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AFGHANISTAN DEVELOPMENT UPDATE JULY 2020

SURVIVING THE STORM

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Preface

The Afghanistan Development Update, which is published twice a year, provides a comprehensive report of the state of the Afghan economy. It covers recent economic developments and the medium-term outlook for Afghanistan. Each edition includes Special Focus sections providing in-depth analysis on specific topics.

The Afghanistan Development Update is intended for a wide audience, including policy makers, the donor community, the private sector, and the community of analysts and professionals engaged in Afghanistan's economy.

This report was prepared by Habiburahman Sahibzada, Sayed Murtaza Muzaffari, Tobias Haque, and Anna Custers. Assistance was provided by Sardar Ghani Ahmadzai. The special topic section was provided by Cesar Cancho and Tejesh Man Pradhan (Section C), and Anna Custers and Cesar Cancho (Section D). The report was prepared under the overall guidance of Manuela Francisco (Manager for South Asia, Macroeconomics, Trade, and Investment) and Henry G.R. Kerali (Country Director).

The authors are grateful for the cooperation received from Government officials in sharing data and statistics and providing comments on draft versions of the report.

From 2021, the World Bank will be aligning publication of Development Updates for all countries across the South Asia region. The next Afghanistan Development Update is therefore now planned for May 2021.

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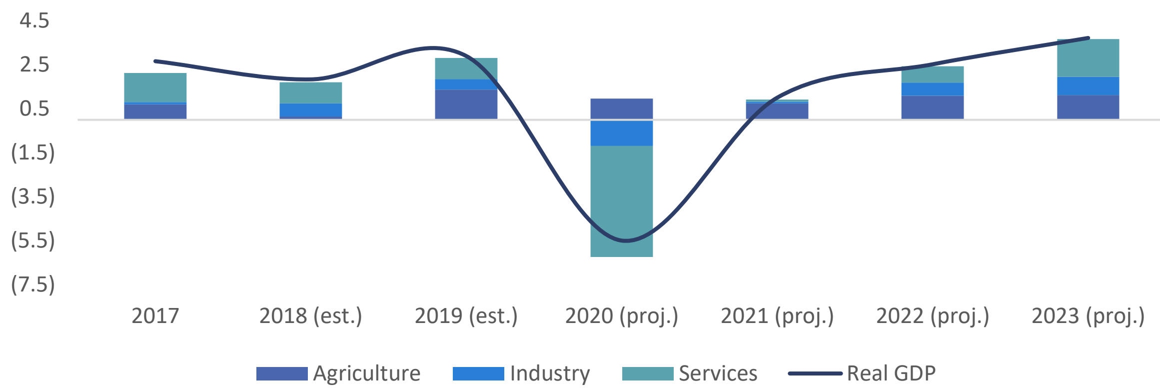
Economic impacts of the pandemic are already severe and could worsen

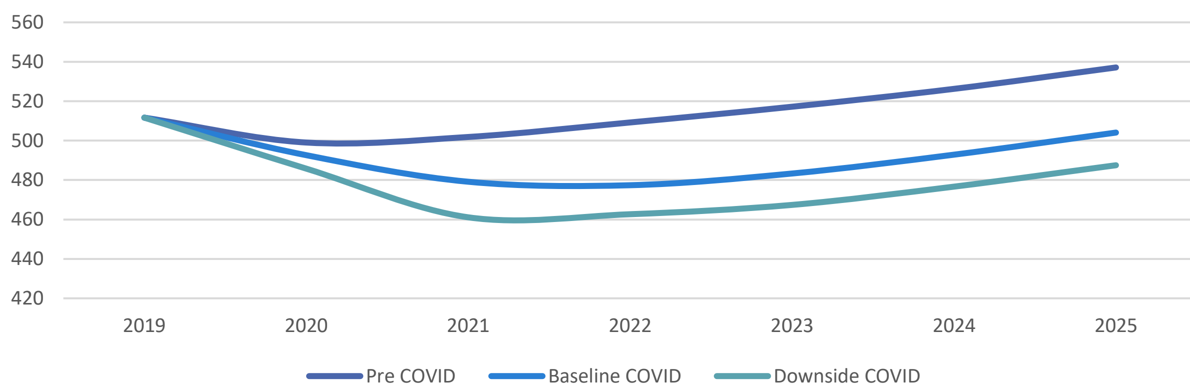
Real GDP Growth by Sector (Percent)



Source: National Statistics and Information Authority and World Bank staff forecast

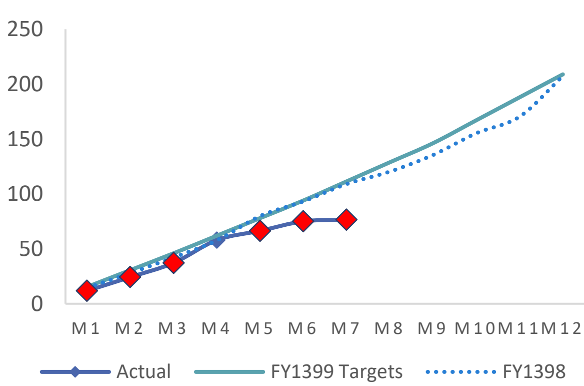
Incomes are expected to substantially decline

GDP per capita (US$)



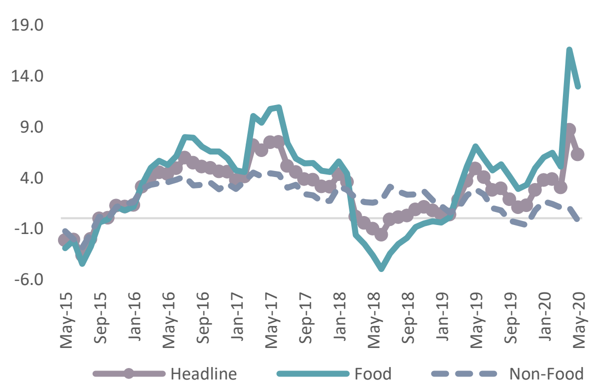
The pandemic is posing challenges for fiscal and economic management

Nominal billion Afs



Source: Ministry of Finance, Afghanistan

CPI Inflation (12 month percent change)



Source: National Statistics and Information Authroity, Afghanistan

Executive summary

Recent economic developments

Afghanistan's economy is facing multiple overlapping challenges

The global COVID-19 crisis has compounded the daunting challenges currently facing Afghanistan. Afghanistan has officially recorded 31,238 cases and 733 deaths as of end-June, with actual cases and fatalities expected to be far higher. The number of cases is increasing rapidly, with no sign that the pandemic is under control. With major disruptions to domestic economic activity, regional trade, and remittance flows, the economy is now contracting rapidly. With declining incomes and increasing food prices, hardship is increasing, with the poverty rate expected to increase to up to 72 percent over 2020. Due to reduced trade, administrative disruptions, and declining economic output, government revenues fell by more than a third below target levels in May, placing major pressure on government finances.

COVID-19 has hit Afghanistan in the midst of a difficult political transition, an intensifying conflict, and significant uncertainty regarding future grant support. A power-sharing agreement has now been signed between the two parties contesting the outcome of the September 2019 presidential elections. Implementation is now underway, leading to changes in senior staff across key ministries. While a peace agreement has been signed between the US and the Taliban, laying the foundations for negotiation of a comprehensive political settlement, Taliban attacks on Afghan security forces have intensified. The future of international assistance remains in question. The US has substantially reduced troop numbers over 2020, with further reductions likely. Current grant pledges expire at the end of 2020, and international partners are due to consider future aid commitments at an international conference in November. Without progress towards a sustainable peace and commitments to continued grant support from international partners, medium-term prospects appear increasingly grim.

Nascent recovery has been undermined by COVID-19

Growth is estimated to have reached 2.9 percent in 2019. The agriculture sector is estimated to have grown by 7.5 percent, driven by recovery from drought conditions in 2018. Industry and services, on the other hand, are estimated to have grown by two and 1.8 percent respectively reflecting weak confidence associated with political uncertainties and continued conflict.

The economy is estimated to have contracted sharply over the first half of 2020, due to the impacts of the COVID-19 crisis. Wheat production (mostly in the subsistence sector) has supported continued agricultural growth, but industry and service output have been heavily impacted by lockdowns and border closures. Household consumption is expected to have declined significantly due to reduced incomes, disruption to services and retail activities, and lower remittances (expected to decline by around 40 percent from 2019 levels). Investment is also expected to have sharply declined given the negative impacts of COVID-19 on already-weak confidence.

Prices were stable over 2019, with inflation reaching just 2.3 percent, largely due to low international energy prices. The COVID-19 crisis drove a significant spike in food prices over the first half of 2020, with prices for some basic food items increasing by more than 20 percent. Prices have since moderated due to distribution

of wheat from strategic grain reserves, enforcement of anti-price-gouging regulations, and the reopening of borders for food imports.

Reflecting high levels of political uncertainty, credit to private sector grew by only two percent in 2019 reaching 3.15 percent of GDP. With the outbreak of COVID-19, credit to private sector shrank by 3.3 percent in the first four months of 2020, wiping out growth over 2019. The loan to deposit ratio declined by around 1.7 percentage points from 17.2 percent to 15.5 percent.

The trade deficit has narrowed with declining imports

In 2019, the trade deficit narrowed slightly to 30.11 percent of GDP (from 32.72 percent of GDP in 2018) driven by a US$ 513 million decline in imports. Goods exports grew by 11 percent (year-on-year) in the first quarter of 2020 due to recovery in agricultural output, but are expected to have since declined sharply due to supply and trade disruptions. Imports shrank by 14 percent over the first quarter of 2020, driven by closure of border points, decreasing demand, and bans on wheat exports in neighboring countries.

The pandemic necessitated significant fiscal adjustments

Revenue performance has collapsed since the onset of the COVID-19 crisis, reflecting lower economic activity, trade disruptions, and weaker compliance. Government revenue estimates for 2020 were revised downward from Afs 209 billion to Afs 144 billion in the budget mid-year review. Grants support increased by US$ 500 million, partially offsetting the decline in revenues. Both recurrent and development expenditures were reallocated towards COVID-19 response activities, including in social protection and healthcare.

Outlook

Afghanistan is facing overlapping uncertainties.

Economic prospects are subject to high levels of uncertainty. Real GDP is expected to contract by between 5.5 percent and 7.4 percent in 2020 due to economic disruptions associated with COVID-19. Industry and services are expected to be hit hard by the imposition of urban lockdowns, while agricultural production continues to expand due to favorable weather conditions. With impacts of the COVID-19 crisis expected to persist through winter, the economy is expected to grow by one percent over 2021, with the possibility of further contraction. Both per capita and real GDP are expected to sharply decline and likely remain below pre-COVID-19 levels over the medium-term.

Higher food prices and lower incomes are likely to increase hardship

Reflecting higher food prices, consumer prices are expected to increase by five percent in 2020. The inflation rate is expected to slow to 3.5 percent in 2021 before stabilizing at around five percent over the medium term. Higher prices combined with lower incomes are expected to harm household welfare and increase humanitarian pressures. The poverty rate is expected to increase to up to 72 percent in 2020.

The current account is expected to remain in surplus over 2020, reflecting increased grants and weaker imports. The trade deficit is expected to decline from 30.11 percent of GDP to 27 percent in 2020, and further narrow to around 28 percent of GDP by 2023. Foreign exchange reserves are expected to remain at comfortable levels, reaching US$ 9,166 million (equal to 16 months of import cover) by end-2020. From 2021, the current account balance is expected to deteriorate, due to declining grants, reaching a deficit of 3.6 percent of GDP by 2023.

The fiscal deficit is constrained by limited financing options

The fiscal deficit is expected to reach around four percent of GDP in 2020 due to weak revenue performance. Constrained by limited financing options, the fiscal deficit is expected to remain below two percent of GDP over the medium-term, with contraction of available fiscal space leading to substantial reductions in development spending.

Risks and medium-term prospects

Improved outcomes depend on careful management of fiscal resources and commitment from international partners

The COVID-19 crisis will have a serious and sustained impact on Afghanistan's economy. Recovery is expected to take several years, with new investment constrained by political uncertainties, continued insecurity, and questions around ongoing international support.

With declining grants and lower revenues, fiscal space is expected to remain highly constrained over the medium-term. Available fiscal resources should be used to protect vulnerable households and maintain delivery of basic services including healthcare. Recovery could be supported by rapid action to improve the business regulatory environment, including through measures to expand access to credit.

For development partners, the highest priority is ensuring continued and predictable grant support. Precipitous declines in grant flows over coming years would force major contraction in government services, undermining development outcomes and future growth prospects. Clear commitment to continued grant support is vital for any improvement in confidence and investment.

A. Recent Economic Developments

1. Context

Afghanistan has been heavily impacted by the global COVID-19 crisis

The global COVID-19 crisis is having a major impact in Afghanistan. 30,000 cases and 600 deaths have been officially recorded, with actual cases and fatalities far higher. Case numbers are currently increasing rapidly, with no sign that spread of the pandemic is yet under control. Policy measures to contain the spread of the virus, including border closures and lockdowns, have had a large and immediate negative economic impact.

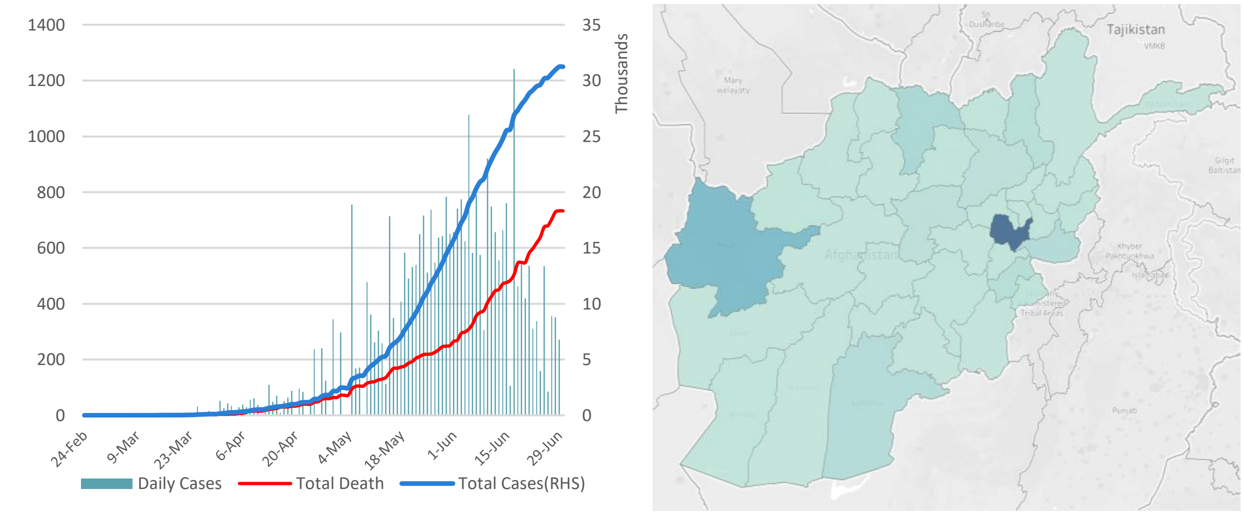
The COVID-19 crisis has struck in the context of ongoing political instability. A power-sharing agreement between the two major factions contesting the outcomes of the September 2019 presidential elections was finally reached in May. Implementation of this agreement is currently underway, including through the allocation of leadership roles for key ministries. Risks of further political instability and administrative disruption remain, constraining confidence and investment.

Conflict continues to impose a heavy toll

Insecurity has continued throughout 2019 and into 2020, despite calls for a ceasefire amid the pandemic. Total civilian causalities reached 10,392 in 2019 slightly lower than 2018, with 3,403 deaths and 6,989 injured. Anti-government elements were responsible for most of the civilian causalities, despite a reduction in attacks by ISIL-KP. Internal displacement induced by the conflict increased to around 399,087 in 2019, with the number of displaced increasing eight percent over 2018 levels.

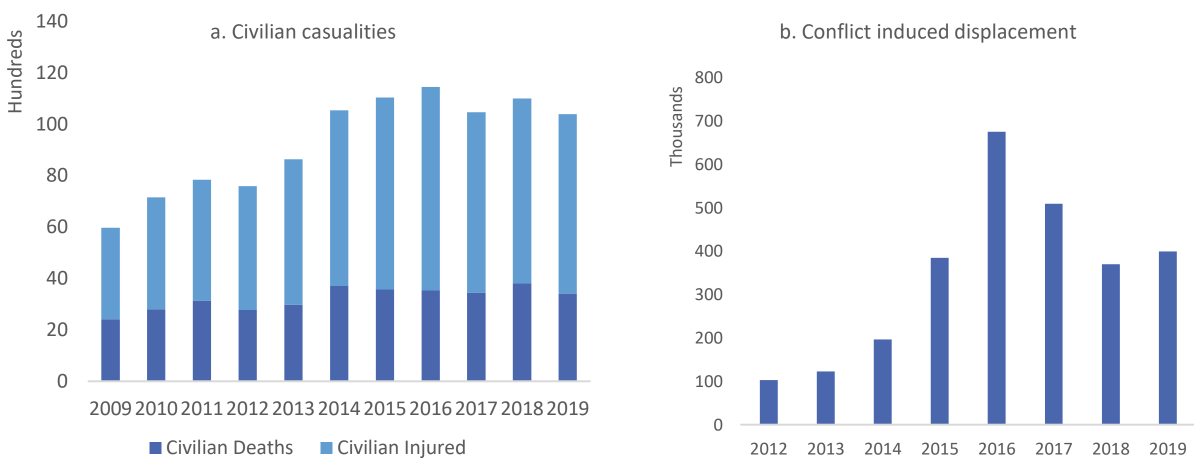
Civilian casualties have recently declined, partly reflecting the Taliban's efforts to comply with terms of its agreement with the United States. Civilian causalities over the first quarter of 2020 reached 1,293 (533 deaths and 760 injured), among the lowest levels observed since 2013 and a decline of 29 from the same period in 2019. Government and international partners are preparing for intra-Afghan negotiations with the Taliban, with the goal of a comprehensive peace agreement. Taliban attacks on Afghan security forces continue, however, and prospects for a sustainable political settlement remain highly uncertain. Calls from the government and international community to extend the brief Eid ceasefire were rejected by the Taliban.

Figure 1: COVID-19 cases are concentrated in main urban centers and continue to grow rapidly



Source: MoPH and WHO

Figure 2: Continued insecurity led to high civilian casualties and ongoing displacement



Source: United Nations Assistance Mission in Afghanistan (UNAMA) and UNHCR

Box 1: COVID-19 in Afghanistan

The first case of COVID-19 in Afghanistan was reported in Herat province on 24 February 2020. A very small number of positive cases were registered throughout March. The rate of infection subsequently accelerated rapidly, with an influx of returnees from Pakistan and Iran (around 150,000 Afghans retruned from Iran, one of the virus' global epicenters, during March). In a bid to contain the spread of the virus, the government introduced social distancing measures in major cities from mid-March. Restrictions were eased following the Eid holidays, despite an increasing number of daily cases.

While actual cases much higher, official COVID-19 cases exceeded 31 thousands as of end-June, with cases reported in every province. Total COVID-19 fatalities are reported at 733, with a total fatality rate of 2.3 percent. Around 76,000 people have been tested. Healthcare personnel constitute more than five percent of total positive cases, and 13 healthcare workers have died of COVID-19. Kabul, with more than 13,448 cases, is the most affected province of the country followed by Herat (4,998 cases), Balkh (1,715), Nangarhar (1,360 cases), and Kandahar (1,305 cases).

Overwhelmed by the spread of virus, the already fragile public health system has faced shortages of medical equipment, personnel, and testing capacity. Government and donor resources were mobilized to establish and repurpose a number of new laboratories, testing faciltiies, and treatment centers in cities with high numbers of cases. As of June, Afghanistan's COVID-19 testing centers had capacity to undertake 790 tests a day, with eight hospitals allocated for exclusive use by COVID-19 patients.

2. Real Sector Activity

A sustained period of slow growth continued into 2019

Afghanistan's economic growth averaged just 2.3 percent over 2014-2019 reflecting declining aid, political instability, and rising insecurity. Growth is estimated to have reached 2.9 percent in 2019, mainly driven by recovery from drought conditions in 2018. The agriculture sector is estimated to have grown by 7.5 percent, driven by 17 percent growth in cereals, following a drought-induced contraction of 16 percent in 2018. Output of fruit is estimated to have increased by around five percent after contracting by 10 percent in 2018. Industry and services, on the other hand, are estimated to have grown by two and 1.8 percent respectively in 2019. Slow growth in industry and services reflected weak confidence associated with the presidential elections, continuing conflict, potential declines in international security and development support, and the uncertain outcome of peace discussions with the Taliban.

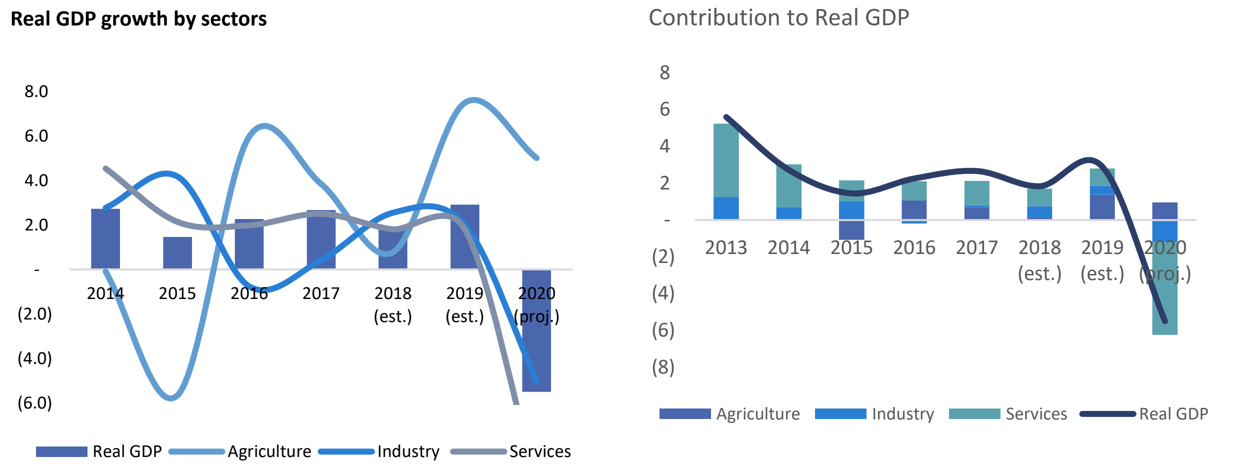
The COVID-19 crisis is having significant negative impacts on the economy

Available indicators show signs of a sharply contracting economy in the first half of 2020, reflecting the impacts of the COVID-19 crisis in the context of continued insecurity and political uncertainty. Consumption and investment have been compressed by social distancing measures and weak confidence. Revenue declines have constrained scope for effective counter-cyclical fiscal policy to maintain economic activity over the first half of the year, with government spending declining over recent months as a result of both declining revenues and administrative disruptions to development project spending associated with social distancing measures.

Impacts of COVID-19 on the agriculture sector have been limited to date. Favorable weather condition during the planting season are expected to see continued recovery in wheat production from the 2018 drought. Lockdown measures have so far had limited impact on agricultural production, remaining unenforced in rural areas. Production of fruit and nuts for processing and export, however, is being negatively impacted by disruption to supply chains and closure of export routes.

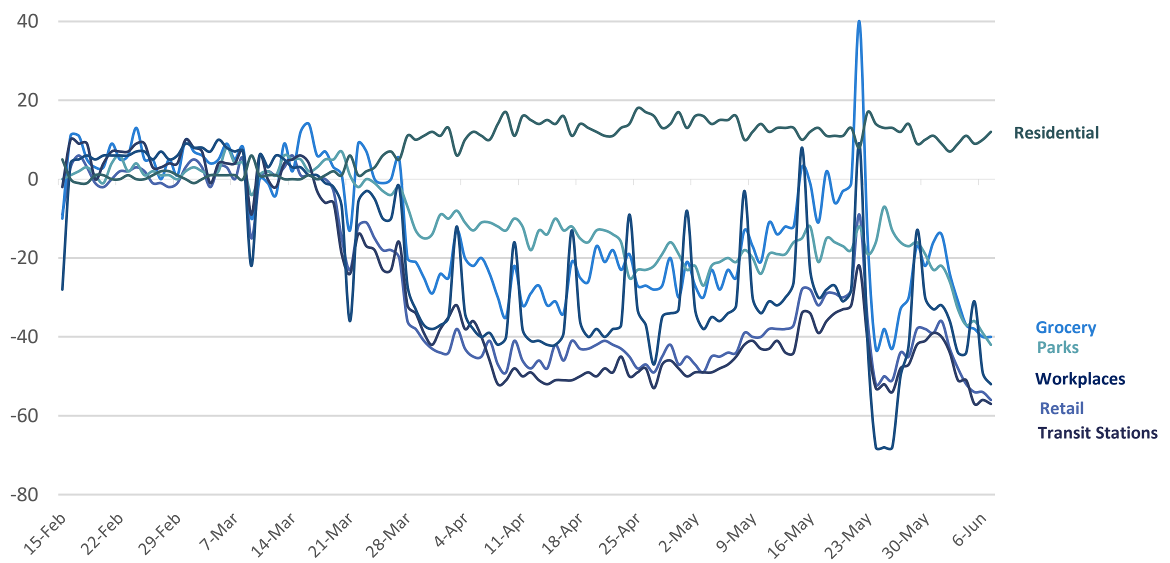
Industry and services, on the other hand, have been severely impacted by the COVID-19 crisis. Border closures are impacting exporting firms and those that rely on imported inputs. Demand for goods and services is being suppressed by lockdown measures. Business activity is also being negatively impacted by a contraction in consumer demand associated with declines in remittances and job losses. Following the imposition of lockdowns in urban areas, travel to retail stores, transit service locations, and workplaces remain more than 50 percent below pre-lockdown levels. Grocery stores have seen a decline in the number of visitors by around 40 percent compared to baseline levels.

Figure 3: Non-agriculture economy contracted significantly in first half of the year
(percent)



Sources: National Statistics and Information Authority (NSIA) for 2013-17 data, World Bank staff projections for 2018

Figure 4: Low social mobility strained services sector since end-March
(percent change compared to baseline)



Source: Google COVID-19 Community Mobility Reports

The pandemic has driven significant volatility in prices

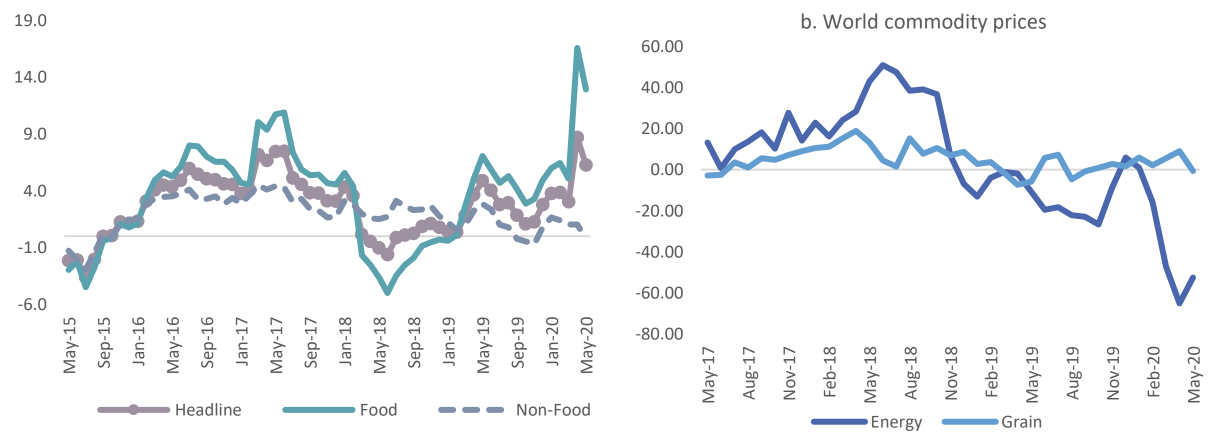
Inflation reached just 2.3 percent over 2019. Food prices increased by around four percent, mainly driven by increased cereal prices due to rising global prices, despite strong recovery in domestic production. Non-food prices increased by less than one percent, partly due to low international energy prices.

The COVID-19 crisis drove a significant spike in food prices over the first half of 2020. Food prices increased by around 17 percent in April year-on-year following imposition of border control and lockdown measures in main urban centers. The impact of trade disruptions on prices for basic household goods has so far

significantly outweighed impacts of lower prices for key imports including oil. Prices seem to have moderated since April, following distribution of wheat from strategic grain reserves, enforcement of anti-price-gouging regulations, and the reopening of borders for food imports.

Figure 5: Consumer prices increased more modestly than expected, reflecting lower energy prices globally

(12-month percentage change)



Source: Central Statistics Organization, and World Bank Global Economic Monitor (GEM)

Poverty is expected to have deepened and worsened due to the impacts of COVID-19

The COVID-19 crisis is expected to have significantly exacerbated poverty. World Bank analysis suggests that the poverty rate may increase to between 61 percent and 72 percent over 2020 as a result of declining incomes and increasing prices for food and other vital household goods (see Focus Section). The impact on household incomes is expected to be larger than the projected decline in GDP. This is because many households depend on informal, low-productivity activities which contribute little to overall GDP and are highly vulnerable to economic shocks. Poverty impacts are expected to be concentrated among households that depend on activities that are vulnerable to the impacts of lockdowns, including small-scale retail activities and daily labor in construction, agriculture, or personal services. Approximately 15 million Afghans live in households that derive more than half of their income from these activities, with around 30 percent of this group living in urban areas where lockdowns have been implemented.

Pressure on living conditions continues to be exacerbated by displacement, including return of refugees from neighboring countries and conflict induced internal displacement. In the year to end-May, an additional 86,419 were displaced due to conflict and an additional 300,512 refugees returned to Afghanistan from Iran and Pakistan. Returnees from Iran account for more than 99 percent of total returnees amid the outbreak of COVID-19 in Iran. The high number of returnees and IDPs is placing pressure on limited services and employment opportunities in main urban centers.

Recent easing of movement restrictions in main urban centers is expected to lead to some recovery in employment. Additionally, the beginning of the wheat harvest in May is expected to have eased access to food and pressure on food prices over recent weeks.

3. Monetary and financial sector developments

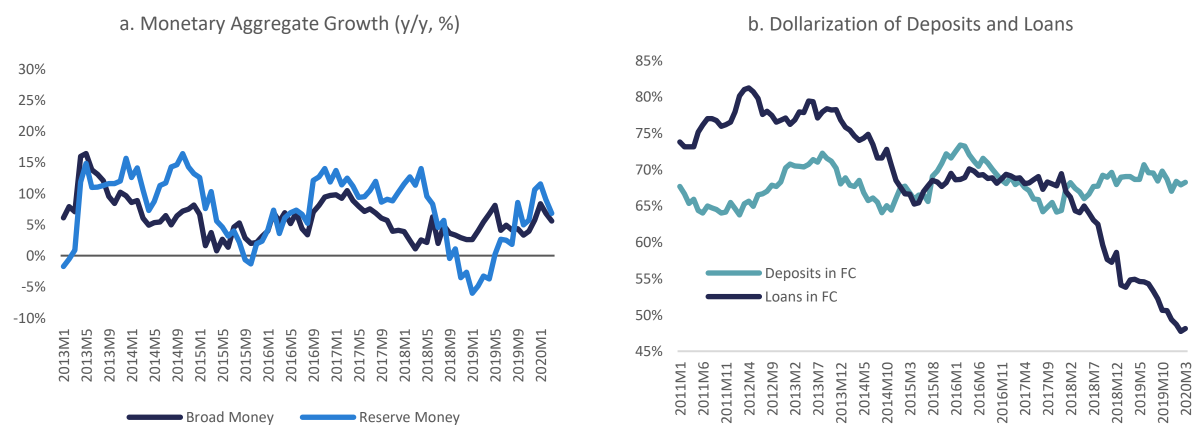
Money supply grew moderately in 2019

After slow growth of 2.6 percent (year-on-year) in 2018, broad money grew at a slightly faster pace of 5.7 percent (year-on-year) in 2019 reflecting gradual economic recovery. Reserve money growth picked up in December to 10.6 percent (year-on-year) driven by increased government spending, but partly offset by DAB's increased foreign exchange interventions. Growth of reserve money mainly reflected a 13.6 percent (year-on-year) increase in currency in circulation and a 12.4 percent (year-on-year) rise in banks' excess reserves with DAB.

Weak economic conditions translated into declining deposits

Total deposits of the banking sector remained stable, shrinking by one percent (year-on-year) to Afs 263 billion (17.8 percent of GDP) at end-December. National and foreign currency denominated deposits declined by 1.2 percent (year-on-year) and 0.7 percent (year-on-year) respectively. The banking sector remained highly dollarized with foreign currency denominated deposits standing at Afs 169 billion (64.21 percent of total deposits) at the end of 2019.

Figure 6: Growth of money supply was moderate and banks deposit remained highly dollarized



Source: Da Afghanistan Bank

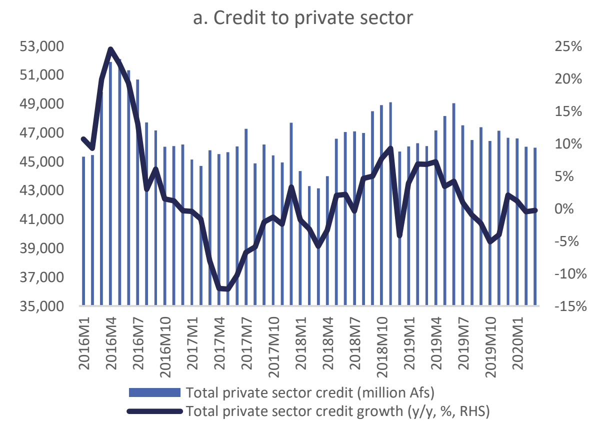
Credit to the private sector remained limited…

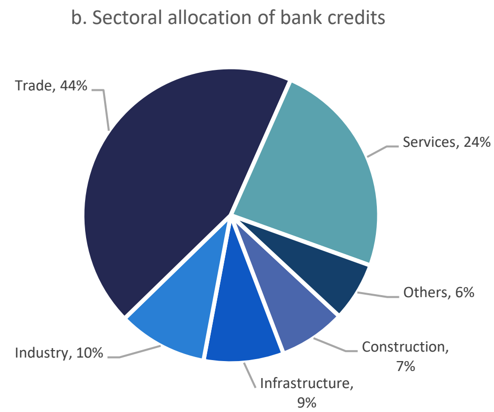
Weak economic activity and low investor confidence continued to inhibit demand for credit throughout 2019. Credit to the private sector grew by only two percent from Afs 45.7 billion in 2018 to Afs 46.6 billion. Afghani denominated loans increased by 23.4 percent (Afs four billion) while foreign currency denominated loans declined by 15 percent (Afs 3.7 billion) reflecting declines in trade credit amid lower imports. Access to credit remained heavily constrained with the total value of intermediated credit to the private sector at end-2019 equal to 3.15 percent of GDP (down slightly from 3.24 percent of GDP in 2018).

… reflecting weak intermediation of credit from banks to private sector

By end-2019, the loan-to-deposit ratio remained close to the end-2018 level at 15.9 percent, reflecting weak intermediation of credit from banks to the private sector. Given a small loan portfolio, the banking sector remained highly liquid. Banks' excess reserves sitting with DAB constituted 28 percent of total deposits at end-2019. The sectoral distribution of banking sector loans remained heavily concentrated. At end-2019, the trade sector accounted for 44 percent of total loans provided to the private sector, with the services and agricultural sectors accounting for 22 percent and three percent respectively.

Figure 7: Bank loans remained concentrated in trade and service sectors





Source: Da Afghanistan Bank

Asset quality and profitability indicators deteriorated

Financial soundness and profitability indicators of the banking sector slightly deteriorated in 2019. The ratio of adversely classified loans (loans that banks doubt will be repaid) to gross loans increased from 14.85 percent in 2018 to 18 percent at end-2019. The share of non-performing loans (NPLs) to total gross loans dramatically increased from nine percent in December 2018 to 15 percent in December 2019. Sector-wide profitability declined with return on assets (ROA) falling from 0.55 percent in 2018 to 0.43 percent in 2019. Low profitability mainly reflected a challenging economic environment and the high business cost.

COVID-19 shock has increased the vulnerability of the banking sector

Monetary and financial sector developments over the first four months of 2020 reflect continued weak confidence and the adverse impact of the COVID-19 crisis. Monetary aggregates registered negative growth while total deposits in the banking system declined. While banks remain highly liquid, there are signs of deterioration of asset quality and profitability indicating rising vulnerability in the banking system.

Monetary aggregates contracted in the first four months of 2020

In the context of subdued economic activities, broad money shrank by four percent from Afs 513.7 billion to Afs 490.8 billion in the first quarter of 2020 before picking up to end-2019's level in April. Contraction in broad money was driven by 8.8 percent drop in central bank and commercial banks deposits. Similarly, reserve money decreased by four percent in the first four months of 2020 mainly reflecting a 33 percent drop in the excess reserves of the banks. As weak economic conditions persist, growth of monetary aggregates is expected to have remained in negative territory through May and June.

Total deposits in the banking sector declined by three percent over the first four months of 2020 from Afs 263.8 billion to Afs 255.6 billion. Afghani and foreign currency denominated deposits declined by four percent and two percent respectively. Contraction in total deposits was mainly driven by generally difficult economic conditions in the context of COVID-19 crisis, high seasonal withdrawal at the beginning of the fiscal year, and closure of Arian Bank's accounts (DAB delicensed Arian bank, a branch of a foreign bank, in 2019). Deposits are expected to have declined further over recent months, as firms have drawn on savings and working capital to meet ongoing business costs in the face of revenues decline.

Credit to private sector is expected to have declined in the first half of 2020

Compounded by COVID-19 pandemic, weak economic conditions and confidence led to lower commercial banks' credit to the private sector in 2020. As of end April, total credit to the private sector declined by 3.3 percent (Afs 1.9 billion) mainly reflecting a seven percent drop in foreign currency denominated loans. As a result, foreign currency denominated loans as a share of total loans decreased by two percentage points from 49.3 percent to 47.3 percent. Credit to the private sector is expected to have further declined in recent months driven by lower demand for credit and increased risk aversion of banks.

The loan to deposit ratio remains at only around 15.5 percent, having further declined by around 1.7 percentage points over the first four months of 2020.

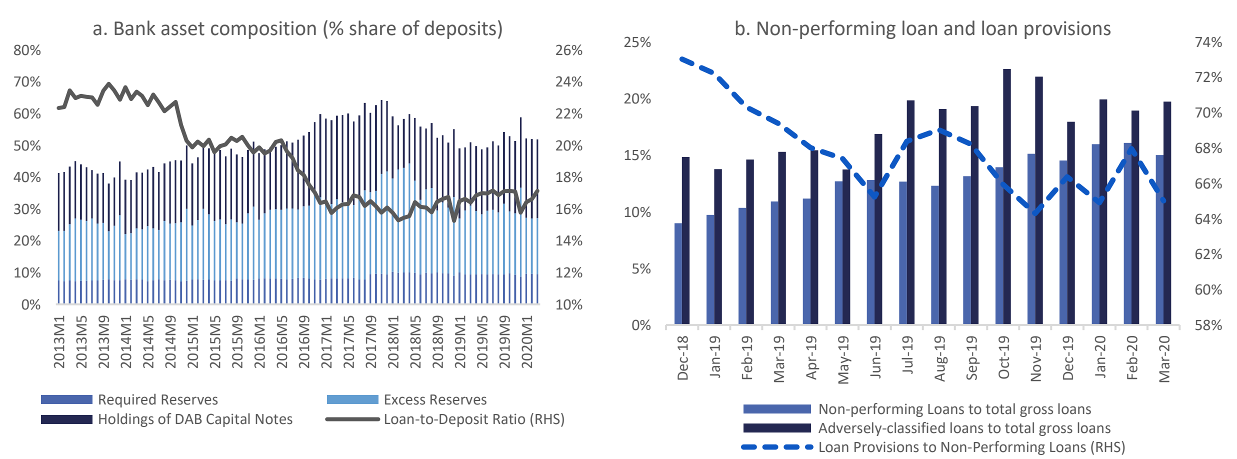
There are signs of rising vulnerability in the banking system

As of end March 2020, the capital adequacy of the banking system remained above specified thresholds (eight percent under Basel II and 10.5 percent under Basel III), with the ratio of capital to risk-weighted assets standing at 26 percent. However, the ratio of non-performing loans to gross loans increased to 16 percent in the first two months of 2020 before falling back to 15 percent by end of March. The banking sector made a small loss in the first quarter of 2020 reflected in a return on asset (ROA) ratio of negative 0.02 percent down from a positive ROA of 0.43 percent in December 2019. With the pandemic affecting borrowers' debt servicing and repayment capacity, financial soundness and profitability of the banking sector are expected to have further deteriorated in the second quarter of 2020.

DAB has taken measures to mitigate impacts of the crisis

To ensure the stability of the financial sector in the face of COVID-related shocks, Da Afghanistan Bank (DAB) has intensified monitoring of weaker banks and has taken measures to reduce operational costs. The measures taken by DAB include suspension of administrative penalties and fees, postponement of the IFRS-9 implementation, and relaxation of mandated loan re-classification. DAB has also developed a post-COVID improvement plan designed to help with the recovery of the banking sector covering July 2020 to December 2021.

Figure 8: Banks are highly liquid while financial soundness indicators are weak



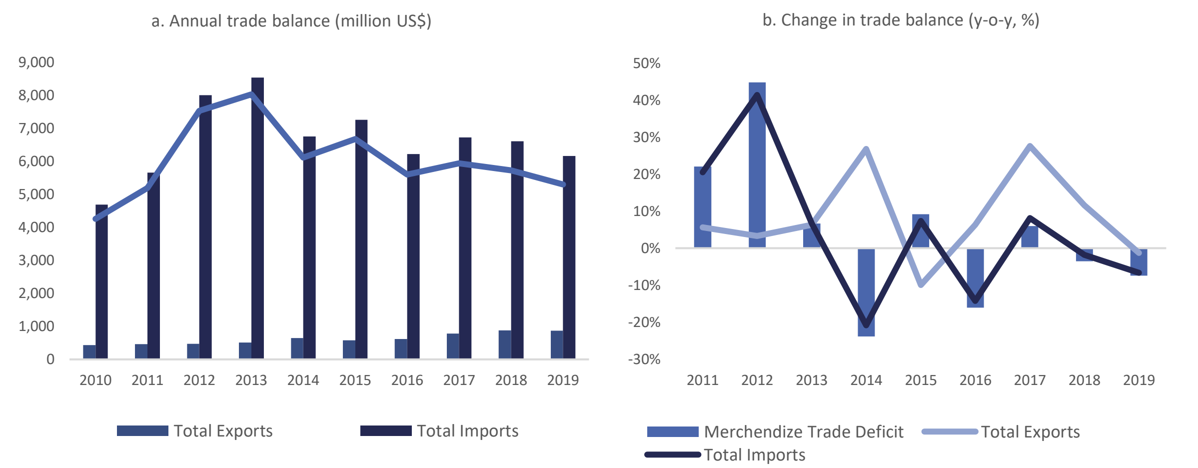
Source: Da Afghanistan Bank

4. External sector

The trade deficit narrowed over 2019 due to declining imports

In 2019, Afghanistan's trade balance slightly improved as imports fell faster than exports. The trade deficit was US$ 5,861 million equal to 30.11% of GDP at the end of 2019, narrowing from of 32.72% of GDP in 2018. The trade deficit is expected to have further narrowed over the first months of 2020, with decreasing demand and bans on wheat exports in neighboring countries negatively impacting imports. The trade deficit was financed almost entirely by aid inflows.

Figure 9: Decline in imports narrowed the trade deficit in 2019 despite weaker exports



Source: National Statistic and Information Agency

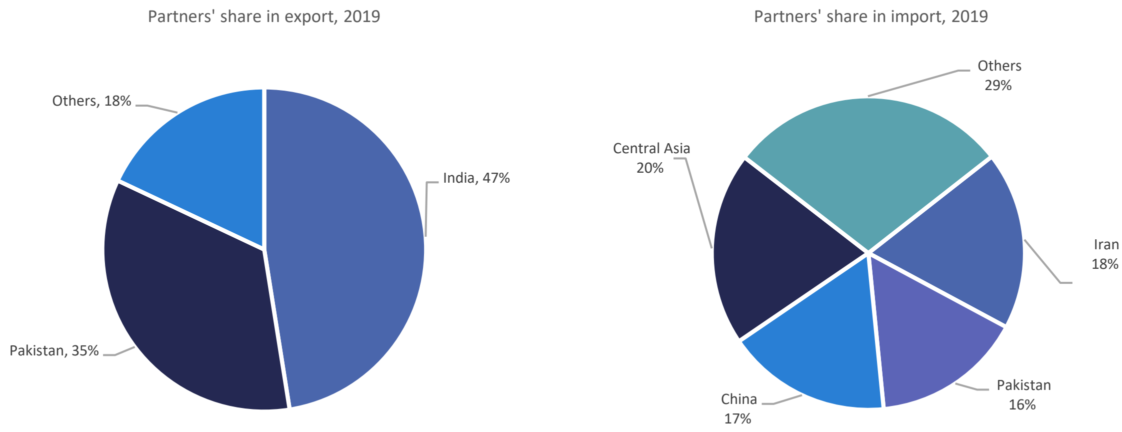
Exports slightly declined in 2019

Exports fell to US$ 863 million in 2019 (from US$ 875 million in 2018), due to trade tensions with Pakistan and the strengthening of the Afghani relative to major trading currencies. Exports to Pakistan fell by US$ 80 million driven by a 32 percent (US$ 75 million) drop in exports of vegetable products. This reflected higher valuation for custom duties imposed by Pakistan amongst mounting trade tensions. Meanwhile, exports to India - the largest export market for Afghan goods – grew substantially by 18 percent due to increased exports through air corridors. Exports to India increased from US$ 346 million in 2018 to US$ 410 million in 2019 reflecting a 20 percent increase in export of vegetable products (mostly dried fig, saffron, onion, raisin, grape and apricot).

Higher agricultural outputs and weak demand resulted in contraction in imports

Imports of goods declined to US$ 6,158 million in 2019 (seven percent or US$ 513 million lower than in 2018). Lower imports were driven by: i) weak economy-wide demand in the context of rising political uncertainty; and ii) reduced reliance on imported grains with the agricultural sector recovering from recent drought. Overall declines in imports reflected a 23 percent (US$ 353 million) drop in import of vegetable products, a 14 percent (US$ 74 million) decrease in import of base metals, an 18 percent (US$ 52 million) decline in import of electricity, and a 34 percent (US$ 135 million) drop in import of vehicles. Meanwhile, imports of cement increased by 20 percent (US$ 61 million), with construction firms building stocks in the context of low cement import prices due to depreciation of Pakistani Rupee and Iranian Toman.

Figure 10: Afghanistan trade is remains undiversified



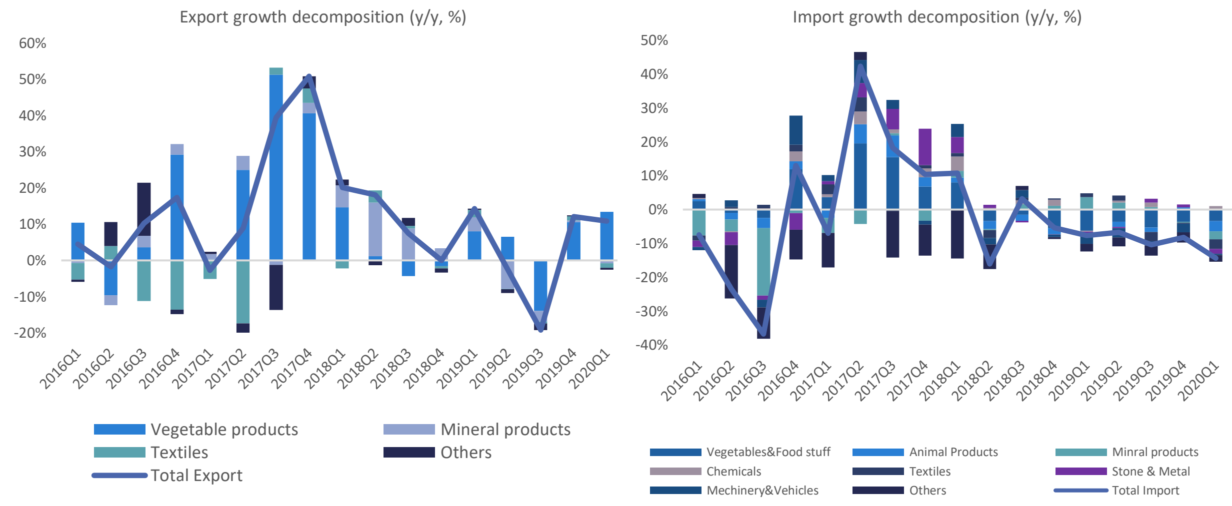
Source: National Statistic and Information Agency

In the first quarter of 2020, exports increased while imports sharply dropped

Exports grew by 11 percent (year-on-year) in the first quarter of 2020 from US$ 182.5 million to US$ 202.4 million. Export growth was driven by an 18 percent (US$ 24.4 million) increase in exports of vegetable products due to improved agricultural output. Exports of dried fig, hing, raisin, and saffron, increased, mainly to India. Meanwhile, exports of mineral products and textiles declined by six percent and 15 percent respectively. Lower export of these products mainly reflected a 20 percent (US$ 1.8 million) decline in export of talc stone and 27 percent (US$ 1.7 million) decline in export of carpets reflecting weak economic conditions and decreased demand in Pakistan. Afghanistan exports are likely to have sharply declined in the second quarter of 2020 driven by border closures, disruptions to land and air transport, and potentially lower demand in Afghanistan's main export markets.

Imports declined by 14 percent (US$ 256 million) in the first quarter of 2020. Lower imports reflected lower economy-wide demand, in the context of political uncertainty and the onset of the COVID-19 crisis. Weak demand drove lower imports for most major categories of goods, including vegetable products (US$ 67.7 million), machinery (US$ 17 million), base metal (US$ 58 million), mineral products (US$ 42 million), and textiles (US$ 50 million). Imports were further impacted by the imposition of export restriction by Kazakhstan in the context of COVID-19 pandemic (import of wheat flour from Kazakhstan declined by US$ 49 million in the first quarter of 2020 compared with 2019 levels). Imports of all goods declined except for cement which increased by 37 percent (US$ 22.8 million). Afghanistan imports are expected to have dropped further in the second quarter of 2020 reflecting subdued economic activity in the context of lockdowns and lower imported fuel prices.

Figure 11: Exports increased while imports declined across all categories of goods except for cement



Source: National Statistics and Information Agency

The exchange rate has remained stable through the onset of the COVID-19 crisis

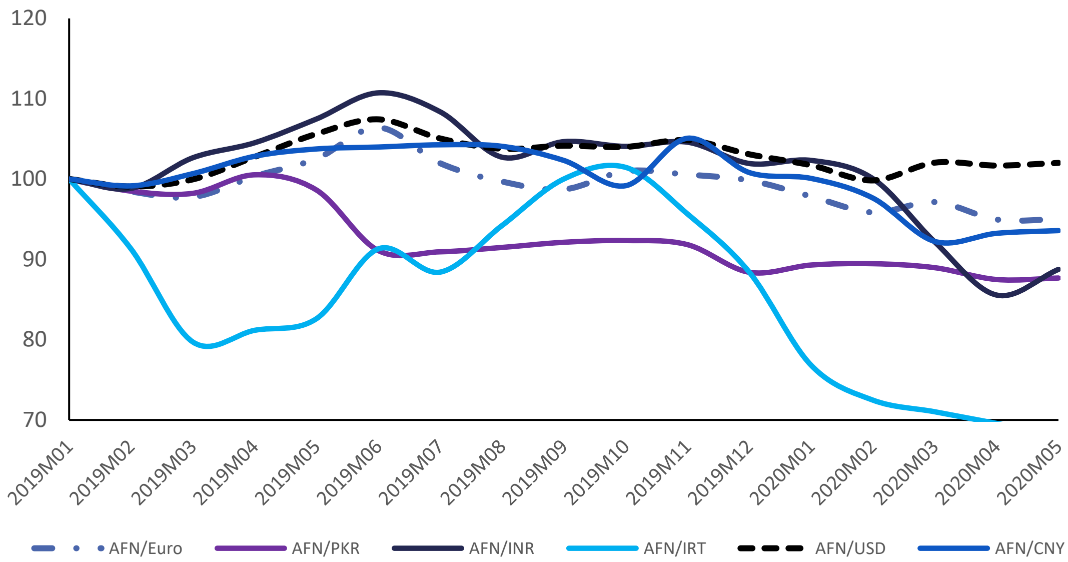
Through 2019, the Afghani remained stable against major international currencies and strengthened against main regional trading currencies. The Afghani depreciated by only 2.8 percent against the strengthening US dollar while remaining stable against the Euro. The Afghani appreciated against the Pakistani Rupee by 11.5 percent and by 11.6 percent against the Iranian Toman, driven by weak economic conditions in both countries, capital outflows from Iran, and devaluation in Pakistan. It remained generally stable against the Indian Rupee and the Chinese Yuan.

Over the period between end-December 2019 and 15th June 2020, the Afghani appreciated against the Euro by 1.5 percent and remained largely stable against the US dollar. Appreciation was driven by lower imports and increased demand for Afghani in provinces neighboring Pakistan, where the central bank is pursuing measures to promote the use of the Afghani instead of the Pakistani Rupee for domestic transactions. Reflecting stability of the Afghani against the US dollar, the central bank limited foreign exchange interventions. As of May 16, DAB had injected US$ 701 million into the market down from US$ 895 million in 2019.

The current account remains in surplus

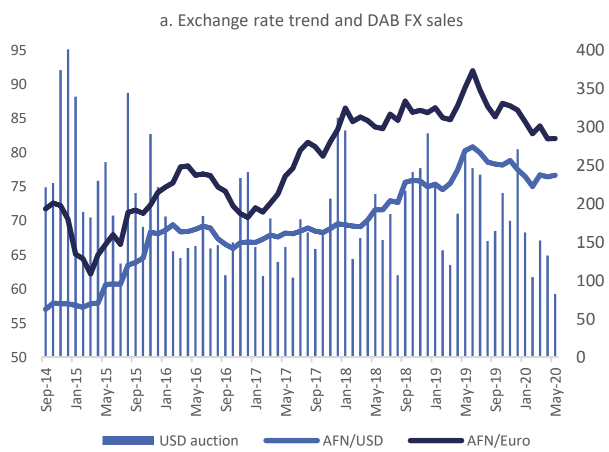
The current account recorded a small surplus of 0.6 percent of GDP in 2019, with large aid inflows financing the large trade deficit. Driven by the current account surplus, foreign exchange reserves continued to accumulate, reaching an estimated US$ 8.6 billion at end-2019, equivalent to 16 months of merchandise import cover. In the first four months of 2020, gross international reserves decreased by three percent mainly due to lower grant inflows. DAB's sales of foreign exchange under its open market operation amounted to US$ 577 million while inflows fell short of the auctioned amount by US$ 130 million over this period.

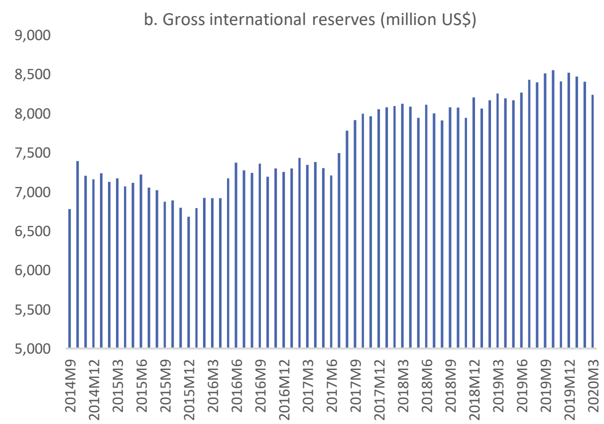
Figure 12: The Afghani appreciated against the currencies of most major trade partners in the region
Change in value of Afghani against major trading currencies (Index = January 2019)



Source: Da Afghanistan Bank

Figure 13: Depreciation of the Afghani slowed and gross international reserves continued to accumulate





Source: Da Afghanistan Bank

5. Fiscal sector

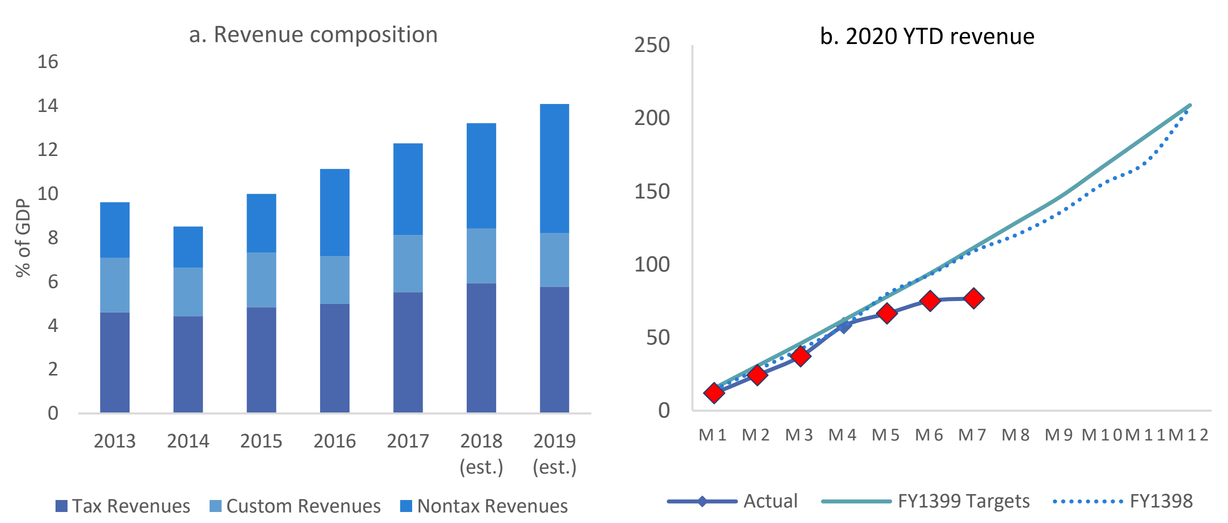
Revenue performance was strong through 2019, but Afghanistan now faces a revenue crisis

Domestic revenues increased to a record high in 2019. Revenues reached Afs 208.8 billion equivalent to 14.1 percent of GDP, a nominal increase of 12 percent over 2018. The strong revenue performance was mainly driven by one-off revenue collections of around Afs 32 billion, of which the majority (Afs 24 billion) were transferred from Da Afghanistan Bank operating profits. Core tax revenues remained flat, in nominal terms, with poor performance of the large taxpayer office (LTO) and small taxpayer office (STO), and mixed performance at customs points.

Domestic revenue collection has rapidly deteriorated in recent months with the COVID-19 crisis. Driven by reduced economic activity, restrictions on international trade, and deteriorating compliance, core domestic revenues (excluding one-off revenue sources) were lower by more than 34 percent against Ministry of Finance targets. Total domestic revenue collection at end-June reached Afs 74.7 billion, 20 percent lower than the target of Afs 94 billion, with overall collections supported by an un-budgeted Afs 12.7 billion transfer of Da Afghanistan Bank operating profits.

Even before the outbreak, monthly revenue collection had fallen below the monthly target by around 19 percent for consecutive months, reflecting both excessive optimism in setting targets and slowing growth in the context of political instability. Revenue collection by the Afghan Revenue Department was below its monthly target by at least 23 percent, over January-March, mainly due to the underperformance of Large Taxpayer Office (LTO) and Medium Taxpayer Office (MTO). Customs revenues fell 12 percent below monthly targets over the same period.

Figure 14: Revenue growth slowed even before the pandemic



Budget execution was strong through 2019

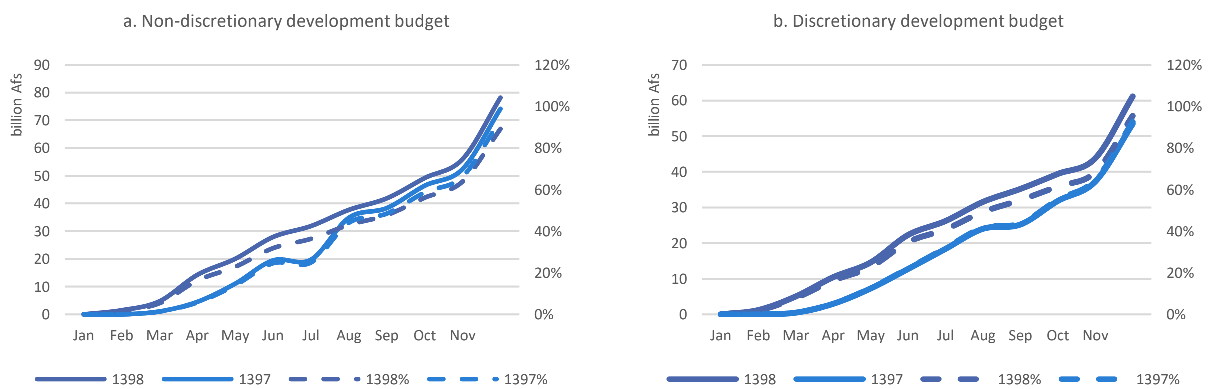
Overall expenditures reached Afs 422.3 billion, equivalent to 28.5 percent of GDP in 2019. Driven mainly by salaries and wages for civilian and security staff, recurrent expenditures reached Afs 283 billion (or 19.1 percent of GDP), an increase of more than nine percent in nominal terms over 2018. Development expenditures also grew by 11 percent, from Afs 125.5 billion in 2018 to Afs 139.3 billion in 2019.

Government spending through 2020 has been disrupted by the COVID-19 crisis

Overall government expenditures reached Afs 157.3 billion or 35 percent of the amended budget as of end-June. Recurrent expenditures reached Afs 115.5 billion with an estimated execution rate of 39 percent, compared to Afs 112 billion with a 38 percent execution rate over the same period last year. The development budget execution rate was relatively low, at around 28.3 percent compared to 34 percent last year. The low development budget execution rate is mainly driven by weak execution of donor-managed non-discretionary projects. Donor financed non-discretionary projects are currently undergoing significant restructuring to repurpose funds to respond to the pandemic.

The budget mid-year review saw substantial adjustment to expenditures. Operating and development expenditures were reprioritized toward health and social relief. Total recurrent expenditures were revised upward from Afs 289.1 billion to 295.6 billion, and development expenditures from Afs 139 billion to Afs 153.8 billion. Increased expenditures are expected to be financed from: i) increased transfers of operating profits from the central bank; ii) new one-off revenues, including auctioning of 4G spectrum; and iii) increased grants, which are expected to increase from Afs 139.3 billion to Afs 153.8 billion.

Figure 15: Execution of development budget remained strong in 2019
(Execution rate in percent, and total cumulative expenditures)



Source: Ministry of Finance data

B. Outlook and Medium-Term Prospects

The growth outlook is subject to substantial uncertainty

Reflecting the extent of current uncertainties, medium-term projections have been developed using both a baseline and downside scenario. The baseline scenario assumes gradual but effective containment of the COVID-19 virus over 2020 with some recovery in the third quarter but a new infection wave in winter resulting in a W-shaped recovery in growth spanning well into the first half of 2021. The downside scenario assumes broader spread of the virus, necessitating deeper and more-sustained lockdown measures, a prolonged global downturn, and a faster-than-expected reduction in international grant support.

Afghanistan's economy will be hard-hit by the COVID-19 pandemic

Real GDP is estimated to contract by between 5.5 percent and 7.4 percent during 2020, compared to pre-COVID projection of 3.3 percent positive growth. Nominal GDP could decline by between seven to nine percent in 2020 compared to pre-COVID projections. The impact is mainly due to a sharp contraction of output in services and industry due to lockdowns and other social distancing measures. Growth in services is estimated to decline by 13 to 14 percent while industry growth is estimated to decline by eight to ten percent compared to pre-COVID estimates. Agriculture growth is projected to remain positive under a baseline scenario, reflecting improved weather conditions and limited impacts of lockdowns in rural areas, but could also decline if the lockdown measures are further intensified, disrupting agricultural supply chains.

Growth is expected to recover slowly, with further contraction possible in 2021. Real GDP is expected to recover to 2019 levels only by 2023 under the baseline scenario and by 2024 under the downside scenario.

The pandemic is expected to have a net positive impact on the trade balance

Per capita GDP is expected to decline sharply and is likely to remain below pre-COVID-19 levels for the medium-term. Under a downside scenario, GDP per capita in current US dollar terms could decline by 13 percent by 2021. Lower incomes are expected to lead to a deterioration in employment and poverty outcomes, with the poverty rate potentially reaching 73 percent over 2020.

Consumer prices are expected to increase by around five percent in 2020 mainly due to increased food prices. Non-food prices are expected to remain stable due to lower demand for discretionary goods and declining oil prices. The inflation rate is expected to slow to 3.5 percent in 2021, as lock-down related supply constraints are removed in the context of continued weak demand, before stabilizing at around five percent over the medium term.

Goods exports are projected to drop by 17 to 28 percent in 2020, depending on the extent and duration of border closures. Imports are projected to decline by between 12 and 19 percent, reflecting border disruptions, depressed domestic demand, and lower global price of fuel. The trade deficit is expected to narrow to between 25.8 and 27.3 percent of GDP, with the decrease in imports outstripping the fall in exports in absolute terms. As a result, the current account surplus (after grants) is expected to increase to between three and five percent of GDP in 2020. As impacts of the COVID-19 pandemic fade and aid flows decline over the medium-term, the

current account is expected to move into deficit in 2021 and reaching between 3.6 to 5.1 percent of GDP by 2023.

The COVID-19 crisis will drive higher fiscal financing needs

The fiscal deficit is expected to increase to around four percent of GDP, relative to a pre-COVID-19 forecast deficit of 1.5 percent of GDP, including new COVID related grant support. The total deficit is constrained by limited financing options, given the absence of a domestic debt market and no access to external commercial debt (and therefore equal under both baseline and downside scenarios). In 2020, the deficit is expected to be financed through increased withdrawals from government's existing cash reserves (around Afs 26.5 billion), a recent disbursement of Afs 16.8 billion from IMF's expected Rapid Credit Facility, and additional concessional borrowing of Afs 11.6 billion.

Over the medium term, the fiscal deficit is expected to remain below two percent of GDP, despite lower revenues and increased expenditure needs, reflecting constrained financing options.

Recent momentum in domestic revenue collection appears to have been lost

Driven by reduced economic activity and restrictions on international trade, domestic revenues are expected to fall by between 30 and 35 percent, or more than three percent of GDP. Under a baseline scenario, domestic revenues are estimated to decline from Afs 209 billion in 2019 to Afs 144.4 billion, including central bank transfers over the first half of 2020. Revenue collection is expected to remain depressed over the medium term in the context of sluggish recovery and lower incomes, and is unlikely to recover to 2019 levels until 2025[1].

Fiscal space for development spending significantly diminished

Government will continue to rely on grant support given weak medium-term revenue prospects. Fiscal sustainability, defined as share of recurrent expenditure financed by domestic revenues, is expected to drop to 48 percent in 2020 under a baseline scenario, from a record high of 74 percent in 2019. Fiscal sustainability is expected to gradually recover to 64 percent by 2023, with increasing revenues.

Expenditures are heavily adjusted to respond to the pandemic

Donors are expected to provide substantial on- and off-budget support to help manage the COVID-19 crisis, both through new commitments and reprioritization within existing project portfolios (this includes approximately US$800 million of expected COVID-response programming from World Bank / ARTF resources, including new programming, restructurings, and reallocations). Total grant levels are expected to increase by around US$500 million from pre-COVID-19 projections.

Over the medium term, grants support is expected to gradually decline. Under a baseline scenario, total on-budget grants are expected to decline from US$ 3.0 billion (or 15.6 percent of GDP) to US$ 2.2 billion (or 11.1 percent of GDP) by 2023. Under a downside scenario, grants are expected to fall to US$ 1.8 billion by 2023 (9.5 percent of GDP). Under both scenarios, declining grants will increase pressure on development spending in the context of declining domestic revenue collection.

Overall expenditures are expected to remain around Afs 430 billion in 2020, despite COVID-19 response needs, reflecting declining revenues, limited new grant inflows, and constraints to available financing sources. Total recurrent expenditures are estimated at Afs 299 billion, an increase of 5.6 percent over 2019. Both discretionary and non-discretionary development spending are being significantly reprioritized to

[1] WB staff assumes revenues from VAT to begin in 2022, originally planned to begin in 2021. The objective is to present a realistic revenue projections reflecting the current progress with VAT implementation, also impacted by the government lockdown.

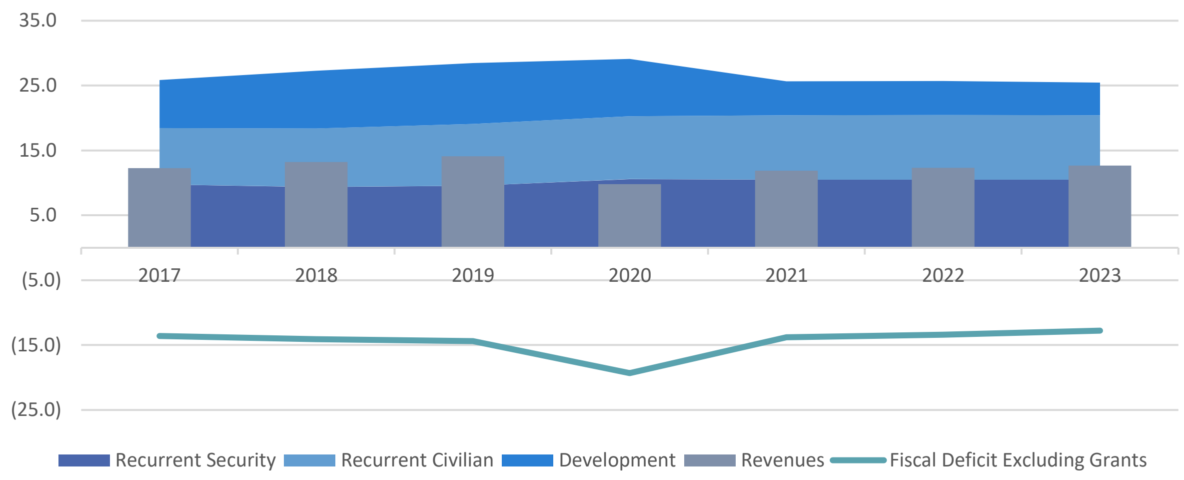
respond to the pandemic. Discretionary development expenditures are expected to decrease by more than 21 percent from Afs 61 billion in 2019 to Afs 48 billion in 2020. Non-discretionary expenditures are expected to increase by Afs 15 billion, partially offsetting the decline in discretionary development expenditure.

Government expenditures are expected to decline over the medium term. Driven by low revenue collection and declining grants, total expenditures are expected to decrease from more than 29 percent of GDP to around 25.7 percent of GDP by 2024. Recurrent expenditures are expected to remain stable at around 20.5 percent of GDP under the baseline scenario. Development expenditure will sharply contract from nine percent of GDP to around five percent in the medium term, reflecting revenue and financing constraints.

Table 1: Fiscal outlook in baseline and downside scenario

	Pre-COVID	Baseline projections				Downside projections			
Fiscal Accounts (in billion USD)	2020	2020	2021	2022	2023	2020	2021	2022	2023
Revenues	5.1	4.9	4.5	4.7	4.8	4.8	4	4.1	4.2
Domestic Revenues	2.6	1.9	2.2	2.4	2.5	1.8	2	2.2	2.4
Grants	2.5	3	2.4	2.3	2.2	3	2	1.9	1.8
WB COVID	-	0.8	-	-	-	0.8	-	-	-
Others COVID	-	0.2	-	-	-	0.2	-	-	-
Expenditures	5.4	5.6	4.9	5	5.1	5.5	4.3	4.5	4.6
Operating	3.7	3.9	3.9	4	4.1	3.8	3.6	3.7	3.8
Development	1.7	1.7	1	1	1	1.7	0.78	0.74	0.73
Discretionary Development	0.8	0.6	0.1	0.1	0.1	0.6	0.04	0.04	0.06
Non-discretionary Development	0.9	1.1	0.9	0.9	0.9	1.1	0.74	0.7	0.67
Fiscal Balance	-0.3	-0.7	-0.4	-0.3	-0.3	-0.7	-0.4	-0.3	-0.3
Financing	0.2	0.4	0.2	0.2	0.2	0.4	0.2	0.2	0.2
Domestic	-	-	-	-	-	-	-	-	-
External	0.2	0.4	0.2	0.2	0.2	0.4	0.2	0.2	0.2
IMF RCF	-	0.2	-	-	-	0.2	-	-	-
Others	0.2	0.1	-	-	-	0.1	-	-	-
Change in cash reserves	-0.1	-0.3	-0.2	-0.1	-0.1	-0.3	-0.2	-0.1	-0.1

Figure 16: Government will remain highly dependent on aid inflows
(Percent of GDP)



Sources: Ministry of Finance data, World Bank staff projections

Table 2: Macro-fiscal outlook with the pandemic shock

	Pre-COVID	Baseline projections				Downside projections			
	2020p	2020	2021	2022	2023	2020	2021	2022	2023
Real				*percentage change*					
Real GDP	3.3	-5.5	1	2.5	3.7	-7.4	-1	2.8	3.5
Agriculture	5	5	3.5	5	5	3.2	3	5	5
Industry	2.5	-5	0.3	2.5	3.5	-7.5	-0.9	2.5	3.5
Services	3	-9.6	0.2	1.5	3.5	-11.3	-2.6	2	3
Per capita GDP (US$)	499	492.6	479.2	477.4	483.4	485.8	461.1	462.7	467.4
CPI (% change)	3.5	5	3.5	4.5	5	5.5	3	5	5
Fiscal				*percent of GDP*					
Revenues	26.3	25.4	23.7	24.1	23.8	25.3	21.7	21.9	21.7
Domestic Revenues	13.2	9.8	11.4	12.3	12.6	9.4	11	11.9	12.2
Grants	13.1	15.6	12.4	11.8	11.1	15.9	10.7	10	9.5
Expenditures	27.8	29.1	25.7	25.7	25.5	29.1	23.7	23.7	23.5
Operating	19	20.2	20.4	20.5	20.4	20.3	19.4	19.7	19.7
Development	8.8	8.9	5.3	5.2	5	8.8	4.2	4	3.8
Fiscal Balance	-1.5	-3.7	-1.9	-1.7	-1.7	-3.8	-2	-1.7	-1.8
External									
Current Account Balance (% of GDP)	2.4	3.2	-1.6	-2.6	-3.6	4.8	-2.4	-3.9	-5.1
Import (merchandise, % change)	3.3	-12	3	3	4	-19	0	4	4
Exports (merchandise, % change)	10	-17	6	10	15	-28	2	10	12
Financing Requirement									
Fiscal (million US$)	294	700	400	300	300	700	400	300	300
External (million US$)	-451	-538	321	488	675	-783	527	736	968

The pandemic has exacerbated short-term risks

The pandemic is expected to have a severe and sustained impact on Afghanistan's economy. The pandemic is likely to further exacerbate economic vulnerabilities, straining medium term economic growth prospects and increasing humanitarian pressures. A protracted global COVID-19 crisis would have serious implications for growth, revenues, and – potentially – international grant support.

Major risks arise from potential reductions in international security and civilian assistance in the context of the COVID-19 crisis. Even with expected gradual grant declines, required fiscal adjustments will significantly impact the capacity of government to finance the public services and infrastructure required to support improved development outcomes and medium-term growth. Faster-than expected reduction in aid support would have severe consequences for service delivery and economic growth. Reductions in security support would lead to the diversion of available fiscal resources towards security needs, further undermining the capacity of government to finance services and infrastructure required for growth and poverty reduction.

Risks to economic recovery are further exacerbated by insecurity and uncertainties associated with planned peace negotiations with the Taliban. Prospects for a peaceful settlement with Taliban remain highly uncertain, while attacks on security services have reached record highs. Continued and intensified violence could further undermine private sector confidence with negative impacts on growth and revenue collection. Deterioration in the security situation could also divert government capacity and policy attention from essential reforms, impede the delivery of essential services, and disrupt implementation of development projects.

Government should focus on optimizing available fiscal resources

Government has few policy levers available to manage the COVID-19 crisis. Monetary transmission channels are weak, and government faces binding financing constraints given limited access to commercial and concessional debt.

With declining revenues and constrained fiscal resources, public expenditures need to be carefully directed to protect the vulnerable, limit long-term economic damage, and establish the foundations for economic recovery. To support households, government should prioritize: i) social protection measures, especially for the poorest and in areas where lockdowns are limiting employment opportunities; and ii) ensuring the continued provision of basic services, especially healthcare. To support the private sector, government should: i) pursue business regulatory reforms to facilitate new investment when the crisis eases; ii) work to expand access to credit; iii) ensure continued provision of basic infrastructure on which firms rely, such as water, electricity, and telecommunications; and iv) support private sector confidence through avoiding accumulation of arrears to private sector vendors. Given heavily constrained available resources, direct support to the private sector should be limited and carefully prioritized towards sectors and firms where business closures would impose lasting economic damage (for example, the relatively few firms that are deeply integrated into local and regional supply chains or provide services on which other businesses depend).

Continued grant support is vital

For development partners, the highest priority is ensuring continued and predictable grant support. Uncertainty regarding future international support is already contributing to weak confidence. With revenues negatively impacted by COVID-19, precipitous declines in grant flows over coming years would force major contraction in government services, undermining development outcomes and future growth prospects. Clear commitment to continued grant support is vital to improve confidence and investment, and to underpin Afghanistan's recovery from the already-severe impacts of the COVID-19 crisis.

C. Focus Section: Household Welfare Impacts of COVID-19 in Afghanistan

1. Introduction

Amidst an already uncertain political and economic climate, Afghanistan faces the prospect of a severe decline in the welfare of its population due to the crisis associated with the COVID-19 pandemic. In order to have a first understanding of the magnitude of these impacts, a microsimulation[2] using household survey data was conducted to estimate the short-term impact on poverty of the COVID-19 economic shock. The microsimulation considers the reduction of household income due to lockdowns and social distancing measures, and the projected contraction of the economy in 2020. It also considers a potential spike in food prices due to border closures implemented to contain the outbreak. Three scenarios were simulated, in an increasing order of the severity of the impact. Accordingly, poverty could increase from a baseline scenario of 54.5 percent to 61, 68 or 72 percent. This corresponds to 1.9, 4 and 6 million Afghans falling into poverty. The impact on household welfare are more pronounced and more regressive in urban areas. With households having limited means of mitigating the long-term consequences of income losses, the results from this analysis highlight the importance of policy responses in support of affected households.

2. Vulnerability to Economic Lockdowns

Many households across the income distribution, especially in urban areas, depend on vulnerable sources of income.

A substantial share of income for households across the income distribution depends on activities vulnerable to lockdowns and social distance measures associated with COVID-19 outbreak, especially in urban areas[3]. At the national level, over 50 percent of household income in the poorest quintile depend on income from activities like shop keeping, street or market sales, or daily labor in construction, agriculture or personal services. These households will be severely impacted by the crisis, as the measures to slow down the spread of the virus will reduce their ability to generate incomes. This is especially true for urban households, for whom two thirds of their average income can be linked to these activities. Rural households, due to their closer link to agriculture and livestock activities, are not expected to be as heavily impacted initially, although due to their initial high poverty rates, is clear that they are particularly vulnerable to even small changes in incomes. Moreover, lockdowns could affect sowing and harvesting processes, and disruptions to supply channels could inhibit access to inputs and disrupt crop sales.

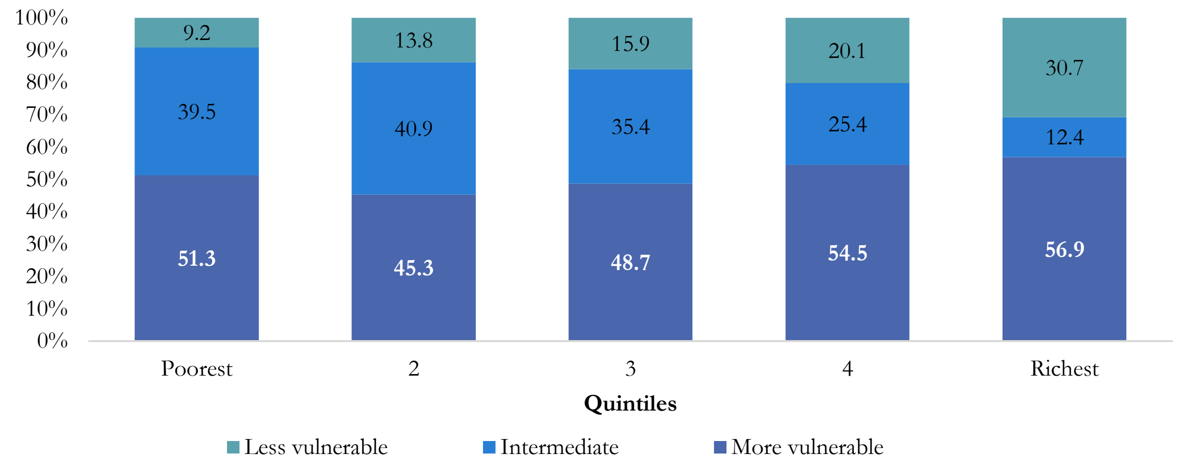
In addition, a slowdown in remittances and price shocks can also affect households across the country. Economic turbulence in countries with large Afghan diasporas (e.g. Iran and Pakistan) can affect households that rely on international remittances. Although remittances account for less than 5 percent of household income nationally, there are regions like Ghazni and Khost where over 20 percent of households heavily depend on them. Further, shortages or disruptions in food supply due to border closings can lead to spikes in import prices, which would adversely

[2] An estimation of ex-ante impacts by simulating potential changes at the household-level.

[3] Activities identified as vulnerable include [production and manufacturing] food production and processing, mechanics work, road and building construction, other production work; [services] taxi and transportation, other service work; [trade] shop keeping and small business, street and market sales, other trade; [other labor] casual wage labor, day labor; [other income] borrowing, zakat, begging.

affect households in the bottom 60 percent for whom food purchases comprises half of their total consumption.

Figure 17: Household income sources by definition of vulnerability



Source: World Bank staff based on ALCS 2016/17. More vulnerable are income sources likely to be affected by lockdowns in cities, like street vendors and construction workers. Intermediate is income from agricultural or livestock activities. Less vulnerable is income from professions like teachers or the military, and activities performed in the house like carpet weaving.

In aggregate, almost 15 million people live in households where at least half of their income is vulnerable.

For 2 million households, corresponding to close to 15 million people, at least 50 percent of their income depend on the vulnerable sources of incomes or remittances. While the poverty rate for these households (53 percent) is close to the national average (54.5 percent), the consumption levels for 70 percent of them are below 1.5 times the value of the poverty line, indicating a high vulnerability to income shocks. The largest concentration of this group is in Kabul, with around 2.9 million people, followed by the provinces of Nangarhar, Herat, Ghazni and Balkh.

3. Methodology

Three scenarios were simulated from moderate to severe impacts. A food price shock was added to all the scenarios.

Three potential scenarios were constructed to estimate the potential welfare impact of economic lockdown related to Covid-19. For this, first, an initial *baseline* was constructed based on the income and consumption distributions of the 2016/17 Afghanistan Living Conditions Survey, the latest household survey data available in the country. This implicitly assumes that income and consumption has remained stable between 2016/2017 and 2020 but is an assumption we take as opposed to try to update the information to 2020, in light of the erratic relation between GDP and welfare in the recent decade[4]. On the scenarios constructed, *Scenario 1* assumed that the sectoral declines in GDP projected for 2020 for the Services and Manufacturing sectors directly translates into loss of household incomes generated from those sectors. These projections are taken from the Spring 2020 edition of the Macro Poverty Outlook (MPO) published by the World Bank in March[5]. In addition, the decline is distributed unevenly during the year, so that the months of April-June are more heavily impacted while the other months are less impacted, trying to replicate the different levels of intensity of the shock expected during the year. For the Agriculture sector, despite a projected growth of 5 percent in 2020 in the MPO, we assumed a more conservative projection of 0 percent for the entire year of 2020.

[4] World Bank (2018) Afghanistan Poverty in Afghanistan. Results based on ALCS 2016-17.
[5] https://www.worldbank.org/en/publication/macro-poverty-outlook

Finally, remittances are assumed to fall by 50 percent in April-June, and by 25 percent in the rest of the year. *Scenario 2* is based on the same assumptions of Scenario1, but with an additional decline in household income from vulnerable sources identified before by 50 percent in April-June, and 25 percent in the rest of the year. *Scenario 3* is also based on the same assumptions of Scenario1, but with an additional decline in household income from vulnerable sources by 75 percent in April-June, and by 50 percent in the rest of the year. In addition, a *food price shock* was added to the simulations, corresponding to price increases of 20 percent in April-June, and no increases thereafter.

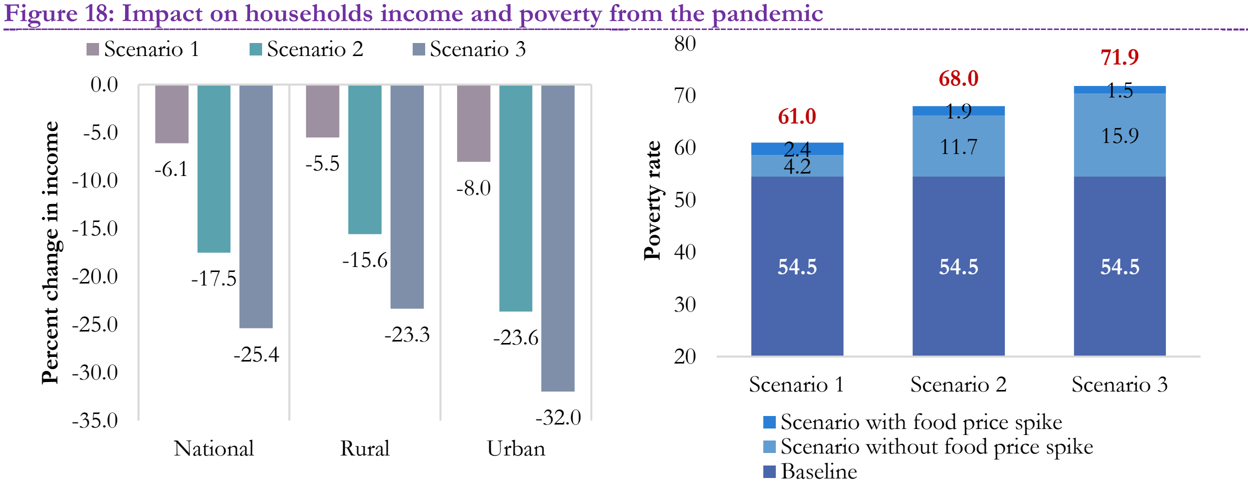
This simulation exercise comes with a few caveats and assumptions. Only short-term impact of the economic lockdown is modeled. In addition, the simulation does not account for any policy response or behavioral adjustments on consumption or occupational choices. Also, general equilibrium impacts on prices and wages are not considered. Quantifying broader welfare impacts of the COVID-19 remains a challenge for future work and will also depend on access to relevant data on households' behavior and firms' performance during the crisis period.

4. Results

Household income is estimated to decline by 6, 18 or 25 percentage points, depending on the scenario.

The microsimulations show moderate to substantial income impacts, with declines on household income of 6.1, 17.5 or 25.4 percentage points nationally, depending of the scenario under consideration (Figure 18: Impact on households income and poverty from the pandemic). The impact is significant in both urban and rural areas, although it is larger in urban regions, in line with their higher dependence on vulnerable activities. The decline in household incomes show considerable heterogeneity across provinces (Scenario 3), with impacts smaller than -15 percent for Wardak, Helmand, Badghis, Zabul and Ghor, while other provinces observe impacts larger than -35 percent (Daykundi, Paktika, Paktya and Nangarhar).

Figure 18: Impact on households income and poverty from the pandemic



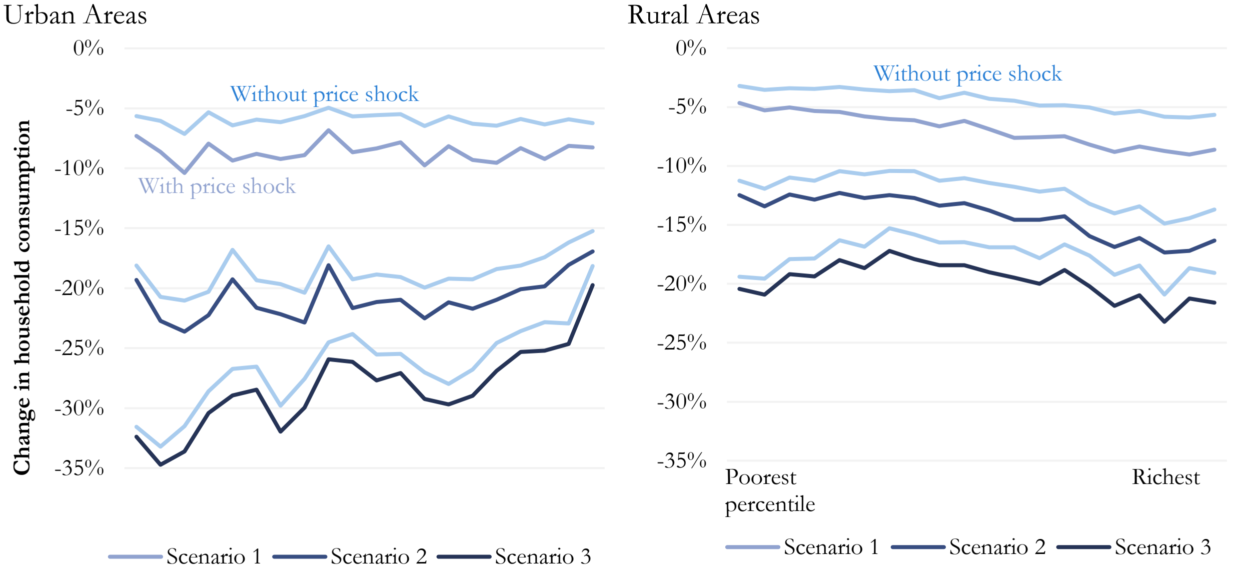
Source: World Bank staff based on ALCS 2016/17.

Poverty is estimated to increase by 7, 14 or 17 percentage points, depending on the scenario.

The microsimulations show also moderate to substantial poverty impacts, with poverty increasing by 6.6, 13.5 or 17.4 percentage points, depending of the scenario assumed (Figure 19: Impact on household consumption, by scenario assumed, location and percentile). To estimate the impacts on poverty, the declines in income were applied to the household consumption estimate, adjusting by a factor of 0.7. The resulting impact is significant in both urban and rural areas, although is larger and

regressive in urban centers, especially for the worst-case scenario, due to the importance of casual work among the poorest (Figure 18). For rural households the impacts are slightly larger for the well-off due to their higher dependence on vulnerable activities in services (e.g. transportation, shop-keeping) and a marginally higher impact of the food prices shock.

Figure 19: Impact on household consumption, by scenario assumed, location and percentile



Source: World Bank staff based on ALCS 2016/2017.

Households with working women are also heavily impacted, as are vulnerable categories

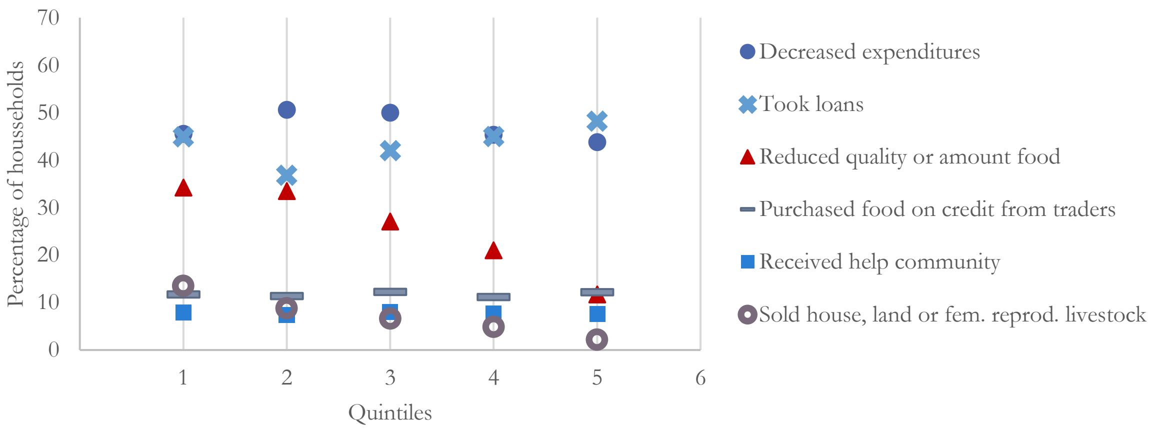
The impact on households with working women is similar in magnitude to those that only depend on male employment. Close to 26 percent of households in the country report having an adult female working, despite very low female labor force participation. These women are employed mainly in the agriculture and manufacturing sectors, both in vulnerable and not vulnerable activities, as per the categorization developed. The baseline poverty rate for these households is slightly lower (51.5 percent) than the national average (54.5 percent), and the impact is of similar magnitude, resulting in final simulated poverty three percentage points below the national average impact. With respect to vulnerable categories, households currently displaced and that have returned from displacement face larger impacts. These households represent a small share of the total national (2 and 11 percent, respectively), and although their baseline poverty rates are lower than national averages, the impacts are larger. In Scenario 3, poverty increases from 46 percent to 69 percent for displaced households, while for returning households the increase is from 53 percent to 75 percent. Households with a member with a disability show impacts similar to the rest of the country. They represent 19 percent of the households in the country, and despite a slightly higher baseline poverty rate (55.6 percent), final poverty rates calculated (72.5 in the Scenario 3) are similar to the national average in the different scenarios discussed.

Afghan households have limited resources to mitigate the consequences of the income shock on their own.

Most common coping mechanisms against negative shocks include decreasing expenditure and borrowing, which are not sustainable at low initial levels of consumption and creditworthiness. Moreover, poorer households are compelled to reduce their quantity or quality of food, exposing them to potential long-term negative impacts, especially for children. (Figure 19). Moreover, a calculation on the time households would be able to survive by selling assets shows that on average

only 2 months of basic consumption could be covered[6]. Although, even selling assets could have enduring negative impacts on the earning capacity of the Afghan households.

Figure 20: Coping strategies of Afghan households



Source: World Bank staff based on ALCS 2016/17. . Coping strategies by households who received a shock that affected their flow of income immediately

5. Conclusion

The expected moderate to high widespread impact on poverty highlights the importance of exploring policy responses in support of affected households.

The limited means to mitigate the welfare effects of income losses from Covid-19-related crisis leaves the Afghan families only with destructive coping strategies that potentially have long-term negative effects. Impacts on household welfare are considerable and widespread across the country. Overall, affected households may be forced to reduce expenditure on education and food, or sell assets, with long-lasting negative impacts on livelihoods and human capital accumulation. Issues associated with a worsening of the security conditions could also compound with these negative effects. Therefore, supporting them to navigate the impact of the crisis is of critical importance to avoid lasting impacts. Policy options explored by other countries in this context include conditional or unconditional food and cash transfers for those affected (excluding top earners) and programs for securing inputs for rural agricultural households. Exploring these policy responses in the Afghan context could benefit affected households, avoiding losses that could take years (and maybe a generation) to overcome.

[6] For this simulation, only durable goods and livestock are considered as assets that can be liquidated. Households are assumed to sell 25% of the value of their assets at a price of 25% of the assets' market value. Basic consumption includes food and basic non-food, but not rents or purchases of durable goods.

D. Focus Section: Revenue and Distributional Impacts of Introducing the VAT in Afghanistan

1. Summary

This note examines the revenue and distributional impacts of introducing the VAT for large companies in Afghanistan. We show that the reform is expected to increase tax revenue by ca. AFN 8 billion, or 0.52 percent of GDP, if introduced in 2021. Additional potential revenue could reach close to 0.73 percent of GDP by 2025. In the long-term, VAT revenues are expected to further increase as it will help to broaden the tax base by formalizing and documenting the production chain. As can be expected from introducing a higher tax rate on goods and services, without additional corrective expenditure measures the VAT will place a small additional burden on households and will slightly increase poverty. Both effects are estimated to be less than half a percentage point. At the same time, VAT will provide additional revenues for pro-poor spending that could correct for these effects. Finally, we show that repealing the BRT below the VAT threshold will lead to a limited foregone revenue of ca. Afs 1.2 billion, while at the same time resulting in expected administrative and economic efficiency gains.

2. Tax Policy Change: Introducing the VAT

The VAT is estimated to raise additional revenue of 0.5-0.7 percent of GDP between its introduction and 2025.

Afghanistan is to replace its turnover tax (Business Receipt Tax, BRT) with a Value Added Tax (VAT) for large companies. With the introduction of the VAT, domestic revenue is expected to rise by an estimated AFN 8 billion, or 0.52 percent of GDP, if introduced in 2021. Additional potential revenue could reach close to 0.73 percent of GDP by 2025. In the long-term, VAT revenues are expected to further increase as it will help to broaden the tax base by formalizing and documenting the production chain. Moreover, with this transition, Afghanistan's exports are expected to become more competitive, as the VAT applies a 'destination-based' approach to taxation in which goods and services are taxed where they are consumed.

The proposed VAT will recast the tax rate system. A 10 percent rate will be applicable to the majority of goods and services.[7] The most important exemptions under the VAT system will be granted to providers of basic food items and basic materials used for household purposes (such as coal, fire wood, liquid gas and soap), education and healthcare services. Under the VAT law, the VAT will be levied at the gross margin of only large companies, defined as companies with a yearly turnover of Afs 150 million (USD 1.97 million) or above. It is estimated that at the time of introducing the VAT, around 1100 large taxpayers will qualify and be subject to the VAT. In addition, VAT will be levied on all imports. VAT paid on imports can be credited against the VAT payable.

Eliminating the BRT upon introducing the VAT outweighs the relatively limited loss in net revenue.

A policy discussion that continues to be undecided is whether to repeal the BRT when introducing the VAT. Based on the current regulatory environment, the VAT will replace the BRT for large companies, while the BRT will continue to apply to sales by companies under the VAT threshold. For these companies, VAT paid on imports can be credited against either the BRT payable, as the partial import credit system will be maintained for BRT payers. Repealing the BRT altogether upon

[7] Exemptions with the right to deduct input VAT.

introduction of the VAT would significantly decrease compliance costs for small and medium taxpayers, and reduce the administrative burden on the ARD to maintain two parallel tax-cycles and structures (incl. audit etc.). The estimated reduction in net revenue is relatively limited at Afs 1.2 billion, or 2.6% of the total estimated revenue from sales tax. This is a relatively minimal reduction, while a net gain of Afs 6.8 billion remains, coupled with expected administrative and economic efficiency gains. It is expected that Afghanistan's *Doing Business, Paying Taxes* raking will rise if the BRT is completely eliminated. The impact analysis in this note, however, is based on the current regulatory environment, under which the BRT will continue to apply to sales by companies under the VAT threshold and the VAT is set to be introduced in 2021.

3. Revenue Impacts

Sales tax is an important tax type in Afghanistan, equivalent to income tax and customs taxes and duties.

Afghanistan's current sales tax – the BRT – represents around 17 percent of total domestic revenue collection. The majority, or around 60 percent of BRT is collected at the border. The remaining 40 percent is collected by the large, medium and small taxpayer offices in Kabul, as well as the provincial Mustofiats. There is a high proportion of non-filers (ca. 34 percent), defined as those who pay BRT at the border when importing, but who do not subsequently file a BRT return with the Afghan Revenue Department (ARD). For the government this implies that a significant portion of BRT paid at customs is never deducted in BRT returns and thus represents a final revenue.

Based on 2019 data (FY1398), the VAT reform is expected to translate into an additional potential revenue of 0.52 percent of GDP in 2021. Over time, as the tax base naturally continues to grow through economic growth and inflation, and the tax administration continues to improve its efficiency, additional potential revenue could reach close to 0.73 percent of GDP in 2025.

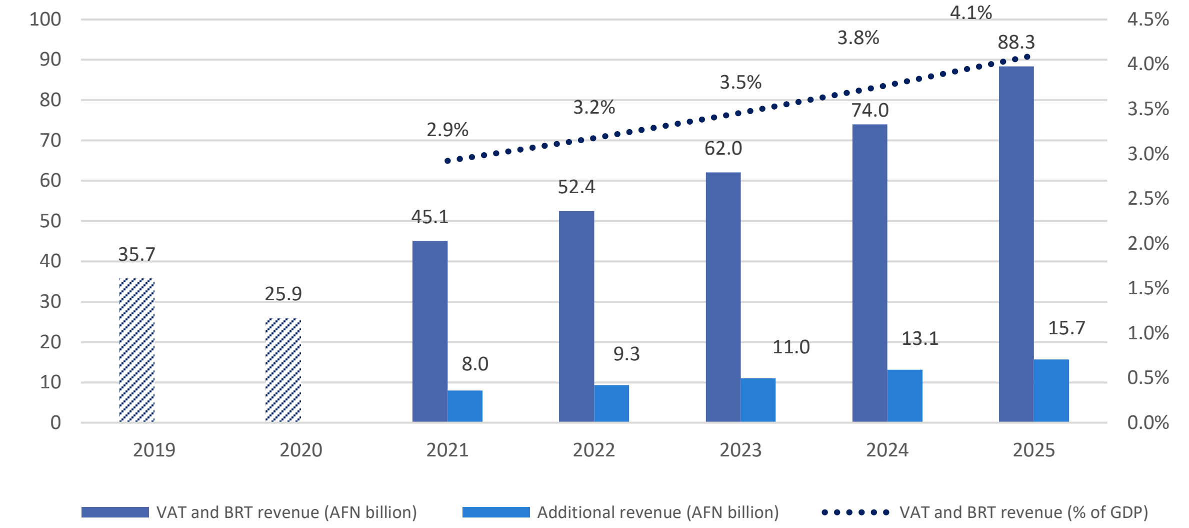
Extrapolating this to revenue forecasts for 2021 and beyond, the VAT reform is expected to increase tax revenue by ca. Afs 8 billion in 2021.[8] In nominal terms, in 2021 sales tax revenue (VAT and BRT combined) is estimated to amount to Afs 45 billion (see Figure 21 and Figure 22).[9] In relative terms, its share will account for ca. 2.9 percent of GDP. Assuming continuation of the trend of increasing efficiency of tax administration of 8.6 percent a year as of 2022,[10] VAT and BRT revenue will reach Afs 88.3 billion and 4.1 percent of GDP in 2025. Additional revenue from introducing the VAT will increase gradually to reach ca. AFN 15.7 billion Afs in 2025.

[8] This assumes a drop in revenue for 2020 due to the impact of COVID19, resulting in a decrease in both the tax base and compliance which is expected to reach ca. 27.5% (average of actual reduction in customs collections in the first 5 months of 2020), but a recovery of the tax base in 2021 compared to 2019.

[9] The post-reform VAT and BRT revenue and their components were estimated using a top-down approach, for which Supply and Use Tables (SUT) and customs data served as sources of information on the tax base. To account properly for the economic activity of non-filers (i.e., non-compliant entities) and potential inaccuracies in the data, SUT were rescaled using actual fiscal revenue figures. In addition, the Afghanistan Living Conditions Survey 2016/2017 (ALCS) and information from fiscal registers served estimating pre- and post-reforms weighted average rates for all groups of products and services.

[10] Since most of the additional revenue will be collected by customs and will not be affected by systemic changes introduced by the VAT reforms, we assume that the efficiency of tax administration between 2020 and 2021 will recover any loss in efficiency in 2020 but otherwise remain stable. As of 2022, the efficiency is expected to continue a positive trend of increasing efficiency observed between 2016 and 2019. Between those years, the revenue went up on average by 8.75 percent faster than increase in the tax base despite no changes in the statutory rates.

Figure 21: Revenue forecast (Afs billion/percent of GDP) [11]

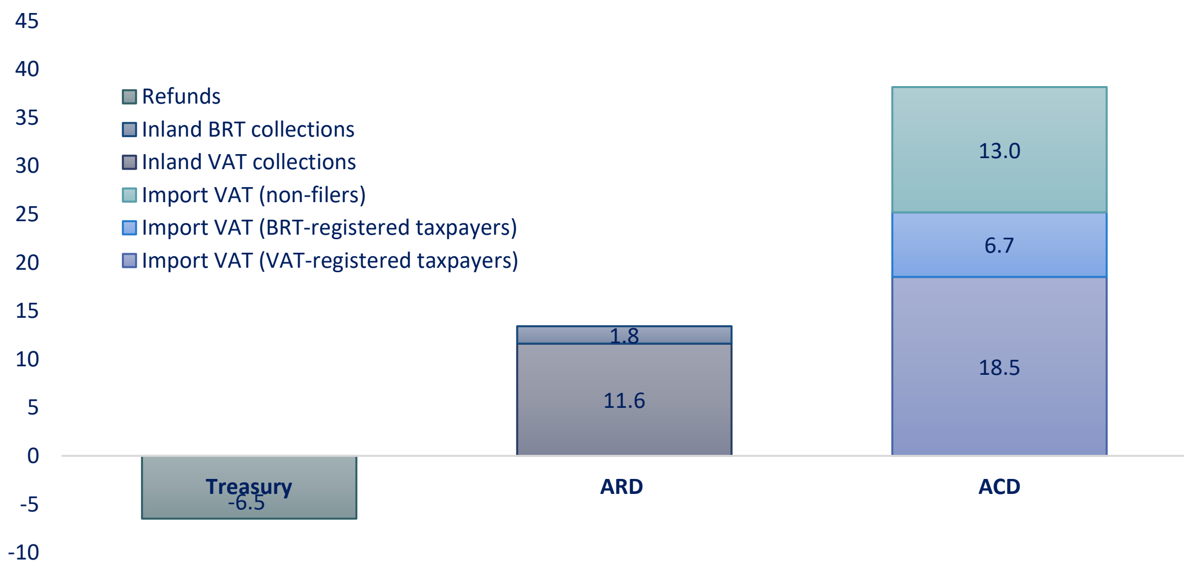


Sources: Ministry of Finance data, World Bank staff projections

The majority of VAT will be collected at the border

Due to the relatively large role of border taxation in Afghanistan's domestic resource mobilization – in particular when it comes to sales tax – the majority of VAT will be collected at the border. Collections by customs are estimated to nearly double in 2021, compared to current BRT collections at customs points, which were Afs 21.5 billion in 2019. Additionally, revenue collected by ARD will amount to roughly Afs 13.4 billion. Of these collections, Afs 6.5 billion is estimated to be refunded to exporters (AFN 3 billion), food producers (Afs 2.9 billion) and BRT payers (Afs 0.6 billion).

Figure 22: VAT and BRT collection by agency (2021, Afs billion)



Sources: Ministry of Finance data, World Bank staff projections

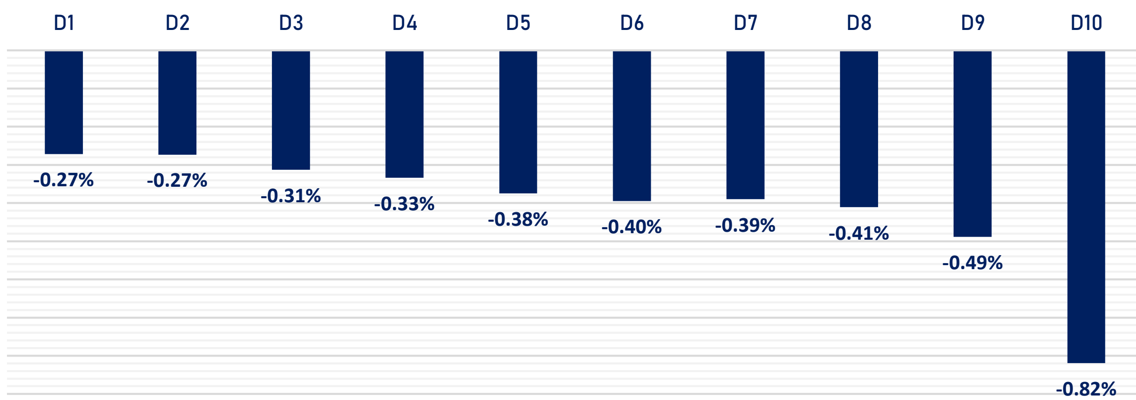
[11] Source of macroeconomic forecasts: World Bank macroeconomic framework. Figures for 2019 and 2020 contain only BRT revenue since at that point in time no VAT is levied yet.

4. Socio-Economic Impacts

The VAT introduction will place a small additional burden on households and will slightly increase poverty.

As can be expected from introducing a higher tax rate on goods and services, the VAT will place a small additional burden on households, though this will be lower than one percent of their current income and more pronounced for richer households. On average, purchasing power – or the capacity to afford goods and services – will reduce by 0.41 percentage points of households' current income. This additional burden is slightly lower at the bottom of the income distribution: the bottom 20 percent loses 0.27 percent of their income in real terms. The loss in purchasing power increases slowly across the income distribution, with an exception for the richest 10 percent of households, who see their purchasing power decrease by 0.82 percent (Figure 23). However, even for the top 10 percent the additional burden is considered modest.

Figure 23: Change in post fiscal income across income groups[12]



Sources: National Statistic and Information Authority: Afghanistan Living Conditions Survey 2016/2017 (ALCS) and Supply and Use Tables, World Bank staff projections

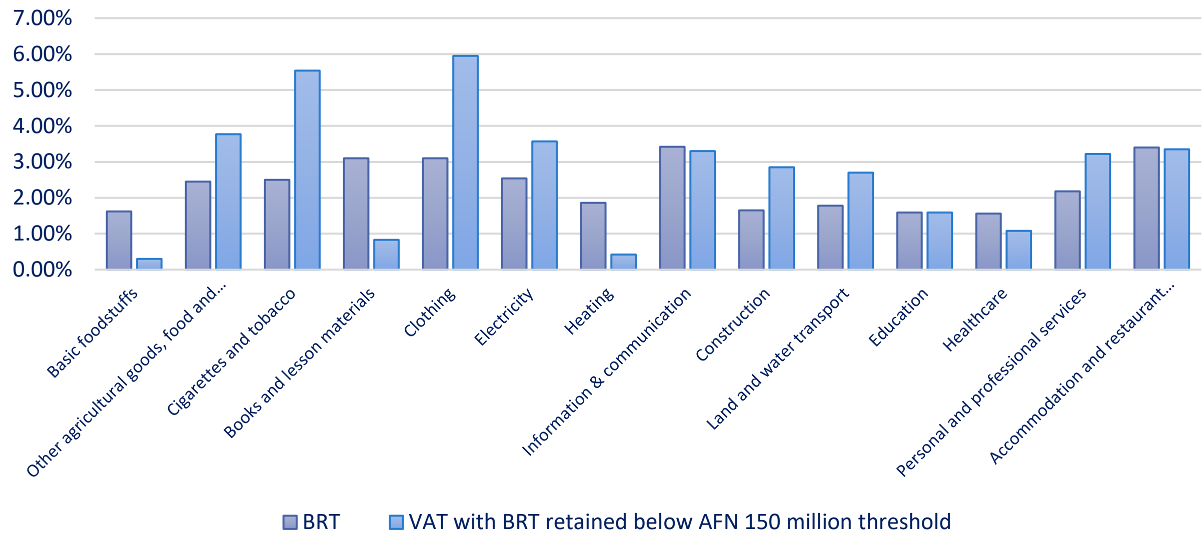
The impact on poverty is also considered to be very modest. The analysis conducted with a microsimulation model accounting for behavioral effects and implicit tax burden of the current and post-reform tax systems shows that, as an immediate effect of introducing the VAT, the share of households living in poverty will increase in net terms by just over 0.3 percentage points, from 54.5 percent up to 54.8 percent. Translated in number of people, the reform would push line close to 150,000 people below the poverty, mainly in rural areas.

Implicit tax rates are minimal for basic food items and basic materials used for household purposes and generally below the statutory VAT rate of 10 percent.

The implicit tax burden on the majority of basic goods and services will nearly fall to zero as a result of the introduced exemptions. The most significant decline in implicit tax burden will be observed for basic foodstuffs, heating, books and lesson martials, for which the proportion of taxed goods and hidden tax accrued at the intermediate stage will be minimal. The overall tax burden for the majority of goods will increase but remain somewhat below the statutory VAT rate of 10 percent, which is mostly due to the proportion of non-filers and the significant portion of companies below the VAT threshold.

[12] Scenario: the introduction of the VAT for large taxpayers and imports while maintaining the BRT for medium and small taxpayers and administering exemptions as currently specified in the VAT Law.

Figure 24: Implicit rates for selected groups of products and services



Sources: National Statistic and Information Authority: Afghanistan Living Conditions Survey 2016/2017 (ALCS) and Supply and Use Tables, World Bank staff projections

Exemptions help to dampen the increased tax burden on low income households in particular

The impact of the reform on the income distribution would have been more pronounced if not for the exemptions that are introduced in the VAT regime. The VAT Law includes exemptions to selected agricultural products, such as wheat, flour, rice, sugar, cooking oil, tea, onions, potatoes and salt. These goods are consumed in larger shares by poorer households, as also illustrated in Figure 23 below, hence the exemptions help reduce the negative impact of the reform on their income. The share of expenditure on basic goods and services which will be subject to VAT exemptions, is close to 42 percent in the poorest income decile, as opposed to 18 percent of the highest income decile (32 percent on average).

Exemptions contribute to making the VAT reform progressive

Moreover, the exemptions contribute to making the VAT reform *progressive*, rather than regressive. Figure 23 illustrates what the distributional impact on households' income of the VAT would have been without exemptions. It is clear that in such a scenario, the poor's income would have disproportionally been affected and the reform would have been regressive in nature.

Figure 25: Consumption pattern by household income level

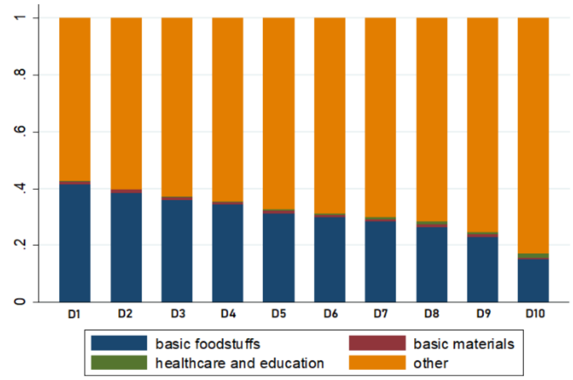
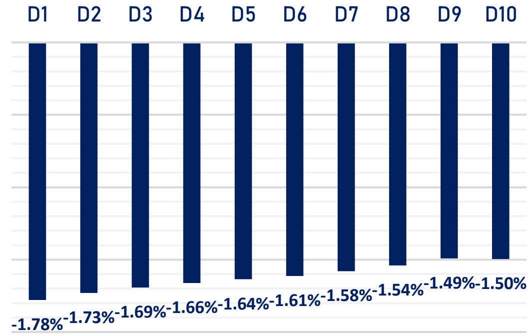


Figure 26: Change in post fiscal income across income groups without VAT exemptions[13]



Sources: National Statistic and Information Authority: Afghanistan Living Conditions Survey 2016/2017 (ALCS) and Supply and Use Tables, World Bank staff projections

The VAT will slightly reduce inequality

More broadly speaking, the reform will play a small equalizing role on incomes. The share of consumption of poorer households in the total national consumption will increase compared to the pre-reform scenario. While before the reform the bottom 40 percent accounted for 16.8 percent of the country's consumption, after the reform this share will increase to 17.9 percent. The Gini coefficient, which also captures the degree of inequality in the country, will decline from 0.407 down to 0.391. As indicated above, this equalizing role results from the exemptions that benefit lower-income households disproportionally, but also from the change in consumption patterns in response to a slightly higher tax burden.

[13] Scenario: the introduction of the VAT for large taxpayers and imports while maintaining the BRT for medium and small taxpayers but without exemptions as currently specified in the VAT Law.

Table 3: Post-fiscal Lorenze curves and Gini coefficients

Percentile	**BRT**	**VAT (with BRT under threshold)**	VAT (without exemptions)
0	0	0	0
5	0.010	0.011	0.011
10	0.025	0.028	0.027
15	0.043	0.047	0.046
20	0.063	0.069	0.068
25	0.086	0.093	0.091
30	0.111	0.119	0.118
35	0.139	0.148	0.146
40	0.168	0.179	0.176
45	0.201	0.212	0.209
50	0.236	0.248	0.244
55	0.274	0.286	0.282
60	0.315	0.327	0.323
65	0.359	0.372	0.367
70	0.408	0.420	0.415
75	0.462	0.472	0.467
80	0.522	0.531	0.525
85	0.590	0.597	0.591
90	0.672	0.678	0.672
95	0.781	0.787	0.782
100	1	1	1
Gini	**0.407**	**0.391**	**0.397**

Sources: National Statistic and Information Authority: Afghanistan Living Conditions Survey 2016/2017 (ALCS) and Supply and Use Tables, World Bank staff projections

Tax expenditures are significant and will cost the government Afs 10.5 billion in 2021

Despite these re-distributional benefits, exemptions do come at a cost. Tax exemptions with the right to deduct input tax granted to producers and traders on basic food items and basic materials will cost the government ca. Afs 10.5 billion in 2021. Note that this is not money that the government will have to actively spend, but it is rather foregone income. Since zero-rated categories of goods and services account for ca. 32 percent of household consumption[14], this element introduces large scale tax expenditures (or foregone income) of 23.2 percent of actual VAT and BRT revenue. As the distributional impact assessment of the VAT shows, these exemptions will benefit the bottom of the income distribution relatively more, although leakages to rich households take place as they too consume exempted basic food items and basic materials. The question is whether better targeting would be possible. Generally speaking, it is recommended to minimize exemptions to the extent possible, so as to not distort the VAT chain and avoid revenue falls. Moreover, the VAT will generate additional revenue that could be used to introduce a poor-targeted safety net. Such a strategy would allow the government to increase revenues while supporting the less well-off.

[14] Estimates based on detailed consumption data from ALCS 2016/17.

Table 4: Macroeconomic indicators

	2017	2018	2019	2020	2021	2022	2023
			est.	*proj.*	*proj.*	*proj.*	*proj.*
Output/Income							
Nominal GDP (billion Afs)	1,376	1,409	1,483	1,475	1,554	1,663	1,808
Nominal GDP (billion USD)	20.2	19.5	19.5	19.2	19.2	19.6	20.3
GDP Per Capita	556.3	524.2	511.6	492.4	482.7	480.9	486.9
Population (million)	36.3	37.2	38.0	38.9	39.8	40.8	41.7
Real Economy							
Real GDP Growth	2.7	1.8	2.9	-5.5	1.0	2.5	3.7
Agriculture	3.8	0.8	7.5	5.0	3.5	5.0	5.0
Industry	0.4	2.5	2.0	-5.0	0.3	2.5	3.5
Services	2.5	1.8	1.8	-9.6	0.2	1.5	3.5
GDP Composition (% of GDP)							
Agriculture	18.6	18.4	19.2	21.3	21.9	22.4	22.7
Industry	24.0	24.1	23.9	24.0	23.9	23.9	23.8
Services	53.1	53.0	52.5	50.2	49.8	49.3	49.2
Prices (12 month % Change)							
CPI Inflation (period average)	5.0	0.6	2.3	5.0	4.3	4.5	5.0
CPI Inflation (end-period)	3.1	0.8	2.8	5.5	3.6	0.0	0.0
Core Inflation (Excl. fuel and cereals)	3.4	-0.9	3.4	…	…	…	…
Fiscal (% GDP)							
Total Revenue and Grants	52.7	57.5	56.2	54.6	50.1	49.1	47.2
Domestic revenues	12.3	13.2	14.1	9.8	11.3	12.2	12.5
Grants	40.4	44.3	42.1	44.8	38.8	36.9	34.7
Security grants	23.0	25.0	23.9	25.0	23.2	22.1	21.4
On-budget	5.5	6.0	5.4	6.2	6.0	5.8	5.6
Off-budget	17.4	19.0	18.5	18.8	17.2	16.3	15.8
Civilian grants	17.4	19.3	18.2	19.8	15.6	14.8	13.3
On-budget	7.5	8.8	8.0	9.4	6.2	5.9	5.5
Off-budget	9.9	10.5	10.3	10.4	9.4	8.9	7.8
Total expenditures	53.2	56.7	57.3	58.3	52.0	50.7	48.9
Security spending	27.2	28.3	28.1	29.4	27.6	26.7	26.2
On-budget security	9.7	9.4	9.6	10.6	10.4	10.4	10.4
Off-budget security	17.4	19.0	18.5	18.8	17.2	16.3	15.8
Civilian spending	26.0	28.4	29.2	29.0	24.4	24.0	22.7
On-budget civilian	16.1	17.9	18.9	18.5	15.1	15.1	14.9
Off-budget civilian	9.9	10.5	10.3	10.4	9.4	8.9	7.8
Budget balance	-0.5	0.7	-1.0	-3.7	-1.9	-1.6	-1.7
Budget balance excl. grants	-13.6	-14.1	-14.4	-19.3	-14.2	-13.4	-12.7
External Sector							
Total trade balance (% GDP)	(33.7)	(32.7)	(30.1)	(27.3)	(27.8)	(27.9)	(27.6)
Exports of goods (million US$)	784	875	864	713	756	831	956
Imports of goods (million US$)	6,716	6,596	6,158	5,419	5,582	5,749	6,008
Service trade balance (million USD$)	(871)	(654)	(567)	(524)	(529)	(544)	(552)
Net current transfers (% GDP)*	44.8	47.0	45.9	45.26	39.1	37.5	35.5
Current account balance (% GDP)**	2.2	2.5	0.6	3.2	(1.5)	(2.5)	(3.6)
Financial account balance (% GDP)	0.6	(1.6)	(0.1)	(0.4)	(0.1)	0.1	0.2
Foreign exchange reserves (million US$)	8,053	8,206	8,628	9,166	8,845	8,357	7,682
Gross foreign exch. res. (months of merchandise impo	12	13	16	16	15	14	11
External debt (million US$)	1,258	1,213	1,321	1,689	1,853	2,038	2,224
Exchange rate (Af/US$, period average)	68.1	72.3	76.2	…	…	…	…
Exchange rate (Af/US$, end-period)	69.5	75.0	77.4	…	…	…	…
Monetary and Financial Statistics							
Broad money (M2, billion Afs)	473.8	486.0	513.8	511.0	538.3	576.1	626.3
Total deposits (% GDP)	18.4	18.9	17.8	17.8	17.8	17.8	17.8
Total deposits (billion Afs)	253.3	266.1	263.8	262.4	276.4	295.8	321.6
Share of dollar deposits (%)	62.4	64.1	64.2	60.7	55.3	50.1	44.7
Credit to private sector, commercial banks (billion Afs	47.7	45.7	46.6	46.4	48.9	52.8	57.9
Loan-to-deposit ratio (%)	17.2	15.7	16.0	16.0	16.0	16.1	16.3

Note: GDP figures for 2018 are WB staff estimate based on available data.

* World bank's estimate of international grants

** Adjusted for the World Bank's estimates on the imports associated with in-kind transfers, off-budget grant flows and other international transactions that are currently captured by the errors and omissions under the official BoP statistics

Table 5: Selected fiscal indicators (billion Afs)

	2017	2018	2019	2020	2021	2022	2023
			est.	*proj.*	*proj.*	*proj.*	*proj.*
in billion Afghanis unless otherwise stated							
Domestic revenues	169.1	186.3	208.8	144.4	175.3	202.5	226.9
Tax revenues*	75.9	83.5	85.5	57.0	81.1	107.5	120.0
Customs duty and fees	35.7	35.2	36.2	25.2	32.1	37.0	42.7
Nontax revenues	57.4	67.6	87.1	62.2	62.2	66.5	74.3
Donor grants	179.2	208.9	198.1	230.2	190.7	194.6	199.6
Discretionary grants	119.0	136.8	119.9	147.5	128.7	133.6	138.5
Nondiscretionary grants	60.2	72.1	78.2	82.7	62.0	61.0	61.1
Total expenditures	355.7	384.7	422.3	429.5	395.8	424.5	456.9
Recurrent expenditures	253.6	259.2	283.0	298.8	314.6	338.1	366.7
Security	133.9	132.3	141.7	156.0	162.0	173.0	188.0
Civilian	119.7	126.9	141.2	142.8	152.6	165.1	178.7
Wages and salaries	63.0	68.1	78.3	80.0	85.0	92.0	100.0
Operations and maintenance	29.1	25.0	24.3	26.0	27.0	28.5	31.0
Capital expenditure	2.8	3.2	2.9	1.0	3.0	4.0	4.0
Social transfers	23.0	28.5	33.5	35.0	37.0	40.0	43.0
Interest payments	1.8	2.0	2.2	0.8	0.6	0.6	0.7
Discretionary development	42.0	53.4	61.1	48.0	5.9	9.7	12.5
Nondiscretionary development	60.2	72.1	78.2	82.7	75.3	76.7	77.7
Discretionary balance	(7.5)	10.5	(15.4)	(54.9)	(16.5)	(11.8)	(13.9)
Overall balance	(7.5)	10.5	(15.4)	(54.9)	(29.8)	(27.4)	(30.4)
Financing	-	-	1.1	28.4	13.2	16.8	19.6
Debt	-	-	1.1	28.4	13.2	16.8	19.6
Domestic	-	-	(7.2)	-	-	1.2	3.0
External	-	-	8.3	28.4	13.2	15.7	16.6
Changes in reserves	*(7.5)*	*10.5*	*(14.3)*	*(26.5)*	*(16.5)*	*(10.6)*	*(10.8)*
Overall balance excluding grants	(186.7)	(198.4)	(213.5)	(285.1)	(220.5)	(222.0)	(230.1)
Revenues to recurrent spending ratio (%)	67	72	74	48	56	60	62

* Revenues from VAT are assumed to begin in 2022, reflecting the likely impact of COVID-19 on the current progress of VAT implementation in 2021.

Table 6: Selected fiscal indicators (percent of GDP)

	2017	2018	2019	2020	2021	2022	2023
			est.	*proj.*	*proj.*	*proj.*	*proj.*
in percent of GDP unless otherwise stated							
Domestic revenues	12.3	13.2	14.1	9.8	11.3	12.2	12.5
Tax revenues*	5.5	5.9	5.8	3.9	5.2	6.5	6.6
Customs duty and fees	2.6	2.5	2.4	1.7	2.1	2.2	2.4
Nontax revenues	4.2	4.8	5.9	4.2	4.0	4.0	4.1
Donor grants	13.0	14.8	13.4	15.6	12.3	11.7	11.0
Discretionary grants	8.6	9.7	8.1	10.0	8.3	8.0	7.7
Nondiscretionary grants	4.4	5.1	5.3	5.6	4.0	3.7	3.4
Total expenditures	25.9	27.3	28.5	29.1	25.5	25.5	25.3
Recurrent expenditures	18.4	18.4	19.1	20.3	20.3	20.3	20.3
Security	9.7	9.4	9.6	10.6	10.4	10.4	10.4
Civilian	8.7	9.0	9.5	9.7	9.8	9.9	9.9
Wages and salaries	4.6	4.8	5.3	5.4	5.5	5.5	5.5
Operations and maintenance	2.1	1.8	1.6	1.8	1.7	1.7	1.7
Capital expenditure	0.2	0.2	0.2	0.1	0.2	0.2	0.2
Social transfers	1.7	2.0	2.3	2.4	2.4	2.4	2.4
Interest payments	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Discretionary development	3.0	3.8	4.1	3.3	0.4	0.6	0.7
Nondiscretionary development	4.4	5.1	5.3	5.6	4.8	4.6	4.3
Discretionary balance	(0.5)	0.7	(1.0)	(3.7)	(1.1)	(0.7)	(0.8)
Overall balance	(0.5)	0.7	(1.0)	(3.7)	(1.9)	(1.6)	(1.7)
Financing	-	-	0.1	1.9	0.9	1.0	1.1
Debt	-	-	0.1	1.9	0.9	1.0	1.1
Domestic	-	-	(0.5)	-	-	0.1	0.2
External	-	-	0.6	1.9	0.9	0.9	0.9
Changes in reserves	*(0.5)*	*0.7*	*(1.0)*	*(1.8)*	*(1.1)*	*(0.6)*	*(0.6)*
Overall balance excluding grants	(13.6)	(14.1)	(14.4)	(19.3)	(14.2)	(13.4)	(12.7)
Revenues to recurrent spending ratio (%)	67	72	74	48	56	60	62

* Revenues from VAT are assumed to begin in 2022, reflecting the likely impact of COVID-19 on the current progress of VAT implementation in 2021.

Table 7: Selected fiscal indicators (billion USD)

	2017	2018	2019	2020	2021	2022	2023
			est.	*proj.*	*proj.*	*proj.*	*proj.*
in billion USD unless otherwise stated							
Domestic revenues	2.5	2.6	2.7	1.9	2.2	2.4	2.5
Tax revenues*	1.1	1.2	1.1	0.7	1.0	1.3	1.3
Customs duty and fees	0.5	0.5	0.5	0.3	0.4	0.4	0.5
Nontax revenues	0.8	0.9	1.1	0.8	0.8	0.8	0.8
Donor grants	2.6	2.9	2.6	3.0	2.4	2.3	2.2
Discretionary grants	1.7	1.9	1.6	1.9	1.6	1.6	1.6
Nondiscretionary grants	0.9	1.0	1.0	1.1	0.8	0.7	0.7
Total expenditures	5.2	5.3	5.5	5.6	4.9	5.0	5.1
Recurrent expenditures	3.7	3.6	3.7	3.9	3.9	4.0	4.1
Security	2.0	1.8	1.9	2.0	2.0	2.0	2.1
Civilian	1.8	1.8	1.9	1.9	1.9	1.9	2.0
Wages and salaries	0.9	0.9	1.0	1.0	1.1	1.1	1.1
Operations and maintenance	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Capital expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social transfers	0.3	0.4	0.4	0.5	0.5	0.5	0.5
Interest payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary development	0.6	0.7	0.8	0.6	0.1	0.1	0.1
Nondiscretionary development	0.9	1.0	1.0	1.1	0.9	0.9	0.9
Discretionary balance	(0.1)	0.1	(0.2)	(0.7134)	(0.2)	(0.1)	(0.2)
Overall balance	(0.1)	0.1	(0.2)	(0.7134)	(0.4)	(0.3)	(0.3)
Financing	-	-	0.0	0.3688	0.2	0.2	0.2
Debt	-	-	0.0	0.3688	0.2	0.2	0.2
Domestic	-	-	(0.1)	-	-	0.0	0.0
External	-	-	0.1	0.3688	0.2	0.2	0.2
Changes in reserves	*(0.1)*	0.1	*(0.2)*	(0.3446)	*(0.2)*	(0.1)	*(0.1)*
Overall balance excluding grants	(2.7)	(2.7)	(2.8)	(3.7)	(2.7)	(2.6)	(2.6)
Revenues to recurrent spending ratio (%)	67	72	74	48	56	60	62

* Revenues from VAT are assumed to begin in 2022, reflecting the likely impact of COVID-19 on the current progress of VAT implementation in 2021.