Da Afghanistan Bank

Economic & Statistical Bulletin

Semi Annual Bulletin - FY 1396

Monetary Policy Department

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Note:

Afghanistan's Fiscal year has been changed effective from 1391 (2012). The new fiscal year begins on December 21st each year. This semi-annual bulletin analyzes developments in the first half of fiscal year 1396, which covers December 21st, 2016 to June 21st, 2017.

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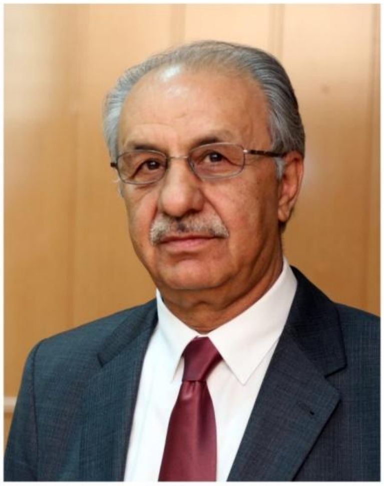
ABBREVIATIONS

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



Khalil Sediq

Governor

Muhammad Qaseem Rahimi

Second Deputy Governor

Wahidullah Nosher

First Deputy Governor

Message

From the Governor

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

EXECUTIVE SUMMARY

Da Afghanistan Bank’s semi-annual economic and statistical bulletin provides a comprehensive account of developments taken place in the Afghan Economy.

In this bulletin, you will find a summary report of the global economy as well as thorough analysis of the developments that have taken place in all sectors of the Afghanistan's economy and succinct examination of the challenges faced by these sectors during the first half of FY2017.

Reports from the World Bank illustrate that global economy is strengthening due to recovery in industrial activities as well as increase in global trade. Global economic growth is expected to rise by 2.7 percent in 2017 up from 2.4 percent in the previous year.

GDP of advanced economies is predicted to maintain momentum during the current year supported by an upturn in the economy of the US. Advanced economies are expected to record 1.9 percent growth rate in 2017 from 1.7 percent in the previous year.

Similarly, the World Bank projects the economic growth rate of emerging and developing economies (EMDEs) to incline to 4.1 percent in the FY2017, while it registered 3.5 percent growth in the preceding year.

Generally, global commodity prices showed an upward slope in international market during the first half of FY2017.

Afghanistan's headline CPI inflation inclined to an average rate of 6.09 percent in the first half of FY2017. Kabul CPI also recorded an upward trend and inclined to 6.25 percent during the period under review.

Inflation in Afghanistan will get intensive effects from increasing prices of commodities in global markets. According to the World Bank group, energy prices are projected to increase by around 26 percent in 2017 and additional 8 percent in 2018. In the meantime, these projections for non-energy prices show a 4 percent increase in 2017, a 1 percent upward revision from start of 2017.

Da Afghanistan Bank maintains monetary targeting regime and targets reserve money to contain inflation. In the first half of fiscal year 2017, reserve money (Da Afghanistan Bank’s operational target) grew by 0.10 percent.

DAB has auctioned total amount of USD 879.74 million during the FY 2016 in order to manage liquidity in the market and to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies especially US dollar. Meanwhile, in the first half of fiscal year 2017, Afghani has experienced a slight depreciation of 1.49 percent against the US dollar.

Da Afghanistan Bank's net international reserve (NIR) consists of monetary gold, reserve position and holdings with the IMF and special drawing rights (SDR) as well as major foreign exchange such as US dollar, Euro, Great Britain Pound and others. During the period under review, NIR decreased slightly by 0.26 percent which is equivalent to USD 17.77 million.

The available data reveals that the overall balance for the first half of the FY 1396 recorded a deficit of USD 2,439.71 million up from a deficit of USD 1,268.82 million recorded in the first half of the FY 1395. This outcome was due to trade deficit which is widened by almost 11 percent and narrowed inflows to the secondary income account (current transfers) by 45 percent in the reporting period.

The current account balance, which is the key measure of an economy's saving and spending behavior, shows a deficit of USD 2,728.08 million in the first half of the FY 1396 higher than a deficit of USD 1,724.25 million in the same period of last year registering 58 percent increase.

Earnings from exports of goods have decreased by almost 3 percent while expenditure on imports of goods increased by 10 percent in the first half of the FY 1396.

The capital account of the Balance of Payments illustrated 63 percent decline on account of inflows (capital transfers) to the government sector in the first half of the FY 1396.

The available data shows that inflows from foreign direct investment declined by 2 percent, while portfolio investment recorded a decline of 95 percent in the outflow during the period under review.

Banking sector earned net profits amounting to AFN 235 million during the first half of FY2017, against AFN net profit of 920 million in the same period of the previous year. The decrease in profitability of the banking sector is mostly ascribed to decrease in non-interest income and increased in credit provision, salary and tax expenses. While net-interest income increased and non-interest expense decreased during the first half of the year 2017. State-Owned Banks (SOB) and branches of foreign banks (BFB) ended up with profits, while Private Banks (PB) suffered from losses.

1

GLOBAL ECONOMIC ENVIRONMENT

1

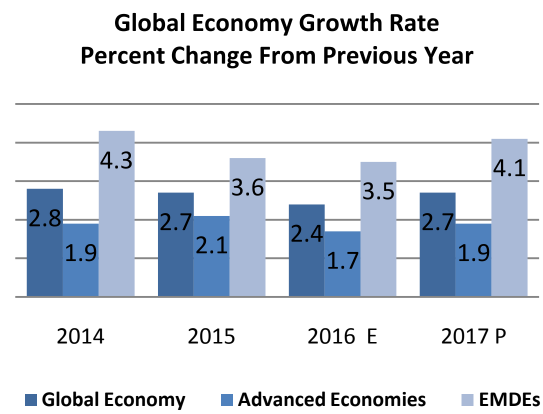
GLOBAL ECONOMIC ENVIRONMENT

According to the World Bank, the global economy is continuing to strengthen as recovery in industrial activity and global trade picked up after two years of weakness. Confidence is improving while the global financing conditions have been benign. The global growth is expected to increase by 2.7 percent in 2017 up from post-crisis rate of 2.4 percent in the previous year.

Activity in the advanced economies is expected to maintain momentum in 2017 supported by an upturn in the United States. In Euro Area and Japan, the growth is expected to increase due to strengthening of the domestic demand and exports. Investment has firmed across the advanced economies while the growth of the private consumption has moderated. The growth in advanced economies is expected to increase to 1.9 percent in 2017 up from 1.7 percent in the previous year.

In emerging market and developing economies (EMDEs), the growth obstacles among commodity exporters are diminishing gradually, whereas the activity among the commodity importers remains robust. Therefore, the growth of the EMDEs is projected by the World Bank at 4.1 percent for 2017 which is higher than 3.5 percent growth in the previous year.

Figure 1.1: The Global Economic Growth Rate



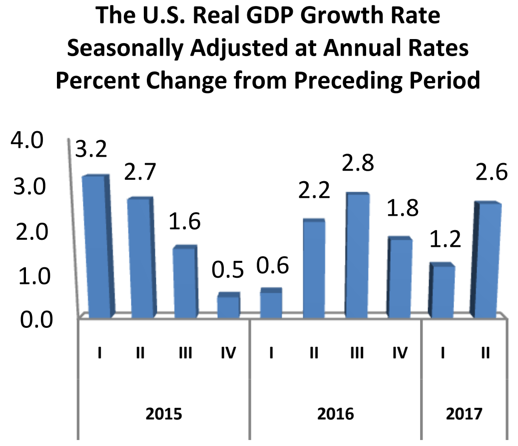
Source: The World Bank

I.I ADVANCED ECONOMIES

1.1.1 The United States Economy

The real gross domestic product (GDP) of the United States (U.S.) increased by 2.6 percent in the second quarter of 2017. Positive contributions to the increase in the real GDP came from personal consumption expenditure, non-residential fixed investment, exports, and federal government spending which were partly affected by negative contributions from private residential fixed investment, private inventory investment, state and local government spending, and higher imports. Similarly in the first quarter of 2017, the real GDP of the U.S. increased by 1.2 percent. The increase in the real GDP was mainly due to increase in the business investment, exports, consumer spending, and housing investment which were partly affected by decreases in inventory investment and government spending as well as an increase in imports.

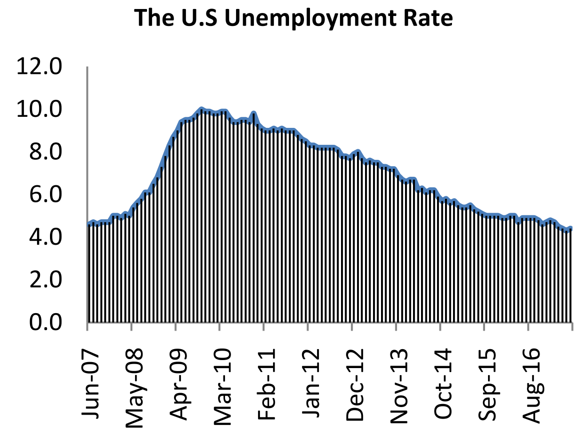
Figure 1.2: The US Read GDP Growth Rate Q1, 2015- Q2, 2017



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

The U.S. unemployment rate increased slightly to 4.4 percent in the second quarter of FY2017. In the month of May, the rate stood at 4.3 percent, which is the lowest rate since June 2007. The unemployment rates for the months of January, February, March, and April were recorded at 4.8 percent, 4.7 percent, 4.5 percent and 4.4 percent respectively. However, the average unemployment rate for the first half of 2017 reached 4.5 percent.

Figure 1.3: The US Unemployment Rate from March, 2007 to June, 2017



Source: Bureau of Labor Statistics, US Department of Labor

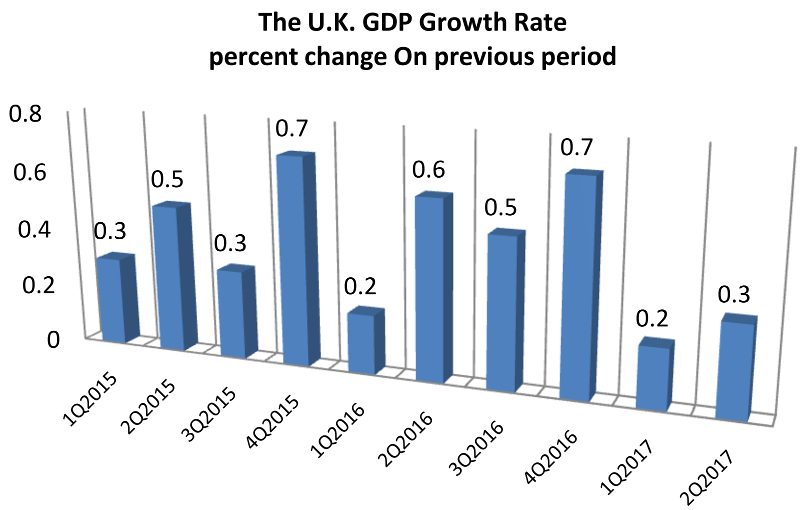
The U.S. consumer price index (CPI) for all urban consumers (all items) rose by 1.6 percent in June 2017 from the same period of the previous year, but indicates a decline since January. The increase in the CPI for the months of January, February, March, April, and May were recorded at 2.5 percent, 2.7 percent, 2.4 percent, 2.2 percent and 1.9 percent respectively. On average, the increase in the CPI reached 2.5 percent and 1.9 percent in the first quarter and second quarters of 2017 respectively.

The U.S. international trade (goods and services) deficit stood at USD 43.6 billion in June 2017 down by USD 2.8 billion from USD 46.4 billion in March 2017. In the following month, the trade deficit was recorded at USD 47.6 billion. Moreover, the trade deficit decreased to USD 40.4 billion in March 2017 from USD 47.0 billion in the previous month indicating a decline of USD 6.6 billion. However, the U.S. international trade deficit was recorded at USD 48.5 billion in January 2017.

1.1.2 The Economy of United Kingdom

The GDP of United Kingdom (U.K.) increased by 0.2 percent in the second quarter of 2017. The increase in the GDP was mainly driven by services which indicated an increase of 0.5 percent. Besides, government spending and investment were higher while the household spending and business investment slowed down. In the first quarter of 2017, the GDP growth slowed to 0.2 percent, while the GDP growth rate stood at 0.7 percent in the fourth quarter of previous year. Lower GDP growth in the first quarter was mainly due to a decrease in the household spending as well as lower activity in the consumer facing industries such as retail and accommodation. A slight growth was noted in construction and manufacturing sectors as well, while business services and finance recorded considerable growth.

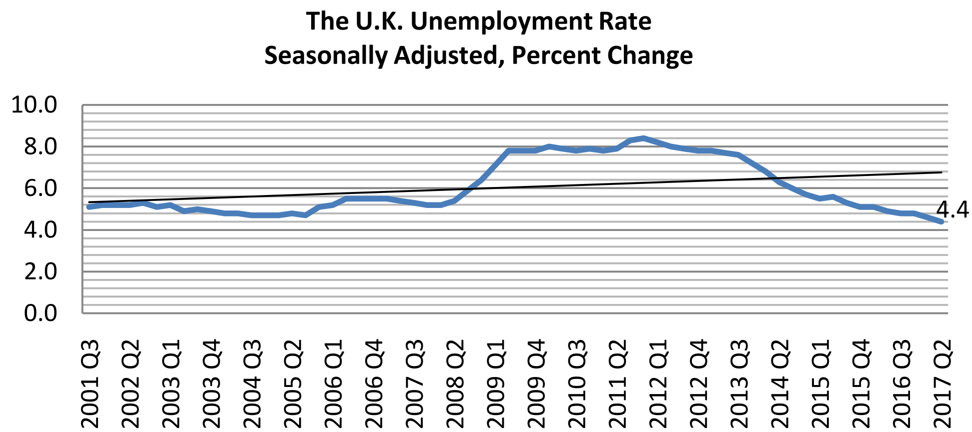
Figure 1.4: The UK GDP Growth from Q1, 2015 - Q2, 2017



Source: Office for National Statistics, U.K.

The seasonally adjusted unemployment rate in U.K. declined to 4.4 percent in the second quarter of 2017. The number of people in work reached 32.07 million indicating an increase of 125,000 persons in work compared to the previous quarter, while it shows an increase of 338,000 persons in work compared to the same period of the previous year. In the first quarter, the seasonally adjusted unemployment rate decreased to 4.6 percent from 4.8 percent in the previous quarter, while in the first quarter of the previous year, the unemployment rate was recorded at 5.1 percent.

Figure 1.5: The UK Unemployment Rate form Q2, 2001 - Q2, 2017



Source: Office for National Statistics, UK

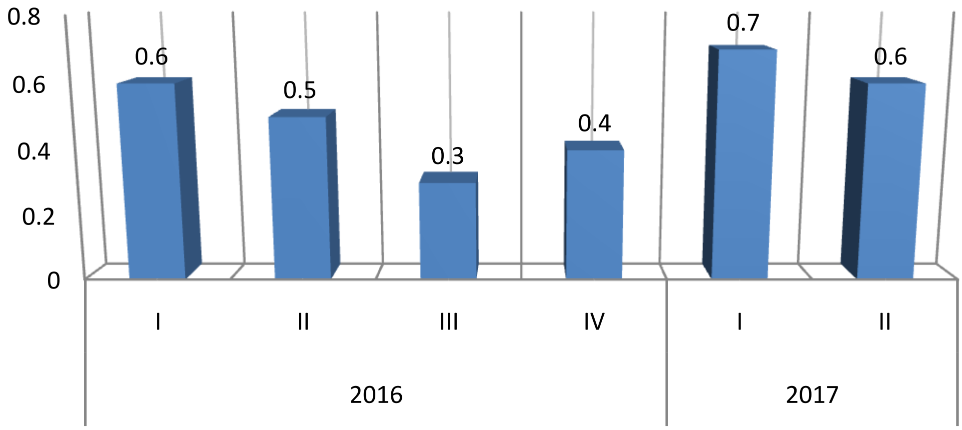
The annual inflation rate of U.K. reached 2.6 percent in June 2017 down from 2.9 percent in the month of May, and the rate stood at 2.7 percent in April 2017. The main contributor to a decline in the consumer prices in June as compared with the month of May were decreasing prices of fuels and certain recreational and cultural goods and services which were partially offset by increasing prices of furniture and furnishings. However, the annual inflation rate stood at 2.3 percent in March same as the previous month. The main contributors to higher consumer prices in March were increased prices of food, alcohol and tobacco, clothing and footwear, and miscellaneous goods and services. Moreover, the U.K. annual inflation rate rose by 1.8 percent in January compared to 1.6 percent increase in the previous month.

The foreign trade deficit (goods and services) of the U.K. increased by GBP 0.1 billion and reached GBP 8.9 billion in the first half of FY2017. During this period, higher imports were closely matched by increases in exports. In the first quarter of 2017, the foreign trade deficit (goods and services) increased by GBP 2.3 billion and was recorded at GBP 4.9 billion. The widening foreign trade deficit in the first quarter was mainly due to higher imports of machinery and transport equipment as well as an increase in the imports of oil and chemicals.

1.1.3 The Economy of Germany

The GDP of Germany (price, seasonally, and calendar adjusted) increased by 0.6 percent in the second quarter of 2017. In the mentioned period, the domestic demand contributed positively to the GDP growth. The fixed capital formation in machinery and equipment, in construction and in other fixed assets indicated increases compared to the previous quarter. Moreover, a significant increase was noted in the fixed capital formation, particularly in construction as well as in machinery and equipment over the previous quarter. Likewise, a slight increase was observed in the final consumption expenditure of the general government and households during the first quarter. In addition, the foreign trade contributed positively to the GDP growth since the exports were higher than imports.

Figure 1.6: The GDP Growth Rate of Germany Q1, 2006 – Q2, 2017 (Q-o-Q) seasonal and calendar adjusted



Source: Federal Statistics Office (DESTATIS), Germany

The consumer prices in Germany increased by 1.6 percent in June 2017 compared to the same period of the previous year. The consumer prices showed an increase of 1.5 percent in May while in April, the consumer prices were up by 2.0 percent. On average, consumer prices recorded 1.7 percent increase in the second quarter. In addition, the consumer prices rose by 1.6 percent in March 2017 down from 2.2 percent in the previous month, while in January, the consumer prices indicated an increase of 1.9 percent. On average, the consumer prices showed an increase of 1.9 percent in the first quarter of 2017.

The unemployment rate of Germany stood at 3.8 percent in the month of June 2017 down from 3.9 percent in the previous month. Meanwhile, the unemployment rate was registered 3.9 percent in the month of April. On average, the unemployment rate in the second quarter stood at 3.86 percent. Moreover, the number of unemployed people in Germany reached 1.63 million in June, while the number of employed people was recorded at 41.29 million. In March, the unemployment rate was recorded at 3.9 percent same as the previous two months. Figures for March show that 41.69 million people were employed, while 1.68 million were unable to find jobs in Germany.

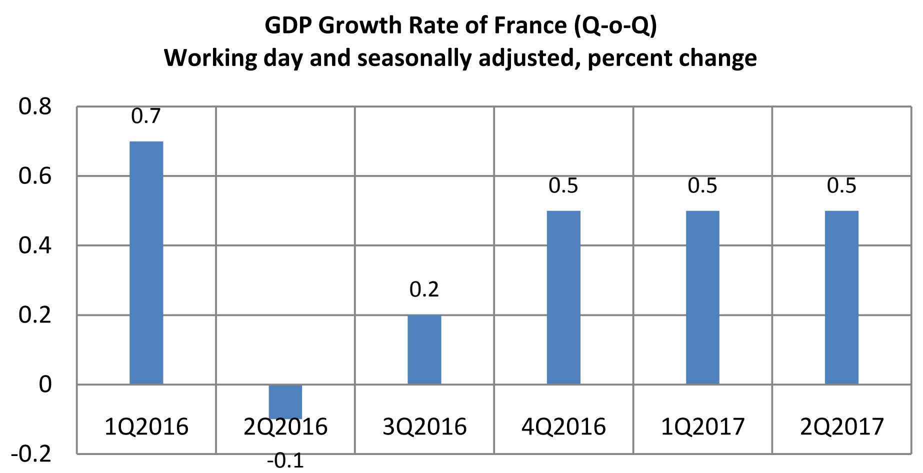
The total exports (goods and services) of Germany reached EUR 638.4 billion in the first half of 2017, while the total imports (goods and services) stood at EUR 516.0 billion indicating a foreign trade surplus of EUR 122.5 billion. The foreign trade surplus of Germany in the months of April, May and June were recorded at EUR 18.1 billion, EUR 22.0 billion and EUR

22.3 billion respectively. In the first quarter of 2017, the total exports of Germany were recorded at EUR 319.4 billion, while the total imports of Germany reached at EUR 259.1 billion indicating a trade surplus of EUR 60.3 billion.

1.1.4 The Economy of France

The GDP of France increased by 0.5 percent in the second quarter of 2017. Household consumption was slightly higher by 0.3 percent while the total gross fixed capital formation indicated a significant decline by 0.5 percent. Final domestic demand excluding changes in inventory contributed positively (0.4 percent) to the GDP growth. In the first quarter of 2017, the GDP of France also indicated an increase of 0.5 percent same as the previous quarter. The growth of household consumption expenditure declined to 0.1 percent from 0.7 percent in the previous quarter while the total gross fixed capital formation picked up and reached 1.4 percent from 0.6 percent increase in the previous quarter. However, changes in inventory contributed 0.7 points to the GDP growth after (-0.2) points contribution in the previous quarter.

Figure 1.7: The GDP Growth Rate of France Q1, 2016 – Q2, 2017



Source: National Institute of Statistics and Economic Studies (INSEE), France

The consumer prices (Y-o-Y) of France were estimated to have declined slightly to 0.7 percent in June 2017 compared to 0.8 percent increase in the previous month. The decline in prices in June was considered mainly due to lower energy prices. In April, the consumer prices showed an increase of 1.2 percent. On average, the consumer prices increased by 0.9 percent in the second quarter of 2017.However, the consumer prices in France were up by 1.1 percent in March which is slightly lower than 1.2 percent increase in the previous month while in January, the consumer prices showed an increase of 1.3 percent. In March, a slight decline in the consumer prices was mainly due to a decrease in the prices of services and energy and a significant decline in the food prices which were offset by higher prices for tobacco and a lesser downturn in the prices of manufactured products. On average, the consumer prices increased by 1.2 percent in the first quarter of 2017.

The unemployment rate in metropolitan France and the overseas departments (excluding Mayotte) was recorded at 9.5 percent (on average) in the second quarter of 2017, slightly down from 9.6 percent in the previous quarter. In metropolitan France only, the unemployment rate reached 9.3 percent in the first quarter, while it stood at 9.2 percent in the second quarter.

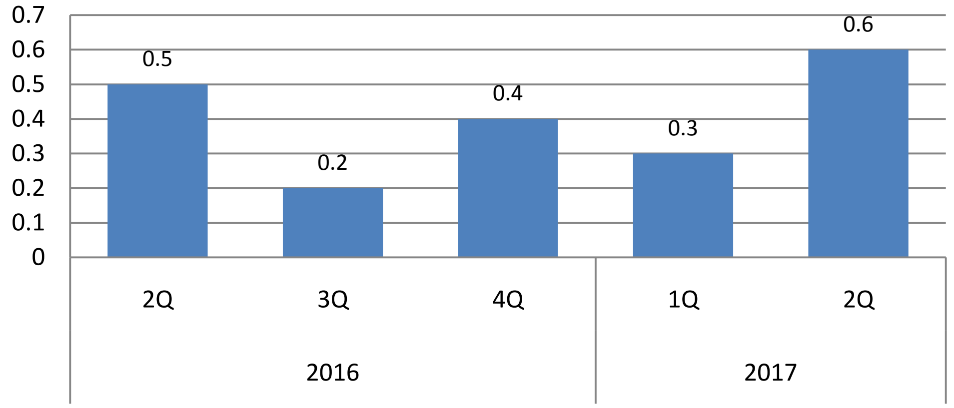
The total exports of France were recorded at EUR 163.9 billion in the second quarter of 2017 while in the previous quarter, the exports stood at EUR 159.9 billion indicating an increase of 2.5 percent. The increase in the total exports was particularly in transport equipment and other manufactured goods. On the other hand, the total imports of France were recorded at EUR 181.7 billion in the second quarter of 2017 up from EUR 181.1 billion in the previous quarter, which showed an increase of 0.4 percent. The trade balance deficit of France declined to EUR 17.8 billion in the second quarter of 2017 from EUR 21.2 billion in the previous quarter.

1.1.5 The Economy of Japan

The GDP of Japan (seasonally adjusted) increased by 0.6 percent (Q-o-Q) in the second quarter of 2017. The domestic demand increased by 0.9 percent; the private demand was up by 0.8 percent while the public demand indicated an increase of 1.5 percent. At an annualized rate, the GDP of Japan was higher by 2.5 percent in the second quarter of 2017. In the first quarter, the GDP of Japan increased by 0.3 percent over the previous quarter. The domestic demand was higher by 0.2 percent; the private demand was higher by 0.2 percent while the public demand was stable (0.0 percent). The GDP of Japan indicated an increase of 1.2 percent at an annualized rate.

Figure 1.8: The GDP growth rate of Japan from Q2, 2016 – Q2, 2017

GDP Growth Rate of Japan (Q-o-Q)
Seasonally Adjusted, Precent change



Source: Cabinet Office, Japan

The seasonally adjusted unemployment rate of Japan stood at 2.8 percent in June 2017 while the rate reached 3.1 percent in the previous month. The unemployment rate for the months February, March, and April was also recorded at 2.8 percent. But in January, the rate was slightly higher and was recorded at 3 percent. On average, the unemployment rate of Japan stood at 2.86 percent and 2.9 percent in the first quarter and second quarter of 2017 respectively.

The annualized rate of inflation of Japan was 0.4 percent in the month of June 2017 same as the last two months. Therefore, the average rate of inflation in the second quarter was also 0.4 percent. Moreover, the inflation rate for the months of January, February, and March were recorded at 0.4 percent, 0.3 percent and 0.2 percent respectively while the average rate of inflation reached 0.3 percent in the first quarter.

The foreign trade balance of Japan recorded a trade surplus of JPY 441.425 billion in June 2017, while the foreign trade balance indicated a deficit of JPY 206.416 billion in the previous month. In April, the foreign trade balance showed a surplus of JYP 479.167 billion. Moreover, the foreign trade balance of Japan reflected surpluses of JPY 811.131 billion, JPY 610.295 billion, and JPY 479.167 billion in the months of January, February and March respectively.

II. EMERGING MARKET ECONOMIES

1.2.1 The Economy of China

The GDP of China increased by 6.9 percent (Y-o-Y) in the second quarter of 2017 same as the previous quarter, while the GDP indicated an increase of 1.7 percent (Q-o-Q) in the second quarter of 2017, up from 1.3 percent in the previous quarter. In the first half of 2017, the GDP of China showed an increase of 6.9 percent. Based on year on year data, the industrial sector indicated a growth of 6.5

percent in the second quarter of 2017, while the growth in the industrial sector was recorded at 6.6 percent in the first quarter. The manufacturing sector grew by 7.0 percent in the second quarter compared to 7.1 percent in the previous quarter. The construction sector showed a growth of 5.3 percent in the second quarter whereas the growth of the mentioned sector was 5.4 percent in the previous quarter.

Figure 1.9: The GDP Growth Rate of China Q1, 2015-Q2, 2017

Source: National Bureau of Statistics of China

The consumer prices in China increased by 1.5 percent (Y-o-Y) in June 2017. The prices in cities picked up by 1.7 percent whereas the prices in rural areas rose by 1.0 percent. The food prices as well as non-food prices declined by 1.2 percent and 2.2 percent respectively. The prices of consumer goods increased by 0.6 percent and the prices of services rose by 3.0 percent. On average, the overall consumer prices increased by 1.4 percent in the first half of 2017 from the same period of previous year.

The urban unemployment rate of China reached 3.95 percent in the second quarter of 2017, which is the lowest rate since third quarter of 2002. In the first quarter of 2017, the urban unemployment rate was recorded at 3.97 percent. In the first half of 2017, China has created 7.35 million new jobs in the urban areas indicating an increase of 180,000 from the same period of previous year.

The trade balance surplus of China was recorded at USD 42.77 billion in June 2017, while in the previous month, the trade surplus stood at USD 40.8 billion. In March and April, the trade surpluses were recorded at USD 23.9 billion and USD 38.5 billion respectively, but in February; China recorded a trade deficit of UDS 9.8 billion. In January 2017, the trade surplus of China was recorded at UDS 50.2 billion.

1.2.2 The Economy of India

The GDP of India was estimated to have increased by 5.7 percent in the second quarter of 2017 over the same period previous year.

Based on estimations, the agriculture, forestry and fishing grew by 2.3 percent whereas mining and quarrying showed a negative growth of -0.7 percent. Manufacturing sector increased by 1.2 percent while the growth of the construction sector was 2.0 percent. In addition, electricity, gas, water supply and other utility services grew by 7.0 percent in the mentioned period. In the first quarter of 2017, the GDP of India increased by 6.1 percent. Agriculture, forestry and fishing increased by 5.2 percent. Mining and quarrying was higher by 6.4 percent. Manufacturing grew by 5.3 percent. Construction sector indicated a negative growth of -3.7 percent. And electricity, gas, water supply and other utility services increased by 6.1 percent.

The consumer price index of India rose by 2.2 percent in the second quarter of 2017. According to the wholesale price index, the prices of food items declined by 1.7 percent, prices of minerals rose by 5.5 percent, prices of the manufactured products were up by 2.6 percent, prices of electricity picked up by 0.7 percent, and prices of all commodities were higher by 2.3 percent over the same period of previous year. In the first quarter of 2017, the consumer prices picked up by 3.6 percent. Based on the wholesale price index, prices of food items increased by 2.2 percent, prices of manufactured products were up by 3.2 percent, prices for electricity rose by 3.3 percent, prices of minerals picked up by 7.2 percent and prices of all commodities were higher by 5.0 percent.

In January 2017, the trade deficit of India was recorded at USD 9.84 billion, while the trade deficit declined to USD 8.89 billion in February, but in March, the trade deficit increased to USD 10.44 billion. Moreover, the trade deficit sharply increased to USD 13.25 billion in April and it continued to increase and reached USD 13.84 billion in May. However, the trade deficit indicated a slight decline in June and stood at USD 12.96 billion.

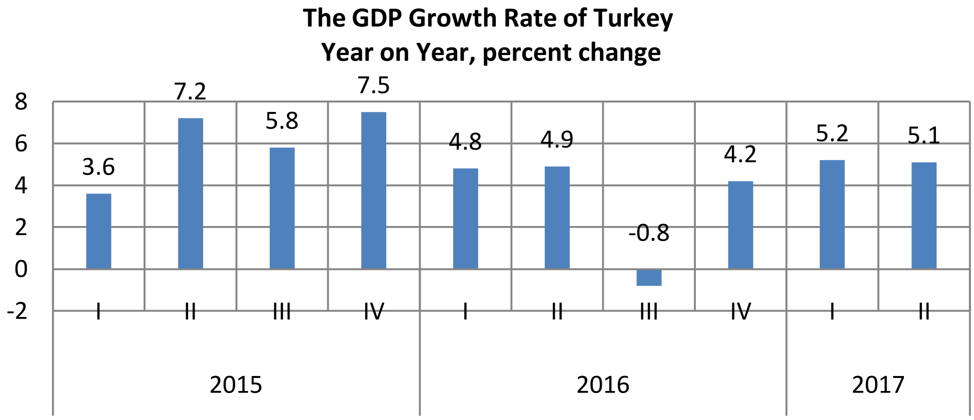
Figure 1.10: GDP Annual Growth Rate of India July, 2014- July, 21017

Source: Ministry of Statistics and Program Implementation (MOSPI), India

1.2.3 The Economy of Turkey

The GDP of Turkey increased by 5.1 percent in the second quarter of 2017 compared to the same period of previous year. The agricultural sector increased by 4.7 percent whereas the industrial and construction sectors grew by 6.3 percent and 6.8 percent respectively. The services sector showed a growth of 5.7 percent. Calendar adjusted GDP increased by 6.5 percent. Compared to the previous quarter, the seasonally and calendar adjusted GDP indicated a growth of 2.1 percent. In the first quarter of 2017, the GDP of Turkey increased by 5.2 percent compared to the same period of previous year. The agricultural sector indicated an increase of 3.2 percent whereas the industrial, construction and services sectors grew by 5.3 percent, 3.7 percent and 5.2 percent respectively. The calendar adjusted GDP indicated an increase of 4.7 percent. Compared to the previous quarter, the seasonally adjusted and calendar adjusted GDP increased by 1.4 percent.

Figure 1.11: The GDP Growth Rate of Turkey Q1, 2015 - Q2, 2017



Source: Turkish Statistical Institute

The annual inflation rate of Turkey declined to 10.90 percent in June 2017 from 11.72 percent in the previous month, while the inflation rate was recorded at 11.87 percent in April. On average, the consumer prices were up by 11.50 percent in the second quarter of 2017. In addition, the annual rate of inflation for the months of January, February and March were recorded at 9.22 percent, 10.13 percent and 11.29 percent respectively. On average, the consumer prices picked up by 10.21 percent in the first quarter of 2017. However, the consumer price in Turkey indicated an average increase of 10.86 percent in the first half of 2017.

The seasonally adjusted unemployment rate of Turkey was recorded at 21.9 percent in June 2017 same as the previous month, while the rate stood at 21.8 percent in April 2017. In addition, the unemployment rates of Turkey for the months of January, February and March were recorded at 22.6 percent, 22.1 percent and 21.7 percent respectively. Similarly, the unemployment rate reached 22 percent for the first half of 2017.

The foreign trade balance deficit of Turkey (seasonally and calendar adjusted) increased to USD 17.9 billion in the second quarter of 2017, while the foreign trade deficit was recorded at USD 13.3 billion in the previous quarter. In the first half of 2017, Turkey recorded a foreign trade deficit of USD 31.2 billion.

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Cabinet Office, Japan	www.esri.cao.go.jp
National Bureau of Statistics of China, People’s Republic of China	www.stats.gov.cn
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Turkish Statistical Institute	www.turkstat.gov.tr
Trading Economics	www.tradingeconomics.com

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

According to the monetary indicators data, reserve money (RM) in comparison to the starting date of the current year shows a slight increase by 0.10 percent at the end first half of the FY 1396 (2017), higher than -1.65 percent of the same period in 2016. CiC as an important component of RM recorded a negative growth of 2.3 percent and commercial banks deposit with the central bank (Overnight Deposits, Required Reserves and Current Accounts), which is another component of reserve money, increased by 19.9 percent at the end of first half of FY2017.

Reserve Money (RM) and Currency in Circulation (CiC) growth, which are Da Afghanistan Bank's operational and indicative targets, remained well below the assigned targets during the course of the period under review.

DAB experienced deaccumulation of 0.26 percent (USD 17.77 million) in net international reserve (NIR) since the beginning of the fiscal year until 21st June 2017.

Narrow money (M1), stood at AFN400,621 million at the end of the year under review, registering a growth of 5.69 percent (Y-o-Y). Broad money (M2) demonstrated similar behavior, representing a growth rate of 7.11 percent (Y-o-Y) standing at AFN437,397 million at the end of first half of fiscal year 2017.

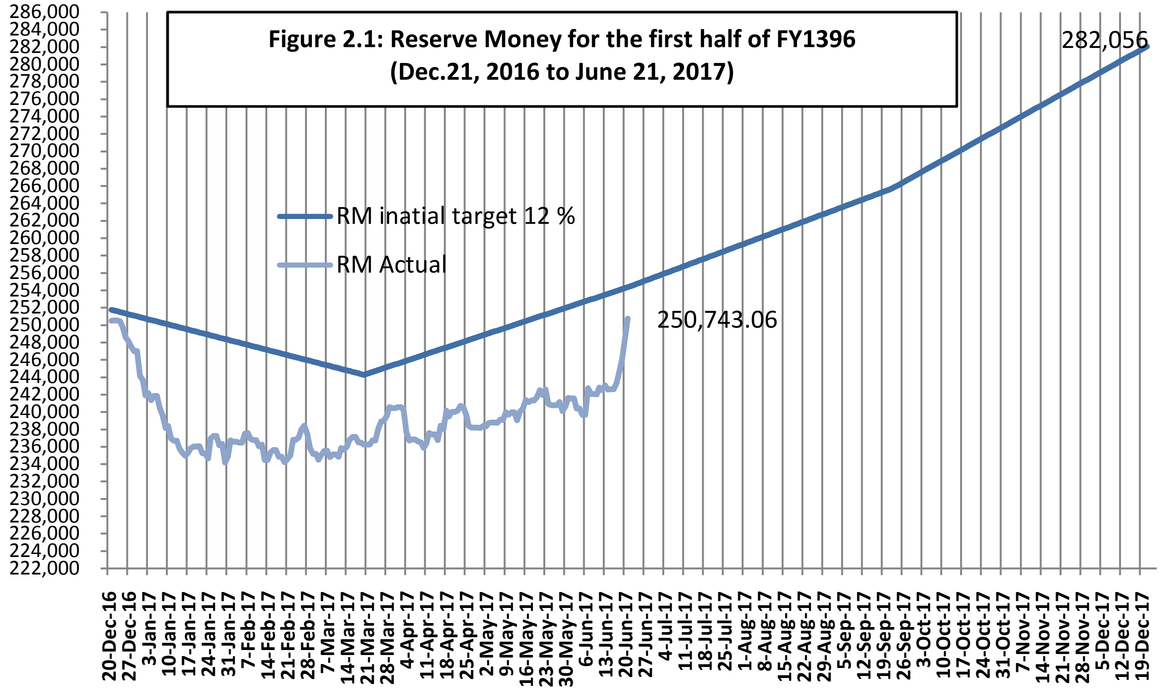
In order to monitor and manage the reserve money growth, DAB utilizes monetary instruments, FX auction and capital notes auction under the open market operation.

In the first half of fiscal year 2017, DAB has auctioned a total amount of USD 879.74 million to absorb the excess liquidity from the market as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at AFN 39.8 billion at the end of the year under review.

Meanwhile, in the first half of fiscal year 2017, Afghani has experienced a slight depreciation of 1.49 percent against the US dollar.

I. MONETARY PROGRAM

DAB applies quantitative theory of money to determine the amount of reserve money (RM) for the purpose of supporting domestic price stability, which is DAB's primary objective. Hence, the ECF targets for RM and CiC are based on expected economic growth and expected inflation during the concerned period. For the fiscal year 2017, the ceilings for reserve money and currency in circulation growth were set at 12%. At the end of the first half of current year, actual RM grew by 0.10 percent and actual CiC growth was minus 2.3 percent. Available data shows that typically, RM and CiC recorded lower growth during the first and second quarters of the previous year, while they show increase during the first half of the FY2017. Generally, actual RM and CiC are well managed under the target during the period under review. The average inflation rate for the first six months of the current year stands at 6.09 percent and projected GDP growth is 3 percent in FY 2017 based on DAB calculations. DAB auctioned USD 879.74 million to mop up the excess liquidity from the market and prevent intense fluctuations of Afghani nominal exchange rate against foreign currencies, especially internationally convertible currencies. The Figure 1.1 and 1.2 illustrate the ceiling and the actual reserve money and currency in circulation for the year under review.



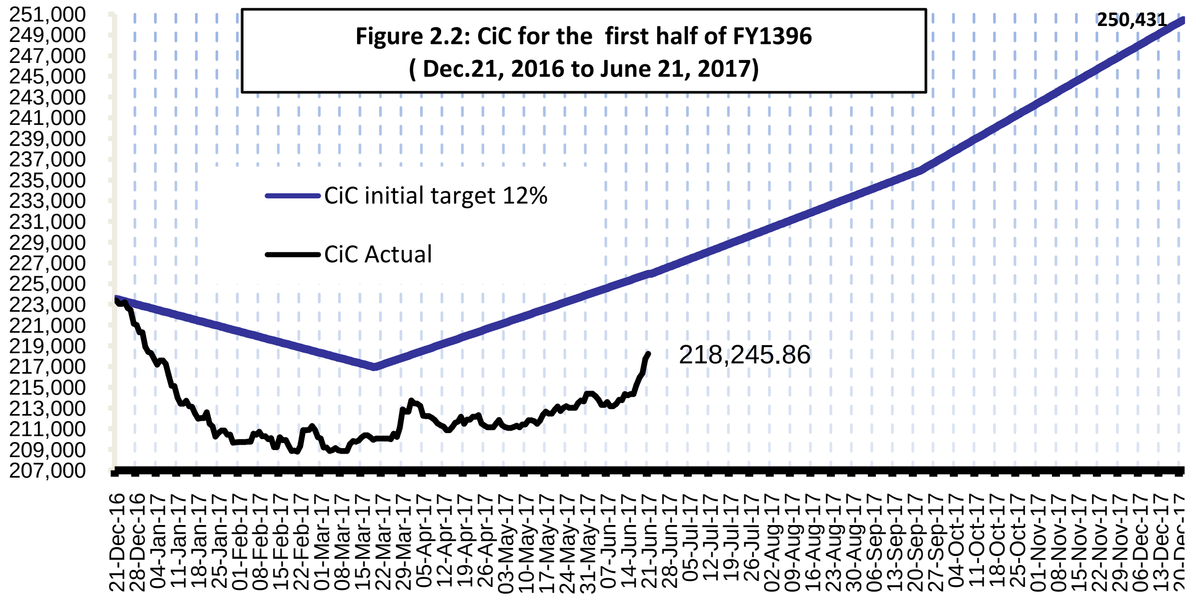


Figure 2.2: CiC for the first half of FY1396 (Dec.21, 2016 to June 21, 2017)

Source: Monetary Policy Department/DAB

II. MONETARY AGGREGATES

Narrow money includes currency outside depository corporations and demand deposits. While broad money includes narrow money components and other less liquid assets or quasi money.

As shown in Table 2.1, narrow money (M1) grew by 5.69 percent in the first half of the current fiscal year showing almost the same growth rate compared with the same period of FY2016. It also shows a point to point difference of AFN 21,553 million. Currency outside depository corporations or CiC, a major component of M1 (53 %), grew by 10.69 percent since the beginning of the year which is higher compared to0.61 percent in the first half of previous year. The difference in currency outside depository corporations in comparison to the same date of FY 2016 recorded AFN 20,410 millions. Demand deposits which are the other component of M1 experienced a growth of 0.61 percent at the end of the current period while its growth rate was 3.9 percent in previous year. Demand deposit figure in comparison with the previous year data shows a difference of AFN 1,144 million.

Broad money (M2) expanded by AFN 437,397 million in the period under review from AFN 408,346 million in the previous year, showing a difference of AFN 29,051 million. This shows an increase of 7.11 percent in first half of 2017 higher from 6.9 percent in the previous year. The current period figures show that M1 (92%) remained the main contributing component of M2. Quasi money or time deposits of commercial banks, which is the other component of M2, grew by 25.61 percent (y-o-

y) at the end of first half of 2017. Quasi money constitutes only 8 percent of broad money during the period under review, which is higher than 7.1 percent in first half of FY 2016. Impact of changes in quasi money on M2 is negligible. The year-on-year difference of Afghani denominated time deposits stood at AFN 6,214 million showing 70% increase while the foreign currency denominated time deposits recorded AFN 1,284 million which is 6 percents higher than previous year. Afghani-denominated time deposits and foreign currency denominated time deposits constitute 3.4 percent and 5 percent of M2 respectively.

Demand deposits as a share of broad money decreased to 43.26 percent (Y-o-Y) at the end of the period under review, down from 49.6 percent in the previous year.

Figure 2.3: NFA,NDA and Broad Money

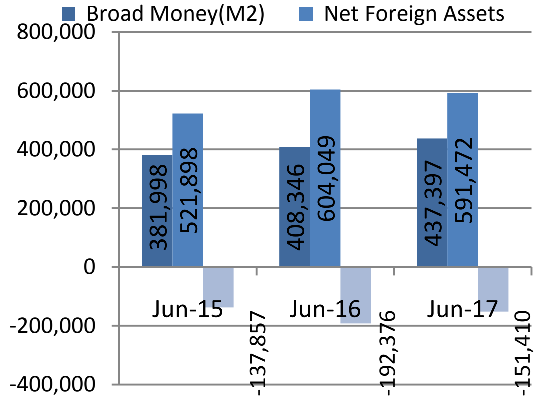
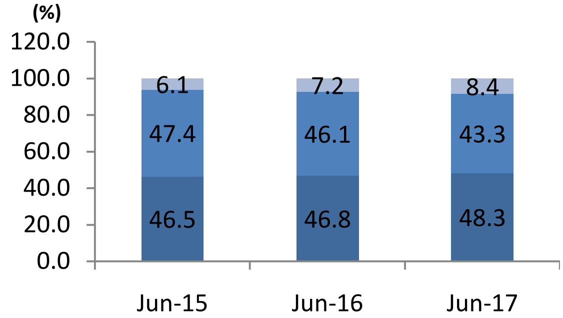


Figure 2.4: CIC, Demand Deposits and Quasi Money as Share of Broad Money



Source: Monetary Policy Department/DAB

Table 2.1: Depository Corporation's (DC's) Analytical Balance Sheet and Monetary Aggregate at the end of first half of FY 1396 (Dec 16 – June 17)

In Million AFN	June – 2015 Amount	June- 2016 Amount	Y-o-Y Δ	Difference	June - 2017 Amount	Y-o-Y Δ	Difference
1- Net Foreign Assets	**521,898**	**604,049**	**15.7%**	**82,151**	**591,472**	**-2.08%**	**-12,577**
(a) Gross Foreign Assets	529,417	614,364	**16.0%**	**84,947**	602,725	**-1.89%**	-11,639
Foreign Exchange Reserves	80,550	95,758	**18.9%**	**15,209**	95,622	**-0.14%**	-136
Gold	50,602	61,636	**21.8%**	**11,034**	59,751	**-3.06%**	-1,885
Other	307,295	352,573	**14.7%**	**45,277**	335,338	**-4.89%**	-17,234
Other Foreign Assets	90,971	104,397	**14.8%**	**13,426**	112,014	**7.30%**	7,617
(b) Foreign Liabilities	7,520	10,315	**37.2%**	**2,795**	11,253	**9.10%**	938
2. Net Domestic Assets	**-137,857**	**-192,376**	**39.5%**	**-54,519**	**-151,410**	**-21.29%**	**40,966**
(a) Net Domestic Credit	-43,078	-62,015	**44.0%**	-18,937	-30,066	**-51.52%**	31,950
Net Credit to Nonfinancial Public Sector	-86,749	-114,038	**31.5%**	-27,289	-76,438	**-32.97%**	37,600
Net Credit to Central Government	-86,622	-114,133	**31.8%**	-27,512	-76,532	**-32.94%**	37,601
Credit to Central Government	27,758	28,456	**2.5%**	697	22,879	**-19.60%**	-5,576
Liabilities to Central Government	114,380	142,589	**24.7%**	28,209	99,411	**-30.28%**	-43,177
Net Credit to State & Local Government	0.000	0.000	**0.0%**	0	0.000	0.000	0
Net Credit to Public Non-financial Corporations	-127	95	**174.9%**	222	94	**-0.78%**	-1
Credit to Private Sector	45,391	53,467	**17.8%**	8,076	47,590.92	**-10.99%**	-5,876
Net Credit to Other Financial Corporations	-1,720	-1,444	**-16.1%**	277	-1,218.70	**-15.58%**	225
(b) Capital Accounts	117,642	150,223	**27.7%**	32,581	142,051	**-5.44%**	-8,172
(c)Other Items Net	22,863	19,862	**-13.1%**	-3,001	20,706	**4.25%**	844
3- Broad Money (M2)	**381,998**	**408,346**	**6.9%**	**26,348**	**437,397**	**7.11%**	**29,051**
Narrow Money (M1)	**358,757**	**379,068**	**5.7%**	**20,311**	**400,621**	**5.69%**	**21,553**
CiC (Currency outside depository corporations)	177,734	191,003	**7.5%**	13,269	211,412	**10.69%**	20,410
Demand Deposits	181,023	188,065	**3.9%**	7,042	189,208	**0.61%**	1,144
Other Deposits (Quasi Money)	23,241	29,278	**26.0%**	6,038	36,776	**25.61%**	7,497
In Afghani	7,941	8,841	**11.3%**	900	15,055	**70.28%**	6,214
In Foreign currency	15,299	20,437	**33.6%**	5,138	21,721	**6.28%**	1,284
Non liquid Liabilities	**2,043**	**3,327**	**62.9%**	1,284	**2,665**	**-19.91%**	**-662**

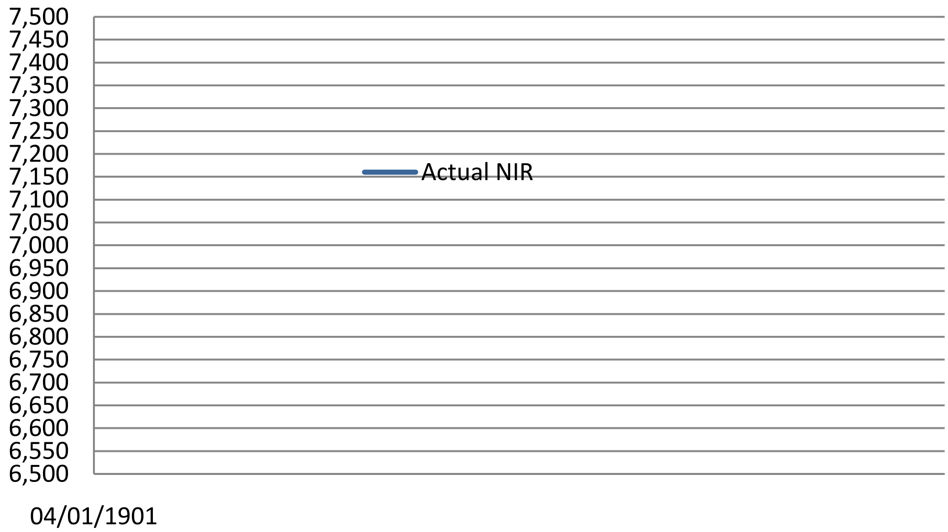
Source: Monetary Survey, Monetary Policy Department/DAB

III. NET INTERNATIONAL RESERVE

Da Afghanistan Bank holds international reserves which consist of monetary gold, reserve position and holdings with the IMF and Special Drawing Rights (SDR) as well as major foreign exchange such as US dollars, Euro, Great British Pound and others. The Net International Reserves (NIR) of Afghanistan expressed in terms of US dollars is defined as reserve assets minus reserve liabilities.

NIR decreased slightly by 0.26 percent which is equivalent to USD 17.77 million. On 21st June of fiscal year 2017, the NIR target was set at USD 6874.66 million, while in actual case, smaller amount of USD 6834.16 million was registered for NIR. It is to be mentioned that this amount in the first quarter of the year was recorded at USD 6851.93 million.

Figure 2.5: Daily NIR FY1396 in Million USD (21 June -2017)



Source: Monetary section, Monetary Policy Department/DAB

IV. FROEIGN EXCHANGE MARKET

4.1 Foreign Exchange Rates

During the first half of FY 2017, Afghani remained stable against the Indian Rupees, Pakistani rupees and Iranian Toman and depreciated against international convertible currencies such as US dollar, Euro and Great British Pound.

The daily historic review of the average exchange rate of AFN against the U.S. dollars for the fiscal year 2016 is shown in figures below.

Figure 2.6: Daily Average Ex- Rate of Afghani Against USD for the first half of FY 1396

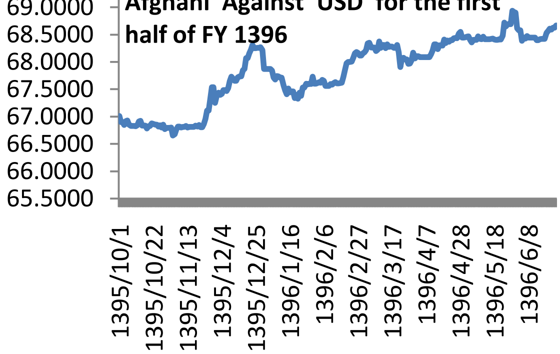


Figure 2.7: Daily Average Ex-Rate of Afghani against GBP & Euro for the first half of FY 1396

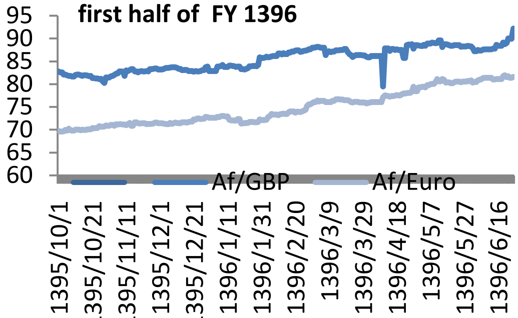
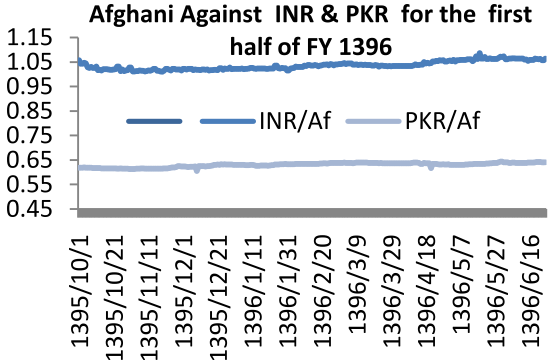
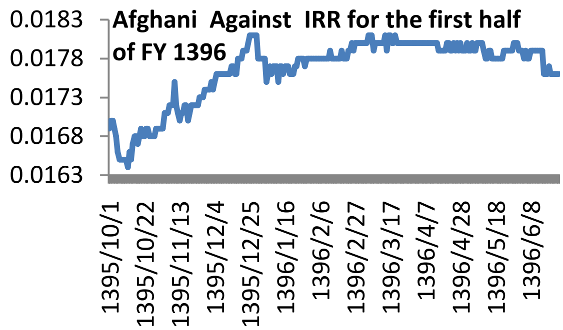


Figure 2.8: Daily Average Ex- Rate of Afghani Against INR & PKR for the first half of FY 1396



winning bids. The average amount of USD 12 million is sold in each auction. Averages for

Figure 2.9: Daily Average Ex- Rate of Afghani Against IRR for the first half of FY 1396



Source: Monetary Section, Monetary Policy Department/ DAB

V. OPEN MARKET OPERATION & LIQUIDITY CONDITIONS

5.1 Foreign Exchange Auction

In order to control the liquidity and money supply in the economy, DAB tries to manage reserve money growth close to its sited ceiling by conducting USD auctions three times a week, and weekly capital notes auctions, which are the instruments used to conduct monetary policy. During this reporting period, DAB continued auctioning FX in order to sterilize excess liquidity from the market and avoid extra volatilities in the exchange rate of Afghani against foreign currencies, especially the U.S dollar.

During the first half of fiscal year 2017, DAB auctioned a total of USD 879.74 million, while the total demand was USD 1,222.64 million. On average, 45 bidders participated in each auction and 32 bids were announced as the lowest, highest and cut off prices for each auction was AFN 67.3, 67.51 and 67.48

respectively. The data for the same period of FY 2016 recorded higher figures. Total awarded amount was recorded at USD 943.44 million, with a total demand of USD 1.311 billion. On average, 48 bidders participated in each auction and 32 bids were awarded with an average amount of USD 13 millions in each auction.

5.2 Capital Note Auction

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

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

Currently, DAB offers capital notes with maturities of one week, one month, three months, six months, and one year. .

Total outstanding stock of capital notes reached AFN 39.8 billion at the end of the first half of fiscal year 2017, which shows an increase of 23.22 percent compared to AFN 32.3 billion at the end of first half of fiscal year 2016. The increase in the level of securities shows the increase of Afghani demand by banking sector and gives the signal for lower amount of FX auction level which may have caused the higher NIR accumulation during the reporting period.

The outstanding stock of 7 day notes stood at AFN 550 million, showing the same amount with the stock of same date in FY2016. 28 day CNs outstanding amount stood at AFN 2,100 million and 91 day outstanding stock of CNs recorded the amount of AFN 10,690 million. The stock of outstanding for 182 and 364 day notes stood at AFN 11,688 million and AFN 14,774 million respectively . Total interest paid to CN figured out to AFN 467.46 million during the first half of the current year.

Figure 2.10- 2.15 exhibit breakdown of the total outstanding stock for all maturities during the first half of fiscal year 2017.

In addition, the weighted average interest rate for 7 day capital note was 1.8 percent, for 28 day security it is recorded 3.51 percent, for 91 day notes were 4.26, for 182 day security it ended at 4.97 percent, and for 364 day capital notes it recorded 6.66 in the first half of FY 2017, which is generally in lower level with small margins during the course of the period under review.

Figure 2.10: Capital Notes Outstanding for the FH of FY 1396

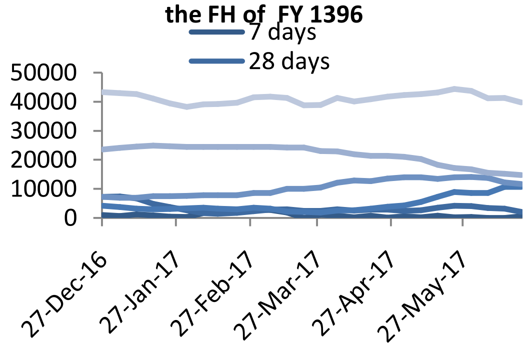


Figure 2.11: 7 Day CNs Demanded and Awarded Amount in Million Af

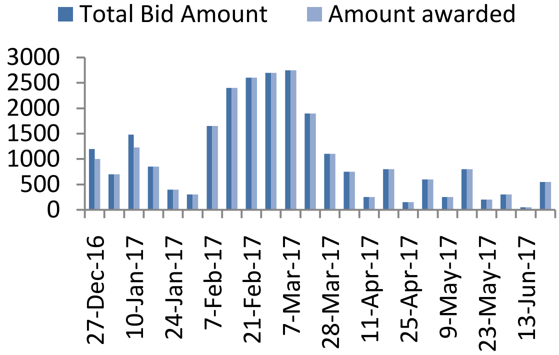


Figure 2.12: 28 Day CNs Demanded and Awarded amount in Million Af

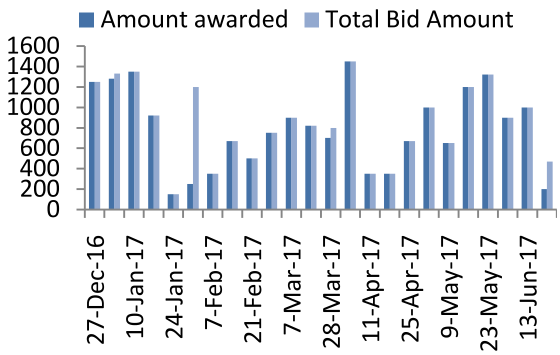


Figure 2.13: 91 Day CNs Demanded and Awarded amount in Million Af

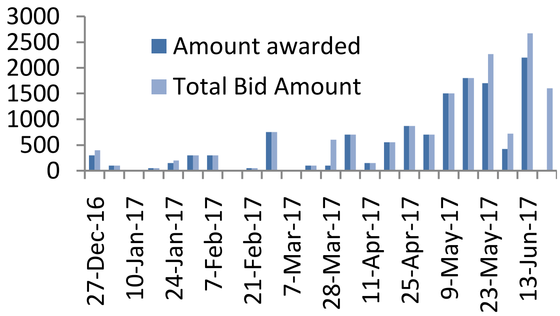


Figure 2.14: 182 Day CNs Demanded and Awarded amount in Million Af

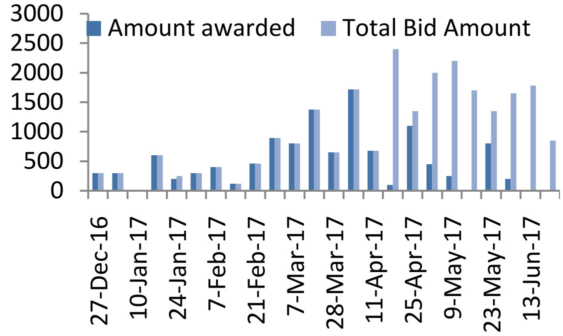
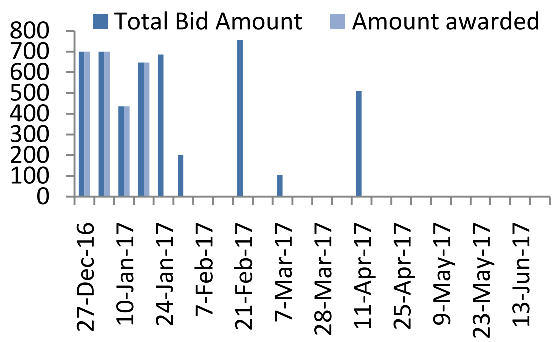


Figure 2.15: 364 Day CNs Demanded and Awarded amount in Million Af



Source: Market Operations Department/DAB

5.3 Required and Excess Reserves

Commercial banks are required to hold 8 percent of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10 percent for foreign exchanges accounts. No interest is given for such deposits to commercial banks. DAB has stopped paying interest rate for required reserve since 28th June, 2015.

Therefore, no interest has been paid for commercial banks required reserves.

Overnight Deposit Facility which is available to all commercial banks to gain interest on their excess balances and provide a floor for rates on capital notes, so it is not counted towards required reserves. The interest rate on the overnight deposit facility is now 100 basis points below 28 day notes auction cut-off rate (based on a circular to all banks approved by DAB Executive Board on June 09, 2010).

The average outstanding amount of overnight deposit facility balances recorded AFN 3,780 million during the reporting period. In the first half of FY 2017, the payment of interest rate to the mentioned facility figured out to AFN 14.88 million.

Overnight Credit Facility: This facility is used by banks for short term cash needs. The facility allows banks to borrow Afghani from Central Bank on an overnight basis when they face a shortfall in cash flow. The rate that the commercial banks are charged for this facility is 350 basis points above the last 28 day CNs auction. This borrowing is collateralized with outstanding capital notes only (according to the circular of Feb 27, 2007).

During the period under review, no bank benefited from credit facility.

3

INFLATION TREND AND OUTLOOK

3

INFLATION TREND

Generally, global commodity prices showed an upward slope in international market during the first half of FY2017. Crude oil prices rose to an average $55 per barrel in 2017 from $43 in 2016. Further oil forecast remained unchanged due to balancing forces of (OPEC) production cuts and US shale oil persistent high stocks. On the other hand, metal prices were expected to rise by 16 percent, while agriculture commodities remained stable during the period under review.

Energy commodity prices rose by 3 percent led by 8 percent increase in crude oil, 16 percent surge in Europe's natural gas and 7 percent increase in liquefied natural gas. During the first half of FY2017, US's natural gas prices dropped by 1 percent because of weak demand arising out of mild weather conditions.

Likewise, non-energy commodity prices rose by 5 percent in the first half of FY 2017. Agriculture prices rose by 1 percent led by 2 percent gain in oils, food and beverages. Similarly, prices of most of other groups registered increase including raw materials which jumped nearly by 1 percent, while fertilizers prices declined by 1 percent. Metal and mineral prices escalated by 5 percent, following an 18 percent jump in iron ore prices. Likewise, prices of all base metals recorded strong increase, however precious metal prices dropped by 2 percent largely due to decline of 5 percent in the price of silver during the period under review.

Consequently, increase has been observed in prices of global commodity market which also affected Afghanistan domestic commodity prices in the second half of FY 2017.

I. CONSUMER PRICE IN AFGHANISTAN

Consumer price index (CPI) in Afghanistan is now being compiled on the base price of April 2015. Previously, CPI prices were being calculated on the base price of March 2011. In this revision, the CPI components are aligned with new weights too. As per

Central Statistics Organization (CSO) data and analysis of Da Afghanistan Bank (DAB),the following results were drawn up from Afghanistan Consumer Price Index during the first half of FY2017.

Afghanistan's headline CPI inflation increased to 5 percent and 7.19 percent in the first and second quarter of 2017 which makes an average of 6.09 percent for the first half of FY2017. The year-over-year measure of changes in consumer price index showed an average inflation rate of average 7.19 percent higher from 5.16 percent observed in the same period of the previous year. This increase is in line with higher price of commodities in global markets. Based on the reports, most of the items of the global commodity price index exhibited higher prices over the last quarter of the first half of FY2017. Similar to the year-over-year measure, inflation when measured on quarter-to-quarter basis also rose over the period under review. Observing the data, semi-annually average inflation by this measure stood at 6.09 percent in the first half of FY2017, strongly higher from 3.83 percent in the same period of FY2016.

Kabul CPI also represented higher inflation rate during the first and second quarter of FY2017. Observing the profile of Kabul headline CPI, inflation escalated to 5.37 percent from 2.39 percent in the first quarter and to 7.13 percent 5.58 percent in the second quarter of FY2017 as compared with the corresponding quarters of the previous year. On semi-annual basis, this index on average increased to 6.25 percent from 3.99 percent in the previous year.

1.1 Developments in National Headline CPI

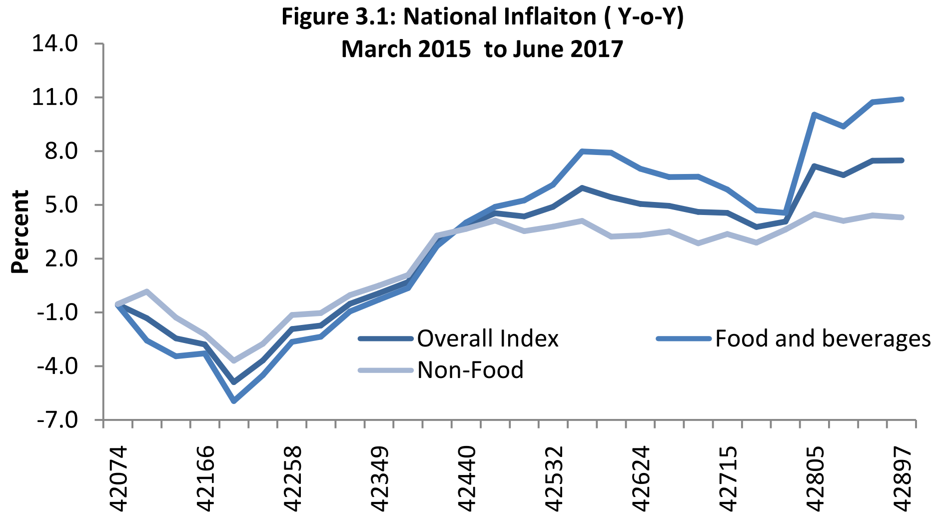
1.1.1 Annual Developments

Headline Consumer Price index (CPI) represented a significant year-over-year increase during the period under review. As per the available data, headline inflation by year-over-year measure increased to an average 6.09 percent in the first half of 1396, up from 3.83 percent recorded in same period of previous year.

In food items, this index jumped up to 8.38 percent from a deflation rate of 4 percent compared with the same period of the previous year. In food index, inflation pressures came from high prices of vegetables, meat, milk, dry fruits, spices and oil fats. The highest increase in the index is recorded in prices of vegetables, which averaged 22.20 percent from -0.26 and spices 22.85 percent from 14.96 percent as compared to previous year on semi-annual average basis. On the other hand, during the review period, price index of bread and cereals decreased to 0.85 percent compared to semi-annual average of 5.03 percent in the same period of the previous year.

In non-food category, inflation is supported by higher prices of housing, transportation and education, while price indices of clothing, furnishing and household, health and communication declined in the first half of FY2017. In non-food category, education and housing prices exhibited the highest increase which rose to 16.06 percent from 6.06 percent and 5.76 percent from -2.11 percent respectively compared to the same period of FY2017.

Core measure of inflation also registered upward movement during the first half of FY2017 compared to the same period of FY2016. Semi-annually trimmed mean as the most common measure of core inflation dropped to 6.22 percent in the period under review from 6.4 percent in the same period of FY2016. In addition, CPI excluding bread and cereals, oil and fats and transportation reached 7.8 percent from 5.8 percent on year-over-year comparison.



Source: Monetary policy Department, DAB

Table 3.1: Breakdown of National inflation Semi-annual FY1396

Period	Weight	2016 Based on 2011 except June 2016			Weight	2017 Based on 2015		
		Q1	Q2	First Half		Q1	Q2	First Half
Overall Index	**100**	2.51	5.16	3.83	**100**	5.00	7.19	6.09
Food & Non-Alcoholic Beverages	**52.0**	2.36	5.63	3.99	**47.8**	6.43	10.32	8.38
Bread and Cereals	**17.7**	3.74	6.33	5.03	**14.6**	-1.25	2.95	0.85
Meat	**7.2**	2.31	5.19	3.75	**7.5**	6.76	10.35	8.55
Milk, cheese and eggs	**4.8**	2.02	3.12	2.57	**4.7**	3.20	5.13	4.16
Oils and fats	**4.0**	-3.72	2.17	-0.78	**4.6**	8.40	9.96	9.18
Fresh and dried fruits	**4.8**	1.77	5.76	3.77	**5.0**	8.26	11.70	9.98
Vegetables	**7.9**	-2.10	1.57	-0.26	**6.0**	12.77	31.63	22.20
Sugar and sweets	**2.9**	8.88	16.98	12.93	**2.7**	17.72	13.28	15.50
Spices	**0.9**	10.16	19.75	14.96	**1.3**	35.72	9.97	22.85
Non-alcoholic beverages	**1.8**	8.30	7.36	7.83	**1.4**	2.17	2.83	2.50
Non-Food Items, Tobacco & Services	**48.0**	2.68	4.63	3.65	**52.2**	3.67	4.27	3.97
Tobacco	**0.4**	20.58	20.30	20.44	**0.3**	9.03	9.04	9.03
Clothing	**7.0**	9.18	9.72	9.45	**4.6**	2.58	3.36	2.97
Housing	**20.7**	-3.91	-0.31	-2.11	**19.1**	5.19	6.32	5.76
Furnishing and household goods	**7.0**	7.99	9.42	8.71	**11.9**	2.36	2.86	2.61
Health	**3.3**	9.34	9.13	9.24	**6.2**	3.13	2.78	2.95
Transportation	**4.7**	1.70	3.22	2.46	**4.3**	4.65	7.48	6.07
Communication	**1.1**	-0.29	1.66	0.68	**1.7**	-1.82	-3.96	-2.89
Information and Culture	**0.1**	6.16	5.96	0.53	**1.1**	-2.75	-3.78	-3.27
Education	**0.7**	-6.27	7.33	6.06	**0.4**	25.11	7.00	16.06
Restaurants and Hotels	**1.0**	0.09	-1.90	-0.90	**1.1**	1.13	1.44	1.28
Miscellaneous	**1.8**	9.28	8.47	8.87	**1.4**	5.48	6.25	5.87

Source: CSO/Monetary Policy Department, DAB

1.1.2 Quarterly Developments in national CPI

The short term measure of inflation represented similar trend to annual measure. National inflation when calculated on average quarter to quarter basis soared to 7.19 percent during the second quarter of FY 2017 from 5 percent recorded in the previous quarter. This increase is the result of the high inflation in food items. On the other hand, non-food category showed lower rate of inflation in the period under review compared to the previous year.

Over a quarter to quarter, food inflation jumped up to 10.32 percent from 6.43 percent. In the index, price indices of food and beverages, vegetables, oil and fats, dry fruits and non-alcoholic increased but rate of spices and sugar weakened. However, the largest quarterly increase in this category was recorded in vegetable price index which stood at 31.63 percent significantly higher from 12.77 percent in the preceding period.

Non-food inflation on the other hand slightly increased from 3.67 percent to 4.27 percent. In this index, transport and housing prices jumped up dramatically. Transportation prices increased to 7.48 percent from 4.65 percent and housing prices increased to 6.32 percent from 5.19 percent recorded in the same period of the previous year, while the largest decrease was observed in education which dropped to 7 percent from 25.11 percent in the period under review.

1.2 Developments in Kabul CPI

1.2.1 Annual Developments

Headline CPI inflation jumped up to an inflation rate of 6.25 percent during the first half of FY2017 from a deflation rate of 3.99 percent recorded in the corresponding period of the previous year.

Food inflation, which accounted around 52 percent weight in previous year, exhibited very higher inflation over one year horizon. In this category, inflationary effects came from higher prices of meat, oils and fats, fresh and dry fruits and vegetables. As a result, food inflation increased to 10.18 percent from 3.91 percent in the same period of the previous year.

Non-food items, comprising around 48 percent weight of the whole index decreased to average 3.78 percent from 4.05 percent in the first half of FY2016. This decrease is mainly attributed to lower prices of tobacco, clothing, furnishing and information and culture. In this item, price index of furnishing and information and culture decreased significantly to 2.54 percent and -5.68 percent from 17.15 percent and 10.02 percent compared with the first half of 2016. While in this index, housing and education increased to 6.12 percent and 21.28 percent from -3.77 percent and 0.45 percent respectively.

Inflation when calculated based on core measures excluding bread & cereals, fats and oils and transportation also registered higher rate as compared with the previous period in FY2016. Core inflation of semi-annual 2016 stood at 3.8 percent compared to 6.9 percent semi-annual 2017 respectively. The 30% trimmed mean represented an inflation rate of average 8.1 percent in June 2016 and 7.3 percent in June 2017.

Food index exhibited a four-quarter string of increasing trend and reached 8.9 percent in September higher from 6.3 percent in the second quarter and -2.1 percent calculated in the third quarter of 2015. Inflationary effects in this item particularly came from meat price index (up to 16.6 percent from 12.1 percent), oils and fats price index (up to 4.7 percent from -4.7 percent), price index of fresh and dried fruits (increased to 13.7 percent from 9.1 percent), and vegetables index (rose to14.8 percent from 3.2 percent).

1.2.2 Quarterly Developments in Kabul CPI

By the end of June 2017, the quarter to quarter measure of inflation in Kabul moved upward, which reflects higher inflation in both food and non-food items of the CPI. Headline inflation soared to average 7.13 percent from 5.37 percent during the review period.

The trend in food index rose to 11.76 percent in the second quarter of FY2017 compared to 8.59 percent in the previous quarter of 2017. In this item, prices of vegetables, fresh and dried fruits, oils and fats and meat increased which led to higher inflation. The highest increase in this item is seen in the price index of vegetables which turned around to 30.31 percent from 10.75 percent. On the other hand, price indices of sugar and sweets, spices and non-alcoholic beverages increased on quarterly basis.

Non-food category of the CPI also contributed to higher inflation during the second quarter of 2017. Inflation in this item reached 4.31 percent in the second quarter of 2017 compared to 3.43 percent recorded in the previous quarter. The increase in non-food inflation is mainly driven by high prices in housing, furnishing and transportation among which the largest increase was observed in transport price index that rose to 6.31 percent from 3.90 percent on quarter to quarter basis in 2017. In contrast, prices indices of clothing, communication, information and culture and education lowered during the review period.

After analyzing the items in the index, the following items with average weight in Food and Beverages are Bread and Cereals 17.7, Vegetables 7.9, Meat 7.2, Oil and Fats 4, Sugar and Sweets 2.9, Spices 0.9. In Non-Food items, Clothing 20.7, Furnishing and Household 7, Transportation 4.7 and Health 3.3 which are mostly imported from neighboring countries especially from Pakistan. In the mentioned items of the index, prices increased when Torkham border between Afghanistan and Pakistan closed due to persistent political tension between the two countries.

Keeping the effect in consideration, Afghanistan government took prompt action and inaugurated Chabahar port in Iran as an import alternative as well as signed agreements with Tajikistan, Uzbekistan and Kyrgyzstan to mitigate the supply shock. . Moreover, Afghanistan government in cooperation with allied international countries has been working in agriculture sector to decrease rate of import dependency.

Furthermore, during the period reviewed, ups and down movements in inflation resulted from domestic insurgency, security situation, and Afghanistan and Pakistan border blockage.

The near-term outlook of inflation is likely to remain steady. The central bank forecasts inflation rate to show slight increase in the second half of 2017. The prospects will be subject to a course of factors.

Inflation in Afghanistan will get intensive effects from increasing prices of commodities in global markets. According to the World Bank group, Energy prices are projected to increase by around 26 percent in 2017 and additional 8 percent in 2018. In the meantime, these projections for non-energy prices show a 4 percent increase in 2017, a 1 percent upward revision from start of 2017.

Table 3.2: Breakdown of Kabul Headline Inflation Semi-annual FY1396

Period	Weight	2016 Based on 2011 except June 2016 Q1	Q2	First Half	Weight	2017 Based on 2015 Q1	Q2	First Half
Overall Index	**100**	2.39	5.58	3.99	**100.0**	5.37	7.13	6.25
Food & Non-Alcoholic Beverages	**52.0**	2.54	5.27	3.91	**37.2**	8.59	11.76	10.18
Bread and Cereals	**17.7**	1.24	0.11	0.68	**9.8**	-3.78	2.91	-0.44
Meat	**7.2**	6.61	10.18	8.40	**6.4**	11.50	14.23	12.87
Milk, cheese and eggs	**4.8**	7.35	5.14	6.25	**3.2**	5.42	5.07	5.25
Oils and fats	**4.0**	-4.97	-3.64	-4.31	**3.6**	10.42	14.24	12.33
Fresh and dried fruits	**4.8**	6.07	12.63	9.35	**5.2**	11.73	13.21	12.47
Vegetables	**7.9**	-7.87	-4.28	-6.07	**4.2**	10.75	30.31	20.53
Sugar and sweets	**2.9**	21.65	35.13	28.39	**2.8**	29.52	18.62	24.07
Spices	**0.9**	25.10	43.74	34.42	**1.0**	23.12	-4.10	9.51
Non-alcoholic beverages	**1.8**	12.66	14.03	13.34	**0.9**	3.18	2.04	2.61
Non-Food Items, Tobacco & Services	**48.0**	2.27	5.82	4.05	**62.8**	3.43	4.31	3.87
Tobacco	**0.4**	20.76	19.82	20.29	**0.3**	15.20	15.14	15.17
Clothing	**7.0**	15.76	17.63	16.70	**4.8**	2.78	2.62	2.70
Housing	**20.7**	-6.52	-1.03	-3.77	**23.5**	5.06	7.18	6.12
Furnishing and household goods	**7.0**	16.67	17.64	17.15	**17.6**	1.92	3.17	2.54
Health	**3.3**	0.92	1.32	1.12	**5.3**	1.43	-0.47	0.48
Transportation	**4.7**	5.98	9.89	7.93	**4.6**	3.90	6.31	5.11
Communication	**1.1**	0.30	0.21	0.26	**2.0**	-1.28	-3.82	-2.55
Information and Culture	**0.1**	-8.58	9.47	10.02	**1.7**	-5.08	-6.28	-5.68
Education	**0.7**	10.04	10.01	0.45	**0.7**	33.26	9.29	21.28
Restaurants and Hotels	**1.0**	0.86	-3.94	-1.54	**1.0**	-3.55	0.49	-1.53
Miscellaneous	**1.8**	19.56	15.99	17.77	**1.3**	11.41	12.85	12.13

Source: CSO/Monetary Policy Department, DAB

4

EXTERNAL SECTOR DEVELOPMENT

4

EXTERNAL SECTOR DEVELOPMENT

The highlights of some major developments in the external sector of the Afghan economy for the first half of the FY 1396 in comparison with the first half of the FY 1395 are captured in this report.

The available data reveals that the overall balance for the first half of the FY 1396 recorded a deficit of USD 2,439.71 million up from a deficit of USD 1,268.82 million recorded in the first half of the FY 1395. This outcome was due to trade deficit which is widened by almost 11 percent and narrowed inflows to the secondary income account (current transfers) by 45 percent in the reporting period.

The current account balance, which is the key measure of an economy's saving and spending behavior, shows a deficit of USD 2,728.08 million in the first half of the FY 1396 higher than a deficit of USD 1,724.25 million in the same period of last year registering 58 percent increase.

Earnings from exports of goods have decreased by almost 3 percent while expenditure on imports of goods increased by 10 percent in the first half of the FY 1396.

The capital account of the Balance of Payments illustrated 63 percent decline on account of inflows (capital transfers) to the government sector in the first half of the FY 1396.

The available data shows that inflows from foreign direct investment declined by 2 percent, while portfolio investment recorded a decline of 95 percent in the outflow during the period under review.

Considering the BOP, the official reserve assets decreased significantly by 99 percent to USD 3.12 million in the first half of the FY 1396 compared to USD 210.36 million in the first half of the FY 1395.

I. BALANCE OF PAYMENTS

4.1.1 Current Account Balance

The current account balance (CAB) recorded an extensive increase of 58 percent to USD 2,728.08 million in the first half of the FY 1396, much higher from a deficit of USD 1,724.25 million in the first half of the FY 1395. This increase in the Current Account Deficit (CAD) was mainly because of higher trade deficit and lower inflow of current transfers to the country during the first half of the FY 1396.

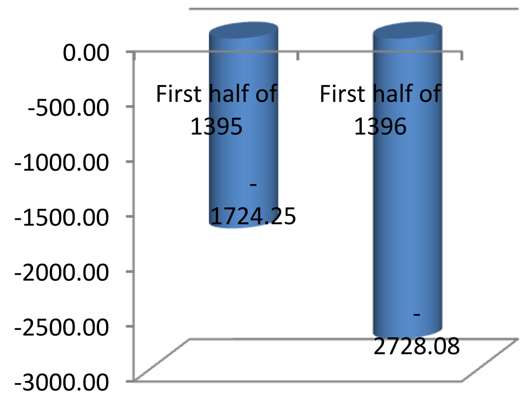
Based on BOP data, exports of goods declined approximately by 3 percent from USD 250.92 million in the first half of the FY 1395 to USD 243 million in the first half of the FY 1396, and at the same time Imports of goods increased by 10 percent to USD 3,307.49 million in the first half of the FY 1396, from USD 3,018.64 million in the same period of last year.

Among the import figures, the deficit in services account rose by 42 percent to USD 514.86 million in the first half of the FY 1396 from USD 361.37 million in the first half of the FY 1395. This could be attributed to addition in out-payments in respect of transportation services.

The surplus in the income account decreased to USD 91.13 million in the first half of the FY 1396 from USD 1,373 million recorded in the first half of the FY 1395.

Meanwhile, current transfers' surplus which was largely influenced by grants and worker's personal remittances from foreign countries dropped by 45 percent to USD 760.14 million in the first half of the FY 1396 from USD 1391.12 million as compared with the same period of last year (table 4.1 figure 4.1).

Figure 4.1: Balance Of Payments Current Account (in million USD)



Source: CSO/DAB staff calculations

4.1.2 Capital Account

The capital account of the balance of payments illustrated a decline of 63 percent in the first half of the FY 1396 when compared to the same period of the last year, as a result of lower inward capital transfers.

Net inflows to the capital account dropped from USD 697.99 million in the first half of the FY 1395 to USD 261.74 million in the first half of the FY 1396. This was mainly due to net capital transfers received by the government, corporations and households decreased from USD 703.75 million in the first half of the FY 1395 compared to USD 262.71 million recorded in the period under review.

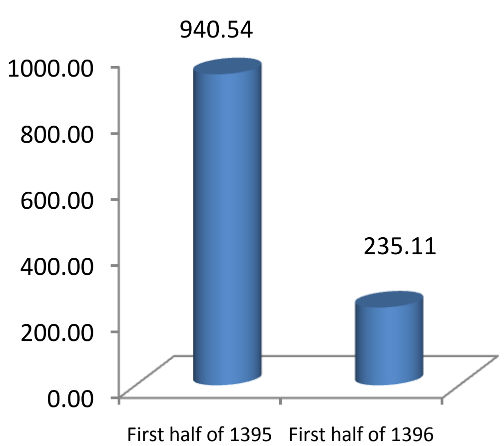
4.1.3 Financial Account

The available data reveals that financial account of the BOP recorded a significant decline of USD 215.93 million in the first half of the FY 1396.

The financial account balance which was recorded at USD 242.56 million in the first half of the FY 1395 decreased to USD 26.63 million in the first half of the FY 1396 (figure 4.2 table 4.2). Further analysis depicted that the country's aggregate financial assets abroad decreased from USD 66.71 million in the first half of the FY1395 to USD 52 million in the first half of the FY 1396.

While, the aggregate financial liabilities, increased from USD 34.52 million in the first half of the FY 1395 to USD 81.75 million in the reporting period.

Figure 4.2: Capital and Financial Account (in million USD)



Source: CSO/DAB staff calculations

4.1.4 Merchandise Trade

The balance on merchandise trade is one part of the current account of the balance of payments. The three other parts of the current account include the balance on services, balance of primary income and balance of secondary income (unilateral transfers).

Accordingly, Afghanistan's merchandise trade deficit increased by 17 percent from USD 2,874.12 million in the first half of the FY 1395 to USD 3,359.36 million recorded in the first half of the FY 1396 due to expansion of aggregate imports and reduction of aggregate exports (Figure 4.4, Table 4.3).

Earnings from exports declined slightly by 3 percent from USD 246.58 million in the first half of the FY 1395, to USD 239.21 million recorded in the first half of FY 1396. Export of carpet and rugs, leather and wool and food item shows downward trend, while medical seeds shows upward trend in the first half of FY 1396. Exports of carpet and rugs which accounted for 4.9 percent of total exports reported USD 11.77 million reflecting 73 percent decline in the first half of the FY 1396.

Exports of leather and wool which accounted for about 3.6 percent of total exports reported USD 8.51 million, which reflected 56 percent decreased in first half of the FY 1396. Similarly, export of food items (fresh and dry fruit) which accounted for about 39.2 percent of the total exports decreased by 18 percent from USD 113.93 million in the first half of the FY 1395 to USD 93.79 million in the first half of the FY 1396.

On the other hand, exports of medical seeds with 52.3 percent of share in total exports increased significantly by 79 percent from a value of USD 70.07 million in the first half of the FY 1395 to a value of USD 125.14 million in the reporting period.

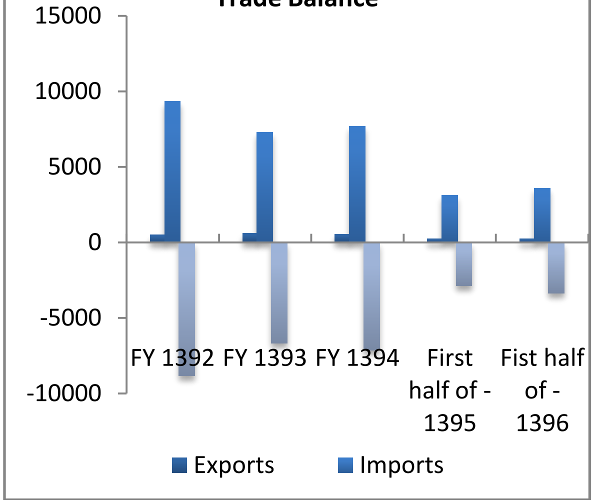
At the same time, aggregate imports increased by 12 percent from a value of USD 3,120.70 million in the first half of the FY 1395 to a value of USD 3,598.57 million recorded in the first half of the FY 1396.

The major contribution of increase in total imports happened from higher imports of consumer goods, industrial supplies and capital goods. Imports of consumer goods which accounted for about 36.5 percent of total imports increased by 51 percent from USD 872.59 million in the first half of the FY 1395 to USD 1,314.64 million in the first half of the FY 1396. Imports of Industrial supplies which accounted for 11 percent of the total imports increased by 46 percent from a value of USD 270.58 million in the first half of the FY 1395 to a value of USD 394.74 million in the reporting period.

Similarly, imports of capital goods which accounted for about 41 percent of the total imports increased by 4 percent from a value of USD 1,418.37 million in the first half of the FY 1395 to a value of USD 1,479.52 million in the first half of the FY 1396.

While, imports of fuel and lubricants, declined largely on account of lower volumes imported in the first half of the FY 1396. Imports of fuel and lubricants which accounted for 11.4 percent of the total imports reported USD 409.67 million reflecting 27 percent decrease during the period under review.

Figure 4.3: Trade Performance and Trade Balance

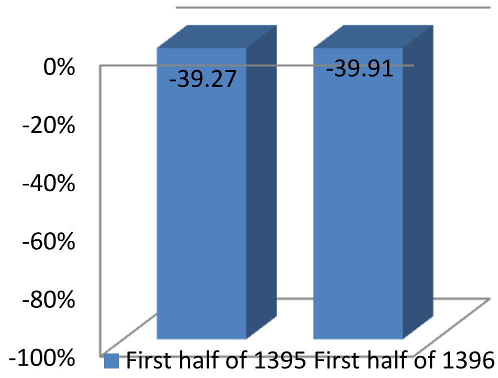


Source: CSO/DAB staff calculations

4.1.5 FDI and Portfolio Inflow

According to the available data, the total foreign direct investment (FDI) related inflows increased slightly by 0.48 percent from USD 39.72 million in the first half of the FY 1395 to USD 39.91 million in the first half of the FY 1396. While, portfolio investment inflows decreased considerably by 95 percent from USD 57.62 million in the first half of the FY 1395 to USD 3 million in the first half of the FY 1396.

Figure 4.4: Afghanistan Foreign Direct Investment inflows (in million USD)



Source: CSO/DAB staff calculations

II. DIRECTION OF TRADE

2.1.1 Direction of Exports

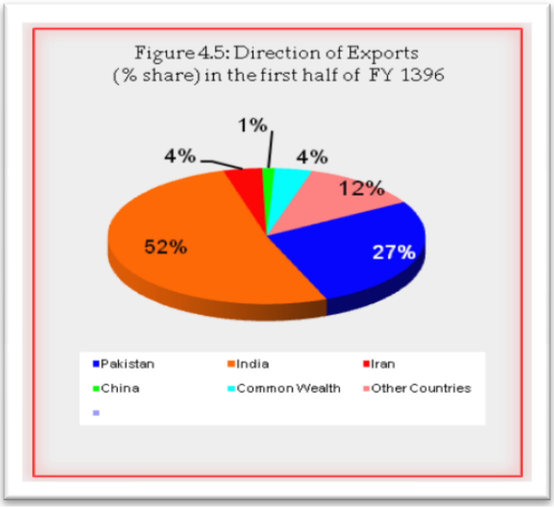
The main export destinations for Afghanistan are Pakistan, Iran, India, China, and Common Wealth of Independent States (CIS).

According to the available merchandise statistics, **Afghanistan's largest export partner has been India during the first half of the FY 1396.** Exports to India have grown significantly by 155 percent from USD 47.49 million in the first half of the FY 1395 to USD 121.21 million in the first half of the FY 1396. As of this period, share of India in Afghanistan's exports rose to (50.67) percent when compared with the same data in the first half of the FY 1395 (19.26) percent.

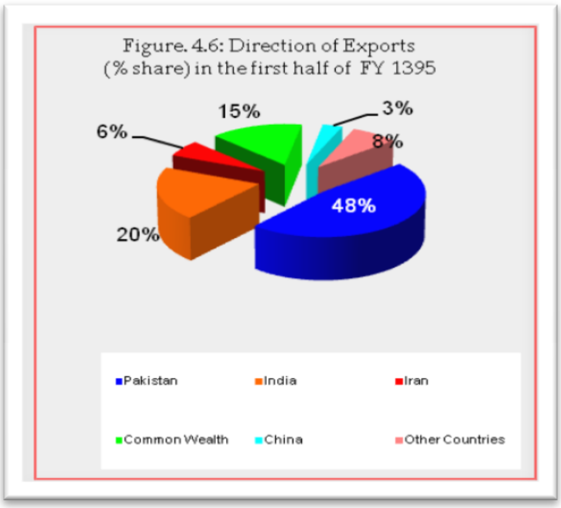
Pakistan ranked the second largest buyer of Afghanistan's exports. Exports to Pakistan declined notably by 44 percent from USD 113.11 million in the first half of the FY 1395 to USD 63.64 million in the first half of the FY 1396. As of first half of the FY 1396, share of Pakistan, in Afghanistan's exports also dropped to 26.60 percent when compared with 45.87 percent in the first half of the FY 1395.

The next two largest export destinations are Iran and CIS countries during the first half of the FY 1396. Exports to Iran fell by 38 percent from USD 14.88 million in the first half of the FY 1395 to USD 9.28 million in the first half of the FY 1396. Share of Iran, in Afghanistan's exports also diminished from about 6 percent in the first half of the FY 1395 to about 4 percent in the first half of the FY 1396. Likewise, total export to CIS countries declined by 76 percent from USD 36.50 million in the first half of the FY 1395 to USD 8.91 million in the first half of the FY 1396. Share of CIS countries in Afghanistan's export also fell from about 15 percent in the first half of the FY 1395 to about 4 percent in the first half of the FY 1396.

(Tables 4.4 -4.5 and figures 4.5-4.6)



Source: CSO/DAB staff calculations



Source: CSO/DAB staff calculations

2.1.1 Direction of Imports

CIS countries were the first largest import origin of Afghanistan in the first half of the FY 1396. Total Imports from CIS countries increased by 59 percent from USD 566.70 million with share of 18.16 percent in the first half of the FY 1395 to USD 900.52 million with share of 25 percent in the first half of the FY 1396. The main imports from CIS countries were, capital goods which accounted for 41.1 percent, consumer goods with 36.5 percent share, petroleum oil constituting 11.4 percent and industrial supplies such as (metal products and fertilizer) with 11 percent share of total imports in the first half of the FY 1396.

Iran was the second largest source of imports for Afghanistan during the first half of the FY 1396.

Aggregate imports from Iran have diminished by 7 percent from USD 639.39 million with share of 20.49 percent in the first half of the FY 1395 to USD 597.35 million with 16.60 percent share in the first half of the FY 1396.

The major importing products from Iran were capital goods, fuel and lubricant, industrial supplies and consumer goods which accounted for about 6, 6, 4 and 1 percent of total imports respectively in the FY1396.

Pakistan has remained the third largest importing country to Afghanistan in the first half of the FY 1396. Total imports from Pakistan declined by 19 percents from USD 726.37 million with share of 23.28 percent in the first half of the FY 1395 to USD 589.60 million with share of 16.38 percent in the first half of the FY 1396.

Consumer goods, industrial supplies, capital goods and petroleum oil products were the main imports categories from Pakistan.

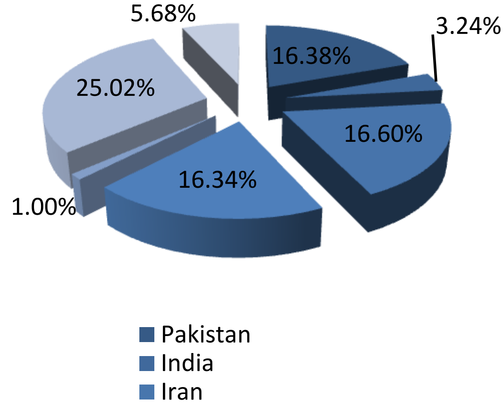
China is the fourth largest import origin to Afghanistan in the first half of the FY 1396. Aggregate imports from China have grown by 19 percent from USD 493.14 million with share of 15.80 percent in the first half of the FY 1395 to USD 587.98 million with share of 16.34 percent in the FY 1396. The main imports from China were capital goods (spare parts), consumer goods and Industrial supplies which accounted for 8, 8 and 1 percent of total imports respectively.

Japan, India, and USA were the fifth, sixth and seventh largest import sourcing countries for Afghanistan, accountable for 5.63 percent, 3.24 percent and 1 percent of total imports respectively. However, total imports from Japan boosted by 85 percent from USD 110.81 million in the first half of the FY 1396 to USD 204.56 million in the first half of the FY 1396, due to higher imports of capital goods and consumer goods in the first half of the FY 1396.

Imports from India grew by 86 percent from USD 62.67 million in the first half of the FY 1395 to USD 116.77 million in the period under review. The major imports from India were fabrics, spare parts, medicines, cloths, tire & tubes, chemical and tea.

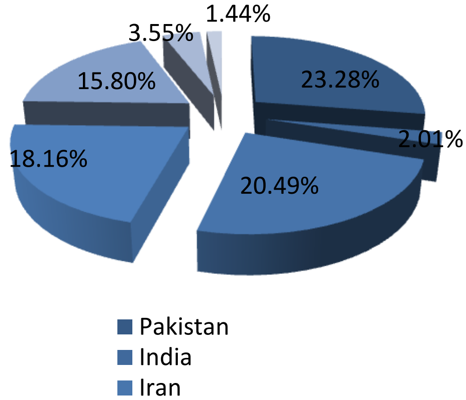
Imports from USA declined by 20 percent to USD 36 million in the first half of the FY 1396 from USD 44.99 million in the first half of the FY 1395. (Tables 4.4-4.5 and figures 4.7-4.8).

Figure 4.7: Direction of Imports (% share) in the first half of FY 1396



Source: CSO and DAB staff calculations

Figure 4.8: Direction of Imports (%share) in the first half of FY 1395



Source: CSO/DAB staff calculations

III. COMPOSITION OF TRADE

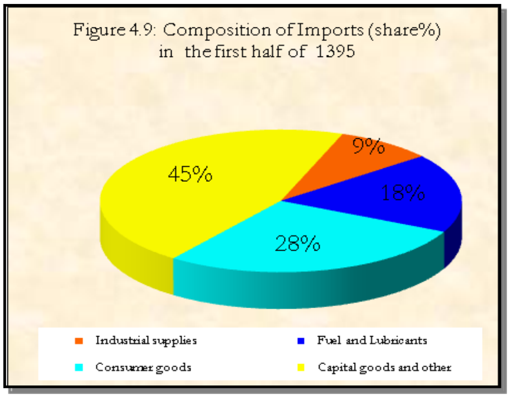
4.3.1. Composition of Imports

The composition of imports in the first half of the FY 1396 indicates that;

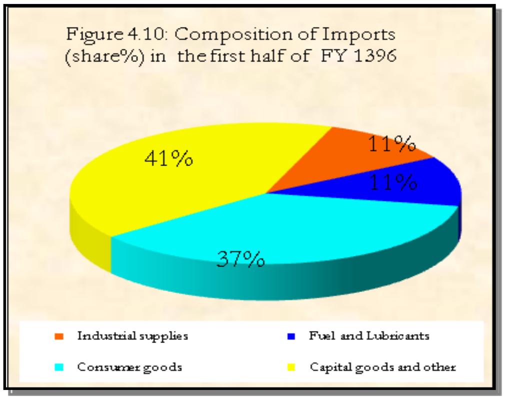
- ✓ Imports of Capital goods had the largest share in the basket of imports despite its share declined from 45.5 percent in the first half of the FY 1395 to 41.1 percent recorded in the first half of the FY 1396. In terms of value, imports of capital goods ascended by 4 percent from USD 1,418.37 million in the first half of the FY 1395 to USD 1479.52 million in the first half of the FY 1396.
- ✓ The second largest share was recorded for consumer goods in the basket of imports during the first half of the FY 1396, the share of consumer goods increased from 28 percent to 36.5 percent. The value of consumer goods in total imports also increased significantly by 51 percent from USD 872.59 million in the first half of the FY 1395 to USD 1,314.64 million in the first half of the FY 1396.
- ✓ Imports of fuel and lubricants (petroleum oil) had the third largest share in the basket of Afghanistan's imports which has decreased from 17.9 percent in the first half of the FY 1395 to 11.4 percent in the reporting period. In terms of value, import of such item in total imports declined by 27 percent from USD 559.16 million in the first half of the FY 1395 to USD 409.67 million in the first half of the FY 1396.
- ✓ Industrial supplies had the smallest share in the basket of Afghanistan's imports during the period under review. The share of industrial supplies in total imports boosted to 11 percent in the first half of the FY 1396 from 8.7 percent recorded in the same period of last year. In terms of value, import of industrial supplies in the total imports of Afghanistan also increased by 46 percent from USD 270.58 million in the first half of the FY 1395 to USD 394.74 million in the first half of the FY 1396.

As a result, the demand for industrial supplies such as cement, chemical materials, fertilizer, and metal production is increasing due to implementation of developing projects throughout the country showing that the country needs to import these materials for economic development and sustained economic growth in the long-run.

(Table 4.3 and figures 4.9-4.10).



Source: CSO and DAB staff calculations



Source: CSO and DAB staff calculations

4.3.2. Composition of Exports

The composition of exports in the first half of the FY 1396 depicted that;

- ✓ Exports of medical seeds had the largest share in the basket of Afghanistan's exports. The share of medical seeds in the total exports increased to 52.3 percent in the first half of the FY 1396 from 28.4 percent recorded in the same period of last year.

In term of value, exports of medical seeds in total exports increased significantly by 79 percent from USD 70 million in the first half of the FY 1395 to USD 125.14 million in the reporting period.

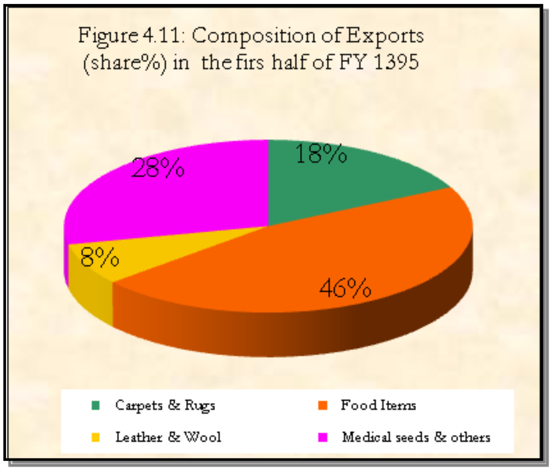
- ✓ The second largest share in total exports was recorded for food items although its share declined from 46.2 percent in the first half of the FY 1395 to 39.2 percent in the first half of the FY 1396.

In term of value, exports of food items (oil seeds, fresh and dry fruits) decreased by 18 percent from USD 113.93 million in the first half of the FY 1395 to USD 93.79 million in the period under review.

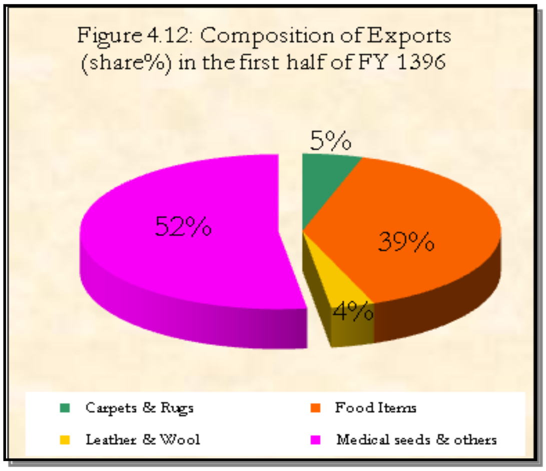
- ✓ Carpet and rugs which are considered as the main component of Afghanistan's exports in the past decades had the third largest share in basket of Afghanistan's exports, which declined from 17.5 percent in the first half of the FY 1395 to 4.9 percent in the period under review.

Earnings from export of carpet and rugs also declined notably by 73 percent from USD 43.27 million in the first half of the FY 1395 to USD 11.77 million recorded in the first half of the FY 1396.

Leather and wool had the smallest share in total exports which decreased from 7.8 percent in the first half of the FY 1395 to 3.6 percent in the reporting period. The value of such goods declined significantly by 56 percent from USD 19.31 million in the first half of the FY 1395 to USD 8.51 million in the first half of the FY 1396. (Table 4.3 and figures 4.11-4.12).



Source: CSO and DAB staff calculations



Source: CSO and DAB staff calculations

IV.EXTERNAL DEBT

Afghanistan's total external debt stock stood at USD 2,110.72 million in the first half of the FY 1396 as against USD 2,417.94 million in the first half of the FY 1395, which shows about 13 percent decline. The fall in total external debt could be attributed mainly to decrease in external commercial borrowings, short and long term debt and non-resident Afghan deposits.

During the period under review, loan principal repayments were made to the World Bank, Asian Development Bank, Saudi fund for development, Kuwait fund International Monetary Fund (IMF), and Bulgaria. While service charges were paid to the World Bank and Asian Development Bank.

During the period under review, only World Bank as a major multilateral creditor to Afghanistan, made some debt forgiveness on principal and services charges.

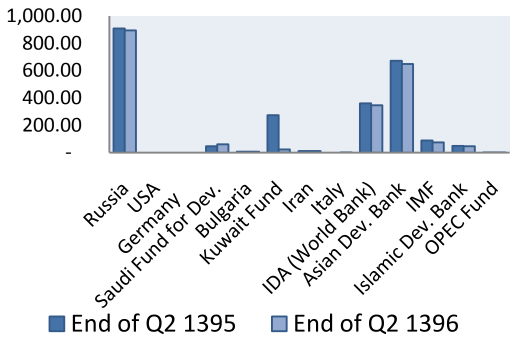
The total loan amounts payable to the Paris Club creditors in the first half of the FY 1395 stood at USD 895.42 million which is payable to Russian federation.

In other words, Afghanistan's total debt from the Paris club members stands at about 42.42 percent of total current external debt which has decreased slightly by about 1 percent compared to the same period of the preceding year.

Furthermore, total debt from Non-Paris Club members including (Saudi Fund for Development, Bulgaria, Kuwait fund and Iran) declined considerably by 70 percent from USD 338.24 million in the first half of the FY 1395 to USD 100.34 million in the first half of the FY 1396.

On the other hand, total debt from multilateral creditors to Afghanistan decreased by 5 percent from USD 1,171.30 million in the first half of the FY 1395 to USD 1,114.96 million which shows USD 56.34 million reduction in total debt from multilateral creditors during the first half of the FY 1396. (Table 4.6 -figure 4.13).

Figure 4.13: External Debt Comparisons; Q2 -1394 & Q2 -1395



Source: Debt Asset Management Unit, Ministry of Finance

V. NET INTERNATIONAL RESERVES

According to the latest available data, the Net International Reserves (NIR) is standing at USD 6,834.37 million in the first half of the FY 1396, down from USD 6,842.50 million that was recorded in the first half of the FY 1395. The slightly decline in the level of NIR was mainly due to the decrease in reserve assets which narrowed by 1 percent from USD 7,479.38 million in the first half of the FY 1395 to USD 7,406.44 million in the first half of the FY 1396.

Likewise, reserve liabilities decreased by 10 percent from USD 636.89 million in the first half of the FY 1395 to USD 572.08 million in the first half of the FY 1396 depicting higher reserve assets than the reserve liabilities. The decrement in reserve liabilities is mainly attributed to the commercial banks deposits in foreign currencies which slaked by 10 percent from USD 561.17 million to USD 506.58 million in the reporting period.

The use of fund resource decrease by 14 percent from USD 75.58 million in the first half of the FY 1395 to USD 65.36 million in the first half of the FY 1396.

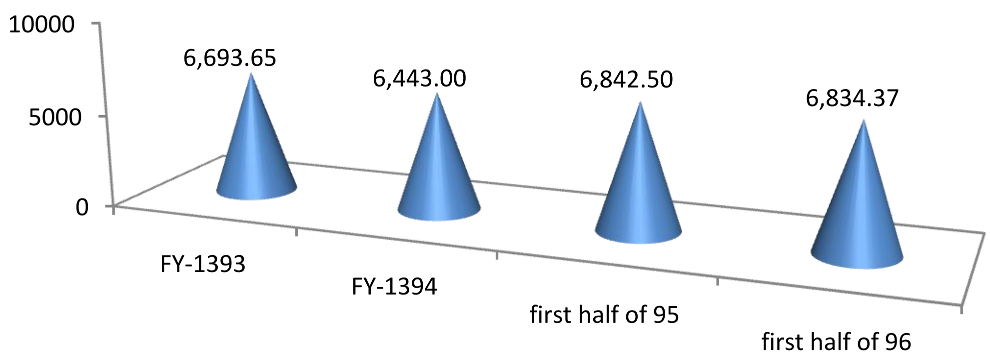
The reserve liability of nonresident deposits in foreign currency almost remained unchanged during the reporting period.

The current position of Afghanistan Net International Reserves (NIR) is providing a good cushion of the capacity of monetary policy and support of balance of payments.

Currently, Net International Reserves (NIR) on average supports almost 11 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

Table 4.7 and Figure 4.14 represent the Net International Reserves (NIR) of Afghanistan for the past few periods.

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



Source: Monetary Policy Department, DAB

Table 4.1: Capital and Financial Accounts (in million USD)

Items/period	FY1394	First half of 1395	First half of 1396
Current account balance	**-3784.26**	**-1724.25**	**-2728.08**
Trade balance	-7085.58	-2767.72	-3064.49
Exports	579.98	250.92	243.00
Imports	7665.56	3018.64	3307.49
Services A/c	802.54	-361.37	-514.86
Income A/c	179.96	13.73	91.13
Current Transfers	2318.82	1391.12	760.14

Source: CSO/DAB staff calculations

Table 4.2: Merchandise Trade (in million USD)

Years	FY 1392		FY 1393		FY 1394		First half of - 1395		First half of - 1396	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	**9,339.60**	**100%**	**7,294.63**	**100%**	**7,679.09**	**100%**	**3,120.70**	**100%**	**3,598.57**	**100%**
Industrial supplies	1,272.14	13.6%	863.19	11.8%	709.19	9.2%	270.58	8.7%	394.74	11.0%
Fuel and Lubricants	2,167.37	23.2%	1,155.94	15.8%	1688.58	22.0%	559.16	17.9%	409.67	11.4%
Consumer goods	1,942.85	20.8%	2,345.86	32.2%	1715.25	22.3%	872.59	28.0%	1314.64	36.5%
Capital goods and other	3,957.24	42.4%	2,929.64	40.2%	3,566	46.4%	1418.37	45.5%	1479.52	41.1%
Exports	**499.81**	**100%**	**620.88**	**100.0%**	**555.71**	**100%**	**246.58**	**100%**	**239.21**	**100%**
Carpets & Rugs	85.49	17%	87.04	14.0%	108.3	19.5%	43.27	17.5%	11.77	4.9%
Food Items	175.92	35%	272.13	43.8%	210.17	37.8%	113.93	46.2%	93.79	39.2%
Leather & Wool	59.54	12%	49.35	7.9%	28.47	5.1%	19.31	7.8%	8.51	3.6%
Medical seeds & others	178.86	36%	212.36	34.2%	208.76	37.6%	70.07	28.4%	125.14	52.3%
Trade Balance	**- 8,839.79**		**- 6,673.75**		**-7,123.38**		**-2,874.12**		**- 3,359.36**	
Trade Balance as % of GDP	**-43%**		**-31%**		**-36%**		**-14%**		**0%**	

Source: Central Statistics Office and DAB staff calculations

Table 4.3: Direction of External Trade: for the first half of the FY 1396 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	63.64	26.60%	589.60	16.38%	-525.96
India	121.21	50.67%	116.77	3.24%	4.44
Iran	9.28	3.88%	597.35	16.60%	-588.07
Germany	3.40	1.42%	24.34	0.68%	-20.94
China	2.96	1.24%	587.98	16.34%	-585.02
England		0.00%	5.86	0.16%	-5.86
Saudi Arabia	1.61	0.67%		0.00%	1.61
USA		0.00%	36.06	1.00%	-36.06
Common Wealth	8.91	3.72%	900.52	25.02%	-891.61
Japan		0.00%	204.56	5.68%	-204.56
Other Countries	28.20	11.79%	535.53	14.88%	-507.33
Total	**239.21**	**100%**	**3,598.57**	**100%**	**(3,359.36)**

Source: CSO and DAB staff calculations

Table 4.4: Direction of External Trade for the first half of FY1395 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	63.64	26.60%	589.60	16.38%	-525.96
India	121.21	50.67%	116.77	3.24%	4.44
Iran	9.28	3.88%	597.35	16.60%	-588.07
Germany	3.40	1.42%	24.34	0.68%	-20.94
China	2.96	1.24%	587.98	16.34%	-585.02
England		0.00%	5.86	0.16%	-5.86
Saudi Arabia	1.61	0.67%		0.00%	1.61
USA		0.00%	36.06	1.00%	-36.06
Common Wealth	8.91	3.72%	900.52	25.02%	-891.61
Japan		0.00%	204.56	5.68%	-204.56
Other Countries	28.20	11.79%	535.53	14.88%	-507.33
Total	**239.21**	**100%**	**3,598.57**	**100%**	**(3,359.36)**

Source: CSO and DAB staff calculations

Table 4.5: External Debt: for the first half of the FY 1395 (in units indicated)

	In million USD	Percent of total
Total external debt	**2,110.72**	**100.00**
Bilateral	995.76	47.18
Paris Club	895.42	42.42
Russian Federation	895.42	42.42
United States	-	0.00
Germany	-	0.00
Non-Paris Club	100.34	4.75
Multilateral	1,114.96	52.82
of which: IDA (World Bank)	345.30	16.36
Asian Development Bank	648.05	30.70
International Monetary Fund	73.86	3.50
Islamic Development Bank	46.04	2.18
OPEC Fund	1.71	0.08

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

Table 4.6: Net International Reserves in the FY 1395 (million of US dollars)

Changes on the previous quarter	FY-1393	% change	FY-1394	% change	First half of -1395	% change	First half of-1396	% change
Net international Reserves (million US Dollar)	**6,693.65**	23.22	**6,443.00**	-3.74	**6,842.50**	6.20	**6,834.37**	-0.12
Reserve Assets	7,247.76	22.71	6,965.81	-3.89	7,479.38	7.37	7,406.44	-1.0
Reserve Liabilities	554.12	10.91	522.80	-5.65	636.89	21.82	572.08	-10
Commercial bank deposits in foreign currency	443.80	4.00	433.57	-2.30	561.17	29.43	506.58	-10
Nonresident deposits in foreign currency	0.14	-89.57	0.14	0.00	0.14	0.01	0.14	0.00
Use of Fund resources	110.18	17.53	89.10	-19.14	75.58	-15.17	65.36	-14
Gross Intl. Reserves (in months of import)	**11.92**		**10.89**		**28.76**		**24.70**	
Net Intl. Reserves (in months of import)	**11.01**		**10**		**13**		**11**	

Source: Monetary Policy Department, DAB

5

FISCAL SECTOR DEVELOPMENT

5

FISCAL DEVELOPMENTS

During the first six months of FY 2017, the overall performance in the Fiscal Sector of the economy was satisfactory.

However, compared to the same period of last year, total revenue collection performance level was low and Afghanistan's public expenditure remained unbalanced at the end of first half of FY 2017, owing to continued deterioration in security conditions which undermined private investment, delayed budget execution, and caused capital flight. In addition, prolonged process of procurement, tardy reporting by the government entities and businesses also put negative impacts on the fiscal sector of the economy.

I. BUDGET EXECUTION RATE

During the first half of the FY 2017, government's total execution rate was 32 percent of the allocated budget showing a slight improvement of 3 percent compared with the same period of the previous year. The execution rate of current (operating) budget was 39 percent during the first half of FY 2017 compared to the first half of 2016 which shows an improvement of 3 percent.

Meanwhile, execution rate of development budget was only 19 percent, compared to 17 percent of execution rate at the end of the same period in the previous year.

The lower execution rate of the core budget was attributed to several factors, and most importantly to suspension of budget approval, deterioration in security conditions in provinces and decline in the level of donor's contribution.

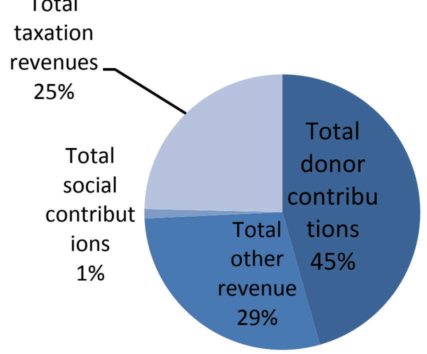
II. BUDGET DEFICIT

The overall budget, excluding the donor's contribution, had a deficit of AF 64.28 billion in the first half of the FY 2017, while including donor grants, budget deficit was recorded at AF 2.01 Billion.

III. REVENUE COLLECTION

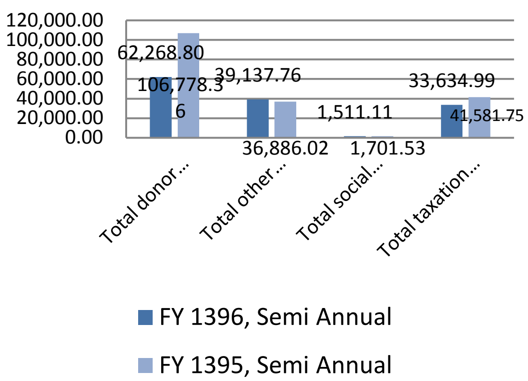
Domestic revenue collected at the end of first half of FY 2017 indicates a significant decrease of 7 percent catapulting the total collection to AF 74.28 billion, lower than AF 80.17 billion collected at the end of first half of FY 2016.

Figure 5.1: Composition of Total Revenue- First Six Months of FY 2017



Source: Ministry of Finance/MPD calculation

Figure 5.2: Comparison of Total Revenue, Six Months of FY 2017 Vs. Six Months of FY 2016 (in millions)



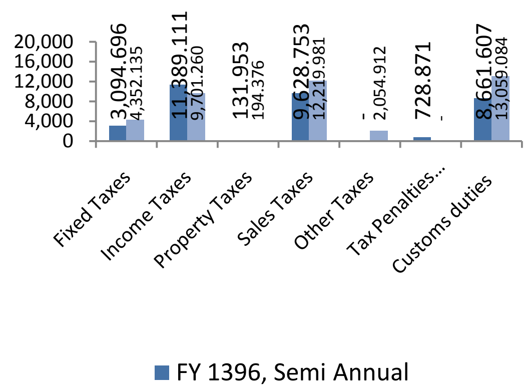
Source: Ministry of Finance/MPD calculation

3.1 Tax Revenue

Total tax collections showed decline during the period under review. Considering the receipts, overall tax revenue decreased from AF 41.58 billion to AF 33.63 billion, compared to the same period of the FY 2016, which represents a significant decrease of 19 percent or AF 7.95 billion.

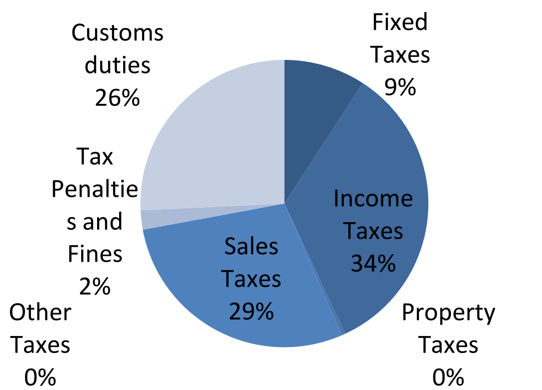
Similarly, total tax collection from of the custom duties presented a substantial reduction of 34 percent, plummeting from a total of AF 13.06 billion to AF 8.66 billion in FY 2016.

Figure 5.3: Comparison of Tax Revenue



Source: Ministry of Finance/MPD calculation

Figure 5.4: Composition of Tax Revenue



Source: Ministry of Finance/MPD calculation

3.2 Non-tax Revenues

The dominant contributor in domestic revenues was non-tax revenues which presented a trivial increase of AF 2.06 billion reaching AF 40.65 billion, compared to AF 38.59 billion over the same period of the previous year. This increase was mainly due to high performance in extractive industry and income from capital property, the major components of the non-tax revenue.

On the other hand, sales of land and building, non-tax fines and penalties, administrative fee and sales of goods and services, under-performed during the period under review compared to the first six months of FY 2016.

Social contribution that constitutes only 2 percent of the total domestic revenue, presented a decline of 11 percent in the first half of FY 2017. The total amount collected was recorded at AF 1.51 billion, down from AF 1.70 billion in the first half of FY 2016.

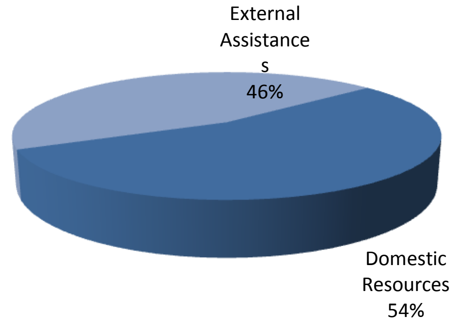
IV. GRANTS

Afghan government receives grants from various donors and international committees to finance varieties of programs in both operating and development expenditures. Integrated grants decreased significantly in the first six months of FY 2017, compared to the same period of FY 2016.

Total development and operating grants at the end of the first half of FY 2017 amounted to AF 62.27 billion down from AF 106.78 billion in FY 2016, screening a significant decrease of 42 percent. Nonetheless, grants received under the ARTF program over the first six months of FY 2017 was AF 17.23 billion that represents 42 percent decline over the same period of the previous year. Similarly, grants received from CSTC, US & USAID witnessed decline by 57 percent and 88 percent respectively during the first half of FY 2017.

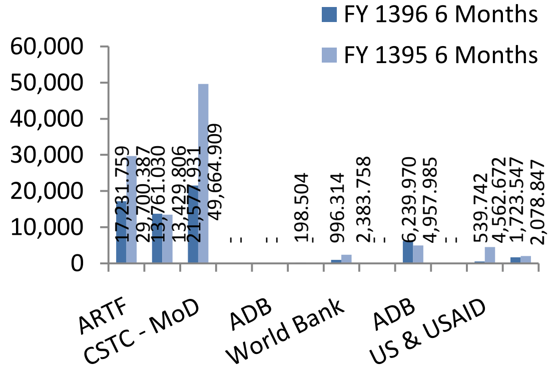
Domestic revenue could finance 54 percent of the total core budget and 46 percent is financed through external grants.

Figure 5.5: Financing Sources of National Budget Semi-annual, FY 2017



Source: Ministry of Finance/MPD calculation

Figure 5.6: Comparison of Donors Contribution



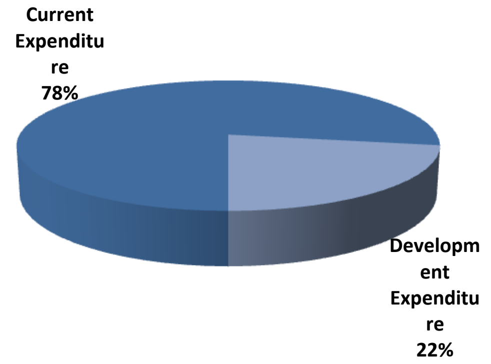
Source: Ministry of Finance/MPD calculation

V. EXPENDITURE

Total expenditure for the quarter under review was recorded at AF 138.56 billion that indicates 4 percent increase over the total spending of AF 133.44 billion in the same period of the previous year.

The current expenditure increased to AF 107.54 billion during the first half of FY 2017 from AF 103.48 billion showing 4 percent increase. Correspondingly, development expenditure recorded an upward trend reaching AF 31.02 billion from AF 29.96 billion, indicating an insignificant rise of 3.5 percent.

Figure 5.7: Composition of Total Government Expenditure Semi-annual, FY 2017



Source: Ministry of Finance/MPD calculation

6

BANKING SYSTEM PERFORMANCE

6

BANKING SYSTEM PERFORMANCE

Asset base of the banking sector shrunk by 3.40 percent during first half of the fiscal year 1396, standing at AF 288.79 billion at end of June, 2017 against 8.33 percent growth in the second half of FY 2016. The decrease in banking system assets was mainly due to decrease in cash in vault and claims on DAB, net-loans and other assets.

- Gross loans portfolio of the banking sector declined by 0.30 percent standing at AF 41.13 billion at end of June, 2017 against 11.20 percent decline in the preceding 6 months of FY 2016. The decrease in the loan portfolio during the first half of the year 2017 was mainly attributed to settlement of loans, charge off of loans and less customer utilization of OD (Overdraft loans).
- Deposits, the main funding source in the banking sector stood at AF 242.89 billion, comprising 95.44 percent of the total liabilities of the sector decreased by 4.73 percent against 7.02 percent growth in the preceding period. The major decrease in deposit base of the banking sector is attributed to demand deposits and occurred mostly in AF and USD currencies. Deposits were largely denominated in USD (61.58 percent) with Afghani denominated deposits lagging at 32.21 percent. AF-denominated deposits indicated 0.78 percent decrease against 14.57 percent increase in the second half of the previous year, USD denominated deposits were down by 7.52 percent against 2.59 percent increase in the preceding period.
- The capital base of the banking sector remained strong and increased by 1.16 percent standing at AF 34.30 billion. The financial capital of two banks is below the set limits. However, the capital adequacy of all banking institutions except one bank in the system, is above the minimum threshold (12 percent of risk-weighted assets). The Basel benchmark for capital to risk weighted is 8 percent. Capital adequacy ratio (CAR) of the banking sector recorded at 28.07 percent.
- Banking sector earned net profits amounting to AF 235 million in the first half of 2017, against AF 920 million net profits in the second half of FY 2016. Return on Assets (ROA) stood at 0.16 percent

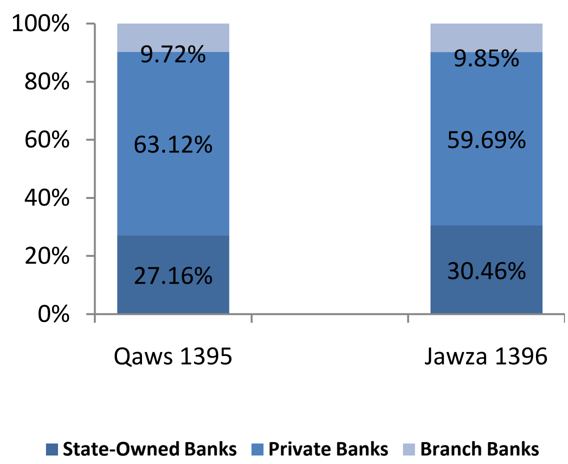
annualized, and Return on Equity (ROE) was recorded at 1.37 percent annualized. The decrease in profitability of the banking sector is mostly ascribed to decrease in non-interest income and increased in credit provision, salary and tax expenses. While net-interest income increased and non-interest expense decreased during the first half of the year 2017. State-Owned Banks (SOB) and branches of foreign banks (BFB) ended up with profits, while Private Banks (PB) suffered from losses.

I. ASSETS OF THE BANKING SYSTEM

The assets size of the banking sector decreased by 3.41 percent in the period under analysis against 8.34 percent increase in the last six months of FY2016. See Table 6.1.

The breakup of total assets reveals that the most obvious decrease was registered in cash in vault and claims on DAB (AF 12.20 billion or 8.63 percent of total assets) mostly in cash in vault and current account with DAB, net-loans (AF 807 million or 2.22 percent), investments (AF 625 million or 2.47 percent), repossessed assets (AF 509 million or 33.20 percent), other assets (AF 370 million or 2.66 percent) and intangible assets (AF 22 million or 2.78 percent). While interbank claims and fixed assets showed an increase of (AF 3.90 billion or 5.36 percent and AF 449 million or 6.40 percent respectively) during the period under review. The most important components of the system's total asset portfolio were cash in vault/claims on DAB (44.73 percent), interbank claims (26.54 percent), net loans (12.33 percent), investments (8.52 Percent), "other assets" (4.68 percent) and fixed assets make 2.58 percent of the total assets. See table 6.1.

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



Source: Financial Supervision Department/ DAB

Table 6.1: Composition of Assets and Liabilities

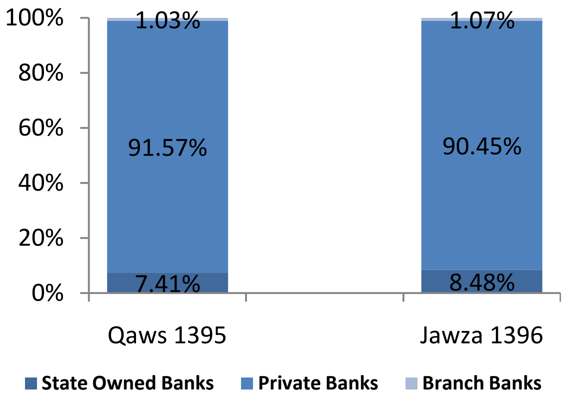
Amount in million AF	Qaws, 1395 Dec. 2016	Jawza, 1396 June, 2017	% of Total Assets/Liability	Growth
Assets				
Cash in vault and claims on DAB	141,367	129,165	44.73	-8.63
Interbank claims(Net)	72,748	76,651	26.54	5.36
Investments (Net)	25,232	24,607	8.52	-2.47
Loans (Net)	36,428	35,621	12.33	-2.22
Intangible assets	785	763	0.26	-2.80
Repossessed Assets	1,534	1,025	0.35	-33.18
Fixed Assets	7,012	7,460	2.58	6.39
Others	13,873	13,503	4.68	-2.66
Total	298,979	288,795		-3.41
Liabilities				
Deposits	254,952	242,892	95.44	-4.73
Borrowings	3,597	4,532	1.78	25.99
Subordinated Debt	21	11	0.00	-47.62
Other	6,502	7,060	2.78	8.58
Total	265,072	254,495		-3.99
Financial Capital	33,906	34,300		1.16

Source: Financial Supervision Department, DAB

1.1 Gross Loans

Total gross loans indicated AFN3.98 billion or 8.57 percent decline since previous quarter, constituting 15.33 percent of the total assets.

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



Source: Financial Supervision Department/DAB

Decline in loan portfolio were observed in six banking institutions, whereas seven banking institutions observed an increase in their loan portfolio, while the remaining two banks did not participate in lending.

Gross loan portfolio declined in Private Banks, while State-owned Banks and Branches of foreign banks have registered increase in their portfolio. Private Banks with 90.44 percent share in total portfolio posted 1.52 percent or AF 574 million decrease. While State-owned banks with 8.48 percent share depicted 14.14 percent or AF 432 million increase and branches of foreign banks holding 1.07 percent share of the portfolio recorded 3.99 percent or AF 17 million increases during the period under review.

1.2 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 and according to revised asset classification and provisioning regulation. From Sep. 2016, banks are required to set at least 1 percent reserve for their standard assets.

By the end of June, 2017, total provision cover of the system was 13.40 percent of total gross loans as opposed to 11.70 percent recorded in the preceding six months period.

1.3 Distribution of Credit

In order to broad-based the loan portfolio and broaden the risk diversification and financial access besides new avenues of earning, DAB has diversified the sector wide distribution of Other Commercial Loans to thirty sectors[1]. The analysis of deployment of credit in different sectors indicate that the major portion of the loan portfolio is

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

classified as "other commercial loans" (90.94 percent against 90.13 percent in the last half of FY2016), mainly in "All other services" (11.70 percent), "Petroleum and Lubricants" (9.88 percent), "Construction and Building" (8.02 percent), and "Telecommunication" sector (6.28 percent). Significant decreases were observed in Retail trading, Residential Mortgage Loans to individuals, Ground Transportation, Petroleum and Lubricants, Food Items sectors both in absolute amount and percentage of total gross loans, while "Cement and other construction material", "Hotel and Restaurant", "Agriculture", "Wholesale", "Services" and "Textile" sectors were among top increasing sectors. Loans designated to Micro Credit sector posted an increase of AF 4.07 billion amounting to AF 4.90 billion provided by one bank, while SME sector witnessed an increase of AF 68 million currently standing at AF 2.66 billion provided by five banking institutions. Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises situation associated to that sector, inversely affecting the overall banking sectors. Banks should closely monitor the potential risk associated with key sectors given the high NPL ratio. Disaggregated analysis show that major portion of NPL originates from trade sector constituting 49.51 percent of total banking sector NPLs. Increases were observed in Trade, Utilities, Services and Communication sectors, while Residential Mortgage loans to individuals, Manufacturing and Other sectors recorded decrease in the period under review. About 69.55 percent of the loans were designated in Kabul while Herat and Balkh provinces in the second and third places with Kandahar and Badghis provinces at fourth and fifth places respectively. The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that with time, the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

Table 6.2: Sectoral Distribution of Credit

Sectors	Hoot, 1388 (Mar. 2010)	Hoot, 1389 (Mar. 2011)	Hoot, 1390 (Mar. 2012)	Qaws, 1391 (Dec. 2012)	Qaws, 1392 (Dec. 2013)	Qaws, 1393 (Dec. 2014)	Qaws, 1394 (Dec. 2015)	Jawza, 1396 (June, 2017)
Commercial Real Estate and Construction Loans	19.92	25.98	2.85	2.29	2.02%	1.80%	1.90%	2.63%
Other Commercial Loans	-	-	-	-	-			
Mining	-	0.02	0.72	0.11	0.07%			
Manufacturing	1.22	2.72	13.32	11.88	9.36%			
Trade	32.29	34.16	27.84	28.3	29.81%			
Communication	1.04	1.23	0.94	2.35	3.70%			
Service	4.84	6.72	11.95	15.94	22.11%			
Utilities	2.47	0.03	0.3	0.07	0.05%			
Agricultural Loans						0.27%	0.33%	0.15%
Livestock and Farms						0%	0.03%	0.11%
Manufacturing and Industry(product of metal, wood, plastic, rubber)						2%	4.42%	3.19%
Manufacturing, Handmade and Machine products						4%	4.24%	4.05%
Cement and Construction Materials						3%	1.96%	3.44%
Textile						2.59%	0.52%	1.46%
Power						0.35%	0.22%	0.36%
Construction and Building						12.52%	7.54%	8.02%
Services						4.79%	3.80%	4.07%
Hotel and Restaurant						1.20%	1.46%	2.24%
Telecommunication						2.92%	5.70%	6.28%
Ground Transportation						4.87%	5.31%	3.32%
Air Transportation						4.18%	2.66%	2.20%
Health and Hygienic						0.71%	1.16%	1.54%
Median, Advertisements and Printer						0.04%	0.04%	0.05%
All Other Services						1.41%	7.56%	11.70%
Wholesales						4.93%	9.89%	5.76%
Machineries						0.12%	0.25%	0.65%
Petroleum and Lubricants						8.74%	9.80%	9.88%
Spare Parts						0.24%	1.42%	0.17%
Electronics						1.40%	1.58%	2.20%
Cement and other Construction						1.87%	2.73%	1.47%

Materials								
Food Items						4.52%	8.24%	6.70%
All Other Items						5.72%	3.47%	3.02%
Retail Trading						3.92%	3.28%	5.28%
Road and Railway						2.41%	1.17%	0.53%
Dames						0.61%	0.09%	0.00%
Mines						0.08%	1.48%	0.52%
Other infrastructure Projects						1.81%	2.44%	2.59%
Financial and Lending Institutions						0.00%	0.00%	0.00%
Agricultural Loans	0.88	0.75	2.06	2.66	2.38%	2.34%	2.35%	4.05%
Consumer Loans	1.33	1.01	0.82	0.74	0.24%	0.26%	0.30%	0.87%
Residential Mortgage Loans to Individuals	7.3	8.95	15.65	14.46	10.84%	7.14%	2.68%	1.05%
All Other Loans	3.69	10	12.65	10.71	9.41%	6.68%	0.00%	0.45%

Source: Financial Supervision Department/DAB

II. CLASSIFICATION OF LOANS

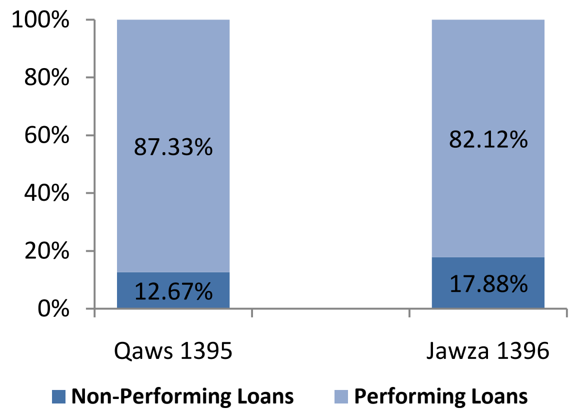
2.1 Non-performing loans

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

In monetary terms, by the end of June, 2017, non-performing loans recorded at AF 7.35 billion or 17.88 percent of total gross loans and 24.30 percent of the system's regulatory capital against AF 5.22 billion or 12.67 percent of the total gross loans in the second half of FY2016. Out of 17.88 percent NPL, 16.33 percent is related to five banks. These banks hold 66.63 percent of the system's gross loans and 49.10 percent of system's regulatory capital.

Financial Supervision Department (FSD) is closely working with the financial institutions with poor loan performance to design and implement plans to improve their asset quality. This situation requires regulatory oversight and prompt remedial action to improve governance of credit risk to avoid negative impact over the profitability and capital adequacy of the banks with poor credit quality. The sector wide distribution of NPL reveals that major part of NPL originates from Trade sector making 49.51 percent and Other sector comprising 22.50 percent of the sector's NPL, while services, Utilities and Manufacturing sectors make 10.37 percent, 9.84 percent and 6.87 percent respectively. Increases were observed in Trade, Utilities, Services and Communication sectors, while Residential Mortgage loans to individuals, Manufacturing and Other sectors were among the decreasing sectors.

Figure 6.3: Quality of Loan Portfolio



Source: Financial Supervision Department/DAB

2.2 Adversely-classified loans

Adversely classified loans (substandard, doubtful)[2] depicted AF 176 million decrease over the first half of the 2017, reaching AF 11.28 billion, constituting 27.42 percent of the total gross loans and 37.26 percent of regulatory capital, therefore requires strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be focused on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk. Management should take appropriate measures to address issues and weaknesses that have resulted in poor credit performance as per prudential regulations. Though systematic risk and economic downturn may have affected, weak and systematically important bank's asset quality especially loans; however, banks management should have mechanisms to predict such risks, hedge their potential risk and take proper precautionary measures as per prudential regulations.

2.3 Loans classified Watch

Loans classified in the "watch"[3] category are AF 3.79 billion, which makes 9.22 percent of total gross loans decreased by 2.66 percent since the last half of FY2016. The decrease is mostly attributed to four private commercial banks in the system. This category of loans require close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

[2] Assets and advances for which the principal and/or interest remains outstanding for 31-90 day (substandard). Default assets and advances for which the principal and/or interest remains outstanding for 91-360 day (doubtful)- as per new Assets Classification and provision Regulation

[3] Assets and advances for which the principal and/or interest remains outstanding for 1-30 day (Watch)-new Assets Classification and provision regulation

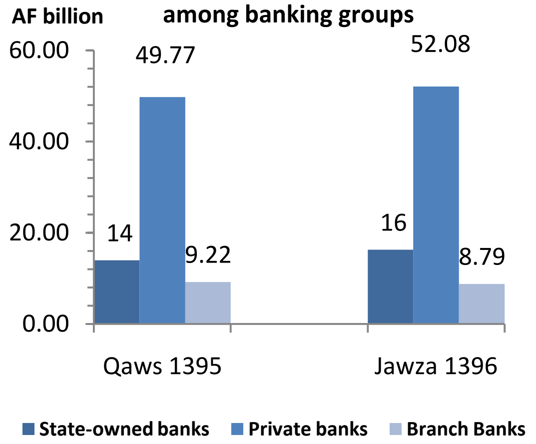
2.4 Loans classified loss4

Loans classified loss amounts to AF 186 million, 0.45 percent of total gross loans are down by AF 370 million since the last half of the previous year, attributed to four banks. Banks are required to maintain enough capital at all times to cover losses resulted from loans classified in this category as it prompts charge-off from balance sheet.

2.5 Inter-bank Claims

Interbank Claims are the second largest among various asset categories, currently comprising AF 76.65 billion 26.54 percent of total assets registered AF 3.90 billion or 5.36 percent increase since the half of FY2016, mostly attributed to four banking institutions, indicating that the banking sector has transferred a portion of its current accounts and DAB capital notes to interbank claims. Later on, by improving security and economic situation of the country banking sector can substitute these assets to higher income earning assets. Banks must not only appropriately measure risks associated with individual bank's but also country or countries in which they have placed funds. See figure 6.4.

Figure 6.4: Share of Inter-bank Claims among banking groups



Source: Financial Supervision Department/DAB

2.6 Investment

The net-investment[5] portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies; declined by 2.47 percent or AF 625 million since the last half of FY2016, standing at AF 24.60 billion or 8.52 percent of total assets, the decrease mostly came from four banking institutions. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, five commercial banks and three branches of foreign banks.

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

[5] Investments include investment in bonds, securities, associated companies, in a subsidiary and in a bank

2.7 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category making 44.73 percent of the total assets, showed an decrease of AF 12.20 billion, both in absolute as well as in percentage of total assets since the second half of the previous year standing at AF 129.16 billion as of end of June, 2017. The decreases were observed in cash in vault and current accounts with DAB with capital notes.

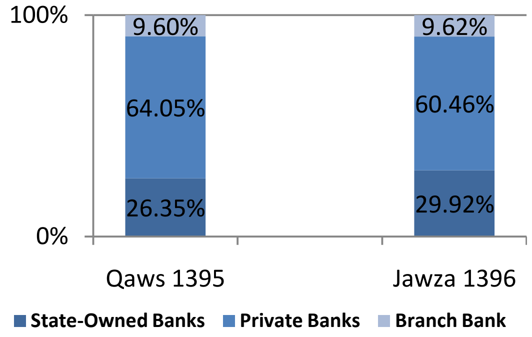
Banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

III. LIABILITIES

Total liabilities of the banking sector decreased by AF 19.57 billion or 3.99 percent standing at AF 254.49 billion against AF 265.07 billion in the second half of FY2016. All components of total liabilities except deposits and subordinated debt have shown increase over the period under review.

The majority of liabilities are made up of deposits (95.44 percent), with “other liabilities “at second and borrowings in third place.

Figure 6.5: Liabilities decreased by AF 19.57 billion or 3.99 percent



Source: Financial Supervision Department/DAB

3.1 Deposits

Deposits being the main funding source, amounted to AF 242.89 billion as of June, 2017, decreased by AF 12.06 billion or 4.37 percent, compared to the second half of the previous year. The major decrease in deposit base of the banking sector is attributed to demand deposits and occurred in AFN and USD currencies. Currency wise analysis shows that Afghani denominated deposits indicated 0.78 percent decrease (against 14.57 percent increase in the second half of FY2016) accounting for 32.21 percent of total deposits, while US dollar denominated deposits decreased only by 7.52 percent (2.59 percent increase in the second half of FY2016) making 61.58 percent of the total deposits of the system.

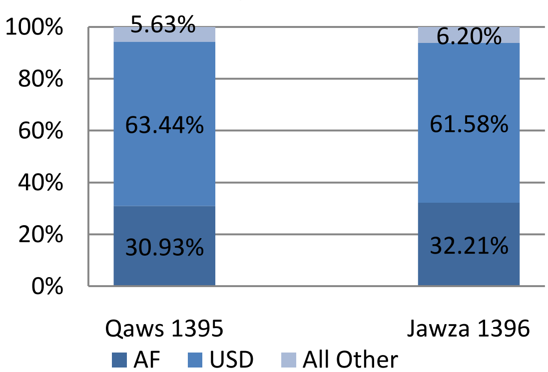
Private Banks attracted AF 147.26 billion deposits, decreased by 10.82 percent against 6.92 percent increase in the preceding period of the previous year making up 60.63 percent of the system's deposits.

The share of state-owned banks amounted to AF 73.28 billion, increased by 11.42 percent (6.92 percent increase in the preceding period) since the second half of the previous year accounted for 30.17 percent of the system's deposits.

The share of branches of foreign banks stands at AF 22.34 billion decreased by 7.05 percent (25.05 percent increase in the last half of FY2016) making up 9.20 percent of total deposits of the system.

In terms of types of deposits, demand deposits accounted for 71.52 percent of the total deposit base, decreased by 8.90 percent, while saving deposits with 20.94 percent of total deposits was in the second place, and depicted 0.66 percent increase and time deposit making up 7.54 percent of the total deposits portfolio was up by 33.36 percent since the last half of FY2016.

Figure 6.6: Currency Composition of Deposits



Source: Financial Supervision Department/DAB

Source: Financial Supervision Department/DAB

Figure 6.7: Afghani Denominated Deposits

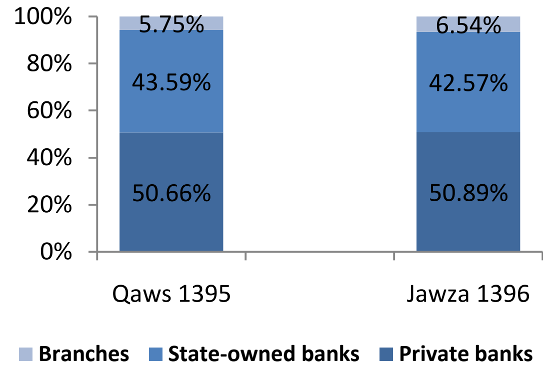
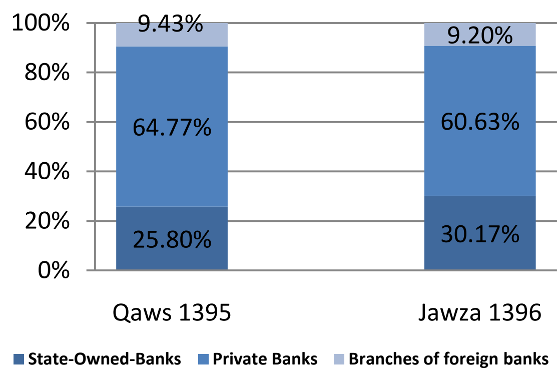
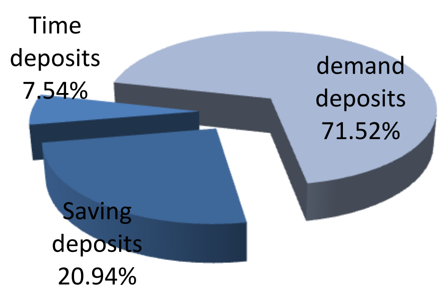


Figure 6.8: Deposits decreased by 4.73 percent or AF 12.05 billion



Source: Financial Supervision Department/ DAB

Figure 6.9: Breakdown of Deposits



Source: Financial Supervision Department/ DAB

3.2 Borrowings

The share of borrowings in total funding structure of the system increased by 25.98 percent standing at AF 4.53 billion at the end of June,2017, making 1.78 percent of total liabilities in comparison with 3.97 percent decrease in the second half of FY2016. The current borrowing position is attributed to four banking institutions.

IV. LIQUIDITY

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

4.1 Liquidity Ratio (broad-based 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. 71.55 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 64.42 percent. All banking institutions were well above the minimum required level.

Table 6.3: Key Financial Soundness Indicators of the banking Sector

Ratio in %	(Mar. 2010)	(Mar. 2011)	(Mar. 2011)*	(Mar. 2011)	(Dec. 2012)	(Dec. 2013)	(Dec. 2014)	(Dec. 2015)	(Dec. 2016)	(June 2017)
Total Capital Adequacy Ratio	25.81	-14.46	30.39	23.06	21.84	26.34	26.46	19.94	27.68	28.07
Tier 1 Capital Adequacy Ratio	24.19	-14.51	30.29	23.98	19.97	24.65	26.09	19.66	22.93	27.35
Non-Performing Loans to Total Gross Loans	0.5	48.4	3.75	5.15	5.31	5.1	8.09	12.34	12.67	17.88
Return on Assets (ROA)	1.41	-20.08	0.24	-1.21	-0.54	0.74	0.90	0.20	0.11	0.16
Return on Equity (ROE)	10.35	-520.66	1.9	-17.9	-7.17	10.03	7.35	1.69	1.08	1.37
Liquidity Ratio (Broad Measure Median)	59.19	63.32	63.83	57.37	72.13	67.93	73.6	68.22	67.74	64.42
Liquidity Assets to Total Assets	0.38	40.58	47.01	55.82	63.75	73.18	73.28	75.05	71.98	71.55

*Excluding Kabul Bank

Source: Financial Supervision Department/ DAB

V. CAPITAL

The banking system is well capitalized. The capital fund of the banking sector stands at AF 34.30 billion; increased by 1.16 percentage points or AF 394 million over the last quarter. The increase in total financial capital is mainly attributed to profits and capital injection.

On an aggregate basis, the Capital Adequacy ratio of the banking sector stands at 28.07 percent. Disaggregated analysis shows that the financial capital of two private banks is below the regulatory limits. However, the regulatory capital ratio of all banks except one bank is above the set regulatory threshold (12 percent of the risk weighted assets). The Basel benchmark for capital to risk weighted is 8 percent.

VI. PROFITABILITY

On a cumulative for the first half of 2017, the banking sector earned AF 235 million net profit against AF 920 million net profits in the second half of 2016, showing huge decrease over the period.

The decrease in profitability of the banking sector as evident from the table 6.5 P/L, is mostly ascribed to decrease in non-interest income and increase in credit provisions, taxes and salary expenses, while net-interest income increased and non-interest expense decreased over the period under review. See table 6.5.

The returns on assets (ROA) shows how well a bank is being managed by conveying how much profit the bank earns per unit of its assets. ROA of the banking sector stands at 0.16 percent, while the returns on equity (ROE), which measures shareholders return on their invested equity in a bank, at the end of June, 2017 recorded at 1.37 percent. The ROA of SOB[6] recorded at 1.08 percent, BOFB[7] recorded 0.16 percent, while PB[8] registered -0.41 percent at the end of June, 2017.

On a cumulative basis, four banking institutions have incurred AF 1.05 billion losses during first half of 2017 against AF 815 million losses posted by three banks in the second half of FY2016. On core income basis, five banks ended with losses, against three banks in the preceding period.

Group wise analysis reveals that State-Owned Banks (SOB) and branches of foreign banks (BFB) ended up with profits in the period under analysis while Private Banks ended up with losses in June, 2017. See figure 6.4.

Major portion of the profitability of the banking sector is attributed to State-Owned Banks standing at AF 459 million and branches of foreign banks which earned AF 153 million profits during first half of 2017, while Private Banks ended up with loss of AF 376 million during this period.

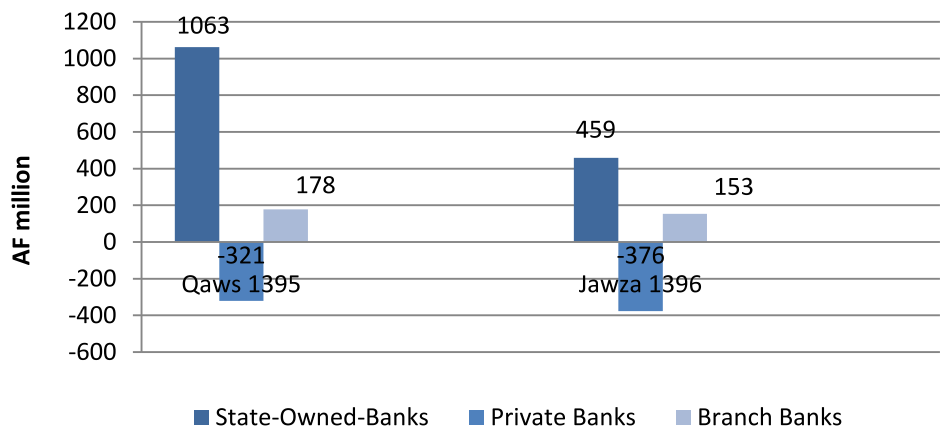
[6] SOB- Stated-Owned Banks
[7] BOFB- Branches of Foreign Banks
[8] PB- Private Banks

Table 6.4: P/L Schedule

Items	Qaws 1395 (Dec. 2016)	Jawza 1396 (June, 2017)	% Change half yearly
Interest income	4,494	4,711	4.83
Interest expense	880	924	5.00
Net interest income	3,614	3,787	4.78
Non-interest income	3,677	3,225	-12.29
Non-interest expenses	3,112	2,977	-4.34
Salary cost	1,910	2,049	7.28
Credit provisions	1,310	1,454	10.99
P/L before tax	959	532	-44.52
P/L after tax	920	235	-75.45

Source: Financial Supervision Department, DAB

Figure 6.10: Profitability of the Banking Sector



Source: Financial Supervision Department, DAB

Figure 6.11: ROE and ROA of the banking system

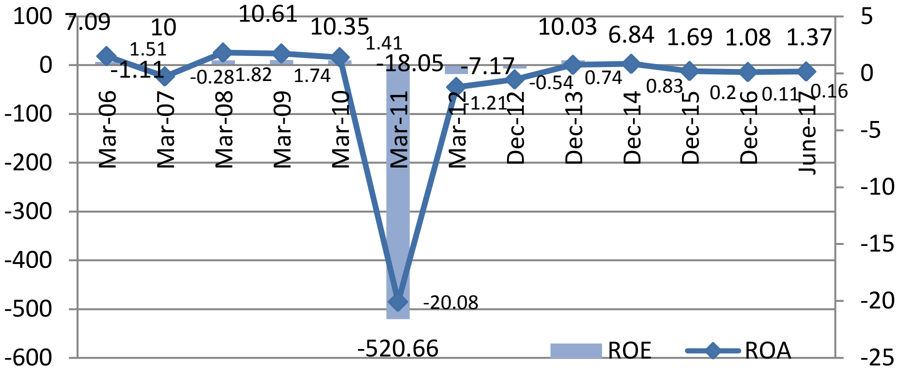
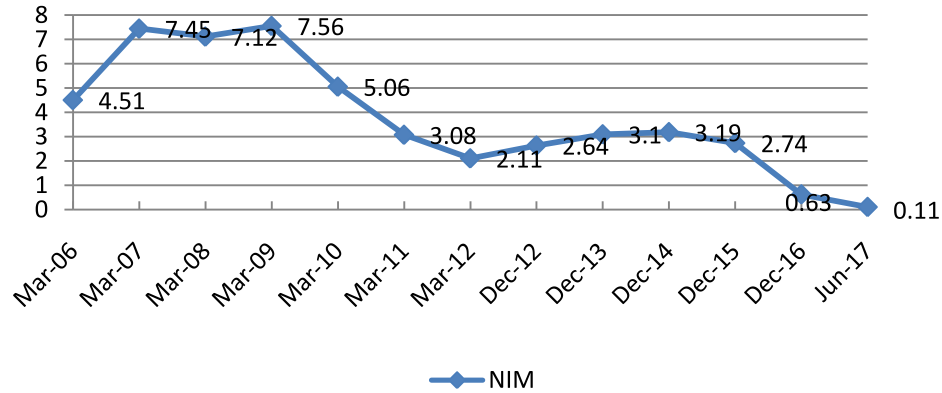


Figure 6.12: Net Interest Margin



Source: Financial Supervision Department/ DAB

VII. Foreign Exchange Risk

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

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20 percent appreciation in exchange rate would increase the regulatory capital of the system by AF 1.57 billion and vice versa. Similarly, a 4 percent change would correspond to AF 315 million and vice versa.

VIII. 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 1.55 billion in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock), interest income will decline by AF 1.55 billion. For five banking institutions, if the interest-rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

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

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