Da Afghanistan Bank

Economic & Statistical Bulletin

Quarterly Bulletin, Q2 - FY 1395

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Quarterly Bulletin, Q2 - FY 1395

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Note:

Afghanistan's Fiscal year has been changed effective from 1391 (2012). The new fiscal year begins on December 21 each year. This Quarterly Bulletin analyzes developments in the second quarter of fiscal year 1395, which covers March 20, 2016 to June 20, 2016.

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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
CSO	Central Statistics Office
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

Senior Management

H.E. Khalil Sediq

Governor

Khan Afzal Hadawal

First Deputy Governor

Alhaj Essa Khan Turab

Second Deputy Governor

Message

From the Governor

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

EXECUTIVE SUMMARY

In the first six months of year 2016 Afghan economy showed signs of recovery despite persistent security challenges and uncertain political and economic environment. Prudent taxation reforms, imposition of further restrictions on imports in confluence with repatriation of large number of emigrant are expected to take the economy on the path of growth. Agriculture sector is also expanding in addition to a modest surge in foreign and domestic investment. The first six month of 2016 also witnessed serious advances in domestic revenue collections. Furthermore, Afghanistan managed to get Accession to World Trade Organization and successfully completed IMF Staff Monitored Program and agreed on and approval of a new three year IMF program.

The upward inflation trend in Afghanistan which started in the mid 2015 remained persistent in the second quarter of 2016 as the headline inflation increased to 5.96 percent (Y-over-Y). Consumer price rose in the back of several factors. First: CPI inflation in Afghanistan increased due to high price of oil in global markets. Compared to the previous quarter, oil price has increased by 47.3 percent, which has well supported the higher commodity price. Second: Decrease in trade volume between Afghanistan and Pakistan (especially in imports side) is another reason for higher price level during the second quarter. Owing to some border problems, the volume of imports from Pakistan has decreased significantly.

After experiencing a considerable negative growth over first quarter of FY 1395, CIC and RM experienced a positive growth of five percent in the second quarter. At the end of second quarter reserve money (RM) which is Da Afghanistan Bank's operational target, is standing at Af 223,151 million while Currency in circulation (CIC) which is indicative target of DAB reaching to Af 199.257 million.

Narrow money (M1), stood at Af 380,284 million at the end of the quarter under review, registering a growth of 3.71 percent (Q-o-Q). Broad money (M2) demonstrated similar behavior, representing a growth rate of 3.76 percent (Q-o-Q) standing at Af 409,104 million at the end of the Q2, FY 1395. Meanwhile, DAB's net international reserve (NIR) recorded an increase of 4.06 percent and reached to USD 6,812.26 million during Q2 1395.

In the second quarter of fiscal year 1395 the current account deficit narrowed in comparison with the corresponding quarter of the FY 1394. This development was attributed to lower imports of goods and services, increased surplus in the current transfer account, increased out-payment in the income account which was caused by lower investment income. Both aggregate exports and imports declined by 4 and 20 percent to USD 116.99 and USD 1,402.13million respectively. The drop in imports shows a fall in domestic demand for foreign goods, mainly capital goods, industrial supplies, and fuel and lubricants. Meanwhile, the capital account of the balance of payments illustrated a decline of 30 percent in the second quarter of the FY 1395 when compared to the same quarter of the FY 1394. Financial account of the BOP turned from a net inflow of USD 84.47 million in the second quarter of the FY 1394 to a net outflow of USD 213.70 million recorded in the second quarter of the FY 1395. Afghanistan aggregate financial assets- claims by Afghans- was USD 91.08 million in the reviewed period compared with USD 20.39 million in the corresponding quarter of pervious year.

1

GLOBAL ECONOMIC ENVIRONMENT

1

GLOBAL ECONOMIC ENVIRONMENT

According to the International Monetary Fund (IMF), the global economy was evolving before the June 23, 2016. Most of advanced economies experienced a lackluster growth while the economic growth indicated a mixed condition across the emerging market and developing economies. The recovery in the financial and oil markets which started in mid-February 2016, continued through June 23 since the United Kingdom (U.K.) was assumed to remain in the European Union.

However, the outcome of the U.K. referendum surprised the financial markets and as a result, the equity prices declined across the world. From a macroeconomic perspective, the Brexit vote means a significant increase in the economic, political and institutional uncertainty which is expected to put negative impact on the macroeconomic performance, particularly, on the macro-economic performance of the advanced European economies.

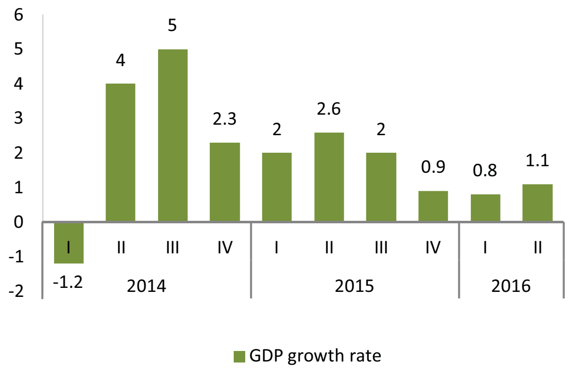
On the other hand, according to the IMF projections, the world output is projected to increase by 3.1 percent (Y-o-Y) in 2016. The GDP of advanced economies is expected to increase by 1.8 percent and a 4.1 percent increase in the output of emerging market and developing economies is projected for 2016.

I. ADVANCED ECONOMIES

1.1.1 The United States Economy

The real GDP of the U.S. increased by 1.1 percent in the second quarter of 2016 up from 0.8 percent in the previous quarter. The main reason behind the increase in real GDP in the second quarter was higher consumer spending; however, the increase in the consumer spending was partly offset by a decrease in the inventory investment. Therefore, the real final sales of domestic product excluding inventory investment indicated an increase of 2.4 percent in the second quarter.

Figure 1.1: The U.S GDP Growth Rate
Change: Quarte on quarter, percent change
Percent: Seasonally adjusted at annual rate



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

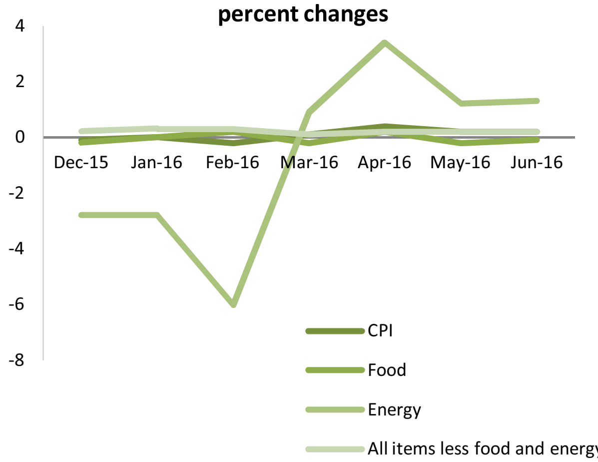
The U.S. unemployment rate increased to 4.9 percent in June 2016 from 4.7 percent in the previous month. The U.S. unemployment rate indicates a decline of 0.1 percentage point in June compared to the month of April which was recorded at 5 percent.

Figure 1.2: The U.S. unemployment rate (seasonally adjusted)

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

The U.S. consumer price index (seasonally adjusted) for all urban consumers indicated an increase of 0.2 percent in June 2016. The food index decreased by 0.1 percent, but the energy index was higher by 1.3 percent mainly due to 3.3 percent rise in the gasoline index. The index for all items was higher by 1 percent for the twelve months ending in June which is the same increase as for the twelve months ending in May. However, in the month of April, the consumer price index for all urban consumers indicated an increase of 0.4 percent on a seasonally adjusted basis.

Figure 1.3: The U.S. CPI for all urban consumers: U.S. city average
Quarter on Quarter seasonall adjusted percent changes

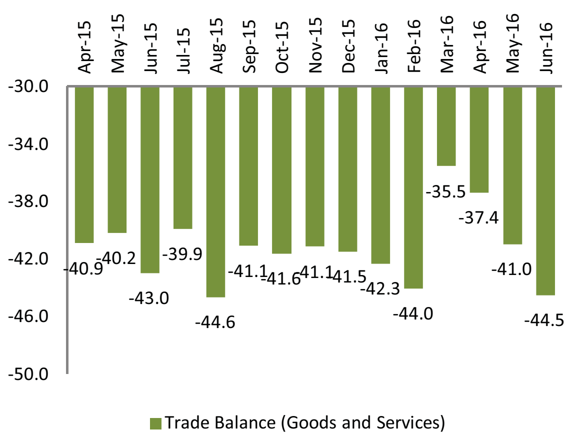


Source: *Bureau of Labor Statistics, the United States Department of Labor*

The U.S. monthly international trade (goods and services) deficit increased from USD 41 billion in May to USD 44.5 billion in June 2016 indicating an increase of 8.5 percent while the trade deficit indicated an increase of 9.6

percent in June compared to USD 37.4 billion in April. In other words, in June 2016, the total exports stood at USD 183.2 billion while the total imports reached USD 227.7 billion showing a deficit of USD 44.5 billion in goods and services. The goods deficit reached USD 66 billion which was higher by USD 3.8 billion in June compared to the previous month, but there was a surplus of USD 21.5 billion in services in the same month which was higher by USD 0.3 billion compared to the last period.

Figure 1.4: The U.S. International Trade in Goods and Services (in billion USD, months seasonally adjusted)

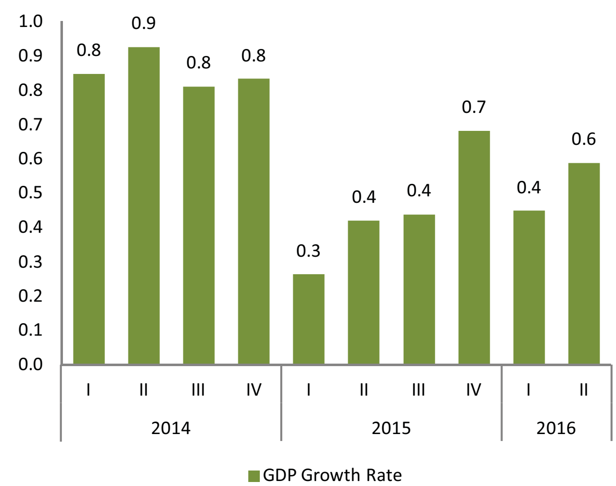


Source: *Bureau of Economic Analysis, U.S. Department of Commerce*

1.1.2 The Economy of United Kingdom

The GDP of U.K. was estimated to have increased by 0.6 percent in the second quarter of 2016 while the GDP of the U.K. indicated an increase of 0.4 percent in the previous period. In the second quarter, output was higher in two of the main groupings of the industrial sector. Services picked up by 0.5 percent and production was higher by 2.1 percent. In contrast, a decline of 0.4 percent and 1 percent was noted in construction and agriculture respectively.

Figure 1.5: The U.K. GDP Growth Rate (Seasonally adjusted)



Source: *Office for National Statistics, U.K.*

The U.K. unemployment rate was recorded at 4.9 percent in the second quarter of 2016 while the rate was recorded at 5.1 percent in the previous quarter indicating a decrease of 0.2 percentage points.

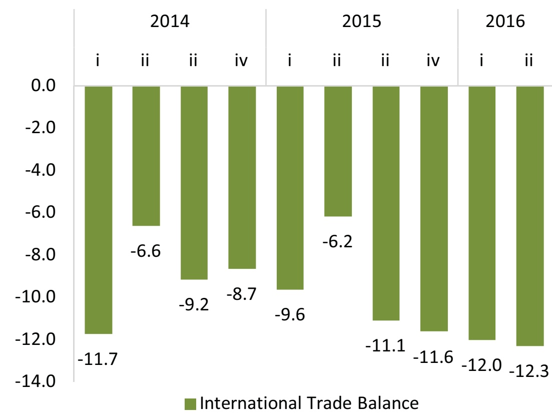
The annual rate of inflation of U.K. rose to 0.5 percent in the month of June- 2016. In the preceding period, the rate indicated an increase of 0.3 percent at an annual rate. The June inflation rate is slightly higher compared to the preceding months of the current year, but it is relatively lower historically. The main contributors to higher inflation rate in June were higher motor fuel prices, higher air fares, and increased prices of various recreational and cultural goods and services. The increasing inflation rate was partially offset by a decline in the prices of furniture and furnishings and accommodation services.

Figure 1.6: The U.K. Annual Inflation Rate

Source: *Office for National Statistics, U.K.*

The U.K. international trade deficit reached 12.3 billion pounds in the second quarter of 2016. In the previous quarter the deficit stood at 12 billion pounds indicating an increase of 0.3 billion pounds in the trade deficit in the second quarter. The UK international trade deficit shows an increase of 6.1 billion pounds (98.4 percent) in the second quarter compared to the same period of last year.

Figure 1.7: The U.K. international trade Balance (goods and services) (amounts in billion pounds)

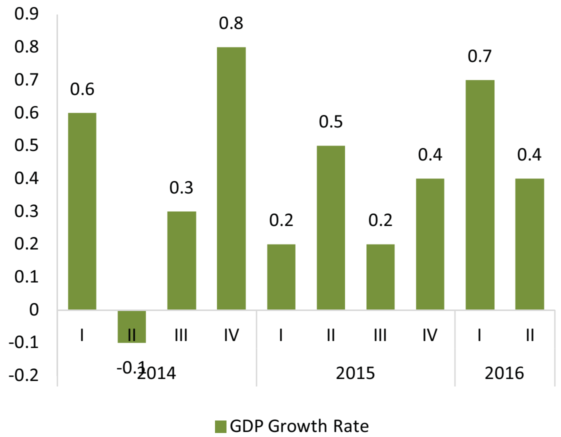


Source: *Office for National Statistics, U.K*

1.1.3 The Economy of Germany

The economy of Germany grew by 0.4 percent (price, calendar and seasonally adjusted rate) in the second quarter 2016 over the previous period. In the first quarter, the GDP growth rate was recorded at 0.7 percent. The balance of the international trade of Germany contributed remarkably to the GDP growth of the country in the mentioned period. In a year-on-year comparison, the GDP growth was higher by 3.1 percent in the second quarter of 2016 which is the highest increase in five years. Overall domestic demand declined slightly compared to the first quarter which reduced the economic growth by 0.2 percentage points. Besides, there was a slight decrease in inventories that put negative impact (-0.1 percentage point) on the GDP growth.

Figure 1.8: GDP Growth Rate of Germany (Q-o-Q) (seasonally and calender adjusted)



Source: *Federal Statistical Office (Destatis)*

The unemployment rate of Germany was recorded at 4.2 percent in the month of June which was unchanged since April. In the month of June, the total labor force reached 42.71 million people of which 40.91 million people were employed while 1.8 million people were unemployed. In the month of January, the total number of labor force stood at 42.64 million people and 40.7 million people of the labor force were employed, but 1.85 million people were unable to find jobs. Since January, 0.05 million unemployed people entered the employed category.

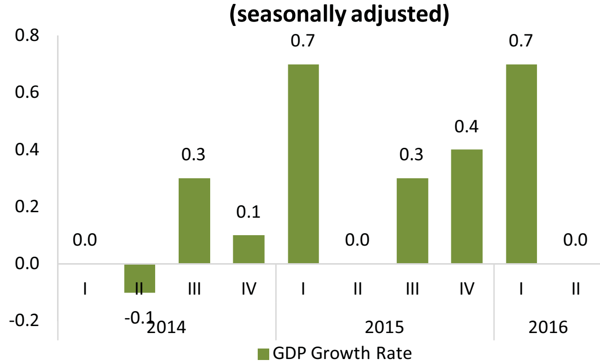
The inflation rate of Germany increased at an annual rate of 0.3 percent in the month of June. In the previous month, the rate stood at 0.1 percent while in April, the rate was recorded at -0.1 percent. In June, the inflation rate of food items was 0.1 percent, the inflation rate of energy (household energy and motor fuels) was -6.4 percent and the inflation rate of services was 1.4 percent. In the previous month, the inflation rates for food items, energy and services were 0.0 percent, -7.9 percent and 1.2 percent respectively. In the month of April, a decline in the overall inflation was mainly due to the price changes in the mineral oil products which were recorded at -16.3 percent.

The exports of goods of Germany reached 106.8 billion euros while the imports of goods were recorded at 82 billion euros in June 2016 indicating a surplus of 24.8 billion euros. In May, the exports of goods stood at 97.2 billion euros and the imports of goods amounted 76.2 billion euros showing a trade surplus of 21 billion euros. In April, the exports of Germany amounted 104.3 billion euros and the imports reached 78.7 billion euros which shows a surplus of 25.6 billion euros.

1.1.4 The Economy of France

The economic growth of France was stable (0.0 percent) in the second quarter 2016 while in the previous quarter the GDP of France indicated a growth of 0.7 percent. In the second quarter, the household expenditure decreased significantly and reached 0.0 percent from 1.2 percent in the first quarter. The Gross Fixed Capital Formation (GFCF) declined to -0.2 percent in the second quarter from the 1.3 percent in the previous quarter. Final domestic demand (excluding inventory changes) contributed 0.1 percentage point to the GDP growth in the second quarter after 1 percentage point in the first quarter. Inventory changes contributed negatively (-0.7 percentage points) to the GDP growth in the second quarter after -0.1 percentage points in the previous quarter.

Figure 1. 9: GDP Growth Rate of France (Q-o-Q) (seasonally adjusted)



Source: *National Institute of Statistics and Economic Studies (Insee)*

The unemployment rate was recorded at 9.9 percent for the metropolitan France and overseas departments in the second quarter while the rate stood at 10.2 percent in the previous quarter indicating a decrease of 0.3 percentage point. Only in metropolitan France, the unemployment rate reached 9.6 percent and in the previous quarter it was recorded at 9.9 percent.

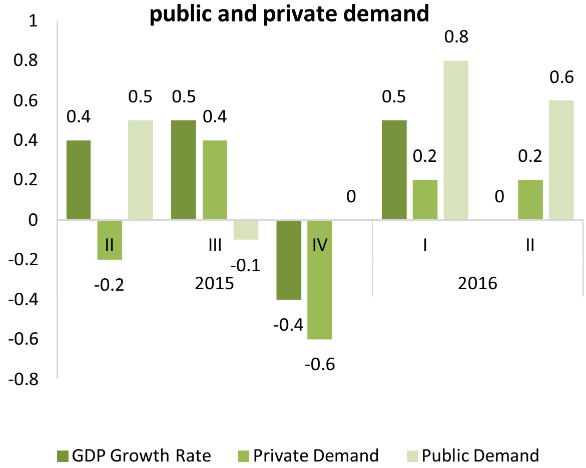
The consumer price index of France increased by 0.1 percent in June 2016 compared with the previous month that indicated an increase of 0.2 percent. In May, the consumer prices were up by 0.4 percent after 0.1 percent increase in April. The main reason behind the increase in the inflation rate in the month of June over the previous month was higher prices for the petroleum products and seasonal rebound in prices of some services, which was partly offset by seasonal decrease in prices of fresh foods and manufacturing products.

In the second quarter of the current year, the exports of France indicated a slight decrease of 0.3 percent. The rate of decline in exports remained the same as it was in the previous quarter. On the other hand, in the second quarter, a significant decline of 1.3 percent was noted in the imports, particularly in raw hydrocarbons and manufacturing products while the imports indicated an increase of 0.5 percent in the previous quarter.

1.1.5 The Economy of Japan

The economic growth of Japan was stable in the second quarter of 2016 compared to 0.5 percent increase in the previous quarter. In the second quarter of previous year, the GDP of Japan indicated a growth of 0.5 percent. Similarly, the domestic demand showed an increase of 0.3 percent in the second quarter compared to 0.4 percent increase in the previous quarter.

Figure 1.10: Japan's GDP growth rate, public and private demand



Source: Cabinet Office, Japan

The seasonally adjusted unemployment rate of Japan stood at 3.1 percent in June compared to 3.2 percent in the previous period while in April the unemployment rate of Japan was also 3.2 percent. The data indicates that the employment situation in Japan is improving. The total number of unemployed people reached 2.08 million in June from 2.12 million in the previous period.

The annual inflation rate in Japan was recorded at -0.4 percent in the month of June of the current year. In the previous month, the rate stood at -0.5 percent. The rate was recorded at -0.4 percent in the second quarter of 2016 while in the first quarter, the inflation rate indicated no change from the previous period and stood at 0.0 percent.

The total amount of the exports of Japan reached 34,518.616 billion yen in the first half of 2016 (an 8.7 percent decline from the same period of last year) while the imports amounted 32,708.982 billion yen (a 17.2 percent decline from the same period of last year) indicating a trade surplus of 1,809.634 billion yen. On monthly basis, the total exports stood at 6,025.816 billion yen in June and the total imports were recorded at 5,335.145 showing a trade surplus of 690.671 billion yen.

II. EMERGING MARKET ECONOMIES

1.2.1 The Economy of China

The economy of china grew by 1.8 percent, more than expected, in the second quarter of 2016 compared to the 1.2 percent in the first quarter indicating a 0.6 percentage point increase in the second quarter. The main reason behind the increase in the GDP was higher government spending and higher industrial activity. A decrease in the GDP is expected in the third quarter with a rebound in fourth quarter due to post flood reconstruction activity.

Figure 1.11: GDP Growth Rate of China (Q-o-Q)

Source: National Bureau of Statistics of China

The urban unemployment rate in China was recorded at 4.05 percent in the end June 2016 which is slightly higher compared 4.04 percent at the end of the first quarter. In the first half of 2016, China created 7.17 million new urban jobs.

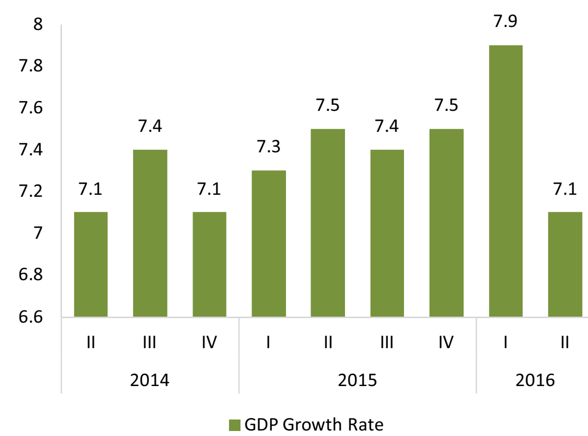
The Chinese consumer price index indicated an increase of 1.9 percent (y-o-y) in June. The prices of food items went up by 4.6 percent while prices of non-food items indicated an increase of 1.2 percent. In the first half of the current year, consumer prices rose by 2.1 percent (on average) compared to the same period of last year.

The exports of China stood at USD 985.48 billion in the first half of 2016 and the imports reached 727.19 billion which indicates a surplus of USD 258.29 billion (Y-o-Y). Both exports and imports were down by 7.7 percent and 10.2 percent respectively in the mentioned period compared to the same period of last year.

1.2.2 The Economy of India

The GDP growth rate of India was estimated at 7.1 percent in the second quarter of 2016 compared to the same period of last year. In the second quarter, the agriculture, forestry and fishing sectors indicated a growth of 1.8 percent compared to 2.6 percent growth in second quarter of previous year. Manufacturing sector showed a growth of 9.1 percent compared to 7.3 percent growth in the same period of last year. Construction sector grew by 1.5 percent compared to 5.6 percent growth in the same period of previous year and Mining and quarrying showed a negative growth of -0.4 percent as compared to 8.5 percent growth in the same quarter of previous year.

Figure 1.12:GDP Growth Rate of India, Seasonally adusted (Y-o-Y)



Source: Ministry of Statistics and Program Implementation, India

The annual inflation rate of India reached 6.13 percent in the month of June while the rate stood at 6.59 percent in the previous month. However, in the second quarter of 2016, the inflation rate of India was recorded at 6.2 percent compared to 5.7 percent in the previous quarter.

The exports of goods of India reached USD 66.5 billion in the second quarter of the current year while the imports of goods stood at USD 83.4 billion indicating a trade deficit (in goods) of USD 16.9 billion. In the second quarter of the previous year, the exports of goods were recorded at USD 67.8 billion and the imports of goods stood at USD 98.4 billion showing a trade deficit (in goods) of USD 30.6 billion. In the second quarter of the current year, both the exports and imports of goods decreased compared to the same period of last year and the trade balance deficit (in goods) also decreased by 81.1 percent compared to the second quarter of last year.

1.2.3 The Economy of Turkey

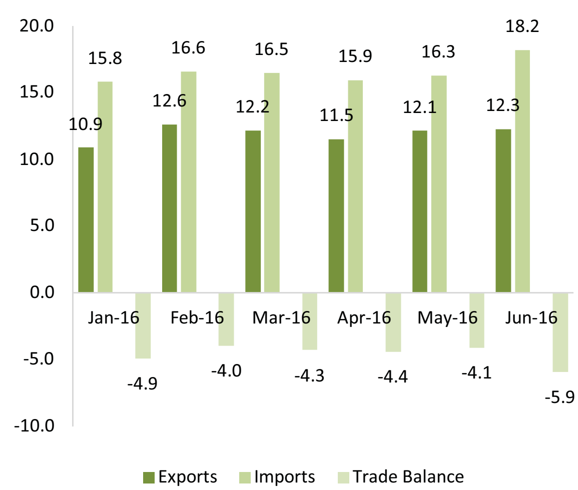
GDP growth of Turkey moderated in the first half of 2016 below the 4 percent increase in 2015. Despite higher domestic consumption, the GDP growth was lower in the first quarter due to slower inventory accumulation. The GDP growth was recorded at an annualized rate of 3.3 percent (Q-o-Q) in the first quarter.

The unemployment rate in Turkey reached 10.2 percent in May. In the previous month, the rate stood at 9.8 percent while in January the rate was recorded at 10.1 percent. In May, the youth unemployment rate stood at 19.1 percent and non-agricultural unemployment rate reached 12.2 percent.

The consumer price index of Turkey went up by 0.47 percent (monthly rate of change) in June. In May the rate was recorded at 0.58 percent while in April the rate stood at 0.78 percent. In June, the highest monthly increase was observed in food and non-alcoholic beverages which showed an increase of 1.16 percent while the highest monthly decrease was noted in clothing and footwear which was down by 1.33 percent.

The exports (seasonally and calendar adjusted) of Turkey was recorded at USD 12.3 billion in the month of June which shows an increase of 1.2 percent over the previous month while the imports reached USD 18.2 billion indicating a 11.9 percent increase over the previous month. In the month of June, Turkey experienced a trade deficit of USD 5.9 billion. In May, Turkey experienced a trade deficit of 4.1 percent and in April, the trade deficit was recorded at 4.4 percent.

Figure 1.13: Exports, Imports and Trade Balance of Turkey (seasonally and calendar adjusted)



Source: Turkish Statistical Institute, Turkey

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

Monetary development chapter provides data and information regarding to the monetary program, monetary aggregates, net international reserves, foreign exchange rates, open market operation and liquidity condition.

After experiencing a considerable negative growth over first quarter of FY 1395, CIC and RM experienced a positive growth of five percents. At the end of this quarter reserve money (RM) which is Da Afghanistan Bank's operational target, is standing at Af 223,151 million while Currency in circulation (CIC) which is indicative target of DAB reaching to Af 199.257 million.

Narrow money (M1), stood at Af 380,284 million at the end of the quarter under review, registering a growth of 3.71 percent (Q-o-Q). Broad money (M2) demonstrated similar behavior, representing a growth rate of 3.76 percent (Q-o-Q) standing at Af 409,104 million at the end of the Q2, FY 1395.

At the Q2, FY 1395 DAB's net international reserve (NIR) recorded an increase of 4.06 percent and reached to USD 6,812.26 million.

At the end of Q2, FY 1395, Afghani depreciated against the US dollar by 1.21 percent in comparison with the first quarter of FY 1395.

At the end of Q2, FY 1395, DAB has auctioned a total amount of USD 462.20 million to manage the liquidity in the market as well as to mitigate the severe fluctuations in exchange rate of Afghani against the foreign currencies. The total outstanding amount of CNs which is central bank's bill stood at Af 32.261 billion at the end of period under review.

I. MONETARY PROGRAM

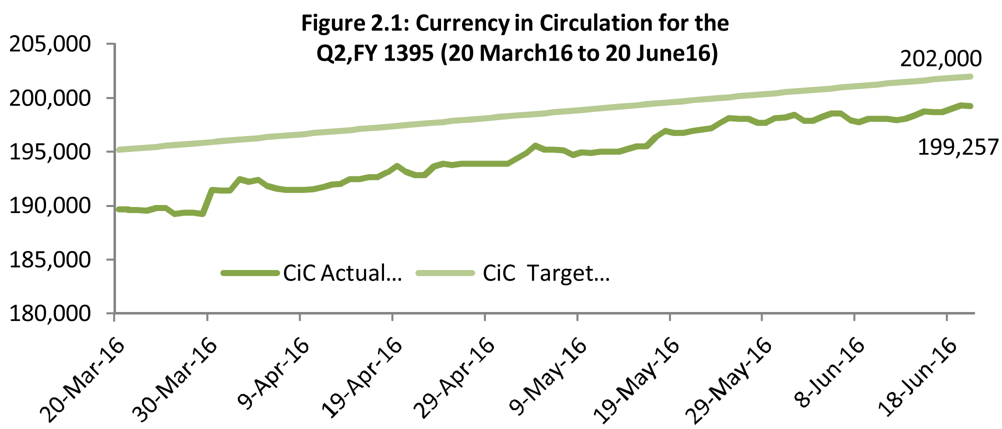
To determine the amount of RM for purpose of supporting domestic price stability, which is DAB's primary objective, DAB uses quantitative theory of money. Hence, the assigned targets for RM and (CIC) are based on expected economic growth and expected inflation during the concerned period.

Over the current quarter (Q2) ceilings for RM and CIC growth planned to be higher than previous quarter which is set three and four percent respectively. The set targets show a slight increase compared to the same quarter of previous year (Q2, FY, 1394) targeted growth, which were near to one percent.

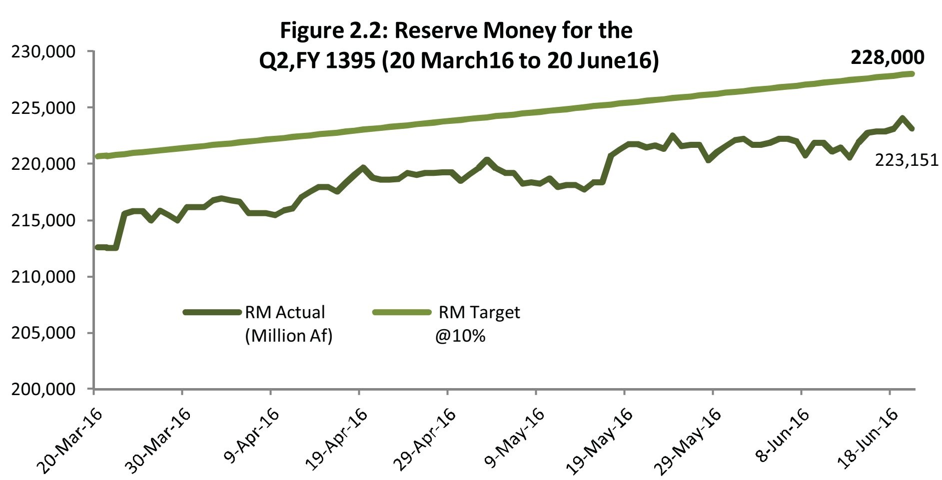
But in actual case of the scenario, although CIC and RM experienced a slight growth compared to actual growth of CIC and RM in previous quarter (Q1-FY1395) and same quarter of last year (Q2-FY1394) they have still remained well below to the target over this quarter which shows the figures of Af 199,257 and Af 223,151millions respectively at the end of period.

DAB continued to conduct a tight monetary policy as previous periods in order to absorb excess liquidity as well as to prevent severe volatilities in the nominal exchange rate of Afghani against foreign currencies.

The Figure 2.1 and 2.2 present the ceiling and actual figures for CIC and RM during the quarter under review.



Source: *Monetary Policy Department/DAB*



Source: *Monetary Policy Department/DAB*

II. MONETARY AGGREGATES

As shown in Table 2.1 narrow money (M1) grew by 3.71 percent, Af 13,605 million at the of Q2, FY1395 in (Q-o-Q) comparison while it recorded 6.2 percent growth in Af 22,058 million comparing to the same period of FY 1394. Currency outside depository corporations or CIC, a major component of M1 (50%), grew by 4.74 percent in Q2 compared to Q1, FY 1395 and 8.3 percent compared to the same quarter of previous year. The difference of CIC in Q1-Q2, 1395 stand at Af 8, 716 million while the difference of CIC in Q2, FY1395 in contrast to Q2-FY1394 shows the figure of Af 14,830 million. Demand deposit which is the other component of M1 experienced a growth of 2.67 percent at the end of Q2, FY1395 comparing to the Q1 of current fiscal year, while its growth recorded 4 percent in previous year same quarter which was Af 7, 227 million lower than current quarter.

The supply of broad money (M2) expanded by Af 409,104 million in the Q2, FY 1395 from Af 394,290, which was in Q1,FY1395 and Af 381,053 million in the same quarter of previous year showing a difference of Af 14,814 and 28,051 million respectively. In percentage the differences shows an increase of 3.76 percent from the Q1, FY1395 and 7.4 percent in the same quarter of previous year. The current period figures show that M1 remained as the main contributing component of M2 (93%).

Quasi money or time deposits of commercial banks, which is the other component of M2, grew by 4.38 percent (Q-o-Q) and 26.3 percent (Y-o-Y) at the Q2 of FY 1395. Quasi money constitutes only 7 percent of broad money during the period under review, albeit higher than 6 percent from the same quarter of the previous fiscal year but still the impact of changes in quasi money on the M2 is negligible. The (Q-on-Q) difference of Afghani denominated time deposits stood at Af 130 million, while the difference of foreign currency denominated time deposits recorded Af 1,079 million. Afghani-denominated time deposits constitute two percent of broad money. While, the share of foreign currency denominated time deposits stood at 4.8 percent of M2 for the quarter under review.

Demand deposits as a share of broad money remained unchanged to 46 percent (Q-o-Q) in the quarter under review, while it is recorded at 44 percent in (Y-o-Y) comparison.

The figures 2.3 and 2.4 indicate some facts about money aggregates and its components.

Figure 2.3: Demand Deposits as Share of Broad Money in %

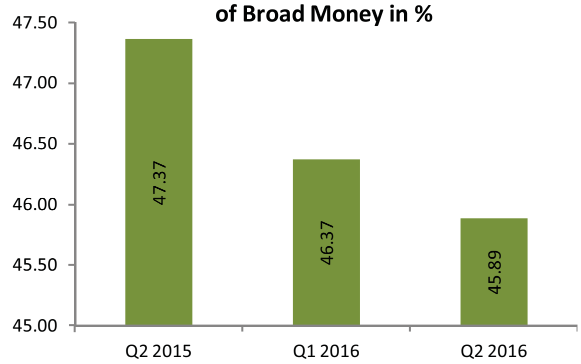
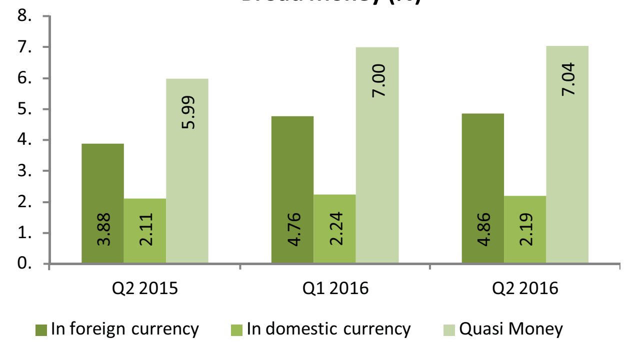


Figure 2.4: Quasi Money As share of Broad Money (%)



Source: *Monetary Policy Department/DAB*

Table 2.1: Monetary Aggregate for the Q2 1395 (March 20 –June 20 ,20 16)

In Million Af	Q2,1394	Q1, 1395	Y-o-Y ∆	Difference	Q2 1395	Q-o-Q ∆	Difference
	Amount	Amount	%		Amount	%	
1- Net Foreign Assets	507,009	548,969	14.5%	73,350	580,358	5.72%	31,389
(a) Foreign Assets	534,797	581,123	14.5%	77,515	612,311	5.37%	31,189
DAB Foreign exchange reserves	448,154	477,665	14.3%	64,006	512,160	7.22%	34,494
Gold	47,509	51,513	8.4%	4,004	51,513	0.00%	0
Other	400,645	426,152	15.0%	60,002	460,647	8.09%	34,494
Other foreign assets	86,643	103,457	15.6%	13,509	100,152	-3.20%	-3,306
(b) Foreign Liabilities	27,788	32,153	15.0%	4,165	31,953	-0.62%	-200
2. Net Domestic Assets	-125,938	-154,485	35.7%	-45,009	-170,947	10.66%	-16,462
(a) Net Domestic Credit	-33,670	-24,097	67.4%	-22,688	-56,357	133.88%	-32,261
Net Credit to Nonfinancial Public Sector	-75,033	-72,640	41.6%	-31,191	-106,225	46.23%	-33,584
Net Credit to Central Government	-74,906	-72,735	42.0%	-31,430	-106,336	46.20%	-33,602
Credit to Central Government	60,369	61,164	23.7%	14,331	74,700	22.13%	13,536
Liabilities to Central Government	135,275	133,898	33.8%	45,761	181,036	35.20%	47,138
Net Credit to State & Local Government	0.000	0.000	0.0%	0	0.000	0.000	0
Net Credit to Public Nonfinancial Corporations	-127	94	-187.6%	239	112	18.40%	17
Credit to Private Sector	43,058	49,975	19.0%	8,192	51,250.50	2.55%	1,276
Net Credit to Other Financial Corporations	-1,694	-1,431	-18.3%	311	-1,383.33	-3.32%	47
(b) Capital Accounts	111,812	142,574	24.3%	27,118	138,931	-2.56%	-3,643
(c)Other Items Net	19,544	12,185	24.5%	4,797	24,342	99.76%	12,156
3- Broad Money(M2)	381,053	394,290	7.4%	28,051	409,104	3.76%	14,814
Narrow Money(M1)	358,226	366,679	6.2%	22,058	380,284	3.71%	13,605
CiC (Currency outside depository corporations)	177,734	183,848	8.3%	14,830	192,565	4.74%	8,716
Demand Deposits	180,492	182,831	4.0%	7,227	187,720	2.67%	4,889
Other Deposits (Quasi Money)	22,827	27,611	26.3%	5,993	28,820	4.38%	1,209
In Afghani	8,035	8,827	11.5%	923	8,957	1.47%	130
In Foreign currency	14,792	18,784	34.3%	5,071	19,863	5.75%	1,079
Securities Other Than Shares	507,009	548,969	14.5%	73,350	580,358	5.72%	31,389

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

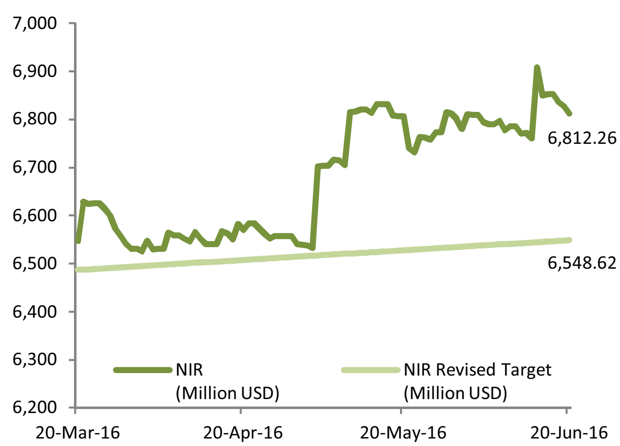
II. NET INTERNATIONAL RESERVE

NIR increased by 4.06 percent, USD 265.88 million, at the end of Q2, FY1395, in comparison with same period of previous quarter. The target of NIR for the second quarter of fiscal year 1395 was set at USD 6578.71 million, the revised target set at amount of USD 6548.62 million while the actual figure of NIR recorded the amount of USD 6812.71 million which is well above from the targeted amount.

By applying market exchange rate at the end of the current quarter, NIR is standing to Af 471.34027 billion which is making 115.21 percent of broad money.

Figure 2.5 explains the trend of NIR actual and target during Q2, FY1395.

Figure 2.5: Net International Reserve Q2,FY 1395 (20 March16 to 20 June16)



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

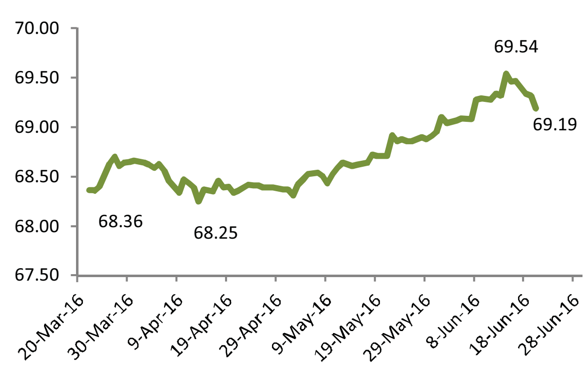
IV. FROEIGN EXCHANGE MARKET

The national currency (Af) experienced a slight depreciation (1.21%) in Q2 compared with the end of period Q1 of the current fiscal year while it has experienced 13.95 percent deprecation in comparison with the same quarter of previous year (FY 1394). During the period under review Af/USD exchange rate deprecation shows an upward trend with a minimum figure of 68.25 and maximum amount of 69.54 Afghani for each USD. The maximum and minimum values have a small deviation from the mean which is 68.71.

Afghani traded at 69.19 per USD at the end of Q2, FY1395.

The daily historic review of the average exchange rate of Af against the U.S. dollar for the Q2, FY, 1395 is shown in figures below.

Figure 2.6 : Daily Average Ex-Rate of Afghani against USD Q2,FY 1395 (20 March16 to 20 June16)



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

V. OPEN MARKET OPERATION & LIQUIDITY CONDITIONS

2.5.1 Foreign Exchange Auction

During the second quarter of fiscal year 1395, DAB auctioned a total amount of USD 464.20 million; while the total demand was USD 653.45 million. On average, 48.5 bidders participated in each auction and 33.03 bidders were the winners with the average amount of USD 12.89 million; while the data for the same period of FY 1394, recorded total awarded amount at USD 681.90 million, with a total demand of USD 960.25 million. Last year on average, 36 bidders participated in each auction and 29 bids were awarded with an average amount of USD 28.41 million.

2.5.2 Capital Note Auction

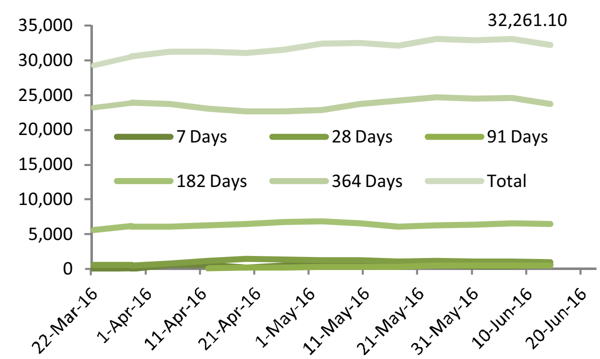
Total outstanding stock of capital notes reached Af 32.261 billion at the end of the Q2, FY, 1395 which shows an increase of 0.45 percent compared to Af 32.12 billion the end of Q1, FY 1395. The increase in the level of CNs shows a slight increase of Afghani demand by banking sector.

The outstanding stock of 7 day note, stood at Af 550 million. 28 day CN outstanding amount stood at 930 million while the outstanding amount of recently published CN stood at 540 million. The stock outstanding for 182 day notes stood at Af 6.505 billion and the amount of outstanding of 364 days capital notes was standing at 23.736 billion at the period under review.

In addition the weighted average interest rate for 7 day capital note was 1.8 percent and for 28 day security it is recorded 3.53 percent, while for 91 day capital note it was 4.33 and for 182 day bill, it ended at 5.15 percent and for 364 days capital notes it recorded 6.66 at the end of this reporting period.

Figure 2.07 exhibits breakdown of the total outstanding stock for all maturities during the Q2, FY1395.

Figure 2.7: Capital Notes Outstanding in Million AfFor The End of Period Q2,1395



Source: Market Operations Department/DAB

2.5.3 Required and Excess Reserves

Commercial banks are required to hold 8 percent of their total deposits as obligatory reserves with the DAB, in recent development from 28 June 2015 onward DAB has stopped paying interest rate for required reserve.

In order to provide commercial banks with facilities to better manage their liquidity and to provide them with a proper opportunity to invest their excess reserves apart from capital notes, DAB introduced the overnight deposit facilities or standing facilities in 1385 (2006-2007). However it has been temporarily called off for a short period of time in order to monitor its effectiveness as a monetary policy instrument. After the assessment of OSF effectiveness as monetary policy tool, DAB uphold overnight standing facilities. During Q2 FY 1395 the interest paid to the mentioned facility reached to Af 9.595 million.

Overnight Credit Facility: This facility allows commercial banks to borrow local currency from Da Afghanistan Bank on an overnight basis, whenever they face a shortfall in their short term liquidity position. The rate that banks are charged for this facility is 350 basis points above the last 28 day CNs auction rate. This borrowing is collateralized with the outstanding of capital notes. The reason behind such high rate of interest is to encourage the inter-bank lending among the commercial bank.

3

INFLATION TREND AND OUTLOOK

3

INFLATION TREND AND OUTLOOK

Global economic activity subdued in the second quarter of 2016. This trend may more precisely be analyzed in the context of BREXIT impacts on global economy. The UK exit from European Union has been translated in materialization of significant downside risks for global economy more specifically in trade and investment sides. The BREXIT mirrored expected macroeconomic consequences of rising uncertainties in political and economic fronts, but at a lower than expected extent.

During the second quarter of 2016, global commodity price has increased owing to sizable effects from the recent increase in oil price. Compared to the previous quarter, oil price has surged up by 47.3 percent. This increase is in line with high demand for oil, and the ongoing disruptions in production side. In addition, agriculture price exhibited significant increase escorted by rising price of food and agricultural raw materials.[1]

In the South Asia region, India showed higher inflation rate of 6.1 percent compared to 5.5 percent in the previous quarter. On the other hand, inflation in China decreased to 1.9 percent from 2.3 percent.[2]

I. CONSUMER PRICE IN AFGHANISTAN

The upward inflation trend in Afghanistan which started in the mid 2015 remained persistent in the second quarter of 2016 as the headline inflation increased to 5.96 percent (Y-over-Y). Consumer price rose in the back of several factors. First: CPI inflation in Afghanistan increased due to high price of oil in global markets. Compared to the previous quarter, oil price has increased by 47.3 percent, which has well supported the higher commodity price. Second: Decrease in trade volume between Afghanistan and Pakistan (especially in imports side) is another reason for higher price level during the second quarter. Owing to some border problems, the volume of imports from

[1] IMF Commodity Price Index, Monthly reports (January to June 2016).

[2] OECD.stat

Pakistan has decreased significantly. Among other commodities, this decrease has been observed more significantly in imports of cement, flour, clothing, and medicine, which has resulted in short-term increase in price of these goods. Third: CPI inflation in Afghanistan during the second quarter has increased also because of increase in repatriation of refugees from Pakistan. As these returnees have been residing in the cities rather than their native villages, the demand for food, housing, furnishing goods, and public services has increased, which has led to higher price of these commodities.

Inflation also increased on quarter to quarter basis, but at a slower pace compared to the year over year measure. In the short-term analysis, headline CPI inflation increased slightly to 0.9 percent in the second quarter from 0.8 percent observed in the first quarter.

Following the price movements in Kabul, overall inflation rate represented a significant increase of 9.7 percentage points and reached to 6.4 percent (Y-over-Y). In the meantime, Kabul headline inflation rose to 1.3 percent from 0.0 percent (quarter to quarter).

3.1.1 Developments in National Headline CPI

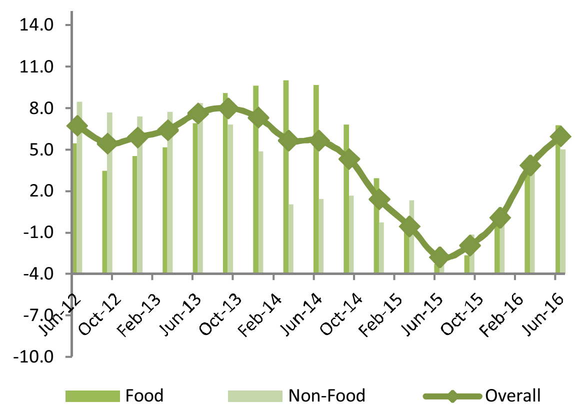
3.1.1.1 Annual Developments

Headline CPI inflation increased in the second quarter of 2016. Inflation when measured on year over year basis reached its 22 months peak and stood at 5.96 percent, up from 3.79 percent. This shows an increase of 2.17 percentage points over the quarter.

During the second quarter, both, food and non-food items of the CPI exhibited higher rates of inflation. Owing to higher price of bread and cereals, meat, milk, cheese and eggs, oils and fats, and vegetables; food inflation increased to 6.8 percent from -3.3 percent observed in the previous month.

In non-food item, inflation rose to 5.0 percent from -2.2 percent, which is mainly because of higher price of clothing, housing, electricity, water and gas, furnishing and household goods, and transportation.

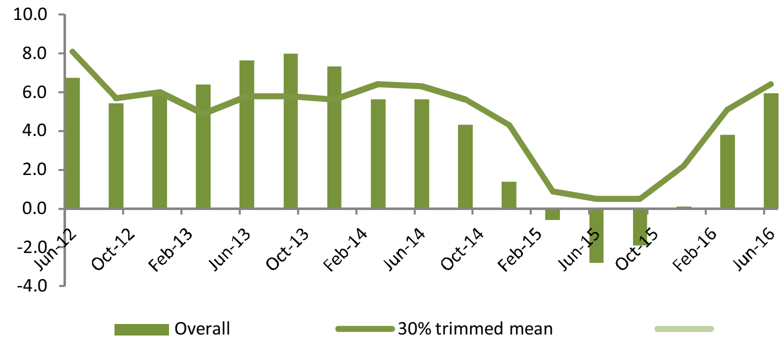
Figure 3.1 National Headline CPI (Y-o-Y)



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

Considering the changes in core measures, the trimmed mean measure of inflation showed a high rate of 6.4 percent, up from 0.5 percent. In addition, the CPI excluding bread and cereals, oils and fats, and transportation jumped to 5.8 percent from -1.9 percent.

Figure 3.2 Core Inflation (30%Trimmed Mean)



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

Table 3.1: Breakdown of National Headline CPI

(Percent changes year on year)

(March 2011=100)

	Weight	1393				1394				1395	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**100.0**	**5.6**	**5.6**	**4.2**	**1.3**	**-0.6**	**-2.8**	**-1.9**	**0.1**	**3.8**	**5.96**
Food and beverages	**52.0**	**10.0**	**9.7**	**6.8**	**2.9**	**-0.6**	**-3.3**	**-2.6**	**-0.3**	**4.0**	**6.8**
Bread and Cereals	17.7	9.5	11.4	11.0	8.0	2.1	-3.4	-2.3	0.5	5.0	7.6
Meat	7.2	2.6	3.4	3.7	3.4	2.4	-0.2	-1.5	0.8	3.2	6.7
Milk, cheese and eggs	4.8	6.5	6.1	2.1	3.4	1.4	1.0	1.5	1.3	2.4	3.1
Oils and fats	4.0	1.8	1.7	0.9	-1.7	-6.2	-7.2	-6.5	-6.6	-1.9	3.9
Fresh and dried fruits	4.8	8.5	9.9	9.2	11.5	6.6	7.9	2.0	0.5	3.6	4.9
Vegetables	7.9	30.3	24.3	7.1	-9.6	-11.7	-15.9	-12.4	-6.3	1.9	4.2
Sugar and sweets	2.9	2.5	-1.6	-0.2	-1.0	-1.1	0.5	0.4	6.0	11.1	19.9
Spices	0.9	10.5	9.4	12.0	5.9	1.0	-1.0	0.3	6.6	13.3	16.9
Non-alcoholic beverages	1.8	7.4	3.7	4.0	2.1	1.3	3.1	4.6	5.3	7.9	7.3
Non-Food	**48.0**	**1.1**	**1.4**	**1.4**	**-0.5**	**-0.5**	**-2.2**	**-1.2**	**0.5**	**3.7**	**5.0**
Tobacco	0.4	8.4	3.0	0.6	6.7	7.2	12.8	25.0	22.4	21.8	12.8
Clothing	7.0	8.3	8.1	6.9	4.2	2.9	2.0	6.6	8.6	9.9	9.1
Housing,	20.7	-8.5	-9.1	-8.8	-9.7	-4.6	-7.0	-7.4	-6.6	-2.7	1.6
Furnishing and household goods	7.0	8.5	10.4	10.3	8.4	4.9	2.1	3.3	5.7	9.7	8.9
Health	3.3	8.8	9.0	10.3	8.5	7.7	7.4	6.9	9.4	9.4	8.7
Transportation	4.7	16.6	20.1	19.5	11.3	-6.9	-10.0	-7.8	-3.4	2.0	3.0
Communication	1.1	-1.5	-1.4	-2.0	-3.4	-4.7	-3.3	-2.2	-1.3	-0.1	1.5
Education	0.7	1.9	5.0	4.0	2.8	2.0	-2.7	-3.7	-5.1	-7.6	9.2
Information and Culture	0.1	6.5	5.4	7.1	7.0	1.2	3.8	5.2	6.3	6.5	5.2
Restaurants and Hotels	1.0	2.6	2.4	4.6	3.2	2.2	4.2	-0.8	-0.3	0.7	-3.6
Miscellaneous	1.8	7.6	10.2	8.2	7.6	7.3	7.2	10.6	9.5	9.1	7.4
core inflation (30% TM)		**6.4**	**6.3**	**5.6**	**4.3**	**0.9**	**0.5**	**0.5**	**2.2**	**5.1**	**6.4**
Core inflation (Headline excl. B&C, O&F and T)		**4.3**	**3.6**	**1.7**	**-0.8**	**-0.4**	**-1.9**	**-1.2**	**-1.0**	**3.8**	**5.8**

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

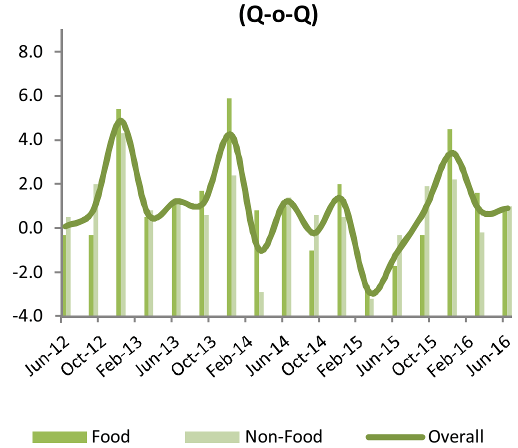
3.1.1.2 Quarterly Developments in national CPI

On quarter to quarter basis, headline inflation showed a slight increase over the second quarter of 2016. Overall inflation during this quarter increased to 0.9 percent from 0.8 percent. This increase is driven by higher inflation in non-food item, while it declined in food category.

Observing the data received from CSO, food inflation dropped to 0.9 percent from 1.6 percent. This decline is in line with lower price of meat, milk, cheese and eggs, and vegetables. However, the largest decrease in this category is seen in vegetables price, which fell by -5.5 percent compared to 5.8 percent increase in the previous quarter. The second largest decrease in this item happened in price of milk, cheese and eggs, which lessened by -1.4 percent from 0.9 percent.

During the second quarter of 2016, inflation in non-food item well supported the increase in headline CPI by showing a higher inflation rate of 1.0 percent from -0.2 percent recorded in the previous quarter. The higher inflation in non-food item was more than to offset the decline in food item. In this category price of housing, electricity, water and gas increased by 1.5 percent in the second quarter from a decrease of -1.7 percent in the previous quarter. Meanwhile, during the review period, price of transportation rose by 0.8 percent compared to a decrease of -3.6 percent seen one quarter back.

Figure 3.3: National Headline CPI (Q-o-Q)



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

Table 3.2: Breakdown of National Headline CPI
(Percent changes quarter-on-quarter)
(March 2011 = 100)

	FY1393				FY 1394				FY1395	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**-1.0**	**1.2**	**-0.2**	**1.3**	**-2.9**	**-1.1**	**0.8**	**3.4**	**0.8**	**0.9**
Food and beverages	**0.8**	**1.0**	**-1.0**	**2.0**	**-2.6**	**-1.7**	**-0.3**	**4.5**	**1.6**	**0.9**
Bread and Cereals	0.6	4.1	2.7	0.4	-5.0	-1.4	4.0	3.2	-0.7	1.0
Meat	0.3	0.7	2.1	0.3	-0.7	-1.9	0.8	2.7	1.7	1.4
Milk, cheese and eggs	1.9	-1.8	0.8	2.5	-0.1	-2.1	1.2	2.4	0.9	-1.4
Oils and fats	-0.9	-0.2	-0.1	-0.5	-5.4	-1.3	0.6	-0.5	-0.7	4.6
Fresh and dried fruits	6.5	3.4	-1.7	3.1	1.8	4.6	-7.1	1.5	4.9	5.9
Vegetables	-0.3	-3.0	-14.7	9.7	-2.7	-7.6	-11.2	17.4	5.8	-5.5
Sugar and sweets	-2.1	-2.8	3.3	0.7	-2.3	-1.2	3.3	6.3	2.4	6.7
Spices	3.3	2.7	0.3	-0.5	-1.5	0.7	1.7	5.7	4.7	3.9
Non-alcoholic beverages	0.5	-0.6	1.9	0.3	-0.3	1.1	3.4	1.0	2.1	0.6
Non-Food	**-2.9**	**1.4**	**0.6**	**0.5**	**-3.2**	**-0.3**	**1.9**	**2.2**	**-0.2**	**1.0**
Tobacco	-0.2	2.2	-2.8	7.6	0.3	7.5	7.8	5.4	-0.2	-0.4
Clothing	1.2	1.9	-0.2	1.3	-0.1	1.1	4.3	3.2	1.1	0.3
Housing,	-10.3	-0.3	-0.1	1.1	-5.7	-2.8	0.0	1.9	-1.7	1.5
Furnishing and household goods	1.8	4.6	1.1	0.7	-1.5	1.7	2.4	3.0	2.3	1.0
Health	4.2	2.0	2.5	-0.4	3.4	1.8	2.0	1.9	3.4	1.1
Transportation	9.1	3.2	2.4	-3.5	-8.7	-0.2	4.9	1.1	-3.6	0.8
Communication	-0.1	-1.3	-1.3	-0.7	-1.4	0.1	-0.3	0.3	-0.3	1.7
Education	1.8	2.4	-0.2	-1.2	1.0	-2.2	-1.3	-2.6	-1.7	15.6
Information and Culture	5.5	-1.0	1.6	0.8	-0.2	1.5	2.9	1.9	0.1	0.2
Restaurants and Hotels	0.9	0.4	3.3	-1.5	0.0	2.3	-1.6	-1.0	1.0	-2.1
Miscellaneous	1.2	2.8	0.1	3.3	1.0	2.6	3.3	2.2	0.6	1.0

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

3.1.2 Developments in Kabul CPI

3.1.2.1 Annual Developments

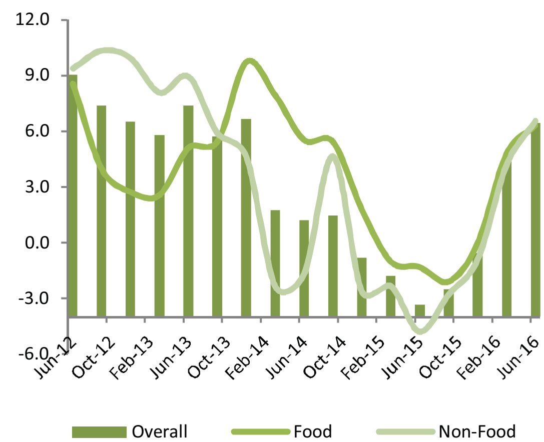
During the second quarter of 2016, the year over year changes in Kabul CPI also showed increasing trend. Headline inflation based on this index increased to 6.4 percent compared to a deflation rate of 3.3 percent recorded in the same quarter of the previous year. Both, food and non-food items of the CPI represented higher inflation rates. Food item rose to 6.3 percent from -1.3 percent, and non-food item increased to an inflation rate of 6.5 percent from a deflation rate of 4.8 percent.

In food item, inflationary effects came from higher price of bread and cereals (rising by -0.2 percent from -2.9 percent), meat price (12.1 percent from 1.1 percent), oils and fats (-4.7 percent from -7.7 percent), fresh and dried fruits (9.1 percent from 8.3 percent), and vegetables (3.2 percent from -1.2 percent). On the other hand, price of milk, cheese and eggs declined by 4.4 percent compared to 6.1 percent calculated in the second quarter of the previous year.

In non-food category, price increased for clothing, housing, electricity, water and gas, furnishing and household goods, and transportation. Price of clothing increased by 16.7 percent higher than 0.8 percent increase observed in the same quarter of previous year. Price of housing, electricity, water and gas rose by 1.7 percent from -8.8 percent. Furnishing and household goods showed a price increase of 15.4 percent from 3.9 percent. Transportation (which includes the fuel price) strengthened by 9.2 percent from -15.4 percent.

In a more specifically analyzing, during the second quarter of 2016, price changes in the Kabul CPI when measured by core measures also showed ascending trend over the one year horizon. One of the common methods of calculating core measure of inflation is trimmed mean (currently calculated by excluding 30% of the index), which rose to 8.5 percent from 1.2 percent. In addition, inflation based on the CPI excluding bread and cereals, oils and fats, and transportation increased to 8.5 percent from a deflation rate of 2.3 percent.

Figure 3.4. Kabul Headline CPI (Y-oY)



Source: Central Statistics Office/DAB staff calculation.

Table 3.3: Breakdown of Kabul Headline CPI

(Percent changes year-on-year)

(March 2011=100)

	Weight	1393				1394				1395	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**100.0**	**1.8**	**1.2**	**1.2**	**-1.1**	**-1.8**	**-3.3**	**-2.5**	**-0.6**	**4.4**	**6.4**
Food and beverages	**52.0**	**7.9**	**5.5**	**5.4**	**1.8**	**-1.0**	**-1.3**	**-2.1**	**0.0**	**4.8**	**6.3**
Bread and Cereals	17.7	7.7	4.8	6.6	3.0	-1.9	-2.9	-3.2	-0.7	1.1	-0.2
Meat	7.2	-1.4	-1.4	3.8	2.6	0.5	1.1	0.7	4.3	8.7	12.1
Milk, cheese and eggs	4.8	6.1	9.9	8.7	5.9	2.7	6.1	8.5	7.1	8.1	4.4
Oils and fats	4.0	-0.9	-3.1	-5.1	-5.5	-12.6	-7.7	-7.5	-5.5	-3.1	-4.7

Fresh and dried fruits	4.8	6.5	8.8	7.4	12.9	5.1	8.3	3.0	3.1	9.7	9.1
Vegetables	7.9	24.7	15.8	8.9	-5.6	-2.3	-10.2	-12.6	-1.5	-3.0	3.2
Sugar and sweets	2.9	-0.5	-6.9	-3.5	-5.1	-2.8	1.4	2.6	13.9	26.9	39.3
Spices	0.9	8.3	7.0	9.2	7.2	1.4	3.6	9.3	19.8	30.0	35.1
Non-alcoholic beverages	1.8	7.8	2.1	2.6	3.2	-0.8	3.0	5.3	9.5	11.6	13.6
Non-Food	**48.0**	**-2.4**	**-1.7**	**-1.6**	**-3.1**	**-2.3**	**-4.8**	**-2.8**	**-0.9**	**4.2**	**6.5**
Tobacco	0.4	11.2	13.3	11.5	15.5	12.9	9.1	22.6	20.1	20.8	17.1
Clothing	7.0	7.8	11.5	11.3	10.3	5.6	0.8	9.8	13.8	17.8	16.7
Housing, electricity, water and gas	20.7	-12.2	-13.2	-13.1	-13.4	-5.5	-8.8	-10.0	-9.6	-4.7	1.7
Furnishing and household goods	7.0	6.2	13.4	13.2	12.5	7.2	3.9	8.5	14.0	19.8	15.4
Health	3.3	7.8	7.3	8.7	4.1	4.1	3.5	0.2	0.3	1.7	0.9
Transportation	4.7	33.3	33.2	32.1	19.4	-14.7	-15.4	-7.4	-3.4	8.2	9.2
Communication	1.1	-0.8	-2.2	-4.0	-5.0	-5.7	-3.6	-1.6	-0.2	0.3	0.0
Education	0.7	-0.1	2.8	1.9	2.1	1.6	-3.8	-5.8	-7.3	-9.7	11.4
Information and Culture	0.1	14.0	14.6	19.1	18.3	1.8	5.6	6.8	9.8	11.7	8.1
Restaurants and Hotels	1.0	1.5	2.3	5.2	3.1	1.7	5.5	-0.6	0.0	2.2	-7.4
Miscellaneous	1.8	4.3	7.9	3.8	5.0	4.5	8.3	17.8	17.9	19.1	12.5
Core inflation (28% TM)		**5.3**	**5.7**	**6.2**	**4.4**	**0.7**	**1.2**	**1.9**	**4.7**	**8.4**	**8.5**
Core inflation (Headline excl. B&C, O&F and T)		**-1.3**	**-1.3**	**-3.8**	**-3.1**	**-1.0**	**-2.3**	**-1.7**	**-0.1**	**5.4**	**8.5**

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

** Afghanistan's Financial Year (December to January) began from 1391, therefore includes 3 quarters*

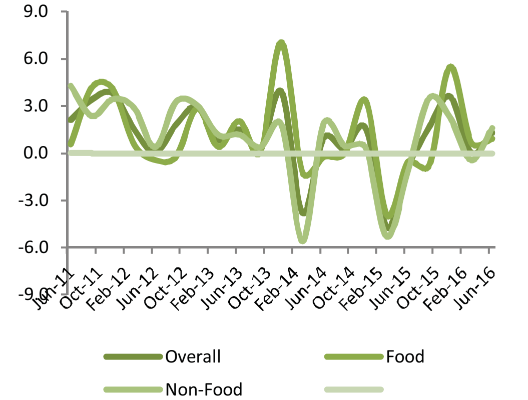
3.1.2.2 3.1.2.2Quarterly Developments, Kabul CPI

During the second quarter of 2016, Kabul CPI inflation based on quarter to quarter measure showed higher rate, which is supported by higher inflation in both, food and non-food items. Headline inflation during the review period increased to 1.3 percent from a zero inflation rate.

During the second quarter, inflation in food item surged up to 0.9 percent compared to 0.7 percent observed in the previous quarter. The reason behind higher inflation in this item is higher price of bread and cereals (increased by -0.3 percent from -5.8 percent), and oils and fats (rose by 2.2 percent from -7.7 percent). In this item, some components showed lower prices. The largest decrease in this category is seen in fresh and dried fruits (7.7 percent from 8.9 percent), and vegetables (-6.0 percent from 5.9 percent).

In non-food category, inflation increased to 1.6 percent from -0.4 percent. Inflationary effects in non-food category came from higher price of housing, electricity, water and gas and transportation. Prices of housing, electricity, water and gas increased by 3.1 percent in the second quarter of 2016 compared to 1.9 percent of decrease recorded in the previous quarter. In addition, price of transportation rose by 0.5 percent from -2.4 percent.

Figure 3.5: Kabul Headline CPI(Q-t-Q)



Source: Central Statistics Organization/ DAB staff calculation.

Table 3.4: Quarter-on-Quarter Changes in Kabul Headline CPI
(Percent changes quarter-on-quarter)
(March 2001=100)

	1393				1394				1395	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**-3.8**	**1.0**	**0.3**	**1.6**	**-4.7**	**-0.6**	**1.4**	**3.6**	**0.0**	**1.3**
Food and beverages	**-1.2**	**-0.2**	**0.0**	**3.3**	**-3.9**	**-0.5**	**-0.8**	**5.5**	**0.7**	**0.9**
Bread and Cereals	-2.8	2.0	5.1	-1.1	-7.4	1.0	4.8	1.4	-5.8	-0.3
Meat	-0.5	-2.5	4.4	1.3	-2.6	-1.9	3.9	4.9	1.5	1.2
Milk, cheese and eggs	2.0	-1.5	2.5	3.0	-1.1	1.7	4.7	1.6	-0.1	-1.8
Oils and fats	-2.6	-1.6	-0.8	-0.6	-9.9	3.9	-0.5	1.5	-7.7	2.2
Fresh and dried fruits	9.9	5.1	-4.5	2.3	2.3	8.3	-9.2	2.4	8.9	7.7
Vegetables	-6.6	-3.9	-11.0	18.2	-3.4	-11.7	-13.4	19.8	5.9	-6.0
Sugar and sweets	-5.2	-5.6	6.0	0.0	-3.0	-1.5	7.3	11.1	8.1	8.1
Spices	3.1	0.9	1.8	1.1	-2.4	3.2	7.4	10.8	5.8	7.2
Non-alcoholic beverages	2.0	-2.6	2.3	1.5	-2.0	1.2	4.6	5.5	-0.1	3.0
Non-Food	**-5.6**	**1.9**	**0.5**	**0.3**	**-5.3**	**-0.7**	**3.0**	**2.3**	**-0.4**	**1.6**
Tobacco	1.9	7.4	0.5	5.0	-0.4	3.8	12.9	2.8	0.2	0.7
Clothing	2.2	5.2	-0.1	2.6	-2.2	0.5	8.8	6.4	1.2	-0.4
Housing	-14.0	0.1	-0.1	0.6	-6.9	-3.4	-0.5	1.0	-1.9	3.1
Furnishing and household goods	1.4	8.2	1.3	1.3	-3.3	4.8	5.8	6.4	1.6	0.9
Health	1.6	0.8	3.7	-2.0	1.7	0.2	0.4	-2.0	3.1	-0.6
Transportation	21.9	0.5	1.7	-4.1	-12.9	-0.4	11.4	0.0	-2.4	0.5
Communication	-0.1	-2.1	-1.9	-1.0	-0.8	0.1	0.1	0.4	-0.3	-0.2
Education	1.0	2.0	0.1	-1.1	0.5	-3.3	-1.9	-2.8	-2.0	19.2
Information and Culture	14.0	-0.3	3.6	0.5	-1.9	3.4	4.8	3.2	-0.2	0.1
Restaurants and Hotels	1.5	0.8	2.9	-2.0	0.0	4.6	-3.1	-1.3	2.2	-5.2
Miscellaneous	0.4	3.2	-1.9	3.3	-0.1	7.0	6.8	3.4	0.9	1.0

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

**Afghanistan's financial year (Dec to January) began form 1391, therefore includes 3 quarters.*

II. NEAR TERM INFLATION OUTLOOK

Afghanistan's inflationary prospects for the next two quarters are likely to be optimistic. That is we do not predict significant rise/fall in the overall price level over the next six months. However, inflation for the end of the year is expected to increase slightly. There are some instances that should be factored in to defining inflationary expectations.

One of the main reasons of high inflation during the first six months of 2016 has been border problems (mostly seen in trade arena) with Pakistan. If these trade obstacles remain solid, we will see more inflationary effects on domestic price level. This is because the market will not be able to meet the demand in the short run.

Meanwhile, since the beginning of the second quarter, more than 200,000 thousand people have returned back from Pakistan and this trend is likely to continue by the end of the year. As these refugees are more likely to reside in the cities rather than their native villages, it may increase demand pressures, which can be another determinant of high inflation in the next two quarters.

3.2.1 Risks

Although the central bank expects slight increase in inflation, still there are some risks to predicting inflation for the next months. Security problems are thought to be one of the main risks to inflation over the next one quarter. If the security situation remains fragile (or even it worsens), the market will face huge shortage of supply (greater than a fall in demand), which can interpolate significant shocks to inflation. Meanwhile, based on the reports, there are signs of production freeze of oil in OPEC members, while the global demand is forecasted to increase. Therefore, spillovers from global price of oil on Afghanistan's inflation may be on atop if it continues to rise.

4

EXTERNAL SECTOR DEVELOPMENT

4

EXTERNAL SECTOR DEVELOPMENTS

This chapter captures highlights of some major developments in the external sector of the Afghan economy in the second quarter of the FY 1395 and compares them with the corresponding quarter of the preceding year.

I. BALANCE OF PAYMENTS

4.1.1 Current Account Balance

Available data showed that the deficit in the current account narrowed in the second quarter of the FY 1395 in comparison with the corresponding quarter of the FY 1394 (figure 4.1).

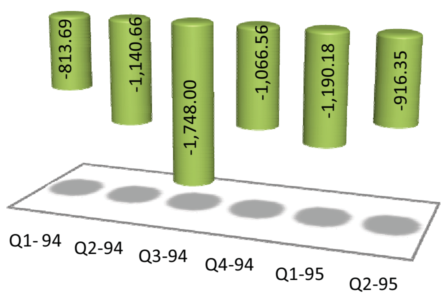
This development was attributed to lower imports of goods and services, increased surplus in the current transfer account, increased out-payment in the income account which was caused by lower investment income. Both aggregate exports and imports declined by 4 and 20 percent to USD 116.99 and USD 1,402.13 million respectively. The drop in imports shows a fall in domestic demand for foreign goods, mainly capital goods, industrial supplies, and fuel and lubricants. .

Also, the deficit in the services account narrowed to USD 148.62 million in the second quarter of the FY 1395 from USD 202.30 million recorded in the same quarter of the previous year. The decline in services account deficit could be mainly attributed to reduction in out-payments for transportation services which declined by 24 percent from USD 255.29 million in the second quarter of the FY 1394 to USD 193.86 million in the reporting quarter.

The income account of the balance of payments registered a deficit of USD 229.97 million in the period under review. The deficit in the income account appears to have been driven by out-payment of distributed profits to foreign investor.

Meanwhile, the surplus in the current transfers account increased by 17 percent compared to second quarter of the FY 1394. The contribution of worker remittance to current transfer surplus was particularly large as it increased by 150 percent. Increase of 15 percent in intergovernmental grants also positively contributed to current transfer surplus.

Figure 4.1: Balance of Payments Current Account (million USD)



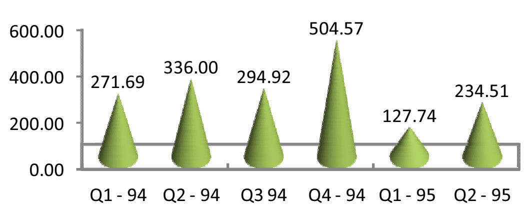
Source: *CSO/DAB staff calculations*

4.1.2 Capital Account

The capital account of the balance of payments illustrated a decline of 30 percent in the second quarter of the FY 1395 when compared to the same quarter of the FY 1394 (Table 4.1, Figure 4.2).

Net inflows to the capital account dropped to USD 234.51 million in the second quarter of the FY 1395 from USD 336 million recorded in second quarter of the previous year. The drop was largely fueled by the decline of USD 109.28 million in net capital transfers received by the government, corporations and households.

Figure 4.2: Capital Account



Source: *CSO/DAB staff calculations*

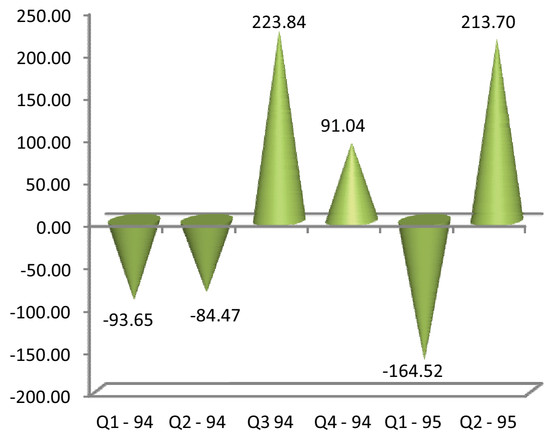
4.1.3 Financial Account

Financial account of the BOP turned from a net inflow of USD 84.47 million in the second quarter of the FY 1394 to a net outflow of USD 213.70 million recorded in the second quarter of the FY 1395 (Table 4.1 Figure 4.3). Further analysis reveals that the country's aggregate financial assets- claims by Afghans- was USD 91.08 million in the reviewed period compared with USD 20.39 million in the corresponding quarter of pervious year.

Further disaggregation of external financial assets revealed that foreign direct investment abroad decreased by 35 percent to USD 21.54 million in the FY 1395 compared to USD 33.18 million in FY 1394. Inward portfolio investment increased by 7 percent to USD 39.15 million in the second quarter of the FY 1395 in comparison with USD 36.55 million recorded in the similar quarter of the previous year.

Aggregate financial liabilities were recorded at USD 446.44 million in the second quarter of the FY 1395 compared with USD -12.98 million recorded in the same quarter of the previous year. Low financial inflows emanating from insecurity challenges were the main driver of the increase in aggregate liabilities.

Figure 4.3: Financial account



Source: CSO/DAB staff calculations

4.1.4 Merchandise Trade

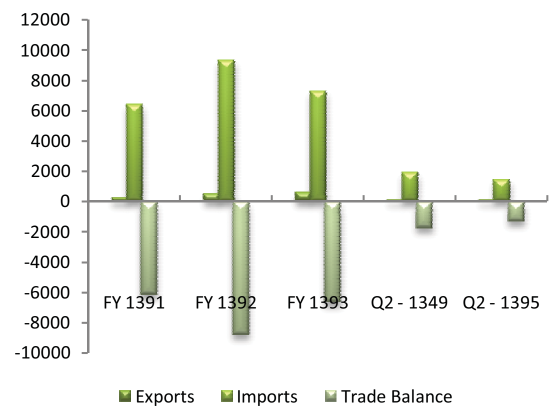
Based on quarter on quarter comparison, available data revealed that Afghanistan trade balance improved in the second quarter of the FY 1395 (Table 4.2, Figure 4.5) following by a significantly contraction in the imports of industrial supplies and capital goods.

Aggregate merchandise exports declined by 2 percent to USD 113.75 million in the second quarter of the FY 1395 from USD 116.22 million recorded in the second quarter of the FY 1394. The drop in medical seeds and carpets and rugs components accounted for decline in merchandise export.

Aggregate merchandise imports declined by 24 percent to USD 1464.49 million in the second quarter of the FY 1395 from USD 1915.84 million recorded in the second quarter of the FY 1394.

Consequently, trade deficit declined by 25 percent to USD 1350.74 million in the second quarter of the FY 1395 from USD 1799.62 million recorded in the same quarter of the previous year.

Figure. 4.4: Trade Performance and Trade Balance



Source: CSO/DAB staff calculations

II. DIRECTION OF TRADE

The main export destinations for Afghanistan are Pakistan, Iran, India, China, and Common Wealth of Independence States (CIS).

According to the merchandize trade statistics, during the second quarter of the FY 1395 Afghanistan's largest exports partner has been Pakistan. The share of Afghanistan's exports to Pakistan increased to 61.33 percent from 47.26percent.

In terms of value, exports to Pakistan grew by 27 percent to USD 69.76 million in the second quarter of the FY 1395 from USD 54.92 million in the second quarter of the FY 1394.

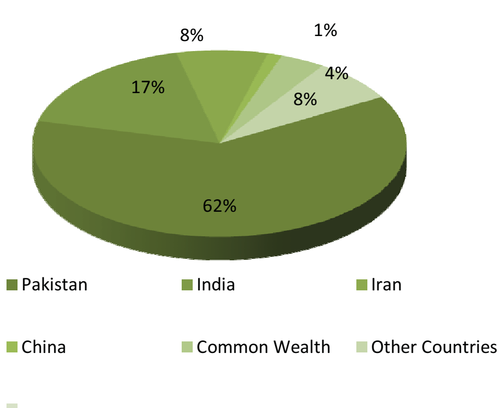
India graded the second largest buyer of Afghanistan's exports in the second quarter of the FY 1395. The share of exports to India increased to 17.16 percent from 13.51 percent recorded in the second quarter of the FY 1394.

In terms of value, exports to India also increased by 24 percent to USD 19.52 million in the second quarter of the FY 1395 from USD 15.70 million in the same quarter of the FY 1394.

Commonwealth of Independent State (CIS) countries ranked the third largest buyer of Afghanistan's exports. The share of Afghanistan's exports to CIS countries descended to 4 percent in the second quarter of the FY 1395 from 12 percent that was recorded in the corresponding quarter of the preceding year.

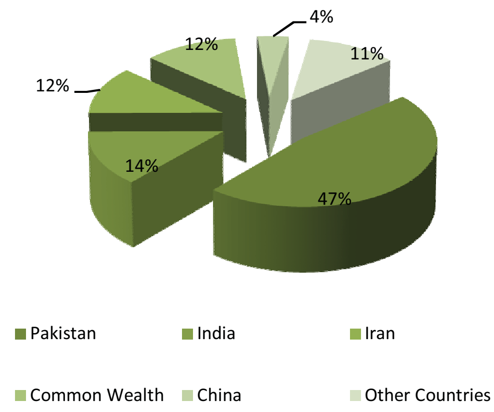
In terms of value Afghanistan's total exports to CIS countries declined significantly by 68 percent to USD 4.34 million in the second quarter of the FY 1395 compared to a USD 13.72 million recorded in the second quarter of the FY 1394.

Figure 4.5: Direction of Exports (% share) in the Q2 - FY 1395



Source: CSO/DAB staff calculations

Figure. 4.6: Direction of Exports (% share) in the Q2 - FY 1394



Source: CSO/DAB staff calculations

Pakistan remains the main origin for Afghanistan imports in the second quarter of the FY 1395. The share of imports from Pakistan in total imports increased from 24.61 percent in the second quarter of the FY 1394, to 29.368 percent in the reviewed quarter.

However, in terms of values the total imports from Pakistan also declined to USD 434.69 million in the second quarter of the FY 1395 from USD 471.42 million in the similar quarter of preceding year, registering 8 percent reduction.

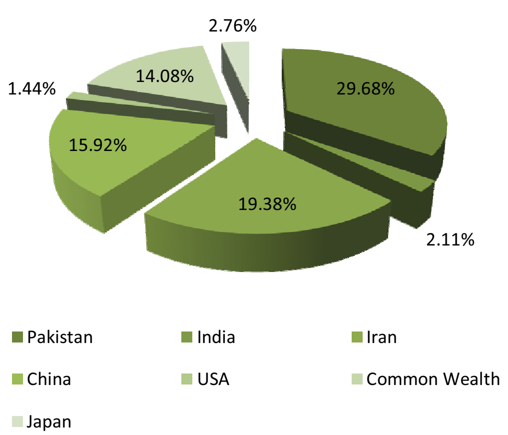
Iran counted the second largest origin for Afghanistan imports in the second quarter of the FY 1395. Total Imports from Iran decreased to USD 283.86 million with share of 19.38 percent in the second quarter of the FY 1395 from USD 453.73 million with share of 23.68 percent in the second quarter of the FY 1394, registering a decline of 37 percent.

China was the third largest import origin to Afghanistan in the second quarter of the FY 1395. Total Imports from China decreased to USD 233.18 million with share of 15.92 percent from USD 253.95 million with share of 13.26 percent, recording a decrease of 8 percent...

CIS countries were the fourth largest imports origin of Afghanistan during the second quarter of the FY 1395. Total Imports from CIS countries decreased by 38 percent from USD 333.65 million with share of 17.42 percent in the second quarter of the FY 1394 to USD 206.23 million with share of 14 percent in the reporting quarter.

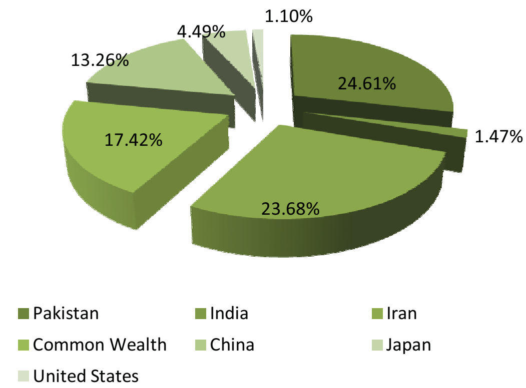
Japan, India and USA were the fifth, sixth and seventh largest import source of Afghanistan, accountable for 2.76 percent, 2.11 percent and 1.44 percent of total imports respectively.

Figure 4.7: Direction of Imports (% share) in the Q2 - FY 1395



Source: CSO and DAB staff calculations

Figure 4.8: Direction of Imports (%share) in the Q2 - FY 1394



Source: CSO/DAB staff calculations

III. COMPOSITION OF TRADE

4.3.1. Composition of Imports

The composition of imports in the second quarter of the FY 1395 indicates that;

- ✓ Imports of Capital goods had the largest share of 43.5 percent in the basket of imports. But in terms of value imports of such goods considerably declined by 33 percent to USD 636.81 million in the second quarter of the FY 1395 from USD 956.24 million recorded in the same quarter of the previous year.
- ✓ The second largest share recorded for consumer goods in the basket of imports during the second quarter of the FY 1395, the share of such goods raised from 19.9 to 27.8 percent in the reporting quarter. In terms of value imports of consumer goods

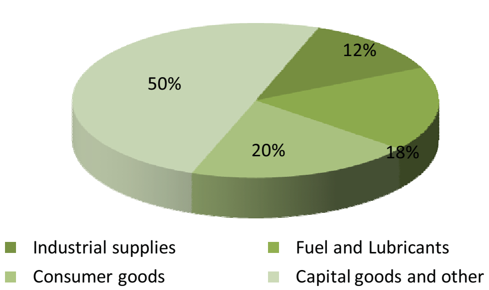
increased by 7 percent to USD 407 million in the second quarter of the FY 1395 from USD 381.21 million recorded in the second quarter of the FY 1394.

- ✓ Imports of fuel and lubricants (petroleum oil) had the third largest share in the basket of Afghanistan's imports. Second quarter of fiscal year 1395 saw a slight 0.9 percent in imports of fuels and lubricants... In terms of value, imports of such goods in total imports decreased by 19 percent to USD 274.47 million in the second quarter of the FY 1395 from USD 340.15 million in the second quarter of the FY 1394.
- ✓ Industrial supplies had the smallest share in the basket of Afghanistan's imports during the reporting quarter, declined to 10 percent from 12.4 percent recorded in the second quarter of the FY 1394.

  In terms of value imports of industrial supplies also declined significantly by 39 percent, to USD 146.16 million in the second quarter of the FY 1395 from USD 238.24 million in the second quarter of the FY 1394.

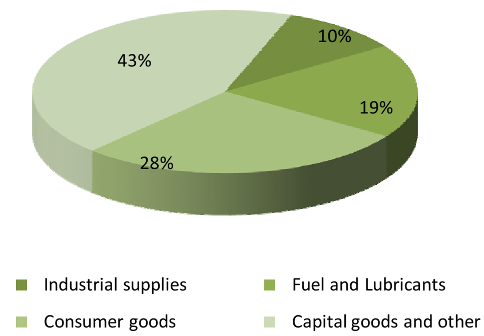
(Table 4.3- 4.4 and Figure 4.9 - 4.10).

Figure 4.9: Composition of Imports (share%) in the Q2 - FY 1394



Source: CSO and DAB staff calculations

Figure 4.10: Composition of Imports (share%) in the Q2 - FY 1395



Source: CSO and DAB staff calculations

4.3.2. Composition of exports

The composition of exports in the second quarter of the FY 1395 reveals that;

- ✓ Exports of food item had the largest share in the basket of Afghanistan's exports which is increased to 40 percent in the reporting quarter from 33 percent recorded in the corresponding quarter of the FY 1394.

  Earnings from exports of food items (oil seeds, fresh and dry fruits) increased by 19 percent to USD 45.66 million in the second quarter of the FY 1395 from USD 38.50 million.
- ✓ The second largest share in total exports was recorded for medical seeds, even though its share decreased to 25.5 percent in the second quarter of the FY 1395 from 39.9 percent recorded in the corresponding quarter of the last year. But in term of value exports of medical seeds declined considerably by 37 percent to USD 28.98 million in the second quarter of the FY 1395

from USD 46.36 million recorded in the second quarter of the FY 1394.

- ✓ Carpets and rugs which are considered the main component of Afghanistan's exports in the past decades had the third largest share in total exports. Its share remained almost unchanged (20 percent) in the second quarter of the FY 1 395.

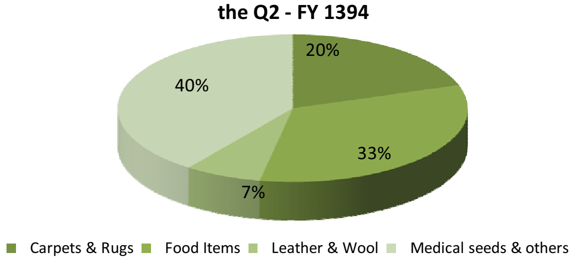
  Earnings from exports of carpet and rugs declined by 2 percent to USD 22.72 million during the quarter under review from USD 23.13 million that was recorded in the same quarter of the previous year.

- ✓ The share of leather and wool was smallest in the basket of Afghanistan's exports. In the second quarter of fiscal year 1395 its share increased from 7 percent to 14.4 percent during the quarter under review.

  Earnings from exports of leather almost doubled to 16.39 million in the second quarter of the FY 1395 from USD 8.23 million recorded in the similar quarter of the last year.

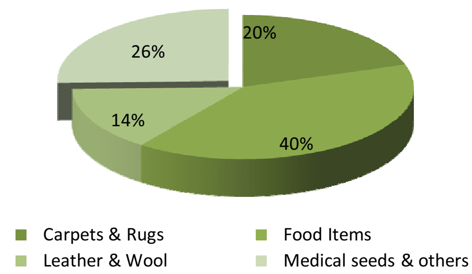
(Figure 4.11 and 4.12) indicated composition of exports in the Q2 FY 1394 with Q2 FY 1395.

Figure 4.11: Composition of Exports (share%) in the Q2 - FY 1394



Source: *CSO and DAB staff calculations*

Figure 4.12: Composition of Exports (share%) in the Q2 - FY 1394



Source: *CSO and DAB staff calculations*

IV. EXTERNAL DEBT

As shown in table 4.5 and figure 4.13 Afghanistan's total external debt increased by almost 6 percent to USD 2,417.94 million in the second quarter of the FY 1395 in comparison with USD 2,281.30 million in the same quarter of the FY 1394, increasing by USD 136.64 million . The increased in total external debt could be attributed to long-term components, like the external commercial loan payment, boosting NIR deposits and Special Drawing Rights (SDR) allocated by the International Monetary Fund (IMF).

During the period under review, Afghanistan made principle repayments to the International Development Association (World Bank), Asian Development Bank, International Monetary Fund (IMF), and Bulgaria, while service charges were paid to the World Bank and Asian Development Bank.

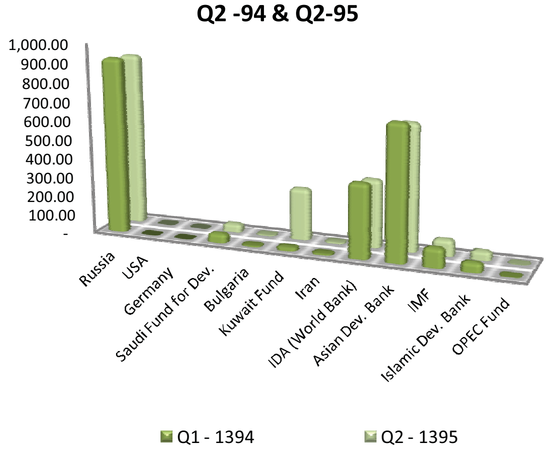
Meanwhile, World Bank, major multilateral creditor to Afghanistan, made some debt forgiveness on principle and services charge during the quarter under review.

Furthermore, total debt from Non-Paris Club members (Saudi Fund for Development, Bulgaria, Kuwait fund and Iran) increased to USD 338.41 million in the second quarter of the FY 1395.

The total loan amounts payable to the Paris Club creditors in the second quarter of the FY 1395 stood at USD 908.41 million (37 percent of the total current external debt) which is payable to Russian federation. It is worth mentioning that the debt from Paris club has decrease by 2 percent in the second quarter of FY1395 compared to corresponding quarter of the previous year.

On the other hand, total debt from multilateral creditors to Afghanistan decreased by 7 percent to USD 1,171.30 million from USD 1,264.98 million, USD 44.3 million reductions in the total debt during the reporting quarter.

Figure 4.13: External Debt Comparisons; Q2 -94 & Q2-95



Source: CSO and DAB staff calculations

V. NET INTERNATIONAL RESERVES

According to the available data, Net International Reserves (NIR) decreased slightly by 2 percent, standing at USD 6,711.72 million in the second quarter of the FY 1395, down from USD 6,831.43 million recorded in the corresponding quarter of the previous year (Table 4.7 and Figure 4.14).

The decrease in the level of NIR was mainly due to the decline in the reserve assets, which narrowed by 1 percent to USD 7,281.65 million in the second quarter of the FY 1395 from USD 7,345.96 million in the corresponding quarter of previous year.

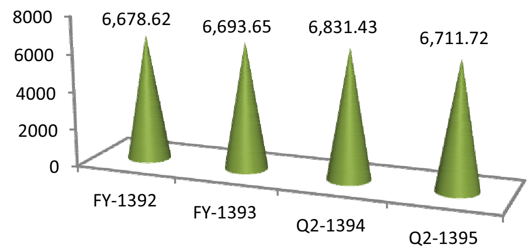
Reserve liabilities increased by 11 percent to USD 569.93 million in the second quarter of the FY 1395 from USD 514.53 million recorded in the second quarter of the FY 1394; this demonstrates that the reserve assets are higher than the reserve liabilities. The increase in reserve liabilities is mainly attributed to the increase in commercial bank deposits in foreign currency which increased by almost 19.28 percent to USD 494.22 million in the second quarter of the FY 1395 from USD 414.35 million recorded in the same quarter of the previous year.

The use of Found Resources decreased by almost 24.46 percent to USD 75.58 million in the second quarter of the FY 1395 from USD 100 million in the preceding and corresponding quarter of the FY 1394.

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

Currently, Net International Reserves (NIR) on average supports almost 14 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

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



Source: CSO and DAB staff calculations

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

Items / Years	Q1- 1394	Q2-1394	Q3-1394	Q4-1394	Q1-1395	Q2-1395
Current Account	-813.69	-1140.66	-1748.00	-1066.56	-1190.18	-916.35
Credit	1244.51	1054.27	990.80	812.58	793.04	1108.66
Debit	-2058.20	-2194.93	-2738.80	-1879.14	-1983.22	-2025.01
Goods Account	-1500.51	-1625.15	-2042.63	-1288.93	-1482.22	-1285.14
Credit	128.89	121.96	162.90	166.24	133.92	116.99
Debit	-1629.41	-1747.10	-2205.53	-1455.17	-1616.14	-1402.13
Services Account	-102.30	-202.30	-200.80	-224.01	-184.31	-148.62
Credit	264.48	190.39	279.20	133.31	131.54	147.93
Debit	-366.78	-392.69	-480.00	-357.33	-315.85	-296.55
Income Account	72.71	48.19	37.34	21.72	-6.82	-229.97
Credit	107.12	68.88	63.58	47.40	14.08	37.74
Debit	-34.41	-20.69	-26.24	-25.68	-20.89	-267.71
Current transfers	716.42	638.59	458.09	424.66	483.17	747.38
Credit	744.02	673.04	485.12	465.63	513.51	806.01
Debit	-27.60	-34.45	-27.03	-40.96	-30.34	-58.63
Capital and financial account	178.04	251.52	518.76	595.60	-36.77	448.21
Capital account	271.69	336.00	294.92	504.57	127.74	234.51
Credit	279.25	349.52	305.29	504.97	130.65	237.36
Debit	-7.56	-13.52	-10.38	-0.41	-2.91	-2.85
Capital transfers	278.32	346.64	304.25	504.57	130.65	237.36
Credit	279.24	349.19	305.24	504.97	130.65	237.36
Debit	-0.93	-2.55	-0.99	-0.41	0.00	0.00
Financial account	-93.65	-84.47	223.84	91.04	-164.52	213.70
Direct investment	17.80	33.18	77.98	40.20	17.74	21.54
Portfolio investment	-14.82	-36.55	-15.83	-14.31	-18.47	-39.15
Assets	-14.82	-36.55	-15.83	-14.31	-18.47	-39.15
Liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Other investment	43.74	-33.37	-80.79	-0.37	-63.70	537.52
Assets	53.87	-20.39	-97.22	-0.38	-87.19	91.08
Liabilities	-10.13	-12.98	16.44	0.01	23.49	446.44
Reserve Assets	-140.36	-47.73	242.48	65.52	-100.09	-306.21
Net errors and omissions	-635.65	-889.13	-1229.24	-470.95	-1226.95	-468.14

Source: CSO and DAB staff calculations

Table 4.2:Merchandise Trade in (Million USD)

Years	FY 1391		FY 1392		FY 1393		Q2 - 1349		Q2 - 1395	
	Total	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*
Imports	6,419.67	100%	9,339.60	100%	7,294.63	100%	1,915.84	100%	1,464.49	100%
Industrial supplies	969.88	15.1%	1,272.14	13.6%	863.19	11.8%	238.24	12.4%	146.16	10.0%
Fuel and Lubricants	1,083.65	16.9%	2,167.37	23.2%	1155.94	15.8%	340.15	17.8%	274.47	18.7%
Consumer goods	1,255.48	19.6%	1,942.85	20.8%	2345.86	32.2%	381.21	19.9%	407.05	27.8%
Capital goods and other	3,110.66	48.5%	3,957.24	42.4%	2,930	40.2%	956.24	49.9%	636.81	43.5%
Exports	261.63	100%	499.81	100.0%	620.88	100%	116.22	100%	113.75	100%
Carpets & Rugs	8.43	3%	85.49	17.1%	87.0	14.0%	23.13	19.9%	22.72	20.0%
Food Items	104.23	40%	175.92	35.2%	272.13	43.8%	38.50	33.1%	45.66	40.1%
Leather & Wool	26.82	10%	59.54	11.9%	49.35	7.9%	8.23	7.1%	16.39	14.4%
Medical seeds & others	122.15	47%	178.86	35.8%	212.36	34.2%	46.36	39.9%	28.98	25.5%
Trade Balance	-6,158.04		-8,839.79		-6,673.75		-1,799.62		-1,350.74	
Trade Balance as % of GDP	-31%		-43%		-31%		-8%			

Source: Monetary Policy Department/DAB

Table 4.3: Direction of External Trade: for the second quarter of the FY 1395 in (Million USD)

	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	69.76	61.33%	434.69	29.68%	-364.93
India	19.52	17.16%	30.91	2.11%	-11.39
Iran	8.80	7.74%	283.86	19.38%	-275.06
Germany	0.93	0.82%	3.86	0.26%	-2.93
China	1.40	1.23%	233.18	15.92%	-231.78
England		0.00%	1.54	0.11%	-1.54
Saudi Arabia	0.69	0.61%		0.00%	0.69
USA		0.00%	21.06	1.44%	-21.06
Common Wealth of Independence States (CIS)	4.34	3.82%	206.23	14.08%	-201.89
Japan		0.00%	40.44	2.76%	-40.44
Other Countries	8.31	7.31%	208.72	14.25%	-200.41
Total	113.75	100%	1,464.49	100%	(1,350.74)

Source: Monetary Policy Department/DAB

Table 4.4: Direction of External Trade: for the second quarter of the FY 1394 in (Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	54.92	47.26%	471.42	24.61%	-416.50
India	15.70	13.51%	28.20	1.47%	-12.50
Iran	13.64	11.74%	453.73	23.68%	-440.09
Germany	0.35	0.30%	9.28	0.48%	-8.93
Common Wealth	13.72	11.81%	333.65	17.42%	-319.93
China	4.52	3.89%	253.95	13.26%	-249.43
Saudi Arabia	0.13	0.11%		0.00%	0.13
Japan		0.00%	85.95	4.49%	-85.95
England		0.00%	1.34	0.07%	-1.34
United States		0.00%	21.17	1.10%	-21.17
Other Countries	13.24	11.39%	257.15	13.42%	-243.91
Total	**116.22**	**100.00%**	**1915.84**	**100.00%**	**-1799.62**

Source: *Central Statistics Organization and DAB staff calculations*

Table 4.5: External Debt: for the second quarter of the FY 1394 (in units indicated)

	In million USD	Percent of total
Total external debt	2,417.94	100.00
Bilateral	1,246.65	51.56
Paris Club	908.41	37.57
Russian Federation	908.41	37.57
United States	-	0.00
Germany	-	0.00
Non-Paris Club	338.24	13.99
Multilateral	1,171.30	48.44
of which: IDA (World Bank)	360.95	14.93
Asian Development Bank	670.78	27.74
International Monetary Fund	88.33	3.65
Islamic Development Bank	49.44	2.04
OPEC Fund	1.80	0.07

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

Table 4. 6: Net International Reserves; in the second quarter of the FY 1394 (millions of US dollars)

Changes in the previous quarter	FY-1392	% change	FY-1393	% change	Q2 - 1394	% change	Q2 - 1395	% change
Net International Reserves (million USD)	6,678.62	23.22	6,693.65	0.22	6,831.43	2.06	6,711.72	-1.75
Reserve Assets	7,183.33	22.71	7,247.76	0.90	7,345.96	1.35	7,281.65	-0.88
Reserve Liabilities	504.71	10.91	554.12	9.79	514.53	-7.14	569.93	10.77
Commercial bank deposits in foreign currency	367.65	4.00	443.80	20.71	414.35	-6.64	494.22	19.28
Non-resident deposits in foreign currency	0.14	-89.57	0.14	-0.02	0.14	0.00	0.14	-0.03
Use of Fund resources	136.92	17.53	110.18	-19.53	100.05	-9.20	75.58	-24.46
Gross Intl. Reserves (in months of import)	9.23		11.92		46.01		59.67	
Net Intl. Reserves (in months of import)	8.58		11		11		14	

Source: *Monetary Policy Department/DAB*

5

FISCAL SECTOR DEVELOPMENT

5

FISCAL DEVELOPMENTS

During the second quarter of FY 2016, the overall performance in the public sector was desirable, especially in revenue collection by the government.

However, Afghanistan's public expenditure remained unbalanced during the second quarter FY 2016, owing to continued deterioration in security conditions which undermined private investment, delayed budget execution, and caused capital flight. In addition, one of the main reasons was the prolonged process of procurement, tardy reporting by the government entities and businesses. These factors coupled with pick-ups in operating expenditure posed serious challenges for the government to achieve fiscal sustainability.

I. BUDGET EXECUTION RATE

During the first half of the FY 2016, government's total execution rate was 29 percent of the allocated budget showing a similar performance compared with the same period of the previous year. The execution rate of current (operating) budget was 36 percent comparing over the first half of 2016 showing an improvement of 3 percentage points compared to the recorded 33 percent of the same period of the FY 2015. Meanwhile, execution rate of development budget was only 17 percent, compared to 20 percent of execution rate at the end of same quarter last year.

The lower execution rate of the core budget was attributed to several factors, and most importantly to suspension of budget approval, deterioration in security condition in provinces and reduction in donors' funds.

II. BUDGET DEFICIT

The overall budget, prior to donor's contribution, had a deficit of Af 36.81 billion in the second quarter of FY 2016. While, including donor grants budget presented a surplus of Af 29.17 Billion.

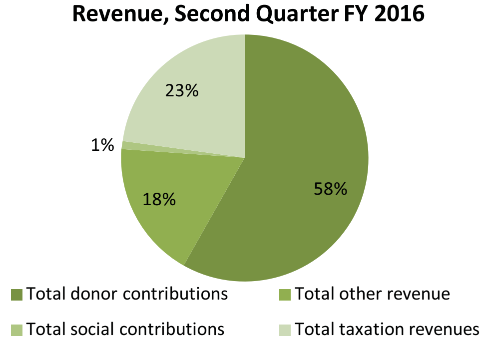
III. REVENUE COLLECTION

Domestic revenue collected in the second quarter of FY 2016 indicates a significant increase of 69 percent catapulting the total collection to Af 47.75 billion, higher compared to Af 28.25 billion of collected revenue in FY 2015.

Moreover, during the first six months of FY 2016 total domestic revenue collection stood at Af 66.58 billion, up from Af 48.78 billion, presenting 36 percent of increase, compared to the same period previous year.

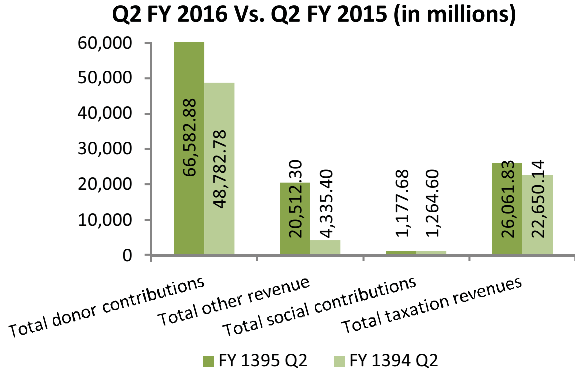
The positive momentum gained in the second quarter was result of reforms undertaken in the revenue collection system and in customs and revenue administration.

Figure 5.1: Composition of Total Revenue, Second Quarter FY 2016



Source: Ministry of Finance/MPD calculation

Figure 5.2: Comparison of Total Revenue Q2 FY 2016 Vs. Q2 FY 2015 (in millions)



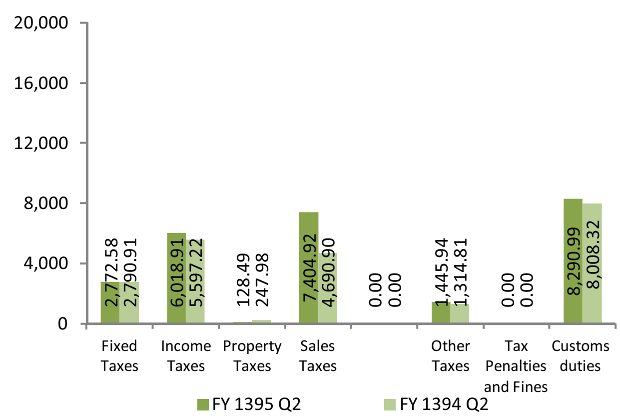
Source: Ministry of Finance/MPD calculation

5.3.1 Tax Revenue

Total tax collections showed growth for the quarter under review, in accordance to receipts, overall tax revenue increased from Af 14.64 billion to Af 17.77, compared to the same quarter of the FY 2015, which represents a significant increment of 21 percent or Af 3.13 billion.

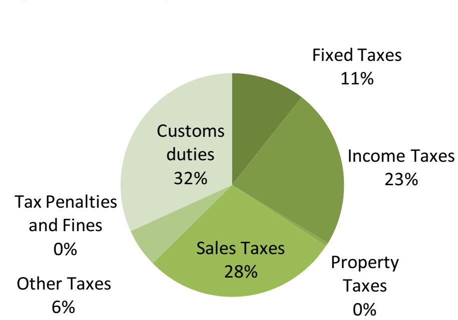
Similarly, total tax collection from the custom duties presented 4 percent increase, plummeting from a total of Af 8.01 billion to Af 8.29 billion in FY 2015.

Figure 5.3:Comparison of Tax Revenue



Source: Ministry of Finance/MPD calculation

Figure 5.4: Composition of Tax Revenue



Source: Ministry of Finance/MPD calculation

5.3.2 Non-tax Revenues

The main contributor in domestic revenues was non-tax revenues which presented a significant increase of Af 16.09 billion reaching Af 20.51 billion, compared to Af 4.34 billion over same quarter of the previous year. The momentous increase was mainly due to high performance in administrative fee, sales of goods and services and royalties.

On the other hand, Extractive industry, miscellaneous revenue and income from capital property the major components of the non-tax revenue, under-performed compared to the second quarter of FY 2015.

Social contribution that constitutes only 2 percent of the total domestic revenue presented a decline of 7 percent. The total amount collected were Af 1.18 billion, down from Af 1.26 billion in FY 2015.

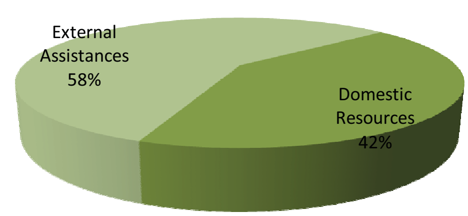
IV. GRANTS

Afghan government receives grants from various donors and international committees to finance varieties of programs in both operating and development expenditures. Integrated grants increased in FY 2016, compared to FY 2015.

Total development and operating grants in the second quarter of FY 2016 amounted to Af 66.58 billion up from Af 48.78 billion in FY 2015, screening a significant increase of 36 percent. Nonetheless, grants received under the ARTF program over the second quarter of FY 2016 was AF 22.06 billion that represents 82 percent increase over the same period of the previous FY 2015. On the contrary, grants received from LOTFA scheme decreased to Af 6.56 billion in the quarter under review compared to Af 7.21 billion in the same quarter FY 2015, witnessing a slight decrease of 9 percent.

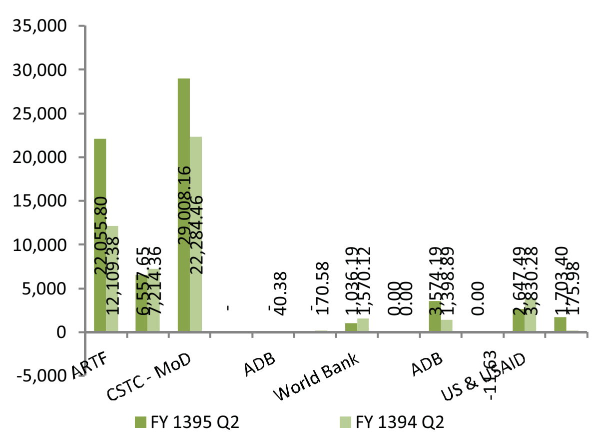
Domestic revenue could finance 42 percent of the total core budget and 58 percent is financed through external grants.

Figure 5.5: Financing Sources of National Budget Quarter 2, FY 1395



Source: Ministry of Finance/MPD calculation

Figure 5.6: Comparison of Donors Contribution



Source: Ministry of Finance/MPD calculation

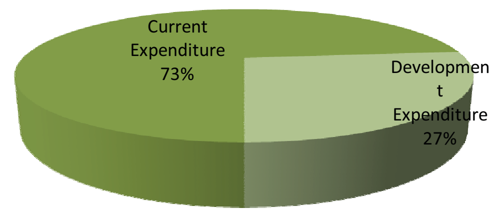
V. EXPENDITURE

Total expenditure for the quarter under review were AF 84.57 billion that indicates the increase of 3 percent over the total spending of AF 82.19 billion in the same period of previous year.

The current expenditure increased to Af 62.06 billion during the second quarter of FY 2016, rose from Af 57.16 billion showing 9 percent supplement.

On the contrary, development expenditure deflated to Af 22.50 billion from sum of Af 25.03 billion, indicating a considerable drop of 10 percent.

Figure 5.7: Composition of Total Government Expenditure Quarter 2, FY 1395



Source: Ministry of Finance/MPD calculation

6

BANKING SYSTEM PERFORMANCE

6

BANKING SYSTEM PERFORMANCE

Asset base of the banking sector increased by 2.51 percent or AF 6.76 billion during the quarter under review compared to 0.55 percent decrease in the previous quarter ending Mar, 2016. The increase in banking system assets was mainly due to increase in deposit base.

Gross loans portfolio of the banking sector witnessed growth of 2.97 percent or AF 1.34 billion over the last quarter against 0.64 percent decline in Mar, 2016. The increase in the loan portfolio over the quarter is mainly attributed to issuance of new loans and more customer utilization of OD loans.

Deposits, the main funding source in the banking sector, stood at AF 238.23 billion, comprising 96.01 percent of the total liabilities of the sector. The increase in deposits was around 3.06 percent against 2.47 percent decrease in the previous quarter (Mar, 2016). The increase in total deposit base (in AF currency) of the banking sector is attributed to increase in demand deposits. Deposits were largely denominated in USD (66.18 percent) with Afghani denominated deposits lagging at 28.89 percent. AF-denominated deposits indicated increase of 14.88 percent against 9.27 percent decrease in Mar, 2016, while USD denominated deposits was down by 1.66 percent against 0.38 percent decrease in Mar, 2016.

The capital base of the banking sector remained strong and increased by 0.52 percent standing at AF 27.78 billion. The increase in total financial capital over the last quarter is attributed to profits during the quarter.

Capital adequacy ratio (CAR) of the banking sector recorded at 20.64 percent. All the banking institutions are above the set limits for CAR, but one banking institution is very close to the limit, and one bank ratio is negative.

Banking sector earned net profits amounting to AFs 384 million for the review quarter, against AFs 2.99 billion net profit in the previous quarter. The decrease resulted in

2.48 percent annualized Return on Assets (ROA) against 4.43 percent annualized in Mar, 2016 and 24.70 percent Return on Equity annualized (ROE) against 44.53 percent annualized in Mar, 2016. The decrease in profitability of the banking sector is mostly ascribed to significant decrease in non-interest income attributed to one of the state-owned banks which had significant gains from the revaluation of investment properties in previous quarter. State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profits during the quarter under analysis.

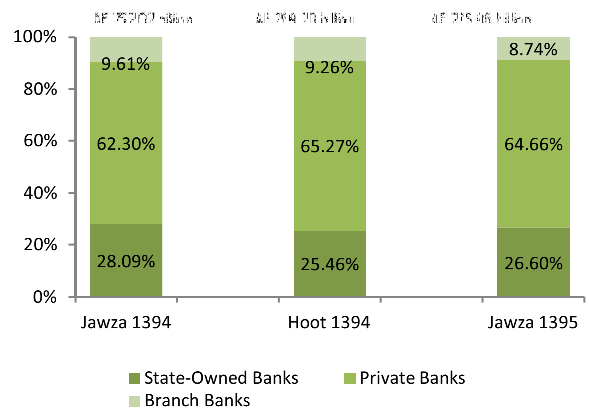
I. ASSETS OF THE BANKING SYSTEM

The assets size of the banking sector increased by 2.51 percent in the quarter under analysis against 0.55 percent decline in Mar, 2016. See figure 6.1.

The breakup of total assets reveals that the most obvious increase was registered in cash in vault and claims on DAB. The total assets increased by AF 9.97 billion (9.50 percent) followed by AF 2.67 billion (13.45 percent) increase in investment and AF 1.34 billion (2.97 percent) in gross loan. While interbank claims and Intangible assets decreased by AF 6.97 billion (8.44 percent) and AF 40 million (6.95 percent) respectively during the review quarter.

The most important components of the system's total asset portfolio were: cash in vault/claims on DAB (41.64 percent), interbank claims (27.48 percent), net loans (15.02 percent), investments (8.15 Percent), "other assets" (4.98 percent) and fixed assets make 2.54 percent of the total assets. See table 6.1

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



Source: *Financial Supervision Department/ DAB*

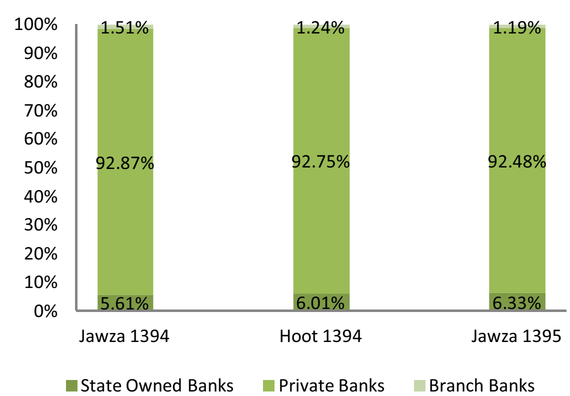
Table 6.1: Composition of Assets and Liabilities

Amount in million AF	Hoot, 1394 Mar, 2016	Jawza, 1395 2016	Jun,	% of Total Assets/Liability	Q-o-Q Growth
Assets					
Cash in vault and claims on DAB	104,946	114,913	41.64	9.50	104,946
Interbank claims	82,817	75,827	27.48	-8.44	82,817
Investments	19,818	22,483	8.15	13.45	19,818
Loans (Net)	40,486	41,443	15.02	2.36	40,486
	575	535	0.19	-6.95	575
Fixed Assets	6,897	7,022	2.54	1.81	6,897
Others	13,666	13,744	4.98	0.57	13,666
Total	269,205	275,967		2.51	269,205
Liabilities					
Deposits	231,156	238,228	95.99	3.06	231,156
Borrowings	3,694	3,745	1.51	1.38	3,694
Other	6,672	6,211	2.50	-6.91	6,672
Total	241,566	248,184		2.74	241,566
Financial Capital					

Source: *Financial Supervision Department, DAB*

6.1.1 Gross Loans

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



Source: *Financial Supervision Department, DAB*

Total gross loans indicated AF 1.34 billion or 2.97 percent growth since previous quarter, constituting 16.84 percent of the total assets. The increase in total loan portfolio is mainly attributed to issuance of new loans and customer utilization of OD (Overdraft loans).

Increases in loan portfolio were observed at nine banking institutions, whereas five banking institutions showed a decrease in their loan portfolio. While the remaining one bank (NKB) did not participate in lending.

Gross loan portfolio showed an increase in private banks and state-owned banks groups while it indicated a decrease in the branches of foreign banks. Private Banks with 92.48 percent share in total portfolio posted 2.68 percent or AF 1.12 billion increase, state-owned banks with 6.33 percent share depicted 8.42 percent or AF 228 million increases, and branches of foreign banks holding 1.19 percent of the portfolio declined by 1.24 percent or AF 7 million during the quarter under review

6.1.2Loan Loss Reserves

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk mitigation framework. Banks are required to make both general reserves (on standard assets) and specific provisions (on non-standard assets) in order to mitigate their credit risk.

By the end of June, 2016 (Jawza 1395), total provision cover of the system was 10.80 percent of total gross loans as opposed to 10.27 percent recorded in the previous year, end of Mar, 2016.

6.1.3 Distribution of Credit

In order to expand the loan portfolio and broaden the risk diversification and financial access besides new avenues of earning, DAB has diversified the sector wide distribution of Other Commercial Loans to thirty sectors. The analysis of deployment of credit in different sectors indicate that the major portion of the loan portfolio is classified as “other commercial loans” (92.81 percent against 92.83 percent in Mar, 2016), mainly in “Petroleum and lubricants” (10.66 percent), “Construction and building” (8.79 percent) “all other services” (8.49 percent), “Retail Trading” (7.93 percent), and “Food Items” (7.67 percent). Significant Increases were observed in retail trading and in all other services sectors both in absolute amount and percentage of total gross loans, while wholesale, Health and Hygienic were among top decreasing sectors. Loans designated to micro credit sector posted an increase of AF 214 million which is currently AF 3.68 billion provided by one bank. While SME sector decreased by AF 90 million which is currently are AF 2.07 billion provided by four banking institutions. Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises associated to that sector. This will inversely affect the overall banking sectors, banks should closely monitor the potential risks associated with key sectors given the high NPL ratio. About 77.08 percent of the loans were designated in Kabul while Herat and Balkh provinces in the second and third places and Badghis and Kandahar provinces are at fourth and fifth places respectively. The proportion of loans in other provinces was negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that with time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

Table 6.2: Sectoral Distribution of Credit

	Hoot, 1388 (Mar, 2010)	Hoot, 1389 (Mar, 2011)	Hoot, 1390 (Mar, 2012)	Qaws, 1391 (Dec, 2012)	Qaws, 1392 (Dec, 2013)	Qaws, 1393 (Dec, 2014)	Qaws, 1394 (Dec, 2015)	Jawza, 1395 (Jun, 2016)
Commercial Real Estate and Construction Loans	19.92	25.98	2.85	2.29	2.02%	1.80%	1.90%	1.76%
Other Commercial Loans	-	-	-	-	-			
Mining	-	0.02	0.72	0.11	0.07%			
Manufacturing	1.22	2.72	13.32	11.88	9.36%			
Trade	32.29	34.16	27.84	28.3	29.81%			
Communication	1.04	1.23	0.94	2.35	3.70%			
Service	4.84	6.72	11.95	15.94	22.11%			
Utilities	2.47	0.03	0.3	0.07	0.05%			
Agricultural Loans						0.27%	0.33%	0.30%
Livestock and Farms						0%	0.03%	0.04%
Manufacturing and Industry(product of metal, wood, plastic, rubber)						2%	4.42%	4.05%
Manufacturing, Handmade and Machine products						4%	4.24%	4.00%
Cement and Construction Materials						3%	1.96%	1.79%
Textile						2.59%	0.52%	0.65%
Power						0.35%	0.22%	0.51%
Construction and Building						12.52%	7.54%	8.79%
Services						4.79%	3.80%	3.20%
Hotel and Restaurant						1.20%	1.46%	1.47%
Telecommunication						2.92%	5.70%	6.07%
Ground Transportation						4.87%	5.31%	5.15%
Air Transportation						4.18%	2.66%	3.59%
Health and Hygienic						0.71%	1.16%	1.20%
Median, Advertisements and Printer						0.04%	0.04%	0.03%
All Other Services						1.41%	7.56%	8.49%
Wholesales						4.93%	9.89%	4.16%
Machineries						0.12%	0.25%	0.35%
Petroleum and Lubricants						8.74%	9.80%	10.66%
Spare Parts						0.24%	1.42%	0.26%
Electronics						1.40%	1.58%	1.83%
Cement and other Construction Materials						1.87%	2.73%	2.22%
Food Items						4.52%	8.24%	7.67%
All Other Items						5.72%	3.47%	4.23%
Retail Trading						3.92%	3.28%	7.93%

Road and Railway						2.41%	1.17%	0.93%
Dames						0.61%	0.09%	0.00%
Mines						0.08%	1.48%	0.44%
Other infrastructure Projects						1.81%	2.44%	2.80%
Financial and Lending Institutions						0.00%	0.00%	0.00%
Agricultural Loans	0.88	0.75	2.06	2.66	2.38%	2.34%	2.35%	2.49%
Consumer Loans	1.33	1.01	0.82	0.74	0.24%	0.26%	0.30%	0.36%
Residential Mortgage Loans to Individuals	7.3	8.95	15.65	14.46	10.84%	7.14%	2.68%	2.58%
All Other Loans	3.69	10	12.65	10.71	9.41%	6.68%	0.00%	0.00%

Source: *Financial Supervision Department/DAB*

II. CLASSIFICATION OF LOANS

6.2.1 Non-performing loans

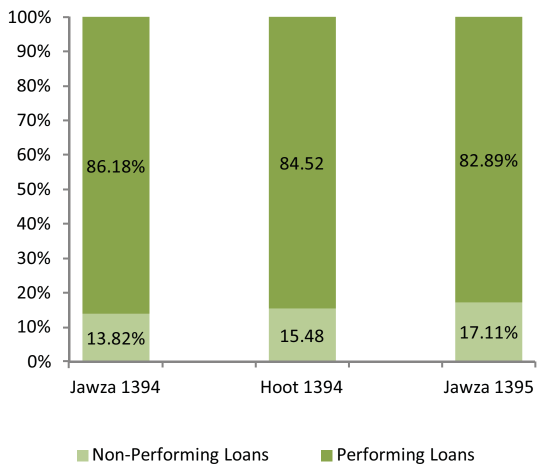
Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs to 17.11 percent of total gross loans or 33.27 percent of regulatory capital, which is not a favorable situation. Moreover, it can be seen that trend of credit risk is increasing and it can be inferred that quality of risk management in banks with poor credit performance is weak. It is essential that banks with poor loan quality to 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 their financial system.

In monetary terms by the end of June 2016, growth in non-performing loans accelerated by AF 1.08 billion, reaching AF 7.95 billion or 17.11 percent of total gross loans, 33.27 percent of the system's regulatory capital against AF 6.86 billion or 15.22 percent of the total gross loans in its preceding quarter. The deterioration is mainly due to weaker loan quality. More than 73 percent of the NPLs relates to three Private commercial banks holding 63.41 percent of total gross loans of the banking sector.

Financial Supervision Department (FSD) is closely working with the financial institutions which have 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.

The sector wide distribution of NPL reveals that a major portion of NPLs originated from commercial loans particularly from trade, services and manufacturing sectors. Increases were posted in manufacturing, trade and services sectors, while utilities and agriculture sectors posted decreases for the review quarter.

Figure 6.3: Quality of Loan Portfolio



Source: *Financial Supervision Department/DAB*

6.2.2Adversely-classified loans

Adversely classified loans (substandard, doubtful) depicted AF 577 million increase over the last quarter to AF 10.03 billion, constituting 21.59 percent of the total gross loans or 41.93 percent of regulatory capital, requires strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be focused on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk. Management should take appropriate 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 risks and take proper precautionary measures as per prudential regulations.

6.2.3 Loans classified Watch

Loans classified in the "watch" category are AF 3.16 billion, which makes 6.80 percent of total gross loans, decreasing by 10.51 percent since the previous quarter (Mar, 2016). The decrease is mostly attributed to three private commercial banks in the system. This category of loans require close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

6.2.4 Loans classified loss3

Loans classified loss amounts to AF 195 million or 0.42 percent of total gross loans are up by AF 123 million since previous quarter, attributed to five banks. Banks are

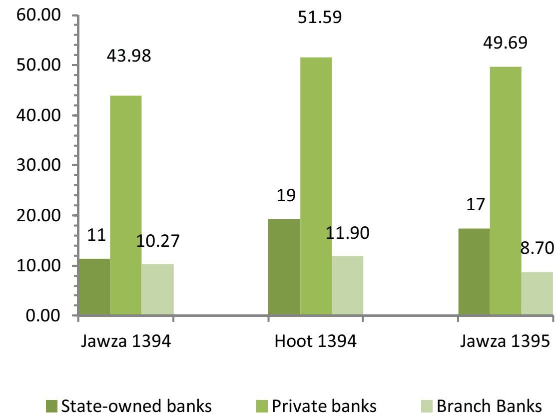
3 Assets on which the payment of principal or interest is due and remains unpaid for 540 days or more (Loss) as per Accounting Letter No. 03/92 dated 16/09/1392

required to maintain enough capital at all times to cover losses resulted from loans classified in this category as it prompts charge-off from balance sheet.

6.2.5 Interbank Claims

Interbank Claims are the second largest among various asset categories, currently comprising
AF 75.83 billion 27.48 percent of total assets registered AF 6.99 billion 8.44 percent decrease since previous quarter (Mar, 2016). The interbank claims was mostly attributed to ten banking institutions, indicating that the banking sector has transferred a portion of its interbank claims to its correspondent accounts with DAB, possibly to decrease the risk level of the assets and strengthen its liquidity position, although all banks broad liquidity ratios are above the minimum threshold. Later on, by improving security and economic situation of the country, banking sector can substitute these assets to higher income earning assets. Banks must not only appropriately measure the risks associated with individual bank's but also country or countries in which they have placed funds. See figure 6.4.

Figure 6.4: Share of Inter bank Claims among banking groups



Source: *Financial Supervision Department/DAB*

6.2.6 Investment

The investment portfolio of the banking sector comprising bonds, Gov. Securities, investment in associated companies; grew by 13.45 percent or AF 2.66 billion over the previous quarter, standing at AF 22.48 billion or 8.15 percent of total assets. The increase came from five banking institutions. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to six commercial banks and three branches of foreign banks.

6.2.7 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category making 41.64 percent of the total assets, showed an increase of AF 9.97 billion, both in absolute as well as in percentage of total assets since previous quarter ending Mar, 2016.

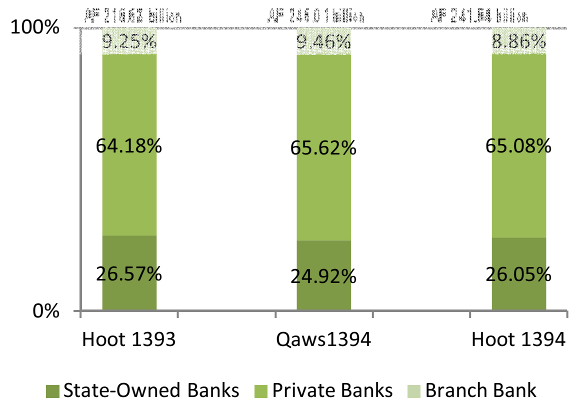
The banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

III. LIABILITIES

Total liabilities of the banking sector increased by AF 6.62 billion or 2.74 percent standing at AF 248.18 billion against AF 241.57 billion in the preceding quarter (Mar, 2016). All components of total liabilities except all other liabilities and suspense accounts have shown increase over the last quarter.

The majority of liabilities are made up of deposits (95 99 percent), with "other liabilities "at second and borrowings in third place. See table 6.5.

Figure 6.5: Liabilities decreased by AF 4.46 billion or 1.81 percent



Source: *Financial Supervision Department, DAB*

6.3.1 Deposits

Deposits being the main funding source, amounted to AF 238.23 billion for the quarter under review, increased by AF 7.07 billion or 3.06 percent, compared to 2.47 percent decrease in Mar, 2016. The increase in deposit base of the banking sector occurred in Afs, which is attributed to increase in demand deposits. Currency wise analysis shows that Afghani denominated deposits indicated 14.88 percent increase (against 9.27 percent decrease in Mar, 2016) accounting for 28.89 percent of total deposits, while US dollar denominated deposits were down by 1.66 percent (0.38 percent decrease in Mar, 2016) making 66.18 percent of the total deposits of the system.

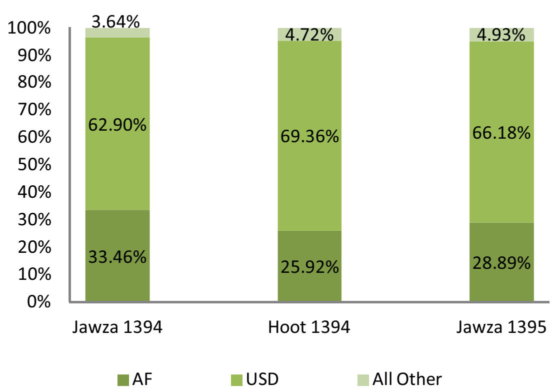
Private Banks attracted AF 154.45 billion deposits. The deposits increased by 2.26

percent against 3.74 percent decrease in previous quarter, making up 64.83 percent of the system's deposits.

The share of state-owned banks amounted to AF 64.56 billion, increased by 7.18 percent (2.91 percent increase in Mar, 2016) since preceding quarter, accounted for 27.10 percent of the system's deposits.

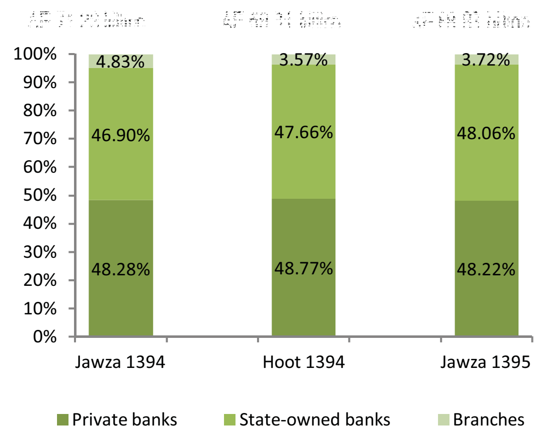
The share of branches of foreign banks stood at AF 19.22 billion, decreasing by 3.34 percent (7.81 percent decrease in March, 2016) making up 8.07 percent of total deposits of the system.In terms of types of deposits, demand deposits accounted for 74.47 percent of the total deposit base, increasing by 2.07 percent. Saving deposits with 19.26 percent of total deposits was in the second place, and depicted 4.22 percent increase while time deposits making up 6.27 percent of the total deposit portfolio, was up by 12.16 percent since Mar, 2016.

Figure 6.6: Currency Composition of Deposits



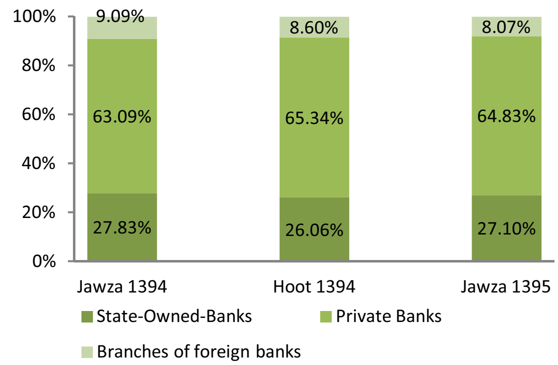
Source: Financial Supervision Department/ DAB

Figure 6.7: Afghani Denominated Deposits



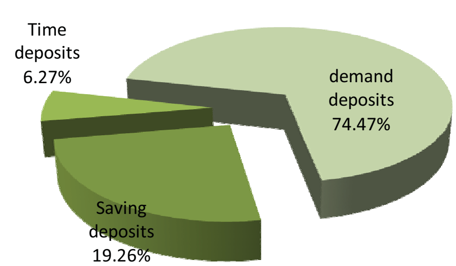
Source: Financial Supervision Department/ DAB

Figure 6.8: Deposits increased by 3.06 percent or AF 7.07 billion



Source: Financial Supervision Department/ DAB

Figure 6.9: Breakdown of Deposits



Source: Financial Supervision Department/ DAB

6.3.2 Borrowings

The share of borrowings in total funding of the system increased by 1.38 percent to AF 3.75 billion by the end of June 2016. This recorded 1.51 percent of total liabilities in comparison with 17.01 percent decrease in the preceding quarter. The current borrowing position is attributed to three banking institutions.

IV.LIQUIDITY

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

Table 6.3: Key Financial Soundness Indicators of the banking Sector

Ratio in %	(Mar, 2010)	(Mar, 2011)	(Mar, 2011)*	(Mar, 2011)	(Dec, 2012)	(Dec, 2013)	(Dec, 2014)	(Dec, 2015)	(Jun, 2016)
Total Capital Adequacy Ratio	25.81	-14.46	30.39	23.06	21.84	26.34	26.46	19.94	20.64
Tier 1 Capital Adequacy Ratio	24.19	-14.51	30.29	23.98	19.97	24.65	26.09	19.66	18.64
Non-Performing Loans to Total Gross Loans	0.5	48.4	3.75	5.15	5.31	5.1	8.09	12.34	17.11
Return on Assets (ROA)	1.41	-20.08	0.24	-1.21	-0.54	0.74	0.90	0.20	2.48
Return on Equity (ROE)	10.35	-520.66	1.9	-17.9	-7.17	10.03	7.35	1.69	24.70
liquidity Ratio (Broad Measure Median)	59.19	63.32	63.83	57.37	72.13	67.93	73.6	68.22	65.71
liquidity Assets to Total Assets	0.38	40.58	47.01	55.82	63.75	73.18	73.28	75.05	73.27

*Excluding Kabul Bank

Source: Financial Supervision Department/ DAB

6.4.1 Capital

The system is well capitalized. The capital fund of the banking sector stands at AF 27.78 billion; increased by 0.52 percentage points or AF 114 million over the last quarter. The increase in total financial capital is attributed to profits.

On an aggregate basis the Capital Adequacy ratio of the banking sector stands at 20.64 percent. See table 6.5.

Disaggregated analysis shows that all banks except one bank in the system registered capital adequacy ratio above the minimum threshold (12 percent of risk-weighted assets). One banking institution is very to the limit and one bank ratio is negative. The

Basel benchmark for capital to risk weighted is 8 percent.

6.4.2 Liquidity Ratio (broad measure)

Banks are required to maintain a liquid asset ratio not less than 15 percent. This should provide a comfortable safeguard against any liquidity shortfall. Generally, a surplus liquidity position was observed in the banking sector during this period. Around 73.27 percent of the sector's total assets are comprised of liquid assets. Ratio of the broad liquidity as a median for the whole system stood at 65.71 percent. All banking institutions were well above the minimum required level. See table 6.5.

V. Profitability

On a cumulative for the quarter ending Jun, 2016, the banking sector earned AF 384 million net profit as compared to AF 2.99 billion net profits in Mar, 2016, showing a significant decrease over the quarter.

The decrease in profitability of the banking sector as evident from the table 6.5 P/L mostly ascribed to significant decrease in non-interest income attributed to one of the state-owned banks which had gain from revaluation of investment properties in previous quarter. Other contributing factors are Increase in operating cost and credit provisions, while net interest income showed increase in the quarter under analysis.

As a result, the returns on assets (ROA) declined to 2.48 percent at annualized rate from 4.43 percent annualized and return on equity (ROE) became 24.70 percent at annualized rate from 44.53 percent in the previous quarter. See table 6.5.

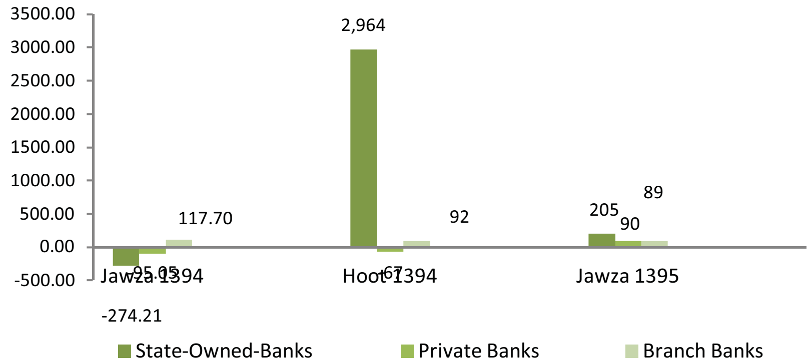
On a cumulative basis four banking institutions have suffered AF 316 million losses in the quarter under analysis against AF 260 million losses posted by six banks in the quarter ending Mar, 2016.

On core income basis three banks ended with losses, against the equal number of banks in the previous quarter.

Group wise analysis reveals that State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profits in the quarter under analysis, whereas the Private Banks (PB) ended up with losses in the preceding quarter. See figure6.10.

Major portion of the profitability of the banking sector is attributed to state-owned banks standing at AF 205 million, Private Banks and Branches of foreign banks are at second and third place with AF 90 million and AF 89 million profits respectively.

Figure 6.9: Profitability of the Banking Sector



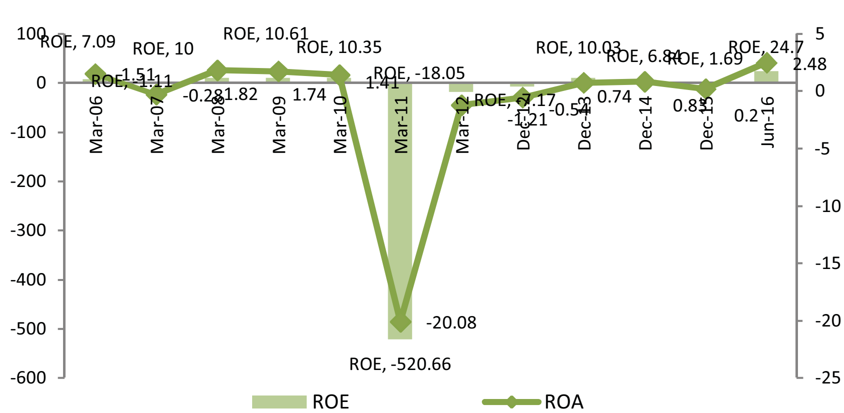
Source: Financial Supervision Department, DAB

Table 6.4: P/L Schedule

	1394 (Jun, 2015)	1394 (Mar, 2016)	1395 (Jun, 2016)	%change Q-o-Q
interest income	2,295	2,198	2,361	7.41
interest expense	498	500	433	-13.4
Net interest income	1,796	1,699	1,928	13.47
Non-interest income	1,360	4,067	2,279	-43.96
Non-interest expenses	1,325	1,327	1,453	9.49
Salary cost	907	911	930	2.08
Credit provisions	1,392	455	589	29.45
P/L before tax	(162)	3,077	1,235	-59.86
P/L after tax	(252)	2,989	384	-87.15

Source: Financial Supervision Department, DAB

Figure 6.10: Return of Equity & Return on Assets



Source: Financial Supervision Department, DAB

Figure 6.12: Net Interest Margin

Source: *Financial Supervision Department/ DAB*

IV. Foreign Exchange Risk

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

The impact of changes in exchange rate upon regulatory capital of the system reveals that a 20 percent appreciation in exchange rate would increase the regulatory capital of the system by AF 9.46 billion and vice versa. Similarly, a 4 percent change would correspond to AF 1.89 billion and vice versa.

V. 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, reveals that the net-interest income of the system over the next 12 months may increase by 3 percent equal to AFs 1.68 billion in the event of increase in the market interest rate (upward interest rate shock). Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AF 1.68 billion. For two banking institution, if the interest-rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

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

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