Economic & Statistical Bulletin

Da Afghanistan Bank

Annual Bulletin FY1392

January 2014

Economic & Statistical Bulletin

Da Afghanistan Bank

Annual Bulletin FY1392

January 2014

Ibn-e-Sina Watt

Kabul

Afghanistan

Telephone: +93-20-2100293

Internet: www.centralbank.gov.af

Email: mp@centralbank.gov.af

Note:
Afghanistan's Fiscal year has been changed effective from 1391 (2012). The fiscal year begins on December 21 each year. This Annual Bulletin describes developments in the fiscal year 1392, which covers December 21, 2012 to December 20, 2013.

CONTENTS

LIST OF FIGURES

LIST OF TABLES

LIST OF ABBREVIATIONS

DAB	Da Afghanistan Bank
GOA	Government of Afghanistan
FEMA	Foreign Exchange Market in Afghanistan
LCs	Letters of Credit
CPI	Consumer Price Index
MOF	Ministry of Finance
CMEA	Ex-Soviet Trading Block
ARTF	Afghanistan Reconstruction Trust Fund
LOTFA	Law and Order Trust Fund for Afghanistan
GDP	Gross Domestic Product
ODCs	Other Depository Corporations
CSO	Central Statistics Office

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."

Governor's Statement

Annual Economic and Statistical Bulletin

On behalf of the Supreme Council, I am pleased to present this edition of the Economic and Statistical Bulletin of Da Afghanistan Bank (DAB) for the fiscal year 1392 (December 21, 2012 – December 20, 2013). This annual bulletin reflects the main results of the Bank's activities aimed at keeping inflation low, maintaining stability of the national currency and developing a more robust banking sector in support of sustainable economic growth.

The fiscal year 1392 was not an easy year for the Afghan economy. The economic growth fell short of expectations, dropping to 6.4 percent, down from 10.9 percent in 1391. Political and security uncertainties arising from the withdrawal of the international peacekeeping forces from the country in 2014, as well as the upcoming Presidential and Provincial Council elections impacted the overall economic activities negatively, which led to low domestic demand.

Inflation gained momentum at the end of the year due to higher food and energy prices in the international markets. The supply side worsened as the food prices picked up in some regional countries such as the Pakistan, Bangladesh, and Indonesia.

On the other hand, monetary aggregates depicted mixed performance in the reporting period. Reserve money, the operational target under the ECF program reserve money grew above the target, mainly due to concerns of post 2014 that led people to use foreign currencies as a store of value. On the other hand, spendthrift of the government current expenditure, mainly in the security sector, caused the RM to grow well above the expectations.

Narrow money (M1), the main contributor to the growth in M2 grew by about 10 percent. Broad money (M2) demonstrated similar behavior at the end of the period under review.

Meanwhile, Afghani depreciated against the U.S. dollar, GBP, INR, while appreciating against the IRR and remained almost unchanged against the Pakistani Rupee in the FY1392.

During the period under review, Afghanistan's balance of payments position was favorable, depicting an overall surplus of 541 million. The merchandise trade deficit widened as a result of increases in aggregate import. The trade deficit, accounts for 8 percent of GDP.

The global economic conditions improved, representing a moderate growth rate in 2013.

The U.S economy continues to recover; and some large emerging economies, including China, seem to have at least stopped a further slowdown. The euro area has finally come out of a prolonged recession, with gross domestic product (GDP) for the region as a whole starting to grow again.

The banking system gained momentum and performed satisfactory. The asset base of the banking sector grew by about 10 percent in 2013. Gross loans, deposits, and capital of the system depicted upward trend. On a cumulative basis, the banking sector earned AF 1.76 billion profit in 2013, compared to AF 1.12 billion losses in the previous year. The return on Assets (ROA) improved, and return on equity (ROE) exhibited a sharp increase of about 10 percent.

At the end, I would like to appreciate the tireless efforts of numerous individuals from several departments of the Bank that contributed to this publication, particularly the team of the Monetary Policy Department.

Noorullah Delawari

Governor,

Da Afghanistan Bank

Senior Management

Noorullah Delawari
Governor

Khan Afzal Hadawal
First Deputy Governor

Alhaj Mohammad Issa Turab
Second Deputy Governor

EXECUTIVE SUMMARY

The global economy experienced a moderate growth in 2013. The world's output increased by 3 percent while, it was recorded at 3.1 percent (IMF). The advanced economies' GDP growth rate recorded at an average rate of 1.3 percent in 2013, which is lower than the last year GDP growth rate of 1.4 percent. Meanwhile, the overall GDP growth rate in Euro area was -0.4 percent that indicates a relative improvement from the previous year's growth rate of -0.7 percent. Similarly, the emerging market and developing economies experienced lower GDP growth rate of 4.7 percent from 4.9 percent in the last year.

The world trade volume (goods and services) was stable at 2.7 percent over the years of 2012 and 2013. The imports (goods and services) of the advanced economies increased by 1.4 percent in 2013, up from 1 percent in the previous year. The emerging market and developing economies experienced an increase of 5.3 percent in imports of goods and services compared to 5.7 percent in the last year.

Afghanistan recorded the highest average economic growth of 9.4 percent in the last decade, which was unprecedented in the last 3 decades. In spite of such a considerable average growth rate, the country experienced a slower growth in 1392. A slower growth was observed in non-agriculture sectors as the GDP grew by 6.4 percent, in contrast to 10.9 percent in the preceding year.

The slowdown in the economic growth in 1392 compared with the previous year is thought to be much more affected by the political and security uncertainties arising from post 2014 as well as political and economic condition of the neighboring countries, the major trading partners and regional conflicts.

In Afghanistan, monetary aggregates depicted mixed performance in FY1392. Reserve money, the operational target under the ECF program, grew by 11.40 percent standing at AF 196,919.14 million. The actual reserve money was above the ECF revised target of 8 percent. Currency in circulation "an indicative target under the ECF program", increased by 11.88 percent in the year FY1392 reaching to AF 167,831.38 million. DAB successfully achieved the floor for net international reserves (NIR). The NIR was above the target floor. Narrow money (M1) stood at AF 350,696 million in the year under review, registering an annual growth rate of 9.88 percent. Broad money (M2) demonstrated similar behavior, representing a growth rate of 9.40 percent (Y-o-Y) standing at AF 370,684 million at the end of the year under review.

In the fiscal year 1392, DAB has auctioned a total amount of USD 3.482 billion to manage liquidity in the market as well as to mitigate the fluctuations in the exchange rate of Afghani against the foreign currencies. The outstanding amount of CNs (the second monetary tool used by DAB) stood at AF 31 billion. Afghani depreciated against the greenback by 7.91 percent.

Inflation in Afghanistan exhibited a downward trend in the FY1392, while it shows some sign of increase, as measured by different measures. The increase in inflation rate could mainly be due to high energy costs, as fuel prices continued to increase. Besides the other factors, a steady depreciation of local currency (afghani) against the USD during the year resulted in higher prices of some imported items such as the food and fuel. The supply side shocks also added up to the increase in inflation rate as the food prices increased, both in the region and international markets. The year-on-year changes in national headline inflation in the fourth quarter of FY1392 was 7.3 percent, higher compared to 5.8 percent recorded in the last quarter of 1391.

Food sub-index, one of the major components of the CPI, was the main driver behind the increase in headline inflation. Food prices have been rising gradually worldwide, while in Afghanistan it has been rising sharply. On the other hand, the non-food prices have been falling, which partially offset the impact of increased food prices.

However, core inflation, which excludes the highly volatile components of bread and cereals, oil and fat, and transportation, is currently at a relatively high level of 7.3 percent, year-on-year, exactly similar to the overall headline inflation, suggesting that inflation has spread beyond these basic commodities.

However, when the quarter-on-quarter changes are observed the picture is quite different. Nationwide headline inflation rose by 4.1 percent in the fourth quarter of FY1392. It went up from a 1.1 percent level of the preceding quarter. Prices of vegetables increased dramatically by 30.9 percentage points which drove the overall headline inflation up. This increase is mostly a seasonal factor, where the prices of vegetables normally increase during the winter due to lower supply.

In the external sector, earnings from exports have increased by almost 61 percent to USD 560.94 million in 1392, compared to USD 347.60 million recorded in the previous year (CSO). The increase in the value of exports, which was mostly dominated by carpet and rugs, rose significantly by about 326 percent, to USD 140.73 million, up from USD 33.02 million in the FY1391. Meanwhile, expenditure on imports grew by 12 percent in this period. The value of total Imports, which was recorded at USD 8,312.22 million in FY 1391, increased to USD 9,339.58 million in the FY1392. This shows a growing domestic demand for foreign goods, mainly consumer goods, industrial supply, and fuel & lubricants.

Consequently, the trade deficit expanded to USD 8,778.64 million in FY 1392 compared to

USD 7,964.62 million in the FY 1391, which shows an increase of about 10 percent. The trade deficit figures almost 8 percent of GDP in the FY 1392.

During FY1392, Afghanistan's public and publicly guaranteed debt stock stood at USD 2,493.07 million, higher from USD 2,447.05 million in the FY 1391.

Afghanistan has an obligation of USD 962.10 million, mainly to the Russian Federation as a member of the Paris Club, and to the other Non-Paris Club creditors. Non-Paris Club debts stood at about USD 134.84 million at the end of the FY 1392. In regards to the multilateral debts, Afghanistan's total debt stood at USD 1,396.13 million at the end of FY 1392.

The net international reserves (NIR) increased by 3.19 percent from USD 6,471.94 million in the FY 1391 to USD 6,678.62 million in the FY1392.

In the fiscal sector, despite significant improvements in the government's ability in the revenue collection and broadening the tax base, the fiscal sustainability indicator was 53 percent in the FY1392. This shows a decline of 19 percent, from 72 percent in the FY1391. However, the decline was due to increase in operating expenditure, specifically in the security sector. It is expected that operating expenditures will increase, which will further increase the budget deficits.

The total core budget for the FY1392 was AF 348.2 billion, which accounts for 30.5 percent of GDP. Operating expenditure allocation inclined to AF 206.6 billion. The operating budget efficiency rate was 90 percent, while the development expenditures also increased to AF 141.7 billion; however the total execution rate for the development budget were 56 percent.

The banking sector performance was satisfactory in the FY1392. The asset base of the banking sector grew by 9.86 percent in the FY1392. Gross loans depicted an increase of 11.37 percent, standing at AF 46.96 billion at the end of 2013. Deposits stood at AF 208.79 billion, up by 8.08 percent. Deposits were largely denominated in USD (65.18 percent) with Afghani denominated deposits lagging at 31.85 percent. Afghani denominated deposits indicated an increase of 16.60 points against 1.85 percent decrease in the year before, while USD denominated deposit were up by 5.17 points showing a slower pace than 17.94 percent growth recorded in December 2012.

The capital base of the banking sector remained strong at AF 28.47 billion, increased significantly on account of profits, capital injections and addition of capital of branches of foreign banks. Capital adequacy ratio (CAR) of the banking sector recorded at 26.34 percent.

On a cumulative basis, during the fiscal year 1392 the banking sector earned a total of AF

1.76 billion profits against AF 1.12 billion losses registered in the previous year. The return on assets (ROA) improved to 0.74 percent, while return on equity (ROE) was 10.03 percent against a negative 0.54 percent and 7.17 percent, respectively from the previous year. Private Banks and Branches of Foreign Banks ended up with profits, while the State-Owned Banks ended with losses during the current year.

CHAPTER I

GLOBAL ECONOMIC ENVIRONMENT

1

GLOBAL ECONOMIC ENVIRONMENT

In 2013, the global economy experienced a moderate growth. According to the data published in the International Monetary Fund's (IMF) official website, the world output increased by 3 percent, while the growth in the world output was recorded at 3.1 percent in the previous year indicating a slight decline compared to a year earlier.

The advanced economies' GDP growth rate recorded at an average rate of 1.3 percent in 2013 which is lower than the last year GDP growth rate of 1.4 percent. Meanwhile, the overall GDP growth rate in Euro area was -0.4 percent that indicates a relative improvement from the previous year total output growth rate of -0.7 percent. Similarly, the GDP growth rate of the emerging market and developing economies slowed to 4.7 percent from 4.9 percent in the last year.

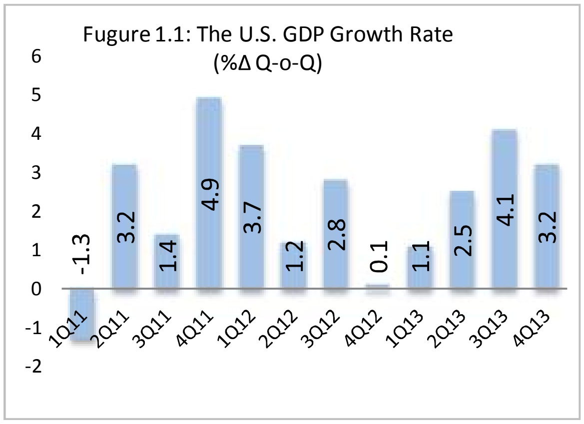
The prices of consumption goods in advanced economies rose by 1.4 percent in 2013 compared to a 2 percent increase in the previous year. The rise in the consumer prices in emerging markets and developing economies reached to 6.1 percent in 2013 compared to a 6 percent increase in the last year.

The percentage change in the world trade volume (goods and services) was stable at 2.7 percent over the years of 2012 and 2013. Imports (goods and services) of the advanced economies increased by 1.4 percent in 2013 compared to a 1 percent increase in the previous year. The emerging markets and developing economies experienced an increase of 5.3 percent in the imports of goods and services compared to 5.7 percent in the last year.

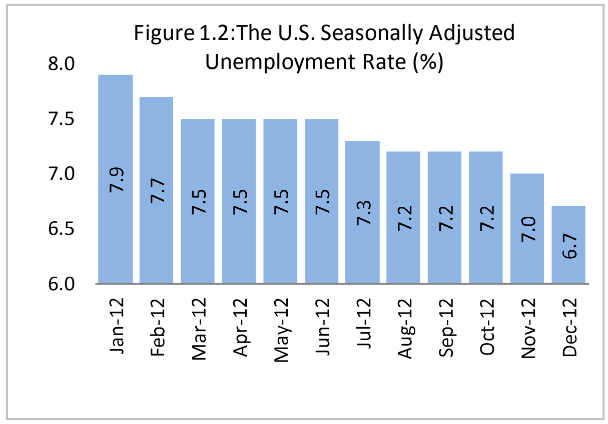
1. ADVANCED ECONOMIES

1.1 The United States Economy

According to estimations released by the U.S. Bureau of Economic analysis, the U.S. real GDP rose by 3.2 percent in the fourth quarter of 2013. The GDP growth rate was 4.1 percent in the previous quarter. The real GDP indicated an increase of 1.9 percent for the full year of 2013, while the real GDP had increased by 2.8 percent in 2012.



Source: *www.TRADING ECONOMIC /BUREAU OF ECNOMICANALYIS*



Source: TRADING ECONOMIC /BUREAU OF ECNOMIC ANALYIS

The U.S. inflation rate in the fourth quarter of 2013 increased by 1.2 percent compared to the previous quarter, which indicated an increase of 1.8 percent. After excluding the food and energy prices since the prices for these items turned down, the inflation rate increased by 1.5 and 1.7 percent for the third and fourth quarter respectively. According to the OECD, the U.S. inflation rate increased by 1.5 percent for the full year 2013 compared to the previous year which the inflation rate was 2.1 percent.

According to the U.S. Bureau of Labor Statistics, the U.S. unemployment rate (seasonally adjusted) reached 6.7 percent in December, 2013 while the unemployment rate stood at 8.5 percent in the same period of last year. According to the OECD, the U.S. unemployment rate was recorded at 7.4 percent for the full year of 2013 compared to the previous year which was recorded at 8.1 percent.

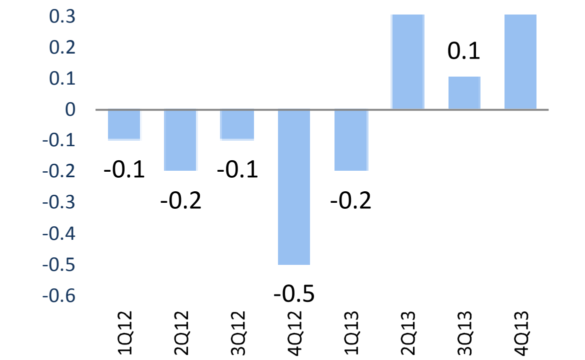
According to the U.S. Bureau of Economic Analysis, the exports of goods rose by USD 33.2 billion, while the imports of goods decreased by USD 7.8 billion in 2013 compared to the previous year. During 2013, the exports of services amounted USD 682 billion, indicating an increase of USD 32.6 billion (5 percent) compared to the last year, while the imports of services stood at USD 450.3 billion indicating an increase of 7.8 billion (1.8 percent) from last year.

The real disposable personal income went up by 0.8 percent in the fourth quarter after increasing 3 percent in the previous quarter. The personal saving rate was recorded at 4.3 percent in the fourth quarter compared to the previous quarter which stood at 4.9 percent.

1.2 The Euro Area Economy

According to the Eurostat (flash estimates), the euro area GDP increased by 0.3 percent in the fourth quarter of 2013 compared to the previous quarter. The increase in the GDP was recorded at 0.1 percent in the third quarter of 2013. The GDP (seasonally adjusted) indicated an increase of 0.5 percent in the euro area in the fourth quarter compared to the same period of last year. For the full year of 2013, the GDP fell by 0.4 percent in the euro area.

Figure 1.3: The Euro Area GDP Growth (%Δ Q-o-Q)



Data Source: Eurostat, the statistical office

The seasonally adjusted unemployment rate in euro area was 12 percent in December 2013. The unemployment rate was 11.9 percent in the same period of last year. Among the member states, lowest unemployment rate was observed in Austria which stood at 4.9 percent.

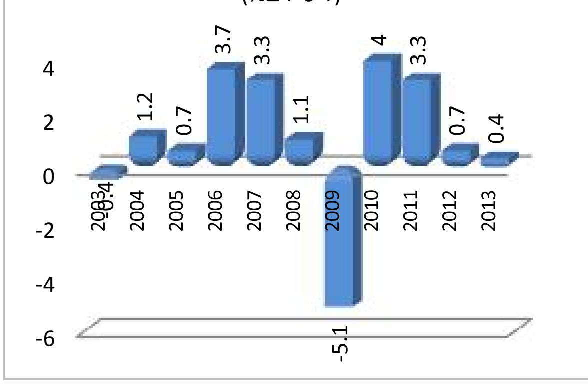
According to the eurostat flash estimates, the annual inflation rate in the euro area was 0.8 percent in December of 2013. In the previous month, the inflation rate was 0.9 percent.

According to a press released by the European Central Bank (ECB), the current account (seasonally adjusted) of the euro area indicated a surplus of 21.3 billion euros in December 2013. For the full year of 2013, the current account of the euro area recorded a surplus of 221.3 billion euros. The euro area current account surplus was 128.6 billion euros in the previous year.

1.3 The German Economy

According to eurostat, the real GDP of Germany grew by 0.4 percent in 2013 compared to the previous year which, was recorded at 0.7 percent indicating a decrease of 0.3 points in 2013.

Figure 1.4 : The Germany GDP growth rate (%Δ Y-o-Y)



Data Source: Federal Statistical office (Destatis)

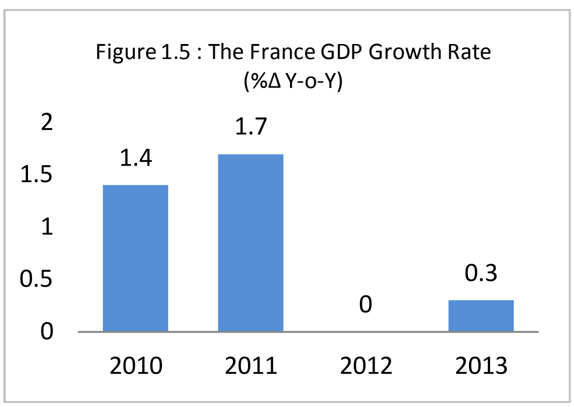
According to the Federal Statistical Office of Germany (DESTATIS), the average annual consumer prices in Germany increased by 1.5 percent in 2013 compared to the previous year. In the previous year, the annual increase in the consumer prices was recorded at 2 percent. In 2011, the annual consumer prices indicated an increase of 2.1 percent.

In December 2013, the total labor force in Germany was 42.61 million of which 40.51 million were employed and 2.1 million (4.9 percent) were unemployed. The German unemployment rate was recorded at 5.3 percent in the same period of the previous year.

According to Federal Statistical Office (Destatis), the trade balance of Germany recorded a surplus of 198.9 billion euro in 2013 while the surplus of the trade balance was 189.8 billion euro in the previous year. During 2013, the Germany's exports of goods amounted 1,093.9 billion euro and imports of goods amounted 895 billion euro.

1.4 The Economy of France

According to Insee, GDP of France increased by 0.3 percent in 2013. In 2012, the GDP indicated no change over the previous period.



Source: National Institute of Statistics and Economic Studies (INSEE)

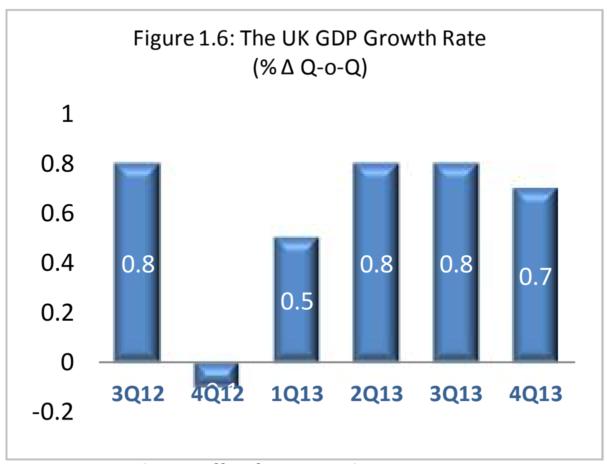
According to the OECD, the unemployment rate of France reached to 10.8 percent in 2013. In the previous year, the unemployment rate was recorded at 10.2 percent. In 2011, the France unemployment rate was 9.6 percent.

According to the OECD, the consumer prices indicated an increase of 0.9 percent in 2013 over the previous year. In 2012, the France inflation rate was recorded at 2 percent.

According to the OECD, the deficit of the France current account amounted 44,134 million dollars in 2013 while the current account deficit was recorded at 57,098 million dollars in 2012. In 2011, the current account deficit indicated a deficit of 48,958 million dollars.

1.5 The Economy of United Kingdom

According to the OECD, the GDP growth in the U.K. was recorded at 2.8 percent in the fourth quarter of 2013 compared to the same quarter of the previous year. According to the theguardian.com, the UK economy grew by 1.9 percent in 2013.



Data Source: The UK Office for National Statistics

According to the OECD, the consumer prices in the U.K. increased by 2 percent in December

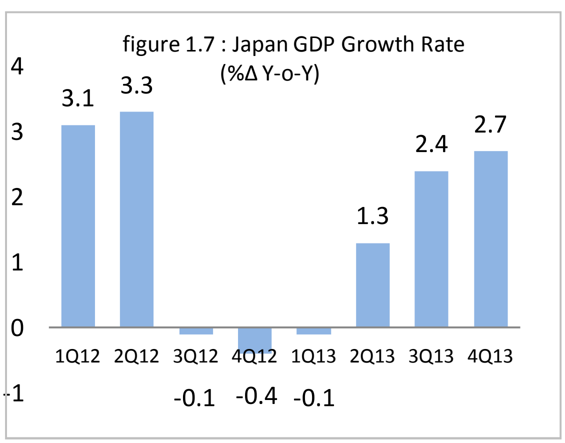
2013 compared to the same period of last year. For the full year 2013, the consumer prices went up by 2.6 percent compared to a year earlier. In 2012, the increase in the consumer prices was recorded at 2.8 percent.

According to the International Labor Organization, the unemployment rate of the United Kingdom was 7.5 percent in 2013. The unemployment rate was 8 percent in the previous year.

According to the OECD (forecast), the trade balance of the U.K. was expected to indicate a deficit of 85,592.28 million dollars in 2013. The current account of U.K. showed a deficit of 92,646 million dollars in the previous year. In 2011, the current account of the U.K. indicated a deficit of 36,028 million dollars.

1.6 The Economy of Japan

According to the OECD, the GDP of Japan indicated an increase of 2.7 percent in the fourth quarter of 2013. In the previous quarter, the GDP growth rate was 2.4 percent compared to the same period of the last year.



According to the OECD, the current account of Japan recorded a surplus of 33,875 million dollars in 2013. In the previous year, the current account surplus of Japan amounted 60,436 million dollars. In 2011, the current account surplus of Japan stood at 119,824 million dollars.

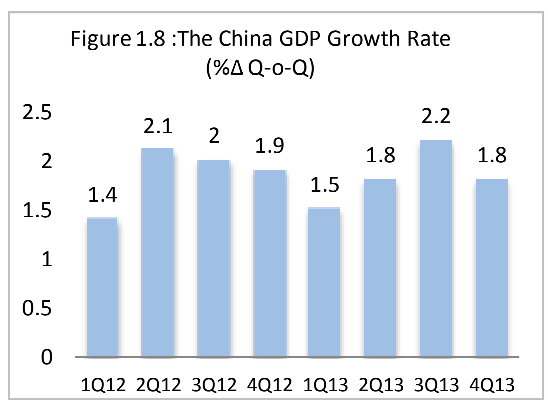
According to the OECD, the Japan seasonally adjusted unemployment rate was recorded at 4 percent in 2013. In last year, the unemployment rate was 4.4 percent, which indicates a decline of 0.4 points in 2013.

The inflation rate in Japan was recorded at 0.4 percent in 2013. In 2012, the annual inflation rate stood at 0 percent, while the rate was recorded at -0.3 percent in 2011.

2. EMERGING ECONOMIES

2.1 The Economy of China

According to the OECD, the GDP of China increased 1.8 percent in the fourth quarter of 2013 compared to the previous quarter, which was recorded at 2.2 percent indicating a decline of 0.4 points.



Source: National Bureau of Statistics of China

2.2 The Economy of India

According to the OECD (forecast), the economy of India was expected to grow by 3 percent in 2013. The GDP growth rate for 2012 was forecasted at 3.8 percent compared to 7.7 percent forecast for 2011.

According to the OECD, the consumer prices were higher by 10.9 percent in 2013 compared to the previous year which indicated an increase of 9.3 percent. In 2011, the annual inflation rate in India was recorded at 8.9 percent.

Figure 1.9 : The India Inflation Rate (%Δ Y-o-Y)

Source: www.tradingeconomics.com

According to the International Labor Organization, the unemployment rate of India was 3.7 percent in 2013, while the unemployment rate was 3.6 percent in the previous year.

According to the tradingeconomics.com, the exports of India increased to 26,346.06 million dollars in December 2013 from 24,613.29 million dollars in the previous month. In October, the exports amounted 27,270.97 million dollars. On the other hand, the imports of India increased to 36,486.3 million dollars in December of 2013 from 33833.2 million dollars in the last month. In October, the imports reached 37,827 million dollars.

2.3 The Economy of Turkey

According to the OECD (forecast), the economy of Turkey was expected to grow 3.6 percent in 2013. According to the Turkish Statistical Institute (Turkstat), the GDP growth rate was 2.2 percent in 2012 while the GDP growth rate was recorded at 8.5 percent in 2011.

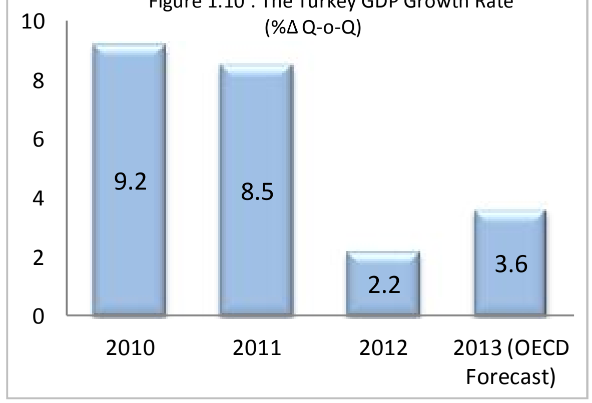


Figure 1.10 : The Turkey GDP Growth Rate (%Δ Q-o-Q)

Source: Turkish Statistical Institute

2.4 The Economy of Pakistan

According to the International Monetary Fund (Projection), the GDP of Pakistan was expected to indicate an increase of 3.6 percent in 2013.

According to the Pakistan Bureau of Statistics, the consumer price index of Pakistan indicated a decrease of 1.32 percent in December 2013 over the previous month. The consumer price index has increased by 9.18 percent if it is compared to the same period of last year.

According to the International Labor Organization, the unemployment rate of India was 5.2 percent in 2013. The unemployment rate was 5 percent in 2012.

According to the Pakistan Bureau of Statistics, the exports of Pakistan amounted 2,275 million dollars in December 2013. In the previous month, the export was recorded at 1,804 million dollars, indicating an increase of 26.11 percent in December over the previous month. On the other hand, the imports of Pakistan amounted 3,561 million dollars in December 2013. In November, the imports amounted 3,651 million dollars which shows a decrease of 2.47 percent in December over the last month.

REFERENCES:

www.bea.gov
www.census.gov
www.publicdebt.treas.gov
www.rbi.org.in
www.tcmb.gov.tr
www.oecd.org
www.ons.gov.uk
www.euronews.com
www.bloomberg.com
www.tradingeconomy.com

HAPTER II

MONETARY AND CAPITAL MARKET DEVELOPMENTS

2

MONETARY AND CAPITAL MARKET DEVELOPMENTS

Monetary and capital market developments evaluate monetary program under the Extended Credit Facility (ECF) program, monetary aggregates, foreign exchange rates, net international reserves, as well as open market operations. During the year under review (FY1392), the operational target of reserve money under the ECF program grew at 11.40 percent standing at AF 196,919.14 million. The actual reserve money was above the ECF revised target of 8 percent. Currency in circulation "an indicative target under the ECF program", increased by 11.88 percent in the year FY1392 reaching to AF 167,831.38 million. DAB breached the targets of reserve money (RM) and currency in circulation (CiC) under the ECF program on the last days of the year due to unexpected increase in the government expenditures. On the other hand, DAB successfully achieved the floor for net international reserves (NIR). The NIR was above the target floor. Narrow money (M1) stood at AF 350,696 million in the year under review, registering an annual growth rate of 9.88 percent (Y-o-Y). Broad money (M2) demonstrated similar behavior, representing a growth rate of 9.40 percent (Y-o-Y) standing at AF 370,684 million at the end of the year under review.

Reserve money (RM) that consists of currency in circulation, eight percent required reserves of commercial banks, current accounts of commercial banks held with DAB, and the overnight deposit facility (ONDF) under the ECF program of the International Monetary Fund (IMF) helped DAB to achieve its ultimate goal of price stability. In order to control the reserve money growth, DAB utilizes its main instruments of FX auction (frequently selling US dollars in the market) and selling of capital notes.

In the fiscal year 1392, DAB has auctioned a total amount of USD 3.482 billion to manage the liquidity in the market as well as to mitigate the fluctuations in the exchange rate of Afghani against the foreign currencies.

The outstanding amount of CNs stood at AF 31 billion in this year.

Afghani depreciated against the greenback by 7.91 percent

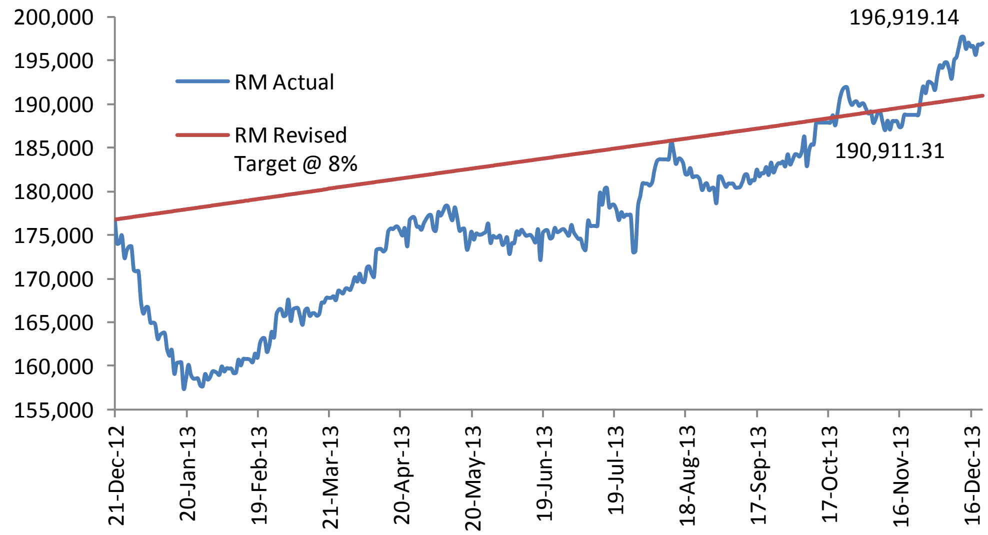
1 – MONETARY PROGRAM UNDER ECF PROGRAM

The Monetary Policy Framework (MPF) is designed under the Extended Credit Facility (ECF) program of the International Monetary Fund (IMF). For the period under review, the key operational target (performance criterion) was the reserve money (RM), while currency in circulation was set as the indicative target designed for achieving DAB's primary objective of domestic price stability.

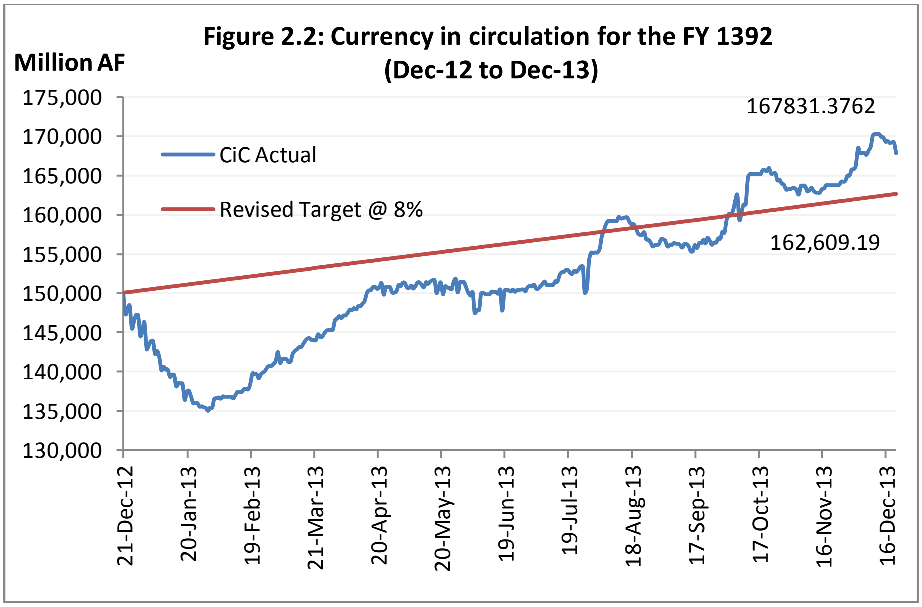
The precise amount of reserve money (RM) conducive to support the domestic price stability is determined using the quantitative theory of money. Therefore, the ECF target is set, taking into account the expected economic growth and expected inflation rates for the current year. For the FY1392, the targets for reserve money and currency in circulation were revised from 12 percent to 8 percent for each of them. However, the actual reserve money ended with a growth rate of 11.40 percent, mainly due to concerns after the 2014 which led people to use foreign currency as a store of value, and on the other hand, spendthrift of current expenditure mainly in the security sector were the reasons that caused the RM to grow fast and cross the target in the last days of the year.

The Figures below provide the ceiling and the actual figures of reserve money and currency in circulation for the period under review.

Figure 2.1: Reserve Money for the FY 1392 (Dec. 12 to Dec. 13)



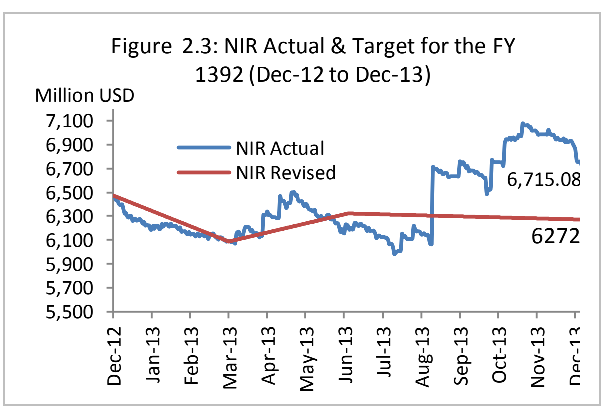
Source: *Monetary Policy Department/DAB*



Source: *Monetary Policy Department/DAB*

1.1 Net International Reserve

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



In the past few years, Afghanistan's NIR which is a crucial indicator of its ability to repay the external debts and to finance the foreign trade deficit grew steadily. At the beginning of the year, the NIR floor was set for an accumulation of USD 200 million, but later on it was revised to a de-accumulation of USD 200 million, mainly due to an expected decrease in the level of inflows from donor community as well as due to a decrease in the military spending of foreign troops. However, the actual accumulation stood at USD 850 million at the end of the year, which led DAB to achieve the NIR floor with a significant margin. The actual NIR ended at USD 6,715 million at the end of the fiscal year 1392.

DAB increased the level of FX auction to reduce pressure on money supply growth and to prevent extra volatility in the exchange rate of Afghani against foreign currencies. DAB auctioned a total of USD 3.482 billion in the year under review in order to satisfy market's demand and sterilize the excess liquidity from the market, while the total demand was USD 4,985 million. During the period under review, total awarded amount of FX auction was about 70 percent of total demand.

2. MONETARY AGGREGATES

The monetary aggregates -- narrow money (M1) and broad money (M2) -- are compiled following the MFS methodology and definition. Narrow money as referred (M1) grew by 9.88 percent on a year-on-year basis.

The stock of broad money (M2) grew to AF 370,684 million that represents an overall growth of 9.40 percent (Y-o-Y), which is higher than 8.88 percent growth recorded in the same period of last year. M1 remained the main contributor to the growth in M2.

Quasi money or time deposits of commercial banks, which is the other component of M2, grew by 7 percent compared with the same period of FY1391. However, quasi money constitutes only 7 percent of broad money; therefore, the impact of its changes on M2 is negligible. The year-on-year difference of Afghani denominated time deposits stood at AF 788 million and the foreign currency denominated time deposits recorded AF -476 million.

Meanwhile, bank deposits as a share of broad money decreased to 50.92 percent (Y-o-Y) in the year under review, down from 52.06 percent in the previous year.

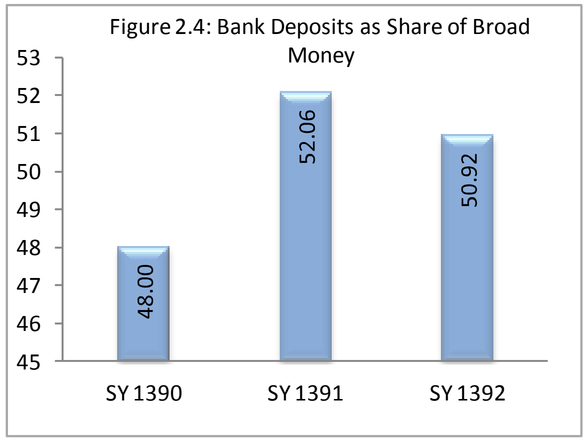


Figure 2.4: Bank Deposits as Share of Broad Money

Source: *Monetary Survey, Monetary Policy Department/ DAB*

Similarly, quasi money as a share of broad money decreased slightly to 5.39 percent at the end of the year under review, down from 5.81 percent in the same period of the last year. Afghani-denominated time deposits constitute 2.12 percent of broad money while the share of foreign currency denominated deposits stood at 3.27 percent of M2.

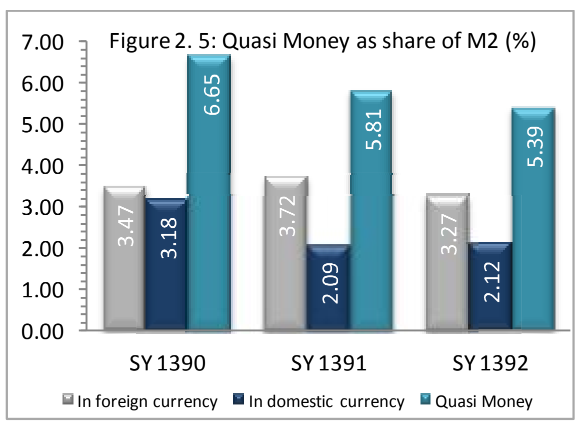


Figure 2. 5: Quasi Money as share of M2 (%)

Source: Monetary Survey, Monetary Policy Department/ DAB

Table 2.1: Monetary Aggregates, FY 1392 (Dec 31, 2012 – Dec 31, 2013)
Figures in million AF, unless otherwise indicated

	1390	1391	Y-o-Y ∆	Difference	1392	Y-o-Y ∆	Difference
	Amount	Amount			Amount		
1-Net Foreign Assets	**338,082**	**425,376**	**25.8%**	**87,294**	**483,924**	**13.76%**	**58,548**
(a) Foreign Assets	370,880	455,731	22.9%	84,851	513,630	12.70%	57,899
DAB Foreign exchange reserves	303,738	372,713	22.7%	68,975	421,774	13.16%	49,061
Gold	45,232	60,424	33.6%	0.000	60,424	0.00%	0.000
Other	258,507	312,289	20.8%	53,782	361,350	15.71%	49,061
Other foreign assets	67,141	83,018	23.6%	15,876	91,856	10.65%	8,838
(b) Foreign liabilities	32,798	30,354	-7.4%	-2,443	29,706	-2.14%	-649
2. Net Domestic Assets	**-26,649**	**-86,537**	**224.7%**	**-59,888**	**-113,241**	**30.86%**	**-26,704**
(a) Net Domestic Credit	-26,715	-44,492	66.5%	-17,777	-45,657	2.62%	-1,165
Net Credit to Nonfinancial Public Sector	-68,472	-86,566	26.4%	-18,094	-91,121	5.26%	-4,555
Net Credit to Central Government	-68,226	-86,267	26.4%	-18,041	-90,911	5.38%	-4,645
Credit to Central Government	30,292	32,831	8.4%	2,539	33,727	2.73%	896
Liabilities to Central Government	98,518	119,097	20.9%	20,579	124,638	4.65%	5,540
Net Credit to State & Local Government	0	0	0.000	0.000	0.000	0.000	0.000
Net Credit to Public Nonfinancial Corporations	-246	-299	21.7%	-53	-210	-29.84%	89
Credit to Private Sector	42,207	43,024	1.9%	817	46,813.54	8.81%	3,789
Net Credit to Other financial Corporations	-450	-950	111.1%	-500	-1,349.40	42.04%	-399
(b) Capital Accounts	36,800	83,686	127.4%	46,886	110,484	32.02%	26,797
(c) Other Items Net	36,866	41,641	13.0%	4,775	42,900	3.02%	1,259
3- Broad Money (M2)	**311,433**	**338,840**	**8.8%**	**27,406**	**370,684**	**9.40%**	**31,844**
Narrow Money (M1)	290,722	319,164	9.8%	28,442	350,696	9.88%	31,532
CiC (Currency outside depository corporations)	141,245	142,761	1.1%	1,516	161,944	13.44%	19,183
Demand Deposits	149,477	176,403	18.0%	26,926	188,751	7.00%	12,348
Other Deposits (Quasi Money)	20,711	19,675	-5.0%	-1,036	19,988	1.59%	312
In Afghani	9,893	7,079	-28.4%	-2,815	7,867	11.14%	788
In Foreign currency	10,818	12,597	16.4%	1,779	12,121	-3.78%	-476
Securities Other Than Shares	0.000	0.000	0.000	0.000	0.000	0.000	0.000

(Source: Monetary Survey Section, Monetary Policy Department DAB)

3. FROEIGN EXCHANGE MARKET

3.1 Foreign Exchange Rates

In order to control the money supply, DAB is targeting reserve money by conducting bi-weekly foreign exchange auctions, and a weekly capital notes auction.

The targeting nominal exchange rate is not a policy stance for DAB; however, it is important to monitor the fluctuation in the exchange rate which can affect the economic indicators. This coerces the Bank to intervene in the market via managed floating exchange rate regime.

The daily historic review of the average exchange rate of AF against the U.S. dollars for the fiscal year 1392 is shown in Figures below. Afghani weakened against the major currencies, as a result of a trade deficit, as well as the budget deficit and concerns over country's destination beyond 2014 that reflected in the local and international media. Afghani depreciated against the U.S. dollar by 7.91 percent from AF 52.16 at the beginning of the fiscal year to AF 56.64 at the end of year under review.

Similarly, Afghani depreciated against the euro, GBP, and INR by 11.17 percent, 8.76 percent, and 4.7 percent respectively. Afghani remained almost unchanged against the PKR appreciating by only 0.24 percent; however, it strengthened against the IRR by 13.61 percent due to the impact of international sanctions on Iranian economy over its controversial atomic program.

Figure 2.6: Daily Average Ex-Rate of Afghani Against USD For the FY 1392 (Dec-12 to Dec-13)

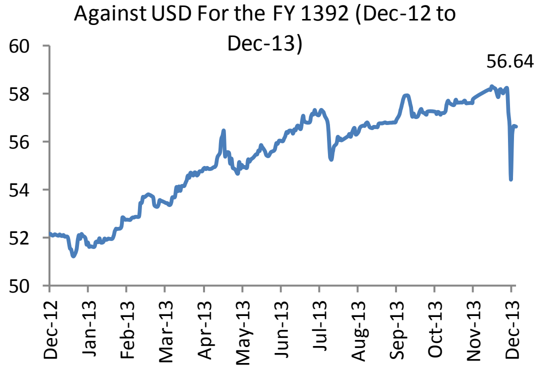
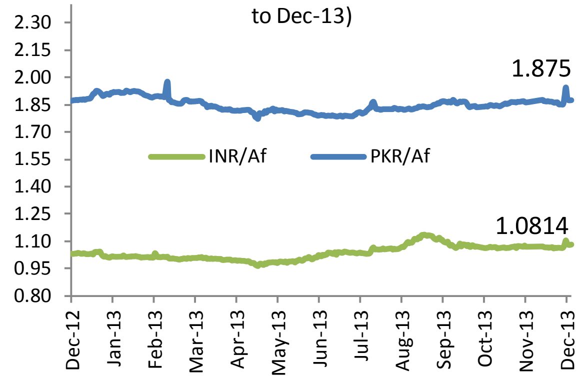
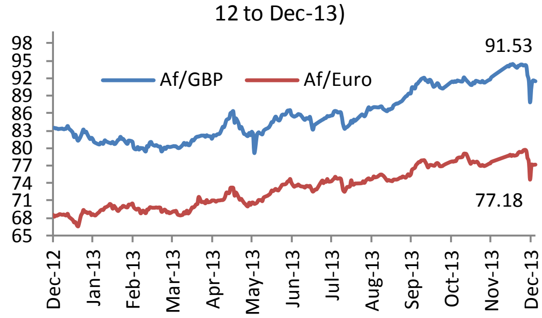


Figure 2.7: Daily Average Ex-Rate of Afghani Against INR & PKR For the FY 1392 (Dec-12 to Dec-13)



Source: *Monetary Survey Section, M PD/ DAB*

Figure 2.8: Daily Average Ex-Rate of Afghani Against GBP & Euro For the FY 1392 (Dec-12 to Dec-13)



Source: *Monetary Survey Section, M PD/ DAB*

Figure 2.9: Daily Average Ex-Rate IRR against Af For the FY 1392 (Dec-12 to Dec-13)

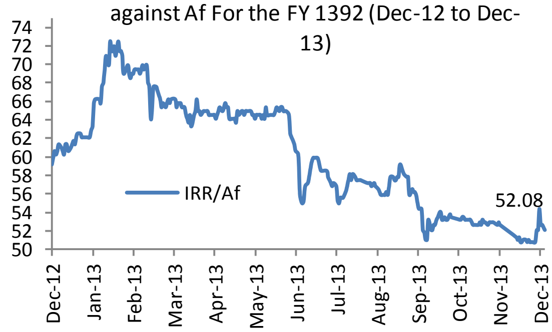


Table 2.2: Foreign Exchange Auction's Summery for FY 1392 (million USD)

Auction Date	No of Bidders	Highest Price	Lowest Price	Market Ex Rate	Cut off Price	Amount Announced	Amount Awarded	Total Demand
14-Sep-13	40	56.80	56.10	56.80	56.75	30.00	30.40	44
17-Sep-13	39	56.82	56.30	56.82	56.77	30.00	29.60	34
21-Sep-13	44	57.14	56.08	57.12	57.09	30.00	30.45	30
24-Sep-13	43	57.82	57.21	57.77	57.74	30.00	38.90	42
28-Sep-13	39	58.00	57.01	-0.69	57.70	30.00	31.65	51
1-Oct-13	43	57.08	56.50	-0.38	57.01	30.00	34.40	39
5-Oct-13	40	57.08	56.70	57.05	57.03	30.00	29.95	34
8-Oct-13	46	57.43	57.11	57.37	57.41	30.00	40.00	37
12-Oct-13	42	57.18	56.20	57.14	57.11	40.00	36.45	37
19-Oct-13	36	57.28	56.90	57.26	57.22	30.00	28.70	32
22-Oct-13	48	57.25	56.23	57.23	57.20	30.00	31.00	39
26-Oct-13	38	57.21	56.50	57.21	57.17	30.00	27.40	36
29-Oct-13	45	57.78	57.01	57.72	57.73	30.00	39.35	42
2-Nov-13	37	57.53	56.91	57.53	57.42	40.00	35.00	45
5-Nov-13	44	57.60	57.06	57.65	57.54	40.00	37.55	50
9-Nov-13	45	57.70	56.66	57.65	57.67	40.00	40.30	33
12-Nov-13	40	57.60	56.86	57.62	57.48	40.00	30.00	38
16-Nov-13	41	57.65	57.10	57.62	57.57	40.00	36.10	37
26-Nov-13	41	57.74	56.70	57.72	57.68	60.00	40.60	32
30-Nov-13	39	58.22	57.13	58.19	58.00	30.00	35.30	54
3-Dec-13	45	58.30	58.00	58.28	58.21	40.00	44.90	50
7-Dec-13	47	57.96	57.30	57.87	57.87	40.00	45.55	40
10-Dec-13	48	58.13	57.21	58.10	57.97	40.00	45.60	47
14-Dec-13	48	58.23	57.91	58.24	58.15	40.00	43.65	52
16-Dec-13	43	57.55	55.10	56.65	56.02	50.00	37.15	53
17-Dec-13	36	54.40	44.05	54.42	54.00	50.00	39.50	40
21-Dec-13	41	56.62	54.20	56.64	56.46	50.00	48.25	43
Total						**1,000**	**987.70**	**1,351.25**

Source: Market Operations Department and Monetary Policy Department staff calculation

4. Capital Markets and Liquidity Conditions

4.1 Capital Note Auctions

Monetary policy anchors monetary targeting of reserve money to control the money supply in the economy to a sustainable price level within its framework.

DAB's monetary policy uses two instruments to target reserve money; Foreign exchange auction, and the capital notes (CNs) auction.

Capital notes are discounted afghani denominated short–term securities offered by DAB to the primary market customers, mostly licensed commercial banks on a weekly basis.

DAB has already developed a computerized security market, where its primary dealers can offer their bid amounts from their own institutions.

DAB offers three types of securities, probably all short-terms of one month, six months, and one year capital notes. The one year security has just been introduced to the market in order to expand the use of this monetary tool.

The auction for CNs is announced every Monday electronically before 10am in the morning. The auction is held every Tuesday with the settlement of t+2 time framework and the announcement is of multiple prices for each security.

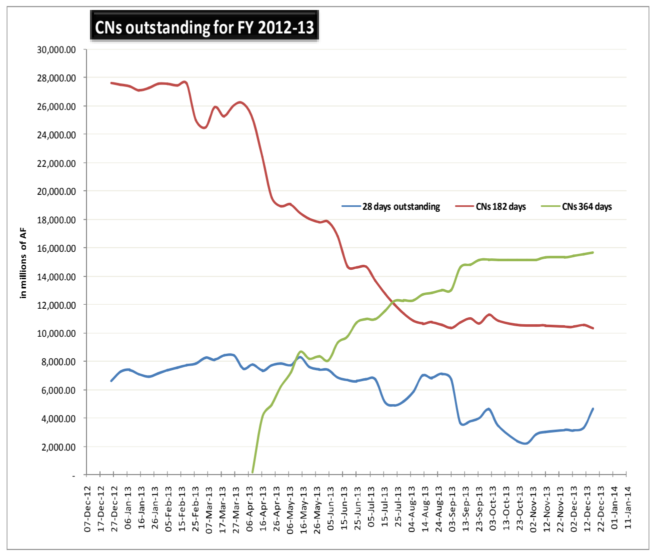
The total outstanding stock of capital notes reached AF 30.66 billion at the end of the fiscal year 1392, which shows a decrease of 15 percent compared to the previous year where ended at AF 36.26 billion. The factors behind such shrinkage in capital notes are thought to be the depreciation of Afghani against the USD, also the real rate of return remained negative that led commercial banks to hoard their excess liquidity expectation of more depreciation.

The outstanding stock for 28 day notes stood at AF 5.67 billion, which remained flat while for 182 day maturity the stock declined by 63 percent, or ended at AF 10.33 billion, on the contrary, the stock outstanding for 364 day notes reached AF 15.66 billion for the fiscal year 2012-13.

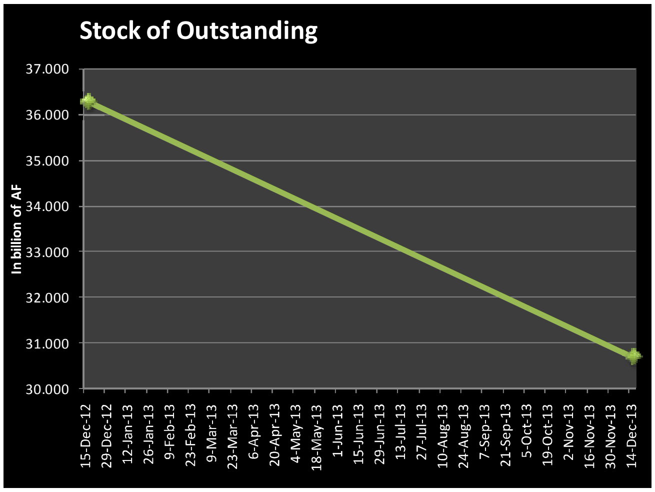
Figure 2.10 exhibits breakdown of the total outstanding stock for all maturities during the fiscal year 2012-13 while figure 2.11 represents total outstanding stocks for the last two years.

DAB increased the announcement amounts for all securities based on its liquidity forecast framework.

The outstanding stock of 28 day notes increased from AF 200 million to AF 2500 million, while the stock of 182 day security, increased from AF 100 million to AF 2000 million, and the one year notes stock increased from AF 500 million to AF 1500 million.



The mean weighted average of interest rates for 28 day capital note remained at 2.50 percent and for 182 day security it reached 3.83 percent, and for 364 day security it increased to 5.46 percent, as the end of fiscal year 1392.



4.2 Required and Excess Reserves

In order to provide commercial banks with facilities to better manage their liquidity and to provide them a proper channel to invest their excess reserves apart from capital notes, DAB introduced the overnight standing facilities in 1385 (2006-2007).

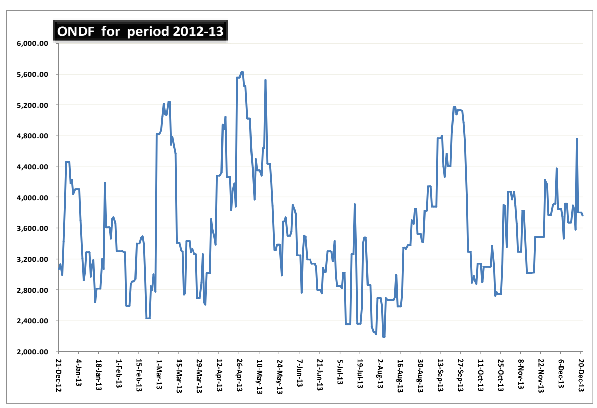
Overnight Deposit Facility: this facility is available to all commercial banks to gain interest on excess balances and to provide a floor for capital notes interest rates. The interest rate on the overnight deposit facility currently is 100 basis points below the cutoff rate of 28 day CNs auction (based on a circular to all banks approved by the DAB Executive Board on June 09, 2010).

The outstanding amount of deposit facility balances followed an uneven trend during the reporting period. It fluctuated on average at AF 3.58 billion during the period under review.

Overnight Credit Facility: This facility is used by commercial banks for their short term cash needs. The facility allows commercial banks to borrow local currency from Da Afghanistan Bank on an overnight basis, when they face a shortfall in their short term liquidity position. The rate that banks are charged with for this facility is 350 basis points above the last 28 day CNs auction rate. This borrowing is collateralized with the outstanding of capital notes only (according to the circular of Feb 27, 2007).

DAB encourages the inter-bank lending among the commercial banks. During the period under review, only one bank benefited from this facility amounting to AF 1.5 billion.

Commercial banks are required to hold 8 percent of their total deposits as an obligatory reserve with DAB and are remunerated at one basis point below the cutoff rate of the last 28 day capital notes auction, or equal to the deposit facility rate. Data shows that the amount of required reserve increased by 8 percent during the fiscal year, which signals an increase in total deposits of commercial banks as elaborated by figure 2.12 below.



Source: *Market Operations Department, DAB*

Table 2.3: Auction of 28 Day Capital Notes (million AF)

Start Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Low Bid %	Highest Bid %	Weighted Avg. %
25-Dec-12	200	3400	4300	5	2	1.95	1.94	1.99	1.95
1-Jan-13	200	2000	2000	1	1	1.93	1.93	1.93	1.93
8-Jan-13	200	1300	1300	4	4	1.92	1.91	1.92	1.91
15-Jan-13	200	400	405	2	2	1.92	1.90	1.92	1.91
22-Jan-13	200	3200	3300	3	2	1.91	1.88	1.92	1.90
29-Jan-13	200	2250	2255	3	3	1.91	1.89	1.95	1.90
5-Feb-13	200	1500	1600	5	5	1.91	1.85	1.92	1.90
12-Feb-13	200	610	610	3	3	1.91	1.90	1.91	1.90
19-Feb-13	200	3360	3370	4	4	1.91	1.88	1.95	1.90
26-Feb-13	200	2380	2380	4	4	1.91	1.90	1.91	1.91
5-Mar-13	2000	1900	1900	5	5	1.91	1.89	1.91	1.90
12-Mar-13	2000	460	460	2	2	1.97	1.90	1.97	1.91
19-Mar-13	2000	3660	3660	5	5	1.96	1.89	1.96	1.95
26-Mar-13	2000	2377	2378	5	5	2.00	1.94	2.30	1.95
2-Apr-13	2000	975	982	4	3	2.02	1.97	2.50	1.98
9-Apr-13	2000	775	775	5	5	2.20	2.00	2.20	2.04
16-Apr-13	2000	3225	3670	6	3	2.19	1.99	2.60	2.01
23-Apr-13	2000	2750	2750	4	4	2.22	1.99	2.22	2.05
30-Apr-13	2000	1100	1100	3	3	2.22	2.00	2.22	2.07
7-May-13	2000	650	650	3	3	2.30	2.20	2.30	2.21
14-May-13	2000	3805	3805	5	5	2.50	2.10	2.50	2.17
21-May-13	2000	2050	2077	3	2	2.50	2.40	2.70	2.43
28-May-13	2000	900	1100	4	3	2.50	2.45	2.60	2.46
4-Jun-13	2000	630	635	4	3	2.55	2.47	2.55	2.51
11-Jun-13	2000	3250	3260	4	3	2.55	2.50	3.00	2.52
18-Jun-13	2500	1870	1885	4	4	2.57	2.52	2.60	2.54
25-Jun-13	2500	850	900	3	2	2.57	2.55	5.57	2.55
2-Jul-13	2500	750	750	6	6	2.62	2.56	2.59	2.59
16-Jul-13	2500	3520	3520	5	5	2.65	2.58	2.65	2.60
23-Jul-13	2500	630	630	5	5	2.70	2.60	2.70	2.65
30-Jul-13	2500	1030	1040	4	3	2.72	2.69	3.00	2.69
6-Aug-13	2500	700	700	4	4	3.00	2.72	3.00	2.90
13-Aug-13	2500	4700	4700	5	5	3.10	2.72	3.10	2.98
20-Aug-13	2500	450	450	2	2	3.20	3.00	3.20	3.14
27-Aug-13	2500	1300	1435	7	4	3.21	3.10	3.60	3.18
3-Sep-13	2500	300	550	3	2	3.22	3.19	3.30	3.21
10-Sep-13	2500	1610	1840	5	4	3.22	3.20	3.30	3.21
17-Sep-13	2500	560	760	3	3	3.22	3.21	3.50	3.22
24-Sep-13	2500	1550	1700	7	6	3.25	3.21	6.95	3.22
1-Oct-13	2500	900	900	4	4	3.30	3.24	3.30	3.26
8-Oct-13	2500	1050	1050	3	3	3.30	3.29	3.30	3.30
22-Oct-13	2500	800	800	2	2	3.30	3.29	3.30	3.30
29-Oct-13	2500	350	350	2	2	3.30	2.29	3.30	3.30
5-Nov-13	2500	1700	1700	6	6	3.35	3.30	3.35	3.31
12-Nov-13	2500	150	450	3	2	3.35	3.34	3.60	3.35
26-Nov-13	2500	1300	1700	6	5	3.36	3.35	3.38	3.35
3-Dec-13	2500	1675	1675	6	6	3.36	3.35	3.36	3.35
10-Dec-13	2500	350	350	3	3	3.37	3.36	3.37	3.36
17-Dec-13	2500	1350	1350	4	4	3.39	3.36	3.39	3.37

Source: *Market Operations Department, DAB*

Table 2.4: Auction of 182 Day Capital Notes (million AF)

Start Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Low Bid %	Highest Bid %	Weighted Average (%
25-Dec-12	100	1,047	1,047	6	6	3.34	3.32	3.34	3.33
1-Jan-13	100	250	250	2	2	3.33	3.33	3.33	3.33
8-Jan-13	100	760	760	4	4	3.36	3.32	3.36	3.33
15-Jan-13	100	620	630	4	3	3.36	3.35	3.36	3.36
22-Jan-13	100	820	825	3	2	3.36	3.35	3.90	3.36
29-Jan-13	100	650	650	3	3	3.36	3.35	3.36	3.36
5-Feb-13	100	500	550	2	2	3.36	3.36	3.37	3.37
12-Feb-13	100	700	700	3	3	3.36	3.35	3.36	3.36
19-Feb-13	100	150	165	2	1	3.36	3.36	3.36	3.36
26-Feb-13	100	600	1,100	6	5	3.36	3.35	3.36	3.36
5-Mar-13	1000	245	1,502	8	4	3.35	1.35	3.38	3.35
12-Mar-13	1000	2,544	2,544	7	7	3.34	3.34	3.34	3.35
19-Mar-13	1000	200	200	1	1	3.40	3.40	3.40	3.40
26-Mar-13	1000	1,152	1,154	8	8	3.45	3.34	3.47	3.39
2-Apr-13	1000	107	107	2	2	3.55	3.44	3.55	3.45
9-Apr-13	1000	931	986	5	5	3.60	3.52	3.70	3.55
16-Apr-13	2000	350	410	4	3	3.62	3.59	4.00	3.16
23-Apr-13	2000	350	700	3	2	3.62	3.59	3.65	3.61
30-Apr-13	2000	970	975	3	3	3.62	3.60	3.65	3.61
7-May-13	2000	350	350	3	3	3.64	3.62	3.64	3.63
14-May-13	2000	400	600	3	3	3.64	3.64	3.68	3.64
21-May-13	2000	250	253	4	3	3.65	3.60	3.90	3.62
28-May-13	2000	100	100	1	1	3.80	3.80	3.80	3.80
4-Jun-13	2000	250	310	4	3	3.90	3.90	4.50	3.82
11-Jun-13	2000	250	260	4	3	3.95	3.90	4.50	3.91
18-Jun-13	2000	400	400	1	1	3.38	3.95	3.98	3.96
25-Jun-13	2000	770	775	3	3	4.00	3.98	4.10	4.00
2-Jul-13	2000	300	300	2	2	4.10	4.01	4.10	4.04
16-Jul-13	2000	580	580	3	3	4.20	2.62	4.20	3.60
23-Jul-13	2000	280	280	3	3	4.50	4.20	4.50	4.26
13-Aug-13	2000	600	700	4	3	0.00	4.50	4.80	4.54
20-Aug-13	2000	255	305	3	3	0.00	4.50	4.70	4.64
27-Aug-13	2000	300	368	4	3	4.60	4.70	5.00	4.72
3-Sep-13	2000	10	130	2	1	4.70	4.75	5.90	4.75
10-Sep-13	2000	2,900	2,920	4	4	4.75	4.74	5.80	4.75
17-Sep-13	2000	500	825	4	2	4.75	4.76	5.82	4.78
24-Sep-13	2000	725	775	5	4	4.77	4.77	5.82	4.79
1-Oct-13	2000	700	750	4	4	4.78	4.79	4.85	4.80
8-Oct-13	2000	626	626	3	3	4.80	4.79	4.85	4.85
22-Oct-13	2000	200	200	1	1	4.80	4.85	4.85	4.85
5-Nov-13	2000	880	930	3	3	4.85	4.850	5.000	4.88
12-Nov-13	2000	400	500	4	3	4.85	4.900	5.000	4.92
26-Nov-13	2000	250	433	5	2	4.90	4.95	5.05	4.95
3-Dec-13	2000	150	253	2	1	4.95	4.95	5.00	4.95
10-Dec-13	2000	253	253	3	3	4.95	4.95	5.96	4.95
17-Dec-13	2000	150	200	1	1	4.96	4.96	4.99	4.96

Source: *Market Operations Department, DAB*

Table 2.5: Auction of 364 Day Capital Notes (million AF)

Start Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Low Bid %	Highest Bid %	Weighted Average %
9-Apr-13	500	150.00	208	4	2	5.00	5	5	5.00
16-Apr-13	500	3,900.00	3,950	7	6	5.20	4.48	4.906	4.91
23-Apr-13	500	880.00	1,180	4	3	5.20	5	5.093	5.09
30-Apr-13	500	1,298.18	1,318	6	5	5.20	5.09	5.192	5.19
7-May-13	500	995.00	995	5	5	5.30	5.09	5.255	5.26
14-May-13	500	1,415.00	1,580	6	4	5.30	5.12	5.259	5.26
21-May-13	500	50.00	55	2	1	5.35	5.35	5.35	5.35
28-May-13	500	175.00	175	3	3	5.50	5.11	5.267	5.27
4-Jun-13	500	678.95	724	6	5	5.55	5.35	5.472	5.47
11-Jun-13	500	1,265.00	1,265	4	3	5.60	5.45	5.534	5.53
18-Jun-13	1500	425.00	425	4	4	5.65	5.5	5.582	5.58
25-Jun-13	1500	1,027.21	1,032	6	5	5.70	5.5	5.684	5.68
2-Jul-13	1500	215.06	215	3	3	5.80	5.7	5.714	5.71
16-Jul-13	1500	575.00	575	4	4	5.90	5.8	5.811	5.81
23-Jul-13	1500	710.28	710	4	4	6.10	5.9	6.034	6.03
30-Jul-13	1500	20.00	35	2	1	6.20	6.2	6.2	6.20
13-Aug-13	1500	423.74	424	2	2	6.50	6.2	6.329	6.33
20-Aug-13	1500	135.02	155	3	3	6.60	6.6	6.6	6.60
27-Aug-13	1500	190.02	260	6	4	6.70	6.65	6.676	6.68
3-Sep-13	1500	Bid Rejected	135	3	0	0.00	6.8	0	0.00
10-Sep-13	1500	1,600.00	1,610	4	4	6.80	6.65	6.675	6.68
17-Sep-13	1500	200.00	220	3	3	6.90	6.82	6.86	6.86
24-Sep-13	1500	320.00	320	3	3	6.95	6.9	6.906	6.91
1-Oct-13	1500	30.00	160	3	1	6.95	6.95	6.95	6.95
22-Oct-13	1500		No bids						
5-Nov-13	1500	All bids rejected	110	2			7		
12-Nov-13	1500	150.00	250	2	1	6.98	6.98	6.98	6.98
26-Nov-13	1500	15.00	130	3	1	6.98	6.98	6.98	6.98
3-Dec-13	1500	80.00	143	2	2	6.98	6.98	6.98	6.98
10-Dec-13	1500	127.00	127	2	2	7.00	6.98	6.988	6.99
17-Dec-13	1500	110.00	110	1	1	7.05	7	7.014	7.01

CHAPTER III

THE INFLATION TREND

3

THE INFLATION TREND AND OUTLOOK

The trend toward accelerating inflation that began in the first quarter of 1392, continued into the second and third quarters, but begun to decline slightly in the fourth quarter of the year. According to different measures inflation has decreased, while by some other measures, it showed evidence of an increase. This situation could cause some problems for the consumers as well as some challenges for policy makers to some extent.

The increase in inflation rate could mainly be due to high energy costs, as fuel prices continued to increase, according to the nationwide CPI. Besides the other factors, a steady depreciation of local currency (afghani) against the USD during the year resulted in higher prices of some import items such as the food and fuel. The supply side shocks also added up to the increase in inflation rate as the food prices increased, both in the region and international markets. The year-on-year changes in national headline inflation in the fourth quarter of FY1392 was 7.3 percent, which is a high number in itself and significantly higher compared to 5.8 percent recorded in the last quarter of 1391.

Food sub-index, one of the significant broad components of the CPI, was the main driver of the increase in headline inflation. Food prices have been rising gradually worldwide, while in Afghanistan it has been rising sharply. In the West-Central Highlands Agro pastoral livelihood zone, the rain fed wheat harvest is expected to be far below the normal measure and the irrigated wheat harvest is also expected to be significantly lower than the normal margin.

On the other hand, the non-food prices have been falling which partially offset the impact of increased food prices. However, core inflation, which excludes the highly volatile components of bread and cereals, oil and fat, and transportation, is currently at a relatively high level of 7.3 percent, year-on-year, exactly similar to the overall headline inflation, suggesting that inflation has spread beyond these basic commodities.

The headline inflation as measured by Year-on-Year changes in Kabul CPI increased moderately in the fourth quarter of 1392 standing at 6.7 percent compared to 6.5 percent recorded in the same period of the last year. Here, the increase in the food prices was significantly offset by a decrease in the non-food sub-index. The food prices increased significantly by 9.7 percent in the fourth quarter of FY1392 compared to a 2.7

percent increase observed in the same period last year. Whereas, the percentage changes in non-food prices was recorded at 4.6 percent, well below the 9.9 percent observed in the last year.

However, when the quarter-on-quarter changes are observed the picture is quite different. Nationwide headline inflation rose by 4.1 percent in the fourth quarter of FY1392. It went up from a 1.1 percent level of the preceding quarter. Prices of vegetables increased dramatically by 30.9 percentage points which drove the overall headline inflation up. This increase is mostly a seasonal factor, where the prices of vegetables normally increase during the winter due to lower supply.

Quarter-on-quarter changes in Kabul CPI demonstrated similar patterns observed nationwide. Inflation increased significantly in the fourth quarter of FY1392, compared with the third quarter, almost the same as it is observed nationwide.

1. INFLATION GAINED MOMENTUM

3.1 Annual Changes in National Headline Inflation

In the fourth quarter of FY1392, nationwide headline inflation registered a 7.3 percent (Y-o-Y) increase higher than 5.8 percent inflation observed in the same period of last year.

To analyze the contributing factors responsible for the increase in the rate of inflation, it is necessary to discuss the behavior of inflation in those components that have the most significant weights in the calculation of the CPI. First, we will analyze those components with the largest unfavorable changes and then we will look at the components with favorable changes.

The 1.5 percentage point increase in the rate of inflation was mainly due to a sharp increase in the prices of food that in some extent was offset by moderate non-food prices. Food prices increased by 9.7 percent (Y-o-Y) at the end of the fourth quarter of FY1392 representing an increase of 5.3 percentage points. Regionally, food prices were affected by rising food prices in Bangladesh, Indonesia, Pakistan, and Sri Lanka, where food prices were a big factor in pushing the overall prices up. In Afghanistan among the other components, rice and wheat were the main sub-items pushing the overall food prices up.

The non-food prices registered an inflation rate of 4.8 percent (Y-o-Y), down from 7.4 percent in the previous year – and its impact on the overall inflation was as pronounced, which contributed significantly to offset the impacts of food prices. Another special characteristic of the current quarter's data is that the major components of the CPI basket depicted decline compared to the previous year.

The most unfavorable development was the rise in the rate of inflation in vegetables. Vegetable prices soared in the fourth quarter of FY1392. Vegetable (7.91 percent of the CPI) increased sharply by 30.7 percent (Y-o-Y) at the end of the year under review, compared to 1.0 percent recorded in the same period a year ago. This significant 29.7 percentage-point increase was the largest contributing factor pushing the food prices up. The main reason for such a huge increase could be the high volume of exports to the neighboring countries.

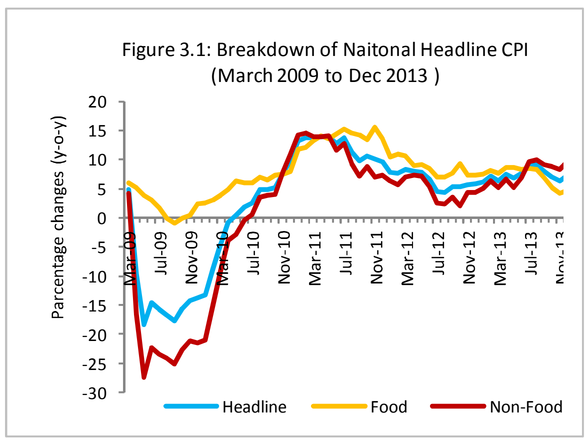
Fruit prices also increased rapidly, another important factor contributing to the rising food prices as well as the overall inflation. These prices rose by 5.6 percent year-on-year in the fourth quarter of FY1392, a sharp increase from a deflation rate of 6.4 percent observed in the same period of last year summing up to an increase of 12 percentage points. Usually at the beginning of the winter, the prices of fresh and dry fruits increase due to both, supply and demand side factors.

Other contributors to the increase in inflation were clothing (7.02 percent weight) increased by 1.1 percentage-points compared to the same period of last year. Transportation (4.72 percent weight) increased by 1.7 percentage-points, and Health (3.32 percent weight) posted an increase of 0.3 percentage-points in the period under review.

On the other hand, some components witnessed favorable changes that partially offset the impacts of increased food prices. These include meat (7.16 percent weight) 5.2 percentage-point decrease; milk, cheese and eggs (4.84 percent weight) 3.3 percentage-point decrease; oil and fat (4.01 percent weight) 3.2 percentage-point decrease; and spices (0.90 percent weight) exhibited 7.2 percentage- point decrease from the previous period.

Core inflation, which excludes extremely volatile components, exhibited exactly similar behavior with that of the overall inflation. Core inflation, which excludes bread and cereals, oil and fat, and transportation increased by 7.3 percent (Y-o-Y) at the end of the fourth quarter of FY1392 compared to 5.7 percent inflation recorded a year ago. Considering a similar rate of core inflation with that of headline inflation gives a message that inflation has gained momentum.

When core inflation is measured by the 28 percent trimmed mean (TM), a different pattern appears. Core inflation increased by 5.6 percent at the end of the fourth quarter of FY1392, down from 6.0 percent recorded in the same period of last year. Such a low rate of inflation could be as a result of three important components of the CPI that were trimmed off. The trimmed components are vegetables, fresh and dried fruits, and bread and cereals that have significant weights in the CPI Basket.



Source: Central Statistics Organization/DAB Staff calculations

Table 3.1: Breakdown of National CPI
Percentage changes, Year-on-Year)

	1390				1391*			FY 1392			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q1	Q2	Q3	Q4
Headline Inflation	**12.7**	**9.9**	**9.7**	**8.4**	**6.7**	**5.4**	**5.8**	**6.4**	**7.6**	**8.0**	**7.3**
Food and beverages	**11.7**	**7.2**	**7.4**	**6.9**	**5.4**	**3.5**	**4.4**	**5.2**	**6.9**	**9.1**	**9.7**
Bread and Cereals	11.5	2.9	5.3	2.3	2.2	4.6	8.4	12.8	13.7	14.6	9.1
Meat	15.6	8.9	9.3	12.2	13.8	12.9	10.2	6.0	5.3	6.6	5.0
Milk, cheese and eggs	8.6	9.4	10.5	14.4	9.7	7.9	8.8	4.9	4.1	7.8	5.0
Oils and fats	25.3	24.2	5.8	7.8	5.2	0.3	3.5	-0.5	-2.3	-0.4	0.3
Fresh and dried fruits	15.1	18.9	22.9	18.3	16.1	6.3	-6.4	-3.2	-2.0	-0.1	5.6
Vegetables	2.7	2.2	-0.2	5.6	4.8	-4.4	1.0	-3.2	6.6	15.3	30.7
Sugar and sweets	8.1	6.3	4.9	0.0	0.5	-2.8	-0.3	3.4	4.7	2.8	2.4
Spices	13.9	27.2	28.4	34.4	25.5	11.8	15.3	8.8	10.2	5.6	8.1
Non-Food	**14.4**	**14.2**	**13.6**	**10.6**	**8.5**	**7.7**	**7.4**	**7.7**	**8.4**	**6.8**	**4.8**
Clothing	9.2	15.4	18.8	17.6	12.5	8.3	7.7	8.0	10.3	8.9	8.8
Health	3.0	2.9	4.4	2.2	1.7	4.4	7.7	11.3	13.0	11.2	8.0
Transportation	22.1	19.6	30.3	12.4	13.1	6.6	-0.3	-2.5	-1.5	3.6	5.8
Communication	2.5	2.6	3.0	4.8	0.2	-2.7	-4.3	-6.7	-6.4	-4.5	-2.5
Education	9.6	11.2	16.2	0.9	4.7	6.7	5.2	7.1	1.7	1.8	1.8
Miscellaneous	12.4	9.9	15.2	21.4	19.2	17.7	9.1	5.5	5.2	6.6	8.0
Core inflation (28% TM)	**11.2**	**11.1**	**11.2**	**10.6**	**8.1**	**5.7**	**6.0**	**4.9**	**5.8**	**5.8**	**5.6**
Core inflation (Headline excl. B&C, O&F and T)	**11.9**	**11.9**	**11.2**	**9.6**	**7.5**	**5.9**	**5.7**	**5.9**	**7.4**	**7.2**	**7.3**

*Afghanistan's new fiscal year (December to January) began from 1391, therefore FY1391 includes only 3 quarters
Source: Central Statistics Organization/ DAB Staff calculations

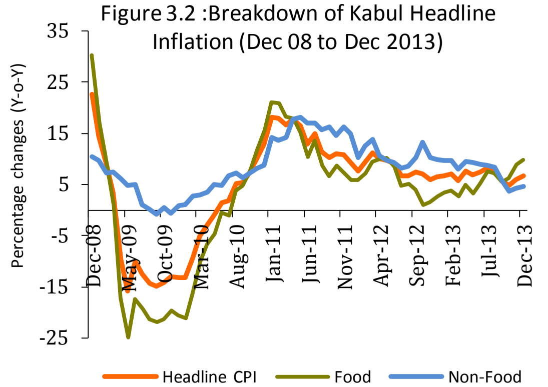
3.2 Annual Changes in Kabul Headline Inflation

The Kabul headline inflation rate, when measured on a year-on-year basis showed almost similar characteristics to that in the nationwide CPI. The 6.7 percent Kabul based headline inflation rate at the end of the fourth quarter of FY1392 is slightly above a 6.5 percent inflation experienced in the same period of last year. The main factors responsible for the increase in Kabul CPI are similar to those affected the nationwide CPI. The prices of bread and cereals remained pretty stable with no large changes, although it is still a high number in itself. In Kabul, bread and cereal prices rose smoothly in the fourth quarter of FY1392 on a year-on-year basis. Fresh and dry fruit experienced a rapidly rising rate, as compared with the previous year. Fresh and dry fruit prices increased dramatically by 14.5 percentage points compared to the previous year, ending up at 2.3 percent. The factors responsible for the changes in Kabul CPI, was similar to that in national CPI.

Vegetables experienced sharp increase, up by 33.2 percentage-points, compared to a year ago representing a 30 percent (Y-o-Y) inflation rate. The reason behind this huge price changes was the similar factors observed in nationwide CPI.

Other components that contributed to this increase in the overall inflation were the clothing (7.02 percent weight) increased by 0.7 percentage-point; transportation (4.72 percent weight), a 10.1 percentage-point increase; education also posted an increase at the end of the fourth quarter.

Figure 3.2 :Breakdown of Kabul Headline Inflation (Dec 08 to Dec 2013)



These unfavorable changes were partially offset by some favorable changes in some other components that posted a decline in the reporting period. These components include sugar and sweets (2.93 percent weight) exhibited a deflation rate of 1.4 percent, meat (7.16 percent weight, a 10 percentage-point decrease); milk, cheese and eggs (4.84 percent weight), the rate of inflation declined by 3.0 percentage-point; spices (0.90 percent weight) posted a 33.1 percentage-point decrease; and health (3.3 percent weight) a 11.0 percentage-point decline compared to the same period of the last year.

Table 3.2: Breakdown of Kabul Headline CPI
(Percent changes year on year)
Consumer Price Index

	1390				1391			1392 FY			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3 FY	Q1	Q2	Q3	Q4
Overall Index	**13.0**	**10.3**	**9.4**	**11.3**	**9.0**	**7.4**	**6.5**	**5.8**	**7.4**	**5.7**	**6.7**
Food and beverages	**10.3**	**6.5**	**5.9**	**9.5**	**8.5**	**4.0**	**2.7**	**2.6**	**5.1**	**5.4**	**9.7**
Bread and Cereals	7.1	0.9	2.7	3.2	6.7	7.2	10.3	11.8	13.4	12.6	10.4
Meat	19.3	7.9	7.2	15.0	15.8	15.5	14.2	9.3	5.3	3.4	4.2
Milk, cheese and eggs	8.8	10.8	8.8	15.5	9.6	6.1	5.3	0.4	-2.0	-1.0	2.3
Oils and fats	28.0	35.1	13.4	15.0	9.8	-0.7	0.7	0.1	-0.4	3.4	1.1
Fresh and dried fruits	17.4	16.3	26.8	28.3	27.4	11.9	-12.6	-8.6	-6.3	-4.2	2.3
Vegetables	0.8	-2.7	-6.6	9.4	4.9	-3.5	-3.2	-6.5	7.2	8.6	30.0
Sugar and sweets	12.1	11.5	6.8	-1.5	-1.6	-4.7	-2.3	2.0	1.1	-1.1	-1.4
Spices	3.1	2.9	2.7	22.2	29.7	35.6	37.9	14.2	9.0	4.0	4.8
Non-Food	**17.0**	**16.2**	**14.9**	**13.9**	**9.4**	**10.3**	**9.9**	**8.0**	**8.9**	**5.9**	**4.6**
Clothing	7.4	9.7	9.2	8.0	3.6	3.8	5.1	3.7	7.5	4.9	5.8
Health	2.3	5.1	5.2	3.7	6.2	15.9	18.9	20.9	19.4	9.1	7.9
Transportation	10.4	12.4	20.5	12.9	5.3	1.8	-2.1	-4.4	-1.9	3.2	8.0
Communication	0.0	0.0	0.0	0.0	0.1	-0.4	-0.4	-0.4	-1.2	-0.7	-0.7
Education	13.0	12.5	10.7	0.8	0.5	1.2	1.3	1.7	0.9	-0.2	2.0
Miscellaneous	13.1	16.0	23.3	20.7	22.5	19.5	4.4	2.4	0.9	2.8	5.0
Core inflation (28% TM)	**10.8**	**10.0**	**10.5**	**11.1**	**7.1**	**6.6**	**3.7**	**3.3**	**3.7**	**3.5**	**4.4**
Core inflation (Headline excl. B&C, O&F and T)	**14.3**	**12.8**	**11.5**	**12.9**	**9.8**	**8.3**	**6.5**	**5.4**	**7.0**	**4.4**	**6.0**

Source: Central Statistics Office/DAB staff calculations

3.1.2 Quarter Changes in National Headline Inflation

To see more closely what is happening to the inflation in the most recent time periods, we may need to compare the quarter-on-quarter changes in the CPI and its various components in the fourth quarter of FY1392, with that experienced in the third quarter. The situation is a bit different when the quarterly changes are observed. The quarterly rate of headline inflation was higher compared to that in the previous quarter, posting a 4.1 percent (q-o-q) increase, compared to 1.1 percent in the previous quarter. After three consecutive quarters of a moderate inflation, the sharp increase in the inflation rate in the fourth quarter indicates that inflation has gained momentum.

The sudden increase in headline inflation in the fourth quarter could be associated with the increase in some sub-categories, in particular the vegetables, which their prices increased by 29.9 percent compared to a deflation rate of 1.0 percent observed in the third quarter of FY1392. The other components that experienced an increase in prices in the fourth quarter were the bread and cereals, oil and fat, clothing and transportation, which increased by 3.2 percent, 2.1 percent, 3.8 percent and 3.6 percent, respectively.

On the other hand, some favorable changes were observed, but these changes were not big enough to completely offset the impact of unfavorable changes. The sub-categories with a favorable change were meat, milk, cheese, eggs, and health where the inflation rates were recorded at 0.6 percent, 1.2 percent and 1.2 percent respectively.

Table 3.3: Quarter-on-Quarter Changes in National Headline CPI

(Percent changes quarter-on-quarter)

Consumer Price Index

	1390				1391			1392- FY			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3-FY	Q1	Q2	Q3	Q4
Overall Index	**1.6**	**2.0**	**4.5**	**0.1**	**0.1**	**0.8**	**4.8**	**0.7**	**1.2**	**1.1**	**4.1**
Food and beverages	**1.1**	**1.6**	**4.3**	**-0.1**	**-0.3**	**-0.3**	**5.3**	**0.6**	**1.3**	**1.7**	**5.9**
Bread and Cereals	1.7	-0.2	4.5	-3.6	1.6	2.2	8.4	0.2	2.4	3.0	3.2
Meat	-0.7	1.3	4.7	6.6	0.7	0.6	2.1	2.6	0.0	1.8	0.6
Milk, cheese and eggs	3.6	2.9	3.0	4.1	-0.6	1.2	3.9	0.4	-1.4	4.8	1.2
Oils and fats	4.3	3.5	-1.7	1.6	1.7	-1.2	1.4	-2.3	-0.2	0.7	2.1
Fresh and dried fruits	2.7	5.9	8.3	0.5	0.7	-2.9	-4.7	3.9	2.0	-1.0	0.7
Vegetables	-7.1	0.4	8.4	4.5	-7.8	-8.5	14.5	0.1	1.6	-1.0	29.9
Sugar and sweets	-0.4	7.4	-0.7	-5.8	0.1	3.8	1.9	-2.3	1.3	1.9	1.5
Spices	9.8	14.6	0.9	7.0	2.5	2.1	2.9	1.0	3.8	-2.1	5.3
Non-Food	**2.3**	**2.7**	**4.8**	**0.5**	**0.5**	**2.0**	**4.3**	**0.8**	**1.1**	**0.6**	**2.3**
Clothing	4.5	6.3	4.4	1.4	-0.1	2.3	3.9	1.7	2.1	0.9	3.8
Health	0.8	0.3	1.0	0.1	0.2	3.0	4.3	3.4	1.8	1.3	1.2
Transportation	-1.4	3.8	8.5	1.2	-0.8	-2.1	1.5	-1.0	0.2	2.9	3.6
Communication	2.8	0.1	0.4	1.4	-1.7	-2.7	-1.3	-1.1	-1.4	-0.7	0.7
Education	0.8	-1.1	1.3	-0.1	4.6	0.8	-0.1	1.7	-0.6	0.8	0.0
Miscellaneous	2.5	1.8	10.7	5.1	0.6	0.5	2.6	1.6	0.3	2.0	4.0

Source: Central Statistics and DAB staff calculation

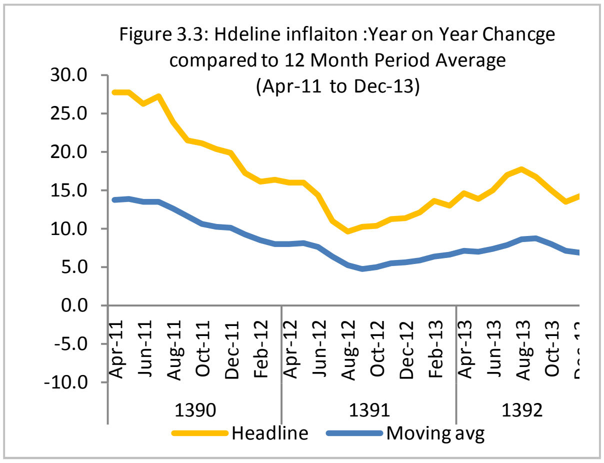


Figure 3.3: Hdeline inflaiton :Year on Year Chancge compared to 12 Month Period Average (Apr-11 to Dec-13)

Source: Central Statistics and DAB staff calculation

3.1.4 Current Quarter Changes in Kabul Headline Inflation

The quarter-on-quarter changes in Kabul CPI presented similar behavior to that in nationwide. Headline inflation increased over the previous quarter representing a 3.9 percent (q-o-q) rate in the fourth quarter, up from 0.3 percent in the third quarter. The pattern of changes in the rate of inflation across the components, however, was almost similar to what was experienced in National CPI.

For instance; vegetables' prices jumped in the fourth quarter, representing a quarterly rate of 36.2 percent, a significant jump from a deflation rate of 5.3 percent in the third quarter of the year.

In addition, the prices of meat, milk, cheese & eggs, clothing and transportation increased sharply in the fourth quarter. The prices of meat increased by 2.5 percent, up from -0.8 percent, this is while the prices of milk, cheese & eggs increased to 5.7 percent from 3.5 percent, clothing increased by 3.6 percent from 0.1 percent, and transportation sub-index rose to 6.1 percent from 2.6 percent in the third quarter of FY1392.

Table 3.4: Quarter-on-Quarter Changes in Kabul Headline CPI

(Percent changes quarter-on-quarter)

Consumer Price Index

	1390				1391			1392 FY			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3 FY	Q1	Q2	Q3	Q4
Overall Index	**2.1**	**3.4**	**3.8**	**1.5**	**0.0**	**1.8**	**3.0**	**0.8**	**1.5**	**0.3**	**3.9**
Food and beverages	**0.6**	**4.2**	**4.1**	**0.6**	**-0.4**	**-0.2**	**2.8**	**0.4**	**2.0**	**0.1**	**7.0**
Bread and Cereals	0.0	3.6	1.4	-1.7	3.4	4.0	4.3	-0.4	4.9	3.2	2.4
Meat	0.5	1.3	2.8	9.9	1.2	1.1	1.7	5.1	-2.6	-0.8	2.5
Milk, cheese and eggs	2.9	5.8	3.1	3.0	-2.5	2.4	2.3	-1.7	-4.9	3.5	5.7
Oils and fats	6.0	7.9	0.7	0.0	1.2	-2.4	2.1	-0.7	0.7	1.3	-0.2
Fresh and dried fruits	1.1	7.9	16.7	0.8	0.4	-5.3	-8.8	5.4	2.9	-3.2	-2.7
Vegetables	-5.8	1.5	13.5	0.8	-9.7	-6.5	13.8	-2.6	3.4	-5.3	36.2
Sugar and sweets	1.9	8.0	-0.5	-10.0	1.8	4.5	2.0	-6.1	0.9	2.3	1.7
Spices	0.9	0.0	0.5	20.4	7.1	4.5	2.2	-0.3	2.2	-0.2	3.0
Non-Food	**4.3**	**2.4**	**3.4**	**2.9**	**0.4**	**3.3**	**3.1**	**1.1**	**1.2**	**0.4**	**1.8**
Clothing	2.3	2.4	1.5	1.5	-1.8	2.6	2.7	0.3	1.8	0.1	3.6
Health	0.1	2.6	0.9	0.1	2.5	12.0	3.5	1.7	1.3	2.4	2.3
Transportation	5.1	0.8	5.4	1.1	-2.0	-2.5	1.4	-1.3	0.5	2.6	6.1
Communication	0.0	0.0	0.0	0.0	0.1	-0.6	0.0	0.0	-0.7	-0.1	0.1
Education	0.3	0.2	-1.3	1.7	-0.1	0.8	-1.1	2.0	-0.9	-0.3	1.1
Miscellaneous	-0.2	2.6	14.4	3.0	1.3	0.1	0.0	1.1	-0.2	1.9	2.2

Source: Central statistics and DAB staff calculation

2. Inflationary Outlook

In the FY1392, inflation was moderate standing in a comfort zone of single digit and the outlook for inflation is benign. Low demand conditions, lower supply side pressures, and well anchored inflation expectation provide further support to the benign inflation outlook. On the other hand, since foreseeable risks to future inflation remain significant, the DAB should remain vigilant. These risks include possible liquidity setback mainly as a result of contracting foreign peacekeeping forces' expenditures after 2014, as well as a possible reduction in the foreign aids given expectations of lower foreign exchange inflows. This can challenge the open market operations that may result in high volatility in the exchange rate and thus, will impact the import prices negatively. Any disruption in the imports, especially from the neighboring countries can also push the domestic prices up.

2.1. Demand conditions are suppressed

Demand side pressures remain subdued as many economic indicators exhibited downward trend. The recent data indicate that demand conditions are weakening for different goods and services such as the vehicle cars, property and rental prices, and tightness in demand for both skilled and unskilled employment.

On the other hand, the overall full year domestic output for the year 1392 fell below the expectations. In addition, core inflation, an indicator of the long-term trend of inflation sustained its decline.

2.2. Supply conditions remained mixed

Supply side pressures remained mixed with positive developments on the supply side is likely to help keep price pressures at bay. This includes that food prices are expected to remain moderate due to favorable winter rains and a bumper harvest in 1392. The moderate food prices in the international and regional markets are expected to continue at least in the current level.

On the supply side, any possible disruption in import of staples (wheat, rice) from trading partner countries, especially, the Central Asian countries can affect the prices negatively. Any interruption in supply such as the poor trade facilities at the border points is likely to be passed through in the form of higher prices.

2.3. Monetary Policy Stance to Remain Vigilant

Going forward, the monetary policy stance requires careful consideration of the risks to inflation. Weak foreign exchange inflows and the resulting contraction in liquidity in the financial system arising from withdrawal of international peacekeeping forces in 2014 as well as a possible decrease in the international aid programs can challenge the open market operation of the central bank.

CHAPTER IV

EXTERNAL SECTOR DEVELOPMENSTS

4

EXTERNAL SECTOR DEVELOPMENTS

The balance of payments (BoP) is a summarized economic - transaction report of a specific country with the rest of the world for a specified time period. B.o.P. reflects all transactions between a country's residents and nonresidents - involving goods, services, income, financial claims and liabilities to the rest of the world. The balance of payments is considered as one of the major indicators that presents a country's status in international trade. Therefore, every country attempts to have a favorable balance of payments to maintain its long run sustainability. Based on the International Monetary Fund (IMF) estimation, Afghanistan's balance of payments position in the FY1392 presents a surplus of USD 541 million; up from USD 505 million recorded the year before.

The favorable outcome in (BOP) was mainly attributed to both, the capital and financial accounts that grew by 168 percent in the reporting period.

Based on the estimations done by the IMF, the current account (CA) balance, which is the key measure of a country's savings and spending behavior, recorded a surplus of USD 117 million in FY1392, lower than a surplus of USD 346 million recorded in the preceding year. The decrease in the current account surplus was mainly attributed to the widening trade deficit. The import expenditures increased considerably during the period under review, due to both higher volumes, and prices.

In FY1392, the capital and financial accounts recorded an inflow of USD 424 million, higher than USD 158 million inflows recorded in the FY 1391; this represents an increase of 168 percent. The increase was mainly attributed to the foreign direct investment (FDI) inflows, which increased from USD 321 million in FY 1391, to USD 593 million in the reporting year. FDI is considered as one of the main sources of long-term financing. Therefore, the current political and security developments in the country can impact the FDI inflows directly.

Based on the data received from the Central Statistics Organization (CSO), earnings from exports have increased by almost 61 percent to

USD 560.94 million in the year under review, compared to USD 347.60 million recorded in the previous year.

The increase in the value of exports, which was mostly dominated by carpet and rugs, rose significantly by about 326 percent, to USD 140.73 million, up from USD 33.02 million in the FY1391. Leather and wool exports increased by 60 percent, to USD 59.56 million, up from 37.22 million. Medical seeds and others increased by 44 percent to USD 178.93 million from USD 124.58 million. Exports of food items increased in the reporting year by 19 percent (USD 181.72 million) from USD 152.58 million in FY1391. Meanwhile, expenditure on imports grew by 12 percent in this period. The value of total Imports, which was recorded at USD 8,312.22 million in FY 1391, increased to USD 9,339.58 million in the FY1392. This shows a growing domestic demand for foreign goods, mainly consumer goods, industrial supply, and fuel & lubricants.

Consequently, the trade deficit expanded to USD 8,778.64 million in FY 1392 compared to USD 7,964.62 million in the FY 1391, which shows an increase of about 10 percent. The trade deficit figures almost 8 percent of GDP in the FY 1392.

During FY1392, Afghanistan's public and Publicly guaranteed debt stock stood at USD 2,493.07 million, higher from USD 2,447.05 million in the FY 1391.

Afghanistan has an obligation of USD 962.10 million, mainly to the Russian Federation as a member of the Paris Club, and to the other Non-Paris Club creditors. Non-Paris Club debts stood at about USD 134.84 million at the end of the FY 1392. In regards to the multilateral debts, Afghanistan's total debt stood at USD 1,396.13 million at the end of FY 1392.

The net international reserves (NIR) increased by 3.19 percent from USD 6,471.94 million in the FY 1391 to USD 6,678.62 million in the FY1392. The reserve assets increased approximately by 4.61 percent from USD 6866.79 million in the FY 1391 to USD 7183.33 million in the reporting year. In addition, the reserve liabilities increased by 27.82 percent, from USD 394.85 million in the FY 1391 to USD 504.71 million in the reporting year.

4.1: BALANCE OF PAYMENTS

According to the International Monetary Fund (IMF) estimations, Afghanistan balance of payments position was favorable in FY1392. The higher inflows to the current account (current transfers), and capital and financial accounts (foreign direct investment and official loans) resulted in a surplus of USD 541 million in the overall BOP in the FY 1392, lower than a surplus of USD 505 million recorded in the FY 1391.

Foreign direct investment, which is a vital factor for the economic growth, witnessed an 85 percent increase in the period under review, from USD 321 million to USD 593 million in the FY 1392. The increase in FDI was due to increased inflows of capitals, as well as the official loans, which increased by 80 percent from USD 59 million in FY 1391 to USD 106 million in FY 1392.

Based on IMF estimation, the current account balance (CAB), the key measure of an economy's saving and spending behavior, recorded an extensive decline of 66 percent to USD 117 million in the FY 1392, significantly lower than a surplus of USD 346 million recorded in FY1391. The decline in the current account balance was mainly because of a sharp decrease in the trade balance.

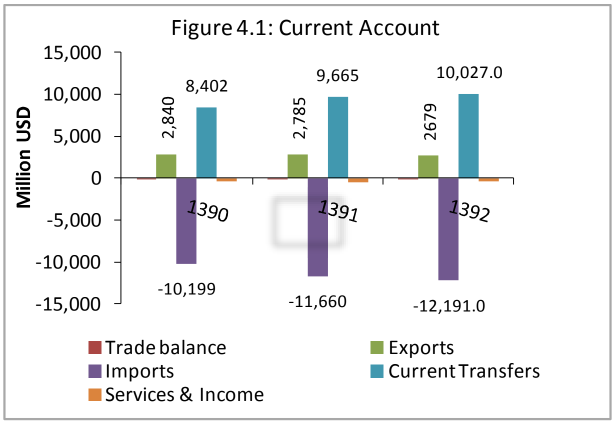
Total exports of goods declined by about 4 percent from USD 2,785 million in the FY 1391, to USD 2,679 million in the FY1392; while, Imports of goods increased 5 percent to USD 12,191 million, up from USD 11,660 million in FY1391.

Table 4.1: Afghanistan's Balance of Payments (million USD)

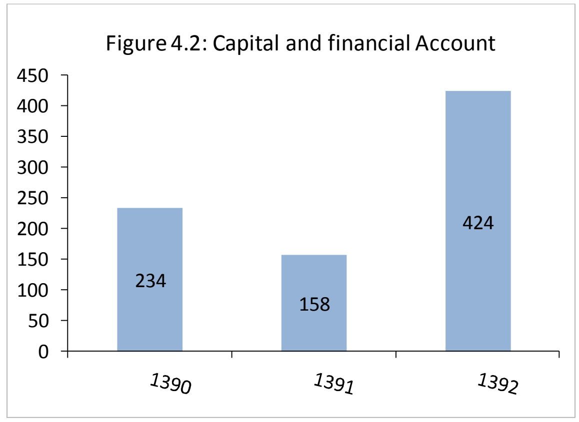
	2011 Est.	2012 Proj.		2013 Proj.	% Change
	1390	1391		1392	
Current account (including grants)	654.0	346.0	-47.1	117	-66
Current account (excluding grants)	-7,360.0	-8,910.0	21.1	-9,481	6
Trade balance	-7,358.0	-8,875.0	20.6	-9,512	7
Exports of goods (f.o.b.) 1/	2,840.0	2,785.0	-1.9	2,679	-4
Imports of goods	-10,199.0	-11,660.0	14.3	-12,191	5
Services and Income, net	-390.0	-444.0	13.8	-398	-10
Of which: Interest due	-12.0	-10.0	-16.7	-15	50
Current transfers	8,402.0	9,665.0	15.0	10,027	4
Public (program grants)	8,014.0	9,257.0	15.5	9,598	4
Private	388.0	409.0	5.4	429.00	5
Financial account	234.0	158.0	-32.5	424	168
Foreign direct investment	315.0	321.0	1.9	593	85
Official loans (net)3/	27.0	59.0	118.5	106	80
Disbursement	29.0	61.0	110.3	119	95
Amortization due	-2.0	-2.0	0.0	-13	550
Other portfolio flows	-108.0	-222.0	105.6	-275	24
of which: Commercial banks	-211.0	-287.0	36.0	-397	38
Errors and omissions	128.0	0.0	-100.0	0	
Overall balance	**1,016.0**	**505.0**	-50.3	**541**	7
Financing	-1,016.0	-505.0	-50.3	-541	7
Central bank's gross reserves,-; = accumulation	-1,035.0	-538.0	-48.0	-565	5
Use of Fund resources (net)	19.0	33.0	73.7	24	-27
Exceptional financing	0.0	0.0		0	
Financing gap	0.0	0.0		0	
Memorandum items:					
Gross international reserves	6,208.0	6,721.0	8.3	7,286	8
(Imports coverage) 4/	6.7	6.8	1.5	7.3	7
(Relative to external debt service)	474.0	421.0	-11.2	181.0	-57
	(In percent of GDP, unless otherwise indicated)				
Trade balance	-40.6	-44.4	9.4	-43.2	-3
Current account balance, including grants	3.6	1.7	-52.8	0.5	-71
Excluding grants	-40.7	-44.6	9.6	-43.0	-4
Total debt service (percent of exports)4/	1.1	0.9	-18.2	1.5	67
Total debt stock	6.9	6.7	-2.9	6.6	-1

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ through 2011/12, the fiscal year corresponded to the Afghan calendar year, which is based on the solar year running from March 21 to March 20, in most years. In 2012, the authorities are transitioning to a fiscal year that is closer aligned with the Gregorian calendar year and runs December 22- December 21, in most years. (According, the interim FY2012 has only 9 months.) In this table, 2011 and 2012 are recalculated to full years for comparison.
2/ Excluding opium exports; includes official exports, estimates of smuggling, re-export, and sales to nonresidents.
3/ Excluding IMF credit.
4/ Excluding re- export-related flows



Source: IMF and DAB staff calculations



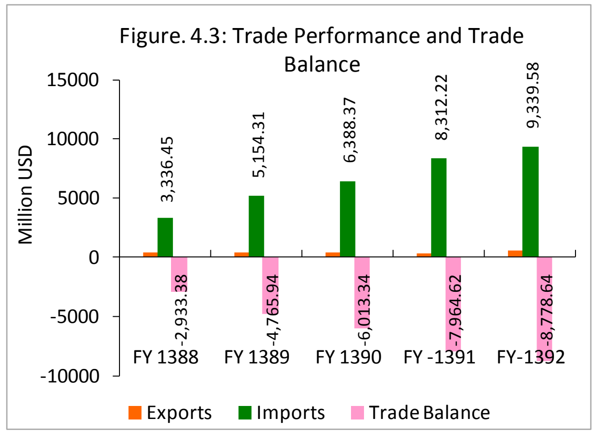
Source: IMF and DAB staff calculations

4.2: MERCHADISE TRADE

Based on the statistics provided by the Central Statistics Organization, Afghanistan's merchandise trade deficit widened in the FY1392, as a result of increase in imports compared with last year. Merchandise trade statistics recorded a deficit of USD 8,778.64 million in the FY 1392, higher than the deficit of USD 7,964.62 million recorded in the FY 1391, which shows approximately a 10 percent increase compared to the previous year. The trade deficit makes up approximately 8 percent of GDP.

In the FY1392, Imports registered an increase of about 12 percent y-o-y, while exports grew sharply by 61 percent compared to the preceding period. The total imports in the FY1392 amounted to USD 9,339.6 million, where this was recorded USD 8,312.2 million in the FY1391. The increase in expenditure on total imports was dominated by almost all import categories. In particular, imports of consumer goods increased by about 28 percent from USD 1,522.51 million in the FY1391 to USD 1,942.83 million in the year under review. The import of fuel and lubricants increased by 18 percent, from USD 1,842.15 million to USD 2,137.67 million in the FY1392. Industrial supply registered an increase of 13 percent from USD 1,126.10 million to USD 1,272.14 million, and Import of capital goods and others increased by 4 percent from USD 3,821.46 million to USD 3957.24 million in the FY 1392.

On the other hand, in the year under review, total exports rose significantly by about 61 percent from USD 347.60 million in the FY1391 to USD 560.94 million in FY1392, driven by almost all export categories, in particular carpets and rugs, which increased significantly by almost 326 percent from USD 33.02 million to USD 140.73 million in the FY1392. The export of leather and wool rose by 60 percent from USD 37.22 million to USD 59.56 million in FY 1392. Likewise, the export of medical seeds and others, increased by 44 percent from USD 124.58 million in the FY1391 to USD 178.93 million in the FY1392. Food items, such as the fresh and dry fruit posted an increase of almost 19 percent from USD 152.78 million to USD 181.72 million in the FY1392. Figure 4.3 and Table 4.2 indicate the breakdown of merchandise trade and trade deficit in absolute terms and as a percentage of GDP from FY 1388 to FY 1392.



Source: Central Statistics Office and DAB staff calculations

Table 4.2: Merchandise Trade (in million USD)

Years	FY 1388		FY 1389		FY 1390		FY -1391		FY-1392	
	Total	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*
Imports	**3,336.45**	**100%**	**5,154.31**	**100%**	**6,388.37**	**100%**	**8,312.22**	**100%**	**9,339.58**	**100%**
Industrial supplies	294.24	8.8%	602.48	11.7%	614.77	9.6%	1126.10	13.5%	1272.14	13.6%
Fuel and Lubricants	707.19	21.2%	1,022.66	19.8%	2184.59	34.2%	1842.15	22.2%	2167.37	23.2%
Consumer goods	728.14	21.8%	803.67	15.6%	857.38	13.4%	1522.51	18.3%	1942.83	20.8%
Capital goods and other	1,606.88	48.2%	2,725.50	52.9%	2,732	42.8%	3821.46	46.0%	3957.24	42.4%
Exports	**403.07**	**100%**	**388.37**	**100.0%**	**375.03**	**100%**	**347.60**	**100%**	**560.940**	**100%**
Carpets & Rugs	68.78	17%	68.83	17.7%	46.6	12.4%	33.02	9.5%	140.73	25.1%
Food Items	224.80	56%	156.35	40.3%	133.39	35.6%	152.78	44.0%	181.72	32.4%
Leather & Wool	24.67	6%	53.84	13.9%	28.07	7.5%	37.22	10.7%	59.56	10.6%
Medical seeds & others	84.82	21%	109.35	28.2%	166.97	44.5%	124.58	35.8%	178.93	31.9%
Trade Balance	**-2,933.4**		**-4,765.94**		**-6,013.3**		**-7,964.6**		**-8,778.6**	
Trade Balance as % of GDP	**-23%**		**-28%**		**-33%**		**-40%**		**-43%**	

Source: *CSO and DAB staff calculations*

1. DIRECTION OF TRADE

The direction of Afghanistan's trade to its trading-partners are depicted in Tables 4.3 and 4.4. During the period under review, Afghanistan's major trading-partners were Pakistan, Iran, India, China and Commonwealth of Independent States (CIS). The merchandise trade statistics show that Afghanistan's total exports increased significantly, by 61 percent in the period under review. The increase in the value of exports is due to high demand for Afghanistan's domestic product in the international markets as a result economic recovery in some of the export destinations of Afghanistan.

In FY1392, Pakistan remained on top among the export destinations in Afghanistan. Afghanistan's exports to Pakistan increased significantly by 132 percent from USD 113 million in the FY1391 to USD 262.14 million in the FY1392. Major export items to Pakistan are classified as carpet and rug, leather, wool, medical seeds, and food items such as fresh and dry fruits.

Based on the available data, exports of almost all items to Pakistan increased due to high demand in Pakistan for Afghani products.

Exports of carpet and rugs surprisingly increased by 583 percent from USD 16.63 million in the FY1391 to USD 113.6 million in the FY1392. The export of leather and wool to Pakistan increased by 60 percent, from USD 37.22 million in the FY1391 to USD 59.56 million in the FY1392. Similarly, export of medical seeds and others to Pakistan increased by 44 percent from USD 124.58 million to USD 178.93 million in the year under review. The export of food items, such as the fresh and dry fruit to Pakistan increased 19 percent from USD 152.78 million to USD 181.72 million in the FY1392.

India remained the second largest export destination among the others, despite its share in total exports fell from 26.02 percent to 16.84 percent in the reporting year. Afghanistan's exports to India increased by almost 4 percent from USD 90.43 million to USD 94.47 million in the FY1392. The increase in total exports to India was mainly dominated by medical seeds, food item such as dry fruits and unspecified items, which increased 9 percent, 41 percent and 304 percent, respectively.

Iran was the third largest export destination of Afghanistan in the FY1392. The share of total exports to Iran declined to 5.15 percent in the FY1392, down from 8 percent in the preceding year.

The value of exports to Iran during the reporting year slightly declined by 4 percent from USD 27.82 million to USD 28.90 million in FY 1392.

However, the Commonwealth of Independent States (CIS) ranked as the fourth largest export destination among others with a total export of USD 27.52 million in the FY1392, down from USD 44.69 million in the year before.

China ranked the fifth export destination with a share of 3.31 percent of total exports in the reporting year. The value of exports to China increased from USD 10.33 million in the FY1391 to USD 18.56 million in FY1392.

Table 4.3: Direction of External Trade: In third Quarter of FY 1392 (in million USD)

Country Name	*Exports*	*% Shares*	*Import*	*% Share*	*Trade Balance*
Pakistan	262.14	46.73%	1760.69	18.85%	-1498.55
India	94.47	16.84%	148.39	1.59%	-53.92
Iran	28.90	5.15%	1613.17	17.27%	-1584.27
Germany	6.80	1.21%	254.73	2.73%	-247.93
China	18.56	3.31%	392.29	4.20%	-373.73
England		0.00%	13.22	0.14%	-13.22
Saudi Arabia	0.57	0.10%		0.00%	0.57
USA		0.00%	74.92	0.80%	-74.92
Common Wealth of Independence States (CIS)	27.52	4.91%	2476.85	26.52%	-2449.33
Japan		0.00%	58.21	0.62%	-58.21
Other Countries	121.98	21.75%	2547.11	27.27%	-2425.13
Total	**560.940**	**100%**	**9,339.58**	**100%**	**(8,778.64)**

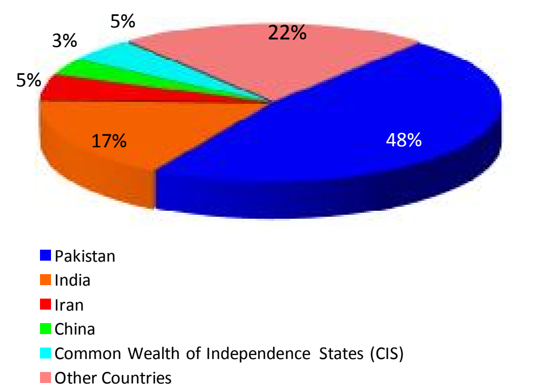
Source: *CSO and DAB staff calculations*

Table 4.4: Direction of External Trade: First Half of FY1391 (In million USD)

Country Name	*Exports*	*% Shares*	*Import*	*% Share*	*Trade Balance*
Pakistan	113.01	32.51%	1674.12	20.14%	-1561.11
India	90.43	26.02%	201.31	2.42%	-110.88
Iran	27.82	8.00%	976.21	11.74%	-948.39
Germany	0.78	0.22%	322.69	3.88%	-321.91
Common Wealth of Independence States (CIS)	44.69	12.86%	2364.95	28.45%	-2320.26
China	10.33	2.97%	585.67	7.05%	-575.34
Saudi Arabia	0.75	0.22%		0.00%	0.75
Japan		0.00%	179.02	2.15%	-179.02
England		0.00%	88.57	1.07%	-88.57
United States		0.00%	115.62	1.39%	-115.62
Other Countries	59.79	17.20%	1804.06	21.70%	-1744.27
Total	**347.60**	**100.00%**	**8312.22**	**100.00%**	**-7964.62**

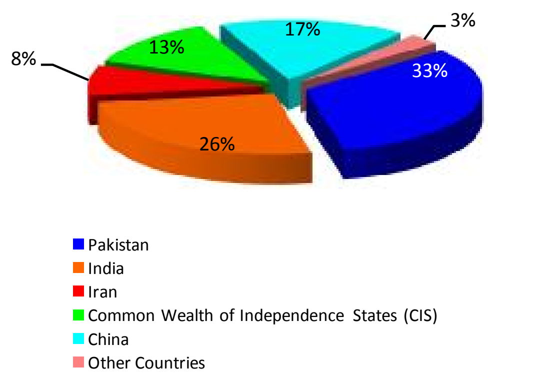
Source: *CSO and DAB staff calculations*

Figure. 4.4: Direction of Exports (% share) in FY- 1392



Source: CSO and DAB Staff calculations

Figure. 4.5: Direction of Exports (% share) in FY- 1391



Source: CSO and DAB Staff calculations

4.3: COMPOSITION OF TRADE

In the year under review, the composition of total Imports is depicted in Figures 4.6 and 4.7.

These Figures compare the composition of imports for FY1391 and FY 1392.

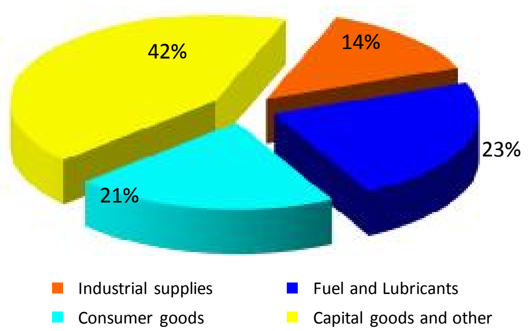
Afghanistan's composition of imports that covers, industrial supplies, capital goods & others, fuel & lubricants, and consumer goods are illustrated in percentage share of total imports baskets. Based on available data, the expenditure of imports of all categories increased in the FY 1392.

The composition of imports indicates that imports of capital goods and others consists the largest share in total imports, although its share contracted in the basket of imports in the reporting year. The share of capital goods and others in total Imports that was recorded by almost 46 percent in the FY1391, slide down to 42.4 percent in the reporting year. The value of capital goods and others that was recorded at USD 3,821.46 million in the FY1391, increased slightly to USD 3,957.24 million in the FY1392.

The second largest share in total Imports was recorded for fuel and lubricants, which increased slightly by 23.2 percent in the FY1392, up from 22.2 percent in the FY1391. As the merchandise trade data indicates, the value of fuel and lubricants increased considerably by 18 percent in the FY1392, standing at USD 2,167.37 million in the reporting year, from USD 1,842.15 million in the FY1391. The increase was mainly driven by the increased price of petroleum oil during the year under review. The third largest share in total imports recorded for consumer goods, which increased 20.8 percent in the FY1392, from 18.3 percent in the preceding year. As merchandise trade statistics shows, the value of consumer goods increased significantly by 28 percent from USD 1,522.51 million to USD

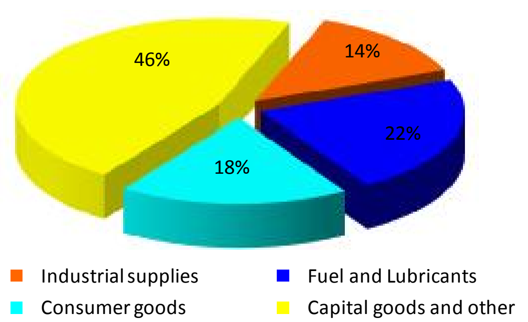
1,942.83 million in the FY1392. Moreover, in the year under review, the lowest share in total Imports was recorded for industrial supplies, which remained almost unchanged at about 13.6 percent. The value of industrial supplies recorded an increase of 13 percent from USD 1126.10 million to USD 1272.14 million in the reporting year. As a result, the demand for industrial supplies such as the cement, chemical materials and fertilizer has been increasing due to the implementation of development projects throughout the country.

Figure 4.6: Composition of Imports (% share) FY-1392



Source: *Central Statistics Office and DAB staff calculations*

Figure 4.7: Composition of Imports (share%) in FY-1391



Source: *Central Statistics Office and DAB staff calculations*

4.4: COMPOSITION OF AFGHANISTAN'S EXPORTS

Figures 4.8 and 4.9 compare the composition of total exports during the FY1392 with the fiscal year 1391.

Figure 4.6 demonstrates the breakdown of the composition of exports for the FY1392. According to the merchandise trade statistics, food items such as fresh and dry fruit had the largest share in total exports, despite its share declined from 44 percent to 32.4 percent in the FY1392.

In terms of value, exports of food items show an increase of 19 percent, from USD 152.78 million in the FY1391 to USD 181.72 million in the year under review.

The second largest share of exports recorded for medical seeds and others. The share of this category in total exports, which was recorded 35.8 percent in the FY1391, fell to almost 31.9 percent in the reporting year. While in terms of value, exports of medical seeds and others indicated a growth rate of 44 percent (Y-o-Y). The export value of medical seeds and others, that was recorded at USD 124.58 million in the FY1391, increased to USD 158.93 million in the FY1392.

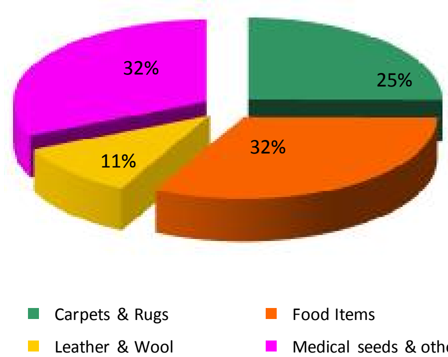
In addition, carpets and rugs, the main export component of Afghanistan, had the third largest share of total exports in the year under review. The share of carpet and rugs in total exports rose to 25.1 percent, up from 9.5 percent in the FY1391.

In terms of value, exports of carpet and rugs also indicated a considerable increase of 326 percent, up from USD 33.02 million in the FY1391 to USD 140.73 million in the year under review.

Finally, leather and wool had the fourth largest share in total exports, remained almost unchanged in the year under review standing at around 10.7 percent, while in terms of value, it increased significantly, representing a Y-o-Y growth of 60 percent, from USD 37.22 million to USD 59.56 million in the reporting year.

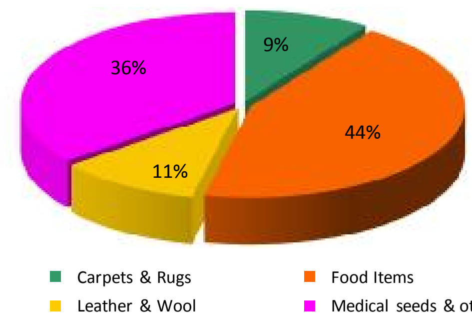
Figures 4.8 and 4.9 demonstrate the composition of main export items for the fiscal years 1391 and 1392.

Figure 4.8: Composition of Exports (share%) in FY1392



Source: Central Statistics Organization/DAB staff calculation

Figure 4.9: Composition of Exports (share%) in FY1391



Source: Central Statistics Organization/DAB staff calculation

4.5: EXTERNAL DEBT

Afghanistan's public and publicly guaranteed debt stock stood at USD 2,493.07 million as of 21 December 2013. During the FY1392, loan principal repayments made to the Asian Development Bank, Islamic Development Bank, Saudi Fund for Development and International Monetary Fund, and only service charges paid to the International development association (World Bank) and Asian Development Bank (ADB). In addition, during the FY 1392, only International Development Association (World Bank) as a number of creditors to Afghanistan made some debt forgiveness of service charges. While United States and Germany as members of Paris Club provided with 100 percent debt relief. Based on Ministry of Finance's data, outstanding loan amounts payable to Paris Club creditors at the end of the FY1392 stood at USD 962.10 million, which is only payable to the Russian Federation. In other words, Afghanistan's total debt only from the Paris Club members stands at about 38.59 percent of total external debt.

Table 4.5: External Debt as end of Dec 21 - 2013 **(**in units indicated)

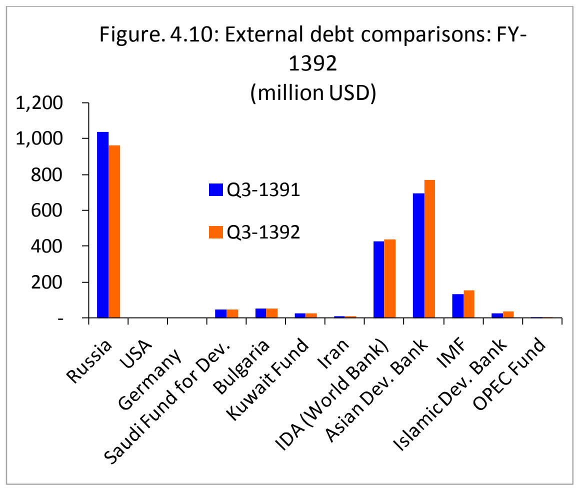
	In million USD	Percent of total
Total external debt	2,493.07	100.00
Bilateral	1,096.94	44.00
Paris Club	962.10	38.59
Russian Federation	962.10	38.59
United States	-	0.00
Germany	-	0.00
Non-Paris Club	134.84	5.41
Multilateral	1,396.13	56.00
of which: IDA (World Bank)	435.56	17.47
Asian Development Bank	767.90	30.80
International Monetary Fund	154.69	6.20
Islamic Development Bank	36.16	1.45
OPEC Fund	1.83	0.07

Source: *Debt, Asset Management Unit, Ministry of Finance, Afghanistan*

On the other side, non-Paris Club credits stood at USD 134.83 million as of the end of FY1392, in which Saudi Fund for Development stood at (USD 48.32 million), Bulgarian economy accounted for (USD 53.29 million), Kuwait Fund accounted for(USD 22.84 million) and Iran accounted for (USD 10.40 million).

As a result, Afghanistan has a total obligation of USD 1,096.94 million in bilateral debt, which comprises about 44 percent of the total debt, while in multilateral debt; Afghanistan has an obligation of USD 1,396.13 million at the end of the FY1392, which comprises the highest share of roughly 56 percent in total debt.

Figure 4.10: compare external debt for FY1391 and FY1392.



Source: *Treasury Department/MoF/DAB staff calculation*

4.6: NET INTERNATIONAL RESERVES

The net international reserves (NIR) held by Da Afghanistan Bank consist of monetary gold, reserve position and holdings with the IMF and special drawing rights (SDR), as well as holdings of foreign exchange inside Afghanistan and abroad such as USD, Euro, British Pound and other major currencies.

During the year under review, the NIR increased by 3.19 percent to USD 6,678.62 million, from USD 6,471.94 million recorded in FY1391. The boost in the NIR is mainly dominated by a substantial increase in the reserve assets which increased by 4.61 percent from USD 6,866.79 million in the FY1391 to USD 7,183.33 million in the fiscal year 1392.

On the other hand, reserve liabilities increased significantly by about 27.9 percent, from USD 394.85 million in the FY1391 to USD 504.71 million in the reporting year, this shows that the reserve assets are obviously higher than the reserve liabilities.

The net increase in foreign reserves reflected the fundamentals of the economy, which shows foreign exchange inflows generated mainly from export earnings, foreign direct investment, current transfers, the injection of foreign exchange by donors, earning on foreign exchange deposits in foreign deposit-taking corporations, and multi-national security forces.

Figure 4.11 represents the net international reserves of Afghanistan for the past few years.

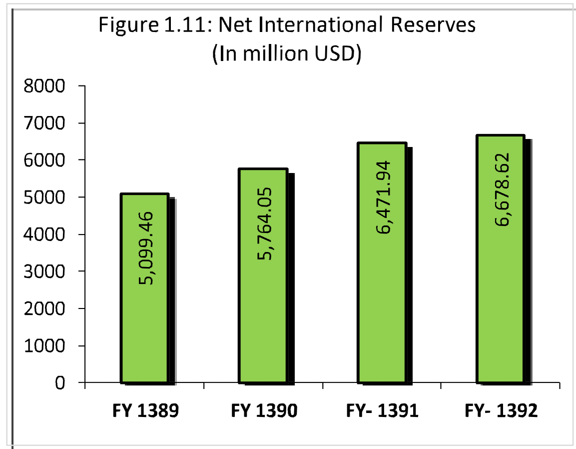


Table 4.6 illustrates the Net International Reserves positions from the FY1389 to FY1392.

Table 4.6: Net International Reserves, 1389 to FY1392 (million of USD)

Changes in the previous quarter	SY 1389	% change	SY 1390	% change	SY 1391	% change	SY 1392	% change
Net International Reserves (million USD)	5,099.46	23.22	5,764.05	13.03	6,471.94	12.28	6,678.62	3.19
Reserve Assets	5,403.21	22.71	6,130.38	13.46	6,866.79	12.01	7,183.33	4.61
Reserve Liabilities	303.75	10.91	366.34	20.61	394.85	7.78	504.71	27.82
Commercial bank deposits in foreign currency	184.15	4.00	227.72	23.66	245.00	7.59	367.65	50.06
Non-resident deposits in foreign currency	0.11	-89.57	0.11	0.00	0.11	0.00	0.14	23.87
Use of Fund resources	119.48	17.53	138.51	15.93	149.73	8.10	136.92	-8.56
Gross Intl. Reserves (in months of import)					9.91		9.23	
Net Intl. Reserves (in months of import)					**9.34**		**8.58**	

The increase in NIR could be attributed to the considerable inflows of foreign exchange, particularly from foreign donations and personal remittances. The current position of Afghanistan Net International Reserves (NIR) is providing a good cushion of the ability of monetary policy and support of the balance of payments. On average, currently the NIR can support about 8.6 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

CHAPTER V

THE REAL SECTOR DEVELOPMENTS

5

THE REAL SECTOR DEVELOPMENTS

During the last decade, exactly from 1381 to 1391, Afghanistan recorded the highest average economic growth of 9.4 percent, which was unprecedented in the last 3 decades. This robust economic performance was particularly supported by flow of international aid to the country and the international peacekeeping force spending.

In spite of such a considerable average growth rate, the country experienced a slower growth in 1392. According to the Central Statistics Organization (CSO), a slower growth was observed in non-agriculture sectors as the GDP grew by 6.4 percent in contrast to 10.9 percent in the preceding year. It is worth mentioning that the GDP and growth figures exclude opium production.

The slowdown in the economic growth in 1392 compared with the previous year is thought to be much more affected by the political and security uncertainties arising from post 2014 as well as political and economic condition of the neighboring countries, the major trading partners and regional conflicts.

1. GROSS DOMESTIC PRODUCT (GDP) BY SECTORS PRODUCTION

Considering a strong economic growth in 1391, with a remarkable and outstanding contribution of the agriculture sector and a rapid growth of the services sector, the economy is confronting uncertainty from the ongoing political and security transitions, which would lead to a further slowdown in economic activities in the current year.

Although the share of agriculture in total GDP has been declining since 2003, Afghanistan still remains an agricultural country. On the other hand, the share of services sector in total GDP has been increasing rapidly. Based on the available data, in 1392, services sector consists 51.75 percent of GDP, while agriculture and industry sectors consist 24.58 percent and 19.72 percent respectively. In conclusion, crop yields, favorable weather conditions as a key influence on agriculture production, and rainfall still play a vital role in determining the agricultural growth.

Afghanistan’s agriculture production normally depends on the level of rainfall and snowfall, and fortunately it was very favorable in 1392 in contrast to the last years, where the country had less frequent of rainfalls and seasonal snowfalls.

According to the data published by the CSO, in FY1392, the overall real GDP growth of 6.4 percent was mainly driven by an 8.1 percent increase in real income from the agriculture sector, compared to 3.2 percent increase in FY1391, higher than the services and industry sectors. Real income from the industrial sector showed a slight decline in growth compared to last year's growth rate, growing by 4.9 percent, in contrast to 7.8 percent recorded in the preceding year. The services sector showed a significant decline in growth in comparison to the last year's growth by 6.3 percent increase in real income.

Favorable winter wheat sowing conditions caused by adequate rainfalls and snowfall in FY1392 resulted in a positive agricultural harvest. Accordingly, total wheat production increased over the previous year as well as the prices of wheat increased throughout the country. As wheat comprises about 70 percent of the diet for most people in Afghanistan, thus, favorable weather conditions and the outstanding harvest resulted in improvements in living standards.

Services sector, the major contributor to the GDP growth for the past one decade recorded a slowdown during the FY1392 which was primarily driven by a sharp decline in income from wholesale and retail trade, restaurants and hotels, transport and storage. For instance, income from wholesale and retail trade fell dramatically to -1.4 percent in comparison to 27.0 percent observed in the preceding year. Wholesale, retail trade, restaurants and hotels, increased by only 0.5 percent in FY1392 compared to 25.0 percent increment in the previous year. Transportation and storage income increased by 7.4 percent in FY1392, that in the previous year was recorded 28.1 percent. This decline in transportation and storage was due to the withdrawal of foreign troops, security and political instability.

On the contrary, activities in finance, insurance, and real estate were somehow impressive compared to a year ago, increasing by 5.5 percent compared to a 3.8 percent growth recorded in the preceding year.

It is worth mentioning that the real estate services used to be very well until a couple of years ago, but after the declaration of withdrawal of the international troops from the country in 1391, and start of the withdrawal process in 1392, the real estate suffered widely and fell by 8.3 per cent in 1392 compared to 3.4 percent increment observed in the preceding year.

Economic activities in the industrial sector are also reported unfavorably. The performance of the industrial sector in contrast with the services sector is reported to be weak. Income from the largest component of manufacturing increased by only 1.6 percent, which were significantly lower than 7.3 percent recorded a year ago. Income from electricity, gas and water sub-sectors increased by only 0.8 percent in FY1392 compared to 4.3 percent increment in the preceding year. Due to its low contribution to GDP, its impact on the overall GDP is negligible. On the other hand, a few numbers of industrial sub-sectors recorded an impressive increment. For instance, income from mining and quarrying sources, in spite of minor share to GDP, has favorably increased.

Table 5.1: Real GDP Growth by Sectors of Production (in percent)

	1390 2010-11	1391 2011-12	1392 est. 2012-13
Agriculture	4.7	3.2	8.1
Cereals	-22.2	42.8	2.3
Fresh Fruits	10.3	8.0	3.2
Dry Fruits	3.2	2.0	-27.3
Livestock	3.0	0.4	-1.7
Others	28.7	-19.1	25.4
Industry	9.8	7.8	4.9
Mining and quarrying	89.6	-1.1	7.0
Manufacturing	3.0	7.3	1.6
Food, beverage & tobacco	3.1	5.1	1.6
Textile, wearing apparel & leather	-1.3	1.1	0.4
Wood & wood production, including furniture	1.9	4.9	3.7
Paper, paper production, printing and publishing	-2.7	4.1	7.7
Chemicals, petroleum, coal, rubber and plastic	4.8	-4.6	0.7
Nonmetallic minerals, except petroleum & coal	1.8	7.0	2.1
Basic metal	5.4	755.7	3.6
Electricity, gas and water	-9.4	4.3	0.8
Construction	13.3	8.9	8.0
Services	10.3	16.0	6.3
Wholesale & retail trade, restaurants & hotels	10.8	25.0	0.5
Wholesale & retail trade	8.4	27.0	-1.4
Restaurants & hotels	27.9	12.8	13.6
Transport, storage and communication	10.1	20.6	10.8
Transport & storage	9.0	28.1	7.4
Post and telecommunication	11.8	9.0	17.0
Finance, insurance, real estate and business	-44.4	3.8	5.5
Finance	-45.4	2.9	5.7
Insurance	728.1	68.3	2.3
Real estate and business services	1.5	3.4	-8.3
Ownership of dwellings	5.9	7.0	-6.3
Community, social and personal service	8.9	13.3	12.9
Government services	22.0	11.6	4.2
Other services	11.5	-14.8	4.8

Source: *Central Statistics Organization*

**Preliminary data*

Table 5.2: GDP Composition by Sectors (in percent)

	1390 (2010-11)	1391 (2011-12)	1392* (2012-13)
Agriculture	24.58	25.39	26.98
Industries	19.72	20.51	21.58
Services	51.75	50.28	47.83

Source: *Central Statistics Organization*

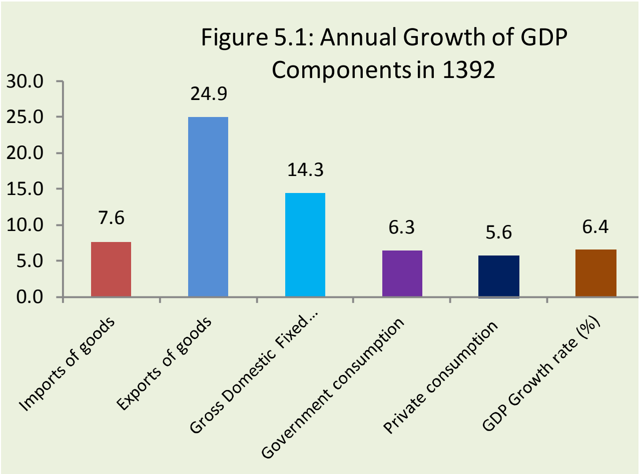
**Preliminary data*

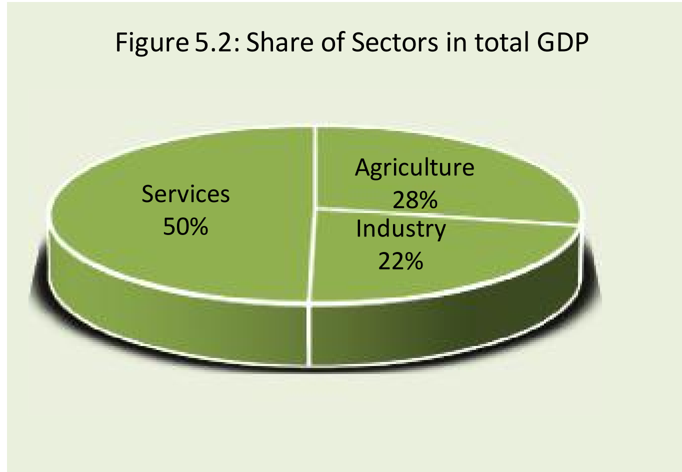
1.1 Gross Domestic Product by Expenditure Categories

The expenditure method is one of the most common measures for calculating the Gross Domestic Product (GDP). Most market-based economies use this measure in order to assess and analyze the private consumption expenditures, private and public investment expenditure and net exports.

Based on the primary analysis, the increment in nominal GDP in FY1392 was driven by a positive contribution of personal consumption expenditure as in some economies; private consumption is an important expenditure category. In Afghanistan, like such economies, private consumption also comprises a considerable share in total GDP. This large expenditure category contributed substantially to overall growth, increasing by 5.6 percent, while compared to 11.5 percent in the preceding year, it is significantly lower. On the other hand, the high growth rate of private consumption was also strengthened by the government expenditure. Government spending increased by 6.3 percent in FY1392, again the growth was lower compared with the previous year's growth of 19.4 percent.

The other two expenditure categories, investment and the trade balance, offset each other. However, gross domestic fixed investment grew by 14.3 percent in FY1392, lower than 25.8 percent increase in 1391, the trade balance is still in a bad shape, although exports increased significantly and imports increased slightly in the FY1392 compared to FY1391, by 24.9 percent and 7.6 percent respectively. The net effect of all these changes in the expenditure components is that the rate of growth of GDP in 1392 decreased, to 10.2 percent from 21.2 percent in 1391.





Source: *Central Statistics Organization*

Table 5.3: Nominal Gross Domestic Product by Expenditure Categories (%Δ Year-on-Year)

Category	1392^est 2013-14	1391 2012 -13
Total final consumption expenditure	5.7	12.4
Private consumption	5.6	11.5
Government consumption	6.3	19.4
Gross Domestic Fixed Investment	14.3	25.8
Gross fixed capital formation	14.3	25.8
Construction	13.5	23.9
Durable capital goods	20.6	43.7
Resource balance	5.5	47.7
Exports of goods and NFS	24.9	12.2
Exports of goods	28.8	13.1
Non-factor Services	9.8	8.7
Less: Imports of goods and NFS	7.6	42.8
Imports of goods	6.1	44.9
Non-factor Services	23.2	24.3
Change in Inventories and data discrepancies	15.1	128.0
GDP at Market Price	10.2	21.2

*Preliminary data

Source: Central Statistic Office

2. OUTLOOK FOR 1393

The Afghan economy is expected to slow further at a pace of between 3 to 5 percent in 2014, particularly in the first half of the year. The main factors responsible for such decline are thought to be the upcoming Presidential elections, withdrawal of international security forces, a possible decline in donor commitments, expectations, uncertainty, security and political transfers, and a possible reduction in investments. However, the economy is expected to recover and pick up in things go smoothly after the declaration of the result of presidential election and re-continuation of donor commitments in the second half.

Domestic demand is expected to decline due to the above mentioned reasons.

The government expects FDI, and domestic private investments to decrease remarkably due to the above mentioned reasons and ongoing uncertainty, high security and political risks.

Agriculture, the main source of employment and subsistence for a large number of Afghans, is expected to have a bumper harvest in FY1393 due to favorable growing conditions and good seasonal rainfall, absence of wheat disease, availability of agricultural inputs as the main reason behind strong growth in the sector.

The services sector, which accounts for 50.28 percent of the country's GDP is expected to slow to 3-4 percent in the FY1393, from 6.3 percent in 1392.

Inflation is expected to remain subdued with the CPI averaging at 5-7 percent during 2014-2015 as the cereals and fuel together attract approximately 22.5 percent of consumer spending and thus having a strong influence on the overall price levels. On the other side, Afghanistan is on the way to become self-sufficient in cereals production as a result of favorable weather conditions. Meanwhile, the global food prices are forecasted to decrease and the global inflation rate is forecasted to increase by 2 percent during 2014-2018.

These factors, (increase in cereals productions due to favorable rainfalls, high level capacity for oil production and slight changes in global inflation rate) together will decrease the price levels in Afghanistan and thus the overall inflation rate will remain in a single digit level of 6-8 percent during 2014-2018.

CHAPTER VI

FISCAL SECTOR DEVELOPMENTS

6

FISCAL DEVELOPMENTS

Since its establishment, the Afghan government focused more on the macroeconomic and fiscal stability. Afghanistan's fiscal policy has been designed to help a sustainable economic development, create employments, and efficient allocation of the resources to endorse the domestic revenues. Besides a significant growth in revenue collection, Afghanistan is still running a huge budget deficit, where its development budget and partly ordinary expenses are financed through donor grants. The fact is that over the years, the expenditure rate was growing faster than revenues due to a growing spending on the Afghan National Army and Police in the security sector. However, the Afghan government has been focusing on mobilizing the revenue collection and contracting the operating budget in post 2014. The government has been exercising to overcome the weaknesses and leakages in the revenue collections process. The government is looking forward to stabilize financial affairs to better off the ground for the implementation of development programs; improvement of public service delivery, and improving the fiscal regime for the natural resources.

In the past few years, despite significant improvements in the government's ability in the revenue collection and broadening the tax base, the fiscal sustainability indicator was only 53 percent in the FY1392, which shows a decline of 19 percent, from 72 percent in FY1391. However, the decline was due to increase in operating expenditure, specifically in the security sector. It is expected that operating expenditures will increase, which will further increase the budget deficits.

The aggregate amounts, however, covers the fact that the second and third largest sources of general domestic revenues were taxes and non-taxes revenues, and both showed high performance, amounting to AF 109.12 billion in the fiscal year 1392, up from AF 82.18 billion, which was above the estimated targets. Ongoing revenues, other than the individual custom duty revenue grew at a lethargic AF 27.33 billion, up from AF 21.40 billion screening only 27.7 percent. Other attributes such as fixed taxes, indicated a considerable increase of 39.2 percent. Income tax revenues stood at AF 15.93 billion, representing 17.7 percent incline. In addition, sales taxes presented 16.2 percent increase.

Income from capital property also presented a high performance of 34.4 percent compared to the same period in FY1391. On the other hand, during the fourth quarter, non- tax revenue was highly considered to be the second category that had contributed to incline in the total domestic revenue, due to receipts from the extractive industry.

Over the course of 1392, GIRA adopted standard mechanisms and techniques to project revenues on higher frequency in order to allow GIRA to prioritize development projects across the country, improve budget and expenditure planning and attain operational efficiency.

The total core budget for the FY1392 was AF 348.2 billion, and accounted for 30.5 percent of GDP. Operating expenditure allocation inclined to AF 206.6 billion. The current budget efficiency rate was 90 percent, while, the development expenditures also increased to AF 141.7 billion, however, the total execution rate for the development budget were 56 percent. Although, the total core budget was still in deficit by the end of 1392. This mainly explains the sluggish performance of fiscal sustainability. Furthermore, the scheduled 1393 Presidential elections had a significant impact on the total execution of the government budget.

Despite the high performance in domestic revenue collections, the government was not able to increase the execution rate of development expenditure compared to the fiscal year 1391, while the implementation of the development expenditure remained comparable. The ratio of actual expenditure and the development budget was slightly lower than that in 1391.

A significant portion of the operating budget still is financed by the donor grants, while not only the entire development expenditure, but also the concessional loans and domestic revenues are being financed through donor grants. Allotted grants for both expenditures inclined and indicated 85 percent of increase in FY1392.

1. REVENUES

Total domestic revenue collection recorded 33 percent with the amount of AF 109.12 billion in the FY1392, compared to AF 82.18 billion in the preceding year, comprising 23 percent of GDP. The development in the revenue collection was attributed to enhanced receipts from both, tax revenue and non-tax revenue sources. However, total collected domestic revenue (gross) remained below the target of AF 123.0 billion for fiscal year 1392. The total collection of domestic revenue performance was significantly sophisticated compared to the quarterly collections during the entire year.

The main domestic revenue measures included collections from the taxes, non-tax revenues, such as the other revenue category, social contributions while excluding foreign donor’s contributions. These measures are deemed sufficient by the government to ensure the achievement in terms of percentage of the GDP deficit target for 1392.

The better performance in the total collection of domestic revenues was due to higher anticipated domestic revenues in custom duties. Total tax revenues, including custom duties increased to AF 77.38 billion, compared to a total of AF 60.04 billion recorded in the twelve months of FY1391, representing a 29 percent increase. On the positive side, the total tax revenue collection also surpassed its annual target of AF 56.7 billion, indicating a 36 percent increase. Analysis of the receipts indicated that the main contributors to the tax revenues were sales tax, income tax, property tax, fixed tax, tax penalties and fines, custom duties and other taxes.

A breakdown of the total revenue collection showed that revenue from fixed taxes and other taxes were higher than other components.

The fixed tax collection presented a significant increase of 39.2 percent with the total amount of AF 11.4 billion in FY1392, compared to the total collection of AF 8.2 billion in FY1391. However, in terms of the level of the target in 1392, it has declined by 7 percent, from the target of AF 12.3 billion. The major collections were from three tax resources; imports by licensed businesses, fixed taxes on the government contracts, and imports by unlicensed businesses.

Sales tax revenue presented a 16.2 percent of increase by a total receipt of AF 17.30 billion in FY 1392, compared to total grosses of AF 14.89 billion in FY 1391. However, it remained below, by 24 percent, from the target of AF 22.6 billion in FY1392. The main contributors in this category were BRT (Receipts from Private Entities) and tax imposed on government contracts for goods and services.

Income taxes increased to AF 15.93 billion, up from AF 13.53 billion, representing 18 percent increment due to withholdings from taxes on employee's salaries and wages, as well as tax on interest and construction. However, it remained below the 1392 target of AF 17.94 billion by 11 per cent. According to MoF, the major factor responsible for this increase is thought to be the government's enforcement measures that helped the innumerable companies to present a better performance of incorporating income tax.

In addition, property taxes amounted to AF 0.29 billion in FY1392, up from AF 0.22 billion in FY1391, indicating a slight upturn of AF 0.7 billion or 34.4 percent. Though, total collection remained behind the target of AF 0.40 billion, which depicts 27 percent of reduction. Conversely, tax penalties and fines also showed an extensive increment of about 80 percent compared to FY1391, with the total collection of AF 0.57 billion in FY1392, up from AF 0.32 billion. Yet, it remained only 2 percent below the target.

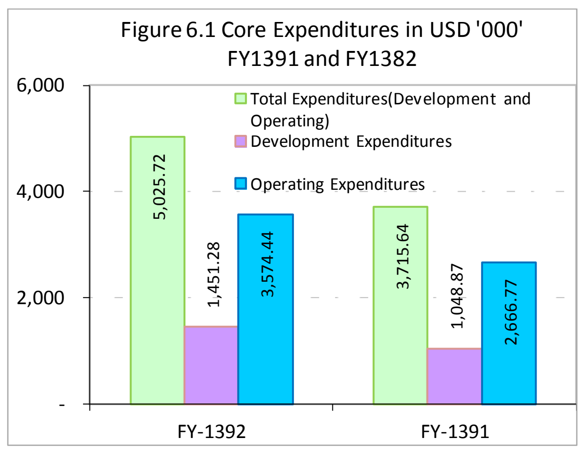
In addition, the other tax category indicated an extensive 209.9 percent increase with a total collection of AF 4.52 billion in the FY1392, up from AF 1.46 billion during the twelve months of 1391.

During the fiscal year 1392, total collected in domestic revenues was robust. Depiction of tax revenues, total collection was also mainly affected by its major contributors, custom duties, which also showed higher performance. The total custom duties collection amounted to AF 27.33 billion, up from AF 21.40 billion, representing a 27.7 percent increase, while it remained behind the benchmark of 34.89 percent in the fiscal year 1392, screening a 22 percent decline. The custom duties' total collection consists of fees collected from the custom offices at the borders or airports.

The second major contributor to domestic revenues was non-tax revenue with a total compilation of AF 28.32 billion in the FY1392, up from AF 19.53 billion recorded in the year 1391, showing a significant increase of 45 percent. Non-tax revenue also hit over the annual target of AF 26.13 billion by 8.40 percent. Non-tax revenues incorporate of income from capital property, sales of goods and services, administrative fees, royalties and non-tax penalties and fines. Nevertheless, the highest collection in this category came from the administrative fee with a total collection of AF 10.38 billion in FY 1392, up from AF 6.57 billion in 1391, depicting 57.9 percent increase.

In addition, social contribution that includes government employee contributions for retirement and pension depicts slight surge of 30.9 percent with a total collection amount of AF 3.43 billion in FY1392, up from AF 2.62 billion in FY1391, still remained behind the target of AF 3.77 billion, representing a 9 percent drop. Most of the social contribution was coming from the share of the employee's in the fund and pension plans of government salaries and wages.

Overall, the collection of domestic revenue during the fiscal year 1392 was robust, besides the facts of the transitional period of security conferral to ANP by NATO and upcoming of the presidential elections during the month of April 2014.



Source: *Ministry of Finance website and DAB staff calculation*

Table 6.1: Total Tax and Non-tax Revenues (in million AF)

Tax and non-Tax Revenues	FY 1392	FY 1391	Change	%Δ 1392 to FY 1390
Taxation & Customs Revenues				
Fixed Taxes	11,443.16	8,223.18	3,219.99	39%
Income Taxes	15,928.55	13,530.90	2,397.65	18%
Property Taxes	288.90	215.02	73.89	34%
Sales Taxes	17,303.52	14,894.72	2,408.80	16%
Excise Taxes	0.00	0.00	0.00	0.00
Other Taxes	4,515.33	1,457.02	3,058.31	210%
Tax Penalties and Fines	570.51	317.36	253.14	80%
Customs duties	27,326.10	21,402.11	5,923.98	28%
Total taxation revenues	**77,376.07**	**60,040.32**	**17,335.75**	29%
Retirement contributions	3,425.45	2,616.45	808.99	31%
Total social contributions	**3,425.45**	**2,616.45**	**808.99**	31%
Income from Capital Property	1,735.20	2,927.23	-1,192.03	-41%
Sales of Goods and Services	7,954.57	7,953.69	0.88	0%
Administrative Fees	10,378.64	6,573.95	3,804.69	58%
Royalties	308.86	199.25	109.62	55%
Non Tax Fines and Penalties	625.86	407.24	218.62	54%
Extractive Industry	499.06	141.30	357.76	253%
Miscellaneous Revenue	6,782.79	1,147.55	5,635.24	491%
Total other revenue	**35.85**	**177.78**	**-141.93**	-80%
Afghanistan Reconstruction Trust Fund (ARTF)	36,747.29	26,420.18	10,327.12	39%
Law and Order Trust Fund – Afghanistan (LOTFA)	27,524.87	18,837.49	8,687.38	46%
CSTC – MoD	97,701.11	32,503.59	65,197.52	201%
Foreign loans	628.08		628.08	
World Bank	0.00	0.00	0.00	0.00
Asian Development Bank	0.00	423.64	-423.64	-100%
Other	891.95	1,399.43	-507.48	-36%
Donor revenue	496.23	348.00	148.24	43%
World Bank	0.00	0.00	0.00	0.00
European Commission	5,909.18	5,352.42	556.75	10%
ADB	0.00	0.00	0.00	0.00
DFID	9,684.30	8,818.14	866.16	10%
US & USAID	39.45	154.89	-115.44	-75%
Others	5,234.87	3,921.07	1,313.80	34%
Total Donor Contributions	**7,752.65**	**3,393.12**	**4,359.53**	128%
Loan from IMF	**192,609.97**	**101,571.96**	**91,038.02**	90%

Table 6.2: Revenue Collection (in million USD)

Tax and Non- Tax Revenues	FY1392 Actual	FY1391 Actual
Total Domestic Revenues (Tax and Non Tax) and Custom Duties	**1,970.43**	**1,614.00**
Tax Revenue with Custom Duites	1,397.18	1,179.11
Non Tax Revenue	511.39	383.50
Miscellaneous Revenue	61.85	51.38
Social Contribution	**3,477.97**	**1,994.74**

Table 6.3: Total Revenue Collection (in million AF)

	1392 Revenue Actual	1391 Revenue Actual	Target FY 1392	% Δ from 1392 to 1391
Total Domestic Revenues (Tax and Non Tax) and Custom Duties	**109,122.34**	**82,184.75**	**121,529.7**	**33**
Tax Revenues including Custom Duties	77,376.07	60,040.32	91,636.9	29
Non Tax Revenues	28,320.83	19,527.98	26,125.5	45
Social Contribution	3,425.45	2,616.45	3,767.3	31
Total Donor Contribution	**192,609.97**	**101,571.96**	-	**90**

2. EXPENDITURES

This section provides outlook on the total government's spending. To main focus will be on the major functional areas of the government budget: security, elementary and secondary education, health care, governance, infrastructures, agricultural and rural development, and other social contributions. It also includes spending on economic governance and private sector development and extra budgetary activities.

Total integrated budgets allocated for FY1392 were AF 354.08 billion that indicates a significant increment of 47 percent from AF 244.74 billion in the fiscal year 1391. However, during the midyear review, this was revised and was abridged to AF 348.2 billion from the billed expenditure, this decrease was mainly due to a 3 percent cut in all line ministries expenditures. However, the development budget execution rate was 56 percent, while the execution rate of current budget was 90 percent.

Overall payout expenditures amounted to AF 278.32 billion during the FY1392, up from AF

189.20 billion in the FY1391, showing a 47 percent or AF 89.12 billion increase. However, with comparison to the amount allocated for FY1392, it showed a 49 percent decrease. The current or operating expenditure increased from AF 135.79 billion to AF 197.95 billion during the FY1392, representing a significant increase of 46 percent, accounting for 17.3 percent of GDP. The final allocated budget for operating expenditures was AF 196.33 billion, up from AF 111.05 billion, showing 77 percent of increment during the FY1392 compared to the preceding year.

In addition, development expenditures were expanded to AF 80.37 billion from AF 53.41 billion, indicating a momentous augmentation of 50 percent or AF 26.92 billion. Moreover, final budget allocated for development expenditures increased to AF 157.75 billion in the FY1392, compared to AF 133.69 billion in the fiscal year 1391, representing a 18 percent increase. Development expenditures accounted for 7 percent of GDP.

Current expenditures are classified into five categories: compensation of employees, goods and services, subsidies and grants, interest payments and acquisition of non-financial assets.

Compensation of employees that includes wages and salaries, food for employees, transportation, advance payments and some minor social benefits, increased from AF 98.41 billion to AF 139.49 billion in the FY1392, which indicates an increase of 0.42 percent, or AF 41.8 billion. The increment in spending usually is due to sharp recruitments of new members in “tashkeel” (structure) of ANSF and implementation of the pay and grading reforms, which led to an increase in the number of civil servants.

Supplier expenses also presented slightly increase of 0.52 percent or AF 13.07 billion, up from AF 25.16 billion in the FY1391 to AF 38.23 billion in the FY1392. This increase accounts for 3.3 percent of GDP. This category includes travel, communication, contracted services, repairs and maintenance, and utilities.

The category that has a significant role in operating expenditure includes pension payments to retired civil servants and officers in the Police and National Army, and subsidies to state owned enterprises and capital transfer. This category remained behind the target of AF 21.52 billion, representing a difference of AF 9.98 billion or 46 percent shortfall. Total spending in this category stood at AF 11.53 billion in the FY1392, up from AF 8.32 billion in the FY1391, showing a slight increase of 39 percent. This accounts for 1 percent of GDP. The performance of this category is based on the total allocation for pension's new system where higher benefits are arranged.

Expenditures on capital also obtained an increase of 119 percent, by a total spending of AF 8.35 billion in the FY1392, up from AF 3.82 billion in the FY1391. Nonetheless, the interest payments increased to AF 0.35 billion in the FY1392, up from AF 0.09 billion in the FY1391, indicating only 283 percent increase. The interest payment is a small sum of concessional loans that helps a government to finance its development projects. Afghanistan is one of the most aid dependent countries that have received significant foreign aids since 2001. After the establishment of the transitional government, the international community pledged significant assistance in rebuilding of Afghanistan.

GIRA borrows on highly concessional terms to finance a limited number of discretionary development projects.

Comparatively, smaller but rapidly growing parts of the operating budget were subsidies, grants and social transfers. Subsides to state owned enterprises, capital transfers to municipalities, and social expenditures such as pension.

Table 6.4: Core Expenditures (in million AF)

Particulars	1392 Expenditures Actual	1391 Expenditures Actual	Allocated Budget	Change	% Δ from 1392-to 1391
Total Expenditures (Development and Operating)	**278,324.63**	**189,200.56**	**354,077.10**	**89,124.06**	**47**
Development Expenditures	80,371.98	53,408.43	157,750.10	26,963.55	50
Operating Expenditures	197,952.64	135,792.13	196,327.00	62,160.51	46

Table 6.5: Total Development Expenditures (in million AF)

Expenditure Splits	FY1392	FY1391	Change	% Δ 1392 to 1391
Employees				
Salaries in cash	-	-	-	-
Salaries in kind	-	-	-	-
Salaries and wages advance	-	-	-	-
Social benefits in cash	-	-	-	-
Social benefits - in kind	-	-	-	-
Total employee expenditure	**-**	**-**	**-**	**-**
Supplier Expenditure				
Travel	361.56	381.87	-20.31	-5
Communications	107.13	0.00	107.13	0.00
Contracted services	23,302.92	16,179.39	7,123.54	44
Repairs and maintenance	103.25	154.36	-51.11	-33
Utilities	195.45	208.77	-13.32	-6
Fuel	165.17	70.22	94.94	135
Tools and materials	6,356.73	693.63	5,663.10	816
Other	1,594.84	722.83	872.01	121
Advances and return of expenditure	7,573.48	3,254.31	4,319.17	133
Total supplier expenses	**39,760.53**	**21,665.38**	**18,095.15**	**84**
Grants	0.00	0	0.00	0.00
Grants to foreign government a	0.00	0	0.00	0.00
Social security cash benefits	0.00	0	0.00	0.00
Social assist benefit in cash	0.00	0	0.00	0.00
Advance Subsides Grants	0.00	0	0.00	0.00
Total subsidies, grants, contributions and pensions expenditure	**0.00**	**0**	**0.00**	**0.00**
Buildings and structures	28,083.13	20,788.10	7,295.03	35
Machinery and equip. (>50,000)	4,518.63	3,583.94	934.68	26
Valuables	0.00	1.14	-1.14	-100
Land	40.31	131.91	-91.59	-69
Capital advance payments	7,969.38	7,237.96	731.41	10
Total capital expenditure	**40,611.45**	**31,743.05**	**8,868.40**	**28**

Source: Ministry of finance website and DAB staff calculation

Table 6.6: Total Operating Expenditures (in million AF)

Expenditure Splits	FY 1392	FY1391	Change	% Δ 1392 to FY1391
Salaries in cash	116,844.84	81,377.75	35,467.09	44
Salaries in kind	21,191.61	16,550.88	4,640.72	28
Salaries and wages advance	164.63	10.60	154.03	1453
Social benefits in cash	1,285.14	466.18	818.96	176
Social benefits - in kind	0.00	0.00	0.00	-
Total employee expenditure	**139,486.21**	**98,405.41**	**41,080.81**	**42**
Travel	1,843.91	1,124.64	719.27	64
Communications	3,884.56	0.00	3,884.56	100
Contracted services	1,454.69	546.34	908.35	166
Repairs and maintenance	9,559.68	1,154.70	8,404.99	728
Utilities	3,024.58	6,981.79	-3,957.21	-57
Fuel	5,622.87	4,658.65	964.22	21
Tools and materials	6,250.91	4,734.68	1,516.23	32
Other	5,902.04	5,240.25	661.78	13
Advances and return of expenditure	689.61	718.32	-28.70	-4
Total supplier expenses	**38,232.86**	**25,159.37**	**13,073.49**	**52**
Grants	928.36	1,045.98	-117.62	-11%
Grants to foreign government a	247.37	148.92	98.45	66%
Social security cash benefits	10,306.35	6,804.71	3,501.63	51%
Social assist benefit in cash	25.82	296.74	-270.92	-91%
Advance Subsides Grants	25.62	24.37	1.25	5%
Total subsidies, grants, contributions and pensions expenditure	**11,533.52**	**8,320.72**	**3,212.79**	**39%**
Buildings and structures	4,399.39	1,503.82	2,895.58	193%
Machinery and equip (>50,000)	3,375.70	2,110.35	1,265.35	60%
Valuables	1.41	11.92	-10.51	-88%
Land	565.43	186.67	378.76	203%
Capital advance payments	11.51	3.47	8.04	231%
Total capital expenditure	**8,353.45**	**3,816.23**	**4,537.21**	**119%**
Interest	346.61	90.39	256.22	283%
Total interest expenditure	**346.61**	**90.39**	**256.22**	**283%**

Source: MoF website and DAB staff calculations

Table 6.7: Core Expenditures (in million USD)

	FY 1392	FY 1391
Total Expenditures	**3,678.80**	**2,741.18**
Development Expenditures	1,038.47	675.23
Operating Expenditures	2,640.33	2,065.95

Source: *Ministry of finance website and DAB staff calculation*

3. FINANCING THE CORE BUDGET

Grants finance the major portion of both, operating and development expenditures. Predominantly the security section of the operating budget is fully financed by the donor grants. However, a small portion of the development expense is financed through concessional loans and domestic revenues. During the FY1392, total receipt grants increased compared to the FY1391. Most of the increase in the finance of operating grants was channeled through the CSTC-A both, Ministry of Defense and Ministry of Interior and LOTFA. Total grant is accounted for 16.8 percent of GDP.

Nonetheless, development budget remained in deficit by AF 31 billion in the fiscal year 1392.

Total development and operating grants in the FY1392 amounted to AF 192.61 billion, up from AF 101.57 billion in the preceding year, showing a significant increase of 91.04 percent, from which the operating grants were AF 143.01 billion in the FY1392, up from AF 65.75 billion in the FY1391, showing a significant increase of 118 percent. However, the significant increase observed in the FY1392 was due to a 3 months difference in total number of months in the newly used FY1391 (Afghanistan changed its fiscal year from 1391, the new FY begins from January instead of March). In addition, development grants stood at AF 49.60 billion, representing an increase of 29 percent, compared to AF 38.40 billion in the FY1391.

Total operating grants were disbursed from the main donors that have continually donated to the Afghan government. Grants received from Law & Order Trust Fund for Afghanistan (LOTFA) scheme has presented a significant increase of 46 percent, up from AF 18.84 billion to AF 27.52 billion in the FY1392. On the contrary, grants from the Afghanistan Reconstruction Trust Fund (ARTF) highlighted a slight decrease, down from AF 14.24 billion in the FY1391 to AF 14.16 billion in the FY1392. Generally, the turn down in grants from ARTF is going to be gradually done while government is able to cover the expenditure from its own domestic revenues and accepting the responsibilities.

Conversely, grants for the Combined Security Transition Command-Afghanistan (CSTC-A), for Ministry of Defense (MoD) & Ministry of Interior (MoI) scheme that is the foremost donor for the operating expenditure enhanced the contribution from AF 32.50 billion to AF 97.70 billion, by increment of 201 percent during the period under review. Total grants for this sector covers almost 70 percent of the total grants received by the government.

The major part of the development budget is supported by the donor grants, while a small portion is financed by concessional loans. Development grants upkeeps with project consideration in building and strengthening the capacity of Community Development Councils and supporting the continued program roll out to additional rural communities. However, to improve health services in the rural areas other donors and World Bank donated an equivalent of almost AF 576 million, for these projects.

The other development projects such as the Education Quality Improvement, Agricultural Development Fund, Energy Sector Development Program, Health services and The Rebuilding of the Maidan Shar Bamyan road were funded by the multinational donors.

During FY1392, total grants received accounted for 75 percent of the domestic revenues, highlighting AF90.3 billion increase from FY1391,

Although, the government has been trying to improve the tax collection and revenue collection from the extractive industry such as, the mineral resource from Aynak copper mine, the government has not been able to finance both, operating and development budgets. Donor grants made up a significant part of the total expenditures, almost 60 percent of the budget, while the remaining portion of expenditure was financed using the concessional loans and domestic revenue.

Table 6.8: Total Donor Contribution, FY-1392 (in million AF)

Particulars	FY 1392	FY 1391	Change	% Δ from 1391 to 1392
ARTF	36,747.29	27,428.73	9,318.56	34
LOTFA	27,524.87	18,837.49	8,687.38	46
CSTC - MoD	97,701.11	32,503.59	65,197.52	201
SPAD - British, French	628.08	0.00	628.08	0.00
Foreign loans	0.00	0.00	0.00	0.00
World Bank	0.00	429.92	-429.92	-100
Asian Development Bank	891.95	1,250.28	-358.33	-29
Other	496.23	348.00	148.24	43
Donor revenue	0.00	0.00	0.00	0.00
World Bank	5,909.18	6,109.78	-200.60	-3
European Commission	0.00	0.00	0.00	0.00
ADB	9,684.30	8,809.59	874.70	10
DFID	39.45	154.89	-115.44	-75
US & USAID	5,234.87	3,921.07	1,313.80	34
Others	7,752.65	4,325.98	3,426.66	79
Total donor contributions	192,609.97	104,119.32	88,490.66	85
Loan from IMF	-	929.86	-929.86	-100

Source: Ministry of Finance website and DAB staff calculation

Table 6.9: Breakdown of Donor Contribution for FY 1391 (in million AF)

Donor contributions	Operating Grants	Development Grants
ARTF	14,157.01	22,590.28
LOTFA	27,524.87	
CSTC – MoD	97,701.11	
SPAD - British, French	628.08	
Foreign loans		
World Bank		0.00
Asian Development Bank		891.95
Other		496.23
Donor revenue		0.00
World Bank		5,909.18
European Commission		0.00
ADB		9,684.30
DFID		39.45
US & USAID		5,234.87
Others	2,994.90	4,757.75
Total	143,005.97	49,604.00

Source: *Ministry of Finance website and DAB staff calculations.*

CHAPTER VII

BANKING SYSTEM PERFORMANCE

7

BANKING SYSTEM PERFORMANCE

Asset base of the banking sector grew by 9.86 percent or AF 22.07 billion during the fiscal year 2013 compared to 13.50 percent growth in December 2012.

Gross loans depicted an increase of 11.37 percent (4.62 percent in June, 2013) standing at AF 46.96 billion at the end of 2013. Deposits stood at AF 208.79 billion, up by 8.08 percent against the 11.28 percent increase in the previous year (December, 2012). Deposits were largely denominated in USD (65.18 percent) with Afghani denominated deposits lagging at 31.85 percent. Afghani denominated deposits indicated an increase of 16.60 points against 1.85 percent decrease in the year before, while USD denominated deposit were up by 5.17 points showing a slower pace than 17.94 percent growth recorded in December 2012.

The capital base of the banking sector remained strong at AF 28.47 billion, increased significantly on account of profits, capital injections and addition of capital of branches of foreign banks. Capital adequacy ratio (CAR) of the banking sector recorded at 26.34 percent.

On a cumulative basis, during the fiscal year 2013 the banking sector earned a total of AF 1.76 billion profits against AF 1.12 billion losses in the previous year. The return on assets (ROA) improved to 0.74 percent, while return on equity (ROE) was 10.03 percent against a negative 0.54 percent and 7.17 percent, respectively from the previous year. Private Banks and Branches of Foreign Banks ended up with profits, while the State-Owned Banks ended with losses during the current year.

1. ASSET OF THE BANKING SYSTEM

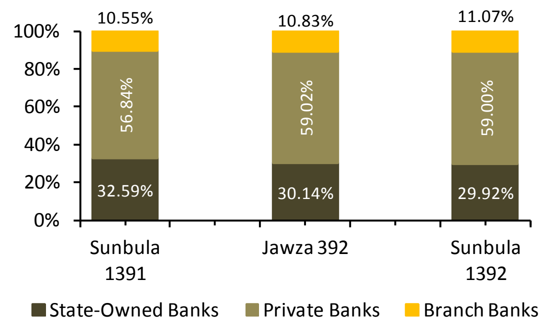
The asset size of the banking sector grew by 9.86 percent against that of 13.50 percent in the previous year (Dec.2012). Figure 6.1 The breakdown of total assets reveals that the most obvious increase was registered by investments, showing an increase of 57.03 percent or AF 4.15 billion over the year under review. The second major increase was posted by the inter-bank claims, up by 21.25 percent or AF 12.10 billion. The other category of the total assets and net-loans showed AF 2.48 billion and 4.38 billion increase respectively, while cash in vault and claims on DAB witnessed slight increase.

The most important components of the system's total asset portfolio were cash in vault/claims on DAB (41.14 percent), inter-bank claims (28.09 percent), net loans (18.23 percent) and "other assets" (7.88 percent). While the share of other components of total assets was negligible, Table 7.1

Table 7.1: Composition of Asset and Liabilities of the Banking Sector

Asset	Qaws FY1391 Dec. 2012	Qaws FY1392 Dec. 2013	% of Total Asset/Liab.	Y-o-Y Growth
Cash in vault and claims on DAB	100,728	101,179	41.14%	0.44%
Inter-bank claims	56,974	69,081	28.09%	21.25%
Investments	7,282	11,435	4.65%	57.03%
Loans (Net)	40,456	44,839	18.23%	10.83%
NDF	1,498	-		
Others	16,900	19,382	7.88%	14.68%
Total	223,838	245,916		9.86
Liabilities				
Deposits	192,247	207,799	95.57%	8.08%
Borrowings	3,349	5,620	2.58%	67.81%
NDT	1,507	-		
Others	10,059	4,023	1.85%	-60.00%
Total	207,162	217,442		4.96%

Figure 7.1: Share of Banking Sector (Total assets)

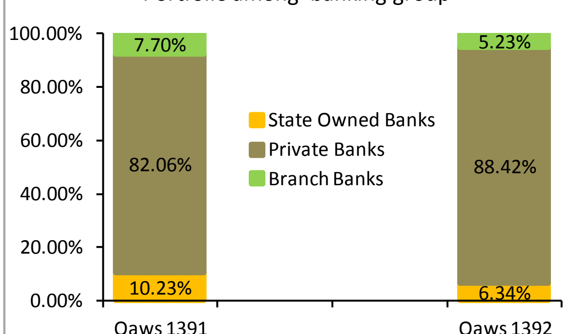


Source: Financial Supervision Department, DAB

1.1 Gross Loans

Total gross loans indicated AF 4.79 billion or 11.37 percent increase from the year before, constituting 19.10 percent of the total assets. Increases in lending were observed in 7 banking institutions, whereas 7 banking institutions decreased their portfolio. While the remaining two banks (NKB and PNB) did not participate in lending; however, more than two-third of the growth in lending is attributable to the private bank group.

Figure 7.2: Share of the Gross Loans Portfolio among banking group



Source: Financial Supervision Department, DAB

Private Banks are the leading lenders, compared to the previous period, their portfolios, both in absolute term as well as percentage of total loans has increased, currently standing at AF 41.52 billion or 88.42 percent of total gross loans. The portfolio of state-owned banks and that of branches of foreign banks were AF 2.98 billion (6.34 percent of the total gross loans) and AF 2.45 billion (5.23 percent of the total gross loans) in shares and amounts respectively.

1.2 Loan Loss Reserves

Whilst 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.

By the end of Dec. 2013 (Qaws, 1392), the total provision cover of the system was 4.52 percent of total gross loans compared to 4.04 percent in the previous year, ending Dec.2013.

1.3 Distribution of Credit

Sector wide analysis shows that the major portion of the loan portfolio is classified as "other commercial loans" increased by 75.11 percent in the FY1392 (Dec. 2013), against 68.08 percent in Dec. 2012, mainly in trade (29.84 percent), services (22.10 percent), and manufacturing (9.35 percent). Agriculture loans showed a slight decrease, making 2.38 percent of the total loans. Concentration in trade, services, mortgage loans and manufacturing loans to the exclusion of all other types of lending has been the dominant trend. Lending in trade, communication, services and "all other loans" category of total loans have witnessed increases during the period under review (Table 6.4), while loans in residential mortgage, manufacturing, consumer, mining, utilities and agriculture sectors posted a decrease. Loans designated to SMEs and Micro Credit sectors increased by AF 174 million, standing at AF 6.58 billion provided by six banking institutions. Lending is picking up, although not significantly in some loan categories related to important sectors of the economy, such as the agriculture, mining and communication sectors. About 79.4 percent of the loans was designated in Kabul with Herat and Balkh provinces in the second and third places respectively. The proportion of loans in other provinces was negligible. The designation of loans by sectors, geography, and institution are not diversified adequately, but is expected to improve gradually. All Commercial Banks are highly required to take active part in lending, in order to diversify lending services and properly perform their main role of financial intermediation.

1.4 Non-performing loans

Banks are required to strengthen credit risk management measures to curtail the level of NPLs. It is essential for banks to evaluate credit applications carefully and closely monitor the financial condition of their borrowers, to ensure that credit expansion will not create a threat to the stability of the financial system.

By the end of the 2013, the growth in non-performing loans accelerated by AF 156 million standing at AF 2.39 billion or 5.10 percent of total gross loans against AF 2.24 billion or 5.31 percent of the total gross loans in the preceding year. About 81.30 percent of the NPLs relates to one State-owned bank and one Private bank.

FSD is closely working with the financial institutions and make them to design and implement specific plans to improve the asset quality.

The sector wide distribution of NPL reveals that a significant portion of NPLs originates from commercial, residential and mortgage loans to individuals. Credit quality in residential loans to individuals, consumer and agriculture loans improved while in commercial loans shown deterioration.

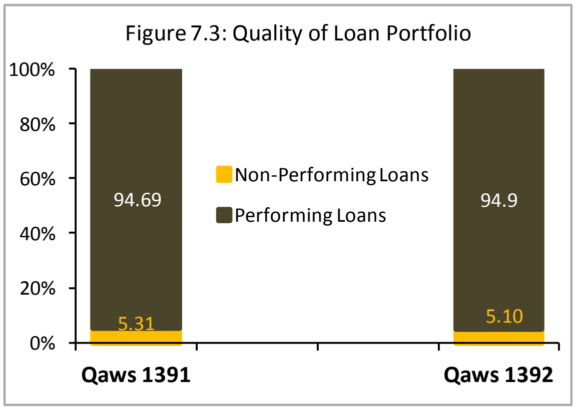
Table 7.2: Sectoral Distribution of Credit

Ratios	Hoot1386 (Mar 08)	Hoot1387 (Mar 09)	Hoot1388 (Mar 10)	Hoot1389 (Mar 11)	Hoot1390 (Mar 12)	Qaws1391 (Dec. 12)	Qaws1392 (Dec. 13)
Commercial Real Estate and Construction Loans	9.54	0.19	19.92	25.98	2.85	2.29	2.02%
Other Commercial Loans	79.14	-	-	-	-	-	-
Mining	N.A	-	-	0.02	0.72	0.11	0.07%
Manufacturing	N.A	0.01	1.22	2.72	13.32	11.88	9.35%
Trade	N.A	0.51	32.29	34.16	27.84	28.30	29.84%
Communication	N.A	0	1.04	1.23	0.94	2.35	3.70%
Service	N.A	0.09	4.84	6.72	11.95	15.94	22.10%
Utilities	N.A	0.01	2.47	0.03	0.3	0.07	0.05%
Others	N.A	0.09	25	8.42	10.89	10.50	9.99%
Agricultural Loans	0.13	0	0.88	0.75	2.06	2.66	2.38%
Consumer Loans	2.17	0.02	1.33	1.01	0.82	0.74	0.24%
Residential Mortgage Loans to Individuals	2.28	0.01	7.3	8.95	15.65	14.46	10.83%
All Other Loans	6.74	0.05	3.69	10	12.65	10.71	9.41%

Source: *Financial Supervision Department/DAB*

1.5 Adversely-classified loans

Adversely classified loans (substandard, doubtful)1 amounted to AF 4.21 billion , as of Dec. 2013, presented an increase of AF 1.62 billion, making 8.98 percent of the total gross loans, compared to preceding year (Dec.2012), whereas adversely classified loans were AF 2.59 billion or 6.15 percent of the total gross loans.



Source: Financial Supervision Department/DAB

1.6 Loans classified Watch

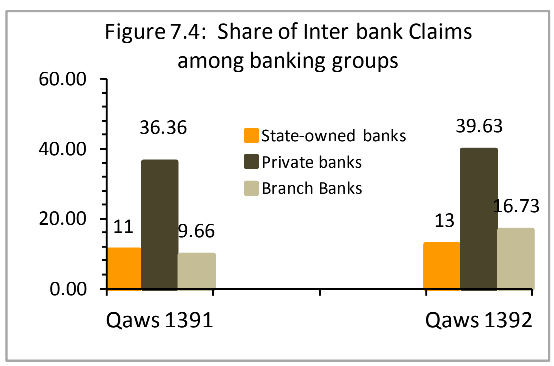
Loans classified in the "watch" category are AF 2.42 billion, which makes 5.16 percent of total gross loans, increased significantly since the previous year (Dec.2012). The significant increase in the watch loans is mainly attributed to one of the private commercial banks. Moreover, five banking institutions witnessed increases, while four banks posted some decreases in the watch loans category. This category of loans requires close monitoring, as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

1.7 Loans classified loss

Loans classified loss amounted to AF 460 million or 0.98 percent of the total gross loans, up by AF 211 million from the previous year, mainly driven by private banks.

1.8 Inter-Bank Claims

Inter-bank claims are the second largest among various asset categories, currently comprising AF 69.08 billion – 28.09 percent of total assets, registered AF 12.10 billion increases since Dec.2012. The increase is attributed to a number of banking institutions, indicating that the banking sector still channels a portion of its attracted funds as deposits in the other financial institutions, if creditable borrowers are not available. These institutions are, both inside and outside the country. Later on, if needed, for liquidity purposes or after receiving applications from low-risk borrowers, these assets can be substituted to higher income earning assets Figure 7.4



[1] Assets on which the payment of principal or interest is due and remains unpaid for 61-90 days (Substandard) and for 91-180 days (Doubtful)
[3] Assets on which the payment of principal or interest is due and remains unpaid for 31-60 days (Watch)

1.9 Investment

The investment[2] portfolio of the banking sector increased by 57.03 percent or AF 4.15 billion standing at AF 11.43 billion or 4.65 percent of total assets over the previous year. The increase was mostly attributed to four banking institutions. Major part of the sector's investment took place outside Afghanistan by 2 commercial banks and 2 branches of foreign banks.

1.11 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category, making 41.14 percent of the total assets, illustrated an increase of AF 451 million, both in absolute term as well as in percentage of total assets for the previous period, ending Dec.2012.

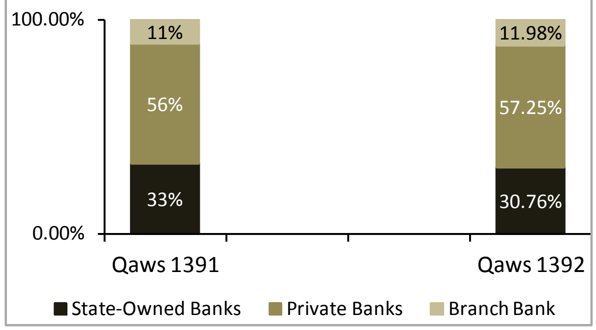
The banking sector is fully compliant with the required reserve regulations and is deploying slowly and prudently the attracted funds into other types of assets.

2. LIABILITIES

Total liabilities of the banking sector increased by AF 10.28 billion or 4.5 percent, standing at AF 217.44 billion against AF 207.16 billion recorded in the preceding year (Dec.2012). All components of the total liabilities except "other liabilities" have shown increases. The decrease in the "other liabilities" category of the total liabilities of the banking sector, was due to newly adopted reporting requirements for branches of foreign banks, as they are now required to report their capital separately, which they used were reporting under other liabilities.

Deposits constitute the largest portion of liabilities with about 95.6 percent share in total liabilities. This is an indication of public confidence on, and good public relations and marketing policies of the banking sector. Borrowings and "other liabilities " rank the second and third places respectively. Table 7.5

Figure 7.5: Liabilities increased by AF 10.28 billion or 4.96 percent



Source: Financial Supervision Department, DAB

2.1 Deposits

Deposits, the main funding source, increased by AF 15.55 billion or 8.08 percent, showing a slower pace compared to 11.28 percent growth of last year. Afghani denominated deposits indicated 16.60 percent growth (1.85 percent decline last year) accounting for 31.85 percent of total deposits, while the USD denominated deposits were up by 5.27 percent (17.94 percent last year), making 65.18 percent of the total deposits of the system.

[2] Investments include investment in bonds, associated companies and in a subsidiary

Private Banks attracted AF 129.06 billion deposits, increasing by 16.33 percent against 31.40 percent growth last year, making up 62.11 percent of the system's deposits.

The share of state-owned banks decreased for AF 55.94 billion for the preceding year (Dec.2012), accounting for 26.92 percent of the total deposits of the system. State-owned banks appeared to become less competitive compared to the Private Banks. The share of branches of foreign banks stood at AF 22.78 billion, increased by 3.14 percent, making up 1.96 percent of total deposits of the system.

In terms of type, demand deposits accounted for 74.03 percent of the total deposit base, up by 10.29 percent, saving deposits consists 21.42 percent of total deposits, stood at the second place, depicted 2.10 percent decrease, and time deposits making up 4.54 percent of the total deposit portfolio, was up by 29.57 percent since Dec.2012.

Figure 7.6: Deposits Increased by 8.08 percent or AF 15.55 billion

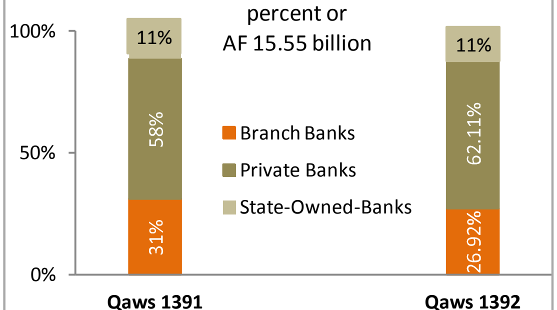
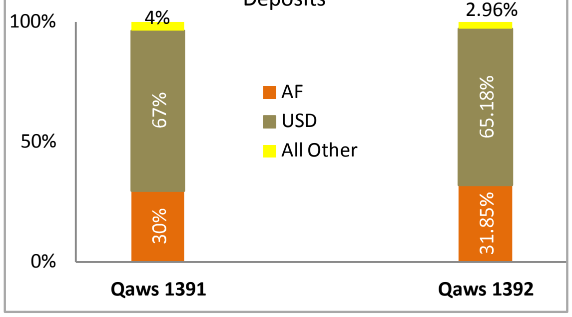


Figure 7.7: Currency Composition of Deposits



Source: *Financial Supervision Department, DAB*

Figure 7.8: Breakdown of Deposits

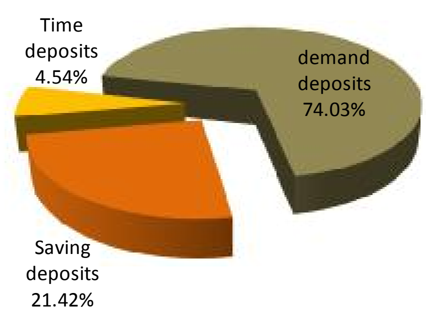
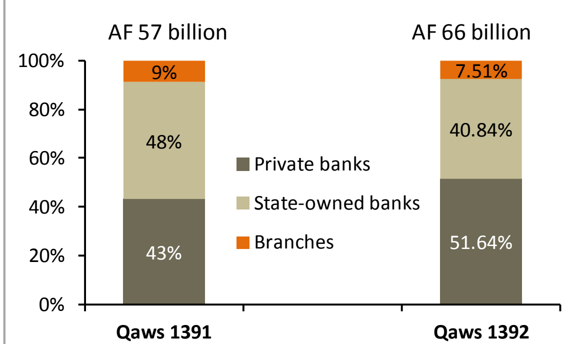


Figure 7.9: Afghani Denominated Deposits



Source: *Financial Supervision Department, DAB*

2.2 Borrowings

The share of borrowings in the total funding structure of the system increased by 67.81 percent, standing at AF 5.62 billion at the end of December 2013, making 2.58

percent of total liabilities compared to 1.61 percent in the last quarter. The current borrowing position is attributed to three banking institutions.

2.3 Liquidity

Liquidity risk can be defined as the risk of unavailability of sufficient liquid assets to meet the demand of borrowers and depositors. All banks are required to maintain a reasonable level of liquidity, 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 the bank policies.

2.3.1 Liquidity Ratio (the broadest 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 the period under review. Excess liquid assets showed a 1.83 percent increase against a 37.59 percent increase in the previous year (end Dec. 2012). About 62.08 percent of the sector's total assets is comprised of liquid assets. The ratio of the broad liquidity as a median for the whole system stood at 67.93 percent. All banking institutions were well above the minimum required level. Table 7.5

2.4 Capital

In order to strengthen the capital base of the banking system and enhance its stability, DAB increased the minimum Paid-in capital requirement to AF 1.00 billion, and all banking institutions were given two year deadline to meet the requirement[3]. Currently, the deadline for the capital increase is over, all the banking institutions, except the branches of foreign banks[4] are in compliance with the requirement.

Except one banking institution, the system is well capitalized. The capital fund of the banking sector stands at AF 28.47 billion, increased significantly by 70.74 points or AF 11.79 billion on account of profits, capital injection and addition of capital of branches of foreign banks[5], which they were reporting under liabilities.

On the aggregate basis, the capital adequacy ratio of the banking sector stood at 26.34 percent. Table 6.3

A disaggregated analysis shows that all banks in the system registered capital adequacy ratio above the minimum threshold (12 percent of risk-weighted

[3] DAB Supreme Council resolution dated 16/03/1389

[4] As per letter No. 3783/4159 dated 17/10/1392 they are given the deadline till end of March, 2014 to fulfill the requirement.

[5] DAB Supreme Council resolution dated 29/12/1391 and Accounting Circular No 92/02 on capital acquirement of foreign branches

assets), except one state-owned bank. The Basel benchmark for capital to risk weighted is 8 percent.

Table 7.3: Key Financial Soundness Indicators of the banking Sector

	1386 (Mar 2008)	1387 (Mar 2009)	1388 (Mar 2010)	1390 (Mar 2011)	1390 (Mar 2011)*	1390 (Mar 2012)	1391 (Dec. 2012)	1392 Dec. 2013)
Total Capital Adequacy Ratio	31.77	**29.81**	25.81	-14.46	30.39	23.06	21.84	26.34
Tier 1 Capital Adequacy Ratio	31.16	29.72	24.19	-14.51	30.29	23.98	19.97	24.65
Non-Performing Loans to Total Gross Loans	0.68	1.15	0.5	48.4	3.75	5.15	5.31	5.10
Return on Assets (ROA)	1.7	1.74	1.41	-20.08	0.24	-1.21	-0.54	0.74
Return on Equity (ROE)	9.89	10.61	10.35	-520.66	1.9	-17.9	-7.17	10.03
Liquidity Ratio (Broad Measure Median)	65.95	40.02	59.19	63.32	63.83	57.37	72.13	67.93
Liquid Assets to Total Assets	23.8	23.8	0.38	40.58	47.01	55.82	63.75	73.18

*Excluding Kabul Bank

Source: *Financial Supervision Department/ DAB*

2.5 Profitability

On a cumulative basis, the banking sector posted AF 1.76 billion profits in the fiscal year 1392 (Dec. 2013), compared to AF 1.12 billion losses in the previous period (December 2012).

The improvements in the profitability of the banking sector at the end of 2013 has come from a significant decrease in credit provisions, decrease in the salary cost and taxes, and increase in net-interest income, non-interest income and FX gains. While, non-interest expense increased over the year 2013.

Analysis of the profit and loss schedule shows that the banking sector was profitable for eight months, and the major part of the profitability was posted in the month of December 2013.

As a result, the return on assets (ROA) improved to 0.74, from a negative 0.54 percent and ROE improved from 7.17 percent to 10.03 percent. Table 6.4

On a cumulative basis, three banking institutions incurred AF 587 million losses against AF 3.03 billion losses posted by three banks in December 2012.

On core income basis, one bank ended with losses.

On an aggregate basis, Private Banks and branches of foreign banks ended up with profits, while State-owned banks ended with losses. Figure 7.10

Table 7.4: Profit of the Banking Sector (million AF)

Items	1391 (Dec. 2012)	1392 (Dec.2013)	Q-O-Q Changes
Interest income	7,496	9,032	20.49
Interest expense	1,961	1,692	-13.72
Net interest income	5,535	7,339	32.59
Non-interest income	4,757	5,349	12.44
Non-interest expenses	4,626	6,319	36.59
Salary cost	3,279	3,217	-1.89
Credit provisions	2,984	1,056	-64.61
P/L before tax	-597	2,096	251.08
P/L after tax	-1,125	1,763	56.71

Figure 7.10: Profitability of the Banking Sector

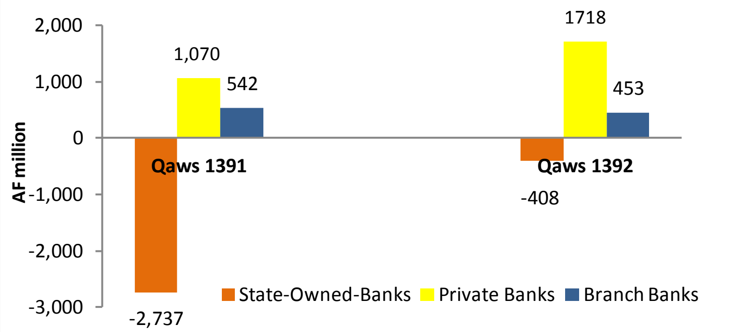
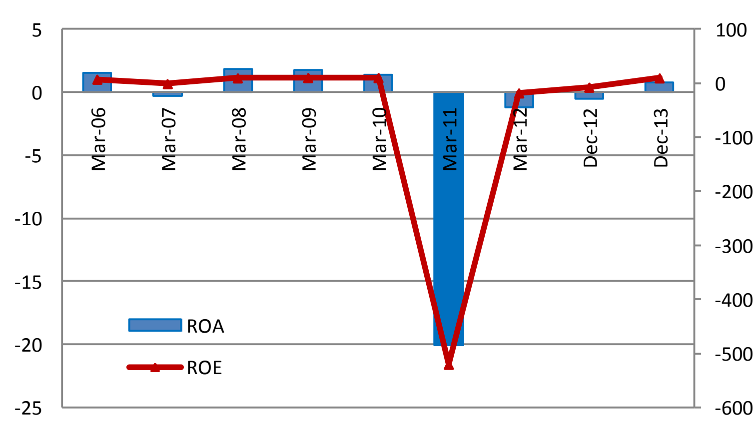
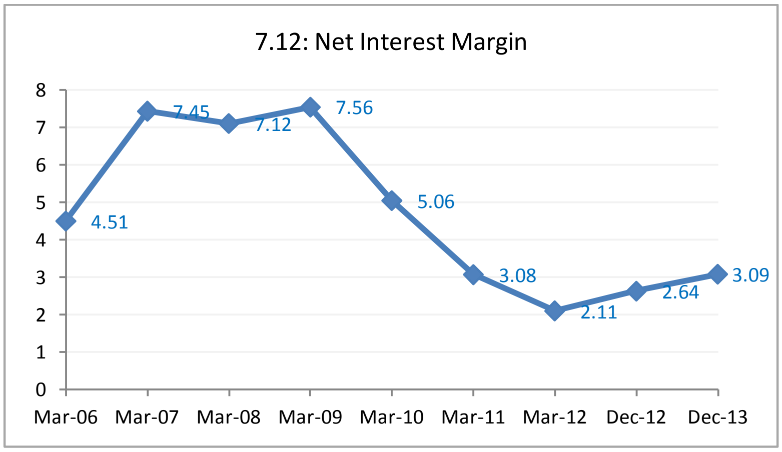


Figure 7.11: Return on Asset and Liability





Source: Financial Supervision Department/DAB

2.6 Foreign Exchange Risk

The level of overall open FX position risk 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 eight banking institutions, including four branches of foreign banks holding open FX positions on the overall and on an individual currency (USD short& long positions) basis violated the limits

The impact of change in exchange rate upon the regulatory capital of the system reveals that a 20 percent appreciation in the exchange rate would increase the regulatory capital of the system by AF 8.04 billion, and vice versa. Similarly, a 4 percent change would correspond to AF 1.61 billion and vice versa.

2.7 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 AF 1.57 billion in an event of an 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 AF 1.57 billion. For two banking institutions, if the interest-rate increases by 3 percentage points, that will decrease in their net interest income over the next 12 months. (Branches of foreign banks are not required to file the interest-rate sensitivity schedule, because, like FX risk, interest-rate sensitivity of the banks is the large excess of risk is theoretically managed on a whole-bank basis).

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

For further information:

Tel. : +93 (0) 20 2100301/ 20 2103032
Fax : +93 (0) 202100305
E-mail : mp@centralbank.gov.af
Website: www.centralbnak.gov.af




CONTACT

Monetary Policy Department
E-mail: mp@centralbank.gov.af
Tel: +93 210 0293