



Malawi Economic Monitor

JULY 2020

FROM CRISIS RESPONSE TO A **STRONG RECOVERY**



THE WORLD BANK
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MALAWI ECONOMIC MONITOR

July 2020

From Crisis Response to a Strong Recovery

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Table of Contents

OVERVIEW	iv
<i>Negative impacts of the COVID-19 crisis are already being felt</i>	iv
<i>The expected impact is large, although with substantial uncertainty</i>	iv
<i>The initial Government policy response needs to be supported and expanded</i>	v
1. ECONOMIC DEVELOPMENTS	1
1.1 Global and Regional Context	1
<i>The global economy will sharply contract in 2020</i>	1
<i>COVID-19 will induce Sub-Saharan Africa's first recession in 25 years</i>	1
1.2. Malawi's Economic Performance Before COVID-19	2
<i>Prior to COVID-19, Malawi was expecting moderate growth in 2020</i>	2
<i>The mid-year revised budget loosened the deficit target</i>	3
<i>Fiscal deterioration continued in the third quarter</i>	5
1.3. The Impact of COVID-19 on Malawi's Economy in 2020: A Severely Weakened Outlook	6
<i>Both global and domestic factors weigh on economic activity</i>	6
<i>Malawi's strong harvest should help avoid increasing food insecurity</i>	8
<i>Services and industrial sectors are being heavily affected</i>	10
<i>COVID-19 will reduce growth sharply</i>	10
<i>Inflation has decelerated since the onset of the maize harvest</i>	11
<i>The kwacha has continued to appreciate in real terms</i>	12
<i>The pandemic is further increasing fiscal pressures</i>	13
<i>The provisional budget expands farm input spending while reducing taxes</i>	14
<i>Debt vulnerabilities will also rise</i>	16
<i>Current account deficit will worsen due to trade disruptions and lower demand</i>	17
<i>RBM has increased liquidity but kept the policy rate unchanged</i>	18
<i>Private sector credit has been increasing but will face pressure as the crisis deepens</i>	18
<i>Poverty will increase, particularly in urban areas</i>	21
2. MEDIUM TERM ECONOMIC OUTLOOK	22
3. GOVERNMENT'S POLICY RESPONSE TO COVID-19 TO DATE	23
<i>The Government has expanded health sector capacity, but court injunctions have halted a lockdown</i>	25
<i>The Government announced economic measures to support consumers and firms</i>	25
4. POLICY OPTIONS FOR STRENGTHENING CRISIS RESPONSE AND MEDIUM-TERM RECOVERY	26
A. Protecting lives.....	26
B. Protecting livelihoods.....	28
<i>Considerations in ramping up cash transfers</i>	28
<i>Ensure trade and market activities continue</i>	29
<i>Support firms and the financial sector</i>	30
C. Protecting the future.....	30
5. REFERENCES	38

List of Figures

Figure 1: GDP growth of Malawi's main trade partners is expected to decelerate in 2020	2
Figure 2: Most countries, apart from low income countries, are expecting a recession in 2020	2
Figure 3: Domestic debt has been increasing, while external debt has declined	5
Figure 4: High primary deficits and interest rates remain key drivers of total public debt	5
Figure 5: Stringency Index.....	9
Figure 6: GDP Forecast Fan Chart.....	11
Figure 7: Food inflation pressures have started subsiding in 2020	12
Figure 8: Inflationary pressures picked up on the regional front	12
Figure 9: Kwacha cash rates are diverging from stable TT rates	13
Figure 10: ... while appreciating in real terms and against regional currencies	13
Figure 11: The deficit expanded in the third quarter of FY 2019-20.....	14
Figure 12: Domestic and customs taxes have decreased since April.....	14
Figure 13: Economic impacts of Government payment arrears	15
Figure 14: Domestic debt has shifted toward longer- maturing instruments	16
Figure 15: ... and borrowing shifting from monetary authorities	16
Figure 16: The policy rate has been held constant to mitigate against potential inflation pressures.....	18
Figure 17: Yields have increased substantially on Government borrowing since January 2020.....	18
Figure 18: Private sector credit growth remains robust through May	19
Figure 19: Financial soundness indicators were healthy at the onset of the crisis.....	19
Figure 20: Most MSMEs are in wholesale/retail and agriculture.....	20
Figure 21: Most MSMEs are at start-up stage.....	20
Figure 22: Employment in rural and urban Malawi	21
Figure 23: Share of labor force by sector.....	21
Figure 24: Forecasted changes in moderate poverty by 2020 due to COVID-19	22

List of Tables

Table 1: Real GDP growth (Percent).....	2
Table 2: Fiscal accounts	4
Table 3: Reduction in Activity for Smartphone Users in Selected Countries as of May 2 and July 10.....	9
Table 4: COVID-19 Governance Response Policies and Status	24
Table 5: Macroeconomic Indicators	37

List of Boxes

Box 1: Lockdowns and Economic Livelihoods in East Africa.....	9
Box 2: Effects of payment arrears on the economy.....	15
Box 3: Debt-relief in the times of COVID-19.....	17
Box 4: MSMEs Scope and Challenges	20
Box 5: A Framework for Policy Responses to the COVID-19 Pandemic	27
Box 6: How ICT can Support Malawi's COVID-19 Response and Recovery.....	32
Box 7: Malawi's Medium- and Longer-Term Options for Charting a New Course	34
Box 8: Responses to COVID-19 in East Africa	35

OVERVIEW

Negative impacts of the COVID-19 crisis are already being felt

Malawi's new Government has inherited a difficult situation: the global COVID-19 pandemic has interrupted the country's trajectory for a third straight year of faster growth, and tackling its impacts will present a considerable challenge. Growth improved to an estimated 4.4 percent in 2019, up from 3.5 percent in 2018, reflecting a rebound in agriculture. Improved agricultural production supported stronger performance in the industrial and service sectors. The uptick in growth also indicated resilience in Malawi's economy in light of the impact of Cyclone Idai and considerable political uncertainty. The economy was on a trajectory for its third consecutive year of faster growth in 2020 before the onset of the COVID-19 pandemic.

The full extent of the epidemic's negative impact is uncertain as the crisis is still unfolding, but a host of external and internal factors are dampening the Malawi economy. Global factors include both supply and demand channels. Disrupted supply chains have reduced imports of key production inputs, particularly from South Africa and China. However, exports from both countries have partially rebounded after their strict containment measures have been reduced in recent months. Preliminary data indicates that Malawi's imports were 26 percent lower in April and May 2020 compared to the same time last year. Increased trade logistics costs and delays are also affecting the flow of goods through borders. Decreased demand from key trade partners is weighing on exports. The tobacco auction season through early July has seen a decrease in sales, with a 11.9 percent reduction in sales values, due to a 14.7 percent reduction in volumes partially offset by a 3.2 percent increase in average price. Tourism has already been severely affected. Remittances (through money transfer) decreased by 57 percent y-o-y in April before rebounding in May, when they were still 15 percent lower than the year prior.

Domestic factors are also contributing to the crisis through increased risk aversion and social distancing policies. COVID-19 case numbers have been accelerating in recent weeks due to increased community transmission. Social distancing behavior and policies are constraining domestic demand. This has been evident in the hospitality industry, where various restaurants closed, and reduced domestic and international tourism has contributed to a significant reduction of hotel occupancy rates. Households are decreasing unnecessary expenditure, while firms are decreasing investment, negatively affecting aggregate demand.

However, the second consecutive bumper harvest, combined with Malawi's relatively small services and industry sectors, is alleviating some of the negative impact on growth. The 11.5 percent increase in maize production over 2019's robust harvest will help assure food security in the short term for the 87 percent of the population working in agriculture. However, this could potentially be eroded if internal trade blockages materialize, or by market distortions which tend to result in high maize prices in the lean season. The bumper harvest, combined with lower international energy prices, should help offset a potential increase in import prices to contain inflation to around 10.1 percent in 2020.

The expected impact is large, although with substantial uncertainty

GDP growth in 2020 is expected to slow sharply, though projections are highly uncertain and evolving as the crisis unfolds. Based on available data through July, GDP growth estimates for 2020 have been revised down from the 4.8 percent projected in September 2019 to a baseline of 2.0 percent. The baseline assumes that Malawi will not experience a full national lockdown. It also assumes the brunt of the external demand shock and disruptions to domestic activity are felt in 2020 and not into 2021. Risks are heavily tilted to the downside, and in a downside scenario with extensive domestic spread of the disease, stricter restrictions on economic activity, and a protracted global health crisis, the economy could contract by 3.5 percent in 2020.

The poverty impact will be particularly acute in urban areas where the sizeable informal services sector is expected to be heavily affected. Within the services sector, accommodation and food services as well as wholesale and retail trade are likely to be significantly affected if Malawi experiences wider

community-level transmission. The forecasted increase in urban poverty could range from 1.6 percentage points (representing around 280,000 Malawians) in the baseline growth forecast, up to 4.9 percentage points (around 880,000 people) in the downside scenario. Given the strong harvest and the agriculture-based rural economy, in the baseline scenario rural poverty may see limited impact. However, in the downside case scenario, vulnerability to falling below the poverty line could increase by 2.2 percentage points in rural areas.

The fiscal deficit was budgeted to increase prior to COVID-19 and could further widen above 10 percent of GDP due to the pandemic. The mid-year 2019-20 budget revision increased the planned deficit from 2.7 to 4.9 percent of GDP, largely on account of unrealized revenue targets and increased recurrent spending. Although the pandemic had limited impact on tax revenues through March, revenues through the first three quarters of FY2019-20 had significantly underperformed optimistic projections, reaching only 58 percent of annual targets. This was accompanied by significant expenditure overruns in the third quarter. Expenditure in the third quarter was 32 percent over Quarter 1 and 18 percent over Quarter 2, on subsidies and transfers, goods and services, interest on debt, and payment of arrears. The impact of the COVID-19 pandemic became clear in May and June, when gross tax revenues were 14 percent below the Q3 average. The impact of the crisis is expected to be felt in the fourth quarter and beyond, with reductions in tax revenue paired with increased expenditure on health and economic policy responses.

The new administration's provisional budget for July to October 2020 expands farm inputs while lowering taxes for lower wage earners. The provisional budget projects a fiscal deficit of 3.9 percent of GDP, almost half that proposed in the May 2020 draft budget yet for only 4 months. Domestic borrowing would finance almost 80 percent of the deficit (3.1 percent of GDP). The budget increases the tax-free bracket from MWK 45,000 to MWK 100,000, which will increase disposable incomes for lower paid employees, but will also reduce income taxes. The budget proposes an Affordable Inputs Program whereby 3.5 million smallholder farmers will access fertilizer at a reduced cost, as well as maize and legume seeds, with an allocation of 0.7 percent of GDP. In addition, it has increased the allocation for the Malawi Enterprise Development Fund (MEDF) from MWK 15 billion to MWK 40 billion (0.6 percent of GDP). Moreover, it also announced the expansion of the youth internship program and introduction of the National Youth Service Program.

External concessional and grant support is needed to maintain debt sustainability and prevent an even greater domestic debt burden at high cost. Wide fiscal deficits are likely to contribute to even higher domestic debt burden at high cost. Domestic interest rates have been increasing, which will contribute to increasing domestic debt service costs. With limited fiscal space, the Government should prioritize concessional and grant support over domestic borrowing for the response to help maintain debt sustainability.

The initial Government policy response needs to be supported and expanded

The new Government will need to balance containment measures with supporting the economy. Various measures have been announced in recent months, including a health response plan, expansion of social protection, fiscal and monetary measures, as well as steps to support the financial sector and the expansion of mobile money services. The immediate health response has focused on detection, treatment and prevention. Social protection benefits were announced to expand to over 185,000 new urban households (around 35 percent of the urban population) and frontloaded 4 months of the rural cash transfer program for existing beneficiaries. The Reserve Bank of Malawi (RBM) has also announced several key initiatives, including establishing an Emergency Liquidity Assistance (ELA) framework to support banks in the event of worsening liquidity conditions, directing commercial banks and microfinance institutions to provide a three-month moratorium on interest and principal payments and restructure loans on a case-by-case basis, reducing fees and increasing transaction amounts for internet banking and mobile money payments, and increasing the MEDF loans allocation from MWK 13 to MWK 15 billion to help Small and Medium Enterprises (SMEs), which has been increased to MWK 40 billion in July.

As the new Government fully recognizes, additional measures are needed to address the evolving challenge of the COVID-19 pandemic, while carefully considering the tradeoff between social distancing policies to reduce the spread of the virus and losses to livelihood. Containment measures are intended to flatten the epidemic curve over the short run, to help isolate cases and hotspots, and to allow as many as possible to access (already limited) health care options, while biding time to ramp up extensive testing, with a longer term target of improving treatment options and developing a vaccine. However, strict lockdown measures would severely affect livelihoods, and the impacts would be aggravated by Malawi's large informal sector and high rates of poverty and food insecurity. Protecting their earnings and reaching affected households through cash transfers is essential to ensure containment measures receive support. So far, the new Government has recognized this risk and its initial measures have been aimed at smart containment that can help reduce high-risk activities that have limited impact on livelihoods nationally, consistent with focusing stricter measures on hotspots, high risk areas, and the vulnerable, informed by extensive testing and close monitoring.

Further policy actions can be organized by three objectives: 1) protecting lives, 2) protecting livelihoods, and 3) protecting the future. Malawi's response to the pandemic is constrained by limited fiscal space, high overall risk of debt distress, and limited capacity. As such, it has limited resources to support the expansion of health services, expand cash transfers, and support affected industries through tax breaks or direct support, and will need to rely on concessional and grant resources for much of the response.

Protecting lives: In the immediate term, the primary concern is saving lives, which requires containing the spread of the disease through smart containment measures and putting in place the measures needed for the prevention, detection, and treatment of the disease. Physical distancing measures are critical and should in particular move toward "smart containment" - targeted physical distancing measures that have the maximum effect on epidemic reduction with the minimum economic damage. Malawi should enhance active case finding, testing, contact tracing, and monitoring, quarantining and isolating cases. It should further maintain essential health services and prepare for COVID-19 case management.

Protecting livelihoods: A second prong in the effort must consider supporting livelihoods during the economic slowdown. This will call for:

- a. **Protecting households** – The Government announced a significant program to ramp up cash transfer programs, particularly to affected households in urban areas. This will call for measures to roll out an abridged version of the social registry's data collection tool in the urban hotspots, registering all households in those hotspots. It will also call for a clearly defined implementation period and payment triggers to activate payments when livelihoods are at risk. It should also work with Mobile Network Operators (MNOs) and development partners to facilitate digital payments. To offset the potential for political capture, fraud and corruption, it is imperative that all key implementation processes for the identification, registration, targeting, enrolment, payment, and case management be managed transparently, with strong accountability mechanisms built into each process. Ways to do this include digitizing and integrating the key processes (registration, enrolment and payments); minimizing manual interference, which is prone to manipulation; and complementing this with phone-based monitoring.
- b. **Ensuring trade continues** – This would entail ensuring food markets and trade continue, and farmers continue to have access to critical inputs, as part of a smart containment approach. Measures can be implemented to keep internal and external trade flowing and in ensuring that Malawians are supplied with essential goods, including food, agricultural inputs, and medicines, at regular prices. This will call for monitoring the current situation in a systematic manner with regular data updates. Moreover, the Government can enable regulatory simplification and fast track border clearance for essential foods, health and safety equipment and medicines. Support for small-scale traders will include expanding and encouraging the use of simplified declarations and processes and being more responsive to consolidated cargo shipments, particularly as small traders will need to consolidate shipments during this time. All this will rely on strengthening health and hygiene

standards in markets and for key trade, production, processing, and marketing activities as a key component of smart containment measures.

- c. **Supporting firms and the financial sector** – Additional measures to support firms could include considering the extension of moratoria on interest and principal payments for loans from commercial banks and microfinance institutions. In addition, it could earmark wholesale financing to support banks, Microfinance Institutions (MFIs), and Savings and Credit Cooperatives (SACCOs) extend credit to Micro, Small, and Medium Enterprises (MSMEs). The Government can further introduce and enhance de-risking instruments such as credit guarantees for enterprises, to lower collateral amounts demanded by financial intermediaries. In addition, the Government can accelerate the repayment of arrears, which can help inject liquidity to MSMEs.

Protecting the future: While much of the effort would necessarily go toward addressing the immediate crisis, investment also needs to be made to support recovery and resilience in the medium term. Malawi needs to return to a medium-term target of 5 to 5.5 percent growth in order to support job creation. Historically growth has been undermined by macro-economic instability and high inflation, which have contributed to one of the lowest investment rates in Sub-Saharan Africa. Therefore, the country needs to ensure that it prioritizes maintaining fiscal sustainability and price stability and strengthening governance in order to help increase investment to support growth.

- a. **Malawi needs to increase fiscal sustainability and build fiscal buffers to better handle the next shock.** The accumulation of high cost domestic debt has led to increasingly limited fiscal space for managing shocks and increasing investment. As the new administration prepares the full fiscal year budget, this will require credible macroeconomic and revenue projections and sustainable expenditure targets, to avoid a continuous buildup of debt and arrears, which can further increase domestic interest rates and crowd out private investment. It further calls for significant expenditure rationalization, in both the investment and recurrent budgets. It should consider how to contain recent increases in the wage and pension bill, as well increases in goods and services expenditure. It should carefully consider the benefits of recent reforms to the Farm Input Subsidy Program (FISP), which have reduced its fiscal burden and fiscal risk. The Public Sector Investment Program (PSIP) should be closely scrutinized to reduce projects to those which are high priority and are justified by borrowing costs of 10 to 22 percent. This could be supported by publishing an annual audit of the PSIP database. In the past fiscal indiscipline has contributed to inflation through the monetization of deficits. Strengthening fiscal discipline will help reduce pressures to revert to monetization and thereby support lower inflation.
- b. **Implementing transparent and credible financial management practices will be essential to ensure value for money for limited fiscal funds.** The rapid deployment of COVID-19 response funds have exacerbated pre-existing governance vulnerabilities including: the coordination and handling of emergency funds between Ministries, Departments, and Agencies (MDAs); balancing the flexibility and accountability needed for time-sensitive, high-value procurements; the transparent receipt of emergency supplies at points of service delivery; and the efficient and equitable hiring of emergency personnel to deal with expanded service delivery needs. Measures to mitigate these risks – both in the immediate COVID-19 response and broader service delivery efforts – will be critical to ensure that limited funds reach their intended purpose and avoid creating further fiscal pressures.
- c. **Strengthening oversight, financial management, and transparency of State-Owned Enterprises (SOEs) will be critical to reduce fiscal risks, mitigate corruption, and improve service delivery.** The new Government has swiftly indicated a priority to strengthen oversight and transparency of SOEs. Doing so has the potential to improve their efficiency, avoid the realization of contingent liabilities and accumulation of arrears, and increase dividend payments—with the ultimate goal of improving service delivery. An immediate step to improve the operational efficiency of utilities would be to competitively fill vacant senior managerial positions at key energy sector institutions. Publishing the selection process, background, and allowances for new SOE board members would also improve governance in an area that has traditionally lacked transparency. The Government could also conduct independent forensic audits on parastatals with performance and

integrity issues. It can further commit to the annual publication of a fiscal risk statement covering contingent liabilities and institutional risk factors. Moreover, increasing transparency of off-budget funds such as the Fuel Price Stabilization Fund could also increase the efficiency of public resources.

- d. **Increasing exchange rate flexibility can support competitiveness and help maintain reserves.** Limited exchange rate flexibility of the kwacha against the US dollar for over three years has increased the real appreciation of the exchange rate, reducing competitiveness and contributing to private sector concerns about queues for foreign exchange. Some measure of exchange rate flexibility could offset these concerns and help preserve foreign exchange reserves for periodic shocks and avoid disruptive macro-economic imbalances. In addition, sustaining a prudent monetary policy will be key to maintaining lower inflation.
- e. **Increasing diversification and commercialization of the agriculture sector will support growth and resilience.** Malawi has been fortunate that the COVID-19 crisis has struck in a year with good agricultural production. However, creating a more resilient agriculture sector in the medium term will call for a predictable and transparent policy environment for agricultural products, to stimulate investment, increase production, and exports. The Agricultural Development and Marketing Corporation's (ADMARC)'s interventions have historically often contributed to market distortions and high price volatility. Instead, ADMARC's market interventions should be transparent, timely, and predictable in order to support growth in the sector. Moreover, the Government should rebalance spending in the agriculture sector beyond input subsidies and maize purchases to instead invest more in priority areas including irrigation as identified in the National Agricultural Investment Plan. It can further leverage information and communication technologies (ICT) to disseminate technology to farmers.
- f. **Malawi should actively promote a more diversified economy, which would help the economy rebound, and also make it more resilient to shocks.** One of the top constraints to business is limited and unreliable access to energy. As such, this will require that critical investment projects in energy generation (such as the Mpatamanga Hydropower Project) and transmission continue during the crisis, to support structural transformation in the medium term.
- g. **Malawi can further simplify business regulations and taxes.** As the Government prepares a domestic resource mobilization strategy, tax policies and administration should be reviewed and revised to increase transparency, to reduce ad hoc changes, and to enable increased value addition and key growth-enabling sectors, such as ICT, and the development of SMEs. It could further benefit from progress on the bankruptcy regime as well as ensuring an effective framework for international investment arbitration. Tangible progress on these policies will be needed to strengthen competitiveness and increase investment, in order to increase employment and incomes.
- h. **The Government can implement measures to further support the stability of the financial sector, while expanding MSMEs' access to finance.** The Government should mitigate against financial sector risks by: i) developing a clear framework for removing the temporary prudential forbearance measures that have been put in place during the COVID-19 crisis; ii) strengthening the bank resolution framework; iii) developing long-term finance including the capital market; and iv) activating the deposit insurance framework. In addition, to support MSMEs' access to finance, the usage of the moveable collateral registry and credit reference bureau should be enhanced.
- i. **Finally, considering Malawi's ongoing vulnerability to climate and other exogenous shocks which have a strong impact on poverty, increasing resilience calls for creating a sustainable, shock-sensitive national safety net program.** A priority should be re-targeting resources from less effective interventions such as the FISP toward more efficient programs to support the poor such as cash transfers. Moreover, the Government should establish a concrete social protection financing strategy by establishing and meeting domestic spending budgets for safety net interventions. Finally, despite high levels of humanitarian assistance, safety nets and humanitarian assistance operate independently from each other. Malawi could therefore also improve the shock sensitivity of social protection through greater linkages between safety nets and humanitarian assistance.

1. ECONOMIC DEVELOPMENTS

1.1 Global and Regional Context

The global economy will sharply contract in 2020

1. Before the onset of the pandemic, global growth was already decelerating. In 2019 the global economy grew by 2.4 percent, the lowest growth rate in the last decade, below the 2010-2018 average growth rate of 3.1 percent (Table 1). Escalating trade tensions between the United States and China and political uncertainty in advanced economies resulted in a decline in consumer expenditure and investor confidence, and in increased volatility in financial markets and lower-than-expected capital inflows to emerging economies. Growth in Sub-Saharan Africa (SSA) also moderated, decelerating from 2.5 percent in 2018 to 2.4 percent in 2019. Economic activity was dampened by lower-than-expected demand from the region's trade partners, and higher global uncertainty. Growth varied across SSA countries. Growth in non-resource intensive countries was generally stronger, with an expansion in public consumption and fixed investment. By contrast, resource intensive economies faced widening current account deficits and a reduction in external buffers due to a decline in exports and capital inflows.

2. Global growth is projected to shrink dramatically due to the current pandemic. The forecast is for the deepest global recession since the Great Depression. Global growth is expected to decline by 5.2 percent in 2020 as global economic activity has collapsed due to the COVID-19 pandemic. Advanced economies are projected to shrink by 7 percent in 2020 and emerging and developing economies by 2.5 percent in 2020 (Figure 2). Mitigation measures such as physical and social distancing have affected labor supply and productivity and severely impacted sectors that rely on social interactions and mobility. Increased risk aversion and heightened uncertainty in consumers and investors have reduced domestic demand, while the decline in production and higher unemployment has decreased disposable income. Some firms, facing lower demand and disruptions in the production process, have started closing down, and many may not reopen even if the pandemic is contained. Additional disruptions in global value chains have interrupted the regular activity of a large share of externally oriented firms in every country. The initial shock has been amplified beyond the real sector. International financial markets have experienced increased volatility, reflecting high uncertainty and the worsening outlook, and a sharp decline in commodity prices, while the surge in risk premia has put pressures on borrowing costs. Capital flows into emerging markets have reversed and the risk of sudden stops is considerable. Governments across the world have adopted a combination of non-economic measures to manage the health impacts, and fiscal and monetary economic measures to protect affected companies and vulnerable households. In advanced economies, the response has been immediate and sizable, whereas in emerging and developing economies the response has varied depending on the available fiscal space and recent macroeconomic performance.

COVID-19 will induce Sub-Saharan Africa's first recession in 25 years

3. Every country in Sub-Saharan Africa has been hit hard by the COVID-19 pandemic. The crisis continues to deepen across Africa. As of July 20, more than 735 000 cases and more than 15 000 deaths were recorded. Country-specific magnitudes remain highly uncertain. Commodity exporting countries are seeing significant declines in export prices and volumes, while overall exporters have experienced supply chain disruptions. Countries with open capital accounts have seen large outflows, which has put pressure on domestic currencies. The collapse of tourism and remittances has taken a toll on household incomes and firms' revenues; even with the reopening of many economies, the flows of visitors and remittances are not expected to recover this year. The pandemic has increased food insecurities for food importers amid closed borders, weakening currencies and rising prices of staple foods. About 44 countries in the region implemented some lockdown-type measures, and while most of these measures have helped contain the spread of the pandemic, the decline in economic activity in April and May has been sizable. The current crisis has been exacerbated by other crises, such as droughts, locust plagues, and conflict. Gaps in income and social protection will contribute to food insecurity. With the expected loss of lives and

the dramatic decline in economic activity, poverty, inequality and unemployment are expected to rise dramatically.

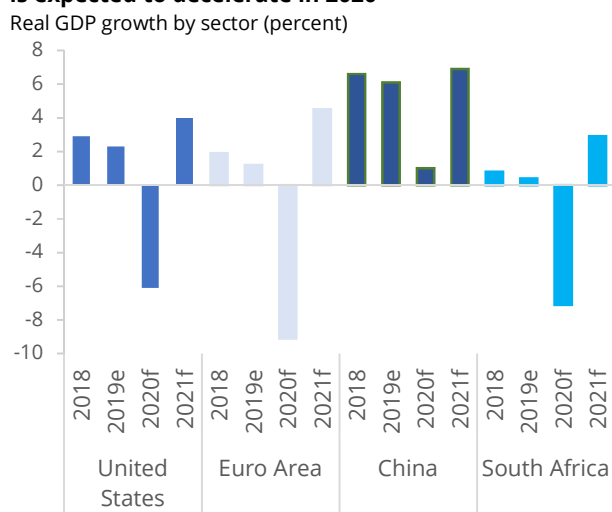
4. External support will be critical to allow SSA countries to adopt mitigation measures. Though the rate of transmission in Africa to date has been slower than in Europe and the United States, responding to COVID-19 has proven to be difficult. The human and economic costs could be heavier for African countries, which generally have less health care capacity, larger informal sectors, shallower financial markets, less fiscal space, and weaker governance. These underlying vulnerabilities have constrained Governments' capacity to deliver services and to implement relief measures. The fiscal position of most African countries is weak and is expected to worsen, and most countries in the region are facing tighter external financing conditions. Fiscal revenues are likely to decline faster than GDP, worsened by the increased risk of taxpayer noncompliance and the inability of tax administrations to maintain business continuity. In addition, Governments have increased budget allocations to health systems, additional cash transfers, and social protection schemes. Currencies are vulnerable to sharp swings, and depreciation could lead to higher costs for debt servicing, slower economic growth and contraction of exports, thus jeopardizing the external sustainability of these countries.

Table 1: Real GDP growth (Percent)

	2017	2018	2019e	2020f	2021f
World	3.2	3.0	2.4	-5.2	-4.2
Malawi	4.0	3.5	4.4	2.0	3.5
Sub-Saharan Africa	2.7	2.5	2.4	-2.8	3.1
Nigeria, RSA and Angola	0.9	1.1	1.0	-4.0	2.5
SSA excl. RSA, Angola and Nigeria	4.9	4.2	4.1	-0.5	4.5

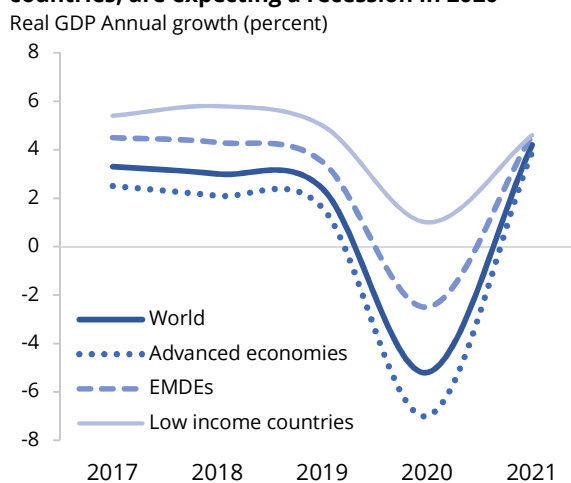
Source: World Bank Global Economic Prospects, Africa Pulse, IMF World Economic Outlook.
NB: e - estimate, f - forecast

Figure 1: GDP growth of Malawi's main trade partners is expected to decelerate in 2020



Source: World Bank Global Economic Prospects.

Figure 2: Most countries, apart from low income countries, are expecting a recession in 2020



Source: World Bank Global Economic Prospects.

1.2. Malawi's Economic Performance Before COVID-19

Prior to COVID-19, Malawi was expecting moderate growth in 2020

5. Malawi's economy was on a trajectory for its third year of faster growth in 2020 before the impact of the COVID-19 pandemic. Malawi's economy grew by 4.4 percent in 2019, a marked increase from 3.5 percent in 2018 (Table 1). This growth was supported by a rebound in agricultural production, as maize and other key crops apart from tobacco increased, despite the impact of Cyclone Idai. In particular,

maize production increased from 3.39 to 3.69 million metric tons from 2018 to 2019. Tobacco sales, however, were weaker, declining from 202.0 million kilograms in 2018 to 165.6 million kilograms in 2019, with average prices reducing from US\$ 1.67/kilogram in 2018 to US\$1.43/kilogram in 2019. Improved agricultural production in turn supported stronger performance in the industrial and services sectors. However, investment and economic activity was negatively affected by the ongoing political impasse which increased uncertainty and reduced business activity during multiple rounds of protests.

6. Real GDP growth for 2020 was projected in September 2019 at 4.8 percent. This was due to an expectation of the second consecutive year of strong harvests, offset by continuing political uncertainty weighing on business activity and investment. Electricity supply challenges as well as a generally uncondusive business environment were expected to continue weighing on economic performance.

7. Headline inflation increased to 11.5 percent in December 2019, due to a rapid increase in food prices. Food price inflation reached 19.3 percent, largely due to heightened maize prices, which reached the highest levels in five years due to scarcity in some areas, tight regional supplies, and trader speculation. Non-food inflation declined to 4.9 percent, supported by a stable kwacha exchange rate.

8. The fiscal deficit target for the first half of FY 2019-20 was missed by 1.0 percent of GDP (Table 2). Revenue and grants missed the optimistic mid-year target by 1.8 percent of GDP. On the other hand, despite overruns reported in recurrent expenditure, total expenditure and net lending performed within the target by 0.9 percent of GDP. Thus, the fiscal deficit widened from a projected deficit of 1.9 percent of GDP to 2.8 percent of GDP.

9. Tax revenue collections fell below ambitious targets, contributing to shortfalls in revenue and grants at the mid-year. Revenue and grants totaled 10.3 percent of GDP through December, below the target of 12.2 percent of GDP. In addition to optimistic assumptions, business activity was further subdued due to recurring disruptions from post-elections demonstrations. Thus, by mid-year, tax revenue totaled 8.3 percent of GDP, far short of the target of 10.0 percent of GDP. Performance of grants remained below anticipated levels as 0.8 percent of GDP was disbursed by mid-year against an expected 1.2 percent of GDP. On the other hand, fuel levies exceeded targets, leading to non-tax revenue reaching 1.2 percent of GDP, surpassing the target of 0.9 percent of GDP.

10. Higher wage and goods and services expenditure led to recurrent expenditure overruns in the first half of FY 2019-20. Nonetheless, total expenditure was below budgeted levels. The Government spent 0.9 percent of GDP below the mid-year target of 14.0 percent, due to under-spending on development expenditure which was partially offset by recurrent expenditure overruns of 0.6 percent of GDP. Recurrent expenditure totaled 10.8 percent of GDP at mid-year compared to the budgeted level of 10.3 percent of GDP. Negotiations by the civil service trade union resulted in a wage increment of 15 percent, higher than the budgeted 12 percent. Overruns were also reported in the use of goods and services due to increased allocations for security related to post-election demonstrations and court cases. Domestically financed development expenditure totaled 0.7 percent of GDP, below the target of 1.1 percent of GDP. Similarly, foreign-financed development expenditure totaled 1.5 percent of GDP, thereby underperforming the target of 2.5 percent of GDP.

The mid-year revised budget loosened the deficit target

11. The revised budget loosened the fiscal deficit from 2.7 to 4.9 percent of GDP. The Government maintained optimistic revised revenue projections, despite missing the target for the first half, and increased budgeted expenditure. The need to manage expenditure with realized revenue collections is even greater considering additional fiscal pressures from COVID-19.

12. Despite missing the target for the first half, the Government maintained optimism in revenue projections for the second half. Tax revenue was revised downwards from 21.8 percent of GDP to 20.4 percent of GDP. However, this was still optimistic considering a performance of 8.3 percent of GDP at mid-year. To attain the projected levels, tax revenue in the second half would need to be 44 percent higher than collected in the first half of the fiscal year. In addition, non-tax revenue and grants were revised upwards, from the approved 1.9 and 2.5 percent of GDP, respectively, to 2.8 and 2.9 percent of GDP. The

projected non-tax revenue would be the highest in recent years and would be driven by increased parastatal dividends and the rural electrification levy. Consequently, total revenue and grants were maintained at the approved level of 26.1 percent of GDP.

Table 2: Fiscal accounts
Percent of GDP

	2015/16	2016/17	2017/18	2018/19	2019/20
					Likely outturn
Revenue and grants	21.6	23.5	20.8	20.8	21.3
Revenue	17.8	20.0	19.3	18.8	18.3
Tax Revenue	16.0	17.6	17.1	17.1	16.6
Nontax revenue	1.8	2.4	2.2	1.7	1.8
Grants	3.7	3.5	1.4	2.0	2.9
Budget support grants	0.5	0.3	-	0.6	-
Dedicated grants	1.8	1.5	0.5	0.7	1.1
Project grants	1.4	1.7	0.9	0.7	1.8
				-	-
Expenditure and net lending	27.6	28.2	28.5	27.4	31.8
Recurrent expenditure	23.5	21.7	23.8	22.2	23.2
Wages and salaries	6.4	6.2	6.5	7.1	7.7
Interest payments	4.0	4.3	3.9	4.1	4.1
Foreign	0.3	0.3	0.3	0.3	0.3
Domestic	3.7	4.1	3.6	3.8	3.8
Goods and services	5.8	5.9	6.7	6.7	6.8
Maize purchases	0.8	0.7	0.7	0.2	0.2
Subsidies and transfers	4.9	3.8	5.0	4.1	4.5
Fertilizer subsidy	1.8	0.7	0.7	0.7	0.6
Arrears payments	2.5	1.4	1.6	0.1	0.1
Development expenditure	4.0	6.4	4.7	5.0	8.4
Domestically financed	0.7	0.7	1.6	1.9	2.9
Foreign financed	3.3	5.8	3.1	3.1	5.5
				-	-
Overall balance (incl. grants)	(6.1)	(4.8)	(7.8)	(6.5)	(10.5)
Financing	6.1	4.9	8.2	6.4	10.5
Net foreign financing	1.9	2.5	2.5	1.1	1.9
Gross foreign borrowing	2.4	3.0	3.1	1.6	2.6
Budget support loans	-	-	1.3	-	-
Project loans	1.9	2.5	1.7	1.4	2.5
Other loans	0.5	0.5	0.1	0.2	0.1
Amortization	(0.5)	(0.6)	(0.6)	(0.6)	(0.8)
Net Domestic borrowing	1.7	0.9	6.2	5.4	8.7
Securitization of domestic arrears	2.5	1.3	(0.5)	(1.4)	-
<i>Memorandum items:</i>				-	-
Primary balance including ZCPN	(2.1)	(0.5)	(3.8)	(2.4)	(6.5)
Primary balance excluding ZCPN	0.9	0.9	(2.3)	(2.4)	(6.5)

13. The mid-year budget revised expenditure upwards on account of election-related expenditure and wages. Total expenditure was revised upwards from 28.9 to 31.0 percent of GDP. Recurrent expenditure was revised upwards from 21.5 percent of GDP to 23.1 percent of GDP, while development expenditure was increased from 7.2 percent of GDP to 7.8 percent of GDP. The revision takes into account increased wages and salaries, increasing from the approved 7.3 percent of GDP to 7.7 percent. Additional

allocations for fresh elections and related security costs increased goods and services expenditure from 5.6 to 6.8 percent of GDP.

Fiscal deterioration continued in the third quarter

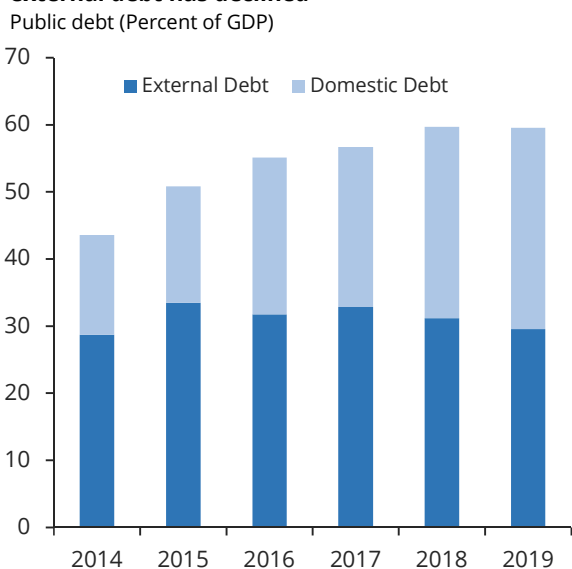
14. Fiscal performance continued deteriorating through the third quarter. The revised budget, despite loosening the targets, implied an improvement in fiscal performance in the second half of the fiscal year. However, fiscal performance continued to deteriorate in the third quarter. Total revenue was down by 8 percent (0.4 percent of GDP) from the second quarter while expenditure increased by 17 percent (1.2 percent of GDP). Consequently, the fiscal deficit for the third quarter further deteriorated to almost double that of the second quarter.

15. Total revenues weakened in the third quarter, despite sustained tax revenues. Revenue and grants in the third quarter declined from 5.5 to 5.0 percent of GDP between the second and third quarter. Tax revenue, supported by strong performance in domestic taxes, totaled 4.2 percent of GDP. Domestic taxes have been increasing through the year to reach 3.0 percent of GDP in the third quarter. While domestic taxes were strong (reflecting limited containment measures in Malawi through end-March), containment measures in neighboring and major trading partners and the resultant disruption in trade may have contributed to the slight decline of 0.1 percent of GDP in custom taxes. Non-tax revenue and grants were significantly lower than the performance of the previous quarters.

16. Expenditure increased substantially in the third quarter. Expenditure in the third quarter totaled 8.4 percent of GDP, significantly more than in each of the preceding two quarters which, together, totaled 13.6 percent. In preparedness for the pandemic, the allocation to the health sector increased to 0.4 percent of GDP (compared to 0.3 and 0.1 percent of GDP in the previous quarters). More spending was also incurred in subsidies and transfers (due to increased funding for the Farm Input Subsidy Program and pensions and gratuities), generic goods and services, interest on debt, and arrears.

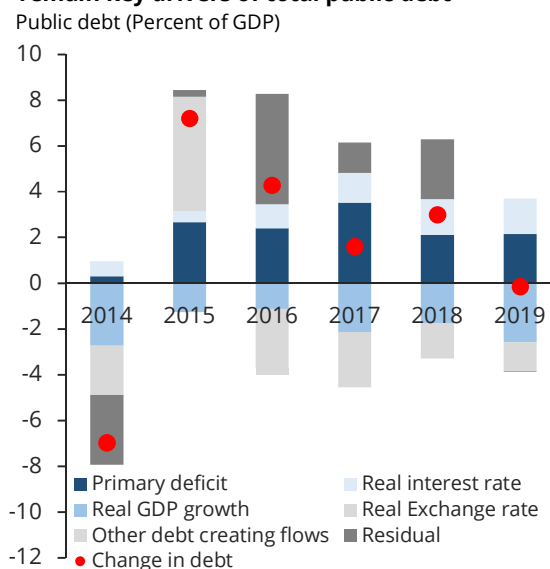
17. Consequently, the fiscal deficit widened further in the third quarter. In light of the underperformance in revenue and grants against higher levels of expenditure, the fiscal deficit expanded to 3.8 percent of GDP, higher than the previous two quarters. Cumulative to the third quarter, the fiscal deficit was 6.8 percent of GDP. Amidst the expected fiscal pressures due to the COVID-19 pandemic, the Government is unlikely to achieve the revised fiscal deficit of 6.5 percent of GDP.

Figure 3: Domestic debt has been increasing, while external debt has declined



Source: World Bank staff calculations based on Ministry of Finance, Economic Planning and Development data

Figure 4: High primary deficits and interest rates remain key drivers of total public debt



Source: World Bank staff calculations based on Ministry of Finance, Economic Planning and Development data

18. Repeated high fiscal deficits have contributed to an accumulation of domestic debt. The stock of domestic debt increased from 28.2 to 29.7 percent of GDP between 2018 and 2019 (Figure 3). However, Malawi's stock of public debt remained level at 59.4 percent of GDP over the same period, due to a decline in the stock of external debt, from 31.2 to 29.7 percent of GDP. Since 2015, debt has been driven by widened primary deficits and interest rates, while GDP growth and the real exchange rate have contributed to lowering debt, though the effect of the latter has narrowed in recent years (Figure 4).

19. The Reserve Bank of Malawi maintained monetary policy rates since May 2019 at 13.5 percent due to sustained lower non-food inflation. It expected the elevation in food prices to be temporary. From September 2019, commercial banks began implementing a new reference rate as their base lending rate. The reference rate was a weighted average of the Lombard rate, the interbank rate, the 91-day Treasury bill rate, and the savings rate.

20. The Malawi kwacha (MWK) experienced some volatility in mid-2019 but stabilized in the second half. It depreciated by about 6 percent relative to the United States dollar (US\$) in the second quarter of 2019, yet regained most of this ground by mid-August and remained roughly stable thereafter. By December 2019, the kwacha had depreciated by only 0.7 percent y-o-y. The volatility of the kwacha could be partly attributed to limited foreign exchange earnings, importers frontloading orders ahead of elections, and slow disbursement of donor projects. The RBM also tightened foreign exchange bureau trading regulations since mid-2019.

21. The current account deficit is estimated to have narrowed to 17.9 percent of GDP in 2019, due to improvements in the trade balance. Import growth was low in light of weak demand and low project-related inflows associated with political uncertainty, although imports related to Cyclone Idai reconstruction activities have increased some import pressures. A continuing trend of lower tobacco exports were partially offset by higher sugar and non-traditional exports. External funding supported the uptick in imports related to the recovery.

1.3. The Impact of COVID-19 on Malawi's Economy in 2020: A Severely Weakened Outlook

Both global and domestic factors weigh on economic activity

22. Malawi recorded the first three cases of coronavirus on April 2, 2020. Since then, total cases have increased to 3,045 as of July 20, of which 1,801 are active, and there have been 64 deaths. Testing capacity has gradually increased, so that 24,475 tests have been carried out, although this remains very low comparatively. Local transmission has been rapidly increasing, so that 70 percent are locally transmitted.

23. The COVID-19 pandemic is having a considerable negative impact on Malawi's growth in 2020. Economic activity is being affected by both global and domestic factors. Global factors impacting Malawi include:

- i. **Disruption in global value chains:** Global value chains, especially the importation of key production inputs, have been disrupted as social distancing affected output in exporting countries. However, Malawi's key trade partners—South Africa and China—have both begun reducing previously severe restrictions. South Africa has reduced its lockdown level from 5 (the most severe) to 4 in May, and 3 in June, which is expected to mitigate this impact. South Africa's exports fell by more than 60 percent y-o-y in April, before rebounding in May, but they were still more than 25 percent below the year prior (OECD 2020). Moreover, China is the largest supplier of intermediate inputs for manufacturing in Malawi. After active COVID-19 cases in China declined, production and exports started rebounding from March, and since that time, they averaged only 1.5 percent below the year prior.¹

¹ Chinese exports declined by only 1.5 percent on average from March to June 2020 compared to the year prior, improving from a 17.2 percent decline in January and February.

- ii. **Increased trade and logistics costs and delays:** Flow of goods through Malawi's borders and those of its key trade partners is being affected by frequent transit stoppage, lack of personal protective equipment (PPE) for border officials, and higher cost of air cargo. This is compounded by policy unpredictability and information asymmetry in a context where Governments are regularly adopting new trade measures. If the different actors engaged in supply chains are not aware of these new requirements, this can risk unnecessary disruptions. Malawi Revenue Authority (MRA) customs data suggest that imports were 26 percent lower in April and May 2020 than in the same period last year (based on value for duty purposes estimates), which coincides with reported delays in shipments from South Africa. Informal imports coming from Mozambique and Zambia have also reportedly decreased. Some countries have also pursued export restrictions on some medical and agricultural commodities, which could trigger negative spillovers. Malawi has blocked re-exports of medical products, particularly masks (World Bank 2020). Moreover, Malawi's continuing export ban on maize in the midst of a bumper harvest is weighing on potential income growth.
- iii. **Decreased demand in export markets:** Lower global demand and trade restrictions are weighing on some export products. Key product markets are facing severe recessions, including the European Union (about 32 percent of Malawi's exports) and other trade partners—South Africa (10 percent) and rest of Africa (26 percent). However, as Malawi's main exports are tobacco (over 50 percent), sugar, and tea, global demand for these products has been relatively inelastic in the past decade, mainly affected by supply shocks and changes in contracts, so that the impact may be somewhat mitigated. However, the tobacco auction season through early July has seen a decrease in sales, with a 11.9 percent reduction in sales values, due to a 14.7 percent reduction in volumes partially offset by a 3.2 percent increase in average price.
- iv. **Significant decrease in tourism:** Tourism has been heavily affected, but its contribution to growth in Malawi is lower than in other East African Community (EAC) countries. The flow of visitors has effectively come to a standstill, with increased risk aversion and travel bans combining with Malawi closing its international airports since the beginning of April. This has also been affected by lower domestic business travel and tourism. However, international tourism is a smaller sector than in some neighboring countries. According to the World Tourism Organization, 870,000 tourists visited the country in 2018, with only 17 percent from outside Africa. This is only about half the total figure for countries such as Kenya and Tanzania, where more than 50 percent of visitors are from outside Africa. The decrease in tourism is expected to reduce GDP growth of services such as transportation (about 2.9 percent of GDP) and accommodation and food services (about 2.0 percent of GDP).
- v. **Remittances have also decreased due to lower global economic activity:** Remittances through money transfer decreased by 57 percent in April y-o-y before rebounding in May, although they were still 15 percent lower than the year prior. This could be largely attributed to strict lockdowns in South Africa (the largest source of Malawi's remittances) in April, which have eased in May and further in June.

24. A domestic demand and supply shock due to increased risk aversion and social distancing policies is further weighing on growth. Social distancing measures have constrained domestic demand. Depending on the extent of a domestic outbreak in the second half of 2020 and the associated policy response, social distancing behavior and policies that are needed to contain the spread of the virus could continue to constrain domestic demand. Households are likely to continue reducing unnecessary expenditure, while firms are expected to decrease investment until the crisis clears, negatively affecting aggregate demand and income.

25. However, the second consecutive strong harvest, combined with Malawi's relatively small services and industry sectors, is alleviating some of the strong negative impact on growth, particularly in rural areas. As a result, Malawi could experience a limited impact of the pandemic compared to other economies that are more integrated into global value chains and with more developed services sectors. Some 87 percent of Malawians are engaged in agricultural activities and the 2020 harvest

is expected to be the second strong harvest in a row. As a result, food security should not be affected in the short term, although this would depend on no major blockages to internal trade.

26. The Government will need to carefully consider the tradeoff between social distancing policies, which are needed to reduce the spread of the virus, and managing citizens' tolerance for these measures, which will rely on their ability to support their livelihoods. Containment measures are intended to flatten the epidemic curve over the short run, to help isolate cases and hotspots, and to allow as many as possible to access (already limited) health care options, while biding time to ramp up extensive testing, with a longer term target of improving treatment options and developing a vaccine. However, social distancing measures would severely affect livelihoods, which will be aggravated by Malawi's large informal sector and high rates of poverty and food insecurity. Protecting their earnings and reaching households through cash transfers is essential to ensuring that containment measures are supported, however, the Government has limited fiscal space to do so. Malawi should consider adopting smart containment measures, which are adapted to the local situation. These would reduce high-risk activities that have limited impact on livelihoods nationally, while focusing stricter measures on hotspots, high-risk areas, and the vulnerable, informed by extensive testing and close monitoring (Box 1).

Malawi's strong harvest should help avoid increasing food insecurity

27. A good harvest is easing the situation from the last lean season. With the harvest season completed, food availability has improved. According to the second round of agricultural production estimates, all major crops have shown an increase in production, particularly maize at 3.78 million tons (11.5 percent), rice (6.5 percent), cotton (112.5 percent), pulses (19.5 percent), and soybeans (19.6 percent).

28. The strong agricultural crop should allow Malawi to avoid an increase in food insecurity, but this will largely depend on maintaining functioning markets and food trade as well as ensuring inputs are available for the winter crop and upcoming season. Malawi has been in a perpetual state of food insecurity in recent decades, which provides limited margins for coping through a crisis. An estimated 1.1 million people are expected to be food insecure this coming lean season, an improvement over 1.9 million during the last lean season. At the same time, chronic malnutrition is high with over 37 percent of children under 5 being stunted (Global Nutrition Report, 2018). A continuing pattern of food insecurity has been exacerbated by the ad hoc imposition of maize export bans. While export bans could help lower prices in the short run, in the longer term, they reduce the incentives for commercial investment in the sector, thereby constraining production and food supply. Moreover, they have also contributed to a high degree of maize price volatility, further deterring commercial investment.

29. Risks to food security associated with the COVID-19 pandemic include potential domestic food supply chain disruptions arising from market closures, movement restrictions, and social distancing. As the crisis unfolds, potential risks in the agriculture value chain could include:

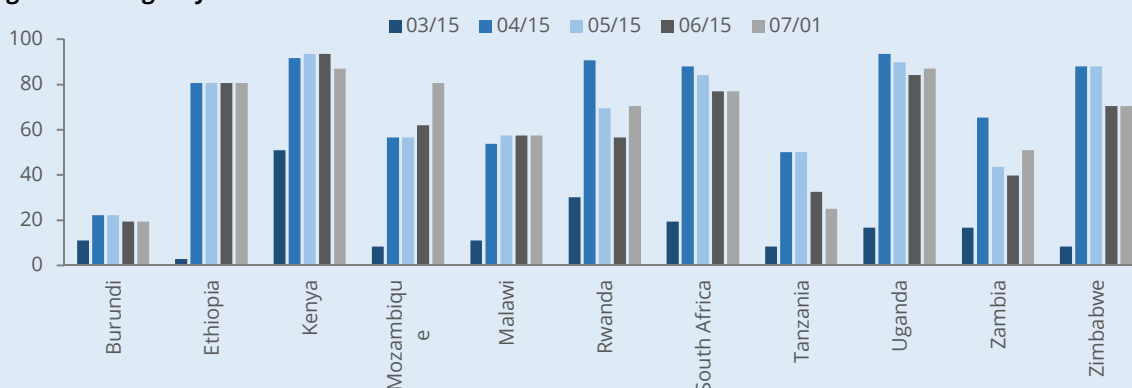
- i. **Poorly functioning food markets and supply chains:** Potential in-country logistics and market disruptions could affect the flow of goods. A ban on central and mobile markets – depending on how enforced – could disrupt the movement of commodities along the marketing chain. Some markets act as wholesale markets that feed smaller markets in rural and urban areas. In a scenario of closing markets, farmers and rural consumers may have trouble accessing quality and nutritious food. Malawi's history of Government- and parastatal-induced market distortions have contributed to volatile food prices. Efforts will need to be made to ensure markets function with minimal distortions. In addition, international logistics disruptions are affecting the agri-food sectors. Maintaining imports of fertilizers and pesticides will be critical to sustain yields and production in the next season. These issues could be compounded by potential liquidity constraints for SMEs providing critical services.
- ii. **A potential increase in food prices:** Food prices in Malawi have fallen after the harvest. However, these could increase toward the end of the year, potentially due to logistics breakdowns, lack of functioning markets, market distortions, and higher costs for imported products. Although more than 80 percent of the population is involved in agriculture, many farmers are net food consumers, largely during the lean season (rural households purchase from 20 to 40 percent of maize, despite

Box 1: Lockdowns and Economic Livelihoods in East Africa

African countries have faced severe challenges coping with the pandemic. If the health crisis is not effectively contained, its spread could lead to a significant number of fatalities. However, measures such as lockdowns have depressed economic activity and may become ineffective. Widespread lockdowns are more costly in developing than in advanced economies and preliminary evidence suggests that the economic benefits of economic suppression measures decline with income level (Barnett-Howell and Mobarak, 2020). African countries have large informal sectors, limited fiscal space, and weak governance. Moreover, less than 20 percent of jobs can be done from home in Africa (Dingel and Neiman 2020).

Most African countries started implementing interventions to enforce social distancing in March. Oxford University's Stringency Index (Figure 5) measures the strictness of policies such as school closures and travel bans. It shows that almost all countries in East Africa took some containment measures, although with varying intensity. Yet, most countries have started relaxing these measures, with Kenya, Ethiopia and Uganda still under lockdown-type measures, while Tanzania has almost lifted all containment measures. Lockdowns have had a clear influence on mobility. Data from Google indicates how people visited less to restaurants and retail stores, transit stations and workplaces, and countries under more stringent measures exhibited a greater decline in mobility.² Yet, this decline in mobility has started to revert in all countries, even in the ones with more stringent measures, highlighting the difficulty of enforcing severe lockdowns for a prolonged time (Table 3).

Figure 5: Stringency Index



Source: Oxford COVID-19 Government Response Tracker, Blavatnik School of Government

Table 3: Reduction in Activity for Smartphone Users in Selected Countries as of May 2 and July 10

	Kenya		Mozambique		Rwanda		Tanzania		Uganda		Zambia		South Africa	
	May	July	May	July	May	July	May	July	May	July	May	July	May	July
Retail & recreation	-42	-21	-17	-16	-64	-15	-36	-5	-70	-32	-17	2	-54	-33
Public Transport	-38	-16	-20	-23	-71	-22	-27	-7	-75	-43	-20	-7	-60	-51
Workplaces	-20	-17	-1	-3	-32	-22	-15	-9	-44	-21	0	-2	-35	-36

Source: Google. Notes: Mobility trends based on location settings in Google Maps. Trends as of May 2 compared to the first five weeks of 2020. Trends for Burundi, Ethiopia, Malawi and Zimbabwe were not available.

Social distancing measures have had profound economic effects and lockdowns, in particular, are difficult to implement in Africa. Social distancing slows the spread of the disease but also forces most people to work less or less productively. Businesses relying on social gatherings and physical presence can come to a halt. Labor-intensive manufacturing plants may sharply curtail their production. Strong social distancing measures, such as lockdowns, may not be feasible for extended periods, particularly in Africa, where most workers are in the informal sector and hold limited safety nets. Moreover, given how more than 70 percent of the urban population across Sub-Saharan Africa is estimated to live in overcrowded conditions, avoiding physical proximity could prove impossible. In addition, lockdowns can reverse internal migration, as temporary workers flee major cities to go back to their home rural areas, further contributing to spreading the disease. Compliance appears to be lower in African countries due to lower perceived gains from compliance, inadequate Government enforcement, lower social trust, and weaker economic policies to offset lost income.

In East African countries, smart containment measures could be more effective and sustainable. Countries in East Africa may weigh less aggressive but targeted containment strategies, with controlled disruption of normal

² Google data is derived from smartphone GPS/location data on smartphones, so that it is not representative of activity of the broader population. Smartphone ownership in Malawi is around 20 percent of the population, which would be expected to be likely wealthier and more urban, and who may be more able to increase social distancing behavior than poorer sections of the population.

economic activity. Smart containment measures are based on targeted lockdowns, shielding vulnerable groups — such as those over age 60—rather than an attempt to lockdown the whole population, group distancing, permanent testing and tracing, and public hygiene measures such as washing hands and wearing masks. Not only can smart containment measures reduce the spread of the virus in highly informal urban settings, but they can also ease the trade-off between lives and livelihoods: by isolating only certain groups of the population, it allows younger and less vulnerable individuals to continue to participate in normal economic activity (Loayza. 2020; Dahab et al. 2020). However, this combination of containment measures can be difficult and costly to implement, as the recent experience of advanced economies has shown, and their effectiveness is reduced if not accompanied by economic support. Moreover, tracing, a key element of smart containment, is practically unheard of in Sub-Saharan Africa.

being producers (Benson and Edelman 2016)). Increasing food prices would be problematic for food security, especially if a breakdown of logistics would prevent producers from taking advantage of high market prices. Reduced production of winter crops (e.g. vegetables) could also contribute to price increases.

- iii. **Decline in labor availability and productivity in the agri-food sector:** Farmers and firms are anticipating lack of farmworkers and other employees if infection rates increase. Transportation issues, increased risk aversion, and health reasons could prevent people from working.
- iv. **Lack of foreign currency for imported inputs:** Some entrepreneurs have raised concerns about the lack of foreign currency to pay suppliers. This could aggravate a scenario of increased prices of inputs such as fertilizers.

Services and industrial sectors are being heavily affected

30. The services and industrial sectors are being heavily affected by risk aversion, lower demand and disposable income, and market restrictions. Urban sectors account for a substantial portion of incomes and non-agriculture employment in Malawi. Only 14 percent of the Malawian labor force holds wage employment (which increases to 39 percent in urban areas), so that the majority of its labor force is highly vulnerable to shocks and hold limited safety nets.

- i. **Retail and wholesale trade has slowed, particularly for the informal sector.** While the purchase of food and essential goods has continued, domestic consumers have reduced their discretionary consumption of non-essential goods. However, Malawi's consumption basket is dominated by food (45 percent of total consumption expenditure), which is relatively inelastic, so that the negative impact on total consumption maybe less than other EAC countries.
- ii. **The transportation and storage sector is also seeing a large impact.** International air travel has been stopped since the beginning of April. Internal and cross-border traffic has slowed somewhat, but could slow further, particularly if restrictive distancing policies are put in place. While the transport of essential goods has been assured across the Southern African Development Community (SADC) region, the outlook is less certain for non-essential goods.
- iii. **The accommodation and food services sector has already been substantially affected.** With international and domestic business travel all but stopped, the accommodation sector has been heavily affected. Moreover, increased social distancing behavior and Government regulations have reduced restaurant sit-down services, so that some have temporarily closed.
- iv. **The manufacturing and construction sectors are also being affected.** The supply of imported inputs, parts, and materials has slowed manufacturing production and construction, as well as general operations and maintenance. While many public and private construction projects are continuing, they could slow due to increased risk aversion and uncertainty, as well as limitations in imported cement and other inputs. Producers who rely on international experts to fly in to provide maintenance are also being affected. While the overall manufacturing sector will see growth decline, some sub-sectors are benefiting due to increased demand and production of plastics and hand sanitizers.

COVID-19 will reduce growth sharply

31. Growth projections are uncertain and evolving as the crisis unfolds. Based on available data through July, GDP growth estimates for 2020 have been revised down from 4.8 percent (projected in

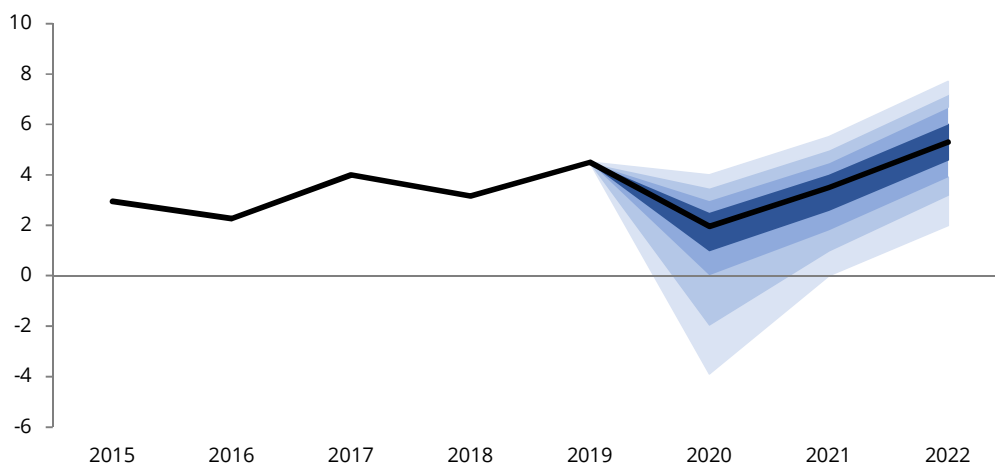
September 2019), to a current baseline of 2.0 percent. This scenario assumes that Malawi will not experience a full nationwide lockdown. Also, it assumes that the Malawian economy will only face a severe external demand shock and tightened financial conditions, and disruptions to domestic activity in 2020 but not in 2021. While the agriculture sector would have only a limited impact, growth of services and industry would diminish considerably.

32. Lower growth for 2020 is expected to be driven by lower consumption, net exports, and investment. Growth in private consumption is projected to decline considerably due to lower disposable income in light of reduced employment and higher consumer risk aversion. On the other hand, public consumption could increase due to higher Government expenditures on health and social protection in response to the pandemic. Growth in private investment will also fall due to increased investor risk aversion, higher borrowing costs and negative spillovers from lower Government development expenditures. The current account deficit is expected to widen to 18.3 percent of GDP, with contractions in agricultural exports such as tobacco and tea outweighing positive price developments for oil. Moreover, travel bans will reduce imports of inputs and food, and disrupt the logistics chain of key exports.

33. Because the COVID-19 crisis is still evolving, the current outlook is very uncertain and the downside potential strong. There are many substantial downside risks that could drive growth even lower and into a recession (Figure 5). In a scenario with an extensive spread of the disease in Malawi and a protracted global health crisis, the economy could contract by up to 3.5 percent in 2020. In this scenario, only the agriculture sector would still be growing, while manufacturing and services would face a significant decrease. In turn, this would cause a severe contraction in disposable income and private consumption. An expected rebound in 2021 will depend critically on an effective containment of the pandemic and a recovery in domestic demand, as well as the implementation of effective economic measures. However, in a downside scenario the pandemic could persist into 2021. Moreover, even if the spread of the virus is contained, transport and travel restrictions could continue to disrupt value chains and production processes, and global business confidence could take longer to recover.

Figure 6: GDP Forecast Fan Chart

Real GDP Annual growth (percent)



Source: World Bank Staff Calculations. Note: The fan chart shows the distributions of the likelihood of different GDP growth outcomes in 2020, 2021 and 2022. The estimation is based on a set of growth scenarios and risk profiles under different combinations of the virus spread, containment measures and economic policy responses. The darker bands are the most likely outcomes, and the central black line is the baseline scenario

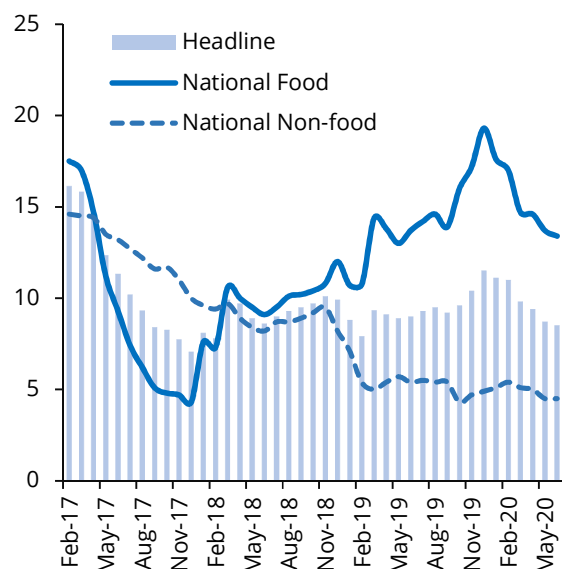
Inflation has decelerated since the onset of the maize harvest

34. Headline inflation has decelerated back to single digits since March 2020 and fell to 8.5 percent in June (Figure 6). A good harvest is supporting lower food prices, which comprise 45 percent of Malawi's consumption basket, while lower international oil prices have also eased transport costs. Both food and non-food inflation decelerated to 13.4 percent, and 4.5 percent in June. Through the third week of June, maize prices had decreased by 40 percent since the start of the harvest period (early March). Markets are

well-supplied and seasonal demand is low as households are still consuming their harvest and trading activity is minimal. Fuel prices decreased due to the drop in global oil prices, which supports lower transportation costs (8 percent of the consumption basket). Passenger transport prices had increased due to restrictions on the number of passengers allowed in a minibus. In April, the Malawi Energy Regulatory Authority reduced the pump price for petrol and diesel by 16.1 percent and 13.8 percent, respectively. A further reduction by 12.3 and 13.1 percent, respectively, was announced on May 4.

Figure 7: Food inflation pressures have started subsiding in 2020 ...

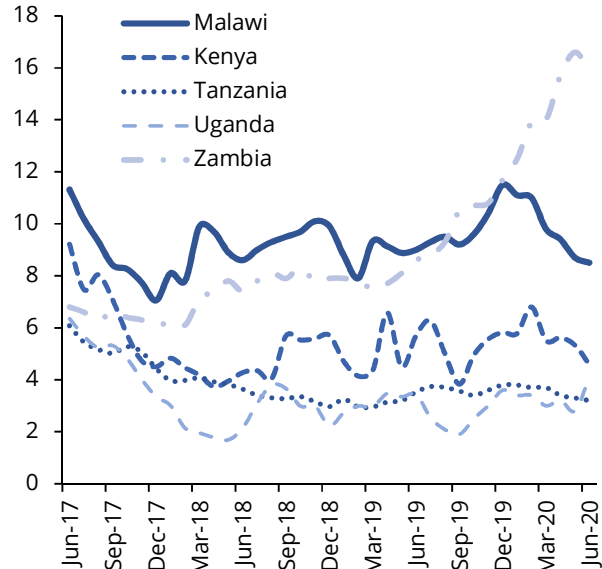
Headline, food and non-food Inflation, y-o-y, percent



Source: World Bank staff calculations based on National Statistical Office (NSO) data

Figure 8: Inflationary pressures picked up on the regional front ...

Headline annual inflation, percent, y-o-y, selected countries



Source: World Bank staff calculations based on data from NSOs/ Central Banks

35. Malawi's inflation remains high relative to regional peers. Figure 8 shows that inflation in Zambia accelerated beyond that of Malawi from September 2019 and has remained higher. Until December 2019, this was driven by food price increases, especially maize. Since January 2020, non-food inflation contributed to the pickup. In Kenya, higher food prices increased inflation in recent months, but it has decelerated to 5.5 percent in May. Inflation has been contained in Uganda and Tanzania, with food price inflation remaining moderate, although Uganda's inflation increased in June due to transport services.

36. Trade bottlenecks and market distortions could increase inflationary pressures. Trade disruptions due to the COVID-19 outbreak could potentially escalate prices of imported goods and induce an upward push on non-food inflation. The locust outbreak in East Africa could also lead to a food shortage in the region and increase food price pressures. In addition, a decline in imported food products and restrictions in in-country mobility due to COVID-19, and potential speculation or market distortions could increase pressure on food prices. Further, the National Food Reserve Agency (NFRA) has started replenishment of the Strategic Grain Reserve (SGR) which could increase maize prices and thereby food inflation. Considering these potential pressures, inflation is projected to average 10.1 percent in 2020.

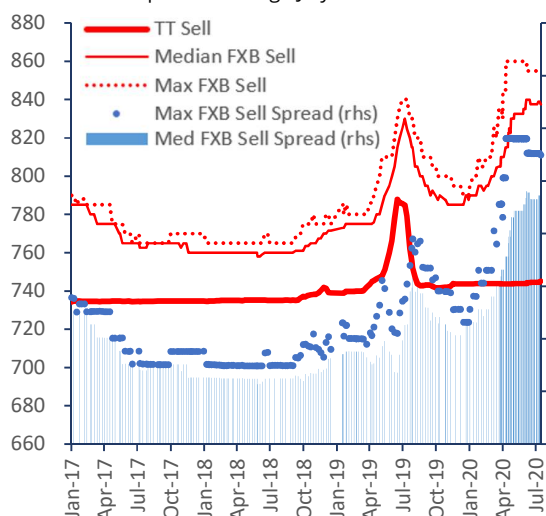
The kwacha has continued to appreciate in real terms

37. Although telegraphic transfer (TT) Malawi kwacha (MWK) rates have remained stable against the US dollar (US\$), cash rates have increased. Through July 20, the MWK/US\$ exchange rate has depreciated by only 0.2 percent since the beginning of the crisis (Figure 9). Although the TT rate has remained stable, foreign exchange bureau (FXB) cash rates have increased considerably since January, so that the spread between FXB and TT rates have increased to their highest levels in recent years. Despite the RBM's reported official gross reserves of US\$ 624.5 million in May (3.0 months of import cover), the private sector reports increasing queues for foreign exchange. The International Monetary Fund's Rapid Credit Facility (RCF), approved on 1 May 2020, helped increase reserve buffers by US\$ 91 million.

38. Many regional currencies – including those of South Africa, Zambia, and Mozambique – have depreciated considerably since the onset of the crisis – thereby increasing the nominal effective appreciation of the kwacha (Figure 10). Combined with Malawi’s inflation rates being higher than its key trading partners, Malawi’s Real Effective Exchange Rate (REER) continued to appreciate, by about 7 percent in May over the previous year, and 20 percent over two years ago. The real appreciation will continue to contribute to increasing imports – both legal and smuggled – while reducing export and potentially longer-term growth prospects. Maintaining a “super-stable” kwacha also negates the currency’s potential role as an automatic stabilizer, in which depreciation would increase exporters’ earnings while making local production and industry relatively more affordable than imports.

Figure 9: Kwacha cash rates are diverging from stable TT rates ...

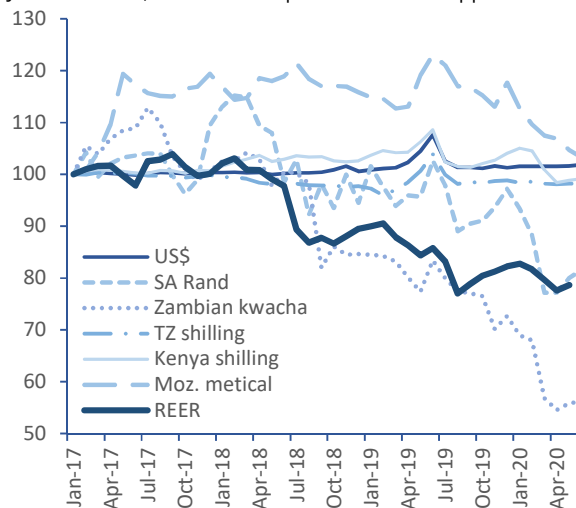
Telegraphic Transfer (TT) and forex bureau (FXB) cash kwacha/US\$ rates and spreads through July 20



Source: World Bank staff calculations based on RBM data

Figure 10: ... while appreciating in real terms and against regional currencies

Kwacha vs selected currencies, REER, index, through June 30 Jan 2017 = 100, a reduction represents kwacha appreciation



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

The pandemic is further increasing fiscal pressures

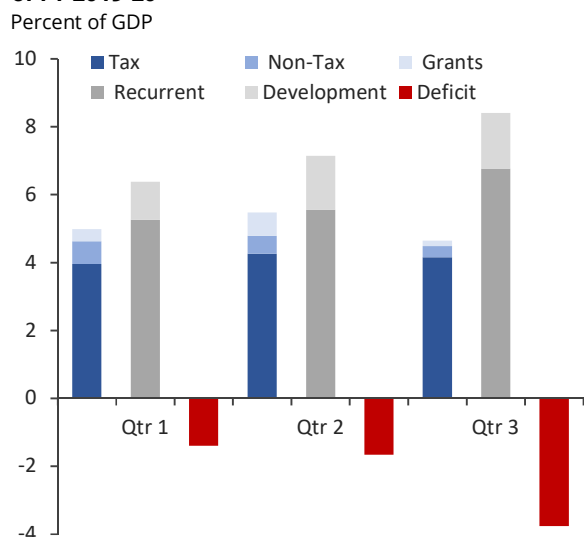
39. The pandemic is negatively affecting revenues. The slowdown in economic activity could have a substantial impact on taxes. May and June gross tax revenues were 14 percent below the Q3 average. On a monthly basis, domestic taxes have declined from an average of 1.3 percent of GDP pre-COVID to 0.9 percent of GDP in May 2020 (Figure 12). The decline is expected to persist through to the last quarter as the pandemic continued affecting the economy. Customs taxes have also registered a decline from a pre-COVID average 0.4 percent of GDP to 0.3 percent of GDP in May. However, some key trading countries, including South Africa and China, have shown a rebound in trade flows, which could alleviate some of the slowdown in customs revenues. Performance of grants, on the other hand, is expected to improve as more development partners disburse to aid the response to the pandemic. Grants have already increased due to the World Bank’s US\$ 30 million Catastrophe Deferred Drawdown Option (Cat-DDO) grant and early disbursements from its US\$ 7 million health response project. Cumulatively to the end of the fiscal year, revenues and grants are likely to underperform the revised levels by 4.8 percent of GDP.

40. Expenditure is expected to increase further. The impact of the pandemic on expenditure will be multifaceted. First, beyond current allocations, increased funding for the health sector is likely to be needed beyond the current US\$ 20.4 million package. The proposed cash transfers to over 185,000 households is also expected to cost US\$ 48 million, although most of this will occur in FY 20-21 and it will be largely funded by partners. Additional response measures would add to this expenditure, as well as further pressures due to higher interest payments and election-related spending. The recurrence of arrears (totaling 1 percent of GDP) in the third quarter, further raise ongoing concern about their impact on broader growth, while also increasing costs to the Government (Box 2). As such, recurrent expenditure

could increase beyond the revised estimates by 0.2 percent of GDP, although this is likely to be offset by some reduction in development expenditure.

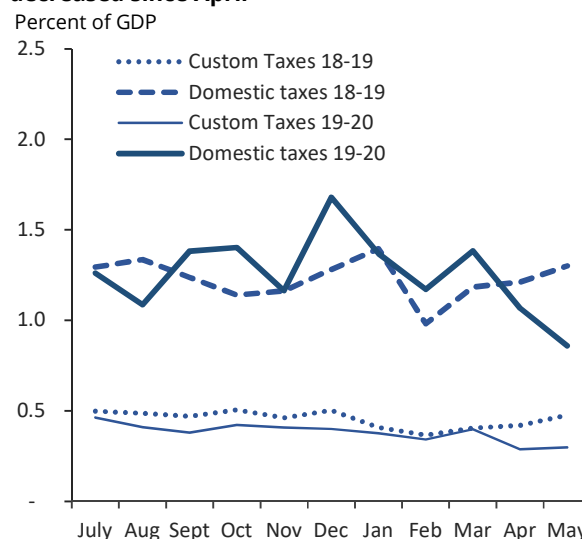
41. The fiscal deficit is expected to widen further beyond 10 percent of GDP, which is largely financed by domestic borrowing. By the third quarter, the Government had already borrowed the equivalent of 4 percent of GDP from the domestic market, beyond the 3.4 percent of GDP in the revised budget (Figure 11). By the end of FY19-20, domestic borrowing could exceed 7 percent of GDP.

Figure 11: The deficit expanded in the third quarter of FY 2019-20



Source: World Bank staff calculations using data from Ministry of Finance, Economic Planning and Development

Figure 12: Domestic and customs taxes have decreased since April



Source: World Bank staff calculations using data from Ministry of Finance, Economic Planning and Development

The provisional budget expands farm input spending while reducing taxes

42. The previous administration had presented a draft FY2020-21 Draft Budget on June 12 which projected a substantial deficit of around 9.7 percent of GDP. This would have been a marginal tightening from the projected deficit of 10.5 percent of GDP for FY2019-20—the highest in more than a decade. Total revenues and grants were expected to increase by 7.3 percent (in nominal terms) over the projected FY2019-20 outturn, while tax revenues were expected increase 10.2 percent. Total expenditure was projected to increase by 5.9 percent, driven by growth in recurrent expenditure (7.2 percent growth), higher than growth in development expenditure (2.2 percent growth). Three-quarters of the deficit was expected to be financed by high cost domestic borrowing.

43. The new administration presented an expansionary provisional budget on June 30. The provisional budget, which would run from July to October 2020, projects revenue at 6.9 percent of GDP while expenditure is estimated at 10.8 percent of GDP. Thus, the fiscal deficit is projected at 3.9 percent of GDP, almost half the proposed estimate in the May 2020 draft budget, but only for four months. Domestic borrowing would finance almost 80 percent of the deficit (3.1 percent of GDP). The budget increases the tax-free bracket from MWK 45,000 to MWK 100,000, which will increase disposable incomes for lower paid employees, but will also reduce income taxes.

44. The provisional budget increases various expenditure measures. The budget has proposed an Affordable Inputs Program whereby 3.5 million smallholder farmers will access fertilizer at MWK 4495 for a 50 kilogram bag, as well as maize and legume seeds, allocating expenditure of 0.7 percent of GDP. In addition, it has increased the allocation for the Malawi Enterprise Development Fund from MWK 15 billion to MWK 40 billion (0.6 percent of GDP). Moreover, it also announced the expansion of the youth internship program and introduction of the National Youth Service Program.

45. The escalating COVID-19 crisis could increase pressures on the full fiscal year budget. It could further reduce economic activity, reducing the resource envelope, while increasing existing expenditure

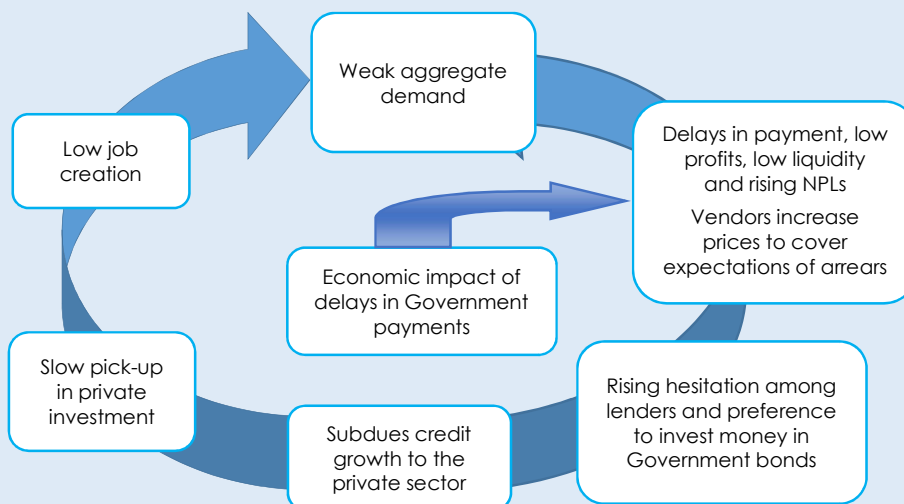
pressures. Considering already high levels of domestic debt, the Government will need to exercise considerable restraint when developing the full fiscal year budget, to help contain the fiscal deficit and contain the growth in domestic debt.

Box 2: Effects of payment arrears on the economy

Payment arrears have had a significant impact on the Government of Malawi's finances in recent years, and they can also affect broader economic growth. Several factors contribute to the Government incurring arrears. Flynn and Pessoa (2014) discuss how the common causes of arrears include: formulation of unrealistic budgets, usually optimistic macroeconomic or revenue projections and the under-budgeting of expenditure obligations; lack of commitment controls, poor cash management, delays in the processing of payments, deliberate deferral of payments, and inadequate sanctions. Budget cuts during the fiscal year and curtailing project implementation mid-way through implementation, also gives rise to payment arrears. In summary, payment arrears are associated with weak expenditure controls. While budget credibility and planning is important in reducing arrears, it is meaningless if expenditure cannot be controlled during budget execution (Pattayanak 2016).

The impact of arrears differs in the different sectors in the economy. Once realized, for the Government sector, they can lead to growth in public debt. In Malawi, payment of arrears comprised 1.3 percent of GDP, on average, between 2014 and 2018. They have added an extra 1.0 percent of GDP of expenditure in 2020. This, with increased future interest obligations, reduces fiscal room for discretionary policy. They also potentially increase the cost of private sector service provision, given uncertainty in payments by the Government, as suppliers price the cost of such credit into the goods and services provided (Checherita-Westphal, Klemm and Viefers, 2015). For instance, in Malawi the roads sector has been one of the heavily affected sectors, and the expectation of arrears may have influenced the current high cost per kilometer of constructing a road in Malawi.

Figure 13: Economic impacts of Government payment arrears



Source: World Bank staff, adapted from Kenya Economic Update, World Bank (2019)

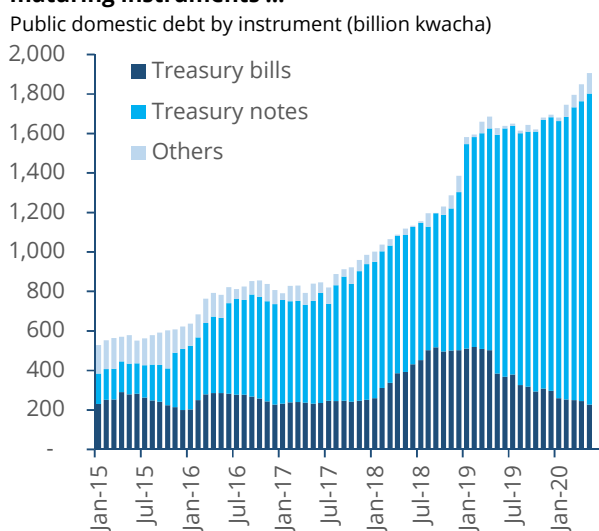
For an economy where most small and medium enterprises are dependent on the Government for their business, delays in Government payments affects liquidity and can lead to increasing non-performing loans (NPLs). As a result, the banking sector can become hesitant to extend loans to the Government contractors and instead invest in Government securities. This can slow economic activity which in turn reduces private sector investment. As a result, fewer jobs are created, even causing retrenchments in extreme cases, and aggregate demand is reduced (Figure 13). Other effects include rent-seeking between Government officials and suppliers of goods and services to accelerate their payments and SMEs withholding payment of taxes until their bills are settled. SMEs with credit constraints may refrain from doing business with the Government or merge with bigger firms which results in price collusion and further influencing the cost of service delivery. In the COVID-19 context, where the Government is seeking to clear the current stock of arrears, expediting the clearance of Government arrears to SMEs would help inject liquidity into the SME sector.

Debt vulnerabilities will also rise

46. Malawi is at high overall risk of debt distress, which will be further tested with the crisis. The April 2020 debt sustainability analysis indicates that Malawi is at a high overall risk of public debt distress, due to the increased incurrence of high-cost domestic debt. However, the risk associated with external debt is moderate, with some space to absorb shocks.

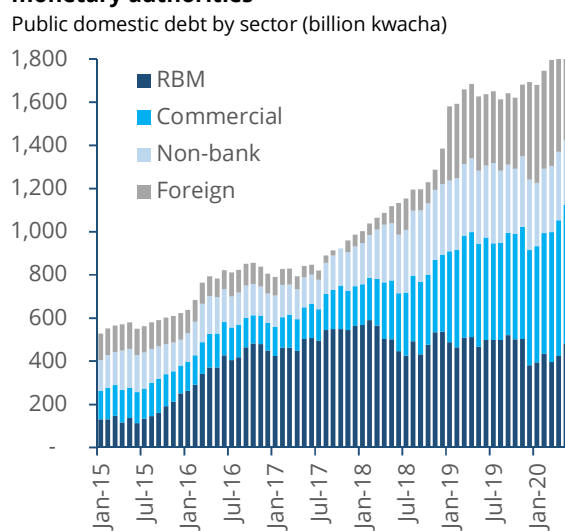
47. Domestic borrowing has continued to expand, increasingly through Treasury notes. The Government has been implementing a deliberate strategy to lengthen the maturity profile of domestic debt. This has resulted in the shift of domestic debt holdings from Treasury bills toward Treasury notes (Figure 14). However, increasing domestic borrowing has contributed to a substantial increase in interest rates on Government borrowing (see Figure 19). Given significantly higher and increasing interest rates on T-notes—which currently range from 16 to 22 percent, compared against T-bills ranging from 8 to 13 percent—this will contribute to higher interest expenditure. With the Government having stopped borrowing from the Reserve Bank of Malawi since early 2018, domestic debt is shifting toward commercial banks and the non-bank sector. Secondary market operations have contributed to increased uptake of domestic debt by foreign sectors (Figure 15).

Figure 14: Domestic debt has shifted toward longer-maturing instruments ...



Source: World Bank staff calculations based on RBM data

Figure 15: ... and borrowing shifting from monetary authorities



Source: World Bank staff calculations based on RBM data

48. While external debt is currently at moderate risk of distress, this could come under increasing pressure due to the crisis. To some extent, the G20 initiative to relieve debt by official bilateral creditors could lessen external debt service pressure in the short term (Box 3). However, potential increased exchange rate movement could increase external debt levels and servicing costs.

49. Increasing domestic debt poses a high risk of undermining fiscal sustainability. The consistent financing of fiscal deficits by high cost domestic borrowing has led to a recent surge in domestic debt, and this is expected to rise further. This will increase vulnerability of public debt which is already at high risk of debt distress. Moreover, given the high and increasing cost of domestic debt, it will further narrow future fiscal space for discretionary policy. There will be some room in the short term from external debt service relief by the IMF and other official bilateral creditors, estimated to save US\$ 18 million in 2020. Nonetheless, the Government needs a deliberate policy to reduce the vulnerabilities that give rise to domestic debt. In particular, the Government needs to improve budget planning and strengthen fiscal discipline if it is to bring domestic debt on a downward trajectory and reduce the risk exposure.

Box 3: Debt-relief in the times of COVID-19

Many International Development Association (IDA) countries lack the resources to respond to the current pandemic. Many countries in this group were already in precarious fiscal positions under moderate to high risk of debt distress and could not maintain adequate social spending and safety nets. As the economic situation has worsened, public and external financing needs have increased abruptly, in a setting where capital markets are cutting off the limited access these countries have had in the last decade.

Official G20 bilateral creditors have temporarily suspended collection of debt payments from May to December 2020. Under this Debt Service Suspension Initiative (DSSI), official bilateral creditors will re-profile all debt services (both principal and interest) falling due during this period. All IDA-member countries and UN Least Developed Countries (LDC) that are currently on debt service to the IMF and World Bank are eligible. There is a possibility of extending this initiative beyond December 2020.

The DSSI will free up resources amounting to US\$ 18 million for Malawi to respond to the COVID-19 crisis. Public sector borrowers will be expected to commit to spending the fiscal space created on COVID-19 related health or economic relief and disclose all their debts. In addition, they are expected to contract no new non-concessional debt during the suspension period.

In addition, the IMF enacted a debt-relief program for 25 of its most vulnerable members under its Catastrophe Containment and Relief Trust (CCRT). This is a grant-based relief of US\$ 500 million to cover IMF debt service obligations, for six months until December 2020. In this way, countries will be able to channel these resources to other COVID-19 response plans or efforts. Malawi is expected to save US\$ 44.9 million under this facility.

Current account deficit will worsen due to trade disruptions and lower demand

50. The WTO predicts that world trade is expected to fall by between 13 and 32 percent in 2020 as the COVID-19 pandemic disrupts global economic activity. The expected recovery in 2021 is equally uncertain, depending on the duration of the global outbreak and the effectiveness of the policy responses. International trade negotiations have also come to a standstill and the implementation of the African Continental Free Trade Agreement did not come into force as planned on July 1, 2020.

51. In Malawi, exports are expected to decline slightly due to lower global demand and trade restrictions. Malawi's main exports are tobacco (over 50 percent of exports), sugar, and tea. Global demand for these products has been relatively inelastic in the past decade, mainly affected by supply shocks and changes in contracts. Key product markets are facing severe recessions, including the European Union (about 32 percent of exports) and other trade partners (South Africa (10 percent) and rest of Africa (26 percent)).

52. Tobacco auctions started in mid-April and have seen an 11.9 percent decrease in sales values. Through the eleventh week of trading in early July, sales were down by 11.9 percent from 2019 (US\$ 110.2 vs US\$ 125.1 million). This was due to a 14.7 percent decrease in sales volume which was partially offset by a 3.2 percent increase in price. The ban imposed by the United States on tobacco from Malawi will continue to affect tobacco exports. However, this could be partially offset by a decline in production of tobacco from other countries within the region, such as Zimbabwe and Zambia, whose tobacco production was adversely affected by drought.

53. Mobility restrictions due to the pandemic are weighing on exports. Delays in the commissioning of repairs and the return of equipment from South Africa due to travel restrictions and travel restrictions for consultants affected the milling of sugar. Further, external sourcing of equipment has been affected and Illovo Sugar Malawi has resorted to relying on domestic suppliers. This has affected production which is anticipated to be lower by 8,000 tons in the 2020 financial year. Supply chain disruptions and failure to complete contracts with customers due to the pandemic have weighed on sugar exports. For tea, an influx of excess stocks from last year as well as the crisis has affected prices both at the Limbe Auction and the Mombasa market. Travel restrictions have affected the movement of tea to Mombasa, further affecting prices. The outlook is still on the downside for both sugar and tea as demand is expected to be depressed both locally and internationally.

54. Total imports declined by 26 percent in April and May 2020 from 2019 levels. Imports could face further delays and higher costs due to disruptions in cross-border trade. Malawi's main sources of imports

are South Africa (roughly 18 percent), China (14 percent), India (9 percent), the United Arab Emirates (UAE) (9 percent), and the United Kingdom (8 percent). While trade channels and shipments have continued to operate, particularly for essential items, including food and medical supplies, transporters have faced delays due to policies countries are implementing to contain the spread of COVID-19. In addition, air cargo services from the UAE was suspended from 27 March, thus contributing to the decline. Imports into Malawi will also rely on how exporting countries ease lockdown restrictions. Petrol and diesel imports (about 11 percent of total imports) will benefit from lower international prices. A reduction in local transport combined with international oil prices about one-third lower than in 2019 could substantially reduce Malawi's import bill.

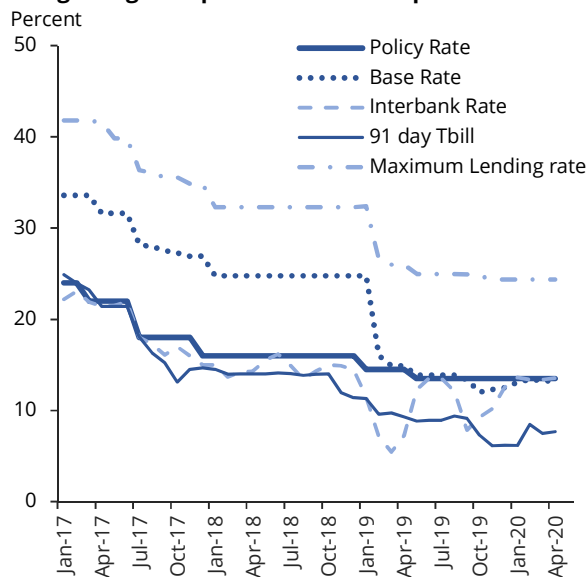
55. The current account balance is expected to widen slightly to 18.3 percent in 2020, up from 17.8 percent in 2019. Although there is a high level of uncertainty as the situation evolves, the trade deficit is expected to widen slightly, as a reduction in exports would outweigh lower imports. A reduction in remittances and tourism would also contribute to the wider deficit.

RBM has increased liquidity but kept the policy rate unchanged

56. The RBM advanced its usual end-April Monetary Policy Committee (MPC) meeting to April 1. It decided to maintain the key Monetary Policy Rate at 13.5 percent (Figure 16) (where it has stood since May 2019), to mitigate potential upward inflation risks from the pandemic. In order to ease banking system liquidity constraints, it reduced the Liquidity Reserve Requirement (LRR) by 125 basis points to 3.75 percent, which is expected to inject MWK 12 billion into the banking system. The RBM also reduced the Lombard Rate—the rate at which commercial banks borrow from the central bank—from 0.4 to 0.2 percentage points above the policy rate (i.e., from 13.9 to 13.7 percent).

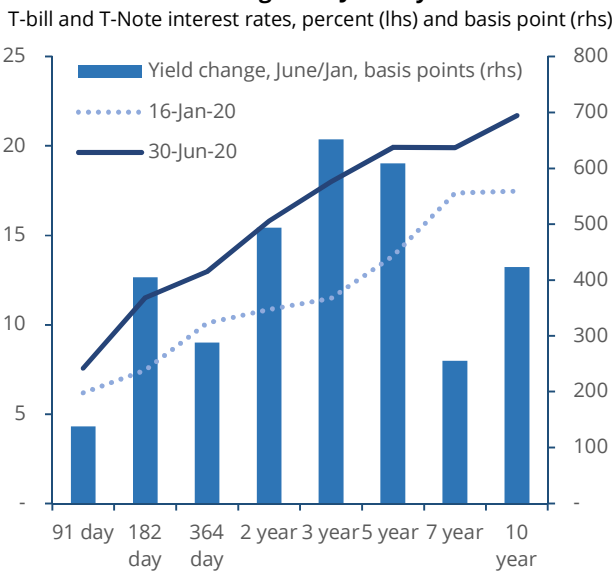
57. Interest rates for T-bill and T-notes have increased substantially across tenors since January 2020 (Figure 17). This has coincided with a further increase in the Government's domestic borrowing, while it has expanded borrowing in longer term Treasury Notes. Inter-bank rates have also indicated tight liquidity.

Figure 16: The policy rate has been held constant to mitigate against potential inflation pressures



Source: World Bank staff calculations based on RBM data

Figure 17: Yields have increased substantially on Government borrowing since January 2020



Source: World Bank staff calculations based on RBM data

Private sector credit has been increasing but will face pressure as the crisis deepens

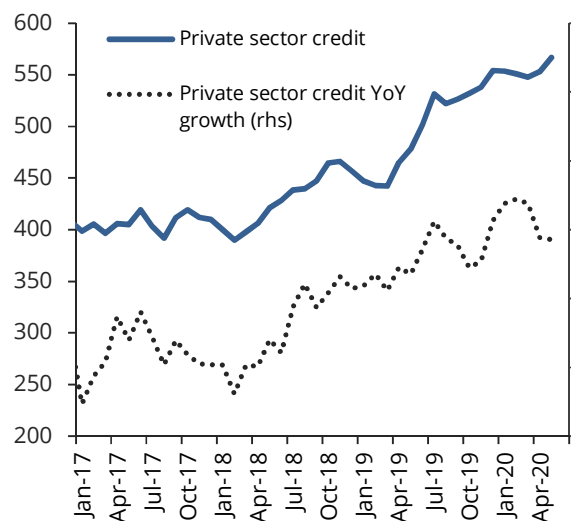
58. Growth of credit to the private sector has slowed since February 2020 but remains robust (Figure 18). Private sector credit growth grew by 18.6 percent y-o-y in May 2020, which is historically high, although a decline from the 24.4 percent peak of February 2020. Key drivers have been lending to community,

social, and personal services sector (which is largely personal loans), as well as lending to the transport and manufacturing sectors.

59. Asset quality has weakened slightly in recent months but remains stronger than in prior years, while the banking sector has been profitable and liquid. The ratio of NPLs to total loans rose to 7.3 percent in April 2020, up from 6.0 percent in January and a low of 4.3 percent in September 2019 (Figure 19). This is considerably lower, though, than the 18.8 percent of September 2017. As of April 2020, the banking system recorded sound levels of profitability, with a high return on equity rate of 21.6 percent. Although a decline from February and March, this is still historically high. Liquidity was also strong, with the liquidity to total asset ratio at 38.2 percent.

Figure 18: Private sector credit growth remains robust through May

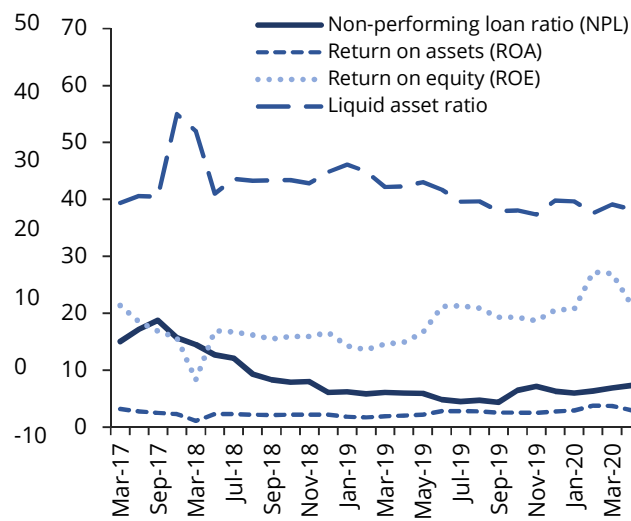
Private sector credit, billion-kwacha, y-o-y percent growth



Source: World Bank staff calculations based on RBM data

Figure 19: Financial soundness indicators were healthy at the onset of the crisis

Private sector (percent GDP) and Sectoral credit (y-o-y)



Source: World Bank staff calculations based on RBM data

60. The pandemic is expected to see a decrease in lending but increase in NPLs. Lending growth is expected to decline, while NPLs would be expected to increase due to liquidity constraints, affecting banks' profitability and capital adequacy. Lending is concentrated in a few sectors such as wholesale, agriculture and manufacturing, and some banks have high exposure to single clients. A downturn in any of these sectors or firms could lead more loans to become non-performing. The RBM conducted a stress test to assess the impact of COVID-19 on Malawi's banking sector. The test assumed NPLs would increase from the current MWK 40 billion to MWK 125 billion by end June and MWK 331 billion by end December 2020. In such a scenario, two banks could fall below the minimum capital regulatory ratio requirements by June 2020, which could spread to all banks by December 2020. Profitability would decline for all banks, but only 5 out of 9 banks could still remain reasonably profitable under both scenarios.

61. The RBM announced measures affecting the banking sector in April. An Emergency Liquidity Assistance (ELA) framework was introduced to support banks in the event of worsening liquidity conditions on a case-by-case basis. It further directed commercial banks and microfinance institutions to provide a three-month moratorium on interest and principal payments, to restructure loans on a case-by-case basis, and to defer dividend payments. It also granted relief on provisioning for restructured loans and loans on moratorium. It further directed commercial banks to reduce fees on internet banking and mobile money transfers by 40 percent and increased daily transaction and balance limits.

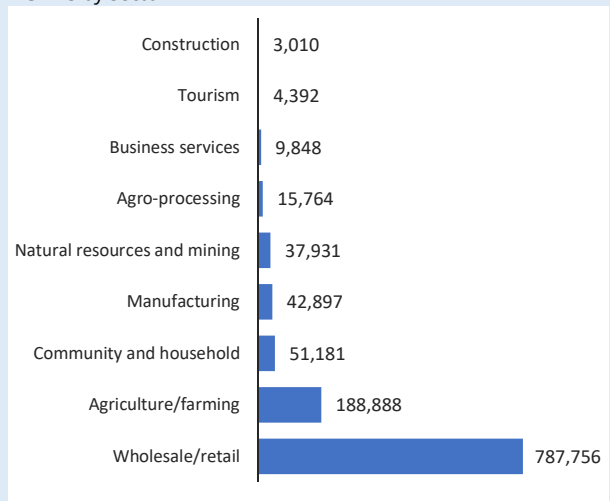
Box 4: MSMEs Scope and Challenges

FinScope MSME Malawi 2019 reports that there are 1.1 million businesses classified as MSMEs³ in Malawi. MSMEs mostly operate in the wholesale/retail and agriculture/farming sectors (Figure 20) and are heavily affected by the COVID-19 outbreak. Identifying appropriate policies to support their survival during the crisis will be critical.

The MSME sector is a significant source of employment, providing jobs to 1.6 million people. About 60 percent of businesses in Malawi are microenterprises (employing 1 to 4 people), 32 percent are small enterprises (employing 5 to 20 people) and only 8 percent are medium enterprises (employing 21 to 99 people). Although a good proportion of MSMEs are in the mature stage (23 percent), the majority are in a start-up phase (Figure 21). The split of the number of MSMEs by business maturity as depicted by Figure 21 is an important descriptor of the sector as MSMEs of different business maturity require different support and financial products.

Figure 20: Most MSMEs are in wholesale/retail and agriculture

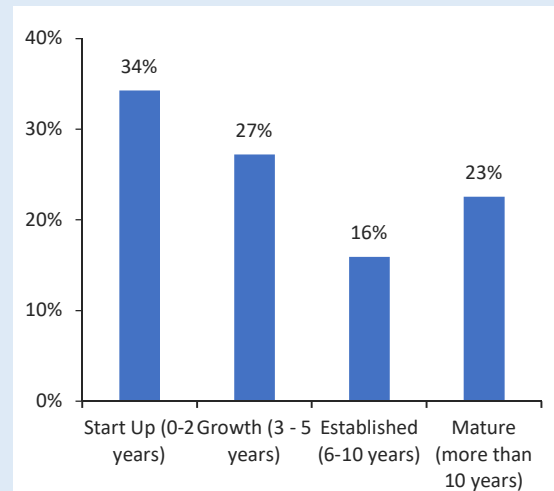
MSMEs by sector



Source: World Bank staff calculations based on 2019 FinScope Survey

Figure 21: Most MSMEs are at start-up stage

MSMEs breakdown by business maturity



Source: World Bank staff calculations based on 2019 FinScope Survey

The sector faces numerous challenges to growth, the major one being lack of access to finance. Only 10 percent of medium enterprises, 5 percent of small enterprises and 3 percent of micro enterprises have credit from commercial banks. The low access to financing is compounded by lack of requisite skills, capacity and aspiration to grow and become eligible for formal financing. MSMEs have poor perceptions of banks, with those not part of the formal banking system perceiving banks as not being interested in extending products and services to them. This is a particular deterrent to women-led and youth-led businesses and start-ups.

Informality is another key challenge. The majority of MSMEs (89 percent) are informal, some do not keep records (36 percent), and they lack innovation and diversification (45 percent). Most women and youth-led entrepreneurs are said to be unaware of the process or the importance of formalizing. Capabilities among firms are not developed in terms of attitude/mindset to skills, financial literacy, management practices, business language, market assessment, and behavioral characteristics of successful entrepreneurs that include: clear goal setting; long-term involvement; drive and energy.

Bank lending to MSMEs is low. Lack of robust lending models results in the reliance on traditional forms of collateral, which are often limiting for MSMEs. Banks continue to perceive MSMEs as too risky. Low literacy levels of MSME owners and entrepreneurs inhibits MSMEs from meeting the requirements for formal financing. Even credible businesses are unable to present the relevant financial history to meet the requirements of banks. There is little understanding of the needs of consumers and/or adequately matched bank products and services. Credit information sharing through credit reference bureaus remains in its infancy. Furthermore, there is limited understanding of the alternative forms of finance such as the collateral system among businesses. Microfinance institutions and savings and credit cooperatives and village savings and loans associations provide easier access to finance, particularly for women and youth-led businesses, but their product offerings are limited by the tenor of loans, cost of money and loan amounts.

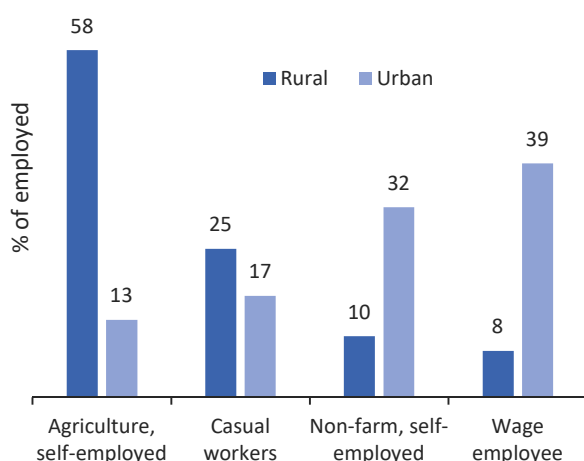
Source: MAP, Micro, Small and Medium Enterprise Diagnostic Report 2019.

Poverty will increase, particularly in urban areas

62. The pandemic is expected to affect households' incomes and employment, although the magnitude will vary depending on the nature and sector of employment. Broadly speaking, the services sector is likely to be the most affected in Malawi, followed by the industrial sector. Within the services sector, accommodation and food services as well as wholesale and retail trade are likely to shrink significantly if Malawi experiences wider community-level transmission. Most rural households engage in agriculture (Figure 24), hence the impact of COVID-19 on rural households is anticipated to be mild.

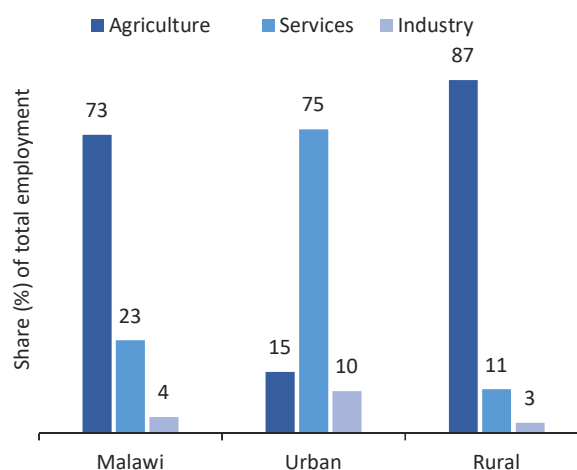
63. Casual employment is expected to reduce, and self-employed businesses are more vulnerable. Those who rely on casual employment, both in urban and rural areas, can expect a substantial reduction in employment opportunities and incomes. Land constrained and landless Malawians in rural areas rely on *ganyu* (informal or piece work) arrangements. Self-employed small business owners can expect a significant reduction in demand and market opportunities. These types of businesses, which are typically in informal retail trade and services provision, are common in urban centers (Figure 22).

Figure 22: Employment in rural and urban Malawi
Percent of employed



Source: An ongoing Policy Brief on socioeconomic impact of COVID-19.

Figure 23: Share of labor force by sector
Share of total employment



Source: An ongoing Policy Brief on socioeconomic impact of COVID-19.

64. Wage earners and salaried employees will face uncertainty. The effect on wage and salaried employees in non-agriculture sectors depends on the terms of their contracts. Some 39 percent of the urban labor force depends on wage employment (Figure 22). When business slows down as a result of social distancing measures, those on short-term contractual employment could lose their jobs.

65. There is a clear urban-rural divide in households' reliance on incomes from jobs in the most severely affected services and industrial sectors. As a result, the economic impact of the pandemic could be different between urban and rural areas. Figure 23 provides a breakdown of employment by major sectors in urban centers and rural areas.

66. About 75 percent of workers in urban areas are employed in the services sector, and another 10 percent are employed in the industrial sector (Figure 23). A large share of services sector workers engages in wholesale and retail trade, which are severely affected, and the accommodation and food services sub-sectors. This is more pronounced in large urban centers like Mzuzu, Lilongwe, Blantyre, and Zomba. Therefore, we can anticipate strong impact in urban centers.

67. In rural areas, the share of employment in the services and industrial sectors is low. These sectors together account for less than 14 percent of employment (Figure 23). The wholesale and retail

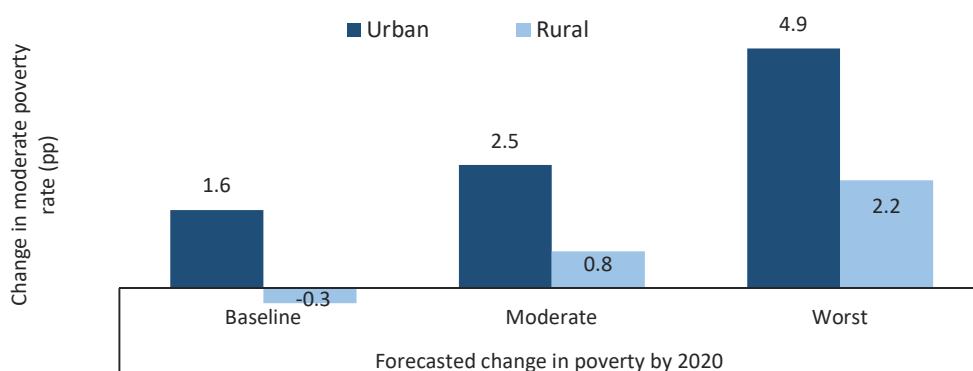
³ A micro enterprise is defined as one that has 1 to 4 employees, a turnover of up to MWK5 million and an asset value of up to MWK 1 million. A small enterprise has 5 to 20 employees, turnover of between MWK 5 million and MWK 50 million and maximum assets value of MWK 20 million (MSME Policy, 2018). A medium enterprise has 21 to 99 employees, turnover of between MWK 50 million and MWK 100 million and maximum asset value of MWK 250 million.

trade sub-sector, which by itself employs 9 percent of the workforce, is relatively important in rural areas. However, agriculture remains the main employer in rural areas. With limited expected impact on agricultural production, the effect of the pandemic on rural jobs and income is likely to be mild.

68. The initial welfare status of households in the services and industrial sectors is generally better than those working in agriculture. For example, in 2016/17, the median consumption per capita in industry and the services sectors ranged from MWK 195,000-212,000 per year (in 2016 prices). This is high compared to only MWK 117,000 for those engaged in agriculture. In 2016/17, only 4-5 percent of those working in services and the industrial sector were below the ultra-poverty line, compared to 27 percent of those working in agriculture. Moderate poverty rates were also low for non-agriculture sector employees (Figure 24).

Figure 24: Forecasted changes in moderate poverty by 2020 due to COVID-19

Change in moderate poverty rate, percent



Source: An ongoing Policy Brief on the socioeconomic impact of COVID-19.

Note: This forecast is based on growth projections for each sub-sector, and accounting for household heads' employment by sub-sector. Simulation is conducted using IHS4 dataset, and sectoral growth since 2017. The result is subject to change.

The forecasted increase in urban poverty during 2019-2020 could range from 1.6 in the baseline growth forecast up to 4.9 percentage points in the worst-case scenario. On the other hand, there could be a limited increase in rural areas of those being vulnerable falling into poverty in the baseline scenario. However, there could be an increase of 2.2 percentage points in vulnerability of falling below the poverty line in rural areas if the worst-case scenario materializes (Figure 24).

2. MEDIUM TERM ECONOMIC OUTLOOK

69. Global risks continue moving to the downside. The global economic outlook is fragile given ongoing spread of the coronavirus and mitigation measures. The duration and intensity of the pandemic as well as the shocks to the real economy and financial sectors are highly uncertain. Moreover, the expansionary fiscal and monetary policies that Governments and central banks are undertaking to stimulate the economy could lose effectiveness under a scenario with protracted higher uncertainty: monetary policy in advanced economies has limited space in which to maneuver and fiscal policy is challenged by high levels of debt. There is considerable uncertainty about the strength of the rebound, which is conditional on the duration of containment measures, the impact in developing and emerging economies, and the recovery of firms and employment, and in household income.

70. Growth prospects are still highly uncertain. Although the clear resolution of elections has supported stability, the escalating COVID-19 pandemic increases uncertainty. Social distancing and containment measures to fight the spread will further weigh on economic activity. The extent of the impact will determine the magnitude of investment that will be required for recovery. Although projections continue to evolve, assuming the good weather persists and supports agricultural growth, and response and recovery investments are well targeted, the economy could register growth of 3.5 percent in 2021. This would assume a significant rebound in the services and industrial sectors, although considerable

downside risks remain. Nonetheless, some sectors could be affected for a longer period, including international tourism.

71. Inflation expectations are also uncertain. The agriculture sector continues to be highly vulnerable to climatic shocks. If Malawi experiences good weather in 2020/21, agriculture output could contribute to moderate food prices. However, risks could emanate from potential trade impediments which could affect the availability and cost of agricultural inputs, as well as possible market distortions. Moreover, uncertainty from the impact of the locust outbreak anticipated in East Africa could also increase pressure on food prices. Potential exchange rate movements could also contribute to increased costs of imports. While non-food inflation benefits from low global oil prices in the short-term, these could pick-up and contribute to increased non-food inflation in the medium term.

72. The already weak fiscal situation is likely to worsen. The FY 2019-20 budget was prepared with overly optimistic revenue projections which would not have been achieved even before the COVID-19 pandemic. In addition, there were significant expenditure overruns in the third quarter before the current crisis on generic goods and services, interest payments, pensions, as well as the payment of arrears. Much of the response to the COVID-19 pandemic is expected to be financed with donor resources. The Government planned for about US\$ 20.8 million for a health response plan, much of which will be funded by donors. Thus, despite increasing the allocation at mid-year, even in the absence of the pandemic, expenditure overruns were very likely. COVID-19 heavily affected revenues in the last quarter of FY 2019-20. These factors will contribute to the fiscal deficit reaching toward 10 percent of GDP (up from 6.5 percent in FY 2018-19).

73. In the medium term, spending pressures will increase further amidst a reduced resource envelope, leading to continuing high deficits. While the Government is preparing the full fiscal year budget, a high fiscal deficit in the provisional budget highlights the need to rein in expenditure in order to reduce domestic borrowing and contain interest costs. However, the pandemic will pose high risks to reduce revenues, while only increasing expenditure pressures to respond, thereby underscoring the need for stronger expenditure prioritization.

74. Debt vulnerabilities are expected to rise. Continuing high fiscal deficits will increase borrowing, which the Government historically has largely financed from the domestic market. However, further increases in domestic debt could push public debt to unsustainable levels. In addition, high interest payments associated with domestic debt could further erode future fiscal space for discretionary policy. Moreover, expanding domestic debt is increasing interest rates, which could further crowd out private sector investment that is needed for the recovery.

75. The COVID-19 outbreak poses considerable downside risks for the economy and, in an adverse scenario, could lead to a recession in 2020 and a weak rebound in 2021. It could further slow and reduce demand for Malawi's exports, slow imports and raise their cost, and reduce public and private investment. Additionally, if the virus spreads extensively, it could severely disrupt the labor force, thereby increasing poverty. Malawi has benefited from two consecutive above-average harvests. However, it is highly vulnerable to weather shocks which can derail growth and increase food inflation, while further increasing the vulnerability of rural households to poverty. Unless social safety net programs are scaled-up, poverty will increase in the years when natural disasters occur. Finally, Malawi faces considerable risks of fiscal slippages, in which arrears could be uncovered following two consecutive election years.

3. GOVERNMENT'S POLICY RESPONSE TO COVID-19 TO DATE

76. Malawi has already taken significant steps to begin addressing the health and economic impact of the epidemic. It has announced measures including a health response plan, expansion of social protection, fiscal and monetary measures, as well as steps to support the financial sector and the expansion of mobile money. These measures are summarized in Table 4.

Table 4: COVID-19 Governance Response Policies and Status

#	Policy Action	Description
Budgetary Reallocations		
1	Emergency Budgetary Reallocations #1	MWK 2.5 billion of immediate funding from Government budget to fund Response Plan
2	Emergency Budgetary Reallocations #2	MWK 3.0 billion of funding provided to Ministry of Health, MWK 2.0 billion to Ministry of Disaster
Social Cash Transfers		
3	Introducing Urban Social Cash Transfers	Introducing an Emergency Cash Transfer Program to low-income households in Blantyre, Lilongwe, Mzuzu, Zomba and others. Government to target over 185,000 households in these areas, an estimated 35 percent of the urban population.
4	Frontloading Rural Cash Transfer Program	The Government of Malawi has dispensed 4 months of social cash transfers in advance as a way of allowing upfront purchase of necessary goods, preventing the spread of COVID-19, and promoting social distance.
Tax and Customs		
5	Easing Tax Obligations	MRA voluntary tax compliance window of six months to allow taxpayers with arrears to settle tax obligations without penalty
6	Removing Customs for Response Materials	Tax waivers on essential goods for COVID-19 Management including PPE, hand sanitizers, soaps, and water treatment chemicals
7	Taxpayer Assistance	MRA to minimize face-to-face contact and exposure by putting in place a range of service options that taxpayers and traders can use to engage with MRA during the crisis including online filing and repayment, online services, and a MRA Call Center
8	Medical Personnel Taxation	Waive resident tax on all foreign doctors and medical personnel
Justice and Prisons		
9	Prisoner Releases	Malawi Prison Services and Juvenile Centers presenting list of prisoners and juveniles who committed petty offences and have done period of time to be released
10	Prison Warden Allowances	All Prison Wardens allowances increased and provided promotions in grade
Civil Service		
11	Healthcare Worker Recruitment	Recruitment of 4,000 new healthcare workers to cope with COVID-19 outbreak
12	Healthcare Allowances	Increase in health worker risk allowances by 20x – 30x
13	Reduce Cabinet Wages	Reduction of salaries by 10 percent for three months for the President, Cabinet Ministers, and Deputy Ministers
14	Civil Servant Homebased Work	All non-essential civil service staff directed to work from home with others working in shifts
Banking, Loans, State Guarantees		
15	Facilitate E-Payments	Removed user fees and charges on person-to-person transfers on the same Mobile Network Operator and reduce user fees and charges on person-to-person transfers across networks from a minimum of MWK 120,00 to MWK20,00 that will accrue to Natswitch
16	Facilitate Mobile Banking	Revise upwards daily transaction and account balance limits on non-bank mobile money services
17	Interest Payments	Immediately provide a 3-month moratorium on interest and principal repayments for loans by borrowers from microfinance institutions (including financial cooperatives), pay-roll borrowers to be included on a case-by-case basis. This must be agreed by the client and bank – it is not automatic.
18	Liquidity Reserves	Liquidity Reserve Requirement (LRR) reduced by 125 basis points to 3.75 percent. An Emergency Liquidity Assistance (ELA) framework introduced to support banks in the event of worsening liquidity conditions on a case-by-case basis.
19	SME Loans	Increase Malawi Enterprise Development Fund (MEDF) loans allocation by MWK 2 billion to help SMEs, increased to MWK 40 billion in provisional budget

Source: World Bank Staff calculations based on various Government notices

The Government has expanded health sector capacity, but court injunctions have halted a lockdown

77. The President of Malawi declared a national disaster on 20 March 2020. The announcement included the closure of schools, restricting gatherings of more than 100 people, banning international and regional meetings of civil servants, and barring the entry of foreign nationals from countries highly affected by the pandemic outside of the Southern African Development Community. It subsequently closed international airports and suspended cross-border passenger services from April 1 though those for returning residents have since resumed. Malawi has officially closed all but three borders to allow transit of essential goods and services.

78. On April 4, the President announced further social distancing measures, as well as a set of measures to address economic and social impacts of the pandemic. This included social distancing measures including ordering that people in offices work in shifts, while formal meetings, gatherings and conferences were suspended. In addition, vulnerable employees including those with underlying medical conditions were allowed to work from or stay at home. Criminals who were jailed for petty offences or had served a significant portion of their sentences were ordered released. It also addressed public health issues, including by announcing the recruitment of 2,000 health workers and increasing risk allowances. It also included fiscal, monetary, and other economic issues (discussed below).

79. Malawi launched the National COVID Preparedness and Response Plan on April 8, which is largely focused on health and social protection. Malawi has about 300 doctors, 22,000 hospital beds (only 25 ICU beds), and 37 ventilators, far below the East African average. The Government's plan comprises the mobilization of materials (PPEs, infrared thermometers, infection prevention materials), capacity building, establishment of Infectious Disease Treatment Centers (IDTCs), training of health workers on case management and increasing public awareness and community engagement among workers at points of entry. The Government has also provided for the recruitment of additional 4,000 health workers to assist in the COVID-19 fight. It has also increased risk allowances for health workers. Implementation of the plan will be through 10 clusters requiring US\$ 213 million. Some of the sector plans are being revised downwards to fit expected fiscal space. Rehabilitation of isolation centers in various districts is underway, while the Emergency Treatment Centre at Kamuzu Central Hospital has been completed.

80. The President announced a 21-day national lockdown on April 14, but it was met with public resistance and its implementation has been halted indefinitely by court injunctions. Informal traders protested against the announcement as no measures were taken to protect their welfare. On April 28, the President announced measures to address these concerns. This included an Urban Emergency Cash Transfer Program to serve small scale businesses in and around major markets in Blantyre, Lilongwe, Mzuzu, Zomba and other municipalities, which would target over 185,000 urban households (some 35 percent of the urban population) with an MWK 35,000 per month transfer for 6 months. In addition, the President replaced the Special Cabinet Committee with a more inclusive Presidential Taskforce on COVID-19 that is co-chaired by a professor from the College of Medicine and the Minister of Finance, Economic Planning, and Development. Some targeted mechanisms have been announced since at local levels, including the requirement to wear facemasks in Lilongwe's markets since mid-May.

81. Testing capacity has expanded but remains low. In mid-April, the country had only four laboratories which could test for COVID-19. As of 20 July, this has expanded to 39 laboratories in all regions. A total of 24,475 samples have been tested and active monitoring of confirmed cases is ongoing.

The Government announced economic measures to support consumers and firms

82. Malawi has taken some early revenue measures to support the response. The Government has waived taxes on importation of essential goods for COVID-19 management; waived non-resident tax on all foreign doctors and medical personnel; and through the MRA, opened up a voluntary tax compliance window for six months to allow tax payers with arrears to settle their tax obligations in instalments without penalty. It has also waived the tourism levy to support the tourism industry.

83. Further economic measures were put in place to ensure trade of essential goods continued and to alleviate price pressures. Tobacco auctions were directed to proceed. The Ministry of Finance was directed to provide a special fund to ADMARC to buy agricultural produce at competitive prices. The Government further increased surveillance of prices of consumer goods to avoid price gouging and held discussions with SADC and the countries in the Common Market for Eastern and Southern Africa to ensure importations of essential goods and raw materials continues. In addition, the Government has reduced fuel prices to reduce transportation costs. In May, it further reduced fuel and diesel prices, while increasing the wholesale and retail margins.

84. The Reserve Bank of Malawi has increased financial sector liquidity and provided for moratoria on debt servicing, while reducing mobile money transaction fees. The RBM has reduced the Liquidity Reserve Requirement (LRR) by 125 basis points to 3.75 percent, which is expected to inject MWK 12 billion into the banking system. In addition, the RBM also reduced the Lombard Rate—the rate at which commercial banks borrow from the central bank—by 50 percent to 0.2 percentage points above the policy rate. It has further announced additional measures for commercial banks and microfinance institutions including: (i) a three-month moratorium on interest and principal payments for loans including payroll borrowers from commercial banks and microfinance institutions on a case-by-case basis; (ii) restructuring and renegotiating loans for borrowers affected by COVID-19 on a case-by-case basis; and (iii) reducing fees and charges related to Internet, banking and mobile payments and increasing daily transaction and account balance limits. RBM also granted relief to banks on the provision of restructured loans and loans on moratorium. It further announced a recapitalization plan under the Prompt Corrective Action (PCA) Directive beyond 90 days in the event of a bank breaching the Prudential Capital Requirement Directive. The Government also increased Malawi Enterprise Development Fund (MEDF) loans allocation from MWK 13 billion to 15 billion in order to help SMEs that have been seriously affected by the pandemic. In the FY20-21 provisional budget, this was further expanded to MWK 40 billion.

4. POLICY OPTIONS FOR STRENGTHENING CRISIS RESPONSE AND MEDIUM-TERM RECOVERY

85. Malawi's new Government has inherited a considerable challenge. Its policy response to the COVID-19 pandemic could be informed by a framework which prioritizes: 1) protecting lives; 2) protecting livelihoods; and 3) protecting the future (Box 5). Further options to strengthen its policy response can follow this framework as part of an overall smart containment approach.

86. The new administration's response to the pandemic will be constrained by limited fiscal space, high overall risk of debt distress, and limited capacity. An already weak fiscal position is expected to deteriorate further with the crisis. As such, it has limited fiscal space to support the expansion of health services, expand cash transfers, and support affected industries through tax breaks or direct support. Most countries with strained fiscal space have focused on less complex fiscal measures and interventions where cost control is manageable and easily reversible, such as deferrals of tax payments, reduction of tax arrears, targeted infrastructure investments to expand healthcare capacity and preferential loans to sectors in distress (see Box 8). Even during the health crisis, the Government will need to continue to maintain macroeconomic stability and allocate expenditure in the most efficient manner possible.

A. Protecting lives

87. Malawi should enhance active case finding, contact tracing and monitoring. This would include enhancing testing and contact tracing, including that of key groups such as health workers and front-line workers who are at risk of exposure, and cross-border travelers. Key actions include: (i) activating surge capacity for contact tracing and active case finding; (ii) rapid deployment to high risk districts and ports of entry; (iii) optimizing existing testing capacity and adapting the testing strategy on an ongoing basis to ensure it is responsive to the outbreak trends in Malawi; and (iv) providing necessary materials such as transport, personal protective equipment (PPE), and data collection tools for contact tracing and monitoring. Given the high positivity rates among returnees, the following specific actions may also be

Box 5: A Framework for Policy Responses to the COVID-19 Pandemic

The Government could consider organizing and implementing further COVID-19 policy responses through a three-pronged framework. Under this framework, policy responses should be oriented toward:

- 1) Protecting lives:** In the immediate term, the primary concern is saving lives, which requires containing the spread of the disease through smart containment measures and putting in place the measures needed for the prevention, detection, and treatment of the disease. Containing the spread of the disease through physical distancing measures is critical. It is especially important that efforts be directed toward “smart containment” – targeted physical distancing measures that have the maximum effect on epidemic reduction with the minimum economic damage.
- 2) Protecting livelihoods:** A second prong in the effort must consider ensuring livelihoods during the period when parts of the economy need to be shut or slowed down. This will call for:
 - a. **Protecting households** – This calls for fiscally sustainable cash transfer programs provided on a timely basis to smooth households’ consumption using e-payments to reduce physical contact.
 - b. **Protecting jobs** – The loss of income and employment, particularly for those in the informal economy, means that efforts are needed to provide support to farms and firms so that they are viable for post crisis recovery and growth.
 - c. **Protecting food security** – This would entail ensuring that food markets and trade continue, and farmers continue to have access to critical inputs.
 - d. **Protecting key Government functions** – Despite sharp declines in revenues, key Government services need to be maintained and households must continue to have access to critical supplies and services.
 - e. **Supporting essential economic activity** – Governments must ensure that households continue to have access to critical supplies (e.g. food, medication) and services (e.g. power, water, sanitation, transport, agriculture) while implementing social distancing and other preventative measures.
- 3) Protecting the future:** While much of the effort would necessarily go toward addressing the immediate crisis, investment also needs to be made to create the foundations for a solid recovery.

considered: (i) strengthen border health operations by setting up testing and quarantine facilities; (ii) improve turnaround times for samples to reduce people absconding before receiving their test results; (iii) develop a comprehensive system for tracking returnees and improve coordination between districts to ensure efficient follow-up; and (iv) close or monitor unchartered routes being used by some travelers.

88. It should further seek to quarantine contacts and isolate cases as part of a smart containment approach. This would include adopting isolation and quarantine measures as needed while accommodating home-based, community-based and institutional approaches. This nuanced approach will make use of existing community capacities to respond to the crisis, avoid stigma and make a more efficient use of existing resources. This would also address challenges presented by returnees such as lack of holding capacity and poor compliance. Intensifying social and behavioral change communication interventions could also improve community compliance to prevention measures and reduce abscondment. Monitoring approaches can also be graduated, for example using: (i) passive monitoring using existing technology such as cell tower triangulation, (ii) use of mobile phone apps; and (iii) active monitoring using community health volunteers or local administrative officials. The use of technologies would need robust protections and oversight.

89. Malawi should strengthen case management capacity. This will include: (i) enhancing capacity of healthcare workers through training, job aides, supportive supervision and communities of practice; (ii) providing safe working environments including infection prevention and control measures, PPE, and motivation through incentives such as health and life insurance; (iii) activating clinical pathways and referral mechanisms for patients with acute respiratory illness while leveraging approaches such as phone-based screening and triage and home-based care for mild illness; and (iv) enhancing capacity of treatment facilities to deliver oxygen and other essential interventions.

90. Finally, it should seek to maintain essential health services. Movement restrictions, lost income related to COVID-19, and fear of exposure and transmission may suppress demand and limit utilization of essential health services, as shown by experience from the Ebola outbreak in West Africa (Shannon, et. al.

2017). The following strategies should be employed to ensure continuity of essential services: (i) regularly assess which services are to be prioritized to maintain continuity of service delivery; (ii) address health service delivery gaps that may arise due to reallocation of resources to COVID-19 response; (iii) optimize service delivery platforms and settings such as outreach mechanisms to deliver services; (iv) establish effective patient flow and promote basic infection and prevention measures at all levels; (v) re-distribute health worker capacity; and (vi) identify mechanisms to maintain the supply of essential medicines and other supplies.

B. Protecting livelihoods

91. Malawi has taken some early steps to support families, firms and key Government functions during the spread of the disease (see discussion above). It can consider further measures in ramping up cash transfers, ensuring trade and market activities continue, and supporting firms and the financial sector. These are elaborated below.

Considerations in ramping up cash transfers

92. On April 28, the Government announced that it will work to address these issues by targeting over 185,000 households in urban and peri-urban areas, representing an estimated 35 percent of the urban population. Given the expectation that livelihood and employment effects will be heavier in urban areas, expanding cash transfers in urban areas is a priority. Options for designing a crisis social assistance response could include:

- i. **Expanding emergency urban cash transfers calls for a new and rapid process to collect beneficiary data in new geographical areas.** This could include an emergency roll-out of an abridged version of the social registry's data collection tool in urban hotspots, registering all households in those hotspots. The Government should explore, where feasible, the utility of other data sources such as Integrated Household Survey and satellite data in order to enhance objectivity and transparency of the identification and targeting process. Although these would not be optimal registration, identification, and targeting methodology options for a normal situation, they would provide a quicker way of identifying and therefore reaching the urban poor in the current emergency.
- ii. **The COVID-19 cash transfer response requires a clearly defined implementation period and payment triggers.** The effect of COVID 19 on livelihoods in both urban and rural areas could be spread over a longer period. It is therefore imperative that, given limited fiscal space, Government undertakes an evidence-based analysis that helps define both triggers and an optimal implementation period for the cash transfer response. This will guide Government to ensure that payment is triggered at the right time for maximum impact, i.e. when households' livelihoods are indeed in need of protection.
- iii. **The Government, development partners, and MNOs should work together to introduce digital payments of safety net benefits.** Safety net programs mostly operate through physical delivery of cash, which would be challenging in a COVID-19 crisis environment.⁴ The current crisis presents an opportunity to expedite the introduction of electronic payments. Partnerships with mobile money operators could be explored as a swift and more secure means of delivering safety nets benefits, particularly in urban areas.
- iv. **The COVID-19 social protection response should build in strong accountability mechanisms across all key implementation processes to help offset the potential for administrative inefficiencies, political capture, fraud and corruption.** Risks could be compounded by logistical challenges and implementation inefficiencies, including high administration costs due to the need to balance between ensuring a swift response and adherence to social distancing practices. All key

⁴ As of 2015, only 8 percent of Malawians were using mobile money platforms, with most of these in urban areas (at 27 percent, compared to 5 percent in rural areas). However, the prevalence and usage of mobile-money platforms for both rural and urban poor is expected to have grown over the past few years.

implementation processes for the identification, registration, targeting, enrolment, payment, and case management should be managed transparently, with strong accountability mechanisms built into each key process. One way of minimizing fraud is to digitize and integrate the processes (registration, enrolment and payments), thereby minimizing manual interference, which is prone to manipulation. This could be complemented by phone-based or remote monitoring and grievance redress mechanisms.

Ensure trade and market activities continue

93. The Government should ensure that trade continues in order to supply critical goods in the Malawian economy. Additional measures can be implemented to support internal and external trade while ensuring that Malawians are supplied with essential goods, including food, agricultural inputs, and medicines, at regular prices.

- i. **Strengthening health and hygiene standards in markets and for key trade, production, processing, and marketing activities is a top priority as part of a smart containment approach.** As a nationwide lockdown may not be feasible, markets need to comply with hygiene standards to be safe places for people to access food and other essential items. Measures requiring masks to be worn in markets should be enforced, and similar measures should be expanded. In addition, mobile or decentralized markets could limit the number of people at a time. Moreover, workers in the food industry and seed dealers should comply with strict protocols to continue production while maintaining their safety. This also extends to workers in customs and immigration, regulatory agencies, clearing agents, cargo handlers, freight forwarders and transporters. Continuing sensitization campaigns are of paramount importance. This should be a collaborative effort between the Government and the private sector.
- ii. **A key priority is to systematically monitor and share information on trade, markets, and disruptions.** The current crisis makes it difficult to gain reliable data, increasing the importance of establishing a countrywide network of people who can report the effects of the crisis and feed into policy decisions. As such, the Government should enable close monitoring of trade and logistics disruptions, prices for essential items, and demand and supply disruptions for essential foods. This data should be made easily accessible and publicly available on the Malawi Trade Information Portal by creating a specific COVID-19 monitoring page with daily updates.
- iii. **The Government could also enable regulatory simplification.** There is a need to simplify the regulatory environment for essential foods, health and safety equipment and medicines. The Government could remove the need for certificates, licenses, permits and other pre-approvals required for essential goods that pose minimal risk to human health, environmental safety or consumer protection and prioritize streamlined testing procedures. This could further support small-scale traders by expanding and encouraging the use of simplified declarations and processes and being more responsive to consolidated cargo, particularly as small traders will need to consolidate shipments during this time. In order to simplify regulation and establish what can be eliminated, the Government should review essential goods and their requirements in terms of certificates, licenses, permits and other pre-approvals. In some cases, more than one import permit is required for a single product, which could present opportunity for rationalization. For example, the Department of Trade requires an import permit for the monitoring of grains, plant products and animal products, although this could be provided by trade data from the Malawi Revenue Authority's Automated System for Customs Data (ASYCUDA) software.
- iv. **Fast tracking border clearance would also expedite trade flows for essential items including food, health and safety equipment and medicines.** Cargo clearance procedures should be streamlined to allow the quick release and onward transport of essential goods. This would call for the Government to: i) enable and promote the use of pre-clearance processing for items beyond food; ii) introduce a duty/tax deferment scheme allowing clearance with later payment of the duties, taxes and related fees; iii) allow customs to undertake inspections on behalf of other border agencies and only where absolutely necessary for goods deemed higher risk; iv) expand

coverage of the authorized economic operator program so that more companies can benefit from fast-track clearance; v) implement separate lanes for commercial and civilian vehicles and complemented by; vi) separate 'green-channel' queue for clearances; and vii) increase acceptance of electronic document copies as means for full clearance without reliance on submission of hard/original copies.

Support firms and the financial sector

94. The Government has already announced significant measures aimed at cushioning the financial sector and the private sector. It further recognizes that it has limited fiscal space to support costly tax measures or direct support to various industries. Potential additional measures to consider to support firms could include:

- i. **Extend moratoria on interest and principal payments for loans from commercial banks and microfinance institutions.** The previously announced moratoria were for only three months and have expired. RBM should assess, in consultation with banks, whether and how to extend these moratoria as well as the continued need for renegotiation and restructuring of loans, in order to provide needed support to the private sector and MSMEs, particularly as the impact of the pandemic accelerates.
- ii. **Enhance liquidity and lending support to the private sector and MSMEs.** Most loans and credit lines being extended by banks in this period are absorbed by large companies and Government, and only a limited number of SMEs. With increasing public domestic debt pushing up interest rates, the cost of borrowing will likely rise, especially for MSMEs who rely on smaller banks and MFIs. The cost of wholesale financing for these smaller financial institutions will become even more expensive, which will be passed on to customers, thereby reducing access to credit by MSMEs when they need it most. As such, in order to support liquidity to the MSME sector, an envelope of wholesale financing could be earmarked and ring-fenced to support banks, MFIs, and SACCOs extend credit to MSMEs. The Government can further introduce and enhance de-risking instruments such as credit guarantees for enterprises, to lower collateral amounts demanded by financial intermediaries.
- iii. **Accelerate repayment of Government arrears, particularly to MSMEs.** The Government has accumulated substantial arrears in recent years, which are being gradually cleared. Expediting clearance of arrears to MSMEs would help inject liquidity into the sector.

C. Protecting the future

95. In addition to containment and relief measures, Malawi should consider measures to boost recovery and resilience into the medium term. Malawi needs to return to a medium-term target of 5 to 5.5 percent growth in order to support job creation. Historically growth has been undermined by macro-economic instability and high inflation, which have contributed to one of the lowest investment rates in Sub-Saharan Africa. Therefore, the country needs to ensure that it prioritizes maintaining fiscal sustainability and price stability and strengthening governance in order to help increase investment to support growth. Moreover, policy reforms will be needed to improve preparedness for the next health crisis and adopt fiscally sustainable universal health care systems. Medium- and longer-term measures for a new administration were discussed in the June 2019 Edition of the Malawi Economic Monitor (Box 7).

96. Malawi needs to increase fiscal sustainability and build fiscal buffers to better handle the next shock. The accumulation of high cost domestic debt has led to increasingly limited fiscal space for managing shocks and increasing investment. Interest rates for Government borrowing have increased considerably since January 2020, which will further increase interest payments. As the new administration prepares the full fiscal year budget, this will require credible macroeconomic and revenue projections and sustainable expenditure targets, to avoid a continuous buildup of debt and arrears, which can increase domestic interest rates and crowd out private investment. It further calls for significant expenditure rationalization, in both the investment and recurrent budgets. It should avoid financing recurrent

expenditure by high cost domestic financing. The Government should carefully examine how to maintain a sustainable wage and pension bill after significant increases in recent years. It should also seek cost savings in goods and services expenditure. Moreover, the reforms to the FISP in recent years should be considered, including how they have significantly freed up fiscal space and reduced fiscal risk, by providing a fixed coupon subsidy and limiting the number of recipients to 900,000. In addition, domestically funded development expenditure has more than doubled in recent years, although many large projects have limited economic returns. The Public Sector Investment Program (PSIP) should be closely scrutinized to reduce projects to those which are high priority and are justified by borrowing costs of 10 to 22 percent. This could be supported by publishing an annual audit of the PSIP database. Finally, fiscal indiscipline has historically contributed to inflation by the monetization of deficits. Strengthening fiscal discipline will help reduce pressures to revert to monetization and thereby support lower inflation.

97. Implementing transparent and credible financial management practices will be essential to ensure value for money for limited fiscal funds. The rapid deployment of COVID-19 response funds have exacerbated pre-existing governance vulnerabilities across the Government including: the coordination and handling of emergency funds between MDAs; balancing the flexibility and accountability needed for time-sensitive, high-value procurements; the transparent receipt of emergency supplies at points of service delivery; and the efficient and equitable hiring of emergency personnel to deal with expanded service delivery needs. The increasingly decentralized and fragmented nature of health service delivery has only intensified these challenges, with reported challenges in bridging national and local COVID-19 response plans while a majority donor funding is often in programmed in parallel systems. Measures to mitigate these risks – both in the immediate COVID-19 response and broader service delivery efforts – will be critical to ensure that limited funds reach their intended purpose and avoid creating further fiscal pressures.

98. Strengthening oversight, financial management, and transparency of SOEs will be critical to reduce fiscal risks, mitigate corruption, and improve service delivery. The new Government has swiftly indicated a priority to strengthen oversight and transparency of SOEs. Doing so has the potential to improve their efficiency, avoid the realization of contingent liabilities and accumulation of arrears, and increase dividend payments—with the ultimate goal of improving service delivery. An immediate step to improve the operational efficiency of utilities would be to competitively fill vacant senior managerial positions at key energy sector institutions. Publishing the selection process, background, and allowances for new SOE board members would also improve governance in an area that has traditionally lacked transparency. The Government could also conduct independent forensic audits on parastatals with performance and integrity issues. It can further commit to the annual publication of a fiscal risk statement covering contingent liabilities and institutional risk factors. Moreover, increasing transparency of off-budget funds such as the Fuel Price Stabilization Fund could also increase the efficiency of public resources.

99. Increasing exchange rate flexibility can support competitiveness and help maintain reserves. Limited exchange rate flexibility of the kwacha against the US dollar for over three years has increased the real appreciation of the exchange rate, contributing to reduced competitiveness and private sector concerns about queues for foreign exchange. These concerns could be offset by some measure of exchange rate flexibility, which could further help preserve foreign exchange reserves for periodic shocks, in order to avoid potentially disruptive macro-economic imbalances. In addition, sustaining a prudent monetary policy will be key to maintain lower inflation.

100. Increasing diversification and commercialization in the agriculture sector will support growth and resilience. Malawi has been fortunate in that the COVID-19 crisis has struck in a year with good agricultural production. However, the shock provides an opportunity to strengthen agricultural production in the medium term. This will call for creating a predictable and transparent policy environment for agricultural products, to stimulate investment and commercialization, which can increase production and exports, while supporting food security. Historically, ADMARC's market interventions have often contributed to market distortions and high price volatility. Instead, ADMARC's market interventions should be transparent, timely, and predictable in order to support growth in the sector. Moreover, the Government should rebalance spending in the agriculture sector beyond input subsidies and maize

Box 6: How ICT can Support Malawi's COVID-19 Response and Recovery

Digital technologies and applications have been an effective tool for containing the spread of COVID-19 and mitigating its reach and adverse effects. Digital technologies such as big data and artificial intelligence have assisted authorities and health professionals with the monitoring of and tracing cases as well as accelerating vaccine research (e.g. DeepMind's AlphaFold system, Baidu's Linearfold algorithm). For instance, Korea's Ministry of Health and Welfare developed a self-diagnosis mobile application, which is mandated for all travelers to monitor and record their health status for 14 days after entry. The private sector is also using digital solutions in the fight against COVID-19. The unprecedented partnership between Google and Apple, two of the world's tech giants, came about in an effort to develop an interoperable contact tracing app, contributing to the global fight against the pandemic. In addition, digital platforms and national portals are increasingly utilized as a means for Governments to communicate with their citizens and continue the delivery of critical public services. According to the United Nations Department of Economic and Social Affairs (UN DESA), more than half of the UN member states (110 countries) have provided some type of information on COVID-19 on their national portals and platforms (UNDESA, 2020).

Digital solutions and Internet access have been pivotal in preserving livelihoods as well as in ensuring continuity of public and private sector activities. In countries where extensive social and physical distancing measures are in place, digital services and applications facilitate remote work. In particular, broadband connectivity is a crucial enabler for distance learning for students impacted by school closures due to COVID-19, accounting over 90% of the world student population, according to UNESCO (2020). To facilitate remote learning, mobile network operators, together with Governments, are offering zero-rating services for content on educational websites. Telekom Networks Malawi (TNM) signed an MoU with the Ministry of Education, Science and Technology of Malawi to offer free access to online education to students. Through this MoU, all students in Forms 1 and 2 can access courses through the ministry's website for free (Kapulula, 2020). Similarly, to ensure business continuity of SMEs in particular, Singapore's telecommunications regulator, IMDA, is providing a suite of technology solutions for remote working, visitor management, and productivity improvements, with industry leaders offering promotional packages and free trials of enterprise-grade solutions (IMDA, 2020). Also, operators are facilitating the use of mobile money by waiving user fees and adjusting the transaction limit for subscribers and agents alike. In Malawi, Airtel and TNM recently followed Rwanda, Kenya and Tanzania to remove user fees on mobile money services (Chauwa, 2020).

However, Malawi is heavily affected by the lack of access to affordable and good quality broadband connectivity. Combined with digital capabilities, digital access has become the lifeline through which Governments, businesses, and citizens continue to function while exercising social distancing. Additional bottlenecks hinder the digitalization of crucial applications and services, such as distance learning, telehealth and e-commerce. These include the low and uneven distribution of broadband devices and equipment, the limited broadband penetration across the country, the relatively high tariff on the ICT sector, and high wholesale bandwidth prices, which contribute to high retail broadband prices borne by consumers.

The Government should drive policy initiatives to facilitate the immediate expansion of broadband capacity, access and price reductions. One possible measure is leveraging connectivity to support health systems in partnership with the private sector, international organizations or development partners. In addition, it can operationalize universal service funds (USF) in a rapid manner by designing policies and rules so USF can help address connectivity gaps of health facilities, police, and other key Government institutions for the Covid-19 response. The Malawi Communications Regulatory Authority (MACRA) has already made strides by providing additional spectrum to operators at discounted rates to easily respond to increased bandwidth demand. Similarly, the Digital Malawi project supported by the World Bank is accelerating the rollout of free public Wi-Fi hotspots to provide connectivity for 30 critical public institutions, including hospitals and schools.

The COVID-19 pandemic and social distancing measures have accelerated digitalization of applications and services globally. The Government of Malawi should not miss the opportunity to support a digital transformation in delivering public services and communicating with citizens. To this end, the Digital Malawi project is currently supporting the development of a platform in Malawi to bring all Government services online that will help accelerate and improve interactions among Government entities, Government and private sector, and Government and citizens through a one-stop shop.

purchases to instead invest more in priority areas identified in the National Agricultural Investment Plan, including irrigation, which will further increase resilience in the sector in the face of weather shocks. It can further leverage ICT-based approaches to disseminate technology to farmers.

101. In addition, Malawi should actively promote a more diversified economy, which would help the economy rebound and increase resilience to shocks. One of the top constraints to business is limited and unreliable access to energy. As such, this will require that critical investment projects in energy

generation (such as the Mpatamanga Hydropower Project) and transmission continue during the crisis, in order to support structural transformation in the medium term. Strengthening the governance and financial performance of sector utilities will also be needed.

102. Malawi can further simplify business regulations and taxes. As it prepares a domestic resource mobilization strategy, tax policies and administration should be reviewed and revised to increase transparency, to reduce ad hoc changes, and to enable increased value addition and key growth-enabling sectors, such as ICT, and the development of SMEs. Supporting the development of the ICT sector can provide broader support for the response and recovery (see Box 6). Making progress on the Doing Business indicators including the bankruptcy/insolvency regime as well as ensuring an effective framework for international investment arbitration will encourage foreign direct investment. Tangible progress on these policies will be needed to strengthen competitiveness and increase investment, in order to increase job opportunities and incomes.

103. The Government can implement measures to further support the stability of the financial sector, while expanding access to finance to MSMEs. The Government should mitigate against financial sector risks by: i) developing a clear framework for removing the temporary prudential forbearance measures that have been put in place during the COVID-19 crisis; ii) strengthening the bank resolution framework; iii) developing long-term finance including the capital market; and iv) activating the deposit insurance framework. In addition, to support MSMEs' access to finance, the usage of the moveable collateral registry and credit reference bureau should be enhanced.

104. Finally, considering Malawi's ongoing vulnerability to climate and other exogenous shocks which have a strong impact on poverty, increasing resilience calls for creating a sustainable, shock-sensitive national safety net program. A priority should be re-targeting resources from less effective interventions to support the poor such as the FISP, toward more efficient programs such as cash transfers. Moreover, the Government should establish a concrete social protection financing strategy. It should establish and meet domestic spending budgets for safety net interventions, involving incremental commitments to national budget lines that clearly reflect core sector priorities. Finally, humanitarian assistance for food security and nutrition averaged 2.2 percent of GDP between 2011 and 2016, which is significantly higher than other countries in the region. However, safety nets and humanitarian assistance operate independently from each other, despite having many overlapping functions. Malawi could therefore also improve the shock sensitivity of social protection through greater linkages between safety nets and humanitarian assistance.

Box 7: Malawi's Medium- and Longer-Term Options for Charting a New Course

In the longer term, the new administration will face both daunting challenges and significant opportunities. Malawi has been able to achieve progress on the macroeconomic front with lower inflation, combined with the recent peaceful democratic transition. However, the country continues to face enormous challenges, with uneven and skewed improvements in human development, with much less significant gains for the poorest 40 percent of the population.

Malawi's leadership will need to take bold actions to achieve higher rates of inclusive growth. Strong and decisive leadership is needed to chart a new course to enable the emergence of a vibrant economy that creates productive jobs and delivers quality basic services to its population. The 9th edition of the *Malawi Economic Monitor: Charting a New Course*, laid out the broader structural challenges the new administration will face and policy options for addressing these challenges. The report identified four key areas of policy priorities that the new administration should focus on, and which continue to be relevant:

- 1) **Malawi must lay solid foundations for growth by implementing supportive macroeconomic policies and establishing an effective public service.** The country has historically suffered from an unstable macroeconomic environment, which has been largely due to weak macroeconomic management and institutions. Together, these factors have undermined growth and failed to facilitate poverty reduction. To address this, the new Government must establish a clear commitment to maintaining fiscal discipline, to improving governance through a commitment to integrity, and to addressing corruption to improve service delivery.
- 2) **Malawi needs to transform the economy and increase growth to create productive job opportunities, and to ensure food security.** Malawi needs to achieve higher levels of economic growth and investment to facilitate structural transformation and to create productive jobs for its rapidly growing population. This will require a concerted, coordinated effort across the Government to change the Government's relationship with the private sector, and to proactively remove blockages to economic transformation within the agricultural and non-agricultural sectors.
- 3) **Malawi needs to strengthen its human capital by improving education and reducing fertility rates and stunting.** To achieve and sustain higher levels of inclusive economic growth, Malawi needs to continue to reduce its high fertility rates, particularly amongst adolescents. This will reduce the rate of incidence of stunting and relieve pressure on limited agricultural land and Government services. Additionally, the Government should implement measures to expand equitable access to higher quality education.
- 4) **Malawi needs to develop systems to increase resilience to shocks.** The frequency and severity of weather and climate shocks in Malawi have been rising, and Malawi's poor are highly vulnerable to shocks. Scaling up social safety nets can provide households with resilience to shocks but increasing and reforming the funding mix is necessary to increase effectiveness. Malawi is facing increasing climate risks, while current growth patterns are causing the massive depletion of natural capital. The Government should actively improve disaster risk management systems and implement measures to address land degradation. This will reduce the vulnerability to shocks and enable higher rates of sustained inclusive growth, while also reducing fiscal risks.

Box 8: Responses to COVID-19 in East Africa

Kenya has been one of the first countries in East Africa to respond. The Government earmarked about 0.4 percent of GDP for: (i) additional health expenditure in surveillance, laboratory services, isolation units, equipment, supplies, and communication; (ii) social protection and cash transfers; (iii) food relief; and funds for expediting payments of existing obligations to maintain cash flow for businesses during the crisis. The Government put forward for inclusion in its FY 2020-21 budget a stimulus package of up to 0.5 percent of GDP that includes a new youth employment scheme, provision of credit guarantees, and fast-tracking payment of value added tax (VAT) refunds. A package of tax measures has been adopted to provide full income tax relief for persons earning below the equivalent of US\$ 225 per month, reduction of the top pay-as you earn rate from 30 to 25 percent, reduction of the base corporate income tax rate from 30 to 25 percent, reduction of the turnover tax rate on small businesses from 3 to 1 percent, and a reduction of the standard VAT rate from 16 to 14 percent. In addition, the central bank: (i) has lowered its policy rate by 125 bps to 7.0 percent; (ii) lowered banks' cash reserve ratio by 100 bps to 4.25 percent; (iii) increased the maximum tenor of repurchase agreements from 28 to 91 days; and (iv) announced flexibility to banks regarding loan classification and provisioning for loans restructured due to the pandemic. Moreover, on April 15 the central bank suspended the listing of negative credit information for borrowers affected by COVID-19. Kenya has started easing its lockdown, one of the strictest of the region, with commercial flights restarting July 15 and international travel due to resume from August 1.

Tanzania has reopened its economy. To support the private sector, the authorities have expedited the payment of verified expenditure arrears with priority given to affected SMEs. The Government has also expanded social security schemes by US\$ 32.1 million to meet the increase in withdrawals benefits for new unemployed due to COVID-19 and granted VAT and customs duties exemptions to imported medical equipment and medical supplies. In addition, the Bank of Tanzania: (i) reduced the discount rate from 7 to 5 percent, (ii) reduced collateral haircuts requirements on Government securities, (iii) reduced the Statutory Minimum Reserves requirement from 7 to 6 percent, and (iv) raised the daily transactions limit for mobile money. Tanzania was one of the few countries in the region that did not implement any type of lockdown, and the Government has lifted the suspension on international flights and reopened educational institutions.

Uganda has mobilized resources to support critical sectors. The Government has used part of their Contingency Fund in the FY 2019-20 budget to finance the Preparedness and Response Plan and has sought a supplementary budget of US\$ 80 million to support critical sectors such as health and security. Another supplementary schedule of US\$ 288 million was passed in May 2020. The Government's mitigation response has five components: (i) recapitalizing the Uganda Development Bank so it can provide financing for manufacturing and import substitution, (ii) increasing agriculture production and productivity, (iii) provide additional funding to SMEs, (iv) delayed payment of taxes for SMEs and by affected sectors and expedited payment of outstanding VAT refunds, and (v) additional funding to the health sector. The Bank of Uganda has committed to providing exceptional liquidity assistance for a period of up to one year to financial institutions that might need it and waived limitations on restructuring of credit facilities at financial institutions that may be at risk of going into distress. Moreover, it has also worked with mobile money providers and commercial banks to reduce charges on mobile money transactions and other digital payment charges. The bank has reduced its central bank rate by 2 percentage points to 6 percent. Other measures include directing that all Supervised Financial Institutions (SFIs) defer dividend payments and bonus for at least 90 days and grant exceptional permission to SFIs to restructure loans of corporate and individual customers that have been affected by the pandemic. Uganda has also started reopening its economy since May 18, but schools are expected to remain closed.

Rwanda has implemented transfers of food provisions to vulnerable households and subsidized loans to affected companies. The Government's emergency response plan, including scaled-up health spending, is estimated at 3.3 percent of GDP. Support to vulnerable households has taken the form of regular door-to-door transfers of food provisions, cash transfers to casual workers, and subsidized access to agricultural inputs. Support to firms is envisaged in the form of subsidized loans from commercial banks and is expected to target SMEs and hard-hit sectors such as the hospitality industry. Tax relief measures include the suspension of down payments on outstanding tax for amicable settlement and the softening of enforcement for tax arrears collection. Rwanda's Central Bank announced liquidity support measures: (i) an extended lending facility worth RWF 50 billion (0.5 percent of GDP) available to liquidity-constrained banks for the next six months; (ii) Treasury bond purchases through the rediscount window for the next six months; (iii) lowering of the reserve requirement ratio by 100 basis points, from 5 to 4 percent. The Bank has also cut the policy rate by 50 basis points to 4.5 percent. Loan repayment conditions were also eased for affected borrowers, and charges on electronic money transactions waived for the next three months. Rwanda is also transitioning from a general lockdown to targeted lockdowns. International and domestic charter flights have been re-instituted and tourism attractions have reopened, while interprovincial travel restrictions have been lifted.

In Zambia, the mix of policies include increasing health spending, paying arrears, and providing liquidity to commercial banks. The Government announced a release of 0.75 percent of GDP to clear arrears and pay contractors. Import duties on mineral concentrate and export duties on metals were suspended to support the mining sector. The Government has set up an Epidemic Preparedness Fund amounting to 0.02 percent of GDP and approved a COVID-19 Contingency and Response Plan with a budget of 0.2% of GDP. Furthermore, 400 doctors and 3 000 paramedics were recruited to fight the COVID-19 pandemic. The Bank of Zambia lowered the policy rate by 225 bps to 9.25 percent. In addition, the bank plans to provide about 3 percent of GDP of medium-term liquidity support to eligible financial services providers and scale up open-market operations to provide short-term liquidity support to commercial banks. The Bank of Zambia has also implemented several measures to stimulate the use of electronic payments and reduce the use of cash. Zambia has started reopening most of its economy. Cinemas, gyms, restaurants, and tourist spots have been allowed to open adhering to some social distancing; and international airports are open since the first week of July.

Source: IMF Policy Tracker as of June 30, 2020, World Bank Policy Notes

Table 5: Macroeconomic Indicators

	2016	2017	2018	2019	2020 Proj.	2021 Proj.
National Accounts and Prices						
GDP at constant market prices (percentage change)	2.5	4.0	3.5	4.4	2.0	3.5
Agriculture	(2.3)	5.0	2.4	4.3	3.1	3.8
Industry	2.4	2.2	2.2	3.8	1.8	3.0
Services	4.7	4.0	3.4	4.5	1.1	3.2
Consumer prices (annual average)	21.7	11.5	9.2	9.3	10.1	8.4
Central Government (percent of GDP on a fiscal year basis)						
Revenue and grants	21.6	23.5	20.8	20.8	21.3	20.5
Domestic revenue (tax and nontax)	17.8	20.0	19.3	18.8	18.3	18.2
Grants	3.7	3.5	1.4	2.0	2.9	2.3
Expenditure and net lending	27.6	28.2	28.5	27.4	31.8	30.3
Overall balance (excluding grants)	(9.8)	(8.2)	(9.2)	(8.6)	(13.4)	(12.1)
Overall balance (including grants)	(6.1)	(4.8)	(7.8)	(6.5)	(10.5)	(9.8)
Foreign financing	1.9	2.5	2.5	1.1	1.9	2.4
Domestic financing	1.7	0.9	6.2	5.4	8.7	7.3
Amortization (zero coupon bonds)	2.5	1.3	(0.5)	(1.4)	(0.8)	-
Privatization Proceeds	-	0.3	-	-	-	-
Money and Credit						
Money and quasi money (percentage change)	15.2	19.7	11.4	8.1	14.3	-
Credit to the private sector (percent change)	4.6	0.4	11.5	21.3	7.8	-
External Sector (US\$ millions, unless otherwise indicated)						
Exports (goods and services)	1,180.1	1,053.2	1,112.2	1,237.7	1,260.3	1,365.1
Imports (goods and services)	2,405.3	2,780.7	2,927.1	3,030.8	3,095.3	3,226.2
Gross official reserves	605.0	757.4	750.1	819.5	861.0	900.0
(months of imports)	2.9	3.6	3.6	3.9	4.1	4.3
Current account (percent of GDP)	(18.9)	(22.4)	(20.5)	(17.8)	(18.3)	(18.5)
Exchange rate (MWK per US\$ average)	718.0	730.3	732.3	745.9	-	-
Debt Stock						
External debt (public sector, percentage of GDP)	31.3	32.4	31.2	29.7	30.6	30.0
Domestic public debt (percentage of GDP)	23.0	23.9	28.2	29.7	32.5	31.7
Total public debt (percentage of GDP)	54.3	56.4	59.4	59.4	63.1	63.0
Poverty						
International Poverty rate (US\$ 1.9 in 2011 PPP terms)	70.3	69.6	69.2	68.3	68.1	67.2
Lower middle-income poverty rate (US\$ 3.2 in PPP terms)	89.4	89.2	89.0	88.6	88.5	87.9
Upper middle-income poverty rate (US\$ 5.5 in PPP terms)	96.7	96.6	96.6	96.5	96.4	96.3

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

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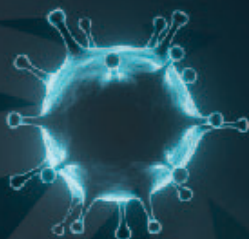
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