Da Afghanistan Bank

Economic & Statistical Bulletin

Annual Bulletin 2017

Monetary Policy Department

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Note:

Afghanistan's Fiscal year has changed effective from 2012 (1391). The new fiscal year begins on December 21st each year. This annual bulletin analyzes economic developments during the fiscal year 2017, which covers December 21st, 2016 to December 20th, 2017.

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ABBREVIATIONS

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

Message

From the Governor

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

EXECUTIVE SUMMARY

World Economic growth is predicted to gain strength in both advanced economies, and emerging markets and developing economies (EMDEs). The growth rate is projected to increase by 2.7 percent in 2017 against 2.4 percent in 2016.

In emerging markets and developing economies (EMDEs), the growth rate is said to be 4.1 percent in 2017, which is higher than 3.5 percent growth rate in 2016.

Prices of industrial products continued to pick up in the fourth quarter of 2017, while most agricultural prices remained broadly stable. In the oil market, inventories continued to fall amid strong demand, OPEC production restraint and stabilization in the U.S. shale oil production.

In Afghanistan, economic growth rate was recorded 7.2% up from 3.6% in 2016 which is the highest rate since the last five years. This growth rate is mainly attributed to sharp recovery in Agriculture and Industry Sectors and healthy performance by Services Sector during the period under review. Although a large proportion of the population is engaged in Agriculture sector, this sector contributed only to 23.7% of the GDP. Services Sector has the largest share in the GDP standing at 50.7% and 21.0% is attributable to the Industry sector of the country.

On the other hand, Afghan economy is largely influenced by the fluctuations in prices of commodities in global markets and developments in the agricultural, industrial, and services sectors within the country.

The main financial indicators of banking sector demonstrate a positive movement over the last year. The growth in total assets base was mostly funded by cash injection, profit and deposits upturn. Gross loans were up due to designation of new loans and pick up in USD rate. Equity capital maintained healthy levels because of rise in the profitability and cash injection along with the adequate level of liquidity buffers.

Banking sector earned net profits of AF 1.93 billion for the year 2017, against AF 4.39 billion net profits in the in 2016. State-owned banks, private banks and branches of foreign banks ended up with profits in the review period.

In the external sector reserve money (RM) increased by 10.3 percent, which is lower than 11.07 percent in 2016 and Currency in Circulation (CIC) as a major component of RM recorded growth of 2.4 percent

Reserve money (RM) and Currency in Circulation (CiC) growth remained well below the assigned targets during the course of the year under review.

DAB has experienced accumulation of 7.3 percent (USD 498.41 million) in net international reserves (NIR) from the beginning of the fiscal year 2017.

1

Global Economic Environment

1

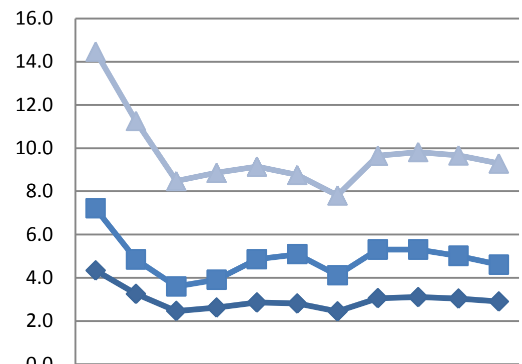
GLOBAL ECONOMIC ENVIRONMENT

The World Bank report illustrates that the global economy is enduring to strengthen due to recovery of industrial activity and increase in the level of global trade after two years of weakness. Growth is predicted to gain strength in all advanced, emerging markets and developing economies (EMDEs). Self-reliance is improving, even though the global financing conditions have been benign. The global growth is projected to increase by 2.7 percent in 2017 up from 2.4 percent in 2016.

In advanced economies the activity is predicted to maintain impetus in 2017, shore up by an upsurge in the United States. In Japan and Euro zone, the growth is projected to increase due to intensification of the domestic demand and export. Investment has compacted across the advanced economies, although the growth of the private consumption has moderated. In these economies, growth is expected to increase to 1.9 percent in 2017, up from 1.7 percent in the year earlier.

In emerging markets and developing economies (EMDEs), the growth blockage is that the commodity exporters are retreating progressively, while the performance of commodity importers remains strong. Hence, the growth rate of the EMDEs is predicted 4.1 percent in 2017 by the World Bank which is higher than 3.5 percent growth rate in 2016.

Figure 1.1: The Global Economic Growth Rate



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
EMDEs	7.3	6.4	4.9	5.0	4.3	3.7	3.7	4.3	4.5	4.7	4.7
Advanced economies	2.9	1.6	1.1	1.3	2.0	2.3	1.7	2.3	2.2	2.0	1.7
World	4.3	3.3	2.5	2.6	2.9	2.8	2.4	3.1	3.1	3.0	2.9

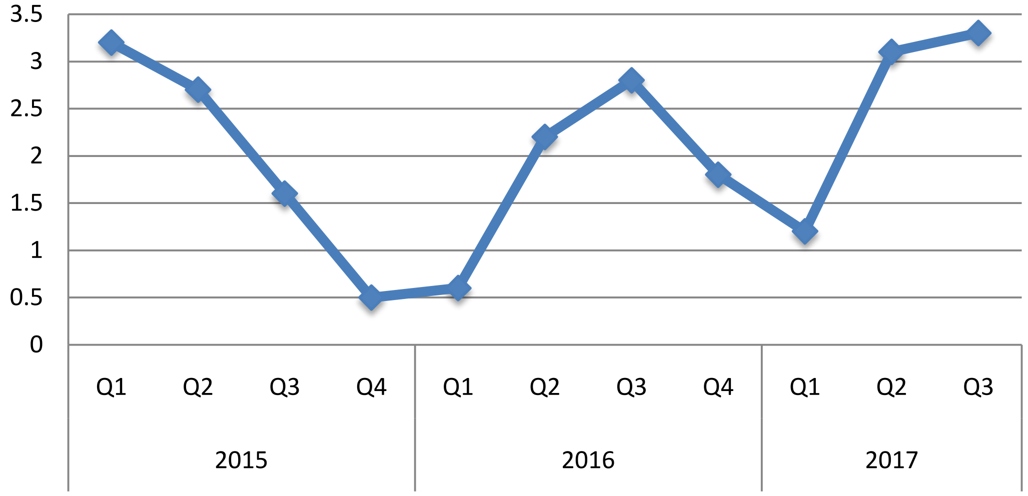
Source: The World Bank

I. ADVANCED ECONOMIES

1.1.1 The United States Economy

The real gross domestic product (GDP) of the United States (U.S.) increased by 2.3 percent in 2017 compared to 1.5 percent in 2016, supported by broad based strength in domestic demand particularly the investment. The boost up in real gross domestic product exposed a positive contribution from private inventory investment, Personal Consumption Expenditures (PCE), non-residential fixed investment, exports and federal government spending. These movements were partially counteracted by decelerations in residential fixed investment and in state and local government spending. Imports, which are a subtraction in the calculation of GDP, accelerated.

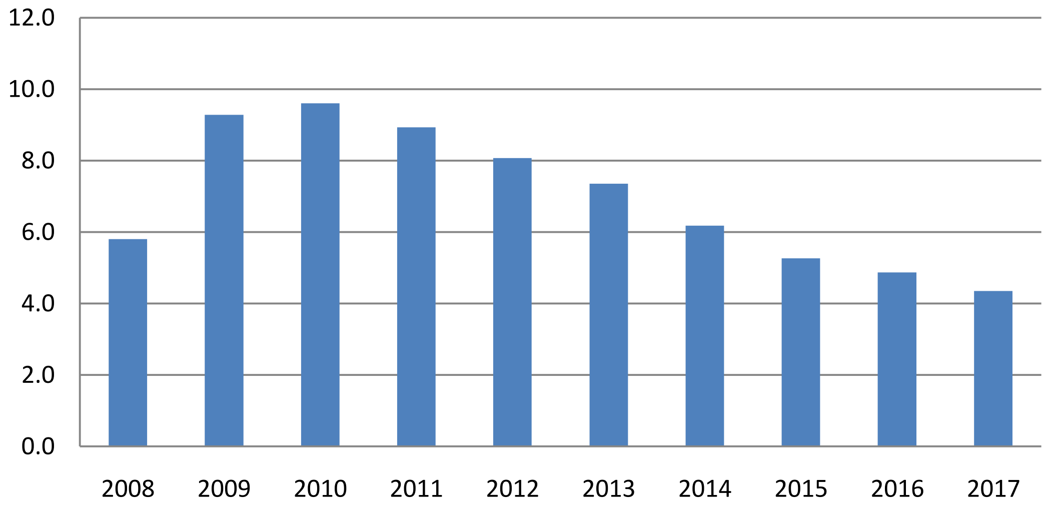
Figure 1.2: The US Real GDP Growth Rate 2015-2017



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

The U.S. unemployment rate edged down to 4.4 compared to 4.9 percent in 2016. In December 2017, 1.6 million people were marginally attached to labor force about unchanged from the previous year. Among the marginally attached labor force, 474,000 are discouraged workers in December, slightly changed from 2016.

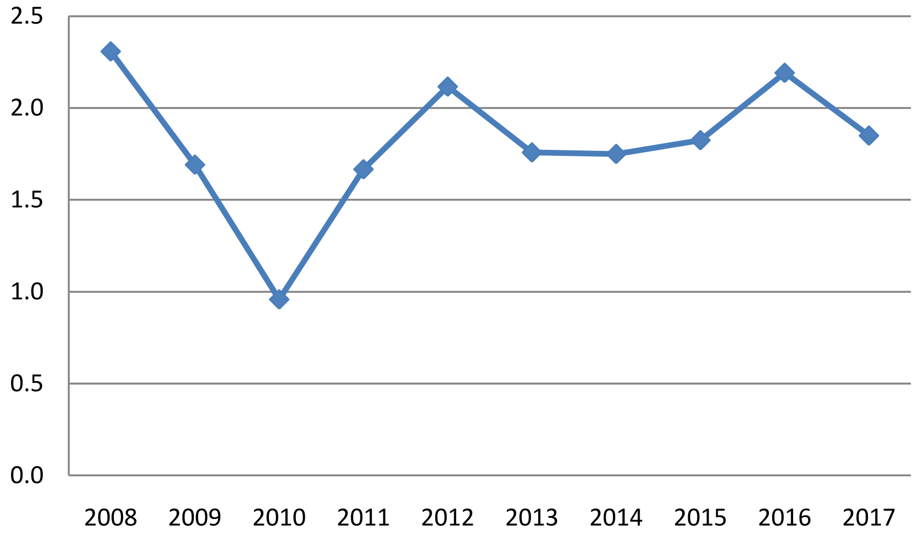
Figure 1.3: The US Unemployment Rate from Jan., 2016 – Oct., 2017



Source: Bureau of Labor Statistics, US Department of Labor

The U.S. consumer price index (CPI) for all urban consumers (all items) was 2.2 percent in 2017 compared to 1.8 percent of 2016, showing 0.4 percent increase in the inflation rate.

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



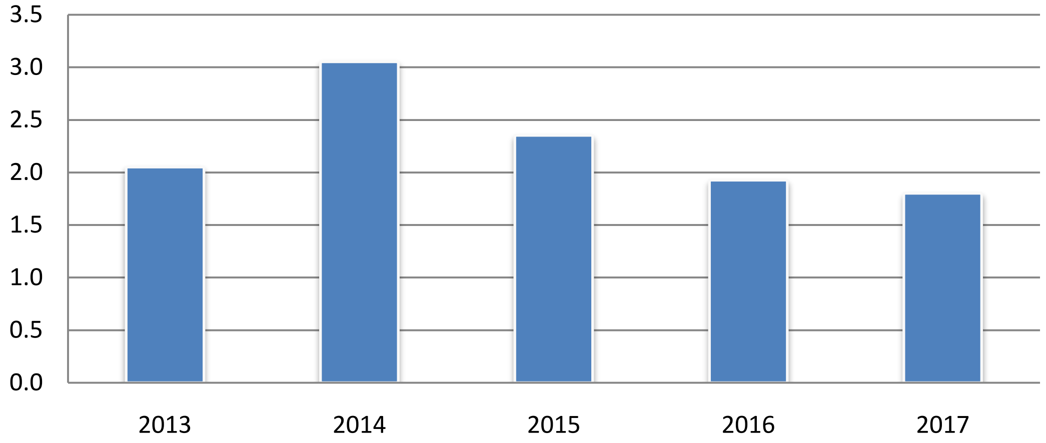
Source: Bureau of Labor Statistics, US Department of Labor

The U.S. international trade (goods and services) deficit stood at USD 53.1 billion in December 2017, up by USD 2.7 billion from the previous month. It has to be mentioned that this deficit increased to $61.2 billion, or 12.1 percent as compared to the previous year. Similarly, exports and imports increased to $121.2 billion (5.5 percent) and $182.5 billion (6.7 percent) respectively in the reference period.

1.1.2 The Economy of United Kingdom

The gross domestic product (GDP) in the UK reached 1.8% a slight decrease from 1.9 % in 2016. Household spending grew by 1.8% between 2016 and 2017, its slowest rate of annual growth since 2012, in part reflecting the increased prices faced by consumers. The UK economy has slowed over the past 12 months due to increase in inflation stemming from drop in the pound in the wake of the 2016 Brexit vote, which has squeezed household disposable incomes. In the meantime, sectors such as agriculture and construction continued to be the strongest contributors to lower GDP growth during 2017, declining by 0.9% and 0.7% respectively.

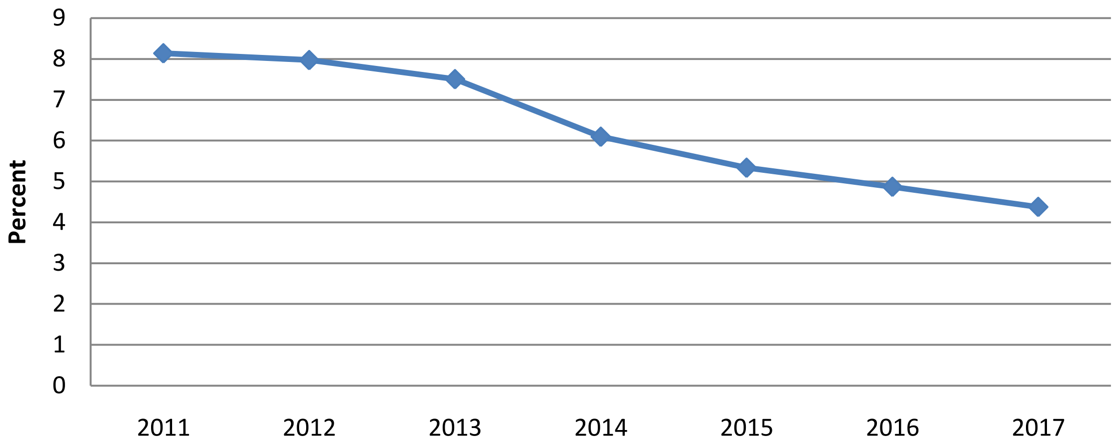
Figure 1.5: The UK GDP Growth from 2013-2017



Source: Office for National Statistics, U.K.

The unemployment rate of the U.K. declined to 4.4 percent in 2017 from 4.9 percent in the previous year. The number of people in work reached 32.36 million, 396000 more than a year earlier. The employment rate was 75.6%, higher from 74.8% in 2016 and the highest since comparable records began in 1971.

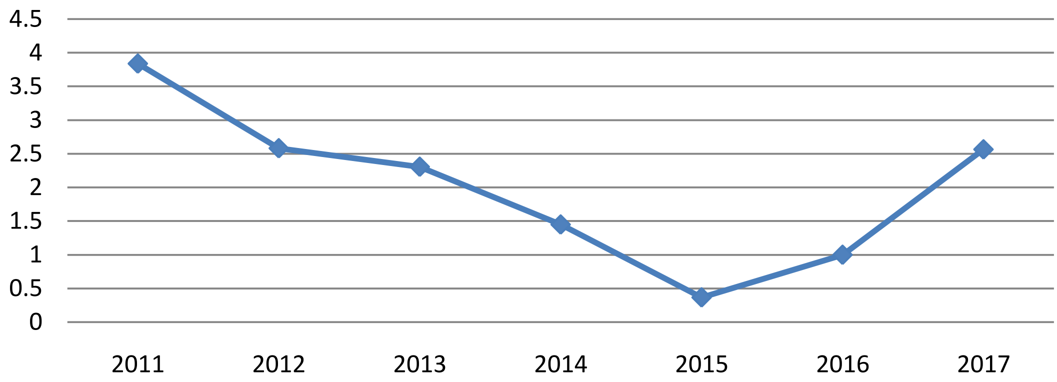
Figure 1.6: The UK Unemployment Rate form 2011-2017



Source: Office for National Statistics, UK

The annual inflation rate of the U.K. reached 2.6 percent in 2017, up by 1.6 percent than a year earlier. The main contributor for raising the overall inflation rate is inflation of non-alcoholic beverages and food which has continuously been increasing since September 2013. The upward contributions were offset by declining prices of fuel and furniture, along with owner occupiers' housing costs, which have risen in 2017 compared to a year ago.

Figure 1.7: The U.K. CPI inflation rate from 2011–2017



Source: Office for National Statistics, U.K.

UK exporters received a significant boost as the latest figures confirm that global demand for UK goods and services is growing.

Data released from the Office for National Statistics shows that in 2017, UK goods and services exports increased faster than imports- up by 12.1% and 9.3% respectively.

A drive in goods exports - up by 13.4% - was due largely to demand for manufactured goods, and a rise in services exports, which increased by 10.7%. This increase was mainly driven by demand in UK business services. As a result, the trade deficit narrowed significantly by £12.1 billion to £28.6 billion from £40.7 billion.

Non-EU countries continued to be the main destination for services exports (£171.4 billion), making up 61.3% of all services exports in the UK.

Overall, UK exports of goods and services have increased by 12.1% to £622.1 billion.

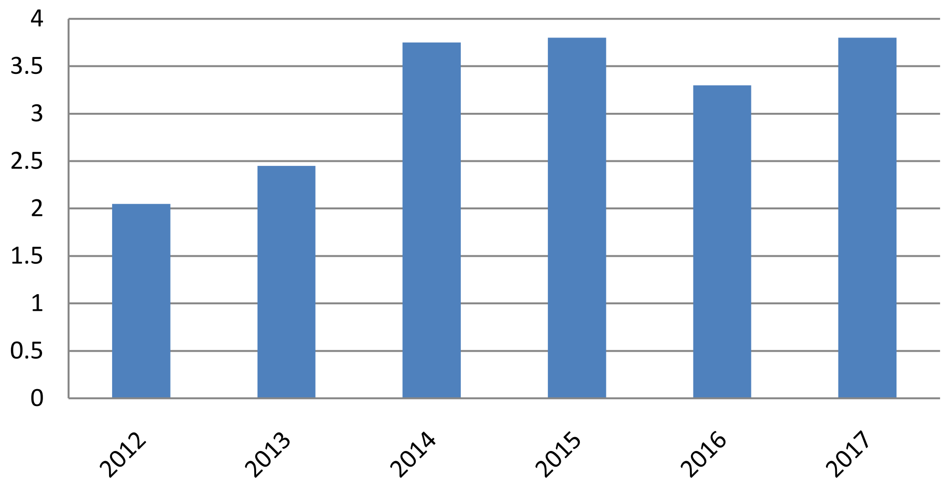
Annually, the UK's current account deficit was £82.9 billion (4.1% of GDP) in 2017, a narrowing of £30.7 billion from a deficit of £113.6 billion in 2016. This is the narrowest deficit as a percentage of GDP since 2011 when it was 2.4%.

1.1.3 The Economy of Germany

The GDP growth of Germany was 3.8 percent in 2017, showing an increase of 0.5 percent from 2016. In the mentioned period, the domestic demand contributed positively to the GDP growth.

In 2017, foreign trade played a key role in GDP growth. Arithmetically, balance of payment has great impact on the gross domestic product growth.

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

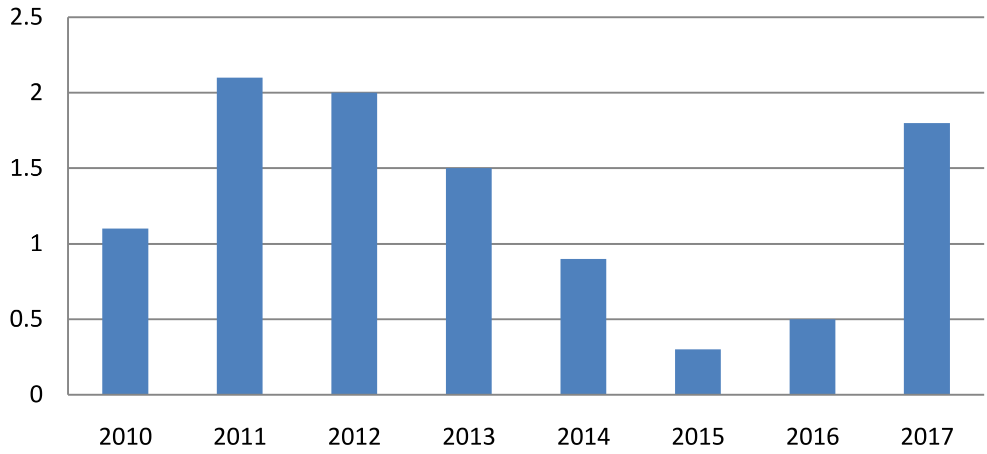


Source: Federal Statistics Office (DESTATIS), Germany

Consumer prices in Germany rose by 1.8% on an annual average in 2017 compared to figures of 2016. The marked increase in consumer prices of 2017 was mainly due to higher energy prices. Energy prices increased by 3.1% in 2017 after a 5.4% decline in the previous year. Food prices increased considerably by 3.0% in 2017 compared to the previous year. In 2017, the year-on-year rise in food prices concerned all product groups. Rise in the level of prices were recorded mainly in edible oils and fats (+21.4%) and dairy products (+9.7%). Inflationary pressures also came from fish and fish products (+3.8%) and fruit (+2.7%). Excluding energy and food prices, the inflation rate would have been +1.4% in 2017.

The prices of goods as a whole increased by 2.2% in 2017 from a year earlier. The largest price increase was registered for non-durable consumer goods (+2.7%), which was mainly attributable to rise in energy and food prices.

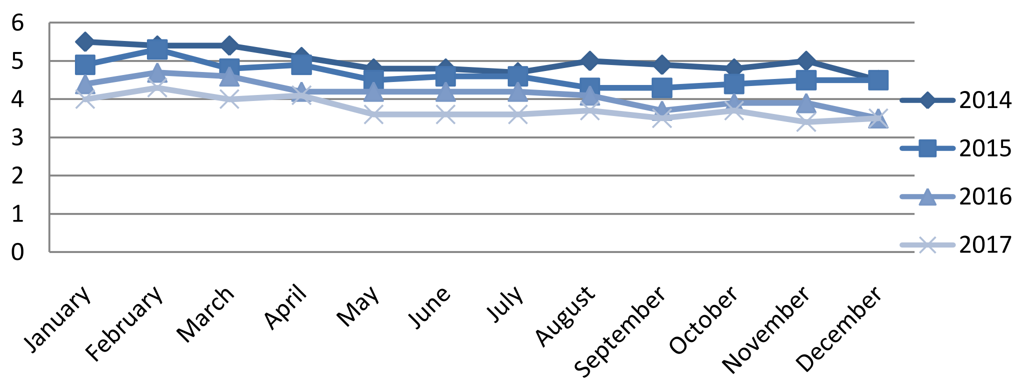
Figure 1.9: CPI of Germany 2010-2017



Source: Federal Statistics Office (DESTATIS), Germany

The unemployment rate of Germany stood at 3.8 percent in 2017. In October 2017, around 41.48 million residents in Germany were employed which is higher than 2016 figures (41.11 million) according to the report released by Federal Statistical Office (Destatis). Comparing to 2016, the unemployment rate decreased by 0.375 percent.

Figure 1.10: The Unemployment rate of Germany 2014-2017



Source: Federal Statistics Office (DESTATIS), Germany

Germany exported goods with total value of 1,279.4 billion Euros and imported goods with total value of 1,034.6 billion Euros in 2017. Based on the report released by the Federal Statistical Office (Destatis), Germany's exports increased by 6.3% and imports rose by 8.3% in 2017 as compared to the figures of 2016. The foreign trade balance showed a surplus of 244.9 billion Euros in 2017, while a year earlier, the surplus had reached an all-time high figure of 248.9 billion Euros.

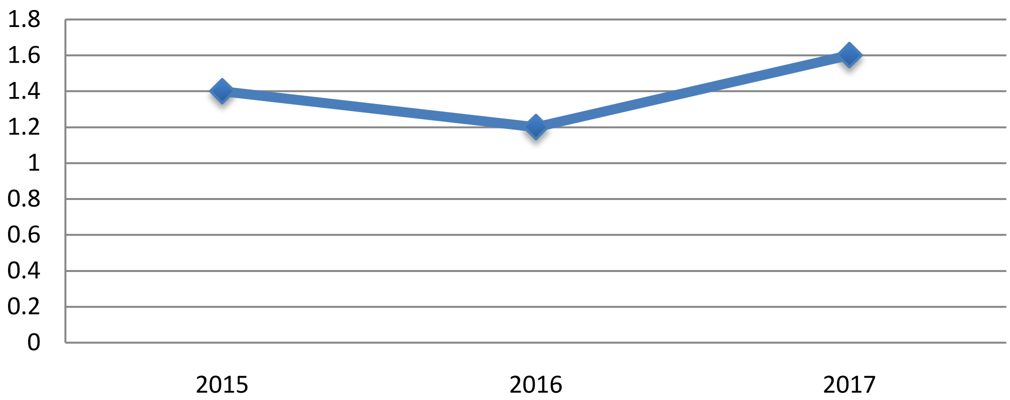
According to Deutsche Bundesbank, provisional results surplus in current account of the balance of payments amounts 257.1 billion

Euros in 2017, which takes into account the balances of trade in goods including supplementary trade items (+266.7 billion Euros), services (-18.0 billion Euros), primary income (+60.6 billion Euros) and secondary income (-52.3 billion Euros). Germany's current account had shown a surplus of 259.3 billion Euros in 2016.

1.1.4 The Economy of Japan

The GDP of Japan (seasonally adjusted) increased by 0.4 percent in fiscal year 2017 supported by exports and private consumption, while business spending grew much faster than expected. The annual real growth rate at the end of 2017 was recorded at 1.7 percent. Japan GDP growth averaged 0.50 percent from 1980-2017, where the lowest growth was recorded at 3.20 percent in the second quarter of 1990, and the highest at 4.90 percent in the first quarter of 2009.

Figure 1.11: The GDP growth rate of Japan (annual) Seasonally Adjusted 2015–2017



Source: Cabinet Office, Japan

The unemployment rate in Japan reached at 2.83 percent in the year 2017 from 3.13% reported in the previous year. The employment rate averaged 59.72 percent from 1980 until 2017, reaching an all time high of 63.50 percent in June of 1991 and the lowest rate of 55.90 percent in January, 2012.

Japan’s all items index of consumer prices in 2017 was 100.4 (2015=100), up 0.5% from the previous year. The index for all items, less fresh food was 100.2, up 0.5% from the previous year.

The index for all items, less fresh food and energy was 100.7, up 0.1% from the previous year. Consumer Price Index (CPI) in Japan averaged 71.62 Index Points from 1957 until the beginning of 2018, reaching an all time high of 101.30 Index Points in January of 2018 and the lowest of 17.40 Index Points in February, 1957.

Food Inflation in Japan averaged 2.73 percent from 1971 until 2017, reaching an all time high of 31.60 percent in February, 1974 and lowest of -3.70 percent in November of 1999.

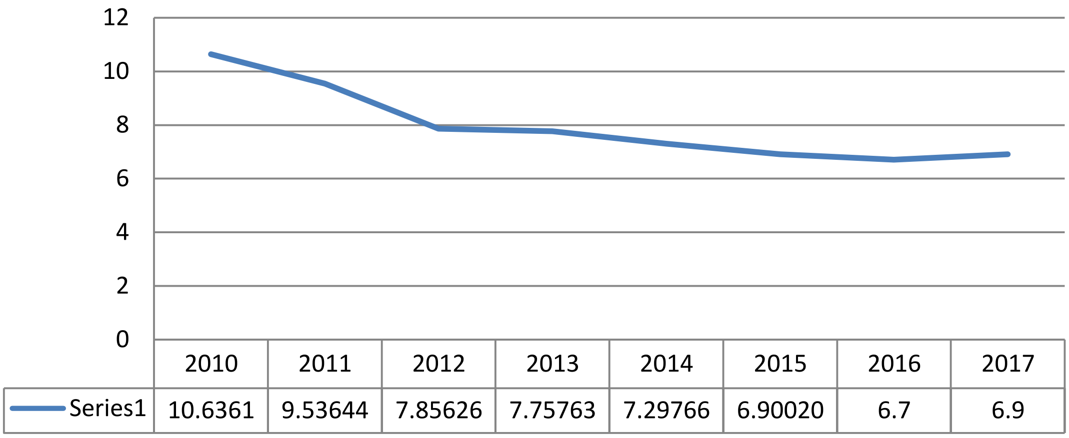
Likewise, prices of fuel, light and water charges increased more than in a month earlier to 6 percent from 5.2 percent in August, mostly due to higher cost of electricity (7.9 percent from 7.0 percent). It has to be mentioned that the CPI of Japan was 0.10 percent in third quarter of 2016.

II. EMERGING MARKET ECONOMIES

1.2.1 The Economy of China

The Chinese economy advanced and the GDP growth of China reached 6.9 percent in 2017, a rise of 0.2 percent compared to a year earlier. Though China's real GDP growth fluctuated substantially in recent years, it intended to decrease through 1998-2017 period ending to 6.9 percent in 2017. The industrial sector advanced 6.6%, the manufacturing sector posted a growth rate of 7.2%, and the services sector posted growth of 8.2%. On the other hand, retail sales and domestic consumption also posted strong growth in 2017.

Figure 1.12: The GDP Growth Rate of China 2010-2017



Source: National Bureau of Statistics of China

China's consumer price index (CPI), a main gauge of inflation, rose 1.6 percent year on year in 2017, down from 2 percent for 2016 according to the National Bureau of Statistics.

The prices grew by 1.9 percent in cities and 1.7 percent in rural areas. The food prices went down by 0.4 percent, and the non-food prices increased by 2.4 percent. The prices of consumer goods and services went up by 1.1 percent and 3.0 percent respectively during the reference period.

Unemployment rate in China decreased to 3.94 percent in 2017 compared to 4.37 a year earlier. Unemployment rate in China averaged 4.11 percent from 2002 until 2018, reaching an all time high of 4.30 percent in the fourth quarter of 2003 and a lowest of 3.89 percent at the end of 2017. The country's Labor Force Participation Rate dropped to 70.54% in 2017.

According to General Administration of Customs (GAC), China's exports increased to 10.8 percent to reach 15.33 trillion Yuan, while imports surged up to 18.7 percent to 12.46 trillion Yuan in 2017.

The trade surplus continued to narrow last year, shrinking by 14.2 percent to 2.87 trillion Yuan, compared with 9.1 percent reduction registered in 2016, recording 3.35 trillion Yuan. The European Union, the United States and ASEAN are the top three trading partners of China, with exports to the United States rising 15.2 percent year on year.

1.2.2 The Economy of India

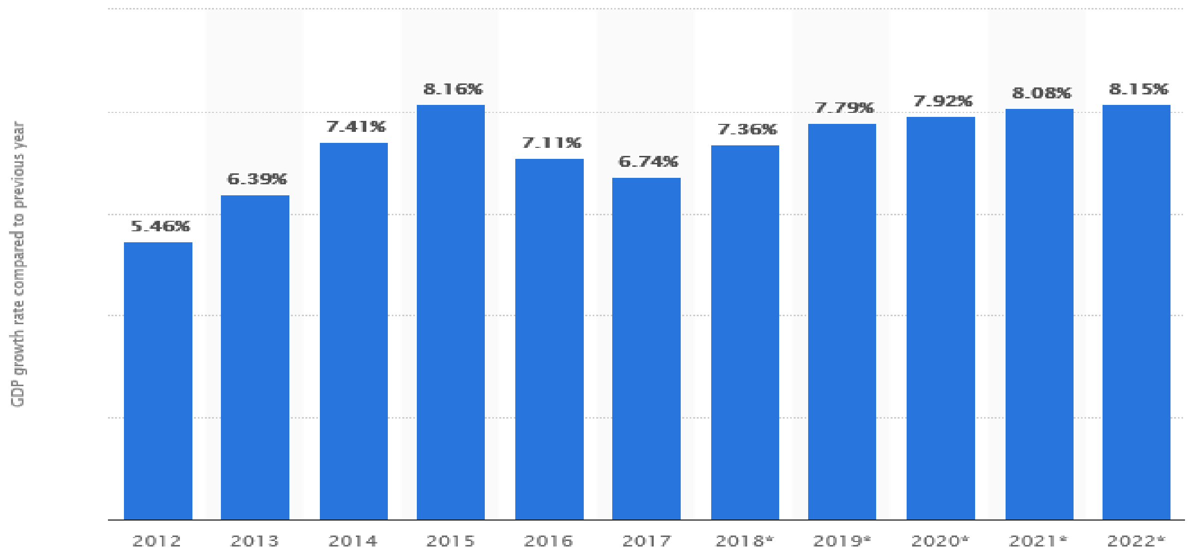
The Indian economy growth rate decreased to 6.624 percent in 2017 compared to 7.113 percent growth recorded in 2016. However, manufacturing activities accelerated due to restocking of warehouses by companies after short term interruption caused by uncertainties surrounding implementation of goods and services tax (GST).

India's annual inflation rate rose to 3.3 percent in 2017 lower than 4.95 in 2016. Food and beverages inflation went up to 3.37 % from 3 percent in April, with the food index alone rising 3.1 (2.80% in April). Upward pressure came from prices of fruits (12.33% vs. 9.65%); vegetables (8.04% vs. 7.29%); eggs (5.78% vs. 6.26%); prepared meals, snacks, sweets etc. (4.98% vs. 4.85%); meat and fish (3.53% vs. 3.59%); milk and products (3.2% vs. 3.21%); oils and fats (2.46% vs. 2.11%); non-alcoholic beverages (1.8% vs. 1.73%); and spices (1.54% vs. 1.25%). On the other hand, prices fell for both pulses and products (-11.57% vs. -12.35%) and sugar and confectionery (-8.12% vs. -4.05%).

Exports from India increased to 275.851 billion USD in 2017 compared to 262.290 billion in 2016. The trade deficit of India decreased to 108.503 billion in 2017 compared to 118.716 billion in 2016.

In recent years, India exported mostly: pearls, precious and semi-precious stones and jewelry (16 percent of total shipments); mineral fuels, oils and waxes and bituminous substances (12 percent); vehicles, parts and accessories (5 percent); nuclear reactors, boilers, machinery and mechanical appliances (5 percent); pharmaceutical products (5 percent); and organic chemicals (4 percent). India's main export partners are: United States (15 percent of the total exports), United Arab Emirates (11 percent), Hong Kong (5 percent), China (4 percent), Singapore (4 percent) and United Kingdom (3 percent).

Figure 1.13: GDP Annual Growth Rate of India 2012-2022



Source: Statista.com

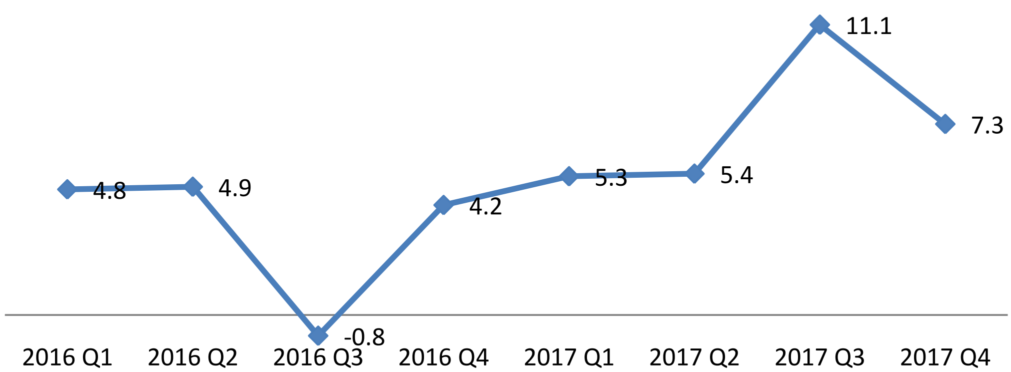
1.2.3 The Economy of Turkey

Gross Domestic Product by production, increased by 7.4% in 2017 compared to the previous year.

Gross domestic product by production approach at current prices increased by 19% and reached 3 trillion 104 billion 907 million TRY in 2017 compared to the previous year.

The value added increased by 4.7% in agricultural sector, 9.2% in industry sector, 8.9% in construction sector, 10.7% in services sector (wholesale and retail trade, transport, storage, accommodation and food service activities) in 2017 compared to the previous year in the chained linked volume index.

Figure 1.14: The GDP Growth Rate of Turkey Q1, 2016 - Q4, 2017



Source: Turkish Statistical Institute

The inflation rate of Turkey reached 11.13 percent in 2017, while this figure was recorded 7.79 percent in 2016. The CPI rose for transportation 1.69%, miscellaneous goods and services 0.05%, hotels, cafes and restaurants 0.47% and for clothing and footwear -2.39%, while the index declined only for food and non-alcoholic beverages amongst the main groups by 1.52%.

In 2017. Within average prices of 414 items in the index, prices of 48 items remained unchanged, while 242 items increased and prices of 124 items recorded lower prices.

The seasonally adjusted unemployment rate of Turkey was recorded at 10.9 percent. Number of unemployed persons aged 15 years old and over has realized as 3 million 454 thousand persons with 124 thousand persons increase in 2017 compared to the previous year. Unemployment rate realized as 10.9% without any change. Unemployment rate realized as 9.4% with 0.2 percentage point decrease for male and 14.1% with 0.4 percentage point increase for female.

In the same year, non-agricultural unemployment rate realized as 13% without any change. While youth unemployment rate including 15-24 age group realized as 20.8% with 1.2 percentage point increase. unemployment rate for 15-64 age group occurred as 11.1% without any change.

Turkey's foreign trade gap rose to $76.7 billion in 2017, with a 36.8 percent year-on-year increase, official data has shown.

The country's exports in 2017 amounted to over $157.05 billion, a 10.2 percent rise compared to the previous year. However, the Turkish Statistical Institute (TÜİK) announced that the Imports climbed 17.7 percent to $233.79 billion.

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Office for National Statistics, U.K.	www.ons.gov.uk
Federal Statistical Office (DESTATIS), Germany	www.destatis.de
National Institute of Statistics and Economic Studies (INSEE), France	www.insee.fr
Cabinet Office, Japan	www.esri.cao.go.jp
National Bureau of Statistics of China, People's Republic of China	www.stats.gov.cn
Ministry of Statistics and Program Implementation of India	www.mospi.gov.in
Turkish Statistical Institute	www.turkstat.gov.tr
Trading Economics	www.tradingeconomics.com
Statista	www.statista.com

2

Money and Capital Market Development

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

According to the monetary statistics, reserve money (RM) increased by 10.3 percent, which is lower than 11.07 percent in 2016. Currency in circulation (CIC) as a major component of RM recorded growth of 2.4 percent and commercial banks deposit with the central bank (Overnight Deposits, Required Reserves and Current Accounts), which is another component of reserve money increased by 75.7 percent at the end of FY 2017.

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

DAB has experienced accumulation of 7.3 percent (USD 498.41 million) in net international reserves (NIR).

Narrow money (M1) stood at AF 436,708 million at the end of the year under review, registering an annual growth of 3.18 percent. Broad money (M2) demonstrated similar behavior, representing a growth rate of 4.10 percent (YoY), standing at AF 473,857 million at the end of fiscal year 2017.

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

In the fiscal year 2017, DAB has auctioned a total amount of USD 1,947.17 million to absorb the excess liquidity from the market as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at AF 38.99 billion at the end of the year.

Meanwhile, Afghani depreciated against the US dollar by 3.7 percent in the year 2017.

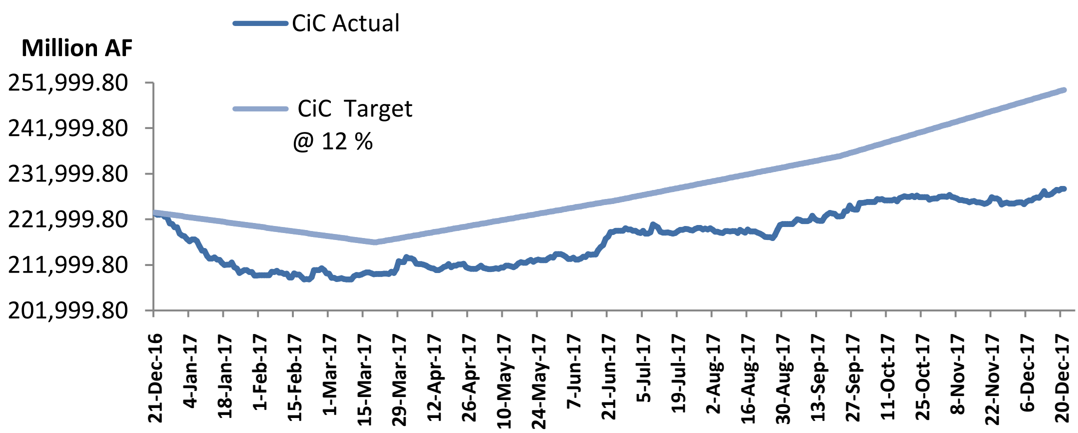
I. MONETARY PROGRAM

Reserve money remained the key operational target of the monetary policy during FY 2017, while currency in circulation was set as the indicative target.

DAB applies quantitative theory of money to determine the amount of reserve money (RM) for the purpose of supporting domestic price stability, which is DAB's primary objective. Hence, the assigned targets for RM and CiC are based on expected economic growth and expected inflation during the concerned period. For the fiscal year 2017, the ceiling for reserve money and currency in circulation growth was set at 12%. At the end of year, actual RM grew by 10.3 percent and actual CiC growth was 2.4 percent, both well managed according to the assigned targets. DAB has auctioned USD 1,947.17 million via open market operation and sold USD 249.84 million to Brishna, (Afghan state owned electricity enterprise) to mop up the excess liquidity from the market and to prevent intense fluctuations of Afghani nominal exchange rate against foreign currencies, especially internationally convertible currencies. The Figure 2.1 and 2.2 illustrate the ceiling and the actual reserve money and currency in circulation for the year under review.

Figure 2.1: Reserve Money for the FY 2017

Figure 2.2: CiC for the FY 2017 (Dec. 21, 2016 to Dec. 20, 2017)



Source: Monetary Policy Department/DAB

II. MONETARY AGGREGATES

Monetary aggregates- narrow money and broad money are compiled based on Monetary and Financial Statistics Manual and Compilation Guide.

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

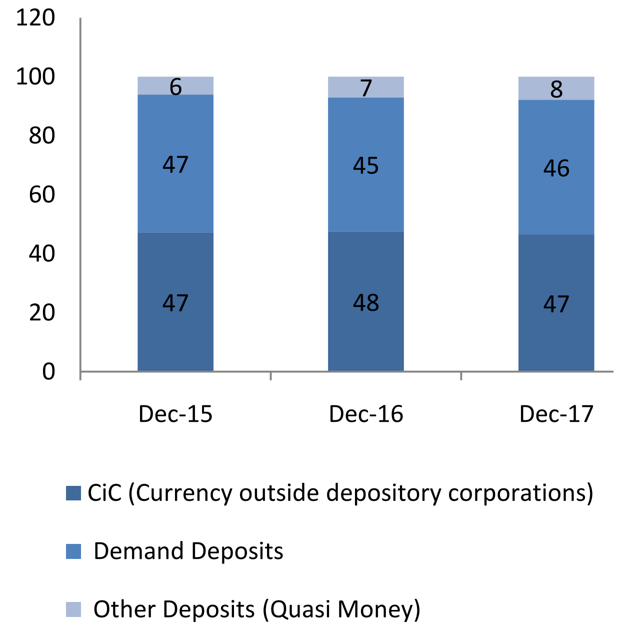
As shown in Table 2.1, narrow money (M1) grew by 3.18 percent at the end of the fiscal year 2017, compared to the same period of FY 2016, showing a difference of AF 13,448.95 million. Currency outside depository corporations or CiC, which accounts for 51 percent of M1, grew by 1.94 percent, which is lower than 10.3 percent of the previous year. Demand deposits which are the other components of M1, experienced a growth of 4.47 percent at the end of 2017, while its growth rate was 7 percent in the previous year. Demand deposit in comparison with the previous year shows a difference of AF 9,250.48 million.

Broad money (M2) expanded by AF 473,857 million in the year under review from AF 455,204 million in the previous year, showing an increase of 4.1 percent, but lower than 9.7 percent growth of the same period in the previous year. Slower growth in broad money is mainly attributable to deceleration in the growth of currency in circulation and downward trend of transferable and other deposits. The data shows that M1 with a share of 92 percent, remained the main contributing component of M2.

Quasi money (time deposits), which is the other component of M2, grew by 16.29 percent (y-o-y) at the end of FY 2017. Quasi money constitutes 7.8 percent of broad money during the year under review, which is slightly higher than 7.02 percent at the end of FY 2016. Therefore, the impact of changes in quasi money on M2 is negligible. The year-on-year change of Afghani denominated time deposits stood at AF 1,405 million, showing an increase of 12.3 percent, while the foreign currency denominated time deposits rose by 18.51 percent, reaching to AF 24,322 million. Afghani-denominated time deposits and foreign currencies denominated time deposits constitute 2.7 percent and 5.1 percent of M2 respectively.

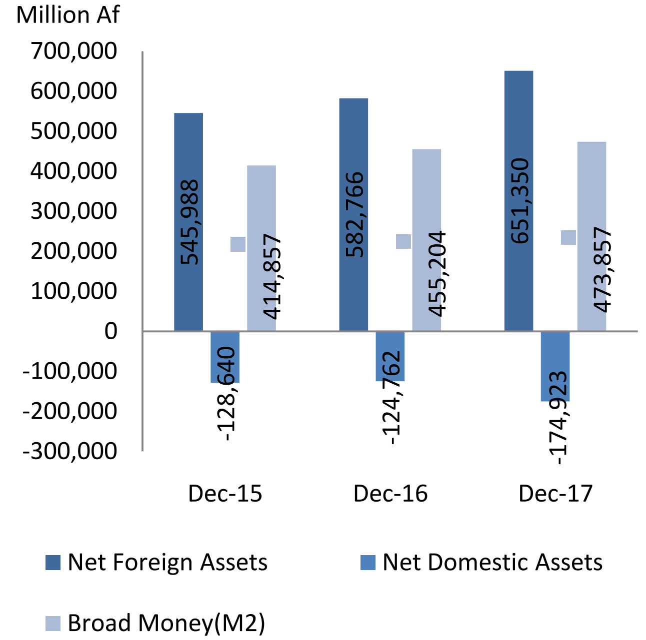
Demand deposits as a share of broad money stand at 46 percent at the end of the year under review (Figure 2.3).

Figure 2.3: CIC, Demand Deposits and Quasi-money as Share of Broad Money (%)



Source: Monetary Policy Department/DAB

Figure 2.4: Net Foreign Assets, Net Domestic Assets and Broad Money



Source: Monetary Policy Department/DAB

Table 2.1: Monetary Aggregates for the FY 2017 (2017)							
In Million AFN	December-15 Q 4 Amount	December-16 Q4 Amount	Y-o-Y Δ	Difference	December-17 Q 4 Amount	Y-o-Y Δ	Difference
1- Net Foreign Assets	**545,988**	**582,766**	**6.7%**	**36,779**	**651,350**	**11.77%**	**68,584**
Foreign Assets	555,577	593,914	**6.9%**	38,338	668,492	**12.56%**	74,578
Foreign exchange reserves	454,720	484,911	**6.6%**	30,191	559,621	**15.41%**	74,710
Gold	51,948	53,391	**2.8%**	1,442	61,681	**15.53%**	8,290
Other	402,772	431,520	**7.1%**	28,749	497,940	**15.39%**	66,420
Other foreign assets	100,857	109,003	**8.1%**	8,146	108,871	**-0.12%**	-132
Foreign Liabilities	9,589	11,148	**16.3%**	1,559	17,142	**53.77%**	5,994
2. Net Domestic Assets	**-128,640**	**-124,762**	**-3.0%**	**3,878**	**-174,923**	**40.21%**	**-50,161**
Net Domestic Credit	-7,236	-17,622	**143.5%**	-10,386	-36,010	**104.34%**	-18,388
Net Credit to Nonfinancial Public Sector	-54,387	-63,847	**17.4%**	-9,460	-84,054	**31.65%**	-20,207
Net Credit to Central Government	-54,482	-63,942	**17.4%**	-9,460	-84,148	**31.60%**	-20,207
Credit to Central Government	28,316	23,015	**-18.7%**	-5,301	15,339	**-33.35%**	-7,676
Liabilities to Central Government	82,798	86,957	**5.0%**	4,159	99,487	**14.41%**	12,530
Net Credit to State & Local Government	0.000	0.000	**0.0%**	0	0.000	0.000	0
Net Credit to Public Nonfinancial Corporations	95	94	**-0.5%**	-1	94	**0.00%**	0
Credit to Private Sector	48,684	47,551	**-2.3%**	-1,133	49,396.61	**3.88%**	1,846
Net Credit to Other Financial Corporations	-1,533	-1,326	**-13.5%**	207	-1,353.09	**2.02%**	-27
Capital Accounts	141,226	127,480	**-9.7%**	-13,746	156,143	**22.48%**	28,664
Other Items Net	19,822	20,340	**2.6%**	519	17,230	**-15.29%**	-3,110
3- Broad Money (M2)	**414,857**	**455,204**	**9.7%**	**40,347**	**473,857**	**4.10%**	**18,653**
Narrow Money (M1)	**389,484**	**423,259**	**8.7%**	**33,775**	**436,708**	**3.18%**	**13,449**
CiC (Currency outside depository corporations)	196,134	216,308	**10.3%**	20,175	220,507	**1.94%**	4,198
Demand Deposits	193,350	206,951	**7.0%**	13,601	216,201	**4.47%**	9,250
Other Deposits (Quasi Money)	25,374	31,945	**25.9%**	6,571	37,149	**16.29%**	5,204
In Afghani	7,631	11,422	**49.7%**	3,791	12,827	**12.30%**	1,405
In Foreign currency	17,743	20,523	**15.7%**	2,780	24,322	**18.51%**	3,799

Source: Monetary Section, Monetary Policy Department/DAB

III. NET INTERNATIONAL RESERVE (NIR)

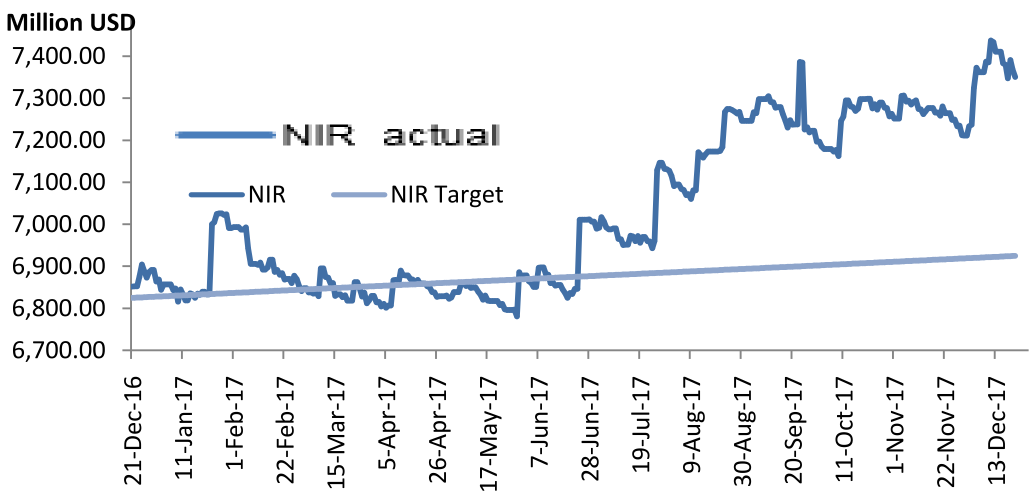
Da Afghanistan Bank holds international reserves, which consist of monetary gold, reserve position and holdings of Special Drawing Rights (SDR) with the IMF and major foreign exchange such as US dollars, Euro, Great British Pound (GBP) and others. The Net International Reserves (NIR) of Afghanistan,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

NIR registered 7.3 percent growth, which is equivalent to USD 498.41 million in the FY 2017.

For the FY year 2017, the NIR accumulation floor was set at USD 6,924.66 million, while in actual case, NIR experienced a significant amount of accumulation, reaching USD 7,350.34 million at the end of the year.

Figure 2.5 illustrates the actual and target trend of NIR during the year 2017.

Figure 2.5: NIR actual and target in million USD for theFY 2017



Source: Monetary section, Monetary Policy Department/DAB

IV.FOREIGN EXCHANGE MARKET

4.1 Exchange Rates

Da Afghanistan Bank's (DAB) ultimate goal is to maintain price stability. In order to achieve and maintain this goal, DAB puts its focus to utilize its monetary instruments, basically the open market operations, effectively with sound policy implementation.

During the FY 2017, Afghani remained relatively stable against the Pakistani rupees and Iranian Toman, while it slightly depreciated against currencies such as US dollar, Euro, Great British Pound and Indian Rupees.

The daily historic review of the average exchange rates of Afghani against the U.S. dollars and other foreign currencies for the fiscal year 2017 are shown in figures below.

Figure 2.6: Daily Average Ex-rate of Afghani against USD for the FY 2017

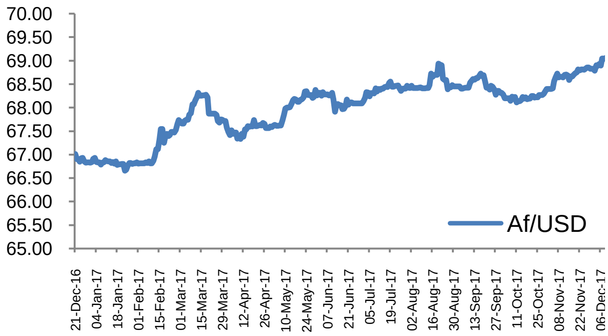


Figure 2.7: Daily Average Ex-rate of Afghani against GBP & Euro for the FY 2017

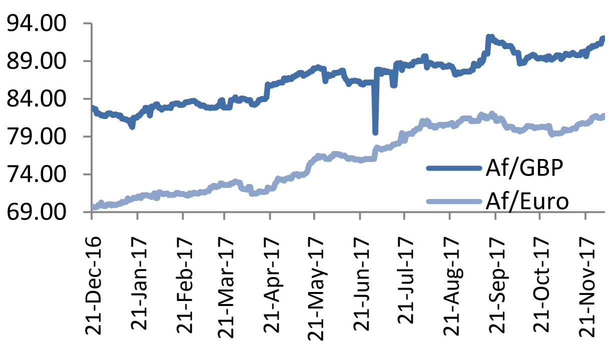


Figure 2.8: Daily Average Ex-rate of Afghani against INR & PKR for the FY 2017

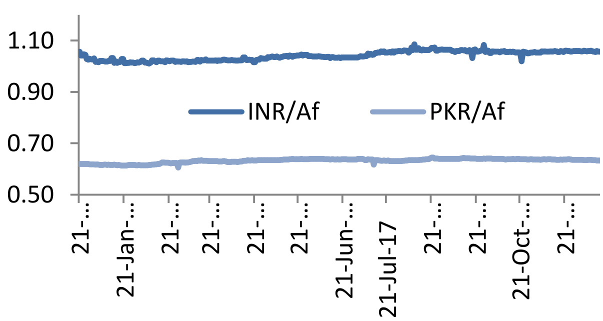
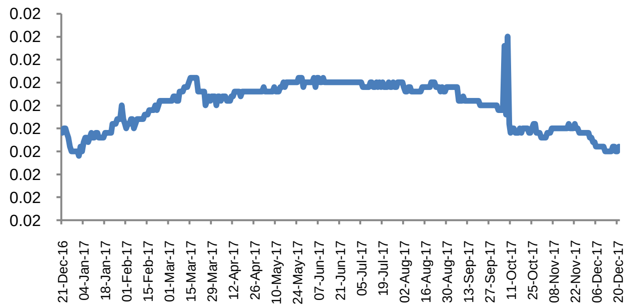


Figure 2.9: Daily Average Ex-rate of Afghani against IRR for the FY 2017



Source: Monetary Section, Monetary Policy Department/ DAB

V. OPEN MARKET OPERATION & LIQUIDITY CONDITIONS

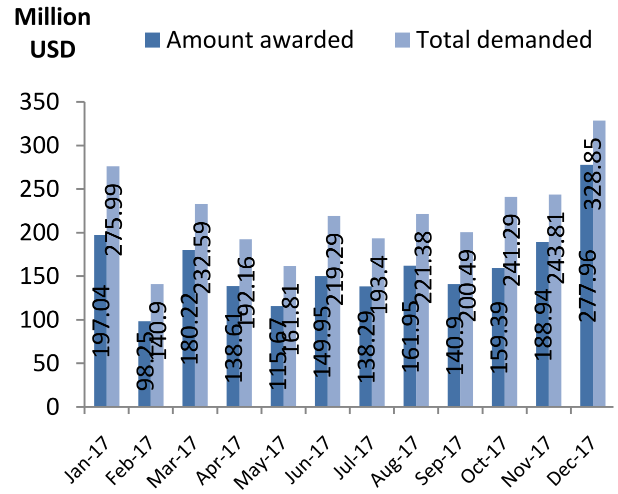
2.5.1 Foreign Exchange Auction

In order to control money supply in the economy, DAB manages the reserve money growth close to its cited ceiling by conducting FX (USD) auctions three times a week and a weekly capital notes auctions, which are the primary monetary instruments. DAB continued the FX auction to mop up excess liquidity from the market and to smooth out excessive volatility of the exchange rate of Afghani against foreign currencies, especially the U.S dollar.

During the fiscal year 2017, DAB auctioned a total amount of USD 1,947.17 million, while the total demand was USD 2,651.95 million. On average, 44 bidders participated in each auction and 32 bids were announced as the winning bids with the average amount of USD 13.34 million sold in each auction. The data for the FY 2016 recorded a total auctioned amount of USD 1,926.25 million, with a total demand of USD 2,669.46 million. On average, 48 bidders participated in each auction and 34 bids were awarded with an average amount of USD 13.28 million in each auction.

Figure 2.10, shows the total amount of USD, awarded and demanded through auctions in the FY 2017.

Figure 2.10: USD awarded and demanded amount for the FY 2017



Source: Monetary Policy Department/DAB

2.5.2 Capital Notes Auction

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

Da Afghanistan Bank uses Capital Notes (CNs) as a monetary tool to manage the money supply growth. Capital notes are used to absorb the excess liquidity of the commercial banks. Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months and one year.

Total outstanding stock of capital notes reached AF 38.99 billion at the end of fiscal year 2017, which shows a decrease of 10.6 percent compared to AF 43.62 billion at the end of fiscal year 2016.

The outstanding stock of 7 day capital notes stood at AF 4200 million, showing higher amount than the stock of FY 2016.

28 day Capital Notes outstanding amount stood at AF 14,451 million, while 91 day outstanding stock of CNs was recorded at AF 15,710 million. The stock of outstanding for 182 and 364 day notes stood at AF 2,050 million and AF 2,582 million respectively. Total interest paid to CNs amounts AF 1,920.3 million till the end of the year under review.

In addition, the weighted average interest rate for 7 day capital notes was 0.16 percent, for 28 day securities recorded at 0.15 percent, for 91 day notes was 0.30, for 182 days security it ended at 4.07 percent and for 364 day capital notes, it recorded 4.98 in the FY 2017, which are generally in lower levels than the same period of the previous year.

Figure 2.11: Capital Notes Outstanding for the FY 2017

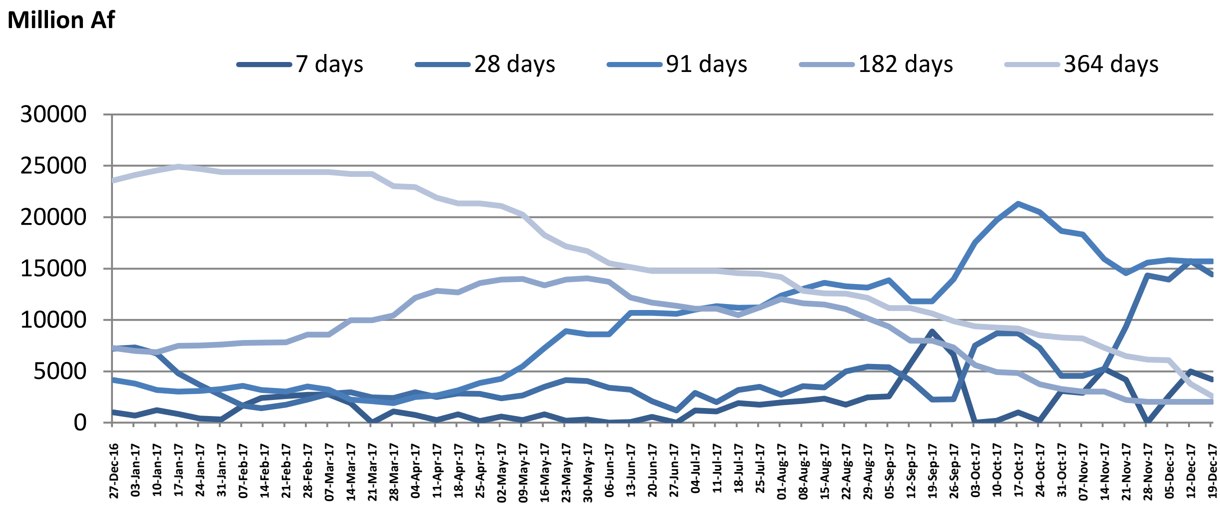
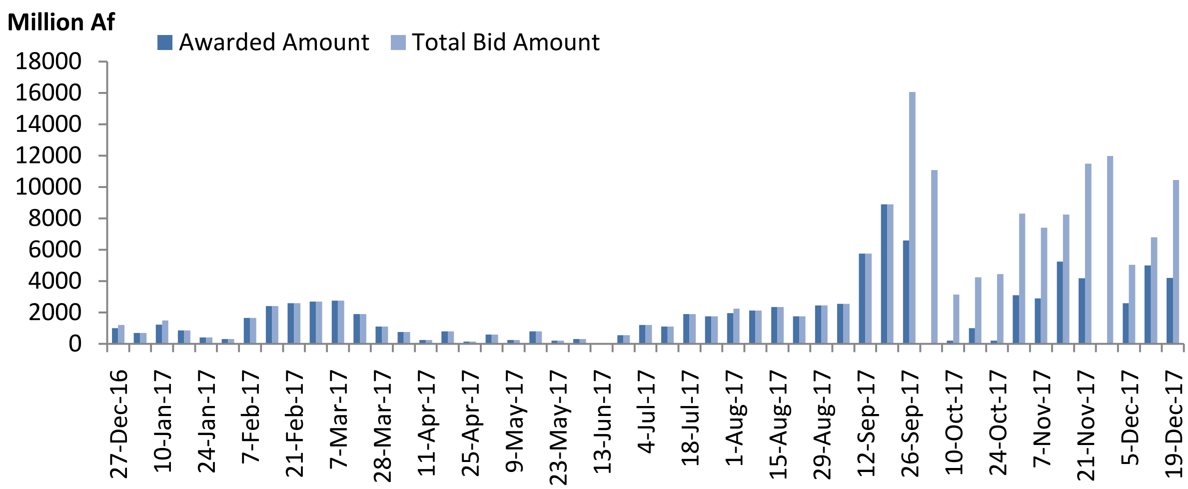


Figure 2.12: 7 Day CNs demanded and awarded amount in Million AF



Source: Monetary Section, Monetary Policy Department, DAB

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

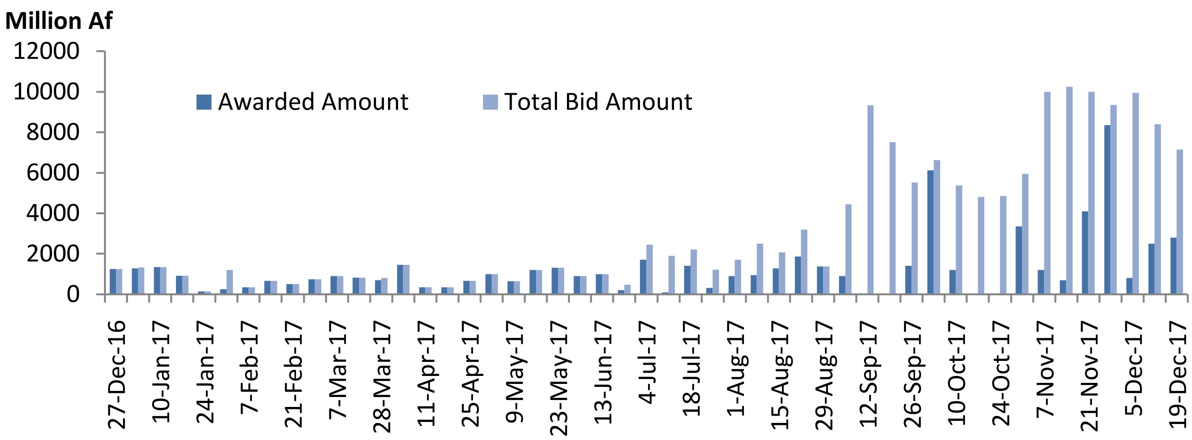


Figure 2.14: 91 Day CNs demanded and awarded amount

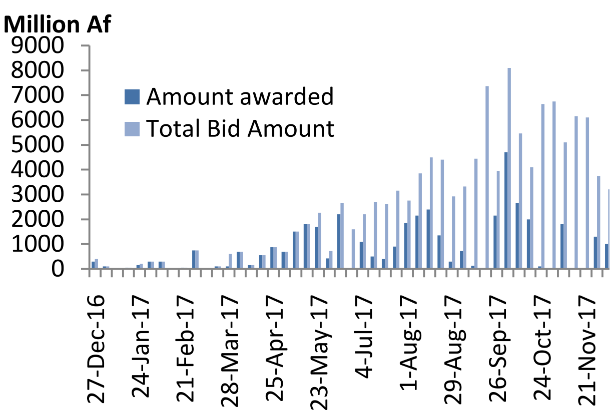


Figure 2.15: 182 Day CNs demanded and awarded amount in Million AF

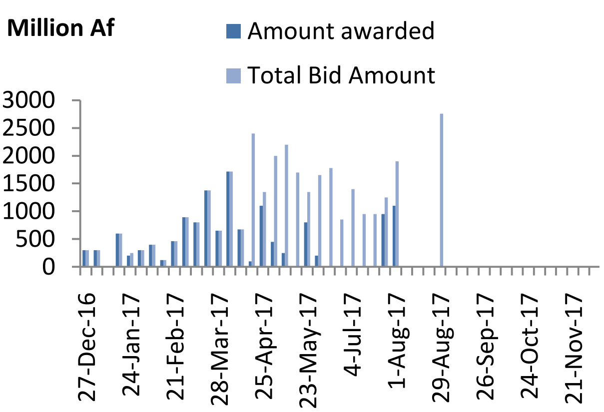
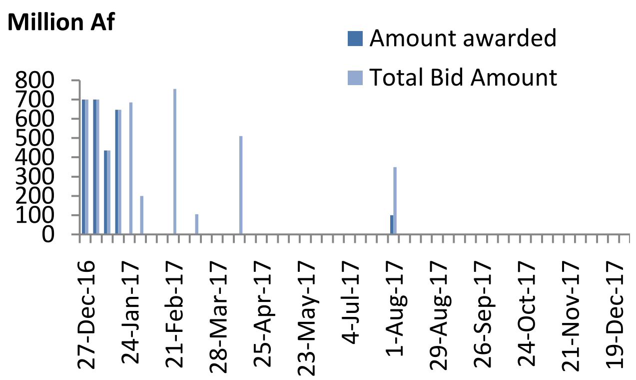


Figure 2.16: 364 Day CNs demanded and awarded in Million AF



Source: Monetary Section, Monetary Policy Department, DAB

2.5.3 Required and Excess Reserves

Commercial banks are required to hold 8 percent of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10 percent for foreign currency denominated accounts. Now, the required reserves are held in the currency of denomination (Domestic and foreign), unlike the previous practice, which required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. At the end of FY 2017, Afghani denominated required reserves recorded AF 7,357.48 Million, while the required reserves for the USD and Euro denominated deposits stood at USD 207.85 and USD 23.21 Million respectively.

Overnight Deposit Facility (ODF): This facility is available to all commercial banks to gain interest on their excess balances and provide a floor for rates on capital notes, so it is not counted towards required reserves. The interest rate on the overnight deposit facility is now 10 basis points. (Based on a circular to all banks, approved by DAB Supreme Council on September 11, 2017).

The average outstanding amount of overnight deposit facility recorded AF 9,305.89 million during the reporting period. At the end of FY 2017, the payment of interest rate to the mentioned facility reached AF 35.03 million.

Overnight Credit Facility (OCF)

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

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

3

Inflation Trend and Outlook

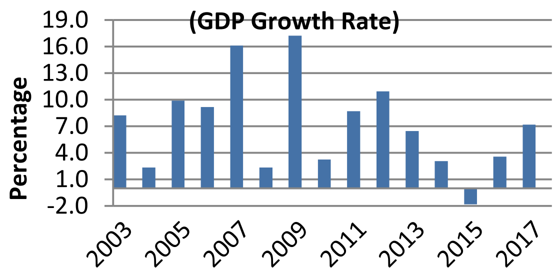
3

INFLATION TREND AND OUTLOOK

I. ANNUAL GDP OUTLOOK 2017

Continuing its growth momentum, Afghanistan GDP showed an upward trend in the end period of 2017 and was higher as compared to 2016. This was the highest growth achieved in the last 5 years period due to sharp recovery in agriculture sector, healthy performance by services sector, and uptick recovery in industry sector respectively. The overall economic growth stood at 7.2 percent in 2017 from 3.6 percent recorded in the previous year. The contribution of each sector in GDP share includes Services 50.7%, Agriculture 23.7%, and Industry sector 21.0% respectively. Overall, growth was largely driven by agriculture, services and industry sectors. In fact, agriculture sector plays crucial role in national economy. In 2017, its growth rate increased compared to the previous year. The agriculture sector was able to achieve sound growth rate of 21.4 percent with a broad-based improvements in production due to favorable weather conditions and supportive facilities in the sector. Both government and non-profit organizations are making efforts to support the sector with more facilities and are jointly working on launching new projects. The sector's growth rate increased to 21.4% compared to 12.4%. Services sector growth rate increased to 3.3% compared to 2.3% and industry sector growth surged to 0.9% compared to -1.9% percent compared to 2016. Technically, services and industry sectors showed moderate growth, while as in comparison, agriculture showed boosting trend. Agriculture sector is heavily dependent on the seasonal rainfalls. Hence, giving that weather condition is expected to be favorable in the coming quarters, Agriculture will continue its upward movement and will contribute to GDP growth in the next year.

Figure 3.1: Afghanistan's GDP Growth Rate 2003-17

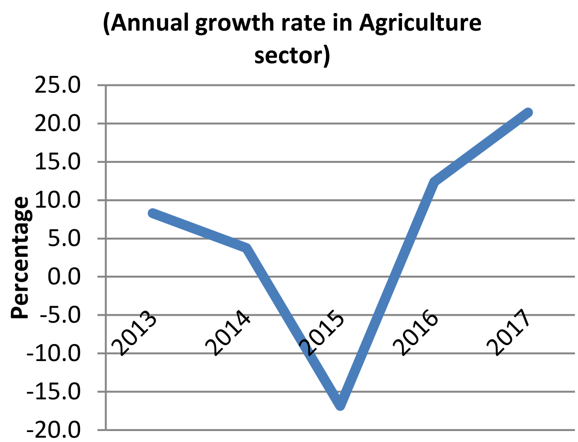


Source: Monetary Policy Department, DAB & NSIA

1.1 Agriculture Sector

The agriculture sector accounts for 23.7 percent of total GDP and majority of the population is directly or indirectly dependent on this sector. The Agriculture sector, based on national Statistics and Information Authority calculation, expanded in 2017 and reached 21.4 percent. This figure was calculated 12.4 percent in 2016. However, share of agriculture sector in total GDP increased to 21.4 percent in 2017. Observing the data in agriculture sector, all sub-components of this sector observed higher growth rate in 2017.

Figure 3.2: Annual Growth Rate of Agriculture Sector 2013-2017



Source: Monetary Policy Department, DAB NSIA

According to the latest Afghanistan Opium Survey, total area under opium cultivation increased by 63 percent in 2017 to an estimated 328,000 hectares. The majority (60 percent) of opium poppy cultivation took place in the southern region of the country. The western region accounted for 17 percent of the total cultivation; the northern for 13 percent, and eastern 7 percent. The remaining regions (North – Eastern and central) together accounted for 3 percent. Considering the aforementioned reasons, the report highlighted an increase of 87 percent in opium production at the end of 2017. This growth was recorded 45.5 percent in the previous year.

Scale poultry feed mill has been one of the main drivers of economic growth in the last quarter of 2017. The largest ever poultry feed mill has been established in Paghman district of Kabul. The feed mill has been established by the financial and technical assistance of the of the CARD-F and private sector, with a shared cost of more than 76 million Afghanis, and it can produce and deliver up to 10 metric tons of different feeds per hour to the farmers for breeder, broiler, layer farms, and cattle. According to Milli Feed Mill, the mill has been operating eight hours per day and has now delivered poultry feed to more than 20 poultry farms in Khost, Kandahar, Bamiyan and Kabul provinces which had a satisfying result.

Livestock contributed 2.8 percent of Agriculture sector in 2017. Livestock production is major source of nutritious food and income for vulnerable farmer, especially women headed households. As it is difficult for people to maintain livestock in the absence of food and water. Due mainly to this reason, livestock production has gone down and sales prices have decreased on average between 20-30 percent in 2017.

Growth of cereals production decreased to -10.0 percent as compared to -4.7 percent recorded in 2016. Low average rainfall, low snow accumulation continues to threaten staple crop production and livestock according to the Famine Early Warning System Network (FEWSNET). Latest indications continue to point to a reduction in cereal output in 2018 and negative prospects for the cereal supply outlook for the forthcoming 2018/19 marketing season.

According to ministry of agriculture the rain-fed agriculture would not be able to produce favorable output due to lack of admiring snow and rainfalls this year. Therefore, agriculture sector being one of the main contributors in shaping Afghanistan economy will have negative contribution in 2018.

Table 3.1: Growth in Agriculture including Poppy

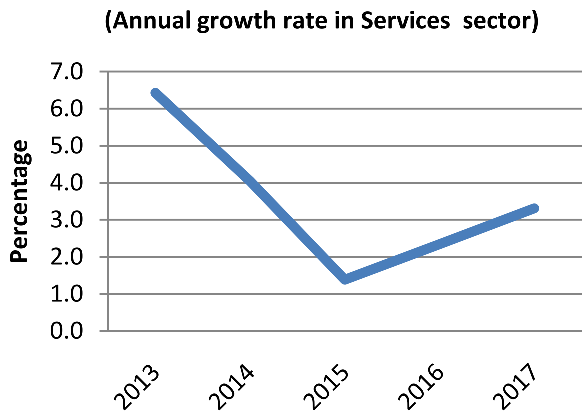
Share and Growth in percent	GDP shares		GDP growth	
Sector	**1396**	**1395**	**1396**	**1395**
	2017-18	**2016-17**	**2017-18**	**2016-17**
Agriculture	**23.7**	**23.1**	**21.4**	**12.4**
Cereals	7.5	8.5	-10.0	-4.7
Fruits	3.6	3.3	25.4	32.1
Livestock *	2.8	2.9	0.1	0.2
Poppy	4.4	2.9	87.5	45.5
Others **	5.3	5.5	46.5	22.9

Source: Monetary Policy Department, DAB & NSIA

1.2 Service Sector

The services sector based on the Central Statistics organization's calculations, comprised of 50.7% of total GDP in 2017. The resurgence of the public sector has led the growth in services and it is recognized as an effective factor in the economic growth of Afghanistan. The growth of services sector in 2017 in comparison to the previous year was recorded 3.3 percent. In contrast, the growth of this sector was calculated 2.3 percent in 2016.

Figure 3.3: Annual Growth Rate in Services Sector 2013-2017



Source: Monetary Policy Department, DAB & NSIA

In the last quarter of 2017, the growth of the wholesale and retail trade, restaurant and hotels item reached 12.8 percent compared to -7.2 percent recorded in 2016. In addition, real estate and business services rose by 2.2 percent, while community, social and personal service ascended to 0 percent from -0.6 percent. Government services increased to 5.5 percent and other services recorded a growth of 9.4 percent. On the other hand, transport, storage and communication item indicated a decline standing 3.0 percent, while in 2016 the figure was calculated 4.9 percent. Similarly, finance, insurance, real estate and business experienced a significant decline and reached -46.9 percent in comparison to 19.4 percent observed in previous year.

The services sector main segments are government services, transport, storage and communication, wholesale and retail trade. Services sector, being Afghanistan's biggest economic player, has been providing a platform for sustainable development and will grow more with following huge projects.

The office of the president (ARG) approved a contract related to the Fiber Optics project with a total value of 383 million USD during a meeting of the National Procurement Commission chaired by President Mohammad Ashraf Ghani. According to statement by ARG, this project is about the issuance of investment licenses by the Telecom Regulatory Authority of Afghanistan (ATRA) (write this in a proper manner) for investment on Fiber Optics project.

Regional leaders launched construction work on the Afghan section of an $8 billion natural gas pipeline that will link the energy-rich Central Asian nation of Turkmenistan through Afghanistan to Pakistan and India. At the same time, economic experts called opening of these projects in the interest of the Afghan people, and emphasized on practical implementation of these projects by private companies and the government. The total length of the project in Afghanistan is 774 kilometers. Afghanistan will receive annually approximately USD 400 million as a transit fee from TAPI project. The project will create thousands of new job opportunities for the people of Afghanistan too. Hence, this project is thought to indirectly create USD 1 billion annually.

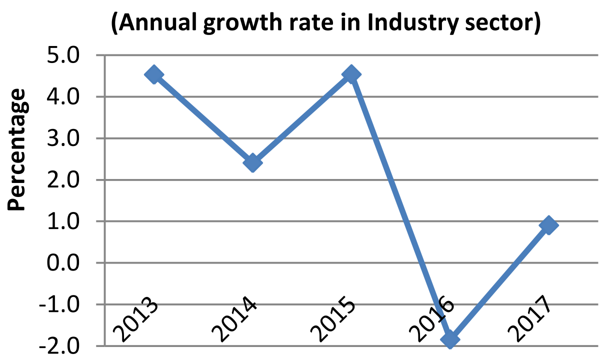
Table 3.2: Growth in Services				
Share and Growth in percent	GDP shares		GDP growth	
Sector	1396	1395	1396	1395
	2017-18	2016-17	2017-18	2016-17
Services	**50.7**	**51.6**	**3.3**	**2.3**
Wholesale & retail trade, restaurants & hotels	8.2	7.8	12.8	-7.2
Wholesale & retail trade	6.8	6.3	15.3	-9.3
Restaurants & hotels	1.4	1.4	2.0	3.6
Transport, storage and communication	24.0	24.1	3.0	4.9
Transport & storage	18.1	18.1	1.3	0.5
Post and telecommunication	5.9	6.0	5.2	11.1
Finance, insurance, real estate and business	1.0	2.0	-46.9	19.4
Finance	1.0	2.0	-47.2	19.6
Insurance	0.0	0.0	1.4	1.6
Real estate and business services	0.0	0.0	2.2	-3.1
Ownership of dwellings *	2.7	2.7	3.2	2.0
Community, social and personal service *	0.7	0.8	0.0	-0.6
Government services	12.3	12.5	5.5	0.5
Other services	1.9	1.8	9.4	6.7
Source: Monetary Policy Department, DAB & NSIA				

1.3 Industry Sector

According to the National Statistics and Information Authority (NSIA), industry sector contribution is 21% in 2017. In modern world, industry sector plays important role in shaping of GDP growth and national economy.

The growth rate of industry sector increased to 0.9 percent in the end of 2017 compared to -1.9 percent in the same quarter of previous year. Industry sector's sub-factors showed positive and negative treatments. Main fluctuations on positive side took place due to increase in mining and quarrying which grew 13.6 this year from 10.4 observed in the previous year. Food and beverages increased to 2.1 percent from 1.1 percent, paper production, printing and publishing jumped up to 4.8 percent compared to 0.1 percent, and construction stood at 0.4 percent compared to -4.7 percent recorded in 2016.

Figure 3.4: Annual Growth Rate in Industry Sector from 2013-2017



Source: Monetary Policy Department, DAB & NSIA

On the other hand, decrease observed in manufacturing which came down to 0.7 percent from 1.1 percent, chemicals, petroleum coal, rubber and plastic decreased to -51.8 percent from 1.8 percent, non metallic minerals declined to -8.9 percent from 21.3 percent and electricity, gas and water growth decreased to 2 percent from 4 percent observed in precious year calculations. Overall, as with other sectors of the economy, the industry sector has been growing and will grow more in 2018 to 2022 due to new projects in progress. The government of Afghanistan has been making tremendous efforts to support and strengthen textile, manufacturing and mining sectors to open gateway to industrialization in the country. Furthermore, the government in collaboration with foreign countries and private sector is keen to invest in different businesses and projects. After analyzing above facts and figures, the performance of the industry sector, meanwhile, remained constrained but growth was positive in 2017.

Table 3.3: Growth in Industry

Share and Growth in percent	GDP shares		GDP growth	
Sector	**1396**	**1395**	**1396**	**1395**
	2017-18	**2016-17**	**2017-18**	**2016-17**
Industry	**21.0**	**21.1**	**0.9**	**-1.8**
Mining and quarrying	0.9	0.7	13.6	10.4
Manufacturing	10.5	11.0	0.7	1.1
Food, beverage & tobacco	10.3	10.8	2.1	1.1
Textile, wearing apparel & leather	0.0	0.0	-5.1	-14.8
Wood & wood production including furniture	0.0	0.0	-3.9	-17.1
Paper, paper production, printing and publishing	0.0	0.0	4.8	0.1
Chemicals, petroleum, coal, rubber and plastic	0.0	0.1	-51.8	1.8
Non-metallic minerals except petroleum & coal	0.0	0.0	-8.9	21.3
Basic metal	0.0	0.0	4.3	10.7
Electricity, gas and water	0.1	0.1	2.0	4.0
Construction	9.6	9.2	0.4	-4.7

Source: Monetary Policy Department, DAB & NSIA

Considering the above facts, figures and calculations, Da Afghanistan Bank forecasts GDP growth rate of 3-4 percent for 2018 (make a more meaningful statement.

II. INFLATION TREND AND OUTLOOK

Prices of industrial products continued to pick up in the fourth quarter of 2017, while most agricultural prices remained broadly stable. In the oil market, inventories continued to fall amid strong demand, OPEC production restraint and stabilization in the U.S. shale oil production. Crude oil prices average USD 53 per barrel in 2017 (up from USD 43 per barrel in 2016) and rise to USD 56 per barrel in 2018, a slight downward revision from the April 2017 forecast. Metal prices are expected to surge 22 percent in 2017 due to strong demand and supply constraints, notably Chinese environmentally-driven supply cuts. With the exception of iron ore, metal prices are expected to increase moderately in 2018.

Agricultural prices were broadly unchanged in 2017 and are anticipated to rise marginally in 2018. Most food markets are well-supplied and the stocks-to-use ratios of some grains are forecasted to reach multi-year highs.

Energy prices increased by two percent in the end of 2017, led by a 17 percent leap in coal prices due to strong demand in China as well as several supply constraints. Crude oil prices rose marginally from the previous quarter by 1.6 percent to USD 50.20 per barrel on average. Oil prices indicated a lower trend during the first half of the year mainly due to large inventories, recovery in the U.S. shale oil production and expanding output from the OPEC member countries.

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

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

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

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

III. CONSUMER PRICES IN AFGHANISTAN

Currently, the consumer price index (CPI) in Afghanistan is compiled on the base prices of April 2015 while previously; the CPI was calculated on the base prices of March 2011. Similarly, in this revision, the CPI components are also aligned with new weights. As per data from the National Statistics and Information Authority (NSIA) and analysis of Da Afghanistan Bank (DAB), the following results were observed from analyzing the consumer price index of Afghanistan.

The year-on-year measure of changes in the consumer price index showed a deflation rate of 3.3 percent on average in the fourth quarter of 2017 lower than 4.7 percent recorded in the fourth quarter of the previous year. The decrease in the inflation rate is in line with low and stable prices of commodities in the global markets. Based on the reports, most items of the global commodity price index indicated lower prices over the last quarter of 2017.

Similar to the year-on-year comparison, the inflation measured on quarter-on-quarter basis, also indicated a decline in the period under review. Observing the previous quarter data, the average inflation rate stood at 3.3 percent in the fourth quarter of 2017, lower than average rate of 4.5 percent in the previous quarter.

The Kabul CPI also reflected disinflation in the fourth quarter of 2017. Observing the Kabul headline CPI, the inflation rate eased to 3.41 percent on average in the fourth quarter of 2017 from 5.44 percent in the same quarter of the previous year. On quarterly basis, the index decreased to 3.41 percent on average from 4.61 percent in the previous period.

3.1 Developments in National Headline Inflation

3.1.1 Annual Developments

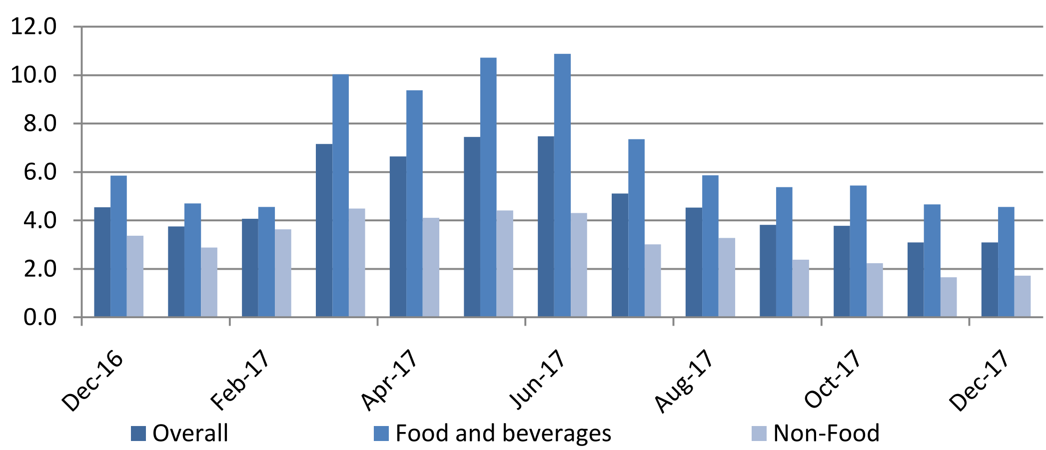
The headline consumer price index reflected a significant decline on year-on-year basis in the fourth quarter of 2017. As per the available data, the headline inflation measured on year-on-year basis, declined to 3.3 percent on average in the fourth quarter of 2017 from 4.7 percent in the same period of the preceding year. On monthly basis, the inflation rate was recorded at 3.8 percent, 3.1 percent, and 3.1 percent in the months of October, November, and December respectively.

In the food index, the inflation declined to 4.9 percent on average in the fourth quarter of 2017 from 6.3 percent in the same quarter of the previous year. In this index, deflationary pressures came from lower prices of meat, non-alcoholic beverages, sugar and sweets, and spices. The highest increase in the index was recorded in prices of vegetables and fresh and dried fruits which increased to 21.6 percent and 8.9 percent on average from 11 percent and 4.9 percent in the same quarter of the previous year. On the other hand the highest decline was observed in the price index of spices which decreased to (-14.6) percent on average in the quarter under review from 32.6 percent in same quarter of the previous year.

In non-food category, inflation declined by lower prices of tobacco, clothing, furnishing and household goods, health, communication, information and culture, education, restaurants and hotels, while prices index of furnishing and household and transportation represented higher prices. Overall inflation in non food category declined from average 3.2 percent in the fourth quarter of 2016 to 1.9 percent in the fourth quarter of 2017. In the mentioned category, the highest decrease was noted in price index of education, tobacco and restaurant and hotels which declined to (-0.1), (4.2) and (-0.2) percent from (21.2), (9.0) and (3.4) percent. On the other hand, price index of transportation and furnishing and household increased to 1.8 and 2.9 percent on average in the fourth quarter of 2017 from (1.3) and (2.5) percent in the same period of previous year respectively.

Core inflation also showed downward slope in the fourth quarter of 2017 compared to the fourth quarter of 2016. Trimmed mean which is the most common measure of core inflation, dropped to 2.0 percent from 4.9 percent. In addition, CPI inflation, excluding bread and cereals, oil and fats and transportation, reached 3.7 percent down from 5.5 percent.

Figure 3.5: National Headline Inflation (Y-o-Y)



Source: National Statistics and Information Authority (NSIA)&Monetary Policy Department, DAB

Table 3.4: National Headline Inflation 2016-17

Period	2016					2017							
	Based on April 2015												
	Weight	Oct-16	Nov-16	Dec-16	Average (3 month)	Jul-17	Aug-17	Sep-17	Average (3 month)	Oct-17	Nov-17	Dec-17	Average (3 month)
Overall Index	**100.0**	**4.9**	**4.6**	**4.5**	**4.7**	**5.1**	**4.5**	**3.8**	**4.5**	**3.77**	**3.09**	**3.08**	**3.3**
Food & Non-Alcoholic Beverages	**47.8**	**6.6**	**6.6**	**5.8**	**6.3**	**7.4**	**5.9**	**5.4**	**6.2**	**5.44**	**4.66**	**4.55**	**4.9**
Bread and Cereals	**14.6**	2.2	1.3	-0.5	1.0	4.0	4.3	3.2	3.8	1.01	0.99	2.04	1.3
Meat	**7.5**	6.3	6.2	6.1	6.2	7.3	4.4	4.8	5.5	5.93	5.65	5.48	5.7
Milk, cheese and eggs	**4.7**	0.1	1.1	2.0	1.0	2.0	2.1	3.7	2.6	4.10	3.99	3.71	3.9
Oils and fats	**4.6**	5.6	6.0	6.7	6.1	9.1	9.6	6.1	8.3	5.42	5.19	4.35	5.0
Fresh and dried fruits	**5.0**	5.4	4.5	4.7	4.9	5.9	6.3	6.9	6.4	8.53	10.25	7.85	8.9
Vegetables	**6.0**	8.8	12.4	11.9	11.0	24.7	18.0	20.2	21.0	25.73	19.65	19.36	21.6
Sugar and sweets	**2.7**	29.4	25.9	20.0	25.1	3.6	-0.4	-2.9	0.1	-4.81	-5.09	-4.61	-4.8
Spices	**1.3**	31.3	32.9	33.5	32.6	1.1	-3.7	-7.5	-3.4	-9.17	-15.54	-19.01	-14.6
Non-alcoholic beverages	**1.4**	4.7	3.6	3.7	4.0	3.2	2.7	2.3	2.7	2.02	1.92	1.67	1.9
Non-Food Items, Tobacco & Services	**52.2**	**3.5**	**2.8**	**3.4**	**3.2**	**3.0**	**3.3**	**2.4**	**2.9**	**2.24**	**1.65**	**1.72**	**1.9**
Tobacco	**0.3**	10.1	9.0	7.9	9.0	8.5	8.8	6.7	8.0	4.07	4.80	3.61	4.2
Clothing	**4.6**	5.6	4.0	3.2	4.3	1.6	2.5	0.8	1.6	2.21	3.78	4.23	3.4
Housing	**19.1**	3.8	2.9	5.0	3.9	4.7	5.3	3.7	4.6	3.04	1.38	1.23	1.9
Furnishing and household goods	**11.9**	3.3	2.3	1.8	2.5	2.3	2.3	1.9	2.2	2.43	3.19	3.14	2.9
Health	**6.2**	4.3	2.8	4.0	3.7	1.0	0.9	1.2	1.0	0.58	0.70	0.93	0.7
Transportation	**4.3**	-0.2	3.0	1.2	1.3	7.0	6.4	5.3	6.2	4.50	0.13	0.67	1.8
Communication	**1.7**	-1.7	-1.8	-1.9	-1.8	-3.3	-2.8	-2.3	-2.8	-2.21	-2.20	-2.1	-2.2
Information and Culture	**1.1**	-1.3	-2.4	-2.4	-2.0	-3.5	-3.8	-5.1	-4.2	-4.71	-4.14	-4.11	-4.3
Education	**0.4**	18.8	22.0	22.8	21.2	5.7	3.7	0.1	3.1	-0.06	-0.44	0.08	-0.1
Restaurants and Hotels	**1.1**	2.9	3.8	3.4	3.4	-0.2	0.2	-0.3	-0.1	-1.11	0.06	0.37	-0.2
Miscellaneous	**1.4**	7.0	6.1	5.1	6.1	2.5	2.7	2.8	2.7	3.58	3.37	4.29	3.7
CPI ex. B & C, O & F, and T		5.7	5.2	5.6	5.5	5.0	4.2	3.7	4.3	4.15	3.53	3.33	3.7
30% trimmed mean		5.0	4.8	4.8	4.9	3.7	3.1	2.4	3.1	2.11	1.92	2.01	2.0

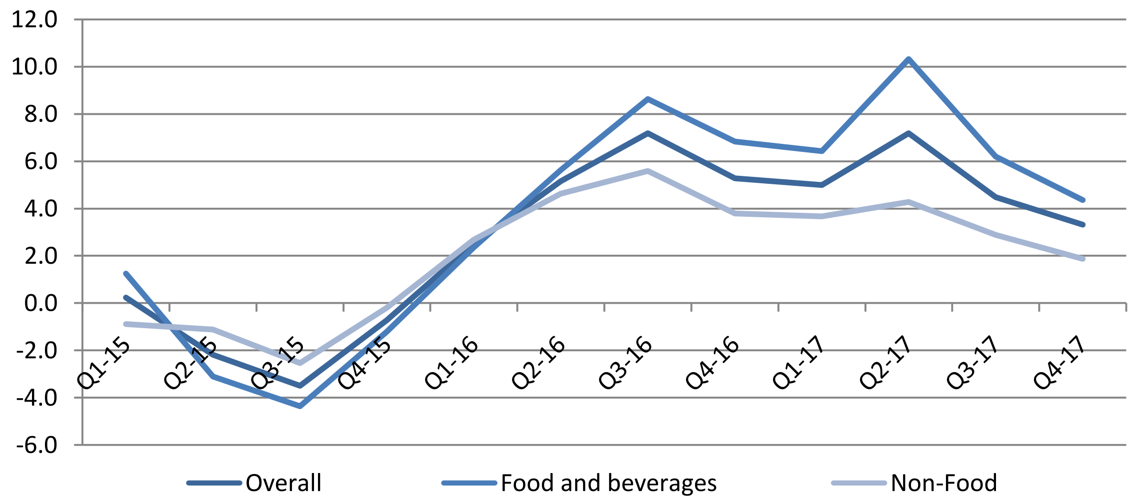
3.1.2 Quarterly Developments in National Headline Inflation

The short term measure of inflation reflected similar trend as the annual measure. The national headline inflation calculated on quarter on quarter basis decreased to 3.3 percent on average in the fourth quarter of 2017 from 4.5 percent recorded in the previous quarter. The main decrease in the inflation rate was the result of disinflation in the food item. In the meantime, non-food category also showed a lower rate of inflation compared to the same period of previous year.

On quarterly basis, the food inflation declined to 4.9 percent on average in the fourth quarter of 2017 from 6.2 percent in the previous quarter of 2017. The price indices of food items such as, bread and cereals, oil and fats, sugar and sweets, and spices decreased dramatically but the prices of meat increased slightly from the previous quarter. However, in this category, the largest quarterly decreases were recorded in spices, sugar and sweets price indices which were recorded at (-14.6) percent and (-4.8) percent respectively.

Non-food inflation also recorded lower rate during 2017/fourth quarter to 2017. Observing the data, inflation in non-food index decreased to 1.9 percent on average in the fourth quarter of 2017 from 2.9 percent in the previous quarter. In this category, the prices of transportation and housing items decreased with big margin. The transportation index declined to 1.8 percent in the fourth quarter from 6.2 percent in the previous quarter and similarly housing index decreased to 1.9 percent from 4.6 percent. Moreover, inflation in furnishing and household index was recorded higher at 2.9 percent compared to 2.2 percent.

Figure 3.6: Quarterly Average National Headline Inflation



Source: NSIA/Monetary policy Department, DAB

3.2 Developments in Kabul Headline Inflation

3.2.1 Annual Developments

The headline CPI inflation in Kabul declined to 3.41 percent on average in the fourth quarter of 2017 from 5.4 percent in the fourth quarter of the previous year.

Food index, which is accounted for 37.2 percent of the overall index, reflected a deflation rate in one-year period. In this category, deflationary pressures came from lower prices of meat, sugar and sweets, milk, cheese and eggs, spices and non-alcoholic beverages. As a result, food inflation decreased to 6.0 percent on average in fourth quarter of 2017 from 9.4 percent in the same quarter of 2016.

Inflation of non-food item which comprises 62.8 percent weight of the whole index, decreased to 1.7 percent on average in the fourth quarter of 2017 from 3.1 percent in the same period of the previous year. The decrease is mainly attributed to lower prices of clothing, housing, communication, restaurants and hotels, health, transport and miscellaneous items. However, in this category, inflation in furnishing and housing increased to 2.9 percent on average from 2.5 percent.

Core inflation excluding bread & cereals, fats and oils and transportation also indicated a decline in the period under review compared to the same period previous year. In the last quarter of 2017, the core inflation rate stood at 4.0 percent on average while the rate was recorded 6.5 percent in the last quarter of 2016. The 30% trimmed mean reflected an inflation rate of 1.2 percent compared to 6.6 percent.

3.2.2 Quarterly Developments in Kabul Headline Inflation

The quarter on quarter measure of headline inflation in Kabul indicated downward movement which reflects disinflation in both food and non-food items of the CPI. The headline inflation in Kabul declined to 3.41 percent on average in the last quarter of 2017 from 4.61 percent recorded in the previous quarter.

Inflation in the food index declined to 6.0 percent from 7.7 percent. In this category, the prices of meat, vegetables, milk, cheese and eggs, oils and fats, sugar and sweets and spices decreased which led to higher deflation rate during the period under review. In this category, the highest decline was observed in price index of spices which further decreased to -17.4 percent on average in the fourth quarter of the reference period from -5.9 percent in the same period of previous year. On the other hand, inflation in bread and cereals index showed an increase on quarterly basis which picked up to 17.0 percent from 7.9 percent.

Non-food category of the CPI also contributed to lower during the last quarter of 2017. Inflation in this category decreased to 1.8 percent on average in the fourth quarter of 2017 compared to 2.7 percent in the previous quarter. The decrease in non-food inflation is mainly driven by lower prices of tobacco, housing, health, transportation, and education, and miscellaneous items among which the largest decrease was observed in the inflation of tobacco (it is correct that tobacco recorded the most significant change, but we should also see the importance of this component and its effect on the overall index. We have other components with higher weights in the index which are important to be reported. So please write about those items rather than tobacco item which declined to 7.1 percent from 14.1 percent.

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

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

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

The near-term outlook of inflation in Afghanistan is likely to remain steady. Da Afghanistan Bank forecasts national headline inflation rate in range between 2 to 4 percent for the first quarter of 2018.

Figure 3.7: Kabul Average Inflation Q1, 2015- Q4, 2017

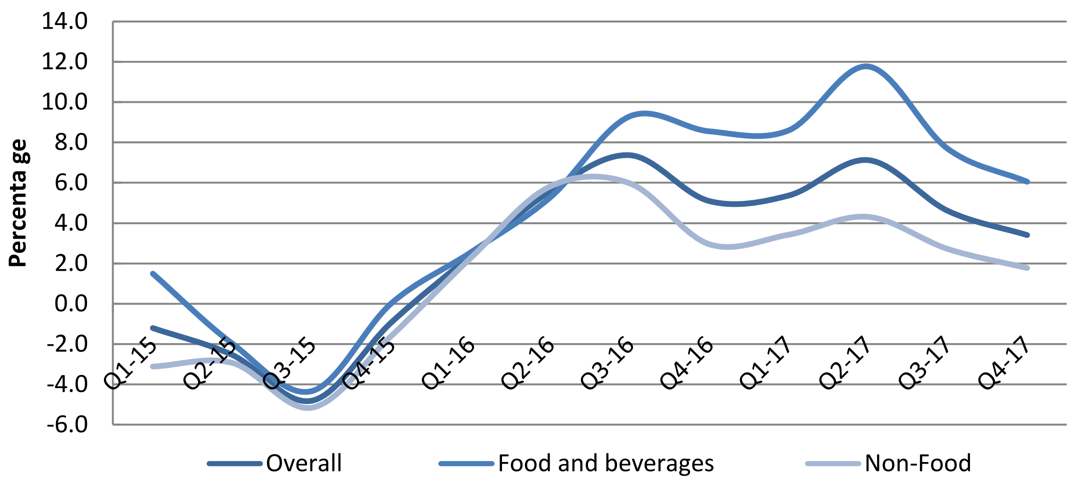


Figure 3.8: Quarterly Trimmed Mean

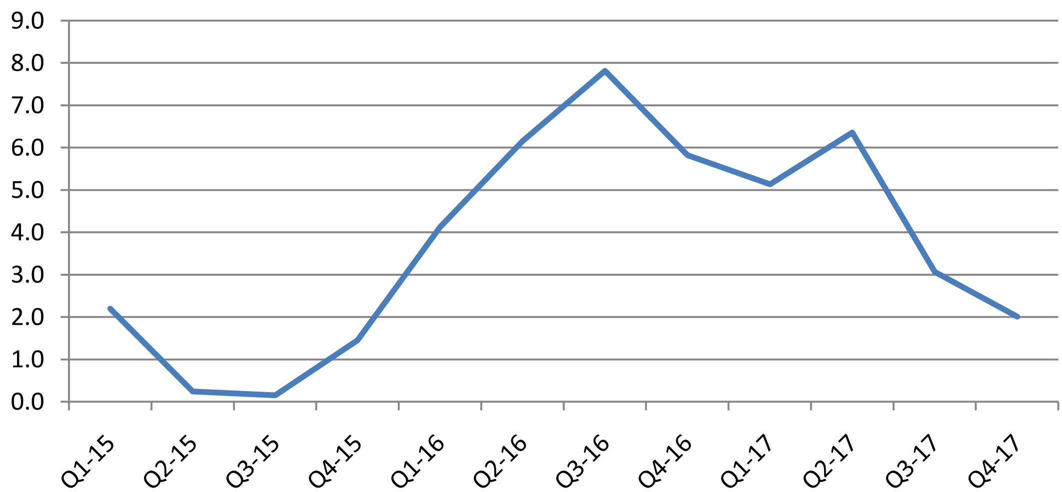
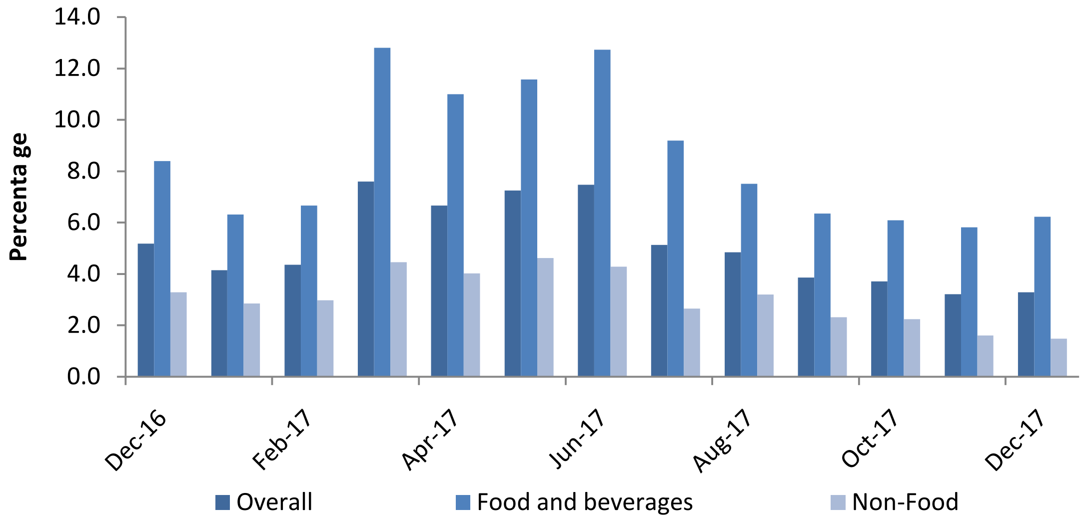


Figure 3.9: Kabul Headline Inflation Dec.,16 - Dec.,17



Source: NSIA/ Monetary Policy Department, DAB

Table 3.5: Kabul Headline Inflation 2016-17

Period	2016					2017							
	Based on 2015												
	Weight	Oct-16	Nov-16	Dec-16	Average (3 month)	Jul-17	Aug-17	Sep-17	Average (3 month)	Oct-17	Nov-17	Dec-17	Average (3 month)
Overall Index	**100.0**	**6.1**	**5.0**	**5.2**	**5.4**	**5.1**	**4.8**	**3.9**	**4.6**	**3.7**	**3.2**	**3.3**	**3.4**
Food & Non-Alcoholic Beverages	**37.2**	**10.4**	**9.4**	**8.4**	**9.4**	**9.2**	**7.5**	**6.4**	**7.7**	**6.1**	**5.8**	**6.2**	**6.0**
Bread and Cereals	9.8	1.7	0.5	-3.1	-0.3	3.6	4.5	2.4	3.5	-1.8	-1.0	1.9	-0.3
Meat	6.4	11.2	10.9	10.0	10.7	10.9	6.3	7.1	8.1	8.8	7.0	7.3	7.7
Milk, cheese and eggs	3.2	3.6	3.8	2.8	3.4	0.5	-0.1	1.1	0.5	0.3	0.3	1.0	0.5
Oils and fats	3.6	6.4	6.0	5.4	6.0	13.7	14.8	4.7	11.1	3.1	2.5	1.9	2.5
Fresh and dried fruits	5.2	10.5	7.2	8.4	8.7	5.6	9.4	8.7	7.9	13.9	20.8	16.3	17.0
Vegetables	4.2	8.3	12.0	18.6	13.0	31.9	22.7	26.9	27.1	33.0	22.2	21.3	25.5
Sugar and sweets	2.8	42.8	39.0	31.8	37.9	10.3	4.8	2.9	6.0	-0.2	-0.6	2.0	0.4
Spices	1.0	35.4	27.9	25.3	29.6	-1.7	-6.7	-9.5	-6.0	-15.1	-17.5	-19.5	-17.4
Non-alcoholic beverages	0.9	11.4	8.9	5.2	8.5	0.5	-2.1	-3.3	-1.6	-2.5	-2.5	-1.2	-2.1
Non-Food Items, Tobacco & Services	**62.8**	**3.6**	**2.5**	**3.3**	**3.1**	**2.6**	**3.2**	**2.3**	**2.7**	**2.2**	**1.6**	**1.5**	**1.8**
Tobacco	0.3	10.0	11.0	10.4	10.4	15.5	15.7	11.3	14.2	7.6	7.9	6.0	7.2
Clothing	4.8	9.2	5.4	3.4	6.0	-0.7	2.2	-1.3	0.1	0.8	4.2	5.0	3.3
Housing	23.5	1.4	1.5	4.7	2.5	5.9	7.2	5.8	6.3	4.6	1.5	0.9	2.3
Furnishing and household goods	17.6	4.4	2.0	1.2	2.5	2.3	1.9	1.5	1.9	2.2	3.4	3.4	3.0
Health	5.3	4.5	0.3	3.2	2.6	-3.3	-2.5	-0.7	-2.2	-0.9	0.5	0.8	0.1
Transportation	4.6	1.8	3.7	2.4	2.6	5.0	4.6	4.2	4.6	4.2	0.2	-0.1	1.4
Communication	2.0	-0.3	-0.3	-0.8	-0.5	-4.4	-4.2	-4.3	-4.3	-4.3	-4.3	-4.1	-4.2
Information and Culture	1.7	-1.6	-3.1	-3.2	-2.6	-5.9	-6.0	-8.1	-6.7	-8.3	-7.3	-7.3	-7.6
Education	0.7	26.4	31.0	31.6	29.7	8.0	5.4	0.4	4.6	0.7	0.2	0.5	0.4
Restaurants and Hotels	1.0	2.2	1.4	1.5	1.7	-3.3	-5.3	-5.0	-4.5	-6.4	-4.0	-3.3	-4.6
Miscellaneous	1.3	15.0	13.9	11.4	13.4	2.4	1.9	1.6	2.0	2.5	0.9	2.3	1.9
CPI ex. B & C, O & F, and T		6.9	5.6	6.3	6.3	5.0	4.5	4.0	4.5	4.3	3.9	3.7	4.0
30% trimmed mean		7.2	6.3	6.3	6.6	3.5	2.8	1.6	2.6	1.2	0.9	1.5	1.2

Source: NSIA/Monetary Policy Department, DAB

4

External Sector Developments

4

EXTERNAL SECTOR DEVELOPMENT

Afghanistan's external sector performance for the FY 2017 in comparison with the previous year, continued to be weak as a result of poor domestic and external conditions.

These developments triggered a deficit in the current account, capital and financial flow reversal and depletion in external reserves.

The available data reveals that the performance of the external sector witnessed severe pressure as current account position posted a deficit of 28 percent due mainly to 6 percent increase in out payments of merchandize trade in goods, 80 percent increase in out payments on respect of services, and 16 percent decrease in net receipts of official grants to the government sector.

Moreover, the decline which is recorded in the capital and financial account points to the need for continuous improvement in the investment climate to encourage investors' confidence for enhancement domestic production.

I. BALANCE OF PAYMENTS

In view of the pressure on the current, capital and financial account, the deficit in the overall balance of payments (BOP) widened to USD 3,708.10 million in the reference period from USD 2,698.29 million in the preceding year, reflecting widening of merchandise trade deficit (6 percent increase), acceleration of the services deficit (80 percent increase) and narrowing in receipts of official grants (16 percent decline) to the government sector (table 4.1).

As a result of higher growth of imports over exports, the merchandise trade deficit also widened reaching to USD 6,306.75 million (31 percent of GDP) in FY 2017 from USD 5,970.47 million (30 percent of GDP) in the same period of previous year.

The deficit of the services account increased to USD 665.36 million in period under review from USD 370.36 million recorded in the preceding year as a result of increased net payments to the transportation, travel and insurance services.

Net payments to transportation services increased to USD 671 million in the year under review from USD 552.8 million in the previous year. Net payments to travel services also increased and stood at USD 116.7 million from USD 30.3 million recorded previously due to education-related expenditure. Likewise, net payments to insurance and pension services increased to USD 107.2 million in the reporting year from USD 97.7 million in FY 2016.

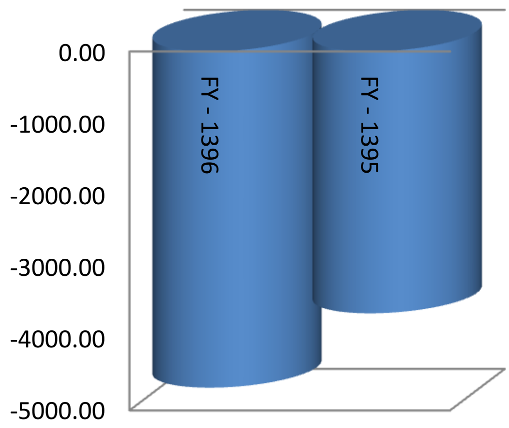
Net receipts on primary income account widened slightly by 2 percent to USD 96.12 million in the period under review from USD 94.57 million in the previous year. Net primary income refers to (receipts and payments) of employees compensation paid to nonresident workers and investment income (receipts and payments on direct investment, portfolio investment, other investments, and receipts on reserve assets).

On the other hand, total unrequited transfers' surplus which was largely influenced by official transfers (grants) to the government and worker personal home remittances from foreign countries dropped by 16 percent to USD 2,192.88 million in reference period from USD 2,598.54 million in the previous period mainly due to declining in official transfers (grants).

1.1 Current Account Balance

The current account deficit (including official transfers) increased by 28 percent to USD 4,683.11 million in the reporting period from USD 3,647.72 million reported in the previous year, reflecting the widening of trade deficit, increase in out payment of the services account and the decline in the surplus of unrequited transfers (official transfers) to the government sector (Table 4.1 figure 4.1).

Figure 4.1: Current Account Balance



Source: NSIA/DAB staff calculations

1.2 Capital Account

The surplus in the capital account of the balance of payments declined by 11 percent to USD 1,478.93 million in FY 2017 from USD 1,654.25 million in the preceding year, as a result of lower inward of capital transfers to the government sector, corporations and households during the reporting year.

1.3 Financial Account

Financial account (Net) decreased by 29 percent from USD 704.82 million in the previous year to USD 503.92 million in FY 2017.

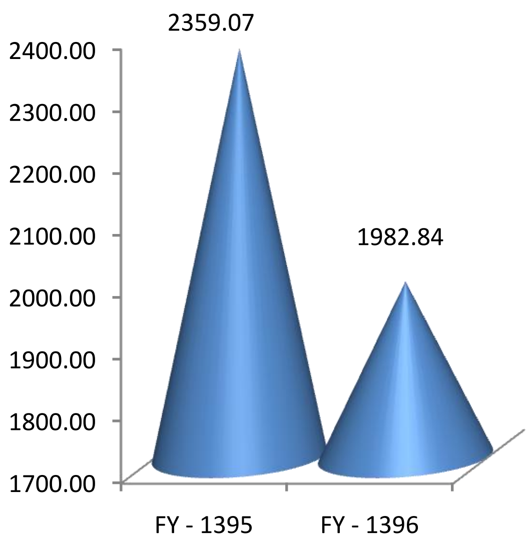
This outcome was mainly due to a significant decline in respect of total foreign investment and foreign exchange reserves (currency and deposits) as a result of less cash flows to the government in the form of grants during the reporting year (Figure 4.2 table 4.1).

Further analysis reveals that the country's aggregate financial assets abroad increased to

USD 35.92 million in year under review compared to USD 5.79 million recorded in the previous year.

Similarly, the aggregate financial liabilities increased to USD 67.40 million in the reporting year from USD 19.32 million recorded in previous year.

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

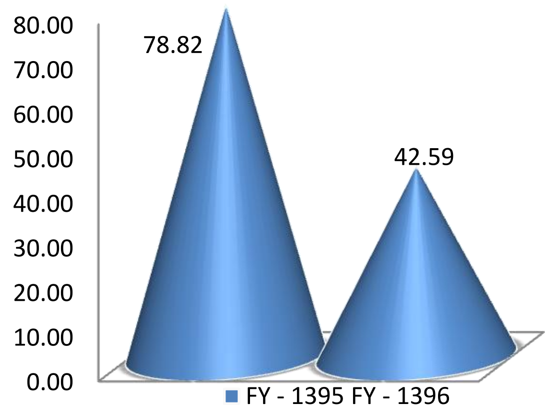


1.4 FDI and Portfolio Inflow

According to the available data, the foreign direct investment (FDI) related net inflows (assets) decreased to USD 42.59 million in the reporting year in comparison to USD 78.82 million recorded in the previous year.

Likewise, the portfolio investment related outflows (liabilities) decreased to USD 29.11 million in the reference period from USD 98.70 million recorded in the preceding year (Figure 4.3).

Figure 4.3: Afghanistan Foreign Direct Investment Inflows (in million USD)



Source: NSIA/DAB staff calculations

II. MERCHANDISE TRADE

This part of the report presents an analysis of the Afghanistan's merchandise trade performance in the reference period in comparison with their trade performance in FY 2016.

Afghanistan's trade balance has been in a deficit position since long period. This means the total value of imported goods has been greater than the total value of exported goods.

During the FY 2017, the external merchandise trade deficit increased by 13 percent to USD 6,570.73 million from USD 5,805.51 million recorded in the previous year (Figure 4.4, Table 4.2).

Aggregate exports of goods indicated an increase of 28 percent to USD 783.93 million in FY 2017, higher than USD 613.80 million recorded in preceding period.

Among the exporting components, exports of food items and medical seeds show upward trend, while leather and wool, carpets and rugs recorded downward trend during FY 2017. Exports of food items (fresh fruits, dry fruits and oil seeds), which accounted for about 56.3 percent of total exports, reported USD 441.51 million reflecting 64 percent increase in the reporting period.

Similarly, export of medical seeds which accounted for about 37.7 percent of the total exports increased by 25 percent to a value of USD 295.55 million in FY 2017 from a value of USD 236.38 million recorded the previous year.

On the other hand, exports of leather and wool which accounted for about 3 percent of the total exports decreased significantly by 58 percent to a value of USD 23.13 million in FY 2017 from a value of USD 55 million recorded in the previous year.

Likewise, exports of carpet and rugs which reported 3 percent of the total exports declined by 55 percent to a value of USD 23.74 million in the reporting year from a value of USD 52.51 million in the preceding year.

At the same time, aggregate imports increased by 15 percent to a value of USD 7,354.66 million during the reporting year compared to a value of USD 6,419.31 million recorded in the previous year.

The major contributions of increase in total imports occurred from higher imports of consumer goods and industrial supplies.

Imports of consumer goods which accounted for about 44.3 percent of the total imports reported USD 3,254.74 million reflected 74 percent increase in .

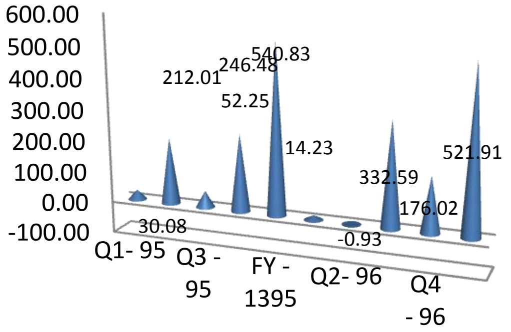
Imports of industrial supply which accounted for about 12 percent of the total imports increased by 65 percent to a value of USD 883.27 million in reporting year from a value of USD 536.74 million in the last year.

Imports of capital goods which accounted for about 31 percent of the total imports declined by 20 percent to a value of USD 2,339 million in the reference period from a value of USD 2,936.75 million in FY 2016.

In addition, imports of fuel and lubricants, declined on account of lower volumes imported in FY 2016.

Imports of fuel and lubricants which accounted for approximately 12 percent of the total imports reported USD 877.65 million in FY 2017, reflecting about 19 percent decrease in the previous reporting year.

Figure 4.4: Reserve Assets Q1, 1395- Q4, 1396



Source: NSIA/DAB staff calculations

III. DIRECTION OF TRADE

Direction of Afghanistan's foreign trade is studied in relation to the country's proportion of exports to different countries and the proportionate imports from different countries.

2.1 Direction of Exports

According to the available merchandise trade statistics, during FY 2017 **India was the largest buyer of Afghanistan's exports.** The share of Afghanistan's total exports to India increased to 43 percent in reference period from 32.19 percent reported in the previous year. The value of total export to India also increased to USD 337.50 million in the reporting year from USD 197.60 million in the preceding year, registering 71 percent increase in exports over the last year.

Earnings from export of dry fruits, fresh fruits, medical seeds and saffron to India increased by 155, 68, 69 and 5 percent respectively in FY 2017, while earnings from export of wool and animals hair to India declined by 71 percent.

Pakistan ranked the second largest buyer of Afghanistan's exports during FY 2017. The share of total exports to Pakistan decreased to 38.19 percent in FY 2017 from 47.54 percent recorded in the previous year.

The value of total exports to Pakistan picked up slightly by 3 percent to USD 299.35 million in reference period from USD 291.77 million in FY 2016.

Earnings from all exporting categories to Pakistan declined except fresh fruits during FY 2017. Exports of dry fruits declined by 60 percent to USD 25.68 million from USD 64 million, exports of medical seeds declined by 73 percent to USD 13.76 million from USD 50.62 million, exports of wool and animals hair declined by 96 percent to USD 0.26 million from USD 6.34 million, exports of karakul skin decreased by 83 percent to USD 2.07 million from USD 12.49 million, and exports of cotton to Pakistan dropped by 3 percent to USD 7.16 million from USD 7.35 million in FY 2017 as compared to the preceding year. This is while exports of fresh fruits to Pakistan increased significantly by 258 percent to USD 133.97 million in FY 2017 from USD 37.44 million recorded in the reference period.

The third largest buyer of Afghanistan's exports was Iran during FY 2017. The share of total exports to Iran is almost remaining unchanged (3.7 percent), but in terms of value, the total exports to Iran shows an increase of 28 percent to USD 28.96 million in FY 2017 from USD 22.60 million in the previous year.

The major exporting items to Iran were oil seeds, medical seeds and dry fruits.

Earnings from export of oil seeds, medical seeds and dry fruits to Iran increased during FY 2017. Earnings from oil seeds expanded to USD 13.14 million from USD 11.6 million reflecting 13 percent increase. Earnings from medical seeds indicated an increase of 18 percent to USD 4.12 million from USD 3.48 million. Earnings from exports of dry fruits to Iran increased slightly to USD 1.72 million from USD 1.42 million reflecting 20 percent increase in FY 2017.

The last largest buyer of Afghanistan's exports was countries from Commonwealth Independent States (CIS) during FY 2017. The share of Afghanistan's exports to CIS countries dropped to 2.55 percent in FY 2017 from 6.67 percent recorded in the preceding year.

Earnings from total exports to CIS countries dropped by 51 percent to USD 20 million in FY 2017 from USD 40.95 million recorded in the previous year.

The major exporting items to CIS countries were dry fruits which accounted for about 2 percent of total exports in the year under review (tables 4.3 -4.4 and figures 4.5-4.6).

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

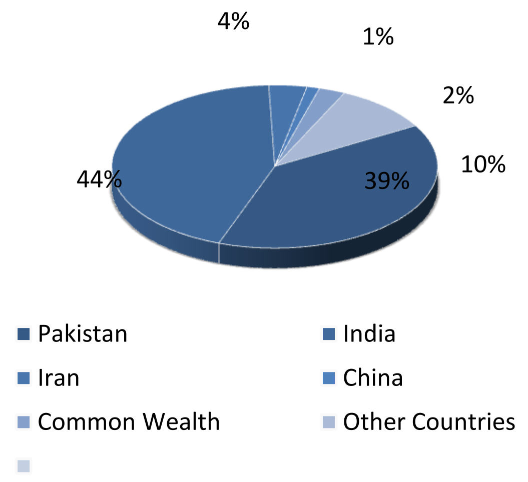
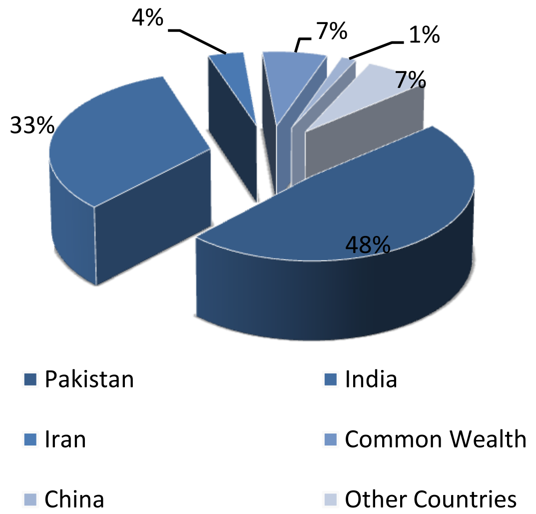


Figure 4.6: Direction of Exports (% share)in FY 2016



Source: NSIA/DAB staff calculations

2.2 Direction of Imports

CIS countries were the first largest import origin of Afghanistan in FY 2017. Total Imports from CIS countries increased to USD 1,965 million with share of 26.72 percent from USD 1,320.70 million (20.75 percent share), showing 49 percent increase during the reference period.

The main imports from CIS countries were consumer goods (flour and wheat flour, electricity, vegetable-oil, medicines, cigarettes, tire and tubes and footwear) which accounted for 14 percent, industrial supplies (Metal production, fertilizer, cement and chemical) accounting for 4 percent, petroleum oil (5 percent) and capital goods accounting for 4 percent of total imports during FY 2017.

Pakistan was the second largest import origin for Afghanistan in FY 2017. The share of imports from Pakistan in the total imports decreased from 20 percent in the preceding year to 17 percent in reporting period. The value of total imports from Pakistan also declined to USD 1,226.77 million in current period from USD 1,285.26 million previously reported, registering a slight reduction of 5 percent.

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

In consumer goods category, import of sugar, vegetable oil, and medicine from Pakistan shows upward trends. However, the remaining items indicated downward trend in FY 2017.

Likewise, in the industrial supplies categories, cement, fertilizers and chemicals had upward trend, while the imports of metal production depicted downward trend during FY 2017.

Iran ranked the third largest source of imports for Afghanistan during FY 2017.

The share of imports from Iran decreased to 16.34 percent in FY 2017, from 20.19 percent recorded in the previous year.

The value of total imports from Iran declined to USD 1,201.57 million from USD 1296.26 million, registered 7 percent reduction in FY 2017. The major importing products from Iran were petroleum oil, consumer goods, industrial supplies and capital goods.

In the imports of consumer goods categories, sugar, vegetable oil, soaps, threads, stationary and medicine items show upward trends, while electricity, cloths and tea items indicate downward trend in the reporting period.

Likewise, in the industrial supplies categories, imports of cement and metal production indicated upward trends, but imports of other items such as chemical and fertilizers from Iran indicated downward trends during FY 2017.

Imports of capital goods and fuel and lubricants categories from Iran as a whole had downwards trend during FY 2017.

China was the fourth largest import origin to Afghanistan in FY 2017. The share of imports from China decreased slightly to 16 percent in the reference period from 17 percent in FY 2016. But in terms of value, the total imports from China increased by 5 percent to USD 1,145.73 million in the reporting year from USD 1,091.85 million from the previous year. The main imports from China were consumer goods and capital goods (spare parts) which accounted for 8 and 7 percent of total imports respectively.

Japan, India, and USA were the fifth, sixth and seventh largest import sourcing countries for Afghanistan, accountable for about 5 percent, 3 percent and 1 percent of total imports respectively. However, total imports from Japan increased by 37 percent to USD 359.24 million in the reporting year from USD 261.33 million in FY 2016, due to lower imports of capital and consumer goods.

Imports from India grew by 76 percent to USD 235.48 million in the reference period from USD 134.16 million in the previous year. The major imports from India were fabrics, medicines, cloths, tea, soaps, sugar, cigarettes and threads.

Imports from USA declined by 22 percent to USD 63.85 million in the current period from USD 81.93 million due to lower imports of capital goods (spare parts), in the preceding year (Tables 4.3-4.4 and figures 4.7-4.8).

Figure 4.7: Direction of Imports (% share) in FY 2017

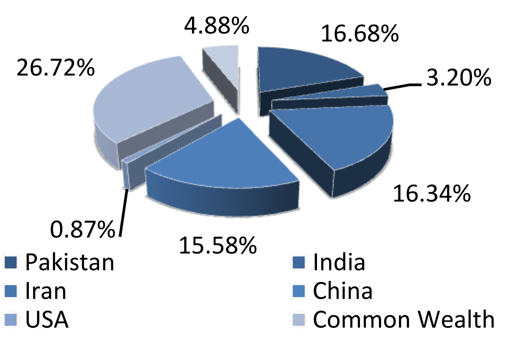
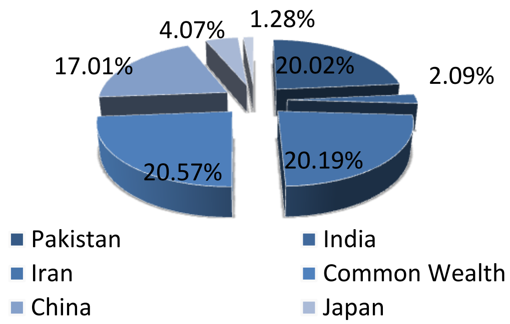


Figure 4.8: Direction of Imports (% share) in FY 2016



Source: NSIA/DAB staff calculations

IV. COMPOSITION OF TRADE

3.1 Composition of Imports

The composition of imports in FY 2017 indicates that;

- Imports of consumer goods had the largest share of 44.3 percent in the basket of imports during the reporting period. In terms of value, imports of such goods increased significantly by 74 percent to USD 3,254.74 million in the reference year from USD 1,867.3 million recorded in FY 2016.
- The second largest share was recorded for capital goods as 31.8 percent in the basket of imports during the current period, despite the decline in its value by 20 percent to USD 2,339 million from USD 2,936.75 million recorded in FY 2016.
- Industrial supplies had the third largest share in the basket of Afghanistan's imports during FY 2017. The share of industrial supplies in total imports increased to 12 percent in the current

period from 8.4 percent in the preceding period. The value of imports of industrial supplies increased by 65 percent, to USD 883.27 million in FY 2017 from USD 536.47 million in the previous year.

- As a result, the demand for industrial supplies such as cement, metal production and other construction stuff increased due to implementation of developing projects throughout the country. The increase implies that Afghanistan needs to import such materials for economic developments and sustained economic growth in the long-run.
- Imports of fuel and lubricants (petroleum oil) had the smallest share in the basket of Afghanistan's imports which has decreased from 16.8 percent in FY 2016 to 11.9 percent in the reporting year. In terms of value, imports of such item in total imports decreased by 19 percent to USD 877.65 million in the reference period from USD 1,078.73 million in FY 2016 (Table 4.2 and figures 4.9-4.10).

Figure 4.9: Composition of Imports (% share) in FY 2016

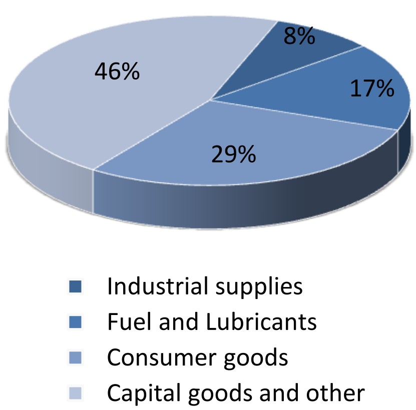
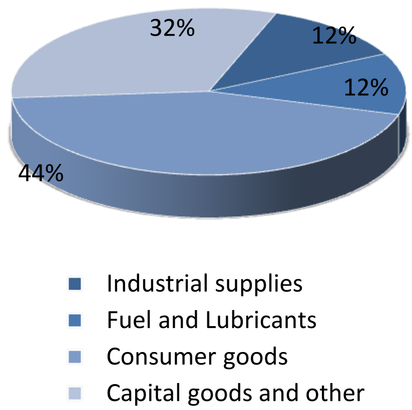


Figure 4.10: Composition of Imports (% share) in FY 2017



Source: NSIA/DAB staff calculations

3.2 Composition of Exports

The composition of exports in the reporting year reveals that;

- Exports of food items had the largest share in the basket of Afghanistan's exports. The share of food items in the total exports increased to 56.3 percent in FY 2017 from 44 percent recorded in reported in the previous year.
  In terms of value, exports of food items (oil seeds, fresh and dry fruits) increased significantly by 64 percent to USD 441.51 million in FY 2017 from USD 269.91 million in previous year.
- The second largest share in total exports was recorded for medical seeds which slightly decreased to 37.7 percent in the period under review from 38.5 percent recorded in the preceding year.
  But in terms of value, exports of medical seeds in total exports increased by 25 percent to

USD 295.55 million in the current period from USD 236.38 million in FY 2016.

- Carpet and rugs which are considered as the main component of Afghanistan's exports in the past decades had the third largest share in the basket of Afghanistan's exports, but declined from 8.6 percent in FY 2016 to 3 percent in FY 2017.

  Earnings from export of carpet and rugs declined by 55 percent to USD 23.74 million in FY 2017 from USD 52.51 million recorded in the previous year.

- Leather and wool had the smallest share in total exports which decreased to almost 3 percent in the period under review from 9 percent recorded in FY 1495. The value of such goods decreased significantly by 58 percent to USD 23.13 million in the reporting period from USD 55 million in recorded in the preceding year (Table 4.2 and figures 4.11-4.12).

Figure 4.11: Composition of Exports (% share) in FY 2016

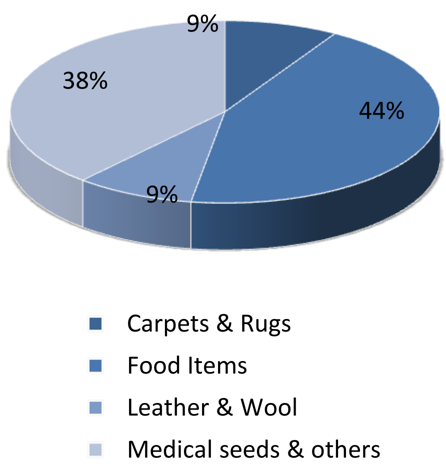
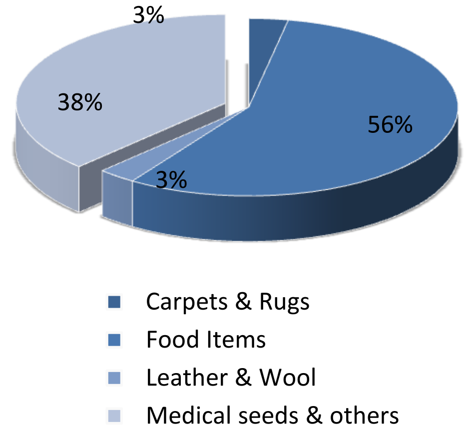


Figure 4.12: Composition of Exports (% share) in FY 2017



Source: NSIA/DAB staff calculations

V. EXTERNAL DEBT

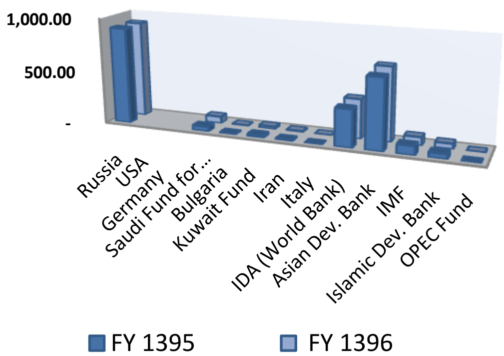
Afghanistan's total external debt increased by almost 3 percent to USD 2,196.89 million in the reporting year from USD 2,129.92 million in the previous year, which shows an increase of about USD 66.97 million.

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

Meanwhile, World Bank as a major multilateral creditors to Afghanistan, made some debt forgiveness on principle and services, and Asian Development Bank made some debt release only on principal during the year under review.

The total loan amounts payable to the Paris Club creditors in the current period stood at USD 909.86 million, which is payable to Russian Federation. In other words, Afghanistan's total debt from the Paris club members stands at about 41.42 percent of total current external debt which has decreased slightly by about 1 percent compared to the preceding year (Table 4.5 -Figure 4.13).

Figure 4.13: External Debt Comparisons for the FY 2016 and 1396 (in million USD)



Source: Debt Asset Management Unit, Ministry of Finance

Furthermore, total debt from Non-Paris Club members including Saudi Fund for Development, Bulgaria, Kuwait fund and Iran stands at about 4.80 percent of total current external debt and has increased by about 22 percent to USD 105.49 million in FY 2017 from USD 86.18 million recorded in the preceding reporting year.

In addition, total debt from multilateral creditors to Afghanistan increased to USD 1,181.55 million from USD 1,138.36 million which shows USD 43.19 million increment in the total debt from multilateral creditors during the reporting year.

VI. NET INTERNATIONAL RESERVES

According to the latest available data, the Net International Reserves (NIR) increased by 8.37 percent, standing at USD 7,345.36 million in the reporting year, up from USD 6,777.87 million recorded in the last year. The increase in the level of NIR was mainly due to increase in reserve assets which extended by 8 percent to USD 8,159 million in the period under review from USD 7,581.98 million recorded in the previous year.

Likewise, reserve liabilities increased slightly by 1.2 percent to USD 813.65 million in the study period from USD 804.11 million that was recorded in the preceding year. This demonstrates that the reserve assets are way higher than the reserve liabilities. This increment in the reserve liabilities is mainly attributed to the commercial banks deposits in foreign currency which boosted up by 2.46 percent to USD 750.66 million in FY 2017 from USD 732.66 million recorded in the previous year.

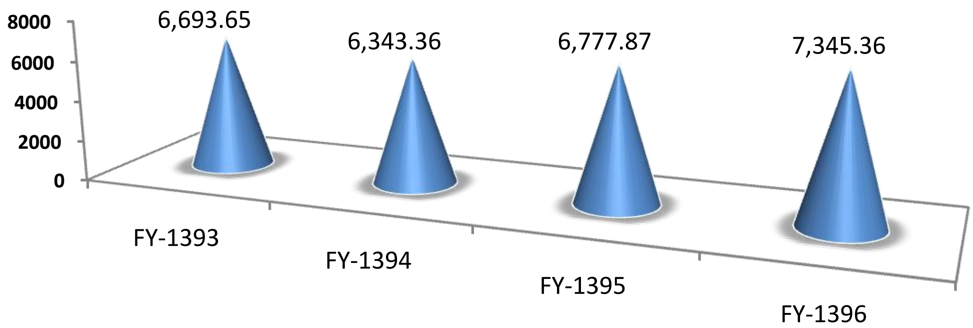
The use of fund resources decreased to USD 62.85 million in the period under review from USD 71.31 million in FY 2016 which represented 11.87 percent decline. The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the reporting year.

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

Currently, Net International Reserves (NIR) on average supports almost 12 months of imports, while countries with 6 months coverage of imports enjoy a relatively comfortable reserve position.

Table 4.6 and Figure 4.14: represents the Net International Reserves (NIR) of Afghanistan for the past few periods.

Figure 4.14: Net International Reserves from FY 2016-FY 2017 (in million USD)



Source: Monetary Policy Department, DAB

Table 4.1: Afghanistan's Balance of Payment (in million USD)											
Items / Years	Q1- 95	Q2- 95	Q3 - 95	Q4 - 95	FY - 1395	Q1- 96	Q2- 96	Q3 - 96	Q4 - 96	FY - 1396	% change
Current Account	**-1083.09**	**-606.80**	**-904.49**	**-1053.34**	**-3647.72**	**-1164.78**	**-1499.29**	**-848.25**	**-1170.79**	**-4683.11**	28%
Credit	900.31	1179.55	823.97	1114.93	**4018.77**	709.56	749.03	1101.78	1094.62	**3654.98**	-9%
Debit	1983.40	1786.35	1728.47	2168.27	**7666.49**	1874.34	2248.31	1950.04	2265.40	**8338.09**	9%
Goods and Services Account	**-1669.82**	**-1459.52**	**-1415.16**	**-1796.34**	**-6340.83**	**-1606.63**	**-1981.14**	**-1568.41**	**-1815.93**	**-6972.11**	10%
Credit	262.35	250.94	289.47	332.48	1135.23	215.78	232.65	351.64	419.76	1219.84	7%
Debit	1932.17	1710.46	1704.62	2128.82	7476.07	1822.42	2213.79	1920.05	2235.69	8191.95	10%
Goods Account	**-1574.31**	**-1395.97**	**-1326.38**	**-1673.81**	**-5970.47**	**-1473.27**	**-1819.11**	**-1385.05**	**-1629.32**	**-6306.75**	6%
Credit	*133.94*	116.99	172.50	195.71	619.14	117.13	125.86	255.87	297.60	796.46	29%
Debit	*1708.25*	1512.95	1498.89	1869.52	6589.61	1590.40	1944.97	1640.92	1926.93	7103.21	8%
Services Account	**-95.51**	**-63.56**	**-88.77**	**-122.52**	**-370.36**	**-133.36**	**-162.03**	**-183.36**	**-186.61**	**-665.36**	80%
Credit	*128.41*	133.95	116.96	136.77	516.09	98.66	106.80	95.76	122.16	423.37	-18%
Debit	*223.92*	197.51	205.74	259.29	886.45	232.02	268.83	279.13	308.77	1088.74	23%
Primary Income Account	**19.04**	**17.31**	**24.42**	**33.80**	**94.57**	**17.17**	**34.91**	**19.25**	**24.79**	**96.12**	2%
Credit	*39.93*	34.51	35.67	55.16	165.27	32.13	47.18	30.77	37.13	147.21	-11%
Debit	*20.89*	17.20	11.25	21.37	70.70	14.96	12.27	11.52	12.34	51.08	-28%
Secondary Income Account	**567.69**	**835.41**	**486.24**	**709.20**	**2598.54**	**424.68**	**446.95**	**700.91**	**620.35**	**2192.88**	-16%
Credit	*598.03*	894.11	498.84	727.29	2718.26	461.64	469.19	719.38	637.72	2287.94	-16%

Debit	*30.34*	58.70	12.59	18.09	119.72	36.96	22.25	18.47	17.38	95.05	-21%
Capital and Financial Account	**183.01**	**199.92**	**269.54**	**782.26**	**2359.07**	**83.52**	**348.09**	**683.79**	**710.99**	**1982.84**	-16%
Capital account	**324.97**	**400.98**	**388.68**	**539.61**	**1654.25**	**153.36**	**356.48**	**480.88**	**488.21**	**1478.93**	-11%
Credit	*327.88*	403.84	388.68	541.53	1661.93	153.36	356.48	480.88	488.21	1478.93	-11%
Debit	*2.91*	2.85	0.00	1.92	7.68	0.00	0.00	0.00	0.00	0.00	-100%
Capital transfers	**327.88**	**403.84**	**388.68**	**541.53**	**1661.93**	**153.36**	**356.48**	**480.88**	**488.21**	**1478.93**	-11%
Credit	*327.88*	403.84	388.68	541.53	1661.93	153.36	356.48	480.88	488.21	1478.93	-11%
Debit	*0.00*	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Financial account	**142.0**	**201.1**	**119.1**	**242.65**	**704.82**	**69.84**	**8.39**	**202.91**	**222.78**	**503.92**	-29%
Direct investment	**15.30**	**17.44**	**19.03**	**27.04**	**78.82**	**6.79**	**13.89**	**9.82**	**12.10**	**42.59**	-46%
Net acquisition of financial assets	-2.43	-4.09	-4.50	-3.75	-14.78	-3.09	-3.27	-3.59	-0.84	-10.80	-27%
Net incurrence of liabilities	17.74	21.54	23.53	30.79	93.59	9.88	17.16	13.41	12.94	53.39	-43%
Portfolio Investment	**18.47**	**39.15**	**20.33**	**20.75**	**98.70**	**36.62**	**-30.15**	**-11.57**	**-24.01**	**-29.11**	-129%
Net acquisition of financial assets	*18.47*	39.15	20.33	20.75	98.70	36.62	-30.15	-11.57	-24.01	-29.11	-129%
Net incurrence of liabilities	*0.00*	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Other investment	**78.11**	**-67.54**	**27.54**	**-51.62**	**-13.52**	**12.19**	**25.58**	**-127.93**	**58.67**	**-31.48**	133%
Assets	*83.22*	-76.13	9.93	-11.21	5.79	32.98	5.36	-100.29	97.87	35.92	520%
Liabilities	*5.11*	-8.59	-17.61	40.41	19.32	20.79	-20.23	27.64	39.20	67.40	249%
Reserve Assets	**30.08**	**212.01**	**52.25**	**246.48**	**540.83**	**14.23**	**-0.93**	**332.59**	**176.02**	**521.91**	-3%
Net errors and omissions	**900.07**	**406.88**	**634.95**	**756.39**	**2698.29**	**1081.26**	**1151.20**	**570.29**	**905.35**	**3708.10**	37%
Overall Balance											

Source: NSIA/DAB staff calculations

Table 4.2: Merchandise Trade (in million USD)										
Years	FY 1392		FY 1393		FY 1394		FY 2016		FY - 1396	
	Total	**Share (%)**	**Total**	**Share (%)**	**Total**	**Share (%)**	**Total**	**Share (%)**	**Total**	**Share (%)**
Imports	*9,339.60*	*100%*	*7,294.63*	*100%*	*7,679.09*	*100%*	*6,419.31*	*100%*	*7,354.66*	*100%*
Industrial supplies	*1,272.14*	*13.6%*	*863.19*	*11.8%*	*709.19*	*9.2%*	*536.47*	*8.4%*	*883.27*	*12.0%*
Fuel and Lubricants	*2,167.37*	*23.2%*	*1,155.94*	*15.8%*	*1688.58*	*22.0%*	*1078.73*	*16.8%*	*877.65*	*11.9%*
Consumer goods	*1,942.85*	*20.8%*	*2,345.86*	*32.2%*	*1715.25*	*22.3%*	*1867.36*	*29.1%*	*3254.74*	*44.3%*
Capital goods and other	*3,957.24*	*42.4%*	*2,929.64*	*40.2%*	*3,566*	*46.4%*	*2936.75*	*45.7%*	*2339.00*	*31.8%*
Exports	*499.81*	*100%*	*620.88*	*100.0%*	*555.71*	*100%*	*613.80*	*100%*	*783.93*	*100%*
Carpets & Rugs	*85.49*	*17%*	*87.04*	*14.0%*	*108.3*	*19.5%*	*52.51*	*8.6%*	*23.74*	*3.0%*
Food Items	*175.92*	*35%*	*272.13*	*43.8%*	*210.17*	*37.8%*	*269.91*	*44.0%*	*441.51*	*56.3%*
Leather & Wool	*59.54*	*12%*	*49.35*	*7.9%*	*28.47*	*5.1%*	*55.00*	*9.0%*	*23.13*	*3.0%*
Medical seeds & others	*178.86*	*36%*	*212.36*	*34.2%*	*208.76*	*37.6%*	*236.38*	*38.5%*	*295.55*	*37.7%*
Trade Balance	*- 8,839.79*		*- 6,673.75*		*-7,123.38*		*- 5,805.51*		*- 6,570.73*	
Trade Balance as % of GDP	*-44%*		*-32%*		*-34%*		*-30%*		*-33%*	
Source: NSIA and DAB staff calculations										

Table 4.3: Direction of External Trade for FY 2017 (in million USD)					
Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	299.35	38.19%	1226.77	16.68%	-927.42
India	337.50	43.05%	235.48	3.20%	102.02
Iran	28.96	3.7%	1201.57	16.34%	-1172.61
Germany	10.33	1.32%	49.36	0.67%	-39.03
China	9.71	1.24%	1,145.73	15.58%	-1136.02
England		0.00%	8.13	0.11%	-8.13
Saudi Arabia	3.95	0.50%		0.00%	3.95
	0.00%	63.85	0.87%	-63.85	
Common Wealth	20.01	2.55%	1965.00	26.72%	-1944.99

Japan		0.00%	359.24	4.88%	-359.24
Other Countries	74.12	9.45%	1099.51	14.95%	-1025.39
Total	**783.93**	**100%**	**7,354.64**	**100%**	**(6,570.71)**

Source: NSIA and DAB staff calculations

Table 4.4: Direction of External Trade for FY 2016 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	*291.77*	*47.54%*	*1285.26*	*20.02%*	*-993.49*
India	*197.60*	*32.19%*	*134.16*	*2.09%*	*63.44*
Iran	*22.60*	*3.7%*	*1296.26*	*20.19%*	*-1273.66*
Germany	*3.57*	*0.58%*	*28.19*	*0.44%*	*-24.62*
Common Wealth	*40.95*	*6.67%*	*1320.70*	*20.57%*	*-1279.75*
China	*9.51*	*1.55%*	*1091.85*	*17.01%*	*-1082.34*
Saudi Arabia	*5.59*	*0.91%*		*0.00%*	*5.59*
Japan		*0.00%*	*261.33*	*4.07%*	*-261.33*
England		*0.00%*	*9.18*	*0.14%*	*-9.18*
United States		*0.00%*	*81.93*	*1.28%*	*-81.93*
Other Countries	*42.21*	*6.88%*	*910.40*	*14.18%*	*-868.19*
Total	*613.80*	*100.00%*	*6419.26*	*100.00%*	*-5805.46*

Source: NSIA and DAB staff calculations

Table 4.5: External Debt for the FY 2017 (in units indicated)

	In million USD	Percent of total
Total external debt	**2,196.89**	**100.00**
Bilateral	**1,015.34**	46.22
Paris Club	909.86	41.42
Russian Federation	909.86	41.42
United States	-	0.00
Germany	-	0.00
Non-Paris Club	105.49	4.80
Multilateral	**1,181.55**	53.78
of which: IDA (World Bank)	367.50	16.73
Asian Development Bank	687.40	31.29
International Monetary Fund	76.47	3.48
Islamic Development Bank	48.48	2.21
OPEC Fund	1.71	0.08

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

Table 4.6: Net International Reserves in the FY 2017 (million of US dollars)								
Changes on the previous quarter	FY-1393	% change	FY-1394	% change	FY-1395	% change	FY-1396	% change
Net international Reserves (million US Dollar)	**6,693.65**	23.22	**6,343.36**	-5.23	**6,777.87**	6.85	**7,345.36**	8.37
Reserve Assets	7,247.76	22.71	6,927.94	-4.41	7,581.98	9.44	8,159.01	8
Reserve Liabilities	554.12	10.91	584.58	5.50	804.11	37.55	813.65	1.2
Commercial bank deposits in foreign currency	443.80	4.00	498.27	12.27	732.66	47.04	750.66	2.46
Nonresident deposits in foreign currency	0.14	-89.57	0.14	0.01	0.14	0.00	0.14	-0.04
Use of Fund resources	110.18	17.53	86.17	-21.79	71.31	-17.24	62.85	-11.87
Gross Intl. Reserves (in months of import)	**11.92**		**10.83**		**14.17**		**13.31**	
Net Intl. Reserves (in months of import)	**11.01**		**10**		**13**		**12**	
Source: Monetary Policy Department, DAB								

5

Fiscal Developments

5

FISCAL DEVELOPMENTS

The key objective in the fiscal sector is to achieve sustained increase in revenue collection to permit the gradual takeover of externally financed operating & development spending to ensure an expenditure allocation consistent with Afghanistan National Development Strategy (ANDS). Furthermore, other goals include improvements in public expenditure management, fiscal policy formulation, efficiency in public enterprises, tax and customs administration.

As other emerging and developing economies around the world, a budget imbalance (Budget Deficit) exists in Afghanistan. Total core expenditure exceeded total domestic revenue (excluding grants) in FY 2017 leading to AF 187.25 billion budget deficit. In FY 2017, a budget deficit of AF 4.79 billion including grants is observed comparably as a result of significant increase in total expenditure during the period under review.

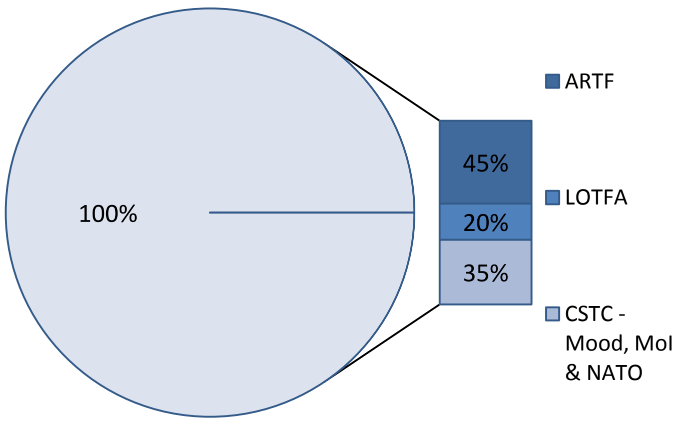
Besides, total domestic revenue is increased from AF 154.49 billion in FY 2016 to AF 169.38 billion during the period under review showing an increase of AF 14.89 billion leading to 9.64 % growth in domestic revenue collection compared to same period of previous year. This increase is result of momentous improvement in business activities during the year and reflecting an improvement in retail activities such as extractive industries, sales tax, administrative fees, customs duty and miscellaneous revenue.

Meanwhile, total core expenditure indicated diminutive increase from AF 352.97 billion in FY 2016 to AF 356.63 billion in FY 2017, showing an increase of 3.66 billion leading to 1.04 % increase in expenditure as compared to the same period of the preceding year. This increase is attributable to miniature decrease in overall annual budget.

Furthermore, donor contributions are used to finance both operating and development expenditure. The total donor contributions (grants) allocated to operating and development expenditure represent a considerable decrease from AF 203.78 billion of FY 2016 to AF 182.46 billion of FY 2017, indicating AF 21.32 billion (10.46%) crucial decrease in the level of grants comparably as result of change in annual pledge, commitment and disbursement. The main donor contributor during the year under review is ADB.

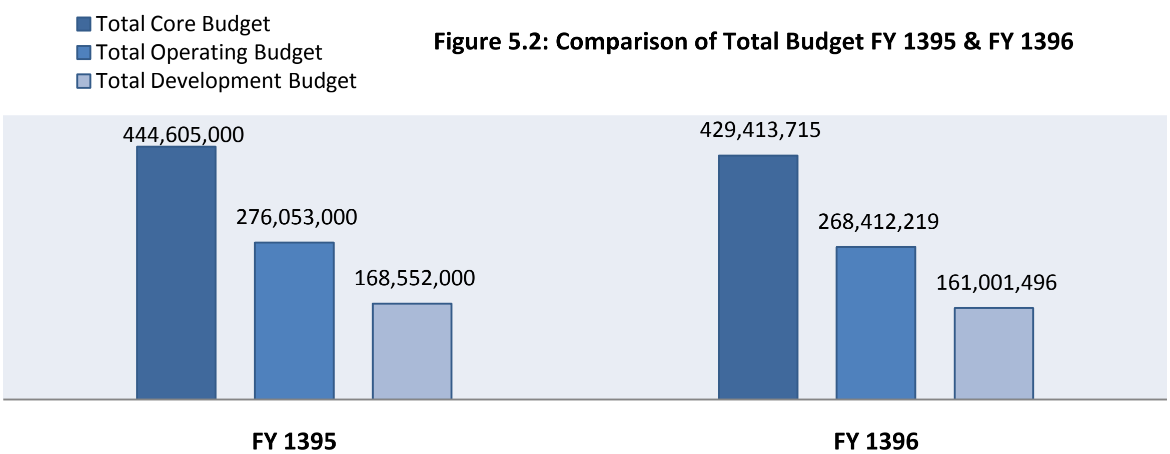
Moreover, total core budget is decreased from AF 444.61 billion of FY 2016 to AF 429.41 billion in the period under review, showing a crucial decrease of AF 15.19 billion (3.4%) decrease which escorts diminutive increase in operating budget execution rate from 90% of FY 2016 to 92% of FY 2017. Simultaneously, development budget execution rate increased from 54.01% of FY 2016 to 67.81% in the FY 2017, leading to an increase of 12.81% as a result of decrease in expenditure by ministry of defense and interior affairs ministry comparably.

Figure 5.1: Components of Donor Contribution in FY 1396



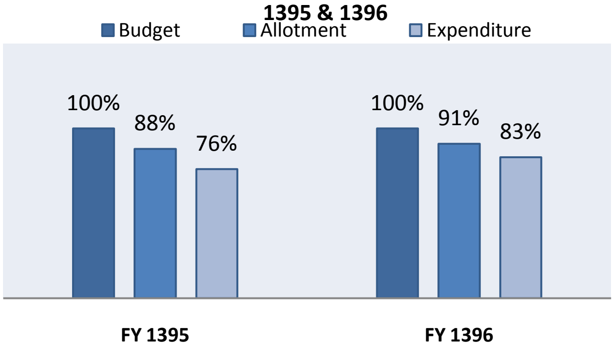
Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.2: Comparison of Total Budget FY 1395 & FY 1396



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.3: Comparison of Budget Execution Rate (Annual Budget, Allotment & Expenditure) FY 1395 & 1396



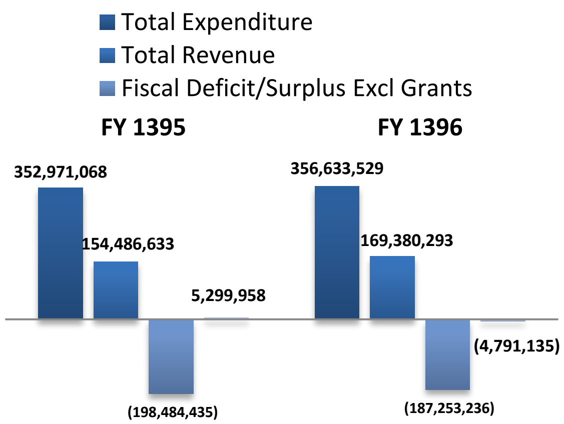
Source: MoF Financial Statement/MPD Staff Calculation

EXECUTION RATE

During the reference period of FY 2017, government successfully managed to spend 83.19 percent out of the total allocated budget of AF 429.41 billion, while it was reported 76.34 percent of the total allocated budget of AF 444.61 billion in the previous year representing 6.85 percent increase in overall budget execution rate. This increase is result of 15.9 decrease in annual approved budget of FY 2017.

Moreover, operating budget execution rate indicated 2.43 percent increase from 89.89 percent of FY 2016 to 92.32 percent out of total allocated budget of AF 268.41 billion in the FY 2017. Besides, development budget execution rate evidently represents 12.81 percent increase from 54.01 percent in FY 2016 to 67.81 percent in the period under review out of the total allocated budget of AF 161.00 billion. Hence, total budget execution rate is presenting a slight increase of only 6.85 percent. Overall, lower execution rate of the core budget below the target of 85% was attributed to several factors in particular to the time consuming procurement process and approval of expenses by the National Procurement Authority, suspension of budget approval, deterioration in security condition in provinces and under performances by the budgetary units.

Figure 5.4: Core Budget Deficit & Surplus in the FY 2016 and FY 2017



Source: Ministry of Finance/MPD calculations

II. CORE BUDGET (DEFICIT AND SURPLUS)

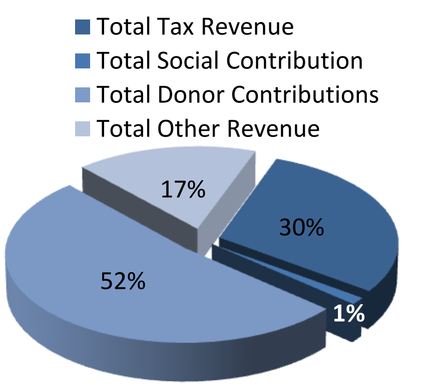
The overall budget prior to donor's contribution had a deficit of AF 187.25 billion in FY 2017, which represents 11.23 billion decrease in overall annual fiscal deficit leading to 5.65 percent decrease compared to annual fiscal deficit of 1395. The decrease is attributed to 9.64 percent increase in domestic revenue and 10.46 percent increase in grants during FY 2017 compared to FY 2016. Meanwhile, external sources of finance plus domestic revenues represent fiscal deficit of AF 4.79 billion in FY 2017. Besides, total annual domestic planned funding source of FY 2017 plainly represents an increase in domestic source from 133.47 billion of FY 2016 to 160.56 billion in the period under review indicating 20.29 percent increase compared to the same period of the previous year. Moreover, total annual external planned funding source of FY 2017 represents a decrease in external source from AF 301.11 billion to 258.80 billion indicating 14.05 percent decrease comparably which is result of pledge, commitment and disbursement from the donor's contribution on annual basis.

III. REVENUE COLLECTION

In accordance with reference period of FY 2017, total revenues including grants decreased to total collection of AF 351.84 billion in FY 2017 compared to AF 358.27 billion in the same period of the previous year, presenting a decrease of AF 6.43 billion (1.8%). This decrease is attributed to decrease in annual collection of planned external sources indicating 42.31 billion decrease from 301.11 billion of FY 2016 to 258.80 billion in the FY 2017, registering 14.05 percent decrease comparably. Therefore, to meet FY 2017 budget deficit, total donor contribution plays a vital role in total revenue collection that steers to annual budget surplus.

Moreover, the positive momentum gained in total revenue collection of FY 2017 was mainly contributed by fixed tax, sales tax, extractive industry, royalties and miscellaneous revenue as a result of reforms in the customs & revenue collection system, improved business activities during the year and reflecting an improvement in retail activities from the low base last year.

Figure 5.5: Total Revenue Contribution in FY 2017



Source: MoF Financial Statement/MPD Staff Calculation

3.1 Domestic Revenue

The total collection of domestic revenue performance in FY 2017 was significantly sophisticated compared to FY 2016, while these measures are deemed sufficient by the government to ensure the achievement in terms of the GDP deficit in FY 2017. The development in domestic revenue collection was attributed to enhanced receipts from Fixed Tax, Sales tax, Royalties, Extractive Industry and miscellaneous revenue excluding foreign donor's contributions.

In addition, total domestic revenue increased from 154.49 billion of FY 2016 to 169.38 billion of FY 2017, an increase of 14.89 billion leading to 9.64 percent growth in domestic revenue collection compared to the previous year as a result of reforms in the customs & revenue collection system, improved business activity during the year and reflecting an improvement in retail activity from the low base last year.

Besides, a breakdown of the total revenue collection showed a momentous acceleration in various domestic revenue components such as income tax, with 3.37 percent increase from AF 24.13 billion in FY 2016 to AF 24.94 billion, sales tax represents a significant increase of 8.46 percent from AF 28.58 billion in FY 2016 to 30.99 billion during the period under review, custom duties signify 6 percent increase from AF 31.27 billion to AF 33.14 billion in the reporting period, administrative fee shows extensive increase of 2.60 percent from AF 24.48 billion to AF 25.12 billion in the reporting period and miscellaneous revenue signify a widespread increase of 559.97 percent from AF 3.06 billion in the previous year to AF 20.22 billion in the FY 2017 comparably.

Figure 5.6: Domestic Revenue Components FY 2017

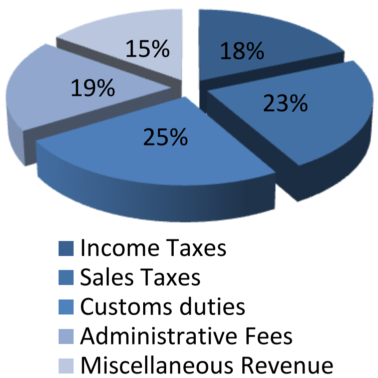
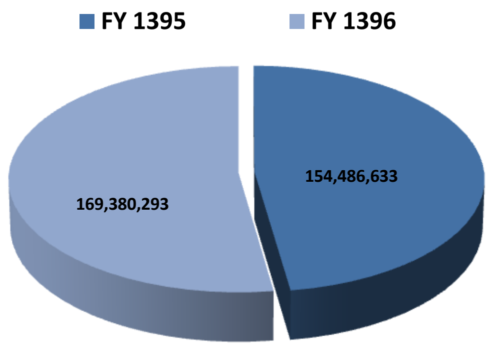


Figure 5.7: Total Domestic Revenue Comparison FY 2016 & FY 2017

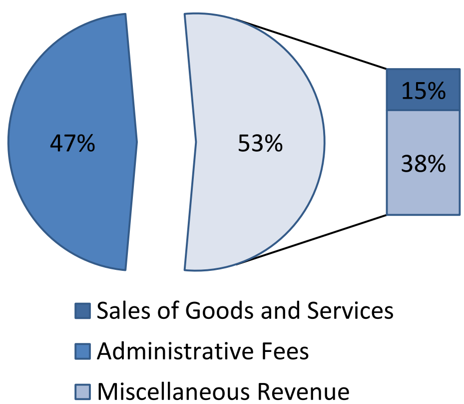


Source: Ministry of Finance/MPD calculation

3.2 Non-tax Revenues

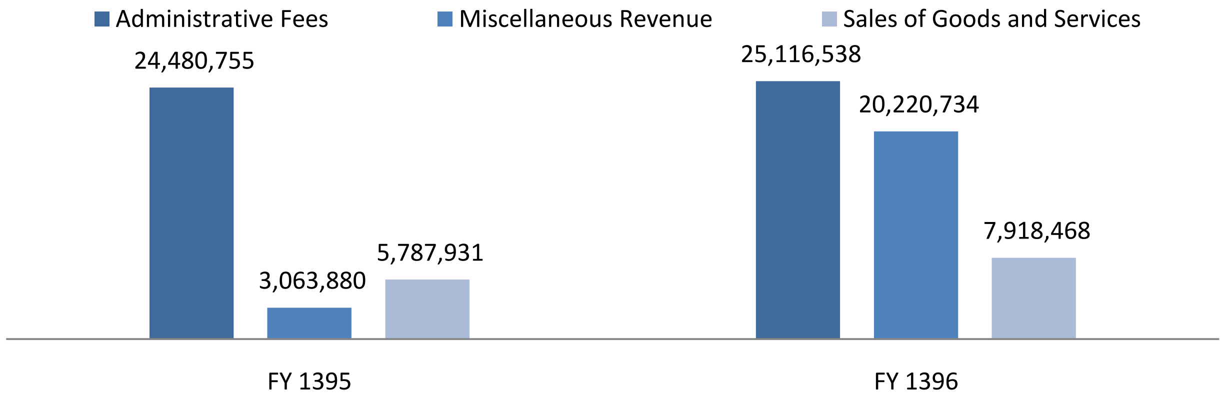
The core contributor in domestic revenues was non-tax revenues which represented a very significant increase of 22.24 percent from AF 53.72 billion in FY 2016 to AF 65.67 billion of in the period under review showing a momentous boost of AF 11.95 billion. This increase is attributed to momentous increase in non tax revenues by Ministry of communication, Ministry of transport, and Ministry of Interior Affairs. These agencies mainly collect non tax revenues such as telecommunication fee and stamp fee for which the main contributors are sales of goods and services (increased from AF 5.79 billion to AF 7.92 billion or 36.81% increase), royalties (from AF 0.27 billion to AF 0.38 billion registering 41.40% increase), extractive industry (from AF 1.09 billion to AF 2.03 billion showing 85.57 percent increase), miscellaneous revenue (from AF 3.06 billion to AF 20.22 billion signifying 559.97 percent increase) and finally unexpected and sales of land and building (from AF 1.12 billion to AF 2.78 billion leading to 148.04 percent unpredicted increase).

Figure 5.8: Major Non-Tax Revenue Contribution FY 2017



Source: Ministry of Finance/MPD calculation

Figure 5.9: Comparison of Major Components Total Non-Tax Revenue
FY 1395 & FY 1396



IV. GRANTS

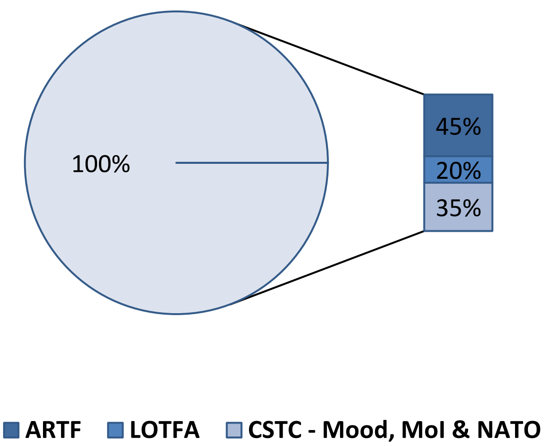
The donor contribution comprises an important part of the national budget as these grants finance major expenditure items in both operating and development budgets. In addition, the government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures. Moreover, In Afghanistan's context, fiscal sustainability is defined as total domestic expenditure financed by total domestic revenue where recently it is being financed by both foreign grants and foreign loans.

On the other hand, total development and operating grants manifestly represent significant decrease of 10.46 percent from AF 203.78 billion to AF 182.46 billion in FY 2017, recording AF 21.32 billion decrease which is comprised of 17.56 percent decrease in Donor Contribution, 38.16 percent increase in Foreign Loans and 22.81 percent increase in Donor Revenue as compared to the same period of the previous year. This decrease is attributed to 14.05 percent decrease (from 301.11 billion of FY 2016 to 258.80 billion or 42.31 billion decrease in the overall planned grants contribution in both operating and development core budgets) comparably as result of decrease in pledge, commitment and disbursement of donors in the reference period. The main donor contributors to operating and development expenditures are ADB and other donor revenue (Figure 5.10).

V. EXPENDITURE

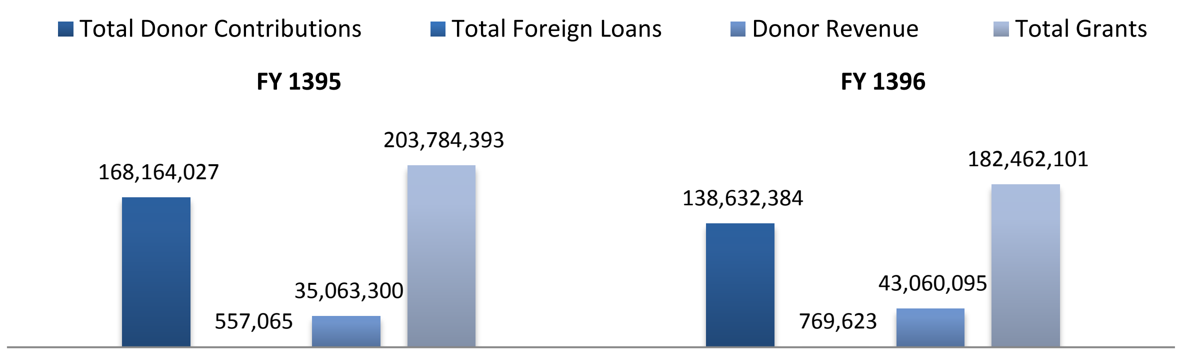
The core expenditures are classified into development and operating expenditures which are allocated to eight different sectors such as security, governance, education, health, agriculture, social protection, infrastructure, and economic governance. Moreover, the sector-wise expenditure is provided for both operating and development budgets that increased expenditure on infrastructure, economic governance and agriculture sectors are in line with the ANDS priority. Furthermore, total core expenditure manifestly presents 1.04 percent increase from AF 352.97 billion in FY 2016 to AF 356.63 billion during the reporting period perceptibly indicating AF 3.66 billion a minor acceleration in overall development and operating expenditures compared to the same period of the previous year. The increase attributed to increase in social transfer and compensation of employees (where a decrease in security sector was observed during the reference period on both monthly and annual basis by ministry of defense and interior affairs). In contrast, operating expenditure plainly indicates 2.31 percent decrease from AF 259.08 billion in FY 2016 to AF 253.09 billion in FY 2017 representing AF 5.99 billion reduction in operating expenditure. Development expenditure registered 10.28 percent increase from 93.89 billion of the previous year to 103.54 billion in the reference period, which manifestly indicates 10.28 billion increase. A minor increase in overall expenditure is indicated by annual development budget as well decrease in core annual expenditure as a result of decrease in expenditure by ministry of defense and interior ministry compared to the same period of the previous year (Figure 5.11-5.12).

Figure 5.10: Components of Donor Contribution FY 2017



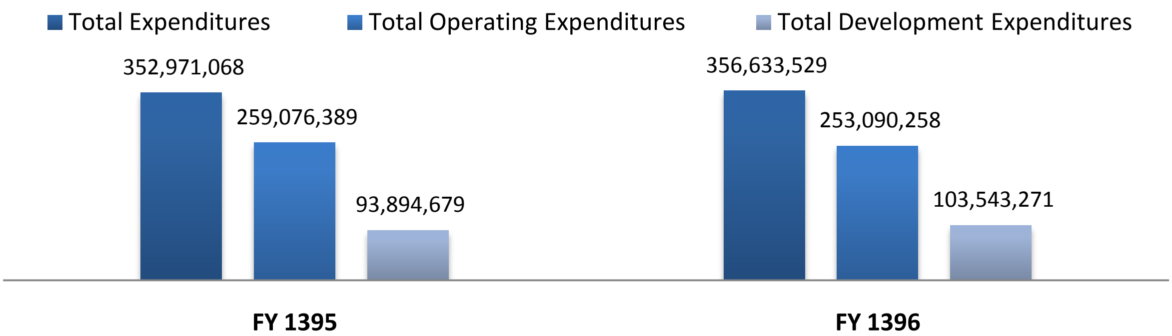
Source: Ministry of Finance/MPD calculation

Figure 5.11: Total Annual Grants Analysis FY 1395 & 1396



Source: MoF Financial Statement/MPD staff calculation

Figure 5.12: Comparison of Total Expenditure
FY 1395 & FY 1396



Source: MoF Financial Statement/MPD staff calculation

6

Banking System Performance

6

BANKING SYSTEM PERFORMANCE

The main financial indicators of banking sector demonstrated a positive movement over the previous year. However, the banking sector is still beleaguered with low asset quality. The growth in total assets base was mostly funded by cash injection, profit and deposits upturn. Gross loans were up due to designation of new loans and pick up in USD rate, while equity capital maintained healthy levels because of rise in the profitability and cash injection along with the adequate level of liquidity buffers.

- Asset base of the banking sector grew by 5.81 percent during the year 2017, standing at AF 316.34 billion, at a slower pace against 10.45 percent growth in 2016. The increase in banking system assets was mainly powered by growth in deposit base, injection of capital and profits over the year. Disaggregated analysis of total assets shows that most obvious increase was recorded in Cash in vault and claims on DAB mostly in overnight deposits. Other contributed components include net loans and fixed assets, whereas the interbank claims, investments and other assets contracted over the year.
- Total gross loan portfolio of the banking sector posted an increase of 3.52 percent over the year, currently standing at AF 42.71 billion. The increase in total gross loans is mainly attributed to disbursement of loans and increase in USD rate.
- Deposits, the main funding source of banking sector, which comprises 96.31 percent of the total liabilities stood at AF 270.15 billion, by representing an increase of 5.81 percent against 7.57 percent growth in 2016. The major increase in deposit base of the banking sector is attributed to demand deposits. Deposits were largely denominated in USD (59.51 percent) with Afghani denominated deposits lagging at 33.30 percent. AF-denominated deposits indicated 14.09 percent increase against 19.42 percent increase in 2016, and USD denominated deposits were down by 0.59 percent against 0.50 percent increase in 2016.
- The capital base of the banking sector remained strong and stood at AF 35.85 billion which shows 5.73 percent

increase. The increase in capital base is attributed to injection and yearly profits. The financial capital of one bank is below the set limits; however the capital adequacy of all banking institutions except one bank is above the minimum threshold (12 percent of risk-weighted assets). The Basel benchmark for capital to risk weighted is 8 percent. Capital adequacy ratio (CAR) of the banking sector is recorded at 30.28 percent.

- Banking sector earned net profits amounting to AF 1.93 billion for the year 2017, against AF 4.39 billion net profits in 2016. Return on Assets (ROA) stands at 0.70 percent annualized, and Return on Equity (ROE) is recorded at 3.67 percent annualized. The decrease in profitability of the banking sector is mostly ascribed to decrease in non-interest income; other contributing factors include increase in operating expenses, taxes and decrease in net-interest income. While the FX losses turned to profit, credit provisions decreased over the year. State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profits in the review period.

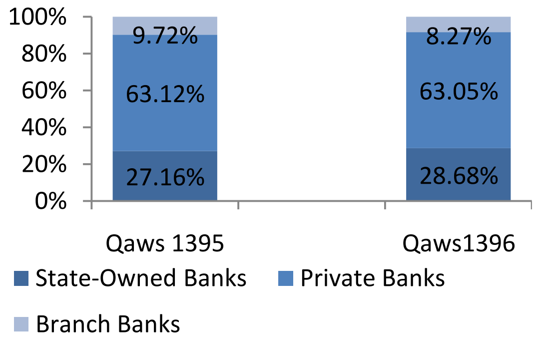
I. ASSETS OF THE BANKING SYSTEM

The assets size of the banking sector increased by 5.81 percent in the period under analysis, lower from 10.45 percent increase in 2016.

The breakup of total assets reveal that the most obvious increase was registered in cash in vault and claims on DAB (AF 23.57 billion or 16.67 percent) mostly in overnight deposits; net-loans (AF 1.92 billion or 5.27 percent) and fixed assets (AF 1.02 billon or 14.64 percent).The increase in intangible assets was negligible, while interbank claims, investments, other assets and repossessed assets showed a decrease of AF 4.42 billion (6.08 percent), AF 2.29 billion (9.08 percent), AF 2.15 billion (15.54 percent), and AF 296 million (19.30 percent) respectively during the period under review.

The major components of the system's total asset portfolio were cash in vault/claims on DAB (52.14 percent), interbank claims (21.60 percent), net loans (12.12 percent), investments (7.25 Percent), "other assets" (3.70 percent) and fixed assets 2.54 percent of the total assets (See table 6.1).

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



Source: Financial Supervision Department, DAB

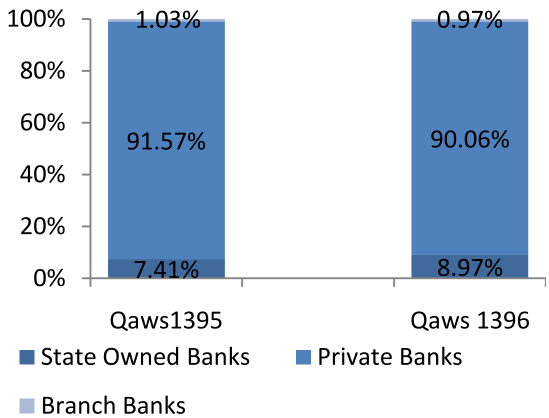
Table 6.1: Composition of Assets and Liabilities				
Amount in million AF	Qaws 1395 Dec. 2016	Qaws 1396 Dec. 2017	% of Total Assets/Liability	Growth
Assets				
Cash in vault and claims on DAB	141,366.69	164,941.72	52.14	16.67
Interbank claims(Net)	72,748.21	68,326.92	21.60	-6.08
Investments (Net)	25,232.31	22,940.21	7.25	-9.08
Loans (Net)	36,428.22	38,350.07	12.12	5.27
Intangible assets	784.77	798.50	0.25	1.75
Repossessed Assets	1,533.86	1,237.76	0.39	-19.30
Fixed Assets	7,011.73	8,038.27	2.54	14.64
Others	13,872.75	11,715.91	3.70	-15.54
Total	298,978.54	316,349.36		5.81
Liabilities				
Deposits	254,951.51	270,153.35	96.31	5.96
Borrowings	3,597.14	3,728.89	1.33	3.66
Subordinated Debt	21.42	-	0	-100
Others	6,502.38	6,615.71	2.36	1.74
Total	265,072.45	280,497.95		5.82

Source: Financial Supervision Department, DAB

1.1 Gross Loans

Total gross loans portfolio stands at AF 42.71 billion, indicating AF 1.45 billion or 3.52 percent increase from 2016, constituting 13.50 percent of the total assets. The increase in total gross loans is mainly attributed to disbursement of loans and increase in USD rate.

Figure 6.2: Share of Gross Loan Portfolioamogng banking group



Source: Financial Supervision Department

Increases in loan portfolio were observed in six banking institutions, whereas seven banking institutions recorded decrease in their loan portfolio, and the remaining two banks did not participate in lending.

Gross loan portfolio increased in private and state-owned banks, while branches of foreign banks have registered decrease in their portfolio, attributed to settlement of loans. Private Banks with 90.06 percent share in total portfolio posted 1.82 percent or AF 688 million increase, and state-owned banks holding 8.96 percent of the banking sector portfolio was up by 25.32 percent or AF 774 million. On the other hand, branches of foreign banks with 0.97 percent share depicted 2.12 percent or AF 9 million decrease during the period under review.

1.2 Loan Loss Reserves

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk mitigation framework. Banks are required to make both general reserves (on standard assets) and specific provisions (on non-standard assets) in order to mitigate their credit risk and according to revised asset classification and provisioning regulation. As per the new assets classification regulation, the creation of reserve for standards loans is optional.

By the end of Dec, 2017, total provision cover of the system was 10.21 percent of total gross loans as opposed to 11.71 percent recorded in the in Dec, 2016.

1.3 Distribution of Credit

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

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

classified as "other commercial loans" (92.29 percent in December against 90.13 percent in Dec, 2016), mainly in "Petroleum and Lubricants" (10.55 percent), "Retail Trading" (8.35 percent),"All other services" (7.92 percent), "Food Item" (7.71 percent),"Construction and Building" sector (7.20 percent) and "Telecommunication" sector (5.40 percent). Significant increases were observed in Construction and cement materials, Retail trading, Media Advertisement and Print, Textile, Spare Parts, Other infrastructure Projects, Road and Railway and Services sectors both in absolute amount and percentage of total gross loans, while "Ground Transportation", "All other services", "Residential Mortgage loans to individual", "Commercial Real estate and Construction loans", and "Manufacturing and Industry", were among top decreasing sectors. Loans designated to Micro Credit sector posted an increase of AF 546 million amounting to AF 4.62 billion provided by one bank, while SME sector witnessed a decrease of AF 244 million currently standing at AF 2.35 billion provided by five banking institutions. Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crisis associated to that sector, inversely affecting the overall banking sectors. Banks should closely monitor the potential risk associated with key sectors given the high NPL ratio. Disaggregated analysis shows that major portion of NPL originates from trade sector constituting 31.46 percent of total banking sector NPLs. Decreases were observed in "Trade", "Other", "Manufacturing" and "Residential Mortgage loans to individual" sectors, while Services and Utilities were among the top increasing sectors. About 69.29 percent of the loans were designated in Kabul, while Herat and Balkh provinces in the second and third places with Kandahar and Badghis provinces at fourth and fifth places respectively. The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that by the passage of time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

Table 6.2: Sectoral Distribution of Credit								
Sectors	Hoot, 1389 (Mar, 2011)	Hoot, 1390 (Mar, 2012)	Qaws, 1391 (Dec, 2012)	Qaws, 1392 (Dec, 2013)	Qaws, 1393 (Dec, 2014)	Qaws, 1394 (Dec, 2015)	Qaws, 1395 (Dec, 2016	Qaws, 1396 (Dec 2017)
Commercial Real Estate and Construction Loans	25.98	2.85	2.29	2.02%	1.80%	1.90%		2.02%
Other Commercial Loans	-	-	-	-	-	-		-
Mining	0.02	0.72	0.11	0.07%				
Manufacturing	2.72	13.32	11.88	9.36%				
Trade	34.16	27.84	28.3	29.81%				
Communication	1.23	0.94	2.35	3.70%				
Service	6.72	11.95	15.94	22.11%				
Utilities	0.03	0.3	0.07	0.05%				
Agricultural Loans					0.27%	0.33%		0.25%
Livestock and Farms					0%	0.03%		0.22%
Manufacturing and Industry(product of metal, wood, plastic, rubber)					2%	4.42%		2.61%
Manufacturing, Handmade and Machine products					4%	4.24%		3.10%
Cement and Construction Materials					3%	1.96%		3.44%
Textile					2.59%	0.52%		1.50%
Power					0.35%	0.22%		0.39%
Construction and Building					12.52%	7.54%		7.20%
Services					4.79%	3.80%		4.08%
Hotel and Restaurant					1.20%	1.46%		1.99%
Telecommunication					2.92%	5.70%		5.40%
Ground Transportation					4.87%	5.31%		1.82%
Air Transportation					4.18%	2.66%		2.84%
Health and Hygienic					0.71%	1.16%		1.69%
Median, Advertisements and Printer					0.04%	0.04%		1.16%
All Other Services					1.41%	7.56%		7.92%
Wholesales					4.93%	9.89%		4.57%
Machineries					0.12%	0.25%		0.25%
Petroleum and Lubricants					8.74%	9.80%		10.55%
Spare Parts					0.24%	1.42%		1.36%
Electronics					1.40%	1.58%		2.70%
Cement and other Construction Materials					1.87%	2.73%		2.51%
Food Items					4.52%	8.24%		7.71%
All Other Items					5.72%	3.47%		3.21%
Retail Trading					3.92%	3.28%		8.35%
Road and Railway					2.41%	1.17%		1.58%
Dames					0.61%	0.09%		0.00%

Mines					0.08%	1.48%	0.47%
Other infrastructure Projects					1.81%	2.44%	3.39%
Financial and Lending Institutions					0.00%	0.00%	0.00%
Agricultural Loans	0.75	2.06	2.66	2.38%	2.34%	2.35%	
Consumer Loans	1.01	0.82	0.74	0.24%	0.26%	0.30%	
Residential Mortgage Loans to Individuals	8.95	15.65	14.46	10.84%	7.14%	2.68%	
All Other Loans	10	12.65	10.71	9.41%	6.68%	0.00%	
Source: Financial Supervision Department/DAB							

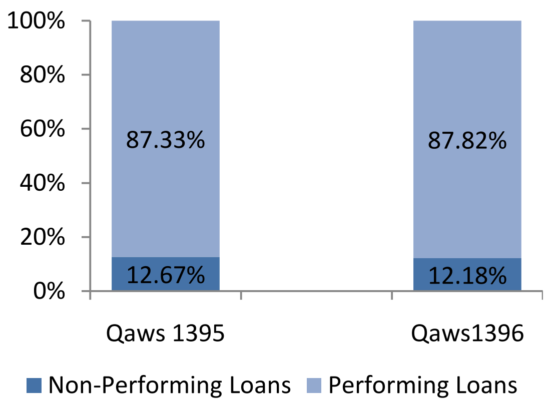
II. CLASSIFICATION OF LOANS

2.1 Non-performing loans

Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs, which is not a favorable situation. Moreover, it can be inferred that quality of risk management in banks with poor credit performance is demonstrating weak performance. It is essential that banks with poor loan quality evaluate credit applications carefully, comply with all applicable laws, regulations, circulars, internal policies and procedures, and closely monitor financial condition of their borrowers to ensure that credit expansion will not pose a threat to the stability of the financial system. In monetary terms, by the end of Dec, 2017, non-performing loans recorded at AF 5.20 billion or 12.18 percent of total gross loans and 16.27 percent of the system's regulatory capital, against AF 5.22 billion or 12.67 percent of the total gross loans in Dec, 2016, showing a slight decrease in monetary terms as well as percentage of total gross loans, came from the charge-offs and settlement of loans. Out of 12.18 percent NPL, 11.62 percent is related to five banks. These banks hold 69.27 percent of the system's gross loans and 49.48 percent of system's regulatory capital.

Financial Supervision Department (FSD) is closely working with banks with poor loan performance to design and implement plans to improve their asset quality. This situation requires regulatory oversight and prompt remedial action to improve governance of credit risk to avoid negative impact over the profitability and capital adequacy of the banks with poor credit quality. The sector wide distribution of NPL reveals that major part of NPL originates from Trade sector making 31.46 percent and the Other sector comprising 27.78 percent of the sector's NPL, while services, utilities, and manufacturing sectors make 14.71 percent, 14.08 percent and 5.40 percent respectively. Increases were observed in Services, Utilities and Communication sectors, while Trade, Manufacturing, residential mortgage loans to individual and Other sectors were among the decreasing sectors.

Figure 6.3: Quality of Loan Portfolio



Source: Financial Supervision Department

2.2 Adversely-classified loans

Adversely classified loans (substandard, doubtful)[2] depicted AF 1.97 billion decrease over the year, reaching AF 9.13 billion, constituting 21.38 percent of the total gross loans and 28.53 percent of regulatory capital, though decreased, but still requires strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be focused on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk. Management should take appropriate measures to address issues and weaknesses that have resulted in poor credit performance as per prudential regulations. Though systematic risk and economic downturn may have affected, weak and systematically important bank's asset quality especially loans. However, banks management should have mechanisms to predict such risks, hedge their potential risk, and take proper precautionary measures as per prudential regulations.

2.3 Loans classified Watch

Loans classified in the "watch"[3] category amount to AF 4.58 billion, which makes 10.74 percent of total gross loans increased by 17.64 percent since Dec, 2016. The increase is mostly attributed to one private commercial bank in the system. This category of loans require close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful) and losses in the future.

2.4 Loans classified loss4

Loans classified loss amount to AF 947 million, 2.21 percent of total gross loans are up by AF 124 million or 70 percent from Dec,

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

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

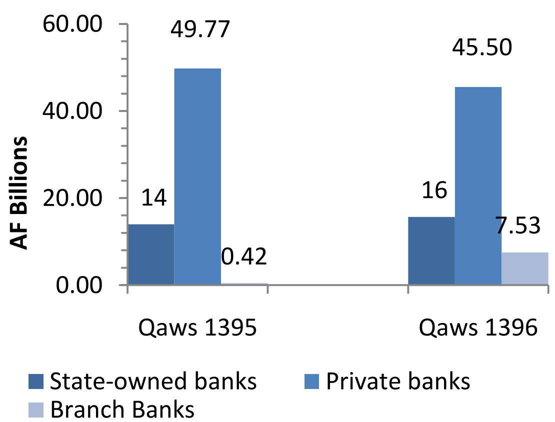
4 Assets on which the payment of principal or interest is due and remains unpaid for 540 day or more (Loss) as per Accounting Letter No. 03/92 dated 16/09/1392

2016 mainly attributed to one bank. Banks are required to maintain enough capital at all times to cover losses resulted from loans classified in this category as it prompts charge-off from balance sheet.

2.5 Inter-bank Claims

Gross Interbank Claims are the second largest among various asset categories, currently comprising AF 68.65 billion (21.70 percent of total assets) registered AF 4.27 billion or 5.86 percent decrease since Dec, 2016, mostly attributed to five banking institutions. This indicates that the banking sector has transferred a portion of its Claims on banks to DAB capital notes and overnight deposits. Later on, by improving security and economic situation of the country banking sector can substitute these assets to higher income earning assets. Banks must not only appropriately measure risks associated with individual banks but also country or countries in which they have placed funds (See figure 6.4).

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



Source: Financial Supervision Department

2.6 Investment

The net-investment[5] portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies, that declined by 9.08 percent or AF 22.91 billion from Dec, 2016 standing at AF 2.29 billion or 7.25 percent of total assets. The decrease mostly came from three banking institutions and attributed to sale of investments. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, five commercial banks and three branches of foreign banks.

2.7 Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category making 52.14 percent of the total assets, showed an increase of AF 23.57 billion, both in absolute as well as in percentage of total assets from Dec, 2016 standing at AF 164.94 billion as of end of Dec, 2017. The increases were observed in cash in vault, required reserves and overnight deposits.

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

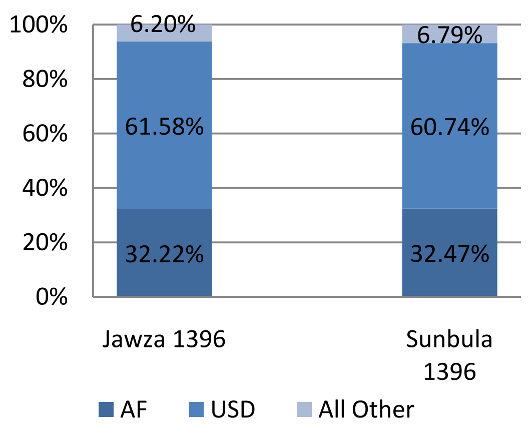
[5]Investments include investment in bonds, securities, associated companies, in a subsidiary and in a bank

III. LIABILITIES

Total liabilities of the banking sector increased by AF 15.42 billion or 5.82 percent standing at AF 280.49 billion against AF 265.07 billion in Dec, 2016. All components of total liabilities except the subordinated debt have increased over the period under review.

The majority of liabilities are made up of deposits (96.31 percent), with "other liabilities" at second and borrowings in third place. See table 6.6.

Figure 6.5: Share of Liabilities among the banking group



Source: Financial Supervision Department

3.1 Deposits

Deposits being the main funding source, amounted to AF 270.15 billion as of Dec, 2017, which have increased by AF 15.20 billion or 5.96 percent, compared to Dec, 2016. The total deposits cover AF 8.23 billion interbank and AF 261.92 billion customer deposits. The major increase in deposit base of the banking sector is attributed to customer deposits and occurred mainly in demand deposits in AF currency, whilst the USD currency registered a decrease in its position. Meanwhile, the interbank deposits indicated decrease over the previous year. Currency wise analysis shows that Afghani denominated deposits indicated 14.09 percent increase accounting for 33.30 percent of total deposits, while US dollar denominated deposits registered 0.59 percent decline making 59.51 percent of the total deposits of the system.

Private Banks attracted AF 173.22 billion deposits, increased by 4.89 percent making up 64.12 percent of the system's deposits.

The share of state-owned banks amounted to AF 75.53 billion, increased by 14.83 percent from Dec, 2016 accounted for 27.96 percent of the system's deposits.

The share of branches of foreign banks stands at AF 21.39 billion, decreased by 11.00 percent making up 7.92 percent of total deposits of the system.

In terms of types of deposits, demand deposits accounted for 74.23 percent of the total deposit base, increased by 5.16 percent and time deposits with 6.53 percent of total deposits was in the second place, depicting 28.42 percent increase, while saving deposit making up 19.25 percent of the total deposits portfolio was up by 2.90 percent from Dec, 2016.

Figure 6.6: Afghani Denominated Deposits

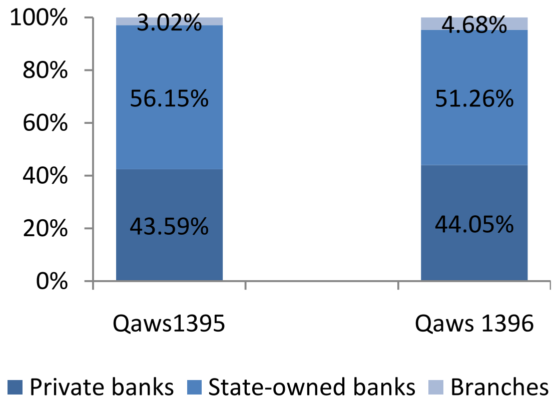


Figure 6.7: Currency Composition of Deposits

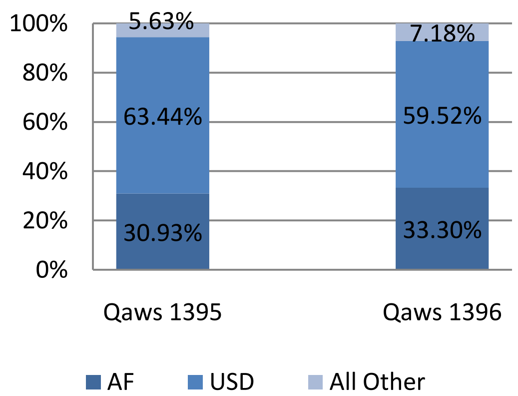


Figure 6.8: Deposits among the banking groups

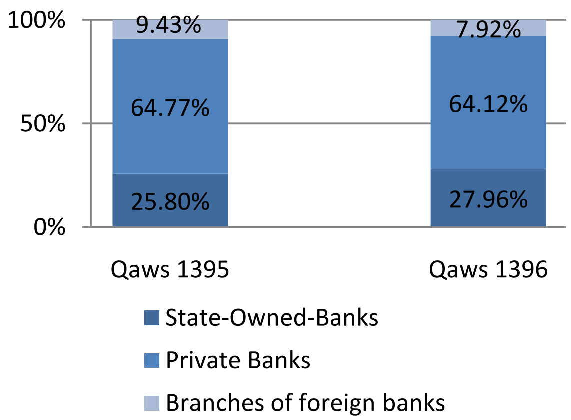
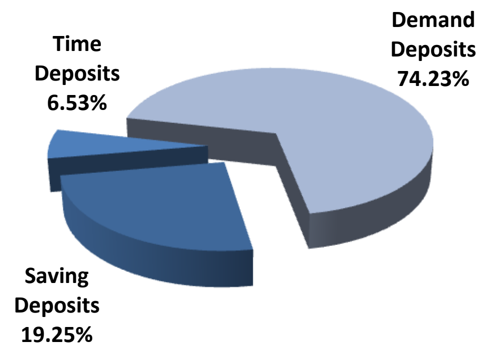


Figure 6.9: Breakdown of Deposits



Source: Financial Supervision Department, DAB

3.2 Borrowings

The share of borrowings in total funding structure of the system increased by 3.66 percent standing at AF 3.73 billion at the end of Dec, 2017, making 1.33 percent in total liabilities. The current borrowing position is attributed to four banking institutions.

IV.LIQUIDITY

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

4.1 Liquidity Ratio (broad-based measure)

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

Generally, a surplus liquidity position was observed in the banking sector during this period. 73.95 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 65.92 percent. All banking institutions were well above the minimum required level(See table 6.5).

Table 6.3: Key Financial Soundness Indicators of the banking Sector

Ratio in %	(Mar, 2010)	(Mar, 2011)	(Mar, 2011)*	(Mar, 2011)	(Dec, 2012)	(Dec, 2013)	(Dec, 2014)	(Dec, 2015)	(Dec, 2016)	(Dec, 2017)
Total Capital Adequacy Ratio	25.81	-14.46	30.39	23.06	21.84	26.34	26.46	19.94	27.68	30.28
Tier 1 Capital Adequacy Ratio	24.19	-14.51	30.29	23.98	19.97	24.65	26.09	19.66	22.93	28.06
Non-Performing Loans to Total Gross Loans	0.5	48.4	3.75	5.15	5.31	5.1	8.09	12.34	12.67	12.18
Return on Assets (ROA)	1.41	-20.08	0.24	-1.21	-0.54	0.74	0.90	0.20	0.11	0.70
Return on Equity (ROE)	10.35	-520.66	1.9	-17.9	-7.17	10.03	7.35	1.69	1.08	3.67
liquidity Ratio (Broad Measure Median)	59.19	63.32	63.83	57.37	72.13	67.93	73.6	68.22	67.74	65.92
liquidity Assets to Total Assets	0.38	40.58	47.01	55.82	63.75	73.18	73.28	75.05	71.98	73.95

*Excluding Kabul Bank Source: Financial Supervision Department/ DAB

V. CAPITAL

The system is well capitalized. The capital fund of the banking sector stands at AF 35.85 billion; increased by 5.73 percentage points or AF 1.94 billion over the previous year. The increase in total financial capital is mainly attributed to profits and capital injection. On an aggregate basis, the capital adequacy ratio of the banking sector stands at 30.28 percent. See table 6.5.

Disaggregated analysis shows that the financial capital of one private bank is below the regulatory limits; however the regulatory capital ratio of all banks except one private bank is above the set regulatory threshold (12 percent of the risk weighted assets).The Basel benchmark for capital to risk weighted is 8 percent.

VI. PROFITABILITY

On a cumulative for the year 2017, the banking sector earned AF 1.93 billion net profit against AF 4.29 billion net profits in Dec, 2016, showing decrease over the year. It's worth mentioning that the major part of the previous year net profit was from the revaluation of investment properties related to Islamic banking of one of the state-owned banks.

The decrease in profitability of the banking sector as evident from the table 6.5 P/L mostly ascribed to decrease in non-interest income; other contributing factors include increase in operating expenses, taxes and decrease in net-interest income. While, the credit provisions decreased under the review period. See table 6.5.

The returns on assets (ROA), shows how well a bank is being managed by conveying how much profit the bank earns per unit of its assets. ROA of the banking sector stands at 0.70 percent annualized, while the returns on equity (ROE),which measures shareholders return on their invested equity in a bank. The ROE of the banking sector by end of Dec, 2017 was recorded at 3.67 percent annualized. The ROA of SOB[6] was recorded at 1.36 percent annualized, BOFB[7] recorded 1.84 percent annualized, and PB[8] registered 0.19 percent annualized at the end of Dec, 2017.

On a cumulative basis, two banking institutions have incurred AF 958 million net-losses during the reference year against AF 1.18 billion net-losses posted by three banks in Dec, 2016. On core income basis, three banks ended with losses, against four banks in Dec, 2016.

Group wise analysis reveals that State-Owned Banks (SOB), Private Banks (PB) and branches of foreign banks (BFB) ended up with profits in the period under analysis. See figure 6.10.

Major portion of the profitability of the banking sector is attributed to State-Owned Banks standing at AF 1.12 billion, Private Banks at AF 334 million, while branches of foreign banks earned AF 472 million net-profits during year ending Dec, 2017.

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

Table 6.4: P/L Schedule			
Items	**Qaws 1395 (Dec., 2016)**	**Qaws 1396 (Dec., 2017)**	**%Change (annual)**
Interest income	9,053.77	8,906.80	-1.62
Interest expense	1,813.48	1,773.26	-2.21
Net interest income	7,240.29	7,133.54	-1.47
Non-interest income	10,004.93	7,428.62	-25.75
Non-interest expenses	5,869.84	6,187.48	5.41
Salary cost	3,750.62	4,153.35	10.73
Credit provisions	2,353.52	1,295.97	-44.93
P/L before tax	5,271.24	2,925.36	-44.50
P/L after tax	4,293.41	1,928.97	-55.07

Source: Financial Supervision Department, DAB

Figure 6.10: Profitability of the Banking Sector

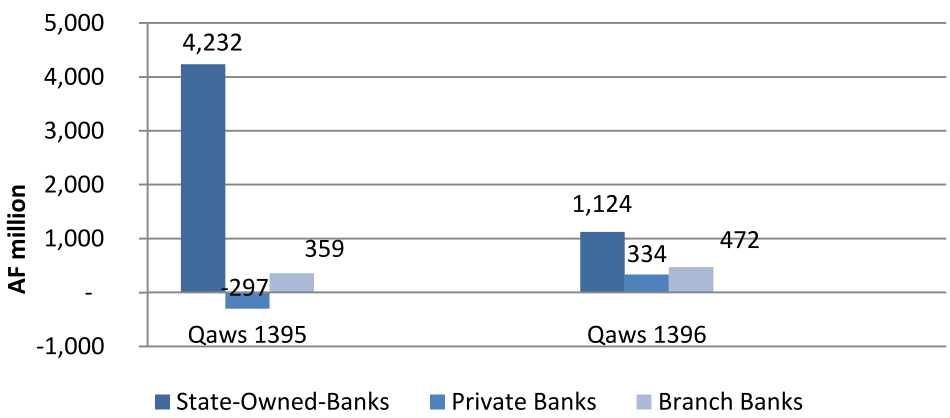


Figure 6.11: ROE and ROA of the banking system

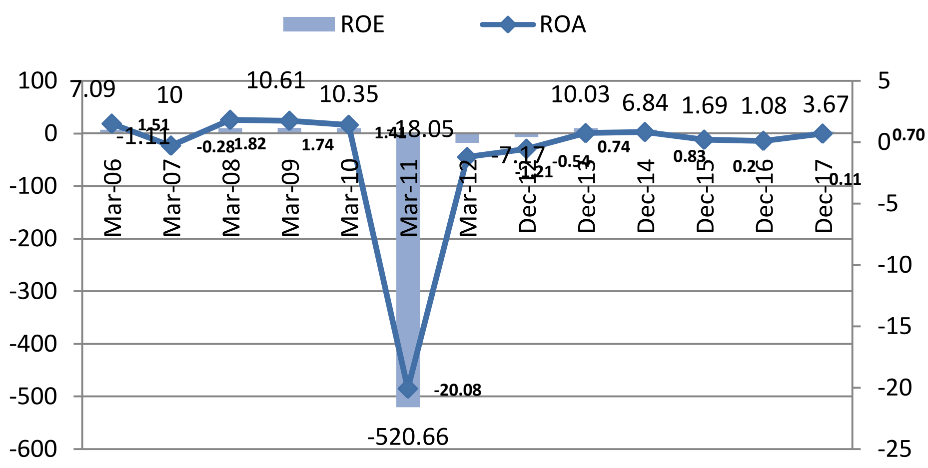
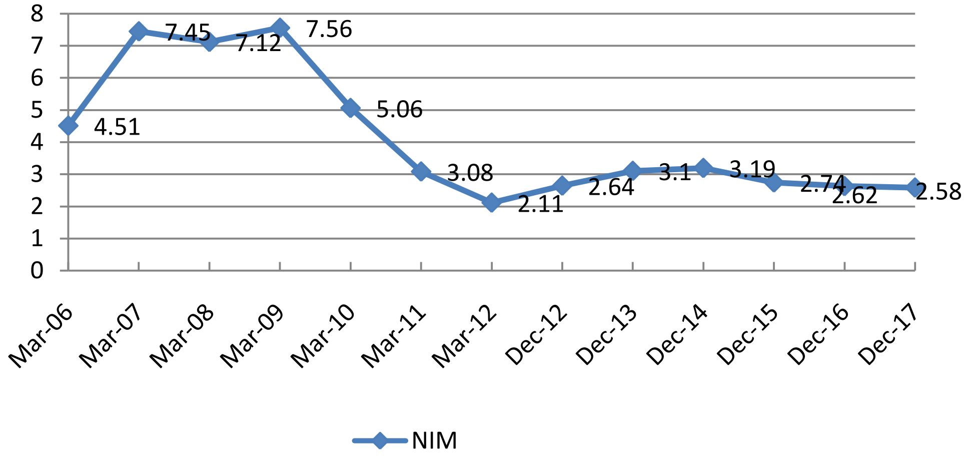


Figure 6.12: Net Interest Margin



Source: Financial Supervision Department, DAB

VII. Foreign Exchange Risk

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

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20 percent appreciation in exchange rate would increase the regulatory capital of the system by AF 1.50 billion and vice versa. Similarly, a 4 percent change would correspond to AF 301 million and vice versa.

VIII. Interest Rate Risk

Overall, the banking system is in an interest-rate sensitive position. However, calculations made from the Interest Rate Sensitivity Schedules of all banks reveal that, the net-interest income of the system over the next 12 months may increase by AF 714.43 million in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AF 714.43. For five banking institutions, if the interest-rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

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

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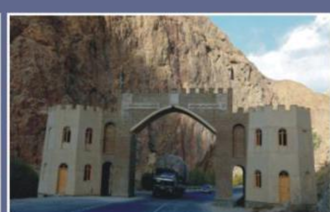

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