Da Afghanistan Bank

First Quarter, 2019

Economic & Statistical Bulletin

Monetary Policy Department

Da Afghanistan Bank

Ibn-e-Sina Watt

Kabul

Afghanistan

Telephone: +93(0)-20-2103930

Internet: **www.dab.gov.af**

Email: **mp@dab.gov.af**

Note:

Afghanistan's fiscal year has changed effective from 2012 (1391). The new fiscal year begins from December 22nd each year. This bulletin analyzes economic developments during the first quarter of fiscal year 2019 (2019), which starts from December 22nd, 2018 to March 20th, 2019.

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ABBREVIATIONS

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

Message

From the Governor

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

EXECUTIVE SUMMARY

Da Afghanistan Bank uses quantitative theory of money as a determinant of Reserve Money (RM) aiming to keep domestic prices stable. Maintaining domestic price stability is the primitive goal of the Da Afghanistan Bank (DAB), where reserve money is the key operational target and Currency in Circulation (CiC) as the indicative target for liquidity.

Narrow Money (M1) had a growth rate of 6% amounted to AFN 431,707 million, on the other hand Broad Money (M2) standing at AFN 464,973.33 million had 5.40% growth in the quarter under review. In order to lessen Afghani exchange rate fluctuations against foreign currencies and to manage liquidity in the market, DAB uses Foreign Exchange Auction and Capital Notes Auction through Open Market Operations (OMO). To mitigate exchange rate fluctuation and sop up excess liquidity form the market, DAB auctioned USD 541.94 million, and the total outstanding amount of capital notes were AFN 26.67 billion at the end the first quarter.

Consumer price Y-on-Y showed an inflation rate of 0.8% (1.9% decrease compare to the first quarter of FY 2018) on average in the quarter under review, while consumer price on Q-on-Q basis indicated decline of 0.1% reaching to inflation rate of 0.8%. Kabul headline inflation was 0.9% in the first quarter of FY 2019, while in first quarter of FY 2018 Kabul inflation was 3.2%.

In the external sector of the economy, the Balance of Payment (BOP) had a deficit of USD 1,091.83 million in quarter under review. Current account had a deficit of USD 1,226.41 million, and the capital account experienced surplus of USD 39.42 million. In financial account; net Foreign Direct Investment (FDI) decreased to USD 17.58 million, while net portfolio investment had an outflow of USD 19.96 million in the quarter under review.

In fiscal sector, government experienced a budget deficit of AFN 8.93 billion (excluding grants), and including grants had a surplus of AFN 5.82 billion in the first quarter of FY 2019. Domestic revenue was AFN 42.88 billion and expenditures incurred were AFN 51.81 billion. Meanwhile from the total allocated budget (AFN 404.57 billion), 14% is executed during the quarter under review.

In the banking sector, overall soundness indicators showed decline in assets, deposits, equity capital and profit, while quality of loan declined even further. Liquidity remained adequate and there was increase in gross loans, and deposits like always were the key source of funding to the banking sector. Islamic banking comprises of one bank and six windows, which shares 4.95% in the assets, 2.21% in gross loans, and 4.99% in deposits of the overall banking sector.

1 Global Economic Environment

1

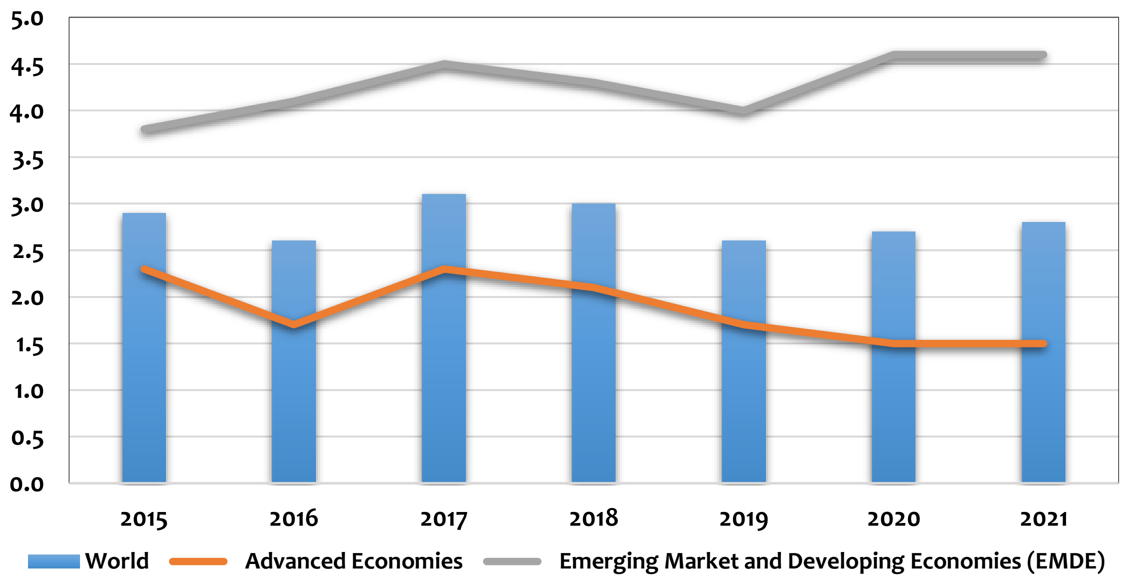
GLOBAL ECONOMIC ENVIRONMENT

According to IMF and the World Bank, global growth is projected to decline in 2019 amidst rise of trade barriers, weak investment, tight financial conditions, higher policy uncertainty, and rising government debts in several economies. Economic activity in several advanced economies specifically in Europe was slow in the first quarter of 2019. Growth was weak in Europe in the first quarter of 2019 resulting from low investment and low trade growth. However, US and Japan GDP growth was 3.1% and 0.6% respectively because of raised public expenditures which contributed in GDP growth of the both economies, while Japan also experienced a sharp decline in imports.

On the other hand, in Emerging Markets and Developing Economies (EMDEs) growth was slower than expected. In most of the EMDEs, service sector remained stable, while countries that are facing sanctions had faced decline in exports. Turkey and Venezuela continued to face economic crisis. Turkey's economy slowed down in 2018 and eventually fell into recession, and continued struggle with Lira depreciation (contraction of 2.6% in year on year term). China's GDP growth was above market expectation which was mainly driven by private consumption.

A comparison among Advanced Economies, EMDEs and global economy is illustrated in figure 1.1.

Figure 1.1: Global Growth, Advanced economies and EMDE



Source: World Bank

1.1 ADVANCED ECONOMIES:

1.1.1 United States' Economy:

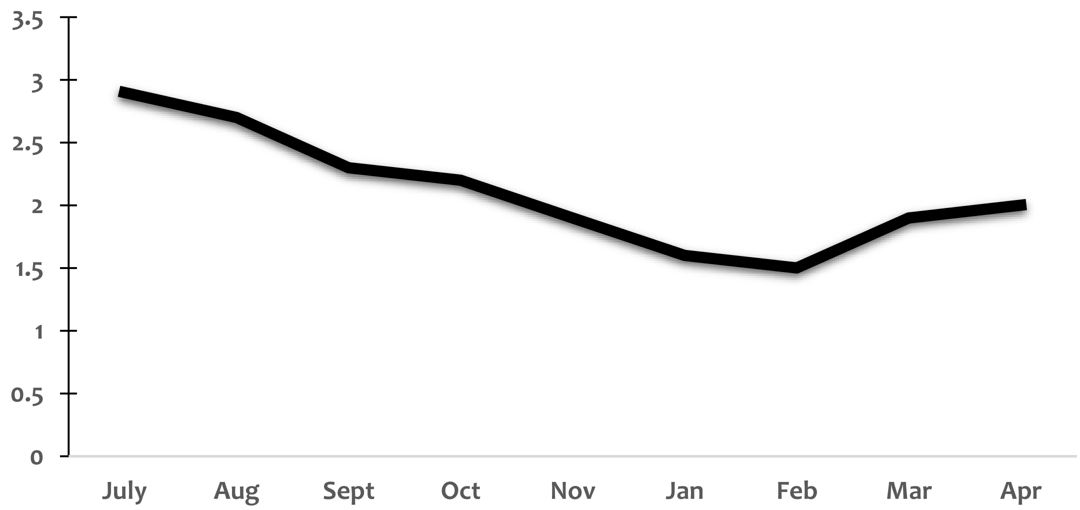
According to the Bureau of Economic Analysis, Real GDP expanded at an annual rate of 3.1% against 2.2% increase in the 4th quarter of 2018. However, the Bureau's initial estimate was 3.2%, with the downward revision of non-residential fixed investment and private inventory investment the GDP, together with upward revision of exports and personal consumption expenditure the growth is estimated to be 3.1% in the first quarter of 2019.

Real Gross Domestic Income (GDI) increased 1.4% in the first quarter, compared to an increase of 0.5% in the previous quarter. Furthermore, profit from current production and domestic nonfinancial profit decreased to USD 65.4 billion and USD 13.6 billion respectively, while profit of domestic financial corporations increased USD 7.4 Billion.

Figure 1.2: US GDP growth % Change in GDP from previous quarter

Source: US Bureau of Economic Analysis

Figure 1.3: US CPI inflation rate



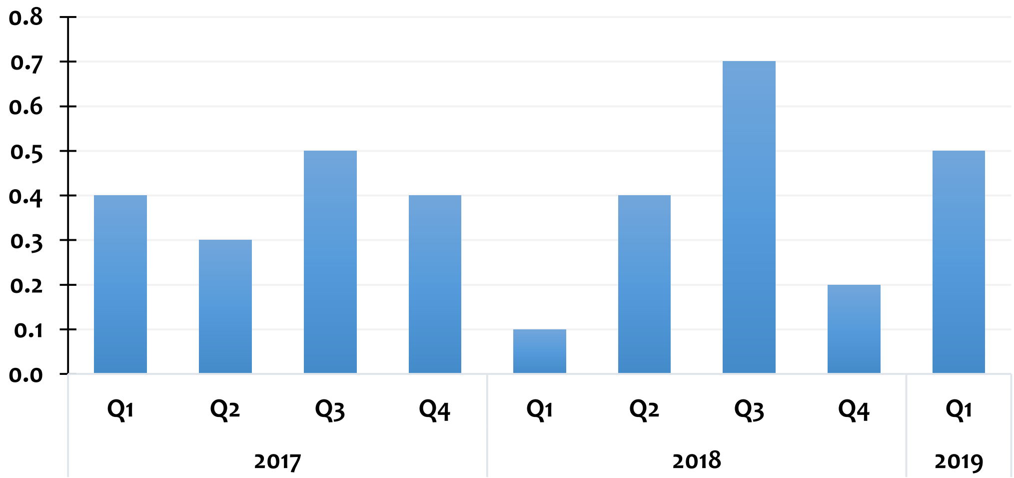
Source: US Bureau of Labor Statistics

The expansion of real GDP in this period is mainly driven by increase in state and local government spending, increase in private inventory investment and in exports, and a smaller decrease in residential investment. On the other hand, these improvements were partially offset by a slowdown in PCE and non-residential fixed investment, and a downturn in federal government spending. Furthermore, imports also slowed down in this quarter. According to US Bureau of Labor Statistics, CPI inflation rate continued to fall, reaching 1.5% in April and rose to 1.9% in March period.

1.1.2 The Economy of UK:

United Kingdom's GDP is estimated to have increased by 0.5% in the first quarter of 2019 and the annual growth is estimated to be 1.8% as compared to the same quarter of 2018 which was 1.4%. Production output increased by 1.4% after a decline in the previous quarter, mainly manufacturing output increased by 2.2%. Construction sector experienced an increase of 1.0% in this quarter. On the other hand, services slowed to 0.3%, while agriculture, forestry and fishing sector fell by 1.8% which caused slowing down the growth.

Figure 1.4: % Change in GDP (quarter on quarter)

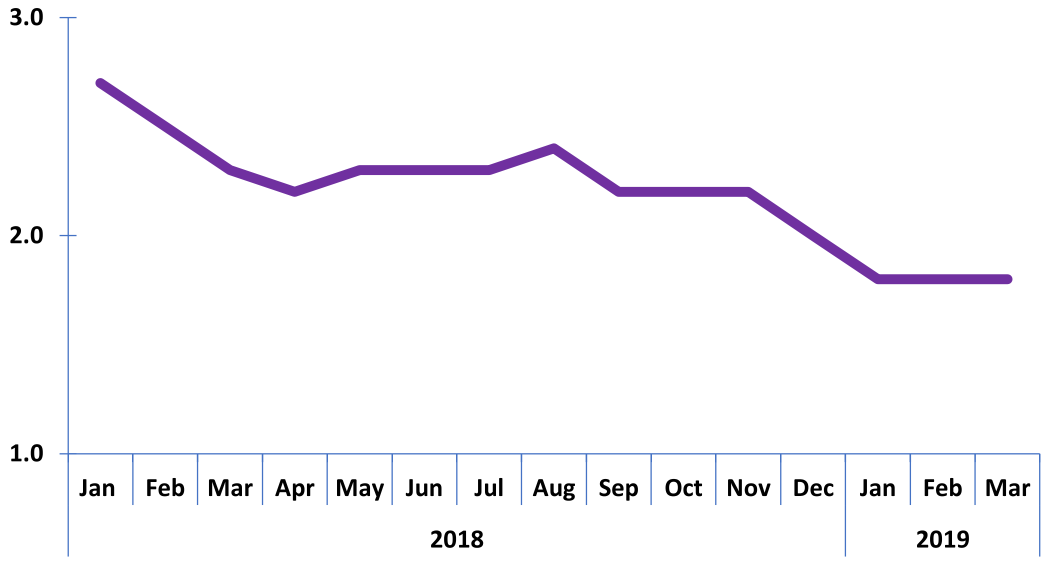


Source: Office for National Statistics

Furthermore, Private consumption, government consumption and gross capital formation (GCF) contributed positively to the growth, while net trade subtracted from GDP growth in this period. Household consumption increased by 0.7% in the first three months of 2019.The trade deficit widened to 3.4% of nominal GDP, the widest deficit in more than 50 years. This is largely a reflection of the volume of imports of unspecified goods, which includes non-monetary gold (NMG).

In this period, government consumption increased by 1.4%, this increase was reflected in several areas including health, which increased by 0.7%, and general public services and economic affairs, which increased by 9.6%. Business investment also grew by 0.5% in this period, driven by higher investment in IT equipment, machinery and other equipment. CPI remained stable at 1.8% throughout the quarter.

Figure 1.5: UK Consumer Price Index including all items



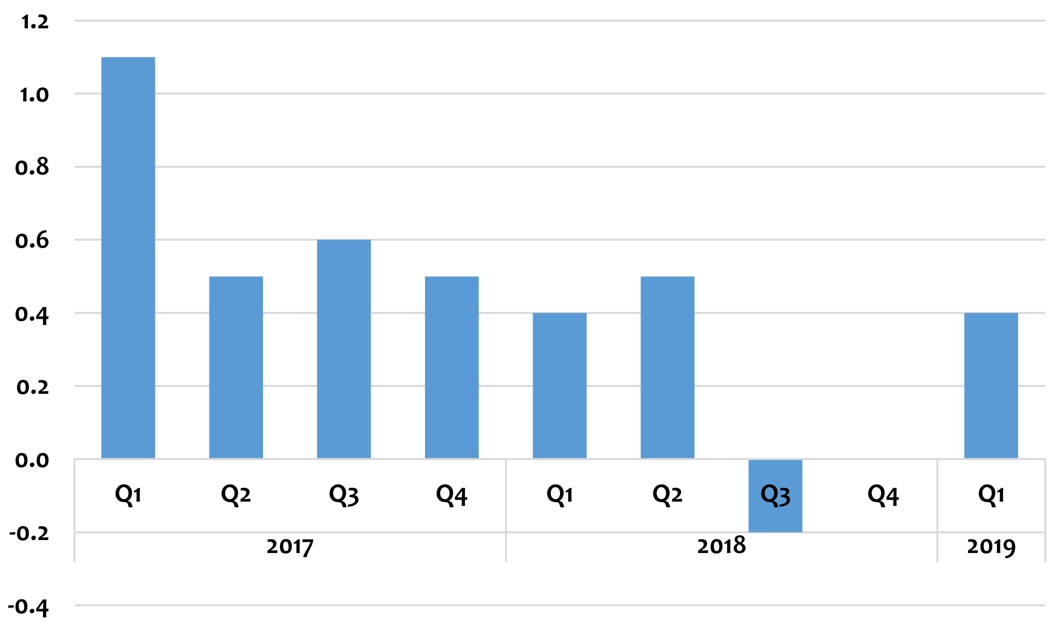
Source: Office for National Statistics

However, political uncertainty pertaining Brexit continues to have a negative impact on investment.

1.1.3 Economy of Germany:

Following a contraction in the third quarter and turning flat in the final quarter of 2018, German GDP grew 0.4% in the first quarter of 2019 on a quarter-on-quarter basis, which was higher than the market expectations. The growth was driven particularly by domestic factors including investment in construction and equipment and private consumption. Household consumption increased due to tax cuts and social benefits.

Figure 1.6: % Change in GDP from previous Quarter



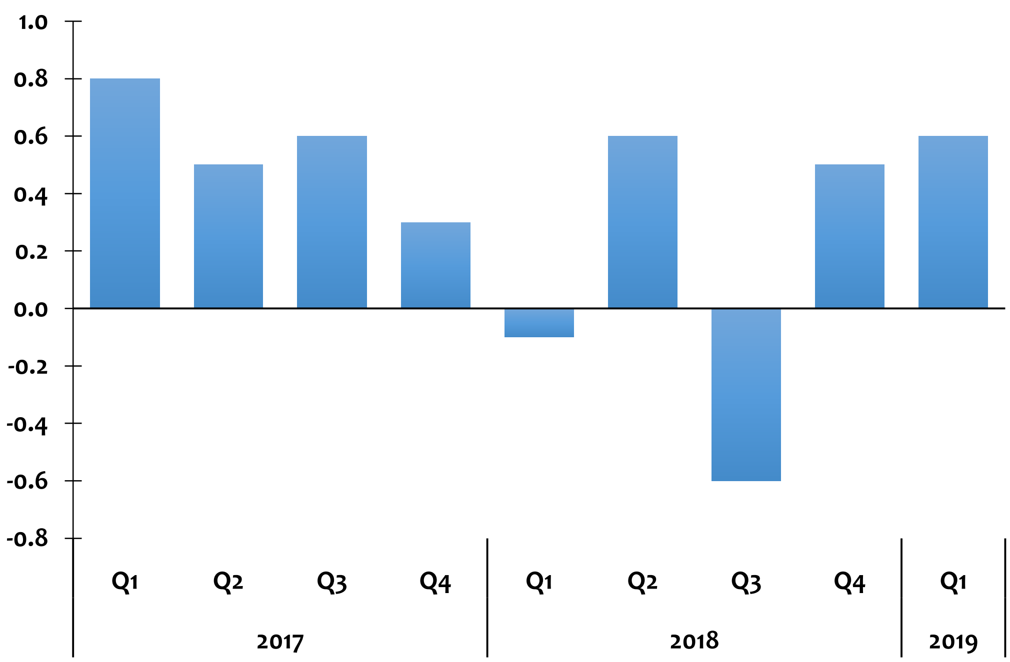
Source: Organization for Economic Co-operation and Development

According to Federal Statistics Organization(Destatis), employment and turnover in service sector increased by 3.5% on a calendar and seasonally adjusted basis in the first quarter of 2019 compared with the same period of last year. The seasonally adjusted number of persons employed in selected service branches rose to 1.8% on the first quarter of 2018 compared to 0.4% in the previous quarter, reaching a record high. Furthermore, both imports and exports increased over this period. The exports increased by 2.5% (USD 377 billion) in the first quarter of 2019 compared to last year which amounted to euro 336 billion. Imports increased by 4.8% compared to last year, amounting to euro 281 billion. Public debt decreased by 1.1%, or 22 billion euros, compared with the first quarter of 2018 and had 0.7% or euro 13.1 billion increase compared with the previous quarter.

1.1.4 Economy of Japan:

According to Tokyo's Cabinet Office, Japan's economy grew 2.1% year-on-year basis in the first quarter of 2019 and 0.6% in quarter-on-quarter terms, which was well above expectations amidst weak exports, weak imports, depressed capital expenditure and low consumer sentiment. Japan's economy contracted by 0.6% in the third quarter of 2018 and grew 0.3% in the final quarter of 2018, however, in the first quarter of 2019, the boost is mainly driven by 6.2% rise in public investment, and 4.6% decrease in imports against 2.4% drop in exports.

Figure 1.7: % change in GDP from previous quarter



Source: Cabinet Office, Government of Japan

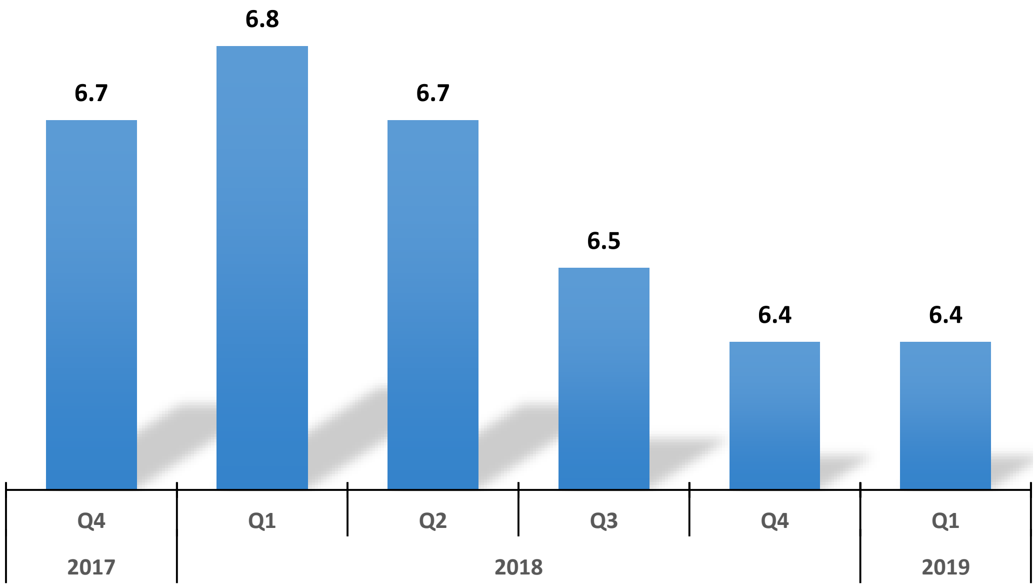
The government is considering to raise sales tax from 8% to 10% which has been postponed twice since October 2018.

1.2 ADVANCED ECONOMIES:

1.2.1 Economy of China:

According to National Bureau of statistics (NBS); Chinese economy expanded 6.4% in the first quarter of 2019 year-on-year basis, beating market expectation and reaching around USD 3.18 trillion in the first quarter of 2019 with similar pace as on 4th quarter of 2018. The industrial and agricultural sectors grew 6.1% and 2.7% respectively, and tertiary sector increased by 7%. Private consumption was the main driver of growth as seen in the previous quarters. Furthermore, industrial output, property investment, resident disposable income and retail sales witnessed growth.

Figure 1.8: % Change in GDP year-on-year basis



Source: National Bureau of Statistics China

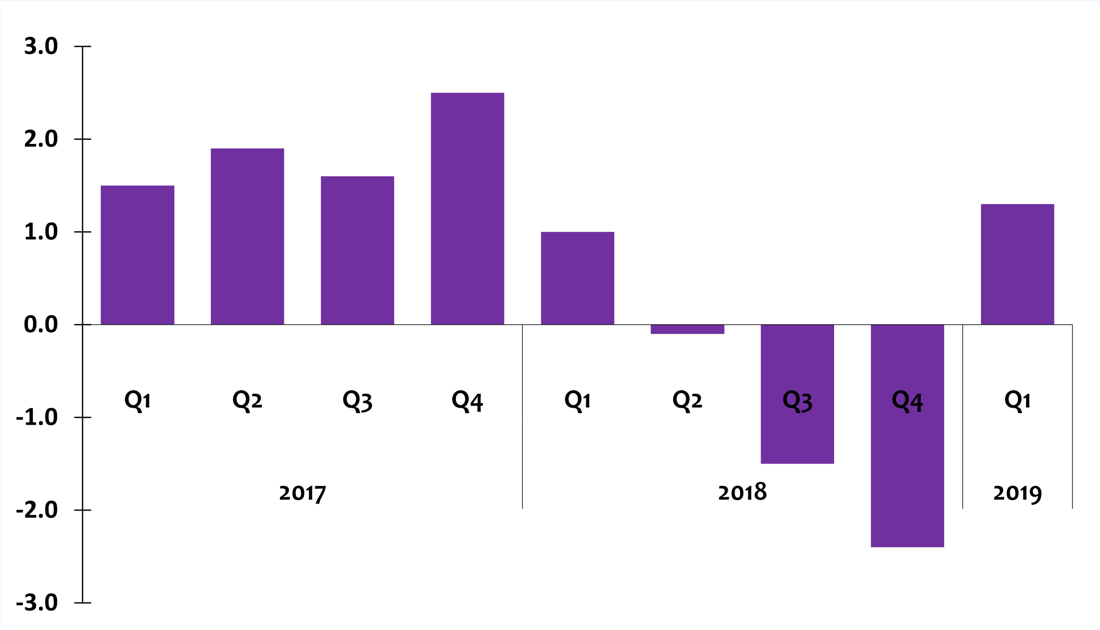
The government has predicted a growth of 6% to 6.5% in 2019 as compared to last year's 6.6% rate of expansion, which was already the slowest annual rate in three decades. The economy lost momentum resulting from government attempts to limit on risky lending, which limited many companies' access to funds. Furthermore, the economy is feeling the heat of trade war with the United states, particularly, the imposition of new tariffs on USD 250 billion worth of Chinese goods.

However, the government has introduced hundreds of billions of dollars intending to stimulate the economy which includes tax cuts, for business, infrastructure spending and a looser monetary policy to keep the economy perform steadily. China's Ministry of Finance also accelerated fiscal support by increasing spending to 5.86 trillion yuan, which includes 0.69 trillion and 5.17 trillion yuan for central and local general public budget expenditure respectively. The growth rate of fiscal spending was around 15%, or 4% points higher than the same period in 2018.

1.2.2 Economy of Turkey:

According to Turkish Statistics Institute (TUIK), Turkey's economy contracted by 2.6% year-on-year basis in January to March period, the GDP at current prices totaled to USD 170.4 Billion in the first quarter. The economy contracted in the fourth quarter of 2018 by 3% bringing the annual growth down to 2.6% while GDP grew at 7.4% in 2017. Gross Domestic Product rose by 1.3% from the previous quarter on seasonally and calendar-adjusted in quarter under review.

Figure 1.9: % Change in GDP from previous quarter



Source: Turkish Statistics Institute

Domestic demand and investment shrank sharply and industrial production contracted 5.7%, while net export made huge contribution to growth in the first quarter of 2019; exports increased by 9.5% while imports decreased by 28.8 % on an annual basis in the first quarter of 2019. Households' final consumption decreased by 4.7% at the meantime government spending increased 7.2% and gross capital formation fell by 13%. Furthermore, agricultural sector's value added improved by 2.5% while industrial output fell by 4.3%, construction by 10.9% and service sector by 4%. According to the new economic program by the Turkish government, the growth is targeted to reach 2.3% in 2019, 3.5% in 2020 and 5% in 2021.

2 Money and Capital Market Development

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

According to the monetary statistics, reserve money (RM) has a negative growth of 0.89% at the end of first quarter of FY 2019 (1398), greater than negative growth of 0.01% at the end of the same quarter in previous year.

Currency in circulation (CiC) as a major component of RM recorded negative growth of 2.65% from beginning to the end of first quarter of FY 2019 (1398). Reserve money (RM) and Currency in Circulation (CiC) growth, which are Da Afghanistan Bank's operational and indicative targets, remained well below the targets due to collecting additional liquidity from the market and banks during the course of the quarter under review.

Narrow money (M1), stood at AFN 431,707 million at the end of the first quarter, registering a growth of 6%. Broad money (M2) demonstrated similar behavior, representing a growth rate of 5.40%, standing at AFN 464,973.33 million.

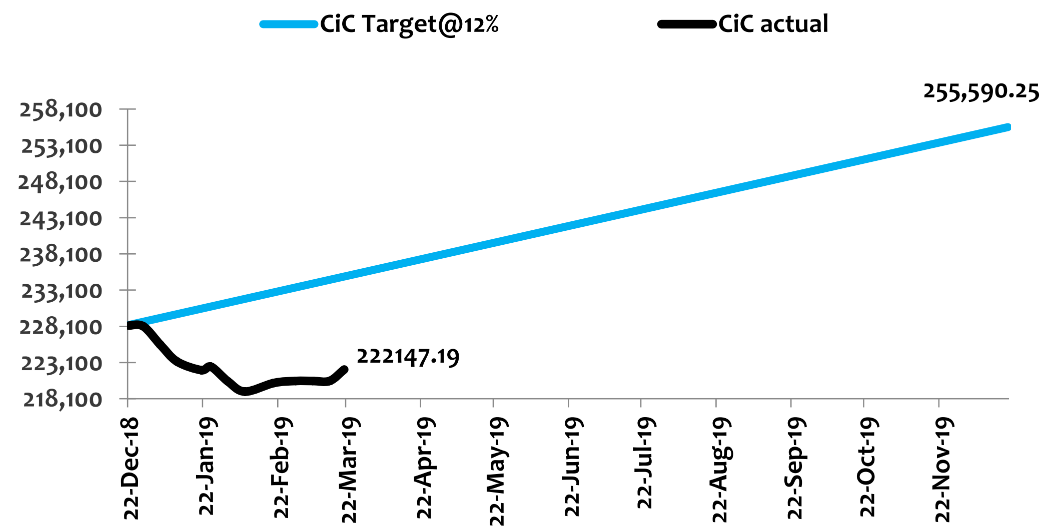
In order to mitigate excessive fluctuations of Afghani exchange rate against foreign currencies and manage liquidity in the market, DAB uses FX (Foreign Exchange) and CNs (Capital Notes) auctions under the open market operations. From the beginning to the end of first quarter of FY 2019 (1398), DAB has auctioned a total amount of USD 541.94 million to absorb the excess liquidity from the market and as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at AFN 26.665 billion at the end of the first quarter of FY 2019 (1398), Meanwhile, Afghani depreciated 0.66% against the US Dollar during the first quarter of FY 2019 (1398).

2.1 MONETARY PROGRAM

Reserve money remained the key operational target for monetary policy of the DAB during first quarter of FY of 2019 (1398), while currency in circulation was set as the indicative target. DAB applies quantitative theory of money to determine the amount of reserve money (RM) for the purpose of maintaining domestic price stability, which is DAB's primary objective. Hence, targets for RM and CiC are based on expected economic growth and expected inflation during the concerned period.

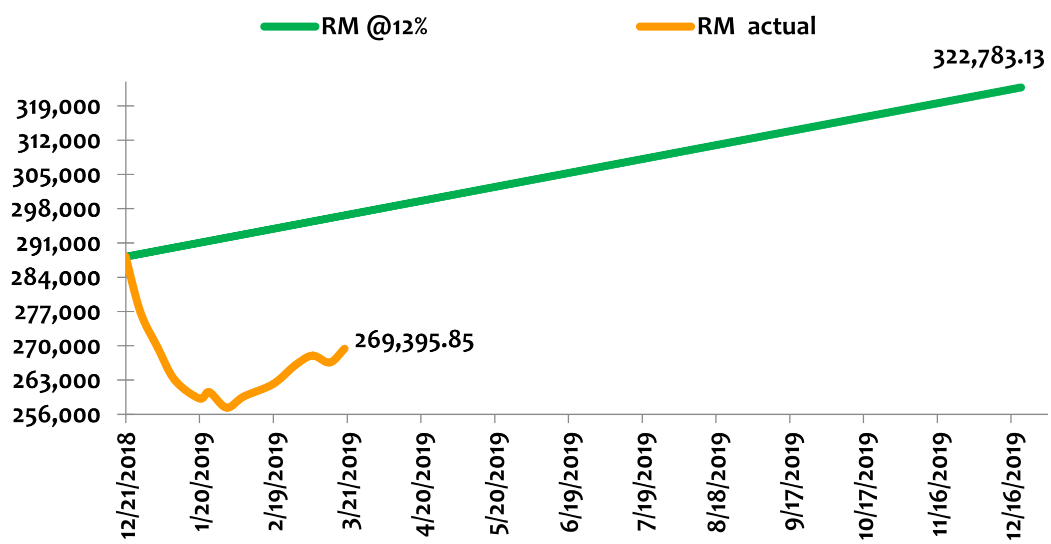
For the fiscal year 2019 (1398), the ceilings for reserve money and currency in circulation growth is set to 12%. It is worth mentioning that in first quarter actual RM and CiC respectively had negative growth of 0.89% and 2.65%, mostly both are bellow to the targets. DAB has auctioned USD 541.94 million via open market operation to mop up the excess liquidity from the market and to prevent intense fluctuations of Afghani nominal exchange rate against foreign currencies, especially internationally convertible currencies. Figures 2.1 and 2.2 illustrate the ceiling (Target)and the actual reserve money and currency in circulation for the period under review.

Figure 2.1: Currency in Circulation during the first quarter of FY 2019 (1398)



Source: Monetary Policy Department/DAB

Figure 2.2: Reserve Money during the first quarter of FY 2019 (1398)



Source: Monetary Policy Department/DAB

2.2 MONETARY AGGREGATES

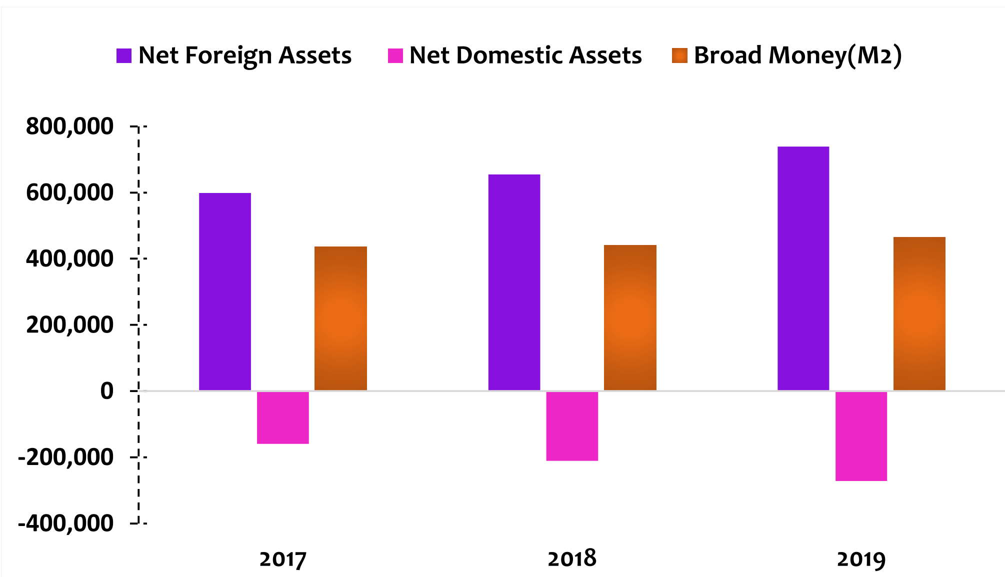
Narrow money and broad money are compiled based on Monetary and Financial Statistics Manual and Compilation Guide.

Narrow money (M1) includes currency outside depository corporations and demand deposits, while broad money (M2) includes narrow money components and other less liquid assets or quasi money. As shown in Table 2.3, narrow money (M1) grew 6% at the end of the first quarter of fiscal year 2019 (1398) almost higher growth than in the same period of FY 2018 (1397).

Currency outside depository corporations or CiC, which accounts for 46% of M2, grew by 3.78%, higher than 1.5% growth of the same quarter in the previous year, showing difference of AFN 7,770 million. Demand deposits, which are the other components of M1, experienced growth of 8.56% at the end of the first quarter of FY 2019 (1398), while its growth rate was 0.6% in same period of previous year. Demand deposit in comparison with the first quarter of FY 2018 shows a difference of AFN 17,212 million.

Broad money (M2) expanded by AFN 464,973.33 million in the quarter under review from AFN 441,161.883 million of the same quarter in the previous year. This change shows 5.4% increase (growth), higher than 1.1% growth of in the same quarter of FY 2018. High growth in broad money is mainly due to money supply in the market. The data shows that M1 is the major component of M2 with 92.85% share.

Figure 2.3: NFA, NDA and M2



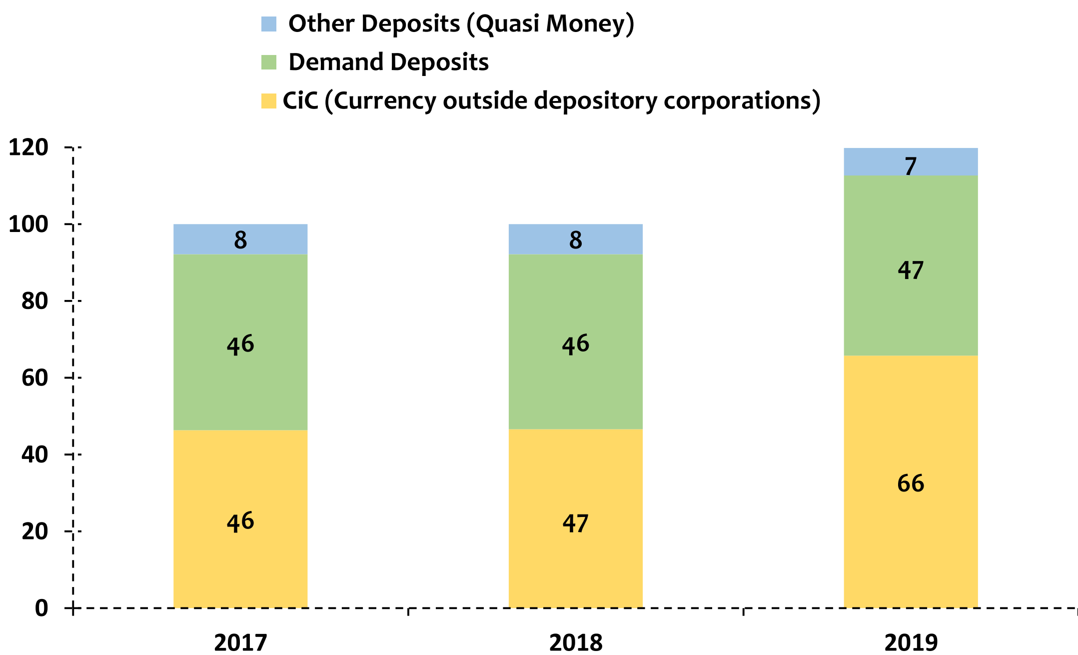
Source: Monetary Policy Department/DAB

Quasi money (other deposits), which is the other component of M2, had negative growth of 3.40% at the end of the first quarter of FY 2019 (1398). Quasi money constitutes 7.15% of broad money at the quarter under review, which is lower than 7.81% at the end of first quarter of FY 2018 (1397).

Therefore, the impact of changes in quasi money on M2 is insignificant. The year-on-year in quarter bases change of Afghani denominated time deposits stood at AFN 9,438 million, showing a negative growth of 22.77%, while foreign currency denominated time deposits rose by 7.25%, reaching to AFN 23,828 million. Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 2.03% and5.12% of M2 respectively.

Demand deposits as a share of broad money stood at 46.95% at the end of the first quarter of year under review (Figure 2.4)

Figure 2.4: CiC, Demand deposits and quasi money as share of broad money (%)



Source: Monetary Policy Department/DAB

Table 2.1: Monetary aggregate for Q1-2018 & Q1-2019

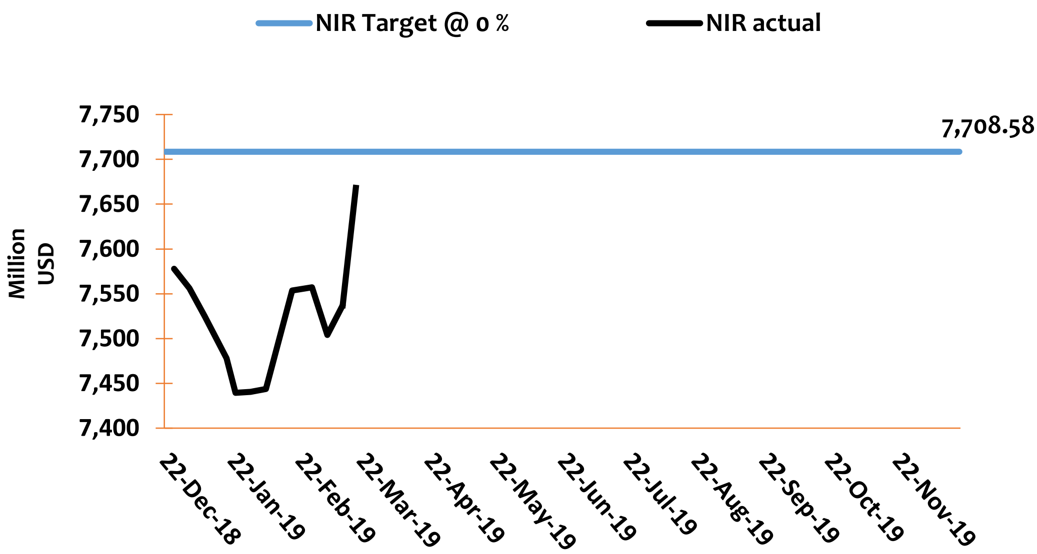
	March-17 Q1	March-18 Q1	Y-o-Y Δ	Difference	March-19 Q1	Y-o-Y Δ	Difference
1- Net Foreign Assets	599,173	654,465	9.2%	55,292	738,943	12.91%	84,479
(a) Foreign Assets	611,094	670,453	9.7%	59,359	750,544	11.95%	80,090
DAB Foreign exchange reserves	498,414	561,526	12.7%	63,112	622,883	10.93%	61,358
Gold	58,803	63,757	8.4%	4,953	69,164	8.48%	5,407
Other	439,611	497,769	13.2%	58,159	553,720	11.24%	55,951
Other foreign assets	112,680	108,928	-3.3%	-3,752	127,660	17.20%	18,733
(b) Foreign Liabilities	11,921	15,988	34.1%	4,067	11,600	-27.45%	-4,388
2. Net Domestic Assets	-159,885.32	-210,591.92	31.7%	-50,707	-271,424.59	28.89%	-60,833
(a) Net Domestic Credit	-42,165	-76,371	81.1%	-34,206	-96,821	26.78%	-20,450
Net Credit to Nonfinancial Public Sector	-88,080	-120,069	36.3%	-31,989	-143,029	19.12%	-22,959
Net Credit to Central Government	-88,175	-120,164	36.3%	-31,989	-143,123	19.11%	-22,959
Credit to Central Government	23,015	15,201	-34.0%	-7,815	7,185	-52.73%	-8,016
Liabilities to Central Government	111,190	135,365	21.7%	24,175	150,308	11.04%	14,943
Net Credit to State & Local Government	0.000	0.000	0.0%	0	0.000	0.00%	0
Net Credit to Public Nonfinancial Corporations	94	94	0.0%	0	94	0.00%	0
Credit to Private Sector	47,183	45,001	-4.6%	-2,182	47,087	4.64%	2,087
Net Credit to Other Financial Corporations	-1,268	-1,302	2.7%	-34	-880	-32.46%	423
(b) Capital Accounts	138,382	159,027	14.9%	20,645	200,473	26.06%	41,445
(c)Other Items Net	20,662	24,806	20.1%	4,145	25,869	4.28%	1,062
3- Broad Money(M2)	436,469.218	441,161.883	1.1%	4,693	464,973.33	5.40%	23,811
Narrow Money(M1)	402,439	406,725	1%	4,286	431,707	6%	24,983
CiC (Currency outside depository corporations)	202,531	205,617	1.5%	3,086	213,388	3.78%	7,770
Demand Deposits	199,908	201,108	0.6%	1,200	218,320	8.56%	17,212
Other Deposits (Quasi Money)	34,030.431	34,437.009	1.2%	407	33,265.906	-3.40%	-1,171
In Afghani	12,543	12,220	-2.6%	-323	9,438	-22.77%	-2,782
In Foreign currency	21,488	22,217	3.4%	729	23,828	7.25%	1,611
Securities Other Than Shares		0.000	0.000	0.000	0.000	0.000	0.000

Source: Monetary Policy Department/DAB

2.3 NET INTERNATIONAL RESERVE (NIR)

Da Afghanistan Bank holds international reserves, which consist of monetary gold, reserve position and holdings of Special Drawing Rights (SDR) with the IMF, as well as major foreign exchange such as US dollars, Euro, Great British Pound and others. The Net International Reserves (NIR) of Afghanistan, which expressed in terms of US dollar, is defined as reserve assets minus reserve liabilities. NIR decreased slightly by 0.53% de-accumulation of USD 40.47 million at the end of the first quarter of FY 2019 (1398). NIR accumulation ceiling was set at USD 7,798.58 million, while in actual case, NIR reached to USD 7,668.11 million for the mentioned period under review.

Figure 2.5: Actual and target trend of NIR during the period under review.



Source: Monetary Sector, Monetary Policy Department/ DAB

2.4 FROEIGN EXCHANGE MARKET

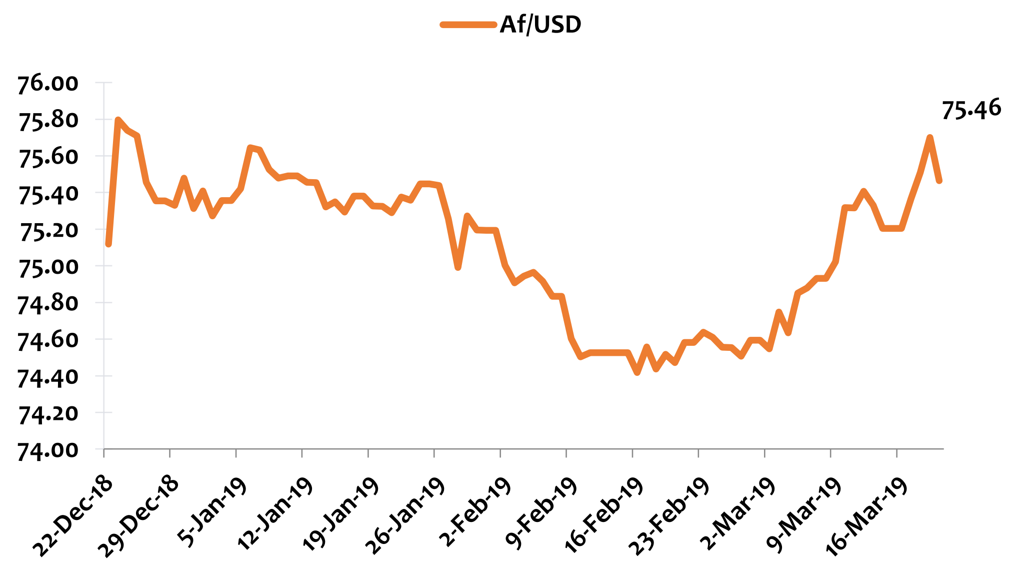
2.4.1 Foreign Exchange Rates

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

During the first quarter of FY 2019 (1398), Afghani relatively depreciated against the Great British pound, European Euro and Swiss Franc, United States Dollar, United Arab Emirates dirham and Saudi Riyal, Indian rupee, Pakistani Rupee, while it appreciated against Iranian Toman.

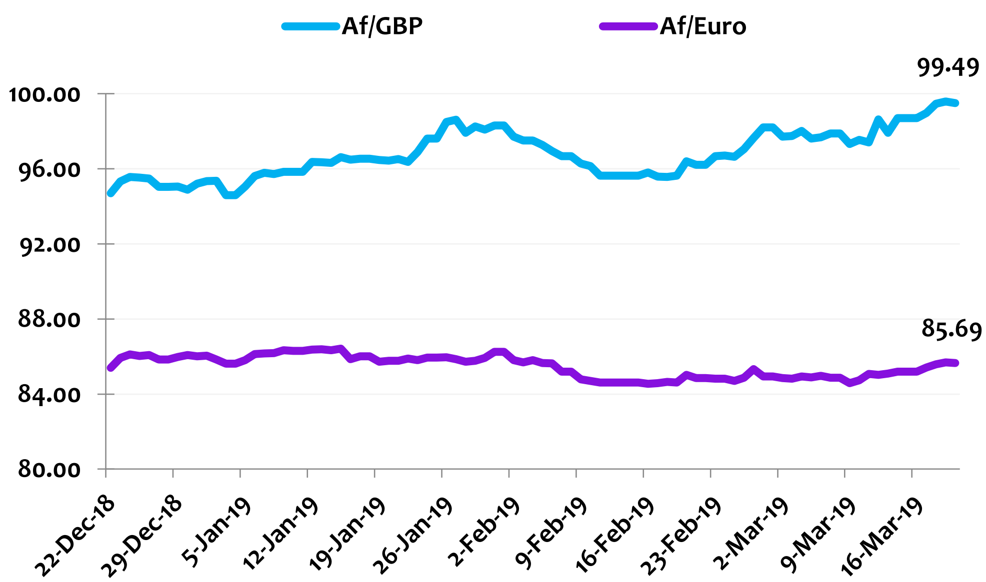
The daily historic review of the average exchange rate of Afghani against the U.S. dollars and other foreign currencies in the first quarter of FY 2019 (1398) are presented in figures below:

Figure 2.6: Daily average ex- rate of Afghani against USD during the first quarter of FY 2019 (1398)



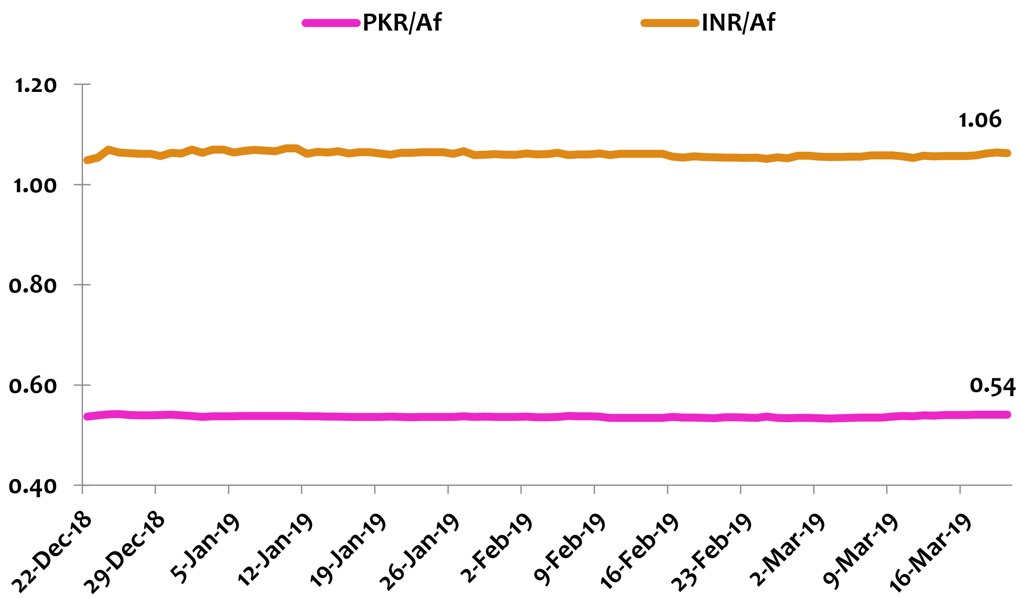
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.7: Daily average ex- rate of Afghani against GBP and Euro during the first quarter of FY 2019 (1398)



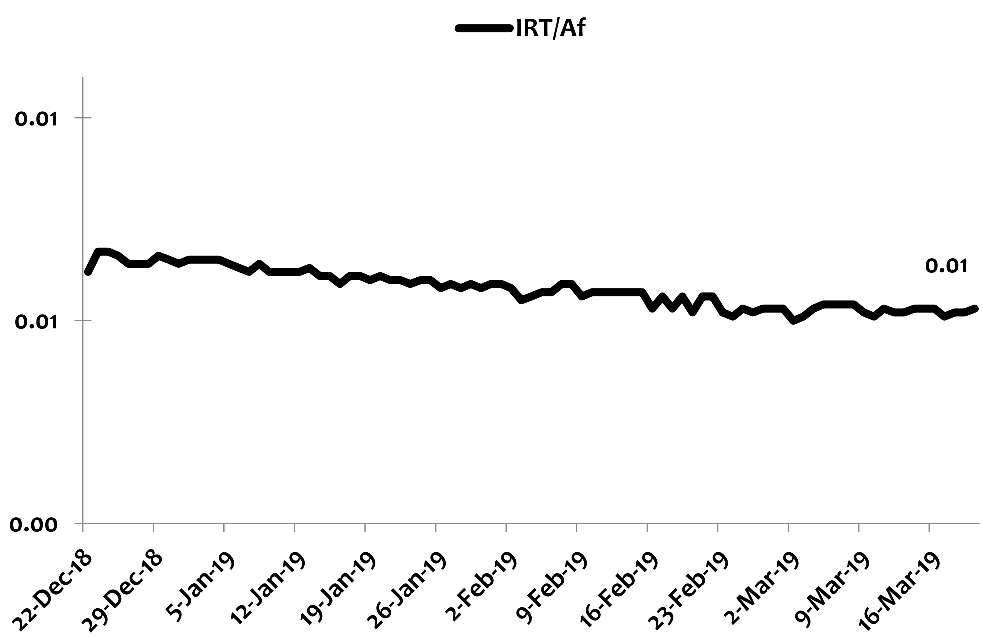
Source: Monetary Sector, Monetary Policy Department/ DAB

figure 2.8: Daily average ex-rate of Afghani against INR and PKR during the first quarter of FY 2019 (1398)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure2.9: Daily average ex- rate of Afghani against IRT during the first quarter of FY 2019 (1398)



Source: Monetary Sector, Monetary Policy Department/ DAB

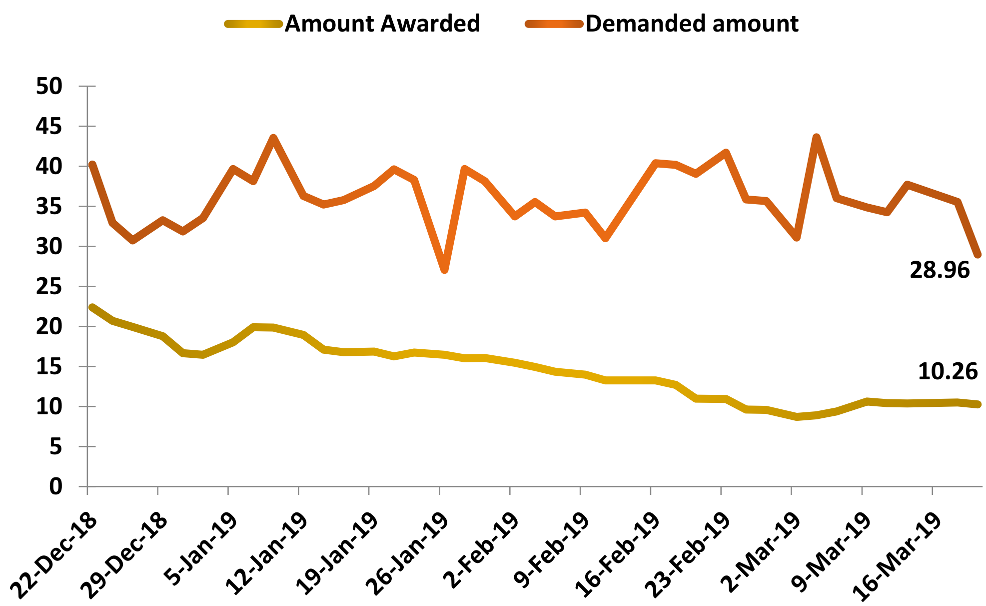
2.4.2 Foreign Exchange Auction

In order to control the money supply and maintain price stability in domestic market, DAB manages the reserve money growth close to its ceiling by conducting FX (USD) auctions three times a week and a weekly capital notes auctions, which are the primary monetary instruments. DAB continued the FX auction to mop up excess liquidity from the market and to smooth out excessive volatility of the exchange rate of Afghani against foreign currencies, especially the U.S dollar.

During the first quarter of FY 2019 (1398), DAB auctioned a total amount of USD 541.94 million, while the total demand was USD 51370.01 million. On average, 59 bidders participated in each auction and 42 bids were announced as the winning bids with the average amount of USD 14.261 million sold in each auction and the total withdrawal is recorded AFN 40.714 billion. In comparison with the 1st quarter of FY 2019 (1398), the data indicates that total auctioned amount was USD 629.69 million during the 1st quarter of FY 2018 (1397), where total demanded amount was USD 883.46 million. On average, 48 bidders participated in each auction and 37 bids were awarded as the winning bids with an average amount of USD 17.991 million in each auction and the total withdrawal is recorded AFN 43.688 billion.

Figure 2.10 shows the total amount of USD, awarded and demanded through auctions in the first quarter of FY 2019 (1398).

Figure2.10: USD awarded and demanded during first quarter of FY 2019 (1398)



Source: Monetary Sector, Monetary Policy Department/ DAB

2.5 CAPITAL MARKET & LIQUIDITY CONDITIONS

2.5.1 Capital Notes Auction

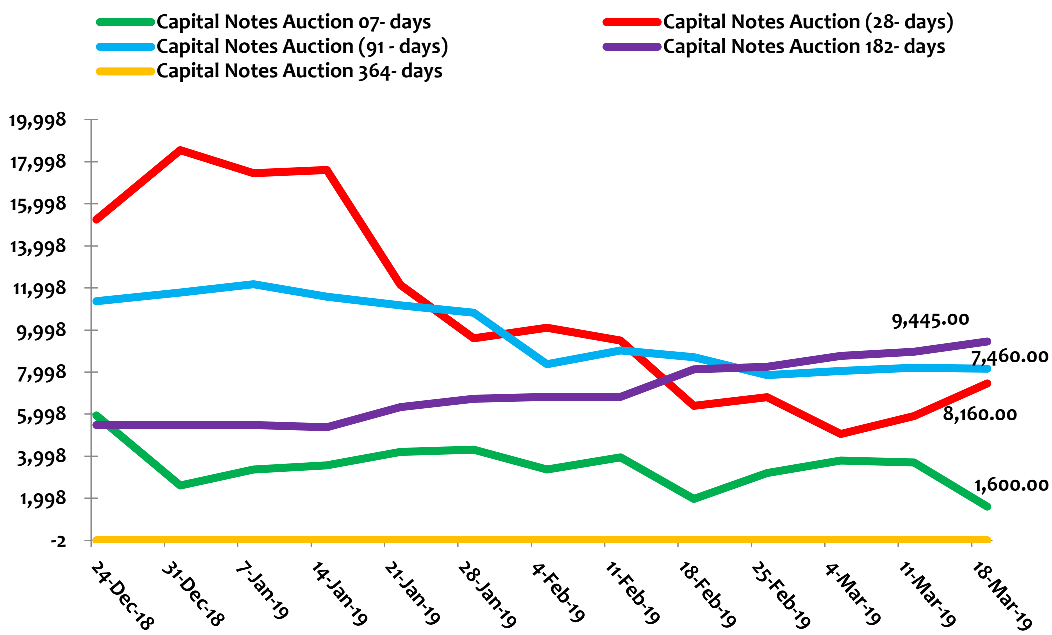
Capital notes are Afghani denominated short–term securities offered by DAB to the primary market customers, which are licensed commercial banks on weekly basis.

Da Afghanistan Bank uses Capital Notes (CNs) as a monetary tool to manage the money supply growth and are used to absorb the excess liquidity of the commercial banks. Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months and one year.

Total outstanding stock of capital notes reached AFN 26.665 billion at the end of the first quarter FY 2019 (1398), which shows an increase of AFN 7.222 billion compared to AFN 19.443 billion at the end of the first quarter of FY 2018 (1397). The main reason for increase in Capital Notes' outstanding amount during the 1st quarter of FY 2019 is due to increase in sales of CNs.

The outstanding stock of 7-days capital notes stood at AFN 1.6 billion, 28-days CNs' outstanding amount stood at AFN 7.46 billion, and 91days outstanding stock of CNs recorded the amount of AFN 8.16 billion. The stock of outstanding amount for 182-days CNs stood at 9.445 billion, and outstanding amount for 364-days CNs is zero, this is because, no auction took place for the mentioned CNs.

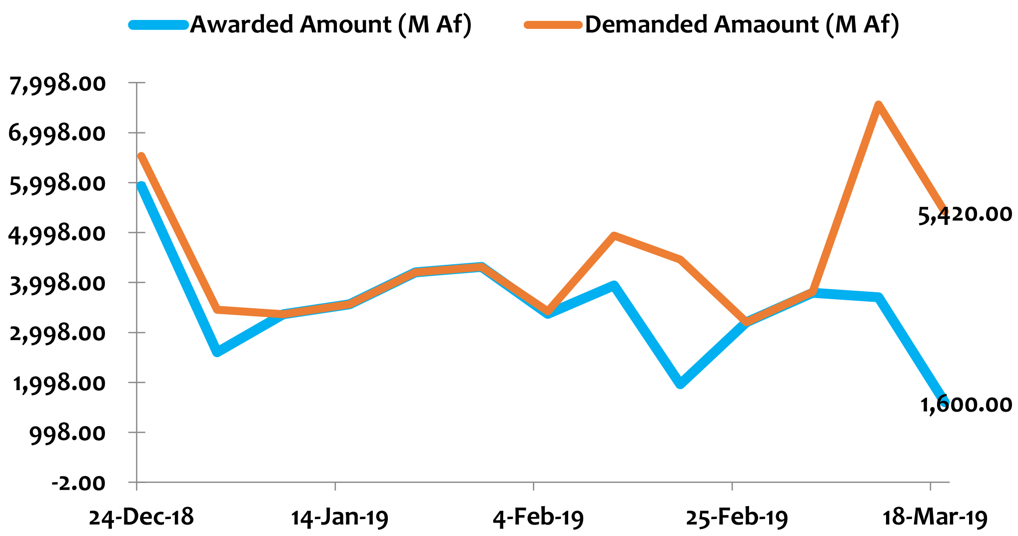
Figure2.11: Capital notes, stock of outstanding during the first quarter of FY 2019 (1398)



Source: Monetary Sector, Monetary Policy Department/ DAB

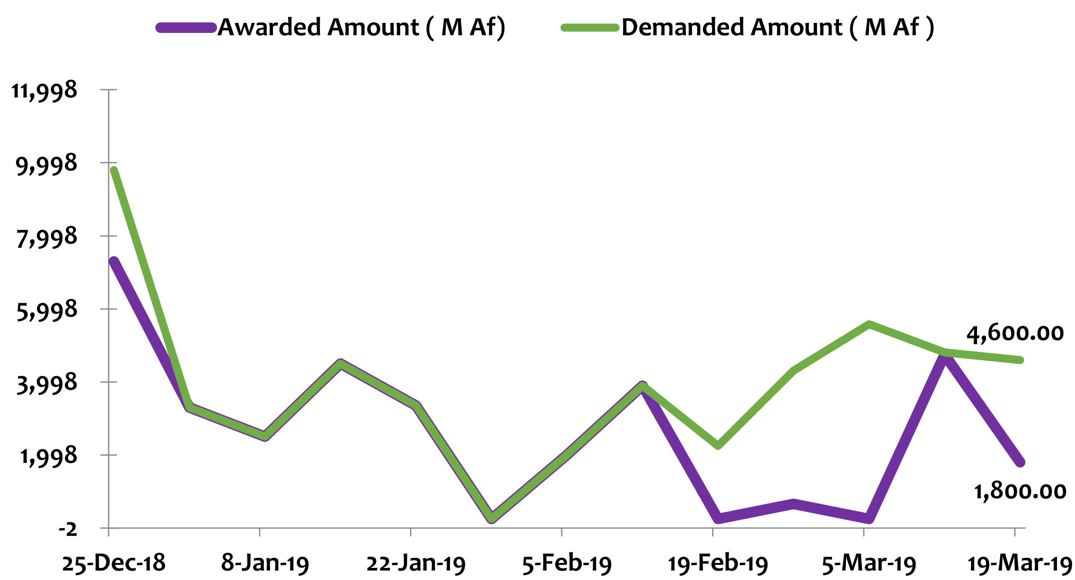
Total amount of interest paid to CNs was AFN 18.77 million at the of the quarter under review. In addition, the weighted average interest rate for 7-days capital note was 0.15%, for 28-days security recorded at 0.36%, for 91-days Capital Notes was 0.55%, for 182-days Capital Notes was 0.75% and for 364-days CNs no interest paid during the first quarter of FY 2019 (1398).

Figure 2.12: 7 days CNs demand and awarded during the first quarter of FY 2019 (1398)



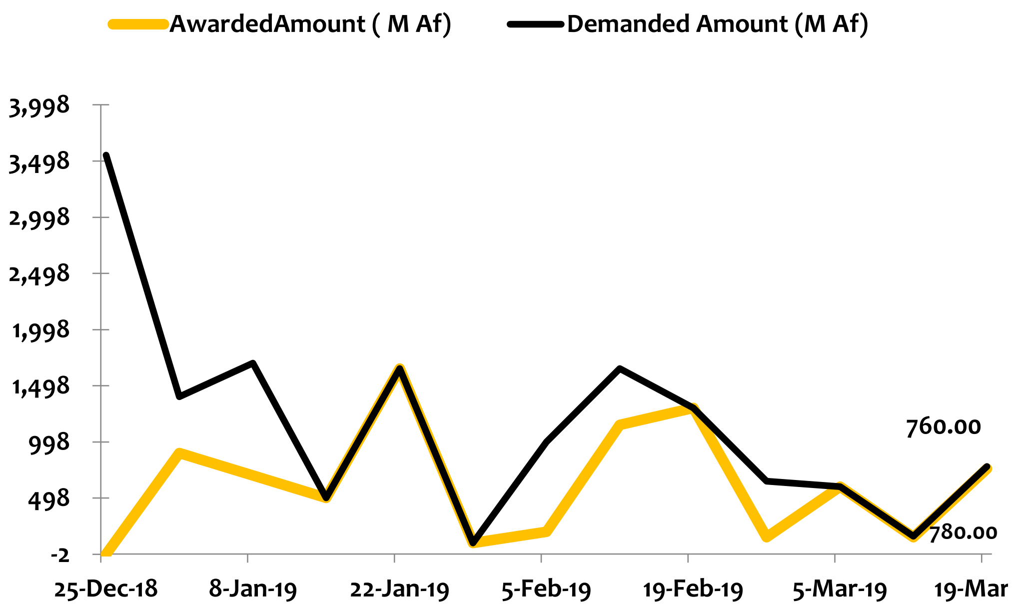
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.13: 28 days CNs demand and awarded amount during the first quarter of FY 2019 (1398)



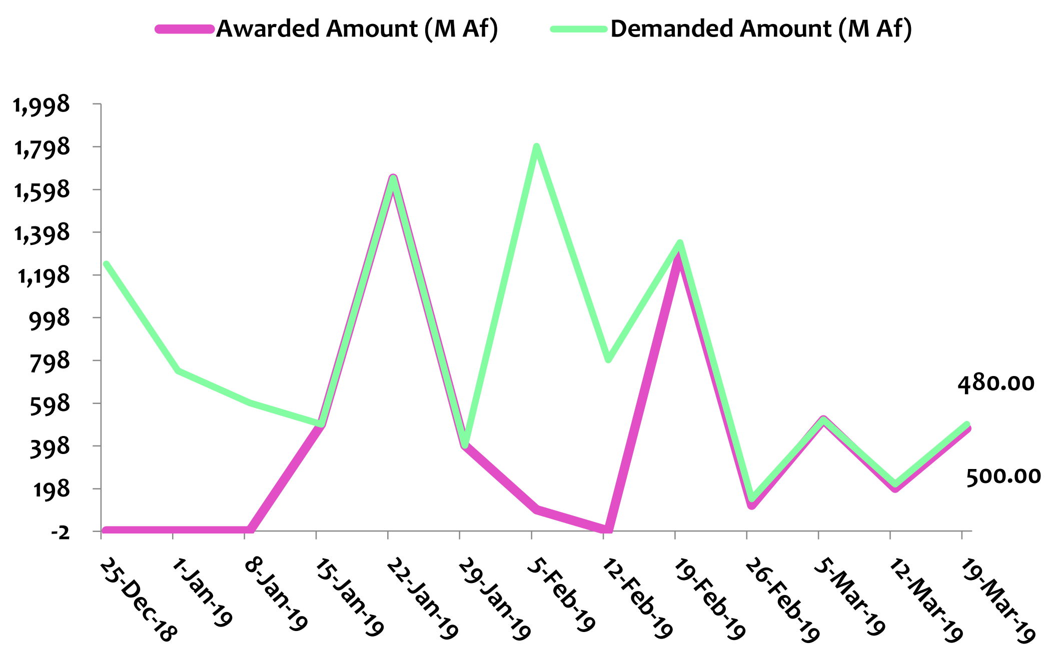
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.14: 91 days CNs demand and awarded during the first quarter of FY 2019 (1398)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.15: 182 days CNs demand and awarded amount during the first quarter of FY 2019 (1398)



Source: Monetary Sector, Monetary Policy Department/ DAB

2.5.2 Required and Excess Reserves

Commercial banks are required to hold 8% of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10% for foreign currency denominated accounts. According to the new regulations, the required reserves are held in the currency of denomination (Domestic and foreign), unlike the previous practice, where required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. The data shows AFN 5,768.54 million, USD 215.33 million and Euro 19.79 million recorded during the first quarter of FY 2019 (1398).

Overnight Deposit Facility (ODF)

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

The outstanding amount of overnight deposit facility recorded AFN 13,451.20 million at the end of the first quarter of FY 2019 (1398) and the payment of interest rate to the mentioned facility reached to AFN 2.14 million for the same period.

Overnight Credit Facility (OCF)

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

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

3

Inflation Trend and Outlook

3

INFLATION TREND AND OUTLOOK

Most commodity prices gained momentum in the first quarter of 2019 following last year's declines, and many have recovered from the previous quarter's lows. Energy prices have diverged as OPEC production cuts have lifted oil prices while record-high U.S. shale gas exports have depressed natural gas and, indirectly, coal prices. Most metal and mineral prices have recovered from losses in the last quarter of 2018, amid strengthening growth prospects for China and supply bottlenecks.

Agricultural prices rose moderately in the first quarter on expectations of lower plantings. Crude oil prices, which averaged USD 68/bbl in 2018, are expected to average USD 66/bbl over 2019 and USD 65/bbl in 2020, with balanced risks primarily related to policy outcomes. Non-energy prices in 2019 are expected to remain below 2018 averages, before rising moderately in 2020 as the global economy emerges from its recent soft patch.

A Special Focus section illustrates the adverse poverty implications of food price spikes that tend to be amplified by commonly used trade-related government responses.

Energy

Energy prices partially recovered in the first quarter of 2019, following a steep decline in almost all energy prices in the preceding quarter. However, there has been significant divergence between different energy commodities. Oil prices have risen 34% since the start of the year, amid production cuts by the Organization of the Petroleum Exporting Countries (OPEC) and other producers, and supply disruptions elsewhere.

In contrast, natural gas prices fell sharply in March and into April in part due to rising liquefied natural gas exports from the United States and Australia, which also weighed on the prices of coal as a close substitute to natural gas. Oil prices are expected to decline from recent highs and average USD 66/bbl in 2019 and USD 65/bbl in 2020, with risks around this outlook broadly balanced.

Non-Energy

Having fallen or having remained subdued in the last quarter of 2018, most non-energy prices had recovered their losses by March, with particularly strong rebounds in metals and minerals.

This recovery in metal prices reflected improving growth prospects for China which accounts for half of global consumption as well as a series of supply bottlenecks and concerns: The Vale dam accident in Brazil (iron ore, nickel); heavy floods in Chile (copper); protests in Peru (copper); smelter restrictions in response to environmental concerns in China (lead, zinc); and export restrictions in Indonesia (tin).

Similarly, supply factors buoyed the return to 2018 levels for most agricultural commodity prices. These included weather-related planting delays for U.S. wheat and corn as well as lower expectations for U.S. soybean plantings on concerns about trade tensions.

Agriculture

Most agricultural commodity prices rose moderately in the first quarter of 2019, following considerable declines during the second half of last year. The World Bank's Agriculture Price Index increased 0.9% in the quarter (q/q), as a 3.4% decline in beverages was balanced by moderate gains in all other categories. The index was still 5.6% lower than a year ago. Most of the factors that depressed prices last year have moderated, including easing of trade tensions and lower prospective plantings in the U.S. for next season's crop. The index is expected to decline 2.6% in 2019 and increase 1.7% in 2020 due to lower production and higher fertilizer prices. Downside risks to the forecast emanate primarily from an escalation of trade tensions. On the upside, higher energy prices could lift the cost of energy-intensive crops, notably grains and oilseeds. Higher-than-projected demand for bio-fuels could also induce higher prices for some commodities.

3.1 CONSUMER PRICES IN AFGHANISTAN

Currently, the consumer price index (CPI) in Afghanistan is compiled on the base prices of April 2015 while previously; the CPI was calculated on the base prices of March, 2011. Similarly, in this revision, the CPI components are also aligned with new weights. As per data from National Statistics and Information Authority (NSIA) and analysis of Da Afghanistan Bank (DAB), the following results were observed in the consumer price index of Afghanistan. The year-on-year measure of the changes in the consumer price index showed Inflation rate of 0.8% on average in the first quarter of 2019 lower than 2.7% recorded in the first quarter of the previous year. The decrease in the inflation rate is in line with low and stable prices of commodities in the global markets. Based on the reports, most items of the global commodity price index indicated lower prices in first quarter of 2019.

Similar to the year-on-year comparison, the inflation measured on quarter to quarter basis, also indicates a decline in the period under review. Observing the previous quarter data, the average inflation rate slightly decreased to 0.8% in the first quarter of 2019, lower than average rate of 0.9% in the previous quarter. The Kabul CPI also reflected disinflation in the first quarter of 2019. Observing the Kabul headline CPI, the inflation rate turned to 0.9% on average in the first quarter of 2019 from 3.2% in the same quarter of the previous year. On quarterly basis, Kabul CPI index decreased to 0.9% on average from 1.7% in the previous quarter.

3.1.1 Developments in the National Headline Inflation (year-on-year changes)

The headline consumer price index reflected a significant decline on year-on-year basis in the first quarter of 2019. As per the available data, the headline inflation measured on year-on-year basis, declined to 0.8% on average in the first quarter of 2019 from 2.7% in the same period of last year while on monthly basis, the inflation rate was recorded at 0.4%, 0.3%, and 1.77% in the months of January, February, and March respectively. In the food index, the inflation declined to 0.8% on average in the first quarter of 2019 from 2.8% in the same quarter of the previous year. In the above mentioned index, the deflationary pressures came from lower prices of meat, milk cheese and eggs, oil and fats and vegetables. The highest decrease in the index was recorded in the prices of vegetables and oil and fats which decreased to -11.2% and -4.2% on average from 11.8% and 3.0% in the same quarter of the previous year. On the other hand, the increase was observed in the price index of bread and cereals, fresh and dried fruits, sugar and sweets, spices and non-alcoholic beverage. The highest increased was observed in sugar and sweets which increased to -1.0% on average in the quarter under review from -7.9% in same quarter of the previous year.

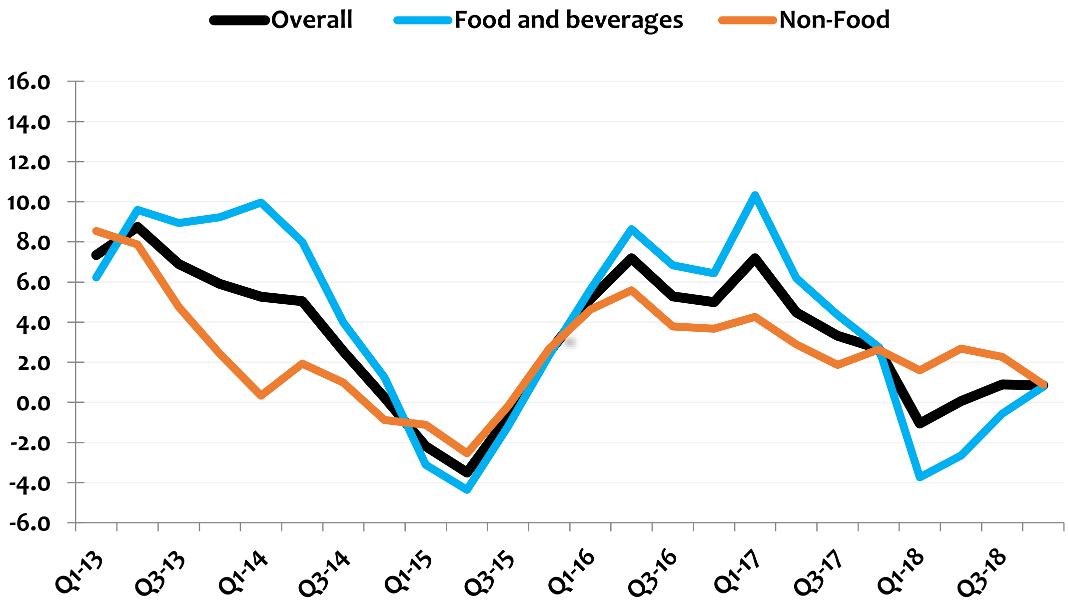
In non-food category, the inflation was declined by lower prices of housing, furnishing and household good, communications, miscellaneous, while inflation increased in the prices of tobacco, health, transportation, information and culture, education and restaurants and hotels. Overall inflation in non-food category declined to average 0.9% from 2.6% in the first quarter of 2019 compared to same quarter of previous year. In the mentioned category, the highest decrease was noted in price index of housing, furnishing and household goods, and communication which declined to -2.8%, 2.8% and -2.6% on average in the first quarter of 2019 from 3.2%, 2.9% and -1.7% recorded in the first quarter of 2018. On the other hand, price index of transportation, education and health, increased to 6.1%, 6.5% and 2.4% on average in the first quarter of 2019 from 2.7%, 1.0% and 1.1 in the same period of previous year respectively. The core inflation shows upward slope in the first quarter of 2019 compared to the first quarter of 2018. The trimmed mean which is the most common measure of core inflation, jumped to 2.3% on average in the first quarter of 2019 from 2.0% in the same period of last year. In addition, the CPI inflation, excluding bread and cereals, oil and fats and transportation, dropped to -0.1% in the first quarter of 2019 down from 2.4% in the same period of previous year.

3.1.2 The National Headline Inflation (Quarter on Quarter Changes)

The short term measure of inflation reflected similar trend as the annual measure. The national headline inflation calculated on quarter on quarter basis decreased to 0.8% on average in the first quarter of 2019 from 0.9% recorded in the previous quarter. The main decrease in the inflation rate was the result of disinflation in food and nonalcoholic beverage is bread and cereals item. In the meantime, the non-food category also showed a lower rate of disinflation compared to the same period of previous year.

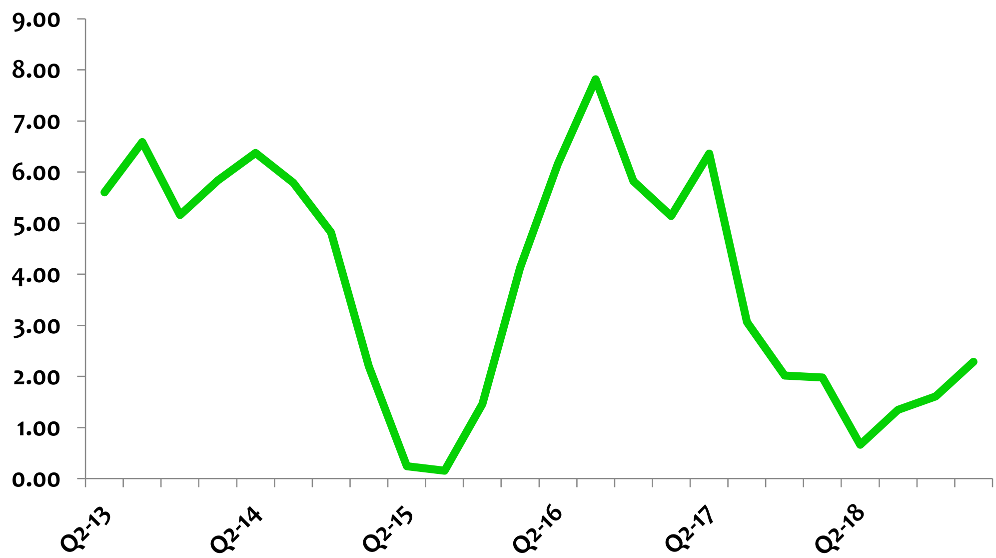
On quarterly basis, the food inflation increased to 0.8% on average in the first quarter of 2019 from -0.6% in the previous quarter of 2018. The price indices of food items such as, fresh and dried fruits, vegetables, sugar and sweets, spices and non-alcoholic beverage increased dramatically but the prices of bread and cereals, milk cheese and eggs, oil and fats, decreased from the previous quarter. However, in this category, the largest quarterly increase was recorded in vegetables and spices, fresh and dried fruits price indices which were recorded as -11.2%, 2.9% and 3.8% respectively On the other hand, the non-food inflation decreased to 0.9% on average in the first quarter of 2019 from 2.3% in the previous quarter. In this category, the prices of clothing, health, information and culture, education and restaurants have been increased. On the other hand, prices decreased in all other sub items of non-food category, the prices declined for tobacco, housing, furnishing and household goods, transportation, communication and miscellaneous in first quarter of 2019.

Figure 3.1: Quarterly Average National Inflation



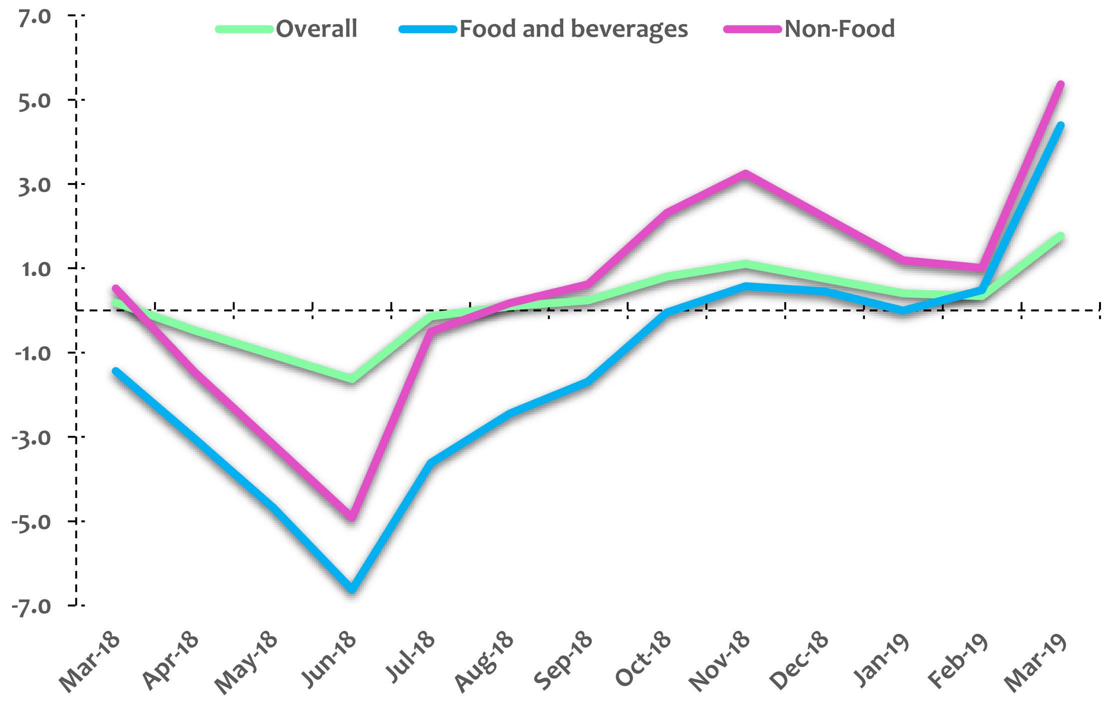
Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

Figure 3.2: Quarterly Trimmed mean



Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

Figure 3.3: National Headline inflation (Y-o-Y)



Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

Table 3.1: National headline inflation 2018-2019

Period	2018									2019			
	Based on Apr 2015												
	Weight	Jan-18	Feb-18	Mar-18	Average (3months)	Oct-18	Nov-18	Dec-18	Average (3months)	Jan-19	Feb-19	Mar-19	Average (3months)
Overall Index	100.0	4.3	3.6	0.2	2.7	0.80	1.11	0.75	0.9	0.41	0.34	1.77	0.8
Food & Non-Alcoholic Beverages	47.8	5.6	4.4	-1.6	2.8	-0.85	-0.53	-0.30	-0.6	-0.41	0.14	2.62	0.8
Bread and Cereals	14.6	5.0	4.9	3.2	4.4	6.74	8.46	8.17	7.8	6.14	5.65	6.88	6.2
Meat	7.5	5.1	4.9	3.2	4.4	1.51	0.79	1.68	1.3	1.39	1.37	1.16	1.3
Milk, cheese and eggs	4.7	3.1	2.1	0.6	1.9	1.81	2.10	1.26	1.7	1.38	1.35	1.92	1.6
Oils and fats	4.6	4.3	3.2	1.6	3.0	-1.64	-2.60	-2.47	-2.2	-2.81	-4.19	-5.46	-4.2
Fresh and dried fruits	5.0	7.7	5.7	-4.3	3.0	-0.86	-3.04	1.01	-1.0	2.45	3.34	5.47	3.8
Vegetables	6.0	23.4	19.1	-7.1	11.8	-17.56	-17.87	-19.00	-18.1	-17.44	-13.67	-2.40	-11.2
Sugar and sweets	2.7	-5.3	-8.0	-10.3	-7.9	-3.42	-1.76	-1.62	-2.3	-0.85	-0.33	4.14	1.0
Spices	1.3	-22.3	-22.8	-26.8	-24.0	-11.68	-5.23	-2.27	-6.4	0.42	3.92	4.21	2.9
Non-alcoholic beverages	1.4	1.8	1.3	0.7	1.3	3.66	4.33	4.49	4.2	5.15	5.39	6.40	5.6
Non-Food Items, Tobacco & Services	52.2	3.1	2.8	2.0	2.6	2.37	2.67	1.76	2.3	1.19	0.53	0.97	0.9
Tobacco	0.3	2.7	2.8	2.4	2.6	6.24	5.98	6.34	6.2	5.56	4.96	4.04	4.9
Clothing	4.6	4.5	4.3	3.9	4.2	3.25	2.41	4.18	3.3	5.22	4.05	3.25	4.2
Housing	19.1	4.2	3.7	1.6	3.2	0.34	0.74	-1.39	-0.1	-2.73	-3.36	-2.31	-2.8
Furnishing and household goods	11.9	3.4	3.0	2.3	2.9	3.32	4.18	3.75	3.7	2.59	2.71	3.20	2.8
Health	6.2	0.8	0.9	1.5	1.1	0.57	1.29	1.60	1.2	3.04	2.14	1.89	2.4
Transportation	4.3	2.9	2.9	2.4	2.7	10.57	10.82	8.74	10.0	7.79	4.80	5.77	6.1
Communication	1.7	-2.0	-2.0	-1.1	-1.7	0.79	-0.92	-1.7	-0.6	-2.63	-2.39	-2.83	-2.6
Information and Culture	1.1	-3.3	-2.7	-1.4	-2.5	1.06	-0.38	-0.90	-0.1	-0.24	0.95	0.35	0.4
Education	0.4	0.4	0.7	1.9	1.0	4.84	6.53	6.40	5.9	7.88	5.32	6.24	6.5
Restaurants and Hotels	1.1	1.8	1.4	1.1	1.5	3.01	2.18	2.51	2.6	3.06	3.62	3.20	3.3
Miscellaneous	1.4	4.9	3.9	3.8	4.2	2.48	2.45	1.40	2.1	1.74	0.69	0.35	0.9
CPI ex. B & C, O & F, and T		4.3	3.4	-0.5	2.4	-0.66	-0.52	-0.82	-0.7	-0.85	-0.60	1.06	-0.1
30% trimmed mean		2.7	2.4	0.9	2.0	1.72	1.48	1.61	1.6	2.02	2.23	2.62	2.3

Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

3.1.3 Development in the Kabul Headline Inflation (year-on-year changes)

The headline CPI inflation in Kabul declined to 0.9% on average in the first quarter of 2019 from 3.2% in the first quarter of the previous year. The food index, which is accounted for 37.2% of the overall weight of the overall index, reflected a disinflation in one-year period. In this category, the deflationary pressures came from lower prices of meat, milk, cheese and eggs, oil and fats, fresh and dried fruits, and vegetables. As a result, the food inflation decreased to 2.0% on average in first quarter of 2019 from 4.4% in the same quarter of 2018.

The inflation of non-food items which comprise 62.8% weight of the whole index, decreased to 0.2% on average in the first quarter of 2019 from 2.5% in the same period of last year. The decrease is mainly attributed to lower prices of clothing, and housing items. However, in this category, the inflation in tobacco increased to 3.6% on average from 1.5% and transportation increased to 3.2% on average from 1.1% in the same period of last year.

On the other hand, the core inflation excluding bread & cereals, fats and oils and transportation also indicated a decline in the period under review compared to the same period previous year. In the first quarter of 2019, the core inflation rate decreased to 0.2% on average while the rate was recorded 3.2% in the first quarter of 2018. The 30% trimmed mean reflected an inflation of 2.6% on average in the first quarter of 2019 compared to 1.4% in same quarter of 2018.

3.1.4 The Kabul Headline Inflation (Quarter on Quarter Changes)

The quarter on quarter measure of headline inflation in Kabul indicated downward movement. The headline inflation in Kabul declined to 0.9% on average in first quarter of 2019 from 1.7% recorded in the previous quarter.

Inflation in the food index increased to 2.0% on average in the first quarter of 2019 from 0.2% in the previous quarter. In this category, the prices of bread and cereals, milk, cheese and eggs, oil and fats decreased during the period under review. In this category, the highest decline was observed in the price index of oil and fats which turned to -2.6% on average in the first quarter of current year from 0.5% in previous quarter. On the other hand, the inflation in spices showed an increase on quarterly basis which picked up to 7.1% on average in the first quarter from -2.3% in the previous quarter which lead to inflation rate in food & non-alcoholic items.

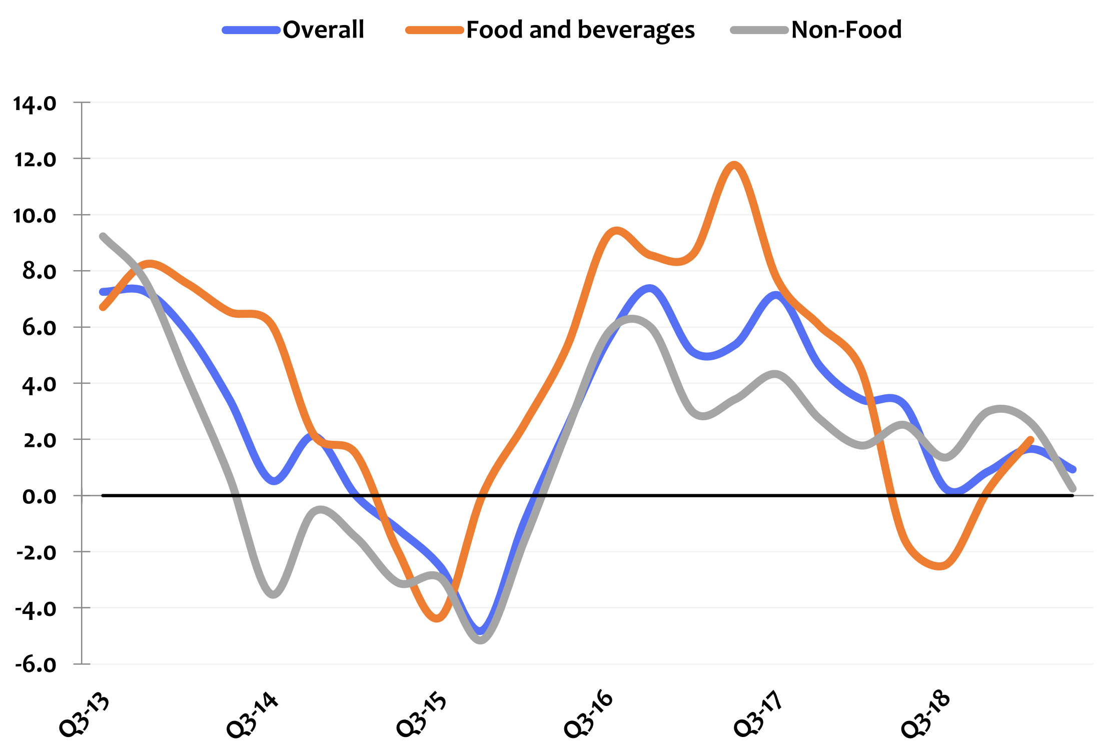
The Non-food category of the CPI showed disinflation rate during the first quarter of 2019. Non-food category decreased to 0.2% on average in the first quarter compared to 2.6% in the previous quarter. The decrease in non-food disinflation is driven by lower prices of all non-food items such as tobacco, clothing, housing, furnishing and household, clothing, housing, health, education, and miscellaneous items among which the largest decrease was observed in the price of housing item which decreased to -3.9% in the first quarter of 2019 from -0.5% in the previous quarter.

Base on first quarter 2019 statistic data the near-term outlook of inflation is likely to remain balanced and move upward gradually. Monetary policy of central bank Afghanistan forecasts inflation rate 1% to 3% for the second quarter of 2019. The forecast is based on the following course of factors. First, as Afghanistan is an imported country and Afghanistan inflation is imported from neighboring countries such as Iran, Pakistan and other trade partner countries. According to the World Bank report Iran and Pakistan have experienced high inflation rate during first quarter of the 2019.

Second, according to Afghan Chamber of Commerce and Industries (ACCI), Millions of dollars in hard currency enter Iran via the Islam Qala border crossing in Herat Province daily, as result illegal U.S dollars' flow from Afghanistan to Iran has also depreciated afghan currency which has huge impact on inflation. Keeping in mind the above facts and figures, U.S sanctions on Iran have been affecting Afghanistan economy in terms of exchange rate and inflation.

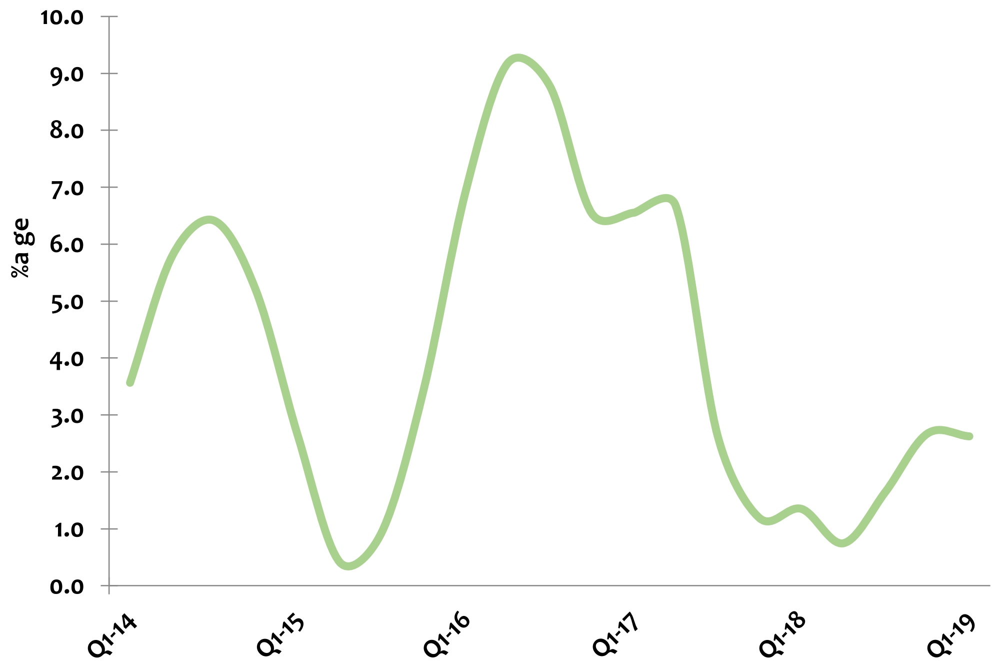
Moreover, Afghanistan is a consuming country and imports are at a greater quantity from neighboring countries, national inflation rate is often influenced by imported inflation of Iran, Pakistan, China, Tajikistan and Uzbekistan. Additionally, the exchange rate of the local currency has been depreciating continuously which has been effecting Afghanistan inflation rate. This case is not only in Afghanistan, but in the whole region especially with Afghanistan Trade partner countries.

Figure 3.4: Kabul Quarterly Average Inflation (%)



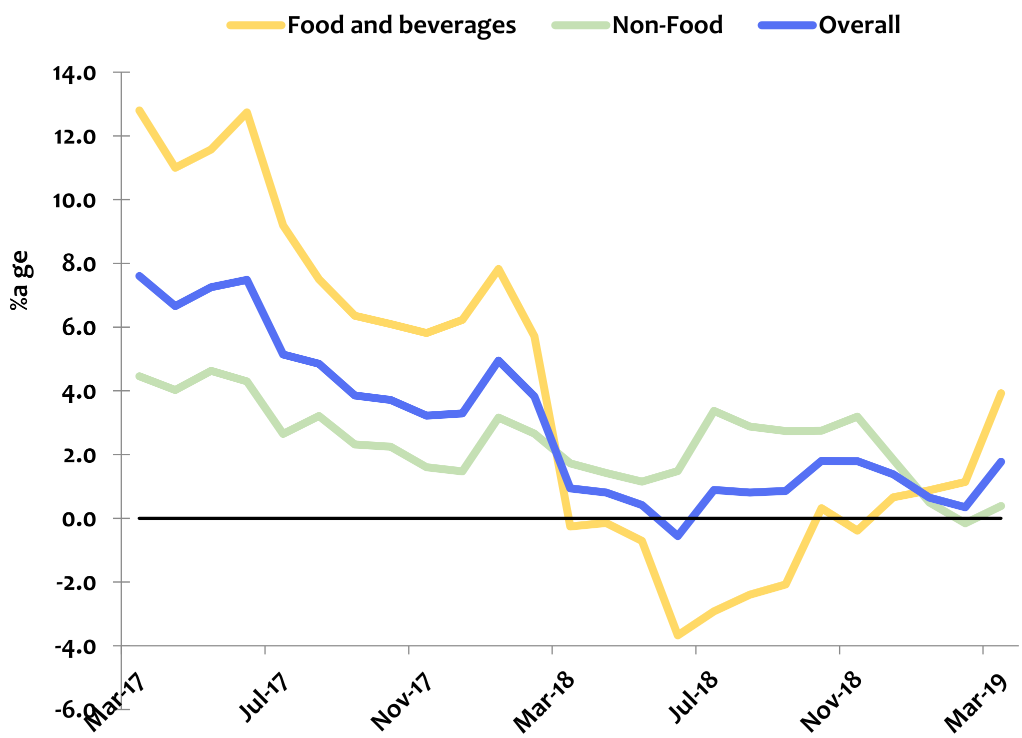
Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

Figure 3.5: Kabul Quarterly Average (30%Trimmed Mean)



Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

Figure 3.6: Kabul Annual Headline Inflation



Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

Table 3.2: Kabul headline inflation 2018-2019

Period	2018									2019			
	Based on Apr 2015												
	Weight	Jan-18	Feb-18	Mar-18	Average (3 month2016)	Oct-18	Nov-18	Dec-18	Average (3mounth)	Jan-19	Feb-19	Mar-19	Average (3mounth)
Overall Index	100.0	4.9	3.8	0.9	3.2	1.8	1.8	1.4	1.7	0.6	0.4	1.8	0.9
Food & Non-Alcoholic Beverages	37.2	7.8	5.7	-0.3	4.4	0.3	-0.4	0.7	0.2	0.9	1.1	3.9	2.0
Bread and Cereals	9.8	7.3	5.7	5.6	6.2	10.9	11.1	9.8	10.6	7.3	8.1	8.3	7.9
Meat	6.4	6.4	6.1	6.2	6.2	3.5	2.5	4.8	3.6	4.2	4.4	2.8	3.8
Milk, cheese and eggs	3.2	-1.0	-1.6	-2.3	-1.6	5.3	5.9	5.6	5.6	4.5	5.3	2.8	4.2
Oils and fats	3.6	1.7	0.4	-1.6	0.2	0.6	1.0	0.0	0.5	-0.5	-1.8	-5.5	-2.6
Fresh and dried fruits	5.2	15.8	12.5	2.3	10.2	-4.3	-9.1	-3.3	-5.5	1.5	0.3	2.5	1.4
Vegetables	4.2	30.8	23.6	-8.1	15.4	-17.9	-20.4	-19.7	-19.3	-17.6	-15.2	2.6	-10.1
Sugar and sweets	2.8	-0.1	-3.5	-6.6	-3.4	-2.3	1.1	1.3	0.0	0.5	-2.1	7.5	2.0
Spices	1.0	-19.6	-18.0	-21.5	-19.7	-6.7	-2.4	-0.4	-3.2	4.3	8.4	8.7	7.1
Non-alcoholic beverages	0.9	0.4	1.0	0.0	0.5	5.1	5.9	6.1	5.7	5.8	7.4	6.0	6.4
Non-Food Items, Tobacco & Services	62.8	3.2	2.7	1.7	2.5	2.7	3.2	1.8	2.6	0.5	-0.2	0.4	0.2
Tobacco	0.3	2.2	0.9	1.3	1.5	4.5	3.2	3.5	3.7	3.9	3.9	3.2	3.6
Clothing	4.8	5.1	4.4	4.4	4.7	4.4	2.0	5.2	3.9	3.7	0.7	-0.6	1.3
Housing	23.5	4.4	3.8	1.6	3.3	0.2	0.8	-2.5	-0.5	-3.8	-4.6	-3.4	-3.9
Furnishing and household goods	17.6	3.6	3.2	2.4	3.1	4.4	5.7	5.3	5.1	2.8	3.3	4.0	3.4
Health	5.3	0.6	0.7	2.0	1.1	2.1	1.8	1.4	1.8	1.7	2.1	1.4	1.7
Transportation	4.6	2.5	1.4	-0.6	1.1	7.8	9.0	5.8	7.5	4.7	1.1	3.8	3.2
Communication	2.0	-3.7	-4.1	-2.3	-3.4	1.9	0.9	1.6	1.5	-0.6	0.1	-1.0	-0.5
Information and Culture	1.7	-5.9	-4.9	-2.5	-4.4	1.4	-2.1	-2.6	-1.1	-1.8	-0.2	-2.2	-1.4
Education	0.7	0.5	1.1	2.8	1.5	6.3	8.8	8.7	7.9	9.8	6.2	7.6	7.8
Restaurants and Hotels	1.0	1.8	0.6	-0.4	0.7	2.3	1.7	2.8	2.3	2.0	3.3	0.7	2.0
Miscellaneous	1.3	3.5	2.0	2.0	2.5	4.4	5.7	4.2	4.7	5.8	4.0	3.0	4.3
CPI ex. B & C, O & F, and T		5.0	3.9	0.7	3.2	0.5	0.4	0.3	0.4	-0.3	-0.4	1.3	0.2
30% trimmed mean		2.5	1.4	0.3	1.4	2.7	2.6	2.7	2.7	2.8	2.3	2.8	2.6

Source: Central Statistics Office/Monetary Policy Department, DAB staff calculation

4 External Sector Developments

4

EXTERNAL SECTOR DEVELOPMEN

The highlights of some major developments in the external sector of the Afghan economy for the first quarter of the FY 2019 in comparison with the corresponded quarter of the previous year are captured in this chapter.

The available data show that the external sector of the economy improved in the first quarter of the FY 2019 with a contraction in the trade deficit. The trade deficit narrowed as a result of an increase in the export earnings together with a reduction in import expenditure.

These developments, together with an increase in receipts in respect of services account together with an increase of workers' remittances and income inflows helped to reduce the external current account deficit to a value of USD 1,226.41 million in the first quarter of the FY 2019 compared to a deficit of USD 1,228.87 million in the first quarter of the FY 2018.

Inflow to the capital account decreased on account of capital transfers to the government sector. Foreign Direct Investment (FDI) net inflows declined while net Portfolio Investment outflows increased during the first quarter of the FY 2019. In view of the improvement in both the current and financial accounts, the BOP recorded a deficit of USD 1,091.83 million in the first quarter of the FY 2019 compared to the deficit of USD 1,270.79 million recorded in the first quarter of the FY 2018. The official reserve assets rose to USD 29.31 million in the first quarter of the FY 2019 compared to USD 22.79 million in the first quarter of the FY 2018.

4.1 BALANCE OF PAYMENTS

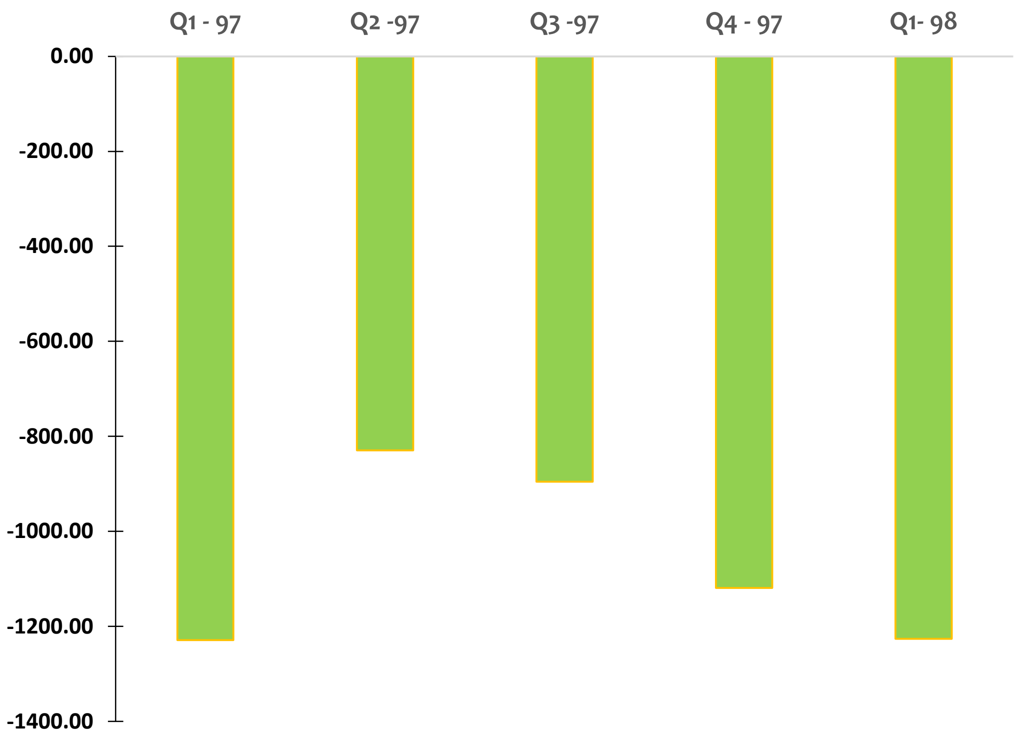
4.1.1 Current Account

The current account of the balance of payments posted a deficit of USD 1,226.41 million in the first quarter of the FY 2019 compared to a deficit of USD 1228.87 million in the same quarter of the previous year. (Table 4.1, figure 4.1).

The slight reduction in current account deficit was primarily as a result of an increase in export earnings together with a reduction in import expenditures as well as increases in the receipts in respect of services account and workers' remittances inflows to the country during the first quarter of the FY 2019.

Earnings from export of goods as a total increased by 6% to a value of USD 182.75 million in the first quarter of the FY 2019 from a value of USD 172.45 million recorded in the first quarter of the FY 2018. Likewise, expenditure on import of goods decreased by 7% to a value of USD 1,710.47 million in the first quarter of the FY 2019 from a value of USD 1783.94 million recorded in the first quarter of the previous year. The deficit of the services account decreased significantly by 61% to a value of USD 45.17 million in the first quarter of the FY 2019 from a value of USD 115.75 million recorded in the first quarter of the FY 2018, mainly due to a rise in net earnings from construction, transportation and other business services.

Figure 4.1: Current account balance (in million USD)



Source: CSO/DAB staff calculations

Net private transfer receipts, mainly representing remittances by Afghans employed overseas significantly rose by 17% to a value of USD 138.94 million in the first quarter of the FY 2019 from a value of USD 118.59 recorded in the corresponding quarter of the previous year. Net official transfers (grants) to the government sector declined by 60% to a value of USD 162.08 million in the first quarter of the FY 2019 from a value of USD 408 million recorded in the first quarter of the previous year.

4.1.2 Capital Account

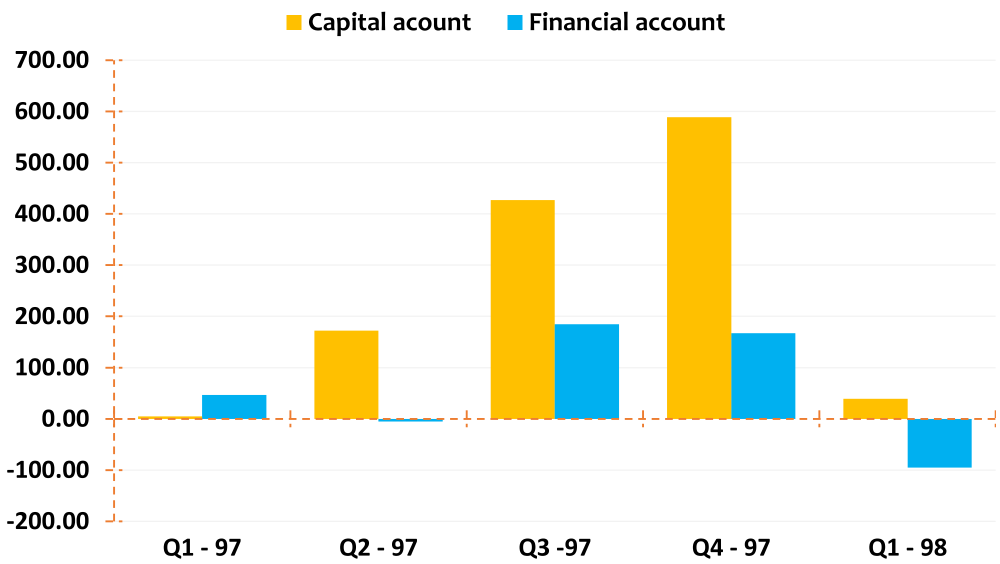
The surplus in the capital account of the balance of payments increased considerably by 714% to a value of USD 39.42 million in the first quarter of the FY 2019 from a value of USD 4.84 million recorded in the first quarter of the FY 2018 as a result of higher inward of capital transfers to the government sector, corporations and households (table 4.1 figure 4.2).

4.1.3 Financial account

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

Net FDI inflows to the country decreased by 44% to a value of USD 17.58 million in the first quarter of the FY 2019 from a value of USD 31.58 million recorded in the first quarter of the FY 2018. The net portfolio investment depicted an outflow of USD 19.96 million in the first quarter of the FY 2019, primarily in the money market instrument segment, as compared with net outflow of USD -54.02 million recorded in the corresponding quarter of the last year.

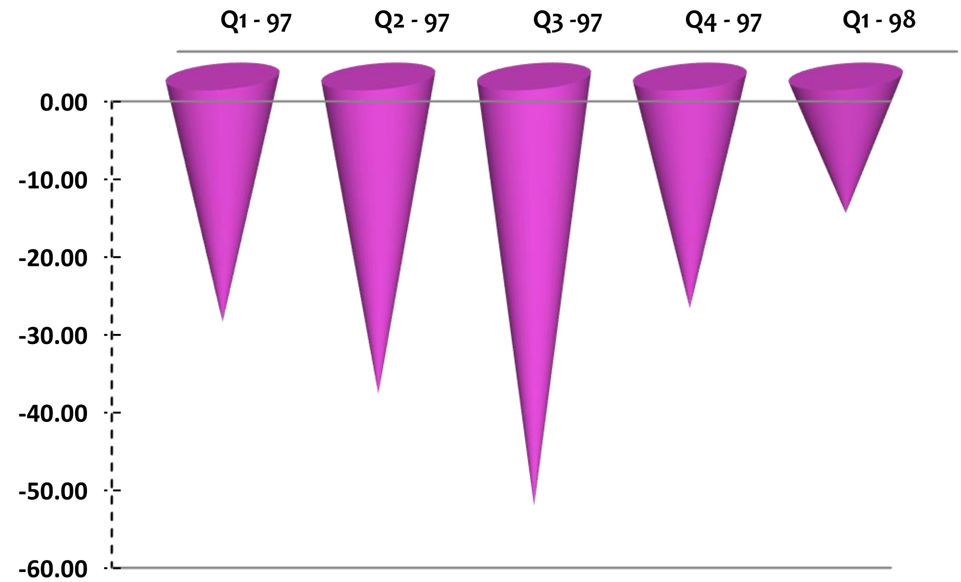
Figure 4.2: Capital and Financial Account (in million USD)



Source: CSO/DAB staff calculations

Further analysis reveals that the country's other aggregate financial assets abroad decreased to a value of USD -131.36 million in the first quarter of the FY 2019 from a value of USD 80.47 million recorded in the corresponding quarter of the FY 2018 (Table 4.1 figure 4.3). On the other hand, total aggregate financial liabilities, decreased to a value of USD 4.51 million in the first quarter of the FY 2019 from a value of USD 29.11 million recorded in the same quarter of the previous year. Reserve assets (on a BOP basis) increased by 29% to a value of USD 29.31 million in the first quarter of the FY 2019 as compared to a value of USD 22.79 million recorded in the first quarter of the FY 2018 as a result of increasing foreign exchange reserves. The financial account balance as a total recorded a value of USD - 95.16 million in the first quarter of the FY 2019, compared to a value of USD 46.8 million recorded in the first quarter of the FY 2018.

Figure 4.3: FDI inflows (in million USD)



Source: CSO/DAB staff calculations

4.2 MERCHANDISE TRADE

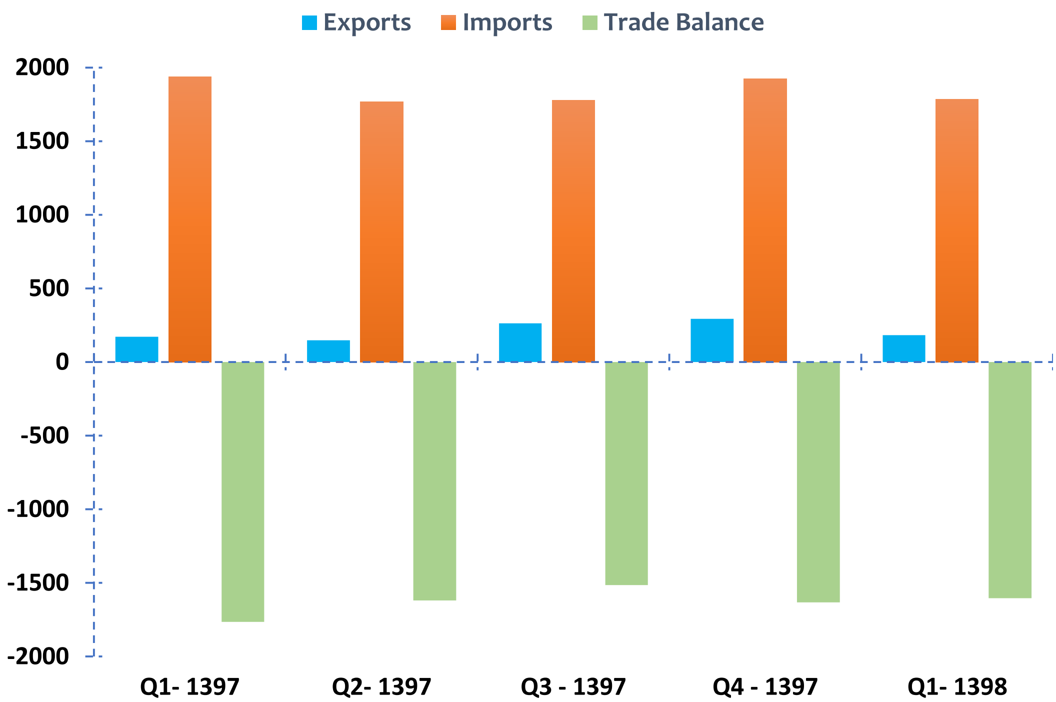
During the first quarter of the FY 2019, Afghanistan's aggregate merchandise exports amounted USD 182.57 million compared to USD 172.45 million in the first quarter of the FY 2018, register a positive growth of 6%. Simultaneously, the aggregate merchandise imports amounted USD 1,786.43 million compared to USD 1,936.84 million in the first quarter of the FY 2018, registering a negative growth of 8%.

As a result, merchandise trade deficit in the first quarter of the FY 2019 decreased by 9% to a value of USD 1603.77 million as compared with a value of USD 1764.38 million recorded in the first quarter of the FY 2018. (Table 4.2 figures 4.4).

Among the exporting components, the exports of all items increased apart from medical seeds during the quarter under review. Exports of food items (fresh fruits, dry fruits and oil seeds) increased by 10% to a value of USD 83.93 million in the first quarter of the FY 2019 from a value of USD 76.32 million recorded in the first quarter of the FY 2018.

Similarly, exports of carpet and rugs increased by 17% to a value of USD 6.57 million in the first quarter of the FY 2019 as against USD 5.62 million recorded in the first quarter of the FY 2018 While, exports of medical seeds declined slightly by 1% to a value of USD 82.37 million in the first quarter of the FY 2019 from a value of USD 83.41 million recorded in the first quarter of the previous year.

Figure 4.4: Trade Performance and Trade Balance



Source: CSO/DAB staff calculations

In the importing components, the decreases were registered in the value of three importing commodity divisions, in particular; imports of consumer goods, capital goods and industrial supplies. The imports of consumer goods declined by 11% to a value of USD 741.35 million in the first quarter of the FY 2019 from a value of USD 828.96 million recorded in the first quarter of the FY 2018.

The imports of capital goods declined by 17% to a value of USD 568.74 million in the first quarter of the FY 2019 from a value of USD 686.91 million recorded in the first quarter of the FY 2018, and the imports of industrial supplies declined by 13% to a value of USD 173.92 million in the first quarter of the FY 2019 from a value of USD 200.38 million recorded in the first quarter of the FY 2018.

Conversely, imports of fuel and lubricants significantly increased by 37% to a value of USD 302.34 million in the first quarter of the FY 2019 from a value of USD 220.58 million recorded in the first quarter of the FY 2018. A result, a significant change in the import structure in favour of industrial supplies and capital goods has been observed during the first quarter of the FY 2019. Industrial supplies mainly comprise of metal productions, fertilizers and cement which are essentials for economic development. Therefore, lower imports of such goods are an obvious evidence of slowing down of economic activities in the country especially, in the industrial and construction sectors.

4.3 DIRECTION OF TRADE

The major trading partners of Afghanistan are Pakistan, Iran, India, China, and Common Wealth of Independent States (CIS). Pakistan, India, Iran, China and CIS countries remained the largest export destinations for Afghanistan, while major import origins are; Pakistan, India, Iran, Germany, China, USA, Japan and CIS countries.

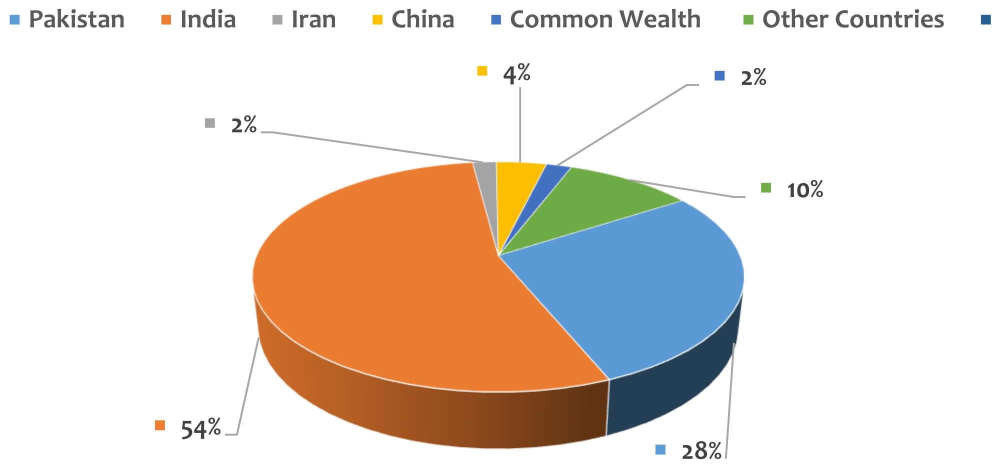
India ranked the first largest buyer of Afghanistan's exports in the first quarter of the FY 2019. The share of Afghanistan's exports to India dropped slightly to 52% in the first quarter of the FY 2019 from 53% recorded in the preceding and corresponding quarter of the last year, registering 5% increase in export earnings over the first quarter of the last year. Food items (fresh and dry fruits), medical seeds and saffron are the major exporting items to India which accounted for 4%, 1%, and 2% of total exports to India respectively. **Pakistan graded the second largest buyer of Afghanistan's exports in the first quarter of the FY 2019.**

The share of Afghanistan's exports to Pakistan is almost remained unchanged -2%, but in terms of value, registered 6% growth in export earnings over the first quarter of the last year. Food items, medical seeds, and cotton products are the major exporting items to Pakistan which accounted for 4%, 45% and 4% of total exports to Pakistan respectively.

China graded the third largest buyer of Afghanistan's exports in the first quarter of the FY 2019. The share of exports to China increased to 4% in the first quarter of the FY 2019 from 2.2% recorded in the first quarter of the FY 2018, registering an 84% growth in the exports earnings in the quarter under review. Dry fruits are the main exporting items to China which accounted for approximately USD 4.8 million of the total exports.

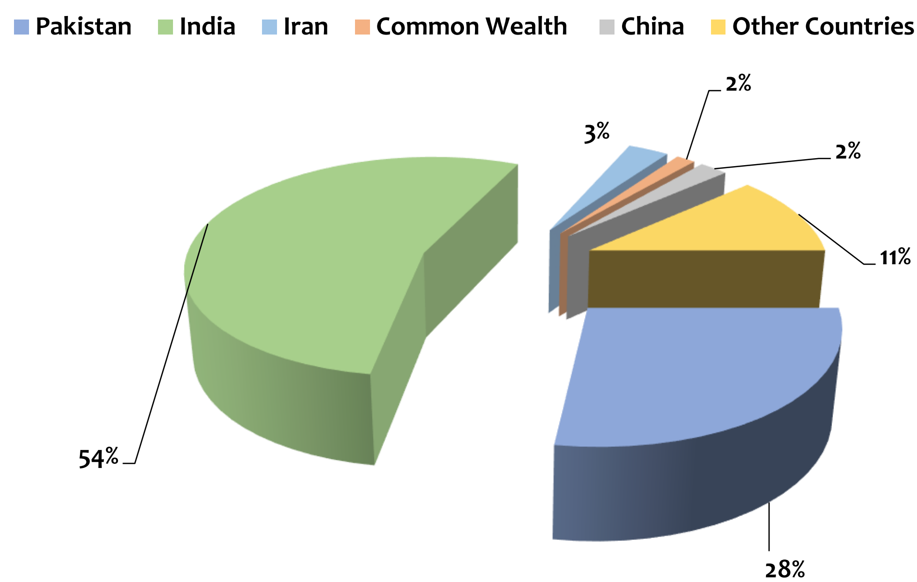
Iran ranked the last largest buyer of Afghanistan's exports in the first quarter of the FY 2019. The share of exports to Iran declined to 2% in the first quarter of the FY 2019 from 3% recorded in the first quarter of the FY 2018, registering 39% reduction in export earnings in the first quarter of the FY 2019, (table 4.3 & 4.4 and figure 4.5 & 4.6).

Figure 4.5: Direction of Exports (% share) in Q1 - FY 2019



Source: CSO/DAB staff calculations

Figure. 4.6: Direction of Exports (% share) in Q1- FY 2018



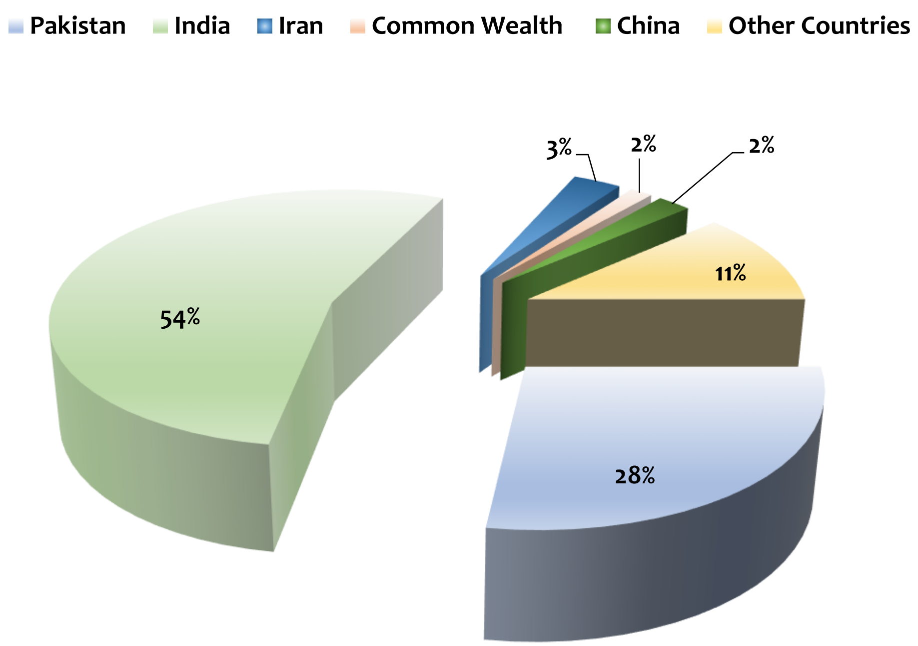
Source: CSO/DAB staff calculations

CIS countries continued to be the single largest source of imports for Afghanistan. During the quarter under review, the imports from CIS countries declined to a value of USD 467.73 million with share of 26% in the first quarter of the FY 2019 from a value of USD 601.32 million with share of 31% in the first quarter of the FY 2018 registering a 22% reduction. The main imported items from CIS countries were (flour and wheat, veg. oil, petroleum oil, Electricity, Metal production, fertilizers and cement).

China graded the second largest import origin to Afghanistan which accounted for 18.8% of total imports in the first quarter of the FY 2019. Aggregate imports from China increased to a value of USD 336.22 million in the first quarter of the FY 2019 from a value of USD 294.39 million in the first quarter of the FY 2018, registering a 14% growth in total imports during the quarter under review. The main imports from China were; spare parts, industrial supplies and consumer goods.

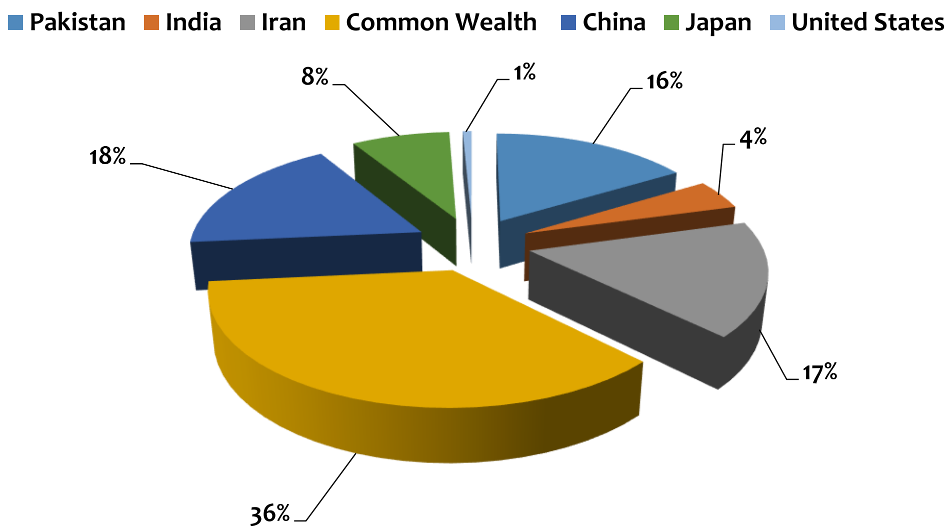
Iran ranked the third largest origin of imports for Afghanistan accounting for approximately 18% of total imports in the first quarter of the FY 2019. Aggregate imports from Iran increased by 13% to a value of USD 314.30 million in the first quarter of the FY 2019 from a value of USD 277.46 million recorded in the first quarter of the FY 2018. The main imports from Iran were; petroleum oil, metal production, cement, electricity, fertilizers, spares parts, and consumer goods.

Figure. 4.7: Direction of Exports (% share) in Q1- FY 2018



Source: CSO/DAB staff calculations

Figure 4.8: Direction of Imports (%share) in Q1 - FY 2018



Source: CSO/DAB staff calculations

Pakistan was the fourth largest import origin for Afghanistan in the first quarter of the FY 2019. The imports from Pakistan declined to a value of USD 255.66 million in the first quarter of the FY 2019 from a value of USD 271.62 million in the first quarter of the FY 2018 registering a 6% reduction. This accounted for approximately 14% of Afghanistan's total imports.

Main imports from Pakistan were; consumer goods, cement, spare parts, and metal production during the quarter under review.

India and Japan were the last largest import sources for Afghanistan accounting for 5% and 3% of total imports respectively during the quarter under review (Figure 4.7 & 4.8).

4.4 COMPOSITION OF TRADE

4.4.1 Composition of Imports

The composition of imports in the first quarter of the FY 2019 indicates that;

- Imports of consumer goods had the largest share in the basket of imports which decreased to 42% in the first quarter of the FY 2019 from 43% recorded in the first quarter of the FY 2018. Expenditure on imports of such goods also dropped by 11% to a value of USD 741.35 million in the first quarter of the FY 2019 from a value of USD 828.96 million recorded in the same quarter of the previous year.
- The second largest share recorded for capital goods in the basket of imports during the first quarter of the FY 2019, although its share dropped to 32% in the

first quarter of the FY 2019 from 35% recorded in the same quarter of the previous year.

Expenditure on imports of capital goods also dropped by 17% to a value of USD 568.74 million in the first quarter of the FY 2019 from a value of USD 686.91 million recorded in the first quarter of the FY 2018.

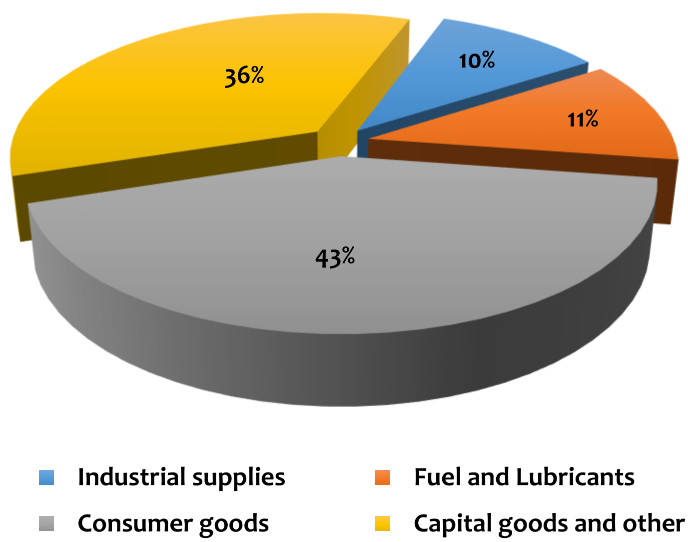
- Imports of fuel and lubricants (petroleum oil) had the third largest share in the basket of Afghanistan's imports which is increased to 17% in the first quarter of the FY 2019 from 11% recorded in the same quarter of the FY 2018.

Expenditure on imports of fuel and lubricants in total imports increased by 37% to a value of USD 302.34 million in the first quarter of the FY 2019 from a value of USD 220.58 million recorded in the first quarter of the FY 2018.

- Industrial supplies had the smallest share in the basket of Afghanistan's imports during the reporting quarter which decreased from 10.3% in the first quarter of the FY 2018 to 9.7% during the reporting quarter.

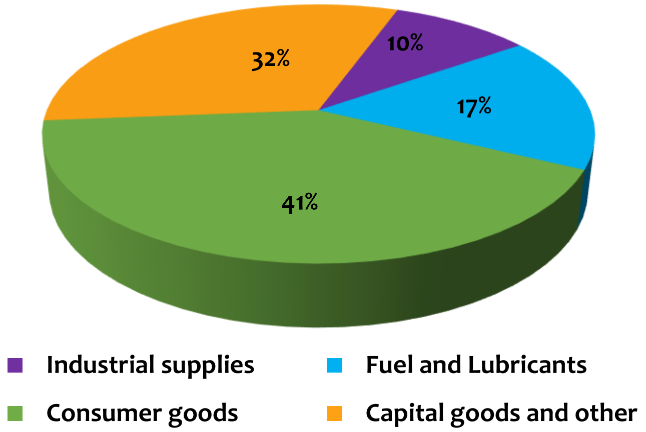
Expenditure on imports of Industrial supplies also decreased by 1% , to a value of USD 173.92 million in the first quarter of the FY 2019 from a value of USD 200.38 million recorded in the first quarter of the FY 2018, (Table 4.2- and Figure 4.9 - 4.10)

Figure 4.9: Composition of Imports (share%) in Q1 of FY 2018



Source: CSO and DAB staff calculations.

Figure 4.10: Composition of Imports (share%) in Q1 of FY 2019



Source: CSO and DAB staff calculations.

4.4.2 Composition of Exports

The composition of exports in the first quarter of the FY 2019 reveals that;

- Exports of food items (oil seeds, fresh and dry fruits), had the largest share in the basket of Afghanistan's exports which is increased to 46% in the reporting quarter from 44% recorded in the preceding and corresponding quarter of the FY 2018.

Earnings from exports of food items increased by 10% to a value of USD 83.93 million in the first quarter of the FY 2019 from a value of USD 76.32 million recorded in the same quarter of the previous year.

- The second largest share in the total exports was recorded for medical seeds, which declined to 45% in the first quarter of the FY 2019 from 48% recorded in the preceding and corresponding quarter of last the year.

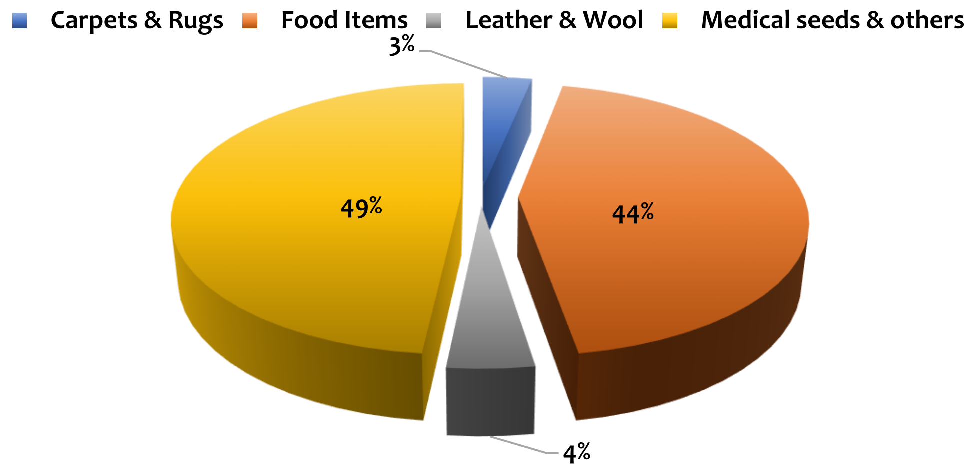
Earnings from the exports of medical seeds decreased slightly by 1% to a value USD 82.37 million in the first quarter of the FY 2019 from a value of USD 83.41 million recorded in the preceding and corresponding of the FY 2018.

- Leather and wool products had the third largest share in the total exports. The share of leather and wool which was recorded at 4% in the first quarter of the FY 2018, increased to 5.3% during the quarter under review.

Earning from exports of leather and wool also increased to a value of USD 9.69 million in the first quarter of the FY 2019 from a value of USD 7.11 million recorded in the same quarter of the last year.

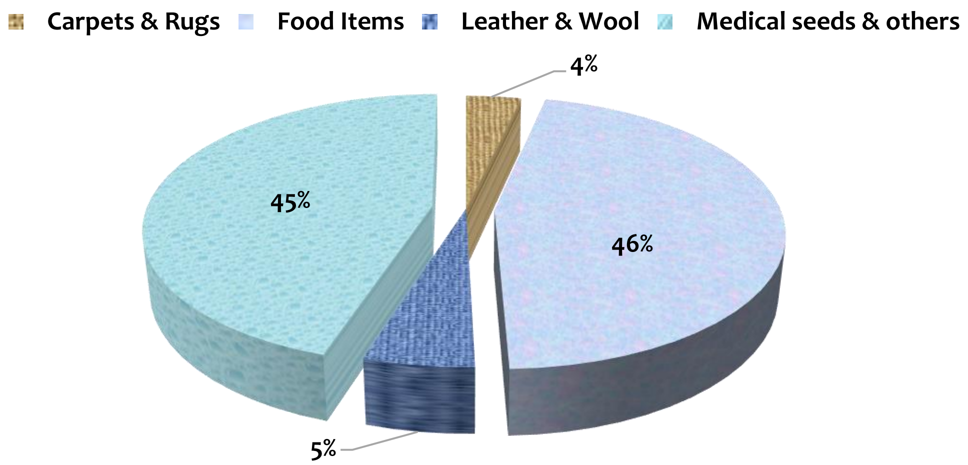
- Carpet and rugs which are considered the main component of Afghanistan's exports in the past decades had the smallest share in the total exports, which increased slightly to 4% in the first quarter of the FY 2019 from 3% recorded in the first quarter of FY 2018. Earnings from the exports of carpet and rugs also raised by 17% to a value of USD 6.57 million during the quarter under review from a value of USD 5.62 million recorded in the same quarter of the last year. (Table 4.2 - figure 4.11 and 4.12).

Figure 4.11: Composition of Exports (share%) in Q1 of FY 2018



Source: CSO and DAB staff calculations

Figure 4.12: Composition of Exports (share%) in Q1 of FY 2019



Source: CSO and DAB staff calculations

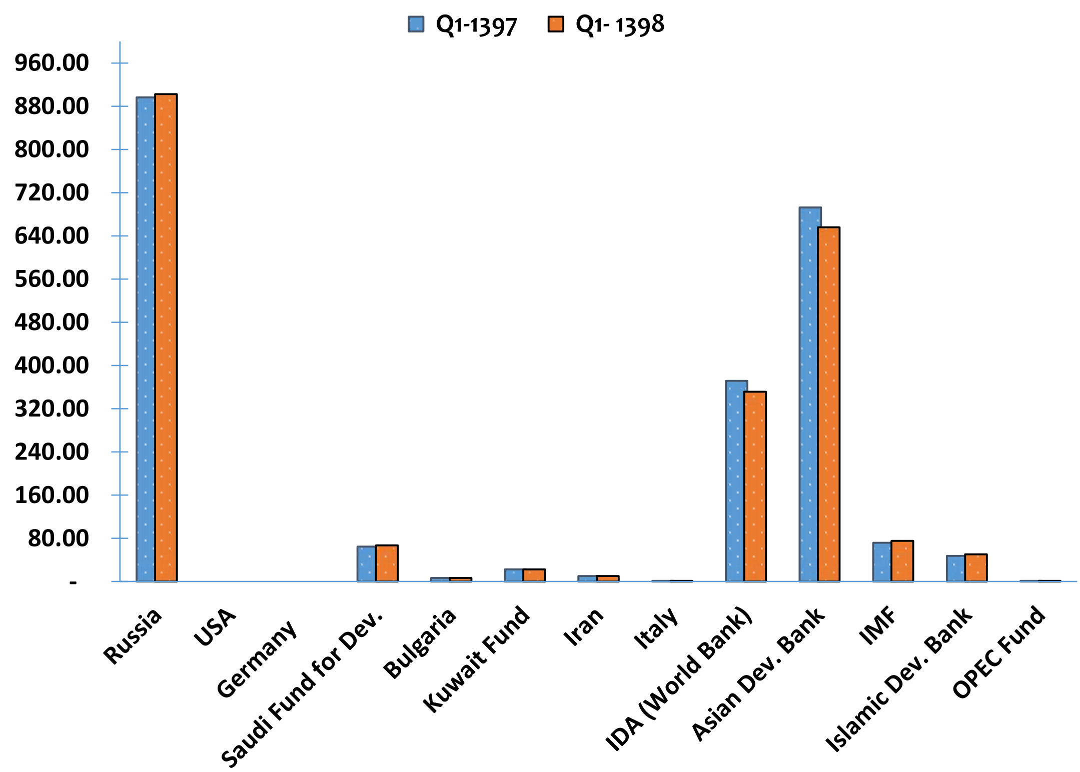
4.5 EXTERNAL DEBT

Afghanistan's total external debt slightly declined by 2% to a value of USD 2,146.13 million in the first quarter of the FY 2019 from a value of USD 2,187.98 million recorded in the similar quarter of the FY 2018, which shows about USD 41.85 million reduction, (table 4.5 and figure 4.13).

During the quarter under review, loan principal repayments were made to the Asian Development Bank, Islamic Development Bank and OPEC fund, while service charges were paid to the World Bank, Asian Development Bank and Islamic Development Bank. World Bank and Asian Development Bank as major multilateral creditors to Afghanistan made some debt releases on principle during the quarter under review.

The total loan amounts payable to the Paris Club creditors in the first quarter of the FY 2019 stood at a value of USD 902.09 million which is payable to Russian Federation. In other words, in the first quarter of the FY 2019, Afghanistan's total debt from the Paris Club members stood at about 42% of total current external debt which increased slightly by about 1% as compared to the first quarter of the

Figure 4.13: External Debt Comparisons; end of Q1-2018 (1397) & end of Q1 – 2019 (1398)



Source: Debt Asset Management Unit, Ministry of Finance.

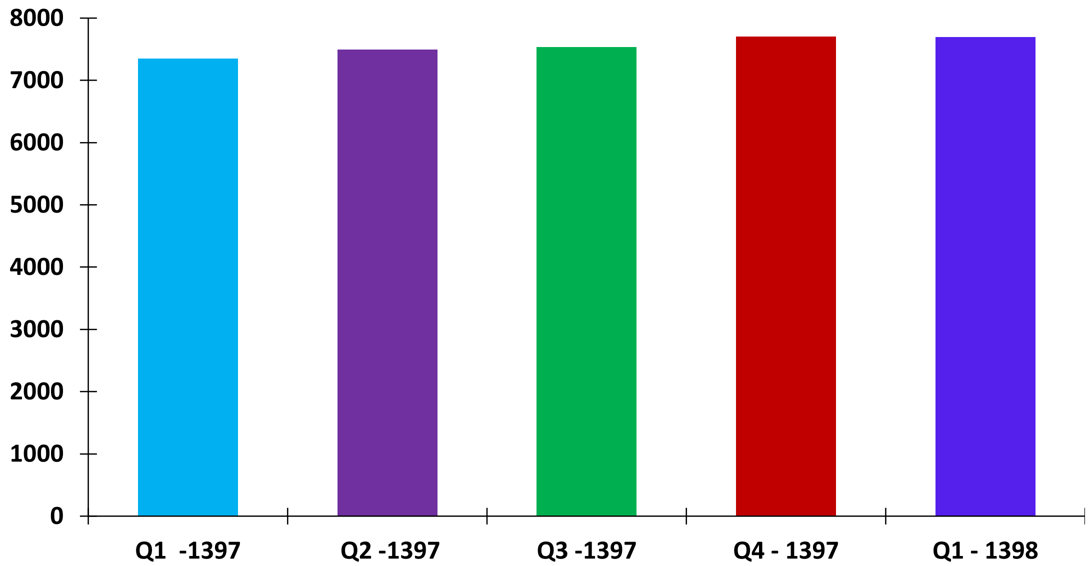
Furthermore, the total debt from Non-Paris Club members that includes Saudi Fund for Development, Bulgaria, Kuwait fund and Iran, increased by 2% to a value of USD 108.81 million in the first quarter of the FY 2019 in comparison with USD 106.43 million recorded in the first quarter of the FY 2018.Total debt from multilateral creditors to Afghanistan decreased to a value of USD 1,135.23 million in the first quarter of the FY 2019 from a value of USD 1,185.46 million which shows a USD 50.32 million decline in the total debt during the quarter under review.

6. NET INTERNATIONAL RESERVES

The net international reserves (NIR), increased by %, standing at a value of USD 7,696.40 million in the first quarter of the FY 2019, up from a value of USD 7,350.92 million recorded in the corresponding quarter of the last year, (Table 4.6 and Figure 4.14).

The increase in the level of NIR was mainly due to the increase in the reserve assets which expanded by 3% to a value of USD 8,345.46 million in the first quarter of the FY 2019 from a value of USD 8,131.13 million recorded in the corresponding quarter of the last year. However, the reserve liabilities decreased by 17% to a value of USD 649.06 million in the first quarter of the FY 2019 from a value of USD 780.21 million recorded in the first quarter of the FY 2018; this demonstrates that the reserve assets are higher than the reserve liabilities.

Figure 4.14: Net International Reserves during the past period (In Million USD)



Source: Debt Asset Management Unit, Ministry of Finance

Table 4.1: Afghanistan Balance of Payments (in Million USD)

Items / Years	Q1- 18	Q2- 18	Q3 - 18	Q4 - 18	Q1- 19	% Change
Current Account	-1228.87	-829.74	-895.81	-1119.14	-1226.41	-0.2%
Credit	924.80	1120.01	1162.74	995.34	798.13	-14%
Debit	2153.66	1949.75	2058.56	2114.48	2024.55	-6%
Goods and Services Account	-1780.24	-1534.46	-1494.92	-1591.78	-1573.07	-12%
Credit	340.42	364.21	461.39	459.30	398.32	17%
Debit	2120.66	1898.68	1956.31	2051.08	1971.39	-7%
Goods Account	-1664.49	-1499.75	-1386.93	-1473.41	-1527.90	-8%
Credit	172.45	146.81	261.88	294.09	182.57	6%
Debit	1836.94	1646.56	1648.81	1767.50	1710.47	-7%
Services Account	-115.75	-34.72	-108.00	-118.37	-45.17	-61%
Credit	167.96	217.40	199.51	165.21	215.75	28%
Debit	283.72	252.12	307.50	283.58	260.92	-8%
Primary Income Account	24.83	54.00	58.70	44.32	44.92	81%
Credit	35.27	65.53	109.23	67.45	61.34	74%
Debit	10.45	11.52	50.52	23.12	16.42	57%
Secondary Income Account	526.55	650.72	540.40	428.32	301.73	-43%
Credit	549.11	690.27	592.13	468.60	338.47	-38%
Debit	22.56	39.55	51.72	40.28	36.74	63%
Current transfers (Official grants)	408.0	530.6	404.4	365.5	162.8	-60%
Personal transfers	118.59	120.11	135.97	62.80	138.94	17%
Credit	141.15	159.65	187.70	103.08	175.68	24%
Debit	22.56	39.55	51.72	40.28	36.74	63%
Capital account	4.84	171.93	427.13	588.81	39.42	714%
Credit	4.84	171.93	427.13	588.81	39.42	714%
Debit	0.00	0.00	0.00	0.00	0.00	
Capital transfers	4.84	171.93	427.13	588.81	39.42	714%
Credit	4.84	171.93	427.13	588.81	39.42	714%
Debit	0.00	0.00	0.00	0.00	0.00	0%
Financial account	46.8	-4.9	184.8	167.23	-95.16	-303%
Direct investment	-31.58	-40.85	-55.28	-29.85	-17.58	-44%
Net acquisition of financial assets	3.78	3.78	-30.90	-19.11	-10.52	-378%
Net incurrence of liabilities	35.36	44.63	24.38	10.75	7.06	-80%

Items / Years	Q1- 18	Q2- 18	Q3 - 18	Q4 - 18	Q1- 19	% Change
Portfolio investment	-54.02	18.22	24.37	34.94	19.96	-137%
Net acquisition of financial assets	-54.02	18.22	24.37	34.94	19.96	-137%
Net incurrence of liabilities	0.00	0.00	0.00	0.00	0.00	0%
Other investment	109.58	57.53	103.07	89.54	-126.85	-216%
Assets	80.47	44.96	79.32	73.59	-131.36	-263%
Liabilities	-29.11	-12.57	-23.75	-15.95	-4.51	-85%
Reserve Assets	22.79	-39.85	112.68	72.60	29.31	29%
Net errors and omissions	1270.79	652.86	653.53	697.56	1091.83	-14%

Source: Debt Asset Management Unit, Ministry of Finance

Table 4.2: Merchandise Trade (in Million USD)

Years	Q1- 2018		Q2- 2018		Q3 - 2018		Q4 - 2018		Q1- 2019	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	1,936.84	100%	1,766.96	100%	1,777.29	100%	1,925.50	100%	1,786.34	100%
Industrial supplies	200.38	10.3%	194.14	11.0%	210.96	11.9%	220.20	11.4%	173.92	9.7%
Fuel and Lubricants	220.58	11%	214.21	12.1%	251.34	14.1%	263.66	13.7%	302.34	17%
Consumer goods	828.96	43%	687.54	38.9%	676.65	38.1%	711.07	36.9%	741.35	42%
Capital goods and other	686.91	35%	671.07	38.0%	638.34	35.9%	731	37.9%	568.74	32%
Exports	172.45	100%	146.81	100.0%	261.88	100%	294.09	100%	182.57	100%
Carpets & Rugs	5.62	3%	5.68	3.9%	5.45	2.1%	5.6	1.9%	6.57	4%
Food Items	76.32	44%	47.30	32.2%	115.88	44.2%	178.19	60.6%	83.93	46%
Leather & Wool	7.11	4%	9.05	6.2%	13.37	5.1%	12.79	4.3%	9.69	5.3%
Medical seeds & others	83.41	48%	84.78	57.7%	127.18	48.6%	97.52	33.2%	82.37	45.1%
Trade Balance	-1,764.38		-1,620.15		-1,515.41		-1,631.42		-1,603.77	
Trade Balance as % of GDP	0%		0%		0%		0%		0%	

Source: Debt Asset Management Unit, Ministry of Finance

Table 4.3: Direction of External Trade: for the first quarter of the FY 2019 in (Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	49.19	27%	255.66	14%	-206.47
India	95.33	52%	85.40	5%	9.93
Iran	3.28	2%	314.30	18%	-311.02
Germany	3.31	1.81%	15.61	0.87%	-12.30
China	6.93	4%	336.22	18.8%	-329.29
England	0.00	0.00%	1.01	0.06%	-1.01
Saudi Arabia	3.33	1.83%	0.00	0.00%	3.33
United Arab Emirates	0.00	0.00%	28.78	1.61%	-28.78
Turkey	0.00	0.00%	19.12	1.07%	-19.12
USA	0.00	0.00%	14.24	0.80%	-14.24
Common Wealth	3.51	1.92%	467.73	26%	-464.22
Japan	0.00	0.00%	49.26	2.76%	-49.26
Other Countries	17.69	9.69%	199.02	11.14%	-181.33
Total	182.57	100%	1,786.34	100%	(1,603.77)

Source: Debt Asset Management Unit, Ministry of Finance

Table 4.4: Direction of External Trade: for the first quarter of the FY 2018 (in Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	46.35	27%	271.62	14.02%	-225.27
India	91.17	53%	73.45	3.79%	17.72
Iran	5.36	3%	277.46	14.33%	-272.10
Germany	1.31	0.76%	20.91	1.08%	-19.60
Common Wealth	2.54	1.47%	601.32	31.05%	-598.78
China	3.77	2.2%	294.39	15.20%	-290.62
Saudi Arabia	2.63	1.52%		0.00%	2.63
Japan	0.00	0.00%	134.56	6.95%	-134.56
England	0.00	0.00%	1.29	0.07%	-1.29
United States	0.00	0.00%	12.19	0.63%	-12.19
Other Countries	19.33	11.21%	249.66	12.89%	-230.33
Total	172.45	100.00%	1936.84	100.00%	-1764.38

Source: Debt Asset Management Unit, Ministry of Finance

Table 4.5: External Debt for the first quarter of FY 2019 (1398)

	In million USD	% of total
Total external debt	2,146.13	100.00
Bilateral	1,010.90	47.10
Paris Club	902.09	42.03
Russian Federation	902.09	42.03
United States	-	0.00
Germany	-	0.00
Non-Paris Club	108.81	5.07
Multilateral	1,135.23	52.90
of which: IDA (World Bank)	351.61	16.38
Asian Development Bank	655.82	30.56
International Monetary Fund	75.61	3.52
Islamic Development Bank	50.50	2.35
OPEC Fund	1.69	0.08

Source: Debt Asset Management Unit, Ministry of Finance

Table 4.6: Net International Reserves; (in millions of US dollars)

Changes on the previous quarter	Q1 - 2018	% change	Q2 - 2018	% change	Q3 - 2018	% change	Q4 - 2018	% change	Q1 - 2019	% change
Net international Reserves (million US Dollar)	7,350.92	23.22	7,491.80	1.92	7,534.42	0.57	7,704.98	2.26	7,696.40	5
Reserve Assets	8,131.13	22.71	8,227.57	1.19	8,241.90	0.17	8,362.42	1.5	8,345.46	3
Reserve Liabilities	780.21	10.91	735.76	-5.70	707.48	-3.84	657.44	-7	649.06	-17
Commercial bank deposits in foreign currency	722.88	4.00	675.38	-6.57	651.17	-3.59	598.08	-8	591.98	-18
Nonresident deposits in foreign currency	0.14	-89.57	0.14	-1.30	0.14	0.00	0.14	1.31	0.14	0
Use of Fund resources	57.19	17.53	60.24	5.33	56.17	-6.76	59.22	5	56.74	-1
Gross Intl. Reserves (in months of import)	12.59		13.97		13.91		13.03		14.02	
Net Intl. Reserves (in months of import)	11		13		13		12		13	

Source: Debt Asset Management Unit, Ministry of Finance

5 Fiscal Developments

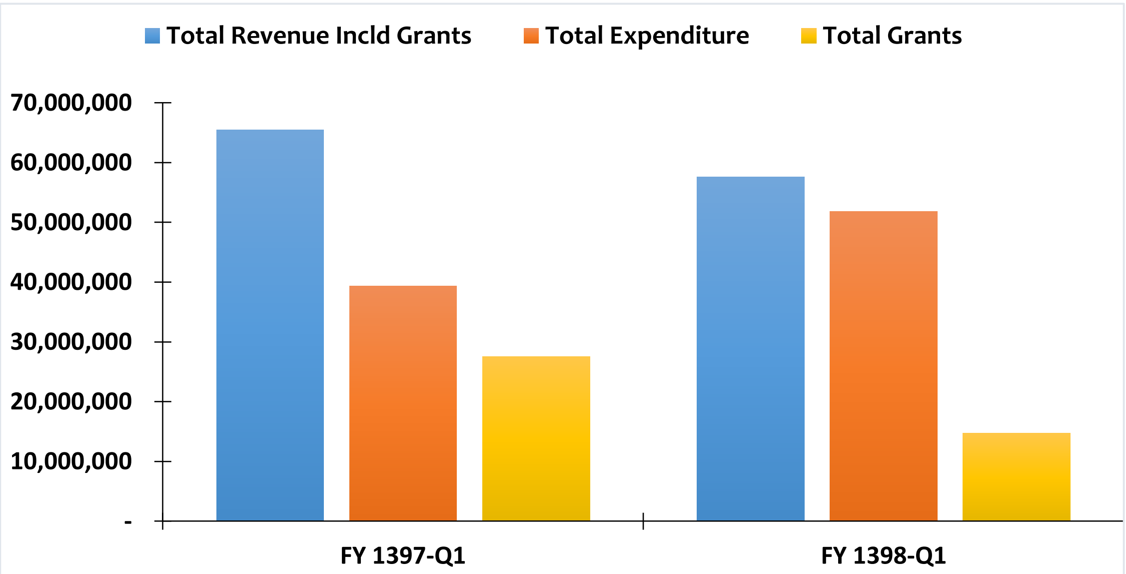
5

FISCAL SECTOR DEVELOPMENT

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

Resembling the other emerging and under developing economies around the world Afghanistan continuously faces budget deficit, the total core expenditure exceeded total domestic revenue in FY 2019-Q_1 leading to AFN8.93billion budget deficit, and by including other revenue (grants) a budget surplus of AFN 5.82billion is observed comparably. Due to a notable decline in donor contribution the total revenue including grant is decreased, however there is a considerable increment in total domestic revenue from AFN 37.92 billion of FY 2018-Q_1 to AFN 42.88 billion of FY2019-Q_1 that shows an increment of AFN 4.96 billion leading to 13.09% growth in domestic revenue collection. Meanwhile increase of employees spending, supplier expenditure, capital expenditure and subsidies, resulted to raise the total core expenditure from AFN 39.37 billion of FY 2018-Q_1 to AFN 51.81 billion of FY 2019-Q_1 that shows an increase of AFN 12.44 billion equivalents to 31% in expenditure compared to the same period of last year.

Figure 5.1: Comparison of Total Revenue, Total Expenditure, Total Budget & Grants FY 2018-Q1 & FY 2019 -Q1



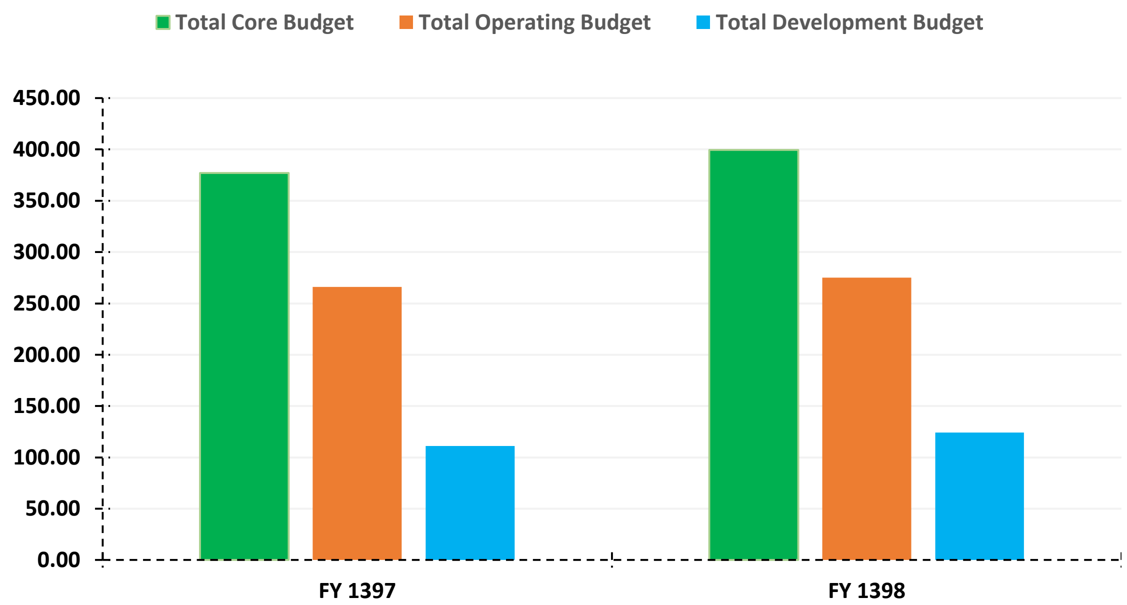
Source: MoF Financial Statement/MPD Staff Calculation

Donor contributions are used to finance both operating and development expenditure, the main donor contributors to the government is ARTF, LOTFA, and CSTC-A. The total donor contribution (grants) allocated to operating and development expenditure represent a considerable decrease from AFN 27.57 billion of FY 2018-Q1 to AFN 14.75 billion of FY 2019-Q_1 indicating amount AFN 12.81billion reduction that is equivalent to 46.49% decline in the level of grants comparably. Furthermore, total core budget is increased form AFN 377.19 billion of FY 2018 to AFN 399.42 billion of FY 2019 showing a notable increase of AFN 22.23 billion equivalents to 5.89% rise in total core budget accordingly, moreover operating budget increased from AFN 268.31 billion of FY 2018 to AFN 275.22 billion of FY 2019 signifying 3.4% % of increment. Similarly, development budget is showing a significant increase from AFN 111.06 billion of FY 2018 to AFN 124.19 billion of FY 2019 representing 11.83% raise that is as a result of high budget approval and allocation for the FY 2019 comparably.

5.1 BUDGET EXECUTION RATE:

During the reference period of FY 2019-Q_1, government spent 14% of the total AFN 404.57 billion of allocated budget, while comparing to 10% of the total AFN 385.09 billion of allocated budget in FY 2018-Q_1 representing increase of 45.8% rise in overall budget execution rate relatively and it is attributed to several factors particularly timely processing and approval of expenses by the National Procurement Authority, security condition in provinces and improved performances by the budgetary units, beside there is an increase in annual approved budget from AFN 385.09 billion of FY 2018 to AFN 404.57 billion of FY 2019 leading to 5% growth comparably.

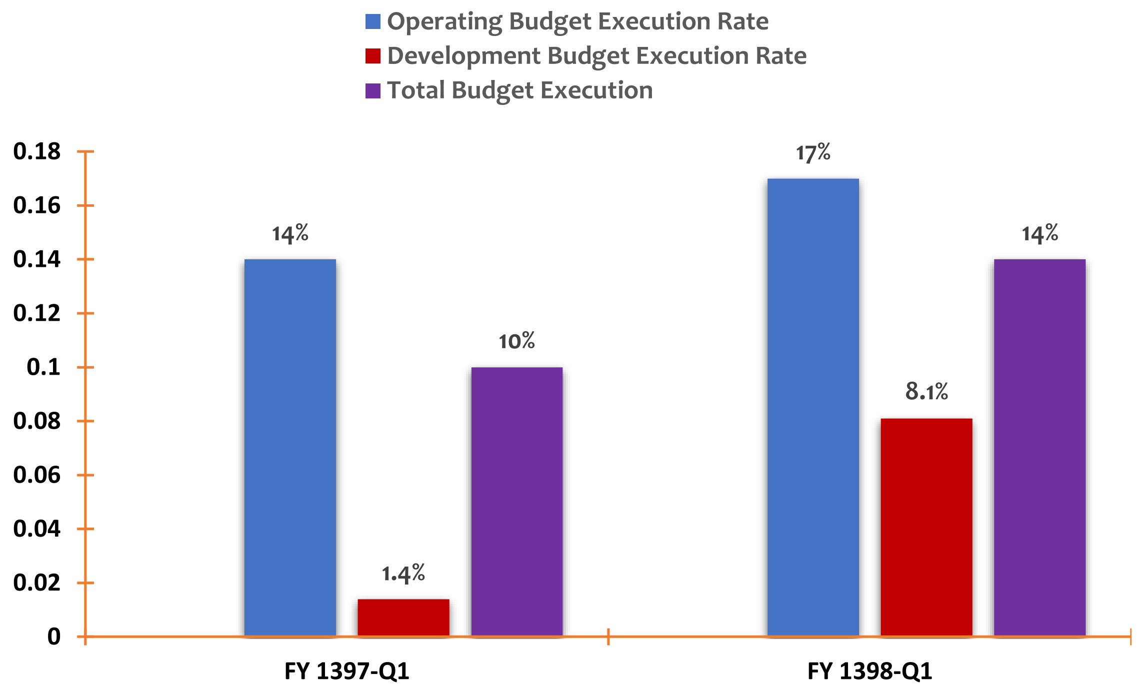
Figure 5.2: Comparison of Total Budget FY 2018 & FY 2019



Source: MoF Financial Statement/MPD Staff Calculation

Operating budget execution rate indicates 17% increase from AFN 37.961 billion of FY 2018-Q_1 to AFN 47.376 of FY 2019-Q_1 moreover the allocated budget was AFN 317.21 billion in FY 2018 and AFN 385.09 billion in FY 2019. The development budget execution rate evidently represents increase of AFN 559.4% comparing both AFN 1.55 billion of the FY 2018-Q_1 and AFN 10.22 billion of FY 2019-Q_1.

Figure 5.3: Comparison of Operation Budget Execution & Development Budget Execution Rates FY 2018-Q1 & 2019-Q1



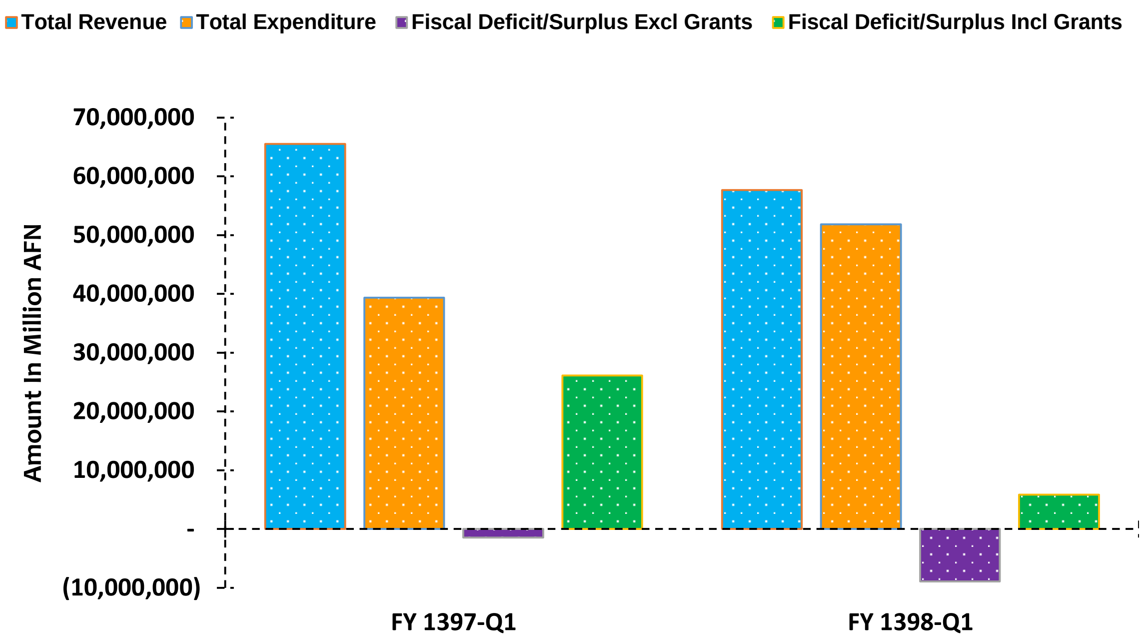
Source: MoF Financial Statement/MPD Staff Calculation

5.2 CORE BUDGET (DEFICIT & SURPLUS)

The overall budget prior to donor's contribution had a deficit of AFN 8.93 billion in FY 2019-Q_1 compared to AFN 1.45 billion deficit in FY 2018-Q_1 that shows AFN 7.48 billion increase and is 514.6% increase in fiscal deficit compared. Meanwhile, external amount of funding represents decline from AFN 27.57 billion in FY 2018-Q_1 comparing to AFN 14.75 billion of the same quarter of FY 2019.

The total annual external planed funding amount in FY 2018 represents an increase from AFN 191.28 billion of FY 2018 to AFN 199.02 billion in FY 2019 indicating 4.04% increment in annual planed external source and it is as a result of pledge, commitment and disbursement from the donor's contribution on annual basis.

Figure 5.4: Core Budget Deficit & Surplus (Including Grants and Excluding Grants) FY 2018-Q1 & 2019-Q1

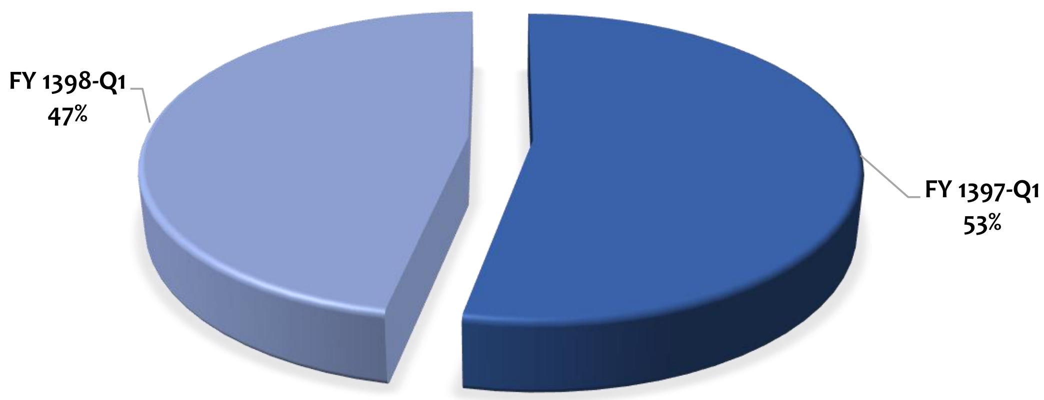


Source: MoF Financial Statement/MPD Staff Calculation

5.3 TOTAL REVENUE:

With reference period of FY 2019 total revenues including grants decreased significantly with total collection of AFN 57.63 billion in FY 2019-Q_1 compared to AFN 65.49 billion of FY 2018-Q_1, presenting decrease of AFN 7.85 billion that shows 11.99% decrease as compared to same quarter of previous year. Annual collection of planed domestic sources indicates 26.38 billion of increment from AFN 161.62 billion of FY 2018 to AFN 188.01 billion of FY 2019 leading to 16.32% increases comparably. To meet FY 2019 budget deficit total domestic revenue &donor contribution play a vital role and revenue collection that steer to annual budget surplus.

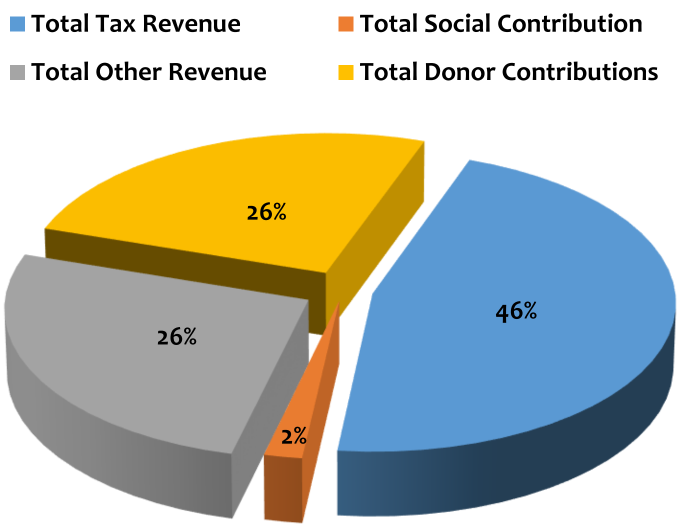
Figure 5.5: Contribution of Total Revenue FY 2018-Q1 & FY 2019-Q1



Source: MoF Financial Statement/MPD Staff Calculation

Moreover, the positive gain in total revenue collection of FY 2019 was as a result of momentous improved in income taxes, sales of goods and services, sale of land and buildings, custom duties and administrative fee show that there had been decline in social contribution and other non-tax revenues including income from capital property, royalties extractive industry, and large difference in miscellaneous revenues during the first quarter of the year and negatively reflected retail activity from the low base last year comprise of property tax, Fixed tax and custom duties.

Figure 5.6: Total Revenue Contribution FY 2019-Q1



Source: MoF Financial Statement/MPD Staff Calculation

5.3.1 Domestic Revenue:

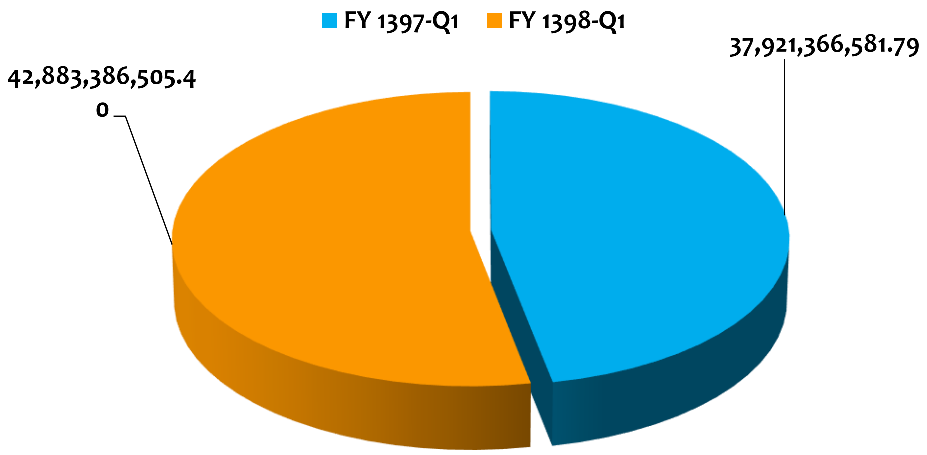
The total collection of domestic revenue performance is enhanced in first quarter of fiscal year 2019 however it was significantly sophisticated compared to first quarter of 2018 while these measures are deemed sufficient by the government to ensure the achievement in terms of the GDP deficit in FY 2019.

The increment in domestic revenue collection was attributed to enhanced receipts from taxations and custom revenue that include Income tax property tax, sales tax, fix taxes and a notable change in retirement contributions.

Total domestic revenue is increased from AFN 37.92 billion of FY 2018-Q_1 to AFN 42.88 billion of FY 2019-Q_1 that shows an increase of AFN 4.96 AFN billion equal to 13.09% growth in domestic revenue collection compared.

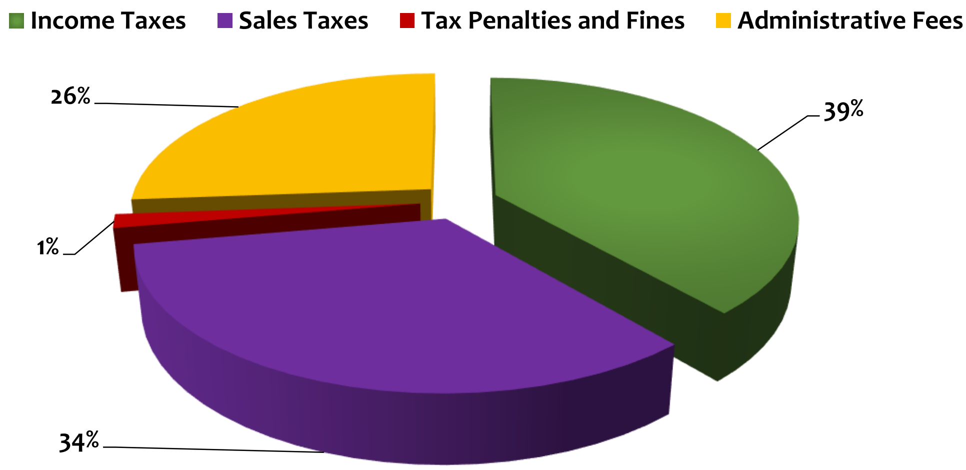
Beside, a breakdown of the total revenue collection showed a mild deceleration in various domestic revenue components such as income from capital property that shows a momentum decrease of 12.59% from AFN 0.35 billion in FY 2018-Q_1 to AFN 0.31 billion in FY 2019-Q_1, the royalties shows decrease of 23.87% from AFN 0.04 billion FY 2018-Q_1 to AFN 0.03 billion in FY 2019-Q_1, extractive industry represents a significant decrease of 18% from AFN 0.08 billion of 2019-Q_1 to AFN 0.06 billion of 2018-Q_1, and a remarkable decrease in miscellaneous revenue showing 63.32% from AFN 16.65 billion of 2018-Q_1 to AFN 6.11 billion of 2019-Q_1 comparably.

Figure 5.7: Total Domestic Revenue Comparison between FY 2018-Q1 & FY 2019-Q1



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.8: Major Domestic Revenue FY 2019-Q1

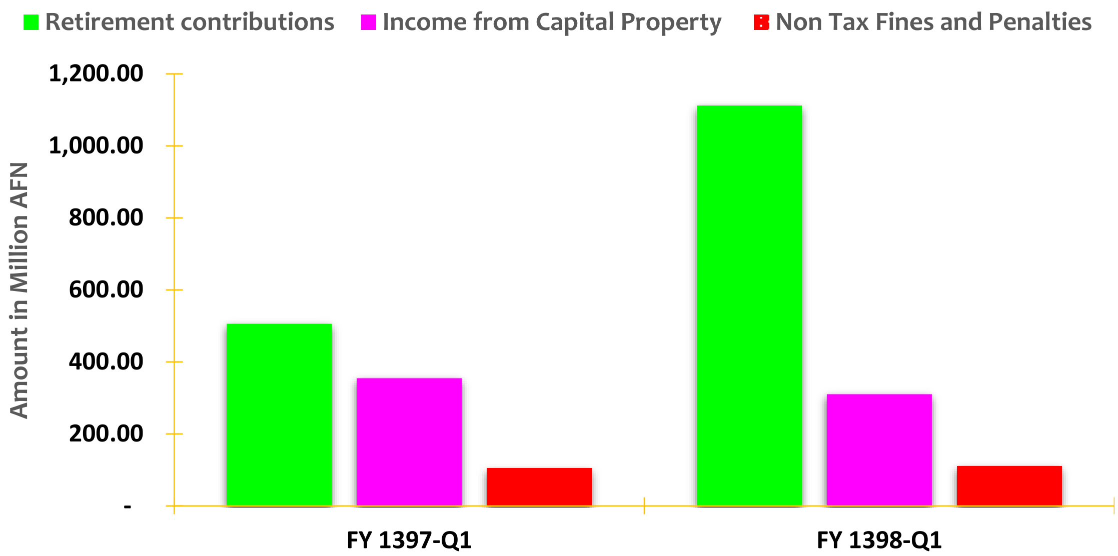


Source: MoF Financial Statement/MPD Staff Calculation

5.3.2 Non Tax Revenue:

One of the initial component of domestic revenues is tax revenues that represents a notable increase of 99.97% from AFN 13.34 billion of FY 2018-Q_1 to AFN 26.67billion of FY 2019-Q_1 billion compared to same comparatively. This is as a result of fundamental increase in income tax from capital property, fix taxes and services and a notable change in miscellaneous return.

Figure 5.9: Comparison of Major Components Total Non-Tax Revenue FY 2018-Q1 & FY 2019-Q1



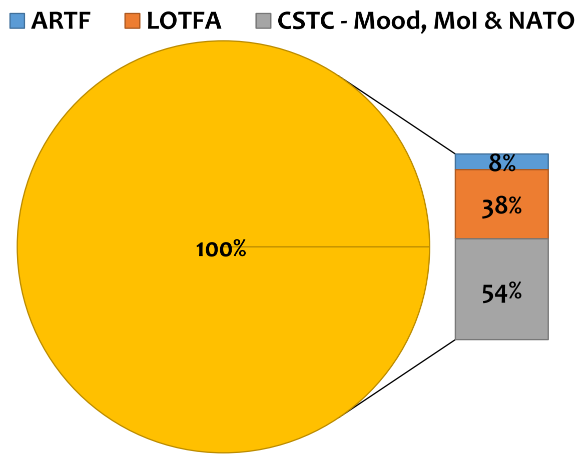
Source: MoF Financial Statement/MPD Staff Calculation

The main contributors of the non-tax revenues are retirement contributions that increased from AFN 0.51 billion of FY 2018-Q_1 to AFN 1.11 billion of FY 2019-Q_1 indicating 119.72% raise, sales of goods and services from AFN 1.12 billion of FY 2018-Q_1 to AFN 2.48 billion of FY 2019-Q_1 showing 120.97% increase, similarly non tax fines and penalties increased from 0.10 billion of FY 2018-Q_1 to 0.11 billion of FY 2019-Q_1 which signifies 6.37% increment, however miscellaneous revenue decreased from AFN 16.65 billion of FY 2018-Q_1 to AFN -6.11 billion of FY 2019-Q_1.

5.3.3 Grants:

The donor contribution comprises an important part of the national budget, meantime donor grants finance major expenditure items in both operating and development budget likewise, the government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures.

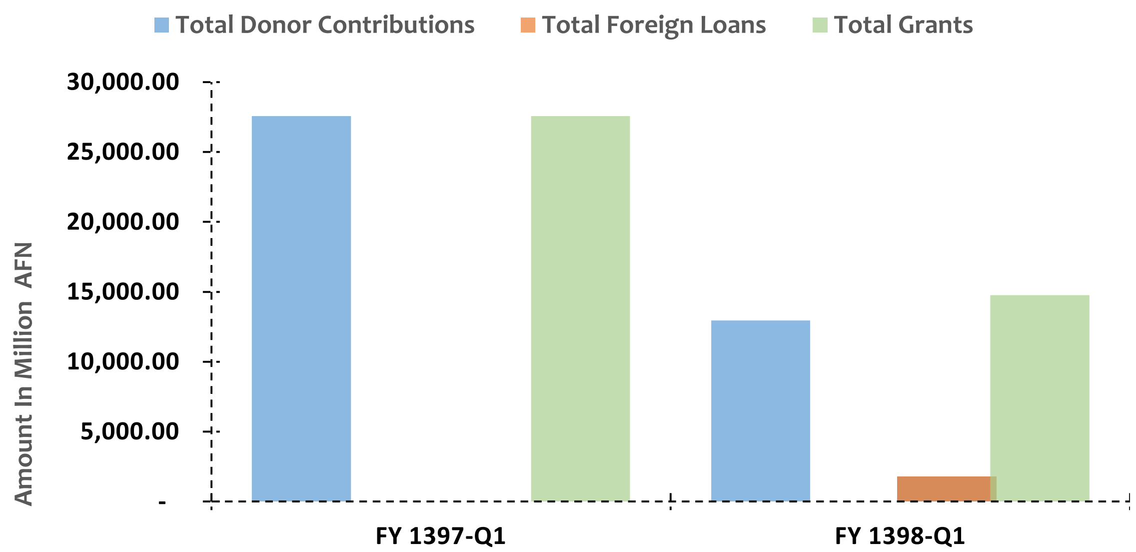
Figure 5.10: Components of Donor Contribution FY 2019-Q1



Source: MoF Financial Statement/MPD Staff Calculation

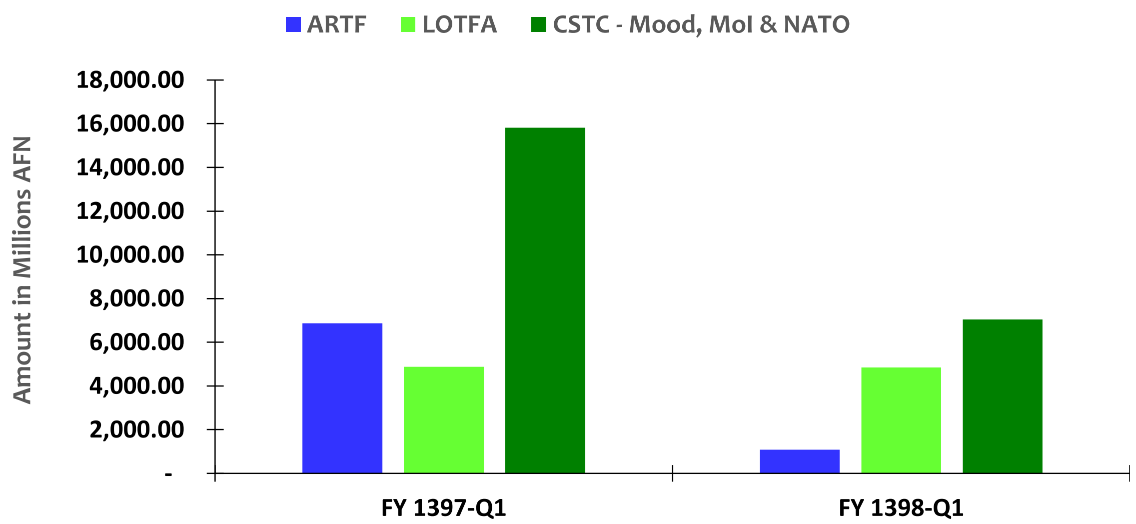
Moreover, In Afghanistan's context, fiscal sustainability is defined as total domestic expenditure and it should be financed by total domestic revenue where recently it is being financed partially by external sources, foreign loans and rest by domestic revenue. The total development and operating grants represents significant decrease of AFN 12.81 billion from AFN 27.57 billion FY 2018-Q_1 to AFN 14.75 billion of FY 2018-Q_1 which clearly indicates a mild decrease to the same period of previous year. The main donor contributors to operating and development expenditures are grants from ARTF that declined 84% from AFN 6.87 billion of FY 2018-Q_1 to AFN 1.08 billion of FY 2019-Q_1 and CSTC-A MoD, MoI& NATO contributed AFN 12.96 billion in FY 2019-Q_1 that shows 55% decrease compared to AFN 27.57 billion of the same quarter FY 2018.

Figure 5.11: Total Annual Grants Analysis FY 2018-Q1 & 2019-Q1



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.12: Comparison of Donor Contributions FY 2018-Q1 & FY 2019-Q1



Source: MoF Financial Statement/MPD Staff Calculation

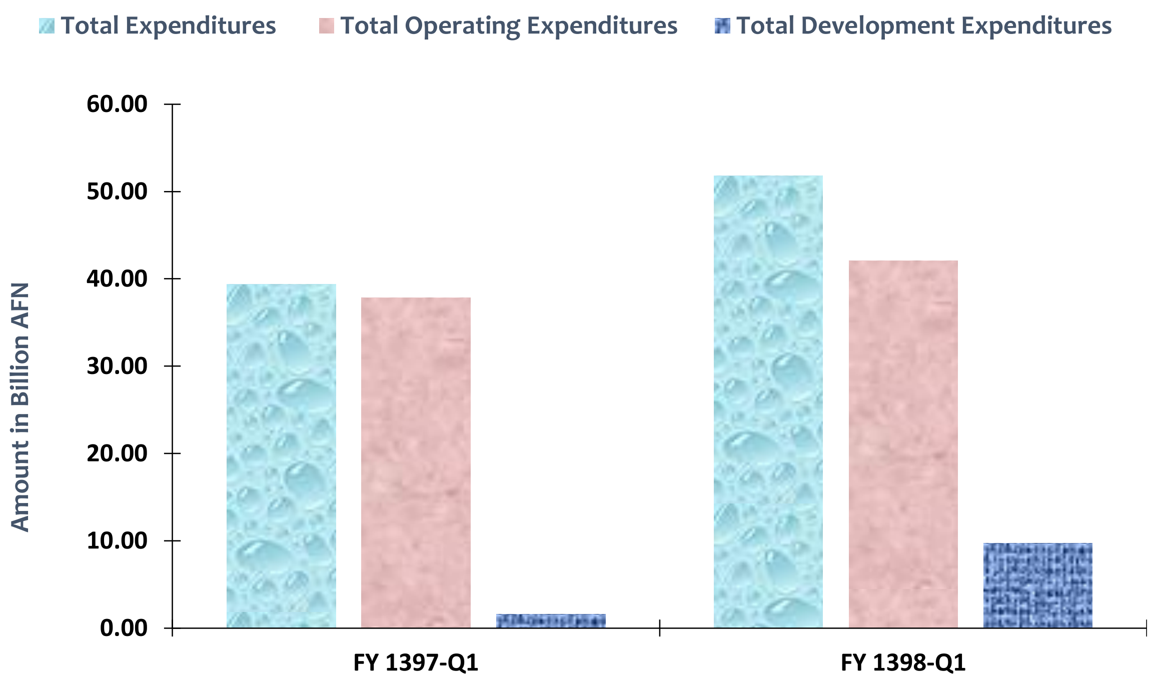
5.4 EXPENDITURE:

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

Furthermore, total core expenditure presents 31.59% increase from AFN 39.37 billion of FY 2018-Q_1 to AFN 51.81 billion of FY 2019-Q_1 indicating AFN 5.67 billion an increase in overall development and operating expenditure compared to same period of previous year and this is as a result of increase in (employee expenditure, grants contribution and pensions and capital expenditure).

In addition, operating expenditure indicates increase of 11.25% from AFN 37.82 billion of FY 2018-Q_1 to AFN 42.08 billion of FY 2019-Q_1 compared to same period of the previous year, meanwhile development expenditure shows 527.87% mark able increase from AFN 1.55 billion of FY 2018-Q_1 to AFN 9.73 billion of FY 2019-Q_1 which indicating AFN 8.18 billion speeding up in development expenditure compare to same period of last year a high increase in overall expenditure is indicated by increase in annual approved development budget as well increase in core annual expenditure.

Figure 5.13: Comparison of Total Expenditure FY 2018-Q1 & FY 2019-Q1



Source: MoF Financial Statement/MPD staff calculation

6 Banking System Performance

6

BANKING SYSTEM PERFORMANCE

The banking sector making 20.82% of GDP comprises of 14 duly licensed and permitted banking organizations. Of which 3 are re-licensed state owned banks, 7 private commercial banks, 1[1] Islamic bank and 3 branches of foreign banks.

The performance of the banking sector in the quarter ending Mar, 2019 is described below followed with analysis of the Islamic banking sector[2] in the given period.

Overall, the soundness indicators of the banking sector demonstrated a decrease to various degrees compared to previous quarter. Total assets, deposits, equity capital and profit declined and quality of loans further deteriorated. However, Liquidity remained adequate and gross loans increased.

- Asset base of the banking sector decreased by 5.10% by over the quarter reaching to AFN 299.65 billion. The declines in banking system's assets mainly attribute to decrease in cash in vault and claims on DAB, interbank claims and other assets. In the meantime, deposits decreased as well in the period under review. However, gross loans and investments in bonds were up.

- Total gross loan portfolio of the banking sector recorded an increase of 1.21% over the quarter currently stands at AFN 41.93 billion. The increase in total gross loans is mainly attributed to issuance of new loans, OD utilization and appreciation of USD.

- Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 257.77 billion, 97.17% of the total liabilities, decreased by 5.69% coming from customer demand deposits, while interbank deposits were up in the quarter under review. Total deposits cover AFN 5.41 billion interbank and AFN 252.35 billion customer deposits. Deposits were largely denominated in USD (64.60%) with Afghani denominated deposits lagging at 28.72%. AFN-denominated deposits indicated 7.97% decrease, while USD denominated deposits were down by 4.78% in the quarter under review.

- The capital base of the banking sector remained strong though decreased by 0.17% stands at AFN 34.37 billion. The decrease in capital base attributed to payment of dividends and decrease in profitability. The capital adequacy ratio of one bank is below the set limits. The Basel benchmark for capital to risk weighted is 8%. Capital adequacy ratio (CAR) of the banking sector recorded at 27.05%.

- Banking sector earned net profits amounts to AFN 113.10 million for the quarter ending Mar 2019, against AFN 1.44billion net profits in the previous quarter. Return on Assets

[1] In the banking sector bulletin Islamic bank is a part of private banks

[2] The Islamic banking sector consists of one bank and six windows

(ROA) stands at0.12% annualized, and Return on Equity (ROE) recorded at 1.07% annualized. State-Owned Banks (SOB) and branches of foreign banks (BFB) ended the quarter with profits, whilst, Private Banks (PB) ended up with losses.

6.1 ASSETS OF THE BANKING SYSTEM

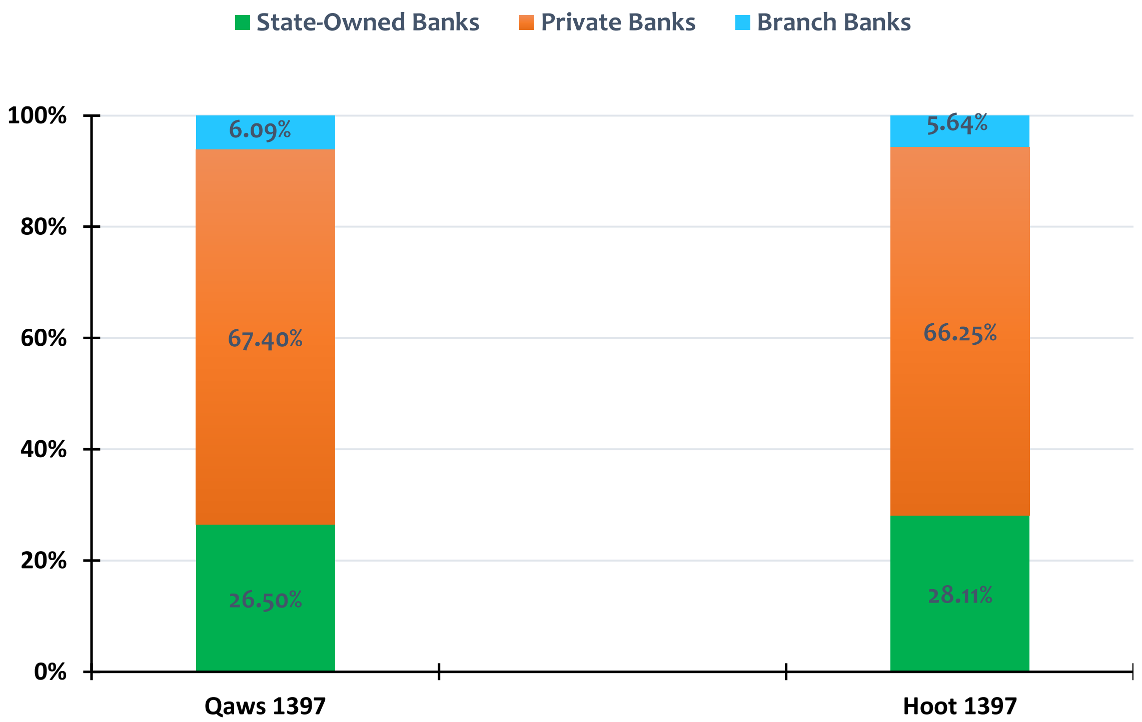
The assets size of the banking sector shrinks by 5.10% in the first quarter of the FY 2019 against 2.48% growth in Dec, 2018. See Table 6.1

The breakup of total assets reveal that the most obvious decrease was observed in cash in vault and claims on DAB (AFN 12.74 billion or 9.41%) mostly in DAB capital notes; and interbank claims (AFN 4.94 billion or 5.22%), while the increasing items include investments, loans and fixed assets.

The most important components of the system's total asset portfolio were cash in vault and claims on DAB (40.92%), interbank claims (29.95%), net loans (12.49%), investments (8.92%), "other assets" (4.33%) and fixed assets make 2.80% of the total assets. See table 6.1.

Private Banks are the leading players in the banking sector accounting for 66.25% of total banking sector assets (Islamic bank makes 4.95% of sector total assets) followed by the State-owned banks with 28.11% share in the market, while branches of foreign banks held 5.64% of the total assets

Figure 6.1: Share of Banking Sector (Total assets) across the banking group for FY Q4-2018 (qaws-97) & and Q1-2019 (hoot-97)



Source: Financial Supervision Department, DAB

Table 6.1: Assets of the Banks

Amount in million AFN	Qaws 1397 (Dec, 2018[3])	Hoot, 1397 (Mar, 2019)	% of Total Assets/Liability	Growth
Assets				
Cash in vault and claims on DAB	135,368.65	122,625.34	40.92	-9.41
Interbank claims(Net)	94,694.66	89,752.85	29.95	-5.22
Investments (Net)	24,950.57	26,725.25	8.92	7.11
Loans (Net)	37,363.12	37,435.07	12.49	0.19
Intangible assets	900.60	872.45	0.29	-3.12
Repossessed Assets	881.67	896.04	0.30	1.62
Fixed Assets	8,301.32	8,377.09	2.80	0.91
Others	13,319.90	12,968.63	4.33	-2.63
Total	315,780.47	299,652.72		-5.10
Liabilities				
Deposits	273,334.89	257,770.70	97.17	-5.69
Borrowings	3,067.81	2,907.38	1.10	-5.23
Other	4,942.75	4,598.32	1.73	-6.96
Total	281,345.45	265,276.40		-5.71
Financial Capital	34,435.02	34,376.33		-0.17

Source: Financial Supervision Department, DAB

6.1.1 Gross Loans

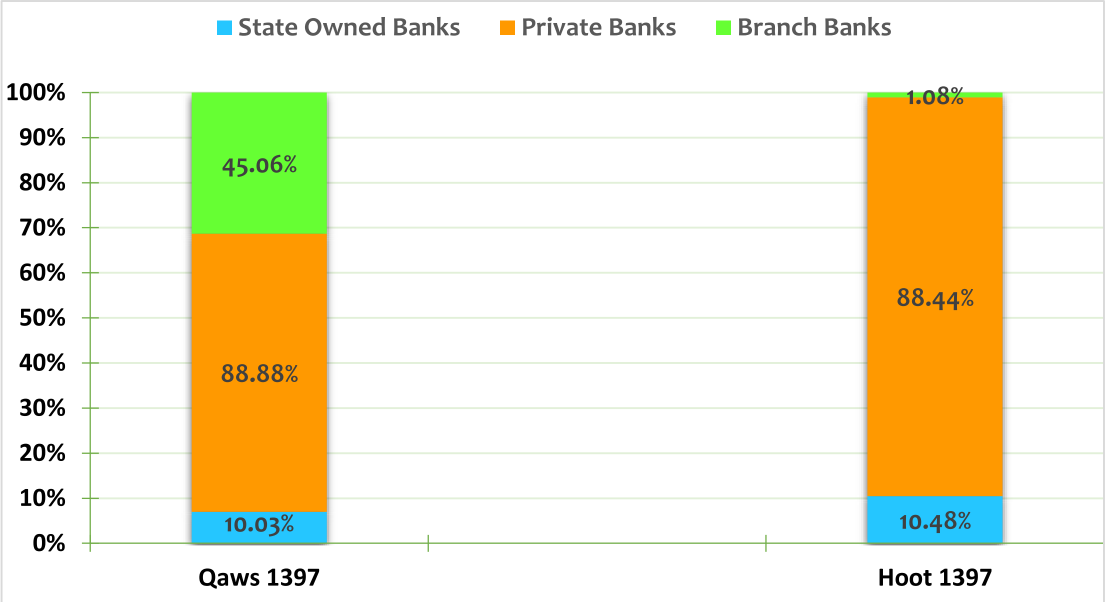
Total gross loans portfolio of the banking as of end of Mar, 2019 stands at AFN 41.93 billion, indicating AFN 501 million or 1.21% increase over the quarter, constituting 13.99% of the total assets and 2.91% of GDP. The increase in total gross loans is mainly attributed to issuance of new loans, OD utilization and increase in USD rate.

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

Disaggregated analysis among the banking groups shows that Private Banks with major share (88.44%) in the banking sector portfolio registered 0.70% increase, State Owned banks with 10.48% of the total banking sector portfolio demonstrated 5.80% increase while Branches of Foreign banks with 1.08% share in the banking sector showed 0.37% growth over the quarter.

[3] Data for Dec, 2018 revised

Figure 6.2: Share of the Gross Loans Portfolio among banking group for FY Q4-2018 (qaws-97) & and Q1-2019 (hoot-97)



Source: Financial Supervision Department, DAB

- ## Loan Loss Reserve

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk mitigation framework. Banks are required to make both general reserves (on standard assets) and specific provisions (on non-standard assets) in order to mitigate their credit risk and according to revised Asset classification and provisioning regulation, as per the new assets classification regulation the creation of reserve for standards loans is optional. By the end of Mar, 2019, total provision cover of the system was 10.73% of total gross loans as opposed to 9.83% recorded as of end of Dec, 2018.

- ## Distribution of Credit

In order to broad-based the loan portfolio and broaden the risk diversification and financial access besides new avenues of earning, DAB has diversified the sector wide distribution of Other Commercial Loans to thirty sectors. The analysis of deployment of credit in different sectors indicate that the major portion of the loan portfolio is invested in Trade sector (43.95% against 43.35%) mostly in petroleum and lubricant (13.07%); other main sectors include: Services sector (20.81% against 20.54%) mainly in telecommunications/scratch cards distributers (6.44%), Manufacturing and Industry sector (11.24% against 12.19%), Infrastructure Projects (8.72% against 6.83%), Commercial real estate and Construction sector (8.52% against 9.03%), Agriculture livestock and farms sector (4.63% against 4.16%) and Consumer sector (2.13% against 1.90%). Increases were observed in Infrastructure Projects, Services, Consumer and Agriculture livestock and farms sectors, while Manufacturing and Industry, Trade, Commercial real estate and construction sectors were the decreasing sectors. Loans designated to Medium, Small and Micro sectors currently stand at AFN 1.31 billion, AFN 1.10 billion and AFN 4.87 billion respectively, provided by eight banking institutions in the banking sector table 6.3. Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises situation associated to that sector, inversely affecting the overall banking sectors. Banks should closely monitor the potential risk associated with key sectors given the high NPL ratio. About 70.31% of the loans were designated in Kabul while Herat and Balkh provinces are in the second and third places with Badghis and Kandahar provinces at fourth and fifth places respectively. The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that with time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

Table 6.2: Loans of the Commercial Banks Sector wise

Sectors[4]	Qaws, 1393 (Dec, 2014)	Qaws, 1394 (Dec, 2015)	Qaws, 1395 (Dec, 2016	Qaws, 1396 (Dec 2017)	Qaws 2018 (Dec, 2018)	Hoot 2018(Mar, 2019)
Commercial Real Estate and Construction						
Construction and Buildings	14.32%	9.44%	11.12%	8.70%	9.03%	8.52%
Infrastructure Projects						
Power	0.35%	0.22%	0.38%	0.40%	0.48%	0.09%
Road and Railway	2.41%	1.17%	0.64%	1.32%	2.18%	2.51%
Dames	0.61%	0.09%	0.04%	0.00%	0.36%	0.36%
Mines	0.08%	1.48%	0.52%	0.48%	0.52%	0.51%
Other infrastructure projects	1.81%	2.44%	2.44%	3.46%	3.28%	5.26%
Manufacturing and Industry						
Manufacturing &Products of Metal wood plastic rubber leather paper	2.477%	4.423%	3.469%	2.671%	4.10%	3.73%
Manufacturing handmade and machine products	4.187%	4.239%	3.743%	3.164%	3.67%	3.94%
Cement and Construction Materials	2.864%	1.962%	1.274%	3.520%	4.42%	3.57%
Trade						
Textile	2.59%	0.52%	0.72%	1.54%	2.21%	2.15%
wholesale	4.93%	9.89%	4.34%	4.67%	3.62%	3.40%
Machineries	0.12%	0.25%	0.13%	0.09%	0.41%	0.48%
Petroleum and Lubricants	8.74%	9.80%	11.08%	10.78%	11.48%	13.07%
Spare parts	0.24%	1.42%	0.26%	1.39%	1.78%	1.81%
Electronics	1.40%	1.58%	1.91%	2.76%	3.21%	3.02%
Cement and other construction Material	1.87%	2.73%	2.35%	2.57%	5.14%	3.07%
Food Items	4.52%	8.24%	7.80%	7.27%	6.44%	6.00%
All other Items	5.72%	3.47%	4.17%	3.28%	7.92%	8.15%
Retail trading	3.92%	3.28%	7.31%	8.15%	3.13%	2.80%
Service						
Education	0.00%	0.00%	0.00%	0.00%	0.03%	0.04%
Hotel and Restaurant	1.20%	1.46%	1.33%	2.04%	2.16%	2.57%
Telecommunication/Scratch cards Distributers	2.92%	5.70%	5.96%	5.52%	5.98%	6.44%
Ground Transportation	4.87%	5.31%	4.86%	1.86%	3.08%	3.52%
Air Transportation	4.18%	2.66%	2.35%	2.90%	1.21%	1.19%
Health and Hygienic	0.71%	1.16%	1.42%	1.73%	1.74%	1.33%
Media, Advertisements, Printer	0.04%	0.04%	0.05%	1.18%	1.28%	1.20%
All other Services	6.19%	11.36%	13.22%	12.26%	5.07%	4.53%
Livestock and farms						
Livestock and farming	0.043%	0.026%	0.059%	0.225%	0.30%	0.68%
Agricultural Loans	2.61%	2.67%	3.20%	3.94%	3.86%	3.95%
Consumer Loans	0.26%	0.30%	0.65%	0.86%	1.90%	2.13%
Residential Mortgage Loans to Individuals	7.14%	2.68%	2.78%	0.71%	0.00%	0.00%
All Other Loans	6.68%	0.00%	0.43%	0.57%	0.00%	0.00%

Source: Financial Supervision Department, DAB

[4] Revised and rearranged under specific sector heads.

Table 6.3: Item amount in AFN million

Classification	Mar, 2019	As % of total gross loans
Medium Loans	1,310	3.12
Small Loans	1,105	24.58
Micro Loans	4,872	13.01

Source: Financial Supervision Department, DAB

- ## Classification of Loans

  - ### Non-performing loans5

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

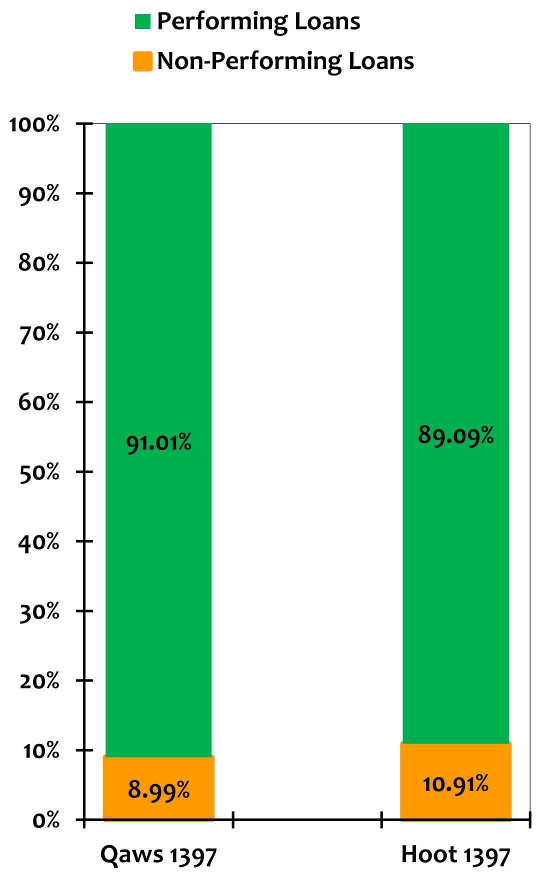
In monetary terms, by the end of Mar, 2019, non-performing loans recorded at AFN 4.57 billion or 10.91% of total gross loans and 15.02% of the system's regulatory capital, against AFN 3.72 billion or 8.99% of the total gross loans in Dec, 2018, indicating AFN 852 million increase shows deterioration in the quality of loans. Out of 10.91% NPL, 8.24% is coming from two private banks. These banks hold 36.58% of the system's gross loans and 10.72% of system's regulatory capital.

Sectoral analysis of the NPLs shows that major portion of the NPLs originate from Trade sector (30.73%) dominant in electronics (10.38%), Services sector is in the second place with 22.95% of the sector NPLs, mostly recorded in ground transportation(12.62%), Construction and building sector with 16.85% of total NPLs is in third place, while Infrastructure projects and Manufacturing and industry sector held 15.58% and 12.12% of the sector NPLs, mainly coming from cement and construction material (7.04%) and road and railways (8.84%)respectively.

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

[5] Defaulted assets and advances for which the principal and/or interest is due and remains outstanding for 121-480 days and more as per the assets classification and provision regulation- (Doubtful and Loss)

Figure 6.3: Quality of Loan Portfolio for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



Source: Financial Supervision Department, DAB

- **Adversely-classified loans**

Adversely classified loans (substandard, doubtful, Loss)[6] depicted Af260millionincrease over the year, reaching AFN 6.41 billion, constituting 14.29% of the total gross loans and 21.05% of regulatory capital, the increase is due to deterioration in the loan quality.

These loans require strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be focused on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk.

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

- **Loans classified Watch**

Loans classified in the "watch"[7] category are AFN 6.24 billion, which makes 14.89% of total gross loans increased by 36.20% since Dec, 2018. The increase is mostly attributed to one bank in the system. This category of loans requires close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

[6] An asset for which the principal and /or interest remains outstanding for 61-120 days - (Substandard),[6] Defaulted assets and advances for which the principal and/or interest is due and remains outstanding for 121-480 days - (Doubtful), An asset for which the principal and /or interest remains outstanding for 481 or more days - (Loss)as per the assets classification and provisioning regulation

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

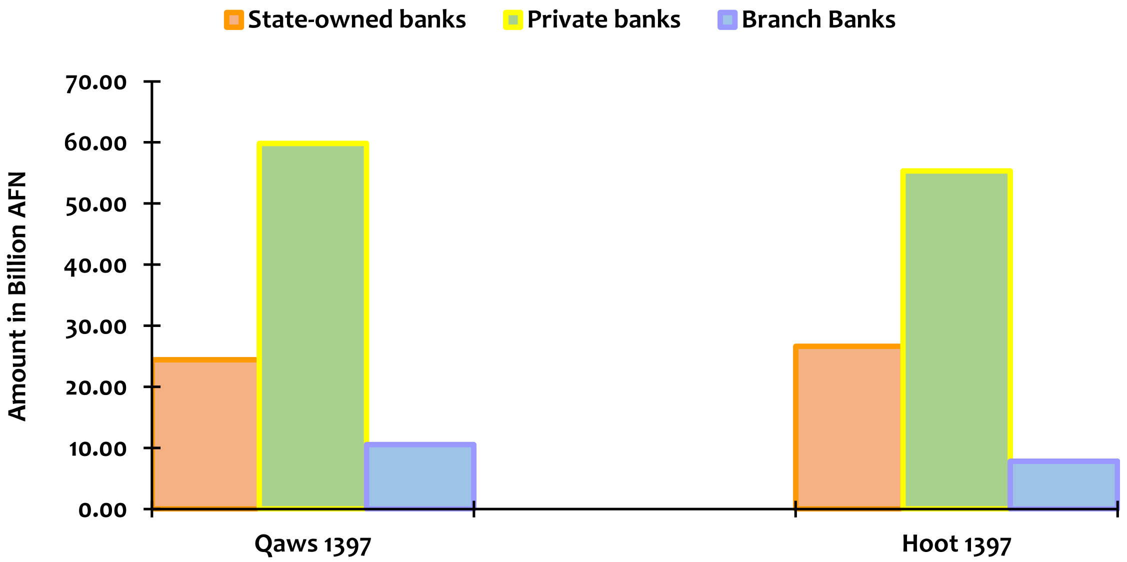
- **Charged-off Loans8**

Loans charged-off as of end of Mar, 2019 amounts to AFN 8.68 million, 0.02% of total gross loans attributed to two banks in the sector.

6.1.2 Interbank Claims

Gross Interbank Claims are the second largest among various asset categories, currently comprising AFN 89.83 billion 29.98% of total assets registered AFN 4.95 billion or 5.22% decrease since Dec 2018, mostly attributed to four banking institutions. Indicating that, the banking sector has channeled a portion of its interbank claims to interest earning assets as loans and investment in bonds. Though decreased, but still banks should not only appropriately measure risks associated with individual bank's but also country or countries in which they have placed funds. See figure 6.4.

Figure 6.4: Share of Interbank Claims among banking groups for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



Source: Financial Supervision Department, DAB

6.1.3 Investment

The net-investment[9] portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies; increased by 7.11% or AFN 1.77 billion since Dec 2018 standing at AFN 26.72 billion or 8.92% of total assets, the increase mostly came from three banking institutions. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, five commercial banks and two branches of foreign banks.

6.1.4 Cash in Vault and Claims On Dab

Cash in vault and claims on DAB remains the largest category making 40.92% of the total assets, showed a decrease of AFN 9.41 billion,

[8] Default assets and advances for which the principal and/or interest remains outstanding for 481 days or more days and retained on the books of banks for the period of 12 months (Loss), After 12 months they are immediately charged-off as per the assets classification and provisioning regulation.

[9] Investments include investment in bonds, securities, associated companies and in subsidiaries

both in absolute as well as in % of total assets since Dec,2018 standing at AFN 122.62 billion as of end of Mar 2018. The decreases were mostly observed in capital notes; cash in vault and corresponding accounts with DAB.

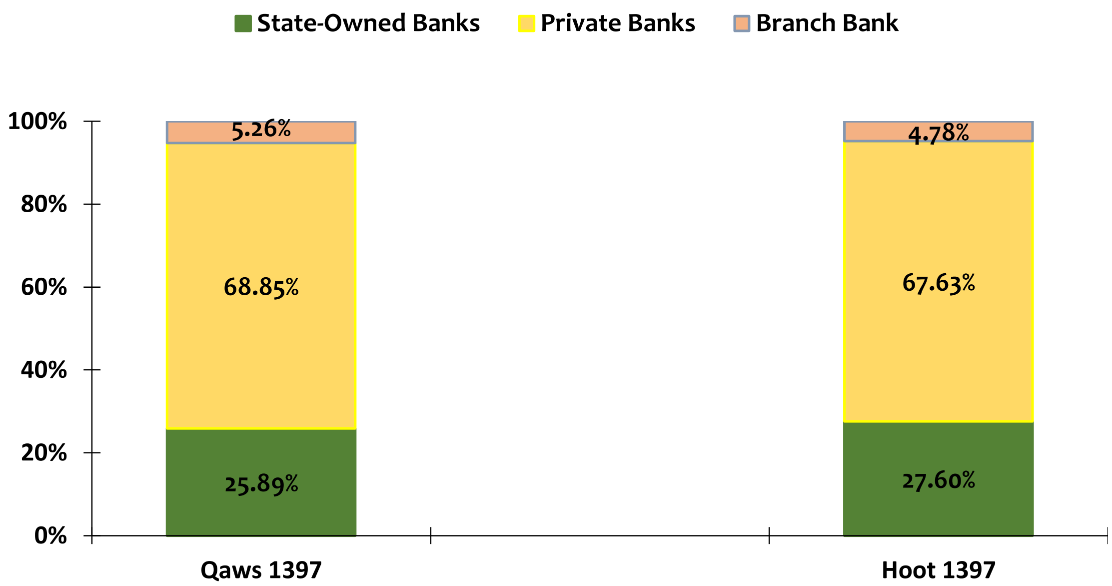
Banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

6.2 LIABILITIES

Total liabilities of the banking sector decreased by AFN 16.06billion or 5.71% standing at AFN 265.27 billion against AFN 281.34 billion in Dec 2018. All components of total liabilities declined over the period under review.

The majority of liabilities are made up of deposits (97.17%), with "other liabilities" at second and borrowings in third place. See table 6.5.

Figure 6.5: Share of Liabilities among banking groups for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



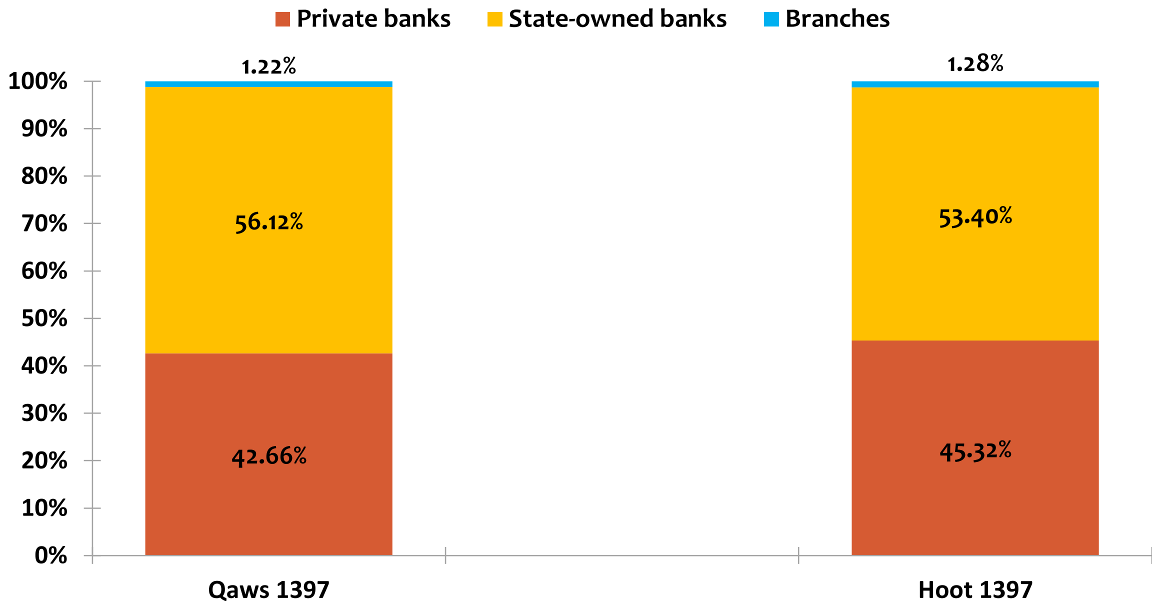
Source: Financial Supervision Department, DAB

6.2.1 Deposits

Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 257.77 billion as of Mar 2019 decreased by AFN 15.56 billion or 5.69%, compared to Dec 2018. The total deposits cover AFN 5.41 billion interbank and AFN 252.35 billion customer deposits. The decrease in deposit base of the banking sector is attributed to customer demand deposits. While interbank deposits were up in the period under review. Currency wise analysis shows that Afghani denominated deposits indicated 7.97% decrease accounting for 28.72% of total deposits, while US dollar denominated deposits decreased by 4.78% making 64.60% of the total deposits of the system, the decrease in deposits is attributed to withdrawals from current accounts.

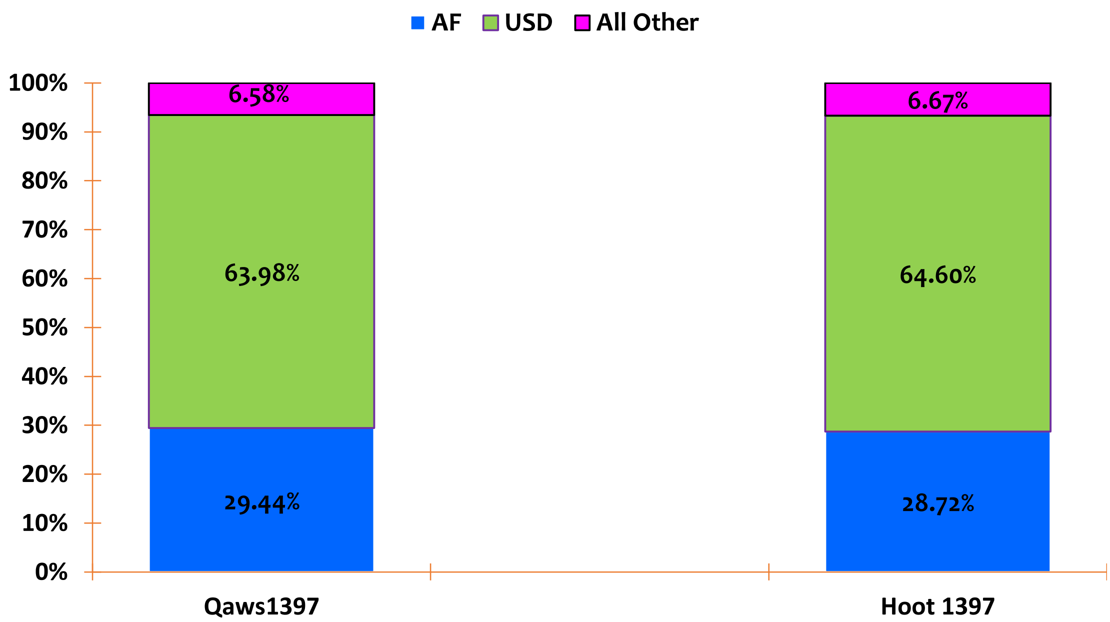
Private Banks attracted AFN 173.89 billion deposits, decreased by 7.54% making up 67.46% of the system's deposits. The share of state-owned banks amounted to AFN 71.37 billion, increased by 1.02% since Dec 2018 accounted for 27.69% of the system's deposits. The share of branches of foreign banks stands at AFN 12.49 billion decreased by 14.45% making up 4.85% of total deposits of the system. In terms of types of deposits, demand deposits accounted for 72.13% of the total deposit base, decreased by 8.57% and time deposits with 8.30% of total deposits was in the second place, and depicted 9.45% increase, while saving deposit making up 19.57% of the total deposits portfolio was up by 0.04% since Dec, 2018.

Figure 6.6: Afghani Denominated Deposits for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



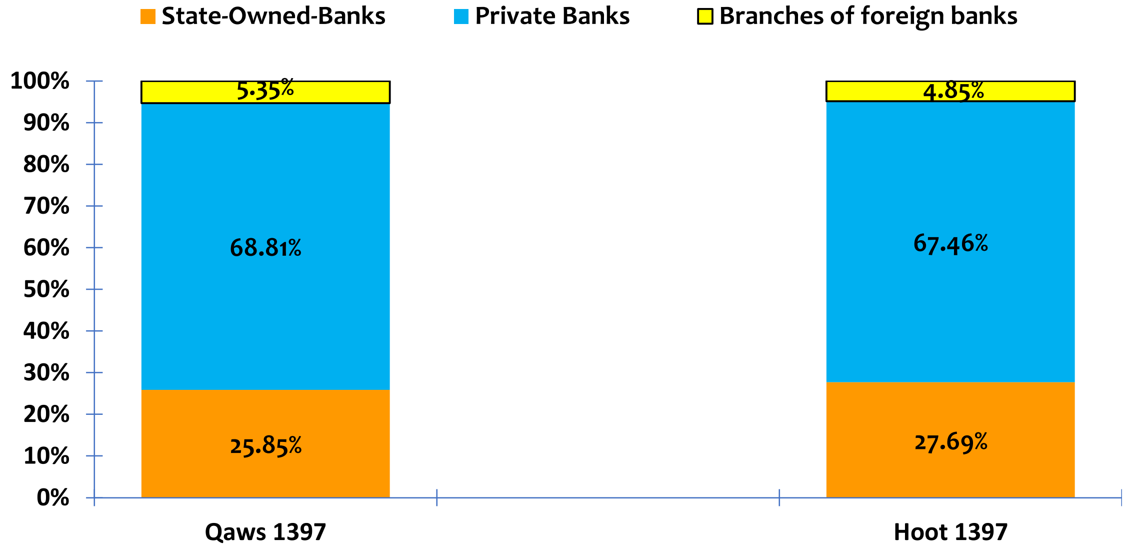
Source: Financial Supervision Department, DAB

Figure 6.7: Currency Composition of Deposits for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



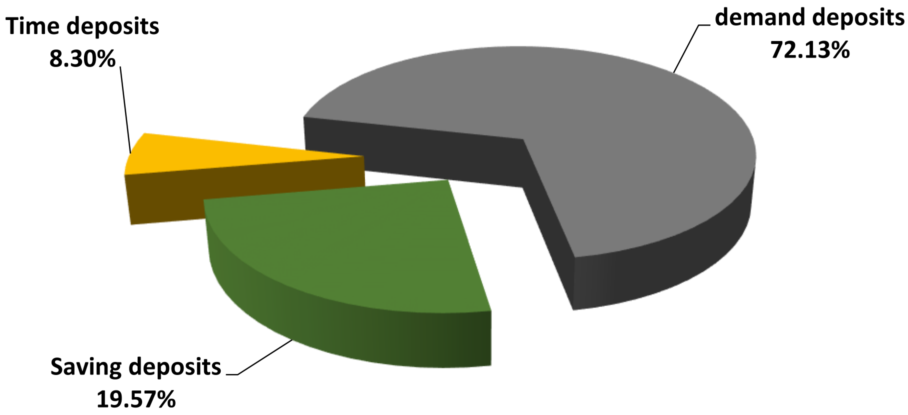
Source: Financial Supervision Department, DAB

Figure 6.8: Deposits among banking groups for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



Source: Financial Supervision Department, DAB

Figure 6.9: Breakdown of Deposits for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



Source: Financial Supervision Department, DAB

6.2.2 Borrowings

The share of borrowings in total funding structure of the system decreased by 5.23% standing at AFN 2.90 billion at the end of Mar 2019 making 1.10% of total liabilities. The current borrowing position is attributed to three banking institutions.

6.3 LIQUIDITY

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

Table 6.4: Liquidity Ratios

Ratio in %	(Dec, 2014)	(Dec, 2015)	(Dec, 2016)	(Dec, 2017)	(Dec, 2018)*	Mar, 2019)
Total Capital Adequacy Ratio	26.46	19.94	27.68	29.81	25.91	27.05
Tier 1 Capital Adequacy Ratio	26.09	19.66	22.93	28.17	24.56	27.53
Non-Performing Loans to Total Gross Loans	8.09	12.34	12.67	12.42	8.99	10.91
Return on Assets (ROA)	0.90	0.20	0.11	0.64	0.81	0.12
Return on Equity (ROE)	7.35	1.69	1.08	3.38	6.91	1.07
liquidity Ratio (Broad Measure Median)	73.6	68.22	67.74	65.92	76.62	76.55
liquidity Assets to Total Assets	73.28	75.05	71.98	73.95	72.88	70.90
*revised						

Source: Financial Supervision Department, DAB

6.3.1 Liquidity Ratio (broad measure)

Banks are required to maintain a liquid asset ratio not less than 15%. This should provide a comfortable safeguard against any liquidity shortfall. Generally, a surplus liquidity position was observed in the banking sector during this period. 70.90% of the sector's total assets are comprised of liquid assets. Ratio of the broad liquidity as a median for the whole system stood at 76.55%. All banking institutions were well above the minimum required level. See table 6.5.

6.4 CAPITAL

The system is well capitalized. The capital fund of the banking sector stands at AFN 34.37 billion; decreased by 0.17% points or AFN 59million since Dec 2018. The decrease in total financial capital is mainly attributed to payment of dividends and decrease in profitability.

On an aggregate basis the Capital Adequacy ratio of the banking sector stands at 27.05%. See table 6.5. Disaggregated analysis shows that the financial capital of all banks are above the regulatory limits; however, the regulatory capital ratio of all banks except one private bank is above the set regulatory threshold (12% of the risk weighted assets). The Basel benchmark for capital to risk weighted is 8%.

6.5 PROFITABILITY

For the quarter ended Mar 2019 banking sector earned AFN 113 million net-profits against AFN 1.44 billion net-profits in Dec 2018, showing significant decrease over the quarter. The major decreasing item was the non-interest income as at the yearend significant amount from the recovery was reported. Other items contributed to the decrease in profitability of the sector includes; decrease in net-interest income and increase in credit provisions. Whilst, operating expenses and tax expenses decreased over the quarter. See table 6.5.

The returns on assets (ROA), shows how well a bank is being managed by conveying how much profit the bank earns per unit of its assets. ROA of the banking sector stands at 0.12% annualized, while the returns on equity (ROE), which measures shareholders return on their invested equity in a bank. The ROE of the banking sector by end of Mar 2019 recorded at 1.07% annualized.

The ROA of SOB[1] recorded at 0.89%, while PB[1] registered negative 0.19%, BOFB[1] recorded 0.09%, at end of Mar 2019.

2

Table 6.5: Profit & Loss (P/L) Schedule

Items	Dec-2018(qaws-1397)	Mar-2019 (hoot-1397)	% change
interest income	2,038.18	1,823.81	-10.51
interest expense	291.86	278.89	-4.44
Net interest income	1,746.32	1,544.92	-11.53
Non-interest income	3,051.43	1,716.02	-43.76
Non-interest expenses	1,622.10	1,439.62	-11.24
Salary cost	1,176.69	1,062.60	-9.69
Credit provisions	177.29	362.93	104.71
P/L before tax	1,821.67	395.79	-78.27
P/L After tax	1,445.01	113.09	-92.17

Source: Financial Supervision Department, DAB

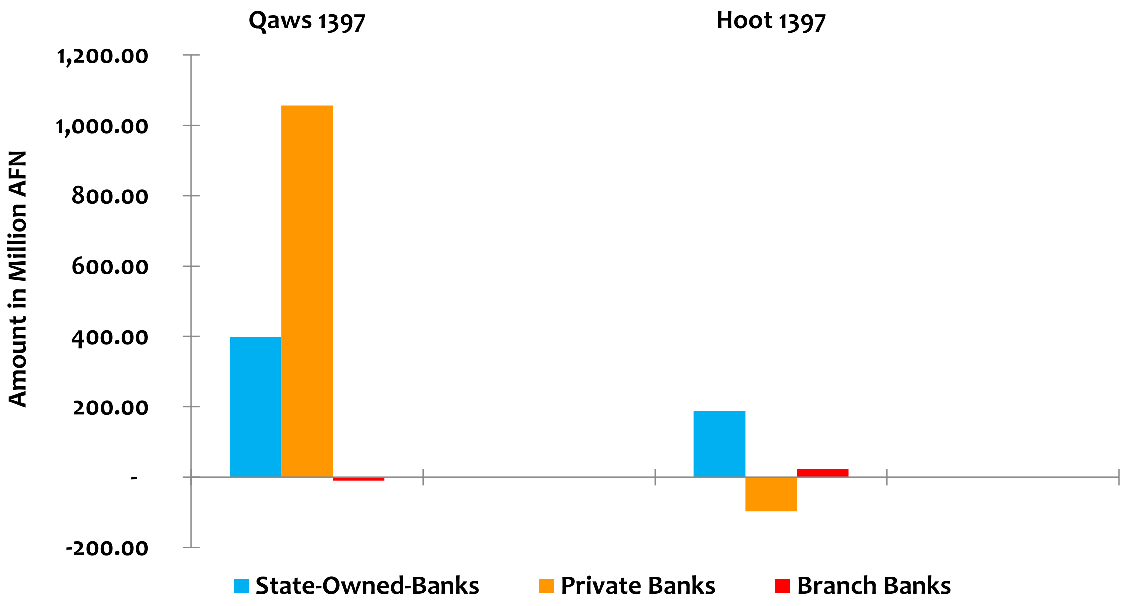
On a cumulative basis five banking institutions have incurred AFN 231 million net-losses during the quarter against AFN 223 million net-losses posted by five banks in Dec 2018.On core income basis, seven banks ended with losses, against seven banks in Dec 2018.

Group wise analysis reveals that State-Owned Banks (SOB) and branches of foreign banks (BFB) ended up with profits, while Private Banks (PB) ended the quarter with losses. See figure 6.10. Major portion of the profitability of the banking sector is attributed to State-Owned Banks standing at AFN 188 million, branches of foreign banks earned AFN 22 million net-profits, while Private Banks recorded at AFN 97 million net-loses during the quarter ending Mar 2019.

[1] SOB- Stated-Owned Banks [0]
[1] PB- Private Banks [1]

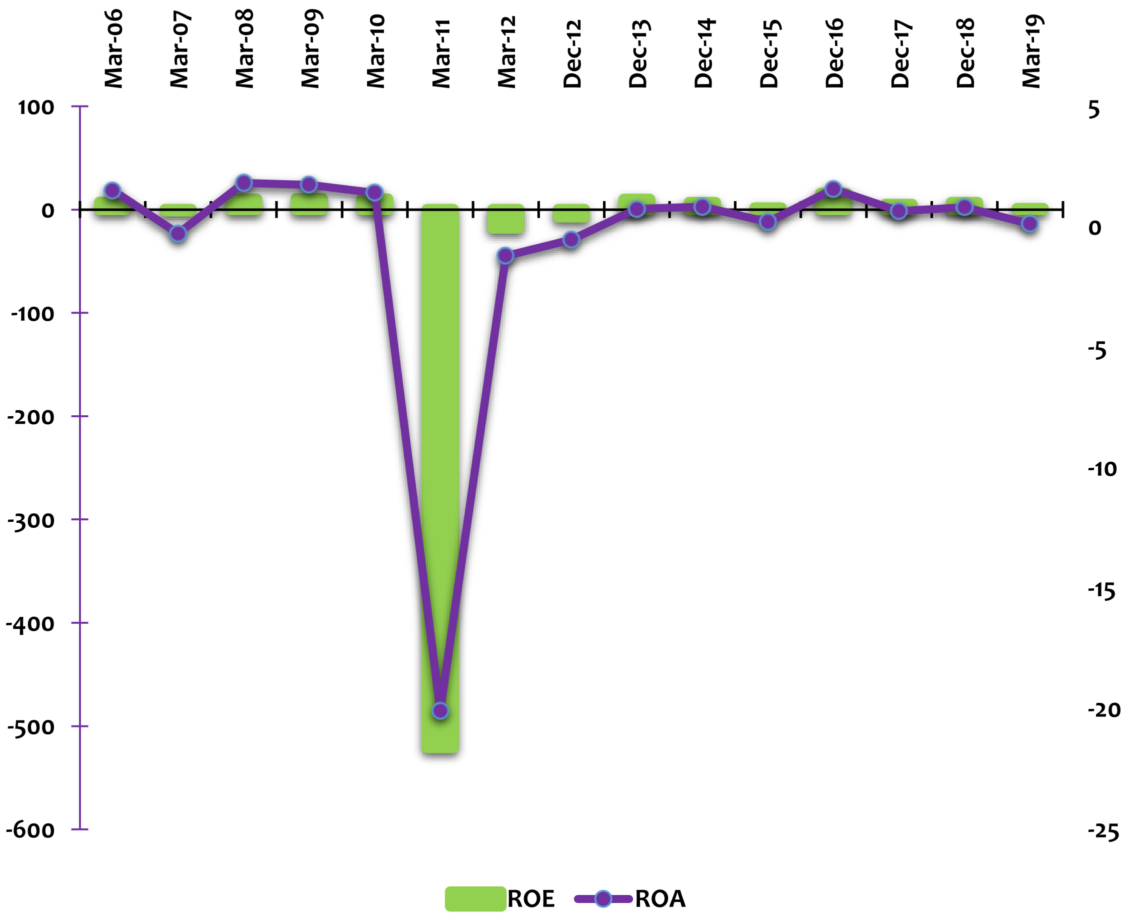
[1] BOFB- Branches of Foreign [2] Banks

Figure 6.10: Profitability of the Banking Sector for Q4-2018 (qaws-97) and Q1-2019 (hoot-97)



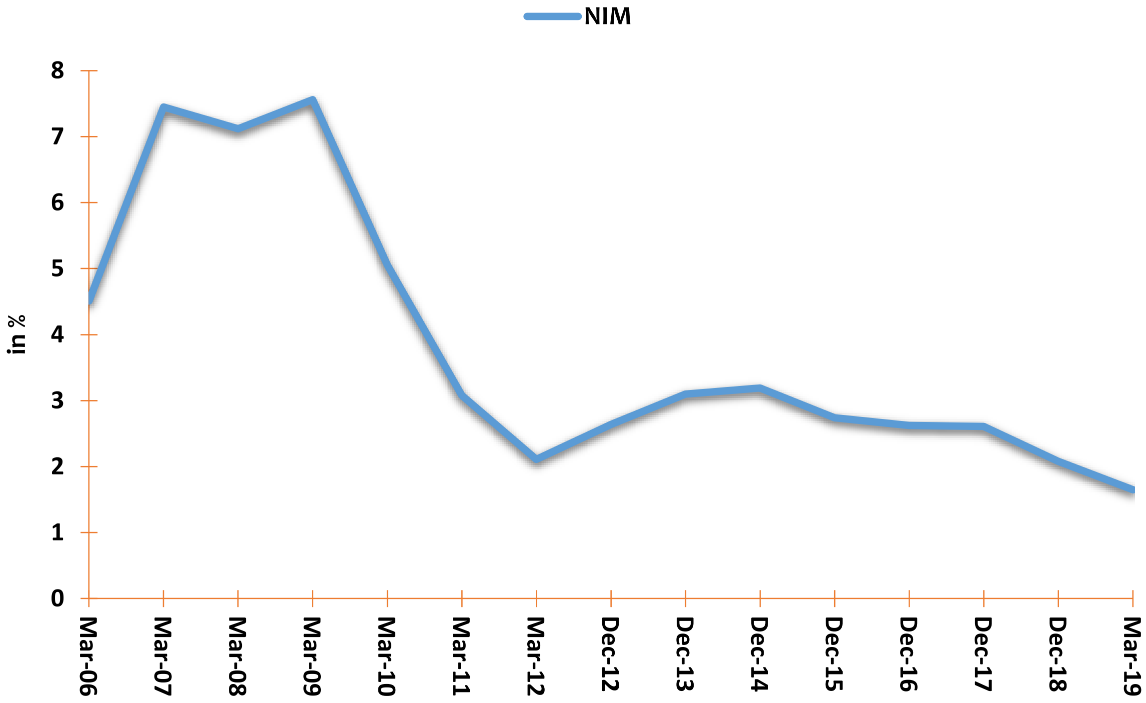
Source: Financial Supervision Department/ DAB

Figure 6.11: ROA and ROE



Source: Financial Supervision Department/ DAB

Figure 6.12: Net Interest Margin



Source: Financial Supervision Department/ DAB

6.6 FOREIGN EXCHANGE RISK

The level of overall open FX position risk being taken by banks is largely within the levels set by DAB. In general, all the banking institutions were within the limits set for the overall open FX position, except for three banking institutions holding open FX positions on overall and on an individual currency (USD and EURO long position) basis violated the limits. Those banks need to bring their FX positions under the set limit; otherwise, depreciation (decrease in the value) of US dollar can lead the banks to more losses.

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20% appreciation in exchange rate would increase the regulatory capital of the system by AFN 1.67 billion and vice versa. Similarly, a 4% change would correspond to AFN 335 million and vice versa.

6.7 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 AFN 1.00 billion in the event of increase in the market interest rate (upward interest rate shock) by 3% points. Conversely, if the interest rate decreases by 3% points (downward interest rate shock) interest income will decline by AFN 1.00 billion. For five banking institution, if the interest-rate increases by 3% points, it will decrease their net interest income over the next 12 months.

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

6.8: ISLAMIC BANKING SECTOR PERFORMANCE

Islamic Banking sector is consisted of 1 bank and six windows, and constitute 4.95% share in assets, 2.21% share in gross loans and 4.99% share in deposits of the overall banking sector.

- Total assets of the Islamic banking sector at the end of first quarter (March 2019) amounted AFN 31.33 billion or equivalent (415.95 million USD) which shows decrease of 9.27% or AFN 3.20 billion as compared to the last quarter (Dec 2018, which was reported amount AFN 34.53 billion).

  The decrease in the assets of Islamic banking sector was mainly due to decline of AFN 3.9 billion in demand deposits of the sector during the quarter under review. The decreased in assets has reported AFN 2.41 billion (16%) in cash in vault and claims on DAB, AFN 741.55 million (13%) in claims on financial institutions, AFN 227.98 million (4%) in Net Murabaha financing and AFN 485.95 million in net other assets. The decrease in the net Murabaha financing over the quarter was due to increased AFN 349.22 million in financing loss reserves.

- Deposits which are the main funding source for the Islamic banking sector at the end of first quarter March stood at AFN 25.83 billion or (342.87 million USD) and comprising 94% of the total liabilities of the sector and decreased by 10.66% or AFN 3.08 billion against the preceding quarter (Dec 2018). The decrease in total deposit base of the banking sector is attributed to decrease AFN 3.9 billion in demand deposits. Meanwhile the time and saving deposits of the sector increased AFN 498.20 million and AFN 318.33 million respectively.

- The capital of Islamic Banking sector is consisting of owner' equity, retained profit/loss of previous years, other comprehensive income and profit/loss of current year. The total capital of the sector stands at AFN 3.83 billion or (50.96 million USD) and decreased by 5.32% or AFN 215.54 million against the previous quarter (Dec 2018). The decrease in total capital is attributed mainly due to loss during the quarter under review.

- During the first quarter of the year 2019, the Islamic Banking sector suffers AFN 215.54 million losses, against AFN 788.41 million profits in last quarter (Dec 2018).

  The returns on assets (ROA) stood at -5.21% annualized, and Return on Equity (ROE) recorded at -26.06% annualized, from -4.86% and -23.83% in fourth quarter Dec 2018. The mean reason of the sector loss in the quarter under review was due to increased AFN 181.56 million in credit provision and decreased AFN 46.28 million in other non-profit income during quarter as compared to previous last quarter, 2018.

As annualized basis one out of six Islamic banking windows and one full-fledged Islamic bank ended up with profit and five windows suffered losses at the end of March 2019.

6.8.1 Assets of the Islamic Banking Sector

The total assets size of the Islamic banking sector stands at AFN 31.33 billion or equivalent (415.95 million USD) which decreased by AFN 3.20 billion or 9.27% in the quarter under analysis against previous fourth quarter (Dec 2018). The reason of decrease in the total assets of sector was due to decreased AFN 3.9 billion in demand deposits of customers. See Table 6.6.

The breakup of total assets reveal that the most noticeable decrease was reported in cash in vaults and claims on DAB, in interbank claims and as well as in other assets, which decreased by AFN 2.41 billion or 16% and AFN 741.55 million (13%) and AFN 486 million (19%) respectively, meanwhile the investment securities (Sukuk) account increased AFN 682 million or 14% during the quarter under review.

The components of the Islamic banking sector total assets portfolio were cash in vault and claims on DAB (40%), interbank transaction (16%), net financing and investment (36%) and other assets make (7%) of the total assets.

Table 6.6: Total Assets and Liabilities of Islamic Banking Sector

Amount in million AF	Qaws,2018 Dec, 2018	Hoot,2018 March, 2019	% of Total Assets/Liability	Quarterly Growth
Assets				
Cash in vault and claims on DAB	14,813	12,403	40%	-16%
Interbank claims	5,881.42	5,139.87	16%	-13%
Financing & Investment(Net)	10,572.27	11,026.04	36%	10%
Other Assets	2,610.02	2,124.06	7%	-19%
Fixed and Intangible Assets	662.811	645.418	1.9%	-5%
Total Assets	34,539.60	31,338.23		-9.27%
Liabilities				
Deposits	28,913.08	25,832.03	94%	-10.66%
Other liabilities	1,571.24	1,762.92	21%	6%
Total liabilities	30,484.32	27,498.50		-10%%
Financial Capital	4,055.26	3,839.72		-5.32%
Total Liabilities + Capital	34,539.60	31,338.23		9.27%

Source: IBFD (Islamic Banking and Finance Department) DAB

• Net Financing and investment

Total Net financing and investment of the sector at end of first quarter Mar 2019, reported AFN 11.02 billion and shows an increase of AFN 454 million or 10% as compared to preceding quarter Dec 2018, constituting 36% the total assets of sector. The increase in total net financing and investment portfolio is mainly due to increase in investment securities (Sukuk) AFN 674.93 million and meanwhile the net financing Murabaha due to increase in loss reserves show decrease of AFN 228 million.

The breakup of total gross financing and investment of sector consists of Murabaha receivables amounted AFN 6.17 billion and increased 2% which makes 53.44% of the gross financing and investment, Diminishing Musharaka amounted AFN 124.10 million or 1.04%, constant Musharaka amounted AFN 50.50 million, Sukuk investment amounted AFN 2.11 billion increased by AFN 674.93 million which makes 18% of total gross financing and investment and asset acquired for leasing amounted AFN 1.95 billion and makes 16.56% of the gross financing, and other investment amounted AFN 1.15 billion which makes 10.62% of total financing and investment of sector during the quarter under review.

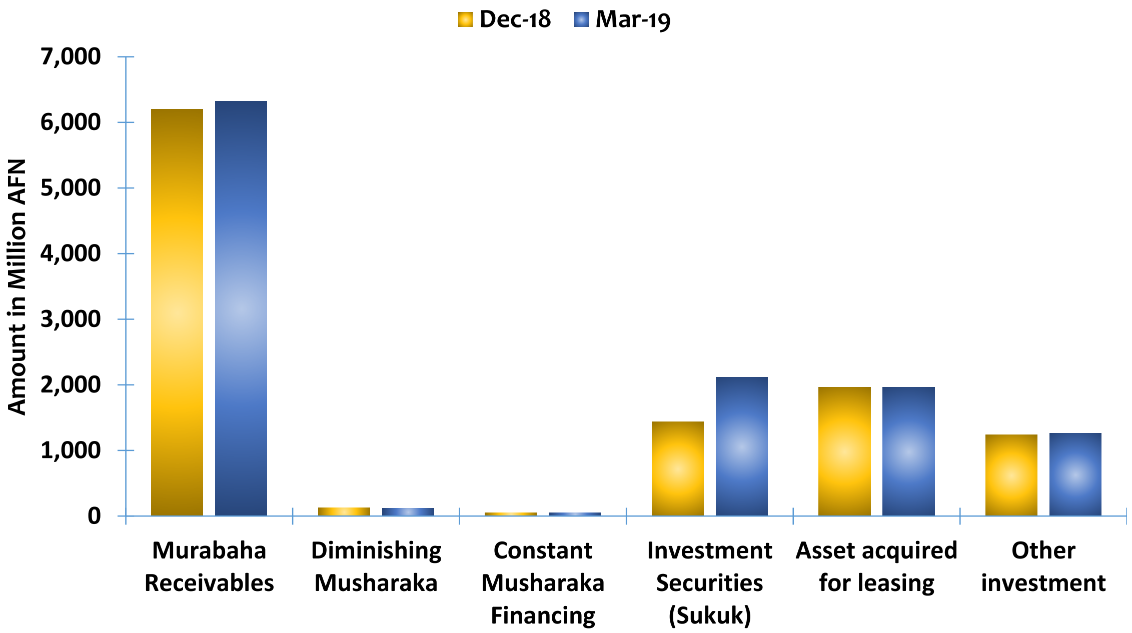
Increase in financing and investment (Sukuk) portfolio was observed at Islamic bank of Afghanistan, and it is worth mentioning here that Islamic banking window of (NKB) has no financing and investment activities.

Table 6.7: Product wise Islamic Banking Sector Financing and investment (gross)

No	Product	Amount in million AFN				
		Dec-18	Mar-19	Difference in Amount	Difference %	Products as % Gross Investment & Financing
1	Murabaha Receivables	6,198.48	6,319.72	121.245	2%	53.44%
2	Diminishing Musharaka	125.51	124.103	1.405	-1%	1%
3	Constant Musharaka Financing	51.076	50.503	0.57	-1%	0.42%
4	Investment Securities (Sukuk)	1,439.84	2,114.77	674.93	47%	18%
5	Asset acquired for leasing	1,965.24	1,958.78	-6.45	-0.33%	17%
6	Other investment	1,241.05	1,256.30	15.24	1%	10. 62%
Grand Total		11,021.20	11,824.19	802.99	16%	100%

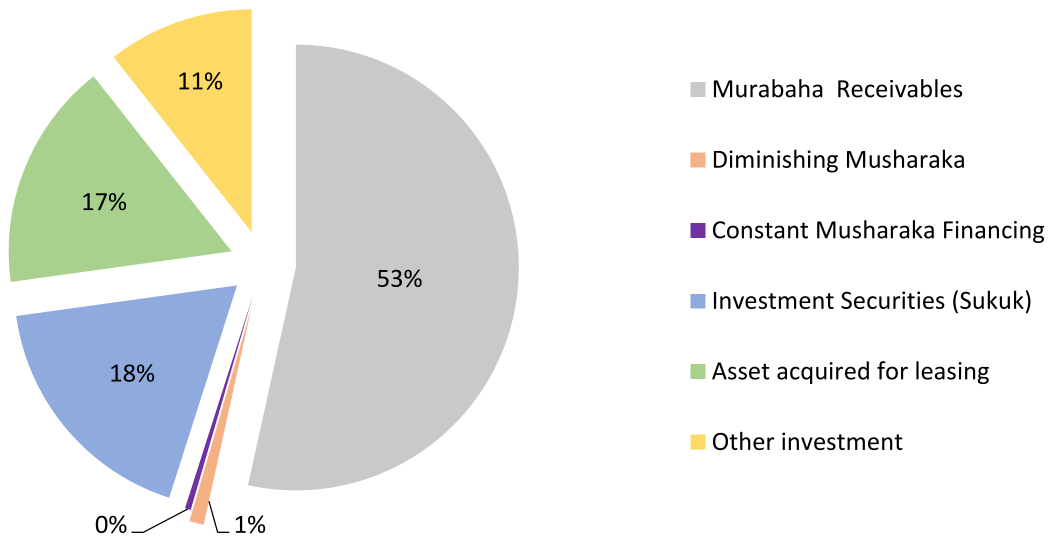
Source: IBFD (Islamic Banking and Finance Department) DAB

Figure 6.13: Product wise Investment and Financing of the Islamic Banking Sector: comparison between Dec 2018 and Mar 2019.



Source: IBFD (Islamic Banking and Finance Department) DAB

Figure 6.14: Product wise investment and financing as per Mar, 2019.



Source: IBFD (Islamic Banking and Finance Department) DAB

- **Financing & Investment Loss Reserve**

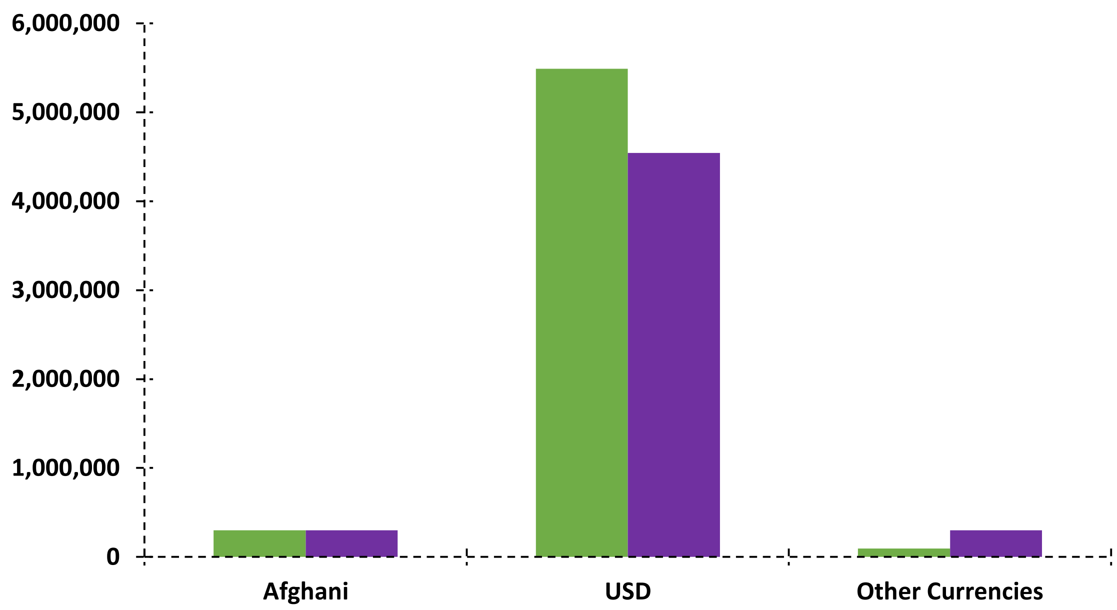
At the end of Mar, 2019 (Hoot 1397), total provision of Islamic Banking sector reported AFN 813.21 million and shows an increase of AFN 351.47 million as compared to previous quarter Dec 2018 which is reported in financing, the provision of the sector comprises AFN 798.15 million for financing and AFN 15 million for account receivable. The provision for financing which cover 13% of total gross financing of Islamic banking sector as opposed to 7% recorded in the previous quarter ending Dec, 2018.

- ## Interbank Claims

The Interbank Claims of the Islamic Banking Sector are the fourth largest among various asset categories, at the end of first quarter March 2019, reported AFN 5.13 billion which makes 16.40% of total assets shows AFN 741.55 million decrease from previous third quarter (Dec 2018). Interbank claims denominated Afghani 5.83%, USD 88.34% and other currencies 5.81%. See figure 6.15.

Two out of six Islamic banking windows and one Islamic bank have interbank claims which consist of amount AFN 2.009 billion time deposit and AFN 3.13 billion demand deposits, the interbank claims used as commodity Murabaha and internal transferring and settlement transactions with their banks.

Figure 6.15: Interbank claims



Source: IBFD (Islamic Banking and Finance Department) DAB

- ## Cash in Vault and Claims on DAB

Cash in vault and claims on DAB indicated AFN 12.40 billion and decreased to amount AFN 2.41 billion as compared to preceding quarter ended Dec 2018, the cash in vault and claims on DAB is first largest item and makes 40% of total assets of the sector. The decrease in Cash in vault and claims on DAB mainly showed AFN 1.72 billion in cash in vault and AFN 724.48 million in current account with DAB. The reason of decline in above item is mainly due to decrease in total deposits of sector compared to the last quarter.

Cash in vault and Claims on DAB consist of AFN 3.84 billion cash in vault, AFN 6.25 billion current Account with DAB and AFN 2.30 billion Required Reserve Account with DAB.

6.8.2 Liabilities

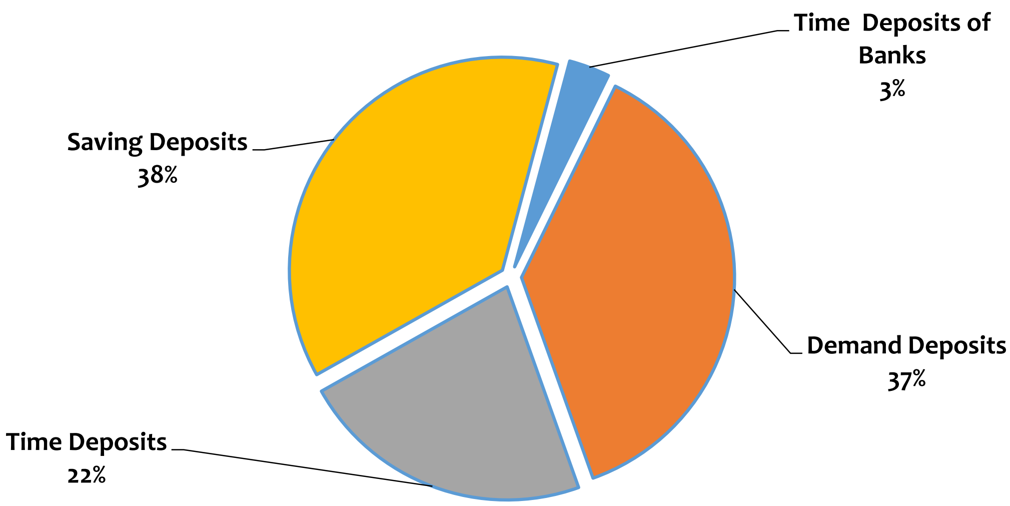
Total liabilities of the Islamic banking sector at the end of March 2019, reached AFN 24.49 billion, and decreased by AFN 2.98 billion (10%) as compared to the preceding quarter (Dec 2018). The reason of decrease in liabilities was mainly due to decrease AFN 3.08 billion in deposits of the sector. As well as the majority of liabilities are made up of deposits (93.93%), and "other liabilities "at second place (4%).

- **Deposits**

Deposits are being the main funding source of the Islamic banking sector, at the end of March 2019, reported AFN 25.83 billion and decreased by AFN 3.08 billion or 10.66% in the first quarter of the year 2019, compared to previous quarter ended by Dec 2018. The decrease in deposits totally took place AFN 3.90 billion in demand deposits; meanwhile the time deposits and saving deposits of the sector shows an increase of AFN 498.20 million and AFN 313.33 million respectively as compared to last quarter.

The total customers' deposits of the sector consist of AFN 9.63 billion of demand deposits, AFN 5.76 billion of time deposits and AFN 9.63 billion of saving deposits. As well as the demand deposits make 37.28%, time deposits 25.39% and saving deposits make 37.31% of the total deposits of the sector, and which is comprised of AFN 25.03 billion customers deposit and AFN 799.56 banks deposits. The deposits of banks make only 3.09% of total deposits of sector.

Figure 6.16: Breakdown of Deposits as Per March 2019:



Source: IBFD (Islamic Banking & Finance Department), DAB

6.8.3 Liquidity

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

Table 6.8: Key Financial Soundness Indicators of the Islamic banking sector as of Mar 2019.

Ratio in %	(Dec, 2018)	(Mar, 2019)
Liquid Assets to Total Assets	60%	56%
Liquid assets to short term liabilities	153%	182%
Foreign-Currency denominated funding to total funding	68%	68%
Foreign- Currency denominated financing to total financing	71%	72%
Return on Assets (ROA)	1.84	(5.21)
Return on Equity (ROE)	14.10	(26.06)

Source: IBFD (Islamic Banking & Finance Department), DAB

6.8.4 Capital

The Islamic banking windows are not well capitalized. because there is no separate Equity capital for Islamic banking windows, and it consists of owner's equity (which is not in the form of liquid assets, but it is the value of investment property which is transfer/given from the conventional bank to Islamic banking windows), Retained profit/loss of previous years, other comprehensive income (income from the revaluation of fixed assets) and profit/loss of current year.

The capital of Islamic banking sector stands at AFN 3.83 billion decreased by 5.32% or AFN 215.54 million over the last fourth quarter of the year 2019. The reason of decrease in capital of Islamic banking sector was due to suffering the loss of the sector during the first quarter of the year 2019. And the capital Adequacy ratio of the Islamic Bank of Afghanistan stands at 12.2%.

6.8.5 Profitability

On cumulative basis, the Islamic banking sector at the end of first quarter of the year 2019, reported AFN 215.54 million loss, the main reason of the sector's loss in quarter under analysis was mainly due to increase of AFN 182 million in accrued provisions and decreased AFN 46 million in nonprofit income, as compared to preceding quarter.

Meanwhile FX revaluation gain of the sector increased AFN 41.23 million and as well as revised reported AFN 40 million of Tax in current quarter reduced the sector loss from AFN 390.70 million to AFN 215.54 million. The returns on assets (ROA) stand at -5.21% from 1.84% in previous quarter. The return on equity (ROE) declined from 14.10% to -26.06%.

Table 6.9: Profit and Loss Schedule of the Islamic Banking Sector

Profit and loss Schedule (Amount in million AFN)			
Item	Dec-18	Mar-19	Difference
Profit income	207.89	196.84	(11.04)
Profit expense	59.40	80.56	21.15
Net profit income	148.48	116.28	(32.20)
Other nonprofit income	138.74	92.45	(46.28)
Other nonprofit expense	82.64	273.09	190.45
Credit provisions	(242.848)	326.35	
P/L before tax	447.43	(390.70)	
Net profit income/Loss after Tax	778.41	(215.54)	

Source: IBFD (Islamic Banking & Finance Department), DAB

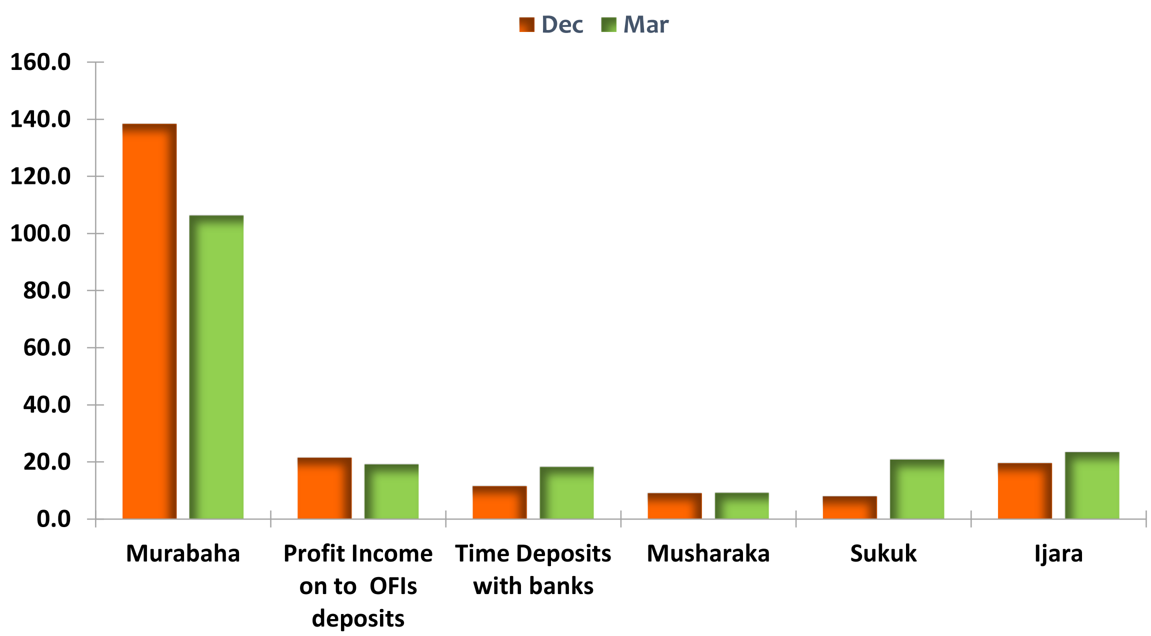
In general, the Islamic banking sector offering seven types of financing products, with the returns from mentioned financing are shown in the table below for the first quarter March of the year, 2019.

Table 6.10: Returns by Major Types of Shariah Compliant Products

Value of returns by major type of Shariah-compliant contract (Amount in million AFN)			
Product	Dec-18	Mar-19	Difference
Time Deposits with banks	21.468	19.118	(2.351)
Profit Income on to OFIs deposits	11.489	18.183	6.694
Murabaha	138.36	106.235	(32.126)
Constant Musharaka	1.229	0	(1.229)
Diminishing Musharaka	7.814	9.173	1.359
Sukuk	7.917	20.778	12.870
Ijara	19.613	23.351	3.738
Total Profit Income	207.892	196.847	(11.045)

Source: IBFD (Islamic Banking & Finance Department), DAB

Figure 6.17: Return by Major Types of Shariah Complaint Products



Source: IBFD (Islamic Banking & Finance Department), DAB

Contact:

Telephone : +93 (0) 20 2103930

E-mail : mp@dab.gov.af

Website : www.dab.gov.af

Monetary Policy Department
E-mail: mp@dab.gov.af
Tel: +93 20 210 3930