



Da Afghanistan Bank



Economic & Statistical Bulletin

Annual, 2018

Monetary Policy Department

Da Afghanistan Bank

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Note:

Afghanistan's fiscal year has changed effective from 2012 (1391). The new fiscal year begins on December 21st each year. This bulletin analyzes economic developments during the fiscal year 2018, which covers December 21st, 2017 to December 20th, 2018.

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ABBREVIATIONS

DAB	Da Afghanistan Bank
GOA	Government of Afghanistan
FEMA	Foreign Exchange Market in Afghanistan
CPI	Consumer Price Index
NCPI	National Consumer Price Index
KCPI	Kabul Consumer Price Index
TM	Trimmed Mean
MOF	Ministry of Finance
CMEA	Ex-Soviet Trading Block
ARTF	Afghanistan Reconstruction Trust Fund
LOTFA	Law and Order Trust Fund for Afghanistan
MPD	Monetary Policy Department
GDP	Gross Domestic Product
WGP	World Gross Product
NSIA	National Statistics and Information Authority
CIS	Commonwealth of Independent States
IMF	International Monetary Fund
IDB	Islamic Development Bank
SDR	Special Drawing Rights
RM	Reserve Money
CiC	Currency in circulation
NIR	Net International Reserves
GIA	Gross International Asset
FX Auction	Foreign Exchange Auction
CNs	Capital Notes
ONDF	Overnight Deposit Facility
ONCF	Overnight Credit Facility
CA	Current Account
FA	Financial Account
FDI	Foreign Direct Investment
FSD	Financial Supervision Department
LCs	Letters of Credit
ODCs	Other Depository Corporations
ROA	Return on Assets
ROE	Return on Equity
NPL	Non-performing L



Message

From the Governor

“Da Afghanistan Bank (DAB) policies/efforts are geared towards protecting the most vulnerable segments of society by focusing on price stability -DAB’s primary mission- through implementing a sound and effective monetary policy”

EXECUTIVE SUMMARY

The global economic growth is moderating as a recovery in manufacturing and loss of steam in trade activities. Although there are ongoing negotiations between major economies, trade tensions stay eminent. These tensions, joint with concern about alleviation of the global growth projection, have considered investors' sentiment and contributed to reduce the prices of global equity. The strengthening of U.S. dollar, heightened financial market volatility, and increase risk premiums have increased the outflow of capital and currency pressures in some large EMDEs, with some vulnerable countries experiencing substantial financial stress. Overall, global growth is projected to moderate from a downwardly revised 3 percent in 2018 to 2.9 percent in 2019.

In advanced economies, economic activity has been diverging. Activity in the Euro Area has been somewhat weaker than previously expected, owing to slowing net exports.

The emerging market and developing countries growth edged down as a number of countries with high current account deficits experienced the pressure of substantial financial market and considerable slowdowns.

In Afghanistan, the year-over-year measurement changes in consumer price index showed an average inflation rate of 0.6 percent in 2018 lower than 5.0 percent recorded in the previous year. The decrease in

inflation rate is in line with low and stable prices of commodities in global markets as well as low local demand in Afghanistan.

DAB auctioned a total amount of USD 2,415.52 million to absorb the excess liquidity from the market and as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies. Meanwhile, Afghani depreciated 8 percent against the US dollar from the beginning to the end of FY 2018.

Asset base of the banking sector expanded by 0.20 percent by the end of Dec, 2018 lower than 5.73 percent growth recorded in the same period of the previous year. The capital base of the banking sector remained strong though decreased by 4.32 percent stands at AFN 34.39 billion. Banking sector earned net profits amounting to AFN 2.43 billion for the year 2018, against AFN 1.77 billion net profits in the 2017.

The external sector worsened in the third quarter of the FY 2018 as compared with the same quarter of the previous year, recording a current account deficit of 21 percent and a deficit of USD 734.86 million in the balance of payment (BOP).

Reserve money (RM) recorded negative growth of 0.40 at the end of FY 2018, lower than 10 percent at the end of FY 2017. Currency in circulation (CiC), a major component of RM, also recorded negative growth of 0.18 percent.

NIR increased slightly by 5 percent accumulation of USD 359.6 million. NIR reached USD 7,705 million in the FY 2018.

1

Global Economic Environment

1

GLOBAL ECONOMIC ENVIRONMENT

The World Bank report illustrates that the global growth is moderating as a recovery in manufacturing and loss of steam in trade activities. Although there are ongoing negotiations between major economies, trade tensions stay eminent. These tensions, joint with concern about alleviation of the global growth projection, have considered investors' sentiment and contributed to reduce the prices of global equity. The cost of borrowing for emerging market and developing economies (EMDEs) has increased, as the continuous removal of policy accommodation in different degrees by the central banks of major advanced-economy. The strengthening of U.S. dollar, heightened financial market volatility, and increase risk premiums have increased the outflow of capital and currency pressures in some large EMDEs, with some vulnerable countries experiencing substantial financial stress. The prices of energy have fluctuated noticeably, essentially due to supply factors, with sharp falls toward the end of 2018. Other commodity prices—mainly metals—

have also weakened, posing renewed headwinds for commodity exporters. Overall, global growth is projected to moderate from a downwardly revised 3 percent in 2018 to 2.9 percent in 2019.

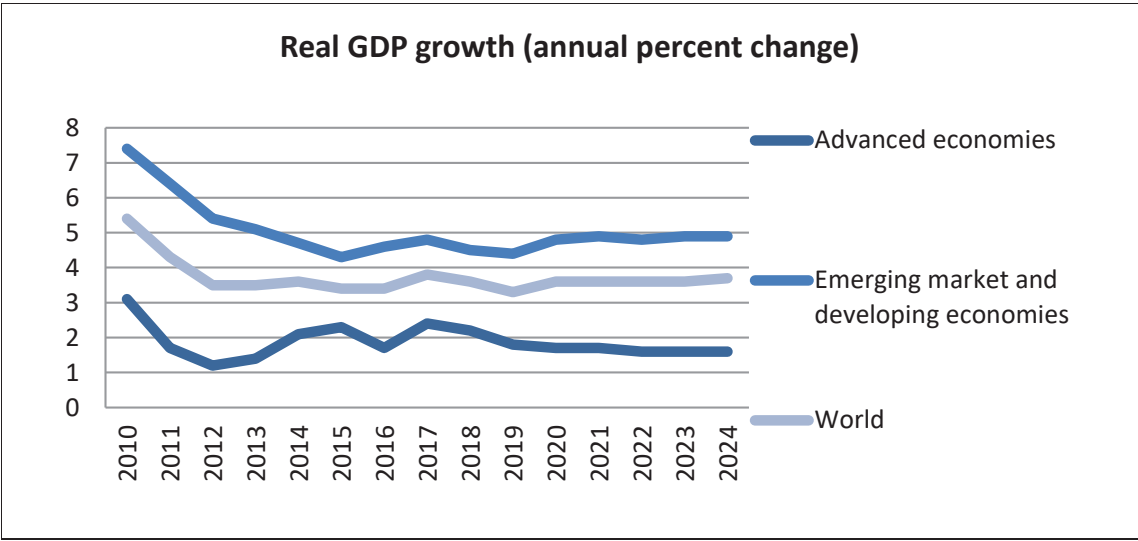
In advanced economies, economic activity has been diverging. Growth in the United States has remained solid, bolstered by fiscal stimulus. In contrast, activity in the Euro Area has been somewhat weaker than previously expected, owing to slowing net exports. While growth in advanced economies is estimated to have slightly decelerated to 2.2 percent since the previous year, it is still above potential and in line with previous forecasts.

The emerging market and developing countries growth edged down to an estimated 4.2 percent in 2018—0.3 percentage point lower than the previous projection—as a number of countries with high current account deficits experienced the pressure of substantial financial market and considerable slowdowns. More generally, as suggested by recent high-frequency indicators, the recovery among commodity exporters has lost momentum significantly,

largely owing to country-specific challenges within this group. Activity in commodity importers, while still robust, has slowed

somewhat, reflecting capacity constraints and decelerating export growth.

Figure 1.1: Advanced Economies, Emerging Economies and World GDP growth



Source: IMF World Economic Outlook

I. ADVANCED ECONOMIES

1.1.1 The United States Economy

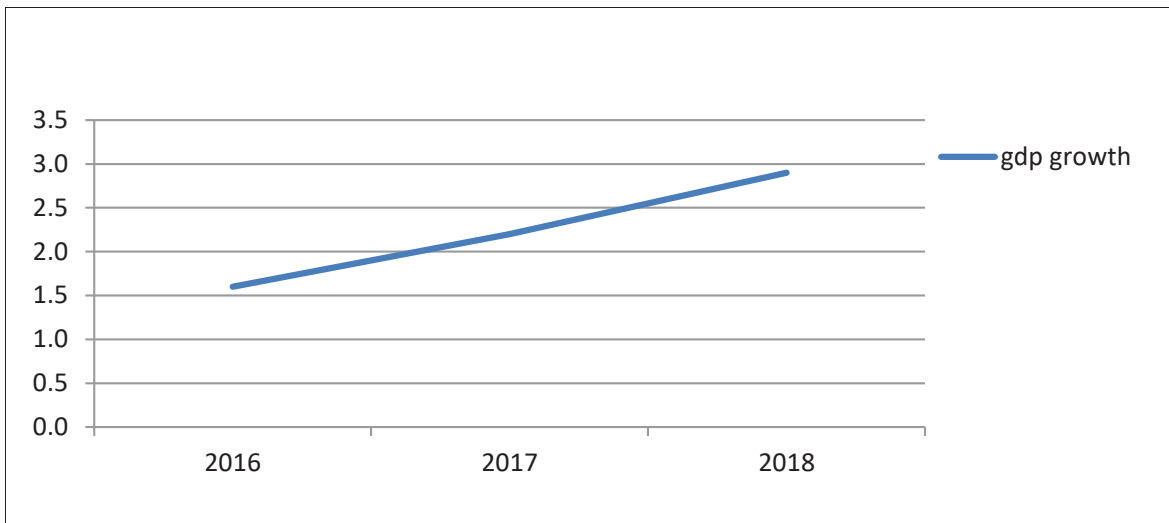
Real gross domestic product (GDP) increased at an annual rate of 2.9 percent in 2018 while in previous year the growth was recorded 2.2 percent.

The increase in real GDP in the fourth quarter reflected positive contributions from personal consumption expenditures (PCE),

nonresidential fixed investment, exports, private inventory investment, and federal government spending. Those were partly offset by negative contributions from residential fixed investment, and state and local government spending. Imports, which are a subtraction in the calculation of GDP, increased.

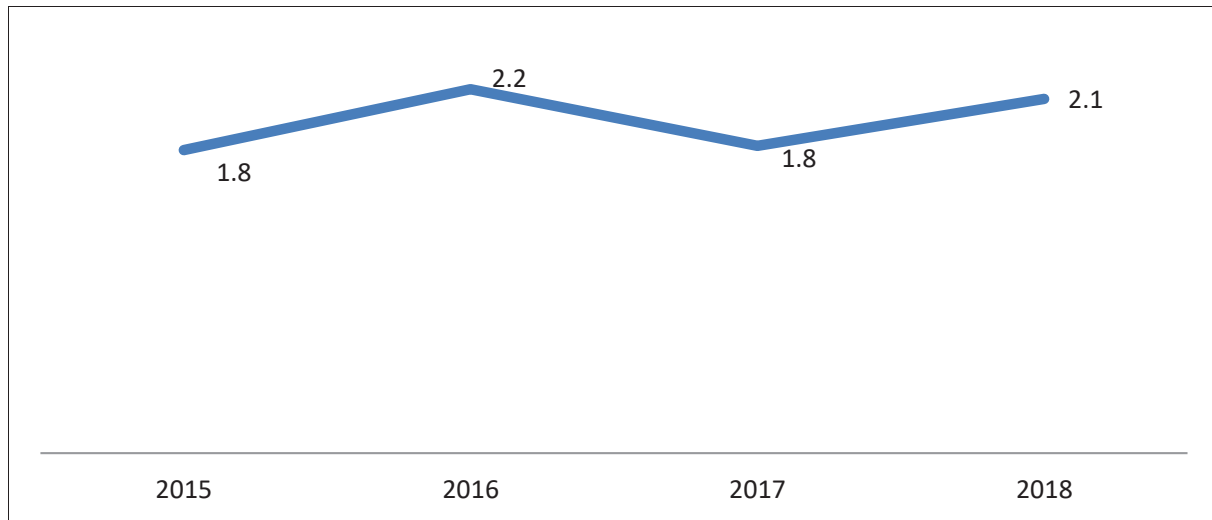
Inflation rate increased to 2.1 percent in 2018 from 1.9 percent in 2017 September.

Figure 1.2: The US Yearly GDP Growth Rate 2016-2018



Source: Bureau of Economic Analysis, U.S. Department of Commerce

Figure 1.3: US CPI- all urban consumers (% change)



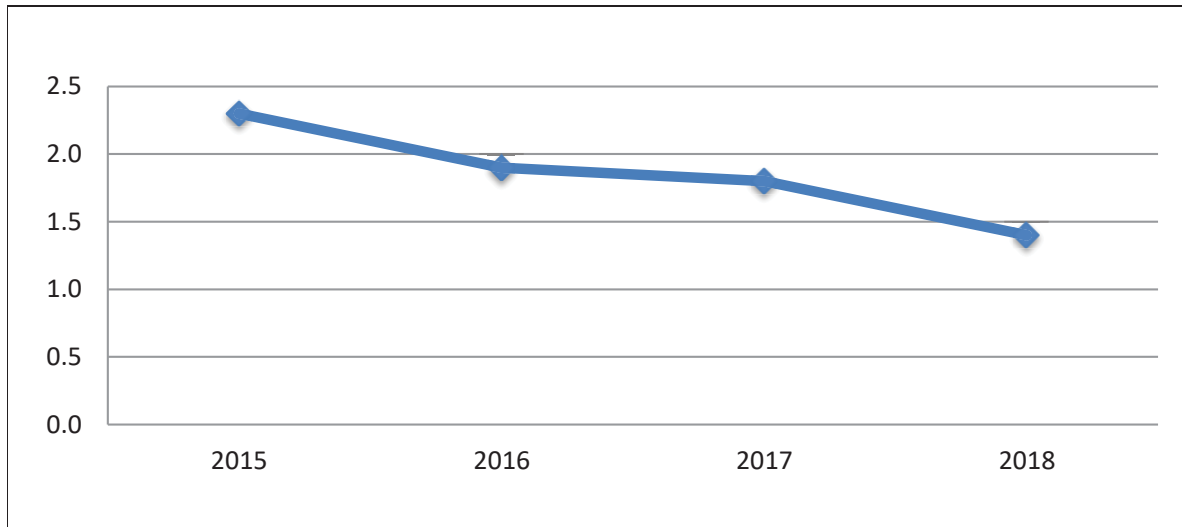
Source: Bureau of Labor Statistics, US Department of Labor

1.1.2 The Economy of United Kingdom

In 2018 the United Kingdom’s economy grew by approximately 1.4 percent, the slowest it had grown since the great recession of the late 2010, where the economy shrank by 4.2 percent. Prior to the economic crash of 2008, the British economy expanded at a relatively healthy rate, particularly in 2000 when gross-domestic product grew by 3.7 percent. In the output approach to measuring GDP, growth

in the latest quarter was driven by professional, scientific, administration and support services within the services sector, while production and construction both contributed negatively to GDP growth. In the expenditure approach to measuring GDP, private consumption and government consumption contributed positively, while gross capital formation and net trade contributed negatively to GDP growth.

Figure 1.4: The UK GDP Growth



Source: Office for National Statistics, U.K.

1.1.3 The Economy of Germany

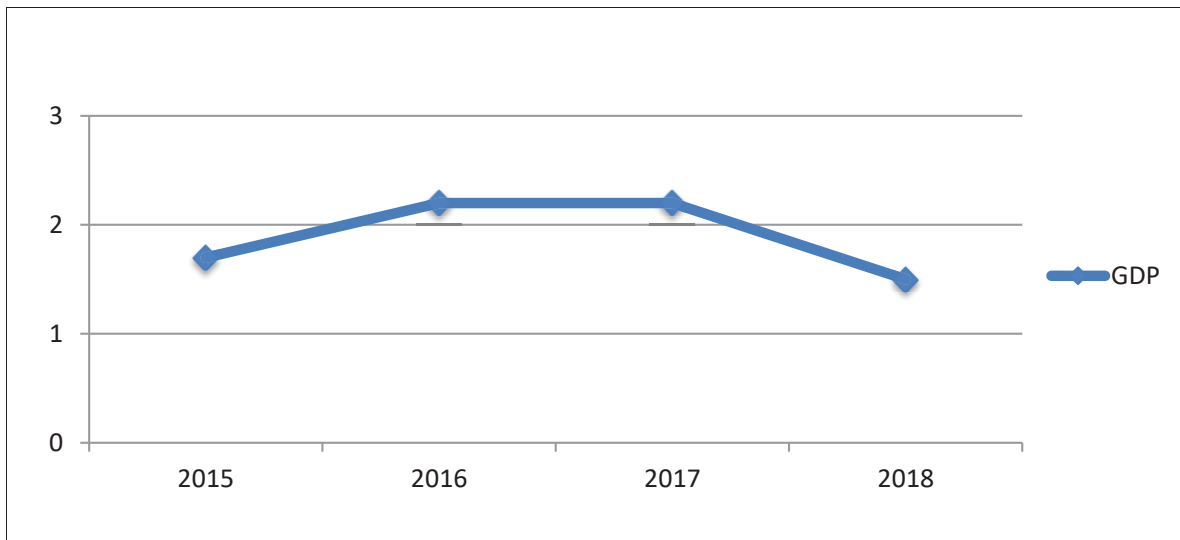
The German economy grew by 1.5 percent in 2018, the weakest rate in five years and markedly slower than the previous year. Preliminary data shows, in a sign that exporters in Europe's largest economy are being hit by trade tensions.

Destatis, Germany's statistics office, said the country's foreign trade position had deteriorated, with exports falling and imports rising during the review period.

It added that there were mixed signals for domestic demand, with German households spending less but firms investing more in machinery, equipment and construction.

The trade weakness was partly caused by temporary factors, including disruption to car production before new and more rigorous emission tests come into force in September. Problems in the auto industry and weakness in the retail sector are credited with the decline in GDP.

Figure 1.5: The GDP Growth Rate of Germany 2015–2018



Source: Federal Statistics Office (DESTATIS), Germany

Another reason for this reduction is Germany's car industry which plays a key role in export-related growth. Car industry also struggled with new emissions standards following the "Dieselgate" cheating scandal that rocked the sector in recent years.

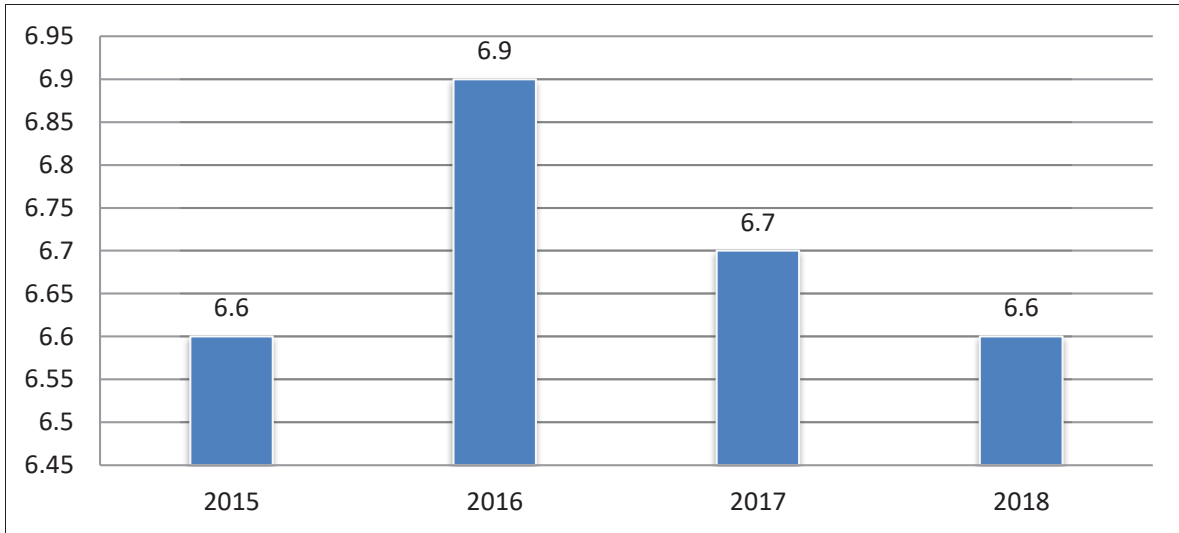
According to data released by German Association of the Automotive Industry, car production in September fell 24% from the same month a year before.

II. EMERGING MARKET ECONOMIES

1.2.1 The Economy of China

China’s economic growth was 6.6 percent in 2018 which is the slowest pace since 1990. Fourth quarter GDP growth was recorded 6.4 percent, matching expectations, a decline from the 6.5 percent year on year growth in the third quarter of 2018.

Figure 1.6: The GDP Growth Rate of China 2015-2018



Source: National Bureau of Statistics of China

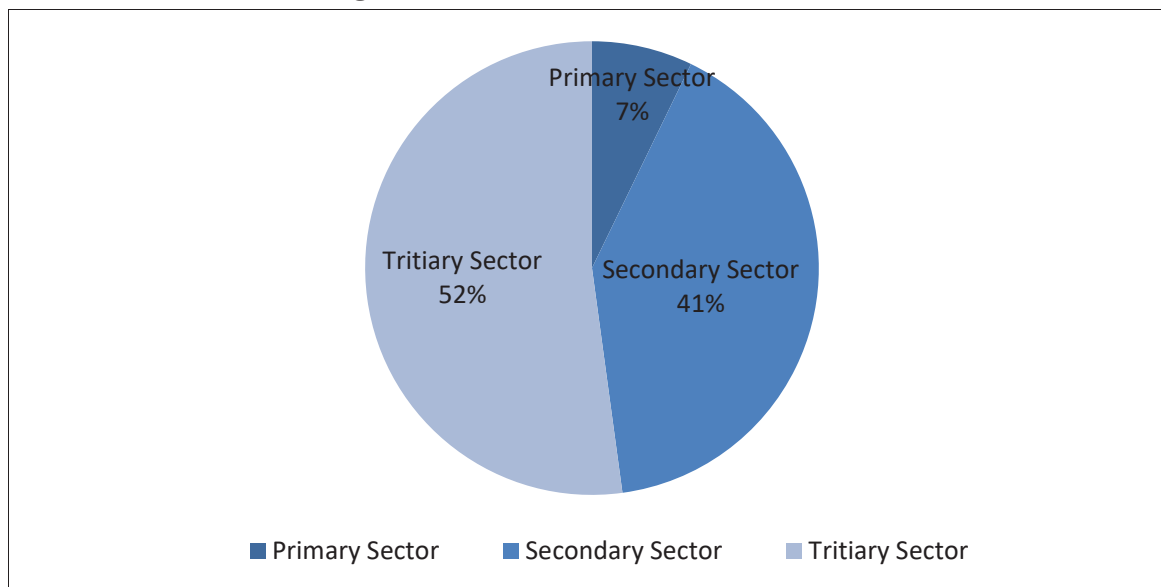
Retail sales data rose 8.2 percent in December year-on-year, in line with a forecast and up from November’s 8.1 percent gain. Industrial output increased 6.2% in 2018, contracting from last year’s 6.6% increase, mainly due to slumping production of cars, smart phones and PCs. Furthermore, industrial output grew 5.7% in December, 2018.

Fixed-asset investment, including construction of plants and condominiums, rose 5.9% in 2018, contracting from the previous year’s 7.2% increase. The biggest factor was slowing infrastructure investment,

including in railways and roads, which grew 3.8% on the year in 2018, down markedly from the previous year’s 19% increase.

Total retail sales of consumer goods - a sum of the sales of department stores, supermarkets and online shopping - jumped 9.0% in the fiscal year 2018, but was slower than previous year’s 10.2% increase. The growth rate of retail consumer goods sales fell below 10% for the first time since 2003, dragged down by sluggish sales of cars and Smartphone. Total retail sale of consumer goods grew only 8.2% in December, FY 2018.

Figure 1.7: Share of sectors to the GDP



Source: German Chamber of Commerce in China

Production metrics and export orders are falling as the country's trade dispute with the U.S. drags on and other factors weigh on growth.

The U.S. and China imposed additional tariffs of up to 25% on each other in July-September. Chinese products worth a total of \$250 billion were affected by the additional U.S. tariffs, and exports to the U.S. fell for these products. As the impact of the trade war became clear, both consumption and production have shown steep declines since autumn. Although, China's trade dispute with the U.S. has affected the domestic economy, but the impact seems to be manageable. The economy is slowing but stabilizing trend in the past few months, and

that the growth was still driven overall by domestic demand.

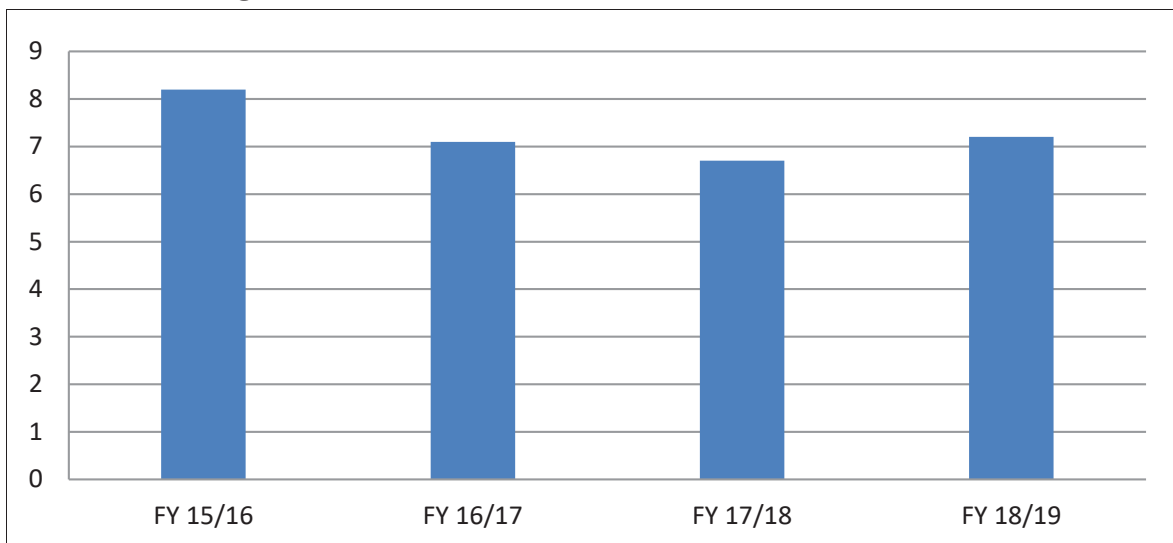
The slowdown should continue in 2019 because it is likely that the influence of the trade tiff will spread and exports will decline further.

1.2.2. The Economy of India

According to Central Statistics Office (CSO), India's GDP is estimated to have grown at 7.2% in Financial Year 2018-2019 which runs through 1st April 2018 to 31st March 2019.

The 7.2% expansion in 2018's GDP is higher compared to the 6.7% growth rate in the previous fiscal year.

Figure 1.8: GDP Annual Growth Rate of India 2015 - 2018



Source: Organization for Economic Co-operation and Development (OECD)

Moreover, real GVA (Gross Value Added) is anticipated to grow at 7% in the current fiscal year as against 6.5% in 2017-18.

Agriculture, forestry and fishing is likely to increase to 3.8 percent in the review year from 3.4 % in the preceding year. Furthermore, the growth of manufacturing sector is expected to accelerate to 8.3% in the current year, up from 5.7% in the FY 2017-18.

However, the mining sector growth rate is estimated to decline from 2.9% in 2017-18 to 0.8% in the current fiscal year. Services sector will too witness deceleration to 6.9% from 8% in the previous fiscal year.

The growth rate of public expenditure is expected dip to 8.9% from 10% in the previous year.

Electricity, gas, water supply and other utility services growth is estimated at 9.4% in 2018-19, up from 7.2% in the previous review period. Similarly, the construction sector is expected to grow at 8.9% from 5.7% in the previous fiscal year. Financial, real estate and professional services growth will be a bit higher at 6.8% against 6.6 percent in 2017-18.

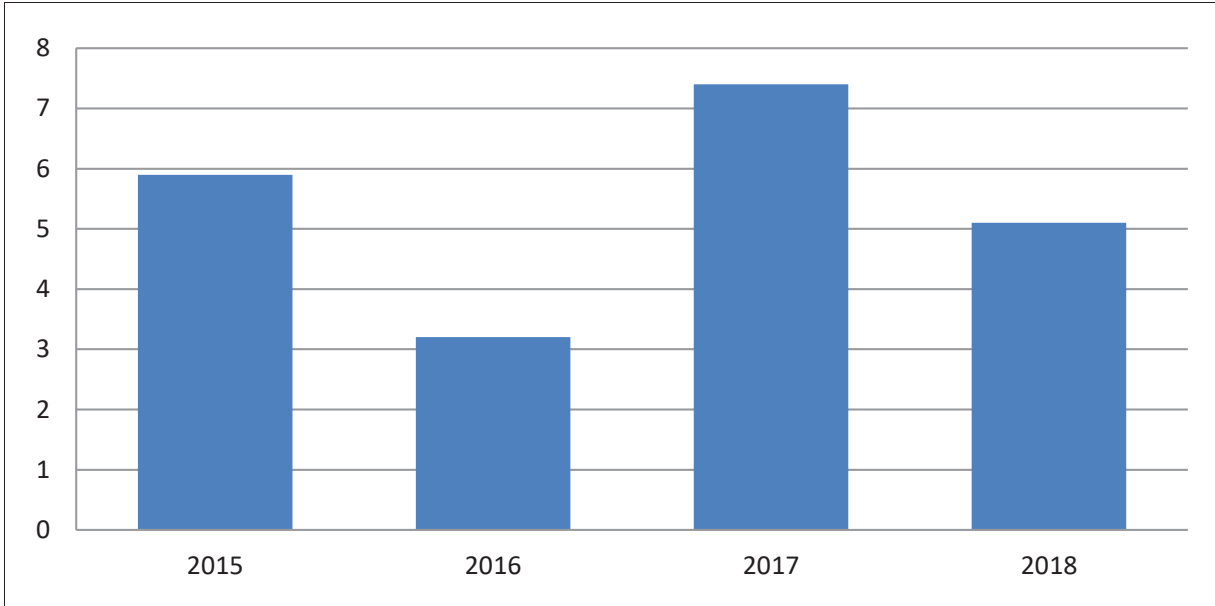
According to the CSO estimates, the per capita net national income during 2018-19 is expected to rise of 11.1 percent as compared to the growth rate of 8.6 in the previous year. Prices during 2018-19 are estimated at 11.5% and 11%, respectively, as against the corresponding rates of 11.4% and 10.8% respectively in FY 2017-18.

1.2.3 The Economy of Turkey

According to Turkish Statistical Institute (TSI), the economy started with a high GDP growth of 7.4% in the first quarter of 2018 and slowed down to 5.6% and 1.8% in the second and third quarter and eventually

contracting by 3% in the final quarter of 2018, falling into recession. The annual GDP growth rate significantly fell from 7.4% in 2017 to 2.6% in 2018. The GDP per capital also fell from \$10,395 to \$9,632 during the same period.

Figure 1.9: The GDP Growth Rate of Turkey 2015 - 2018

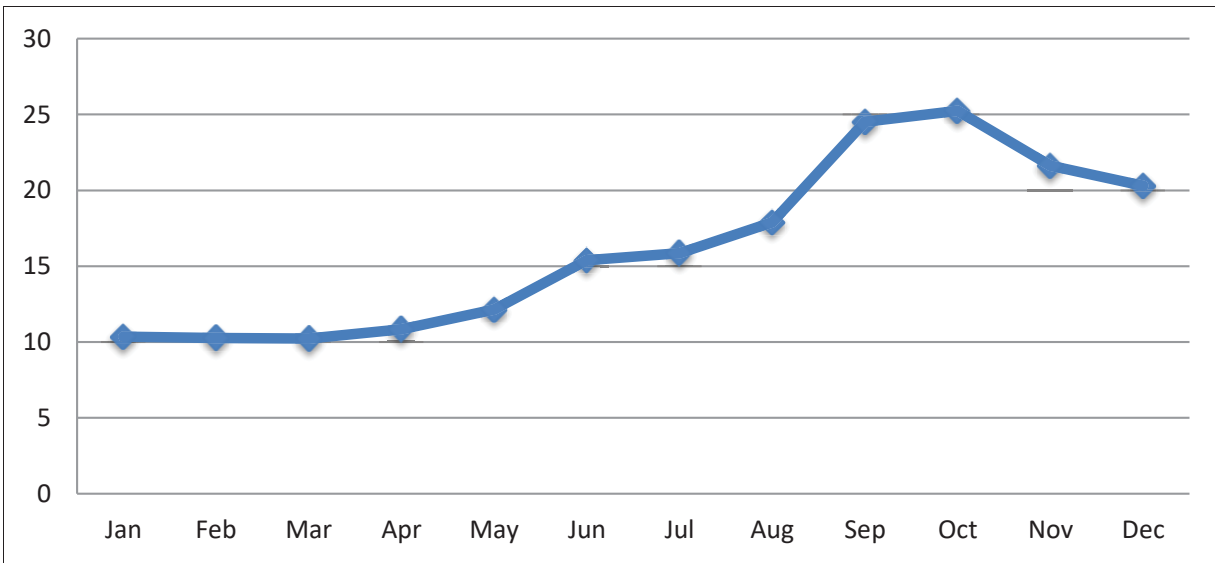


Source: Turkish Statistical Institute

Turkey's Lira fell depreciated by one-third against US dollars and the inflation was 15

years high. The consumer inflation is illustrated in the graph below.

Figure 1.10: Turkey's Consumer Price Index Jan - Dec, 2018



Source: Turkish Statistical Institute

Similarly, private consumption, which accounts to more than half of the GDP, fell sharply and turned negative in the last quarter contracting by 8.9% year on year basis.

According to the data, the value added increased by 1.3 percent in the agricultural sector and 1.1 percent in the industry sector last year, while 1.9 percent decrease was

registered in the construction sector. The services sector's value added- wholesale and retail trade, transport, storage, accommodation and food service activities- surged 5.6 percent on a yearly basis.

Unemployment continued to rise throughout the year, reaching 13.5% in December, making it the highest since 2010.

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German Chamber of Commerce in China

Turkish Statistical Institute

Trading Economics

Organization for Economic co-operation and Development

Focus Economics

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<http://www.oecd.org/>

<https://www.focus->

2

Money and Capital Market Development

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

According to the monetary statistics, reserve money (RM) has a negative growth of 0.40 at the end of FY 2018, lower than 10 percent at the end of FY 2017. Currency in circulation (CiC) as a major component of RM recorded negative growth of 0.18 percent from beginning to the end of FY 2018.

Reserve money (RM) and Currency in Circulation (CiC) growth, which are Da Afghanistan Bank's operational and indicative targets, remained well below the targets due to absorption of additional liquidity from the market and banks during the period under review.

Narrow money (M1), stood at AFN 453,480 million at the end of the year under review, registering a growth of 4 percent. Broad money (M2) demonstrated similar behavior, representing a growth rate of 2.57 percent (Y-o-Y), standing at AFN 486,034.18 million at the end of FY 2018.

In order to mitigate excessive fluctuations of AFN exchange rate against foreign currencies and manage liquidity in the market, DAB uses

FX and CNs auctions under the open market operations.

From the beginning to the end of FY 2018, DAB has auctioned a total amount of USD 2,415.52 million to absorb the excess liquidity from the market and as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at AFN 33.725 billion at the end of FY 2018.

Meanwhile, Afghani depreciated 8 percent against the US dollar from the beginning to the end of FY 2018.

I. MONETARY PROGRAM

Reserve money remained the key operational target of the monetary policy during FY 2018, while currency in circulation was set as the indicative target.

DAB applies quantitative theory of money to determine the amount of reserve money (RM) for the purpose of supporting domestic price stability, which is DAB's primary objective. Hence, targets for RM and CiC are based on expected economic growth and expected inflation during the concerned period. For the

fiscal year 2018, the ceilings for reserve money and currency in circulation growth was 12%. It is worth mentioning that in FY 2018, actual RM and CiC respectively had negative growth by 0.40 and 0.18 percent, which are bellow to the targets. DAB has auctioned USD 2,415.52 million via open market operations, selling USD 10 million to Brishna, (Afghan state owned electricity enterprise),

and EUR 128.45 million to mop up the excess liquidity from the market and to prevent intense fluctuations of Afghani nominal exchange rate against foreign currencies, especially internationally convertible currencies.

The Figure 2.1 and 2.2 illustrate the ceiling and the actual reserve money and currency in circulation for the period under review.

Figure 2.1: Reserve Money for the FY 2018

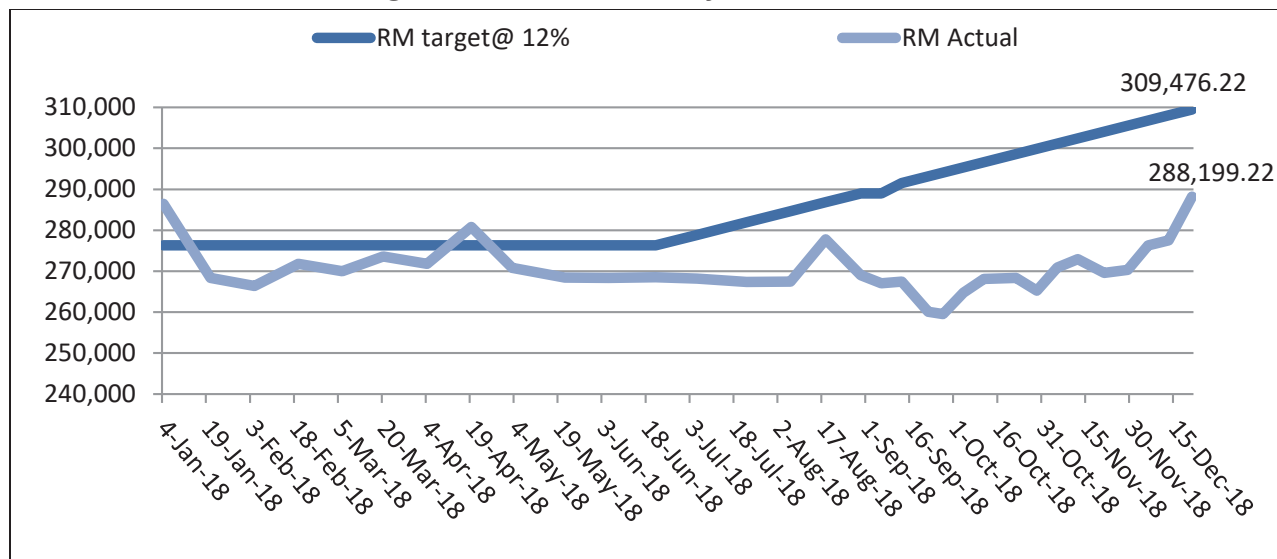
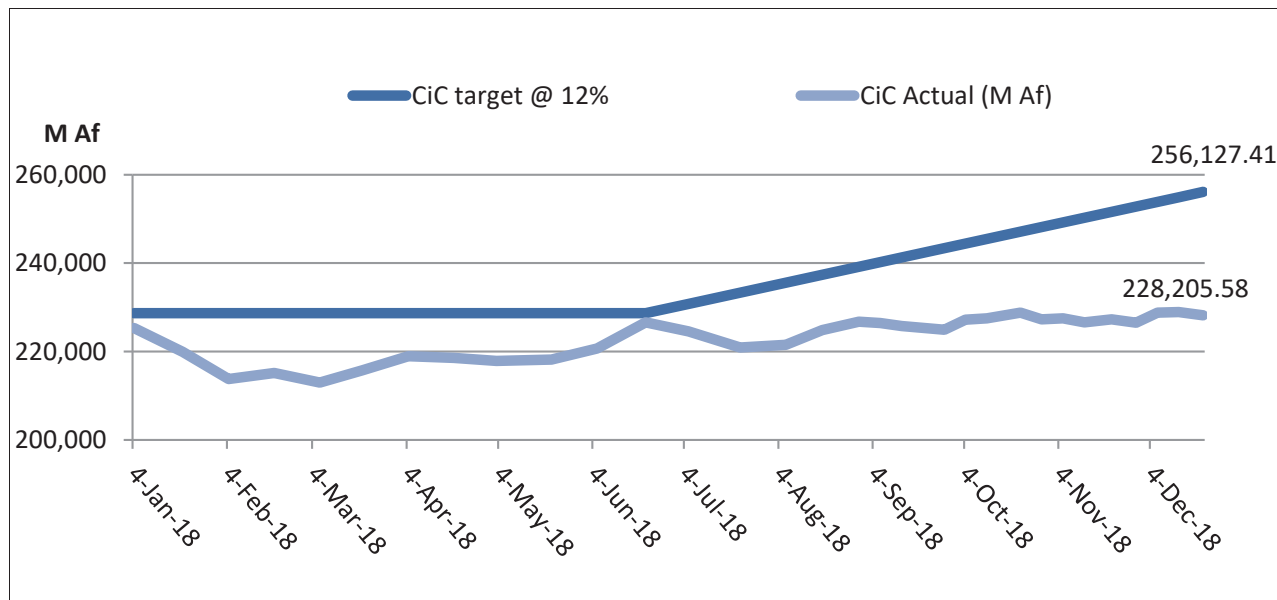


Figure 2.2: CiC for the FY 2018 (Dec. 22, 2017 to Dec. 22, 2018)



Source: Monetary Policy Department/DAB

II. MONETARY AGGREGATES

Narrow money and broad money are compiled based on Monetary and Financial Statistics (MFS) Manual and Compilation Guide.

Narrow money (M1) includes currency outside depository corporations and demand deposits, while broad money (M2) includes narrow money components and other less liquid assets or quasi money.

As shown in Table 2.3, narrow money (M1) grew 4 percent at the end of fiscal year 2018, almost higher growth with the same period of FY 2017.

Currency outside depository corporations or CiC, which accounts for 51.50 percent of M1, grew negatively by 0.27 percent, but lower from 1.9 percent growth of the same period in the previous year, showing difference of AFN 595 million. Demand deposits, which are the other components of M1, experienced growth of 8.01 percent at the end of FY 2018, while its growth rate was 4.5 percent in same period of previous year. Demand deposit in comparison with the previous year shows AFN 17,327 million difference.

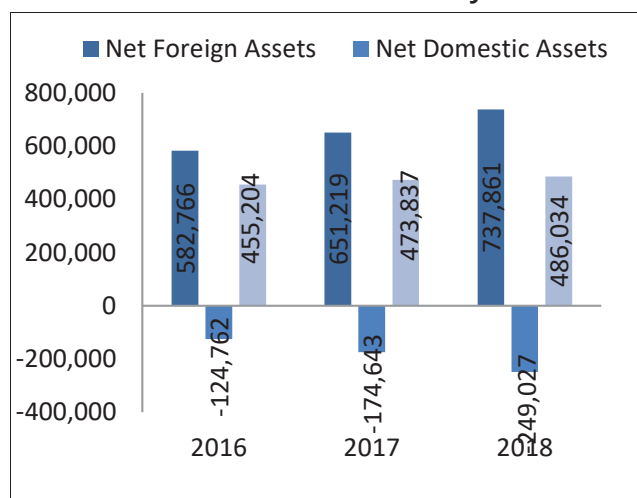
Broad money (M2) expanded by AFN 486,034.18 million in the year under review from AFN 473,836.89 million in the previous year, showing an increase of 2.57 percent, but lower from 4.1 percent growth of the same period in the previous year. Slower growth in broad money is mainly attributed to

deceleration in the growth of currency in circulation. The data shows that M1 with a share of 93.30 percent remained the main contributing component of M2.

Quasi money (other deposits), which is the other component of M2, had negative growth of 12.23 percent (y-o-y) at the end of FY 2018. Quasi money constitutes 6.70 percent of broad money at the year under review, which is lower than 7.83 percent at the end of FY 2018. Therefore, the impact of changes in quasi money on M2 is negligible. The year-on-year change of Afghani denominated time deposits stood at AFN 9,752 million, showing a negative growth of 23.98 percent, while the foreign currency denominated time deposits rose negatively by 6.01 percent, reaching AFN 22,803 million. Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 2.01 percent and 4.69 percent of M2 respectively.

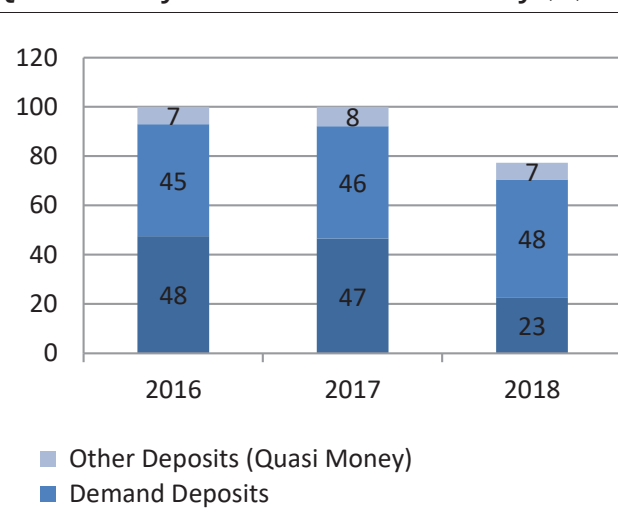
Demand deposits as a share of broad money stood at 48.06 percent at the end of the year under review (Figure 2.4).

Figure 2.3: Net Foreign Assets, Net Domestic Assets and Broad Money



Source: Monetary Policy Department/DAB

Figure 2.4: CIC, Demand Deposits and Quasi-money as Share of Broad Money (%)



Source: Monetary Policy Department/DAB

Table 2.1: Monetary Aggregate for the FY 2018 (12/22/2017 to 12/22/2018)

In Million AFN	December-16	December-17	Y-o-Y Δ	Difference	December-18	Y-o-Y Δ	Difference
	Q4	Q4			Q4		
	Amount	Amount			Amount		
1- Net Foreign Assets	582,766.04	651,218.74	11.7%	68,453	737,860.93	13.30%	86,642
(a) Foreign Assets	593,914	668,361	12.5%	74,447	751,125	12.38%	82,764
DAB Foreign exchange reserves	484,910.99	559,620.75	15.4%	74,710	615,123.05	9.92%	55,502
Gold	53,391	61,681	15.5%	8,290	66,179	7.29%	4,498
Other	431,520	497,940	15.4%	66,420	548,944	10.24%	51,004
Other foreign assets	109,003	108,740	-0.2%	-263	136,002	25.07%	27,262
(b) Foreign Liabilities	11,148	17,142	53.8%	5,994	13,265	-22.62%	-3,878
2. Net Domestic Assets	-124,761.76	-174,643.39	40.0%	-49,882	-249,027.01	42.59%	-74,384
(a) Net Domestic Credit	-17,622	-36,028	104.4%	-18,406	-76,284	111.73%	-40,256
Net Credit to Nonfinancial Public Sector	-63,847	-84,054	31.6%	-20,207	-121,906	45.03%	-37,853
Net Credit to Central Government	-63,942	-84,148	31.6%	-20,207	-122,001	44.98%	-37,853
Credit to Central Government	23,015	15,339	-33.4%	-7,676	7,185	-53.16%	-8,154
Liabilities to Central Government	86,957	99,487	14.4%	12,530	129,185	29.85%	29,699

Net Credit to State & Local Government	0.000	0.000	0.0%	0	0.000	0.00%	0
Net Credit to Public Nonfinancial Corporations	94	94	0.0%	0	94	0.00%	0
Credit to Private Sector	47,551	49,386	3.9%	1,835	46,633	- 5.57%	-2,753
Net Credit to Other Financial Corporations	-1,326	-1,361	2.6%	-34	-1,011	- 25.70 %	350
(b) Capital Accounts	127,480	155,842	22.2%	28,363	189,935	21.88 %	34,093
(c) Other Items Net	20,340	17,227	- 15.3%	-3,113	17,193	- 0.20%	-34
3- Broad Money (M2)	455,204.13	473,836.89	4.1%	18,633	486,034.18	2.57%	12,197
Narrow Money (M1)	423,259	436,748	3%	13,489	453,480	4%	16,732
CiC (Currency outside depository corporations)	216,308	220,507	1.9%	4,198	219,911	- 0.27%	-595
Demand Deposits	206,951	216,242	4.5%	9,291	233,568	8.01%	17,327
Other Deposits (Quasi Money)	31,945.25	37,088.74	16.1%	5,143	32,554.44	- 12.23 %	-4,534
In Afghani	11,422	12,827	12.3%	1,405	9,752	- 23.98 %	-3,076
In Foreign currency	20,523	24,262	18.2%	3,739	22,803	- 6.01%	-1,459
Securities Other Than Shares	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Source: Monetary Section, Monetary Policy Department/DAB

III. NET INTERNATIONAL RESERVE (NIR)

Da Afghanistan Bank holds international reserves, which consist of monetary gold, reserve position and holdings of Special Drawing Rights (SDR) with the IMF, as well as major foreign exchange such as US dollars, Euro, Great British Pound and others. The Net International Reserves (NIR) of Afghanistan, which expressed in terms of US dollar, is defined as reserve assets minus reserve liabilities.

NIR increased slightly by 5 percent accumulation of USD 359.6 million at the end of FY 2018.

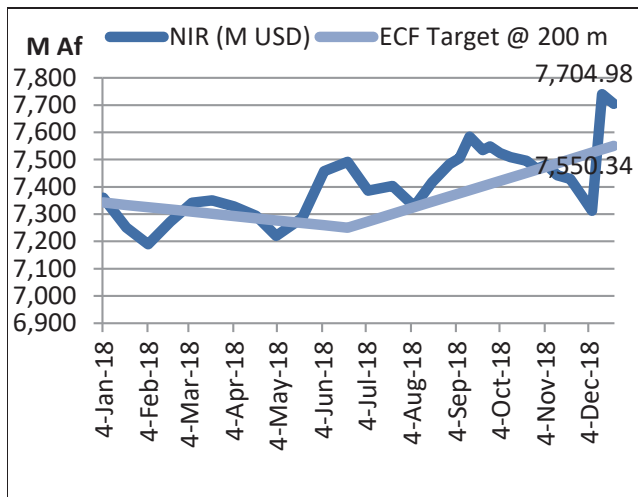
NIR accumulation ceiling was set at USD 7,550.34 million, while in actual case, NIR reached USD 7,705 million for the mentioned period.

Figure 2.5 illustrates actual and target trend of NIR during period under review.

NIR accumulation ceiling was set at USD 7,402.80 million, while in actual case, NIR reached to USD 7,534.41 million for the mentioned period under review.

Figure 2.5 illustrates actual and target trend of NIR during the period under review.

Figure 2.5: NIR actual and target FY 2018



Source: Monetary section, Monetary Policy Department/DAB

IV. FOREIGN EXCHANGE MARKET

4.1 Exchange Rates

Da Afghanistan Bank's (DAB) ultimate goal is to maintain price stability. In order to achieve and maintain this goal, DAB puts its focus to utilize its monetary instruments via the open market operations, effectively with sound policy implementation.

During the FY 2018, Afghani relatively depreciated against the Great British pound, European Euro and Swiss Franc, United States Dollar, United Arab Emirates dirham and Saudi Riyal, while it appreciated against Indian rupee, Pakistani Rupee and Iranian Toman.

The daily historic review of the average exchange rate of Afghani against the U.S. dollars and other foreign currencies in the FY 2018 that are shown in figures below.

Figure 2.6: Daily Average Ex-rate of Afghani against USD during FY 2018

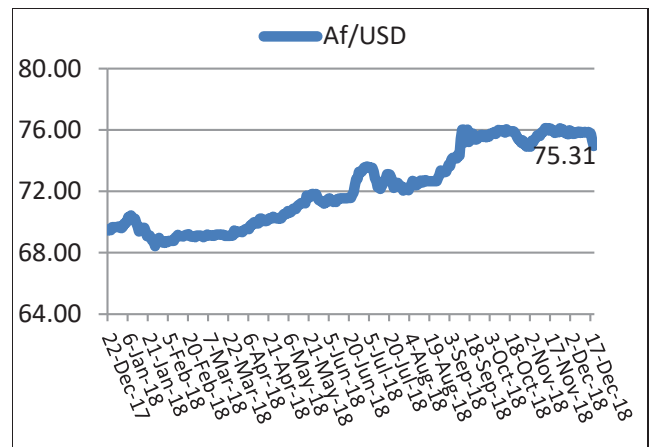


Figure 2.7: Daily Average Ex-rate of Afghani against GBP & Euro during FY 2018

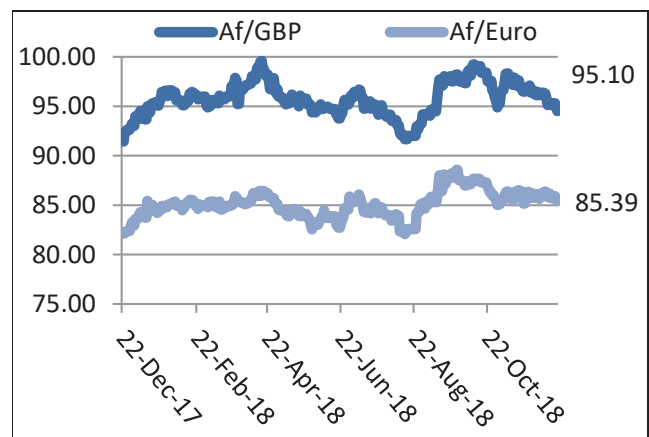


Figure 2.8: Daily Average Ex-rate of Afghani against INR & PKR during FY 2018

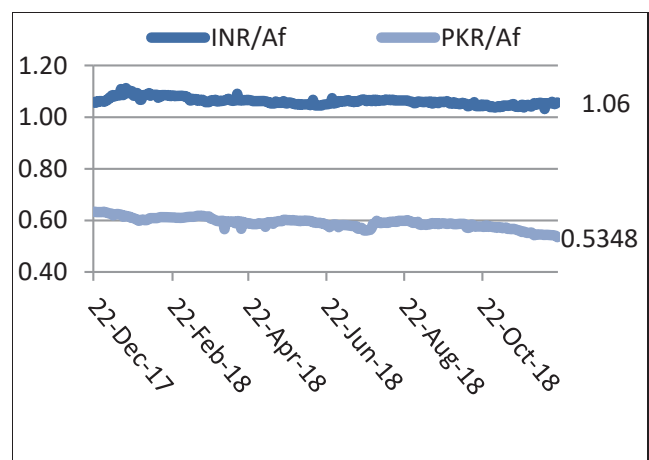
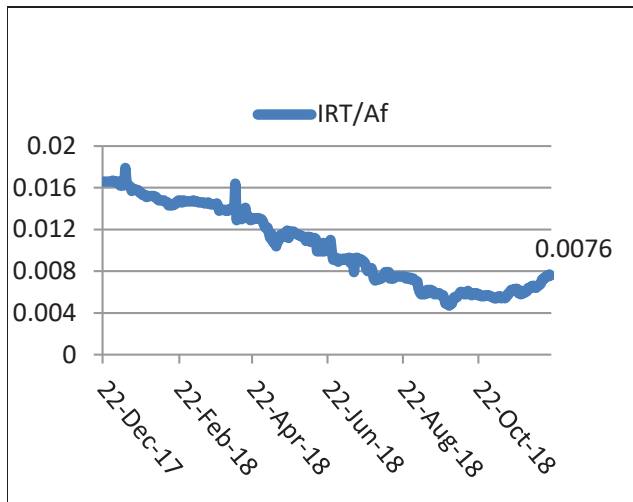


Figure 2.9: Daily Average Ex-rate of Afghani against IRR during FY 2018



Source: Monetary Section, Monetary Policy Department/ DAB

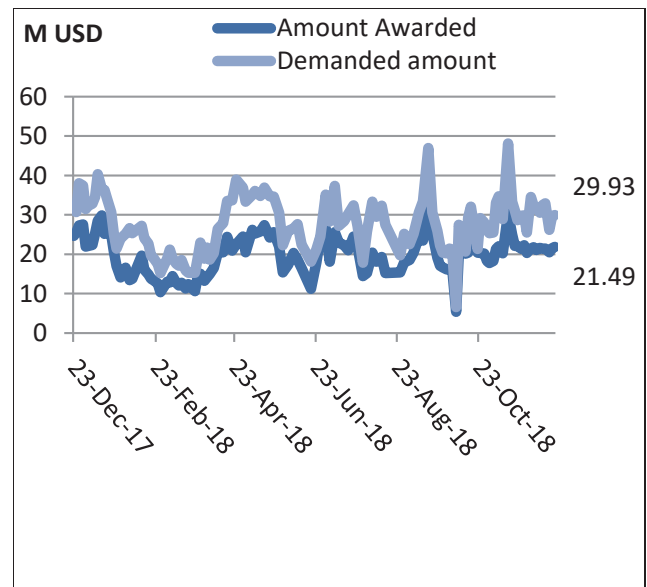
V. OPEN MARKET OPERATION & LIQUIDITY CONDITIONS

2.5.1 Foreign Exchange Auction

In order to control the money supply and maintain price stability in domestic market, DAB manages the reserve money growth close to its ceiling by conducting FX (USD) auctions three times a week and a weekly capital notes auctions, which are the primary monetary instruments. DAB continued the FX auction to mop up excess liquidity from the market and to smooth out excessive volatility of the exchange rate of Afghani against foreign currencies, especially the U.S dollar. During FY 2018, DAB auctioned a total amount of USD 2415.52 million, while the total demand was USD 3,361.15 million. On average, 52 bidders participated in each auction and 40 bids were announced as the

winning bids with the average amount of USD 19.63 million sold in each auction and the total withdrawal is recorded AFN 174.838 billion. The data for the end of FY 2017 recorded a total auctioned amount of USD 1,947.17 million, with a total demand of USD 2,651.95 million. On average, 44 bidders participated in each auction and 33 bids were awarded with an average amount of USD 13 million in each auction and the total withdrawal is recorded AFN 132.617 billion. Figure 2.10, shows the total amount of USD, awarded and demanded through auctions in FY 2018.

Figure 2.10: USD awarded and demanded amount till the end of FY 2018



Source: Monetary Policy Department/DAB

2.5.2 Capital Notes Auction

Capital notes are Afghani denominated short-term securities offered by DAB to the primary market customers, which are licensed commercial banks on weekly basis.

Da Afghanistan Bank uses Capital Notes (CNs) as a monetary tool to manage the money supply growth. Capital notes are used to absorb the excess liquidity of the commercial banks.

Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months and one year.

Total outstanding stock of capital notes reached AFN 33.725 billion at the end of FY 2018, which shows a decrease of AFN 5.268 billion compared to AFN 38.993 billion at the end of FY 2017. The main reason for decrease in outstanding compared to same period of last year was the scale down of auction of 182, 364 Days capital notes with regards to the current economic situation in the country, DAB has gradually decreased the auction of 182 and 364 day capital notes as well as their interest rates in order to encourage investment and increase peoples' access to finance. Lower interest rates on

these notes will facilitate the issuance of banking credits to the public with simple requirements and lower interest.

The outstanding stock of 7-day capital notes stood at AFN 7.62 billion, 28 day CNs outstanding amount stood at AFN 8.25 billion, and 91 day outstanding stock of CNs recorded the amount of AFN 12.37 billion. The stock of outstanding for 182 day stood at 5.47 billion. Total interest paid to CNs figured out to AFN 108.30 million till the end of the year under review.

In addition, the weighted average interest rate for 7-day capital note was 0.15 percent, for 28 day security recorded at 0.34 percent, for 91 day notes was 0.54, for 182 day notes was 0.89 and in 364 day there was no auction in capital notes from beginning to the end of FY 2018, which are generally in lower levels than the same period of the previous fiscal year.

Figure 2.11: Capital notes stock of outstanding during FY 2018

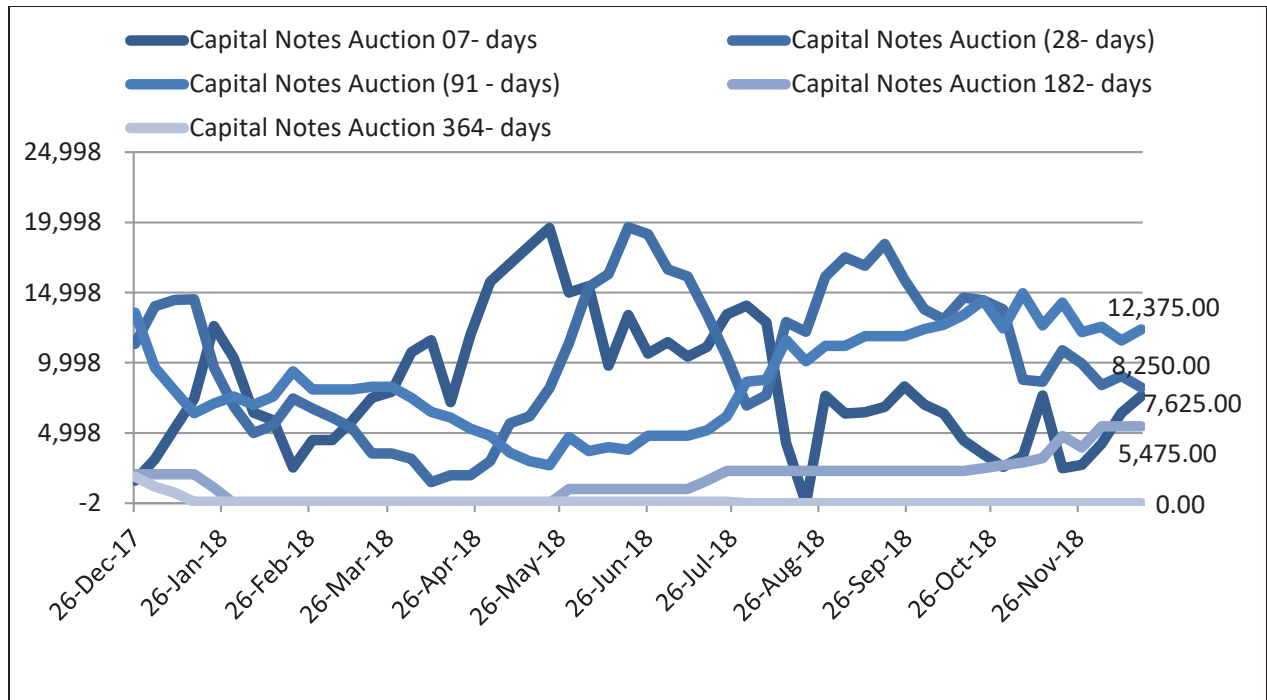


Figure 2.12: 7 Day CNs demanded and awarded amount in Million Af

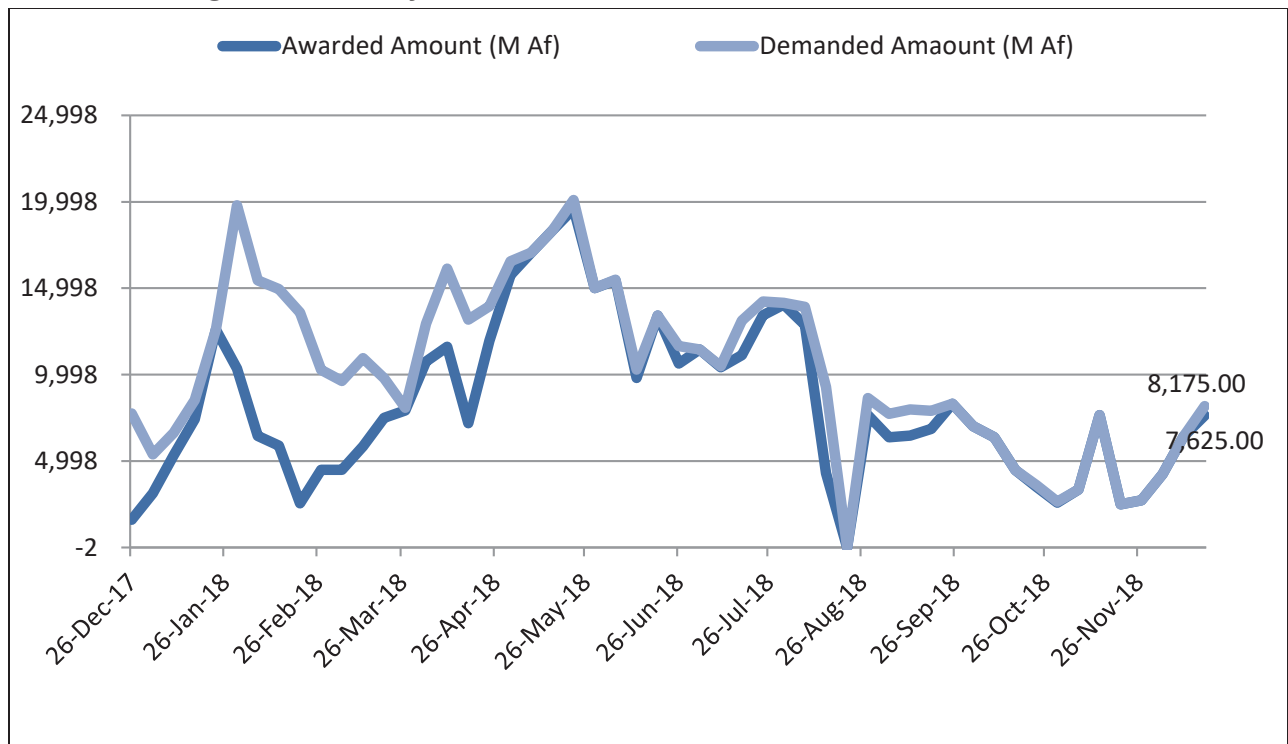


Figure 2.13: 28 Day CNs demand and awarded amount during FY 2018

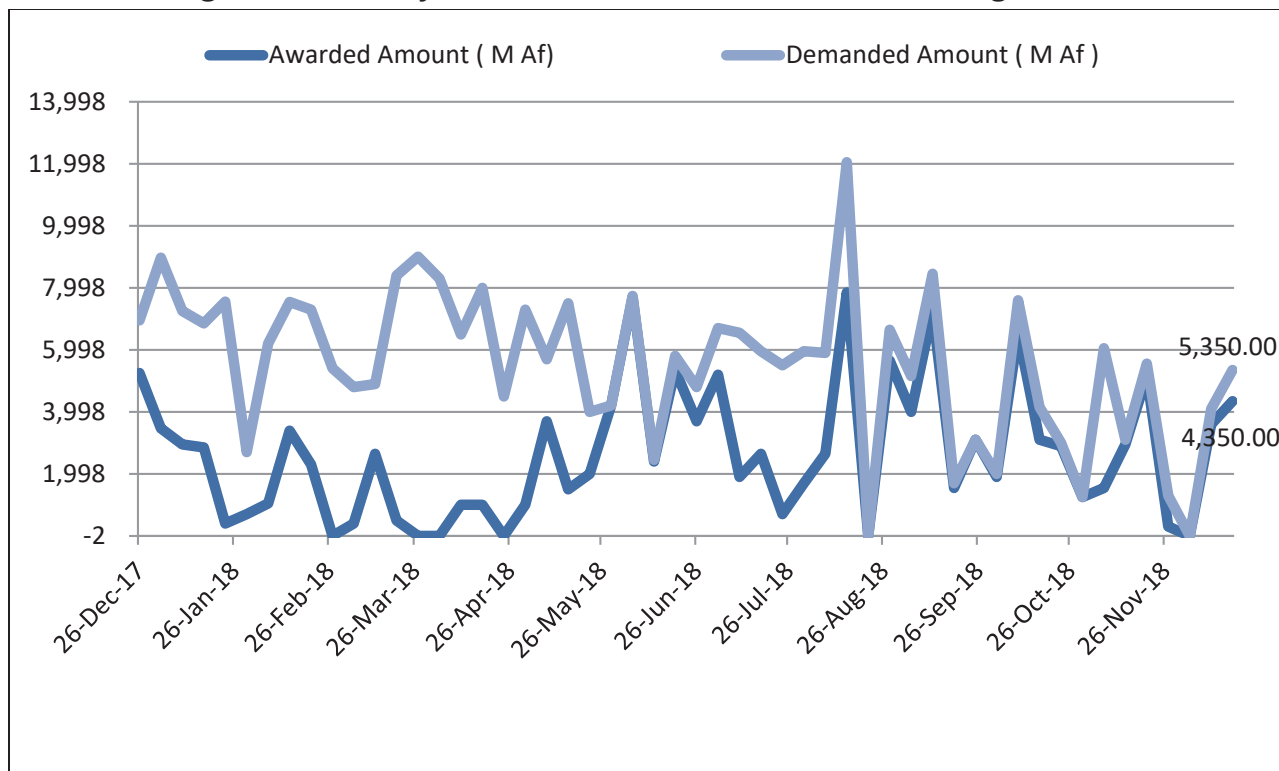


Figure 2.14: 91 day CNs demand and awarded amount

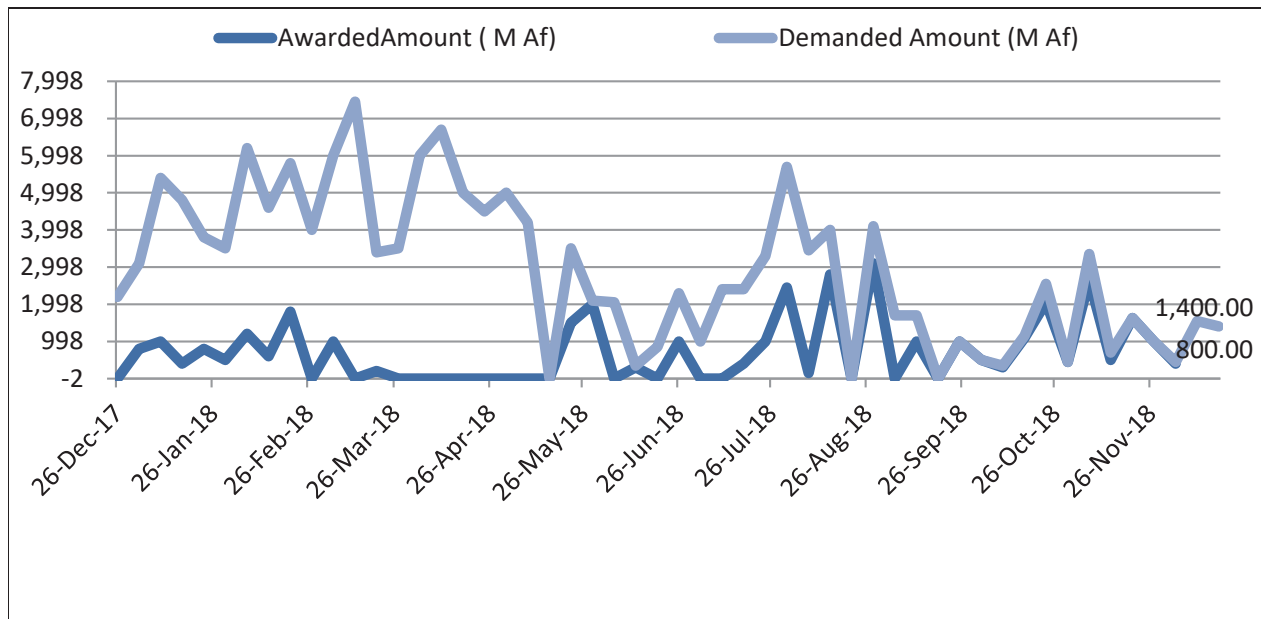
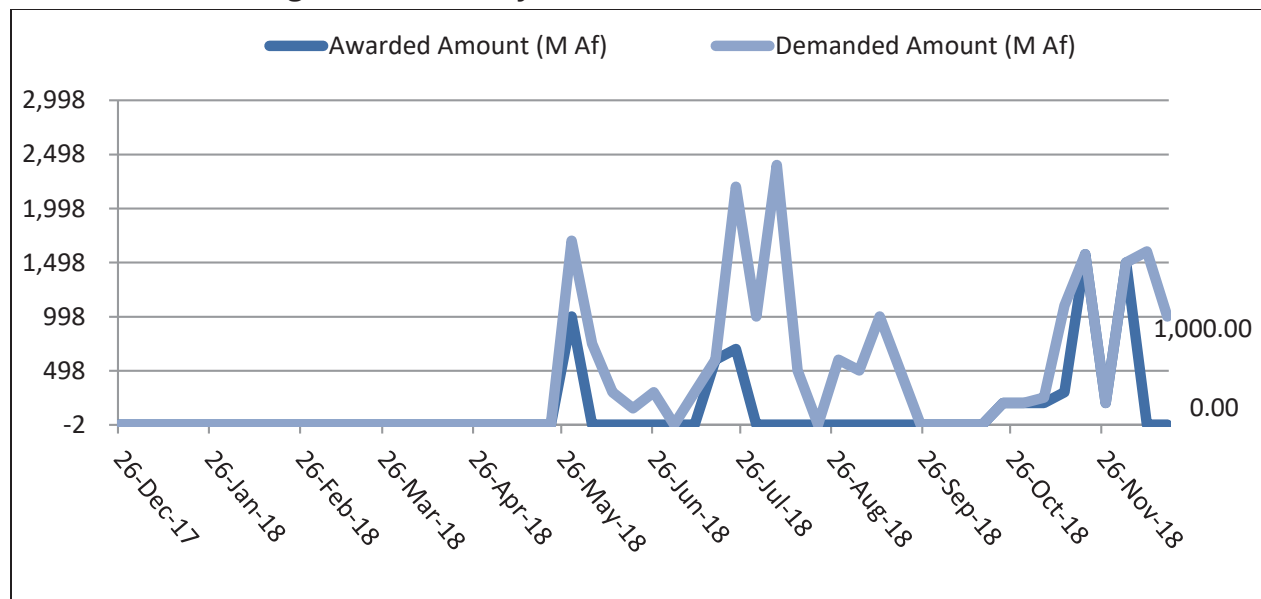


Figure 2.15: 182 day CNs demand and awarded amount



Source: Monetary Sector, Monetary Policy Department/DAB

2.5.3 Required and Excess Reserves

Commercial banks are required to hold 8 percent of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10 percent for

foreign currency denominated accounts. Now the required reserves are held in the currency of denomination (domestic and foreign), unlike the previous practice, which required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. It shows

AFN 5,696.11 million and USD 219.70 million and Euro 21.63 million recorded at the end of FY 2018.

Overnight Deposit Facility (ODF)

This facility is available to all commercial banks to gain interest on their excess balances. The interest rate on the overnight deposit facility, based on a circular to all banks, approved by DAB Supreme Council on September 11, 2017 is now 10 basis points.

The average outstanding amount of overnight deposit facility recorded AFN 10,780.83 million at the end of FY 2018 and the payment of interest rate to the mentioned facility reached AFN 19.4 million for the same period.

Overnight Credit Facility (OCF)

This facility is used by banks for short term cash needs. The facility allows banks to borrow Afghani from Central Bank on an overnight basis when they face a shortfall in cash flow. The rate that the commercial banks are charged for this facility is 10 basis points above the last 28 day CNs auction. This borrowing is collateralized with outstanding capital notes only.

During the period under review, no bank has used from credit facility.

3

Inflation Trend and Outlook

3

INFLATION TREND AND OUTLOOK

Commodity prices were driven by a number of factors in 2018, including commodity specific supply disruption, rising U.S. interest rates, an appreciation of the U.S. dollar, growing trade tensions between major economies, and financial market pressures in some emerging market and developing economies. Energy demand worldwide grew by 2.3% in 2018, its fastest pace this decade, an exceptional performance driven by a robust global economy and stronger heating and cooling needs in some regions. Natural gas emerged as the fuel of choice, posting the biggest gains and accounting for 45% of the rise in energy consumption. Gas demand growth was especially strong in the United States and China. Global coal consumption rose 0.7%, with increases seen only in Asia, particularly in China, India and a few countries in South and Southeast Asia. Following a broad-based upswing in cyclical growth that lasted nearly two years, the global economic expansion decelerated in the

second half of 2018. Activity softened amid an increase in trade tensions and tariff hikes between the United States and China, a decline in business confidence, a tightening of financial conditions, and higher policy uncertainty across many economies. Against this global backdrop, a combination of country- and sector-specific factors further reduced momentum. After peaking at close to 4 percent in 2017, global growth remained strong, at 3.8 percent in the first half of 2018, but dropped to 3.2 percent in the second half of the year.

Oil demand grew 1.3% worldwide, with the United States again leading the global increase for the first time in 20 years, thanks to a strong expansion in petrochemicals, rising industrial production and trucking services. Crude oil prices showed an upward trend, price averaged 68.3 percent in 2018 compared to 52.8 percent recorded in 2017. Crude oil price has been forecasted to hit \$74 per barrel in 2019.

Demand for all fuels increased, with fossil fuels meeting nearly 70% of the growth for the second year running. Solar and wind generation grew at double-digit pace, with solar alone increasing by 31%. Still, that was not fast enough to meet higher electricity demand around the world that also drove up coal use in 2018.

Agricultural prices fell 1 percent in 2018 after gaining momentum earlier in the year, most agricultural commodity prices weakened significantly in last quarter of 2018. This was mostly in response to upward revisions to production estimates for key crops and to a lesser extent, currency depreciations among some commodity exporters. Oil and meals suffered the largest losses following the China's 25 percent tariff on U.S. soybeans. Beverage price fell more than 5 percent in 2018 with tea prices decreased to average 2.5 percent compared to 3 percent recorded in previous year. Oil and meals fell almost 2 percent while accumulatively price for soybeans, meals and coconut oil declined 11 percent in 2018. Meat and agricultural raw material prices slightly decreased compared to last year. Agriculture price index is expected to rise by 2 percent in 2019, mainly owing to higher costs of energy and fertilizers respectively.

I. CONSUMER PRICES IN AFGHANISTAN

Currently, the consumer price index (CPI) in Afghanistan is compiled on the base prices of

April 2015, while previously the CPI was calculated on the base prices of March 2011. In this revision, the CPI components are also aligned with new weights. As per data from the National Statistics and Information Authority (NSIA) and analysis of Da Afghanistan Bank (DAB), the following results were observed in consumer price index of Afghanistan.

The year-over-year measurement changes in consumer price index showed an inflation rate of 0.6 percent on average in 2018 lower than 5.0 percent recorded in the previous year. The decrease in inflation rate is in line with low and stable prices of commodities in global markets as well as low local demand in Afghanistan. Most items of the global commodity price index, especially non energy commodities, indicated lower prices over the last year in 2016.

Similar to the year-over-year comparison, inflation measured on quarter-on-quarter basis also indicated a decline in the period under review. Observing the data, the average inflation rate decreased to 0.9 percent in the fourth quarter of 2018, lower than the average rate of 3.3 percent recorded in the same quarter of 2017.

In the Capital, Kabul CPI turned to 1.4 percent on average in 2018 from 5.1 percent observed in previous year. On quarter to quarter basis, the index decreased to 1.7 percent on average in last quarter of 2018 compared to 3.2 percent in the same quarter of 2017.

3.1 Developments in National Headline Inflation (Y-o-Y)

3.1.1 Annual Developments

The headline consumer price index exhibited a significant decline on year-over-year basis as compared to 2017. As per the available data, the headline inflation measured on year-over-year basis, declined dramatically to 0.6 percent on average in 2018 from 5.0 percent recorded in last year. On monthly basis, the inflation rate was recorded at 0.75 percent, 1.11 percent, and 0.80 percent in the months of October, November, and December respectively.

Both food and non-food items showed lower prices. In the food index, the inflation declined to -1.0 percent on average in 2018 compared to higher 7.0 percent in previous year. In the above mentioned index, the deflationary pressures came from lower prices of vegetables, fresh and dried fruits, oil and fats, meat, milk cheese and eggs, non-alcoholic beverages, sugar and sweets as well as spices. The highest decrease in the index was recorded in the prices of vegetables and spices which declined to -9.6 percent and -16.7 percent on average from 21.7 percent and 6.9 percent. On the other hand, the highest increase was observed in the price index of bread and cereals which increased to 3.5 percent on average in 2018

from 1.7 percent recorded in the previous year.

In non-food category, the inflation declined by lower prices of tobacco, education, housing, and health and miscellaneous, while prices of furnishing and household clothing, communication, restaurant and hotels and transportation increased in the course of the review period. Inflation in non-food category declined to average 2.3 percent in 2018 compared to 3.2 percent observed in 2017. In the mentioned category, the highest decrease was noted in price index of housing, tobacco and health which declined to 1.5, 4.1 and 0.7 percent on average from 4.5, 7.6 and 1.9 percent. On the other hand, price index of clothing and transportation increased to 3.5 percent and 6.5 percent in 2018 from 2.8 and 5.0 percent in the previous year respectively.

Core inflation also showed downward slope in 2018 compared to the previous year. Trimmed mean which is the most common measure of core inflation, dropped to 1.4 percent on average in 2018 from 4.1 percent recorded in 2017. In addition, the CPI inflation, excluding bread and cereals, oil and fats and transportation, dramatically decreased to -0.1 percent in 2018 from 5.4 percent observed in the previous year.

3.1.2 Quarterly Developments in National Headline Inflation

The short term measure of inflation reflected a similar trend to the annual measure. The national headline inflation by this measure decreased to 0.9 percent on average in the fourth quarter of 2018 from 3.3 percent recorded in the same quarter of previous year. The decrease in inflation rate was mainly as a result of disinflation in the food item. On the contrary, the non-food category showed higher inflation in the fourth quarter of 2018 compared to the same period of 2017.

On quarterly basis, food inflation declined to -0.6 percent on average in the fourth quarter of 2018 from 4.9 percent reported in the same quarter of the previous year. The price indices of food items such as, vegetables, fresh and dried fruits, oil and fats, milk cheese and eggs and meat prices decreased dramatically, but the prices of bread and cereals and spices increased from the same period of FY 2017. However, in this category, the largest quarterly decreases were

rerecorded in vegetable and fresh and dried fruits price indices which were recorded -18.1 percent and -1.0 percent in the last quarter of 2018 compared to 21.6 percent and 8.9 percent in the last quarter of 2017 respectively.

On the other hand, non-food inflation increased to 2.3 percent on average in the fourth quarter of 2018 from 1.9 percent recorded in the same quarter 2017. In this category, the prices of transportation, education, tobacco and furnishing and household goods items increased with big margin in the period under review. The transportation index increased to 10 percent from 1.8 percent. Similarly, index of furnishing and household goods increased to 3.7 percent in the fourth quarter of 2018 from 2.9 percent in the same quarter of 2017. On the other hand, the inflation in the clothing and miscellaneous indices lowered to 3.3 percent and 2.1 percent compared to 3.4 percent and 3.7 percent observed in the fourth quarter of 2017.

Figure 3.1: National Headline Inflation (Y-o-Y)

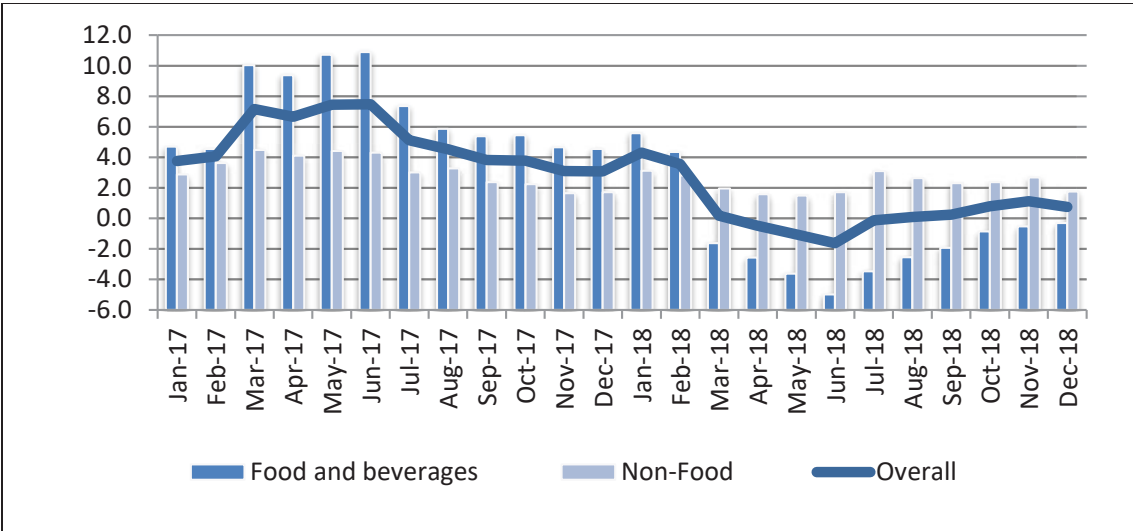
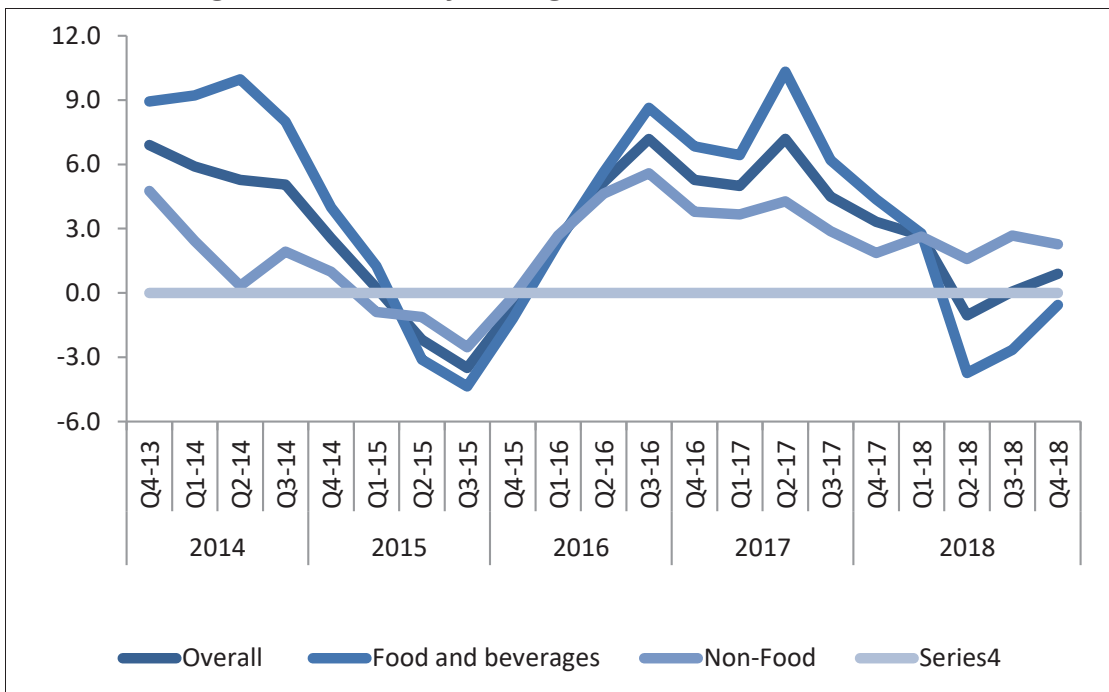


Figure 3.2: Y-o-Y Trimmed Mean



Figure 3.3: Quarterly Average Headline Inflation (Y-o-Y)



Source: NSIA/Monetary Policy Department, DAB

Table 3.1: National Headline Inflation 2018

Period	2017					2018						
	Weight	Oct-17	Nov-17	Dec-17	Average 12 months	Based on April, 2015						
						Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Average 12 months
Overall Index	100.0	3.8	3.1	3.1	5.0	-0.1	0.1	0.2	0.80	1.11	0.75	0.6
Food & Non-Alcoholic Beverages	47.8	5.4	4.7	4.6	7.0	-3.5	-2.5	-1.9	-0.85	-0.53	-0.30	-1.0
Bread and Cereals	14.6	1.0	1.0	2.0	1.7	0.6	1.0	3.3	6.74	8.46	8.17	3.5
Meat	7.5	5.9	5.7	5.5	7.1	-0.8	0.1	1.1	1.51	0.79	1.68	1.4
Milk, cheese and eggs	4.7	4.1	4.0	3.7	3.7	0.9	1.0	1.0	1.81	2.10	1.26	1.0
Oils and fats	4.6	5.4	5.2	4.4	7.9	-1.6	-2.2	-2.2	-1.64	-2.60	-2.47	-0.6
Fresh and dried fruits	5.0	8.5	10.3	7.8	8.8	1.3	3.3	0.0	-0.86	-3.04	1.01	0.9
Vegetables	6.0	25.7	19.6	19.4	21.7	-18.3	-16.1	-17.2	-17.56	-17.87	-19.00	-9.6
Sugar and sweets	2.7	-4.8	-5.1	-4.6	6.6	-8.3	-7.6	-3.6	-3.42	-1.76	-1.62	-6.7
Spices	1.3	-9.2	-15.5	-19.0	6.9	-17.2	-15.7	-13.9	-11.68	-5.23	-2.27	-16.7
Non-alcoholic beverages	1.4	2.0	1.9	1.7	2.4	2.0	2.6	2.2	3.66	4.33	4.49	2.3
Non-Food Items, Tobacco & Services	52.2	2.2	1.6	1.7	3.2	3.1	2.6	2.3	2.37	2.67	1.76	2.3
Tobacco	0.3	4.1	4.8	3.6	7.6	4.2	4.2	5.2	6.24	5.98	6.34	4.1
Clothing	4.6	2.2	3.8	4.2	2.8	3.3	3.6	3.8	3.25	2.41	4.18	3.5
Housing	19.1	3.0	1.4	1.2	4.5	3.5	2.1	0.8	0.34	0.74	-1.39	1.5
Furnishing and household goods	11.9	2.4	3.2	3.1	2.6	2.1	2.2	2.8	3.32	4.18	3.75	2.8
Health	6.2	0.6	0.7	0.9	1.9	0.8	0.5	0.2	0.57	1.29	1.60	0.7
Transportation	4.3	4.5	0.1	0.7	5.0	9.2	9.4	9.7	10.57	10.82	8.74	6.5
Communication	1.7	-2.2	-2.2	-2.1	-2.7	0.2	0.2	0.4	0.79	-0.92	-1.7	-0.5
Information and Culture	1.1	-4.7	-4.1	-4.1	-3.8	-1.6	-0.7	0.5	1.06	-0.38	-0.90	-1.0
Education	0.4	-0.1	-0.4	0.1	8.8	8.5	5.6	4.5	4.84	6.53	6.40	5.8
Restaurants and Hotels	1.1	-1.1	0.1	0.4	0.6	3.4	2.7	3.0	3.01	2.18	2.51	2.3
Miscellaneous	1.4	3.6	3.4	4.3	4.5	3.2	3.2	2.7	2.48	2.45	1.40	3.0
CPI ex. B & C, O & F, and T		4.2	3.5	3.3	5.4	-0.7	-0.4	-0.7	-0.66	-0.52	-0.82	-0.1
30% trimmed mean		2.1	1.9	2.0	4.1	1.2	1.4	1.4	1.72	1.48	1.93	1.4

Source: NSIA/Monetary Policy Department, DAB

3.2 Developments in Kabul Headline Inflation

3.2.1 Annual Developments

Headline CPI inflation in Kabul declined to 1.49 percent on average in 2018 compared to 5.1 percent recorded in the previous year. Food index, which is accounted for 37.2 percent of the overall index, reflected a deflation rate in one-year period based on year over year changes. In this category, the deflationary pressures came from lower prices of meat, vegetables, sugar and sweets, fresh and dried fruits, spices, oil and fats and milk, cheese and eggs. As a result, food inflation decreased to 0.16 percent on average in 2018 from 8.5 percent observed in 2017.

Inflation in non-food item which comprises 62.8 percent weight of the whole index, slightly decreased to 2.3 percent on average in 2018 compared to 3.0 percent in the previous year. The decrease is mainly attributed to lower prices of tobacco, housing, education and miscellaneous items. However, in this category, inflation in furnishing and housing increased to 3.2 percent from 2.4 percent.

Inflation based on core measures also recorded similar trend to the overall rate. Core inflation excluding bread & cereals, fats and oils and transportation also indicated a declining trend in the period and stood at 1.0 percent on average while the

rate was recorded 5.5 percent in 2017. Also, the 30% trimmed mean reflected a deflation rate of 1.6 percent on average in 2018 compared to 4.3 percent recorded cumulatively in 2017.

3.2.2 Quarterly Developments in Kabul Headline Inflation

The The quarter to quarter measure of headline inflation in Kabul indicated downward movement which reflected lower inflation in food index and exhibited higher inflation rate in non-food items of the CPI. Headline inflation in Kabul declined to 1.7 percent on average in fourth quarter of 2018 as compared to 3.2 percent recorded in the last quarter of 2017.

Inflation in the food index declined to 0.2 percent on average from 5.8 percent recorded in fourth quarter of 2017. In this category, the prices of meat, vegetables, oils and fats and fresh and dried fruits decreased which led to lower inflation rate during the period under review. In this category, the highest decline was observed in the price index of vegetables which turned down to -19.3 percent on average in 2018 from 23.1 percent observed in same period of the previous year. On the other hand, inflation in bread and cereals index showed an increase on quarterly basis and jumped

up to 10.6 percent on average in last quarter of 2018 from -0.3 percent recorded in last quarter of 2017.

Non-food category of the CPI showed an upward trend and contributed to inflation rate during last quarter of 2018. Inflation in this category increased to 2.6 percent on average in the fourth quarter of 2018 compared to 1.6 percent recorded in the fourth quarter of 2017. Based on quarter to quarter comparison, the increase in non-food inflation is mainly driven by higher prices of transportation, furnishing and household goods, health, education, information and culture, communication and miscellaneous items among which the largest price hike was observed in the indices of transportation item which increased to 7.5 percent from 1.4 percent. On the contrary, decline observed in the prices of housing and meat indices.

Overall, the prices of many items with higher weights in both, food and non-food indices, showed deflationary behavior especially due to seasonal changes and lower demand, During the period under review, fluctuations

in the prices were observed which were due to major supplies of gas and oil, development of farms and smooth trade with neighboring countries. In addition, production of greenhouses in different parts of the country as well as better equilibrium in supply and demand also contributed to the deflation in the country.

In Afghanistan, inflation is influenced by developments in agriculture, industry, and services sectors as well as the increasing or decreasing prices of commodities in global markets. According to the World Bank, energy prices are expected to moderate in 2019. While on the other hand, the projection for non-energy prices shows a 1 percent gain in 2019, a marginal upward revision from last year 2018.

The near-term outlook of inflation in Afghanistan is likely to move up and keep positive trend in 2019. Da Afghanistan Bank forecasts national headline inflation rate in range between 1 to 3 percent for the first haft of 2019 and 4 to 5 percent for the second half.

Figure 3.4: Kabul Annual Average Inflation 2004-2018

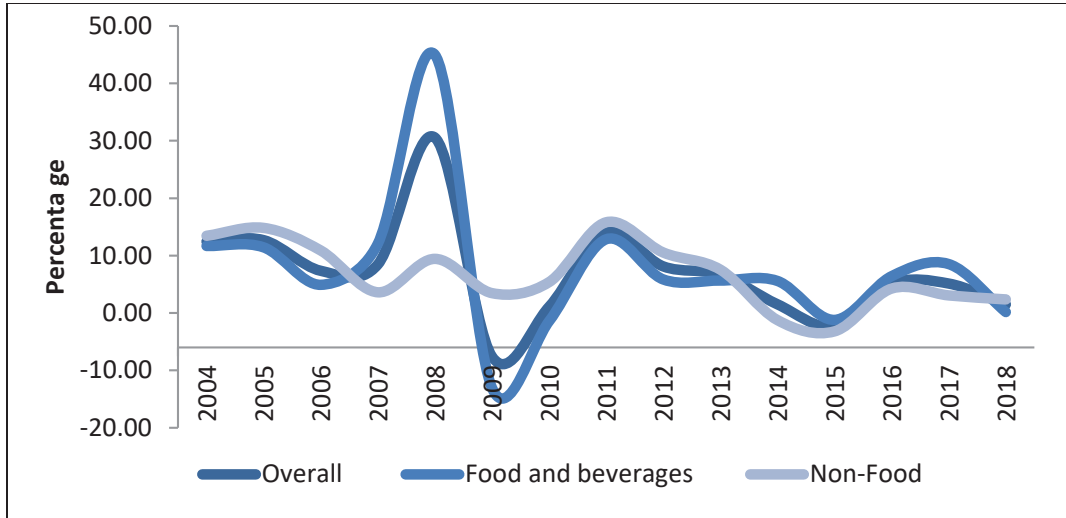
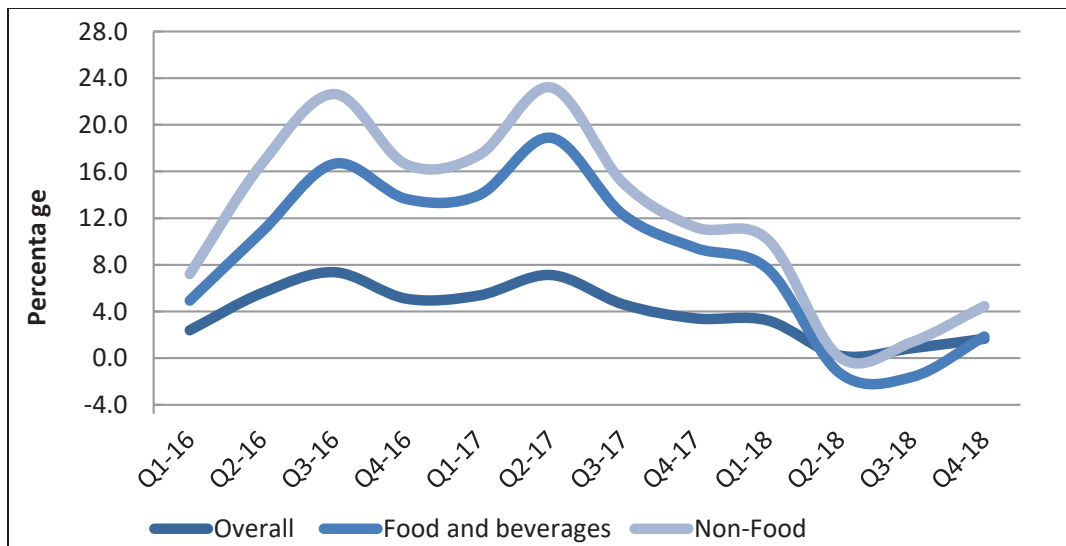


Figure 3.5: Kabul Headline Inflation 2004-2018



Source: NSIA/ Monetary Policy Department, DAB

Table 3.2: Kabul Headline Inflation 2018

Period	2017						2018						
	Weight	Based on April 2015											
		Oct-17	Nov-17	Dec-17	Average 12 month	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Average 12 month	Average (3 month)
Overall Index	100.0	3.7	3.2	2.8	5.1	0.9	0.8	0.9	1.8	1.8	1.4	1.49	0.9
Food & Non-Alcoholic Beverages	37.2	6.1	5.8	5.5	8.5	-2.9	-2.4	-2.1	0.3	-0.4	0.7	0.16	-2.5
Bread and Cereals	9.8	-1.8	-1.0	1.9	0.6	0.8	0.6	4.1	10.9	11.1	9.8	4.97	1.8
Meat	6.4	8.8	7.0	7.1	10.4	-0.9	1.3	2.9	3.5	2.5	4.8	3.05	1.1
Milk, cheese and eggs	3.2	0.3	0.3	0.0	2.8	1.7	1.5	0.4	5.3	5.9	5.6	0.91	1.2
Oils and fats	3.6	3.1	2.5	1.6	9.5	-3.1	-2.5	-1.1	0.6	1.0	0.0	-1.03	-2.3
Fresh and dried fruits	5.2	13.9	20.8	19.0	12.7	4.8	4.2	-1.6	-4.3	-9.1	-3.3	4.02	2.5
Vegetables	4.2	33.0	22.2	14.0	22.8	-19.2	-18.2	-21.8	-17.9	-20.4	-19.7	-9.28	-19.7
Sugar and sweets	2.8	-0.2	-0.6	0.4	13.5	-6.8	-5.4	-0.5	-2.3	1.1	1.3	-3.83	-4.2
Spices	1.0	-15.1	-17.5	-18.1	-1.0	-14.1	-16.7	-15.3	-6.7	-2.4	-0.4	-13.61	-15.4
Non-alcoholic beverages	0.9	-2.5	-2.5	-1.7	0.3	2.1	1.9	2.2	5.1	5.9	6.1	2.38	2.1
Non-Food Items, Tobacco & Services	62.8	2.2	1.6	1.1	3.0	3.4	2.9	2.7	2.7	3.2	1.8	2.36	3.0
Tobacco	0.3	7.6	7.9	6.9	13.0	5.5	4.6	5.0	4.5	3.2	3.5	3.05	5.0
Clothing	4.8	0.8	4.2	4.1	2.1	4.3	4.7	5.7	4.4	2.0	5.2	4.12	4.9
Housing	23.5	4.6	1.5	0.6	5.2	4.2	2.8	1.3	0.2	0.8	-2.5	1.31	2.8
Furnishing and household goods	17.6	2.2	3.4	2.7	2.4	2.1	2.3	3.3	4.4	5.7	5.3	3.21	2.6
Health	5.3	-0.9	0.5	0.3	-0.3	3.3	2.3	1.3	2.1	1.8	1.4	1.90	2.3
Transportation	4.6	4.2	0.2	-0.1	4.1	6.1	5.9	6.8	7.8	9.0	5.8	4.20	6.3
Communication	2.0	-4.3	-4.3	-4.5	-3.4	0.2	0.2	0.8	1.9	0.9	1.6	-0.38	0.4
Information and Culture	1.7	-8.3	-7.3	-7.3	-6.4	-3.3	-2.3	0.0	1.4	-2.1	-2.6	-2.19	-1.9
Education	0.7	0.7	0.2	0.4	11.9	11.8	8.2	6.6	6.3	8.8	8.7	8.05	8.9
Restaurants and Hotels	1.0	-6.4	-4.0	-3.3	-3.0	2.4	2.4	4.1	2.3	1.7	2.8	2.28	2.9
Miscellaneous	1.3	2.5	0.9	3.1	7.1	2.2	3.1	2.3	4.4	5.7	4.2	3.13	2.5
CPI ex. B & C, O & F, and T		4.3	3.9	3.1	5.5	0.8	0.7	0.3	0.5	0.4	0.3	1.0	0.6
30% trimmed mean		1.2	0.9	1.5	4.3	1.5	1.6	1.9	2.7	2.6	2.7	1.6	1.6

Source: NSIA/Monetary Policy Department, DAB

4

External Sector Developments

4

EXTERNAL SECTOR DEVELOPMENT

The external sector slightly improved further, benefiting from sustained growth in export of goods and services, modest import reduction and enhanced inflows to the primary account and worker home remittances. A substantial increase in earnings from export of goods and services helped offset expenditure on imports to a small extent. The export of services, such as construction, telecommunication and government related services recorded a significant growth. These developments, together with an increase of workers' remittances, helped reduce the external current account deficit to a low level of USD 4,055.78 million in the FY 2018 compared to the deficit of USD 4,145.23 million in the FY 1396.

Inflows to the capital account declined significantly on account of capital transfers in the FY 2018. However, Inflows to the financial account of the BOP continued during the FY 2018. Foreign Direct Investment (FDI), net inflows significantly expanded.

Likewise, other aggregate assets in the form of banking sectors currency and deposits

outside increased and on the other hand other aggregate liabilities dropped in the FY 2018. In view of these developments, the BOP recorded a deficit of USD 3,065.03 million in the FY 2018 , compared to the deficit of USD 2,807.83 million in the FY 1396.

I. BALANCE OF PAYMENTS

1.1 Current Account Balance

The current account of the balance of payments comprises the balance of trade in goods and services plus net investment incomes from overseas assets and net transfers.

Current account of the balance of payments recorded a deficit of USD 4,055.78 million in the FY 2018 , lower than a deficit of USD 4,145.23 million in the FY 2017 which depicted 2 percent decline in the deficit (Table 4.1 figure 4.1).

The contraction in current account deficit was primarily on account of increasing in earnings of goods and services account, a higher inflows to the primary income account in the form of both compensation of employees and investment income as well as increasing

inflows to the secondary income account in the form of workers home remittances.

The deficit of trade balance (goods & services) declined by 6 percent which is brought about by a larger increase in merchandise exports relative to imports. Earnings from export of goods as a total increased by 12 percent to a value of USD 875.24 million in the FY 2018 from a value of USD 783.96 million recorded in the FY 1396.

Likewise, expenditure on imports of goods slightly increased by 2 percent to a value of USD 6,899.80 million in the FY 2018 from a value of USD 7,023.80 million recorded in the FY 1396.

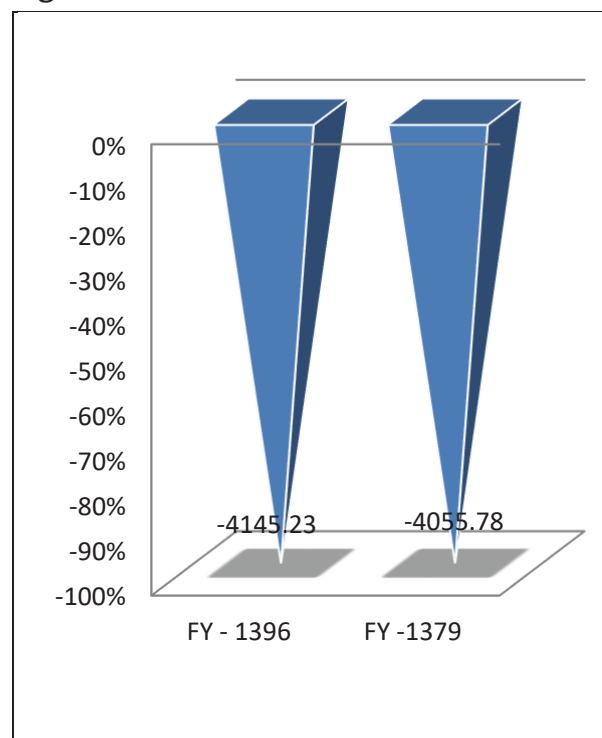
In the services account, net services out-payments decreased significantly by 30 percent to a value of USD 515.48 million in the FY 2018 from a value of USD 737.28 million recorded in the FY 1396, mainly on the back of a rise in net earnings from construction, telecommunication and government goods and services.

Net primary income increased significantly by 44 percent to a value of USD 221.69 million in the FY 2018 as compared to a value of USD 153.45 million recorded in the FY 1396.

Likewise, net private transfer receipts, mainly representing remittances by Afghans employed overseas notably rose by 42 percent to a value of USD 381.10 million in the FY 2018 from a value of USD 268.88 million recorded in the previous year.

Vice-Versa, net current transfers (current grants) to the government sector declined by 16 percent to a value of USD 1,768.24 million in the FY 2018 from a value of USD 2,105.12 million recorded in the previous year.

Figure 4.1: Current Account Balance



Source: NSIA/DAB staff calculations

1.2 Capital Account

The surplus in the capital account of the balance of payments decline by 22 percent to a value of USD 1,404.53 million in the FY 2018 from a value of USD 1,790.78 million recorded in the FY 2017 as a result of lower inward of capital transfers to the government sector, corporations and households (Table 4.1, Figure 4.2).

1.3 Financial Account

Under financial account of the Balance of Payments (BOPs), foreign investment is an important component which consists of foreign direct investment (FDI), foreign portfolio investment (FPI) and Other Investments.

FDI inflows to the country increased by 123 percent to a value of USD 115.12 million in the FY 2018 from a value of USD 51.53 million recorded in the FY 1396.

Whilst portfolio investment depicted an outflow of USD 23.51 million in the FY 2018, primarily in the money market instrument segment, as compared with outflow of USD -29.11 million recorded in the last year.

Further analysis reveals that the country's other aggregate financial assets abroad increased to a value of USD 273.34 million in the FY2018 from a value of USD 35.92 million recorded in the FY 2017 (Table 4.1 figure 4.3).

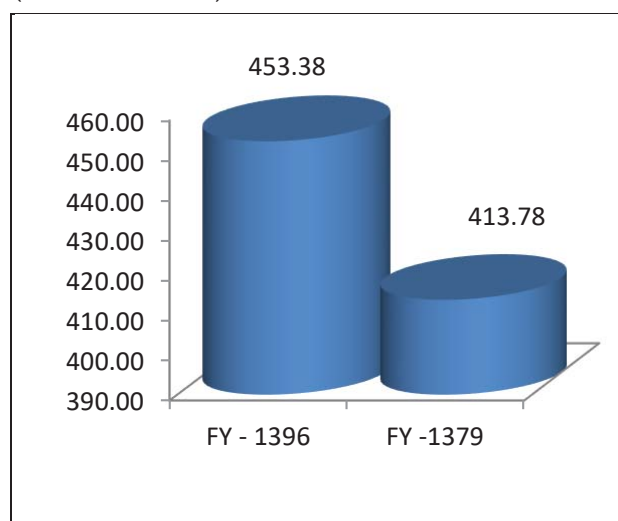
On the other hand, total aggregate financial liabilities, decreased to a value of USD -88.39 million in the FY 2018 from a value of USD 67.40 million recorded in the previews year.

Reserve assets (on a Bop basis) declined by 71 percent to a value of USD 167.65 million in the FY 2018 as compared to a value of USD 576.29 million recorded in the FY 2017 as a result of declining foreign exchange reserves.

The financial account balance as a total recorded a value of USD 413.78 million in the

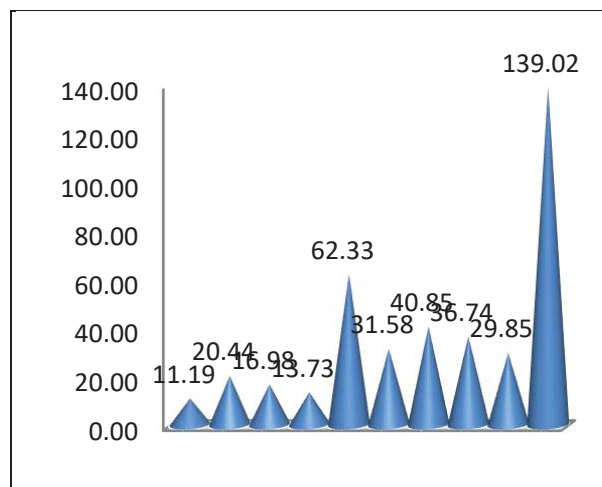
FY 2018 as compared to a value of USD 453.38 million recorded in the FY 1396.

Figure 4.2: Capital and Financial Account (in million USD)



Source: NSIA/DAB staff calculations

Figure 4.3: Afghanistan Foreign Direct Investment Inflows (in million USD)



Source: NSIA/DAB staff calculations

II. MERCHANDISE TRADE

This part of the report presents an analysis of the Afghanistan's merchandise trade performance in the FY 2018 in comparison with their trade performance in the FY 1396.

Afghanistan's trade balance has been in a deficit position since long period. This means that the total value of imported goods has been greater than the total value of exported goods, (table 4.2 figures 4.4).

During the FY 2018 the external merchandise trade deficit declined by 2 percent to a value of USD 6,531.36 million in the FY 2018 from a value of USD 6,664.21 million recorded in the previous year.

Aggregate exports of goods indicated an increase of 12 percent to a value of USD 875.24 million in the FY 2018, higher than a value of USD 613.80 million recorded in the FY 1396.

Among the exporting components, exports of leather and wool and medical seeds shows upward trend, while food items and carpet and rugs shows downward trend during the reporting year.

Export of leather and wool increased by 83 percent to a value of USD 42.32 million in the FY 2018 from a value of USD 23.13 million recorded in the FY 1396.

Similarly, exports of medical seeds reported USD 392.88 million in the FY 2018 as against USD 295.55 million recorded in the FY 1396, reflected 33 percent increase.

While, exports of food items (fresh fruits, dry fruits and oil seeds) decreased by 5 percent

to a value of USD 417.69 million in the FY 2018 from a value of USD 441.51 million recorded in the FY 1396.

Likewise, export of carpet and rugs declined by 6 percent to a value of USD 22.35 million in the FY 2018 from a value of USD 23.74 million recorded in the previous year.

At the same time, aggregate imports slightly increased by 1 percent to a value of USD 7,406.60 million in the FY 2018 compared to a value of USD 7,448.14 million recorded in the previous year.

Over the same period of comparison, decreases were registered in the value of two importing commodity divisions, in particular imports of consumer goods and imports of industrial supplies.

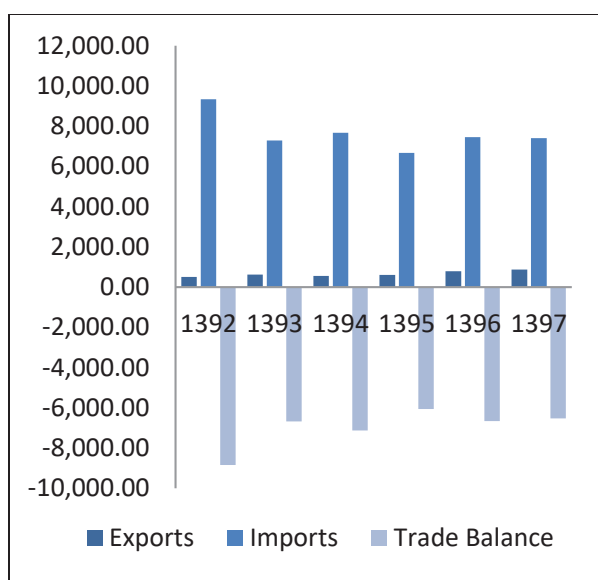
Imports of consumer goods decreased by 3 percent to a value of USD 2,904.23 million in the FY 2018 from a value of USD 2981.46 million recorded in the FY 1396, imports of industrial supplies declined by 7 percent to a value of USD 825.68 million in the FY 2018 from a value of USD 883.27 million recorded in the FY 1396.

Unlike the consumer goods trend, imports of fuel and lubricant increased by 8 percent to a value of USD 949.78 million in the FY 2018 from a value of USD 877.65 million recorded in the FY 1396, and imports of capital goods dropped slightly by 1 percent to a value of USD 2,726.90 million in the FY 2018 from a value of USD 2,705.75 million recorded in the FY 1396.

A result, a significant change in the import structure in favor of industrial supplies has

been observed during the third quarter of the FY 2018. Industrial supplies mainly comprise metal productions, fertilizer and cement which are essentials for economic development. So, higher imports of such goods are an obvious evidence of accelerating of economic activities in the country especially, in the industrial and construction sectors.

Figure 4.4: Trade Performance and Trade Balance



Source: NSIA/ DAB staff calculations

III. DIRECTION OF TRADE

The major trading partners of Afghanistan are Pakistan, Iran, India, China, and Common Wealth of Independence States (CIS).

Pakistan, India, Iran, China and CIS countries remained the largest export destinations for Afghanistan, While, major import origins for Afghanistan are; Pakistan, India, Iran, Germany, China, USA, Japan and CIS countries.

2.1 Direction of Exports

Pakistan continued to be the single largest buyer of Afghanistan's exports for a long period.

The share of Afghanistan's exports to Pakistan increased to 43 percent in the FY 2018 from 38 percent that was recorded in the FY 1396, registered 26 percent growth in export earnings over the last year. The main drivers of increasing exports in the year under review are fresh fruits, dry fruits cotton and carpet products, , and medical seeds which accounted for 9 percent, 6 percent, 2 percent, 2 percent and 1 percent of total exports respectively to Pakistan.

India ranked the second largest buyer of Afghanistan's exports in the FY 2018.

The share of Afghanistan's exports to India dropped to 41 percent in the FY 2018 from 43 percent recorded in the last year, registered 7 percent growth in export earnings over the last year. Fresh and dry fruits, medical seeds and saffron are the major exporting items to India which accounted 25 percent 14 percent and 2 percent of total exports respectively to India.

China graded the third largest buyer of Afghanistan's exports in the FY 2018.

The share of exports to China increased to 3.25 percent in the FY 2018 from 1.24 percent recorded in the FY 1396, registered 192 percent growth in exports earning in the year under review. Dry fruits and Wool & Animals Hair are the main exporting items to China which accounted for about 1.38 percent and 1

percent of total exports respectively in the FY 2018.

Iran ranked the last largest buyer of Afghanistan’s exports in the FY 2018. The share of exports to Iran declined to 2 percent in the FY 2018 from 3 percent recorded in the FY 1396, registered 33 percent reduction in export earnings (table 4.3 & 4.4 and figure 4.5 & 4.6).

Figure 4.5: Direction of Exports (% share) FY 2018

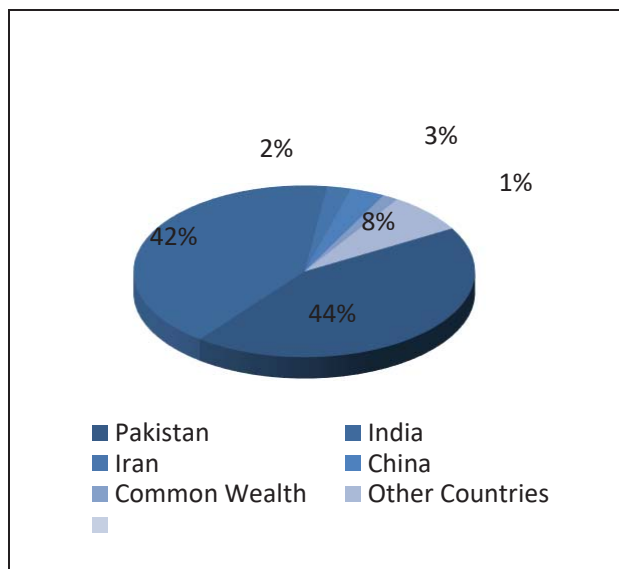
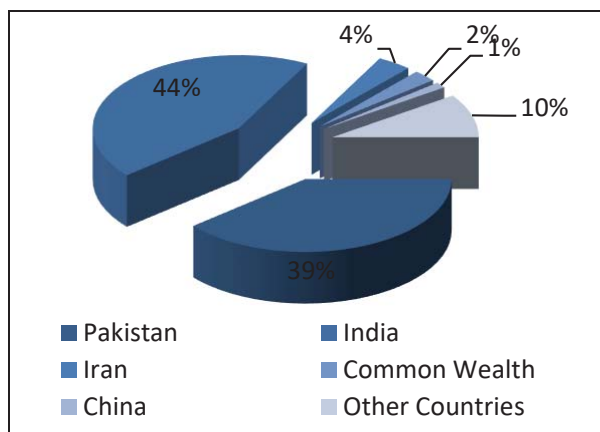


Figure 4.6: Direction of Exports (% share) in FY 2017



Source: NSIA/DAB staff calculations

2.2 Direction of Imports

CIS countries continued to be the single largest sources of imports for Afghanistan.

During the year under review Imports from CIS countries declined to a value of USD 1,983.59 million with share of 26.78 percent in the FY 2018 from a value of USD 2,039.50 million with share of 27.38 percent in the FY 2017 registering 3 percent reduction.

The main imported items from CIS countries are (flour and wheat flour, veg. oil, petroleum oil, Electricity, Metal production, fertilizer and cement).

Iran ranked the second largest origin of imports for Afghanistan accounted for about 17 percent of total imports in the FY 2018.

Aggregate Imports from Iran increased by 4 percent to a value of USD 1,264.18 million in the FY 2018 from a value of USD 1,220.57 million recorded in the FY 1396. The main imports from Iran were; petroleum oil, Metal production, cement, Electricity, fertilizer, spare parts, and consumer goods.

China graded the third largest import origin to Afghanistan accounted for 15.7 percent of total imports in the FY 2018.

Aggregate Imports from China increased to a value of USD 1,165.94 million in the FY 2018 from a value of USD 1,145.73 million recorded in the FY 1396, registered 2 percent growth in total imports during the FY 2018. The main imports from China were; spare parts, Metal production, fertilizer, Tire and tubes and consumer goods.

Pakistan was the fourth largest imports origin for Afghanistan accounted for about 15 percent of total imports in the FY 2018.

Imports from Pakistan declined to a value of USD 1,086.86 million in the FY 2018 from a value of USD 1,226.77 million in the FY 2017 registered 11 percent reduction.

The main imports from Pakistan were; spare parts, Industrial supplies and consumer goods.

Japan and India were the last largest import sources for Afghanistan, accountable for 6 and 5 percent of total imports respectively in the FY 2018 (Figure 4.7 & 4.8).

Figure 4.7: Direction of Imports (% share) in FY 2018

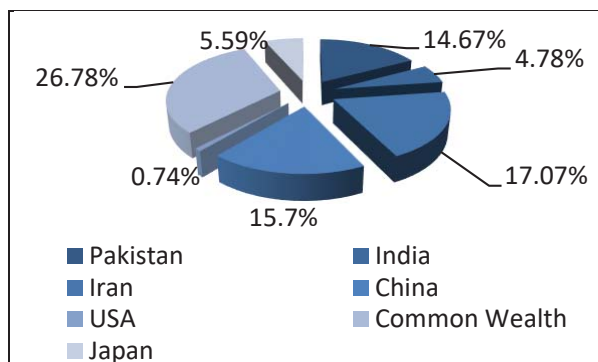
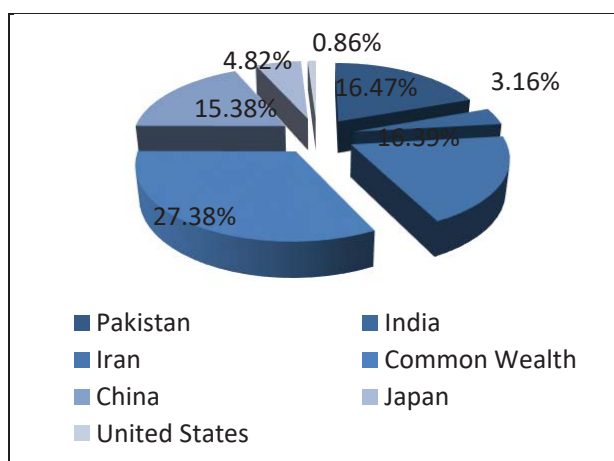


Figure 4.8: Direction of Imports (% share) in FY 2017



Source: NSIA/DAB staff calculations

IV. COMPOSITION OF TRADE

4.1 Composition of Imports

The composition of imports in the FY 2018 indicates that;

- ✓ Imports of consumer goods had the largest share in the basket of imports which declined slightly to 39.2 percent in the FY 2018 from 40 percent recorded in the FY 1396.

Expenditure on imports of such goods also decreased by 3 percent to a value of USD 2,904.23 million in the FY 2018 from a value of USD 2,981.46 million recorded in the previous year.

- ✓ The second largest share recorded for capital goods in the basket of imports during the FY 2018. The share of capital goods increased slightly to 37 percent in the FY 2018 from 36 percent recorded in the previous year.

Expenditure on imports of capital goods also increased by 1 percent to a value of USD 2,726.90 million in the FY 2018 from a value of USD 2,705.75 million recorded in the FY 1396.

- ✓ Imports of fuel and lubricants (petroleum oil) had the third largest share in the basket of Afghanistan's imports which is slightly increased to 13 percent in the FY 2018 from 12 percent recorded in the FY 1396.

Expenditure on imports of fuel and lubricants in total imports increased by 8 percent to a value of USD 949.78 million in the FY 2018 from a value of USD 877.65 million recorded in the FY 1396.

- ✓ Industrial supplies had the smallest share in the basket of Afghanistan’s imports during the FY 2018 which decreased from 12 percent in the FY 1396, to 11 percent during the year under review.

Expenditure on imports of Industrial supplies also decreased by 7 percent, to a value of USD 825.68 million in the FY 2018 from a value of USD 883.27 million recorded in the FY 1396, (Table 4.2- and Figure 4.9 - 4.10).

Figure 4.9: Composition of Imports (% share) in FY 2018

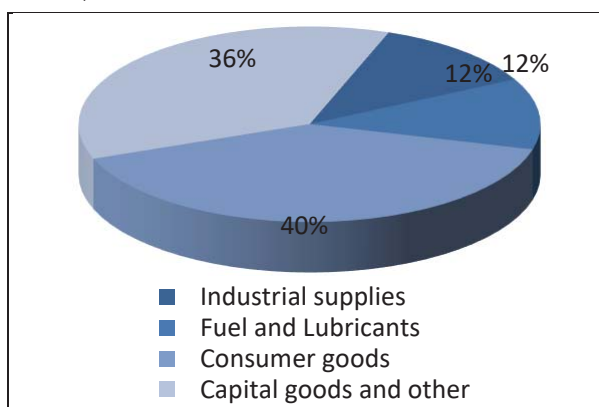
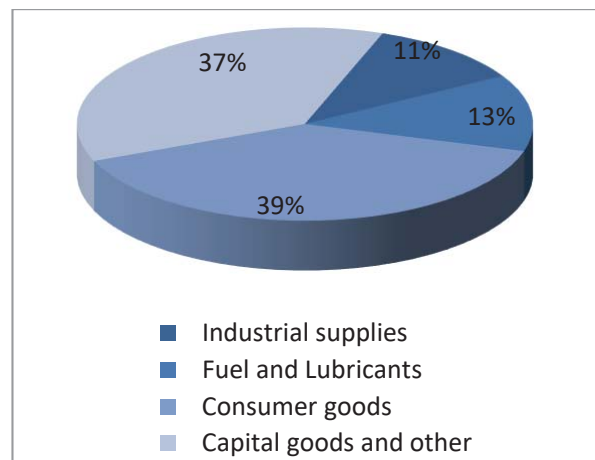


Figure 4.10: Composition of Imports (% share) in FY 2017



Source: NSIA/DAB staff calculations

4.2 Composition of Exports

The composition of exports in the FY 2018 reveals that;

- ✓ Exports of food items (oil seeds, fresh and dry fruits) had the largest share in the basket of Afghanistan’s exports although it’s declined to 48 percent in the FY 2018 , from 56 percent recorded in the FY 1396.

Earnings from exports of medical seeds declined by 5 percent to a value of USD 417.69 million in the FY 2018 from a value of USD 441.51 million recorded in the previous year.

- ✓ The second largest share in total exports was recorded for medical seeds which increased to 45 percent in the FY 2018 from 38 percent recorded in the last year.

Earnings from exports of medical seeds increased by 33 percent to a value of USD 392.88 million in the FY 2018 from a value of USD 295.55 million recorded in the FY 1396.

- ✓ Leather and wool products had the third largest share in the total exports. The share of leather and wool which recorded 3 percent in the FY 2017 it's increased to 5 percent during the year under review.

Earning from exports of leather and wool increased to a value of USD 42.32 million in the FY 2018 from a value of USD 23.13 million recorded in the last year.

- ✓ Carpet and rugs which are considered the main component of Afghanistan's exports in the past decades had the smallest share 3 percent in total exports,

Earnings from exports of carpet and rugs declined by 6 percent to a value of USD 22.35 million in the FY 2018 from a value of USD 23.74 million that was recorded in the last year (table 4.2 - figure 4.11 and 4.12).

Figure 4.11: Composition of Exports (% share) in FY 2018

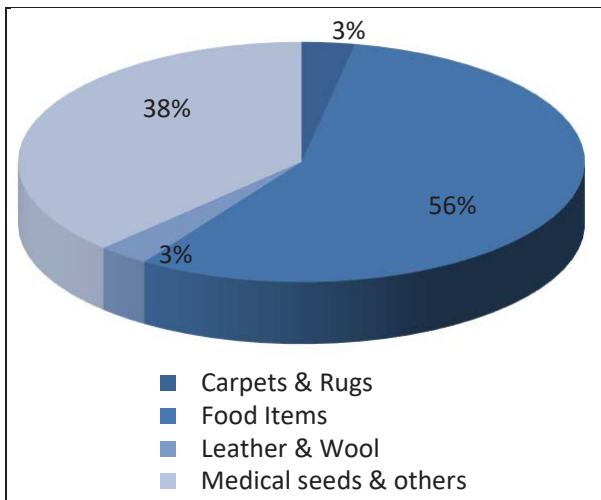
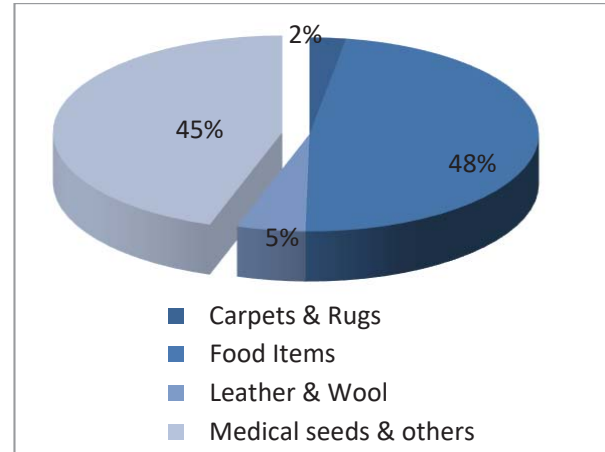


Figure 4.12: Composition of Exports (% share) in FY 2017



Source: NSIA/DAB staff calculations

V. EXTERNAL DEBT

Afghanistan's total external debt decreased by 4 percent to a value of USD 2,102.19 million in the FY 2018 from a value of USD 2196.95 million recorded in the FY 1396, which shows about USD 94.76 million reduction, (table 4.5 and figure 4.13).

During the quarter under review, loan principal repayments made to the World Bank, Asian Development Bank, Saudi Fund for Development and Bulgaria, while service charges were paid to the World Bank, Asian Development Bank and Kuwait Fund.

World Bank and Asian Development Bank as major multilateral creditors to Afghanistan, mad some debt release on principle and services charge during the year under review.

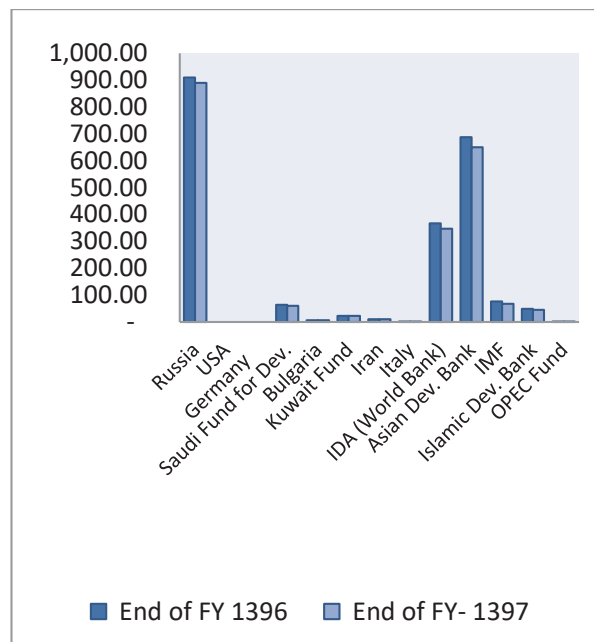
The total loan amounts payable to the Paris Club creditors in the FY 2018 stood at a value of USD 889.40 million which is payable to Russian federation.

In other words, Afghanistan’s total debt from the Paris club members stands at about 42.31 percent of total current external debt which has decreased slightly by about 2 percent compared to the last year.

Furthermore, total debt from Non-Paris Club members which are including, (Saudi Fund for Development, Bulgaria, Kuwait fund and Iran) decreased by 4 percent to a value of USD 100.86 million in the FY 2018 in comparison with a value of USD 105.49 million recorded in the FY 1396.

On the other hand, total debt from multilateral creditors to Afghanistan slightly decreased to a value of USD 1,111.93 million in the FY 2018 from a value of USD 1181.58 million which shows USD 69.65 million decline in the total debt during the year under review.

Figure 4.13: External Debt Comparisons for the FY 2018 and 2017 (in million USD)



Source: Debt Asset Management Unit, Ministry of Finance

VI. NET INTERNATIONAL RESERVES

According to the latest available data the net international reserves (NIR), increased by 5 percent, standing at a value of USD 7,704.98 million in the FY 2018 , up from a value of USD 7,345.36 million recorded in the last year, (Table 4.6 and Figure 4.14).

The increase in the level of NIR was mainly due to the increase in the reserve assets which expanded by 2.5 percent to a value of USD 8,362.42 million in the FY 2018 from a value of USD 8,159.01 million recorded in the last year.

While, reserve liabilities decreased by 19.2 percent to a value of USD 657.44 million in the FY 2018 from a value of USD 813.65 million recorded in the FY 1396; this

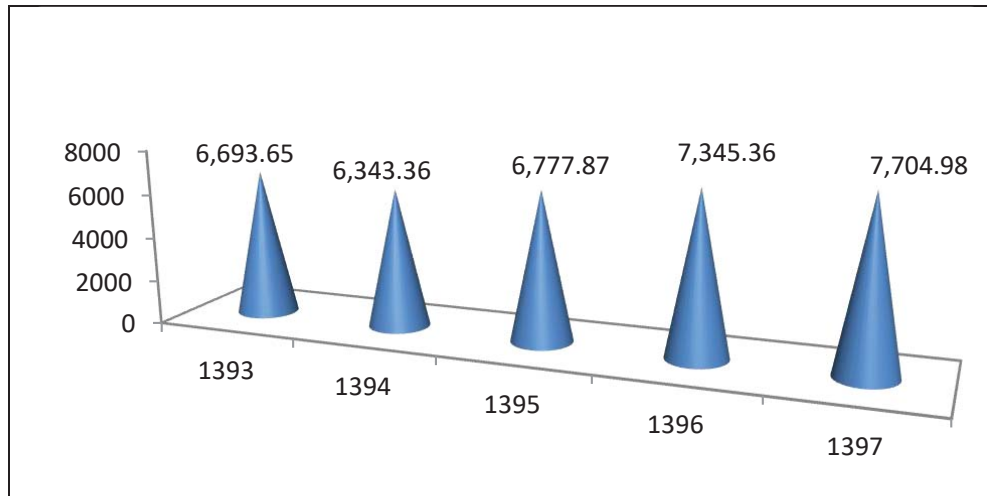
demonstrates that the reserve assets are higher than the reserve liabilities. The drop in reserve liabilities was mainly due to decline of commercial bank deposits in foreign currency which declined by 20.3 percent to a value of USD 598.08 million in the FY 2018 from a value of USD 688.49 million recorded in previous year.

The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the reporting year.

The increase in the Net International Reserves (NIR) could be attributed to significant inflows of foreign exchange to the government sector and personal home remittances.

The current level of net international reserve assets are able to support approximately 12 months of goods imports and also putting the country in a better position to withstand external shocks.

Figure 4.14: Net International Reserves from FY 2014-18 (in million USD)



Source: Monetary Policy Department, DAB

Table 4.1: Afghanistan Balance of Payments in the FY 2018 (in million USD)

Items / Years	Q1- 96	Q2- 96	Q3 - 96	Q4 - 96	FY 1396	Q1- 97	Q2- 97	Q3- 97	Q4- 97	FY 2018	%change
Current Account	-1055.43	-1430.28	-744.20	-915.32	-4145.23	-1267.08	-842.40	-889.89	-1056.42	-4055.78	-2%
<i>Credit</i>	817.97	816.60	1194.05	1297.50	4126.13	920.99	1133.74	1153.73	1060.70	4269.16	3%
<i>Debit</i>	1873.41	2246.88	1938.25	2212.82	8271.36	2188.07	1976.14	2043.62	2117.12	8324.94	1%
Goods and Services Account	-1607.57	-1981.82	-1573.42	-	-6977.11	-1834.57	-1560.85	-1543.16	-1601.46	-6540.05	-6%
				1814.31							
<i>Credit</i>	213.70	230.54	334.67	368.78	1147.70	320.49	364.21	438.04	437.41	1560.16	36%
<i>Debit</i>	1821.27	2212.36	1908.09	2183.09	8124.81	2155.06	1925.07	1981.21	2038.87	8100.20	-0.3%
Goods Account	-1456.11	-1802.22	-1372.09	-	-6239.83	-1664.49	-1499.75	-1386.93	-1473.41	-6024.57	-3%
				1609.40							
<i>Credit</i>	115.06	124.17	251.37	293.36	783.96	172.45	146.81	261.88	294.09	875.24	12%
<i>Debit</i>	1571.17	1926.39	1623.46	1902.77	7023.80	1836.94	1646.56	1648.81	1767.50	6899.80	-2%
Services Account	-151.45	-179.59	-201.33	-204.90	-737.28	-170.09	-61.11	-156.24	-128.05	-515.48	-30%
<i>Credit</i>	98.64	106.37	83.30	75.42	363.74	148.03	217.40	176.16	143.32	684.92	88%
<i>Debit</i>	250.10	285.97	284.63	280.32	1101.02	318.12	278.51	332.40	271.37	1200.40	9%
Primary Income Account	19.02	36.24	21.39	76.80	153.45	24.83	54.00	98.54	44.32	221.69	44%
<i>Credit</i>	33.98	48.50	32.91	89.14	204.53	35.27	65.53	109.23	67.45	277.47	36%
<i>Debit</i>	14.96	12.27	11.52	12.34	51.08	10.45	11.52	10.69	23.12	55.78	9%
Secondary Income Account	533.11	515.30	807.83	822.18	2678.43	542.67	664.46	554.74	500.71	2262.57	-16%
<i>Credit</i>	570.29	537.55	826.47	839.58	2773.89	565.23	704.00	606.46	555.85	2431.53	-12%
<i>Debit</i>	37.18	22.25	18.64	17.40	95.46	22.56	39.55	51.72	55.13	168.96	77%
Current transfers	439.15	428.08	665.51	572.39	2105.12	424.08	544.35	418.76	381.05	1768.24	-16%
<i>Credit</i>	439.15	428.08	665.51	572.39	2105.12	424.08	544.35	418.76	381.05	1768.24	-16%
<i>Debit</i>	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	#DIV/0!
Workers' remittances	50.40	55.16	76.53	86.79	268.88	91.92	96.60	95.42	97.16	381.10	42%
<i>Credit</i>	58.49	71.81	85.38	97.02	312.70	102.94	114.36	107.55	112.08	436.94	40%
<i>Debit</i>	8.08	16.65	8.84	10.24	43.82	11.02	17.76	12.13	14.92	55.84	27%
Capital and financial account	186.20	454.67	327.92	368.62	1337.41	16.80	226.09	276.57	471.30	990.75	-26%
Capital account	237.56	428.20	555.72	569.29	1790.78	62.89	221.38	478.72	641.53	1404.53	-22%
<i>Credit</i>	237.56	428.20	555.72	569.29	1790.78	62.89	221.38	478.72	644.71	1407.71	-21%
<i>Debit</i>	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	3.18	3.18	
Capital transfers	237.56	428.20	555.72	569.29	1790.78	62.89	221.38	478.72	644.71	1407.71	-21%
<i>Credit</i>	237.56	428.20	555.72	569.29	1790.78	62.89	221.38	478.72	644.71	1407.71	-21%
<i>Debit</i>	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	

Financial account	51.36	-26.46	227.80	200.68	453.38	46.09	-4.70	202.16	170.23	413.78	-9%
Direct investment	-11.19	-20.44	-16.98	-13.73	-62.33	-31.58	-40.85	-36.74	-29.85	-139.02	123%
Net acquisition of financial assets	-3.09	-3.27	-3.59	-0.84	-10.80	3.78	3.78	-12.36	-19.11	-23.90	121%
Net incurrence of liabilities	8.10	17.16	13.39	12.89	51.53	35.36	44.63	24.38	10.75	115.12	123%
Portfolio investment	36.62	-30.15	-11.57	-24.01	-29.11	-54.02	18.22	24.37	34.94	23.51	-181%
Net acquisition of financial assets	36.62	-30.15	-11.57	-24.01	-29.11	-54.02	18.22	24.37	34.94	23.51	-181%
<i>Net incurrence of liabilities</i>	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Other investment	12.19	25.58	-127.93	58.67	-31.48	109.58	57.53	102.07	92.54	361.73	-1249%
<i>Assets</i>	32.98	5.36	-100.29	97.87	35.92	80.47	44.96	79.32	68.59	273.34	661%
<i>Liabilities</i>	20.79	-20.23	27.64	39.20	67.40	-29.11	-12.57	-22.75	-23.95	-88.39	-231%
Reserve Assets	13.73	-1.45	384.28	179.74	576.29	22.11	-39.61	112.46	72.60	167.56	-71%
Net errors and omissions	869.23	975.61	416.28	546.71	2807.83	1250.27	616.31	613.32	585.13	3065.03	9%

Table 4.2: Merchandize Trade in FY 2018 (in million USD)

Years	FY - 1392		FY - 1393		FY - 1394		FY - 1395		FY - 1396		FY - 1397	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	9,339.60	100%	7,294.63	100%	7,679.09	100%	6,672.39	100%	7,448.14	100%	7,406.60	100%
Industrial supplies	1272.14	13.6%	863.19	11.8%	709.19	9.2%	536.47	8.0%	883.27	11.9%	825.68	11.1%
Fuel and Lubricants	2167.37	23.2%	1,155.94	15.8%	1,688.58	22.0%	1078.73	16.2%	877.65	11.8%	949.78	12.8%
Consumer goods	1942.85	21%	2,345.86	32.2%	1,715.25	22.3%	2120.44	31.8%	2981.46	40.0%	2904.23	39.2%
Capital goods and other	3957.24	42.4%	2,929.64	40.2%	3,566.07	46.4%	2,937	44.0%	2705.75	36.3%	2726.90	37%
Exports	499.81	100%	620.880	100.0%	555.71	100%	613.80	100%	783.93	100%	875.24	100%
Carpets & Rugs	85.49	17%	87.04	14.0%	108.31	19.5%	52.5	8.6%	23.74	3%	22.35	3%
Food Items	175.92	35.2%	272.13	43.8%	210.17	37.8%	269.91	44.0%	441.51	56%	417.69	48%
Leather & Wool	59.54	12%	49.35	7.9%	28.47	5.1%	55.00	9.0%	23.13	3.0%	42.32	4.8%
Medical seeds & others	178.86	36%	212.36	34.2%	208.76	37.6%	236.38	38.5%	295.55	37.7%	392.88	44.9%
Trade Balance	-8,839.79		-6,673.75		-		-		-		-	
					7,123.38		6,058.58		6,664.21		6,531.36	

Table 4.3: Direction of External Trade in the FY 2018 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	378.24	43%	1086.86	14.67%	-708.62
India	359.44	41%	354.28	4.78%	5.16
Iran	19.51	2%	1264.18	17.07%	-1244.67
Germany	5.34	0.61%	65.56	0.89%	-60.22
China	28.41	3.25%	1,165.94	15.7%	-1137.53
Turkey		0.00%	45.41	0.6%	-45.41
England		0.00%	4.66	0.06%	-4.66
Saudi Arabia	6.60	0.75%	58.46	0.79%	-51.85
USA		0.00%	55.03	0.74%	-55.03
Common Wealth	12.67	1.45%	1983.59	26.78%	-1970.92
Japan		0.00%	414.02	5.59%	-414.02
Other Countries	65.03	7.43%	908.62	12.27%	-843.59
Total	875.24	100%	7,406.60	100%	(6,531.36)

Table 4.4: Direction of External Trade FY 2017 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	299.35	38%	1226.77	16.47%	-927.42
India	337.50	43%	235.48	3.16%	102.02
Iran	28.96	4%	1220.57	16.39%	-1191.61
Germany	10.33	1.32%	49.36	0.66%	-39.03
Common Wealth	20.01	2.55%	2039.50	27.38%	-2019.49
China	9.71	1.24%	1145.73	15.38%	-1136.02
Turkey		0.00%		0.00%	0.00
Saudi Arabia	3.95	0.50%		0.00%	3.95
Japan		0.00%	359.24	4.82%	-359.24
England		0.00%	8.13	0.11%	-8.13
United States		0.00%	63.85	0.86%	-63.85
Other Countries	74.12	9.45%	1099.51	14.76%	-1025.39
Total	783.93	100.00%	7448.14	100.00%	-6664.21

Table 4.5: External Debt for the FY 2018 (in units indicated)		
	In million USD	Percent of total
Total external debt	2,102.19	100.00
Bilateral	990.26	47.11
Paris Club	889.40	42.31
Russian Federation	889.40	42.31
United States	-	0.00
Germany	-	0.00
Non-Paris Club	100.86	4.80
Multilateral	1,111.93	52.89
of which: IDA (World Bank)	346.95	16.50
Asian Development Bank	649.91	30.92
International Monetary Fund	68.20	3.24
Islamic Development Bank	45.21	2.15
OPEC Fund	1.67	0.08

Table 4.6: Net International Reserves (million USD)										
Changes on the previous quarter	2014	% change	2015	% change	2016	% change	2017	% change	2018	% change
Net international Reserves (million US Dollar)	6,693.65	23.22	6,343.36	-5.23	6,777.87	6.85	7,345.36	8.37	7,704.98	4.9
Reserve Assets	7,247.76	22.71	6,927.94	-4.41	7,581.98	9.44	8,159.01	7.6	8,362.42	2.5
Reserve Liabilities	554.12	10.91	584.58	5.50	804.11	37.55	813.65	1	657.44	-19.2
Commercial bank deposits in foreign currency	443.80	4.00	498.27	12.27	732.66	47.04	750.66	2	598.08	-20.3
Nonresident deposits in foreign currency	0.14	-89.57	0.14	0.01	0.14	0.00	0.14	-0.04	0.14	1.3
Use of Fund resources	110.18	17.53	86.17	-21.79	71.31	-17.24	62.85	-12	59.22	-5.8
Gross Intl. Reserves (in months of import)	9.31		11.40		11.85		14.67		13.47	
Net Intl. Reserves (in months of import)	9		10		11		13		12	
Source: NSIA/DAB staff calculations										

5

Fiscal Developments

5

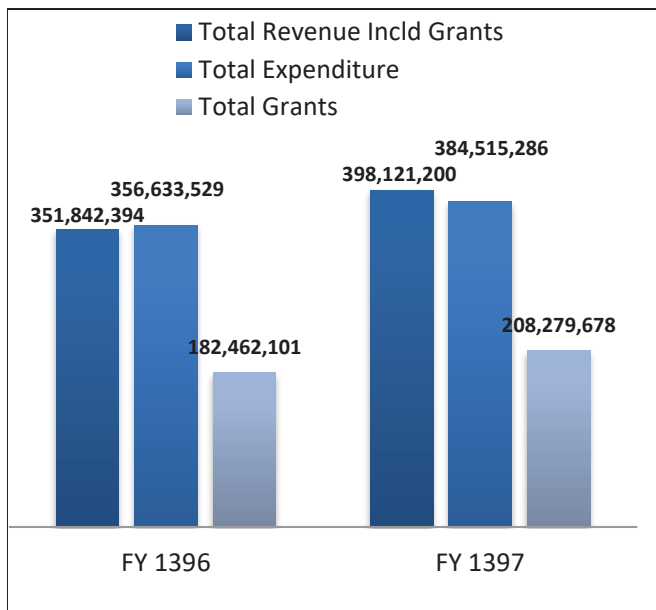
FISCAL DEVELOPMENTS

The key objective in the fiscal area is to achieve sustained increase in revenue collection and to permit the gradual takeover of externally financed operating & development spending and to ensure an expenditure allocation consistent with Afghanistan National Peace and Development Framework (ANPDF). The other goals include improvement in public expenditure management, fiscal policy formulation, and efficiency in public enterprises, taxes and customs duties administration.

Resembling the other emerging and under developing economies around the world Afghanistan continuously faces budget deficit, the total core expenditure exceeded total domestic revenue in FY 2018 leading to 194.67 billion budget deficit, and by including other source's revenue (grants) a budget surplus of AFN 13.61 billion is observed comparably. Due to increment in taxation and customs revenue "income taxes, fixed taxes, income from sales of goods and services, extractive industry, income from capital property, miscellaneous return and a large difference in non-tax revenues" the total

domestic revenue is increased from 169.68 billion of FY 2017 to AFN 189.84 billion of FY 2018 that shows an increment of AFN 20.46 billion leading to 12.08% growth in domestic revenue collection. Meanwhile increase of employees spending, capital expenditure and subsidies, grants contributions and pension expenditures resulted to raise the total core expenditure from 356.63 billion of FY 2017 to 384.52 billion of FY 2018 that shows an increase of 27.88 billion equivalents to 7.82% in expenditure compared to the fiscal year of the previous year.

Figure 5.1: Comparison of Total Revenue, Expenditure, Budget and Grants FY 2017-18



Source: MoF/MPD staff calculations

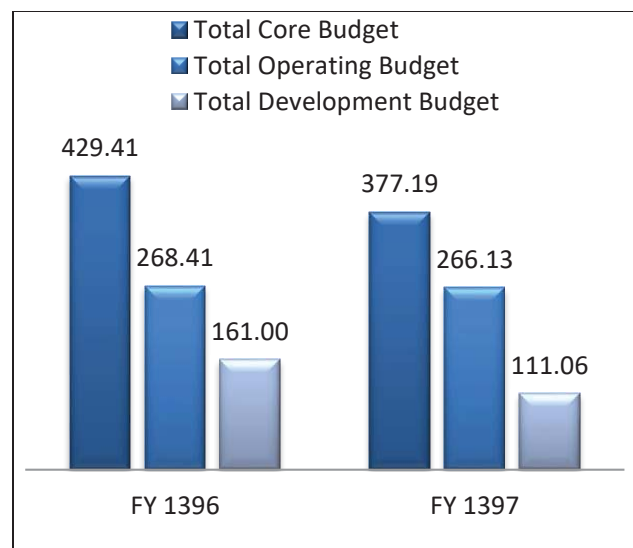
Furthermore, donor contributions are used to finance both operating and development expenditure. The total donor contribution (grants) allocated to operating and development expenditure represent a considerable increase from 196.47 billion of FY 2017 to AFN 229.79 billion of FY 2018 indicating AFN 33.32 billion that is equivalent to 17% increment in the level of grants comparably and it is as a result of change in annual pledge, commitment and disbursement of donor revenues. The level of grants has been increased comparatively the main contributors of grants are ARTF, LOTFA, CSTC-A, WB and Asian ADB and others. Furthermore, total core budget is decreased form AFN 429.41 billion of FY 2017 to AFN 377.19 billion of FY 2018 showing a crucial decrease of AFN 52.22 billion equivalents to 12% decrease in total core budget accordingly, moreover operating budget decreased from AFN 268.41 billion of FY 2017

to AFN 266.13 billion of FY 2018 indicating 0.8% percent of decline. Similarly development budget is showing a significant decrease from AFN 161.00 billion of FY 2017 to AFN 111.06 billion of FY 2018 representing 31% decrement and it is as result of low level of external source and budget allocation for the FY 2018 comparably.

I. BUDGET EXECUTION RATE

During the reference period of FY 2017, government spent 77 percent of the total AFN 377.19 billion of allocated budget, while comparing to 83 percent of the total AFN 429.41 billion of allocated budget for FY 2017 representing increase of 12 percent decline in overall budget execution rate relatively and it is attributed to several factors particularly late processing and approval of expenses by the National Procurement Authority, security condition in provinces and low performances by the budgetary units.

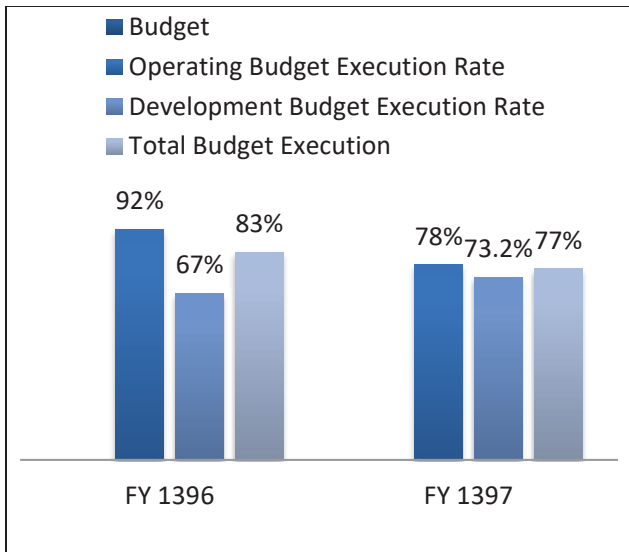
Figure 5.2: Comparison of Total Budget FY 2017 & FY 2018



Source: MoF/MPD staff calculations

Operating budget execution rate indicates 13.9 percent decrease from 92 percent of FY 2017 to 78 percent of FY 2018. The development budget execution rate evidently represents increase of 7.2 percent comparing both 67 percent of FY 2017 and 73.2 percent in FY 2016.

Figure 5.3: Comparison of Operating & Development Budget Execution Rate FY 2017-18

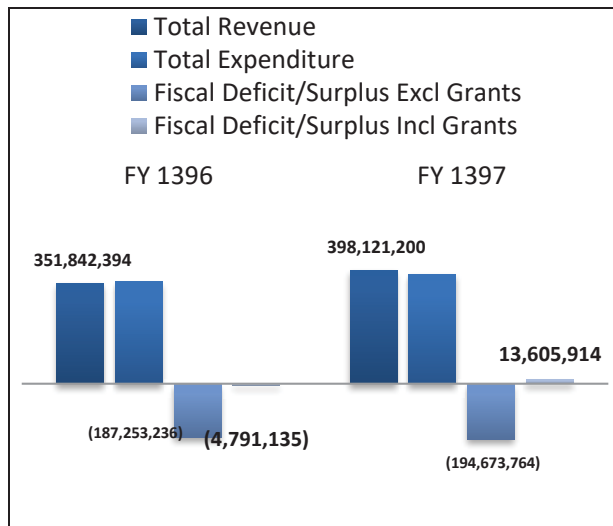


Source: MoF/MPD staff calculations

II. CORE BUDGET (DEFICIT AND SURPLUS)

The overall budget prior to donor’s contribution had a deficit of AFN 194.67 billion in FY 2018 compared to AFN 187.25 billion deficit in FY 2017 that shows 3.96 percent showing AFN 7.42 billion increase and in fiscal deficit compared. Meanwhile, external amount of funding represents increased from AFN 182.46 billion in FY 2017 to AFN 208.28 billion of the FY 2018. The total annual external planed funding amount in FY 2018 represents a decrease from 258.80 billion of FY 2017 to 191.28 billion in FY 2018 indicating 26.09 percent decrement in annual planed external source and it is as a result of low pledge, commitment and disbursement from the donor’s contribution on annual basis.

Figure 5.4: Core Budget Deficit & Surplus (Inc and Excl Grants)



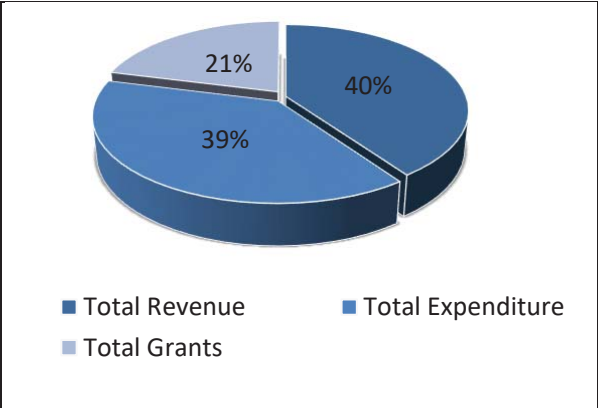
Source: MoF/MPD staff calculations

III. REVENUE COLLECTION

With reference period of FY 2018 , total revenues including grants increased significantly with total collection of AFN 398.12 billion in FY 2018 compared to AFN 351.84 billion of FY 1396, presenting amid raise of AFN 46.28 billion that shows 13.2 percent increment as compared to the previous year.

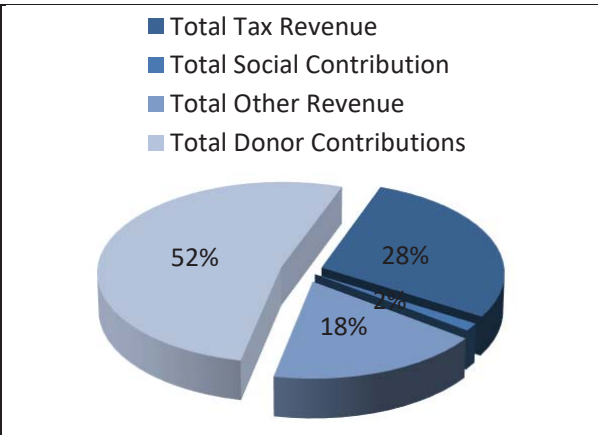
Annual collection of planed domestic sources indicates 1.06 billion of increment from 160.56 billion of FY 2017 to 161.62 billion of FY 2018 leading to 0.66 percent increase comparably. To meet FY 2018 budget deficit total domestic revenue & donor contribution play a vital role and revenue collection that steer to annual budget surplus.

Figure 5.5: Contribution of Total Revenue FY 2017-18



Moreover, the positive gain in total revenue collection of FY 2018 was as a result of momentous improved in income taxes, sale taxes sales of goods and services, extractive industry however there had been decline in administrative fees, royalties and income from capital property miscellaneous revenue and a considerable change in social contribution and other revenue sources.

Figure 5.6: Total Revenue Contribution FY 2018



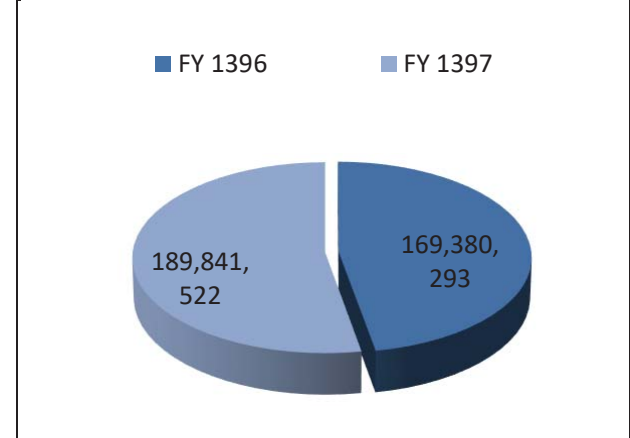
Source: MoF/MPD Staff Calculations

3.1 Domestic Revenue

The total collection of domestic revenue performance is enhanced in fiscal year 2018

however it was significantly sophisticated compared to 2017 while these measures are deemed sufficient by the government to ensure the achievement in terms of the GDP deficit in FY 2018. The increment in domestic revenue collection was attributed to enhanced receipts from custom duties, income taxes, administrative fees, sale taxes, income from capital property, sales of goods and services, extractive industry, and a notable change in miscellaneous revenue. Total domestic revenue is increased from AFN 169.38 billion of FY 2017 to AFN 189.84 billion of FY 2018 that shows an increase of AFN 20.46 billion equal to 12 percent growth in domestic revenue collection compared.

Figure 5.7: Total Domestic Revenue Comparison FY 2017- 18

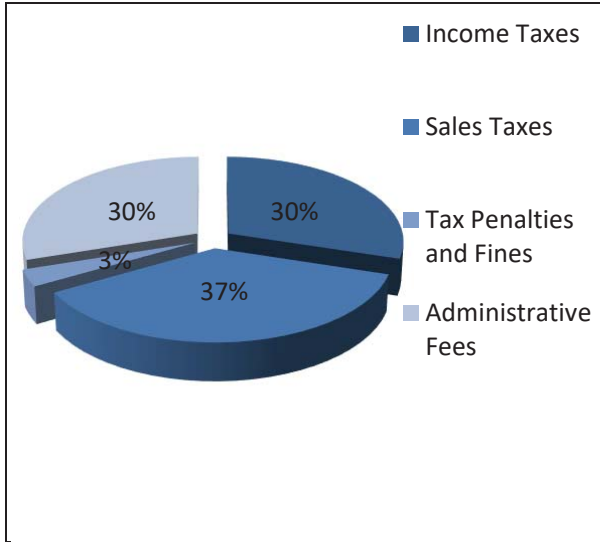


Source: MoF/MPD staff calculations

Besides, a breakdown of the total revenue collection revealed a mild deceleration in few domestic revenue components such as tax penalties, non-tax fines and penalties and revenue collected from sources under claims, that shows respectively a momentum decrease of 27.24 percent from AFN 2.70 billion in FY 2017 to AFN 1.96 billion in FY

2018 , non-tax penalties shows decrease of 11.90 percent from AFN 0.77 billion FY 2017 to AFN 0.43 billion in FY 2018 , and revenue collected from sources under claims represents a significant decrease of 5.75 percent from AFN 2.78 billion of 2017 to AFN 2.62 billion of 2018 comparably.

Figure 5.8: Major Domestic Revenue FY 2018

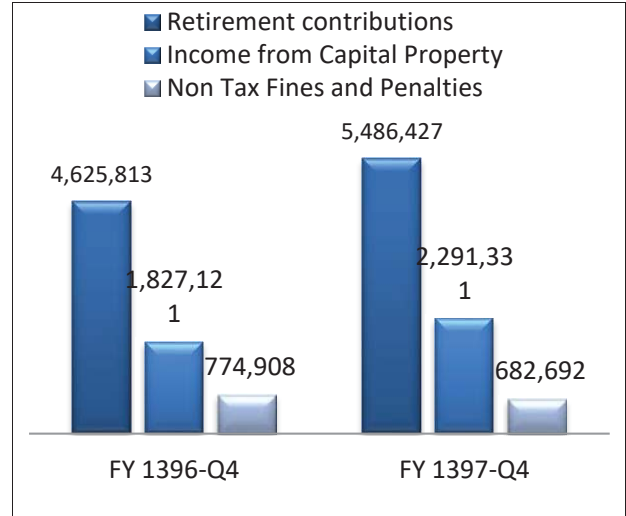


Source: Ministry of Finance/MPD calculation

3.2 Non-tax Revenues

One of the initial component of domestic revenues is non-tax revenues that represented a notable increase of 17 percent from AFN 65.67 billion of FY 2017 to AFN 77.10 billion of FY 2018 that shows a crucial increase of AFN 12.57 billion compared to previous fiscal year. This is as a result of vital increase in income from capital property, sale of goods and services, administrative fee, retirement contribution and a notable change in miscellaneous return.

Figure 5.9: Comparison of Major Components Total Non-tax Revenue FY 2017-18



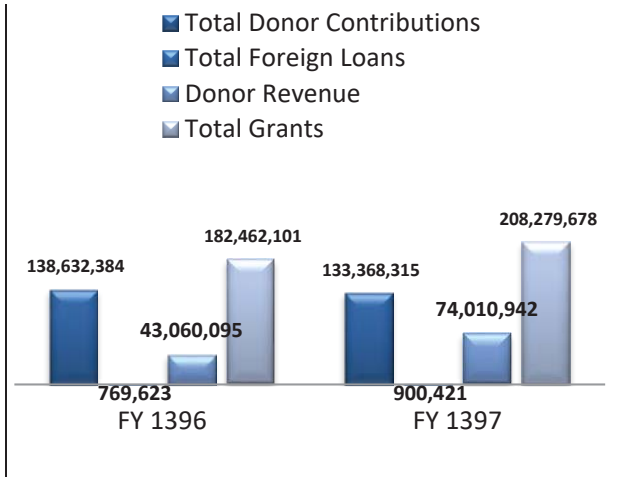
Source: Ministry of Finance/MPD calculation

The main contributors of the non-tax revenues are retirement contributions that increased from AFN 4.63 billion of FY 2017 to AFN 5.49 billion of FY 2018. indicating 18.60 percent increment in Retirement Contribution, sales of goods and services from AFN 7.92 billion of FY 2017 to AFN 9.3 billion of FY 2018 showing 17.48 percent increase, however income from capital property increased from 1.83 billion of FY 2017 to 2.29 billion of FY 2018 which signifies 32.89 percent decline, moreover miscellaneous revenue increased from AFN 20.22 billion of FY 2017 to AFN -25.50 billion of FY 2018.

IV. GRANTS

The donor contribution comprises an important part of the national budget, meantime donor grants finance major expenditure items in both operating and development budget likewise, the government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures, Moreover, In Afghanistan’s context, fiscal sustainability is defined as total domestic expenditure and it should be financed by total domestic revenue where recently it is being financed partially by external sources, foreign loans and rest by domestic revenue.

Figure 5.10: Total Annual Grants Analysis FY 2017-18

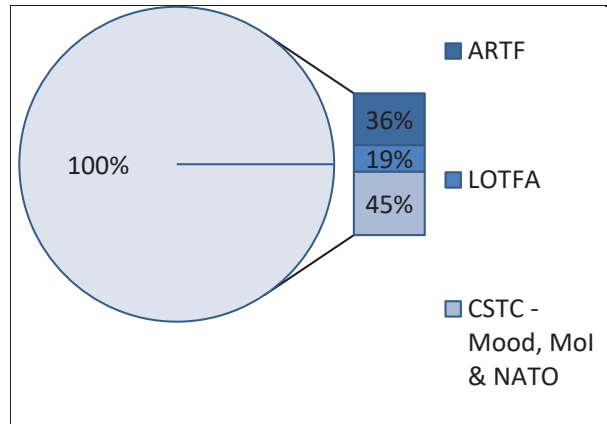


Source: MoF/ MPD staff calculations

The total development and operating grants represents significant increase of AFN 33.32 billion from AFN 196.47 billion FY 2017 to AFN 229.79 billion of FY 2018 which clearly

indicates a notable change compared to the previous year.

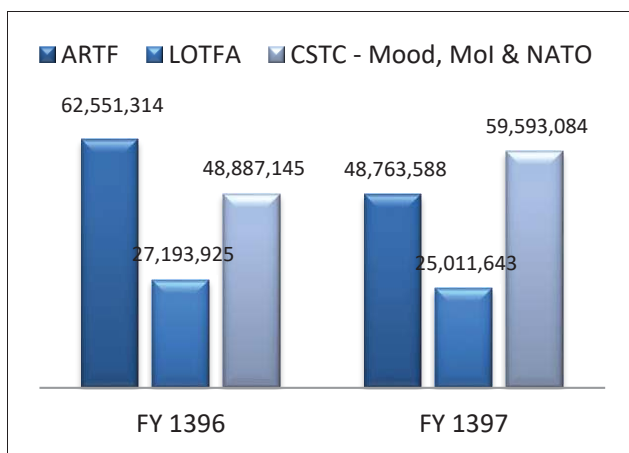
Figure 5.11: Components of Donor Contribution FY 2018



Source: MoF/MPD staff calculations

The main donor contributors to operating and development expenditures are grants from LOTFA that declined 8 percent from AFN 27.19 billion of FY 2017 to AFN 25.01 billion of FY 2018 and CSTC-A MoD, Mol & NATO contributed AFN 48.89 billion in FY 2017 that shows 22% increase compared to AFN 59.59 billion of the same quarter FY 2018.

Figure 5.12: Comparison of Donor Contributions FY 2018



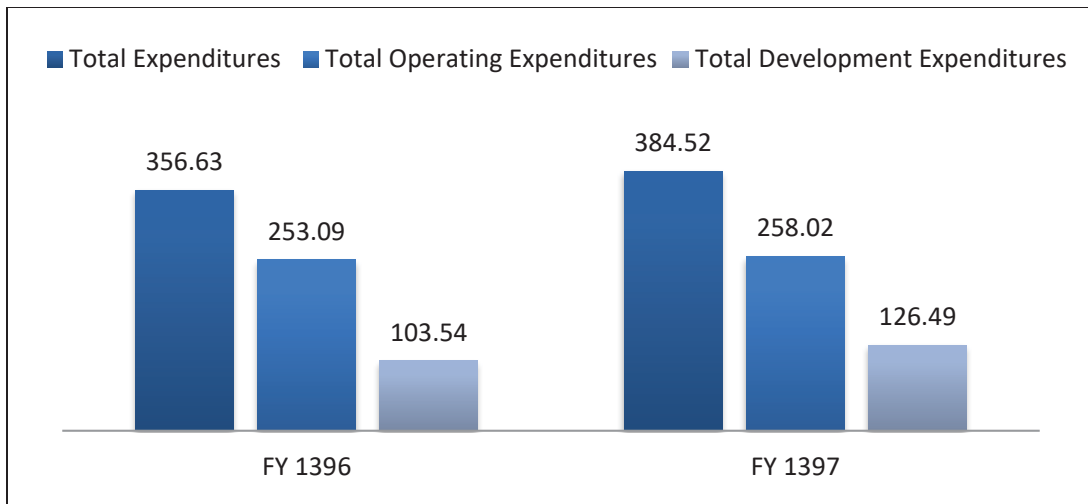
V. EXPENDITURE

The core expenditures are classified into development and operating expenditures which are allocated in eight different sectors such as security, governance, education, health, agriculture, social protection, infrastructure, and economic governance, moreover, the sector wise expenditure is provided for both operating and development budget, while, increased expenditure on infrastructure, economic governance, and agriculture sectors are in line with the ANPDF priority. Furthermore, total core expenditure presents 7.8 percent increase from AFN

356.63 billion of FY 2017 to AFN 384.52 billion of FY 2018 indicating AFN 27.88 billion increase in overall development and operating expenditure compared to same period of previous year and this is as a result of increase in (employee expenditure, grants contribution and pensions and capital expenditure).

In addition, operating expenditure indicates increase of 1.95 percent from AFN 253.09 billion of FY 2017 to AFN 258.02 billion of FY 2018 that apparently represents AFN 4.93 billion raise in operating expenditure compared to fiscal year 1396, Meanwhile development expenditure shows 22.16 percent significant increase from AFN 103.54 billion of FY 2017 to AFN 126.49 billion of FY 2018 which indicating AFN 22.95 billion speeding up in development expenditure compare to the last year. Development budget as well increase in core annual expenditure.

Figure 5.13: Comparison of Total Expenditure FY 2017-18



6

Banking System Performance

6

BANKING SYSTEM PERFORMANCE



Overall, the soundness indicators of the banking sector demonstrated increases to various degrees in the FY 2018 compared to previous year. However, a large part of the rise comes from the depreciation of AFN against USD. The growth in total assets, net loans, deposits and profitability apart from the exchange rate fluctuations can mainly be attributed to decrease in reserves, deposits upturn and profits. Liquidity remained adequate; however the banking sector is still beleaguered with low asset quality.

- Asset base of the banking sector expanded by 0.20 percent by the end of Dec, 2018 lower than 5.73 percent growth recorded in the same period of the previous year. Total assets stand at AFN 316.76 billion. The expansion in banking system assets, apart from the exchange rate fluctuations was mainly contributed by growth in interbank claims, investments, net-loans, other assets, fixed assets and intangibles assets. However, cash in vault and claims on DAB decreased over the year.

- Total gross loan portfolio of the banking sector posted a decrease of 0.87 percent over the year against the 1.31 percent growth in the comparable period of the previous year, currently standing at AFN 41.43 billion. The decrease in total gross loans is mainly attributed to charge-offs, settlement of loans and getting in a receivership of a private bank. However, the net-loans increased following the decrease in the reserves.

- Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 273.78 billion comprising 96.96 percent of the total liabilities, banks have been able to mobilize additional deposits during 2018, though a large part of the 1.28 percent or AFN 3.48 billion increases come from the exchange rate fluctuation. Total deposits cover AFN 5.10 billion interbank and AFN 268.68 billion customer deposits. The increase in deposit base of the banking sector is attributed to customer deposits and occurred mainly in demand and time deposits. While, interbank deposits

decreased over the year. Deposits were largely denominated in USD (64.04 percent) with Afghani denominated deposits lagging at 29.38 percent. Afghani denominated deposits indicated 10.64 percent decrease against 14.18 percent increase in Dec, 2017. USD denominated deposits was up by 9.00 percent against 0.54 percent increase in Dec, 2017.

- The capital base of the banking sector remained strong though decreased by 4.32 percent stands at Af 34.39 billion. The decrease in capital base attributed payment of dividends and getting in a receivership of a private bank. The capital adequacy ratio of one bank is below the set limits. The Basel benchmark for capital to risk weighted is 8 percent. Capital adequacy ratio (CAR) of the banking sector recorded at 26.69 percent.

- Banking sector earned net profits amounting to AFN 2.43 billion for the year 2018, against AFN 1.77 billion net profits in the 2017. Return on Assets (ROA) stand at 0.80 percent annualized, and Return on Equity (ROE) recorded at 6.83 percent annualized. The improvement in profitability of the banking sector as evident from the table 6.5 P/L mostly ascribed to increase in non-interest income; other contributing factors include decrease in non-interest expense, tax expense and credit provision. While, salary expenses increased and net-interest income decreased over the year. State-

Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up the year 2018 with profits.

I. ASSETS OF THE BANKING SYSTEM

The assets size of the banking sector increased by 0.20 percent in the period under analysis against 5.73 percent increase in Dec, 2017.

The breakup of total assets reveal that the most obvious increase was registered in interbank claims (AFN 26.27 billion or 38.47 percent) mostly in US accounts; Investments (AFN 1.94 billion or 8.40 percent), Other assets (AFN 1.44 billion or 11.48 percent), Fixed assets (AFN 305 million or 3.87 percent), Intangible assets (AFN 140 million or 17.74 percent) and net-loans (AFN 109 million or 0.29 percent). While cash in vault and claims on DAB and repossessed assets showed a decrease of (AFN 29.57 billion or 17.93 percent, AFN 30 million or 1.21 percent respectively) during the period under review.

The most important components of the system's total asset portfolio were cash in vault and claims on DAB (42.73 percent), interbank claims (29.85 percent), net loans (11.79 percent), investments (7.93 Percent), "other assets" (4.42 percent) and fixed assets make 2.59 percent of the total assets. See table 6.1.

Figure 6.1: Share of Total Assets across the banking group

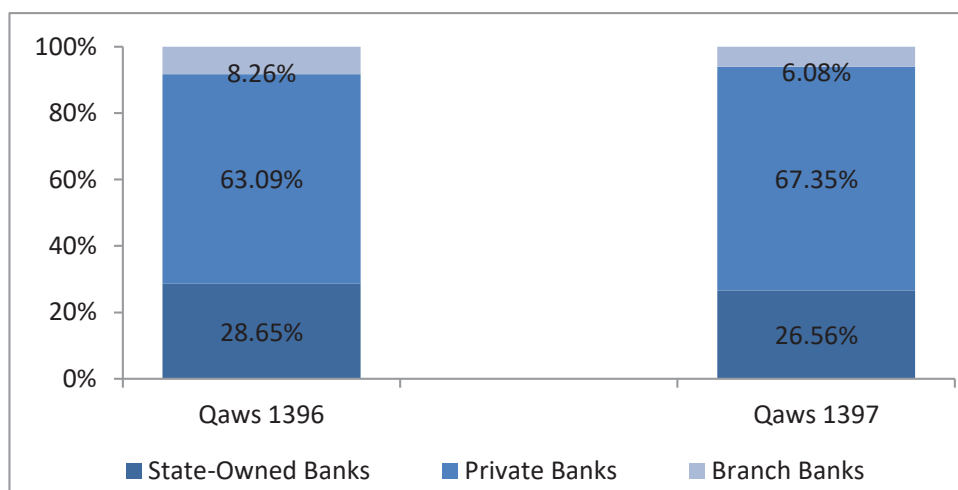


Table 6.1	Jawza 2018 June, 2018	Mezan 2018 Sep, 2018	% of Total Assets/Liability	Growth
Amount in million AFN				
Assets				
Cash in vault and claims on DAB				
DAB	164,943	135,370	42.73	-17.93
Interbank claims(Net)	68,284	94,558	29.85	38.47
Investments (Net)	23,163	25,110	7.93	8.40
Loans (Net)	37,247	37,356	11.79	0.29
Intangible assets	789	929	0.29	17.74
Repossessed Assets	1,238	1,223	0.39	-1.21
Fixed Assets	7,914	8,220	2.59	3.87
Others	12,559	14,001	4.42	11.48
Total	316,137	316,767		0.20
Liabilities				
Deposits	270,304	273,787	96.96	1.28
Borrowings	3,736	3,068	1.09	-17.88
Other	6,148	5,517	1.95	-10.26
Total	280,188	282,372		0.78
Financial Capital	35,949	34,395		-4.32

1.1 Gross Loans

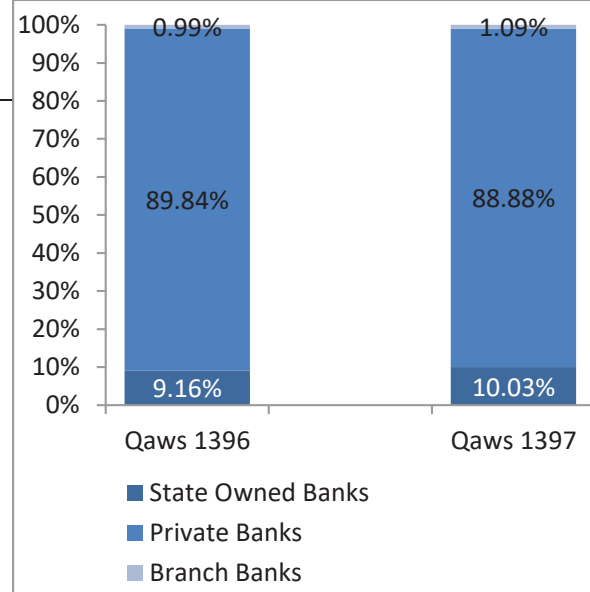
Total gross loans portfolio of the banking as of end of 2018 stands at Af 41.43 billion, indicating Af 366 million or 0.87 percent decrease over the year, constituting 13.08 percent of the total assets. The decrease in total gross loans is mainly attributed to charge-off of loans, settlement of loans, less OD utilization and getting in a receivership of a private bank and was obvious in USD accounts.

Figure 6.2: Share of Gross Loan Portfolio among banking group

Source: Financial Supervision Department

Six banking institutions recorded increases in their loan portfolio, while six other registered decrease, whereas three banks did not participate in lending.

Disaggregated analysis among the banking groups show that State Owned banks with 10.03 percent of the total banking sector portfolio demonstrated 8.48 percent increase and Branches of Foreign banks with 1.09 percent share in the banking sector showed 8.67 percent growth. While Private Banks with major share (88.88 percent) in the banking sector portfolio registered 1.93 percent decrease over the year.



1.2 Loan Loss Reserves

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk mitigation framework. Banks are required to make both general reserves (on standard assets) and specific provisions (on non-standard assets) in order to mitigate their credit risk and according to revised Asset classification and provisioning regulation, as per the new assets classification regulation the creation of reserve for standards loans is optional.

By the end of 2018, total provision cover of the system was 9.84 percent of total gross loans as opposed to 10.89 percent recorded as of end of 2017.

1.3 Distribution of Credit

In order to In order to broad-based the loan portfolio and broaden the risk diversification and financial access

besides new avenues of earning, DAB has diversified the sector wide distribution of Other Commercial Loans to thirty sectors. The analysis of deployment of credit in different sectors indicate that the major portion of the loan portfolio is invested in Trade sector (45.35 percent against 42.29 percent) mostly in petroleum and lubricant (11.48 percent); other main sectors include: Services sector (20.54 percent against 27.49 percent) mainly in telecommunications/ scratch cards distributors (5.98 percent), Manufacturing and Industry sector (12.19 percent against 9.35 percent), Commercial real stat and Construction sector (9.03 percent against 8.70 percent), Infrastructure sector (6.83 percent against 5.66 percent), Agriculture livestock and farms sector (4.16 percent against 4.17 percent) and Consumer sector (1.90 percent against 0.86 percent). Significant increases were observed in Manufacturing and Industry, Trade, Infrastructure Projects and Consumer sectors, while the Services, Agriculture livestock and farms and Residential mortgage loans to individuals sectors were the decreasing sectors. Loans designated to Micro Credit sector

posted an increase of AFN 443 million currently are AFN 4.98 billion provided by four banks, while SME sector witnessed a decrease of Af 56 million currently stands at Af 2.38 billion provided by five banking institutions. Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises situation associated to that sector, inversely affecting the overall banking sectors. Banks should closely monitor the potential risk associated with key sectors given the high NPL ratio. About 69.72 percent of the loans were designated in Kabul while Herat and Balkh provinces are in the second and third places with Kandahar, and Badghis provinces are at fourth and fifth places respectively. The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that with time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

Table 6.2: Distribution of Loans Dec, 2014-Sep, 2018

Sectors ¹	Qaws, 1393 (Dec, 2014)	Qaws, 1394 (Dec, 2015)	Qaws, 1395 (Dec, 2016)	Qaws, 2017 (Dec 2017)	Qaws 2018 (Dec, 2018)
Commercial Real Estate and Construction					
Construction and Buildings	14.32%	9.44%	11.12%	8.70%	9.03%
Infrastructure Projects					
Power	0.35%	0.22%	0.38%	0.40%	0.48%
Road and Railway	2.41%	1.17%	0.64%	1.32%	2.18%
Dams	0.61%	0.09%	0.04%	0.00%	0.36%
Mines	0.08%	1.48%	0.52%	0.48%	0.52%
Other infrastructure projects	1.81%	2.44%	2.44%	3.46%	3.28%
Manufacturing and Industry					
Manufacturing & Products of Metal wood plastic rubber leather paper					4.10%
Manufacturing handmade and machine	2.477%	4.423%	3.469%	2.671%	
Cement and Construction Materials	4.187%	4.239%	3.743%	3.164%	3.67%
Trade	2.864%	1.962%	1.274%	3.520%	4.42%
Textile					
wholesale	2.59%	0.52%	0.72%	1.54%	2.21%
Machineries	4.93%	9.89%	4.34%	4.67%	3.62%
Petroleum and Lubricants	0.12%	0.25%	0.13%	0.09%	0.41%
Spare parts	8.74%	9.80%	11.08%	10.78%	11.48%
Electronics	0.24%	1.42%	0.26%	1.39%	1.78%
Cement and other construction Material	1.40%	1.58%	1.91%	2.76%	3.21%
Food Items	1.87%	2.73%	2.35%	2.57%	5.14%
All other Items	4.52%	8.24%	7.80%	7.27%	6.44%
Retail trading	5.72%	3.47%	4.17%	3.28%	7.92%
Service	3.92%	3.28%	7.31%	8.15%	3.13%
Education					
Hotel and Restaurant	0.00%	0.00%	0.00%	0.00%	0.03%
Telecommunication/Scratch cards	1.20%	1.46%	1.33%	2.04%	2.16%
Distributers	2.92%	5.70%	5.96%	5.52%	5.98%
Ground Transportation	4.87%	5.31%	4.86%	1.86%	3.08%
Air Transportation	4.18%	2.66%	2.35%	2.90%	1.21%
Health and Hygienic	0.71%	1.16%	1.42%	1.73%	1.74%
Media, Advertisements, Printer	0.04%	0.04%	0.05%	1.18%	1.28%
All other Services	6.19%	11.36%	13.22%	12.26%	5.07%
Livestock and farms					
Livestock and farming	0.043%	0.026%	0.059%	0.225%	0.30%
Agricultural Loans	2.61%	2.67%	3.20%	3.94%	3.86%
Consumer Loans	0.26%	0.30%	0.65%	0.86%	1.90%
Residential Mortgage Loans to Individuals					
All Other Loans	7.14%	2.68%	2.78%	0.71%	0.00%
	6.68%	0.00%	0.43%	0.57%	0.00%

Source: Financial Supervision Department, DAB

¹ Revised and rearranged under specific sector heads.

II. CLASSIFICATION OF LOANS

2.1 Non-performing loans

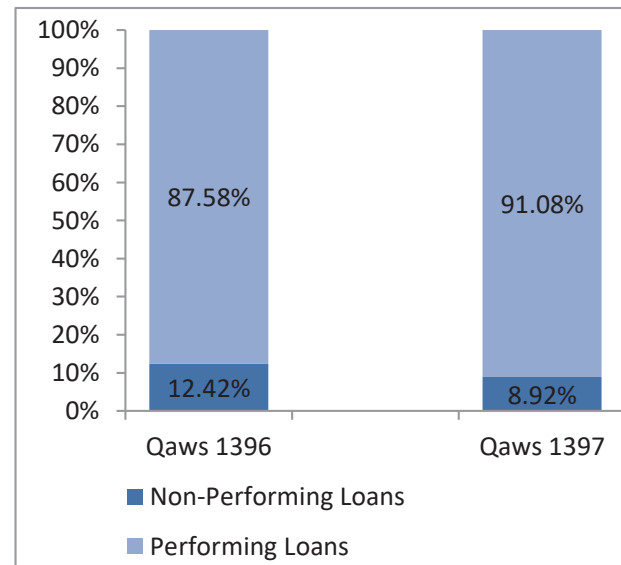
Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs, which is not a favorable situation. Moreover, it can be inferred that quality of risk management in banks with poor credit performance is demonstrating weak performance. It is essential that banks with poor loan quality evaluate credit applications carefully, comply with all applicable laws, regulations, circulars, internal policies and procedures, and closely monitor financial condition of their borrowers to ensure that credit expansion will not pose a threat to the stability of the financial system.

In monetary terms, by the end of 2018, non-performing loans recorded at Af 3.69 billion or 8.92 percent of total gross loans and 12.12 percent of the system's regulatory capital, against Af 5.19 billion or 12.42 percent of the total gross loans in Dec, 2017, showing Af 1.49 billion decrease mainly attributed to charge-off of loans and getting in a receivership of a private bank. Out of 8.92 percent NPL, 6.76 percent is related to two private banks. These banks hold 37.34 percent of the system's gross loans and 10.91 percent of system's regulatory capital.

Sectoral analysis of the NPLs show that major portion of the NPLs originate from

Services sector (30.18 percent) dominant in ground transportation (16.31 percent), Trade sector is in the second place with 22.64 percent of the sector NPLs, mostly recorded in retail trading (4.72 percent), Construction and building sector with 20.94 percent of total NPLs is in third place, while Infrastructure projects and Manufacturing and industry sector held 14.93 and 9.54 percent of the sector NPLs, mainly coming from road and railways (10.83 percent) and manufacturing and products of metal wood plastic rubber leather paper (7.71 percent) respectively.

Financial Supervision Department (FSD) is closely working with banks with poor loan performance to design and implement plans to improve their asset quality. This situation requires regulatory oversight and prompt remedial action to improve governance of credit risk to avoid negative impact over the profitability and capital



adequacy of the banks with poor credit quality.

Figure 6.3: Quality of Loan Portfolio

Source: Financial Supervision Department

2.2 Adversely-classified loans

Adversely classified loans (substandard, doubtful, Loss)² depicted Af 2.51 billion decrease over the year, reaching Af 6.06 billion, constituting 14.63 percent of the total gross loans and 19.89 percent of regulatory capital, the decrease is due to charge-off of loans, reclassification of loans and getting in a receivership of a private bank. Though decreased, but still requires strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be focused on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk. Management should take appropriate

² An asset for which the principal and /or interest remains outstanding for 61-120 days - (Substandard), ² Defaulted assets and advances for which the principal and/or interest is due and remains outstanding for 121-480 days - (Doubtful), An asset for which the principal and /or interest remains outstanding for 481 or more days - (Loss) as per the assets classification and provisioning regulation

measures to address issues and weaknesses that have resulted in poor credit performance as per prudential regulations. Though systematic risk and economic downturn may have affected, weak and systematically important bank's asset quality especially loans; however, banks management should have mechanisms to predict such risks, hedge their potential risk and take proper precautionary measures as per prudential regulations.

2.3 Loans classified Watch

Loans classified in the "watch"³ category are AFN 4.67 billion, which makes 11.29 percent of total gross loans decreased by 2.85 percent since Dec, 2017. The decrease is mostly attributed to five banks in the system. This category of loans require close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

2.4 Loans classified loss⁴

Loans charged-off as of end of Dec, 2018 amounts to AFN 711 million, 1.72 percent of total gross loans attributed to two banks in the sector.

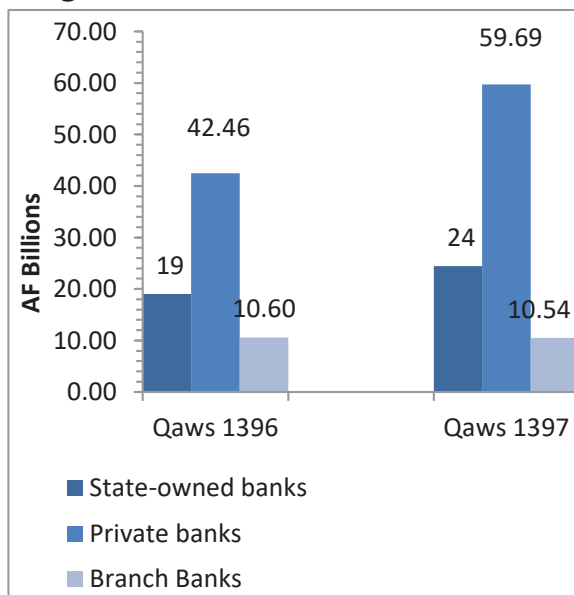
2.5 Inter-bank Claims

³ An assets for which the principal and/or interest remains outstanding due for 31-60 days as per the assets classification and provisioning regulation-(Watch)

⁴ Assets on which the payment of principal or interest is due and remains unpaid for 540 day or more (Loss) as per Accounting Letter No. 03/92 dated 16/09/1392

Gross Gross Interbank Claims are the second largest among various asset categories, currently comprising Af 94.64 billion 29.85 percent of total assets registered Af 26.15 billion or 38.18 percent increase since Dec, 2017, mostly attributed to nine banking institutions, indicating that the banking sector has channeled a portion of its attracted funds as deposits to other financial institutions. Later on, by improving security and economic situation of the country banking sector can substitute these assets to higher income earning assets. Banks must not only appropriately measure risks associated with individual bank's but also country or countries in which they have placed funds. See figure 6.4.

Figure 6.4: Share of Inter-bank claims



Source: Financial Supervision Department

2.6 Investment

The net-investment⁵ portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies; increased by 8.40 percent or Af 1.94 billion since Dec, 2017 standing at Af 25.11 billion or 7.93 percent of total assets, the increase mostly came from three banking institutions. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, five commercial banks and three branches of foreign banks.

2.7 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category making 42.73 percent of the total assets, showed a decrease of AFN 29.57 billion, both in absolute as well as in percentage of total assets since Dec, 2017 standing at AFN 135.37 billion as of end of Dec, 2018. The decreases were observed in cash in vault, corresponding accounts with DAB, overnight deposits and DAB capital notes.

Banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

⁵ Investments include investment in bonds, securities, associated companies and in subsidiaries

III. LIABILITIES

Total liabilities of the banking sector increased by AFN 2.18 billion or 0.78 percent standing at AFN 282.37 billion against AFN 280.18 billion in Dec, 2017. All components of total liabilities except deposits declined over the period under review.

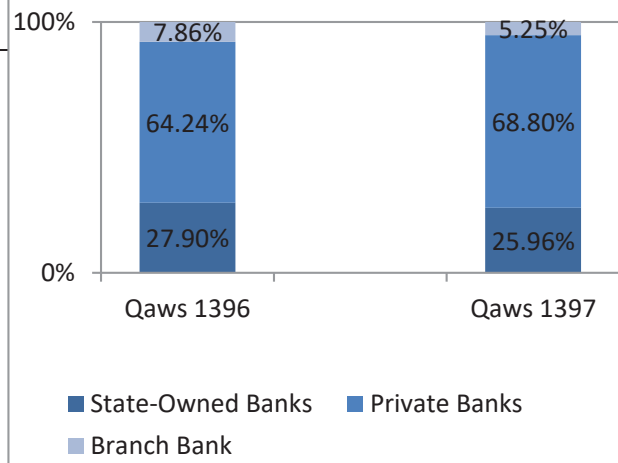
The majority of liabilities are made up of deposits (96.96 percent), with “other liabilities” at second and borrowings in third place. See table 6.

Figure 6.5: Share of Liabilities among the banking group

Source: Financial Supervision Department

3.1 Deposits

Deposits Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to Af 273.78 billion as of Dec, 2018 increased by Af 3.48 billion or 1.28 percent, compared to Dec, 2017. The total deposits cover Af 5.10 billion interbank and Af 268.68 billion customer deposits. The increase in deposit base of the banking sector is attributed to customer deposits and occurred mainly in demand and time deposits. While interbank deposits were down. Currency wise analysis shows that Afghani denominated deposits indicated 10.64 percent decrease accounting for



29.39 percent of total deposits, while US dollar denominated deposits increased 9.00 percent making 64.04 percent of the total deposits of the system, attributed to increase in deposits and USD rate.

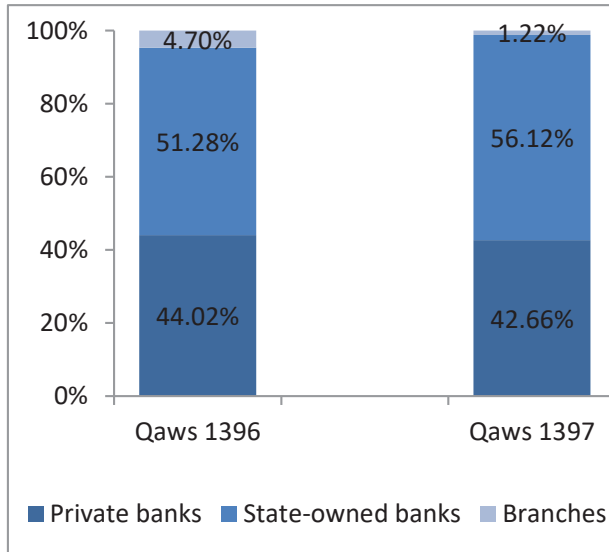
Private Banks attracted Af 188.52 billion deposits, increased by 8.77 percent making up 68.86 percent of the system’s deposits.

The share of state-owned banks amounted to Af 70.65 billion, decreased by 6.47 percent since Dec, 2017 accounted for 25.81 percent of the system’s deposits.

The share of branches of foreign banks stands at Af 14.61 billion decreased by 31.85 percent making up 5.34 percent of total deposits of the system.

In terms of types of deposits, demand deposits accounted for 77.41 percent of the total deposit base, increased by 1.56 percent and time deposits with 7.42 percent of total deposits was in the second place, and depicted 10.84 percent increase, while saving deposit making up 19.15 percent of the total deposits portfolio was down by 3.02 percent since Dec, 2017.

Figure 6.6: Afghani Denominated



Deposits

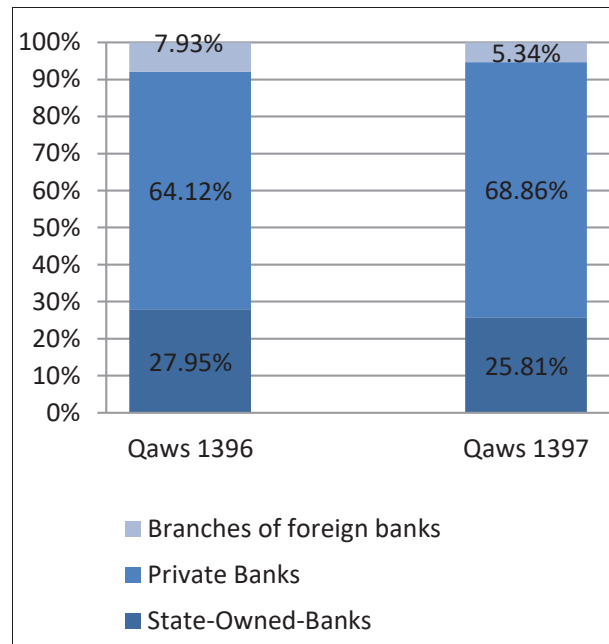


Figure 6.9: Breakdown of Deposits

Figure 6.7: Currency Composition of Deposits

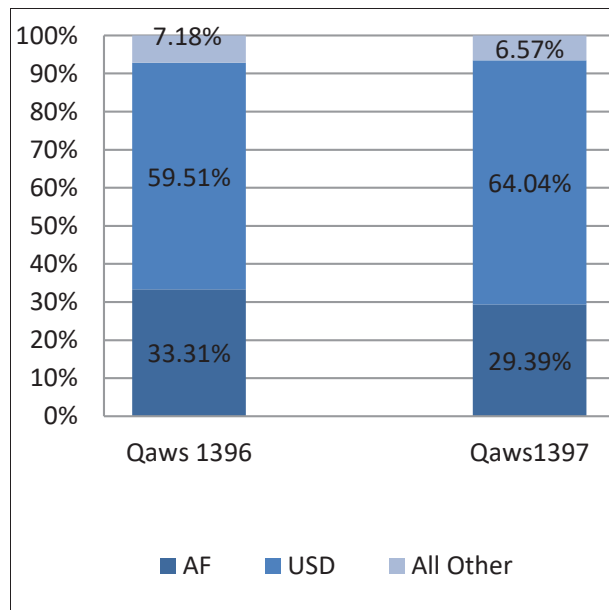
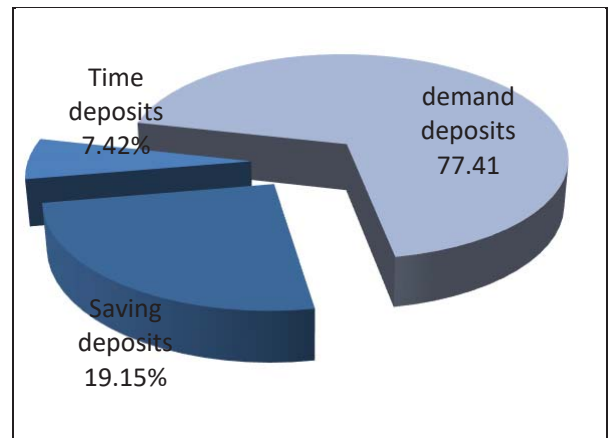


Figure 6.8: Deposits among banking group



Source: Financial Supervision Department, DAB

3.2 Borrowings

The share of borrowings in total funding structure of the system decreased by 17.85 percent standing at AFN 3.06 billion at the end of Dec, 2018, making 1.09 percent of total liabilities. The current

borrowing position is attributed to three banking institutions.

IV. LIQUIDITY

Liquidity risk can be defined as the risk of not having sufficient liquid assets to meet the demand of borrowers and depositors. All banks are required to maintain a reasonable level, in order to avoid any liquidity problem. For this reason, banks should maintain an asset liability committee (ALCO); one of its tasks is the liquidity management of the bank through gap analysis, stress testing, scenario analysis, cash flow analysis, etc. according to policies of the bank.

4.1 Liquidity Ratio (broad-based measure)

Banks are required to maintain a liquid asset ratio not less than 15 percent. This should provide a comfortable safeguard against any liquidity shortfall.

Generally, a surplus liquidity position was observed in the banking sector during this period. 72.61 percent of the sector's total assets are comprised of liquid assets. Ratio of the broad liquidity as a median for the whole system stood at 76.57 percent. All banking institutions were well above the minimum required level. See table 6.5.

V. CAPITAL

The system is well capitalized. The capital fund of the banking sector stands at AFN 34.39 billion; decreased by 4.32 percentage points or AFN 1.55 billion over the last year.

The decrease in total financial capital is mainly attributed to payment of dividends and getting in a receivership of a private bank.

On an aggregate basis the Capital Adequacy ratio of the banking sector stands at 26.69 percent. See table 6.5.

Disaggregated analysis shows that the financial capital of all banks are above the regulatory limits; however the regulatory capital ratio of all banks except one private bank is above the set regulatory threshold (12 percent of the risk weighted assets). The Basel benchmark for capital to risk weighted is 8 percent.

VI. PROFITABILITY

For the year ending Dec, 2018 banking sector earned AFN 2.43 billion net-profits against AFN 1.77 billion net-profits in Dec, 2017, showing an improvement over the previous year. The improvement in profitability of the banking sector as evident from the table 6.5 P/L mostly ascribed to increase in non-interest income; other contributing factors include decrease in non-interest expense, tax expense and credit provision. While, salary expenses increased and net-interest income decreased over the year. See table 6.5.

The returns on assets (ROA), shows how well a bank is being managed by conveying how much profit the bank earns per unit of its assets. ROA of the banking sector

stands at 0.80 percent annualized, while the returns on equity (ROE), which

up with profits in the period under analysis. See figure 6.10.

Table 6.3: Key Financial Soundness Indicators of the banking sector

Ratio in %	(Dec, 2014)	(Dec, 2015)	(Dec, 2016)	(Dec, 2017)	(Dec, 2018)
Total Capital Adequacy Ratio	26.46	19.94	27.68	29.81	25.69
Tier 1 Capital Adequacy Ratio	26.09	19.66	22.93	28.17	24.40
Non-Performing Loans to Total Gross Loans	8.09	12.34	12.67	12.42	8.92
Return on Assets(ROA)	0.90	0.20	0.11	0.64	0.80
Return on Equity(ROE)	7.35	1.69	1.08	3.38	6.83
Liquidity Ratio (Broad Measure Median)	73.6	68.22	67.74	65.92	76.57
Liquidity Assets to Total Assets	73.28	75.05	71.98	73.95	72.61

measures shareholders return on their invested equity in a bank. The ROE of the banking sector by end of Dec, 2018 recorded at 6.83 percent annualized.

The ROA of SOB⁶ recorded at 1.2 percent, while PB⁷ registered 0.46 percent, BOFB⁸ recorded 2.18 percent, at end of Dec, 2018.

On a cumulative basis two banking institutions have incurred AFN 49 million net-losses during the year against AF 790 million net-losses posted by two banks in Dec, 2017. On core income basis nine banks ended with losses, against four banks in Dec, 2017.

Group wise analysis reveals that State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended

Major portion of the profitability of the banking sector is attributed to State-Owned Banks standing at AFN 1.06 billion, Private Banks profitability recorded at AFN 901 million while branches of foreign banks earned AF 471 million net-profits during year ending Dec, 2018.

⁶ SOB- Stated-Owned Banks

⁷ PB- Private Banks

⁸ BOFB- Branches of Foreign Banks

Table 6.4: P/L Schedule			
Items	Qaws 1395 (Dec., 2016)	Qaws 2017 (Dec., 2017)	%Change (Annual)
Interest income	8,964	7,498	-16.35
Interest expense	1,743	1,137	-34.76
Net interest income	7,221	6,362	-11.89
Non-interest income	7,647	8,368	9.42
Non-interest expenses	6,360	6,030	-5.18
Salary cost	4,167	4,374	4.96
Credit provisions	1,488	983	-33.93
P/L before tax	2,853	3,343	17.17
P/L after tax	1,776	2,433	36.99

Source: Financial Supervision Department, DAB

Figure 6.10: Profitability of the Banking Sector

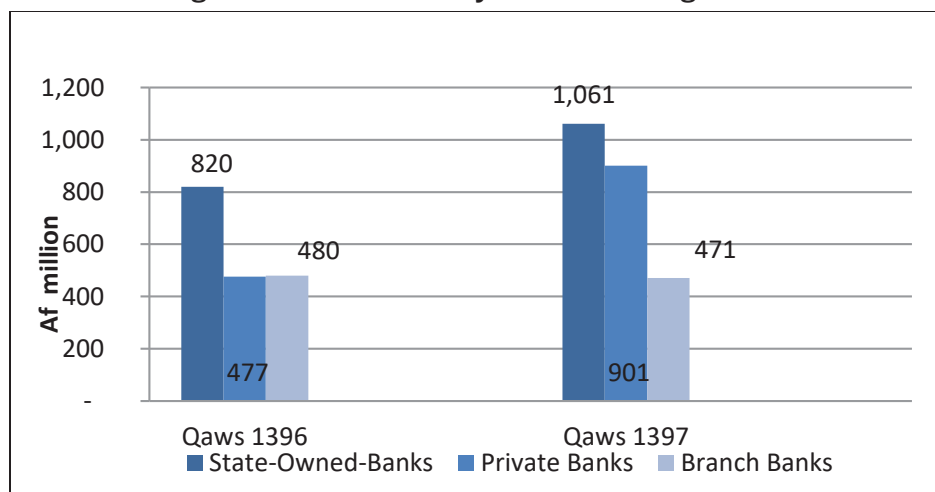


Figure 6.11: ROE and ROA of the banking system

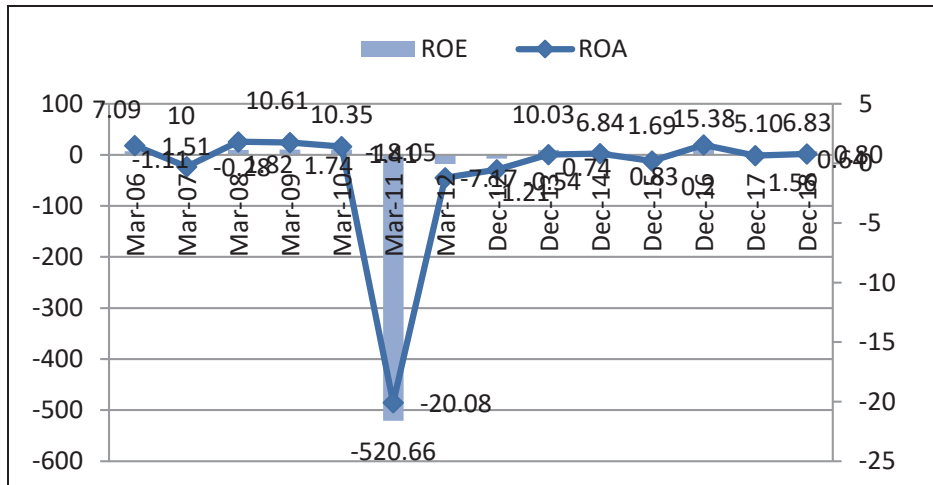
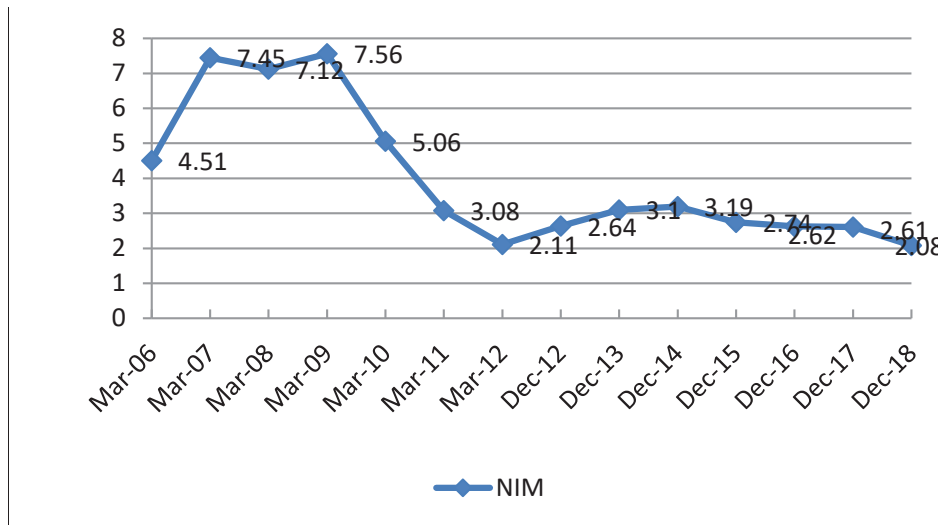


Figure 6.12: Net Interest Margin



Source: Financial Supervision Department, DAB

VII. Foreign Exchange Risk

The level of overall open FX position risk being taken by banks is largely within the levels set by DAB. In general, all the banking institutions were within the limits set for the overall open FX position, except for three banking institutions holding open FX positions on overall and on an individual currency (USD long position) basis violated

the limits. Those banks need to bring their FX positions under the set limit; otherwise, depreciation (decrease in the value) of US dollar can lead the banks to more losses.

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20 percent appreciation in exchange rate would increase the regulatory capital of the system by AFN 1.89 billion and vice versa. Similarly, a 4

percent change would correspond to AFN 380 million and vice versa.

VIII. Interest Rate Risk

Overall the banking system is in an interest-rate sensitive position. However, calculations made from the Interest Rate Sensitivity Schedules of all banks reveal that, the net-interest income of the system over the next 12 months may increase by AFN 1.24 billion in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest

rate shock) interest income will decline by AFN 1.24 billion. For five banking institution, if the interest-rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

The major reason for the over whelming asset-sensitivity of the banks is the large excess of interest earning assets over interest bearing liabilities. Although it may improve the net interest margin and overall profitability of banks, this situation makes the banks more vulnerable to a sudden decrease in the market rates.

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