




Da Afghanistan Bank

Central Bank of Afghanistan

Quarterly Economic and Statistical Bulletin

Third Quarter-1386

Sep 2007 - Dec 2007

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First printing February 2008

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Data Notes

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 third quarter of 1386 which is equivalent September, 2007 – December 2007 in the Gregorian calendar.

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

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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

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FOREWORD

I am pleased to present the Quarterly Bulletin of Economic and Statistics for the period September to December 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.

On the fiscal side, total operating expenditures rose to AF 15.2 billion (305 million USD) or about (3.7 percent of GDP). Expenditure of development budget was AF 11.5 billion or 15 percent of the total development budget for the year 1386. On the revenue side, total domestic revenue at the end of the third quarter 1386 stood at AF 8.1 billion (162 million USD) or about (2 percent of GDP), a decline of about 11 percent compared to the second quarter of 1386.

Developments on the inflation side remained positive though there were some signs of inflationary pressure building up in the economy. Headline inflation as measured by year-on-year percentage changes in Kabul CPI, continues its upward trend increasing to 17 percent at the end of the third quarter of 1386. Afghanistan is experiencing its sharpest inflationary surge in years, with price increases in the third quarter of 1386 coming in well above expectations.

The main drivers of inflation in the third quarter of 1386 were the prices of food and construction material. The food sub-index rose sharply by 25.6 percent at the end of the third quarter largely as result of developments in global commodity markets. Construction material prices rose by 17 percent at the end of the quarter under review largely because of acceleration of construction works on the project under construction due to arrival of winter.

Diesel and Petrol prices, the main components of fuel index, rose by 1.7 and 32.9 percent respectively at the end of quarter under review largely as a result of 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 74 billion (USD 1.5 billion) at the end of third quarter 1386, up by 64 percent or AF 29 billion from third quarter of last year, and 37 percent since the beginning of solar year 1386. Loans amounted to AF 35 billion (USD 693 million) an increase of AF 18 billion (USD 349 million) or 106 percent since December 2006. Deposits stood at AF 58 billion (USD 1.2 million) over the period under review; a 77 percent increase since December 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 10 billion (USD 205 million). Banking sector overall was profitable earning a year-to-date net profit of AF 674 million (USD 13.5 million) over first nine months of 1386, for an overall return on assets (ROA) of 1.42 percent which was higher than previous year same period's – 0.86 percent.

In the external sector, the trade deficit, the difference between exports and imports of goods, in the third quarter of 1386 stood at USD 1605 million or 17 percent of GDP. This was lower than the trade deficit in the year 1382 which stood at 39 percent.

Comparing merchandise trade in the three quarters of 1386 with that in the year 1386 shows that imports declined by 8 percent to USD 1931 million. Imports were dominated by capital goods (USD 980 million) and industrial supplies and materials (USD 70 million). Domestic exports increased by 127 percent to USD 623 million and were dominated by carpets and rugs (USD 157 million) and food items (USD 78 million). With respect to the direction of trade, Pakistan remained Afghanistan's major export destination with a 57 percent share of total exports, followed by India, with 17 percent share of total exports in the three quarters of 1386.

In conclusion, on an overall assessment, economic performance in the third 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

FISCAL DEVELOPMENTS

Summary

Fiscal conditions were below expectations in the third quarter of the year as political instability in Pakistan hobbled customs revenue collection and changes to import tariffs negatively impacted revenue collection. At the beginning of the fiscal year, Afghanistan budgeted a total of 130.6 billion AF (2.6 billion USD) for 1386. The total development budget stood at 77 billion AF (1.5 billion USD), while the total operating budget stood 53 billion AF (1.1 billion USD). In the quarter under review, total operating expenditures rose to 15.2 billion AF (305 million USD) or about (3.7 percent of GDP). Expenditure of development budget was 11.5 billion AF or 15 percent of the total development budget for the year 1386. On the revenue side, total domestic revenue at the end of the third quarter 1386 stood at 8.1 billion AF (162 million USD) or about (2 percent of GDP), a decline of about 11 percent compared to the second quarter 1386.

Government Revenue

Total domestic revenue at the end of third quarter 1386 stood at 8.1 billion AF (1.96 percent of GDP), down by 11 percent compared to the second quarter 1386. The slow down in revenue performance in the third quarter 1386 was observed in taxes AF 959 million decrease in the third quarter or about 12 percent lower compared to the second quarter as shown in (Table 1.1)

Non-tax revenue performance followed a negative trend as well falling AF 73 million below that of the second quarter 1386. Several reasons have been provided for the slow down in revenue performance in third quarter 1386.

First was the decision to reduce the customs tariffs applying to one category of fuels, machinery from 4percent to 0 percent , raw materials from 5 percent and 10 percent to 1percent, flour from 2.5 percent to 0 percent , and gee and cooking oil from 3.5 to 2.5 percent.

Second, was the fact that collection of fixed taxes on exports, and the ban on the importation of older motor vehicles and those with converted steering wheels (e.g. from right hand to left hand) in Herat and Kandahar was stopped. For example, Herat used to process about 170 to 200 vehicle imports per day and collected an average of AF 180 million per month before the ban.

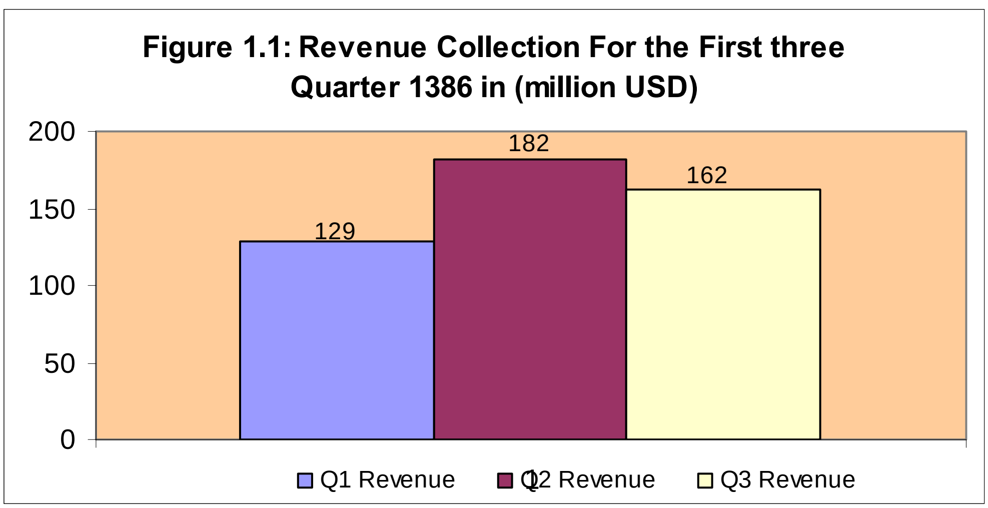
Third, is the presence of anti-corruption investigators in the main revenue collection areas and the lack of resources dedicated to revenue collection in the provinces.

In this environment, and with delays in implementing new revenue measures due to legal processes, the only way to meet the 1386 target is through increased efforts to improve compliance with existing tax laws by non-compliant sectors, including the airline sector.

Table 1.1: Revenue Collection as Third Quarter 1386 in million AF

Particulars	Q1 1386 Revenue Actual	Q2 1386 Revenue Actual	Q3 1386 Revenue Actual	% ∆ from Q1 to Q2 1386	% ∆ from Q2 to Q3 1386
Total Domestic Revenues (Tax and Non Tax)	6,441	9,116	8,083	42%	-11%
Total Tax Revenues	4,614	7,954	6,995	72%	-12%
Non Tax Revenues	1,828	1,162	1,089	-36%	-6%

Source: Ministry of Finance, Revenue Department



Government expenditure of core budget shows a significant increase in 1386 compared with the same period in the year 1385. Total operating expenditures for the third quarter 1386 was 15.2 billion AF (305 million USD) or about (3.7 percent of GDP) an increase of about 1 percent compared to the second quarter 1386 as shown in (Table 2.1). In the quarter under review, operating expenditures rose due to heavy expenditures in line ministries specifically on wages and salaries and acquisition of goods and services for the government. Particular ministries with heavy expenditures were Education, Defense, Interior Affairs, and National Security. It is clear that because of the security challenges confronting the nation the government has had to boost the expenditures on security in order to maintain a stable and strong government in order to lead a stable economy.

While government expenditures on security is higher compared to other sectors, the security challenge from insurgents and suicide bombers is the main obstacle to faster execution of strategic plans, infrastructure projects infrastructure and development initiatives.

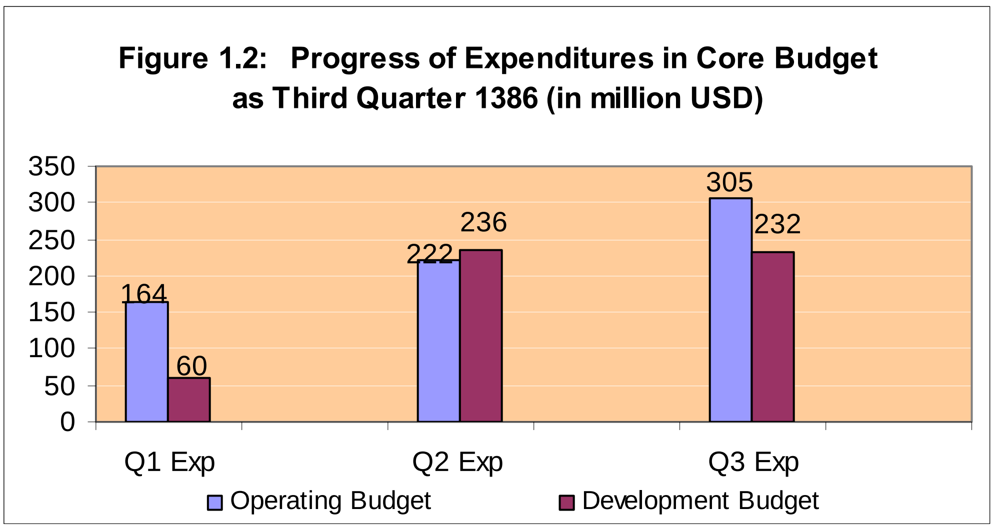
With respect to the development budget, (comprised of grants from donors), the ARTF (Afghanistan Reconstruction Fund) and LOTFA (Law and Order Trust Fund) has played crucial role for the infrastructure and development projects. The total development budget for the year 1386 approved by Ministry of Finance was 77 billion AF (1.5 billion US dollars) as shown in (Table 1.2).

However at the end of third quarter 1386 total development expenditures stood at 11.6 billion AF (2.8 percent of GDP) which was disbursed towards current and capital expenditures like acquisition of fixed assets (8.6 billion AF) followed by wages, allowances, goods and services (3.0 billion AF). Development expenditures declined by 2 percent in the third quarter 1386 compared to the second quarter 1386. However overall government operating and development expenditure rose by 17 percent in third quarter 1386 (Table 1.2)

Table 1.2: Progress of Expenditures in Core Budget as Third Quarter 1386 in million AF

Type of Budget	Currency	1386 Budget	1st Qtr Expenditures Amount	1st Qtr Expenditures %Budget	2nd Qtr Expenditures Amount	2nd Qtr Expenditures % Budget	3rd Qtr Expenditures Amount	3rd Qtr Expenditures % Budget	%Δ from Q1 to Q2 1386	%Δ from Q2 to Q3 1386
Operating Budget	AF m	53,600	8,178	15%	11,117	21%	15,253	28%	36%	37%
	USD m	1,072	164		222		305			
Development Budget	AF m	77,008	3,007	4%	11,806	15%	11,585	15%	293%	-2%
	USD m	1,540	60		236		232			
Total AF		130,608	11,185	9%	22,923	18%	26,838	21%	105%	17%
Total USD		2,612	224		458		537			

Source: Ministry of Finance and DAB staff calculation



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MONETARY AND CAPITAL MARKET DEVELOPMENTS

Summary

Monetary policy remained conservative in the third quarter of the year in the face of growing inflationary pressures from seasonal shifts in money demand, surges in remittances and higher oil and staple food prices. Monetary developments are tracked using two distinct but correlated data: monetary program and the monetary survey data. This is a transitional measure until the data is unified. According to the monetary program data reserve money increased by 11 percent in the quarter under review from 4 percent in the previous quarter. Bank deposits with the central bank, which is a component of reserve money, increased by 23 percent in the third quarter 1386.

According to the monetary survey data, Narrow Money (M1) grew by 10 percent in the quarter under review from 10 percent in the previous quarter. Currency outside depository corporations which is the other component of narrow money grew by 8 percent from 4 percent in the previous quarter while quasi-money grew by 14 percent in the quarter under review from 6 percent in the second quarter 1386.

The capital market continued to deepen and mature in the quarter under review. There was no change in outstanding stock of 182 day maturity from the previous quarter. On the other hand, the 28 day maturity with volume of 200 million AF per auction witnessed a gradual build up. The volume of 28 day maturity increased by AF 200 million to its maximum outstanding of AF 800 million AF during this quarter.

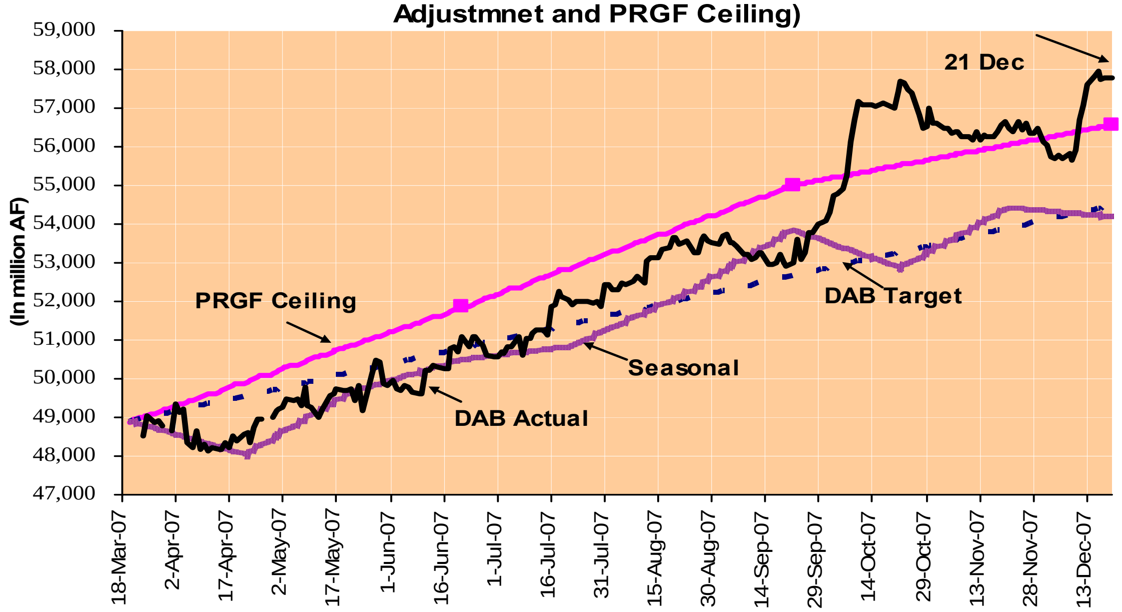
In the quarter under review, the weighted average interest rate ranged between 7.31 percent and 8.41 percent for the 28 day maturity and 9.18 and from 8.50 percent to 9.00 percent for the 182 day notes.

PRGF Monetary Program

Figure 2.1 describes trends in currency in circulation relative to the DAB target and the PRGF ceiling. From Figure 2.1 the DAB seasonally adjusted currency in circulation was below the PRGF ceiling while the DAB actual is above PRGF. This reflects an increase in currency outside depository corporations over the third quarter 1386. The surge in liquidity was attributed to increased demand for cash for national security reasons, an upward shift in money demand associated with the Holy Month and inflationary pressures arising from higher import prices for oil and staple foods.

Reserve money increased by 11 percent in the third quarter 1386 from 4 percent in the second quarter 1386. This was mostly attributed to a surge in bank deposits with the central bank which increased by 23 percent in the quarter under review from 8 percent in previous quarter.

Figure 2.1: Daily Currency in Circulation (DAB Actual, Target, Seasonal Adjustmnet and PRGF Ceiling)



According to the Monetary Program data, which is shown in Table 2.1, Net Domestic Assets decreased by -1 percent in the third quarter 1386 from less than -20 percent in the previous quarter. This represents 5 percent deviation from monetary program. This is because of the other items net, which decreased by -13 percent in the quarter under review from 8 percent in the previous quarter

Net Foreign Assets increased by 6 percent in the third quarter of 1386 down from 11 percent in the previous quarter. It is driven by other foreign assets which grew by 29 percent down from 211 percent in the previous quarter.

According to the Monetary Survey data which is shown in Table 2.2, the supply of broad money (M2) expanded by 10,893 million AF in the quarter under review from 9591 million

AF in the previous quarter. This shows an increase of 10 percent in the third quarter from 10 percent in the second quarter 1386.

Table 2.1: Performance of Afghanistan Monetary Program (In million AF)

	1386 Q1 Actual	1386 Q2 Actual	Quarter Change (Q1 -Q2)	1386 Q3 Target	1386 Q3 Actual	Quarter Change (Q2- Q3)	Deviation From Target
1. Net Foreign Assets (a+b)	**103,586**	**115,342**	**11%**	**120,430**	**122,132**	**6%**	**1%**
(a) Foreign Assets (i+ii)	107,206	119,845	12%	125,032	125,832	5%	1%
i. Foreign exchange reserve	105,367	114,149	8%	118,035	118,424	4%	0%
ii. Other foreign assets	1,842	5,736	211%	6,997	7,408	29%	6%
(b) Foreign liabilities	-3,620	-4,503	24%	-4,601	-3,701	18%	20%
2. Net Domestic Assets (a+b)	**-45,430**	**-54,671**	**-20%**	**-58,078**	**-55,038**	**-1%**	**5%**
(a) Domestic Assets (i+ii)	-25,864	-33,608	30%	-35,179	-31,337	7%	11%
i. Net claims on general government	-25,864	-33,608	30%	-28,263	-31,337	7%	-11%
ii. Capital Notes and Other Claims	-	-	-	-	-	-	
(b) Other Items Net	-19,567	-21,064	8%	-22,899	-23,702	-13%	-4%
3. Reserve Money (a+b)	**58,156**	**60,671**	**4%**	**62,352**	**67,093**	**11%**	**8%**
(a) Currency in Circulation	51,094	53,021	4%	56,682	57,721	9%	2%
(b) Bank deposits with DAB	7,062	7,650	8%	5,670	9,372	23%	65%

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

Table 2.2: Monetary Aggregate (In million AF)

	1386 Q1 Amount	1386 Q2 Amount	Quarter Change (Q1-Q2)	Difference (Q1 - Q2)	1386 Q3 Amount	Quarter Change (Q2 - Q3)	Difference (Q2-Q3)
1- Narrow Money(M1)	**94,395**	**103,780**	**10%**	**9,385**	**114,139**	**10%**	**10,359**
Currency outside depository corporations	51,196	53,045	4%	1,850	57,220	8%	4,174
Demand Deposits	43,200	50,735	17%	7,535	56,920	12%	6,185
2- Quasi Money	**3,706**	**3,912**	**6%**	**206**	**4,445**	**14%**	**534**
In Afghani	956	993	4%	37	1,055	6%	62
In Foreign currency	2,750	2,919	6%	169	3,391	16%	471
3- Broad Money(M2)	**98,101**	**107,692**	**10%**	**9,591**	**118,585**	**10%**	**10,893**
Determinants							
1- Net Foreign Assets	**119,651**	**140,770**	**18%**	**21,119**	**150,368**	**7%**	**9,598**
(a) Foreign Assets	124,390	145,974	17%	21,584	155,047	6%	9,073
DAB Foreign exchange reserves	112,505	126,109	12%	13,604	131,916	5%	5,808
Other foreign assets	11,886	19,865	67%	7,980	23,131	16%	3,266
(b) Foreign Liabilities	4,739	5,204	10%	465	4,679	-10%	-525
2. Net Domestic Assets	**-21,550**	**-32,628**	**-51%**	**-11,078**	**-31,784**	**3%**	**844**
(a) Net Domestic Credit	1,302	-1,787	-237%	-3,089	1,051	-159%	2,839
Net Claim on General Government	-28,064	-36,671	-31%	-8,607	-36,651	0.1%	20
Claims on other Sectors	29,366	34,884	19%	5,518	37,702	8%	2,818
(b)Other Items Net	8,704	2,501	-71%	-6,203	812	-68%	-1,689
(c) Capital Accounts	31,556	33,342	6%	1,785	33,647	1%	305

Source: Monetary Survey Section, Monetary Policy Department DAB

The increase in broad money is largely due to developments in quasi-money which increased by 14 percent in the quarter under review from 6 percent in the previous quarter.

Narrow money (M1) grew by 10 percent in the quarter under review from 10 percent in the second quarter 1386. Currency outside depository corporations, which is another component of (M1) grew by 8 percent in the third quarter from 4 percent in the second quarter.

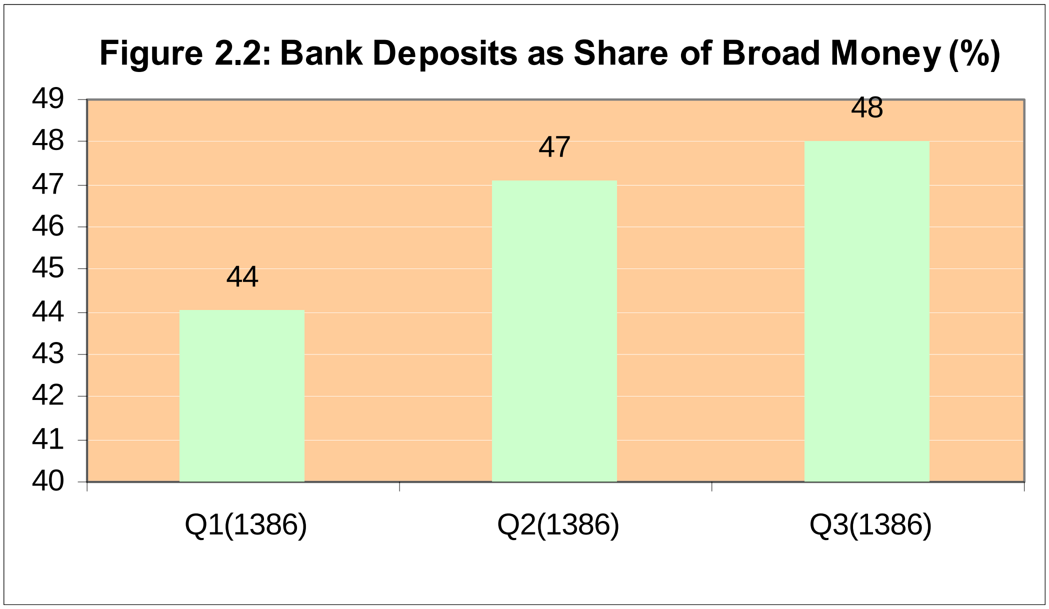
Quasi-money, which is another component of (M2,) grew by 14 percent in the third quarter 1386 up from 6 percent in the previous quarter.

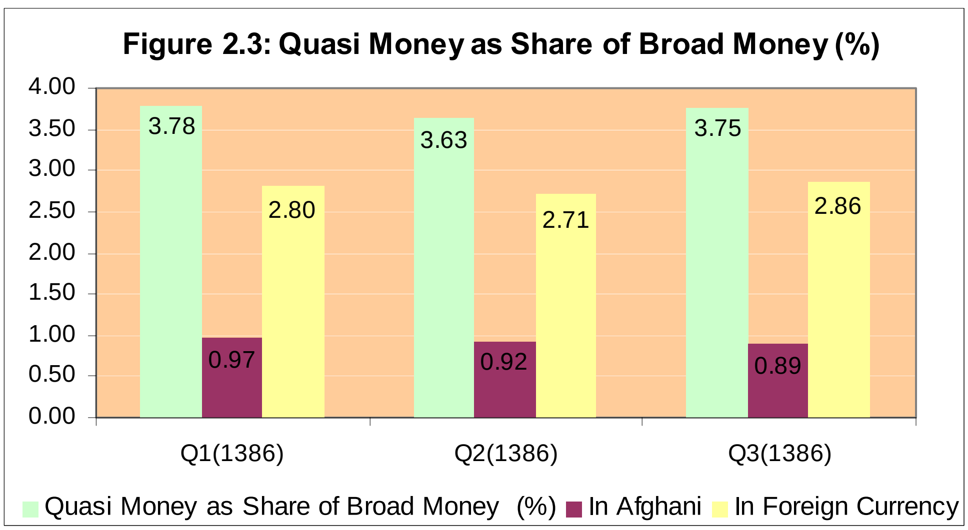
Net domestic assets, which is a determinant of monetary growth increased by 3 percent in the quarter under review up from -51 in the previous quarter which is a difference of 844 million AF. This is because of Net Domestic Credit which declined by -159 percent in the third quarter 1386 from -237 percent in the previous quarter. Net Claims on General Government, a key component of Net Domestic Assets is another reason for the increase in Net Domestic Assets. It grew by 0.1 percent in the third quarter from -31 percent in the previous quarter which shows a difference of 20 millions AF.

Claims on Other Sectors, which is another component of Net Domestic Assets, grew by 8 percent in the third quarter 1386 down from 19 percent in the previous quarter.

According to figure 2.2, Bank deposits as share of Broad Money increased by 48 percent in the third quarter 1386 from 47 percent in the previous quarter.

Quasi-money as share of Broad Money increased by 3.75 percent in the quarter under review up from the 3.63 percent in the previous quarter. This is due to increase in Foreign Currency which declined by 2.86 percent in the third quarter 1386 form 2.71 percent in the first quarter 1386.





2. Capital Markets and Liquidity Conditions

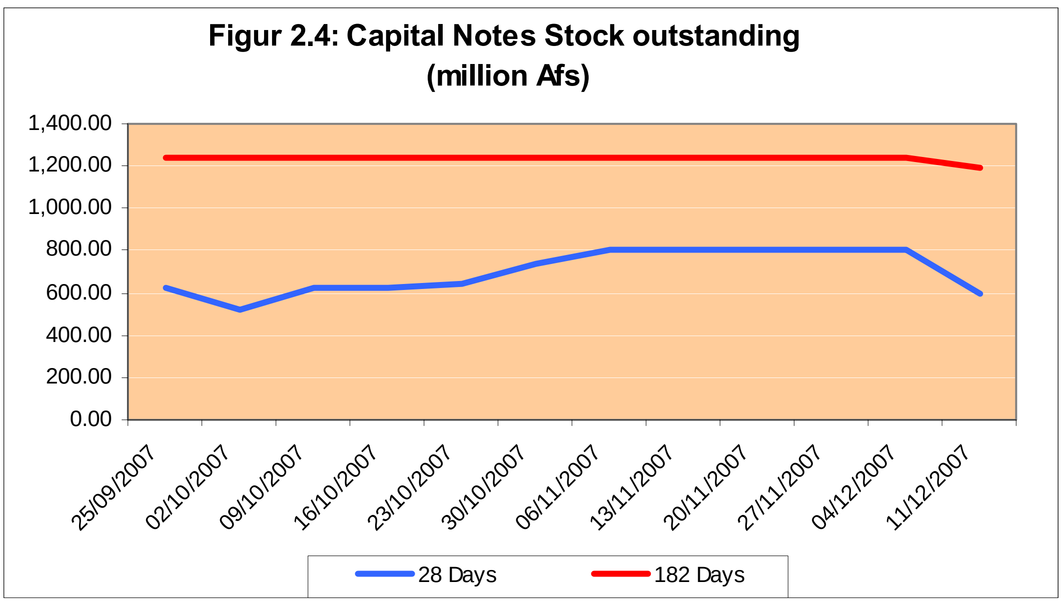
A. Capital Note Auctions

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). 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.

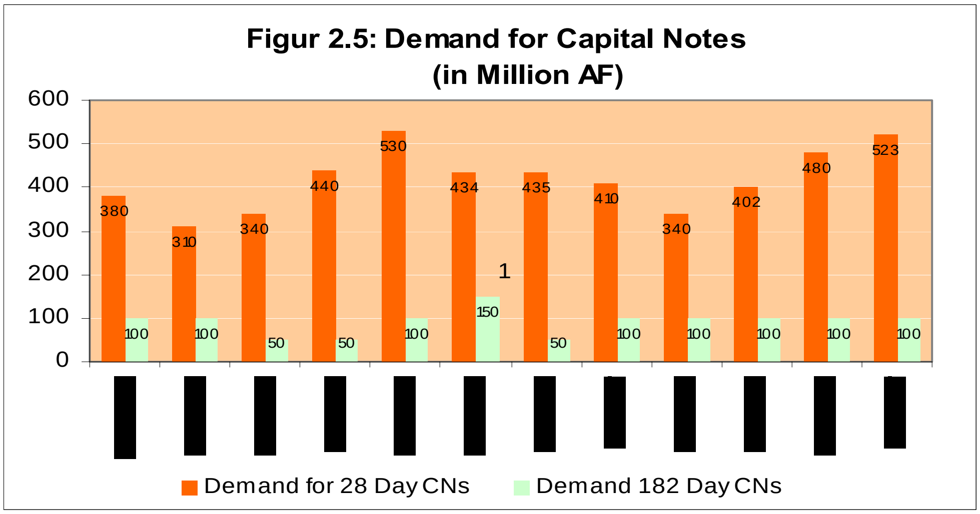
The 182 day maturity , with volume fixed at AF 50 million per auction, reached its maximum stock outstanding of AF 1,250 billion in the preceding quarter. There was no change in outstanding stock in the third quarter of 1386. On the other hand, the 28 day maturity, with volume of 200 million AF per auction, witnessed a gradual build up. It increased by AF 200 million to reach its maximum outstanding level of AF 800 million AF during this quarter.

(See Figure 2.4)



Source: Market Operations DAB.

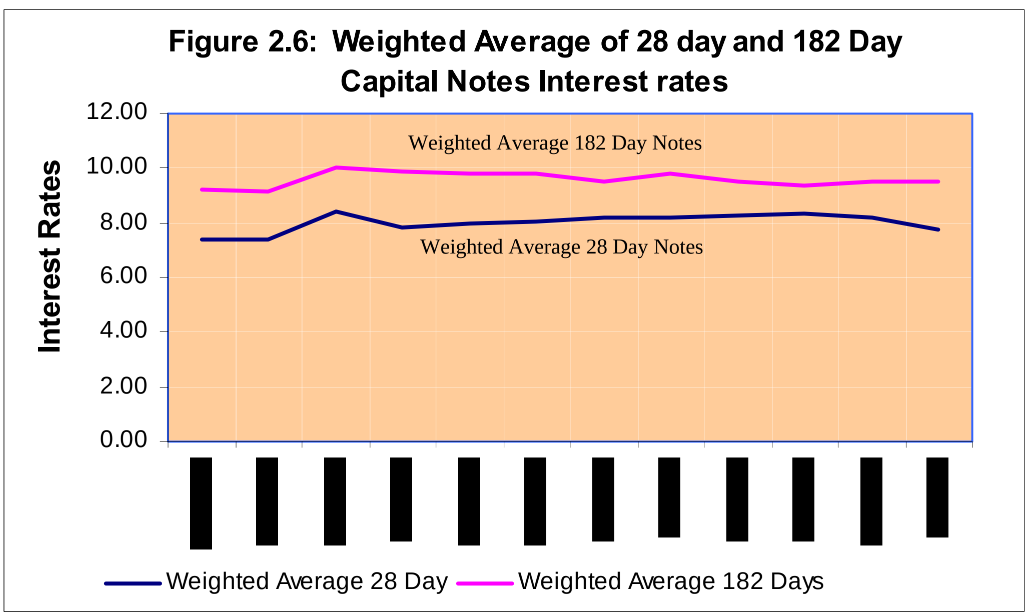
The high demand for CNs is reflected in the cover ratio, the ratio of amounts bid to amounts offered. The bid amount for 28 days notes was 419 million AF 28 day notes and 92 million AF for 182 day on an average basis, these figures were 387 million AF 28 day notes and 92 million AF 182 notes to maturity in the preceding quarter whereas these notes' were offered at amount 191 million AF, 50 million AF on an average basis respectively. The figures clearly illustrate that demand for both maturities remained high during the period (see figure 2.5 for CNs demand).



Source: Market Operations Department/ DAB

The average numbers of participants for 28 days notes were 5 and 2 for 182 days notes. (See table 2.3).

The weighted average interest rates ranged between 7.31 percent and 8.41 percent 28 day maturity and 9.18 percent to 10.00 percent auction increased from 8.50 percent to 9.00 percent 182 day notes. (See figure2.6).

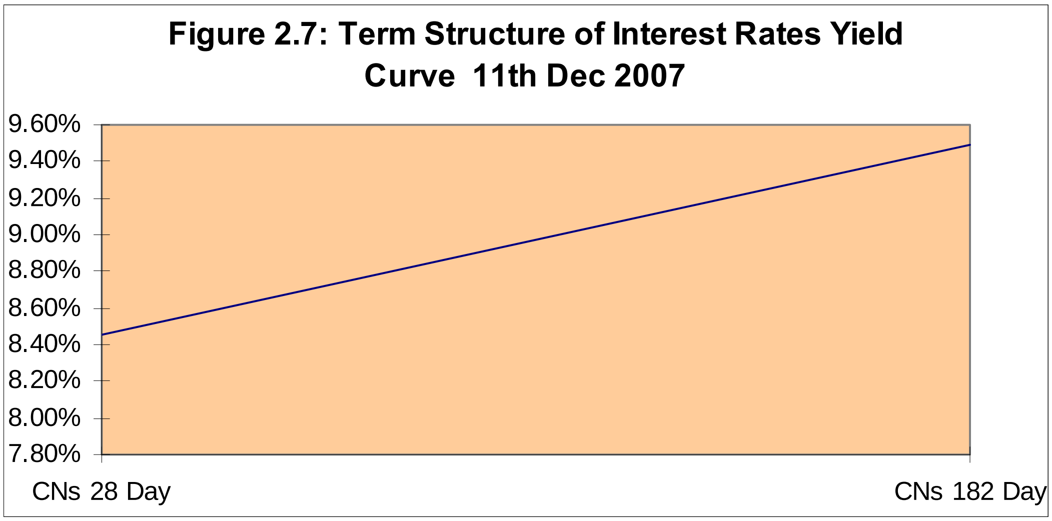


Source: Market Operations Department/DAB

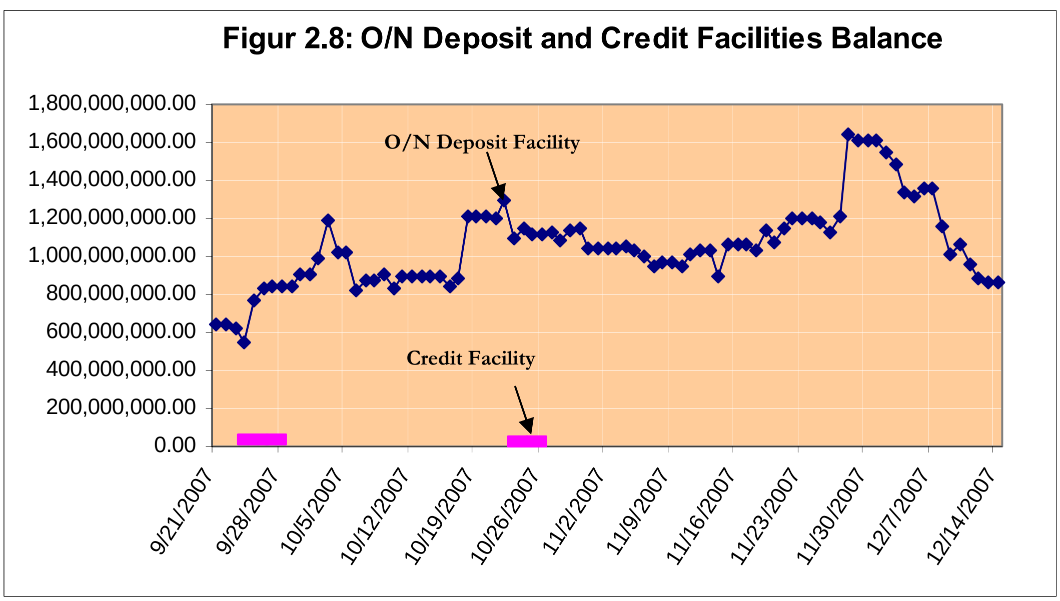
Term Structure of Interest Rates

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 11th Sep is positive and 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.

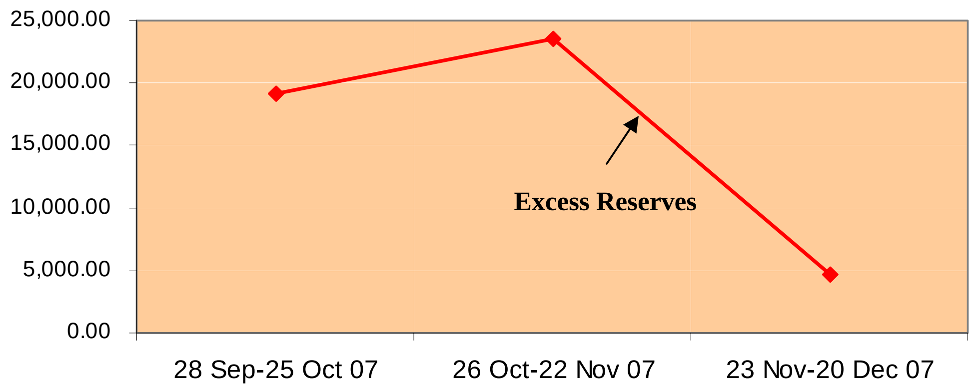
Overnight Standing Deposit Facility: This facility is available for all commercial banks to gain interest on excess balances and provides a floor for rates on capital notes, so it is not counted for Required Reserves. The interest rate on overnight deposit facility is now 1.5 percent below 28 auction cut off rate, based on a circular to all banks approved by DAB supreme counsel on 27th Feb 2007. Based on the commercial Banks demand for funds, the outstanding amount of deposit facility balances was subject to fluctuations, at one point in the first month of the quarter the amount was 547 million AF, but gradually increased to 1.6 billion AF during the last month of the quarter; the highest amount maintained during the quarter. The quarter ended with stock outstanding amount of 1.02 billions AF (see figure 2.8).

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. Two Banks used the credit facility during quarter amounting 30 million AF and 25 millions at 9.45 percent and 9.80 respectively (see figure 2.8).

During the quarter required reserves averaged 255,618910.00 AF per Bank, while excess reserves (including overnight deposits) averaged 119,554,851.40 AF per Bank. These figures were 245,851,320.00 AF and 77,851,320.00 AF respectively.

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.

Figure 2.9: Excess Reserves 28 Sep 07 - 20 Dec 07, Deposit Facility not included (Thousand AF)



Source: Market Operations Department/DAB.

Table 2.3: Auctions of 28 Day Capital Notes

Da Afghanistan Bank, Capital Notes 28 Days Auctions Report (million Afs)								
Date	Auction Amount	Amount awarded	Total Bid Amount	No. of Wining bids	Total No. of Bids	Cut off Rate	Low Bid	Weighted Average
25/09/2007	200	180	380	3	4	8.50	7.25	7.37
02/10/2007	200	100	310	3	4	8.49	7.24	7.40
09/10/2007	200	140	340	2	3	8.50	7.99	8.41
16/10/2007	200	200	440	4	6	8.25	7.35	7.86
23/10/2007	200	200	530	3	5	8.30	7.80	7.99
30/10/2007	200	200	434	4	5	8.30	7.90	8.08
06/11/2007	200	200	435	3	5	8.30	8.00	8.21
13/11/2007	200	200	410	4	5	8.40	7.99	8.17
20/11/2007	200	200	340	4	4	8.30	8.18	8.30
27/11/2007	200	200	402	3	4	8.50	8.25	8.32
04/12/2007	200	200	480	4	5	8.50	8.30	8.21
11/12/2007	200	200	523	4	6	8.45	8.25	7.73
	4,750	4,370						

Table 2.4: Auctions of 182 Day Capital Notes

Da Afghanistan Bank, Capital Notes 182 Days Auctions Report (million Afs)								
Date	Auction Amount	Amount awarded	Total Bid Amount	No. of Wining	Total No. of bids	Cut of Rate	Low Bid	Weighted Average
25/09/2007	50	50	100	1	2	9.19	9.19	9.19
02/10/2007	50	50	100	1	2	9.18	9.18	9.18
09/10/2007	50	50	50	1	1	10.00	10.00	10.00
16/10/2007	50	50	50	1	2	9.90	9.90	9.90
23/10/2007	50	50	100	1	2	9.80	9.80	9.80
30/10/2007	50	50	150	1	2	9.80	9.80	9.80
06/11/2007	50	50	50	1	1	9.50	9.50	9.50
13/11/2008	50	50	100	1	2	9.80	9.80	9.80
20/11/2007	50	50	100	1	2	9.50	9.50	9.50
27/11/2007	50	50	100	1	2	9.40	9.40	9.40
4/12/2007	50	50	100	1	1	9.50	9.50	9.50
11/12/2007	50	50	100	1	2	9.49	9.49	9.49
	600	600						

3

THE INFLATION TRENDS AND OUTLOOK

Summary

Headline inflation is currently experiencing its sharpest inflationary surge in years, despite successfully reigning to single digits between 2002 and 2007. Headline inflation followed an upward trend, from a high of 16 percent in March 2005 to a low of 4.8 percent in March 2007, before reversing course and closing at 12.1 percent at the end of second quarter (September 2007) of 1386. Headline inflation as measured by year-on-year percentage changes in Kabul CPI, continues its upward trend increasing to 17 percent at the end of the third quarter of 1386. Afghanistan is experiencing its sharpest inflationary surge in years, with price increases in the third quarter of 1386 coming in well above expectations.

The main drivers of inflation in the third quarter of 1386 were the prices of food and construction material. The food sub-index rose sharply by 25.6 percent at the end of the third quarter largely as result of developments in global commodity markets. Construction material prices rose by 17 percent at the end of the quarter under review largely because of acceleration of construction works on the project under construction due to arrival of winter.

Diesel and Petrol prices, the main components of fuel index, rose by 1.7 and 32.9 percent respectively at the end of quarter under review largely as a result of developments in international markets where crude oil price hit all time nominal highs.

Inflation experiences its sharpest surge.

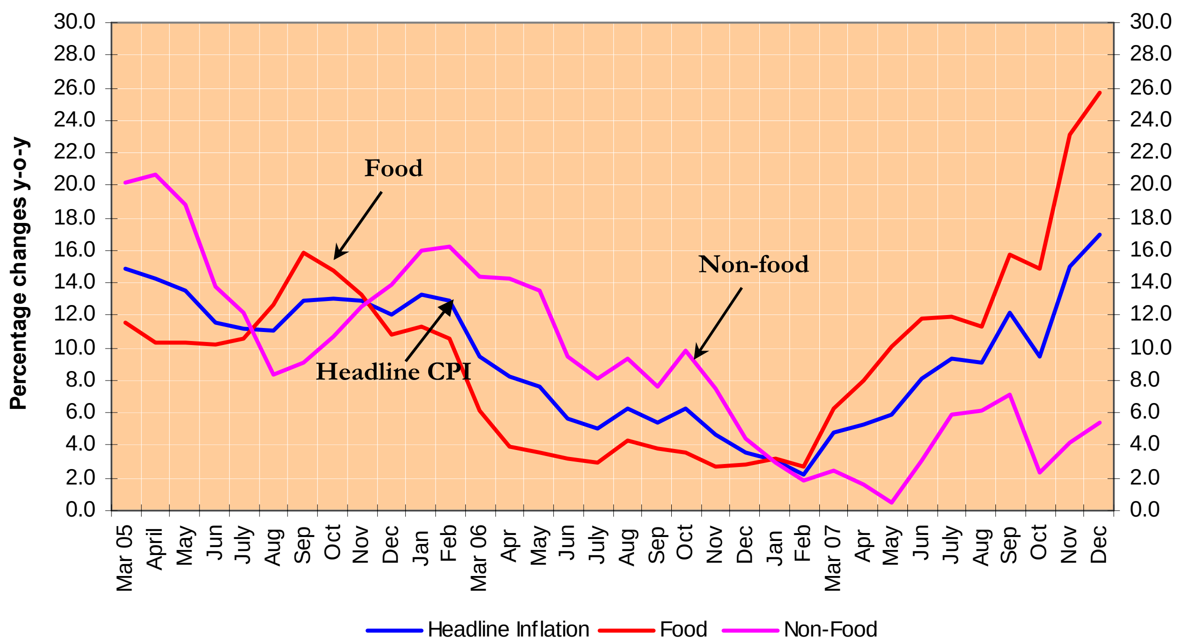
1. Annual Changes in Kabul Headline Inflation

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.

Headline inflation as measured by year-on-year percentage changes in Kabul CPI, displayed a "U Shaped" trend at the end of the third quarter of 1386. Looking at the overall index in Figure 3.1, we can see that the inflation began to increase since beginning of the first quarter of 1386 moving toward double digits.

Headline inflation, as measured by year-on-year percentage changes increased to 17 percent at the end of the third quarter of 1386 from 3.5 percent at the end of the same quarter a year ago. The breakdown of Kabul headline CPI inflation is presented in Table 3.1 and illustrated in Figure 3.2.

Figure 3.1: "U shaped" Trend in Kabul CPI Inflation



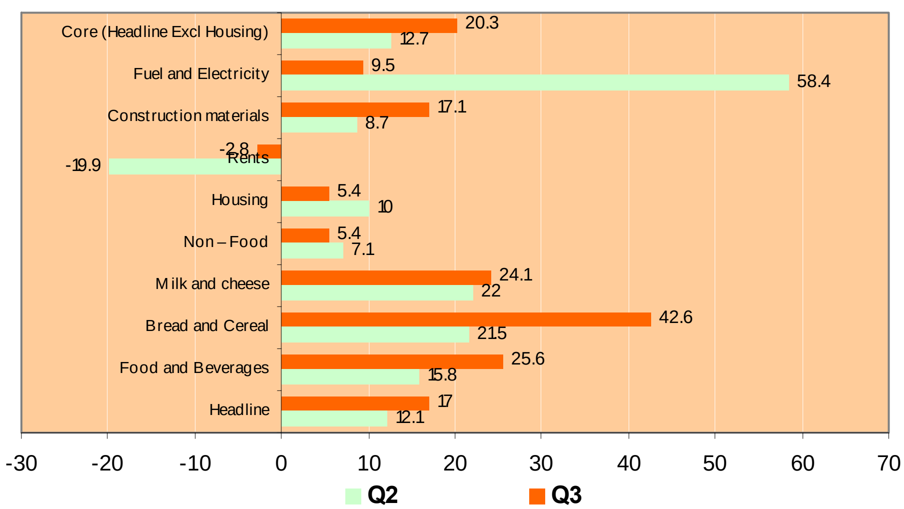
Source: Central Statistical Office and DAB staff calculations.

Table 3.1: 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	Q2	Q3*
Headline	**100**	**11.6**	**12.9**	**12.1**	**9.5**	**5.5**	**5.4**	**3.5**	**4.8**	**8.1**	**12.1**	**17**
Food and Beverages	**61.3**	**10.1**	**14.8**	**10**	**6.2**	**2.9**	**3.8**	**2.8**	**6.3**	**11.8**	**15.8**	**25.6**
Bread and Cereal	28	11.8	24	17.6	7	0.7	-0.2	-3.1	3.6	13	21.5	42.6
Milk and cheese	5.6	5.7	6.2	3.6		2.3	4.7	4.6	6.8	18.9	22	24.1
Non – Food	**38.7**	**13.5**	**9.1**	**13.5**	**14.4**	**9.4**	**7.6**	**4.4**	**2.5**	**3**	**7.1**	**5.4**
Housing	17.2	20.8	11	18.6	22.6	10.5	6.7	3.3	-1	1.3	10	5.4
Rents	7.1	34.2	13.3	21.8	24.9	8.6	1	-21.9	-27.1	-25.3	-19.9	-2.8
Construction materials	3.2	7.8	11.8	12.2	10.4	1.8	-5.4	-11.9	-11.3	-5.3	8.7	17.1
Fuel and Electricity	6.8	7.1	6.5	16.5	25.1	19.4	24.7	54.8	51.4	52.8	58.4	9.5
Core (Headline Excl Housing)		**9.5**	**13.4**	**10.3**	**6.2**	**4.2**	**5.1**	**3.6**	**6.4**	**9.9**	**12.7**	**20.3**

Source: Central Statistical Office and DAB staff calculations.
* The y-o-y changes at the end of quarter, September – September

Figure 3.2: Contribution to Kabul CPI inflation, end of second quarter - 1386



Source: Central Statistical Office and DAB staff calculations.

The increase of 17 percent in Kabul headline CPI at the end of the third quarter of 1386 from 3.5 percent at the end of the same quarter a year ago was largely due to the following factors:

The food sub-index accounts for 61.3 percent of the CPI basket. This sub-index rose sharply by 25.6 percent at the end of the third quarter of 1386, compared to 2.8 percent at the end of 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 form major importing countries such as China, Japan and Taiwan. In addition, recent political developments in Pakistan, which is the biggest exporter of food items, especially flour, cooking oil and rice to Afghanistan has also had a negative impact on food prices.

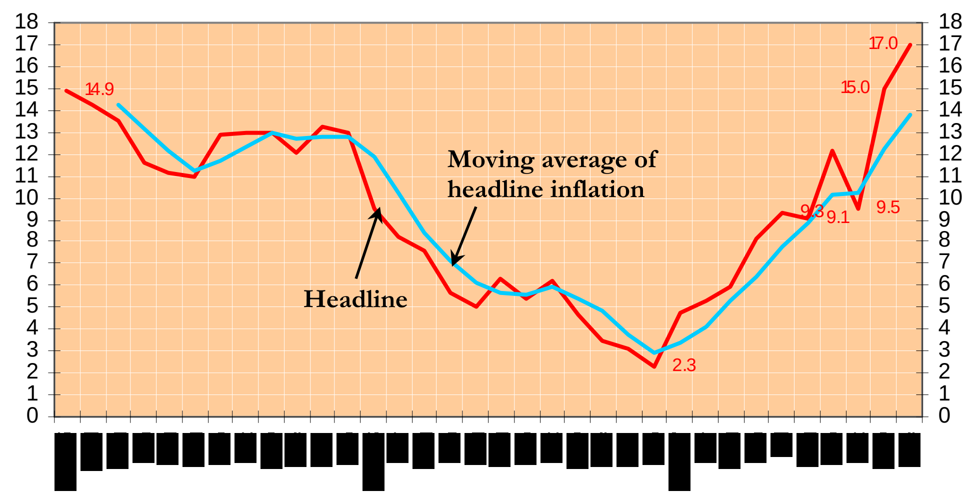
The fuel and electricity sub-index accounts for 6.8 percent of the CPI basket. This sub-index rose by 9.5 percent at the end of the third quarter of 1386 largely because of the recent developments in international crude oil prices contributed to increase in this sub-index.

The housing sub-index accounts for 17.2 percent of the CPI basket. This sub-index rose by 5.4 percent at the end of the quarter under review from 3.3 percent at the end of the same quarter a year ago. It is mainly because of the increase in the prices of the sub-indexes such as construction materials.

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

The rents sub-index accounts for 7.1 percent of the CPI basket. Overall rents have exhibited a declining trend in the recent year. This sub-index declined by 2.8 percent at the end of the third quarter of 1386, which is lower than the decline at the end of the same quarter a year ago of 21.9 percent. The decline in rents is mainly due to construction of new residential buildings and small towns in both outside and inside of Kabul. In addition the shelter reconstruction program carried out by UNHCR and other international agencies also contributed to decrease in this sub-index.

Figure 3.3: Headline inflation: Kabul CPI
(Annual percentage changes)

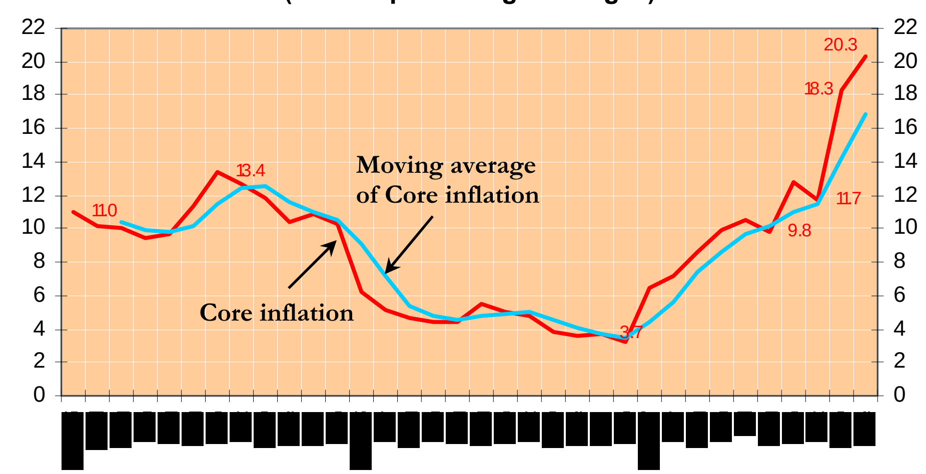


Source: Central Statistical Office and DAB staff calculations.

The volatility of Kabul inflation as measured by the standard deviation was 3.3 percent at the end of the third quarter of 1386, up from 1.1 percent at the end of the same quarter a year ago. 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.

In Table 3.1 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 20.3 percent at the end of the third quarter of 1386 up from 3.6 percent at the end of the same quarter a year ago. (See Figure 3.4)

Figure 3.4: Core inflation: Kabul CPI
(Annual percentage changes)



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 20.5 percent at the end of the third quarter of 1386 from 3.4 percent at the end of the same quarter a year ago. The breakdown of national CPI into its respective components is presented in Table 3.2 and illustrated in Figure 3.5.

The increase in the national CPI to 20.5 percent at the end of the third quarter of 1386 from 3.4 percent at the end of the same quarter a year ago was mainly because of the following factors:

The bread and Cereals sub-index accounts for 28 percent of the CPI basket. This price index rose sharply by 41.8 percent at the end of quarter under review from -1.1 percent at the end of the same quarter a year ago. The reasons behind this increase could be the decrease in worldwide food productions especially wheat and other grains, which pushed up the demand for major importing countries. In addition, recent political developments in Pakistan, which is one of the main wheat and other grain exporting countries to Afghanistan, also caused a shortage in supply of these items, especially flour.

The housing sub-index accounts for 17.2 percent of the CPI basket. This sub-index rose by 12.1 percent at the end of the third quarter of 1386 from 1.5 percent at the end of the same quarter a year ago. The reasons could be increase in demand for construction materials to accelerate construction activities due to arrival of winter, during which the construction trends go significantly down.

The rents sub-index accounts for 7.1 percent of the CPI basket. This sub-index rose by 4.7 percent at the end of third quarter of 1386 from -14.7 percent at the end of the same quarter a year ago.

On the other hand some categories of the national CPI posted decline:

The fuel and electricity sub-index accounts for 6.8 percent of the CPI basket. This sub-index shows slightly decline by 18.6 percent at the end of the quarter under review from 26.1 percent at the end of the same quarter a year ago.

Table 3.2: Breakdown of National Headline CPI

(percent changes year on year)

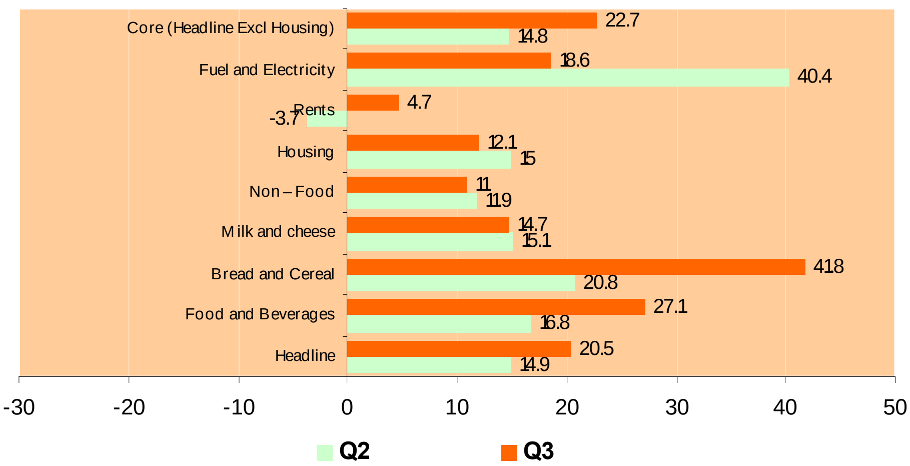
Consumer Price Index, (March 2004 = 100)

	Weight	1384				1385				1386		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3*
Headline	100	11	11.8	11.9	9.8	5.7	5.3	3.4	3.8	9.6	14.9	20.5
Food and Beverages	61.3	10.6	14.4	12	9.1	4.1	4.1	3.5	4.9	13	16.8	27.1
Bread and Cereal	28	16.4	23	18.5	10.8	2.3	1.2	-1.1	3	16.2	20.8	41.8
Milk and cheese	5.6	3.6	7.1	8.6	9.5	7.9	6.6	7.1	6.6	10.9	15.1	14.7
Non – Food	38.7	11.8	8	11.7	10.9	8	7	3.6	2.2	4.4	11.9	11
Housing	17.2	21.5	13.3	17.1	16.4	8.9	5.1	1.5	-1.5	3.7	15	12.1
Rents	7.1	37.2	21.6	17.5	14.9	3.3	-4.2	-14.7	-20	-12.8	-3.7	4.7
Fuel and Electricity	6.8	11.4	5.5	20.3	22.7	17.9	21.8	26.1	25.3	28.6	40.4	18.6
Core (Headline Excl Housing)		8.8	11.4	10.6	8.2	4.9	5.3	4.1	5.2	11	14.8	22.7

Source: Central Statistical Office and DAB staff calculations.

* The figures reported in the Q columns are y-o-y changes at the end of that quarter.

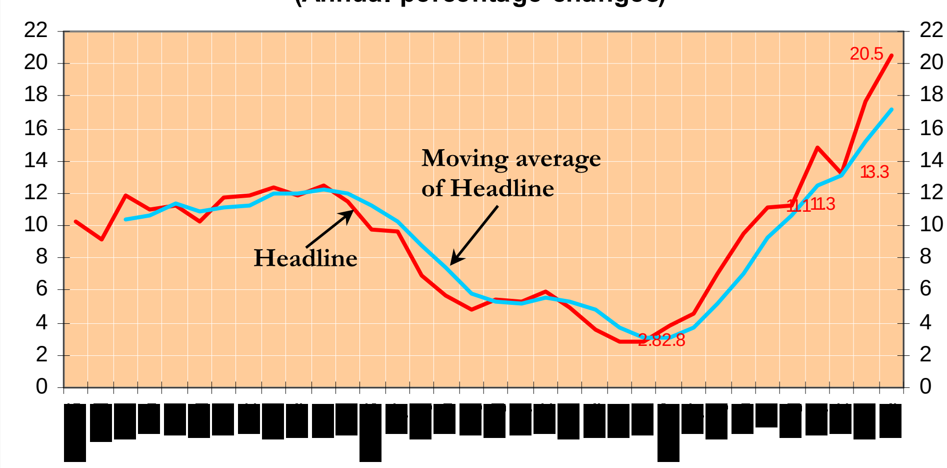
Figure 3.5: Contribution to national CPI inflation, end of Third Quarter-1386



Source: Central Statistical Office and DAB staff calculations.

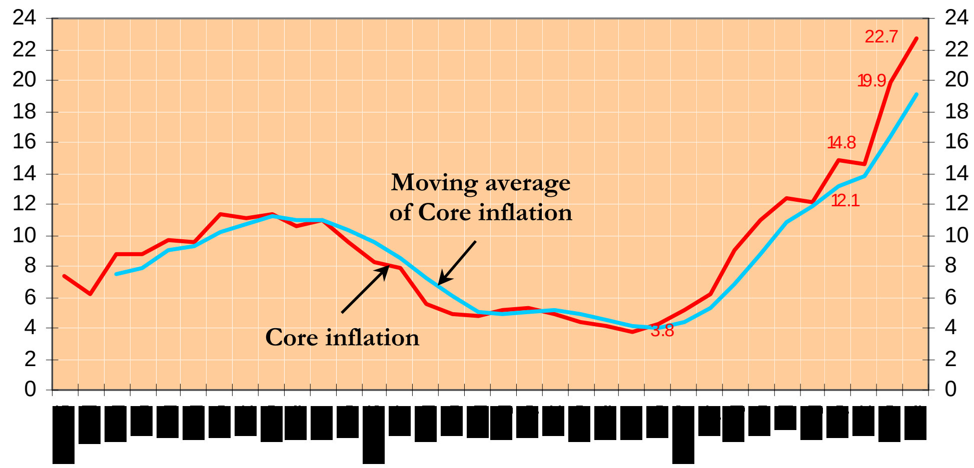
The volatility of inflation for national CPI as measured by the standard deviation at the end of the third quarter was 3.2 percent, up from 0.3 percent at the end of the same quarter last year. The volatility of inflation remains a concern for monetary policy, because volatile prices distort market signals making it difficult for business and private individuals to plan appropriately.

Figure 3.6: Headline inflation: National CPI
(Annual percentage changes)



Source: Central Statistical Office and DAB staff calculations.

Figure 3.7: 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.

Overall Kabul CPI remained almost the same in the third quarter of 1386. Headline CPI shows slightly decrease by 5.9 percent in the third quarter of 1386 from 6 percent in the second quarter.

The food and beverages sub-index accounts for 61.3 percent of the CPI basket. This sub-index rose by 9.4 percent in the quarter under review from 5.3 percent in the second quarter of 1386 with a contribution of 17 percent by Bread and Cereal and 5.1 percent by meat. The increase in meat sub-index at the end of quarter under review is mainly due to Eid-ul-Adha during which the demand for live stocks goes up.

The non-food sub-index accounts for 38.7 percent of the CPI basket. This sub-index as a whole shows a decrease by 0.8 percent at the end of the third quarter of 1386 from 7.1 percent at the end of the second quarter with contribution of housing, rents and fuel and electricity sub-indexes by 0.6 percent, -0.9 percent and 1.7 percent respectively.

Table 3.3 presents price indicators for quarter-on-quarter changes in Kabul CPI.

Table 3.3: 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	Q2	Q3
Headline	**2.87**	**2.45**	**3.38**	**0.5**	**-0.87**	**2.33**	**1.57**	**1.7**	**2.4**	**6**	**5.9**
Food and Beverages	**2.5**	**0.96**	**1.82**	**0.77**	**-0.68**	**1.87**	**0.83**	**4.2**	**4.7**	**5.3**	**9.4**
Bread and Cereal	2.9	1.6	2.7	-0.4	-3.1	0.7	-0.3	6.4	5.7	8.2	17
Milk and Cheese	-1.3	2.1	1.2	0.4	-1.3	4.5	1.1	2.5	9.8	7.2	2.9
Meat	6.2	-0.6	0.9	2.5	0.5	2.6	-0.3	1.5	-2.6	-4.6	5.1
Non – Food	**3.24**	**4.75**	**5.7**	**0.07**	**-1.24**	**3.02**	**2.5**	**-1.7**	**-0.7**	**7.1**	**0.8**
Housing	5.23	6.46	8.47	0.86	-5.12	2.76	5.1	-3.3	-2.9	11.5	0.6
Rents	8.1	6.43	5.65	2.67	-5.9	-1	-18	-4.1	-3.6	6.1	-0.9
Fuel and Electricity	-0.4	7.5	18.58	-1.5	-4.87	12.25	47.19	-3.7	-4	16.4	1.7

Source: Central Statistical Office and DAB staff calculations.

4. Quarterly Changes in national Headline CPI

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

The national headline CPI decreased slightly by 7 percent in the third quarter of 1386 from 7.2 percent in the second quarter of 1386. The slightly decrease in quarter-on-quarter inflation is mainly contributed by the non-food sub-index, while food prices are witnessed of an increase in the quarter under review. The major categories of the decrease in q-o-q changes in the quarter under review are traced as follow:

The food sub-index accounts for 61.3 percent of the CPI basket. This price index rose by 10 percent in the quarter under review from 5.8 percent in the previous quarter with the contribution of bread and cereals increasing by 16.7 percent and meat sub-indexes increasing by 4.7 percent respectively.

The non-food sub-index accounts for 38.7 of the CPI basket. This sub-index decreased by 2.3 percent in the quarter under review from 9.5 percent in the previous quarter with the housing sub-index decreasing by 2.5 percent, rents decreasing by 0.6 percent and fuel and electricity decreasing by 5 percent respectively. Table 3.4 presents price indicators for quarter-on-quarter changes in national CPI.

Table 3.4: 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**	**Q2**	**Q3**
Headline	**2.18**	**2.66**	**3.54**	**1.09**	**-1.7**	**2.27**	**1.89**	**1.3**	**3.8**	**7.2**	**7**
Food and Beverages	**2.85**	**2.32**	**1.66**	**1.97**	**-1.9**	**2.32**	**1.09**	**3.3**	**5.8**	**5.8**	**10**
Bread and Cereal	4	4.1	1.6	0.8	-4	2.9	-0.7	4.9	8.3	6.9	16.7
Milk and Cheese	1.3	2.8	3.4	1.6	-0.2	1.6	4	1.6	3.9	5.4	3.6
Meat	-2.9	1.1	1.7	3.7	-2.2	1.6	2.2	1.1	-1.9	0.2	4.7
Non – Food	**1.24**	**3.16**	**6.47**	**-0.24**	**-1.4**	**2.2**	**3.1**	**-1.5**	0.6	**9.5**	**2.3**
Housing	1.69	5.54	8.85	-0.34	-4.84	1.82	5.14	-3.3	0.2	13	2.5
Rents	4.07	6.21	3.92	-0.06	-6.33	-1.55	-7.43	-6.3	2.1	8.7	0.6
Fuel and Electricity	-1.7	5.09	20	-0.99	-5.53	8.54	24.2	-1.6	-3.1	18.6	5

Source: Central Statistical Office and DAB staff calculations.

The Dynamics of Inflation

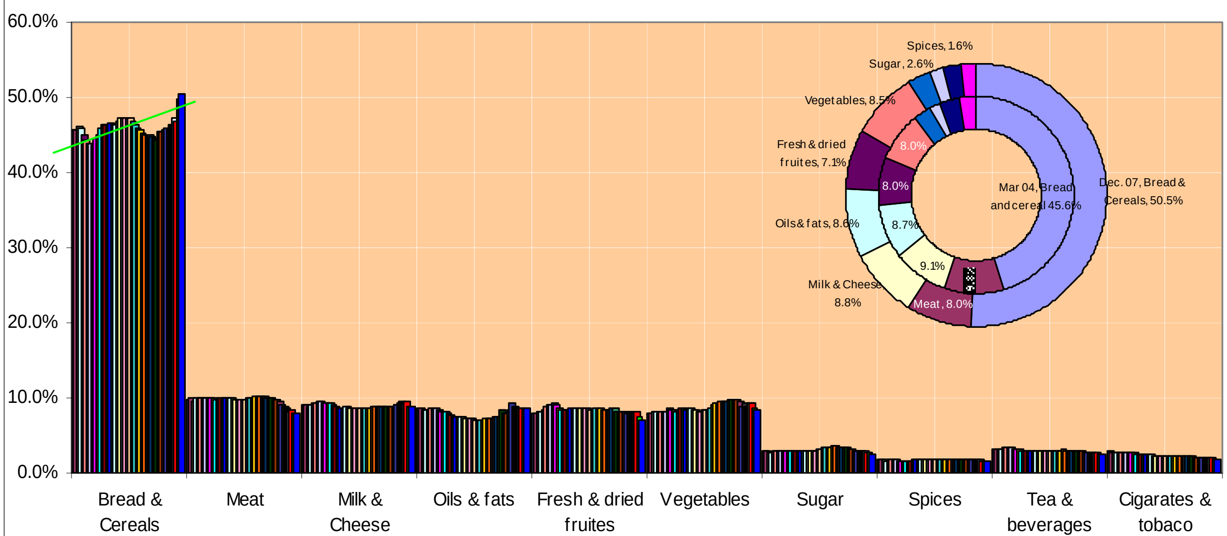
This section takes a closer look at trends in inflation by relaxing the assumption of fixed weights in the CPI basket. To understand better the dynamics of CPI it is useful to look beyond nominal Laspyere-based fixed weighting in which food has an overall weight in the index of about 61 percent and non-food 39 percent and analyze trends in the effective weights. These are based on the relative share of point's contribution of 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 following a decrease occurred in effective weight of food between March 2004 and October 07; the effective weight began to increase again from Nov 07, and has reached to 61.5 percent in Dec. 07. 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 3.8.

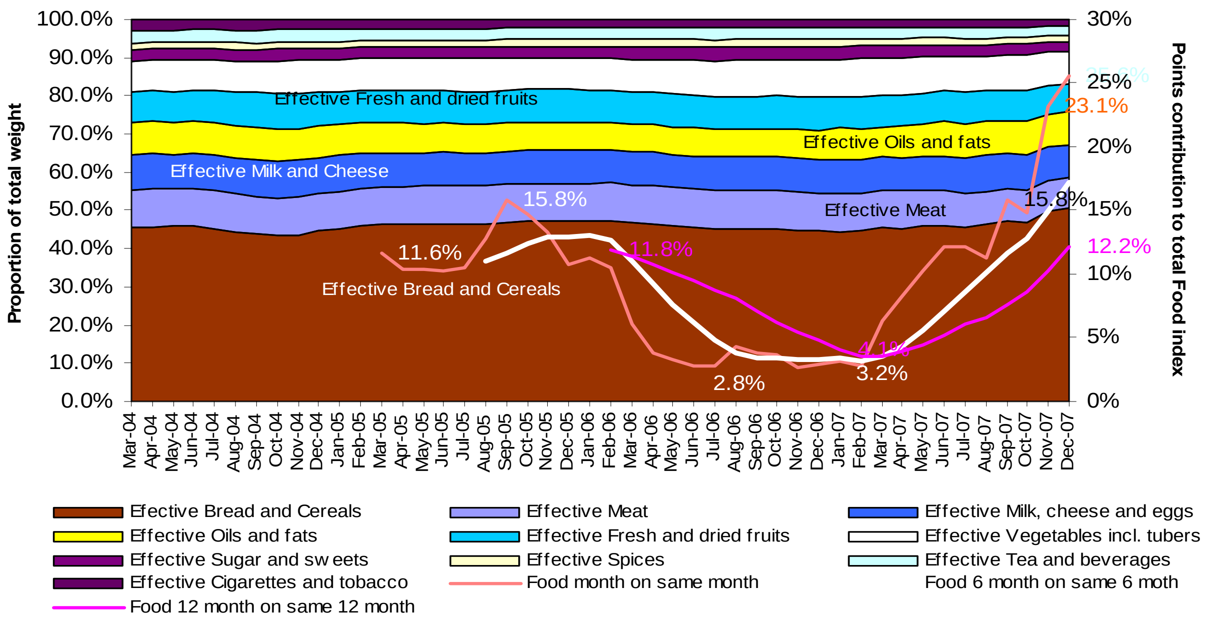
Figure 3.8: Effective weighting within the Kabul Food Price Index
(Mar-04 to Dec - 07)



Source: Central Statistical Office and DAB staff calculations.

The relative effective weight for food sub-items is shown in Figure 3.8. As can be seen from the figure, the effective weight for bread and cereals has increased to 50.3 percent, shown by the increased area shaded red in Figure 3.9 below.

Figure 3.9 : Analysis of change - Food index by sub-items



Source: Central Statistical Office and DAB staff calculations.

Inflation Outlook

Afghanistan is suffering from imported inflation caused by higher global commodity prices, domestic-demand inflation caused by excess demand driven by the opium trade. Going forward, inflation is expected to decline in the coming winter months as the effect of the one-off jumps in food costs diminishes. The food inflationary pressure should slow next year (1387) assuming good winter rains. However, the overall inflationary outcome will depend on the extent and duration of high oil prices.

Risks to Inflation Remain

Foreseeable risks to future inflation remain. These risks include further increase in oil and grain prices and prolonged liquidity surge given expectations of steady foreign exchange inflows from remittances, the illegal opium trade and donor funds.

Additional risks include the secondary effects of inflation on asset prices. Inflation will depress real returns to saving, bringing real (inflation-adjusted) deposit rates to negative levels. Negative real interest rates would lead to record high loan growth. A negative interest rates scenario favours barrowers, and risks fuelling asset inflation and sparking a housing property boom.

BOX 1: Wheat prices surge increases inflation fears

A fall in US inventories of wheat to a 60-year low drove prices of the grain sharply higher to a fresh record, intensifying fears of rising global food price inflation.

US wheat futures-global benchmarks for the grain have jumped by their daily trading limit each day. Prices for Minneapolis wheat, the US variety most suitable for making flour, rose by 10.7 percent, extending its price surge since the beginning of the year to 50 percent.

"The market is desperately trying to tell the global producers that we need more acres for wheat production."

The price gains came after the latest update from the US Department of Agriculture fuelled concerns over low inventory levels. The USDA reduced its estimates for wheat stocks at the end of the 2007/08 marketing year to 272m bushels, compared with its January estimate of 292m bushels.

"The US has sold too much wheat and will have a major impact on the rest of the world if consuming countries can't buy US wheat and Europe becomes the global supplier."

Global stocks of wheat are expected to fall to a 30-year low as consuming countries have scrambled to ensure they have enough supplies for domestic consumption.

"The question for the market is how these high prices will influence US farmers' decisions to allocate land to crops this year."

Record wheat and soya bean prices mean these crops are expected to win land at the expense of corn cultivation in 2008. The USDA will update the market on farmers' planting intentions in March.

Analysts say India and China should allow domestic wheat prices to rise to attract land away from cotton. India says it expects to produce 74.81m tones of wheat in 2008, down from 75.81m tones last year.

India, the world's second largest wheat consumer, has imported wheat for the past two years, but it says it might not need to import this year if favorable weather boosted production.

But Mark Samson from US Wheat Associates, the wheat marketing group, said India might have to buy 3m tones of wheat in the year starting in April, a 68 percent rise on the previous year.

As a result of price pressure, the Minneapolis Grain Exchange will remove the daily price limit on the spot-month hard red spring wheat contract for trading on February 25, the first time it has done so.

4

BANKING SYSTEM PERFORMANCE

Summary

Total assets of the banking system rose to AF 74 billion (USD 1.5 billion) at the end of third quarter 1386, up by 64 percent or AFN 29 billion from third quarter of last year, and 37 percent since the beginning of solar year 1386. Loans amounted to AF 35 billion (USD 693 million) an increase of AF 18 billion (USD 349 million) or 106 percent since December 2006. Deposits stood at AF 58 billion (USD 1.2 million) over the period under review; a 77 percent increase since December 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 10 billion (USD 205 million). Banking sector overall was profitable earning a year-to-date net profit of AF 674 million (USD 13.5 million) over first nine months of 1386, for an overall return on assets (ROA) of 1.42 percent which was higher than previous year same period's – 0.86 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 Q3-1386 was AF 74 billion (USD 1.5 billion), up by 64 percent or AF 29 billion (USD 578 million) from December 2006, Figures 6.1 and 6.2.

The major components of this increase were increases in loans (up AF 18 billion) and cash in vault/claims on DAB (up AF 5 billion). Moreover, the remaining part is made up of other asset categories such as claims on financial institutions, other assets and Net Due From (NDF).

The most important components of the banking system's total asset portfolio are loans

(47 percent), claims on financial institutions (19 percent), cash in vault/claims on DAB (18 percent), and Net Due From (9 percent). Other components of total assets are negligible. The rapid increase in the relative importance of loans can be traced to immediate deployment of attracted funds into new loans (72 percent), while the remaining part was mainly retained in the form of liquid assets.

Figure 4.1: Banking System's Growth Rate
Growth Rate = 64 percent or AF 29 billion

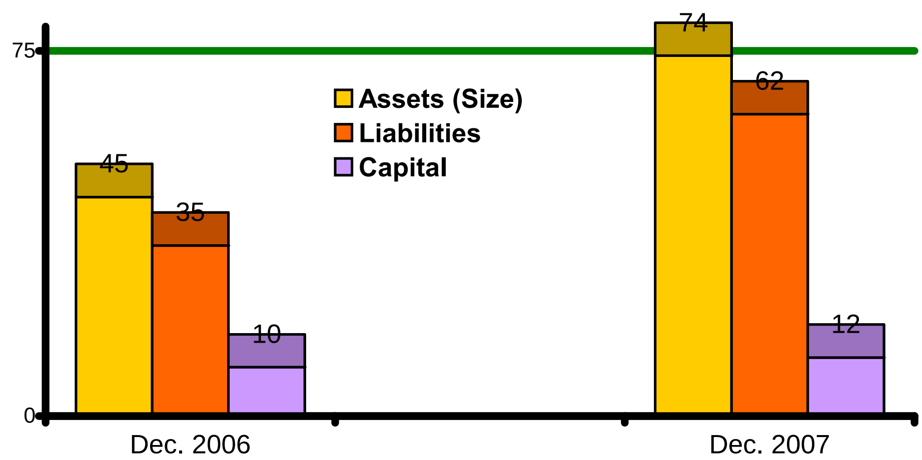
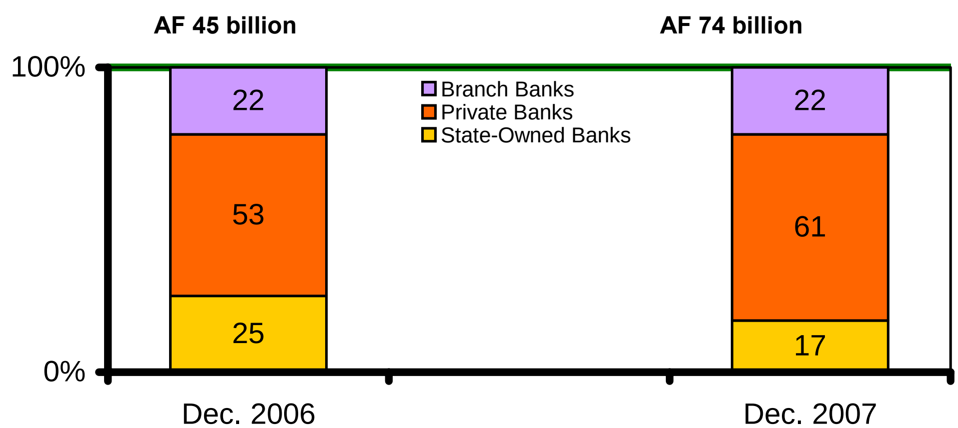


Figure 4.2: Size of Banking Sector (Total assets)
Increased by 64 percent or AF 29 billion



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 14 billion – a 27 percent increase since December 2006 total – 19 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 4.3: Major Asset Categories

(As percentage of Total Assets)

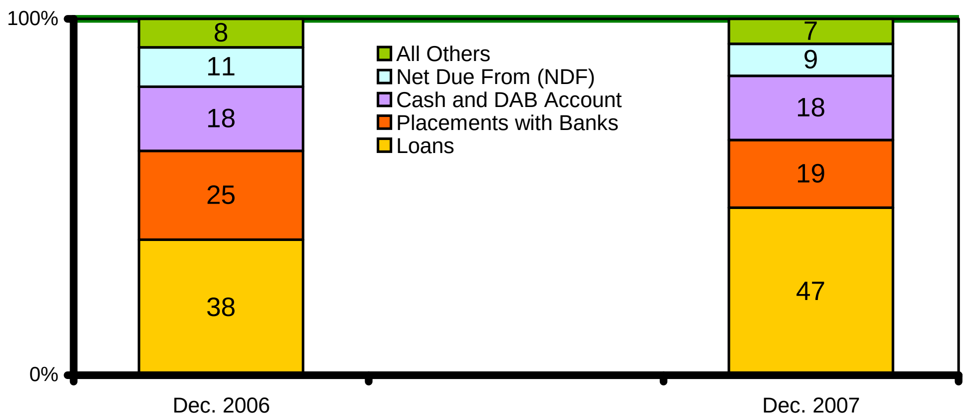
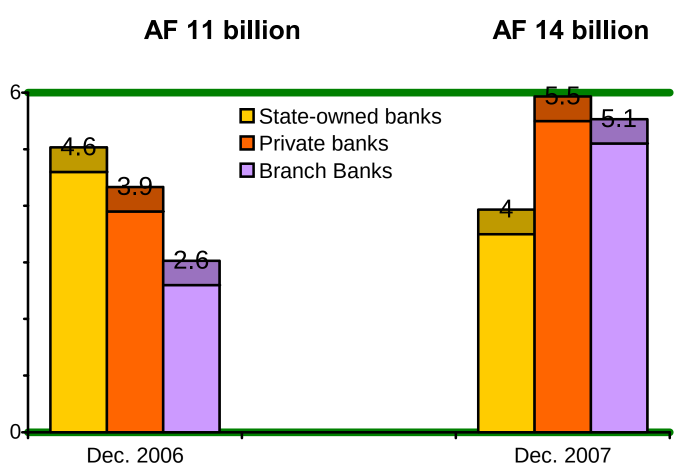


Figure 4.4: Claims on Financial Institutions



Private Banks are the leading creditors, increasing their portfolio both in absolute terms as well as percentage of total loans, currently at AF 28 billion or 83 percent of total loans. Changes in State-owned banks and branches of foreign banks' share and amount were insignificant.

Net Loans

The loan portfolio continues to grow, totaling AF 35 billion (USD 693 million) as of December 31, 2007 – a 106 percent increase since December 2006 – or 47 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 as percentage of gross loans remained unchanged at around 1 percent. Increases in lending were observed at all but two of the banking organizations; however more than two-third of the growth is still attributable to private bank's group; and more than half to one banking institution.

By far, the major component of loan portfolio is "other commercial loans (81 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 4.5: Loans Portfolio Increased 106 percent or AFN 18 billion

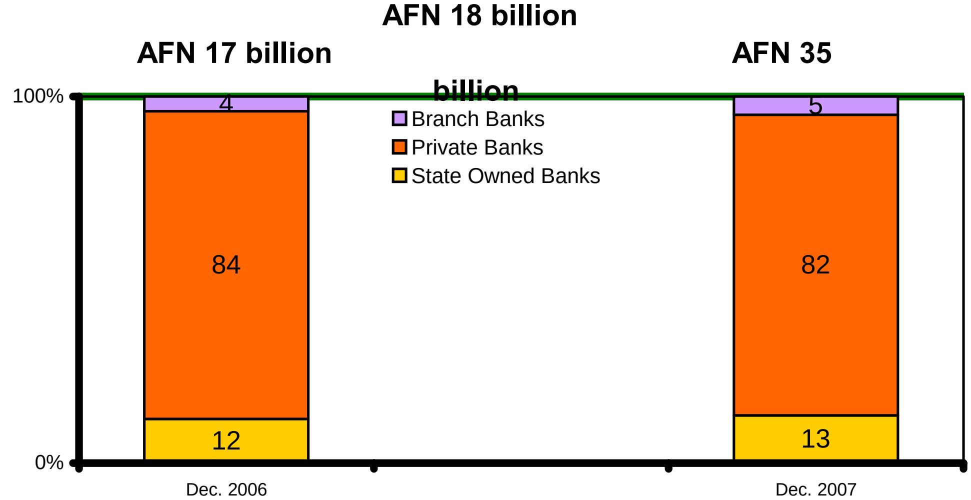
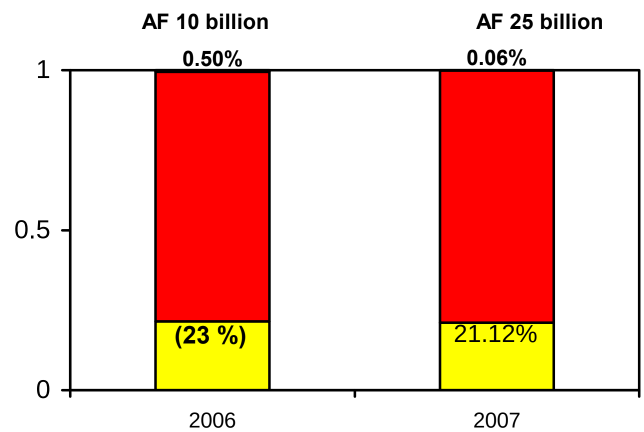


Figure 4.6: Currency Composition of Loans



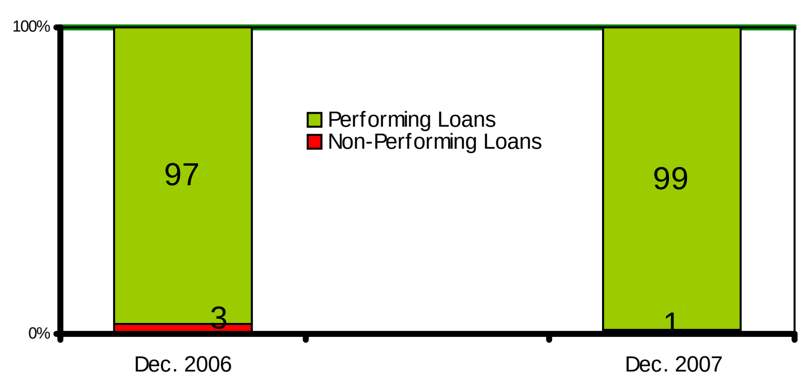
Non-performing loans

The system's non-performing loans increased over the year, jumping to AF 410 million or 1.15 percent of gross loans; lower than December 2006 figure of 2.95 percent. This is an improving sign over the year and the sector's loan administration function is still strong, limiting the NPLs percentage at the lowest possible level.

Adversely-classified loans

Adversely-classified loans increased to AF 695 billion from AF 573 million at the end December 2006. However, their share percentage in total loans decreased by 1 percentage point and stands at 2 percent. Loans under "doubtful" category decreased while "Watch" loans 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 4.7: Quality of Loan Portfolio

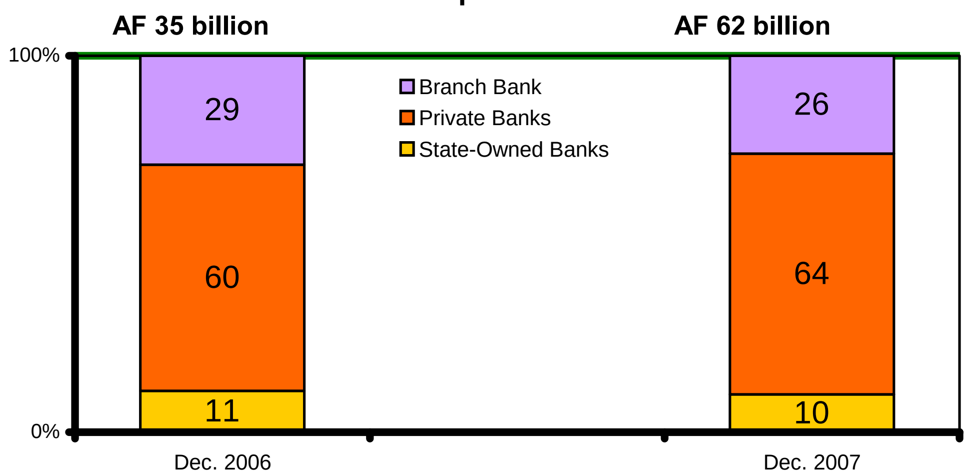


Adversely-classified loans are greater than non-performing loans, which is what one would expect given the definitions of these two indicators of problem assets.

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.

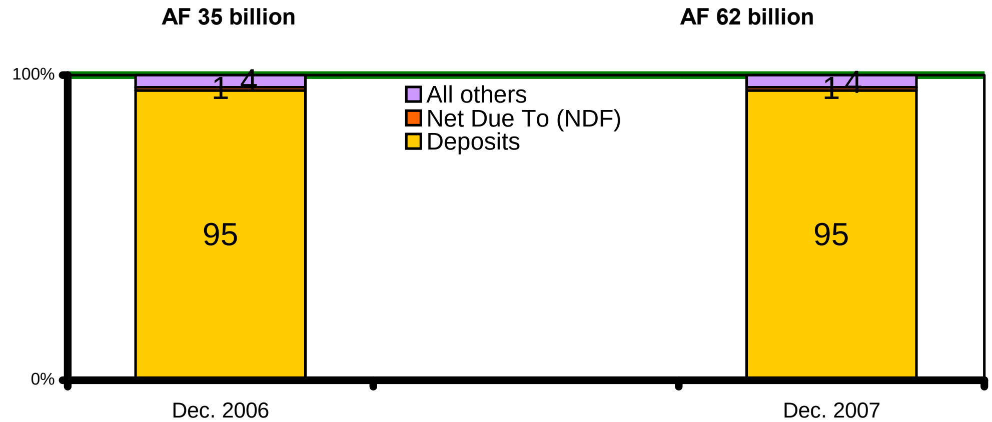
Figure 4.8: Liabilities Increased by AF 27 billion or 77 percent



2. Liabilities

Total liabilities of the banking sector were AF 62 billion, up by 77 percent from December 2006. This is an indication of growing public confidence and good public relations and marketing policies of the banking sector.

Figure 4.9: 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.

Deposits

Deposits are the major component of liabilities, currently equal to AF 58 billion, a 77 percent or AFN 25.5 billion increases since December 2006. Private Banks attracted AF 18 billion more deposits, 70 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 has lost some ground in favor of private banks.

Figure 4.10: Deposits Increased by AF 26 billion or 77 percent

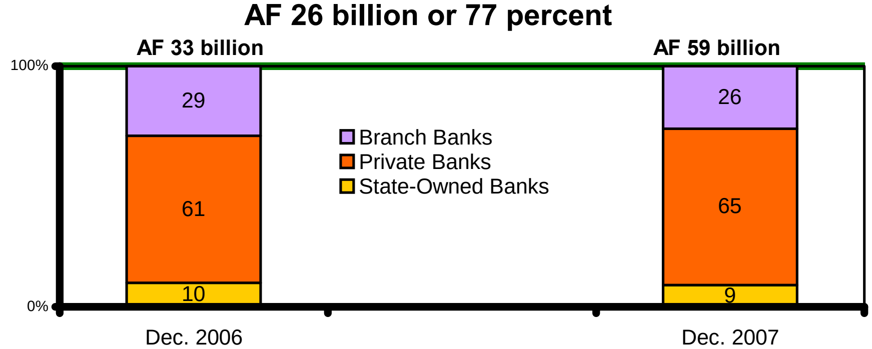
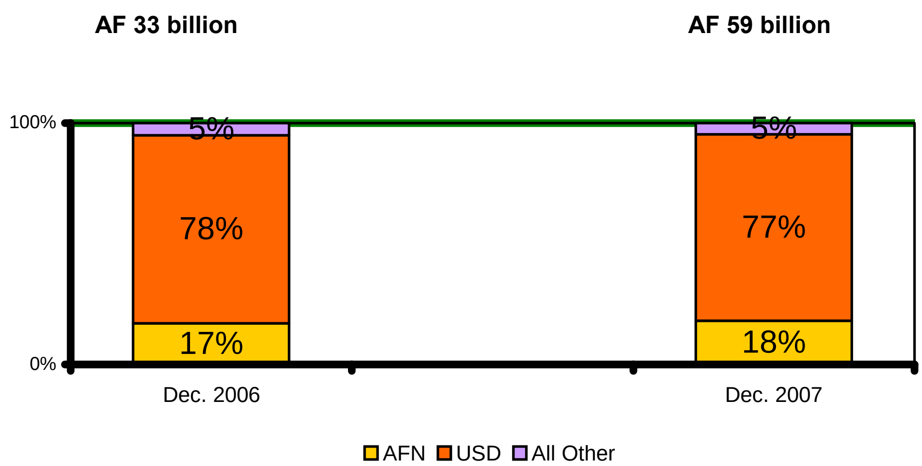
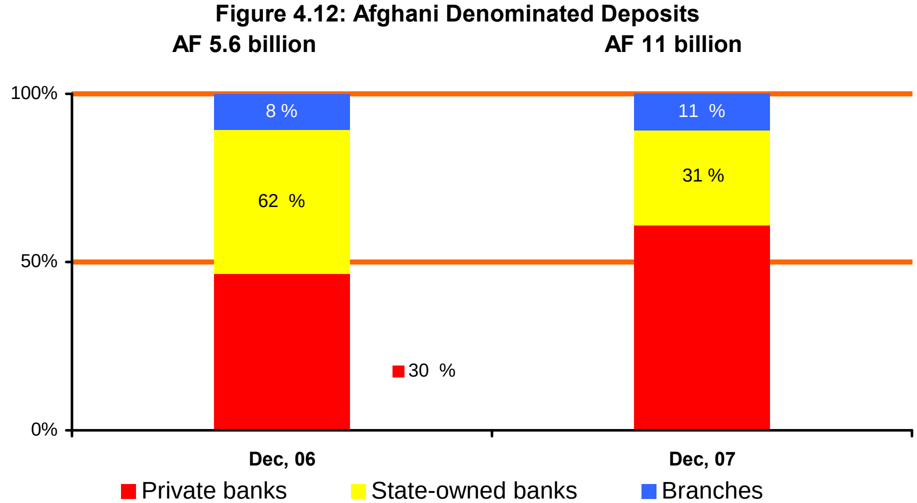


Figure 4.11: Currency Composition of Deposits



Other liabilities except Interest Payable remain the second major component of liabilities, up by 50 percent, or 2.9 percent of total liabilities.

Figure 4.12: Afghani Denominated Deposits

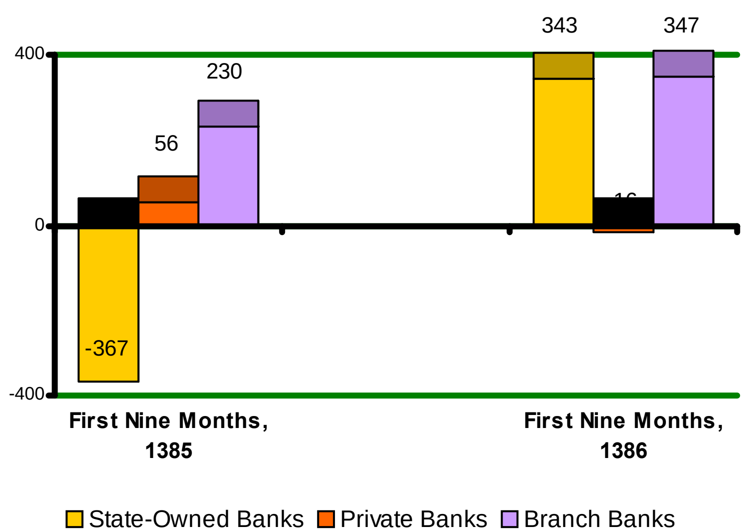


Capital

The system, as a whole, is well capitalized. Total financial capital at full-fledged banks is AF 12.5 billion, up by 22 percent sine December 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 12.5 billion can support assets of AF 63 billion, while total assets of the full-fledged commercial banks are AF 58 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 branch of foreign bank was AF 4 billion, up by 48 percent over the year.



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 nine months of 1386 is AF 674 million, whereas AF 81 million net losses was incurred during first three quarters of 1385, resulting in an overall return of assets (ROA) of -0.26

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

Branches of foreign banks and state-owned banks are almost equally the most profitable groups. Private Banks, as a group, is not profitable mainly due to high overhead expenses of two banks which affected negatively the overall results of the group. The main reasons for profitable operations of the first two peer groups 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 3222 million, up by 85 percent than last year's first quarter.

The second major component of income is other Non-Interest Income totaling AF 892 million, a 63 percent increase over previous period.

The most important component of expense is the Non-Interest Expense (NIE), currently equal to AF 2819 billion, a 67 percent increase compared to previous year's total of first three quarters.

The efficiency ratio, (*net interest income* + *trading account gain/loss* + *other non-interest income* **divided** *by operating expenses*) of the system as a median stands at 1.47. Four banking institutions ended up with lower efficiency ratios.

Foreign Exchange Risk

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

In general, all but two private banks which are relatively new in the commercial banking market 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 2.04

percent or AFN 255 million and vice versa. Similarly, a 4 percent change would correspond to 1.51 percent or AFN 188 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.

5

EXTERNAL SECTOR DEVELOPMENTS

SUMMARY

The trade deficit, the difference between export and imports of goods, in the three quarters of 1386 stood at USD 1605 million or 17 percent of GDP. This was lower than the trade deficit in the year of 1382 which stood at 39 percent.

Comparing merchandise trade in the three quarters of 1386 with that in the year of 1382 shows that imports decline by 8 percent to USD 1931 million. Imports were dominated by capital goods (USD 980 million) and industrial supplies and materials (USD 70 million). Domestic exports increased by 127 percent to USD 623 million and were dominated by carpets and rugs (USD 157 million) and food items (USD 78 million). With respect to the direction of trade, Pakistan remained Afghanistan's major export destination with a 57 percent share of total exports, followed by India, with 17 percent share of total exports in the three quarters of 1386.

Merchandise Trade

Over the year under review the trade deficit stood at USD 1604.79 billion or 17 percent of GDP. Table 5.1 shows merchandise trade by its main categories with percent changes and trade deficit as percentage of GDP from 1382 up to three quarters of 1386 Imports of USD 1,931 million were dominated by capital goods (USD 980 million) and industrial supplies and materials (USD 70 million). Exports of USD 326 million were dominated by carpets and rugs (USD 157 million) and food items (USD 78.14 million). As long as the donor support continues and the deficit is declining as a percentage of GDP, this should be a manageable and appropriate level of deficit given the magnitude of the country's reconstruction requirements, particularly in the area of physical infrastructure. Significantly, the trade deficit appears to be declining as a percentage of GDP; however, continued steady progress is needed in the coming years.

Table. 5.1: Merchandise Trade (In million US$)

	1383		1384		1385		1386 (Q3)	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	**2150.9**	**100**	**2470.74**	**100**	**1733.31**	**100**	**1931.0**	**100.00**
Consumer goods	383.3	17.82	478.63	19.37	318.39	18.37	677.23	35.07
Industrial supplies	667.4	31.03	541	21.9	422	24.35	70	3.63
Capital goods & others	1034	48.07	1206.5	48.83	854.25	49.28	980	50.73
Fuel & lubricants	66.2	3.08	244.61	9.9	138.67	8	204.16	10.57
Exports	**303.3**	**100**	**383.72**	**100**	**259.96**	**100**	**326.21**	**100**
Carpets & Rugs	154.3	50.87	206.94	53.93	116.34	44.75	156.86	48.09
Food items	95.6	31.52	104.11	27.13	92.87	35.72	78.14	23.95
Leather & Wool	27.3	9	36.51	9.51	26.27	10.11	44.84	13.75
Medical seeds & others	26.1	8.61	36.16	9.42	24.48	9.42	46.37	14.21
Trade Balance	**-1848.6**		**-2087.02**		**-1473.35**		**-1604.79**	
Trade Balance as % of GDP	**33.38**		**31.28**		**17.85**		**16.505**	

Source: Central Statistics Office, IMF and Da Afghanistan Bank staff calculations.

Direction of Trade

Tables 5.2 and 5.3 compare the direction of trade in three quarters of 1386 with 1382. The tables show that Pakistan remained Afghanistan's largest export destination by a large share with 58 percent of exports in three quarters of 1386 compared to 67 percent in 1382. Exports to Pakistan have increased by 95 percent from USD 96 million in 1382 to USD 188 million in three quarters of 1386. Pakistan is followed by India increased by 369 percent from USD 12 million in 1382 to USD 54 million in three quarter of 1386. The Ex-soviet commonwealth states are also a major export destination for Afghanistan. In 1382 exports with the Ex-soviet commonwealth countries were USD 13 million compared to USD 43 million in three quarters of 1386: an increased of 220 percent. European countries are also a major export destination for Afghanistan despite a decline of 10 percent from USD 7.2 million in 1382 to just USD 6.5 million in the three quarters of 1386 period under review.

Table 5.2: Direction of External Trade for 1382 (in million USD)

Country Name	Exports		Imports		Trade Balance
	Millions of USD	% share	Millions of USD	% share	
Pakistan	96.3	66.97	179.60	8.55	-83.30
India	11.5	8.00	119.70	5.70	-108.20
Japan	0.0	0.00	320.00	15.23	-320.00
China	0.0	0.00	378.80	18.03	-378.80
Ex-soviet Common Wealth	13.4	9.32	229.20	10.91	-215.80
European Countries	7.2	5.01	242.60	11.54	-235.40
Other Countries	15.4	10.71	631.56		-616.16
Total	**143.80**	**100.00**	**2,101.46**	**100.00**	**-1,957.66**

Source: Central Statistics Office and DAB staff calculations.

Table 5.3: Direction of External Trade for the First three quarters of 1386 (In million US$)

Country Name	Exports		Imports		Trade Balance
	Million (US$)	Share (%)	Million (US$)	Share (%)	
Pakistan	187.70	57.54	355.34	19.7	-167.64
India	53.93	16.53	142.51	7.9	-88.58
Japan	0	0.00	126.72	7.0	-126.72
China	0.16	0.05	300.95	16.7	-300.79
Ex Soviet Commonwealth	42.83	13.13	483.33	26.7	-440.50
European Countries	6.50	1.99	43.29	2.4	-36.79
Others	28.09	8.61	355.3	19.7	-327.21
Total	**326.21**	**98**	**1807.44**	**100.0**	**-1481.23**

Data source: Central Statistics Office and AB staff calculations.

Figure 5.1: Direction of Exports (%share) 1382

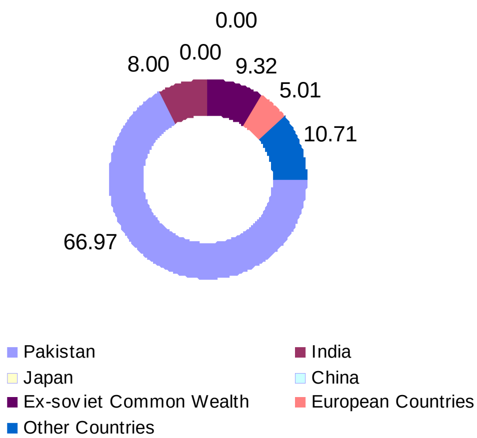
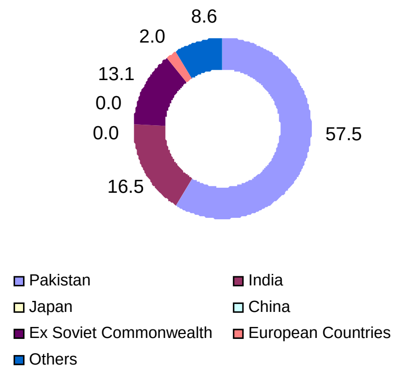


Figure 5.2: Direction of Exports (% Share) Q3 1386



Composition of Trade

Figures 5.3 and 5.4 show the composition of total imports for the period of 1382 up to three quarters of 1386. The composition of imports during the year 1382 indicates that imports of item "Others" had the largest share of 24 percent followed by "Machinery & Equipments" at 23 percent, "Textile Clothing & Footwear" totaling 21 percent followed by "Food Items" at 14 percent, "Construction Material" at 10 per cent, "Transportation Equipments & Spare parts" at 6 per cent, and the item "Fuel" at 2 percent.

Analysis of the composition of imports during the three quarters of 1386 reveals that imports of item "Others" had the largest share of 42 percent followed by "Machinery & Equipments" at 13 percent, "Construction Materials" at 3 percent, "Textile Clothing & Footwear" totaling 8 per cent followed by "Food Items" at 13 percent, "Fuel" at 8 percent, and at last "Transportation Equipments & Spare Parts" at 3 percent share of total imports to Afghanistan.

Figure 5.3: Composition of Imports for 1382 (% share)

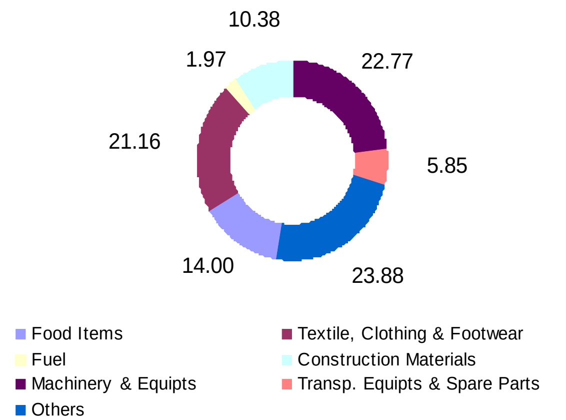
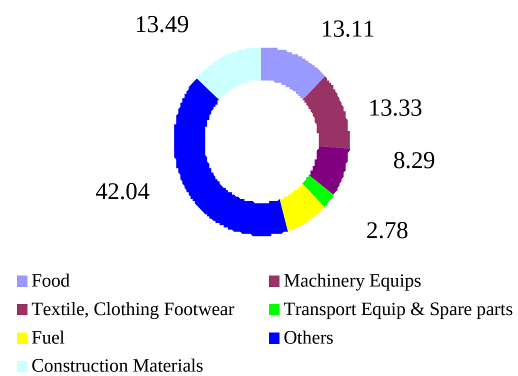


Figure 5.4: Composition of Imports (% share) Q3-1386



Comparing imports in three quarters of 1386 with 1385 shows considerable variability. The share of item "Others" has increased in three quarters of 1386 to 42 percent from 24 per cent in the year 1382 though on the other hand, the share of item "Fuel" has also increased to 8 percent during the three quarters of 1386 from 2 percent in the year 1382 Also decrease in the item "Textile Clothing & Footwear" in the three quarters of 1386 to 8 percent from 21 percent in the year 1382 while on the other hand, the share of item "Machinery & Equipments" has also increased to 13 percent during in the three quarters of 1386 from 23 percent in the year 1382. year 1382.

Figures 5.5 and 5.6 show composition of the total exports for the years 1382 and for the three quarters of 1386.

Figure 5.5 shows composition of the total exports for 1382. Through the main commodities and products, "Food Items" with 49 percent is the largest export component followed by the item "Leather" which constituted some 19 percent of total exports, "Carpet & Rugs" at 15 per cent, "Medical Seeds" at 9 percent "Others" 5 percent, and at last the item "Wool" at 2 percent.

Figure 5.6 shows composition of the total exports for three quarters of 1386. By the main commodities and products, "Carpet & Rugs" with 48 percent is the largest export component followed by "Food Items" which constituted some 24 percent of total exports, "Leather" at 4 percent, Medical Seeds at 8 percent "Others" 7 percent, and at last the item "Wool at 9 percent.

Figre 5.5: Composition of Exports for 1382 (% share)

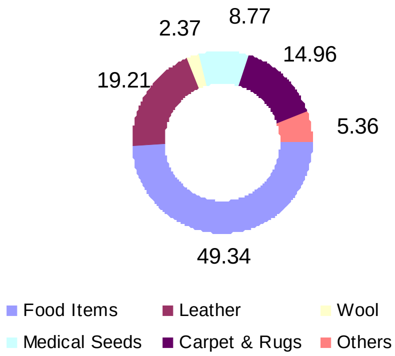
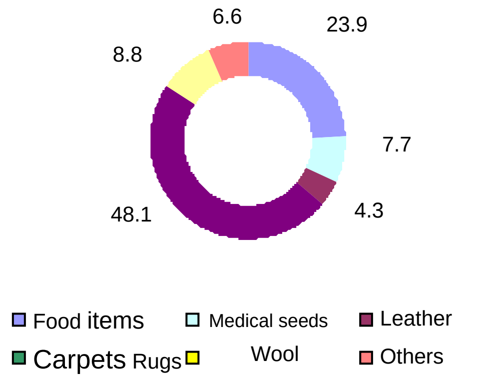


Figure 5.6: Composition of Export (% share) Q3-1386



Comparing the composition of exports for three quarters of 1386 with the year 1382 it is clear that the composition is almost the same. There is only slight shift in the pattern; especially the share of "Carpet & Rugs" has increased in three quarters of 1386 to 48 percent from only 15 percent in the year 1382, while on the other hand, the share of "Food Items" has declined to 24 percent in the three quarters of 1386 from 49 percent in the year 1382 .Also the share of item "Leather" has decreased to 4 percent in the three quarters of 1386 from 19 percent in the year 1382, and on the other hand, the share of item "Medical Seeds" has decreased to *8* percent during in three quarters of 1386 from 9 percent in the year 1382 .

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 5.4 External Debt as of March 20, 2006 (in units indicated)

	In million USD	% of total
Total external debt	11,939.40	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 % 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.

3/Calculated using a backward-looking three year average of exports of goods and services; excluding transit goods.

Net International Reserves

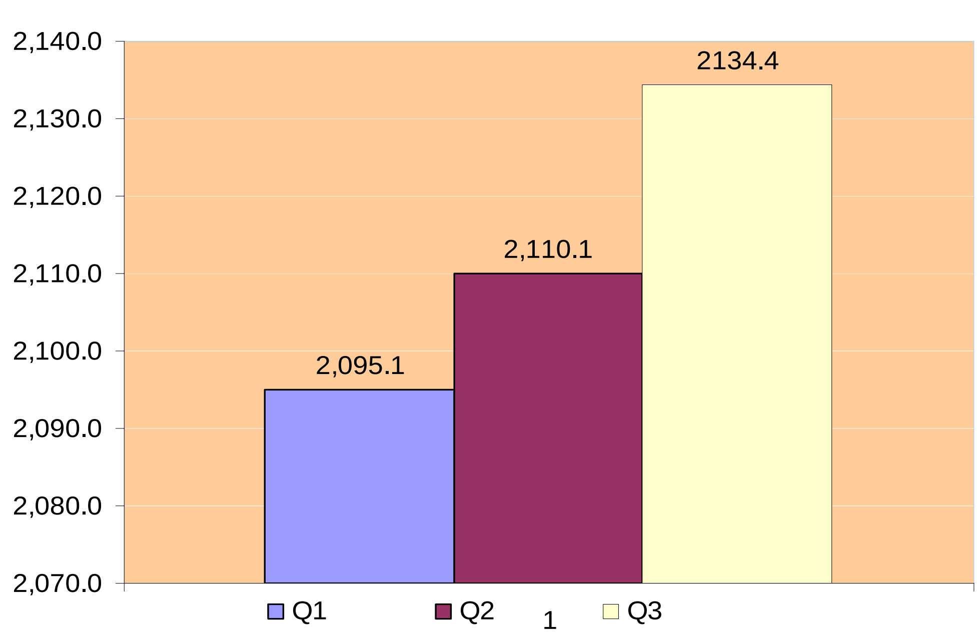
Net International Reserves (NIR) held by Da Afghanistan Bank includes holdings of foreign exchange and gold, IMF Reserve position and holdings of Special Drawing Rights (SDR). As compared the second quarter with the third quarters of 1386, net international reserves slightly decreased 0.86 percent to USD 2,272.0 million from USD 2,291.7 million, the minor decline is due to Foreign Exchange Auction to keep the stability of Afghan currency. The reserves assets decreased 0.56 percent from USD 2,378.1 million to USD 2,364.7 million. While on the other side, the reserves liabilities increased by 7.41 percent from USD 86.33 million to USD 92.73 million, because there is a significant increase in the commercial banks deposits in foreign currency from USD 30.39 million to USD 37.75 million, and a decline of 16.80 percent in the non-resident deposits in foreign currency from USD 2.63 million to USD 2.19 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.

Table 5.5 Net International Reserve(in million of US$)

	1386					
	Q1	%	Q2	%	Q3	%
Net International Reserve	2033.6	9.62	2291.7	12.69	2272.0	-0.86
Reserve assets	2104.0	11.35	2378.1	13.03	2364.7	-0.56
Reserve liabilities	70.39	105.51	86.33	22.65	92.73	7.41
Commercial bank deposits in foreign currency	28.70	13.10	30.39	5.89	37.75	24.21
Non-resident deposits in foreign currency	6.05	-31.79	2.63	-56.50	2.19	-16.80
Use of Fund resources	0		0		0	

Figure 5.7: Net Internationa Reserve 3Q of 1386 (in million US$)



6

THE WORLD ECONOMIC OUTLOOK

Summary

Following the strong growth through the 2nd quarter of 1386 (3rd quarter -2007), the global economic growth has begun to moderate in the third quarter of 1386 (Q4 2007) due to continuing financial turbulence. Most of the industrial economies experienced a moderation in economic activities while Asian regional economies maintained their growth momentum. (Table 6.1)

The U.S Economy Slows

The US economy, a USD15 trillion giant which makes up 25 percent of the world economy, is in trouble and could drag down the world economy. Economic growth in the U.S slowed notably in the fourth quarter, the growth rate declined to 0.6 (advanced estimate) percent in the fourth quarter comparing to 4.9 (actual GDP growth) percent in the third quarter of 2007. The recent indicators show weakening of manufacturing and housing sector activities, employment and consumption. Moreover, higher energy costs, in particular for crude oil, had a negative impact on consumer spending. On the other hand, there are interest rate reductions by the U.S. Federal Reserve Bank and the exports benefiting from the development of the exchange rate parity of the U.S. dollar. However, the positive impulses were unable to full compensate for the decline in the growth rate.

The U.S economy is also facing inflationary pressures because of high oil prices which have pushed up the price of petrol and heating oil. The inflation rose to 3.9 percent in the fourth quarter of 2007, comparing to 2.3 percent in the previous quarter of the same year.

The Growth in Euro Area Moderated

The real GDP growth rate in the Euro Area in fourth quarter-2007 to 2.3 percent comparing to 2.7 percent in the previous quarter of the same year. The growth was limited by weaker growth in Germany, Italy and France. In Germany the growth rate in the fourth quarter of 2007 slowed down to 1.8 percent, comparing to 2.4 percent in the third quarter. The decline in the growth rate was due to decrease in consumption activities. Growth in France was also constrained by a reduction in exports and weaker consumer spending.

In Euro Area the HICP (Harmonized Index of Consumer Prices) for the fourth quarter-2007 increased to 2.2 percent, comparing to an increase of 1.9 percent in the previous quarter of the same year. These price developments were largely driven by increases in energy and food prices in the international markets.

Japan's Economic Activities Were Resilient

In Japan, economic activities have continued to recover. The growth rate in the fourth quarter of 2007 is 1.8 percent, comparing to 1.9 percent in the previous quarter of the same year. Showing very slight change of 0.1 percentage points comparing to the third quarter-2007. The growth has been supported by healthy domestic demand and strong exports. In fiscal year 2007 (ending in March 2008) companies continue to report a growing sense of labor shortage pointing to further improvement in employment conditions.

However consumer price inflation has recently returned to positive territory, reflecting past increases in the price of raw materials. In November 2007 the annual change in the CPI was 0.6 percent after 0.3 percent in October, while the annual change in the CPI in fourth quarter of 2007 was 0.5 percent, comparing to -0.13 percent in the previous quarter of the same year.

United Kingdom

In the United Kingdom, the real GDP growth decreased to 2.9 percent in the fourth quarter-2007, comparing to 3.3 percent in the previous quarter of the same year; showing a decline of 0.4 percentage points in the growth. Growth in the service industries was 0.7 per cent in the fourth quarter, down from 0.9 per cent recorded in the previous quarter. The main drivers were weaker retail sales growth and a slowdown in the business services and finance sector. Household expenditure rose 0.1 per cent, down from 0.8 per cent in the previous quarter.

In December annual HICP (harmonized index of consumer prices) inflation was unchanged from the two previous months at 2.1 percent. The lower contribution of utility bills continues to offset higher fuel and good prices. The inflation in the fourth quartr-2007 was 2.1

percent, comparing to 1.8 percent in the previous quarter. The increase in inflation was mainly supported by higher energy and good prices.

Emerging Asia, Economic Activities Continued to Expand

In emerging Asia, economic activity continued to expand at a robust pace in the last months of 2007, driven by both domestic demand and strong exports in most countries. Simultaneously, inflationary pressures picked up further in this region, largely driven by increasing food prices.

China's Economy Grows for the 5th Consecutive Year of Double Digit Growth

In China, GDP growth reached 11.4 percent in 2007; comparing to 11.5 percent in the previous quarter of the same year, a 13-year high and the fifth consecutive year of double-digit expansion. Fueled by strong exports and vigorous domestic external demand. To prevent overheating, the Government raised interest rates and banks reserve requirements, abolished or cut export tax rebates on certain products, and imposed tariffs on some exports. Rapid economic growth and sound government policies to promote employment helped create 12 million new jobs in urban areas in 2007.

The inflation rate in the fourth quarter-2007 was 4.5 percent, comparing to 4.77 percent in the previous quarter of the same year. Inflation was driven by higher energy and good prices in the world markets, plus higher prices of imported raw materials.

India's Economic Growth Follows China

The impressive economic performance of the past few years continued, In India the GDP grew on annualized basis by 8.7 percent in the fourth quarter of 2007, comparing to 8.9 percent in the previous quarter of the same year. Tough tight monetary policy to cool overheating slowed growth, but India remained among the fastest growing economies in the world. The growth in India is driven by vigorous domestic demand; the country is nevertheless vulnerable to the worsening global economic environment. Key structural challenges include establishing a new fiscal adjustment road map, raising labor productivity and enhancing structural reforms and fair distribution of output.

Table 6.1: World Economic Indicators
3rd Quarter 1386 (4th Quarter 2007)
Percentage Change over the same Quarter Previous Year

Developed Countries	GDP growth		Inflation	
	Q3	Q4	Q3	Q4*
U.S	4.9	0.6**	2.32	3.9
U.K	3.3	2.9	1.78	2.1
Euro Area	2.7	2.3	1.9	2.1
Japan	1.9	1.8	-0.13	0.5
Developing Countries				
China	11.5	11.4	4.77	4.5
India	8.9	8.7	4.1	3.4
Pakistan	6.6	7.02	7.06	8.9

* Qs represent data in Gregorian calendar (2007)
** Advanced estimate
Source: Different Official Websites.

The inflation rate in the fourth quarter of 2007 was 3.4 percent, down from 4 percent in the previous quarter of the same year. The main driving factors of inflation were similar with the other countries of the world and are higher energy and food prices.

2. Commodity Prices

2.1 Food Commodity

The wheat prices rose by 30.36 percent in the 4th quarter of 2007 (3rd Quarter-1386) comparing to an increase of 33.6 percent in the previous quarter of the same year. The basic economic factors of supply and demand play the role in high food commodity and grain prices. On one side there is high demand for grains and on the other side the supply has decreased due to the cultivation of the land for the usage of biofuels and poor weather, which in terms results high prices for these commodities.

The rice prices rose by 7.6 percent in the 3rd quarter of 1386 comparing to 2.56 percent in the previous quarter of the same year. The beef prices declined by a minor percentage of 0.04 percent since people substituted the beef with chicken, as they felt safe from chicken influenza. (Table 6.2) Higher livestock prices can, in turn, be explained by the rising cost of grains.

Table 6.2: Food Commodity Prices, 3rd Quarter 1386
(October – December 2007)

	Wheat USD/MT[1]	Rice USD/MT[2]	Beef US cents/pound[3]
Avg. Oct	353	335	116
Average. Nov.	338	357	118
Average. Dec.	384	378	120
Avg. Q3-86	358.33	356.67	118
% Change	30.36	7.64	-0.04

1. US. No2, Hard Red Winter, FOB, Gulf
2. 5% Broken Milled White Rice, Thailand Nominal Price quote,
3. Australian & New Zealand 85% lean fores, FOB U.S. import Price

Note: 1Kg = 2.2 Pounds
Source: UNCTAD

2.2 Oil Prices Keep Raising

The oil prices keep going up, the OPEC (Organization of Petroleum Exporting Countries) basked oil price increased by 18.67 percent in the third quarter of 1386, comparing to 10.22 percent increase in the previous quarter of the same year. Volatility, as measured by standard deviation, for the oil prices was 5.3 percent in the 3rd quarter of 1386, comparing to 2.6 percent in the previous quarter. (Table 6.3)

Table 6.3: OPEC Basket Oil Prices*/Barrel
3rd Quarter 1386 (Sept.24- Dec.21-07)

	USD per Barrel
Average. Sept.24-Nov.22	77.2
Average. Nov.22- Oct.21	86.8
Average. Oct.22-Dec.21	87.32
Average Q3 - 1386	83.97
% Change	18.67
Lowest Price	74.47
Highest Price	91.91

Source: OPEC

Geopolitical factors and weak dollar contributed to the high prices of oil. Disorder in Iraq is one of geopolitical factors which accelerate the oil prices up. Security crisis in big oil producer, Nigeria is another geopolitical factor pushing the prices up.

2.3 Gold Prices

The gold price rose by 15.55 percent in the 3rd quarter of 1386 comparing to the 2nd quarter of the same year. The average gold price in the 3rd quarter-86 was USD 780.6 per ounce (Table 6.4 Volatility, as measured by standard deviation, in the 3rd quarter-1386 was high as 30.8 percent comparing to 21.7 percent in the previous quarter of the same year.

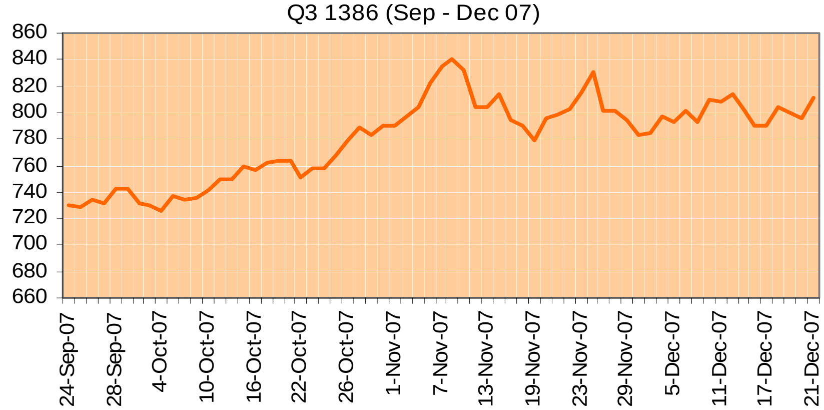
Table 6.4: Gold Price against USD
3rd Quarter of 1386 (Sept.24- Dec.21- 07)

	1Ounce Gold
Average. Sep.24-Oct.22	742.87
Average.Oct.22-Nov.21	796.46
Average. Nov.22-Dec.21	800.99
Average Q3-1386	780.68
Quarterly % Change	15.55
Lowest	725.5
Highest	841.1

Source: Bank of England

Gold prices change because of weak dollar since investors feel less risk investing in gold rather than in volatile currencies. Another factor which pushes the gold prices high is the changes in oil prices, as investors see as a haven against inflation risk caused by higher crude prices.

Figure 6.1: Gold Price USD/Ounce
Q3 1386 (Sep - Dec 07)



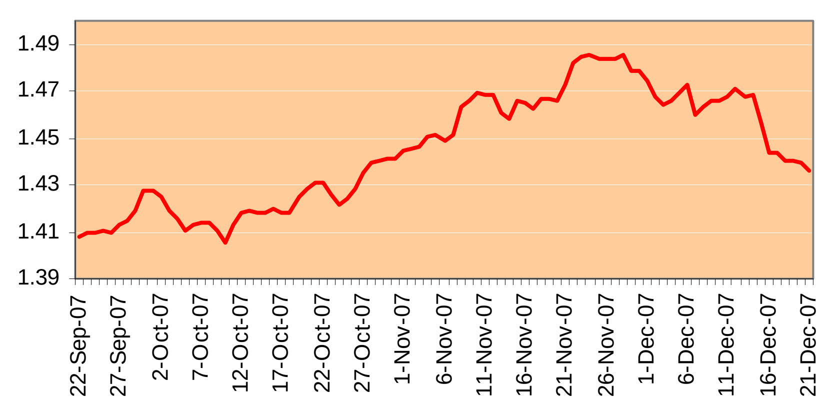
Source: Bank of England

3. Nominal Exchange Rates of Selected Currencies against USD

The Nominal Value of USD depreciated against major currencies- Euro, Pound Sterling and Japanese Yen in the 3rd Quarter of 1386.

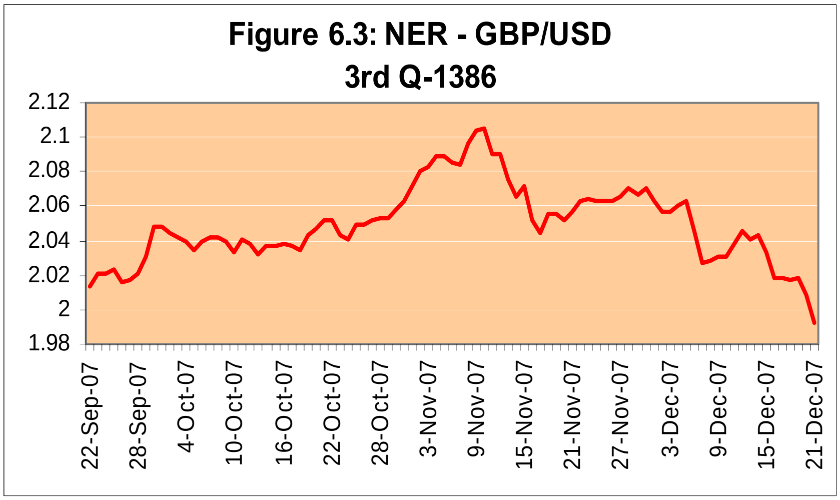
In the 3rd quarter-1386 the USD touched USD 1.49 against the Euro (Table 6.6), this was worse than the previous record low of USD 1.47 during the start of November-07. The USD depreciated against the Euro by 5.46 percent in the 3rd Quarter-86 comparing to a depreciation of 1.48 percent in the 2nd quarter of the same year.

Figure 6.2: NER - Euro/USD



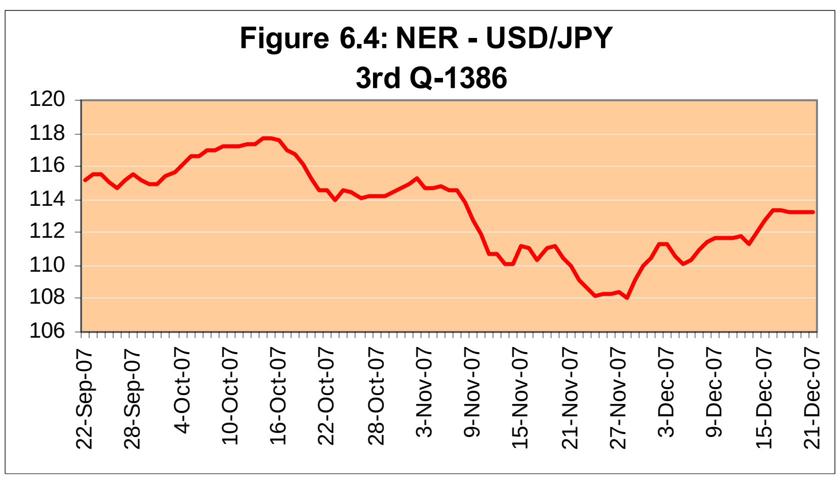
Source: Reuters

The nominal value of USD depreciated by 1.45 percent against Pound Sterling in the 3rd quarter-86, comparing to a depreciation of 1.9 percent in the 2nd quarter of the same year. On November the Pound hit USD 2.1 its highest level against the USD since the early 1980's.



Source: Reuters

The nominal value of USD depreciated against Japanese Yen by 4.31 percent in the 3rd quarter-86 comparing to a depreciation of 1.43 percent in the previous quarter of the same year.



Source: Reuters

The USD weakness was in a result of U.S. bad mortgage debt crisis, which has led to a growing number of American banks revealing millions USD losses. Besides the lower interest rates make the dollar less attractive for currency investors, who instead have been turning to other currencies, such has the pound, euro, and Japan's Yen, and this would decrease the demand for USD which would decrease the nominal value of USD.

Table 6.5: Exchange Rates of Selected Currencies Against USD
3rd Quarter 1386 (Sept.22- Dec.21- 07)

	Euro/USD	GBP/USD	USD/JPY
Average - Sept22 - Oct21	1.42	2.04	116.17
Average - Oct.22-Nov21	1.45	2.07	112.99
Average - Nov.22-Dec.21	1.47	2.04	110.9
Average for Q3	1.44	2.05	113.35
Lowest Exchange Rate	1.4	1.98	107.22
Highest Exchange Rate	1.49	2.1	117.93
USD - Appreciation (+)			
USD - Depreciation (-)	5.46	1.45	4.31

Source: Reuters

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 rate is expressed in dollars per euro. Thus an increase in this rate indicates a decline in the value of the dollar versus the euro.