

JULY 2023

**POWERING**

**MALAWI'S GROWTH**

**RAPIDLY AND SUSTAINABLY  
INCREASING ENERGY ACCESS**



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# ABBREVIATIONS

<b>AIP</b>	Affordable Inputs Programme	<b>MRA</b>	Malawi Revenue Authority
<b>BAU</b>	Business as Usual	<b>MW</b>	Megawatt
<b>BOP</b>	Balance of Payments	<b>MWK</b>	Malawi Kwacha
<b>DRM</b>	Disaster Risk Management	<b>NEP</b>	National Energy Policy
<b>DSA</b>	Debt Sustainability Analysis	<b>NES</b>	National Electrification Strategy
<b>ECF</b>	Extended Credit Facility	<b>NLB</b>	Net Lending and Borrowing
<b>EDF</b>	Export Development Fund	<b>NNNF</b>	Ngwee Ngwee Ngwee Fund
<b>EMDEs</b>	Emerging Markets and Developing Economies	<b>NPL</b>	Non-Performing Loan
<b>ESCOM</b>	Electricity Supply Corporation of Malawi	<b>NSO</b>	National Statistics Office
<b>FY</b>	Fiscal Year	<b>PAYE</b>	Pay-As-You-Earn
<b>GDP</b>	Gross Domestic Product	<b>PAYG</b>	Pay-As-You-Go
<b>GoM</b>	Government of Malawi	<b>PDNA</b>	Post Disaster Needs Assessment
<b>HFPS</b>	High-Frequency Phone Survey	<b>PFM</b>	Public Financial Management
<b>IDA</b>	International Development Association	<b>PPG</b>	Public and publicly guaranteed
<b>IFI</b>	International Financial Institution	<b>PPP</b>	Purchasing Power Parity
<b>IFMIS</b>	Integrated Financial Management Information System	<b>PSF</b>	Price Stabilization Fund
<b>IMF</b>	International Monetary Fund	<b>RBF</b>	Result-based Financing
<b>LIC</b>	Low Income Country	<b>RBM</b>	Reserve Bank of Malawi
<b>LV</b>	Low Voltage	<b>ROA</b>	Return on Assets
<b>MAIIC</b>	Malawi Agricultural and Industrial Investment Corporation	<b>ROE</b>	Return on Equity
<b>MAREP</b>	Malawi Rural Electrification Program	<b>SDG</b>	Sustainable Development Goals
<b>MTDS</b>	Medium-Term Debt Strategy	<b>SHS</b>	Solar Home System
<b>MEAP</b>	Malawi Energy Access Program	<b>SOE</b>	State Owned Enterprise
<b>MEM</b>	Malawi Economic Monitor	<b>SSA</b>	Sub-Saharan Africa
<b>MIS</b>	Management Information System	<b>TA</b>	Technical Assistance
<b>MoE</b>	Ministry of Energy	<b>TT</b>	Telegraphic Transfer
<b>MoFEA</b>	Ministry of Finance and Economic Affairs	<b>USAID</b>	United States Agency for International Development
<b>MPC</b>	Monetary Policy Committee	<b>VAT</b>	Value Added Tax
		<b>Y-o-Y</b>	Year-on-Year

# OVERVIEW

## Malawi's economy continues to struggle amidst a devastating cyclone, rising inflation and a protracted macro-fiscal crisis

**Weak growth performance in 2022 was driven by longstanding macroeconomic imbalances culminating in a protracted balance of payments (BOP) crisis and was exacerbated by numerous external shocks.** The economy was weakened by foreign exchange shortages that constrained the importation of essential commodities and production inputs, a generally unfavorable external environment, and continued challenges in advancing key macroeconomic and governance policy reforms. This constrained growth for 2022 to just 0.9 percent, equating to a per capita output reduction of 1.8 percent.

**The widespread destruction caused by Cyclone Freddy and the persistence of external balance challenges in early 2023 already weighed down economic performance for the current year.** Cyclone Freddy was the most destructive in a series of increasingly frequent extreme weather events affecting Malawi, causing US\$505 million material loss and damage, as well as production losses equivalent to a real gross domestic product (GDP) loss of 0.5 percent for 2023. The effects of the cyclone have particularly impacted the outlook for the agriculture sector in the coming season, with potentially grave consequences for the poorest.

**Higher domestic food prices due to disappointing harvests and high agricultural input prices continue to exert pressure on household incomes, pushing many into poverty.** The proportion of people living on less than US\$2.15 Purchasing Power Parity (PPP) per capita a day (approximately Malawi kwacha (MWK) 1,220 as of April 2023) increased to 71.3 percent in 2022. High fertilizer prices as well as the increased growth potential of other crops has caused many households to shift away from maize towards legumes, oilseeds, and nuts. While this could result in reduced supply of staples and consequently upward pressure on domestic food prices, it could also result in increased agricultural export potential and diversification. The Government's efforts to support commercialization and diversification through the "Mega Farms Programme" could further accelerate this favorable dynamic if implemented in a way that incentivizes private sector participation.

**The industrial sector has been particularly impacted by foreign exchange, fuel, and electricity shortages.** While the fuel allocation mechanism is not public, industry often is first affected by rationing. Industry is reliant on adequate electricity supply, which was intermittent throughout 2022 and the start of 2023. In recent years Malawi has often struggled to meet the country's energy supply requirements. The partial restoration of the Kapichira hydroelectric power station is a first step towards the alleviation of energy supply challenges. Larger plans to increase generation capacity both through the expansion of solar power generation and the Mpatamanga hydropower plant could further address energy needs, but this will take time.

**Industry is also reliant on accessing capital and production inputs, but Malawi's imports continue to be constrained by the foreign exchange shortages.** Inputs are often not accessible in the domestic market and the ensuing BOP crisis makes their importation difficult. Official real imports in the year to April 2023 are at a level approximately 65 percent below their 5-year average through 2021, though this likely overstates the actual decline in imports given the significant volumes of informal trade. However, a robust start to the tobacco marketing season promises some alleviation this year, while the growth of new non-traditional agricultural exports, and increased investor interest in the mining sector, could generate new sources of foreign exchange over the medium term.

## The FY2023/24 budget signals a shift towards consolidation, but successful implementation depends on improved fiscal governance

**Driven by expenditure overruns, the planned fiscal deficit for FY2022/23 was exceeded by over 4 percent of GDP.** Supported by good performance in taxes and grants, revenue surpassed the FY2022/23 target. However, Government overspent in compensation of employees and acquisition of non-financial assets (previously development expenditure) resulting in significant expenditure overruns and consequently offsetting the good performance in revenue collection. The fiscal deficit worsened to 10.9 percent of GDP, exceeding the revised mid-year target of 6.4 percent of GDP. This lack of budget discipline has been a consistent feature over recent years, with the fiscal deficit largely financed by domestic borrowing.

**Government projects that the fiscal deficit will reduce in FY2023/24, but fiscal room remains highly constrained.** Although the fiscal deficit is projected to narrow, it will remain high at 7.7 percent of GDP in FY2023/24. Revenue is projected to improve to 16.0 percent of GDP, while expenditure is projected to decline to 23.8 percent of GDP. Amidst rising domestic interest rates and high domestic debt levels, interest payments are projected to increase to 5.7 percent of GDP in FY2023/24 from 4.8 percent of GDP in FY2022/23, leaving little room for much-needed investment, and constraining the government's ability to respond to shocks.

**In this context, doing more with less will be essential, including making further progress on ongoing fiscal governance reforms.** The Government is making some strides in implementing public financial management (PFM) reforms to improve expenditure management and advance the fiscal consolidation process. Since the beginning of FY2023/24, the Government is piloting quarterly budgetary allotments and requiring Ministries, Departments, and Agencies to commit up to the amount allotted within the Integrated Financial Management Information System (IFMIS). If properly implemented, this will help address overcommitments, which have resulted in the growth of spending arrears.

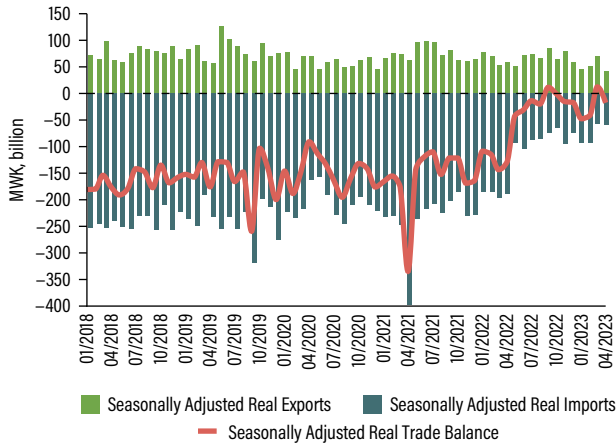
**Government debt is still in distress and unsustainable, but ongoing debt restructuring negotiations, if successful, will help ease the burden.** Weak performance of the external sector and the deteriorating fiscal deficit have contributed to worsened debt vulnerabilities, already pressured by rising debt and debt servicing costs. The joint World Bank-IMF November 2022 Debt Sustainability Analysis reported that public debt is in distress under current policies, but achieving progress in the ongoing debt restructuring negotiations with commercial and bilateral creditors would bring debt on a downward trajectory over the medium term.

**The Malawi kwacha has experienced a sharp depreciation, as foreign exchange shortages remain severe.** The Malawi kwacha continued to weaken, with spreads exceeding 50 percent between telegraphic transfer (TT) and bureau MWK-US\$ exchange rates. Gross foreign exchange reserves remain at around 0.8 months of import cover. Net reserves have been negative for over one year, and gross reserves have been mainly supported by swaps as well as World Bank International Development Association (IDA) project disbursements and the International Monetary Fund (IMF) Rapid Credit Facility approved in November 2022. Various measures to rebuild foreign reserves, including conducting foreign exchange auctions, have had limited impact on foreign exchange accumulation so far, as foreign exchange sales by the Reserve Bank of Malawi (RBM) have continued. However, the introduction of foreign exchange auctions is contributing to the facilitation of price discovery and addressing the growing exchange rate misalignment.

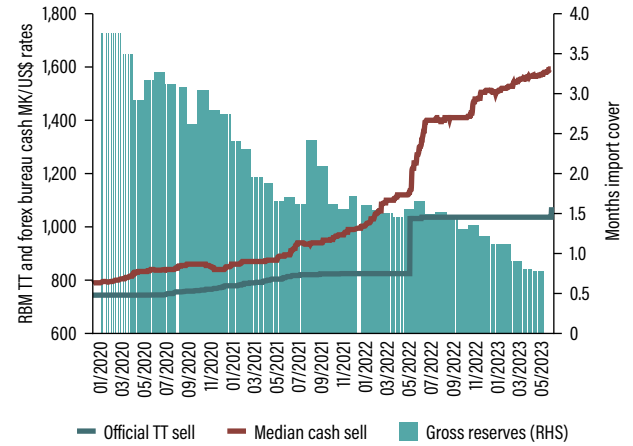
**The tightening of monetary conditions has been insufficient to contain inflationary pressures—in large part due to the continued increase in the money supply.** The Monetary Policy Committee (MPC) increased the policy rate from 18 to 22 percent in April 2023. This policy rate increase and strong Government demand led to a rise in monthly average treasury bill and note yields. Despite some efforts by the RBM to address rising inflation, the real policy rate has been negative, reaching -7.2 percent and the money supply has continued to expand.

**FIGURE 0.1** A snapshot of Malawi's economic situation

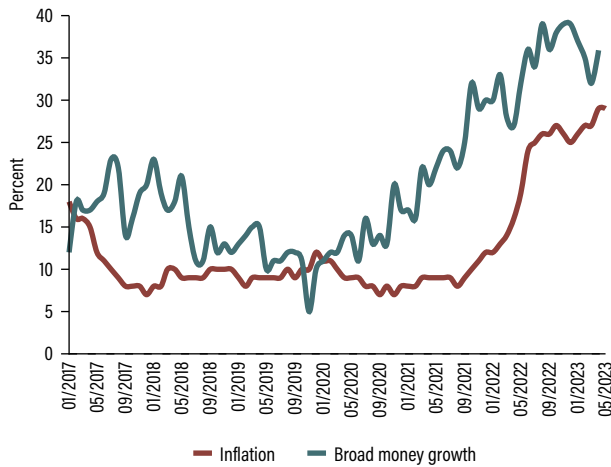
a. Shortage of foreign reserves has constrained imports and exports, contributing to an improved trade balance



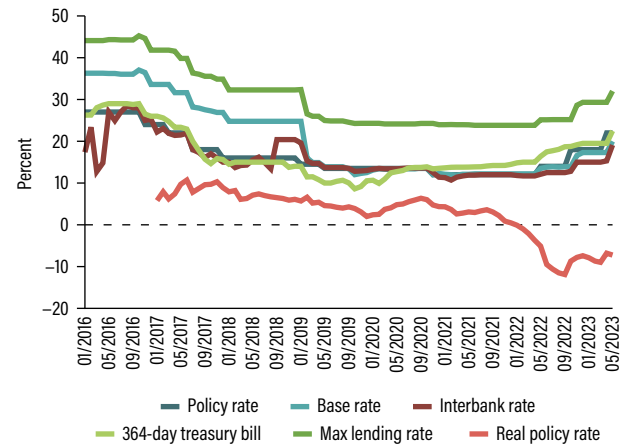
b. The exchange rate remains overvalued, despite the continued decline of foreign exchange reserves



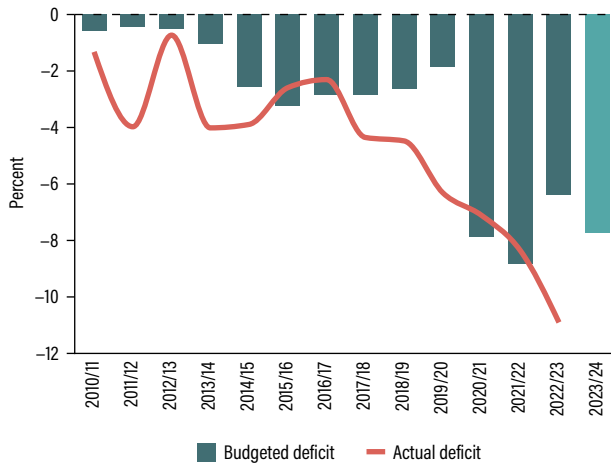
c. Inflation has been rising, with pressures from the increased money supply mounting



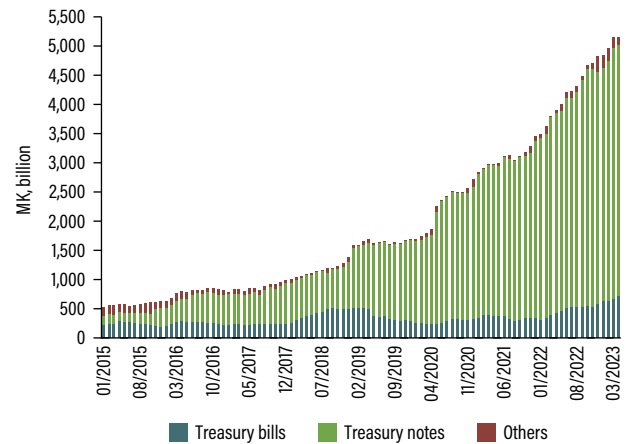
d. The RBM has adjusted the policy rate to address rising inflation, but the real policy rate is still negative



e. Spending overruns continue to drive the fiscal deficit beyond budgeted levels



f. Deficits are largely financed through domestic borrowing, and the issuance of high-cost treasury notes



Sources: a. World Bank staff calculations based on National Statistics Office Trade Bulletin data and RBM Consumer Price Index data; b. World Bank staff calculations based on RBM data; c. World Bank with data from RBM and NSO; d. World Bank staff calculations based on RBM data; e. World Bank with data from Ministry of Finance and Economic Affairs.; f. World Bank staff calculations based on RBM data.

## Getting Malawi back on track will require significant reforms to increase macro-stability, growth, and resilience

**The growth of Malawi's economy is projected to slightly pick up in 2023, followed by higher rates of growth in the subsequent years.** Economic growth is expected to increase to 1.4 percent in 2023, driven by a partial recovery of the agriculture sector, which was impacted by Cyclone Freddy, and the resumption of electricity generation at the Kapichira hydropower plant. However, this is still a decline in output in per-capita terms. Lingering effects of the cyclones that occurred in 2022 and 2023 may delay the economy's full recovery to the pre-COVID-19 growth trajectory and further external shocks may result in increasing poverty and food insecurity. Over the medium term, economic growth is projected to increase moderately, underpinned by gradual macroeconomic stabilization and a recovery across all sectors.

**Elevated inflationary pressures may constrain headline inflation from reaching its target in the near term.** The projected decline of global commodity prices is expected to ease inflationary pressures from 2023. However, food prices are still rising and additional pressure from anticipated lower agricultural output could further increase food inflation.

**Persistent current account pressures are expected to further strain foreign reserves, leading to continued forex shortages.** While agricultural exports are expected to improve, albeit moderately, imports are also projected to slightly pick up in 2023. These periods of foreign exchange shortages inflict severe and enduring impacts on the economy. Due to the unavailability of imported inputs, businesses are forced to forgo lucrative investment opportunities, thereby worsening the medium-term economic growth outlook.

**Despite efforts towards fiscal consolidation, the fiscal deficit is likely to remain persistently high due to continued high expenditure pressures.** Interest expenditures will continue to rise and absorb a higher proportion of the resource envelope, in turn continuing to constrain fiscal space, especially for needed investment to spur growth. Financing assurances from these creditors, supported by supportive fiscal, monetary, and exchange rate policies, could pave the way towards a sustainable debt path and enable the country to qualify for an IMF Extended Credit Facility (ECF). However, debt vulnerabilities will remain elevated, even if successful external debt restructuring with commercial and bilateral creditors is achieved due to the growing domestic debt burden. Key to addressing these vulnerabilities is sustained fiscal consolidation, which progressively lowers expenditure, and additional measures to reduce debt vulnerabilities, particularly through improved PFM systems, in turn, engendering trust from private investors and development partners. The financial sector is expected to remain resilient though access to credit remains highly constrained amidst the continued rise in Government borrowing from commercial banks.

**There is a significant degree of uncertainty surrounding these economic prospects, with both downside risks and potential for higher growth.** Downside risks include prolonged foreign exchange shortages, setbacks in the ongoing negotiations for external debt restructuring, financial stress, delays in the Affordable Inputs Programme (AIP) reform process, intensifying climate change impacts, and a renewed cholera outbreak. However, if the economy is able to bounce back quickly from the impacts of the recent cyclone and the Government is able to advance on its reform agenda, the coming year could also exceed current expectations. The path towards achieving the goals of *Malawi 2063* is narrow but still feasible and will require a sustained focus on implementing tough but necessary reforms.

**This 17<sup>th</sup> edition of the Malawi Economic Monitor (MEM) calls for urgent actions to stabilize the economy and enhance growth.** As in the previous MEMs, this edition includes addressing three key areas:

- i) *Restoring macroeconomic stability:* Despite the recognition within Government that macro-stabilization is a prerequisite for achieving broader development aims, stepped-up reforms are needed

to rebuild foreign reserves, instill budget discipline, improve public financial management, and achieve debt sustainability.

- ii) *Increasing production and exports:* Malawi’s private sector has been hit hard by the instability and shocks of the past years. To achieve growth, reforms that support private investment and the enhancement of productive capacity in firms will be needed to boost exports, strengthen agricultural diversification and commercialization initiatives, and bring in more foreign investment.
- iii) *Building resilience and protecting the poor:* Given the growing frequency and severity of climate-related shocks, it will be essential to step up efforts to support the most vulnerable. This includes moving forward with the implementation of the Disaster Risk Management (DRM) Act, expending the roll-out, coordination, and scaling up of key social protection programs and improving disease surveillance and response in the case of a new disease outbreak, such as cholera.

## Special Topic on “Powering Malawi’s Growth”

### Enhancing access to energy is critical to achieving economic development and the aims of *Malawi 2063*

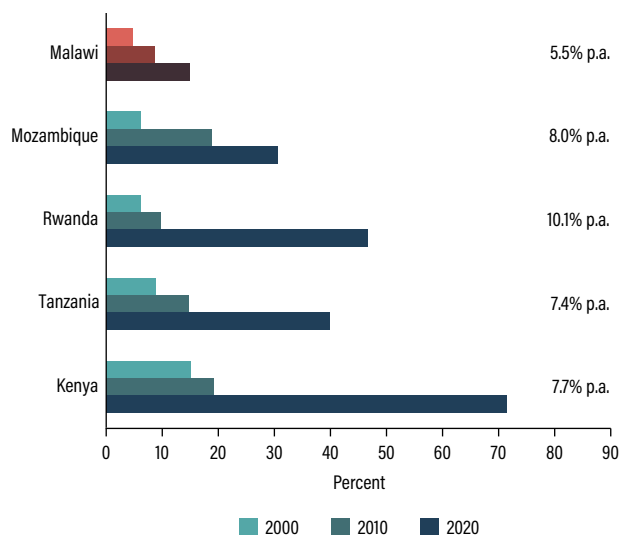
Given the challenges highlighted in Chapter 1 of this MEM, it will be important to create the conditions and enabling environment for growth. Increasing access to energy, the focus of Chapter 2 of this MEM, is essential for economic development, and its impact on a nation’s GDP can be substantial. In Malawi, energy access is a key element for the achievement of *Malawi 2063* of transforming the country into a more industrialized and prosperous nation. As such, investment in energy access is a top priority to advance the country’s economic development and wealth creation aims.

In households, energy access can significantly improve living conditions by providing access to modern technologies, lighting, and cooking. This directly translates to improved living standards, and better economic opportunities, particularly benefiting poor and rural households. Moreover, energy access plays a crucial role in the delivery of essential public services such as health and education, ultimately contributing to human development and poverty reduction.

In the past decade, several Sub-Saharan African (SSA) countries have made strides in accelerating electrification efforts. Countries in East Africa, including Malawi’s neighbors Mozambique and Tanzania, significantly increased access rates, having started from electricity access rates below 10 percent in 2000 like Malawi. These countries now have access rates over 30 percent, while Malawi still lags, with access below 20 percent (Figure O.2). They offer valuable lessons, highlighting the need for comprehensive, long-term electrification efforts that build nationwide and sector-wide electrification platforms, leveraging both grid and off-grid electrification, and mobilizing public and private sector resources in a coordinated manner. The success of these countries has been attributed to political commitment, a conducive enabling environment, a long-term electrification strategy, least-cost planning, and a commitment to adopting adaptive approaches that fine-tune implementation based on lessons learned.

**FIGURE O.2** Malawi lags behind other East African countries in increasing energy access

Progress in electrification in Malawi and other East African Countries from 2000–2020 and annual growth rates



Source: World Bank Global Electrification Database.

## Malawi's rate of electricity access is among the lowest in the world, but important lessons have emerged from past electrification programs

**Malawi has one of the lowest electricity access rates in the world.** In 2023, the electricity access rate is estimated at 19 percent with severe disparities between urban (42 percent) and rural areas (5 percent). The inequity among the rich and poor is also stark—access among the richest 20 percent of the population is about 30 times higher than the poorest 20 percent. The annual population growth rate of 2.8 percent is outstripping the pace of electrification. World Bank data shows that Malawi had the fourth-lowest energy access rate in Africa in 2022, just ahead of South Sudan, Chad, and Burundi.

**Malawi's government has set an ambitious policy goal to achieve universal energy access by 2030.** Through the publication of the revised National Energy Policy (NEP) in 2018 and other framework documents, the Government set a strong foundation for progress. Despite a robust strategic and policy framework, electrification program implementation over the past five years yielded mixed results. While the rate of access has climbed from 11 percent in 2018 to 19 percent in 2023, owing to the expansion of the private sector-led off-grid solar home system (SHS) development<sup>1</sup>, the share of the population linked to the grid has remained stagnant at about 12 percent. As a result, overall progress remains below expectations. A significant grid connection backlog of over 50,000 households<sup>2</sup> demonstrates program execution issues. The COVID-19 pandemic compounded implementation challenges and slowed electrification efforts significantly.

### Here are some key lessons learned from past electrification programs:

- Increasing energy access requires political support and government ownership.
- Solving energy access deficit requires a value chain approach.
- Improving the operational efficiency of Electricity Supply Corporation of Malawi (ESCOM) is key to its success.
- Attracting private sector capital and expertise can leverage new technology and business models.

**Malawi has the potential to achieve rapid electrification in the coming years if lessons from previous electrification programs are effectively implemented and essential changes are initiated.** Malawi can break the pattern of slow progress, thanks to the country's advantage of high population density and the emergence of off-grid technology and innovative business models. However, it is critical that ESCOM reforms are implemented quickly and successfully to achieve the promise of rapid electrification.

### How can Malawi rapidly increase its energy access rate?

**Business as usual will not move the country above the 30 percent access rate by 2030.** Assuming the same number of ESCOM connections per year as in the past (about 35,000 per year), new grid connections will be offset by population growth, resulting in only marginal contributions to the overall electrification rate increase. The off-grid solar market will continue to grow, but due to affordability challenges, it will be increasingly difficult to achieve annual growth rates much higher than 15 percent and for the country to achieve an overall electricity access rate of more than 30 percent (Figure O.3).

**Crucial policy and reform measures will be required to reach 50 percent access rate by 2030.** A joint effort from the Government<sup>3</sup> and private sector is needed with both ESCOM and off-grid solar

1. Fueled by supportive government policies, such as value added tax (VAT) and duty exemptions, the SHS market has grown exponentially with 400,000 SHS sold as of 2022

2. Estimated at the beginning of 2023.

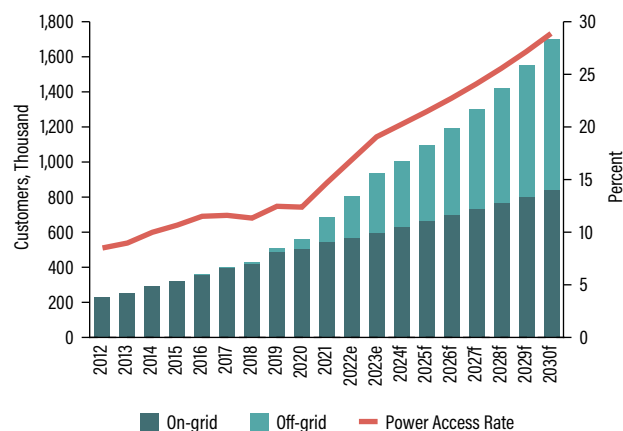
3. The Ministry of Energy and Ministry of Finance and Economic Affairs started the reform in 2023 through the resolution and implementation of long-standing legacy issues (e.g., single buyer governance and sector arrears).

companies having a shared responsibility to connect about a quarter of the population each in the next 7 years. ESCOM needs to triple its annual connection rate to 100,000 households, prioritizing grid densification to achieve both speed and efficiency. The off-grid solar companies need to grow at 25 percent annually, which requires supportive government policy, new financing mechanisms and business model innovations.

**Universal access by 2030 remains an ambitious target that Malawi should strive for.** Crucial reforms must be achieved in the power sector, but financing and sector coordination are also key. It is estimated that connecting all people to the grid will cost US\$2–3 billion, most of which will be borne by the Government, donors, or existing ESCOM customers. Achieving universal access also requires a concerted effort from the Government and private sector to make best use of scarce public finance resources and to avoid duplicated efforts.

**FIGURE 0.3** Business as usual will only increase Malawi's access rate to 30 percent by 2030

Thousands of customers connected to on-grid and off-grid connections



Source: ESCOM, World Bank team estimate.

Note: e indicates estimates and f forecasts.

### The pathway to universal access requires leadership, reforms, and partnership

*Leadership: Government leadership and clear policy goals will be central to progress*

- 1. The Government should establish institutional arrangements and regularly update the generation and transmission master plans to ensure adequate supply and transmission capacity.** Updating and implementing generation and transmission least cost plans are important for connections, as this will facilitate new connections and better serve existing customers. The least cost plans have not been updated and implemented in the past five years, making them ineffective tools to guide sector development. To address this issue, the Ministry of Energy (MOE) has hired international consultants to update these plans, with technical support from ESCOM. The updated generation and transmission plans are expected to be published by the end of 2023. The MOE should also ensure the timely execution of these least cost plans.
- 2. The MOE can take a stronger coordination role in balancing the roll-out plans for on-grid and off-grid connections.** This can be achieved by working closely with ESCOM and the private sector to ensure that resources are allocated appropriately to both on-grid and off-grid electrification projects. While the private sector has been driving off-grid deployment, there have been limitations in the ability of the MOE to monitor progress and coordinate between ESCOM and off-grid players, as not all data has been collected. Addressing these monitoring issues is crucial to ensure that the progress towards increased access to electricity is effectively tracked. As the country faces significant affordability challenges, it will become increasingly important for the Government to play a driving policy role in facilitating financing and providing targeted subsidies to solar companies and end users respectively to support electrification efforts.
- 3. The MOE is encouraged to update the NEP 2018 to ensure its alignment with current challenges.** While the NEP 2018 provides a good framework for energy sector development, certain aspects of the policy need to be reviewed, considering the increasing threat of climate change impacts and the current progress towards universal energy access. An updated NEP will provide policy guidance on incorporating climate risks in energy sector planning and set an ambitious yet achievable energy access target for 2030.

4. **The Government should formally adopt the draft Guidelines for Implementation of the National Electrification Program, which outlines the connection and connection fee policy.** The formalization will remove any financial uncertainties for potential customers and the implementing agency, thereby facilitating scale-up.

*Reform: Government needs to reform ESCOM to improve its operational efficiency and financial sustainability*

1. **The Government needs to foster a culture of accountability and continuous improvement within ESCOM.** The operational efficiency of the connection team should be measured against clear targets in a systematic manner. Such approaches, when combined with a comprehensive training program and human resource development policies, can dramatically boost connection speed.
2. **ESCOM should improve its procurement processes.** Exploring options to further standardize connection design and procurement documents can streamline the availability of materials and resources, reducing the possibility of procurement delays and ensuring cost competitive contracts.
3. **ESCOM needs to fully operationalize its Management Information System (MIS).** Currently the under-utilization of the MIS leads to manual work and human errors that significantly slow down the roll-out of connections. The ESCOM management team need to execute a comprehensive change management program to maximize the utilization of the advanced MIS<sup>4</sup> already in place.
4. **The Government needs to work with ESCOM to achieve financial sustainability.** Improving ESCOM's financial position is vital for increasing access rates. Previously, ESCOM was discouraged from expanding its connection program, in part because of perceived risks of increasing losses. A financially stable ESCOM will have adequate resources for routine maintenance and customer service, reducing losses and line faults. Additionally, it will also be able to access more medium- and long-term capital without the need for a sovereign guarantee, which can be used to fund eligible consumer connections. A recent World Bank study identified critical areas where ESCOM and the Government should collaborate to improve ESCOM's financials, including revenue management, loss reduction, tariff adjustment mechanisms, balance sheet optimization, and sector arrears elimination.

*Partnership: The Government needs to work with the private sector to sustain the growth momentum in the off-grid solar market*

1. **The Government is encouraged to continue supportive policies, such as a value added tax (VAT) and duty exemptions, to stimulate additional private sector investment.** These incentives have proven effective in attracting investment and driving growth in the sector. Additionally, the government can explore other incentives, such as result-based financing (RBF) comparable to USAID's "Kickstarter" program and the World Bank-financed Malawi Energy Access Program (MEAP), to entice more enterprises to join the Malawian market. Increased competition will not only drive down prices but also spur innovation and the development of new technologies, enhancing the efficiency and efficacy of off-grid solar systems.
2. **The Government is encouraged to facilitate more local currency financing<sup>5</sup> for off-grid companies.** Financing has been a major barrier to the growth of local off-grid solar companies. The ongoing macroeconomic crisis and issues of currency inconvertibility have exacerbated the challenge. International off-grid solar companies that rely on hard currency loans face substantial

4. The MIS implementation was not fully successful, and many modules of the system remain underutilized.

5. As an example, the "Ngwee Ngwee Ngwee Fund" under the MOE is providing local currency financing to Malawi-based solar companies.

foreign exchange risks due to a currency mismatch between funding and revenue currencies. By facilitating local currency loans, the government can create funding opportunities and reduce risks associated with hard currency financing. This will enable solar companies to expand their business and cut their price, leading to market growth.

3. **Targeted end-user subsidies can be introduced to further reduce the price of off-grid solar products for those who need them most.** An affordability analysis suggests that increasing access beyond business-as-usual projections will require additional price reductions, particularly for low-income users. The Government can work with its development partners to create financial instrument that enable targeted end-user subsidies. Currently development partners like EnDev and the World Bank are piloting end-user subsidies, with the goal of testing design and paving the way for future scale-up.
4. **The Government is encouraged, in consultation with off-grid solar companies, to set market standards for mini-grid and SHS to ensure quality products and services.** Implementing proven standards and best practices, which have been locally adapted and successfully implemented in other countries such as Bangladesh, Kenya, and Rwanda, will enhance consumer confidence and drive increased demand in the off-grid solar market.

1

**ECONOMIC**

**DEVELOPMENTS**



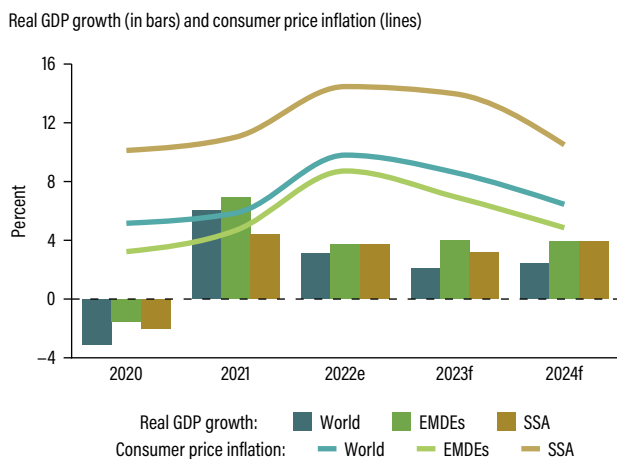
# GLOBAL AND REGIONAL CONTEXT

## Global growth remains steady as inflation moderates, but low-income countries are facing new policy challenges

**Despite continued shocks, global growth conditions remain stable.** Global real economic growth in 2022 is now estimated at 3.1 percent in the most recent World Bank *Global Economic Prospects* (June 2023)—slightly lower than the forecast of 3.2 percent in the 16<sup>th</sup> edition of the *Malawi Economic Monitor* in December 2022 (Figure 1.1). Several major forces that slowed growth in early 2022, including volatile commodity prices, the economic fallout from Russia’s invasion of Ukraine, and the impacts of the COVID-19 pandemic continue to play a role but have moderated.

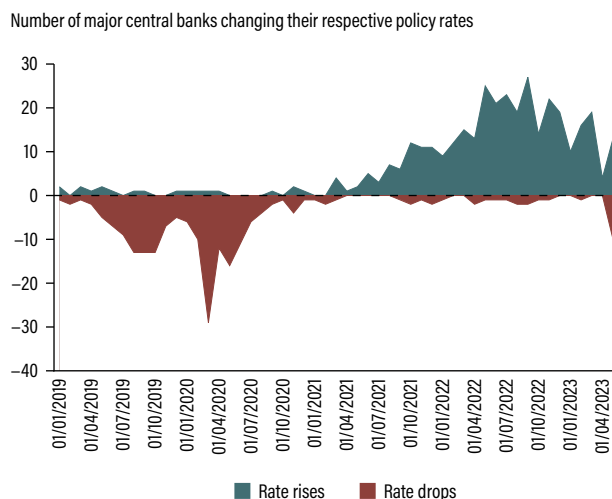
**With inflation stubbornly high, central banks are increasingly walking a tightrope between taming inflation and risking financial instability and output losses.** After peaking at 8.7 percent in 2022 (Figure 1.1), inflation has recently started declining, largely driven by a fall in fuel and energy prices. Nonetheless, it remains far above historical averages and central bank targets in most countries. In response, central banks around the world to continue to tighten monetary policy (Figure 1.2). Central bankers must balance a commitment to inflation targets with the risk of significantly dampening economic growth. Tighter monetary policy also ends a period of abundant, low-cost liquidity. Resulting pressure on the balance sheets of many firms and financial institutions led to the failure of some banks, such as Credit Suisse, Silicon Valley Bank and First Republic Bank, but contagion was avoided through proactive policy.

**FIGURE 1.1** Global growth is steady while inflation is likely to have peaked in 2022



Sources: World Bank Global Economic Prospects (growth) and IMF World Economic Outlook 06/2023 (inflation).  
 Note: e indicates estimates and f forecasts.

**FIGURE 1.2** Above target inflation has prompted most central banks to tighten interest rates

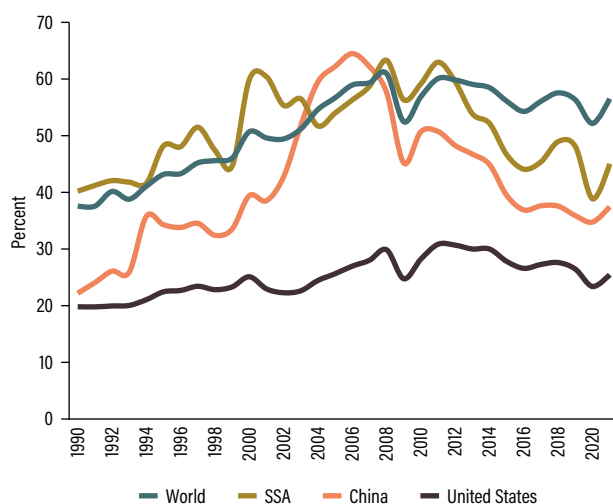


Source: World Bank staff calculations based on Bank for International Settlements data.

**Global trade openness has declined amidst increased economic nationalism.** Following disruptions due to the COVID-19 pandemic and rising trade tensions, many high-income countries are increasingly “re-shoring” and “friend-shoring” production (IMF, 2023).<sup>6</sup> This comes on top of a longstanding decline in trade openness, which has steadily fallen since 2008, when global trade as a share of GDP was at 61 percent (Figure 1.3). The speed at which new trade and investment restrictions are being announced also greatly outweighs the number of new liberalizing reforms (Figure 1.4). New World Bank analysis shows that a worldwide shift towards reshoring could drive an additional 52 million people into poverty, most of them in Sub-Sahara Africa (Brenton, Ferrantino, and Maliszewska, 2022). New supply chain due-diligence laws, which aim to protect labor rights in producer countries, may also have the unintended consequence of hurting commodity exporters (Felbermayr et al., 2021).<sup>7</sup>

**FIGURE 1.3** Trade openness has declined following a steady increase from 1990 until the Global Financial Crisis

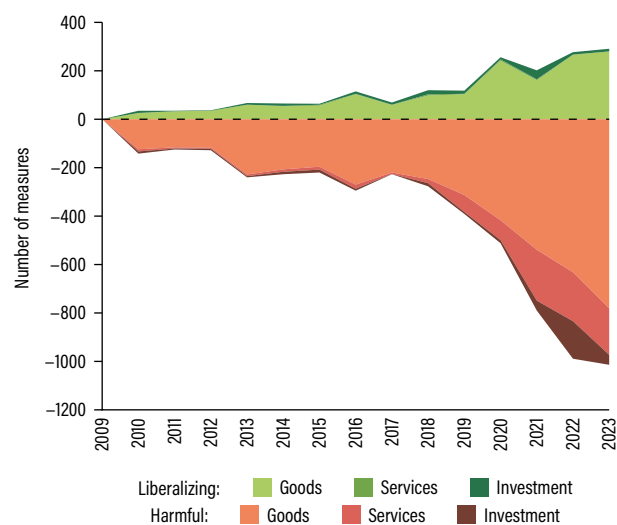
Trade as a share of GDP globally and in selected regions



Source: World Bank national accounts data, and OECD National Accounts data files.04/2023.

**FIGURE 1.4** Trade and investment restrictions have been on the rise, especially since 2018

Liberalizing reforms and restrictions harmful to international trade



Source: Global Trade Alert as of 31/03/2023.

**More than half of low-income countries (LICs) are at high risk of debt distress or in debt distress, including Malawi, holding back growth in these countries.** According to World Bank-IMF Debt Sustainability Analyses (DSA), the number of low-income countries in “debt distress”<sup>8</sup> has grown to eleven as of the end of May 2023. Debt burdens have increased and non-Paris Club<sup>9</sup> bilateral and commercial creditors account for a larger share of creditors than in previous episodes of widespread debt distress. The new composition of creditors significantly increases the complexity of debt workouts, and the need to ensure increased debt transparency.

6. The term “reshoring” refers to a country’s transfer of (part of the) supply chain back to its origin “Friend-shoring” limits supply-chain networks and the sourcing of inputs to countries allied with the home country and trusted partners.

7. A German law that came into force at the start of 2023 raised the standard on the enforcement of human rights across global supply chains. It makes larger companies liable for any human rights violations across their entire supply-chain, with offences punishable with fines of up to two percent of average annual turnover. A similar law is being developed at the EU level. Research by the Kiel Institute for the World Economy shows such laws include could result in producers in middle- and low-income countries being cut out of profitable global value chains (Felbermayr et al. 2021). This is because it can often be cheaper for companies to switch to suppliers from high-income countries where less intensive compliance processes are needed. This has also impacted Malawi: US legislation to prevent child labor resulted a suspension of all tobacco imports from Malawi to the US in 2019 following allegations that some Malawian producers were in violation of these rules.

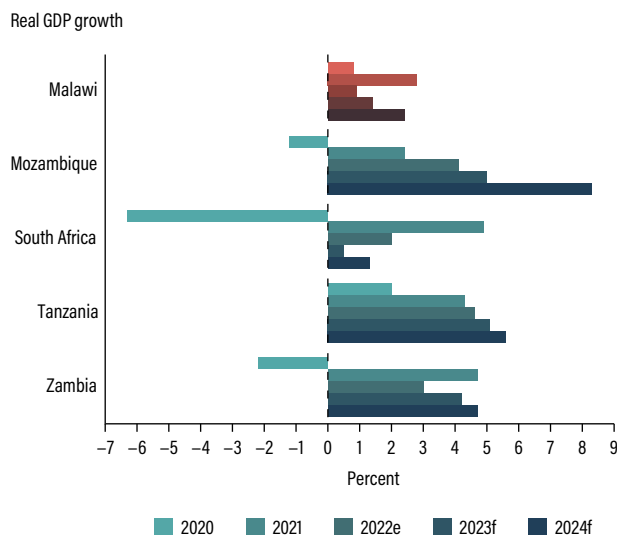
8. DSAs include an assessment of the risk of external and overall debt distress based on four categories: low risk; moderate risk; high risk, and in debt distress (i.e., when a distress event, like arrears or a restructuring, has occurred or is considered imminent). See IMF (2018) for details.

9. The Paris Club is a group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. The Paris Club has 22 permanent members, all of which are high-income countries (Paris Club, 2023).

**Zambia, the first country to default on its debt after the onset of the COVID-19 pandemic, has finally achieved a breakthrough in its debt restructuring negotiations.** After the disbursement of over US\$460 million under an IMF Extended Credit Facility and World Bank budget support for an ambitious reform program<sup>10</sup>, further support is conditional on the restructuring of bilateral debt under the G20 Common Framework for Debt Treatments to facilitate Zambia’s return to debt sustainability and increased growth. In June 2023, the country reached a debt restructuring deal with its key creditors, with lenders led by China agreeing to restructure US\$6.3 billion in loans.

**Growth in the Southern African region is being bolstered by Mozambique and Tanzania, while South Africa’s economy continues to falter.**<sup>11</sup> High global commodity prices and a fully flexible exchange rate have supported South Africa’s fiscal and external balances. However, mining production fell while manufacturing stagnated, as load-shedding and transport bottlenecks intensified leading to just two percent real economic growth in 2022 (Figure 1.5). High global demand for its key exports—coal and aluminum—also shored up Mozambique’s economy, which grew by 4.1 percent in 2022. However, Mozambique was the second-most impacted country by Cyclone Freddy (after Malawi), with 1.1 million impacted people and 183 deaths, dampening the economic growth outlook for 2023. Tanzania’s post-pandemic recovery, with 4.6 percent growth in 2022, has been broad-based as all subsectors surpassed their pre-pandemic production levels by the third quarter of 2022. However, despite a generally robust economy, the decline in the Bank of Tanzania’s official liquid reserves amidst increased import bills from higher food and fuel prices is a cause for concern.

**FIGURE 1.5 Economic fortunes in the region are diverging**



Source: World Bank Macro Poverty Outlook (World Bank 2023a).  
 Note: e indicates estimates and f indicates forecasts.

10. Key components of Zambia’s reform program underpinned by the ECF and the World Bank Development Policy Financing series included (i) restoring fiscal and debt sustainability through a fiscal adjustment and debt restructuring; (ii) creating fiscal space for social spending to cushion the burden of adjustment; and (iii) strengthening governance and reducing corruption vulnerabilities, including by improving public financial management (PFM).

11. Analysis of economic developments in Southern African region is based on the April 2023 World Bank Macro Poverty Outlook (World Bank 2023a).

# 1.2

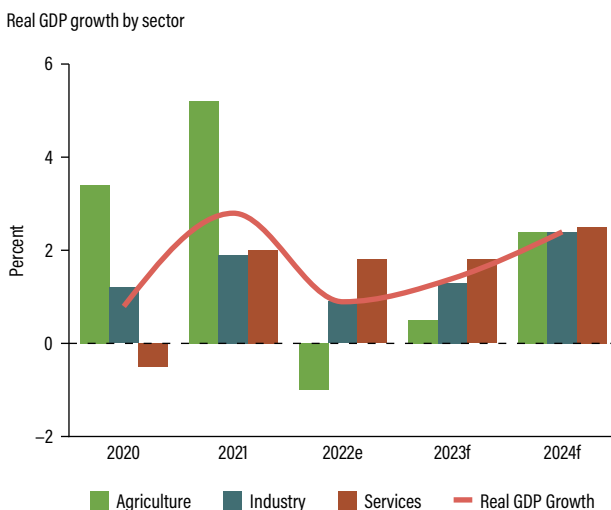
## RECENT ECONOMIC DEVELOPMENTS

### Malawi’s economic growth has fallen following the impacts of Cyclone Freddy and an ongoing debt and balance of payments crisis

Following the weak growth performance in 2022, the impact of Cyclone Freddy paired with continued macroeconomic imbalances has resulted in a difficult start to 2023 for Malawi’s economy. In 2022, the economy was weakened by foreign exchange shortages that constrained the importation of essential commodities and production inputs, a generally unfavorable external environment, and continued challenges in advancing key macroeconomic and governance policy reforms. Additionally, the damages caused by Cyclone Ana impacted crop production and further worsened an already erratic electricity supply situation. This constrained real economic growth to just 0.9 percent, equating to a per capita output reduction of 1.8 percent (Figure 1.6). The widespread destruction caused by Cyclone Freddy and a persistence of external economy challenges in early 2023 already dampen economic performance for the current year.

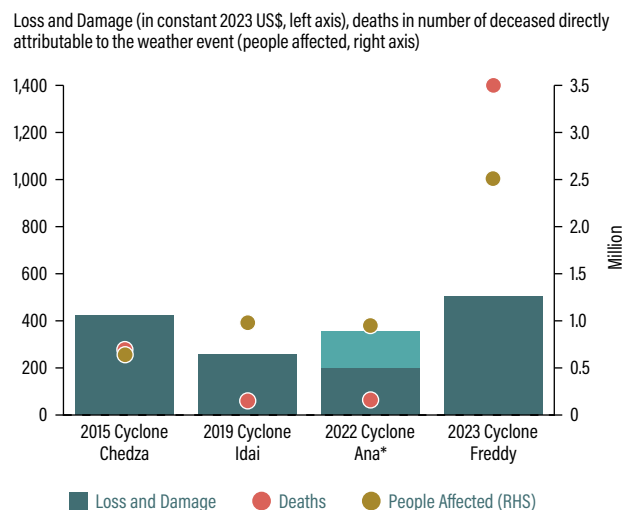
**Cyclone Freddy was the most destructive in a series of increasingly frequent extreme weather events affecting Malawi.** Between March 12<sup>th</sup> and March 14<sup>th</sup>, 2023, some areas in Malawi experienced more rainfall than their average annual amount. These heavy rains led to multiple floods and landslides. The Post Disaster Needs Assessment (PDNA, Government of Malawi 2023) estimates more than 2.5 million Malawians were affected and over 1,400 died as a result of the cyclone (Figure 1.7).

**FIGURE 1.6** Not the post-COVID recovery Malawians had hoped for



Source: World Bank Macro Poverty Outlook (World Bank 2023a).  
 Note: e indicates estimates and f forecasts.

**FIGURE 1.7** Cyclones are becoming more frequent and destructive



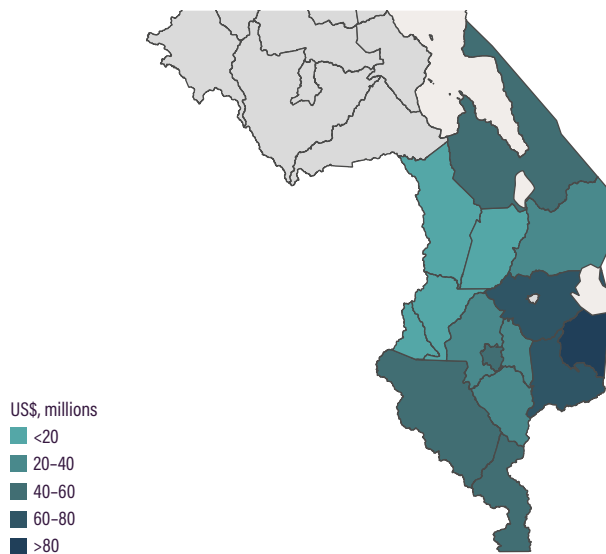
Source: World Bank staff calculations based on PDNA (Government of Malawi 2023).  
 Note: \* Range of estimates based on Global Rapid Damage Estimation (World Bank 2022d).

Additionally, the storm is estimated to have caused US\$505 million in material loss and damage. While destruction from previous storms was concentrated in low-lying areas, Cyclone Freddy affected the Southern highlands, with Phalombe and Mulanje most affected and Nsanje, Chikwawa, and the city of Blantyre also reporting significant damage (Figure 1.8).

**The economic impacts from Cyclone Freddy led to a downward revision of economic growth expectations in 2023.** The cyclone is estimated to have caused production losses equivalent to US\$36.4 million, which translate to a real GDP loss of 0.5 percent for 2023. These impacts further call attention to Malawi's vulnerability to climate change highlighted in the recent *Country Climate and Development Report* (World Bank, 2022e), which shows that without significant investments in adaptation, the impacts of climate change will lead to GDP losses of 3 to 9 percent by the end of the decade. It will also be important, in the aftermath of the cyclone, to ensure that a renewed outbreak of cholera, as was the case following Tropical Storm Ana and Tropical Cyclone Gombe in 2022, can be avoided (Box 1.1).

**FIGURE 1.8 Cyclone Freddy's impacts affected highland districts more than previous storms**

Total loss and damage across affected councils



Source: PDNA (Government of Malawi 2023).

#### BOX 1.1 Lessons from Malawi's recent cholera outbreak

**The 2022/23 cholera outbreak was the worst in Malawi's recent history.** The severity of the outbreak was driven in part by Tropical Storms Ana and Gombe in early 2022, which caused substantial flooding, accelerated displacement of populations from affected districts, and reduced access to safe water, sanitation, and hygiene – which all contributed to an increased risk of a cholera outbreak and its eventual spread. On March 3, 2022, Malawi declared a cholera outbreak after a case reported to Machinga District Hospital was confirmed. By mid-August 2022, the surge in cases reached previously unaffected districts in the north of Malawi, and by late 2022 all districts had reported cases of cholera. By late February 2023, the number of new cases each day reached nearly 500. Since then, the number of new cases each day has gradually declined. Over the course of this outbreak, 58,000 cases and slightly more than 1,700 total deaths have been confirmed across the country, and the cumulative case fatality rate has been approximately three percent.

**Following the declaration by President Chakwera of a "public health emergency" in December 2022, the "National Cholera Response Plan" was updated in December 2022.** In turn, a multi-sectoral emergency response mechanism building on the COVID-19 Presidential Task Force was activated. Following a stepped-up response by Government, and significant development partner support, case numbers gradually declined in the early months of 2023.

#### Several factors complicated the cholera outbreak response.

These factors include: (i) COVID-19 and its impact on the economy and the public health system, which was already under stress; (ii) Russia's invasion of Ukraine, which exacerbated Malawi's forex crisis, contributing to a worsening of chronic and severe shortages of essential medicines; (iii) measles and polio outbreaks in late 2021 and early 2022 and the subsequent vaccination campaigns that followed, which further strained the health systems; (iv) a global supply shortage of oral cholera vaccines; and (v) inadequate availability of staff at cholera treatment centers.

**Avoiding future severe cholera outbreaks will require learning from lessons from the 2022/23 outbreak.** In the short term it is critical to build on the experiences gained through the COVID-19 response and the ongoing cholera response, and (i) further strengthen integrated disease surveillance and response to detect and contain outbreaks promptly, and (ii) improve awareness of safe water and hygiene practices. Longer-term measures involve increasing resources for the health sector to both strengthen health emergency preparedness and increase access to and quality of essential health services (including routine immunizations), especially among socially and economically vulnerable populations. It will also be important to ensure better access to safe water and sanitation facilities. Furthermore, future investments in health, water, and energy infrastructures need to be climate-resilient to ensure that impacts from future climate-related shocks on the ability to respond to disease outbreaks is minimized.

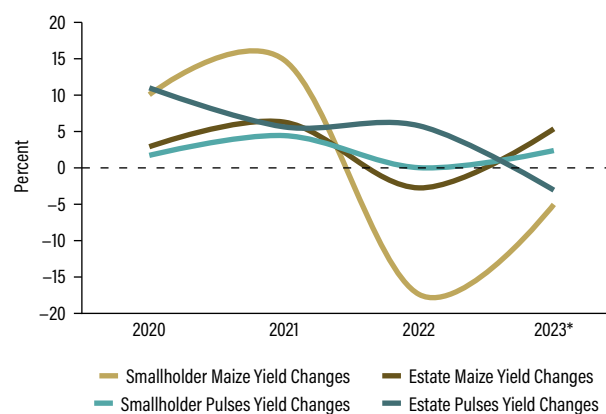
**The impacts of Cyclone Freddy have dampened the performance of the agriculture sector in the coming season.** About 47 percent of total production losses were located in the agriculture sector, and predominantly through crop loss. Acute crisis level food insecurity is expected to persist after the harvest in parts of Southern Malawi, where many households have limited food and income from their own

crops (FEWS NET, 2023). While most camps for flood victims have been closed, many affected households still reside in temporary shelters within their villages. Higher domestic food prices due to below-trend harvests have continued to exert pressure on household incomes, pushing many into poverty. The proportion of people living on less than US\$2.15 Purchasing Power Parity (PPP) per capita a day (approximately MWK 1,220 as of April 2023) has increased to 71.3 percent in 2022.

**High fertilizer prices have contributed to a shift among many farming households away from maize to other crops.**

Aggregate yields of maize and pulses are set to decline or stagnate in 2023 according to the second of three rounds of official agricultural production estimates (Figure 1.9). This has been driven by the impacts of Cyclone Freddy, high agricultural input prices, and the limited availability of inputs, while the expansion of irrigation has been advancing slowly. Farmers have responded to these challenges by planting 10.4 percent more land with soya and 4.7 with groundnuts in 2022/23 compared to 2021/22, while cereal hectareage is estimated to have grown by less than one percent. Whether the Government's efforts to support productivity, commercialization, and diversification through the "Mega Farms Programme" can turn this dynamic around depends on its design and implementation, and in particular the extent to which it incentivizes private sector participation (Box 1.2).

**FIGURE 1.9** Yields of maize and pulses



Source: World Bank Staff Calculations based on Ministry of Agriculture third round Agricultural Production Estimates.

Note: \* APES Round 2 estimates.

**BOX 1.2** A balance between private sector leadership and public facilitation will determine the success of the Mega Farms Programme

**The Government's Mega Farms Programme intends to develop anchor farms to provide production support services to small and medium-scale farmers in surrounding areas.** Mega Farms are expected to use more capital-intensive and technically advanced farming techniques on larger tracts of land than traditional farms. Working with the Greenbelt Authority, the Ministry of Agriculture's private sector arm, Mega Farms should also process on site for exports, thereby boosting Malawi's trade balance.

**A clear financial vision for the Programme has yet to emerge.**

The stated intention is to primarily rely on existing financing mechanisms. Support from the budget is intended to especially target government and parastatal entities and suffers from limited financial capacity. This leaves the Export Development Fund (EDF) and the Malawi Agricultural and Industrial Investment Corporation (MAAIC) as primary financing vehicles for the private sector. With EDF disbursements of MWK 2 billion in 2022 and a total loan book of MWK 4 billion for MAAIC, financing likely would have to grow significantly to meet the ambitions for capital-intensive production. An Agriculture Development Bank is yet to be established and would require capitalisation. These have also often been unprofitable and reliant on subsidies in other country contexts (Seibel 2000).

**Mega Farms represent an evolution from the Government's longstanding smallholder focus.** An emphasis on

government-led agriculture in the 1970's morphed into a policy of granting estates in the 1980s (Deininger and Xia, 2018). From the late 1990s, the Government shifted its focus to smallholder agriculture with programs like the Starter Pack program, which later became Farm Input Support Programme, and eventually the Affordable Inputs Programme. A renewed focus on larger Mega Farms signifies a continued transition in policy priority towards larger, commercialized farms, though these would continue to rely on smallholder production.

**Malawian and international experience show that the success of large-scale farming initiatives depends on private sector involvement and a conducive enabling environment.** While Joseph, Dijk, and Krisztin (2023) find that large-scale farms can have positive spillovers, previous research shows that Malawi's existing large-scale farms tend to be less productive than their smallholding peers (Deininger and Xia, 2018). Most importantly, operations and management of Mega Farms are best led by the private sector, with the Government providing a conducive environment for investors. The Government's plans for the Mega Farms Program discusses "leverage[ing] the private sector participation in the agricultural sector" through PPP arrangements. However, to date the Government has established two Mega Farms led by the Malawi Prison Services and the Malawi Defense Force (Chikoti 2023), respectively, indicating that this ambition is not yet reflected in policy.

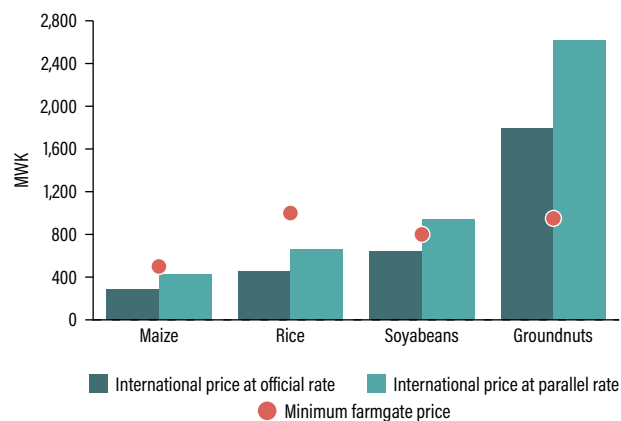
**The Ministry of Agriculture's new minimum farmgate prices for this season may make it difficult for Malawian producers and products to be internationally competitive.** Aggregating, grading, and transporting agricultural produce is costly. Thus market-based farmgate prices are generally lower than

market prices. The minimum farmgate prices announced for the 2022/23 agricultural season, however, are in many cases higher than international prices, with regional prices for locally produced commodities often even lower (Figure 1.10). Enforcing such high minimum farmgate prices encourages imports and favors those traders who are inclined to ignore Ministry-mandated minimum prices. Setting minimum farmgate prices too high can also counter the Government’s policy goals of supporting smallholder farmers and promoting local value addition. For example, high soybean minimum farmgate prices encourage the importation of cooking oil from neighboring countries, leaving local value-adding oil mills without business.

**The industrial sector has been particularly impacted by foreign exchange, fuel, and electricity shortages.** Industry is reliant on adequate electricity supply, which was intermittent throughout 2022 and the start of 2023. Many companies invested in energy back-up systems to supplement their supply. The World Bank’s Business Pulse Survey from October 2022 showed that between January and October 2022 alone, 17 percent of firms acted in response to frequent load-shedding, with 7 percent of firms purchasing a solar backup system. However, many larger electricity backup generator systems are diesel-powered, which has also often been in short supply. While the fuel allocation mechanism is not public, industry often is affected first by rationing. These shortages are primarily a function of administered prices directly in the fuel market and in the market for foreign exchange. Fuel becomes scarce when prices are not reflective of economic costs (see Figure 1.11). Available resources in the Price Stabilization Fund (PSF) and the incurrence of arrears by importers can only cushion the market for short periods. Additionally, industry is also reliant on accessing capital and production inputs. Both have closely circumscribed availability in the domestic market and the ensuing balance of payments (BOP) crisis makes their importation difficult. The Business Pulse Survey shows foreign exchange shortages weighed down on the profitability of more than three quarters of firms, highlighting the need for policy reforms to address distortions in the foreign exchange market.

**FIGURE 1.10** Announced minimum farmgate prices are often too high to make trading financially viable

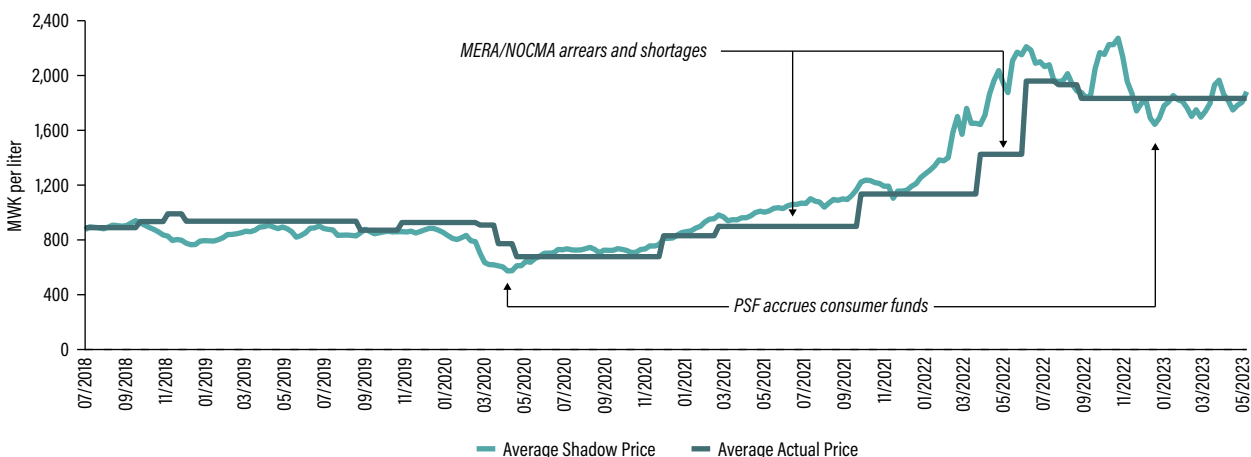
Minimum farmgate prices and international commodity prices as of end-March 2023 at official and foreign exchange bureau median mid-market rates



Source: Staff calculations based on Ministry of Agriculture data, World Bank Commodity Markets data, and Reserve Bank of Malawi exchange rate data.

**FIGURE 1.11** Shortages loom when the fuel price exceeds the economic costs of fuel

MERA-regulated ruling pump price and shadow price of fuel



Source: World Bank staff calculations based on MERA data and State of New York Transportation Fuels Spot Prices data.

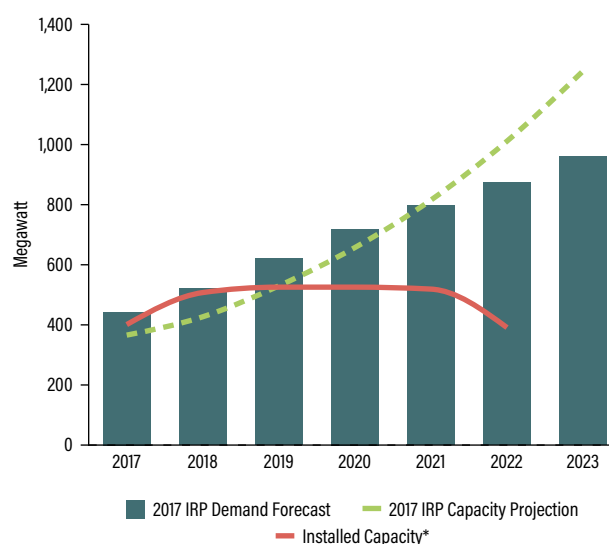
Notes: Averages are taken between diesel and petrol. The Shadow Price is calculated as international landed costs of fuel at the median Foreign Exchange Bureau selling rate plus the proportional taxes calculated based on the international landed costs plus the fixed taxes and levies contained in the official price build-up. It does not contain financing levies or levies for the Price Stabilisation Fund.

**The restoration of the Kapichira hydroelectric power station is a first step towards the alleviation of energy supply challenges.**

The partial restoration of Kapichira’s capacity in May 2023, which constituted a third of Malawi’s total power generation capacity before the station was damaged by Tropical Storm Ana in January 2022, restored stability in Malawi’s energy supply. Full rehabilitation of Kapichira is planned to be completed in the second half of 2023. However, this was a temporary reprieve, considering the changing seasonality of power demand and the fact that, for Malawi, the actual and unmet or suppressed demand for power still outstrips the available supply. Plans to further increase generation capacity through various supply options are under consideration, including solar power and hydropower, such as the Mpatamanga hydropower plant. These could address energy needs, and in turn economic growth, but they will take time. Since 2018 installed capacity has largely stagnated—and temporarily even declined following the damages to Kapichira in 2022—while supply needs have continued to increase (Figure 1.12). Cyclone Freddy caused some losses and damages to the energy sector (US\$13.4 million) but did not critically impact the national grid for an extended period, as temporary measures were put in place while awaiting arrangements for permanent repairs to the damaged sections of the grid. A World Bank study based on the 2014 Enterprise Survey showed that load shedding costs the Malawian economy more than 3 percent of GDP (Rentschler et al., 2019). This was the second highest share among 137 low- and middle-income countries. Considering increased blackouts since this time, the economic benefits from meeting electricity demand are now likely to be even higher. Chapter 2 focuses in more depth on the how electricity access can be rapidly and sustainably increased if the Government implements the appropriate reforms.

**FIGURE 1.12 Malawi is falling behind on energy supply**

Requirements, projections, and actual installed national grid electricity-generating capacity



Source: World Bank staff calculations based on the 2017 Integrated Resource Plan (IRP, Government of Malawi, 2017) and MERA installed capacity data (2022).

Note: \* Excludes capacity for the damaged Kapichira hydroelectric power station for 2022.

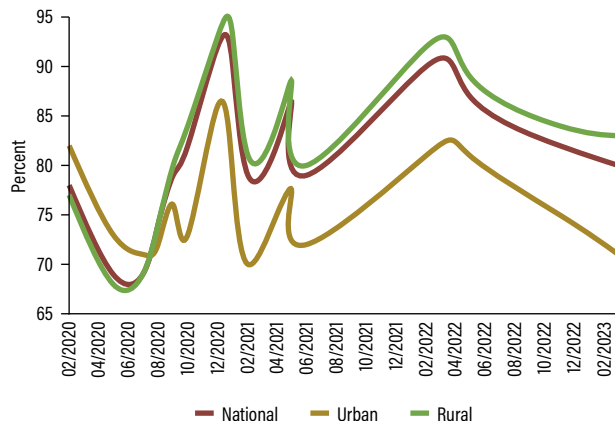
**The tourism recovery in Malawi from the pandemic has been among the slowest in the region.** Before 2020 and the COVID-19 pandemic, Malawi received 4.3 percent of its export earnings from international tourism. Travel and tourism also represented 7.3 percent of GDP and employed over 500,000 Malawians. While the number of available airplane seats to Malawi had reverted to pre-pandemic levels of around 6,000 per week in early 2023, similar to the trend seen across the continent, estimated aviation passenger arrivals have recovered to just about half their 2019 levels (World Bank, 2023b). Aside from Namibia, this is the slowest recovery on the continent. While global factors play a role, the domestic environment for tourism enterprises has not supported a more rapid rebound. In the 2021 World Economic Forum Travel and Tourism Development Index, Malawi ranks only 109<sup>th</sup> out of 117 evaluated countries. Malawi’s new “National Tourism Investment Masterplan 2022–2042” makes some advances by focusing on the creation of an enabling environment for subsectors where Malawi has a competitive advantage, including eco-tourism, hiking, and the numerous lakeside tourist hubs.

**The employment rebound from the COVID shock has been highly varied, with non-farming family businesses struggling.**

The Malawi High-Frequency Phone Survey (HFPS) implemented by the Malawi National Statistical Office (NSO), in collaboration with the World Bank’s Living Standards Measurement Study program, shows that the post-pandemic employment rebound was varied and uneven (Figure 1.13). While a higher share of the urban population was working than their rural peers in early 2020, this relationship has meanwhile reversed. A challenging business environment also means that Malawians are pursuing different activities to make a living (Figure 1.14). Farming continues to occupy a larger share of Malawians than before COVID. Family businesses used to be the main source of livelihood for one in three Malawians before COVID, but by 2022 this has been reduced to one in six.

**FIGURE 1.13** Employment levels are trending down since early 2022

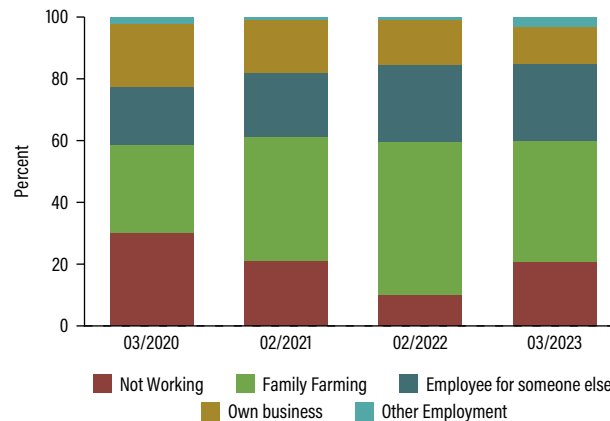
Share of respondents having worked in the past week



Source: National Statistics Office and World Bank High Frequency Phone Survey.

**FIGURE 1.14** The COVID-induced return to farming has been reversed but family businesses are not absorbing workers

Share of respondents by type of job currently worked

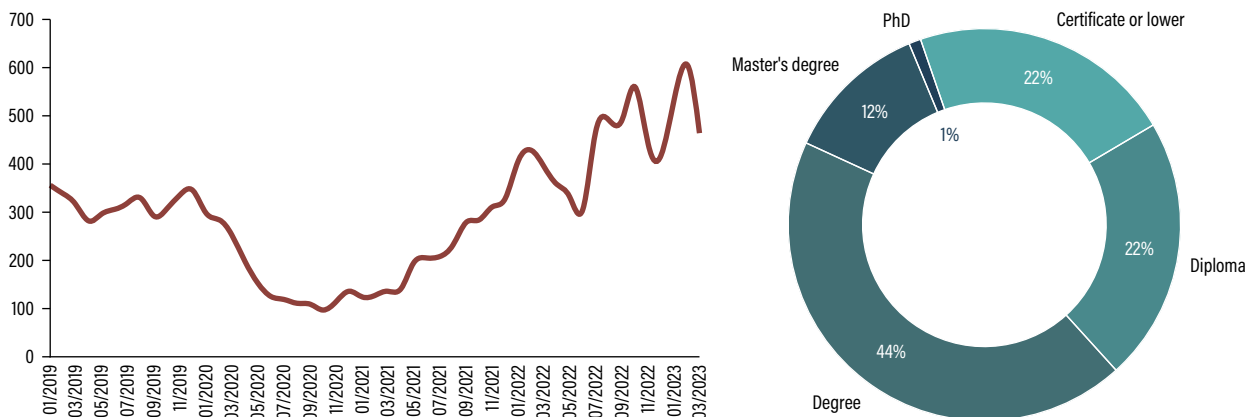


Source: National Statistics Office and World Bank High Frequency Phone Survey.

**Increasing skilled employment will require improvements in human capital.** An analysis of data from Malawi's largest jobs website, MyJobo, which has over 100,000 subscribers, shows that the skilled segment, which the website focuses on, has recovered since the pandemic, driven by the increased posting of public sector jobs (Figure 1.15). As an online platform, MyJobo is biased towards higher-skilled jobs, with the majority of jobs advertised in 2022 requiring at least a tertiary education degree.<sup>12</sup> However, in order to support the country's long-term growth, increased investments in human capital are needed. While Malawi has made significant gains in improving its human capital in recent years, according to the World Bank's Human Capital Index,<sup>13</sup> a child born today will only be 41 percent as productive when she grows up as she could have been if she enjoyed complete education and was fully healthy (up from 36 percent 10 years ago).

**FIGURE 1.15** The labor market for the educated has recovered

Number of jobs advertised on the MyJobo online platform and shares of minimum required educational qualification in 2022 job advertisements



Source: World Bank staff calculations based on data provided by MyJobo.

12. With 5,096 vacancies posted in 2022, the jobs advertised on MyJobo can cover a large share of the graduates of Malawi's public higher education institutions. While higher education has expanded rapidly, participation remains one of the lowest in the world with just 56,000 students enrolled (Ministry of Education, 2022).

13. The World Bank's Human Capital Index combines metrics for child survival, schooling, and health. It is associated with the knowledge and skills of a population, which is a critical component of economic development. Last measured in 2020, Malawi scores beyond what would be expected based on its income, and on par with much wealthier countries like Iraq and Botswana.

**The learning loss caused by school closures in response to the COVID pandemic has created additional challenges for the education system and the labor market.** Recent World Bank analysis shows that students lost approximately 1.6 years’ learning in 2020–21 (Asim, Bashir, and Gera 2023). Losses were most severe in English and Maths. Girls had more severe direct learning losses while boys found it more challenging to revert to their already slower pre-pandemic learning pace. Recent climate-related disasters disrupted education, with approximately a million students out of school following Cyclone Freddy as over 400 schools were either not functional or used to house displaced families. This exacerbates already low learning outcomes where, for example, only 22 percent of Grade 4 students can read and comprehend a short passage in Chichewa.

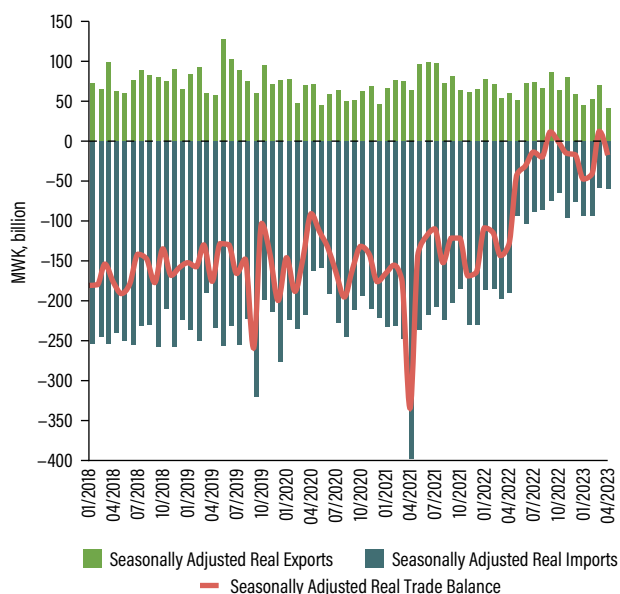
**The balance of payments crisis has resulted in continued foreign exchange shortages, while the policy response remains inadequate**

**Malawi has entered the second year of an acute BOP crisis.** Double-digit current account imbalances (in terms of percentage of GDP) between 2013 and 2021 have led to the accumulation of substantial external liabilities. With Malawi entering debt distress in 2022 and net official reserves negative, Malawi experienced a dramatic import compression caused by an acute foreign exchange shortage, which even a 25 percent devaluation of the kwacha was not able to alleviate. With these issues unresolved halfway through 2023, Malawi is entering a second year of an acute BOP crisis.

**Malawi’s imports continue to be constrained by the shortage of foreign exchange.** Official real imports in the year to April 2023 are approximately 65 percent below their 5-year average through 2021 (Figure 1.16). While fuel and fertilizer continue to be largely protected from this shock through prioritized access to official financing, the contraction is severe across all other major imports (Figure 1.17). Other arguably essential imports, such as medical supplies and pharmaceutical imports, have been 78 percent below their 2020–21 average while goods that primarily serve production purposes, such as machinery, have also declined by 74 percent.

**FIGURE 1.16** Without access to foreign exchange, imports have dwindled, closing the trade deficit

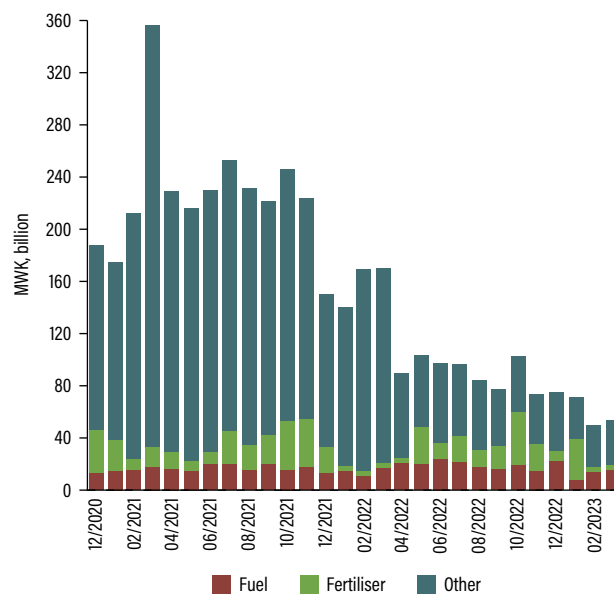
Seasonally adjusted merchandise imports, exports, and trade balance in 01/2022 in MWK



Source: World Bank staff calculations based on National Statistics Office Trade Bulletin data and Reserve Bank of Malawi Consumer Price Index data.

**FIGURE 1.17** Fuel and fertilizer have been largely protected from the fallout that affected other imports

Merchandise imports by component in 01/2022 in MWK



Source: World Bank staff calculations based on National Statistics Office Trade Bulletin data and Reserve Bank of Malawi Consumer Price Index data.

**Official exports are constrained by a weakness in some of Malawi's core export commodities and an adverse policy environment.** Tobacco continues to be predominantly officially exported. However, the global tobacco market continues to face long-term challenges of weakening global demand. The last exporting season through April 2023 yielded only 72 percent of the preceding 5-year average in real MWK. Prospects for the current exporting season, however, look promising with tobacco sales up by over 60 percent in volume by June 16<sup>th</sup> compared to the same time a year earlier, incentivized by a 11 percent higher price in nominal US\$. For other export crops, the incentives to export unofficially continue to grow with an increasing exchange rate spread, continued mandatory conversions of export proceeds, and other burdensome regulatory interventions.

**Official foreign exchange inflows increasingly come from international financial institution (IFI) disbursements rather than exports or foreign investment.** While tobacco exports have been declining and other merchandise exports have not been able to fully make up for this, the external financing gap has increasingly been filled by World Bank International Development Association (IDA) and IMF financing. In the year to June 2022, IDA disbursed US\$371 million while tobacco contributed US\$363 million. The IMF additionally disbursed US\$177 million during the same period, more than the second-largest category of merchandise exports, nuts, which contributed US\$112 million. The emergence of new non-traditional agricultural exports, and especially mining, could generate new sources of foreign exchange over the medium term (Box 1.3).

**Malawi's terms of trade have improved after declining for more than two years through June 2022.** The prices of many of the key commodities that Malawi imports such as petroleum fuel have decreased in recent months while the prices of Malawi's core export commodities have stabilized at a high level (Figure 1.18). This is reflected in improved terms of trade since the second half of 2022 (Figure 1.19). The prices of Malawi's commodity exports relative to its commodity imports are approximately at the level they were in late 2021, before the recent commodity price shock, and similar to mid-2019, before the onset of pandemic-induced disruptions.

**Amidst a thriving parallel market, the official exchange rate is increasingly only used for a limited number of transactions.** While officially a managed float regime, the Reserve Bank of Malawi (RBM) has attempted to enforce a peg to the US\$. A small section of strategic imports and government payments are supported directly through the RBM and most foreign exchange is allocated through Authorized Dealer Banks, which have to record transactions at the official rate. With the de-facto value of foreign currency significantly higher than the exchange rate set by the RBM, sellers of foreign exchange are becoming increasingly creative in ensuring they receive fair value. This is a phenomenon seen across countries with an overvalued exchange rate, such as in Ethiopia and (until recently) Nigeria (World Bank, 2022a). Sellers may charge fees or demand other benefits equivalent to the parallel market rates in actual trades. The primary exception are mandatory conversions instituted by the RBM in 2021, the enforcement of which have been stepped up recently, as well as transfers from development partners. 30 percent of official export proceeds

#### BOX 1.3 What potential does the mining sector hold for Malawi?

Malawi's mining sector can play a key role in driving growth and addressing fiscal and foreign exchange constraints. This is recognized in *Malawi 2063*, which sees mining as central driver of industrialization, especially if appropriate investments in domestic value addition can be achieved. However, currently the sector still plays a relatively small role, accounting for less than 1 percent of the GDP.

Currently, seven larger projects are moving ahead and may begin production before the end of the decade, with many of these likely to produce so-called "green minerals" necessary to support the energy transition. However, past mining projects in Malawi and elsewhere in the region have often failed to deliver on their promise. While projections from mining firms indicate that the sector could play a significant role in the economy, these projections need to be treated with caution at this stage given the many variables that could influence the materialization of these benefits.

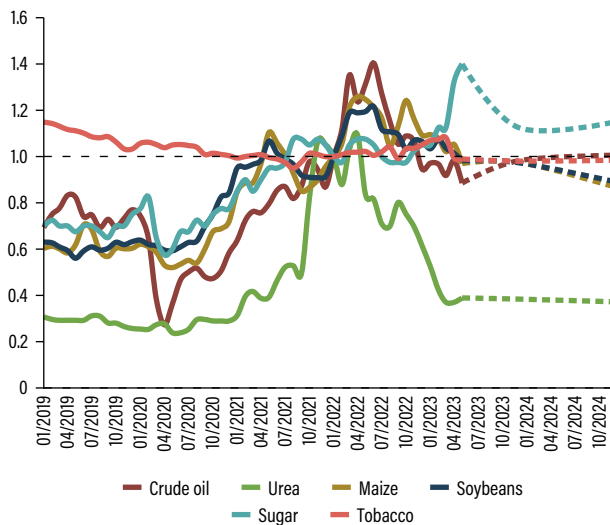
Moving ahead it will be important to ensure that these assets, which belong to the country, are not squandered. Production delays are common and price fluctuations can create significant uncertainty around likely revenue and export outcomes. The ongoing debt crisis in Ghana, was the result of, among others, heavy borrowing following the discovery of oil and poor public investment decisions. This means both incentivizing investment and ensuring that the Government maximizes the fiscal gains from these resources over many years, and spends these resources effectively to benefit the population. This will require a stable (but not necessarily low tax) fiscal regime, as well as careful assessments of the potential impact of different incentives.

The government is currently reforming the legal and institutional structure to support the sector. In this context, it will be important to ensure that expertise is sought to support negotiations and that all contracts are made public. Malawi's participation in the Extractives Industry Transparency Initiative creates an important institutional framework to support this.

have to be converted into Malawi kwacha immediately upon receipt. At the current 54 percent spread between official exchange rate and parallel market rate, this translates into an effective tax of approximately 10 percent on exports.

**FIGURE 1.18** Fertilizer and oil have been getting cheaper recently while Malawi's main exports have maintained their value

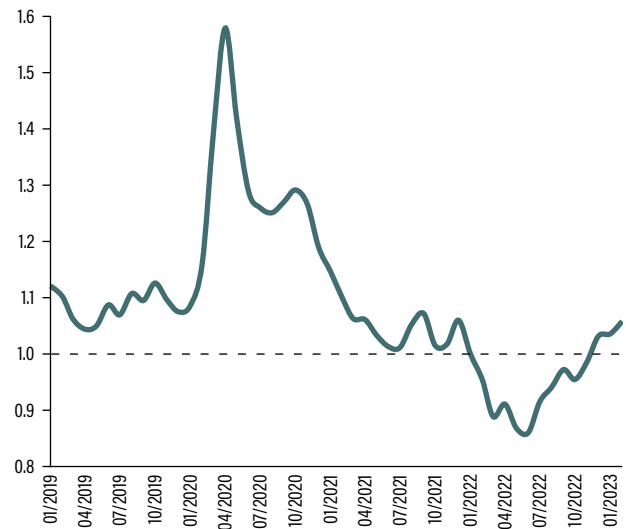
Price indices for select commodities (01/2022 = 1)



Source: World Bank staff calculations based on World Bank Commodity Markets data.

**FIGURE 1.19** After a long decline, Malawi's terms of trade are looking up

Commodity terms of trade, rolling weights by ratio of net exports to total commodity trade (01/2022 = 1)



Source: World Bank staff calculations based on IMF Commodity Terms of Trade data.

**Barter trade arrangements are unlikely to address the fact that Malawi exports too little of value to support its imports.** Plans for a commodity barter scheme to import fertilizer drew criticism from experts and have reportedly been cancelled in response to concerns (*The Investigator Magazine* 2023). The pricing structure was questioned, as were the amounts of commodities pledged by the Ministry of Agriculture, which constitute very large shares of official national production estimates (54.4 percent on average across the eight mentioned commodities,) and, except for sugar, exceeding 2022 total exports at least three-fold. Typically, countries resort to bartering when they are restricted from the international financial system or when they are highly indebted and commodities have superior credit enforcement properties (Marin and Schnitzer 2002). However, it is unlikely that Malawi would gain from barter relative to currency-based exchange, as money introduces advantages of transparency (an easily comprehensible unit of account), removes the requirement of coincidence of wants (that both trading parties have something on offer of value for the other party), removes some of the incentive to deliver low-quality goods (a common problem in barter arrangements) and tends to be a better store of value (money can easily be transferred and invested while goods often lose value when not needed immediately).

**Recent trade and industrial policy predominantly attempts to contend with the symptoms of these imbalances, rather than addressing their underlying causes.** This is exemplified by the introduction of Malawi Revenue Authority (MRA) export warehouses in the FY2023/24 budget that all official exports must pass through. Implementation on this measure started in May with the revocation of all export licenses, requiring all exporters to reapply. The measure adds another cost and potential delays for exporters. Malawi's capital account is already one of the more restrictive in the world (as measured by the Chinn-Ito Index), but this is likely to increase further following the gazetting of exchange control regulations in May 2022. While the justification of the exchange control regulations is to "increase the circulation of scarce foreign currency resources in the Malawi economy" and strengthened controls introduced with the budget are "in order to curb smuggling", such enforcement can have unintended consequences, including deterring foreign investors and incentivizing smuggling.

## Supply-side constraints and money supply growth are pushing inflation upwards

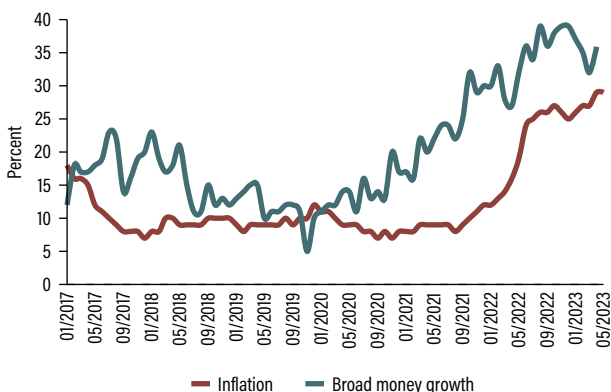
**Headline inflation continues on an upward trajectory driven by rising food prices.** Upward pressures on prices have contributed to headline inflation increasing to 29.2 percent in May 2023. Additional supply-related constraints to maize and other commodities on the domestic market induced inflationary pressures, contributing to food inflation rising to 38.8 percent in May 2023. While food inflation remains the primary driver of headline inflation, non-food inflation has gained momentum in recent months, increasing 18.4 percent, year-on-year (y-o-y), in May 2023. This is the highest since February 2016. Transportation is among the key drivers of non-food inflation, increasing by 26 percent year-on-year in May 2023. Moreover, electricity supply was still erratic at the beginning of the year and the additional cost of production from reliance on diesel-run generators to supplement power exerted pressure on non-food inflation.

**Money supply growth remains persistently high, further contributing to elevated inflation.** Annual growth of money supply has continued to increase since late 2019, following the onset of the COVID-19 pandemic (Figure 1.20). Induced by higher government borrowing to finance fiscal policy, especially through monetization of the fiscal deficit, money supply increased by 35.9 percent (year-on-year) in April 2023. The additional demand for goods and services emanating from this, amidst constrained output growth, is intensifying inflationary pressures.

**Domestic food prices remain elevated even after the harvest for the new agriculture season has commenced, with the impacts of Cyclone Freddy exerting additional pressure on prices.** Global food markets moderated during the first half of 2023. While this contributes to pressure easing on food prices, rising informal exports to the region have contributed to maize prices remaining on an upward trajectory, increasing from MWK 185.0 per kilogram in March 2022 and peaking at MWK 696.5 per kilogram in March 2023 (the highest annual increase in over 15 years) before declining to MWK 473.5 per kilogram in May 2023 (Figure 1.21). Further, the damage to crops and livestock by Cyclone Freddy and expected lowered agriculture output will likely result in food prices remaining elevated. Prices of other staple products have also remained high throughout this period.

**FIGURE 1.20** Increasing money supply is inducing pressure on inflation

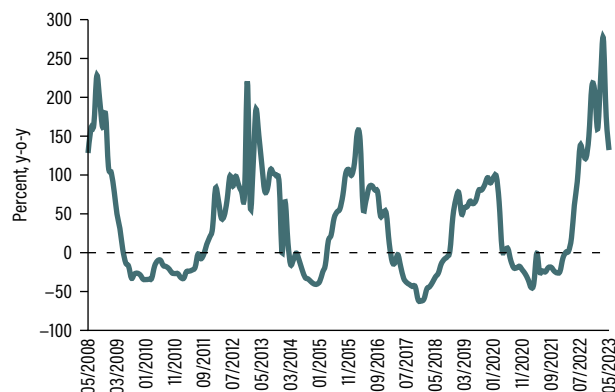
Currency in circulation (y-o-y) and inflation



Source: World Bank with data from RBM and NSO.

**FIGURE 1.21** Maize prices have seen the sharpest year-on-year increase in over 15 years

Percentage change



Source: World Bank with data from FAO FPMA Tool.

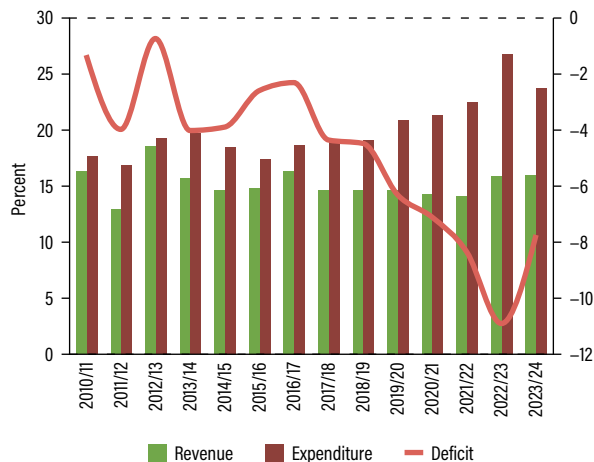
**While global pressures that contributed to rising non-food inflation have eased, domestic prices are still increasing.** Tariffs for electricity have not been adjusted yet, but erratic supply has increased the demand for charcoal and firewood, consequently pushing their prices upwards. Further planned tariff increases in electricity as well as water will exert additional pressure on non-food inflation. Consequently, housing, water and electricity inflation increased by 18 percent in May 2023, year-on-year.

## Despite strong performance on revenues, higher spending across budget categories led to a worsening fiscal position for FY2022/23

**Government overspent by over 4 percent of GDP relative to the revised FY2022/23 fiscal deficit.** Supported by good performance in taxes and grants, revenue surpassed the FY2022/23 target. However, overspending in compensation of employees and acquisition of non-financial assets (previously development expenditure) resulted in substantial expenditure overruns, and offset the good performance in revenue collection (Figure 1.22). Consequently, this exerted pressure on the fiscal deficit, reaching 10.9 percent and exceeding the revised target of 6.4 percent of GDP. This lack of budget discipline has been a consistent feature in recent years (Figure 1.23).

**FIGURE 1.22** Increased expenditure is contributing to worsened fiscal deficits

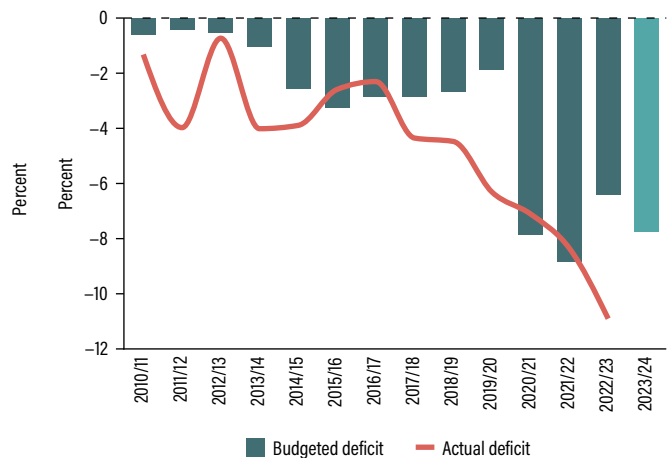
As a share of GDP



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

**FIGURE 1.23** Fiscal deficits continue to miss their approved targets

As a share of GDP



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

**While tax intake declined slightly, government exceeded its target contributing to a reasonably strong performance in domestic revenue, totaling 12.6 percent of GDP.** In FY2022/23, all categories of tax revenue, except “other taxes”, surpassed their fiscal year targets. Taxes on income, profits and capital gains totaled 5.7 percent of GDP against a target of 5.4 percent of GDP, boosted by strong performance in PAYE following the revision of the middle tax bracket. Due to intermittent electricity supply, most businesses sought alternative energy sources which increased their operational costs. This, compounded by forex and fuel shortages during the second quarter of the fiscal year, resulted in lower than anticipated corporate tax collection. The impact of these challenges extended to taxes on goods and services. Nonetheless, taxes on goods and services still marginally surpassed their FY target, totaling 5.2 percent of GDP against their fiscal year target of 5.1 percent of GDP. This performance was supported by a good performance of excise taxes. Taxes on international trade and transactions also performed well (1.1 percent of GDP), supported by the implementation of the advance income tax. Remittance of parastatal dividends was lower than anticipated, an indicator of the struggling performance of most parastatals. Consequently, this contributed to “other revenue” totaling to 0.6 percent of GDP, below the fiscal year target of 0.7 percent of GDP.

**Owing to frontloading of project resources, as well as increased disbursements for cholera and cyclone response, grants surpassed their fiscal year target.** Anticipating the recent trend to continue, the Government projected a total of 2.4 percent to be disbursed as grants for budget and project support. However, frontloading of project resources in the first half of the FY resulted in increased disbursements for the fiscal year and as a result, grants reached 3.2 percent of GDP, exceeding the revised target of 2.9 percent of GDP.

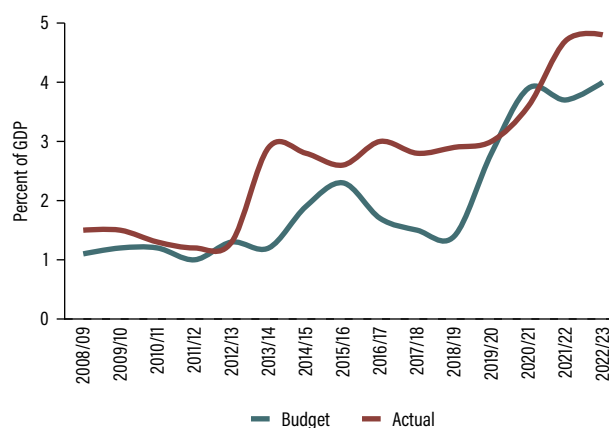
**Statutory expenditures, including salaries and wages, as well as interest expenses, continue to increase.**

These two components of statutory expenditure alone absorbed 67 percent of revenue in FY2022/23 (84 percent of domestic revenue), eroding fiscal room for other expenditures. The government overspent on employee compensation, reaching 5.9 percent of GDP and higher than the revised fiscal year target of 5.3 percent of GDP. This was driven by a higher than budgeted adjustment in wages and salaries. Interest expense reached 4.8 percent of GDP (Figure 1.24), which was within the fiscal year target of 4.9 percent of GDP.

**The performance of statutory expenditure, compounded by higher than targeted spending in other expenditure categories, resulted in significant overruns in FY2022/23.**

Spending on goods and services reached 3.2 percent of GDP, exceeding the revised target of 3.0 percent of GDP. This was mainly driven by overspending in generic goods and services which totaled 2.0 percent of GDP, higher than the revised target of 1.8 percent of GDP. Spending pressures on the Affordable Input Programme (AIP) also contributed to overruns in social benefits which reached 2.0 percent of GDP, compared to a revised target of 1.7 percent of GDP. Acquisition of non-financial assets (previously development spending) totaled 7.3 percent of GDP, exceeding the targeted 4.8 percent of GDP. This was driven by overruns in both foreign financed components, supported by frontloading of project resources, and domestically financed expenditure. Cumulatively, total expenditure for FY2022/23 amounted to 26.8<sup>14</sup> percent of GDP, exceeding the target of 21.6 percent of GDP.

**FIGURE 1.24** Interest expense has mostly missed FY targets contributing to expenditure overruns



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

**Given constraints to foreign non-concessional borrowing, the Government continued to finance the fiscal deficit using domestic borrowing.**

In FY2022/23, 4.0 percent of GDP<sup>15</sup> was borrowed from the domestic market, and especially the banking sector. This increased borrowing is contributing to increased money supply, which is inflationary, and crowds out resources for private sector investment. In addition, interest rates are high and still increasing. This will further push public debt service charges upwards.

**TABLE 1.1** Fiscal accounts

Percent of GDP

	2019/20	2020/21	2021/22	2022/23			2023/24
				Act	Rev	App	App
<b>Revenue</b>	14.6	14.3	14.1	15.9	15.2	14.9	16.0
<b>Domestic Revenue</b>	13.1	12.8	13.0	12.6	12.4	12.4	14.1
<b>Taxes</b>	12.4	12.0	12.3	12.1	11.6	11.7	13.3
Taxes on Income, Profits and Capital Gains	5.8	5.6	5.5	5.7	5.4	5.6	6.2
Taxes on Goods and Services	5.5	5.4	5.7	5.2	5.1	5.1	5.6
Taxes on International Trade and Transactions	1.0	1.0	1.1	1.1	1.1	1.0	1.5
Other Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Grants</b>	1.5	1.5	1.1	3.2	2.9	2.4	2.0
From Foreign Governments	—	—	—	0.2	0.2	—	0.1
From International Organizations	1.5	1.5	1.1	3.1	2.7	2.4	1.9

14. This includes capital transfers for RBM recapitalization.

15. This figure is still missing February and March 2023.

	2019/20	2020/21	2021/22	2022/23			2023/24
				Act	Rev	App	App
<b>Other Revenue</b>	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.6</b>	<b>0.7</b>	<b>0.8</b>	<b>0.7</b>
Property Income	0.3	0.4	0.1	0.1	0.4	0.5	0.3
Sale of Goods and Services	0.5	0.3	0.6	0.4	0.3	0.3	0.4
Fines, Penalties and Forfeits	0.0	0.1	0.0	0.0	0.0	0.0	0.0
<b>Expenditure</b>	<b>20.9</b>	<b>21.4</b>	<b>22.5</b>	<b>26.8</b>	<b>21.6</b>	<b>21.5</b>	<b>23.8</b>
<b>Expense</b>	<b>16.7</b>	<b>17.8</b>	<b>18.7</b>	<b>19.5</b>	<b>16.9</b>	<b>15.3</b>	<b>18.5</b>
Compensation of Employees	5.5	5.8	6.1	5.9	5.3	5.2	5.8
Goods and Services	4.0	3.6	3.7	3.2	3.0	2.7	3.4
Generic goods and services	2.5	2.2	2.2	2.0	1.8	—	2.1
Interest	3.0	3.6	3.3	4.8	4.9	4.0	5.7
To non-residents	0.2	0.2	0.2	0.3	0.3	0.1	0.2
To residents other than general government	2.8	3.4	3.2	4.5	4.6	3.8	5.5
Grants	2.7	1.9	2.1	3.4	1.8	1.6	1.9
Social Benefits	1.4	2.5	3.1	2.0	1.7	1.6	1.6
Fertilizer payments	0.3	1.3	2.0	1.1	0.7	0.7	0.6
Other Expenses	0.1	0.3	0.4	0.1	0.1	0.1	0.1
<b>Acquisition of Non-Financial Assets</b>	<b>4.3</b>	<b>3.6</b>	<b>3.8</b>	<b>7.3</b>	<b>4.8</b>	<b>6.2</b>	<b>5.2</b>
Foreign financed	2.4	2.6	2.0	5.6	3.9	4.4	3.8
Domestically financed	1.8	1.0	1.7	1.7	0.9	1.8	1.4
<b>Net borrowing</b>	<b>-6.3</b>	<b>-7.1</b>	<b>-8.4</b>	<b>-10.9</b>	<b>-6.4</b>	<b>-6.7</b>	<b>-7.7</b>
<b>Primary Balance</b>	<b>-3.3</b>	<b>-3.5</b>	<b>-5.0</b>	<b>-6.1</b>	<b>-1.5</b>	<b>-2.7</b>	<b>-2.0</b>
<b>Net incurrence of liabilities</b>	<b>5.7</b>	<b>6.9</b>	<b>8.6</b>	<b>7.2</b>	<b>6.4</b>	<b>6.7</b>	<b>7.7</b>
<b>Foreign Liabilities</b>	<b>0.8</b>	<b>1.0</b>	<b>0.9</b>	<b>1.9</b>	<b>2.0</b>	<b>1.7</b>	<b>0.8</b>
Programme Borrowing	0.0	0.3	-	-	0.7	0.3	-
Project Loans	1.2	1.1	0.9	2.6	2.4	2.0	1.8
Amortization	-0.4	-0.4	0.0	-0.7	-1.2	-0.5)	-1.0
<b>Domestic Liabilities</b>	<b>4.9</b>	<b>5.9</b>	<b>7.7</b>	<b>5.3</b>	<b>4.4</b>	<b>5.0</b>	<b>6.9</b>

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

## Government projects that the budget deficit will improve in FY2023/24, but fiscal room remains highly constrained

**Supported by an expected improvement in revenue collection, the fiscal deficit is projected to slightly narrow in FY2023/24.** Revenue is projected to increase to 16.0 percent of GDP. This is expected to keep the deficit at 7.7 percent of GDP in FY2023/24, considering increased expenditure.

**Higher tax collection is expected to drive the improvement in revenue.** All major tax categories are projected to increase over FY2022/23 collections, reaching 13.3 percent of GDP, supported by implementation of new tax measures and efficiency-improving administrative reforms. The government introduced a 40 percent tax on banks that are making profits beyond K10 billion. While these charges are likely to increase government revenues, they will probably also be passed on to consumers, potentially further reducing access to credit. Across budget components, the main drivers of expected increases in tax revenue are taxes on income, profits, and capital gains as well as taxes on goods and services, which are projected to reach 6.2 and 5.6 percent of GDP, respectively. Other revenues are projected to slightly improve to 0.7 percent of GDP but poor performing State-Owned Enterprises (SOEs) may make it difficult to reach targets on the remittance of parastatal dividends (Box 1.4). Contrary to anticipated good performance in taxes, disbursements of grants are projected to decline to 2.0 percent of GDP.

**BOX 1.4 Fiscal risks emanating from poor performing SOEs are increasing**

**Performance of SOEs has deteriorated in recent years, posing significant fiscal risks.** In Malawi, SOEs are grouped into three categories – commercial (those that are market oriented); semi-subservent (relying on partial funding from the government); and fully subservent (those relying solely on government funding). An assessment of 28 commercial SOEs categorized into trading (14), regulatory (9) and service providers (5) revealed that 46 percent incurred losses in 2021 – an increase from 23 percent in 2018. This was driven by trading SOEs, with 71 percent reporting losses in 2021, an increase from 21 percent in 2018, and especially in the water and energy SOEs due to the persistence of non-cost reflective tariffs. The proportion for regulators reporting losses remained the same, and others registered surpluses but at a declining rate.

**Overall, commercial SOEs have a high-risk position in terms of their return to assets (ROA).** About 90 percent of the total assets are in the trading sector. However, the return to assets for this category was consistently below the international threshold of 5 percent and has been negative since 2021. The main driver of this performance were SOEs in the communication sector, reporting a ROA of -20 percent in 2021. SOEs in the energy and water sectors reported a ROA of 2 percent. While regulatory SOEs continue to register a strong ROA, the ratio declined from 21 percent

in 2018 to 9 percent in 2021, driven by the performance of the Malawi Communications Regulatory Authority. Service providers had an ROA of -23 percent in 2021.

**Return on equity for the commercial SOEs also dwindled.** Driven by poor performing SOEs in the communication and water sectors, return on equity dwindled for trading entities, from 9 percent in 2019 to -8 percent in 2021. A similar trend was also reported for service providers, with their ROE dwindling to -3 percent in 2021, down from -1 percent in 2019. This was driven by poor performing SOEs in the governance sector. Regulators continued to report good ROEs, albeit at a declining rate, to 18 percent in 2021 from 25 percent in 2019, thus maintaining their performance above the international threshold of 15 percent.

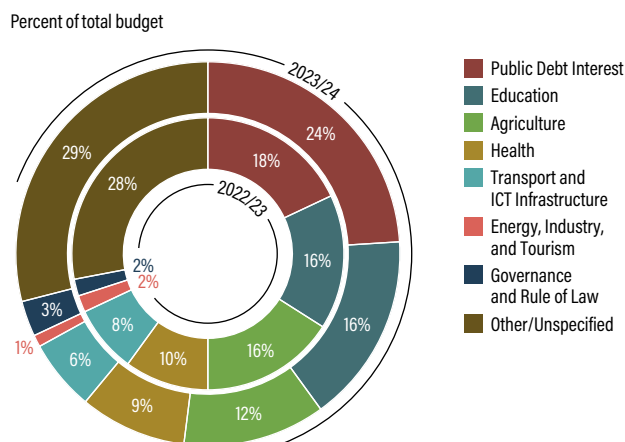
**Most SOEs were still heavily indebted taking into account trade receivables.** Though significant, the interest-bearing debt was still low but needs to be kept in check as it has a bearing on the budget. There was a steady increase in the portions of the cash flow of trading SOEs that was used for debt service from 2017 to 2020. This proportion increased in 2021 to 4.5 percent from 0.11 percent in 2019 indicating that institutions were facing challenges in meeting interest payments.

Source: MoFEA (forthcoming)

**Driven mainly by compensation of employees and interest expense, expenditure is projected to increase to 23.8 percent of GDP in FY2023/24.** The Government has adjusted wages and salaries for the civil service by 8 percent, significantly below the rate of inflation of 17.9 percent as well as the requested 35 percent by civil service trade union. Nonetheless, this has contributed to higher allocation for compensation of employees, reaching 5.8 percent in FY2023/24. This amount also includes an allocation of MWK 36 billion for transport allowance for the civil service. Amidst rising domestic interest rates in light of high domestic debt levels, interest payments are projected to increase to 5.7 percent of GDP in FY2023/24 from 4.8 percent of GDP in FY2022/23. Consequently, statutory expenditures will absorb 94.7 percent of the total domestic revenue (or 99.8 percent of taxes), thereby further constraining fiscal room for discretionary policy as well as the ability to respond to shocks. Government is reforming the AIP and has reduced its allocation to K102 billion, which implies a real decline in the size of the program. However, based on the outturn performance in the previous two fiscal years, there is a significant risk that this target could be exceeded. In addition, poor performing SOEs (Box 1.4) pose an additional fiscal risk to implementation of the budget and the fiscal consolidation process. Acquisition of non-financial assets (development spending) is also projected to increase, reaching 5.2 percent of GDP in FY2023/24, supported by projected growth in both domestically and foreign financed components.

**Sectoral allocation has not changed significantly, and spending on social and productive sectors is increasingly being crowded out by interest expense.** Education continues to be the largest sector, representing 15.6 percent of the total budget, followed by agriculture, representing 11.8 percent of the total budget. In addition to the reduction on AIP, the agricultural sector will receive a lower share of the budget in 2023/24 than in 2022/23. Like last FY, interest expenditure will eclipse all other sectors, with an allocation of MWK 914 billion compared to MWK 603 for education (Figure 1.25).

**FIGURE 1.25 Allocation for interest expense is eclipsing sectoral allocations**



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

**Government continues to finance the deficit using mainly domestic resources.** The projected net borrowing of 7.7 percent of GDP in FY2023/24 will be financed by 0.9 percent of GDP foreign borrowing and 6.9 percent of GDP domestic borrowing. If the trend of financing the deficit using borrowing from the RBM is maintained in FY2023/24, this will likely induce additional inflationary pressures.

**The Government is advancing implementation of public finance management (PFM) reforms to support expenditure management and the fiscal consolidation process.** Since the beginning of FY2023/24, the Government is piloting quarterly budgetary allotments and requiring Ministries, Departments and Agencies to commit up to the amount allotted within the Integrated Financial Management Information System (IFMIS). This will help address overcommitments, which has resulted in growth of spending arrears. To this effect, the Government communicated to ministries, departments and agencies through a circular to adhere to this requirement. In addition, to support this directive, the Government communicated to suppliers that delivery of goods and services should be supported by an IFMIS-generated Local Purchase Order.

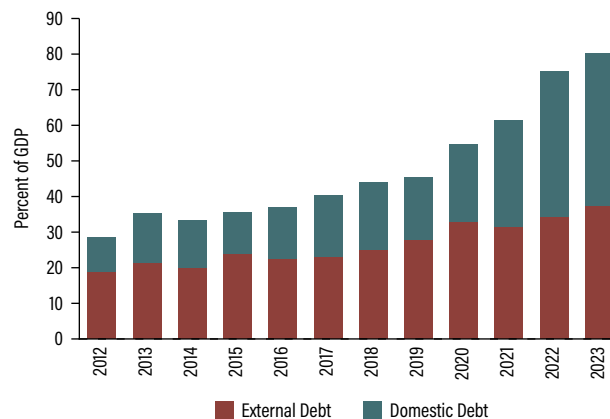
### Government debt is still in distress and unsustainable, but ongoing external debt restructuring negotiations, if successful, will help ease the burden

**Rising total public debt and debt servicing costs pushed public debt into distress.** Weak performance of the external sector and insufficient revenue mobilization over many years have contributed to worsened debt vulnerabilities, already pressured by rising debt and debt servicing costs. The joint World Bank-IMF November 2022 Debt Sustainability Analysis reported that public debt is in distress under current policies but ongoing external debt restructuring negotiations with commercial and bilateral creditors will help bring debt on a downward trajectory over the medium term. The negotiations remain ongoing and focus on interest rate deductions, repayment moratoria, as well as extending the maturity profile of both commercial and bilateral external debt to reduce refinancing risk and thus contribute to easing the pressure on forex reserves.

**Government's public debt is high and still rising.** The worsening fiscal deficit continues to push public debt on an upward trajectory. Public debt increased to 75.2 percent of GDP in December 2022, up from 61.5 percent of GDP in December 2021 (Figure 1.26). This jump was driven by both domestic and external debt. The Government's recourse to mainly finance high fiscal deficits with high-cost domestic borrowing contributed to domestic debt reaching to 40.8 percent of GDP in 2022, up from 30.0 percent in 2021. External debt also increased to 34.4 percent in 2022, from 31.5 percent of GDP in 2021. This was driven by conversion of short-term swaps, which were contracted for increasing liquidity, into medium-term swaps.

**Monetization of the fiscal deficit is shifting public debt towards the monetary sector, with inflationary impacts.** The share of domestic debt in total public debt increased to 57 percent in 2022, up from 53 percent in 2021. Within this subsector, the composition of public debt by holder, is shifting towards the RBM, exerting upward pressure on already high levels of money supply and thereby increasing risks of further inflation. By December 2022, total public debt held by the RBM had increased to 21 percent of total debt, up from 15 percent in December 2021 (Figure 1.27). For external debt, multilateral organizations remain the largest creditors, holding 32 percent of total public debt (74 percent of public and publicly guaranteed (PPG) external debt) in 2022 compared to 68 percent of PPG external debt in 2021. However, debt held by bilateral and commercial lenders declined to 5 and 6 percent of total public debt in 2022 from 6 and 9 percent, respectively, in 2021. The non-concessional form of the latter has increased the external debt burden, especially from debt servicing.

FIGURE 1.26 Public debt is still increasing rapidly



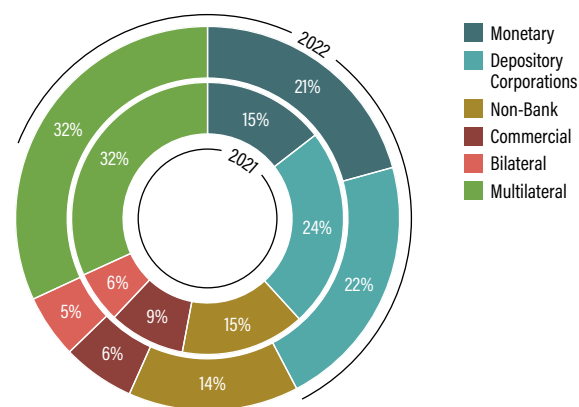
Source: World Bank with data from Ministry of Finance and Economic Affairs.

**Domestic debt continues to move towards long-term treasury notes, in line with the Government’s Medium-Term Debt Strategy (MTDS).** The new MTDS for 2023 to 2026 maintains the option of financing using long-term instruments, to contain the refinancing risk from a high share of short-term debt. However, debt held in treasury bills had increased to 12.3 percent of total debt by December 2022, compared to 9.9 percent in December 2021 (Figure 1.28). Consequently, debt held in treasury notes declined, from 87.8 percent of total debt in 2021 to 82.2 percent in 2022. Recapitalization of the RBM’s loss from the 25 percent devaluation in May 2022 pushed debt held in other instruments upwards, from 2.4 percent in 2021 to 5.5 percent in 2022.

**High and rising cost of domestic debt instruments have contributed to rising debt servicing costs.** While multilaterals are the highest holder, the concessional nature of their debt contributes to lower external debt servicing costs. In FY2022/23, external interest expense increased slightly to 0.3 percent of GDP from 0.2 percent in in FY2021/22, driven by increased interest payments towards commercial external debt. Higher domestic debt held in treasury notes, given the high-cost nature of these instruments, has resulted in significant increase of domestic debt servicing costs.

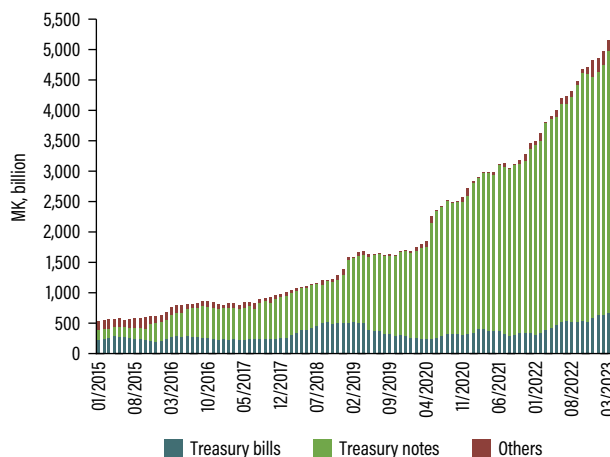
**To effectively ease the debt burden, on-going debt restructuring negotiations need to be supported by fiscal consolidation and prudent monetary policy.** To attain this, the Government needs to ensure that borrowing to support implementation of fiscal and monetary policy, especially medium to long-term debt, adheres to a non-concessional borrowing limit. Projects that the government is implementing with borrowed funds, such as the Lilongwe-Salima water project (Box 1.5), should be cost-effective and ably generate resources for debt repayment. Otherwise these risk adding pressures to the country’s debt vulnerability.

**FIGURE 1.27** Composition of public debt by holder



Source: World Bank with data from MoFEA.

**FIGURE 1.28** Increased interest expense has been driven by higher debt held in high-cost treasury notes



Source: World Bank with data from RBM.

**BOX 1.5** The Lilongwe-Salima water project raises transparency and debt sustainability concerns

**The Government of Malawi is planning on commencing implementation of the Lilongwe-Salima Water Project.** The project will abstract and treat water in Lifuwu in Salima and transport the treated water to Lilongwe. The project was initiated in 2015 but implementation was delayed due to challenges in accessing private sector funding.

**In the FY2023/24 budget, the Government allocated MWK500 million to the secretariat of Special Purpose Vehicles for the project.** These resources were allocated to facilitate financing agreements, preparatory works and documentation, among others. Towards the end of the parliamentary sitting ending in April 2023, the Government submitted to parliament a bill to authorize National Bank of Malawi and NBS banks to source private resources of MWK105 billion which would be injected into the project as equity for the government. However, transparency on the project remains a problem. Information on the

conditions for the loan were not provided to parliament for vetting, nor was the loan included in the budget for FY2023/24. This understates the fiscal deficit and domestic borrowing for the fiscal year.

**In line with other large-scale investment projects, it will be important to conduct a cost-benefit analysis to ensure that the project is cost-effective, especially given the high-cost nature of domestic debt and the consequent debt vulnerabilities that would result from this.** Moreover, this project is energy-intensive considering the amount of energy required to pump water from Salima to Lilongwe, which is 600 meters above the lake. This will crowd out already limited energy supply (see chapter 2) to other productive sectors. Further, to ensure that there is transparency and accountability in implementation of the project, the Government should submit relevant information, including on project financing, to parliament.

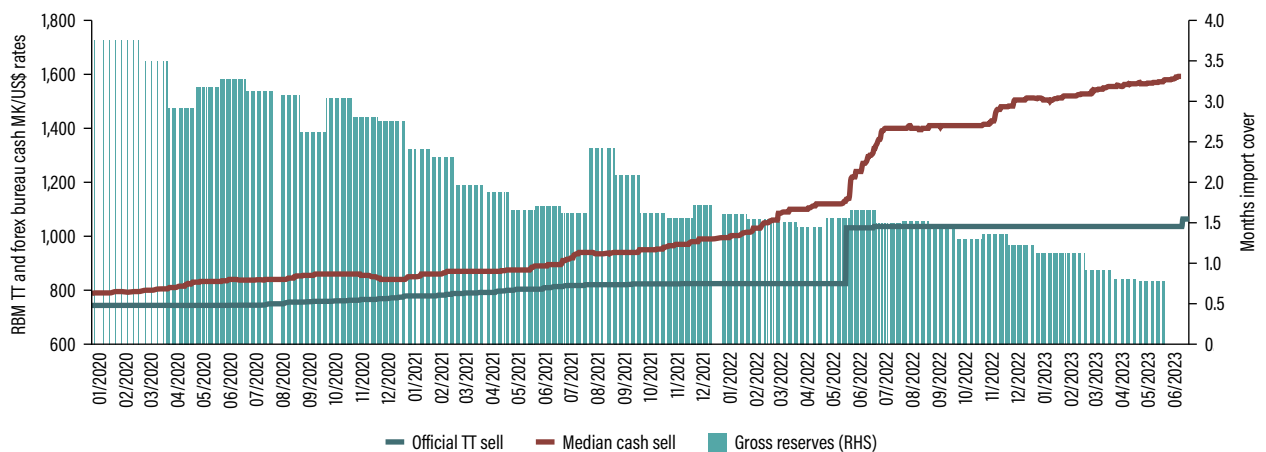
## The Malawi kwacha has experienced a sharp depreciation, as foreign exchange shortages remain severe

**The Malawi kwacha continued to weaken in the first half of 2023, with widening spreads between telegraphic transfer (TT) and bureau MWK-US\$ exchange rates.** Despite the official kwacha-US dollar exchange rate being adjusted downward by 25 percent in May 2022, the spread between the official rate and the less strictly controlled rates on cash purchases at foreign exchange bureaus at times exceeded 54 percent in June 2023 (Figure 1.29). This spread has surpassed the pre-devaluation level of late May 2022. While the official exchange rate remains at MWK1,064 per US\$ since May 2022, the median bureau rate reached MWK1,592.5 in mid-June 2023, the highest in recent years.

**The forex shortage remains acute.** Gross reserves decreased by half from US\$388 million in May 2022 to US\$195 million in May 2023, equivalent to around 0.8 months of import cover (Figure 1.29). This is much lower than the recommended adequacy level of 3.9 months of import cover for a credit-constrained economy (IMF, 2022b). The May 2022 exchange rate adjustment had only limited impact to support the build-up of official reserves. Net reserves have been negative, and gross reserves have been mainly supported by substantial rollover swaps.<sup>16</sup> The disbursements of IDA projects and the IMF Rapid Credit Facility also eased pressures in late 2022 and early 2023.

**FIGURE 1.29** As reserves decline, the spreads between TT and bureau MWK-US\$ exchange rates continue to widen

RBM telegraphic transfer (TT) and forex bureau (FXB) cash MWK/US\$ rates and spreads through June 28 and official gross reserves, months import cover



Source: World Bank staff calculations based on RBM data.

**Various measures have been taken to rebuild foreign reserves, albeit challenges remain.** Given constraints on non-concessional external borrowing, short-term swap rollovers remain a key source of reserves, though the RBM has begun to wind down new foreign exchange swaps with non-residents in recent months (Figure 1.30). The RBM plans to increase purchases of foreign exchange from the market and conduct foreign exchange auction with market-determined rates, but these plans are only proceeding slowly. The pilot auction in January 2023 was cancelled due to insufficient interest by authorized dealer banks. A further auction held in June 2023 saw the participation of all Authorized Dealer Banks and resulted in the new market selling price increasing to MWK1,063.86 per US\$. While this marks the first rate increase since May 2022, the spread between TT and bureau MWK-US\$ exchange rates remains large.

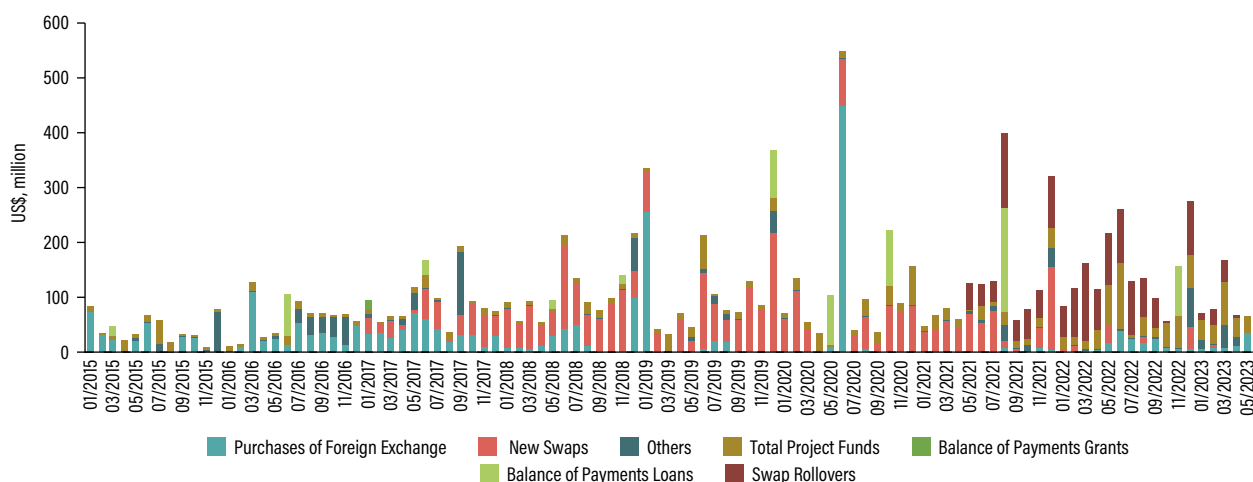
**The new “Foreign Exchange Act” being proposed by Government aims to address some of these issues but may also have unintended consequences on investment.** The draft legislation puts more

16. Net reserves subtract predetermined short-term liabilities, such as swaps with maturity of one year or less.

restrictive capital controls and transfer restrictions on multinational companies and places restrictions on domestic firms' access to foreign exchange. These measures could have an adverse impact on attracting new foreign investment and potentially undermine the competitiveness of the domestic private sector that may not be able to import critical inputs for production or services they provide. In finalizing this legislation, it will be important to find a balance between bringing stronger controls into the foreign exchange market and ensuring that this does not create additional barriers for much-needed investment.

**FIGURE 1.30** Swap rollovers have been increasingly used as sources of foreign exchanges

RBM source of foreign exchange by type



Source: World Bank staff calculations based on RBM data.

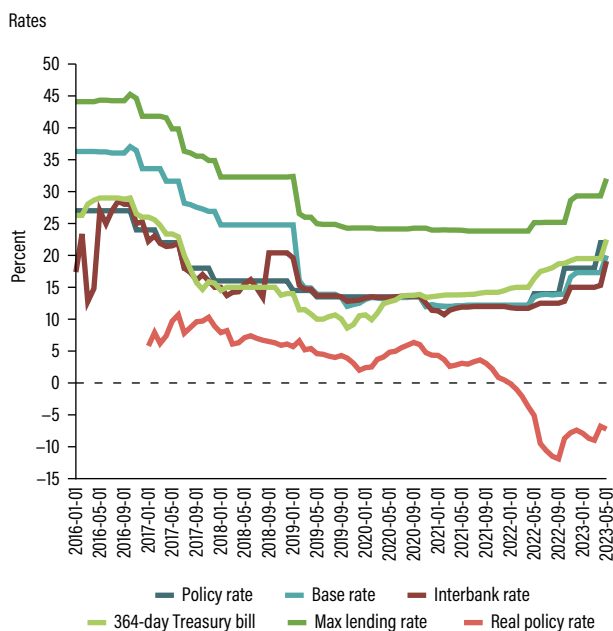
## The RBM has further increased the policy rate to 22 percent, but so far monetary policy has had limited impact on containing inflation

**With rising inflationary pressure in early 2023, the Monetary Policy Rate was increased by four percent in April 2023.** The Monetary Policy Committee (MPC) increased the policy rate from 18 to 22 percent in April 2023 after noting that the inflation outlook had worsened since the last MPC meeting in February 2023. Inflationary pressures have increased since early 2023 induced by domestic shocks, including the impact of the Cyclone Freddy. In addition, the need to rehabilitate the infrastructure damaged by the cyclone may amplify aggregate demand and further fuel inflation (RBM 2023). The MPC also adjusted the Liquidity Reserve Requirement upwards to 5.75 percent to contain the growth in money supply.

**To date, the tightening of monetary conditions has been insufficient to contain inflationary pressures—in large part due to the continued increase in the money supply primarily through monetization of fiscal deficits.** In response to the policy rate increases, the base lending rate and interbank rate have increased (Figure 1.31). The policy rate increase and strong government demand led to a rise in monthly average Treasury bill and note yields across all the tenors (Figure 1.32). Yields on 364-day bill increased by 269 basis points since the beginning of the fiscal year. This exerts additional pressure on an already difficult domestic public debt situation by increasing interest payments. Despite some efforts by the RBM to address rising inflation, the real policy rate has been negative, reaching  $-7.24$  percent in May 2023 and the money supply continue to expand (Figure 1.31).<sup>17</sup>

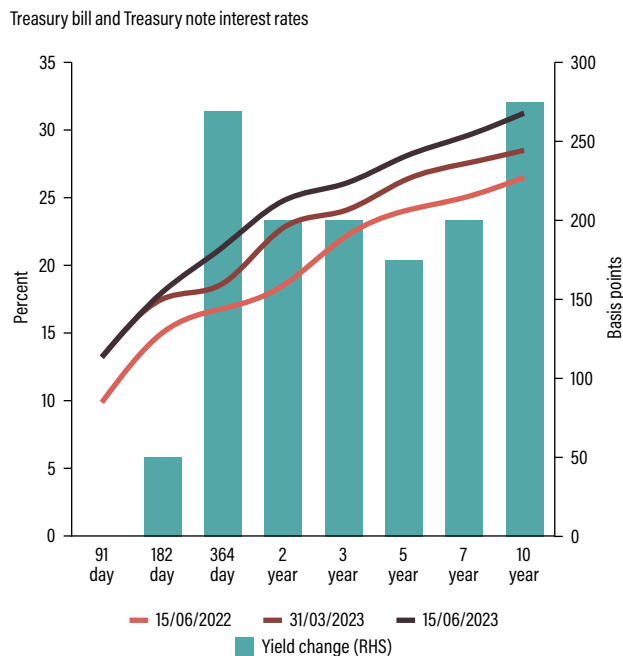
17. There was an uptake of Treasury bills by RBM in 2022, while the commercial banks remain the largest holder.

**FIGURE 1.31** While the real policy rate remains negative, the base lending rate and interbank rate have increased



Source: World Bank staff calculations based on RBM data.

**FIGURE 1.32** The yield of 364-day bills climbed over the year



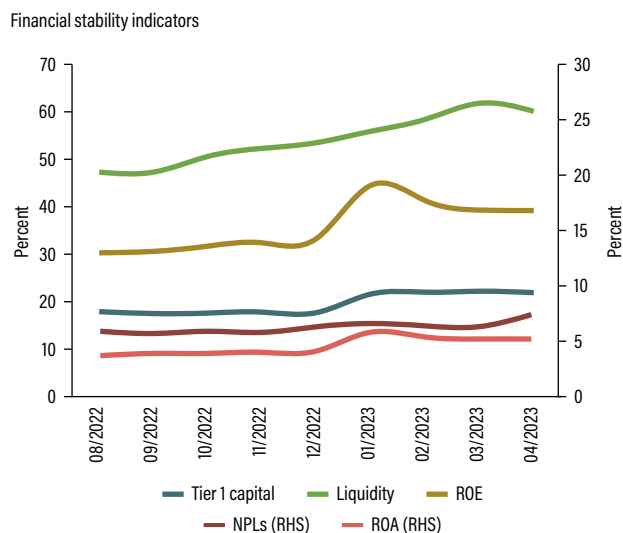
Source: World Bank staff calculations based on RBM data.

### The banking sector remains well capitalized, highly profitable and has ample liquidity, though NPLs are on the rise

**The Malawian banking sector has maintained a solid capital and liquidity position despite economic challenges facing the country.** As of May 2023, the total capital ratio and tier I capital ratio was at 21.6 percent and 24.8 percent, respectively, compared to regulatory minimum levels at 10.0 percent and 15.0 percent (Figure 1.33). This is higher than in May 2022 when the ratios reached 18.9 percent and 22.3 percent. The liquidity coverage ratio increased to 58.4 percent from 47.4 percent in May 2022.

**By April 2023, the level of non-performing loans (NPLs) had increased by 20.7 percent per year over the same period in 2022.** NPL as a ratio of gross loans increased to 7.4 percent in April 2023, compared to 6.1 in April 2022 and 6.6 in January 2023, representing faster growth in 2022 and the first quarter of 2023. As at the beginning of 2023, the wholesale and retail sector accounted for 29.2 percent of total NPLs, followed by the restaurants and hotels sector at 23.0 percent and the community, personal and social services sector at 19.4 percent. Although lending to the restaurants and hotels sector accounted for 3.8 percent of the total private sector credit, the NPLs for this sector account for 23.0 percent of NPLs, reflecting a potential impact of lagged returns from capital investments to cover loan obligations. Provisioning for NPLs has remained high, at 31 percent in April 2023, implying that banks are comfortably covered for the cost of NPLs.

**FIGURE 1.33** Bank resilience is reflected in financial stability indicators



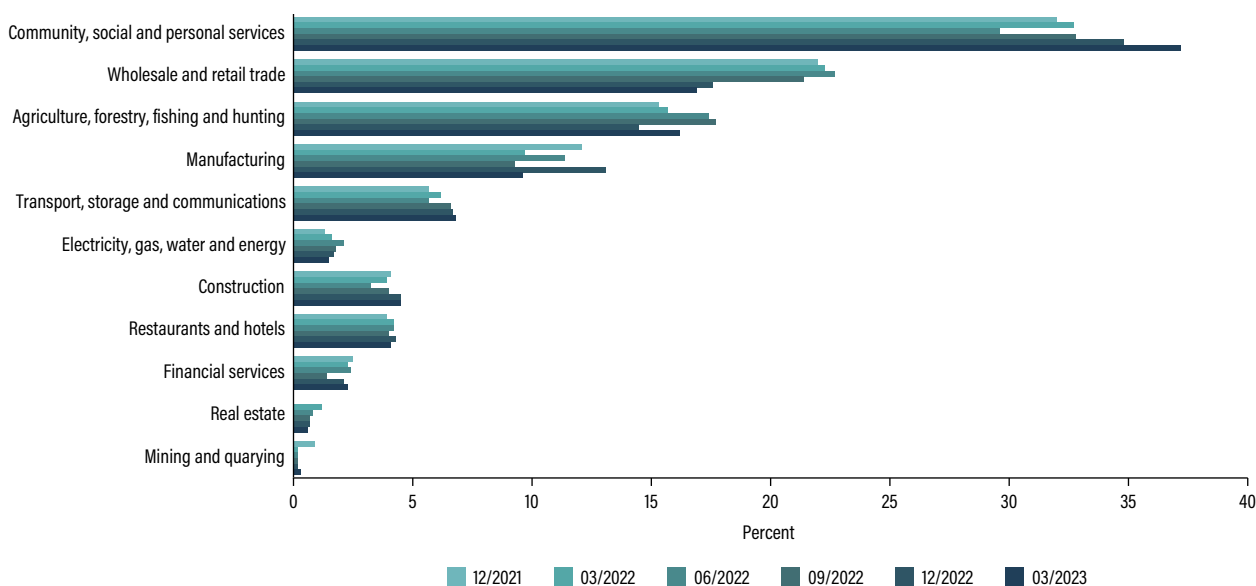
Source: World Bank staff calculations based on RBM data.

**Malawian banks reported higher profit levels in December 2022 compared to the previous year.** The sector’s profit after tax increased by 54.5 percent compared to the same period in 2021. This can be attributed to a large increase in gross income by 124.1 percent, and a slightly lower increase in expenses of 114.5 percent. The growth in gross income was mainly due to an increase of 41 percent in net interest income, 89.5 percent in foreign exchange income and 27.7 percent in other non-interest income. As of April 2023, return on equity and return on assets increased by 39.2 and 5.2 percent, respectively. While the economy is struggling, banks have been able to increase their profits by lending to Government and other low-risk clients with strong willingness and capability to repay, leveraging the resources of their clients efficiently, and earning significant foreign exchange revenues amid acute foreign exchange shortages.

**There has been an increase in bank lending to the private sector, notably for consumption.** In total, MWK 960 billion of loans were outstanding as of March 2023 a slight decrease from MWK 980 billion in December 2022 primarily directed at three sectors: the community, social, and personal services sector, the wholesale and retail trade sector, and the agriculture, forestry, fishing, and hunting sector (Figure 1.34). In total, MWK 1.1 trillion of loans were outstanding as of December 2022 from MWK 868.6 billion in December 2021 primarily directed at three sectors: the community, social, and personal services sector, the wholesale and retail trade sector, and the agriculture, forestry, fishing, and hunting sector. Combined, these three sectors accounted for 70.3 percent of the total loan portfolio. Specifically, loans to community, social, and personal services accounted for 37.2 percent in April 2023. These loans are typically used to finance consumption. A similar trend was observed in the recent survey on access to finance from informal sources (Box 1.6). Although banks are supporting economic growth through lending, total exposure of just 30 percent in December 2022 going to agriculture (14.5 percent), manufacturing (11.7 percent) and restaurants and hotels (3.8 percent), reflects a need for more focused commitment to these sectors as they have more impact on economic growth, generation of export revenues and creation of jobs.

**FIGURE 1.34 Bank lending is predominant in three sectors**

Monthly share to total lending in selected sectors



Source: World Bank staff calculations based on RBM data.

**The other subsectors of the financial sector are resilient, albeit with increasing challenges.** The micro-finance sector remained stable, resilient, and profitable. The total assets of the sector have continued to grow, and total capital and liquidity ratios are adequate and above the regulatory minimum. A strong growth in assets and positive investment returns was recorded in the pension sector in the second

half of 2022. This was primarily due to the new members who were enrolled in the national pension scheme. In December 2022, the capital to total assets ratio of the Life Insurance sector increased to 7.1 percent from 6.6 percent in June 2022. Over the period, the industry’s aggregate core capital increased by 19.9 percent. With two life insurers accounting for 87.5 percent of gross premiums, market concentration risk has remained high in the sector. The capital and solvency position of General Insurance was adequate, albeit marginally. However, amid rising need for credit, most Malawian households borrow through informal channels (Box 1.6).

**BOX 1.6 Consecutive shocks have pushed many Malawian households to borrow money, relying primarily on informal sources**

**The High-Frequency Phone Survey (HFPS)\* shows that during COVID-19 and the most recent period of rising inflation, the share of households with outstanding loans has increased in the country.** The proportion of indebted households grew from 15 percent in 2020 to 63 percent in 2022. While most households (84 percent) attempted to borrow during the pandemic, about 50 percent of households asked for a loan between 2021 and 2022, which is still higher than the pre-Covid level (30 percent) observed in the 2019/20 Household Survey (Figure B1.6.1). Economic shocks in the form of job losses of the main earner, the reduction in the price of the selling output, as well as adults not eating for a whole day, are closely related to the likelihood of trying to borrow (between 50 and 70 percent) in the subsequent months following the shock.

**Access to finance for households comes mainly through friends and relatives, a trend that has increased in 2022.**

Personal ties have been the main source of finance for households even before the COVID-19 pandemic. Nevertheless, the share of households reporting such loans has grown from 28 percent during the pandemic to 45 percent in 2022. Similarly, saving groups, which consist of a group of people pooling their money into a fund to be able to borrow from it, also gained importance during 2022 with 30 percent of households reporting it as the main source of finance, in contrast to the 23 percent of households relying on savings groups during the pandemic. Instead, only 3 percent of households reported credits with commercial banks in 2022, just above the 2 percent reported during COVID-19 and the 1 percent before it. Use of other credit institutions was reported by 9 percent of households in 2022.

**The share of households who borrowed to buy food increased, similar to the trend observed in the formal banking sector, reflecting rising the cost of living faced by households.**

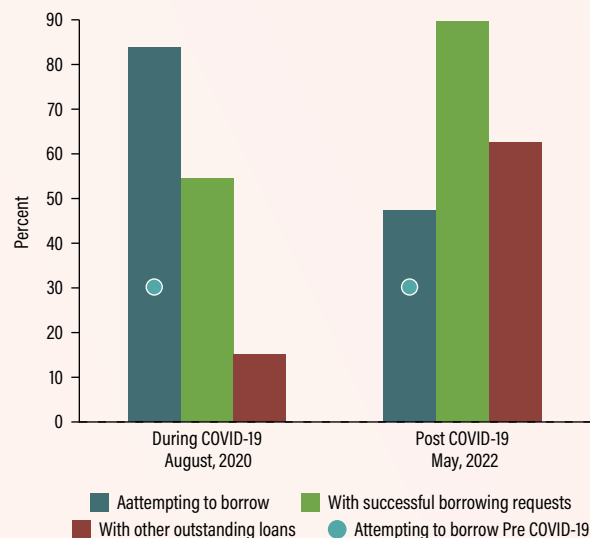
During the food price increase of 2022, households borrowed to buy food (35 percent) followed by purchases of working capital inputs (30 percent) and to cover education expenses (15 percent). In comparison, during the COVID-19 pandemic, loans were

mainly to buy working inputs (52 percent), while food purchases were reported by 20 percent of the households, a share that was slightly below the 25 percent observed before the pandemic.

**Providing timely access to finance in the presence of economic shocks is critical.** Financial inclusion is very limited, and it has been stalled in the last few years, while saving groups and village associations have gained importance over time. For many households, already out of the scope of the formal financial sector, joining saving groups could be a starting point for formal lending to access to resources in a timely and accessible manner.

**FIGURE B1.6.1 Almost half of Malawian households attempted to borrow money**

Share of households attempting to borrow



Source: World Bank (2023).

\* The High Frequency Phone Survey has been conducted in Malawi since the COVID-19 outbreak. Households have been interviewed monthly or bi-monthly since May 2020, and these are ongoing. The HFPS has aimed to monitor the living conditions of households during the COVID-19 pandemic and more recently after the different external shocks hit the country. In August 2020 and May 2022, the survey included two financial modules.

## 1.3

## MEDIUM-TERM ECONOMIC OUTLOOK

**Malawi's economy is projected to slightly improve in 2023, followed by moderate growth in the subsequent years.**<sup>18</sup> Economic growth is expected to increase to 1.4 percent in 2023, driven by a partial recovery in the agriculture sector, which was impacted by Cyclone Freddy, and the resumption of electricity generation at the Kapichira hydropower plant, which will support the manufacturing sector. However, this is still a decline in output in per-capita terms. Over the medium term, economic growth is forecast to increase moderately, underpinned by gradual macroeconomic stabilization and a recovery across all sectors. Lingering effects of the cyclones that occurred in 2022 and 2023 and the ongoing economic crisis could constrain the economy's full recovery to the pre-COVID-19 growth trajectory.

**The persistent deterioration of the current account deficit is expected to further weaken foreign reserves, leading to continued forex shortages.** While agricultural exports are expected to improve, albeit moderately, imports are projected to significantly pick up in 2023. Consequently, the current account deficit is projected to widen further to 11.3 percent of GDP in 2023, assuming foreign exchange constraints can at least in part be addressed. Persistent challenges, including limited diversification and declining global demand for tobacco, are expected in counter efforts to reduce the current account deficit. Promoting new potential export sectors, particularly in agribusiness and mining, and boosting exports will be crucial going forward. Extended periods of foreign exchange shortages may inflict severe and enduring impacts on the real economy. Due to the unavailability of imported investment items, businesses are forced to forgo lucrative investment opportunities, thereby restricting the medium-term economic growth.

**Elevated inflationary pressures may constrain headline inflation from reaching its target in the near term.** The projected decline of global commodity prices is expected to ease inflationary pressures from 2023. However, food prices are still rising and additional pressure from anticipated lower agricultural output could further increase food inflation. Furthermore, the possibility of upward adjustments in energy prices may result in higher electricity costs and exacerbate production expenses, compounding the effects of rising inflation. Malawi's elevated inflation is attributed to both external shocks and a lack of coordinated measures among trade, exchange rate, monetary, and fiscal policies. A combination of these factors will likely constrain inflation from reaching the RBM's near term target of 5 percent.

**Despite efforts towards fiscal consolidation, the fiscal deficit is likely to persist due to continued high expenditure pressures.** The gradual recovery and expansion of business operations, facilitated by the resumption of the Kapichira hydropower plant, could potentially bolster domestic revenue. However, fiscal consolidation efforts are challenged by continued spending pressures, especially the high share of statutory expenditures. Interest expense will continue to rise and absorb a higher proportion of the resource envelope, given increased domestic financing of the fiscal deficit using high-cost domestic instruments. This will continue to constrain fiscal space, especially for needed investment to spur growth.

18. Forecasts in this MEM draw on the World Bank Macro-Poverty Outlook published in April 2023.

**Debt vulnerabilities will remain elevated, though they could be mitigated by successful debt restructuring negotiation.** Currently, the Government is engaging commercial and bilateral creditors to restructure external debt. Financing assurances from these creditors, supported by credible fiscal, monetary, and exchange rate policies, could pave the way for a sustainable debt path and enable the country to qualify for a full IMF program supported by an ECF. The key to achieving this lies in sustained fiscal consolidation, which progressively lowers expenditure, and additional measures to reduce debt vulnerabilities, particularly through improved PFM systems. This, in turn, engenders trust from private investors and crowd-in further budget support from development partners. The financial sector is expected to remain resilient though access to credit remains highly constrained amidst the continued rise in government borrowing from commercial banks.

**The absence of sustained economic growth, coupled with persistent inflationary pressures and recurring weather shocks, is likely to pose significant challenges for Malawi in its efforts to alleviate poverty.** The share of people living on less than US\$2.15 per day is projected to increase to 72 percent in 2022 and 2023. Further external shocks may result in increasing poverty rates and push more people into food insecurity.

**There is a significant degree of uncertainty surrounding the country's economic prospects, with numerous potential downside risks.** Several factors, including prolonged foreign exchange shortages, setbacks in the ongoing negotiations for external debt restructuring, the materialization of rollover risk from short-term swaps, a surge in corporate bankruptcies, financial stress, delays in the AIP implementation and reform process, and the recurrence of a cholera outbreak could potentially impede a recovery of the economy and exacerbate poverty. Prolonged effects from Cyclone Freddy, and generally intensifying climate change impacts, especially on agriculture production, continue to pose a major downside risk to the economic outlook.

**However, if the economy can bounce back quickly from the impacts of the cyclone and the Government is able to make progress on its reform agenda, the coming year could also exceed current expectations.** The diversification and commercialization of the agricultural sector is proceeding and could mean that new viable export sectors are able to emerge and grow, reducing the reliance on tobacco as the main foreign exchange earner. Implementing difficult but much-needed fiscal consolidation measures and PFM reforms, as well as successful debt restructuring can create the necessary space to invest in growth-enhancing projects. Addressing the root causes of persistent fuel and power shortages could greatly improve the ability of firms to succeed. However, this will require a sustained focus on implementing tough but necessary reforms.














### **Policy Options: Restoring macroeconomic stability, supporting the recovery of growth, and protecting the poor against shocks**

**The Government has initiated several steps to curb the ongoing economic crisis.** Notably, the RBM has introduced foreign exchange auctions to facilitate price discovery. Progress has been made with Malawi's largest bilateral and commercial creditors towards an agreement that restores debt sustainability. The Government has also put forth substantial reforms in key structural policy areas. These include enhancing State-Owned Enterprises' transparency for improved performance and strengthening PFM systems. Efforts to reform the AIP are in progress, though clear plans have not been announced yet. A breakthrough in disaster response capabilities has been realized with the passage of the Disaster Risk Management (DRM) Bill, though it will be important to proceed urgently with its implementation. Lastly, debt management has been bolstered through a new Medium-Term Debt Strategy and an Annual Borrowing Plan in alignment with the PFM Act of 2022.

**The 17<sup>th</sup> edition of the Malawi Economic Monitor (MEM) outlines urgent actions required to stabilize the economy, enhance growth, and protect the most vulnerable.** It specifically recommends:

1. *Restoring macroeconomic stability*: Despite the recognition within Government that macro-stabilization is a prerequisite for achieving broader development aims, stepped-up reforms are needed to rebuild foreign reserves, instill budget discipline, improve public financial management, and achieve debt sustainability. While many technical details remain to be elaborated, these reforms are necessary ingredients to stabilize the economy.
2. *Increasing production and exports*: Malawi's private sector has been hit hard by the instability and shocks of the past years. To achieve growth, reforms that enhance production capacity and private investment will be needed to boost firms' ability to export, strengthen agricultural diversification and commercialization initiatives, and bring in more foreign investment.
3. *Building resilience and protecting the poor*: Given the growing frequency and severity of climate-related shocks, it will be essential to step up efforts to support the most vulnerable. This includes moving forward with the implementation of the DRM Act, expediting the roll-out, coordination, and scaling up of key social protection programs and improving disease surveillance and response in the case of a new disease outbreak, such as cholera.

TABLE 1.2 Priority policy areas and key actions

 <b>1. Restoring macroeconomic stability</b>			
<b>Building foreign reserves</b>	Continue the progression towards a market-based exchange rate regime by increasing foreign exchange auctions.	Short	
<b>Balancing the budget</b>	Implement announced fiscal consolidation measures in line with the targets under the Staff Monitored Program agreed with the IMF.	Short	
<b>Improving public financial management</b>	Adhere and commit to quarterly allotment ceiling in IFMIS to reduce growing spending arrears that arise from overspending and committing outside the system.	Medium	
<b>Achieving debt sustainability</b>	Finalize the restructuring of external debt and contain domestic debt and reduce costs.	Short	
 <b>2. Increasing production and exports</b>			
<b>Simplifying access to regional and global markets</b>	Review planned legislation and processes such as the Foreign Exchange Bill and export licensing procedures to ensure these incentivize investment and exports.	Medium	
<b>Increasing electricity generation</b>	Increase access to reliable power by ensuring the financial sustainability of ESCOM, bringing additional generating capacity online and accelerating the connection of households to the grid.	Medium	
<b>Stimulating agricultural growth</b>	Sustain momentum in the agricultural commercialization agenda by announcing and implementing AIP reform plans and rolling out AGCOM 2.0.	Medium	
 <b>3. Building resilience and protecting the poor</b>			
<b>Finalizing Universal Beneficiary Registry reforms</b>	Improve the delivery of social support services through the Universal Beneficiary Registry.	Medium	
<b>Preparing for the next disaster</b>	Implement the DRM Bill and PDNA lessons to ensure rapid disaster recovery and continued human capital increases.	Short	
<b>Responding to health threats</b>	Further strengthen integrated disease surveillance and response to detect and contain outbreaks promptly, while improving awareness of safe water and hygiene practices.	Short	



2

**POWERING UP:  
HOW MALAWI CAN RAPIDLY  
INCREASE ELECTRICITY ACCESS**

## Enhancing access to energy is critical to achieving economic development and the aims of *Malawi 2063*

**Expanding access to energy is a critical component of economic development, and its impact on a nation's GDP can be substantial.** In Malawi, energy access is an essential element for the achievement of *Malawi 2063* of transforming the country into a more industrialized and prosperous nation. As such, investment in energy access is a top priority to advance the country's economic development and wealth creation aims.

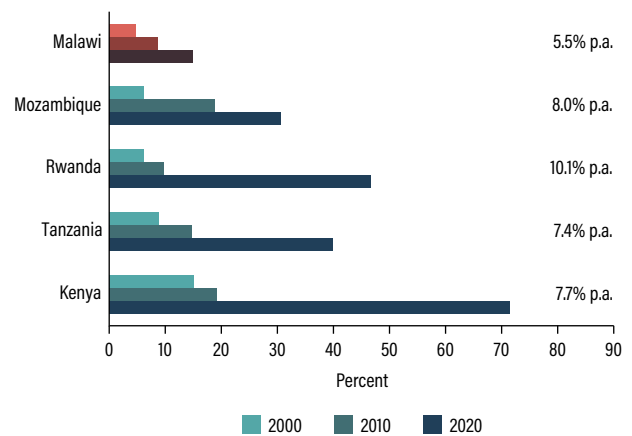
**In households, energy access can significantly improve living conditions by providing access to modern technologies, lighting, and cooking.** This directly translates to increased productivity, improved living standards, and better economic opportunities, particularly benefiting the poor and rural households. Moreover, energy access plays a crucial role in the delivery of essential public services such as health and education, ultimately contributing to human development and poverty reduction.

**Despite the recognized benefits of energy access, Sub-Saharan Africa (SSA) still faces significant electrification challenges.** According to the 2022 Tracking Sustainable Development Goal (SDG) 7 report,<sup>19</sup> nearly half of SSA's population (568 million people) currently lacks access to electricity. Malawi has one of the lowest electricity access rates in SSA at below 20 percent.

**In the past decade, several countries in the region have made strides in accelerating electrification efforts, and some are now on the path towards achieving universal electricity access.** Countries in East Africa, including Malawi's neighbors Mozambique and Tanzania, significantly increased the access rate, having started from below 10 percent electricity access rate in 2000, and now have over 30 percent access, while Malawi, which started at a similar point in 2000, still lags behind (Figure 2.1). These countries offer valuable lessons, highlighting the need for comprehensive, long-term electrification efforts that build nationwide and sector-wide electrification platforms, leveraging both grid and off-grid electrification, and mobilizing public and private sector resources in a coordinated manner. The success of these countries has been attributed to political commitment, a conducive enabling environment, a long-term electrification strategy, least-cost planning, and adopting adaptive approaches that fine-tune implementation based on lessons learned.

**FIGURE 2.1** Malawi lags other East African countries in increasing energy access

Progress in electrification in Malawi and other East African Countries from 2000–2020 and annual growth rates



Source: World Bank Global Electrification Database.

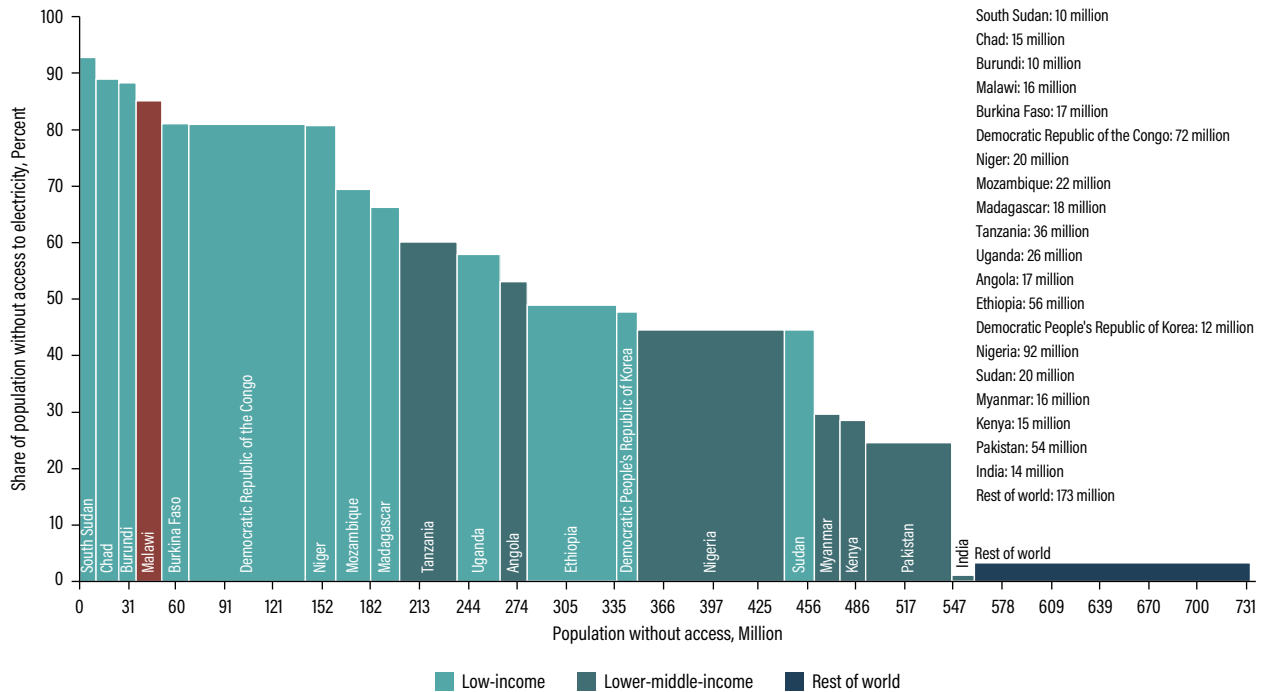
## Malawi's rate of electricity access is among the lowest in the world

**Malawi has one of the lowest electricity access rates in the world.** The electricity access rate for 2023 is estimated at 19 percent with severe disparities between urban (42 percent) and rural areas (5 percent). The inequity among the rich and poor is stark—access among the richest 20 percent of the population was about 30 times higher than the poorest 20 percent. The annual population growth rate of 2.8 percent has been outstripping the pace of electrification in recent years. World Bank data shows that in 2022 Malawi had the fourth-lowest energy access rate in Africa, just ahead of South Sudan, Chad and Burundi (Figure 2.2). Over 16 million Malawians currently lack access to electricity (World Bank, 2022c).

19. See <https://trackingsdg7.esmap.org/>. SDG7 aims to achieve access to affordable, reliable, sustainable and modern energy for all by 2030.

**FIGURE 2.2** Malawi has one of the largest electricity access deficits, with over 80 percent of the population not connected to power

Share of population without access to electricity and total population without access



Source: World Bank (2022).

## Malawi has set ambitious policy goals, but implementation has often lagged behind

**The Government of Malawi set a goal to achieve universal energy access by 2030.** In 2018, the Government published a revised National Energy Policy (NEP 2018), which serves as the main guiding document for the sector. The NEP 2018 set the target of universal access by 2030, in line with the Government's commitment to achieve Sustainable Development Goal 7. This builds on the experiences of longstanding programs to increase electricity access and also incorporates recent programs, such as the USAID-funded "Kick-Start Program" and the World Bank-funded "Malawi Energy Access Program (MEAP)" (Box 2.1).

**In 2019, the Ministry of Energy (MOE) prepared a National Electrification Strategy (NES) in line with policies in the NEP 2018.** The NES proposes a framework through which the Government will guide accelerated access to households and businesses at acceptable quality and levels of service that is anchored in the priority policies presented in the NEP 2018. The strategic elements of the NES are organized in four thematic pillars—institutional, policy and regulatory, technical and planning, and financial<sup>20</sup>—that taken together define the means and processes by which electrification expansion will be implemented. Elements of the NES are very similar to those of electrification strategies being successfully implemented by governments in other countries in the region, including Ethiopia, Kenya, Mozambique, Niger, and Rwanda.

20. The institutional pillar includes defining the roles and responsibilities of electrification agencies and developing capacity building programs. The policy and regulatory pillar include defining minimum service levels, adopting quality standards for off-grid electrification, and scaling up mini-grid and standalone off-grid systems. The technical and planning pillar involves identifying power supply shortfalls, establishing a least-cost planning framework, and evaluating low-cost electrification design standards. The financial pillar includes promoting affordable access to electricity and developing a financing plan to support expansion goals.

### BOX 2.1 Overview of the key electricity access programs in Malawi

#### Malawi Rural Electrification Program (MAREP)

The MAREP started in 1980 with ESCOM as the implementing agency, supported both through its own financing and donor funds. The Government of Malawi took over implementation of the Program in 1995 and the Department of Energy, now Ministry of Energy (MoE), was appointed lead implementing agency.

MAREP is funded by the Rural Electrification Fund sourced from a 4.5 percent levy on all energy sales as stipulated in Section 25 (2) Energy Regulation Act, and Rural Electrification Act Section 12 (b). The Rural Electrification Management Committee with the Board of Directors chaired by the Principal Secretary of Ministry of Energy oversee the implementation of MAREP. The Rural Electrification Unit in the Ministry of Energy executes the activities of MAREP.

Since MAREP's inception, eight phases of the program have been implemented. This involved extending power distribution lines to district administration centers, major trading centers, tobacco growing areas and the development of the 4.5 megawatt (MW) Wowwe Hydroelectric Power Plant. Since Phase IV, MAREP has electrified over 1,100 sites, including popular trading centers.

#### Malawi Energy Access Program (MEAP)

MEAP is an ongoing energy access program financed by the World Bank which includes on-grid, off-grid and technical assistance components. The on-grid and off-grid components are implemented by ESCOM and MoE, respectively. MEAP aims to connect 170,000 households to the grid and 200,000 to off-grid solutions by the end of 2024. Progress has been slow. As of May 2022, only about 10,000 connections were made by ESCOM.

MEAP's on-grid component focuses on on-grid densification. MEAP off-grid component facilitates eligible Solar Home System (SHS) companies to expand services by issuing working capital loans and result-based-financing (RBF). Under this component, the MoE established the "Ngwee Ngwee Ngwee Fund" (NNNF), which manages financing through US\$14 million in loans and US\$6 million of grants, as well as technical assistance (TA). The RBF window (up to US\$5.5 million) provides end-user subsidies to close the affordability gap of customers that cannot afford solar home systems. The remaining US\$0.5 million will be used to support market-based innovative solutions to scale up energy access.

In addition, through the MEAP TA component, the MoE is launching consumer awareness campaigns, supporting efficient financial management, establishing national off-grid solar product standards, and conducting mini-grid feasibility studies.

#### Kick-Starter Program

Under USAID's Southern Africa Energy Program, the "Kick-Starter Program" in Malawi was a three-year initiative, launched in 2019, to incentivize market entry and scale-up of SHS companies through RBF, operational support and access to working capital.

Four companies were awarded RBF grants: Solar Works!, Vitalite, Yellow Solar and Zuwa Energy. A wide range of partners supported the program, including local banks and lending institutions (FDH Bank, Kuwa Capital, National Bank of Malawi and Standard Bank), international financiers (Lion's Head Global Partners and SunFunder), industry associations (EnDev), and awareness-raising institutions (Maeve).

**In 2021, the MoE also prepared the draft Guidelines for Implementation of the National Electrification Program, which include connection charge policies, provision of government financing, and roles and responsibilities of government implementation agencies.** According to the guidelines, low-income families meeting certain criteria will be eligible for free connections or a soft loan with zero interest to finance connections. The Electricity Supply Corporation of Malawi (ESCOM) is also planning to introduce a cross subsidy within the domestic customer category by allowing the first 50 units consumed per month to be charged at a lower rate to support the basic social needs of low-income households.

## Implementation results of the electrification policy has been mixed

**Despite the existence of a strong strategic and policy framework for energy access, the implementation of these policies has been slow and inadequate.** This is partly due to lack of consistent political commitment, limited financial resources, weak institutional capacity, bureaucratic procedures, and governance issues.

### On-Grid

**Electrification has traditionally been driven by the expansion of the grid connections, funded by the Government and implemented by ESCOM.** Malawi has made progress in the past decade towards expanding access to electricity. For example, ESCOM connected over half a million residential, commercial and industrial customers to the grid since 2012, increasing its customer base by over 8 percent on an annualized basis (Figure 2.3). This translates to an average of over 34,000 new connections every year.

**Despite these achievements, the national electrification rate has remained stagnant since 2016, with the grid connection rate only increasing by 0.2 percent between 2016–2021.** While ESCOM has made

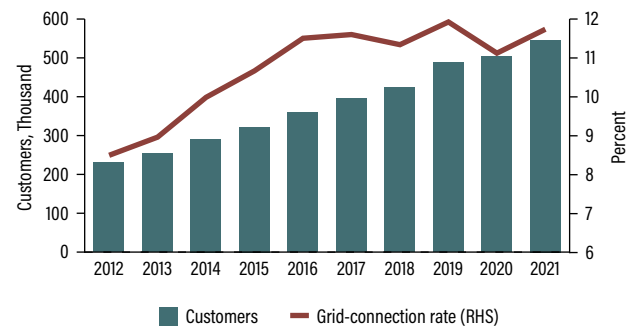
new connections, these have been mostly offset by the impact of the country's rapidly growing population, which is increasing at a rate of 2.8 percent annually. As a result, the electricity access rate has been effectively flat in recent years, highlighting the need for further action to accelerate electrification efforts and bring sustainable and reliable power. The on-grid connections have mostly been supported by MAREP and MEAP.

### Off-Grid

**Off-grid electrification, dominated by solar home systems (SHS)<sup>21</sup>, is growing rapidly and plays a significant role in the Government's electrification plans.** Off-grid electrification is led by the private sector, incentivized by favorable Government regulations and fiscal incentives. Malawi is considered an emerging off-grid solar market characterized by both fast growing sales and a large remaining electricity access gap (World Bank 2022b). Private-sector operators like Yellow Solar, Vitalite, Solarworks!, and Zuwa, among others, have increased sales of high-quality SHS of tier 1 and above<sup>22</sup> through the introduction of Pay-As-You-Go (PAYG) contracts.

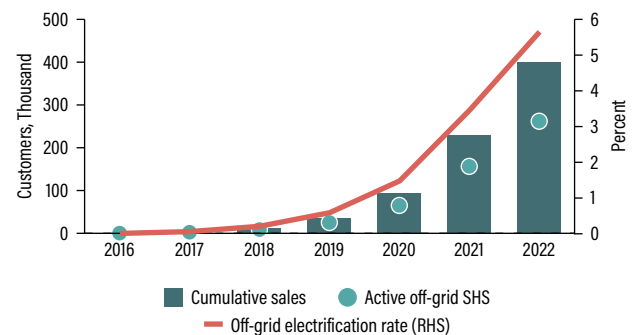
**About 400,000 SHS have been sold in Malawi as of 2022.** About two thirds of these (260,000) are estimated<sup>23</sup> to be actively serving off-grid households, thus contributing about 6 percent (Figure 2.4) to the electricity access rate. This makes Malawi one of the top 20 countries (Figure 2.5) in the world by the share of population with access to solar.<sup>24</sup>

**FIGURE 2.3** ESCOM increased connections from 2012 to 2021, but on-grid access rate stalled



Source: ESCOM.

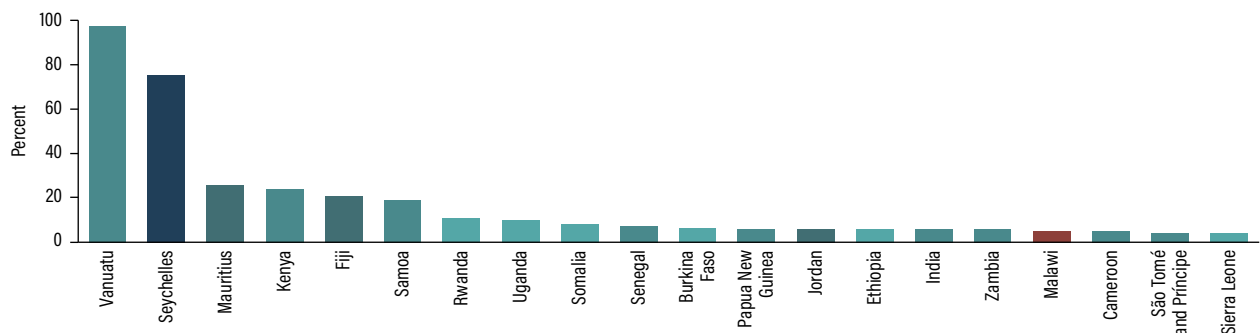
**FIGURE 2.4** Malawi has a dynamic off-grid market connecting over 5 percent of population



Source: GOGLA sales data, own analysis based on interviews with market players.

**FIGURE 2.5** Malawi is among the countries with highest share of access to solar

Share of population using solar lights



Source: IRENA 2021.

21. A Solar Home System (SHS) is a small-scale electricity generation system that uses solar photovoltaic technology to generate electricity from sunlight. It typically includes a solar panel or panels, a battery, and other components such as charge controllers and inverters, and can be used to power lights, appliances, and other electrical devices in homes, businesses, and other settings.

22. Tier 1 and above per the Multi-Tier framework developed by ESMAP. Unlike solar lanterns, the government counts these SHS of tier 1 and above as connections and, thus, they contribute to the electrification rate.

23. Estimates based on a default rate of 10% (meaning SHS sold are inactive or repossessed), average active life of 3 years, and the assumption that 20% of SHS are installed as back-up in grid-connected households and thus do not contribute to the access rate.

24. Source: IRENA 2021 data cited in the World Bank: Tracking SDG7 report 2022, page 37. Accessed on April 22, 2023: [https://www.esmap.org/mtf-multi-tier-framework-for-energy-access.](https://www.esmap.org/mtf-multi-tier-framework-for-energy-access)

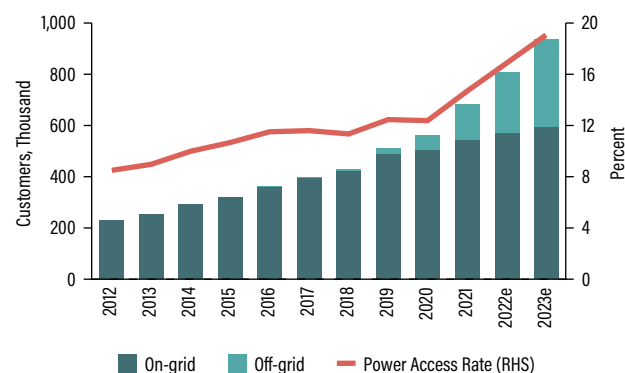
**The off-grid market in Malawi has taken off due to several factors.** First, there has been a strong increase in the availability of affordable off-grid systems, coupled with the use of the Pay-As-You-Go (PAYG) business model. This has made it easier for households in remote areas to access electricity and enjoy the benefits that come with it. Second, development partners and private sector investors have shown a keen interest in investing in this market, recognizing its potential for growth and profitability. Third, the Government has taken important steps to support the off-grid sector, including streamlining the licensing process and providing import duty and value added tax (VAT) exemptions for solar home systems. These measures have made it more attractive for investors to enter the market and expand their operations. Lastly, the slow progress of on-grid electrification and unreliable electricity supply has created a market gap for off-grid solutions, which has further spurred the growth of this sector.

**The impact of mini-grids on increasing the country's access rate has been negligible so far.**<sup>25</sup> While some mini-grids have been developed through donor funding, there are few commercially viable models for scaling these up. There are several challenges associated with mini-grid development, including high upfront capital costs, operational costs, and difficulties in accessing finance. Additionally, there is a need for robust policies and regulations to support mini-grid development, including clear tariff structures and standardization of technical standard and installation practices.

## Overall

**The fast-growing sales of SHS has driven the increase in electricity access between 2020 and 2023, with on-grid connections remaining stagnant at around 12 percent (Figure 2.6).** There is a significant backlog of over 50,000 households waiting for grid connections. Addressing this backlog will require Government and ESCOM working together to establish clear targets informed by integrated energy planning, streamline the connection process and improve overall efficiency in order to clear this backlog and provide access to future applicants. It is also important to continue supporting the growth of off-grid solutions such as SHS<sup>26</sup>, which can help to bridge the gap until grid connections can be made. Overall, while progress has been made, a lot more needs to be done to accelerate electrification, especially for grid connections.

**FIGURE 2.6** Off-grid solar is driving the electricity access rate increase while on-grid connections stalled



Source: ESCOM, World Bank team estimate.  
Note: e indicates estimates and f indicates forecasts.

## Key lessons learned from Malawi's Power Access Programs

**Malawi still lags behind its neighboring countries in increasing the electricity access rate.** This is despite the fact that it has a clear sector policy since 2018, sufficient financing since the approval of the MEAP in 2019, and dedicated implementation agencies such as the Rural Electrification Unit in the Ministry of Energy and the Project Implementation Unit in ESCOM. While government policies and investments have set a strong foundation for progress, there are still significant challenges that need

25. Mini-grids are power generation and distribution systems designed to provide electricity in areas that the main grid has not yet reached, or where the cost of a grid-based connection is too high. While there is no universally accepted definition of mini-grids, they are typically used to supply electricity to local communities, covering a range of needs including domestic, commercial, and industrial demand. These systems can operate on a range of power sources, including solar, wind, hydro, and diesel generators. Mini-grids can play a crucial role in expanding access to electricity in rural areas, where the cost of grid extension is prohibitively expensive or logistically challenging.

26. The off-grid connection numbers presented here are based on reported company sales, estimated active PAYG contracts, and the number of grid customers using SHS as a backup service. These numbers may not reflect the actual situation, and a more accurate report is expected to be obtained from the Multi-tier Energy Expenditure Survey that will be conducted by the Malawi Bureau of Statistics in 2023.

to be overcome, such as inefficient and slow implementation processes, lack of coordination between agencies, and limited capacity in both the public and private sectors. Additionally, the COVID-19 pandemic has further compounded these challenges and led to delays in the electrification efforts. Some of the key lessons learned in the past five years include the following.

### 1. Increasing energy access requires political support and government ownership

The Government's and ESCOM's ownership and prioritization of the access agenda are key to its success. Unfortunately, both lacked the urgency to implement MEAP and MAREP during a difficult period marked by multiple crises including COVID-19, the depreciation of the kwacha, dollar shortages, and natural disasters affecting the power sector. ESCOM lacked a permanent CEO in 2021, creating a void of strong leadership and focus. ESCOM's failure to prioritize energy access during this tough period has hampered progress, and neither the Ministry of Energy nor the Ministry of Finance and Economic Affairs has been able to drive the necessary reforms. As a result, the energy access agenda has trailed behind other government initiatives, and access has slowed. All stakeholders must take ownership and prioritize energy access to accelerate progress toward universal energy access.

### 2. Reforming governance of MAREP and increasing transparency

The reputation of the Government's main electrification program, the Malawi Rural Electrification Program (MAREP), is mixed due to governance concerns. The MAREP initiative has previously been a subject of perceived corruption. Transparent and fair procurement processes are essential not only for fostering public confidence but also for attracting potential investors and encouraging healthy competition among suppliers and contractors. By addressing the perception of corruption associated with the MAREP initiative, the Government can demonstrate its commitment to effectiveness and accountability. Financially while MAREP has a robust funding mechanism in place—a 4.5 percent levy on fuels and energy sales, which generates about \$10 million funding per year—it has failed to achieve the rapid electrification goals. The Government is re-designing the MAREP procurement methodology as a step towards achieving better governance and financial management.<sup>27</sup>

### 3. Solving the energy access deficit requires a value chain approach

There needs to be sufficient energy generation and transmission infrastructure to support connections. Malawi has been struggling with severe supply shortages for most years since 2017. From 2017 to 2020, due to low water flow, the dominated generation system dominated by hydro power could not meet demand. The supply shortage led to the installation of emergency diesel-based power supply. While the river flow improved, in 2022 Malawi lost supply from Kapichira Power Plant, the largest hydro plant in the system, because of damages caused by Tropical Storm Ana, leading to frequent and extended load shedding for existing electricity users. The load shedding and unreliable power supply compelled many consumers to seek alternative sources of electricity, such as off-grid diesel generators and SHS. ESCOM's ability to make new connections was severely hindered by its inability to meet the demand of existing customers, disincentivizing ESCOM from expanding its customer base. Additionally, insufficient transmission capacity from the southern hydro power base to the northern region has also posed a challenge for ESCOM. Therefore implementation of least cost plans and the construction of more generation and transmission capacity to allow rapid growth of power connections is urgent. The Mpatamanga Hydro Plant (361 MW capacity), which is expected to generate power in 2029–2030 will be a critical step to ensure sufficient generation capacity to achieve universal access for Malawi. This will increase the current installed capacity (536 MW) by almost 70 percent.

27. Detailed measures include: 1. Streamlining the procurement process; 2. Robust evaluation and selection criteria; 3. Staffing the MAREP department with qualified projects managers and engineers; 4. Enhanced disclosure and reporting; and 5. Capacity building and training.

#### 4. Improving ESCOM's operational efficiency is key to the success of the electrification program

ESCOM's performance under MEAP has been a cause for concern, with progress falling far short of expectations. As of April 2023, ESCOM had only managed to make connections to approximately 10,000 customers. This slow progress can be attributed to a range of factors, including ESCOM's overly bureaucratic procurement and hiring practices, as well as ineffective management in motivating staff performance. The utility company has also struggled to incorporate large amounts of new connections into its customer management systems. ESCOM's operational challenges have been further compounded by a lack of necessary equipment, including vehicles and machinery. With construction works being carried out by its own staff, these additional bottlenecks have significantly slowed progress. It is clear that Malawi's electrification efforts will not move forward as quickly as desired unless ESCOM's operational performance is improved. ESCOM, with the support of MOE and MOFEA, has started to implement critical reforms to address these issues.

#### 5. Leverage new technology and business models by attracting private sector capital and expertise

The use of solar home systems and the PAYG business model has rapidly grown, which has been the driving force behind electricity access gains in both urban and rural areas. Private sector companies offering these solutions have demonstrated that the business model and technology<sup>28</sup> are viable in Malawi. These solutions have proved to be particularly successful in remote and underserved areas where grid connections are not feasible or cost-effective. The success of these off-grid models underscores the importance of leveraging new technology and innovative business models in addressing energy access challenges.

The declining cost of SHS is another key driver of the off-grid success, resulting from not only economies of scale but also more efficient operations. Malawi's leading SHS companies have created highly efficient sales and distribution networks and adopted modern customer management systems, in contrast to ESCOM's inefficiencies in these areas.

## Malawi has an opportunity to rapidly increase electricity access

**If energy sector reforms are restarted, Malawi is poised to finally achieve rapid electrification in the years ahead.** This means it will need to continue its commitment to market-friendly policies and significantly improve the implementation capacity of government and ESCOM. Several factors combined present the Government an opportunity to rapidly increase the electricity access rate.

**As a densely populated country, Malawi can achieve universal access at lower costs than some larger countries, such as its neighbors Mozambique and Tanzania.** Malawi is a densely populated country with an existing medium voltage grid network of broad reach. It is estimated that about 95 percent of the population live within 10 km of the existing network. Even more promising, a high percentage of people already live within 5 km of existing ESCOM network infrastructure (Figure 2.7). This means that there are a large number of potential connections in the range of existing transformers and can be reached with little to no additional medium voltage lines in the near term. Specifically, if these households were to be connected to the grid, it would bring the national access rate to over 30 percent.

**There is strong demand for electricity connections despite macro-fiscal challenges, as evidenced by the overwhelming number of applications submitted to ESCOM.** Unfortunately, ESCOM's capacity to make these connections is lagging, resulting in a backlog of over 50,000 households. On average, these households have been waiting for more than a year after making their application fee payment of MWK 92,000.

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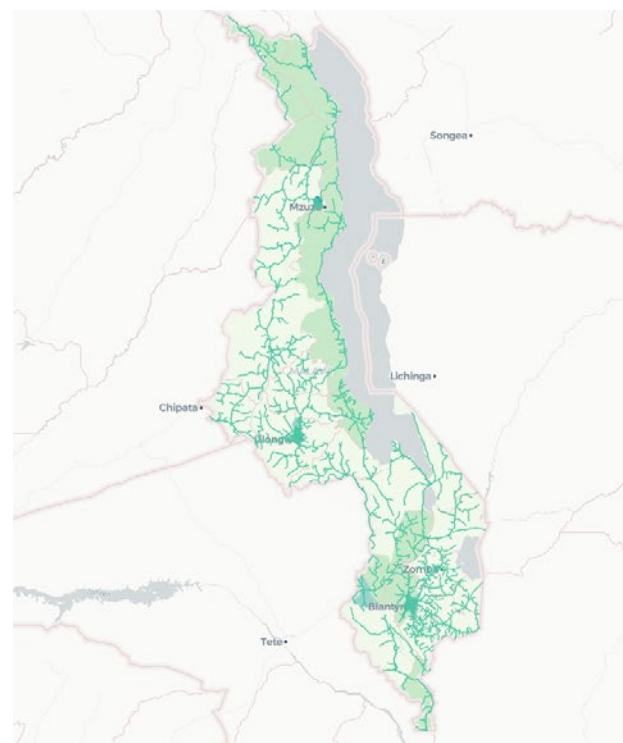
28. This includes key enabling technologies including remoting monitoring and mobile payment.

**ESCOM has reported that the demand for grid connection is even higher than what has been seen through the application process.** This is evidenced by marketing and consultation meetings with district councils. According to the Ministry of Energy's estimate, there are over 200 MW of suppressed demand (the total installed capacity of Malawi is 536 MW) that has not been met by the existing supply.

**For households that are not yet connected to the power grid, the cost of energy-related expenditure is significant.** A recent study conducted by SE4All in 2022 found that current levels of energy expenditure in areas close to grid infrastructure, would translate to a monthly electricity consumption well above 50 kilowatt-hours<sup>29</sup> for 50 percent of households. The high cost of energy-related expenditure for households not yet connected to the power grid is a significant concern but also an opportunity for ESCOM. By addressing this issue, ESCOM can simultaneously improve the quality of life for its customers, increase its revenue base and achieve economies of scale.

**The rapid advancement of technology in recent years has led to the emergence of innovative solutions to the long-standing challenge of expanding energy access in Malawi.** The difficulties of consumer financing and complexities to collect payment from relatively poor residential users have long been obstacles for private sector solar companies to develop viable business models and expand their business. The recently emerged PAYG business model has proved to be a game changer, as it allows consumers to purchase small-scale solar systems on a payment plan, making solar power more affordable and accessible to those who might otherwise be unable to afford it. Additionally, off-grid solar systems have become increasingly affordable and effective thanks to economies of scale, providing a viable alternative to grid infrastructure. In Malawi, PAYG payment terms are typically structured as monthly payments over a period of ranging from 12 to 36 months depending on the product and the company. An up-front payment, roughly equivalent to two monthly payments, is required from customers. Customer payments are typically made via mobile money, in exchange for a code (token) that keeps the device activated. Devices are otherwise locked, in case of delayed payment. After meeting all PAYG payments, customers own the product. In case of defaults, repossessions are the last-resort option for suppliers.

**FIGURE 2.7** Malawi's existing MV network



Source: ESCOM.

## How can Malawi achieve the electrification target set in *Malawi 2063*?

### Business-as-usual will not go beyond 30 percent

The Government of Malawi is targeting universal access by 2030, however in a business-as-usual (BAU) scenario for Malawi's electrification, the access rate will fall far behind the target, reaching about 30 percent, with ESCOM and off-grid each connecting about 15 percent of population.

**Sales of off-grid solar systems are expected to continue to grow at 15 percent in the BAU scenario.** More international companies are entering the market, increasing competition, which is expected to reduce prices and the expansion of distribution networks into underserved parts of the country. As a

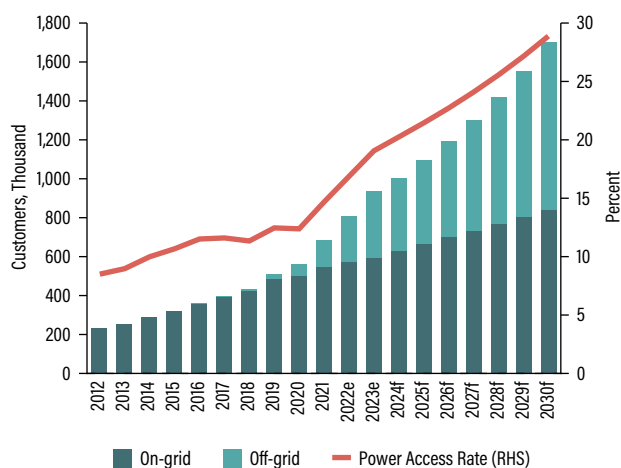
29. The 50 kilowatt hours per month per household equates to tier-3 access per the Multi-tier Framework for energy access. It is also the tariff threshold for ESCOM 1-phase pre-paid customers.

result, off-grid solar is projected to serve 860,000 off-grid customers by 2030<sup>30</sup>, increasing the population served by off-grid technology from 6 percent today to 15.3 percent.

**On the other hand, the country will continue to rely on ESCOM to connect additional customers to the grid.** Without reforms, ESCOM will struggle to install connections in line with population growth. Assuming the same average number of connections per year as in the past (approximately 35,000 connections annually), grid connections will not significantly contribute to the increase of the electrification rate.

**Under the BAU scenario, Malawi is expected to achieve a 30 percent electrification rate by 2030, primarily through off-grid solar installations.** However, with the increasing number of off-grid installations, affordability is becoming a major challenge. A 2019 World Bank survey suggests that affordability may not be a major barrier until the 30 percent target is reached. Nevertheless, every additional connection thereafter will pose a challenge. Therefore, it is difficult to expect the off-grid sector to achieve a growth rate much higher than 15 percent by 2030, and for the country to achieve an overall electricity access rate over 30 percent (Figure 2.8).<sup>31</sup>

**FIGURE 2.8** Business-as-usual will only get Malawi to a 30 percent access rate by 2030



Source: ESCOM, World Bank team estimate.  
Note: e indicates estimates and f indicates forecasts.

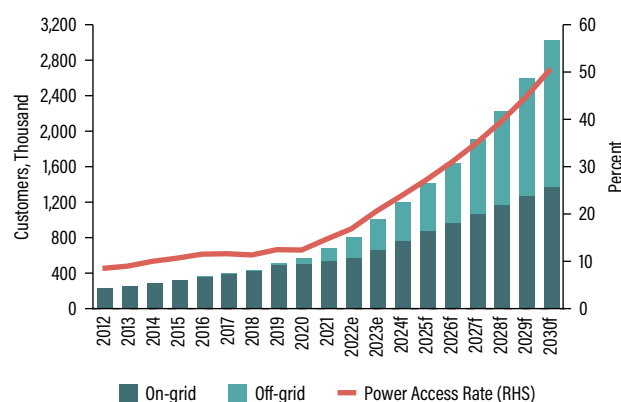
### Crucial changes needed to achieve 50 percent electricity access target in Malawi 2063

**An electricity access rate of 50 percent by 2030 is achievable but requires a joint effort from the Government and private sector.** Under the “50 percent by 2030” scenario, both ESCOM and off-grid solar companies have equal responsibility to each connect about a quarter of the population (Figure 2.9).

**ESCOM needs to triple its annual connection rate from the current average of 35,000 households to at least 100,000 households, prioritizing grid densification to achieve both speed and efficiency.** The financing requirement for these connections would also be relatively modest. However, as a key lesson learned in the past five years, this target cannot be achieved without significant improvements in ESCOM’s operational efficiency and financial sustainability, which should be addressed through key reforms.

**On the other hand, the off-grid market needs to continue its growth.** In comparison to 15 percent sales growth in the BAU, this scenario calls for 25 percent growth, which requires new financing mechanisms and business model innovation. Otherwise, the growth will slow down when the relatively

**FIGURE 2.9** Achieving the electrification target set in Vision 2063



Source: ESCOM, World Bank team estimate.  
Note: e indicates estimates and f indicates forecasts.

30. 15 percent year-on-year growth is based on 2022 sales growth of 15 percent in Malawi and the average growth of the off-grid solar industry globally, at 10 percent. Assumptions on how sales translate into active off-grid customers include a 10 percent default rate, 3-year useful life of SHS, and 30 percent of sales going to grid-connected households or recurrent off-grid customers, and thus not contributing to access.

31. An assessment of the World Bank of 2019 suggests that 60 percent of off-grid households cannot afford to spend more than US\$4 per month on electricity, while the current PAYG is priced at about US\$5 a month. The affordability issue will become a significant barrier with as SHS penetration approaches 30 percent.

wealthier market segment is saturated. The Government's recent launch of the NNNE, providing local currency financing to off-grid solar companies, is a good start for catalyzing the market through the supply of capital while mitigating foreign exchange risks. It is essential to continue the partnership between the MOE and the private sector to sustain the off-grid market growth.

### Raising the bar: striving for universal access by 2030

**Universal access by 2030 remains an ambitious target.** Crucial reforms must be accomplished in the power sector to break away from the past pattern of slow progress, and financing and sector coordination need to improve to deliver this higher access rate by 2030.

**Expanding the grid is essential to achieve universal access.** In the 50 percent access scenario, the focus is on-grid densification, utilizing existing medium and low voltage (LV) lines. In the universal access scenario, grid expansion is necessary. The SE4All Integrated Energy Plan study estimates that connecting the remaining 50 percent of the population to the ESCOM grid will require a significant investment of US\$2–3 billion. Most of these costs will need to be borne by the government, donors, or existing ESCOM customers. As such, financing will be a critical challenge that needs to be addressed.

**Universal access by 2030 would require an annual connection target of close to 500,000 per annum.** This is over 15 times faster than the current speed and calls for a complete overhaul of the implementation model of ESCOM and MAREP, requiring streamlined and transparent processes, efficient contractors, and a larger and dedicated delivery unit.

**Universal access will also need fast growth of the off-grid solar market in addition to grid expansion.** In addition to SHS market, a significant scale up of mini-grid connections may be needed.<sup>32</sup> The scale up of mini-grid, SHS and on-grid connections requires a concerted effort from the Government and private sector to make best use of scarce public finance resources and to avoid duplicated efforts.

## The pathway to universal access requires leadership, partnership, and reforms

### Leadership: the Government can demonstrate sector leadership and set clear policy goals

- 1. The Government should establish institutional arrangements and regularly update the generation and transmission master plans to ensure adequate supply and transmission capacity.** Updating and implementing generation and transmission least cost plans are important for connections, as this will facilitate new connections and better serve existing customers. The least cost plans have not been updated and implemented in the past five years, making them ineffective in guiding sector development. To address this issue, the MOE has hired international consultants to update these plans, with technical support from the System Operator (ESCOM). The updated generation and transmission plans are expected to be published by the end of 2023. MOE should also ensure the timely execution of the least cost plans.
- 2. The MOE can take a stronger coordination role in managing the roll-out plans for on-grid and off-grid connections.** This can be achieved by working closely with ESCOM and the private sector to ensure that resources are allocated appropriately to both on-grid and off-grid electrification projects. While the private sector has been driving off-grid deployment, there have been limitations in the ability of MOE to monitor progress and coordinate between ESCOM and off-

32. According to SE4All's Integrated Energy Plan, best connection technology for over 300,000 households will be mini grid where the grid expansion costs are over US1,300 per household.

grid players, as not all data has been collected. Addressing these monitoring issues is crucial to ensure that the progress towards increased electricity is effectively tracked. As the country faces significant affordability challenges, it will become increasingly important for the Government to play a policy role in facilitating financing and providing targeted subsidies to solar companies and end users, respectively, to support electrification efforts.

3. **The MOE is encouraged to update the NEP 2018 to ensure its alignment with current challenges.** While the NEP 2018 provides a good framework for energy sector development, certain aspects of the policy need to be reviewed, considering the increasing threat of climate change impact and the progress towards universal energy access. An updated NEP will provide policy guidance on incorporating climate risks in the energy sector planning and set an ambitious yet achievable energy access target for 2030.
4. **It is recommended that the government formally adopt the draft Guidelines for Implementation of the National Electrification Program, which outlines the connection and connection fee policy.** The formalization will remove any financial uncertainties for potential customers and the implementation agency, thereby facilitating scale-up.

#### **Reform: Government needs to reform ESCOM to improve its operational efficiency and financial sustainability**

1. **The Government, through governance reforms, needs to foster a culture of accountability and continuous improvement within ESCOM.** The operational efficiency of the connection team should be measured against clear targets in a systematic manner. Such approaches, when combined with a comprehensive training program and appropriate human resources policies, can dramatically boost connection speed.
2. **ESCOM should focus on improving its procurement processes to tackle a major bottleneck of electrification.** Exploring options to further standardize connection design and procurement documents can streamline the availability of materials and resources, reducing the possibility of procurement delays and ensuring cost competitive contracts.
3. **ESCOM needs to fully operationalize its Management Information System (MIS).** Currently the under-utilization of MIS leads to manual work and human errors that significantly slow down the roll-out of connections. The ESCOM management team need to execute a comprehensive change management program to maximize the utilization of the advanced MIS already in place.<sup>33</sup>
4. **The Government needs to work with ESCOM to achieve its financial sustainability.** Improving ESCOM's financial position is vital for increasing access rates. Previously, a loss-making ESCOM was discouraged from expanding its connection program, in part because of perceived risks of increasing technical and financial losses. A financially stable ESCOM will have adequate resources for routine maintenance and customer service, reducing losses and line faults. Additionally, it will also be able to access far more medium to long-term capital without the need for a sovereign guarantee, which can be used to fund eligible consumer connections. A recent World Bank study identified critical areas where ESCOM and the Government should collaborate to improve ESCOM's financials, including revenue management, loss reduction, tariff adjustment mechanisms, balance sheet optimization, and sector arrears elimination.

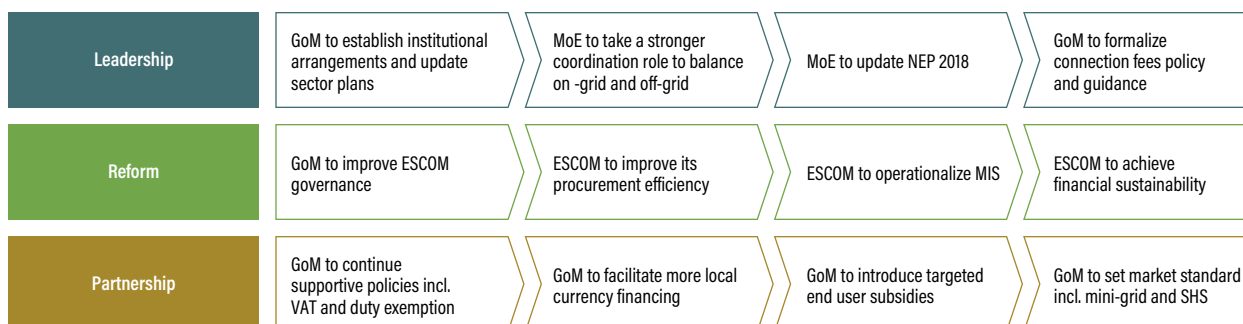
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33. The MIS implementation was not fully successful, and many modules of the system remain underutilized.

### Partnership: Government needs to work with the private sector to sustain the growth momentum in the off-grid solar market

- 1. The Government is encouraged to continue supportive policies, such as VAT and duty exemptions, to stimulate additional private sector investment.** These incentives have proven effective in attracting investment and driving growth in the sector. Additionally, the government can explore other incentives, such as RBF similar to USAID’s “Kickstarter Project” and the World Bank’s MEAP, to incentivize more enterprises to enter the Malawian market. Increased competition will not only drive down prices but also spur innovation and the development of new technologies, enhancing the efficiency and efficacy of off-grid solar systems.
- 2. The Government is encouraged to facilitate more local currency financing<sup>34</sup> for off-grid companies.** Financing has been a major barrier to the growth of local off-grid solar companies. The ongoing macroeconomic crisis and issues of currency inconvertibility have exacerbated the challenge. International off-grid solar companies that rely on hard currency loans, face substantial foreign exchange risks due to currency mismatch between funding and revenue currencies. By facilitating local currency loans, the government can create funding opportunities and reduce risks associated with hard currency financing. This will enable solar companies to expand their business and cut their price, leading to market growth.
- 3. Targeted end-user subsidies can be introduced to further reduce the price of off-grid solar products for those who need them most.** Affordability analysis suggests that increasing access beyond the business-as-usual projections will require additional price reductions, particularly for the lowest-income facilities. The Government can work with its development partners to create financial instruments that enable targeted end-user subsidies. Currently development partners like EnDev and the World Bank are piloting end-user subsidies, with the goal of testing design and paving the way for a future scale-up.
- 4. The Government is encouraged, in consultation with off-grid solar companies, to set market standards for mini-grid and SHS to ensure quality products and services.** Implementing proven standards and best practices, which have been locally adapted and successfully implemented in other countries such as Bangladesh, Kenya, and Rwanda, will enhance consumer confidence and drive increased demand in the off-grid solar market

**FIGURE 2.10** Malawi’s pathway to achieve 50 percent electricity access rate by 2030



Source: World Bank.

Note: GoM – Government of Malawi.

34. As an example, NNNF under MOE is providing local currency financing to Malawi based solar companies.

### BOX 2.2 Electrifying public institutions

**Access to reliable and affordable electricity is critical for the provision of essential health and education services.** However, only 59 percent of health facilities in Malawi have regular electricity from the grid, including 36 percent of health centers and 25 percent of clinics.<sup>a</sup> Many schools and some 12–15 percent of health facilities in Sub-Saharan Africa have no electricity whatsoever. Rural schools in Malawi often serve as the only community infrastructure and their electrification provides a resource that is enjoyed by the many villages that these public institutions serve. On one hand, electrification of schools can provide numerous benefits, such as improved learning outcomes, increased access to digital technology and resources, and improved teacher retention. On the other hand, unreliable electricity translates into shorter light hours suitable for studying and community activities and limited ability of individuals to use digital solutions hindering digitalization drive and development of Malawi's STEM program. Given the central role that schools often play as community centers, school electrification can improve learning, catalyze teacher training and engagement, and enable community activities that can support youth and adult training.

**Malawi faces significant challenges in ensuring that public institutions have access to electricity, particularly in rural areas.** Despite the main grid running mostly along the main roads, the grid connection fees remain prohibitively high for hospitals located just 1–2 km away from these roads. Even if the health facilities can afford the connection fees, the time it takes for connection is exceptionally long. Even grid-connected healthcare facilities often still require diesel or solar-based additions to supplement grid power due to grid unreliability and load-shedding.

**For this reason, off-grid electrification via solar photovoltaic systems became the main choice for providing electricity to rural clinics in Malawi.** Solar panels, typically installed on rooftops, collect energy from the sun which is then stored in batteries and can be used to power various applications, ranging from task lighting to delivering supplemental oxygen. However, current off-grid approach to electrifying essential public institutions in Malawi does not place an adequate focus on long-term operations and maintenance, which is imperative for sustainable service. Most grant-based donor interventions in Malawi, similar to those in other Sub-Saharan African countries, have focused on the procurement of power generating assets for public institutions, following a traditional grant-based donor-funded model, a so-called "install and forget" approach to decentralized electrification. To ensure sustainable electricity supply to public institutions, there is a need for a shift towards a more comprehensive and sustainable approach<sup>b</sup> that includes long-term operations and maintenance of solar systems, including:

- i. Long-term operation and maintenance of energy systems, along with replacement of batteries and spare parts;
- ii. Funding for long-term operation and maintenance of a facility's energy systems, including costs of battery replacement

and waste management as an integral part of budget planning for health-care facility electrification;

- iii. Funding procedures and disbursement time frames of governments and development partners should be adapted to cover these long-term maintenance costs; and
- iv. Functionality of installed energy systems in the medium and long term should be monitored (including through remote monitoring), and accountability mechanisms should be put in place.

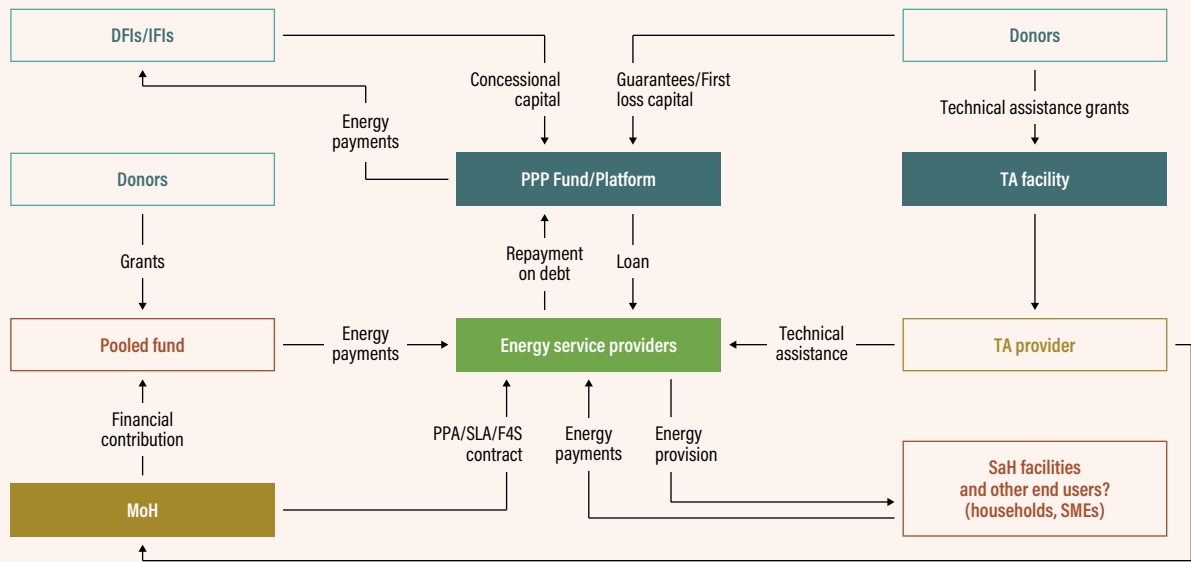
**Electrification of health facilities is essential to enable Malawi to reach its healthcare policy goals outlined in the Health Sector Strategic Plan II (2017–2022).** Electricity is essential to power lighting system prolonging service hours, in particular for medical emergencies and child birth; to facilitate critical communications and to assure adequate water supply; to maintain refrigeration of cold-chains for vaccine deployment; to power medical devices and equipment, and to improve medical records systems.

**Increased and more efficient financing will be critical.** A new 2023 joint report by the World Bank, IRENA, SE4All and WHO, states that solutions for electrification of health facilities in low income countries are readily available and rapidly deployable. Their implementation requires better cooperation between the energy and health sectors. Ministries of Health and Energy and other relevant stakeholders at all levels must be involved, from strategy and planning to policies, budgeting, procurement and implementation. Strong collaboration between public, private and nongovernmental institutions need to be facilitated to leverage synergies and unlock resources. Donors and development partners need to increase dialogue and collaboration at country level, to maximize impact and avoid duplication of efforts.

**Currently, publicly owned clinic and hospital electricity connection and usage are funded through national budget allocations, concessional finance, and grants.** However, these sources are insufficient to meet the country's future energy capacity needs. To triple its generation capacity by 2030 and meet the growing population's energy needs, Malawi requires significant investment in connecting these healthcare facilities to power. The absence of investors in the country due to an underdeveloped market and small investment opportunities is a challenge. Innovative business models could be introduced to attract international investors.

**The initial investment outlay can be provided by the existing energy financing initiatives present in the country.** Other financing options, such as commercial loans and national funding sources, can be used to lower the cost of capital and make this investment affordable to the country and people. Risk mitigation instruments, such as payment guarantees and guarantees, insurance, and hedging, can facilitate investment decisions and bridge the bankability gap (Figure B2.1.1)

**FIGURE B2.2.1** Various financing initiatives and options to support healthcare facility electrification in Malawi



Source: UNDP 2019.

Notes: DFIs—development finance institutions; F4S—finance for sustainability; IFIs—international financial institutions; MoH—Ministry of Health; PPA—power purchase agreement; PPP—public-private partnership; S4H—Solar for Health; SLA—solar license agreement; SMEs—small and medium enterprises; TA—technical assistance.

a. UNDP's "Solar for Health (S4H) Innovative Financing Feasibility Study", Country Report for Malawi, July 8, 2019

b. "Energizing health: accelerating electricity access in health-care facilities", the World Health Organization, the World Bank, the International Renewable Energy Agency, and Sustainable Energy for All, January 2023

TABLE 2.1 Macroeconomic indicators

	2019	2020	2021	2022e	2023p	2024p
<b>National Accounts and Prices</b>						
GDP at constant market prices (% change)	5.4	0.8	2.8	0.9	1.4	2.4
Agriculture	5.9	3.4	5.2	-1.0	0.5	2.4
Industry	7.7	1.2	1.9	0.9	1.3	2.4
Services	5.5	-0.5	2.0	1.8	1.8	2.5
Consumer prices (annual average)	9.4	8.6	9.3	21.8	25.7	20.8
<b>Central Government (FY % of GDP)</b>						
Revenue and grants	14.7	14.6	14.3	14.1	15.9	16.0
Domestic revenue (tax and non-tax)	13.2	13.1	12.8	13.0	12.6	14.1
Grants	1.4	1.5	1.5	1.1	3.2	2.0
Expenditure and net lending	19.1	20.9	21.4	22.5	26.8	23.8
Overall balance (excluding grants)	-5.9	-7.8	-8.6	-9.5	-10.9	-9.7
Overall balance (including grants)	-4.5	-6.3	-7.1	-8.4	-7.7	-7.7
Foreign financing	0.8	0.8	1.0	0.9	1.9	0.8
Domestic financing	3.8	4.9	5.9	7.7	5.3	6.9
<b>Money and Credit</b>						
Money and quasi-money (% change)	10.2	16.7	30.0	38.5	25.0	20.2
Credit to the private sector (% change)	27.3	16.1	17.8	23.2	14.7	10.9
<b>External Sector (US\$ millions)</b>						
Exports (goods and services)	1238	1202	1266	1216	1417	1487
Imports (goods and services)	3031	3088	3250	2707	2941	3077
Gross official reserves	815	566	429	110	379	513
(months of imports)	3.9	2.1	1.6	0.4	1.5	1.9
Current account (percent of GDP)	-11.6	-13.8	-14.3	-3.2	-11.3	-11.3
Exchange rate (MWK per US\$ average)	745.5	749.5	805.9	949.0	–	–
<b>Debt Stock</b>						
External debt (public sector, % of GDP)	27.8	32.9	31.5	34.7	37.6	36.0
Domestic public debt (percentage of GDP)	17.5	21.9	30.0	40.8	42.9	44.3
Total public debt (percentage of GDP)	45.3	54.8	61.5	75.5	80.5	80.3
<b>Poverty</b>						
Poverty rate (US\$1.90 in 2017 PPP terms)	73.5	74.3	74.3	74.4	74	73.4
Poverty rate (US\$3.20 in 2017 PPP terms)	90.4	90.7	90.7	90.8	90.5	90.3
Poverty rate (US\$5.50 in 2017 PPP terms)	97.1	97.2	97.2	97.2	97.1	97.1

Sources: World Bank staff calculations based on MFMMod, MoFEA, RBM and IMF data.

Note: e indicates estimates and p indicates projections.

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