

WEEKLY ANALYSIS

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THE CURRENT STATE AND OUTLOOK FOR AFGHANISTAN'S BANKING SECTOR



Weekly Analysis is one of the CSRS publications analyzing significant weekly political, social, economic, and security events in Afghanistan and the region. The prime motive behind this is to provide strategic insights and policy solutions to decision-making institutions and individuals in order to help them design better policies. Weekly Analysis is published in Pashto, Dari, English and Arabic languages.

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THE CURRENT STATE AND OUTLOOK FOR AFGHANISTAN'S BANKING SECTOR

INTRODUCTION

The fall of Republic in 2021 had huge consequences for the people of Afghanistan. . The economy was severely damaged since billions of aid dollars were abruptly cut off thousands of development projects were suspended or terminated. As a result, thousands of people lost their jobs, which caused decreasing revenues and savings in the country.

On the other hand, there has been a shortage of dollars, which were used as reserves to support the value of the domestic currency. As a result, by the end of 2021, the value of the Afghani was falling, which resulted in rising prices for goods. After the government fell, individuals flocked to the banks to withdraw their deposits, but because the banks were unable to refund all of their customers' accounts, the banking industry was forced to deal with severe liquidity issues. The international sanctions on the Afghan banks and the economy increased the severity of the crisis, leading to growing poverty and the emigration of thousands of Afghans.

The banking sector, as a stimulus of economic activities of the country, was seriously damaged by the economic crisis and disservice of banks until it stood on the verge of collapse. If the caretaker government had not taken the clever actions of combating smugglers and extortionists, monitoring and imposing restrictions on withdrawals from bank deposits, and if the humanitarian aid from the United Nations had not arrived, the banking sector and the economy would have completely collapsed.

This analysis, with a brief overview of the state of the banking sector before the political developments of 2021 and the current state of the banking sector in Afghanistan, examined and



analyzed possible future scenarios and recently provided solutions to improve the current state of the country's banking .

AFGHANISTAN'S BANKING SECTOR PRIOR TO THE 2021'S POLITICAL TRANSITION

The Central Bank of Afghanistan was established in 1939. After 2001, the banking sector grew significantly through private investments. Dozens of local banks and branches of foreign banks began operating in the country. According to statistics provided by the Afghan Banking Association, 12 banks were active in Afghanistan in the second quarter of 2021 including three state-owned banks, seven private banks and two branches of international banks. Overall, these banks had a total of 413 branches across the country.

The total capital of the banking sector amounted AFN 313.4 billion, deposits amounted AFN 259.3 billion and the amount of executed credits was AFN 37.2 billion. The total number of bank accounts at the second quarter of 2021 reached to 4.603 million.

However, the banking sector's activities over the past two decades have been associated with many ifs and buts. Afghanistan's largest private bank filed bankruptcy in 2010, while its total debts were reaching \$1,179 million. Factors that contributed to the collapse of Kabul Bank included intervention of foreigners, Americans in particular, political and economic mafia, unhealthy competition between private banks, war and insecurity, false economic policies of the bank, the illegal withdrawal of millions of dollars by shareholders and a lack of sound management of the Central Bank of Afghanistan.

Also, poor banking practices, shaky political and security conditions, and state interference in the banking sector, have historically posed challenges for the sector.

THE BANKING SECTOR AFTER THE FALL OF THE REPUBLIC

Previously, Afghanistan was receiving \$4 billion annually from the international community, and nearly the same amount was spent by international organizations operating in Afghanistan. The aids were halted by the donor nations following the Islamic Emirate take over, which were



often channeled through Afghan banks, leading to a lack of cash and liquidity issue. This shook the entire economy and prevented the public and private banks to access their reserves and interact with international financial institutions.

Situation got complicated when ordinary Afghans rushed to the banks to withdraw their money. This was so serious that prompted the Central Bank of Afghanistan to enact a policy of constraints on the withdrawal of bank deposits. Despite the central bank's constraints on bank withdrawals, people are still trying to withdraw money from their accounts as possible.

Less people are willing to keep their money in the banks for a variety of reasons, including recent political changes and a decline in confidence and trust in banks. Additionally, the banks' liquidity has decreased as a result of this. National banks have also lost the respect and confidence of multinational banks. As it turns out, even once sanctions are lifted, Western banks will not be eager to conduct straightforward financial transactions with Afghan institutions. Through commission, lending, investing, and giving consumers credit, banks make money and fund their expenses. The closure of some bank branches in the country supports this assertion. The reduction in liquidity caused by sanctions and the separation of banks in the country has significantly reduced the banks' income sources and brought them to the point where they are currently unable to cover even their own expenses. Over the past two decades, banks in Afghanistan have not acted professionally in making investment portfolios. On the one hand, they made a large part of their investments abroad, which became impossible to get access after banking sanctions were imposed, and on the other hand, in their domestic investments, less foresight and the possibility of different political scenarios were considered.

For example, banks in Afghanistan had paid more attention to investing in real estate and securities while there were opportunities in the country to invest in important areas such as mines and agriculture. With the drop in property prices and the slackness of the home market and apartments, the banks faced serious problems. As statistics from the Afghan Banking Association by the end of the second quarter of 2021 show that the total amount of loans provided by the banks is AFN 37.2 billion to building , manufacturing and industry, construction



projects, trade and services, including 2.99 billion, 4.1 billion, 2.96 billion, 14 billion, 10.3 billion AFN, respectively. So far, no country in the world has recognized the Islamic Emirate of Afghanistan. In addition to political problems, this has prevented Afghanistan from dealing economically with other countries.

The reduction of economic activities also causes economic problems for the banks, because in most cases, on the one hand, money from trade transactions is transferred through banks, and on the other hand, trade with other countries improves the economic situation, which in turn increases people's savings. It is natural that normally people keep their extra money in banks, which causes to increasing liquidity of banks.

Considering the challenges mentioned above, unfortunately, at the moment, banks in Afghanistan are not in good condition, although after the upheavals, statistics by the Central Bank or the Union of Banks of Afghanistan has not been published, but by reviewing financial statements of banks in the country it can be realized that the banks are not in good condition. The number of deposits of banks is often declining, although its downward trend is lower as compared to the first six months ruling of the Islamic Emirate. But on the other hand, due to economic problems, banks are not able to collect their dues from debtors and, as noted, their revenues have decreased greatly compared to the past.

Afghanistan's economy, particularly the banking sector, has been strengthened by the monetary infusion of UN humanitarian aid, government policies in support of the banking sector, the relative reduction of banking sanctions and increasing relations with the acting government. The banking sector is strengthening day by day and the activities of the sector are becoming normal. A package of humanitarian aid worth \$40 million dollars arrives in Afghanistan each week and so far, more than \$1.7 billion from this address has been imported into the country's economic cycle through banks.

These packages of humanitarian aid in cash, on the one hand, have saved the country's economy as a whole and the Afghanistan banking system in particular, and on the other hand, has resulted in relative control of Afghani prices, as well as Afghanistan's economic activities.



FUTURE OF THE BANKING SECTOR

The future of banking sector in Afghanistan depends on how the world deal with the Islamic Emirate of Afghanistan. Three scenarios could be predicted:

If the situation moves forward in a way that leads to the recognition of the current government or at least deal more freely with Afghanistan, then the banking situation will also get better. Because on the one hand, the economic situation in general will get better which will affect positively on banking activities, and on the other hand, banks will have access to their reserves and investments with the Central Bank of Afghanistan, and in the long run the credibility and trust of banks in the public will be enhanced.

In the second case, If the government and international community relations continue as it is , the banks will continue their operations in a half-life manner provided that be able to finance their expenditures.

In the third case, if Afghanistan's relations with the world deteriorate further, then with more probability, economic sanctions will be one of the most effective options for the international community to impose pressure on the Islamic Emirate of Afghanistan. Any economic pressure on Afghanistan will have a negative impact on the banking sector, which will further undermine the banking industry and could even cause a complete collapse of the banking system.

RECOMMENDATIONS

Considering the above-mentioned issues to solve the problems of the banking sector the following solutions are suggested.

1. The most important factor for surviving banks currently is package of humanitarian aid in cash which is provided by UN, so that the Islamic Emirate should try to increase it and seek new sources of such aids in addition to continuing with this existing source.
2. Afghanistan is currently in global isolation, improving Afghanistan's relations with the world, positively affecting the country's economy as a whole, and banking sector in particular. Therefore, it is required seriously that the Islamic Emirate of Afghanistan make serious efforts ,by using appropriate flexibility and diplomacy in this regard.
3. The government should implement accurate and comprehensive programs to improve the credibility of banks in public by implement these programs through trustworthy and



expert persons specialty , when they are trying to change banking system from conventional to Islamic banking system.

4. People's trust in government, providing security, planning and implementation of major economic projects, attracting investments in domestic and foreign sectors and so on are the factors lead to moving economic cycles of the country, which directly and positively affect the banking sector in the country. It is needed that the Islamic Emirate take appropriate strategies in this regard
5. It is recommended that Islamic Emirate cooperates seriously with banks, in the collection of debts, which are overdue and act more strictly in this regard if possible.
6. The government should try to release at least the amount of reserves assets of non-governmental banks through using human rights channels out of the total in frozen Afghan reserves.

CONCLUSION

Currently, the reduction of capital, liquidity and credibility of banks are counted as main problems, banking sector has involved in Afghanistan. If Afghanistan's relations with the world, including the United States improve, it is possible to strengthen the liquidity of local banks, but the credibility of banks cannot be easily restored and it requires a lot of time.

There is no doubt that reducing liquidity in the short term is one of the serious challenges of the banks in Afghanistan, but in the long run, the challenge of reducing banks' creditability among the public and other financial institutions is bigger than decreasing liquidity , because it is the deposits and transactions of people through banks that drive the cycle of banking operations.

In short, banks in Afghanistan cannot operate significantly without global support, whether in the area of increasing liquidity and income or in the field of creditability restoration. For this reason, the Islamic Emirate of Afghanistan needs to pay more attention to strengthening relations with the international community as a rooted issue in order to solve the problems of banks and other economic activities.



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