Malawi Economic Monitor

POWERING MALAWI'S GROWTH

RAPIDLY AND SUSTAINABLY INCREASING ENERGY ACCESS

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POWERING MALAWI'S GROWTH

MACROECONOMIC DEVELOPMENTS

KEY MESSAGES

Malawi's current economic crisis is acute, severe, and widespread.

While external shocks have contributed, the main drivers have been sustained macroeconomic imbalances.

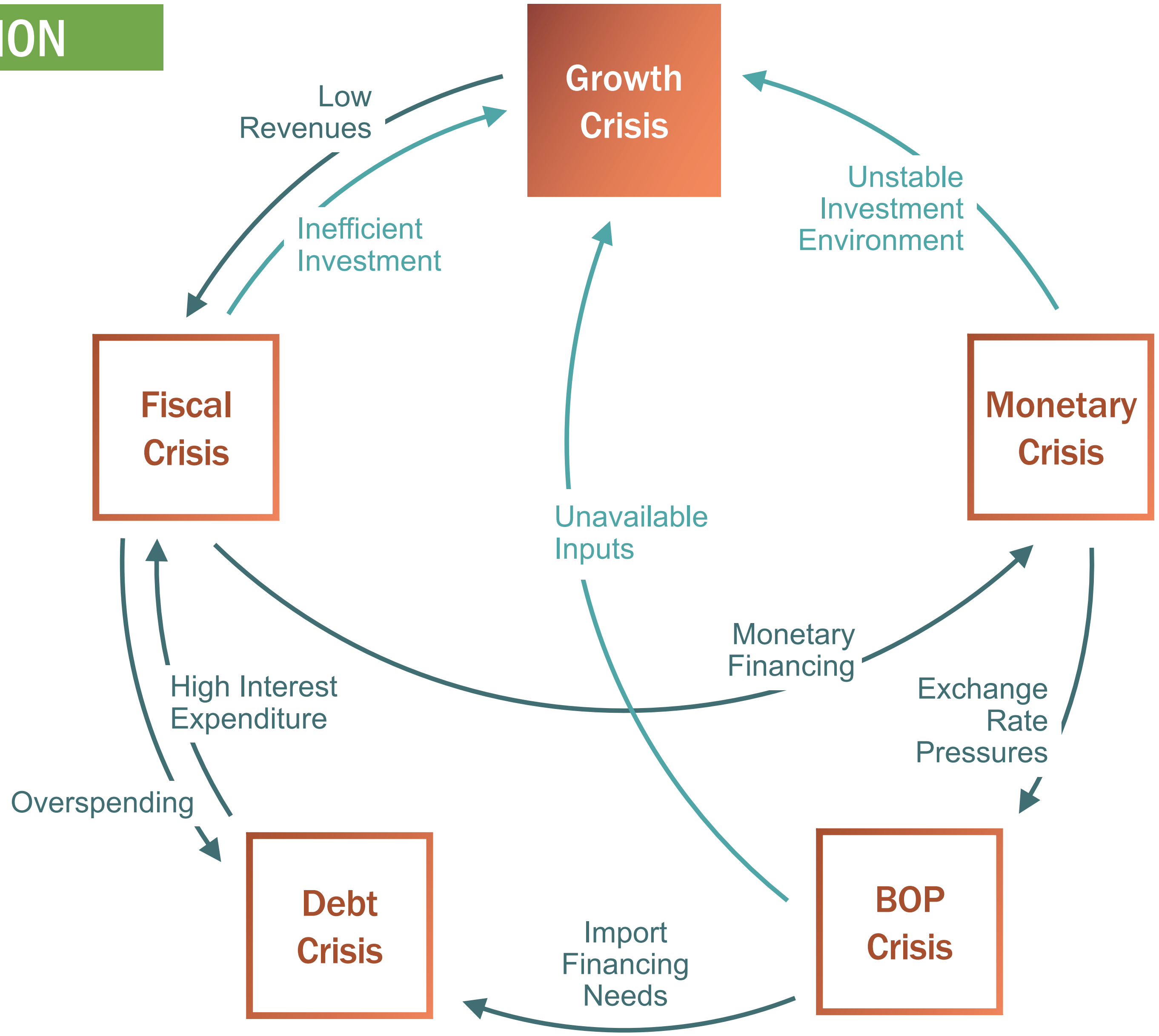
The cost of inaction is rising quickly.

To avoid further hardship, a comprehensive package of reforms is urgently needed.

MALAWI'S CURRENT ECONOMIC SITUATION

MALAWI'S FAILURE A CYCLE OF CRISES AND LOW GROWTH ARE INTER-LINKED

Malawi's slow growth is caused by macroeconomic imbalances that are themselves worsened by slow growth



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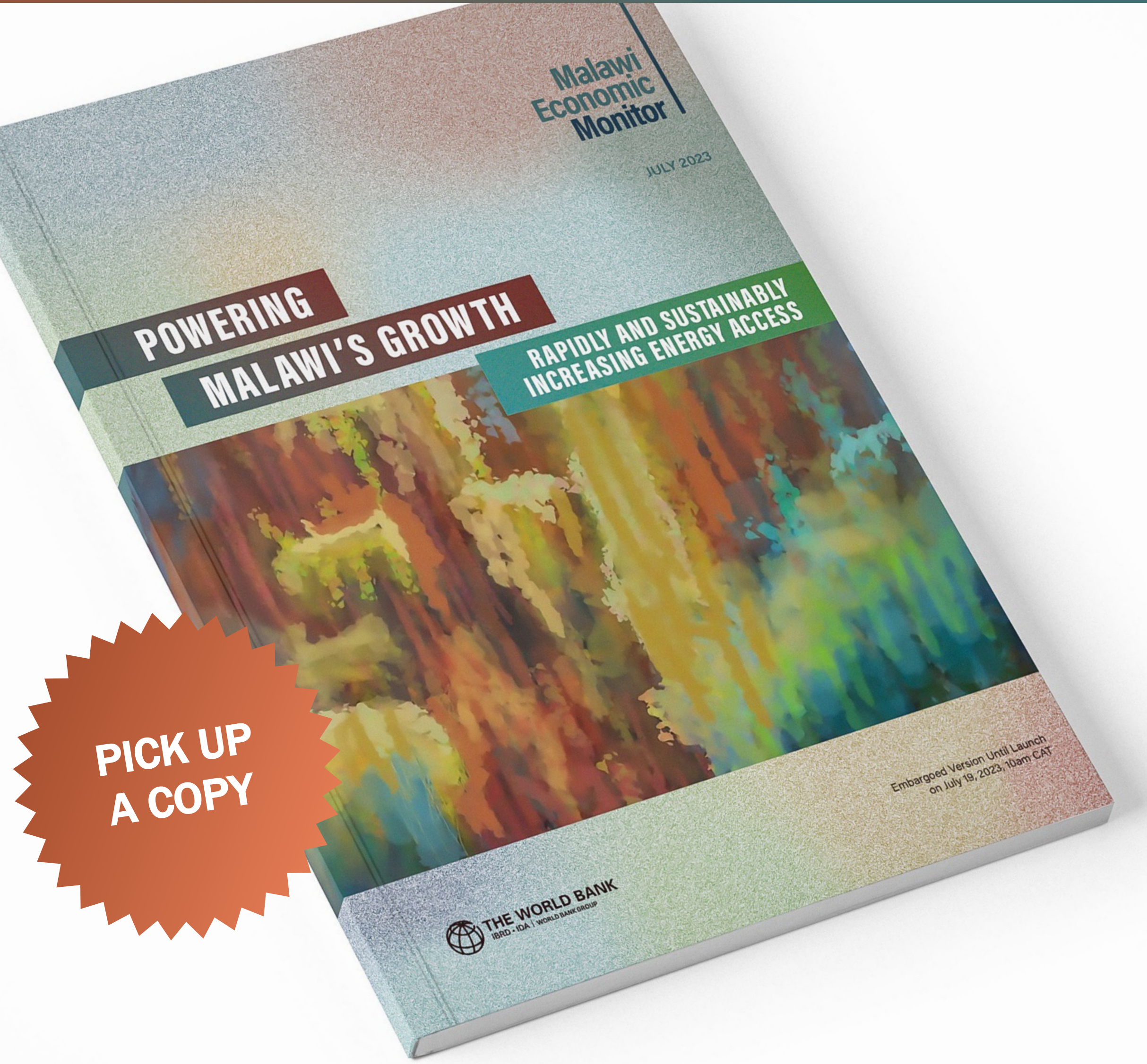


- Impact of the **global developments** on Malawi's economy
- Analysis of **agricultural sector** performance
- International perspectives on developing **Mega Farms**
- Lessons from Malawi's recent **cholera outbreak**
- Malawi's slow **tourism sector recovery**
- New insights into Malawi's **labour market**
- The impact of **school closures on learning**
- The potential of the **mining sector**
- An overview of **SOE performance**
- Analysis of **financial sector and commercial lending**
- The evolution of **household borrowing dynamics**

SECTION 1

MALAWI'S CURRENT ECONOMIC SITUATION

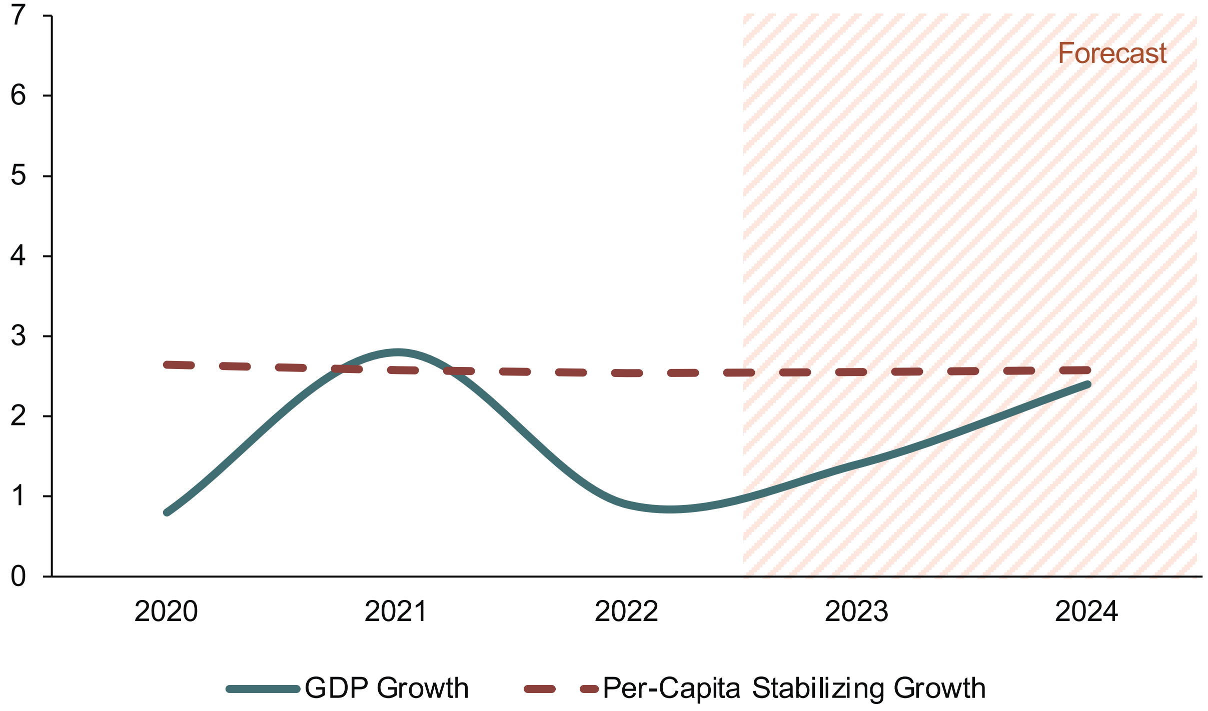
ECONOMIC GROWTH IS TOO SLOW TO LIFT INCOMES

- Malawi is likely to experience a fourth and fifth consecutive year of stagnant or falling per capita GDP.

- Slow growth makes the 2063 targets of the *Malawi 2063* increasingly difficult to attain. Meeting these targets would require annual growth exceeding 7 percent.

Not the post-COVID recovery Malawians had hoped for

Real GDP growth by sector



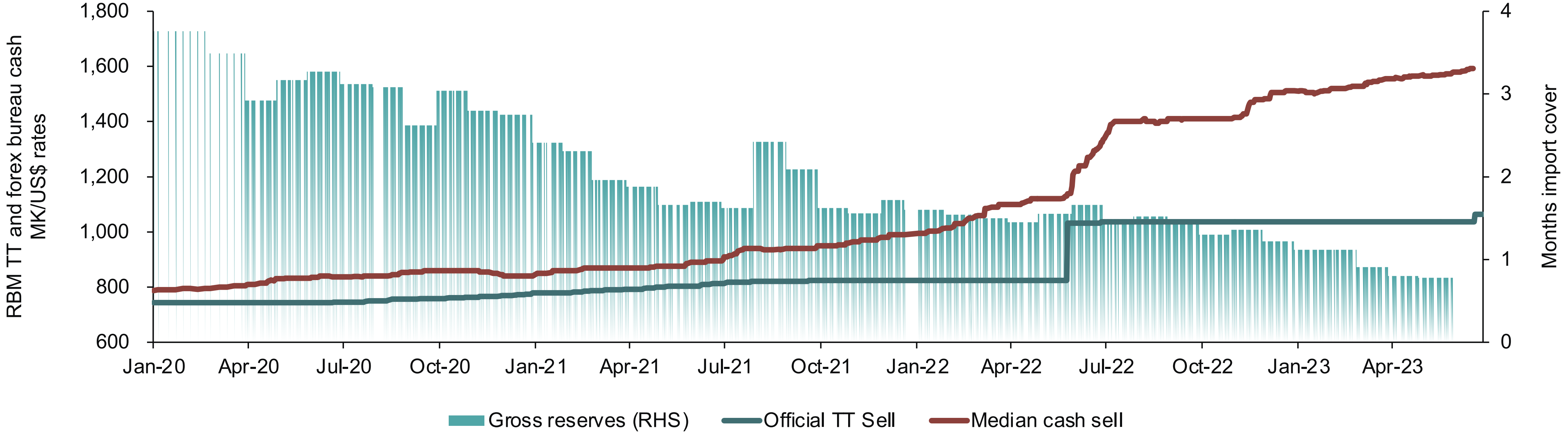
Source: World Bank Macro Poverty Outlook

MALAWI'S CURRENT ECONOMIC SITUATION

AN OVERVALUED EXCHANGE RATE CONTRIBUTES TO FOREIGN EXCHANGE UNAVAILABILITY

As reserves decline, the spreads between TT and bureau MWK – US$ exchange rates continue to widen

Official gross reserves, months import cover and RBM telegraphic transfer (TT) rates, MWK/US$ and forex bureau (FXB) cash rates MWK/US$ through June 28 2023



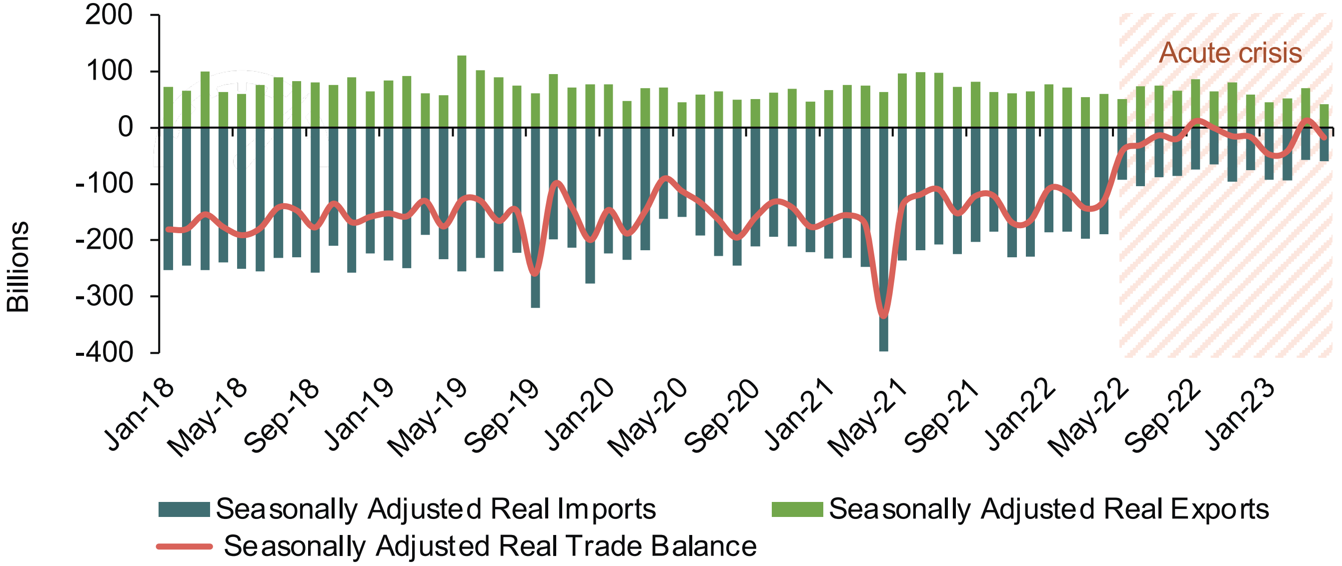
Source: World Bank staff calculations based on RBM data.

FOREIGN CURRENCY SHORTAGES LEAD TO SHORTAGES OF IMPORTED GOODS

- Official real imports for May 2022 to April 2023 are approximately 65 percent below their 5-year average.
- While fuel and fertiliser are largely protected, companies do not have access to imported investment inputs, constraining growth.
- Malawians do not have access to essential imports such as medical and pharmaceutical supplies at any price.

Without foreign exchange, imports have dwindled

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



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

TRADE POLICY IS NOT CONTRIBUTING TO INCREASED SELF-RELIANCE

A good tobacco harvest and stable prices for Malawi's exports have the potential to help Malawi rely less on international financial institutions (IFIs) for foreign exchange access

In the year to June 2022, IFIs disbursed USD 548 million, compared to tobacco proceeds of USD 363 million and total exports of USD 936 million

Current trade and industrial policy addresses symptoms rather than causes

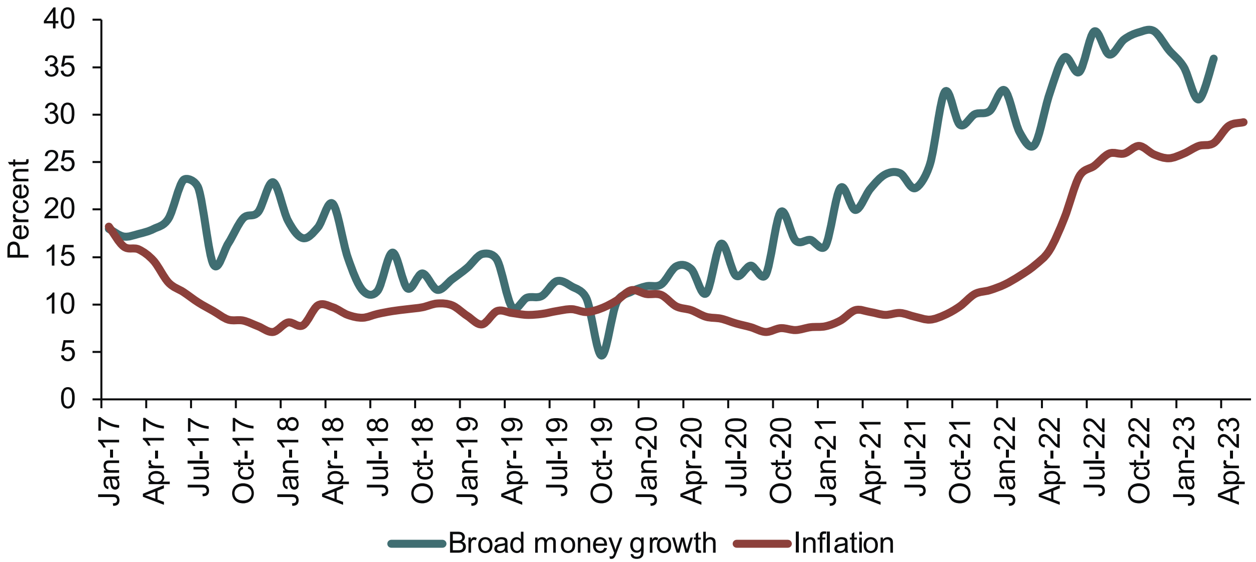
- MRA warehousing mandates make exporting more burdensome
- Malawi's financial system is further isolated through restrictive exchange control regulations
- Mandatory conversion of export proceeds into Malawi Kwacha at the official rate disincentivises official exports

MALAWI'S CURRENT ECONOMIC SITUATION

MONEY SUPPLY AND LIMITED PRODUCTION DRIVE INFLATION

Increasing money supply is inducing pressure on inflation

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



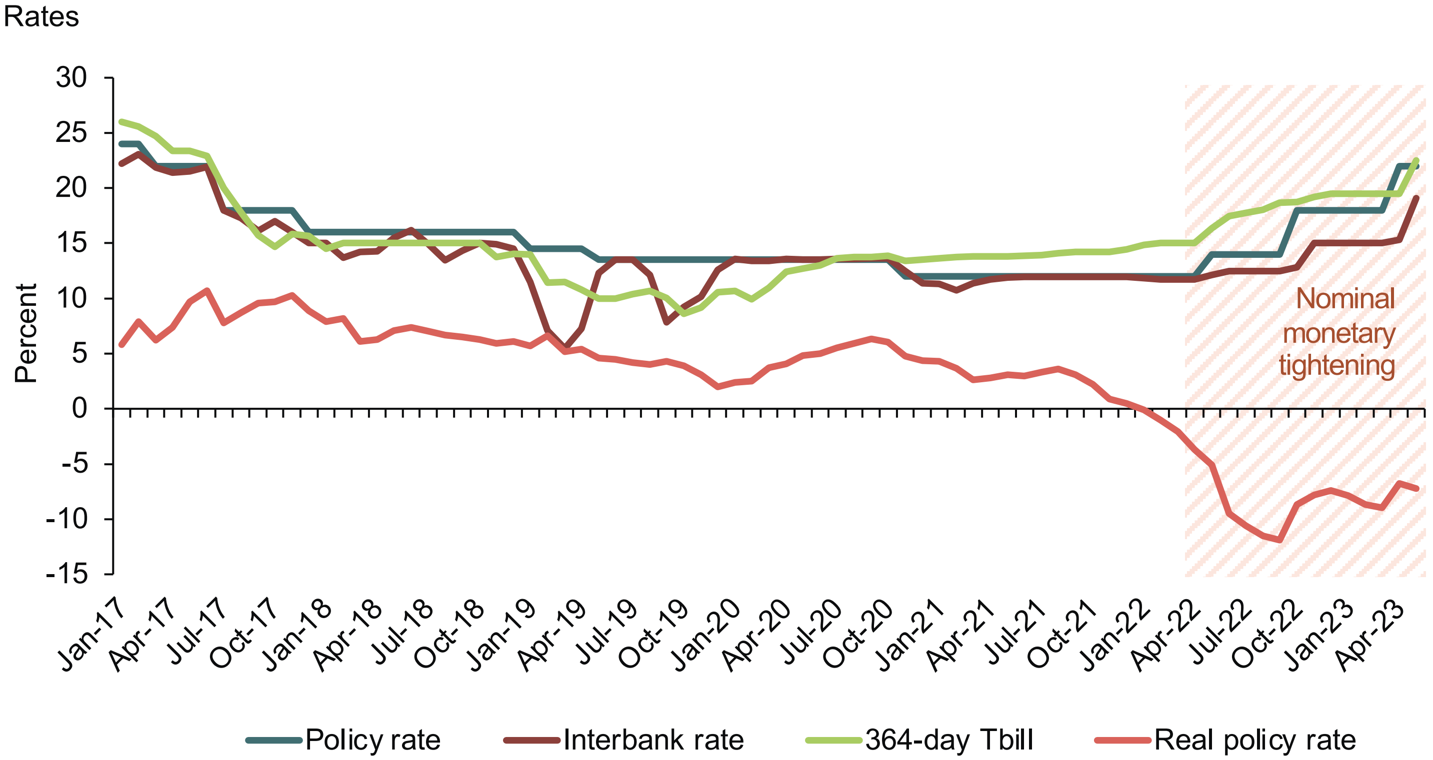
Source: World Bank with data from RBM and NSO.

- Inflation is rising because new Malawi Kwacha are being made available more quickly than new goods and services – this is further exacerbated by weak harvests.
- Inflation stands at 29 percent year-on-year as of May 2023 with food inflation at 39 percent.
- This contributes to increased poverty – currently estimated to stand at almost 72 percent of Malawians at the international poverty line of US$2.15 per day (PPP)

MALAWI'S CURRENT ECONOMIC SITUATION

HIGHER INTEREST RATES FOLLOW INFLATION

Interest rates have increased while real policy rate remains negative



Source: World Bank staff calculations based on RBM data.

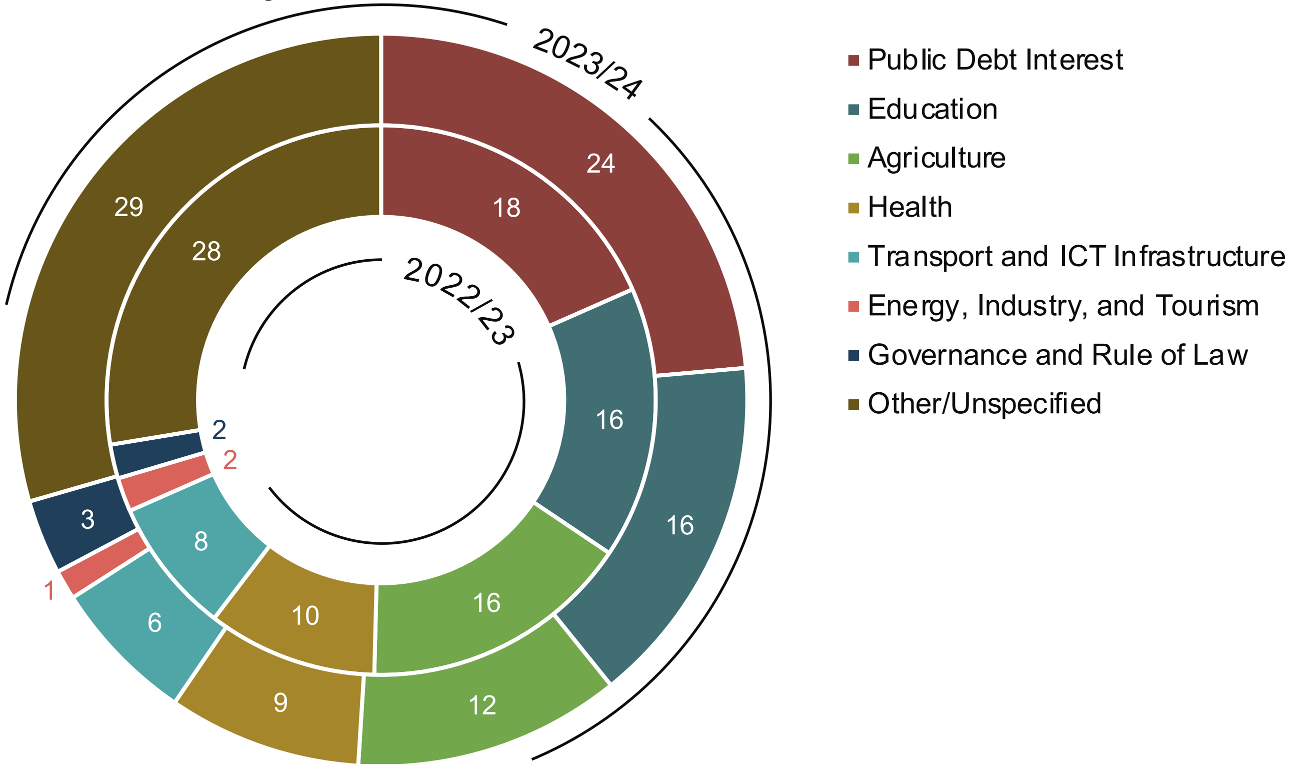
- The RBM has taken the important step to increase the policy rate from 18 to 22 percent. The current real policy rate continues to be negative
- Interest rates across the economy are increasing
- Banks are nevertheless highly profitable – supported by high Government demand for credit

MALAWI'S CURRENT ECONOMIC SITUATION

FISCAL CHALLENGES FOLLOW HIGHER RATES

Allocation for interest expense is eclipsing sectoral allocations

Percent of total budget



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

- Higher interest rates mean that a quarter of the current budget needs to be spent on interest expenses alone
- This leaves less money for essential services and investments in Malawi's future

MALAWI'S CURRENT ECONOMIC SITUATION

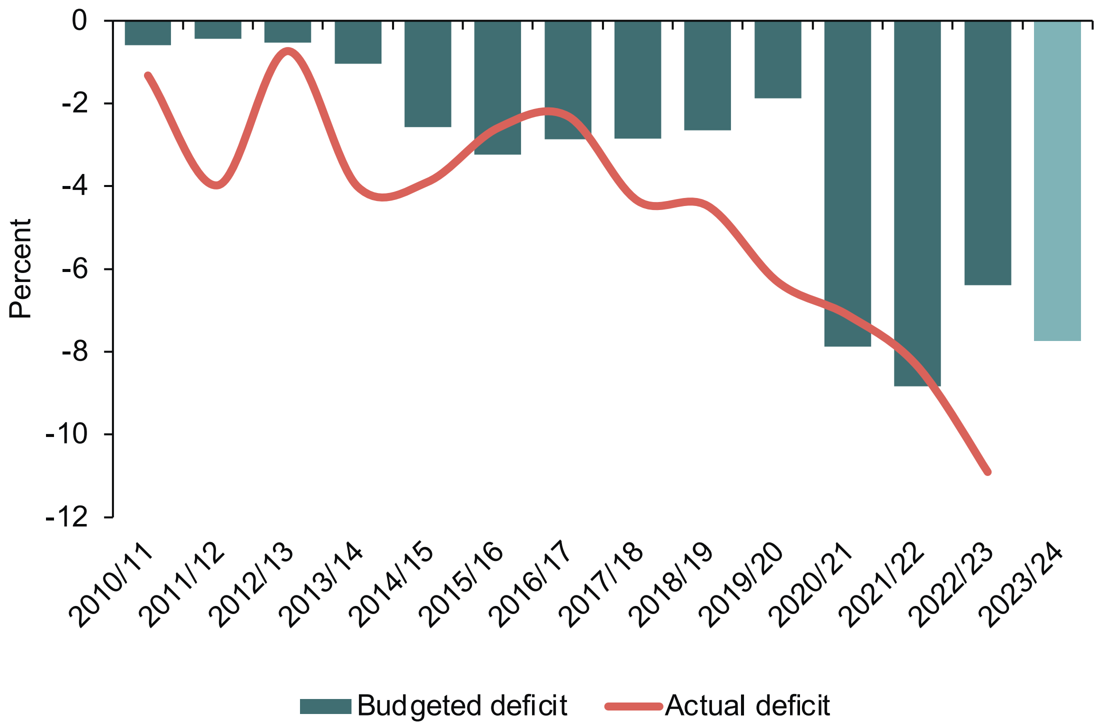
DEFICITS CONTINUE TO ESCALATE

The government has approved large and increasing deficits in recent years

- On account of increasing grants, revenue as a share of GDP has increased by 13 percent last FY
- However, the government spent 69 percent more than it raised last year
- Much of this was unplanned for in the approved budget – making it hard to realise the fiscal turn-around agreed to with the IMF

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.

MALAWI'S CURRENT ECONOMIC SITUATION

RECENT FISCAL DECISIONS COULD CREATE FURTHER VULNERABILITIES AND RISKS

Under-provision for statutory expenditure already committed during the FY23 mid-year budget, such as debt interest and wages, resulted in a negative FY22/23 budget outturn

The approval of the Lilongwe-Salima water project raises transparency and debt sustainability concerns

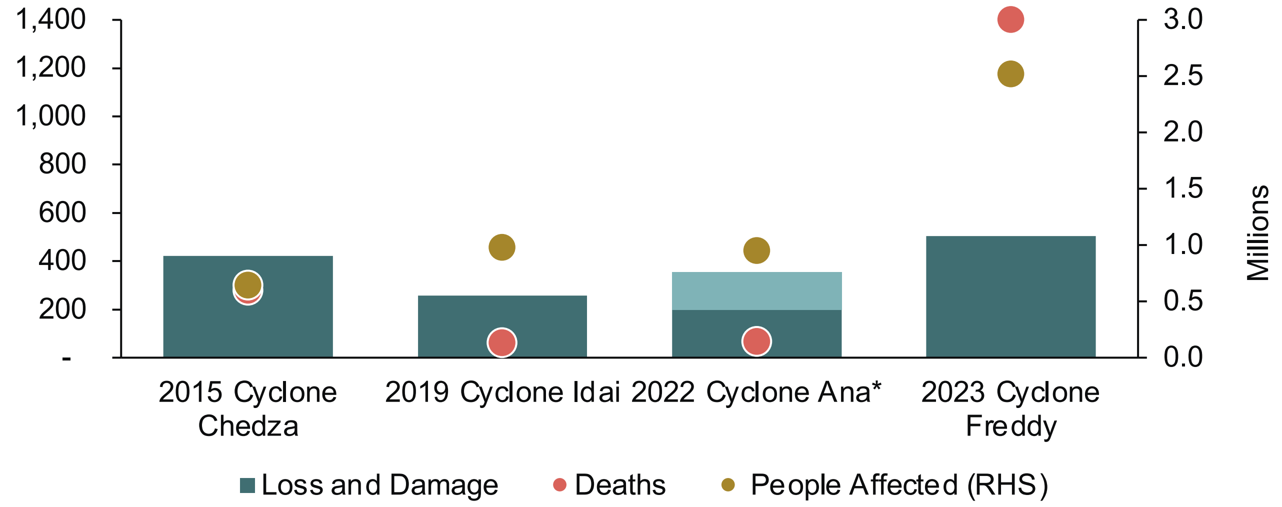
Barter trade arrangements can create public liabilities while not alleviating the core constraint: that Malawi exports too little to support its imports

MALAWI'S CURRENT ECONOMIC SITUATION

CLIMATE-RELATED SHOCKS CONTINUE TO WEAKEN THE ECONOMY AND EXACERBATE MACRO IMBALANCES

Cyclones are becoming more frequent and destructive

Loss and Damage (in constant 2023 US$ millions, left axis), deaths in number of deceased directly attributable to the weather event (people affected, right axis)



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).

- Cyclone Freddy was the most deadly and destructive in a series of increasingly frequent disasters
- The cyclone is estimated to have led to a GDP loss of 0.5 percent
- Climate change-related losses are estimated at 3 to 9 percent of GDP by the end of the decade, but increased investments in resilience can help avoid this

MALAWI'S CURRENT ECONOMIC SITUATION

MALAWI'S ECONOMY CONTINUES TO HOLD AMPLE POTENTIAL

Malawi has a youthful and increasingly educated population

The World Bank's Human Capital Index rose to 41 from 36 just 10 years ago, positioning Malawi among middle-income countries like Botswana.

If managed well, Malawi's mining sector can play a key role in driving growth

International experience shows that with a conducive operating environment and private sector leadership, mega farms can become a success

SECTION 2

OUTLOOK AND POLICY PRIORITIES

OUTLOOK AND POLICY PRIORITIES

"BUSINESS AS USUAL" IS NOT A VIABLE OPTION

Downside risks could impact the outlook

- Prolonged FX shortages
- Setbacks in debt negotiations
- Intensified climate change impacts
- Health risks, including a renewed cholera outbreak

A narrow but feasible path exists to exceed current expectations

A more accelerated and more determined reform program is needed. This includes:

- Achieving fiscal targets
- A resilient financial sector
- Decelerated money growth
- A decline in BOP pressures from lower international commodity prices

OUTLOOK AND POLICY PRIORITIES

A COMPREHENSIVE AND INTEGRATED APPROACH TO POLICY REFORMS

To return to rising incomes, Malawian authorities should implement an integrated set of reforms that bolster one another.

These can help cushion necessary yet costly adjustments.

OUTLOOK AND POLICY PRIORITIES

OPTIONS FOR REFORM

Three broad priority areas emerge from the 17th edition of the Malawi Economic Monitor

OPTIONS FOR REFORM

Restoring macroeconomic stability

- Building foreign reserves ← Using auctions to determine a market-based exchange rate
- Balancing the budget ← Implementing fiscal consolidation in FY23/24
- Improving fiscal management ← Adhering to quarterly ceilings in IFMIS
- Achieving debt sustainability ← Restructuring external debt and containing domestic borrowing

OPTIONS FOR REFORM

Increasing production and exports

- Simplifying trade ← Review new legislation and regulations to ensure they incentivize investment
- Increasing electricity generation ← ESCOM financial sustainability, increasing generation capacity, and accelerating connection roll-out
- Stimulating agricultural growth ← Implementing AIP reforms and AGCOM 2.0

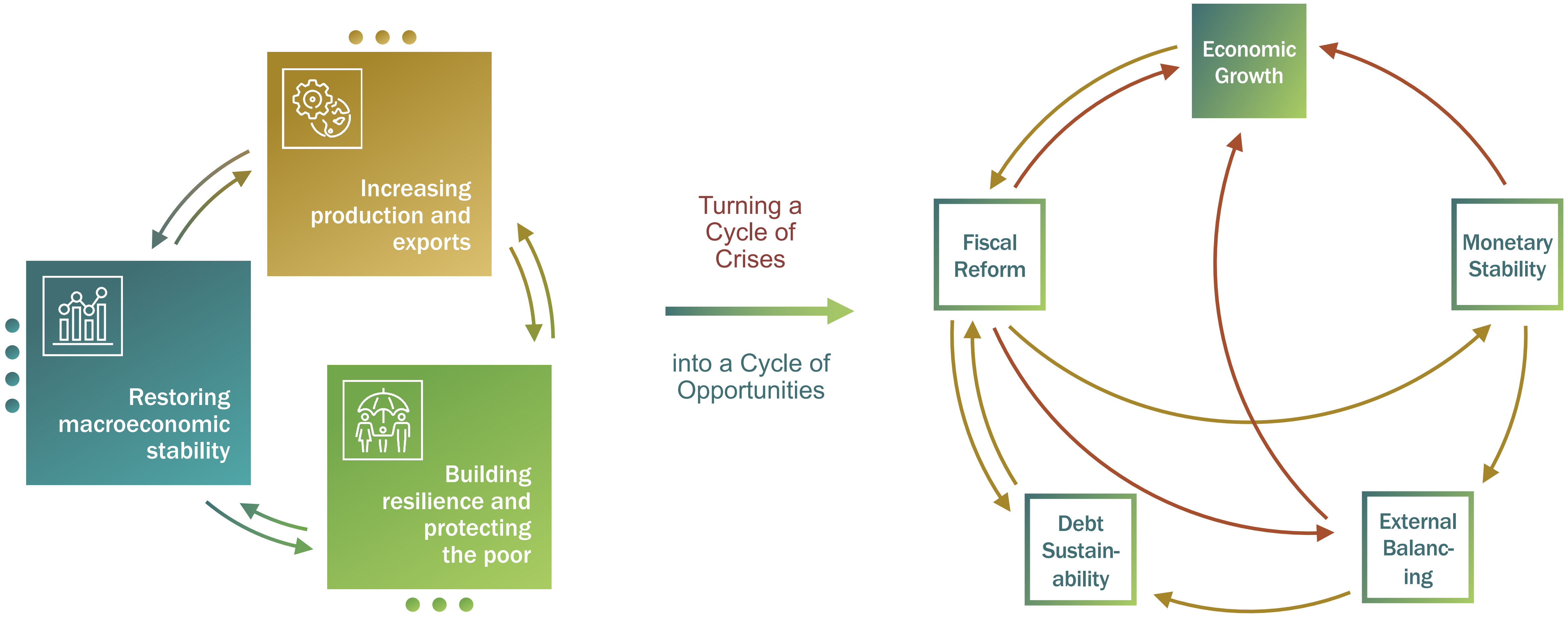
OPTIONS FOR REFORM

Building resilience and protecting the poor

- Finalising UBR reforms ← Improving delivery of social services
- Preparing for the next disaster ← Implementing DRM bill and PDNA lessons
- Responding to health threats ← Strengthening disease surveillance, response, and water/sanitation

OUTLOOK AND POLICY PRIORITIES

OPTIONS FOR REFORM



Malawi Economic Monitor

POWERING MALAWI'S GROWTH

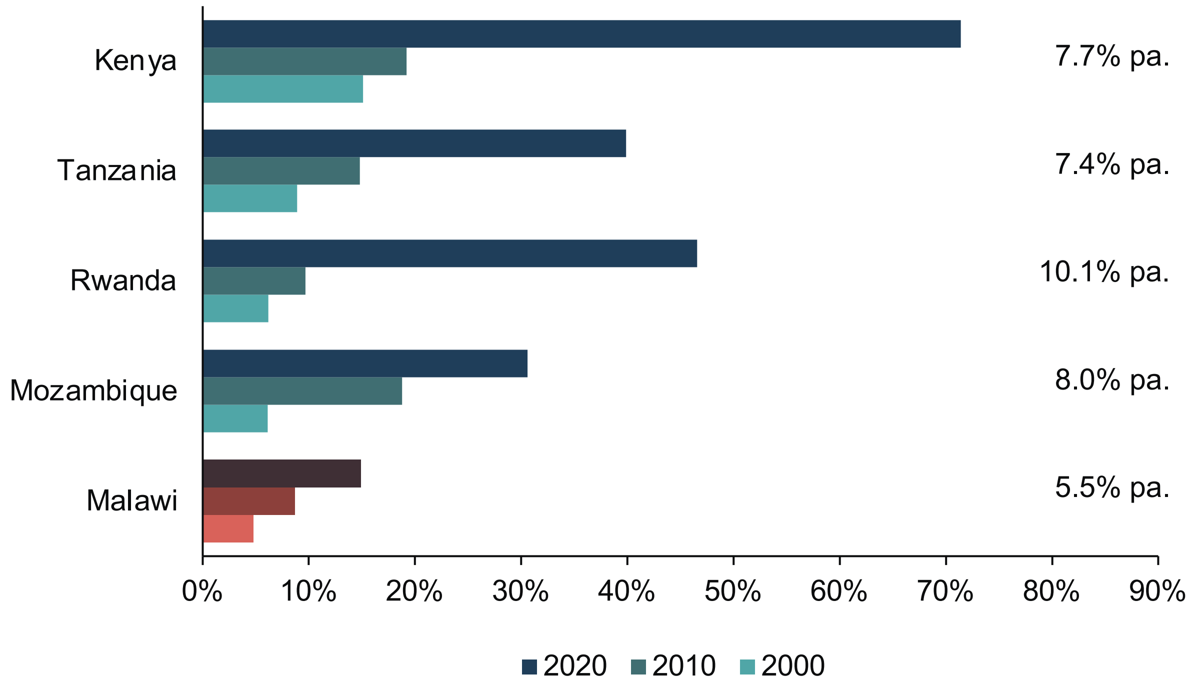
POWERING UP

HOW MALAWI CAN RAPIDLY INCREASE ELECTRICITY ACCESS

OVERVIEW

ACCESS RATE COMPARED TO OTHER COUNTRIES

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



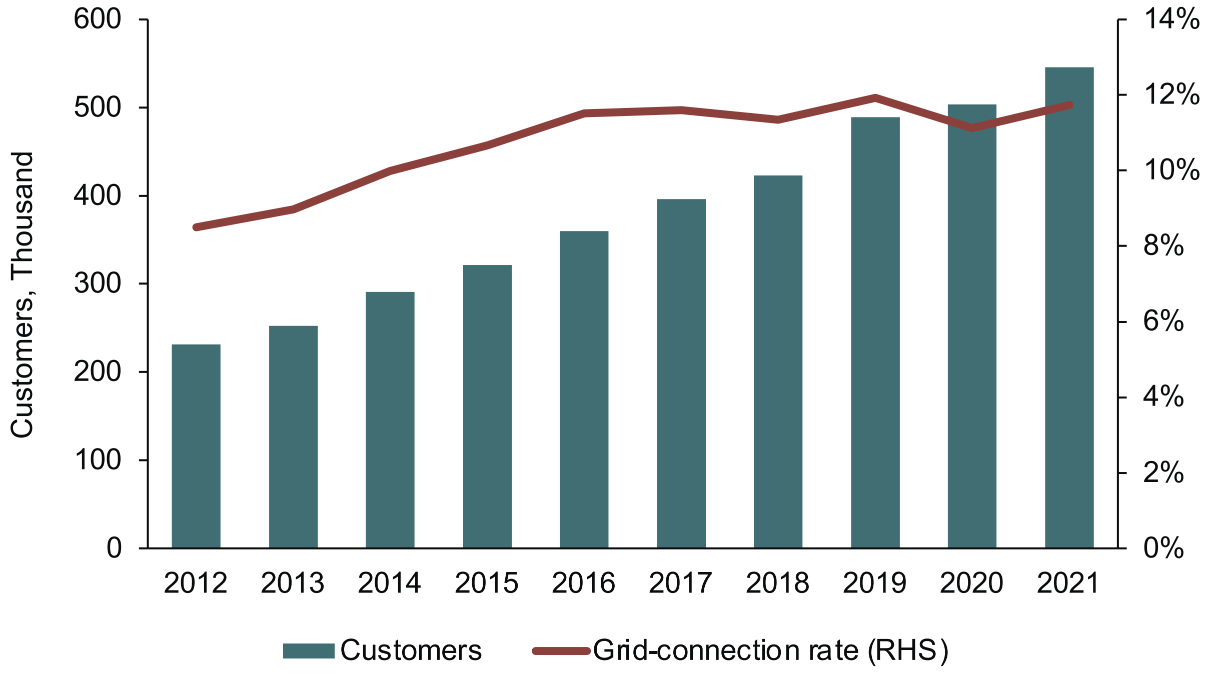
Source: World Bank Global Electrification Database.

- Countries in East Africa, including Malawi's neighbors Mozambique and Tanzania, significantly increased their access rates, having started from below 10 percent electricity access rate in 2000 to over 30 percent access
- Malawi still lags behind with 19 percent (including 7 percent from off-grid solar solutions), the fourth lowest in the world
- The success of other countries has been attributed to political commitment, the enabling environment, a long-term electrification strategy, least-cost planning, and adopting adaptive approaches that fine-tune implementation

MALAWI ELECTRICITY ACCESS OVERVIEW

ESCOM CONNECTION 2012–2021

ESCOM On-Grid connections trajectory from 2012 to 2021



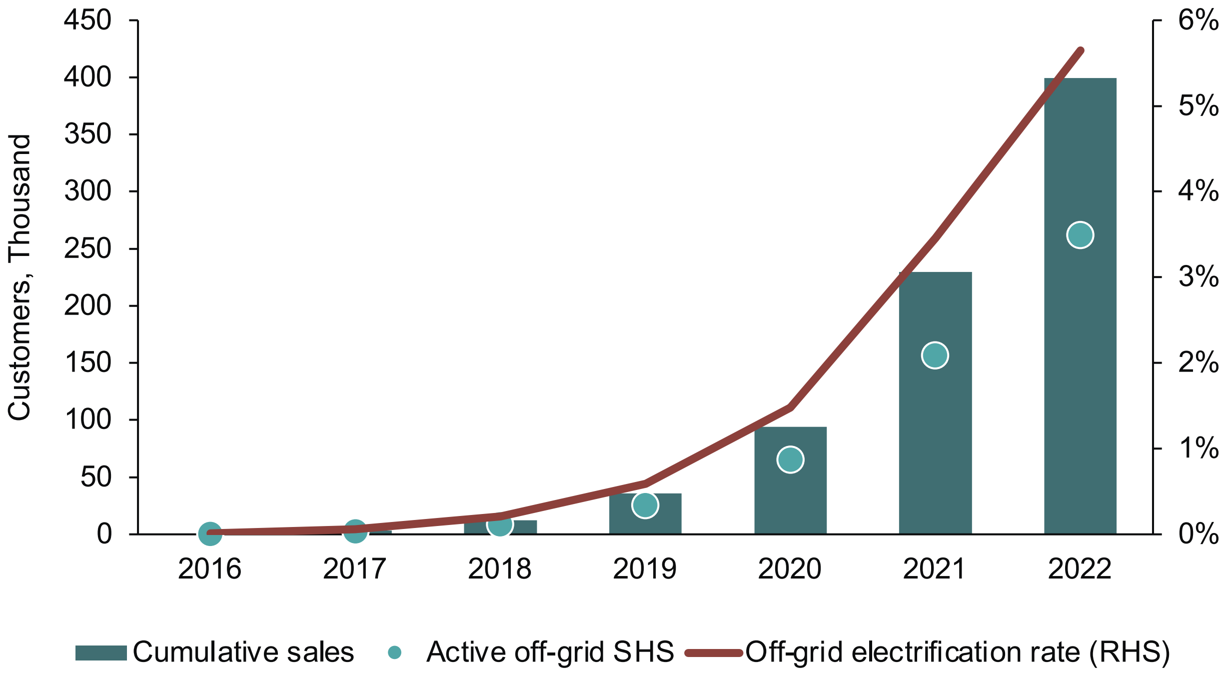
Source: ESCOM.

- 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. This translates to an average of over 34,000 new connections every year.
- However, the national electrification rate has remained stagnant since 2016 because of the country's rapidly growing population, which is increasing at a rate of 2.8 percent annually.
- As a result, the grid connection rate has been effectively flat since 2016, highlighting the need for further action to accelerate electrification efforts and bring sustainable and reliable power.

MALAWI ELECTRICITY ACCESS OVERVIEW

OFF-GRID TECHNOLOGY CHANGED THE DYNAMICS

Malawi dynamic off-grid market connections trajectory from 2016-2022

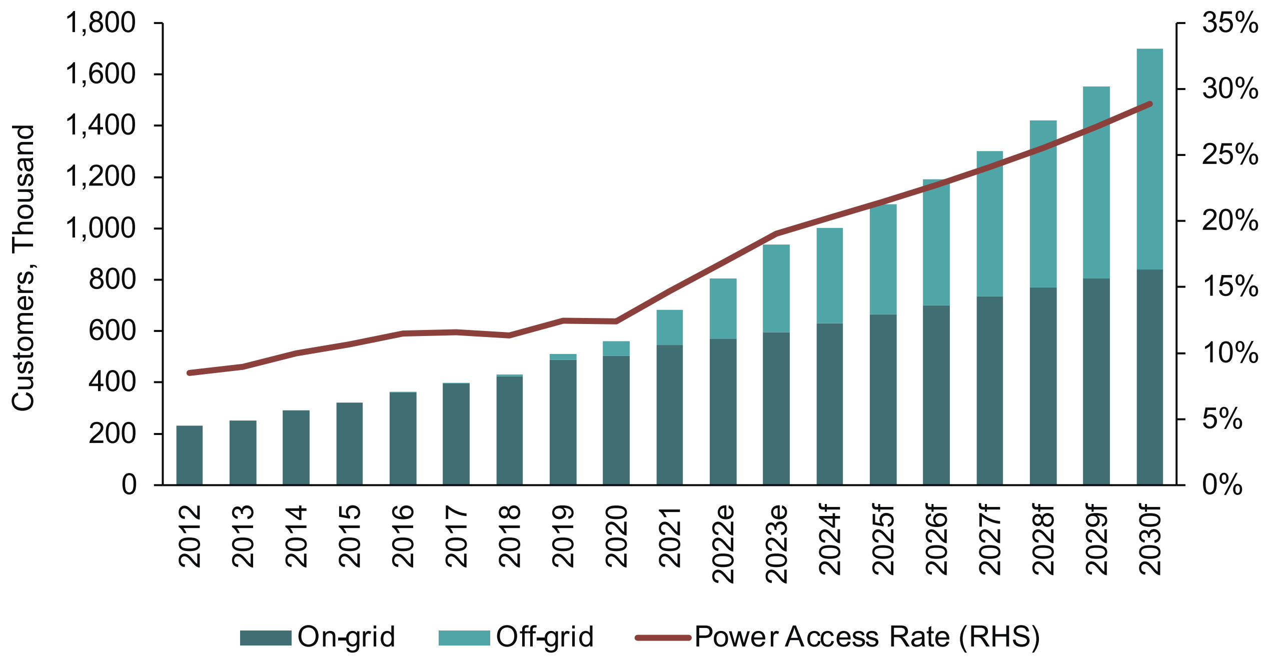


Source: GOGLA sales data, own analysis based on interviews with market players.

- Off-grid electrification, dominated by solar home systems (SHS), has grown rapidly since 2020 and is playing a significant role in the GoM’s electrification plans
- About 400,000 SHS have been sold in Malawi as of 2022. About two thirds of these (260,000) are estimated to be actively serving off-grid households, contributing about 6 percent of electrification rate
- SHS was implemented as an interim solution for achieving final electrification, specifically catering to households' primary electricity needs such as lighting and charging mobile devices.

BUSINESS-AS-USUAL SCENARIO 2023–2030

Business-as-usual access trajectory – will achieve only 30 percent access rate for Malawi by 2030



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

- Under the BAU scenario, Malawi is expected to achieve a 30 percent electrification rate by 2030, primarily through off-grid solar installations.
- The country will continue to rely on ESCOM to connect additional customers to the grid. Without reforms, ESCOM will struggle to install connections much faster than population growth.
- 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.

LESSONS LEARNED

MALAWI ELECTRICITY ACCESS OVERVIEW

LESSONS LEARNED FROM PAST ELECTRIFICATION PROGRAMS

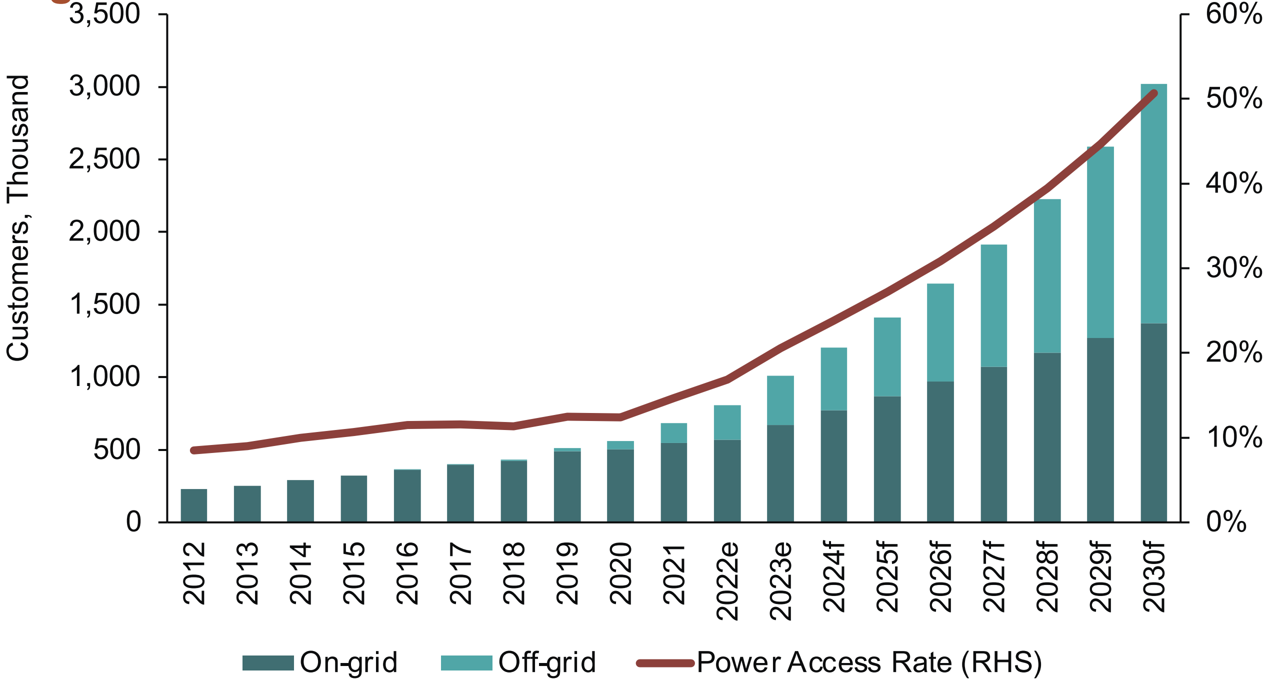
- Increasing energy access requires political support and government ownership
- MAREP needs governance reform and increased transparency
- Solving energy access deficits requires a value chain approach
- Improving ESCOM's operational efficiency is key to the success of the electrification program
- New technology and business models can attract private sector capital and expertise

VISION FOR 2063

WHAT IT TAKES TO ACHIEVE *MALAWI 2063* ACCESS TARGET AT 50%

CHALLENGING BUT FEASIBLE TO ACHIEVE

Year-on-year access trajectory to achieve the electrification target set in *Malawi 2063*



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

- 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 off-grid market needs to continue its growth at 25 percent annual growth, which requires new financing mechanisms and business model innovation.
- Overall, under this scenario, both ESCOM and off-grid solar companies have equal responsibility to each connect about a quarter of the population.

WHAT ABOUT UNIVERSAL ACCESS BY 2030?

RAISING THE BAR:

STRIVING FOR UNIVERSAL ACCESS BY 2030

- Universal access by 2030 would require an annual connection target of close to 500,000 per annum, over 15 times faster than the current speed. This would require a complete overhaul of the implementation model of ESCOM and MAREP
- Universal access also requires significant investment in generation and transmission network, estimated to cost over $2–3 billion by SE4all
- Aggressive scale-up SHS and mini-grid solutions are likely to be required

WHAT IT TAKES TO ACHIEVE *MALAWI 2063* ACCESS TARGET AT 50%

A FRAMEWORK TO ACHIEVE VISION 2063

Malawi's pathway to achieve 50 percent electricity access rate by 2030

LEADERSHIP	GoM to establish institutional arrangements and update sector plans	MoE to take a stronger coordination role to balance on-grid and off-grid	MoE to update NEP 2018	GoM to formalize connection fees policy and guidance
REFORM	GoM to improve ESCOM governance	ESCOM to improve its procurement efficiency	ESCOM to operationalize MIS	ESCOM to achieve financial sustainability
PARTNERSHIP	GoM to continue supportive policies incl. VAT and duty exemption	GoM to facilitate more local currency financing	GoM to introduce targeted end user subsidies	GoM to set market standard incl. mini-grid and SHS

Source: World Bank.
Note: GoM — Government of Malawi. MoE – Ministry of Energy

WHAT IT TAKES TO ACHIEVE *MALAWI 2063* ACCESS TARGET AT 50%

LEADERSHIP

1

The GoM should establish institutional arrangements and regularly update the generation and transmission master plans to ensure adequate supply and transmission capacity.

2

The MoE can take a stronger coordination role in balancing the roll-out plans for on-grid and off-grid connections.

3

The MoE is encouraged to update the NEP 2018 to ensure it aligns with current challenges.

4

The government should formally adopt the draft Guidelines for Implementation of the National Electrification Program.

REFORM

1. The GoM, through governance reforms, needs to foster a culture of accountability and continuous improvement within ESCOM.
2. ESCOM should focus on improving its procurement processes to tackle a major bottleneck of electrification.
3. ESCOM needs to fully operationalize its Management Information System (MIS).
4. GoM needs to work with ESCOM to achieve its financial sustainability.

WHAT IT TAKES TO ACHIEVE *MALAWI 2063* ACCESS TARGET AT 50%

PARTNERSHIP

1

The GoM is encouraged to continue supportive policies, such as VAT and duty exemptions, to stimulate additional private sector investment.

2

The GoM is encouraged to facilitate more local currency financing for off-grid companies.

3

Targeted end-user subsidies can be introduced to further reduce the price of off-grid solar products for those who need them most.

4

The GoM is encouraged, in consultation with off-grid solar companies, to set market standards for mini-grid and SHS to ensure quality products and services.