Da Afghanistan Bank

Economic & Statistical Bulletin

Annual Bulletin FY1393

January 2015

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Note:
Afghanistan's Fiscal year has been changed effective from 1391 (2012). The new fiscal year begins on December 21 each year. This Annual Bulletin describes developments in the fiscal year 1393, which covers December 21, 2013 to December 20, 2014.

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ABBREVIATIONS

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

Senior Management

H.E. Khalil Sediq

Governor

Khan Afzal Hadawal

First Deputy Governor

Alhaj Essa Khan Turab

Second Deputy Governor

Message

From the Governor

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

GOVERNOR'S STATEMENT

On behalf of the Supreme Council and the Executive Board, I am pleased to present this edition of the Economic and Statistical Bulletin of Da Afghanistan Bank (DAB) for the fiscal year 1393 (December 21, 2013 – December 20, 2014). This annual bulletin presents the main outcomes of the Bank's activities toward keeping inflation low, maintaining stability of the national currency and enhancing a more robust banking sector in support of sustainable economic growth.

The fiscal year 1393 was a challenging year for the Afghan economy. The economic activities have been overshadowed by the political events resulting to a sharp decline in the economic growth. The real GDP growth is estimated at 2.1 percent, well below the expectations. Uncertainty over the political and security transition had a negative impact on the overall confidence of investors and consumers. Agricultural production was robust in 1393, but did not exceed the record levels of 1392. Based on several indicators, the economic growth is expected to further slowdown in 1394.

Inflation recorded the lowest rate since March 2009. The downward movements in the overall inflation rate started in the fourth quarter of last year continued its way to the end of the fourth quarter 1393 (Dec 2014). Inflation stood at 1.3 percent (y-o-y) at the end of FY1393. Both, food and non-food components of the CPI basket, recorded lower rates of inflation, but the pace of decrease in food items was more pronounced.

Monetary and capital market exhibited mixed trend in the fiscal year FY1393. Reserve money, the operational target of the monetary policy, grew at 13 percent, standing at AF 225 billion at the end of the year. The actual reserve money was slightly above the end year target of 12.7 percent. On the other hand, DAB successfully achieved the target (floor) for the net international reserves (NIR).

Narrow money (M1), grew by 9.5 percent on an annual basis. Broad money (M2) demonstrated similar behavior, representing a growth rate of 8.34 percent standing at AF 402 billion at the end of the year under review.

External sector remained under pressure due to the current account deficit, although it has narrowed, as well as a reduction in capital inflows in the period under review. The trade deficit narrowed and is expected to improve further. Inflows from services and export earnings helped the current account deficit during the period under review.

On the other hand, Afghanistan's net international reserves grew by 6 percent, covering about 11 months of imports as of end FY1393, which is well above the internationally accepted reserve adequacy standards; meanwhile, Afghanistan's total external debt stocks registered a decline during the FY1393.

The banking system gained momentum and performed well in the reporting period. The asset base of the banking sector observed a modest growth driven mainly by deposits.

Deposits, the main funding source in the banking sector increased slightly compared to a year ago. The slower pace in deposits growth was mainly attributed to the prolonged Presidential elections process and the political uncertainty in the economy.

At the end, I would like to appreciate the tireless efforts of numerous individuals from several departments of the Bank that contributed to this publication, particularly the team of the Monetary Policy Department.

Khalil Sediq

Governor,

Da Afghanistan Bank

EXECUTIVE SUMMARY

The global economy continued to expand at a moderate manner in 2014, but the pace of GDP growth was noticeably lower in most economies compared to pre-crisis levels. The World Gross Product (WGP) is estimated to have a 2.6 percent growth during 2014, this indicates 1 percentage point expansion over the previous year, but is lower than 2.9 percent projected growth.

Advanced economies growth rate is estimated to be 1.6 percent in 2014 indicating 4 percentage point expansion over the previous year. The world largest economy (name the country) contracted in the first quarter of the year, mainly due to unkind winter weather condition, but got considerable momentum in the second quarter, recording a 4.6 percent growth. Finally, the economy grew at 2 percent (Y-o-Y) at the end of 2014.

The Japan's economy swung from a robust growth in the first quarter of 2014, and fell into a technical recession in the following two consecutive quarters. Higher consumption tax that suppressed private consumption is thought to be the main driver of contraction. The annual economic growth is expected to be 0.4 percent in 2014.

Economic growth of Canada and Australia in 2014 is estimated to be 2.3 percent and 3 percent respectively, however France's economic performance stagnated, while Italy's economy is expected to contract for the third consecutive year.

Economic performance in the Europe, especially in the euro area was sluggish as some economies turned to recession and some other were about to enter to a recession.

East Asia's robust performance with a growth rate of 6.1 percent in 2014 indicates that the region proves to be the world fastest growing region, while West Asia's economic growth was hampered by a low oil prices and armed conflicts in Middle East. The economic growth rate of West Asia is estimated to be 2.9 percent in 2014, lower than the 4 percent recorded in the previous year.

Economic acceleration in transition economies slowed due to geopolitical tensions in the region. Russian economy contracted due to imposed sanctions over the Ukraine crisis. Small economies of Common Interest States (CIS) hampered due to deceleration in inflow and remittance.

The monetary and capital market exhibited mixed trend in the fiscal year 1393 (21 Dec. 2013 to 20 Dec. 2014). Reserve money, the operational target, grew at 13 percent, standing at AF 224,885.81 million at the end of the year. The actual reserve money was slightly above the end year target of 12.7 percent. Currency in circulation "an indicative target" increased by 17 percent in the year under review, reaching AF 197, 022.95 million.

On the other hand, DAB successfully achieved the target (floor) for the net international reserves (NIR).

Narrow money (M1), stood at AF 384,152 million at the end of the year under review, registering an annual growth of 9.54 percent (Y-o-Y). Broad money (M2) demonstrated similar behavior, representing a growth rate of 8.34 percent (Y-o-Y) standing at AF 401,583 million at the end of the year under review.

In order to control the reserve money growth, DAB utilizes monetary instruments of FX auction and selling of capital notes under the open market operations.

In the fiscal year 1393, DAB has auctioned a total amount of USD 3,341.43 million to manage the liquidity in the market as well as to mitigate the unnecessary fluctuations in the exchange rate of afghani against the foreign currencies.

The outstanding amount of Capital Notes stood at AF 38 billion, while afghani depreciated against the US dollar by 1.79 percent in period under review.

The trend of movements in crude oil price was descending in the last quarter of 2014, which could potentially impose severe economic stress on oil producers around the world. There is also a concern that the further decrease in oil prices will threaten the economic and political stability of oil producing countries. Policy makers believe of some factors that played significant role in falling oil price. Major shocks to oil price came from OPEC announcement regarding maintaining the current production levels. The headline inflation in Afghanistan recorded its lowest rate since March 2009. The downward movements in the overall inflation rate started in the fourth quarter of the last year when the inflation rate was 7.3 percent. At the end of the fourth quarter (Dec 2014), the nationwide inflation rate stood at 1.3 percent (y-o-y). Both, food and non-food, the main components of the CPI basket, recorded lower rates of inflation compared to the fourth quarter of 2013, but the pace of decrease in food items was most significant due mainly to lower vegetables prices. The price of this sub component of the basket reached -9.6 percent, which is far below 30.7 percent recorded in the same quarter of last year. Beside the early mentioned external factors, the decline in the rate of inflation could be analyzed considering the downward trend of key economic indicators in the country. The political concerns stemming from prolonged presidential elections, unfavorable security situations, lower number of development projects, led to a weak economic performance during the period under review. Thus, the aggregate income seriously diminished, which in turn suppressed the aggregate domestic demand.

The changes in the inflation rate based on Kabul CPI exhibited similar pattern to that in National CPI during the period under review. Since March 2009, Kabul headline inflation as measured by annual percentage changes recorded its lowest rate of -1.1 percent in December 2014.

Similar to national CPI, Kabul food sub-index exhibited significant decrease over the fourth quarter of 2014. The main contributors to such low food prices in Kabul was the vegetables, which declined dramatically by 35.6 percentage points compared to a year ago. This sub-component of food sub-index dropped to a deflation rate of 5.6 percent (Y-o-Y) at the end of the FY1393 from an inflation rate of 30.0 percent recorded a year ago.

The external sector remained under pressure because of current account deficit and reduction in capital inflows in the period under review. The trade deficit narrowed by 23 percent it is expected to improve further. Based on the available data, the current account deficit narrowed from USD 5,592.26 million during the FY1392 to USD 4392.85 million in the FY1393. Inflows from services and exports earnings, helped to reduce the current account deficit during the period under review.

Net international reserves (NIR) grew by 5.99 percent, covering about 11 months of imports as of end FY1393.

Meanwhile, Afghanistan total external debt stock declined by 8 percent at the end of FY 1393.

In the last decade, Afghanistan had a great opportunity for rehabilitation and reconstruction of the country. Since then, Afghanistan recorded the highest average economic growth rate of 9.4 percent, which is unprecedented in the last decade. After such considerable average growth rate, Afghanistan experienced a sharp slowdown in economic growth to an estimated 2.1 percent in 1393 from 6.5 percent during 1392.

In the real sector, the aggregate demand was impacted negatively by the prolonged election process as well as the political and security transition which led to a decrease in investors as well as consumers confidence.

Agricultural production was at satisfactory, but did not exceed the record level of preceding year. Going forward with the current indicators, the economic growth is expected to remain low in 1394.

Agriculture sector grew by 3.7 percent (y-o-y) in 1393, lower than 8.3 percent recorded in the preceding year. The non-agriculture sectors also exhibited slower growth rates in the year under review. The industry sector recorded an annual growth rate of 2.4 percent, and the services sectors grew by 2.2 percent respectively.

The asset base of the banking sector observed a modest growth of 4.50 percent or AF 11.04 billion in the FY1393 (December 2014) compared to 9.78 percent growth in December 2013. The increase in total assets of the banking sector came from the increase in total deposits of the system.

Gross loans portfolio of the banking sector witnessed a decrease of 7.89 percent or AF 3.71 billion over the year, standing at AF 43.23 billion, down from 11.33 percent growth recorded in Dec.2013. The decrease in the loan portfolio is mainly attributed to repayment, settlement; charge-off and less customer utilization of OD loans and restriction on disbursement of new loans on some banks.

Deposits, the main funding source in the banking sector stood at AF 218.84 billion, comprising 96.60 percent of the total liabilities of the sector, increased by 5.31 percent at a slower pace compared to 8.10 percent increase in the preceding year (Dec. 2013). The slower pace in deposits growth was mainly attributed to prolonged Presidential elections process and the political uncertainty in the economy. Deposits were largely denominated in USD (62.61 percent) with Afghani denominated deposits lagging at 34.08 percent.

The capital base of the banking system remained strong and increased by 6.60 percent, reaching AF

30.17 billion due to an increase in profitability of the banking sector. Capital adequacy ratio (CAR) of the banking sector was recorded at 26.46 percent. All the banking institutions are above the set limits for CAR.

Banking sector profit improved over the year amounted to AF 2.17 billion compared to AF 1.43 billion recorded in Dec. 2013, resulting to 0.90 percent.

Return on Equity (ROE) declined to 7.35 percent compared to 8.18 percent in Dec.2013. The decrease in ROE is attributed to the increase in the denominator of the ratio. State-Owned Banks, Private Banks and Branches of Foreign banks ended up with profits during the year under analysis.

1

GLOBAL ECONOMIC ENVIRONMENT

1

GLOBAL ECONOMIC ENVIRONMENT

During 2014, global economy continued to expand at a moderate manner, but the pace of GDP growth was noticeably lower in most economies compared to pre-crisis levels. The World Gross Product (WGP) is estimated to have a 2.6 percent growth during 2014, this indicates 1 percentage point expansion over the previous year, but is lower than 2.9 percent projected growth.

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Economic acceleration in transition economies slowed due to geopolitical tensions in the region. Russian economy contracted due to imposed sanctions over the Ukraine crisis. Small economies of Common Interest States (CIS) hampered due to deceleration in inflow and remittance.

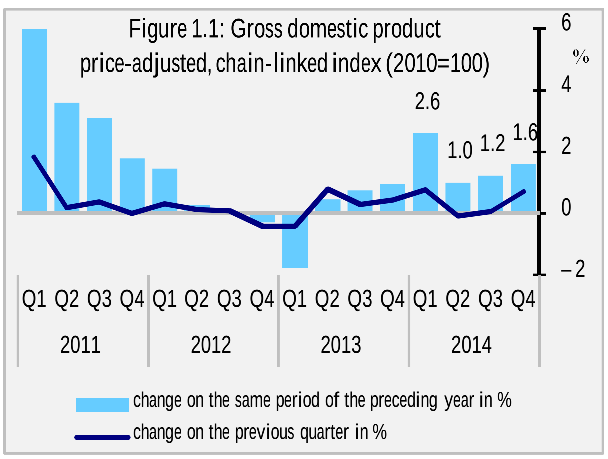
I. EMERGING ECONOMIES

In 2014, growth in developing and transition economies was divergent. Some of these countries faced different challenges such as the structural imbalances, infrastructural bottlenecks, and ineffective macroeconomic management in addition to the geopolitical and political tensions.

Growth in countries as a group is estimated to be 4.3 percent in 2014 and is expected to grow in the coming two years, while transition economies have only 0.8 percent estimated growth with favorable prospects for the coming year.

Tighter global financial conditions, risk of slowdown in emerging economies, geopolitical tensions, and Ebola epidemic will have a negative effect on the regional as well as global economic growth.

Figure 1.1: Gross domestic product price-adjusted, chain-linked index (2010=100)



Source: www.TRADING ECONOMICS /BUREAU OF ECNOMICANALYIS

1.1 Economy of China

Chinese GDP stood at 63,646.3 billion Yuan in 2014, indicating a 7.4 percent growth from the last year, the weakest growth in 24 years.

Within the year, Q2 recorded the highest (y-o-y) growth standing at 7.5 percent, while the lowest growth rate was recorded in Q3 and Q4 as both of them recorded 7.3 percent growth respectively.

The growth mainly was driven by agricultural product, industrial product and market sales growing by 0.9 percent, 8.3 percent, and 12 per cent at nominal annual rate respectively. The slowdown in fixed asset investment as well as export and import could be the main reason behind the weak growth rate.

1.2 Economy of Russia

As a result of European sanctions and lower oil prices, the world largest energy exporter's economy grew by 0.7 percent in 2014, lower than the growth of previous year.

1.3 Economy of India

By registering 7.5 percent growth in 2014, Indian economy surpassed china's economic growth in the same period. According to the advanced estimate of national income released on Feb 9th 2015, India's real GDP is estimated to attain a level of 106.57 Lakh crore rupees. The advanced estimate of GDP was more than the first estimate of 7.4 Lakh crore. The growth mainly was attributed to financial sector, real estate and other sectors which recorded more than 7 percent growth followed by manufacturing and construction, which grew by 6.8 and 4.5 percent respectively.

1.4 Economy of Turkey

Turkish economy expanded at a rate of 2.9 percent in 2014 reaching 126.70 billion Liras. The growth was mainly driven by the government final expenditure, household final expenditure and gross fixed capital formation. In the year 2014, government expenditure increased by 4.6 percent followed by house hold expenditure and gross fixed capital formation.

II. ADVANCED ECONOMIES

2.1 The United States Economy

The U.S. real GDP growth increased at an annual rate of 2.4 percent in 2014, higher than the last two years by 2 and one percentage points respectively.

The growth in GDP was driven by personal consumption expenditures, non-residential fixed investment, exports, and local and state governments spending.

2.2 Economy of German

German economic performance was stable in 2014 recording a 1.6 percent GDP growth, higher than the previous year and the annual average rate of 1.2 percent in the last decade.

Final consumption expenditure was the main contributing factor to the growth. Other factors were capital formation, and trade and production.

2.3 The United Kingdom Economy

In the year 2014, U.K recorded a positive GDP growth, reaching £1698 billion. According to the second estimate released by Office for National Statistics on 26 Feb 2015, U.K economy grew by 2.6 percent compared to 1.3 percent in the last year. GDP growth remained unchanged from preliminary estimate released on 27-Jan-2015.

2.4 France Economy

After worsening in the first half of 2014, signs of remedy were seen in the second half in the horizon of French economy.

In 2014, French economy had a positive growth of 0.4 percent, similar to previous year. Over the year 2014, French economy had a mixed performance. Following the stagnation in the first quarter and contraction in the second quarter, the French economy began to recover in the third quarter, exhibiting a 0.3 percent growth and continued a modest growth in the last quarter, standing at 0.1 percent.

2.5 Economy of Japan

Japanese economy rebounded from a recession by registering an annualized growth rate of 2.2 percent in Q4- 2014. According to preliminary data, Japan's GDP grew by 0.6 percent (q-o-q) after two consecutive quarters of contraction. External demand contribution to the overall growth was 2 percentage points, while private consumption picked up by 0.3 percent.

Japanese economy went into technical recession in 2014 due to an increase in sale tax hampering private consumption.

2.6 Economy of Italy

Italy's economy has been suffering from contraction since 2012. During Q4 - 2014, Italian GDP shrunk by 0.5 percent compared to the same period of previous year. The decline in GDP was mainly driven by transport equipment, construction, and gross fixed capital formation.

GLOBAL UNEMPLOYMENT IN 2014

In the year 2014, global employment is estimated to have grown by 1.4 percent, unchanged from the previous year, but lower than 1.7 percent rate recorded before the crisis years.

In the developed countries, employment rate had a gradual movement toward improvements, but still it is below the pre crisis level. Weak labor demand, lower labor participation rate and structural factors are considered as the main reasons behind it.

Employment picked up notably in some large emerging economies such as Brazil and Russia, but no considerable momentum was seen in developing countries.

United States of America: unemployment was recorded 5.6 percent at the end of 2014 down from 6.7 percent at the end of the previous year. The unemployment rate was down in 2014 by 1.1 percentage point. The number of unemployed persons decreased by about 20 percent at the end of 2014 compared to a year ago.

Germany: Unemployment rate (adjusted) was 4.8 percent in 2014, down from the same period of previous year, when it was recorded 5.1 percent. There were 1.91million unemployed at the end of 2014, lower than 2.1 million in the last year.

United Kingdom: The unemployment rate of U.K. was 5.7 percent at the end of 2014, lower than 7.2 percent in the same period of last year. Employment continued to increase at the end of 2014 as proportion of people aged 16 to 64 in work was 73.2 percent, higher than both, previous quarter and the same period of last year.

9.05 million people aged from 16-64 who were out of work and not seeking for a job 22,000 more than previous quarter.

Japan: In the year 2014, the average annual unemployment rate was 3.4 percent, down from previous year by 4 percentage point. Over the year, the highest monthly unemployment rate was recorded in the first, sixth, and seventh months (3.7 percent), while the lowest rate was recorded in the last month, standing at 3.4 percent.

Italy: In Q4 of 2014, unemployment rate rose by 13.2 percent compared to that of previous year, while inactivity rate declined by 35.3 percent.

China: According to data released by Ministry of Human Resources and Social Security (MHRSS) on 23 Jan 2015, China's registered unemployment rate in urban areas stood at 4.9 percent in 2014, indicating 8 percentage point decline from that of 2013. The rate was below the target specified by Chinese government. Government pledged to create more than 10 million jobs and keep unemployment rate below 4.6 percent.

Russia: In the year 2014, the unemployment rate was 5.2 percent lower than 5.6 percent of previous year. The highest quarterly unemployment rate was recorded in Q1 standing at 5.5 percent, while the lowest rate was recorded in Q3 standing at 4.9 percent.

GLOBAL INFLATION TREND

In 2014, inflation was uneven across the globe. Inflation picked up in some of the developed countries, remained high in developing and transition economies, while some countries have been facing risk of deflation.

Global inflation is expected to be 1.5 percent indicating a 2 percentage point increase than that of the previous year. More than 50 percent decline is estimated for inflation rate in EU countries. Inflation was recorded at 0.7 percent in 2014, down from 1.5 percent of previous year. Weak recovery, output gap, and local currencies appreciation are considered as the main reasons behind the drop in the rate of inflation.

The average inflation rate for transition economies is estimated to increase by 1.8 percent, driven up by currency depreciation.

The United States: CPI rose in 2014 by 0.8 percent, lower than the previous year by 0.7 percentage points. CPI in 2014 recorded the second lowest Dec-to Dec in the last five decades and considerably lower than 2.1 percent annual average increase over the last decade.

The main factor behind the decrease in CPI was energy index, which declined by 10.6 percent in 2014.

Germany: In the recent years, Germany has been experiencing disinflationary pressures in annual average inflation rate. The downward trend in inflation began from 2011 when the inflation rate was recorded 2.1 percent and continued its downward trend standing at 0.9 percent in 2014.

The major factor leading to a decrease in overall prices in 2014 was a sharp decline in the energy prices. The largest decline recorded for heating oil followed by motor fuel prices as the first one declined by 7.8 percent and the second one declined by 4.4 percent.

Compared to previous year, in 2014 total goods prices increased by 0.2 percent, significantly lower than increase in services, which increased by 1.6 percent.

United Kingdom: The CPI stood at 5 percent at the end of 2014. The main contributors to the CPI at the end of the year were restaurants and hotels, education, alcohol and tobacco.

The highest contribution came from restaurants and hotels recording a 28 percent increase.

In 2014, the highest rate was recorded in the months of January and June, while the lowest rate was recorded in December.

France: CPI rose by 0.1 percent (y-o-y). Services and manufactured products increased by 1.6 and 0.2 percent respectively, while food prices and energy prices declined by 0.4 and 4.4 percent respectively. Core inflation remained in the negative territory recording -0.1 percent (Y-o-Y).

Japan: In the year 2014, inflation in Japan stood at 2.7 percent, up from 0.4 percent recorded in 2013. Prices of energy, fresh food, durable goods and services were the main factors behind the increase in overall inflation.

Italy: The average annual inflation rate for 2014 measured by NIC was reported 0.2 percent, down from 1.2 percent of previous year.

China: CPI increased by 2.0 percent in 2014. The overall prices went up by 2.1 percent in urban areas and 1.8 percent in rural areas.

Russian Federation: Annual inflation rate was 11.4 percent at the end of 2014, the highest monthly inflation rate through the year. The price hike was mainly due to the imposed sanctions by the United States and the EU as well as the depreciation of Rubble.

India: At the end of 2014, combined CPI (rural and urban) stood at 5 percent, indicating a considerable decline from the same period of previous year.

Prices of most items declined compared to the previous year.

Household final consumption expenditure increased by 1.3 percent, government final consumption expenditure increased by 4.6 percent at constant prices in 2014.

GLOBAL TRADE

World trade had a sluggish growth in 2014, standing at an estimated rate of 3.4 percent.

Export growth of developed countries was 3.5 percent and expected to pick up in the coming year. The U.S. export growth was strong in 2014; however it is expected to decline in the coming year as a result of stronger greenback. Further stabilization measures taken by the Western Europe may improve export growth and euro depreciation to limit imports in these countries, while weakness of Japanese yen will have positive impacts on its export growth. Export of CIS countries was badly affected by the regional geopolitical tensions in 2014 and it is expected to stand near zero. Imports also declined at an estimated rate of 3.4 percent in 2014.

Export growth of developing countries is expected to be 3.9 percent, while import is estimated to fall behind it only by 1 percentage point.

United States: In the year 2014, export of goods and services valued at USD 2345.42 billion, while imports valued USD 2850.47 billion, indicating a deficit of USD 505.05 billion. The trade deficit in 2014 was 6 percent higher than the previous year. The U.S. trade deficit consist 2.9 percent of GDP in 2014, up from 2.8 percent in the last year.

Germany: In the year 2014, Germany experienced a trade surplus of € 218.9 billion with a total export of € 1133.5 billion and a total import of € 916.6 billion.

France remained the most important trade partner of Germany as a total of € 169.4 billion was traded between two countries in the year under review. Netherland ranked the second trade partner with a total trade of € 161.3 billion followed by china with a total trade turnover of € 154.0 billion.

United Kingdom: In 2014, trade deficit of U.K widened to £34.8 billion more than that of previous year by 3.3 percent, the largest deficit since 2010. Both, exports and imports declined in 2014; however exports declined more significantly than imports. Exports declined to £14.6 billion, while imports declined to £7.3 billion.

France: In 2014, both merchandise exports and imports of France declined compared to that in the previous year. Total merchandise trade reached USD 566.7 bn, while total merchandize imports reached to USD 659.9 bn, indicating a deficit of USD 93.2 bn. The deficit was lower than that of the previous year by USD 8.6 bn. Aircraft; medicament and motor cars were among the top export commodities, while petroleum stood at the top of import commodities.

Italy: According to the report released by the National Statistics Institute of Italy (Istat), during Q4 - 2014, total exports of Italy valued € 114,094 million, indicating a 3.8 percent increase from the same period of previous year, while total imports stood at € 100,829 million indicating a 2.0 percent increase over the same period of previous year.

China: China's foreign trade accelerated by 3.4 percent (y-o-y) in 2014, lower than that recorded in the previous year, when it rose by 7.6 percent.

In 2014, China's trade registered a surplus of USD 382.46 billion indicating a 47.7 percent increase over the previous year. Total exports reached USD 4.3 trillion, while total imports reached USD 1.96 trillion. Compared to the previous year's figures, exports increased by 6.1 percent, total imports increased by 0.4 percent, resulting to a trade surplus of 47.7 percent. In 2014, China's trade with the European Union, China's biggest trade partner, increased by 8.9 percent, while with the U.S and ASEAN increased by 5.4 and 2.95 percent respectively. However, trade with Japan contracted by 1 percent.

Russia: In the year 2014, Russia's total export reached USD 497.76 bn, while its total imports stood at USD 308.03 bn, indicating a surplus of USD 189.1 bn. Compared to the previous year, Russia's trade surplus picked up by 4.3 percent.

India: Total exports of India (Apr to Dec 2014) valued USD 241,153.68 million compared to USD 231,829.87 million of the previous year, indicating a 4.02 percent growth, while on a cumulative basis, total imports (Apr-Dec 2014) was USD 351,205.7 million, compared to USD 338,907.35 million of the same period of previous year. The trade deficit is estimated at USD 110,051.92 million in 2014 (Apr-Dec), higher than the deficit of 2.8 percent in the previous year.

Turkey: Exports of goods and services increased by 6.8 percent in 2014, while imports of goods and services decreased by 0.2 percent at constant prices. Exports of goods and services increased by 6.8 percent, reached 34.111 billion Turkish Liras at constant prices and increased by 20.7 percent, reaching 484.983 billion Turkish Liras at current prices.

In 2014, imports of goods and services decreased by 0.2 percent standing at 35.582 billion Turkish Liras at constant prices and increased by 11.5 percent standing at 562.271 billion Turkish Liras at current prices.

CONTRIBUTION OF TRAVEL AND TOURISM TO THE GLOBAL ECONOMY

Travel and Tourism sector opens the way for business, trade, job creation and besides protecting historical places and cultural heritages; it contributes to the GDP as well.

According to the report released by World Travel and Tourism Council (WTTC), in the year 2014, the sector generated USD 7.6 trillion (10 percent of world GDP) and created 277 million jobs for the world economy. Although the sector faced challenges such as currency depreciation and volatilities of currencies against USD, the value it generated grew by 7.14 percent than previous year.

The sector's direct contribution to the world economy reached USD 2364.8 billion (3.1 percent of global economy) higher than that of previous year when stood at USD 2155.4 billion, but lower than the forecast of 4.3percent, it is expected to contribute to the world economy in the coming year by USD 2451.1 billion.

In the year 2014, the sector generated 105 million jobs directly, contributing to the total employment by 3.6 percent. Compared to last year, the sector's employment generation picked up by 4.5 percent creating 4.5 million jobs which is higher than early projected 2.2 percent. Its total contribution to the employment was 9.4 percent, higher than that of previous year by 5 percentage points.

Visitor's exports grew by 6.8 percent in 2014 valuing USD 1383 billion, contributing 5.7 percent to total exports.

The sector's contribution to the global investment was 4.3 percent, reaching USD 814.4 bn.

Table 1.1: the economic contribution of Travel and Tourism: Nominal Prices

World (USDbn, nominal prices)	2008	2009	2010	2011	2012	2013	2014E	2024F
1. Visitor exports	1,088	971	1,061	1,200	1,237	1,296	1,356	2,617
2. Domestic expenditure (includes government individual spending)	2,785	2,550	2,733	3,072	3,147	3,221	3,360	6,822
3. Internal tourism consumption (= 1 + 2)	3,874	3,521	3,794	4,272	4,384	4,517	4,716	9,438
4. Purchases by tourism providers, including imported goods (supply chain)	-2,019	-1,805	-1,959	-2,227	-2,288	-2,361	-2,469	-2,019
5. **Direct contribution of Travel & Tourism to GDP** (= 3 + 4)	1,855	1,716	1,834	2,045	2,096	2,156	2,247	4,448
Other final impacts (indirect & induced) 6. Domestic supply chain	1,739	1,584	1,712	1,951	2,007	2,070	2,165	4,413
7. Capital investment	733	637	640	713	735	755	800	1,775
8. Government collective spending	350	357	379	410	415	415	423	753
9. Imported goods from indirect spending	271	233	273	297	313	329	344	600
10. Induced	1,091	1,044	1,088	1,204	1,235	1,266	1,312	2,588
11. **Total contribution of Travel & Tourism to GDP** (= 5 + 6 + 7 + 8 + 9 + 10)	6,038	5,571	5,926	6,620	6,801	6,991	7,291	14,576
Employment impacts ('000) 12. Direct contribution of Travel & Tourism to employment	99,207	96,198	96,548	98,096	99,502	100,894	103,069	126,257
13. **Total contribution of Travel & Tourism to employment**	262,457	254,666	251,604	256,757	261,152	265,855	272,417	346,901
Other indicators 14. Expenditure on outbound travel	991	886	966	1,080	1,121	1,171	1,224	2,338

Source: WTTC Travel and Tourism Economic Impact 2015

FISCAL POLICY

In 2014, major developed countries focused on fiscal consolidation, both on revenue and expenditure sides, as a result, the average budget size of these countries will shrink and would have small contractionary impact on their economies.

Several years of fiscal austerity reduced U.S budget deficit to USD 649 bn, lower than that of previous year by USD 31 bn. In the EU, fiscal consolidation has been progressing slowly due to economic down tern, loss of income tax and bailout of banking system.

In Japan stimulus measures taken in 2013 and higher consumption tax enacted in 2014 has narrowed the deficit in 2014.

Public debt and budget deficit of developing and transition economies are generally lower than that of developed economies and their fiscal development varied in 2014.

MONETARY POLICY

Different regions in the world adopted different monetary policies based on their situations. Due to slow recovery, central banks of major developed countries continued quantitative easing stance in 2014. Fed decided to maintain federal fund rate within the range of 0.00 to 0.25 percent if inflation remains below 0.2 percent.

According to forward guidance issued by ECB in July, it was decided to keep interest rate at its level or lower for an extended period of time. In September 2014, ECB kept interest rate on facilities such as deposit facility and marginal lending facility unchanged.

Bank of England in its meeting held in October, kept its policy rate unchanged at 5 percent, it further signaled that it would keep it unchanged until unemployment rate downs below 7 percent. Even though, the unemployment rate came below the specified rate, policy rate was kept unchanged.

Bank of Japan continued its quantitative and qualitative easing policy and kept its policy rate below 0.10 percent since 2009.

Central banks of developing and emerging economies adopted different stances from developed countries.

In order to control capital flight and currency depreciation, central banks of Brazil, India and South Africa increased their policy rates. Central Bank of Brazil increased its policy rate three times in 2014 while Russia increased its key policy rate six times to tame inflation and control Rubble depreciation. Indonesian central bank kept its policy rate unchanged.

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2

MONETARY AND CAPITAL MARKET DEVELOPMENTS

2

MONETARY AND CAPITAL MARKET DEVELOPMENTS

Monetary and capital market developments evaluate monetary program, monetary aggregates, foreign exchange rates, net international reserves, as well as the open market operations. In the fiscal year 1393 (21 Dec. 2013 to 20 Dec. 2014) , reserve money, Da Afghanistan Bank's operational target, grew at 13 percent, standing at AF 224,885.81 million at the end of the year. The actual reserve money growth slightly exceeded the end year target of 12.7 percent. Currency in circulation "an indicative target" increased by 17 percent in the year under review, reaching AF197, 022.95 million.

On the other hand, DAB successfully achieved the target (floor) for the net international reserves (NIR).

Narrow money (M1), stood at AF 384,152 million at the end of the year under review, registering an annual growth of 9.54 percent (Y-o-Y). Broad money (M2) demonstrated similar behavior, representing a growth rate of 8.34 percent (Y-o-Y) standing at AF 401,583 million at the end of the year under review.

In order to control the reserve money growth, DAB utilizes monetary instruments of FX auction and selling of capital notes under the open market operations.

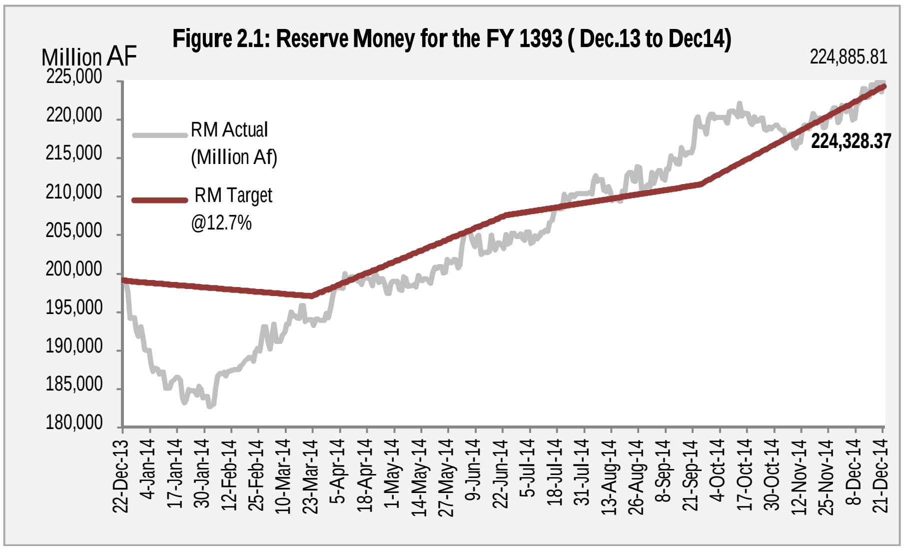
In the fiscal year 1393, DAB has auctioned a total amount of USD 3,341.43 million to manage the liquidity in the market as well as to mitigate the unnecessary fluctuations in the exchange rate of afghani against the foreign currencies.

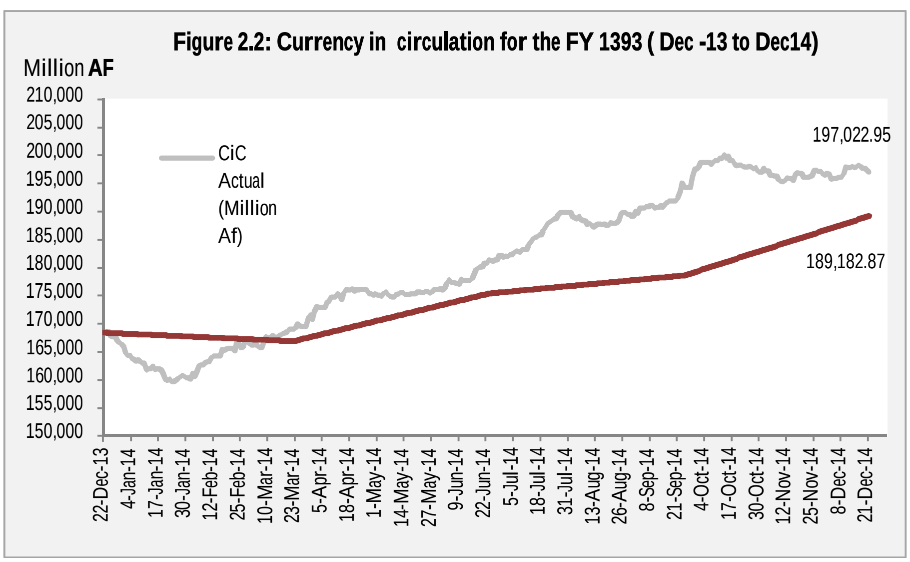
The outstanding amount of CNs stood at AF 38 billion, while afghani depreciated against the US dollar by 1.79 percent in period under review.

I – MONETARY PROGRAM

Under the monetary policy framework (MPF), reserve money remained the key operational target (performance criterion) in the period under review, while currency in circulation was set as the indicative target. The precise amount of reserve money (RM) conducive to support the domestic price stability, DAB's primary objective, is determined using the Quantitative Theory of Money. For the FY1393, the ceilings for reserve money growth and growth in currency in circulation were revised upward from early 8 percent to 12.7 percent and 12.3 percent respectively. The actual reserve money ended with a growth rate of 13 percent, slightly above the target, at the end of the year. (Name the main drivers)

At the beginning of the FY 1393, both RM and CiC experienced downward trend, mainly because of the significant delay in approval of the national budget by the Parliament, however onward ,both grew at a faster pace due to decrease in the level of domestic revenues. Domestic revenues remained below the target in the reporting period mainly as a result of weak economic activities, deteriorating poor security environment, prolonged presidential elections, the withdrawal of international security forces from Afghanistan, and the increased government expenditures.





Source: *Monetary Policy Department/DAB*

II. MONETARY AGGREGATES

The Monetary Section of the Monetary Policy Department compiles monetary aggregates - narrow money (M1), and broad money (M2) in accordance to the Monetary and Financial Statistics (MFS) methodology and definition.

Narrow money, includes all banknotes, coins, and demand deposits, and other liquid assets of the commercial banks with the central bank, while broad money includes narrow money components and other less liquid assets. In the FY1393, narrow money (M1) grew by 9.54 percent on a year-on-year basis.

The stock of broad money (M2) grew to AF 401,583 million, which represents an overall growth rate of 8.34 percent (Y-o-Y), lower than 9.4 percent growth recorded in the same period of last year. M1 remained as the main contributing component of the M2.

Quasi money or time deposits of commercial banks, which is the other component of M2, grew by -12.79 percent (y-o-y) at the end of 1393 compared with the same period of FY1392. However, quasi money constitutes only 4 percent of broad money. Therefore, the impacts of its changes on the M2 are negligible. The year-on-year difference of Afghani denominated time deposits stood at AF -2,653million, while the foreign currency denominated time deposits recorded AF 96 Million.

Meanwhile, demand deposits as a share of broad money decreased 48.73 percent (Y-o-Y) in the year under review, down from 50.92 percent in the previous year.

Similarly, quasi money as a share of broad money decreased slightly to 4.34 percent at the end of the year under review, down from 5.39 percent in the same period of last year. Afghani-denominated time deposits constitute 1.30 percent of broad money. While, the share of foreign currency denominated deposits stood at 3.04 percent of M2.

Figure 2.4: Demand Deposits as Share of Broad Money (%)

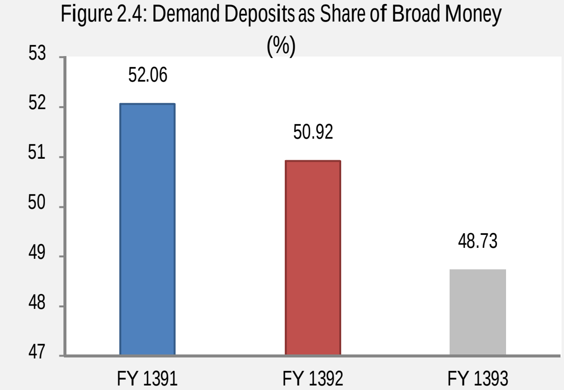
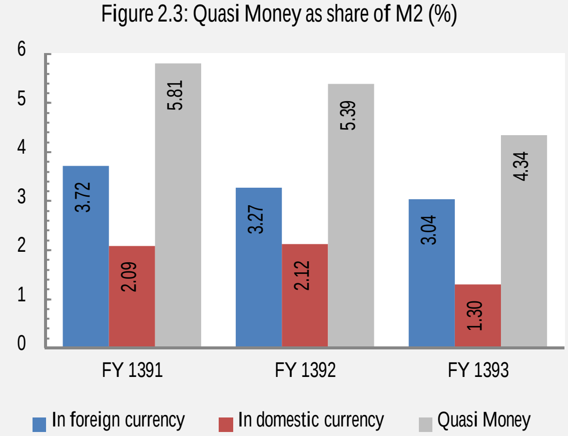


Figure 2.3: Quasi Money as share of M2 (%)



Source: *Monetary Policy Department/DAB*

Table 2.1: Monetary Aggregate, FY 1393 (Dec 21, 2013 – Dec 20, 2014)

Figures in million AF, unless otherwise indicated

	1391 Amount	1392 Amount	Δ Y-o-Y	Difference	1393 Amount	Δ Y-o-Y	Difference
1-Net Foreign Assets	425,376	483,924	13.8%	58,548	487,005	0.64%	3,081
(a) Foreign Assets	455,731	513,630	12.7%	57,899	514,730	0.21%	1,100
DAB Foreign exchange reserves	372,713	421,774	13.2%	49,061	427,621	1.39%	5,847
Gold	60,424	60,424	0.0%	0.000	47,509	-21.37%	0.000
Other	312,289	361,350	15.7%	49,061	380,112	5.19%	18,762
Other foreign assets	83,018	91,856	10.6%	8,838	87,109	-5.17%	-4,747
(b) Foreign liabilities	30,354	29,706	-2.1%	-649	27,725	-6.67%	-1,981
2. Net Domestic Assets	-86,537	-113,241	30.9%	-26,704	-85,422	-24.57%	27,819
(a) Net Domestic Credit	-44,492	-45,657	2.6%	-1,165	-28,650	-37.25%	17,008
Net Credit to Nonfinancial Public Sector	-86,566	-91,121	5.3%	-4,555	-71,193	-21.87%	19,928
Net Credit to Central Government	-86,267	-90,911	5.4%	-4,645	-71,077	-21.82%	19,834
Credit to Central Government	32,831	33,727	2.7%	896	32,922	-2.39%	-805
Liabilities to Central Government	119,097	124,638	4.7%	5,540	103,999	-16.56%	-20,639
Net Credit to State & Local Government	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Net Credit to Public Nonfinancial Corporations	-299	-210	-29.8%	89	-116	-44.61%	94
Credit to Private Sector	43,024	46,814	8.8%	3,789	43,943.42	-6.13%	-2,870
Net Credit to Other financial Corporations	-950	-1,349	42.0%	-399	-1,399.69	3.73%	-50
(b) Capital Accounts	83,686	110,484	32.0%	26,797	100,220	-9.29%	-10,263
(c) Other Items Net	41,641	42,900	3.0%	1,259	43,448	1.28%	548
3- Broad Money (M2)	338,840	370,684	9.4%	31,844	401,583	8.34%	30,899
Narrow Money (M1)	319,164	350,696	9.9%	31,532	384,152	9.54%	33,456
CiC (Currency outside depository corporations)	142,761	161,944	13.4%	19,183	188,451	16.37%	26,507
Demand Deposits	176,403	188,751	7.0%	12,348	195,701	3.68%	6,950
Other Deposits (Quasi Money)	19,675	19,988	1.6%	312	17,431	-12.79%	-2,557
In Afghani	7,079	7,867	11.1%	788	5,214	-33.72%	-2,653
In Foreign currency	12,597	12,121	-3.8%	-476	12,217	0.79%	96
Securities Other Than Shares	0.000	0.000	0.000	0.000	0.000	0.000	0.000

2.1 Net International Reserve

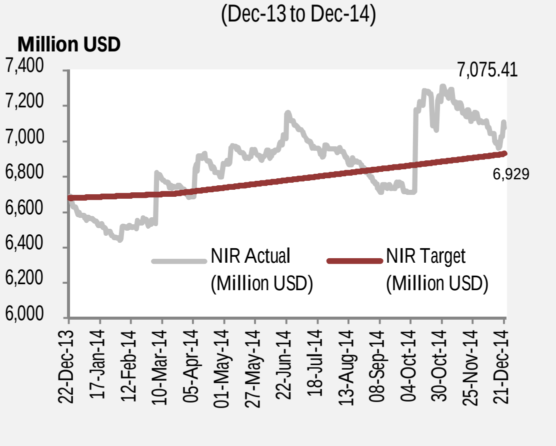
Da Afghanistan Bank's International reserves consist of monetary gold, reserve position and holdings with the IMF Special Drawing Rights (SDR) as well as major foreign exchange such as the U.S dollars, Euro, and Great British Pound.

For the fiscal year 1393, the NIR accumulation floor was set at USD 250 million, while the actual accumulation surpassed the target by USD 144 million standing at USD 394 million.

The actual NIR ended at USD 7,075.41 million at the end of the fiscal year 1393.

The increase in the NIR is attributed to inflows of foreign exchange particularly from donor's contribution and a portion of accumulation from the investment of the reserves.

Figure 2.5: NIR Actual and target for the FY 1393 (Dec-13 to Dec-14)



Source: Monetary Survey, Monetary Policy Department/ DAB

III. FROEIGN EXCHANGE MARKET

3.1 Foreign Exchange Rates

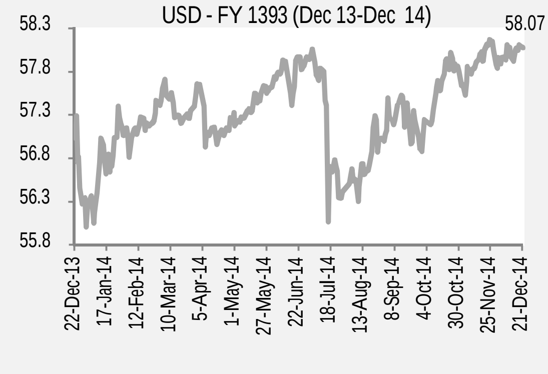
Da Afghanistan Bank (DAB's) ultimate goal is to maintain price stability. In order to achieve and maintain its goal, DAB utilizes its monetary instruments effectively with sound policy implementation.

DAB does not target the nominal exchange rate of afghani against the foreign currencies; however, it is important to monitor the fluctuation in the exchange rate which can affect the economic indicators. This coerces DAB to intervene in the market via managed floating exchange rate regime.

The daily historic review of the average exchange rate of AF against the U.S. dollars for the fiscal year 1393 is shown in figure below. Afghani weakened against the major currencies, as a result of trade deficit, as well as the withdrawal of foreign troops from the country and concerns over the uncertain economic and political situation of the country. Afghani depreciated against the U.S dollar by 1.79 percent, traded at AF 58.07 per U.S. dollar at the end of the year under review.

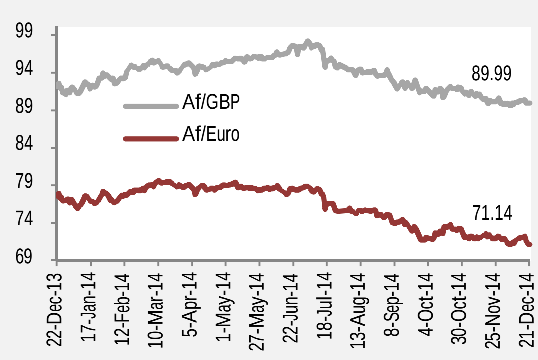
Similarly, Afghani depreciated against the INR and PKR by 0.77 and 6.68 percents respectively. On the other hand, Afghani appreciated against the Euro, GBP and IRR by 9.07 percent, **2.46** percent and 14.29 percents respectively.

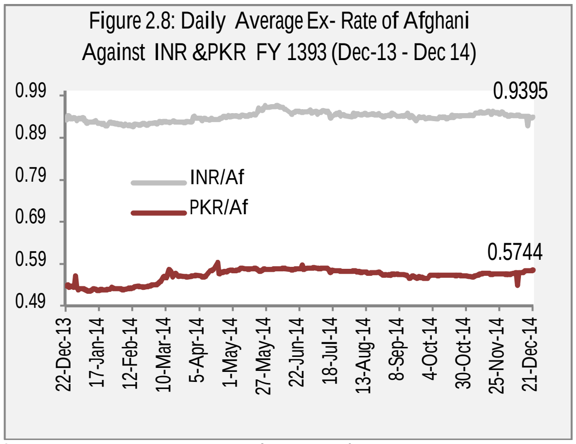
Figure 2.6: Daily Average Ex-Rate of Afghani against USD - FY 1393 (Dec 13-Dec 14)



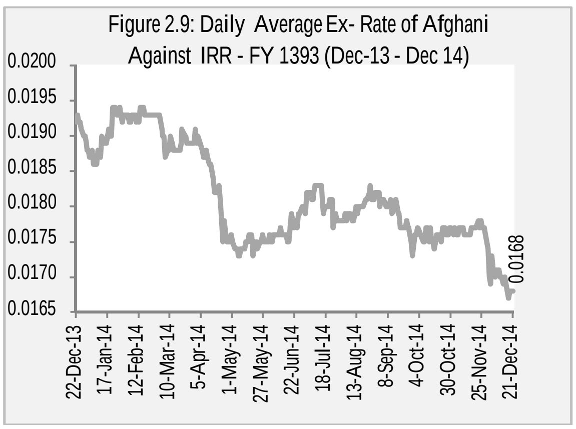
Source: Monetary Survey, Monetary Policy Department/ DAB

Figure 2.7: Daily Average Ex-Rate of Afghani against GBP & Euro - FY 1393 (Dec 13 - Dec 14)





Source: *Monetary Survey Section, M PD/ DAB*



Source: Monetary Survey, Monetary Policy Department/ DAB

3.2 Foreign Exchange Auction

In order to control the money supply, DAB anchors reserve money by conducting bi-weekly foreign exchange auctions, and a weekly capital notes auction, the primary monetary instrument used by DAB. DAB increased the size of FX auction to mop up excess liquidity from the market and to avoid extra volatilities in the exchange rate of Afghani against the foreign currencies, especially the U.S dollar.

DAB auctioned a total of USD **3.341** billion in the year under review; when the total demand was USD **4.698** billion. On average, 37 bidders participated in each auction and 32 bids were the winning bids with the average amount of USD 34.81 million; as compared to FY 1392, where total awarded amount stood at USD 3.482 billion, with a total demand of USD 4.985 billion. On average, 38 bidders participated in each auction and 34 bids were awarded with an average of USD 33.81 million.

Table 2.2: Foreign Exchange Auction's Summery for FY 1393 (million USD)

Auction Date	No of Bidders	Highest Price	Lowest Price	Market Ex Rate	Cut off Price	Amount Announced	Amount Awarded	Total Demand
24-Dec-13	48	56.72	56.00	56.75	56.64	50	50.25	75.1
28-Dec-13	45	56.26	55.80	56.27	56.12	50	49.93	65.78
31-Dec-13	43	55.99	55.30	56.01	55.92	40	39.8	69.35
04-Jan-14	30	56.44	56.00	56.37	56.40	35	34.55	59.95
07-Jan-14	45	56.20	55.80	56.17	56.18	30	19.65	50.75
11-Jan-14	46	56.90	56.10	56.75	56.84	25	25.6	47.35
14-Jan-14	39	56.94	56.01	56.95	56.84	25	24.65	32.2
18-Jan-14	42	56.93	56.12	56.85	56.88	25	25.3	39.15
21-Jan-14	40	56.73	56.01	56.71	56.65	25	19.65	35.8
25-Jan-14	37	57.04	56.50	57.04	57.00	25	20.1	30.9

28-Jan-14	40	57.22	56.12	57.20	57.18	30	29.85	40.2
01-Feb-14	39	57.35	56.85	57.07	57.06	30	24	36.95
04-Feb-14	31	56.86	56.55	56.81	56.80	25	9.25	27.5
08-Feb-14	37	57.19	57.00	57.14	57.16	20	19.7	33.42
11-Feb-14	36	57.14	56.80	57.14	57.13	20	20.5	28.45
16-Feb-14	26	57.60	56.50	57.26	57.22	20	17.05	22.7
18-Feb-14	27	57.23	57.02	57.21	57.20	20	19.65	25.5
22-Feb-14	33	57.21	56.60	57.20	57.16	20	19.85	25.95
25-Feb-14	38	57.36	57.10	57.32	57.32	20	24.1	30.95
01-Mar-14	38	57.44	56.80	57.41	57.39	30	30	38.6
04-Mar-14	36	57.69	57.46	57.65	57.64	30	35.2	44.65
08-Mar-14	33	57.47	57.03	57.48	57.30	40	30.9	36.3
12-Mar-14	30	57.36	56.85	57.44	57.16	35	30.25	32.25
15-Mar-14	34	57.25	56.75	57.30	57.11	35	34.75	39.25
18-Mar-14	41	57.18	56.80	57.20	57.12	35	34.7	50.95
23-Mar-14	36	57.36	57.13	57.31	57.27	25	25.35	35.35
25-Mar-14	35	57.25	57.00	57.26	57.23	25	24.5	37.95
29-Mar-14	39	57.45	57.25	57.40	57.40	25	30.05	40.25
01-Apr-14	39	57.59	57.00	57.61	57.53	35	34.45	49.5
08-Apr-14	40	57.05	56.62	57.09	56.96	60	51.65	72.15
12-Apr-14	39	57.21	57.00	57.15	57.16	30	33.05	49.65
15-Apr-14	40	57.05	56.60	57.07	57.00	35	34.45	43.85
19-Apr-14	37	57.11	56.90	57.11	57.05	30	32.65	39.1
22-Apr-14	39	57.05	56.89	57.06	57.02	30	31.45	45.55
26-Apr-14	39	57.14	56.95	57.12	57.12	30	31.2	46.6
29-Apr-14	39	57.29	57.10	57.25	57.24	30	30.7	45
03-May-14	40	57.22	56.20	57.22	57.20	40	34.75	56.4
06-May-14	38	57.32	57.14	57.28	57.30	30	28.2	48.55
10-May-14	38	57.33	57.01	57.32	57.31	30	31.6	43.15
13-May-14	36	57.34	57.06	57.35	57.32	35	36.5	44.5
17-May-14	36	57.55	57.11	57.55	57.49	30	29.35	40.5
20-May-14	35	57.50	57.30	57.50	57.47	30	30	43.4
24-May-14	41	57.63	57.14	57.64	57.60	30	33.85	44.05
27-May-14	29	57.53	57.33	57.55	57.36	35	35.05	35.95
31-May-14	35	57.60	57.38	57.62	57.55	35	34.15	47.95
03-Jun-14	39	57.71	57.13	57.71	57.68	35	34.4	54.05
07-Jun-14	40	57.81	57.21	57.77	57.78	35	41.2	54.25
10-Jun-14	39	57.92	57.68	57.92	57.90	40	41	61.3
17-Jun-14	39	57.51	57.12	57.63	57.48	60	60.35	85.65
21-Jun-14	41	58.00	57.12	57.97	57.96	35	35.35	55.55
24-Jun-14	35	57.81	57.40	57.82	57.73	40	39.95	49.9
28-Jun-14	37	57.99	57.78	57.97	57.93	40	40.9	55.05
01-Jul-14	35	57.96	57.80	57.97	57.90	40	39.9	50.9
05-Jul-14	38	57.91	57.66	57.90	57.87	40	40	54.15
08-Jul-14	32	57.72	57.50	57.70	57.62	40	40	46.05
12-Jul-14	33	57.76	57.60	57.80	57.72	35	34.35	43.55

15-Jul-14	32	56.96	56.61	56.96	56.81	35	35.2	41.55
19-Jul-14	32	56.64	56.25	56.64	56.52	30	36.35	38.25
22-Jul-14	33	56.68	56.41	56.71	56.61	30	39.45	48.55
26-Jul-14	33	56.31	55.90	56.34	56.25	35	39.4	52.3
02-Aug-14	29	56.49	56.28	56.51	56.42	35	35.25	41.8
05-Aug-14	33	56.60	56.29	56.54	56.46	35	35.35	46.6
09-Aug-14	36	56.30	55.80	56.30	56.26	35	36.3	51.65
12-Aug-14	39	56.75	56.55	56.74	56.73	35	37.25	61.85
16-Aug-14	38	56.71	56.12	56.67	56.68	40	40.3	64.05
23-Aug-14	39	57.29	56.61	57.29	57.22	35	36.3	48.7
26-Aug-14	37	57.06	56.81	57.02	57.02	35	35.85	49.35
30-Aug-14	38	57.05	56.73	57.00	56.99	35	35.3	50.2
02-Sep-14	41	57.51	57.12	57.50	57.48	35	35	61.1
06-Sep-14	36	57.24	56.80	57.24	57.17	35	38.65	45.05
13-Sep-14	34	57.60	57.30	57.51	57.46	35	34.7	42.15
16-Sep-14	36	57.18	56.55	57.16	57.07	35	33.2	48.6
23-Sep-14	36	57.37	57.00	57.35	57.30	35	34.3	46.35
27-Sep-14	34	56.90	56.50	57.05	56.80	35	24.85	34.3
30-Sep-14	35	56.96	56.81	56.88	56.92	20	20.15	32.45
11-Oct-14	33	57.55	57.20	57.36	57.52	25	30.45	36.6
14-Oct-14	34	57.56	57.40	57.70	57.50	35	37.4	44.6
18-Oct-14	32	57.75	57.11	57.77	57.72	35	36	43.7
21-Oct-14	36	57.90	57.50	57.92	57.83	40	40.4	52.6
25-Oct-14	35	57.94	57.45	57.81	57.70	35	43.05	46.3
28-Oct-14	37	57.84	57.60	57.87	57.78	40	39.5	58.6
01-Nov-14	36	57.61	57.35	57.64	57.51	40	39.85	55.5
04-Nov-14	38	57.57	57.35	57.65	57.53	40	37.65	63.9
08-Nov-14	35	57.82	57.41	57.81	57.78	35	37.8	51.05
11-Nov-14	39	57.83	57.60	57.83	57.82	35	35.15	61.95
15-Nov-14	37	57.93	57.76	57.94	57.91	35	35.15	54.45
18-Nov-14	40	57.93	57.76	57.92	57.89	40	41.35	63.4
22-Nov-14	43	58.15	57.81	58.12	58.12	40	48.2	71.95
25-Nov-14	39	58.16	57.96	58.14	58.13	45	44.5	65.7
29-Nov-14	38	57.89	57.50	57.88	57.84	50	54.05	67.45
02-Dec-14	42	57.88	57.14	57.89	57.85	50	49.2	78.25
06-Dec-14	38	57.99	57.80	57.97	57.94	50	49.45	62.55
09-Dec-14	39	58.06	57.88	58.04	58.03	50	47.55	72.75
13-Dec-14	37	57.88	57.66	57.92	57.84	50	49.25	66.75
16-Dec-14	40	58.05	57.80	58.07	58.01	50	47.6	76.65
20-Dec-14	37	58.07	57.80	58.09	58.02	45	45.15	58.7
Total						**3,340.00**	**3,341.43**	**4,698.00**

Source: Market Operations Department and Monetary Policy Department staff calculation

IV. CAPITAL MARKET & LIQUIDITY CONDITIONS

4.1 Capital Note Auctions

Da Afghanistan Bank uses Capital Notes (CNs) as the second monetary tool to manage the money supply growth. Capital notes are used to absorb the excess liquidity of the commercial banks.

Capital notes are afghani denominated short–term securities offered by DAB to the primary market customers, mostly licensed commercial banks on a weekly basis.

Currently, DAB offers one month, six months, and one year capital notes. The one year security has recently been introduced to the market in order to expand the use of this monetary tool.

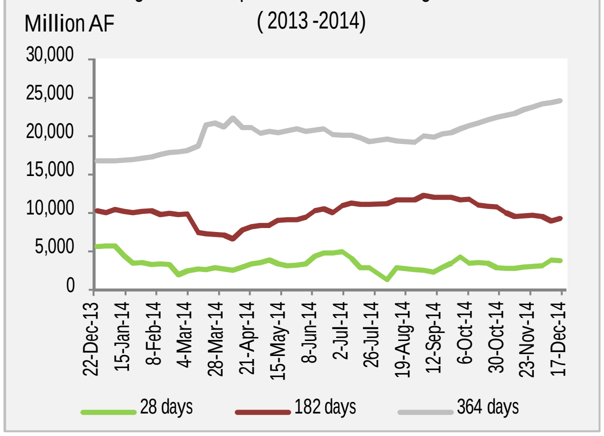
Total outstanding stock of capital notes reached AF 37.8 billion at the end of the fiscal year 1393, which shows an increase of 23.3 percent compared to the FY 1392, when it was AF 30.66 billion. Such increase in the level of securities is a positive sign toward expansion of this monetary tool, which enables DAB to reduce size of the FX auction and to build up its reserves position.

The outstanding stock of 28 day notes stood at AF 3.8 billion, remaining flat during the year under review, while for 182 day maturity the stock declined by 10 percent, ended at AF 9.3 billion. The stock outstanding for 364 day notes stood at AF 24.7 billion in the fiscal year 1393 (2014).

Figure 2.10 exhibits breakdown of the total outstanding stock for all maturities during the fiscal year 2014.

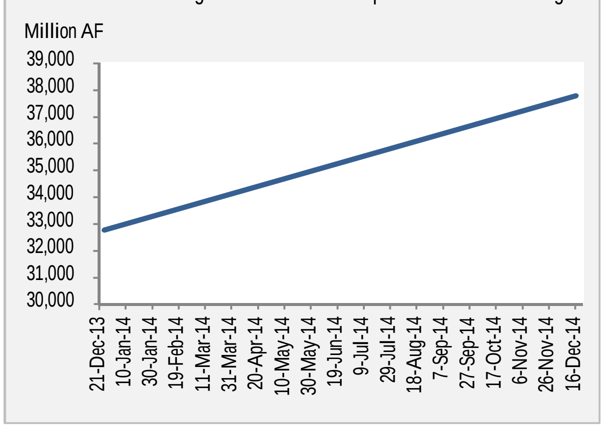
The weighted average interest rate for 28 day capital note was 3.5 percent and for 182 day security it reached 5.17 percent, while for 364 day security, it ended at 7.1 percent in the FY 1393.

Figure 2.10: Cspital Notes Outstanding FY 1393 (2013 -2014)



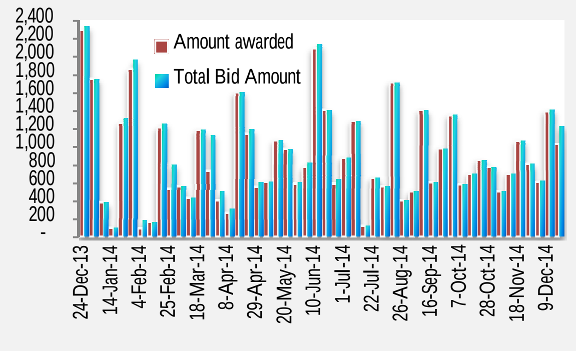
Source: Market Operations Department/DAB

Figure 2.11: Stock of Capital Notes Outstanding



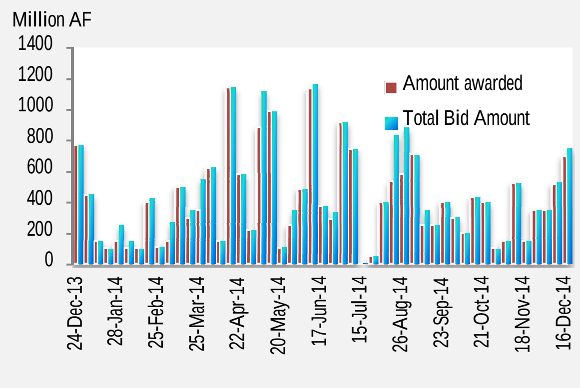
Source: Market Operations Department/DAB

Figure 2.12: 28 Day CNs Demand and Awarded amount



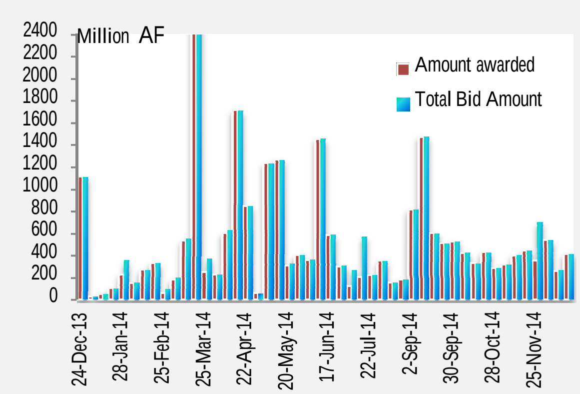
Source: Market Operations Department/DAB

Figure 2.13: 182 Day CNs Demand and Awarded amount



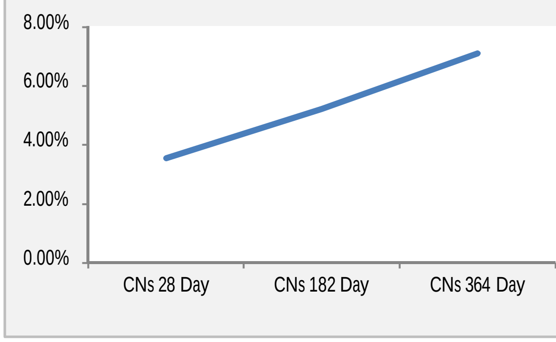
Source: Market Operations Department/DAB

Figure 2.14: 364 Day CNs Demand and Awarded amount



Source: Market Operations Department/DAB

Figure 2.15: Term Structure of Interest rates
Yield curve (Dec 13 - Dec 14)



4.2 Required and Excess Reserves

Commercial banks are required to hold 8 percent of their total deposits as obligatory reserves with the DAB, which remunerated at one basis point below the cut-off rate of the last 28 day capital notes auction, or equal to the deposit facility rate.

In order to provide commercial banks with facilities to better manage their liquidity and to provide them with a proper opportunity to invest their excess reserves apart from capital notes, DAB introduced the **overnight standing facilities** in 1385 (2006-2007). However it has been temporarily called off in order to monitor its effectiveness as a monetary instrument which may lead to better monetary formulation.

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

Table 2.3: Auction of 28 Day Capital Notes (million AF)

Start Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Win Bids	Cut off Rate (%)	Low Bid (%)	Highest Bid (%)	Weighted Avg. (%)
24-Dec-13	2,500	2,290	2,330	6	6	3.4	3.38	3.41	3.388
31-Dec-13	2,500	1,750	1,750	5	5	3.41	3.38	3.41	3.391
7-Jan-14	1,850	380	380	2	2	3.42	3.4	3.42	3.407
14-Jan-14	2,850	100	100	2	2	3.43	3.42	3.43	3.422
21-Jan-14	2,600	1,260	1,310	4	4	3.45	3.043	3.5	3.437
28-Jan-14	1,750	1,860	1,960	5	5	3.46	3.44	3.5	3.445
4-Feb-14	1,500	90	180	1	1	3.46	3.46	3.47	3.46
11-Feb-14	1,500	160	160	1	1	3.46	3.45	3.46	3.455
18-Feb-14	2,000	1,210	1,260	3	3	3.46	3.45	3.49	3.459
25-Feb-14	2,000	530	800	4	3	3.46	3.45	3.6	3.458
4-Mar-14	1,500	560	560	4	4	3.5	3.45	3.5	3.469
12-Mar-14	1,500	430	430	4	4	3.52	3.49	3.52	3.5
18-Mar-14	2,500	1,180	1,180	3	3	3.56	3.51	3.56	3.518
25-Mar-14	1,500	730	1,130	5	4	3.56	3.55	3.6	3.555
1-Apr-14	1,500	400	500	3	3	3.56	3.55	3.58	3.557
8-Apr-14	1,400	260	310	2	2	3.56	3.55	3.58	3.557
15-Apr-14	1,500	1,600	1,600	5	5	3.56	3.53	3.56	3.547
22-Apr-14	2,000	1,140	1,190	6	6	3.56	3.54	3.6	3.556
29-Apr-14	2,000	550	600	5	5	3.56	3.55	3.58	3.557
6-May-14	1,000	610	610	4	4	3.56	3.47	3.56	3.541
13-May-14	2,000	1,070	1,070	5	5	3.56	3.55	3.56	3.557
20-May-14	1,500	970	970	6	6	3.56	3.55	3.56	3.555
27-May-14	1,000	590	605	4	4	3.56	3.55	3.57	3.544
3-Jun-14	1,000	770	820	4	4	3.56	3.55	3.58	3.555
10-Jun-14	1,500	2,083	2,133	9	9	3.56	3.49	3.57	3.551
17-Jun-14	2,500	1,400	1,400	7	7	3.56	3.54	3.56	3.555
24-Jun-14	1,500	590	640	4	4	3.56	3.55	3.56	3.554
1-Jul-14	2,000	880	880	5	5	3.56	3.55	3.56	3.558
8-Jul-14	3,000	1,283	1,283	5	5	3.56	3.55	3.56	3.553
15-Jul-14	2,500	120	120	1	1	3.56	3.56	3.56	3.56
22-Jul-14	1,000	650	650	3	3	3.56	3.55	3.56	3.554
5-Aug-14	2,500	560	560	4	4	3.56	3.55	3.56	3.554
12-Aug-14	1,500	1,710	1,710	5	5	3.56	3.54	3.56	3.554
26-Aug-14	1,000	400	400	1	1	3.56	3.56	3.56	3.56
2-Sep-14	1,500	500	500	2	2	3.56	3.56	3.56	3.56
10-Sep-14	2,500	1,400	1,400	6	6	3.56	3.55	3.56	3.554
16-Sep-14	1,500	600	600	5	5	3.56	5	3.56	3.558
23-Sep-14	2,500	980	980	6	6	3.56	3.55	3.56	3.56
30-Sep-14	3,000	1,350	1,350	6	6	3.56	3.55	3.56	3.55
7-Oct-14	2,000	580	580	4	4	3.56	3.55	3.56	3.559
14-Oct-14	2,000	700	700	3	3	3.56	3.55	3.56	3.551
21-Oct-14	2,000	850	850	6	6	3.56	3.55	3.56	3.558
28-Oct-14	2,000	770	770	7	7	3.56	3.55	3.56	3.559
4-Nov-14	1,500	500	500	4	4	3.56	3.554	3.56	3.559
11-Nov-14	1,000	700	700	3	3	3.56	3.55	3.56	3.554
18-Nov-14	1,500	1,060	1,060	6	6	3.56	3.555	3.56	3.559
25-Nov-14	1,500	810	810	6	6	3.56	3.557	3.56	3.56
2-Dec-14	1,500	610	620	4	4	3.56	3.559	3.56	3.56
9-Dec-14	1,500	1,390	1,410	6	6	3.56	3.55	3.59	3.557
16-Dec-14	2,500	1,025	1,225	5	5	3.56	3.56	3.561	3.56
Total	**91,950**	**43,991**	**45,636**						

Table 2.4: Auction of 182 Day Capital Notes (million AF)

Start Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Wing Bids	Cut off Rate (%)	Low Bid %	Highest Bid (%)	Weighted Avg. Rate (%)
24-Dec-13	2000	770	770	4	4	4.97%	4.96	4.97	4.96
7-Jan-14	1000	450	450	2	2	4.98%	4.97	4.98	4.98
14-Jan-14	1380	150	150	2	2	5.00%	4.98	5.00	4.99
21-Jan-14	1500	100	100	1	1	5.05%	5.05	5.05	5.05
28-Jan-14	1500	150	250	3	2	5.05%	5.05	5.11	5.05
4-Feb-14	1500	100	150	2	1	5.05%	5.05	5.06	5.05
11-Feb-14	2000	100	100	2	2	5.06%	5.05	5.06	5.05
18-Feb-14	1500	404	424	4	4	5.06%	5.06	5.10	5.06
25-Feb-14	1500	110	110	1	1	5.15%	5.10	5.15	5.11
4-Mar-14	1000	150	270	3	2	5.17%	5.15	5.20	5.16
12-Mar-14	3500	500	500	4	4	5.19%	5.15	5.19	5.17
18-Mar-14	2500	300	350	2	2	5.20%	5.19	5.25	5.19
25-Mar-14	1500	350	550	3	2	5.20%	5.19	5.24	5.19
1-Apr-14	1700	624	624	4	4	5.20%	5.19	5.20	5.20
8-Apr-14	1600	150	150	2	2	5.20%	5.19	5.20	5.20
15-Apr-14	1500	1142	1142	4	4	5.21%	5.18	5.21	5.20
22-Apr-14	1200	580	580	3	3	5.21%	5.19	5.21	5.21
29-Apr-14	1500	220	220	2	2	5.21%	5.20	5.21	5.21
6-May-14	1500	885	1118	4	4	5.21%	5.05	5.25	5.19
13-May-14	1000	988	988	4	4	5.23%	5.21	5.23	5.21
20-May-14	1000	106	106	2	2	5.23%	5.22	5.23	5.22
27-May-14	1000	250	348	4	3	5.23%	5.23	5.23	5.23
3-Jun-14	1000	488	488	3	3	5.23%	5.23	5.23	5.23
10-Jun-14	1000	1135	1165	7	7	5.23%	5.06	5.23	5.21
17-Jun-14	1500	375	375	3	3	5.23%	5.22	5.23	5.22
24-Jun-14	2000	293	333	4	4	5.23%	5.23	5.23	5.23
1-Jul-14	1500	916	916	3	3	5.23%	5.20	5.23	5.23
8-Jul-14	2000	744	744	3	3	5.23%	5.23	5.23	5.23
15-Jul-14	1500	4	4	1	1	5.23%	5.23	5.23	5.23
22-Jul-14	1000	50	50	1	1	5.23%	5.23	5.23	5.23
5-Aug-14	1000	400	400	3	3	5.23%	5.23	5.23	5.23
12-Aug-14	1500	534	834	2	2	5.23%	5.23	5.23	5.23
26-Aug-14	1500	582	882	3	3	5.23%	5.23	5.23	5.23
2-Sep-14	1500	708	708	3	3	5.23%	5.23	5.23	5.23
10-Sep-14	1500	250	350	3	2	5.23%	5.22	5.23	5.23
16-Sep-14	1500	250	250	2	2	5.23%	5.23	5.23	5.23
23-Sep-14	2500	400	400	2	2	5.23%	5.23	5.23	5.23
30-Sep-14	3000	300	300	2	2	5.23%	5.22	5.23	4.67
7-Oct-14	3000	200	200	1	1	5.23%	5.23	5.23	5.23
14-Oct-14	2500	435	435	3	3	5.23%	5.22	5.23	5.22
21-Oct-14	1000	400	400	3	3	5.23%	5.23	5.23	5.23
28-Oct-14	1000	100	100	2	2	5.23%	5.23	5.23	5.23
4-Nov-14	1500	150	150	1	1	5.23%	5.23	5.23	5.23
11-Nov-14	1500	525	525	3	3	5.23%	5.23	5.23	5.23
18-Nov-14	1000	150	150	2	2	5.23%	5.23	5.23	5.23
25-Nov-14	1000	350	350	3	3	5.23%	5.23	5.23	5.23
2-Dec-14	1000	350	350	3	3	5.23%	5.23	5.23	5.23
9-Dec-14	2000	520	530	3	3	5.23%	5.23	5.23	5.23
16-Dec-14	2000	698	748	5	5	5.23%	5.23	7.10	5.23
Total	**77380**	**19885**	**21585**						

Table 2.5: Auction of 364 Day Capital Notes (million AF)

Start Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Wing Bids	Cut off Rate (%)	Low Bid %	Highest Bid (%)	Weighted Avg. (%)
9-Apr-13	500	150.00	208	4	2	5.00	5	5	5.00
16-Apr-13	500	3,900.00	3,950	7	6	5.20	4.48	4.906	4.91
23-Apr-13	500	880.00	1,180	4	3	5.20	5	5.093	5.09
30-Apr-13	500	1,298.18	1,318	6	5	5.20	5.09	5.192	5.19
7-May-13	500	995.00	995	5	5	5.30	5.09	5.255	5.26
14-May-13	500	1,415.00	1,580	6	4	5.30	5.12	5.259	5.26
21-May-13	500	50.00	55	2	1	5.35	5.35	5.35	5.35
28-May-13	500	175.00	175	3	3	5.50	5.11	5.267	5.27
4-Jun-13	500	678.95	724	6	5	5.55	5.35	5.472	5.47
11-Jun-13	500	1,265.00	1,265	4	3	5.60	5.45	5.534	5.53
18-Jun-13	1500	425.00	425	4	4	5.65	5.5	5.582	5.58
25-Jun-13	1500	1,027.21	1,032	6	5	5.70	5.5	5.684	5.68
2-Jul-13	1500	215.06	215	3	3	5.80	5.7	5.714	5.71
16-Jul-13	1500	575.00	575	4	4	5.90	5.8	5.811	5.81
23-Jul-13	1500	710.28	710	4	4	6.10	5.9	6.034	6.03
30-Jul-13	1500	20.00	35	2	1	6.20	6.2	6.2	6.20
13-Aug-13	1500	423.74	424	2	2	6.50	6.2	6.329	6.33
20-Aug-13	1500	135.02	155	3	3	6.60	6.6	6.6	6.60
27-Aug-13	1500	190.02	260	6	4	6.70	6.65	6.676	6.68
3-Sep-13	1500	Bid Rejected	135	3	0	0.00	6.8	0	0.00
10-Sep-13	1500	1,600.00	1,610	4	4	6.80	6.65	6.675	6.68
17-Sep-13	1500	200.00	220	3	3	6.90	6.82	6.86	6.86
24-Sep-13	1500	320.00	320	3	3	6.95	6.9	6.906	6.91
1-Oct-13	1500	30.00	160	3	1	6.95	6.95	6.95	6.95
22-Oct-13	1500		No bids						
5-Nov-13	1500	All bids rejected	110	2			7		
12-Nov-13	1500	150.00	250	2	1	6.98	6.98	6.98	6.98
26-Nov-13	1500	15.00	130	3	1	6.98	6.98	6.98	6.98
3-Dec-13	1500	80.00	143	2	2	6.98	6.98	6.98	6.98
10-Dec-13	1500	127.00	127	2	2	7.00	6.98	6.988	6.99
17-Dec-13	1500	110.00	110	1	1	7.05	7	7.014	7.01

Source: Market Operations Department/DAB

3

THE INFLATION TREND AND OUTLOOK

3

THE INFLATION TREND AND OUTLOOK

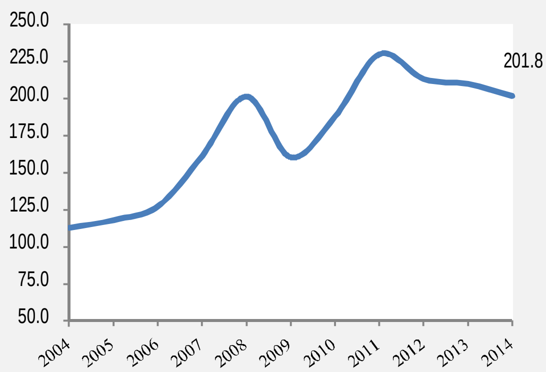
After the great recession of 2008-09, the global economy experienced a notable, but uneven recovery in 2014, compared to that in the previous year. Toward the end of the year, the global economic performance was running light-footed due mainly to improvements in major developed economies as well as some developing countries in East Asia, but the pace of change was not at the surface to optimize the future prospects prevailed one year back. Even though, the globe came through the year without major afflicts affecting the world economy, it has not been a good year at all. The main reason was escalation of political tensions in Ukraine and Arab countries. Global trade also continued its horizontal path with GDP rather than expanding sharply, which mainly reflects weakness in spending on imports and investment goods. Observing the state of economy in G20 countries, growth in the United States remained solid mainly because of favorable financial conditions and monetary policy support in comparison to the last few years, while Japan and the Euro Area (especially Germany, France, and Italy) tell a story of lower growth in 2014. Due to weaker activity in construction related activities and contributing to slower consumption growth, the rate of economic growth in China slightly decreased. India shows higher rate of growth, which could somehow buffer the downplaying effects of weak economic performance of some countries on global economy. In India, higher investment, lower political uncertainties, and the government commitments fueled the growth engine in 2014.

The trend of movements in crude oil price was descending in the last quarter of 2014, which could potentially impose severe economic stress on oil producers around the world. There is also a concern that further decrease in oil prices will threaten the economic and political stability of oil producing countries. Major shocks to oil price came from OPEC announcement regarding maintaining the current production levels. Moreover, the headwinds in oil prices were due mainly to meager performance in global real economic activities. The setbacks in oil price have come from positive shocks by supply side, which mirrors unexpected increase in oil production, and negative shocks to the demand for oil reflecting prospects of extreme future oil production as well. The total OPEC and Non-OPEC oil supply is shown at a higher growth, while the demand for OPEC crude oil had a slight drop over the year.

In the light of lateral behavior in economic performance, lower demand in the globe, positive prospects of food production, and a snippy decline in oil price, the global inflation rate also declined during the fourth quarter of the year.

In response to weaker oil price, and abundant food production relative to demand, commodity price dropped significantly by almost 28 percent, among which the food stuff prices declined by an average of 3.8 percent1 in 2014.

Figure 3.1: FAO Food Price Index



Inconspicuous economic performance, which gives rather disappointing global economic recovery, also contributed to the down lift trend of commodity prices. Meanwhile, stronger U.S dollar against major currencies was detrimental in global commodity prices.

United States illustrated anemic rate of inflation by the end of the year, which was the lowest in the last five years. In Euro Area, the inflation rate reached its lowest level since September 2009. Greece, Bulgaria, and Spain recorded the smallest figures, while the highest rates were shown in Romania, Austria, and Finland.

Similarly, the emerging economies also experienced low inflation rate over the year. China, the world's second largest economy recorded a five year low inflation rate. In India, the tightening monetary policy by raising interest rates during 2013-2014 put downward pressure on the general prices. After several years of double digit, the inflation rate in this country lessened to around 5 percent in 2014.

The spill downs in the inflation rate in both, regional and global level impacted the overall prices in Afghanistan. The annual inflation rate in Afghanistan declined dramatically to 1.3 percent over the fourth quarter of 2014 (FY 1393) from 7.3 percent in the same period of last year. Lower food and oil prices and moderate economic performance in the world are considered as the external factors leading the inflation rate in Afghanistan to decline. Moreover, political uncertainties and less aggregate demand are noted as internal contributors to the low inflation rate in the country. During the fourth quarter of the year under review, political and security instability reached its highest level (especially in north and south regions of the country), that led to weak economic activities. Meanwhile, based on the findings from the survey of regional economic activities2 except some favorable developments in

1 FAO food price index

[2] DAB conducts Survey of Regional Economic Activities in six major provinces every two months.

the agriculture sector, all the other sectors reported significant downfall in the level of activities during the fourth quarter of the year. The number of projects implemented by the government and NGOs also witnessed significant decline the period under review.

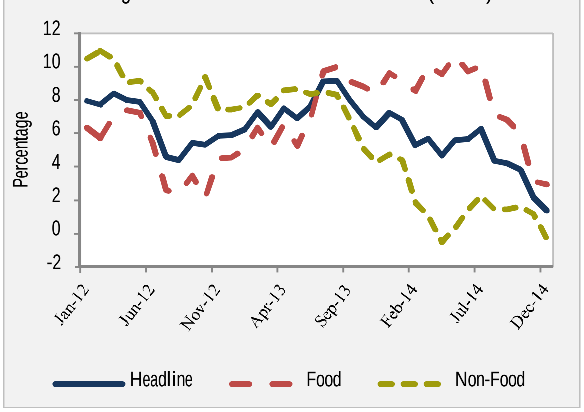
I. CONSUMER PRICE IN AFGHANISTAN

The headline inflation in Afghanistan recorded its lowest rate since March 2009. The downward movements in the overall inflation rate started in the fourth quarter of the last year when the inflation rate was 7.3 percent. At the end of the fourth quarter (Dec 2014), the nationwide inflation rate stood at 1.3 percent (y-o-y). Both, food and non-food, the main components of the CPI Basket, recorded lower rates of inflation compared to the fourth quarter of 2013, but the pace of decrease in food items was most significant due mainly to lower vegetables prices. The price of this sub component of the basket reached -9.6 percent, which is far below 30.7 percent recorded in the same quarter of last year. Beside the early mentioned external factors, the decline in the rate of inflation could be analyzed considering the downward trend of key economic indicators in the country. The political concerns stemming from a prolonged presidential elections process, unfavorable security situations, lower number of development projects, led to a weak economic performance during the period under review. Thus, the aggregate income seriously diminished, which in turn suppressed the aggregate domestic demand.

The changes in the inflation rate based on Kabul CPI exhibited similar pattern to that in National CPI during the period under review. Since March 2009, Kabul headline inflation as measured by annual percentage changes recorded its lowest rate of -1.1 percent in December 2014.

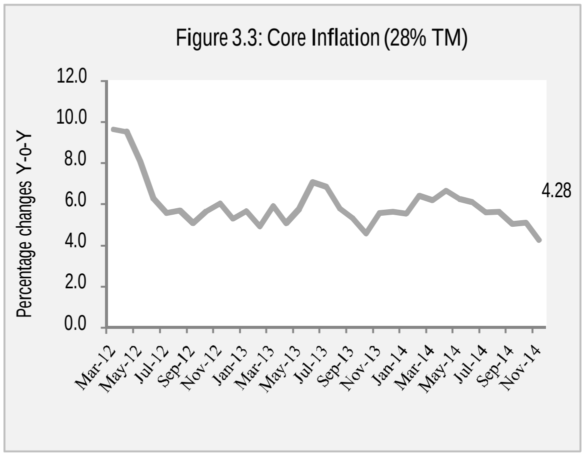
Similar to National CPI, Kabul food sub-index exhibited significant decrease over the fourth quarter of 2014. The main contributors to such low food prices in Kabul was the vegetables, which declined dramatically by 35.6 percentage points compared to a year ago. This sub-component of food sub-index dropped to a deflation rate of 5.6 percent (Y-o-Y) at the end of the FY1393 from an inflation rate of 30.0 percent recorded a year ago.

Figure 3.2: Breakdown of National CPI (Y-o-Y)



Source: Central Statistics Organization/DAB staff calculation

In order to exclude the effects of extraneous factors and attribute the effectiveness of MPD policies on overall price stability, it is necessary to measure core inflation (using 30 percent Trimmed Mean method). Core inflation measured by this method stood at 4.28 percent (Y-o-Y) at the end of the year under review.



Source: Monetary Policy Department/DAB

1.1 Developments in National Headline CPI

1.1.1 Annual Developments

The national headline inflation, the broadest measure of calculating changes in the overall prices in the country, has been declining since September 2013. In the fourth quarter of 2013, the inflation rate was recorded at 7.3 percent. One year later in the same period of 2014, the rate declined significantly to 1.3 percent (Y-o-Y), which represents a 6 percentage points decrease over the period of one year. Food sub-index, which comprises a considerable weight in the overall CPI, showed significant decline compared to the non-food sub-index. Food inflation dropped to 2.9 percent in December 2014, down from 9.6 percent at the same quarter of 2013. The pace of change in food sub-index was 6.7 percent owing a sharp fall in the price of vegetables. This sub-component of the CPI carries a healthy weight of 7.9 percent in the overall index. Thus, any changes in its price can contribute to the change in the overall inflation. The price of vegetables plunged to a deflation rate of 9.6 percent in December 2014, which is far below the inflation rate of 30.0 percent in the same period of last year. The main cause of such decline in vegetable prices is noted as favorable weather conditions, which resulted to higher domestic agriculture production. Except a common rise in fresh and dried fruits price, other sub-components of the food also recorded a downward trend due mainly to good harvest in the country and a downward global food prices over the year. Meanwhile, non-food sub-index of the CPI when measured on a y-o-y basis subsided to a deflation rate of 0.5 percent in the reporting period, down from the inflation rate of 4.9 percent during the fourth quarter of 2013. Housing, electricity, water and gas are observed as the main deteriorating factors of non-food deflation during the review period. The price of this sub-component fell to a deflation rate of 9.7 percent, down from an inflation rate of 2.1 percent in the same period of last year. Decline in prices of housing during the fourth quarter of 2014 was mainly because of a low demand for rental properties and despairing prospects on future political and security concerns in the country. Other major sub-components of non-food item, such as clothing, furnishing and household goods, also declined considerably over the period under review. On the other hand, transportation exhibited substantially higher rate of inflation over the fourth quarter of 2014 compared to the same quarter of 2013. Security concerns are the main contributor to the higher price of transportation.

Table 3.1: Breakdown of National Headline CPI

(Percent changes year on year)

(March 2011=100)

	Weight	1392				1393			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Overall Index	**100.0**	**6.4**	**7.6**	**8.0**	**7.3**	**5.6**	**5.6**	**4.2**	**1.3**
Food and beverages	**52.0**	**5.2**	**6.9**	**9.1**	**9.6**	**10.0**	**9.7**	**6.8**	**2.9**
Bread and Cereals	17.7	12.8	13.7	14.6	9.1	9.5	11.4	11.0	8.0
Meat	7.2	6.0	5.3	6.6	5.0	2.6	3.4	3.7	3.4
Milk, cheese and eggs	4.8	4.9	4.1	7.8	5.0	6.5	6.1	2.1	3.4
Oils and fats	4.0	-0.5	-2.3	-0.4	0.3	1.8	1.7	0.9	-1.7
Fresh and dried fruits	4.8	-3.2	-2.0	-0.1	4.7	8.5	9.9	9.2	11.5
Vegetables	7.9	-3.3	6.6	15.3	30.7	30.3	24.3	7.1	-9.6
Sugar and sweets	2.9	3.4	4.7	2.8	2.4	2.5	-1.6	-0.2	-1.0
Spices	0.9	8.8	10.2	5.6	8.1	10.5	9.4	12.0	5.9
Non-alcoholic beverages	1.8	7.6	8.5	6.8	6.6	7.4	3.7	4.0	2.1
Non-Food	**48.0**	**7.7**	**8.4**	**6.8**	**4.9**	**1.1**	**1.4**	**1.4**	**-0.5**
Tobacco	0.4	11.5	19.5	21.2	10.9	8.4	3.0	0.6	6.7
Clothing	7.0	8.0	10.3	8.9	8.8	8.3	8.1	6.9	4.2
Housing,	20.7	11.8	11.1	6.8	2.1	-8.5	-9.1	-8.8	-9.7
Furnishing and household goods	7.0	3.9	6.0	6.5	8.7	8.5	10.4	10.3	8.4
Health	3.3	11.3	13.0	11.2	8.0	8.8	9.0	10.3	8.5
Transportation	4.7	-2.5	-1.5	3.6	5.8	16.6	20.1	19.5	11.3
Communication	1.1	-6.7	-6.4	-4.5	-2.5	-1.5	-1.4	-2.0	-3.4
Education	0.7	7.1	1.7	1.8	1.8	1.9	5.0	4.0	2.8
Information and Culture	0.1	3.2	3.5	2.6	2.3	6.5	5.4	7.1	7.0
Restaurants and Hotels	1.0	2.4	2.8	3.7	1.8	2.6	2.4	4.6	3.2
Miscellaneous	1.8	5.5	5.2	6.6	8.0	7.6	10.2	8.2	7.6
core inflation (30% TM)		**4.9**	**5.8**	**5.8**	**5.6**	**6.4**	**6.3**	**5.6**	**4.3**
Core inflation (Headline excl. B&C, O&F and T)		**5.9**	**7.4**	**7.2**	**7.2**	**4.3**	**3.6**	**1.7**	**-0.8**

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

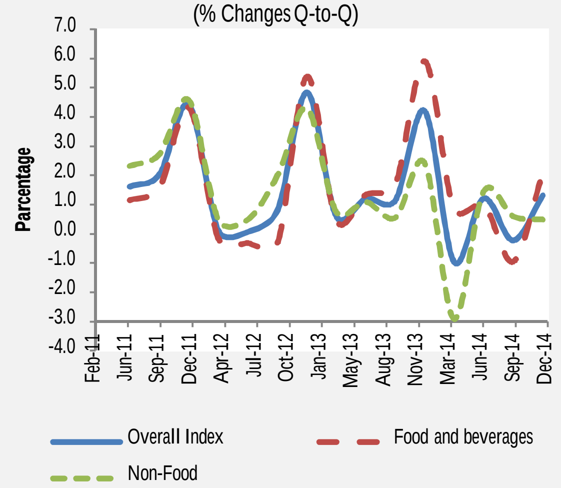
1.1.2 Quarterly Developments in national CPI

The quarterly changes in inflation rate give another aspect of price changes in the country. This helps us in analyzing the price movements in consumer basket in shorter periods.

The national headline inflation rate in the fourth quarter of 2014 showed an upward trend due mainly to the increased food prices. The overall inflation rate stood at 1.3 percent (Q-o-Q) in December 2014, which is the highest figure since the first quarter of the year. Unlike the Year-on-Year changes, the main components of the CPI (food and non-food) represented mixed trends over the fourth quarter of 2014. Food sub-index recorded an increase during the reporting period, while non-food sub-index presented a downward trend that partially offset the impacts of food prices.

Food item exhibited 2.0 percent increase in the fourth quarter of the year under review, compared to 1.0 percent deflation recorded in the preceding quarter. Similar to annual changes in CPI, vegetables remained the main contributor to the food sub-index in the fourth quarter of the year under review. Other components of food sub-index showed mixed trends. Prices of bread and cereals, and meat dropped, while milk, cheese, and Eggs, Oils and fat, and fresh and dried fruits experienced higher prices. On the other hand, non-food portion of the index represented a slight decrease over the period (0.5 percent in December from 0.6 percent in Sep), mainly because of a notable decrease in the price of transportation. Transportation recorded a deflation rate of 3.5 percent in the fourth quarter of 2014 compared to 2.4 percent inflation recorded in the preceding quarter.

Figure 3.4: Breakdown of National CPI
(% Changes Q-to-Q)



Source: *Central Statistics Organization/ DAB staff calculation.*

By focusing on a quarter-on-quarter basis analysis, some internal and external factors that are thought to be responsible for the changes in overall inflation have been identified. The trend of changes in global prices as well as the worsening political and economic conditions within the country led to a subdued non-food inflation, while seasonal factors affected the supply side and caused food prices to increase.

Table 3.2: Breakdown of National Headline CPI

(Percent changes quarter-on-quarter)

(March 2011 = 100)

	FY1391*			FY1392				FY1393			
	Q1	Q2	Q3	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Overall Index	**0.1**	**0.8**	**4.8**	**0.6**	**1.2**	**1.1**	**4.2**	**-1.0**	**1.2**	**-0.2**	**1.3**
Food and beverages	**-0.3**	**-0.3**	**5.4**	**0.5**	**1.3**	**1.7**	**5.9**	**0.8**	**1.0**	**-1.0**	**2.0**
Bread and Cereals	1.6	2.2	8.4	0.2	2.4	3.0	3.2	0.6	4.1	2.7	0.4
Meat	0.7	0.6	2.1	2.6	0.0	1.8	0.6	0.3	0.7	2.1	0.3
Milk, cheese and eggs	-0.6	1.2	3.9	0.4	-1.4	4.8	1.2	1.9	-1.8	0.8	2.5
Oils and fats	1.7	-1.2	1.4	-2.3	-0.2	0.7	2.1	-0.9	-0.2	-0.1	-0.5
Fresh and dried fruits	0.7	-2.9	-3.6	2.7	2.0	-1.0	0.9	6.5	3.4	-1.7	3.1
Vegetables	-7.8	-8.5	14.5	0.0	1.7	-1.0	29.9	-0.3	-3.0	-14.7	9.7
Sugar and sweets	0.1	3.8	1.9	-2.3	1.3	1.9	1.5	-2.1	-2.8	3.3	0.7
Spices	2.5	2.1	2.9	1.0	3.8	-2.1	5.3	3.3	2.7	0.3	-0.5
Non-alcoholic beverages	2.1	3.2	2.3	-0.2	3.0	1.6	2.1	0.5	-0.6	1.9	0.3
Non-Food	**0.5**	**2.0**	**4.3**	**0.8**	**1.1**	**0.6**	**2.4**	**-2.9**	**1.4**	**0.6**	**0.5**
Tobacco	0.4	-1.9	11.0	2.1	7.5	-0.5	1.5	-0.2	2.2	-2.8	7.6
Clothing	-0.1	2.3	3.9	1.7	2.1	0.9	3.8	1.2	1.9	-0.2	1.3
Housing,	1.1	3.6	6.7	0.1	0.4	-0.4	2.0	-10.3	-0.3	-0.1	1.1
Furnishing and household goods	0.8	0.7	0.4	1.9	2.8	1.2	2.5	1.8	4.6	1.1	0.7
Health	0.2	3.0	4.3	3.4	1.8	1.3	1.2	4.2	2.0	2.5	-0.4
Transportation	-0.8	-2.1	1.5	-1.0	0.2	2.9	3.6	9.1	3.2	2.4	-3.5
Communication	-1.7	-2.7	-1.3	-1.1	-1.4	-0.7	0.7	-0.1	-1.3	-1.3	-0.7
Education	4.6	0.8	-0.1	1.7	-0.6	0.8	0.0	1.8	2.4	-0.2	-1.2
Information and Culture	-0.2	0.8	1.2	1.3	0.1	0.0	0.9	5.5	-1.0	1.6	0.8
Restaurants and Hotels	0.2	0.2	1.7	0.2	0.6	1.1	-0.1	0.9	0.4	3.3	-1.5
Miscellaneous	0.6	0.5	2.6	1.6	0.3	2.0	4.0	1.2	2.8	0.1	3.3

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

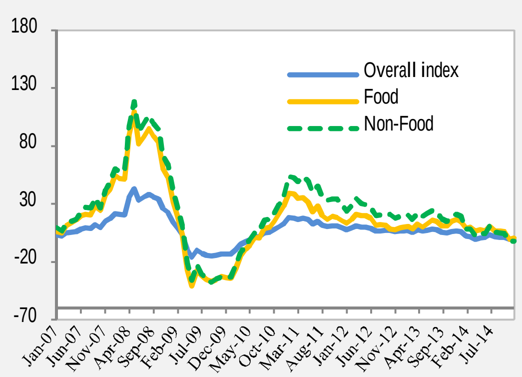
* Afghanistan has changed its fiscal year effective from 1391. The new fiscal year begins on December 21 and ends on December 20 each Gregorian year. New fiscal year 1391 contains 9 months due to this change.

1.2 Developments in Kabul CPI

1.2.1 Annual Developments

Similar to the nationwide consumer price index, Kabul based CPI inflation also experienced a downward trend over the fourth quarter of 2014. The overall inflation rate in Kabul turned down to a deflation rate of 1.1 percent in Dec 2014 from an inflation rate of 6.7 percent at the same period of last year. The main components of the CPI basket (Food and Non-food) decelerated remarkably over the end of the fourth quarter. Food, the most important component of the CPI in Afghanistan, declined considerably by 7.9 percentage point at the end of the fourth quarter and reached 1.8 percent (y-o-y), while it was recorded at 9.7 percent during the last quarter of 2013. Vegetables recorded the most significant changes over the period declining by 35.6 percentage points. On annual basis, the price of this sub-component of food dropped to -5.6 percent from 30.0 percent a year ago.

Figure 3.5: Breakdown of Kabul CPI (Y-o-Y)



Source: *Central Statistics Office/ DAB staff calculation.*

Non-food, the other main component of the CPI basket also recorded a deflation over the fourth quarter of 2014. Housing prices exhibited a downward spiral pushing the non-food sub-index to a deflation rate of 3.1 percent at the end of the fourth quarter 2014 from an inflation rate of 4.6 percent in the same period of last year. Due to political uncertainty, the demand for rental houses declined at a high rate that caused this component to decline considerably recording a deflation rate of 13.4 percent in Dec 2014 compared to 3.6 percent inflation recorded in Dec 2013.

Table 3.3: Breakdown of Kabul Headline CPI

(Percent changes year-on-year)

(March 2011=100)

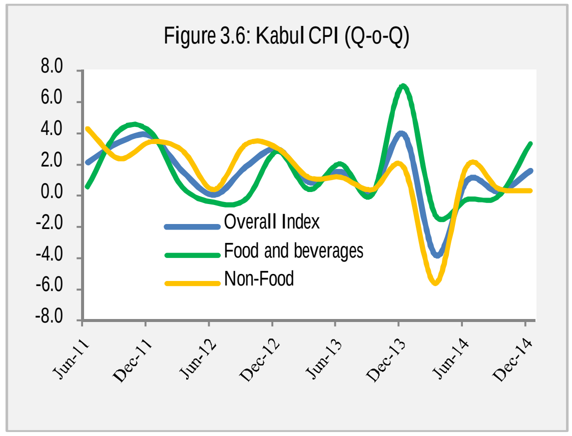
	Weight	1392				1393			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Overall Index	**100**	**5.8**	**7.4**	**5.7**	**6.7**	**1.8**	**1.2**	**1.2**	**-1.1**
Food and beverages	**52.0**	**2.6**	**5.1**	**5.4**	**9.7**	**7.9**	**5.5**	**5.4**	**1.8**
Bread and Cereals	17.7	11.8	13.4	12.6	10.4	7.7	4.8	6.6	3.0
Meat	7.2	9.3	5.3	3.4	4.2	-1.4	-1.4	3.8	2.6
Milk, cheese and eggs	4.8	0.4	-2.0	-1.0	2.3	6.1	9.9	8.7	5.9
Oils and fats	4.0	0.1	-0.4	3.4	1.1	-0.9	-3.1	-5.1	-5.5
Fresh and dried fruits	4.8	-8.6	-6.3	-4.2	2.3	6.5	8.8	7.4	12.9
Vegetables	7.9	-6.5	7.2	8.6	30.0	24.7	15.8	8.9	-5.6
Sugar and sweets	2.9	2.0	1.1	-1.1	-1.4	-0.5	-6.9	-3.5	-5.1
Spices	0.9	14.2	9.0	4.0	4.8	8.3	7.0	9.2	7.2
Non-alcoholic beverages	1.8	4.1	6.8	6.4	6.6	7.8	2.1	2.6	3.2
Non-Food	**48.0**	**8.1**	**8.9**	**5.9**	**4.6**	**-2.4**	**-1.7**	**-1.6**	**-3.1**
Tobacco	0.4	6.0	10.0	11.6	10.3	11.2	13.3	11.5	15.5
Clothing	7.0	3.7	7.5	4.9	5.8	7.8	11.5	11.3	10.3
Housing, electricity, water and gas	20.7	11.7	12.3	7.0	3.6	-12.2	-13.2	-13.1	-13.4
Furnishing and household goods	7.0	3.8	3.8	4.9	6.8	6.2	13.4	13.2	12.5
Health	3.3	20.9	19.4	9.1	7.9	7.8	7.3	8.7	4.1
Transportation	4.7	-4.4	-1.9	3.2	8.0	33.3	33.2	32.1	19.4
Communication	1.1	-0.4	-1.2	-0.7	-0.7	-0.8	-2.2	-4.0	-5.0
Education	0.7	0.5	0.7	1.0	0.9	-0.1	2.8	1.9	2.1
Information and Culture	0.1	1.7	0.9	-0.2	2.0	14.0	14.6	19.1	18.3
Restaurants and Hotels	1.0	0.8	0.0	0.0	0.0	1.5	2.3	5.2	3.1
Miscellaneous	1.8	2.4	0.9	2.8	5.0	4.3	7.9	3.8	5.0
Core inflation (28% TM)		**3.3**	**3.7**	**3.5**	**4.4**	**5.3**	**5.7**	**6.2**	**4.4**
Core inflation (Headline excl. B&C, O&F and T)		**5.5**	**7.0**	**6.7**	**6.0**	**-1.3**	**-1.3**	**-3.8**	**-3.1**

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

1.2.2 Quarterly Developments, Kabul CPI

In contrast to the annual changes, the quarterly movements in Kabul CPI were uprising in the last quarter of 2014. Based on the available data from CSO, the headline inflation rate jumped to 1.6 percent (q-o-q) in the fourth quarter of 1393, up from 0.3 percent in the preceding quarter, mainly as a result of increased food prices. Among all, the prices of vegetables rose sharply by 18.2 percent (q-o-q) in the fourth quarter, up from a deflation rate of 11.0 percent in the preceding quarter. Other sub-components of food exhibited different behaviors.

The upward pressures driven by the increased food prices were partially offset by the favorable changes in the prices of non-food. This component of the CPI basket showed a moderate increase compared to a quarter ago, recording a 0.3 percent increase in Q4-1393, down from 0.5 percent recorded in Q3. Lower transportation cost is thought as the main factor contributing to the lower non-food inflation over the period under review.



***Source:** Central Statistics Organization/ DAB staff calculation.*

Table 3.4: Quarter-on-Quarter Changes in Kabul Headline CPI

(Percent changes quarter-on-quarter)

(March 2001=100)

	1392				1393			
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Overall Index	**0.9**	**1.5**	**0.3**	**3.9**	**-3.8**	**1.0**	**0.3**	**1.6**
Food and beverages	**0.4**	**2.0**	**0.1**	**7.0**	**-1.2**	**-0.2**	**0.0**	**3.3**
Bread and Cereals	-0.4	4.9	3.2	2.4	-2.8	2.0	5.1	-1.1
Meat	5.1	-2.6	-0.8	2.5	-0.5	-2.5	4.4	1.3
Milk, cheese and eggs	-1.7	-4.9	3.5	5.7	2.0	-1.5	2.5	3.0
Oils and fats	-0.7	0.7	1.3	-0.2	-2.6	-1.6	-0.8	-0.6
Fresh and dried fruits	5.4	2.9	-3.2	-2.7	9.9	5.1	-4.5	2.3
Vegetables	-2.6	3.4	-5.3	36.2	-6.6	-3.9	-11.0	18.2
Sugar and sweets	-6.1	0.9	2.3	1.7	-5.2	-5.6	6.0	0.0
Spices	-0.3	2.2	-0.2	3.0	3.1	0.9	1.8	1.1
Non-alcoholic beverages	0.9	2.9	1.8	0.9	2.0	-2.6	2.3	1.5
Non-Food	**1.2**	**1.2**	**0.4**	**1.8**	**-5.6**	**1.9**	**0.5**	**0.3**
Tobacco	1.0	5.4	2.2	1.4	1.9	7.4	0.5	5.0
Clothing	0.3	1.8	0.1	3.6	2.2	5.2	-0.1	2.6
Housing	1.5	1.3	-0.3	1.0	-14.0	0.1	-0.1	0.6
Furnishing and household goods	2.0	1.3	1.5	1.9	1.4	8.2	1.3	1.3
Health	1.7	1.3	2.4	2.3	1.6	0.8	3.7	-2.0
Transportation	-1.3	0.5	2.6	6.1	21.9	0.5	1.7	-4.1
Communication	0.0	-0.7	-0.1	0.1	-0.1	-2.1	-1.9	-1.0
Education	2.0	-0.8	1.0	-1.2	1.0	2.0	0.1	-1.1
Information and Culture	2.0	-0.9	-0.3	1.1	14.0	-0.3	3.6	0.5
Restaurants and Hotels	0.0	0.0	0.0	0.0	1.5	0.8	2.9	-2.0
Miscellaneous	1.1	-0.2	1.9	2.2	0.4	3.2	-1.9	3.3

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

II. REGIONAL INFLATION TREND

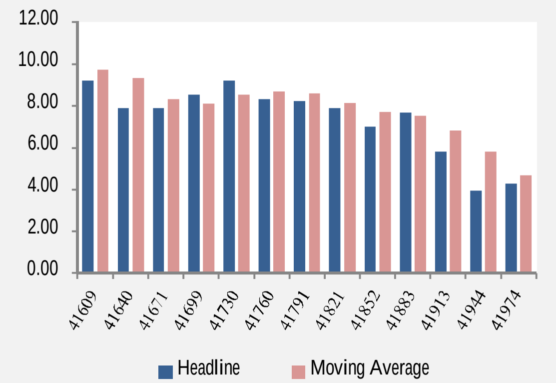
In this section, recent developments in the overall price levels in the regional economies and its impacts on the Afghan economy are taken under consideration. Following a weak economic performance associated with the after effects of the financial crisis of 2008-2009, the South Asian countries enjoyed a favorable GDP growth in 2014. On the other hand, the inflation rate in the region fell dramatically in the period under review. Pakistan and India, the major trade partners of Afghanistan experienced low inflation rate in the period under review, which were reflected in the prices of imports, especially oil and food stuff, in Afghanistan.

2.1 Inflation in Pakistan

Pakistan experienced stronger agriculture harvest in 2014. Despite the distractive floods in September, total wheat production is estimated around 25.3 million metric tons compared to 24 million metric tons in 2013. Moreover, rice production was satisfactory, but slightly lower than the level of 2013. As a result, the food sub-index of the Consumer Price Index exhibited a downward trend in the reporting period. Moreover, lower global oil prices helped the non-food sub-index in Pakistan to decline.

At the end of the fourth quarter of 2014, Pakistan headline inflation eased to 4.3 percent compared to 9.2 percent recorded a year back. Food sub-index experienced a sharp decrease compared to non-food items. Food price-index stood at 3.4 percent in December 2014, down from 9.3 percent observed in December 2013. Similarly, non-food recorded a lower rate of 4.9 percent at the end of the quarter compared to 9.1 percent at the same period of last year.

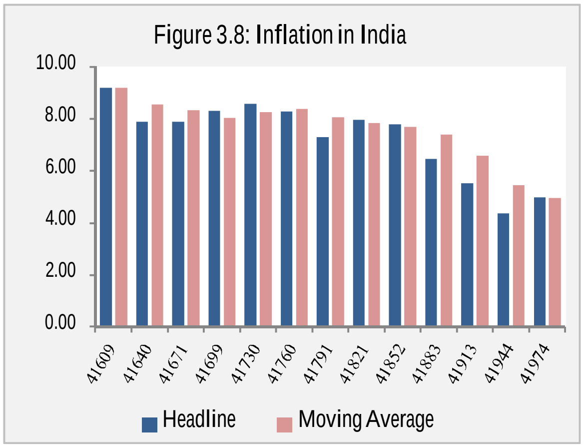
Figure 3.7: Inflation in Pakistan



2.2 Inflation in India

In India, the tightening monetary policy, raising interest rates during 2013-2014, put a downward pressure on general prices. After several years of double digits, the headline inflation hit single digit by the end of 2013 and through 2014. In December 2013, the overall inflation rate was 9.2 percent, while one year later (December 2014), the inflation rate stood at 5 percent, which is below the 6 percent target set by RBI.

Although, the price of food stuff casted upward pressure on the overall inflation, but lower prices of clothing and oil offset the impacts and caused the overall inflation to decline.



III. NEAR TERM INFLATION OUTLOOK

Being a net importing country, it is important for Afghanistan to carefully track developments in the commodity prices in both, the global and regional levels.

Considering the current level of oil and commodity prices, as well as a greater global agriculture production prospects, the global inflation rate is expected to decline further in 2015. As a result, the South Asia region will enjoy lower inflation rate during this period. The rate of inflation in this region is estimated to stand at 2.6 percent in 2015 compared to 3.1 percent in 2014.

In Afghanistan, the consumer price index is expected to maintain its downward trend during the first six months of 2015. Food sub-index is likely to record lower prices due to low global food prices and greater crop harvest in the country. Meantime, the non-food category of the CPI basket is expected to remain close to the current levels.

3.1 Risks

For the last decade, prices in Afghanistan remained highly vulnerable to the changes in the global and regional markets. Despite significant economic progress, the country still depends on imported commodities, especially food stuff. Hence, any disturbance and changes in the supply side will have an impact on the overall prices in Afghanistan. Moreover, the exchange rate stability of afghani against the foreign currencies, especially the U.S dollar is the other factor that can impact the overall imported prices to change in Afghanistan.

4

EXTERNAL SECTOR DEVELOPMENTS

4

EXTERNAL SECTOR DEVELOPMENTS

The external sector remained under pressure because of current account deficit and reduction in capital inflows in the period under review. The trade deficit narrowed by 23 percent it is expected to improve further. Based on the available data, the current account deficit narrowed from USD 5,592.26 million during the FY1392 to USD 4392.85 million in the FY1393. Inflows from services and exports earnings, helped to reduce the current account deficit during the period under review.

Net international reserves (NIR) grew by 5.99 percent, covering about 11 months of imports as of end FY1393.

Afghanistan's total external debt stock declined 8 percent at the end of the FY1393.

4.1: Balance of Payments

4.1.1 Current Account Balance

During the year under review, the current account deficit decreased considerably by 21 percent to USD 4,392.85 million during the FY1393, from a deficit of USD 5,592.26 million during the FY1392.

Improved merchandise trade performance, and increased services inflows contributed to the improvements in the current account. Trade deficit decreased by 23 percent during the FY1393 due to an increase in the export earnings, and a decrease in import expenditure.

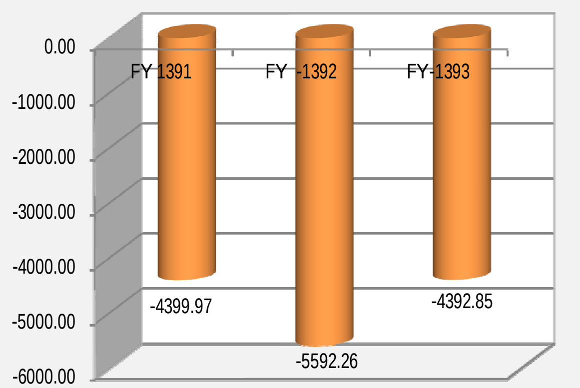
Moreover, the services account recorded higher earnings mainly from construction and transport sectors.

Table 4.1: Current Account Balance

	FY1391	FY1392	FY1393
Current account balance	**-4399.97**	**-5592.26**	**-4392.85**
Trade balance	-5988.25	-8241.30	-6345.32
Exports	367.18	507.08	658.29
Imports	-6355.43	-8748.38	-7003.61
Services A/c	-71.69	-452.67	-74.83
Income A/c	45.53	90.10	18.53
Current Transfers	1614.43	3011.60	2008.76

Source: Central Statistics Organization/DAB staff calculations

Figure 4.1: Current Account Balance



Source: Central Statistics Organization/DAB staff calculations

4.1.2 Capital and Financial Accounts

The surplus in the capital account declined as a result of lower capital transfers received by the government. The capital account recorded a net inflow of USD 1,622.11 million in the FY1393 compared to USD 2,578.27 million in the FY 1392.

Similarly, the financial account of the Balance of Payments (BOP) which shows net acquisition and disposal of financial assets and liabilities recorded a surplus of 32 percent in the FY1393, (Table 4.2 and Figure 4.2).

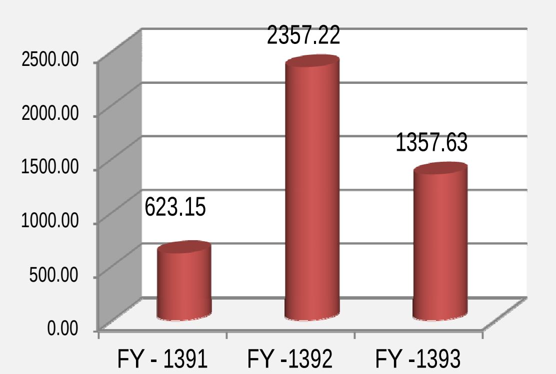
Such surplus could be attributed mainly to a significant increase in the country's reserve assets, Further analysis reveals that the country's financial assets abroad decreased by 214 percent, while aggregate financial liabilities decreased by 327 percent from USD 42.29 million to USD -95.86 million in the year under review because of lower financial flows driven by the security concerns.

Table 4.2: Capital and Financial Account

	FY 1391	FY1392	FY1393
Capital and financial account	623.15	2357.22	1357.63
Capital account	1604.16	2578.27	1622.11
Capital transfers	1625.25	2588.18	1655.49
Financial account	-981.01	-221.05	-264.48
Reserve Assets	-687.09	-273.89	-361.66

Source: Central Statistics Organization/DAB staff calculations

Figure 4.2: Capital and Financial Account

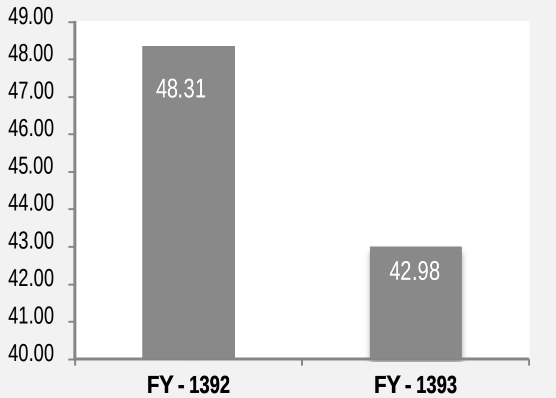


Source: Central Statistics Organization/DAB staff calculations

4.1.3 Foreign Direct Investment (FDI)

According to the available data, inflows from foreign direct investment (FDI) stood at USD 42.98 million during the FY 1393, compared to USD 48.34 million received in the FY 1392, a decrease of 11 percent. The decrease in FDI inflows was mainly due to security and political uncertainty which affected overall confidence of investors. Figure 4.3 shows FDI inflows in the FY 1392 & FY 1393.

Figure 4.3: Foreign Direct Investment (FDI)



Source: External Sector/Monetary Policy Department/DAB

4.2 Merchandise Trade

Merchandise trade statistics shows that the trade deficit narrowed by 25 percent, from USD 8,839.79 million in the FY1392 to a deficit of USD 6,673.75 million during the FY1393. The trade deficit accounts about 31 percent of GDP in the period under review.

4.2.1 Imports

According to the merchandise trade statistics, expenditure on total imports decreased during the FY1393 compared to the FY1392. The Imports decreased significantly, which was mainly due to a decrease in imports of three categories, in particular (i) fuel and lubricants, decreased by 47 percent, from USD 2,167.37 million in the FY1392 to USD 1,155.94 million during the FY1393, (ii) Industrial supplies decreased by 32 percent from USD 1,272.14 million to USD 863.19 million and (iii) capital goods decreased by 26 percent, from USD 3,957.24 million in the FY1392, to USD 2,929.64 million in the FY1393.

Accordingly, expenditure on total imports in the year under review declined by 22 percent, from USD 9,339.60 million in the FY 1392 to USD 7,294.63 million during the FY 1393. On the contrary, imports of consumer goods rose by about 21 percent, from USD 1,942.85 million in the FY1392, to USD 2,345.86 million. The relative share of consumer goods in total imports increased from 20.8 to 32.2 percent in the FY1393.

Conversely, during the year under review, share of fuel and lubricants in total imports decreased from 32.2 to 15.8 percent, industrial supplies declined from 13.6 to 11.8 percent, and share of capital goods and others in total imports declined from 42.4 to 40.2 percent respectively.

However, a declining share of capital goods and industrial supplies in total imports is a sign of slowdown in the economic growth prospects.

4.2.2 Exports

Improved external demand along with enhanced trade relations with the trade partners of Afghanistan, favorable weather condition that led to good harvest, and improved transit facilities are some of the factors that supported the export in the FY1393.

Accordingly, in the FY1393, earnings from exports increased by 24 percent standing at USD 620.88 million as compared to USD 499.81 million recorded last year.

Trade statistics indicates that all export categories had an upward trend in the FY 1393. Exports of fresh and dry fruit, and medical plants represented about 44 percent and 34.2 percent share in total exports respectively that contributed fundamentally to the overall exports in the FY1393.

Earnings from food items, increased substantially by 55 percent from USD 175.92 million in the FY1392 to USD 272.13 million in the FY1393.

Export earnings on medical plants and others grew by 19 percent to USD 212.36 million in the FY 1393, from USD 178.86 million in the FY 1392.

Export earnings on carpet and rugs also increased by 2 percent in the FY 1393. However, export earnings on leather and wool, declined by 17 percent to USD 49.35 million from USD 59.54 million.

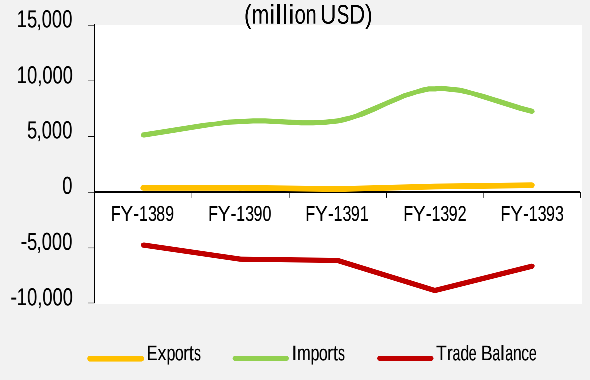
Table 4.3 depicts the breakdown of the merchandise trade statistics from FY1389 up to end of FY1393.

Table 4.3: Breakdown of Merchandise Trade (in million USD)

	1389		1390		FY1391		FY1392		FY1393	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	5,154.31	100%	6,388.37	100%	6,419.67	100%	9,339.60	100%	7,294.63	100%
Industrial supplies	602.48	11.7%	614.77	9.6%	969.88	15.1%	1272.14	13.6%	863.19	11.8%
Fuel and Lubricants	1,022.66	19.8%	2,184.59	34.2%	1083.65	16.9%	2167.37	23.2%	1155.94	15.8%
Consumer goods	803.67	15.6%	857.38	13.4%	1255.48	19.6%	1942.85	20.8%	2345.86	32.2%
Capital goods and other	2,725.50	52.9%	2,731.63	42.8%	3,111	48.5%	3957.24	42.4%	2929.64	40.2%
Exports	388.37	100%	375.03	100.0%	261.63	100%	499.81	100%	620.88	100%
Carpets & Rugs	68.83	18%	46.60	12.4%	8.4	3.2%	85.49	17.1%	87.04	14.0%
Food Items	156.35	40%	133.39	35.6%	104.23	39.8%	175.92	35.2%	272.13	43.8%
Leather & Wool	53.84	14%	28.07	7.5%	26.82	10.3%	59.54	11.9%	49.35	7.9%
Medical seeds & others	109.35	28%	166.97	44.5%	122.15	46.7%	178.86	35.8%	212.36	34.2%
Trade Balance	-4,765.94		-6,013.34		-6,158.04		-,839.79		-,673.75	
Trade Balance as % of GDP	-28%		-33%		-31%		-43%		-31%	

Source: *Central Statistics Organization and DAB staff calculations*

Figure 4.4: Trade Performance & Trade Balance (million USD)



Source: Central Statistics Organization and DAB staff calculations

4.3 Direction of Trade

In the year under review, Afghanistan's major export destinations were Pakistan, Iran, India, China, and Commonwealth of Independent States (CIS).

According to the merchandise trade statistics, Pakistan remained on top with a share of 34.24 percent among the other export destinations (Tables 4.4 & 4.5). Afghanistan's exports to Pakistan increased by almost 6 percent to USD 212.61 million in the FY1393, up from USD 201.16 million in the FY 1392. The major export items to Pakistan were carpets and rugs, fresh and dry fruits, cotton, medical plants and others.

Exports of food items, such as fresh and dry fruit to Pakistan increased sharply by 46 percent standing at USD 61.4 million, up from USD 41.99 million in the preceding year.

Similarly, exports of carpet and rugs rose by 5 percent to USD 61.5 million in the FY 1393..

India ranked the second largest export destination of Afghanistan with a share of about 24.65 percent among the others. Total exports to India increased by almost 62 percent to USD 153.05 million in the FY1393, up from USD 94.48 million recorded in the FY 1392. The increase in total exports to India was mainly dominated by leather and wool, fresh and dry fruit, and medical seeds.

Iran was the third largest export destination with a total share of 6.59 percent. Total exports of Afghanistan to Iran increased by 42 percent, USD 40.89 million in the FY 1393, up from USD 28.82 million in the preceding year. The main exported items to Iran were dry fruit, oil seeds, and medical seeds.

China remained the fourth largest export destination of Afghanistan with a share of almost 5 percent during the year under review. Total exports to China increased by 68 percent to USD 31.32 million, up from USD 18.60 million in the FY1392.

However, the Commonwealth of Independent States (CIS) ranked the last largest exports destination with a share of about 4.9 percent among others. Afghanistan's total exports to CIS increased by 9 percent to USD 30.22 million in the year under review, up from USD 27.64 million recorded in the preceding year.

Table 4.4: Direction of External Trade: FY 1393 (in million USD)

	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	212.61	34.24%	1360.89	18.66%	-1148.28
India	153.05	24.65%	117.32	1.61%	35.73
Iran	40.89	6.59%	1424.21	19.52%	-1383.32
Germany	18.56	2.99%	76.47	1.05%	-57.91
China	31.32	5.04%	824.13	11.30%	-792.81
England		0.00%	5.73	0.08%	-5.73
Saudi Arabia	0.43	0.07%		0.00%	0.43
USA		0.00%	78.13	1.07%	-78.13
Common Wealth of Independence States (CIS)	30.22	4.87%	1739.20	23.84%	-1708.98
Japan		0.00%	216.27	2.96%	-216.27
Other Countries	133.80	21.55%	1452.31	19.91%	-1318.51
Total	620.88	100%	7,294.66	100%	(6,673.78)

Source: *CSO and DAB staff calculations*

Table 4.5: Direction of External Trade: FY1392 (In million USD)

	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	201.16	40.25%	1760.72	18.85%	-1559.56
India	94.48	18.90%	148.38	1.59%	-53.90
Iran	28.82	5.77%	1613.17	17.27%	-1584.35
Germany	6.71	1.34%	254.73	2.73%	-248.02
Common Wealth of Independence States (CIS)	27.64	5.53%	2476.90	26.52%	-2449.26
China	18.60	3.72%	392.29	4.20%	-373.69
Saudi Arabia	0.46	0.09%		0.00%	0.46
Japan		0.00%	58.21	0.62%	-58.21
England		0.00%	13.22	0.14%	-13.22
United States		0.00%	74.92	0.80%	-74.92
Other Countries	121.94	24.40%	2547.11	27.27%	-2425.17
Total	499.81	100.00%	9339.65	100.00%	-8839.84

Source: *Central Statistics Organization and DAB staff calculations*

Figure 4.5: Direction of Exports (% share) FY1393

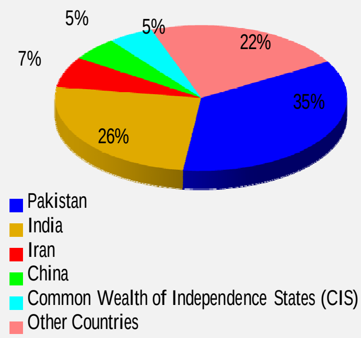
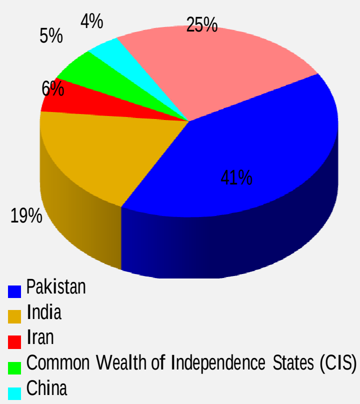


Figure 4.6: Direction of Exports (% share) FY1392



Source: CSO and DAB Staff calculations

4.4: Composition of Trade

Figures 4.7 and 4.8 provide a comparative picture of commodity composition of Afghanistan imports, between FY1392 and FY1393. The composition of imports indicates that imports of capital goods had the largest share in the basket of imports despite its share dropped from 42.4 percent to 40.2 percent during the FY1393. Expenditure on import of capital goods in total imports declined by 26 percent to USD 2,929.64 million in the FY1393, down from USD 3,975.24 million in the preceding year.

The second largest share recorded for consumer goods in the FY1393 which, rose by 32.2 percent from 20.8 percent in the FY1392. Expenditure on imports of consumer goods, which accounted for about 32.2 percent of total imports, amounted to USD 2,345.86 million in the FY1393, reflecting a 21 percent increases over the FY1392.

This increase was mainly due to the higher domestic demand for foreign goods, which incurred expenditure on certain food items in the year under review.

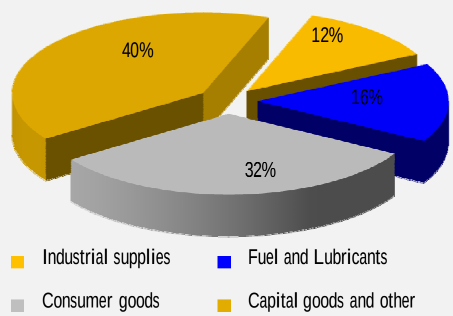
The third largest share recorded for fuel and lubricants despite its share and value in total imports declined.

Expenditure on import of fuel and lubricants (Petroleum Oil) in total of imports declined noticeably by about 47 percent from USD 2,167.37 million with a shares of 23.2 percent in the FY1392, to USD 11.55.94 million with a share of 15.8 percent in the year under review.

Likewise, the last largest share in total imports was recorded for industrial supplies, which has declined to 11.8 percent from 13.6 percent. Expenditure on imports of industrial supplies in total imports declined by about 32 percent, from USD 1,272.14 million to USD 863.19 million in the year under review.

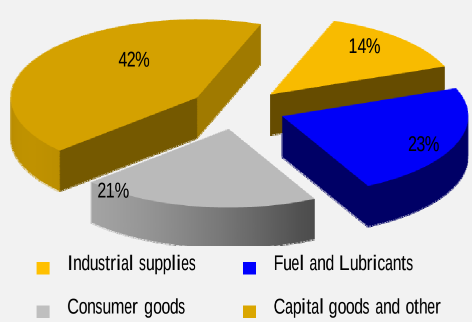
Industrial supplies that includes metals, fertilizer, chemical, and cement, posted a decline due to a reduction in the number of development projects all over the country as a result of political and security uncertainties.

Figure 4.7: Composition of Imports (% share) FY1393



Source: *Central Statistics Office and DAB staff calculations*

Figure 4.8: Composition of Imports (% share) FY1392



Source: *Central Statistics Office and DAB staff calculations*

Figures 4.9 and 4.10 provide a comparative picture of commodity composition of Afghanistan exports between FY1392 and FY1393.

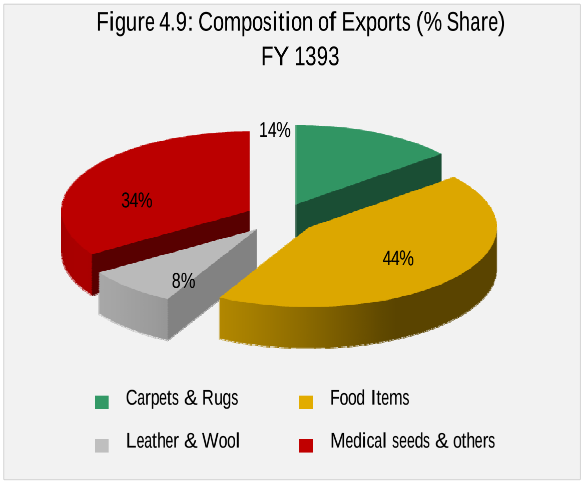
According to the merchandise trade statistics, exports of food items represent about 43.8 percent of total exports contributed largely to export growth in the FY1393. Earnings from exports of food items increased by 55 percent (year-on-year) standing at USD 272.13 million in the FY1393 mainly due to a significant increase in fresh and dry fruit exports, which increased by 39 and 69 percent respectively.

Meanwhile, export of medical plants rank the second largest shareholder of total exports of Afghanistan, despite its share has declined from 35.8 percent to 34.2 percent in the year under review. Export earnings on medical plants also increased by 19 percent, standing at USD 212.36 million in the FY1393 from USD 178.86 million in the previous year.

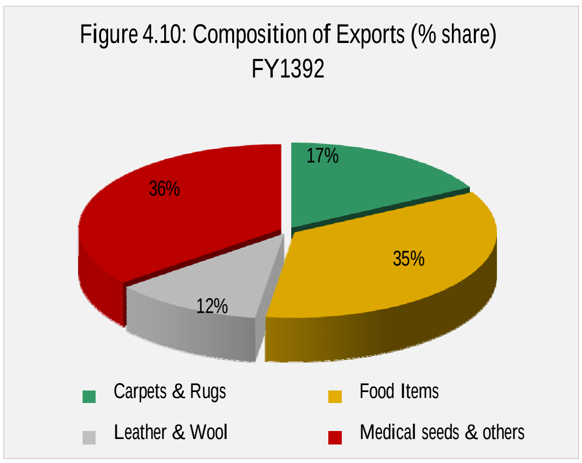
Moreover, exports of carpets and rugs, the main export item of Afghanistan, made the third largest share in total exports in the FY1393.

Export earnings on carpets and rugs increased by about 2 percent to USD 87.04 million in the year under review, up from USD 85.49 million in the preceding year.

However, share of leather and wool in total exports declined from 11.9 percent to 7.9 percent in the year under review.



Source: Central Statistics Organization/DAB staff calculation



Source: Central Statistics Organization/DAB staff calculation

4.5 External Debt

Afghanistan's external debt stock decreased by 8 percent, or USD 211.52 million at the end of the year under review compared to a year ago. The decline in the stock of debt was mainly due to a decline in external commercial loan payments and Special Drawing Rights (SDR) allocated by the International Monetary Fund (IMF). The ratio of external debt to GDP stood at 11 percent in the FY1393 slightly down from 12 percent recorded in the FY1392.

During the year under review, loan principal repayments made to the International Development Association (World Bank), Islamic Development Bank (IDB), and International Monetary Fund (IMF), while service charges paid to the (World Bank) and (IMF).

Meanwhile, during the year under review only International Development Association as the major multilateral creditor to Afghanistan made some debt forgiveness on principal and services charges.

Afghanistan's total loan amounts payable to Paris Club creditors stood at USD 933.02 million which is payable to Russian Federation. In other words, Afghanistan's total debt from the Paris Club members accounts for about 40.9 percent of total current external debt which has decreased by about 3 percent compared to the last year.

Table 4.6: Breakdown of External Debt as end of, Dec 21 - 2014 (in units indicated)

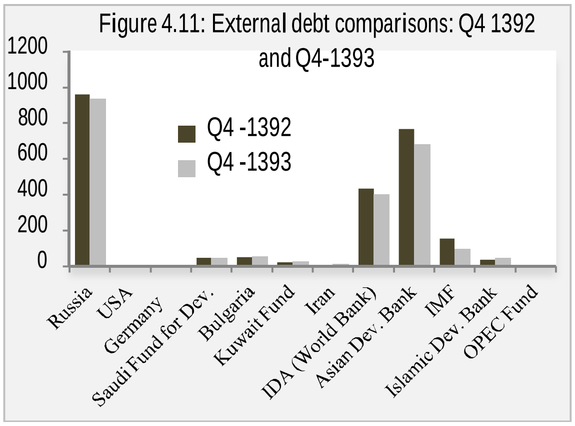
	In million USD	Percent of total
Total external debt	2,281.55	100.00
Bilateral	1,063.14	46.60
Paris Club	933.02	40.89
Russian Federation	933.02	40.89
United States	-	0.00
Germany	-	0.00
Non-Paris Club	130.12	5.70
Multilateral	1,218.41	53.40
of which: IDA (World Bank)	398.42	17.46
Asian Development Bank	678.06	29.72
International Monetary Fund	94.21	4.13
Islamic Development Bank	45.93	2.01
OPEC Fund	1.79	0.08

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

Furthermore, total debt from Non-Paris Club members, Saudi Fund for Development, Bulgaria, Kuwait Fund, and Iran declined by 3 percent to USD 130.12 million from USD 134.84 million in the FY1392.

Multilateral credits to Afghanistan decreased by 13 percent to USD 1,218.41 million from USD 1,396.13 million at the end of the FY1392.

Figure 4.11: External debt comparisons: Q4 1392 and Q4-1393



***Source:** Treasury Department/MoF/DAB staff calculation*

4.6 Net International Reserves

According to the latest available data, Afghanistan's Net International Reserves (NIR) increased by almost 6 percent to USD 7,078.92 million in the FY1393, up from USD 6,678.62 million recorded in the last year.

The increase in the level of NIR was due mainly to the increase in the reserve assets which rose by 6.40 percent from USD 7,183.33 million in the FY1392 to USD 7,642.81 million in the year under review.

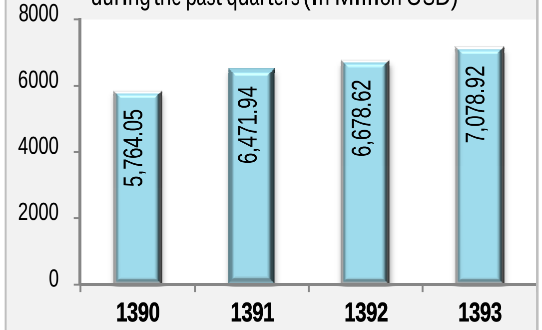
Reserve liabilities increased by almost 11.7 percent from USD 504.71 million in the FY1392 to USD 563.89 million in the period under review, this indicates that the reserve assets are clearly higher than the reserve liabilities. In the year under review, the increase in reserve liabilities was mostly attributed to the commercial banks deposits in foreign currency, that rose from USD 367.65 million to USD 446.62 million (21.84 percent increase).

On the other hand, the use of fund resource decreased from USD 136.92 million to USD 117.13 million (14.46 percent decrease) in the period under review.

The reserve liability of nonresident deposits in foreign currency remained unchanged during the year under review.

The increase in reserves was mainly due to inflows from the export earnings, foreign direct investment, current transfers, earning on foreign exchange deposits in foreign deposit-taking corporations, and multi-expenditures of security forces.

Figure 4.12: Net International Reserves during the past quarters (In Million USD)



Source: Monetary Policy Department/DAB

The current NIR position is providing a good cushion of the capacity of monetary policy and support of balance of payments.

Currently, on average, NIR supports about 11 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

Table 4.7: Net International Reserves, 1390 to FY1393 (million of USD)

Changes in the previous quarter	1390	% change	1391	% change	FY 1392	% change	FY 1393	% change
Net International Reserves (million USD)	5,764.05	23.22	6,471.94	12.28	6,678.62	3.19	7,078.92	5.99
Reserve Assets	6,130.38	22.71	6,866.79	12.01	7,183.33	4.61	7,642.81	6.40
Reserve Liabilities	366.34	10.91	394.85	7.78	504.71	27.82	563.89	11.73
Commercial bank deposits in foreign currency	227.72	4.00	245.00	7.59	367.65	50.06	446.62	21.48
Non-resident deposits in foreign currency	0.11	-89.57	0.11	0.00	0.14	23.87	0.14	0.00
Use of Fund resources	138.51	17.53	149.73	8.10	136.92	-8.56	117.13	-14.46
Gross Intl. Reserves (in months of import)	11.52		12.84		9.23		12.57	
Net Intl. Reserves (in months of import)	10.83		12		9		12	

5

THE REAL SECTOR DEVELOPMENTS

5

THE REAL SECTOR DEVELOPMENTS

In the last decade, Afghanistan had a great opportunity for rehabilitation and reconstruction of the country. Since then, Afghanistan recorded the highest average economic growth rate of 9.4 percent, which is unprecedented in the last decade. After such considerable average growth rate, Afghanistan experienced a sharp slowdown in economic growth to an estimated 2.1 percent in 1393 from 6.5 percent during 1392.

A prolonged election process and political and security transition led to a decrease in investor and consumer confidence that in turn impacted the aggregate demand negatively.

Agricultural production was at its potential, but did not exceed the record levels of preceding year. Going forward with the current indicators, the economic growth is expected to remain low in 1394.

Agriculture sector grew by 3.7 percent (y-o-y) in 1393, lower than 8.3 percent recorded in the preceding year. The non-agriculture sectors also exhibited slower growth rates in the year under review. The industry sector recorded an annual growth rate of 2.4 percent, and the services sector grew by 2.2 percent, which are lower than 4.5 and 6.4 percent growth in the previous year.

I. GROSS DOMESTIC PRODUCT (GDP) BY SECTORS PRODUCTION

Economic growth fell dramatically in 1393 (2014-15) mainly as a result of uncertainty over the political and security transition that led to a substantial slowdown in the non-agriculture sectors. Real GDP is estimated to have declined sharply to 2.1 percent in 1393 from 6.5 percent in 1392. Non-agricultural sectors including services, manufacturing and construction weakened significantly as uncertainty shaded the investment and consumer confidence. Transport and communications, important components of services sector, had a slower growth in the reporting period.

Agriculture sector performance was satisfactory, but remained below the record level of 2012. However, the Afghan economy still is dominant by the agriculture sector, as a significant portion of the population, especially in the rural areas are involved in this sector.

Since majority of Afghanistan population is employed by agriculture sector, therefore, changes in this sector impact the GDP behavior strongly. Due to favorable seasonal rainfalls, agricultural harvests rose by 3.7 percent in 1393, although it is well below the growth rate of 1392.

Cereals, fresh and dried fruits, and livestock showed higher growth in comparison to the last year. The most significant rise was observed in fresh fruits. Due to improved horticulture in 1392, the income earned from fresh fruits increased by 18.9 percent compared to 3.2 percent a year ago. The other sub-component of agriculture declined sharply to 4.1 percent, while it was 25.6 percent in the last year.

Industry sector eased in 1393. Based on the data released by the CSO a 2.4 percent (y-o-y) growth was observed in the is sector in 1393, down from4.5 percent recorded a year ago. Except for printing and publishing industries, all the other sub sectors of industry declined in the reporting period. Among all, textile, wood products, chemicals, non-metallic minerals, and basic metals turned around to a negative growth.

Likewise, services, the major contributor to GDP showed downward movements in 1393. Based on the data from CSO, the growth rate of services sector stood at 2.2 percent (y-o-y), which is lower than 6.4 percent recorded in 1392. Among the others, transport and storage, and community, social and personal services performance was the worst during the period under review. The rate of growth in these sub-sectors of services dropped to -1.7 percent and -1.2 percent from 9.1 and 12.9 percent respectively. The downward pressures of these components were somehow offset by a better performance of government services. The income earned from this sub-sector rose by 8.0 percent in 1393, compared to 4.2 percent in the previous year.

Table 5.1: Gross Domestic Production (GDP) by Sectors (in percent)

	1391 (2011-12)	1392 (2013-14)	1393* 2014-15
Agriculture	25.39	24.67	24.32
Industries	20.51	19.63	20.92
Services	50.28	51.74	51.30

Source: Central Statistics Organization (CSO)

Table 5.2: Real GDP Growth by Sectors of Production (in percent)

	1391 2011-12	1392 2012-13	1393 est. 2014-15
Agriculture	3.2	8.3	3.7
Cereals	42.8	2.3	3.7
Fresh Fruits	8.0	3.2	18.9
Dry Fruits	2.0	-27.3	-26.2
Livestock	0.4	-1.7	0.1
Others	-19.1	25.6	4.1
Industry	7.8	4.5	2.4
Mining and quarrying	-1.1	-1.8	-2.2
Manufacturing	7.3	1.2	-2.5
Food, beverage & tobacco	5.1	1.2	0.7
Textile, wearing apparel & leather	1.1	0.4	-35.7
Wood & wood production including furniture	4.9	3.7	-25.2
Paper, paper production, printing and publishing	4.1	7.7	9.2
Chemicals , petroleum, coal, rubber and plastic	-4.6	0.7	-16.2
Non-metallic minerals except petroleum & coal	7.0	4.6	-26.1
Basic metal	755.7	5.9	-76.9
Electricity, gas and water	4.3	15.6	2.7
Construction	8.9	8.0	7.0
Services	16.0	6.4	2.2
Wholesale & retail trade, restaurants & hotels	25.0	0.4	-1.2
Wholesale & retail trade	27.0	-1.5	-2.9
Restaurants & hotels	12.8	13.6	9.2
Transport, storage and communication	20.6	11.9	1.8
Transport & storage	28.1	9.1	-1.7
Post and telecommunication	9.0	17.0	7.8
Finance, insurance, real estate and business	3.8	-10.9	-7.2
Finance	2.9	-11.3	-7.4
Insurance	68.3	2.3	2.3
Real estate and business services	3.4	-8.3	-4.5
Ownership of dwellings	7.0	-6.3	-2.4
Community, social and personal service	13.3	12.9	-1.2
Government services	11.6	4.2	8.0
Other services	-14.8	4.8	-0.6

Source: *Central Statistics Organization*

**Preliminary data*

1.1 Gross Domestic Production by Expenditure Categories

One of the most common methods for calculating the gross domestic products (GDP) is the expenditure approach, which is used by most of market-based economies. In Afghanistan, beside the factors of production method, the expenditure approach is also used to show the government and private consumption, expenditures on investments, and the net export.

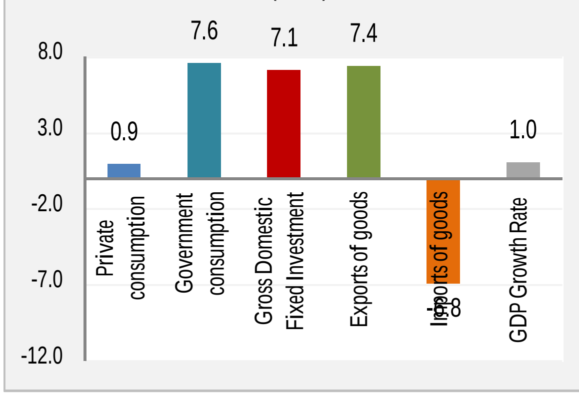
Lower growth of gross domestic products in 1393 was contributed mainly by a modest rise in private consumption compared to the previous year. This category of total consumption comprises a healthy share in the overall GDP. The latest figures released by the CSO shows a 0.9 percent increase in private consumption, which is well below the growth rate of 5.6 percent observed last year.

The role of government consumption in total GDP is also significant. In contrast to the private consumption, the government consumption grew at a higher pace (7.6 percent in 1393, up from 6.3 percent in 1392.

Similar to private consumption, gross fixed investment showed lower rate of growth compared to the last year. This component of GDP recorded a 7.1 percent growth in 1393 compared to 12.2 percent in the previous year. Such a considerable decline in the level of investments in 1393 is due mainly to the increased uncertainty in the country.

On the other hand, a declining trade deficit is good news for the economy. Although, the trade deficit remains large, it is expected to narrow slightly. Total exports grew by 6.4 percent in 1393, compared to 24.9 percent in last year. On the other hand, the total imports recorded a negative growth of 5.9 percent over the year compared to 6.9 percent increase recorded in the last year. As a result, the trade deficit improved by 7.7 percent.

Figure 5.1: Annual GDP Growth by Consumption (1393)



Source: Central Statistics Organization

Figure 5.2: Share of Sectors in Total GDP

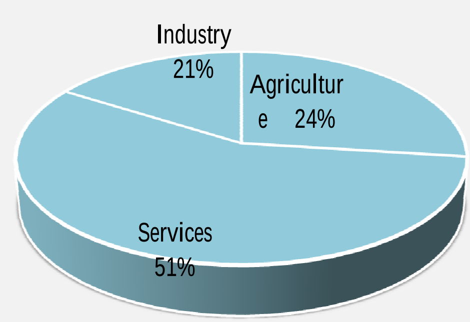


Table 5.3: Nominal Gross Domestic Product by Expenditure Categories (%Δ Year-on-Year)

Category	1392 2013 -14	1393est 2014-15
Total final consumption expenditure	5.7	1.8
Private consumption	5.6	0.9
Government consumption	6.3	7.6
Gross Domestic Fixed Investment	12.2	7.1
Gross fixed capital formation	12.2	7.1
Construction	13.5	12.8
Durable capital goods	1.4	-44.9
Resource balance	4.7	-7.8
Exports of goods and NFS	24.9	6.4
Exports of goods	28.8	7.4
Non-factor Services	9.9	2.1
Less: Imports of goods and NFS	6.9	-6.0
Imports of goods	5.4	-6.8
Non-factor Services	23.2	2.0
Change in Inventories and data discrepancies	15.2	-15.2
GDP at Market Price	10.2	1.0

*Preliminary data

Source: Central Statistic Office

II. OUTLOOK FOR 1394

Economic growth is expected to pick up modestly from 2.1 percent in 1393 to a narrow range of 3-5 percent in 1394. Considering the pace of economic growth in 1393, the expected recovery in 1394 depends on the political and security uncertainty. After the establishment of national unity government, the economic prospects are positive, as the new government is committed to continue reforms, and the donor support is thought to increase. The growth is expected to pick-up in 1394 and the inflation will remain in the single digit territory supported by a favorable global food and oil prices.

Industry and services sectors are expected to gain momentum in the upcoming year. The new Afghan government is committed to provide facilities to local and international investors in order to encourage investments in the country.

6

BANKING SYSTEM PERFORMANCE

6

BANKING SYSTEM PERFORMANCE

Asset base of the banking sector observed a modest growth of 4.50 percent or AF 11.04 billion in the FY1393 (December 2014) compared to 9.78 percent growth in December 2013. The increase in total assets of the banking sector came from the increase in total deposits of the sector.

Gross loans portfolio of the banking sector witnessed a decrease of 7.89 percent or AF 3.71 billion over the year standing at AF 43.23 billion against 11.33 percent growth in Dec.2013. The decrease in the loan portfolio is mainly attributed to repayment, settlement; charge-off and less customer utilization of OD loans and restriction on disbursement of new loans on some banks.

Deposits the main funding source in the banking sector stood at AF 218.84 billion, comprising 96.60 percent of the total liabilities of the sector increased by 5.31 percent at a slower pace compared to 8.10 percent increase in the preceding year (Dec. 2013), the slower pace in deposits growth was mainly attributed to prolonged Presidential elections process and political uncertainty in the economy. The Deposits were largely denominated in USD (62.61 percent) with Afghani denominated deposits lagging at 34.08 percent. AF-denominated deposits indicated an increase of 12.64 points against 16.62 percent increase in Dec.2013, while USD denominated deposits was up by 1.15 points against 5.28 percent increase in Dec.2013

The capital base of the banking sector remained strong and increased by 6.60 percent reaching at AF 30.17 billion due to the increase in profitability of the banking sector. Capital adequacy ratio (CAR) of the banking sector was recorded at 26.46 percent. All the banking institutions are above the set limits for CAR.

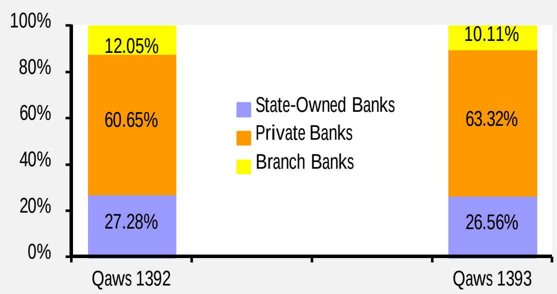
Banking sector profit improved over the year amounted to AF 2.17 billion compared to AF 1.43 billion recorded in Dec.2013, resulting to 0.90 percent. Return on Assets (ROA) against 0.61 percent in last year, Return on Equity (ROE) declined to 7.35 percent against 8.18 percent in Dec.2013. The decrease in ROE is attributed to the increase in the denominator of the ratio. State-Owned Banks, Private Banks and Branches of Foreign banks ended up with profits during the year under analysis.

Currently, the banking system in Afghanistan comprises of 15 duly-licensed and permitted branches of foreign banks. One of the branches of a foreign bank stopped and transferred its operation to another private bank. The reason behind this decision was declared the security concerns over the country.

I. ASSETS OF THE BANKING SYSTEM

The asset size of the banking sector observed a growth of 4.50 percentage points in the year under review against 9.78 percent growth in Dec. 2013 (Figure 6.1).

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



Source: Financial Supervision Department/DAB

The breakup of total assets of the banking system reveals that the most obvious increase was registered by investments that increased by AF 3.60 billion (31.56 percent) over the year under analysis, followed by cash in vault and claim on DAB increased by AF 11.44 billion (11.29 percent) and all other assets depicted AF 1.53 billion increase during the year under analysis. While net-loans, interbank claims and fixed assets category of total assets witnessed a decrease of AF 4.55 billion or 10.15 percent, AF 0.78 billion or 1.14 percent and AF 0.20 billion or 2.98 respectively. The most important components of the system's total asset portfolio were cash in vault/claims on DAB (43.93 percent), interbank claims (26.49 percent), net loans (15.69 percent), and investments (5.85 percent), "other" makes (5.46 percent) while fixed assets comprise (2.57 percent) of the total assets (Table 6.1).

Table 6.1: Composition of Assets and Liabilities

	Qaws 1392 Dec. 2013	Qaws 1393 Dec. 2014	% of Total Assets/Liabilities	Y-o-Y growth
Assets				
Cash in vault and claims on DAB	101,374	112,820	43.93%	11.29%
Interbank claims	68,809	68,025	26.49%	-1.14%
Investments	11,430	15,038	5.85%	31.56%
Loans (Net)	44,834	40,281	15.69%	-10.15%
Fixed Assets	6,797	6,594	2.57%	-2.98%
Others	12,507	14,037	5.46	12.23%
Total	245,751	256,795		4.50%
Liabilities				
Deposits	207,822	218,847	96.57%	5.31%
Borrowings	5,620	3,981	1.76%	-29.16%
Other	4,000	3,790	1.67%	-5.25%
Total	217,442	226,618		4.21%

Source: Financial Supervision Department, DAB

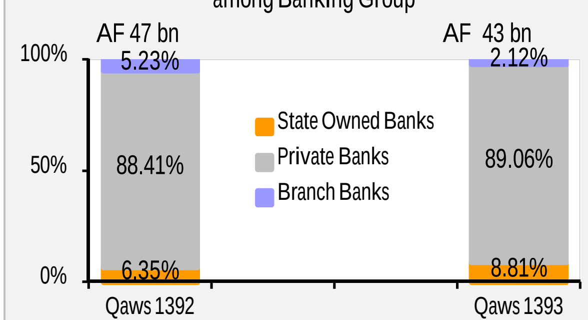
1.1 Gross Loans

Total gross loans indicated AF 3.71 billion or 7.89 percent decrease since last year, constituting 16.84 percent of total assets. The decrease in loan portfolio is mainly attributed to repayment of loans; settlement, charge-off and restriction on issuance of new loans on some banks.

Increases in loan portfolio were observed at six banking institutions, whereas eight banking institutions decreased their portfolio, while the remaining one bank (NKB) did not participate in lending.

Gross loan portfolio showed a decrease across the Private Banks and Branches of Foreign banks. Private Banks with 89.06 percent share in total portfolio posted 7.22 percent or AF 2.99 billion decrease, Branches of Foreign Banks holding 2.12 percent of total portfolio declined by 62.65 percent or AF 1.54 million and State-owned Banks possessing 8.81 percent share, increased by 0.83 billion or 27.87 percent during the year under analysis.

Figure 6.2: Share of the Gross Loans Portfolio among Banking Group



1.1.1 Loan Loss Reserves

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

By the end of December 2014 (Qaws 1393), total provision cover of the system was 6.83 percent of total gross loans in comparison with 4.48 percent in the previous year.

1.1.2 Distribution of Credit

In order to broad-base the loan portfolio and broaden the risk diversification and financial access besides new avenues of earning, DAB has diversified the sector-wide distribution of Other Commercial Loans to 30 sectors3. Sector-wide analysis reveals that the major portion of the loan portfolio is classified as "Other commercial loans" 81.77 percent against 75.10 in Dec.2013, mainly in "construction and building" (12.52 percent), "petroleum and lubricants" (8.74 percent), "wholesale" (4.93 percent) and "ground transportation" (4.87 percent). Agriculture and mortgage loans showed a slight decrease making 2.34 percent and 7.14 percent of total loans respectively. Concentration in construction and building, petroleum and lubricants, wholesale, services, ground transportation and mortgage loans to the exclusion of all other types of lending has been the dominant trend. Loans designated to SME and Micro Credit sectors posted a decrease of AF 1.68 billion currently standing at AF 4.90 billion provided by four banking institutions. Lending is picking up, although not significantly in some loans categories related to important sectors of the economy, such as agriculture, mining and communication. Concentration of loans to a few sectors of the economy would expose banks to credit risk in case of possible crises associated with that sector, inversely affecting the overall banking sector; Banks should closely monitor the potential risk associated with the key sectors given the high NPL ratio. About 80.98 percent of the loans were designated in Kabul with Herat and Balkh provinces in the second and third places respectively. The proportion of loans in other provinces is negligible. The designation of loans by sector, geography and institution is not adequately diversified, it is expected to improve. It is desirable that all banks take active part in lending process, in order to diversify lending services and properly perform their role in financial intermediation.

[3] Accounting Circular No. 93/01 dated 26/06/1393

Table 6.2: Sectoral Distribution of Credit

	Hoot 1387 (Mar 09)	Hoot 1388 (Mar 10)	Hoot 1389 (Mar 11)	Hoot 1390 (Mar 12)	Qaws 1391 (Dec. 12)	Qaws 1392 (Dec. 13)	Qaws 1393 (Dec. 14)
Commercial Real Estate and Construction Loans	0.19	19.92	25.98	2.85	2.29	2.02%	1.80%
Other Commercial Loans	-	-	-	-	-	-	
Mining	-	-	0.02	0.72	0.11	0.07%	
Manufacturing	0.01	1.22	2.72	13.32	11.88	9.36%	
Trade	0.51	32.29	34.16	27.84	28.3	29.81%	
Communication	0	1.04	1.23	0.94	2.35	3.70%	
Service	0.09	4.84	6.72	11.95	15.94	22.11%	
Utilities	0.01	2.47	0.03	0.3	0.07	0.05%	
Agricultural Loans							0.27%
Livestock and Farms							0%
Manufacturing and Industry(product of metal, wood, plastic, rubber)							2%
Manufacturing, Handmade and Machine products							4%
Cement and Construction Materials							3%
Textile							2.59%
Power							0.35%
Construction and Building							12.52%
Services							4.79%
Hotel and Restaurant							1.20%
Telecommunication							2.92%
Ground Transportation							4.87%
Air Transportation							4.18%
Health and Hygienic							0.71%
Median, Advertisements and Printer							0.04%
All Other Services							1.41%
Wholesales							4.93%
Machineries							0.12%
Petroleum and Lubricants							8.74%
Spare Parts							0.24%
Electronics							1.40%
Cement and other Construction Materials							1.87%
Food Items							4.52%
All Other Items							5.72%
Retail Trading							3.92%
Road and Railway							2.41%
Dames							0.61%
Mines							0.08%
Other infrastructure Projects							1.81%
Financial and Lending Institutions							0.00%
Agricultural Loans	0	0.88	0.75	2.06	2.66	2.38%	2.34%
Consumer Loans	0.02	1.33	1.01	0.82	0.74	0.24%	0.26%
Residential Mortgage Loans to Individuals	0.01	7.3	8.95	15.65	14.46	10.84%	7.14%
All Other Loans	0.05	3.69	10	12.65	10.71	9.41%	6.68%

Source: *Financial Supervision Department/DAB*

1.1.3 Classification of Loans

1.1.3.1 Non-performing loans

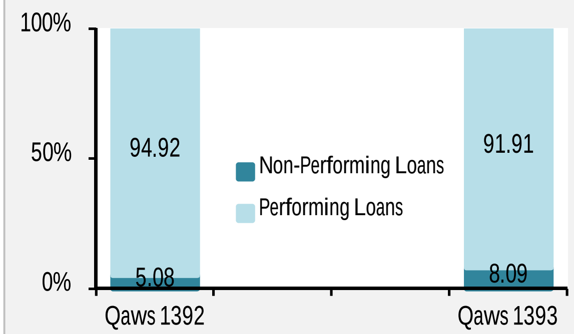
Banks should try to strengthen credit risk management measures to curtail the level of NPLs. It is essential for banks to evaluate credit applications carefully and closely monitor the financial condition of their borrowers, to ensure that credit expansion will not pose a threat to the stability of the financial system.

By the end of December 2014 the growth in non-performing loans accelerated by AF 1.11 billion standing at AF *3.49* billion *or 8.09 percent* of total gross loans compared to AF 2.34 billion or 5.08 percent of the total gross loans in the preceding year, mainly due to weaker loan quality and decrease in total loan portfolio. About 53.41 percent of the NPLs belong to one private bank, holding 31.27 percent of total gross loans of the banking system.

Financial Supervision Department (FSD) is closely working with the financial institutions to design and implement plans to improve their asset quality.

The sector-vise distribution of NPL reveals that a major portion of NPLs originated from trade sector with 43.97 percent of the NPL and services with 33.65 percent of NPLs is the second highest NPL holding sector in the banking system. Credit quality in communication and manufacturing sectors deteriorated, while in trade, agriculture and residential mortgage loans to individuals improved.

Figure 6.3: Quality of Loan Portfolio



1.1.3.2 Adversely-classified loans

Adversely classified loans (substandard, doubtful)4 depicted AF 1.79 billion increase over the last year amounting to AF 6.32 billion, constituting 13.95 percent of total gross loans.

1.1.3.3 Loans classified Watch

Loans classified in the "watch"5 category stood at AF 2.39 billion, which makes 5.55 percent of total gross loans, decreased since the previous year (Dec.2013). This category of loans require close monitoring, as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

[4] Assets on which the payment of principal or interest is due and remains unpaid for 61-90 days (Substandard) and for 91-539 days (Doubtful) as per accounting letter No. 03/92 dated 16/09/1392
[5] Assets on which the payment of principal or interest is due and remains unpaid for 31-60 days (Watch)

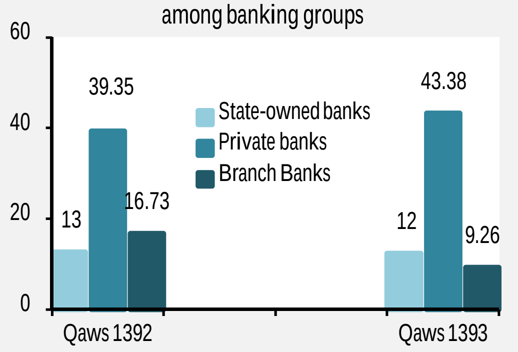
1.1.3.4 Loans classified loss[6]

Loans classified loss amounted to AF 168 million or 0.39 percent of total gross loans, down by AF 292 million since previous year. AF 168 million loss loans came from three private banking institutions.

1.2 Interbank Claims

Interbank Claims are the second largest among various asset categories, currently comprising 26.49 percent of total assets registered AF 0.78 billion decrease since previous year (Dec.2013). The decrease in interbank claims is attributed to a number of banking institutions, indicating that the banking sector has channeled a portion of its attracted funds as deposits in other financial institutions. These institutions are both inside and outside the country. Later on, if needed for liquidity purposes or after receiving applications from low-risk borrowers, these assets can be substituted to higher income earning assets. (Figure 6.4)

Figure 6.4: Share of Inter bank Claims among banking groups



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

1.3 Investment

The investment[7] portfolio of the banking sector increased by 31.56 percent or AF 3.60 billion in the FY 1393. The investments portfolio of the banking sector stood at AF 15.03 billion, accounted for 5.85 percent of total assets, mainly attributed to seven banking institutions. Major portion of the banking sector's investment took place outside Afghanistan by four commercial banks and two branches of foreign banks.

1.4 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category of total assets, making 43.93 percent of the total assets of the banking system, showed an increase of AF 11.44 billion, both in absolute as well as in percentage of total assets since the preceding year. The increase in cash in vault and claims on DAB is attributed to increase in deposit base of the banking sector.

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

II. LIABILITIES

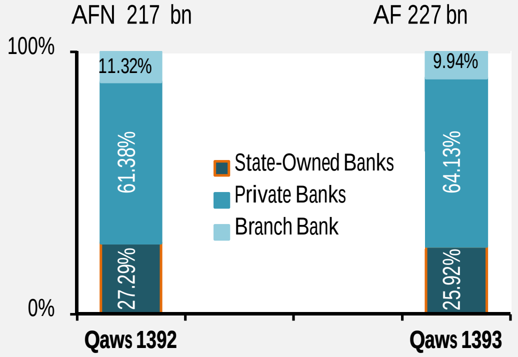
Total liabilities of the banking sector increased by AF 9.17 billion or 4.21 percent standing at AF 226.62 billion at the end of FY 1393 (Dec.2014) against AF 217.44 billion in the preceding year

7 Investments include investment in bonds, associated companies, in a subsidiary and in a bank

(Dec. 2013), attributed to an increase in the deposit base of the sector. Other components of total liabilities have shown a decrease over the last year.

The majority of liabilities are made up of deposits (96.57 percent). This is an indication of public confidence, good public relations and marketing policies of the banking sector. The “borrowings” and “other liabilities” stood at the second and third places respectively. (Table 6.1)

Figure 6.5: Liabilities increased by AF 9.17 bn or 4.22 percent



Source: *Financial Supervision Department, DAB*

2.1 Deposits

Deposits, the main funding source in the banking system increased by AF 11.02 billion or 5.30 percent in Dec.2014, compared to 8.10 percent increase in Dec.2013.The deposits base of the banking sector in the first three quarters of 2014 had a fluctuating trend; the decrease in the USD deposits were dominant. The decrease was mainly driven by the prolonged election process and uncertainty in the economy. During the last quarter, the deposits picked up and increased by 13 percent.

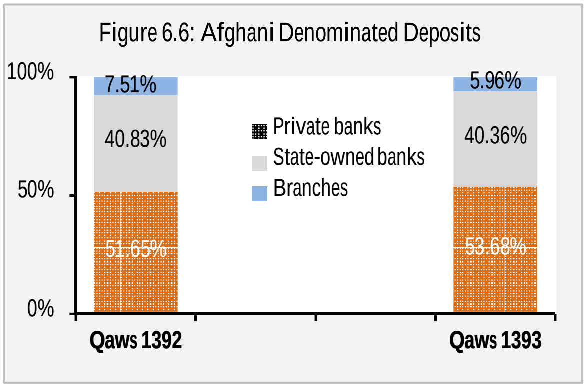
Afghani denominated deposits indicated 12.64 percent increase (16.62 percent increase in Dec.2013) accounting for 34.08 percent of total deposits, while US dollar denominated deposits were up by 1.15 percent (5.28 percent increase in Dec. 2013) making 62.61 percent of the total deposits of the system.

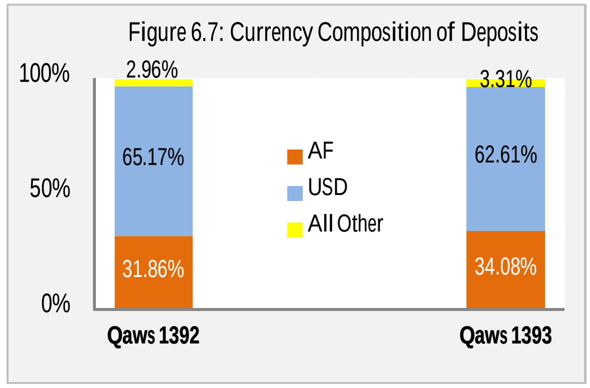
Private Banks attracted AF 140.69 billion deposits, up by 8.98 percent against 16.35 percent increase in the previous year, making up 64.29 percent of the system’s deposits.

The share of state-owned banks in the total deposits increased to AF 57.42 billion in Dec.2013, accounted for 26.24 percent of the system’s deposits.

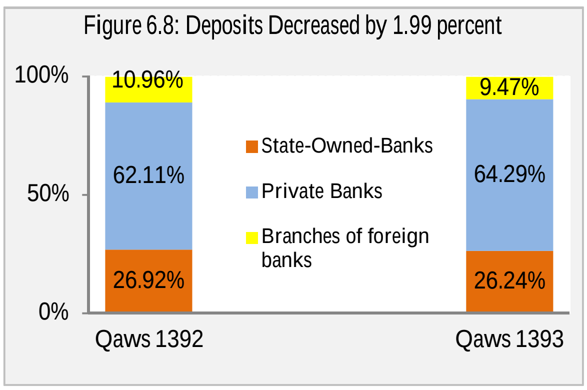
The share of branches of foreign banks stands at AF 20.72 billion decreased by 9.05 percent making up 9.47 percent of total deposits of the system.

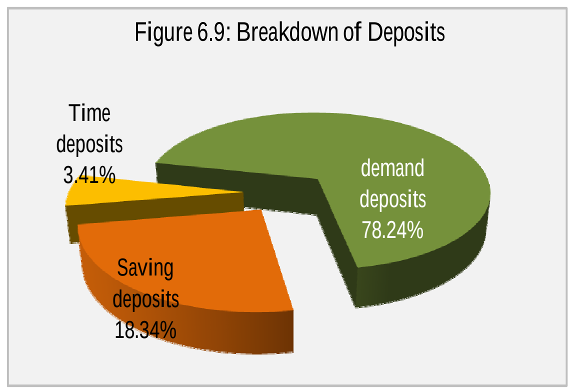
In terms of types of deposits, demand deposits accounted for 78.24 percent of the total deposit base, up by 11.29 percent. Saving deposits with 18.34 percent of total deposits was in the second place, depicted 9.83 percent decrease, while time deposits making up 3.41 percent of the total deposit portfolio, was down by 20.89 percent since Dec.2013.





Source: Financial Supervision Department, DAB





Source: Financial Supervision Department, DAB

2.2 Borrowings

The share of borrowings in total funding structure of the system decreased by 29.16 percent standing at AF 3.98 billion at the end of Dec. 2014, making 1.76 percent of total liabilities in comparison with 67.81 percent increase in Dec-2013. The decrease in the borrowing is attributed to settlements from two banking institutions. The current borrowing position is attributed to three banking institutions.

III. LIQUIDITY

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

3.1 Liquidity Ratio (broad measure)

Banks are required to maintain a liquid asset ratio not less than 15 percent. This should provide a comfortable safeguard against any liquidity shortfall.

Generally, a surplus liquidity position was observed in the banking sector during this period. 73.21 percent of the sector's total assets are comprised of liquid assets. Ratio of the broad liquidity as a median for the whole system stood at 73.60 percent. All banking institutions were well above the minimum required level.

IV. CAPITAL

In order to strengthen the capital base of the banking system and enhance its stability, DAB increased the minimum Paid-in capital requirement to AF 1.00 billion, and all banking institutions are required to fulfill the requirement.

The system is well capitalized. The capital fund of the banking sector stands at AF 30.17 billion, increased by 6.60 points or AF 1.86 billion due to an increase in the profitability of the banking sector.

On an aggregate basis the Capital Adequacy ratio of the banking sector stands at 26.46 percent. Table 6.3

Disaggregated analysis shows that all banks in the system registered capital adequacy ratio above the minimum threshold (12 percent of risk-weighted assets).The Basel benchmark for capital to risk weighted is 8 percent.

V. PROFITABILITY

On a cumulative basis, for the fiscal year 1393 (Dec.2014) the banking sector earned AF 2.17 billion profits against AF 1.43 billion profits recorded in the same preceding year, showing an increase of 51.56 percent or AF 741 million.

The profitability of the banking sector is attributed to an increase in the net-interest income and a decrease in non-interest expense and credit provisions. While

Table 6.3: Key Financial Soundness Indicators of the banking Sector

	1387 (Mar 09)	1388 (Mar 10)	1390 (Mar 11)	1390 (Mar 11)*	1390 (Mar 12)	1391 (Dec. 12)	1392 (Dec. 13)	1393 (Dec. 14)
Total Capital Adequacy Ratio	**29.81**	25.81	-14.46	30.39	23.06	21.84	26.20	26.46
Tier 1 Capital Adequacy Ratio	29.72	24.19	-14.51	30.29	23.98	19.97	24.78	26.09
Non-Performing Loans to Total Gross Loans	1.15	0.5	48.4	3.75	5.15	5.31	5.08	8.09
Return on Assets (ROA)	1.74	1.41	-20.08	0.24	-1.21	-0.54	0.61	0.90
Return on Equity (ROE)	10.61	10.35	-520.66	1.9	-17.9	-7.17	8.18	7.35
liquidity Ratio (Broad Measure Median)	40.02	59.19	63.32	63.83	57.37	72.13	67.07	73.60
liquidity Assets to Total Assets	23.8	0.38	40.58	47.01	55.82	63.75	62.16	73.28

*Excluding Kabul Bank

Source: *Financial Supervision Department/ DAB* non-interest income decreased and salary cost increased over the previous year.

As a result the returns on assets (ROA) improved to 0.90 from 0.61 percent and return on equity decreased to 7.35 from 8.18 percent in the last year. The decrease in the ROE is attributed to an increase in denominator of the ratio. Table 6.3

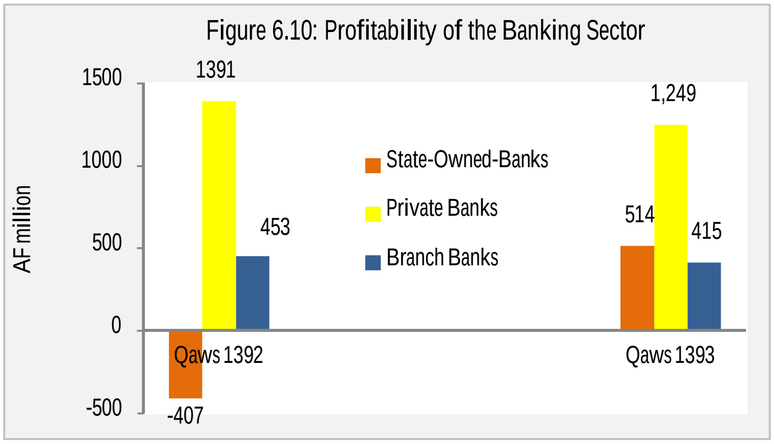
On a cumulative basis two banking institutions have incurred AF 366 million losses against AF 587 million losses posted by three banks in Dec.2013.

On core income basis one bank ended with losses, against the same number of banks in the previous year.

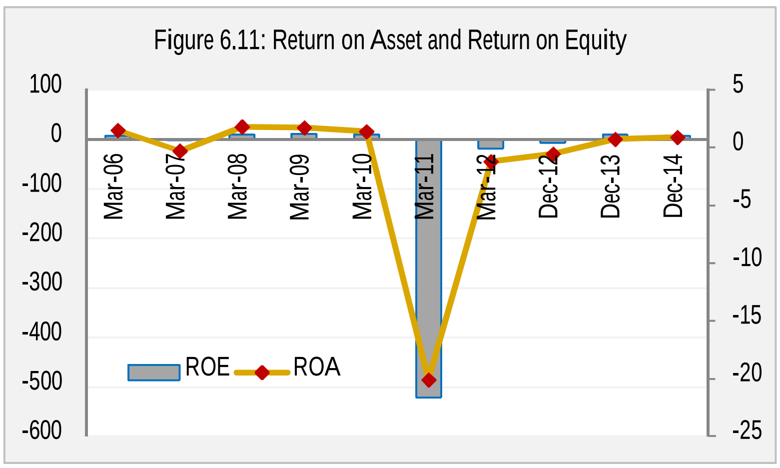
On an aggregate basis Private Banks, Branches of Foreign Banks and State-owned Banks ended up with profits. Figure6.10

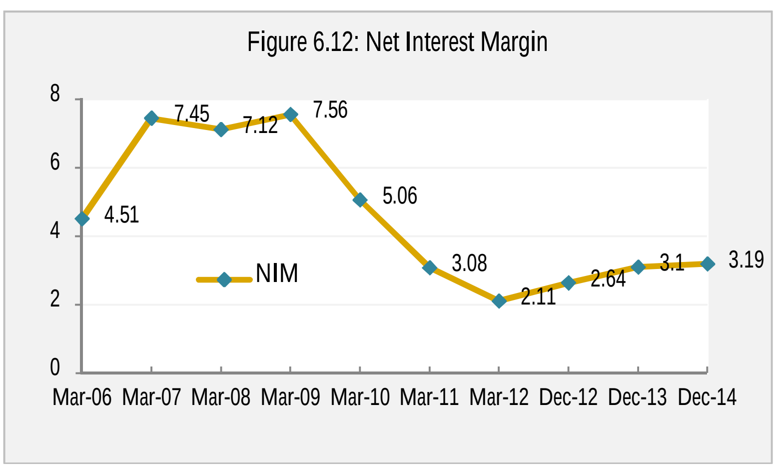
Table 6.4: P/L Schedule

	1392 (Dec. 2013	1393 (Dec. 2014)	% change Y-o-Y
interest income	9,051	9,659	6.71%
interest expense	1,692	1,893	11.87%
Net interest income	7,359	7,765	5.51%
Non-interest income	5,412	5,313	-1.83%
Non-interest expenses	6,341	5,788	-8.72%
Salary cost	3,212	3,551	10.55%
Credit provisions	1,173	1,124	-4.17%
P/L before tax	2,045	2,615	27.87%
P/L after tax	1,437	2,178	51.56%



Source: Financial Supervision Department/ DAB





Source: Financial Supervision Department/DAB

VI. FOREIGN EXCHANGE RISK

The level of overall open FX position risk OF banks is mostly within the levels set by DAB. In general, all the banking institutions were within the limits set for overall open FX position, except four banking institutions including one branch of foreign bank holding open FX positions on overall and on an individual currency (USD and EURO long positions) basis violated the limits. These banks need to bring their FX positions under the set limit; otherwise the decrease in value of the above mentioned currencies or the depreciation in these currencies can lead banks to more losses.

The impact of changes in the exchange rate upon regulatory capital of the system reveals that a 20 percent appreciation in exchange rate would increase the regulatory capital of the system by AF 8.27 billion, and vice versa. Similarly, a 4 percent change would correspond to AF 1.65 billion and vice versa.

VII. INTEREST RATE RISK

Overall the banking system is in an interest-rate sensitive position. However, calculations made from the Interest Rate Sensitivity Schedules of all banks reveal that, the net-interest income of the system over the next 12 months may increase by AF 1.70 billion in an event of increase in the market interest-rate (upward interest rate shock) by 3 percentage points. Conversely if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AF 1.70 billion. For one banking institution, if the interest-rate increases by 3 percentage points, that will decrease in its net interest income over the next 12 months.

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.

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