Da Afghanistan Bank

Economic & Statistical Bulletin

Annual Bulletin 2019

Monetary Policy Department

Da Afghanistan Bank

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Note:

Afghanistan's fiscal year has changed effective from 1397 (2012). The new fiscal year begins from first of Jadi (December 22nd) each year. This bulletin analyzes economic developments from for FY 2019 (from Jadi, 1397 till Qaws, 1398.

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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

EXECUTIVE SUMMARY

Da Afghanistan Bank maintains monetary aggregate targeting regime, where main operational target is Reserve Money and Currency in Circulation is the indicative target for liquidity. Reserve money remained below the target in the FY 1398, meanwhile CiC, major component of the RM went above the targeted level for a shorter period during FY 1398. For the purpose of achieving operational targets, Da Afghanistan Bank uses Open Market Operation to control and manage liquidity in the market. Narrow money (M1) recorded growth of 6% where Broad Money (M2) registered 5.70% growth during the FY 1398.

Consumer Price Index (CPI) is calculated on the basis of April-2015 base prices. On Year-on-Year basis, inflation rate on average was 2.31%, higher than 0.6% in the previous year. Similarly, comparing on Quarter-on-Quarter basis, inflation rate shows an increase reaching to 1.71% in the 4th Quarter of FY 1398, where it was 0.89% in the same quarter of the last year.

External sector of the economy registered a deficit of USD 2,948 million in the FY 1398. The deficit of the Current account decreased by 2%, which was mainly due to 8% decrease in trade deficit. Investment income increased by 61% in the year under review, and personal transfer increased by 14%. Capital account inflow decreased by 37% on the ground of decrease in the level of grants to the government, while financial account of the BoP experienced a downward trend, stood at a value of USD 117.18 million in FY 1398. FDI inflow was USD 2.90 million while portfolio investment outflow was USD -14.62 million.

In Fiscal sector of the economy, total core budget increased to AFN 399.41 billion in FY 1398 from AFN 377.19 billion in FY 1397. Excluding grants, Core budget experienced a deficit of AFN 203.62 billion, while including grants, the deficit was AFN 11.24 billion. Domestic revenue reached to AFN 208.42 billion in FY 1398, and expenditures also increased to AFN 412 billion. Furthermore, grants to government was AFN 192.38 billion in FY 1398, while it was AFN 208.28 billion in FY 2018, which showed decrease of AFN 15.90.

In the Banking sector, data indicates decreasing trend in FY 1398. Total assets, deposits and gross loans shows a decline while equity capital indicates an increase. Further, liquidity remains adequate but the quality of assets remains low. Trade sector with share of 44.4% received the highest amount of loan from the banks, while farms and consumer loans together received 6.19% of the total credit of the banks. Deposits were the main source of funding for the banking sector which consist of customer deposits and interbank deposits. Profitability of the sector was higher compared to the last year resulting in increased Return on Investment (ROA) and Return on Equity (ROE).

Islamic Banking, on the other hand, witnessed growth in its main financial indicators. Assets base of the Islamic banking recorded 10.71% growth, while gross investment and financing portfolio of the sector showed an increase of 17.57% in FY 1398. The Islamic banking sector incurred loss of AFN 279.53 million during the FY 1398, which resulted in lower ROA and ROE, -10% and -6.96% respectively.

1

Global Economic Environment

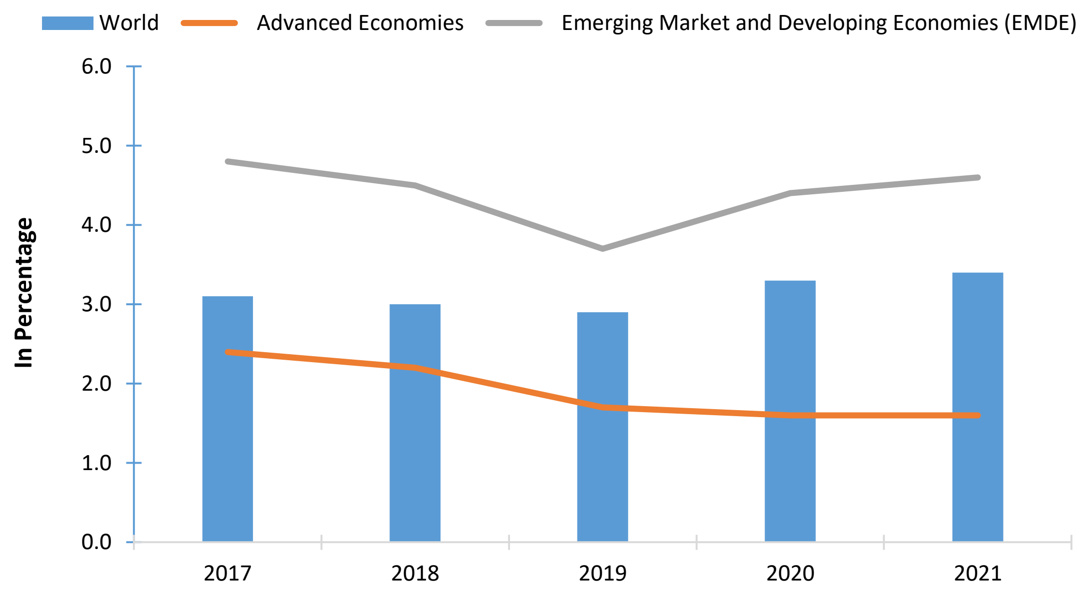
1

GLOBAL ECONOMIC ENVIRONMENT

Global economic growth continued to remain low in FY 2019. Weak trade, low industrial production, and low investment in emerging markets, decelerating economic growth in many developing and emerging markets including China, India, Brazil and Russia, and tensions pertaining to Brexit were the main determinants for the global economy in FY 2019.

The IMF in its World Economic Outlook (WEO) has estimated growth rate of 1.7% in 2019 and projected a growth rate of 1.6% for in FY 2020 for advanced economies, 1.2% in FY 2019 and 1.3% in FY 2020 for euro areas, 3.7% in FY 2019 and 4.4% in FY 2020 for emerging market and developing economies. The global growth projection was revised down mainly due to sharp drop in growth in some of the economies such as India. Among advanced economies, US economy grew at 2.3% in FY 2019, while UK and Germany experienced growth of 1.4% and 0.4% respectively in the same period. Among the emerging economies, China's economy slowed to 6.1% reaching thirty years' low and Turkey's economy grew by 0.9% in FY 2019.

Figure 1.1: Advanced and Emerging economies' GDP growth



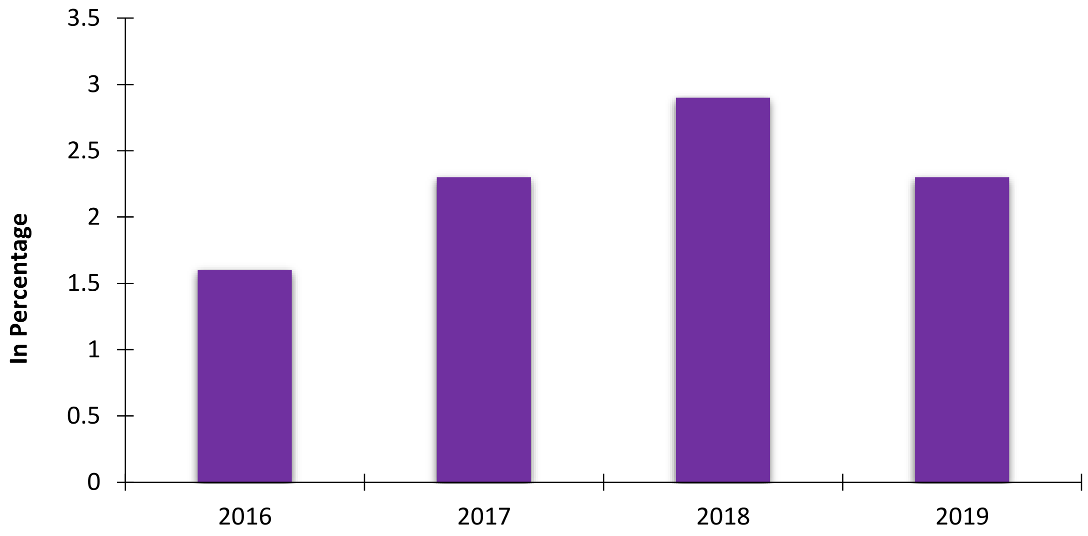
Source: IMF, World Economic Outlook

1.1. ADVANCED ECONOMIES:

1.1.1 United States' Economy:

US real GDP growth was 2.1% in the fourth quarter of FY 2019. The real GDP recorded an annual increase of 2.3% in FY 2019 compared to 2.9% of FY 2018 missing the 3% targeted growth rate. The US economy started with a strong growth of 3.1% in the first quarter of FY 2019, slowing to 2% and 2.1% in the second and third quarter respectively as the trade war deepens and tax cut effects fading away.

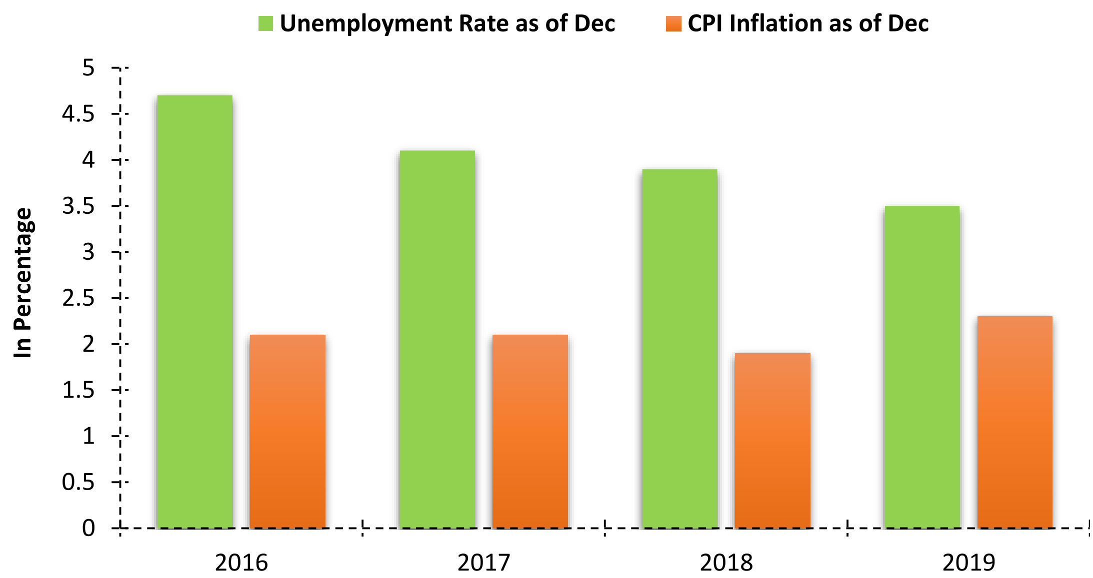
Figure 1.2: US annual GDP growth rate



Source: US Bureau of Economic Analysis

In the final quarter of FY 2019, decrease in import and increase in government spending were offset by decrease in private investment and personal consumption expenditure. The increase in GDP current dollar equalled to USD 184.2 billion in the final quarter, reaching USD 21.43 trillion. The increase in real GDP in FY 2019 reflected positive contributions from PCE, non-residential fixed investment, federal government spending, state and local government spending, and private inventory investment that were partly offset by a negative contribution from residential fixed investment.

Figure 1.3: Unemployment rate and CPI



Source: US Bureau of Labor Statistics

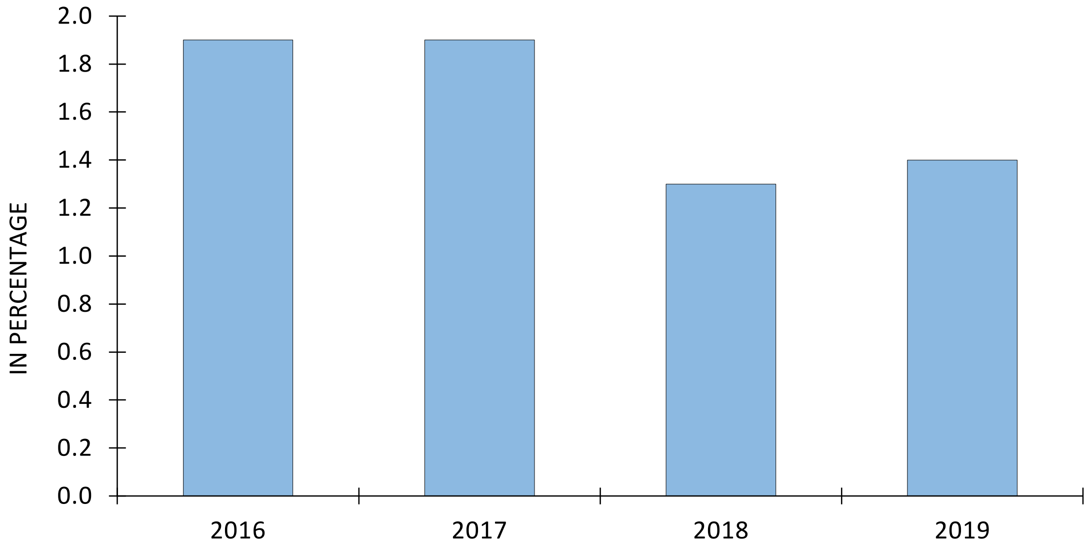
The trade deficit dropped 1.7% to $616.8 billion, declining for the first time since FY 2013. Goods imports dropped to 1.7% in FY 2019 amid steep declines in industrial materials and supplies, consumer goods and other goods. The 1.3% drop in exports was led by decreases in shipments of capital goods, industrial supplies and materials, as well as other goods.

As of December unemployment rate was 3.5% in the US. Job gains were mainly recorded in retail, leisure and hospitality, and health care. Construction and professional, and business services also reported job gains, while manufacturing, transportation, warehousing and mining sectors reported job losses.

1.1.2 The Economy of UK:

The UK GDP grew at 1.4% pace in FY 2019 slightly higher than 1.3% in FY 2018. However, the fourth quarter of FY 2019 witnessed no growth and the growth line became flat. In the fourth quarter the service sector grew but the growth was lower than the previous quarter and the growth was offset by contraction in manufacturing sector. Furthermore, the car industry experienced decline due to shutdown of plants. The services sector, comprising more than three-quarter of the UK economy grew by just 0.1% in the final quarter of FY 2019, meanwhile the construction sector grew by 0.5%. However, the manufacturing sector saw output fall by 1.1%. That came after some car factories paused work in November in case Britain left the European Union without a deal on 31 October FY 2019.

Figure 1.4: UK annual GDP growth rate



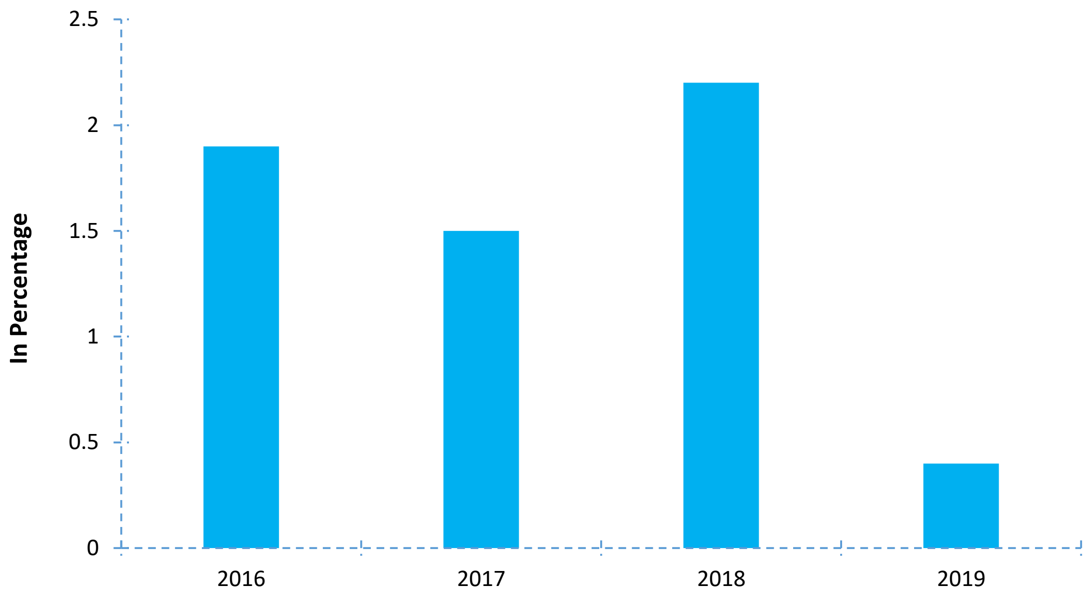
Source: Office for National Statistics

The fourth quarter of FY 2019 also saw the trade deficit in goods and services widen to £6.5 billion from the £4 billion deficit seen in the third quarter. The deficit widened largely because of the shrinking of the surplus in UK trade in services. By contrast, the goods trade deficit shrank in the fourth quarter of FY 2019. That was mostly accounted for by a £2.2 billion decrease in machinery and transport equipment's imports. For FY 2019 as a whole, the trade deficit for goods and services narrowed slightly by £0.5 billion reaching to £29.3 billion.

1.1.3 Economy of Germany:

Germany, Europe's largest economy which is also considered as the main driver of growth in the Eurozone, expanded at a pace of 0.4% in FY 2019. However, the 0.6% growth rate is the slowest yearly growth since 2013 given that the economy expanded by 1.5% in FY 2018 and 2.2% in FY 2017 as depicted in the chart below. Germany's economy survived a recession where the economy is contracted by 0.2% in the second quarter and expanded by 0.1% in the third quarter of FY 2019. Germany economy has been hit hard by the weakening global demand, trade war and Brexit uncertainties.

Figure 1.5: Germany's annual GDP growth rate



Source: Federal Statistical Office

The growth in FY 2019 was mainly seen in the service sector while the industrial output, which is the backbone of German economy shrunk. The auto industry also slowed down due to weakening domestic and global demand and transition of the auto industry to the manufacturing greener vehicles. Furthermore, in FY 2019 the consumption expenditure contributed positively to the growth while exports declined in this period.

According to the Federal Statistics Office, general government budgets achieved a surplus in FY 2019 for the eighth time in a row, amounting to 49.8 billion euros which was lower than surplus of 62.4 billion euros recorded in FY 2018.

1.1.4 Economy of Japan:

According to data released by Cabinet Office of Japan, the GDP expanded at an annualized rate of 1.9% in the fourth quarter following a revised 2.4% annualized contraction in the third quarter. The capital expenditure component of GDP grew by 2.7% in October-December from the previous quarter which is the fastest expansion since January-March 2015. Furthermore, private consumption, which accounts for roughly 60% of GDP, grew by 0.4%. Domestic demand contributed 0.8 percentage point to GDP and household spending rose 2.0% year-on-year in January, more than the median estimate for a 0.4% annual contraction which shows a sign of relief for the growth. On the other hand, net export contracted by 0.3%.

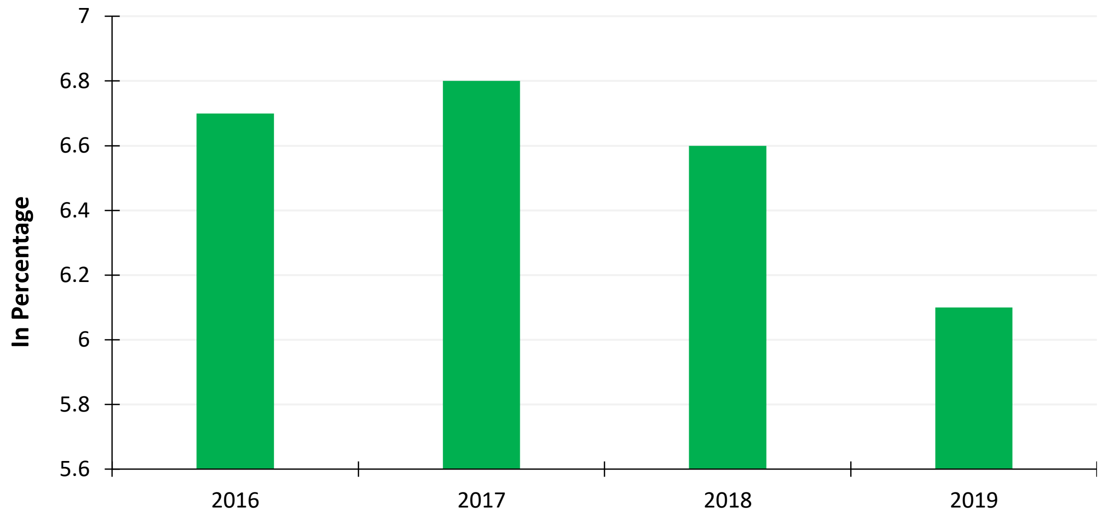
In 2019, Japan economy was hit hard by the uncertainties pertaining to trade war and slowdown in global trade. Some economists warn that capital expenditure and overall economic growth are likely to weaken in the first half of this year as exports decrease and inventories pile up due to a slowdown in global trade.

1.2 EMERGING ECONOMIES:

1.2.1 Economy of China:

The world's second-largest economy expanded by 6.1% in FY 2019 compared to 6.6% growth rate in FY 2018. The 6.1% growth rate is in line within the government targets which was set earlier between 6% to 6.5%, however it is the lowest growth rate China's economy has witnessed in 30 years. The economy started with a growth of 6.4% in the first quarter, slowed to 6.2% in the second and to 6% in the third and fourth quarter of FY 2019. The GDP growth rate slowed down in FY 2019 due to the US and China's trade war which weakened global and domestic demands, as well as export's contribution to the growth shrunk in this period. Two economic bright spot in December FY 2019 were an 8% jump in retail sales and a growth of 6.9% in industrial production, one whole percentage point above analyst estimates.

Figure 1.6: China's annual GDP growth rate



Source: National Bureau of Statistics China

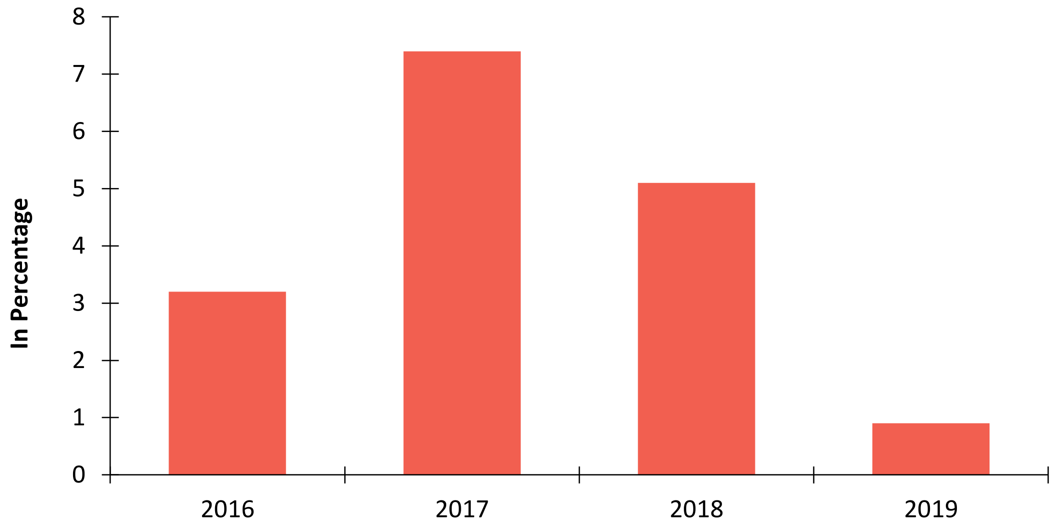
In order to maintain growth, the government introduced several fiscal measures and stimulus packages to support consumption and investment this year, however, the effect is expected to fade away in the coming quarters. The general public budget revenue increased by only 3.3% which was caused by the policy measures of cutting taxes and fees. Furthermore, the government also introduced several economic reform policies last year, subsequently there are significant improvement in the business climate ranking last year which is raised from 78th to 46th. According to the world bank annual report in Doing Business 2020, China now ranks 31st in terms of the ease of doing business after implementing eight business reforms during the year.

1.2.2 Economy of Turkey:

According to Turkish Statistical Institute (TurkStat) Turkey's economy posted a growth rate of 0.9% in FY 2019 compared to an impressive growth of 7.4% in FY 2018. The country's GDP expanded 0.9% year-on-year in the third quarter of last year after contracting 2.3% in the first quarter and 1.6% in the second, on an annual basis. The slowdown started in the last quarter of FY 2018 recording 2.2% growth. Turkish economy experienced currency and debt crisis in FY 2018. Plunging Lira value, high inflation and large current account deficit and rising debt severely affected the economy and hampered growth in FY 2019. The country's gross domestic product

(GDP) at current prices stood at 4.28 trillion Turkish liras (some $755 billion) in FY 2019. The data showed that GDP per capita reached 51,834 Turkish liras ($9,127) in FY 2019 at current prices.

Figure 1.7: Turkish Annual GDP growth rate



Source: Turkish Statistical Institute (TurkStats)

In period under review, the agricultural sector grew by 3.3%, the services and industrial sectors grew by 1.5% and 0.2% respectively, while the construction sector dropped 8.6%. The U.S. dollar/Turkish lira exchange rate was 5.68 on average in FY 2019. Turkey's New Economic Program, targets growth of 0.5% in FY 2019 and 5% in the following three years. The three-year plan aims to control inflation, drive growth and cut the current account deficit. The government plans to spent $10 billion dollars and focus on value-added areas to increase export volume and long term production capacity and aims to create two million jobs by FY 2021.

1.2.3. The Economy of India

The GDP growth in the third quarter of FY 2019 was 4.7%. The government has projected a growth of 5% for the FY 2020 ending in March 2020 compared to a 6.8% growth in FY 2019. The growth in the previous quarter was recorded at 4.5%. The growth in the first nine months of this financial year Apr-Dec 2019 is 5.1%.

Furthermore, Fiscal deficit in the first 10 months was Rs 9.85 trillion, where target for the full year was Rs 7.66 trillion. The economic slowdown is mainly attributed by weak manufacturing, falling export, weak consumer demand, drop in private investment and global economic and trade slowdown. The balance of payment stood at a surplus of $21.6 billion in the third quarter of FY2020 compared to $4.3 billion a year ago however, the surplus is mainly added by $5.1 billion from the previous quarter.

2

Money and Capital Market Development

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

According to the monetary statistics, reserve money (RM) has a positive growth of 11.60% at the end of FY 1398 (2019), greater than -0.4% at the end of FY 1397 (2018). Currency in circulation (CiC) as a major component of RM recorded positive growth of 13.65% from the beginning to the end of FY 1398 (2019).

As Reserve money (RM) is the main tool of monetary policy and Da Afghanistan Bank's operational target, which remained well below the target. On the other hand, CiC experienced going over the target for a short period of time at the end of FY 1398 due to the issuance of new banknote, high government expenditure and less Capital Notes (CNs) awarded during the course of the year under review.

Narrow money (M1), stood at AFN 479,896 million at the end of the year under review, which registered growth of 6%. Broad money (M2) demonstrated similar behavior with 5.70% growth rate represented (Y-o-Y), it stood at AFN 513,759.32 million at the end of FY 1398 (2019).

In order to mitigate excessive fluctuations of AFN exchange rate against foreign currencies and manage liquidity in the market, DAB uses Forex (FX) and Capital Notes (CNs) auctions under the open market operations.

From the beginning to the end of FY 1398 (2019), DAB has auctioned a total amount of USD 2,430.404 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 24.905 billion at the end of FY 1398 (2019). Meanwhile, Afghani depreciated by 4.61% against the US dollar during the FY 1398 (2019).

2.1. MONETARY PROGRAM

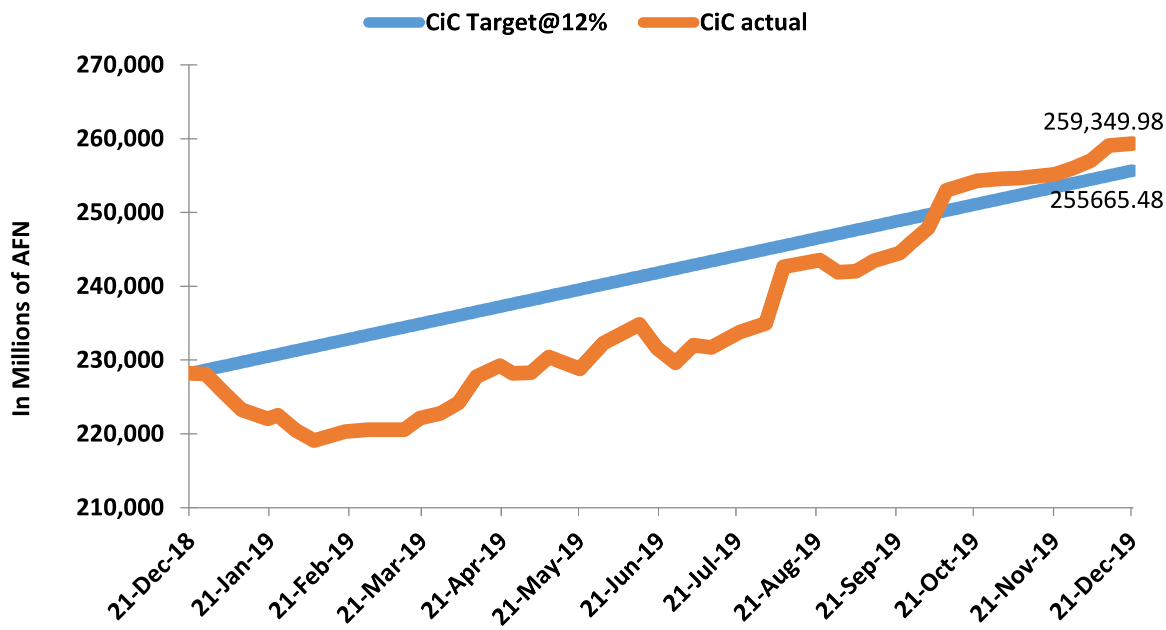
Reserve money remained the key operational target of the monetary policy during FY 1398 (2019), while currency in circulation was set as the indicative target.

DAB applies quantitative theory of money to determine the amount of reserve money (RM) for the purpose of supporting domestic price stability, which is DAB's primary objective. Hence, targets for RM and CiC are based on expected economic growth and expected inflation during the concerned period. For the fiscal year 1398 (2019), the ceilings for reserve money and currency in circulation growth is 12%.

It is worth mentioning that in FY 1398 (2019) actual RM and CIC respectively had positive growth by 11.60% and 13.65%. DAB has auctioned USD 2,430.404 million via open market operation to mop up the excess liquidity from the market and to prevent intense fluctuations of Afghani's nominal exchange rate against foreign currencies, especially internationally convertible currencies.

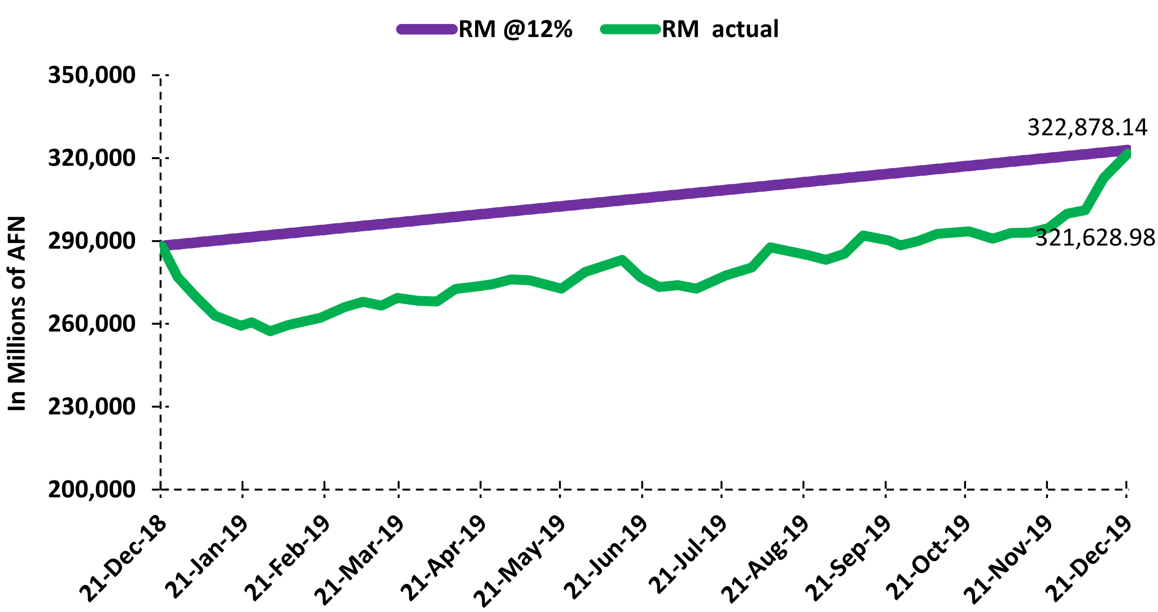
Figure 2.1 and 2.2 illustrate the ceiling and the actual reserve money and currency in circulation for the period under review.

Figure 2.1: Currency in Circulation during FY 1398 (2019)



Source: Monetary Policy Department/DAB

Figure 2.2: Reserve Money during FY 1398 (2019)



Source: Monetary Policy Department/DAB

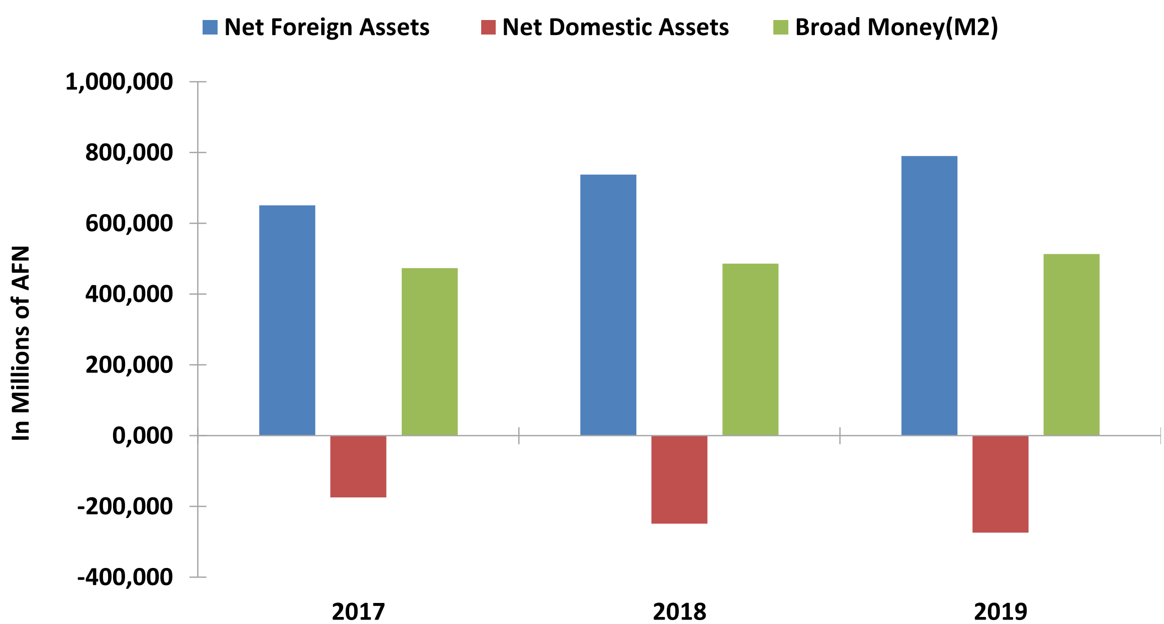
2.2. MONETARY AGGREGATES

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 by 6% at the end of fiscal year 1398 (2019), slightly higher growth than FY 1397 (2018). Currency outside depository corporations or CiC, which accounts for 52% of M1, grew positively by 13.65%, but greater from negative growth of 0.3% in the previous year, showing difference of AFN 30,028 million. The reason for CiC growth is new banknote issuance beside government expenditure during the period under review.

Demand deposits, which are the other components of M1, experienced negative growth of 1.55% at the end of FY 1398 (2019), while its growth rate was 8% in the previous year. Demand deposit in comparison with the previous year declined by AFN 3,612 million. Broad money (M2) expanded by AFN 513,759.32 million in the year under review from AFN 486,034.180 million in the previous year, showing an increase of 5.70%, but greater than 2.6% growth of the previous year. Growth in broad money is mainly attributed to accretion in the growth of currency in circulation.

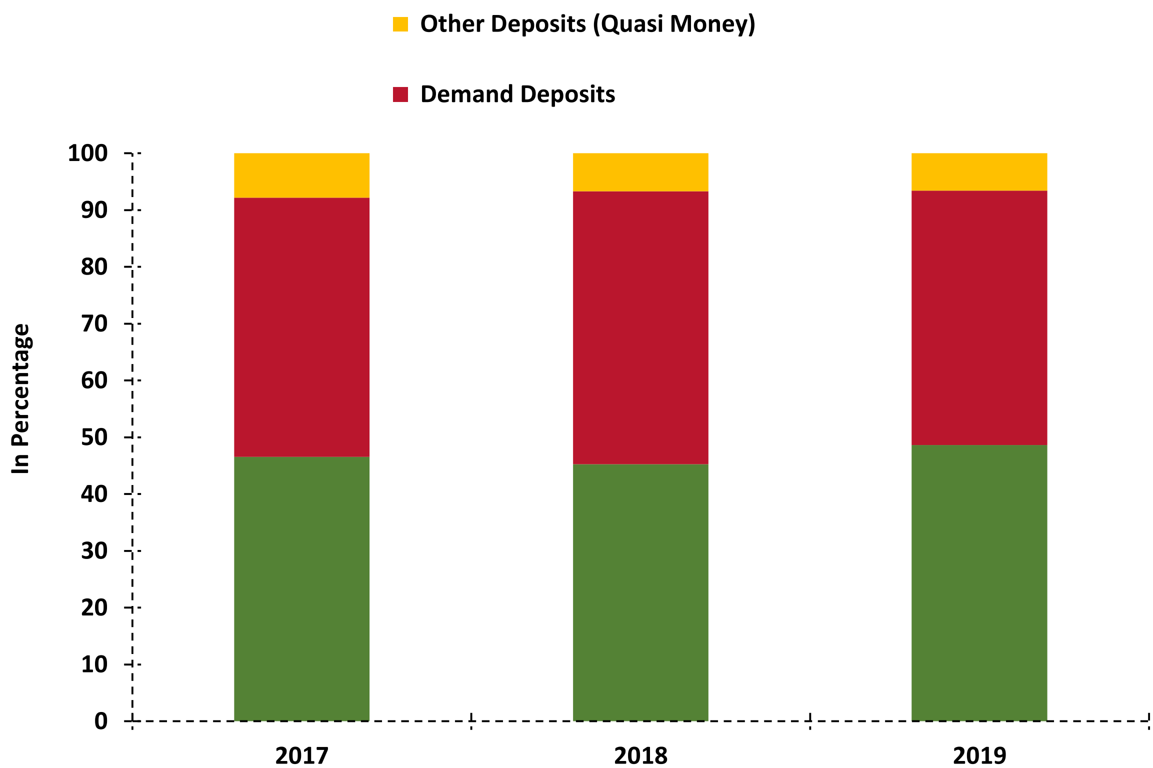
Figure 2.3: NFA, NDA and M2



Source: Monetary Policy Department/DAB

The data shows that M1 with share of 93.41% remained the main contributing component of M2. Quasi money (other deposits), which is the other component of M2, had positive growth of 4.02% (y-o-y) at the end of FY1398 (2019). Quasi Money constitutes 6.59% of broad money at the year under review, which is lower than 6.70% at the end of FY 1397 (2018). Therefore, the impact of changes in quasi money on M2 is negligible. The year-on-year change of Afghani denominated time deposits stood at AFN 7,267 million, showing a negative growth of 25.48%, while the foreign currency denominated time deposits rose positively by 16.63%, reaching to AFN 26,596 million. The reason for negative growth of Afghani denominated time deposits and positive growth of foreign currency denominated time deposits is considered for exchange rate instability and AFN depreciation against US dollar during year under review. This fluctuation caused people to deposit in foreign currency accounts rather that AFN accounts. Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 1.41% and 5.18% of M2 respectively. Demand deposits as a share of broad money stood at 44.76% at the end of the 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 the FY 2019 (9/21/1397 to 12/21/1398)

In Million AFNs	Dec-17	Dec-18	Y-o-Y Δ	Difference	Dec-19	Y-o-Y Δ	Difference
	Q4	Q4			Q4		
	Amount	Amount			Amount		
1- Net Foreign Assets	651,219	737,861	13.3%	86,642	790,414	7.12%	52,553
(a) Foreign Assets	668,361	751,125	12.4%	82,764	800,775	6.61%	49,649
DAB Foreign exchange reserves	559,621	615,123	9.9%	55,502	667,897	8.58%	52,774
Gold	61,681	66,179	7.3%	4,498	81,580	23.27%	15,401
Other	497,940	548,944	10.2%	51,004	586,318	6.81%	37,373
Other foreign assets	108,740	136,002	25.1%	27,262	132,877	-2.30%	-3,125
(b) Foreign Liabilities	17,142	13,265	-22.6%	-3,878	10,361	-21.89%	-2,904
2. Net Domestic Assets	-174,643.39	-249,027.01	42.6%	-74,384	-274,010.48	10.03%	-24,983
(a) Net Domestic Credit	-36,028	-76,284	111.7%	-40,256	-74,678	-2.11%	1,606
Net Credit to Nonfinancial Public Sector	-84,054	-121,906	45.0%	-37,853	-121,678	-0.19%	228
Net Credit to Central Government	-84,148	-122,001	45.0%	-37,853	-122,263	0.21%	-262
Credit to Central Government	15,339	7,185	-53.2%	-8,154	181	-97.49%	-7,004
Liabilities to Central Government	99,487	129,185	29.9%	29,699	122,443	-5.22%	-6,742
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	585	519.37%	490
Credit to Private Sector	49,386	46,633	-5.6%	-2,753	47,467	1.79%	835
Net Credit to Other Financial Corporations	-1,361	-1,011	-25.7%	350	-468	-53.74%	543
(b) Capital Accounts	155,842	189,935	21.9%	34,093	213,973	12.66%	24,038
(c)Other Items Net	17,227	17,193	-0.2%	-34	14,641	-14.84%	-2,552
3- Broad Money(M2)	473,836.890	486,034.180	2.6%	12,197	513,759.32	5.70%	27,725
Narrow Money(M1)	436,748	453,480	4%	16,732	479,896	6%	26,417
CiC (Currency outside depository corporations)	220,507	219,911	-0.3%	-595	249,940	13.65%	30,028
Demand Deposits	216,242	233,568	8.0%	17,327	229,957	-1.55%	-3,612
Other Deposits (Quasi Money)	37,088.739	32,554.444	-12.2%	-4,534	33,862.893	4.02%	1,308
In Afghani	12,827	9,752	-24.0%	-3,076	7,267	-25.48%	-2,485
In Foreign currency	24,262	22,803	-6.0%	-1,459	26,596	16.63%	3,793
Securities Other Than Shares	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Source: Monetary Policy Department/DAB

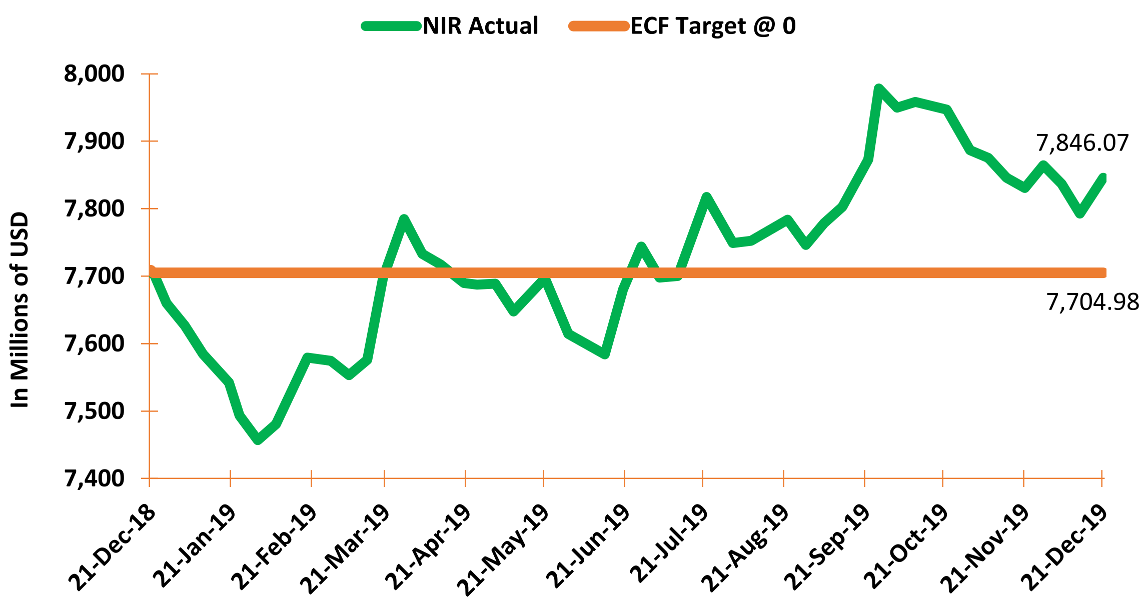
2.3. NET INTERNATIONAL RESERVE (NIR)

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 increased slightly by 1.83 % indicating accumulation of USD 141.08 million at the end of FY 1398 (2019).

NIR accumulation ceiling was set at USD 7,704.98 million, while in actual case, NIR reached to USD 7,846.07 million for the mentioned period under review. Figure 2.5 illustrates actual and target trend of NIR during the year 1398 (2019).

Figure 2.5: NIR; actual and target during FY 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

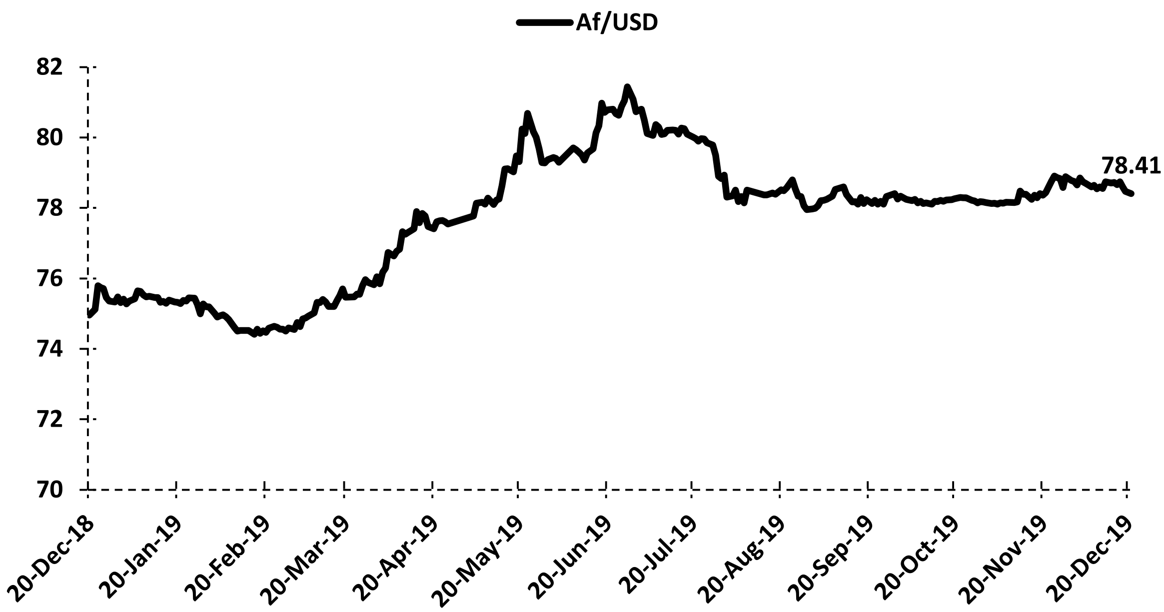
2.4. FROEIGN EXCHANGE MARKET

2.4.1. Foreign Exchange Rates

Da Afghanistan Bank's (DAB) ultimate goal is to maintain price stability. In order to achieve its goal, DAB puts its focus to utilize its monetary instruments via the open market operations, effectively with sound policy implementation. During the FY 1398 (2019), Afghani relatively depreciated against the Great British pound, European Euro and Swiss Franc, United States Dollar, United Arab Emirates dirham, Indian Rupee, Chinese Yuan and Saudi Riyal, while it appreciated against Pakistani Rupee and Iranian Toman.

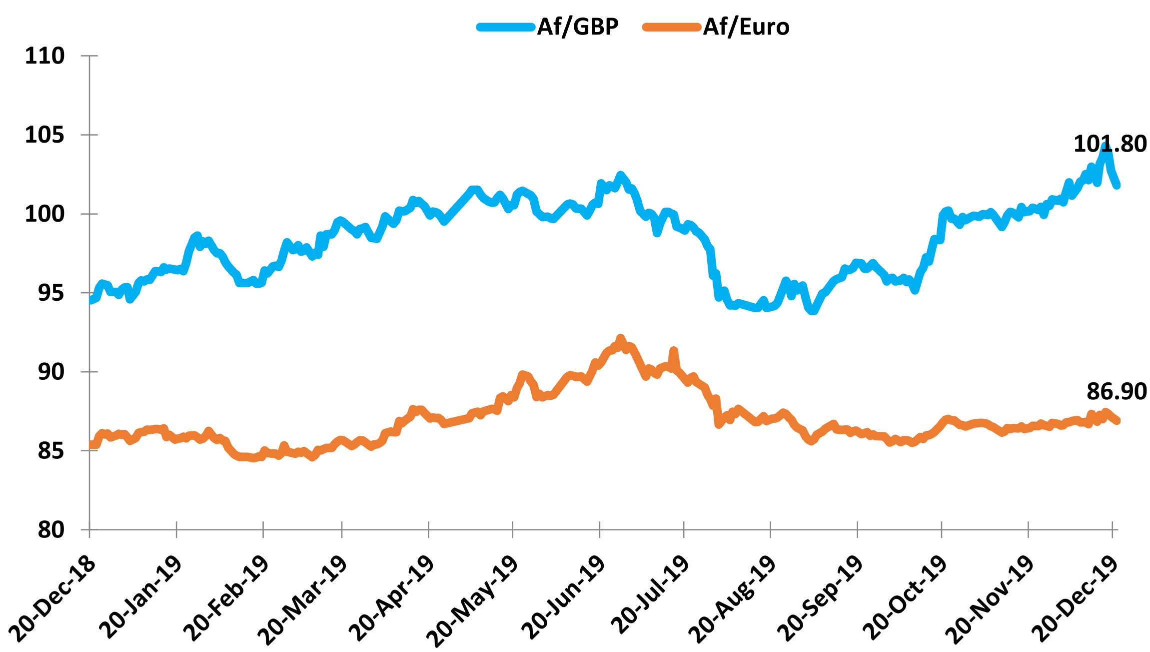
The daily historic review of the average exchange rate of Afghani against the U.S. dollars and other foreign currencies in the FY 1398 (2019) are shown in figures below:

Figure 2.6: Daily average ex- rate of Afghani against USD during FY 1398 (2109)



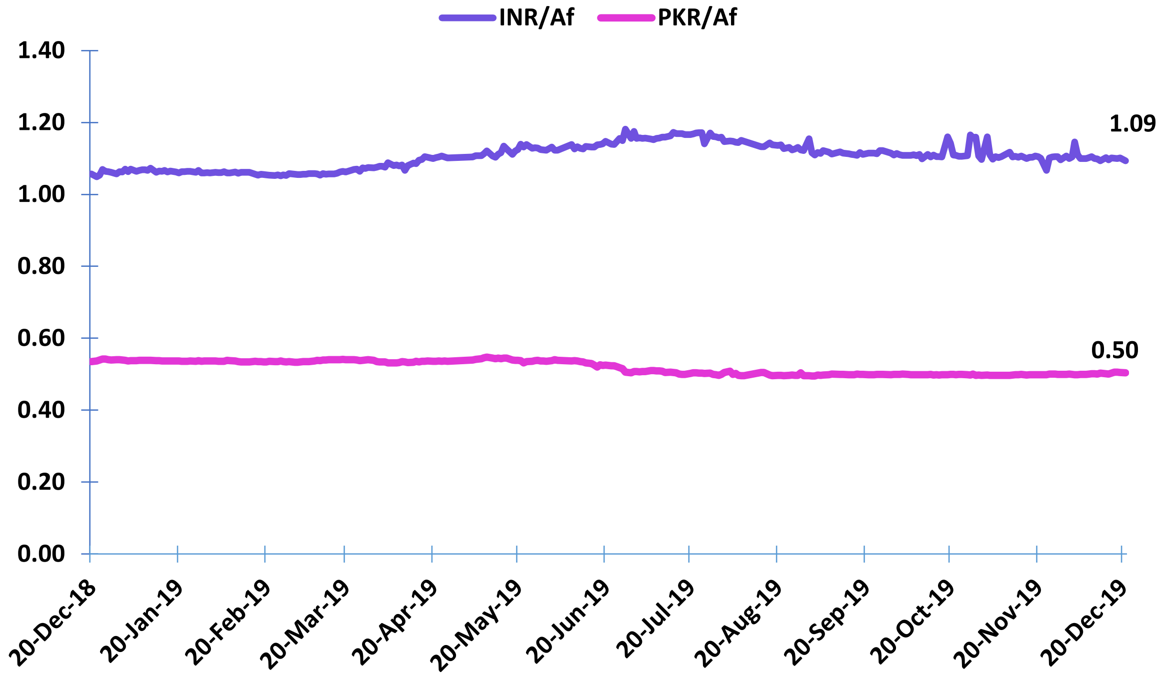
Source: Monetary Sector, Monetary Policy Department/ DAB

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



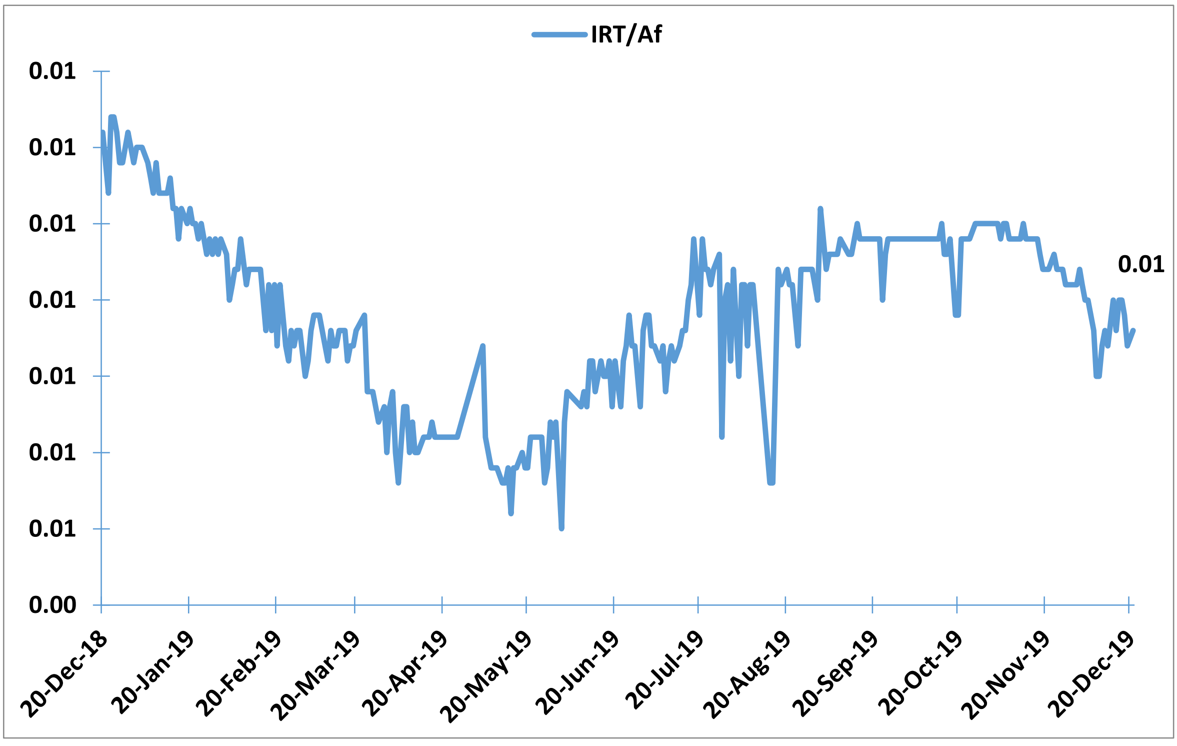
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.8: Daily average ex-rate of Afghani against INR and PKR during FY 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.9: Daily average ex- rate of Afghani against IRT during FY 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

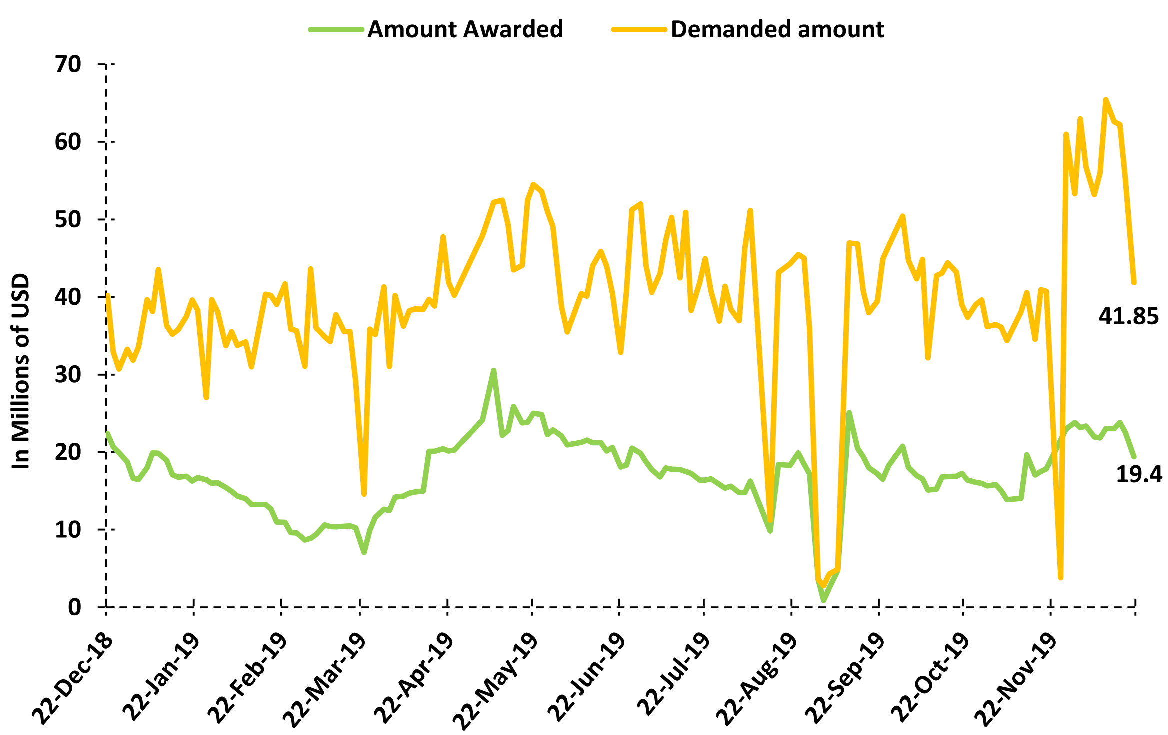
2.4.2. Foreign Exchange Auction

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 FY 1398 (2019), DAB auctioned a total amount of USD 2,430.40 million, while the total demand was USD 5,779.21 million. On average, 56 bidders participated in each auction and 42 bids were announced as the winning bids with the average amount of USD 16.20 million sold in each auction and the total withdrawal is recorded AFN 189.25 billion. The data for the end of FY 1397 (2018) recorded a total auctioned amount of USD 2,415.52 million, with a total demand of USD 3,361.15 million. On average, 52 bidders participated in each auction and 40 bids were awarded with an average amount of USD 18 million in each auction and the total withdrawal is recorded AFN 174.83 billion.

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

Figure 2.10: USD awarded and demanded during FY 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

2.5. CAPITAL MARKET &LIQUIDITY CONDITIONS

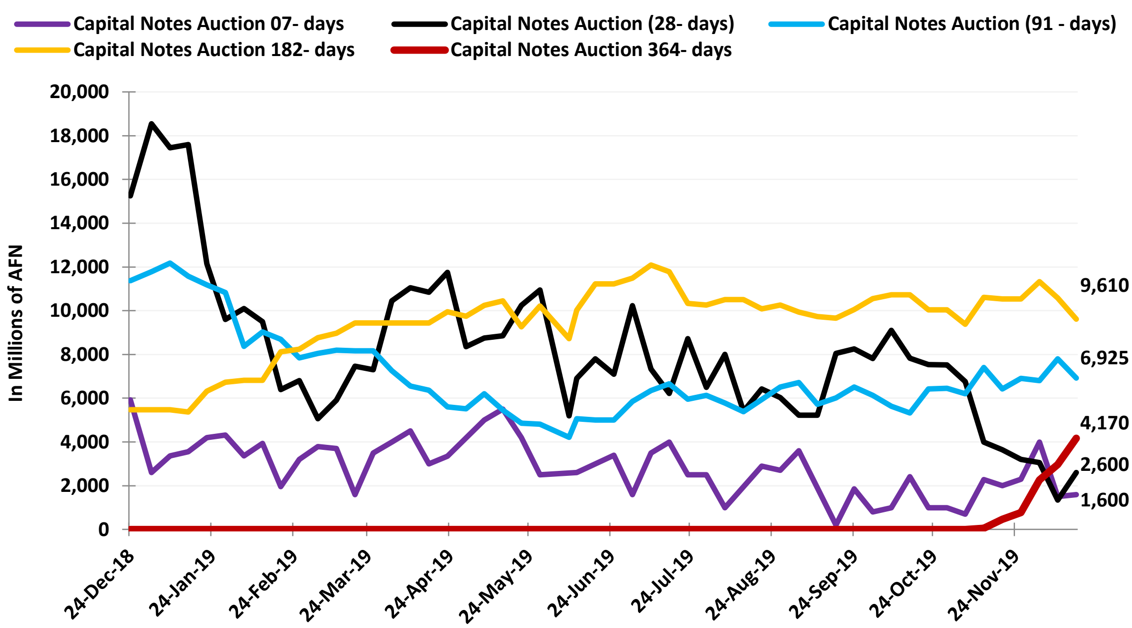
2.5.1. Capital Notes Auction

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. Capital notes are used to absorb the excess liquidity of the commercial banks.

Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months and one year. Total outstanding stock of capital notes reached to AFN 24.90 billion at the end of FY 1398 (2019), which shown a decrease of AFN 8.82 billion compared to AFN 33.72 billion at the end of FY 1397 (2018). The main reason for decreasing of outstanding compared to the last year was the less awarded amount of capital notes and increasing the interest rate compare to the last year.

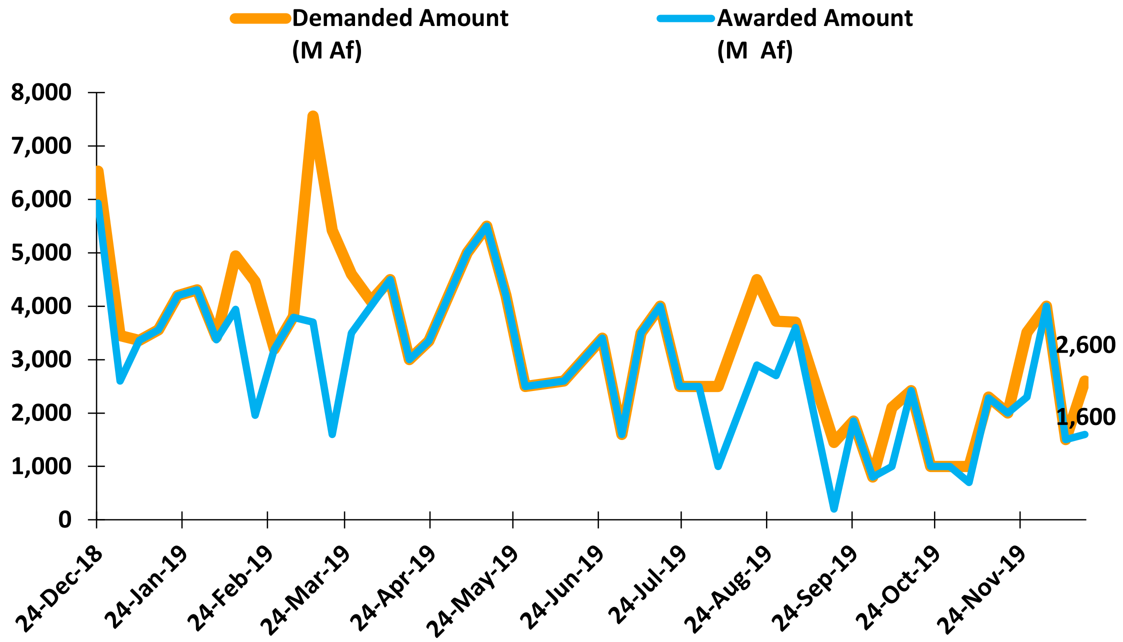
The outstanding stock of 7-days capital notes stood at AFN 1.6 billion, 28 days CNs outstanding amount stood at AFN 2.6 billion, and 91 days outstanding stock of CNs recorded amount of AFN 6.92 billion, the stock of outstanding for 182 days stood at AFN 9.61 billion and The stock of outstanding CNs for 364 days stood at 4.17 billion. Total interest paid to CNs figured out to AFN 166.85 million till the end of the year under review. In addition, the weighted average interest rate for 7-days capital note was 0.50%, for 28 days CNs was 0.83%, and for 91 days CNs was 1.16%, for 182 days CNs was 1.40% and for 364 days CNs was 2.19% from beginning to the end of FY 1398 (2019), which are generally in lower levels than the previous year.

Figure 2.11: Stock of outstanding Capital Notes during FY 1398 (2019)



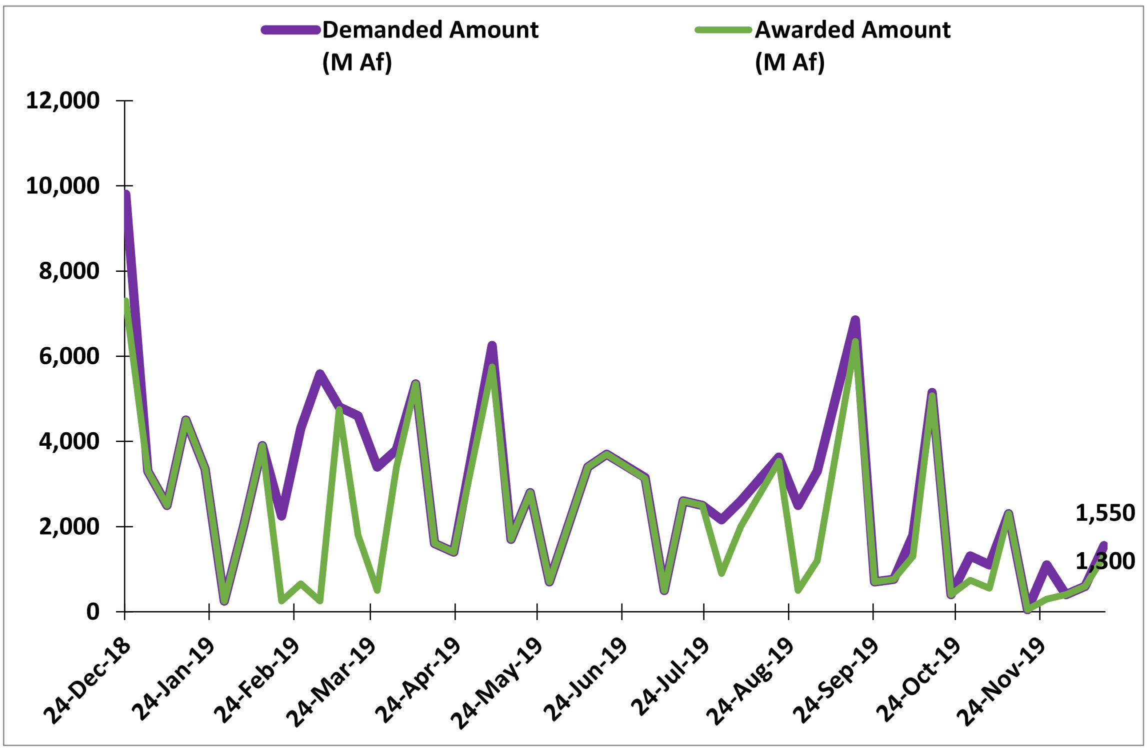
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.12: 7-days CNs demanded and awarded during FY 1398 (2019)



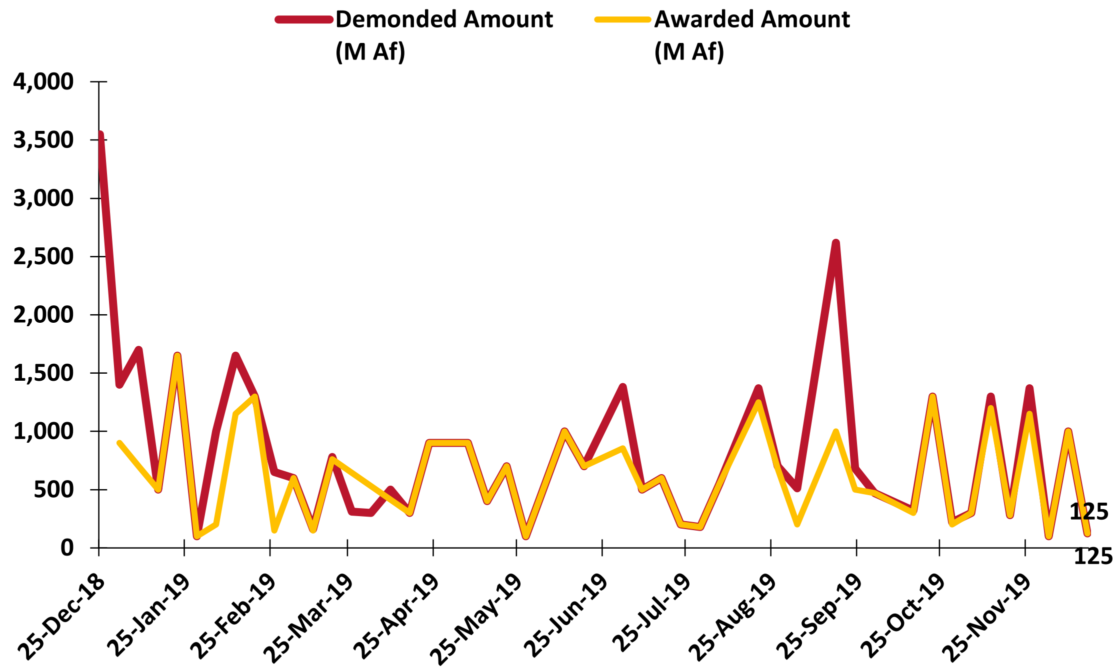
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.13: 28-days CNs demanded and awarded amount during FY 1398 (2019)



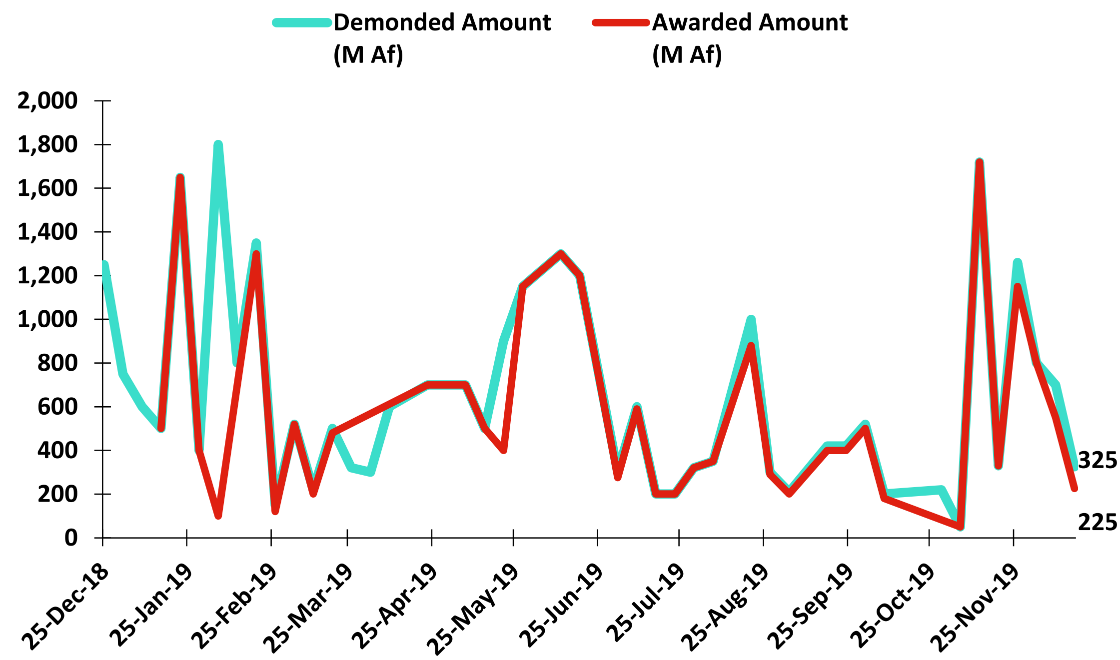
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.14: 91-days CNs demanded and awarded during FY 1398 (2019)



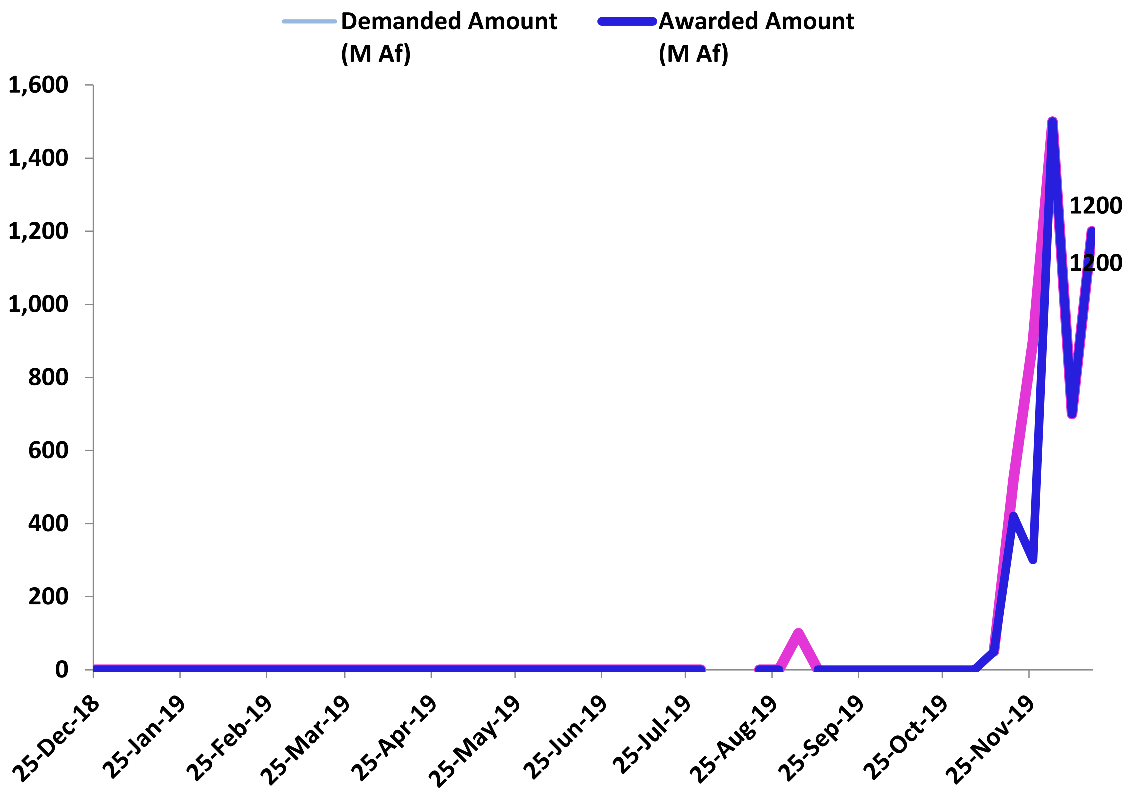
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.15: 182-days CNs demanded and awarded amount during 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.16: 364-days CNs demanded and awarded amount during FY 1398 (2019)



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. Now the required reserves are held in the currency of denomination (Domestic and foreign), unlike the previous practice, which required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. It shows AFN 5,734.43 million and USD 202.05 million and Euro 15.61 million at the end of FY 1398 (2019).

Overnight Deposit Facility (ODF)

This facility is available to all commercial banks to gain interest on their excess balances. The interest rate on the overnight deposit facility, based on a circular to all banks, approved by DAB Supreme Council on September 11, 2017, is now 10 basis points. The average outstanding amount of overnight deposit facility recorded AFN 8,215.63 million during the FY 1398 (2019) and the payment of interest rate to the mentioned facility reached to AFN 8.30 million for the same period.

Overnight Credit Facility (OCF)

This facility is used by banks for short term cash needs. The facility allows banks to borrow Afghani from Central Bank on an overnight basis when they face a shortfall in cash flow. The rate that the commercial banks are charged for this facility is 3.5% above the last 28 day CNs auction interest rate. This borrowing is collateralized with outstanding capital notes only. During the period under review, no bank has used from overnight credit facility.

3

Inflation Trend and Outlook

3

INFLATION TREND AND OUTLOOK

3.1. GLOBAL

in 2020. Oil prices averaged $61/bbl in 2019, a 10% fall from 1397 and $5/bbl below previous projections. Prices were supported by production cuts by OPEC and its partners, including the December 2019 decision to remove 0.5 mb/d of production on top of previous reductions of 1.2 mb/d implemented since January 2019.

Production has also been constrained in the Islamic Republic of Iran by a variety of geopolitical and domestic factors. However, these pressures were offset by weakening oil demand, as shown by downward revisions to demand projections. Forecasts of oil prices depict that it will decline slightly to an average of $59/bbl in 2020 and 2021.

U.S supply is expected to continue to increase in 2020 as new pipeline capacity comes on stream. The greatest downside risk to the forecast is a further deterioration of growth. Current expectations are for oil consumption growth to pick up to just over 1% in 2020, which is comparable to the pace of global oil demand seen during previous global downturns. A critical upside risk to the forecast is the possibility of a further significant reduction in trade tensions between the United States and China, which could boost oil demand prospects.

Prices for most base metals weakened in the second half of 2019, primarily reflecting weaker global growth and trade tensions. Metals prices are expected to decline further in 2020, reflecting serious industrial commodity demand. As with oil, a significant continued mitigation of U.S. - China trade tensions present a key upside risk to metals price projections. Agricultural prices declined in the second half of 2019 due to improved weather conditions that ensured elevated stock levels for grains. Agricultural prices are expected to stabilize in 2020, with risks to the forecast broadly balanced.

3.2. 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 the 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 measurement changes in the consumer price index showed an inflationary rate of 2.31% on average in 2019 higher than 0.6% recorded in previous year. Similar to the year-on-year comparison, the inflation measured on quarter-on-quarter basis, also indicate an incline in the period under review. Observing the quarterly 2019 data, the average inflation rate increased to 1.71% in the fourth quarter of 2019, higher than average rate of 0.89% recorded in the same quarter of 2018.

Kabul CPI also reflected inflation in 2019. Observing the Kabul headline CPI, the inflation rate turned to 2.08% on average in 2019 from 1.39% observed in previous year. On quarter to quarter basis, the index decreased to 1.09% on average in last quarter of 2019 compared to 1.48% in the same quarter of 2018

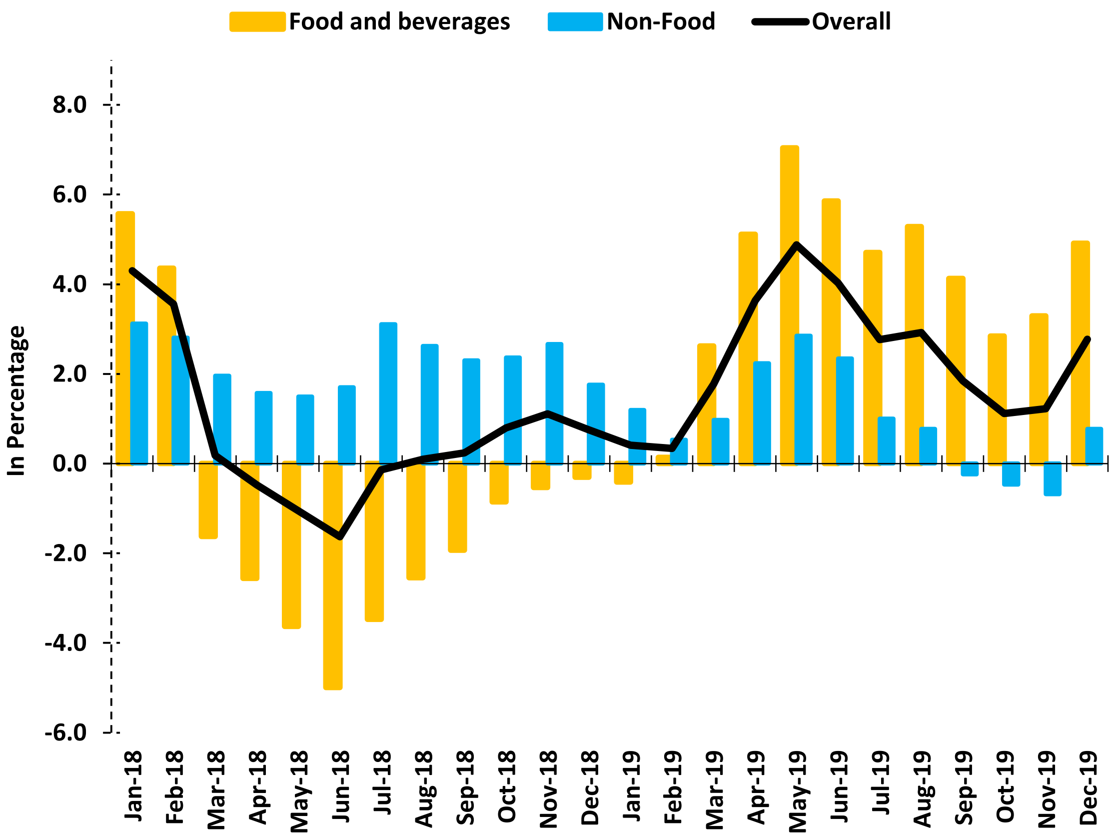
3.2.1. Developments in the National Headline Inflation (year-on-year changes)

The headline consumer price index exhibited a significant increase on year-over-year basis as compared to 2018. As per the available data, the headline inflation measured on year-over-year basis, increased to 2.31% on average in 2019 from 0.655 recorded in last year, while on monthly basis, the inflation rate was recorded at 1.1%, 1.22%, and 2.77% in the months of October, November, and December respectively.

In the food index, the inflation inclined to 5.84% on average in 2019 compared to lower -1.04% in previous year. In the above mentioned index, the inflationary pressures came from higher prices of bread and cereals, meat, fresh and dried fruits, vegetables, sugar and sweets, spices, and non-alcoholic beverages.

The highest increase in the index was recorded in the prices of spices, sugar and sweets which inclined to 16.4% and 5.61% on average from -16.73% and -6.68% in 2019 compared to 2018. On the other hand, the highest decrease was observed in the price index of oil and fats which decreased to -2.23% on average in 2019 from -0.62% recorded in previous year.

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



Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

In non-food category, the inflation was declined by lower prices of tobacco, housing, transportation, communication, and education. While on the other hand, inflation increased in the prices of clothing, furnishing and household, health, information and culture, and restaurants and hotels.

Overall inflation in non-food category declined on average to 0.94% in 2019 as compared to 2.29% observed in 2018. In the mentioned category, the highest decrease was noted in price index of transportation, and housing which declined to 0.36%, and -2.48% on average in 2019 from 6.55% and 1.49% recorded in 2018. On the other hand, price index of clothing and information and culture increased to 5.54% and 2.08% in 2019 from 3.50% and -0.99% in the previous year respectively.

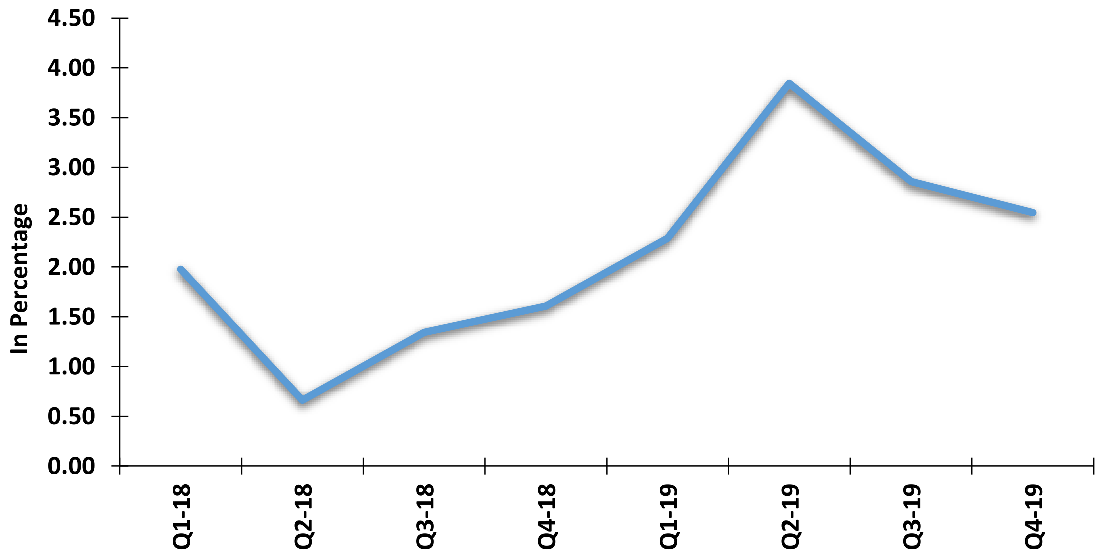
The core inflation also showed upward movement in 2019 compared to the previous year. The trimmed mean which is the most common measure of core inflation, jumped to 2.88% on average in 2019 from 1.40% recorded in 2018. In addition, the CPI inflation, excluding bread and cereals, oil and fats and transportation, increased to 2.06% in the 2019 from -0.10% observed in previous year.

3.2.2. Developments in the National Headline (Quarter-on-Quarter Changes)

The short term measure of inflation reflected similar trend as the annual measure. The national headline inflation calculated on quarter to quarter basis increased to 1.71% on average in the fourth quarter of 2019 from 0.89% recorded in the same quarter of the previous year.

The main increase in the inflation rate was the result of increase in the food items. On the contrary, the non-food category showed disinflation trend in 2019 compared to the same period of 2018. On quarterly basis, the food inflation inclined to 3.68% on average in the fourth quarter of 2019 from 0.89% in the same quarter of 2018. The price indices of food items such as, meat, oils and fats, vegetables, sugar and sweets, and spices prices increased but the prices of bread and cereals, milk, and cheese and eggs decreased from the previous quarter.

Figure 3.2: Quarterly Trimmed mean



Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

However, in this category, the largest quarterly increases were recorded in vegetable, fresh and dried fruits, and spices price indices which were recorded 5.36% and 22.88% in the last quarter of 2019 compared to -18.14% and -6.39% in the last quarter of 2018 respectively. On the other hand, the non-food inflation decreased to -0.13% on average in the fourth quarter of 2019 from 2.27% recorded in the same quarter 2018. In this category, the prices of tobacco, housing, furnishing and household goods, transportation, communication, and education have decreased in the period under review.

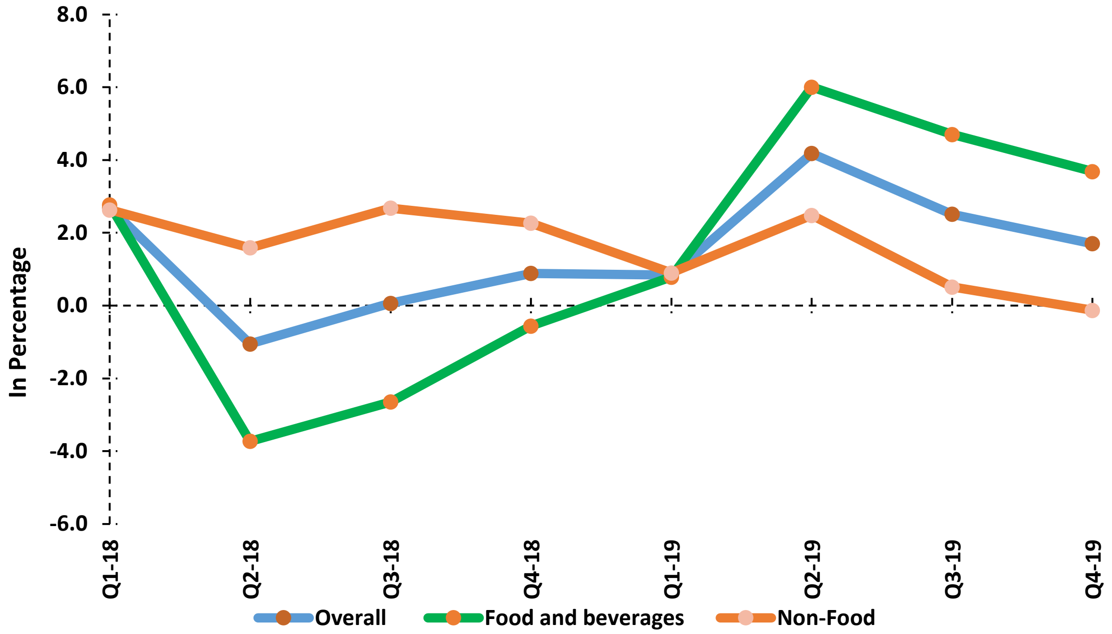
The tobacco index decreased to -1.90% in the fourth quarter from 6.19% on average compared to same quarter of previous year and similarly transportation index decreased to -6.81% in the fourth quarter of 2019 from 10.04% in the same quarter of 2018. On the other hand, the inflation in the clothing, health, information and culture has declined in the fourth quarter of 2019 compare to the fourth quarter of 2018.

Table 3.1: National headline inflation for FY 2018-2019

Period	2018						2019				
Based on Apr 2015											
Description	Weight	Oct-18	Nov-18	Dec-18	Q4 Average	Average (12 Month)	Oct-19	Nov-19	Dec-19	Q4 Average	Average (12 Month)
Overall Index	100.0	0.80	1.11	0.75	0.89	0.65	1.12	1.22	2.77	1.71	2.31
Food & Non-Alcoholic Beverages	47.8	-0.85	-0.53	-0.30	-0.56	-1.04	2.85	3.29	4.91	3.68	3.79
Bread and Cereals	14.6	6.74	8.46	8.17	7.79	3.48	1.31	1.29	2.06	1.55	5.84
Meat	7.5	1.51	0.79	1.68	1.32	1.36	7.57	8.34	8.00	7.97	5.37
Milk, cheese and eggs	4.7	1.81	2.10	1.26	1.72	1.04	-0.92	-2.31	-1.74	-1.66	0.91
Oils and fats	4.6	-1.64	-2.60	-2.47	-2.23	-0.62	-0.71	0.25	2.18	0.58	-2.23
Fresh and dried fruits	5.0	-0.86	-3.04	1.01	-0.96	0.89	2.88	3.89	3.74	3.50	5.20
Vegetables	6.0	-17.56	-17.87	-19.00	-18.14	-9.64	-0.50	3.34	13.24	5.36	-0.65
Sugar and sweets	2.7	-3.42	-1.76	-1.62	-2.27	-6.68	6.28	3.96	4.66	4.97	5.61
Spices	1.3	-11.68	-5.23	-2.27	-6.39	-16.73	24.01	23.29	21.34	22.88	16.40
Non-alcoholic beverages	1.4	3.66	4.33	4.49	4.16	2.35	4.54	3.70	4.10	4.11	4.90
Non-Food Items, Tobacco & Services	52.2	2.37	2.67	1.76	2.27	2.29	-0.47	-0.69	0.77	-0.13	0.94
Tobacco	0.3	6.24	5.98	6.34	6.19	4.11	-1.08	-2.44	-2.18	-1.90	2.05
Clothing	4.6	3.25	2.41	4.18	3.28	3.50	6.02	7.48	7.52	7.01	5.54
Housing	19.1	0.34	0.74	-1.39	-0.10	1.49	-4.07	-4.17	-1.49	-3.25	-2.48
Furnishing and household goods	11.9	3.32	4.18	3.75	3.75	2.78	1.42	-0.03	0.42	0.60	2.85
Health	6.2	0.57	1.29	1.60	1.15	0.72	5.53	5.67	6.08	5.76	4.53
Transportation	4.3	10.57	10.82	8.74	10.04	6.55	-6.67	-7.59	-6.18	-6.81	0.36
Communication	1.7	0.79	-0.92	-1.70	-0.61	-0.50	-6.68	-5.32	-4.43	-5.48	-4.37
Information and Culture	1.1	1.06	-0.38	-0.90	-0.07	-0.99	0.61	3.98	4.33	2.97	2.08
Education	0.4	4.84	6.53	6.40	5.92	5.81	2.83	0.33	1.58	1.58	2.13
Restaurants and Hotels	1.1	3.01	2.18	2.51	2.57	2.28	1.82	4.07	4.26	3.38	3.14
Miscellaneous	1.4	2.48	2.45	1.40	2.11	3.04	6.77	5.53	9.83	7.38	3.82
CPI ex. B & C, O & F, and T		-0.66	-0.52	-0.82	-0.67	-0.10	1.66	1.80	3.48	2.31	2.06
30% trimmed mean		1.72	1.49	1.64	1.62	1.40	2.14	2.23	3.26	2.55	2.88

Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

Figure 3.3: Quarterly Average National Inflation



Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

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

The headline CPI inflation in Kabul inclined to 2.08% on average in 2019 compared to 1.39% recorded in previous year. The food index, which is accounted for 37.2% of the overall weight of the overall index, reflected inflation rate in one-year period based on year over year changes. In this category, the inflationary pressures came from higher prices of bread and cereals, meat, vegetables, sugar and sweets, and spices. As a result, the food inflation increased to 4.05% on average in 2019 from 0.10% observed in 2018.

The inflation of non-food items which comprise 62.8% weight of the whole index, decreased to 0.74% on average in 2019 compared to 2.33% in last year. The decrease is mainly attributed to lower prices of tobaccos, clothing, housing, furnishing and household goods, transportation, communication, and education. However, in this category, the inflation in health, and information and culture increased to 6.67% and 1.70% on average from 1.86% and -2.20% observed in last year.

On the other hand, the core inflation excluding bread & cereals, fats and oils and transportation indicates an inclining trend in the period under review compared to previous year. In the year 2019, the core inflation rate increased to 1.85% on average while the rate was recorded 0.96% in 2018. The 30% trimmed mean reflected an inflation rate of 2.85% on average in 2019 compared to 1.60% recorded in 2018.

3.2.4. Development in the Kabul Headline Inflation (Quarter on Quarter Changes)

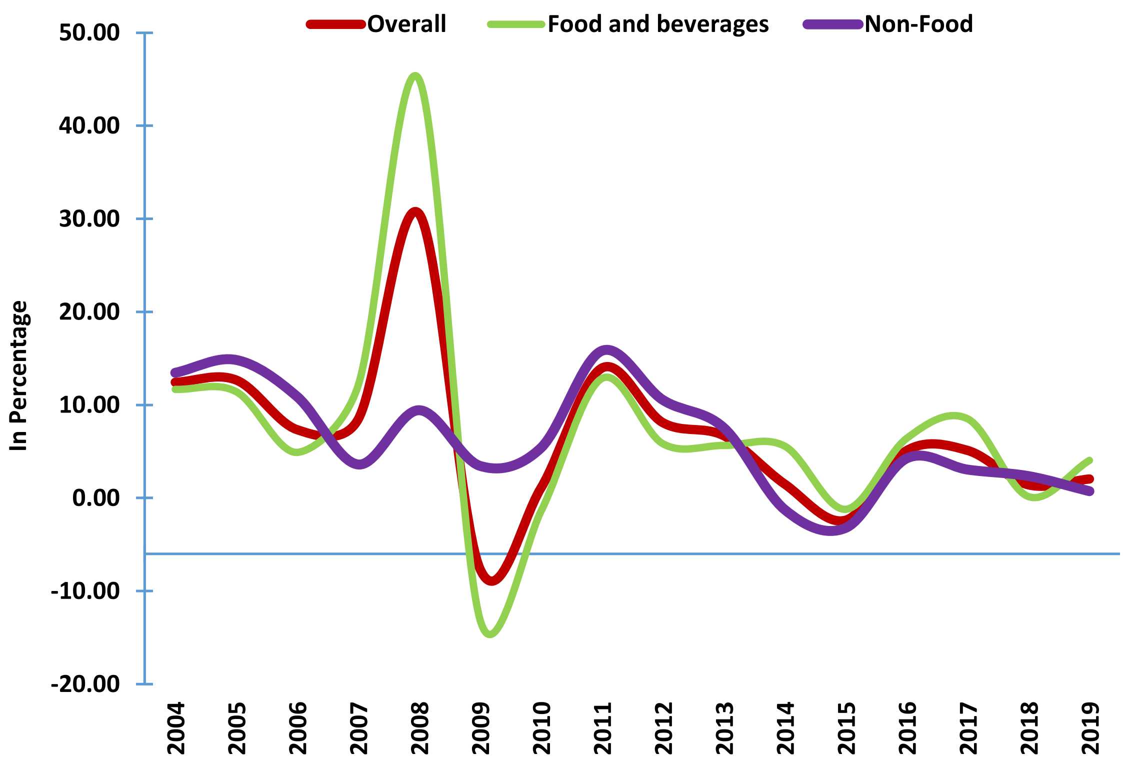
The quarter to quarter measure of headline inflation in Kabul indicates downward movement which reflected disinflation in non-food index items. The headline inflation in Kabul declined to 1.09% on average in fourth quarter of 2019 as compared to 1.48% recorded in the last quarter of 2018.

Inflation in the food index increased to 2.71% on average from -0.04% recorded in fourth quarter of 2018. In this category, the prices of fresh and dried fruits, vegetable, sugar and sweets, and spices increased which led to higher inflation rate in food index during the period under review. In this category, the highest incline was observed in the price index of vegetables and spices which increased to 2.97% and 26.28% on average in 2019 from -20.96% and -2.59% observed in same period of previous year. On the other hand, the inflation in bread and cereals, meat, milk, cheese and eggs, showed decrease in fourth quarter of 2019 compared to the fourth quarter of 2018.

The Non-food category of the CPI showed downward trend during fourth quarter of 2019 compared to the fourth quarter of 2018. Inflation in this category decreased to 0.06% on average in fourth quarter of 2019 compared to 2.46% recorded in fourth quarter of 2018. Based on quarter to quarter comparison, the decrease in non-food inflation is mainly driven by lower prices of tobacco, housing, furnishing and household goods, transportation, communication, and education items among which the largest price decrease was observed in the indices of transportation items which decreased to -6.27% in the last quarter of 2019 from 7.52% observed in the same quarter of previous year. On the contrary, incline observed in the prices of clothing, health, information and culture, restaurants and hotels, and miscellaneous indices.

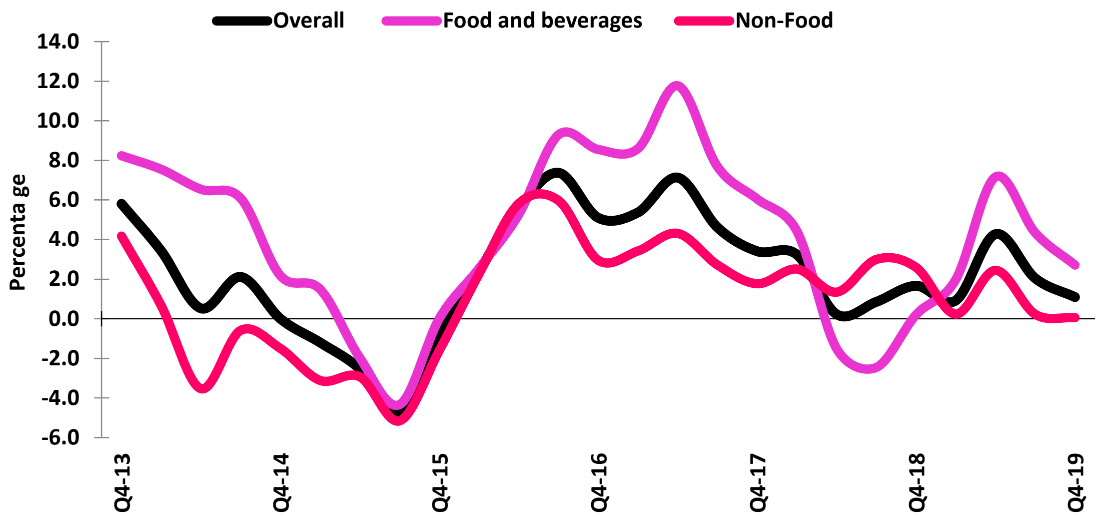
The near-term outlook of inflation in Afghanistan is likely to move up and keep positive trend in 2020. Da Afghanistan Bank forecasts national headline inflation rate in the range between 3-4% for the year 2020.

Figure 3.4: Kabul Annual Average Inflation



Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

Figure 3.5: Kabul Quarterly Average Inflation



Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

Table 3.2: Kabul headline inflation for FY 2018-2019

Period	2018						2019				
	Based on Apr 2015										
	Weight	Oct-18	Nov-18	Dec-18	Q 4 Average	Average (12 Months)	Oct-19	Nov-19	Dec-19	Q 4 Average	Average (12 Months)
Overall Index	**100.0**	**1.80**	**1.79**	**0.86**	**1.48**	**1.39**	**-0.52**	**0.30**	**3.48**	**1.09**	**2.08**
Food & Non-Alcoholic Beverages	**37.2**	**0.32**	**-0.39**	**-0.06**	**-0.04**	**0.10**	**-0.08**	**2.24**	**5.98**	**2.71**	**4.05**
Bread and Cereals	9.8	10.95	11.14	9.83	10.64	4.97	1.45	2.76	5.75	3.32	7.74
Meat	6.4	3.52	2.51	4.62	3.55	3.04	2.21	3.42	2.16	2.60	4.46
Milk, cheese and eggs	3.2	5.34	5.88	4.62	5.28	0.83	-3.50	-6.38	-5.98	-5.28	0.28
Oils and fats	3.6	0.58	0.96	-0.25	0.43	-1.04	-1.59	-3.89	-0.47	-1.98	-3.85
Fresh and dried fruits	5.2	-4.26	-9.06	-1.09	-4.80	4.20	-1.75	4.20	7.54	3.33	4.17
Vegetables	4.2	-7.90	-0.36	-4.61	-0.96	-9.69	-4.95	-0.01	23.88	2.97	-3.11
Sugar and sweets	2.8	-2.27	1.06	-0.37	-0.53	-3.97	6.41	2.70	4.07	4.39	7.94
Spices	1.0	-6.70	-2.40	1.33	-2.59	-13.46	25.78	30.85	22.22	26.28	23.18
Non-alcoholic beverages	0.9	5.12	5.92	5.62	5.55	2.34	4.97	4.54	3.78	4.43	4.82
Non-Food Items, Tobacco & Services	**62.8**	**2.75**	**3.19**	**1.45**	**2.46**	**2.33**	**-0.80**	**-0.91**	**1.88**	**0.06**	**0.74**
Tobacco	0.3	4.51	3.19	4.35	4.02	3.12	-0.37	-2.31	-2.07	-1.59	1.65
Clothing	4.8	4.43	2.03	4.29	3.58	4.04	2.74	5.51	7.38	5.21	3.12
Housing	23.5	0.17	0.85	-2.78	-0.59	1.29	-3.59	-3.39	1.30	-1.90	-2.76
Furnishing and household goods	17.6	4.35	5.70	4.58	4.88	3.15	-0.58	-2.60	-2.00	-1.73	2.39
Health	5.3	2.06	1.79	0.91	1.59	1.86	7.25	9.69	13.37	10.10	6.67
Transportation	4.6	7.78	8.96	5.81	7.52	4.20	-5.76	-7.62	-5.43	-6.27	-0.31
Communication	2.0	1.93	0.87	1.12	1.31	-0.41	-1.47	-1.38	-0.84	-1.23	-0.72
Information and Culture	1.7	1.40	-2.05	-2.64	-1.10	-2.20	-0.67	6.62	7.11	4.35	1.70
Education	0.7	6.30	8.79	8.56	7.88	8.04	1.13	-2.36	-0.76	-0.66	1.27
Restaurants and Hotels	1.0	2.31	1.66	2.83	2.26	2.28	3.41	9.36	9.31	7.36	2.86
Miscellaneous	1.3	4.36	5.67	5.04	5.02	3.20	11.80	8.65	18.17	12.87	7.83
CPI ex. B & C, O & F, and T		0.54	0.43	-0.32	0.22	0.96	-0.40	0.66	3.89	1.38	1.85
30% trimmed mean		**2.70**	**2.57**	**2.69**	**2.65**	**1.60**	**0.89**	**1.88**	**4.12**	**2.30**	**2.85**

Source: National Statistics and Information Authority/Monetary Policy Department, DAB staff calculation

4

External Sector Developments

4

EXTERNAL SECTOR DEVELOPMEN

SUMMARY

The highlights of some major developments in the external sector of the Afghan economy for the FY 1398 in comparison with the previous year are captured in this report. It is intended to enable the Bank's management gain a better insight into the policy issues arising from these developments and their impact on the Afghan economy.

Staff calculations indicated that Afghanistan external sector strengthened further with a contraction of 8% in trade deficit, an expansion of 61% in investment income inflow together with compensation of employees and 14% increase in personal transfers to the country during the FY 1398. Inflow to the capital account decreased by 37% especially on account of capital transfers to the government sector.

Foreign Direct Investment (FDI), inflows increased to USD 2.90 million while Portfolio Investment outflows declined to USD -14.62 million. Likewise, official reserve assets (In terms of BOP) decreased significantly by 37% to a value of USD 104.03 million in the FY 1398 from a value of USD 164.26 million in the FY 1397. In view of these developments the BOP recorded a deficit of USD 2,948 million in the FY 1398 compared to the deficit of USD 2,897 million recorded in the FY 1397.

4.1. BALANCE OF PAYMENTS

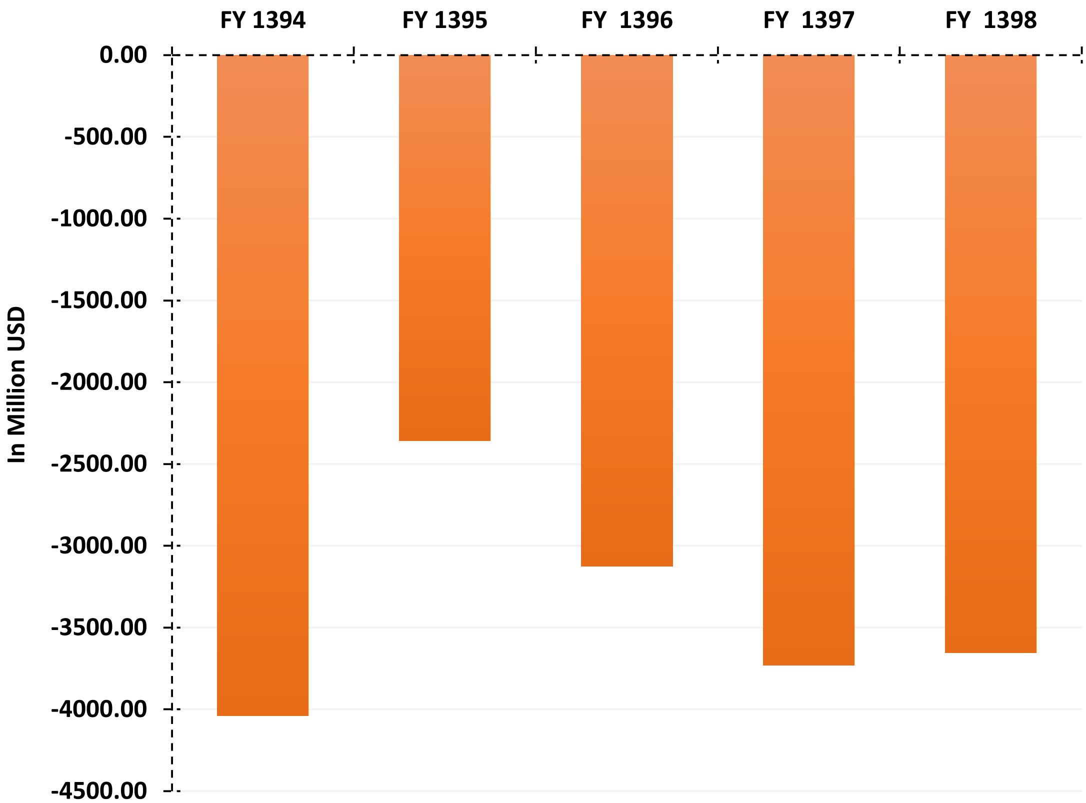
4.1.1. Current Account

Based on Y-o-Y comparison the current account deficit fell down slightly by 2% to a value of USD 3,654.07 million in the FY 1398 from a value of USD 3,731.77 million registered in the FY 1397 (table 4.1 and figure 4.1).

The contractions in current account deficit were mainly due to declining deficit of trade balance (goods and services) lowering inflow of official grants to the government sector and an increase in compensation of employees together with investment income inflows during the period under review.

The deficit of goods account narrowed by almost 7.45% to a value of USD 5,294.17 million in the FY 1398 from a value of USD 5,720.63 million recorded in the FY 1397. At the same time, the deficit of services account dropped dramatically by 13% and stood to a value of USD 567.19 million in the FY 1398 from a value of USD 653.75 million recorded in the previous year.

Figure 4.1: Current Account Balance



Source: NSIA/DAB staff calculations

On the other hand, compensation of employees together with investment income inflows jumped up by 61% to a value of USD 306.66 million in the FY 1398 from a value of USD 190.73 million recorded a year ago. As well as, official grants to the government sector and worker personal home remittances from foreign countries reduced significantly by 22% and stood to a value of USD 1,900.64 million in year under review from a value of USD 2,451.87 million recorded last year.

4.1.2. Capital Account

The capital account of the balance of payments changed dramatically during the period under review. This change was mainly attributed to low level of donors' grants in development projects and shrinking of the debt relief by the creditors. Based on Y-o-Y comparison, the inflows to the capital account declined significantly by 37% to a value of USD 823.55 million in the FY 1398 from a value of USD 1,314.41 million recorded in the FY 1397.

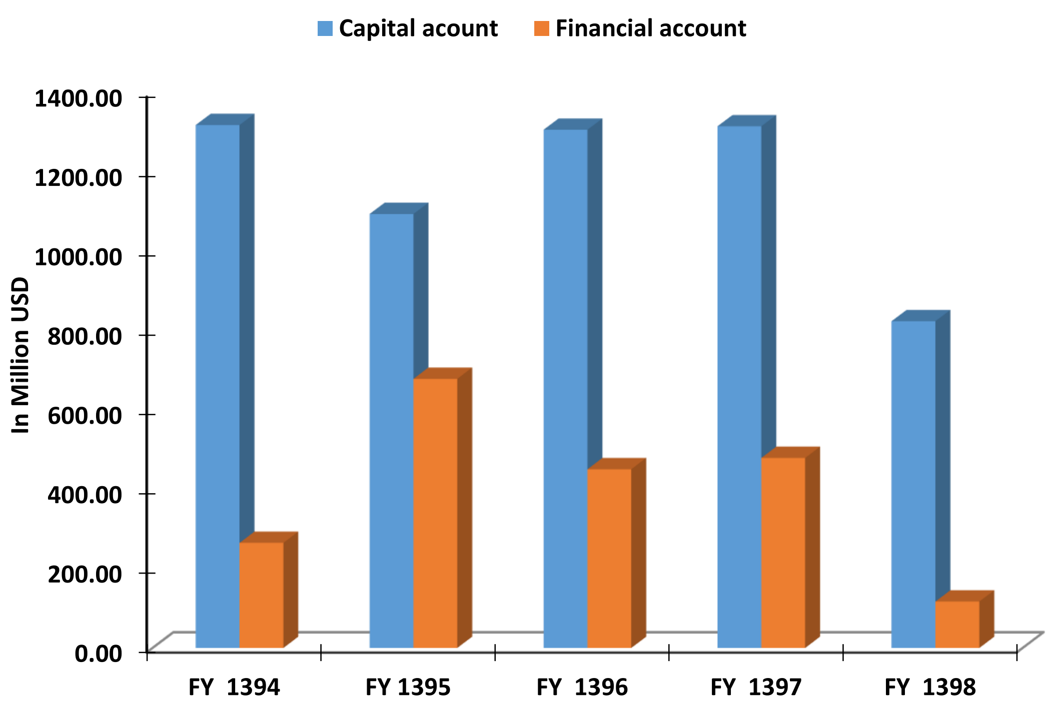
4.1.3. Financial account

Under financial account of the Balance of Payments (BOPs), foreign investment is an important component which consists of foreign direct investment (FDI), foreign portfolio investment (FPI) and Other Investments. Sustained security and political concerns hit the level Net FDI inflows in the country. Considering the statistics, net FDI inflow stood at USD 2.9 million in the FY 1398 from a value of USD 80.63 million recorded in the FY 1397.

Meanwhile, net portfolio investment exhibits USD -14.62 million which reflects withdrawal of Afghanistan investment from foreign countries in the FY 1398 from the value USD 147.70 million registered in the FY 1397. Further analysis reveals that the country's other aggregated financial assets abroad dropped significantly to a value of USD 17.95 million in the period under review from a value of USD 157.69 million that was captured in the FY 1397 (figure 4.2 & 4.3).

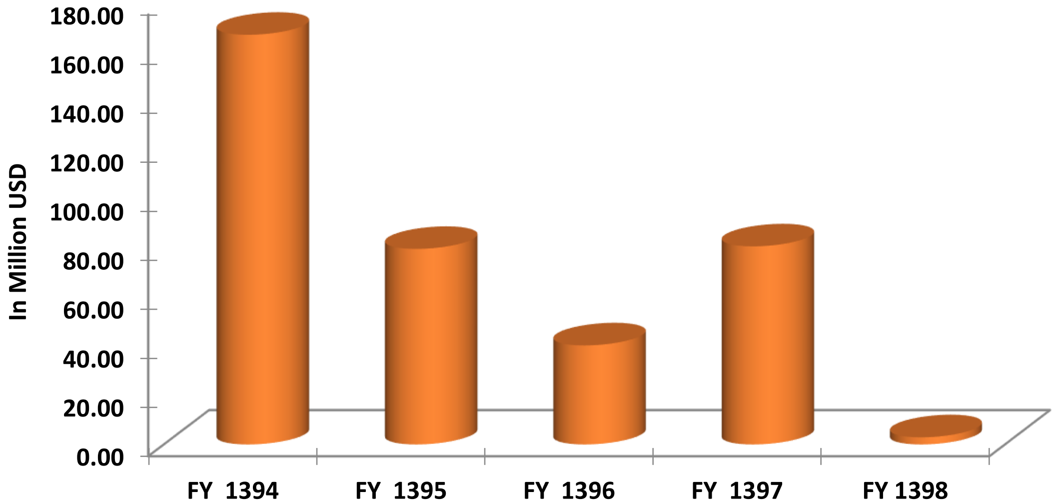
Likewise, other aggregated financial liabilities, also followed downward trend and stood to a value of USD -6.93 million in the FY 1398 from a value of USD -95.33 million recorded in the previews year. The financial account balance as a total stood at USD 117.18 million in the FY 1398 which is well below the value USD 479.35 million recorded in the FY 1397.

Figure 4.2: Capital and Financial Account Balance



Source: NSIA/DAB staff calculations

Figure 4.3: Foreign Direct Investment Inflows (FDI)



Source: NSIA/DAB staff calculations

4.2. MERCHANDISE TRADE

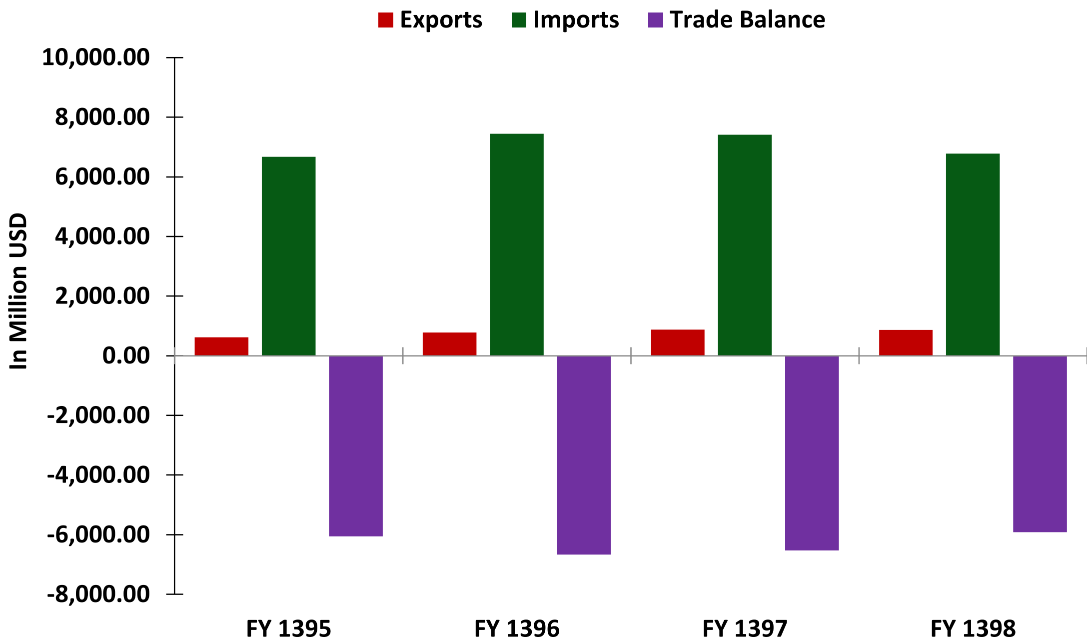
Merchandise trade, covers movements of all types of goods between Afghanistan and its trading partners, by air, land and posts through custom territory and free economic zones. Based on the available statistics, Afghanistan's merchandise trade balance has been in a deficit position for a long period of time.

This indicates that the total value of imported goods has been greater than the total value of exported goods. Considering the data, deficit of merchandise trade balance had a downward slope and stood at USD 5,912.29 million in the FY 1398 from a deficit of USD 6,531.36 million recorded in the FY 1397. This shows approximately 9.47% declines in trade deficit as compared to the previous year (table 4.3, figure 4.4).

The record showed that the total exports of goods shrank by 1.3% to a value of USD 863.83 million in the FY 1398, from a value of USD 875.24 million recorded in the FY 1397. Looking to export components, the exports of carpet and rugs, leather and wool and medical seeds shows upward trends; while the only food items (fresh fruits) followed downward trend during the year under review.

The Year-on-Year (Y-o-Y) comparison of aggregated import showed that it declined by almost 8.51% to a value of USD 6,776.12 million during the FY 1398 compared to a value of USD 7,406.60 million recorded in previous year. Observing the data in the composition of imports, the decreases in the imports were mainly due to slowing down of local demand for consumer goods, capital goods and merely the industrial supplies during the FY 1398.

Figure 4.4: Trade Performance and Trade Balance



Source: NSIA/DAB staff calculations

4.3. DIRECTION OF TRADE

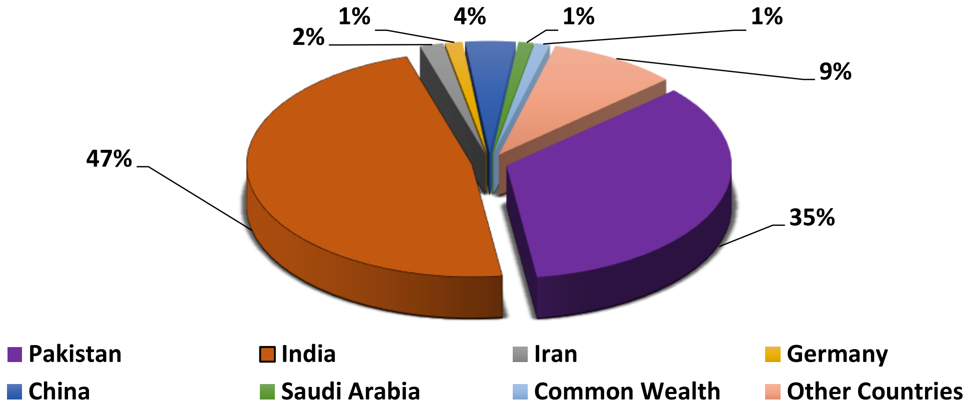
Trade between Afghanistan and its trading partners are categorized; as export destinations and import origins. Figure 4.5 and 4.6 shows Afghanistan's direction of trade with its trading-partners during the FY1398. Based on the statistics, Commonwealth of Independent States (CIS), Iran, China, Pakistan and India remained major trading partners to Afghanistan.

4.3.1. Direction of Exports

Observing the data, India **ranked as the first and top export destination for Afghanistan during the FY 1398**. During the year under review, the share of Afghanistan's exports to India reached to 47% which is well above 41% registered in the FY 1397. In terms of value, exports to India rose by 14% to a value of USD 410.14 million in the FY 1398 from a value of USD 359.44 million recorded in previous year.

Pakistan used to be the first largest export destinations for Afghanistan dropped to the second largest buyer of exports during the FY 1398. The share of Afghanistan's exports to Pakistan dropped down considerably and stood at 35% during the FY 1398 from 43% that was recorded during the last year.

Figure 4.5: Direction of Exports (% share) in FY 1398

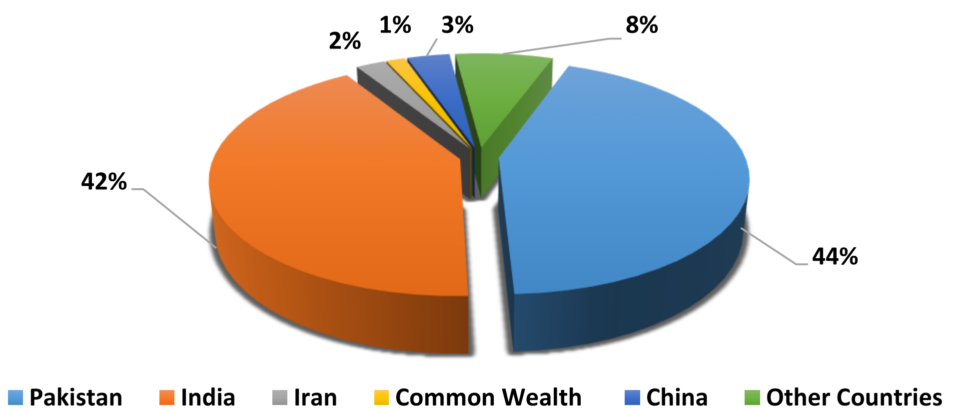


Source: NSIA/DAB staff calculations

In respect of value, Afghanistan's total exports to Pakistan decreased by 21% to a value of USD 298 million in the FY 1398 compared to a value of USD 378 million recorded in the FY 1397. **China and Iran stood the third and fourth largest export destination for Afghanistan during the FY 1398. In the year under review,** share of exports to China slightly rose to 4% in the year under review from 3.2% registered in the FY 1397.

While, the share of Iran in Afghanistan's total remained unchanged, this stood at 2% in the FY 1398 and FY 1397. Total exports to China jumped up by 9% to a value of USD 31 million in the FY 1398 from a value of USD 28.41 million captured in the FY 1397. Whereas, the total exports to Iran turned down by 25% to a value of USD 14.62 million in the FY 1398 from a value of USD 19.51 million which was recorded in the previous year, (figure 4.5 & 4.6).

Figure 4.6: Direction of Exports (% share) in FY 1397



Source: NSIA/DAB staff calculations

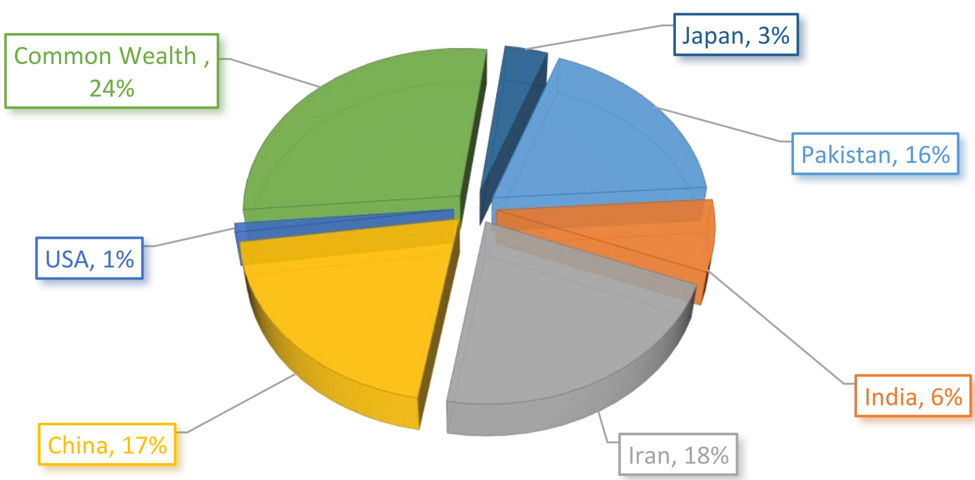
4.3.2. Direction of Imports

CIS countries were the first largest sources of imports for Afghanistan during the FY 1398. Total Imports from CIS countries exhibits a significant decline on year-over-year basis as compared to FY 1397. Based on statistics the total imports from mentioned sources declined by 18% to a value of USD 1,633.78 million with share of 24% in the FY 1398 from a value of USD 1,983.59 million with share of 26.8% in the last FY 1397.

Iran ranked the second largest imports origin for Afghanistan in the FY 1398. The total imports from Iran slightly reduced by 1% and stood at USD 1,247.26 million with share of 18% in the period under review from a value of USD 1,264.18 million with share of 17% recorded in the FY 1397. **China was the third largest source of imports for Afghanistan in the FY 1398.** The total Imports from China also declined by 1% to a value of USD 1,156.68 million with share of 17% in the FY 1398 from a value of USD 1,165.94 million with shares of 16% registered in the FY 1397.

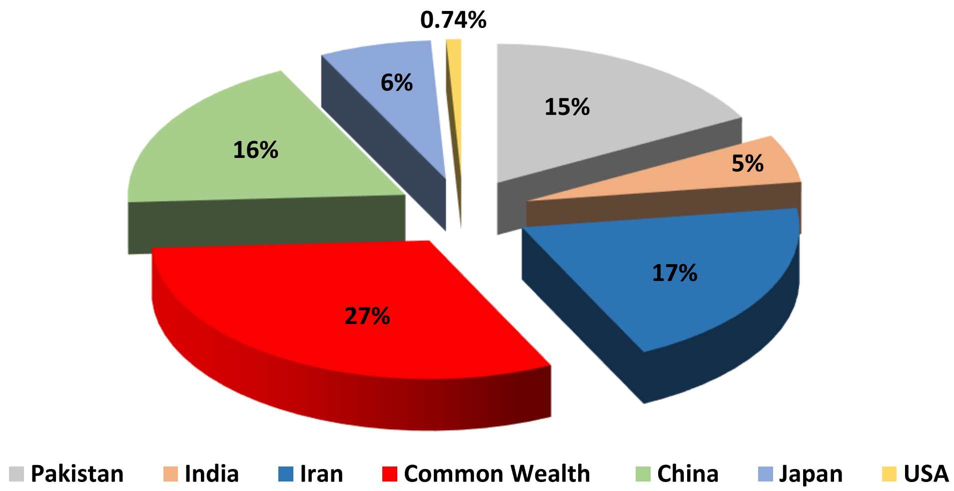
Pakistan graded the fourth largest import origin to Afghanistan in the year under review. As per the statistics, imports from Pakistan slightly declined by 3% to a value of USD 1,058 million with share of 16% in the FY 1398 from a value of USD 1086 million with share of 15% in the FY 1397. India, Japan, United Arab Emirates, Germany and United States of America were the last largest sources of imports for Afghanistan in the FY 1398. The shares of each source to the total imports were accounted as 6%, 3%, 2%, 1%, and 1% respectively. (Figure 4.7 & 4.8).

Figure 4.7: Direction of Imports (% share) in FY 1398



Source: NSIA/DAB staff calculations

Figure 4.8: Direction of Imports (% share) in FY 1397



Source: NSIA/DAB staff calculations

4.4. COMPOSITION OF TRADE

4.4.1. Composition of Imports

The total imports of Afghanistan in the FY 1398 are classified into four categories which were described as follows:

- ✓ Despite diminishing imports of consumer goods, yet, it holds the first largest share in total imports baskets of the FY 1398. Observing the data, its share, decreased from 39% to 37%. In terms of value, imports of consumer goods significantly reduced by 14.27% to a value of USD 2,489.80 million in the FY 1398 from a value of USD 2,904.23 million recorded in the previous year.
- ✓ Imports of Capital goods had the second largest share in the basket of imports during the FY 1398, which compressed to 35% from 37% that was recorded a year ago.

At the same time, the import value of such goods also shrank by 12.26% to a value of USD 2,392.40 million in the year under review from a value of USD 2,726.90 million registered in the FY 1397.

- ✓ The fuel and lubricants (petroleum oil) owned the third largest share in the total imports' basket. Based on statistics, its share grew to 16% from 13% in the FY 1398.

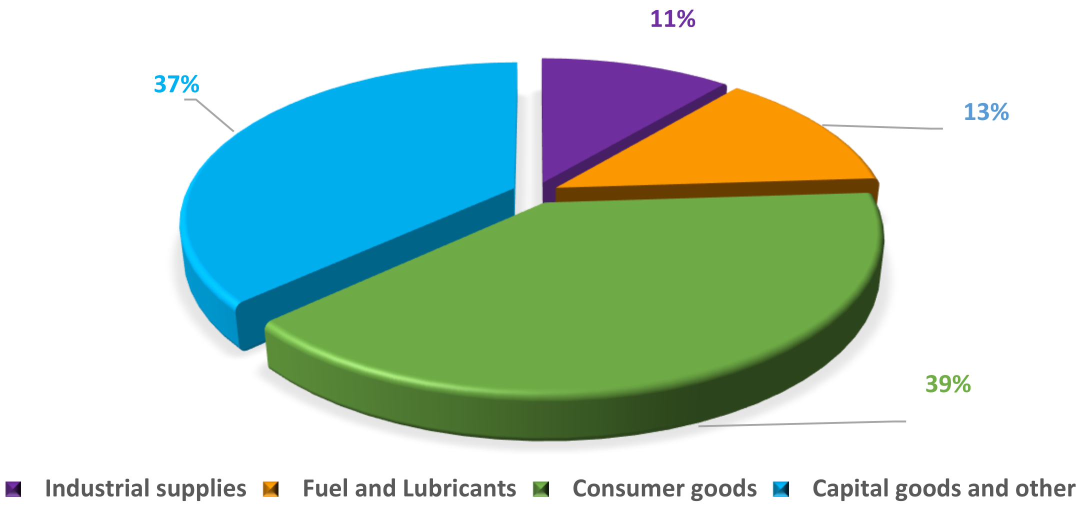
In terms of value, imports of fuel and lubricants in total imports rose by 13.50% which showed a significant jump to a value of USD 1,078 million in the period under review from a value of USD 949.78 million recorded in the FY 1397.

- ✓ In the import category the industrial supplies hold the smallest share in the basket of

Afghanistan's imports during the year under review. Despite of increment in the share of the same category from 11% in the FY 1397 to 12% in the period under review.

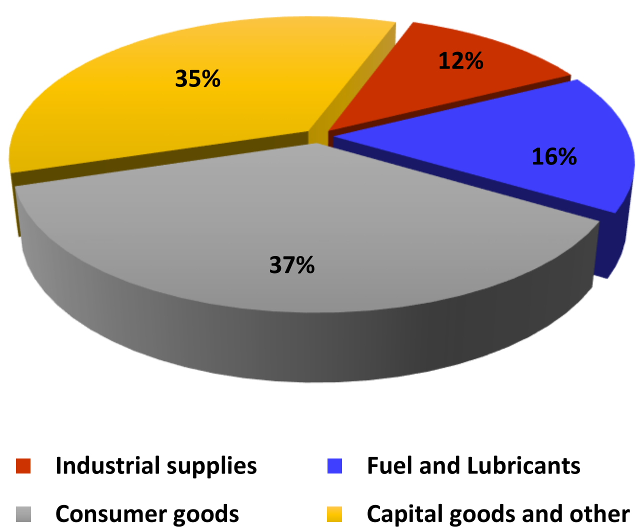
It exhibits that the imports of such goods shrank by 1.18%, which stood to a value of USD 815.90 million in the FY 1398 from a value of USD 825.68 million captured in the FY 1397, (Figure 4.9 - 4.10).

Figure 4.9: Composition of Imports (% share) in FY 1397



Source: NSIA/DAB staff calculations

Figure 4.10: Composition of Imports (% share) in FY 1398



Source: NSIA/DAB staff calculations

4.4.2. Composition of Exports

The merchandise exports have also been categorized and analyzed as bellow:

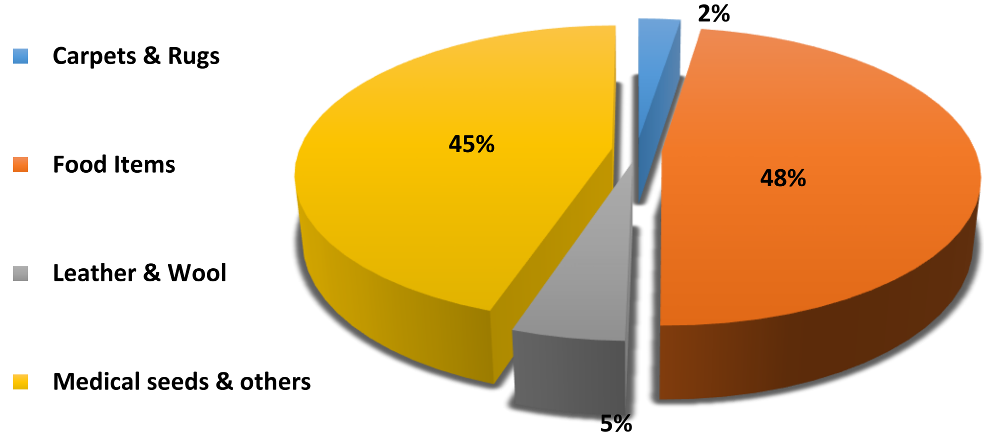
- Exports of medical seeds had the largest share in the category of total basket of Afghanistan's exports. It slightly rose to 46% in the period under review from 45% recorded in the previous year. The increment was mainly due to rise in the exports of medical seeds and saffron to USD 168.69 million and USD 25.76 million during the period under review from USD 146.14 million and 21.22 million recorded in the FY 1397 respectively.

At the same time, Earnings from exports of medical seeds grew by 1.61% to a value of USD 399.24 million in the FY 1398 from a value of USD 392.88 million recorded in the previous year.

- The food items (oil seeds, fresh and dry fruits) stood the second largest share in total exports during the period under review. Based on statistics, share of the mentioned item reduced to 46% in the FY 1398 from 48% recorded in the last year. At the same time exports value of food items declined by 5% to a value of USD 396.53 million during the FY 1398 from a value of USD 417.69 million registered in the FY 1397. The same has occurred mainly due

to reduction in harvesting of oil seeds and fruits all over the country.

Figure 4.11: Composition of Exports (% share) in FY 1397



Source: NSIA/DAB staff calculations

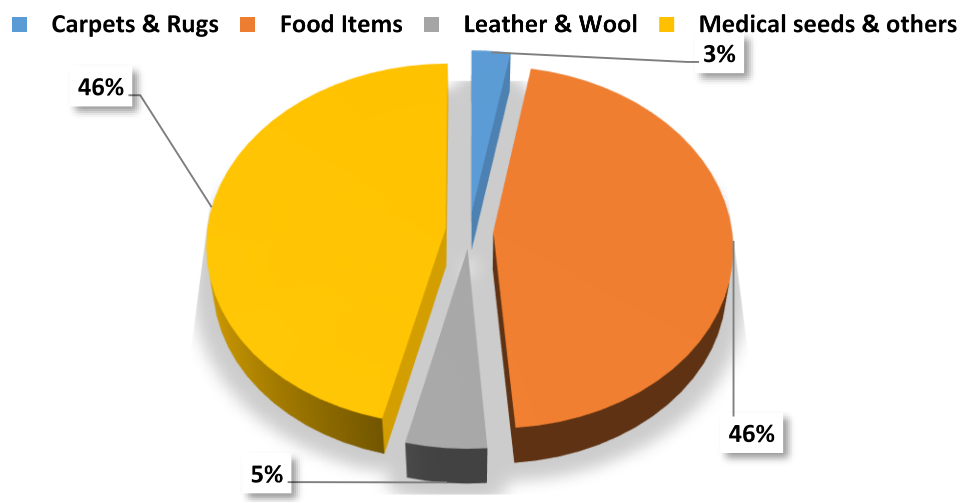
- The Leather and wool products stood the third largest share in the total exports. Share of this item recorded 5% in the year under review and as well as in the FY 1397, respectively.

Based on Y-O-Y comparison, earning from exports of leather and wool slightly jumped up by 2% and reached to a value of USD 43.16 million in the FY 1398 from a value of USD 42.32 million recorded in preceding year.

- Carpet and rugs are considered as main components of Afghanistan's exports in the past decades. It has constituted the last largest share in total exports which stood at 3% in the FY 1398 and FY 1397 respectively.

The total value of exports on carpet and rugs had an upward movement and stood to USD 24.9 million which showed a noticeable increment of 11.43% as compared to the value of USD 22.35 million that was recorded in the last year. Composition of exports in the related periods are indicated in figures 4.11 and 4.12.

Figure 4.12: Composition of Exports (% share) in FY 1398



Source: NSIA/DAB staff calculations

4.5. EXTERNAL DEBT

Afghanistan's total public external debt stood at USD 1,955.52 million at the end FY 1398, which showed USD 146.67 million reductions from the value of USD 2,102.19 million recorded in previous year. Considering the statistics, the total public external debt shrank by 7% during the period under review.

The reduction was not only due to repayment of the loan principle and the accumulated interest of the previous periods but it was also due to the exchange rate fluctuations during the period under review (figure 4.13). **A**mong all, the World Bank, Asian Development Bank, Islamic Development Bank, OPEC Fund, Saudi Fund for

Development, Bulgaria and Kuwait were the creditors received their loan principles, while service charges were paid only to the World Bank, Asian Development Bank, Islamic Development Bank and Kuwait fund during the period under review.

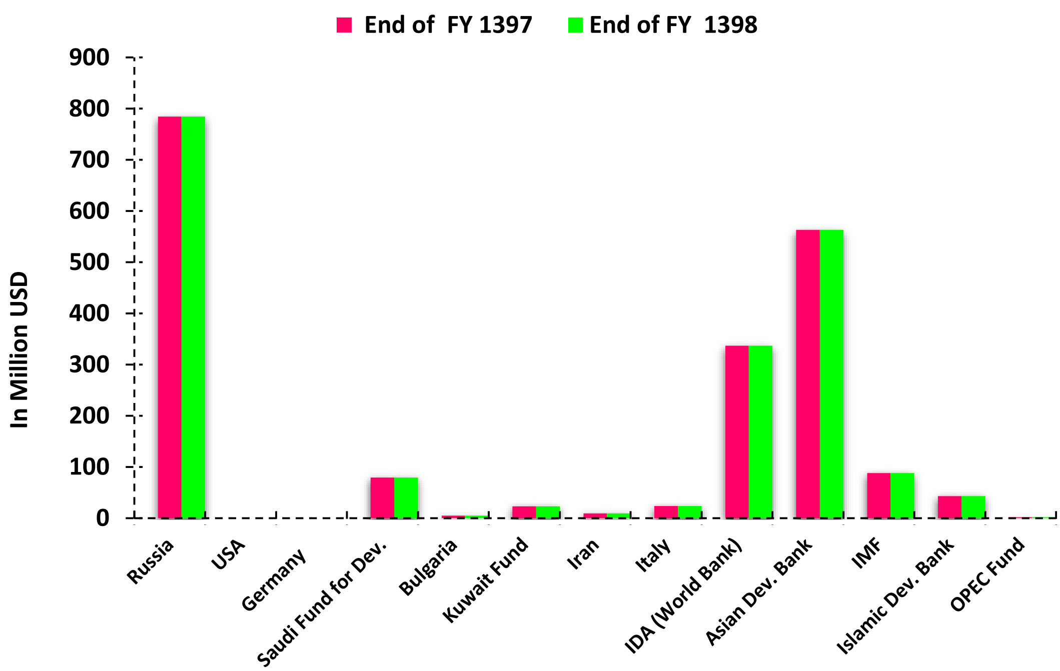
The World Bank and Asian Development Bank as major multilateral creditors have forgiven about USD 8.2 million on their debt principles and as well as services charge during the FY 1398.

Bilateral loan is segregated into two parts: Paris club and Non-Paris Club creditors. The total amount of loan payable to Paris Club creditors especially Russian federation stood at USD 784.67 million at the end of the FY 1398 from the amount USD 889.40 million recorded a year ago. Based on Y-O-Y comparison, it registered 12% decline to debt stocks to the mentioned creditor. The reduction was mainly due to the depreciation of Russian's Ruble against USD.

Total debt from Non-Paris Club members (Saudi Fund for Development, Bulgaria, Kuwait fund, Iran and Italy) rose to a value of USD 139.22 million in the FY 1398 from a value of USD 100.89 million recorded in the FY 1397. Looking to the figure, it reflects 38% increment in debt liabilities to the creditors on Y-o-Y comparison.

On the other hand, total debt from multilateral creditors to Afghanistan dropped by 7% to a value of USD 1031.64 million in the FY 1398 from a value of USD 1111.93 million recorded in the FY 1397 which shows USD 80.29 million decline in the total debt during the period under review.

Figure 4.13: External Debt Comparison between FY 1397 & FY 1398



Source: NSIA/DAB staff calculations

4.6. NET INTERNATIONAL RESERVES

The Da Afghanistan Bank holds and manages the Gross and Net International Reserve, which consist of monetary gold, reserve position in the fund, Special Drawing Rights (SDR) other liquid foreign exchanges such US dollars, Euro and Great British Pound. The Afghanistan Net International Reserve (NIR) is measured as country Gross International Reserves (GIR) minus reserve related liabilities.

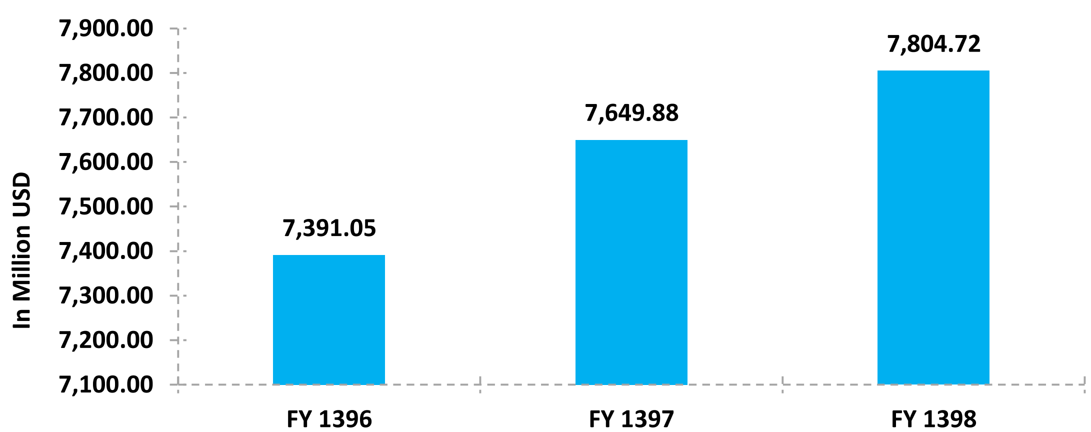
The GIR reached its highest records and stood at USD 8,409.69 million at the end of FY 1398 from the amount USD 8,309.88 million registered in the previous year. Based on the figure, about a USD 100 million have been accumulated in the GIR during the period under review. The NIR has also followed upward trend during the period under review and surged to the value of USD 7,804.72 million from a value of USD 7,649.88 million recorded in the last year, it showed the increment of 2% in the NIR (Figure 4.14).

Reserve related liabilities declined by 8.3% to a value of USD 604.98 million in the FY 1398 from a value of USD 660 million recorded in the FY 1397. The decline in reserve related liabilities was mainly due to withdrawal of commercial bank deposits in foreign currency from Da Afghanistan Bank which dropped by 8% to a value of USD 549.22 million in the FY 1398 from a value of USD 600.64 million and as well as Use Fund Resources shrank by 6% to the value USD 55.62 million in the year under review from the value of USD 59.22 million recorded in the previous year.

The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the FY 1398.

The current position of Afghanistan Net International Reserves (NIR) is best cushion for conducting a sound and appropriate monetary policy in the country.

Figure 4.14: Net International Reserve during the past periods



Source: NSIA/DAB staff calculations

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

Items / Years	FY - 1394	FY - 1395	FY - 1396	FY - 1397	FY - 1398	% change
Current Account	**-4040.55**	**-2357.87**	**-3125.24**	**-3731.77**	**-3654.07**	**-2%**
Credit	4658.20	5145.05	4983.73	4543.65	3946.24	-13%
Debit	8698.74	7502.92	8108.98	8275.42	7600.31	-8%
Goods and Services Account	**-7044.38**	**-6191.46**	**-6803.56**	**-6374.38**	**-5861.36**	**-8%**
Credit	1417.30	1136.01	1152.90	1609.47	1509.21	-6%
Debit	8461.68	7327.48	7956.46	7983.85	7370.58	-8%
Goods Account	**-6667.74**	**-5594.98**	**-5932.25**	**-5720.63**	**-5294.17**	-7%
Credit	577.86	614.22	783.96	875.24	863.83	-1%
Debit	7245.60	6209.19	6716.21	6595.87	6158.00	-7%
Services Account	**-376.65**	**-596.49**	**-871.31**	**-653.75**	**-567.19**	-13%
Credit	839.44	521.80	368.93	734.23	645.38	-12%
Debit	1216.09	1118.28	1240.24	1387.97	1212.57	-13%
Primary Income Account	**179.97**	**179.55**	**248.32**	**190.73**	**306.66**	**61%**
Credit	286.99	239.84	299.54	289.43	352.58	22%
Debit	107.02	60.29	51.22	98.70	45.92	-53%
Secondary Income Account	**2823.87**	**3654.05**	**3430.00**	**2451.87**	**1900.64**	**-22%**
Credit	2953.91	3769.20	3531.30	2644.75	2084.45	-21%
Debit	130.03	115.15	101.30	192.88	183.81	-5%
Current transfers (Official grants)	**2838.2**	**3232.0**	**2613.9**	**1950.4**	**1331.1**	**-32%**
Credit	2838.20	3232.01	2613.9	1950.4	1331.1	-32%
Debit	0.00	0.00	0.0	0.0	0.0	
Personal transfers	**-14.32**	**422.04**	**816.10**	**501.44**	**569.49**	**14%**
Credit	115.71	537.19	917.40	694.32	753.30	8%
Debit	130.03	115.15	101.30	192.88	183.81	-5%
Capital account	**1317.57**	**1093.57**	**1305.69**	**1314.41**	**823.55**	**-37%**
Credit	1317.57	1093.57	1305.69	1314.41	823.55	-37%
Debit	0.00	0.00	0.00	0.00	0.00	
Capital transfers	**1317.57**	**1093.57**	**1305.69**	**1314.41**	**823.55**	**-37%**
Credit	1317.57	1093.57	1305.69	1314.41	823.55	-37%
Debit	0.00	0.00	0.00	0.00	0.00	
Financial account	**-265.3**	**678.4**	**450.8**	**479.35**	**117.18**	**-76%**

Items / Years	FY - 1394	FY - 1395	FY - 1396	FY - 1397	FY - 1398	% change
Direct investment	**-166.98**	**-79.59**	**-40.27**	**-80.63**	**2.9**	**-104%**
Net acquisition of financial assets	2.16	14.01	11.26	38.80	26.32	-32%
Net incurrence of liabilities	169.15	93.59	51.53	119.44	23.42	-80%
Portfolio investment	**80.68**	**99.47**	**-29.57**	**142.70**	**-14.62**	**-110%**
Net acquisition of financial assets	80.68	99.47	-29.57	142.70	-14.62	-110%
Net incurrence of liabilities	0.00	0.00	0.00	0.00	0.00	
Other investment	**111.78**	**30.02**	**-50.12**	**253.02**	**24.87**	**-90%**
Assets	110.51	35.73	17.65	157.69	17.95	-89%
Liabilities	-1.26	5.72	67.77	-95.33	-6.93	-93%
Reserve Assets	**-290.73**	**628.55**	**570.73**	**164.26**	**104.03**	**-37%**
Net errors and omissions	**2458**	**1943**	**2270**	**2897**	**2948**	**2%**

Source: NSIA/DAB staff calculations

Table 4.2: Merchandise Trade in (Million USD)

Years	FY - 1395		FY – 1396		FY - 1397		FY - 1398	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	**6,672.39**	**100%**	**7,448.14**	**100%**	**7,406.60**	**100%**	**6,776.12**	**100%**
Industrial supplies	536.47	8.0%	883.27	12%	825.68	11%	815.90	12%
Fuel and Lubricants	1078.73	16%	877.65	11.8%	949.78	13%	1078.01	16%
Consumer goods	2120.44	32%	2,981.46	40.0%	2,904.23	39%	2489.80	37%
Capital goods and other	2936.75	44%	2,705.75	36%	2,726.90	37%	2392.40	35%
Exports	**613.80**	**100%**	**783.93**	**100.0%**	**875.24**	**100%**	**863.83**	**100%**
Carpets & Rugs	52.51	9%	23.74	3.0%	22.35	3%	24.9	3%
Food Items	269.91	44%	441.51	56.3%	417.69	48%	396.53	45.9%
Leather & Wool	55.00	9%	23.13	3.0%	42.32	5%	43.16	5%
Medical seeds & others	236.38	39%	295.55	37.7%	392.88	44.9%	399.24	46.2%
Trade Balance	**-6,058.58**		**-6,664.21**		**-6,531.36**		**-5,912.29**	

Source: NSIA/DAB staff calculations

Table 4.3: Direction of External Trade: for the FY 1398 in (Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	298.04	35%	1058.01	16%	-759.97
India	410.14	47%	404.91	6%	5.22
Iran	14.62	2%	1247.26	18%	-1232.64
Germany	10.88	1.3%	75.82	1%	-64.94
China	31.00	4%	1,156.68	17%	-1125.68
England		0.00%	4.39	0.06%	-4.39
Saudi Arabia	9.37	1%		0.00%	9.37
United Arab Emirates		0.00%	130.14	2%	-130.14
Turkey		0.00%	66.02	0.97%	-66.02
USA		0.00%	49.73	1%	-49.73
Common Wealth	9.47	1%	1633.78	24%	-1624.31
Japan		0.00%	201.21	3%	-201.21
Other Countries	80.31	9%	748.16	11.04%	-667.85
Total	**863.83**	**100%**	**6,776.12**	**100%**	**(5,912.29)**

Source: NSIA/DAB staff calculations

Table 4.4: Direction of External Trade: for the FY 1397 in (Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	378.24	43%	1086.86	15%	-708.62
India	359.44	41%	354.28	5%	5.16
Iran	19.51	2%	1264.18	17%	-1244.67
Germany	5.34	0.6%	65.56	1%	-60.22
Common Wealth	12.67	1%	1,983.59	27%	-1970.92
China	28.41	3%	1165.94	16%	-1137.53
United Arab Emirates			58.46		
Saudi Arabia	6.60	0.00%		1%	-58.46
Turkey			45.41	0.61%	
Japan		0.00%	414.02	6%	-414.02
England		0.0%	4.66	0%	-4.66
USA		0.00%	55.03	0.74%	-55.03
Other Countries	65.03	7.43%	908.62	12.27%	-843.59
Total	**875.24**	**99%**	**7,406.6**	**100%**	**(6,492.55)**

Source: NSIA/DAB staff calculations

Table 4.5: External Debt for the FY 1398 (In million USD)

	FY - 1397	% share	FY - 1398	% share
Total external debt	**2,102.19**	**100.00**	**1,955.52**	**100.00**
Bilateral	**990.26**	**47.11**	**923.89**	**47.25**
1- Paris Club	**889.40**	**42.31**	**784.67**	**40.13**
Russian Federation	889.40	42.31	784.67	40.13
United States		0.00	-	0.00
Germany		0.00	-	0.00
2- Non-Paris Club	**100.86**	**4.80**	**139.22**	**7.12**
Multilateral	**1,111.93**	**52.89**	**1,031.64**	**52.75**
of which: IDA (World Bank)	346.95	16.50	336.87	17.23
Asian Development Bank	649.91	30.92	562.93	28.79
International Monetary Fund	68.20	3.24	87.64	4.48
Islamic Development Bank	45.21	2.15	42.65	2.18
OPEC Fund	1.67	0.08	1.53	0.08

Source: NSIA/DAB staff calculations

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

Changes on the previous quarter	FY - 1396	% change	FY - 1397	% change	FY - 1398	% change
Net international Reserves (million US Dollar)	**7,391.05**	23.22	**7,649.88**	3.50	**7,804.72**	2.02
Reserve Assets	8,214.52	22.71	8,309.88	1.16	8,409.69	1.2
Reserve Liabilities	823.47	10.91	660.00	-19.85	604.98	-8.3
Commercial bank deposits in foreign currency	760.48	4.00	600.64	-21.02	549.22	-8.6
Nonresident deposits in foreign currency	0.14	-89.57	0.14	0.00	0.14	0.00
Use of Fund resources	62.85	17.53	59.22	-5.77	55.62	-6.08
Gross Intl. Reserves (in months of import)	**13.23**		**13.39**		**13.63**	
Net Intl. Reserves (in months of import)	**13**		**12**		**13**	

Source: NSIA/DAB staff calculations

5

Fiscal Developments

5

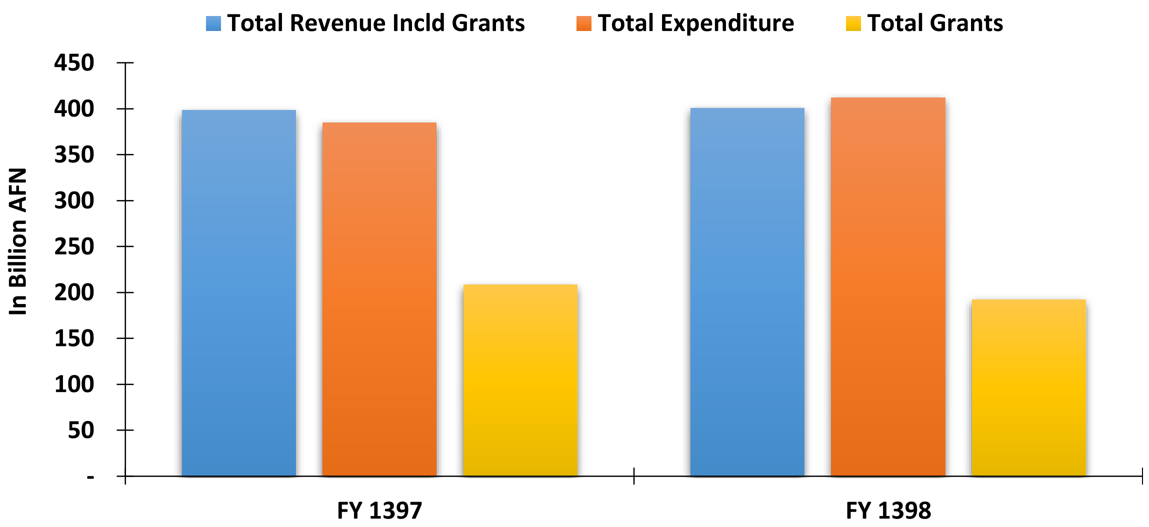
FISCAL SECTOR DEVELOPMENT

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 duties' administration.

Resembling the other emerging and under developing economies around the world, Afghanistan continuously faces budget deficit where total core expenditures exceeds total domestic revenue in FY 2019 leading to budget deficit of AFN 203.62 billion (excluding grants). While, including grants a budget deficit of AFN 11.24 billion is observed compared to 13.61 billion surpluses in 2018.

Due to increment in overall taxation, sources under claims, administrative fees, sales of goods and services, the total domestic revenue is increased from AFN 186.84 billion in FY 2018 to AFN 208.42 billion in FY 2019 (increment of AFN 18.57 billion or 9.78%). Meanwhile expenditures increased to AFN 412 billion compared with the AFN 384.52 billion expenditures of the previews year.

Figure 5.1: Comparison of Total Revenue, Total Expenditure, Grants for FY 1397 & FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

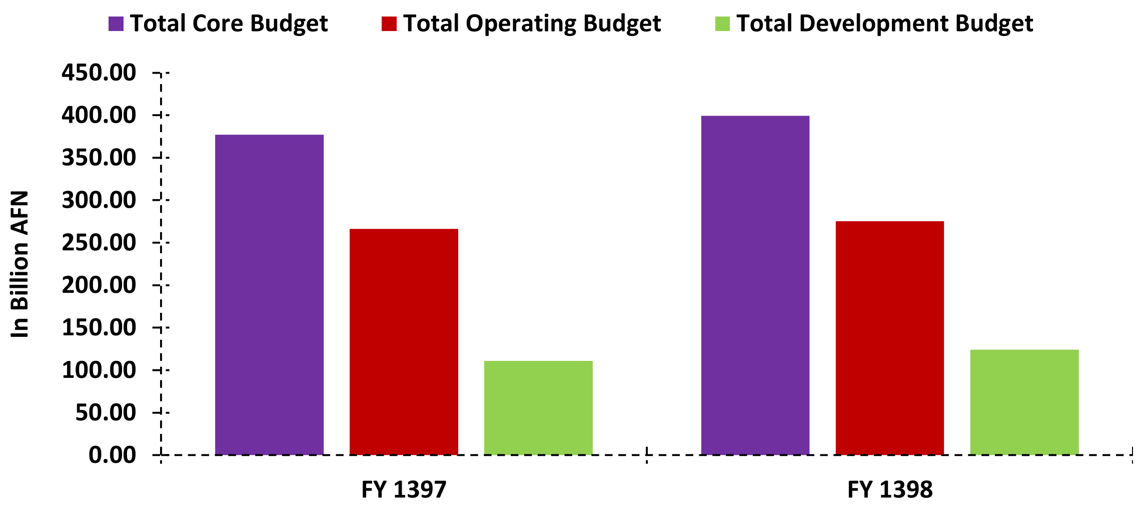
Furthermore, donor contributions are used to finance both operating and development expenditure. The total donor contribution (grants) allocated to operating and development expenditure represent a considerable decrease of AFN 15.90 billion or 8% (from AFN 208.28 billion in FY 2018 decreased to AFN 192.38 billion in FY 2019). This decrease was due to change in annual pledge, commitment and disbursement of donor revenues.

Total core budget is increased form AFN 377.19 billion in FY 2018 to AFN 399.41 billion in FY 2019 which showed an increase of AFN 22.23 billion (5.9%) in total core budget.

5.1. BUDGET EXECUTION RATE

During the FY 2019, government spent 89% of its total allocated budget of AFN 445.77 billion compared to the execution rate of 83% from AFN 377.19 billion in FY 2018 which represents 6% raise in overall budget execution rate. This increase was attributed to several factors particularly; well processing and approval of expenses by the National Procurement Authority, security condition in provinces and high performances by the budgetary units.

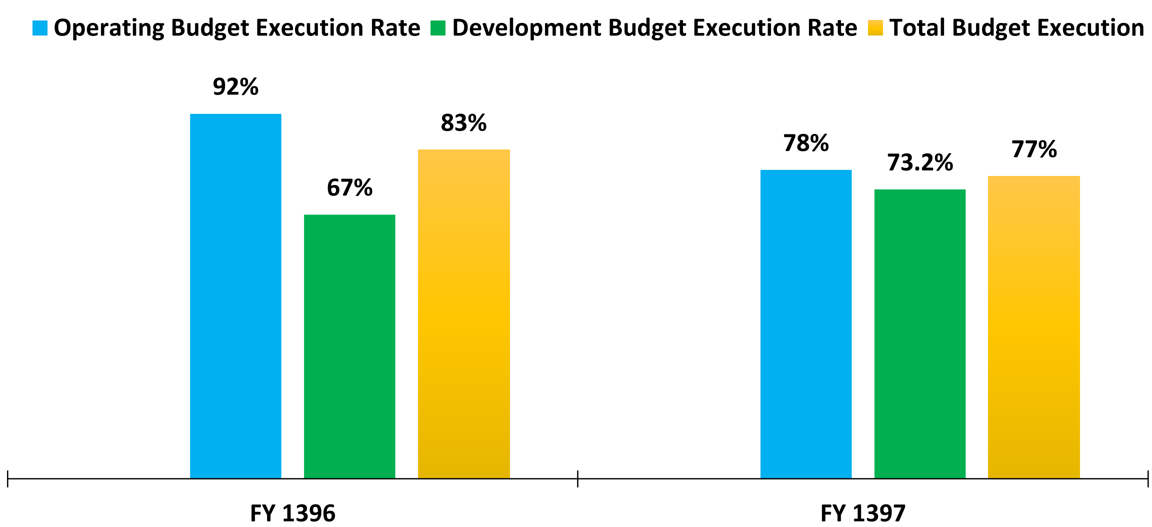
Figure 5.2: Comparison of Total Budget FY 1397 & FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

Operating budget execution rate indicates 13.9% increase from 78% of FY 1397 to 91% of FY 1398. The development budget execution rate evidently represents increase of 12% when comparing 73.2% execution rate in FY 2018 with 85.2% execution rate in FY 2019.

Figure 5.3: Comparison of Operation Budget Execution & Development Budget Execution Rates FY 1396 & 1397



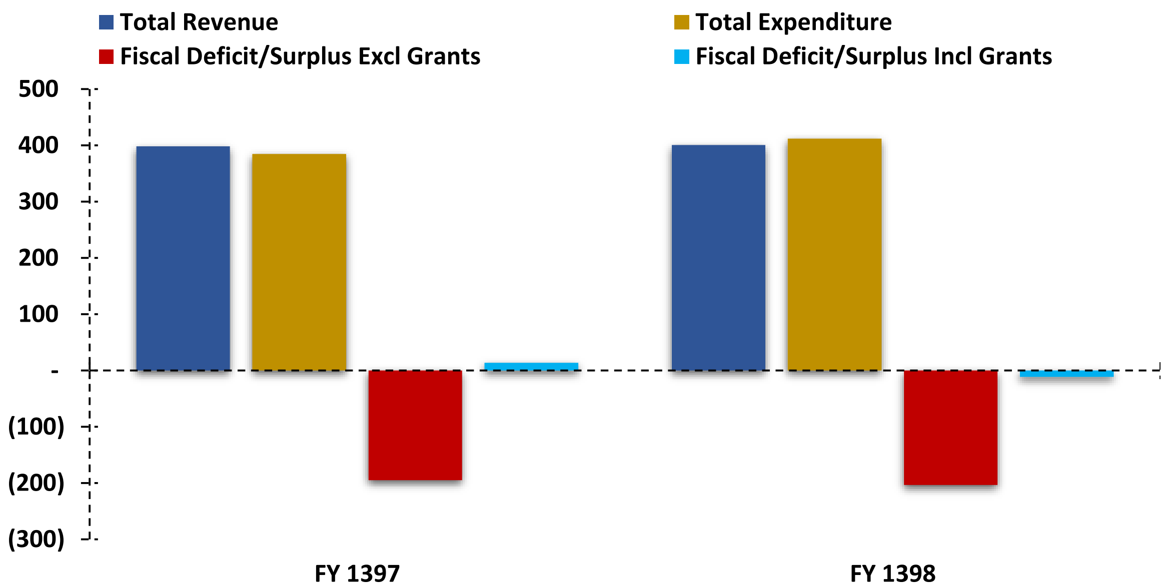
Source: MoF Financial Statement/MPD Staff Calculation

5.2. CORE BUDGET (DEFICIT & SURPLUS)

The overall budget prior to donor's contribution had a deficit of AFN 203.62 billion in FY 2019 compared to AFN 194.68 billion deficit in FY 2018 which showed 4.59% or AFN 8.95 billion increase in fiscal deficit. Meanwhile, external amount of funding decreased from AFN 208.28 billion in FY 2018 to AFN 192.38 billion in FY 2019.

Operating budget raised to AFN 275.22 billion in FY 2019 from AFN 266.13 billion of FY 1397 (3.4% increase). However, development budget showed a significant increase from AFN 111.06 billion of FY 2018 to AFN 124.19 billion in FY 2019 that represented 11.83% increments which was due to high level of grants and proper budget allocation for the FY 2019. The total annual external planed funding amount represents increase of 4.04% from AFN 191.28 billion of FY 2018 to AFN 199.02 billion in FY 2019.

Figure 5.4: Core Budget Deficit & Surplus (Including Grants and Excluding Grants) FY 1397 & 1398 in AFN



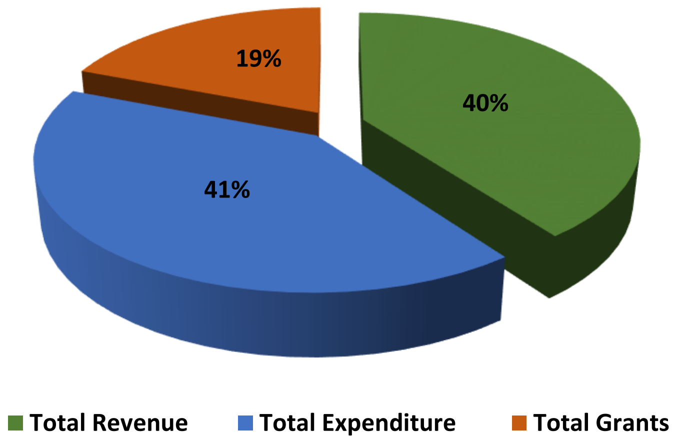
Source: MoF Financial Statement/MPD Staff Calculation

5.3. TOTAL REVENUE:

During FY 2019, total revenues including grants increased to AFN 400.80 billion compared with the AFN 398.12 billion of FY 2018. This represented a mild raise of AFN 2.68 billion or 0.7% as compared to the previous year.

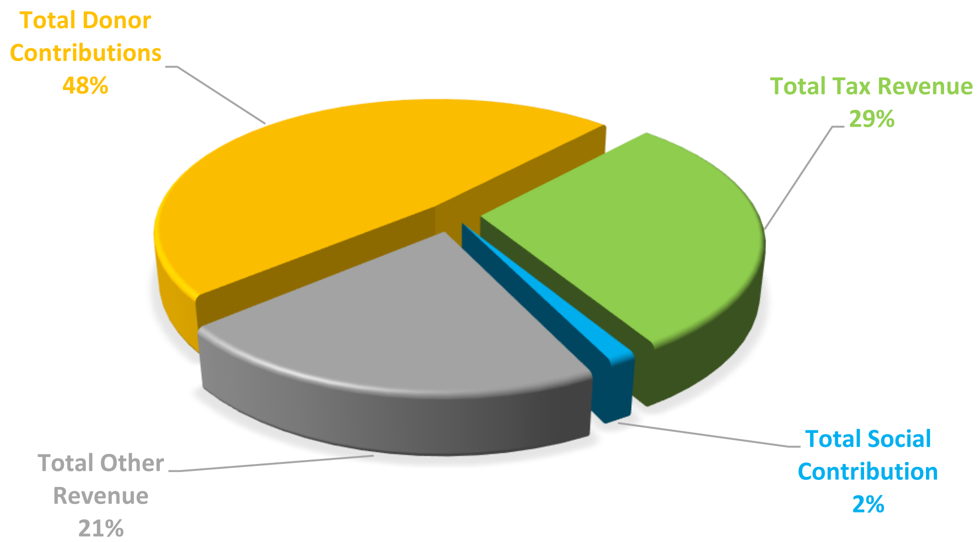
Annual collection of planed domestic revenue for FY 2019 indicates a significant increase of AFN 26.38 billion (16.32%) reaching to AFN 188.01 billion from AFN 161.62 billion in FY 2018. To meet FY 2018 budget deficit, total domestic revenue & donor contribution plays a vital role and revenue collection that steer to annual budget surplus. Increase in total revenue collection in FY 2019 was as a result of momentous improvement in tax revenue (sale taxes, property taxes, income taxes and tax penalties & fine), social contribution and taxes on the other revenue sources (income from capital property and revenue collected from the sources under claims and etc.). However, there had been decline in customs duties, royalties and miscellaneous revenue and a considerable change in donor contribution.

Figure 5.5: Contribution of Total Revenue, Expenditure & Grants for FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.6: Total Revenue Contribution for FY 1398



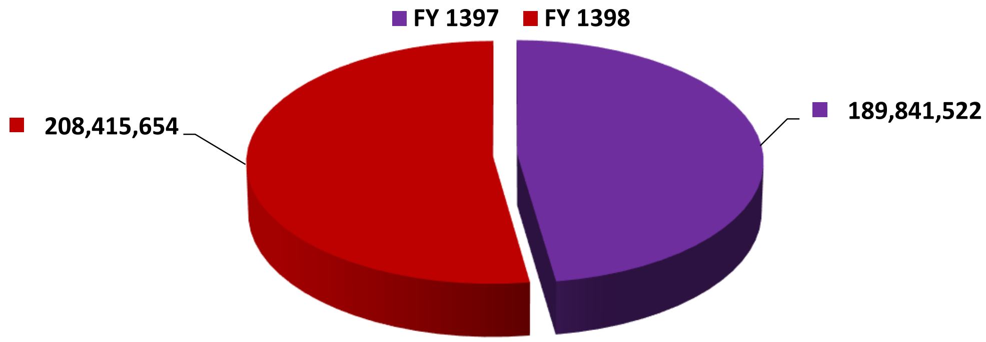
Source: MoF Financial Statement/MPD Staff Calculation

5.3.1. Domestic Revenue:

Collection of total domestic revenue is enhanced in FY 2019 however it was significantly sophisticated compared to the FY 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 tax revenue (income taxes, sale taxes, property tax and fixed tax), social contributions, and total other revenues (income from capital property, administrative fees, sale of land and building, and revenue collected from the sources under claims). Total domestic revenue is increased from AFN 189.84 billion of FY 2018 to AFN 208.42 billion in FY 2019, which showed an increase of AFN 18.57 billion equal to 9.78% growth in domestic revenue collection comparatively.

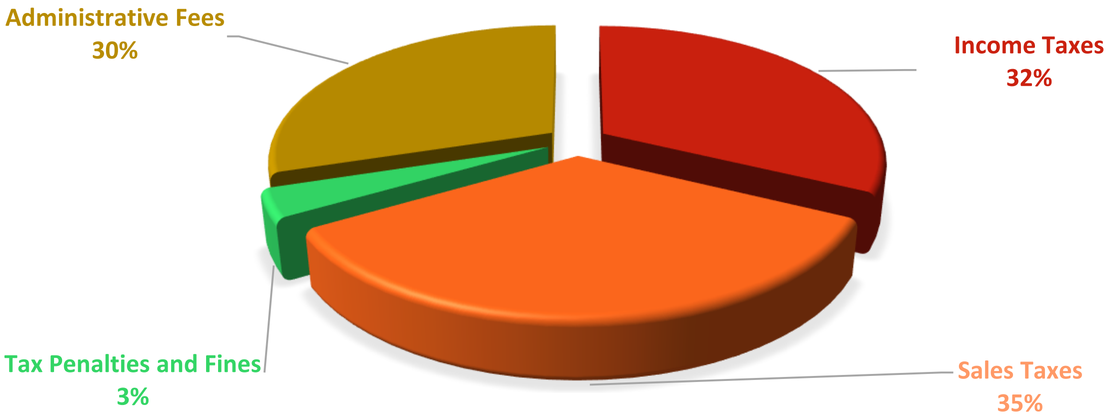
Figure 5.7 Total Domestic Revenue Comparison FY 1397 & FY1398 (in Thousands AFN)



Source: MoF Financial Statement/MPD Staff Calculation

Besides, the data revealed a mild acceleration in some of the domestic revenue's components such as; fixed taxes increased from AFN 12.64 billion of FY 2018 to AFN 12.73 billion in FY 2019, sale taxes increased from AFN 32.45 billion to AFN 34.11 billion. Similarly, income taxes raised to AFN 31.79 billion in FY 2019 compared to AFN 30.08 billion of FY 2018 while few domestic revenue components had decline like; miscellaneous revenue decreased from AFN 25.15 billion in FY 2018 to AFN 15.64 billion in FY 2019, extractive industry declined from AFN 2.30 billion in FY 2018 to AFN 1.80 billion in FY 2019 comparatively.

Figure 5.8: Major Domestic Revenue for FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

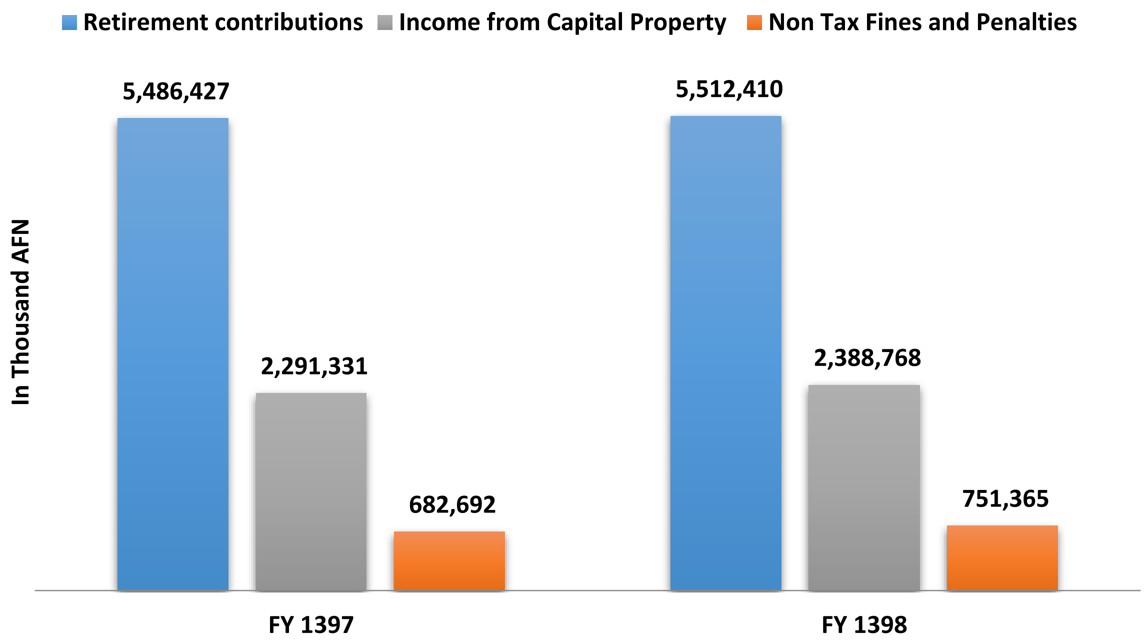
- ## Non Tax Revenue

One of the main component of domestic revenues is non-tax revenues that represented a notable increase of 17.72% (AFN 13.66 billion) from AFN 77.10 billion of FY 2018 to AFN 90.76 billion in FY 2019. This increase was as a result of vital increment in income from capital property, administrative fee, retirement contribution and a notable change in miscellaneous return.

The main component of the non-tax revenues are retirement contributions that increased from AFN 5.49 billion of FY 2018 to AFN 5.51 billion in FY 2019, indicating 0.47% increment, revenue collected from the sources under claims increased to AFN 26.39 billion in FY 2019 from AFN 2.62 billion of FY 2018 which showed 908.56% increase, moreover income from capital property increased from AFN 2.29

billions of FY 2018 to AFN 2.39 billion in FY 2019 which signified 4.25% raise, in contrast miscellaneous revenue declined from AFN 25.50 billion of FY 2018 to AFN 15.64 billion in FY 2019 that indicated 38.67% decline comparatively.

Figure 5.9 Comparison of Major Components Total Non-Tax Revenue for FY 1397 & FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

5.3.2. Grants

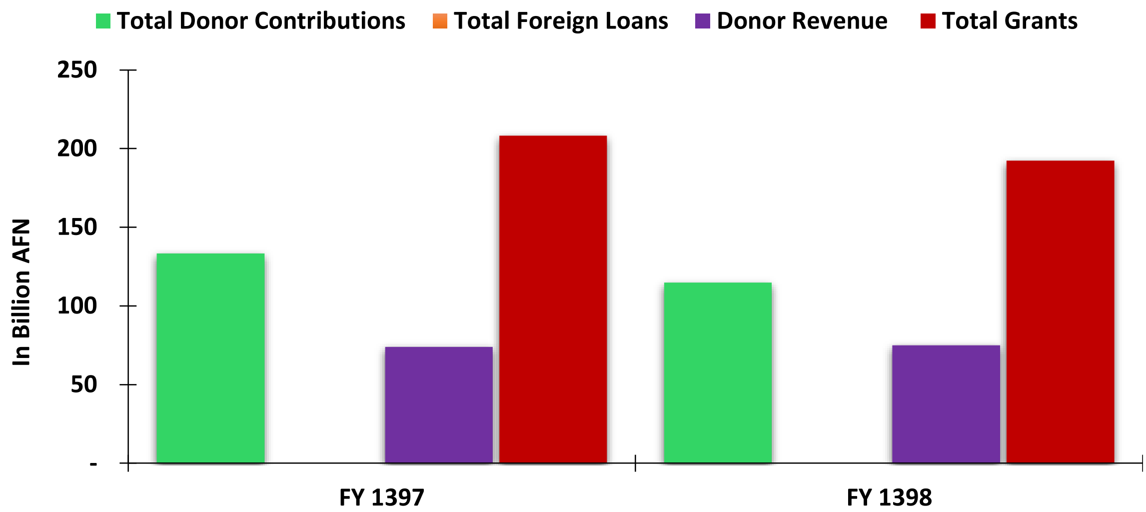
The donor contribution comprises an important part of the national budget, meantime donor grants finance major expenditure items in both operating and development budget.

Government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures. Moreover, In Afghanistan's context, fiscal sustainability, is when total domestic expenditures is financed by total domestic revenue. But still, total expenditure is being financed partially by external sources, foreign loans and rest by domestic revenue.

The level of grants has been decreased in recent years and the main contributors of grants are Afghanistan Reconstruction and Trust Fund (ARTF), Law and Order Trust Fund for Afghanistan (LOTFA), Combined Security Transition Command Afghanistan (CSTC-A), World Bank (WB) and Asian Development Bank (ADB) and others.

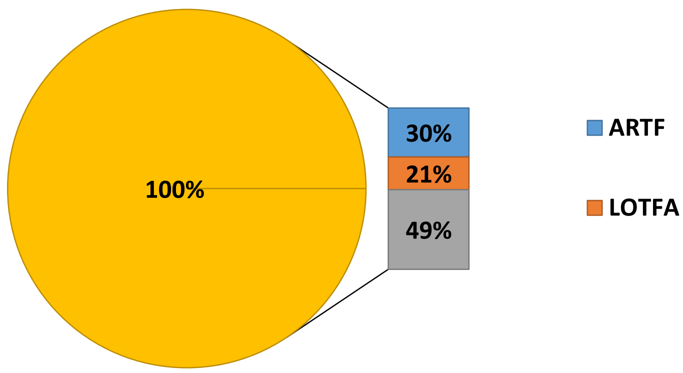
The total development and operating grants represents significant decrease from AFN 208.28 billion in FY 1397 to AFN 192.38 billion of FY 1398 that indicates a notable change of AFN 15.90 billion compared to the FY 1397. The grants from LOTFA is declined 6% from AFN 25.01 billion of FY 1397 to AFN 23.45 billion of FY 1398 and CSTC-A, MoD, MoI & NATO contributed AFN 56.58 billion in FY 1398 that shows 5% decrease compared to AFN 59.59 billion of the FY 1397.

Figure 5.10: Total Annual Grants Analysis for FY 1397 & 139



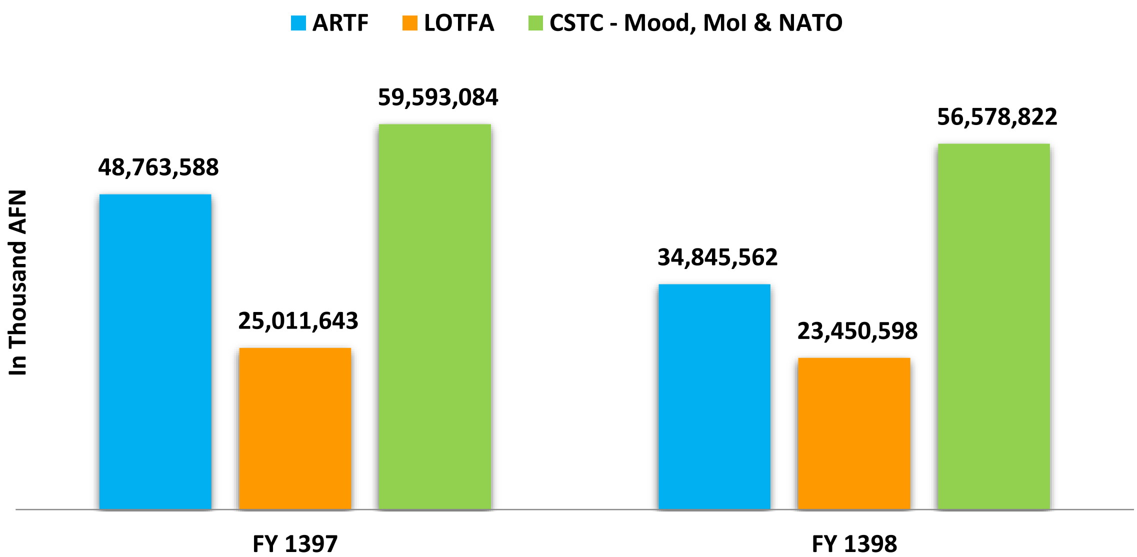
Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.11: Components of Donor Contribution for FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.12: Comparison of Donor Contributions for FY 1397 & FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

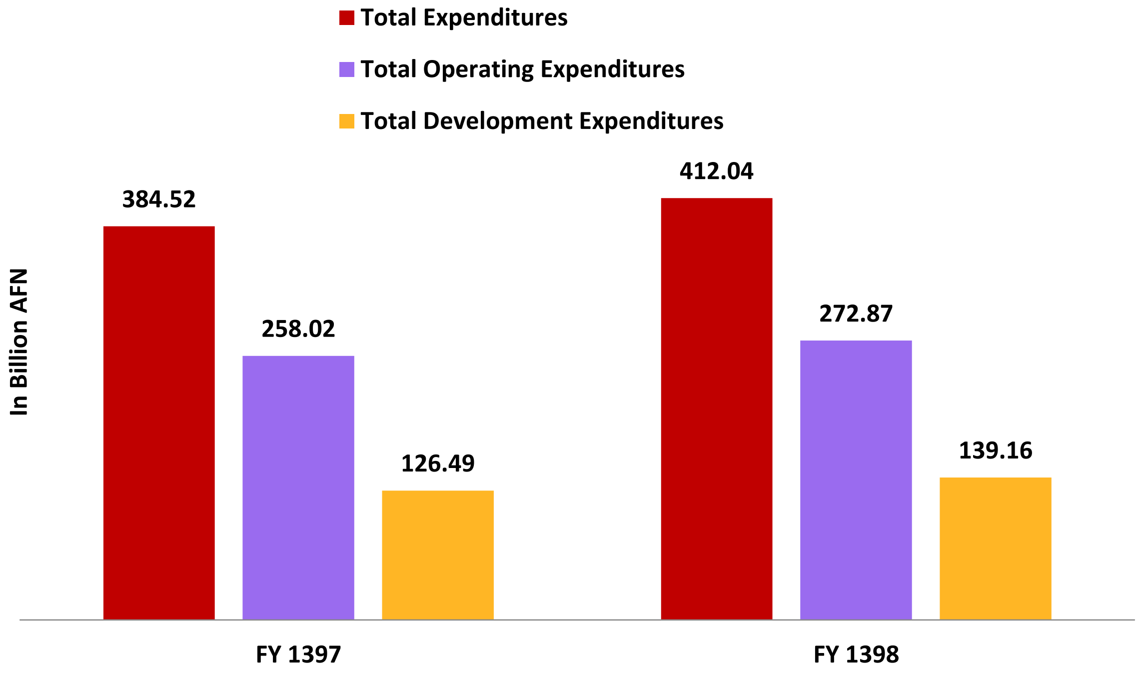
5.4. EXPENDITURE

Total 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. Increased expenditure on infrastructure, economic governance, and agriculture sectors are in line with the ANPDF priority.

Furthermore, total core expenditures indicate 7.16% increase from AFN 384.52 billion of FY 2018 to AFN 412.04 billion in FY 2019 which shows AFN 27.52 billion increase in overall development and operating expenditure compared to the previews year. The increase is due to increase in employee expenditure, and capital expenditure.

In addition, operating expenditures demonstrate increase of 5.75% from AFN 258.02 billion of FY 2018 to AFN 272.87 billion in FY 2019 that represents AFN 14.85 billion raise in operating expenditure in comparison with the previews year. Meanwhile development expenditures showed 10.02% significant increase from AFN 126.49 billion of FY 2018 to AFN 139.16 billion in FY 2019 which indicated AFN 12.67 billion raise in development expenditures compared with the last year.

Figure 5.13: Comparison of Total Expenditure for FY 1397 & FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

6

Banking Systems Performance

6
BANKING SYSTEM PERFORMANCE
FOR
QAWS 1398 (DEC, 2019) YEARLY BULLETIN

The overall banking system performance chapter presents an overview of the financial trends Y-o-Y. The financial statistics tables accompanying graphs on key financial indicators with the source are provided below each graph and table.

The banking sector comprises of 13 duly-licensed and permitted banking organizations. Of which 3 re-licensed state owned banks, 7 private full-fledged commercial banks, 1[1] private full-fledged Islamic bank and 2 branches of foreign banks. The performance of the banking sector during the FY 2019 is described below followed with analysis of the Islamic banking sector[2] in the given period.

At the end of FY 2019, the main banking sector data demonstrated a decreasing trend as compared with the last year. Total assets, gross loans, deposits showed decreases, attributed to settlement and charge-off of loans, closure of a branch of a foreign bank, dividend payment and deposit withdrawals, while equity capital increased owing to profitability. Liquidity remained adequate but the banking sector still beleaguered with the low asset quality.

6.1. ASSETS OF THE BANKING SYSTEM

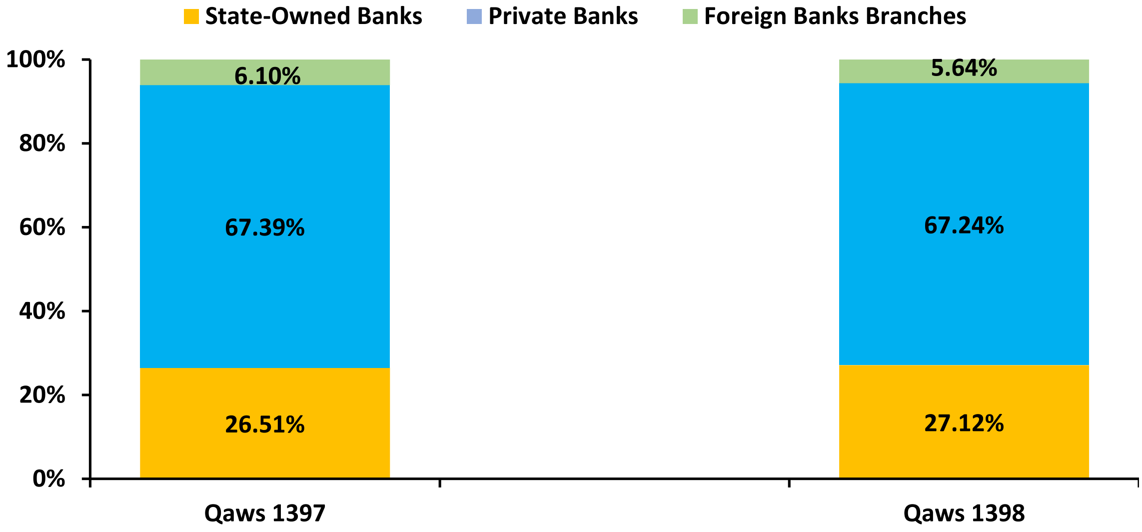
The total assets of the banking sector registered 0.82% Y-o-Y decline, and reached to AFN 313.06 billion, higher than the 0.15% decrease recorded in the previous year. (See Table 6.1)

The above mentioned decrease in the total assets was mainly contributed by deposit withdrawals (dominant in customer demand deposits), other contributing factors include closure of a foreign bank branch and dividend payments. Disaggregated analysis of total assets showed that top decreasing item was interbank claims (USD accounts), while net loans (USD loans) and cash in vault and claims on DAB witnessed slight decreases as well.

The most important components of the system's total asset portfolio were cash in vault and claims on DAB (42.97%), net interbank claims (26.62%), net loans (11.54%), investments (11.13%), net other assets (4.97%) and fixed assets was 3.11% of the total assets, while the share of the repossessed assets and intangible assets were negligible. (See table 6.1). Private Banks are the leading player in the banking sector accounting for 67.24% of total banking sector assets (Islamic bank makes 6.9% of the sector total assets); state-owned banks with 27.12% are at the second place while branches of foreign banks shares 5.64% in the system's total asset.

[1] In the banking sector bulletin Islamic bank is part of private banks
[2] The Islamic banking sector consists of one bank and six windows

Figure 6.1: Share of Banking Sector (Total assets) across the banking group



Source: Banking Supervision Department, DAB

Table 6.1: Assets, Liabilities, and Capital of the Banking Sector

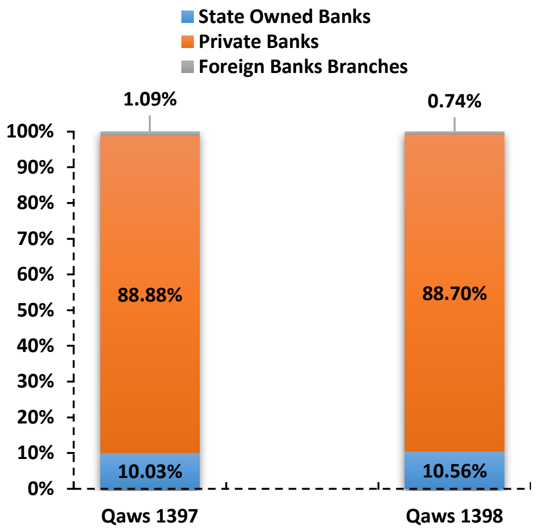
Amount in million AFN	Dec-18	Dec-19	% of Total Asset/liabilities	Growth
Assets				
Cash in vault and claims on DAB	135,369	131,392	42%	-2.9%
Interbank claims(Net)	94,677	83,338	26.6%	-11.9%
Investments (Net)	24,951	34,848	11.1%	39.7%
Loans (Net)	37,363	36,127	11.5%	-3.3%
Repossessed Assets	882	1,087	0.3%	23.3%
Other Asset (Net)	13,300	15,555	5%	16.9%
Intangible assets	901	971	0.3%	7.8%
Fixed Assets	8,223	9,751	3.1%	18.6%
Total Asset	**315,666**	**313,069**	**100%**	**-0.82%**
Liabilities				
Total Deposits	273,335	266,576	96.1%	-2.5%
Borrowings	3,068	4,615	1.7%	50.4%
Other Liability	4,943	6,174	2.2%	24.9%
Total Liability	281,345	277,365	100%	-1.4%
Financial Capital	34,320	35,704		4.0%
Total liability and capital	315,666	313,069		-0.82%

Source: Banking Supervision Department, DAB

6.1.1. Gross Loans

The gross loan portfolio of the banking sector recorded Y-o-Y decrease of 0.69%, currently stands at AFN 41.15 billion, constituting 13.14%of the total assets, whereas it was AFN 41.43 billion at the end of Dec, 2018 comprising 13.13% of the total assets and was down by 0.87% on Y-o-Y basis. The decreases in total gross loans mainly come from settlement and charge-off of loans.

Figure 6.2: Share of the Gross Loans Portfolio among banking group



Source: Banking Supervision Department

Four banking institutions recorded increases in their loan portfolio, while seven other registered decrease, whereas two banks did not participate in lending. Disaggregated analysis among the banking groups show that State Owned banks with 10.56% of the total banking sector portfolio demonstrated 4.55% increase, while private banks with major share (88.70%) in the banking sector portfolio registered 0.89% decrease and branches of foreign banks with 0.74% share shows 32% decrease on Y-o-Y.

- **Loan Loss Reserve**

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk management framework.

As per the assets classification and provisioning regulation banks are required to make specific provision on non-standard assets, while general reserves on standard assets is optional, in order to mitigate their credit risk.

By the end of Dec, FY 2019, total provision cover of the system was 12.21% of total gross loans as opposed to 9.83% recorded at the end of Dec, FY 2018.

- **Distribution of Credit**

Breakup of gross loans across the various sectors indicates that some sectors are receiving greater credit while others witnessing a contraction.

Noticeably loans disbursed to trade sector was 44.36% which is decreased by 0.99% against 45.34% in Dec, FY 2018 (mostly in all other items and in cement and other construction material); other main sectors include: Services sector constitutes 22.15% against 20.54% mainly increased in ground transportation, Manufacturing and Industry sector making 11.03% against 12.19%, Infrastructure Projects constitute 8.75% against 6.83%, Commercial real estate and Construction sector make 7.51% against 9.03%, Agricultural, livestock and farms and consumer loan altogether constitute 6.21% in FY 2019 against 6.06% in FY 2018.

Increases were observed in four sectors such as infrastructure projects, service, livestock and farms and consumer, while commercial real estate and construction, manufacturing and industry, trade and agriculture sectors witnessed decrease comparing to previous year.

Loans designated to medium, small and micro sectors decreased over the year, provided by nine banking institutions in the banking sector (See figure 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, 73% of the loans were designated in Kabul while Balkh and Herat provinces are in the second and third places with Badghis and Kandahar provinces are at fourth and fifth places respectively.

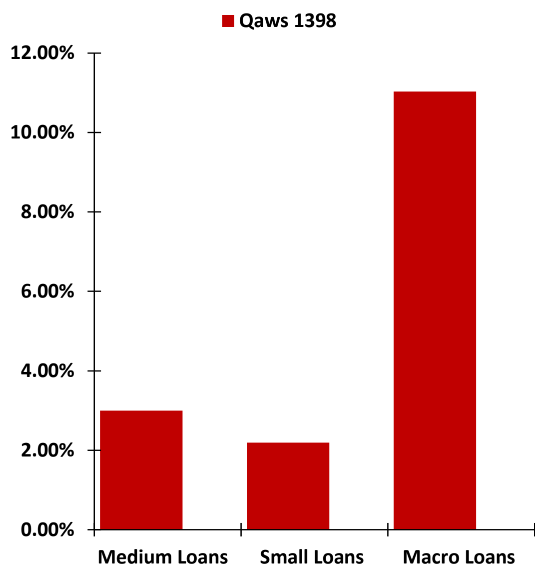
Table 6.2: Sectors wise distribution of Credit

	Qaws, 1393 (Dec, 2014)	Qaws, 1394 (Dec, 2015)	Qaws, 1395 (Dec, 2016	Qaws, 1396 (Dec, 2017)	Qaws1397 (Dec,2018)	Qaws 1398 (Dec, 2019)
Commercial Real Estate and Construction	**14.32%**	**9.44%**	**11.12%**	**8.70%**	**9.03%**	**7.51%**
Construction and Buildings	14.32%	9.44%	11.12%	8.70%	9.03%	7.51%
Infrastructure Projects	**5.26%**	**5.40%**	**4.02%**	**5.66%**	**6.82%**	**8.75%**
Power	0.35%	0.22%	0.38%	0.40%	0.48%	0.12%
Road and Railway	2.41%	1.17%	0.64%	1.32%	2.18%	2.84%
Dames	0.61%	0.09%	0.04%	0.00%	0.36%	0.38%
Mines	0.08%	1.48%	0.52%	0.48%	0.52%	0.49%
Other infrastructure projects	1.81%	2.44%	2.44%	3.46%	3.28%	4.92%
Manufacturing and Industry	**9.53%**	**10.62%**	**8.48%**	**9.35%**	**12.19%**	**11.03%**
Manufacturing &Products of Metal wood plastic rubber leather paper	2.48%	4.42%	3.47%	2.67%	4.10%	5.38%
Manufacturing handmade and machine products	4.19%	4.24%	3.74%	3.16%	3.67%	3.63%
Cement and Construction Materials	2.86%	1.96%	1.27%	3.52%	4.42%	2.01%
Trade	**34.05%**	**41.18%**	**40.07%**	**42.50%**	**45.34%**	**44.36%**
Textile	2.59%	0.52%	0.72%	1.54%	2.21%	1.90%
Wholesale	4.93%	9.89%	4.34%	4.67%	3.62%	4.74%
Machineries	0.12%	0.25%	0.13%	0.09%	0.41%	0.37%
Petroleum and Lubricants	8.74%	9.80%	11.08%	10.78%	11.48%	11.30%
Spare parts	0.24%	1.42%	0.26%	1.39%	1.78%	1.89%
Electronics	1.40%	1.58%	1.91%	2.76%	3.21%	2.66%
Cement and other construction Material	1.87%	2.73%	2.35%	2.57%	5.14%	3.99%
Food Items	4.52%	8.24%	7.80%	7.27%	6.44%	8.21%
All other Items	5.72%	3.47%	4.17%	3.28%	7.92%	6.36%
Retail trading	3.92%	3.28%	7.31%	8.15%	3.13%	2.94%
Service	**20.11%**	**27.69%**	**29.19%**	**27.49%**	**20.55%**	**22.15%**
Education	0.00%	0.00%	0.00%	0.00%	0.03%	0.03%
Hotel and Restaurant	1.20%	1.46%	1.33%	2.04%	2.16%	2.44%
Telecommunication/Scratch cards Distributers	2.92%	5.70%	5.96%	5.52%	5.98%	6.57%
Ground Transportation	4.87%	5.31%	4.86%	1.86%	3.08%	4.13%
Air Transportation	4.18%	2.66%	2.35%	2.90%	1.21%	0.91%
Health and Hygienic	0.71%	1.16%	1.42%	1.73%	1.74%	1.66%
Media, Advertisements, Printer	0.04%	0.04%	0.05%	1.18%	1.28%	1.92%
All other Services	6.19%	11.36%	13.22%	12.26%	5.07%	4.50%
Livestock and farms	**0.04%**	**0.03%**	**0.06%**	**0.23%**	**0.30%**	**0.50%**
Livestock and farming	0.04%	0.03%	0.06%	0.23%	0.30%	0.50%
Agricultural Loans	2.61%	2.67%	3.20%	3.94%	3.86%	3.07%
Consumer Loans	0.26%	0.30%	0.65%	0.86%	1.90%	2.63%
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: Banking Supervision Department-DAB

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.

Figure 6.3: Share of medium, small and micro loans in total gross loans



Source: Banking Supervision Department-DAB

- **Classification of Loans**
  - **Non-performing loans**[3]

Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs. 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 Dec, FY 2019, non-performing loans recorded at AFN 5.95 billion or 14.47% of the total gross loans and 18.95% of the system's regulatory capital, increased by AFN 2.23 billion. The increase is mostly attributed to three banks in the system owing to switching of loan to lower classes.

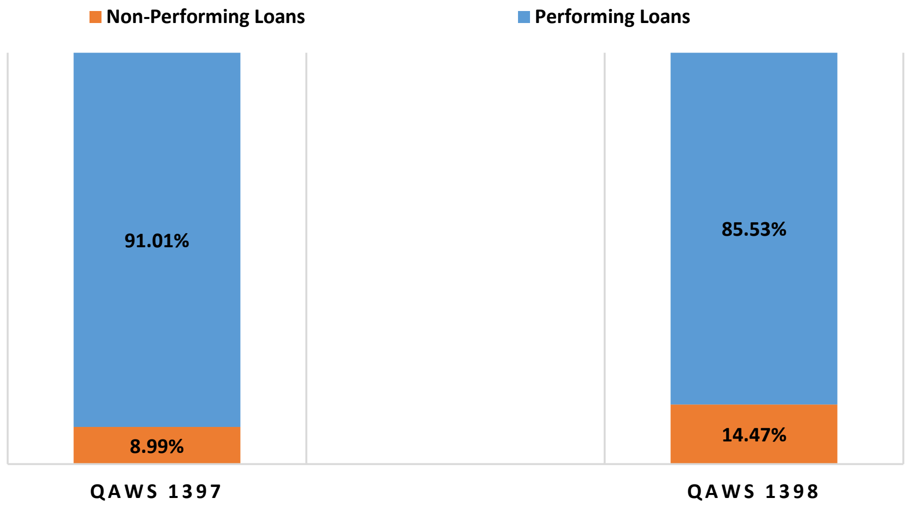
Group wise analysis show that out of AFN 5.95 billion total NPLs, AFN 5.86 billion NPL is coming from private banks making 14.26% of the banking sector total gross loans (98.53% of banking sector total NPLs) and AFN 87 million is attributed to one state-owned bank constituting 0.21% of the banking sector total gross loans (1.47% of banking sector total NPLs).

Sectorial analysis of the NPLs show that major portion of the NPLs originate from trade sector which constitute 51.88% (dominant in food item and spare parts 11.30% and 10.56% respectively), followed by service sector with 18.16% (mostly recorded in ground transportation 13.25%), manufacturing and industry held 11.26%, infrastructure projects and commercial real estate and construction constitute 9.37% and 7.15% of the sector's NPLs respectively.

Banking Supervision Department (BSD) 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.

[3] 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 6.4: Quality of Loan Portfolio



Source: Banking Supervision Department, DAB

○ Adversely-classified loans

Adversely classified loans (substandard, doubtful, Loss)[4] depicted AFN 1.21 billion increase Y-o-Y basis, reaching AFN 7.36 billion, constituting 17.90% of the total gross loans and 23.44% of regulatory capital, and 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 to mitigate further deterioration and distress in the banking system.

○ Loans classified Watch

Loans classified in the "watch"[5] category at the end of FY 2019 stood at AFN 5.54 billion, which made 13.47% of total gross loans increased by 20.87% compared with the previous period (End of FY 2018).

The increase is mostly attributed to two banks in the system coming from shifting of loan to lower classes and reclassification of loans. This category of loans requires close monitoring as it may lead to more adversely classified loans (substandard, doubtful and losses) in the future.

[4] An asset for which the principal and /or interest remains outstanding for 61-120 days - (Substandard), 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

[5] 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)

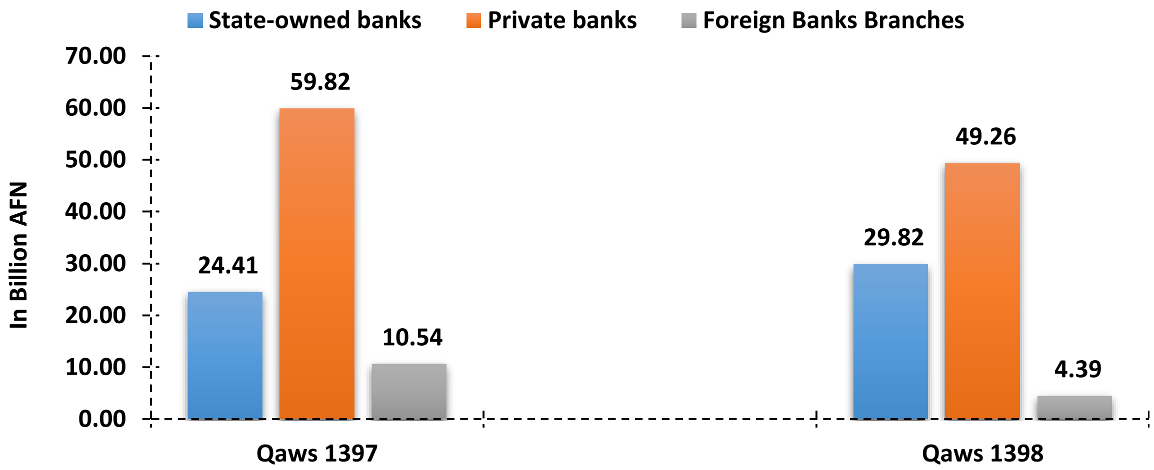
○ Charged-off Loans[6]

Loans charged-off at the end of FY 2019 stands at AFN 16.59 million, which makes 0.04% of total gross loans attributed to three banks in the sector.

6.1.2. Interbank Claims

Gross Interbank Claims are the second largest among various asset categories, currently standing at AFN 83.46 billion (26.66% of total assets), registered AFN 11.30 billion or 11.92% decrease compared to the previous year, mostly attributed to seven banking institutions mainly in USD accounts. In the meantime, AFN placements increased indicating that, the banking sector has channeled a portion of its available funds to less interest earning assets in other banking institutions. It's worth mentioning that, banks should not only appropriately measure risks associated with individual bank but also country or countries in which they have placed funds (See figure 6.4).

Figure 6.5: Share of Interbank Claims among banking groups



Source: Banking Supervision Department, DAB

6.1.3. Investment

The net-investment[7] portfolio of the banking sector comprised of bonds, Government Securities, investment in associated companies; which is increased by 39.67% or AFN 9.89 billion compared to the last year, currently stood at AFN 34.84 billion or 11.13% of total assets, the increase mostly came from three banking institution. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, four private banks and a branch 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 41.97% of the total assets, shows decrease of AFN 3.97 billion. The decrease came in both, absolute as well as in percentage of total assets compared to FY 2018, which Stood at AFN 131.39 billion at the end of FY 2019. The decrease was observed in DAB capital notes and required reserve account 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.

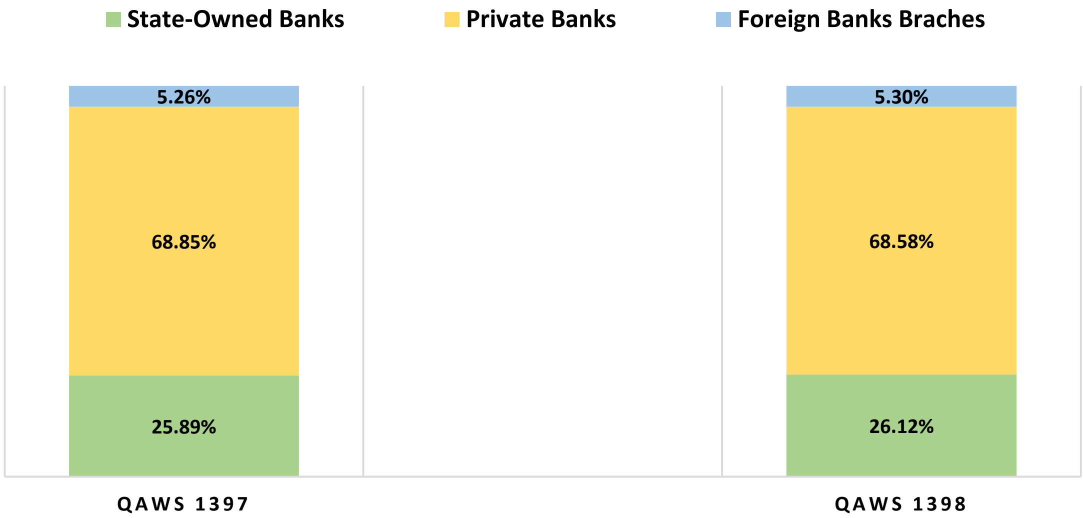
[6] Default assets and advances for which the principal and/or interest remains outstanding for 481 days or more days and retained on the books of banks for the period of 12 months (Loss), after 12 months they are immediately charged-off as per the assets classification and provisioning regulation.

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

6.2. LIABILITIES

Total liabilities of the banking sector decreased by AFN 3.98 billion or 1.41% stood at AFN 277.36 billion against AFN 281.34 billion in FY 2018. The mentioned decrease in total liability was mainly contributed by deposit withdrawals (dominant in customer demand deposits). The majority of liabilities are made up of deposits (96.11%), followed by other Liabilities (2.23%) and borrowings in third place (1.66%). See table 6.1.

Figure 6.6: Share of Liabilities among banking groups



Source: Banking Supervision Department, DAB

6.2.1. Deposits

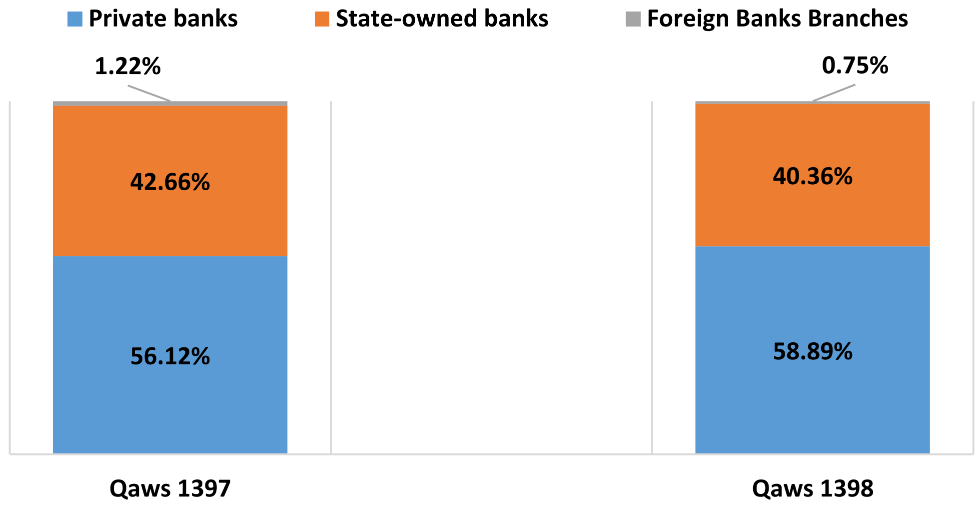
Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 266.57 billion at the end of FY 2019 decreased by AFN 6.75 billion (2.47%), compared to FY 2018. The total deposits cover AFN 4.86 billion interbank and AFN 261.7 billion customer deposits.

The decrease in deposit base of the banking sector is attributed to customer demand deposits mainly in USD and other currencies, while the other contributing factor include closure of a foreign bank branch. Currency wise analysis shows that Afghani denominated deposits increased by 2.43% accounted for 30.92% of the total deposits, while US dollar denominated deposits decreased by 2.31% making 64% of the total deposits, and other currency decreased by 26% accounted for 5% of the total deposits of the system.

Private Banks attracted AFN 182 billion deposits, which is decreased by 3.21% and made up 68.29% of the system's deposits. The share of state-owned banks amounted to AFN 70 billion, showed decrease of 0.89% compared with FY 2018 which accounted for 26.27% of the system's deposits. The share of branches of foreign banks stood at AFN 14.51 billion decreased by 0.67% which made 5.44% of the total deposits of the system.

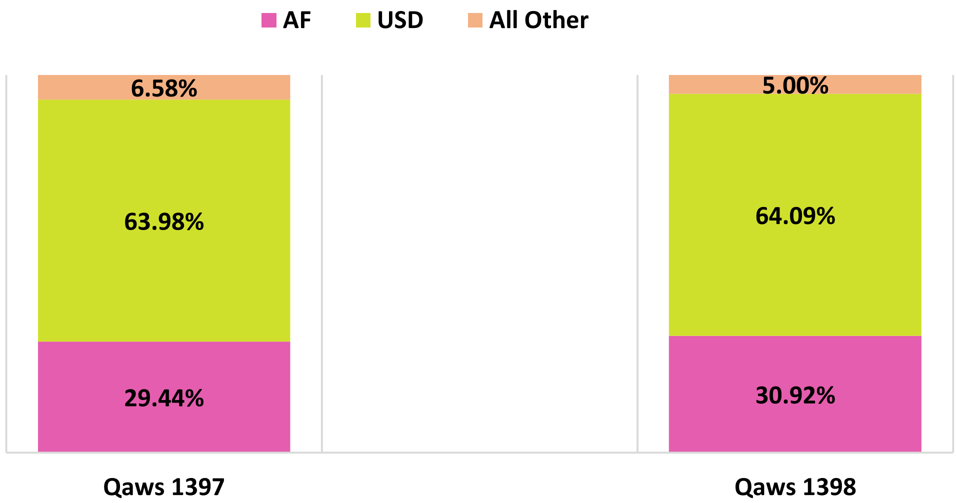
In terms of types of deposits, demand deposits accounted for 72.82% of the total deposit base (decreased by 4.55%), saving deposits with 19.7% of total deposits was in the second place (depicted 4.12% increase), while time deposit made 7.49% of the total deposits portfolio with 2.12% increase compared to the previous period (FY 2018).

Figure 6.7: Afghani Denominated Deposits



Source: Banking Supervision Department, DAB

Figure 6.8: Currency Composition of Deposits

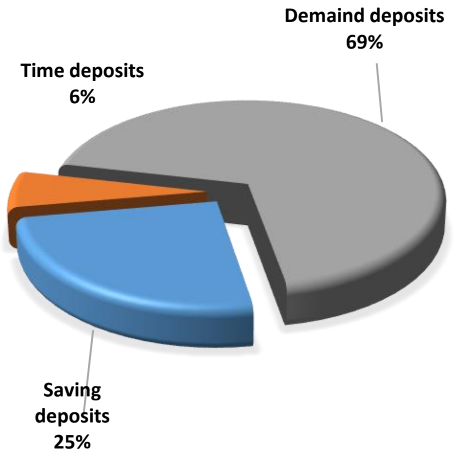


Source: Banking Supervision Department, DAB

Figure 6.9: Deposits among banking groups

Source: Banking Supervision Department, DAB

Figure 6.10: Types of deposits



Source: Banking Supervision Department, DAB

6.2.2. Borrowings

The share of borrowings in total funding structure of the system increased by 50% stood at AFN 4.61 billion at the end of FY 2019 which made 1.66% of total liabilities. The current borrowing position is attributed to four 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.

6.3.1. Liquidity Ratio (broad measure)

Overall, all banking institutions are above the set minimum for the broad liquidity ratio (15%) and the Quick Liquidity Ratio (20%). Broad liquidity ratio of the banking sector as a median stand at 55.89%points against 76.62% in the preceding period (FY 2018), showing a decrease of 20.73 points. See table 6.3.

Table 6.3: Liquidity Ratio of the Banking Sector

Ratio in %	Dec, 2014	Dec, 2015	Dec,2016	Dec,2017	Dec,2018	Dec, 2019
Total Capital Adequacy Ratio	26.46	19.94	27.68	29.81	25.83	25.93
Tier 1 Capital Adequacy Ratio	26.09	19.66	22.93	28.17	24.49	24.50
Non-Performing Loans to Total Gross Loans	8.09	12.34	12.67	12.42	8.99	14.47
Return on Assets (ROA)	0.9	0.2	0.11	0.64	0.78	0.83
Return on Equity (ROE)	7.35	1.69	1.08	3.38	6.68	7.24
liquidity Ratio (Broad Measure Median)	73.6	68.22	67.74	65.92	76.62	55.89
liquid Assets to Total Assets	73.28	75.05	71.98	73.95	72.90	68.63

Source: Banking Supervision Department, DAB

6.4. CAPITAL

The banking sector is well capitalized, making 11.40% of total assets. The net equity position of the sector recorded at AFN 35.70 billion, increased by 4.03% Y-o-Y basis, mainly attributed to profits during the year and share profit received from the associated companies. CAR of the sector recorded at 25.93% against 25.83% in FY 2018 showing 0.1% increase over the year. See table 6.3.

Disaggregated analysis shows that the financial capital of all banks are above the regulatory limits and the regulatory capital ratio of all banks are above the set regulatory threshold (12% of the risk weighted assets). The Basel benchmark for capital to risk weighted is 8%.

6.5. PROFITABILITY

In terms of the profitability, on cumulative basis the banking sector recorded AFN 2.68 billion net profit for fiscal year 2019 against AFN 2.37 billion net-profits recorded in the comparable period last year, showing an improvement over the year, resulting in ROA and ROE of 0.83% and 7.24% annualized as compared to 0.78% and 6.68% annualized respectively in FY 2018.

The factors contributed towards the increase in the profitability of the banking sector in FY 2019

compared to FY 2018 was increase in net-interest income owing to increase in interest bearing investments, FX gains on account of increase in FX rates and FX deal, investment gains coming from sale of bonds and decrease in tax expenses.

However, operating expenses and provision increased in the period under review and non-interest income also decreased. Group wise analysis reveals that State-Owned Banks (SOB), Private Banks (PB) and Branches of foreign banks (BFB) ended with profits. See figure 6.10.

Profitability of the banking sector is mostly coming from State owned Banks standing at AFN 1.47 billion (54.96% of the sector net-profit), with annualized ROA of 1.74%, Private Banks earned net-profits amounted to AFN 1.01 billion (37.94% of the sector net-profit) with annualized ROA of 0.51%, while profit for branches of foreign banks were AFN 190 million (7.1% of the sector net-profit) with annualized ROA of 0.47% in the period under review.

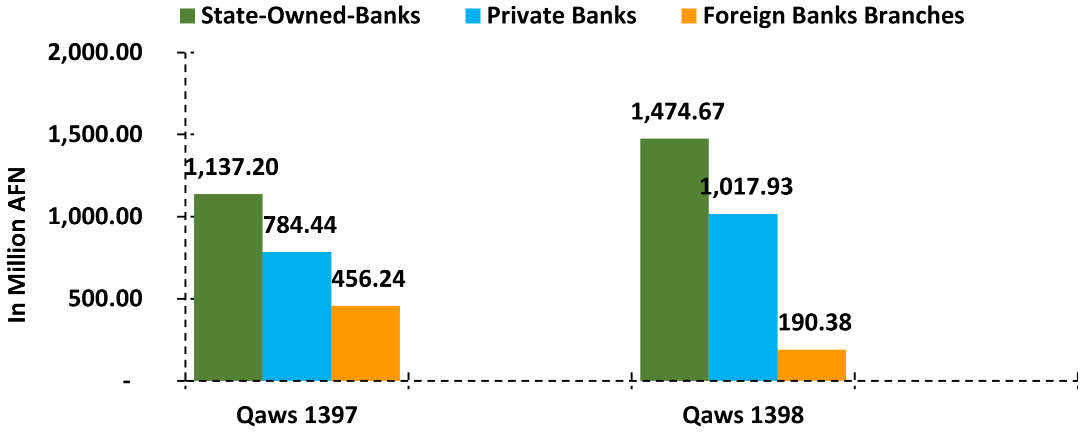
Four banks incurred AFN 210 million losses against AFN 142 million losses in the previous comparable period with three banks at loss. On core income basis six banks ended with losses against nine banks in the previous period.

Table 6.4: Profit &Loss Schedule (cumulative) Amount in million AFN

Items	Dec, 2018	Dec, 2019	Growth
Interest income	**7,487**	**7,501**	**0.2%**
Interest expense	**1,136**	**1,100**	**-3.2%**
Net interest income	**6,351**	**6,402**	**0.8%**
Non-interest income	**7,778**	**7,615**	**-2.1%**
Non-interest expenses (except salary)	**6,181**	**6,315**	**2.2%**
Salary expense	**4,367**	**4,390**	**0.5%**
Net credit provisions	**1,006**	**1,279**	**27.1%**
Gain/Loss on Investments	**14**	**240**	**1575.4%**
Income before Tax & FX gain/loss	**2,590**	**2,273**	**-12.2%**
FX gain/loss	**670**	**1,078**	**60.9%**
TAX	**882**	**668**	**-24.3%**
Net profit	**2,378**	**2,683**	**12.8%**

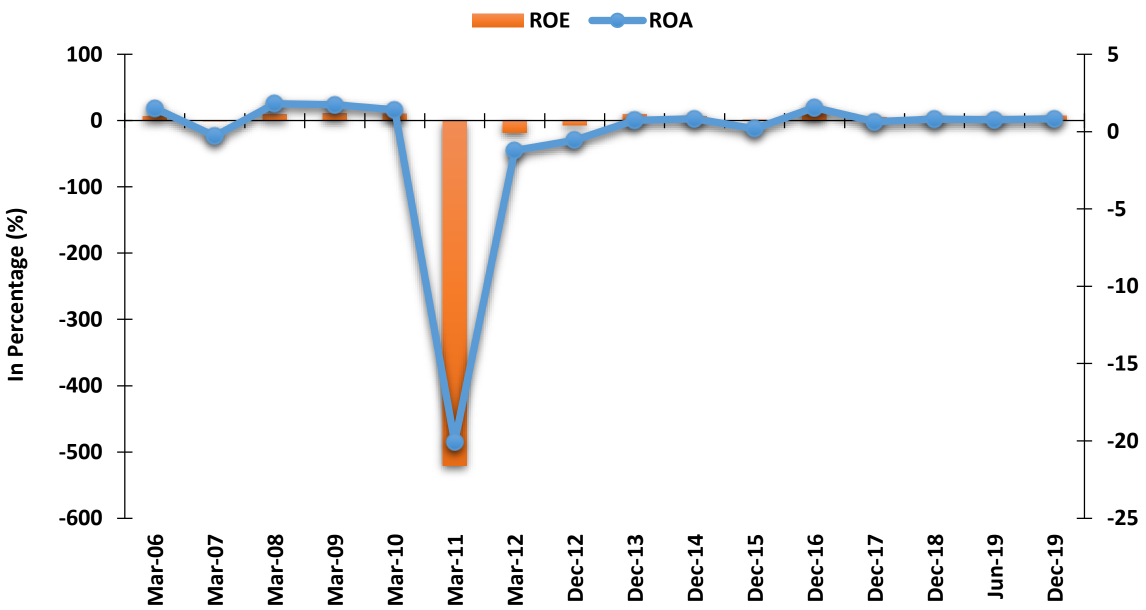
Source: Banking Supervision Department, DAB

Figure 6.11: Profitability of the Banking Sector



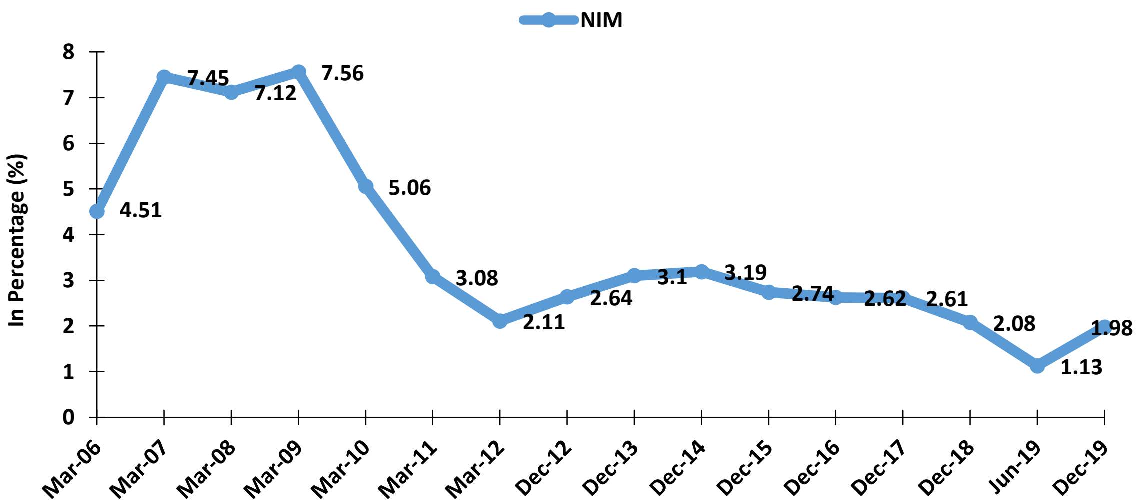
Source: Banking Supervision Department-DAB

Figure 6.12: ROA and ROE



Source: Banking Supervision Department, DAB

Figure 6.13: Net Interest Margin



Source: Banking Supervision Department/ DAB

6.6. FOREIGN EXCHANGE RISK

All banking institutions are within the set regulatory threshold for overall open FX position (± 4%) and on an individual currency (± 2%) basis except for two banks, which have violated the limits on overall and on an individual currency basis (USD and EURO long position). 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 2.06 billion and vice versa. Similarly, a 4% change would correspond to AFN 412.06 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 708 million in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AFN 708 million. For three banking institution, if the interest-rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

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

6.8. ISLAMIC BANKING PERFORMANCE

Summary

The Islamic banking sector recorded a growth trend for its main financial indicators over the last year, as apparent from the increased in total assets, which is mostly due to deposits upturn. The capital of four windows out of six windows is negative and the equity capital of one full fledge bank is maintained at healthy levels attributed to rise in the profitability along with adequate level of liquidity position.

However, gross financing has downward trend due to settlement of financing of a window and meanwhile investment has growth trend mainly due to issue of new investment.

The asset base of the sector during the fourth quarter of FY 2019, demonstrated 10.71% growth over the previous year stood at AFN 38.23 billion at the end FY 2019 as compared to AFN 34.53 billion of the FY 2018. The increase in total assets mostly originates from increase in cash in vault and in Sukuk investment. Total gross financing and investment portfolio of the sector shows increase of 17.57% over the year, currently stands at AFN 12.95 billion. The increase in total gross financing and investment over the year is mainly due to the issue of new Sukuk investment during the year, at the same time the Murabaha financing due to settlement has decreased over the period, it worth to be mentioned that the new Murabaha financing taken place as well over the year. The percentage decrease of total gross financing portfolio of the sector is 16.16% and vice versa. The Sukuk investment shows 61% increase.

Deposits, the main source of funding in the Islamic banking sector witnessed 8.59% growth over the last year and stood at AFN 31.39 billion. The increase in total deposits was due to increase in the customers' time and saving deposits which made 60.66% of the overall deposits (time deposits with 24.7% and saving deposits with 36.58% shares of the total deposits). On the other hand, the appreciation rate of USD against AFN also has attributed in the increase of total deposits of the sector.

While the demand deposits of the customers faced downturn for the current year. There is no statutory requirement for Islamic Banking windows to maintain a separate limit of financial capital. The capital of one full fledges bank stands above regulatory limit. The total capital of the sector decreased by 0.88% over the last year (FY 2018) resulted from losses over the year.

The financial capital of four windows out of six windows is negative; however, the regulatory capital ratio (CAR) of full fledge bank is very close to the threshold (12% of the risk weighted assets). On a cumulative basis for the FY 2019 (FY 1398) the Islamic banking sector suffers AFN 279.93 million net-losses against AFN 751.78 million net-profit of the FY 2018, resulting in ROA of -10.6% annualized compared to that of 5.4% and ROE of 18.5% annualized in FY 2018 respectively. Liquidity and FX positions of windows are in accordance with the benchmarks set by the central bank (20% Quick and 15% Broad liquidity Ratios and ±40% for overall FX position and ±20% on individual currency position) on overall and individual currency basis (USD long position). On the other hand, the full fledge bank lies in violation of both FX limits set by the Central Bank.

6.8.1. Total Assets

Assets base of the Islamic banking sector registered a growth of 10.71% in FY 2019, standing at AFN 38.23 billion (USD 487.28 Million), against 109.42% growth in FY 2018. The increase in total assets was mostly due to increase in deposit base. The analysis of total assets showed that most obvious increase was recorded in Cash in vault and in Sukuk investment.

Looking at the increase in total assets across the sector, the growth took place in full-fledged Islamic bank and meanwhile the assets of Islamic Banking windows showed decline of 5.42% as compared to last year. The percentage share of fully-fledged bank in the sector's total asset is reported 57%; state-owned banks windows with 11.5% and while the four windows of private commercial banks have 32.2%shares in the sector's total assets. The trend of assets of the Islamic Banking Sector for FY 2019 is depicted in graph 6.14.

The fluctuation in the assets of Islamic banking sector during the month of Dec and Jan 2019 was mainly due to decline in demand deposits of the customers during the mentioned period. The components of the Islamic banking sector assets portfolio were cash in vault and claims on DAB without interest (46.5%), interbank claims (12.3%), net Murabaha financing (10.8%), investment in Sukuk and assets acquired for leasing (20.3%) and other assets make 10% of the total assets.

Table 6.5: Assets of the Islamic Banking sector in descending order for the month of Sep, 2019

Serial number	Names of Banks	Assets(in million AFN)	Size of Industry: Banks as % of Total Assets of the sector
1	Islamic Bank Afghanistan	21,638.39	56.59
2	Islamic Banking window of AUB	4,791.709	12.53
3	Islamic Banking Window of BMA	4,265.31	11.15
4	Islamic Banking Window of GB	3,293.93	8.61
5	Islamic Banking Window of MB	2,795.56	7.31
6	Islamic Banking Window of AIB	1,343.	3.51
7	Islamic Banking Window of NKB	108.36	0.28
Total		**38,237.18**	**100.00**

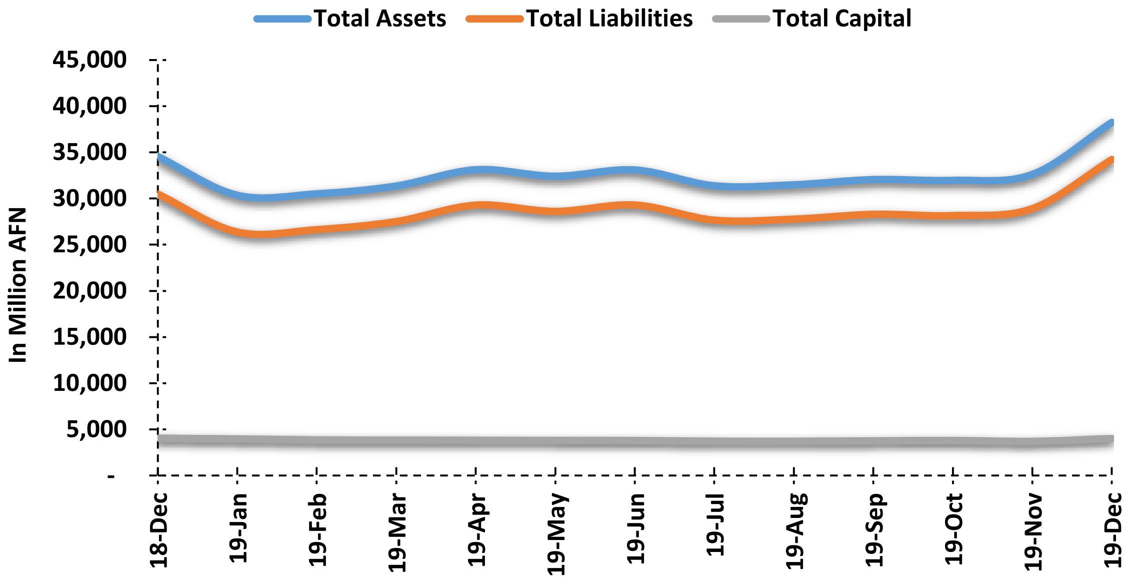
Source: IBFD, Islamic Banking and Finance Department, DAB

Table 6.6: Total Assets and Liabilities of Islamic Banking Sector

Amount in million AFN	Qwas,1397 Dec, 2018	Qwas,1398 Dec, 2019	% of Total Assets/Liability	Quarterly Growth/Decline
Assets				
Cash in vault and claims on DAB	14,813.06	17,768.07	46.47%	19.95%
Interbank claims	5,881.42	4,719.97	12.34%	-19.75%
Financing Murabaha (Net)	5,749.55	4,111.42	10.75%	-28%
Investment (Sukuk and other)	4,822.72	7761.42	20.30%	61%
Other Assets	2,610.02	2,824.52	7.38%	7%
Fixed and Intangible Assets	662.81	776.61	2.48%	34.9%
Total Assets	**34,539.601**	**38,237.18**		**10.71%**
Liabilities				
Deposits	28,913.085	32,815.85	91.76%	8.59%
Other liabilities	1,571.24	2,819.76	8.24%	79.46%
Total liabilities	30,484.32	34,217.75		12%
Financial Capital	4,055.26	4,019.61		-0.88%
Total Liabilities + Capital	**34,539.601**	**38,237.18**		**10.71%**

Source: IBFD, Islamic Banking and Finance Department, DAB

Figure 6.14: Trend of assets of the Islamic Banking Sector



Source: IBFD, Islamic Banking and Finance Department, DAB

- **Gross Murabaha Financing and Investment (Sukuk)**

Gross Murabaha financing and investments (Sukuks and others) of the Islamic banking sector at the end of FY 2019 (1398) stands at AFN 12.958 billion (USD 165.133 million), constituting 31.05% of the total assets, which show 17.57% or AFN 1.93 billion increase. Whereas, the gross Murabaha financing were AFN 6.198 billion (USD 78.99 million) or 17.94% of total assets and investment (Sukuk and other) were AFN 4.822 billion (USD 61.45 million) constituting 13.96% of total assets. The increase in Gross Murabaha financing and investments (Sukuks and others) has taken place in Sukuk investment but Murabaha financing due to settlement has decreased.

Total Afghani denominated financing and investment recorded at AFN 3.76 billion (USD 48.02 million), which makes 29.08% of total Gross financing and investment or 9.85% of total assets. While the US Dollar denominated financing and investment are AFN 9.18 billion (USD 117.11 million), and makes 70.91%of total gross financing and investment or 24.03% of the total assets. The decrease in total financing and investment portfolio is mainly due to settlement of Murabaha financing (AFN 1.26 billion) of a window during the year under review, meanwhile, investment securities (Sukuk) shows increase of AFN 2.93 million over the year. The increase in total gross investment is mainly attributed to new financing of Sukuk during the reviewed period. At the same time, settlement and instalment of Murabaha financing have been collected during the quarter.

The sectoral lending of Murabaha financing in Afghanistan is dominated by Islamic Banking window, constituted 84.22% of total gross Murabaha financing of the sector, while the share of fully fledged bank in total Murabaha financing was 15.7%, as well as the total investment securities in Sukuk of the sector which was invested out of the country is dominated 83.33% of total investment by fully fledged bank and remaining 16.66% followed by two Islamic banking windows of the commercial banks.

The breakup of total gross financing and investment of the sector consisted of Murabaha receivables AFN 5.05 billion that decreased by 16% and made 40.10% of the gross financing and investment. Diminishing Musharaka amounted to AFN 115.83 million or 0.89%, constant Musharaka amounted to AFN 53 million, Sukuk investment amounted to AFN 4.67 billion which is increased by AFN 3.23 billion made 36% of total gross financing and investment, and asset acquired for leasing amounted to AFN 2.007 billion, constituted 15.5% of the gross financing and investment during the year under review.

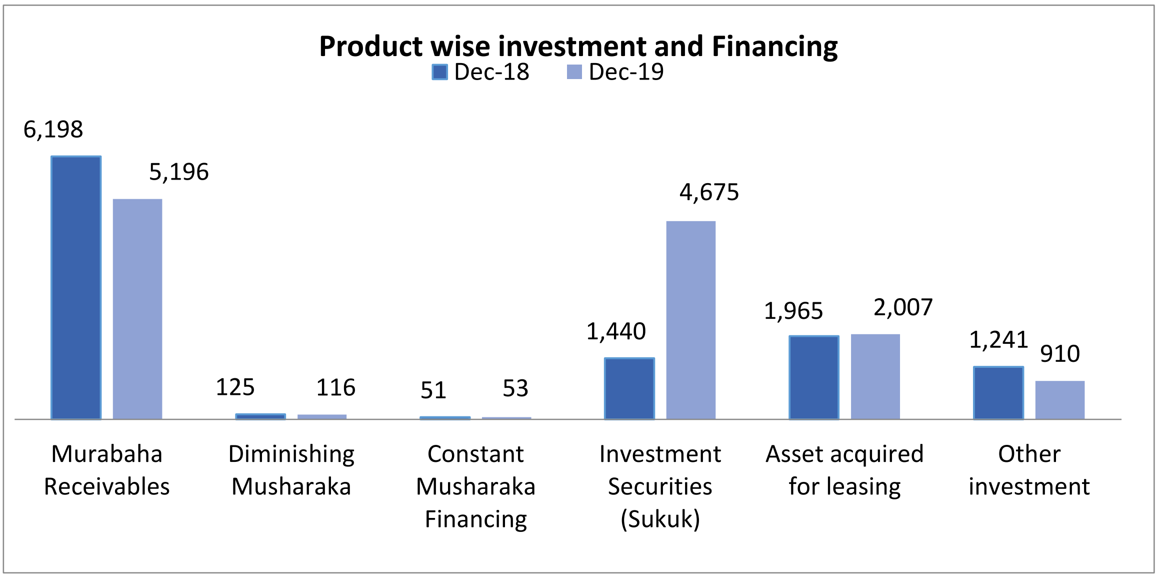
Increase in investment (Sukuk) portfolio was observed at one bank window and at full-fledged bank, and it worth to be mentioned here that Islamic banking window of New Kabul Bank (NKB) has no financing and investment activities.

Table 6.7: Product wise Islamic Banking Sector Financing and investment (gross), In Million AFN

No	Product	Dec-18	Dec-19	Difference in Amount	Difference %	Products as % Gross Investment& Financing
1	Murabaha Receivables	6,198.48	5,196.55	-1,001.93	-16.16%	40.10%
2	Diminishing Musharaka	125.51	115.83	(9.675)	-8%)	0.89%
3	Constant Musharaka Financing	51.07	53.01	1.94	4%	0.41%
4	Investment Securities (Sukuk)	1,439.83	4,675.01	3,235.17	255%	36.08%
5	Asset acquired for leasing	1,965.24	2,007.48	42,23	2%	15.5%
6	Other investment	1,241.05	910.08	(330.98)	-27%	7.02%
Grand Total		11,021.20	12,957.13	1,936.76	17.57%	100%

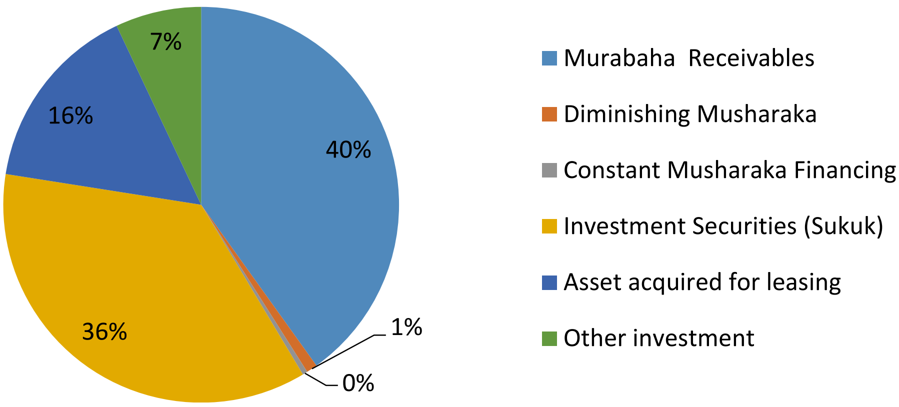
Source: IBFD, Islamic Banking and Finance Department, DAB

Figure 6.15: Product wise Investment and Financing of the Islamic Banking Sector: comparison between FY 2018 & FY 2019. (Amount in Million AFN)



Source: IBFD, Islamic Banking and Finance Department, DAB

Figure 6.16: Product wise investment and financing as Percentage at the end of FY 2019



Source: IBFD, Islamic Banking and Finance Department, DAB

- **Financing & Investment Loss Reserve**

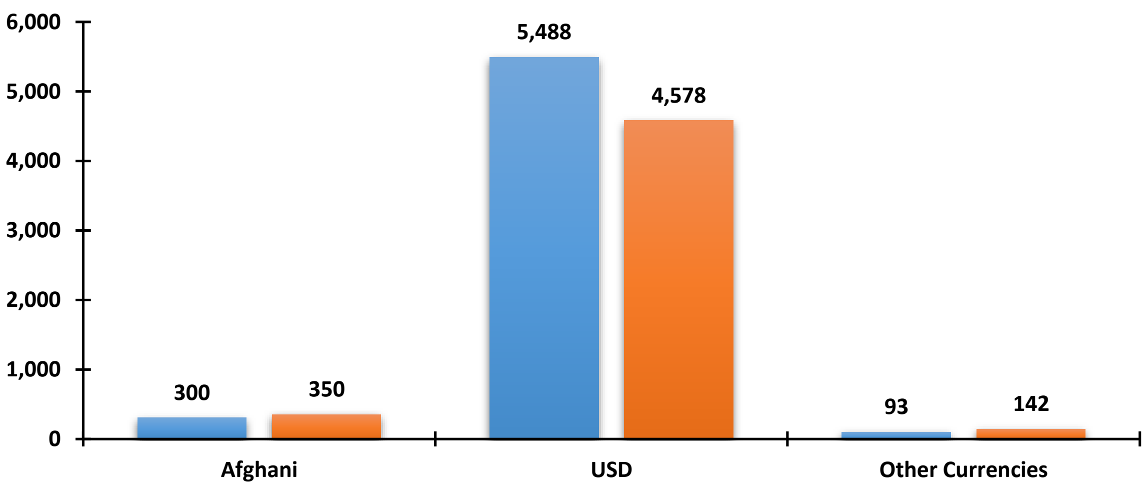
At the end of FY 2019 (FY 1398), total provision of Islamic Banking sector stood at AFN 1.179 billion and which shown increase of AFN 718 million as compared to previous year, reported wholly for Murabaha financing. The provision of the sector is comprised of AFN 1.08 billion for Murabaha financing, AFN 74.85 million for interbank claims and AFN 19.16 million for account receivable. The provision for Murabaha financing encompasses 9.09% of the total gross financing of the Islamic banking sector as against 4.19% of the last year.

- **Interbank Claims**

The Interbank Claims of the Islamic Banking Sector are the fourth largest among various asset categories, which at the end of FY 2019, stands at AFN 4.71 billion (USD 60.15 million) constituting 13.26% of the total assets, and decreased AFN 1.698 billion comparing to previous year. The decrease has reported in time deposits with banks due to maturity of contract. Interbank claims denominated Afghani 7.4%, USD 96.98% and other currencies 3.4%, See figure 6.17.

Two out of six Islamic banking windows and one Islamic bank have interbank claims which consists of AFN 1.428-billion-time deposit and AFN 3.64 billion demand deposits. The interbank claims used as commodity Murabaha and internal bank transferring & settlement transactions with other banks.

Figure 6.17: Interbank claims of the Islamic Banking Sector



Source: IBFD, Islamic Banking and Finance Department, DAB

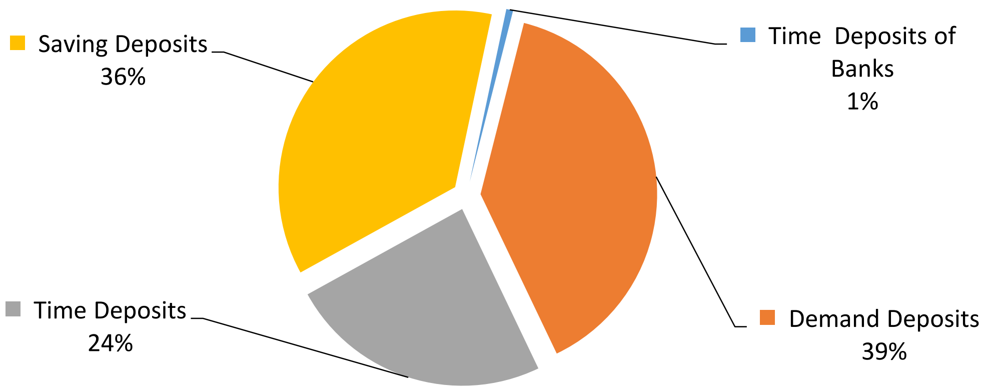
- **Cash in Vault and Claims on DAB**

The Islamic Banking Sector's Cash in vault and claims on DAB at the end of FY 2019 stands at AFN 17.76 billion (USD 226.43 million) and shows increase of AFN 2.955 billion as comparing to preceding year. The cash in vault and claims on DAB is the largest item and makes 46.47% of total assets of the sector. The increase in Cash in vault and claims on DAB mainly relates to claims on DAB. The reason of increase in above item is mainly due to upturn in total deposits of the sector over the year under review. Cash in vault and Claim on DAB consists of AFN 5.48 billion cash in vault, AFN 9.73 billion non-interest bearing current Account with DAB and AFN 2.54 billion Required Reserve Account with DAB.

6.8.2. Total Deposits

Deposits, the main source of funding and the major component of liabilities, stand at AFN 31.39 billion (USD 400.12million), making 91.76% of the total liabilities, which shows increase of 8.59% since starts of FY 2019 against AFN 28.91 billion (USD 368.46million) with 136% growth in last year. The increase in total deposits was most obvious in time deposits and saving deposits of full fledge bank, the increase reflected by AFN1.698 million or 28.04% in time deposits and AFN2.093billion or 22.46% increase in saving deposits of the customers during the reviewed period, while demand deposits of customers showed decrease of AFN 1.307 billion or 9.66% over the last year.

Figure 6.18: Breakdown of Deposits as Per Dec, 2019



Source: IBFD, Islamic Banking & Finance Department, DAB

Furthermore, the increase mostly occurred in AFN deposits, while USD deposits registered decline in its position. AFN-denominated deposits of the sector are AFN 12.06 billion (USD 153.76 million), or 38.42% of the total deposits, increased by 30.5%, while the USD-denominated deposits of the sector stand at AFN 19.33 billion (USD 246.36million), or 61.57% of total deposits decreased by 6.47%. Full-fledged bank has the highest percentage share in total deposits of the sector, standing at 58.36% followed by Islamic banking windows with 41.63% share.

The total customers' deposits of the sector consist of AFN 12.22 billion of demand deposits, AFN 7.75 billion of time deposits and AFN 11.41 billion of saving deposits. As well as the demand deposits make 38.94%, time deposits 24.70% and saving deposits make 36.35%of the total deposits of the sector, and comprises of AFN 31.202 billion of customer's deposit and AFN 195.33 million of banks deposits. The deposits of banks make only 0.62%of total deposits of sector.

6.8.3. Liquidity

The liquidity position of all Islamic Banking Windows and fully fledged Islamic bank are above the set minimum for the broad liquidity ratio (15%) and the Quick Liquidity Ratio (20%). Broad liquidity ratio of the banking sector as a median stand at 53.54% points against 57.19% in the preceding period (Dec, 2018), showing a decrease of 3.65%. Since there is no Capital Market inside Afghanistan, the banking sector remained highly liquid. 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 Dec 2019

Ratio in %	(Dec, 2018)	(Dec, 2019)
Liquid Assets to Total Assets	59.92%	58.81%
Liquid assets to short term liabilities	153%	184%
Foreign-Currency denominated funding to total funding	68.04%	61.57%
Foreign- Currency denominated financing to total financing	70.98%	70.92%
Return on Assets (ROA)	4.39	(10.6)
Return on Equity (ROE)	18.48	(6.96)

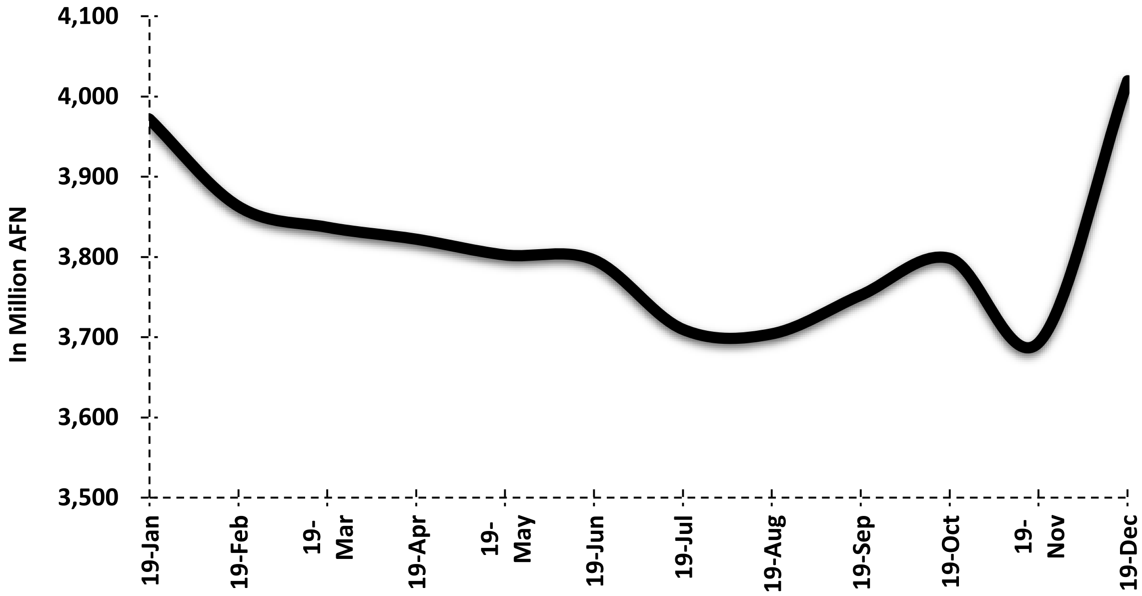
Source: IBFD, Islamic Banking & Finance Department, DAB

6.8.4. Capital

The capital of the sector stands at AFN 4.019 billion (USD 51.67 million), decreased by 0.88% since previous period (Dec, 2018) when it was AFN 4.055 billion. The decrease in the total equity capital is due to loss over the year. CAR of the Islamic Bank of Afghanistan remains above the regulatory limit.

The capital of windows 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 trend of the sector financial capital as described above is given in the graph 6.19.

Figure 6.19: Trend of Financial Capital of the Islamic Banking Sector



Source: IBFD, Islamic Banking & Finance Department, DAB

One Banking window has highest 72.84% share in total capital of sector and second fully fledged bank has 35% contributions in total capital of the sector.

6.8.5. Profitability

- **Quarter–to–Quarter:**

The Islamic banking sector earned AFN 23.51 million net profit in the current quarter (fourth quarter) ending Dec, 2019 against AFN 35.53 million net losses in last quarter, three out of six Islamic banking windows ended with net losses amounting to AFN 133.40 million as compared to AFN 46.25 million losses reported by four windows in last quarter.

The decrease in the losses of the sector in the current quarter is mainly attributed to increase in non-profit income of the sector over the quarter. The main reason profit of the sector is due to reported AFN 210.93 million as non-profit income and shows 130 million increases to last quarter. The full-fledged bank reported AFN 103.09 million of net profit during the reviewed quarter. It is worth mentioning that the loss of one full-fledged bank in the current quarter before FX revaluation reported AFN 73.98 million, but due to FX revaluation gain AFN 177.07 million the loss of the bank has converted from AFN 73.98 million to AFN 103.09 million, the gain AFN 177.07 million which the bank earned due to FX revaluation is not core income for the bank.

- **Cumulative (Jan - Dec, FY 2019 OR Jadi 1397 – Qaws 1398)**

In terms of the profitability on cumulative basis, (From Jan to Dec 2019) the Islamic banking sector ended with AFN 279.53 million (USD 3.567 million) net-losses for the financial year 1398 (Dec, 2019) against AFN 752.09 million net-profit recorded in the same period of last year. Resulting in ROA of -10.6% and ROE of -6.96% annualized, against 5.39% and 18.48% annualized in Dec, 2018.

The reason the loses of the sector was mainly due to calculated AFN 1.428 billion as gross credit provisions reported 94.01% by 4 windows and remaining by one full-fledged, in the meantime the sector reported AFN 746.16 million as reintegration of provision which is AFN 677.56 million reported by four windows and AFN 68.59 million by fully fledged bank and decrease AFN 137.80 million in net-profit income and increase AFN 549.13 million in non-profit expenses (operating expense) are the others contributing factors in the losses of sector. However, not-profit income, FX gain increased as well tax expense revised over the period. Five out of six Islamic windows incurred losses of AFN 423.94 million, against AFN 122.71 million losses in the previous period (Dec, 2018) with three Islamic banking windows at loss at that period.

The sole full fledge bank ended with net profit worth AFN 142.48 Million, due to significant FX revaluation gain worth AFN 668.56 during the reviewed period.

Table 6.9: Profit and Loss Schedule of the Islamic Banking Sector during the year 2019

Profit and loss Schedule (Amount in million AFN)			
Item	**Dec-18**	**Dec-19**	**Difference**
Profit income	917.11	704.14	(14.97)
Profit expense	182.801	305.62	122.82
Net profit income	536.31	398.51	(137.801)
Other non-profit income	385.78	488.59	102.81
Other non-profit expense	680.46	1,229.60	549.13
Income (Loss) before FX revaluation	**288.53**	**(1,024.76)**	**(1,313.3)**
Net Credit provisions	(46.906)	682.26	729.17
FX revaluation Gain/loss	234.82	648.22	413.39
Tax	(228.426)	(96.414)	132.012
Net profit income/Loss after Tax	**752.09**	**(279.93)**	**(1,032.02)**

Source: IBFD, Islamic Banking & Finance Department, DAB

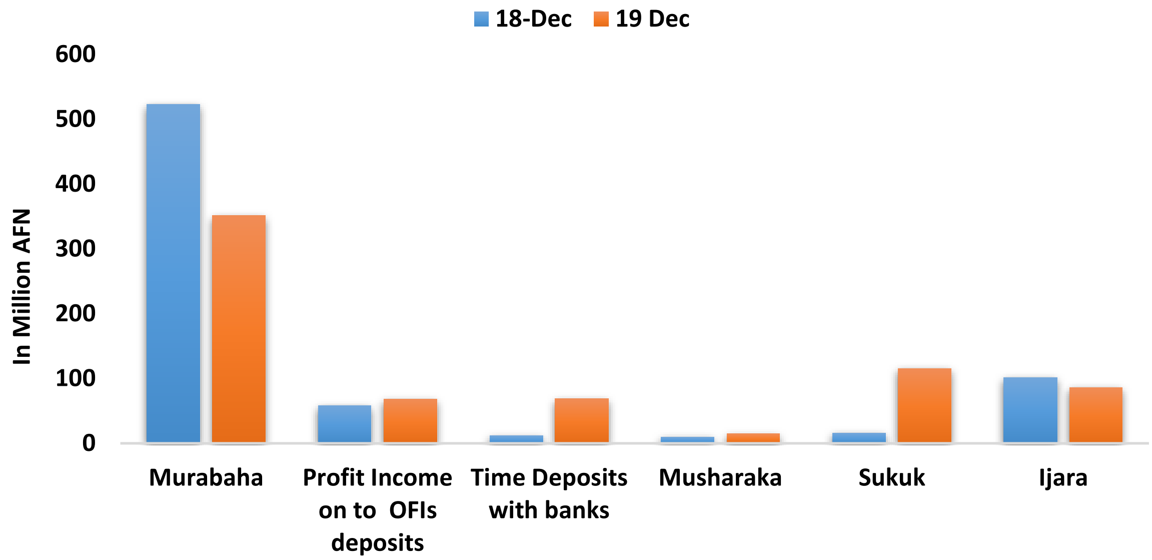
In general, the Islamic banking sector offering seven types of financial products. The returns from financing of the year (Dec, 2019) are shown in the following table,

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**	**Dec-19**	**Difference**
Time Deposits with banks	58.02	68.23	10.21
Profit Income on to OFIs deposits	11.48	68.44	56.95
Murabaha	522.86	351.27	(171.58)
Diminishing Musharaka	9.34	14.87	5.53
Sukuk	15. 702	115. 58	99.87
Ijara	101.695	85.72	(15.97)
Total Profit Income	**719.11**	**704.14**	**(14.97)**

Source: IBFD, Islamic Banking & Finance Department, DAB

Figure 6.20: Return by Major Types of Shariah Complaint Products



Source: IBFD, Islamic Banking & Finance Department, DAB

Total number of employees, borrowers, depositors and other-clients of the Islamic banking sector as of Dec, 2019, all across the country are as follow:

Table 6.11: Employees, borrowers, depositors of the Islamic Banking Sector

Particulars	No.
Full-time all Employees	1,018
Present Borrowers	762
Present Depositors	441,861

Source: IBFD, Islamic Banking & Finance Department, DAB

CONCLUSION:

The total assets of the Islamic banking sector at the end of fourth quarter Dec, of the year 2019, stands at AFN 38.32 billion (USD 487.28 million) showing 10.71%increase over the preceding year, Dec 201. The increasing in assets of Islamic banking sector is mainly due to upturn in the deposits of the sector during the year.

Gross financing and investment portfolio of the Islamic banking sector increased by 17.57% or AFN 1.93 billion as compared to last year, and stands at AFN 11.68 billion at the end of Dec 2019. The increase in the financing and investment portfolio of the sector during the year was mainly due to issue new Sukuk over the year.

Deposits, the main funding source for the Islamic banking sector stands at AFN 31.39 billion, comprising 91.76% of the total liabilities of the sector, and shows increase by 8.59% over the last year, Dec 2018. The Islamic banking sector suffered amounted AFN 279.93 million net losses for the year 2019. The reason the loses of the sector was mainly due to calculated AFN 1.428 billion as gross credit provisions reported 94.01% by 4 windows and remaining by one full-fledged.

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