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# COVID-19 PANDEMIC IN THE SAARC COUNTRIES: POLICY RESPONSES AND ITS IMPACT

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## Introduction

Afghanistan reported its first COVID-19 case on February 24, 2020. As the infection spread, the government tightened containment measures, including introducing screening at ports of entry, quarantine for infected people, and closure of public places for gathering. It imposed countrywide lockdown in late March 2020, which was subsequently extended twice.

COVID-19 outbreak and the subsequent restriction measures pushed the economy of Afghanistan into recession. The economic activities began to slowdown in early 2020 and exacerbated further when Afghan government imposed nation-wide lockdown in March in an attempt to contain the outbreak. The declining trend of economic activities in Afghanistan which started in early 2020 remained persistent through-out the second quarter with the worst impact on the livelihoods of the vulnerable and poor population of the country, resulting in unprecedented increases in unemployment and poverty.

Afghanistan GDP growth showed downward trend at the end of 2020 and economic growth was lower as compared to 2019. A downward trend in agriculture sector and also weak performance by services and industry sectors caused the economic growth to turn down to -1.9<sup>1</sup> percent in 2020 which shows significant decrease from 3.9 percent in 2019. The year-on-year measurement changes in the consumer price index showed an inflationary trend of 5.6<sup>2</sup> percent on average in 2020, higher than 2.31% recorded in previous year. The trade deficit improved despite reduction in merchandise imports and due to slowdown of economic activities the exports was decline during 2020. Based on data, the Reserve Money (RM) had positive growth and net International Reserve (NIR) shows accumulation in fiscal year 2020 which indicates 5 percent increase. National currency appreciated against major foreign currencies and the appreciation rate against U.S. dollars was 2.12 percent. Budget deficit was severing due to effect of COVID-19 outbreak both on expenditure and mostly revenue generation, while the banking sector, unlike the other sectors, performed well regardless of the COVID-19 pandemic. Main financial indicators such as total assets including cash in vault and claims on DAB, investments in bonds, deposits and financial

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<sup>1</sup> Annual Economic Bulletin FY (2020)

<sup>2</sup> Annual Economic Bulletin FY (2020)

capital increased while loans and interbank claims had a decreasing trend. The banking sector was profitable though the profit decreased since Dec, 2019 and loan quality remained weak.

### **Da Afghanistan Bank and Monetary policy role in combating against the pandemic:**

Central bank responses to COVID-19 have been extraordinary in speed, in size and in scope. Much easier monetary policy, massive liquidity provision, and targeted credit support to the real economy all played a role in stabilizing financial conditions and credit. DAB as central bank of Afghanistan played a major role during COVID-19 pandemic, there have been no liquidity pressures in part thanks to Da Afghanistan Bank (DAB)'s actions to maintain confidence in the Afghani and high liquidity in the banking sector. The authorities increased the frequency of Financial Stability Committee meetings, enhanced the monitoring of early signs of liquidity stress, and reviewed banks' business continuity plans. DAB postponed the IFRS 9 implementation to June 2021, subsequently by another year to June 2022, and froze loan classifications at the pre-pandemic cutoff of End-February. It also suspended administrative penalties and fees, with no retrospective applications for breaches/noncompliance. DAB phased out emergency pandemic measures in July. It ended the freeze on loan classifications and recommenced the enforcement of all prudential requirements in August with flexible application of penalties and prudential triggers in recognition of persisting risks. The emergency measures for the nonbank sector were allowed to expire at End-July. DAB remains focused on achieving price stability in the context of a flexible exchange rate regime. With domestic demand subdued the Afghani has remained broadly stable against the US\$. DAB has engaged money-service providers, who play a systemic role in financial intermediation, to ensure uninterrupted services.

### **Afghanistan Fiscal measure to combat against Covid-19 pandemic:**

The government initially used contingency funds for emergency pandemic response, including for urgent health needs, such as establishing testing labs; setting up special wards to boost hospitalization and care capacity; and procuring critical medical supplies.

In April-June 2020, the government provided free bread to the poor in Kabul, later extended to other cities. In May, it waived electricity bills of less than Af 1,000 (US\$13) for a family residence

in Kabul for two months and paid utility bills of the past two months for 50 percent of households in Kabul. The decision benefited more than 1.5 million Kabul residents (IMF).

The authorities rolled out about 0.8 percent of GDP social assistance under the World Bank-funded REACH program in 2020, with the remaining 0.6 percent of GDP continuing in 2021. The program targets Afghan households with incomes of \$2 per day or lower (twice the national poverty line), with households in rural areas receiving an equivalent of \$50 in essential food staples and hygiene products, while those in urban areas a combination of cash and in-kind equivalent to \$100, in two tranches. Altogether, the authorities spent about 2.2 percent of GDP to Fight in 2020 including: health package of around Af 10.9 billion of which Af 2.6 billion of building hospitals and provincial clinics; the social package of around Af 14.7 billion, of which Af 2 billion on the bread distribution program and Af 12.7 billion on the World bank Supported social distribution program, transfers to provinces to finance COVID-19 response of about Af 1.3 billion; support to agriculture and short-term jobs of about Af 5.2 billion and Af 1.0 billion.

Similarly, the 2021 budget includes the Following COVID-19-related spending health package of Af 2.4 billion, social package of Af 8.9 billion; other Af 3.3 billion. Recognizing that taxpayers were facing liquidity strains, the government extended the tax filing deadline for the first quarter of 2020 by 45 days. No further extensions have been provided. In late 2020, the government offered to waive tax and customs payment penalties if taxpayers clear their due taxes before the end of the first quarter 2021<sup>3</sup>.

### **DAB Supportive schemes and incentives provided during Covid-19:**

Overall the banking sector performed well during 2020 despite the COVID-19 pandemic, rendering necessary services to the public. No liquidity short fall was noticed in any of the banks and their capital positions remained within the regulatory threshold. Main financial indicators such as total assets including cash in vault and claims on DAB, investments in bonds, deposits and

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<sup>3</sup> <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>

financial capital increased while loans and interbank claims had a decreasing trend. The banking sector was profitable though the profit decreased since Dec, 2019 and loan quality remained weak.

Given the spread of the pandemic, in the coming months, the banking sector may experience more Non-Performing Loans (NPLs), high provisions which will lead to lower profitability, capital, and financial ratios. Therefore, banks have to opt for more precautionary measures to cope with the expected financial downturn. DAB has issued an incentive package (the Post C19 Plan) that covers the expansion of banking activities, disbursement of new credit facilities, cost reduction measures including suspension of dividend payments in 2020, electronic reporting option, renewal of loans, relaxation in loan classification and risk weighting of loans guaranteed by the third parties such as ACGF, IFC, USAID etc.

Da Afghanistan Bank (DAB), as the central bank of Afghanistan, is responsible for regulating and supervising the financial system, particularly the banking system of Afghanistan. Strong legal framework and organizational/institutional arrangements would ease the implementation of policies and help the ruling authorities sustain efficient financial market. DAB has issued the following Supportive schemes and incentives during COVID-19 in 2020:

a. . Reserve Requirements of the Commercial Banks According to CAMEL Rating

Recently, commercial banks were asked by DAB to maintain their required reserves in accordance to the CAMEL Rating. It is worth mentioning that the Banking supervision department of DAB assigns a specific rate to a commercial bank based on CAMEL rating after carrying out risk assessment and supervision of the commercial bank. The commercial banks, to which No. 1 ratings are assigned, indicate the best performance while the commercial banks that fall into No. 5 rating, show poor performance.

The following table shows the required reserves rates of the commercial banks in accordance to the CAMEL rating:

Table 1: Reserve Requirements of the Commercial Banks According to CAMEL Rating

Required Reserve Rates of the Commercial Banks in Accordance with the CAMEL Rating					
CAMEL Rating	1	2	3	4	5
RR Rates of the U.S. Dollar deposit	8%	9%	10%	12%	14%
RR Rates of the Afghani Deposits	6%	7%	8%	10%	12%

According to the Banking Law of Afghanistan, DAB can increase the reserves requirements after risk assessment and considering the overall performance of commercial banks.

- b. . Interest rate increases from 0.1% to 0.5 on commercial's banks overnight deposits

Since March 20, 2006, Da Afghanistan Bank has been using standing facilities (most often the deposit facilities) as primary tool to control short-term liquidity. As the financial system of Afghanistan was not well developed, commercial banks became reluctant to conduct interbank transactions. In addition, banks were not willing to use interbank transactions at undesirable costs-interest rate. Thus, they initiated using central bank's standing facilities, which allowed them to place their excess liquidity to, and refinance their deficit from the central bank's cash under smooth conditions.

In addition, the size of interest rate on overnight deposits is also important in determining the demand for these facilities.

Supreme Council of DAB is known as highest decision-making and policy-making body of Da Afghanistan Bank. Members of Supreme Council are responsible to develop overall policies of DAB and supervise administration and its operations.

On 21 December 2020 supreme council of DAB approved the increment of interest rate on overnight deposit for all commercial banks in Afghanistan from 0.1 percent to 0.5 percent.

### C. The SMEs Support Procedure:

This procedure is prepared based on DAB supreme council and the implementation of the incentive package to SMEs approved by the High economic council. The main objectives to this procedure are to provide fiscal, monetary and structural support for SMEs, enhance support for women SMEs, provide immediate SME support as well as lay the foundation for longer-term institutional

support structures for SMEs to create a fiscal incentive committee to manage fiscal support to SMEs, to create a first-loss loan fund to provide banking support to SMEs.

### **Impact of policy measures taken by Da Afghanistan Bank:**

The pandemic continues to affect the livelihoods and economic activity in the country, and the economy is being negatively affected by subsequent restrictive measures. Intermittent border closures, subdued demand in domestic and international market left a substantial negative impact on businesses. Exports and imports witnessed a substantial decline in 2020. Based on year-on-year comparison the deficit of trade balance on BOP bases narrowed by 6% and stood at a value of USD 5,506.86 million in the FY 2020 compared with a value of USD 5,855.03 million recorded in the FY 2019. In the period under review export of goods and services dropped by 3% and reached at a value of USD 1,476.31 million in FY 2020 from a value of USD 1,515.76 million recorded in the last year. While, import of goods and services declined by 5% and stood at a value of USD 6,983.16 million in FY 2020 compared with a value of USD 7,370.79 million recorded in the last year. To combat COVID-19, Da Afghanistan Bank has taken early actions to reduce and minimize its impact on Afghan economy and the banking sector. DAB played a major role during COVID-19 pandemic, and there have been no liquidity pressures in part thanks to Da Afghanistan Bank (DAB)'s actions to maintain confidence in the Afghani and high liquidity in the banking sector. Furthermore, compared to other neighboring countries, inflation was relatively low at 5.6% in 2021.

DAB issued the first relaxation package, covering 17 points to the banking sector on 9th April, 2020. Mostly, the main aim of the package was to decrease the negative impacts of the Covid-19, assist the banks to minimize the costs and help them to continue delivering the services to the customers without delay. DAB also issued the second relaxation package in 4th August, 2020 under the name of "Post COVID-19 rehabilitation and Improvement plan of the Banking Sector". It is valid till end of 2021.

Overall the banking sector performed well during 2020 despite the COVID-19 pandemic, rendering necessary services to the public. No liquidity short fall was noticed in any of the banks and their capital positions remained within the regulatory threshold. Main financial indicators such



as total assets including cash in vault and claims on DAB, investments in bonds, deposits and financial capital increased while loans and interbank claims had a decreasing trend. The banking sector was profitable though the profit decreased since Dec, 2019 and loan quality remained weak. Nevertheless, the total assets experienced a slight fluctuation during 2020. Loan, a major component of the assets also experienced fluctuation, but as of Dec-20 comparing to Dec-19, the total gross loan of the sector experienced a slight decrease mainly due to loan repayment, settlement, recovery, charge off and USD depreciation. Furthermore, loan classification of the sector was fluctuating from one class to another mainly due to the hit of COVID-19 that led to increase of NPLs. This led to increase of credit provision in some months, from April-20, banks' profit showed decrease in profits or even experienced losses. According to a survey conducted by the BSD, MSMEs loans had more demand comparing to other types of loans, despite they were affected negatively, and corporate loans were decreased and the banks reported that the increase or decrease of the loans highly depends to the external factors and COVID-19 situation.

On the other hand, the total deposits, and total number of depositors, branches, ATMs, POS and employees of the banking sector increased in the year 2020.

Therefore, DAB played an important role in maintaining macroeconomic and financial sector stability by keeping national currency stable, inflation in single digit, banking sector stable.

### **Challenges of implementing the policy measures:**

DAB signals its monetary policy stance through adjustments in money supply in the market. Changes in money supply will impact the overall demand in the economy. To maintain its primary objective of domestic price stability, Da Afghanistan Bank has adopted a framework which is known as the Monetary Aggregate Targeting Framework. Controlling liquidity condition is highly important in the economy; hence any changes in the rate of liquidity have a direct impact on the overall economic activities in the country. Therefore, changes in liquidity rate should be consistent with the rate of economic growth as well as the demand for the national currency in the economy.

DAB focuses on achieving monetary stability by targeting monetary Aggregate-Reserve Money. At the same time, DAB also aims to ensure financial stability, particularly the smooth functioning of the banking sector and financial system of Afghanistan. The emergency measures for the

nonbank sector were allowed to expire at End-July. DAB remains focused on achieving price stability in the context of a flexible exchange rate regime. With domestic demand subdued the Afghani has remained broadly stable against the US\$. DAB has engaged money-service providers, who play a systemic role in financial intermediation, to ensure uninterrupted services. According to Afghanistan economic and financial condition, DAB has taken appropriate measure and it was successfully implemented as well.

### **Policy recommendations and way forward:**

The unprecedented health shock of the COVID-19 pandemic and its unparalleled economic repercussions have been felt worldwide, impacting most countries and simultaneously affecting demand, supply and financial conditions. In order to achieve and enhance financial stability DAB had made changes in the required reserve ratio. At the same time, DAB increased interest rate on overnight deposits to make sure that banks have enough liquidity for their demand deposits and bare their cost in this difficult time, both Banking supervision department and Non-banking supervision department have taken several measures to avoid the negative impact of COVID-19 on Financial sector. Moreover, to boost the economic growth, reduce poverty and unemployment rate in the country, DAB supreme council approved SMEs Support procedure as well.

Although the Afghan economy is import-oriented, the country imports very basic consumer goods. Due to COVID-19 outbreak, Afghanistan international borders were closed and international trade was shut down, but still DAB was able to maintain inflation in single digit. Afghani has remained broadly stable against the USD and GDP growth was contracted less than 2% percent. The data showed all measures taken by DAB were implemented effectively and the result was in favor of DAB as well, moreover GDP growth is forecasted 3% for 2021 despite political uncertainty and high rate of violence.

In April 2021, DAB also initiated the lending program for industrialists, entrepreneurs, agricultures and craftsmen by Commercial banks.

Afghanistan ministry of public health has started administering COVID-19 vaccines to all citizens above the age of 18, the health ministry designated health centers in all 34 provinces and have started vaccinating citizens with the Oxford-AstraZeneca jabs and willing to receive more doses

of vaccine from republic of china under the COVAX Facility, this will have positive impact on all economic activities and the economic activities will become normal and reach to its pre pandemic level.

As mentioned before DAB closely studying the economic and financial condition of country, we are now in the middle on third wave of pandemic and the government imposed partial lockdown, educational institutions and wedding halls are closed, employees aged 55, pregnant women and employees suffer from cancer, diabetes and blood pressure perform their jobs from home. On the other hand, if the situation gets worsen DAB is ready to take further measures to combat pandemic because experience is already built and DAB is full aware of situation and will take necessary actions accordingly.