AFGHANISTAN

Afghanistan's economy grew by 2.7 percent in FY2023-24, partially recovering from a 27 percent contraction following the Taliban's takeover. Growth in agriculture, industry, and services contributed to the recovery. Humanitarian aid and inward remittances supported aggregate demand. However, the outlook remains subdued, with high downside risks due to persistent deflation, a trade deficit, and restrictive laws, particularly affecting women's rights. Afghanistan's long-term economic prospects depend on internal policy reforms and external aid.

Key conditions and challenges

Afghanistan faces numerous socio-economic challenges since the Taliban's return to power, including a sharp decline in international aid, frozen foreign reserves, persistent deflation, growing trade deficit, restrictive laws particularly affecting women's rights, and persistently low levels of human capital. Private consumption remains constrained, and nearly half of the population lives in poverty with fewer quality jobs and increased unemployment, particularly affecting youth and women. The Interim Taliban Administration (ITA) has strengthened domestic revenue mobilization efforts, but progress is insufficient to offset the reduction in external support. Afghanistan's underdeveloped infrastructure, particularly in energy and transportation, hinders industrial and commercial productivity, especially in rural areas.

Recent developments

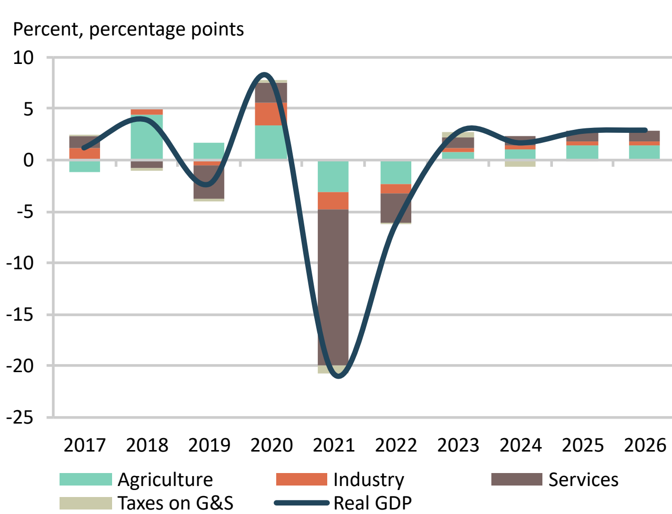
In FY2023-24, Afghanistan's GDP began to expand. Agriculture expanded by 2.1 percent and the industrial sector by 2.6 percent, supported by a halving of the business receipt tax (BRT) for industries and lower tariffs on raw and semi-raw materials. The services sector grew by 2.3 percent, with notable contributions from wholesale and retail trade and transportation. However, the education sub-sector declined by 9.4 percent, and the health and social services sub-sector declined by 3.1 percent. On the demand side, private consumption increased by 6.2 percent, with government consumption contributing modestly at 1.1 percent. However, overall growth in aggregate demand was constrained by the decline in investment and exports.

Headline inflation fell in April 2023 and remained negative throughout the Afghan fiscal year. Domestic prices declined by 7.7 percent on average in FY2023-24. Core inflation, excluding volatile food and energy prices, was also negative, falling by about 3 percent by the end of the FY in March 2024.

Declining prices, notably in food, have supported a progressive improvement in Afghan households' self-reported welfare. According to the latest estimates (Spring 2023), monetary poverty is at 48.3 percent, a 4-percentage point decline compared to the same period in 2020. Poverty in urban areas remains on an upward trend, reflecting the lack of quality job opportunities while improvement in the security situation, better access to markets, and a good agriculture season supported a decline in poverty in rural areas. Afghan households have coped with the crisis by increasing their labor supply. However, a weak labor demand has caused a doubling of unemployment and a 25 percent increase in underemployment between 2020 and 2023.

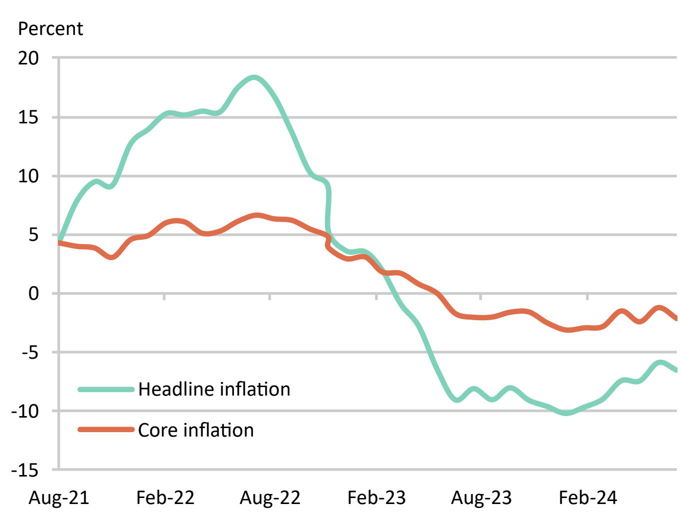
Afghan women continue to suffer the consequences of restrictive policies. Between 2022 and 2023, girls' secondary school enrollment collapsed from 14 percent to 3 percent

FIGURE 1 Afghanistan / Real GDP growth and contributions to real GDP growth



Sources: National Statistic and Information Authority (NSIA) and World Bank staff.

FIGURE 2 Afghanistan / The country is facing deflation



Sources: NSIA and World Bank staff projections.

due to the ban on secondary education. While more women have entered the labor force to support their households' livelihoods compared to 2020, limited mobility and other restrictions largely reduce their employment opportunities to home production in the manufacturing sector. The Morality Law recently promulgated, if fully enforced, could further restrict women's socio-economic inclusion and the country's development prospects.

Afghanistan's current account deficit increased to 13.5 percent of GDP in FY2023-24, driven by a growing trade deficit and declining foreign aid. Despite increased remittance inflows, total income from abroad declined by approximately two percentage points of GDP, falling to 33.7 percent. Financing the current account deficit has been challenging due to limited foreign direct investment and limited borrowing capacity.

Despite improvements in domestic revenue mobilization, the fiscal deficit (cash-basis) widened to 1.4 percent of GDP in FY2023-24. Operating expenditures increased by 0.3 percentage points to 15.6 percent of GDP, while development expenditures grew from 0.8 percent of GDP in FY2022-23 to 1.3 percent in FY2023-24. The fiscal deficit was potentially financed by a reduction in deposits at the central bank.

Outlook

Economic activity is expected to grow modestly over the medium term, averaging 2.75 percent annually from 2024 to 2026, with agriculture growing faster than the rest of the economy Domestic prices are expected to stabilize in the second half of FY2023-24, with inflation turning positive.

With projected GDP growth barely at par with that of the population, per capita GDP is expected to stagnate and poverty to remain above 40 percent. Moreover, vulnerability to falling into poverty because of shocks remains a concern, as does unemployment and job quality challenges.

The current account deficit in Afghanistan is projected to increase to 17.7 percent of GDP in the forecast period, up from 13.5 percent in FY2023-24 driven by a high trade deficit accounting for 40 percent of GDP. Exports of goods and services are expected to decline by two percentage points, stabilizing around 10 percent of GDP, while imports are expected to slightly exceed 50 percent of GDP. Total income from abroad is expected to decline to around 22 percent of GDP, and financing of the current account deficit will remain a challenge, even more so in a context of declining aid.

The fiscal deficit is expected to narrow to 0.7 percent in FY2024-25, with a balanced budget projected for FY2025-26 and FY2026-27. Revenue collection has improved during the first four months of FY2024-25, totaling AFN 69.7 billion, marking an 11 percent increase from the previous year, primarily driven by higher non-tax revenues. With borrowing constraints, the revenue increase is expected to be matched by a corresponding rise in expenditure.

Afghanistan's economic outlook faces major risks, including political instability that weakens investor confidence and long-term planning. The country's isolation and lack of international recognition limit access to foreign aid, investment, and trade, slowing its economic recovery. A high current account deficit strains foreign reserves, and with limited financial options, the central bank struggles to manage currency stability, which could lead to inflation. The ITA relies heavily on customs duties and non-tax revenues but falling exports and lower tax income make it harder to balance the budget. The agriculture sector, which provides a livelihood for 40 percent of the population, remains vulnerable to climate change and weather shocks, leading to potentially severe impacts on poverty and food security.