AFGHANISTAN

In August the Taliban assumed power in Afghanistan, with immediate repercussions across an economy already facing daunting development challenges. Rapid reduction in international grant support, loss of access to offshore assets, and disruption to international financial linkages are expected to lead to a major economic contraction, increasing poverty and food insecurity, and macroeconomic instability.

Key conditions and challenges

The August political crisis has resulted in an abrupt cessation of most international aid and all international security assistance (security and civilian grant inflows were previously equivalent to 45 percent of GDP, financing 75 percent of public expenditure). Under international sanctions arrangements, Afghanistan has lost access to offshore central bank assets of around $9 billion (45 percent of GDP), while the capacity of commercial banks to transact internationally has been substantially curtailed. The financial sector has been hobbled by a shortage of both foreign and domestic currency notes. The combined impacts of rapidly declining grants, loss of access to offshore assets, and financial sector dysfunction are likely to include a sharp contraction of economic activity, inflation or shortages of imported goods, and a severe increase in poverty and hardship.

Beginning in April 2021, Afghanistan experienced a third COVID-19 wave. Infection rates have reached record highs, with less than five percent of the population fully vaccinated. At the same time, severe drought conditions are driving a mounting food security crisis. The UN is now estimating that the total number facing acute food insecurity could increase to 14 million (or more than one-third of the total population). As a result of recent conflict, an estimated 3.5 million internally displaced persons, 80 percent of whom are women and children, will need humanitarian assistance.

Recent Developments

Afghanistan’s economic growth was slow up to August 2021, reflecting weak confidence amid a rapidly worsening security situation. In addition, drought conditions negatively affected agricultural production. Output is expected to have contracted sharply since the Taliban takeover due to the combined impacts of a sudden stop in donor and government expenditure, disruptions to trade, and dysfunction of the banking sector.

Inflation accelerated gradually over the first half of 2021. Energy prices increased by 12 percent in the first half of the year in line with global trends. Prices for basic household goods, including food and fuel, increased substantially as the Taliban captured border posts and key transit hubs, disrupting supply chains. Inflation further accelerated following the Taliban takeover, reflecting depreciation, hoarding, and disruptions to international trade.

Government revenues fell short of budgeted levels throughout 2021, reflecting excessively optimistic revenue targets. Since mid-July, revenue performance worsened as the Taliban captured major border crossings. Budget execution faltered in the context of deteriorating security conditions for project implementation (the development budget execution rate was 28.4 percent at end-July, compared to 32.1 percent in 2020, and slowed sharply thereafter). By early August, the Taliban had gained control of customs points accounting for around 57 percent of total customs collections, equivalent to roughly 27 percent of total government revenue collection. In the Mid-Year Budget Review, government revised down revenue targets by 26 percent and slashed allocations to development projects and other discretionary expenditures by 45 percent (or $0.5 billion). Limited information is available regarding fiscal performance since the Taliban takeover. The interim Taliban government has resumed centralized customs collections, with daily collections equal to around 50-60 percent of the 2020 average.

The financial sector, already facing important constraints, has been pushed into crisis. Liquidity of both commercial banks and the central bank were substantially eroded in the lead-up to August 15, due to a high volume of cash withdrawals from commercial banks and intensified USD auctions. Banks ceased operating immediately following the Taliban takeover, and since reopening have faced major difficulties in processing international transactions due to central bank regulatory measures to control capital outflows and offshore corresponding banks’ reluctance to engage in transactions given sanctions concerns. Firms and households have been unable to access bank deposits, with strict limits imposed by the central bank on the withdrawal of USD and local currency. Constrained ability to process international transactions has undermined formal sector international trade, with firms unable to transfer funds overseas to pay for imports.

Severe uncertainty and anticipated lower donor inflows placed pressure on the exchange rate through the first half of 2021 with the Afghani depreciating by around four percent against the USD. The central bank responded through increased USD interventions (totaling $1.2 billion, or around 15 percent over 2020 levels) leading to a slight depletion of international reserves. Money market fragmentation and sporadic Taliban efforts to control rates offered by traders preclude any accurate assessment of exchange rate movements since the Taliban takeover.

The poverty rate for the April-September 2020 period was estimated at 49.5 percent. Poverty is expected to have remained at similar levels over the first half of 2021, with recovery from the COVID-19 crisis impeded by political developments and drought conditions.

Outlook

The economic and development outlook is stark. Sharp reductions in international aid are driving a collapse in basic health and education services. The sudden loss of public sector activity will have impacts throughout the economy, especially in the service and construction sectors (which account for 58 percent of GDP). Declining grants combined with a loss of access to foreign exchange is expected to result in a balance of payments crisis, with Afghanistan historically reliant on grant inflows to finance its very large trade deficit (28 percent of GDP in 2020). On the current trajectory, Afghanistan is likely to face depreciation of the Afghani, inflation, and shortages of critical household goods, including food and fuel (around 80 percent of electricity, between 20-40 percent of wheat, and nearly all fuel oil is imported).
A substantial share of the population is expected to move below the poverty line, reflecting negative impacts through employment and price channels. Ten million Afghans are vulnerable to falling into poverty, living with incomes between one and 1.5 times the poverty line ($0.94 per person per day). The food security situation will also deteriorate, with potential long-term negative impacts given Afghanistan’s young population.

Note: The World Bank has paused disbursements in our operations in Afghanistan and does not have the authorizing environment to engage in financing. We are closely monitoring and assessing the situation in line with our internal policies and procedures. As we do so, we will continue to consult closely with our Board of Directors, the international community, and development partners.