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Report No: PAD00106

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED GRANT

IN THE AMOUNT OF SDR 45.7 MILLION
(US\$60 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MALAWI

FOR

DE-RISKING IMPORTATION OF STRATEGIC COMMODITIES PROJECT (P500589)

NOVEMBER 7, 2023

Finance, Competitiveness and Innovation
Eastern and Southern Africa Region

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CURRENCY EQUIVALENTS

(Exchange Rate Effective October 6, 2023)

Currency Unit = Malawi Kwacha (MWK)

US\$1 = MWK 1159.73

US\$1 = SDR 0.76

FINANCIAL YEAR

April 1 - March 31

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ABBREVIATIONS AND ACRONYMS

| | |
|---------|--|
| ADB | Authorized dealer bank |
| AM | Accountability Mechanism |
| AML/CFT | Anti-Money Laundering and Combating the Financing of Terrorism |
| BAU | Business as usual |
| BP | Bank Procedure |
| CERC | Contingent Emergency Response Component |
| CCDR | Country Climate and Development Report |
| CPF | Country Partnership Framework |
| CRW | Crisis Response Window |
| DDO | Deferred Drawdown Option |
| DF | Development Finance |
| DFIL | Disbursement and Financial Information Letter |
| DISC | De-risking Importation of Strategic Commodities |
| DNFBP | Designated Non-Financial Businesses and Professions |
| DPO | Development Policy Operation |
| DSA | Debt Sustainability Analysis |
| E&S | Environmental and social |
| ECF | Extended Credit Facility |
| ESMS | Environmental and Social Management System |
| ESRS | Environmental and Social Review Summary |
| FAM | Fertilizer Association of Malawi |
| FI | Financia Intermediaries |
| FINES | Financial Inclusion and Entrepreneurship Scaling Project |
| FM | Financial Management |
| FX | Foreign Exchange |
| GDP | Gross domestic product |
| GHG | Greenhouse gas |
| GoM | Government of Malawi |
| GRS | Grievance Redress Service |
| GTFP | Global Trade Finance Program |
| IBRD | International Bank for Reconstruction and Development |
| IDA | International Development Association |
| IEG | Independent Evaluation Group |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| IPC | Integrated Food Security Phase Classification |
| IPF | Investment Project Financing |
| IPF-DDO | Investment Project Financing with Deferred Drawdown Option |
| LC | Letter of credit |
| LUCF | Land use change and forestry |
| MFD | Maximizing Finance for Development |
| MTI | Macroeconomics, Trade and Investment |
| NDC | Nationally Determined Contribution |
| OP | Operational Policy |

| | |
|------|--|
| PBA | Performance Based Allocations |
| PDO | Project development objective |
| PFI | Participating Financial Institution |
| PIU | Project Implementation Unit |
| RBM | Reserve Bank of Malawi |
| SML | Shorter-Term Maturity Loan |
| SORT | Systematic Operations Risk-Rating Tool |
| TFS | Targeted financial sanctions |

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DATASHEET

BASIC INFORMATION

| | | | |
|------------------------------------|---|--|---------|
| Project Beneficiary(ies) Malawi | Operation Name De-risking Importation of Strategic Commodities | | |
| Operation ID P500589 | Financing Instrument Investment Project Financing (IPF) | Environmental and Social Risk Classification Moderate | Process |

Financing & Implementation Modalities

| | |
|---|--|
| <input type="checkbox"/> Multiphase Programmatic Approach (MPA) | <input checked="" type="checkbox"/> Contingent Emergency Response Component (CERC) |
| <input type="checkbox"/> Series of Projects (SOP) | <input type="checkbox"/> Fragile State(s) |
| <input type="checkbox"/> Performance-Based Conditions (PBCs) | <input type="checkbox"/> Small State(s) |
| <input checked="" type="checkbox"/> Financial Intermediaries (FI) | <input checked="" type="checkbox"/> Fragile within a non-fragile Country |
| <input type="checkbox"/> Project-Based Guarantee | <input type="checkbox"/> Conflict |
| <input checked="" type="checkbox"/> Deferred Drawdown | <input checked="" type="checkbox"/> Responding to Natural or Man-made Disaster |
| <input type="checkbox"/> Alternative Procurement Arrangements (APA) | <input type="checkbox"/> Hands-on Expanded Implementation Support (HEIS) |

| | |
|---------------------------------------|--|
| Expected Approval Date 20-Nov-2023 | Expected Closing Date 30-Jun-2026 |
| Bank/IFC Collaboration Yes | Joint Level Complementary or Interdependent project requiring active coordination |

Proposed Development Objective(s)

The development objective of this project is to increase supply of trade finance for importation of essential commodities to Malawi.



Definition: For the purpose of this Project Appraisal Document (PAD), essential commodities refers to fertilizer, pharmaceuticals and potentially more strategically important commodities which will be selected by the client, subject to a 'No Objection' from the World Bank.

Components

| Component Name | Cost (US\$) |
|----------------------------|----------------|
| Trade Facility for Imports | 360,000,000.00 |

Organizations

Borrower: Ministry of Finance and Economic Affairs
 Implementing Agency: Reserve Bank of Malawi

PROJECT FINANCING DATA (US\$, Millions)**Maximizing Finance for Development**

Is this an MFD-Enabling Project (MFD-EP)? Yes
 Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

| | |
|-----------------------------|---------------|
| Total Operation Cost | 360.00 |
| Total Financing | 360.00 |
| of which IBRD/IDA | 60.00 |
| Financing Gap | 0.00 |

DETAILS**World Bank Group Financing**

| | |
|---|-------|
| International Development Association (IDA) | 60.00 |
| IDA Grant | 60.00 |

Non-World Bank Group Financing

| | |
|----------------------|--------|
| Commercial Financing | 300.00 |
|----------------------|--------|



Unguaranteed Commercial Financing

300.00

IDA Resources (US\$, Millions)

| | Credit Amount | Grant Amount | SML Amount | Guarantee Amount | Total Amount |
|--|---------------|--------------|-------------|------------------|--------------|
| National Performance-Based Allocations (PBA) | 0.00 | 60.00 | 0.00 | 0.00 | 60.00 |
| Total | 0.00 | 60.00 | 0.00 | 0.00 | 60.00 |

PRACTICE AREA(S)

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Macroeconomics, Trade and Investment

CLIMATE

Climate Change and Disaster Screening

Yes, it has been screened and the results are discussed in the Operation Document

SYSTEMATIC OPERATIONS RISK- RATING TOOL (SORT)

| Risk Category | Rating |
|---|---------------|
| 1. Political and Governance | ● Moderate |
| 2. Macroeconomic | ● Substantial |
| 3. Sector Strategies and Policies | ● Moderate |
| 4. Technical Design of Project or Program | ● Substantial |
| 5. Institutional Capacity for Implementation and Sustainability | ● Moderate |



| | |
|---------------------------|------------|
| 6. Fiduciary | ● Low |
| 7. Environment and Social | ● Moderate |
| 8. Stakeholders | ● Moderate |
| 9. Other | |
| 10. Overall | ● Moderate |

POLICY COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

Yes No

Does the project require any waivers of Bank policies?

Yes No

Have these been approved by Bank management?

Yes No

Is approval for any policy waiver sought from the Board?

Yes No

ENVIRONMENTAL AND SOCIAL

Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

| E & S Standards | Relevance |
|---|------------------------|
| ESS 1: Assessment and Management of Environmental and Social Risks and Impacts | Relevant |
| ESS 10: Stakeholder Engagement and Information Disclosure | Relevant |
| ESS 2: Labor and Working Conditions | Relevant |
| ESS 3: Resource Efficiency and Pollution Prevention and Management | Relevant |
| ESS 4: Community Health and Safety | Relevant |
| ESS 5: Land Acquisition, Restrictions on Land Use and Involuntary Resettlement | Not Currently Relevant |
| ESS 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources | Not Currently Relevant |



| | |
|--|------------------------|
| ESS 7: Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities | Not Currently Relevant |
| ESS 8: Cultural Heritage | Not Currently Relevant |
| ESS 9: Financial Intermediaries | Not Currently Relevant |

NOTE: For further information regarding the World Bank’s due diligence assessment of the Project’s potential environmental and social risks and impacts, please refer to the Project’s Appraisal Environmental and Social Review Summary (ESRS).

LEGAL

Legal Covenants

Sections and Description

Conditions

| Type | Citation | Description | Financing Source |
|--------------|---|---|------------------|
| Disbursement | Financing Agreement: Section III - B - 1 | Notwithstanding the provisions of Part A of the Financing Agreement, no withdrawal shall be made: (a) for payments made prior to the Signature Date. (b) under Category (1) to pay the Guaranteed Amount, unless and until the Recipient through the Project Implementing Entity has provided evidence satisfactory to the Association in accordance with the Verification Protocol that an Eligible Event has occurred or a PFI has defaulted on its payment obligations to a Correspondent Bank for a continuous period of 15 days from the date the payments were due. | IBRD/IDA |



| | | | |
|--------------|---|---|----------|
| Disbursement | Financing Agreement: Section III - B - 3 | 3. If the Association determines at any time that the Grant proceeds were not used for payments supported by the evidence provided by the Correspondent Bank through the Project Implementing Entity, in accordance with the Verification Protocol, the Recipient shall request the Project Implementing Entity to obtain additional evidence from the Correspondent Bank, or, if the Association shall so request, the Recipient shall ensure that Correspondent Bank refunds the Association an amount equal to the amount of such payment. Unless the Association agrees, no further withdrawal shall be made to the Correspondent Bank, until the Correspondent Bank has provided such evidence or made such refund as the case may be. | IBRD/IDA |
| Disbursement | Financing Agreement: Section III - B - 2 | 2. Except as the Recipient and the Association may otherwise agree, the Recipient may request withdrawal(s) associated with a Letter of Credit or an Eligible Event described under Section III.B.1 (b) of Schedule 2 to of the Financing Agreement, for a cumulative amount not | IBRD/IDA |



| | | | |
|---------------|--|---|----------|
| | | exceeding the Guaranteed Amount. | |
| Effectiveness | Financing Agreement: Article V-5.01 (a) | The Recipient shall ensure that the Project Implementing Entity: (a) updates its existing Environmental and Social Management System to include project-specific requirements and procedures and thereafter disclose it, all in a manner satisfactory to the Association. | IBRD/IDA |
| Effectiveness | Financing Agreement: Article V-5.01 (b) | The Recipient shall ensure that the Project Implementing Entity: (b) prepares a Project Operation Manual in form and substance satisfactory to the Association. | IBRD/IDA |



I. STRATEGIC CONTEXT

A. Summary

1. **Summary: This project, De-risking Importation of Strategic Commodities (DISC), aims to establish a foreign currency (FX) trade facility to Malawi in the amount of US\$60 million.** The objective of this facility is to de-risk importation of strategic commodities, particularly fertilizer and pharmaceuticals, by providing backstopping on payment obligations of local issuing banks to their correspondent confirming banks. Currently, correspondent banks lack confidence to extend letter of credit (LC) lines to banks in Malawi due to the high-risk profile of local banks, which largely emanates from the country risk. The proposed facility will provide correspondent banks with the assurance that the World Bank, standing behind the Reserve Bank of Malawi (RBM), will assume the payment obligations of the local issuing banks in the unlikely event that local banks default on their payment obligations on their LC commitments for essential commodities, thereby increasing correspondent banks' confidence to extend LC lines to local issuing banks. This project will provide a bridging solution to respond to the acute shortage of critical and lifesaving commodities in the local market which, if left unaddressed, has the potential to trigger a huge food insecurity and health crisis. The Project sought and received a waiver from the Regional Vice President (RVP) to use condensed procedures for this urgent needs' operation, per Paragraph 12 under Section III of the IPF Policy. In terms of financing instrument, the project will use an Investment Project Financing with a Deferred Drawdown Option (IPF-DDO). IPF-DDO is an optimal financing instrument for this operation as it addresses the underlying issue of credibility by backstopping LC transactions through a contingent financing, against pre-defined triggers.

B. Country Context

2. **Malawi is a low-income country with one of the highest incidences of poverty, food insecurity and frequent climate shocks.** Malawi's population stands at 20.4 million with a gross domestic product (GDP) per capita of US\$645 in 2022¹, making it one of the poorest countries in the world. In the last two decades, real per capita GDP has remained largely flat. The internationally comparable poverty headcount ratio - US\$2.15 a day - for Malawi stands at 71 percent, one of the highest globally.

3. **Malawi relies on subsistence, rainfed agriculture, which limits its growth potential and increases its susceptibility to climate shocks, creating food insecurity.** About 84 percent of the country's population lives in rural areas, with high proportion of smallholder farmers who primarily engage in rain-fed subsistence agriculture. The agricultural sector contributes to more than 80 percent of total export earnings and total employment. However, there is a gender gap in agricultural productivity in that female farmers have lower productivity than their male counterparts; this is partly attributed to women having less access to productive inputs like fertilizer.² Subject to recurrent climate shocks, the recent Cyclone Freddy, inflicted severe damage on Malawi's economy, particularly on the agricultural sector. Cyclone Freddy was the most destructive in a series of increasingly frequent extreme weather events affecting Malawi, causing US\$505 million material loss and damage, as well as production losses equivalent to a

¹ World Bank, World Development Indicators. 2022.

² Joe-Nkamuke, U., K. O, Olagunju, K.O., E. Njuguna-Mungai, E., et al. 2019. "Is There Any Gender Gap in the Production of Legumes in Malawi? Evidence from the Oaxaca-Blinder Decomposition Model." *Rev Agric Food Environ Stud* 100: 69–92.



real GDP loss of 0.5 percent for 2023.³ The effects of the cyclone have particularly impacted the outlook for the agriculture sector in the coming season, with potentially grave consequences for the poorest. According to Integrated Food Security Phase Classification (IPC), 3.3 million people in Malawi are currently experiencing high acute food insecurity (IPC Phase 3).⁴ This number is projected to increase to 4.4 million (22 percent of the population) by October 2023.

4. Malawi is one of the most vulnerable and least ready country to respond to climate change, ranking 161 (out of 185 countries) in Notre Dame Global Adaptation Initiative's (ND-GAIN) index.⁵

Malawi is already exposed to various natural hazards, such as flood, cyclone, and extreme heat, which will worsen with climate change. Malawi's Country Climate and Development Report (CCDR) suggests that the average projected increase in temperature is 1.03°C by 2040 and 1.34°C by 2050. Globally and in southeastern Africa in particular, extreme precipitation events are expected to intensify and become more frequent. Warming will intensify very wet and dry weather, with implications on flooding and drought.⁶ In addition, Malawi is exposed to non-climate related disaster risks. Climate change and geophysical hazards could exacerbate the health and food insecurity crisis in Malawi. For example, rising temperatures could lead to an increase in outbreaks of vector- and water-borne diseases (for example, malaria and cholera). Increased dry spells and floods could reduce maize yields and earthquakes could trigger landslides, leading to further disruptions in agricultural supply chains and increasing food insecurity. As an example, according to the CCDR, the first year of the devastating drought in 2015–2017 left 6.5 million people food-insecure, including 3.5 million children. The Tropical Storm Ana in 2022 also destroyed 71,700 hectares of crops and killed or injured tens of thousands of livestock. Women and girls are particularly vulnerable to these risks. The CCDR pointed that women have inadequate access to healthcare and family planning. The CCDR also shows that women are more vulnerable to climate shocks to food consumption, partly due to their lack of access to land-tenure security.⁷

5. Currently, Malawi's economy is struggling with a toxic cocktail of foreign exchange shortage, high inflation, and large current account and fiscal deficits.

These macroeconomic challenges are reflected in a parallel market premium of above 50 percent, low forex reserves of less than one month of import cover, annual inflation of around 28 percent, and large current account and fiscal deficits equivalent to around 12 percent and 10.9 percent of GDP, respectively. The Government tried to ensure fuel and fertilizer importation by providing prioritized access to official financing by the RBM. But as the official reserve dwindles further, RBM and the banking sector in Malawi are finding it difficult to finance these strategic imports. An acute lack of FX is impeding businesses and is increasingly reflected in the shortage of critical and lifesaving imports such as fertilizer and pharmaceuticals.

6. Real Effective Exchange Rate: In 2022, the Malawi kwacha appreciated in real effective terms to an annual average Real Effective Exchange Rate (REER) index of 41.83 in 2022 from 41.34 in 2021, representing a loss in trade competitiveness of 1.2 percent. The outturn was due to an unfavorable inflation differential against trading partner countries. Malawi's average inflation differential compared to her trading partner countries worsened to 13.8 percent in 2022 compared to 3.9 percent in 2021. The

³ World Bank. 2023. Malawi Economic Monitor.

⁴ Integrated Food Security Phase Classification, Acute Food Insecurity Analysis for Malawi. 2023.

⁵ [The ND-GAIN Country Index](#) summarizes a country's vulnerability to climate change in combination with its readiness to improve resilience. A lower country ranking means that the country is more vulnerable and/or less ready to respond to climate change.

⁶ World Bank (2022). [Malawi Country Climate and Development Report](#).

⁷ World Bank (2022). [Malawi Country Climate and Development Report](#).



annual average domestic inflation edged up by 11.7 percent to 21.0 percent in 2022, compared to the basket foreign inflation which rose by 1.8 percent to an annual average of 7.1 percent in 2022. Subsequently, the Nominal Effective Exchange Rate (NEER) annual average index depreciated by 10.2 percent to 13.38 in 2022 from 14.90 in 2021.

7. **The September 2023 Debt Sustainability Analysis (DSA) by the World Bank Group and International Monetary Fund (IMF) indicated that Malawi’s external and public debt is assessed as “in distress” but debt is sustainable on forward looking basis.** The stock of public and public-guaranteed debt is projected to reach 79.5 percent of GDP in 2023, continued to be driven by both domestic and external debt accumulation. Continued reliance on domestic borrowing may lead to a liquidity squeeze, and deepening challenges for the government to secure required amounts from the market in 2023. Going forward, moderation of domestic debt would need to be supported by further fiscal reforms. The baseline macroeconomic framework underpinning the DSA entails significant fiscal adjustment and incorporate projected new financing from the World Bank and IMF. Nevertheless, large financing gaps would remain over this period and would need to be filled through a debt restructuring. Successful implementation of debt restructuring will be key to moderate external debt in the medium term. Debt dynamics are thus set to improve supported by an improved fiscal balance, significant growth in exports and moderation of imports.

8. **Cognizant of the macroeconomic challenges, Malawi’s authorities have reached out to the World Bank and IMF seeking support to restore a stable and sustainable macroeconomic position.** In September 2023, Malawian authorities and IMF reached a staff-level agreement on macroeconomic and financial policies and reforms to be supported by a new 48-month financing arrangement under the Extended Credit Facility (ECF) of US\$174.00 million.⁸ In parallel, Malawian authorities are in discussion with the World Bank on a new development policy operation (DPO). These foreseen World Bank and IMF operations will support the authorities’ ongoing efforts to restore a stable and sustainable macroeconomic position consistent with strong and durable poverty reduction and growth envisaged under Malawi 2063.⁹ Moreover, the authorities are working toward securing debt restructuring with bilateral official and external commercial creditors which is key to restore medium-term debt sustainability.

9. **As the envisaged macroeconomic reforms take time to take effect, a bridging solution is required to avoid disruption of critical economic functions.** In light of this, the Government of Malawi has made an official request to the World Bank requesting the latter to support the financing of imports of essential commodities, particularly fertilizer and pharmaceuticals. This project responds to the urgent needs of Malawi and is part of a package of World Bank and IMF programs aimed at tackling the country’s macroeconomic challenges. International banks have also confirmed that even after the underlying reform happen it will take time for regular trade finance to return to Malawi.

C. Sectoral and Institutional Context

⁸ The agreement is subject to IMF Management and Executive Board approval and receipt of the necessary financing assurances.

⁹ The Malawi 2063 (MW2063) aims to transform Malawi into a wealthy and self-reliant industrialized ‘upper-middle-income country’ by the year 2063.



10. **Malawi’s financial sector is small, shallow, and dominated by banks.** The financial sector consists of banks, microfinance institutions, a nascent capital market, and a small number of institutional investors (insurance and pension markets). As of December 2022, 59.5 percent of total financial sector assets were held in the country’s eight commercial banks. The banking sector in Malawi comprises eight banks. The two largest banks held 46.7 percent of the total assets and 48.1 percent of the loans in 2022. Four of these banks are privately owned and represent 56.2 percent of total net assets, while the remaining four are foreign owned and represent 43.8 percent of total net assets.¹⁰

11. **The Financial Sector is sound despite the economic challenges facing the country.** While the other sectors of the economy have grappled with the effects of a series of macroeconomic shocks that have hit the economy, the financial sector has remained resilient. The macroeconomic environment has weakened following adverse global conditions, including that of COVID-19, on the recent global commodity price and created its spillover effect on the domestic market. Nonetheless, the financial system in Malawi remains well capitalized, liquid, and profitable.

Figure 1: Bank Resilience Reflected in Financial Stability Indicators¹¹ (Percent)

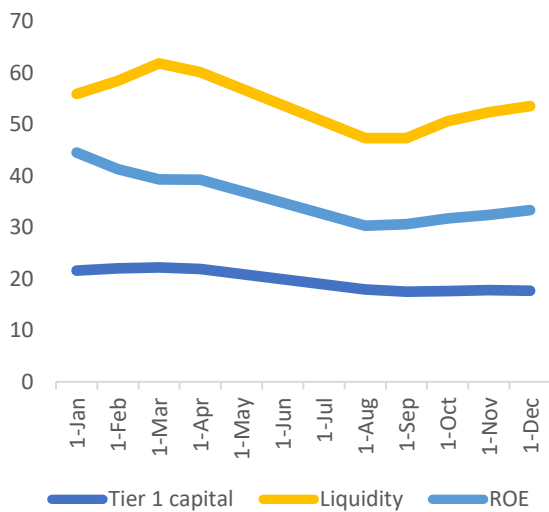
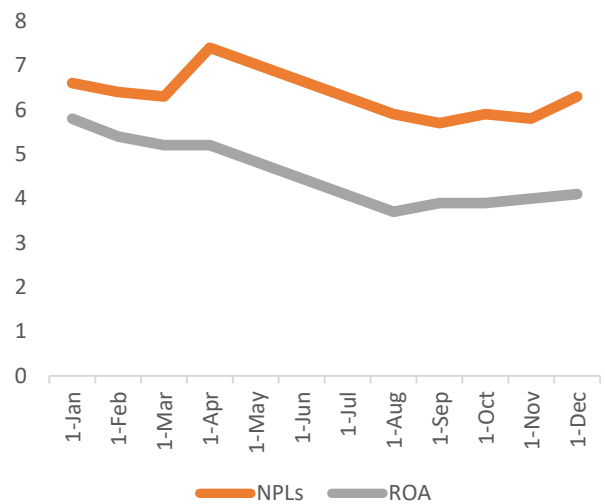


Figure 2: Bank Resilience Reflected in Financial Stability Indicators¹² (Percent)



¹⁰ Financial Institutions Annual Report for 2022, RBM 2022.

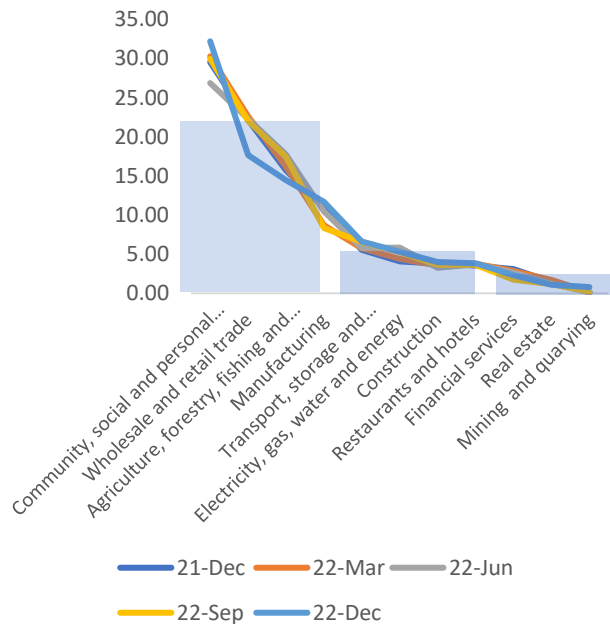
¹¹ Financial Institutions Annual Report for 2022, RBM 2022.

¹² Financial Institutions Annual Report for 2022, RBM 2022.



Figure 3: Bank Lending is Predominant in Three Sectors¹³

Monthly share to total lending in selected sectors



12. **Malawi has adopted a risk-based approach to supervise Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).** However, Malawi is yet to apply sanctions for violation of AML/CFT requirements by Designated Non-Financial Businesses and Professions (DNFBPs). Though Malawi has a legal framework to implement targeted financial sanctions (TFS) against terrorist financing and to some extent against proliferation financing (PF), implementation of the laws is at formative stage. Moreover, unlike the well-established commercial banks, small to medium financial institutions and DNFBPs are yet to effectively implement their TFS obligations.

Trade Finance

13. **Goods and services to Malawi are imported through open account, advance payments, payment guarantees as well as conventional letters of credit with or without paying cash up front.** Advance payments are rarely used by importers that source goods from their regular suppliers but are common for importers who are unable to establish credibility with their suppliers. Recently, there has been an increased reliance on LCs for import transactions due to FX scarcity which inhibited open account transaction.

¹³ Financial Institutions Annual Report for 2022, RBM 2022.

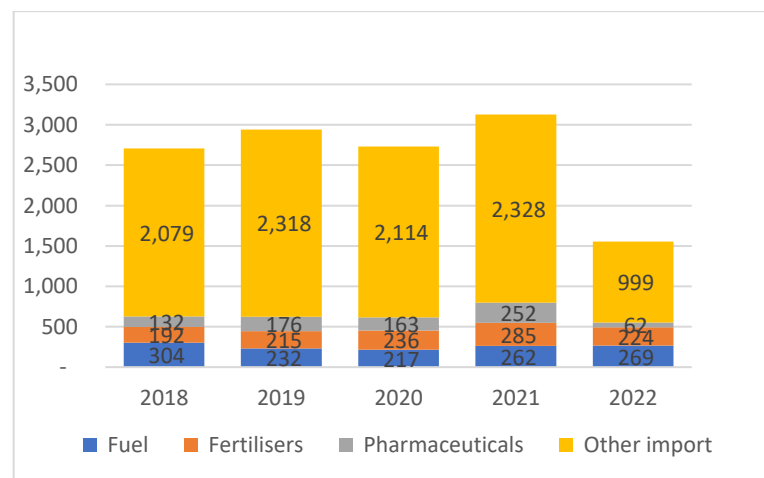


14. **Banks’ main sources of forex are its clients who are exporting, and receiving donor funds, or diplomatic missions who sell forex when they have financial obligations in local currency, and remittances.**¹⁴ Commercial banks get forex to sell to importers when the central bank sells forex in the market or when their customers with forex deposits sell part of their deposits. The RBM intervenes periodically by selling forex to banks to enable them to meet demand for payment of strategic import commodities. However, the RBM has not been able to do so in the recent past due to forex shortages and the new regulation that was introduced toward the end of 2021 requiring all exporters to convert 30 percent of their forex earning into local currency and to remit forex in the central bank. Thus, banks must continue to meet the said demands on their meagre export proceeds, donor aid projects, and remittances. Occasionally, commercial banks may run short currency positions (that is, borrow forex from their clients) to cover import bills.

15. **This lack of depth in the forex market implies that banks would not open LCs with forex amounts beyond what they think they can mobilize by the time the LC matures.** As a result, importers are no longer able to secure the FX needed to bring in products into the country. Some importers have indicated that they have not managed to get their banks to issue LCs, even at a premium price. Some international banks are not willing to confirm LCs while some are willing to confirm them but want to see upfront the cash in the account, which is a departure from the normal working procedures.

16. **Malawi’s import has been on a declining trend recently.** In 2022, the total import bill of Malawi dropped to US\$1.6 billion, down by 48 percent from US\$3.1 billion in 2021 (Figure 4). During the same period, the value of annual import of fertilizer and pharmaceuticals declined by 20 percent and 75 percent, respectively. The decline in volume of import is even more pronounced as there was a significant price increment for commodities over the last two years. In 2022, the total volume of fertilizer import stood at 239 thousand Metric Ton (MT), down by 44 percent from the total import volume of 431 thousand MT in 2021. The decline in imports is largely due to shortage of forex supply.

Figure 4: Annual Import Value (US\$, millions)¹⁵



¹⁴ Net remittance reduced to an average of about US\$12 million in 2021 from US\$20.6 million in 2019.

¹⁵ <https://www.trademap.org/>



17. **Malawi’s terms of trade have improved after declining for more than two years through June 2022.** The prices of many key commodities that Malawi imports such as petroleum fuel have decreased in recent months while the prices of Malawi’s core export commodities have stabilized at a high level (Figure 5). This is reflected in improved terms of trade since the second half of 2022 (Figure 6). The prices of Malawi’s commodity exports relative to its commodity imports are approximately at the level they were in late 2021, before the recent commodity price shock, and early 2019, before the onset of pandemic-induced disruptions.

Figure 5: Fertilizer and oil have been getting cheaper recently while Malawi’s main exports have held their value¹⁶

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

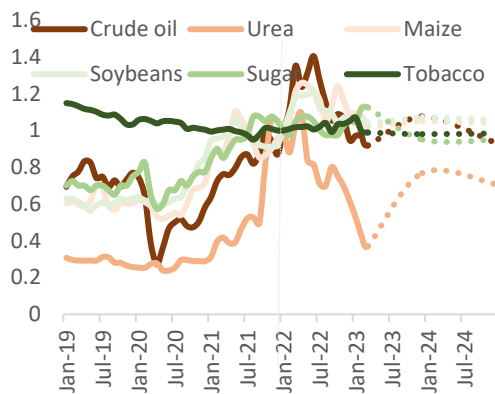
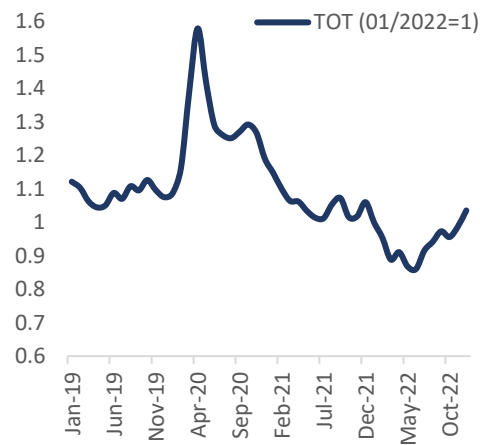


Figure 6: After a long decline, Malawi’s terms of trade are looking up¹⁷

Commodity terms of trade (01/2022 = 1)



D. Relevance to Higher Level Objectives

18. **The proposed operation supports the achievement of the World Bank’s goal of ending extreme poverty on a livable planet and is in line with the Evolution Roadmap.** Individuals and households stand to lose their livelihood and fall further into poverty or abject poverty without support measures to enhance supply of essential commodities such as fertilizer and pharmaceuticals.

19. **The proposed operation is well aligned with the Country Partnership Framework (CPF) for Malawi for the period 2021-2025 discussed by the Board of Executive Directors on May 4, 2021 (Report No. 154505-MW).** It contributes to the three focus areas of the CPF: (1) bolstering foundations for growth and accountability; (2) promoting private sector-led jobs and livelihoods; and (3) strengthening human capital development. The importation of fertilizers and pharmaceuticals will help reduce the likelihood of food insecurity and health crises, which disproportionately affect the vulnerable and poor, thereby contributing to the livelihood agenda of the CPF. Moreover, enhancing the supply of medicines will contribute to Objective 3.1 of the CPF which aims to accelerate the demographic dividend through strengthening targeted health systems. On the other hand, this project will foster key reforms to move away from the importation of essential commodities by the state and create space for the private sector to import essential commodities which is well aligned with Objective 1.1 of the CPF: Strengthening fiscal

¹⁶ World Bank staff calculations based on World Bank Commodity Markets data.

¹⁷ World Bank staff calculations based on World Bank Commodity Markets data.



and debt management for sustainability and resilience. Moreover, by avoiding direct public procurement and allowing private actors to import essential commodities, this operation also contributes to Focus Area 2: Promoting Private Sector-led Jobs and Livelihoods.

20. **The proposed operation is aligned with the recently announced suite of World Bank’s new and expanded actions to help countries respond quickly and effectively to economic and social crises¹⁸, these are expected to be discussed by the Board in December 2023.** The proposed approach is in line with World Bank’s toolkit for crisis preparedness, response, and recovery that includes: (a) redirecting financing to respond to urgent needs; (b) linking crisis preparedness and financing; and (c) backstopping development with private sector support. The Project sought and received a waiver from the RVP to use condensed procedures for this urgent needs’ operation, per Paragraph 12 under Section III of the IPF Policy. The proposed approach is in line with previous IPF-DDO use, including alignments with IDA financing. The forthcoming proposal to the Board will formalize the IPF-DDO modality as part of the crisis preparedness and response toolkit. The project is also aligned with IFC’s “3.0” strategy, which defines proactive measures to create markets and support expanded private sector investment activity, based on the recognition of the weakness of the financial sector and the need to create space for the private sector.

21. **The project is also closely linked to other operations in the Malawi Portfolio.** This includes the Financial Inclusion and Entrepreneurship Scaling Project (FINES, P168577), by working with several Participating Financial Institutions (PFI) that are part of that project and thus on whom due diligence has been carried out and as partners under an existing project are familiar with the World Bank’s environmental and social (E&S) and fiduciary requirements. Additionally, by facilitating fertilizer flows to the country this project will also enhance the outcomes of the World Bank funded projects in the agriculture sector such as the Malawi Agricultural commercialization project (P158434).

22. **The project is also aligned with Malawi’s climate mitigation and adaptation goals under its Nationally Determined Contribution (NDC) to the Paris Agreement.** Even though Malawi has one of the smallest greenhouse gases (GHG) footprints in the world, the country’s updated NDC lays out an agenda to reduce emissions across multiple sectors, including in energy, industrial processes, waste management and agriculture. Under the NDC, Malawi has an unconditional target to reduce GHG emissions by 6 percent no later than 2030 relative to a business-as-usual (BAU) pathway, and to keep emissions at 6 percent below BAU up to 2040. The conditional pledge is to reduce GHG emissions by another 45 percent before 2040. Given Malawi’s vulnerability to climate risks, the NDC also lays out more than 70 adaptation actions across a range of sectors, including water, agriculture and health. As further described in Annex 2, the project aims to support Malawi’s climate mitigation NDC goal by reducing GHG emissions associated with fertilizer use and road transport. This is done by developing good practice guidance with the Fertilizer Association of Malawi (FAM) and integrating climate considerations into the project’s E&S due diligence process. The project also aims to support Malawi’s climate adaptation agenda, as outlined in Malawi’s NDC and National Adaptation Plan Framework, by improving the country’s resilience to food security and health risks which will be exacerbated by climate change.¹⁹

II. PROJECT DESCRIPTION

¹⁸ World Bank Group Announces Comprehensive Toolkit to Support Countries After Natural Disasters: https://www.worldbank.org/en/news/factsheet/2023/06/22/comprehensive-toolkit-to-support-countries-after-natural-disasters?intcid=ecr_hp_headerZ_en_ext

¹⁹ Ministry of Natural Resources, Energy and Mining (2020). Malawi’s National Adaptation Plan Framework.



23. **The proposed operation will de-risk importation of essential commodities to Malawi by backstopping the payment obligations of local issuing banks to their correspondent confirming banks.** In effect, the project would assume the payment risk of local issuing banks to their correspondent confirming banks. Currently, correspondent banks lack confidence to extend LC lines to Malawian banks due to the high-risk profile of local banks, which largely emanates from country risk. As a result, Malawi is witnessing a huge deficit in the supply of essential commodities such as fertilizers and pharmaceuticals. The proposed facility will provide correspondent banks with the assurance that the World Bank stands behind the RBM and will assume the payment obligations of the local issuing banks in the unlikely event that local banks default on their payment obligations, thereby increasing correspondent banks' confidence to extend LC lines to local issuing banks. The facility is akin to a credit guarantee facility in its intent to make markets work by enhancing confidence.

24. **This project aims to expand the supply of trade finance by restoring confidence to the market and mitigating risks that would otherwise inhibit the activity of local issuing banks.** The relevance of this trade finance facility lies in its structure to make markets work, without undermining market solutions. The proposed operation offers an opportunity to enhance supply of trade finance through a market-driven solution that focuses on the private sector and leverages banking sector resources. The facility aims to support commercial banks in facilitating LC for private importers while leveraging a portion of their forex liquidity to achieve a multiplier effect and provide time for the market to correct itself. The program will also help local banks develop relationships with correspondent banks and enhance their trade finance capabilities. The additionality of this operation lies in the extent to which it helps enable viable trade transactions that would otherwise not occur because of the inadequate supply of trade finance for essential commodities.

25. **This operation will only support importation of essential commodities by the private sector.** Supporting a program of imports through the private sector is a more efficient approach that complements a set of reforms on the macro-fiscal front. This includes reducing the pervasive role of the State in importing commodities through a graduated pathway and enabling markets to function. The proposed operation through the private sector is consistent and closely linked with the broader reform agenda with less reliance of the import of strategic commodities through the state budget.

26. **The project will be working through selected PFIs.** There are eight commercial banks in Malawi and there is a selection and due diligence process that will be followed for the final selection of the PFIs. All PFIs will be selected based on an eligibility criterion that is a combination of the IFC and the World Bank's due diligence process that will be outlined on the operations manual. The assessments will cover: 1) Financial Performance; 2) Business Practices with a special focus on treasury operations given the nature of the project; 3) Governance arrangements especially concerned with related party lending; and 4) In-house ability to apply the World Bank's environment and social policies. Additionally, banks that are more active in the importation of commodities supported under this project will be selected.

A. Project Development Objective



PDO Statement

27. The development objective of this project is to increase supply of trade finance for importation of essential commodities to Malawi. For the purpose of this Project Appraisal Document (PAD), essential commodities refers to fertiliser, pharmaceuticals, and potentially more strategically important commodities which will be proposed by the client, subject to a 'No Objection' from the World Bank.²⁰

PDO Level Indicators

28. The achievement of the PDO would be measured by the result indicators below:

- (a) Total value of imports backstopped through this operation as a percentage of total imports of essential commodities to Malawi;
- (b) Total value of import supported by the backstopping facility;
- (c) Number of trade finance transactions supported by the facility.

B. Project Components

29. **The Project will have a single component, with a Deferred Drawdown Option (DDO), through which the World Bank will provide contingent financing to backstop the payment obligations of local issuing banks to their correspondent confirming banks.** By using an Investment Project Financing with a Deferred Drawdown Option (IPF-DDO) financing instrument, this component will provide contingent financing to the confirming banks against pre-defined triggers. This instrument has an added benefit of utilizing the released allocation whenever local issuing banks settle their payment on matured LCs, allowing to release earmarked positions from the contingent financing which can then be reused to backstop fresh LCs. In addition, given the nature of the instrument, in the event of no drawdowns the IDA allocation can be reallocated to other priorities after the close of the project.

30. **The Project is leveraging the IFC's Global Trade Finance Program (GTFP) to enhance the impact of the intervention.** Two windows are envisioned under the proposed operation: 1) working via GTFP; and 2) working directly with corresponding banks.²¹ GTFP will work with local issuing banks and correspondent banks to support the import of select commodities into the country. This will be done by the onboarding of selected issuing banks in phase 1 and later expand to include additional banks in Malawi. GTFP already has relationships with more than 300 correspondent banks and the expertise to help manage the facility effectively. If the issuing bank is not part of GTFP, the RBM facility will work directly with correspondent banks. Under both windows, IDA will backstop these transactions to settle payments with the correspondent banks in the case of default, be it via GTFP or directly.

31. **The main trigger for the partial or full drawdown of IDA financing from this component is the occurrence of events that require a payout to correspondent bank(s).** The trigger event for the drawdown of funds would be when local issuing bank(s) default on its/their payment obligations to a

²⁰ Note that fuel will be explicitly excluded.

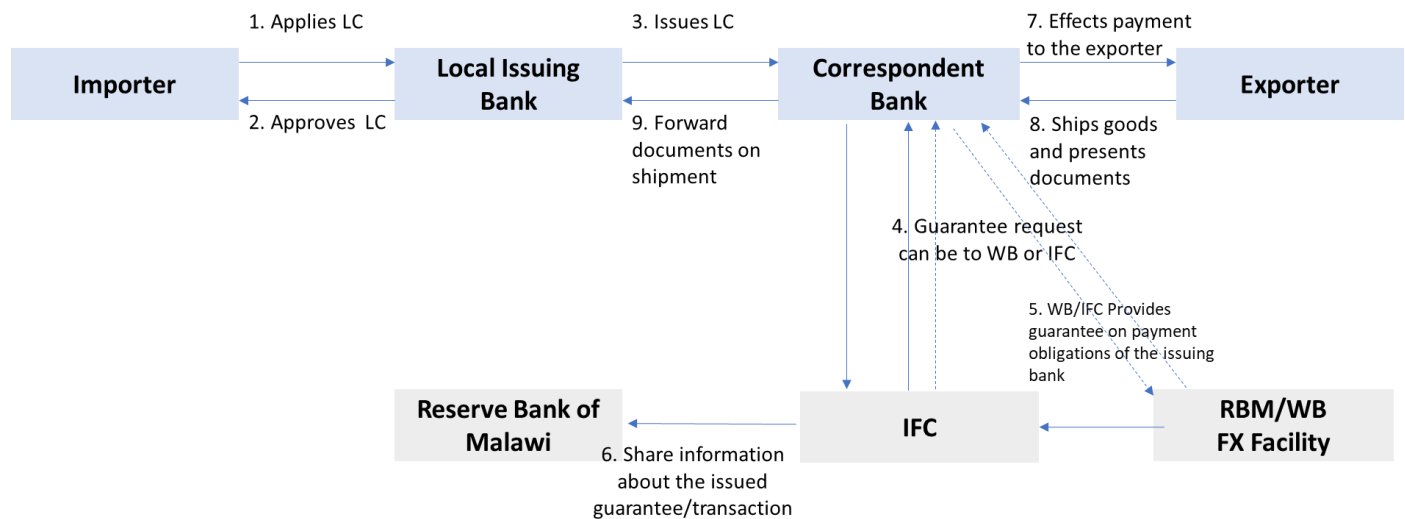
²¹ Window 2 is a risk mitigation measure in the unlikely event that GTFP is not able to expand its operations in Malawi.



correspondent bank for an LC(s) backstopped by this FX facility. A confirming bank may trigger payment if the local issuing bank fails to settle its payment on the due date. The facility will have a 15-day buffer period to settle the payment. In such instances, the confirming bank is required to notify payment default from the local issuing banks to the RBM and World Bank/IFC, and the World Bank/IFC needs to verify the payment request before providing clearance for payment. The maximum exposure of the World Bank payout is limited to the total budget allocated for this component. The workflow and procedures for triggering, and verification, of payment is indicated in Annex 1.

32. The diagram below illustrates the operation of a typical LC transaction supported by this project. First, an importer places an order for essential commodities from an exporter. Then, the importer’s bank issues a LC through a correspondent bank. When each LC is issued, funds will be earmarked from the FX facility to backstop the transaction. If the local issuing bank could not meet its payment obligation when the LC matures, then funds will be drawn down from the FX facility and payment will be made to the correspondent bank. In such instances, the RBM will impose sanctions to penalize the defaulting bank.²² If the local bank settles its payment when the LC matures, earmarked positions from the FX facility will be released and used for other transactions again. An additionality for this financing arrangement is that in the likely event of no draw down at the end of the project, the earmarked position will be pulled back to Malawi’s IDA envelope and be used for some other development projects.

Figure 7: Workflow of a Typical LC Backstopped by the Proposed Operation



C. Project Beneficiaries

33. The direct beneficiaries of the project are local banks that will benefit from new or increased LC lines from confirming banks. Currently, prudential regulations based on Basel III requirements, which govern capital adequacy and leverage ratios, impact an international confirming bank’s confidence of doing business in high-risk countries such as Malawi. By substituting the payment risk of banks from Malawi with a backstopping from AAA rated World Bank/IFC, this operation can also help reduce capital costs for correspondent banks, thereby incentivizing them to extend more LC lines to local banks. Broadly,

²² This will help address potential moral hazard issues that may arise in the absence of sanctioning measures.



this operation will support Malawi's financial system through improved credibility and increased supply of trade finance.

34. **Given its inherent focus on making the markets work, in addition to local banks and the financial sector, this operation will also benefit a wide range of actors ranging from consumers to producers to importers.** Notably, this operation will have the following indirect beneficiaries:

- (a) **Farmers including women smallholders, and the wider Malawian society:** This operation will benefit farmers and the wider society by increasing the supply of fertilizers and medicine in the market, enhancing agricultural productivity and supply of agricultural products, and taming the price pressure on agricultural commodities. Given the pro-poor nature of eligible commodities for this operation – pharmaceuticals and fertilizer– people in the bottom of the income pyramid, particularly women and girls, are more likely to benefit from this operation. Fertilizer management in Malawi is facilitated by the FAM which has 20 members that represent all activities related to production, trade, and distribution of all types of fertilizer; the members cover more than 90 percent of the annual fertilizer consumption in Malawi. There are close to a thousand retail centers for fertilizers in Malawi with the expected beneficiaries numbering 1.5 million. Data from Malawi shows that there is a gender gap in agricultural productivity, partly attributed to gender gap in access to inputs including fertilizer with farm plots managed by men producing an average of 25 percent higher yields than plots managed by women with an estimated loss of US\$100 million per year.²³ Related research shows that the value of fertilizer used by women smallholders/women farm managers is 65 percent less than that used by male peers.²⁴ This Project would serve to improve access to fertilizer for women smallholders by increasing overall supply in the market and developing targeted mechanisms in collaboration with fertilizer retailers to disseminate information. However, the fertilizer suppliers in the country do not have any mechanisms to capture the gender of buyers and therefore it is not possible yet to develop a deeper understanding of where geographically gender gap is most pressing and what the seasonal variations might be. This information would be essential to ongoing marketing and information campaigns that fertilizer sellers can undertake as part of their regular market development activities. The project will work with the FAM to develop a gender disaggregated data collection mechanism to identify proportion of buyers who are women in order to better target its information and outreach campaigns geographically and seasonally. The FAM will collaborate with women smallholder cooperatives, farmers' associations, and community organizations etc. to develop and roll-out dedicated information and dissemination programs to educate women smallholders about availability and usage of fertilizers and develop targeted marketing strategies to facilitate increased access for women smallholders. Two indicators will be used to measure the reduction in the data availability and access to fertilizer gaps: Indicator 1: Gender disaggregated data collection system set up within the FAM.; Indicator 2: Number of women smallholders benefitting from the additional fertilizer imports under this operation.

²³ <https://blogs.worldbank.org/youth-transforming-africa/achieving-gender-and-youth-inclusivity-malawi-through-productive>

²⁴ [Joe-Nkamuke, U., Olagunju, K.O., Njuguna-Mungai, E. et al. Is there any gender gap in the production of legumes in Malawi? Evidence from the Oaxaca–Blinder decomposition model. Rev Agric Food Environ Stud 100, 69–92 \(2019\)](#)



- (b) **Private sector:** The proposed operation through the private sector is consistent and closely linked with the broader reform agenda of Malawi toward less reliance of the import of essential commodities on the state budget. Private sector actors such as importers and actors along the supply chain will benefit from an increased trade finance supply, allowing them to expand their business operation.

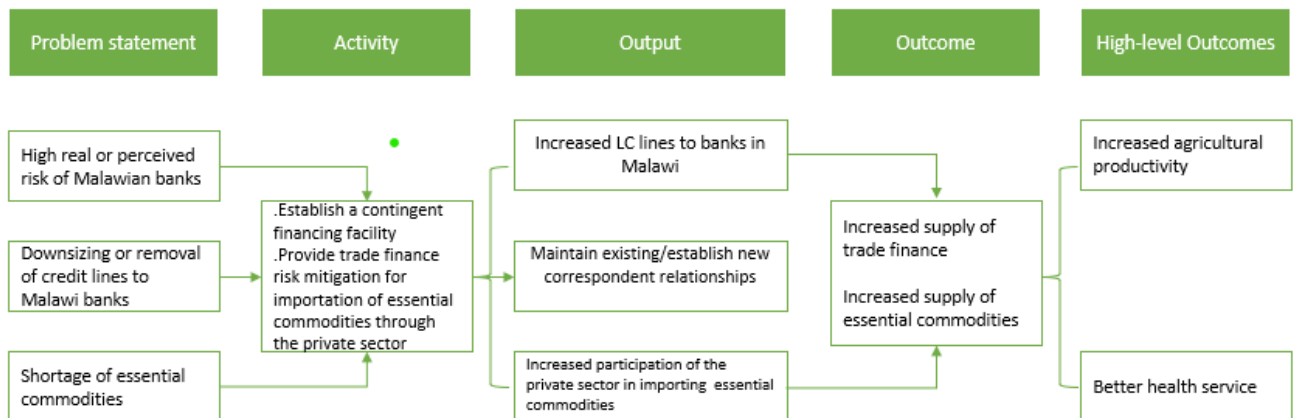
Figure 8: Gender Tag Results Chain





D. Results Chain

Figure 9: Results Chain



E. Rationale for Bank Involvement and Role of Partners

35. **This intervention is necessitated to respond to the urgent needs of importing fertilizer and pharmaceuticals into Malawi.** Due to the worsening macro-fiscal imbalances of Malawi and the subsequent increase in country risk, local banks are experiencing a drying up of LC lines which has translated into shortage of commodities in the country. And this is acutely felt in the shortage of critical and lifesaving imports such as fertilizer and pharmaceuticals. The major suppliers of pharmaceuticals reported that more than 60 percent of ‘must-have’ medicines are out of stock. The total stock of medicine has also dwindled from a typical coverage of 18 months to less than 2 months. As of August 2023, the stock of fertilizer in the country stood at 64,981 MT, which covers a mere 14.8 percent of the total fertilizer (440,000 MT) required for the upcoming planting season. If left unaddressed, this acute shortage of fertilizer and medicine in the local market has a potential to trigger a huge food insecurity and health crisis.

36. **Considering the need to respond to the acute shortage of critical and lifesaving commodities in Malawi, the World Bank has invoked Paragraph 12 of the IPF Policy.** These flexibilities in project preparation allow the World Bank to process the project with a condensed process to expedite the flow of necessary financing to enhance the supply of essential commodities in the country.

37. **This project is closely coordinated with the IFC and plans to utilize the GTFP platform.** The proposed operation will enhance confidence to unlock markets while buying time for the market to self-correct. This intervention is a bridging solution to restore confidence on local banks, enabling them to



work with IFC (with the support of the RBM/World Bank) or other market actors in the near future. In the meantime, this operation will be implemented in close collaboration with IFC team and will leverage the expertise and established networks of IFC. The duration of this project is deliberately capped at three years, to allow IFC and other market actors to step in in few years and allow the market to work as it should. The design of the project closely mirrors GTFP and thus at project sunset IFC would be able to step in. The selected PFIs are also those that indicatively IFC will be working with and some of which have already passed an integrity due diligence.

F. Lessons Learned and Reflected in the Project Design

38. **This operation builds upon existing World Bank, IFC, and Government of Malawi programs on enhancing access to trade finance, and lessons learned from prior projects.** Notably, this operation builds on and complements IFC's GTFP and the Independent Evaluation Group's (IEG's) review of the GTFP that provides valuable lessons on how to enhance the relevance, efficiency, and effectiveness of trade finance programs. This operation alludes to IEG's recommendation to strengthen trade finance interventions by focusing on areas where additionality is high and increasing the share of trade finance programs in high-risk markets where the supply of trade finance and alternate risk-mitigation instruments are less available. Additionally, when it comes to designing the financing instrument, this project is largely informed by Romania's Institutional Strengthening and Financial Safety Net Resilience Project (P171039) which is the latest World Bank financed project to use IPF-DDO.

39. **This project also complements and build on existing World Bank and Government of Malawi lending and analytical operations on the financial sector, particularly the FiNES project.** The project incorporates lessons from FiNES project on effective implementation of financial intermediation operations without distorting the market. The project will also leverage the existing soft infrastructures of FiNES to support implementation of this project. The project further builds upon the lessons learned from previous World Bank and IFC engagements on trade facilitation programs.

40. **Based on the development challenge an IPF-DDO is an ideal product for this operation.** The project design carefully balances two key objectives: to maximize impact (in terms of facilitating imports and trade finance) while also minimizing risks (including the risk of moral hazard). A contingent instrument therefore responds to the inherent uncertainty in the need and timing for cash outflows and the divergence of perception of credit risk between the issuing banks and the correspondent banks. An IPF-DDO enables the authorities to increase resilience to shocks (for example, further deterioration of macro-fiscal conditions, natural disasters, or a banking crisis). The presence of this facility in itself could be instrumental in providing a supportive environment and boosting confidence for the international correspondent banks. A guarantee is typically used to cover against the risk of non-payment by the government. The IPF-DDO aims to increase financial resilience to events outside the government's control. Given the emergency nature of the project and the unlikelihood of any drawdowns, an IPF-DDO is an efficient usage of IDA resources versus a straightforward IPF which will have limited multiplier effect and would count against the country exposure limits event after the project closes.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements



41. **Ministry of Finance and Economic Affairs will represent the GoM in signing the financing agreement with a deferred drawdown option, while RBM will be the main implementing agency for this operation.** As this trade finance operation falls under RBM’s mandate of ensuring price and financial stability, RBM is best positioned to implement the project.

42. **Implementation arrangement for this Project is expected to be fairly straightforward as it does not involve procurement of goods or services, and disbursements will only take place upon the occurrence of pre-defined trigger events.** To manage the reporting, E&S standards and (light) supervision functions, RBM will assign focal persons who will work closely with the FINES PIU. The principal activities of the implementing agency will comprise: (a) preparing environmental and social instruments, particularly ESMS and communication mechanisms in line with the Project Environmental and Social Action Plan; (b) gathering required documentation for verification of trigger events, (in case they occur) and use of funds (in case withdrawal(s) are requested), in accordance with protocols agreed with the World Bank; and (c) reporting on trade finance transactions supported by the project.

B. Results Monitoring and Evaluation Arrangements

43. **The outcome and intermediate indicators for the Project (listed in section VII), and the verification protocols (listed in Annex 1), will serve as the basis for results monitoring and evaluation.** RBM will be responsible for collecting the data required for monitoring and evaluation and for verification of the trigger events – in case they occur – and use of funds – in case withdrawal(s) are requested – based on protocols outlined in Annex 1. Indicators will be measured against agreed targets and compared to defined baselines. Project progress reports will be prepared by RBM on a quarterly basis.

C. Sustainability

44. **The sustainability of this operation is ensured through its inherent design feature to enhance the supply of trade finance without preempting existing market solutions.** A core design element for this operation is to help issuing and confirming banks establish direct relationships with each other that can then lead to enhanced flows of trade finance. By backstopping trade finance transactions between issuing and confirming banks through a contingent financing, this operation enables viable trade transactions that would otherwise not occur due to a credibility deficit.

45. **This sustainability feature of the project is further strengthened in its choice of the IPF-DDO financing instrument which provides contingent financing to the confirming banks against pre-defined triggers, thereby increasing correspondent banks’ confidence to extend credit lines to local issuing banks.** The envisaged structure of the financing instrument is of a standby facility such that whenever payments are made to matured LCs, the earmarked position will be released and used again to guarantee fresh LCs, thereby ensuring a continuous reflow of the financing unless drawdown is made in case of payment default. This arrangement also helps leverage additional resources from the market, which would not be possible in the case of a direct liquidity facility. Moreover, this operation helps local financial institutions establish working partnerships with correspondent banks and helps increase their LC lines and reduce cash collateral requirements. This enables the continued flow of trade credit into the market at a time when imports are critical.



IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis

Technical Analysis

46. Several measures have been taken to ensure the project's alignment with the Paris Agreement:

47. Alignment with climate mitigation goals: The project could increase Malawi's GHG emission from the use of fertilizers, although it should be noted that Malawi's use of fertilizers is still far lower than the global average. Since manure and synthetic fertilizers (which are key contributors to GHG emission) represent most of Malawi's importation, actions will be taken to reduce the impact of Malawi's fertilizer use on GHG emissions. Beyond GHG emissions from fertilizer use, the project could also increase GHG emissions from road transport. Road transport, like fertilizer use, is expected to contribute to a rise in Malawi's GHG emissions in the coming years, according to the CCDR. To address this risk to Malawi's climate mitigation agenda, the project will work with the FAM and other relevant counterparts such as the Ministry of Agriculture and Food Security and the Ministry of Natural Resources and Climate Change to develop best practices for reducing emissions from fertilizer use. Climate mitigation considerations will also be incorporated into the E&S due diligence and supervision to ensure Paris Alignment throughout implementation.²⁵ In addition, since the project could potentially support other types of commodities on a No Objection basis, the World Bank will ensure that a Paris Alignment assessment is conducted before deciding whether to proceed.

48. Alignment with climate adaptation goals: The climate and disaster risk screening suggest that this project is exposed to a range of climate and geophysical hazards, such as floods, extreme heat, volcanic eruptions, wildfire, and earthquakes, all of which could exacerbate existing development challenges related to health and food security. Women and girls are identified as particularly vulnerable to the impacts of these climate change and geophysical hazards on food and health, partly because of their lower access to healthcare and land tenure security. Even though climate-related natural hazards will have negative implications on the indirect beneficiaries of the project (e.g., farmers, low-income households), climate hazards are unlikely to have a material impact on the project delivery itself (i.e., enhancing trade finance). For this reason, adaptation measures for this project are not applicable.

Economic and Financial Analysis

49. **The project is expected to facilitate importation of essential commodities in the amount of US\$562.5 million over three years, nine times the initial IDA financing.** This financial leverage is enabled through: (a) the structuring of the instrument as a standby facility such that whenever payments are made to matured LCs, the earmarked position will be released and used again; and (b) leveraging own capital from correspondent banks. Historical data from RBM reveals that Malawi banks have never defaulted on their payment obligations to their correspondent confirming banks. Taking this zero default²⁶ rate, an

²⁵ For example, commodities that are imported via rail transport or blended biofuels could have a lower mitigation risk, and thus contribute to a lower E&S risk score. The project will also ensure that the E&S specialist for this project will have strong climate expertise and will receive training on Paris Alignment to ensure compliance throughout project implementation.

²⁶ This historical data on zero default should not be taken for granted as local banks may default in the absence of proportionate sanction and redress policy.



average of 180 days tenure for LCs, and a lag of 30 days from releasing an earmarked position to reusing the fund for fresh guarantees, US\$1 of the backstopping facility is expected to leverage up to US\$9 of trade finance in three years. This financial leverage is further compounded by own capital from correspondent banks which is estimated to fuel 25 percent of the total financing. Beyond helping leverage additional capital, a partial guarantee arrangement will allow correspondent banks to have a skin in the game. Details of the financial analysis is presented in Annex 2.

50. **Moreover, the project would lead to significant economic benefits for Malawi by increasing agricultural productivity.** Assuming 70 percent share of the backstopping facility will be used for importation of fertilizer, this operation will help facilitate importation of 210,000 MT of fertilizer per year. This accounts for 58 percent of the average annual fertilizer supply of Malawi. Taking an average consumption of 59 kilogram²⁷ per hectare and 88 percent productivity increase per hectare due to fertilizer usage, this supply of fertilizer would lead to a production gain of 2.3 million MT of cereals. On the other hand, assuming that 30 percent of the backstopping facility will be used for importation of pharmaceuticals, this operation will help facilitate annual importation of pharmaceuticals in the amount of US\$67.5 million, accounting for 43 percent of the average annual pharmaceutical import of Malawi (US\$157 million).

51. **Given that this is a pure market-based FX trade facility project, the project remains viable and has a high development impact.** In recent months, the government has renewed its focus on addressing exchange rate distortions and is working closely with the IMF and the World Bank to identify an appropriate exchange rate reform strategy to move toward market-reflective exchange rate in the context of the recently agreed ECF Staff Level Agreement. However, this project has no local currency component and is based on using the open market exchange rate to facilitate import of strategic commodities thus, though economically disruptive, the parallel exchange rate does not impact the mechanics of this project.

B. Fiduciary

(i) Financial Management

52. The proposed operation will rely on the existing organizational and management structures of RBM, as the financing mechanism for this project is straightforward with contingent payments made directly through the World Bank. In terms of financial management, RBM's role is largely limited to: (a) monitoring and reporting of trade finance transactions; (b) verification of payment requests from confirming banks, if payment is triggered; and (c) applying sanctioning/penalty measures on local banks that may default on their payment obligation. RBM has the requisite Financial Management (FM) arrangements for the successful implementation of World Bank-financed projects as demonstrated by its implementation of the Financial Sector Technical Assistance Project-FSTAP (P122616) and Financial Inclusion and Entrepreneurship Scaling Project- FINES (P168577). The entity has the appropriate accounting package to conduct project monitoring and reporting. The proposed operation will use existing system of internal controls, accounting and financial reporting. RBM has a well-established internal audit function that is accountable to the Board's subcommittee. The entity is also regularly externally audited as required by law. Throughout the implementation of the FINES and FSTAP, the FM arrangements of the RBM were assessed as satisfactory and with a moderate risk level. As the financial management role of

²⁷ World Development Indicators (WDI).



RBM for this project is minimal as compared to the broader role it plays in managing projects like FINES, the FM risk of the project is assessed as “low.”

53. **Disbursement arrangements.** Project funding will be made available on the occurrence of pre-defined trigger events and will be certified through verification protocols described in Annex 1. Project funds will flow from the World Bank by direct transfer or via GTFP to the correspondent bank. If the transaction is issued via the GTFP platform, the funds will flow through the platform; if not, the funds will flow through direct transfer. Transfers from the World Bank Loan will be initiated by submission of withdrawal applications accompanied by the notification by the World Bank (a) confirming that the disbursement condition has been met and (b) indicating the amount payable. RBM will be responsible for submission of withdrawal applications and submission of annual audits.

54. **Verification of trigger events and use of funds.** Upon occurrence of a pre-defined trigger event, correspondent bank(s) will have the right to request one or more withdrawals and their specific amount. Evidence of the trigger events – in case they occur – and use of funds – in case withdrawal(s) are requested – will be verified by the World Bank technical team after their occurrence, based on the information and documents provided by RBM and correspondent bank in accordance with the verification protocols. If the ex-post assessment determines that the requested funds – if any – were not used for the intended purposes, RBM will be required to refund the withdrawn amount. Withdrawal applications may be submitted at any time after the pre-defined trigger event has occurred, but in any case, not beyond the disbursement deadline date as defined in the Disbursement and Financial Information Letter (DFIL). In addition, RBM’s external auditors will conduct ex-post review of trigger events and use of funds annually (exceptions can be sought when audit is not required), in line with terms of reference satisfactory to the World Bank.

(ii) Procurement

55. **The Project does not trigger any World Bank procurement policies.** The proceeds from the Project will not be used for procurement of goods or services.

C. Legal Operational Policies

| Legal Operational Policies | Triggered? |
|---|------------|
| Projects on International Waterways OP 7.50 | No |
| Projects in Disputed Area OP 7.60 | No |

D. Environmental and Social

56. The Project will apply OP4.03, as the focus of this operation is letters of credit for backstopping of trade activities which are facilitated by private sector institutions to private sector institutions. The project will therefore apply the World Bank’s (IFC) Performance Standards (PSs), including relevant WBG



Environment, Health, and Safety (EHS) Guidelines, to all the activities implemented by RBM in lieu of the World Bank Environmental and Social Framework. The PSs are considered more suitable for this operation since RBM's existing Environmental and Social Management System (ESMS) is based on the IFC Performance Standards, and the Confirming Banks are more familiar with the PSs and in some cases have ESMS that are aligned with them. Under PS1 there is effective community engagement through disclosure of project-related information and consultation with local communities on matters that directly affect them.

57. The Environmental and Social Risk is rated as Moderate. The risk rating for environment is Moderate while for social it is rated as Low. The main risks relate to the limited capacity of the confirming and local issuing banks to manage environmental and social risks including ensuring that ESMS are in place and implemented proportionate to the nature and scale of their activities. Furthermore, the Borrower's framework and the institutions overseeing import and distribution of the commodities have weak E&S frameworks. Once purchased the commodities will enter the supply chain in Malawi through existing distribution channels using existing national systems. Poor road networks and road safety enforcement has resulted in multiple road accidents during commodity distribution. Furthermore, lack of community sensitization, especially children, to safety requirements of commodities, for example, fertilizer, has resulted in multiple poisoning cases, as well as pollution of water resources. The ESMSs of the borrowing banks will be required to consider the E&S frameworks for the procured commodities and recommend improvements especially regarding transportation, waste disposal, and community awareness to the safety issues of the commodities. There is a need for proportionate communication methods to be in place including for responding to concerns and complaints from stakeholders. The ESMS will also need to include requirements to ensure that distribution does not exclude vulnerable groups or those most in need. The development of the ESMS will exclude activities that may present a significant or high environmental risk, for example, oil-based fuels, and ensure that systems are followed to address any evolving risks, the exclusions are to be included in the Financial Agreement.

58. An Environmental and Social Task Team, consisting of a team of appropriately qualified ESHS consultants, will be established in the DISC Operation Project Management Team (PMT) to work with the World Bank's team to conduct a due diligence of each trade considering the E&S and fiduciary requirements and compliance with the exclusion list and make recommendations for go/no-go decision on making the proposed trade. The verification protocol in case of defaults will also include review of the E&S requirements.

V. GRIEVANCE REDRESS SERVICES

59. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by a project supported by the World Bank may submit complaints to existing project-level grievance mechanisms or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted to the AM at any time after concerns have been brought directly to the attention of Bank Management and after Management has been given an opportunity to respond. For



information on how to submit complaints to the Bank's Grievance Redress Service (GRS), visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the Bank's Accountability Mechanism, visit <https://accountability.worldbank.org>.

VI. KEY RISKS

60. **The overall risk rating of this operation is Moderate.** Risks rated as substantial and above are explained further in the paragraphs that follow.

61. **Macroeconomic risks (Substantial). Risks stem from stresses on the macro-fiscal space and significant inflationary pressures.** Moreover, external strains—including shortages of forex and a widening spread between official and bureau exchange rates - may heighten further. These macro risks may lead to a further downgrading of Malawi's credit rating which in turn may reduce access to trade credit, forex swaps, and other short-term loans. Conflicting signals on policy intentions can also adversely affect market participants' confidence. The Bank will monitor developments in the macroeconomy and respond to challenges accordingly.

62. **Technical design of the project (Substantial).** The technical design of the project presents substantial risks given that this is an intervention not done before in Malawi and one that involves multiple stakeholders working in tandem with each other. Additionally, the proposed backstopping facility may potentially create a moral hazard problem, that is, the risk of encouraging an adverse behavior. To mitigate this, the project will have effective communication channels between all stakeholders and have a living project manual that will be able to respond to the project. On the moral hazard side, first the project will work with financial institutions that have passed a due diligence screening by the project. This will help ensure that the project will work with financial institutions that are viable, creditworthy and have systems in place. Second, the project, as part of its operations manual, will put a cap on a single transaction limit that gets covered. This measure, in addition to the inherent reputational risk of banks that default, will serve as a disincentive for adverse behaviors. Third, RBM will put certain penalties on banks that default on their LC payment obligations; these penalties will be specified in the Project Operations Manual. A combination of these three measures will be used a deterrent for moral hazard problem.



VII. RESULTS FRAMEWORK AND MONITORING

PDO Indicators by PDO Outcomes

| Baseline | Period 1 | Period 2 | Closing Period |
|--|------------|-------------|----------------|
| Increase supply of trade finance for importation of essential commodities to Malawi | | | |
| Number of trade finance transactions supported by the facility (cumulative) (Number) | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | 8 | 20 | 32 |
| Total value of import supported by the backstopping facility. (Amount(USD)) | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | 80,000,000 | 200,000,000 | 300,000,000 |
| Total value of imports backstopped through this operation as a percentage of total imports of fertilizer and pharmaceuticals to Malawi (Percentage) | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | 10% | 15% | 20% |

Intermediate Indicators by Components

| Baseline | Period 1 | Period 2 | Period 3 | Closing Period |
|--|----------|----------|----------|----------------|
| Trade Facility for Imports | | | | |
| Number of local issuing banks and international confirming banks participating in the scheme (Number) | | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 | Nov/2026 |
| 0 | 2 | 3 | 4 | 4 |
| Default on LC payments guaranteed trade finance transactions (Percentage) | | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 | Nov/2026 |
| 0 | 10% | 10% | 10% | 10% |
| Percentage increase on the LC limits from confirming banks to local issuing banks (Percentage) | | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 | Nov/2026 |
| 0 | 5 | 10 | 15 | 15 |
| Gender disaggregated data collection system set up within FAM (Yes/No) | | | | |
| Sep/2023 | Jun/2025 | | | Jun/2024 |



| No | Yes | | | Yes |
|--|----------|----------|----------|----------|
| Number of women smallholders benefitting from the additional fertilizer imports under this operation (Number) | | | | |
| Sep/2023 | Jun/2024 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | TBC | TBC | TBC | TBC |
| Percentage of citizen complainants satisfied with response and grievance redress process (Percentage) | | | | |
| Sep/2023 | Sep/2024 | Jun/2025 | | Jun/2026 |
| 0 | 35 | 75 | | 85 |

Legal Operational Policies

Triggered?

Projects on International Waterways OP 7.50

No

Projects in Disputed Area OP 7.60

No

PDO Indicators by PDO Outcomes

| Baseline | Period 1 | Period 2 | Closing Period |
|--|------------|-------------|----------------|
| Increase supply of trade finance for importation of essential commodities to Malawi | | | |
| Number of trade finance transactions supported by the facility (cumulative) (Number) | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | 8 | 20 | 32 |
| Total value of import supported by the backstopping facility. (Amount(USD)) | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | 80,000,000 | 200,000,000 | 300,000,000 |
| Total value of imports backstopped through this operation as a percentage of total imports of fertilizer and pharmaceuticals to Malawi (Percentage) | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | 10% | 15% | 20% |



Intermediate Indicators by Components

| Baseline | Period 1 | Period 2 | Period 3 | Closing Period |
|--|----------|----------|----------|----------------|
| Trade Facility for Imports | | | | |
| Number of local issuing banks and international confirming banks participating in the scheme (Number) | | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 | Nov/2026 |
| 0 | 2 | 3 | 4 | 4 |
| Default on LC payments guaranteed trade finance transactions (Percentage) | | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 | Nov/2026 |
| 0 | 10% | 10% | 10% | 10% |
| Percentage increase on the LC limits from confirming banks to local issuing banks (Percentage) | | | | |
| Sep/2023 | Jun/2024 | Jun/2025 | Jun/2026 | Nov/2026 |
| 0 | 5 | 10 | 15 | 15 |
| Gender disaggregated data collection system set up within FAM (Yes/No) | | | | |
| Sep/2023 | Jun/2025 | | | Jun/2024 |
| No | Yes | | | Yes |
| Number of women smallholders benefitting from the additional fertilizer imports under this operation (Number) | | | | |
| Sep/2023 | Jun/2024 | Jun/2024 | Jun/2025 | Jun/2026 |
| 0 | TBC | TBC | TBC | TBC |
| Percentage of citizen complainants satisfied with response and grievance redress process (Percentage) | | | | |
| Sep/2023 | Sep/2024 | Jun/2025 | | Jun/2026 |
| 0 | 35 | 75 | | 85 |



ANNEX 1: Summary of Verification Protocol

| Trigger Event | Summary of Verification Protocol |
|---|--|
| <u>Eligible Event (Trigger) 1:</u> [Refer to LA] | Communication of the Occurrence of an Eligible Event: Official letter from Confirming Bank confirming that the Eligible Event occurred before the Closing Date, accompanied by (a) a copy of the original LC issued and (b) a copy of the notification sent by the Confirming Bank to the Malawian Bank alerting that Payment has not been made. |
| | Withdrawal of funds: Submission of a withdrawal application accompanied by the letter from the WB to RBM notifying WB acceptance of the evidence submitted in fulfillment of the conditions precedent to disbursement (that is, occurrence of the trigger event) for which withdrawal is sought and the maximum amount eligible for withdrawal. |
| | Use of funds: Account statements showing that the amount of WB funds withdrawn have been spent for compensation for the failure of payment made by the Malawian Bank |



Annex 2: Economic and Financial Analysis

Table 3.1. Assumptions and Computations for Economic and Financial Analysis

| | Source of Data/Computation | Value/Percent/Number | Assumptions | |
|---|----------------------------|--------------------------|---|---------------------------------------|
| | | | | |
| Total IDA financing | From the PAD | US\$60,000,000.00 | Guarantee coverage | 75% |
| Total financing | 1.25*60,000,000 | US\$75,000,000.00 | Private capital leveraged | 25% of IDA financing (US\$15 million) |
| Total import value to be backstopped per year | 75,000,000*3 | US\$225,000,000.00 | Estimated share of commodities from the total backstopping facility | |
| Total import value to be backstopped during the project period (2.5 years) | 225,000,000*2.5 | US\$562,500,000.00 | Fertilizer | 70% |
| Fertilizer import value to be backstopped per year | 0.75*225,000,000 | US\$157,500,000.00 | Pharmaceuticals | 30% |
| Average cost/MT | FAM | US\$750.00 | Average LC tenure | 6 months |
| Total volume of fertilizer import facilitated (MT) | 157,500,000/750 | 210,000 | Time lags from release of earmarked position to reallocating it for fresh LCs | 1 month |
| Average annual fertilizer import of Malawi (in '000 MT) | Trade Map | 362,000 (in '000 MT) | Average rolling rate per year (1 year/4 months) | 3 |
| Share of fertilizer import | 210,000,000/362,000 | 58% | | |
| Average value of annual import of pharmaceuticals (in US\$) | Trade map | US\$157,086,600.00 | | |
| Value of pharmaceutical import supported by this facility | 30%*225,000,000 | US\$67,500,000.00 | | |
| percentage of pharmaceutical product supported by the facility from the total required import | 67,500,000/157,086,600 | 43% | | |