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AFGHANISTAN DEVELOPMENT UPDATE APRIL 2021

SETTING COURSE TO RECOVERY

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AFGHANISTAN DEVELOPMENT UPDATE

April 2021

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Preface

The Afghanistan Development Update 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 Akhtar Haque, and Muhammad Waheed. Valuable inputs were provided by Aminata Ndiaye, Andrej Popovic, and Andrea Dall'Olio. Assistance was provided by Sardar Ghani Ahmadzai. The special topic section was provided by Erwin W. Knippenberg, Cesar Cancho, Ghazala Mansuri, and Andrea Dall'Olio. The report was prepared under the overall guidance of Manuela Francisco (Manager for South Asia, Macroeconomics, Trade, and Investment), Zoubida Allaoua (Regional Director for Equitable Growth, Finance, and Institutions), Homa-Zahra Fotouhi (Operations Manager), 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.

Table of Contents

LIST OF FIGURES

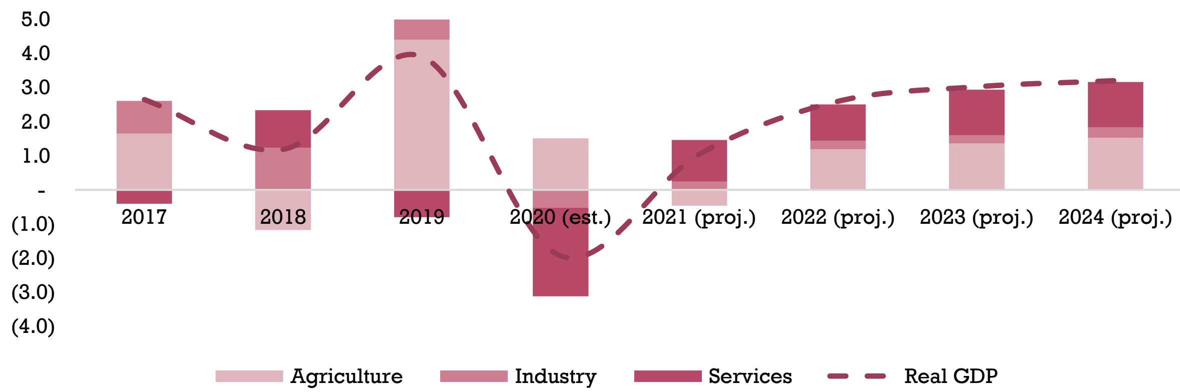
List of Tables

List of Boxes

Key Messages in Charts

Recovery from the impacts of the COVID-19 will be slowed by ongoing uncertainty.

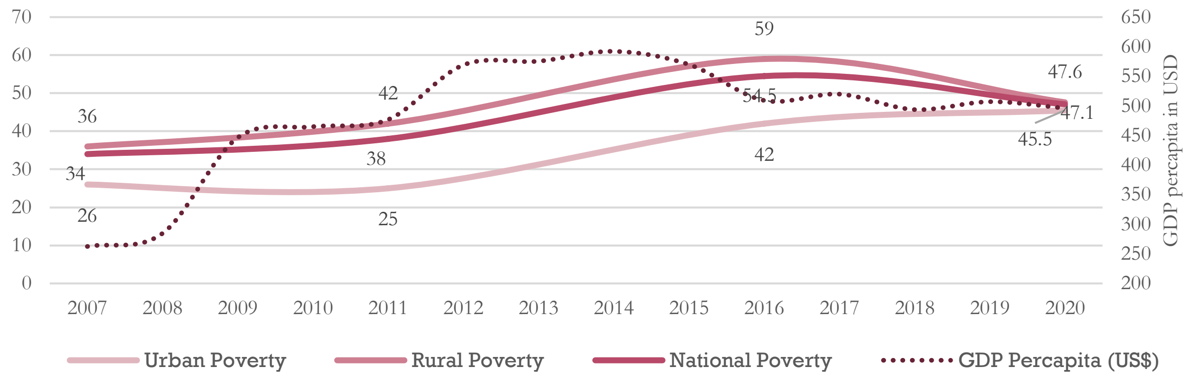
Real GDP Growth by Sector (Percent)



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

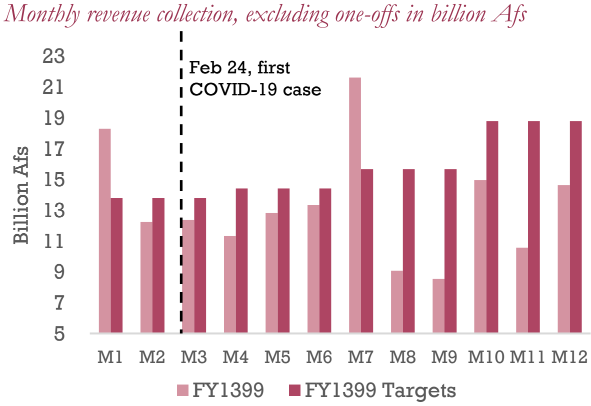
New data shows a decline in poverty since 2016, but COVID-19 has harmed incomes and livelihoods.

Poverty rate and GDP per capita (USD)

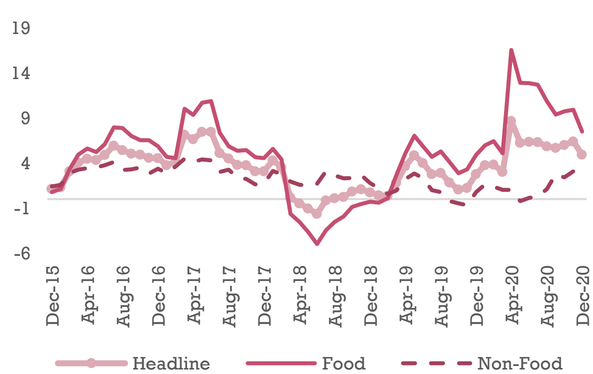


The pandemic exacerbated fiscal challenges and drove up inflation

Monthly revenue collection, excluding one-offs in billion Afs



CPI Inflation (12 month percent change)



Source: Ministry of Finance, Afghanistan

Source: National Statistics and Information Authroity, Afghanistan

Executive summary

Afghanistan's recovery from the COVID-19 crisis depends on the continued support of the international community

Afghanistan continues to face daunting challenges and uncertainties. The COVID-19 crisis imposed a heavy burden on the economy, public finances, and private sector investment in 2020. While favorable weather conditions supported the continued growth of agricultural production and improvements in rural livelihoods, the urban services and industry sectors were hit hard by lockdown measures and trade disruptions. Urban unemployment and hardship increased, while declining revenues limited the feasible extent of the government's response. With many firms closed and jobs lost, recovery from the impacts of the crisis now depends on re-investment and a recovery in confidence.

Restoration of confidence has been hampered, however, by challenging political and security conditions, and uncertainties regarding future international support. Peace talks between the government and the Taliban are making slow progress, while the frequency of Taliban attacks has increased. The extent and duration of international security support, including the presence of international troops, remains uncertain. At the Geneva Conference on Afghanistan, held in November 2020, the international community committed to continued civilian grant support. But overall pledges fell substantially below previous levels, and a large share of pledged support was made conditional on government achieving progress with peace talks, protection of human rights, and fighting corruption.

Economic recovery will depend on a continued strong partnership between the government and its international partners. To help restore private sector confidence and facilitate continued international support, the government needs to demonstrate substantial progress on revenue, anti-corruption, and private sector reforms. Donors could usefully work towards providing greater certainty and supporting confidence by establishing clearer multi-year commitments and defining a small set of measurable priority reforms against which continued grant support will be mobilized.

Recent economic developments

The economy is estimated to have contracted by 1.9 percent in 2020

In the absence of new official national accounts data, growth estimates are subject to a high degree of uncertainty. Based on proxy indicators and preliminary National Statistics and Information Authority (NSIA) data, real GDP is estimated to have contracted by around 1.9 percent in 2020. The agricultural sector is estimated to have grown by 5.3 percent, mainly due to favorable weather conditions throughout 2020 and limited impacts of COVID-19 disruptions on the rural economy. The industry and services sectors, however, were heavily impacted by lockdown measures and border restrictions, and are estimated to have contracted by 4.2 percent and 4.8 percent, respectively.

Some recent gains in poverty reduction were lost

Results of a new Integrated Expenditure and Labor Force Survey (IE-LFS) show that poverty declined to 47.1 percent in 2019-20 from 54.5 percent in 2016-17. Rural poverty declined from 59 percent in 2016-17 to 47.6 in 2019-20, mainly reflecting expanded agricultural output after recovery from the 2018 drought. Urban poverty, however, increased to 47.6 percent in 2019-20 compared to 41.6 in 2016-17. Urban poverty may have since increased further, with several private sector studies showing increased unemployment and loss of income for urban households through the COVID-19 crisis.

Food prices soared with the onset of the COVID-19 crisis

Period average inflation reached 5.6 percent in 2020, up from 2.3 percent in 2019. Border closures and lockdown measures led to a food price spike of 17 percent in April y-o-y. Food prices moderated from May, with increased supply through a good agricultural harvest. Non-food prices remained largely stable throughout 2020 largely due to lower international energy prices.

Credit to the private sector further declined

Credit to the private sector declined by 1.1 percent in the context of weak business confidence, reaching around 3.03 percent of GDP at end-2020. With increasing deposits, as firms and individuals sought to reduce cash holdings amid increasing political uncertainty and insecurity, the loan to deposit ratio declined to 13.8 percent from 15.8 percent in 2019.

The trade balance improved

Both imports and exports declined, reflecting COVID-19 induced border closures, weak domestic economic conditions, and weakened demand from major trade partners. With the decrease in the level of imports outstripping the decrease in the level of exports, the trade deficit narrowed by two percentage points form 30.4 percent in 2019 to 27.6 percent of GDP in 2020. Reflecting large grant inflows, the current account surplus grew to 2.9 percent of GDP, and foreign exchange reserves remained at very comfortable levels (16 months of import cover). Consistent with the growing current account surplus, the Afghani remained stable against the US dollar.

Fiscal balances deteriorated

Domestic revenues collapsed from 14.1 percent of GDP in 2019 to 11.4 percent in 2020. Suppressed consumption and investment confidence led to a sharp decline in inland taxes and custom duties during April-June with some gradual recovery from the third quarter. Overall tax revenues declined by 7.6 percent in 2020 compared to 2019. Reflecting closure of government offices, non-tax revenues declined by around 30 percent. Donors provided substantial on- and off-budget support to help manage the COVID-19 crisis, with grants increasing to Afs 226.2 billion (14.9 percent of GDP) in 2020 from 188.9 billion (12.9 percent of GDP) in 2019.

Government and donor spending underwent major adjustments to respond to the COVID-19 crisis. Both recurrent and development spending were reprioritized through three budget amendments during 2020. Overall government expenditures reached Afs 434.5 billion (or 28.6 percent of GDP) in 2020 compared to Afs 419.4 billion (or 28.5 percent of GDP) in 2019, but fell below budgeted levels.

Reflecting lower revenues, and despite increased grant support and lower-than-budgeted expenditures, the overall deficit reached 2.3 percent of GDP compared to an original budgeted deficit of 0.8 percent in 2020. The deficit was financed mainly through concessional borrowing from the IMF (Afs 25.4 billion) and the drawing down of government cash reserves (Afs 10 billion).

Outlook and Risks

Under a baseline scenario, growth is

Economic prospects are subject to high levels of uncertainty. Under a baseline scenario, Afghanistan will face: i) continuation of current security and political conditions, ii) continued international grant support at levels indicatively pledged at

expected to remain sluggish

the 2020 Geneva Conference (around 20 percent lower than over the preceding pledging period); and iii) no major acceleration in reform progress, reflecting the continued difficult political environment.

Under this scenario, real GDP is expected to grow by one percent in 2021, reflecting contraction in agriculture sector in the context of drought. Recovery in the industry and services sectors is expected to be sluggish due to continued weak investment confidence. Over the medium term, growth is expected to pick up to around three percent. With rapid population growth (around 2.3 percent), per capita incomes are unlikely to recover to pre-COVID levels until 2025.

Inflation is expected to remain moderate

Consumer prices are likely to increase by 3.8 percent in 2021, reflecting recovery in global energy prices, the impacts of drought on food production, and disruptions of trade through Herat following the major fire at the Islam Qala customs point – Afghanistan's busiest border crossing. Consumer price inflation is expected to average around five percent during 2022-2024, as aggregate demand picks up.

The current account is expected to deteriorate with declining grants

The current account balance is expected to deteriorate, reflecting a worsening trade balance and lower grants. With economic recovery and resolution of border disruptions, both imports and exports are likely to recover in 2021, but with increases in the level of imports outstripping increases in the level of exports, the trade balance is expected to worsen. International reserves are expected to gradually decline, but remain at comfortable levels, covering 14 months of imports by 2024.

Despite recovery in revenues, declining grants will drive a larger fiscal deficit in 2020

Recovery in domestic revenues is likely to remain slow, with revenues recovering to 14 percent of GDP in 2024 (contingent on effective implementation of the new VAT). Overall expenditure as a share of GDP is expected to gradually decline to around 27 percent of GDP, reflecting declining grant support. With increasing security spending and growing payroll and pension costs, fiscal space for development spending is expected to shrink to 7.6 percent of GDP from 9.4 percent in 2019.

The fiscal deficit is likely to expand further to 3.2 percent of GDP in 2021, before averaging around one percent of GDP over 2022-24. Government cash reserves and limited external concessional borrowing will continue to finance the deficit. Government debt is expected to remain at low levels, increasing to 10 percent of GDP by 2024.

The outlook is subject to substantial downside risks

Significant risks include: i) a deterioration in the security situation following either the withdrawal of international troops or a breakdown in the current peace negotiations; ii) a resurgence in COVID-19 cases, which may necessitate new lockdown or social distancing measures; iii) worse-than-expected weather conditions, negatively impacting agricultural production and rural livelihoods; and iv) faster-then-expected reductions in international grant support, predicated on inadequate government progress against anti-corruption and other reform commitments. Covid-19 has amplified financial sector risks with continued and more rapid deterioration in asset quality, while bank resolution tools, financial safety nets and institutional capacity remain limited.

A. Recent Economic Developments

1. Economic Context

Afghanistan remains an undiversified economy, heavily dependent on aid and with a large illicit sector

Afghanistan's economy is shaped by fragility and aid dependence. The private sector is extremely narrow, with employment concentrated in low-productivity agriculture (44 percent of the total workforce works in agriculture and 60 percent of households derive some income from agriculture). Private sector development and diversification is constrained by insecurity, political instability, weak institutions, inadequate infrastructure, widespread corruption, and a difficult business environment (Afghanistan was ranked 173rd of 190 countries in the 2020 Doing Business Survey). Weak institutions and property rights constrain financial inclusion and access to finance, with credit to the private sector equal to only three percent of GDP. Weak competitiveness drives a structural trade deficit, equal to around 30 percent of GDP, financed almost entirely from grant inflows. Grants continue to finance around 75 percent of public spending. Security expenditures (national security and police) are high at around 28 percent of GDP in 2019, compared to the low-income country average of around three percent of GDP, driving total public spending of around 57 percent of GDP. The illicit economy accounts for a significant share of production, exports, and employment, and includes opium production, smuggling, and illegal mining.

Following a sustained period of impressive development progress, Afghanistan has faced intensifying and interlinked economic, security, and political challenges

With an influx of aid since 2002, Afghanistan sustained rapid economic growth and improvements against important social indicators for more than a decade. Annual growth averaged 9.4 percent between 2003 and 2012, driven by a booming aid-driven services sector, and strong agricultural growth. A range of factors have since slowed economic and social progress, with the economy growing by only 2.5 percent per annum between 2015-2020, and gains against development indicators slowing or – in some cases – reversing. Aid flows decreased from around 100 percent of GDP in 2009 to 42.9 percent of GDP in 2020 (with the number of international troops declining from more than 130,000 in 2011, to around 15,000 by end-2014, to around 10,000 today). Declining grants led to a protracted contraction of the services sector, with an associated deterioration in employment and incomes. The security situation deteriorated, with the Taliban insurgency gaining control over increased territory and intensifying attacks on military and civilian targets, with civilian casualties totaling more than 10,000 per year between 2014 and 2019. The impacts of declining grants and worsening security were exacerbated by political instability following the disputed outcome of the 2014 presidential elections. The formation of the National Unity Government under an extra-constitutional power-sharing agreement led to administrative disruptions and slowed reform progress. Recent uncertainties regarding the extent and duration of international security support and the outcome of any potential peace agreement with the Taliban have further sapped confidence, leading to further reductions in investment, and capital flight.

Afghanistan now faces daunting challenges in sustaining recent development gains in the face of mounting political uncertainties, declining international grant support, and continued insecurity. Policy options are narrowed by the weak implementation capacity of government agencies, reflecting governance constraints, and tightly constrained macroeconomic policy options in the context of narrowing fiscal space and weak monetary transmission mechanisms.

2. COVID-19 and Recent Political Developments

Officially recorded COVID-19 cases remain relatively low, but increased towards the end of the year

The COVID-19 crisis continued to place pressure on Afghanistan's fragile health care system through 2020, exacerbating existing socio-economic challenges. As of February 15, 2021, a total of 55,492 cases and 2,400 deaths have been officially recorded (with weak testing capacity, actual cases and fatalities may be far higher). As of mid-February 2021, 276,878 COVID-19 tests had been conducted, with a positive test rate of around 20 percent. This compared to India's 5.3 and Pakistan's 6.9 percent. Lockdown measures have been avoided since May 2020, despite a slight uptick in cases in mid-October.

Political uncertainty continued

Following the disputed outcomes of the 2019 presidential elections, a power-sharing agreement between the two leading contenders was signed in May 2020. Most cabinet appointments under the new arrangements were not confirmed by parliament until December 2020, contributing to administrative disruptions and slowing reform progress.

Direct negotiations between the Taliban and the Afghan government officially began on September 12, 2020 following the Doha agreement signed between the US and the Taliban in February 2020. Under the terms of the US-Taliban agreement, US forces have scaled down offensive operations, large numbers of Taliban prisoners have been released, and Taliban mass civilian casualty bombings and attacks on international forces have ceased. Nonetheless, Taliban attacks on Afghan security forces have reached record levels, and more than 20 civil society activists and other prominent civilians have been killed in a campaign of targeted killings. In response to slow progress with Intra-Afghan negotiations and continued high levels of violence, the new US administration announced a review of the Doha agreement, including its commitment to withdraw all US troops by May 2021. The future of negotiations, and how the Taliban may respond to any delay in the US withdrawal remains unclear.

Conflict continues to impose a heavy toll

Reflecting the reduction in mass-civilian casualty attacks, overall civilian causalities recorded in the first nine months of 2020 declined by 30 percent compared to the same period in 2019. During this period, total civilian causalities reached 5,939 in 2020, with 2,117 deaths and 3,822 injured. However, since the beginning of intra-Afghan talks, civilian causalities have soared. Total civilian causalities reached 2,792 during fourth quarter of 2020, an unprecedent increase of 45 percent compared to the same period in 2019. Anti-government elements remain responsible for the majority of civilian causalities.

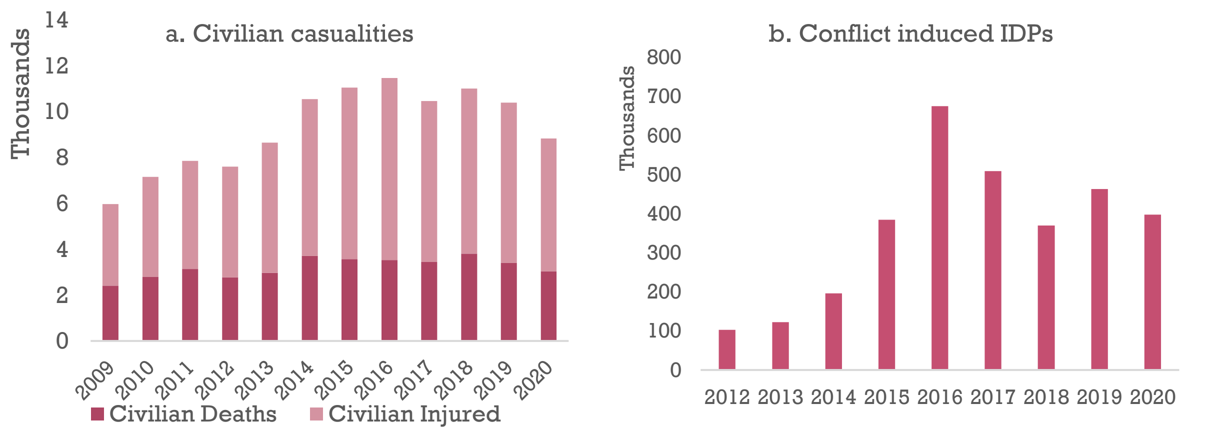
Displacement continues to impose humanitarian pressures

A record 865,793 refugees returned to Afghanistan in 2020 from Iran and Pakistan. This largely reflected a campaign of forced deportation of Afghans from Iran in the context of difficult economic conditions brought about by the COVID-19 pandemic and international sanctions. Internal displacement continued, with a total of 397,138 conflict-induced IDPs in 2020 (slightly down from 399,087 in 2019). With continued difficult economic conditions and the expected onset of drought, humanitarian needs are expected to increase in 2021.

The international community renewed its commitment to Afghanistan at the 2020 Geneva Conference

At the Geneva conference held in November 2020, donors renewed their commitment to aid support to Afghanistan for 2021-2024. However, several major donors provided only single-year pledges, with future support made conditional upon the government achieving accelerated progress in efforts to combat corruption, reduce poverty, and advance ongoing peace talks. Aid support is now expected to decline by around 20 percent from the previous pledging period (US$15.2 billion over 2016-2020) but could fall even lower if conditions are not met or if major donors further reduce commitment levels amid domestic fiscal pressures.

Figure 1: Continued insecurity led to high civilian casualties and ongoing displacement



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

Figure 2: New COVID-19 cases are dropping, however, underreporting of cases remains a concern

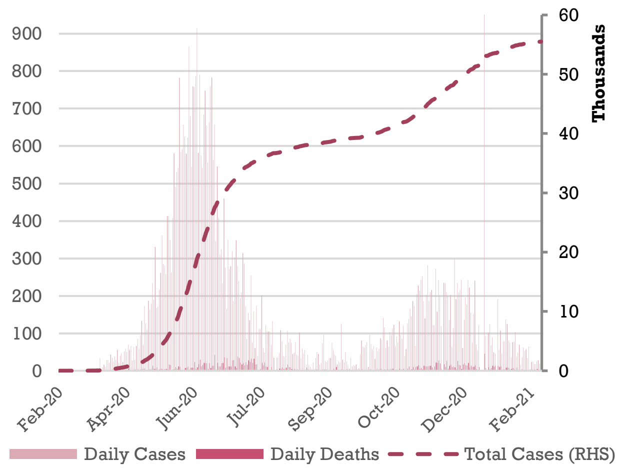
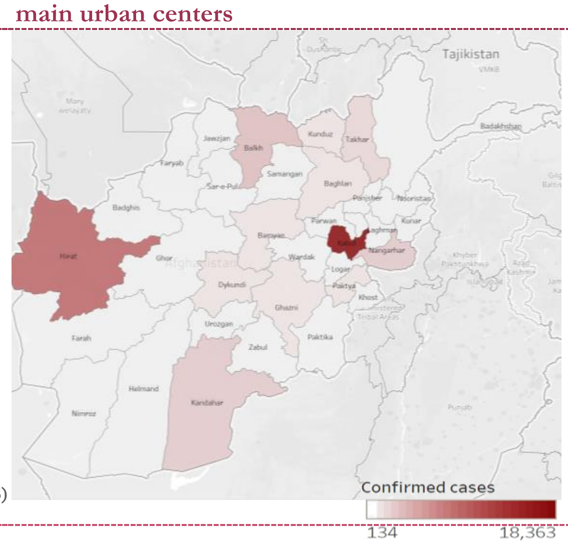


Figure 3: COVID-19 cases remain concentrated in main urban centers



Source: MoPH and WHO

3. Real Sector

The economy is estimated to have contracted slightly in 2020

Based on preliminary NSIA estimates, Afghanistan's economy is estimated to have contracted by 1.9 percent in 2020, following an average growth rate of 2.4 percent over 2014-2019, reflecting weak confidence amid continued political instability and the impacts of the COVID-19 crisis.

Investment remained suppressed in the context of pervasive uncertainty. Private consumption is estimated to have contracted by around 6.6 percent, reflecting lower incomes and increased precautionary savings. Government consumption, on the other hand, increased by around 5.6 percent, mainly due to the increase in donor-financed COVID-19 related expenditures.

The pandemic is expected to have had uneven impacts on the rural economy

The agriculture sector is estimated to have grown by 5.3 percent over 2020. Strong growth reflected favorable weather conditions and the limited impact of COVID-19 related disruptions on the harvesting of cereals and fruits, and on livestock.

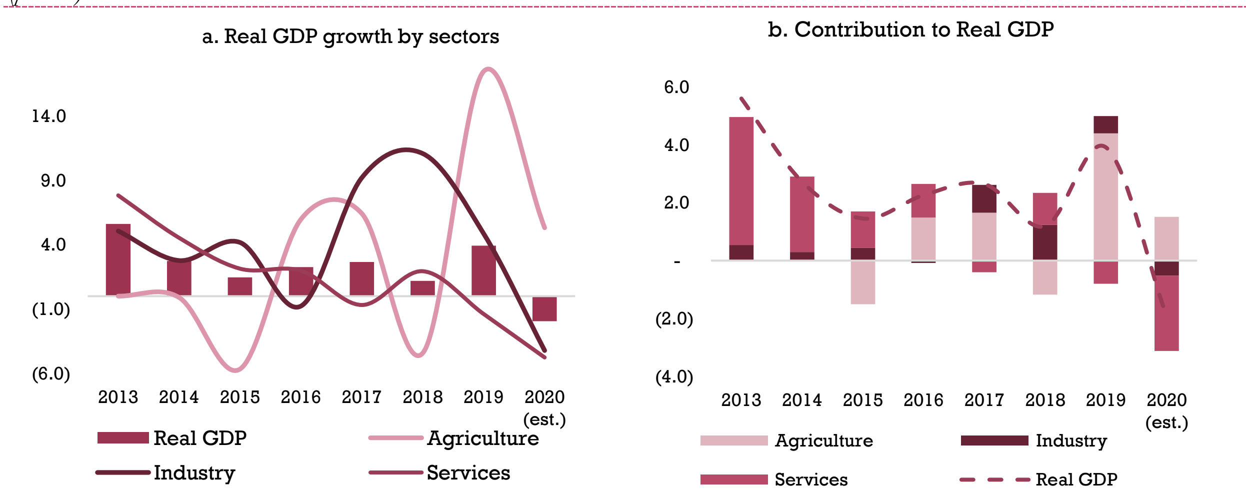
The manufacturing and services sectors were hard hit

The impacts of lockdowns and border closures were more severe for the industry and services sectors, which are estimated to have contracted by 4.2 percent and 4.8 percent, respectively. Even before COVID-19, growth in the industry and services sectors was sluggish due to very weak confidence in the context of political instability, insecurity, and uncertainty regarding future international support. Agricultural processing and trade were heavily impacted by COVID-19 related lockdown measures and logistical disruptions, with more than 50 percent of processing units for cereals (50 percent), fruits (57 percent), vegetables (70 percent), and dairy (97 percent) operating at reduced capacity or closed.[1]

The severe impacts of the COVID-19 crisis are reflected in available survey data.

The IFC's recent Business Pulse Survey (BPS) shows that 63 percent of businesses were either partially or completely closed during the pandemic. Impacts were much more severe for exporting firms, reflecting disruptions to logistics and border closures. 64 percent of workers lost income due to mandatory and voluntary firm closures, across the industry sector (78 percent), services (43 percent), and agriculture (47 percent). The recent ACCI Business Climate Survey showed a continuation of negative business sentiment over the first half of 2020, with business sentiment declining to an index score of -19 for small businesses compared to -7.5 for large businesses.

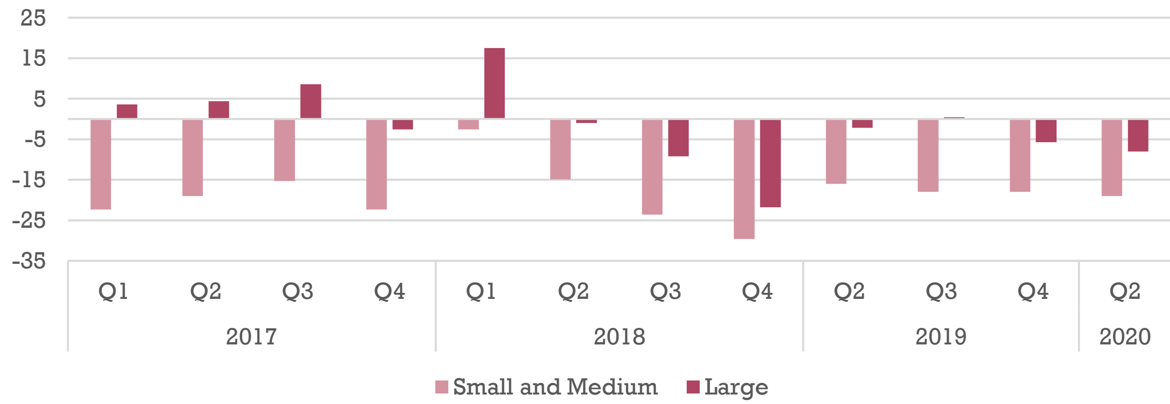
Figure 4: Non-agriculture economy contracted significantly in first half of the year
(percent)



Sources: National Statistics and Information Authority (NSIA) for 2013-18 data

[1] http://www.fao.org/3/cb0199en/CB0199EN.pdf

Figure 5: Investment confidence further deteriorated throughout 2020
Business confidence by firm size (Index)



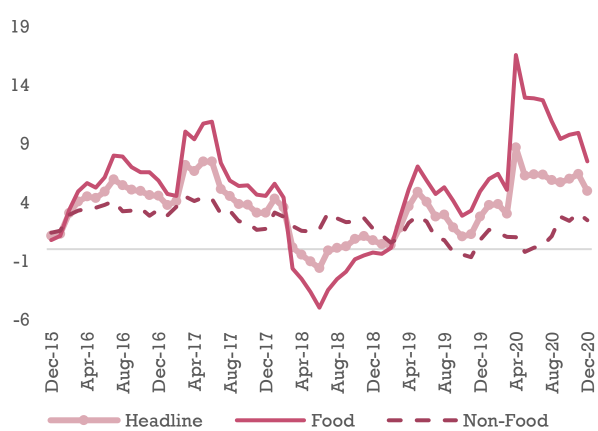
Source: Afghanistan Chambers of Commerce and Industries, Business Climate Survey

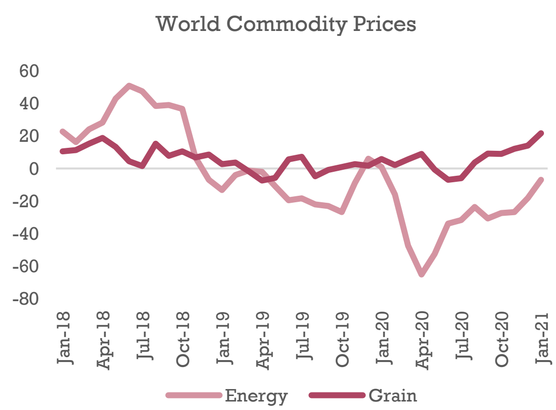
The pandemic has driven significant volatility in prices

Period average inflation increased to 5.6 percent in 2020 compared to 2.3 percent in 2019, with food prices increasing by 10 percent on average. Food prices increased by around 17 percent in April year-on-year following the imposition of border closures and lockdown measures in main urban centers, which disrupted urban supply and drove hoarding. Food prices moderated later in the year with the increased supply of domestically produced agricultural products, reflecting the good harvest.

Non-food prices increased by around 1.4 percent through 2020. Low non-food inflation mainly reflected declining international energy prices. Non-food prices remained largely stable in the first half of 2020 – increasing by less than one percent, and then gained momentum as the economy began to gradually recover from pandemic related disruptions.

Figure 6: 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)

While total poverty rates have fallen since 20167-17, urban poverty continued to increase

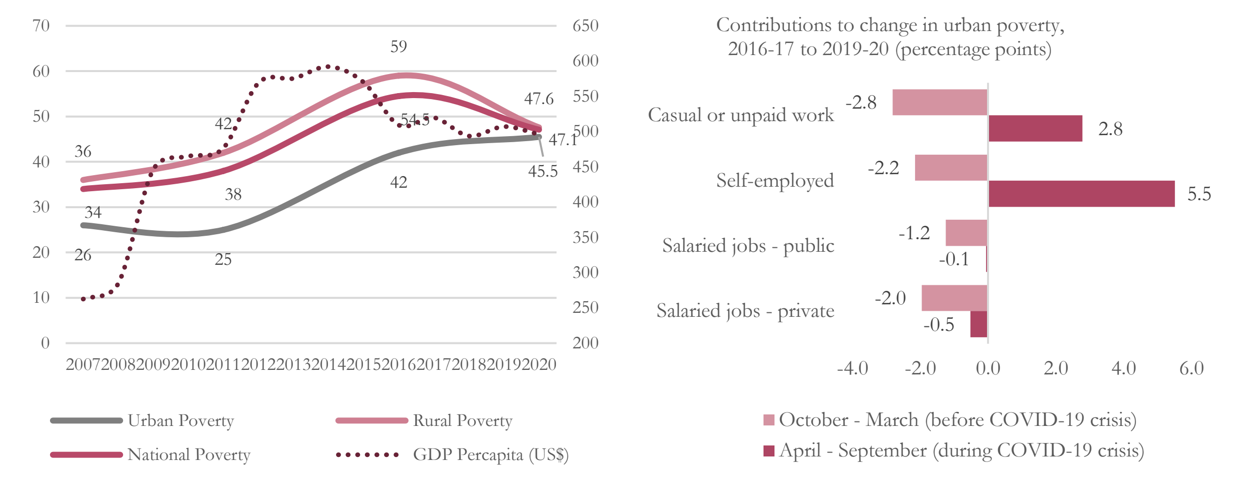
Based on the results of the most recent household survey, the national poverty rate has declined from 54.5 percent in 2016-17 to 47.1 percent in 2019-20, mainly due to improvements in rural livelihoods.

Rural poverty is estimated to have declined from 58.5 percent in 2016-17 to 47.6 percent in 2019-20, reflecting strong agricultural production following recovery from the 2018 drought and associated increases in incomes derived from fruit and vegetable crops. Growth of fruit and vegetable production is associated with expansions of irrigated land, partly due to public irrigation rehabilitation and construction programs. While data is scarce, rural poverty reduction is thought to have been supported by very strong opium production and prices over 2017-2018, which allowed increased investment in solar irrigation systems. While opium prices and production collapsed in 2019, opium-financed investment and savings may still be providing a buffer against hardship for some households, including by allowing diversification into licit crops over newly irrigated land.

Urban poverty, on the other hand, has reached a new high of 45.5 percent in 2019-20 (up from 41.6 percent in 2016-17 and 24.6 percent in 2011-12), reflecting weakness in service and industry sectors, and the negative impacts of COVID-19 lockdowns and disruptions. Poverty in urban areas peaked at 55.2 percent during the early phases of the pandemic, reflecting the negative impacts of lockdown measures on employment opportunities in the context of higher prices. Increases in poverty were most pronounced among households dependent on self-employment and casual employment in services and manufacturing, including daily laborers and small-scale retailers. With the easing of movement restrictions by the third quarter, the estimated urban poverty rate declined to 49.6 percent.

Pressure on living conditions continues to be exacerbated by displacement, including accelerated and forced return of refugees from neighboring countries and conflict-induced internal displacement. The high number of returnees and IDPs is placing pressure on limited services and employment opportunities in main urban centers.

Figure 7: The COVID-19 crisis fueled an increase in urban poverty, narrowing the distance to rural poverty.



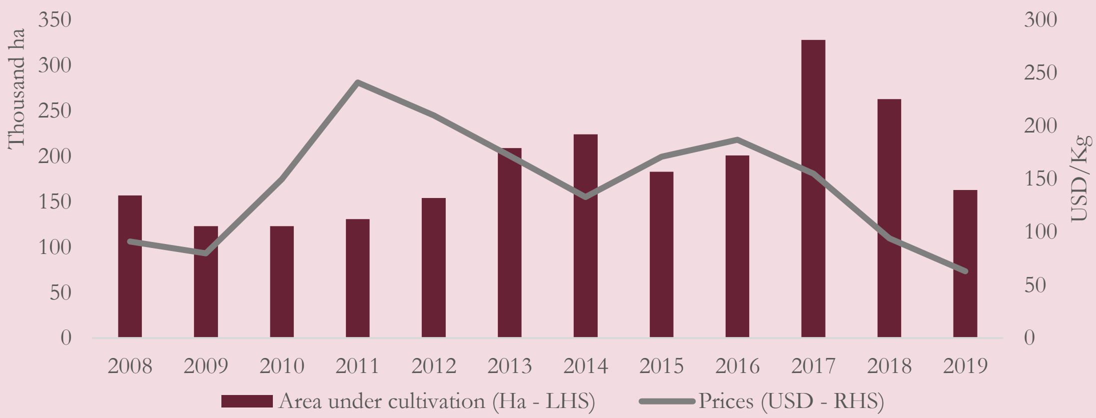
Source: Staff calculation using NSIA IELFS 2019-20

Box 1: Afghanistan's Opium Economy

Illicit activity remains central to the Afghan economy. The opium economy employs up to 119,000 Afghans, while income generated by domestic consumption, production, and export of opiates was estimated at between USD 1.2 billion and USD 2.1 billion in 2019 (between seven and eleven percent of GDP). The opium economy is driven by absence of alternative livelihood generating activities, weak rule of law, and easy access to key trade routes. The major role of illicit activity in the Afghan economy, including opium production and smuggling, weakens overall governance and deprives government of much-needed revenues.

Reflecting saturation of global markets, the farmgate price of opium fell to record lows in 2019 (33 percent below 2018 prices). Accordingly, areas under poppy cultivation declined by 38 percent, the lowest level since 2013. Declining opium production did not lead to measured increases in rural poverty, suggesting that favorable previous market conditions allowed opium-growing households to accumulate assets and savings, and potential diversify into production of other crops.

Figure 8: Opium Production and Prices



Source: UNODC 2019 Opium Survey, World Bank

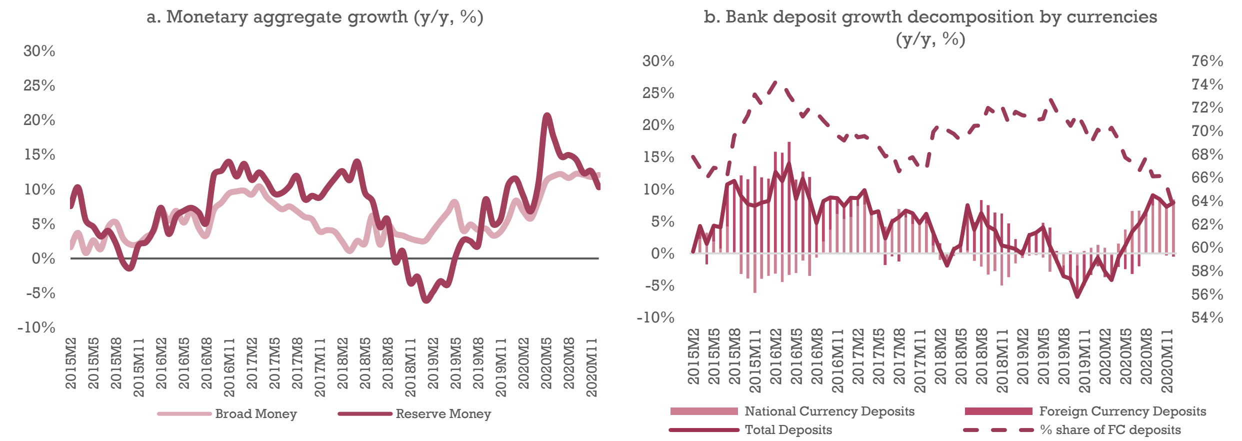
4. Monetary and financial sector

Money supply growth picked up in 2020, despite economic contraction

Broad money and reserve money grew rapidly in 2020 driven by COVID-related government and donor expenditures and lower forex market intervention by DAB. After a sharp contraction in the first two quarters of 2020, reflecting slowing economic activity, broad money and reserve money growth recorded year-on-year (y-o-y) growth of 12 percent and 10.3 percent, respectively, at end-2020.

Total bank deposits declined with the onset of the COVID-19 crisis, with total deposits in the banking sector declining by three percent over the first four months of 2020. As grant-financed donor and government spending fueled private sector activity through new contracting opportunities, bank deposits gradually recovered, reaching Afs 292.6 billion (equivalent to 19.9 percent of GDP) at end-2020, compared to Afs 263.8 billion at end-2019 (18 percent of GDP). Bank deposits remained highly dollarized with foreign currency deposits accounting for 60 percent of total deposits of the banking system, as of end-December 2020. Increasing bank deposits during the second half of 2020 may also have reflected individuals' and firms' reluctance to hold cash in the context of increased insecurity, and requirements imposed by neighboring country immigration authorities for arrivals from Afghanistan to hold bank accounts in Afghanistan with deposits above a specified minimum threshold.

Figure 9: Growth of money supply picked-up and banks deposit remained highly dollarized

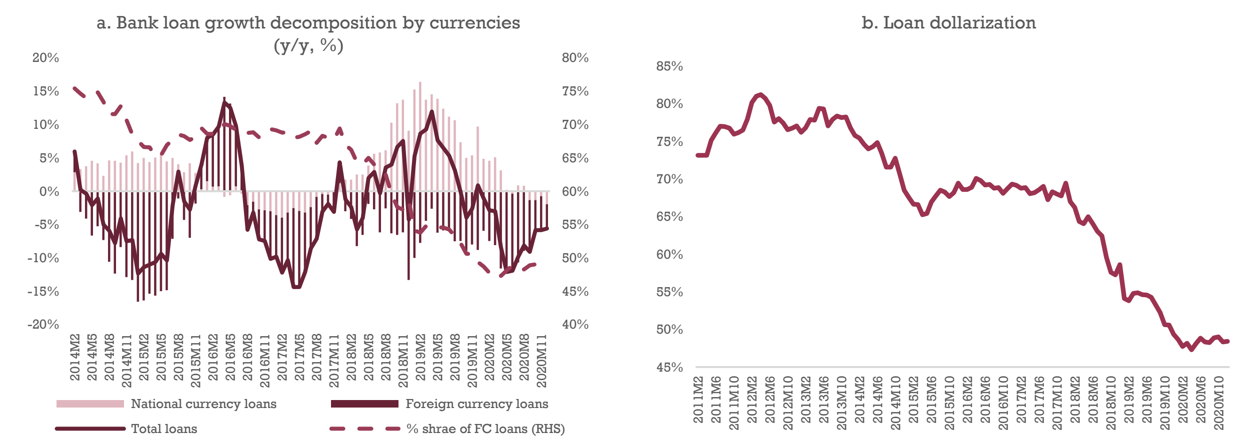


Source: Moneatry and Financila Statistics, Da Afghanistan Bank

Credit to the private sector further contracted, while bank reserves accumulated

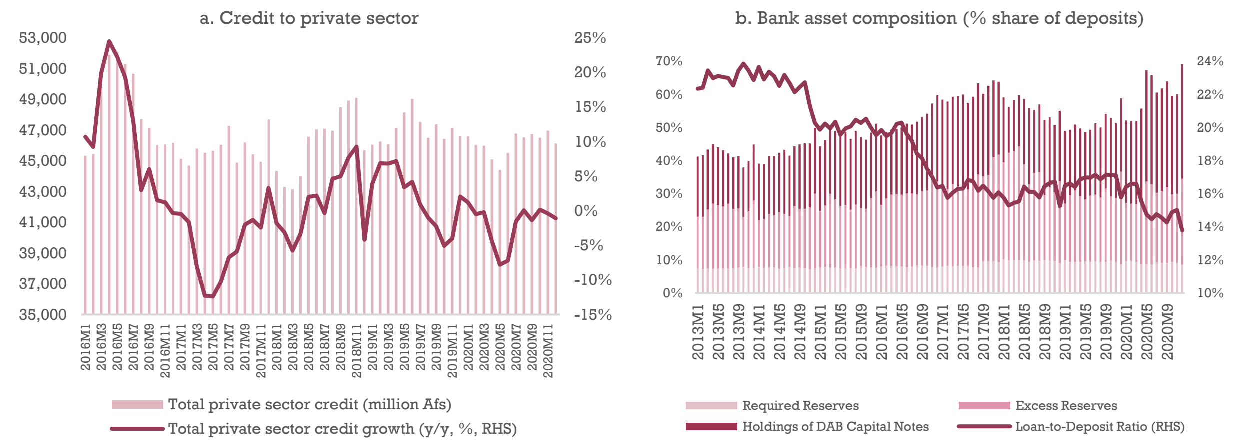
Weak economic conditions and business confidence, exacerbated by the adverse impacts of the COVID-19 pandemic, drove a 1.1 percent contraction of private sector credit over 2020. Accordingly, the loan-to-deposit ratio declined to 14.1 percent (from an already low 15.8 percent in 2019) indicating inefficient financial intermediation. Total bank loans to the non-financial private sector stood at Afs 46.1 billion in December 2020, equivalent to only 3.13 percent of GDP. Liquidity of the banking sector is high due to very low level of lending, with 26 percent of deposits sitting with DAB as excess reserves and 34.6 percent invested in the central bank capital notes. This reflects weak economic conditions and lack of investment opportunities. Private sector credit remains highly concentrated in trade (41 percent) and services (27 percent) sectors.

Figure 10: Share of foreign currency denominated loans declined slightly



Source: Monetary and Financial Statistics, Da Afghanistan Bank

Figure 10: Bank loans declined while excess liquidity remained ample



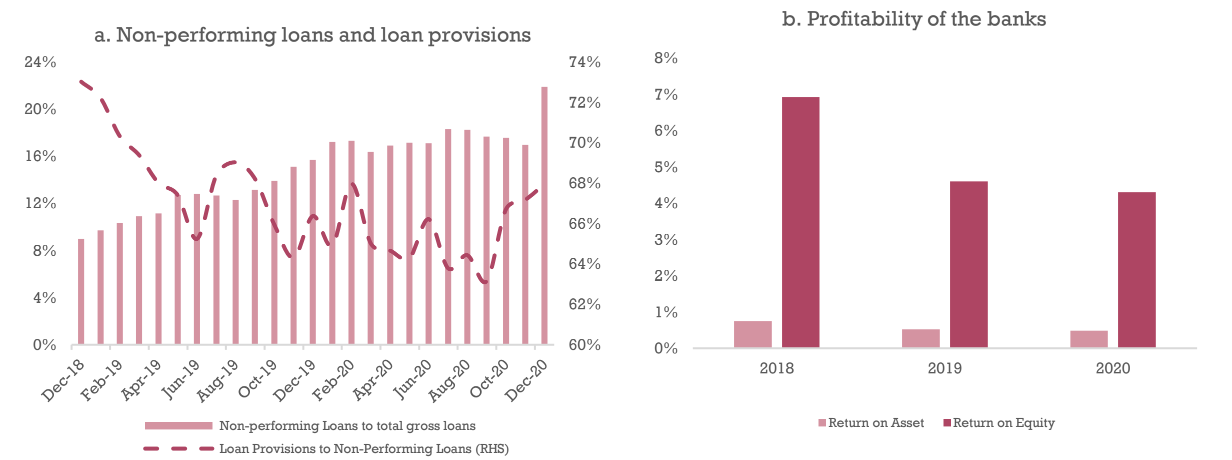
Source: Monetary and Financial Statistics, Da Afghanistan Bank

COVID-19 has amplified financial stability risks with continued and more rapid deterioration in the asset quality of the banking system.

The overall system presents capital buffers well above DAB's 12 percent requirement, due to low levels of lending activity. Aggregate capital to risk-weighted assets increased by two percentage points to a relatively high 27.9 percent. However, following a steady increase since 2018, the ratio of non-performing loans (NPLs) to gross loans increased rapidly from 15.7 percent at end-2019 to 21.9 percent at end-2020, reflecting weak economic conditions and impacts of the pandemic on borrower's debt servicing and repayment capacity. As NPLs are a lagging and underreported indicator their true level is likely to be higher. Afghan banks also have high sensitivity to market risk due to foreign exchange risks associated with high dollarization. A few weak banks with impaired loans and low profitability will likely need capital injections.

Profitability indicators of the banking have also deteriorated, but remained positive, with profitability mainly attributed to foreign exchange revaluation gains and non-interest incomes. As of end-2020, the return on asset (ROA) and return on equity (ROE) ratios decreased from 0.52 percent and 4.6 percent in December 2019 to 0.49 percent and 4.36 percent in December 2020 respectively. Overall, the profitability of the banking sector has been barely positive and on the decline since 2018. In absence of the core lending activities bank profitability is not sustainable in the long run. Financial sector risks are exacerbated by limited bank resolution tools, the absence of a legal framework for deposit insurance, and related institutional capacity constraints.

Figure 11: Financial soundness and profitability indicators are weak



Source: Banking Supervision Department, Da Afghanistan Bank

Box 2: Financial sector reform and policy response to COVID-19

In response to the COVID-19 crisis, DAB intensified monitoring of the weak banks and announced a post-COVID improvement plan for the sector which provided for a relaxation of loan classification, suspension of administrative penalties and fees, and postponement of the International Finance Reporting Standard (IFRS-9) implementation. DAB has begun intensified monitoring of banks based on a post-pandemic plan that entails loan recovery, capital augmentation, and strengthening corporate governance and management. The capital of one weak bank has been strengthened during the past few months, and lending restrictions put in place for some banks.

To enhance Micro, Small and Medium Enterprises (MSME) finance, the central bank assigned a zero risk-weighting for loans guaranteed by third parties (i.e. ACGF, IFC, USAID), in complement to the relaxed provisioning requirements for such loans. In support of digital financial services, bank interoperability is now effective following the integration of all banks and payment institutions with the Afghanistan Payments System—the country's national payments switch. Furthermore, the implementation of the e-payment reform agenda continues with the integration of Ministry of Finance tax and customs systems (SIGTAS, ASYCUDA) and DAB payment systems. Meanwhile, efforts to modernize the three state-owned banks are progressing slowly. Following earlier progress with investments in information technology and corporate governance reforms (e.g. which established supervisory boards at each of the three state-owned banks), the planned merger of Bank-e-Millie Afghan and New Kabul Bank has been substantially delayed due to shifts in policy direction and reconsiderations of the appropriate technical approach. Efforts in this area have been recently revived with plans for due diligence of the two banks ahead of the merger process.

Source: World Bank

5. External sector

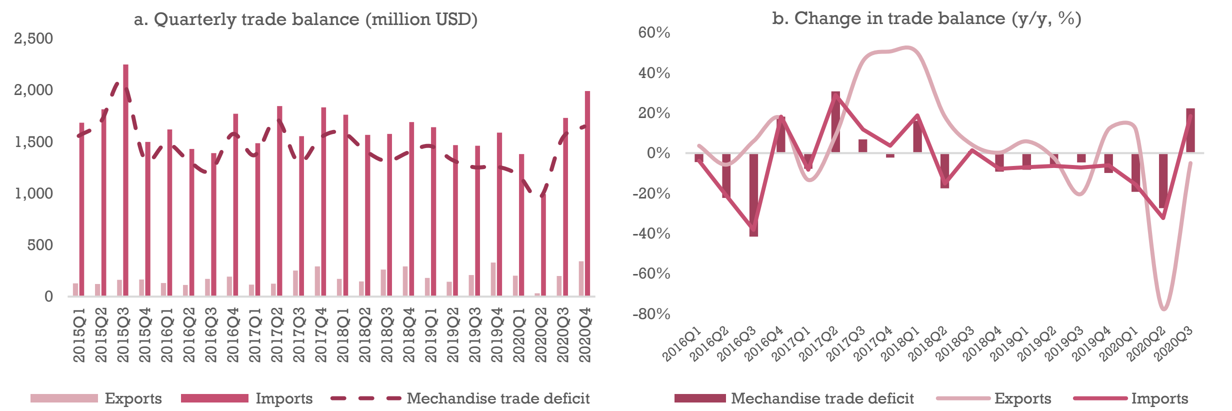
Trade was disrupted by border closures, but picked up in the second half of 2020

The COVID-19 outbreak triggered stringent movement restrictions and intermittent border closures in the second quarter of 2020, disrupting regional trade and supply chains. Trade in goods fell by 23.6 percent (y-o-y) by the end of June 2020. The contraction was broad-based, affecting all categories of goods. As border closures and trade restrictions were relaxed, trade recovered in the second half of the year.

The trade deficit narrowed over 2020 due to declining imports

The trade deficit of USD 5,507 million, narrowed by around three percentage points to 27.6 percent of GDP in 2020 compared to 30.4 percent in 2019 due to a much sharper contraction in imports relative to exports. Subdued domestic demand was translated into a 4.5 percent year-on-year drop (USD 278 million) in imports, while COVID-19 induced border closures and weak demand in major trade partners also reduced exports by ten percent year-on-year (a USD 87 million drop).

Figure 12: Decline in imports slightly narrowed the trade deficit in 2020 despite weaker exports



Source: National Statistic and Information Agency

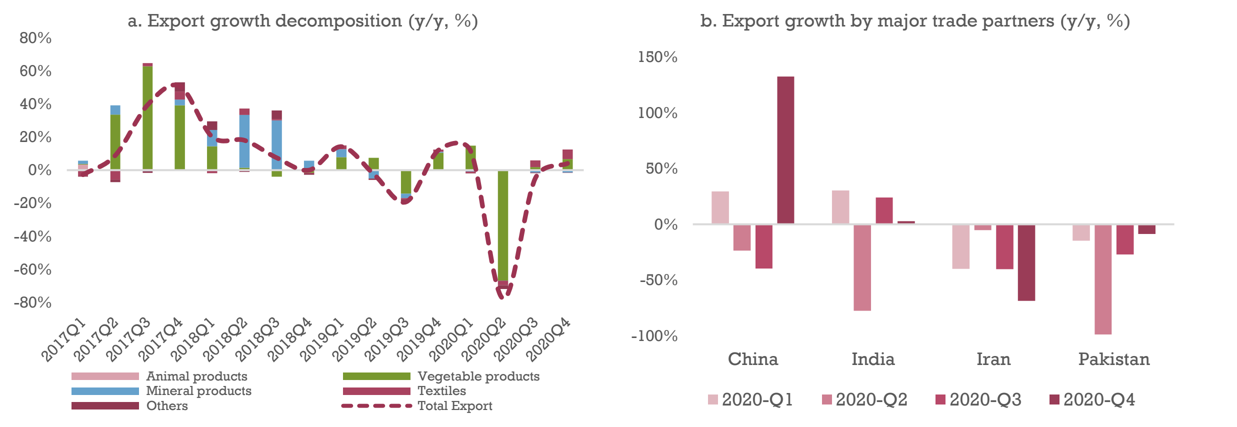
Exports declined due to border closures

Before the onset of the COVID-19, exports grew by 11 percent in the first quarter of 2020. However, exports declined sharply in the second quarter, driven by border closures, disruptions to land and air transport, and lower demand in main export markets. Despite the lifting of border closures, exports continued to contract in the third quarter falling by six percent (y-o-y) before increasing by four percent (y-o-y) in the fourth quarter.

The decline in goods export was broad-based, with vegetable exports contracting by 3.6 percent (y-o-y) and minerals falling by 64.6 percent (y-o-y). Vegetable exports increased by 17.7 percent in the first quarter, reflecting improved agriculture conditions but plunged by 71.1 percent (y-o-y) in the second quarter due to border closures. As for vegetable exports, the categories which suffered the most were fresh fruits (pomegranate, apricot, and grape) and vegetables (onion and cucumber), while export of dry fruits (pinecone, saffron, and pistachio) increased. Vegetable exports recovered in the third and fourth quarters growing by 2.1 and 7.6 percent respectively. Mineral exports declined throughout the year, with the export of coal falling by 62.3 percent (y-o-y), talc stone contracting by 10.3 percent (y-o-y), and marble dropping by 44.9 percent (y-o-y), mainly reflecting decreased demand in main export markets, particularly Pakistan.

Exports to Iran and Pakistan dropped by 46.7 percent and 29 percent respectively in 2020, compared with 2019, reflecting the impact of border closures. Exports to India, in the meantime, remained relatively stable while exports to China picked up by 78.5 percent (y-o-y), thanks to the recently established air corridor. India and Pakistan remained the top-two destination markets for Afghan goods accounting for 80 percent of total exports.

Figure 12: Afghanistan exports remained undiversified both in terms of goods and destination markets



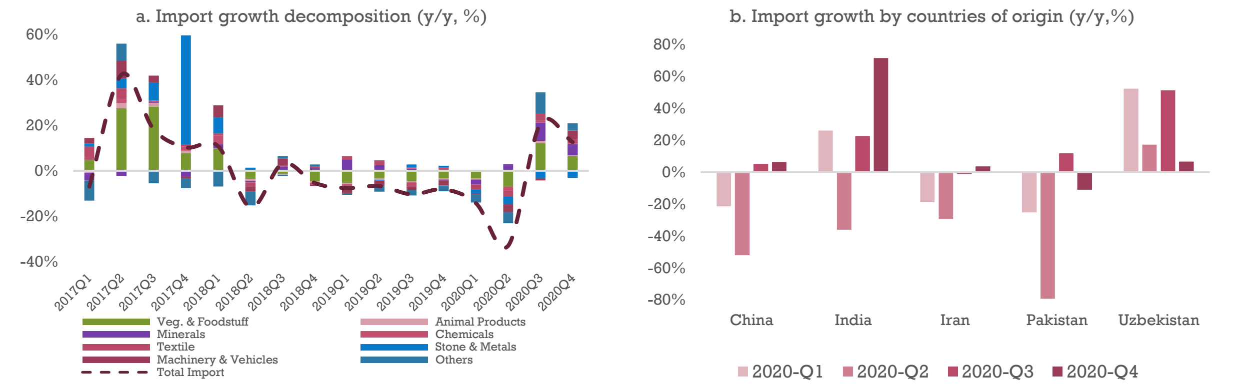
Source: National Statistic and Information Agency

Weak demand resulted in contraction in imports

Merchandise imports declined by 4.5 percent (y-o-y), from USD 6,158 million in 2019 to USD 5,880 million in 2020, reflecting subdued domestic consumption, lower global oil prices, and COVID-related trade disruptions. Driven by nation-wide lockdowns, imports contracted by 33 percent (y-o-y) in the second quarter of the year, reflecting lower demand for minerals, machinery, chemicals, textiles, and base metals. Imports were also impacted by the imposition of export restrictions on wheat flour in neighboring countries, which declined by 27.2 percent (USD 85 million) in the first half of 2020, compared with the same period of 2019. Imports rebounded, surpassing pre-pandemic levels, in the second half of the year, with 20.9 and 12.6 percent y-o-y growth in the third and fourth quarters.

Import contraction was broad-based, reflecting lower imports for most major categories of goods, with import of vegetable products falling by two percent y-o-y (USD 23.6 million), machinery by 25.8 percent (USD 106 million), base metal by 28.9 percent (USD 129.8 million), mineral products by 2.1 percent (USD 22.7 million), textiles by 8.4 percent (USD 44.6 million), and cement by 23.5 percent (USD 84.9 million). Lower imports of these goods reflected lower economy-wide demand in the context of political uncertainty and the COVID-19 crisis. Import of all goods declined except for electricity, which increased by 7.2 percent year on year (USD 16.9 million) due to increased demand with the expansion of the national grid.

Figure 14: Imports declined across all categories of goods except for electricity



Source: National Statistics and Information Agency

Remittances are estimated to have fallen by around ten percent

Remittances[2] (net) are estimated to have fallen by around ten percent in 2020, declining from USD903 million from USD824 million in 2019. Reduced remittance inflows reflected the weakening of labor market conditions in key remittance sending countries, including Iran, Saudi Arabia, and the United Arab Emirates.

Reflecting elevated political uncertainty and the impacts of the COVID-19 crisis, both foreign direct investment (FDI) and portfolio investment recorded net outflows in 2020. Net FDI outflows reached USD24.3 million, from outflows of USD 2.9 million in 2019. Portfolio investment recorded a net outflow of USD 63.2 million after a net inflow of USD 14.6 million in 2019.

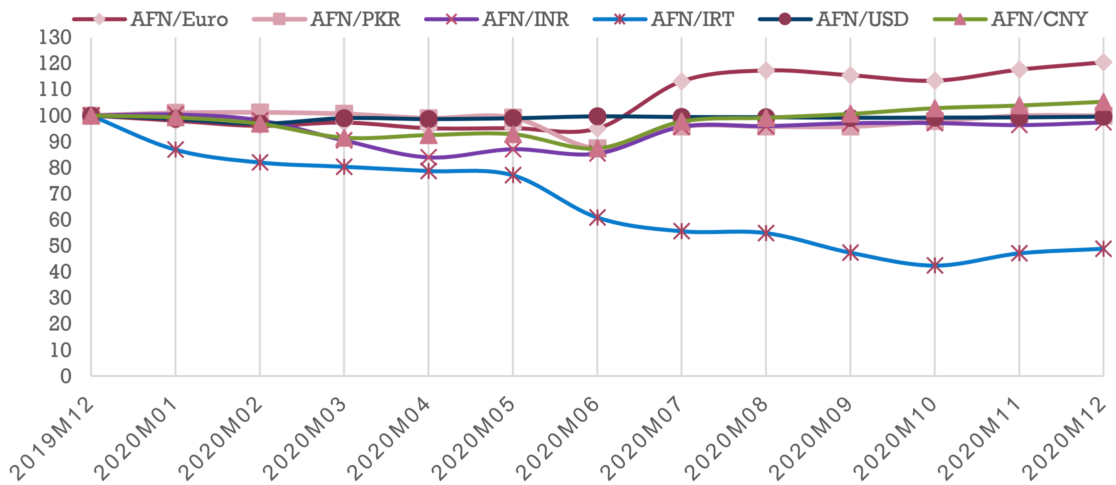
The current account balance improved, and the exchange rate remained stable

The current account balance improved, recording a surplus of 2.9 percent of GDP in 2020 up from 0.6 percent in 2019. This improvement was driven by: (i) increased COVID-19 related aid inflows; and (ii) the slight improvement in the trade balance. Despite elevated political uncertainty, the Afghani remained stable against the US dollar throughout 2020 (registering a small appreciation of 0.46 percent), consistent with the higher current account surplus. The Afghani depreciated by around 20 percent against the Euro, reflecting an overall strengthening of the Euro against other global currencies. Compared to the currencies of major trade partners, the Afghani appreciated by 2.7 percent and 51 percent relative to the Indian Rupee and Iranian Toman (reflecting economic difficulties in Iran and rapid general depreciation of its currency) respectively, while maintaining stable relative to the Pakistani Rupee.

[2] World Bank estimation of total remittances differ from officially recorded remittances. Official remittances (recorded in the BOP statistics) rose by 12 percent in 2020. This increase reflected improved coverage of Hawala transfers by the central bank's balance of payments statistics rather than increases in overall remittance flows.

Figure 15: The Afghani remained stable against the USD while strengthening against the currencies of most major trade partners in the region

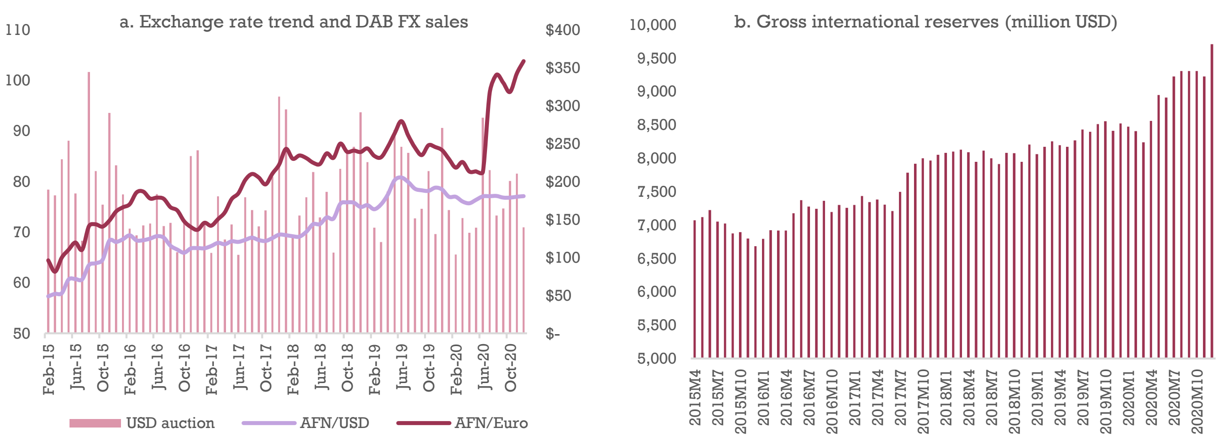
Change in value of Afghani against major trading currencies (Index = December 2019)



Source: Da Afghanistan Bank

After declining by 6.2 percent in the first quarter of 2020, gross international reserves increased by 15.5 percent over the next three quarters, driven by the current account surplus and a 22 percent increase in gold prices. In nominal terms (including valuation effects), foreign exchange reserves increased by USD 1.1 billion. Gross international reserves stood at USD 9.7 billion by the end of 2020, equivalent to 16 months of imports—an adequate level by international standards.

Figure 16: The Afghani maintained its stability and gross international reserves continued to accumulate



Source: Da Afghanistan Bank

6. Fiscal sector

Revenues collapsed in 2020 due to COVID-19

Domestic revenue collapsed to 11.4 percent of GDP in 2020 after reaching a record high of 14.1 percent in 2019. Total domestic revenues amounted to Afs 172.9 billion in 2020 compared to Afs 207.3 billion in 2019, falling below both the original budget target of Afs 208.9 billion, and the revised budget target of Afs 177.7 billion.

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. Performance deteriorated markedly with the onset of the COVID-19 crisis and associated reductions in domestic economic activity, restrictions on international trade, and deteriorating compliance. Revenues began to recover in the third quarter of the year as the economy picked up, and administrative disruptions impacting compliance were resolved.

Suppressed consumption and investment led to lower taxes

Overall tax revenues including customs amounted to Afs 113.5 billion, a nominal decline of 7.6 percent compared to 2019. Inland tax revenues declined by about 32 percent during April-June y-oy, partly reflecting an extension on filing deadlines. During the same period, customs revenue also dropped by 48 percent year-on-year. With easing of COVID-19 related restrictions, both inland tax and customs revenues began to gradually recover in the third quarter.

Core non-tax revenues were hit harder by the pandemic

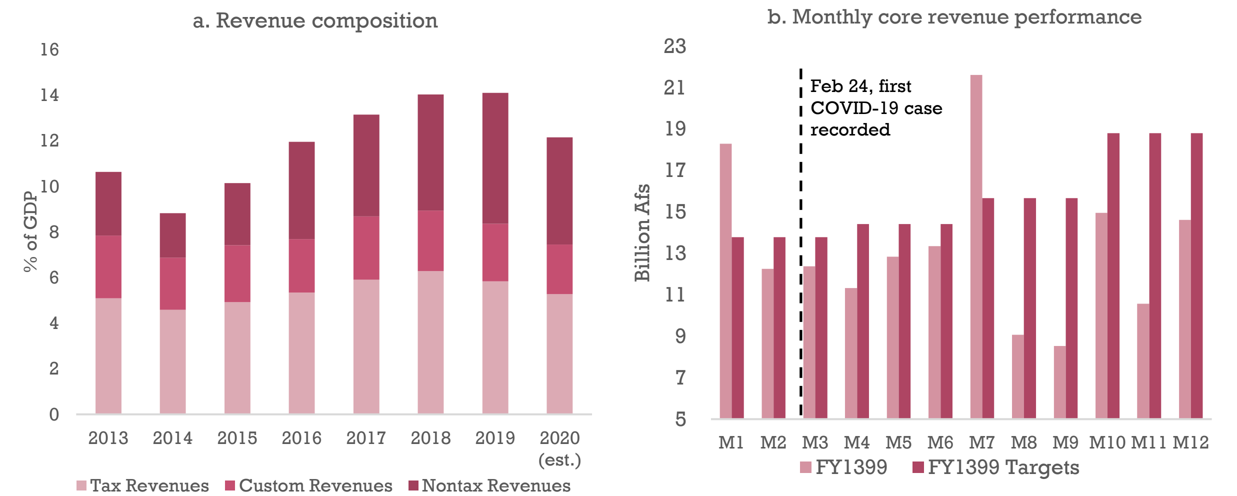
Total non-tax revenues, including one-off revenues, amounted to Afs 59.4 billion in 2020 compared to Afs 84.4 billion in 2019. Due to closure of government offices, core non-tax revenues declined by 41 percent during April-June y-o-y and 46 percent compared to the annual target. To offset the shortfall, the government transferred Afs 12.8 billion from Da Afghanistan Bank (DAB) operating profits in April. Additional short-term revenue measures, including issuance of one-key vehicle licenses, were also implemented, supporting additional non-tax collections of around Afs 390 million in 2020.

The government's preliminary data shows that core revenues (excluding one-off) collection by the Afghan Revenue Department (ARD) was below its annual target by at least 12 percent at the end of 2020. Underperformance was mainly due to provincial Mustofiats (68 percent), Large Taxpayer Office (18 percent) and Small Taxpayer Office (19 percent). Similarly, driven by poor performance in two of the largest custom points (Herat – 21 percent and Nangarhar – 23 percent), collection by Afghanistan Customs Department (ACD) was below its annual target by 11 percent.

Donor aid was quickly mobilized to respond to COVID-19

Donors provided substantial on- and off-budget support to help manage the COVID-19 crisis, both through new commitments and reprioritization of existing project portfolios. Grant support increased from Afs 188.9 billion in 2019 to Afs 227 billion, mainly through increased discretionary support from multi-laterals. Discretionary grants increased by around Afs 25 billion, from Afs 121.2 billion to Afs 146 billion. Non-discretionary support was substantially adjusted toward social relief and health related projects.

Figure 11: Revenue performance was below target even before the pandemic



Source: AFMIS data

Government spending was heavily disrupted by the COVID-19 crisis

Overall government expenditures reached Afs 434.5 billion, equivalent to 28.6 percent of GDP in 2020. Through three budget adjustments, both operating and development budget were reprioritized toward health and social relief spending to fight COVID-19. The overall budget deficit increased from 0.8 percent of GDP in the pre-COVID budget to 3.8 percent in the Mid-Year Review (MYR). Total expenditures also increased by seven percent from budgeted levels, increasing from Afs 428.4 billion to Afs 459.3 billion.

Budget execution slowed due to significant restructuring and movement restrictions

Preliminary data shows that total recurrent expenditures amounted to Afs 274 billion, a decline of 2.5 percent compared to Afs 281.2 billion in 2019 and only around 87 percent of budgeted levels. Reflecting cash shortages and reprioritization efforts, civilian recurrent spending declined by 1.2 percent of GDP, mainly due to a decline in salaries and wages, use of goods and services and subsidies. Security expenditures, however, continued to increase from Afs 140.5 billion to 149.3 billion, standing at 9.8 percent of GDP in 2020.

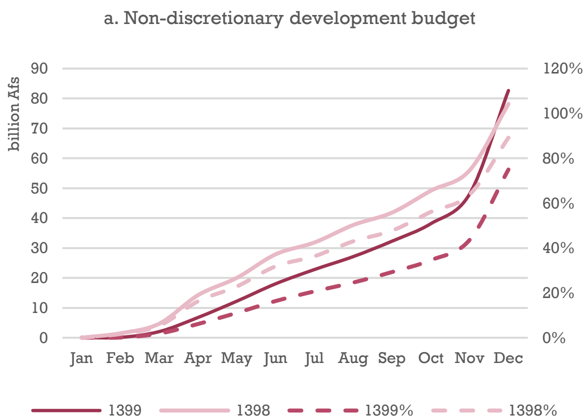
Driven by increased donors grant support, development spending increased by more than 16 percent, from Afs 138.3 billion in 2019 to Afs 160.5 billion in 2020, but also reached only around 92 percent of budgeted levels. Several new programs were introduced to respond to the pandemic, including a country-wide bread distribution program, construction of emergency COVID-19 treatment centers, and other health and social relief projects. Donor financed and managed non-discretionary projects also underwent significant restructuring to respond to the pandemic.

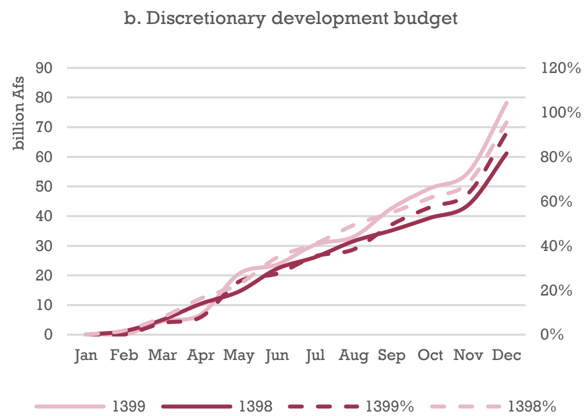
Reflecting lower revenues, and despite increased grant support and lower-than-budgeted expenditures, the overall fiscal deficit reached Afs 35.4 billion or 2.3 percent of GDP (up from 1.6 percent of GDP in 2019). This compared to an originally budgeted deficit of 0.8 percent of GDP. The deficit was financed from new concessional borrowing of Afs 25.4 billion from the IMF (a disbursement of USD223 million under the Rapid Credit Facility and a disbursement of USD117 million under the new Extended Credit Facility (ECF) program), and an Afs 10 billion drawdown of cash reserves.

External debt increased in 2020

The government's total debt stock increased to Afs 114.5 billion (or 7.5 percent of GDP) as of end-2020 from Afs 90.1 billion (or 6.1 percent of GDP) in 2019. The increase was mainly driven by the IMF loans. As part of G20 Debt Services Suspension Initiative (DSSI), Afghanistan received a debt service suspension worth USD 3.9 million from eligible creditors for the period of May-December 2020 to free up fiscal space for COVID-19 expenditures.[3] Afghanistan's existing outstanding debt is almost entirely external and denominated in foreign currency, of which 90 percent is from multilateral creditors.

Figure 12: Execution of development budget weakened due the pandemic
(Execution rate in percent, and total cumulative expenditures)





Source: Ministry of Finance data

[3] The debt service suspension further extended to January-June 2021 period with estimated USD2.7 million in delayed debt service during 2021.

B. Outlook and Medium-Term Prospects

a. Medium-term outlook

The outlook is subject to enormous uncertainty

Afghanistan's economic and development prospects remain highly uncertain. Major sources of uncertainty include: i) future political developments, including progress and outcomes of ongoing peace discussions with the Taliban; ii) possible changes in security conditions; iii) future levels of international security and aid support; and iv) domestic, regional, and global economic conditions in the context of the ongoing COVID-19 pandemic.

Under a baseline scenario, Afghanistan will face: i) continuation of current security and political conditions, involving high levels of uncertainty, slow progress with peace talks, a sustained US troop presence, and continued widespread violence; ii) continued international grant support at levels indicatively pledged at the 2020 Geneva Conference (around 20 percent lower than over the preceding pledging period); and iii) no major acceleration in reform progress, reflecting the continued difficult political environment.

Growth is expected to remain sluggish

Under this scenario, real GDP is expected to grow by one percent in 2021. Reflecting low precipitation through the 2021 winter season, agriculture growth is expected to be weak amid widespread drought conditions. While both rainfed farming and livestock are likely to contract, irrigated farming is expected to experience moderate growth. The industry and services sectors are expected to grow at a sluggish two percent, reflecting weak private sector confidence.

Over the medium term, real GDP growth is expected to average around three percent reflecting ongoing uncertainty, aid declines, continued insecurity, and slow reform progress. In the context of rapid population growth (around 2.3 percent), per capita incomes are not expected to recover to pre-COVID levels until 2025.

Drought conditions will impact livelihoods

Rural poverty is expected to increase in the short-term due to the impacts of drought on subsistence and other agricultural activities. Over the medium-term, significant further reductions in poverty will depend on increased agricultural productivity, and the generation of new economic opportunities for a growing urban population.

Inflation is expected to pick up

Consumer prices are expected to increase by 3.8 percent over 2020. Despite weak demand, food prices are expected to increase with drought conditions impacting cereal production and causing supply constraints across the region. Inflation is expected to accelerate to around five percent over the medium-term, as aggregate demand picks up.

The trade balance is expected to remain roughly stable

Merchandise exports are expected to recover in 2021 but not robustly, as drought conditions are expected to dampen agricultural production. Merchandise imports are also expected to expand, reflecting general economic recovery. With growth in the level of imports outstripping growth in the level of exports, the trade deficit is expected to increase slightly to 28.14 percent of GDP in 2021. Over the medium term, the trade deficit is expected to remain stable at around 28 percent of GDP. Continued export growth will offset the expansion of imports, which are expected to expand at around the pace of economic growth.

The current account will move into deficit

Driven by declining international grants, the current account surplus is expected to shrink over coming years, with a deficit of around two percent of GDP expected by 2024. Accordingly, international reserves are projected to decline but remain at comfortable levels of around fourteen months of import cover by 2024.

Revenues are expected to remain weak

Domestic revenues are expected to recover gradually, reaching 12.3 percent of GDP (or Afs 196.5 billion) in 2021, compared to 14.1 percent of GDP (or Afs 207 billion) in 2019. Predicated on an annual collection of 0.5 percent of GDP from VAT revenues starting in 2022, the revenue-to-GDP ratio is expected to recover to 14 percent by 2024. Grants are expected to remain close to 13.4 percent of GDP over 2021-22, and gradually decline over the medium term.

Fiscal space for development spending is likely to shrink

Total expenditures are expected to increase slightly to Afs 459.4 billion (or 28.8 percent of GDP) in 2021 from Afs 434.5 billion 2020, supported by increased revenues and new concessional borrowing. Recurrent expenditure growth is expected to squeeze out development expenditures over the medium-term, reflecting increased payroll and pension costs, and as government takes on an increasing share of security sector costs. Development expenditures are expected to reach 9.5 percent of GDP in 2021 (down from 10.6 percent of GDP in 2020), and gradually decline to 7.8 percent of GDP by 2024.

The fiscal deficit will continue to increase in 2021

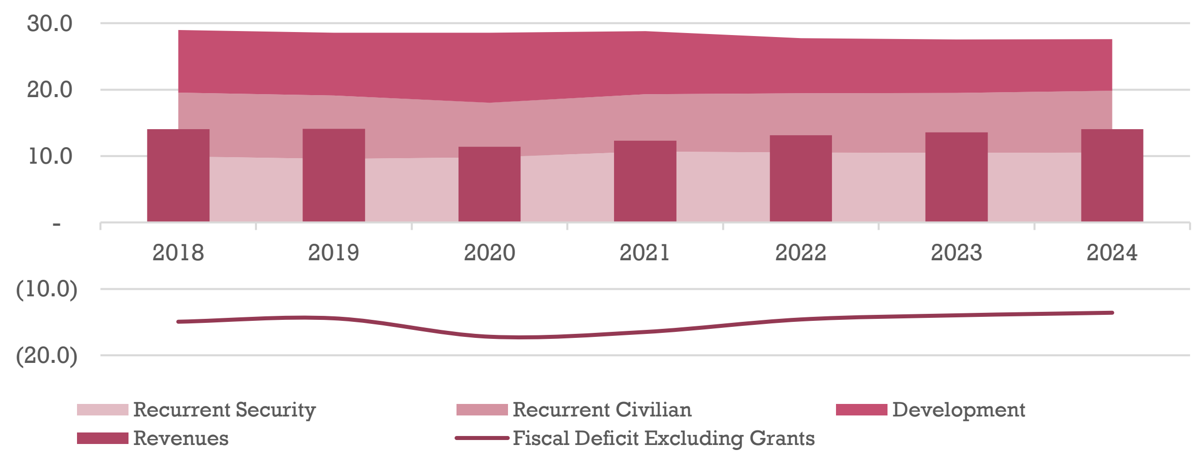
With declining grants, the fiscal deficit is expected to increase from Afs 35.4 billion (or 2.3 percent of GDP) in 2020 to Afs 48.8 billion (or 3.1 percent of GDP) in 2021. The deficit will be financed from the expected disbursement of Afs 23.9 billion under the IMF Extended Credit Facility program, and increased government cash drawdown of Afs 25 billion. Over the medium term, the fiscal deficit is likely to fall below 0.6 percent of GDP reflecting constrained financing options.

Government reliance on donor aid will remain at elevated levels given weak medium-term revenue prospects. Fiscal sustainability, defined as the share of recurrent expenditure financed by domestic revenues, is expected to remain at around 64 percent in 2021, recovering gradually recovery to 71 percent by 2024.

Afghanistan remains at high risk of external and overall debt distress

The government debt stock is estimated to increase to 8.7 percent of GDP in 2021 and further to 10 percent in 2024. Despite low levels of debt, Afghanistan is considered at 'high' risk of debt distress under the WB-IMF debt sustainability framework. This assessment reflects Afghanistan's heavy dependence on external grant support, low exports, low revenues, and weak debt management capacity.

Figure 13: Government will remain highly dependent on aid inflows
(Percent of GDP)



Sources: Ministry of Finance data, World Bank staff projections

Table 1: Macro-fiscal outlook in the medium term

	2018	2019	2020	2021	2022	2023	2024
	Actuals/Estimates			*--- Staff projections ---*			
Growth and prices							
Real GDP growth (%)	1.2	3.9	-1.9	1.0	2.6	3.0	3.2
Nominal GDP (Afs billion)	1,328	1,470	1,520	1,594	1,707	1,844	1,995
CPI Inflation (period average, %)	0.6	2.3	5.6	3.8	4.5	5.0	5.0
Fiscal	***percent of GDP***						
Revenues and grants	29.8	27.0	26.3	25.8	26.6	26.8	27.0
Domestic Revenues	14.0	14.1	11.4	12.3	13.1	13.6	14.0
Foreign grants	15.7	12.9	14.9	13.4	13.5	13.2	13.0
Total Expenditures	29.0	28.5	28.6	28.8	27.7	27.5	27.6
Recurrent expenditures	19.5	19.1	18.0	19.3	19.4	19.5	19.8
Development expenditures	9.5	9.4	10.6	9.5	8.3	8.0	7.8
Overall balance (excl. grants)	(14.9)	(14.4)	(17.2)	(16.5)	(14.6)	(14.0)	(13.6)
Overall balance (incl. grants)	0.8	(1.6)	(2.3)	(3.1)	(1.1)	(0.8)	(0.6)
Finaning	-	0.1	1.7	1.5	0.6	0.2	0.1
External	***percent of GDP***						
Trade balance	(34.7)	(30.4)	(27.6)	(28.1)	(28.1)	(28.0)	(28.0)
Current account balance (incl. grants)	2.6	0.6	2.9	1.2	0.3	(0.6)	(1.6)

Note: GDP figures for 2020 are NSIA preliminary estimates.

b. Risks and priorities

The COVID-19 pandemic continues, with Afghanistan experiencing a spike in case numbers over late 2020. Donor financing is being secured for the acquisition of vaccines, but the roll-out of vaccination programs has only just begun. With limited testing capacity and severe weaknesses in basic healthcare infrastructure, the pandemic may continue to negatively impact confidence, commerce, and trade.

The political and security outlook is subject to substantial uncertainty in the context of ongoing peace negotiations. Security could rapidly deteriorate under a range of possible scenarios, including a withdrawal of international troops, or following any breakdown in peace talks. The contours of any possible peace agreement are unknown, and any future Taliban-influenced government may face resistance from groups that have previously opposed Taliban control.

While the 2020 Geneva Conference saw the international community reaffirming its commitment to Afghanistan, future aid levels remain subject to substantial uncertainty. Many donors conditioned continued civilian aid support upon adequate progress with peace talks, critical reforms, and efforts to address corruption. A perceived or real lack of progress against these objectives may see rapid declines in grant support, forcing a difficult macroeconomic adjustment. The withdrawal of US troops or reductions in international grant support to the Afghanistan security forces would have a range of unpredictable impacts on security, political cohesion, and the economy.

Covid-19 has amplified risks to financial stability with continued and more rapid deterioration in asset quality. Bank resolution tools, financial safety nets, and institutional capacity across the financial sector remain limited.

The government has few policy options for resolving current difficult economic conditions. Fiscal space remains tightly constrained in the context of weakened revenue performance and declining international grants. Government cash reserves are being depleted, Afghanistan has no domestic debt market, and debt sustainability concerns constrain future external borrowing. Weak transmission mechanisms limit the effectiveness of monetary policy.

In the context of current fiscal pressures and slow growth, it is vital for the government to: i) strengthen revenue performance, including through the effective implementation of the VAT; ii) encourage continued grant support through demonstrating adequate reform progress against established policy benchmarks and commitments, especially in relation to governance and anti-corruption; iii) take measures to ensure the quality and efficiency of public expenditures, including urgent measures to stem unsustainable growth in payroll costs and pension liabilities; and iv) support the restoration of some level of private sector confidence through addressing unnecessary regulatory and institutional constraints to investment. In the context of intensifying financial sector risks, it will be critical for DAB to maintain strong oversight and be prepared to intervene quickly as needed. Over the medium-term it will be important to implement critical policy and institutional reforms for improved risk management (including developing and implementing a legal framework for deposit insurance), strengthen crisis preparedness and the bank resolution framework, implement the national money laundering and terrorist financing risk assessment action plan, and ensure regular publication of financial stability reports.

Over the medium-term, Afghanistan must mobilize new sources of growth to create economic opportunities for the 600,000 Afghans reaching working age every year, provide revenues to replace declining grants, and generate foreign exchange receipts to finance the large fiscal deficit. Further investment in irrigation rehabilitation could support continued recent growth of agriculture production, driven by fruit and vegetables, and facilitate further expansion in food processing sectors. Establishing a sound and stable policy, legal, and regulatory framework for extractives investment will be critical to mobilizing Afghanistan's substantial mining and hydrocarbon potential.

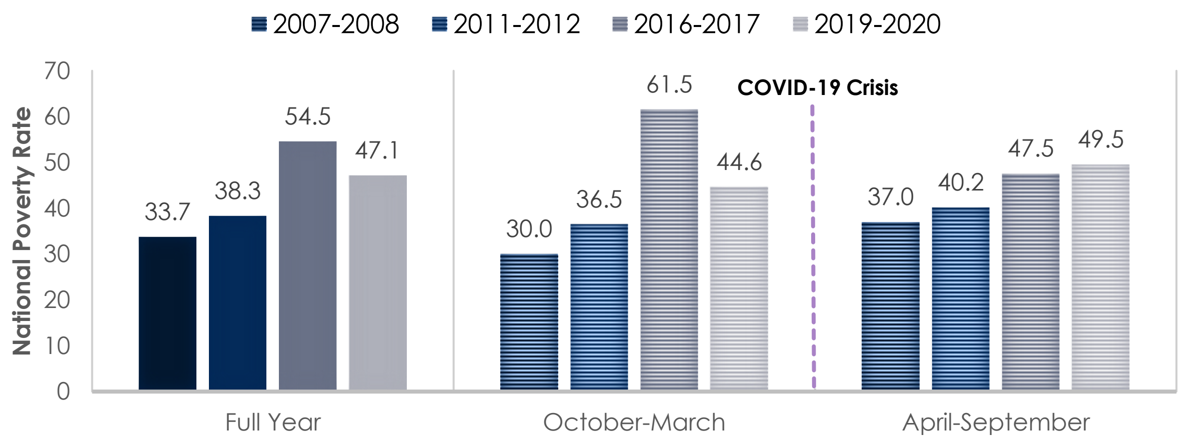
For donors, continued grant support to Afghanistan is vital. Any precipitous reduction of either civilian or security support would force a difficult macroeconomic adjustment, undermine the capacity of government to sustain core services, and put at risk development gains achieved over the past two decades. Current broadly defined conditionalities, such as those embodied in the Afghanistan Partnership Framework, risk undermining certainty and predictability, contributing to low confidence and weak investment. Donors could usefully work towards: i) establishing clearer multi-year commitments; ii) defining a smaller set of priority reforms against which continued grant support would be mobilized; and iii) clearly defining the consequences if conditionalities are not met, including potential decisions to reduce aid levels, or move aid support off-budget.

C. Focus Section: Diverging Poverty Trends - Insights from the 2019–2020 Income, Expenditure, and Labor Force Survey (IE-LFS)[4]

Poverty decreased in Afghanistan in 2019–2020, though gains were partially reversed by the impact of the COVID-19 crisis.

Poverty in Afghanistan decreased to 47.1 percent in 2019–2020, down from the peak of 54.5 percent in 2016–2017 (Figure 13). This decline was observed despite the negative impacts of the COVID-19 crisis, whose effects have been felt in the country since April 2020 and were captured during the second half of the IE-LFS (the household survey used to calculate poverty in 2019–2020). Data collected prior to the onset of the crisis (between October 2019 and March 2020) show that poverty had declined markedly, relative to the same period in the 2016–2017 survey. Data captured after the arrival of COVID-19 and its associated disruptions to people's livelihoods (between April and September 2020), show that poverty increased by two percentage points relative to the same period in the 2016–2017 round. Underlying this broad trend is a sharp divergence between urban and rural areas. In rural areas, despite the onset of COVID-19, poverty continued to decline, though at a much slower pace. In urban areas, by contrast, poverty increased considerably during the months of the COVID-19 crisis. It is important to note that, even with the overall decline in poverty in Afghanistan, close to half the population of the country cannot afford a minimum standard of living, and poverty remains higher than it was in 2007–2008 and 2011–2012.

Figure 13: Poverty in Afghanistan decreased overall in 2019–2020, though gains were partially reversed by the impact of the COVID-19 crisis



Note: Poverty rates are calculated from estimated expenditures necessary to secure a food basket equivalent to 2,100 calories and minimal levels of non-food expenditures, rent, and assets, accounting for inflation. In 2019–2020 this was equivalent to 0.94 USD per person per day.
Source: Staff calculations using NRVA 2007–2008, NRVA 2011–2012, ALCS 2016–2017, and IELFS 2019–2020.

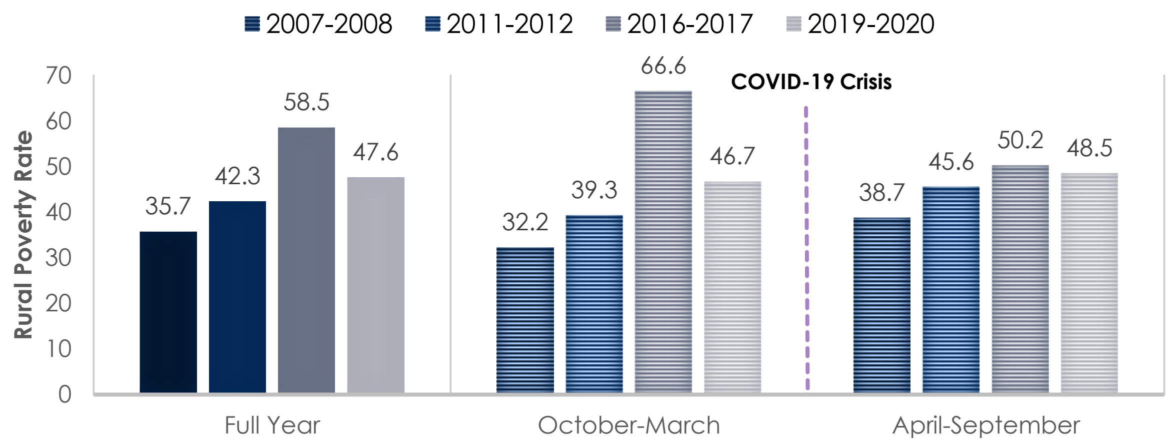
[4] The 2019-2020 Income, Expenditure and Labor Force Survey (IE-LFS) was administered by the National Statistics and Information Authority (NSIA) between October 2019 and September 2020. A nationally representative household survey, the IE-LFS collected critical information on households' livelihoods and living conditions to update key indicators of socioeconomic development in Afghanistan. Preliminary results were made available in December 2020, and the release of final results was pending at the release of this report.

Poverty reduction in rural areas

The decline in national poverty in 2019–2020 was driven by a steep reduction in rural poverty.

In rural areas, where 77 percent of the population in the country resides, poverty declined from 59 to 48 percent between 2016–2017 and 2019–2020 (Figure 14). This decline was most evident before COVID-19, when poverty dropped by 20 percentage points relative to 2016–2017. Gains have moderated somewhat since the onset of COVID-19, although poverty still decreased by almost two percentage points.

Figure 14: Rural poverty declined sharply between 2016–2017 and 2019–2020, for the period before the onset of the COVID-19 crisis

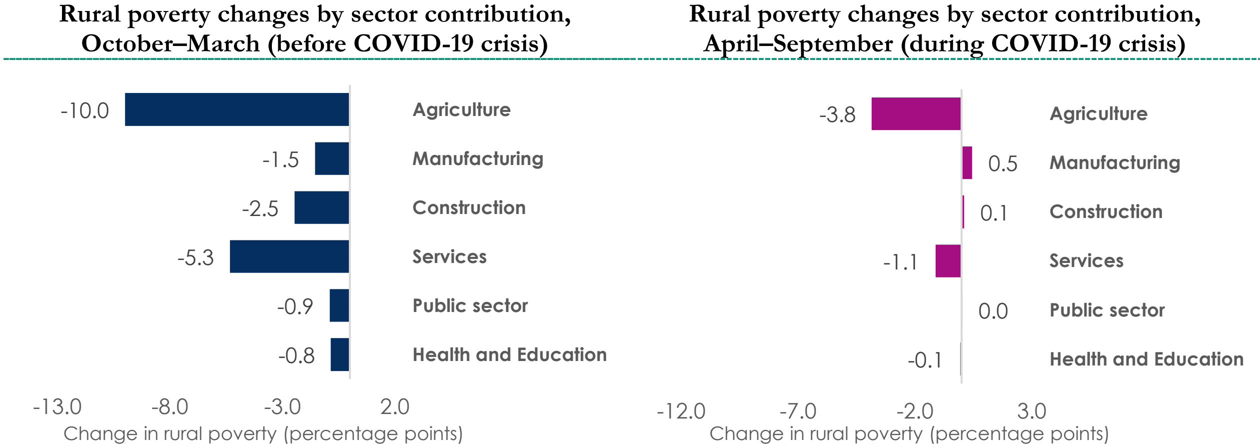


Note: Poverty rates are calculated from estimated expenditures necessary to secure a food basket equivalent to 2,100 calories and minimal levels of non-food expenditures, rent, and assets, accounting for inflation. In 2019–2020 this was equivalent to 0.94 USD per person per day.
Source: Staff calculations using NRVA 2007–2008, NRVA 2011–2012, ALCS 2016–2017, and IELFS 2019–2020.

Increased earnings from agricultural activities are the main driver of poverty reduction in rural areas.

An analysis of household income sources shows that activities related to agriculture, which accounts for 57 percent of employment in rural areas, played a key role in the decline in rural poverty (Figure 15). Before the onset of the COVID-19 crisis, agriculture accounted for close to half of the observed reduction in rural poverty, followed by services such as retail, transport, and personal services. Following the COVID-19 economic crisis, earnings from agriculture continued to drive poverty reduction in rural areas. Earnings from the services sector contributed only slightly to this decline. Households relying on stable sources of income, such as employment in government or in the health sector, were the least heavily affected by the crisis, in line with their higher levels of consumption and lower poverty rates.

Figure 15: The decrease in rural poverty was driven by agriculture

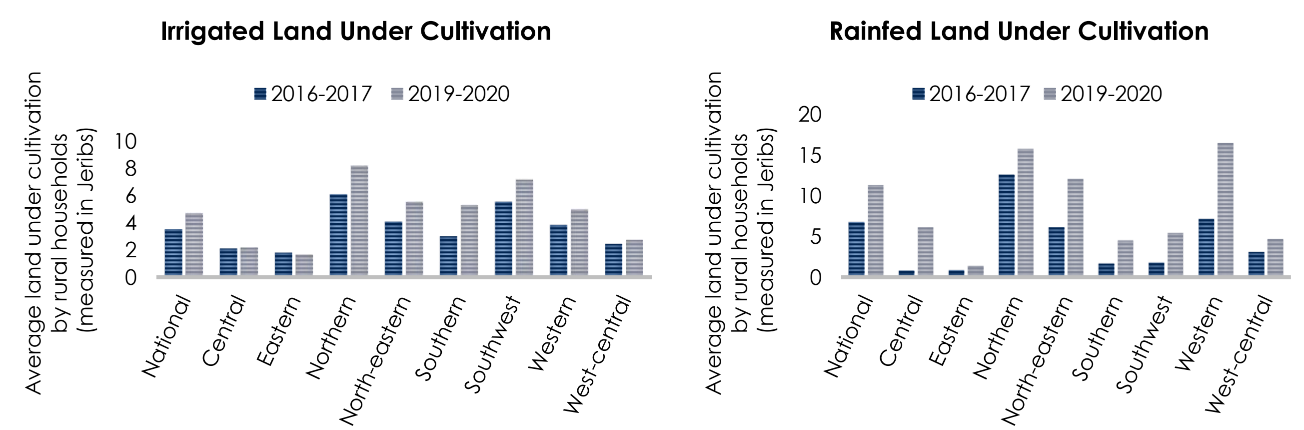


Notes: Results obtained from Ravallion and Huppi (1991) decompose changes in poverty over time into intrasectoral effects, a component due to population shifts across sectors. The sector of employment is defined based on reported hours of work in each sector.
Source: Staff calculations using ALCS 2016–2017 and IELFS 2019–2020.

The importance of agricultural earnings for rural poverty reduction in 2019–2020 coincides with an expansion in agricultural output, increases in arable land under cultivation, and growth in exports of fruits and vegetables.

Indicators of agricultural production show improvements in the sector's performance between 2016–2017 and 2019–2020 that corroborate the observed decline in rural poverty. Despite a drought in 2018, agricultural sector value added grew by an accumulated 26 percent between 2016 and 2020, owing to two consecutive good years in 2019 and 2020. In line with these results, household survey data show a 27 percent increase in irrigated area under cultivation and a 37 percent increase in cultivated rainfed land (Figure 16). The share of rural households cultivating fruits and vegetables increased during this period, as did the net export of these crops, particularly in the four regions that show the largest declines in rural poverty (Figure 16).

Figure 16: Irrigated and rainfed land under cultivation increased

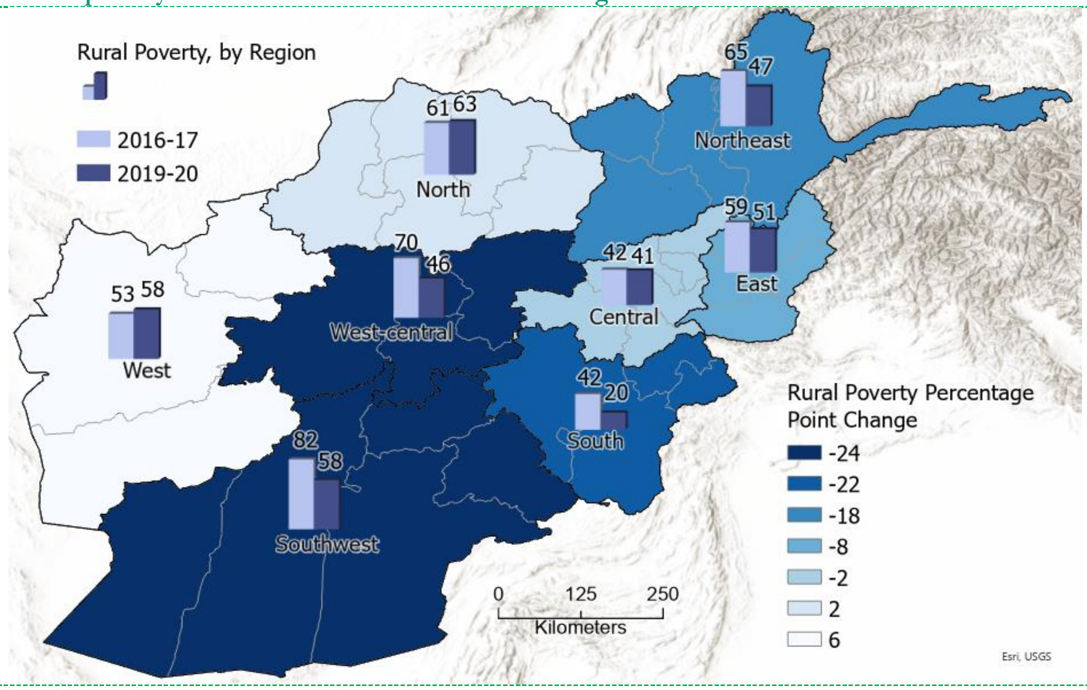


Source: Staff calculations using ALCS 2016–2017 and IELFS 2019–2020.

From a regional perspective, rural poverty reduction was concentrated in four regions of the country, with one of the largest declines observed in the Southwest, a region that has traditionally concentrated on opium poppy production.

Four regions (South, Southwest, West-Central, and Northeast) experienced declines in poverty close to or over 20 percentage points (Figure 17). Among these, the Southwest region has traditionally been the area where most of Afghanistan's opium poppies are grown. According to the United Nations Office on Drugs and Crime, in 2019 nearly three-quarters of the land dedicated to opium poppy production in the country was in the Southwest[5]. Opium production and profits reached a high-water mark with the 2017 harvest, which took place after the conclusion of data collection for the 2016–2017 survey. There is some indication that this could have driven investment in solar-powered water pumps in the Southwest region, which has led to an expansion in cultivation in non-irrigated areas (Box 1). In fact, household-level data show that 56 percent of rural households in the Southwest region reported owning more than one solar panel in 2019–2020, an increase of 19 percentage points over the number in 2016–2017.

Figure 17: Rural poverty reduction was concentrated in four regions



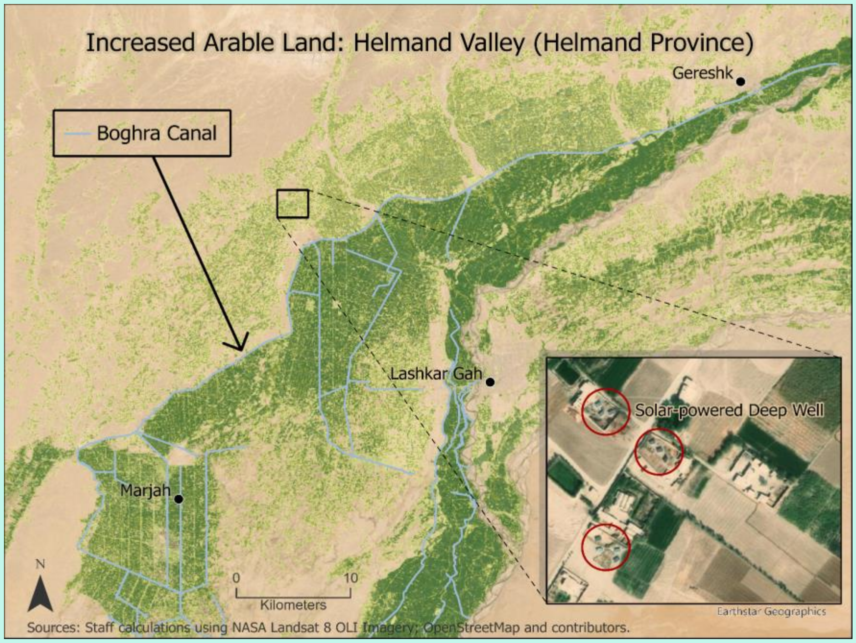
Source: Staff calculations using ALCS 2016–2017 and IELFS 2019–2020.

[5] United Nations Office on Drugs and Crime, and National Statistics and Information Authority. 2021. *Afghanistan opium survey 2019-Socio-economic survey report: Drivers, causes and consequences of opium poppy cultivation.* Report available at: https://www.unodc.org/documents/crop-monitoring/Afghanistan/20210217_report_with_cover_for_web_small.pdf. Retrieved on March 19, 2021

Box 1: Expansion of agriculture driven by solar powered pumps

A 2018 report from the Afghanistan Research and Evaluation Unit (AREU), *Still Water Runs Deep*, outlines how the past five years have seen increased use of solar-powered boreholes to irrigate otherwise desertic areas up to 2017.[6] The report finds that this expansion was financed by opium poppy cultivation. The World Bank extended the AREU analysis to investigate how and where these changes occurred between 2014 and 2019, specifically mapping known agricultural expansion in the Helmand Valley.

Figure B1.1 Arable land increased in Helmand province



Note: This map illustrates the increase in arable land in Helmand Province, outside of Lashkar Gah. Areas north of the canal experienced an increase in vegetation irrigated by solar-powered water pumps, as measured using the normalized difference vegetation index (NDVI).
Source: Staff calculations using NASA Landsat imagery from Oct 8, 2020; OpenStreetMap and Contributors.

Using crowd-sourced geospatial data from OpenStreetMap, the World Bank team identified highly concentrated clusters of solar panels in areas that transformed from desertic to vegetated between 2014 and 2019. In the Helmand Valley, gravity-fed irrigation from the Boghra Canal has historically served as the primary irrigation source for the area. As a result, the population and vegetation were concentrated downstream from and south of the canal. The analysis determined that the increase in vegetation upstream of the canal coincided with the location of solar panel clusters. It concluded that the expansion in arable land upstream of the canal was driven by the widespread adoption of solar-powered water pumps. While, in the short term, this has driven an expansion in arable land and corresponding agricultural output, these pumps draw from aquifers at an unsustainable rate and risk depletion within the next decade, potentially reversing the recent expansion in arable land and the consequent reduction in poverty.

The impact of COVID-19 in urban areas

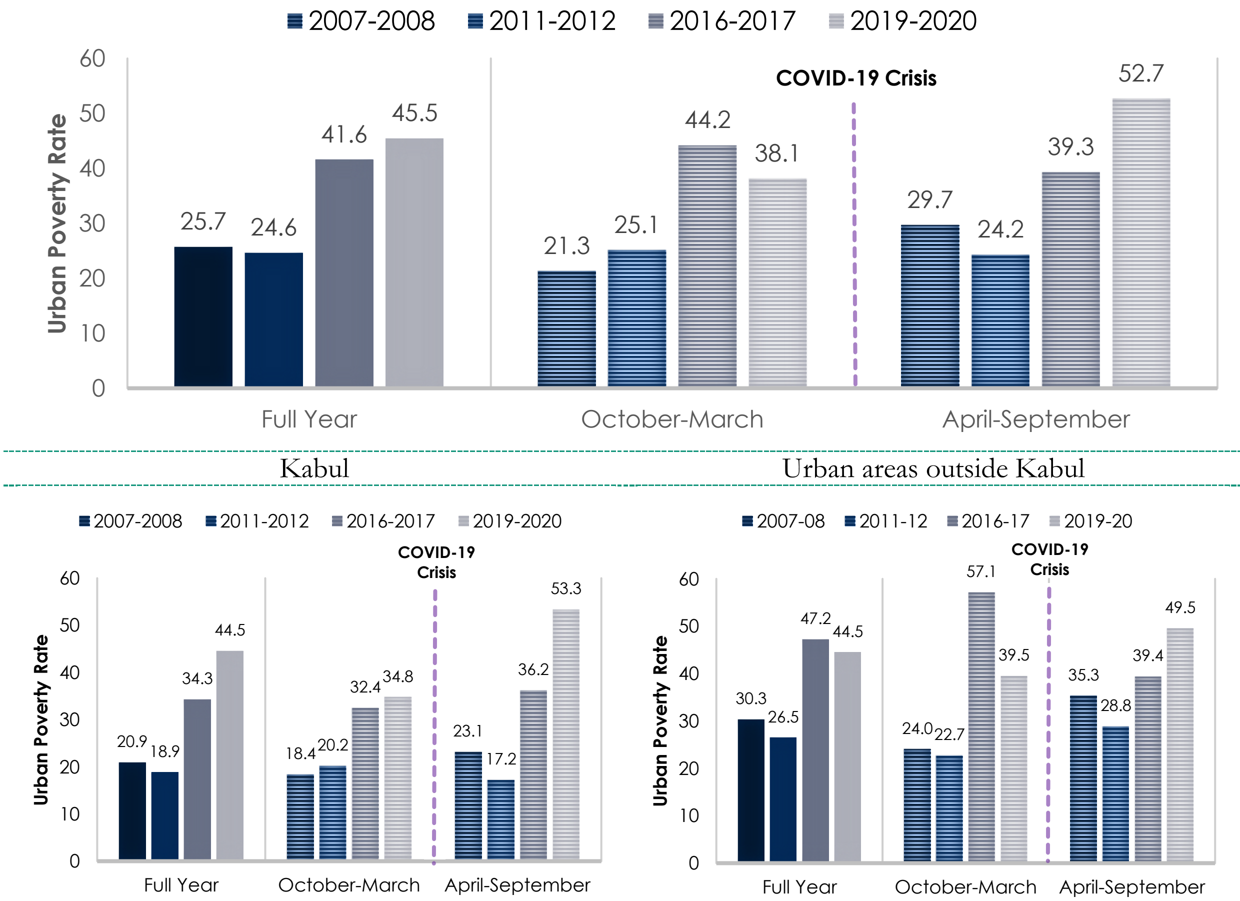
Urban poverty was decreasing, but gains were reversed by the COVID-19 crisis, especially in Kabul.

Poverty in urban areas has increased overall, from 42 percent in 2016–2017 to 45 percent in 2019–2020 (Figure 18), due in large part to the effects of COVID-19. Before the pandemic-fueled economic crisis hit the country, urban poverty had declined from 44 percent to 38 percent, led by marked improvements in urban areas outside of Kabul. Interestingly, Kabul, which represents 55 percent

[6] David Mansfield. 2018. *Still Water Runs Deep: Illicit Poppy and the Transformation of the Deserts of Southwest Afghanistan*. Kabul: Afghanistan Research and Evaluation Unit. Report available at https://reliefweb.int/report/afghanistan/still-water-runs-deep-illicit-poppy-and-transformation-deserts-southwest. Retrieved on March 19, 2021.

of the country's urban population, saw a small increase in urban poverty, even before the onset of COVID-19, relative to 2016–2017. The impact of COVID-19 was severe in all urban areas of the country, and urban poverty increased from 39 to 53 percent. Not surprisingly, Kabul fared worse than other urban areas. Poverty in the capital city increased by 17 percentage points during the COVID-19 crisis months, compared to a similar period in 2016–2017. In contrast, poverty increased by 11 percentage points in other urban areas.

Figure 18: Urban poverty decreased initially, but gains were reversed by COVID-19

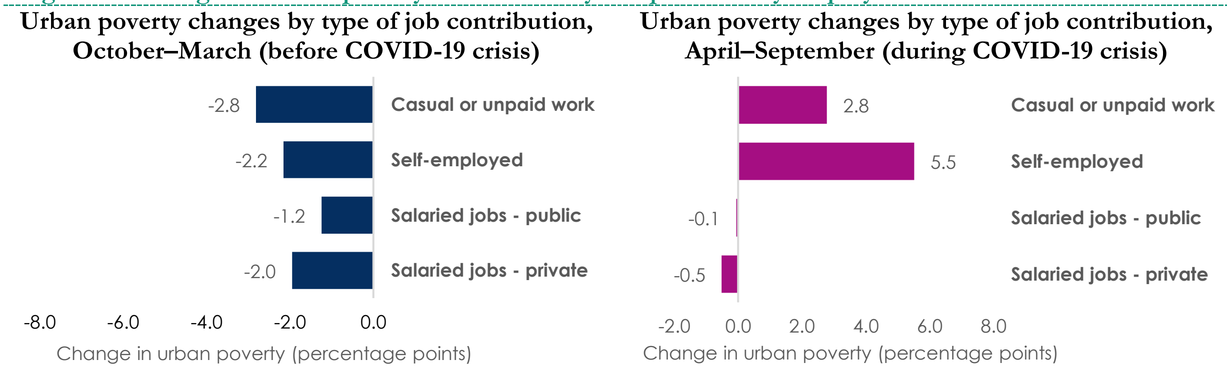


Note: Poverty rates are calculated from estimated expenditures necessary to secure a food basket equivalent to 2,100 calories and minimal levels of non-food expenditures, rent, and assets, accounting for inflation. In 2019–2020 this was equivalent to 0.94 USD per person per day.
Source: Staff calculations using NRVA 2007–2008, 2011–2012, ALCS 2016–2017, IELFS 2019–2020.

Increases in earnings from self-employment and casual work were the main drivers of urban poverty reduction, a trend dramatically reversed by COVID-19

Before COVID-19, urban poverty reduction was driven by improvements in earnings from low-productivity activities, mainly among the self-employed and for those in casual jobs (Figure 19). Most of these workers are employed in the informal economy as shop keepers, taxi or van drivers, construction workers or street vendors (to mention a few examples) and hold precarious positions. As expected, these trends were reversed by the lockdown and economic crisis, which disrupted economic activities in the cities and severely affected the livelihoods of urban households. Between Fall 2019 and Spring 2020, reported monthly earnings decreased by 14 percent for the self-employed and 15 percent for casual laborers, which include workers in small establishments such as restaurants, shops, and market retailers. A rapid telephone survey confirmed these findings: almost three-fourths of self-employed workers reported a deterioration in earnings (Box 2). Urban households also faced a steep rise in food prices. When the COVID-19 pandemic closed the borders and restricted commerce, the food price index increased by 12 percent. Lower earnings and higher prices reduced consumption, driving up poverty. In urban centers, as in rural areas, workers in the government, health, and education sectors did not experience significant income changes with respect to 2016–2017 nor were they severely affected by the crisis.

Figure 19: Changes in urban poverty were driven by low productivity employment



Notes: Results obtained from Ravallion and Huppi (1991) decompose changes in poverty over time into intrasectoral effects, a component due to population shifts across sectors. The type of employment is self-reported.
Source: Staff calculations using ALCS 2016–2017 and IELFS 2019–2020.

While worst-case projections did not materialize, the economic crisis precipitated by COVID-19 increased urban poverty

At the onset of COVID-19, the World Bank sought to estimate the potential impact of the crisis on the Afghan economy, with projections indicating a 17 percentage point increase in poverty under the worst-case scenario.[7] The realized outcomes, fortunately, indicate a far more modest decline in growth than initially projected, and a decline, rather than a rise, in poverty, driven largely by gains in agricultural productivity.

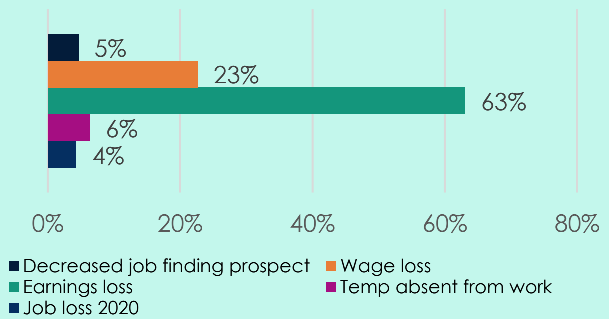
[7] World Bank Group. 2020. *Afghanistan Development Update, July 2020: Surviving the Storm*. Washington, DC: World Bank. Report available at https://openknowledge.worldbank.org/handle/10986/34092.

Box 2: Deterioration in labor and business conditions due to COVID-19

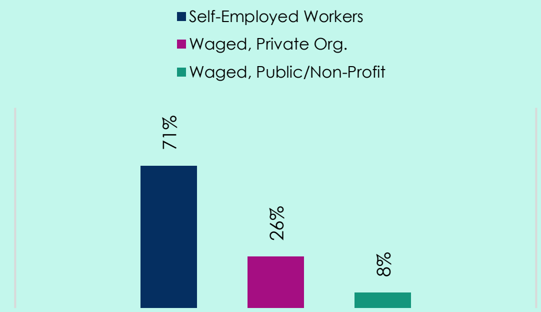
To observe the effects of the COVID-19 crisis on livelihoods and employment in Afghanistan, the World Bank conducted a rapid response telephone survey between August and November 2020.[8] According to the survey, 40 percent of respondents who were active in the labor force before the crisis faced at least one COVID-related deterioration in their labor outcomes. The loss of earnings among the self-employed was especially salient, most likely associated with lockdown measures and reduced demand from clients. Almost three-fourths of self-employed workers and household enterprises experienced a negative shock to their livelihoods due to COVID-19. Respondents signaled a strong deterioration in their food security status as well, with 39 percent indicating that they would be unable to meet food and other basic needs for more than a week. Having exhausted their savings and other coping strategies, 68 percent of women and 48 percent of men reported not being able to cope with a generic emergency expense. These independent results confirm the magnitude of COVID-19's impact on urban households, particularly those with precarious employment.

Figure B2.1: Reported deterioration in livelihoods due to COVID-19

Respondents reporting a deterioration in labor outcomes related to COVID-19, by type of deterioration



Respondents reporting a deterioration in earnings, by job type



Note: Estimates are based on 5,057 interviews conducted remotely via telephone. Selection of telephone numbers was based on the random digit dialing method, and a combination of quotas and weights were considered to ensure gender and spatial representativeness. The labor force was defined as all those currently working, looking for work, or economically active since January 2020. The self-employed were defined as all those working but not salaried, including informal workers and day laborers.

Source: Staff calculations using the regional SAR COVID-19 rapid response survey, administered in Afghanistan from August to November 2020.

[8] Results available on the World Bank's COVID-19 High Frequency Monitoring Dashboard, available at: https://www.worldbank.org/en/data/interactive/2020/11/11/covid-19-high-frequency-monitoring-dashboard .

Table 2 Macroeconomic Indicators

	2018	2019	2020	2021	2022	2023	2024
				proj.	*proj.*	*proj.*	*proj.*
Output/Income							
Nominal GDP (billion Afs)	1,328	1,470	1,520	1,594	1,707	1,844	1,995
Nominal GDP (billion USD)	18.4	19.3	20.0	19.9	20.3	20.9	21.5
GDP Per Capita	493.8	507.1	512.7	500.3	498.8	501.7	505.7
Population (million)	37.2	38.0	38.9	39.8	40.8	41.7	42.6
Real Economy							
Real GDP Growth	1.2	3.9	-1.9	1.0	2.6	3.0	3.2
Agriculture	-4.4	17.5	5.3	-1.5	4.0	4.5	5.0
Industry	11.1	4.8	-4.2	2.0	2.0	2.0	2.5
Services	1.9	-1.4	-4.8	2.3	2.0	2.5	2.5
GDP Composition (% of GDP)							
Agriculture	25.2	28.5	30.6	29.8	30.2	30.7	31.2
Industry	12.2	12.3	12.0	12.2	12.1	12.0	11.9
Services	57.5	54.6	53.0	53.7	53.4	53.1	52.7
Prices (12 month % Change)							
CPI Inflation (period average)	0.6	2.3	5.6	3.8	4.5	5.0	5.0
CPI Inflation (end-period)	0.8	2.8	5.0	5.5	0.0	0.0	0.0
Core Inflation (Excl. fuel and cereals)	-0.9	3.4	6.6	…	…	…	…
Fiscal (% GDP)							
Total Revenue and Grants	61.0	56.0	54.3	52.3	51.2	49.4	47.9
Domestic revenues	14.0	14.1	11.4	12.3	13.1	13.6	14.0
Grants	47.0	41.9	42.9	40.0	38.0	35.9	33.9
Security grants	26.5	24.1	23.5	22.4	21.3	20.1	19.0
On-budget	6.4	5.4	5.4	6.6	6.6	6.4	6.3
Off-budget	20.1	18.7	18.0	15.8	14.7	13.7	12.7
Civilian grants	20.5	17.8	19.5	17.6	16.7	15.8	14.8
On-budget	9.4	7.4	9.4	6.8	6.9	6.8	6.7
Off-budget	11.1	10.4	10.0	10.7	9.9	9.0	8.2
Total expenditures	60.2	57.6	56.6	55.4	52.3	50.2	48.5
Security spending	30.1	28.2	27.9	26.5	25.3	24.1	23.3
On-budget security	10.0	9.6	9.8	10.7	10.5	10.5	10.5
Off-budget security	20.1	18.7	18.0	15.8	14.7	13.7	12.7
Civilian spending	30.2	29.3	28.8	28.9	27.1	26.1	25.3
On-budget civilian	19.0	19.0	18.8	18.2	17.2	17.1	17.1
Off-budget civilian	11.1	10.4	10.0	10.7	9.9	9.0	8.2
Budget balance	0.8	-1.6	-2.3	-3.1	-1.1	-0.8	-0.6
Budget balance excl. grants	-14.9	-14.4	-17.2	-16.5	-14.6	-14.0	-13.6
External Sector							
Total trade balance (% GDP)	(34.7)	(30.4)	(27.6)	(28.1)	(28.1)	(28.0)	(28.0)
Exports of goods (million US$)	875	864	777	831	914	1,006	1,106
Imports of goods (million US$)	6,596	6,158	5,880	6,009	6,195	6,412	6,669
Service trade balance (million USD$)	(654)	(567)	(404)	(430)	(438)	(450)	(468)
Net current transfers (% GDP)*	49.9	45.7	46.4	42.54	41.0	39.2	37.6
Current account balance (% GDP)**	2.6	0.6	2.9	1.2	0.3	(0.6)	(1.6)
Financial account balance (% GDP)	(1.7)	(0.1)	1.2	(0.3)	0.2	0.7	1.2
Foreign exchange reserves (million US$)	8,206	8,628	9,709	9,898	10,003	10,030	9,956
Gross foreign exch. res. (months of merchandise imports	13.4	14.8	16.3	16.1	15.7	15.2	14.5
External debt (million US$)	1,359	1,157	1,490	1,764	2,028	2,256	2,490
Exchange rate (Af/US$, period average)	72.3	76.2	76.2	…	…	…	…
Exchange rate (Af/US$, end-period)	75.0	77.4	77.1	…	…	…	…
Monetary and Financial Statistics							
Broad money (M2, billion Afs)	486.0	513.8	575.4	603.3	646.1	698.0	755.2
Total deposits (% GDP)	20.0	18.0	19.3	19.3	19.3	19.3	19.3
Total deposits (billion Afs)	266.1	263.8	292.8	307.0	328.8	355.2	384.3
Share of dollar deposits (%)	64.1	64.2	60.2	58.5	54.1	49.6	45.4
Credit to private sector, commercial banks (billion Afs)	45.7	46.6	46.1	48.8	52.8	57.5	62.8
Loan-to-deposit ratio (%)	15.7	16.0	13.5	13.5	13.5	13.5	13.5

Note: GDP figures for 2020 are preliminary NSIA estimate.

* 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 3 Selected fiscal indicators (billion Afs)

	2018	2019	2020	2021	2022	2023	2024
				proj.	*proj.*	*proj.*	*proj.*
in billion Afghanis unless otherwise stated							
Domestic revenues	186.3	207.3	172.9	196.5	224.2	250.0	279.8
Tax revenues*	83.5	85.8	81.2	94.4	113.0	125.9	140.9
Customs duty and fees	35.2	37.1	32.4	39.2	43.7	48.9	55.0
Nontax revenues	67.6	84.4	59.4	63.0	67.5	75.2	84.0
Donor grants	208.9	188.9	226.2	214.0	229.9	243.7	258.6
Discretionary grants	136.8	121.2	146.0	142.0	155.0	164.8	176.0
Nondiscretionary grants	72.1	67.7	80.2	72.0	74.9	78.8	82.7
Total expenditures	384.7	419.4	434.5	459.4	473.5	508.0	551.0
Recurrent expenditures	259.2	281.2	274.1	307.7	331.7	359.8	396.0
Security	132.3	140.5	149.3	170.0	180.0	193.0	210.0
Civilian	126.9	140.6	124.8	137.7	151.7	166.8	186.0
Wages and salaries	68.1	78.0	74.5	82.0	90.0	98.0	110.0
Operations and maintenance	25.0	24.1	20.7	26.0	28.5	31.0	33.0
Capital expenditure	3.2	2.9	3.9	4.0	4.5	5.0	5.0
Social transfers	28.5	33.4	23.7	25.0	28.0	32.0	37.0
Interest payments	2.0	2.2	2.0	0.7	0.7	0.8	1.0
Discretionary development	53.4	60.9	78.4	59.0	45.1	60.7	65.4
Nondiscretionary development	72.1	77.4	82.1	92.7	96.7	87.5	89.6
Discretionary balance	10.5	(13.6)	(33.5)	(28.1)	2.4	(5.6)	(5.6)
Overall balance	10.5	(23.3)	(35.4)	(48.8)	(19.4)	(14.3)	(12.6)
Financing	-	1.1	25.4	23.9	9.5	4.2	2.5
Debt	-	1.1	25.4	23.9	9.5	4.2	2.5
Domestic	-	(7.2)	-	-	1.2	3.0	4.9
External	-	8.3	25.4	23.9	8.3	1.2	(2.3)
Changes in reserves	10.5	(22.2)	(10.0)	(25.0)	(10.0)	(10.0)	(10.0)
Overall balance excluding grants	(198.4)	(212.2)	(261.6)	(262.9)	(249.4)	(257.9)	(271.2)
Revenues to recurrent spending ratio (%)	72	74	63	64	68	69	71

* 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 4 Selected fiscal indicators (percent of GDP)

	2018	2019	2020	2021	2022	2023	2024
				proj.	*proj.*	*proj.*	*proj.*
in percent of GDP unless otherwise stated	29.77	27.0	26.3	25.8	26.6	26.8	27.0
Domestic revenues	14.0	14.1	11.4	12.3	13.1	13.6	14.0
Tax revenues*	6.3	5.8	5.3	5.9	6.6	6.8	7.1
Customs duty and fees	2.7	2.5	2.1	2.5	2.6	2.7	2.8
Nontax revenues	5.1	5.7	3.9	4.0	4.0	4.1	4.2
Donor grants	15.7	12.9	14.9	13.4	13.5	13.2	13.0
Discretionary grants	10.3	8.2	9.6	8.9	9.1	8.9	8.8
Nondiscretionary grants	5.4	4.6	5.3	4.5	4.4	4.3	4.1
Total expenditures	29.0	28.5	28.6	28.8	27.7	27.5	27.6
Recurrent expenditures	19.5	19.1	18.0	19.3	19.4	19.5	19.8
Security	10.0	9.6	9.8	10.7	10.5	10.5	10.5
Civilian	9.6	9.6	8.2	8.6	8.9	9.0	9.3
Wages and salaries	5.1	5.3	4.9	5.1	5.3	5.3	5.5
Operations and maintenance	1.9	1.6	1.4	1.6	1.7	1.7	1.7
Capital expenditure	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Social transfers	2.1	2.3	1.6	1.6	1.6	1.7	1.9
Interest payments	0.2	0.1	0.1	0.0	0.0	0.0	0.1
Discretionary development	4.0	4.1	5.2	3.7	2.6	3.3	3.3
Nondiscretionary development	5.4	5.3	5.4	5.8	5.7	4.7	4.5
Discretionary balance	0.8	(0.9)	(2.2)	(1.8)	0.1	(0.3)	(0.3)
Overall balance	0.8	(1.6)	(2.3)	(3.1)	(1.1)	(0.8)	(0.6)
Financing	-	0.1	1.7	1.5	0.6	0.2	0.1
Debt	-	0.1	1.7	1.5	0.6	0.2	0.1
Domestic	-	(0.5)	-	-	0.1	0.2	0.2
External	-	0.6	1.7	1.5	0.5	0.1	(0.1)
Changes in reserves	0.8	(1.5)	(0.7)	(1.6)	(0.6)	(0.5)	(0.5)
Overall balance excluding grants	(14.9)	(14.4)	(17.2)	(16.5)	(14.6)	(14.0)	(13.6)
Revenues to recurrent spending ratio (%)	72	74	63	64	68	69	71

* 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 5 Selected fiscal indicators (billion USD)

	2018	2019	2020	2021	2022	2023	2024
				proj.	proj.	proj.	proj.
in billion USD unless otherwise stated							
Domestic revenues	2.6	2.7	2.3	2.5	2.7	2.8	3.0
Tax revenues*	1.2	1.1	1.1	1.2	1.3	1.4	1.5
Customs duty and fees	0.5	0.5	0.4	0.5	0.5	0.6	0.6
Nontax revenues	0.9	1.1	0.8	0.8	0.8	0.9	0.9
Donor grants	2.9	2.5	3.0	2.7	2.7	2.8	2.8
Discretionary grants	1.9	1.6	1.9	1.8	1.8	1.9	1.9
Nondiscretionary grants	1.0	0.9	1.1	0.9	0.9	0.9	0.9
Total expenditures	5.3	5.5	5.7	5.7	5.6	5.8	6.0
Recurrent expenditures	3.6	3.7	3.6	3.8	3.9	4.1	4.3
Security	1.8	1.8	2.0	2.1	2.1	2.2	2.3
Civilian	1.8	1.8	1.6	1.7	1.8	1.9	2.0
Wages and salaries	0.9	1.0	1.0	1.0	1.1	1.1	1.2
Operations and maintenance	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Capital expenditure	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Social transfers	0.4	0.4	0.3	0.3	0.3	0.4	0.4
Interest payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary development	0.7	0.8	1.0	0.7	0.5	0.7	0.7
Nondiscretionary development	1.0	1.0	1.1	1.2	1.2	1.0	1.0
Discretionary balance	0.1	(0.2)	(0.4)	(0.4)	0.0	(0.1)	(0.1)
Overall balance	0.1	(0.3)	(0.5)	(0.6)	(0.2)	(0.2)	(0.1)
Financing	-	0.0	0.3	0.3	0.1	0.0	0.0
Debt	-	0.0	0.3	0.3	0.1	0.0	0.0
Domestic	-	(0.1)	-	-	0.0	0.0	0.1
External	-	0.1	0.3	0.3	0.1	0.0	(0.0)
Changes in reserves	0.1	(0.3)	(0.1)	(0.3)	(0.1)	(0.1)	(0.1)
Overall balance excluding grants	(2.7)	(2.8)	(3.4)	(3.3)	(3.0)	(2.9)	(2.9)
Revenues to recurrent spending ratio (%)	72	74	63	64	68	69	71

* 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.