Da Afghanistan Bank

Economic & Statistical Bulletin

Quarterly Bulletin, Q2 - FY1394

April - June 2015

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Note:

Afghanistan's Fiscal year has been changed effective from 1391 (2012). The new fiscal year begins on December 21 each year. This Annual Bulletin describes developments in the fiscal year 1394, which covers April 22nd, 2015 to June 22nd, 2015.

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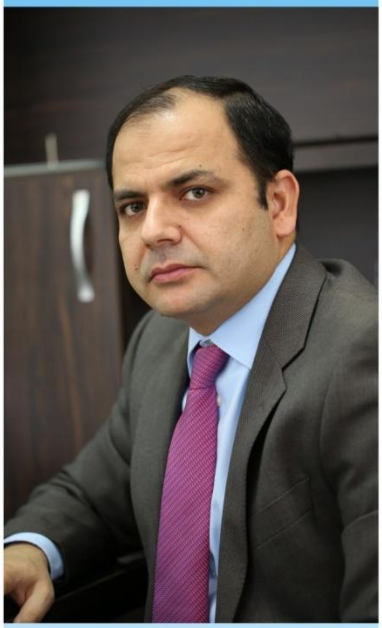
ABBREVIATIONS

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

Senior Management

Alhaj Essa Khan Turab

Second Deputy Governor



Khan Afzal Hadawal

First Deputy Governor

Khalil Sediq

Governor, Da Afghanistan Bank

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

This Bulletin provides a comprehensive account development in all sectors of the economy of the country while specifically focusing on the outcomes of DAB's activities toward achieving it main objective, price stability.

The second quarter of the current fiscal year has been quite challenging one for Afghan economy. The economic performance remained subdued mainly due to turbulent political environment and deteriorating security. All three sectors, Agriculture, industry and services, failed to deliver strong performance.

In the second quarter of FY1394, inflation, as measured on a year on year changes in national CPI, entered the negative territory. The National headline inflation rate was -2.8 percent (y-o-y), a sharp decline from 5.6 percent inflation observed in the same period of previous year.

Nonetheless, Afghanistan managed to qualify for Staff Monitored Program (SMP) of IMF; SMP was nine month program which primarily focused on addressing fiscal and banking vulnerabilities, preserving macroeconomic stability (low inflation, low debt, and a comfortable international reserves position), enhancing the economic environment for higher and inclusive growth, and providing a track record of policy implementation.

Under SMP, Afghanistan maintained monetary targeting monetary policy in which reserve money was set as operational target with price stability being the ultimate goal.

At the end of the second quarter of FY1394, reserve money stood at AF 208.5 billion recording a negative growth of 7.43 percent (y-o-y), below the ceiling of 1.2 percent. Similarly, CiC represented also a negative growth of 4.9 percent, ending at AF 187.4 billion at the end of the quarter.

External sector remained under pressure due to the current account deficit and considerable capital flight. The weak performance of external sector is reflected in overall deficit of USD 1679.67 million in balance of payment which equates 8 percent of GDP. Similarly, Net international reserves (NIR) of Afghanistan declined by 2.62 percent standing at USD 6,831.43 million at the end of the second quarter of FY1394, down from USD 7,015.39 million in the same period of last year, which can cover about 11 months of current imports.

The banking system gained momentum and performed well in the reporting period. Asset base of the banking sector grew by 2.47 percent or AF 6.08 billion during the quarter under analysis against 4.23 percent decrease in March, 2015, registering 3.79 percent (y-o-y). Meanwhile, Banking sector incurred losses amounting to AF 252 million for the second quarter of 2015, against 966 million losses in the previous quarter, resulting in negative 0.30 percent Return on Assets (ROA) against -1.16 percent in Mar.2015 and negative 2.54 percent Return on Equity (ROE) against negative 2.45 percent in Mar. 2015. State-Owned Banks and Private Banks ended up with losses, while Branches of Foreign banks ended up with profits during the quarter under analysis.

1

GLOBAL ECONOMIC ENVIRONMENT

1

GLOBAL ECONOMIC ENVIRONMENT

Global economic growth decreased in the first half of the year 2015 indicating weaker recovery in advanced economies as well as further sluggish economic activities in the emerging market economies. The global economic growth stood at 2.9 percent in the first half of 2015. Advanced economies experienced a modest growth over the first half of 2015 while the continued growth slowdown in emerging economies was mainly due to lower commodity prices, tighter external financial conditions, rebalancing in China, structural problems, and economic distress related to geopolitical factors.

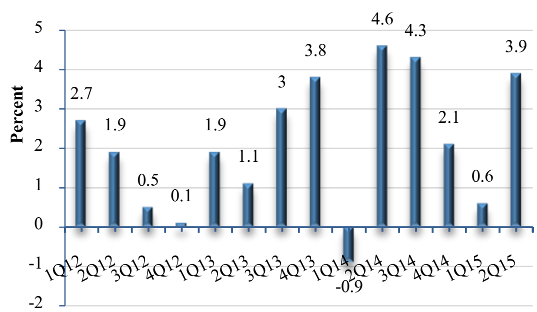
The oil prices rebounded more than expected in the second quarter of 2015. The main reasons behind the rebounded oil prices were higher demand and expectation about slower oil production growth in the United States. Due to the rebound in the oil prices, the prices of fuel end user started to rise over this period. In many advanced economies, the monthly headline inflation bottomed out but the core inflation was stable. The headline inflation declined in many emerging market economies with weaker domestic demand.

I. ADVANCE ECONOMIES

1.1 The United States Economy

The Economy of United States: The GDP of the United States increased at an annual rate of 3.9 percent in the second quarter of 2015 while the increase in the GDP was 0.6 percent during the previous quarter. The main reasons behind the increase in the real GDP were higher exports, lower imports, higher personal consumption expenditure, higher government spending and higher non-residential fixed investment.

Figure 4.1: The U.S. GDP Growth Rate (Seasonally Adusted Annual Rates)



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

The U.S. unemployment rate was recorded at 5.3 percent in the month of June compared to the 5.7 percent in the month of January. The unemployment rate showed no change compared to the previous month. Besides, the U.S. current account deficit decreased to USD 109.7 in the second quarter from USD 118.3 in the previous quarter. Moreover, the trade balance deficit of the United States stood at USD 43.8 billion in June up USD 2.9 billion from previous month which was recorded at USD 40.9 billion.

1.2 The United Kingdom Economy

The Economy of U.K.: The economy of U.K. grew by an estimated rate of 0.7 percent in the second quarter compared to 0.4 percent growth in previous quarter. The total output was 2.6 percent higher compared to the same period of last year. Increase in the output was noted in the two of the main industrial groupings within the economy. Services indicated an increase of 0.7 percent while production recorded an increase of 1 percent but construction showed no change in the quarter. In contrast, agriculture recorded 0.7 percent decline in the second quarter. In addition, the U.K. CPI was recorded at 0.0 percent in the month of June. Besides, the unemployment rate in U.K. stood at 5.6 percent in June 2015, while the rate was recorded at 5.7 percent in the month of January.

1.3 Economy of German

The Economy of Germany: The German economy grew by 0.4 percent in the second quarter of 2015 while the GDP growth of Germany stood at 0.3 percent in the previous quarter. Besides, the unemployment rate of Germany was stable during the past few months and was recorded at 4.7 percent. Moreover, the consumer prices went up by 0.2 percent in the month of July. The trade surplus of Germany reached 24.13 billion Euros, which was higher compared to the previous months of the year 2015.

1.4 France Economy

The Economy of France: The economy of France indicated no change in economic growth in the second quarter 2015 over the 0.7 percent growth in the last quarter. The French unemployment rate was recorded at 10.3 percent that showed no change from the previous quarter. The consumer prices indicated an increase of 0.3 percent in the month of June compared to the 0.3 percent in the previous month. The trade balance deficit of France stood at 2.54 billion Euros in the month of June.

1.5 Economy of Japan

The Economy of Japan: The Japan economy contracted by 0.4 percent in the second quarter of 2015 compared to 1.1 percent growth in the first quarter. The seasonally adjusted unemployment rate in Japan was recorded at 3.4 in the month of June, while the rate reached 3.6 percent in the month of April. The consumer prices indicated an increase of 0.4 percent in the month of June, compared to 0.5 percent of the previous month. Moreover, the trade deficit of Japan was recorded at 74.42 billion Japanese yen.

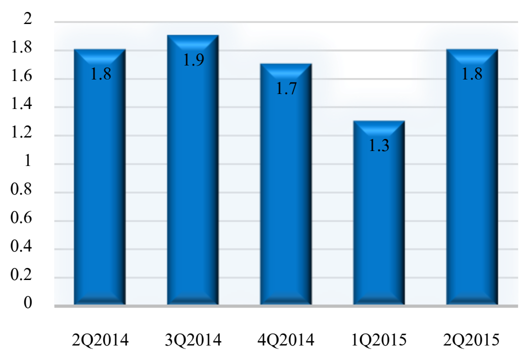
II. EMERGING ECONOMIES

2.1 Economy of China

The Economy of China: The economy of China grew at an annual rate of 7 percent in the second quarter of

2015, which indicated no change compared to the previous quarter, while it was expected that it would grow at a rate of 6.8 percent over the period. However, the GDP growth rate of China stood at 1.8 percent over the previous quarter, which was recorded at 1.3 percent.

Chines GDP Growth Rate (%)



Source: National Bureau of Statistics of China

In addition, the annual inflation rate of China stood at 1.4 percent in the month of June 2015, up from 1.2 percent in the previous month. Moreover, the unemployment rate of China decreased to 4.04 percent in the second quarter of 2015, from 4.1 percent in the previous quarter. The Chinese trade surplus was recorded at USD 46.53 billion in the month of June, while it stood at USD 58.86 in the previous month.

2.2 Economy of India

The Economy of India: The economy of India expanded at an annual rate of 7.1 percent for the period of April – June of 2015. Besides, the annual inflation rate in India was recorded at 5.4 percent in the month of June which was the highest compared to the previous months of the current year. Moreover, India recorded a trade deficit of USD 10.83 billion in the month of June 2015 while the trade deficit stood at USD 10.4 billion in the previous month.

REFERENCES:

International Monetary Fund (IMF)

Organization for Economic Coordination and Economic Development (OECD)

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

U.S. Department of Labor Statistics, Bureau of Labor Statistics

U.K. Office for National Statistics

Euro state news release

National Institute of Statistics and Economic Studies (INSEE)

Statist a, the statistics portal

Trading Economics

The Wall Street Journal

National Bureau of Statistics of China

Ministry of Statistics and Program Implementation

2

MONETARY AND CAPITAL MARKET DEVELOPMENTS

2

MONETARY AND CAPITAL MARKET DEVELOPMENTS

This chapter evaluates the performance and developments in the monetary and capital market sector in the second quarter of FY1394. In addition, this chapter will shed light on the role and performance of Da Afghanistan Bank (DAB) in promoting and developing of Afghanistan's monetary and capital market.

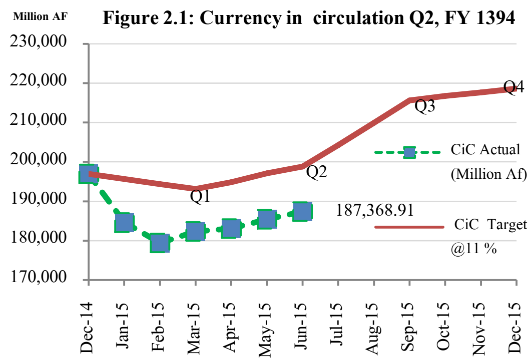
I – MONETARY PROGRAM

For the period under review, the key operational target (performance criterion) remained the reserve money (RM), while currency in circulation was set as indicative target designed for achieving DAB's primary objective of domestic price stability.

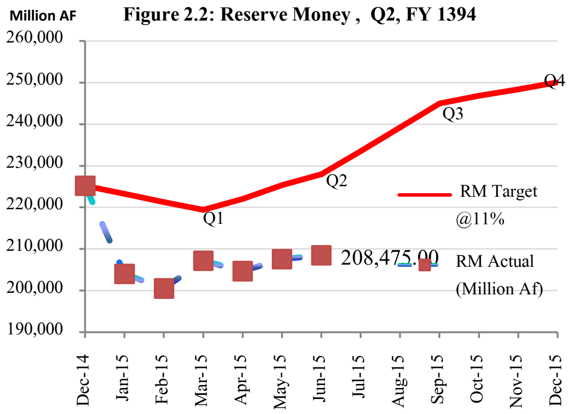
The right amount of reserve money conducive for supporting the domestic price stability is determined using the quantitative theory of money.

Reserve money (RM) consists of currency in circulation (CiC), eight percent required reserves of commercial banks, current account of commercial banks held with DAB, and overnight deposit facility. DAB uses open market operations using two main instruments of Foreign Exchange and Capital Notes auctions. For FY1394, the targets for reserve money and currency in circulation were revised downward to 7 percent from 11 percent.

At the end of the second quarter of FY1394, RM recorded a negative growth of 7.43 percent (y-o-y), below the ceiling of 1.2 percent. RM ended at AF 208.5 billion, while CiC represented a negative growth of 4.9 percent, ending at AF 187.4 billion at the end of the quarter.



Source: Monetary Policy Department/DAB



Source: Monetary Policy Department/DAB

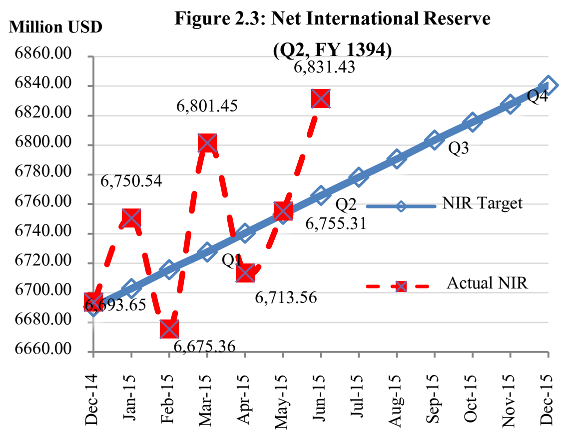
The political instability, security concerns and challenges, resulted in low economic activities in the economy. Meanwhile, in addition to the aforementioned factors, a delay in approval of nation budget by the Parliament, which resulted to low government expenditures in the first quarter of the year, are the key reasons behind the negative growth of Reserve Money and CiC.

1.1 Net International Reserve

The international reserves of Da Afghanistan Bank consist of monetary gold, reserve position and holdings with the IMF, special Drawing Rights (SDR), and reserves of major foreign currencies such as the U.S. dollar, euro and British Pound. The international reserves of Afghanistan expressed in term of U.S. dollars, defined as reserve assets minus reserve liabilities. It had an upward trend since the transitional government, mainly due to inflows received as grants.

In the past few years, Afghanistan's NIR, which is a crucial indicator of its ability to repay the external debts, and to finance the foreign trade deficit, grew steadily. For the FY1394, the NIR accumulation target (floor) was revised to zero, however, the actual accumulation stood at USD 138 million at the end of second quarter of FY1394. The actual NIR ended at USD 6,831.42 million at the end of the second quarter of FY1394. The increase in the NIR is mainly attributed to inflows of foreign exchange from export earnings and donor's contribution.

During the period under review, DAB increased the level of FX auction to meet the extra demand formed in the market. DAB auctioned a total of USD 1.432 billion in the quarter under review in order to meet market's demand and to mop up the excess liquidity from the market, while the total demand was USD 1.967 billion. During the period under review, total awarded amount of FX auction was about 73 percent of total demand.



Source: Monetary Policy Department/DAB

II. MONETARY AGGREGATES

DAB's Monetary Policy Department (MPD) compiles monetary aggregates - narrow money (M1) and broad money (M2) according to the MFS (Monetary and Financial Statistics), methodology and definitions.

Narrow money includes all banknotes, coins and demand deposits with the central bank and the commercial banks, while the broad money includes narrow money and other less liquid assets.

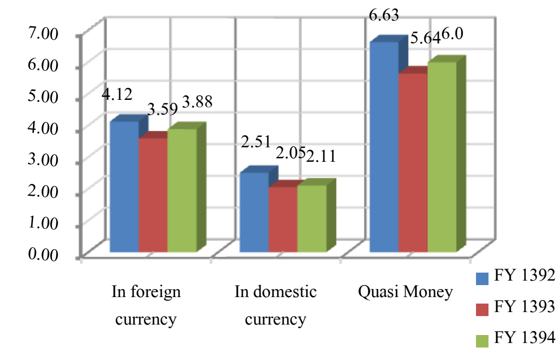
Narrow money (M1) grew by 0.98 percent on a year-on-year basis. The stock of broad money (M2) grew to AF 381,053 million that represents an overall growth rate of 1.36 percent (Y-o-Y), lower than 5.7 percent growth recorded in the same period of last year. M1 remained as the main contributor to the growth in M2.

Quasi money or time deposits of commercial banks, which is the other component of M2, grew by 7.67 percent compared with the same period of FY1393. However, quasi money constitutes only 6 percent of broad money; therefore, the impact of its changes on M2 is negligible. The year-on-year difference of Afghani denominated time deposits stood at AF 329 million and the foreign currency denominated time deposits recorded AF 1297.7 Million.

Meanwhile, demand deposits as the share of broad money decreased to 47.37 percent in the year under review, down from 48.36 percent in the previous year.

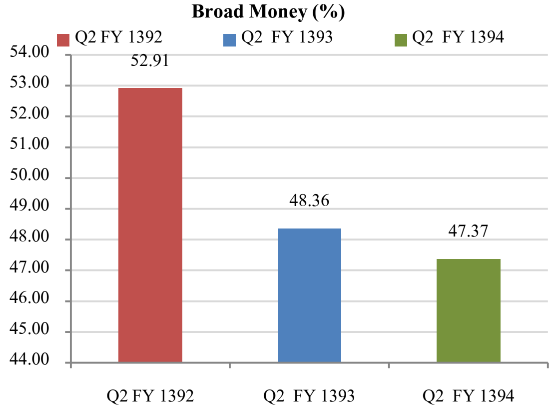
Similarly, quasi money as the share of broad money increased slightly to 5.99 percent at the end of the quarter under review, up from 5.64 percent in the same period of last year. Afghani-denominated time deposits constitute 2.11 percent of broad money. While, the share of foreign currency denominated deposits stood at 3.88 percent of M2.

Figure 2.4: Quasi Money As share of M2 (%)



Source: Monetary Survey Section, Monetary Policy Department/ DAB

Figure 2.5: Bank (Demand) Deposits as Share of Broad Money (%)



Source: Monetary Survey Section, Monetary Policy Department/ DAB

Table 2.1: Monetary Aggregates, Q2 FY1394

In Million Afs	1392 Q2 Amount	1393 Q2 Amount	Y-o-Y %Δ	Difference	1394 Q2 Amount	Y-o-Y % Δ	Difference
1- Net Foreign Assets	**445,926**	**481,918**	**8.1%**	**35,992**	**507,009**	**5.21%**	**25,091**
(a) Foreign Assets	476,487	510,941	7.2%	34,454	534,797	4.67%	23,856
DAB Foreign exchange reserves	389,186	423,601	8.8%	34,416	448,154	5.80%	24,552
Gold	60,424	47,509	-21.4%	0.000	47,509	0.00%	0.000
Other	328,762	376,093	14.4%	47,331	400,645	6.53%	24,552
Other foreign assets	87,301	87,340	0.0%	39	86,643	-0.80%	-697
(b) Foreign Liabilities	30,561	29,023	-5.0%	-1,538	27,788	-4.26%	-1,235
2. Net Domestic Assets	**-90,248**	**-105,976**	**17.4%**	**-15,728**	**-125,938**	**-126.22%**	**133,763**
(a) Net Domestic Credit	-37,926	-44,199	16.5%	-6,273	-33,670	-23.82%	10,529
Net Credit to Nonfinancial Public Sector	-83,100	-90,945	9.4%	-7,845	-75,033	-17.50%	15,911
Net Credit to Central Government	-82,870	-90,915	9.7%	-8,045	-74,906	-17.61%	16,009
Credit to Central Government	33,611	34,703	3.3%	1,092	60,369	73.96%	25,665
Liabilities to Central Government	116,481	125,619	7.8%	9,138	135,275	7.69%	9,656
Net Credit to State & Local Government	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Net Credit to Public Nonfinancial Corporations	-229.875	-29.500	0.000	200	-127.497	0.000	-98
Credit to Private Sector	46,403.902	48,145.650	0.000	1,742	43,058.127	0.000	-5,088
Net Credit to Other Financial Corporations	-1,230	-1,400	13.8%	-170	-1,694.19	21.04%	-294
(b) Capital Accounts	98,111	108,025	10.1%	9,914	111,812	3.51%	3,788
(c)Other Items Net	45,789	46,248	1.0%	459	19,544	-57.74%	-26,704
3- Broad Money(M2)	**355,657**	**375,932**	**5.7%**	**20,275**	**381,053**	**1.36%**	**5,121**
Narrow Money(M1)	332,073	354,732	6.8%	22,659	358,226	0.98%	3,494
CiC(Currency outside depository corporations)	143,880	172,929	20.2%	29,050	177,734	2.78%	4,805
Demand Deposits	188,194	181,803	-3.4%	-6,391	180,492	-0.72%	-1,311
Other Deposits (Quasi Money)	23,583	21,200	-10.1%	-2,383	22,827	7.67%	1,627
In Afghani	8,923	7,705	-13.6%	-1,217	8,035	4.27%	329
In Foreign currency	14,661	13,495	-8.0%	-1,166	14,792	9.62%	1,298
Securities Other Than Shares		0.000	0.000	0.000	0.000	0.000	0.000

III. FOREIGN EXCHANGE MARKET

3.1 Foreign Exchange Rates

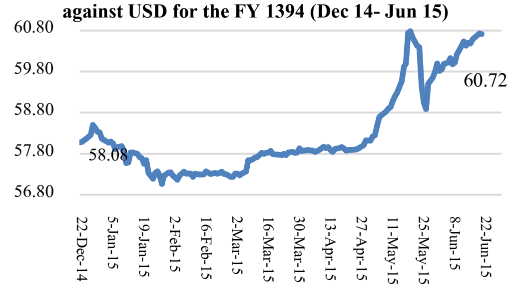
To maintain price stability is the primary objective of the Da Afghanistan Bank (DAB). The benefits of price stability are significant. Maintaining price stability on a sustained basis is one of the critical pre-conditions for enhancing economic growth and economic welfare. In order to control the money supply, DAB is targeting reserve money through a weekly capital notes auction and bi-weekly foreign exchange auctions.

DAB does not target the nominal exchange rate of domestic currency against the foreign currencies; however, it is important to monitor the exchange rate fluctuation which will impact the economic indicators negatively. To mop up excessive money supply from the market, preserve the value of the domestic currency, to maintain favorable reserve position, and to ensure external balance without compromising on the overall goal of macroeconomic stability.

The daily historic review of the average exchange rate of Afghani against the USD is shown in Figure 2.6. The value of Afghani against the U.S. dollar depreciated by 4.5 percent from AF 58.08 per U.S. dollar at the beginning of fiscal year to AF 60.72 at the end of the period under review.

Certain reasons can be outlined for such fluctuation in the value of Afghani against the U.S. dollar. Such reasons could be the security challenges, political uncertainty, decline in the financial assistance by the donor countries, and the increased number of immigrants. When there is capital flight the money in circulation declines and economic cycle face with deficit. Ultimately it negatively affects the economic development and pushes toward recession. All these impact the demand for foreign currency.

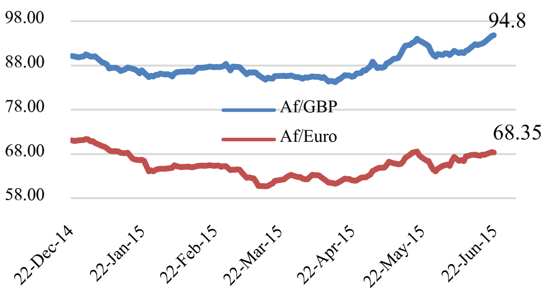
Figure 2.6 : Daily Average Ex-Rate of Afghani against USD for the FY 1394 (Dec 14- Jun 15)



Source: Monetary Policy Department/ Market operations Department/ DAB

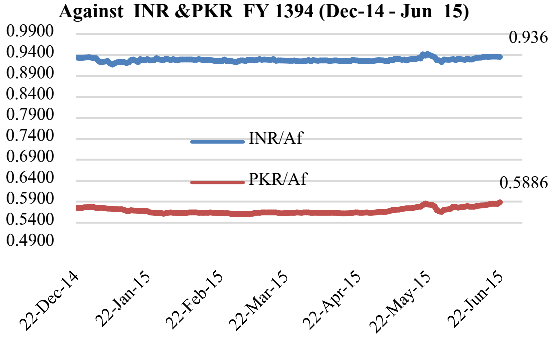
Similarly Afghani depreciated against GBP, INR, IRR and PKR by 5.2, 0.1, 10.2 and 2.3 percent respectively. On the other hand, Afghani strengthened against the Euro by 4 percent in the period under review.

Figure 2.7: Daily Average Ex-Rate of Afghani against GBP & Euro FY 1394 (Dec 14 - Jun 15)



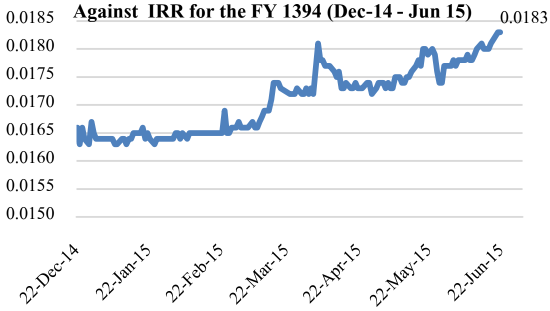
Source: Monetary Policy Department/ Market operations Department/ DAB

Figure 2.8: Daily Average Ex- Rate of Afghani Against INR &PKR FY 1394 (Dec-14 - Jun 15)



Source: Monetary Policy Department DAB

Figure 2.9: Daily Average Ex- Rate of Afghani Against IRR for the FY 1394 (Dec-14 - Jun 15)



Source: Monetary Policy Department DAB

3.2 Foreign Exchange Auction

Foreign exchange auction is the primary instrument used by DAB to control growth of money supply. The size of foreign exchange auction is determined by a liquidity forecasting framework, which takes into account the money demand on one hand and the currency growth ceiling on the other.

DAB's total intervention reached USD 1.432 billion in the period under review by which a total of AF 83.45 billion was sterilized from the market.

Table 2.2: DAB Foreign Exchange Auction's Summary for Q2, FY 1394 (In million USD)

Date	No of Bidders	Highest Price	Lowest Price	Market ER	Cut off rate	Amount Announced	Amount Awarded	Demanded amount	No. of Awarded Bids
23-Dec-14	38	58.12	57.85	58.09	58.10	40.00	40.20	65.50	25
27-Dec-14	38	58.33	58.00	58.26	58.29	40.00	40.80	65.55	25
30-Dec-14	37	58.34	58.06	58.34	58.30	50.00	52.35	63.45	38
4-Jan-15	33	58.08	57.82	58.07	58.00	50.00	44.35	47.80	41
6-Jan-15	35	57.98	57.45	58.05	57.93	50.00	50.15	61.80	41
10-Jan-15	35	57.99	57.80	57.99	57.96	45.00	45.15	56.25	36
13-Jan-15	34	57.59	57.25	57.59	57.56	40.00	34.60	48.20	39
17-Jan-15	38	57.81	57.62	57.80	57.76	40.00	42.55	47.70	39
20-Jan-15	34	57.54	57.39	57.69	57.51	40.00	35.20	43.95	32
24-Jan-15	33	57.17	56.83	57.33	57.12	40.00	27.80	38.35	32
27-Jan-15	33	57.28	56.82	57.26	57.24	35.00	31.45	41.25	29
31-Jan-15	30	57.32	57.02	57.34	57.29	30.00	28.00	35.80	26
3-Feb-15	31	57.22	57.08	57.22	57.18	30.00	30.45	39.15	29
7-Feb-15	36	57.39	57.03	57.36	57.35	25.00	26.85	39.60	28
10-Feb-15	32	57.25	57.05	57.32	57.23	30.00	29.70	37.30	29
14-Feb-15	34	57.28	57.10	57.32	57.26	30.00	23.35	35.55	26
17-Feb-15	36	57.39	57.10	57.30	57.36	25.00	24.50	37.80	36
21-Feb-15	33	57.30	57.01	57.33	57.27	25.00	22.55	30.25	29
24-Feb-15	33	57.37	57.31	57.36	57.32	20.00	18.00	24.00	27
28-Feb-15	38	57.26	57.13	57.24	57.23	20.00	13.75	21.35	23
3-Mar-15	38	57.35	57.00	57.32	57.33	15.00	13.20	24.60	20
7-Mar-15	31	57.45	57.37	57.37	57.41	10.00	10.00	15.50	20
10-Mar-15	34	57.70	57.47	57.67	57.68	15.00	14.80	25.00	21
14-Mar-15	34	57.82	57.41	57.82	57.80	20.00	25.30	30.40	32
17-Mar-15	36	57.82	57.61	57.83	57.79	25.00	25.15	31.00	32
24-Mar-15	34	57.77	57.30	57.80	57.73	35.00	32.95	42.30	36
28-Mar-15	35	57.83	57.51	57.85	57.81	25.00	25.35	32.80	29
31-Mar-15	36	57.95	57.40	57.93	57.92	25.00	35.10	41.05	35
4-Apr-15	30	57.84	57.51	57.88	57.83	35.00	32.90	45.65	24
7-Apr-15	33	57.86	57.30	57.88	57.82	35.00	35.00	42.65	31
11-Apr-15	32	57.94	57.80	57.97	57.91	35.00	35.10	38.30	37
14-Apr-15	33	57.88	57.45	57.89	57.84	35.00	35.20	43.45	36
18-Apr-15	34	57.94	57.70	57.94	57.92	30.00	30.50	40.50	29
21-Apr-15	36	57.88	54.76	57.88	57.84	30.00	30.65	41.15	30
25-Apr-15	33	57.94	57.82	57.90	57.92	30.00	30.10	42.05	27
2-May-15	33	58.13	56.50	58.12	58.10	30.00	22.30	40.35	22
5-May-15	35	58.56	58.25	58.49	58.52	20.00	20.10	32.10	23

9-May-15	36	58.84	58.11	58.83	58.82	25.00	25.00	35.80	29
12-May-15	39	59.13	58.04	59.09	59.07	35.00	33.40	52.05	33
16-May-15	38	59.64	58.61	59.57	59.60	30.00	29.80	46.65	26
19-May-15	38	60.91	59.51	60.75	60.75	30.00	35.45	47.90	34
23-May-15	41	60.46	59.80	60.44	60.38	33.00	33.25	48.20	37
26-May-15	39	59.12	58.11	59.46	59.06	30.00	29.75	43.30	30
30-May-15	40	59.76	59.30	59.66	59.72	25.00	24.70	38.75	26
2-Jun-15	40	59.86	58.80	59.82	59.80	28.00	26.20	38.10	34
6-Jun-15	36	60.07	59.60	60.02	60.04	26.00	24.05	34.10	27
9-Jun-15	36	60.04	59.61	60.02	60.02	24.00	18.05	33.70	21
13-Jun-15	39	60.61	60.20	60.54	60.57	18.00	18.65	31.70	22
16-Jun-15	39	60.56	60.00	60.49	60.53	18.00	18.35	27.65	25

Source: Monetary sector, Monetary Policy Department DAB

IV. CAPITAL MARKET & LIQUIDITY CONDITIONS

4.1. Capital Notes Auction

DA Afghanistan Bank uses Capital Notes (CNs) as the secondary monetary policy tool. Capital notes are discounted Afghani denominated short–term securities offered by DAB to the primary market customers, currently the licensed commercial banks, on a weekly basis.

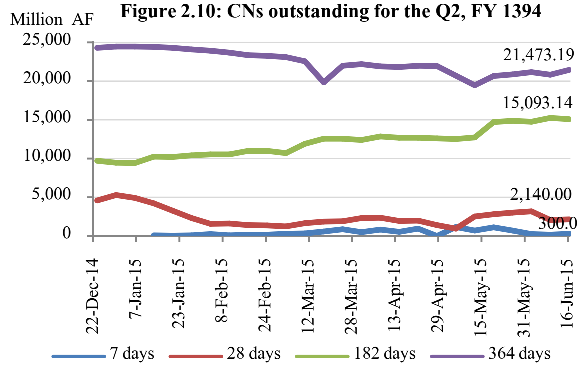
DAB offers four types of securities of seven day, one month (28 day), six months (182 day), and one year (364 day) capital notes.

The total outstanding stock of capital notes reached AF 39 billion at the end of the second quarter of FY1394, which shows an increase of 7.19 percent compared to the second quarter of year before, while it was AF 36.39 billion, this indicates that demand for capital notes are increasing.

The outstanding stock for 7day notes stood at AF 0.3 billion, for 28 day notes it was AF 2.14 billion, for182 day notes it stood at AF 15 billion, and the stock outstanding for 364 day notes stood at AF 21.5 billion in the period under review.

Figure 2.10 exhibits breakdown of the total outstanding stock for all maturities during the second quarter of fiscal year 1394.

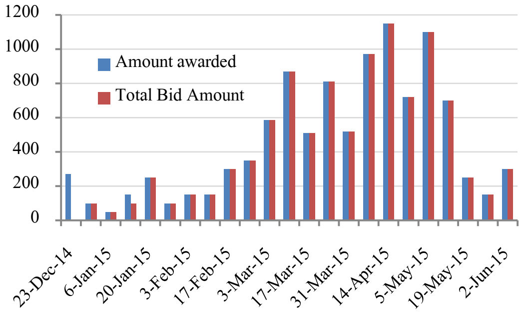
Figure 2.10: CNs outstanding for the Q2, FY 1394



Source: Market Operations Department, DAB

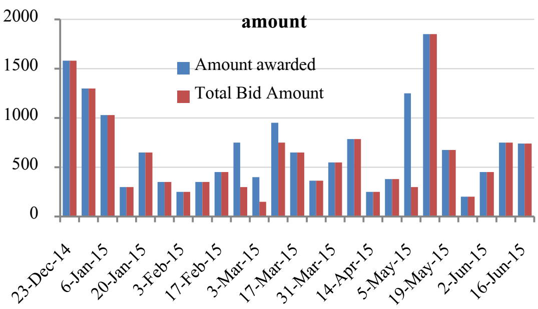
During the first and second quarters of the current year, DAB increased the announced amounts for all types of securities. The mean weighted average interest rate for 7 day capital note was 1.80 percent, for 28 day capital note remained at 3.5 percent, for 182 day security it was 5 percent, and for 364 day security it increased to 7 percent in the period under review. Total interest paid for CNs at the end of the second quarter stood at AF 467.2 million.

Figure 2.11: 7 Day CNs Demand and Awarded amount



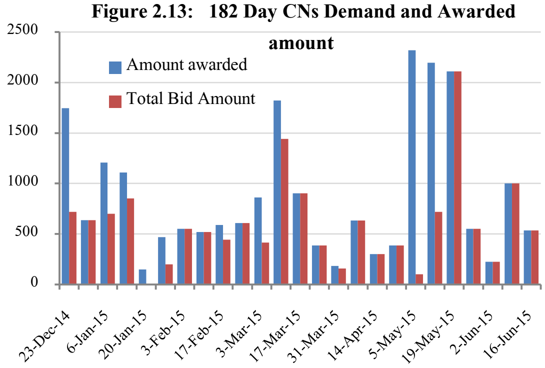
Source: Market Operations Department, DAB

Figure 2.12: 28 Day CNs Demand and Awarded amount



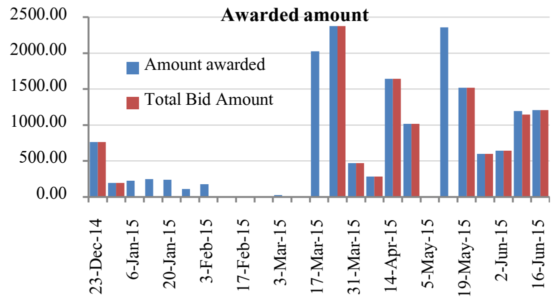
Source: Market Operations Department, DAB

Figure 2.13: 182 Day CNs Demand and Awarded amount



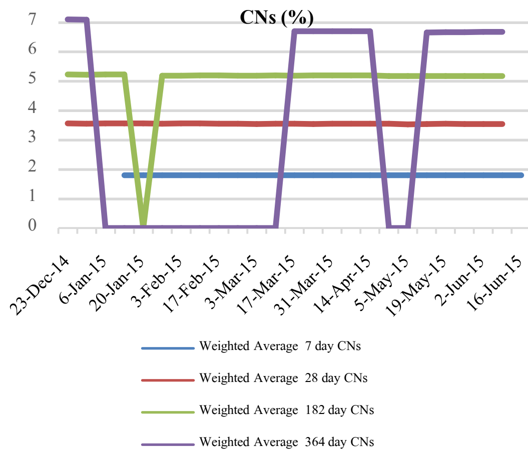
Source: Market Operations Department, DAB

Figure 2.14: 364 Day CNs Demand and Awarded amount



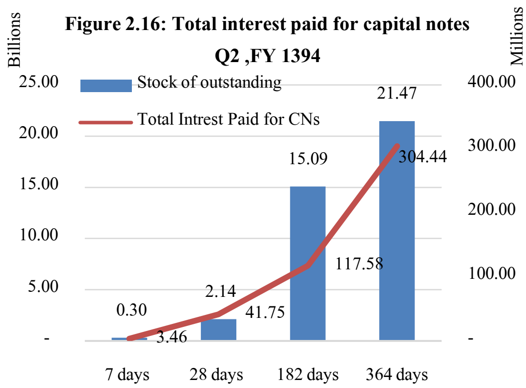
Source: Market Operations Department, DAB

Figure 2.15: Weighted average interest rates of CNs (%)



Source: Market Operations Department, DAB

Figure 2.16: Total interest paid for capital notes Q2 ,FY 1394



Source: Market Operations Department, DAB

Commercial banks are required to hold 8 percent of their total deposits as an obligatory reserve with DAB.

In order to facilitate commercial banks to better manage their liquidity, and to provide them a proper channel to invest their excess reserves, DAB reintroduced the overnight standing facility from the second quarter of FY1394.

Overnight Deposit Facility (ONDF): This facility is provided to commercial banks to better gain interest on their excess balances. The outstanding amount of ONDF stood at AF 1,901.9 million at the end of the second quarter of FY1394.

Overnight Credit Facility: This facility is used by commercial banks for their short term cash needs. This facility allows commercial banks to borrow local currency from Da Afghanistan Bank on an overnight basis, when they face a shortfall in their short term liquidity position. The rate that banks are charged is 350 basis points above the last 28 day CNs auction rate. This borrowing is collateralized with the outstanding of capital notes only.

4.2 Required and Excess Reserves

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Table 2.3: Auction of 7 day CNs

Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Lowest Bid %	Highest Bid %	Weighted Average 7 day CNs
6-Jan-15	2000	270	Rejected					3.00	
13-Jan-15	2000	100	100	1	1	1.80	1.80	1.80	1.80
20-Jan-15	1500	50	50	2	1	1.80	1.80	1.85	1.80
27-Jan-15	1000	150	100	2	1	1.80	1.80	1.83	1.80
3-Feb-15	1000	250	250	3	3	1.80	1.80	1.80	1.80
10-Feb-15	1000	100	100	1	1	1.80	1.80	1.80	1.80
17-Feb-15	500	150	150	2	2	1.80	1.80	1.80	1.80
24-Feb-15	300	150	150	2	2	1.80	1.80	1.80	1.80
3-Mar-15	300	300	300	2	2	1.80	1.80	1.80	1.80
10-Mar-15	500	350	350	2	2	1.80	1.80	1.80	1.80
17-Mar-15	1000	585	585	4	4	1.80	1.80	1.80	1.80
24-Mar-15	500	870	870	5	5	1.80	1.80	1.80	1.80
31-Mar-15	1500	510	510	3	3	1.80	1.80	1.80	1.80
7-Apr-15	1000	810	810	5	5	1.80	1.80	1.80	1.80
14-Apr-15	1000	520	520	3	3	1.80	1.80	1.80	1.80
21-Apr-15	1000	970	970	6	6	1.80	1.80	1.80	1.80
5-May-15	1000	1150	1150	6	6	1.80	1.80	1.80	1.80
12-May-15	1500	720	720	4	4	1.80	1.80	1.80	1.80
19-May-15	1500	1100	1100	5	5	1.80	1.80	1.80	1.80
26-May-15	2000	700	700	3	3	1.80	1.80	1.80	1.80
2-Jun-15	1500	250	250	1	1	1.80	1.80	1.80	1.80
9-Jun-15	250	150	150	1	1	1.80	1.80	1.80	1.80
16-Jun-15	500	300	300	1	1	1.80	1.80	1.80	1.80

Source: Market Operations Department, DAB

Table 2.4: Auction of 28 day CNs

Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Lowest Bid %	Highest Bid %	Weighted Average 28 day CNs
23-Dec-14	2000	1580	1580	7	7	3.560	3.6	3.56	3.6
30-Dec-14	2000	1300	1300	5	5	3.559	3.6	3.56	3.6
6-Jan-15	2000	1030	1030	6	6	3.560	3.6	3.56	3.6
13-Jan-15	2000	300	300	2	2	3.560	3.6	3.56	3.6
20-Jan-15	2000	650	650	2	2	3.560	3.6	3.56	3.6
27-Jan-15	1500	350	350	3	3	3.560	3.6	3.56	3.6
3-Feb-15	1500	250	250	2	2	3.559	3.6	3.56	3.6
10-Feb-15	1000	350	350	2	2	3.560	3.6	3.56	3.6
17-Feb-15	1000	450	450	2	2	3.560	3.6	3.56	3.6
24-Feb-15	500	750	300	5	1	3.559	3.6	3.56	3.6
3-Mar-15	500	400	150	3	1	3.550	3.6	3.56	3.6
10-Mar-15	1000	950	750	5	4	3.548	3.5	3.57	3.5
17-Mar-15	1000	650	650	4	4	3.549	3.5	3.55	3.5
24-Mar-15	1000	365	365	4	4	3.549	3.6	3.55	3.5
31-Mar-15	1000	550	550	4	4	3.546	3.5	3.55	3.5
7-Apr-15	1500	785	785	6	6	3.549	3.5	3.55	3.5
14-Apr-15	1000	250	250	2	2	3.550	3.6	3.55	3.6
21-Apr-15	1000	380	380	5	5	3.550	3.6	3.55	3.6
5-May-15	1500	1250	300	8	1	3.549	3.5	3.55	3.5
12-May-15	1250	1850	1850	7	7	3.529	3.5	3.55	3.5
19-May-15	1500	675	675	5	5	3.541	3.5	3.55	3.5
26-May-15	1000	200	200	1	1	3.549	3.5	3.55	3.5
2-Jun-15	1500	450	450	2	2	3.545	3.5	3.55	3.5
9-Jun-15	2000	750	750	4	4	3.547	3.5	3.55	3.5
16-Jun-15	1500	740	740	6	6	3.543	3.53	3.549	3.5

Source: Market Operations Department, DAB

Table 2.5: Auction of 182 day CNs

Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Lowest Bid %	Highest Bid %	Weighted Average 182 day CNs
23-Dec-14	1500	1747.3	718.3	7	6	5.23%	5.23	7.10	5.23
30-Dec-14	1500	635.5	635.5	4	4	5.23%	5.22	5.23	5.22
6-Jan-15	1500	1208.5	700.0	3	3	5.23%	5.23	5.23	5.23
13-Jan-15	1000	1110.0	852.7	4	4	5.23%	5.23	5.23	5.23
20-Jan-15	1000	150.0	0.0	2	0	5.23%	0.00	5.23	0.00
27-Jan-15	1000	470.0	200.0	3	1	5.20%	5.20	5.23	5.20
3-Feb-15	1000	550.0	550.0	3	3	5.20%	5.16	5.20	5.19
10-Feb-15	1500	519.1	519.1	3	3	5.20%	5.19	5.20	5.19
17-Feb-15	1000	587.9	444.0	5	5	5.20%	5.20	5.21	5.20
24-Feb-15	1000	607.6	607.6	4	4	5.20%	5.19	5.20	5.20
3-Mar-15	1000	862.3	415.0	5	3	5.19%	5.18	5.21	5.18
10-Mar-15	1000	1822.3	1442.3	8	6	5.19%	5.18	5.20	5.19
17-Mar-15	1000	903.4	903.4	5	5	5.18%	5.18	5.20	5.20
24-Mar-15	1000	385.2	385.2	4	4	5.19%	5.19	5.20	5.19
31-Mar-15	1000	185.0	160.0	4	3	5.20%	5.19	5.20	5.19
7-Apr-15	1000	635.0	635.0	3	3	5.20%	5.19	5.20	5.20
14-Apr-15	500	300.0	300.0	3	3	5.95%	5.20	5.20	5.20
21-Apr-15	500	385.0	385.0	3	3	5.20%	5.20	5.20	5.20
5-May-15	500	2320.0	100.0	5	1	5.18%	5.18	5.20	5.18
12-May-15	750	2195.0	720.0	6	4	5.18%	5.15	5.18	5.17
19-May-15	1000	2110.0	2110.0	6	6	5.18%	5.17	5.18	5.18
26-May-15	1500	550.0	550.0	4	4	5.18%	5.17	5.18	5.18
2-Jun-15	1000	225.0	225.0	2	2	5.18%	5.18	5.18	5.18
9-Jun-15	500	1000.0	1000.0	4	4	5.18%	5.18	5.18	5.18
16-Jun-15	1500	535.0	535.0	4	4	5.18%	5.18	5.18	5.18

Source: Market Operations Department, DAB

Table 2.6: Auction of 364 day Capital Notes

Date	Auction Amount	Amount awarded	Total Bid Amount	No. of total bids	No. of Winning Bids	Cut off Rate %	Lowest Bid %	Highest Bid %	Weighted Average 364 day CNs
23-Dec-14	1500	765.00	765.00	6	6	7.1	7.09	7.1	7.1
30-Dec-14	1000	195.00	195.00	3	3	7.1	7.10	7.1	7.1
6-Jan-15	500	225.00	Rejected	4	0	0.0	0.00	7.1	0.0
13-Jan-15	500	250.00	Rejected	2	0	7.1	0.00	7.1	0.0
20-Jan-15	500	241.57	Rejected	2	0	0.0	7.05	7.1	0.0
27-Jan-15	500	110.00	Rejected	2	0	0.0	7.00	7.0	0.0
3-Feb-15	500	176.57	Rejected	2	0	6.9	0.00	6.9	0.0
10-Feb-15	500	5.00	Rejected	1	0	6.8	0.00	6.8	0.0
17-Feb-15	500	Rejected	Rejected	0	0	0.0	0.00	0.0	0.0
24-Feb-15	500	Rejected	Rejected	1			6.75	6.8	
3-Mar-15	500	25.00	Rejected	0	0	0.0	6.75	6.8	0.0
10-Mar-15	1000	10.00	Rejected	0	0	0.0	6.75	6.8	0.0
17-Mar-15	1000	2025.00	Rejected	1	0	0.0	6.73	6.8	0.0
24-Mar-15	500	2374.00	2374.00	2	2	6.7	6.69	6.7	6.7
31-Mar-15	500	470.00	470.00	4	4	6.7	6.69	6.7	6.7
7-Apr-15	500	283.00	283.00	3	3	6.7	6.70	6.7	6.7
14-Apr-15	1000	1643.00	1643.50	4	4	6.7	6.70	6.7	6.7
21-Apr-15	1000	1016.00	1016.00	4	4	6.7	6.70	6.7	6.7
12-May-15	250	2360.00	Rejected	5	0	6.7	0.00	6.7	0.0
19-May-15	500	1520.00	1520.00	3	3	6.7	6.60	6.7	6.7
26-May-15	1500	600.00	600.00	3	3	6.7	6.65	6.7	6.7
2-Jun-15	1500	642.47	642.47	3	3	6.7	6.67	6.7	6.7
9-Jun-15	1500	1195.22	1145.22	7	6	6.7	6.68	6.7	6.7
16-Jun-15	1000	1210.00	1210.00	7	6		6.68	6.7	6.7

Source: Market Operations Department, DAB

3

THE INFLATION TREND AND OUTLOOK

3

THE INFLATION TREND AND OUTLOOK

Being a net importing country, Afghanistan is highly vulnerable to global and regional price developments. Changes in the price levels of neighboring countries, particularly the trade partners of Afghanistan, impact the overall prices in domestic economy.

The South Asian Association for Regional Cooperation (SAARC) members has been enjoying healthy economic growth in the first two quarters of 2015, which somehow offset the slow-moving export growth in the region. A fall in the global oil price from mid 2014-- a robust and healthy remittances in some of the countries such as Pakistan, Sri Lanka and Bangladesh-- an excellent harvest season in Pakistan, Bangladesh and Afghanistan—implementation and construction of hydropower projects in Bhutan—are among the activities which helped the economic growth in the region.

Like other parts of the World, the lower global energy and food prices had a significant impact on the SAARC region's inflation rate, which has fallen to a record low level in years.

To meet the fiscal targets in India, the government liberalized the diesel prices to bolster government revenue, so the domestic fuel prices have been relatively slow to fall, but in Pakistan and Sri Lanka low oil prices helped the inflation to decrease to its low level. In Bangladesh inflation eased but still remained relatively high, partly owing to limited spare capacity in the economy and recent transport disruptions.

I. CONSUMER PRICES IN AFGHANISTAN

In the second quarter of FY1394, inflation, as measured on a year on year changes in national CPI, entered the negative territory. The National headline inflation rate was -2.8 percent (y-o-y), a sharp decline from 5.6 percent inflation observed in the same period of previous year.

Like a persistent higher inflation, long term deflation also has negative impacts on the overall economic activities. Deflation is not necessarily bad, but discourages investment and consumer spending. Moreover, deflation leads to economic stagnation and high unemployment if it persists for a long time.

Observing the existing data, it is easily recognized that the decline in the inflation level over this period was due mainly to the continued decline in the prices of non-food.

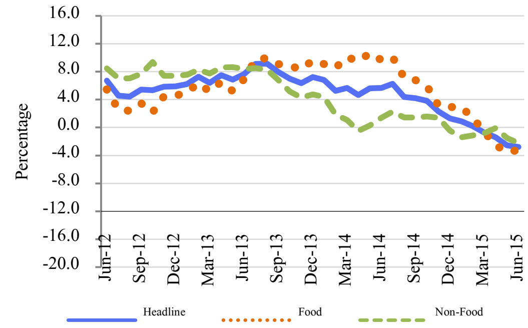
Based on the available data, deflationary pressures deepened in the second quarter of FY1394, both in Kabul and nationwide CPI.

For example, nationwide year-on-year inflation rate fell dramatically in the second quarter of FY1394 from the same quarter of previous year. Both, food and non-food prices drove the overall index down. Among the other components of the CPI, changes in bread and cereals, oil and fat, meat, vegetables, transportation and miscellaneous, were more significant.

Furthermore, core inflation, which excludes bread and cereals and oil & fat, is at its record low level of -1.9 percent (year-on-year) in the second quarter of FY1394.

The annual changes in Kabul headline inflation in the second quarter of FY1394 was -3.6 percent, same patterns were observed in nationwide CPI, and it was significantly lower than 1.2 percent inflation rate recorded in the second quarter of FY1393. This considerable decrease in inflation was led by both, food and non-food prices, the two main components of the CPI.

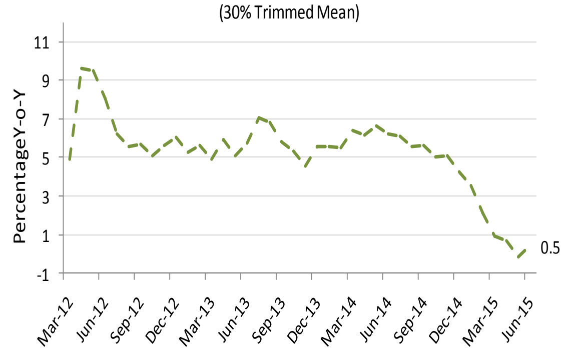
Figure 3.2: National CPI (Y-o-Y)



Source: Central Statistics Organization/DAB staff calculation

To eliminate the impacts of the most volatile components of CPI, and to get a better picture of the persistent inflation trend in the country, we measure core inflation. Core inflation as measured by the 28 percent trimmed mean (TM) method, a different pattern appears. Core inflation measured by Trimmed Mean (TM) stood at 0.5 percent in the second quarter of 1394, down from 6.3 percent in the same quarter last year.

Figure 3.3: Core Inflation
(30% Trimmed Mean)



Source: Monetary Policy Department/DAB

1.1 Developments in National Headline CPI

1.1.1 Annual Developments

To analyze the contributing factors responsible for changes in headline inflation, it is necessary to discuss the behavior of inflation in those components that have the most significant weights in the CPI basket.

The 8.4 percentage-point decrease in the overall inflation rate was primarily due to a sharp decrease in food prices. Non-food sun-index also exhibited a downward trend in the reporting period that helped headline inflation to decline.

Food prices, turned around and registered a deflation rate of 3.3 percent (y-o-y) in the second quarter of FY1394, fell dramatically by an alarming 13.0 percentage-point from the same period of last year. After a sharp increase experienced in the first three quarters of FY1393, food prices fell sharply in the first two quarters of FY1394, as a result of improved global wheat supply that increased by regionally, in Pakistan as a result good wheat harvest, prices of wheat dropped significantly. Similarly, the domestic agricultural production was satisfactory in FY1394 compared with FY1393.This eased the overall pressure on the food prices.

Non-food inflation also fell dramatically to -2.2 percent in the second quarter of FY1394 from 1.4 percent in the same period of previous year –its impacts on overall inflation was as pronounced as the food items.

The most important development was a sharp decline in the prices of bread and cereals that recorded a deflation rate of 3.4 percent, compared to 11.4 percent increase recorded in the same period last year. This 14.8 percentage-point decrease was one of the most important factors pushing the overall inflation down. Cooking oil and fat, another important component, representing 4.0 percent of the CPI, displayed a sharp decline, standing at -7.2 percent (y-o-y) in the second quarter of FY1394, a sharp decline from 1.7 percent increase recorded in the same period of last year. This 8.9 percentage point decrease in the rate of inflation could be attributed to a dramatic fall in petroleum prices that helped the transportation costs.

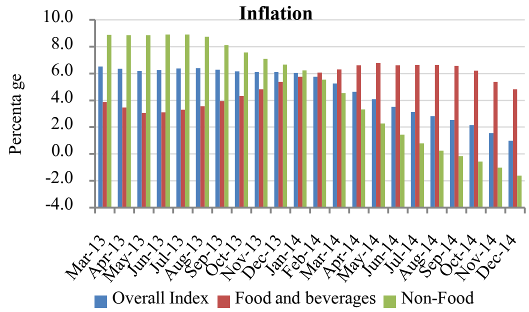
Vegetables prices also continued to fall dramatically in the period under review. Similar factors that affected the prices of bread and cereals are responsible for the decline in the prices of vegetables (7.9 percent of the CPI). After showing a high increase in the second quarter of FY1393 (24.3 percent), vegetables prices fell dramatically in the second quarter of FY1394 standing at -15.9 percent (y-o-y), a significant decline of 40.2 percentage points.

Meat prices have also fallen in the first half of FY1394. Meat prices (7.2 percent of the CPI) stood at -0.2 percent (y-o-y), compared to 3.4 percent increase recorded in the same period a year ago. This 3.6 percentage-point was mainly attributed to the supply side. Another important explanation is that meat prices were affected by the prices of cereal grains, which have been falling rapidly.

Housing, the largest component of non-food, comprises 20.7 percent of the CPI basket showed slightly improvements in the rate of deflation. Housing decreased by -7.0 percent in the second quarter of FY1394, compared to -9.1 percent a year ago. The reason behind such a decline in the prices of housing was the low demand for housing driven by the political and security uncertainty in the country.

Transportation (comprises 4.7 percent of the index) fell dramatically to -10.0 percent (y-o-y) in the second quarter of 1394, compared with a 20.1 percent increase recorded in the previous year. This dramatic 30.1 percentage-point decrease, a noticeable decrease among non-food items, was largely due to decreases in the world energy prices, withdrawal of foreign troops from Afghanistan and handing over the security responsibilities to the Afghan forces.

Figure3.4:12 Months Average National Inflation



Source: Central Statistics Organization/DAB staff calculation

Table 3.1: Breakdown of National Headline CPI

(Percent changes year on year)

(March 2011=100)

	Weights	1392				1393				1394	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**100.0**	**6.4**	**7.6**	**8.0**	**7.3**	**5.6**	**5.6**	**4.2**	**1.3**	**-0.7**	**-2.8**
Food and beverages	**52.0**	**5.2**	**6.9**	**9.1**	**9.6**	**10.0**	**9.7**	**6.8**	**2.9**	**-0.6**	**-3.3**
Bread and Cereals	17.7	12.8	13.7	14.6	9.1	9.5	11.4	11.0	8.0	1.9	-3.4
Meat	7.2	6.0	5.3	6.6	5.0	2.6	3.4	3.7	3.4	2.4	-0.2
Milk, cheese and eggs	4.8	4.9	4.1	7.8	5.0	6.5	6.1	2.1	3.4	1.4	1.0
Oils and fats	4.0	-0.5	-2.3	-0.4	0.3	1.8	1.7	0.9	-1.7	-6.2	-7.2
Fresh and dried fruits	4.8	-3.2	-2.0	-0.1	4.7	8.5	9.9	9.2	11.5	6.6	7.9
Vegetables	7.9	-3.3	6.6	15.3	30.7	30.3	24.3	7.1	-9.6	-11.7	-15.9
Sugar and sweets	2.9	3.4	4.7	2.8	2.4	2.5	-1.6	-0.2	-1.0	-1.1	0.5
Spices	0.9	8.8	10.2	5.6	8.1	10.5	9.4	12.0	5.9	1.0	-1.0
Non-alcoholic beverages	1.8	7.6	8.5	6.8	6.6	7.4	3.7	4.0	2.1	1.3	3.1
Non-Food	**48.0**	**7.7**	**8.4**	**6.8**	**4.9**	**1.1**	**1.4**	**1.4**	**-0.5**	**-0.8**	**-2.2**
Tobacco	0.4	11.5	19.5	21.2	10.9	8.4	3.0	0.6	6.7	2.8	12.8
Clothing	7.0	8.0	10.3	8.9	8.8	8.3	8.1	6.9	4.2	2.9	2.0
Housing,	20.7	11.8	11.1	6.8	2.1	-8.5	-9.1	-8.8	-9.7	-5.1	-7.0
Furnishing and household goods	7.0	3.9	6.0	6.5	8.7	8.5	10.4	10.3	8.4	4.9	2.1
Health	3.3	11.3	13.0	11.2	8.0	8.8	9.0	10.3	8.5	7.7	7.4
Transportation	4.7	-2.5	-1.5	3.6	5.8	16.6	20.1	19.5	11.3	-6.9	-10.0
Communication	1.1	-6.7	-6.4	-4.5	-2.5	-1.5	-1.4	-2.0	-3.4	-4.7	-3.3
Education	0.7	7.1	1.7	1.8	1.8	1.9	5.0	4.0	2.8	2.0	-2.7
Information and Culture	0.1	3.2	3.5	2.6	2.3	6.5	5.4	7.1	7.0	1.2	3.8
Restaurants and Hotels	1.0	2.4	2.8	3.7	1.8	2.6	2.4	4.6	3.2	2.2	4.2
Miscellaneous	1.8	5.5	5.2	6.6	8.0	7.6	10.2	8.2	7.6	7.3	7.2
core inflation (30% TM)		**4.9**	**5.8**	**5.8**	**5.6**	**6.4**	**6.3**	**5.6**	**4.3**	**-0.1**	**0.5**
Core inflation (Headline excl. B&C, O&F and T)		**5.9**	**7.4**	**7.2**	**7.2**	**4.3**	**3.6**	**1.7**	**-0.8**	**-0.7**	**-1.9**

Source: Central Statistics Organization/ DAB staff calculation.

1.1.2 Quarterly Developments in national CPI

This section examines the quarterly changes in national CPI.

To see more clearly what is happening to inflation in the most recent time periods, we may compare the quarter-on-quarter changes in the CPI and its various components in the second quarter of FY1394 with that experienced in the first quarter of 1394. Fortunately, some improvements are observed in the deflation rate in the quarter under review.

The quarterly rate of the overall CPI remained in the negative territory, but improved to -0.9 percent, compared to -2.9 percent in the previous quarter.

In food category there were some decreases in the deflation rate, but its impact on the overall headline was negligible. For example, bread and cereals and oil and fat are the food components that recorded improvements in the deflation rate. Bread and cereals and oil and fat recorded deflation rate of1.3 percent and 1.3 percent in the second quarter of FY1394 compared to 5.1 percent and 5.4 percent deflation in the preceding quarter.

Among the non-food sub-categories, tobacco, clothing, and furnishing & household, increased over the previous quarter by 12.1 percent, 1.1 percent and 1.7 percent from -3.8 percent, -0.1 percent and 1.7 percent respectively. Some components of the non-food witnessed improvements in the rate of deflation over the previous quarter. , For example, housing and transportation recorded-2.2 percent and -0.2 percent from -5.7 percent and -8.7 percent respectively.

Table 3.1: Breakdown of National Headline CPI

(Percent changes quarter-on-quarter)

(March 2011 = 100)

	1392				1393				1394	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**0.6**	**1.2**	**1.1**	**4.2**	**-1.0**	**1.2**	**-0.2**	**1.3**	**-2.9**	**-0.9**
Food and beverages	**0.5**	**1.3**	**1.7**	**5.9**	**0.8**	**1.0**	**-1.0**	**2.0**	**-2.7**	**-1.7**
Bread and Cereals	0.2	2.4	3.0	3.2	0.6	4.1	2.7	0.4	-5.1	-1.3
Meat	2.6	0.0	1.8	0.6	0.3	0.7	2.1	0.3	-0.7	-1.9
Milk, cheese and eggs	0.4	-1.4	4.8	1.2	1.9	-1.8	0.8	2.5	-0.1	-2.1
Oils and fats	-2.3	-0.2	0.7	2.1	-0.9	-0.2	-0.1	-0.5	-5.4	-1.3
Fresh and dried fruits	2.7	2.0	-1.0	0.9	6.5	3.4	-1.7	3.1	1.8	4.6
Vegetables	0.0	1.7	-1.0	29.9	-0.3	-3.0	-14.7	9.7	-2.7	-7.6
Sugar and sweets	-2.3	1.3	1.9	1.5	-2.1	-2.8	3.3	0.7	-2.3	-1.2
Spices	1.0	3.8	-2.1	5.3	3.3	2.7	0.3	-0.5	-1.5	0.7
Non-alcoholic beverages	-0.2	3.0	1.6	2.1	0.5	-0.6	1.9	0.3	-0.3	1.1
Non-Food	**0.8**	**1.1**	**0.6**	**2.4**	**-2.9**	**1.4**	**0.6**	**0.5**	**-3.3**	**0.0**
Tobacco	2.1	7.5	-0.5	1.5	-0.2	2.2	-2.8	7.6	-3.8	12.1
Clothing	1.7	2.1	0.9	3.8	1.2	1.9	-0.2	1.3	-0.1	1.1
Housing,	0.1	0.4	-0.4	2.0	-10.3	-0.3	-0.1	1.1	-5.7	-2.2
Furnishing and household goods	1.9	2.8	1.2	2.5	1.8	4.6	1.1	0.7	-1.5	1.7
Health	3.4	1.8	1.3	1.2	4.2	2.0	2.5	-0.4	3.4	1.8
Transportation	-1.0	0.2	2.9	3.6	9.1	3.2	2.4	-3.5	-8.7	-0.2
Communication	-1.1	-1.4	-0.7	0.7	-0.1	-1.3	-1.3	-0.7	-1.4	0.1
Education	1.7	-0.6	0.8	0.0	1.8	2.4	-0.2	-1.2	1.0	-2.2
Information and Culture	1.3	0.1	0.0	0.9	5.5	-1.0	1.6	0.8	-0.2	1.5
Restaurants and Hotels	0.2	0.6	1.1	-0.1	0.9	0.4	3.3	-1.5	0.0	2.3
Miscellaneous	1.6	0.3	2.0	4.0	1.2	2.8	0.1	3.3	1.0	2.6

Source: Central Statistics Organization/ DAB staff calculation.

1.2 Developments in Kabul CPI

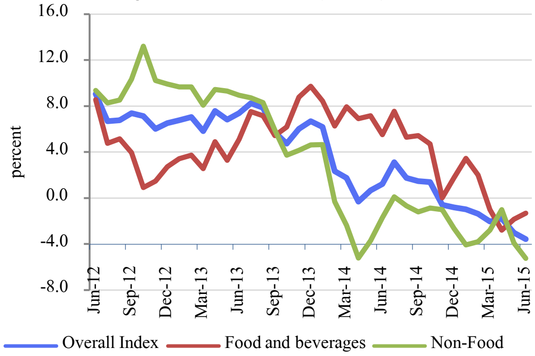
1.2.1 Annual Developments

The Kabul headline inflation rate, when measured on a year-on-year basis, showed similar characteristics to what was observed nationwide. The -3.6 percent change in Kabul headline inflation in the second quarter of 1394 shows a sharp decline from inflation rate of 1.2 percent experienced in the same quarter of FY1393. The main causes of such decrease were similar to what was observed nationwide. Again, food and non-food sub-indices played a combined role in pushing the overall inflation down.

Similarly, bread &cereals prices were the most significant factor in Kabul headline CPI Throughout Afghanistan, bread and cereals prices fell in the second quarter of FY1394 at a year-on-year rate of -2.9 percent.

Oil and fat also experienced rapidly-rising deflation, when compared with the previous year. Oil and fat prices decreased sharply in the second quarter of FY1394 compared to the same period of previous year, standing at -7.7 percent.

Figure 3.7: Kabul CPI (Y-o-Y)



Source: Central Statistics Office/ DAB staff calculation.

Similar to the nationwide CPI, housing prices which comprise 20.7 percent of the index is one of non-food items that showed slight improvements in the deflation rate. Housing, one of the largest non-food components, decreased by -9.7 percent in the second quarter of FY1394, compared to -13.4 percent a year ago.

Transportation prices are also following similar trend of what was observed nationwide Transportation prices (comprises 4.7 percent of the index) fell dramatically by -15.4 percent (year-on-year) in the second quarter of FY1394, compared to a 33.2 percent increase recorded in the previous year. This dramatic 48.6 percentage-point decrease was largely due to decreases in world energy and oil prices.

Table 1.2: Breakdown of Kabul Headline CPI

(Percent changes year on year)

(March 2011=100)

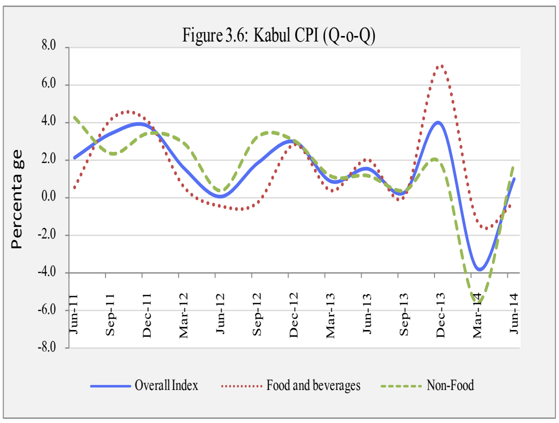
	Weights	1392				1393				1394	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**100.0**	**5.8**	**7.4**	**5.7**	**6.7**	**1.8**	**1.2**	**1.2**	**-1.1**	**-2.0**	**-3.6**
Food and beverages	**52.0**	**2.6**	**5.1**	**5.4**	**9.7**	**7.9**	**5.5**	**5.4**	**1.8**	**-1.0**	**-1.3**
Bread and Cereals	17.7	11.8	13.4	12.6	10.4	7.7	4.8	6.6	3.0	-1.9	-2.9
Meat	7.2	9.3	5.3	3.4	4.2	-1.4	-1.4	3.8	2.6	0.5	1.1
Milk, cheese and eggs	4.8	0.4	-2.0	-1.0	2.3	6.1	9.9	8.7	5.9	2.7	6.1
Oils and fats	4.0	0.1	-0.4	3.4	1.1	-0.9	-3.1	-5.1	-5.5	-12.6	-7.7
Fresh and dried fruits	4.8	-8.6	-6.3	-4.2	2.3	6.5	8.8	7.4	12.9	5.1	8.3
Vegetables	7.9	-6.5	7.2	8.6	30.0	24.7	15.8	8.9	-5.6	-2.3	-10.2
Sugar and sweets	2.9	2.0	1.1	-1.1	-1.4	-0.5	-6.9	-3.5	-5.1	-2.8	1.4
Spices	0.9	14.2	9.0	4.0	4.8	8.3	7.0	9.2	7.2	1.4	3.6
Non-alcoholic beverages	1.8	4.1	6.8	6.4	6.6	7.8	2.1	2.6	3.2	-0.8	3.0
Non-Food	**48.0**	**8.1**	**8.9**	**5.9**	**4.6**	**-2.4**	**-1.7**	**-1.6**	**-3.1**	**-2.8**	**-5.2**
Tobacco	0.4	6.0	10.0	11.6	10.3	11.2	13.3	11.5	15.5	12.9	9.1
Clothing	7.0	3.7	7.5	4.9	5.8	7.8	11.5	11.3	10.3	5.6	0.8
Housing, electricity, water and gas	20.7	11.7	12.3	7.0	3.6	-12.2	-13.2	-13.1	-13.4	-6.4	-9.7
Furnishing and household goods	7.0	3.8	3.8	4.9	6.8	6.2	13.4	13.2	12.5	7.2	3.9
Health	3.3	20.9	19.4	9.1	7.9	7.8	7.3	8.7	4.1	4.1	3.5
Transportation	4.7	-4.4	-1.9	3.2	8.0	33.3	33.2	32.1	19.4	-14.7	-15.4
Communication	1.1	-0.4	-1.2	-0.7	-0.7	-0.8	-2.2	-4.0	-5.0	-5.7	-3.6
Education	0.7	0.5	0.7	1.0	0.9	-0.1	2.8	1.9	2.1	1.6	-3.8
Information and Culture	0.1	1.7	0.9	-0.2	2.0	14.0	14.6	19.1	18.3	1.8	5.6
Restaurants and Hotels	1.0	0.8	0.0	0.0	0.0	1.5	2.3	5.2	3.1	1.7	5.5
Miscellaneous	1.8	2.4	0.9	2.8	5.0	4.3	7.9	3.8	5.0	4.5	8.3
Core inflation (30% TM)		**3.3**	**3.7**	**3.5**	**4.4**	**5.3**	**5.7**	**6.2**	**4.4**	**0.7**	**1.2**
Core inflation (Headline excl. B&C, O&F and T)		**5.5**	**7.0**	**6.7**	**6.0**	**-1.3**	**-1.3**	**-3.8**	**-3.1**	**-0.5**	**-2.6**

1.2.2 Quarterly Developments, Kabul CPI

In Kabul, there was a decrease in the deflation rate over the quarter under review, followed a similar trends of what was observed nationwide. The overall headline rate reached -0.6 percent in the second quarter of 1394, down from -4.7 percent in the first quarter of the same year. The pattern of changes in the rate of deflation across the components, however, was almost the same from what was experienced in nationwide.

In food category, there were some turnarounds that helped the deflation rate to improve compared to the previous period. Bread & cereals, milk, cheese & eggs, and oil & fat are among the components that depicted some improvements.

In the non-food category housing and transportation, recorded a decline in the rate of deflation over the previous quarter by -3.4 percent and -0.4 percent from -7.0 percent and -12.9 percent respectively.



Source: Central Statistics Organization/ DAB staff calculation

Table 1.4: Quarter-on-Quarter Changes in Kabul Headline CPI

(Percent changes quarter-on-quarter)

(March 2001=100)

	1392				1393				1394	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall Index	**0.9**	**1.5**	**0.3**	**3.9**	**-3.8**	**1.0**	**0.3**	**1.6**	**-4.7**	**-0.6**
Food and beverages	**0.4**	**2.0**	**0.1**	**7.0**	**-1.2**	**-0.2**	**0.0**	**3.3**	**-3.9**	**-0.5**
Bread and Cereals	-0.4	4.9	3.2	2.4	-2.8	2.0	5.1	-1.1	-7.4	1.0
Meat	5.1	-2.6	-0.8	2.5	-0.5	-2.5	4.4	1.3	-2.6	-1.9
Milk, cheese and eggs	-1.7	-4.9	3.5	5.7	2.0	-1.5	2.5	3.0	-1.1	1.7
Oils and fats	-0.7	0.7	1.3	-0.2	-2.6	-1.6	-0.8	-0.6	-9.9	3.9
Fresh and dried fruits	5.4	2.9	-3.2	-2.7	9.9	5.1	-4.5	2.3	2.3	8.3
Vegetables	-2.6	3.4	-5.3	36.2	-6.6	-3.9	-11.0	18.2	-3.4	-11.7
Sugar and sweets	-6.1	0.9	2.3	1.7	-5.2	-5.6	6.0	0.0	-3.0	-1.5
Spices	-0.3	2.2	-0.2	3.0	3.1	0.9	1.8	1.1	-2.4	3.2
Non-alcoholic beverages	0.9	2.9	1.8	0.9	2.0	-2.6	2.3	1.5	-2.0	1.2
Non-Food	**1.2**	**1.2**	**0.4**	**1.8**	**-5.6**	**1.9**	**0.5**	**0.3**	**-5.3**	**-0.7**
Tobacco	1.0	5.4	2.2	1.4	1.9	7.4	0.5	5.0	-0.4	3.8
Clothing	0.3	1.8	0.1	3.6	2.2	5.2	-0.1	2.6	-2.2	0.5
Housing	1.5	1.3	-0.3	1.0	-14.0	0.1	-0.1	0.6	-7.0	-3.4
Furnishing and household goods	2.0	1.3	1.5	1.9	1.4	8.2	1.3	1.3	-3.3	4.8
Health	1.7	1.3	2.4	2.3	1.6	0.8	3.7	-2.0	1.7	0.2
Transportation	-1.3	0.5	2.6	6.1	21.9	0.5	1.7	-4.1	-12.9	-0.4
Communication	0.0	-0.7	-0.1	0.1	-0.1	-2.1	-1.9	-1.0	-0.8	0.1
Education	2.0	-0.8	1.0	-1.2	1.0	2.0	0.1	-1.1	0.5	-3.3
Information and Culture	2.0	-0.9	-0.3	1.1	14.0	-0.3	3.6	0.5	-1.9	3.4
Restaurants and Hotels	0.0	0.0	0.0	0.0	1.5	0.8	2.9	-2.0	0.0	4.6
Miscellaneous	1.1	-0.2	1.9	2.2	0.4	3.2	-1.9	3.3	-0.1	7.0

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

II. REGIONAL INFLATION TREND

Being a net importing oriented economy, Afghanistan depends more on the imports, especially from its trading partners, such as Pakistan and India. Therefore, any developments in the regional markets have a direct impact on the Afghan economy.

In the South Asian region, Inflation has fallen to a record low in years. This decline was mainly because of the oil and food prices around the world; the disinflation trend has been further reinforced by relatively high local currencies and has facilitated policy easing in Pakistan and India.

2.1 Inflation in Pakistan

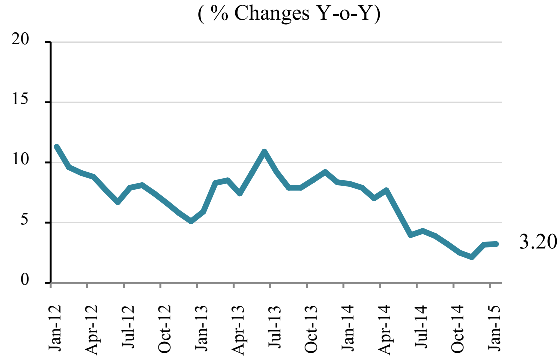
Headline CPI inflation is recorded at 3.2 percent (y-o-y) in June 2015 compared to 8.2 percent in the corresponding month of last year. The weaker demand in the economy and low oil prices kept the inflation rate at 3.2 percent, which allowed the authorities to cut the benchmark discount rate.

Due to the slowdown in the global economy and the dramatic fall in the oil prices, the government of Pakistan hopes to have inflation below 6 percent for the remaining months of 2015 and the year after.

Even though, it is not expected that there will be external factors to fuel the inflation, some internal factors will push the indicator up in the coming months. Over the last year, the government has imposed 600 billion rupees additional taxes; most of these taxes are indirect in nature, which will affect the prices of commodities in the coming months.

The fall in energy prices affected the other sectors in Pakistan's economy as well. Core inflation (non-food, non-energy) fell by 4.6 percent compared to 8.7 percent observed a year ago. The declining trend in core inflation was more significant than the headline CPI; this forced the State Bank to lower the discount rate.

Figure 3.7: Pakistan Headline CPI
(% Changes Y-o-Y)

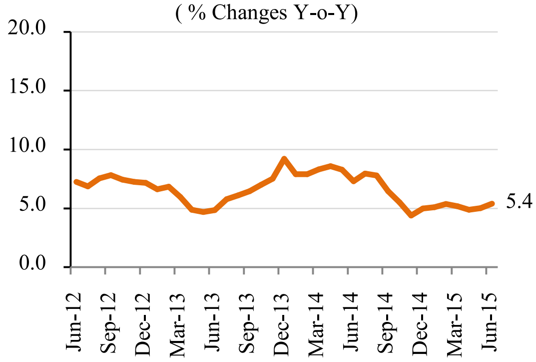


2.2 Inflation in India

In June 2015, the Consumer Price Index (CPI) inflation in India recorded 5.40 percent compared to 7.31 percent a year ago; this was mainly due to the prices of food and beverages. Food items have increased during June 2015 by 5.48 percent, lower than the food inflation of 7.21 percent observed in June 2014. Retail inflation rose to eight-month high, 5.4 percent, in June 2015.

According to the Reserve Bank of India, which follows retail inflation as a benchmark for its monetary policy, has termed the monsoon as the biggest uncertainty facing the Indian economy and expected the inflation to rise to 6 percent in the coming few months.

Figure 3.7: India Headline CPI
(% Changes Y-o-Y)



III. NEAR TERM INFLATION OUTLOOK

The persistence of uncertainty did affect the demand and supply for goods and services in Afghanistan. This discouraged investment levels as whole, consumers prefer to save more rather to consume.

Oil prices play an important role in any economy around the world. Therefore, changes a in the oil prices have a impact on the overall prices. Since June2014, many oil exporting countries have lost and many oil importing countries have gained due to a sharp decline in the oil prices. Afghanistan, as a small oil importing country, enjoys the low oil prices. Going forward, it is expected that headline inflation will turn positive at the end of the FY1394.

3.1 Risks

As mentioned before, a long last deflation has always been a matter of concern for any economy because it will lead to unemployment. Any disruption in the supply of goods and services from the global and regional markets will cause the overall prices to increase rapidly.

Moreover, the exchange rate volatility is thought the other factor that will affect the import prices.

4

EXTERNAL SECTOR DEVELOPMENTS

4

EXTERNAL SECTOR DEVELOPMENTS

This chapter presents developments in the external sector for the first half of the FY1394. Available data reveals that external sector performance weakened in the first half of the FY1394 as compared to the same period of previous year. This was reflected in an overall deficit of USD 1,679.57 million, which accounts for 8 percent of the GDP, in the balance of payments. Such developments are attributed to the increase of import expenditures and a continued decline in the export earnings, capital inflows, portfolio investment, and inflows from other investments as a result of persistent political uncertainty during the period under review.

Net international reserves (NIR) of Afghanistan declined by 2.62 percent standing at USD 6,831.43 million at the end of the second quarter of FY1394, down from USD 7,015.39 million in the same period of last year, which can cover about 11 months of current imports.

The trade balance position worsened as the total imports exceeded far the total exports. Inflows from income and current transfers (grants) helped to reduce the current account deficit in the first half of the FY1394.

However, the external debt stock decreased by 3 percent in the reporting period. The external debt policy pursued by the government helped the external debt position to stay within the manageable limits. Most importantly, the debt service payments should be monitored in order, not to restrict the financing of key development programs.

4.1: Balance of Payments

4.1.1 Current Account Balance

Available data shows that the current account deficit in the reporting period was USD 2,010.63 million; down from a deficit of USD 2,192.06 million a year ago. The current account deficit in the reporting period comprises about8 percent of GDP. The deficit was mainly attributed to lower exports earnings and higher out-payments of imports in the period under review. The CA deficit declined by 8 percent during the first half of the FY1394.

Income earnings with current transfers (grants and worker remittances) the main sources of inflows, helped to reduce the current account deficit in the first half of the FY1394.

The deficit in trade balance rose by 13 percent, standing at USD 3,148.06 million in the first half of the FY1394 compared to USD 2,796.69 million in the first half of the FY1393.Further analysis reveals that aggregate exports of goods declined by 13 percent to USD 250.79 million from USD 289.85 million a year ago. On the other hand, aggregate imports grew by 10 percent to USD 3,398.85 million in the first half of the FY1394 in comparison to USD 3,086.54 million recorded in the same period of last year.

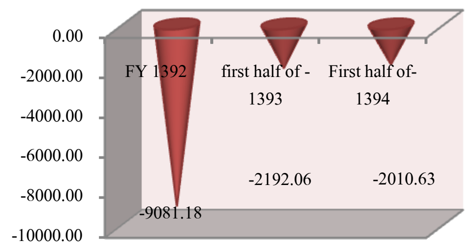
However, the deficit in the services account widened by 2 percent to USD 271.70 million from USD 266.10 million in the same period of previous year. While the surplus in income account increased dramatically by 584 percent to USD 120.80 million in the reporting period, up from USD 17.65 million a year ago.

The current transfers surplus, which was largely influenced by grants and worker remittances from abroad increased by 51 percent to USD 1,288.33 million, up from USD 853.08 million recorded in the preceding year.

Table 4.1: Current Account Balance

	FY 1392	first half -1393	first half -1394
Current account balance	-9081.18	-2192.06	-2010.63
Trade balance	-8241.30	-2796.69	-3148.06
Exports	507.08	289.85	250.79
Imports	-8748.38	-3086.54	-3398.85
Services A/c	-1362.67	-266.10	-271.70
Income A/c	68.22	17.65	120.80
Current Transfers	454.57	853.08	1288.33

Figure. 4.1: Current Account Balance



Source: CSO/DAB staff calculations

4.1.2 Capital Accounts

The capital account of the balance of payments showed a decline of 61 percent in the first half of the FY1394 compared to the same period of FY1393, as a result of lower capital transfers.

Net inflows to the capital account declined from USD 1,170.69 million in the first half of FY1393 to USD 452.09 million during the first half of FY1394. This was mainly due to net capital transfers received by the government, corporations and households which have reduced to USD 469.36 million in the first half of the FY1394 from USD 1,183.66 million in the first half of th3 FY 1393.

4.1.3 Financial Accounts

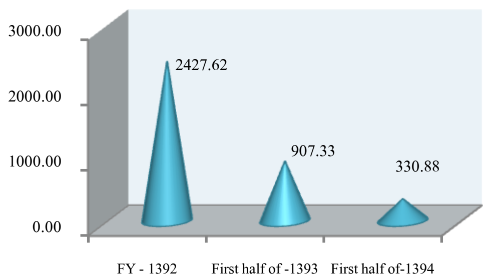
The financial account of the BOP recorded a net inflow of USD 121.21 million in the first half of the FY1394, lower from a net inflow of USD 263.36 million recorded in the same period of FY1393. This development was attributed mainly to a significant decline in the country's reserve assets during the first half of the FY1394. Further analysis reveals that the country's aggregate assets abroad decreased by USD 13.73 million in the first half of FY1394, lower than a decrease of USD 123.81 million recorded in the first half of the FY1393.

Likewise, the aggregate financial liabilities, decreased from USD 130.55 million to USD 3.52 million as a result of lower financial inflows owing to the security challenges that affected both, FDI and portfolio investments.

Table 4.2: Capital and Financial Accounts

	FY - 1392	First half of -1393	First half of-1394
Capital and financial A/c	2427.62	907.33	330.88
Capital **account**	535.39	1170.69	452.09
Capital transfers	2860.54	1183.66	469.36
Financial account	-423.01	-263.36	-121.21
Reserve Assets	-475.86	-278.54	-182.03

Figure 4.2: Afghanistan's Balance of Payments Capital and Financial Account (Million USD)

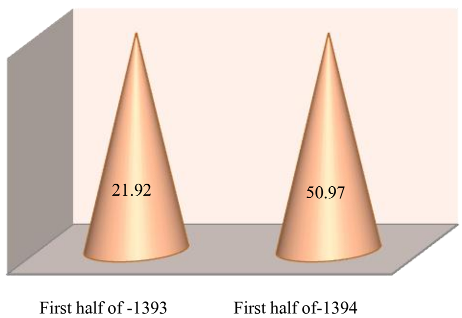


Source: CSO/DAB staff calculations

4.1.4 Foreign Direct Investment (FDI) and Portfolio Inflows

According to the available data, total inflows from foreign direct investment (FDI) amounted to USD 50.97 million it the first half of the FY1394, up from USD 21.92 million in the first half of the FY1393. Similarly, portfolio investment inflows increased from USD 32.69 million to USD 55.63 million in the period under review. The continued dominance of portfolio investment in aggregate foreign capital inflows suggests that a long term framework for managing short-term capital inflows should be adopted.

Figure 4.3: Foreign Direct Investment (FDI) Inflow

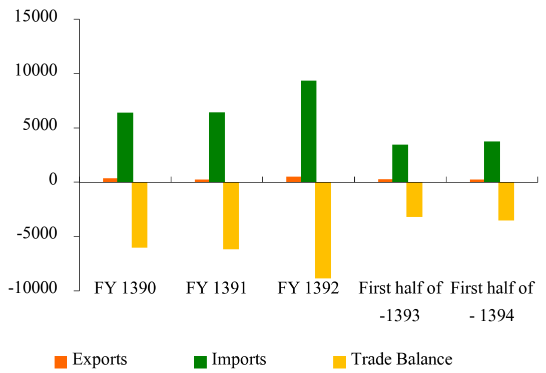


Source: CSO/DAB staff calculations

4.2Merchandise Trade

The merchandise trade deficit which had improved in the first half of the FY1393 turned around in the first half of the FY1394 and widened again. During the first half of the FY1394, earnings from exports dropped by 13 percent, while expenditure on imports grew by 8 percent. Consequently the trade deficit widened by 10 percent in the reporting period compared to the same period of FY1393. However, imports grew faster, while export decelerated in the first half of the FY1394. The overall trade deficit stood at USD 3,510.54 million in the reporting period.

Figure 4.4: Exports, Imports and Trade Balance



Source: CSO/DAB staff calculations

However, the trade deficit stood at 16 percent of GDP in the first half of the FY1394, slightly up from 15 percent in the first half of the FY1393.

The continued political and security concerns in the country suppressed the local production which resulted to a decline in total exports during the first half of the FY1394. Accordingly, earnings from exports declined to USD 233.46 million in the first half of the FY1394, down from USD 269.39 million in the same period of last year.

Trade statistics indicates that all export categories except carpet and rugs exhibited downward trend in the first half of the FY1394. Earnings from carpet and rugs export increased by 13 percent, standing at USD 61 million, up from USD 53.86 million recorded in the same period of last year. While, food items such as the fresh and dry fruit, leather-wool, and medical seed exports declined by 24 percent, 52 percent and 5 percent in the reporting period respectively.

Meanwhile, expenditure on imports increased moderately by 8 percent form USD 3,454.81 million to USD 3,744 million in the first half of the FY1394.

Major import expenditure categories in the reporting period were capital goods and fuel and lubricants. Expenditure on import of fuel and lubricants, accounted for about 18.6 percent of total imports in the first half of the FY1394, standing at USD 696.30 million which reflects 39 percent increase over the first half of the FY1393. Meanwhile, expenditure on imports of capital goods increased significantly in the first half of the FY1394. Overall expenditure on the import of capital goods increased by 48 percent, amounting to USD 1,746.09 million in the reporting period, which accounts for almost 46.6 percent of total imports.

Conversely, expenditure on imports of consumer goods declined by 27 percent, valued USD 916.66 million, down from USD 1,252.09 million in the same period of last year accounting for 24.5 percent of total imports in the first half of the FY1394. Expenditure on industrial supply accounted for about 10.3 percent of total imports, standing at USD 384.95 million, down from USD 518.23 million a year ago. This indicates a 26 percent decrease over the first half of the FY1393.

Table 4.3presents a detailed break-down of the merchandise trade statistics from 1390 up to the first half of the FY1394.

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

	FY 1390		FY 1391		FY 1392		First half of -1393		First half of - 1394	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	6,388.37	100%	6,419.67	100%	9,339.60	100%	3,454.81	100%	3,744.00	100%
Industrial supplies	614.77	9.6%	969.88	15.1%	1272.14	13.6%	518.23	15.0%	384.95	10.3%
Fuel and Lubricants	2,184.59	34.2%	1,083.65	16.9%	2167.37	23.2%	502.44	14.5%	696.30	18.6%
Consumer goods	857.38	13.4%	1,255.48	19.6%	1942.85	20.8%	1252.09	36.2%	916.66	24.5%
Capital goods and other	2,731.63	42.8%	3,110.66	48.5%	3,957	42.4%	1182.05	34.2%	1746.09	46.6%
Exports	375.03	100%	261.63	100.0%	499.81	100%	269.39	100%	233.46	100%
Carpets & Rugs	46.60	12%	8.43	3.2%	85.5	17.1%	53.86	20.0%	61.00	26.1%
Food Items	133.39	36%	104.23	39.8%	175.92	35.2%	98.79	36.7%	74.67	32.0%
Leather & Wool	28.07	7%	26.82	10.3%	59.54	11.9%	28.12	10.4%	13.51	5.8%
Medical seeds & others	166.97	45%	122.15	46.7%	178.86	35.8%	88.62	32.9%	84.28	36.1%
Trade Balance	-6,013.34		-6,158.04		-8,839.79		-3,185.42		-3,510.54	
Trade balance as % of GDP	-33%		-31%		-43%		-15%		-16%	

Source: CSO/DAB staff calculations

4.3 Direction of Trade

The main export destinations for Afghanistan were Pakistan, Iran, India, China, and Common Wealth of Independence States (CWS).

According to the merchandize trade statistics, in the reporting period Pakistan continued to be the largest export destination for Afghanistan with a total share of 40.64 percent, up from 34.90 percent recorded in the first half of the FY1393, this shows a 5.74 percentage point increase in total exports to Pakistan. The shares of carpets and rugs, medical seeds, karakul fur, and dry fruits in total exports to Pakistan were 21 percent, 3 percent, 2 percent, and 2 percent respectively.

India ranked the second largest buyer of Afghanistan's exports. The share of exports to India increased to 23.44 percent in the first half of the FY1394 from 18.81 percent that was recorded in the first half of the FY1393. Export of dry fruits, medical seeds and saffron accounted for 8 percent, 5 percent, and 1 percent of total exports to India respectively. Exports to India accounted for 8 percent of total exports, valued USD 54.73 million in the first half of the FY1394, compared to USD 50.68 million in the same period of last year.

The third largest buyer of Afghanistan's exports was Commonwealth of Independent State (CIS) countries. The share of Afghanistan's exports to CIS increased by 13.82 percent in the first half of the FY1394, up from 4.7 percent in the same period of last year. Afghanistan's total exports to CIS stood at USD 32.26 million in the first half of the FY1394 compared to USD 12.63 million in the first half of the FY1393. The major export categories to CIS countries were fresh fruits, carpet and rugs.

Figure 4.5: Direction of Exports (% share) in the first half of 1393

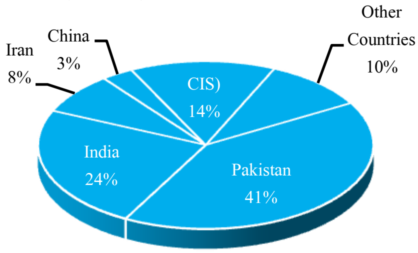
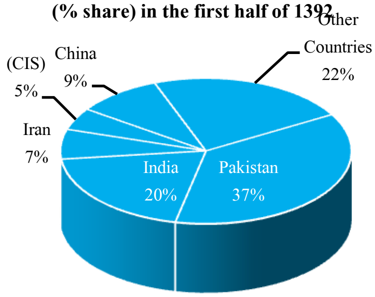


Figure. 4.6: Direction of Exports (% share) in the first half of 1392



Source: CSO/DAB staff calculations

Pakistan remained the largest source of imports for Afghanistan during the period under review with a share of 22 percent in total imports. Imports from Pakistan stood at USD 808.72 million in the first half of FY1394, up from USD 654.71 million a year ago, registering a 24 percent increase. Consumer goods, industrial supplies, fuel, lubricants and capital goods are the main import items from Pakistan.

The CIS remained the second largest import resource for Afghanistan, although its shares to total imports declined in the reporting period. Total Imports from CIS declined to USD 794.43 million with a share of 21.22 percent in the first half of FY1394, down from, USD 852.38 million with a share of 24.67 percent in total imports in the first half of the FY1393. The main import categories from this region were petroleum oil, wheat flour, metal production, vegetable-oil, and fertilizers.

Iran ranked the third largest import origin for Afghanistan. Total imports from Iran increased by2 percent standing at USD 793.48 million, up from USD 779.09 million in the same period of last year. Share of imports from Iran to total import accounted for 21.2 percent. The main import categories were industrial supplies, fuel, lubricants and capital good products.

China remained the fourth largest import country for Afghanistan. Total Imports from China increased to USD 560.93 million in the reporting period, up from USD 198.38 million a year ago, this shows a significant increase of 183 percent, which accounts for about 15 percent of total imports. Consumer goods, industrial supplies, and capital goods were the main imports categories from China.

Japan, India and USA were the fifth, sixth and seventh largest import sourcing countries for Afghanistan respectively. Imports from these countries accounted for 4.45 percent, 1.51 percent, and 1.20 percent of total imports, respectively. However, total imports from Japan increased by 160 percent in the first half of the FY1394 to USD 166.61 million, up from USD 64.17 million, mainly due to higher import of capital goods. Likewise, imports from the USA grew by 35 percent to USD 45.02 million in the first half of FY1394, slightly up from USD 33.27 million a year ago. Major import categories from Japan and USA were spare parts of machinery, and motor cars.

Conversely, imports from India dropped by 6 percent to USD 56.67 million, down from USD 60.48 million for the same periods. The share of imports from India in total imports declined to 1.5 percent from 1.75 percent in the first half of the FY1393.

Firgure 4.8: Direction of Imports (% share) in the first half of 1394

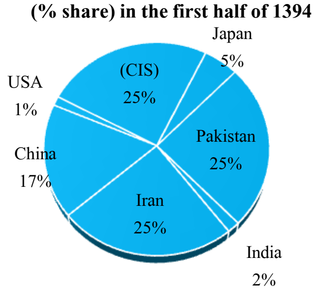
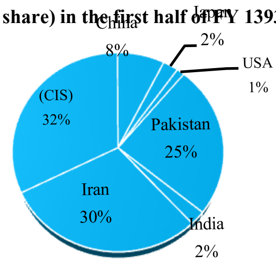


Figure 4.7: Direction of Imports (% share) in the first half of FY 1393



Source: CSO/DAB staff calculations

Table 4.4: Direction of External Trade: for the first half of the FY 1394 (in million USD)

	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	94.87	40.64%	808.72	21.60%	-713.85
India	54.73	23.44%	56.67	1.51%	-1.94
Iran	18.17	7.78%	793.48	21.19%	-775.31
Germany	3.18	1.36%	19.22	0.51%	-16.04
China	7.09	3.04%	560.93	14.98%	-553.84
England		0.00%	2.94	0.08%	-2.94
Saudi Arabia	0.25	0.11%		0.00%	0.25
USA		0.00%	45.02	1.20%	-45.02
Common Wealth of Independence States (CIS)	32.26	13.82%	794.43	21.22%	-762.17
Japan		0.00%	166.61	4.45%	-166.61
Other Countries	22.91	9.81%	495.98	13.25%	-473.07
Total	233.46	100%	3,744.00	100%	(3,510.54)

Table 4.5: Direction of External Trade: for the first half of the FY 1393 (in million USD)

	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	94.03	34.90%	654.71	18.95%	-560.68
India	50.68	18.81%	60.48	1.75%	-9.80
Iran	16.97	6.30%	779.09	22.55%	-762.12
Germany	13.19	4.90%	58.91	1.71%	-45.72
Common Wealth of Independence States (CIS)	12.63	4.69%	852.38	24.67%	-839.75
China	24.43	9.07%	198.38	5.74%	-173.95
Saudi Arabia	0.07	0.03%		0.00%	0.07
Japan		0.00%	64.17	1.86%	-64.17
England		0.00%	2.17	0.06%	-2.17
United States		0.00%	33.27	0.96%	-33.27
Other Countries	57.39	21.30%	751.25	21.75%	-693.86
Total	**269.39**	**100.00%**	**3454.81**	**100.00%**	**-3185.42**

Source: CSO/DAB staff calculations

4.4: Composition of Trade

4.4.1: Composition of imports

The composition of imports in the first half of the FY1394 indicates that import of capital goods had the largest share of 46.6 percent in the basket of import. In terms of value, the import of capital goods increased by 48 percent from USD 1,182.05 million in the first half of the FY1393 to USD 1,746.09 million in the reporting period.

The second largest share was recorded for consumer goods, although it has declined to 24.05 percent in the first half of FY1394 from 36.2 percent in the first half of the FY1393. In terms of value, imports of consumer goods also declined to USD 916.66 million from USD 1,252.09 million in the period under review.

Import of fuel and lubricants ranked the third largest share in the basket of imports in the first half of the FY1394. Expenditure on import of fuel and lubricants (petroleum oil) in total imports increased considerably by about 39 percent to USD 696.30 million with a share of 18.6 percent in the first half of the FY1394, up from USD 502.44 million with a share of 14.5 percent in the same period of last year.

The last largest share was recorded for industrial supply which has declined to 10.3 percent from 15 percent in the first half of the FY1393. In terms of value, the imports of industrial supplies in total imports dropped by about 26 percent, standing at USD 384.95 million in the first half of the FY1394 from USD 518.23 million in the first half of the FY1393.Industrial supplies, which include metals, fertilizer, chemical, and cement, posted a decline due to a reduction in the number of development projects all over the country as a result of political and security uncertainties.

Figure 4.10: Composition of Imports (share%) in the first half of FY1394

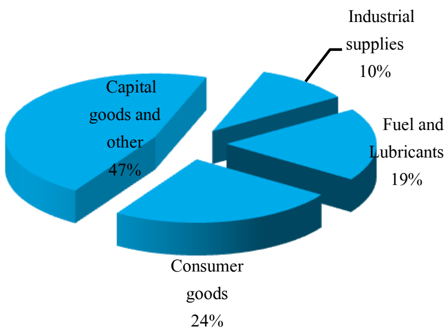
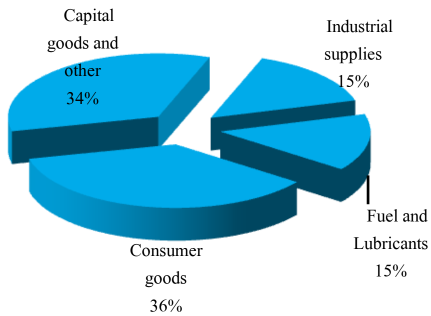


Figure 4.9: Composition of Imports (share%) in the first half of FY1393



Source: CSO and DAB Staff calculations

4.4.2: Composition of exports

The composition of exports in the first half of the FY1394 indicates that during the period under review, exports of medical seeds had the largest share of 36.1 percent in the export basket, despite of a 5 percent decline recorded in terms of value. Total exports of medical seeds stood at USD 84.28 million, down from USD 88.62 million that was recorded in the same period of last year.

The second largest share in total exports was recorded for food items despite its share decreased from 36.7 percent in the first half of the FY1393 to 32 percent in the first half of the FY1394. Earnings from export of food items (oil seeds and fresh and dry fruits) also decreased by 24 percent to USD 74.67 million in the first half of the FY1394 from USD 98.79 million in the same period of last year.

In addition, carpets and rugs which are considered the main component of Afghanistan's export items in the past decades had the third largest share of 26.1 percent in total exports in the first half of the FY1394.Based on the available data, earnings from export of carpet and rugs have increased by about 13 percent, standing atUSD 61 million in the first half of the FY1394, from USD 53.86 million recorded in the same period of last year.

The last largest share holder in the export basket was recorded for leather and wool. The export of these items declined from 10.4 percent in the first half of FY1393 to 5.8 percent in the period under review. Earnings from exports of leather and wool considerably declined by 52 percent to USD 13.51 million compared to USD 28.12 million in the first half of the FY1393.

Figure 4.11: Composition of Exports (share%) in the first half of FYof 1393

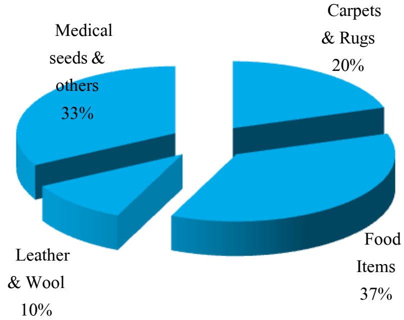
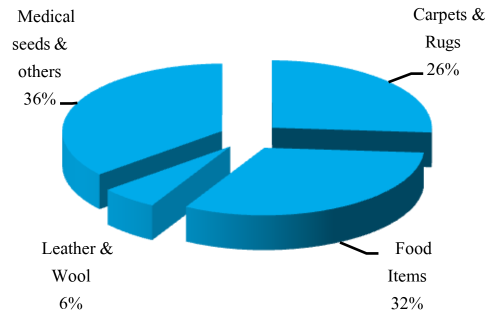


Figure 4.12: Composition of Exports (share%) in the first half of FY of 1394



Source: CSO and DAB Staff calculations

4.5External Debt

Afghanistan's external debt decreased by almost USD 77.35 million or 3 percent from USD 2,358.65 million in the first half of FY1393 to USD 2,281.30 million in the period under review. During the period under review, loan principal repayments made to the International Development Association (World Bank), Asian Development Bank (ADB), International Monetary Fund (IMF) and Bulgaria, while service charges were paid to the International Development Association (World Bank) and Asian Development Bank (ADB).

Meanwhile, International Development Association as the major multilateral creditor to Afghanistan made some debt forgiveness on principle and service charges and Asian Development Bank made some debt forgiveness only on principal during the period under review.

Based on the MoF data, Afghanistan's total loan amounts payable to the Paris Club creditors at the first half of the FY1394 stood at USD 952.77 million, which is payable to Russian Federation.

In other words, Afghanistan's total debt from the Paris Club members stands at about 40.58 percent of total current external debt, which has decreased by about 2.5 percent compared to the same period of the last year.

Table 4 .6: External Debt for the first half of the FY 1394(in units indicated)

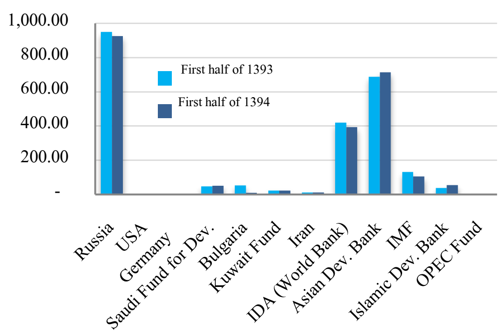
	In million USD	Percent of total
Total external debt	2,281.30	100.00
Bilateral	1,016.32	44.55
Paris Club	925.77	40.58
Russian Federation	925.77	40.58
United States	-	0.00
Germany	-	0.00

Non-Paris Club	90.55	3.97
Multilateral	1,264.98	55.45
of which: IDA (World Bank)	393.28	17.24
Asian Development Bank	713.44	31.27
International Monetary Fund	103.71	4.55
Islamic Development Bank	52.72	2.31
OPEC Fund	1.84	0.08

In addition, total debt from Non-Paris Club members which includes Saudi Fund for Development, Bulgaria, Kuwait fund and Iran, declined by 31 percent to USD 90.55 million from USD 131.81 million in the first half of the FY1393.

On the other hand, multilateral credits to Afghanistan increased by 1 percent from USD 1,264.98 million to USD 1,277.34 million at the end of the first half of the FY1394.

Figure 4.13: External Debt Comparisons; 1th half of 93 & 1th half of 94



4.6 Net International Reserves

According to the latest available data, DAB's net international reserves (NIR) decreased slightly by about 3 percent, standing at USD 6,831.43 million at the end of the first half of the FY1394, down from USD 7,015.39 million recorded in the same period of last year. The decrease in the level of NIR was mainly due to a decline in the reserve assets, which narrowed by one percent to USD 7,345.96 million in the first half of the FY1394 from USD 7,421.09 million in the same period of last year.

On the other hand, during the period under review, reserve liabilities increased by almost 27 percent standing at USD 514.53 million, up from USD 405.70 million in the previous period. The increase in reserve liabilities is mainly attributed to the commercial bank deposits in foreign currency, which increased by 49.23 percent to USD 414.35 million from USD 277.66 million in the previous period.

The use of fund resource depicted a 21.78 percent decrease from USD 127.90 million in the first half of the FY 1393 to USD 100.05 million in the period under review. The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the reviewed period.

Table 4.7: Net International Reserves; First half of the FY 1394(million of US dollars)

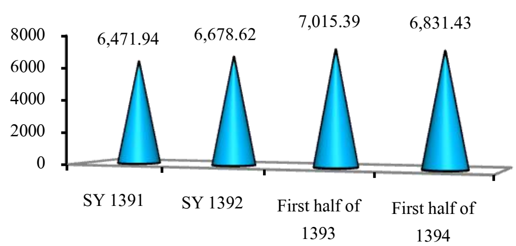
Changes on the quarterly basis	First half of 1393	% change	First half of 1394	% change
Net international Reserves (million US Dollar)	7,015.39	5.04	6,831.43	-2.62
Reserve Assets	7,421.09	3.31	7,345.96	-1.01
Reserve Liabilities	405.70	-19.62	514.53	26.83
Commercial bank deposits in foreign currency	277.66	-24.48	414.35	49.23
Nonresident deposits in foreign currency	0.14	0.00	0.14	-0.02
Use of Fund resources	127.90	-6.59	100.05	-21.78
Gross Intl. Reserves (in months of import)	12.89		11.77	
Net Intl. Reserves (in months of import)	12		11	

Source: Monetary Policy Department, DAB

The decline in the level of net international reserves could be attributed to the significant outflows of foreign exchange, particularly from foreign and personal remittances. The current position of Afghanistan's NIR is providing a good cushion of the capacity of monetary policy and support of balance of payments. Currently, on average, NIR supports about 11 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

Figure 4.14: represents the Net International Reserves (NIR) of Afghanistan for the past few periods.

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



Source: Monetary Policy Department, DAB

5

FISCAL SECTOR DEVELOPMENTS

5

FISCALSECTOR DEVELOPMENTS

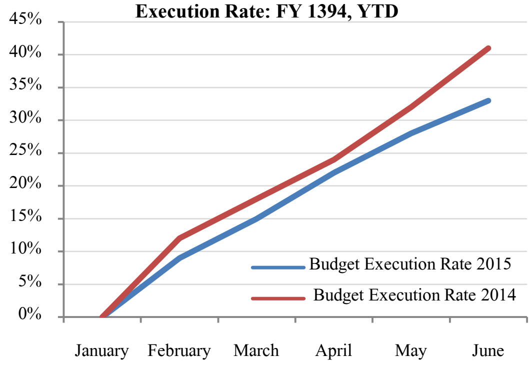
Fiscal year 1394 started with continuous internal political and security challenges reinforcing the downward pressures on the level of economic activities in the country. Consequently, reduction in economic activity contracted tax base in the country, lowering the overall domestic tax revenues over the first half of the fiscal year 1394. In addition, at the same time the donors postponed their committed funds to finance the government activities, correspondingly the late approval of the national budget by the Parliament caused lower spending over the first half of the fiscal year under review.

In spite of complicated security circumstances and political problems, the administrative management has made a strong commitment to reforms, and has taken corrective measures and policies to recover the macro-fiscal situation in the country. The economic growth for FY1394 is estimated 1.5 percent, which exhibits a sluggish economic performance compared to the previous year's growth of 2.1 percent. Excluding grants, there is a huge gap between the domestic revenues and core expenditures during the second quarter of 1394. In general, the total revenues collection slightly increased over the first half of 1394 fiscal year compared to the same period of preceding year.

5.1 Budget Execution Rate

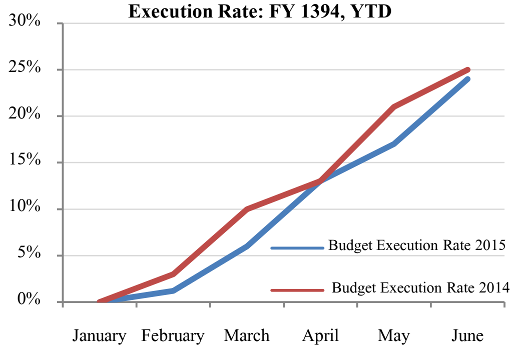
The observed consistent weak budget execution rate both, in the operating and development budgets repeated over the fiscal year of 1394. According to the Ministry of Finance, the overall spending in the first six months of FY1394 has not been implemented as it was anticipated. The execution data exhibits an 8 percent decrease in the operating expenditures by the end of the second quarter of FY1394. Approximately 33 percent expenditure has been made in the operating budget in the period under review, while it was 41 percent in the same period of preceding year. An enormous amount of the spending was made on compensation of employees in the quarter under review.

Figure 5.1: Operating Budget Execution Rate: FY 1394, YTD



Unlikely, an insignificant variation has been recorded concerning the execution rate of the development budget during the months of April, May, and June of the current and previous years. The execution rate of the development budget has moved slightly downward from 25 percent to 24 percent in the first six months of the current fiscal year, which signifies a 1 percent decline from the same period of a year ago. But a significant deviation has been observed in the monthly execution rate of both, operating and development budgets during the first six months of the current and preceding fiscal year.

Figure 5.2: Development Budget Execution Rate: FY 1394, YTD



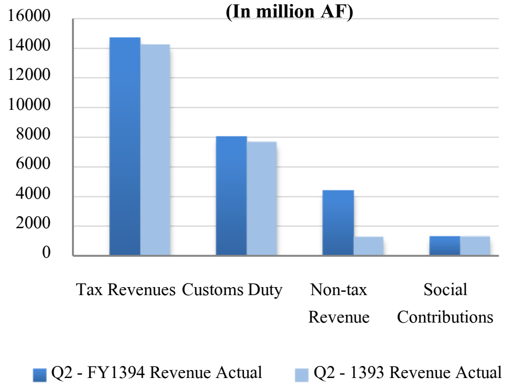
5.2 Budget Deficit

Government revenue and donor's fund collection over the first two quarters of FY1394 relatively improved compared to the same period of previous year. Donor's fund share in total revenue collection of the first quarter of FY1394 increased considerably, exhibiting AF 14,257 million increases against the same quarter a year earlier. Consequently, an AF 26,443 million budget surplus has been achieved by the end of the first quarter of FY1394. The national budget surplus in the first quarter dropped to a budget deficit of AF 5,162 million in the second quarter (June 2015) .. The contribution of the development budget deficit was noted AF 11,452 million in the total budget deficit of AF 5,162 million, while AF 6,290 million surplus was observed in the input of operating budget out of the total national budget by the end of the quarter under review.

5.3 Revenue Collection

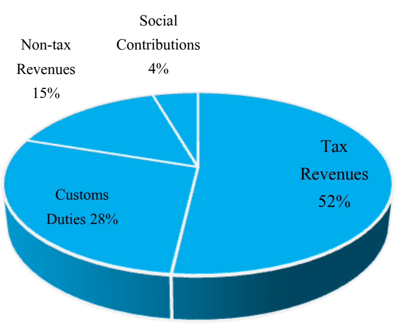
Despite of political and security uncertainties observed in the current fiscal year, some improvements have been noted in domestic revenue collection compared to the same period of previous fiscal year. According to the consolidated revenue collection data, the overall revenue collection performance continued to remain mix. The total revenue collected by the government excluding donor's fund indicates a negligible increase over the first quarter of FY1394. However, a considerable growth of 14 percent was recorded in total domestic revenue during the months of April-May-June 2015 that stood at AF 28,250 million compared to AF 24,409 million in the same period of the current and proceeding fiscal year.

Figure 5.3: Sources of Domestic Revenue (In million AF)



In the period under review, a positive movement observed in the domestic revenue due to a positive growth of income tax and sales tax. To get a better picture of sources of domestic revenue, the domestic revenue is analyzed by splitting it into tax and non-tax components. (Figure 5.4)

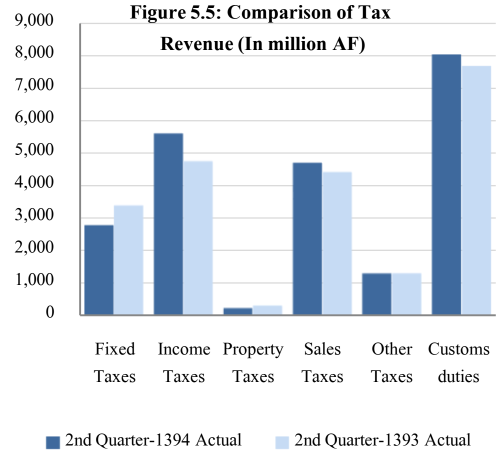
Figure 5.4: Composition of Domestic Revenue: YTD FY 1394 (actuals)



5.3.1. Tax Revenue

Normally a huge portion of the domestic revenues comes from the tax base revenue. Out of the total domestic revenue, 59 percent contribution of the tax revenue was recorded during the first quarter of FY1394. The contribution of tax revenue to total domestic revenue was AF 22,650 million in the second quarter of FY1394, whereas it was AF 21,811 million in the same period of the previous year, which indicates 4 percent increase in the tax based revenue.

Figure 5.5: Comparison of Tax Revenue (In million AF)

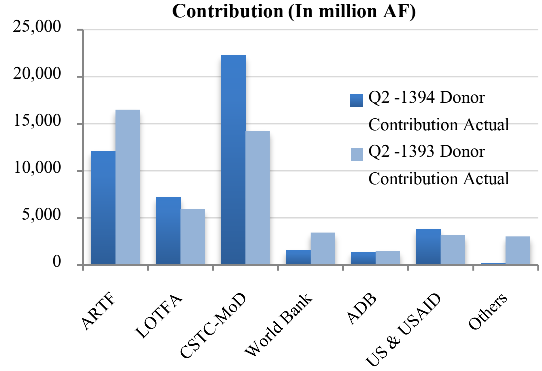


5.3.2 Non-tax Revenue

Non tax revenue, the other main source of domestic revenue, showed a strong positive growth, generating AF 5,600 million during April-May-June 2015 in comparison to AF 2,598 million in the corresponding months of the previous year; this indicates a 54 percent growth by the end of the second quarter of FY1394. Non-tax revenue comes from the components of retirement contribution, income from capital and properties, sales of goods and services, administrative fees, and extractive industry. Moreover, the growth in the components of non tax revenue exhibited a significant change in the period of April-May-June 2015. Moreover, an upward trend was depicted by the miscellaneous revenue which recorded AF 3,231 million increases by the end of the second quarter of

FY1394. The growth in the remaining components of non tax revenue slightly changed during the second quarter of FY1394 compared to the same period of proceeding year. Unlikely, the revenue collected from social contribution which is counted one of the main contributors of non tax revenue dropped down to AF 1,265 million from AF 1,312 million in the second quarter of previous year, representing a decline of 4 percent.

Figure 5.6: Comparison of Donors Contribution (In million AF)



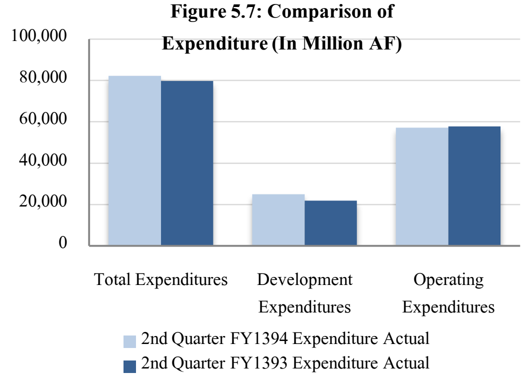
5.3 Donor Grants

Donor contribution remains the major source to finance the core budget and approximately consists sixty to seventy percent of the national budget. The total external resources (foreign grants) for the current fiscal year were estimated at about AF 302,753 million, funding 71 percent of the total national budget. Overall donor commitments made by the donor contributors in support of national budget recorded AF 95,395 million during the first six months of FY1394 The main portion of the foreign grants has funded by ARTF, LOTFA, and CSTC-MoD donor contributors over the six months of the current year, which comprises 17, 15 and 54 percent assistance of the overall donor contributions, against 31, 16 and 35 percent in the same period of preceding year respectively.

5.4 Expenditures

The overall government expenditure stood at AF 126,455 million during the first six months of FY1394 which is constituted of AF 94,139 million of operating expenditure and AF 32,315 million of development expenditure. This figure is slightly smaller compared to AF 131,203 million of the total expenditure in the corresponding period of the previous year. The overall expenditure shows a slight decline of 4 percent in the first six months of FY1394 against the same duration of the preceding year.

Figure 5.7: Comparison of Expenditure (In Million AF)



6

BANKING SYSTEM PERFORMANCE

6

BANKING SYSTEM PERFORMANC

Asset base of the banking sector grew by 2.47 percent or AF 6.08 billion during the quarter under analysis against 4.23 percent decrease in March, 2015, registering 3.79 percent increase since the preceding period (June 2014). The increase in banking system assets was mainly due to increase in deposits of the sector.

Gross loans portfolio of the banking sector witnessed an increase of 3.72 percent or AF 1.51 billion (5.95 percent decrease in March 2015) over a quarter standing at AF 42.16 billion. Compared to June 2014 gross loans depicted 10.12 percent decrease. The increase in the loan portfolio is mainly accounted for disbursements of new loans and customer utilization of OD loans.

Deposits the main funding source in the banking sector stood at AF 213.02 billion, comprising 96.19 percent of the total liabilities of the sector increased by 2.51 percent against 5.04 percent decrease in the previous quarter (Mar. 2015). The Deposits were largely denominated in USD (62.89 percent) with Afghani denominated deposits lagging at 33.46 percent. AF-denominated deposits indicated an increase of 2.90 points against 7.12 percent decrease in Mar. 2015 while USD denominated deposits was up by 1.98 points against 4.11 percent decrease in Mar.2015.

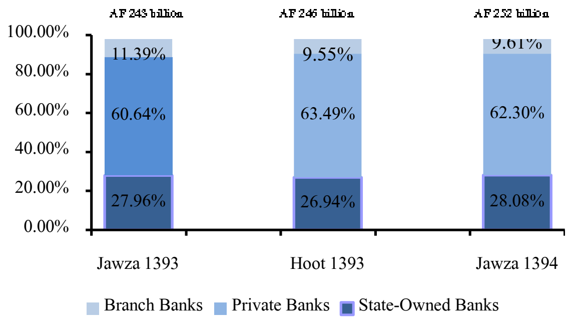
The capital base of the banking sector remained strong at AF 30.55 billion increased on account of decreases in losses of the banking sector. Capital adequacy ratio (CAR) of the banking sector recorded at 25.63 percent. All the banking institutions are above the set limits for CAR, but three banking institutions are very close to the limit.

Banking sector incurred losses amounting to AF 252 million for the second quarter of 2015, against 966 million losses in the previous quarter, resulting in negative 0.30 percent Return on Assets (ROA) against -1.16 percent in Mar.2015 and negative 2.54 percent Return on Equity (ROE) against negative 2.45 percent in Mar. 2015. State-Owned Banks and Private Banks ended up with losses, while Branches of Foreign banks ended up with profits during the quarter under analysis.

I. Assets of the Banking System

The assets size of the banking sector grew by 2.47 percentage points against 4.23 percent decline in Mar.2015. Figure 6.1

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



Source: Financial Supervision Department, DAB

The breakup of total assets reveals that the most obvious increase was registered by Other category of the total AF 2.03 billion (13.71 percent) followed by investments increased by AF 1.57 billion (9.86 percent), cash in vault and claims on DAB increased by AF 999 million (0.93 percent) and net loans increased by AF 805 million (2.16 percent) during the quarter under analysis. The increase in other asset categories was negligible.

The most important components of the system's total asset portfolio were cash in vault/claims on DAB (42.60 percent), interbank claims (26.04 percent), net loans (15.07 percent), investments (6.94 percent) and "other assets" (6.70 percent), and fixed assets make 2.65 percent of the total assets. Table 6.1

Table 6.1 Composition of Assets and Liabilities

Assets	Jawza 1393 June 2014	Hoot 1393 Mar.2015	Jawza 1394 June 2015	% of Total Assets/Liabilities	Q-o-Q growth
Cash in vault and claims on DAB	98,694	106,352	107,351	42.60	0.93
Interbank claims	65,863	65,046	65,636	26.04	0.91
Investments	13,357	15,917	17,488	6.94	9.86
Loans (Net)	44,526	37,169	37,974	15.07	2.16
Fixed Assets	6,659	6,597	6,683	2.65	1.30
Others	13,717	14,853	16,890	6.70	13.71
Total	242,816	245,934	252,022		2.47
Liabilities					
Deposits	204,620	207,807	213,023	96.19	2.51
Borrowings	3,767	3,995	4,023	1.82	0.70
Other	4,180	4,910	4,423	1.99	-9.91

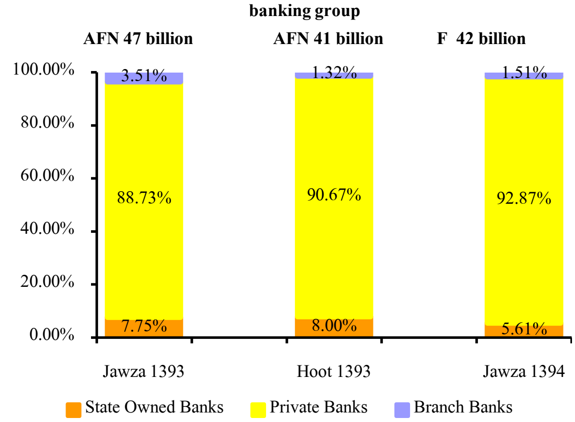
Source: Financial Supervision Department, DAB

1.1 Gross Loans

Total gross loans indicated AF 1.51 billion or 3.72 percent increase since last quarter, constituting 16.73 percent of the total assets. The increase in loan portfolio is mainly attributed to disbursement of new loans and customer utilization of OD loans. Increases in loan portfolio were observed at eight banking institutions, whereas six banking institutions decreased their portfolio. While the remaining one bank (NKB) did not participate in lending; Gross loan portfolio showed increase across the banking groups except the state owned banks. Private Banks with 92.87 percent share in total portfolio posted 6.23 percent or AF 2.29 billion increases, Branches of foreign banks holding 1.51 percent of the portfolio was up by 18.58 percent or AF 100 million, while state-owned banks having 5.61 percent shares declined by 887 million or 27.25 percent during the quarter under analysis.

Source: Financial Supervision Department, DA

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



1.1.1 Loan Loss Reserves

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

By the end of June 2015 (Jawza 1394), total provision cover of the system was 9.94 percent of total gross loans in comparison with 8.58 percent in the previous quarter ending Mar. 2015.

1.1.2 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 have diversified the sector wide distribution of Other Commercial Loans to thirty sectors[1]. The analysis of deployment of credit in different sectors indicates that the major portion of the loan portfolio is classified as "other commercial loans" (90.46 percent against 89.38 in Mar. 2015), mainly in "construction and building" (8.13 percent), "manufacturing and industry" (8.12 percent), "wholesale" (7.69 percent) and "petroleum and lubricant" (6.86 percent) sectors. Significant Increases were observed in Manufacturing and industry, Wholesales, and "Other infrastructure projects", sectors both in absolute amount and percentage of total gross loans, while Construction and building, media advertisement and printer, all other items, Retail trading and mining sectors were dominant decreasing sectors. Loans designated to SME and Micro Credit sectors posted an increase of AF 475 million currently are AF 4.46 billion provided by four 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. About 80.06 percent of the loans were designated in Kabul with Herat and Balkh provinces in the second and third places respectively. The proportion of loans in other provinces was 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.

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

Table 6.2: Sectoral Distribution of Credit

	Hoot 1387 (Mar 09)	Hoot 1388 (Mar 10)	Hoot 1389 (Mar 11)	Hoot 1390 (Mar 12)	Qaws1391 (Dec. 12)	Qaws 1392 (Dec. 13)	Qaws1393 (Dec. 14)	Jawza 1394 (June.15)
Commercial Real Estate and Construction Loans	0.19	19.92	25.98	2.85	2.29	2.02%	1.80%	1.75%
Other Commercial Loans	-	-	-	-	-	-		
Mining	-	-	0.02	0.72	0.11	0.07%		
Manufacturing	0.01	1.22	2.72	13.32	11.88	9.36%		
Trade	0.51	32.29	34.16	27.84	28.3	29.81%		
Communication	0	1.04	1.23	0.94	2.35	3.70%		
Service	0.09	4.84	6.72	11.95	15.94	22.11%		
Utilities	0.01	2.47	0.03	0.3	0.07	0.05%		
Agricultural Loans							0.27%	0.37%
Livestock and Farms							0%	0.90%
Manufacturing and Industry(product of metal, wood, plastic, rubber)							2%	8.12%
Manufacturing, Handmade and Machine products							4%	2.21%
Cement and Construction Materials							3%	2.05%
Textile							2.59%	0.47%
Power							0.35%	0.41%
Construction and Building							12.52%	8.13%
Services							4.79%	2.67%
Hotel and Restaurant							1.20%	1.21%
Telecommunication							2.92%	6.53%
Ground Transportation							4.87%	4.03%
Air Transportation							4.18%	3.59%
Health and Hygienic							0.71%	0.97%
Median, Advertisements and Printer							0.04%	0.03%
All Other Services							1.41%	6.60%
Wholesales							4.93%	7.69%
Machineries							0.12%	0.14%
Petroleum and Lubricants							8.74%	6.86%
Spare Parts							0.24%	0.92%
Electronics							1.40%	1.60%
Cement and other Construction Materials							1.87%	2.42%
Food Items							4.52%	3.68%
All Other Items							5.72%	4.40%
Retail Trading							3.92%	6.71%
Road and Railway							2.41%	1.29%
Dames							0.61%	0.39%
Mines							0.08%	1.24%
Other infrastructure Projects							1.81%	4.83%
Financial and Lending Institutions							0.00%	0.00%
Agricultural Loans	0	0.88	0.75	2.06	2.66	2.38%	2.34%	2.93%
Consumer Loans	0.02	1.33	1.01	0.82	0.74	0.24%	0.26%	0.31%
Residential Mortgage Loans to Individuals	0.01	7.3	8.95	15.65	14.46	10.84%	7.14%	4.54%
All Other Loans	0.05	3.69	10	12.65	10.71	9.41%	6.68%	0.00%

Source: Financial Supervision Department/DAB

1.1.3 Classification of Loans

1.1.3.1 Non-performing loans

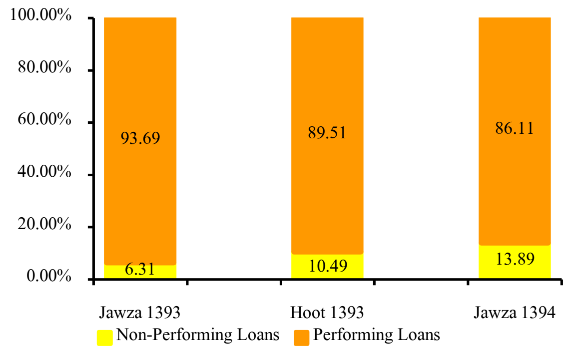
Banks should try to strengthen credit risk management measures to curtail the level of NPLs. It is essential for banks to evaluate credit applications carefully and closely monitor the financial condition of their borrowers, to ensure that credit expansion will not pose a threat to the stability of the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

By the end of June 2015 the growth in non-performing loans accelerated by AF 1.56 billion stands at AF 5.89 billion or 13.89 percent of total gross loans and 21.74 percent of the system's regulatory capital against AF 4.26 billion or 10.49 percent of the total gross loans in the preceding quarter, more than 65 percent of the NPLs relates to two Private commercial banks.

FSD is closely working with financial institutions and required them to design and implement plan to improve their asset quality.

The sector wide distribution of NPL reveals that a major portion of NPLs originates from trade and manufacturing sectors. Increases were posted in manufacturing, trade, utilities and residential loans to individuals sectors, while communication and in services posted decrease.

Figure 6.3: Quality of Loan Portfolio



Source: Financial Supervision Department, DAB

1.1.3.2Adversely-classified loans

Adversely classified loans (substandard, doubtful)[2]depicted AF 1.13 billion increase over the last quarter amounting to AF 8.51 billion, constituting 20.19 percent of the total gross loans, mainly attributed to two banks in the system.

1.1.3.3 Loans classified Watch

Loans classified in the "watch"[3] category are AF 5.68 billion, which makes 13.48 percent of total gross loans amplified by 93 percent since the previous quarter (Mar. 2015) attributed mainly to two private commercial banks in the system. This

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

[3] Assets on which the payment of principal or interest is due and remains unpaid for 31-60 days (Watch)

may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

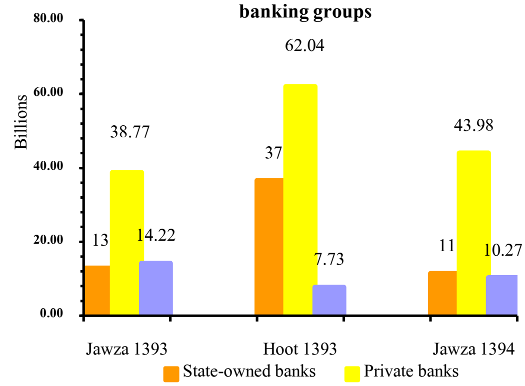
1.1.3.4 Loans classified loss[4]

Loans classified loss amounts to AF 5 million or 0.01 percent of total gross loans are down by AF 497 million since previous quarter.

1.2 Interbank Claims

Interbank Claims are the second largest among various asset categories, currently comprising AF 65.63 billion – 26.04 percent of total assets registered AF 590 million increases since previous quarter (Mar. 2015), attributed to a number of banking institutions, indicating that the banking sector has channeled a portion of its attracted funds as deposits in other financial institutions, if creditable borrowers were not found. These institutions are both inside and outside the country. Later on, if needed for liquidity purposes or after receiving applications from low-risk borrowers, these assets can be substituted to higher income earning assets Figure 6.4

Figure 6.4: Share of Inter bank Claims among banking groups



Source: Financial Supervision Department

1.3 Investment

The investment[5] portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies grew by 9.86 percent or AF 1.57 billion standing at AF 17.48 billion or 6.94 percent of total assets over the previous quarter came from seven banking institutions. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to five commercial banks and two branches of foreign banks.

1.4 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category making 42.60 percent of the total assets, showed a increase of AF 999 million, both in absolute as well as in percentage of total assets since previous quarter ending Mar. 2015. The increase in cash in vault and claims on DAB is

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

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

attributed to increase in deposit base of the banking sector.

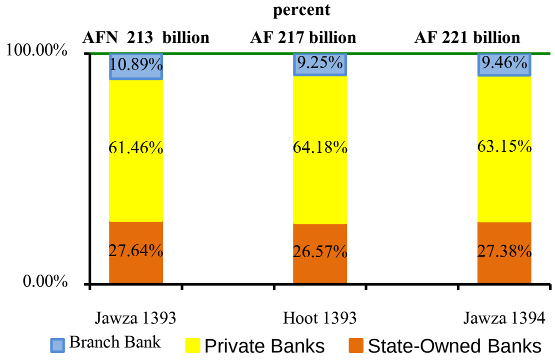
The banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

II. LIABILITIES

Total liabilities of the banking sector increased by AF 4.75 billion or 2.19 percent standing at AF 221.46 billion against AF 216.71 billion in the preceding quarter (Mar. 2015). Except the "Other liability" category of the total liabilities, other components of total liabilities have shown increase over the last quarter.

The majority of liabilities are made up of deposits (96.19 percent). This is an indication of public confidence, and good public relations and marketing policies of the banking sector, with "other liabilities "at second and borrowings in third place. Table 6

Figure 6.5: Liabilities increased by AF 4.75 billion or 2.19 percent



Source: Financial Supervision Department, DAB

2.1 Deposits

Deposits being the main funding source, increased by AF 5.21 billion or 2.51 percent, against 5.04 percent decrease in Mar. 2015.the increase in Deposit base of the banking sector mostly attributed to three banking institutions.

Afghani denominated deposits indicated 2.90 percent increase (7.12 percent decrease in Mar. 2015) accounting for 33.46 percent of total deposits and US dollar denominated deposits were up by 1.98 percent (4.11 percent decrease in Mar.2015) making 62.89 percent of the total deposits of the system.

Private Banks attracted AF 134.39 billion deposits, up by 1.02 percent against 5.44 percent decrease in previous quarter, making up 63.08 percent of the system's deposits.

The share of state-owned banks increased to AF 59.27 billion since preceding quarter (Mar. 2015) accounted for 27.82 percent of the system's deposits.

The share of branches of foreign banks stands at AF 19.35 billion increased by 4.48 percent making up 9.08 percent of total deposits of the system.

In terms of types of deposits, demand deposits accounted for 69.42 percent of the total deposit base, up by 1.63 percent, saving deposits with 19.40 percent of total deposits was in the second place, and depicted 1.74 percent increase while time deposits making up 5.32 percent of the total deposit portfolio, was up by 20.54 percent since March 2015.

Figure 6.6: Currency Composition of Deposits

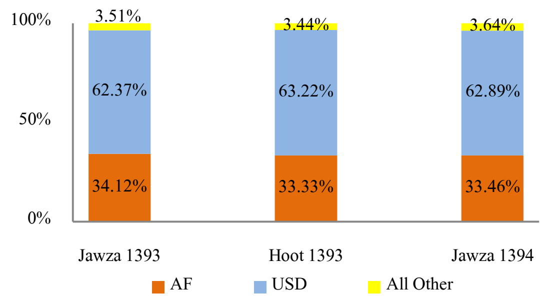


Figure 6.7: Afghani Denominated Deposits

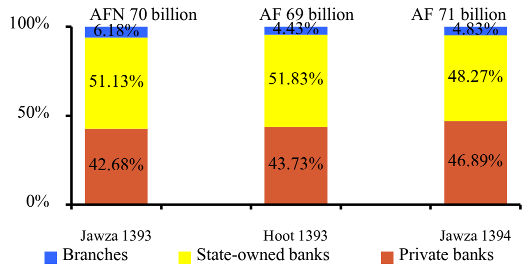


Figure 6.8: Deposits Increased by 2.51 percent or AF 5.21 billion

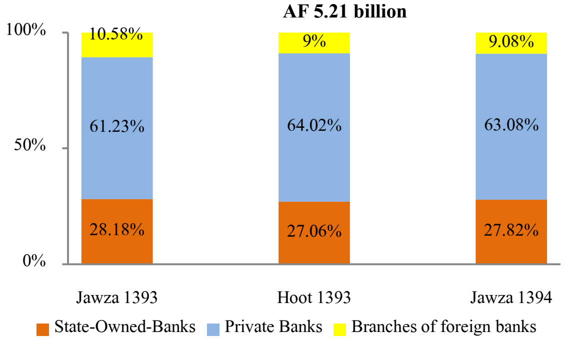
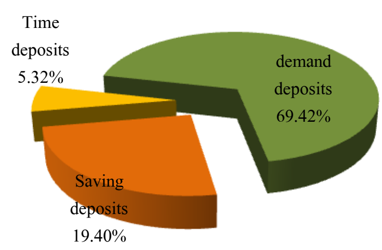


Figure 6.9: Breakdown of Deposits



Source: Financial Supervision Department, DAB

2.2 Borrowings

The share of borrowings in total funding structure of the system increased by 0.70 percent standing at AF 4.02 billion at the end of the June, making 1.84 percent of total liabilities in comparison with 1.82 percent increase since last quarter. The current borrowing position is attributed to three banking institutions.

III. Liquidity

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

3.1 Liquidity Ratio (broad measure)

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

Generally, a surplus liquidity position was observed in the banking sector during this period. 74.52 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 71.60 percent. All banking institutions were well above the minimum required level. Table 6.5

IV. Capital

The system is well capitalized. The capital fund of the banking sector stands at AF 30.55 billion, increased by 4.55 points or AF 1.337 billion on account of decrease in losses during the quarter.

On an aggregate basis the Capital Adequacy ratio of the banking sector stands at 25.63 percent. Table 6.5

Disaggregated analysis shows that all banks in the system registered capital adequacy ratio above the minimum threshold (12 percent of risk-weighted assets), but three banking institutions are very close to the limit. The Basel benchmark for capital to risk weighted is 8 percent.

Table 6.3: Key Financial Soundness Indicators of the banking Sector

Ratio	1387 (Mar 2009)	1388 (Mar 2010)	1390 (Mar 2011)	1390 (Mar 2011)*	1390 (Mar 2012)	1391 (Dec. 2012)	1392 (Dec. 2013)	1393 Dec. 2014)	1394 (June 2015)
Total Capital Adequacy Ratio	**29.81**	25.81	-14.46	30.39	23.06	21.84	26.34	26.46	25.63
Tier 1 Capital Adequacy Ratio	29.72	24.19	-14.51	30.29	23.98	19.97	24.65	26.09	26.99
Non-Performing Loans to Total Gross Loans	1.15	0.5	48.4	3.75	5.15	5.31	5.10	8.09	13.82
Return on Assets (ROA)	1.74	1.41	-20.08	0.24	-1.21	-0.54	0.74	0.90	-0.30
Return on Equity (ROE)	10.61	10.35	-520.66	1.9	-17.9	-7.17	10.03	7.35	-2.54
liquidity Ratio (Broad Measure Median)	40.02	59.19	63.32	63.83	57.37	72.13	67.93	73.60	71.60
liquidity Assets to Total Assets	23.8	0.38	40.58	47.01	55.82	63.75	73.18	73.28	74.52

*Excluding Kabul Bank

Source: Financial Supervision Department/ DAB

V. Profitability

On a cumulative for the second quarter of 2015, the banking sector incurred AF 251 million losses against AF 966 million losses in previous quarter ending June 2015, showing a decrease of AF 715 million over the quarter.

The losses of the banking sector as evident from the table 6.5 are mostly ascribed to credit provisions on created account of deteriorating asset quality, although the net-interest income and non-interest income increased and the operating cost shoed decreases over the quarter.

As a result the returns on assets (ROA) decreased to negative 0.30 from negative 1.16 percent improved by 0.86 percent and return on equity became negative 2.54 percent from negative 2.45 percent in the quarter under analysis. Table 6.5

On a cumulative basis four banking institutions have incurred AF 918 million losses against AF 1.32 billion losses posted by eight banks in the quarter ending Mar.2015.

On core income basis three banks ended with losses, against two banks in the previous quarter.

For the quarter under analysis only branches of foreign banks ended up with profits, while Private Banks and State-owned banks ended up with losses. Figure6.10

Table: 6.4: P/L Schedule

Items	1393 (June 2014	1393 (Mar. 2015)	1394 (June 2015)	%change
Interest income	2,322	2,131	2,295	7.69
Interest expense	419	519	498	-4.04
Net interest income	1,903	1,612	1,797	11.47
Non-interest income	1,384	926	1,665	79.80
Non-interest expenses	1,562	1,354	1,325	-2.14
Salary cost	896	896	907	1.23
Credit provisions	276	1,176	1,392	18.36
P/L before tax	553	-888	-162	-54.98
P/L after tax	458	-966	-251	-73.96

Source: Financial Supervision Department/ DAB

Figure 6.10: Profitability of the Banking Sector

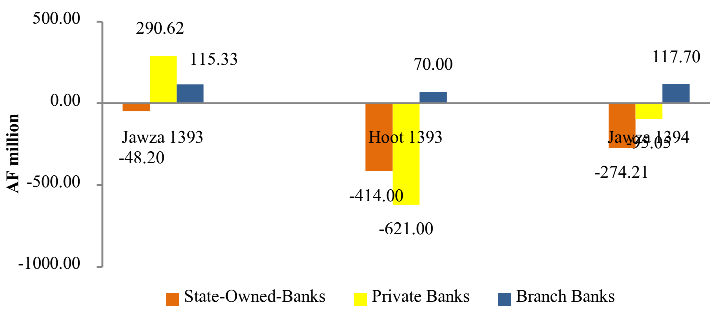


Figure 6.11 ROA and ROE of the banking Sector

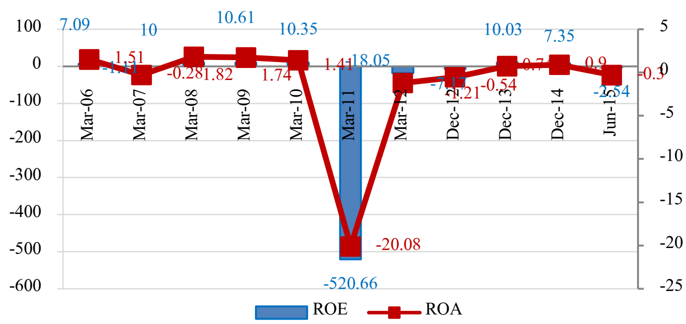
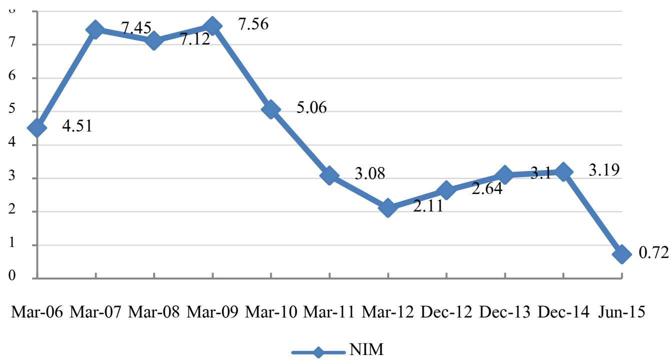


Figure 6.12 Net interests Margin of the Banking Sector



Source: Financial Supervision Department, DAB

VI. 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 overall open FX position, except three banking institutions holding open FX positions on overall and on an individual currency (USD long position) basis violated the limits. These banks need to bring their FX positions under the set limit; otherwise the decrease in value of the above mentioned currencies or the depreciation in these currencies can lead 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 8.44 billion, and vice versa. Similarly, a 4 percent change would correspond to AF 1.67 billion and vice versa.

VII. Interest Rate Risk

Overall the banking system is in an interest-rate sensitive position. However, calculations made from the Interest Rate Sensitivity Schedules of all banks reveal that, the net-interest income of the system over the next 12 months may increase by AF 2.24 billion in an event of increase in the market interest- rate (upward interest rate shock) by 3 percentage points. Conversely if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AF 2.24 billion. For one banking institution, if the interest-rate increases by 3 percentage points, that will decrease in their net interest income over the next 12 months. (Branches of foreign banks are not required to file the interest-rate sensitivity schedule, because like FX risk, interest-rate sensitivity of the banks is the large excess of risk is theoretically managed on a whole-bank basis).

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

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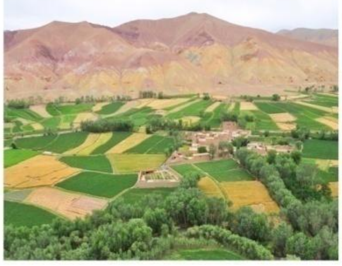   

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