>
<td>3.0</td>
</tr>
<tr>
<td>Current account (percent of GDP)</td>
<td>-8.5</td>
<td>-9.2</td>
<td>-14.7</td>
<td>-11.3</td>
<td>-9.2</td>
</tr>
<tr>
<td>Exchange rate (MWK per US$ average)</td>
<td>424.4</td>
<td>499.6</td>
<td>714.8</td>
<td>727.5</td>
<td>-</td>
</tr>
<tr>
<td><strong>Debt Stock and Service</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External debt (public sector, percentage of GDP)</td>
<td>33.1</td>
<td>37.0</td>
<td>33.2</td>
<td>32.6</td>
<td>32.1</td>
</tr>
<tr>
<td>Domestic public debt (percentage of GDP)</td>
<td>14.9</td>
<td>16.8</td>
<td>21.2</td>
<td>22.6</td>
<td>22.2</td>
</tr>
<tr>
<td>Total public debt (percentage of GDP)</td>
<td>48.0</td>
<td>53.8</td>
<td>54.4</td>
<td>55.1</td>
<td>54.3</td>
</tr>
<tr>
<td><strong>Poverty</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>International Poverty rate (US$ 1.9 in 2011 PPP terms)</td>
<td>69.3</td>
<td>69.4</td>
<td>69.6</td>
<td>69.4</td>
<td>69.1</td>
</tr>
<tr>
<td>Lower middle-income poverty rate (US$ 3.2 in PPP terms)</td>
<td>87.4</td>
<td>87.5</td>
<td>87.3</td>
<td>87.7</td>
<td>87.6</td>
</tr>
<tr>
<td>Upper middle-income poverty rate (US$ 5.5 in PPP terms)</td>
<td>95.6</td>
<td>95.6</td>
<td>95.7</td>
<td>95.8</td>
<td>95.8</td>
</tr>
</tbody>
</table>

Source: World Bank staff calculations based on MFMod, MoFEPD, RBM and IMF data
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