AFGHANISTAN

After a severe contraction in the gross domestic product (GDP) of 20.7 percent in 2021, signs had emerged by mid-2022 that the Afghan economy was settling around a fragile low-level equilibrium. Revenue collection by the Interim Taliban Administration (ITA) was at levels comparable with previous years. In addition, the exchange rate had stabilized, exports increased, and imports showed resilience. Yet these signs of stabilization could not override the substantial pressures Afghan families faced in sustaining their livelihoods. The contraction of the aid-driven service and security sectors had widespread spillovers into other sectors of the economy, affecting the entire welfare distribution. Recent data suggest that aggregate demand has weakened in winter as activities around agriculture, construction, and other associated sectors have slowed. However, this seems broadly in line with seasonal trends.

Key conditions and challenges

The political crisis of Aug 15, 2021, morphed into an economic confidence crisis. The cessation of aid caused a collapse in aggregate demand. The freeze of central bank reserves and the indirect effects of sanctions crippled the financial sector, resulting in a rapid depreciation of Afghani (AFN) and a spike in inflation. Job losses and economic deprivation remained widespread as the economy adjusted to a lower-level equilibrium during 2022 when aid was partially resumed (off-budget and on a smaller scale at about US$3.5 billion compared to US$9 billion in 2020), shipments of cash in US$ (amounting to nearly US$1.8 billion in 2022) by the United Nations eased hard currency shortages and supported exchange rate stabilization. The ITA managed to restore some basic public services and collect revenues.

Some key challenges persist. The financial system remains constricted; trade and other payments flowing into and out of Afghanistan are carried out to a large extent through informal channels. Moreover, the low demand remains a critical constraint to the rebound of the private sector. Poverty was already high at 47 percent in 2019-2020. Recent data shows that by mid-2022, two-thirds of Afghan households reportedly could not afford food and other basic non-food items, forcing many adults to engage in low-productivity activities to generate income. Living conditions during the harsh winter months appear to have worsened partly because of significant electricity shortages in cities.

Recent developments

After remaining elevated during most of 2022, year-on-year headline inflation decelerated substantially to 5.3 percent in December 2022, when the base effect of the exchange rate depreciation took full effect. A reduction in international prices, exchange rate stability, and a seasonal weakening of aggregate demand supported this trend. The slackening of cereal price increases provided some respite for households—especially those at the bottom 40 percent of the welfare distribution. However, the cyclical slowdown of the economy during the winter season translated into a contraction of income-generation opportunities for self-employed and casual workers.

Merchandise exports were strong in 2022. Afghanistan's exports reached US$1.9 billion in 2022, more than twice the average of the previous four years. Unofficial customs data show that a surge in vegetables, minerals, and textiles exports—collectively contributing 94 percent of total exports—drove the strong performance. Major export destinations included Pakistan (63 percent) and India (22 percent). Coal became a significant export commodity (at around US$0.5 billion) for the first time as Pakistani importers switched to cheaper Afghan coal. Food exports to Pakistan also surged (to about US$0.5 billion, compared to US$0.16 billion in 2021) as devastating floods in Pakistan created additional demand. The labor-intensive nature of the exports suggests that at least some windfall gains due to the export surge could have benefited workers in those sectors.

Afghanistan's merchandise imports showed resilience in 2022, reaching US$6.3 billion, like the 2019 level (US$6.5 billion). Major imports include minerals/fuels (21 percent), food products (18 percent), and textiles (10 percent), which collectively contributed around half of the total imports. The primary origin countries for Afghanistan's imports were Iran (22 percent), Pakistan (17 percent), and China (17 percent).

The AFN has recovered following its initial depreciation and remained stable during 2022. The AFN value against the US$ hovered between 87 and 90 over Q4-2022 and, as of January 31, 2023, is trading close to 89.6 AFN/US$—a depreciation of 3.9 percent from its August 15, 2021 value. Cash shipments of US$ and strengthened ITA controls such as regulating the Money Service providers (MSP) sector and prohibiting foreign currency-denominated domestic transactions have supported exchange rate stability. The consistent availability of US$ in the domestic market and a stable AFN suggest that the ITA was able to identify sources to finance the estimated US$2 billion current account deficit for 2022.

Unofficial revenue statistics show that between March 22, 2022, and January 21, 2023 (the first ten months of the fiscal year), collection amounted to AFN149.6 billion (US$1.68 billion), in line with 2020 figures. The most collection comes from indirect taxes collected at borders. The latest available data show that revenue from inland sources totaled AFN 68.6 billion (US$0.8 billion), with non-tax sources contributing the most. Non-tax sources, primarily from royalties (from coal mining) and administration fees collected by ministries, contribute 52 percent of total inland revenues. Anecdotal evidence suggests significant revenue receipts are one-offs (e.g., arrears collection). The availability of public expenditure statistics remains limited. However, it seems that the ITA is using off-budget resources and mining concessions to finance the development projects such as the Qosh Tepa Canal (the first phase of 108km, out of a total of 285km).

The banking sector showed some signs of normalization amid large-scale financial disintermediation. The liquidity situation appears to have improved: although withdrawal limits remain in place for pre-August 15 deposits, most banks can service individual withdrawals up to the limit. At the same time, there is no withdrawal limit for fresh deposits. Deposits appear to have stabilized after decreasing 30 percent from January 2021 to June 2022. Banking sector vulnerabilities have deepened, however. International payments and trade finance are held back by the fractious correspondent banking relationships. The quality of assets is deteriorating, the transition to Islamic finance constrains lending, and banks' revenues from core functions declined by 32 percent. Stability risks are elevated—absent the current forbearance measures; most banks would be undercapitalized. The microfinance sector is dire and close to insolvency unless new equity is injected.

Outlook

Under the baseline scenario, in which Afghanistan continues to receive humanitarian and basic service support from the international community (amounting to about 20–25 percent of GDP), the economy is projected to move to a low growth trajectory (2.0 to 3.0 percent) during 2023–25, with no improvement in per capita income due to high population growth. Inflation is projected to remain between 5 and 10 percent, close to the historical average. Under this scenario, poverty is likely to remain high until the economy has identified new sources of growth that provide income-generation opportunities, especially for the large number of self-employed workers that represent 80 percent of the employment.

The new low-level equilibrium remains fragile, with significant downside risks. First, the non-inclusive nature of the regime and its regressive gender policies, most noticeably the December 2022 edicts, may reduce external support and, over the medium term, result in a loss of human capital, which will permanently lower future growth prospects. Second, the stoppage or reduction of cash shipments of US$ could undermine exchange rate stability. Other risks include the inability of the economy to finance the current account deficit and the worsening of stability concerns in the banking sector. If these risks materialize, real GDP will contract in 2023, pushing even more people into deprivation and food insecurity and potentially creating regional and global negative spillovers.