

**Da Afghanistan Bank**

**Monetary Policy Department**

 **Monthly Inflation Report**

**July 2020**

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# PREFACE

Based on the article 2 of Da Afghanistan Bank (DAB) law, the primary objective of DAB is to maintain price stability, which is a situation where inflation is low enough that it no longer has a substantial effect on people’s economic decisions.

Generally, the aim of the Monetary Policy Department (MPD) is the price stability and reaps benefit from low inflation in the economy. Besides, MPD is responsible to design and implement sound and prudent monetary policy to contribute to economic growth and strengthen financial stability.

Inflation always refers to an increase in the overall price level, which showed by national currency. Inflation does not refer to an increase in the cost of one product or service or even several products. Prices tend to go up when demand for goods and services exceeds the economy’s capacity to meet the extreme demand of goods and services.

MPD evaluates changes in inflation by monitoring several different price indices. A price index measures changes in the price of a basket of consumer goods and services. They also consider several price indices, because different indices track different products and services, and since indices are calculated differently, therefore, various indexes can send diverse signals about inflation.

It is obvious that an economy cannot have a dynamic and sustainable growth if there are extreme fluctuations in the price level. MPD is committed to feature, adapt and execute a prudent and sound monetary policy in order to maintain inflation in a single digit up to an acceptable level and strengthen its dynamic contribution to the economic growth considering the economic performance of the country and the stability in the country as a whole.

# THE CONSUMER PRICE INDEX

The Consumer Price Index (CPI) is a broad measure of cost of living in Afghanistan. However, there are some other methods to measure movements in price level, but still the CPI is accepted and known as the most important indicator due to its widespread use.

The National Statistics and Information Authority (NSIA) have brought some changes in the CPI basket in both base-year (changed to April 2015 from March 2011) and items. As a result, significant changes can be observed in the current weight and index. The CPI basket has changed as some of previous items have excluded and some of them have merged. The new changes to the basket will represent a good picture of inflation trend. For example, in the Food items, beverages now merged with Food main item, tea and beverages, which came under the Food items replaced by non-alcoholic beverages. In the Non-food items, housing item renamed as housing, electricity, water and gas and some of the previous items under housing such as rent, construction materials and fuel have excluded. Meanwhile, in the non-food items some items have been included such as recreation, culture, restaurants, and hotels.

Weight of any item in the basket reflects the percentage that the item has in the total basket and reflects typical consumer spending patterns. For instance, since people usually spend more on food than health, changes in the price of food have a bigger impact on the index than changes in the price of health.

**A CONCISE REVIEW OF INFLATION IN AFGHANISTAN**

From a long run perspective, the inflationary prospects can only be favorable, controllable and manageable by the central bank if the economic policies, strategies and plans could lead and result to reduction of the gap of production and dependency level of the local markets to imported goods. In addition, regarding the factors of inflation in Afghanistan, currently there are a number of factors in the country that play role in unfavorable price movements. The main driver of inflation in Afghanistan is imported inflation from the major trading partners of the country such as Pakistan and Iran. As mentioned above, the country is deeply dependent on importing consuming goods from abroad, thus the inflation of these countries directly affects the inflationary prospects in Afghanistan.

Low level of production in the country, high level of dollarization, non-existence of a proper transportation system inside the country, cross border issues in transportation of goods and services through Pakistan and Iran, imperfect competition, existence of monopoly in the market, political and economic instability, and future uncertainty are the major contributors to the fluctuation in prices in the country. Beside those obstacles, the Monetary Policy Department has successfully maintained the inflation rate in a single digit and the inflation rate is still at a moderate level.

# KEY POINTS

* Headline inflation decreased in the month of July 2020 year over year basis. The year over year inflation decreased to 6.33 percent in July from 6.36 percent observed in the previous month. This decrease is caused by lower prices of food and beverages items, while nonfood items increased during the period.
* Food index which accounts for around 48 percent of the whole CPI decreased to 12.71 percent from 12.88 percent. In the meantime, non-food category which comprises about 52 percent of the overall index increased to 0.31 percent from 0.13 percent.
* Core inflation when measured based on 30% trimmed mean decreased to 5.28 percent from 5.99 percent.
* Considering price changes in the short-term (month-to-month), headline inflation decreased to -1.11 percent from -0.81 percent. Based on this measure, food items increased to -1.81 percent from -1.87 percent and non-food items decreased to -0.35 percent from 0.35 percent.
* Based on Kabul CPI, headline inflation increased to 4.69percent from 4.47 percent. Food prices exhibited higherrate and non-food items decreased in the capital Kabul, relatively food items increased to 9.99percent from 8.67 percent and non-food category decreased to 1.30 percent from 1.74 percent in the period under review.

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| **Table 1. Headline Inflation (June 20- July 20)**  |
|  | **Y-o-Y** | **M-to-M** |
| **June**  | **July** | **June**  | **July** |
| **National CPI** |  |  |  |  |
| **Headline** | 6.36 | 6.33 | -0.81 | -1.11 |
| *Food*  | 12.88 | 12.71 | -1.87 | -1.81 |
| *Non-Food* | 0.13 | 0.31 | 0.35 | -0.35 |
|  *CPI ex. B&C, O&F, and T* | 4.61 | 5.23 | -1.45 | -0.93 |
|  *Trimmed Mean* | 5.99 | 5.28 |  |  |
| **Kabul CPI** |  |  |  |  |
| **Headline** | 4.47 | 4.69 | 0.07 | -0.93 |
| *Food* | 8.67 | 9.99 | -1.39 | -0.88 |
|  *Non-Food* | 1.74 | 1.30 | 1.11 | -0.96 |
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# HEADLINE INFLATION

Headline inflation decreased in the month of July 2020. Observing the data, headline inflation decreased to 6.33 percent from 6.36 percent (year over year). This decrease is caused by lower prices of food items. Core measure of inflation when measured based on 30% trimmed mean decreased to 5.28 percent, while it was calculated 5.99 percent in the previous month.

Source: Da Afghanistan bank/NSIA

The short-term (month-to-month) change in inflation shows downward trends in the period under review. When measured on the month-to-month basis, headline inflation decreased in July 2020. Observing the data, overall inflation decreased to a rate of -1.11 percent from -0.81 percent recorded in the previous month. During the reporting period, food items of the CPI increased to -1.81 percent from -1.87 percent. Core measures also increased on the month-to-month basis. CPI excluding bread and cereals, oils and fats and transportation increased to -0.93 percent from -1.45 percent on month to month basis.

Source: Da Afghanistan Bank/NSIA

**Source:** *Da Afghanistan Bank and/NSIA*

FOOD INFLATION**:** Decreased in month of July 2020. Food and beverages items are weighted for 47.8 percent of the overall index. Food inflation in July 2020, when measured on year over year basis, decreased to 12.71 percent compared to 12.88 percent calculated in previous month. This decreases come from lower prices of bread and cereals, milk, cheese and eggs, oils and fats, vegetables, sugar and sweets, and spices.

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| **Table 2.Food and Non-alcoholic beverage Inflation(June 20- July 20)**  |
| **Items** | **Weight** | **Y-o-Y** | **M-to-M** |
| **June**  | **July** | **June** | **July** |
| **Food and Non-alcoholic Beverages** | 47.8 | 12.88 | 12.71 | -1.87 | -1.81 |
|  *Bread and Cereals* | 14.6 | 15.78 | 14.07 | 1.17 | -1.41 |
|  *Meat* | 7.5 | 12.49 | 12.63 | 1.67 | 1.26 |
|  *Milk, cheese and eggs* | 4.7 | 3.58 | 3.35 | -0.86 | -0.96 |
|  *Oils and fats* | 4.6 | 21.62 | 19.60 | 2.30 | 0.02 |
|  *Fresh and dried fruits* | 5.0 | 10.88 | 20.05 | -3.76 | 1.79 |
|  *Vegetables*  | 6.0 | 16.15 | 14.60 | -15.03 | -11.85 |
|  *Sugar and sweets* | 2.7 | 3.59 | 2.84 | 1.15 | 0.10 |
|  *Spices* | 1.3 | 11.57 | 1.70 | -4.80 | -9.69 |
|  *Non-alcoholic beverages* | 1.4 | 4.08 | 5.15 | 0.58 | 0.51 |
| **Source :***Da Afghanistan Bank /NSIA* |   |  |   |   |   |

The month-to-month measure of food inflation shows higher rate in the month of July compared to the previous reporting period. The latest data released by NSIA exhibits an inflation rate of -1.81 percent in the review period higher from -1.87 percent observed in the previous month.

**Source:** *Da Afghanistan Bank and/NSIA*

**Price index of bread and cereals** which accounts for about 15 percent of the consumer price index decreased to 14.07 percent from 15.78 percent (year over year). On the other hand, when measured on the month-to-month basis, this sub-indexes also decreased to -1.41 percent from 1.17percent.This decrease is mainly due to increase of wheat production and improve of wheat supply in the market. Wheat harvest in Farah province increased by 20 percent compare to the same period of previous year.

**Meat price index** which is weighted for around 7 percent of the CPI, increased to 12.63 percent from 12.49 percent (year over year). When measured on the month to month basis, Price of this index decreased to 1.26 percent from 1.67 percent.Price of livestock has increased mainly due to public engagement in Eid- ul- Adha preparation, and keeping livestock for Eid -ul- Adha sacrifices.

In July 2020, **price index of milk, cheese and eggs** which comprises around 5 percent of the overall index showed lower prices. During the review period, this index decreased to 3.35 percent (year over year) from 3.58 percent observed in previous month. When measured on the month-to-month basis, also decreased to -0.96 percent from -0.86 percent recorded in previous month. Reason behind decrease is the seasonal effect, July is favorable weather for grass growing and provides good grassland for cattle to feed, therefore the production of milk has increased and the price of milk has decreased in this particular period, and also Illegal import of eggs has increased the supply of mentioned index which has caused the decrease in price of eggs in domestic market.

**Oils and Fats index** which comprises 4.6 percent of overall index, during the period decreased to 19.60 percent from 21.62 (Y-o-Y). And also, price of this index has decreased to 0.02 percent from 2.30 percent on the month-to-month basis. In the previous month, the price of oils and fats in the country had increased due to transport restrictions and inadequacy supply chain to the domestic market. Nowwith the eased of restrictions and smooth supply chain helped to bring back the price of mentioned index to the normal level.

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**Fresh and dried Fruit** prices increased in the month of July 2020. Observing the data, during the review period, this index which comprises of 5 percent of the whole index increased to 20.05 percent (year over year) from 10.88 percent recorded in the previous month. On the other hand, month-to-month basis also increased to 1.79 percent from -3.76 percent. Afghanistan exports 350 thousand tons of fruits and vegetable to Pakistan on annual basis, during covid-19 pandemic, the borders were closed for any kind of trade with Afghanistan. Now the borders reopened between Afghanistan and Pakistan and started their trade which caused increased in the price of this index.

**Vegetables price index** which is dedicated for 6 percent of the overall index, decreased to 14.60 percent (year over year) from 16.15 percent observed in the previous month. When measured on the month to month basis this index has increased to -11.85 percent; however, it was recorded -15.03 percent in the previous month. The main reason behind decrease of this index is, seasonal effect which has led to increase of supply to the domestic market

**Price index of sugar and sweets** decreased on year over year basis. This index which comprises around 2.7 percent of the consumer price index decreased to 2.84 percent (year over year) from 3.59 percent. When measured on month to month basis, this index also decreased to 0.10 from 1.15 percent. However, this change is not likely to affect the CPI dramatically, because it does not make significant weight in the index. One of the main reasons behind decrease of this index is bee keeping and honey production in the country, which has significantly increased in recent years, for example in Farah Province the production of honey has increased by 40 percent during the period.

**Spices**

During the reporting period, there was decrease in **spices price index**. Observing the data, this index significantly decreased to 1.70 percent from 11.57 percent (Year over year). In addition, when measured on month to month basis, also decreased to -9.69 percent from -4.80 percent.

The main reason for the decrease of this index is the local harvest season and high supply of garlic and pepper to the domestic market.

**Non-alcoholic beverages** increased to 5.15 percent in July from 4.08 percent recorded in previous month. Measuring on month to month basis decreased to 0.51 percent from 0.58 percent in the month of July 2020.

The reason for increase of this index is seasonal effects, usuallyin the summer consumption of non-alcoholic beverages increasing.

# NON-FOOD INFLATION

Inflation in non-food items exhibited upwards trend in the month of July 2020. On the year over year basis, non-food inflation increased to 0.31 percent from 0.13 percent observed in the previous month. This increase mainly comes from higher prices of housing, furnishing and households, communication, and education.

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| **Table 3. Non-Food Inflation (June20-July 20)** |
|  | **Weight** | **Y-on-Y** | **M-to-M** |
| **June**  | **July** | **June**  | **July** |
| **Non-Food** | **52.2** | 0.13 | 0.31 | 0.35 | -0.39 |
|  *Tobacco* | **0.3** | 1.40 | 2.73 | 0.29 | 0.05 |
|  *Clothing*  | **4.6** | 7.54 | 6.77 | -1.59 | -0.78 |
|  *Housing,*  | **19.1** | -4.02 | -2.77 | 0.16 | 0.14 |
|  *Furnishing and household goods* | **11.9** | 0.78 | 1.89 | -0.60 | 0.43 |
|  *Health*  | **6.2** | 8.86 | 8.72 | 4.60 | 0.19 |
|  *Transportation* | **4.3** | -10.44 | -14.76 | -0.12 | -5.10 |
|  *Communication* | **1.7** | -2.40 | -2.06 | -0.20 | -0.07 |
| *Information and Culture* | **1.1** | 3.15 | 0.68 | 0.70 | -1.85 |
| *Education* | **0.4** | 0.83 | 1.16 | 0.07 | 0.01 |
|  *Restaurants and Hotels* | **1.1** | 0.97 | -1.20 | 0.09 | -1.89 |
|  *Miscellaneous* | **1.4** | 14.17 | 13.37 | 1.14 | 0.33 |
| Source: National Statistics and Information Authority (NSIA) / DAB  |  |  |  |  |  |

Non-food inflation on the month-to-month basis exhibited lower rate from its previous month’s value. Observing the data, it decreased to -0.35 percent from 0.35 percent

**Clothing price index** which comprises around 4.6 percent of the overall index, decreased in July 2020 to 6.77 percent (year over year), while it was calculated 7.54 percent in the previous month. On the other hand, this index increased on month to month basis turning around to -0.78 percent from -1.59 percent. In the previous month the price of clothing in the country had increased due to transport restrictions and inadequate supply chain of cloth and foot wears from neighboring countries, now with the eased of restrictions, and smooth supply chain helped to bring back the price of mentioned index to the normal level. Also as most of clothing is importing from Pakistan since the price of clothing and foot wear has been decreased from 11 percent to 10.03 percent in Pakistan therefore it has direct effect on price of this index.

**Price index of housing, electricity, water and gas** increased in July 2020. On year over year basis, this index increased to -2.77 percent from -4.02 percent observed in the previous month. This index is dedicated for more than 19 percent of the whole index; therefore, any changes in its price may significantly affect the overall CPI. Considering the month to month changes, housing index decreased to 0.14 percent from 0.16 percent. With the eased of lockdown, and restarting home constructions, demand for construction materials grew up which lead to increase the prices of mentioned index.

**Price index of furnishing and household goods** increased in the month of July 2020. This index which holds a healthy weight of 12 percent in the CPI, increased to 1.89 percent from 0.78 percent. in the meantime, month to month basis this index also increased to 0.43 percent from -0.60 percent. The main reason behind increase in price of this index is due to Eid-ul - Adha Preparation which demandfor purchasing furnishing and household’s goods has increased.

**Price index of Health** decreased in the month of July 2020. Health index which comprises more than 6 percent of the overall CPI decreased to 8.72 percent from 8.86 percent (year over year). While, measured on the month to month basis, it also decreased to 0.19 percent from 4.60 percent observed in the previous month. As the number of covid-19 patients have been reduced in the country, therefore demand for purchasing medicine has been declined which caused decrease in price of this index.

**Transportation price index** accounts for 4.3 percent of the whole index. Observing the data, transportation index year on year basis decreased to -14.76 percent from -10.44 percent recorded in the previous month. Inflation rate month to month basis also decreased to -5.10 percent from -0.12 percent. The main reason behind decrease of this index is diesel and crude oil prices decreased respectively by -0.31 percent and -35 percent in global markets.

**Communication price index** during July 2020, increased to -2.06 percent (year over year) from -2.40 percent observed one month back. This index also increased on month to month basis turning around to -0.07 percent from -0.20 percent.

 In addition, **price index of information and culture** recorded a rate of 0.68 percent (year over year) in July from its previous value of 3.15 percent. On the month to month basis, this index decreased to -1.85 percent from 0.70 percent.

**Education price index,** increased in the month of July. Observing the data, this index increased to 1.16 percent from 0.83 percent (year over year), this index is decreased to 0.01 percent from 0.07 percent (month to month).

Previously in order to prevent covid-19 pandemic, education centers were closed which caused decrease in price of this index, now with reopening of universities has increased the demand for purchasing stationaries.

During July 2020 price decreased in **Restaurants and hotels**(-1.20 percent from 0.97 percent year on year basis), and decreased to -1.89 percent from 0.09 percent on month to month basis. Price of food and beverages has decreased in the month of July which caused decrease in the price of this index as well.

**Price index of Miscellaneous** decreased to 13.37 percent from 14.17 percent on year-over-year basis. Meantime on the month-to-month basis, price index of miscellaneous also decreased to 0.33 percent from 1.14 percent in the period under review.

# CORE INFLATION

Core measure of inflation gives a more specific view of price changes. This method is used to analyze the inflationary developments cutting off the effects of eccentric factors, which may be seasonal or other specific cases. In this method, those components, which show abnormal changes in their price level, are ignored to put down their effects from the CPI.

One of the most common methods of core inflation is **trimmed mean**. This measure is defined for a particular part of the CPI, and is calculated by taking the simple average of the index after excluding the targeted components. During July 2020, trimmed mean (30 % of CPI) decreased to 5.28 percent (year over year) from 5.99 percent observed in the previous month.

Another core measure of inflation is the CPI excluding **bread and cereals, oils and fats, and transportation**, which increased to 5.23 percent compared to 4.61 percent recorded in the previous month. Inflation by this measure increased on month to month basis to -0.93 percent from -1.45 percent.