Da Afghanistan Bank

Economic & Statistical Bulletin

Annual Bulletin 2020

Monetary Policy Department

Da Afghanistan Bank

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Note:

Afghanistan's fiscal year has changed effective from 2012 (1391). The new fiscal year begins from December 22nd. This bulletin analyzes economic developments during the fiscal year 1399, which starts from December 22nd, 2019 to December 20th, 2020 (Jadi 01, FY 1399 – Qaws 30, FY 1399).

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ABBREVIATIONS

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

EXECUTIVE SUMMARY

2020 posed economic challenges of enormous proportions to struggling Afghan economy. COVID-19 outbreak and the subsequent restriction measures pushed the economy of Afghanistan deep into recession. Intermittent border closures, subdued demand in domestic and international market left a substantial negative impact on businesses. Exports and imports witnessed a substantial decline in 2020. On the positive side, higher external grant inflows have laid mitigating effects on the deficit of current account. The economic activities began to slowdown in early 2020 and exacerbated further when Afghan government imposed nation-wide lockdown in March in an attempt to contain the outbreak. Afghanistan relaxed restriction in the start of third quarter of the current fiscal year. COVID outbreak and the subsequent restrictive measure severely damaged the economy of Afghanistan. On the positive side, activities normalized faster than anticipated. The economic recovery process is gaining continuous momentum as all four sector of the economy are steady moving to pre pandemic levels

With hindsight, Afghan economy contracted by 1.93% in FY 2020, which is the lowest rate since FY 2016. This negative growth rate was mainly due to decrease in agriculture sector along with weak performances of the service and industry sectors during FY 2020. Services, industry, and agriculture sectors, each had 56.07%, 12.47%, and 27.01% shares in the GDP of FY 2020. The growth rate in these sectors were -4.76%, -4.22%, and 5.31% for services, industry, and agriculture sectors respectively in FY 2020, unlike of the FY 2019 which the sectors had -1.39%, 4.85%, and 17.46% respectively. The highest negative growth observed was in agriculture sector which reduced by almost 23% during the year.

Consumer Price Index (CPI) is computed based on April-2015 base prices. Measuring National inflation by Y-On-Y, the overall index on average stands at 5.60% (on average) in FY 1399 (2020), where it was 2.31% (on average) in FY 1398 (2019). Based on quarterly measures, inflation rate (overall index) stood at 5.78% in the 4th quarter of FY 2020, where it recorded 1.70% in FY 2019.

Reserve Money had 9.52% growth which stood at Afs 352,255.99 million at the end of FY 1399, meanwhile, Currency in Circulation -major component of RM witnessed 13.11% growth, standing at Afs 293,341.38 at the end of FY 1399. For the purpose of absorbing excess liquidity from the market and to smooth exchange rate fluctuations between Afghani and foreign currencies, DAB auctioned USD 2,127.42 million during FY 1399 (2020).

Balance of payment overall deficit was USD 2,967 million at the end of the third quarter of FY 1399 (2020). Current account deficit of the BoP shows decrease of 17% and standing at USD 3,136.12 million, while it stood at USD 3,791.94 million in FY 1398 (2019). The decrease in current account deficit was due to increase; in official transfer, and receipts of services account in FY 1399 (2020).

Capital account inflow stood at USD 752.35 with a 37% decrease from USD 1,193.49 million registered in FY 1398 (2019) owing to lower inward of capital transfer to the government sector. Looking at the

Financial account, FDI inflow were USD 12.97 million while outflow stood at USD 37.23 million. Portfolio investment recorded USD 63.24 million which showed increase in Afghanistan's investment abroad compared to USD 14.62 million registered in FY 1398 (2019).

Core budget including donor contributions had a deficit of Afs 40.5 billion. Total revenue decreased to Afs 393 billion in FY 1399 (2020) where it was recorded Afs 401 billion in FY 1398. Total expenditures on the other hand, increased to Afs 434 billion in FY 1399 compared to Afs 412 billion in FY 1398. Total domestic revenue decreased to Afs 173.6 billion in FY 1399 compared to Afs 208.4 billion registered in FY 1398. Donor contribution increased by 14% (Afs 27 billion) recorded at Afs 220 billion in FY 1399, where it was Afs 192 billion in FY 1398. Meanwhile, budget execution rate (actual spending) reached to 86% from the total approved budget of Afs 453.8 billion at the end of FY 1399 (2020).

Banking sector comprises of twelve (12) duly licensed banks. Overall, the banking sector performed well during FY 1399, no liquidity deficit was observed and the capital position of all banks remained within the regulatory threshold. main financial indicators (total assets, investment in bond, deposits and financial capital) of the banking sector demonstrated increase.

Assets of the banking sector registered Afs 327 billion with 4.4% increase which was due to increase in total deposits. Profit of the banking sector recorded Afs 1.60 billion of net profit (on cumulative basis), while liabilities of the sector show increase of Afs 12.81 billion standing at Afs 290.23 billion in FY 1399 (2020). On the other hand, the banking sector is well capitalized which make 11.25% of the total assets. Major profitability components are above the set regulatory threshold (12% of the risk weighted assets).

Islamic Banking sector's main financial indicators show that the sector performed well during the FY 1399 (2020). Assets of the sector stood at Afs 48.79 billion with 28.04% growth, while liability also increased by Afs 10.52 billion and stood at Afs 44.74 billion in FY 1399. Liquidity position of all Islamic banking windows and full-fledge Islamic bank was above the set minimum for broad liquidity ratio (15%) and quick liquidity ratio (20%). Meanwhile, capital of the Islamic banking sector stands at Afs 4.05 billion making 8.3% of the total assets of the sector during FY 1399 (2020).

1

Global Economic Environment

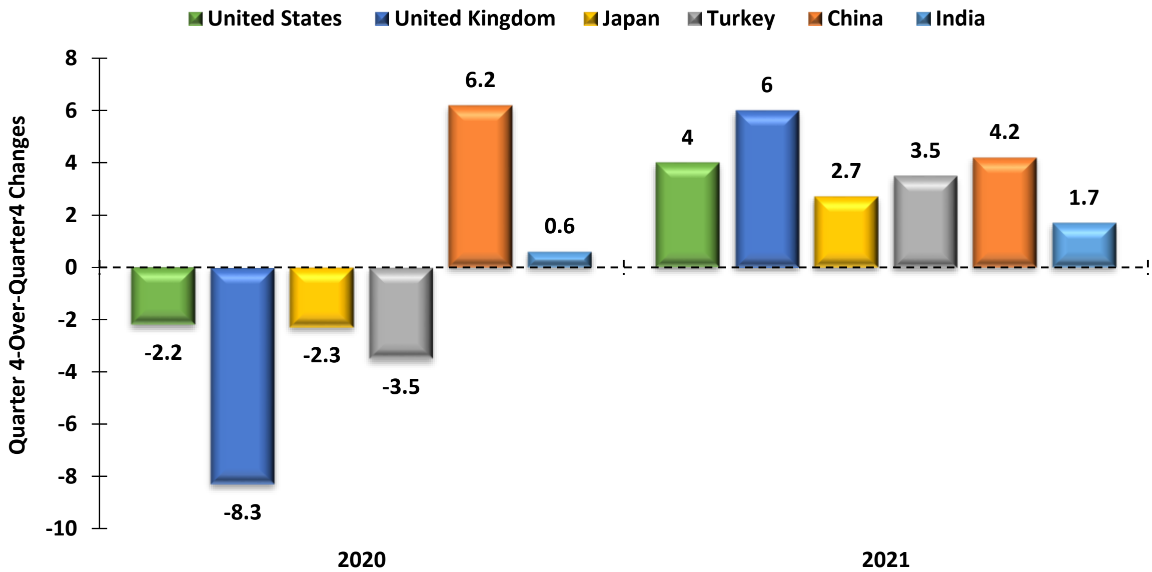
1

GLOBAL ECONOMIC ENVIRONMENT

The strength of the recovery is projected to vary significantly across countries, depending on access to medical interventions, effectiveness of policy support, exposure to cross-country spillovers, and structural characteristics entering the crises. The global economy is projected to grow 5.5% in 2021 and 4.2% in 2022. The 2021 forecast is revised up 0.3% relative to the previous forecast, reflecting expectations of a vaccine-powered strengthening of activity later in the year and additional policy support in a few large economies. In addition to this, the global growth contraction for 2020 is estimated at -3.5%, 0.9% higher than projected in the previous forecast (reflecting stronger-than-expected momentum in the second half of 2020).

Furthermore, global trade volumes are forecasted to grow about 8% in 2021, before moderating to 6% in 2022. Besides, Services trade is expected to recover more slowly than merchandise volumes which is consistent with subdued cross-border tourism and business travel until transmission declines everywhere. On the other hand, inflation is expected to remain subdued during 2021–22. In advanced economies it is projected to remain generally below central bank targets at 1.5%. Among emerging market and developing economies inflation is projected just over 4%, which is lower than the historical average of the group1. Reflecting the projected global recovery, oil prices are expected to rise in 2021 just over 20% from the low base for 2020, but will still remain well below their average for 2019. Non-oil commodity prices are also expected to increase with those of metals, in particular, projected to accelerate strongly in 2021.

Figure 1.1: Q_4-over-Q_4 Growth of Advanced and Emerging Economies, World Economic Outlook Growth Projection



Source: IMF, World Economic Outlook Update January 2021/MPD Staff calculation

[1] IMF Economic Outlook, January 2021

1.1. Advanced Economies:

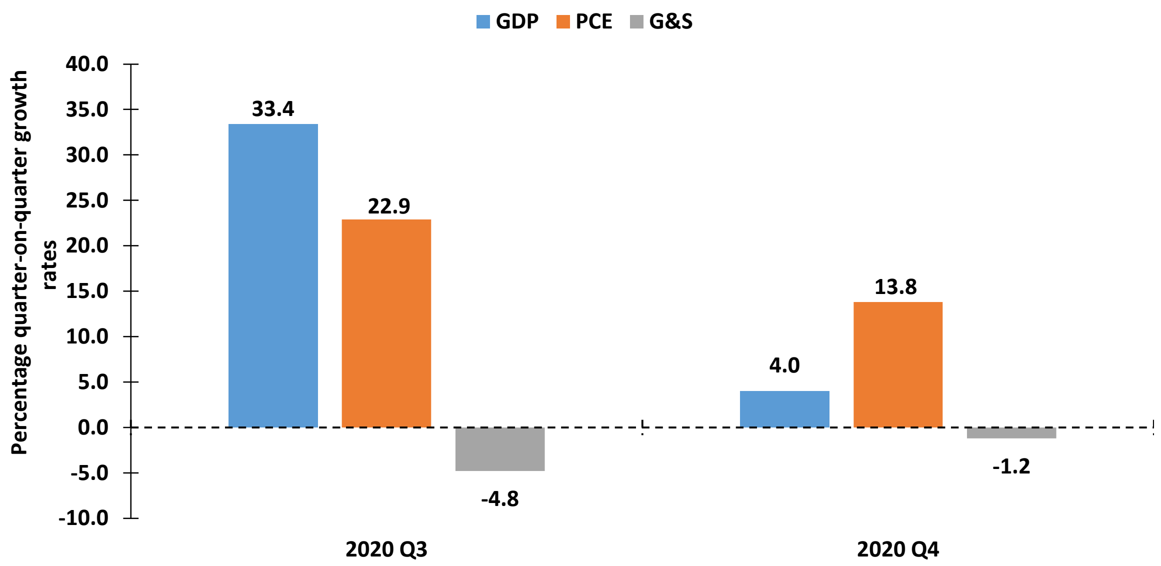
1.1.1. United States' Economy:

Real gross domestic product (GDP) increased at an annual rate of 4.0% in the fourth quarter of 2020. The increase in real GDP reflected increases in exports, non-residential fixed investment, personal consumption expenditures (PCE), residential fixed investment, and private inventory investment that were partly offset by decreases in state and local government spending and federal government spending.

Imports, which are a subtraction in the calculation of GDP, increased. Furthermore, the price index for gross domestic purchases increased 1.7% in the fourth quarter, compared with an increase of 3.3% in the third quarter. The personal consumption expenditure (PCE) price index increased 1.5%, compared with an increase of 3.7% in the third quarter. Excluding food and energy prices, the PCE price index increased 1.4%, compared with an increase of 3.4%.

Moreover, personal income increased $116.6 billion (0.6%) in December. Disposable personal income (DPI) increased $111.6 billion (0.6%) and personal consumption expenditures (PCE) decreased $27.9 billion (0.2%). The increase in personal income in December primarily reflected increases in government social benefits, compensation, and personal dividend income that were partly offset by a decrease in proprietors' income.

Figure 1.2: Comparison of Quarterly GDP, Personal Consumption Expenditure (PCE) and Goods and Services Import (S&G)



Source: US Bureau of Economic Analysis/MPD Staff Calculation

Besides, US international trade in goods and services deficit was $66.6 billion in December, $2.4 billion lower than $69.0 billion in November. Exports and imports in December 2020 reflect both the ongoing impact of the COVID-19 pandemic and the continued economic recovery from the sharp declines earlier in the year. Meanwhile, December exports were $190.0 billion, $6.2 billion more than November exports. December imports were $256.6 billion, $3.8 billion more than November imports.

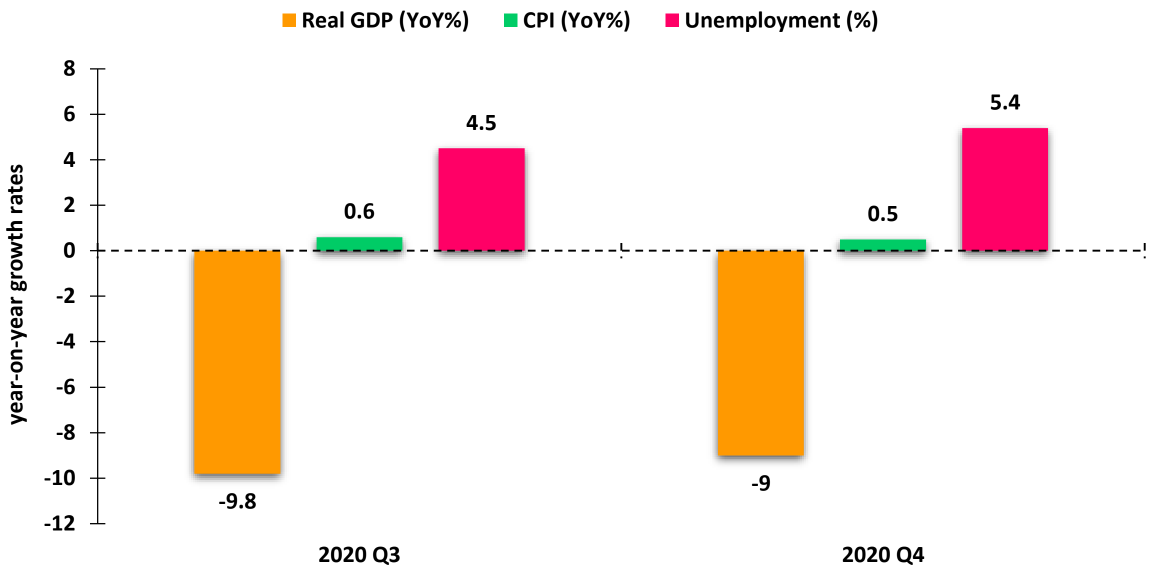
The decrease in the goods and services deficit in December reflected a decrease in the goods deficit of $2.8 billion to $84.2 billion and a decrease in the services surplus of $0.4 billion to $17.5 billion and as a summary for 2020, the goods and services deficit was $678.7 billion, $101.9 billion higher than $576.9 billion in 2019. Exports were $2,131.9 billion, $396.4 billion lower than 2019. Imports were $2,810.6 billion, $294.5 billion lower than 2019[2].

1.1.2. The Economy of UK:

GDP fell by 8.9% in the 12 months to November 2020, compared with an annual decline of 6.8% to October[3]. GDP fell by 2.6% in November 2020 as government restrictions reduced economic activity while construction output has continued to increase in November 2020, services and production has fallen. On the other hand, the construction sector grew by 1.9% in November and, in recent months' construction output has seen a divergence between repair and maintenance and new work activity.

Services acted as the main drag on growth in November, fell by 3.4% as restrictions on activity were reintroduced in some parts of the UK in response to the coronavirus (COVID-19) pandemic. The services sector is now 9.9% below the level of February 2020. The largest contributor to this fall was accommodation, food service, wholesale and retail trade, arts, entertainment and recreation, which accounted for nearly 80% of the fall in services.

Figure 1.3: Annual Change Y-On-Y, Annual Changes for Real GDP (RGDP), Consumer Price Index (CPI) and Unemployment Rate



Source: Bloomberg/MPD Staff Calculation

Furthermore, the production sector also fell marginally by 0.1% in November 2020, remaining 4.7% below the February 2020 level. Meanwhile, output in the production sector fell by 0.1% in November 2020 as Manufacturing has continued its recovery, while mining and quarrying has fallen every month since a peak in June 2020. Besides, Consumer Prices Index (CPI) 12-month rate was

[2] US Bureau of Economic Analysis

[3] Office for National Statistics-GDP

0.6% in December 2020, higher than 0.3% in November; on a monthly basis, CPI grew by 0.3% in December 2020, following a 0.1% fall in November. The Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 0.8% in December 2020, greater than 0.6% in November. The largest contribution to the CPIH 12-month inflation rate came from recreation and culture (0.35%). Rising transport costs contributed 0.11% to the monthly change, while increasing prices for clothing, and recreation and culture items both contributed 0.10% to help increase inflation; these were partially offset by a downward contribution from falling food and non-alcoholic beverage prices.

In addition, in last three months to November, there was a large decrease in the unemployment rate, while, the employment rate continues to fall the UK unemployment rate in three months to November 2020. Unemployment rate was estimated at 5.0%, 1.2% higher than a year earlier and 0.6% higher than the previous quarter. Early estimates for December 2020 indicate that the number of pay-rolled employees fell by 2.7% compared with December 2019, which is a fall of 793,000 employees; since February 2020, 828,000 fewer people were in pay-rolled employment.

1.1.3. Economy of Japan:

The Government will implement the "Emergency Economic Measures to cope with the Novel Coronavirus" including the FY 2020 supplementary budget, and the FY 2020 second supplementary budget, and smoothly and steadily implement the " Comprehensive Economic Measures to Secure People's Lives and Livelihoods toward Relief and Hope[4]. Furthermore, by industry, transport equipment is picking up, production machinery is almost flat, and electronic parts and devices are increasing moderately, meanwhile, as for short-term prospects, production is expected to continue to pick up.

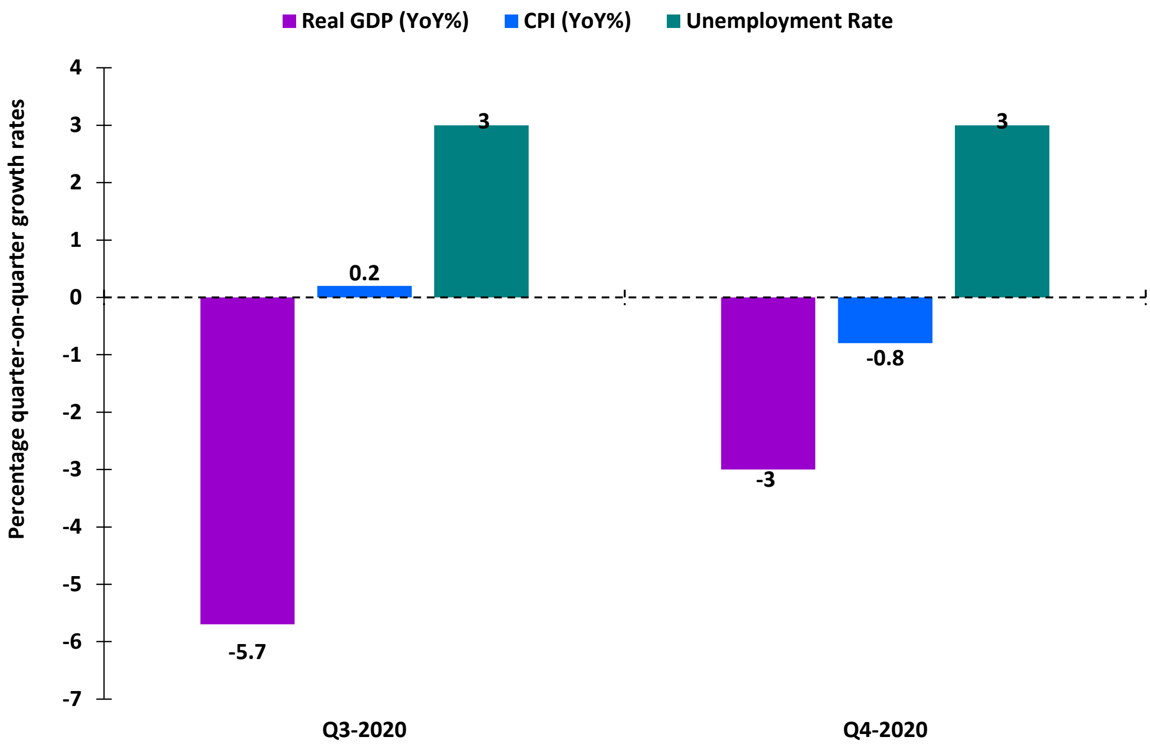
While, full attention should be given to the further downside risks of overseas economies, and to the effects of supply-chain risk by the infectious disease. On the other hand, the Indices of Industrial Production increased by 4.0% from the previous month in October. The Indices of Industrial Inventories decreased by 1.8% from the previous month in October. The Survey of Production Forecast in Manufacturing expects an increase of 2.7% in November, and a decrease of 2.4% in December. Besides, consumer prices are flat.

Consumer prices in terms of general, excluding fresh food and energy, are flat on the basis of excluding special factors in the form of policy measures. According to the Monthly Consumer Confidence Survey (multi-person households), the ratio of households which forecast a rise in prices was 68.4% in November, a decrease of 4.0% from the previous month. Furthermore, as for short-term prospects, consumer prices (general, excluding fresh food and energy) are expected to remain flat on the basis of excluding special factors in the form of policy measures. In addition, exports are increasing, imports are leveling off and the balance of goods and services is in surplus[5].

[4] December 8th, The Cabinet Office

5 Economic Development Report, The Cabinet Office

Figure 1.4: Annual Change Y-o-Y, Annual Comparison of GDP, Inflation, and Unemployment



Source: Bloomberg/MPD Staff Calculation

While, exports are increasing by region such as to Asia, U.S, EU and other regions are picking up simultaneously effects of the infectious disease on inbound tourism, the number of foreign tourists in December decreased by 97.7% concerning short-term prospects, exports are expected to continue to increase, supported by the improvement in overseas economies, therefore, full attention should be given to the downside risks of overseas economies.

Moreover, employment situation shows steady movements in some components such as the number of employees, while weakness remains, due to the influence of the infectious disease and accordingly, the total unemployment rate was 3.1% in October, an increase of 0.1% from the previous month. The labor force, the number of employed persons, and the number of unemployed persons all increased.

1.2. Emerging Economies:

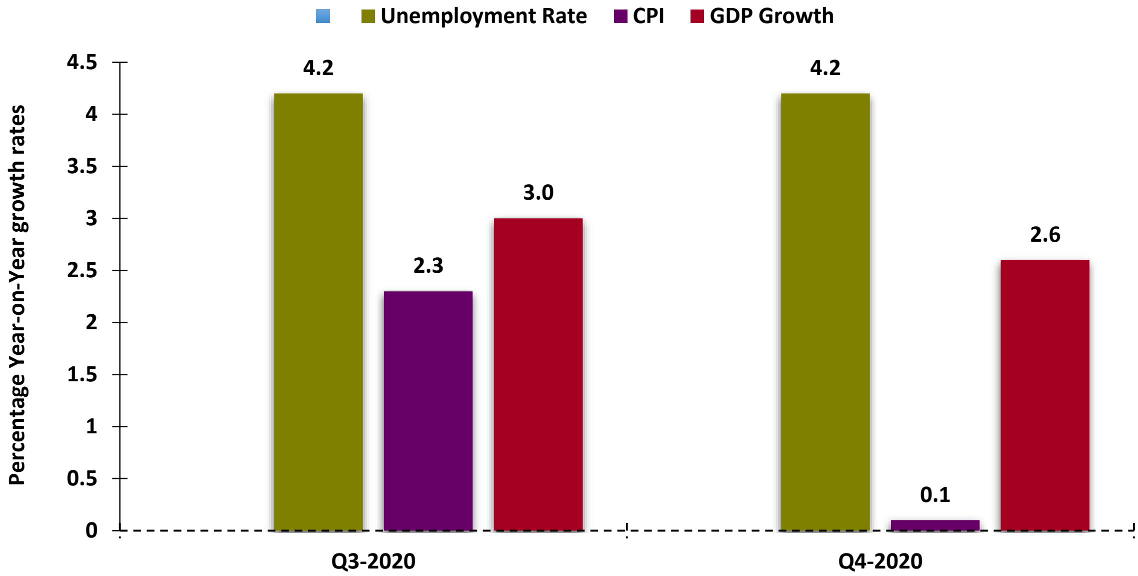
1.2.1. Economic of China:

In 2020, the added value of industries above designated size increased by 2.8% over the previous year. Meanwhile dividing industrial production into three categories, in December, the added value of the mining industry increased by 4.9% year-on-year, 2.9% faster than that in November. the manufacturing industry increased by 7.7%, the same as last month, and the production and supply of electricity, heat, gas and water increased by 6.1%, 0.7% faster.

Moreover, In December, the added value of industries above designated size increased by 7.3% year-on-year (the growth rate of added value is below the real growth rate after deducting price factors), 0.3% faster than that in November.

On a month-on-month basis, the added value of industries above designated size increased by 1.10% in December[6].

Figure 1.5: Quarterly Percentage Changes, Comparison of GDP, CPI, and Unemployment Rate



Source: National Bureau of Statistics China/MPD Staff Calculation

Furthermore, In December 2020, the national Consumer Price Index (CPI) rose by 0.2% year on year. Among them, both urban and rural areas grew by 0.2%. The prices of food stuff went up by 1.2%, while that of non-food stuff unchanged; the prices of consumer goods rose by 0.2%, and that of services increased by 0.3%. Besides, In December, national consumer prices rose by 0.7% month-on-month basis. Among them, the prices in urban and rural went up by 0.7% and 0.9%; the prices of food stuff and non-food stuff increased by 2.8% and 0.1%; that of consumer goods rose by 1.2%, while that of services unchanged[7].

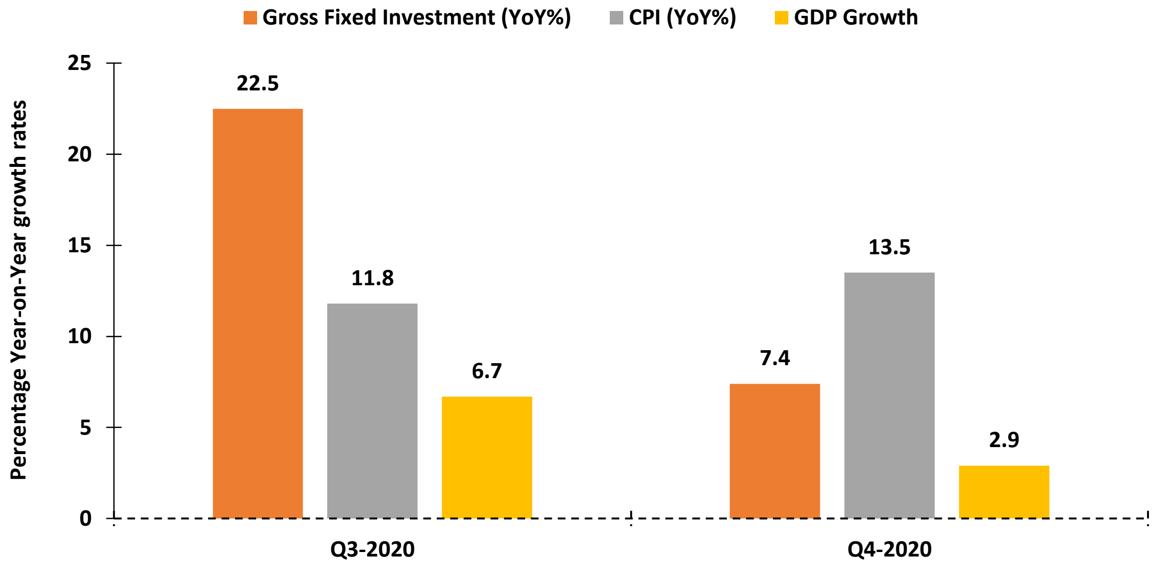
1.2.2. The Economy of Turkey:

Industrial production increased by 1.3% monthly, 10.1% compared with the same quarter of the previous year and 9.0% on annually basis. Meanwhile, mining and quarrying index increased by 6.0%, manufacturing index increased by 9.5% and electricity, gas, steam and air conditioning supply index increased by 4.9% in December 2020 compared with same month of previous year. Domestic Producer Price Index increased by 2.66% on monthly basis and 26.16% on annual basis, meanwhile, Manufacturing increased by 28.42% annually, 2.73% increase on monthly basis, while the lowest annual increase was in electricity, gas, steam and air conditioning which increased by 0.02% and the highest monthly decrease was in metal ores with 1.61% decrease. In addition, Services Producer Price Index increased by 22.12% on annually and 0.57% on monthly basis, besides, transportation and storage services increased by 30.88% annually and 1.89% on monthly basis. Moreover, the only annual decrease was in real estate services with 5.46% decrease, and the highest monthly decrease was in real estate

[6] Bureau of National Statistics China
[7] Bloomberg

services which decreased by 10.15%. On the other hand, overall export increased by 2.8% and the overall export unit value index increased by 2.8% in December. Compared to December 2019, the overall export unit value index increased by 1.4% in fourth Quarter of 2020, meanwhile, the overall import unit value index increased by 3.8% in December. Index for fuels decreased by 27.9%, the index for food, beverages and tobacco, crude materials (except fuels) and manufactured goods (except food, beverages and tobacco) increased by 17.1%, 15.6% and 10.0%, respectively. Besides, economic confidence index realized as 86.4% that shows Economic confidence index which was 89.5% in November decreased by 3.5% in December to 86.4%. This decrease in economic confidence index stemmed from the decreases in services, retail trade and construction confidence indices.

Figure 1.6: Annual Growth, Comparison of GD, Inflation, and Gross Fixed Investment



Source: Bloomberg/MPD Staff Calculation

Furthermore, services confidence index decreased by 9.2% and became 70.4%, retail trade confidence index decreased by 7.8% and became 87.6%, and construction confidence index decreased by 7.2% and became 73.3% in December compared to the previous month. On the other hand, consumer confidence index remained unchanged at 80.1%, real sector (manufacturing industry) confidence index increased by 2.8% and became 110.4%[8].

1.2.3. The Economy of India:

India focused on saving lives and livelihoods by its willingness to take short-term pain for long-term gain, at the onset of the COVID-19 pandemic, meanwhile, an early intense lockdown provided a win-win strategy to save lives and preserve livelihoods via economic recovery in the medium to long-term[9]. On the other hand, a strong V-shaped recovery of economic activity further confirmed by Index of Industrial Production (IIP) data which showed that the recovery in the IIP resulted in a growth of -1.9% in Nov, 2020 as compared to a growth of 2.1% in Nov, 2019.

India focused on saving lives and livelihoods by its willingness to take short-term pain for long-term gain, at the onset of the COVID-19 pandemic,

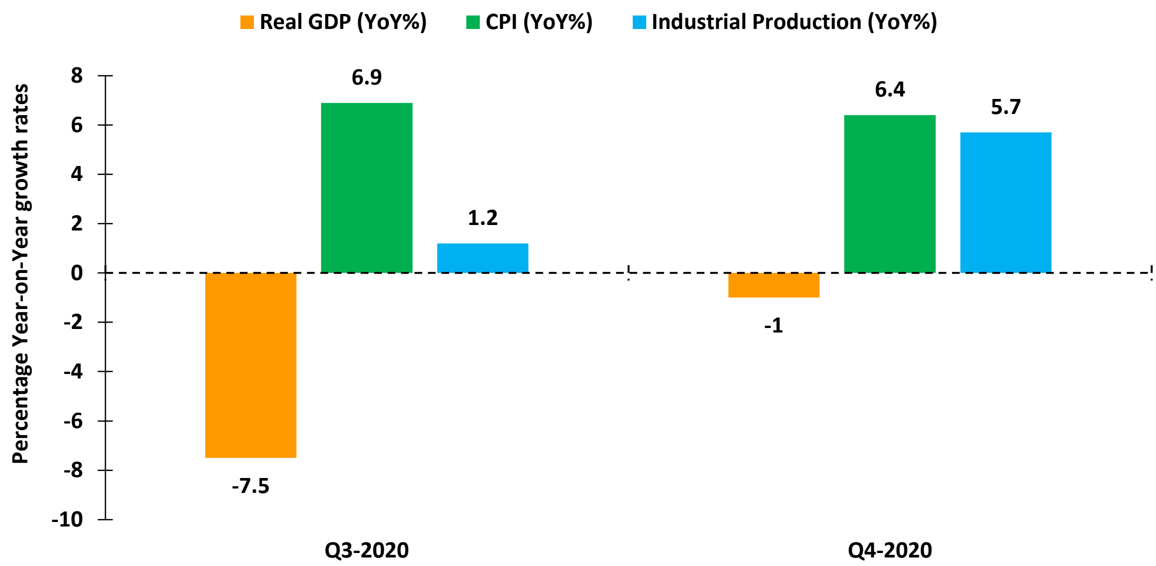
[8] Turkish Statistical Institute

[9] Economic Division Affairs, Ministry of Finance

meanwhile, an early intense lockdown provided a win-win strategy to save lives and preserve livelihoods via economic recovery in the medium to long-term[10]. On the other hand, a strong V-shaped recovery of economic activity further confirmed by Index of Industrial Production (IIP) data which showed that the recovery in the IIP resulted in a growth of -1.9% in Nov, 2020 as compared to a growth of 2.1% in Nov, 2019.

Meanwhile, Further improvement and firming up in industrial activities are foreseen with the Government enhancing capital expenditure, the vaccination drive, and the resolute push forward on long pending reform measures, besides that, Food Processing Industries (FPI) sector growing at an Average Annual Growth Rate (AAGR) of around 9.99% as compared to around 3.12% in Agriculture and 8.25% in Manufacturing at 2011-12 prices in the last 5 years ending 2018-19. Furthermore, consumer Price Index (CPI) inflation stood at 4.6% in December 2020, mainly driven by rise in food inflation (from 6.7% in 2019-20 to 9.1% in April-December 2020, owing to build up in vegetable prices).

Figure 1.7: Annual Growth, Comparison of GDP, Inflation, and Industrial Production



Source: Bloomberg/MPD Staff Calculation

Meanwhile, the fiscal deficit of the Central Government for 2019-20 is placed at 3.8% of GDP in the revised estimates as against 3.3% of GDP in the budget estimates. The fiscal deficit is budgeted to decline to 3.5% of GDP in 2020-21. Besides, according to the Government, the deviation in 2019-20 from the fiscal deficit target was necessitated on account of structural reforms such as reductions in corporation tax, furthermore, the fiscal expansion is within the provisions of the Fiscal Responsibility and Budget Management Act, 2003. A similar variation from the 2020-21 target of 3% of GDP is anticipated on account of the spill over impact of the reforms. It is expected that government will return to the path of fiscal consolidation in the medium term (3.3% in 2021-22 and 3.1% in 2022-23)[11].

[10] Economic Division Affairs, Ministry of Finance

[11] News Letter, SAARC Finance

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2

Money and Capital Market Development

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

Based on the monetary and financial statistics of DAB, reserve money (RM) had positive growth of 9.52% at the end of the FY 1399 (2020) while it grew by 11.60% at the end of the same period in previous year.

Currency in circulation (CiC) as a major component of RM, had positive growth of 13.11% during FY 1399 (2020). The data showed CiC increased from late April to the end FY 2020.the increase was as a result of; quarantine expenditures due to the Covid-19 in late April, Holy Month of Ramadan related spending, and end of year government's salary expenditures. Reserve money (RM) growth remained well below the Ceiling due to collection of additional liquidity from the market and banks during the period under review.

Narrow money (M1), stood at Afs 535,364 million at the end of FY 1399, registering growth of 12%. Broad money (M2) representing growth rate of 12.07%, standing at Afs 575,737.94 million. The main reason behind the growth of M1 is increased government expenditures which in turn surged the CiC by 13.29%, and CiC was a dominant component of M1. In order to mitigate excessive fluctuations of exchange rate against foreign currencies and manage liquidity in the market, DAB uses FX and CNs auctions under the open market operations.

During the FY 1399 (2020), DAB has auctioned 2,127.42 million USD to absorb excess liquidity from the market and as well as to smoothen fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at Afs 46.40 billion at the end of the period under review. Meanwhile, Afghani appreciated by 1.69% against the US dollar during the period under review.

2.1. Monetary Program:

In the latest ECF agreement signed between IMF and Da Afghanistan Bank (DAB), Reserve Money (RM) and Net International Reserves (NIR) are set as quantitative targets. DAB applies quantitative theory of money to determine the level of reserve money (RM) for the purpose of maintaining domestic price stability, which indeed is one of the key responsibilities of the central bank.

Ceilings for RM and CiC are based on projected economic growth and projected inflation for the period under consideration. For the fiscal year 1399 (2020), the ceilings for reserve money and currency in circulation are set as 12.2% and 14.7% respectively (see figure 2.1).

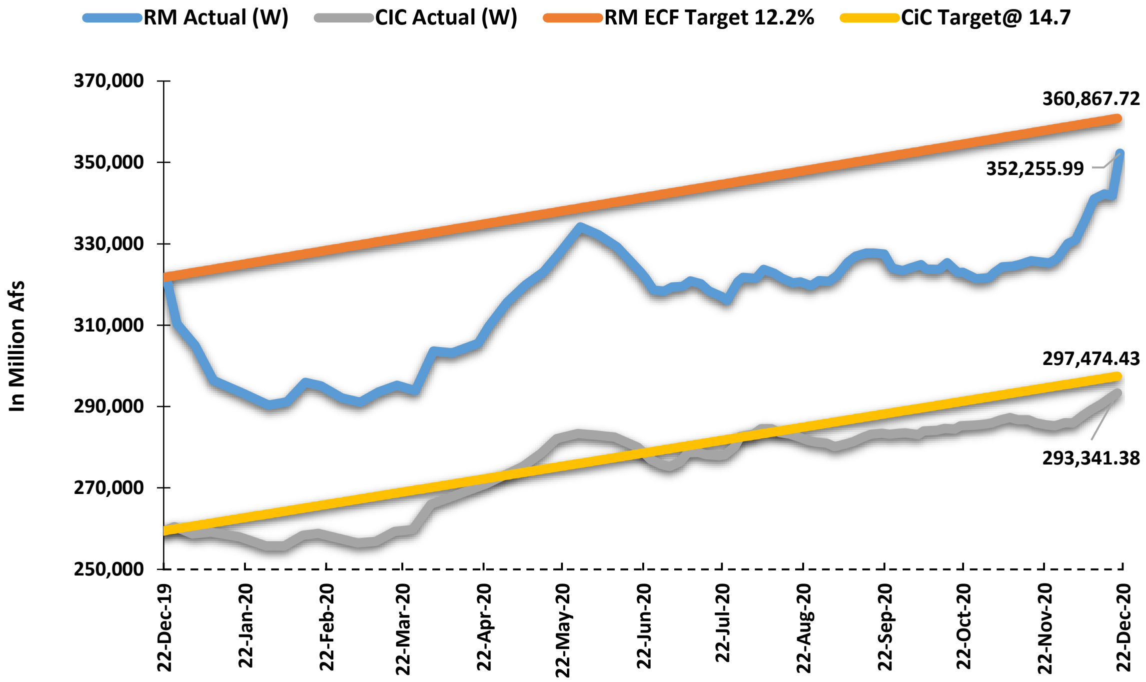
2.2. Monetary Aggregates:

Narrow money and broad money are compiled based on Monetary and Financial Statistics Manual and Compilation Guide (MFS Guide). Narrow money (M1) includes currency outside depository corporations and demand deposits, while broad money (M2) includes narrow money components and other less liquid assets or quasi money. As shown in Table 2.1, narrow money (M1) grew by 12% at the end of fiscal year 1399 (2020) as compared to 6% of the last year.

Currency outside depository corporations, which accounts for 49% of M2, grew by 13.29%, slightly lower than 13.7% growth of the same period in the previous year, showing difference of Afs 33,205.64

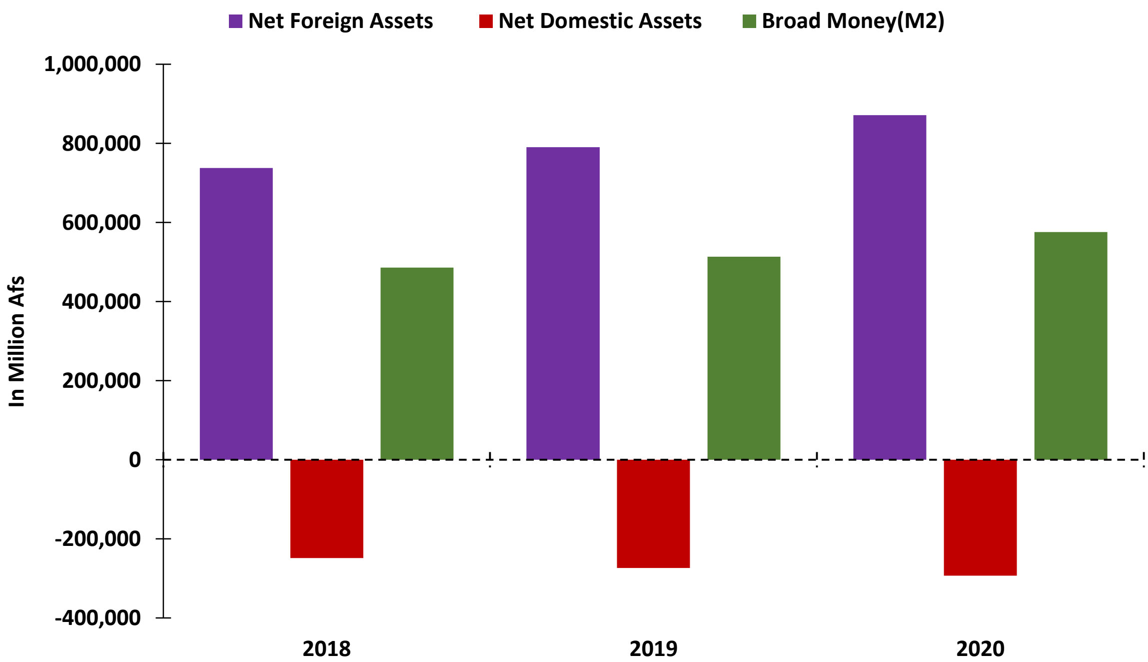
million. Demand deposits, which are other components of M1, experienced 9.69% growth at the end of FY 1399 (2020), while it had negative growth of 1.6% in the same period of previous year. The main reason for high demand deposits are end year outstanding salary payments by Ministry of Finance (MoF) and projects implementation due to Covid-19 during FY 1399 (2020). Demand deposit in comparison with the previous year in same period shows a difference of Afs 22,286.14 million.

Figure 2.1: Reserve Money and currency in circulation during FY 1399 (2020)



Source: Monetary Policy Department/DAB

Figure 2.2: Net Foreign Assets, Net Domestic Assets, and M2 during the FY 1399 (2020)



Source: Monetary Policy Department/DAB

Broad money (M2) expanded by Afs 575,737.94 million in the period under review from Afs 513,735.13 million in the previous year, showing an increase of 12.07% greater than 5.7% growth of last year, the reason behind it is already discussed in the above paragraph. Data shows that M1 with a share of 92.99% remained the main contributing component of M2.

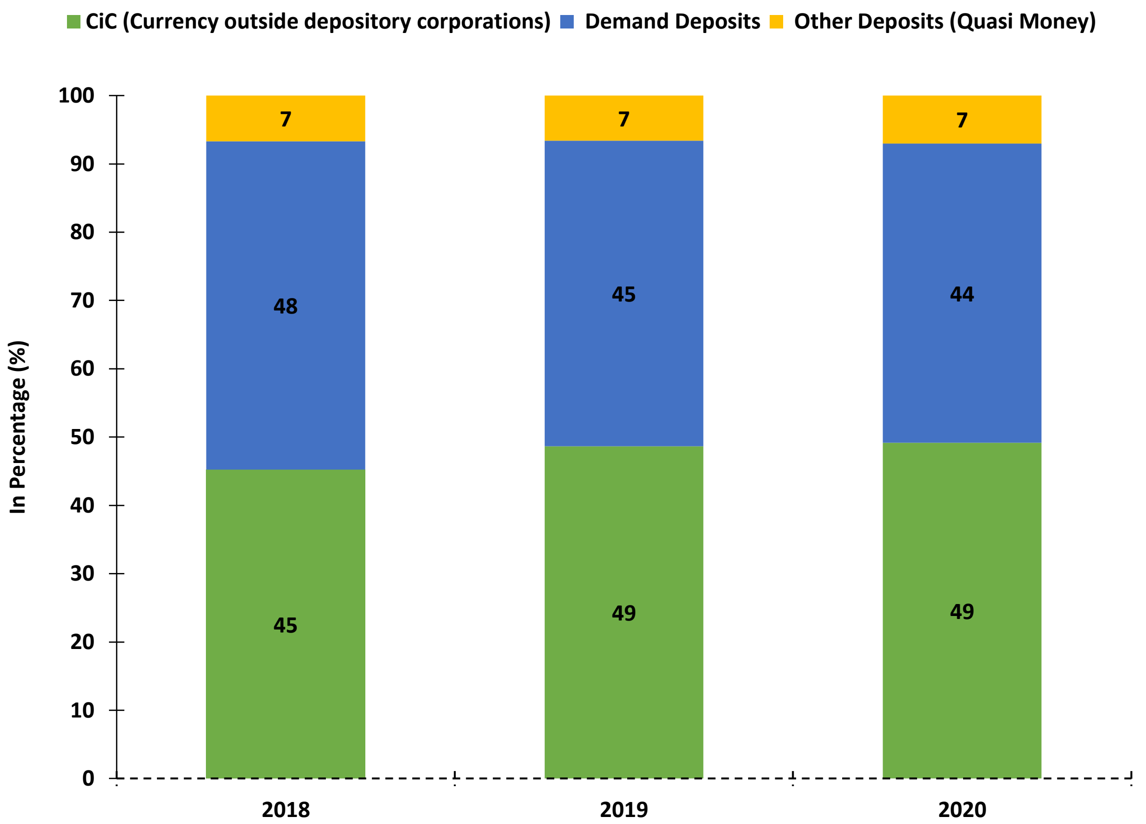
Quasi money (other deposits), which is other component of M2, had growth of 19.23% at the end of the period under review. Afghani denominated time deposits had grown by 26.49% during FY 1399 (2020). Quasi money constitutes 7.01% of broad money at the period under review, which is higher than 6.59% in the same period of last year. Therefore, the impact of changes in quasi money on M2 is negligible.

The year-on-year quarterly change of Afghani denominated time deposits stood at Afs 9,191.67 million, showing growth of 26.49%, while, the foreign currency denominated time deposits rose by 17.24%, reaching to Afs 31,182.26 million.

During the period under review DAB increased CNs interest rate in order to avoid excess liquidity in the market. This made commercial banks to increase the Afs deposit interest rate therefore, individuals made more deposits.

Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 1.60% and 5.42% of M2 respectively. Demand deposits as a share of broad money stood at 43.81% at the end of the year under review (table 2.1)

Figure 2.3: Quasi Money and Demand Deposits during the FY 1399 (2020)



Source: Monetary Policy Department/DAB

Table 2.1: Monetary Aggregates for FY 1399 (2020), from Dec-19 to Dec-20

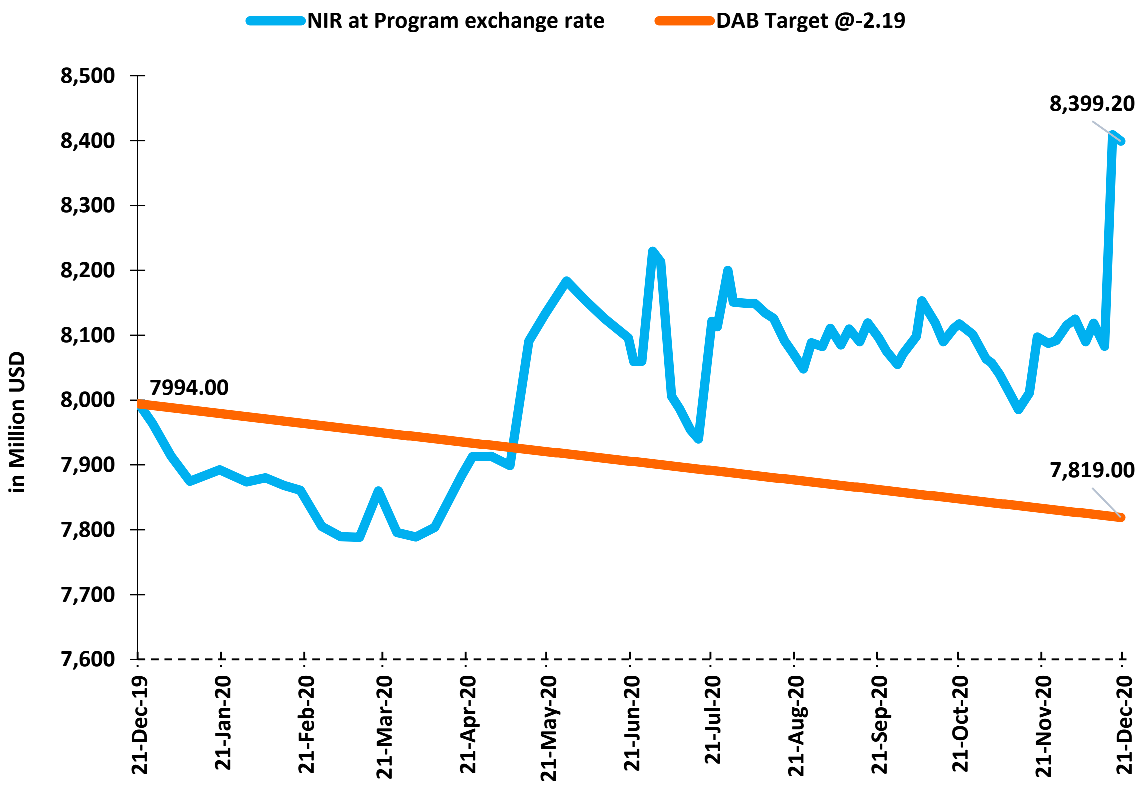
Amount In Million Afs	Dec-18 (Q4) Amount	Dec-19 (Q4) Amount	Y-o-Y Δ	Difference	Sep-20 (Q4) Amount	Y-o-Y Δ	Difference
1- Net Foreign Assets	**737,860.93**	**790,567.05**	**7.1%**	**52,706**	**871,882.14**	**10.29%**	**81,315**
(a) Foreign Assets	751,125	800,928	6.6%	49,802	881,352	10.04%	80,424
DAB Foreign exchange reserves	615,123	667,897	8.6%	52,774	748,586	12.08%	80,689
Gold	66,179	81,580	23.3%	15,401	101,770	24.75%	20,191
Other	548,944	586,318	6.8%	37,373	646,816	10.32%	60,498
Other foreign assets	136,002	133,030	-2.2%	-2,972	132,766	-0.20%	-265
(b) Foreign Liabilities	13,265	10,361	-21.9%	-2,904	9,470	-8.60%	-891
2. Net Domestic Assets	**-249,027.01**	**-274,174.73**	**10.1%**	**-25,148**	**-292,931.61**	**6.84%**	**-18,757**
(a) Net Domestic Credit	-76,284	-74,678	-2.1%	1,606	-80,108	7.27%	-5,430
Net Credit to Nonfinancial Public Sector	-121,906	-121,678	-0.2%	228	-127,484	4.77%	-5,806
Net Credit to Central Government	-122,001	-122,263	0.2%	-262	-127,700	4.45%	-5,438
Credit to Central Government	7,185	181	-97.5%	-7,004	175	-3.04%	-5
Liabilities to Central Government	129,185	122,443	-5.2%	-6,742	127,876	4.44%	5,432
Net Credit to State & Local Government	0.000	0.000	0.0%	0	0.000	0.00%	0
Net Credit to Public Nonfinancial Corporations	94	585	519.4%	490	216	-63.02%	-368
Credit to Private Sector	46,633	47,467	1.8%	835	47,710	0.51%	242
Net Credit to Other Financial Corporations	-1,011	-468	-53.7%	543	-333	-28.70%	134
(b) Capital Accounts	189,935	213,964	12.7%	24,028	227,165	6.17%	13,201
(c)Other Items Net	17,193	14,467	-15.9%	-2,726	14,341	-0.87%	-126
3- Broad Money(M2)	**486,034.18**	**513,735.13**	**5.7%**	**27,701**	**575,737.94**	**12.07%**	**62,003**
Narrow Money(M1)	453,480	479,872	6%	26,392	535,364	12%	55,492
CiC (Currency outside depository corporations)	219,911	249,940	13.7%	30,028	283,145	13.29%	33,205.64
Demand Deposits	233,568	229,933	-1.6%	-3,636	252,219	9.69%	22,286.14
Other Deposits (Quasi Money)	32,554.44	33,862.89	4.0%	1,308	40,373.93	19.23%	6,511
In Afghani	9,752	7,267	-25.5%	-2,485	9,191.67	26.49%	1,924.71
In Foreign currency	22,803	26,596	16.6%	3,793	31,182.26	17.24%	4,586.33
Securities Other Than Shares	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Source: Monetary Policy Department/DAB

2.3. Net International Reserve (NIR):

Da Afghanistan Bank holds international reserves, which consists of monetary gold, reserve position and holdings of Special Drawing Rights (SDR) with the IMF, as well as major foreign exchange such as US dollars, Euro, Great British Pound and other currencies. The Net International Reserves (NIR) of Afghanistan, which expressed in terms of US dollar, is defined as reserve assets minus reserve liabilities. NIR increased by 5.06% and had accumulation of USD 404.74 million at the end of FY 1399 (2020). NIR floor was set at USD 7,819.00 million, while in actual case, NIR in program exchange rate compiled weekly, reached to USD 8,399.20 million at the end of period under review.

Figure 2.4: Actual and target NIR (Net International Reserve) during the FY 1399 (2020)



Source: Monetary Sector, Monetary Policy Department

2.4. Foreign Exchange Market:

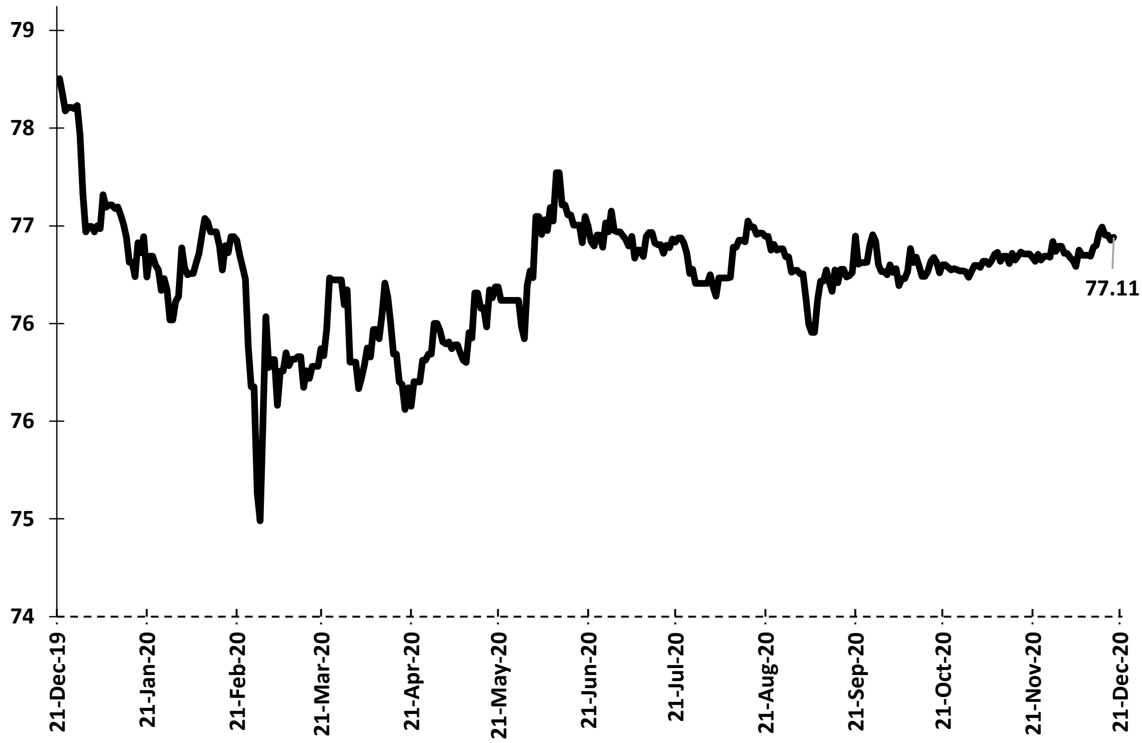
2.4.1. Foreign Exchange Rates:

Da Afghanistan Bank's (DAB) primary objective is to maintain price stability. In order to achieve and maintain this objective, DAB puts its focus on to utilize its monetary instruments via the open market operations.

During the FY 1399 (2020), Afghani relatively depreciated against the Euro, Swiss Frank, Great British Pound and Chinese Yuan, but appreciated against SD, Indian rupee, Pakistani Rupee, Iranian Toman, United Arab Emirates dirham, and Saudi Riyal.

Daily exchange rates of Afghani against USD and other key currencies for the FY 1399 (2020) are graphically presented as below:

Figure 2.5: Daily average ex- rate of Afghani against USD during FY 1399 (2020)

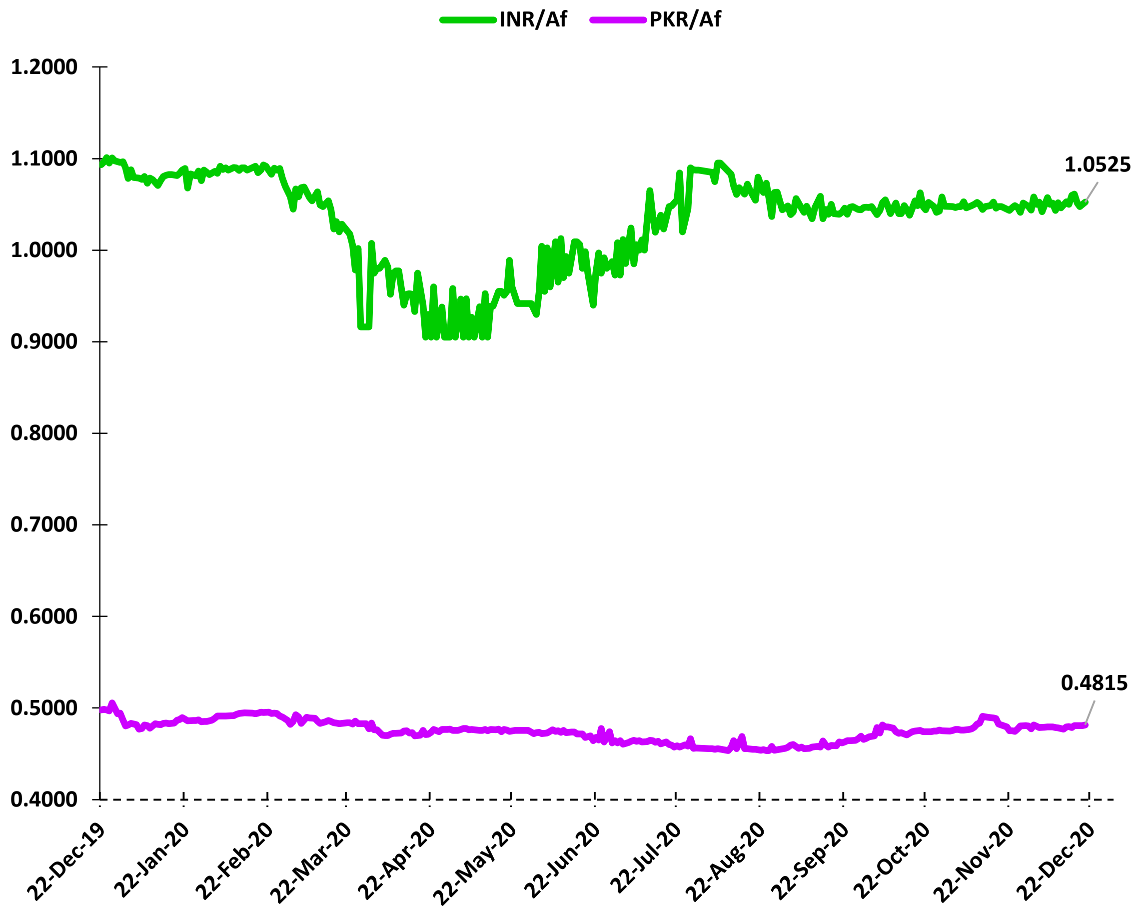


Source: Monetary Sector, Monetary Policy Department

Figure 2.6: Daily average ex- rate of Afghani against GBP and Euro during FY 1399(2020)

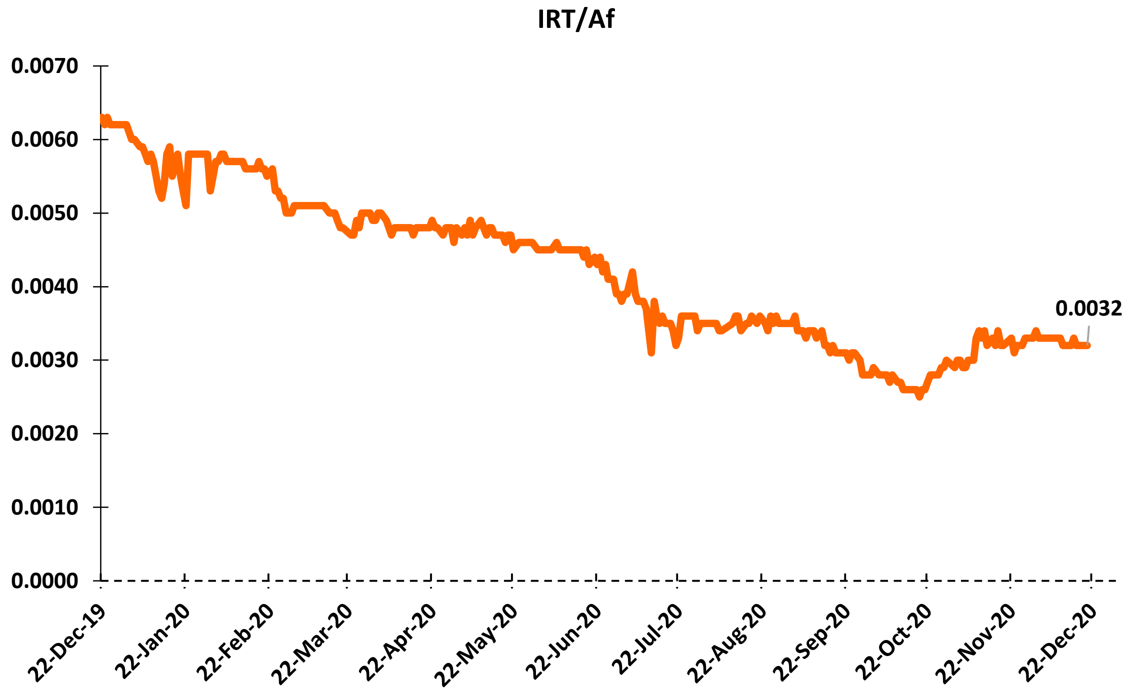
Source: Monetary Sector, Monetary Policy Department

Figure 2.7: Daily avarage ex-rate of Afghani against INR and PKR during FY 1399 (2020)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.8: Dailly average ex- rate of Afghani against IRT during FY 1399(2020)



Source: Monetary Sector, Monetary Policy Department/ DAB

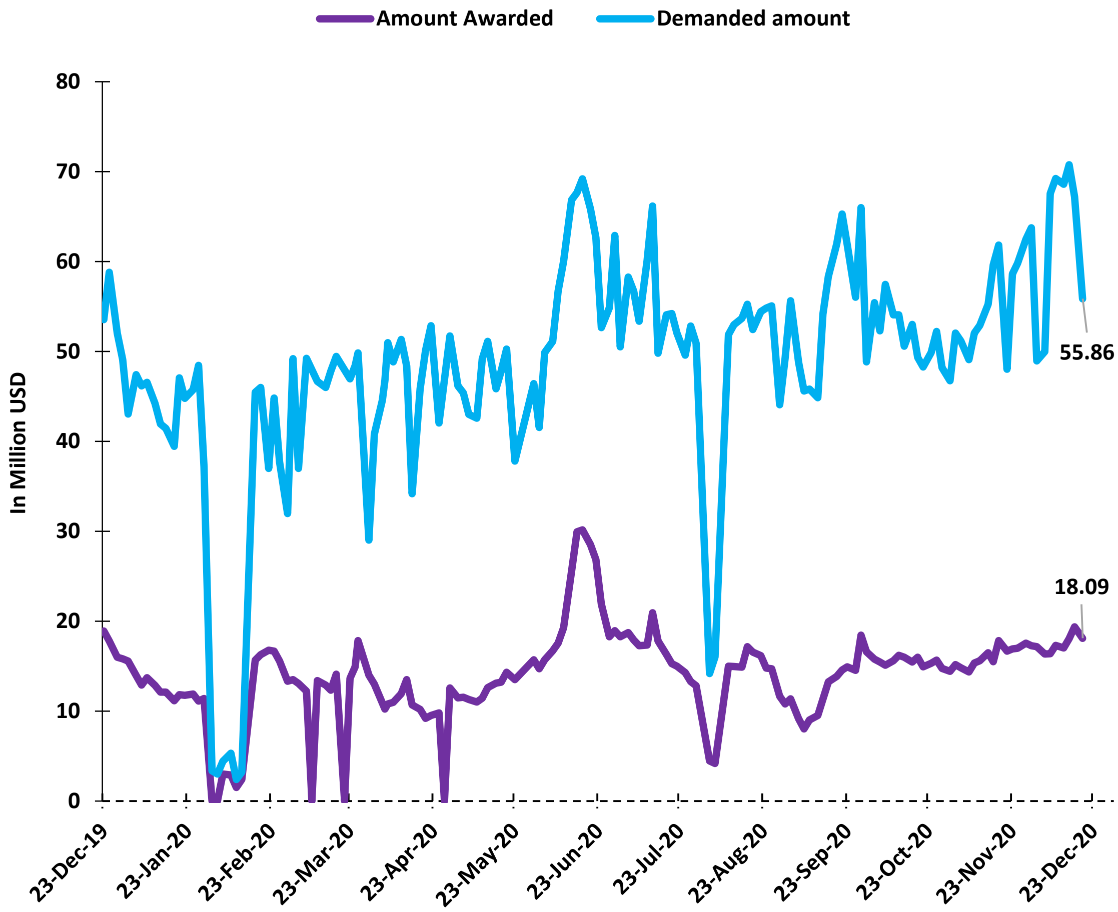
2.4.2. Foreign Exchange Auction:

In order to control the money supply and maintain price stability in domestic markets, DAB manages the reserve money by conducting FX (USD) auctions three times a week and a weekly capital notes auction. DAB continued the FX auction to mop up excess liquidity from the market and to smoothen volatility of the exchange rate of Afghani against foreign currencies, especially the US dollar.

During the FY 1399 (2020), DAB auctioned a total amount of USD 2,127.42 million, while the total demand was USD 7,298.14 million. On average 57 bidders participated in each auction and 41 bids were announced as the winning bids with the average amount of USD 14.08 million sold in each auction and the total withdrawal is recorded Afs 163.42 billion. Whereas, the data during the FY 1398 (2019) recorded a total auctioned amount of USD 2430.40million, with a total demand of USD 5820.46 million. On average, 56 bidders participated in each auction and 41 bids were awarded with an average amount of USD 17.11 million in each auction and the total withdrawal is recorded Afs 189.25 billion.

According to the approval of DAB executive board members on 6th of March 2020, DAB would sell US dollar to Da Afghanistan Brishna Sherkat (DABS) through commercial banks. The total USD sold to DABS during the period under review amounted to 254 million.

Figure 2.9: US Dollar awarded and demanded amount during the FY 1399 (2020)



Source: Monetary Policy Department/DAB

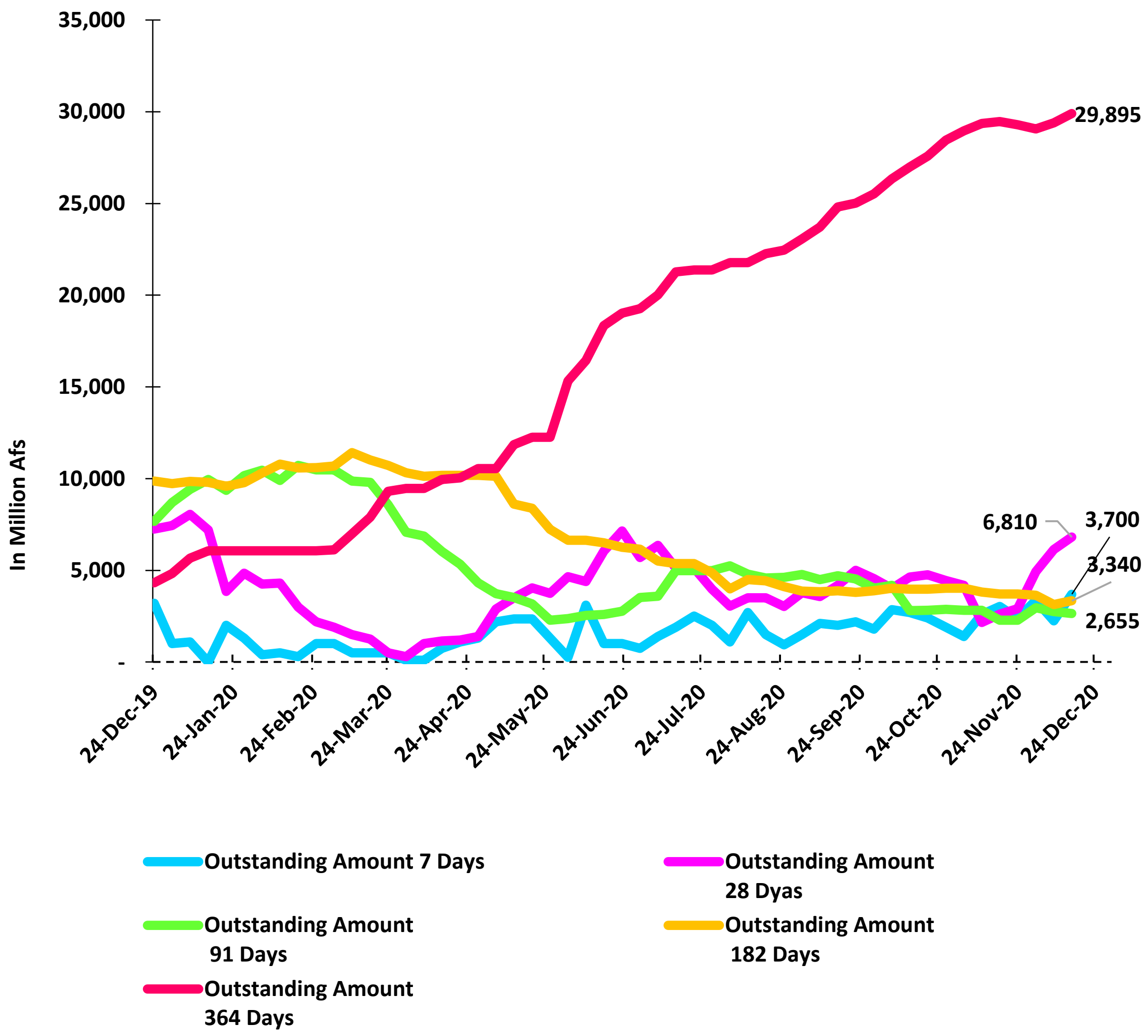
2.5. Capital Market & Liquidity Conditions:

Capital notes are Afghani denominated short–term securities offered by DAB to licensed commercial banks on weekly basis. Da Afghanistan Bank uses Capital Notes (CNs) as a monetary instrument to manage the money supply and to absorb the excess liquidity from commercial banks. Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months, and one year.

2.5.1. Capital Notes Auction:

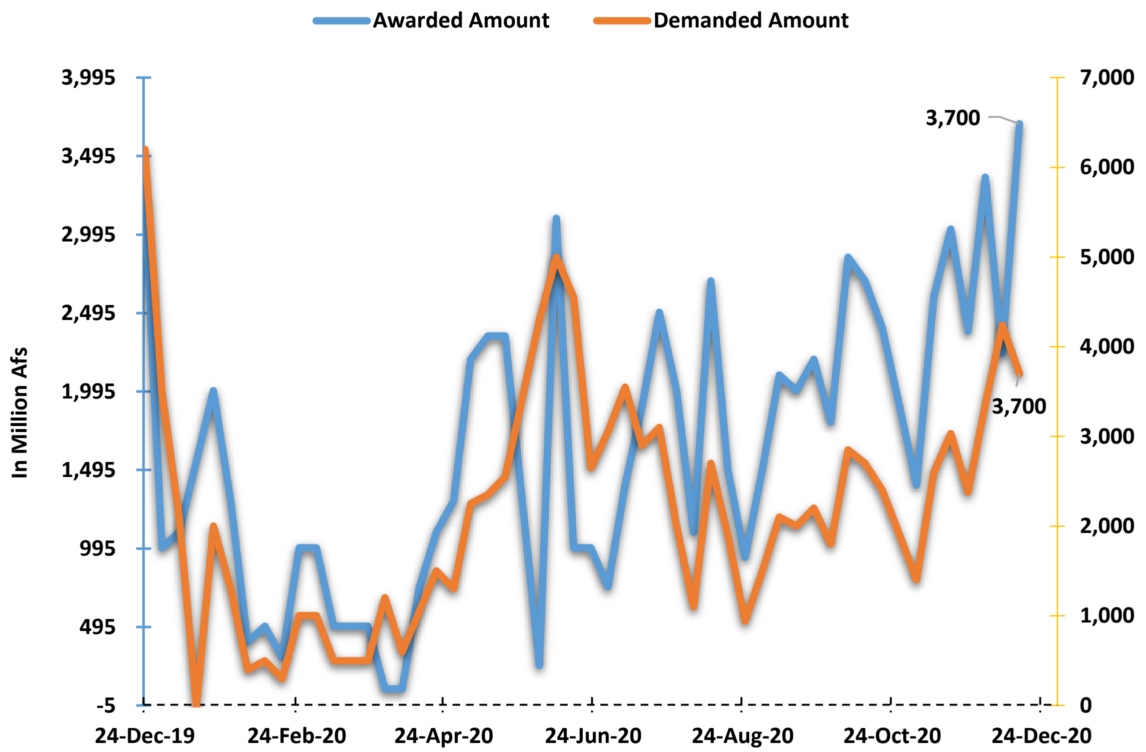
Total outstanding stock of capital notes reached Afs 46.40 billion at the end of FY 1399 (2020), which shows an increase of Afs 21.49 billion compare to Afs 24.90 billion at the end of last year. The main reason for the increase in outstanding compared to the same period of last year was higher CNs sales. Total interest paid on CNs is Afs 655.17 million at the end of FY 1399.

Figure 2.10: Stock of outstanding Capital Notes during FY 1399 (2020)



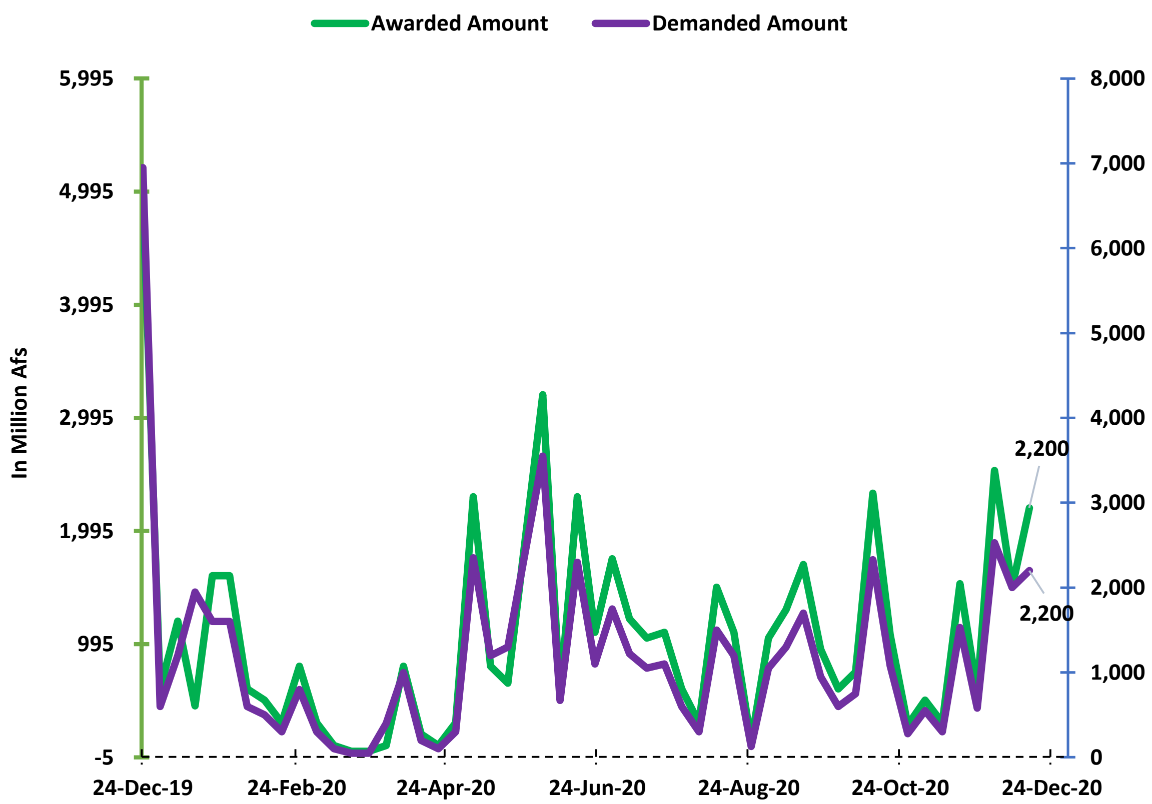
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.11: 7-days CNs demanded and awarded amount during the FY 1399 (2020)



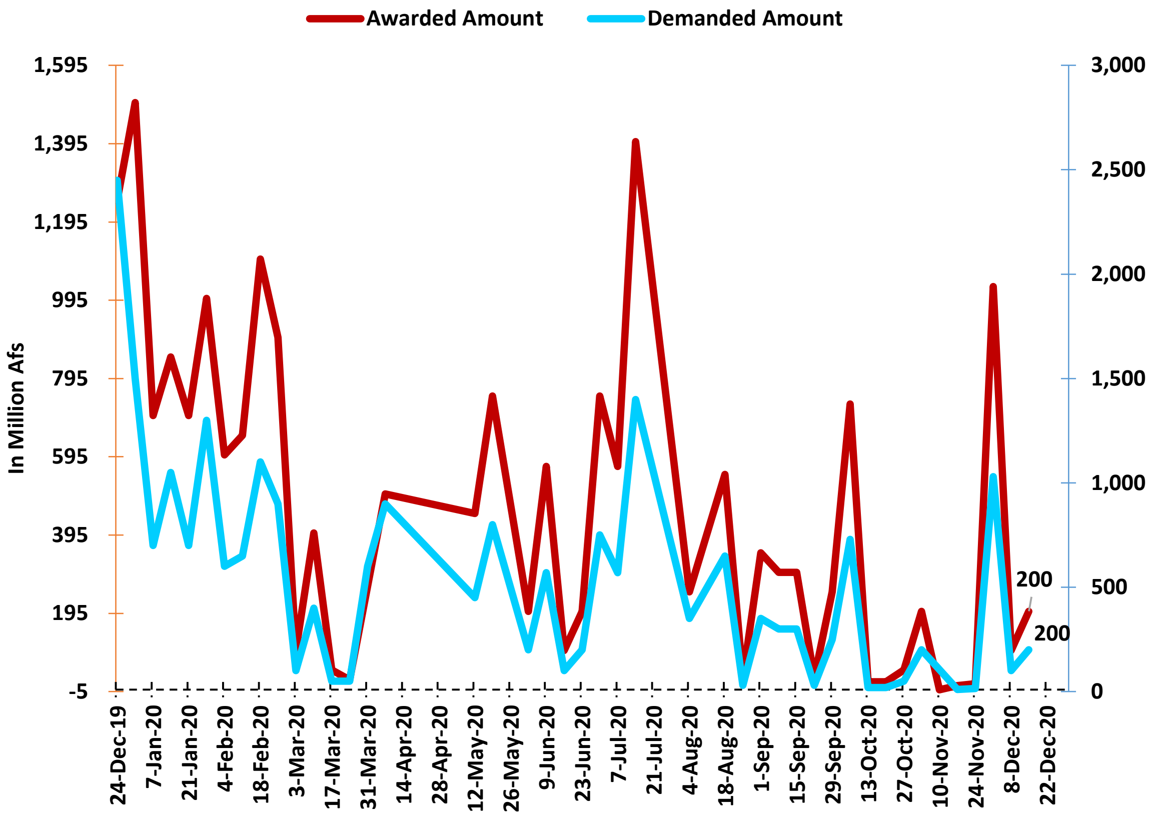
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.12: 28-days CNs demanded and awarded amount during FY 1399 (2020)



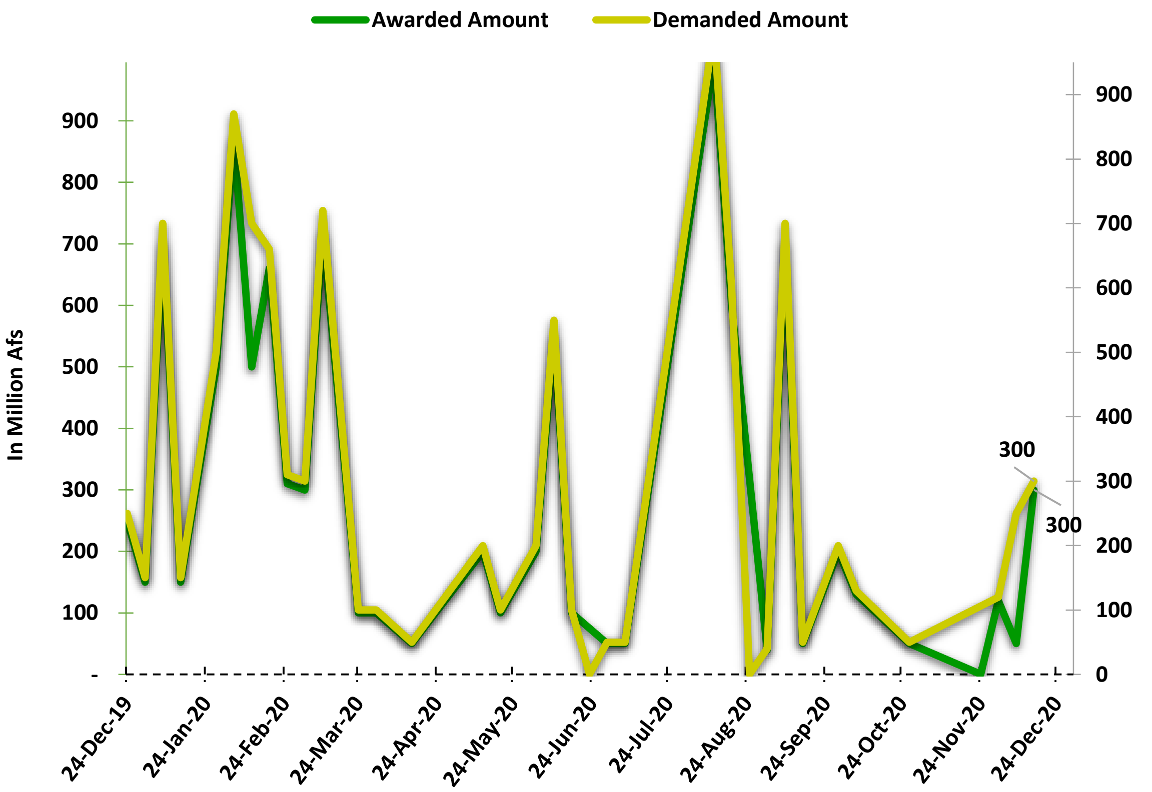
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.13: 91-days CNs demanded and awarded amount during the FY 1399 (2020)



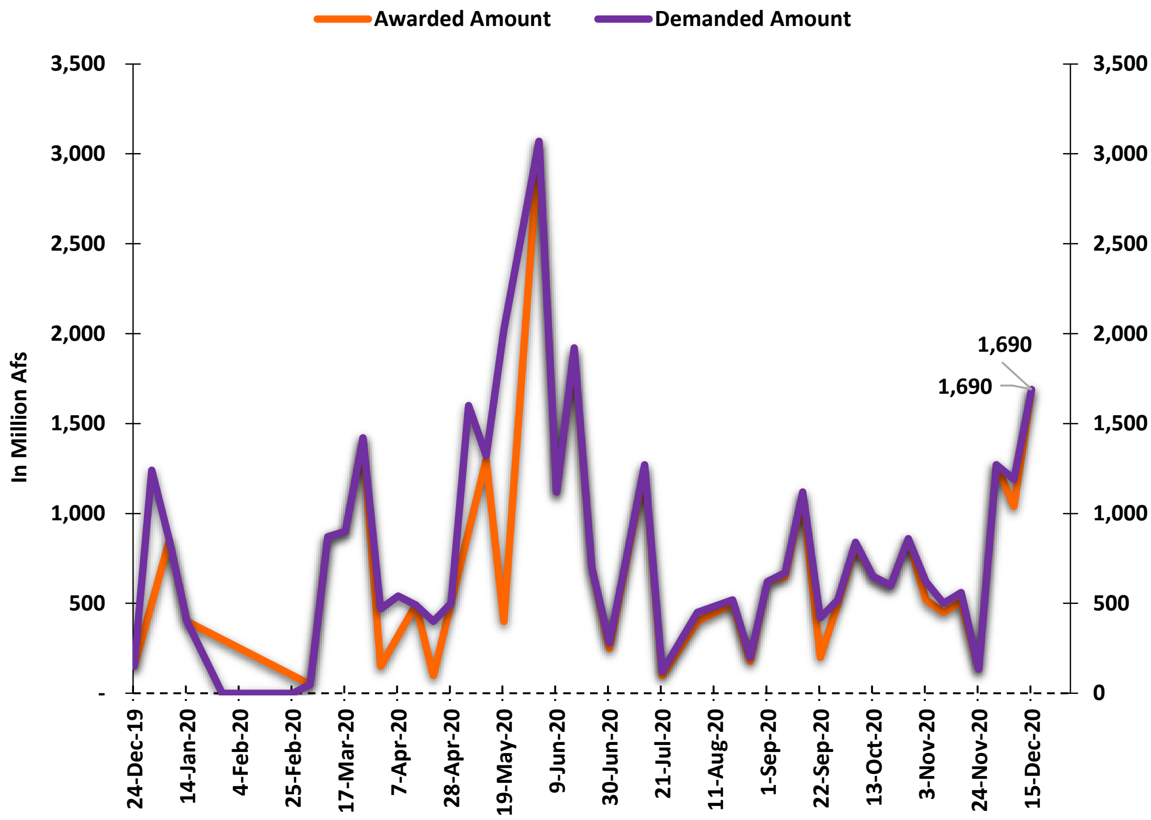
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.14: 182-days CNs demanded and awarded amount during the FY 1399 (2020)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.15: 364 -days CNs demanded and awarded amount during the FY 1399 (2020)



Source: Monetary Sector, Monetary Policy Department/ DAB

2.5.2. Required and Excess Reserves:

Commercial banks are required to hold 8% of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10% for foreign currency denominated accounts. Now the required reserves are held in the currency of denomination (Domestic and foreign), unlike the previous practice, in which required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. Required reserve amount at the end of FY 1399 (2020) recorded; Afs 7,314.98 million, USD 208.48 million and Euro 13.59 million.

- **Overnight Deposit Facility (ODF):**

This facility is available to all commercial banks to gain interest on their excess balances. The interest rate on the overnight deposit facility, based on a circular to all banks, approved by DAB Supreme Council on September 11, 2017, is now 10 basis points. The outstanding amount of overnight deposit facility stood at Afs 9,927.37 million at the end of FY 1399 (2020), and the payment of interest rate to the mentioned facility reached to Afs 7.2 million.

- **Overnight Credit Facility (OCF):**

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

3

Inflation Trend and Outlook

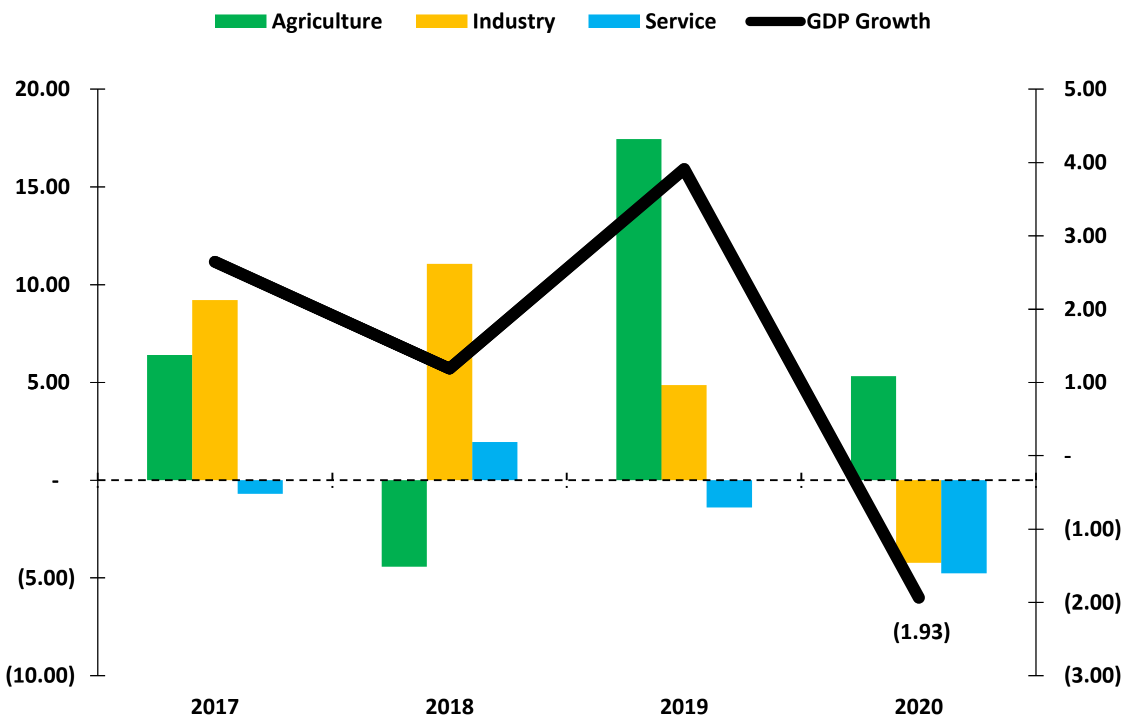
3

INFLAITON TREND AND OUTLOOK

3.1. Annual GDP:

2020 posed economic challenges of enormous proportions to struggling Afghan economy. COVID-19 outbreak and the subsequent restriction measures pushed the economy of Afghanistan deep into recession. The economic activities began to slowdown in early 2020 and exacerbated further when Afghan government imposed nation-wide lockdown in March in an attempt to contain the outbreak. Moreover, the existing political turmoil and security uncertainties amplified the negative economic effects of the Corona outbreak and quarantine. The declining trend of economic activities in Afghanistan which started in early 2020 remained persistent through-out the second quarter with the worst impact on the livelihoods of the vulnerable and poor population of the country, resulting in unprecedented increases in unemployment and poverty. The security unrests, picked up in 2020, coupled with outbreak of COVID-19 acted as a catalyst worsening the overall economic conditions.

Figure 3.1: GDP growth from 2017-2020 (1396-1399)



Source: NSIA/Monetary Policy Department, DAB staff calculation

Afghanistan GDP growth showed downward trend at the end of 2020 and economic growth was lower as compared to 2019. A downward trend in agriculture sector and also weak performance by services and industry sectors caused the economic growth to turn down to -1.9% in 2020 which shows significant decrease from 3.9% in 2019.

The contribution of GDP sectors shares reached to, Agriculture 27.01%, Industry 12.47%, and Services 56.07%. Overall, negative growth was largely the result of frightening decline in agriculture sector. of which the growth rate decreased to 5.31% compared to 17.46%. Growth in industry sector decreased to -4.22% compared to 4.85%. The impacts of services sector on the overall economic growth was also negative as the sector's growth rate decreased further to -4.76% in 2020 from -1.39% observed in 2019.

3.1.1. Agriculture Sector:

Agriculture sector is perhaps the most important sector for Afghanistan economy. This component accounts for 27.01% of the overall economy. Agriculture sector has also been effected by Covid-19 pandemic during 2020. Poultry and livestock farmers across all provinces have faced significant challenges in managing their poultry and livestock citing reasons that relate to structural deficits now worsened by COVID-19, including lack of access to day-old chicks/pullets, feed, inputs and resources, markets and veterinary services. Farmers also reported challenges in selling products (dairy, fruits, vegetables, honey) due to market closures. A significant number of small-scale provincial and national traders effected by the restrictions in procuring fresh agricultural products mainly because of difficulties in front of farmers in transporting their products to local markets due to increased transportation costs and road closures. These restrictions have seriously affected the export of food, as more than one third of large traders reported disruptions in exporting agricultural products due to border blockages.

The agriculture sector accounts for 27.01% of total 2020 GDP and majority of the population is directly or indirectly dependent on this sector. Growth in agriculture sector, based on national Statistics and Information Authority calculation, decreased to 5.31% in 2020, while the figure was calculated 17.46% in 2019. However, share of agriculture sector in total GDP increased to 27.01% in 2020 from 25.77% in 2019. Observing the data, except livestock which increased to 5.71% in 2020 from -12.63% in previews year, all sub-components of this sector represented lower growth rate in 2020.

Table 3.1: Agriculture Sector growth and share in the GDP

Agriculture Sector				
Share and Growth in percentage (%)	**GDP shares**		**GDP growth**	
	2019	**2020**	**2019**	**2020**
Agriculture	**25.77**	**27.01**	**17.46**	**5.31**
Cereals	**9.43**	**9.92**	**19.01**	**5.65**
Fruits	**4.96**	**5.22**	**23.88**	**5.62**
Livestock	**2.89**	**3.04**	**-12.63**	**5.71**
Others	**8.49**	**8.84**	**26.62**	**4.62**

Source: Monetary Policy Department, DAB & NSIA

3.1.2. Industry Sector:

Afghanistan industrial sector has experienced considerable decline in 2020 as the sector has been appallingly affected by the corona virus. Afghan government to control the epidemic applied social restrictions as a result which the industrial sector's performance recorded its lowest level since 2016.

According to the National Statistics and Information Authority (NSIA), industry sector contribution to GDP is 12.47% in 2020. The growth rate of industry sector decreased to -4.22% in 2020 compared to 4.85% in the previous year. Industry sector's sub-sectors also showed negative trend. Mining and quarrying decreased to -8.28% in 2020 compared to 14.77% in 2019, manufacturing stood at -3.52% in 2020 much lower from 6.45% in the previews year, electricity, gas and water weakened to -3.78% from 2.44% in the previews year, and construction decreased to -3.38% in 2020 compared to -1.79% recorded in 2019.

Table 3.2: Industry Sector growth and share in the GDP

Industry Sector				
Share and Growth in percentage (%)	GDP shares		GDP growth	
	2019	2020	2019	2020
Industry	**14.06**	**12.47**	**4.85**	**-4.22**
Mining & Quarrying	**1.89**	**1.56**	**14.77**	**-8.28**
Manufacturing	**7.04**	**5.96**	**6.45**	**-3.52**
Food and Beverages	**5.08**	**4.04**	**7.30**	**2.09**
Non-Food Manufacturing	**1.97**	**1.92**	**4.68**	**-15.43**
Electricity, Gas and Water	**2.04**	**1.79**	**2.44**	**-3.78**
Construction	**3.09**	**3.16**	**-1.79**	**-3.38**

Source: Monetary Policy Department, DAB & NSIA

3.1.3. Services Sector:

Service sector is also affected by the outbreak of corona virus in 2020. This component which accounts for 56.07% of the overall GDP involves the daily transaction of the people. Except telecommunication services, all other components such as transportation (international and national flights), international trade, hotel and restaurants (social gatherings) were on halt in first half of the year which have negatively affected GDP growth. However, this sector has resumed its operations in the third quarter. The growth rate of service sector decreased to -4.76% in 2020 compared to -1.39% in the previous year. Most of the sub-sectors of this item showed negative trend. Wholesale and retrial trade decreased to -1.21% in 2020 compared to 4.44% in 2019, restaurants and hotels dropped to -23.82% from 0.16%, and real estate eased to -13.37% compared to 2.18% recorded in 2019.

Table 3.3: Services Sector growth and share in the GDP

Service Sector				
Share and Growth in percentage (%)	**GDP shares**		**GDP growth**	
	2019	**2020**	**2019**	**2020**
Services	**55.47**	**56.07**	**-1.39**	**-4.76**
Wholesale & retail trade	**7.44**	**7.16**	**4.44**	**-1.21**
Transport, Repair of Motor vehicles & Storage	**5.34**	**6.83**	**-7.57**	**-5.24**
Restaurants & hotels	**3.12**	**2.52**	**0.16**	**-23.82**
Post and telecommunications	**3.03**	**3.70**	**1.82**	**0.95**
Finance and Insurance	**1.85**	**1.46**	**-12.73**	**-8.20**
Real Estate	**6.43**	**6.24**	**2.18**	**-13.37**
Education	**2.52**	**2.10**	**-26.72**	**-18.07**
Health and Social Services	**6.24**	**6.82**	**0.44**	**5.54**
Other Service	**19.51**	**19.23**	**0.14**	**-1.95**

Source: Monetary Policy Department, DAB & NSIA

3.1.4. GDP Outlook:

Afghan economy began recovering with relaxation of restrictions in Q3 of 2020, the normalization of economic activities is expected to expedite in the coming year as economic activities are more likely to reach the locality of pre pandemic levels in 2021. Despite some minor setbacks due to late approval of the fiscal budget, 2021 is expected to witness a robust recovery of industry and services sector.

Two major Railway projects aimed at enhancing regional connectivity inaugurated in late 2020 and early 2021; Khawaf Railway which connects Afghanistan with turkey and central Europe, Aqina Railway which will strengthen trade and transit between central Asia & Afghanistan. Meanwhile, the scarring effects of pandemic over potential is assumed to be vivid in the medium term. Production costs are expected to increase as businesses expenditure on infrastructure and health measure increases resulting in lower efficiency gains.

The downside risk emanating from uncertainties and shortage of rainfall remain large. On the positive side some advances are expected in the political front as peace negotiations paves the way for an integration process. In Addition, International community generously pledge assistance to Afghan Government in Geneva Conference which was held in November 2020. All these factors paint a relatively optimistic economic picture for 2021, the GDP growth in 2021 is likely to be in the vicinity of 3%. Economic growth is expected to gain further momentum in 2022 and 2023 and is likely to register economic growth of 3.5% and 4% respectively.

3.2. Global Commodity Review:

3.2.1. Summary:

Most of the commodity prices has been recovered at end of 2020. Crude oil prices have doubled since their April low, supported by sharp oil supply cuts by OPEC+, but prices remain one-third lower than their pre-pandemic levels.

Gold prices eased during 4th quarter of 2020, after reaching an all-time high of USD 2,067 per ounce on August 6. Silver prices have declined after reaching a seven-year high of USD 29 per ounce on August 10, but remains substantially higher than in January.

Platinum prices, which plunged in April, have held up much better in recent months. Both silver and platinum prices are supported by robust industrial demand. More than half of silver's demand comes from industrial applications, such as in electrical and electronics, while a quarter of platinum's supplies are used by the automotive industry.

3.2.2. Recent Trends:

Energy prices surged in December, led by a more than 15% increase in oil prices, on the other side, Non-energy prices jumped 4.7%.

Agricultural prices advanced 2.1% in December. Food prices were up 2.6%, led grains (+3.8%) and oils and meals (+2.6%). Raw materials rose 1.4%, while beverages gained marginally +0.8%. Fertilizer prices rose 2.2%, although, fertilizer prices have been resilient amid the pandemic, they have followed different paths and are projected to increase modestly by 3% in 2021. Phosphate and urea prices surged in the second half of 2020, following losses earlier in the year, reflecting robust demand and higher input costs. Potash prices remain subdued due to oversupply.

Metals prices surged more than 10% in December, with all components moving higher including; iron ore (+25%), copper (+10%), tin and nickel (+6.5% each). Precious metals gained almost 1%, led by a surge in platinum prices (+12.8%).

3.3. Consumer Prices in Afghanistan:

Currently, the consumer price index (CPI) in Afghanistan is compiled on the base prices of April 2015 while previously; the CPI was calculated on the base prices of March 2011. Similarly, in this revision, the CPI components are also aligned with new weights. As per data from the National Statistics and Information Authority (NSIA) and analysis of Da Afghanistan Bank (DAB), the following results were observed in the consumer price index of Afghanistan.

The year-on-year measurement changes in the consumer price index showed an inflationary rate of 5.60% on average in 2020, higher than 2.31% recorded in previous year. Similar to the year-on-year comparison, the inflation measured on quarter-on-quarter basis, also indicate an incline in the period under review. Observing the quarterly data for 2020, the average inflation rate increased to 5.78% in the fourth quarter of 2020, higher than average rate of 1.70% recorded in the same quarter of 2019.

Kabul CPI also reflected inflation in 2020. Observing the Kabul headline CPI, the inflation rate turned to 4.40% on average in 2020 from 2.08% observed in previous year. On quarter to quarter basis, the index increased to 4.91% on average in final quarter of 2020 compared to 1.09% in the same quarter of 2019.

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

The headline consumer price index exhibited a significant increase in 2020 on year-on-year basis as compared to 2019. As per the available data, the headline inflation measured on year-on-year basis, increased to 5.60% on average in 2020 from 2.31% recorded in last year, while on monthly basis, the inflation rate was recorded at 5.99%, 6.40%, and 4.95% in the months of October, November, and December respectively.

In the food index, the inflation increased to 10.0% on average in 2020 compared to lower rate of 3.79% in previous year. In the above mentioned index, the inflationary pressures came from higher prices of bread and cereals, meat, milk cheese and eggs, oils and fats, fresh and dried fruits, and vegetables. The highest increase in the index was recorded in the prices of oils and fats, and vegetables which changed to 13.51% and 14.52% on average in 2020 from -2.23% and -0.65% in 2019.

In non-food category, the inflation was increased by higher prices of clothing, housing, health communication, education and restaurants and hotel. While on the other hand, inflation decreased in the prices of tobacco, furnishing and household, health, and transportation. Overall inflation in non-food category increased on average to 1.38% in 2020 as compared to 0.94% observed in 2019. In the mentioned category, the highest increase was noted in price index of miscellaneous and clothing which increased to 11.27%, and 7.78% on average in 2020 from 3.82% and 5.54% recorded in 2019. The core inflation also showed upward movement in 2020 compared to the previous year. The trimmed mean which is the most common measure of core inflation, jumped to 4.83% on average in 2020 from 2.88% recorded in 2019. In addition, the CPI inflation, excluding bread and cereals, oil and fats, and transportation, increased to 4.88% in the 2020 from 2.06% observed in previous year.

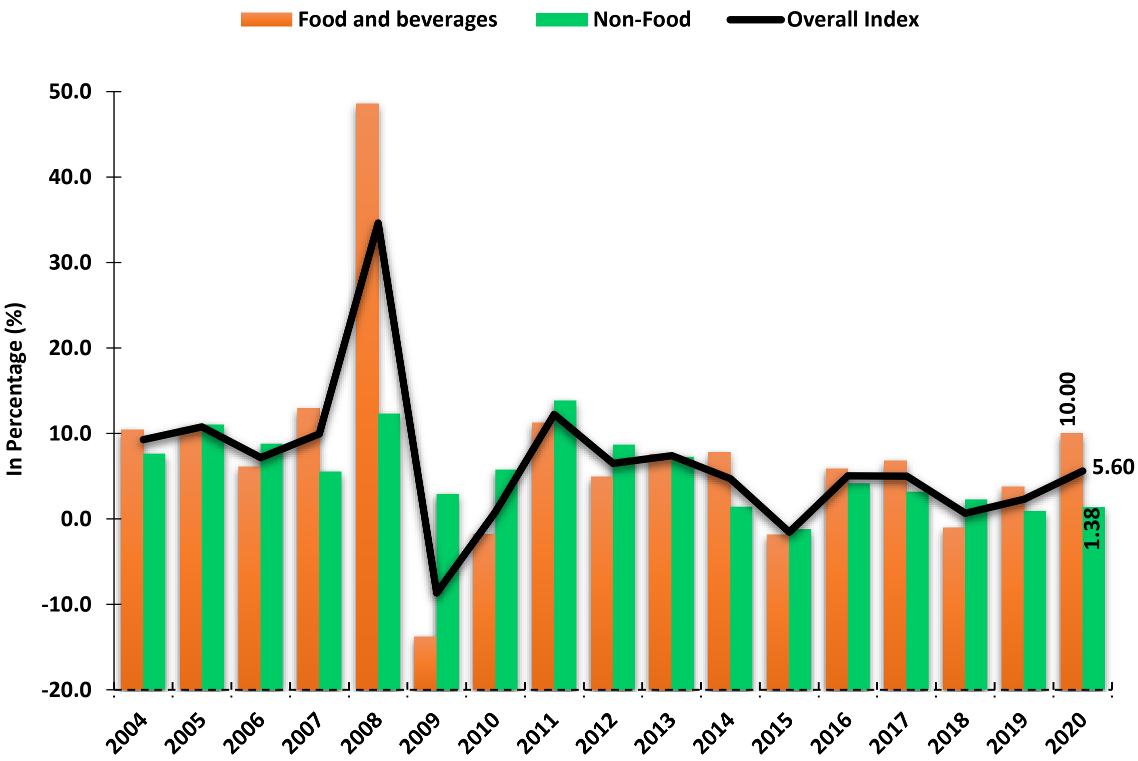
The headline consumer price index increased on year-on-year basis in the fourth quarter of 2020. As per the available data, the headline inflation by this measure increased to 5.78% on average in the fourth quarter of 2020 from 1.70% in the same period of the previews year, while, on monthly basis, the inflation rate was recorded at 5.99%, 4.40%, and 4.95% in the months of October, November, and December 2020 respectively.

In the food index, inflation increased to 9.04% on average in the fourth quarter of 2020 from 3.68% in the same quarter of the previous year. In the above mentioned index, the inflationary pressures came from higher prices of bread and cereals, meat, milk, cheese and eggs, oil and fats, fresh and dried fruits, vegetables, sugar and sweets, and spices. The highest increase in the index was recorded in the prices of oils and fats, bread and cereals which increased to 12.07% and 11.35% on average from 0.58% and 1.55% respectively.

Overall inflation in non-food category increased to average 2.65% from -0.13% in the fourth quarter of 2020 compared to same quarter of previous year. This increase was due to higher prices of tobacco, clothing, housing, furnishing and household goods, health, communication and information and culture increased over the one-year period. In the mentioned category, the highest increase was noted in price index of tobacco and communication, which increased to 4.07% and -0.30% on average from -1.90% and -5.48% respectively.

Core inflation also shows upward slope in the fourth quarter of 2020 compared to the fourth quarter of 2019. Trimmed mean which is the most common measure of core inflation, jumped to 5.18% from 2.55%. In addition, the CPI inflation excluding bread and cereals, oil and fats and transportation, increased to 5.33% in the fourth quarter of 2020 from 2.31% in the same period of the previous year.

Figure 3.2: Average National Inflation (Y-o-Y changes) for FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

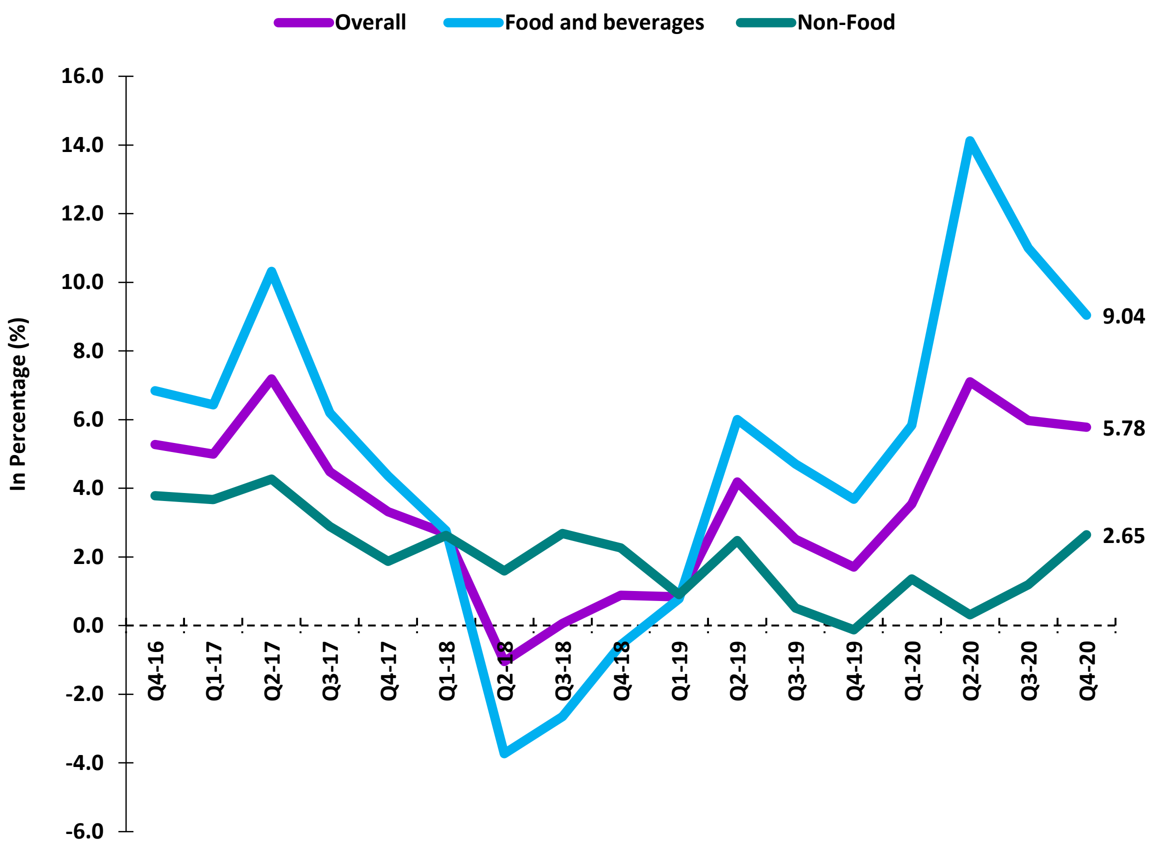
3.3.2. Developments in the National Headline Inflation (Quarter on Quarter Changes):

The short term measure of inflation shows downward trend. The national headline inflation on quarter-to-quarter basis decreased to 5.78% on average in the fourth quarter of 2020 from 5.97% recorded in the previous quarter. Food items represented low prices during the review period but on the other hand, Non-food items represented high prices.

Food inflation decreased to 9.04% in the fourth quarter of the current year from 11.00% in the third quarter of the current year. This decrease was as a result of price decrease in bread and cereals, meat, milk, oil and fats, fresh and dried fruits, and spices items. The price indices of food sub-items, milk, cheese and eggs, vegetables, and sugar and sweets, have increased in the fourth quarter of 2020 compared to the third quarter of the same period.

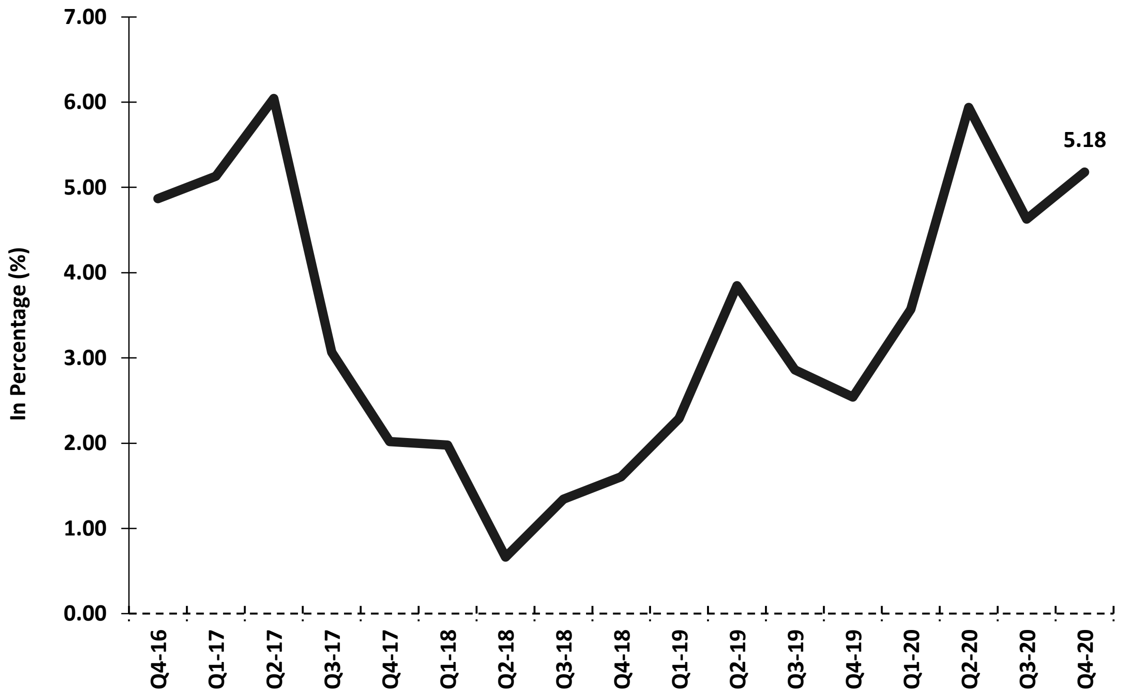
On the other hand, Non-food inflation increased in the fourth quarter of 2020 from the previous quarter. Observing the data, inflation in this index went up to 2.65% from 1.19%. In this category, the prices of housing and furnishing, and household goods increased with big margin compared to the other non-food items. On the other hand, prices decreased in some other sub items of non-food category such as; health, restaurants and hotels.

Figure 3.3: National Average CPI (Q-o-Q) for FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Figure 3.4: Trimmed mean (Q-o-Q) for FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Table 3.4: National Headline Inflation for FY 2020 (1399)

Based on April 2015											
Period	2019						2020				
	Weight	Oct 19	Nov 19	Dec 19	4Q Avg	12 Months Avg	Oct 20	Nov 20	Dec 20	4Q Avg	12 Months Avg
Overall Index	100.0	1.12	1.22	2.77	1.70	2.31	5.99	6.40	4.95	5.78	5.60
Food & Non-Alcoholic Beverages	47.8	2.84	3.29	4.91	3.68	3.79	9.75	9.87	7.50	9.04	10.00
Bread and Cereals	14.6	1.31	1.29	2.06	1.55	5.84	12.43	10.93	10.69	11.35	11.33
Meat	7.5	7.57	8.34	8.00	7.97	5.37	10.96	10.56	10.13	10.55	10.57
Milk, cheese and eggs	4.7	-0.92	-2.31	-1.74	-1.66	0.91	3.30	4.29	3.81	3.80	1.62
Oils and fats	4.6	-0.71	0.25	2.18	0.58	-2.23	11.98	11.62	12.61	12.07	13.51
Fresh and dried fruits	5.0	2.88	3.89	3.74	3.50	5.20	10.52	13.75	5.03	9.76	10.10
Vegetables	6.0	-0.51	3.34	13.24	5.36	-0.65	11.97	13.75	2.20	9.31	14.52
Sugar and sweets	2.7	6.28	3.96	4.66	4.97	5.61	3.74	5.77	5.92	5.14	3.85
Spices	1.3	24.01	23.29	21.34	22.88	16.40	-2.47	-4.98	-3.64	-3.69	8.12
Non-alcoholic beverages	1.4	4.54	3.70	4.10	4.11	4.90	3.54	2.93	3.40	3.29	4.03
Non-Food Items, Tobacco & Services	52.2	-0.47	-0.69	0.77	-0.13	0.94	2.42	3.07	2.47	2.65	1.38
Tobacco	0.3	-1.08	-2.44	-2.18	-1.90	2.05	3.11	4.50	4.60	4.07	1.78
Clothing	4.6	6.02	7.48	7.52	7.01	5.54	8.64	8.72	7.61	8.32	7.78
Housing	19.1	-4.07	-4.17	-1.49	-3.25	-2.48	0.56	2.26	1.34	1.39	-0.87
Furnishing and household goods	11.9	1.42	-0.03	0.42	0.60	2.85	4.30	4.92	5.03	4.75	2.33
Health	6.2	5.53	5.67	6.08	5.76	4.53	7.42	7.19	5.98	6.86	6.73
Transportation	4.3	-6.67	-7.59	-6.18	-6.81	0.36	-12.22	-13.01	-12.35	-12.53	-9.77
Communication	1.7	-6.68	-5.32	-4.43	-5.48	-4.37	-0.33	0.20	-0.77	-0.30	-2.25
Information and Culture	1.1	0.61	3.98	4.33	2.97	2.08	3.46	2.14	2.55	2.72	2.08
Education	0.4	2.83	0.33	1.58	1.58	2.13	5.29	7.02	4.43	5.58	2.80
Restaurants and Hotels	1.1	1.82	4.07	4.26	3.38	3.14	2.22	-0.35	-0.32	0.52	1.70
Miscellaneous	1.4	6.77	5.53	9.83	7.38	3.82	9.52	10.52	7.61	9.22	11.27
CPI ex. B & C, O & F, and T		1.66	1.80	3.48	2.31	2.06	5.39	6.27	4.32	5.33	4.88
30% trimmed mean		2.14	2.23	3.26	2.55	2.88	5.47	5.85	4.23	5.18	4.83

Source: NSIA/Monetary Policy Department, DAB staff calculation

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

The headline CPI inflation in Kabul inclined to 4.40% on average in 2020 compared to 2.08% recorded in previous year. The food index, which is accounted for 37.2% of the overall weight of the overall index reached to 7.28% on average in 2020 compare to 4.05% in previews year. In this category, the inflationary pressures came from higher prices of meat, oils and fats, fresh and dried fruit vegetables and non-alcoholic beverages.

The inflation of non-food items which comprises 62.8% weight of the whole index, increased to 2.53% on average in 2020 compared to 0.74% in previews year. The increase is mainly attributed to higher prices of clothing, housing, health, communication, information and culture, restaurants and hotels, and miscellaneous. In this category, the inflation in health, and miscellaneous increased to 12.44% and 15.21% on average from 6.67% and 7.83% which observed in last year.

On the other hand, the core inflation excluding bread & cereals, fats and oils, and transportation indicates an increasing trend in the period under review compared to previous year. In the year 2020, the core inflation rate increased to 4.48% on average while it was recorded 1.85% in 2019. The 30% trimmed mean reflected an inflation rate of 4.80% on average in 2020 compared to 2.85% recorded in 2018.

The headline CPI inflation in Kabul (year-on-year) has increased to 4.91% on average in the fourth quarter of 2020 from 1.09% in the same quarter of the previous year.

The food index, which accounted for 37.2% of the overall weight of the CPI, reflected upward movement in one-year period. In this category, inflationary pressures came from most of the food items. In the food category, higher prices of; meat, milk and cheese and eggs, oils and fats, fresh and dried fruits, vegetables, and sugar and sweets pushed the inflation rate to 5.62% on average in fourth quarter of 2020, while it was calculated 2.71% in the fourth quarter of 2019.

Inflation in non-food item, which comprises 62.8% weight of the whole index, has increased to 4.46% on average in the fourth quarter of 2020 from 0.06% in the same period of the previous year. This increase is attributed to high prices of tobacco, clothing, housing, communication, and information and culture. In this category tobacco increased to 2.43% on average from -1.59%, clothing increased to 13.44% from 5.21%, housing increased to 2.77% from -1.90%, communication increased to 1.44% from -1.23%, and information and culture increased to 6.42% from 4.35% in the fourth quarter of 2020 compared to the same quarter of previews year.

Core inflation excluding bread & cereals, fats and oils, and transportation also indicates increase in the period under review compared to the same period of the previous year. In the fourth quarter of 2020, core inflation rate increased to 5.71% on average while the rate was recorded 1.38% in the same quarter of the previews year. The 30% trimmed mean also reflected higher inflation rate, standing at 5.00% on average in the fourth quarter of 2020 compared to 2.30% in same quarter of 2019.

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

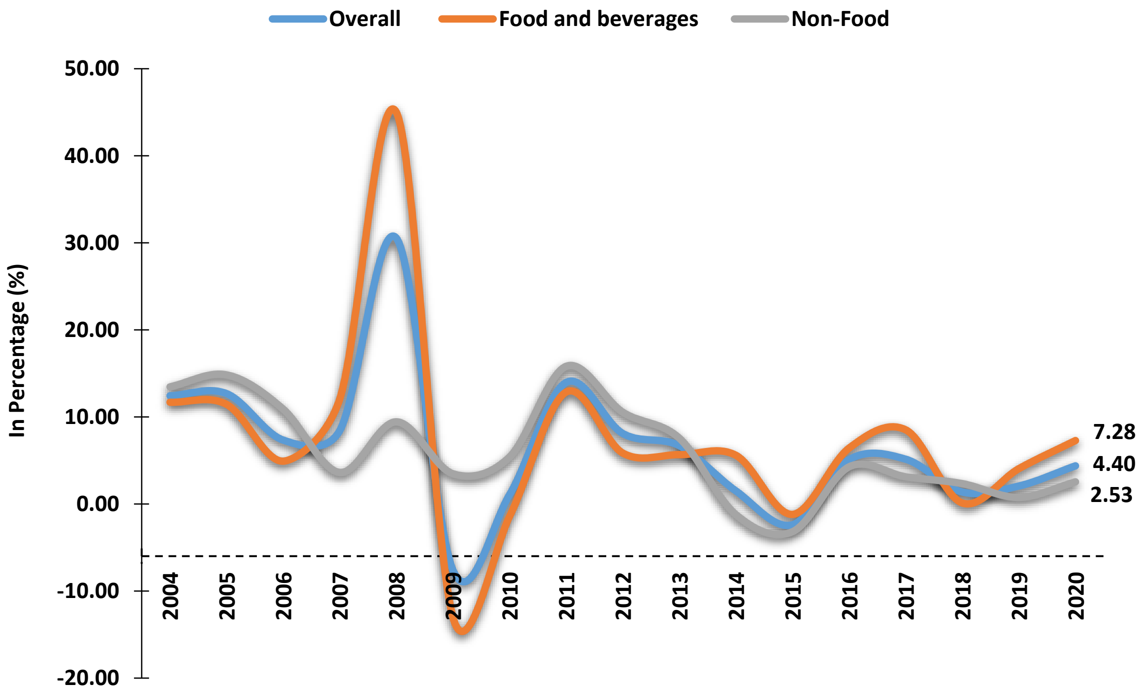
The quarter on quarter measure of headline inflation in Kabul indicated upward movement which reflected higher inflation in foods items of the CPI. The headline inflation in Kabul increased to

4.91% on average in fourth quarter of 2020 from 4.48% recorded in the third quarter of 2020.

Inflation in the food index decreased to 5.62% on average in the fourth quarter of 2020 from 7.89% in the previous quarter. In this category, the prices of meat, milk and cheese and eggs, vegetables, and sugar and sweets increased which led to high inflation rate during the period under review in food price index. The highest increase was observed in the price index of sugar and sweets which increased to 4.70% on average in the fourth quarter of 2020 from -6.13% in the third quarter of 2020.

The Non-food category of the CPI also showed increase in inflation rate during the fourth quarter of 2020 compared to the third quarter of 2020. Inflation in this category went up to 4.46% on average from 2.31%. The increase in non-food inflation is driven by high prices of tobacco, housing, clothing, transportation, education, information and culture, and furnishing and household goods, in which the highest increase was observed in the price of education index which went up to 5.25% from 0.22% compared to the previous quarter of the current year.

Figure 3.5: Kabul annual average inflation for FY 2020



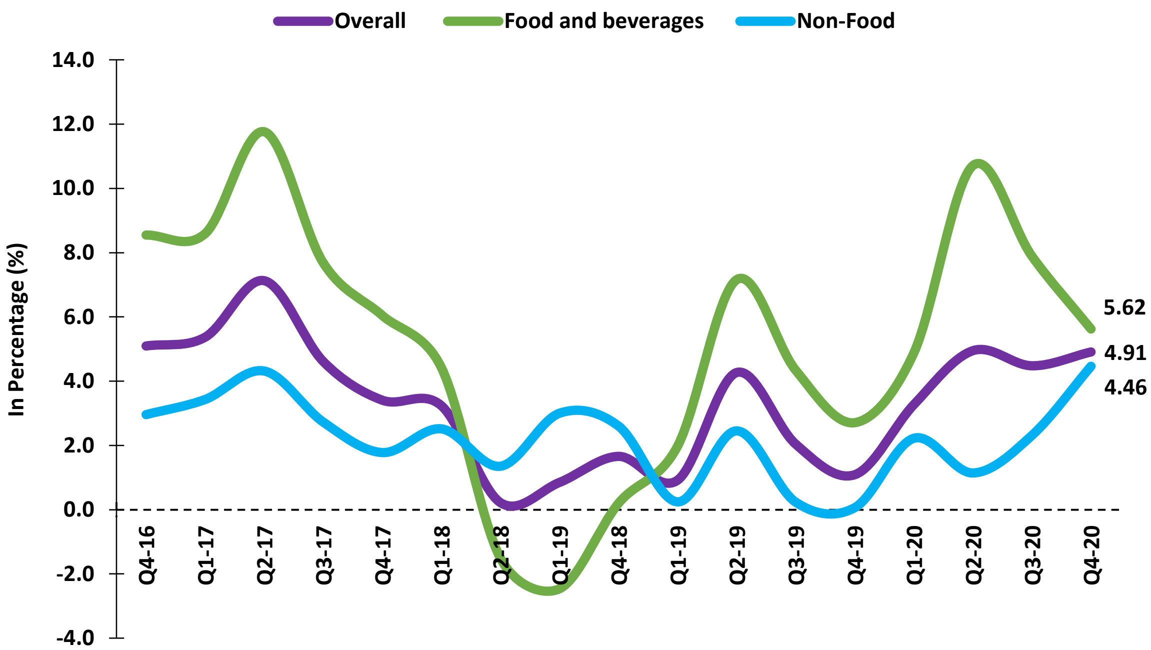
Source: NSIA/Monetary Policy Department, DAB staff calculation

3.3.5. Afghanistan Inflation Outlook for The 1st Quarter of FY 2021:

The near-term outlook of inflation is likely to move slightly upward gradually due to ongoing COVID-19 pandemic. Monetary policy department forecasts inflation rate 4% to 6% for the first quarter of 2021. The forecast is based on the following factors.

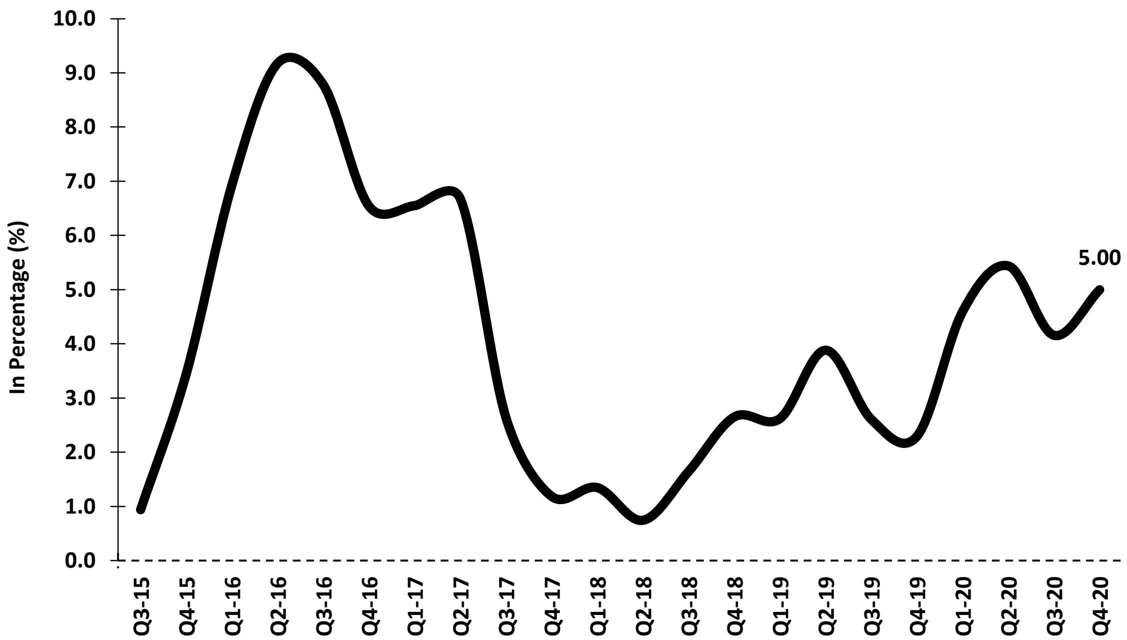
Since Afghanistan is an import oriented country and imports are at a greater quantity from neighboring countries; national inflation rate is often influenced by imported inflation from Iran, Pakistan, China, Turkey and other regional countries. There are so many factors which affect inflation rate but most importantly, Afghanistan's inflation is correlated with its trade partner countries' inflation rate and Afghani currency exchange rate against the US dollar. Regional inflation forecast may have some effects on Afghanistan's inflation rate. Inflation forecast in Afghanistan may also be conditional to the further spread of COVID-19 pandemic. Continuity of restrictive measures may cause supply shortage which may result in higher commodity prices. Also, security is another concern that increases the uncertainty level in forecasting inflation for the first quarter of 2021.

Figure 3.6: Kabul Average CPI (Q-o-Q) for FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Figure 3.7: Kabul Quarterly Average CPI (30% Trimmed Mean) for FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Table 3.5: Kabul Headline Inflation for FY 2019 and 2020

Based on Apr 2015											
Period	2019						2020				
	Weight	Oct 19	Nov 19	Dec 19	4Q Avg	12 Months Avg	Oct 20	Nov 20	Dec 20	4Q Avg	12 Months Avg
Overall Index	100.0	-0.52	0.30	3.48	1.09	2.08	4.85	6.28	3.59	4.91	4.40
Food & Non-Alcoholic Beverages	37.2	-0.08	2.24	5.98	2.71	4.05	6.30	7.81	2.76	5.62	7.28
Bread and Cereals	9.8	1.45	2.76	5.75	3.32	7.74	3.18	3.15	2.01	2.78	5.68
Meat	6.4	2.21	3.42	2.16	2.60	4.46	8.92	9.16	8.80	8.96	6.67
Milk, cheese and eggs	3.2	-3.50	-6.38	-5.98	-5.28	0.28	-2.16	3.66	3.60	1.70	-1.62
Oils and fats	3.6	-1.59	-3.89	-0.47	-1.98	-3.85	9.84	10.45	12.73	11.01	14.10
Fresh and dried fruits	5.2	-1.75	4.20	7.54	3.33	4.17	13.58	20.77	1.03	11.79	12.17
Vegetables	4.2	-14.95	-0.01	23.88	2.97	-3.11	13.39	10.63	-10.94	4.36	12.54
Sugar and sweets	2.8	6.41	2.70	4.07	4.39	7.94	2.30	4.99	6.81	4.70	1.90
Spices	1.0	25.78	30.85	22.22	26.28	23.18	-9.46	-13.68	-5.69	-9.61	4.41
Non-alcoholic beverages	0.9	4.97	4.54	3.78	4.43	4.82	3.58	2.87	4.39	3.61	5.30
Non-Food	62.8	-0.80	-0.91	1.88	0.06	0.74	3.94	5.30	4.15	4.46	2.53
Tobacco	0.3	-0.37	-2.31	-2.07	-1.59	1.65	1.15	3.46	2.66	2.43	-0.03
Clothing	4.8	2.74	5.51	7.38	5.21	3.12	14.53	14.67	11.13	13.44	11.28
Housing	23.5	-3.59	-3.39	1.30	-1.90	-2.76	0.89	4.29	3.13	2.77	-0.21
Furnishing and household goods	17.6	-0.58	-2.60	-2.00	-1.73	2.39	4.93	5.98	6.34	5.75	1.39
Health	5.3	7.25	9.69	13.37	10.10	6.67	12.31	9.71	5.42	9.15	12.44
Transportation	4.6	-5.76	-7.62	-5.43	-6.27	-0.31	-10.92	-10.29	-8.68	-9.96	-6.83
Communication	2.0	-1.47	-1.38	-0.84	-1.23	-0.72	1.30	2.76	0.27	1.44	0.64
Information and Culture	1.7	-0.67	6.62	7.11	4.35	1.70	8.27	5.61	5.37	6.42	6.05
Education	0.7	1.13	-2.36	-0.76	-0.66	1.27	4.53	7.13	4.08	5.25	0.79
Restaurants and Hotels	1.0	3.41	9.36	9.31	7.36	2.86	5.01	-0.16	-1.11	1.25	6.80
Miscellaneous	1.3	11.80	8.65	18.17	12.87	7.83	10.59	12.06	5.41	9.35	15.21
CPI ex. B & C, O & F, and T		-0.40	0.66	3.89	1.38	1.85	5.71	7.38	4.04	5.71	4.48
30% trimmed mean		0.89	1.88	4.12	2.30	2.85	5.49	5.99	3.53	5.00	4.80

Source: NSIA/Monetary Policy Department, DAB staff calculation

4

External Sector Developments

4
EXTERNAL SECTOR DEVELOPMEN

4.1. Summary:

Afghanistan's external sector continued to recover in relation to many aspects during the FY 1399, mainly supported by an improved trade deficit and a notable increment in grants inflows to the government sector as well as a moderate improvement in services account related receipts. The trade deficit improved on a year-on-year basis, with a reduction in merchandise imports due to following the slowdown in domestic economic activities as a result of COVID-19 pandemic, despite earnings from merchandise exports recorded a year-on-year decline during the FY 1399.

Meanwhile, compensation of employees together with investment income inflows and workers' remittances depicted a substantial reduction during the year under review. While, net official transfers (Operating and development) had upward trends mainly due to higher official cash receipts from both multilateral and bilateral donors during the FY 1399.

However, in the financial account a substantial increase was observed in foreign direct investment (FDI) outflow, and FDI inflows continue to worsened further in the year under review. With the increased inflows to the government sector in the form of grants (current transfer) and increased inflows in the form of foreign investments, the Central Bank of Afghanistan was able to build up gross official reserves during the FY 1399.

4.2. Balance of Payments:

4.2.1. Current Account:

The current account deficit (including official transfers) narrowed by 17% and reached at a value of USD 3,136.12 million in the FY 1399 from a value of USD 3,791.94 million recorded in preceding year, reflecting the improvement of official transfers and accelerating in services account related receipts. (Table 4.1 and figure 4.1).

Base on year-on-year comparison the deficit of trade balance[12] on BoP bases narrowed by 6% and stood at a value of USD 5,506.86 million in the FY 1399 compared with a value of USD 5,855.03 million recorded in the FY 1398. In the period under review export of goods and services dropped by 3% and reached at a value of USD 1,476.31 million in FY 1399 from a value of USD 1,515.76 million recorded in the last year. While, import of goods and services declined by 5% and stood at a value of USD 6,983.16 million in FY 1399 compared with a value of USD 7,370.79 million recorded in the last year.

Meanwhile, compensation of employees together with investment income inflows declined by 32% and stood at a value of USD 240.25 million in the FY 1399 from a value of USD 352.81 million recorded in the last year. As well as, official transfers to the government sector significantly increased by 35% and stood at a value of USD 1,798.3 million in the FY 1399 from a value of USD 1,331.2 million recorded in the last year. Whereas, Personal transfers to the country dropped by 4% and stood at a value of USD 722.23 million in the FY 1399 compared with a value of USD 753.35 million recorded in the last year.

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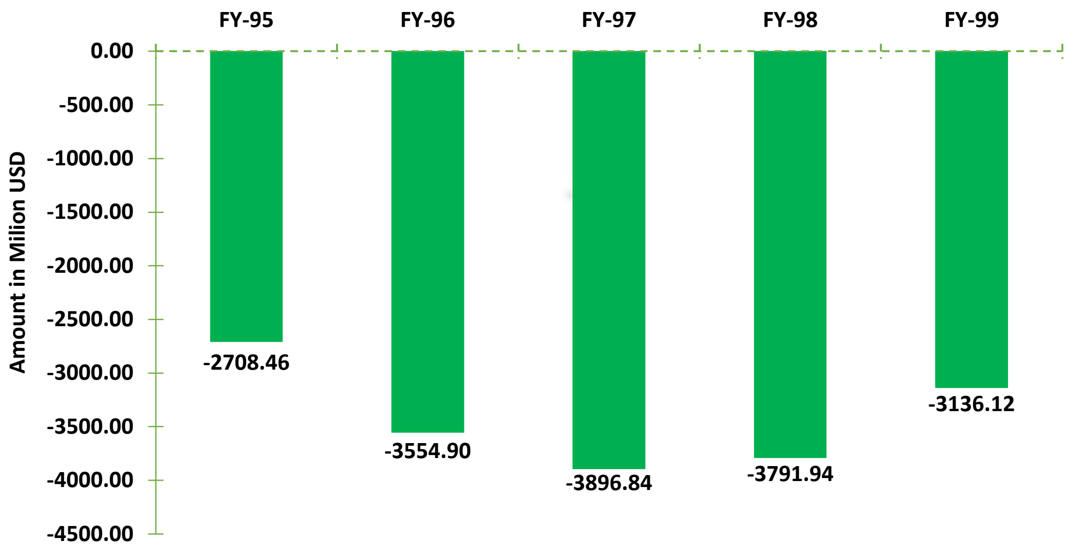
[12] *The trade balance is mostly calculated as the difference between the exports and imports of goods and services. A positive number means trade surplus and a negative number means trade deficit*

Figure 4.1: Current account balance for the FY 2020 (1399)



Source: NSIA/Monetary Policy Department, DAB staff calculation

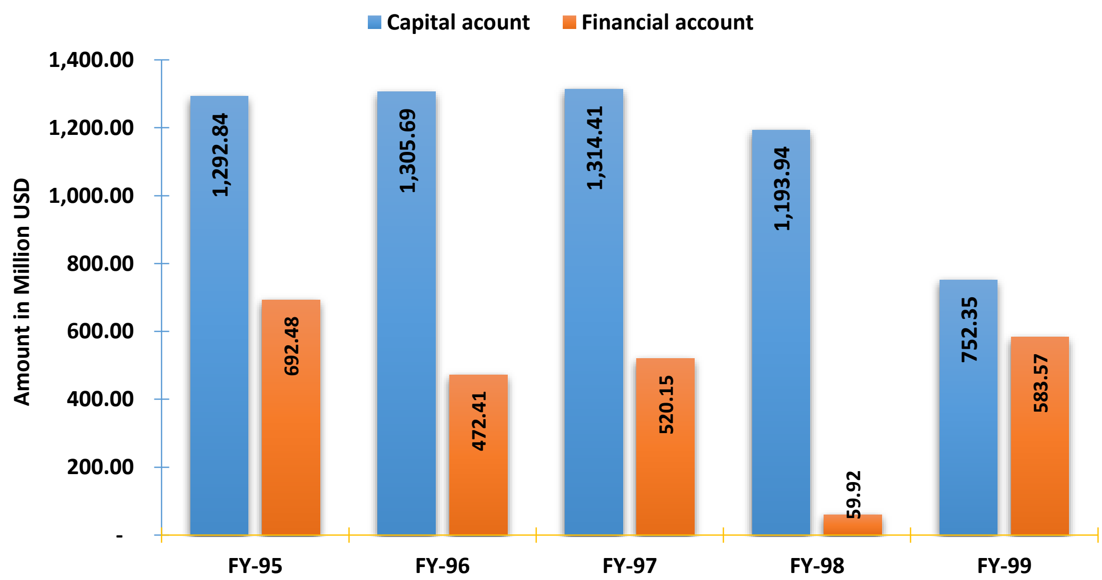
4.2.2. Capital Account:

Inflows to the capital account decreased by 37% and reached at a value of USD 752.35 million in the FY 1399 from a value of USD 1,193.49 million recorded in the FY 1398, as a result of lower inward of capital transfers to the government sector.

4.2.3. Financial account:

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

Figure 4.2: Capital and Financial Account for the FY 2020 (1399)



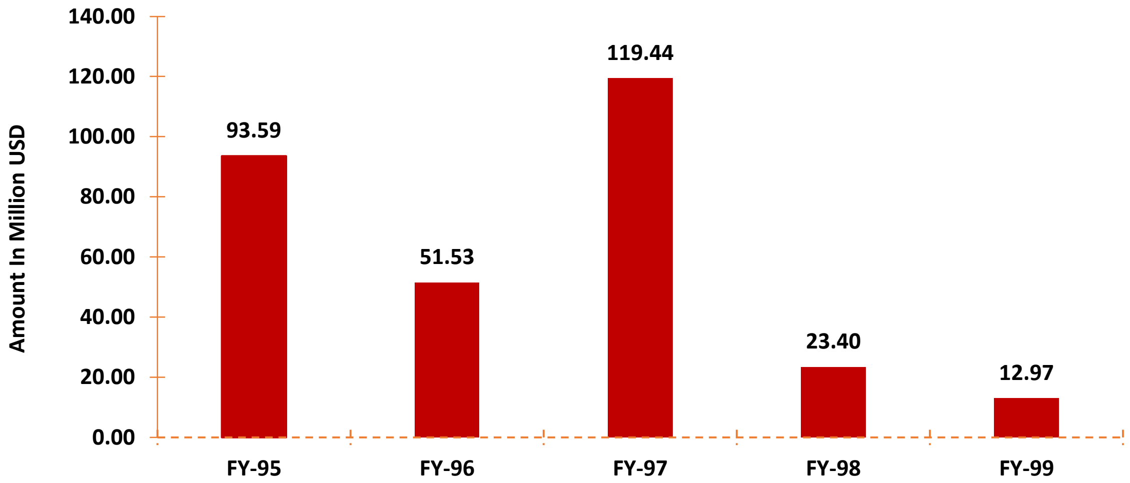
Source: Monetary Policy Department, DAB staff calculation

Considering the statistics, FDI inflow stood at a value of USD 12.97 million in the FY 1399 from a value of USD 23.40 million recorded in the FY 1398. While, FDI outflow reached at a value of USD 37.23 million in the

FY 1399 in comparison with a value of USD 26.32 million recorded in the last year. In the meantime, portfolio investment exhibits USD 63.24 million which reflects insertion of Afghanistan investment in foreign countries during the FY 1399 from the value of USD -14.62 million recorded in the FY 1398.

Further analysis reveals that the country's other aggregated financial assets abroad dropped to a value of USD 34.89 million in the FY 1399 from a value of USD 37.21 million recorded in the FY 1398. Other aggregated financial liabilities, followed upward trend and stood at a value of USD 299.27 million in the FY 1399 from a value of USD -8.18 million recorded in the previews year. The financial account balance as a total stood at USD 583.57 million in the FY 1399 which was well above the value of USD 59.92 million recorded in the FY 1398, (See table 4.1, figures 4.2 and 4.3).

Figure 4.3: FDI inflows for the FY 2020 (1399)



Source: Monetary Policy Department, DAB staff calculation

4.3. Developments in Merchandise Trade:

4.3.1. Trade in Goods:

The trade in goods account registered a deficit of USD 5,760.92 million in the FY 1399, 3% lower than a deficit of USD 5,912.29 million recorded in previous year as a result of higher contraction in exports of goods of 10% compared to that of goods imports of 5% (table 4.3, figure 4.4).

- **Exports of Goods:**

  Total exports of goods dropped at a value of USD 776.73 million in the FY 1399 compared with a value of USD 863.83 million recorded in the FY 1398. This decline in total exports of goods originated mainly from lower export of fresh fruits, medical seeds, carpet and rugs products during the period under review. Exports of fresh fruits significantly declined by 54% and stood at a value of USD 55.05 million in the FY 1399, from a value of USD 119.86 million recorded in the FY 1398.

  Exports of medical seeds and others dropped by 11% and stood at a value of USD 356.56 million in the FY 1399 from a value of USD 399.24 million recorded in the FY 1398. Exports of handmade carpet and rugs products declined by 33% and reached at a value of USD 16.65 million in the FY 1399 from a value of USD 24.9 million recorded in the last year. Export of wool and animal's hair, karakul skin and oil seeds products also contributed to the overall decline in total exports of goods.

Meanwhile, the expansions recorded in exports of leather and wool products helped ease the decrease in total exports of goods. Exports of leather and wool products continued to rise fairly by almost 1% and reached at a value of USD 43.48 million in the FY 1399 from a value of USD 43.16 million recorded FY 1398.

- **Imports of Goods:**

Import of goods declined to a value of USD 6,537.64 million in the FY 1399 from a value of USD 6,776.12 million in the last year. All major commodity groups recorded downturn following the slowdown in domestic economic activities as a result of COVID-19 pandemic even as the government has started to gradually open the domestic economy in selected areas of the country.

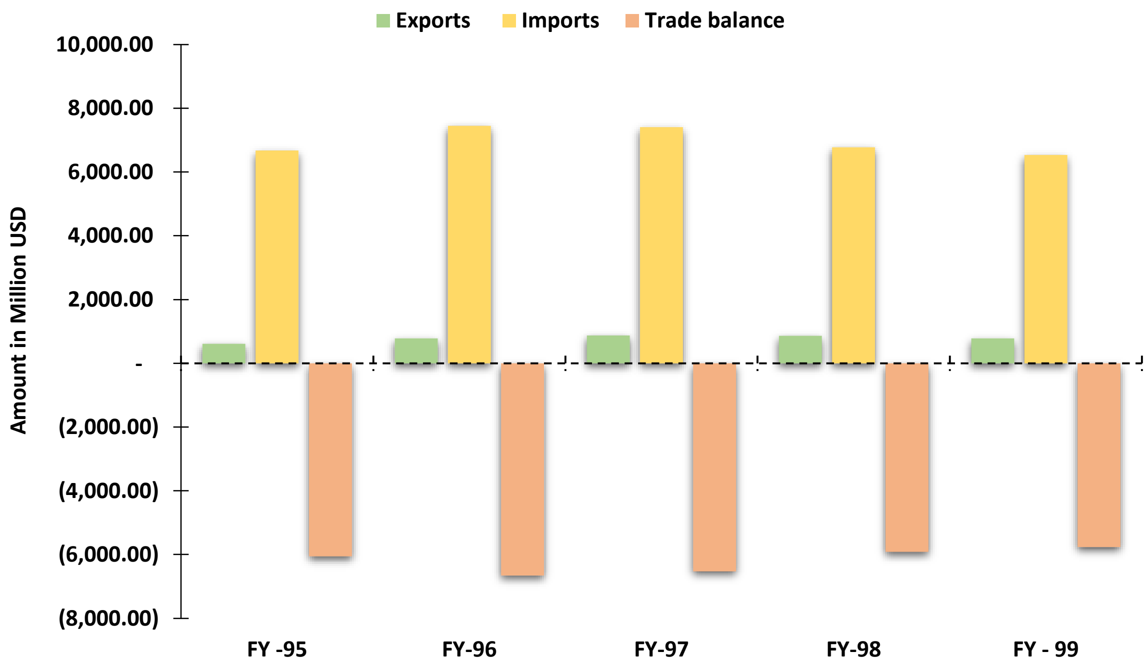
Considering the data, imports of goods registered almost 4% decline in the year under review. In particular, imports of industrial supplies decreased by 32% and stood at a value of USD 553.52 million in the FY 1399 from 815.90 million recorded in the FY 1398, largely on account of the decreases in metal production (39%), cement (28%) and fertilizer (23%).

Imports of fuel and lubricants dropped by 3% and stood at a value of USD 1,049.92 million in the FY 1399 from a value of USD 1,078.01 million in the FY 1398 mainly due to lower demand on petroleum oil by the restriction in international flights and land transportation during the FY 1399.

Imports of consumer goods also decreased by 3% and stood at a value of USD 2,407.35 million in the FY 1399 from a value of USD 2,489.80 million recorded in the FY1398, largely due to decreased demand for imports of tea 34%, vegetable oils 31% and fabrics 16% during the period under review.

Vice versa, imports of capital goods grew by 6% and reached at a value of USD 2,526.85 million in the FY 1399 compared to a value of USD 2,392.40 million recorded in the FY 1398.

Figure 4.4: Trade performance and Trade balance for the FY 2020 (1399)



Source: NSIA /DAB staff calculation

4.4. Direction of Trade:

Trade between Afghanistan and its trading partners are categorized as export destinations and import origins. Figures 4.5 and 4.6 show Afghanistan direction of trade with its trading partners in the FY 1399.

According to the National Statistic and Information Authority (NSIA), Commonwealth of Independent States (CIS), Iran, China, Pakistan, UAE and India remained the major trading partners with Afghanistan which represented 89% of total trade by Afghanistan in the FY 1399. These figures included trade in goods and commodities, but do not included trade in services.

Out of the total exports to the trading partners the major recipients of Afghanistan's exports are India, Pakistan, China, CIS, and Iran.

4.4.1. Direction of Exports:

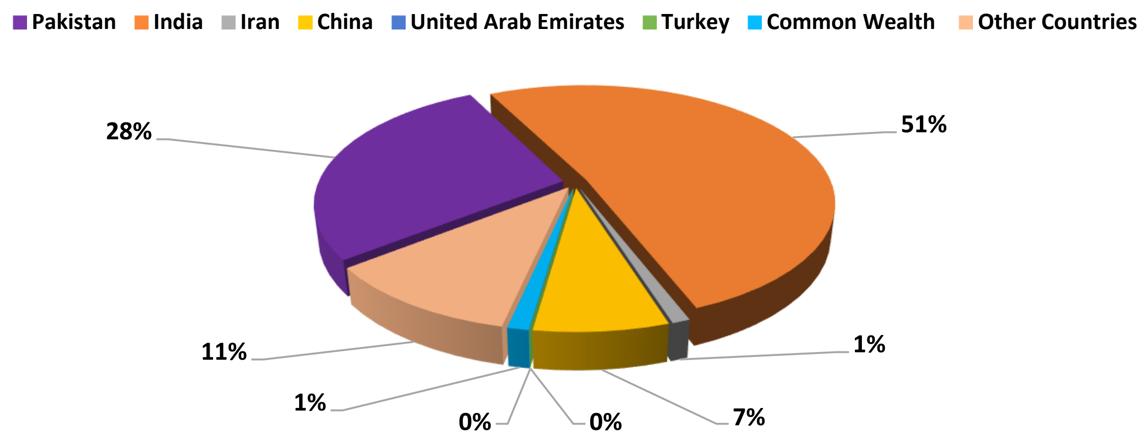
Base on the statistics, **India ranked as the first and top export destination for Afghanistan** in the FY 1399**.** The share of total exports to India reached to 51% in the FY 1399 which was well above than 47% registered in the FY 1398. In terms of value, total exports to India slightly decreased by 4% and stood at a value of USD 394.29 million in the FY 1399 from a value of USD 410.14 million recorded in the FY 1398.

Pakistan ranked the second largest buyer of Afghanistan export during the FY 1399. The share of the total exports to Pakistan declined to 28% which was below than 35% registered in the FY 1398. In term of value, total exports to Pakistan also dropped by 28% and reached to a value of USD 214.69 million in the FY 1399 compared to a value of USD 298.04 million recorded in the FY 1398.

China ranked the third largest buyer of Afghanistan export during the FY 1399. The share of Afghanistan's exports to China increased to 7% which is well above than 4% registered in the FY 1398. But in respect of value, Afghanistan's total exports to China increased by 78% and stood at a value of USD 55.34 million in the FY 1399 compared to a value of USD 31 million recorded in the FY 1398.

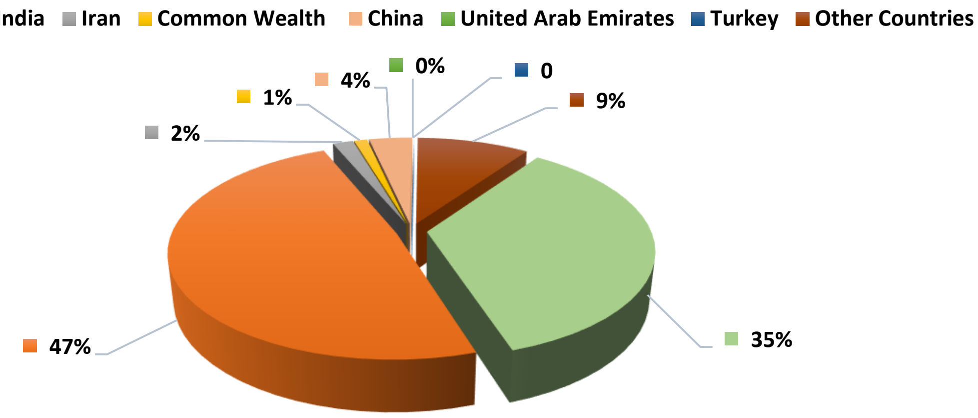
The last two largest export destinations are CIS countries and Iran during the FY 1399. The share of total exports to CIS countries slightly increased to 1.13% in the FY 1399 from 1.10% registered in the FY 1398.

Figure 4.5: Direction of Exports (% share) for the FY 2020



Source: NSIA /DAB staff calculation

Figure 4.6: Direction of Exports (% share) for the FY 2019



Source: NSIA /DAB staff calculation

The last two largest export destinations are CIS countries and Iran during the FY 1399. The share of total exports to CIS countries slightly increased to 1.13% in the FY 1399 from 1.10% registered in the FY 1398. In term of value, Afghanistan total exports to CIS countries declined by 7% and stood at a value of USD 8.81 million in the FY 1399 from a value of USD 9.47 recorded in the FY 1398. Whereas, the share of total export to Iran also indicate a little decline to 1% in the FY 1399 from 2% registered in the FY 1398. In respect of value, total exports to Iran decreased by 49% and reached to a value of USD 7.47 million in the FY 1399 from a value of 14.62 million registered in the last year. (See tables 4.4, 4.5 and figures 4.5, 4.6).

4.4.2. Direction of Imports:

Major parts of Afghanistan import are sourced from CIS countries, Iran, China, Pakistan, India, Malaysia, Turkey, United Arab Emirates and Japan.

CIS countries which are followed by "Russia, Tajikistan, Uzbekistan, Turkmenistan and Kazakhstan**" were the first largest sources of imports for Afghanistan during the FY 1399.** Imports from CIS countries grew by 18% and stood at a value of USD 1,932.31 million with share of 30% in the FY 1399 from a value of USD 1,633.78 million with share of 24% in the FY 1398.

Iran ranked the next largest import source for Afghanistan in the FY 1399. Imports from Iran dropped by 11% and stood at a value of USD 1,110.95 million with share of 17% in the FY 1399 from a value of USD 1247.26 million with share of 18% in the FY 1398.

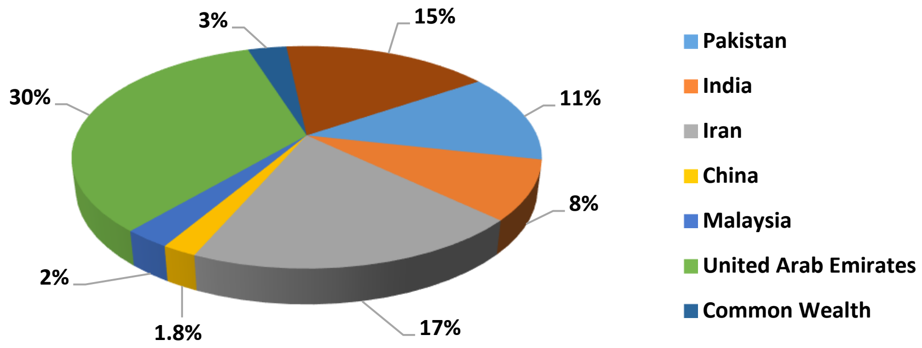
After Iran the next largest import sources is China in the FY 1399. The total imports from china decreased by 15% and stood at a value of USD 984.47 million with share of 15% in the FY 1399 from a value of USD 1,156.68 million with share of 17% recorded in the last year.

Pakistan graded the fourth largest import origin to Afghanistan in the FY 1399. Total imports from Pakistan decreased by 30% and stood at a value of USD 736.73 million with share of 11% in the FY 1399 from a value of USD 1058.01 million with share of 16% in the FY 1398.

India was the fifth largest import origin to Afghanistan in the FY 1399. Total Imports from India increased by 21% to a value of USD 490.96 million with share of 8% in the FY 1399 from a value of USD 404.91 million with share of 6% in the FY

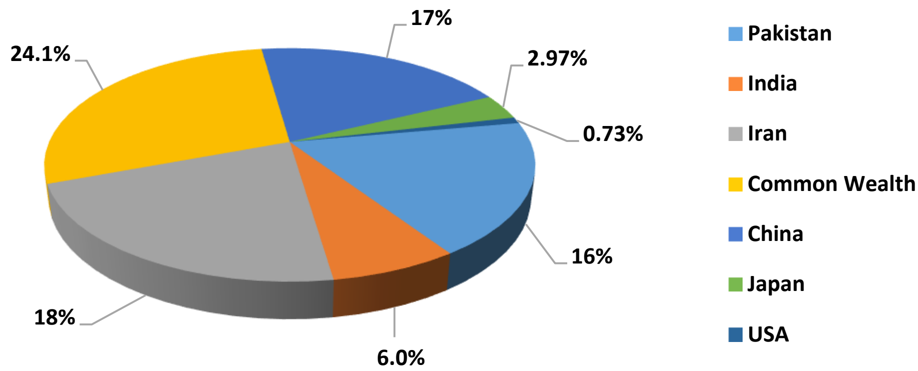
1398. **Japan, UAE and Malaysia** were the last largest sources of imports for Afghanistan in the FY 1399. The shares of each source in the total imports were accounted as 3%, 2.4% and 1.8% respectively.

Figure 4.7: Direction of Imports (% share) for the FY 1399 - 2020



Source: NSIA /DAB staff calculation

Figure 4.8: Direction of Imports (%share) for the FY 1398-2019



Source: NSIA /DAB staff calculation

4.5. Composition of Trade:

The Statistical analysis of a country's product groups in its international trade is referred to as Composition of trade.

4.5.1. Commodity Composition of Exports:

The analysis carried out for products groups exported is known as the Composition of Exports. So, Afghanistan's exports are comprised of fresh and dry fruits, medical seeds products, leather and wool, carpet and rugs which has been categorized and analyzed as bellow:

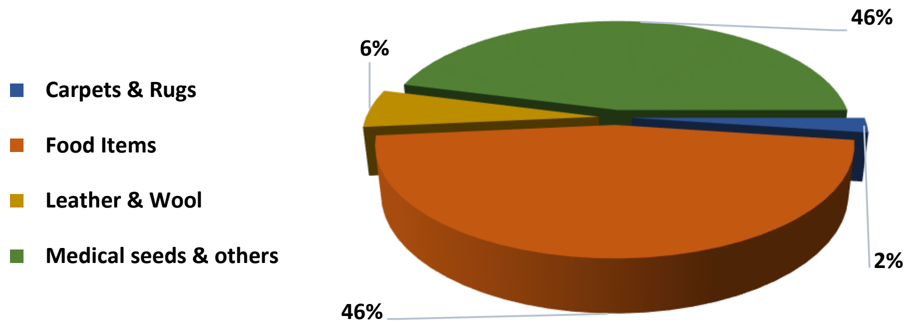
Medical seeds products which constituted 46.2% of total exports in the FY 1398 decreased to 45.9% in the FY 1399. In term of value the export of such items also had downward trend and stood at a value of USD 356.56 million in FY 1399 from a value of USD 399.24 million recorded in the FY 1398. The major medical seeds commodities exported by Afghanistan are included in Red asafetida, Green caraway, Water melon seed and Wild rue seed.

Exports of food items (oil seeds, fresh and dry fruits) drastically faded by 9% and reached at a value of USD 360.02 million in the FY 1399 from a value of USD 396.53 million recorded in the FY 1398. At the same time export of food items in the basket of total exports slightly increased to 46.4% in the FY 1399 from 45.9% recorded in the last year.

Export of leather and wool production which included; cotton, Wool, Animals Hair and Skin as well as karakul Skin and sheep Gut slightly increased by 1% and stood at a value of USD 43.48 million in the FY 1399 from a value of USD 43.16 million recorded in the preceding year. In terms of shares the leather and wool products had the third largest share in the basket of total exports which is increased to 5.6% in third FY 1399, from 5% recorded in the previous year.

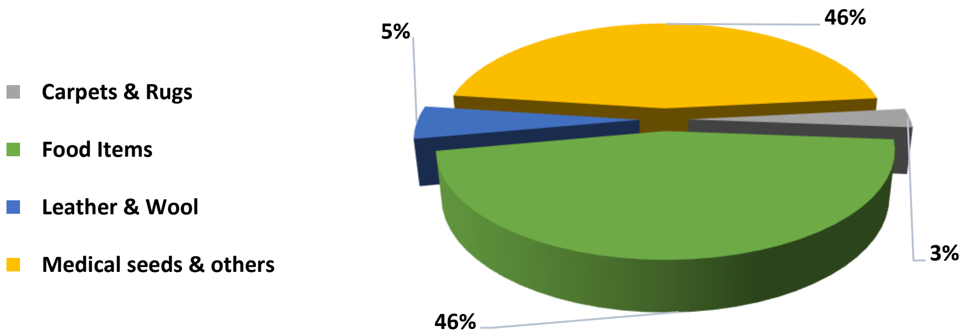
Export of carpet and rugs which are considered as a main component of Afghanistan's exports in the past decades constituted 2.9% of total exports in the FY 1398, decreased to 2.1% in the FY 1399. While the exports value of such items had downward movement and stood at a value of USD 16.65 million in FY 1399 which showed a significant decrement of 33% as compared to the value of USD 24.9 million recorded in the last year. (Figures 4.11 and 4.12 indicate composition of exports in the related periods).

Figure 4.9: Composition of Exports (share in %) for FY 2020



Source: NSIA/DAB staff calculation

Figure 4.10: Composition of Exports (share in %) for the FY 2019



Source: NSIA/DAB staff calculation

4.5.2. Composition of Imports:

Commodity imports of the country are classified into four categories which are described as below:

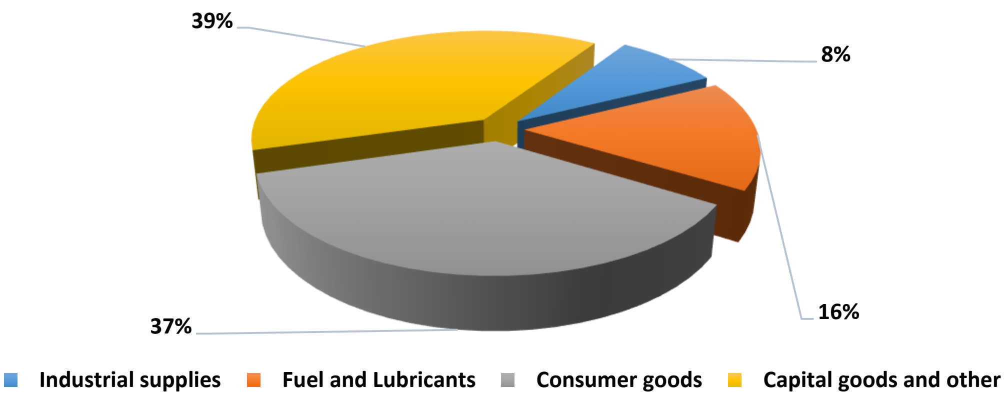
Imports of capital goods has grown by 6% and stood at a value of USD 2,526.85 million in the FY 1399 from a value of USD 2,392.40 million recorded in the FY 1398. The share of capital goods in overall imports was the highest in the basket of imports which expanded to 39% in the FY 1399 from 35% recorded in the preceding year.

Import of consumer goods on the other hand, have dropped by 3% over this period, and stood at a value of USD 2,407.35 million in the FY 1399 from a value of USD 2,489.80 million recorded in the FY 1398. Consumer goods is comprised of major import items such as flour and wheat flour, fabrics, sugar, electricity, vegetable-oil, cigarettes, medicines, soaps, cloths, footwear, tire and tubes and electronic goods. Observing the data, the share of consumer goods in overall imports slightly increased from 36.7% in the FY 1398 to 36.8% in the year under review.

The other major segment of imported goods is fuel and lubricant imports, under which the petroleum oil makes the major share. The value of petroleum oil in the basket of total imports decreased by 3% and stood at a value of USD 1,049.92 million in the FY 1399 from a value of USD 1,078.01 million recorded in the FY 1398, the share of which in overall imports slightly increased to 16.1% in the FY 1399 from 15.9% recorded in the FY 1398.

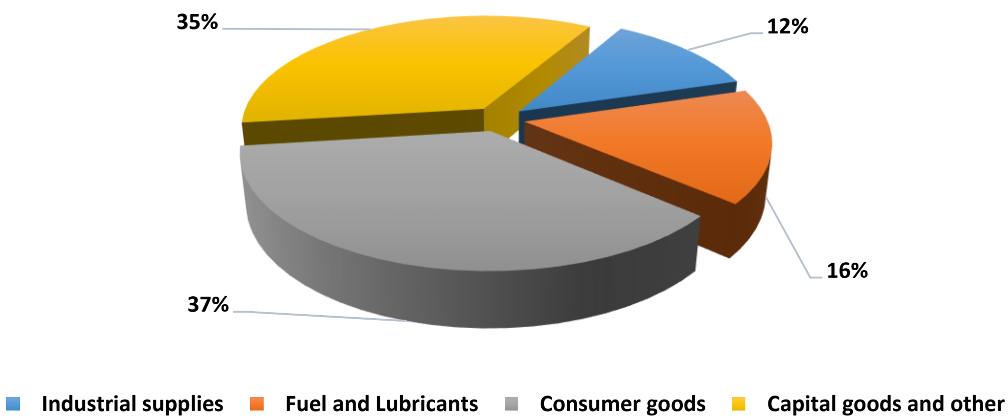
In the import category the industrial supplies hold the smallest share in the basket of Afghanistan's imports which is decreased to 8% in the FY 1399 from 12% recorded in the FY 1398. In term of value it exhibited that the imports of such goods contracted notably by 32% and stood at a value of USD 553.52 million in the FY 1399 compared to a value of USD 815.90 million captured in the FY 1398, (see table 4.2, and figures 4.9, 4.10).

Figure 4.11: Composition of Imports (share %) for the FY 2020



Source: NSIA/DAB staff calculation

Figure 4.12: Composition of Imports (share %) for the FY 2019



Source: NSIA/DAB staff calculation

4.6. External Debt:

Afghanistan's external debt stood at a value of USD 2,273.59 million at the end of the FY 1399, recorded an increase of USD 316.96 million over its level at the end of the FY 1398, mainly on account of a rise in official borrowings.

Considering the statistics, the total public external debts grew by 16% during the year under review (Figure 4.13). Loan principal repayments together with services made to the World Bank, Asian Development Bank and Islamic Development Bank during the FY 1399.

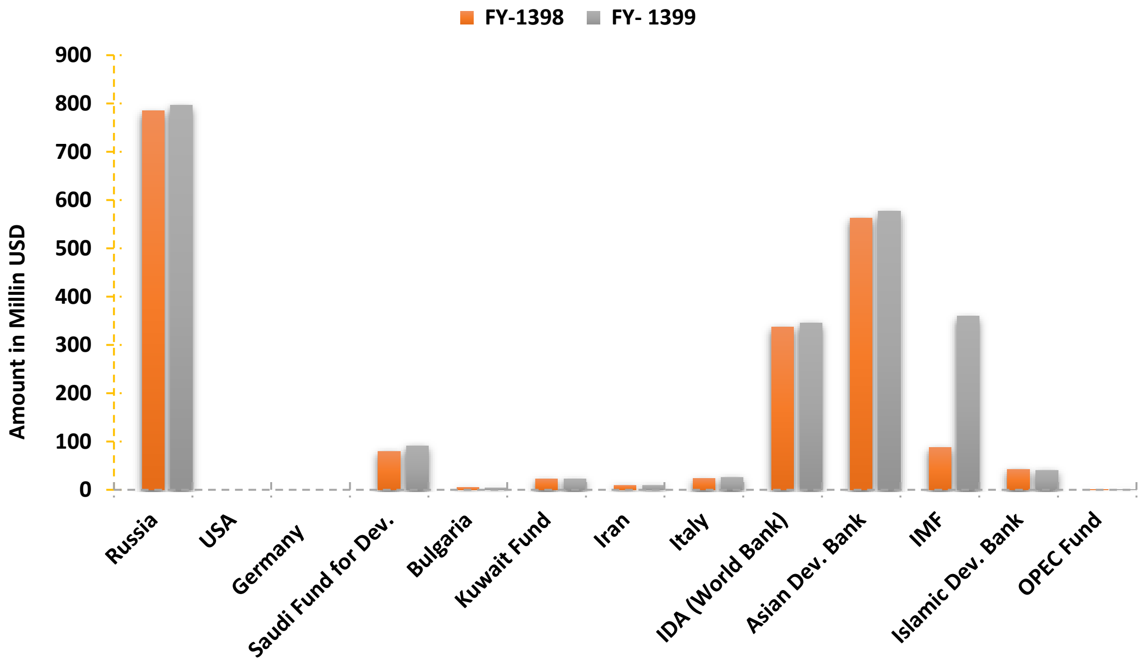
The World Bank and Asian Development Bank as a major multilateral creditor to Afghanistan made USD 1.67 million debt release on principles as well as USD 0.13 million as services charges during the year under review.

Bilateral loan is segregated into two parts; Paris club and Non-Paris Club creditors: The total amount of loan payable to Paris Club creditors especially Russian federation stood at a value of USD 796.03 million at the end of the FY 1399 from the amount of USD 785.11 million recorded in the last year. Based on year-on-year comparison, it registered 1% increase to debt stocks due to variation in exchange rate to the mentioned creditor.

Compared to the last year, the total debt from Non-Paris Club members (Saudi Fund for Development, Bulgaria, Kuwait fund, Iran and Italy) rose by 10% and stood at a value of USD 153.57 million in the FY 1399 from a value of USD 139.30 million recorded in the FY 1398.

On the other hand, total debt from multilateral creditors to Afghanistan increased by 28% and stood at a value of USD 1,324 million in the FY 1399 from a value of USD 1,032.22 million recorded in the FY 1398 which shown USD 291.78 million increase in the total debt during the year under review.

Figure 4.13: External Debt Comparison for the FY 2019 (1398) & FY 2020 (1399)



Source: NSIA/DAB staff calculation

4.7. Net International Reserves:

The foreign International reserves include four items; monetary gold, reserve position in the fund, SDRs (special drawing rights of the IMF) and foreign currency assets accumulated by Afghanistan and controlled by the central Bank of Afghanistan (Da Afghanistan Bank).

The Net International Reserve (NIR) is measured as Gross International Reserves (GIR) minus reserve related liabilities. At the end of the FY 1399 the level of Afghanistan's GIR has steadily increased by 11.48% and stood at a value of USD 9,478.49 million from the amount of USD 8,502.15 million registered in the previous year.

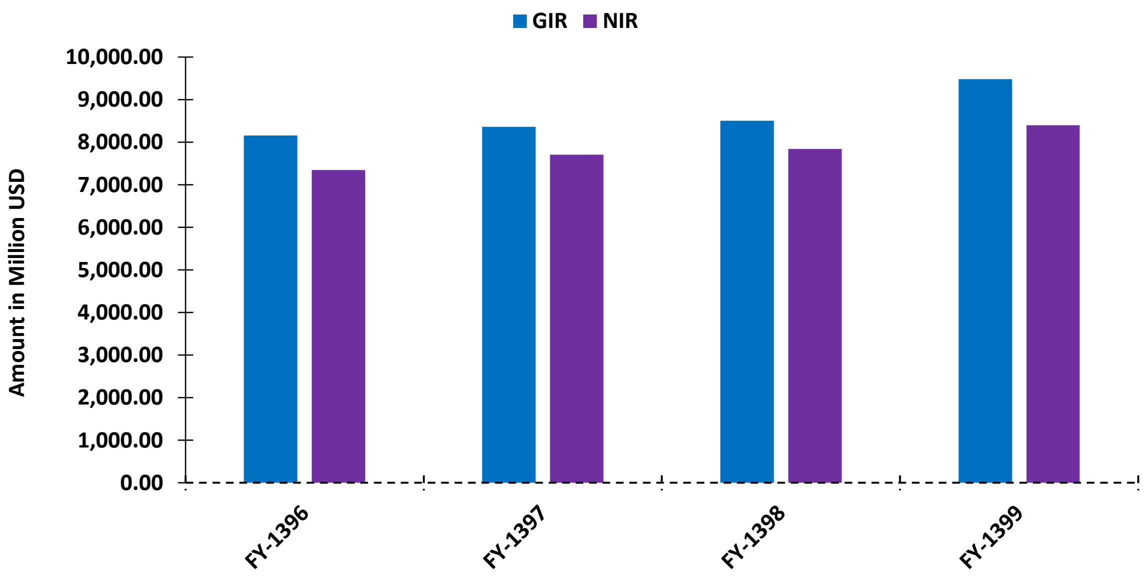
Based on the figure, Afghanistan's GIR jumped by a record of USD 976.35 million during the year under review. The NIR has also followed upward trend and surged to the value of USD 8,399.20 million in the FY 1399 from a value of USD 7,846.07 million recorded in the FY 1398, it showed for about USD 553.13 million increments in the country's NIR (Figure 4.14).

At the same time, Reserve related liabilities increased by 64.51% to a value of USD 1,079.29 million in the FY 1399 from a value of USD 656.08 million recorded in the FY 1398. The increment in reserve related liabilities was mainly due to insertion of foreign currency in commercial bank deposits with DAB which jumped up by 15.52% to a value of USD 693.51 million in the FY 1399 from a value of USD 600.32 million recorded in the previous year.

The Use of Fund Resource significantly increased to a value of USD 385.65 million in the FY 1399 from a value of USD 55.62 million recorded in the previous year. The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the FY 1399.

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

Figure 4.14: Gross and Net Internation Reserves during the past periods



Source: DAB staff calculations

Table 4.1: Afghanistan Balance of Payments in Million USD for the FY 2020

Items / Years	FY - 95	FY - 96	FY - 97	FY - 98	FY - 99	% change
Current Account	**-2708.46**	**-3554.90**	**-3896.84**	**-3791.94**	**-3136.12**	**-17%**
Credit	4945.79	4722.47	4543.67	3953.10	4237.09	7%
Debit	7654.25	8277.36	8440.51	7745.04	7373.21	-5%
Goods and Services Account	-6191.46	-6803.56	-6374.38	-5855.03	-5506.86	-6%
Credit	1136.01	1152.90	1609.47	1515.76	1476.31	-3%
Debit	7327.48	7956.46	7983.85	7370.79	6983.16	-5%
Goods Account	-5594.98	-5932.25	-5720.64	-5294.17	-5102.94	-4%
Credit	614.22	783.96	875.24	863.83	776.73	-10%
Debit	6209.19	6716.21	6595.88	6158.00	5879.67	-5%
Services Account	-596.49	-871.31	-653.75	-560.86	-403.92	-28%
Credit	521.80	368.93	734.23	651.92	699.57	7%
Debit	1118.28	1240.24	1387.97	1212.79	1103.49	-9%
Primary Income Account	179.55	248.32	190.73	306.90	189.07	-38%
Credit	239.84	299.54	289.43	352.81	240.25	-32%
Debit	60.29	51.22	98.70	45.90	51.17	11%
Secondary Income Account	3303.45	3000.34	2286.81	1756.19	2181.66	24%
Credit	3569.94	3270.03	2644.77	2084.53	2520.53	21%
Debit	266.49	269.69	357.95	328.34	338.87	3%
Current transfers (Official grants)	3032.7	2613.9	1950.4	1331.2	1798.3	35%
Credit	3032.75	2613.92	1950.4	1331.2	1798.3	35%
Debit	0.00	0.00	0.0	0.0	0.0	
Personal transfers	422.04	554.81	501.44	569.54	531.44	-7%
Credit	537.19	656.11	694.32	753.35	722.23	-4%
Debit	115.15	101.30	192.88	183.81	190.79	4%
Capital account	**1292.84**	**1305.69**	**1314.41**	**1193.94**	**752.35**	**-37%**
Credit	1292.84	1305.69	1314.41	1193.94	752.35	-37%
Debit	0.00	0.00	0.00	0.00	0.00	
Capital transfers	1292.84	1305.69	1314.41	1193.94	752.35	-37%
Credit	1292.84	1305.69	1314.41	1193.94	752.35	-37%
Debit	0.00	0.00	0.00	0.00	0.00	

Items / Years	FY - 95	FY - 96	FY - 97	FY - 98	FY - 99	% change
Financial account	**692.5**	**472.4**	**520.2**	**59.92**	**583.57**	**874%**
Direct investment	-79.59	-40.27	-80.63	2.92	24.3	732%
Net acquisition of financial assets	14.01	11.26	38.80	26.32	37.23	41%
Net incurrence of liabilities	93.59	51.53	119.44	23.40	12.97	-45%
Portfolio investment	99.47	-29.57	142.70	-14.62	63.24	-532%
Net acquisition of financial assets	99.47	-29.57	142.70	-14.62	63.24	-532%
Net incurrence of liabilities	0.00	0.00	0.00	0.00	0.00	
Other investment	30.02	-50.12	254.09	-29.03	-334.16	1051%
Assets	35.73	17.65	158.76	-37.21	-34.89	-6%
Liabilities	5.72	67.77	-95.33	-8.18	299.27	-3760%
Reserve Assets	**642.58**	**592.37**	**204.00**	**100.66**	**830.23**	**725%**
Net errors and omissions	**2108**	**2722**	**3103**	**2658**	**2967**	**12%**

Source: NSIA and DAB staff calculations

Table 4.2: Merchandise Trade in Million USD for the FY 2020

Years	FY 1395		FY 1396		FY 1397		FY 1398		FY 1399	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	6,672.39	100%	7,448.14	100%	7,406.60	100%	6,776.12	100%	6,537.64	100%
Industrial supplies	536.47	8%	883.27	12%	825.68	11.1%	815.90	12%	553.52	8%
Fuel and Lubricants	1078.73	16%	877.65	11.8%	949.78	12.8%	1078.01	15.9%	1049.92	16.1%
Consumer goods	2120.44	32%	2,981.46	40.0%	2,904.23	39.2%	2489.80	36.7%	2407.35	36.8%
Capital goods and other	2936.75	44%	2,705.75	36%	2,726.90	36.8%	2,392.40	35%	2526.85	39%
Exports	613.80	100%	783.93	100.0%	875.24	100%	863.83	100%	776.73	100%
Carpets & Rugs	52.51	8.6%	23.74	3.0%	22.35	2.6%	24.9	2.9%	16.65	2.1%
Food Items	269.91	44%	441.51	56.3%	417.69	47.7%	396.53	45.9%	360.02	46%
Leather & Wool	55.00	9%	23.13	3.0%	42.32	4.8%	43.16	5.0%	43.48	5.6%
Medical seeds & others	236.38	38.5%	295.55	37.7%	392.88	44.9%	399.24	46.2%	356.56	46%
Trade Balance	-6,058.58		-6,664.21		-6,531.36		-5,912.29		-5,760.92	

Source: NSIA and DAB staff calculations

Table 4.3: Direction of External Trade for the FY 2020(in Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	214.69	28%	736.73	11%	-522.03
India	394.29	51%	490.96	8%	-96.68
Iran	7.47	1%	1110.95	17%	-1103.48
Germany	5.35	0.7%	88.23	1%	-82.88
China	55.34	7%	984.47	15%	-929.13
Malaysia		0.00%	114.48	1.8%	-114.48
Vietnam	6.66	0.86%	27.46	0.42%	-20.80
United Arab Emirates		0%	155.03	2%	-155.03
Turkey		0%	61.23	0.94%	-61.23
USA		0.0%	48.66	1%	-48.66
Common Wealth	8.81	1%	1932.31	30%	-1923.50
Japan		0.00%	184.09	3%	-184.09
Other Countries	84.11	11%	603.04	9%	-518.92
Total	**776.73**	**100%**	**6,537.64**	**100%**	**(5,760.92)**

Source: NSIA and DAB staff calculations

Table 4.4: Direction of External Trade for the 2019 (in Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	298.04	35%	1058.01	16%	-759.97
India	410.14	47%	404.91	6.0%	5.22
Iran	14.62	2%	1247.26	18%	-1232.64
Germany	10.88	1.3%	75.82	1.12%	-64.94
Common Wealth	9.47	1%	1,633.78	24.1%	-1624.31
China	31.00	4%	1156.68	17%	-1125.68
United Arab Emirates		0%	130.14	2%	-130.14
Vietnam	9.37	0%	71.99	1.92%	-130.14
Turkey	0.00		66.02	0.97%	-62.61
Japan	0.00	0.00%	201.21	2.97%	-201.21
Malaysia	0.00	0.0%	319.98	5%	-319.98
USA	0.00	0.00%	49.73	0.73%	-49.73
Other Countries	80.31	9%	360.58	5.32%	-280.27
Total	**863.83**	**99%**	**6,776.12**	**101%**	**(5,976.40)**

Source: NSIA and DAB staff calculations

Table 4.5: External Debt for the FY 2020 (in million USD)

	FY - 1398	% share	FY - 1399	% share
Total external debt	1,956.63	100.00	2,273.59	100.00
Bilateral	924.41	47.25	949.60	41.77
Paris Club	785.11	40.13	796.03	35.01
Russian Federation	785.11	40.13	796.03	35.01
United States		0.00	-	0.00
Germany		0.00	-	0.00
Non-Paris Club	139.30	7.12	153.57	6.75
Multilateral	1,032.22	52.75	1,324.00	58.23
of which: IDA (World Bank)	337.06	17.23	345.48	15.20
Asian Development Bank	563.25	28.79	576.89	25.37
International Monetary Fund	87.69	4.48	359.60	15.82
Islamic Development Bank	42.68	2.18	40.54	1.78
OPEC Fund	1.53	0.08	1.49	0.07

Source: MOF and DAB staff calculations

Table 4.6: Net International Reserves for the FY 2020 (in million USD)

Changes on the previous quarter	FY 1396	% change	FY 1397	% change	FY 1398	% change	FY 1399	% change
Net international Reserves (in million US Dollar)	7,345.36	7.67	7,704.98	4.90	7,846.07	1.83	8,399.20	7.05
Reserve Assets	8,159.01	8.19	8,362.42	2.49	8,502.15	1.67	9,478.49	11.48
Reserve Liabilities	813.65	13.14	657.44	-19.20	656.08	-0.21	1079.29	64.51
Commercial bank deposits in foreign currency	750.66	15.90	598.08	-20.33	600.32	0.37	693.51	15.52
Nonresident deposits in foreign currency	0.14	0.00	0.14	0.00	0.14	0.00	0.14	-0.06
Use of Fund resources	62.85	-11.87	59.22	-5.77	55.62	-6.08	385.65	593.35
Gross Intl. Reserves (in months of import)	13.15		13.55		15.06		17.40	
Net Intl. Reserves (in months of import)	11.83		12.48		13.89		15.42	

Source: DAB staff calculation

5

Fiscal Developments

5

FISCAL SECTOR DEVELOPMENT

Fiscal sector of monetary policy directorate is responsible to keep coordination between fiscal and monetary policy implementation units of the Ministry of Finance (MOF) and Da Afghanistan Bank (DAB). The key objective in the fiscal area is to achieve sustainable increase in revenue collection and to permit the gradual takeover of externally financed operating & development spending, and to ensure an expenditure allocation consistent with Afghanistan National Peace and Development Framework (ANPDF). The other goals are included improvement in public expenditure management, fiscal policy formulation, efficiency in public enterprises, taxes and customs administration. While monetary policy is responsible to maintain price stability by smoothing Afghani (Afs) exchange rate volatility.

Resembling the other emerging and under developing economies around the world, Afghanistan continuously faces budget deficit and this time it is sever due to the effect of COVID-19 pandemic on both expenditure and mostly revenue generation. The total core expenditure increased about Afs 22 billion at the end of FY- 1399, and there is notable decrease of Afs 7.4 billion in total revenue collection. Total revenue at the end of the fiscal year 1399 decreased to Afs 393.3 billion from Afs 401 billion in 1398. by including other revenue and grants Afs 40.5 billion budget deficit is being observed. However, as a result of the reallocation of budget due to COVID-19 pandemic, the estimated budget for the fiscal year 1399 was 453.8 billion Afs.

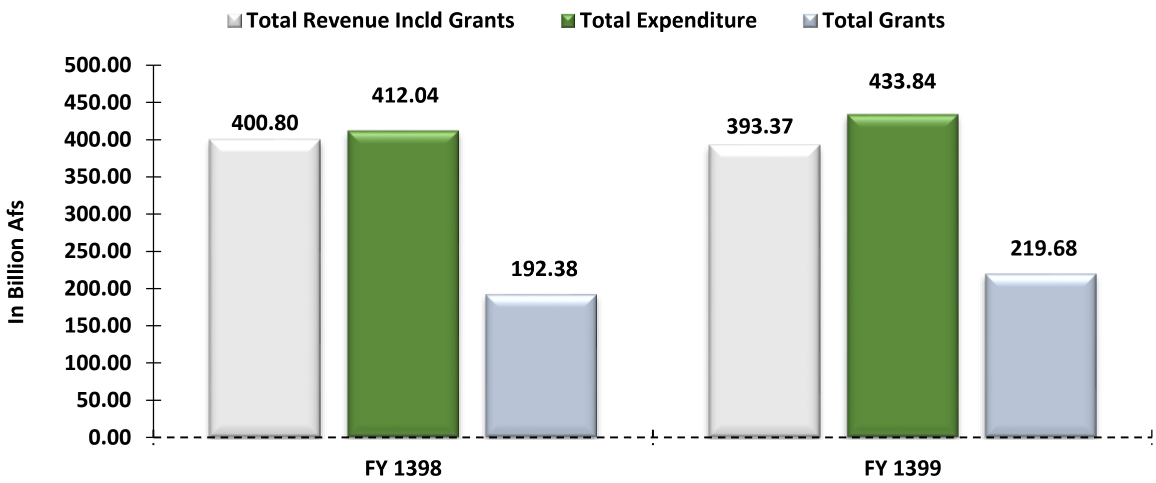
Table 5.1: budget and expenditure of the FY 1399, and 1398, amounts in the table are in Billions of Af and rounded off

National Budget (Amounts in billion Afs)			
	Estimated FY- 1399	**Actual FY- 1398**	**Actual FY- 1399**
Expenditure	**428.38**	**412**	**434**
Operating	**289.11**	**273**	**274**
Development	**139.27**	**139**	**160**
Budget	**415.98**	**401**	**393**
Internal Sources	**208.90**	**208**	**174**
External Sources	**207.08**	**192**	**220**
Deficit	**-12.40**	**-11**	**-40.5**

Source: MoF Financial Statement/MPD Staff Calculation

Donor contributions are used to finance both operating and development expenditure, the main donor contributors to the government are ARTF, LOTFA, and CSTC-A. The total grants allocated to operating and development expenditure represents increase of Afs 27 billion.

Figure 5.1: Comparison of Total Revenue including grants, Total Expenditure, Total Grants between FY 2019 (1398) & FY 2020 (1399)

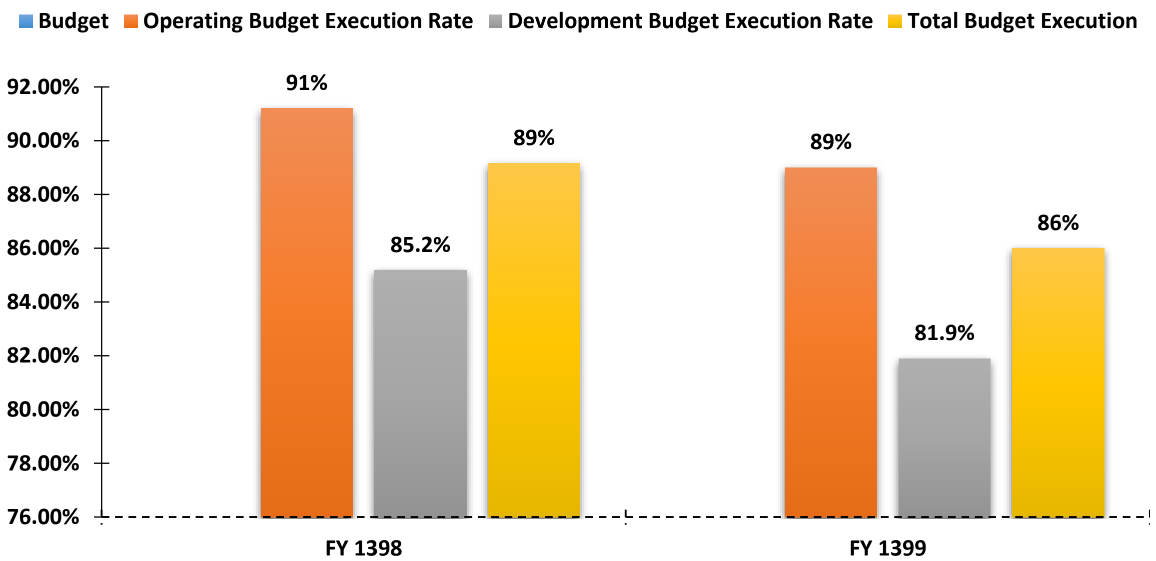


Source: MoF Financial Statement/MPD Staff Calculation

5.1. Budget Execution Rate:

During the period of FY 1399, government spent 86% of the total Afs 453.8 billion of allocated budget, while comparing to 89% of the total Afs 445.8 billion of allocated budget in FY 1398 representing nearly increase of 9.5% in overall budget execution rate relatively.

Figure 5.2: Comparison of Operation & Development Budget Execution Rates for FY 1398 & 1399



Source: MoF Financial Statement/MPD Staff Calculation

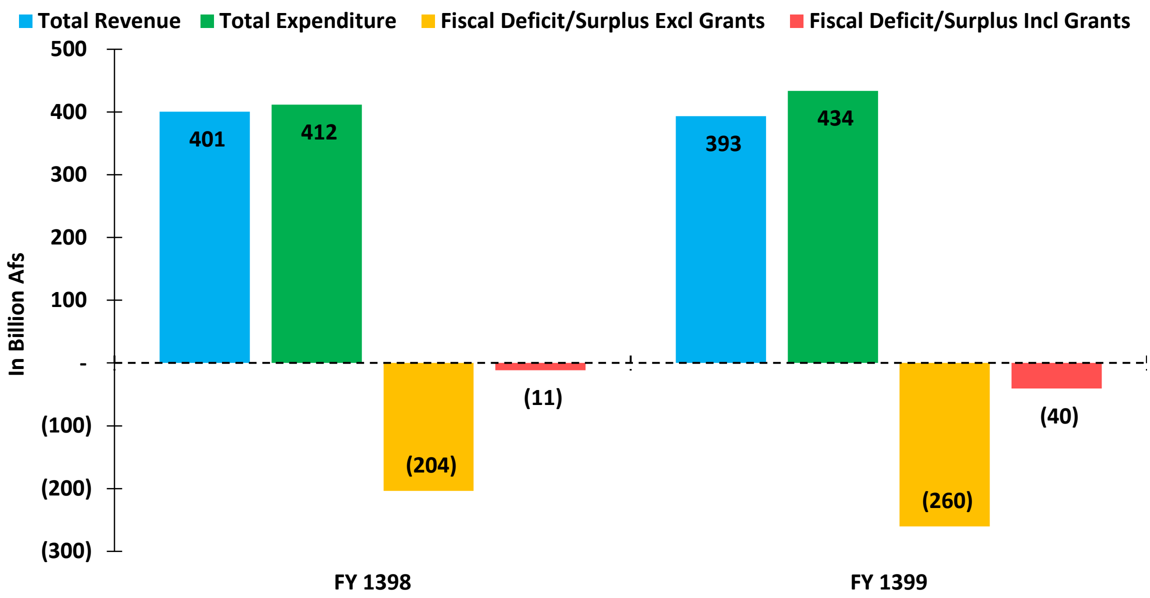
This increase is attributed to several factors particularly due to increase in overall budget reallocation, processing of expenses by the National Procurement Authority, security condition in provinces and good performances by the budgetary units.Operating budget execution rate indicates 2.4% increase from Afs 269 billion at the end of FY 1398 to Afs 276 at the end of FY 1399, however, the allocated budget was Afs 446 billion in FY 1398 while it was about Afs 453.8 billion at the end of FY-1399. The development budget execution rate represents increase of 24% comparing both Afs 129 billion of the FY 1398 and Afs 161 billion of FY 1399.

5.2. Core Budget (Deficit & Surplus):

The total core budget represents approved development and operating budget, it was calculated Afs 428 billion at the beginning of the fiscal year 1399 but due to COVID-19 pandemic it was revised and after mid-year review it is reallocated to Afs 453.8 billion that showed about 6% increase from Afs 428 billion which was at the beginning of the FY-1399, while in FY-1398 it was Afs 399.

This major change in the budget was as a result of high budget approval and reallocation for the FY 1399 due to COVID-19 pandemic. The overall budget prior to donor's contribution had a deficit of Afs 260 billion in FY 1399 compared to Afs 204 billion deficit at FY 1398. Meanwhile, donor contributions funding and grants increased from Afs 192 billion in FY 1398 to Afs 220 billion for the FY 1399.

Figure 5.3: Comparison of total revenue, expenditure and Fiscal deficit between FY 1398 & FY 1399



Source: MoF Financial Statement/MPD Staff Calculation

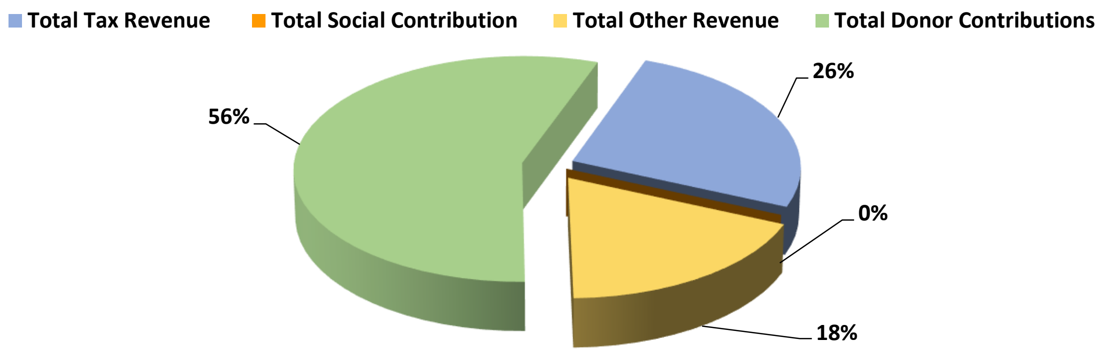
The total annual external source funding amount in FY 1399 represents significant raise from Afs 203 billion of FY 1398 to Afs 225 billion in FY 1399, indicating 11% increment in annual planed external sources and it is as a result of; IMF Extended Credit Facilities, other funding for COVID-19 pandemic as grant, and donor's contribution on annual basis. Including grants there is Afs 40.5 billion of budget deficit in FY-1399 comparing to Afs 11 billion deficit in FY-1398.

5.3. Total Revenue:

During FY 1399 total revenue including grants decreased considerably to Afs 393 billion, where it was reached to Afs 401 billion in FY 1398, this change indicates a notable decrease of Afs 7.4 billion or 2% in FY 1399 compared to previous year. Annual collection of planed domestic sources indicates Afs 35 billion drop, down from Afs 208 billion of FY 1398 to Afs 174 billion in FY 1399, leading to 17% decrease comparatively.

To meet FY 1399 budget deficit, the total domestic revenue, grants, and donor contribution plays a vital role and similarly revenue collection that steers to annual budget surplus. Moreover, the negative trend in total revenue collection of FY 1399 was as a result of COVID-19 pandemic affecting mostly administrative fees, fixed taxes, income taxes, custom revenue, revenue collected from sources under claims, and retirement contributions, however, there had been increment in sale of goods and services, income from capital property, miscellaneous revenue, and extractive industries during the FY 1399.

Figure 5.4: Components of Total Revenue for the FY -1399

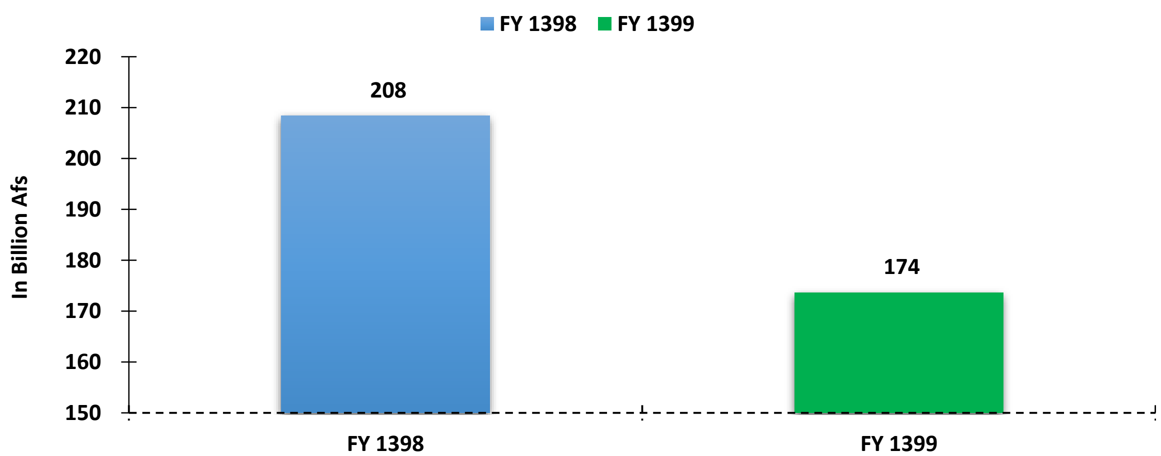


Source: MoF Financial Statement/MPD Staff Calculation

5.3.1. Domestic Revenue:

The total collection of domestic revenue performance slowed down in the fiscal year 1399 however it was challenging to compare to the FY-1398, because due to covid-19 pandemic, overall domestic revenue affected negatively in FY-1399. The decrement in domestic revenue collection was attributed to fall in revenue collection from the sources under claims, notable change in administrative fees, custom duties, sale tax, income taxes, fixed taxes, tax penalties and fines, and a significant change in total retirement contributions. Domestic revenue was approximately decreased from Afs 208.4 billion of FY 1398 to Afs 173.6 billion in FY 1399, that shows decrease of Afs 34.7 Afs billion equal to 17% comparatively.

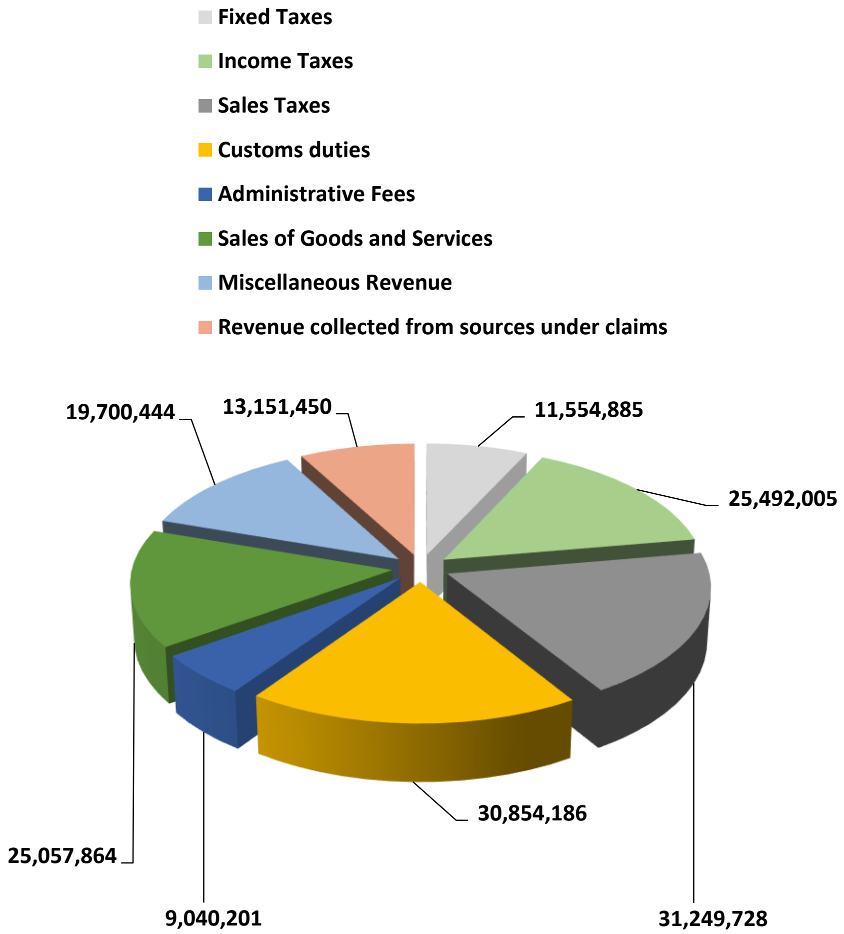
Figure 5.5: Total Domestic Revenue Comparison between FY 2019 (1398) & FY 2020 (1399)



Source: MoF Financial Statement/MPD Staff Calculation

However, some components in the breakdown of the total revenue showed increment in their various domestic revenue sub-components such as; miscellaneous revenue that is unclassified revenue shows growth of approximately 26% from Afs 16 billion in FY 1398 to Afs 20 billion in FY 1399, sale of goods and services, and extractive industries.

Figure 5.6: Major Domestic Revenue components for FY-1399, amounts are in thousands of Afs

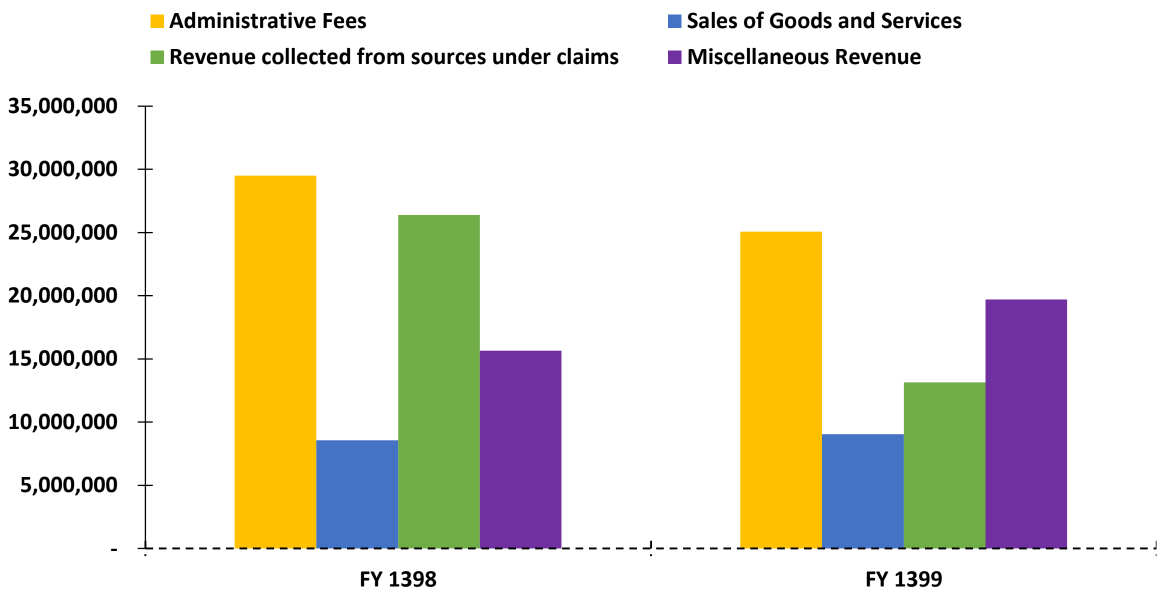


Source: MoF Financial Statement/MPD Staff Calculation

- **Non Tax Revenue:**

On aggregate bases a major and initial component of domestic revenues is non tax revenues that represents a notable decrease of 16% from Afs 91 billion of FY 1398 to Afs 71 billion in FY 1399 comparatively, this is mainly as a result of low revenue collection performance from retirement contribution, administrative fees, sale of goods and services, revenue collected from the sources under claim, and extractive industries. The main contributors of the non-tax revenues are retirement contributions that decreased notably to approximately zero, administrative fees decreased from Afs 29.5 billion of FY 1398 to Afs 25 billion in FY 1399 which signified 15% decline, similarly revenue collected from the sources under claim was very low showing change from Afs 26 billion to Afs 13 (50% decline), non-tax revenue from sale of goods and services, extractive industries, and income from capital property has declined respectively in the FY- 1399.

Figure 5.7: Major Components of Non-Tax Revenue for the FY 2019 and FY 2020 (amounts rounded off in thousands of Afs)

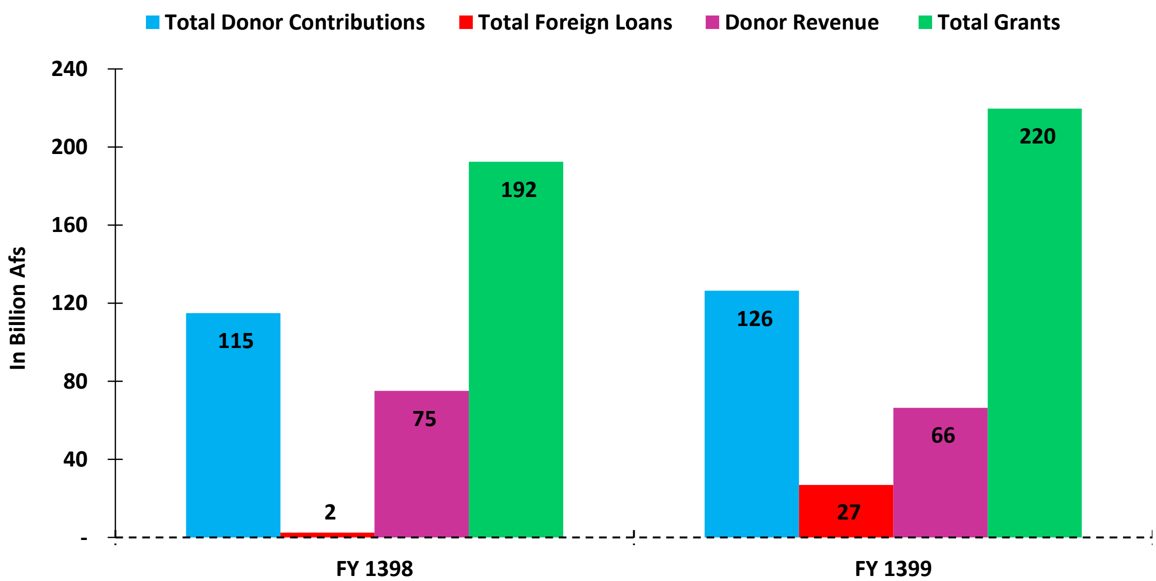


Source: MoF Financial Statement/MPD Staff Calculation

5.3.2. Grants and Loans:

The donor contribution comprises an important part of the national budget, meantime donor grants finances major expenditure items in both operating and development budget. Similarly, the government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures. In Afghanistan's context, fiscal sustainability is defined as total domestic expenditure and it should be financed by total domestic revenue, where recently it is being financed partially by external sources, foreign Loans and rest by domestic revenue.

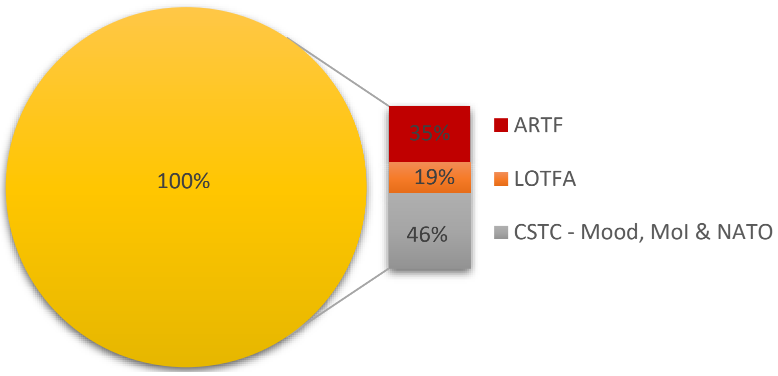
Figure 5.8: Total Annual Grants Analysis between FY 1398 & 1399



Source: MoF Financial Statement/MPD staff calculation

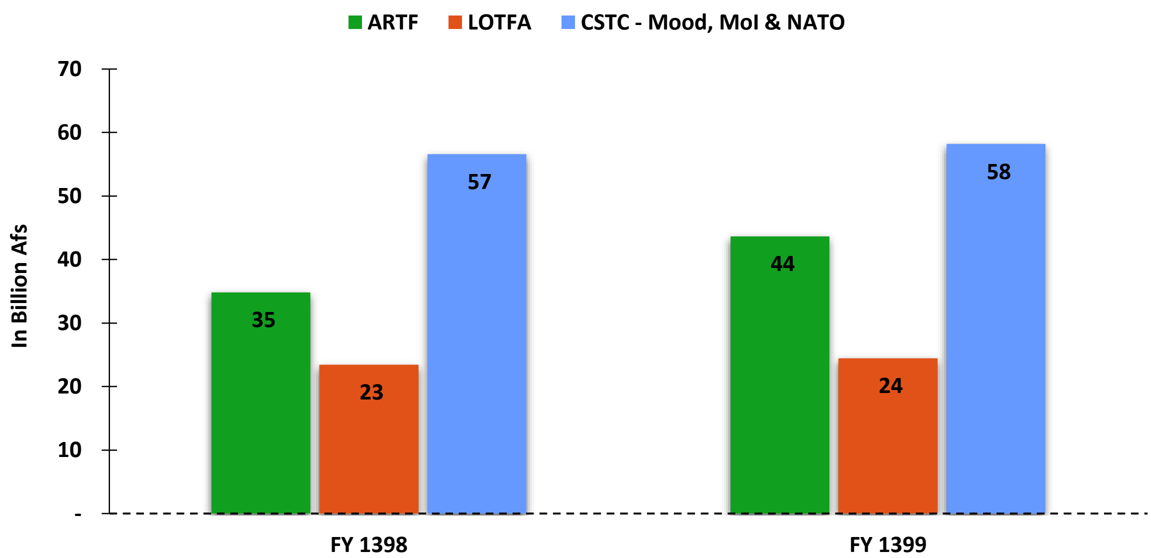
The total development and operating grants represents significant increase of Afs 27 billion from Afs 192 billion in FY 1398 to Afs 220 billion, showing 14% raise in the FY 1399 comparatively. The main donor contributors to operating and development expenditures are grants from ARTF that raised 25% from Afs 35 billion of FY 1398 to Afs 44 billion in FY 1399, CSTC-A (MoD, MoI & NATO) contributed Afs 58 billion in FY 1399 compared to Afs 57 billion in FY-1398 that showed around 3% increment and, similarly LOTFA funded Afs 24 billion in FY 1399 compared to Afs 23 billion in FY-1398 that shows 4% increase relatively.

Figure 5.9: Components of Donor Contribution for FY 1399



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.10: Comparison of Donor Contributions for FY 1398 & FY 1399



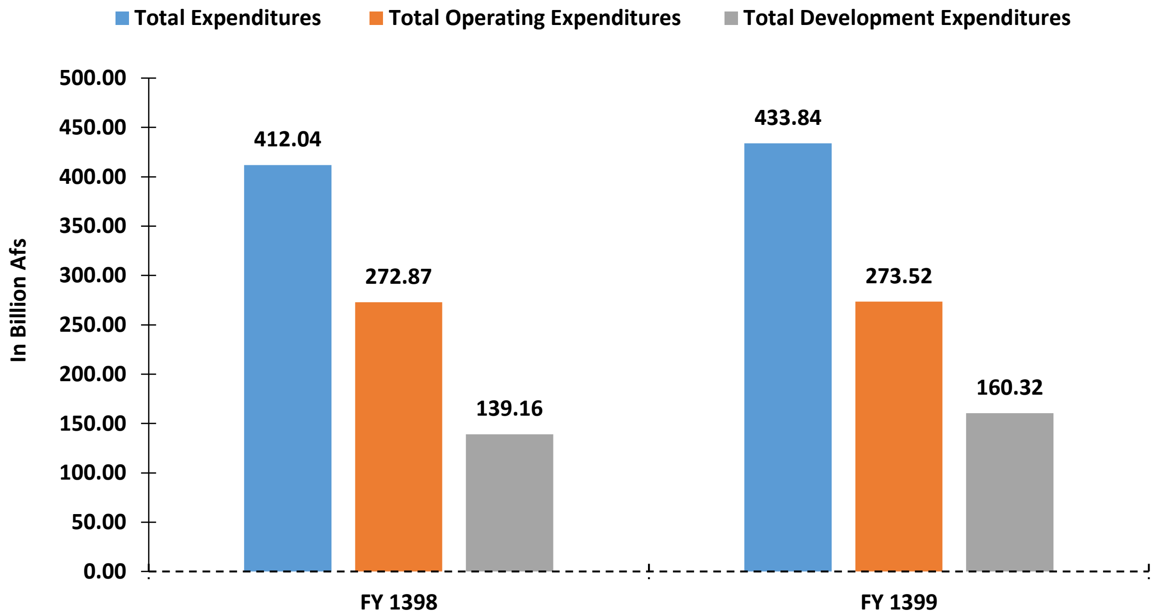
Source: MoF Financial Statement/MPD Staff Calculation

5.4. Expenditure:

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

Furthermore, total core expenditure represents 15% increase from Afs 412 billion of FY 1398 to Afs 434 billion in FY 1399 indicating Afs 22 billion rise in overall development and operating expenditure compare with the previous year, this is mostly as a result of increase in supplier expenditures and capital expenditures. In addition, operating expenditures indicate a mild increase of 0.24% from Afs 272.9 billion of FY 1398 to Afs 273.5 billion in FY 1399, Meanwhile development expenditures show 15% raise from Afs 139 billion of FY 1398 to Afs 160 billion in FY 1399 indicating Afs 21 billion which is a notable change in development expenditure compare to same period of last year.

Figure 5.11: Comparison of Total Expenditures for FY 1398 & FY 1399



Source: MoF Financial Statement/MPD staff calculation

6

Banking Systems Performance

6

BANKING SYSTEM PERFORMANCE

Overall the banking sector performed well during 2020 despite the COVID-19 pandemic, rendering necessary services to the public. No liquidity short fall was noticed in any of the banks and their capital positions remained within the regulatory threshold. Main financial indicators such as total assets including cash in vault and claims on DAB, investments in bonds, deposits and financial capital increased while loans and interbank claims had a decreasing trend. The banking sector was profitable though the profit decreased since Dec, 2019 and loan quality remained weak.

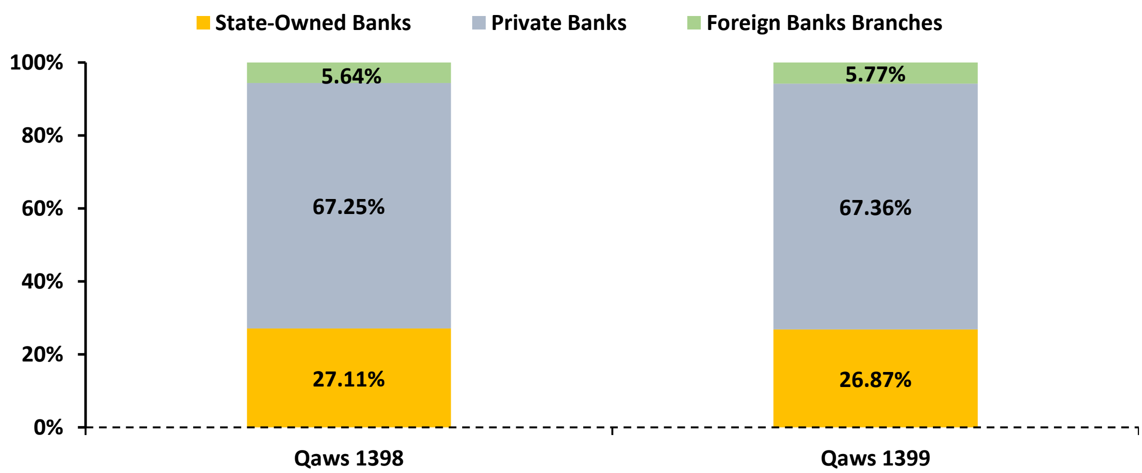
Given the spread of the pandemic, in coming months, the banking sector may experience more Non-Performing Loans (NPLs), high provisions which will lead to lower profitability, capital, and financial ratios. Therefore, banks have to opt for more precautionary measures to cope with the expected financial downturn. DAB has issued an incentive package (the Post C19 Plan) that covers the expansion of banking activities, disbursement of new credit facilities, cost reduction measures including suspension of dividend payments in 2020, electronic reporting option, renewal of loans, relaxation in loan classification and risk weighting of loans guaranteed by the third parties such as ACGF, IFC, USAID etc.

6.1. Assets of The Banking System:

The total assets of the banking sector registered 4.4% increase over the year, and reached to Afs 327 billion, while in previous year it recorded 0.8% decrease (See Table 6.1).

The above mentioned increase in the total assets was mainly contributed by increase in total deposits (dominant in customer demand and Saving deposits), Disaggregated analysis of total assets showed that top increase item were cash in vault and claims on DAB (specifically in DAB capital notes), investments in bonds and other assets while net interbank claims and net loans witnessed decrease over the year.

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



Source: Banking Supervision Department, DAB

The most important components of the system's total asset portfolio were cash in vault and claims on DAB with 46.29% share, net interbank claims constitute 22.64% share, investments with 11.72% share, net loans constitute 10.04% share, net other assets with 5.5% and fixed assets constitute 3.21% share of the sector total assets, while the share of the repossessed assets and intangible assets were negligible (See table 6.1).

Private Banks are the leading player in the banking sector accounting for 67.36% of total banking sector assets (Islamic bank of Afghanistan makes 9.13% of the sector total assets), state-owned banks with 26.87% are at the second place while branches of foreign banks' shares are 5.77% in the system's total assets.

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

Amount in million Afs	Dec, 2019	Dec, 2020[13]	% of Total Asset/liabilities	Growth
Assets				
Cash in vault and claims on DAB	131,392	151,387	46.29%	15.22%
Interbank claims(Net)	83,338	74,026	22.64%	-11.17%
Investments (Net)	34,848	38,340	11.72%	10.02%
Loans (Net)	35,691	32,846	10.04%	-7.97%
Repossessed Assets	1,087	1,018	0.31%	-6.35%
Other Asset (Net)	15,555	17,991	5.50%	15.67%
Intangible assets	971	909	0.28%	-6.40%
Fixed Assets	10,252	10,495	3.21%	2.37%
Total Asset	313,135	327,012	100.00%	4.43%
Liabilities				
Total Deposits	266,576	280,468	96.63%	5.21%
Borrowings	4,615	3,661	1.26%	-20.66%
Other Liability	6,226	6,106	2.10%	-1.93%
Total Liability	277,417	290,235	100%	4.62%
Financial Capital	35,718	36,777		2.97%
Total liability and capital	313,135	327,012		4.43%

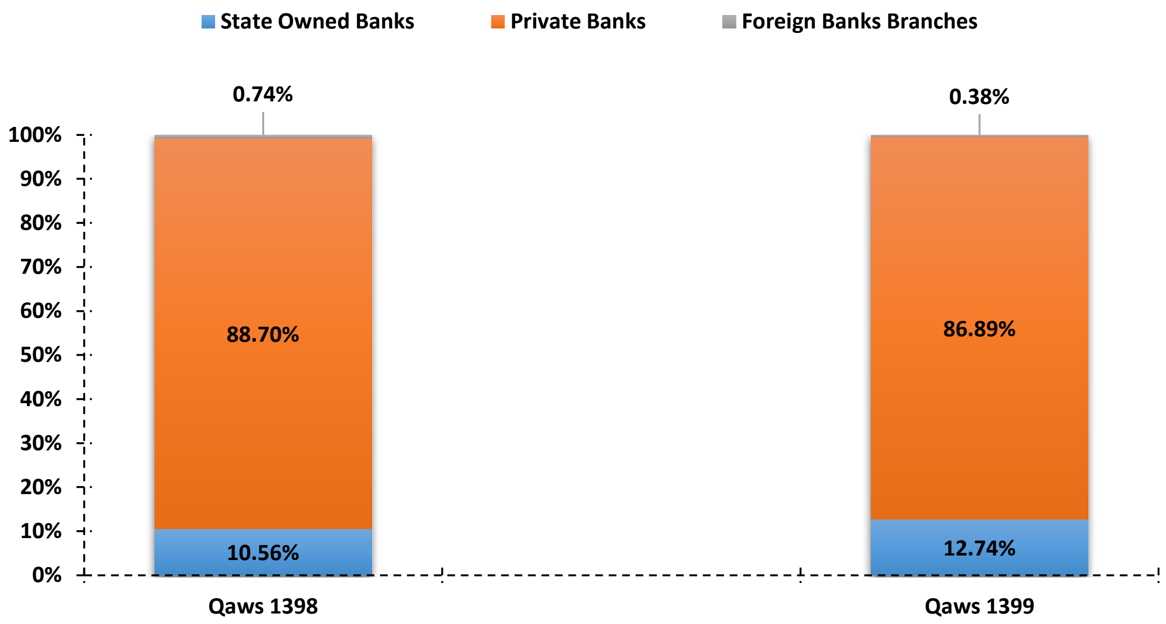
Source: Banking Supervision Department, DAB

[13] Dec, 2020 data are based on unaudited financial statements.

6.1.1. Gross Loans:

The gross loan portfolio of the banking sector recorded decrease of 3.87% over the year, currently stands at Afs 39.55 billion, constituting 12.10% of the total assets, whereas it was Afs 41.15 billion at the end of Dec, 2019 comprising 13.14% of the total assets. The decrease in total gross loans mainly comes from settlement, repayment, charge-offs and less OD utilizations.

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



Source: Banking Supervision Department

Nine banking institutions recorded decrease in their loan portfolio, while three other registered increase. Disaggregated analysis among the banking groups shown that State Owned banks with 12.74% of the total banking sector loan portfolio demonstrated 15.97% increase while private banks with major share (86.89%) in the banking sector portfolio registered 5.83% decrease and branches of foreign banks with 0.38% share show 51.45% decrease comparing to the previous year.

Gross loans are mostly concentrated in Afs denominations making 51.62% of the total portfolio followed with USD denominated loans at 48.25% of the sector total loans, while the loans designated in other currencies remain negligible (0.13% of portfolio).

- **Loan Loss Reserve:**

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk management framework. As per the assets classification and provisioning regulation, banks are required to make specific provision on non-standard assets, while general reserves on standard assets is optional, in order to mitigate their credit risk.

By the end of Dec, 2020, total provision cover of the system was 16.97% of total gross loans as opposed to 13.27% recorded at the end of Dec, 2019. The increase comes due to deterioration of loans quality.

- **Distribution of Credit:**

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

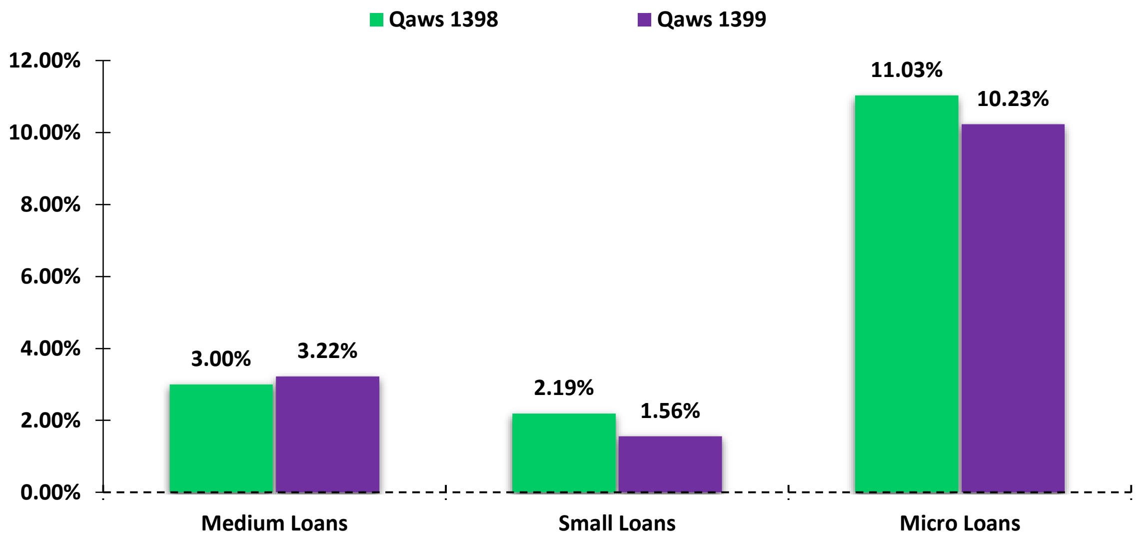
Noticeably loans disbursed to trade sector were 41.23% which decreased by 3.13% against 44.36% in Dec, 2019 (mostly in all other items, food items, and cement and other construction material). Other main sectors include: Services sector constitutes 27.15% against 22.15%, mainly increased in telecommunication/scratch cards distributers, all other services and in ground transportation. Manufacturing and Industry sector making 9.93% against 11.03%, Infrastructure Projects constitute 8.06% against 8.75%, Commercial real estate and Construction sector make 7.62% against 7.51%, Agricultural, livestock and farms, and consumer loan altogether constitute 6.02% in Dec, 2020 against 6.2% in Dec, 2019.

Increase was observed in three sectors such as Commercial Real Estate and Construction, Service and Agriculture loans, while Trade, Manufacturing & Industry, Infrastructure Projects, Livestock and Farming and Consumer loans witnessed decrease comparing to previous year.

Loans designated to small and micro sectors decreased while medium loans increased over the year, provided by ten banking institutions in the sector (see figure 6.3). Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises situation associated to that sector, inversely affecting the overall banking sectors. Banks should closely monitor the potential risk associated with key sectors given the high NPL ratio.

73% of the loans were designated in Kabul while Balkh and Herat provinces are in the second and third places with Badghis and Kandahar provinces at fourth and fifth places respectively. The proportions of loans in other provinces were negligible. The designation of loans by sector, geography, and institution is not adequately diversified, but it is expected that with time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

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



Source: Banking Supervision Department-DAB

Table 6.2: Sectors wise distribution of Credit

	Qaws 1398 (Dec, 2019)	Qaws 1399 (Dec, 2020)
Commercial Real Estate and Construction	**7.51%**	**7.62%**
Construction and Buildings	7.51%	7.62%
Infrastructure Projects	**8.75%**	**8.06%**
Power	0.12%	0.04%
Road and Railway	2.84%	2.22%
Dames	0.38%	0.39%
Mines	0.49%	0.21%
Other infrastructure projects	4.92%	5.19%
Manufacturing and Industry	**11.03%**	**9.93%**
Manufacturing &Products of Metal wood plastic rubber leather paper	5.38%	4.42%
Manufacturing handmade and machine products	3.63%	3.47%
Cement and Construction Materials	2.01%	2.04%
Trade	**44.36%**	**41.23%**
Textile	1.90%	1.88%
Wholesale	4.74%	6.52%
Machineries	0.37%	0.28%
Petroleum and Lubricants	11.30%	10.92%
Spare parts	1.89%	1.70%
Electronics	2.66%	2.85%
Cement and other construction Material	3.99%	3.07%
Food Items	8.21%	7.23%
All other Items	6.36%	4.22%
Retail trading	2.94%	2.58%
Service	**22.15%**	**27.15%**
Education	0.03%	0.09%
Hotel and Restaurant	2.44%	2.42%
Telecommunication/Scratch cards Distributers	6.57%	9.37%
Ground Transportation	4.13%	5.12%
Air Transportation	0.91%	0.75%
Health and Hygienic	1.66%	1.64%
Media, Advertisements, Printer	1.92%	1.90%
All other Services	4.50%	5.86%
Livestock and farms	**0.50%**	**0.45%**
Livestock and farming	0.50%	0.45%
Agricultural Loans	3.07%	3.12%
Consumer Loans	2.63%	2.45%
Residential Mortgage Loans to Individuals	0.00%	0.00%
All Other Loans	**0.00%**	**0.00%**

Source: Banking Supervision Department-DAB

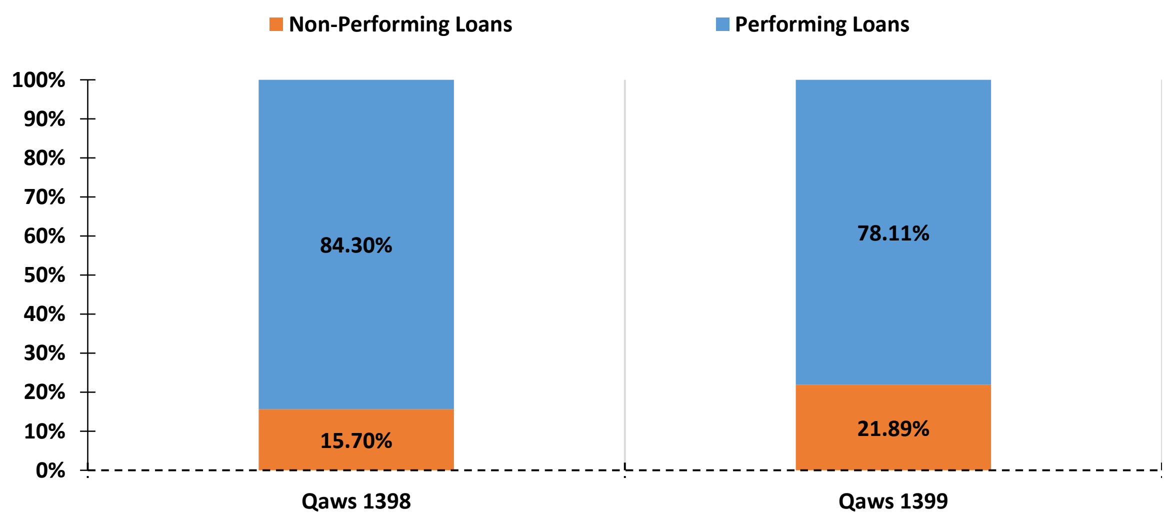
- **Classification of Loans:**
  - **Non-performing loans[14]:**

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

In monetary terms, by the end of Dec, 2020, non-performing loans recorded at Afs 8.65 billion or 21.89% of the total gross loans and 26.54% of the system's regulatory capital, increased by Afs 2.2 billion over the year. The increase is mostly attributed to four banking institutions owing to deterioration of loans quality.

Group wise analysis shows that out of Afs 8.65 billion total NPLs, Afs 7.85 billion NPL is coming from private banks making 19.85% of the banking sector's total gross loans (90.67% of banking sector's total NPLs), and Afs 807 million is attributed to one state-owned bank which constituted 2.04% of the banking sector's total gross loans (9.33% of banking sector's total NPLs).

Figure 6.4: Quality of Loan Portfolio



Source: Banking Supervision Department, DAB

Sectorial analysis of the NPLs shows that major portion of the NPLs originated from trade sector which constituted 47.09% (dominant in food items, Petroleum & Lubricants, and Spare parts which make 17.65%, 8.13% and 6.53% respectively), followed by services sector with 28.53% (mostly recorded in Telecommunication/Scratch cards Distributers, and ground transportation with 10.69% and 8.60% respectively), infrastructure projects held

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

9.98%, manufacturing & industry, and commercial real estate and construction constitute 7.24% and 5.75% of the sector's NPLs respectively.

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

- **Adversely-classified loans:**

Adversely classified loans (substandard, doubtful, Loss)[15] depicted Afs 1.12 billion increase over the year, reaching Afs 8.98 billion, constituting 22.72% of the total gross loans and 27.55% of the regulatory capital, and the increase is mainly due to deterioration of loan quality coming from two banking institutions.

These loans require strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be given on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk. Management should take appropriate measures to address issues and weaknesses that have resulted in poor credit performance as per prudential regulations.

Though systematic risk and economic downturn may have affected weak and systematically important bank's asset quality especially loans; however, banks management should have mechanisms to predict such risks, hedge their potential risk and take proper precautionary measures to mitigate further deterioration and distress in the banking system.

- **Loans classified Watch:**

Loans classified in the "watch"[16] category at the end of Dec, 2020 stood at Afs 4.22 billion, which made 10.67% of total gross loans and decreased by 23.86% compared with the previous period (end of Dec, 2019). The decrease is mostly attributed to two banks in the system, coming from deterioration of loan quality. This category of loans requires close monitoring as it may lead to more adversely classified loans (substandard, doubtful and losses) in the future.

- **Charged-off Loans[17]:**

Loans charged-off at the end of Dec, 2020 stands at Afs 254 million, which makes 0.64% of total gross loans attributed to two banks in the sector.

6.1.2. Interbank Claims:

Gross Interbank Claims are the second largest among various asset categories, currently standing at Afs 74.13 billion (22.67% of total assets), registered Afs 9.33 billion or 11.18% decrease

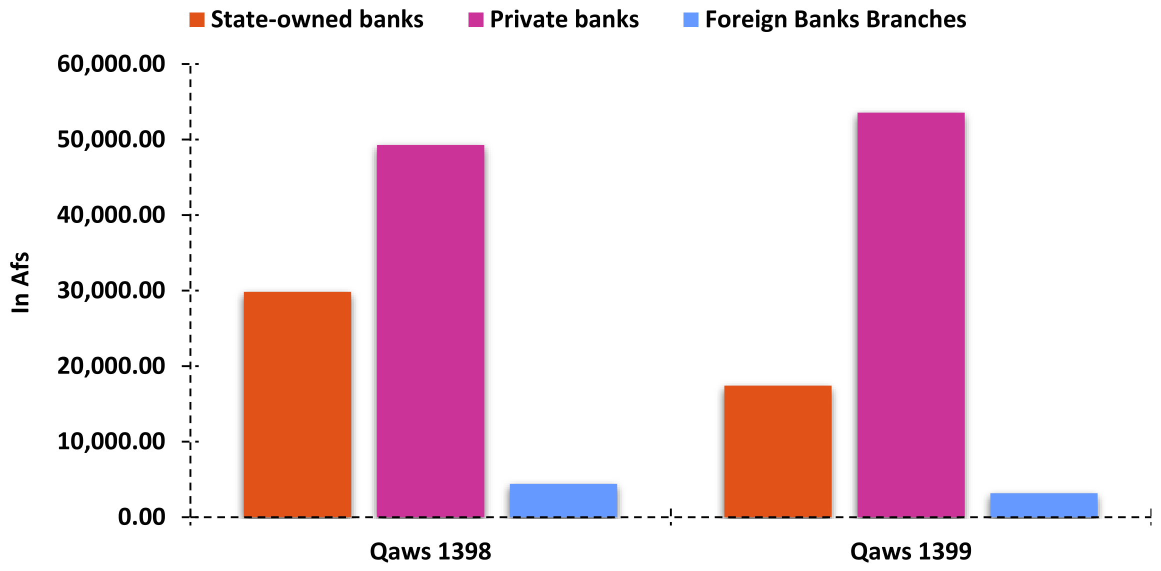
[15] An asset for which the principal and /or interest remains outstanding for 61-120 days - (Substandard), Defaulted assets and advances for which the principal and/or interest is due and remains outstanding for 121-480 days - (Doubtful), An asset for which the principal and /or interest remains outstanding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

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

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

compared to the previous year and the decrease was attributed to eight banking institutions mainly in USD and other currency accounts. In the meantime, Afs placements indicates slightly increase. It's worth mentioning that, banks should not only appropriately measure risks associated with individual bank but also country or countries in which they have placed funds (See figure 6.4).

Figure 6.5: Share of Interbank Claims among banking groups



Source: Banking Supervision Department, DAB

6.1.3. Investment:

The net-investment[18] portfolio of the banking sector comprises of bonds, Government Securities, and investment in associated companies; currently stands at Afs 38.34 billion (11.72% of the total assets) which shows increase of Afs 3.49 billion or 10.02% compare to the previous year; the increase mostly came from four banking institutions.

Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, four private banks and a branch of a foreign bank.

6.1.4. Cash in Vault and Claims on DAB:

Cash in vault and claims on DAB remains the largest category, making 46.29% of the total assets, and stood at Afs 151.38 billion which shown increase of Afs 20 billion. The increase was observed mainly in DAB capital notes and corresponded account with DAB while overnight deposits decreased compared to previous year.

6.2. Liabilities:

Total liabilities of the banking sector increased by Afs 12.81 billion or 4.62% and stood at Afs 290.23 billion against Afs 277.41 billion in Dec, 2019. The mentioned increase in total liabilities was mainly contributed by increase in total deposits (dominant in customer demand deposits mostly in Afs currency). The majority of liabilities are made up of deposits (96.63%), followed by other liabilities (2.10%) and borrowings in third place (1.26%), (See table 6.1.).

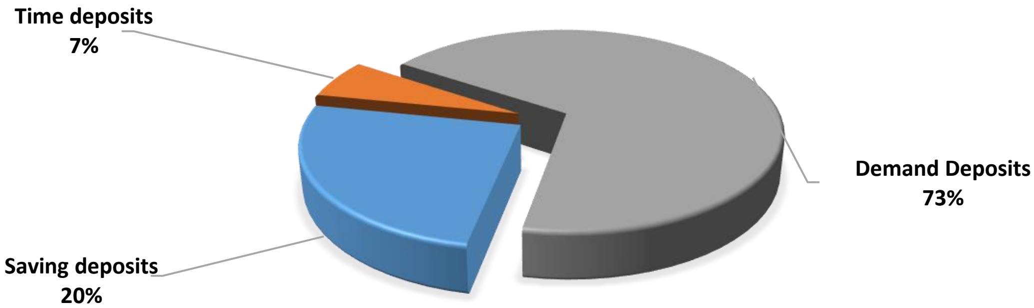
[18] Investments include investment in bonds, securities, associated companies and in subsidiaries

6.2.1. Deposits:

Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to Afs 280.46 billion at the end of Dec, 2020, and increased by Afs 13.89 billion or 5.21% over the year. The total deposits include Afs 7.94 billion interbank and Afs 272.52 billion customer deposits. The increase in deposit base of the banking sector is attributed to customer demand deposits mainly in Afs accounts.

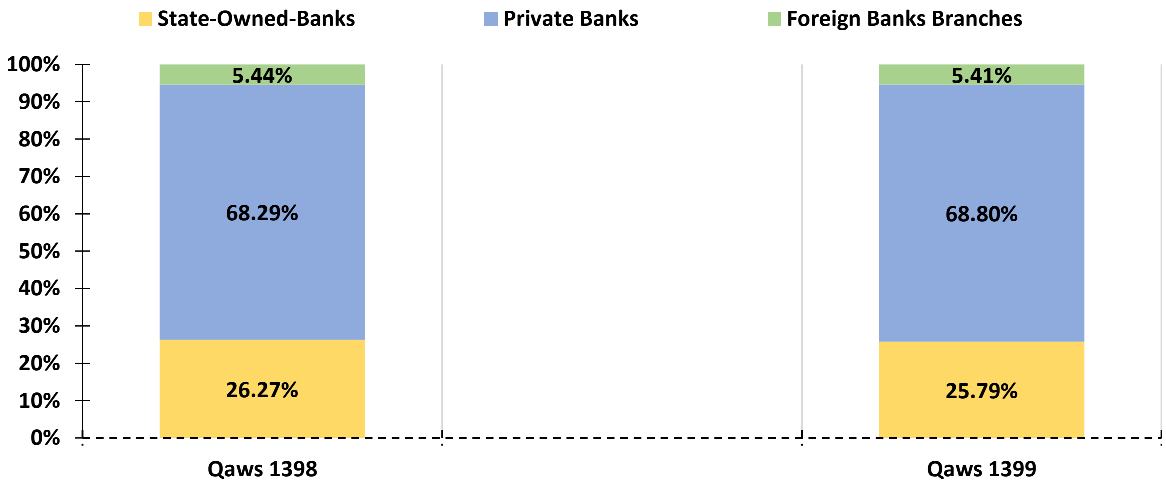
Currency wise analysis showed that Afghani denominated deposits increased by 27.95% and accounted for 37.60% of the total deposits, while US dollar denominated deposits decreased by 0.70%, making 60.48% of the total deposits, and other currency deposits decreased by 59.57% which accounted for 1.92% of the total deposits of the banking sector.

Figure 6.6: Types of deposits



Source: Banking Supervision Department, DAB

Figure 6.7: Deposits among banking groups

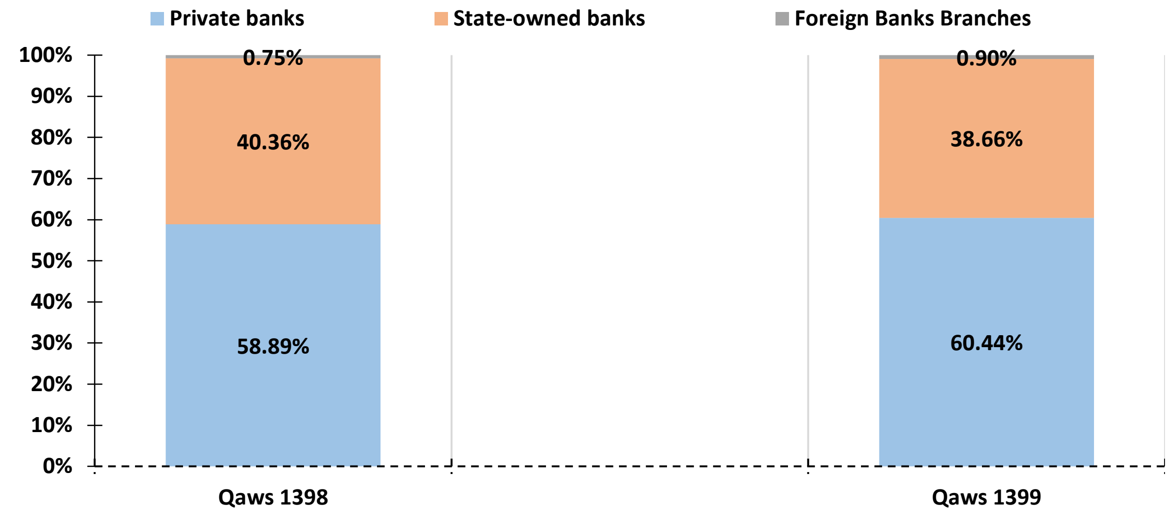


Source: Banking Supervision Department, DAB

Private Banks attracted Afs 192.96 billion deposits, which increased by 6% and made 68.80% of the system's total deposits. The share of state-owned banks amounted to Afs 72.32 billion, showed increase of 3.28% over the year which accounted for 25.79% of the system's total deposits. The share of branches of foreign banks stood at Afs 15.18 billion, increased by 4.62% which made 5.41% of the total deposits of the system.

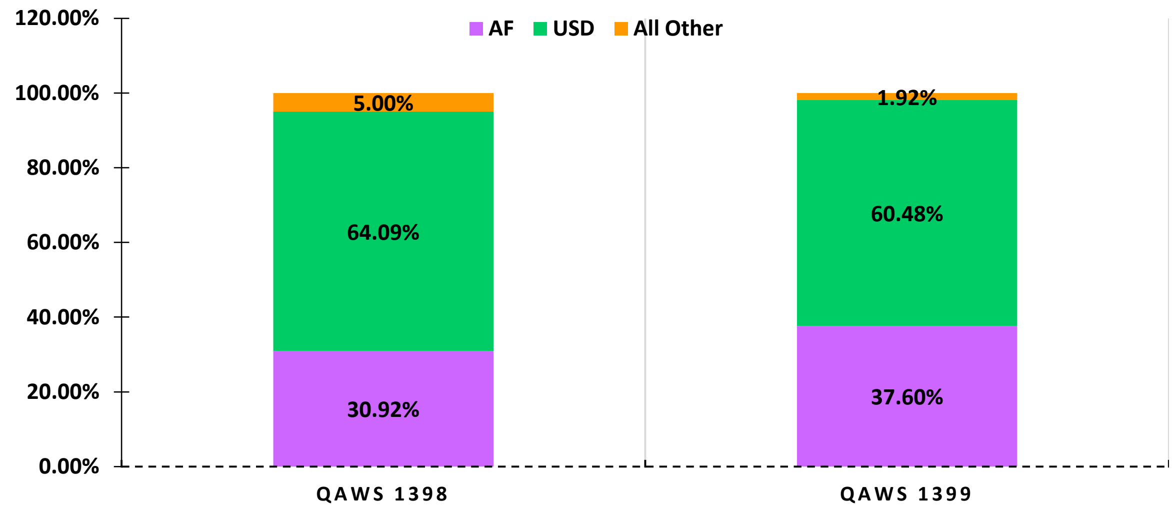
In term of types of deposits, demand deposits accounted for 72.81% of the total deposit base (increased by 5.20%), saving deposits with 20.20% of total deposits was in the second place (depicted 7.92% increase), while time deposit made 6.99% of the total deposits portfolio with 1.80% decrease compared to the previous period (Dec, 2019).

Figure 6.8: Afghani Denominated Deposits



Source: Banking Supervision Department, DAB

Figure 6.9: Currency Composition of Deposits



Source: Banking Supervision Department, DAB

6.2.2. Borrowings:

The share of borrowings in total funding structure of the system decreased by 20.66% and stood at Afs 3.66 billion at the end of Dec, 2020 which made 1.26% of total liabilities. The current borrowing position is attributed to four banking institutions.

6.3. Liquidity:

Liquidity risk can be defined as the risk of not having sufficient liquid assets to meet the demand of borrowers and depositors. All banks are required to maintain a reasonable level in order to avoid any liquidity problem.

For this reason, banks should maintain an Asset Liability Committee (ALCO); one of its tasks is the liquidity management of the bank through gap analysis, stress testing, scenario analysis, cash flow analysis, etc. according to the policies of the bank.

6.3.1. Liquidity Ratio (broad measure):

Overall, all banking institutions are above the set minimum for the Broad Liquidity Ratio (15%) and the Quick Liquidity Ratio (20%). Broad liquidity ratio of the banking sector as a median stands at 59.30% against 55.89% in the preceding period (Dec, 2019), showing an increase of 3.42% (See table 6.3.).

Table 6.3: Liquidity Ratio of the Banking Sector

Ratio in %	Dec, 2019	Dec, 2020
Total Capital Adequacy Ratio	25.94%	27.84%
Tier 1 Capital Adequacy Ratio	24.49%	26.65%
Non-Performing Loans to Total Gross Loans	15.70%	21.89%
Return on Assets (ROA) Annually	0.54%	0.53%
Return on Equity (ROE) Annually	4.43%	4.53%
Liquidity Ratio (Broad Measure Median)	55.89%	59.30%
Liquid Assets to Total Assets	68.62%	68.96%

Source: Banking Supervision Department, DAB

6.4. Capital:

The banking sector is well capitalized, making 11.25% of total assets. The net equity position of the sector recorded at Afs 36.77 billion, increased by 2.97% Y-o-Y basis. The increase was mainly attributed to capital injection, profit in the current year, and gain in Revaluation of Available for Sale Investments. CAR of the sector recorded at 27.84% against 25.94% in Dec, 2019, showing 1.9% increase over the year (See table 6.3).

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

6.5. Profitability:

In terms of the profitability, on cumulative basis the banking sector recorded Afs 1.60 billion net profit for current year against Afs 1.64 billion net profit recorded in the previous year, showing slight decrease over the year, resulted in ROA and ROE of 0.53% and 4.53% in current year as compared to - 0.54% and 4.43% respectively in previous period (Dec, 2019).

The factors contributed towards the profitability of the banking sector in FY 2020 were; non-interest income, interest income and FX gains. Although interest income and FX gains decreased compared to previous period, while non-interest income increased. Major profitability components are interest and non-interest income, while main expanses are non-interest expenses and salary expenses.

Group wise analysis revealed that State-Owned Banks (SOB), Private Banks (PB) and Branches of foreign banks (BFB) ended with profits (See figure

6.10). Profitability of the banking sector is mostly coming from Private Banks which standing at Afs 825 million (51.4% of the sector net-profit), with annualized ROA of 0.41%, State Owned Banks earned net-profits amounted to Afs 654 million (40.8% of the sector net-profit) with annualized ROA of 0.75%, while profit for Branches of Foreign Banks were Afs 126 million (7.8% of the sector net-profit) with annualized ROA of 0.73% in the period under review.

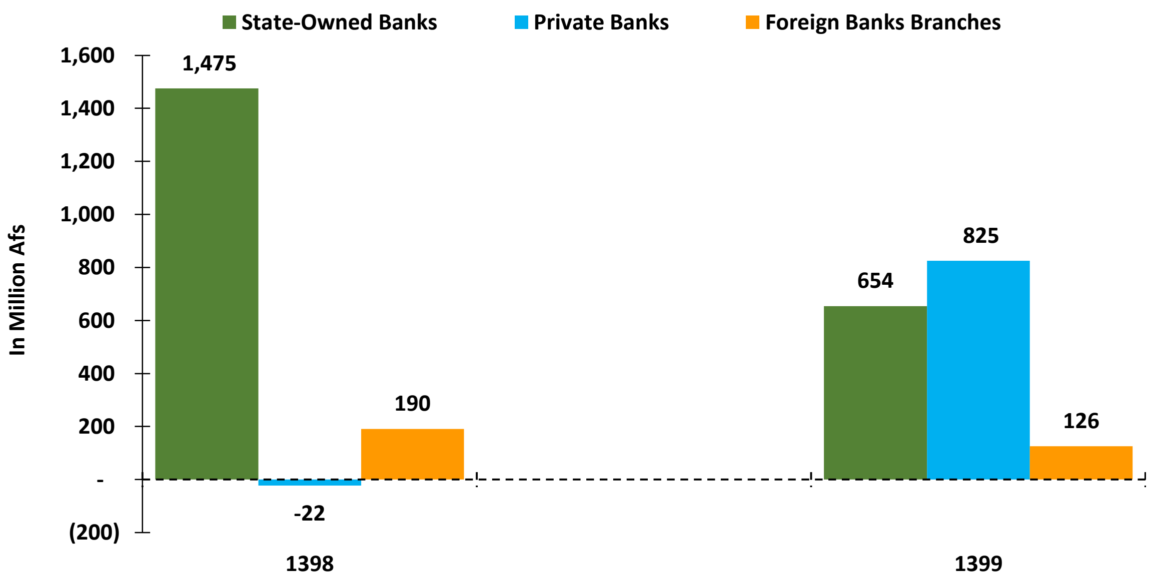
On core income basis five banks ended with losses against six banks in the previous period.

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

Items	Dec, 2019	Dec, 2020	Growth
Interest income	7,501	6,617	-11.78%
Interest expense	1,100	959	-12.78%
Net interest income	6,402	5,658	-11.61%
Non-interest income	7,615	7,718	1.35%
Non-interest expenses (except salary)	6,318	6,263	-0.87%
Salary expense	4,390	4,398	0.17%
Net credit provisions	2,316	1,944	-16.04%
Gain/Loss on Investments	240	288	19.95%
Income before Tax & FX gain/loss	1,233	1,059	-14.10%
FX gain/loss	1,078	747	-30.70%
TAX	668	202	-69.77%
Net profit	1,643	1,604	-2.35%

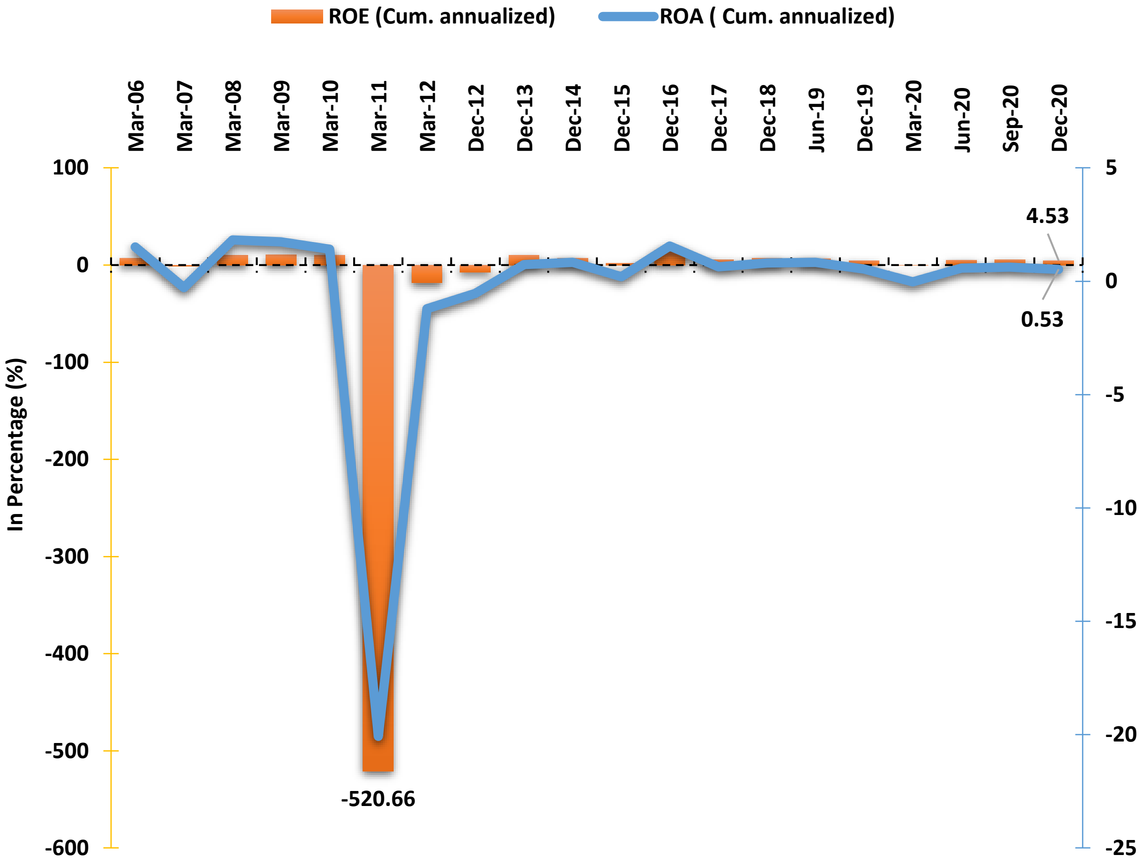
Source: Banking Supervision Department, DAB

Figure 6.10: Profitability of the Banking Sector



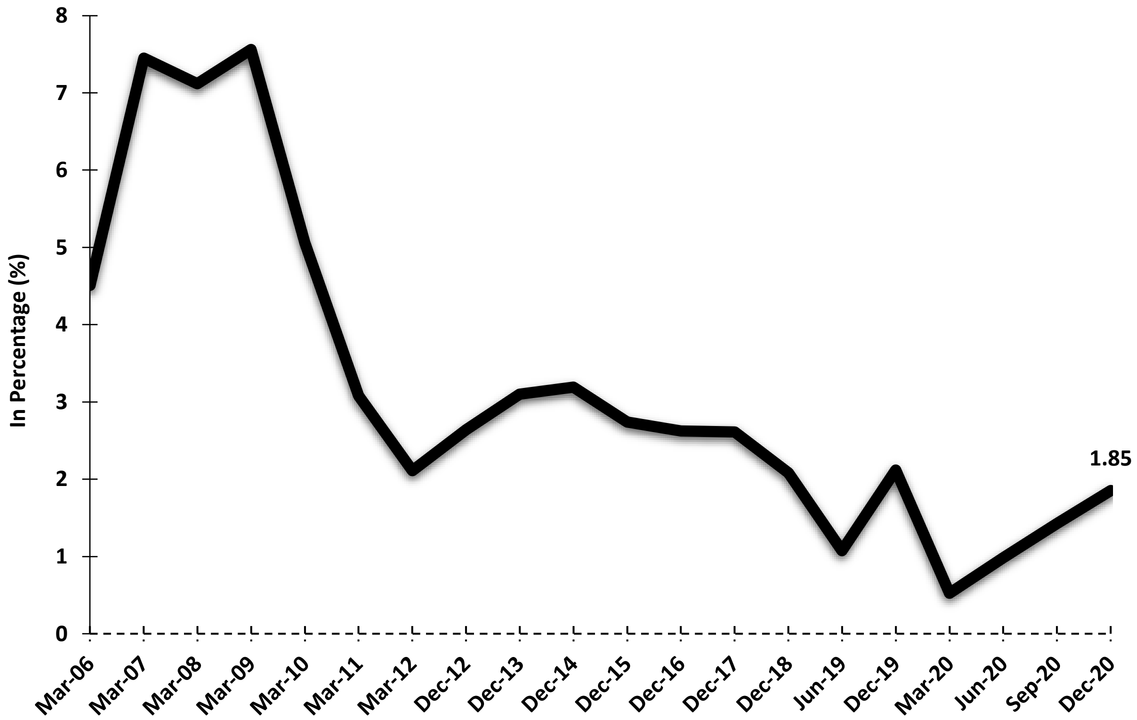
Source: Banking Supervision Department-DAB

Figure 6.11: ROA and ROE



Source: Banking Supervision Department, DAB

Figure 6.12: Net Interest Margin



Source: Banking Supervision Department/ DAB

6.6. Foreign Exchange Risk:

All banking institutions are within the set regulatory threshold for overall open FX position (± 40%) and on an individual currency (± 20%) basis except for three banks which have violated the limits on overall and on an individual currency basis (USD and EUR long position). Those banks need to bring their FX positions under the set limit, otherwise, depreciation (decrease in the value) of US dollar can lead the banks to more losses.

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20% appreciation in exchange rate would increase the regulatory capital of the system by Afs 2.76 billion and vice versa. Similarly, a 4% change would correspond to Afs 552 million and vice versa.

6.7. Interest Rate Risk:

Overall the banking system is in an interest-rate sensitive position. However, calculations made from the interest rate sensitivity schedules of all banks revealed that, the net-interest income of the system over the next 12 months may increase by Afs 301 million in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock), interest income will decline by Afs 301 million. For six banking institution, if the interest rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

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

6.8. ISLAMIC BANKING PERFORMANCE

6.8.1. Summary:

Overall, the Islamic banking sector recorded an upward trend for its main financial indicators during FY 2020, as apparent from the increase in total assets which was mostly due to increase in deposits. The equity capital of one full-fledged bank remained in stable level which was attributed to rise in the profitability along with adequate level of liquidity position, and capital adequacy ratio of bank was above the set regulatory threshold. Gross financing has downward trend due to settlement and FX variation, meanwhile, new financing has taken place also. Investment of the sector has growth trend mainly due to new investment in Sukuk in foreign countries and Ijara inside the country.

The total assets of the Islamic banking sector at the end fourth quarter of FY 2020, demonstrated 28.04% growth and stood at Afs 48.79 billion as compared to Afs 38.1 billion in the same quarter of preceding year. The increase in total assets mostly originates from increase in liquid assets, investment, and interbank claims of the sector.

Deposits, as a main source of funding in the Islamic banking sector witnessed 29.4% increase over the review year and reported Afs 40.62 billion. The increase in total deposits was due to increase in the time, saving and demand deposits of the sector during the year.

Liquidity and FX positions of windows are in accordance with the benchmarks set by the central bank (20% for Quick and 15% for Broad Liquidity Ratios, ± 40% for overall FX position and ± 20% on individual currency position) on overall and individual currency basis (USD long position).

6.8.2. Total Assets:

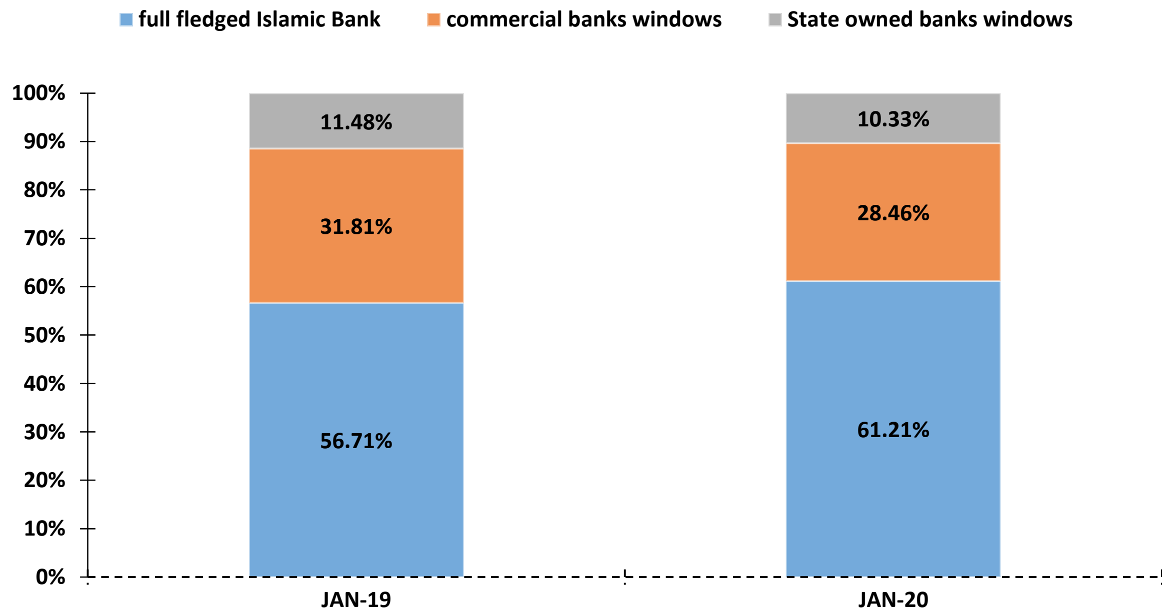
Total assets of the Islamic Banking sector stood at Afs 48.79 billion (USD 632.87 million) during FY 1399 which indicated 28.04% growth as compared to 10.71% growth of the previous year, and the increase was mainly reported in fourth quarter of the year under review.

The increase in total assets was mostly contributed by increase in total deposits of the sector during the year. The individually item wise analysis of total assets confirmed that the considerable increasing items were investment in Sukuk, Ijara, interbank claims and, in cash in vault and claim on DAB, whereas, the Murabaha financing showed slight decrease for the mentioned period.

The components of the Islamic banking sector assets portfolio were cash in vault and claims on DAB without interest (42.03%), interbank claims (12.89%), net Murabaha financing (6.68%), investment (Musharaka, Sukuk and assets acquired for leasing) 29.02%, other assets (7.9%) and, fixed and intangible assets makes only 2.04% of the total assets of the Islamic banking sector.

The full-fledged Islamic bank has leading share in the sector's total assets with 61.2%; four windows of private commercial banks have second position with 28.5% shares and, state owned banks windows make 10.3% of the sector's total assets. Looking at the increase in total assets across the sector, the 77.3% growth has taken place in full-fledged Islamic bank and the remaining 22.7% reported in the assets of Islamic banking windows.

Figures 6.13: Percentage Share in Islamic banking sector Assets



Source: Islamic Banking & Finance Department, DAB

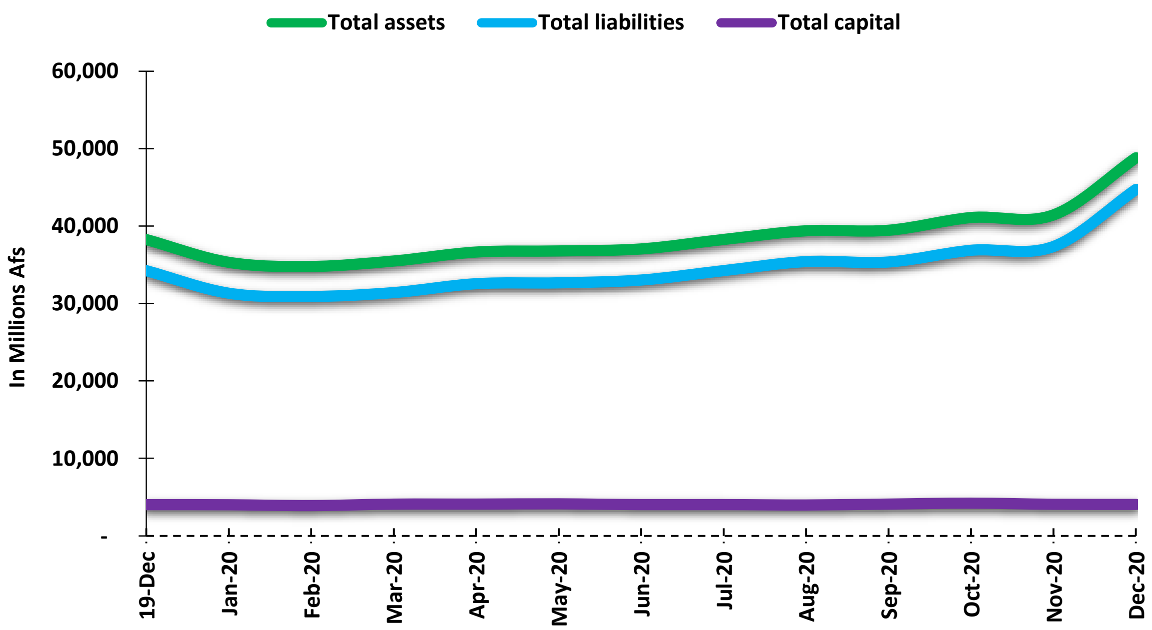
Table 6.5: Assets, Liabilities and Capital of Islamic Banking Sector

Amount in million Afs	Dec-2019	Dec-2020	% of Total Asset/liabilities	Growth
Assets				
Cash in vault and claims on DAB	17,768	20,506	42.03%	15.41%
Investment (Net)	7,747	14,158	29.02%	82.75%
Interbank claims (Net)	4,995	6,289	12.98%	15.91%
Financing (Net)	4,024	3,359	6.68%	-19.01%
Other Asset (Net)	2,799	3,862	7.91%	37.97%
Intangible assets	296	262	0.53%	-11.7%
Fixed Assets	455	446	0.93%	-4.5%
Total Asset	38,110	48,794	100%	28.04%
Liabilities				
Total Deposits	37,398	40,628	90.91%	29.4%
Borrowings	1,418	1,162	4.1%	-18.1%
Other Liability	1,402	2,952	6.6%	110.57%
Total Liability	34,218	44,742	100%	30.76%
Equity Capital	**3,892**	**4,053**		**4.12%**
Total Liabilities and capital	**38,110**	**48,794**		**28.04%**

Source: Islamic Banking & Finance Department, DAB

The growth trend of assets of the Islamic Banking Sector from Dec 2019 to Dec 2020 is depicted in figure 6.14.

Figure 6.14: Growth trend of Islamic Banking Sector from Dec 2019 to Dec 2020



Source: Islamic Banking & Finance Department, DAB

As figure 6.14 indicated that the total assets of Islamic banking sector at end of fourth quarter of 2020 reached to Afs 48.79 billion which showed 23.7% increase as compared to last quarter, at the same time the total deposits of the sector witnessed 24.89% upturn which recorded 77.03% in demand deposits.

- **Gross Murabaha Financing, Investment:**

The gross Murabaha financing and investments portfolio of the Islamic banking sector registered increase of 43.22% over the review year of 2020, stood at Afs 18.55 billion and constituted 35.7% of the total assets, whereas at the end of fourth quarter of previous year it was Afs 12.95 billion and made 34% of total assets of the sector.

The breakup of total gross financing and investment of the sector consists of; investment in Sukuk Afs 10.06 billion and increased by Afs 5.38 billion, making 54.23% of total gross financing and investment; Murabaha receivables Afs 4.38 billion that decreased by 14.59% and made 23.63% of total gross financing and investment, assets acquired for leasing Afs 3.94 billion and showed Afs 1.02 billion increase which constituted 21.26% of total gross financing and investment, Diminishing Musharaka Afs 111.02 million or 0.59% and constant Musharaka amounted to Afs 51.87 million of the total gross financing and investment at the end of Dec 2020.

The increase in Gross Murabaha financing and investments has observed 96.2% in investment in Sukuk of full-fledged bank and by a window and, 18.4% recorded in assets acquired for leasing by a window, meanwhile the Murabaha financing have been decreased by 14.5% during the review year.

The increase in total investment portfolio is mainly due to purchasing new Sukuk by full-fledged bank in the international Islamic finance market, and invested by window in investment properties (Ijara) and, at the same time, settlement and installment of Murabaha financing has been collected during the year.

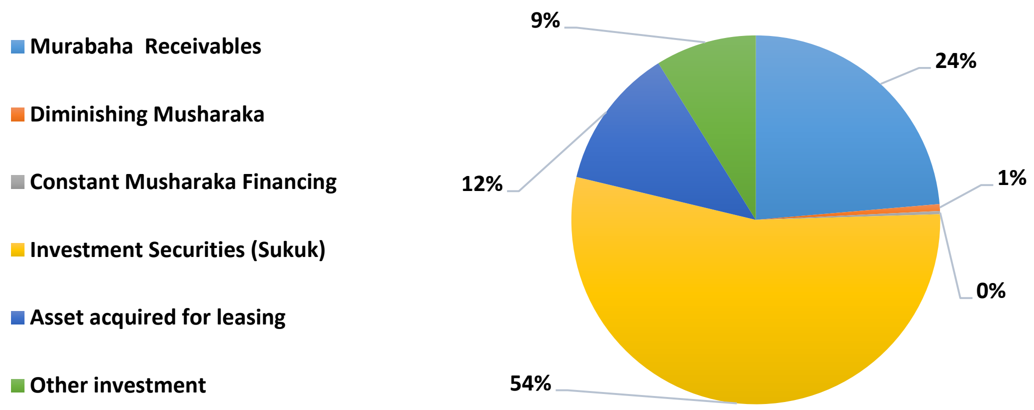
Table 6.6: Product wise Islamic Banking Sector Financing and investment (gross)

No	Product	Dec-19	Dec-20	Difference in Amount	Difference in %	Products as % of Gross Investment & Financing
		Amount in million Afs				
1	Investment in Sukuk	4,675	10,064	5,388	115%	54.2%
2	Murabaha Receivables	5,197	4,386	(810)	-15.59%	23.63%
3	Asset acquired for leasing	2,007	2,303	295.4	15%	12.4%
4	Other investment	910	1,643	733	80.49%	8.85%
5	Diminishing Musharaka	116	111	-4.54	-3.92%	0.6%
6	Constant Musharaka	53	52	-1.1	-2.14%	0.28%
Grand Total		12,958	18,558	5,600	43.22%	100%

Source: Islamic Banking and Finance Department, DAB

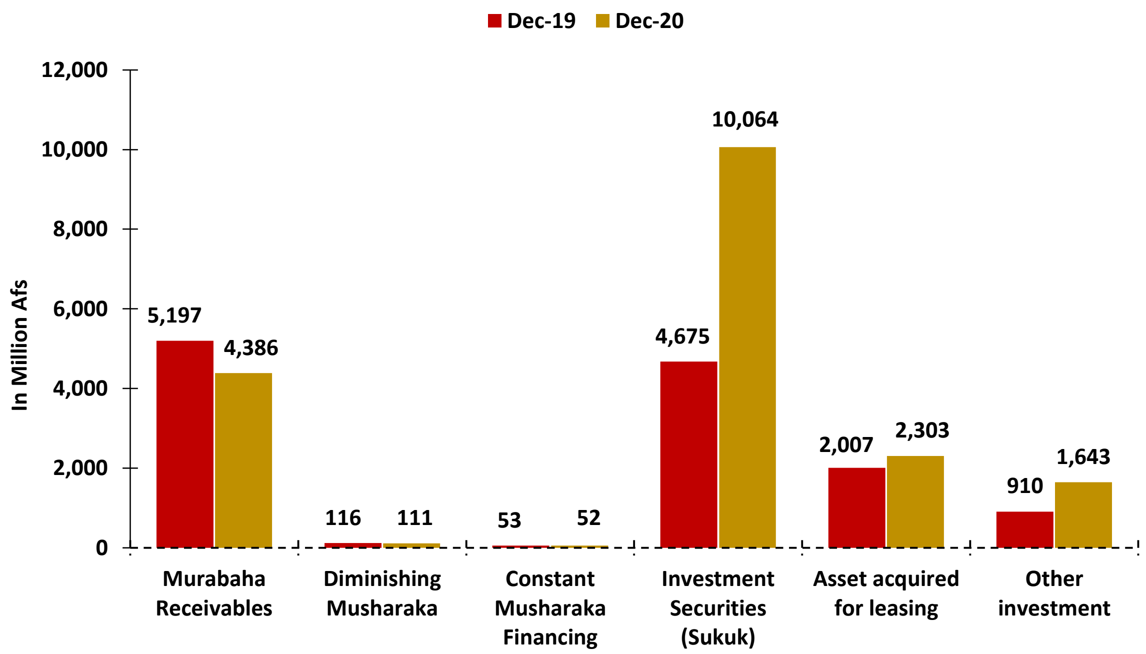
Total Afghani denominated financing and investment of the sector registered at Afs 4.91 billion which made 26.5% of total Gross financing and investment and 10.1% of total assets of the sector. While the US Dollar denominated financing and investment are Afs 13.64 billion and make 73.4% of total gross financing and investment and 28% of total assets. The sector wise lending of Murabaha financing in Afghanistan is dominated by Islamic banking windows, constituting 87.6% of total gross Murabaha financing of the sector, while the share of full-fledged bank in total Murabaha financing is only 12.3%. Whereas the total overseas investment in Sukuk of the sector is dominated 90.8% by full-fledged Islamic bank and remaining 9.2% by two Islamic banking windows of commercial bank.

Figure 6.15: Product wise investment and financing as Percentage as per Dec, 2020



Source: Islamic Banking and Finance Department, DAB

Figure 6.16: Product wise Investment and Financing of the Islamic Banking Sector: comparison between Dec 19 and Dec 2020



Source: Islamic Banking and Finance Department, DAB

Financing & Investment Loss Reserve:

At the end of Dec 2020 (Qaws 1399), total provision of Islamic banking sector for financing and investment stands at Afs 1.25 billion and shows decrease of 2.36% as compared to previous year (Dec 2019), and the decrease amount recorded in credit provision for Murabaha financing. The total provision of the sector is consisting of Afs 1.128 billion for Murabaha financing and makes 25.71% of total gross Murabaha financing, Afs 77.47 million for interbank claims, Afs 13.6 million for investment and Afs 31.55 million for account receivable. As well as the total provision makes 2.56% of total assets and 6.7% of total gross financing and investment of the Islamic banking sector.

- **Interbank Claims:**

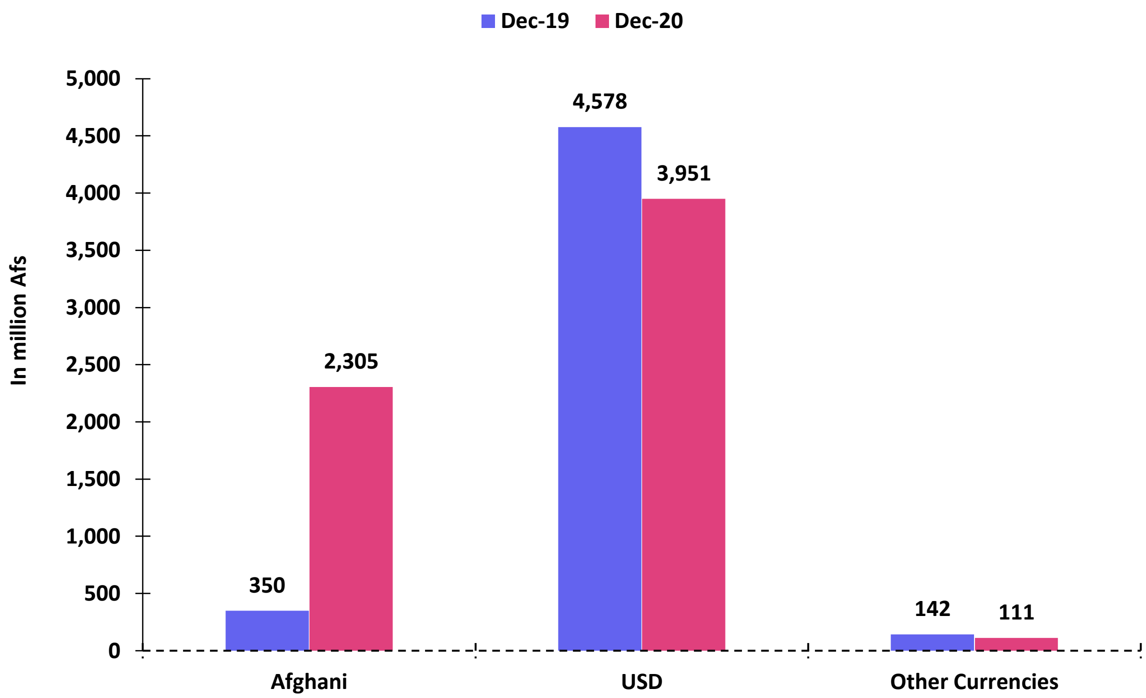
The Interbank Claims of the Islamic Banking Sector are the third largest among various asset categories, which at the end of Dec of 2020, stands at Afs 6.29 billion, constituted 12.89% of total assets and increased by Afs 1.29billion (25.6%) over the last year. Interbank claims denominated by Afghani 36.2%, US Dollar 62.051% and other currencies 1.74% (see figure 6.17).

Three out of six Islamic banking windows and one full-fledged Islamic bank have interbank claims, which consist of Afs 880 million of time deposits that makes 14% of total interbank claims, and Afs 5.48 billion of demand deposits that makes 86% of total interbank claims of the sector (see figure 6.17)

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

Cash in vault and claims on DAB is the largest category and making 42.03% of total asset of the sector, at the end of Dec 2020 stood at Afs 20.5 billion and increased by 15.41% as compared to preceding year 2019. Cash in vault and claims on DAB consists of Afs 5.41 billion cash in vault, Afs 11.96billion non-interest bearing current account with DAB, and Afs 3.12 billion required reserve account with DAB.

Figure 6.17: Interbank claims



Source: Islamic Banking and Finance Department, DAB

6.8.3. Liabilities:

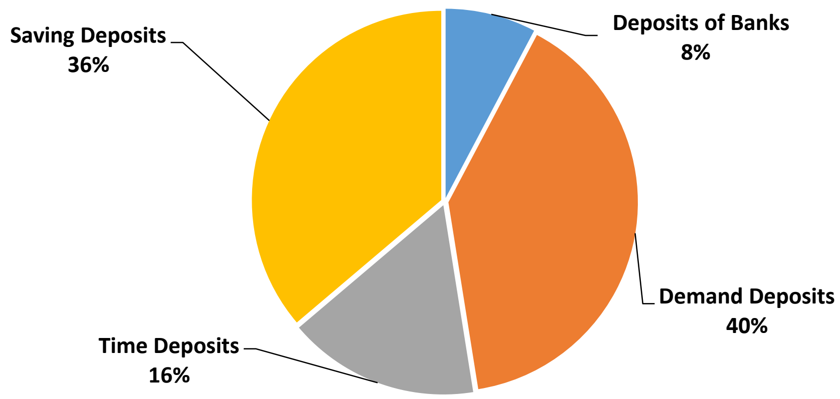
Total liabilities of the Islamic Banking sector at the end of Dec 2020 stood at Afs 44.74 billion against Afs 34.21 billion in the fourth quarter of FY 2019, which shows Afs 10.52 billion increase over the year. The increase in total liabilities of the sector was mainly contributed by increase in total deposits (dominant in customer's banks 'demand and time deposits which are reported in both currencies; Afs and US Dollar). The majority of liabilities of the sector are made up of deposits (90.81%), followed by other liabilities (6.6%), and short term borrowings has placed in third position (4.14%).

- **Total Deposits:**

Deposits are the main source of funding and the larger component of liabilities, at the end of Dec 2020 stands at Afs 40.62 billion, making 90.81% of total liabilities of the sector, increased by 29.4% since last year Dec 2019 (Qaws 1398). The increase in total deposits was mostly obvious in demand and saving deposits; Furthermore, the increase is mostly occurred in Afs deposits, as well as USD deposits registered positive trend in its position. It must be noted that during the assessment year, the time deposits of customers have been decreased by Afs 929.16 million against the time deposits of banks which had positive trend and showed Afs 1.11 billion increase since last year.

Total Afs-denominated deposits of the sector are Afs 18.82 billion or 46.3% of the total deposits, increased by 56%, while the USD-denominated deposits of the sector stand at Afs 21.8 billion or 53.66% of total deposits with 12.78% increase. The total deposits of the sector consist of Afs 17.97 billion of demand deposits (with 44.2% share), Afs 14.7 billion of saving deposits (with 36.2% share), and Afs 7.94 billion of time deposits (with 19.6% share). On the other hand, total deposits of the sector comprise of Afs 37.48 billion of customers deposits with 92.3% share, and Afs 3.14 billion of banks deposits, with 7.7% share in the total deposits of the sector.

Figure 6.18: Breakdown of Deposits as Per Dec, 2020



Source: Islamic Banking & Finance Department, DAB

6.8.4. Liquidity:

The liquidity position of all Islamic banking windows and full-fledged Islamic bank is above the set minimum for the broad liquidity ratio (15%) and the quick liquidity ratio (20%). Broad liquidity ratio of the Islamic banking sector as a median stand at 53.09% against 56.09% in previous year (Dec 2019), showing a decrease of 3%. All banks are required to maintain a reasonable liquidity ratio level, in order to avoid any liquidity problem.

Table 6.7: Key Financial Soundness Indicators of the Islamic Banking Sector as of Dec 2020

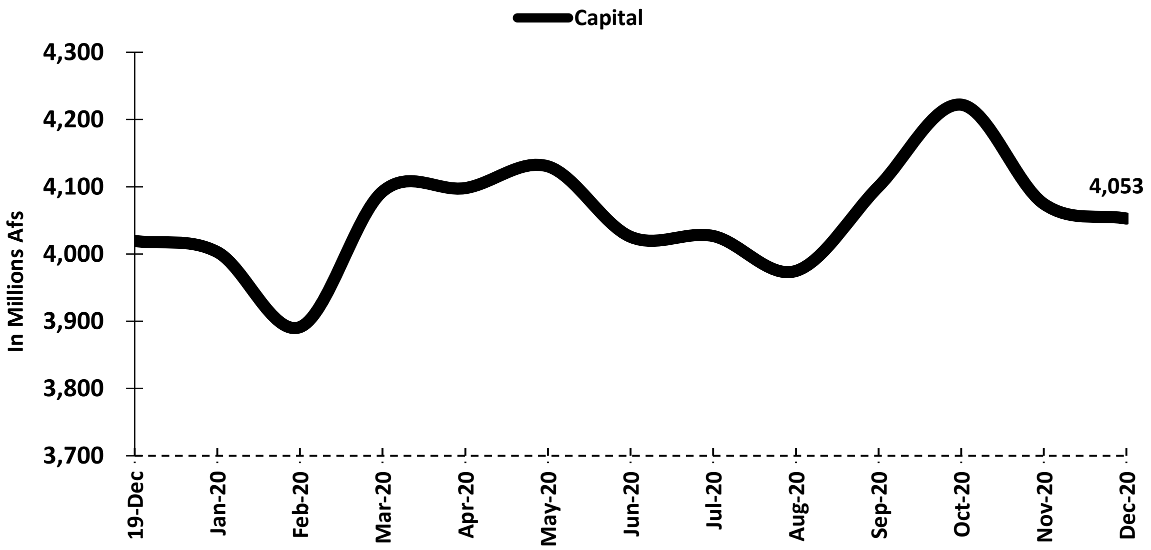
Ratio in %	(Dec, 2019)	(Dec,2020)
Liquid Assets to Total Assets	59.73%	54.91%
Liquid assets to short term liabilities	167%	155%
Total financing to Total Assets	34%	35.7%
Total financing to Total Time & Saving deposits	68.29%	86.97%
Time & Saving deposits to Total deposits	62.42%	52.52%
Foreign-Currency denominated funding to total funding	61.5%	53.66%
Foreign- Currency denominated financing to total financing	71.91%	73.5%
Return on Assets (ROA) Cumulative	-1.4	0.003
Return on Equity (ROE) Cumulative	-10.96	0.026

Source: Islamic Banking & Finance Department, DAB

6.8.5. Capital:

At the end of Dec 2020, the equity capital of the sector stands at Afs 4.05 billion, making 8.3% of total assets and showing increase of 4.12% since previous year (Dec 2020) which was Afs 3.89 billion. The increase of Afs 105.5 million in the total capital is due to profit of the sector and remaining is due to adjusted entries in an Islamic banking window during the review year. CAR of full-fledged Islamic bank remains above the regulatory limit.

Figure 6.19: Equity Capital Trend of the Islamic Banking Sector as Per Dec, 2020



Source: Islamic Banking & Finance Department, DAB

The equity capital of windows consists of; owner's equity (which is not in the form of liquid assets, but it is the value of investment property which is transfer/given from the conventional bank to Islamic banking windows), retained profit/loss of previous years, other comprehensive income (income from the revaluation of fixed assets), and profit/loss of the current year. The trend of the sector equity capital is described above and is depicted in the figure 6.19.

6.8.6. Profitability:

- **Cumulative, Jan-Dec 2020 (Jadi-1398 to Qaws-1399):**

The Islamic banking sector on cumulative basis (from Jan to Dec 2020), ended with Afs 105.5 million net-profit for the financial year of 2020 (1399) against Afs 406.14 million net-losses recorded in the last year, resulting in ROA of 0.003% and ROE of 0.026% annualized against ROA of -1.4% and ROE of -10.04% annualized in Dec 2019.

Table 6.8: Returns by Major Types of Shariah Compliant Products

Value of returns by major type of Shariah-compliant contract (Amount in million Afs)			
Product	**2019**	**2020**	**Difference**
Time Deposits with banks	68.23	19,11	(49.12)
Profit Income on to OFIs deposits	68.44	36.03	(32.41)
Murabaha financing	351.27	245.89	(105.3)
Musharaka and Diminishing Musharaka	14.81	9.46	(5.41)
Sukuk investment	115.58	299.89	114.31
Ijara	85.7	112.6	26.8
Total Profit Income	704.14	653	(51.13)

Source: Islamic Banking and Finance Department, DAB

The main reason for the profit of the sector during the year of 2020 was mainly due to decrease of Afs 574 million in net credit provisions as compared to last year which was reported Afs 784 million. As well as the sector since Jan 2020, reported Afs 717 million as reintegrated provisions. Another contributing factor in the profit of the sector is the increase of Afs 171 million in non-profit income of the sector, meanwhile the non-profit expenses (operating expense) increase of Afs 49 million.

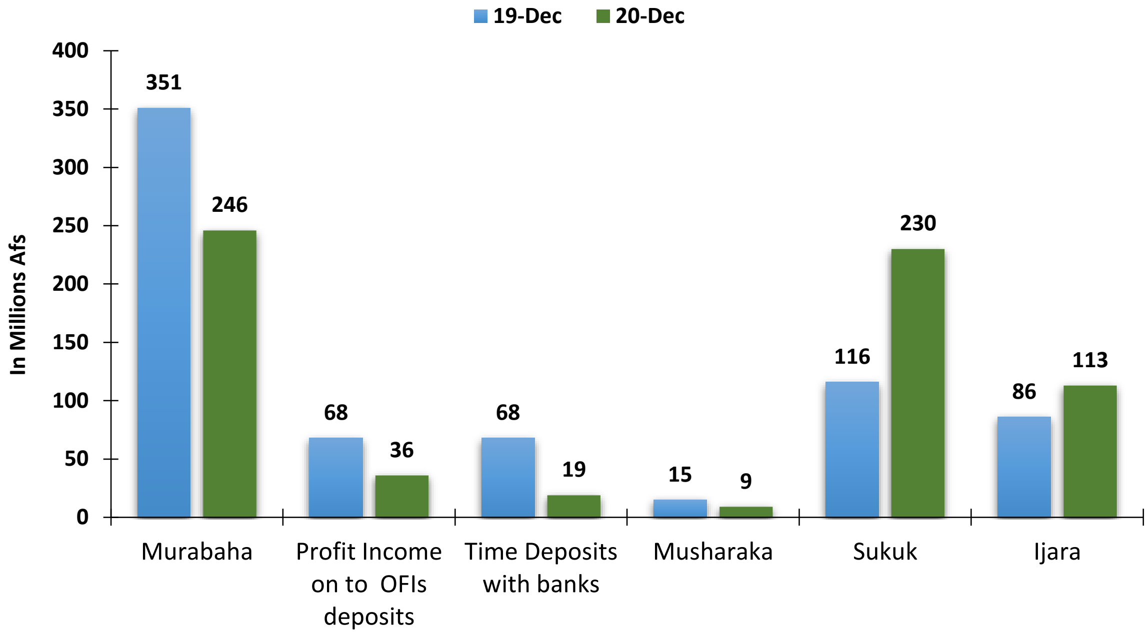
Table 6.9: Profit and Loss Schedule of the Islamic Banking Sector

Profit and loss Schedule (Amount in million Afs)			
Item	**2019**	**2020**	**Difference**
Profit income	704.14	653	(51.18)
Profit expense	305.62	231.17	(74.57)
Net profit income	358.51	421.82	23.31
Net Credit provisions	784	210	(573.9)
Other nonprofit income	405.4	576.12	170.7
Total operating expenses	1,255	1,304	48.9
Income (Loss) before FX revaluation	(1,235.22)	(516.17)	(719)
FX revaluation Gain/loss	732.46	667.77	(64.69)
Tax	(96.41)	46.19	142.6
Net profit income/Losses after Tax	(406.14)	105.5	511.7

Source: Islamic Banking and Finance Department, DAB

In general, the Islamic banking sector was offering six types of Islamic financial products. The returns from financing and investment during 2020 are shown in the following table:

Figure 6.20: Return by Major Types of Shariah Complaint Products



Source: Islamic Banking & Finance Department, DAB

Total number of employees, borrowers and depositors of the Islamic banking sector as of Dec, 2020, all across the country are shown in following table:

Table 6.10: Employees, borrowers, and depositors of the Islamic Banking Sector at the end of Dec, FY 2020

Particulars	Number
Full-time all Employees	1,042
Present Borrowers	823
Present Depositors	577,495

Source: Islamic Banking & Finance Department, DAB

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