Da Afghanistan Bank

Central Bank of Afghanistan

Quarterly Economic and Statistical Bulletin

First Quarter-1386

March 2007 - June 2007

Ibn-e-Sina Watt

Kabul

Afghanistan

Telephone: +93-20-2100293

Internet: www.centralbank.gov.af

Email: mp@centralbank.gov.af

First printing August 2007

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Data Notes

Data reported in this bulletin is valid as of June 21, 2007 (1386).
Afghanistan uses the Persian calendar also known as the Jalali calendar, which was introduced on March 15, 1079 by the Seljuk Sultan Jalal-u-ddin Malik Shah I, based on the recommendations of a committee of astronomers, including Omar Khaiyam, at the imperial observatory in his capital city of Isfahan. It is a solar calendar in which each year begins on March 21. This Quarterly Bulletin covers developments in first quarter of 1386 which is equivalent to March 21, 2007 – June 21, 2007 in the Gregorian calendar.

Afghanistan figures are in current Afghani unless otherwise specified.
Billion means 1,000 million

CONTENTS

List of Figures

List of Tables

List of Abbreviations

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

FOREWORD

I am pleased to present the Quarterly Bulletin of Economic and Statistics for the period March 21 to June 21, 2007. This Quarterly Bulletin reflects the main developments in the Bank's activities aimed at keeping inflation low, maintaining the stability of the national currency and developing a robust banking sector in support of sustainable economic growth.

The first quarter of 1386 comes after a difficult year for the Afghan economy. On the one hand, economic growth fell short of expectations, dropping to 7.6 percent from 14 percent in 1384. The steep drop in economic growth was exacerbated by a dramatic 49 percent increase in the opium harvest in the country which led to a new record in the world production of opium. Afghanistan now accounts for 92 percent of global opium production.

In the quarter under review, the momentum of global economic growth continued to be robust supported by buoyant economic activity in emerging markets with China growing by 11.5 percent and India and Russia are also growing very strongly. Global price developments continued to be strongly influenced by changes in commodity prices. Strong world growth, along with some specific supply factors, led to further increase in commodity prices. Food and energy prices generally have been increasing with the switch to the use of agricultural land and grains for bio-fuel production. This is raising concerns about wider inflationary pressures. It is also likely to have greater effect on low-income countries as well as on global environment.

The Afghan economy rebounded in the first quarter of the year as agriculture recovered from the drought of 1385. Food availability in the first quarter was good; prior to the main wheat harvest that began in June. Imported wheat was widely available as is normal for this time of year, although prices were higher than normal in areas of the northwest and northeast that were impacted by drought during 2006.

Monetary policy in the quarter under review remained cautious, underpinned by the broader objective of maintaining price stability while supporting the development of capital markets. Reserve money declined by -3 percent, down from 13 percent in the previous quarter. Bank deposits with the central bank, which is a component of reserve money declined by -46 percent in the first quarter of 1386.

On the fiscal side, expenditures from the operating budget stood at AF 8,178 million or 46% of the AF 17,659 million allotments at the end of the quarter. Expenditures from the development budget were AF 3,007 million or only 16% of AF 18,247 million allotments. On the revenue side, total domestic revenue at the end of the first quarter stood at 6.4 billion (1.6 percent of GDP) about 0.6 billion AF or 8 percent below the indicative target for the first quarter 1386.

Developments on the inflation side remained positive though there were some signs of inflationary pressure building up in the economy. Headline inflation, the broadest measure of the rise in the general level of prices, edged up slightly in the first quarter of 1386. The headline Consumer Price Index (CPI) for Kabul stood at 135 at the end of the first quarter 1386, representing an inflation rate of 8.1 percent; up from 5.5 percent in the same quarter a year ago.

The main drivers of inflation were the prices of fuel and electricity, transportation and food. The food price index rose dramatically by 11.8 percent largely due to the increase in the transportation price index and the decrease in the worldwide wheat production. Since Afghanistan is a net food importing country, both reasons attributed to the spike in food prices in the quarter under review.

Diesel and petrol prices -- the main components of the fuel index--rose by 6 and 10.1 percent respectively compared to the same period a year ago. The increase in fuel prices largely reflected developments in international markets where crude oil price hit all time nominal highs.

The Banking system continued to perform satisfactorily. Total assets of the banking system rose to AF 58.8 billion (USD 1.2 billion) at the end of first quarter 1386, up by 68 percent from first quarter of last year, and 9 percent since the beginning of solar year. Loans amounted to AF 24.9 billion (USD 0.5 billion) an increase of AF 15.2 billion (USD 304 million) or 157 percent since June 2006. Deposits stood at AF 45 billion (USD 906 million) over the period under review; a 93 percent increase since June 2006. Deposits were largely denominated in USD (77 percent) with AF -denominated deposits were lagging at 19 percent.

In the external sector, the trade deficit, the difference between exports and imports of goods, in the first quarter of 1386 stood at USD 585 million or 24 percent of GDP. This was slightly higher than the trade deficit in the first quarter of 13865 which stood at 21 percent. Imports were dominated by capital goods (USD 337 million) and industrial supplies and materials (USD 156 million). Domestic exports increased by 48 percent to USD 107 million and were dominated by carpets and rugs (USD 57 million) and food items (USD 23 million).

With respect to the direction of trade, Pakistan remained Afghanistan's major export destination with a 60 percent share of total exports, followed by India, with 21 percent share of total exports in the first quarter of 1386. Exports from the first quarter of 1385 up to first quarter of 1386 expanded by a phenomenal 24 percent and 265 percent correspondingly.

In conclusion, on an overall assessment, economic performance in the first quarter was broadly satisfactory notwithstanding concerns about the buildup of inflationary pressure due to record oil prices and surges in the prices of wheat in international markets.

Noorrullah Delawari

Governor, Da Afghanistan Bank
(Central Bank)

1

THE INTERNATIONAL ECONOMIC ENVIRONMENT

Summary

The momentum of global economic growth continues to be robust in the first quarter of 1386 supported particularly by buoyant economic activity in emerging markets. China growing by 11.5 percent in the 1st quarter of 1386, and India and Russia are also growing very strongly.

Global price developments continue to be strongly influenced by changes in commodity prices. Strong world growth, along with some specific supply factors, has led to further increase in commodity prices. Food and energy prices generally have been increasing with the switch to the use of agricultural land and grains for bio-fuel production. This is raising concerns about wider inflationary pressures. It is also likely to have greater effect on low-income countries as well as on global environment.

1. United States Recovers on the Back of Exports and Investment

In the United States, economic activity recovered sharply during the second quarter of 2007, and inflation remained somewhat elevated. The real GDP growth increased to 3.4 percent on a quarterly annualized basis or a non-annualized 0.8 percent in the 1st quarter of 1386 (2nd quarter of 2007), from 0.6 percent in the first quarter of 2007.This mainly reflected a rebound in net exports and investment, while the contribution from private consumption was lower.

Inflationary pressures have remained somewhat elevated in recent months, with CPI annual inflation standing at 2.7 percent in June-as it did in May- comparing to 2.4 percent in the previous term.

2. Japan's Economy Slows

In Japan, the seasonally adjusted quarter-on-quarter growth slowed to -0.3 percent in the last quarter of 1385, down from 0.73 percent in the previous quarter.

Inflation remained subdued. In June the general CPI declined by 0.2 percent on an annual basis, where as the annual change in the CPI excluding fresh food was -0.1 percent the same rate as in the previous month. Negative contributions from numerous items, most notably food, as well as reading and recreation, continued to dampen inflation in June.

3. Emerging Asia

In emerging Asia, economic activity continued to expand at a robust pace, particularly in China. Inflationary pressures picked up further in China, but continued to moderate in other large economies in the region, most notably India.

In China, real GDP grew by 11.9 percent on an annual basis in the second quarter of 2007, compared with 11.1 percent in the previous quarter. This is fastest pace of growth in more than a decade.

In June annual consumer price inflation in China rose to 4.4 percent, from 3.4 percent in May, with higher food prices largely behind the increase. On quarterly basis the CPI in China increased to 3.6 percent in the 2nd quarter of 2007 comparing to 2.7 percent in the previous quarter.

In India, real GDP grew by 10.2 percent in the 2nd quarter of 2007, comparing to 9.6 percent growth in the 1st quarter of the same year.

The wholesale price index in India rose to 1.32 percent in the 2nd quarter of 2007 comparing to 0.22 percent in the previous quarter. This shows an increase of 1.1 percentage number over the previous quarter.

In Pakistan, the real GDP grew by 7 percent in the 2nd quarter of 2007 comparing to 6.6 percent growth in the previous quarter. Despite the underperformance of key kharif crops, a bumper wheat harvest and indications of strong outrun by livestock, and rise in investment, particularly in foreign direct investment contributed to the growth of GDP.

The inflation increased to 1.7 percent in the 2nd quarter-2007 comparing to 0.52 percent in the previous quarter of the same year.

4. Euro Area

In the euro area, seasonally adjusted quarter-on-quarter GDP growth moderated to 0.8 percent in the first quarter of 2007 following growth of 0.9 percent in the previous quarter. This was on account of a slowdown in consumer spending and external demand.

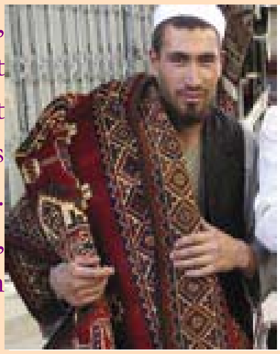
Euro area HICP annual inflation stood at 1.9 percent in June 2007, for the fourth consecutive month. With the exception of energy prices, the annual rate of growth of all components remained broadly unchanged in June. Hence, the annual rate of change in the HICP excluding unprocessed food and energy remained at 1.9 percent- the rate at which it has been since February 2007.

Table1.1: World Economy, Key Economic Indicators
1st Quarter-1386 (2nd Quarter-07)

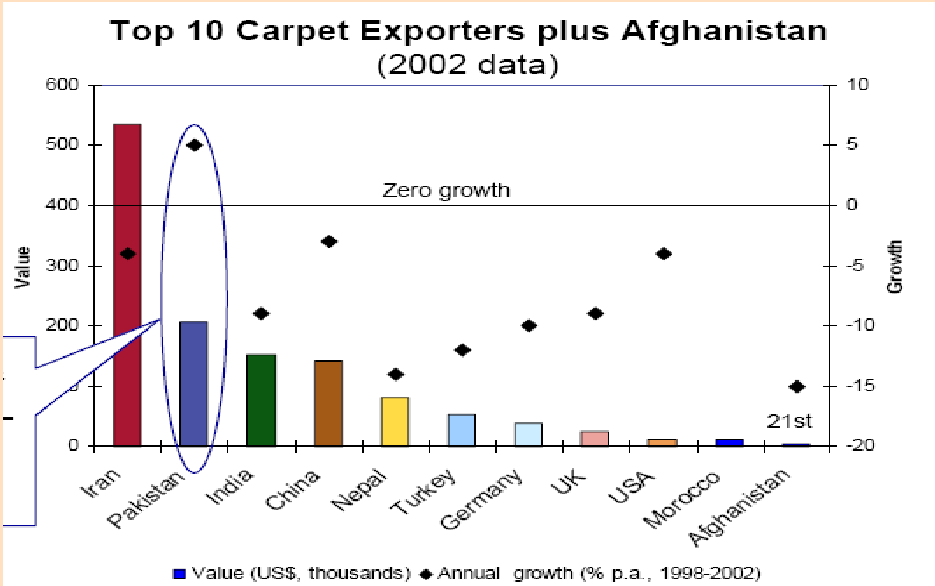
	Real GDP Growth (%)		Inflation (%)	
	Q4-1385	**Q1- 1386**	**Q4-1385**	**Q1- 1386**
World				
Major Industrial Countries*				
United States	0.6	0.8	2.4	2.7
Japan	0.73	-0.3	-0.1	-0.1
Euro Area	0.9	0.8	1.9	1.9
Regional Economies**				
Pakistan	6.6	7	0.52	1.67
Iran	5.0	5.1	5.14	3.85
Emerging Economies**				
China	11.1	11.9	2.7	3.6
India	9.6	10.2	0.22	1.32

Source: Afghanistan Research and Evaluation Unit

BOX 1: The Challenges and Opportunities for Carpet Market in Afghanistan



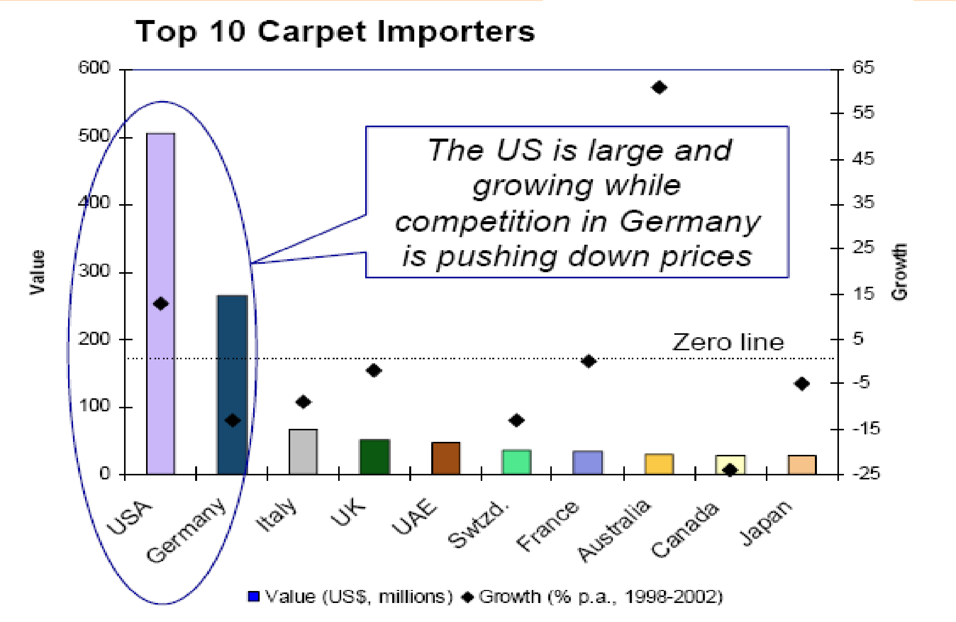
The carpet industry is one of Afghanistan's traditional products and, despite the war; entrepreneurs in the business suggest that a sufficient supply of the necessary skilled labor remains in the country. The carpet sector is of importance for the future development of Afghan trade. This sector is considered as a key candidate for increased export earnings. Besides the benefits that business people are getting from carpet trade, carpet weaving is an important source of income for the rural population in some areas of the country, particularly for women.



Afghanistan is one of the leading manufacturers of quality handmade carpets in the world. Carpets are Afghanistan's largest export; valued at $140 mil in 2005, over 90 percent of this production is sold to Pakistan, where it is then on-sold to wholesale and retailers in end markets. Cutting and washing is undertaking almost wholly in Pakistan, building a strong Afghan brand will require that carpets cut and washed in Afghanistan and not finished in Pakistan. 60 percent of Pakistan export originates in Afghanistan.

Afghanistan's finishing infrastructure was either destroyed or outmoded over the past two decades, compelling most producers to ship quasi-goods to Pakistan for final processing. To develop this sector and create a strong brand for Afghan Carpets, Afghanistan should have the capacity to wash and cut carpets inside the country. Carpet vendors indicate that one finishing facility in Mazar-e-Sharif has recently opened, but it is not clear if the factory has the capacity to lure back a significant amount of the finishing business presently being shipped to Peshawar. Another challenge for the carpet sector is the supply of raw materials; due in part to the devastation of local sources of wool and dyes, an average of 53 percent of the raw materials for this sector is imported mainly from Pakistan. There is the difficulty of finding regular and affordable supplies of quality dyes, wool and other inputs. Importing these raw materials simply adds transport and customs costs and on the other hand the quality of imports is suspect. Carpet makers suggest that shipping carpets from Afghanistan via air is not an economic option given the high cost of limited outbound air cargo space. Today between 90-100 percent of carpets are exported via Pakistan, shipping through Pakistan adds costs and time and Afghanistan lacks its own seaport. Poor customs administration is another challenge for carpet traders as well as for other exporters and importer.

On the other hand, there are the opportunities for the carpet sector in Afghanistan. Although more needs to be done, Afghan carpets and traditional textiles sector retains a generally favorable international image. Carpets in Afghanistan are considered a traditional handicraft, reflection a rich history and a range of quality designs. Handmade Afghan carpets have been granted preferential duty free access to the world's top carpet importer countries (United States and European Union). This provides a pricing advantage for Afghan carpet.



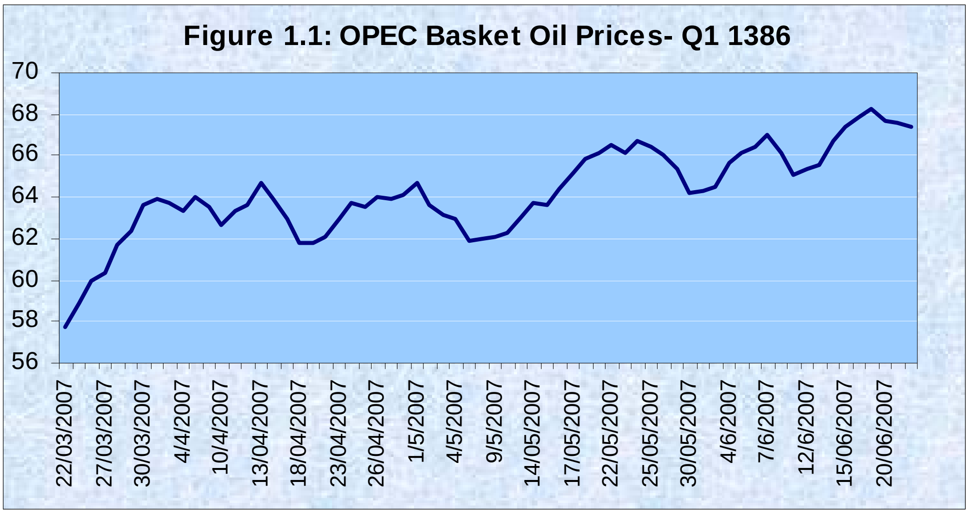
Afghanistan has the potential to improve adequate international image which can help counter some of the concerns of poor quality and renew general interest in Afghan carpets through a successful marketing campaign. Industry experts suggest that despite production problems, Afghan carpets retain a largely favorable image internationally. The demand for raw materials for this sector is consistent and the raw materials (wool dyes) are anticipated to increase inside the country. As noted previously, most Afghan carpets are washed, and finished in Pakistan. Many interviewees have expressed their preference to complete the finishing processes in Afghanistan if comparable facilities existed. Although carpet and textiles manufacturing in Afghanistan has traditionally been a low technology business, the sector could take advantage of modern machinery to increase output and improve quality. For example, increased reliance on the internet would improve marketing and sales. Bringing weavers from their households into factories can extend working hours, improve skills through sharing of technical information and know-how among weavers, and allow for greater monitoring of quality. The use of computer aided drafting (CAD) software can improve the efficiency of creating designs and enable customers to contract with traders for made-to-order carpets.

5. Commodity Prices

5.1 Oil Price

The main motives behind the high oil prices in 1st quarter of 1386 (Mar-June-07) were strong oil demand and geopolitical concerns.

The OPEC Basket Price of Oil* increased to 64.2 USD per barrel in the Q1 of 1386 comparing to 54.4 USD per barrel in the last quarter of 1385. This shows 18.8 percent increase over the last quarter.



*OPEC collects price data on a 'basket' of crude oils of eleven oil rich countries, and uses average prices for these oil streams to develop an OPEC reference price to monitor world oil market conditions.
Source: OPEC

Table 1.2: OPEC Basket Oil Prices
1st Quarter 1386 (22.Mar.-22.June,07)

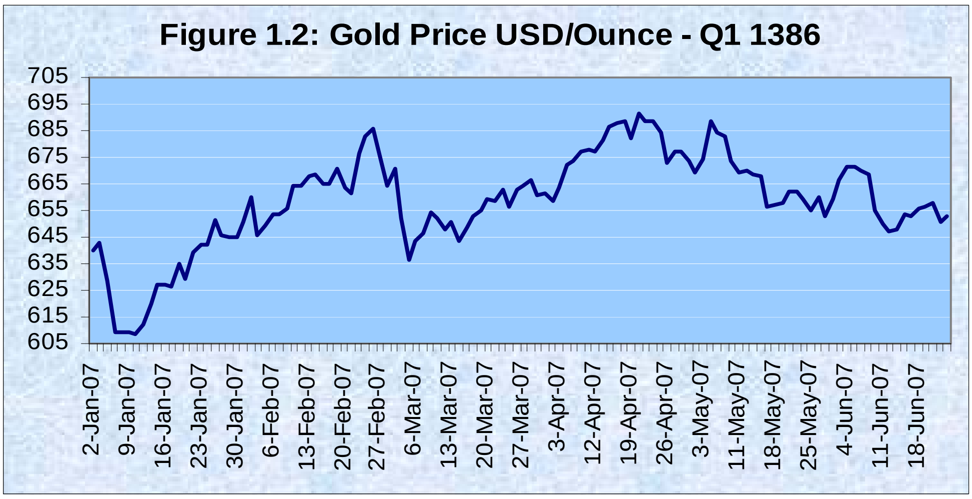
	USD per Barrel
Avrg. Hamal	62.42
Avrg.Sawr	63.83
Avrg.Jowza	66.26
Avrg.Q1 1386	64.20
% Change	18.8
Lowest Price	57.78
Highest Price	68.23

Source: OPEC

Prices were mainly supported by tighter oil-market balances and lingering geopolitical tensions. OPEC output restraint and near-term tightness on North Sea crude supplies coincided with strong summer demand, exerting upward pressure on prices.

5.2. Gold Prices

The average gold price in the 1st Quarter of 1386 (Mar22-June22-07) was 667.86 USD per ounce comparing to 646.60 USD per ounce in the last quarter of 1385, showing an increase of 7.29 percent over the previous quarter. Volatility for gold prices, as measured by standard deviation, in the 1st quarter-1386 was 12.00 percent comparing to 18.66 percent in the last quarter of 1385. (Figure 1.2)



Source: Routers

The gold prices increase due to high demand for gold, since investors believe metals are a sounder investment than share, bonds or currencies, because of uncertainty about the volatility of interest rates or inflation (investment demand) and Demand for jewellery.

Table 1.3: Gold Price Against USD
1st Quarter of 1386 (22 Mar - 22 June, 07)

	1Ounce Gold
Avrg. Hamal	672.73
Avrg.Sawr	673.56
Avrg. Jowza	658.00
Average Q1	667.86
% Change	7.29
Lowest	647.25
Highest	691.4

Source: Bank of England

5.3. Food Commodity Prices

Food commodity prices are expected to rise due to bad weather in main agricultural countries like Canada and Australia and China, and high demand for grain for the usage of biofuels.

Wheat prices increased by 3.68 percent in the second quarter of 2007 (1st quarter 1386) comparing to a decrease of 4.35 percent in previous quarter. Low supply due to droughts and floods were motives for increase in wheat prices. While the rice prices decreased to 1.41 percent in the second quarter of 2007 from 3.9 percent in the first quarter of 2007.

The beef prices were modest, the price of beef rose to 0.79 percent in Q2 of 2007 from -1.19 percent in Q1 of 2007. The poultry price rose by 7.64 percent in second quartet of 2007 comparing to 6.4 percent in previous quarter. Increase in demand for poultry was motive behind the increase in its price. Since some countries stated they have no influenza cases or the chicken influenza is over.

Table 1.4: Food Commodity Prices

1st Quarter 1386 (Apr-Jun-07)

	Wheat[1] USD/MT[2]	Rice[3] USD/MT	Beef.4 US cents/pound.5	Poultry6 US cents/pound
Average April	198.31	322.29	117.63	78.1
Average May	195.72	320.61	116.63	79.52
Average June	223.04	326.29	119	80.75
Quarterly Average	205.69	323.06	117.75	79.46
%Change Over Previous Quarter	3.68	1.41	0.79	7.64

1. No. One Hard Red Winter
2. Metric Ton
3. Five percent broken milled white rice, Thailand Nominal Price quote.
4. Australian and New Zealand 85% Lean fores, FOB U.S. import price.
5. 1Kg = 2.2 Pound

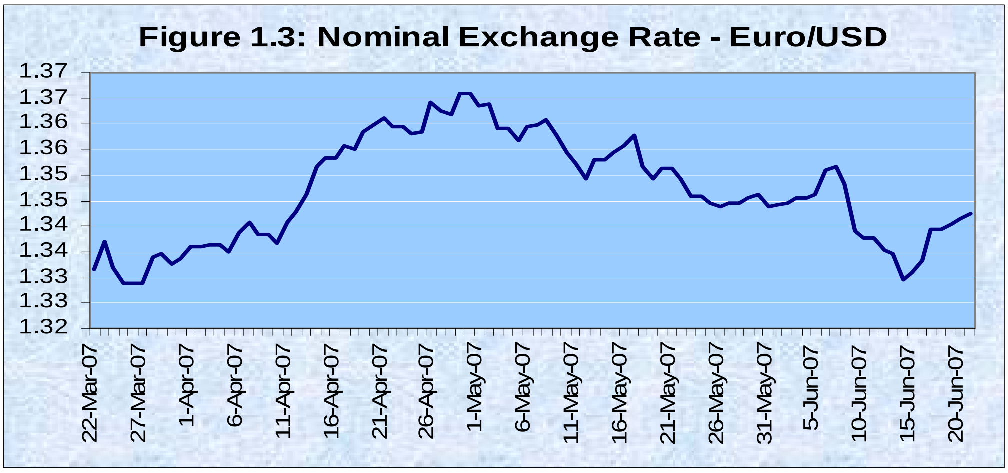
6.Chicken, Whole bird spot price, Georgia docks

Source: IMF

6. Nominal Exchange Rates of Selected Currencies against USD

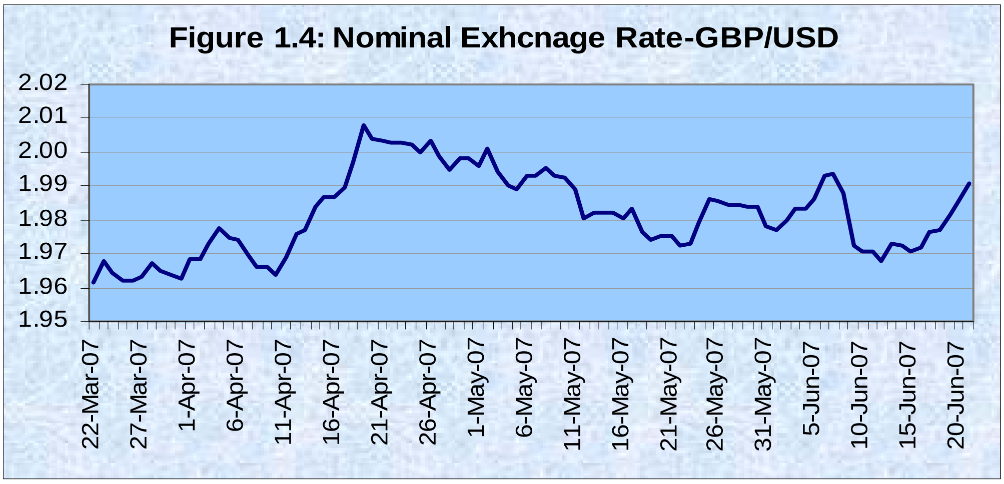
In the foreign exchange market, the nominal rate of USD depreciated against the Euro and Sterling. As in previous months, changes in the perceived cyclical differences between the United States and the euro area were mirrored by movements in the interest rate differentials between the two economic areas.

The value of USD depreciated against Euro by 3.05 percent in the 1st quarter of 1386 comparing to 2.34 percent depreciation in the last quarter of 1385. Volatility, as measured by standard deviation, was 0.01 percent in the 1st quarter of 1386, unchanged with the previous quarter.



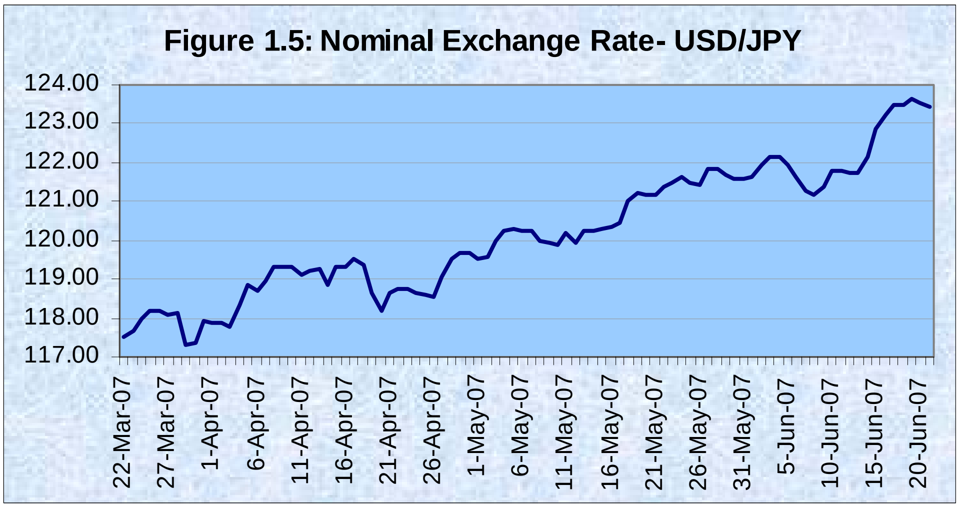
Source: Routers

The nominal value of USD depreciated against Sterling by 1.54 percent in the first quarter of 1386 comparing to depreciation of 2.01 percent in the last quarter of 1385, which shows 0.47 percent decrease in the depreciation over the previous quarter. Volatility USD against Sterling was 0.011 percent in the 1st quarter of 1386 comparing to 0.013 percent in the previous quarter.



Source: Routers

The Japanese Yen, depreciated against the USD by 0.51 percent in the 1st quarter of 1386 comparing to depreciation of 1.67 percent in the previous quarter. Volatility as measured by standard deviation was 1.65 percent in the 1st quarter of 1386, unchanged comparing to the previous quarter.



Source: Routers

Table 1.5: Exchange Rates of Selected Currencies Against USD
1st Quarter 1386 (22.Mar- 21.June.07)

	Euro/USD	GBP/USD	USD/JPY
Average for Hamal	1.34	1.97	118.52
Average for Sawr	1.36	1.99	119.91
Average for Jowza	1.34	1.98	122.07
Average for Q1	**1.35**	**1.98**	**120.17**
Lowest Exchange Rate	1.33	1.96	117.31
Highest Exchange Rate	1.37	2.01	123.66
Appreciation (+)			0.51
Depreciation (-)	3.05	1.54	

Source: oanda.com

Note: As a matter of convention, the dollar-yen exchange rate is expressed in yen per dollar. Hence, an increase in this rate indicates an increase in the value of the dollar versus the yen. In contrast, the euro-dollar exchange rates are expressed in dollars per euro. Thus an increase in this rate indicates a decline in the value of the dollar versus the euro.

2

THE REAL ECONOMY

Summary

The Afghan economy continued to rebound in the first quarter of the year as agriculture recovered from the drought of 1385. Food availability in the first quarter was good; prior to the main wheat harvest that will begin in June. Imported wheat was widely available as is normal for this time of year, although prices were higher than normal in areas of the northwest and northeast that were impacted by drought during 2006.

The size of the Afghan economy, as measured by GDP in 2006/07, stood at AF 367,908 million. The value of agricultural production stood at AF 117,741 million or about 32 % of GDP in 1385. Overall, cereal production decreased from 5.3 million tons in 2005 to 4.5 million tons in 1385. The decrease in cereal production was driven by the decline in wheat production from 4.3 million tons in 2005 to 3.4 million tons. Other crops such as fruits showed a moderate increase in 2006.

The value of production in the industrial sector in 1385 was AFS 99,067 million. This represents 26.9 % of the GDP. Overall, industrial output grew by 20.4 % in 1385. The highest growth in the sector came from Textile (14.5%), especially carpet production due to the demand for exports. Food, beverage, & tobacco increased by 12.0 % in 1385.

Agriculture

The Afghan economy continued to be dominated by the agriculture sector in the first quarter of the year. Food availability was good; prior to the main wheat harvest that began in June. Imported wheat was widely available as is normal for this time of year, although prices were higher than normal in areas of the northwest and northeast that were impacted by drought during 2006.

Iran, home to more than two million Afghan refugees and illegal immigrants, began deporting Afghans living illegally in Iran back to Afghanistan. Most of the repatriated immigrants work in construction or in factories, and it is likely that they will increase competition for jobs in the already saturated Afghan labor market. This increase in labor availability will likely decrease wages and purchasing power, which will restrict access to food for the repatriated and for households in communities to which the workers return.

A normal to above-normal harvest is expected in June, following good seasonal precipitation since October 2006. The harvest will increase food availability, which will improve food access for households that rely on the market to purchase their food.

Food availability was good in most of Afghanistan in the quarter under review. Imported cereals continued to be widely available in most markets, although prices were higher than normal for this time of year in areas of the northeast and northwest that were impacted by drought in 2006.

Wheat production in 2006 was below normal in these areas as a result of the drought, which reduced food availability and has increased food prices. Transportation costs have also increased wheat prices in these markets; most wheat available in these areas is imported from Kazakhstan via Turkmenistan and Uzbekistan, and the global increase in oil prices has caused the cost of transporting wheat to rise, which has increased the cost of wheat.

Elsewhere, wheat prices are normal for this time of year. In Kabul, Jalalabad and Kandahar, the price of wheat in April 2007 was the same or slightly lower than the price in April 2006. The main source of wheat in these areas is Pakistan, and the proximity between production areas in Pakistan and markets in Afghanistan keeps prices relatively low. The wheat policy of the Government of Pakistan also generally keeps wheat prices low. However, the recent restriction on wheat exports to Afghanistan by the Pakistani government will likely cause wheat prices to increase again.

A normal to above-normal harvest is expected to begin in June, following good seasonal precipitation from October through April. The harvest will increase food availability and cause wheat prices to decrease, including in the northeast and northwest, where drought limited production in 2006. This increase in availability will likely improve food access for households that rely on the market to purchase their food. However, if prices drop significantly, it may be difficult for producers to recover their costs, which will depend on the amount of competition from Pakistani production, which is subsidized by the government. A decrease in income from the sale of wheat would provide a disincentive to production in future agricultural cycles.

Afghanistan's food security situation is in a transitional state, affected by drought in 2006 and now facing a good likelihood of normal to above-normal harvests in 2007. However, because imported cereals are widely available and cheaper than domestic cereals, normal to above-normal harvest may have negative impact on surplus producers in northern Afghanistan.

Despite the likelihood of a normal to above-normal harvest in 2007, chronic food insecurity is going to persist in remote, isolated central highlands and northeastern Afghanistan.

Upcoming harvest projection

Based on remote sensing and ground meteorology data from the United States Geological Service (USGS), the cumulative precipitation from October 1, 2006 to March 10, 2007 was greater than long term average everywhere except in the northeast, where precipitation was below the long term average.

The extended mode of the Water Requirement Satisfaction index (WRSI) indicates that rain-fed crops, which suffered heavy losses due to the drought in 2006, are likely have enough water needed to produce normal to above-normal yield this season. There are two exceptions: Maruf in southern and Khaki Safid in western Afghanistan.

The median Irrigation Water Supply/Demand Index indicates that conditions are favorable for irrigated corps. South and north central parts of Afghanistan are likely to have more than adequate levels of irrigation water while crops in east, central and western Afghanistan are likely to have near average levels of water available.

The positive soil moisture and irrigation indicators support a favorable most likely case scenario, with normal to above normal harvests, particularly in agricultural surplus areas of northern Afghanistan.

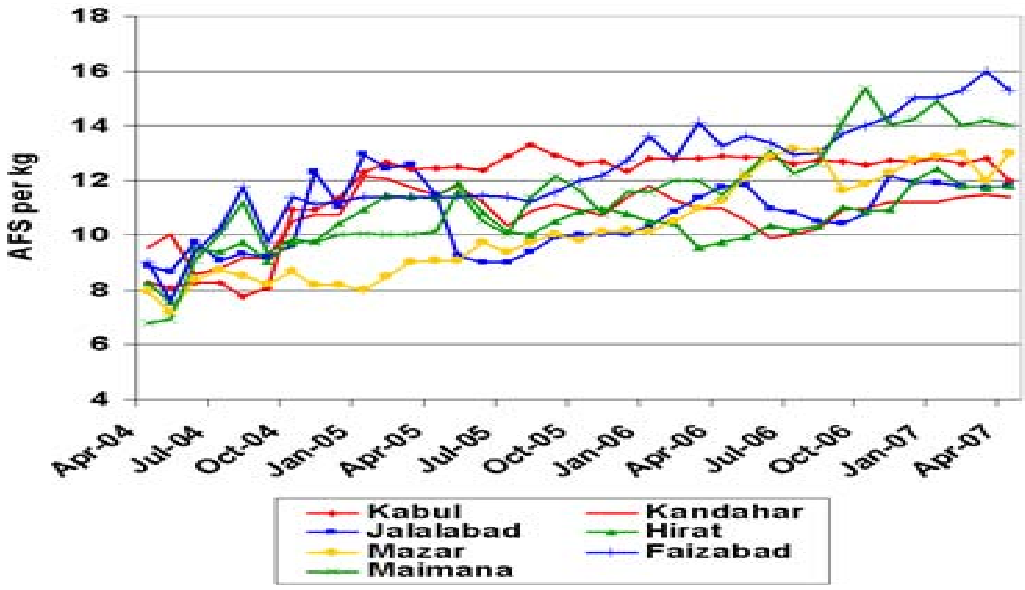
While generally positive for food security, normal to above-normal harvests and subsequent decreases in wheat prices may have negative consequences for producers, given the competitive regional trade environment. Pakistan's wheat market policy can seriously harm the Afghan producers, particularly when harvests are normal to above-normal result and lower producer prices combined with Afghanistan's non-protective agricultural policy and the high cost of agricultural inputs in Afghanistan:

a. The Pakistan government provides subsidies for agricultural inputs such as seed, chemical fertilizer, machinery and transportation. In addition, the government buys 70 percent of the total wheat surplus, selling back to the market on a daily basis, effectively controlling wheat prices. There are no export duties levied on Pakistan wheat. This makes imported wheat from Pakistan very competitive with Afghan wheat in Afghan markets.

b. Afghan wheat market policy is comparatively liberal, largely due to the fact that as a post-conflict country with many pressing priorities, Afghanistan has limited financial and administrative capacity to adopt and enforce countervailing protectionist agricultural policies. All agricultural inputs are not subsidized, but imported from neighboring countries and sold in Afghanistan at a higher cost than in neighboring countries. Furthermore, Afghan labor tends to be more costly as well.

Consequently, Afghan farmers have difficulty competing with their Pakistani counterparts. The abovementioned factors are disincentives for Afghan wheat producers. Their profit margins are eroded as prices decline with the great influx of Pakistan wheat, and some farmers are left unable to cover the costs of production in a good harvest year. The relatively high internal transportation costs only exacerbate this situation. Government and/or humanitarian agencies may want to consider adopting strategies to mitigate the negative affects and disincentives created by this imbalanced policy environment.

Figure 2.1: Wheat Prices in Afghanistan



Source: VAM Unit, WFP/Afghanistan

Even with normal to above normal harvests this year, Afghanistan will not be self sufficient in food production, and about 20 percent of the Afghan population will suffer from chronic food insecurity. (This figure needs to be verified during the upcoming NRVA 2007). Response to chronic and transitory food insecurity requires a wide range of discussions among the stakeholders that FEWS NET Afghanistan intends to hold in April 2007.

Flood risks

There is a significant probability of flooding in Afghanistan this year, based on three factors:

- High and above average levels of cumulative precipitation from October 1, 2006 to March 2007
- High temperatures in March could lead to a rapid melt of larger amounts of snow
- Environmental degradation, which further accelerates flooding

Afghanistan is alerting agencies that are working in the natural disaster sector to be prepared for the likelihood of flooding in high risk flooding zones.

Mineral Industry

The country has extensive deposits of barite, chromites, coal, copper, gold, iron ore, lead, natural gas, petroleum, precious and semiprecious stones including high quality emerald, lapis lazuli and ruby. The country has approximately 200 mines however; the country's remote and rugged terrain and an inadequate infrastructure and transportation network have made mining these deposits difficult.

Metals

Copper—No copper mines were active in the country in the quarter under review. In the past copper had been mined in Herat Province and Farah Province in the west, Kapisa province in the east and Kandahar province and Zabul province in the south. Currently interest is focused on the Aynka, the Darband and the Jawkhar copper deposits in Southeastern Afghanistan. Copper mineralization at Aynak in Logar province was stratabound and characterized by bornite and chalcopyrite disseminated in dolomite marble and quartz-biotite-dolomite schists of the Loy Khwar formation. Although a resource of 240 million metric tons at a grade of 2.3% has been reported, a number of small ore lenses are potentially not economically minable. Open pit and underground mining would be needed to exploit the main body of ore and other infrastructure problems such as inadequate power and water are also impeding development of these resources.

The Government issued a public tender for development of the Aynak copper deposit in 2006, with a deadline of October 28, 2006 and expected the granting of the concession in February 2007. Nine mining companies from Australia, China, India and the United Sates were interests in the prospect (British Geological Survey 2006b; Mining Journal 2006a).

Gold----Gold was mined from the Smati placer deposit in Takhar province in the north by groups of artisanal miners. Badakhshan Province has occurrences of placer gold deposits. The deposits are found on the western flanks of the mountain sin alluvium or alluvial fans in several river valleys; particularly in the Anjir, the Hasar, the Nooraba and the Panj Valleys. The Smati deposit is located in the Panj River valley and was estimated to contain between 20 and 25 metric tones of gold. Alluvial gold also occurs near the Zarkashan skarn deposit in Ghazni Province (British Geological Survey 2006d).

Iron Ore---The best know and largest Hajigak iron oxide deposit in Afghanistan is located in Bamiyan Province where the ore occurs in both primary and oxidized states. The primary ore accounts for 80- percent of the deposit and conists of magnetite, pyrite and minor chalcopyrite. The remaining 20 percent is oxidized and consist of three hematitic ore types. The presence of coking coal nearby at Shabashak in the Dar-I-Suf District and large iron ore resources make this deposit viable for future development. Open pity mining and blast furnace smelting were envisioned by an early feasibility study (British Geological Survey, 2006c)

Industrial Minerals

Gemstones---Afghanistan is known to have an abundance of precious and semiprecious gemstone deposits. These deposits include aquamarine, emerald, fluorite, garnet, kunzite, ruby, sapphire, semiprecious lapsi lazuli, topaz, tourmaline and varieties of quartz. The four main gemstone producing areas are Bardakshan, Jegdalek, Nuristan and the Panjshir Valley. Artisanal mining of gemstones uses primitive methods. Some gemstones were exported illegally mostly to India (which was the world leading import market for colored gemstones and an outlet for higher quality gems) and to the Pakistan market (British Geological Survey 2006a).

Petroleum and Natural Gas—The US Geological Survey and the Ministry of Mines and Industry jointly assessed the oil and gas resources in northern Afghanistan. The estimated mean volumes of undiscovered petroleum have been placed at 1, 596 million barrels (Mbbl) or crude oil, 444 billion cubic meters of natural gas and 562 Mbbl of natural gas liquids. Most of the undiscovered crude oil occurs in the Afghan-Tajik basin and most of the undiscovered natural gas is locate in the Mau darya basin. These two basins within Afghanistan encompass areas of approximately 515, 000 square kilometers.

3

MONETARY AND CAPITAL MARKET DEVELOPMENTS

Summary

Da Afghanistan Bank (DAB) continued to pursue a cautious and restrained monetary policy in the quarter under review, underpinned by the broader objective of maintaining price stability while supporting the development of capital markets.

In the quarter under review, reserve money declined by -3 percent, down from 13 percent in the previous quarter. Bank deposits with the central bank which is a component of reserve money declined by -46 percent in the first quarter of 1386.

According to the monetary survey data, narrow money (M1) grew by 6 percent in the quarter under review down from 12 percent in the last quarter.

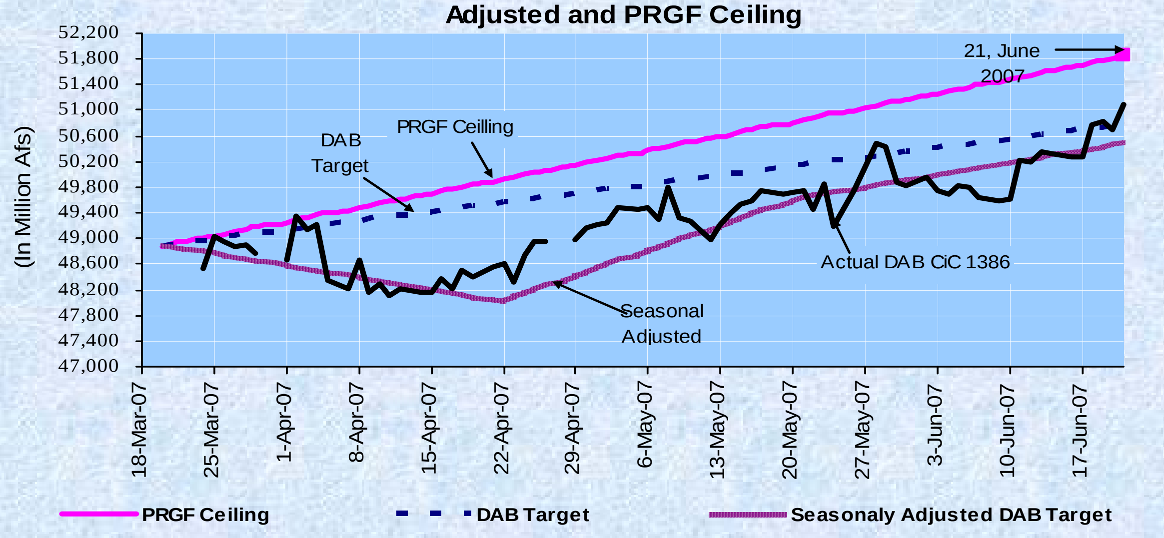
Currency outside depository corporations which is the other components of narrow money also grew by 3 percent down from 6 percent in the previous quarter while quasi money expanded by 79 percent in the quarter under review compared to 19 percent in the last quarter 1385.

PRGF Monetary Program

Figure 3.1 presents trends in currency in circulation along with a seasonal adjusted trend drawn from historical data. In addition, DAB's target for currency in circulation and the PRGF ceiling are indicated Currency in circulation in the period under review was approached the DAB target for few days during the quarter under review but fell below the DAB target subsequently and fell in line with the DAB target after June 17, 2007.

Reserve money declined by -3 percent in the first quarter 1386 from 13 percent in the last quarter 1385. This is because of bank deposits with the central bank which decreased by -48 percent in the quarter under review from 91 percent in previous quarter.

Figure 3.1: Currency in Circulation (DAB Actual, DAB Target, Seasonal Adjusted and PRGF Ceiling



Source: IMF and DAB Monetary Policy Department.

According to the monetary program data, which is shown in table 3.1 below, Net Domestic Assets decreased by -28 percent in the first quarter 1386 from 9 percent in the previous quarter. This represents 0.12 percent deviation from monetary program. This decrease is because of the capital notes and other claims, which are zero in the quarter under review compared to -30 percent in the previous quarter.

Net Foreign Assets increased by 10 percent in the first quarter of 1386 from 2 percent in the previous quarter. It was driven by other foreign assets which declined by -64 percent from 83 percent in the previous quarter.

Table 3.1: Performance of Afghanistan Monetary Program (In million AF)

	1385		Quarter Change (Q3 -Q4)	1386		Quarter Change (Q4- Q1)	Deviation From Target
	Q3	Q4		Q1			
	Actual	Actual		Target	Actual		
1. Net Foreign Assets (a+b)	**96,067**	**98,177**	**2%**	**111,094**	**108,153**	**10%**	**-3%**
(a) Foreign Assets (i+ii)	97,144	100,812	4%	114,628	111,840	11%	-2%
i. Foreign exchange reserve	94,359	95,716	1%	109,316	109,999	15%	1%
ii. Other foreign assets	2,784	5,096	83%	5,311	1,842	-64%	-65%
(b) Foreign liabilities	-1,076	-2,635	-145%	-3,534	-3,687	-40%	-4%
2. Net Domestic Assets (a+b)	**-45,722**	**-41,379**	**9%**	**-53,020**	**-53,085**	**-28%**	**0.12%**
(a) Domestic Assets (i+ii)	-34,365	-33,802	2%	-35,594	-31,555	7%	11%
i. Net claims on general government	-30,039	-28,182	6%	-29,326	-25,935	8%	12%
ii. Capital Notes and Other Claims	-4,326	-5,620	-30%	-6,268	-5,620	0%	10%
(b) Other Items Net	-11,357	-7,577	33%	-16,426	-21,530	-184%	-31%
3. Reserve Money (a+b)	**50,345**	**56,798**	**13%**	**59,074**	**55,069**	**-3%**	**-7%**
(a) Currency in Circulation	46,480	49,406	6%	51,896	51,094	3%	-2%
(b) Bank deposits with DAB	3,865	7,392	91%	7,178	3,975	-46%	-45%
4. Time Deposits	32,691	**39,686**	21%	**-**	**43,200**	9%	-

Source: International Monetary Fund, Central Statistical Office and DAB staff calculation

According to the monetary survey data which is shown in table 3.2 below, the supply of Broad Money (M2) expanded by AF 98101 million in the quarter under review from AF 91317 million in the previous quarter. This shows an increase of 7 percent which is down from 12 percent in the last quarter 1385.

Table 3.2: Monetary Aggregate (In million AF)

	1385		Quarter Change (Q3-Q4)	Difference (Q3 - Q4)	1386	Quarter Change (Q4 - Q1)	Difference (Q4-Q1)
	Q3	Q4			Q1		
	Amount	Amount			Amount		
1- Narrow Money(M1)	**79,506**	**89,252**	**12%**	**9,746**	**94,395**	**6%**	**5,144**
Currency outside depository corporations	46,815	49,566	6%	2,751	51,196	3%	1,630
Demand Deposits	32,691	39,686	21%	6,995	43,200	9%	3,514
2- Quasi Money	**1,742**	**2,066**	**19%**	**323**	**3,706**	**79%**	**1,640**
In Afghani	604	754	25%	150	956	27%	202
In Foreign currency	1,138	1,312	15%	174	2,750	110%	1,438
3- Broad Money(M2)	**81,248**	**91,317**	**12%**	**10,069**	**98,101**	**7%**	**6,784**
Determinants							
1- Net Foreign Assets	**105,827**	**110,720**	**5%**	**4,893**	**119,651**	**8%**	**8,932**
(a) Foreign Assets	109,449	115,383	5%	5,935	124,390	8%	9,007
DAB Foreign exchange reserves	100,283	103,326	3%	3,043	112,505	9%	9,178
Other foreign assets	9,166	12,057	32%	2,892	11,886	-1%	-172
(b) Foreign Liabilities	3,622	4,664	29%	1,042	4,739	2%	75
2. Net Domestic Assets	**-24,579**	**-19,402**	**21%**	**5,177**	**-21,550**	**-11%**	**-2,148**
(a) Net Claim on General Government	-30,391	-29,735	2%	657	-28,200	5%	1,535
(b) Claims on other Sectors	23,382	26,474	13%	3,091	29,366	11%	2,892
Less							
Other Items Net	6,460	8,182	27%	1,722	8,831	8%	649

Source: Monetary Survey Section, Monetary Policy Department DAB

The increase of Broad Money is due to quasi money which increased by 79 percent in the quarter under review which is more than 19 percent in the last quarter 1385.

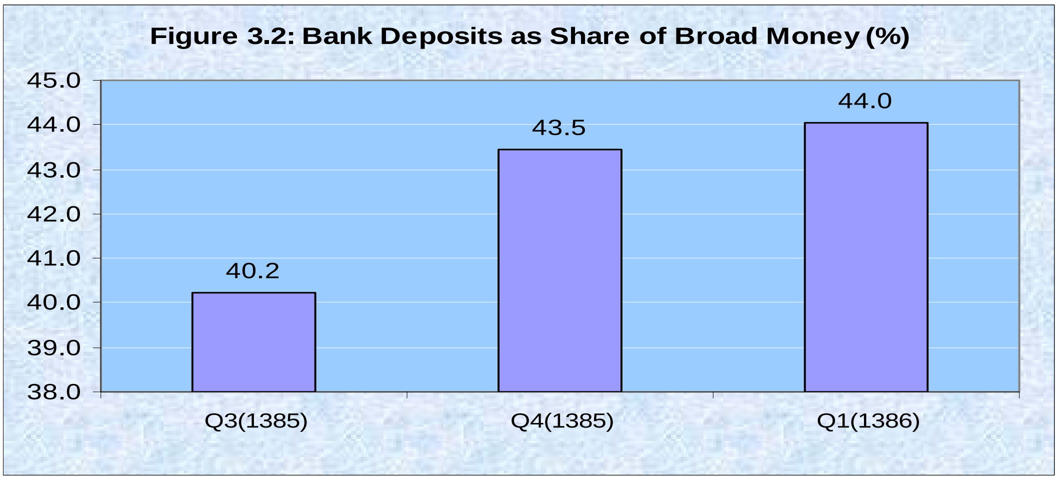
The 9 percent growth of the demand deposits in the first quarter 1386 which is less from the 21 percent in the previous quarter is because of an increase in the foreign currency time deposits which is increased by 110 percent in the first quarter 1386 from 15 percent in the previous quarter.

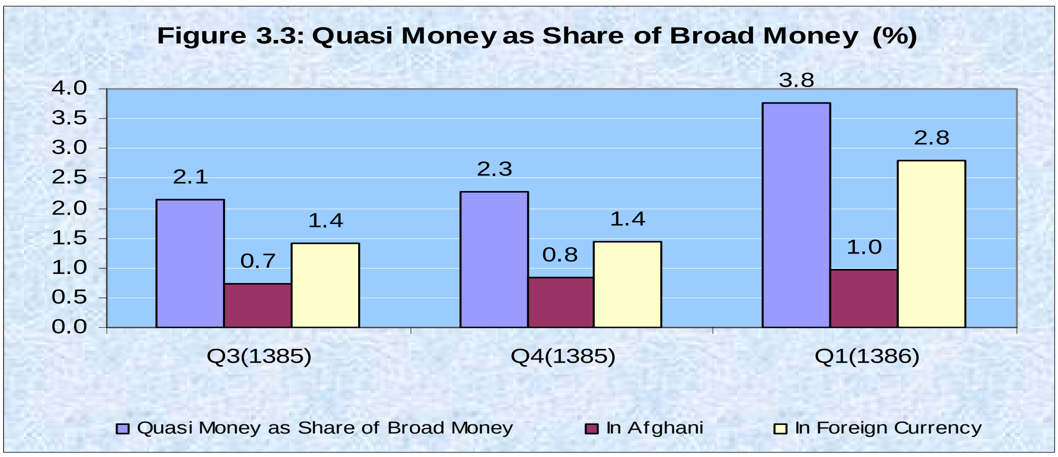
Narrow Money (M1) also grew by 6 percent in the quarter under review less than 12 percent in the last quarter 1385. Currency outside depository corporations, which is another component of (M1) also, grew by 3 percent in the first quarter 1386 which is less than 6 percent in the last quarter 1385. Quasi Money, which is another component of (M2,) grew by 79 percent in the first quarter 1386 from 19 percent in the previous quarter.

Net domestic assets which is a determinant of monetary growth decreased by -11 percent in the quarter under review form 21 percent in the previous quarter which shows a difference of AF -2148 million. Net claim on general government, a key component of Net Domestic Assets also increased by 5 percent in the first quarter 1368 from 2 percent in the previous quarter which shows a difference of AF 1535 million.

Claims on Other Sectors, which is another component of Net Domestic Assets increased by 11 percent in the first quarter 1386 down from 13 percent in the last quarter 1385.

Bank deposits as share of broad money increased by 44 percent in the first quarter 1386 from 43.5 percent in the previous quarter because as you see in the below figure 3.2, the Foreign Currency in Quasi Money as Share of Broad Money increased by 3.8 percent in the quarter under review from 1.4 percent in the previous quarter.





Capital Markets and Liquidity Conditions

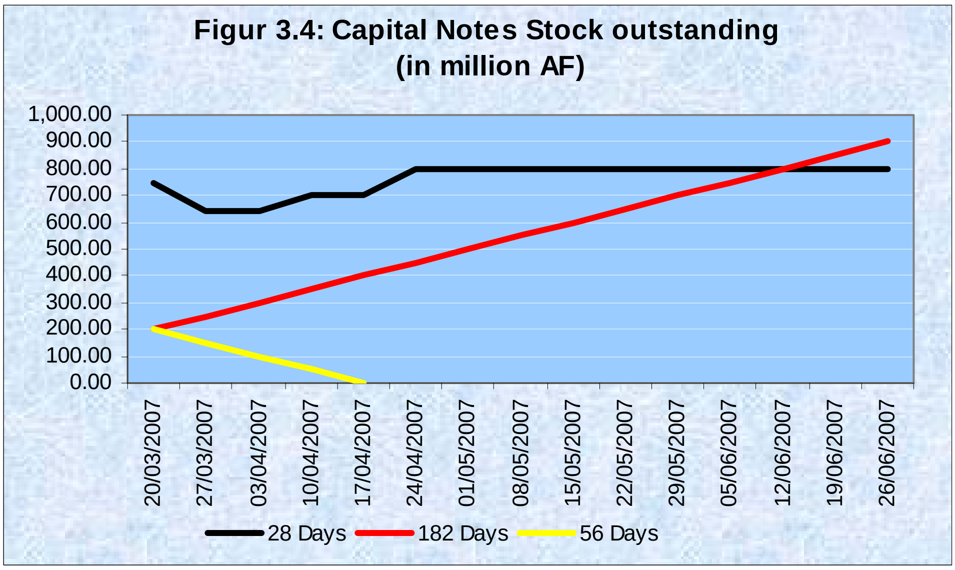
Capital Note Auctions

Capital Notes are short-term Afghani denominated securities sold by the Central Bank at weekly auctions. An investor buys the Notes at a discount and receives payment of face value on the maturity date. Currently the Capital Notes on offer are for maturity periods of 28 days (1 month), and 182 days (six months). It is brought into consideration that, 56 days Capital Notes has been discontinued and its outstanding stock matured in the first month of this quarter. Only licensed Commercial Banks and money changers can participate in the auctions. Private individuals seeking to purchase capital notes can do so through their Commercial Bank.

The amount to be auctioned is announced every Monday to the Banks electronically. The auction is held on Tuesday with settlement T+1 except when it coincides with public holidays. In the auction, investors bid to purchase desired values of Capital Notes at different discount prices. Bids have to be submitted before 11:00 am on the auction day.

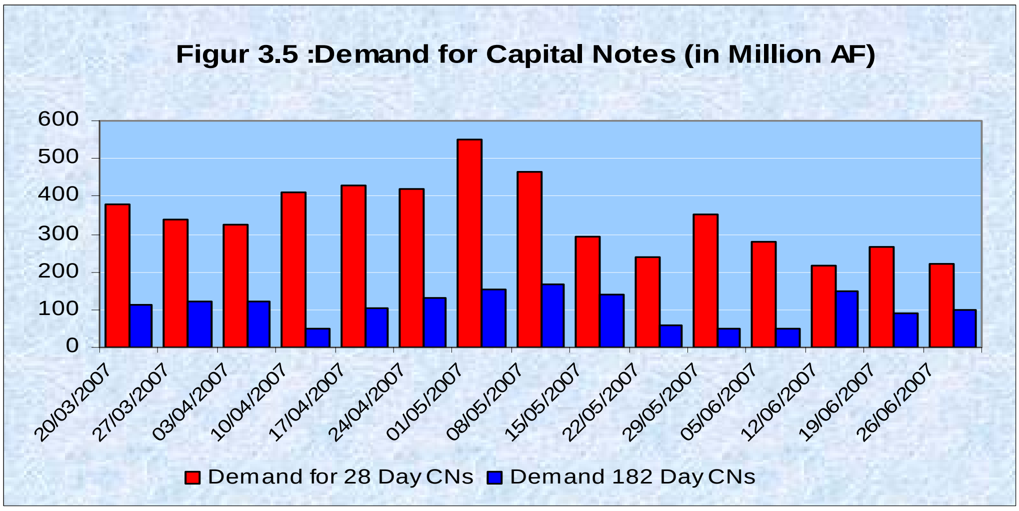
The volume for 28 days that was doubled to AF 200 million in the last quarter of 1385 pushed the stock outstanding for the said maturity to AF 745 million after it dropped back to AF 645 million because of the decrease in supply by AF 100 million for 28 day notes. In the middle of the period, the outstanding stock reached to AF 800 million, but had declination to the current outstanding of AF 600 million at the end of the quarter as the auction day coincided with public holidays.

On other hand, the outstanding stock for 182 day notes increased to AF 1,150 million in this quarter from this figure was AF 200 million in the preceding quarter, (See Figure 3.4)



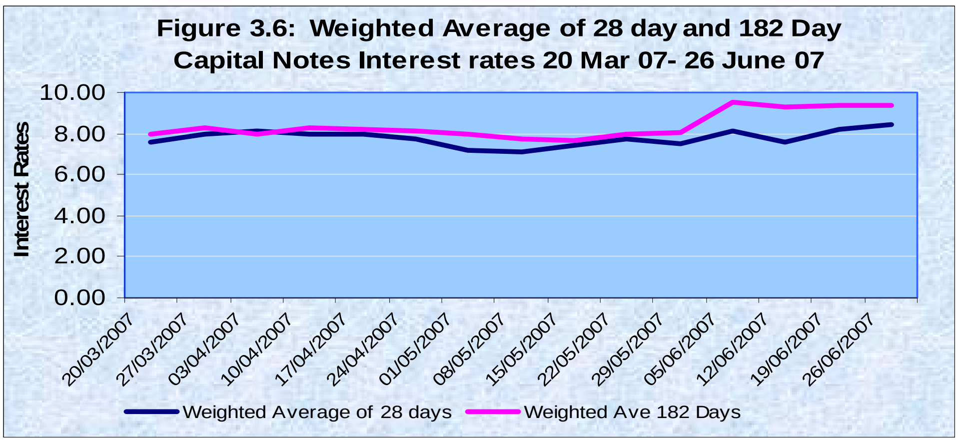
Source: Market Operations DAB.

The high demand for CNs is reflected in the cover ratio, the ratio of amounts bid to amounts offered. The bid amount for 28 days notes was AF 362 million and AF 104 million for 182 day on an average basis, while these notes' were offered at amount AF 195 million, AF 50 million on an average basis respectively (see figure 3.5 for CNs demand).



Source: Market Operations Department/ DAB

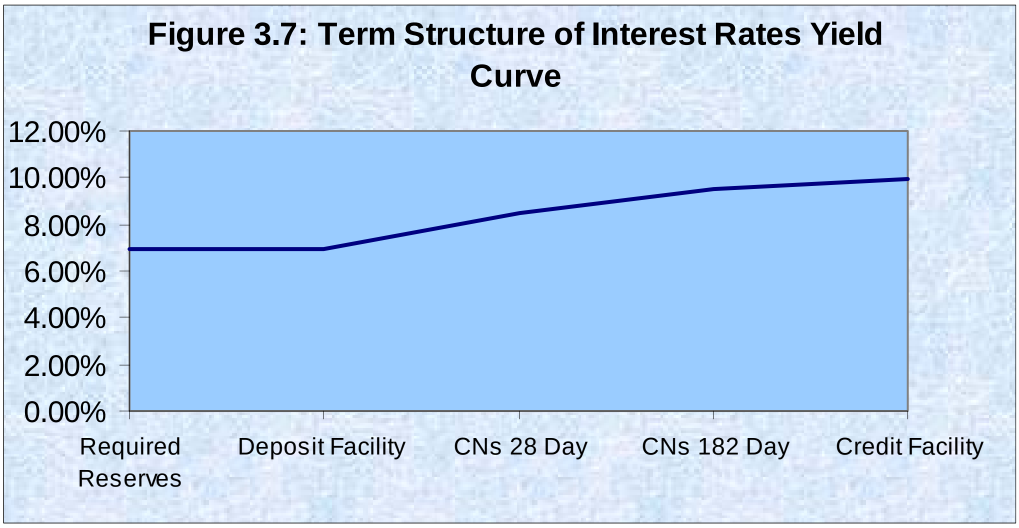
Number of participants fluctuated between 1 to 6 persons for 28 days notes and 1 to 5 persons for 182 days notes. The number increased for some specific auctions in which there was high demand for these notes. It prompted the interest rates decline from 8.50 percent to 7.30 percent 28 days notes, on other hand, the interest rates for 182 notes increased from 8.00 percent to 10.00 percent at one point of time after when it dropped back to 9.50 at the end of the period (see figure 3.6).



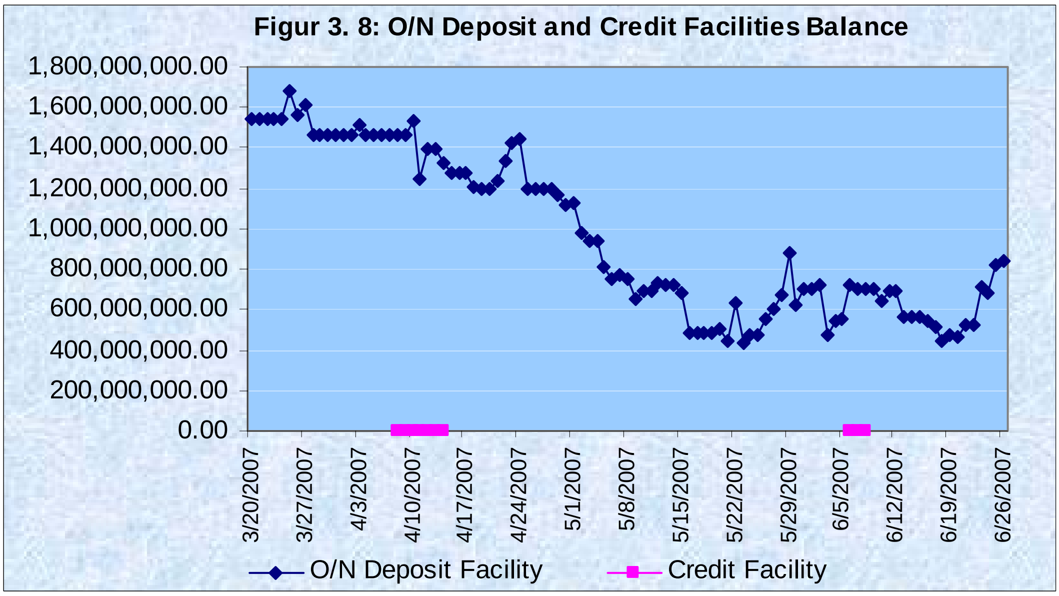
Source: Market Operations Department/DAB.

Term Structure of Interest Rates

The Term Structure of interest rates, also called the yield curve, is the relation between the interest rate (cost of borrowing) and the time to maturity on a security. The yield of the Capital Notes is the annualized percentage increase in the value of the CN. The yield curve for 26th June is sloping upward.



Source: Market Operations Department/DAB.



Source: Market Operations Department/DAB

Required and Excess reserves

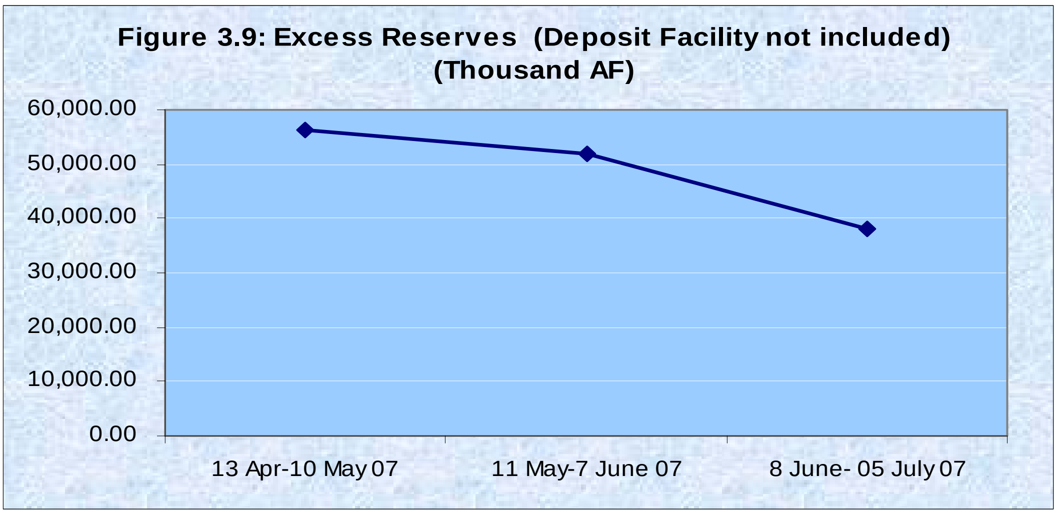
Overnight Standing Facilities were first introduced at the beginning of the year 1385 (2006-2007) at the initiatives of the banks. The purpose of introduction is to provide commercial banks with products to use them as safety net and to provide them with vehicle where they can invest their excess reserves.

Overnight Standing Deposit Facility: This facility is available for all commercial banks to gain interest on excess balances and provides a floor for rates on capital notes, so it is not counted for Required Reserves. The interest rate on overnight deposit facility is now 1.5 percent below 28 auction cut off rate, based on a circular to all banks approved by DAB supreme counsel on 27th Feb 2007. During first quarter of 1386 there was significant decrease in the overnight deposit facility outstanding it declined from AF 1,600 million to AF 400 million (see figure 3.8) the declination was because of the increase 182 days Capital stock out standing that rose to AF 1,150 million.

Overnight Standing Credit Facility: This facility is used by banks for short term cash need. The facility allows banks to borrow Afghani from Da Afghanistan Bank on an overnight basis when they face a short fall in cash flow. The rate that the banks are charged for this facility is 1.5 percent above the last 28 day CNs auction. This borrowing is collateralized with outstanding capital notes only, according to the circular on 27th Feb 2007. Seven times banks have used the credit facility during the quarter and collateralized AF 195 million Capital notes (see figure 3.8).

During the quarter required reserves averaged AF 223,600.98 thousand per Bank, while excess reserves (including overnight deposits) averaged AF 823,006.83 thousand.

Required reserves were remunerated at 1.5 percent below the cut off rate of 28 days Capital Notes Auction rate or equal to deposit facility rate.



Source: Market Operations Department/DAB.

Table 3.3: Auctions of 28 Day Capital Notes

Date	Auction Amount	Amount awarded	Total Bid Amount	No. of bids	Cut off Rate	Low Bid	Weighted Average
20/03/2007	200	200	380	4	8.50	7.50	7.60
27/03/2007	100	100	340	4	8.00	7.94	7.99
03/04/2007	200	200	325	4	8.50	7.94	8.16
10/04/2007	200	200	410	3	8.40	7.90	7.98
17/04/2007	200	200	430	5	7.95	7.95	7.95
24/04/2007	200	200	420	6	7.89	7.19	7.71
01/05/2007	200	200	550	7	7.50	7.10	7.20
08/05/2007	200	200	465	5	7.30	7.00	7.12
15/05/2007	200	200	295	4	7.77	7.00	7.44
22/05/2007	200	200	240	4	7.77	7.00	7.71
29/05/2007	200	200	350	3	7.77	7.25	7.47
05/06/2007	200	200	280	4	8.50	7.49	8.11
12/06/2007	200	200	215	3	8.25	7.33	7.60
19/06/2007	200	200	265	4	8.50	7.35	8.17
26/06/2007	200	200	220	3	8.50	8.09	8.46
03/07/2007	200	200	360	4	9.00	7.25	7.92
10/07/2007	200	200	510	6	8.75	7.25	7.82
17/07/2007	200	200	420	5	8.50	7.30	7.86
31/07/2007	200	200	430	5	8.50	7.50	7.74
07/08/2007	200	200	345	4	8.50	7.49	8.50
	6,250	6,050					

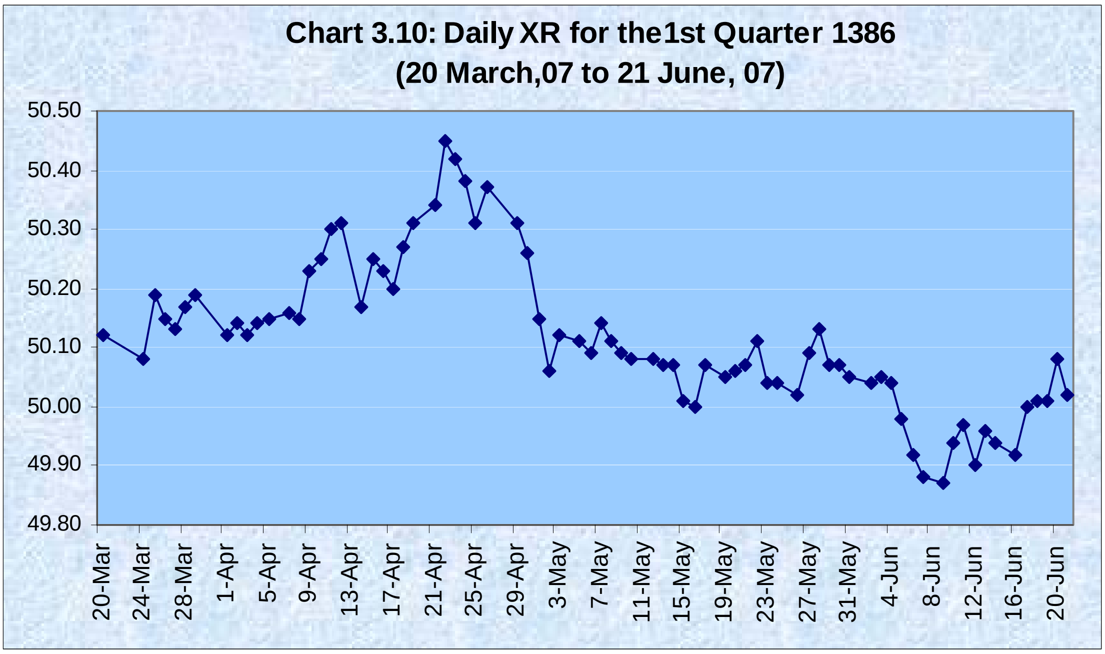
Table 3.4: Auctions of 28 Day Capital Notes

Da Afghanistan Bank, Capital Notes 182 Days Auctions Report (million Afs)							
Date	Auction Amount	Amount awarded	Total Bid Amount	No. of bids	Cut of Rate	Low Bid	Weighted Average
20/03/2007	50	50	115	1	8.00	8.00	8.00
27/03/2006	50	50	120	1	8.25	8.25	8.25
03/04/2007	50	50	120	1	8.00	8.00	8.00
10/04/2007	50	50	50	1	8.25	8.25	8.25
17/04/2007	50	50	105	2	8.20	8.19	8.20
24/04/2007	50	50	130	1	8.14	8.14	8.14
01/05/2007	50	50	155	3	8.00	8.00	8.00
08/05/2007	50	50	165	5	7.90	7.70	7.74
15/05/2007	50	50	140	4	7.65	7.59	7.64
22/05/2007	50	50	60	2	8.07	7.58	7.98
29/05/2007	50	50	50	1	8.07	8.07	8.07
05/06/2007	50	50	50	1	9.50	9.50	9.50
12/06/2007	50	50	150	1	9.30	9.30	9.30
19/06/2007	50	50	90	2	9.50	9.35	9.38
26/06/2007	50	50	100	2	9.40	9.40	9.40
03/07/2007	50	50	75	2	10.00	9.40	9.70
10/07/2007	50	50	100	2	9.80	9.80	9.80
17/07/2007	50	50	100	2	9.79	9.79	9.79
31/07/2007	50	50	100	2	9.80	9.80	9.80
07/08/2007	50	50	107	3	9.50	9.50	9.50
	1,000	1,000					

Foreign Exchange Market

Foreign Exchange Rates:

The daily historic review of the exchange rate, AF vis a vis USD, for the 1st quarter of 1386 (21 Mar, 07 to 21 June, 07) is shown below in figure 3.10. On the whole, the exchange rate of Afghani moved in a relatively narrow corridor of AF49.87 to 50.45 per USD, throughout the quarter. On the end quarter basis the Afghani appreciated by 0.2 per cent from AF 50.12 per USD at the start of the quarter to AF 50.02 per USD at the end of the quarter. On annual basis, the Afghani depreciated by 0.744 per cent from the 1st quarter 1385 (AF 49.75 per USD), to the present level of (AF 50.12 per USD) in the quarter under review.



Source: MOD and MPD (DAB)

Table 3.5: Exchange Rates Against Selected Currencies

Period	USD	Pak.Rs	EURO
Average for Q1 1386	50.12	82.52	67.29
average for Q1 1385	49.75	82.53	61.92
% Appreciation (-) or depreciation (+) of Afghani against respective currency	0.744	-0.012	8.672
Closing rate on June 21, 2007	50.02	81.14	66.86
Closing rate on March 20, 2007	50.12	82.54	66.42
% Appreciation (-) or depreciation (+) of Afghani against respective currency	-0.200	-1.696	0.662

Source: Market Operations Department/DAB

Foreign Exchange Auction:

For achieving the stability of the exchange rate, Da Afghanistan Bank has continued using its main policy instrument viz., the Foreign Exchange Auctions for the periodic intervention in the market to smoothen the fluctuations in the exchange rates and to control the growth of money supply. The Da Afghanistan Bank has maintained this bi-weekly sterilization policy, to mop up extra liquidity arising principally from government expenditures and the foreign peace-keeping forces. The foreign exchange auction size is determined by a liquidity forecasting framework, which takes in account the money demand on one hand and the currency growth ceiling agreed by the DAB with the IMF on the other.

Table 3.6 summarizes the results of DAB foreign exchange auctions during the period from 19 December, 2006, to 19 June, 2007 which covers the last two quarters.

In the most recent quarter (gray colored) the DAB intervention was USD.168.63 million. The weighted average of the entire 26 awarded auctions rate (sale price of the USD) was 50.1, covering March, April, May and half of June, in which the total number of awarded bidders were 536. Compared with the last quarter, there were 24 auctions of USD.179.70 million. The weighted average was 49.99, with the participation of 472 bidders.

Table 3.6: Foreign Exchange Auctions

Auction Date	No of Bidders	High Price	Low Price	Cut off Price	Amount Announced	Amount Awarded	No of Awarded Bidders
19-Dec-06	35	49.89	49.70	49.83	7.50	10.10	30
23-Dec-06	32	49.80	49.68	49.77	7.50	6.10	16
26-Dec-06	15	49.82	49.70	49.76	7.50	4.05	11
6-Jan-07	31	49.94	49.81	49.88	6.00	7.05	19
9-Jan-07	32	50.00	49.80	49.95	6.00	6.85	21
13-Jan-07	32	50.00	49.91	49.98	6.50	7.85	16
16-Jan-07	41	50.05	49.90	50.03	6.50	6.10	17
20-Jan-07	34	50.06	49.96	49.99	7.00	8.45	28
23-Jan-07	45	49.95	49.85	49.93	7.00	6.05	17
27-Jan-07	34	50.05	49.80	50.02	7.50	7.35	19
30-Jan-07	36	50.07	49.92	50.04	7.50	7.45	18
3-Feb-07	39	50.04	49.94	50.01	7.50	7.85	22
6-Feb-07	35	50.07	49.97	50.05	7.50	8.30	20
10-Feb-07	43	50.08	50.00	50.06	7.00	6.90	19
13-Feb-07	35	50.14	50.01	50.13	7.00	8.25	18
17-Feb-07	34	50.08	49.97	50.05	7.50	8.25	20
20-Feb-07	41	50.10	50.03	50.09	7.50	8.05	20
24-Feb-07	34	50.08	50.00	50.06	7.50	7.00	18
27-Feb-07	41	50.06	49.98	50.04	7.50	7.95	22
3-Mar-07	28	50.04	49.95	50.00	7.50	8.25	25
6-Mar-07	34	49.99	49.88	49.96	7.50	7.10	15
10-Mar-07	35	50.04	49.97	50.03	7.50	7.75	17
13-Mar-07	38	50.09	50.00	50.07	7.50	8.40	19
17-Mar-07	32	50.03	49.91	49.98	10.00	8.25	25
24-Mar-07	35	50.11	50.00	50.09	8.00	7.25	13
27-Mar-07	34	50.21	50.10	50.17	8.00	7.80	17
1-Apr-07	24	50.19	50.14	50.17	2.50	3.55	15
3-Apr-07	32	50.18	50.12	50.15	2.50	4.85	23
7-Apr-07	29	50.19	50.15	50.17	2.25	4.80	22
10-Apr-07	28	50.30	50.23	50.28	2.25	4.13	20
14-Apr-07	31	50.27	50.20	50.26	4.50	5.35	16
17-Apr-07	31	50.25	50.17	50.22	4.50	3.80	10
21-Apr-07	34	50.42	50.25	50.39	5.00	4.45	10
24-Apr-07	31	50.43	50.30	50.38	5.00	7.95	26
29-Apr-07	23	50.26	50.10	50.22	8.50	4.55	14
1-May-07	21	50.08	50.02	50.06	8.50	6.10	14
5-May-07	34	50.14	50.05	50.10	6.50	8.30	24
8-May-07	30	50.11	49.95	50.05	6.50	5.65	22
12-May-07	33	50.07	49.90	50.00	8.50	8.15	30
15-May-07	31	50.00	49.80	49.95	6.50	7.05	26
19-May-07	38	50.06	49.90	50.00	9.00	9.95	30
22-May-07	35	50.12	49.90	50.07	7.00	9.05	29
26-May-07	35	49.98	49.80	49.95	7.00	5.85	20
29-May-07	35	50.05	49.90	50.00	7.00	9.05	39
2-Jun-07	33	50.02	49.92	49.97	7.00	7.15	23
5-Jun-07	37	49.95	49.84	49.92	7.00	7.95	26
9-Jun-07	33	49.84	49.00	49.80	7.00	7.10	21
12-Jun-07	34	49.90	49.75	49.88	7.50	3.90	11
16-Jun-07	34	49.94	49.82	49.91	7.50	6.05	13
19-Jun-07	35	50.08	50.00	50.04	7.50	8.85	22
Total Amount Sold in US Dollars						**348.33**	

4

GOVERNMENT FINANCES

Summary

The Annual Budget for 1386 is composed of the core operating budget and the development budget. The main objective of the budget is to allocate resources in a manner that will enable the country to achieve its strategic goals and objectives.

The total budget for 1386 is AF 130,608 million (US$ 2.6 billion) of which the operating budget is AF 53,600 million (US$ 1.07 billion) and the development budget is AF 77,008 million (US$1.5 billion). At the end of the first quarter expenditures from the operating budget stood at AF 8,178 million which is 46% of that AF 17,659 million allotment. Expenditures from the development budget were AF 3,007 million or only 16% of AF 18,247 million allotments. On the revenue side, total domestic revenue at the end of the first quarter stood at AF 6.4 billion (1.6 percent of GDP) about AF 0.6 billion or 8 percent below the indicative target for the first quarter 1386.

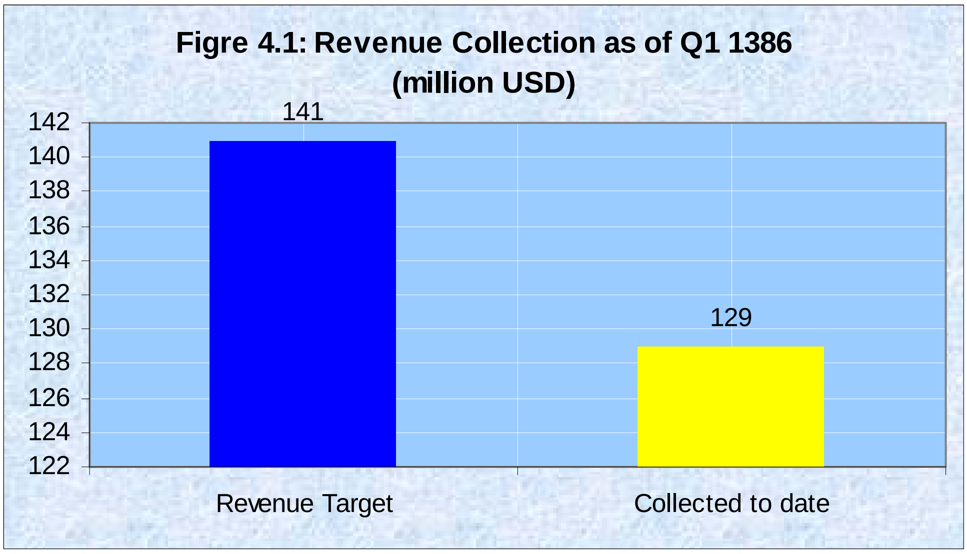
1. Revenues

Total domestic revenue at the end of first quarter 1386 stood at AF 6,441 million (1.6 percent of GDP) it was short by 596 million or 8 percent lesser from the targeted amount of 7.03 billion for the first quarter 1386. Furthermore, it declined by 14.4 percent compare to the same period last year. In addition, the lower than expected revenue performance seen in customs (AF 1.7 billion below target) but non tax revenue performance seems in positive trend (AF 1.1 billion above the target) and compare to the first quarter 1385 as well.

Table 4.1: 1386 First Quarter Revenues Target versus Actual Collection (in million AF)

Particulars	1st Qtr Revenue Actual	1st Qtr Revenue Target	Difference	% of 1st Qtr Actual to Target	1st Qtr 1385 Revenue Actual	%Δ from Q1 86 to Q1 85
Total Domestic Revenues (Tax and Non Tax)	6,441	7,037	-596	92%	7,368	-13%
Total Tax Revenues	4,614	6,317	-1,703	73%	5,899	-22%
Income (Fixed Taxes, Withholding)	921	1,121	-200	82%	3,909	-76%
Customs duties, fines and fees	2,323	3,450	-1,127	67%	1,990	17%
Other Non Tax Revenues	1,369	1,745	-376	78%	1,421	-4%
Total Non Tax Revenues	1,828	720	1,108	254%	1,469	24%

Source: Ministry of Finance & DAB Staff Calculation



Source: Ministry of Finance and DAB Staff calculations

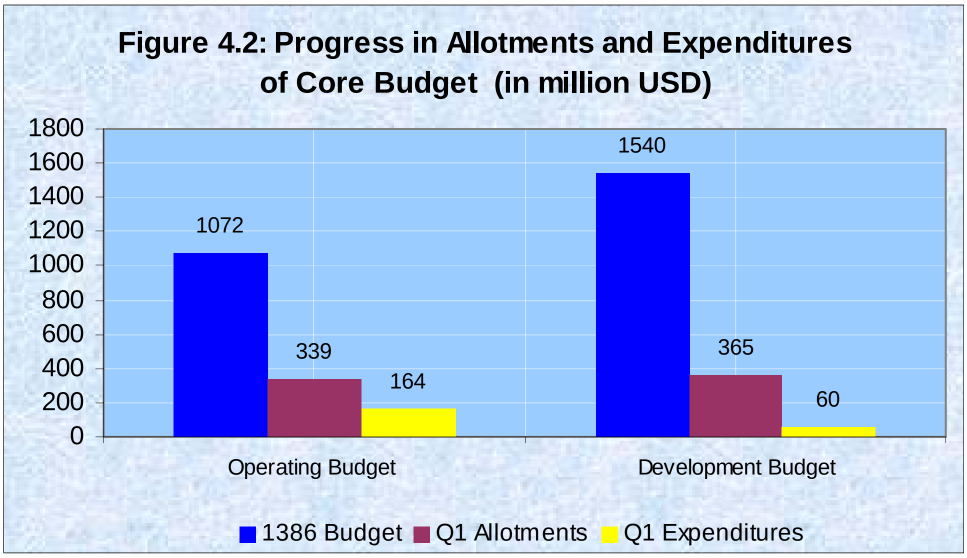
2. Expenditures

Total operating expenditures for the first quarter 1386 was AF 8,178 million (15.3 percent from the total budget) it has raised about 37% compared to the same period last year, as shown in (Table 4.2). The expenditure tool rose due to heavy expenditures in line ministries such as, Education 18.5 percent, followed by Defense 18.1 percent and Interior Affairs 17.5 percent, from the last few years' government has faced security challenges which it lead the government to boost expenditures on security issues, in order to bring security stability. Therefore, the tool of expenditure on securities are higher compare to other sectors, and this security challenges is the main obstacle that makes the government to act slower than expected to implement infrastructure and development projects on time frame.

Looking to development budget, which is the main grants from the donors side for the re infrastructure and development projects, total development budget for the year 1386 approved by Ministry of Finance is AF 77,008 million (1,540 million US dollars) as shown in table 4.2. However at the end of first quarter 1386 total development expenditures stood at AF 3,007 million (only 16% from the allocated fund) was spend on the development projects, as mentioned above the main obstacles is the security threats for the government and private sectors to move forward.

Table 4.2: Progress of Expenditures and Allotments in Core Budget as First Quarter 1386						
Type of Budget	Currency	1386 Budget	1st Qtr Allotments		1st Qtr Expenditures	
			Amount	%Budget	Amount	%Budget
Operating Budget	AF m	53,600	17,659	33%	8,178	46%
	USD m	1,072	339		164	
Development Budget	AF m	77,008	18,247	24%	3,007	16%
	USD m	1,540	365		60	
Total AF		130,608	35,906	27%	11,185	32%
Total USD		2,612	704		224	

Source: Ministry of Finance and DAB staff calculation

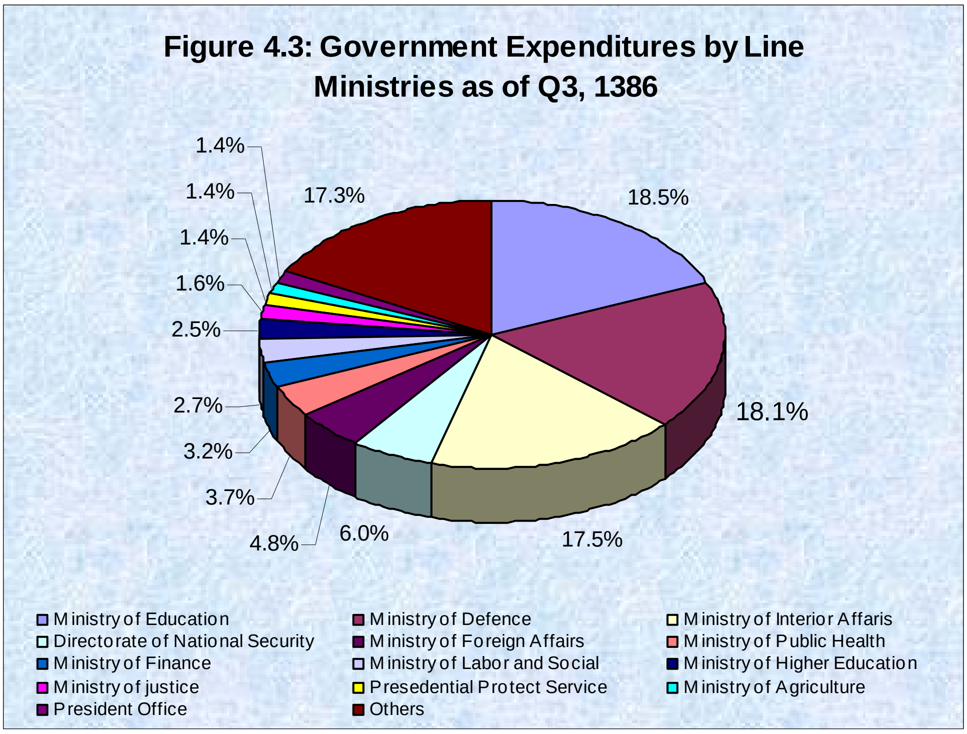


Source: Ministry of Finance and DAB Staff calculations

Table 4.3: The Line Ministries Expenditures as First Quarter 1386 (in million AF)

Ministries	Expenditure	As Total Expenditures (%)
Ministry of Education	1,506	18.5
Ministry of Defense	1,478	18.1
Ministry of Interior Affairs	1,432	17.5
Directorate of National Security	223	6.0
Ministry of Foreign Affairs	396	4.8
Ministry of Public Health	300	3.7
Ministry of Finance	265	3.2
Ministry of Labor and Social	490	2.7
Ministry of Higher Education	206	2.5
Ministry of justice	131	1.6
Presidential Protect Service	113	1.4
Ministry of Agriculture	116	1.4
President Office	114	1.4
Others	1,408	17.3
Total	**8,178**	**100**

Source: Ministry of Finance and DAB staff calculation



Source: Ministry of Finance and DAB staff calculations.

5

INFLATION TRENDS AND OUTLOOK

Summary

Headline inflation, the broadest measure of the rise in the general level of prices, edged up slightly in the first quarter of 1386. The headline Consumer Price Index (CPI) for Kabul stood at 135 at the end of the first quarter 1386, representing an inflation rate of 8.1 percent; up from 5.5 percent in the same quarter a year ago.

The main drivers of inflation were the prices of fuel and electricity, transportation and food. The food price index rose dramatically by 11.8 percent largely due to the increase in the transportation price index and the decrease in the worldwide wheat production. Since Afghanistan is a net food importing country, both reasons attributed to the spike in food prices in the quarter under review.

Diesel and petrol prices -- the main components of the fuel index--rose by 6 and 10.1 percent respectively compared to the same period a year ago. The increase in fuel prices largely reflected developments in international markets where crude oil price hit all time nominal highs.

Core inflation, defined as headline CPI excluding rents, fuel and construction materials increased by 9.9 percent in the first quarter 1386 from 4.2 percent in the same quarter a year ago.

The outlook for Inflation in the second quarter of the year is favorable.

Inflation edges up slightly

1. Annual Changes in Kabul Headline Inflation

The CPI measures the average price of a fixed set (or basket) of goods. The basket of goods is intended to reflect all of the items a typical family buys to achieve some minimum standard of living in some base period (currently 2004). The CPI does not count the price of each item equally but weights each according to its share of total household expenditures in the base period, so that changes in the index from one period to the next are broadly reflective of changes in a representative household's current cost of living.

The CPI has displayed an upward trend in inflation in the first quarter of 1386. Looking at the overall index in figure 5.2, we can see that the inflation began to increase since beginning of the first quarter 1386 moving toward double digits again.

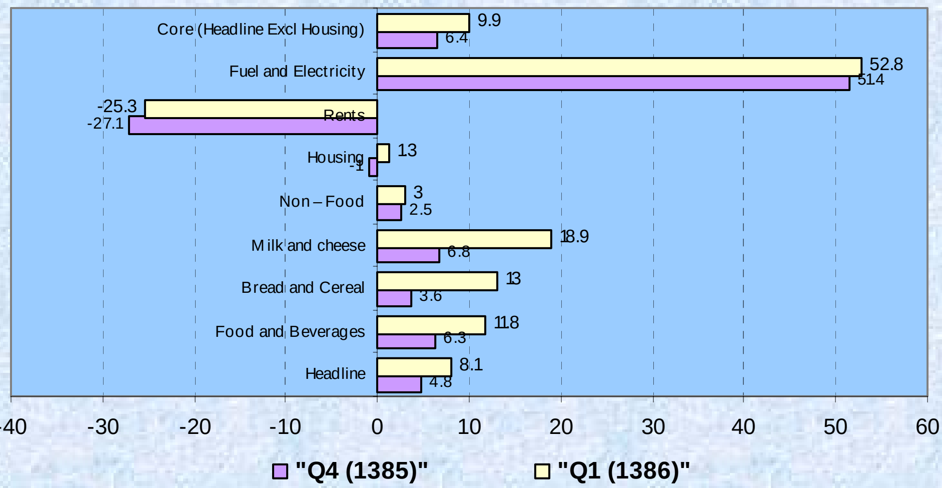
Headline inflation, as measured by year-on-year percentage changes in Kabul CPI, increased to 8.1 percent in the first quarter of 1386 from 5.5 percent in the same quarter a year ago. The breakdown of Kabul headline CPI inflation is presented in Table 5.1 and illustrated in Figure 5.1

Table 5.1: Breakdown of Kabul Headline CPI
(percent changes year on year)
Consumer Price Index
(March 2004 = 100)

	Weight	1384				1385				1386
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Headline	**100**	**11.6**	**12.9**	**12.1**	**9.5**	**5.5**	**5.4**	**3.5**	**4.8**	**8.1**
Food and Beverages	**61.3**	**10.1**	**14.8**	**10**	**6.2**	**2.9**	**3.8**	**2.8**	**6.3**	**11.8**
Bread and Cereal	28	11.8	24	17.6	7	0.7	-0.2	-3.1	3.6	13
Milk and cheese	5.6	5.7	6.2	3.6	2.4	2.3	4.7	4.6	6.8	18.9
Non – Food	**38.7**	**13.5**	**9.1**	**13.5**	**14.4**	**9.4**	**7.6**	**4.4**	**2.5**	**3**
Housing	17.2	20.8	11	18.6	22.6	10.5	6.7	3.3	-1	1.3
Rents	7.1	34.2	13.3	21.8	24.9	8.6	1	-21.9	-27.1	-25.3
Fuel and Electricity	6.8	7.1	6.5	16.5	25.1	19.4	24.7	54.8	51.4	52.8
Core (Headline Excl Housing)		**9.5**	**13.4**	**10.3**	**6.2**	**4.2**	**5.1**	**3.6**	**6.4**	**9.9**

Source: Central Statistical Office and DAB staff calculations.

Figure 5.1: Contribution to CPI inflation (Kabul CPI)



Source: Central Statistical Office and DAB staff calculations.

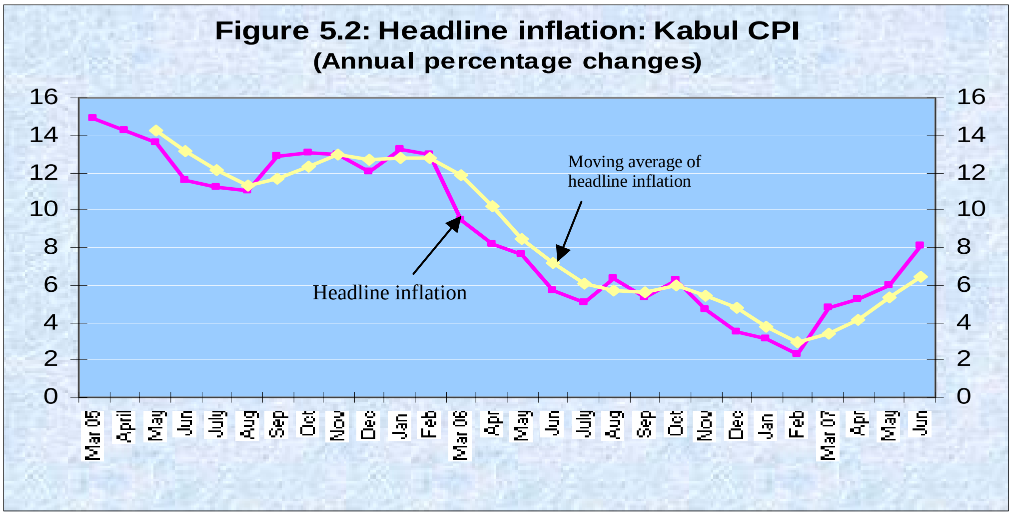
The increase in Kabul headline CPI to 8.1 percent in the first quarter of 1386 from 5.5 percent in the same quarter a year ago was largely due to the following factors:

- **Fuel and electricity:** this price index rose by 52.8 percent because of a 300 percent increase in administered electricity prices by Ministry of Water and Energy in September 2006. The increase in fuel prices largely reflected developments in international crude oil prices over this period.

- **Food**: this price index rose by 11.8 percent in the first quarter of 1386, compared to 2.9 percent in the same quarter a year ago. The main reasons behind this increase are thought to be the decline in the worldwide food production especially wheat and other grains, which pushed up the demand level of the main importing countries such as China, Japan and Taiwan. Secondly the increases in the transportation and fuel prices have also had a negative impact on food prices.

On the other hand the following categories of the Kabul headline CPI posted decline:

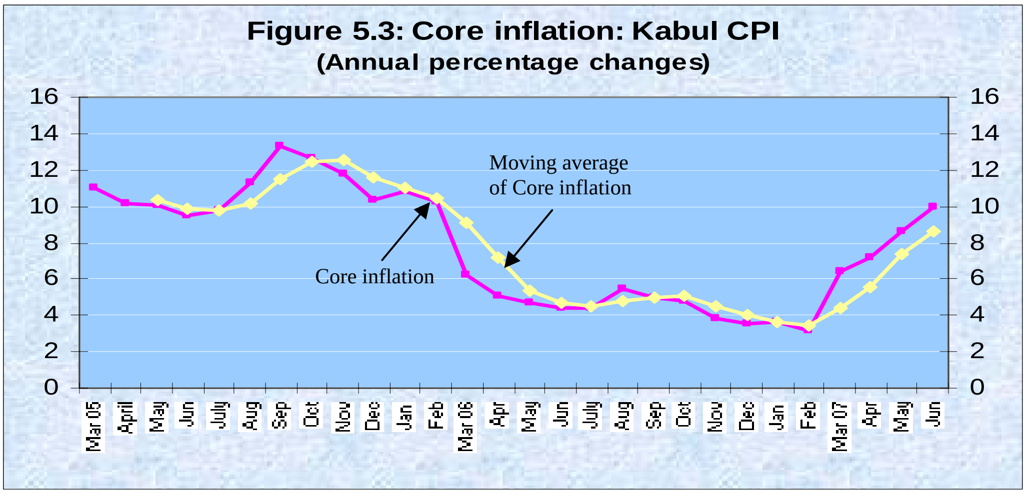
- **Rents:** this price index fell dramatically by 25.3 percent in the quarter under review compared to a year ago. It is mainly due to a decrease in demand for housing by NGOs and other international organizations, as well as construction of new residence buildings and small towns in both inside and outside of Kabul.
- **Housing:** this price index had a decline of 1.3 percent in the quarter under review from 10.3 percent in the same quarter a year ago. It is mainly because of the expansion of the domestic production of cement, which was stopped due to civil war during 1990s as well as increase in the cement and other construction materials supply from neighboring countries.



Source: CSO and DAB staff calculations.

The volatility of Kabul inflation as measured by the standard deviation was 1.5 percent in the first quarter of 1386, slightly down from 1.6 percent in the same quarter a year ago.

In Table 5.1 the breakdown of inflation includes a measure of core inflation because comparing one period's price statistics with some other periods gives a crude measure of inflation (if the general level of prices has risen). But such a measure does not discriminate between relative price changes and inflation, so an increase in the price of a single item, such as rent, may cause a price index to rise. For this reason, a measure of core inflation, which is CPI excluding rents, construction materials and fuel has been calculated. Core inflation is also often interpreted as measuring the long run or persistent component of the index. Core inflation stood at 9.9 percent in the first quarter of 1386 up from 4.4 percent in the same quarter a year ago. (See figure 5.3)



Source: Central Statistical Office and DAB staff calculations.

2. Annual Changes in National Headline Inflation

This section analyzes trends in national CPI on a year-on-year basis.

Headline inflation, as measured by year-on-year percentage changes in national CPI increased by 9.6 percent in the first quarter of 1386 from 5.7 percent in the same quarter a year ago. The breakdown of national CPI into its respective components is presented in Table 5.2 and illustrated in Figure 5.4.

Table 5.2: Breakdown of National Headline CPI

(percent changes year on year)

Consumer Price Index

(March 2004 = 100)

	Weight	1384				1385				1386
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Headline	**100**	**11**	**11.8**	**11.9**	**9.8**	**5.7**	**5.3**	**3.4**	**3.8**	**9.6**
Food and Beverages	**61.3**	**10.6**	**14.4**	**12**	**9.1**	**4.1**	**4.1**	**3.5**	**4.9**	**13**
Bread and Cereal	28	16.4	23	18.5	10.8	2.3	1.2	-1.1	3	16.2
Milk and cheese	5.6	3.6	7.1	8.6	9.5	7.9	6.6	7.1	6.6	10.9
Non – Food	**38.7**	**11.8**	**8**	**11.7**	**10.9**	**8**	**7**	**3.6**	**2.2**	**4.4**
Housing	17.2	21.5	13.3	17.1	16.4	8.9	5.1	1.5	-1.5	3.7
Rents	7.1	37.2	21.6	17.5	14.9	3.3	-4.2	-14.7	-20	-12.8
Fuel and Electricity	6.8	11.4	5.5	20.3	22.7	17.9	21.8	26.1	25.3	28.6
Core (Headline Excl Housing)		**8.8**	**11.4**	**10.6**	**8.2**	**4.9**	**5.3**	**4.1**	**5.2**	**11**

Source: Central Statistical Office and DAB staff calculations.

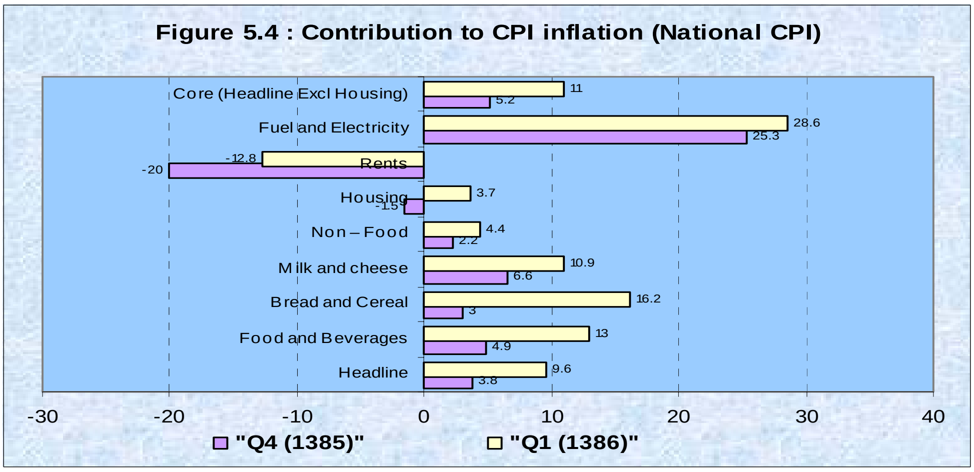
The increase in the national CPI to 9.6 percent in the first quarter 1386 from 5.7 percent in the same quarter a year ago was mainly because of the following factors:

- **Fuel and electricity**: this price index rose by 28.6 percent due to an increase in electricity prices by the Ministry of Energy and Water.
- **Bread and Cereals:** This price index rose significantly by 16.2 percent. The reason could be the increase in the transportation (increase in the petrol and diesel which are sub indexes of the transportation) and recent decrease in the food productions especially wheat in Canada (the second largest wheat producer in the world) and rising of the demand by major wheat importing countries.
- **Milk and cheese:** this price index also rose by 10.9 percent from 7.9 percent a year ago.

On the other hand the following categories of the national headline CPI posted declines:

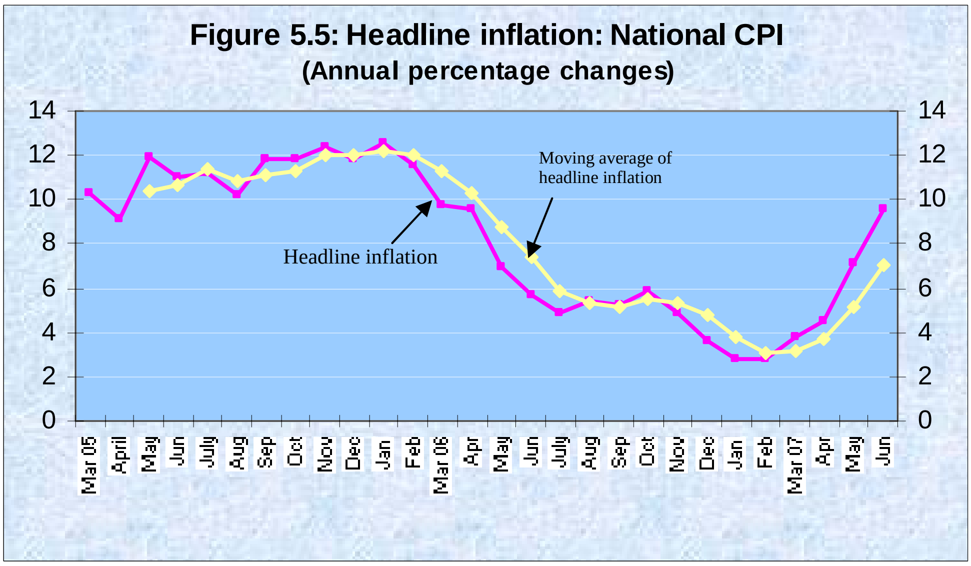
- **Housing:** this price index declined by 3.7 percent in the first quarter of 1386 from 8.9 percent in the same quarter last year. It is mainly because of the expansion of the cement supply from neighboring countries as well as the increase in the level of domestic construction materials production such as cement, which was stopped due to civil war during the 1990s.
- **Rents:** this price index fell dramatically by 12.8 percent in the quarter under review compared to a year ago reflecting decline in rental prices in Kabul. The reason is

construction of new residential small towns all over the country and rebuilding programs carried out by International community. (Figure 5.4)



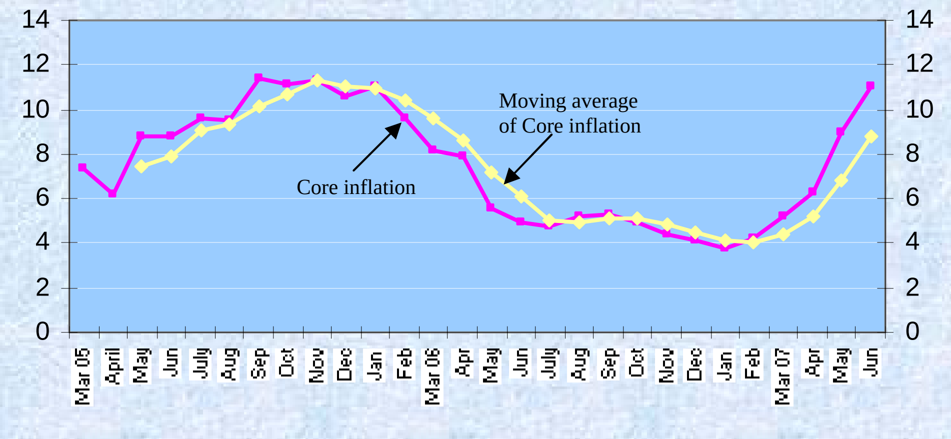
Source: Central Statistical Office and DAB staff calculations.

The volatility of inflation for national CPI as measured by the standard deviation in the first quarter was 2.6 percent, up from 2 percent in same quarter last year. The volatility of inflation remains a concern for monetary policy, because volatile prices distort market signals making it difficult for business and private individuals to plan appropriately.



Source: Central Statistical Office and DAB staff calculations.

Figure 5.6: Core inflation: National CPI
(Annual percentage changes)



Source: Central Statistical Office and DAB staff calculations.

3. Quarterly Changes in Kabul Headline CPI

This section analyzes trends in quarter-on-quarter changes in Kabul headline CPI.

The Kabul headline CPI in the first quarter of 1386 increased by 2.4 percent from 1.7 percent in the fourth quarter of 1385. The increase in quarter-on-quarter inflation can be traced to the following major categories:

- **Housing** fell by 2.9 percent driven by 3.6 percent decrease in rents and 4 percent decrease in Fuel and Electricity, as a whole all these components caused the non-food index to decline.
- **Food and Beverages:** this index rose slightly by 4.7 percent in the quarter under review from 4.2 percent in fourth quarter of 1385 with a contribution of 9.8 percent by Milk and Cheese.

Tables 5.3 presents price indicators for quarter-on-quarter changes in Kabul CPI.

Table 5.3: Quarter-on-Quarter Changes in Kabul Headline CPI
(percent changes quarter on quarter)
Consumer Price Index (March 2004 = 100)

	1384				1385				1386
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Headline	**2.87**	**2.45**	**3.38**	**0.5**	**-0.87**	**2.33**	**1.57**	**1.7**	**2.4**
Food and Beverages	**2.5**	**0.96**	**1.82**	**0.77**	**-0.68**	**1.87**	**0.83**	**4.2**	**4.7**
Bread and Cereal	2.9	1.6	2.7	-0.4	-3.1	0.7	-0.3	6.4	5.7
Milk and Cheese	-1.3	2.1	1.2	0.4	-1.3	4.5	1.1	2.5	9.8
Meat	6.2	-0.6	0.9	2.5	0.5	2.6	-0.3	1.5	-2.6
Non – Food	**3.24**	**4.75**	**5.7**	**0.07**	**-1.24**	**3.02**	**2.5**	**-1.7**	**-0.7**
Housing	5.23	6.46	8.47	0.86	-5.12	2.76	5.1	-3.3	**-2.9**
Rents	8.1	6.43	5.65	2.67	-5.9	-1	-18	-4.1	**-3.6**
Fuel and Electricity	-0.4	7.5	18.58	-1.5	-4.87	12.25	47.19	-3.7	**-4**

Source: Central Statistical Office and DAB staff calculations.

4. Quarterly Changes in National Headline CPI

This section analyzes quarter-on-quarter changes in national headline CPI.

The national headline CPI in the first quarter 1386 increased by 3.8 percent from 1.3 percent in the fourth quarter of 1385. The increase in quarter-on-quarter inflation can be traced to the following major categories:

- **Food and Beverages:** this price index increased by 5.8 percent with the bread and cereals sub-index increasing by 8.3 percent and Milk and cheese by 3.9 percent respectively.
- **Non Food:** this price index increased slightly by 0.6 percent with the housing sub-index increasing by 0.2 percent, rents 2.1 percent respectively. Fuel and Electricity fell by 3.1 percent compared to the previous quarter. Table 5.4 presents price indicators for quarter-on-quarter changes in national CPI.

Table 5.4: Quarter on Quarter Changes in National Headline CPI
(percent changes quarter-on-quarter)
Consumer Price Index
(March 2004 = 100)

	1384				1385				1386
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Headline	**2.18**	**2.66**	**3.54**	**1.09**	**-1.7**	**2.27**	**1.89**	**1.3**	**3.8**
Food and Beverages	**2.85**	**2.32**	**1.66**	**1.97**	**-1.9**	**2.32**	**1.09**	**3.3**	**5.8**
Bread and Cereal	4	4.1	1.6	0.8	-4	2.9	-0.7	4.9	8.3
Milk and Cheese	1.3	2.8	3.4	1.6	-0.2	1.6	4	1.6	3.9
Meat	-2.9	1.1	1.7	3.7	-2.2	1.6	2.2	1.1	-1.9
Non – Food	**1.24**	**3.16**	**6.47**	**-0.24**	**-1.4**	**2.2**	**3.1**	**-1.5**	**0.6**
Housing	1.69	5.54	8.85	-0.34	-4.84	1.82	5.14	-3.3	0.2
Rents	4.07	6.21	3.92	-0.06	-6.33	-1.55	-7.43	-6.3	2.1
Fuel and Electricity	-1.7	5.09	20	-0.99	-5.53	8.54	24.2	-1.6	-3.1

Source: Central Statistical Office and DAB staff calculations.

The Dynamics of Inflation

To understand better the dynamics of CPI it is useful to look beyond nominal Laspyere-based fixed weighting in which food has an overall weight in the index of about 61 percent and non-food 39 percent and analyze trends in the *effective weights.* These are based on the relative share of *point's contribution* each sub index to the total Kabul index.

Effective weights are calculated as the proportion of point's contribution to the all groups index. If prices are changing more significantly within one sub-index than in the other, then the effective weights will shift over time. In simple terms, stronger price movements in a sub-item will exert more influence on the overall index than what its basic weighting would suggest. This is important because prices react to shifts in demand and supply in the market and it gives an early indication of a move away from the basic Laspyere-based fixed weight regimen that underlies the CPI index. An analysis of the effective weight shows that between March 2004 and June 2007, the effective weight of food has decreased from 61 percent slightly down to 59.9 percent. An increase/decrease in the effective weight can either be affected by upwards or downwards movements in prices, the key is that it shows us the *strength* of the price movement.

It is clear that non-food items and their price movements are responsible for pushing back the relative weighting of food items. The share of sub-indexes of food has been shown in Figure 5.7.

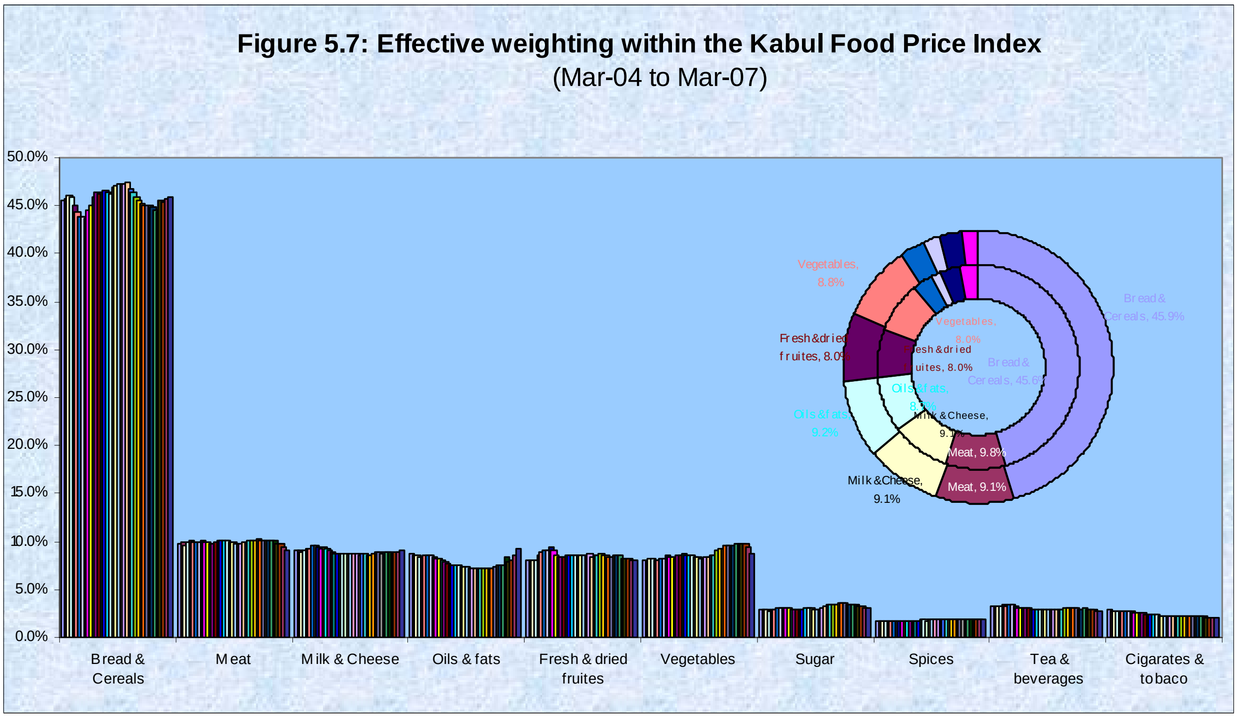
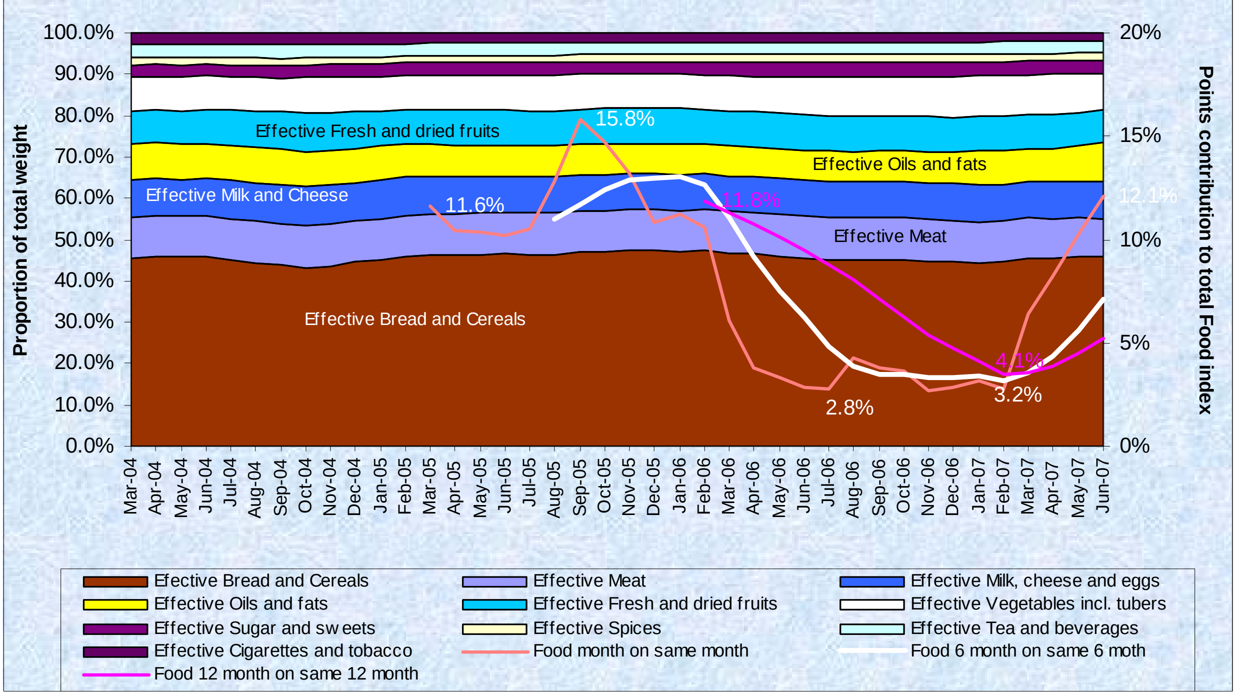


Figure 5.7: Effective weighting within the Kabul Food Price Index
(Mar-04 to Mar-07)

Source: Central Statistical Office and DAB staff calculations.

The relative effective weight for food sub-items is shown in Figure 5.8. As can be seen from the figure, the effective weight for oils and fats has increased to 9.2 percent, shown by the increased area shaded yellow in Figure 5.8 below.

Figure 5.8 : Analysis of change - Food index by sub-items



Source: Central Statistical Office and DAB staff calculations

6

BANKING SYSTEM PERFORMANCE

Summary

Total assets of the banking system rose to AF 58.8 billion (USD 1.2 billion) at the end of first quarter 1386, up by 68 percent from first quarter of last year, and 9 percent since the beginning of solar year. Loans amounted to AF 24.9 billion (USD 0.5 billion) an increase of AF 15.2 billion (USD 304 million) or 157 percent since June 2006. Deposits stood at AF 45 billion (USD 906 million) over the period under review; a 93 percent increase since June 2006. Deposits were largely denominated in USD (77 percent) with AF -denominated deposits were lagging at 19 percent. Total capital of the banking system stood at AF 11.8 billion (USD 235 million). Banking sector overall was profitable earning a net profit of AF 128 million (USD 2.6 million) over first quarter of 1386, for an overall return on assets (ROA) of 0.89 percent which was higher than previous year same quarter's -2.02 percent. The main causes for the hike in ROA are significant increases in interest income and non-interest income, which more than completely offset notable rises in overhead expenses. State-owned banks are among top three profitable banking institutions.

1. Assets of the Banking System

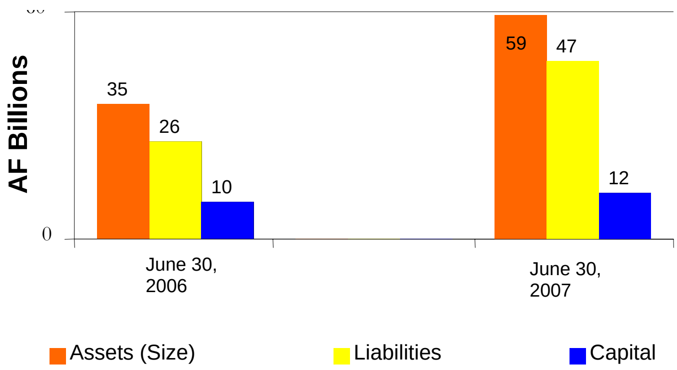
The banking system continues to grow at a brisk rate. Total assets (size) of the banking system at the end of Q1-1386 was AF 58.8 billion (USD 1.2 billion), up by 68 percent or AF 23.8 billion (USD 476 million) from June 2006, Figures 6.1 and 6.2.

The major components of this increase were increases in loans (up AF 15.2 billion) and cash in vault/claims on DAB (up AF 4.2 billion). Moreover, the remaining part is made up of other asset categories such as claims on financial institutions, fixed assets and NDF.

The most important components of the banking system's total asset portfolio are loans (42.4 percent), claims on financial institutions (21.6 percent), cash in vault/claims on DAB (17.6 percent), and Net Due From (9.5 percent). Other components of total assets are negligible. The rapid increase in the relative importance of loans can be traced to immediate deployment of major portion of attracted funds into new loans (70 percent), while a small part has been retained as liquid assets. Moreover, some placements also were substituted for loans.

Figure 6.1: Banking System's Growth Rate

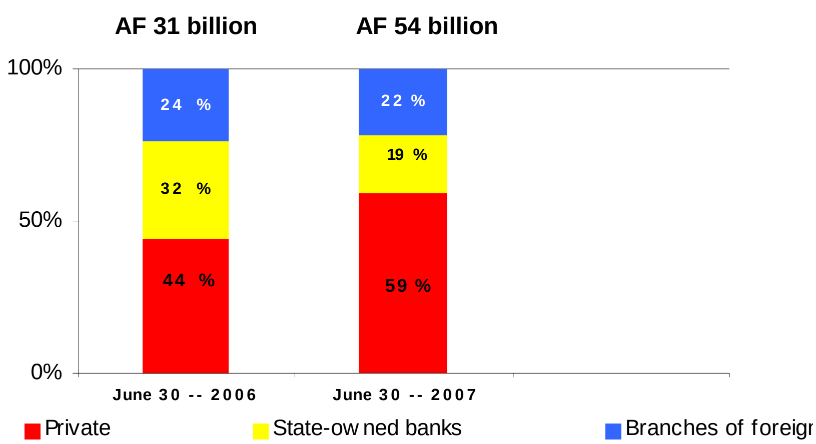
Growth Rate = 68 percent or AF 24 billion



Source: Banking Supervision Department

Figure 6.2: Size of Banking Sector (Total assets)

Increased by 68 percent or AF 24 billion



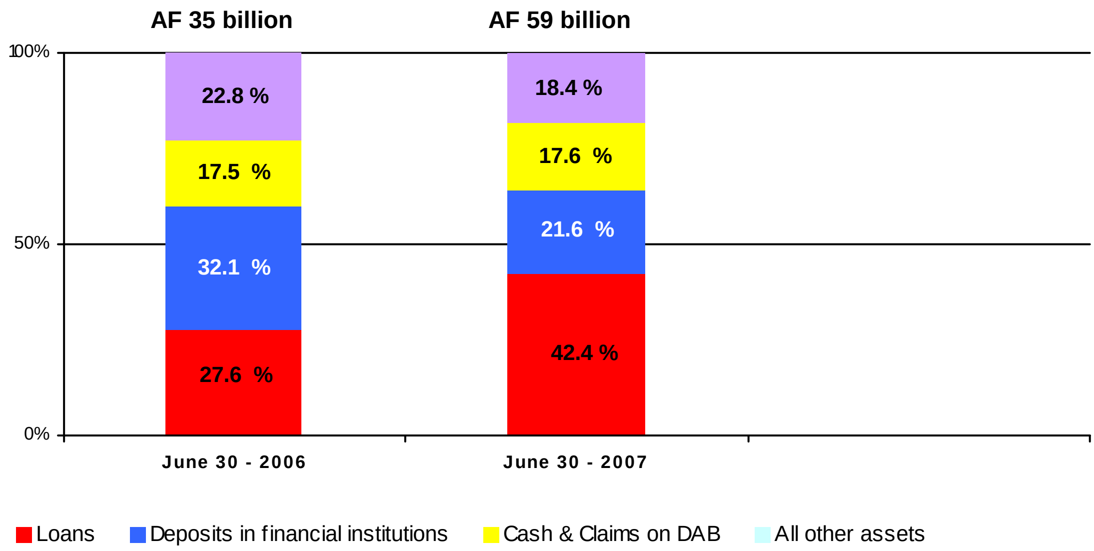
Source: Banking Supervision Department

The major components of assets, as a percentage of total assets, are discussed hereafter:

Claims on Financial Institutions:

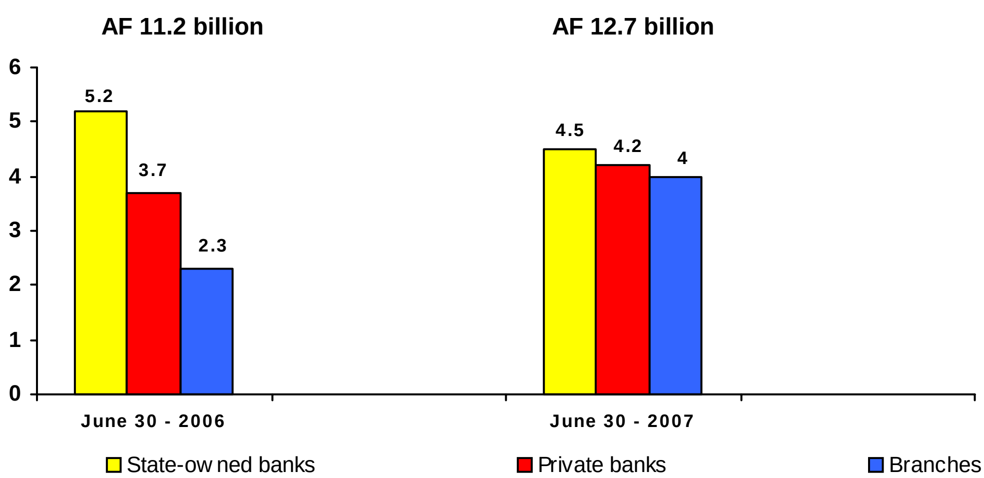
Claims on financial institutions are the second largest among various asset categories, currently comprising AF 12.7 billion – a 13 percent increase since June 2006 total – 21.6 percent of total assets, indicating that the banking sector channeled a portion of its attracted funds as deposits in other financial institution, if credible borrowers were not found. Later on, if needed for liquidity purposes or after getting loan application from low-risk borrowers, these assets can be substituted to higher income earning assets.

Figure 6.3: Major Asset Categories (As percent of Total Assets)



Source: Banking Supervision Department

Figure 6.4: Claims on Financial Institutions



Source: Banking Supervision Department

Net Loans

The loan portfolio continues to grow, totaling AF 25 billion (USD 0.5 billion) as of June 30, 2007 – a 157 percent increase since June 2006 – or 42.4 percent of total assets; the highest amount as well as share percentage in total assets among different asset categories. The increase occurred in the gross loan portfolio; loss reserves increased insignificantly. Increases in lending were observed at all but one of the banking organizations; however two-third of the growth is still attributable to one banking institution.

By far, the major component of loan portfolio is "other commercial loans (88 percent). This concentration in other commercial loans, to the exclusion of all other types of lending, has been the dominant trend. Thus, lending is picking up, but still not sufficient enough in some loans categories related to important sectors of the economy, e.g. agriculture.

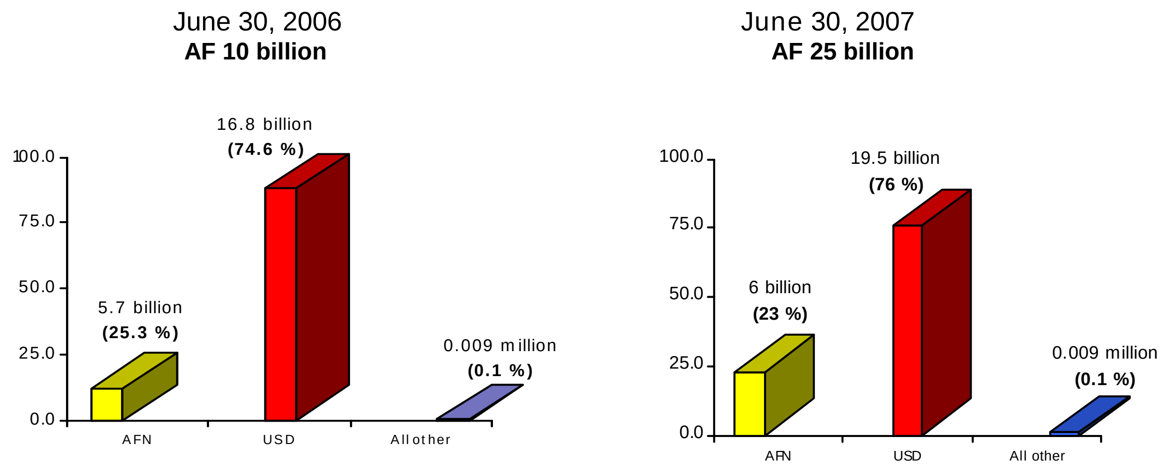
Figure 6.5: Loans Portfolio

Increased 157 percent or AF 15.2 billion

AF 8 billion **AF 25 billion**

Private Banks are the leading creditors, increasing their portfolio both in absolute terms as well as percentage of total loans, currently at AF 21.6 billion or 87 percent of total loans. Changes in State-owned banks and branches of foreign banks' share and amount were insignificant.

Figure 6.6: Currency Composition of Loans



Source: Banking Supervision Department

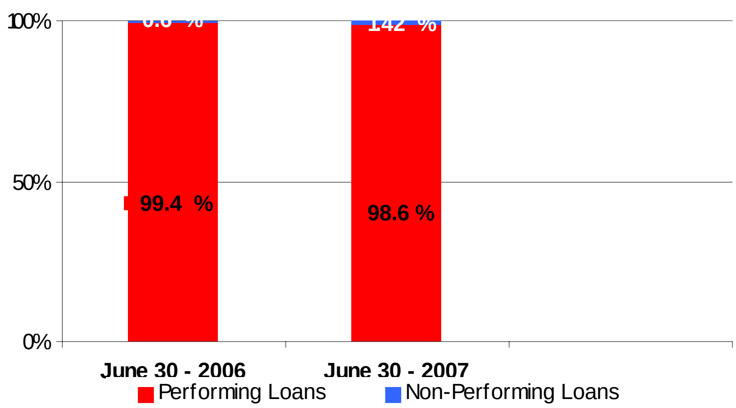
Non-performing loans

The system's non-performing loans increased over the year, jumping to AF 365 million from AF 61 million at the end of previous year's first quarter, and stand at 1.42 percent of the total loan portfolio. This is an increase over the year; however, the banking sector's loan administration function is still strong, limiting the NPLs percentage at the lowest possible level.

Adversely-classified loans

Contrary to the increase in non-performing loans, adversely-classified loans increased to AF 1.7 billion from AF 203 million at the end June 2006. These loans represent 13.2 percent of the portfolio. However, loans on the "substandard" and "loss" increased slightly. This trend should be monitored closely, to see if it is a leading indicator of future increases in adversely-classified loans, or if it is just an indication that the classification of loans is becoming more conservative.

Figure 6.7: Quality of Loans Portfolio



Adversely-classified loans are greater than non-performing loans, which is what one would expect given the definitions of these two indicators of problem assets.

Cash in Vault and Claims on DAB

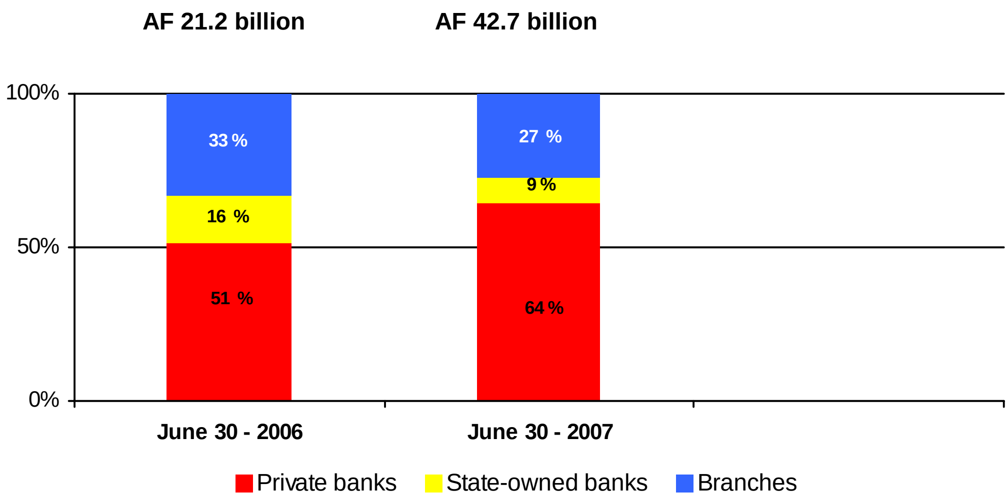
Cash in vault and claims on DAB remains the third largest category, increasing both in absolute as well as percentage of total assets. The banking sector is considering compliance with required reserves, or deploying slowly and prudently the attracted funds into other types of assets.

2. Liabilities

Total liabilities of the banking sector were AF 47 billion, up by 84 percent from June 2006. This is an indication of growing public confidence and good public relations and marketing policies of the banking sector.

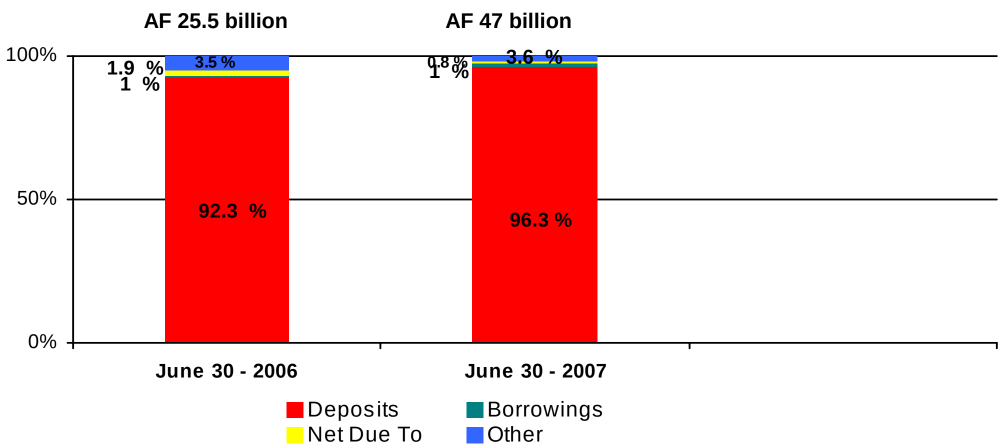
Figure 6.8: Liabilities

Increased by AF 22 billion or 88 percent



Source: Banking Supervision Department

Figure 6.9: Major Liability Categories



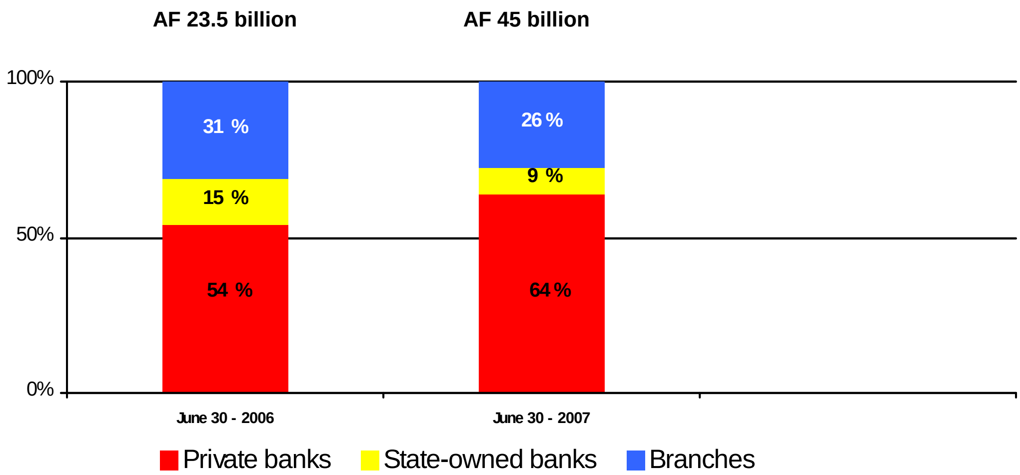
Increases in deposits of branches were reflected as highly comparable increases in total assets with unrelated parties for the period, indicating a shift from a source of funds for the home office towards active engagement in the country, and gradual compliance with DAB's supreme council's resolution on investment of 80 percent of attracted funds inside the country within two years.

Deposits

Deposits are the major component of liabilities, currently equal to AF 45 billion, a 93 percent increase since June 2006. Private Banks attracted AF 17 billion more deposits, 76 percent of the total increase. Total deposits increased in absolute terms, as well as percent of total liabilities. Total deposits of private banks also increased both ways. Even though deposits of state-owned banks and branches are expanding in absolute terms, their share in total deposits is losing ground.

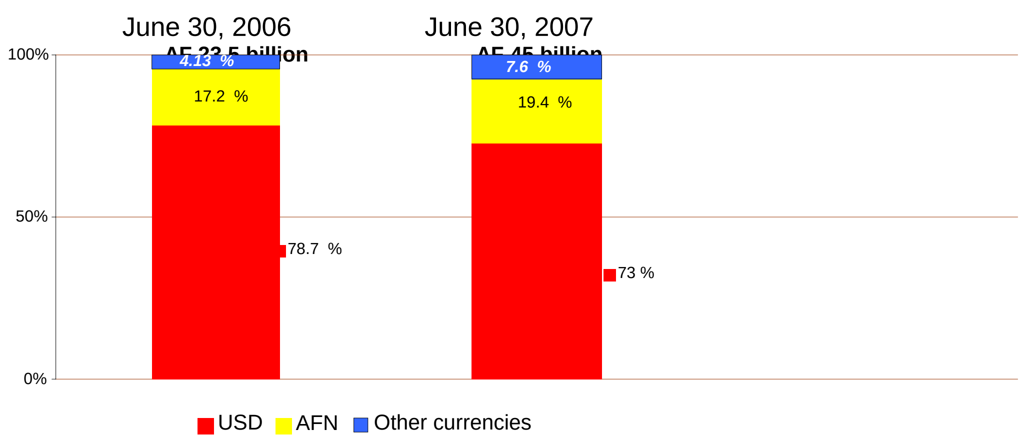
Figure 6.10: Deposits

Increased by AF 22 billion or 93 percent



Source: Banking Supervision Department

Figure 6.11: Currency Composition of Deposits



Other liabilities except Interest Payable remain the second major component of liabilities, down by 38 percent, or 1.8 percent of total liabilities.

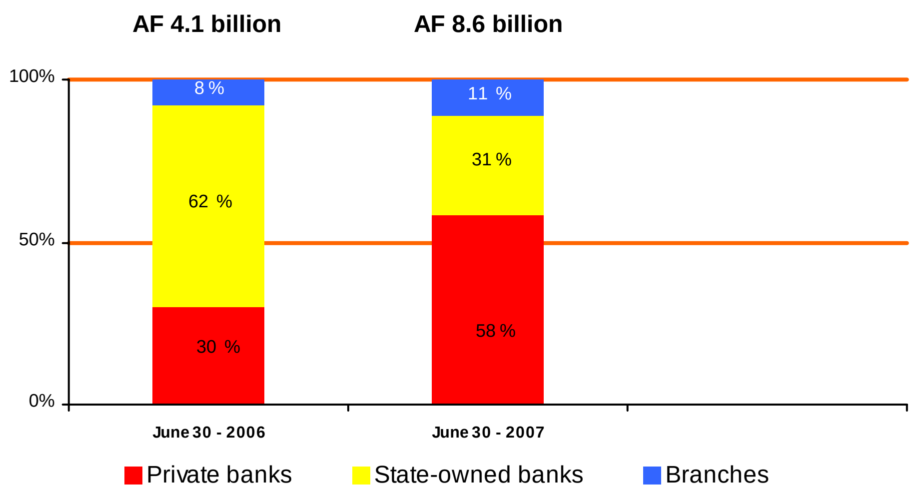
Capital

The system, as a whole, is well capitalized. Total financial capital at full-fledged banks is AF 11.8 billion, up by 24 percent sine June 2006. If the 20 percent capital/assets ratio or assets support by capital is taken as benchmark which is an internationally applied ratio for the banks, the AF 11.8 billion can support assets of AF 59 billion, while total assets of the full-fledged commercial banks are AF 46 billion.

Branches of foreign banks do not have separate capital. The most analogous concept to positive capital is the Net Due to Related Depository Institutions, primarily the home office and other branches of the same bank (NDT), while the closest analogue to negative capital is the Net Due from Related Depository Institutions, primarily the home office and other branches of the same bank (NDF).

The NDT and NDF positions of branches of foreign banks are the same as in the previous quarter. So, two of them are in a favorable NDT position, much smaller than the relatively large, unfavorable NDF positions for the remaining three. Put differently, only two banks are actively seeking investment outlets for the funds they have attracted, while the others are simply sending their acquired funds to their international networks. The largest NDF position by a commercial bank was AF 3.4 billion, up by 70 percent over the year.

Figure 6.12: Afghani Denominated Deposits



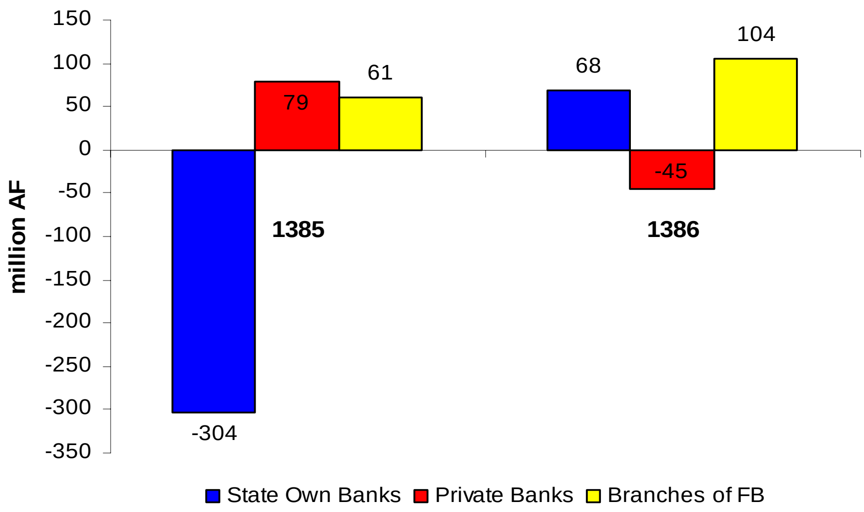
NDF is probably a normal situation for a foreign branch in the first year or so of existence when the branch is establishing itself and seeking loan customers and other investment opportunities. Supervisory action will only be required if the branch persists for another year or two in a NDF position or the bank's overall worldwide condition and performance is deteriorating.

Profitability

The banking sector overall is profitable. Total net profit of the banking sector over the first quarter of 1386 is AF 128 million, whereas AF 164 million net losses was incurred during first quarter of 1385, resulting in an overall return of assets (ROA) of 0.89

The main causes for the increase in ROA are significant increases in net interest income and non-interest income, which more than more than completely offset notable hikes in overhead expenses.

Figure 6.13: Profitability



Source: Banking Supervision Department

Branches of foreign banks are the most profitable group, followed by state-owned banks. Private Banks, as a group, is not profitable mainly due to expansionary activities of one single bank which affected negatively the overall results of the group. The main reasons for profitable operations were lower credit provisions and higher net interest income and non-interest income, which more than completely offset hiking overhead expenses.

The major component of income was Net Interest Income (NII) with total amount of AF 899 million, up by 80 percent than last year's first quarter.

The second major component of income is other Non-Interest Income totaling AF 252 million, a 56 percent increase over previous period.

The most important component of expense is the Non-Interest Expense (NIE), currently equal to AF 909 billion, a 100 percent increase compared to previous year's first quarter.

The efficiency ratio, (net interest income + trading account gain/loss + other non-interest income divided by operating expenses) of the system improved from a median of 1.54 from Q1-1385 to 1.69 for the current period. Four banking institutions ended up with lower efficiency ratios.

Foreign Exchange Risk

The level of foreign exchange risk being taken by banks is within the levels set by DAB.

In general, all private banks are in compliance with set limits achieved mainly through successful implementation of enforcement actions. (The state-owned banks were not subject to enforcement actions; this issue will be addressed as part of their overall restructuring.) According to Open Positions in Foreign Currencies' Regulation, the overall open position in all foreign currencies shall not exceed 40 percent of the institution's regulatory capital. (Branches of foreign banks are not subject to limitations on open FX position, since that risk is managed on a whole-bank basis and not branch-by-branch).

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20 percent change in exchange rate would increase the regulatory capital by 8 percent or AFN 894 million and vice versa. Similarly, a 4 percent change would correspond to 1.6 percent or AFN 179 million.

Interest Rate Risk

Interest rate sensitivity of the banks remained unchanged since June 2006, and all banks are in an asset sensitive position (benefiting from an increase in the interest rate).

(Branches of foreign banks are not required to file the interest-rate sensitivity schedule, because like FX risk, interest-rate risk is managed on a whole-bank basis).

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

7

EXTERNAL SECTOR DEVELOPMENTS

Summary

The trade deficit, the difference between exports and imports of goods, in the first quarter of 1386 stood at USD 585 million or 24 percent of GDP. This was slightly higher than the trade deficit in the first quarter of 13865 which stood at 21 percent.

Comparing merchandise trade in the first quarter of 1386 with that in the first quarter of 1385 shows that imports rose by 36 percent to USD 692 million. Imports were dominated by capital goods (USD 337 million) and industrial supplies and materials (USD 156 million). Domestic exports increased by 48 percent to USD 107 million and were dominated by carpets and rugs (USD 57 million) and food items (USD 23 million). With respect to the direction of trade, Pakistan remained Afghanistan's major export destination with a 60 percent share of total exports, followed by India, with 21 percent share of total exports in the first quarter of 1386. Exports from the first quarter of 1385 up to first quarter of 1386 expanded by a phenomenal 24 percent and 265 percent correspondingly.

Merchandise Trade

At the end of the first quarter of 1386 the trade deficit stood at USD 585 million or 24 percent of GDP. At this pace, the trade deficit is projected to be nearly the same as in the first quarter of 1385. Table 7.1 shows merchandise trade by its main categories with percent changes and the trade deficit as a percentage of GDP from 1382 up to first quarter of 1386. Imports of USD 692 million were dominated by capital goods (USD 337 million) and industrial supplies and materials (USD 156 million). Exports of USD 107 million were dominated by carpets and rugs (USD 57 million) and food items (USD 23 million).

Table 7.1: Merchandise Trade (in USD million)

	1382		1383		1384		1385		First Q 1386	
	Total	% share	Total	% share	Total	% share	Total	% share	Total	% share
Imports	**2,118.90**	**100**	**2,150.90**	**100**	**2,470.74**	**100**	**2,744.19**	**100**	**692.11**	**100.00**
Consumer goods	441.2	20.82	383.3	17.82	478.63	19.37	477.28	17.39	136.91	19.78
Industrial supplies & materials	639.9	30.2	667.4	31.03	541	21.9	622.94	22.70	155.51	22.47
Capital goods & others	996.5	47.03	1,034.00	48.07	1,206.50	48.83	1,389.76	50.64	336.80	48.66
Fuel and lubricants	41.3	1.95	66.2	3.08	244.61	9.9	254.21	9.26	62.89	9.09
Exports:	**143.71**	**100**	**303.3**	**100**	**383.72**	**100**	**416.46**	**100**	**106.78**	**100**
Carpets & Rugs	21.5	14.96	154.3	50.87	206.94	53.93	186.53	44.79	56.60	53.01
Food Items	70.9	49.34	95.6	31.52	104.11	27.13	165.15	39.66	23.43	21.94
Leather & Wool	31	21.57	27.3	9	36.51	9.51	30.94	7.43	8.26	7.74
Medical Seeds & Others	20.31	14.13	26.1	8.61	36.16	9.42	33.84	8.13	18.49	17.32
Trade Balance:	**-1,957.29**		**-1,847.60**		**-2,087.02**		**-2,327.73**		**-585.33**	
Trade Balance as % of GDP:	**39.2**		**33.38**		**31.28**		**28.19**		**24.09**	

Source: Central Statistical Office and DAB staff calculations

Direction of Trade

Tables 7.2 and 7.3 compare the direction of trade in the first quarter of 1385 with the first quarter of 1386.Pakistan remained Afghanistan's largest export destination with 60 percent share of total exports in the first quarter of 1386 compared to 71 percent in the first quarter of 1385. Exports to Pakistan have increased by 24 percent from USD 52 million in the first quarter of 1385 to USD 65 million in the first quarter of 1386. The second major export destination is India. Exports to India have increased by 265 percent from USD 6 million in the first quarter of 1385 to USD 23 million in the first quarter of 1386. The Ex-soviet commonwealth states have also remained major export destinations for Afghanistan. In the first quarter of 1385 exports with the Ex-soviet commonwealth were USD 3 million compared to USD 4 million in the first quarter of 1386: an increase of 17 percent.

Table. 7.2: Direction of External Trade for 1st Quarter of 1385 (in millions US$)

Country Name	Exports		Imports		Trade Balance
	Millions of US$	% share	Millions of US$	% share	
Pakistan	51.93	71.93	128.07	25.16	-76.14
India	6.20	8.59	38.09	7.48	-31.89
Japan	0.00	0.00	93.60	18.39	-93.60
China	0.12	0.17	95.23	18.71	-95.11
Ex-soviet Common Wealth	3.27	4.53	22.06	4.33	-18.79
European Countries	1.70	2.35	14.77	2.90	-13.07
Other Countries	8.98	12.44	117.18	23.02	-108.20
Total	**72.20**	**100**	**509.00**	**100**	**-436.80**

Source: Central Statistical Office and DAB staff calculations

Table. 7.3: Direction of External Trade for 1st Quarter of 1386 (in millions US$)

Country Name	Exports Millions of US$	Exports % share	Imports Millions of US$	Imports % share	Trade Balance
Pakistan	64.50	60.40	126.40	18.26	-61.90
India	22.62	21.18	51.99	7.51	-29.37
Japan	0.00	0.00	53.80	7.77	-53.80
China	0.00	0.00	113.40	16.38	-113.40
Ex-soviet Common Wealth	3.83	3.59	159.91	23.10	-156.08
European Countries	2.20	2.06	11.87	1.72	-9.67
Other Countries	13.63	12.76	174.74	25.25	-161.11
Total	**106.78**	**100**	**692.11**	**100**	**-585.33**

Source: Central Statistical Office and DAB staff calculations

Figure 7.1: Direction of Exports (% share) for first quarter of 1385

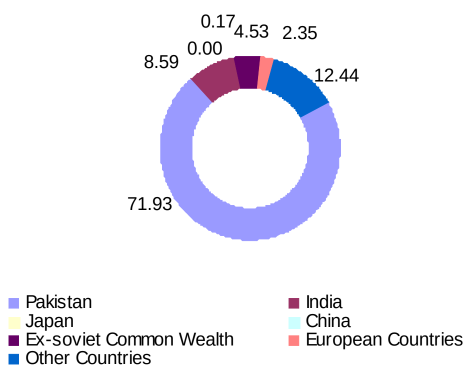
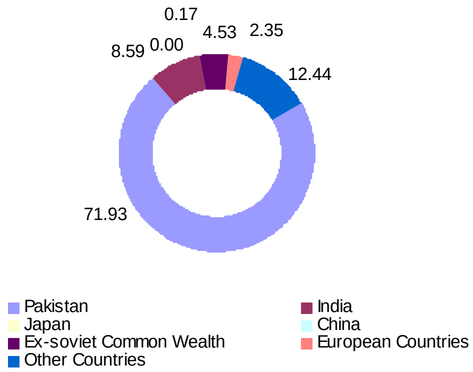


Figure 7.2: Direction of Exports (% share) for first quarter of 1386



Source: Central Statistical Office and DAB staff calculations

Composition of Trade

Figures 5.3 and 5.4 show the composition of the total imports from first quarter of 1385 up to first quarter of 1386. The composition of imports during the first quarter of 1385 shows that imports of item "Others" had the largest share of 37 percent followed by "Machinery & Equipments" at 23 percent, "Textile Clothing & Footwear" totaling 12 percent followed by "Food Items" at 11 percent, "Construction Material" at 10 percent, "Transportation Equipments & Spare parts" at 5 percent, and at last the item "Fuel" at 3 percent.

The composition of imports during the first quarter of 1386 expose that imports of item "Others" had the largest share of 36 percent followed by "Construction Materials" at 14 percent, "Machinery & Equipments" at 13 percent, "Food Items" totaling 13 percent followed by "Textile Clothing & Footwear" at 13 percent, "Fuel" at 9 percent, and at last "Transportation Equipments & Spare Parts" at 3 percent share of total imports to Afghanistan.

Figure 7.3: Composition of Imports (%share) for first quarter of 1385

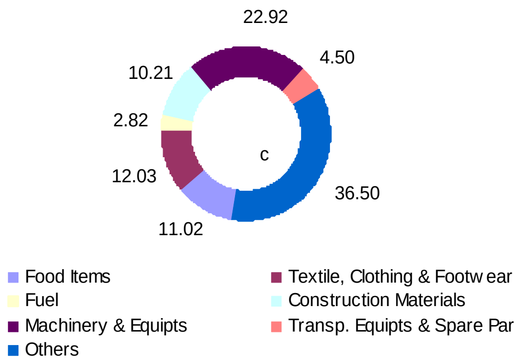
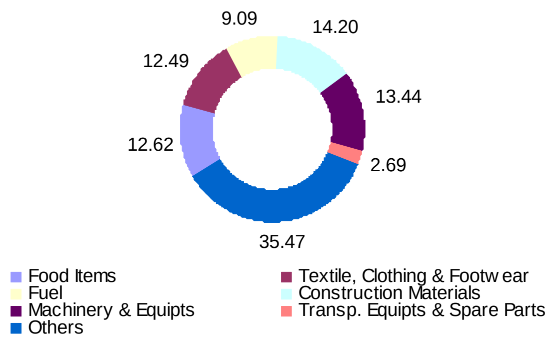


Figure 7.4: Composition of Imports (% share) for first quarter of 1386



Source: Central Statistical Office and DAB staff calculations

Comparing imports for the first quarter of 1386 with that of the first quarter of 13865 shows that the composition of imports has changed significantly. The share of "Construction Materials" increased in the first quarter of 1386 to 14 percent up from 10 per cent in the first quarter of 1385, though on the other hand, the share of "Fuel" has also increased to 9 percent during the first quarter of 1386 from 3 percent in the first quarter of 1385. There is also a decline in "Machinery & Equipments" in the first quarter of 1386 to 13 percent from 23 percent in the first quarter of 1385 along with this, the share of item "Textile Clothing & Footwear" has also declined to 3 percent during the first quarter of 1386 from 5 percent in the first quarter of 1385.

Figures 7.5 and 7.6 show the composition of total exports for the first quarter of 1385 with the first quarter of 1386. Figure 7.5 shows the composition of exports for the first quarter of 1385.Through the main commodities and products, "Carpets and Rugs" with 51 percent is the largest export component followed by the item "Food Items" which represent some 26 percent of total exports, "Medical Seeds" at 8 percent, the item "Others" at 7 percent "Leather" 5 percent, and at last the item "Wool" at 3 per cent.

Figure 7.6 shows the composition of total exports for the first quarter of 1386 by the main commodities and products. "Carpet & Rugs" with 53 percent is the largest export component followed by "Food Items" which comprises some 22 percent of total exports, "Medical Seeds" at 11 percent, the item "Others" at 7 percent, "Leather" at 6 percent, and finally the item "Wool" at 2 percent.

Figure 7.5: Composition of Exports (% share) for first quarter of 1385

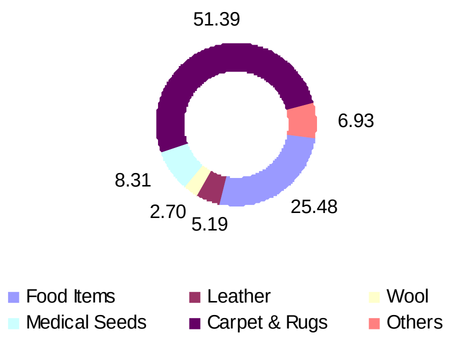
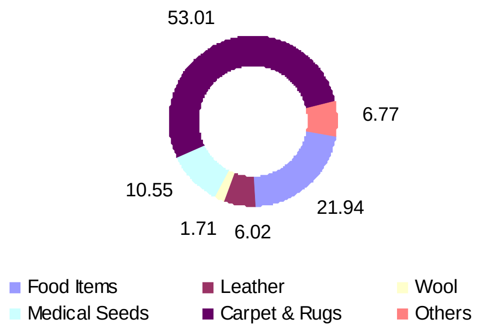


Figure 7.6: Composition of Exports (% share) for first quarter of 1386



Source: Central Statistical Office and DAB staff calculations

Comparing the composition of exports for the first quarter of 1386 with that of the first quarter of 1385 it is clear that the composition of exports remained approximately the same. There are only minor changes in the share of "Medical Seeds" which has increased to 11 percent in the first quarter of 1386 from 8 percent in the first quarter of 1385. The share of "Carpet & Rugs" has increased in the first quarter of 1386 to 53 percent from 51 percent in the first quarter of 1385. On the other hand, the share of "Food Items" has declined to 23 percent during the first quarter of 1386 from 26 percent in the first quarter of 1385. Also the share of "Leather" has increased to 6 percent in the first quarter of 1386 from only 5 percent in the first quarter of 1385.

External Debt

Afghanistan's public and publicly guaranteed external debt prior to the application of traditional debt relief mechanisms is estimated at USD 11,939.4 million in nominal terms as of March 20, 2006 (Table 7.5). Afghanistan's external debt strategy continues to focus on providing a stable foundation for sustainable debt environment over the longer term. The mechanism through which external debt sustainability can best be achieved is under the HIPC (Highly Indebted Poor Country) initiative. The Russian Federation accounts for the vast majority of total external debt (93.4 percent before the application of an up-front discount on its debt). The United States (0.9 percent) and Germany (0.4 percent) are the other Paris Club creditors. Multilateral creditors include IDA and the Asian Development Bank (ADB), representing 2.5 percent and 2.1 percent of Afghanistan's nominal debt, and Non-Paris Club creditors account for 0.8 percent of total claims respectively. At the time, there was no outstanding debt to the IMF or commercial creditors.

Table 7.4: External Debt as of March 20, 2006.
(in units indicated)

	In million USD	Percent of total
Total external debt	11,934.40	100
Bilateral	11,382.10	95.4
Paris Club	11,283.50	94.5
Russian Federation/1	11,127.90	93.2
United States	111.7	0.9
Germany	43.9	0.4
Non-Paris Club	98.5	0.8
Multilateral	557.3	4.7
of which: IDA	300.8	2.5
Asian Development Bank	254.6	2.1
Memorandum Items:		
NPV of debt after traditional debt relief/2	1,118.30	……..
(in percent of exports)/3	305.8	……..

Source: Data provided by Afghan authorities; and IMF staff estimates.

1/ Before up-front 80 percent discount on Russian debt

2/After up-front 80 percent discount on Russian debt priority the application of traditional debt relief.

Net International Reserves

Net International Reserves (NIR) held by Da Afghanistan Bank includes holdings of foreign exchange and gold, IMF Reserve position and holdings of Special Drawing Rights (SDR). When compared the first quarter of 1386 with the first quarter of 1385, net international reserves increased 11 percent to USD 2069 million from USD 1866 million. The reserves assets increased 10 percent from USD 1919 million to USD 2101 million. Whereas on the other side, the reserves liabilities declined 34 percent from USD 53 million to USD 35 million, because there is a significant decrease of 38 percent in commercial bank deposits in foreign currency from USD 46 million to USD 29 million. The net increase in the reserves reflected the fundamentals of the economy with foreign exchange inflows generated mainly from export earnings, foreign direct investment and injections of foreign exchange by donors and multi-national forces. The reserves position of the quarter under review is adequate to finance 4.8 months of imports.

Table 7.5: Net International Reserves, 1385 and first quarter of 1386

Changes on the previous quarter	1385								1386	
	Q1	% change	**Q2**	% change	**Q3**	% change	**Q4**	% change	**Q1**	% change
Net International Reserves	1699	4.2	1728.4	1.8	1851.5	7.1	1866.3	0.8	2069.2	10.9
Reserves assets	1726	3.9	1769.6	2.5	1885.8	6.6	1918.8	1.75	2104	9.7
Reserves liabilities	27.7	-14.2	41.2	48.7	34.3	-16.7	52.6	53.4	34.8	-33.8
Commercial bank deposits in foreign currency	23.3	-17.4	35.6	52.8	25.4	-28.7	46.4	82.7	28.7	-38.1
Non resident deposits in foreign currency	4.3	2.4	5.6	30.2	8.9	58.9	6.2	-30.3	6.1	-1.6
Use of Fund resources	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Memorandum items:										
Gross reserves (in months of imports)	4.6	-2.1	4.8	4.3	5.1	6.3	5	-2.0	5.3	6.0
NIRs (in months of imports)	4.6	0	4.7	2.2	5	6.4	4.8	-4	5.1	6.3

Source: DAB and IMF estimations.

Figure 7.7:Net International Reserves, 1385 and first quarter of 1386