



Da Afghanistan Bank



Economic & Statistical Bulletin

Quarterly Bulletin, Q3 - FY 1396



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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 quarterly bulletin analyzes developments during the third quarter of fiscal year 1396, which covers July 21st, 2017 to September 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



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

Report from the World Bank illustrates that global economy is strengthening due to recovery in industrial activities as well as increase in global trade. Global GDP growth is estimated to have picked up from 2.4 percent in 2016 to 3 percent in 2017, above the June forecast of 2.7 percent. The upturn is broad based, with growth increasing in more than half of the world's economies. In particular, the rebound in global investment growth—which accounted for three quarters of the acceleration in global GDP growth from 2016 to 2017—was supported by favorable financing costs, rising profits, and improved business sentiment across both advanced economies and emerging market and developing economies (EMDEs).

In Afghanistan, the economy is largely influenced by the increasing prices of commodities in the global markets and developments in the agricultural, industrial, and services sectors within the country.

The headline consumer price index in Afghanistan (CPI) reflected a significant decrease in the third quarter of 2017. As per the available data, the headline inflation measured on year-on-year basis declined to 4.5 percent on average in the third quarter from 7.2 percent in the same period of the preceding year.

The near-term inflation outlook in Afghanistan is likely to remain steady. Da Afghanistan Bank forecasted the national headline inflation rate in range between 3 to 4 percent for the fourth quarter of 2017.

During the period under review, banking sector earned net profit of AF 743 million against AF 98 million in the previous quarter which is mainly attributed to decrease in credit provisions; the banking sector recorded AF 63 million re-integrated provisions (attributed to repayments of loans). State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profit in the review quarter.

Since the beginning of the FY 2017 until 22nd September, DAB experienced accumulation of 5.62 percent (USD 385 million) in net international reserve (NIR).

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. Since the beginning of the FY 2017 until 22nd September, DAB experienced accumulation of 5.62 percent (USD 385 million) in net international reserve (NIR).



GLOBAL ECONOMIC ENVIRONMENT

1

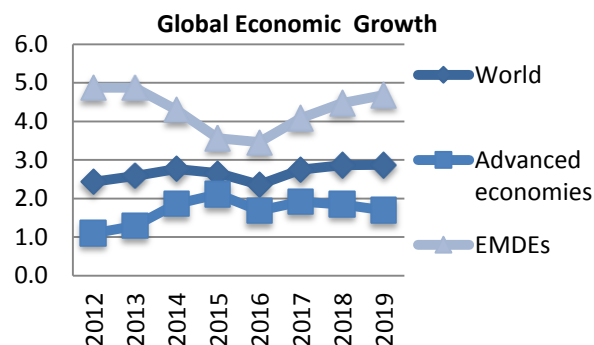
GLOBAL ECONOMIC ENVIRONMENT

The World Bank report illustrates that the global economy is enduring to strengthen due to recovery of industrial activity and increase in the level of global trade after two years of weakness. Growth is predicted to gain strength in both advanced, emerging market and developing economies (EMDEs). Self-reliance is improving, even though the global financing conditions have been benign.

In advanced economies, the activity is predicted to maintain impetus in 2017, shore up by an upsurge in the United States. In Japan and Euro zone, the growth is projected to increase due to intensifying of the domestic export and demand. Investment has compacted across the advanced economies, although the growth of the private consumption has moderated. In advanced economies, the growth is expected to increase to 1.9 percent in 2017, up from 1.7 percent in the year earlier. In emerging market and developing economies (EMDEs), the growth blockage is that the commodity exporters are retreating progressively, while the performance of the commodity importers remains strong. Hence, the growth rate of the EMDEs is predicted 4.1

percent in 2017 by the World Bank, which is higher than 3.5 percent growth rate in 2016.

Figure 1.1: The Global Economic Growth Rate



Source: The World Bank

I. ADVANCED ECONOMIES

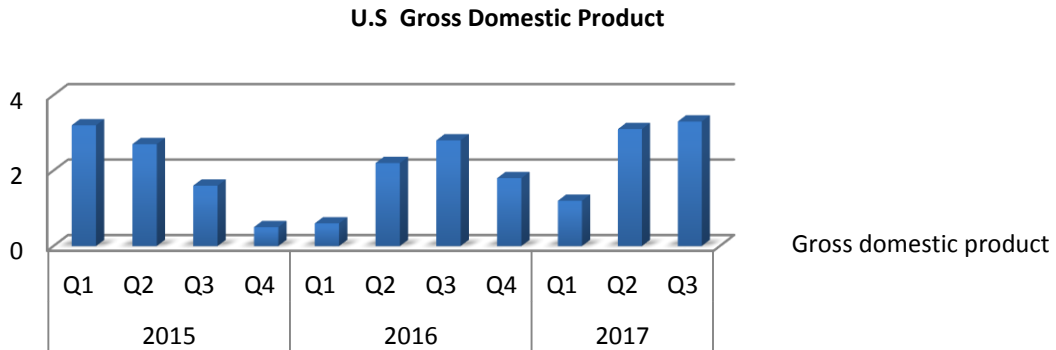
1.1.1 The United States Economy

The real gross domestic product (GDP) of the United States (U.S.) increased by 3.0 percent in the third quarter of 2017 according to the estimate release by Economic Bureau of United State. The boost up in real gross domestic product exposed a positive contributions from private inventory investment, personal consumption expenditures (PCE), non-residential fixed investment, exports, and federal government spending. While in the third quarter of 2016,

the real GDP of the U.S. increased by 2.8 percent. The growth in the real GDP was essentially due to the personal consumption expenditures (PCE), exports, private inventory

investment and federal government spending, while the residential fixed investment and state and local government spending contributed negatively to the increase in the GDP.

Figure 1.2: The US Real GDP Growth Rate Q1, 2015- Q3, 2017

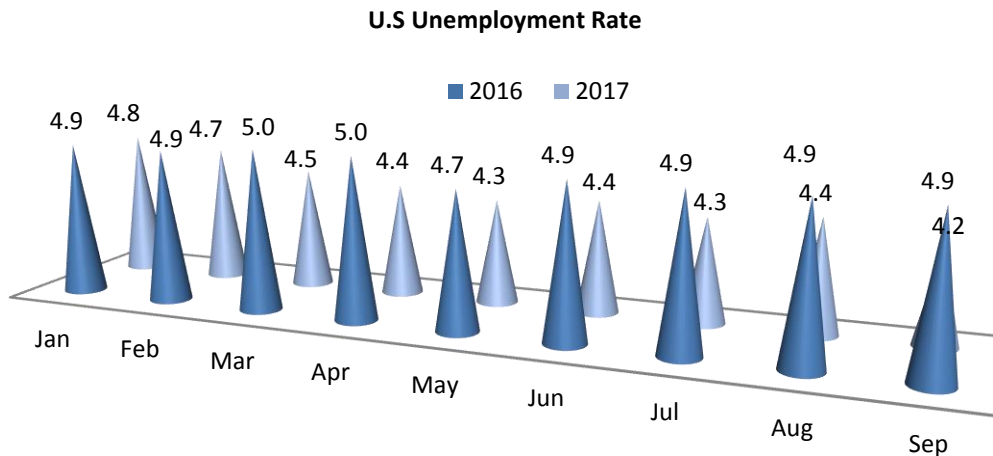


Source: Bureau of Economic Analysis, U.S. Department of Commerce

The U.S. unemployment rate edged down to 4.2 percent in October 2017. From the third

quarter of 2016 to the third quarter of 2017, productivity increased by 1.5 percent.

Figure 1.3: The US Unemployment Rate from Jan, 2016 – Oct 2017

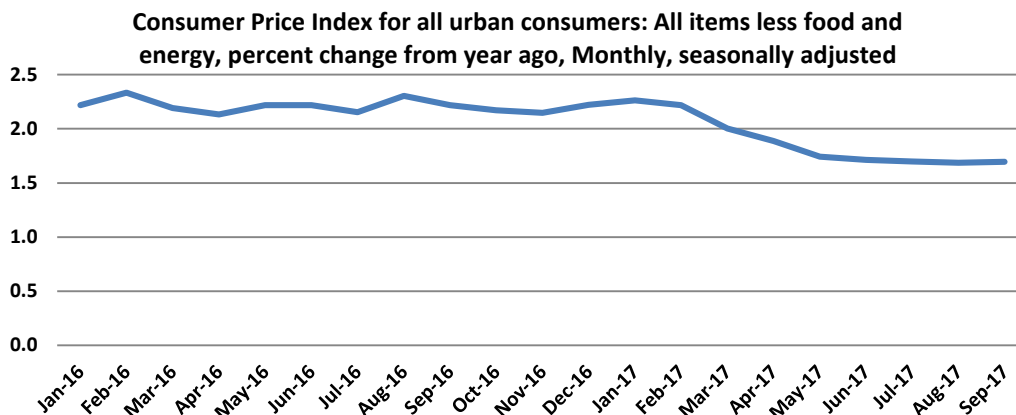


Source: Bureau of Labor Statistics, US Department of Labor

The U.S. consumer price index (CPI) for all urban consumers (all items) rose by 1.7 percent in third quarter of 2017 as compared to

2.2 percent in the same quarter of 2016 which indicates a decline in inflation rate.

Figure 1.4: US CPI for all urban consumers (all items)



Source: Bureau of Labor Statistics, US Department of Labor

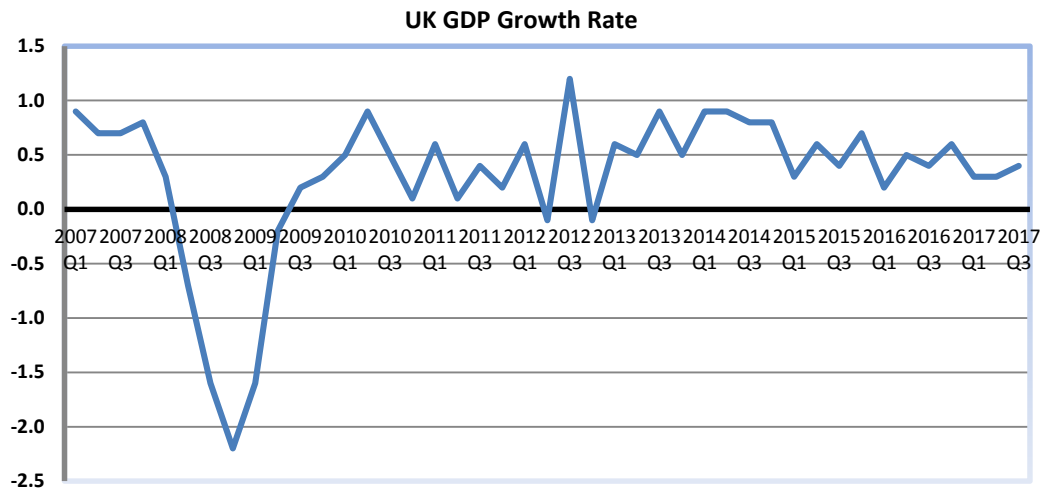
The U.S. international trade (goods and services) deficit stood at USD 43.5 billion in the third quarter of 2017 up by USD 0.7 billion in the previous month of August. While it has to be mentioned that the international deficit soared up to 9.3 percent (\$34.5 billion) from the same period in 2016. Exports increased by \$93.0 billion or 5.6 percent. Imports also increased by \$127.5 billion 6.3 percent.

1.1.2 The Economy of United Kingdom

The gross domestic product (GDP) of UK was estimated to have increased by 0.4% between

quarter two and quarter three of 2017. The growth rate in household final consumption and expenditure hold up to 0.6% between quarter two and quarter three of 2017. In the meantime, services such as agriculture, production, construction and services continue to be the strongest contributors to GDP growth during the third quarter 2017, where agriculture increase by 0.2%, production increased by 1.1%, construction decreased by 0.9% and services increased by 0.4%.

Figure 1.5: The UK GDP Growth from Q1, 2007 - Q3, 2017

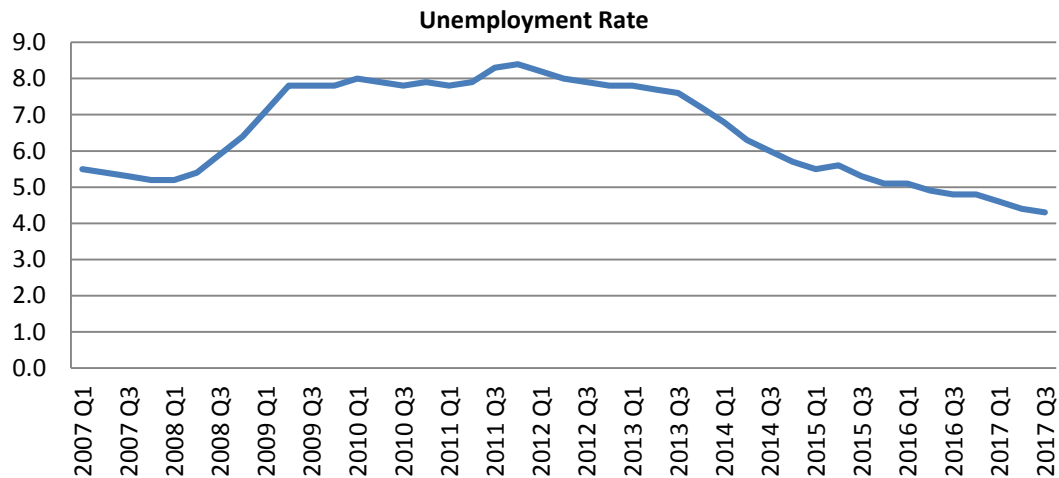


Source: Office for National Statistics, U.K.

The unemployment rate of U.K. declined to 4.3 percent in the third quarter of 2017 sliding down from 4.8% year earlier. The number of people in work reached 32.06 million which is 14,000 lower than the figure of April to June 2017, but it shows an increase of 279,000 than year earlier although the number of

unemployed people declined by 182,000 during the third quarter compared to the same period of the previous year. Meanwhile, it has to be mentioned that the employment rate was 75% in the third quarter of 2017 up from 74.4% compared to the same period of FY 2016.

Figure 1.6: The UK Unemployment Rate from Q1, 2007 - Q3, 2017

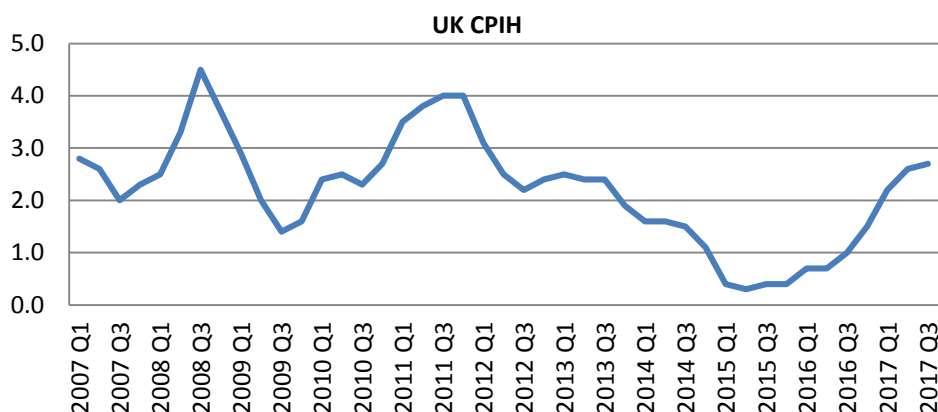


Source: Office for National Statistics, UK

The annual inflation rate of U.K. reached 2.8 percent during the period under review, up from 1.0% in the same period of 2016. The main contributor for raising the inflation rate is inflation of non-alcoholic beverages and food which continuously increased to 4.1% reaching

its peak level since September 2013. The upward contributions were offset by declining fuel of motors and prices of furniture along with owner occupiers' housing costs, which have risen in September 2017 compared to a year ago.

Figure 1.7: The U.K. CPIH Rate from Q1, 2007 – Q3, 2017



Source: Office for National Statistics, U.K.

The foreign trade deficit (goods and services) of U.K. widened by GBP 3.0 billion to 9.5 billion in the third quarter of 2017. This was mainly due to boost up in imports of goods such as machinery, fuels, unspecified goods (including non-monetary gold) and moderately offset by a drop-off in imports of aircraft. Although the import of goods from EU and non-EU countries increased by GBP 0.9 billion in the last three months till September 2017, the total trade deficit of UK broadened as a result of a momentous increase in imports in contrast with exports which has almost doubled to £14.8 billion third quarter of 2017.

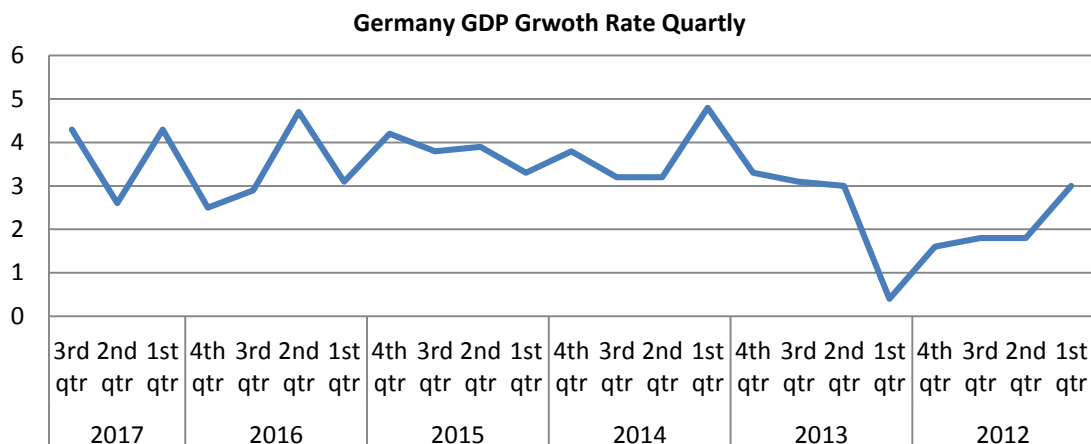
Meanwhile, total trade deficit of UK excluding erratic commodities constricted by GBP 0.1 billion reaching GBP 3.8 billion between August to September 2017.

1.1.3 The Economy of Germany

The GDP of Germany increased by 0.8 percent in third quarter of 2017. While comparing to the same quarter of 2016, the GDP shows an increase of 0.5 percent. In the mentioned period, the domestic demand contributed positively to the GDP growth.

During the period under review, foreign trade played key role in GDP, whereas exports of goods and services rose by 1.7% and imports increased less markedly (+0.9%) than exports in the previous quarter. Arithmetically, the balance of import and export have great impact on the gross domestic product growth.

Figure 1.8: The GDP Growth Rate of Germany Q1, 2012 – Q3, 2017

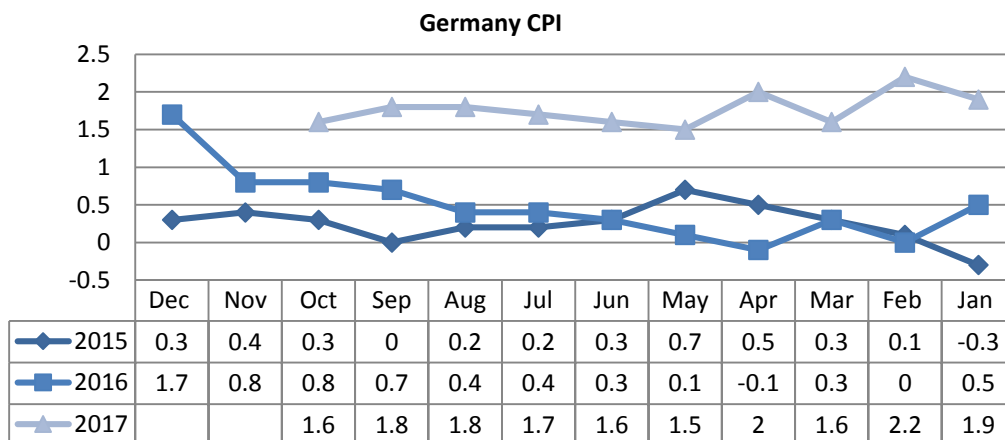


Source: Federal Statistics Office (DESTATIS), Germany

The consumer prices in Germany increased by 1.8 percent in September 2017, while the CPI rate was recorded at 0.6 percent in the third quarter of 2016. Comparing the overall inflation rate of Germany, the overall prices of goods increased by an average above 2.2% during the third quarter of 2017 from a year earlier,

which was mostly because of an increase in food prices (+3.6%) and energy prices (+2.7%). Noteworthy that year-on-year increase in prices was also witnessed for other goods, particularly for products (+4.3%), newspapers and periodicals (+5.2%) and tobacco.

Figure 1.9: CPI of Germany Q1, 2015- Q3, 2017



Source: Federal Statistics Office (DESTATIS), Germany

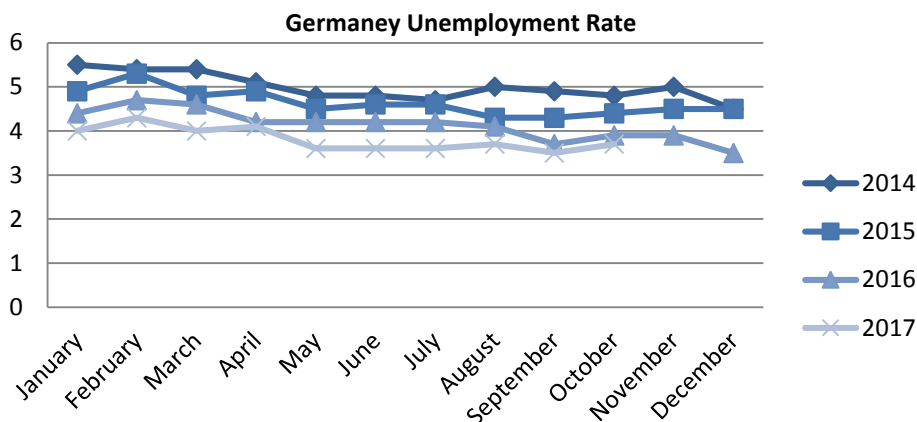
The unemployment rate of Germany stood at 3.5 percent in September 2017. In October 2017, around 44.6 million people resident in Germany were in employment according to the

report released by Federal Statistical Office (Destatis). While in October 2016, the number of people in employment rose by 1.5% (65000). In October 2017, approximately 1.6

million people were unemployed, which is 92,000 lesser than a year earlier. According to provisional results of the employment

accounts, the figure of persons in employment as of October 2017 rose by 105,000 (0.2%) in the previous month due to the autumn upturn.

Figure 1.10: The Unemployment rate of Germany Jan, 2014-Dec, 2017



Source: Federal Statistics Office (DESTATIS), Germany

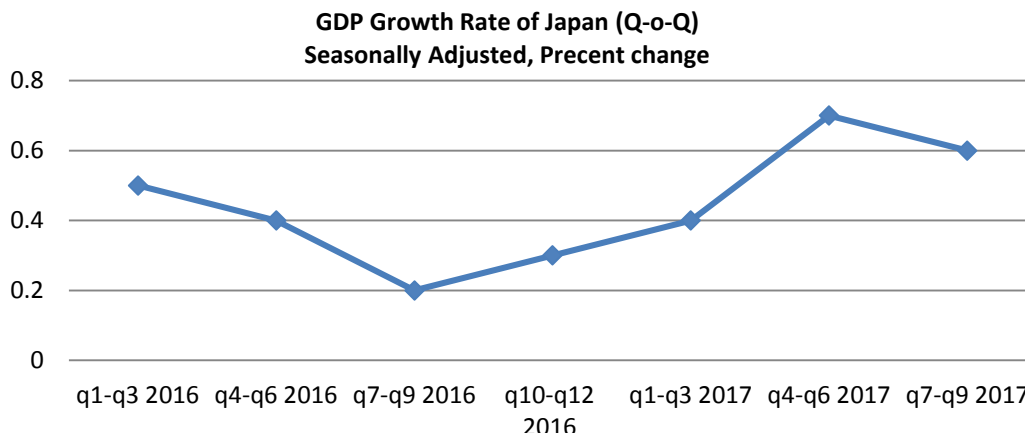
German exported goods reached 110.394 billion Euros and imported goods worth 86.292 billion Euros in October 2017. Based on provisional data, the Federal Statistical Office (Destatis) also reports that German exports and imports increased by 4.6 percent and 5.5 percent respectively in September 2017. The foreign trade balance showed a surplus of 24.1 billion Euros in September 2017, while in September 2016, it was recorded at 23.7 billion Euros. In third quarter 2017, Germany exported goods amounting 65.0 billion Euros to the state member of the European Union (EU), whereas imported goods amount 57.6 billion Euros from those countries. While it has to be mentioned that in September 2016, exports to EU countries increased by 3.3 percent and imports rose by 4.7 percent. Goods to the value of 40.8 billion Euros were sent out to EU countries, while the value of the goods

received from those countries was 38.1 billion Euros during the third quarter of 2017.

1.1.4 The Economy of Japan

The GDP of Japan (seasonally adjusted) increased by 0.6 percent (Q-o-Q) in third quarter of 2017 supported by exports, while business spending grew much faster than expected. On an annualized basis, the economy grew by 2.5 percent, stronger than the estimate of 1.4 percent which is higher than market expectations of 1.5 percent growth. Japan GDP growth averaged 0.50 percent from 1980-2017, where the highest growth was recorded at 3.20 percent in the second quarter of 1990 and the lowest at 4.90 percent in the first quarter of 2009.

Figure 1.11: The GDP growth rate of Japan from Q1, 2016 – Q3, 2017



Source: Cabinet Office, Japan

The unemployment rate of Japan was 2.8 percent in third quarter of 2017, same as the previous quarter. The unemployment rate during the third quarter of 2017 remained at its lowest in 23 years. In the meantime, the jobs-to-applicants ratio was recorded at 1.52, same as the preceding period, whereas market expected the ratio was recorded at 1.53. The ratio stayed at its highest level since February 1974.

In contrast to the previous month, there were 1.88 million unemployed, 2000 more than the figures in August. Employment turned down by 15 thousand to 65.50 million after rising by 20 thousand in a month earlier. A year earlier, unemployment was higher at 3.0 percent.

Japan's consumer price index (CPI) increased by 0.7 percent in September of 2017, the same as in the previous month and matching market consensus.

In the period under review, prices of food increased at a faster rate of one percent from a year earlier (from 0.9 percent rise in August),

namely fresh food (1.2 percent from 0.8 percent), fish and seafood (5.6 percent from 4.2 percent) and fresh fruits (3.6 percent from 3.4 percent). At the same time, prices of dairy products and eggs fell at a slower pace for (-0.4 percent from -0.6 percent).

Likewise, prices of fuel, light and water charges increased more than in a month earlier to (6 percent from 5.2 percent in August), mostly due to higher cost of electricity (7.9 percent from 7.0 percent). It has to be mentioned that the CPI of Japan was 0.10 percent in third quarter of 2016.

II. EMERGING MARKET ECONOMIES

1.2.1 The Economy of China

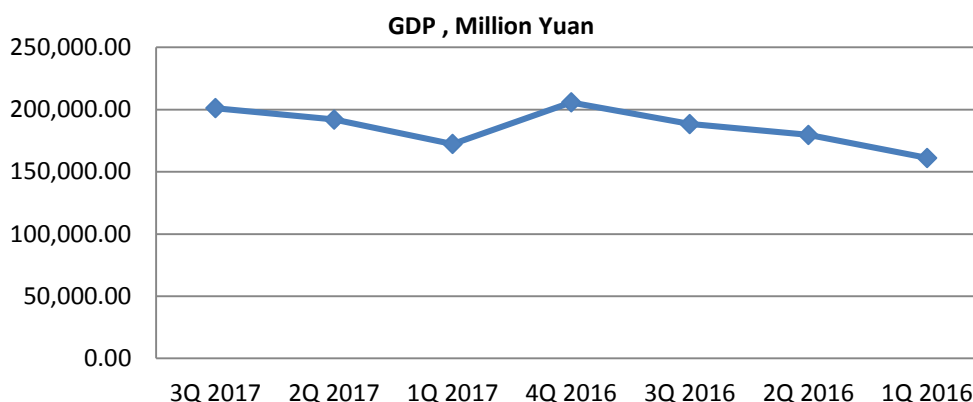
China's gross domestic product increased by 6.8 percent in the third quarter from a year earlier, slowing down from a 6.9 percent gain in the first half of the year and an uptick on last year's 6.7 percent expansion.

China's fixed-asset investment slowed during the third quarter though the monthly retail sales and industrial output picked up.

The investment of nominal fixed assets growth turned down, but still strike an expectation of 8.6% year-on-year for the first half of 2017. Exports rebounded after a weak performance during the first quarter, on the back of stronger global demand.

With regard of services and consumption, the services sector rose by 7.7 percent year-on-year, while construction and industry increased only by 6.4 percent. Retail sales sustained their rapid expansion with a growth rate of approximately 10 percent year-on-year.

Figure 1.12: The GDP Growth Rate of China Q1, 2016-Q3, 2017



Source: National Bureau of Statistics of China

In third quarter of 2017, the consumer price index (CPI) raised up by 1.6 percent year-on-year. The prices increased by 1.4 percent in rural areas and 1.7 percent in cities. Meanwhile, the food prices decreased by 1.4 percent but non-food prices grew by 2.4 percent. Although the prices of services grew by 3.3 percent and prices of consumer goods went up by 0.7 percent. Taking the average from January to September, consumer prices went up by 1.5 percent from the same period of the previous year.

In September, the CPI grew by 0.5 percent month-on-month, whereas the prices increased by 0.6 percent in rural areas and 0.5 percent in

cities. The food prices increased by 0.5 percent and the non-food prices grew up by 0.5 percent. At the same time, prices of services and consumer goods increased by 0.7 percent and 0.4 percent respectively.

China's Unemployment Rate remained the same at 3.95 % in the third quarter of 2017, same as reported in June 2017, while the average rate was recorded at 4.09 percent. The unemployment rate reached its highest rate of 4.30 percent in Dec. 2009 and witnessed the lowest at 3.00 percent in June 2000. In the meantime, China's population reached 1,382.71 million in Dec. 2016. The

country's Labor Force Participation Rate dropped to 70.54 % in late 2017.

The trade surplus of China declined sharply to USD 28.61 billion during the third quarter of 2017 from USD 42.94 billion in the same period a year earlier. It was the smallest trade surplus since March, as imports improved. China's imports jumped to 18.6 percent from the previous year to USD 169.79 billion in third quarter of FY 2017. The country's iron ore imports rose to a record of 103 million tons, while copper imports were the highest since March. Also, imports of soybean rose by 12.7 percent to 8.1 million tons, boosted by faster-than-expected loading of beans in South America, while exports rose by 8.1 percent to USD 198.26 billion, below forecasts of 8.8 percent but beating 5.5 percent of August.

1.2.2 The Economy of India

The GDP of India grew to 6.3% in the third quarter of 2017, in line with independent estimates, compared with 5.7% growth in the second quarter of 2017 and 7.5% in the year earlier. However, manufacturing activities accelerated due to restocking of warehouses by companies after short term interruption caused by uncertainties surrounding implementation of goods and services tax (GST). At the same time, it has to be mentioned that agriculture sector slowed down to 1.7% in the third quarter from 2.3% in second quarter due to unfavorable Kharif output, manufacturing sector grew by 7% against 1.2% during the same period,

electricity generation and mining output also grew faster than the first quarter at 5.5% and 7.6% respectively. Nevertheless, most of the services sectors decelerated including the public expenditure which grew at 6% in the second quarter against 9.5% in the first quarter.

The Consumer price index of India was 3.28% in third quarter of 2017, while data revealed shows that the consumer price of food rose by 1.25% in September, slower than 1.52% in August, 2017. In the meantime, the Index of Industrial Production grew by 4.3% in August, after rising 0.9% in July and index of non-food categories such as 'fuel and light' segment's inflation rate accelerated to 5.56% in September, though other noteworthy products such as milk-based products increased by 3.87%, meat and fish recorded a rise of 3.19%. The inflation also turned down for prepared meals, snacks, sweets etc. to 5.06%, confectionery and sugar 6.77% and non-alcoholic beverages 2.22% during the third quarter of 2017. The overall index from April-August period, as compared to the same period in 2016, grew by 2.2%.

Exports of India during the third quarter of 2017 grew by 25.67 percent in dollar terms valued at US \$ 28613.41 million as compared to US \$ 22768.35 million during the third quarter 2016. During the period under review, ten commodity groups of export have shown positive growth over the corresponding month of last year comprising 82.14% share in total exports. These are Gems and Jeweler

(7.10%), Engineering Goods (44.24%), Petroleum Products (39.69%), Organic & Inorganic Chemicals (46.06%), RMG of all Textiles (29.39%), Drugs & Pharmaceuticals (14.67%), Cotton Yarn/Fabrics./made-ups, Handloom Products etc. (15.20%), Marine

Products (32.73%), Rice (45.66%) and Electronic Goods (14.32%). The trade deficit for September 2017 was estimated at US \$ 8984.29 million, which was 0.95 per cent lower than the deficit of US \$ 9070.67 million during third quarter, 2016.

Figure 1.13: GDP Annual Growth Rate of India January, 2015- September, 2017



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

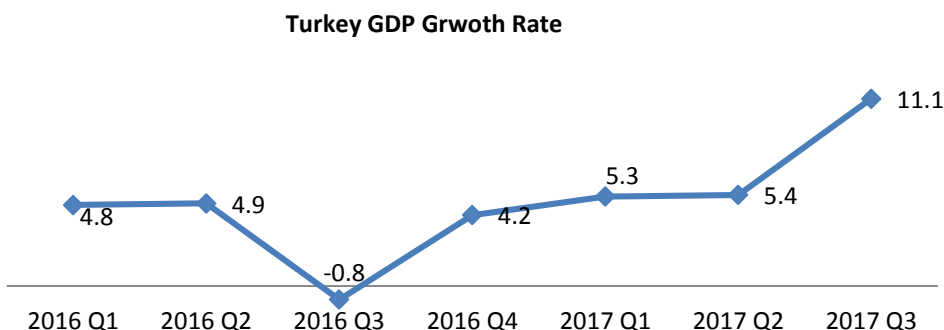
1.2.3 The Economy of Turkey

The GDP of Turkey increased by 11.1% in the third quarter of 2017 as compared with the same quarter of the previous year. Gross domestic product increased by 24.2% and reached 827230 million TRY current prices. The agricultural sector increased by 2.8%, industry sector by 14.8%, construction sector

18.7%, services sector by 20.7% in (wholesale and retail trade, transport, storage, accommodation and food service activities) compared with the same quarter of the previous year.

The calendar adjusted gross domestic product denotes that GDP in the third quarter of 2017 increased by 9.6% compared with the same quarter of the previous year.

Figure 1.14: The GDP Growth Rate of Turkey Q1, 2016 - Q3, 2017



Source: Turkish Statistical Institute

The inflation rate of Turkey declined to 9.8 percent during the third quarter of 2017, from 10.9 percent in the previous quarter, while the inflation rate was recorded at 11.20 percent in the same period of the previous year. The CPI rose for transportation 1.58%, miscellaneous goods and services 1.34%, hotels, cafes and restaurants 1.02% and for clothing and footwear 0.80%, while the index declined only for food and non-alcoholic beverages amongst the main groups by 0.23%.

It also has to be mentioned that in third quarter of 2017 among the average prices of 414 items, the average prices of 61 items remained unchanged, while average prices of 281 items raised and average prices of 72 items decreased. The seasonally adjusted unemployment rate of Turkey was recorded at 10.6 percent with 0.7 percentage point decrease during the third quarter of 2017 and in the meantime, non-agricultural unemployment rate was 12.8% with 0.9 percentage point decrease. While youth unemployment rate including population aged

between 15-24 was 20% with 0.1 percentage point increase, the unemployment rate for population aged between 15-64 was recorded at 10.8% with 0.8 percentage point decrease.

It is worth to mention that number of unemployed population aged 15 years old and over shrunk by 104 thousand to 3 million and 419 thousand in the third quarter of 2017, compared with the same period of the previous year.

The foreign trade deficit of Turkey was 8.135 billion dollars in the period under review with a 85% increase compared to 4.362 billion dollar in the third quarter of 2016.

In the third quarter of 2017, the exports were 11.848 billion dollars with a 8.7% increase and imports were 19.982 billion dollars with a 30.6% increase compared to 10.935 billion and 15.296 billion dollar in the third quarter of 2016. However, in third quarter of 2017, exports coverage imports was recorded at 59.3%, while it was reported at 71.3% in the third quarter of 2016.

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**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 slightly increased by 1.11 percent, which is lower than 5.63 percent observed in the same period in 2016. Currency in circulation CiC, as an important component of RM recorded a negative growth of 0.33 percent in the third quarter from a positive growth of 0.10 percent in the previous reporting period. Another component of RM is commercial banks deposit with the central bank (Overnight Deposits, Required Reserves and Current Accounts), which increased by 8.45 percent at the end of third quarter of FY 2017 from 19.9 percent in the previous quarter.

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 period under review.

Since the beginning of the FY 2017 until 22nd September, DAB experienced accumulation of 5.62 percent (USD 385 million) in net international reserve (NIR).

Narrow money (M_1), stood at AF 412,843 million at the end of the third quarter, registering a growth rate of 4.83 percent (Y-o-Y). Broad money (M_2) demonstrated similar behavior, representing a growth rate of 6.02 percent (Y-o-Y) standing at AF 450,437 million.

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

During the first three quarters of FY 2017, DAB has auctioned a total amount of USD 1,538.24 million to absorb the excess liquidity from the market as well as to mitigate sharp fluctuations in the exchange rate of Afghani. The total outstanding amount of CNs stood at AF 41.570 billion at the end of this reporting period. During the first three quarters of the year, Afghani valued against the US dollar has depreciated by around 2.1 percent.

I. MONETARY PROGRAM

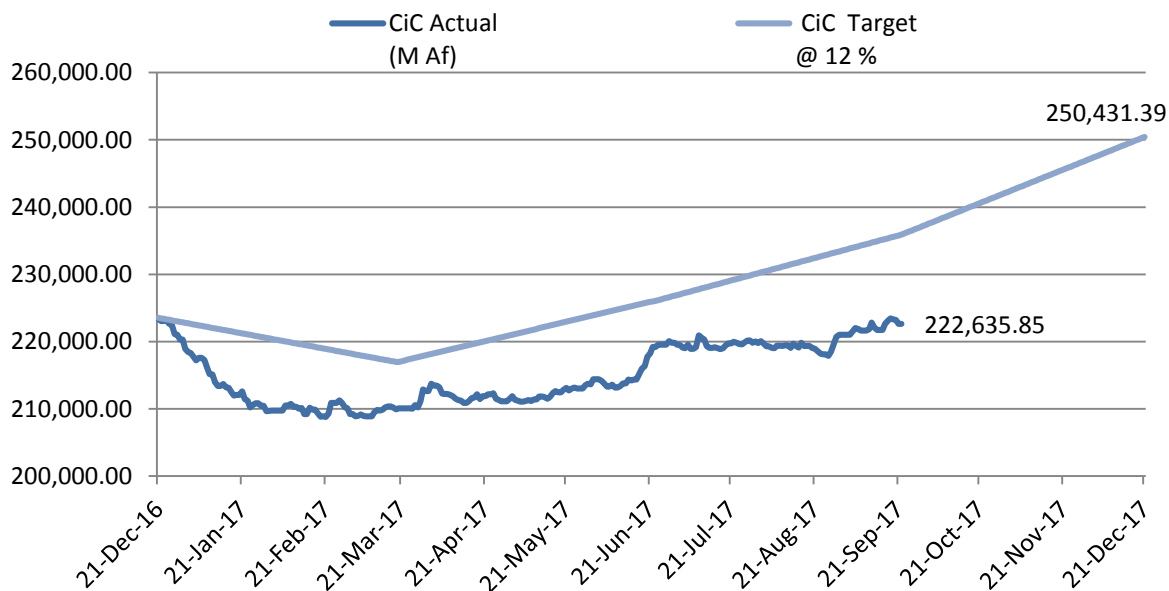
Based on Da Afghanistan Bank monetary policy framework, reserve money is the operational

target (performance criterion), while currency in circulation is considered as indicative target. DAB applies quantitative theory of money to determine the amount of reserve money 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 third quarter of current year, actual RM grew by 1.11 percent, and actual CiC recorded a negative growth of 0.33 percent, which are well under the selected

target. Average inflation rate for the third quarter of current fiscal year stood at 4.5 percent and projected GDP growth is 3 percent in FY 2017. DAB has auctioned USD 1320.88 million via open market operation and sold USD 217.36 to Brishna, Afghan state owned electricity enterprise to mop up the excess liquidity from the market and prevent intense fluctuations in nominal exchange rate of Afghani especially against internationally convertible currencies.

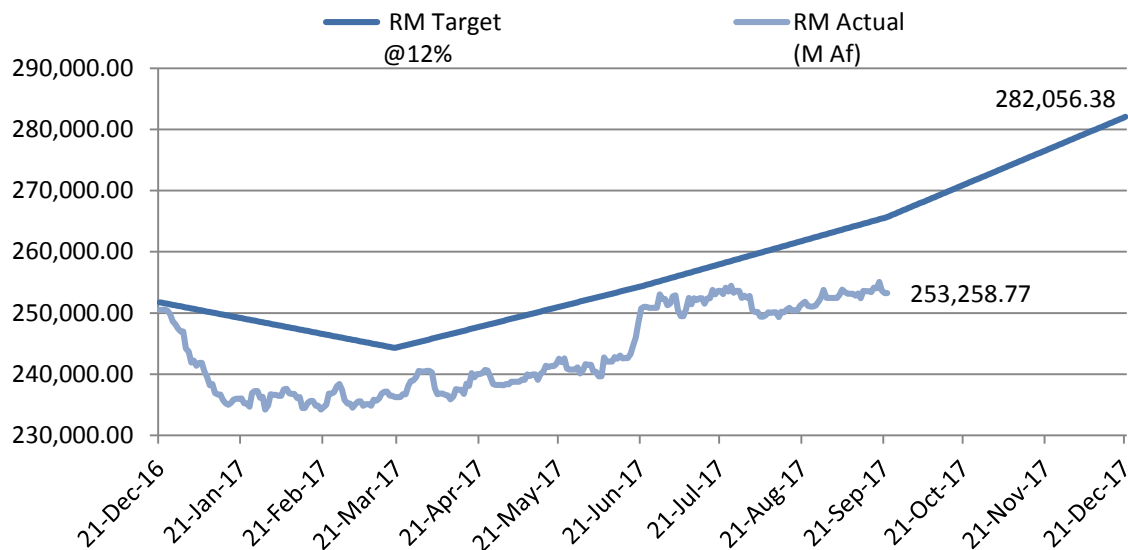
The Figure 2.1 and 2.2 illustrate the ceiling and the actual reserve money and currency in circulation for the quarter under review.

Figure 2.1: Reserve Target and Actual FY 1396 (Dec. 21, 2016 to Dec. 21, 2017)



Source: Monetary Policy Department/DAB

Figure 2.2: CiC Target and Actual FY 1396 (Dec. 21, 2016 to Dec. 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 4.83 percent in the third quarter slightly lower from the same date of FY 2016, which shows a point to point difference of AF 19,034 million. Currency outside depository corporations or CiC, which comprises 52 percent of M₁, grew by 3.39 percent which is lower from 8.4 percent recorded in the same quarter of the previous year. The difference in currency outside depository corporations in comparison to the same date of FY 2016

recorded AF 6,995 millions. Demand deposits which is another component of M1 experienced a growth rate of 6.42 percent 2.2 percent in the same period of the previous year, which shows an increase of AF 12.04 million.

Broad money (M₂) expanded by AF 450,437 million from AF 424,875 million, showing a difference of AF 25,563 million. This figure shows an increase of 6.02 percent lower from 7 percent in the same period of the previous year. Figures show that M1 by comprising 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 21.02 percent (y-o-y). Although the share of this component in M₂ has increased to 8.3 percent in the third quarter of 2017 from 3

percent recorded in the previous year, the impacts of its changes on total M2 is still negligible. Afghani denominated time deposits also increased in the third quarter. The year-on-year difference of these deposits stood at AF 4,359 million showing 40% increase over a one year period. At the time, foreign currency denominated time deposits recorded AF 2,170 million which is 11 percent higher than the previous year's value. Afghani-denominated time deposits and foreign currencies denominated time deposits constitute 3.4 percent and 5 percent of M2 respectively. Demand deposits as a share of broad money remained unchanged at 44 percent (Y-o-Y) at the end of the period under review, comparing to the third quarter of the previous year.

Figure 2.3: NFA, NDA and Broad Money

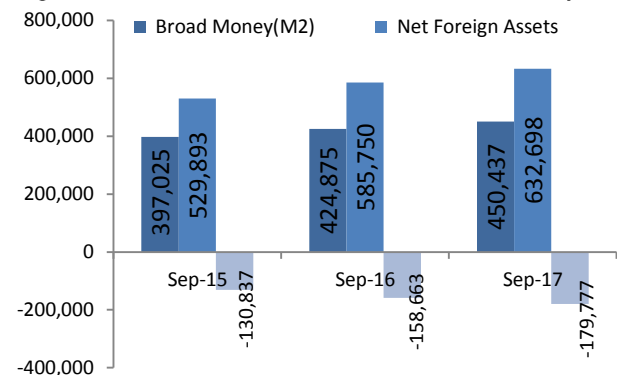
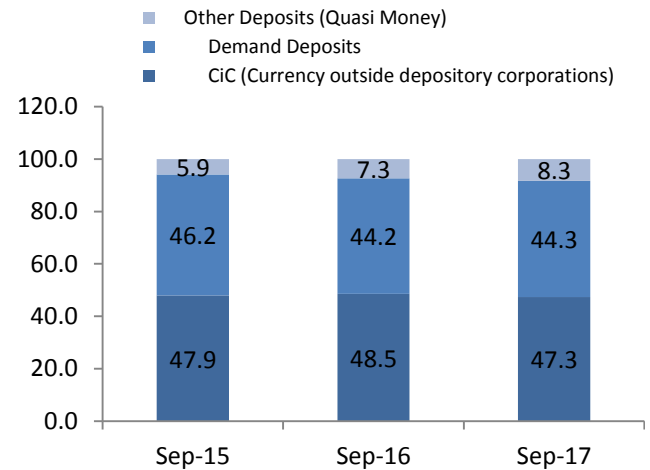


Figure 2.4: CIC, Demand Deposits and Quasi-money as Share of Broad Money (%)



Source: Monetary Policy Department/DAB

Table 2.1: Depository Corporation's (DC's) Analytical Balance Sheet and Monetary Aggregate at the end of third quarter, FY 1396 (Dec. 16 – Sep. 17)

In Million AFN	June – 2015	June- 2016	Y-o-Y Δ	Difference	June - 2017	Y-o-Y Δ	Difference
	Amount	Amount			Amount		
1- Net Foreign Assets	529,893	585,750	10.5%	55,857	632,698	8.02%	46,948
(a) Gross Foreign Assets	538,419	595,982	10.7%	57,563	645,556	8.32%	49,575
Foreign Exchange Reserves	95,398	95,720	0.3%	322	95,826	0.11%	105
Gold	50,783	62,246	22.6%	11,463	62,533	0.46%	287
Other	292,744	331,915	13.4%	39,171	383,269	15.47%	51,354
Other Foreign Assets	99,493	106,101	6.6%	6,607	103,928	-2.05%	-2,173
(b) Foreign Liabilities	8,525	10,232	20.0%	1,707	12,858	25.67%	2,627
2. Net Domestic Assets	-130,837	-158,663	21.3%	-27,827	-179,777	13.31%	-21,114
(a) Net Domestic Credit	-27,602	-46,994	70.3%	-19,393	-54,608	16.20%	-7,614
Net Credit to Non-Financial Public Sector	-72,871	-94,915	30.3%	-22,044	-101,228	6.65%	-6,313
Net Credit to Central Government	-71,562	-95,009	32.8%	-23,447	-101,323	6.65%	-6,313
Credit to Central Government	27,756	27,685	-0.3%	-71	19,457	-29.72%	-8,228
Liabilities to Central Government	99,318	122,694	23.5%	23,376	120,780	-1.56%	-1,914
Net Credit to State & Local Government	0.000	0.000	0.0%	0	0.000	0.000	0
Net Credit to Public Nonfinancial Corporations	-1,309	94	107.2%	1,403	94	0.00%	0
Credit to Private Sector	46,823	49,305	5.3%	2,482	47,770.56	-3.11%	-1,534
Net Credit to Other Financial Corporations	-1,553	-1,384	-10.9%	169	-1,150.40	-16.89%	234
(b) Capital Accounts	133,244	135,072	1.4%	1,828	151,731	12.33%	16,659
(c) Other Items Net	30,009	23,403	-22.0%	-6,606	26,562	13.50%	3,159
3- Broad Money (M2)	397,025	424,875	7.0%	27,850	450,437	6.02%	25,563
Narrow Money (M1)	373,701	393,809	5.4%	20,108	412,843	4.83%	19,034
CiC (Currency outside depository corporations)	190,190	206,175	8.4%	15,985	213,170	3.39%	6,995
Demand Deposits	183,511	187,634	2.2%	4,123	199,673	6.42%	12,039
Other Deposits (Quasi Money)	23,323	31,065	33.2%	7,742	37,594	21.02%	6,529
In Afghani	8,099	10,964	35.4%	2,865	15,323	39.76%	4,359
In Foreign currency	15,225	20,102	32.0%	4,877	22,271	10.79%	2,170
Non-liquid Liabilities	2,032	2,212	8.9%	180	2,483	12.26%	271

Source: Monetary Survey, Monetary Policy Department/DAB

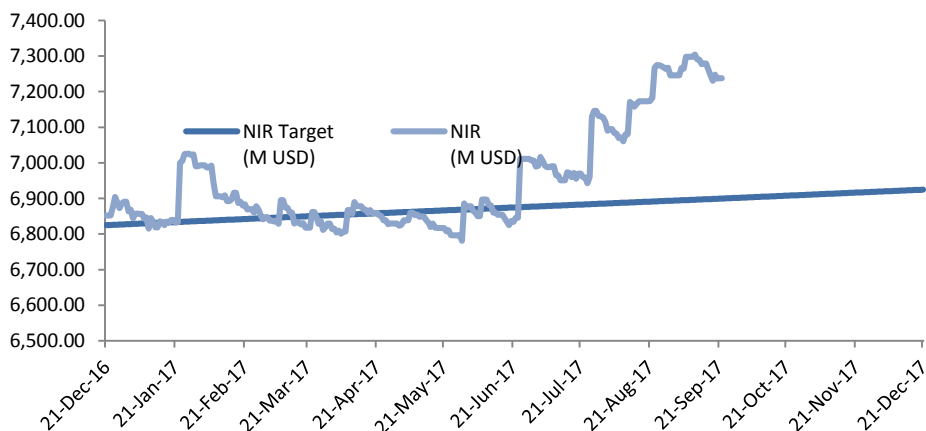
III. NET INTERNATIONAL RESERVE (NIR)

Da Afghanistan Bank’s international reserves consist of monetary gold, reserve position and holdings with the IMF and Special Drawing Rights (SDR) as well as major foreign exchanges 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 increased significantly by 5.62 percent which is equivalent to USD 385.33 million. On 22nd September of FY 2017, the NIR targeted amount was set at USD 6,899.66 million, while in actual case, the total amount of accumulation stood at USD 7,237.26 million. This amount at the end of the previous year was recorded at USD 6,851.93 millions.

Figure 2.5 illustrates actual and target trend of NIR during the first half of FY 2017.

Figure 2.5: NIR actual and target in million USD for the third quarter of FY 1396



Source: Monetary section, Monetary Policy Department/DAB

IV. FOREIGN EXCHANGE MARKET

4.1 Exchange Rates

Da Afghanistan Bank’s (DAB) ultimate goal is to maintain price stability. DAB monitors and intervenes in foreign exchange markets in order to achieve and maintain its primary goal.

During the third quarter 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 AF against the U.S. dollars for

the first three quarter of fiscal year 2017 is shown in figures below.

Figure 2.6: Daily Average Ex-rate of Afghani against USD for the third quarter of FY 1396

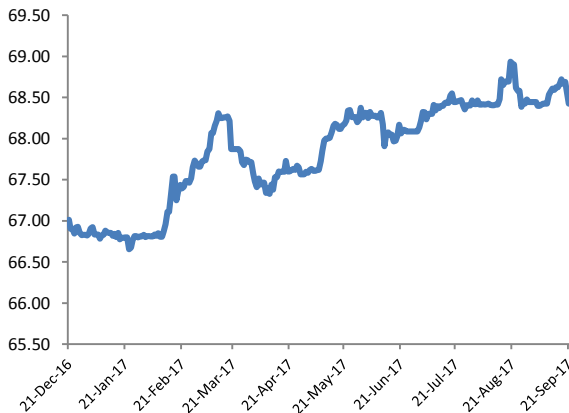
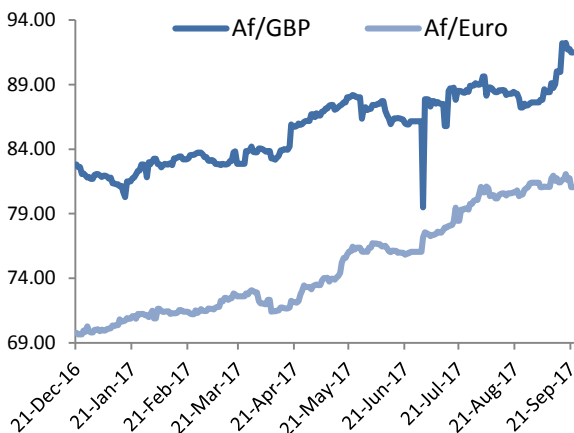


Figure 2.7: Daily Average Ex-rate of Afghani against GBP & Euro for the third quarter FY 1396



Source: Monetary Section, Monetary Policy Department/ DAB

Figure 2.8: Daily Average Ex-rate of Afghani against INR & PKR for the third quarter of FY 1396

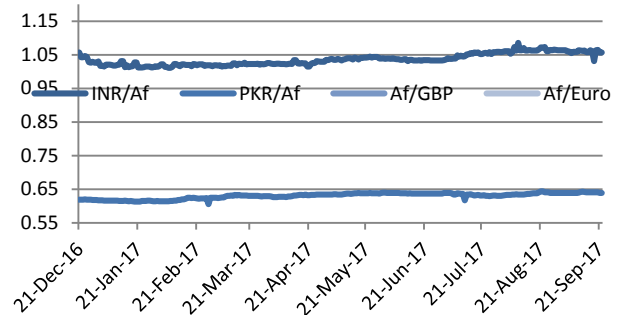
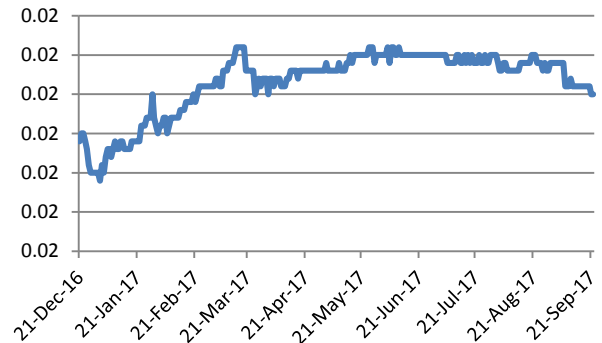


Figure 2.9: Daily Average Ex-rate of Afghani against IRR for the third quarter of FY 1396



Source: Monetary Section, Monetary Policy Department/ DAB

V. OPEN MARKET OPERATION & LIQUIDITY CONDITIONS

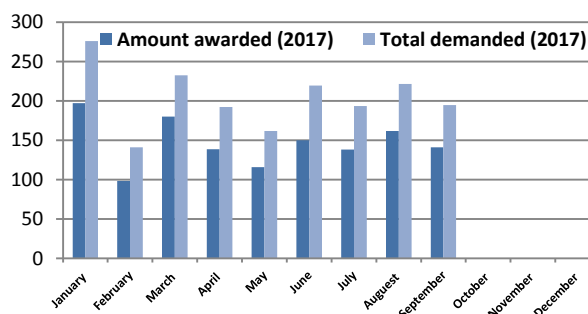
2.5.1 Foreign Exchange Auction

In order to control the liquidity and money supply in the economy, DAB is committed to manage reserve money growth close to its sited ceiling by using FX auctions three times a week, and weekly capital notes auction, as its monetary policy instruments. During this reporting period, DAB continued auctioning

CNs in order to sterilize excess liquidity from the market, and avoid extra volatilities in the exchange rate of Afghani against foreign currencies, especially the US dollar.

During the first three quarters of FY 2017, DAB auctioned a total amount of USD 1320.88 million through open market operation process, while the total demand was USD 1838.01 million. On average, 44 bidders have participated in each auction, and 31 bids were announced as the winning bids. The average amount of USD 12.23 million is sold in each auction. Averages for lowest, highest and cut off prices for each auction was AF 67.62, 67.81 and 67.76 respectively. The data for the same period of FY 2016 recorded higher figures. Total awarded amount was USD 1361.48 million, with a total demand of USD 1910.155 million during FY 2016. On average, 47 bidders participated in each auction and 33 bids were awarded with an average amount of USD 12.61 millions in each auction. Figure 2.10 shows USD auction awarded and demanded amount for the first three quarters of FY 2017.

Figure 2.10: USD awarded and demanded amount in the first three quarters of FY 2017



Source: Monetary Policy Department/DAB

2.5.2 Capital Notes 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 AF 41.570 billion at the end of the third quarter of FY 2017, which shows an increase of 33.63 percent compared to AF 31.108 billion recorded at the same period of the previous year.

The outstanding stock of 7 day notes stood at AF 8890 million, showing lower amount in comparison to AF 1050 million observed in the same date of FY 2016. 28 day CNs outstanding amount stood at AF 2270 million and 91 day outstanding stock of CNs recorded the amount of AF 11808 million. The stock of outstanding for 182 and 364 day notes stood at AF 7990 million and AF 10612 million respectively. Total interest paid to CN figured out to AF 943.96 million at the end of the quarter under review.

In addition, the weighted average interest rate for 7 days capital note was 1.8 percent, for 28 days security it is recorded 3.28 percent, for 91 day notes were 3.47, for 182 days security it ended at 3.23 percent, and for 364 days capital

notes it recorded 6.33 in the first half of FY 2017, which is generally in lower level with small margins during the course of the period under review.

In addition, the weighted average interest rate was 1.8 percent for 7 day capital notes, 3.28 percent for 28 day security, 3.47 percent for 91 day notes, 3.23 percent for 182 day, and 6.33 percent for 364 day capital notes 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 2.11: Capital Notes Outstanding for the third quarter of FY 2017

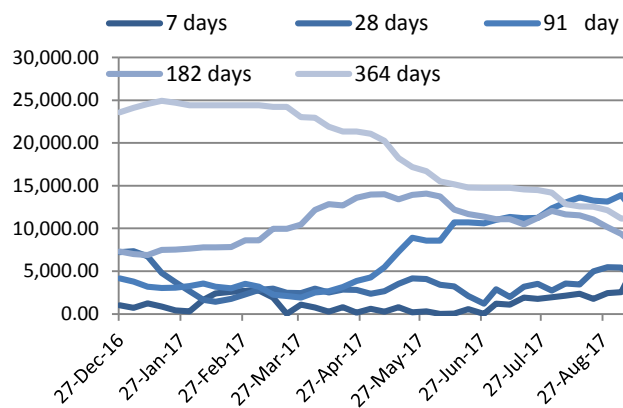


Figure 2.12: 7 Day CNs demanded and awarded amount in Million AF

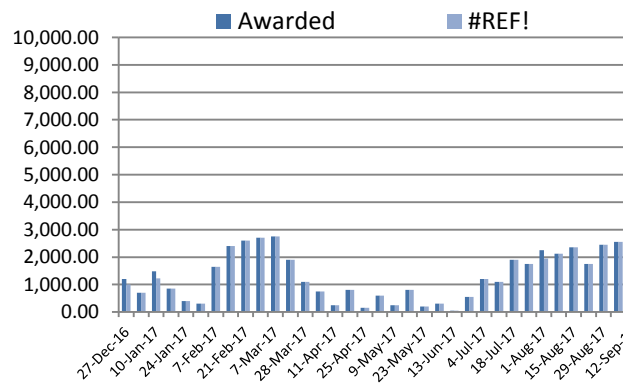


Figure 2.13: 28 Day CNs demanded and awarded amount in Million AF

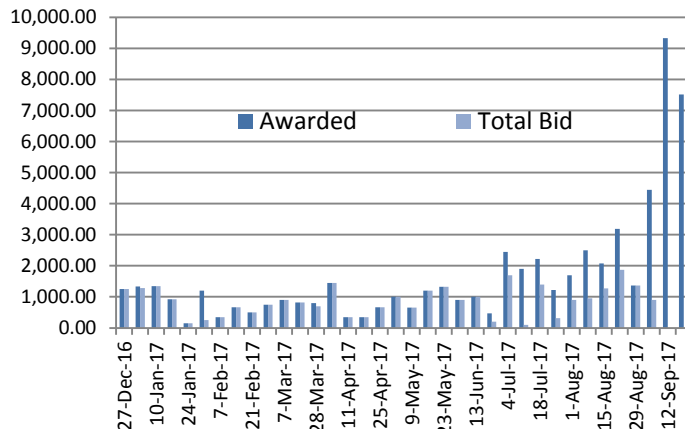


Figure 2.14: 91 Day CNs demanded and awarded amount in Million AF

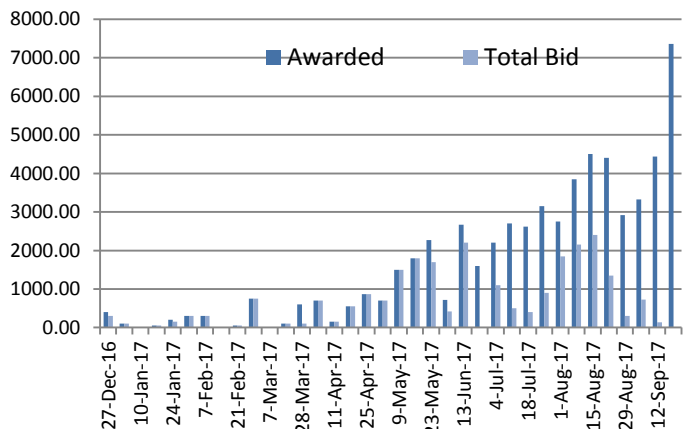


Figure 2.15: 182 Day CNs demanded and awarded amount in Million AF

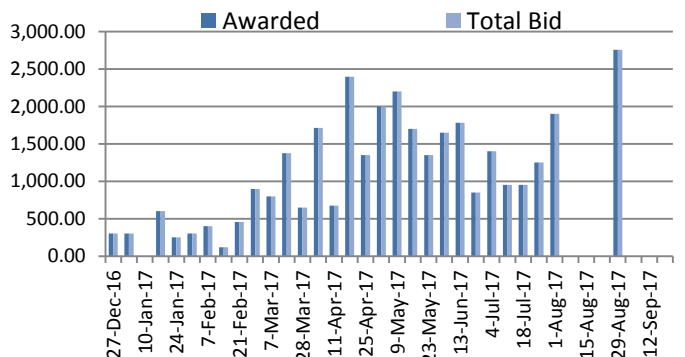
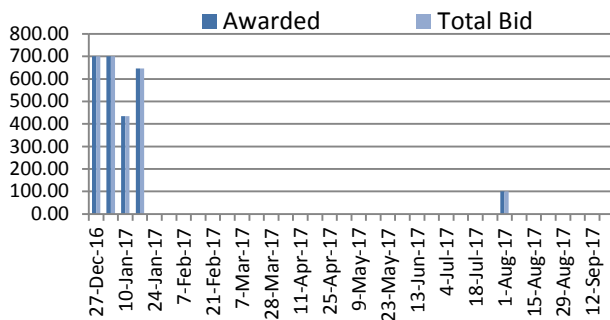


Figure 2.16: 364 Day CNs demanded and awarded in Million AF



Source: Monetary Section, Monetary Policy Department/ DAB

2.5.3 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 stopped paying interest rate for required reserve in 28th June 2015. Since then, no interest has been paid for such deposits to commercial banks.

Overnight Deposit Facility: This facility 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 10 basis points (based on a circular to all banks

approved by DAB supreme council on September 11, 2017).

The average outstanding amount of overnight deposit facility balances recorded AF 16,018 million during the reporting period. At the end of third quarter FY 2017, the payment of interest rate to the mentioned facility stood at AF 29.87 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.



INFLATION TREND AND OUTLOOK

3

INFLATION TREND AND OUTLOOK

Prices of industrial products continued to pick up in the third quarter of 2017, while most agricultural prices remained broadly stable. In the oil market, inventories continued to fall amid strong demand, OPEC production restraint and stabilization in the U.S. shale oil production. Crude oil prices are expected to average USD 53 per barrel in 2017 (up from USD 43 per barrel in 2016) and rise to USD 56 per barrel in 2018, a slight downward revision from the April 2017 forecast. Metal prices are expected to surge 22 percent in 2017 due to strong demand and supply constraints, notably Chinese environmentally-driven supply cuts. With the exception of iron ore, metal prices are expected to increase moderately in 2018. Agricultural prices were broadly unchanged in 2017 and are anticipated to rise marginally in 2018. Most food markets are well-supplied and the stocks-to-use ratios of some grains are forecasted to reach multi-year highs. Energy prices increased by two percent in the third quarter of 2017, led by a 17 percent leap

in coal prices due to strong demand in China as well as several supply constraints. Crude oil prices rose marginally from the previous quarter by 1.6 percent to USD 50.20 per barrel on average. Oil prices indicated a lower trend during the third quarter of FY 2017 mainly due to large inventories, recovery in the U.S. shale oil production and expanding output from the OPEC member countries.

In the third quarter, prices recovered moderately on declining inventories due to strong global demand, improving compliance among the OPEC and non-OPEC producers with agreement and stabilization in the U.S. shale oil production. Natural gas prices in Europe and prices of liquefied natural gas in Asia which are linked to oil were steady.

Non-energy commodity prices also rose by two percent in the third quarter of 2017 with large variations among major groups. Metal prices surged up by 10 percent in the third quarter due to strong demand, particularly in China's property, infrastructure and manufacturing sectors. Precious metal prices

moved up by one percent as a result of solid investment demand and a weaker dollar.

Agricultural prices declined by nearly one percent continuing a trend of weakness that began earlier in the year. Food prices dropped by one percent, reflecting softer prices for maize, rice and other food items such as sugar. Prices of oil and metals moved the trend by gaining one percent on the back of strengthening soybean prices due to smaller than expected North America crop. Prices of beverages increased moderately due to increase in coffee prices. Raw material prices edged up two percent with rises mainly in urea due to strong production outages in North Africa and Middle East.

Consequently, a positive trend has been observed in the prices of global commodity market which also affected Afghanistan's domestic commodity prices accordingly in the third quarter of 2017.

I. CONSUMER PRICE IN AFGHANISTAN

Currently, the consumer price index (CPI) in Afghanistan is compiled on the base prices of April 2015 while previously, the CPI was calculated on the base prices of March 2011. Similarly, in this revision, the CPI components are also aligned with new weights. As per the data from the Central Statistics Organization (CSO) and analysis of Da Afghanistan Bank (DAB), the

following results were observed in the consumer price index of Afghanistan.

The year-on-year measure of changes in the consumer price index showed an inflation rate of 4.5 percent on average in the third quarter of 2017 lower than 7.2 percent recorded in the same quarter of the previous year. The decrease in the inflation rate is in line with low and stable prices of commodities in the global markets. Based on the reports, most items of the global commodity price index indicated lower prices over the last quarter in 2017.

Similar to the year-on-year comparison, the inflation measured on quarter-on-quarter basis also indicated a decline in the period under review.

The Kabul CPI also reflected disinflation in the third quarter of 2017. Observing the Kabul headline CPI, the inflation rate turned to 4.6 percent on average in the third quarter of 2017 from 7.4 percent in the third quarter of the previous year. On quarterly basis, the index decreased to 4.6 percent on average from 7.1 percent in the previous quarter.

1.1 Developments in National Headline CPI

1.1.1 Annual Developments

The headline consumer price index reflected a significant decline on year-on-year basis in the third quarter of 2017. As per the available data, the headline inflation measured on year-on-year basis, declined to 4.5 percent on average in the third quarter of 2017 from 7.2 percent in the same period of last year while

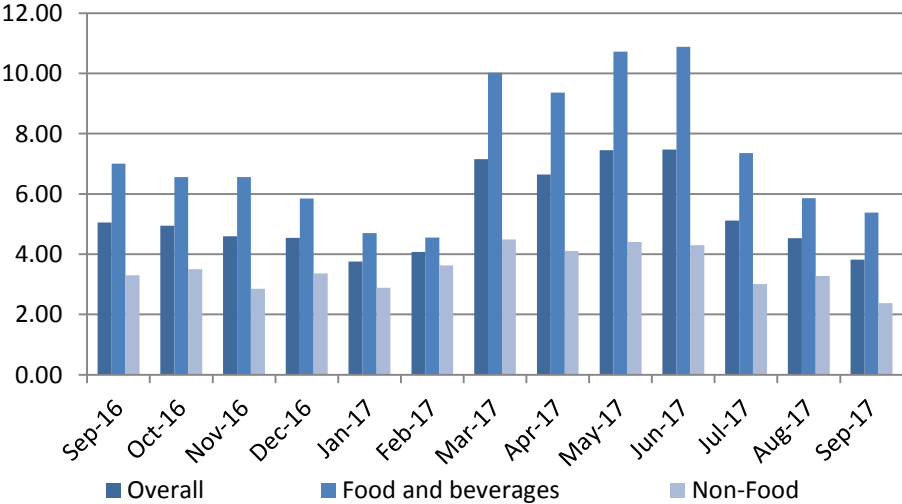
on monthly basis, the inflation rate was recorded at 5.1 percent, 4.5 percent, and 3.8 percent in the months of July, August, and September respectively.

In non-food category, the inflation was strengthened by higher prices of housing, and transportation, while the prices of other items in the mentioned category such as tobacco, clothing, furnishing and household goods, health, communication, information and culture, education, restaurants and hotels contributed negatively to the inflation in the third quarter of 2017. In the mentioned category, the highest increase was noted in the price index of transportation which increased to 6.2 percent on average in the third quarter of 2017 from (-1.0) percent in the same period of previous year. However, the

highest decline was observed in the price index of education which declined to 3.1 percent on average in the third quarter of 2017 from the 17.6 percent in the third quarter of 2016.

The core inflation also showed downward slope in the third quarter of 2017 compared to the third quarter of 2016. The trimmed mean which is the most common measure of core inflation, dropped to 3.1 percent on average in the third quarter of 2017 from 7.8 percent in the same period of last year. In addition, the CPI inflation, excluding bread and cereals, oil and fats and transportation, reached 4.3 percent in the third quarter of 2017 down from 8.0 percent in the same period of previous year.

Figure 3.1: National Headline Inflation (Y-o-Y)



Source: Monetary Policy Department, DAB

Table 3.1: Breakdown of National Inflation Q3, FY 1396

Period	Weight	2016				Weight	2017			
		Based on March-2011					Based on April-2015			
		Jul 16	Aug 16	Sep 16	Q3, 16		Jul 17	Aug 17	Sep 17	Q3, 17
Overall Index	100.0	7.4	7.3	6.9	7.2	100.0	5.1	4.5	3.8	4.5
Food & Non-Alcoholic Beverages	52.0	8.7	8.9	8.3	8.6	47.8	7.4	5.9	5.4	6.2
Bread and Cereals	17.7	7.9	6.0	4.0	6.0	14.6	4.0	4.3	3.2	3.8
Meat	7.2	9.4	11.9	11.3	10.9	7.5	7.3	4.4	4.8	5.5
Milk, cheese and eggs	4.8	3.1	2.6	2.2	2.6	4.7	2.0	2.1	3.7	2.6
Oils and fats	4.0	7.6	7.7	9.8	8.4	4.6	9.1	9.6	6.1	8.3
Fresh and dried fruits	4.8	7.3	4.3	10.0	7.2	5.0	5.9	6.3	6.9	6.4
Vegetables	7.9	9.5	14.9	13.3	12.6	6.0	24.7	18.0	20.2	21.0
Sugar and sweets	2.9	23.7	27.3	24.1	25.1	2.7	3.6	-0.4	-2.9	0.1
Spices	0.9	19.9	20.4	20.0	20.1	1.3	1.1	-3.7	-7.5	-3.4
Non-alcoholic beverages	1.8	6.9	6.9	6.1	6.6	1.4	3.2	2.7	2.3	2.7
Non-Food Items, Tobacco & Services	48.0	5.9	5.6	5.2	5.6	52.2	3.0	3.3	2.4	2.9
Tobacco	0.4	15.9	12.9	13.3	14.0	0.3	8.5	8.8	6.7	8.0
Clothing	7.0	9.4	8.3	7.8	8.5	4.6	1.6	2.5	0.8	1.6
Housing	20.7	3.8	4.1	3.4	3.8	19.1	4.7	5.3	3.7	4.6
Furnishing and household goods	7.0	9.3	9.6	8.6	9.1	11.9	2.3	2.3	1.9	2.2
Health	3.3	9.8	8.6	9.3	9.2	6.2	1.0	0.9	1.2	1.0
Transportation	4.7	-1.2	-1.4	-0.5	-1.0	4.3	7.0	6.4	5.3	6.2
Communication	1.1	0.6	0.4	-0.4	0.2	1.7	-3.3	-2.8	-2.3	-2.8
Information and Culture	0.1	3.5	3.1	1.6	2.7	1.1	-3.5	-3.8	-5.1	-4.2
Education	0.7	13.6	15.9	23.2	17.6	0.4	5.7	3.7	0.1	3.1
Restaurants and Hotels	1.0	0.4	0.9	2.0	1.1	1.1	-0.2	0.2	-0.3	-0.1
Miscellaneous	1.8	9.5	8.5	7.4	8.5	1.4	2.5	2.7	2.8	2.7
CPI ex. B & C, O & F, and T										
30% Trimmed Mean		7.8	8.3	8.0	8.0		5.0	4.2	3.7	4.3

Source: CSO/Monetary Policy Department, DAB

1.1.2 Quarterly Developments in national CPI

The short term measure of inflation reflected similar trend as the annual measure. The national headline inflation calculated on quarter on quarter basis soared to 4.5 percent on average in the third quarter of 2017 from 7.2 percent recorded in the previous quarter.

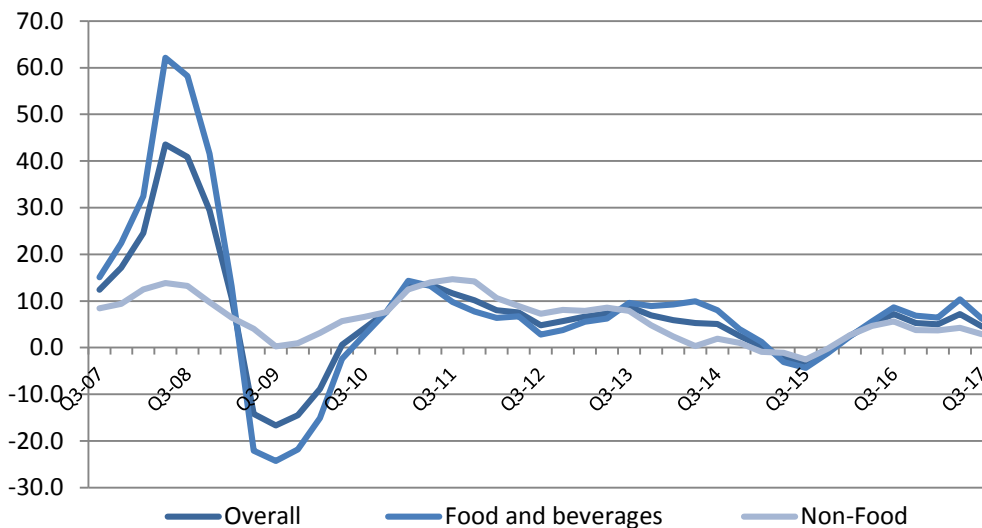
The decrease in the inflation rate was the result of disinflation in the food items. In the meantime, the non-food category also showed a lower rate of inflation compared to the same period of previous year.

On quarterly basis, the food inflation declined to 6.2 percent on average in the third quarter of 2017 from 10.3 percent in the third quarter of 2016. The price indices of food items such as vegetables, oil and fats, fresh and dry fruits, sugar and sweets, and spices decreased dramatically but the prices of meat increased slightly from the previous quarter. However, in this category, the largest quarterly decreases were recorded in spices, and sugar and sweets price indices which were recorded at (-3.4) percent and 0.1 percent respectively.

On the other hand, the non-food inflation also decreased to 2.9 percent on average in the

third quarter of 2017 from 4.3 percent in the previous quarter. In this category, the prices of education and miscellaneous items decreased dramatically. The education index declined to 3.1 percent in the third quarter from 7.0 percent in the previous quarter and similarly miscellaneous index decreased to 2.7 percent in the third quarter from 6.3 percent in the last quarter. Moreover, the inflation in the communication index was recorded at (-2.8) percent in the third quarter compared to (-4.0) percent in the previous quarter.

Figure 3.2: Quarterly Average National Headline Inflation



Source: CSO/Monetary policy Department, DAB

1.2 Developments in Kabul CPI

1.2.1 Annual Developments

The headline CPI inflation in Kabul declined to 4.6 percent on average in the third quarter of 2017 from 7.4 percent in the third quarter of the previous year.

The food index, which is accounted for 37.2 percent of the overall weight of the overall index, reflected a disinflation in one-year period. In this category, the disinflationary pressures came from lower prices of meat, sugar and sweets, fresh and dry fruits, spices and non-alcoholic beverages. As a result, the food inflation decreased to 7.7 percent on average in third quarter of 2017 from 9.3 percent in the same quarter of 2016.

The inflation of non-food items which comprise 62.8 percent weight of the whole index, decreased to 2.7 percent on average in the third quarter of 2017 from 6.0 percent in the same period of last year. The decrease is mainly attributed to lower prices of clothing, furnishing and household goods,

communication, restaurants and hotels, information and culture, and miscellaneous items. However, in this category, the inflation in housing and transportation increased to 6.3 percent and 4.6 percent on average in the period under review from 2.9 percent and (-1.0) percent recorded in the same period of last year respectively.

On the other hand, the core inflation excluding bread & cereals, fats and oils and transportation also indicated a decline in the period under review compared to the same period of the previous year. During the period under review, the core inflation rate stood at 4.5 percent on average, while the rate was recorded at 10.2 percent in the third quarter of 2016. The 30% trimmed mean reflected an inflation of 2.6 percent on average in the third quarter of 2017 compared to 8.8 percent in the same quarter of 2016.

1.2.2 Quarterly Developments in Kabul CPI

The quarter on quarter measure of headline inflation in Kabul indicated downward movement which reflects disinflation in both food and non-food items of the CPI. The headline inflation in Kabul declined to 4.6 percent on average during the third quarter of 2017 from 7.1 percent recorded in the previous quarter.

The inflation in the food index declined to 7.7 percent on average in the third quarter of 2017 from 11.8 percent in the previous quarter. In this category, the prices of meat, vegetables, fresh and dried fruits, oils, fats and sugar and sweets decreased which led to higher disinflation rate. In this category, the highest decline was observed in the price index of sugar and sweets which turned to 6.0 percent on average in the third quarter the current year from 18.6 percent in same period of previous quarter. Moreover, the inflation in the bread and cereals index showed an increase on quarterly basis which picked up to 3.5 percent on average in the third quarter from 2.5 percent in the previous quarter.

The Non-food category of the CPI also contributed to lower disinflation rate during the third quarter of 2017. Inflation in this category reached 2.7 percent on average in the third quarter of 2017 compared to 4.3 percent in the previous quarter. The decrease in non-food inflation is mainly driven by lower

prices of clothing, housing, furnishing, transportation, and education, and miscellaneous items among which the largest decrease was observed in the inflation of miscellaneous items which declined to 2.0 percent in the third quarter of 2017 from 15.8 percent in the previous quarter.

The prices of many items of the non-food index were affected in a negative manner by seasonal changes, while the prices of housing and meat declined mainly due to lower demand. During the period under review, up and down changes in the prices were observed which were due to major supplies of gas and oil, development of farms and smooth trade with neighboring countries. In addition, the sound domestic goods production conditions as well as better equilibrium in supply and demand also contributed to the disinflation.

Considering the effects, the government took prompt action and inaugurated Chabahar port in Iran as an alternative route for importing goods. Besides, the government also signed agreements with Tajikistan, Uzbekistan and Kyrgyzstan to ease trade and to cope with the shortage of aggregate supply. Moreover, the government in cooperation with international allied countries has been working for further improvements of the agricultural and industrial sectors to decrease imports and promote domestically produced goods and services.

In Afghanistan, inflation will be influenced by the developments in the agricultural, industrial, and services sectors and increasing prices of commodities in the global markets. According to the World Bank, the energy prices are expected to increase by 4 percent in 2018 after a projected 24 percent leap in 2017. In the meantime, the projection for non-energy prices show a 1 percent gain

in 2018, a marginal upward revision from the start of 2017.

The near-term outlook of inflation in Afghanistan is likely to remain steady. Da Afghanistan Bank forecasted the national headline inflation rate in range between 3 to 4 percent for the fourth quarter of 2017.

Figure 3.3: Kabul Average Inflation Q3, 2008- Q3, 2017

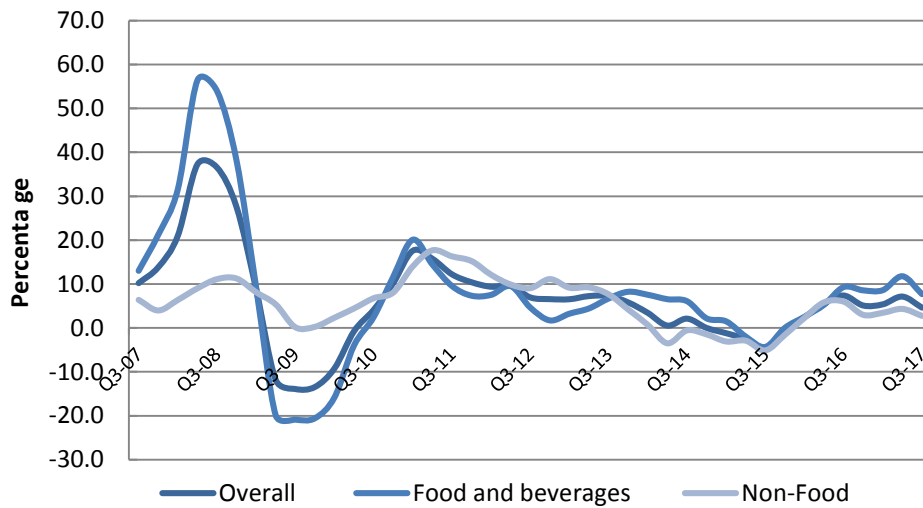


Figure 3.4: Trimmed Mean

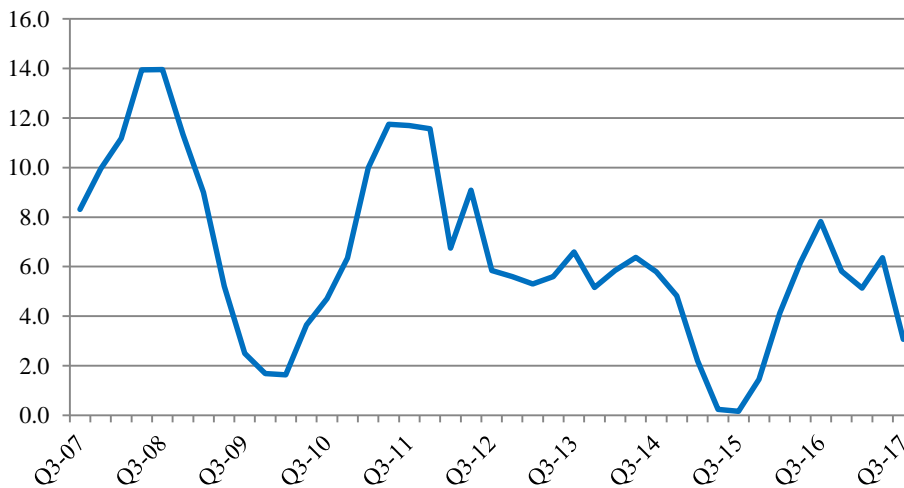
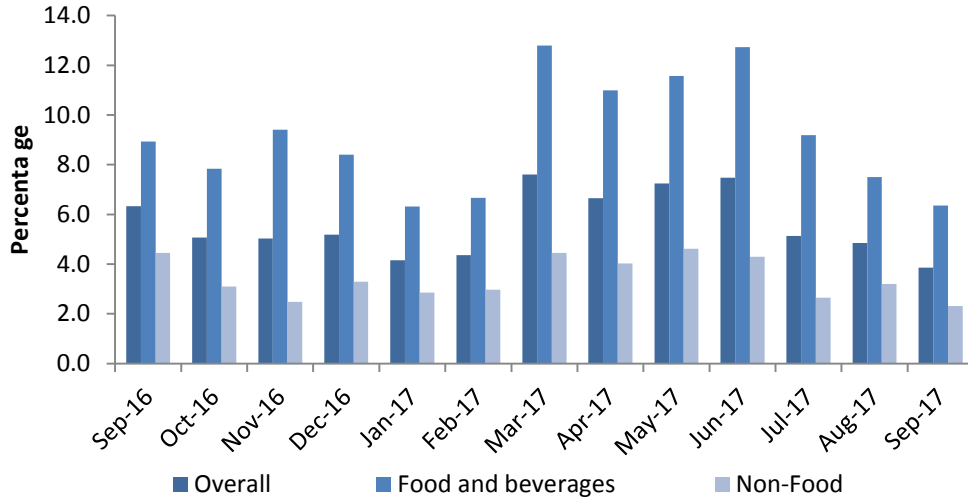


Figure 3.5: Kabul Headline Inflation Sept. 16- Sept. 17



Source: CSO/ Monetary Policy Department, DAB

Table 3.2: Breakdown of Kabul Headline Inflation Q3, FY 1396

Period	Weight	2016				Weight	2017			
		Based on March-2011					Based on April-2015			
		July 16	Aug. 16	Sept. 16	Q3, 16		July 17	Aug. 17	Sept. 17	Q3, 17
Overall Index	100	8.0	7.8	6.3	7.4	100.0	5.1	4.8	3.9	4.6
Food & Non-	52.0									
Alcoholic Beverages		9.2	9.8	8.9	9.3	37.2	9.2	7.5	6.4	7.7
Bread and Cereals	17.7	2.3	0.5	-2.9	0.0	9.8	3.6	4.5	2.4	3.5
Meat	7.2	16.1	19.3	16.6	17.3	6.4	10.9	6.3	7.1	8.1
Milk, cheese and eggs	4.8									
		5.2	4.8	3.1	4.4	3.2	0.5	-0.1	1.1	0.5
Oils and fats	4.0	1.1	-0.3	4.7	1.8	3.6	13.7	14.8	4.7	11.1
Fresh and dried fruits	4.8	11.5	6.3	13.7	10.5	5.2	5.6	9.4	8.7	7.9
Vegetables	7.9	6.3	14.8	14.8	12.0	4.2	31.9	22.7	26.9	27.1
Sugar and sweets	2.9	42.4	49.1	40.4	44.0	2.8	10.3	4.8	2.9	6.0
Spices	0.9	35.4	36.1	33.3	34.9	1.0	-1.7	-6.7	-9.5	-6.0
Non-alcoholic beverages	1.8									
		12.7	14.6	12.0	13.1	0.9	0.5	-2.1	-3.3	-1.6
Non-Food Items, Tobacco & Services	48.0									
Tobacco	0.4	13.9	11.2	9.1	11.4	0.3	15.5	15.7	11.3	14.2
Clothing	7.0	15.5	12.8	11.4	13.2	4.8	-0.7	2.2	-1.3	0.1
Housing	20.7	4.2	3.6	1.0	2.9	23.5	5.9	7.2	5.8	6.3
Furnishing and household goods	7.0									
		14.6	13.6	9.9	12.7	17.6	2.3	1.9	1.5	1.9
Health	3.3	2.9	2.6	1.4	2.3	5.3	-3.3	-2.5	-0.7	-2.2
Transportation	4.7	-0.9	-1.6	-0.5	-1.0	4.6	5.0	4.6	4.2	4.6
Communication	1.1	0.5	0.3	0.1	0.3	2.0	-4.4	-4.2	-4.3	-4.3
Information and Culture	0.1									
		16.5	19.6	29.7	21.9	1.7	-5.9	-6.0	-8.1	-6.7
Education	0.7	4.9	4.7	1.9	3.8	0.7	8.0	5.4	0.4	4.6
Restaurants and Hotels	1.0									
		0.4	1.6	0.8	0.9	1.0	-3.3	-5.3	-5.0	-4.5
Miscellaneous	1.8	17.3	15.3	14.9	15.8	1.3	2.4	1.9	1.6	2.0
CPI ex. B&C, O&F, and T										
30% Trimmed Mean										

Source: CSO/Monetary Policy Department, DAB



EXTERNAL SECTOR DEVELOPMENT

4

EXTERNAL SECTOR DEVELOPMENT

Major developments in the external sector of Afghanistan economy for the third quarter of the FY 1396 relative to third quarter of the FY 1395 are presented in this report.

The performance of the external sector was weak in the third quarter of the FY 1396 due to increased current account deficit and depletion of capital inflows. Widening trade deficit together with depleting of inflows to the primary income account caused to increase current account deficit during the third quarter of the FY 1396. Meanwhile, the Balance of Payments (BOP) recorded a higher deficit of USD 849.39 million caused from the increased current account deficit, narrowed capital inflows (capital transfers) and inflows to the financial account in term of foreign direct investment (FDI) to the country.

I. BALANCE OF PAYMENTS

1.1 Current Account Balance

Available data shows that the deficit in the current account increased by 6 percent to USD 966.74 million in the third quarter of the FY 1396, higher from a deficit of USD 916.17 million in the third quarter of the FY 1395. (Table 4.1 figure 4.1)

This development was attributed to higher imports of goods, decreased inflows to the primary income account which was caused by lower compensation of employees resident and working abroad, lower investment income and increased out-payment in the services account during the third quarter of the FY 1396.

Both aggregate exports and imports (fob) increased by 48 and 9 percent to USD 255.53 and USD 1517.09 million, from USD 172.50 and 1393.41 million respectively

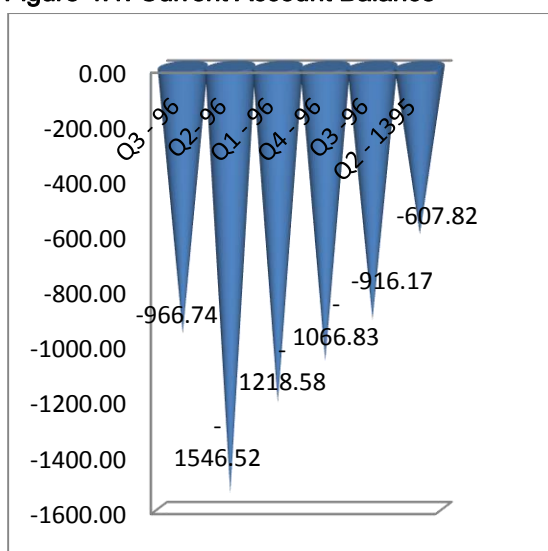
compared with the same quarter of the FY 1395.

The deficit in the services account rose by 70 percent to USD 329.17 million in the third quarter of the FY 1396 from USD 193.24 million recorded in the corresponding quarter in the FY 1395. This is attributed to increment in out-payments in respect of transportation services which increased by 39 percent in the reporting quarter.

The surplus in the income account narrowed by 49 percent from USD 17.50 million in the third quarter of the FY 1395 to USD 8.92 million in the reporting quarter.

Likewise, current transfers' surplus which was largely influenced by grants and worker personal home remittances from foreign countries grew by 28 percent from USD 480.48 million in the third quarter of the FY 1395 to USD 615.07 million in the reporting quarter.

Figure 4.1: Current Account Balance



Source: CSO/DAB staff calculations

1.2 Capital Account

The capital account of the balance of payments demonstrated a slight decline of 2 percent in the third quarter of the FY 1396 when compared to the corresponding quarter of the preceding year, as a result of lower inward capital transfers.

Net inflows to the capital account dropped from USD 375.23 million in the third quarter of the FY 1395 to USD 368.48 million in the third quarter of the FY 1396. This was mainly due to net capital transfers received by the government, corporations and households.

1.3 Financial Account

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

Net FDI inflows to the country declined by 28 percent from USD 23.53 million in the third quarter of the FY 1395 to USD 16.92 million in the quarter under review. (figure 4.2)

Similarly, net portfolio investment depicted an outflow of USD 11.77 million in the third quarter of the FY 1396 against the net outflow of USD 20.33 million in the

corresponding quarter of the previous year. Total net foreign investment (total net outflows) is less volatile during the third quarter of the FY 1396 which increased from USD -3 million in the third quarter of the FY 1395 to USD 5 million in the reporting quarter.

External commercial borrowings (ECBs) is another item of the financial account which is relatively more volatile than foreign investment. Net ECBs were USD 5.12 million in the third quarter of the FY 1396 as compared to USD 0.71 million in the third quarter of the FY 1395.

The financial account balance as a total recorded USD 251.13 million in the third quarter of the FY 1396 against USD 82.6 million in the third quarter of the FY 1395. (Table 4.1 - Figure 4.3)

Figure 4.2: Afghanistan Foreign Direct Investment inflows (million USD)

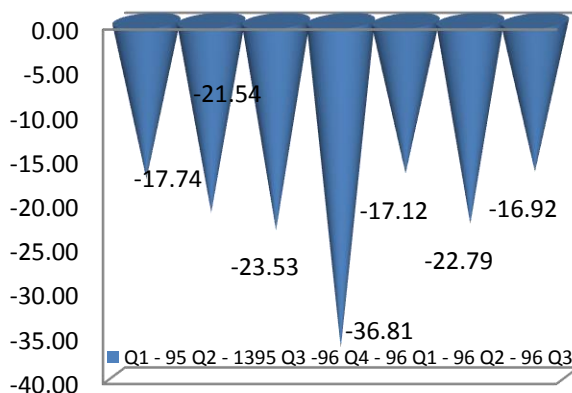
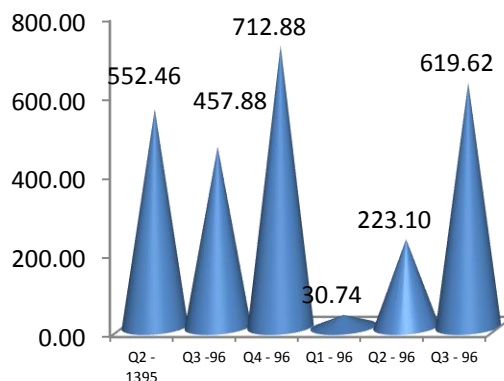


Figure 4.3: Capital and Financial Accounts (million USD)



Source: CSO /DAB staff calculations

1.4 Merchandise Trade

This part of the report presents an analysis of Afghanistan’s merchandise trade performance in the third quarter of the FY 1396 in comparison with their trade performance in the third quarter of the FY 1395.

During the third quarter of the FY 1396, the values of Afghanistan’s total exports and imports of goods, both recorded quarter-on-quarter increases.

The value of total domestic exports of goods as a whole rose by 46 percent and the value of total imports of goods increased by 18 percent over the same quarter in the FY 1395. So a visible trade deficit of USD 1,469.57 million which is equivalent to 15 percent, was recorded in the third quarter of the FY 1396. (Figure 4.4)

Analysis by major commodities:

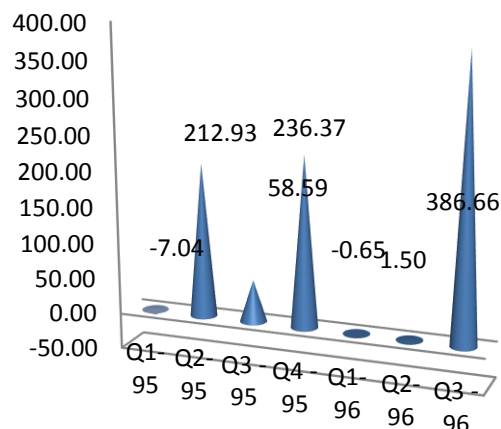
Comparing the third quarter of the FY 1396 with the third quarter of the FY 1395, the values of total exports of some principal commodity divisions increased, in particular; food items "oil seeds, fresh and dry fruits" (increased by 136 percent or USD 154.11 million), "carpet and rugs" (by 43 percent or USD 6.56 million) and "medical seeds" (increased by 17 percent or USD 87.66 million).

However, a decrease was registered in the value of total exports of "leather and wool" (by -89 percent or USD 3.05 million).

Over the same period of comparison, the values of imports of most principal commodity divisions also increased, in particular; "consumer goods" increased (by 65 percent or USD 681.66 million), "industrial supplies" increased (by 39 percent or USD 235.13 million) and "fuel and lubricant" increased (by 5 percent or USD 225.33 million). However, a decrease was registered in the value of imports of "capital goods" (by USD 578.83 million or -12 percent).

For further information, table 4.2 at the annex presents the analysis of external merchandise trade statistics for the third quarter of the FY 1396.

Figure 4.4: Reserve Assets Q1, 1395- Q3, 1396



Source: CSO /DAB staff calculations

II. DIRECTION OF TRADE

Direction of Afghanistan's foreign trade is studied in relation to the country's proportion of exports to different countries and the proportionate imports from different countries. To study Afghanistan's direction of foreign trade, the major trading partners have been; Pakistan, Iran, India, China, and Commonwealth of Independent States (CIS).

2.1 Direction of Exports

Pakistan is ranked the largest export partner of Afghanistan during the third quarter of the FY 1396. The share of exports to Pakistan dropped to 51.62 percent in the third quarter of the FY 1396 when compared with 64.13 percent in the third quarter of the FY 1395. But in terms of value, exports to Pakistan have grown by 17 percent to USD 129.75

million in the third quarter of the FY 1396 from USD 110.60 million in the same quarter of the FY 1395.

The second largest buyer of Afghanistan’s exports is India. Share of Afghanistan’s exports to India increased to 33.67 percent in the third quarter of the FY 1396 when compared with 28.27 percent in the third quarter of the FY 1395. In terms of value, exports to India increased notably by 74 percent to USD 84.64 million in the third quarter of the FY 1396 from USD 48.75 million in the comparable quarter of the FY 1395.

The next two largest buyer of Afghanistan’s export are Iran and CIS countries. Afghanistan’s exports to Iran increased to USD 6.98 million in the third quarter of the FY 1396 from USD 1.75 million recorded in the same quarter of the previous year. Share of exports to Iran increased slightly to 2.78 percent from about 1 percent in the third quarter of the FY 1396. Likewise, total export to CIS countries rose by 258 percent to USD 6.19 million in the third quarter of the FY 1396 from USD 1.73 million in the third quarter of the FY 1395. Share of Afghanistan’s exports to CIS countries also increased to 2.46 percent in the reporting period from 1 percent recorded in the third quarter of the FY 1395.

Figure 4.5: Direction of Exports (% share) Q3, FY 2017

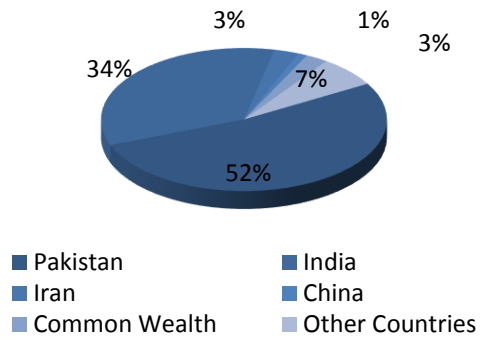
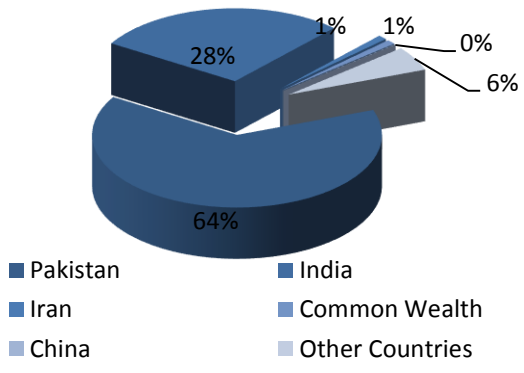


Figure 4.6: Direction of Exports (% share) Q3, FY 2016



Source: CSO/DAB staff calculations

2.2 Direction of Imports

CIS countries were the first largest import origin of Afghanistan in the third quarter of the FY 1396.

Total Imports from CIS countries increased by 50 percent to USD 479.40 million with share of 27.86 percent in the third quarter of the FY 1396 from USD 320.60 million with share of 22.05 percent in the third quarter of the FY 1395. The main imports from CIS countries were, Flour and Wheat flour which accounted by 10 percent, Petroleum Oil and electricity accounted by 8 percent, and Vegetable Oil accounted by about 2 percent

of total imports in the third quarter of the FY 1396.

Iran was the second largest source of imports for Afghanistan during the third quarter of the FY 1396.

Aggregate imports from Iran have increased by 7 percent to USD 284.44 million with share of 16.53 percent during the period under review from USD 265.88 million with share of 18.28 percent in the third quarter of the FY 1395.

The major importing products from Iran were Petroleum oil, Industrial supplies such as (metal production, fertilizer, chemical and cement), and Consumer goods which accounted for about 6, 4 and 2 percent of total imports respectively in the reporting period.

China has ranked the third largest import origin to Afghanistan in the third quarter of the FY 1396.

Aggregate imports from China have dropped by 16 percent to USD 282.06 million with share of 16.39 percent in the third quarter of the FY 1396 from USD 335.09 million with share of 23.04 percent in the same quarter of the previous year. The main imports from China include consumer goods and capital goods (spare parts) accounting for 7 and 3 percent of total imports respectively.

Pakistan is the fourth largest import sourcing country to Afghanistan.

Total imports from Pakistan grew by 19 percent to USD 268 million with share of

15.57 percent in the third quarter of the FY 1396 from USD 225.15 million with share of 15.48 percent in the third quarter of the FY 1395. Consumer goods, industrial supplies, capital goods and petroleum oil products were the main imports categories from Pakistan.

India and Japan were the fifth and sixth largest import sourcing countries for Afghanistan, accountable for 3.45 and 2.72 percent of total imports respectively. However, total Imports from India grew by 80 percent from USD 32.90 million in the third quarter of the FY 1395 to USD 59.32 million in the period under review. The major imports from India were; fabrics, spare parts, medicines, cloths, tire & tubes, chemical and tea.

Imports from Japan declined by 26 percent from USD 63.58 million in the third quarter of the FY 1395 to USD 46.87 million in the third quarter of the FY 1396, due to lower imports of capital goods and consumer goods.

Figure 4.7: Direction of Imports (% share) in Q3, FY 1396

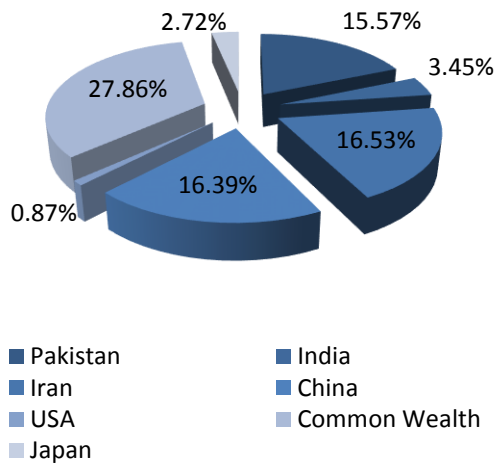
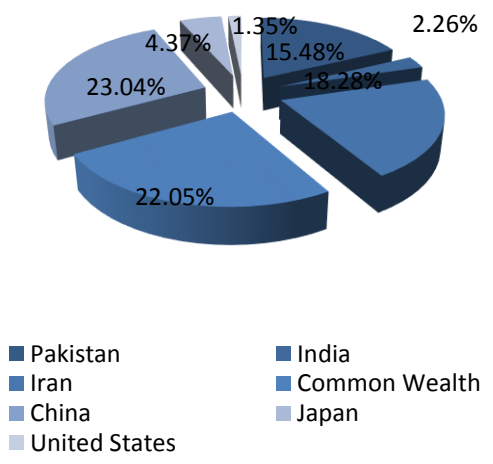


Figure 4.8: Direction of Imports (% share) in Q3, FY 1395



Source: CSO/DAB staff calculations

III. COMPOSITION OF TRADE

3.1 Composition of Imports

The composition of imports in the third quarter of the FY 1396 indicates that;

- ✓ Imports of consumer goods had the largest share in the basket of imports during the third quarter of the FY 1396. The share of consumer goods increased from 28.4 percent to 39.6 percent. The value of consumer goods in total imports also increased significantly by 65 percent from USD 413.27 million in the third quarter of the FY 1395 to USD 681.66 million in the quarter under review.
- ✓ The second largest share recorded for Capital goods in the basket of imports despite its share declined from 45.2 percent in the third quarter of the FY 1395 to 33.6 percent recorded in the third quarter of the FY 1396. In terms of value, imports of capital goods descended by 12 percent from USD 657.39 million in the third quarter of the FY 1395 to USD 578.83 million in the period under review.
- ✓ Imports of Industrial supplies had the third largest share in the basket of Afghanistan’s imports which is increased from 11.7 percent in the same quarter of the previous year to 13.7 percent in the third quarter of the FY 1396. In terms of value, imports of such item in total imports rose by 39 percent from USD 169.66 million in the third quarter of the FY 1395 to USD 235.13 million in the reporting period.

✓ Fuel and lubricants had the smallest share in the basket of Afghanistan’s imports during the period under review. The share of fuel and lubricants in total imports dropped to 13.1 percent in the third quarter of the FY 1396 from 14.7 percent recorded in the same period of last year. In terms of value, import of such items in the total imports of Afghanistan increased by 5 percent from USD 213.85 million in the third quarter of the FY 1395 to USD 225.33 million in the reporting period.

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 and proves that this country needs to import these materials for economic development and sustained economic growth in the long-run.

Figure 4.9: Composition of Imports (% share) Q3, FY 1395

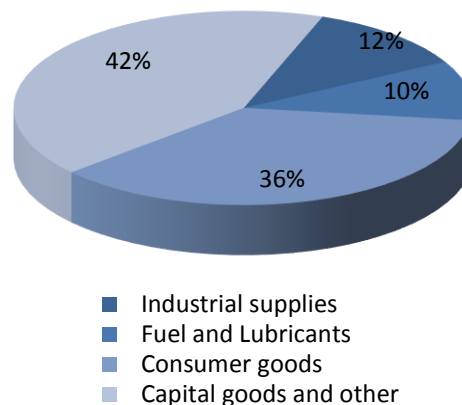
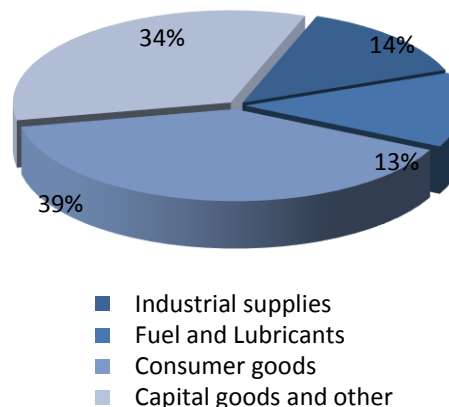


Figure 4.10: Composition of Imports (% share) Q3, FY 1396



Source: CSO/DAB staff calculations

3.2 Composition of Exports

The composition of exports in the third quarter of the FY 1396 illustrated that;

✓ Exports of food items (oil seeds, fresh and dry fruits) had the largest share in the basket of Afghanistan’s exports. The share of food items in the total exports increased to 61 percent in the third quarter of the FY 1396 from 38 percent recorded in the same quarter of the previous year.

In terms of value, exports of such items in total exports increased significantly by 136 percent from USD 65.28 million in the third quarter of the FY 1395 to USD 154.11 million in the quarter under review.

- ✓ The second largest share in total exports was recorded for medical seeds although its share declined from 43 percent in the third quarter of the FY 1395 to 34.9 percent in the quarter under review.

In terms of value, exports of medical seeds increased by 18 percent from USD 74.66 million in the third quarter of the FY 1395 to USD 87.66 million in the quarter under review.

- ✓ The third largest share in the basket of Afghanistan’s exports was recorded for carpet and rugs. The share of carpet and rugs in total exports remained unchanged (3 percent) in the third quarter of the FY 1396. But in terms of value, export of carpet and rugs increased by 43 percent from USD 4.59 million in the third quarter of the FY 1395 to USD 6.56 million recorded in the third quarter of the FY 1396.

- ✓ Leather and wool had the smallest share in total exports which decreased significantly from 16 percent in the third quarter of the FY 1395 to 1.2 percent in the reporting quarter. The value of such goods so declined considerably by 89

percent from USD 27.92 million in the third quarter of the FY 1395 to USD 3.05 million in the third quarter of the FY 1396. (Table 4.2 and figures 4.11-4.12)

Figure 4.11: Composition of Exports (% share) in Q3, FY 1395

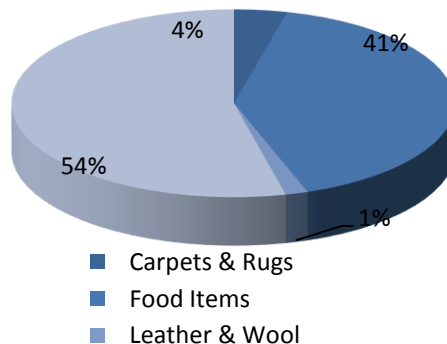
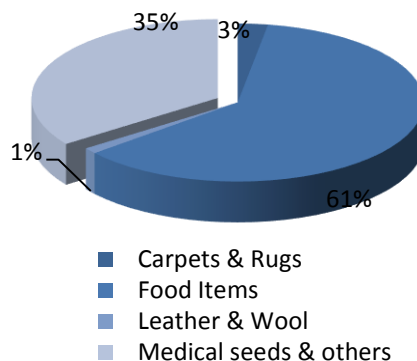


Figure 4.12: Composition of Exports (% share) in Q3, FY 1396



Source: CSO and DAB staff calculations

IV. EXTERNAL DEBT

Afghanistan’s total external debt stock stood at USD 2,185.87 million in the third quarter of the FY 1396 as against USD 2,147.27 million in the third quarter of the FY 1395, which shows about 2 percent decline. This decline in total external debt during the

quarter under review 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 made to the Asian Development Bank, Islamic Development Bank, OPEC Fund and International Monetary Fund (IMF), while service charges were paid to the World Bank, Asian Development Bank and Islamic development Bank.

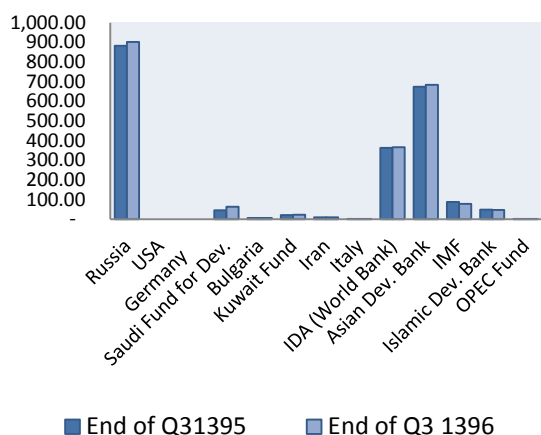
World Bank and Asian Development Bank as major multilateral creditors to

Afghanistan, made some debt forgiveness on principle and services charges.

Furthermore, total debt from Non-Paris Club members which are including, (Saudi Fund for Development, Bulgaria, Kuwait fund and Iran) increased by 21 percent from USD 87.23 million in the third quarter of the FY 1395 to USD 105.30 million in the third quarter of the FY 1396. Total loan payable to the Paris club creditors in the third quarter of the FY 1396 stood at USD 901.40 million which is payable to Russian Federation.

On the other hand, total debt from multilateral creditors to Afghanistan increased slightly from USD 1,177.72 million in the third quarter of the FY 1395 to USD 1,179.07 million which shows USD 1.35 million increases in total debt from multilateral creditors during the reporting quarter. (Table 4.6 -figure 4.13)

Figure 4.13: External Debt Comparisons for Q3, FY 1395 and Q3, 1396 (in million USD)



Source: Debt Asset Management Unit, Ministry of Finance

V. NET INTERNATIONAL RESERVES

According to the latest available data, the Net International Reserves (NIR) increased to USD 7,246.39 million in the third quarter of the FY 1396 from USD 6,814.01 million recorded in the third quarter of the FY 1395. The increase in the level of NIR was mainly due to the increase in the reserve assets which boosted by almost 7 percent from USD 7,498.84 million in the third

quarter of the FY 1395 to USD 7,994.81 million in the third quarter of the FY 1396.

Likewise, reserve liabilities increased by 9 percent from USD 684.83 million in the third quarter of the FY 1395 to USD 748.42 million in the third quarter of the FY 1396 revealing that the reserve assets are higher than the reserve liabilities. The increment in reserve liabilities is mainly attributed to the commercial banks deposits in foreign currencies which grew by 13 percent from USD 611.79 million to USD 688.49 million in the reporting period.

The use of fund resource decreased by 18 percent from USD 72.90 million in the third quarter of the FY 1395 to USD 59.80 million in the third quarter of the FY 1396.

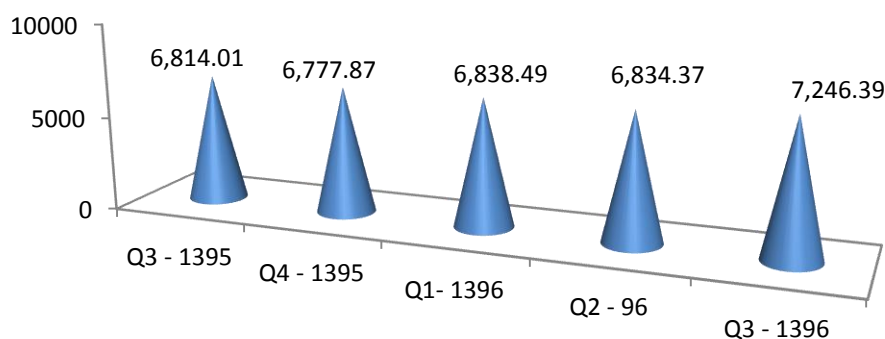
The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the reporting quarter.

The current position of Afghanistan’s 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 25 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

Table 4.6 and Figure 4.14 represent the Net International Reserves (NIR) of Afghanistan since Q3, 1395.

Figure 4.14: Net International Reserves Q3, 1395- Q3, 1396 (in million USD)



Source: Monetary Policy Department, DAB

Table 4.1: Afghanistan's Balance of Payment (in million USD)

Items / Years	Q1- 95	Q2- 95	Q3 - 95	Q4 - 95	Q1- 96	Q2- 96	Q3 - 96
Current Account	-1114.29	-607.82	-916.17	-1066.83	-	-	-966.74
<i>Credit</i>	867.97	1177.26	811.29	1095.38	649.88	700.94	984.35
<i>Debit</i>	1982.27	1785.08	1727.46	2162.21	1868.45	2247.46	1951.09
Goods and Services Account	-1668.69	-1458.25	-1414.15	-1790.27	-	-	-
<i>Credit</i>	262.35	250.94	289.47	332.48	213.77	231.98	330.02
<i>Debit</i>	1931.03	1709.19	1703.62	2122.75	1819.45	2212.95	1920.75
Goods Account	-1481.20	-1286.27	-1220.91	-1552.18	-	-	-
<i>Credit</i>	133.94	116.99	172.50	195.71	117.13	125.87	255.53
<i>Debit</i>	1615.13	1403.25	1393.41	1747.89	1513.09	1794.11	1517.09
Services Account	-187.49	-171.98	-193.24	-238.09	-209.72	-312.73	-329.17
<i>Credit</i>	128.41	133.95	116.96	136.77	96.65	106.10	74.49
<i>Debit</i>	315.90	305.93	310.20	374.86	306.36	418.84	403.66
Primary Account							
Income	-6.82	20.54	17.50	20.49	14.45	33.33	8.92
<i>Credit</i>	14.08	37.74	28.75	41.86	29.41	45.60	20.78
<i>Debit</i>	20.89	17.20	11.25	21.37	14.96	12.27	11.86
Secondary Account							
Income	561.21	829.89	480.48	702.95	372.65	401.12	615.07
<i>Credit</i>	591.55	888.58	493.07	721.04	406.69	423.37	633.54
<i>Debit</i>	30.34	58.70	12.59	18.09	34.04	22.25	18.47

Capital and financial account	238.56	223.73	292.58	712.88	19.54	274.06	619.62
Capital account	309.85	388.10	375.23	525.04	25.14	248.58	368.48
<i>Credit</i>	312.76	390.95	375.23	526.96	25.14	249.55	368.48
<i>Debit</i>	2.91	2.85	0.00	1.92	0.00	0.97	0.00
Capital transfers	312.76	390.95	375.23	526.96	25.14	249.55	368.48
<i>Credit</i>	312.76	390.95	375.23	526.96	25.14	249.55	368.48
<i>Debit</i>	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Financial account	71.3	164.4	82.6	187.84	5.60	-25.48	251.13
Direct investment	-17.74	-21.54	-23.53	-36.81	-17.12	-22.79	-16.92
Net acquisition of financial assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net incurrence of liabilities	17.74	21.54	23.53	36.81	17.12	22.79	16.92
Portfolio investment	18.47	39.15	20.33	12.90	32.61	-29.55	-11.77
Net acquisition of financial assets	18.47	39.15	20.33	12.90	32.61	-29.55	-11.77
Net incurrence of liabilities	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other investment	77.59	-66.19	27.26	-24.63	-9.23	25.35	-106.84
<i>Assets</i>	83.08	-76.43	9.93	-1.82	35.84	5.12	-96.20
<i>Liabilities</i>	5.49	-10.24	-17.33	22.81	45.07	-20.23	10.64
Reserve Assets	-7.04	212.93	58.59	236.37	-0.65	1.50	386.66
Net errors and omissions	875.73	384.08	623.58	729.62	1199.03	1272.46	849.39
Overall Balance							

Source: CSO/DAB staff calculations

Table 4.2: Merchandise Trade (in million USD)

Years	Q3 - 1395		Q4 - 1395		Q1 - 1396		Q2 - 1396		Q3 - 1396	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	1,454.17	100%	1,844.45	100%	1,508.66	100%	2,089.91	100%	1,720.95	100%
Industrial supplies	169.66	11.7%	96.24	5.2%	153.24	10.2%	241.50	11.6%	235.13	13.7%
Fuel and Lubricants	213.85	14.7%	305.72	16.6%	202.05	13.4%	207.62	9.9%	225.33	13.1%
Consumer goods	413.27	28.4%	581.50	31.5%	553.77	36.7%	760.87	36.4%	681.66	39.6%
Capital goods and other	657.39	45.2%	860.99	46.7%	600	39.7%	879.92	42.1%	578.83	33.6%
Exports	172.45	100%	194.77	100.0%	115.04	100%	124.17	100%	251.38	100%
Carpets & Rugs	4.59	3%	4.65	2.4%	7.0	6.1%	4.77	3.8%	6.56	3%

Food Items	65.28	37.9%	90.70	46.6%	43.14	37.5%	50.65	40.8%	154.11	61%
Leather & Wool	27.92	16%	7.77	4.0%	6.49	5.6%	2.02	1.6%	3.05	1.2%
Medical seeds & others	74.66	43%	91.65	47.1%	58.41	50.8%	66.73	53.7%	87.66	34.9%
Trade Balance	-		-1,649.68		-1,393.62		-1,965.74		-	
Balance as % of GDP	1,281.72								1,469.57	
Trade Balance as % of GDP	-6%		-8%		-30%		-34%		0%	

Source: Central Statistics Office and DAB staff calculations

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

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	129.75	51.62%	268.00	15.57%	-138.25
India	84.64	33.67%	59.32	3.45%	25.32
Iran	6.98	2.78%	284.44	16.53%	-277.46
Germany	3.52	1.40%	9.17	0.53%	-5.65
China	2.55	1.01%	282.06	16.39%	-279.51
England		0.00%	1.13	0.07%	-1.13
Saudi Arabia	0.71	0.28%		0.00%	0.71
USA		0.00%	14.96	0.87%	-14.96
Common Wealth	6.19	2.46%	479.40	27.86%	-473.21
Japan		0.00%	46.87	2.72%	-46.87
Other Countries	17.04	6.78%	275.64	16.02%	-258.60
Total	251.38	100%	1,720.99	100%	(1,469.61)

Source: CSO and DAB staff calculations

Table 4.4: Direction of External Trade for the third quarter of FY 1395 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	110.60	64.13%	225.15	15.48%	-114.55
India	48.75	28.27%	32.90	2.26%	15.85
Iran	1.75	1.01%	265.88	18.28%	-264.13
Germany	0.25	0.14%	7.02	0.48%	-6.77
Common Wealth	1.73	1.00%	320.60	22.05%	-318.87
China	0.06	0.03%	335.09	23.04%	-335.03
Saudi Arabia	0.03	0.02%		0.00%	0.03
Japan		0.00%	63.58	4.37%	-63.58
England		0.00%	2.21	0.15%	-2.21
United States		0.00%	19.59	1.35%	-19.59
Other Countries	9.28	5.38%	182.19	12.53%	-172.91
Total	172.45	100.00%	1454.21	100.00%	-1281.76

Source: CSO and DAB staff calculations

Table 4.5: External Debt for the third quarter of FY 1396 (in units indicated)

	In million USD	Percent of total
Total external debt	2,185.87	100.00
Bilateral	1,006.76	46.06
Paris Club	901.46	41.24
Russian Federation	901.46	41.24
United States	-	0.00
Germany	-	0.00
Non-Paris Club	105.30	4.82
Multilateral	1,179.11	53.94
of which: IDA (World Bank)	366.85	16.78
Asian Development Bank	683.57	31.27
International Monetary Fund	79.01	3.61
Islamic Development Bank	48.00	2.20
OPEC Fund	1.69	0.08

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

Table 4.6: Net International Reserves in the FY 1396 (million of US dollars)

Changes in the previous quarter	Q3 - 1395	% change	Q4 - 1395	% change	Q1 - 1396	% change	Q2 - 1396	% change	Q3 - 1396	% change
Net international Reserves (million US Dollar)	6,814.01	23.22	6,777.87	-0.53	6,838.49	0.89	6,834.37	-0.06	7,246.39	6.35
Reserve Assets	7,498.84	22.71	7,581.98	1.11	7,593.12	0.15	7,406.44	-2.5	7,994.81	6.6
Reserve Liabilities	684.83	10.91	804.11	17.42	754.63	-6.15	572.08	-24	748.42	9
Commercial bank deposits in foreign currency	611.79	4.00	732.66	19.76	692.19	-5.52	506.58	-27	688.49	13
Nonresident deposits in foreign currency	0.14	-89.57	0.14	0.00	0.14	0.00	0.14	0.00	0.14	-0.04
Use of Fund resources	72.90	17.53	71.31	-2.18	62.31	-12.63	65.36	5	59.80	-18
Gross Intl. Reserves (in months of import)	61.88		49.33		60.40		42.53		55.75	
Net Intl. Reserves (in months of import)	56		44		27		20		25	

Source: Monetary Policy Department, DAB



FISCAL SECTOR DEVELOPMENT

5

FISCAL DEVELOPMENTS

During the third quarter of FY 2017, public sector performance in terms of domestic revenue collection was quite vivid. Afghanistan’s public expenditure was slightly lower compared to the third quarter of FY 2016, due to lower execution rate, owing to continued deterioration in security conditions in the provinces and Kabul, which also undermined private investment.

I. BUDGET EXECUTION RATE

From the beginning of FY 2017 up to the end of the third quarter, government managed to spend 52 percent of the allocated budget, compared to 47 percent in the same period of the previous year. The execution rate of current budget was 63 percent comparing to 56 percent at the end of third quarter FY 2016. Meanwhile, execution rate of development expenditure was 33 percent, compared to 30 percent of execution rate at the end of the same quarter of the previous year. Comparing to the end of the third quarter FY 2016, execution rate for total budget is presenting a slight increase of 5 percent.

The lower execution rate of the core budget was attributed to several factors in particular to

time consuming procurement process and approval of expenses by the National Procurement Authority, suspension of budget approval and deterioration in security condition in provinces and under performances by the budgetary units.

Figure 5.1: Operating budget of FY 1396

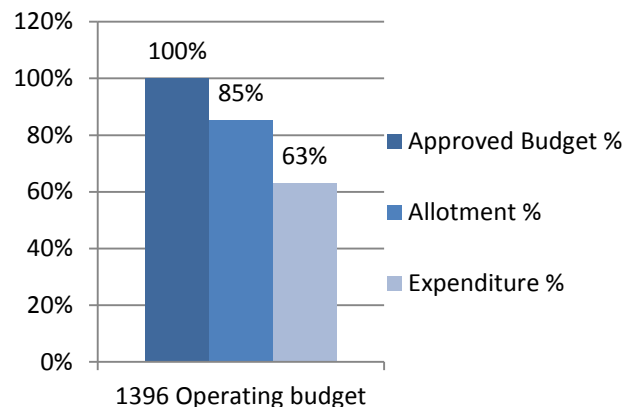


Figure 5.2: Development budget of FY 1396

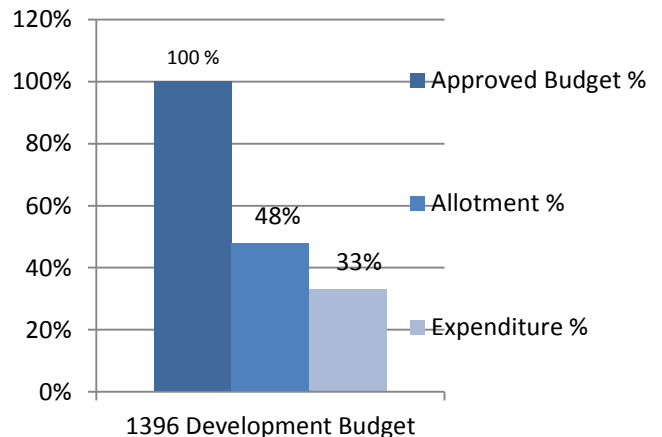
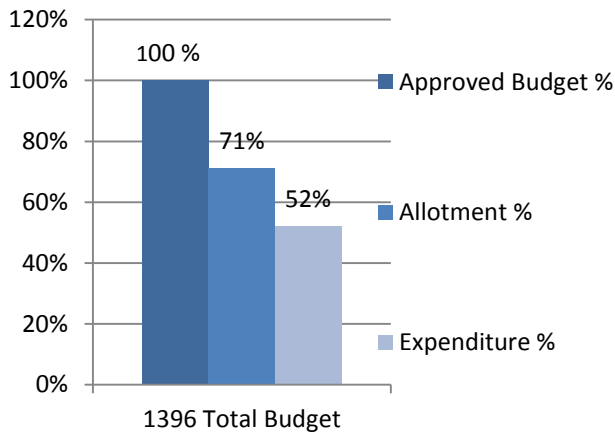


Figure 5.3: Total budget of FY 1396



Source: Ministry of Finance/MPD calculations

II. BUDGET DEFICIT

The overall budget prior to donor’s contribution had a deficit of AF 34.15 billion in the third quarter of FY 2017. However, external source of finance plus domestic revenue’s total budget presents a surplus of AF 29.26 billion in the quarter under review.

III. REVENUE COLLECTION

During the third quarter of FY 2017, domestic revenues increased significantly with total collection of AF 53.18 billion from the total of AF 35.41 billion, compared to the same quarter of FY 2016, presenting a significant increase of 50 percent.

The positive momentum gained in the third quarter was mainly due to the reforms in the revenue collection system, the implementation of new tax measures, increase in tax components and other

important institutional reforms in customs and revenue administration.

Figure 5.4: Composition of Total Revenue Q3, FY 2017

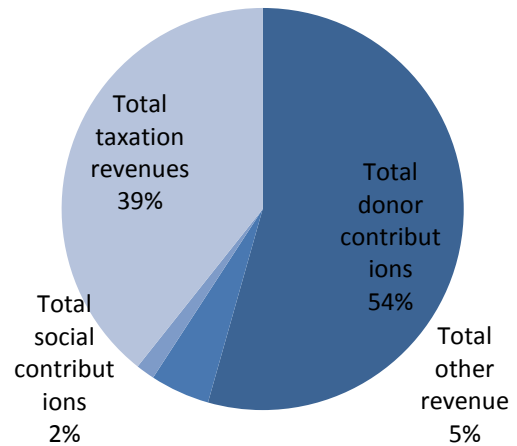
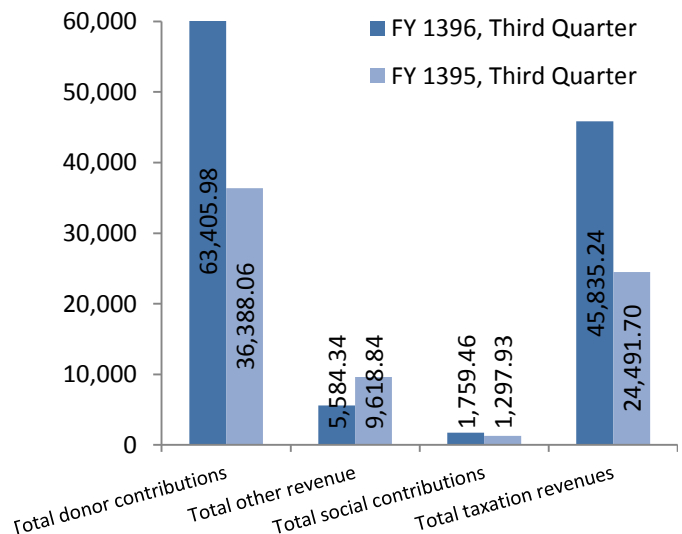


Figure 5.5: Comparison of Total Revenue Q3, FY 2017 Vs. Q3 FY 2016 (in million AF)



Source: Ministry of Finance/MPD calculation

3.1 Tax Revenue

According to available data, overall tax revenue including custom duties increased from AF 24.49 billion to AF 45.84 billion, compared to

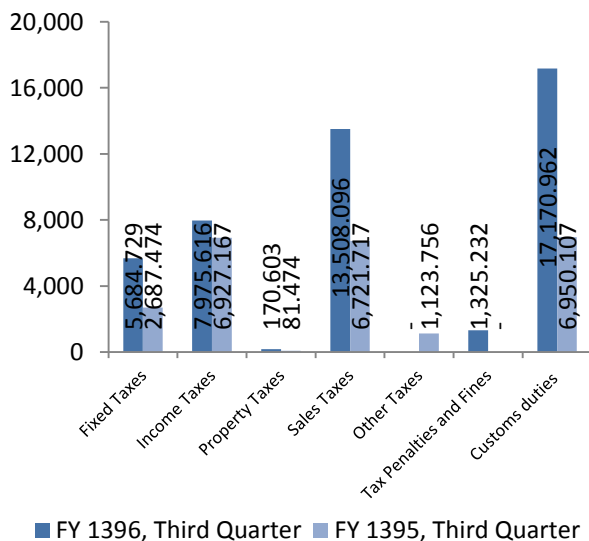
the same quarter of the FY 2016, which represents a significant increment of 87 percent or AF 21.34 billion.

The main contributors in the total tax collection were from custom duties, direct taxes and fixed taxes.

Total collection from the custom duties presented a considerable increment of 147 percent, by total collection of AF 17.17 billion from AF 6.95 billion, same period last year.

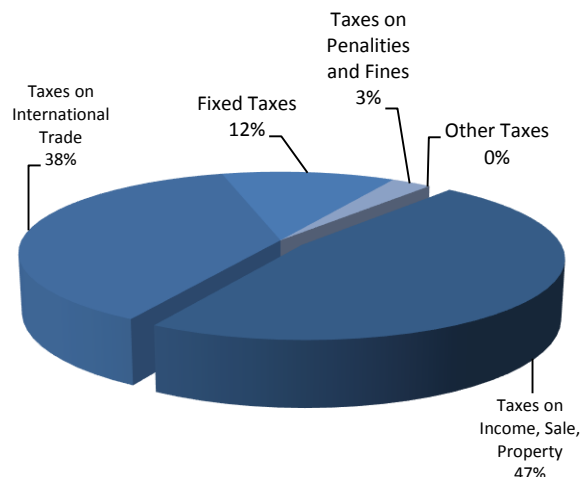
Similarly, direct taxes (sales, property, income taxes), and fixed taxes showed momentous performance by presenting increase in total collection of AF 21.65 billion and AF 5.68 billion, compared to AF 13.73 billion and AF 2.69 billion, third quarter FY 2016.

Figure 5.6: Comparison of Tax Revenue



Source: Ministry of Finance/MPD calculation

Figure 5.7: Composition of Tax Revenue Q3, FY 2017



Source: Ministry of Finance/MPD calculation

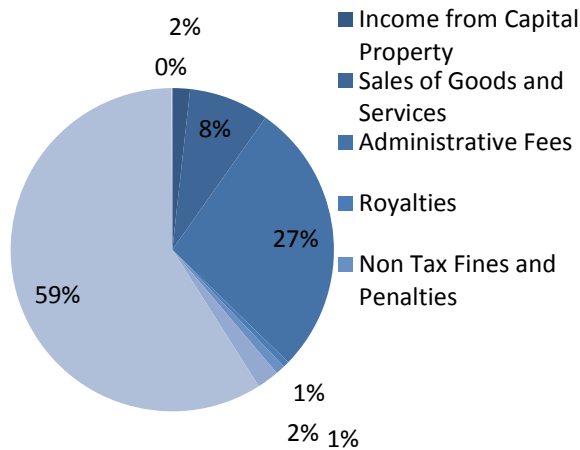
3.2 Non-tax Revenues

The other main component in the total domestic revenue was non-tax revenue which presented lower performance as compared to the same period of the previous year.

The other revenues collection was AF 5.58 billion down from AF 9.62 billion, presenting 42 percent of decrease. The decrease was mainly due to lower collection in Income from Capital Property and Non Tax Fines and Penalties.

However, revenues from miscellaneous revenues, a major component of the non-tax revenue, increased significantly with contribution of AF 18.47 billion from AF 12.16 billion in the same quarter of FY 2016 registering an increase of 52 percent.

Figure 5.8: Composition of Other Revenue Q3, FY 2017



Source: Ministry of Finance/MPD calculation

On the contrary, social contribution that constitutes only 2 percent of the total domestic revenue presented an increase of 36 percent. The total amount collected were AF 1.76 billion, up from AF 1.30 billion in FY 2016.

IV. GRANTS

Afghan government receives grants from various donors, trusts and international committees to finance variety of projects in both operating and development expenditures. Integrated grants presented a slight increase in the third quarter of FY 2017, compared to the same period of the previous year.

Total development and operating grants in the third quarter of FY 2017 amounted to AF 63.41 billion up from AF 36.39 billion in the same quarter of FY 2016, screening a significant increase of 74 percent. Nonetheless, ARTF is one of the main contributors to the government. Grants received under the ARTF program over

the third of FY 2017 was AF 25.98 billion that represents a large increase of 197 percent over the same period of the previous year. In contrast, grants received from LOTFA scheme decreased to AF 6.19 billion in the quarter under review compared to AF 6.36 billion in previous reporting period, witnessing a slight decrease of only 3 percent.

During the third quarter, government was able to finance 46 percent of the total expenditure by using domestic revenues and 54 percent is financed through external grants.

Figure 5.9: Financing Sources of National Budget Q3, FY 2017

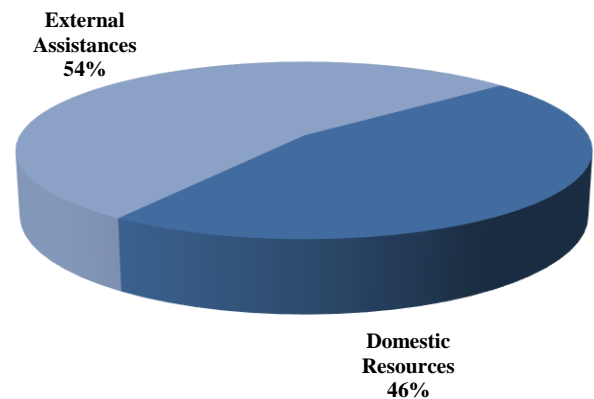
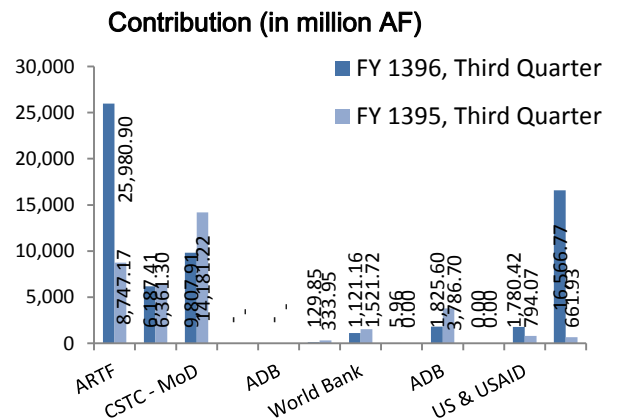


Figure 5.10: Comparison of Donors Contribution (in million AF)



Source: Ministry of Finance/MPD calculation

V. EXPENDITURE

During the third quarter of FY 2017, total expenditures were AF 87.33 billion that indicates decline of 2 percent over the total spending of AF 89.16 billion in the same period of previous year.

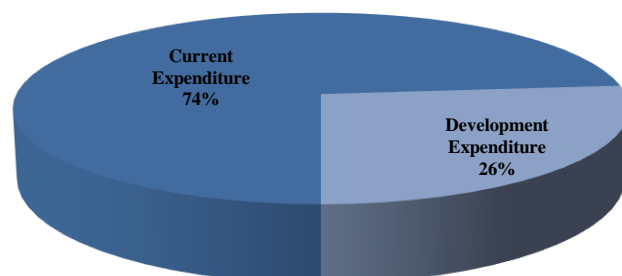
There were also decrease in both components, current and development expenditure.

The current expenditure presented a slight decrease of 1 percent from AF 65.09 billion to AF 64.22 billion during the third quarter of FY 2017.

Similarly, development expenditure declined to AF 23.10 billion from sum of AF 24.07 billion indicating a decrease of 4 percent.

From the total spending, 74 percent were current budget and 26 percent development budget.

Figure 5.11: Composition of total Government Expenditure Q3, FY 2017



Source: Ministry of Finance/MPD calculation



BANKING SYSTEM PERFORMANCE

6

BANKING SYSTEM PERFORMANCE

Asset base of the banking sector grew by 3.29 percent during the third quarter ending Sep. 2017, standing at AF 298.21 billion against 3.81 percent decline in June, 2017. The increase in banking system assets was mainly powered by cash in vault and claims on DAB, repossessed assets, fixed assets and other assets. While the interbank claims and investments were the major decreasing items.

- Gross loans portfolio of the banking sector declined by 0.17 percent standing at AF 41.05 billion at the end of Sep. 2017 against 0.45 percent increase in June, 2017. The decrease in the loan portfolio during the third quarter was mainly attributed to settlement of loans, charge-off of loans and repossession of loan. At the same time, new loans have been disbursed as well.
- Deposits, the main funding source of banking sector stood at AF 252.92 billion, comprising 96.15 percent of the total liabilities of the sector, increased by 4.13 percent against 4.50 percent growth in June 2017. The major increase in deposit base of

the banking sector is attributed to demand deposits. Deposits were largely denominated in USD (60.73 percent) with Afghani denominated deposits lagging at 32.47 percent. AF-denominated deposits indicated 9.13 percent increase against 0.40 percent increase in June 2017. USD denominated deposits were up by 3.87 percent against 7.30 percent decrease in June, 2017.

- The capital base of the banking sector remained strong and increased by 2.23 percent amounting to AF 35.16 billion. The financial capital of two banks is below the set limits; however, the capital adequacy of all banking institutions 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 is recorded at 30.43 percent in the third quarter of FY 1396.
- Banking sector earned net profits amounting to AF 743 million in the third quarter of 2017, against AF 98 million net profits in the June, 2017. Return on Assets (ROA) stands at 0.51 percent annualized

and Return on Equity (ROE) recorded at 2.38 percent annualized. The increase in profitability of the banking sector is mostly ascribed to decrease in credit provisions; the banking sector recorded AF 63 million re-integrated provisions (attributed to repayments of loans) in the review quarter. Other contributing factor includes decrease in non-interest expense, whilst net-interest income and non-interest income decreased and salary expense increased over the quarter. State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profits in the review quarter.

I. ASSETS OF THE BANKING SYSTEM

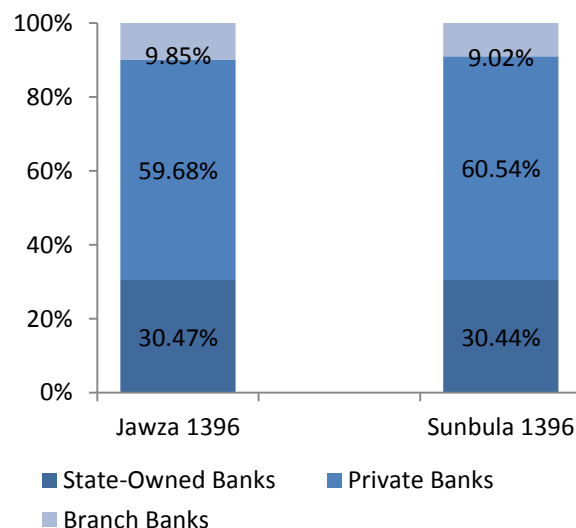
The assets size of the banking sector increased by 3.29 percent in the period under analysis against 3.81 percent decline in June, 2017. See Table 6.1.

The breakup of total assets reveals that the most obvious increase was registered in cash in vault and claims on DAB (AF 22.94 billion or 17.76 percent) mostly in cash in vault and current account with DAB, overnight deposits and required reserves, other assets (AF 621 million or 4.60 percent), fixed assets (AF 239 million or 3.21 percent), repossessed assets (AF 149

million or 14.53 percent), but the increase in intangible assets and net-loans was negligible. While interbank claims and investments showed a decrease of (AF 13.69 billion or 18.05 percent and AF 935 million or 3.67 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 (51.01 percent), interbank claims (20.84 percent), net loans (11.97 percent), investments (8.21 Percent), "other assets" (4.73 percent) and fixed assets make 2.57 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	Jawza, 1396 June, 2017	Sunbula, 1396 Sep, 2017	% of Total Assets/Liability	Growth
Assets				
Cash in vault and claims on DAB	129,165	152,106	51.01	17.76
Interbank claims(Net)	75,851	62,154	20.84	-18.05
Investments (Net)	25,416	24,481	8.21	-3.67
Loans (Net)	35,597	35,687	11.97	0.25
Intangible assets	745	832	0.28	11.67
Repossessed Assets	1,025	1,174	0.39	14.53
Fixed Assets	7,439	7,677	2.57	3.19
Others	13,477	14,098	4.73	4.60
Total	288,715	298,209		3.29
Liabilities				
Deposits	242,896	252,926	96.15	4.13
Borrowings	4,531	3,557	1.35	-21.49
Subordinated Debt	11	11	0.00	0.00
Other	6,880	6,550	2.49	-4.79
Total	254,318	263,044		3.43
Financial Capital	34,397	35,165		2.23

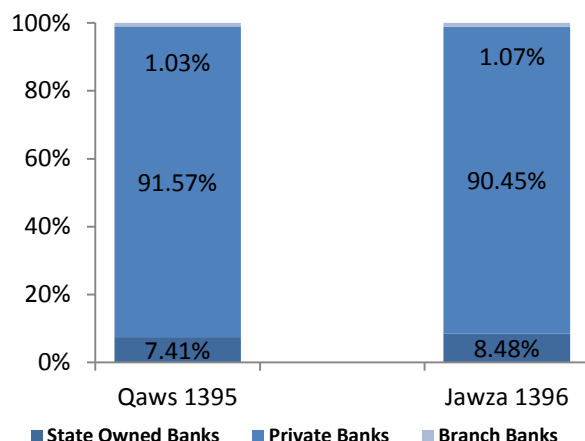
Source: Financial Supervision Department, DAB

1.1 Gross Loans

Total gross loans portfolio stands at AF 41.05 billion, indicating AF 73 million or 0.17 percent decline since June, 2017, constituting 13.77 percent of the total assets. The decrease in total loan portfolio is mainly attributed to settlement of loans, charge-off of loans and repossession of

loans. At the same time, new loans have also been disbursed.

Figure 6.2: Share of Gross Loan Portfolio among banking group



Source: Financial Supervision Department

Decline in loan portfolio was observed in eight banking institutions, whereas four banking institutions recorded increase in their loan portfolio, and the remaining two banks did not participate in lending.

Gross loan portfolio declined in private and branches of foreign banks, while state-owned banks have registered increase in their portfolio. Private banks with 89.94 percent share in total portfolio posted 0.72 percent or AF 271 million decreases, branches of foreign banks holding 1,03 percent of the banking sector portfolio declined by 3.40 percent, while State-owned banks with 9.01 percent share depicted 6.10 percent or AF 213 million increase in loan portfolio 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 Sep., 2017, total provision cover of the system was 13.07 percent of total gross loans as opposed to 13.45 percent recorded in the in June, 2017.

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 sectors¹. The analysis of deployment of credit in different sectors indicate that the major portion of the loan portfolio is classified as “other commercial loans” (91.20 percent against 90.95 percent in June, 2017), mainly in “Petroleum and Lubricants” (10.13 percent), “Retail Trading” (8.45 percent), “All other services” (7.52

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

percent), “Construction and Building” (7.49 percent), “Food Items” (7.33 percent) and “Telecommunication” Sector (4.97 percent). Significant increases were observed in Retail trading, Textile, Manufacturing, Services and Food items sectors both, in absolute amount and percentage of total gross loans. While “All other services”, “Hotel and Restaurant”, “Other infrastructure Projects”, “Machineries”, and “Petroleum and Lubricants” were among top increasing sectors. Loans designated to Micro Credit sector posted a decrease of AF 135 million and currently amount to AF 4.77 billion provided by one bank, while SME sector witnessed an increase of AF 57 million currently standing at AF 2.72 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 47.18 percent of total banking sector NPLs. Decreases were observed in “Trade”, “Other” and “Communication” sectors, while Services, Utilities and Manufacturing were among the increasing sectors. About 68.32 percent of the loans were designated in Kabul, while Herat and Balkh provinces in the second and third places with Kandahar and Badghis provinces are 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)	Sunbula, 1396 (Sep, 2017)
Commercial Real Estate and Construction Loans	19.92	25.98	2.85	2.29	2.02%	1.80%	1.90%	2.59%
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%	0.27%
Livestock and Farms						0%	0.03%	0.22%

Manufacturing and Industry(product of metal, wood, plastic, rubber)						2%	4.42%	3.63%
Manufacturing, Handmade and Machine products						4%	4.24%	4.55%
Cement and Construction Materials						3%	1.96%	2.57%
Textile						2.59%	0.52%	1.95%
Power						0.35%	0.22%	0.40%
Construction and Building						12.52%	7.54%	7.49%
Services						4.79%	3.80%	4.17%
Hotel and Restaurant						1.20%	1.46%	1.23%
Telecommunication						2.92%	5.70%	4.97%
Ground Transportation						4.87%	5.31%	2.52%
Air Transportation						4.18%	2.66%	3.31%
Health and Hygienic						0.71%	1.16%	1.43%
Median, Advertisements and Printer						0.04%	0.04%	0.64%
All Other Services						1.41%	7.56%	7.52%
Wholesales						4.93%	9.89%	5.53%
Machineries						0.12%	0.25%	0.22%
Petroleum and Lubricants						8.74%	9.80%	10.13%
Spare Parts						0.24%	1.42%	0.25%
Electronics						1.40%	1.58%	2.97%
Cement and other Construction Materials						1.87%	2.73%	2.73%
Food Items						4.52%	8.24%	7.33%
All Other Items						5.72%	3.47%	3.31%
Retail Trading						3.92%	3.28%	8.45%
Road and Railway						2.41%	1.17%	0.85%
Dames						0.61%	0.09%	0.00%
Mines						0.08%	1.48%	0.51%
Other infrastructure Projects						1.81%	2.44%	2.07%
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%	3.88%
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%	0.91%
All Other Loans	3.69	10	12.65	10.71	9.41%	6.68%	0.00%	0.55%

Source: Financial Supervision Department/DAB

II. CLASSIFICATION OF LOANS

2.1 Non-performing loans

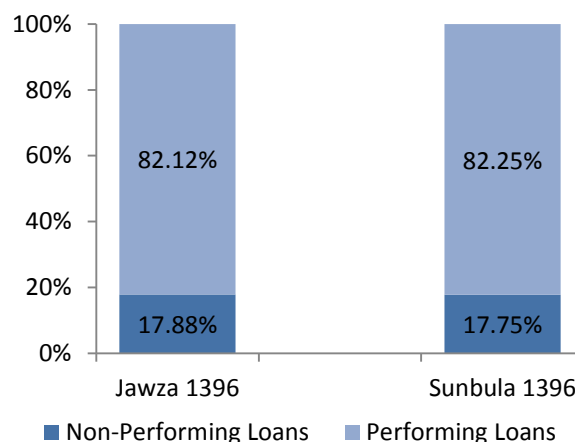
Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs, which is not a favorable situation. Moreover, it can be inferred that quality of risk management in banks with poor credit performance is also weak. It is essential that banks with poor loan quality 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 Sep. 2017, non-performing loans were recorded at AF 7.28 billion or 15.75 percent of total gross loans and 23.38 percent of the system's regulatory capital against AF 7.35 billion or 17.88 percent of the total gross loans in June, 2017. Out of 17.75 percent NPL, 16.06 percent is related to five banks. These banks hold 67.96 percent of the system's gross loans and 49.92 percent of system's regulatory capital.

Financial Supervision Department (FSD) is closely working with banks with poor loan performance to design and implement plans to improve their asset quality. This situation requires regulatory oversight and prompt remedial action to improve governance of

credit risk and avoid negative impact over the profitability and capital adequacy of these banks. The sector wide distribution of NPL reveals that major part of NPL originates from trade sector making 47.18 percent and Other sector comprising 21.09 percent of the sector's NPL, while services, Utilities and Manufacturing sectors make 13.57 percent, 10.85 percent and 7.13 percent respectively. Increases were observed in Services, Utilities and Communication sectors, while Trade, Communication and Other sectors were among the decreasing sectors.

Figure 6.3: Quality of Loan Portfolio



Source: Financial Supervision Department

2.2 Adversely-classified loans

Adversely classified loans (substandard, doubtful)² depicted AF 403 million decrease

² Assets and advances for which the principal and/or interest remains outstanding for 31-90 days (Substandard). Default assets and advances for which the principal and/or interest remains outstanding for 91-360 days (Doubtful)- as per new Assets Classification and provision Regulation

over the quarter, reaching AF 10.87 billion, constituting 26.49 percent of the total gross loans and 34.89 percent of regulatory capital, though decreased, but still 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 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 3.78 billion, which makes 9.21 percent of total gross loans decreased by 0.38 percent since June, 2017. The decrease is mostly attributed to one private commercial bank in

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

the system. This category of loans requires close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

2.4 Loans classified loss⁴

Loans classified loss amounts to AF 62 million, 0.15 percent of total gross loans are down by AF 124 million since June, 2017 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.

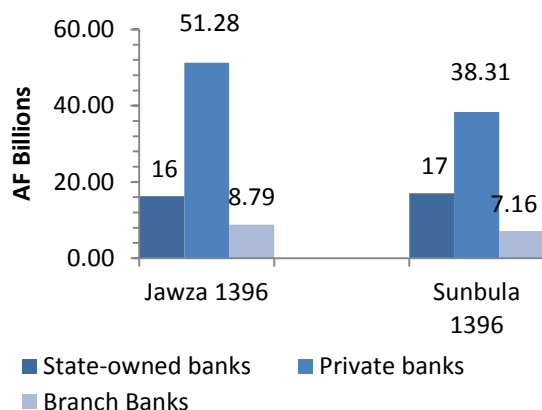
2.5 Inter-bank Claims

Gross Interbank Claims are the second largest among various asset categories. Currently, Interbank claims comprise AF 62.48 billion 20.95 percent of total assets registering AF 18.14 billion or 5.36 percent decrease since June, 2017, mostly attributed to four banking institutions. It indicates that the banking sector has transferred a portion of its Claims on banks to current accounts and overnight deposits. 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

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

individual banks, but also country or countries in which they have placed funds.

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



Source: Financial Supervision Department

2.6 Investment

The net-investment⁵ portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies; which declined by 3.67 percent or AF 935 million since June, 2017, standing at AF 24.48 billion or 8.21 percent of total assets. The decrease mostly came from one banking institution. 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.

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

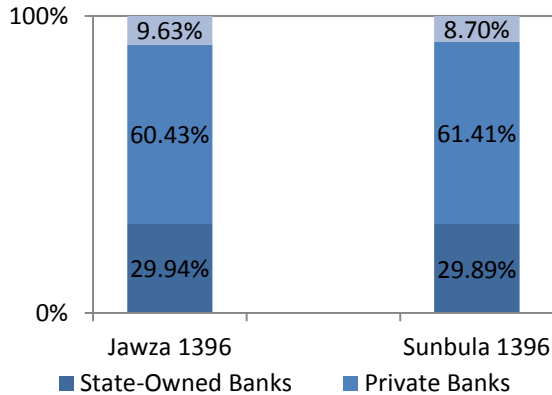
Cash in vault and claims on DAB remains the largest category making 51.01 percent of the total assets, showed an increase of AF 22.94 billion, both in absolute as well as in percentage of total assets, standing at AF 152.10 billion as of end of June, 2017. The increases were observed in cash in vault, required reserves and overnight deposits. 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 increased by AF 8.72 billion or 3,43 percent standing at AF 263.04 billion against AF 254.31 billion in June, 2017. All components of total liabilities except deposits have shown decrease over the period under review.

The majority of liabilities are made up of deposits (96.15 percent), with “other liabilities” at second and borrowings in third place. See table 6.6.

Figure 6.5: Liabilities increased by AF 8.72 billion or 3.43%



Source: Financial Supervision Department

3.1 Deposits

Deposits being the main funding source, amounted to AF 252.92 billion as of Sep. 2017. Deposits increased by AF 10.03 billion or 4.13 percent, compared to June, 2017. The total deposits cover AF 8.73 billion interbank and AF 244.19 billion customer deposits. The major increase in deposit base of the banking sector is attributed to demand deposits and occurred in AFN and USD currencies. Currency-wise analysis show that Afghani denominated deposits indicated 4.95 percent increase accounting for 32.47 percent of total deposits, while US dollar denominated deposits increased 2.70 percent making 60.74 percent of the total deposits of the system.

Private Banks attracted AF 155.37 billion deposits, increased by 5.50 percent making up 61.43 percent of the system's deposits.

The share of state-owned banks amounted to AF 73.28 billion, increased by 3.48 percent since June, 2017 accounted for 29.98 percent of the system's deposits.

The share of branches of foreign banks stands at AF 21.70 billion decreased by 2.83 percent making up 8.58 percent of total deposits of the system.

In terms of types of deposits, demand deposits accounted for 72.72 percent of the total deposit base, increased by 5.88 percent and time deposits with 7.74 percent of total deposits was in the second place, and depicted 6.89 percent increase, while saving deposit making up 19.54 percent of the total deposits portfolio was down by 2.83 percent since June, 2017.

Figure 6.6: Currency Composition of Deposits

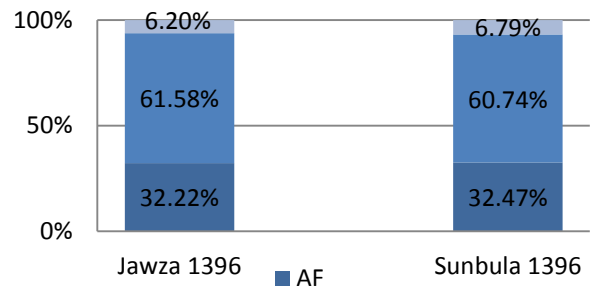


Figure 6.7: Afghani Denominated Deposits

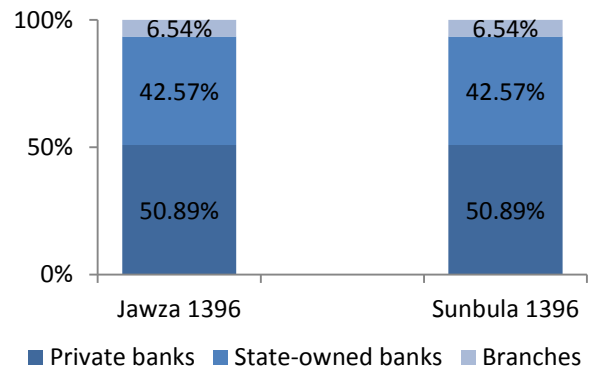


Figure 6.8: Deposits decreased by 4.23% or AF 10.03 billion

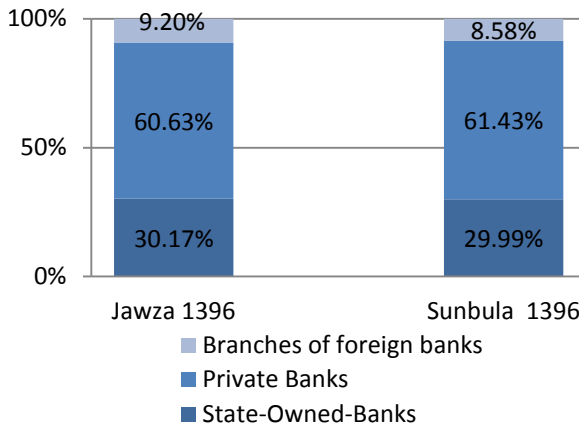
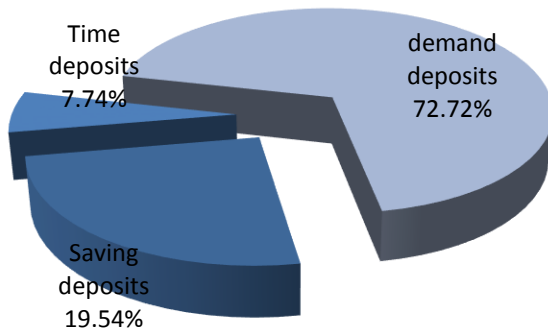


Figure 6.9: Breakdown of Deposits



Source: Financial Supervision Department

3.2 Borrowings

The share of borrowings in total funding structure of the system decreased by 21.50 percent standing at AF 3.55 billion at the end of Sep. 2017, making 1.35 percent of total liabilities. 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. 72.07 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 62.54 percent. All banking institutions were well above the minimum required level. See table 6.5.

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	30.43
Tier 1 Capital Adequacy Ratio	24.19	-14.51	30.29	23.98	19.97	24.65	26.09	19.66	22.93	28.99
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	17.75
Return on Assets (ROA)	1.41	-20.08	0.24	-1.21	-0.54	0.74	0.90	0.20	0.11	0.51
Return on Equity (ROE)	10.35	-520.66	1.9	-17.9	-7.17	10.03	7.35	1.69	1.08	2.38
liquidity Ratio (Broad Measure Median)	59.19	63.32	63.83	57.37	72.13	67.93	73.6	68.22	67.74	62.54
liquidity Assets to Total Assets	0.38	40.58	47.01	55.82	63.75	73.18	73.28	75.05	71.98	72.07

*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 35.16 billion; increased by 2.23 percentage points or AF 768 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 20.43 percent. See table 6.5.

Disaggregated analysis show that the financial capital of two private banks is below the regulatory limits. However, the regulatory capital ratio of all banks 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 third quarter of 2017, the banking sector earned AF 743 million net profit against AF 98 million net profits in June, 2017, showing huge increase over the quarter.

The increase in profitability of the banking sector as evident from the table 6.5 P/L mostly ascribed to decrease in credit provisions, the banking sector has recorded AF 63 million re-integrations for the quarter ending Sep. 2017. The other contributing factors include the decrease in non-interest expense. Whilst, the net-interest income, non-interest income decreased and salary expenses increased 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 0.51 percent annualized, while the returns on equity (ROE), which measures shareholders return on their invested equity in a bank, at the end of Sep. 2017 was recorded at 2.38 percent annualized. The ROA of SOB⁶ recorded at 1.19 percent annualized, BOFB⁷ recorded 0.51 percent annualized, while PB⁸ registered -0.04 percent annualized at end of Sep., 2017.

On a cumulative basis, four banking institutions have incurred AF 286.87 million

losses during the quarter against AF 681 million losses posted by four banks in June, 2017. On core income basis, six banks ended with losses, against five banks in June, 2017.

Group wise analysis reveal that State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profits in the period under analysis.

See figure 6.10.

Major portion of the profitability of the banking sector is attributed to State-Owned Banks standing at AF 317 million, Private Banks profitability recorded at AF 269 million, while branches of foreign banks earned AF 156 million profits during quarter ending Sep., 2017.

⁶ SOB- Stated-Owned Banks

⁷ BOFB- Branches of Foreign Banks

⁸ PB- Private Banks

Table 6.4: P/L Schedule

Items	Jawza 1396 (June, 2017)	Sunbula 1396 (Sep. 2017)	% Change quarterly
Interest income	2,416	2,214	-8.36
Interest expense	454	450	-0.88
Net interest income	1,962	1,764	-10.09
Non-interest income	1,676	1,610	-3.93
Non-interest expenses	1,486	1,447	-2.62
Salary cost	1,010	1,052	4.15
Credit provisions	919	(63)	-106.85
P/L before tax	223	938	320.62
P/L after tax	98	743	658.16

Source: Financial Supervision Department, DAB

Figure 6.10: Profitability of the Banking Sector

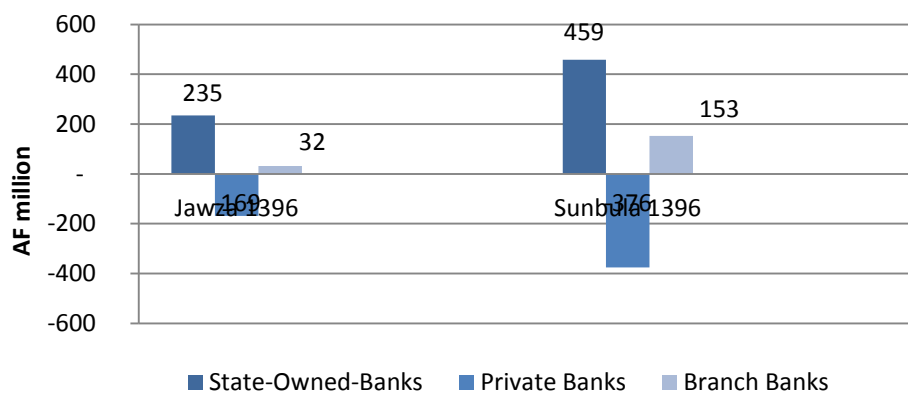


Figure 6.11: ROE and ROA of the banking system

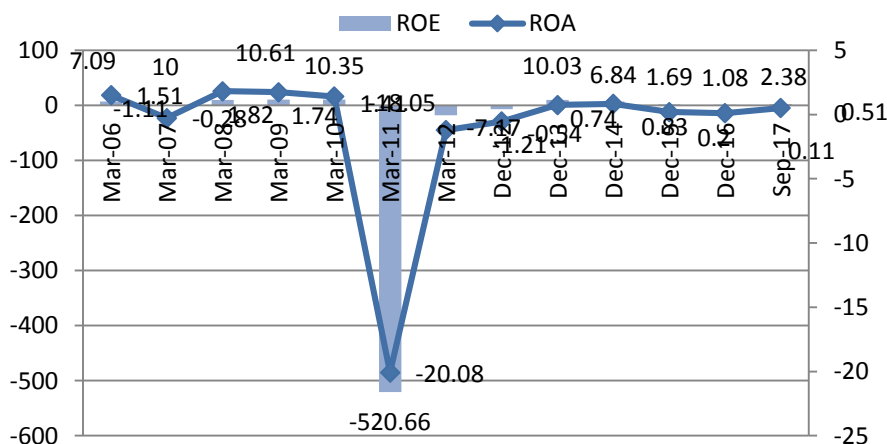
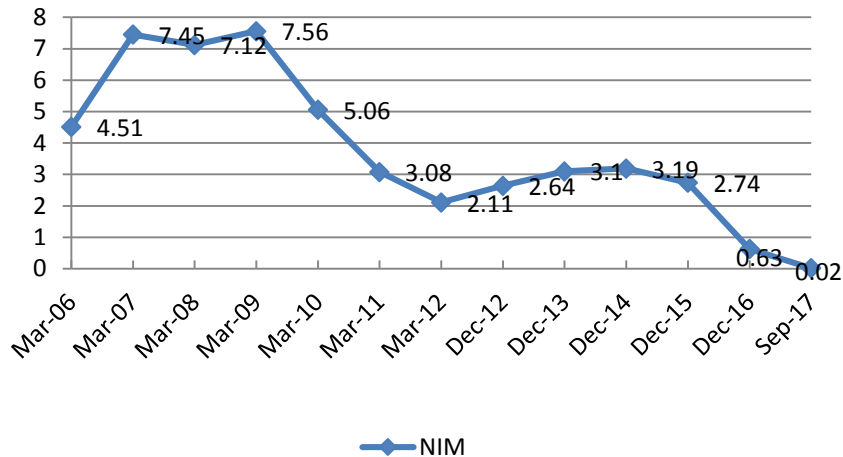


Figure 6.12: Net Interest Margin



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 six 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 1.53 billion and vice versa. Similarly, a 4 percent change would correspond to AF 307 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 494.45 million in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AF 494.45. For five banking institution, if the interest-rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

The major reason for the 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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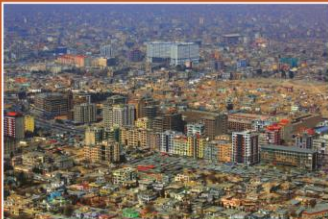
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