# AFGHANISTAN DEVELOPMENT UPDATE

December 2024

## DISCLAIMER:



## COPYRIGHT STATEMENT:

## PREFACE

The Afghanistan Development Update provides a comprehensive report on the state of the Afghan economy. It covers recent economic developments and the medium-term outlook for Afghanistan. Each edition includes Special Focus sections that provide in-depth analysis of specific topics. The Afghanistan Development Update is intended for a wide audience, including policymakers, the donor community, the private sector, and analysts and professionals engaged in Afghanistan's economy.

This report has been prepared by Mamadou Ndione (Senior Economist, ESAC1 and Task Team Leader), Silvia Redaelli (Senior Economist, ESAPV and Acting Program Leader), Ruslan Piontkivsky (Lead Country Economist, Program Leader, ESADR), Abdul Rahman Rahimi (Economist, ESAC1), Namoos Zaheer (Senior Financial Sector Specialist, ESAF1), Wasim Shahid Malik (Consultant, ESAC1), Arvind Nair (Senior Economist, ESAC1), Oscar Eduardo Barriga Cabali (Economist, ESAPV), Diana Ya-Wai Chung (Senior External Affairs Officer, ECRSA), Payamulhaq Barrai (Consultant, ECRSA), Amna Sehar (Consultant, ESAC1), and Sanam Kohistani (Consultant, ESAC1). The report was produced under the guidance of Faris H. Hadad-Zervos (Country Director for Afghanistan, SACKB), Mathew A. Verghis (Regional Director for Equitable Growth, Finance, and Institutions), Shabih Ali Mohib (Practice Manager, ESAC1), and Elena Karaban (Manager, ECRSA). The team was supported by Mashood Ahmad Awan (SACKB), and Kabir Poya (Program Assistant, SACKB).

# TABLE OF CONTENTS

## LIST OF FIGURES



## LIST OF BOXES

# LIST OF ABBREVIATIONS

| | |
|---|---|
| ABA | Afghanistan Banks Association |
| ACLED | Armed Conflict Location & Event Data |
| ADU | Afghanistan Development Update |
| AFN | Afghan Afghani |
| ASYCUDA | Automated System for Customs Data |
| AWMS | Afghanistan Welfare Monitoring Survey |
| BRT | Business Receipt Taxes |
| DAB | Da Afghanistan Bank (Central Bank) |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| ITA | Interim Taliban Administration |
| NSIA | National Statistics and Information Authority |
| R1 | Round 1 |
| R2 | Round 2 |
| R3 | Round 3 |
| SAR | South Asia Region |
| SMEs | Small and Medium-size Enterprises |
| UAE | United Arab Emirates |
| UN | United Nations |
| USD | United States Dollar |
| UNODC | United Nations Office on Drugs and Crime |
| WB | World Bank |

# EXECUTIVE SUMMARY

**Afghanistan's economic recovery remains uncertain and fragile. Modest growth, driven by private consumption has done little to address the country's deeper structural issues. The economy faces significant headwinds, including fiscal constraints, trade imbalances, and a limited capacity for public investment. Enabling women's participation in the economy, strengthening domestic resource mobilization, maintaining price stability, and addressing critical deficits in human capital—such as education and healthcare—will be essential for supporting long-term recovery and reducing vulnerability to future shocks.**

**Afghanistan's economy has shown modest growth following two years of severe contraction, primarily driven by private consumption.** In fiscal year 2023, real GDP grew but recovered only about 10 percent of the losses from previous years, highlighting the slow and fragile nature of the recovery. This performance falls short of regional averages, indicating that Afghanistan lags behind its neighbors in bouncing back from the economic shocks. At the current pace, it could take over a decade for the economy to return to levels before the Taliban took over in August 2021, reflecting the deep structural challenges the country faces in rebuilding its economy.

**Despite some growth, economic drivers such as physical capital accumulation, human capital development, and productivity remain weak, limiting long-term prospects for sustainable recovery.** Without targeted reforms and investments, particularly in sectors like education, especially for women and girls, healthcare, infrastructure, and agriculture, Afghanistan risks being trapped in a low-growth equilibrium. The persistent economic challenges, exacerbated by policy uncertainty and international isolation, continue to constrain the country's potential.

**Afghanistan faced deflationary pressures throughout FY2023, with both headline and core inflation staying in negative territory.** This deflation was driven by several factors, including declining global food and energy prices, a stronger Afghani, and weak domestic demand. The Afghani saw significant appreciation in 2023, likely due to limited supply of Afghani banknotes and potentially undisclosed foreign financial inflows, which helped reduce import costs. However, this trend began to reverse slightly in 2024 as the currency stabilized and external inflows diminished.

**Inflation is expected to turn positive in late FY2024 as the effects of deflation subside.** However, the period of lower food prices and reduced costs of goods has provided temporary relief to Afghan households, particularly in easing the burden of rising food insecurity. The challenge moving forward will be managing inflationary pressures without eroding the purchasing power of households, especially as the economy regenerates and aggregate demand starts to recover.

**The partial recovery, coupled with falling food prices, has contributed to a gradual improvement in household welfare.** However, most Afghan households continue to struggle with meeting basic needs, and poverty remains widespread. Urban areas, in particular, have seen limited benefits from the economic recovery, with many regions still facing high levels of unemployment and underemployment. Vulnerable groups, including women, children, and displaced populations, continue to bear the brunt of the economic hardship, as social protection mechanisms remain underdeveloped.

**Despite improvements in reported welfare, the economic recovery has been uneven, with rural centers benefiting more than urban areas.** The lack of job opportunities, coupled with ongoing displacement of population, has exacerbated regional disparities. Moreover, high levels of informal labor and the limited formalization of businesses restrict access to secure livelihoods and social safety nets, further deepening poverty for millions of Afghans.

**In FY2023/24, the Interim Taliban Administration (ITA) achieved its revenue target due to increased inland tax collections and non-tax revenues.** This reflects an improved focus on domestic resource mobilization, though challenges remain. However, revenues were barely sufficient to cover operating expenditures, leaving no fiscal space for stimulus or significant development spending. The ITA's ability to invest in critical infrastructure projects or provide economic relief remains severely constrained, as development expenditures were financed primarily through drawing-down deposits accumulated during the previous Republic era.

**Without increased external financial support or substantial improvements in domestic revenue collection, Afghanistan's fiscal constraints are likely to persist.** The ITA faces a difficult balancing act: ensuring fiscal sustainability while addressing pressing needs for social spending and public investment in sectors like education, healthcare, and infrastructure. The reliance on reserves for development projects is unsustainable in the long term, and fiscal space will continue to narrow without significant reforms or foreign assistance.

**Afghanistan's trade dynamics remain a significant challenge.** In 2023-24, the country's exports remained stable, but imports surged, leading to a widening trade deficit. However, the appreciation of the Afghani made imports cheaper, fueling demand for foreign goods, while domestic industrial activity revived, increasing the need for imported inputs. The trade deficit, exacerbated by Afghanistan's reliance on imports for essential goods like fuel, food, and machinery, might pose a risk to the country's economic stability.

**The current account deficit is another major concern, as undisclosed foreign exchange inflows temporarily balanced the market in 2023**. However, questions remain about the sustainability of these inflows, raising concerns about the long-term stability of the Afghani. The sharp rise in imports and/or a reduction in cash shipments from the UN, combined with the limited growth of exports, threatens to erode available foreign reserves, which could lead to increased inflationary pressures and currency depreciation if not managed carefully.

**Afghanistan's monetary base has shown considerable volatility in recent years.** In FY2023/24, the money supply grew by only 0.6 percent, following a stronger growth rate of 2.1 percent in the previous year, and a sharp contraction of 4.4 percent in FY2021/22. This volatility reflects broader economic uncertainties, including fluctuations in foreign exchange inflows, political instability, and the challenges of managing a monetary system with limited access to international reserves.

**The central bank's relaxation of withdrawal limits has provided some liquidity relief, improving financial flows within the economy.** However, the broader financial system remains constrained by Afghanistan's isolation from the international banking system and limited access to foreign exchange deposits, which hampers the central bank's ability to manage inflation and currency stability effectively. Ongoing restrictions on banking services, capital controls, and currency management continue to pose significant risks to financial stability.

**While some banks have seen improved profits, overall profitability remains below pre-2021 levels.** The removal of forbearance measures in October 2024, which will require banks to recognize losses from non-performing loans, poses a significant threat to sector stability. The microfinance sector, serving 35,738 borrowers—43 percent of whom are women—has become increasingly vital for small enterprises, but new regulations must be carefully implemented to avoid disrupting lending.

**Additionally, Afghanistan's digital payments system continues to face setbacks. Key systems like Real-Time Gross Settlement (RTGS) and Automated Clearing House (ACH) remain offline.** The older Afghanistan Clearing and Settlement System (ACSS) is operational but lacks automation, limiting its efficiency. Mobile money services are active but primarily focused on humanitarian payments, resulting in high wallet dormancy rates, while many agencies still rely on hawala networks. These issues highlight the ongoing challenges in developing a robust digital payments ecosystem.

**Innovative methods, such as night-time lights analysis, confirm signs of economic recovery and suggest that local economic activity may be stronger than official GDP figures indicate. However, the uneven nature of this recovery, combined with concentrated economic distress in regions reliant on security and aid, highlights the significant vulnerabilities within Afghanistan's economic structure. Without increased investment and providing equal educational opportunities for all, improved governance, and improved international cooperation, Afghanistan faces the risk of prolonged stagnation, with limited prospects for sustainable development.**

**An innovative analysis using night-time lights data has provided further insights into the economic shock caused by the Taliban takeover and the subsequent recovery.** Between 2020 and 2021, local economic activity, as measured by civilian night-time lights, declined by 7.1 percent—significantly less than the 22.6 percent contraction in total (security and civilian) night-time lights and the 20.7 percent contraction in GDP. By 2023, civilian night-time lights data suggest a recovery of 10.5 percent above the 2020 baseline, indicating a stronger rebound in local economic activity than is reflected in official GDP estimates.

**The spatial distribution of night-time lights highlights the uneven nature of the economic shock and subsequent economic recovery.** In 2021, provinces whose economy was more heavily reliant on foreign aid and security spending —particularly Kabul and the southern provinces of Kandahar, Helmand, and Zabul—experienced the sharpest declines in economic activity compared to 2020. Similarly, by 2023, the level of economic activity captured by civilian night-time lights remains sizably below its 2020 baseline in Parwan, Kapisa, Zabul and, notably, in Kabul.

**Afghanistan's economic outlook remains highly fragile.** Major risks include policy uncertainty, continued international isolation, and a heavy reliance on a limited revenue base. The country's high trade deficit, dependence on imports, and shrinking fiscal space present formidable challenges to sustainable recovery. Key sectors such as agriculture remain vulnerable to the effects of climate change, insecurity, and a lack of investment, further complicating the recovery process.

**The lack of international recognition and ongoing diplomatic isolation severely restrict access to foreign aid, investment, and financial markets.** This isolation not only limits the ability of Afghanistan to engage with global trade but also impedes the ITA's ability to attract the external financing needed to support long-term development projects and address critical human capital deficits. Without broader international engagement and economic reforms, Afghanistan risks prolonged stagnation, with growth remaining dependent on consumption and limited industrial activity.

# INTRODUCTION

**Afghanistan's economy has shown modest signs of growth after two years of sharp decline, largely driven by private consumption.** However, the recovery has been limited, recouping only 10 percent of the economic losses from the past two years. This growth lags behind the regional average and neighboring countries, highlighting the sluggish pace of Afghanistan's rebound. At this rate, it could take more than a decade for the country's economy to return to levels before the Taliban takeover in August 2021, underscoring the magnitude of the economic damage and the long road ahead for recovery.

**Despite the fragile recovery, deflationary pressures persist, with both headline and core inflation remaining negative throughout the Afghan fiscal year.** This prolonged deflation is largely attributed to lower global food and energy prices, a stronger Afghani, and weak aggregate demand. The appreciation of the local currency, although stabilizing, has made imports cheaper, further contributing to falling domestic prices. While lower food prices and the partial economic recovery have slightly improved Afghan households' self-reported welfare, the majority still face significant difficulties in meeting basic needs, particularly in urban areas. High poverty rates and widespread unemployment continue to weigh heavily on the population, limiting the broader impact of economic growth.

**In fiscal year 2023/24, the Interim Taliban Administration (ITA) met its revenue target of AFN 210 billion, driven primarily by increased inland tax collections and non-tax revenues.** However, revenues were barely sufficient to cover operating expenditures, leaving little to no room for fiscal stimulus or development spending. This reflects a narrow fiscal space, limiting the ITA's ability to invest in infrastructure or stimulate the economy. Development expenditures, meanwhile, had to be financed from reserves accumulated during the previous Republic era, further underscoring the constrained fiscal environment and the lack of resources for new investment initiatives. While this revenue performance demonstrates improved efforts at domestic resource mobilization, it highlights the ongoing challenges of balancing the budget while addressing the pressing needs for economic development and recovery.

**Afghanistan's trade balance continues to pose significant challenges.** Exports remained stable throughout 2023-24, but a sharp surge in imports widened the trade deficit. This was fueled by a strong afghani, making imports more affordable, and a revival in domestic industrial activity that increased demand for imported goods. Although the Afghani appreciated significantly in early 2023 due to strong but undisclosed foreign exchange inflows, it began to stabilize with a slight depreciation in 2024, raising concerns about the sustainability of these foreign inflows and the long-term stability of the exchange rate.

**Amid the backdrop of weak recovery and persistent deflation, Afghanistan's monetary environment remains volatile.** The money supply grew by 0.6 percent in 2023/24, following stronger growth of 2.1 percent in 2022/23, though this follows a severe contraction of 4.4 percent in 2021/22. This fluctuation in the monetary base highlights the broader economic uncertainties the country faces, with liquidity concerns and the central bank's capacity to manage the economy under international sanctions remaining key risks.

**Despite some banks reporting improved profits, overall profitability remains below pre-2021 levels.** The removal of forbearance measures in October 2024, forcing banks to recognize non-performing loan losses, threatens sector stability. The microfinance sector, with 43 percent of loans held by women, is crucial for small enterprises, but new regulations must be carefully managed.

Overall, Afghanistan's economic outlook remains fragile, constrained by structural challenges, international isolation, and limited fiscal capacity, with only tentative signs of recovery amid significant risks to sustainability.

# 1. THE ECONOMIC DEVELOPMENTS

## REAL SECTOR DEVELOPMENTS

Afghanistan's GDP has shown some growth after two years of sharp decline, mainly driven by private consumption. However, the recovery has been modest, regaining only 10 percent of the losses from the last two years, and lagging the regional average and neighboring countries. At this current pace, it could take over a decade for the economy to return to pre-Taliban levels.

**After two consecutive years of sharp economic contraction—20.7 percent in 2021-22 and an additional 6.2 percent in 2022-23—the Afghan economy experienced a modest recovery, growing by 2.7 percent in 2023-24**. The agriculture, industrial, and services sectors all contributed to this growth, with the industrial sector slightly outperforming the others (Figures 1 and 2). The agriculture sector, which accounts for 36 percent of GDP, grew by 2.1 percent in 2023-24, recovering from a 6.6 percent contraction the previous year. This recovery was driven by favorable weather conditions for cereal production in 2023, including above-average precipitation that benefited crops emerging from dormancy in March, and crop diversification following the opium ban[1].

**The industrial sector saw a 2.6 percent increase, partially reversing the 5.7 percent decline from the previous year.** Growth was primarily driven by a 6.9 percent expansion in the mining and quarrying sector, particularly in coal and mineral extraction. Although the Interim Taliban Administration (ITA) has auctioned several small mining contracts to meet its cash requirements, many of these contracts have yet to commence operations. The electricity, gas, and water sectors grew by 5 percent, boosted by enhanced solar energy generation and improved water storage infrastructure. The manufacturing sector also grew by 1.7 percent, with contributions evenly split between food and non-food manufacturing. Despite greater availability of key inputs due to improved agricultural yields, the sector faced challenges from increased imports, facilitated by an appreciated exchange rate. In contrast, the construction sector continued to contract, shrinking by 0.9 percent after a 0.8 percent decline in 2022-23 and a steep 35.4 percent drop in 2021-22, reflecting weak investment.

**The services sector, which accounts for nearly 45 percent of Afghanistan's economy, grew by 2.3 percent in 2023-24, marking a modest recovery from the 6.5 percent contraction the previous year.** This growth was primarily driven by activities such as trade (17.9 percent), including transit trade, transportation, and vehicle repairs (5.9 percent). While growth in hotels and restaurants (1.6%), finance and insurance (1.6 percent), and post and telecommunications (1.4 percent) turned positive, it remained subdued. Conversely, the education and health sectors continued to face significant challenges, contracting by 9.3 percent and 3.1 percent, respectively. The ban on female education and disruptions in health services have exacerbated these declines. Despite these setbacks, the health sector has managed to stay afloat due to international support. However, the ongoing struggles in education and health highlight a critical lack of investment in human capital, which could jeopardize Afghanistan's long-term economic prospects.

---

[1] The sharp decline in Afghanistan's opium poppy production, down by 95 percent from 6,200 tons in 2022 to 333 tons in 2023 according to the United Nations Office on Drugs and Crime (UNODC), has created significant economic uncertainty. Opium cultivation provided 46 percent of household income in some regions, particularly in Farah, Helmand, Kandahar, and Nangahar. Without viable alternatives, Afghanistan faces deep economic challenges, with the risk of rising rural poverty, food insecurity, and reduced domestic demand for goods and services. This could push farmers back into illicit activities if no sustainable solutions are found.

**Overall, the economy, measured by the value produced in agriculture, industry, and services, grew by 2.3 percent in 2023/24, after shrinking by 6.4 percent the previous year.** Import taxes, which make up a large part of indirect taxes, increased by 11.4 percent, helping the overall economy grow by 2.7 percent when measured by market prices.

Figure 1: Real GDP Growth by Sector (%)

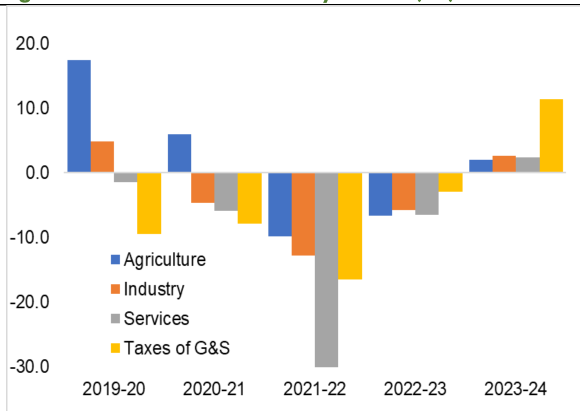
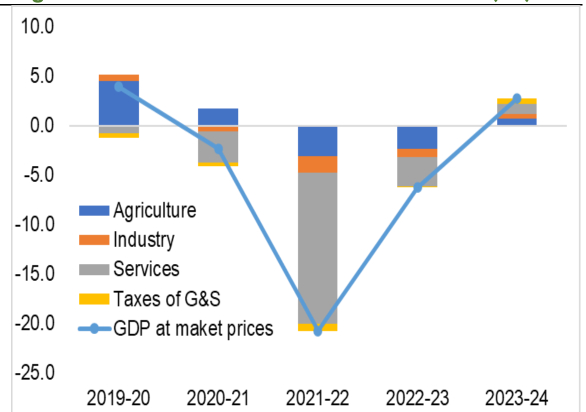



Figure 2: Contribution to Real GDP Growth (%)




*Source:* National Statistics and Information Authority (NSIA).

**On the demand side, Afghanistan's economic recovery was largely driven by strong private consumption, thanks to lower domestic prices, higher remittances, ongoing humanitarian aid (including cash transfers and assistance to returned refugees[2]), and better harvests, despite limited ITA support.** According to the national account statistics recently published by the National Statistics and Information Authority (NSIA), private consumption increased by 6.2 percent in 2023/24 driven by better agriculture harvest and lower domestic prices. ITA spending on goods and services grew slightly by 1.1 percent, but investment overall dropped by 5.8 percent. Public investment was limited due to reduced funding, and private investment remained low as businesses lacked confidence in the future. A recent survey showed that the number of businesses worried about uncertainty rose from 11 to 20 percent. Many businesses turned to imports, which offer more stable costs and supply chains in uncertain times. This shift contributed to a negative trade balance, with exports down 9 percent and imports up slightly by 0.7 percent, helped by a stronger currency and lower global food and fuel prices.

[2] Since 15 September, over 722,000 Afghans have returned to Afghanistan. In 2024, returns reached its peak in May-June (38,000 returns each). Returns have decreased since then with 10,500 so far in September 2024. https://data.unhcr.org/en/documents/details/111217

**Figure 3: Contribution to Growth by component (%)**

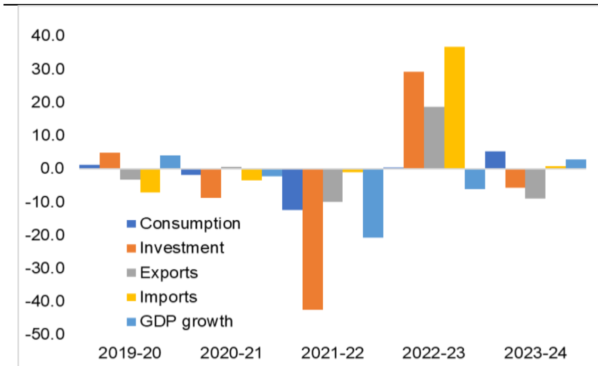
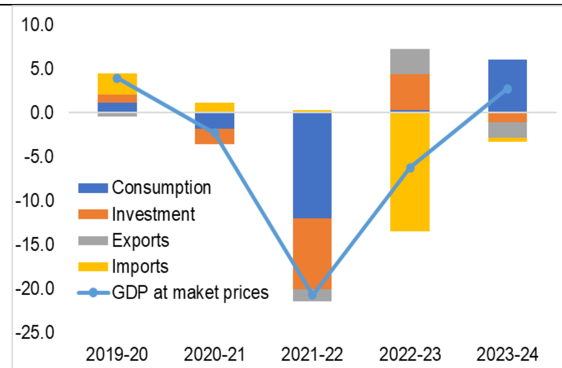


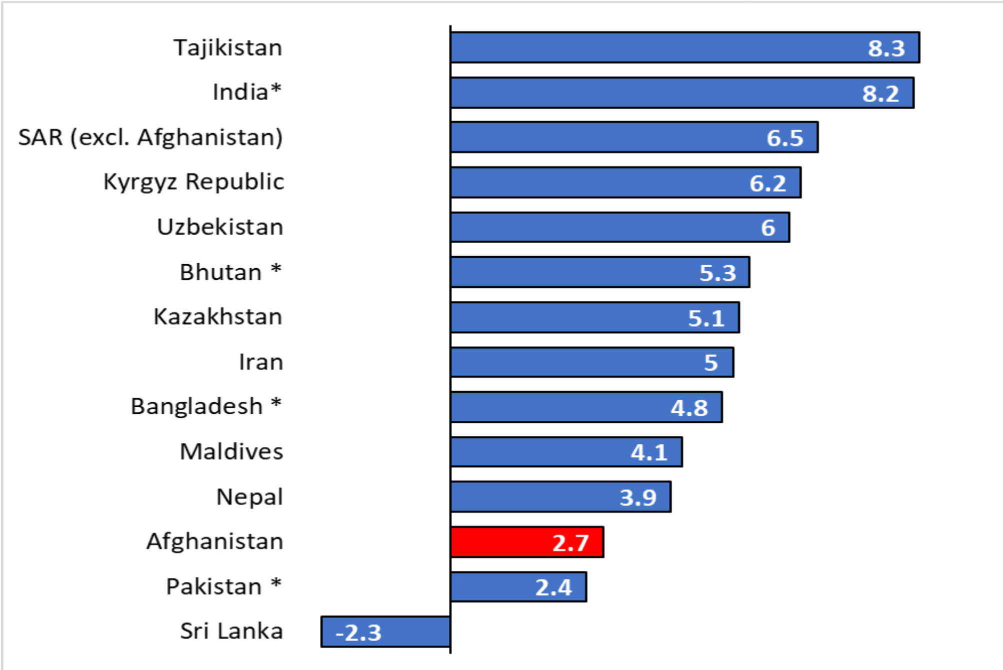

**Figure 4: GDP Growth by demand component (%)**




*Source:* National Statistics and Information Authority (NSIA).

**Afghanistan's economic recovery has been modest in several ways.** First, after an unprecedented 25 percent contraction over the past two years, the recent rebound has been small, recovering only about 10 percent of the real economic value lost in 2021 and 2022. At the current growth rate, it would take more than a decade for the economy to return to the levels seen before the Interim Taliban Administration (ITA) took control. Second, Afghanistan's recovery lags that of other countries in the South Asian region. While Afghanistan grew by just 2.7 percent, the region averaged 6.5 percent growth. Most countries grew by more than 4 percent, except for Nepal (3.9 percent), Pakistan (2.4 percent), and Sri Lanka, whose economy contracted by 2.3 percent. Afghanistan also grew more slowly than its neighbors and key trading partners, such as Iran (5 percent), Uzbekistan (6 percent), Kazakhstan (5.1 percent), China (5.2 percent), and India (8.2 percent). Finally, Afghanistan's growth barely keeps up with its fast-growing population, which is increasing at 2.1 percent annually—almost double the growth rate of South Asia. With a high fertility rate of 5.3 births per woman, compared to 2.2 in the region, this population growth, along with returning refugees (close to 2 percent of the total population), puts further pressure on the economy.

**Figure 5: Real GDP growth in Afghanistan and selected countries and trading partners (2023).**




*Source:* South Asia Region Development Update, World Bank Macro-Poverty Outlook
* Fiscal year 2023 for India, Bhutan, Bangladesh, and Pakistan

## PRICE TREND

Despite the modest recovery, domestic prices continue to fall, with both headline and core inflation remaining negative throughout the Afghan fiscal year 2023. This is due to lower global food and energy prices, a stronger local currency, and still weak aggregate demand.

**After the Taliban's takeover in August 2021, domestic prices rose sharply, increasing by an average of 1.4 percent per month and peaking in July 2022.** Over this period, prices climbed by 18 percent due to major supply disruptions and sharp increases in food (+13 percent) and energy prices (+43 percent), partly fueled by the Russian invasion of Ukraine in February 2022 (Figure 6 & Figure 7). Since then, domestic prices have been steadily declining by 0.7 percent monthly, with year-on-year inflation turning negative in April 2023. This decline has been supported by improved supply conditions, falling global food and energy prices, and the appreciation of the Afghani. By the end of the Afghan fiscal year in March 2024, domestic prices had dropped by 12 percent compared to their peak in July 2022, but remained 4 percent higher than their level before the Taliban's takeover.

**Both food and non-food prices had declined, with food seeing a sharper drop of 17 percent compared to July 2022, while non-food prices fell by 6.5 percent.** Despite these reductions, most key commodity prices, except for cooking oil and wheat, remained higher than their July 2021 levels. For instance, the price of one kilogram of bread and high-quality rice rose from AFN 53.8 and AFN 89.7 in July 2021 to AFN 68.4 and AFN 122.4 in July 2022, before falling to AFN 62.7 and AFN 100.8 in March 2024, still above prices before the Taliban takeover by AFN 8.9 and AFN 11.1, respectively. Additionally, prices declined across all provinces, with drops ranging from 2.4 percent in Parwan to 15 percent in Ghazni, and major cities like Herat, Kabul, Helmand, and Kandahar seeing decreases of 3.5, 6.6, 7.5, and 8.6 percent, respectively.

**Core inflation, which excludes the more volatile food and energy prices, continued its downward trend, with a drop of about 3 percent by the close of the fiscal year in March 2024.** This extended period of core deflation underscores the persistent economic challenges Afghanistan faces, particularly in terms of weak aggregate demand. When core inflation remains negative for such a prolonged period, it suggests that the broader economy is failing to generate sufficient demand to support stable pricing levels, whether from consumers or businesses. This signals a concerning lack of economic activity and a failure to stimulate demand, both on the private and public fronts.

**While falling prices might seem beneficial in the short term—by lowering living costs for households already struggling with financial insecurity—deflation can have damaging long-term effects on the economy.** When consumers expect prices to keep dropping, they may delay spending on goods and services, hoping for even lower prices in the future. This reluctance to spend creates a vicious cycle: as consumer spending falls, businesses respond by cutting back on production and investments, slowing down economic activity even further. This is particularly harmful in a fragile economy like Afghanistan's, where the need for economic expansion and job creation is critical for lifting people out of poverty. If businesses scale back investments and hiring due to poor demand, the country risks stagnating or even regressing, making it even harder to achieve sustainable growth or reduce poverty levels in the long term.

**Figure 6: Headline and Core Consumer Price Index**

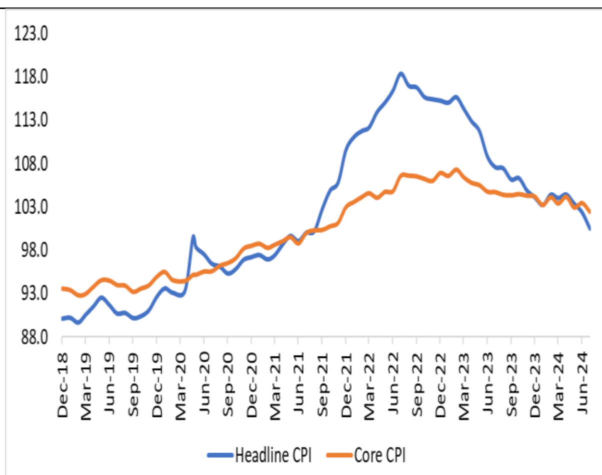
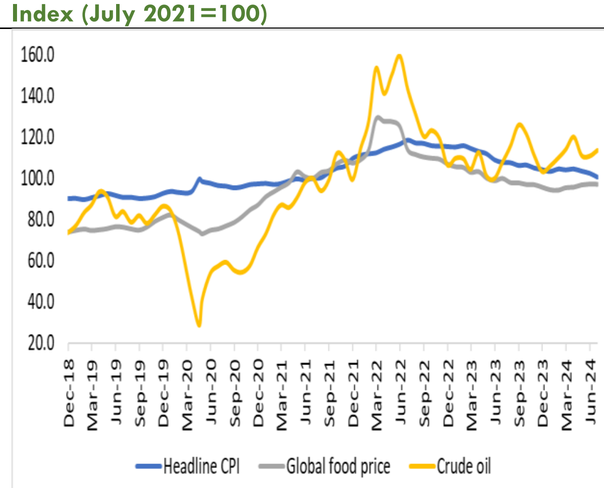
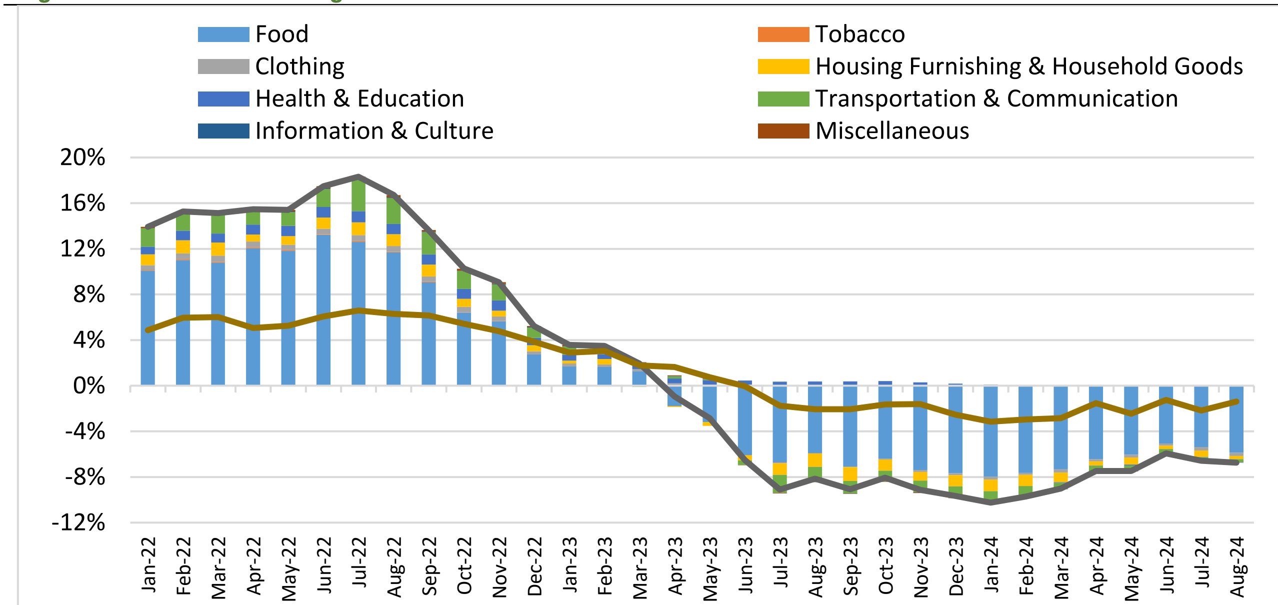



**Figure 7: Headline, Global Food and Crude Oil Price Index (July 2021=100)**




*Source:* National Statistics and Information Authority (NSIA).

**Figure 8: Factors Contributing to Headline Inflation**




*Source:* National Statistics and Information Authority (NSIA) and WB staff calculations.

## HOUSEHOLD WELFARE AND FOOD SECURITY

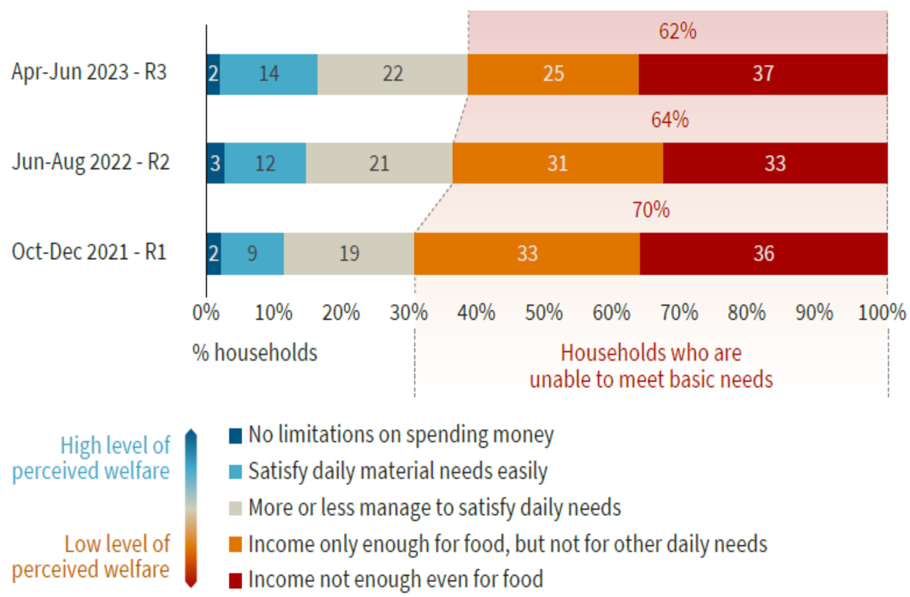
The partial recovery, along with falling food prices, has contributed to a gradual improvement in Afghan households' self-reported welfare. Nevertheless, most Afghan households continue to struggle with meeting their basic needs.

**Despite the decline in domestic prices and a modest recovery in private consumption, a significant number of Afghan households continue to struggle to meet their basic needs.** According to the Afghanistan Welfare Monitoring Survey (AWMS), approximately 62 percent of households were still unable to meet their basic consumption needs in April-June 2023, showing only a slight improvement from 64 percent in mid-2022 and 70 percent in late 2021. This marginal progress highlights the persistent hardships faced by millions of Afghans. As of mid-2023, roughly half of the population—about 20 million people—were living in poverty. The poverty trends reveal a stark contrast between urban and rural areas: rural poverty decreased from 51 percent to 44 percent, largely due to improved security, better access to markets, and a strong agricultural season. In contrast, urban poverty increased from 55 percent to 58 percent, underscoring the lack of quality job opportunities in cities. These diverging trends suggest that while rural areas have benefited from more stability and a successful farming season, cities are grappling with rising unemployment and stagnant economic activity.

**In response to the ongoing crisis, many Afghan households have been forced to increase their labor supply, with more family members seeking work to make ends meet.** However, weak labor demand has led to a doubling of unemployment and a 25 percent rise in underemployment between 2020 and 2023, further compounding the challenges faced by Afghan families. Afghan women, in particular, face significant obstacles due to restrictive policies that have severely limited their participation in education and the workforce. Girls' secondary school enrollment plummeted from 14 percent to just 3 percent between 2022 and 2023 following the ITA's ban on female education. As a result, many women have entered the labor force to support their households, but their job opportunities are restricted primarily to home-based work in the manufacturing sector due to mobility restrictions. This shift in women's labor participation, while necessary for family survival, often traps them in low-paying, informal jobs with limited prospects for advancement.

**The recent introduction of the Morality Law threatens to exacerbate the situation further.** If fully enforced, this law could severely restrict women's socio-economic participation, not only curbing their educational and employment opportunities but also dealing a blow to Afghanistan's broader development goals. The exclusion of women from key sectors of the economy and public life could stifle innovation, reduce household incomes, and hinder the nation's ability to recover from its current economic crisis. In the long term, the marginalization of women risks deepening poverty and slowing progress toward sustainable development, making it even more difficult for Afghanistan to improve the living standards of its people and foster inclusive growth.

**Figure 9: Self-reported household capacity to cover food and non-food expenses.**




Source: AWMS 2021 (R1); AWMS 2022 (R2) and AWMS 2023 (R3).

## FISCAL DEVELOPMENTS

In FY 2023, the ITA met its revenue target of AFN 210 billion, driven by inland taxes and non-tax revenues. Operating expenses tracked revenue trends, while development expenditures were funded from reserves accumulated during the Republic era.

### REVENUES:

**The ITA successfully achieved its FY 2023 revenue target through improved compliance and enforcement.** Total revenue for the fiscal year reached AFN 210.7 billion (15.5 percent of GDP), marking a 9 percent increase from the previous year and slightly exceeding the annual target of AFN 210 billion (Figure 10). This included AFN 108.1 billion from customs and AFN 102.6 billion from inland revenue. Non-tax revenues showed positive year-on-year growth, while customs duties saw a decrease in 2023 (Figure 11).

**Despite the nominal decline in tax on international trade, the composition of revenue has shifted in response to economic conditions.** Prior to the ITA's takeover, inland taxes made up the largest portion of revenue, followed by non-tax revenues and customs duties, with a significant share coming from inland sources. However, with the economic collapse in 2021 and 2022, inland tax revenue declined significantly, prompting the ITA to focus more on international trade tax collection. As a result, more than half of total revenue is currently generated from customs duties and non-tax revenues, while inland tax revenues saw a notable reduction.

**With the modest economic recovery, inland tax has also started to regain momentum with its share in total revenue increasing compared to the first two years of ITA rule.** In 2023, tax revenues reached approximately AFN 72.2 billion, representing a 31 percent increase from the 2022. This upward trend signals progress toward establishing a more balanced revenue base. Moreover, despite the strong inland revenue collection, the ITA has implemented several tax policy measures to stimulate aggregate demand and restore economic growth. These measures include exempting businesses with turnovers under AFN 2 million from income tax, halving the Business Receipt Tax (BRT) for industries, reducing small taxpayer rates from 1.5 percent to 0.5 percent, pardoning pre-2016 tax arrears, and offering scaled exemptions and amnesty for post-2016 arrears. The small business, those with annual sales exceeding AFN2 million pay a reduced tax rate of 0.3 percent, down from the previous 0.5 percent.

**Non-tax revenues have also been on the rise, largely driven by income from mining, vehicle registrations, passport issuance, transport services, railway operations, and telecommunication fees.** In 2023, non-tax revenues totaled around AFN 89.3 billion, marking a 10.8 percent increase from the previous year. These non-tax revenue streams are expected to continue growing as their underlying sources remain stable, except for some regulation of vehicle registration and passport issuance. The improvement across all revenue categories can be attributed to enhanced enforcement and collection efficiency by the ITA, contributing to stronger overall revenue performance.

**Surprisingly, customs revenues in 2023 experienced a notable decline, despite a significant increase in the value of imports in US dollar terms.** Customs revenue for the year stood at approximately AFN 49.3 billion, a 16 percent drop from 2022, even though import surged by 23 percent in nominal US dollar terms. One of the primary factors behind this paradox was the appreciation of the Afghani by 12 percent during FY 2023. This currency appreciation meant that while imports rose in US dollar terms, the conversion of customs duties into Afghanis yielded lower revenues. Customs duties, which are typically calculated based on the value of imports in USD, suffered from this stronger local currency, leading to reduced collections when converted into the local currency. However, currency fluctuations were not the only factor behind the decline in customs revenue. A significant reduction in coal exports to neighboring countries also played a crucial role. Coal exports had previously been a major source of customs duties, and the sharp decline in this sector's exports created a noticeable gap in revenue. Additionally, fluctuating global demand for Afghan exports, coupled with regional trade challenges, further hindered the potential for customs revenue growth.

**The decline in customs duties is concerning, as they have traditionally played a crucial role in the ITA's revenue stream, particularly in the absence of strong domestic tax collections.** The ITA's reliance on border collections underscores the vulnerability of Afghanistan's fiscal position to external factors, such as currency movements and trade volumes. Moving forward, the ITA will need to focus on stabilizing its revenue base by diversifying income streams, improving customs valuation processes, and ensuring more consistent export activity to prevent similar declines in the future.

**Figure 10:Cumulative Monthly Revenue Collection and its Comparison (AFN Billions)**

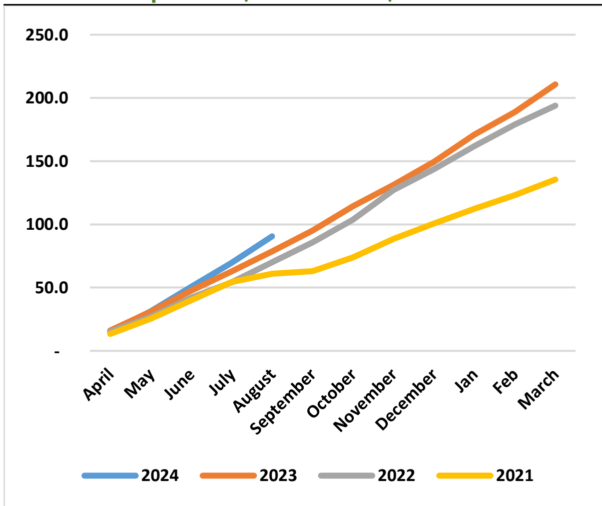
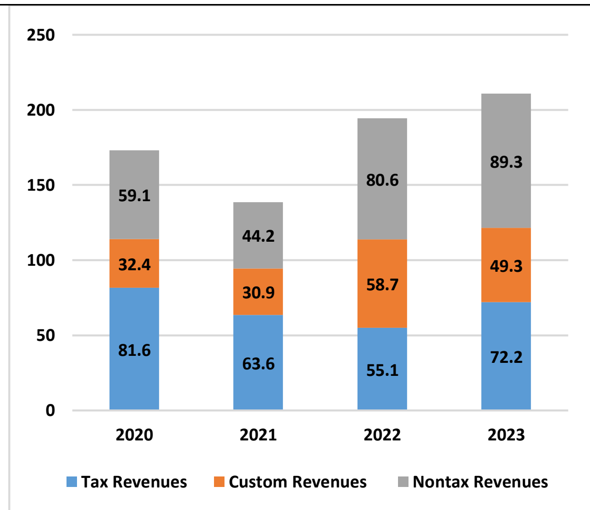



**Figure 11: Revenue Collection by Object (AFN Billions)**




*Source:* Ministry of Finance.
*Note:* The Afghan fiscal calendar month, Hamal, runs from March 22–April 21.

## EXPENDITURES:

**In FY 2023, total on-budget expenditure was approximately AFN 229.2 billion (16.9 percent of GDP), with AFN 211.6 billion (15.6 percent of GDP) allocated to operating expenses, making up 92.3 percent of the budget**. AFN 17.6 billion (1.3 percent of GDP) was directed toward development projects, representing 7.7 percent of the budget. While overall spending increased by 11percent compared to the previous year, operating expenses rose by 7.8 percent, and development spending nearly doubled from 2022 but remains too modest to significantly stimulate growth.

**Following a drastic fiscal consolidation in 2021, the ITA is gradually shifting toward an expansionary fiscal policy aligned with its domestic revenue mobilization efforts**. With the suspension of the on-budget grants, the ITA reduced operating expenditures by over 40 percent, from AFN 276.8 billion (18 percent of GDP) in 2020 under the former republic to AFN 164 billion (13.3 percent of GDP) in 2021. Key measures included salary harmonization across sectors, reduced recruitment of consultants, and the discontinuation of salary top-ups, which collectively lowered the wage bill by more than one-third, from AFN 197 billion (12.8 percent of GDP) in 2020 to AFN 127.3 billion (10.2 percent of GDP) in 2021. Pension and social transfers were also cut by more than half and standardized for all recipients.

**Since 2022, operating expenses have started to increase to AFN 196.2 billion (15.3 percent of GDP) driven by new hiring and higher consumption.** The ITA plans to gradually increase in the workforce (tashkeel[3]), within the constraints of available resources. This expansion is planned across most sectors, with a particular focus on increasing the number of teachers and security personnel. As a result, the wage bill increased by 5.6 percent from the previous year to AFN 148.2 billion (10.9 percent of GDP), while spending on goods and services was up by 6.8 percent to around AFN 46.7 billion (3.4 percent of GDP). The total number of civil service employees in FY2023/24 was reported to be 445,120, with 80.7 percent being

[3] The Tashkeel process is overseen by the inter-ministerial Salary and Tashkeel Committee, chaired by Deputy Prime Minister for Administrative Affairs. This committee consists of two sub-committees: the Salary Sub-committee, led by the Ministry of Finance, and the Tashkeel Sub-committee, headed by the Administrative Office of the President (AOP). The Tashkeel Sub-committee receives proposals from line ministries regarding plans to expand their staff. These proposals are reviewed and then submitted to the Salary Sub-committee for further consideration.

male[4]. This represents a 9.2 percent increase compared to FY2022/23. The Ministry of Education recorded the highest change in tashkeel, adding nearly 22,000 new staff to the workforce. Transfers and subsidies remained largely consistent with the previous year's levels at around 0.9 percent of GDP. The ITA also managed to settle part of the debt owed by some multilateral creditors, although the total size of the debt remains unclear.

**Development expenditures have been significantly reduced following the cessation of on-budget grants. In 2023, the ITA allocated approximately AFN 17.6 billion to development projects.** Key investments included AFN 5.5 billion for the Qosh Tepah Canal construction, AFN 1.9 billion for road maintenance and repair, and AFN 1.1 billion for building residential camps for immigrants. The prioritization of operating expenses over development reflects the ITA's focus on maintaining essential government functions and security. However, the limited funding for development could hinder long-term growth. Critical sectors like infrastructure, education, and other areas vital for sustainable development remain underfunded due to ongoing financial constraints, posing risks to Afghanistan's future economic prospects.

**In FY 2023, Afghanistan's fiscal deficit expanded to AFN 18.4 billion, equivalent to 1.4 percent of GDP, up from AFN 12.6 billion (1 percent of GDP) in 2022.** This increase in the deficit reflects growing expenditure pressures amid stagnant revenue sources. To finance this shortfall, the ITA relied on withdrawing funds from deposits accumulated during the former republic. Over the past three years, approximately AFN 35 billion has been drawn from these reserves, allowing the ITA to meet its spending needs without implementing additional revenue measures, as the country lacks borrowing capacity.

**However, these deposits are now nearly depleted, raising serious concerns about the sustainability of future fiscal policy.** With limited reserves left to tap into, the ITA will face significant constraints in financing upcoming deficits, particularly in critical areas such as development spending. The depletion of reserves limits the administration's capacity to fund essential infrastructure projects and long-term investments, which are vital for economic recovery and growth. As these resources dwindle, Afghanistan may find itself struggling to balance operational needs, such as maintaining basic government functions and security, with the pressing requirement to invest in development initiatives.

**This looming fiscal challenge will likely force the ITA to make difficult choices in the coming years.** Without access to external on-budget grants or loans, and with domestic revenues already stretched, the ITA may have to impose stricter austerity measures, cut back on development expenditures even further, or explore alternative revenue-generation strategies. The constraints on development funding could slow down essential projects in areas such as infrastructure, education, healthcare, and agriculture, all of which are key to driving long-term economic growth and reducing poverty.

**In the absence of new financial inflows, the shrinking fiscal space will also make it harder for the ITA to respond to unexpected economic shocks or emergencies, further jeopardizing the country's fragile economic stability.** Moving forward, Afghanistan will need to find sustainable ways to address its fiscal deficit while balancing the need for both operational efficiency and development investments, or risk further stalling its economic progress.

**The fiscal stance will be further exacerbated by the declining off-budget grants.** In 2023, donor grants amounted to approximately AFN 243 billion (17.9 percent of GDP), declining by about 25 percent

4 The Interim Taliban Administration (ITA) issued a decree setting the monthly salary for all women previously employed by the former government, now paid by the ITA, at AFN 5,000 per month (approximately USD 75). This order excludes female employees permitted to work, such as primary school teachers and medical personnel..

compared to 2022. These grants have primarily been channeled through humanitarian programs and initiatives aimed at providing basic social services, thus contributing to the modest economic recovery.

**Looking forward, the reduction in donor grants is expected to continue, with a gradual decline likely to become more evident over time.** This potential decrease in external assistance may pose significant challenges for Afghanistan's already fragile economy, especially as the country remains heavily reliant on these funds to support humanitarian efforts and basic services. As international priorities shift, the need for sustainable domestic revenue generation and alternative funding mechanisms will become increasingly urgent for the ITA.

**Figure 12:On-budget Operating Expenditures (AFN Billions) Economic Classification**

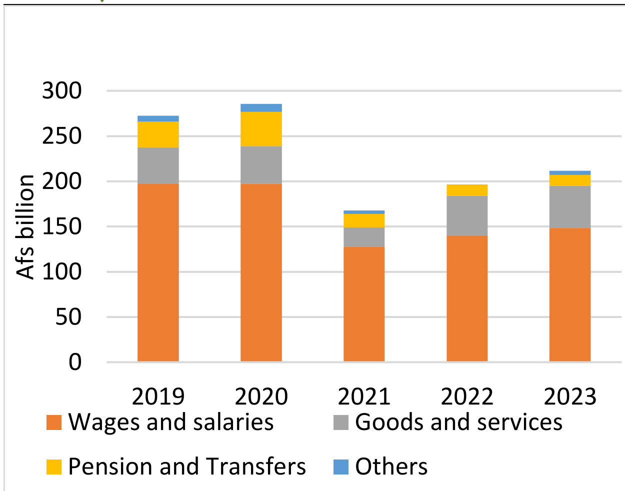
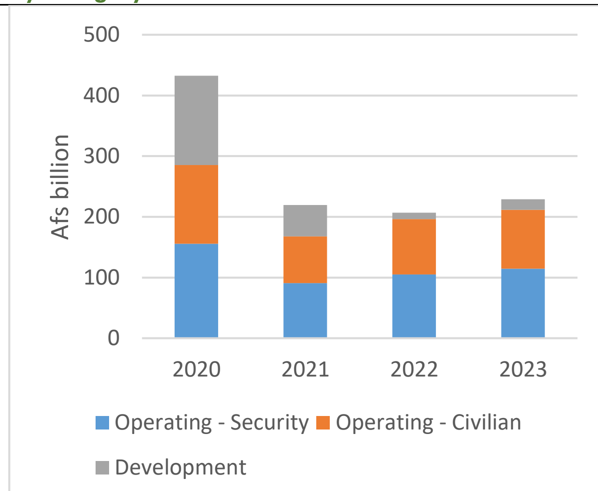



**Figure 13: On-budget Total Expenditures (AFN Billions) by Category**



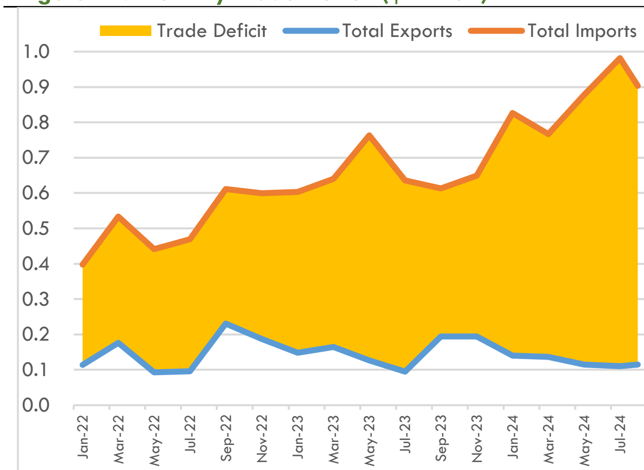

*Source:* Ministry of Finance.
*Note:* The Afghan fiscal calendar month, Hamal, runs from March 22–April 21.

## EXTERNAL SECTOR

In 2023-24, Afghanistan's exports remained stable, while imports surged, leading to a widening trade deficit. This was largely due to the appreciation of the exchange rate, which made imports cheaper, alongside a revival in domestic industrial activity. Although the Afghani stabilized after its significant appreciation earlier in 2023, the constrained supply of Afghani banknotes and undisclosed foreign exchange inflows have helped balance the market. However, these factors raise concerns about the long-term sustainability of the country's economic outlook.

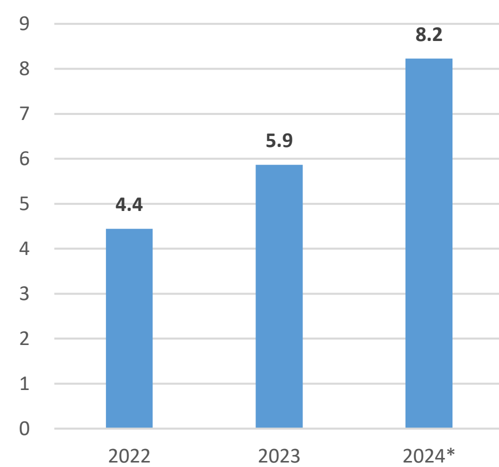
The rise in imports, coupled with stagnant exports, led to a significant widening of the trade deficit in 2023-24. The deficit grew by 32 percent, increasing from $4.4 billion (30 percent of GDP) in 2022 to $5.9 billion (34 percent of GDP) in 2023 (Figure 15). When factoring in the negative balance in service trade, which adds an additional $1 billion, the total deficit reached approximately $7 billion. This widening gap was primarily fueled by changes in Pakistan's trade policies—particularly around coal imports—and the continued appreciation of the Afghani against major trading partners, which made imports cheaper but further strained domestic production and exports.

**Figure 14: Monthly Trade Deficit ($Million)**




*Source:* ASYCUDA

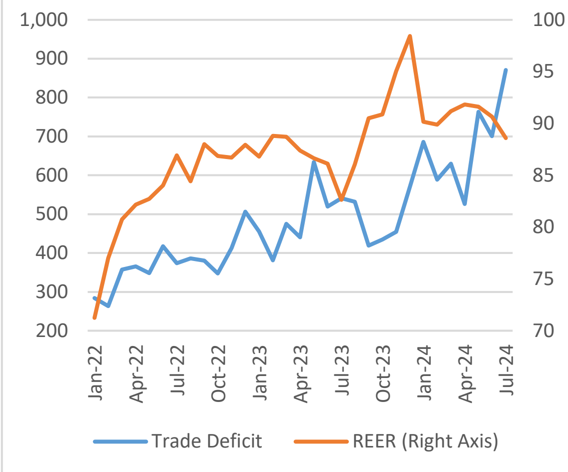
**Figure 15: Annual Trade Deficit ($Billion)**




* The 2024 value is simulated based on the January 2024 value of the trade deficit and the 2023 seasonal pattern.

**In addition to trade relations with neighboring countries, the appreciating effective exchange rate has significantly contributed to Afghanistan's growing trade deficit.** In 2023, the nominal effective exchange rate (NEER) increased by 30 percent, while the real effective exchange rate (REER) appreciated by 7 percent. This appreciation made domestically produced goods less competitive, leading to a surge in imports of manufactured goods and stagnation in agricultural exports, ultimately resulting in a 32 percent increase in the trade deficit. In the first seven months of 2024, despite some depreciation of the Afghani against the US dollar, it continued to appreciate in both nominal and real terms against the currencies of its trading partners, further exacerbating the trade deficit.

**Figure 16: Trade Deficit ($Million) and REER (Index)**




Source: WB staff calculations

**Table 17: Growth in Trade Deficit and Effective Exchange Rate**

| | 2023 | 2024* |
|---|---|---|
| Appreciation of NEER | 30.2% | 22.6% |
| Appreciation of REER | 6.9% | 4.4% |
| Trade Deficit Growth | 31.9% | 38.2% |
| Jan 2022 to Jul 2024 | | |
| Correlation (Trade Deficit and NEER) | 0.82 | |
| Correlation (Trade Deficit and REER) | 0.63 | |

* The 2024 growth rates (YoY) are calculated for first seven months.

## EXPORTS:

**In 2023, Afghanistan's export performance showed relative stability, with gains in certain sectors balancing out a sharp decline in others.** Total exports for the year amounted to $1.9 billion, a modest increase of 0.4 percent compared to 2022. This growth was driven largely by the food and textile sectors, which experienced notable expansions despite significant logistical and regulatory challenges.

**Food exports, in particular, grew by 13 percent, rising from $1.1 billion to $1.3 billion, even amid headwinds such as increased tariffs, new transit regulations, and the closure of the Torkham border, a key trade route with Pakistan.** The resilience of food exports, despite these obstacles, highlights Afghanistan’s ability to maintain supply chains for essential goods like wheat, flour, fruits, and vegetables. This sector’s growth underscores its crucial role in Afghanistan's export economy, providing a relatively stable income stream despite regional disruptions.

**Textile exports also saw substantial growth, surging by 46 percent to reach $281 million, up from $192 million the previous year.** The textile sector, particularly cotton products, has benefited from competitive pricing and lower domestic costs, making Afghan textiles more attractive to international buyers. Much of this growth was driven by demand from neighboring countries like Pakistan, where lower domestic cotton production has increased reliance on Afghan imports. Textiles remain a key non-food export for Afghanistan, helping to diversify the country’s export base beyond agricultural products.

**In addition to these sectors, exports of other goods, including base metals, stone and glass products, transportation equipment, wood products, and animal and vegetable fats, experienced a sharp rise.** These categories grew by 58 percent, from $60 million to $95 million, largely due to heightened demand from key trading partners like the UAE, Pakistan, Iran, and China. This growth reflects Afghanistan’s increasing integration into regional supply chains for a broader array of industrial and manufacturing goods, suggesting a potential diversification of the country’s export economy beyond traditional sectors like agriculture and textiles.

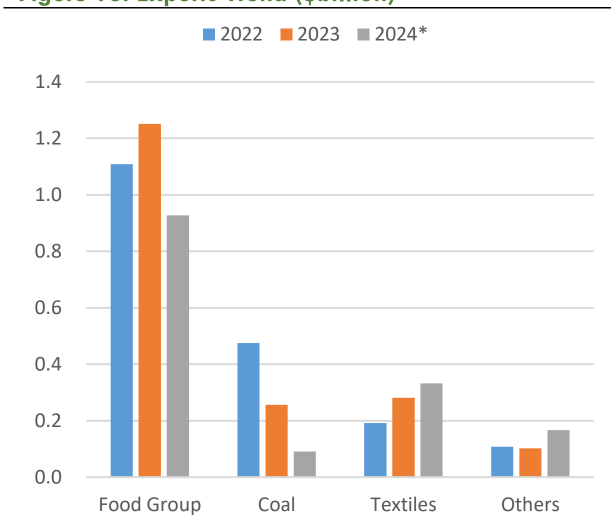
**Conversely, coal exports, which had been a major source of revenue, suffered a severe decline.** Coal exports fell by 46 percent, dropping from $476 million in 2022 to $257 million in 2023. This decline can largely be attributed to Pakistan's strategic shift toward using domestically sourced coal to reduce import dependency. Given that coal had previously been a significant contributor to Afghanistan's export earnings, this downturn has had a noticeable impact on the overall export figures. The drop in coal exports also reflects the vulnerabilities in Afghanistan's reliance on a narrow set of export products, particularly those subject to shifting regional policies and trade dynamics.

**Despite the overall decline in exports, Pakistan continued to be Afghanistan's largest export market, although its share of Afghan exports decreased.** From January to July 2024, 47 percent of Afghanistan's exports went to Pakistan, compared to 58 percent during the same period in 2023. The decrease in Pakistan's share is largely due to substantial declines in food and coal exports, which together made up about 70 percent of Afghanistan's total exports to Pakistan. These reductions were driven by a combination of factors, including Pakistan's policy changes regarding coal imports and increased tariffs on Afghan goods, as well as logistical disruptions caused by border closures and transit issues.

**India, on the other hand, saw an increase in its share of Afghanistan's exports, rising to 27 percent from 24 percent in the same period in 2023.** India's growing demand for Afghan food products, particularly fresh and dried fruits, played a key role in this shift. Additionally, Afghanistan's ability to maintain trade routes with India, even in the face of regional instability, has allowed for a steady flow of exports, positioning India as a critical market for Afghan goods.

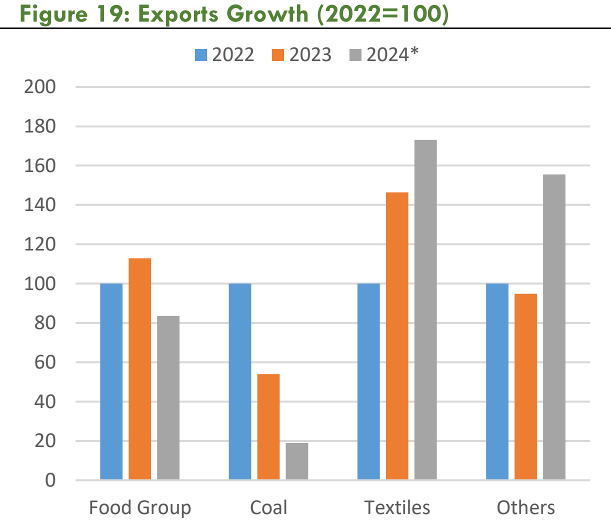
**Looking forward, Afghanistan faces both opportunities and challenges in its export sector.** While growth in food, textiles, and other goods points to the potential for further diversification and resilience, the sharp decline in coal exports highlights the risks of over-reliance on a few key sectors. To sustain and enhance its export performance, Afghanistan will need to continue expanding its trade relationships, improve infrastructure to facilitate smoother transit, and adapt to regional trade policy changes. Addressing these issues will be crucial for maintaining export growth and ensuring long-term economic stability.

**Figure 18: Exports Trend ($billion)**




*Source:* WB Staff calculations based on Automated System for Customs Data (ASYCUDA)

**Figure 19: Exports Growth (2022=100)**




* The 2024 value is simulated based on the January 2024 value of exports and the 2023 seasonal pattern.

## IMPORTS:

**In 2023, Afghanistan witnessed a substantial surge in imports, despite a modest economic recovery and constrained foreign exchange availability due to declining off-budget transfers.** Total imports grew by 23 percent, increasing from $6.3 billion in 2022 to $7.8 billion in 2023. This upward trajectory continued into 2024, with imports reaching $5.6 billion from January to July, reflecting a 28 percent year-on-year increase. This surge highlights the complex dynamics of Afghanistan's trade landscape, where increased demand for imports contrasts with limited foreign exchange inflows and domestic production challenges.

**Food imports, which accounted for 21 percent of Afghanistan's total imports, rose sharply to $1.7 billion in 2023.** The growth of the food import sector reflects Afghanistan's ongoing reliance on foreign agricultural products to meet domestic demand. From January to July 2024, food imports reached $1.1 billion, marking an 18 percent year-on-year increase. Key contributors to this surge included staples such as wheat, flour, sugar, rice, and various vegetables and fruits. The increase in food imports also points to Afghanistan's vulnerability to agricultural production fluctuations and challenges in achieving self-sufficiency in key food categories.

**Mineral imports, primarily consisting of fuel and mineral oils, represented another significant portion of Afghanistan's import bill.** These imports grew by 15 percent in 2023, totaling $1.6 billion, a reflection of Afghanistan's heavy dependence on foreign energy sources. By July 2024, mineral imports reached $1.1 billion, compared to $906 million during the same period in 2023. The rise in fuel imports underscores the country's limited domestic energy production and highlights the strain of global energy price fluctuations on the Afghan economy.

**Textile imports, accounting for 9 percent of total imports, experienced modest growth of 11 percent in 2023, reaching $721 million.** However, this category faced a downturn in early 2024, with textile imports falling by 12 percent year-on-year to $397 million by July. This decline may reflect changes in domestic demand for textiles or shifts in global market conditions. Despite this, the textile sector remains a crucial element of Afghanistan's trade, driven by the country's consumer needs and domestic production constraints.

**Collectively, these three categories—food, minerals, and textiles—represented 51 percent of total imports in 2023.** However, their combined share dropped to 47 percent in early 2024 as Afghanistan diversified its import portfolio and increased imports of industrial and intermediate goods.

**While consumer goods imports showed moderate growth, there was a notable shift toward intermediate goods such as machinery, transportation equipment, and chemicals.** This trend signals a potential recovery of Afghanistan's industrial sector, particularly in industries such as cement, steel, and manufacturing. In 2023, imports of intermediate goods totaled $1.8 billion, with transportation equipment leading the way, increasing by 85 percent, followed by machinery (63 percent growth) and chemicals (37 percent growth). This momentum carried into 2024, with imports in these categories totaling $1.5 billion in the first half of the year. Transportation equipment imports rose by 77 percent, machinery by 46 percent, and chemicals by 54 percent.

**Iran remained Afghanistan's largest source of imports in 2023, accounting for 23 percent of total imports.** By the first half of 2024, this share had risen to 30 percent, with imports from Iran increasing by 80 percent year-on-year. This surge can be largely attributed to Afghanistan's shift in transit trade routes, moving away from Pakistan due to the imposition of trade restrictions and increased tariffs. Iran's strategic importance in Afghanistan's trade framework has grown, as the country has positioned itself as a key supplier of essential goods, energy, and industrial inputs to its neighbor.

**The UAE also became a more prominent trading partner for Afghanistan.** The share of Afghan imports from the UAE increased from 15 percent in 2023 to 22 percent by mid-2024. The UAE's role as a re-export hub, particularly for goods like machinery and transportation equipment, has bolstered its position as a key source of imports.

**Pakistan, traditionally a major trading partner, contributed 16 percent of Afghanistan's total imports in 2023.** However, its share has remained relatively static, with Afghanistan increasingly turning to alternative trade routes like Iran. Trade tensions and regulatory changes, such as the closure of the borders with Pakistan, have contributed to this shift. China, meanwhile, accounted for 7 percent of Afghanistan's imports, with its influence primarily focused on industrial goods and raw materials needed for Afghanistan's burgeoning manufacturing sector.

**Figure 20: Imports Trend ($billion)**

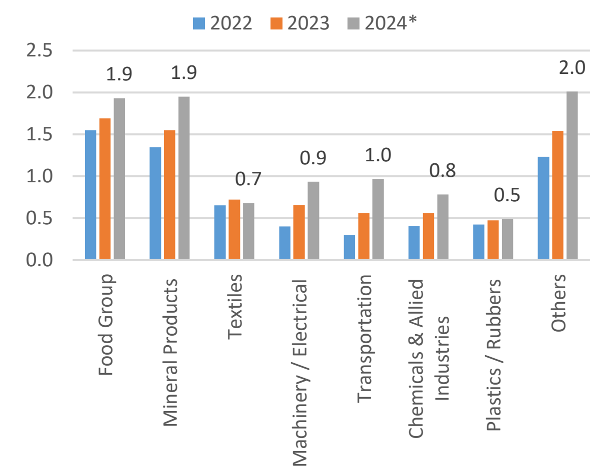
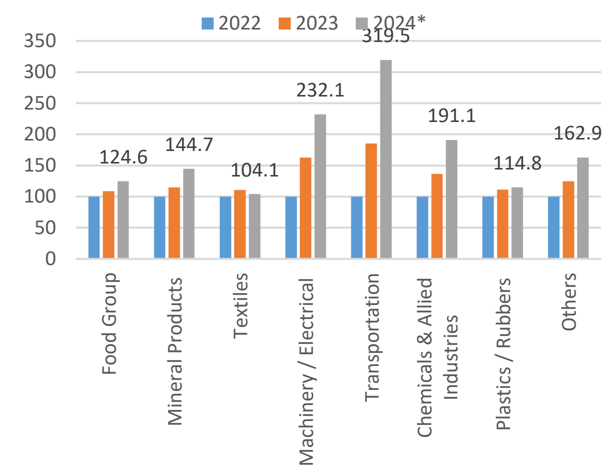



**Figure 21: Imports Growth (2022=100)**




*Source:* WB Staff calculations based on Automated System for Customs Data (ASYCUDA)

* The 2024 value is simulated based on the January 2024 value of exports and the 2023 seasonal pattern.

## EXCHANGE RATE:

### The Afghani appreciated significantly in 2023 due to strong foreign inflows; however, it began to stabilize with a slight depreciation in 2024.

**In 2023, the Afghani experienced a significant appreciation against major currencies, primarily driven by foreign exchange inflows that effectively covered Afghanistan's substantial trade deficit.** The currency's strength can be attributed to a combination of financial inflows, including approximately an estimated $2 billion in remittances from Afghans living abroad, about $3 billion off-budget transfers, including UN cash shipments[5], and other undisclosed sources. These inflows created a surplus in the foreign exchange market, despite the country's ongoing trade imbalance, which resulted in the Afghani strengthening

[5] Special Inspector General for Afghanistan Reconstruction, SIGAR 24-32 Evaluation Report

significantly. Over the year, the Afghani appreciated by 27.1 percent against the US dollar (Figure 23) and posted substantial gains against the Euro, Yuan, Indian Rupee, and Iranian Toman (Figure 22).

**Figure 22: Exchange Rate – Index**

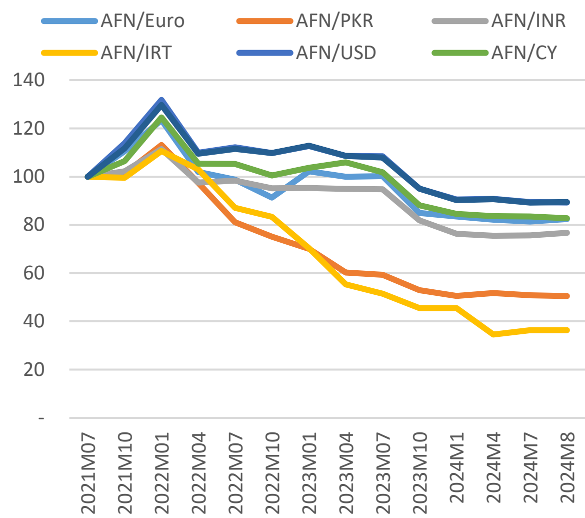
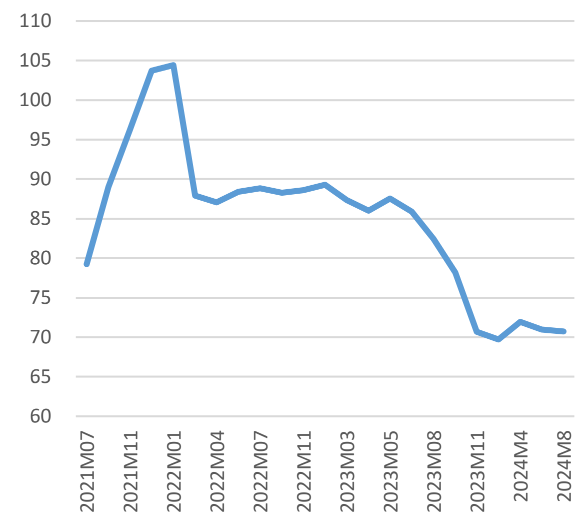



**Figure 23: Average Monthly AFN/$Exchange Rate**




*Source:* Da Bank of Afghanistan (DAB).

**In 2023, Afghanistan's effective exchange rate appreciated significantly in both nominal and real terms against its major trading partners.** Specifically, the nominal effective exchange rate (NEER) rose by 38 percent compared to the average level in 2022 (Figure 24). During this period, Afghanistan experienced a deflation of 5 percent, while its trading partners saw a weighted average inflation rate of 22 percent, driven largely by inflation in Pakistan and Iran. Despite this deflation, the substantial nominal appreciation resulted in a 7 percent increase in the real effective exchange rate (REER) (Figure 25). In the first seven months of 2024, the Afghani depreciated against the US dollar but appreciated by 28 percent in nominal terms and 4 percent in real terms against the currencies of its trading partners, primarily due to the weakening of the Pakistani Rupee and Iranian Toman.

**Figure 24: Nominal Effective Exchange Rate – Index**

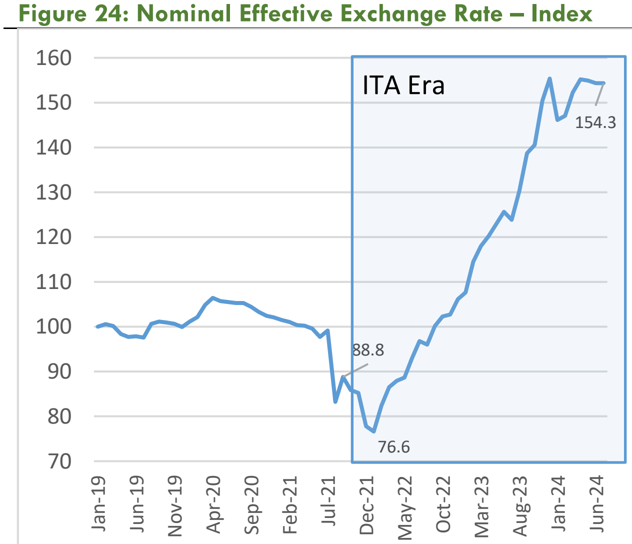
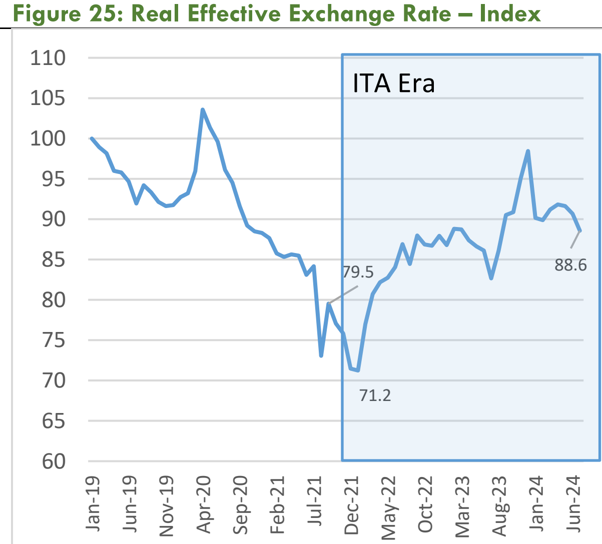



**Figure 25: Real Effective Exchange Rate – Index**




*Source:* Da Bank of Afghanistan (DAB).

**The improved supply of US dollars played a crucial role in stabilizing Afghanistan's currency.** UN cash shipments, primarily intended for humanitarian assistance and distributed through local banks and other channels, including the informal money serve providers (hawalas); significantly improved liquidity in the financial system. Remittances, another key inflow, supported families, boosted domestic consumption, and injected foreign currency into the economy. However, despite these known sources, the size of the trade deficit—approximately $7 billion, or 40 percent of GDP—along with the absence of large-scale foreign or portfolio investment, raises questions about the origin of the additional foreign exchange. Speculations point to informal cross-border trade, undeclared private investments, financial aid from unreported sources, or higher-than-reported remittance inflows, all of which likely contributed to stabilizing Afghanistan's foreign exchange market in 2023.

**The Afghan central bank (DAB), through frequent foreign exchange auctions, took an active role in managing the Afghani's exchange rate.** DAB's commitment to maintaining a strong currency was evident, as the central bank sold foreign reserves to control fluctuations, indicating a deliberate policy of exchange rate targeting. The focus on maintaining a strong currency, while beneficial for controlling inflation and stabilizing prices, came at a cost to Afghanistan's domestic economy. The cheaper imports reduced demand for locally produced goods, exacerbating unemployment and stifling growth in domestic industries that could not compete on price. Additionally, the sustained appreciation of the Afghani limited Afghanistan's export potential, as Afghan products became more expensive for foreign buyers. This created a paradox: while the country's exchange rate was stable, the broader economy faced challenges in terms of growth and employment, as the reliance on imports grew and domestic industries struggled to remain viable.

**As Afghanistan entered 2024, the dynamics of the foreign exchange market began to shift.** The decline in foreign exchange inflows, particularly due to reduced UN cash shipments and the stabilization of remittances, led to a more stable exchange rate, with the Afghani trading between 67 and 71 per US dollar since January 2024. This period of stabilization represented a critical adjustment in the foreign exchange market. The central bank responded by reducing the frequency of its foreign exchange auctions, signaling a shift away from direct intervention and allowing the currency to correct naturally in response to reduced inflows.

**This stabilization provided some relief from the sharp fluctuations that had characterized the currency market in previous years.** However, it also underscored the reduced capacity of Afghanistan's foreign exchange reserves to shield the economy from external shocks. As inflows from international aid and remittances slowed, the central bank's ability to support the Afghani diminished, leading to a more market-driven exchange rate. The balance achieved in early 2024 suggests that while the currency is stabilizing, Afghanistan remains vulnerable to further disruptions if foreign exchange sources continue to dwindle.

**Looking ahead, the Afghani's future stability will depend largely on Afghanistan's ability to secure consistent foreign exchange inflows, either through sustained remittances, aid, or by diversifying its export base.** Without a steady stream of foreign currency, the central bank will face challenges in managing the exchange rate and controlling inflation. The delicate balance between maintaining a stable currency and fostering domestic economic growth will be key to Afghanistan's financial and economic stability in the coming years. The current stabilization, while promising, highlights the structural vulnerabilities in Afghanistan's economic system, with its heavy reliance on external inflows and limited domestic production capacity.

**Box 1: Understanding the Afghani's Paradox: Currency Appreciation Amidst a Widening Current Account Deficit.**

The persistent appreciation of the Afghani, despite a widening current account deficit, presents an economic puzzle. Typically, a growing deficit would signal higher demand for foreign currency (like the US dollar), leading to depreciation of the local currency. However, several unique factors seem to be driving the Afghani's appreciation.

One key factor is the country's high level of dollarization. Although the demand for US dollars is expected to rise alongside the trade deficit, policies aimed at increasing the use of the Afghani have significantly altered this dynamic. The ITA's enforcement of using the Afghani in domestic transactions—prohibiting foreign currencies such as the Pakistani Rupee, Iranian Toman, and US Dollar—has increased the demand for Afghani within the economy. As a result, currency in circulation grew by 7.6 percent in 2023/24, comprising 65 percent of the money supply (M2), while Afghani-denominated deposits surged by 18.5 percent, rising from 30 percent in 2021/22 to 41 percent of total deposits.

At the same time, the central bank, DAB, lacks the capacity to print and distribute Afghani banknotes,, leading to a shortage of physical currency in the market. This scarcity, coupled with the increased reliance on the Afghani for domestic transactions, has driven up its value. Currency exchangers report that this mismatch between high demand and limited supply of Afghani notes is one of the primary factors behind the currency's appreciation.

Another critical factor contributing to this situation is the central bank's regular auctions of US dollars to manage liquidity and stabilize the exchange rate. By injecting US dollars into the market, DAB helps ease the pressure on the Afghani. However, this intervention, combined with the scarcity of new Afghani notes, has created a delicate balance in the market, preventing the local currency from depreciating, as might be expected.

Despite the demand for hard currency driven by rising imports, the supply of US dollars has remained robust, thanks to several external factors. These include UN cash shipments, increased remittance inflows, and other undisclosed financial inflows. Additionally, strict capital controls implemented by the central bank—particularly measures to prevent capital flight—have helped preserve foreign currency reserves, further supporting the Afghani's value. By limiting the outflow of foreign currencies, the central bank has ensured a stable supply of US dollars, preventing the trade deficit from exerting downward pressure on the Afghani.

In summary, the Afghani's appreciation, despite a widening current account deficit, can be attributed to a combination of factors: enforced reliance on the Afghani for domestic transactions, a constrained supply of Afghani banknotes, regular US dollar auctions by the central bank, and robust foreign currency inflows. While this combination has supported the currency's value in the short term, it raises questions about the long-term sustainability of this delicate equilibrium.

## MONETARY POLICY AND FINANCIAL SECTOR

Afghanistan's economic landscape has been marked by a weak recovery and persistent deflationary pressures. Despite these challenges, the money supply showed marginal growth, increasing by 0.6 percent in 2023/24, following a stronger growth of 2.1 percent in 2022/23 and a sharp contraction of 4.4 percent in 2021/22. This trend highlights the fluctuating nature of the country's monetary base and points to broader economic uncertainties, amidst stressed financial sector.

**One of the more notable shifts has been the significant fluctuations in the components of the money supply, particularly the currency in circulation and bank deposits.** In 2023/24, the currency in circulation saw an increase of 7.6 percent, now comprising 65 percent of M2, the broad measure of money supply. This growth came after a contraction of 2.7 percent in the previous fiscal year, suggesting an increasing reliance on physical currency within the economy. Conversely, deposits shrank by 10.3 percent in 2023/24, now accounting for 35 percent of broad money, in stark contrast to a 9.3 percent rise in 2022/23. This decline in deposits reflects easing the withdrawal limit, but also declining public confidence in the banking sector, use of the informal financial services, constrained economic activity, or ongoing liquidity challenges facing financial institutions.

**However, deposits in the domestic currency, the afghani, have been an exception to this downward trend.** Afghani-denominated deposits surged by 18.5 percent in 2023/24, building on the 13 percent growth recorded in 2022/23. These deposits now account for 41 percent of total deposits, a significant increase from approximately 30 percent in 2021/22. The rising share of afghani deposits suggests a growing preference for local currency over foreign currencies, driven in part by the country's shifting monetary policies and the Central Bank's efforts to promote the use of the national currency. The DAB has formally prohibited the use of foreign currencies (such as the Pakistani rupee, Iranian Toman, and US dollar) in domestic transactions to promote the use of the afghani and the reduction of the level of dollarization.

**The evolution of the money supply has been closely linked to changes in withdrawal restrictions imposed by the Central Bank of Afghanistan.** In the immediate aftermath of the political transition in 2021, the Central Bank implemented strict withdrawal limits to prevent capital flight and stabilize the financial system. Initially, individual account holders were restricted to withdrawing a maximum of $200 or AFN 20,000 per week. These measures were part of broader efforts to manage the economic fallout and maintain liquidity within the banking system.

**Over time, these restrictions were gradually eased.** In November 2021, the weekly withdrawal limit was increased to $400, with a monthly cap of $1,200 or AFN 100,000. Despite these changes, the economy remained under pressure, with limited access to funds for both individuals and businesses. It wasn't until April 2023 that the Central Bank made a more substantial adjustment to withdrawal limits, raising the weekly allowance to AFN 50,000 (around $578) and setting a monthly limit of AFN 200,000 (approximately $2,313). For US dollar accounts, the weekly withdrawal limit was set at $600, with a monthly cap of $1,200. These revisions marked an important step toward restoring some confidence in the banking system.

**Businesses, however, continued to face tighter restrictions, with corporate accounts being subject to a 5 percent withdrawal limit of the total account balance, capped at $40,000 per month.** This restriction, combined with limited bank guarantees for small and medium-sized enterprises (SMEs), constrained business activity and hampered private sector growth. SMEs were also limited to bank guarantees of AFN 300,000 (roughly $3,469), restricting their ability to access credit and make significant investments.

**In December 2023, further relaxation of withdrawal limits took place, allowing individuals to withdraw up to $1,000 or AFN 70,000 per week, with monthly limits rising to $3,000 or AFN 250,000.** These measures signal a gradual normalization of the banking sector and suggest that the Central Bank is becoming more confident in its ability to manage liquidity without the need for stringent withdrawal controls.

**The changes in Afghanistan's money supply and withdrawal policies are symptomatic of a broader struggle to stabilize the economy in the face of both internal and external challenges.** The limited growth in money supply, coupled with the decline in deposits, points to weak economic activity and low levels of investment. However, the increased circulation of currency and the rise in afghani deposits indicate a degree of resilience within the domestic economy, as well as efforts by the authorities to shift towards greater reliance on local currency.

**The progressive easing of withdrawal restrictions, particularly in 2023, reflects the Central Bank's balancing act between ensuring sufficient liquidity in the banking system and preventing large-scale capital outflows.** While these measures have provided some short-term relief, significant challenges remain, particularly for businesses and financial institutions, which continue to operate under tight constraints. The success of Afghanistan's monetary policies will ultimately depend on the broader recovery of the economy, including the revival of key sectors such as agriculture, trade, and construction. Additionally, the country's financial stability will rely heavily on maintaining confidence in the banking system, which requires both prudent monetary management and the gradual relaxation of restrictions on financial transactions.

**The contraction in deposits has significantly reduced the banking sector's capacity to extend credit.** Deposits are the foundation of the loan-making process, as banks typically lend a portion of the funds held in deposit accounts. When deposits decline, banks become more risk-averse, less willing, and less able to lend. As a result, total loans have consistently and significantly contracted, with an average reduction of 18 percent over the past three years. The loan-to-deposit ratio fell from 17.5 percent in 2021/22 to just 11.6 percent in 2023/24. This reduction in credit availability contributed to the severe economic contraction in 2021/22 and 2022/23, as well as the weak recovery in 2023/24. Businesses, particularly small and medium-sized enterprises (SMEs), which often rely on bank financing, face significant difficulties in accessing capital, limiting their ability to expand or sustain operations.

**By adopting a combination of these strategies, the Central Bank of Afghanistan can address the decline in deposits, enhance the stability of the banking system, and support broader economic recovery.** The key focus should be on restoring public confidence, improving liquidity, promoting deposit growth, and implementing monetary policies that stimulate economic activity. Long-term structural reforms, including financial inclusion initiatives and international cooperation, can also play a vital role in building a resilient banking sector capable of weathering future challenges.

**The transition to Islamic finance in Afghanistan could offer several benefits to the country's banking sector, especially in the context of the challenges it currently faces.** Islamic finance is aligned with the religious beliefs of the majority of Afghanistan's population, making it more acceptable to many people who may distrust or avoid conventional banks due to concerns over interest-based transactions. By shifting to Islamic banking, the Central Bank of Afghanistan can attract a wider customer base, encouraging individuals and businesses to engage with the banking system. Restoring public confidence is key to reversing the decline in deposits and stabilizing the banking sector. The focus on asset-backed and socially responsible investments could reassure depositors that their money is being used for productive and ethical purposes.

**Figure 26: M2 and its components Expenditures (AFN Billions)**

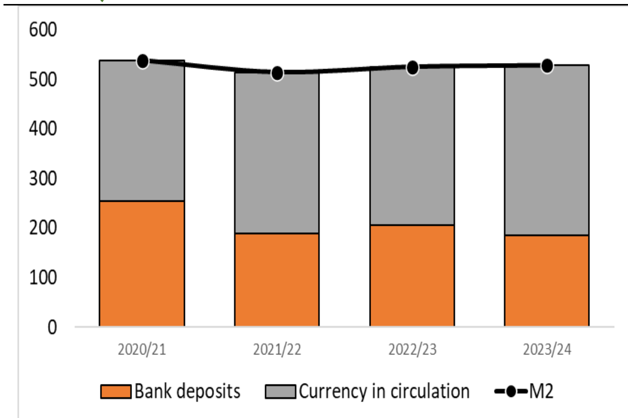
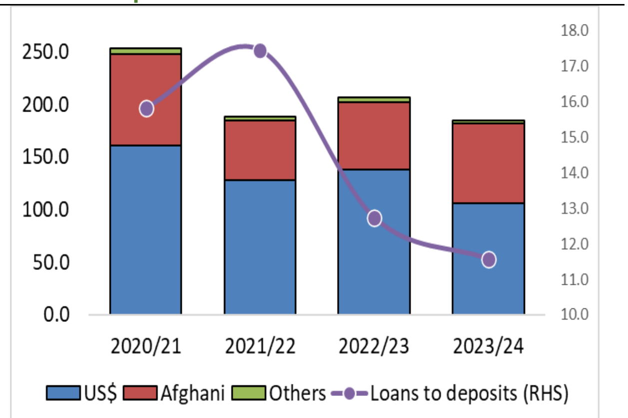



**Figure 27: Composition of deposits (AFN Billions) and loans to deposits ratio**




*Source:* Da Bank of Afghanistan (DAB).

**As of 2023, only 2 of the 11 commercial banks operating in Afghanistan have published Non-Qualified Audited financial statements, while the others released unaudited reports, making it difficult to fully assess the sector's health.** Data from the Afghanistan Banks Association shows that 6 banks increased net profits, 2 reduced net losses, and 3 saw declines in net profits from June 2023 to June 2024, with improved performance linked to new fee-based services, foreign exchange investment returns, and gains from Afghani appreciation. However, profitability remains significantly below pre-August 2021 levels. The capital base remained stable through June 2024, but DAB's removal of forbearance measures in October 2024, which had allowed banks to avoid recognizing losses on non-performing loans, is expected to significantly erode capital, posing serious stability risks. Banks must now recognize these NPL-related losses, further straining their balance sheets, while the mandatory conversion to Islamic finance hampers their ability to generate new revenue through lending. Discussions between banks and DAB are ongoing, but how these growing stability risks will be addressed remains unclear.

**In the context of a stressed banking sector, the microfinance sector is becoming increasingly relevant for lending, especially to micro and small enterprises.** According to the Microfinance Investment Support Facility for Afghanistan (MISFA) quarterly report, the sector had 35,738 borrowers using the only Islamic product available, Murabaha, with an outstanding portfolio of AFN 2.3 billion as of June 2024, 43 percent of which is held by women. This highlights the sector's pivotal role in supporting vulnerable groups, particularly in rebuilding livelihoods. In August 2024, DAB introduced new regulations for the microfinance sector, which had previously been unregulated by the central bank and overseen de facto by MISFA, the state-owned wholesale financier. While these new regulations are a welcome development, given the sector's potential to serve the "bottom of the pyramid," careful implementation is crucial to avoid stifling the only segment of the financial sector currently providing meaningful lending.

**Digital payments in Afghanistan continue to face significant challenges, many of which have remained unresolved since August 2021.** The country's financial infrastructure has experienced notable setbacks, with both the Real-Time Gross Settlement (RTGS) and Automated Clearing House (ACH) systems still non-operational. In their absence, the older Afghanistan Clearing and Settlement System (ACSS) has been reinstated. However, ACSS lacks straight-through processing (STP), requiring commercial bank operators to manually input transactions through a web-based interface. While ACSS is connected to some Ministry of Finance systems, including SIGTAS (for tax collection) and ASYCUDA (for customs payments), the lack of automation and the absence of connections to Electronic Money Institutions (EMIs), such as mobile money providers, limit the use of digital payment instruments for government transactions.

**The national payment system, known as the Afghanistan Payment System (APS), is partially operational. APS manages the AfPay domestic card scheme and supports ATM withdrawals, subject to limits prescribed by DAB.** However, some commercial banks have yet to restore ATM interoperability for their machines, likely due to concerns over counterparty risks and the limited supply of Afghani banknotes. Mobile money services, operating under Electronic Money Institution (EMI) licenses, continue to function, but they primarily focus on facilitating mass disbursements for humanitarian aid, which has resulted in high wallet dormancy rates. Estimates suggest there are between 20,000 and 50,000 active mobile wallets, depending on the definition of inactivity. Meanwhile, many humanitarian agencies continue to rely on hawala networks (Money Service Providers) for their disbursements, underscoring the ongoing challenges in developing a sustainable digital payments ecosystem in Afghanistan.

## 2. OUTLOOK AND MEDIUM-TERM PROSPECTS

Despite significant improvements in security, Afghanistan's economic outlook remains clouded with uncertainty. The key drivers of growth—physical capital accumulation, human capital development, and total factor productivity—are currently subdued. Without bold and transformative reforms to improve the business environment, real GDP growth is likely to barely keep pace with demographic expansion, leading to stagnation or slow growth in per capita GDP.

**Economic activity is projected to grow modestly over the medium term, with an average annual GDP growth rate of 2.75 percent from 2024 to 2026.** This growth, while positive, is far from robust and reflects an economy still grappling with fundamental structural weaknesses. Agriculture is expected to remain a crucial driver of growth in the coming years. A resilient agricultural sector, benefiting from favorable weather conditions, improved irrigation practices, and potentially a shift from opium to food production, is forecasted to support GDP growth. Given Afghanistan's heavy reliance on agriculture—both as a source of employment and food security—the sector's performance will be critical. However, agriculture in Afghanistan remains highly vulnerable to droughts, climate change, and conflict, which could quickly reverse any progress made in productivity or food supply.

**The industrial sector is projected to grow at a modest 2.6 percent over the same period, reflecting ongoing challenges.** Afghanistan's industrial growth will remain constrained by several factors: a still-strong Afghani, shifting trade and policy relations with Pakistan, and persistent deflation. Industrial production—particularly in mining and manufacturing—has been hampered by the limited access to international markets, the depreciation of key trading partners' currencies, and a lack of modern infrastructure.

**The services sector, another crucial pillar of Afghanistan's economy, is expected to continue under pressure.** A significant decline in foreign aid, coupled with Afghanistan's international isolation, will constrain growth in areas such as finance, communications, and trade services. Many businesses in the service sector depend heavily on foreign funding and partnerships, making them vulnerable to global policy shifts and Afghanistan's strained diplomatic relations.

**On the demand side, consumption will continue to be the primary driver of economic growth, supported by an increase in remittances and improved liquidity following the relaxation of withdrawal limits by the central bank.** The Central Bank of Afghanistan has announced in August 2024 a new increase in withdrawal limits for individual bank account holders. The weekly withdrawal limit was increased to $2,000 or AFN 150,000, with a monthly cap of $6,000 or AFN 500,000. This policy shift is part of ongoing efforts to enhance financial flexibility and support economic activity in the country. However, consumption-led growth is inherently limited in its ability to stimulate long-term economic development, as it does not drive investment or productivity improvements. Investment and exports are projected to remain subdued over the medium term, reflecting Afghanistan's challenging business environment, lack of foreign direct investment, and declining foreign aid. While consumption may temporarily lift GDP, the lack of robust investment in key sectors will limit long-term growth potential. This stagnation in investment, combined with weak export performance, could trap the economy in a cycle of low productivity and limited income growth.

**While deflationary pressures marked the beginning of FY2023-24, Afghanistan is expected to see domestic prices stabilize towards end 2024.** Inflation is projected to turn positive as the exchange rate levels out by November 2024. In the first five months of FY2023-24, prices dropped by an average of 7.3 percent, largely driven by an 11.5 percent reduction in food prices and a 2.6 percent decline in non-food prices. These price decreases were aided by a strong Afghani, which lowered the cost of imports, and a favorable agricultural season that increased domestic food supplies. However, inflationary pressures are expected to mount again, with forecasts suggesting a rise to 6 percent in 2025 and 10 percent in 2026.

The anticipated depreciation of the Afghani, combined with potential disruptions to the agricultural sector, could lead to higher import prices, fueling inflation. Furthermore, challenges in maintaining a strong currency amid political instability and trade deficits will likely contribute to upward price pressures.

**Afghanistan's current account deficit is projected to widen from 13.5 percent of GDP in FY2023-24 to 17.7 percent over the medium term.** This widening deficit is primarily driven by a persistently high trade imbalance, with the trade deficit remaining at around 40 percent of GDP. The large trade deficit underscores the country's dependence on imports, which are projected to slightly exceed 50 percent of GDP from 2024 to 2026. Exports are expected to remain weak, stabilizing at around 10 percent of GDP as key exports, such as coal to Pakistan, face reductions. In the first five months of 2024, exports fell by 16 percent, largely due to a dramatic 78 percent drop in coal exports and a 5.5 percent decline in food exports. The overall decline in exports was offset slightly by growth in textiles, which highlights a potential area for diversification, though much remains to be done to increase competitiveness and scale. Meanwhile, imports surged by 22 percent to $3.8 billion, driven by secondary imports like transportation equipment, machinery, and chemicals, reflecting the country's need to import goods to sustain basic industries. Food and fuel imports also increased, further widening the trade deficit.

**Remittances, a key source of foreign exchange, have increased, but they are insufficient to offset the decline in foreign aid.** Afghanistan's reliance on foreign grants has diminished, and income from abroad is expected to fall to around 22 percent of GDP. This decline, coupled with a widening current account deficit, will strain Afghanistan's foreign reserves. With international assets frozen, the central bank's ability to manage currency stability is severely limited, raising concerns about future inflation and exchange rate volatility.

**Afghanistan's fiscal deficit is expected to narrow to 0.7 percent in FY2024-25, with the ITA targeting a balanced budget by FY2025-26 and FY2026-27.** Despite improved revenue collection, particularly from non-tax revenues, fiscal constraints will remain a significant challenge. Revenue collection increased by 11 percent in the first four months of FY2024-25, driven by higher non-tax revenues, but customs revenue declined due to lower coal export taxes and import duties. Given Afghanistan's limited borrowing capacity and reliance on revenue increases to fund expenditures, the ITA will need to make difficult choices to manage its fiscal position. Public spending is expected to rise in line with revenue gains, with little room for discretionary spending beyond essential services. As the Interim Taliban Administration (ITA) attempts to raise spending, fiscal flexibility will be limited, especially if domestic resources continue to dwindle.

**Figure 28: Contribution to growth by production factors**

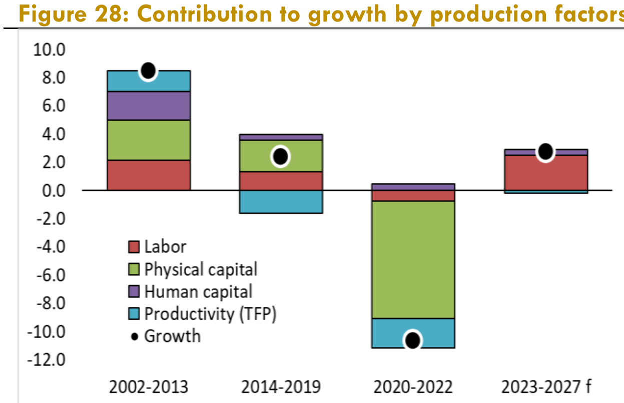
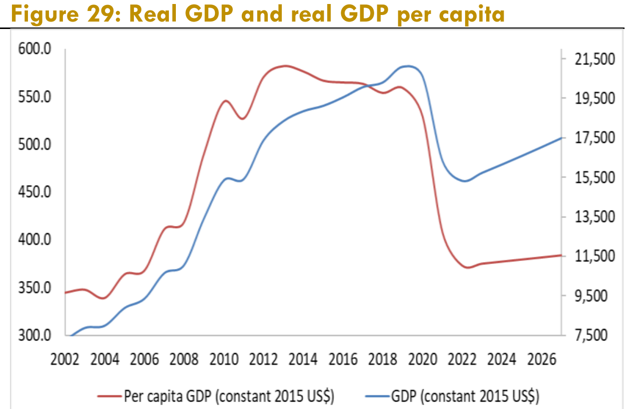



**Figure 29: Real GDP and real GDP per capita**




*Source:* Da Bank of Afghanistan (DAB).

Tax policy measures remain ad hoc, sending mixed signals. On August 27, 2024, the ITA's Revenue and Customs Administration reduced taxes in some sectors: restaurant and hotel profits below AFN 750,000 per quarter were taxed at 2 percent (down from 5 percent), and the petrol tax at pump stations dropped to 0.3 percent per liter. Refined coal exports and machinery parts also saw tariff reductions from 5 percent to 1 percent. Meanwhile, tariffs on several imported goods rose: chocolate, biscuits, cake, and cookies to 30 percent; bran flour to 8 percent; jelly to 12 percent; fans to 6.5 percent; and milk, pasta, and eggs to 30 percent, 20 percent, and 16 percent, respectively. Construction materials like Isogam and Alkoban, as well as notebooks, chips, cleaning paper, and coolers, saw tariff increases ranging from 10 percent to 60 percent.

**Afghanistan's economic outlook faces major risks.** The primary risk to Afghanistan's economic outlook is policy uncertainty. Continued uncertainty and lack of international recognition of the ITA weaken investor confidence, hamper long-term planning, and limit access to foreign aid and investment. Without stable governance, it is unlikely that the economy can recover robustly, and foreign investors will remain reluctant to engage with the Afghan market. Afghanistan's isolation on the global stage severely limits its access to trade, investment, and financial markets. As the ITA is not recognized by key nations, its ability to negotiate trade deals, secure foreign direct investment, or tap into international financial institutions is limited. As a result, the country's economic recovery is constrained by a lack of international support. The agriculture sector, despite being a key driver of growth, remains highly vulnerable to climate change, drought, and conflict. These risks threaten food security, disrupt supply chains, and undermine the sector's long-term sustainability. Additionally, persistent challenges in infrastructure, water management, and rural development continue to impede agricultural productivity.

**To navigate these challenges, Afghanistan's policymakers must prioritize improving the overall business environment, diversifying exports, strengthening agriculture.** Reforms aimed at reducing regulatory barriers, improving property rights, and enhancing access to finance will be critical to attracting investment and fostering private sector growth. Efforts should focus on expanding Afghanistan's export base beyond traditional commodities like coal and agricultural products. Developing sectors such as textiles, mining, and manufacturing could help reduce the trade deficit and create more sustainable growth opportunities. Given the importance of agriculture to the Afghan economy, investments in irrigation, modern farming techniques, and climate resilience will be essential to sustaining this critical sector.

**Human capital development and social protection are critical for Afghanistan's long-term economic recovery and stability.** These areas are particularly vital given the country's youthful population, widespread poverty, and vulnerability to shocks such as conflict, natural disasters, and policy uncertainty. Education is a fundamental pillar of human capital, yet Afghanistan has one of the lowest literacy and education attainment rates in the world, especially for women and girls. This presents a major obstacle to improving productivity, innovation, and long-term growth. One of the most pressing challenges in Afghanistan's education system is the gender gap. Restrictions on girls' education, especially at secondary and tertiary levels, have severe long-term economic implications. Studies show that improving female education leads to higher productivity, better health outcomes, and stronger economic growth. Policies that aim to re-open schools for girls and expand access to education for both genders are critical.

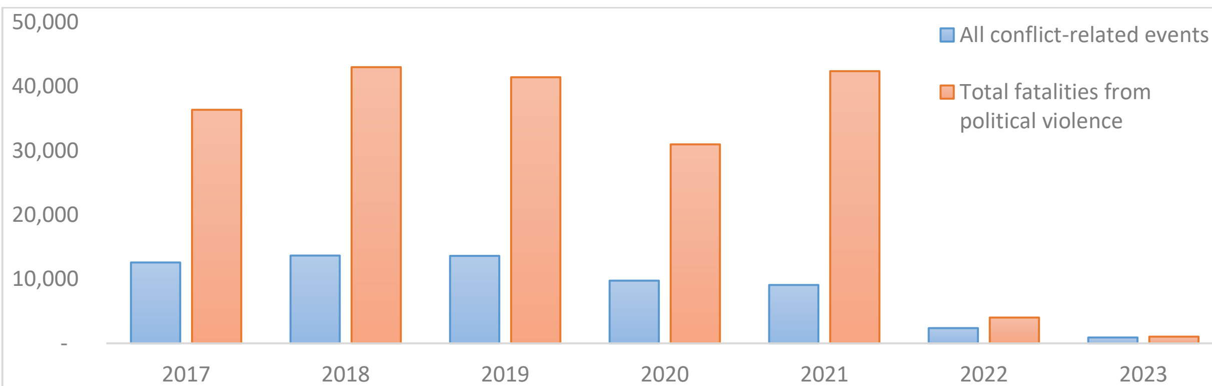
**A healthy workforce is essential for economic growth and productivity.** Afghanistan faces substantial health challenges, including malnutrition, maternal and child mortality, and inadequate healthcare infrastructure. Afghanistan's high levels of malnutrition, particularly among children, severely hinder human capital development. Malnutrition leads to stunting, lower cognitive development, and reduced productivity later in life. Addressing food insecurity through improved agricultural productivity, food distribution systems, and nutrition programs should be a priority.

**Social protection systems are critical to reducing vulnerability, managing risks, and fostering resilience among Afghanistan's population.** In a country with widespread poverty, food insecurity, and exposure to natural disasters, an effective social protection system can act as a buffer, preventing households from falling into extreme poverty during crises. Cash transfers can be an effective tool to provide immediate financial relief to the poorest households. Programs such as conditional cash transfers (linked to education or health outcomes) or unconditional transfers (for vulnerable groups like widows, the elderly, or the disabled) can play a significant role in reducing extreme poverty and improving household resilience.

# 3. SPECIAL FOCUS – THE AFGHAN ECONOMY POST-TALIBAN TAKEOVER: INSIGHTS FROM NIGHT-TIME LIGHT DATA

**The Afghan economy has undergone substantial changes since the Taliban takeover, and the analysis of night-time light data can provide useful insights into the most recent patterns of economic activity.** On the one hand, the scale and composition of international aid changed, with international spending in the security sector – which in 2020 constituted up to 60 percent of international assistance - going to zero, and civilian aid, primarily in the form of humanitarian assistance, moving off-budget. On the other hand, with the Taliban gaining control of the country, the security situation has substantially improved, possibly benefiting areas and activities previously most affected by the conflict (Figure 30). Given current data limitations, the analysis of night-time light data can provide useful insights into current economic dynamics both at the national and sub-national levels.[6]

**Figure 30: Conflict intensity**




Source: Author's calculation using ACLED data.

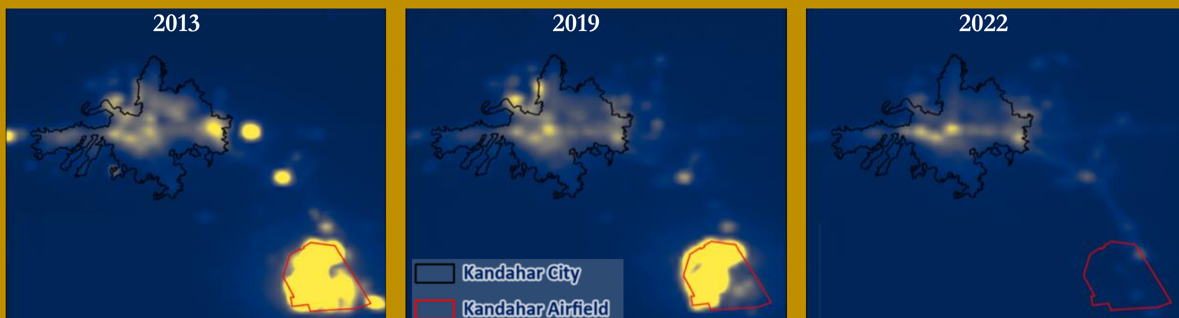
**In Afghanistan, international military bases were an important source of radiance, and "civilian" night-time lights can provide a better proxy for assessing the temporal and spatial evolution of local economic activity.** At its height in 2013, military bases accounted for about 30 percent of all the night light captured by satellites in Afghanistan. While the presence of military bases might have undoubtedly contributed to stimulating the local economy, the radiance directly emitted by military bases was related to conflict dynamics, driven by security spending, and – ultimately – bound to disappear with the withdrawal of international forces in August 2021 (Box 3). Overall, failing to consider the distinct temporal and spatial dynamics of civilian and military radiance emissions leads to an imprecise account of the baseline against which to assess the current patterns of local economic activity in the country.

[6] The relationship between night-time light data and economic activity has been well-established in the literature (Henderson et al., 2012; Donaldson & Storeygard, 2016; Gibson et al., 2020, among others). A primary advantage of nighttime lights is that they provide an independent and consistent benchmark of economic activity (Pinkovskiya & Sala-i-Martin 2016), and their relationship with economic activity is independent of potential measuring concerns about the GDP (Martinez, 2022).

**Box 2: Why is it important to filter-out lights from military bases?**

The importance of filtering our radiance from military bases is well represented by the luminosity trends of the city of Kandahar and the nearby military airfield (Figure 24). In 2013, the brightness of the military airfield rivaled that of the city, which possibly also benefited from its economic spillovers. In 2022, the airfield had completely shut off following the military withdrawal. Consequently, not accounting for the luminosity originating from the airfield leads to a significant overestimation of the level of local economic activity in the broader Kandahar areas before 2021. Similarly, the size of the local economy's contraction following the regime change will also be overestimated since most of the reduction in light emissions was caused by a pre-planned shutdown of the military airfield.

**Figure 31: Comparing lights from Kandahar city with the Kandahar Airfield.**




Source: Barriga-Cabanillas et al. (2024). Note: The figure displays how the lights from Kandahar Airfield compared with the lights produced by civilian activities around the city proper. The red polygon indicates the airfield, while the black boundaries are the Kandahar city limits.

The data series of civilian night-time lights is constructed after netting out the radiance emitted from 558 bases identified in the OSM-military dataset and other 52 bases through high-resolution satellite images.

Irrespective of the period under consideration, the civilian night-time lights series shows a strong correlation with GDP, whereas the total night-time lights series – inclusive of military installations – poorly correlates with GDP over the period 2014-2020 (Table 1)

**Table 2. Correlation GDP and nighttime lights**

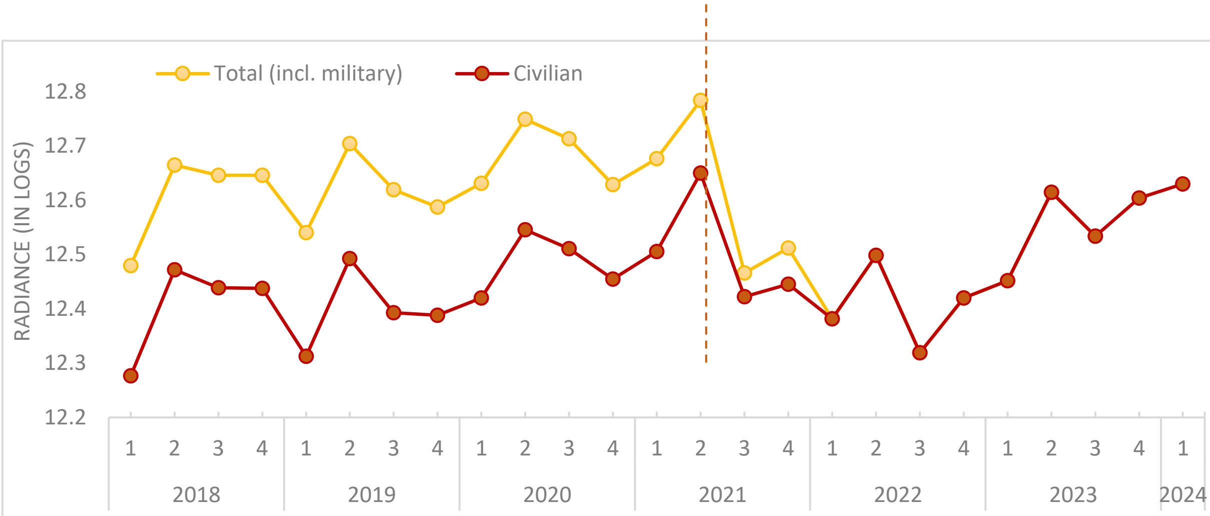
| | | |
|---|---|---|
| Nighttime lights | **Panel a. 2003-2013** | |
| | Total radiance (incl. military lights) | 0.95 |
| | Civilian lights | 0.94 |
| | **Panel b. 2014-2020** | |
| | Total radiance (incl. military lights) | 0.07 |
| | Civilian lights | 0.75 |
| | **Panel c. 2003-2020** | |
| | Total radiance (incl. military lights) | 0.95 |
| | Civilian lights | 0.97 |

Note: Total radiance includes military lights.

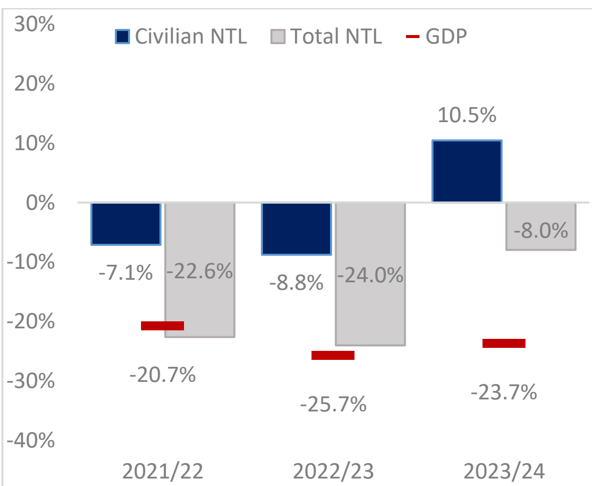
**Trends in civilian night-time lights indicate a smaller shock to local economic activity and a larger extent of economic recovery since the Taliban takeover.** To the extent that the series of civilian nightlight data provides a better proxy for local economic activity, the analysis of trends in civilian lights also indicates a different magnitude of the shock that the Taliban takeover and the extent of the economic recovery that followed (Figure 32). Between 2020 and 2021, the decline in local economic activity captured through the analysis of civilian night-time lights is 7.1 percent, against a contraction of approximately 22.6 percent captured in total night-time lights and a 20.7 percent contraction in GDP. Moreover, as of 2023, the level of economic activity captured through night-time lights is 10.5 percent higher compared to the civilian lights baseline in 2020, possibly reflecting a stronger recovery in local economic activity compared to the one reflected in official GDP estimates.

**Figure 32: Evolution of nighttime and real GDP.**

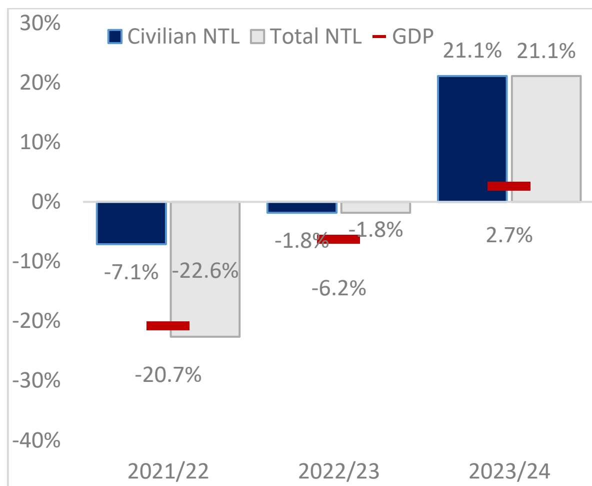
**Panel a. Relative reduction in nighttime lights: Civilian and total luminosity**




**Panel b. Levels relative to 2020/21**




**Panel c. Year-on-year growth**



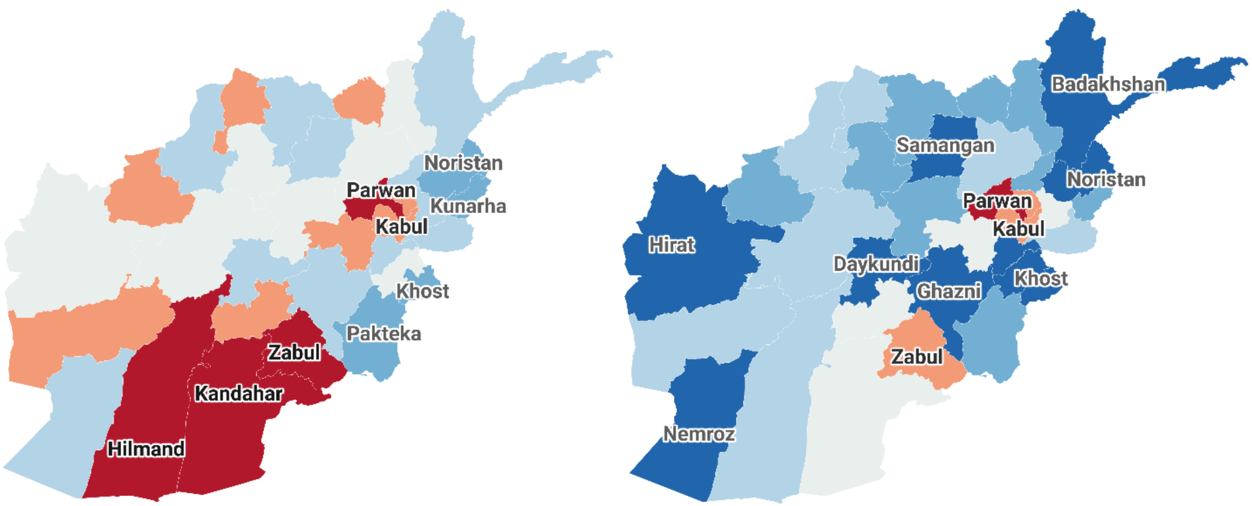

Source: Barriga-Cabanillas et al. (2024). Note: Vertical line indicates the change in the political regime. GDP calculated on a solar calendar. To capture the regime change shock, luminosity growth rates use only last three quarters of the solar year; conclusions remain if full solar year is used.

**The extent of the shock that accompanied the political transition in 2021 was the highest in areas most dependent on conflict-related economic activities and aid.** In 2021, the reduction in civilian lights concentrated in the provinces around Kabul and in the South (Kandahar, Helmand and Zabul). In these areas, civilian luminosity fell by more than 15 percent compared with their 2020 level, which is aligned with the significant military presence in those provinces. Meanwhile, large areas of Afghanistan experienced no significant change in civilian lights, with some even displaying marginal increases (Figure 33a).

**The no-conflict dividend and the extent of economic recovery has not benefited Afghan provinces equally.** The level of local economic activity captured by night-time lights in 2023 was higher compared to the civilian lights baseline of 2020 in most provinces, but the increment was particularly pronounced in Khost (63.4 percent), and in Hirat, Nemroz and Badakhshan and Noristan (about 38 percent). The marked exceptions are Parwan, where civilian luminosity in 2023 is 43.3 percent lower than two years prior; the provinces of Kapisa and Zabul, with a luminosity about 11 percent lower; and Kabul, where civilian lights emitted 8.1 percent less radiance in 2023 compared to 2020 (Figure 33b).7

**Figure 33: Change in civilian nighttime lights relative to 2020.**

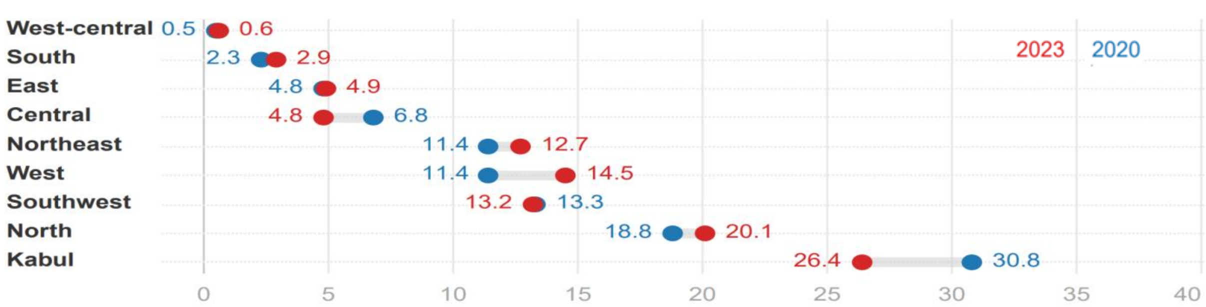
**Panel a. 2021** **Panel b. 2023**




Source: Barriga-Cabanillas et al (2024). Note: Selected provinces names displayed.

**The combined effect of differences in the impact of the political transition in 2021 shock and in the extent of economic recovery have determined a change in the spatial distribution of economic activity in Afghanistan.** This result, we argue, is linked to the no-conflict dividend and the emergence of new economic activities in areas previously more affected by the conflict. In particular, while Kabul remains the country's main contributor to the country's overall level of economic activity (26 percent of total civilian lights in 2023), its share fell by 14 percent compared to 2020. The opposite situation occurred in the northern and western regions of the country, which increased their contribution to total economic activity during the period (Figure 34).

**Figure 34: Regional civilian lights (% of National)**




Source: Barriga-Cabanillas et al (2024).

7 In the case of Parwan, it is important to consider that 75 percent of all the nighttime lights in the province during 2020 were produces by military installations. Making that the economic impact of the military withdrawal was highest.

**The analysis of night-time lights data underscores the importance of updating Afghanistan's system of National Accounts.** The current system of national accounts uses 2016 as the base year and input surveys dating back to 2011-2014, a period when aid-driven economic activity favored service sector expansion in urban areas and conflict limited investments and economic development, especially in rural areas. In particular, estimates of economic output would require a new sampling frame to capture sectoral shifts, the latest spatial distribution of activity, and the significant increases in the informal sector.

# REFERENCES


Barriga Cabanillas, Oscar Eduardo; Kosmidou-Bradley, Walker Turnbull; Redaelli, Silvia; Tateishi, Eigo; Teruggi, Ivo. *Afghanistan's New Economic Landscape: Using Nighttime Lights to Understand the Civilian Economy after 2021.* Policy Research working paper; Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/099256511062426629/IDU1f7011ce815ecb1494d1a0e61042efed1a409

Da Afghanistan Bank. Financial Statements for the Year Ending March 2023. Kabul: Da Afghanistan Bank, 2023.

Donaldson, D. and Storeygard, A. (2016). The view from above: Applications of satellite data in economics. Journal of Economic Perspectives, 30(4), pp.171-198.

Gibson, J., Olivia, S. & Boe-Gibson, G. (2020). Night lights in economics: Sources and uses. Journal of Economic Surveys, 34(5), 955–980.

Henderson, J.V., Storeygard, A. and Weil, D.N., (2012). Measuring economic growth from outer space. American Economic Review, 102(2), 994–1028.

James Windle. (2013). A Very Gradual Suppression: A History of Turkish Opium Controls, 1933-1974. European Journal of Criminology.

Spain, James W. "The United States, Turkey and the Poppy." *Middle East Journal*, vol. 29, no. 3, Summer 1975, pp. 295-309. Middle East Institute.

Martinez, L.R., (2022). How much should we trust the dictator's GDP growth estimates? Journal of Political Economy, 130(10), pp.2731-2769.

National Statistics and Information Authority (NSIA). Afghanistan Statistical Yearbook 2023/24. Kabul: NSIA, 2024.

Pinkovskiy, M. and Sala-i-Martin, X., (2016). Lights, camera… income! Illuminating the national accounts-household surveys debate. The Quarterly Journal of Economics, 131(2), pp.579-631.

Special Inspector General for Afghanistan Reconstruction (SIGAR). *U.S. Currency Shipments to Afghanistan: UN Shipments Stabilized the Afghan Economy but Benefit the Taliban. SIGAR 24-32 Evaluation Report.* Arlington, VA: SIGAR, July 2024.

United Nations Office on Drugs and Crime (UNODC). *Afghanistan Opium Survey*. UNODC Research Brief, November 2023.

United Nations Office on Drugs and Crime (UNODC). *Opium Poppy Cultivation in the Golden Triangle.* October 2006.

Windle, J. (2012). "Insights for Contemporary Drug Policy: A Historical Account of Opium Control in India and Pakistan." *Asian Journal of Criminology*, vol. 7, no. 1, pp. 55-74. Pre-print copy.

World Bank. *Afghanistan Welfare Monitoring Survey (AWMS), Round 3*. Washington, DC: World Bank, October 2023.

World Bank. *Macro Poverty Outlook*. Washington, DC: World Bank, October 2024.

World Bank. *South Asia Development Update: When Women Work*. Washington, DC: World Bank, October 2024.