Da Afghanistan Bank

Third Quarter, 2019

# Economic & Statistical Bulletin

Monetary Policy Department

Da Afghanistan Bank

Ibn-e-Sina Watt

Kabul

Afghanistan

Telephone: +93(0)-20-2103930

Internet: **www.dab.gov.af**

Email: **mp@dab.gov.af**



Note:

Afghanistan's fiscal year has changed effective from 2012 (1391). The new fiscal year begins from December 22nd each year. This bulletin analyzes economic developments during the third quarter of fiscal year 2019 (1398), which starts from June 22nd, 2019 to September 22nd, 2019.

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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 |

# EXECUTIVE SUMMARY

Da Afghanistan Bank maintains monetary aggregate targeting regime, under which Reserve M0ney is the operational target and Currency in Circulation is the indicative target for liquidity. In order to control and manage liquidity in the market Da Afghanistan Bank uses Open Market Operation for achieving its operational target.

Targets for Reserve Money and Currency in Circulation set, were 12% and 0% respectively, where Da Afghanistan Bank has been successful in achieving both the targets. DAB through its primary monetary instruments (Foreign Exchange Auction and Capital Notes Auction) manages Reserve Money growth in order to maintain price stability and control money supply.

Consumer Price Index (CPI) in Afghanistan is calculated based on April 2015 prices. Measuring inflation quarter on quarter basis, it showed decline in the third quarter of FY 2019. The average inflation rate reduced to 2.51% which was in line with reduced commodity prices in the global market.

Meanwhile, to measure inflation based on year-by-year, it shows increase and reaching 2.51% (average) in the quarter under review. Likewise, Kabul CPI indicates decline based on quarter-by-quarter, while on year-by-year basis, it is increased in the quarter under review.

External Sector of the economy deteriorated (20% increase in the current account deficit) in the third quarter of FY 2019 as a result of reduction in merchandized trade in goods, receipt from services, and receipt of government grants. Capital account inflow showed decrease of 15% due to reduced capital transfer for government sector.

On the other hand, inflow of Foreign Direct Investment (Net) experienced reduction, while outflow of the portfolio investment also decreased during the quarter under review. As a result of decay in all three account; Current, Capital and the Financial accounts, Balance of Payments (BoP) registered USD 569.00 million deficits in the third quarter of FY 2019.

According to Fiscal sector indicators; in the third quarter of FY 2019, budget deficit (excluding donor's revenue) was AFN 55.72, while budget deficit (including donor's revenue) was AFN 6.26. Meanwhile domestic revenue reduced by 9.70% in the quarter under review, while core expenditures increased by 4.89%.

Donor grants showed increase of AFN 3.54 billion in the quarter under review. Furthermore, budget execution rate reached to 61% at the end of the third quarter of FY 2019, where it was 59% at the end of the same quarter of FY 2018.

Banking sector accounts for 20.73% of the country's GDP. The sector includes thirteen licensed banks three of which are the State-Owned-Banks, eight private commercial banks, and there are two branches of the foreign banks. Most of the indicators showed decrease such as; Total assets, deposits, loans, equity capital and profit, however, quality of loans remained low and liquidity was adequate.

Deposits were the main source of funding for the banking sector which consist of customer deposits and interbank deposits. Profitability of the sector was affected by higher allocation of provision and revaluation loss in foreign exchange.

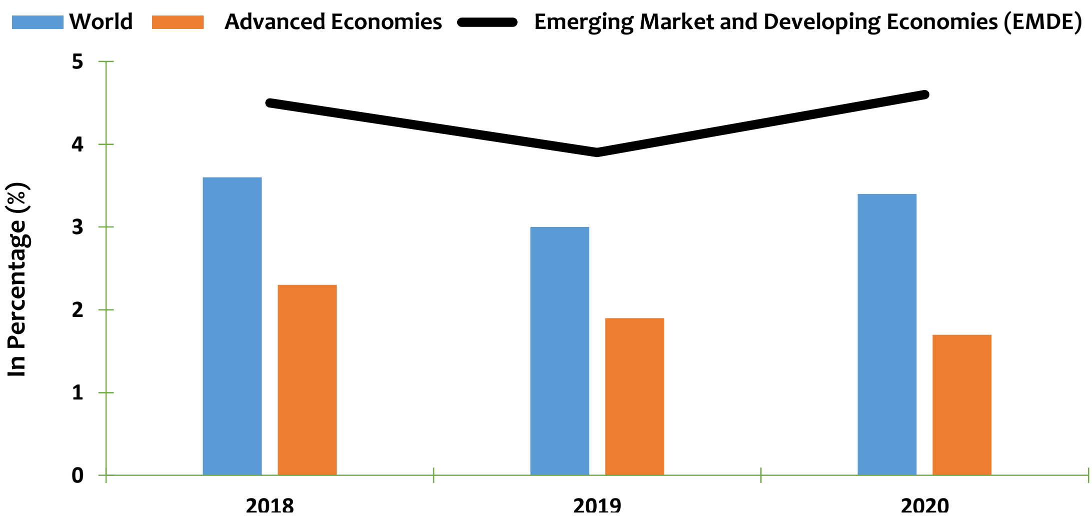
# 1 Global Economic Environment

# 1

# GLOBAL ECONOMIC ENVIRONMENT

Global economic growth continued to remain low in the third quarter of FY 2019. Weak trade, low industrial production, and low investment in emerging markets, decelerating economic growth in many developing and emerging markets including China, India, Brazil and Russia, and tensions pertaining to Brexit were the main determinants for the global economy in the third quarter. The IMF in its World Economic Outlook (WEO) has projected growth rate of 1.9% and 1.7% in 2019 and 2020 respectively for advanced economies. GDP growth for Euro areas projected 1.2% in 2019 and 1.4% in 2020, while growth rate projections for emerging market and developing economies were 3.9% in 2019 and 4.6% in 2020. Among advanced economies, US economy grew at 3.1% in the third quarter of FY 2019, while UK and Germany GDP which contracted in the previous quarter grew by 0.3% and 0.1% respectively in the third quarter. Among the emerging economies, China's economy slowed to 6% reaching twenty-seven and half year low, India's economy grew by 4.5% reaching six and half year low and Turkey's economy contracted by 0.9% after three consecutive quarter contraction in the third quarter of FY 2019.

**Figure 1.1:** Global growth, Advanced and Emerging economies' GDP growth



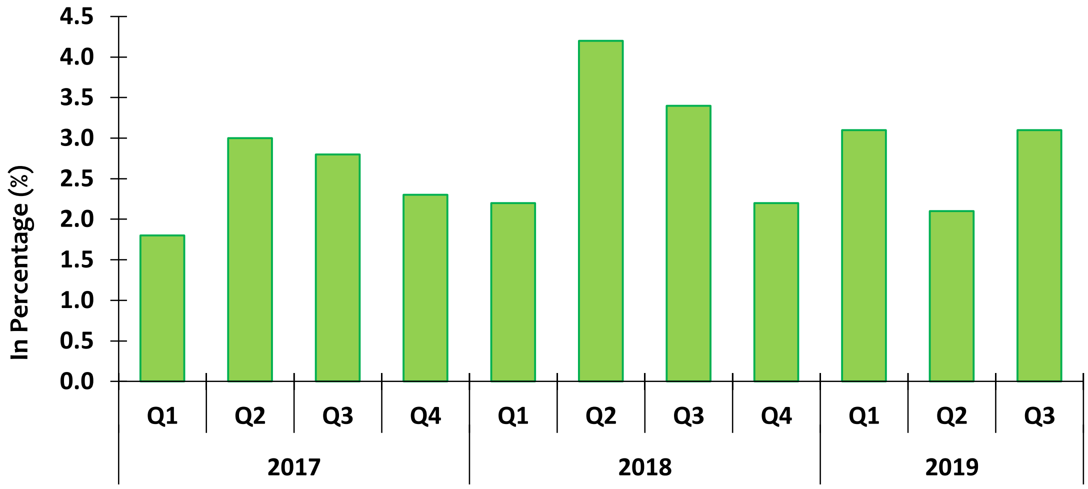

**Source:** IMF, World Economic Outlook

## 1.1. ADVANCED ECONOMIES:

### 1.1.1 United States' Economy:

The U.S. GDP started with a GDP growth of 3.1% in the first quarter of FY 2019 and reached 2% in the second quarter, while in the third quarter the GDP grew by 2.1% at annualized. The GDP slowdown was due to fading the $1.5 trillion tax cut effect and the U.S China trade war. Consumer spending and the government expenditure were the major driver of the GDP growth and each grew by 3.2% and 1.7% respectively. On the other hand, the gross private domestic investment continued to fall, reaching 1.5% in the third quarter of FY 2019.

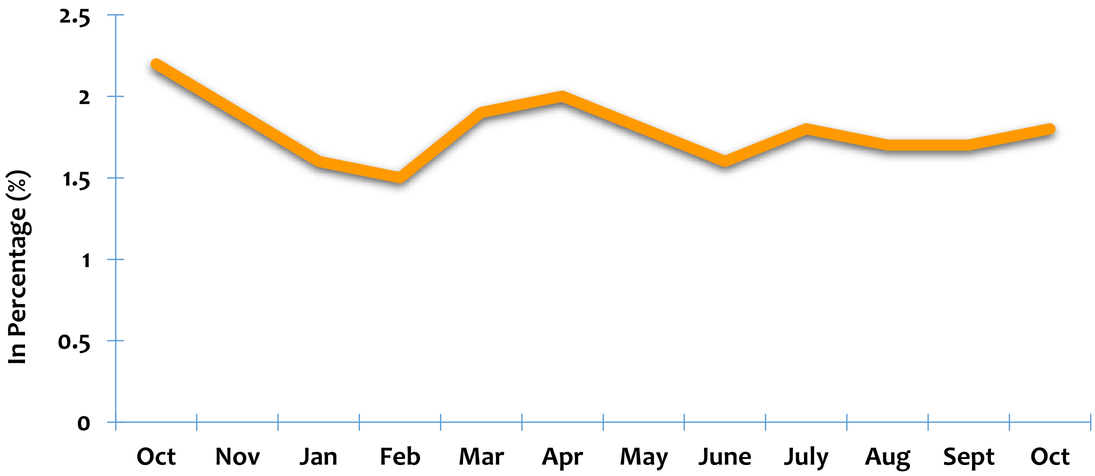
**Figure 1.2:** U.S. GDP growth rate




**Source:** US Bureau of Economic Analysis

The business investment fell at 2.3% and spending on mining exploration, shafts and wells declined at 9.9%. Residential investment grew at 4.6% in this period. Furthermore, trade deficit is estimated to be $990.1 billion than previously estimated $988.3 billion. The imports were higher and subtracted from GDP 0.14 percentage point.

**Figure 1.3:** US CPI inflation



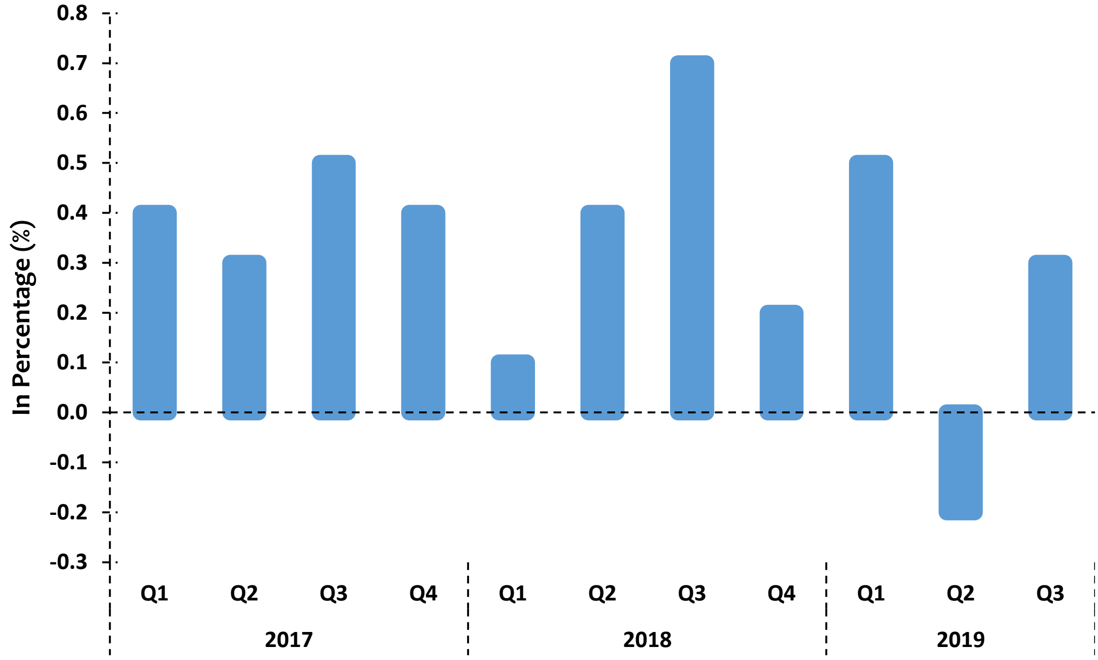

**Source:** US Bureau of Labor Statistics

US CPI inflation on unadjusted bases changes was 1.7% in August and September while increasing in 1.8% October of 2019 as illustrated above.

### 1.1.2 The Economy of UK:

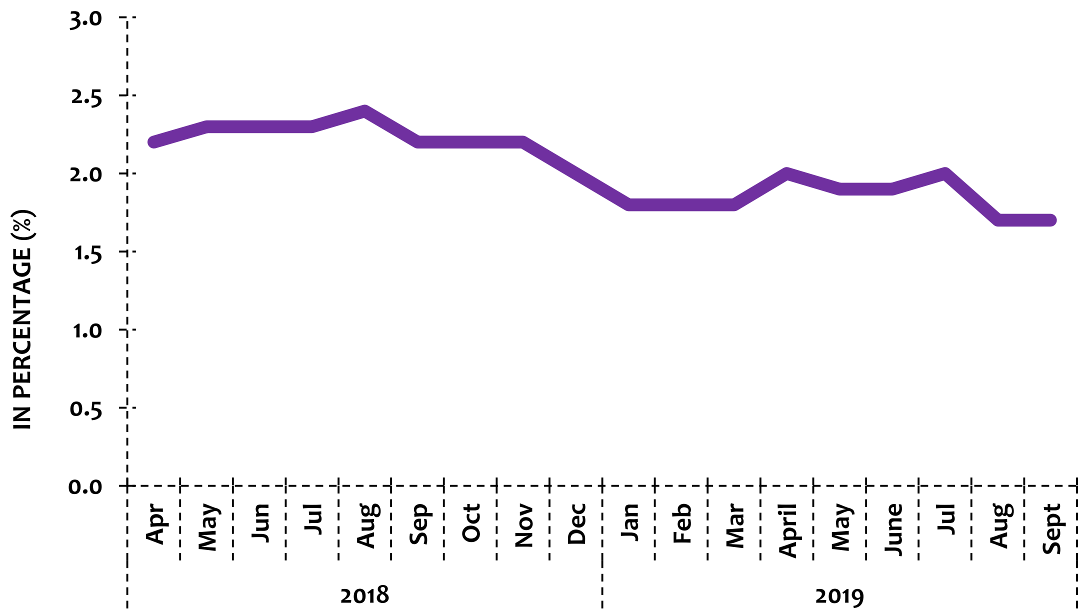
The United Kingdom's GDP grew by 0.3% in the third quarter of FY 2019. The growth in service and construction sectors were the main driver for the GDP growth. Industrial production fell sharply in the first half of FY 2019 due to persisting uncertainties in initial Brexit plan. However, in the third quarter growth in manufacturing and production outputs improved but did not show any sign of growth and was flat. The car production which experienced a decline in the second quarter due to shutdown of various car manufacturing plants, recovered.

**Figure 1.4:** UK GDP growth rate (Percentage change from previous quarter)




**Source:** Office for national Statistics

**Figure 1.5:** UK CPI inflation (Change over 12 months)



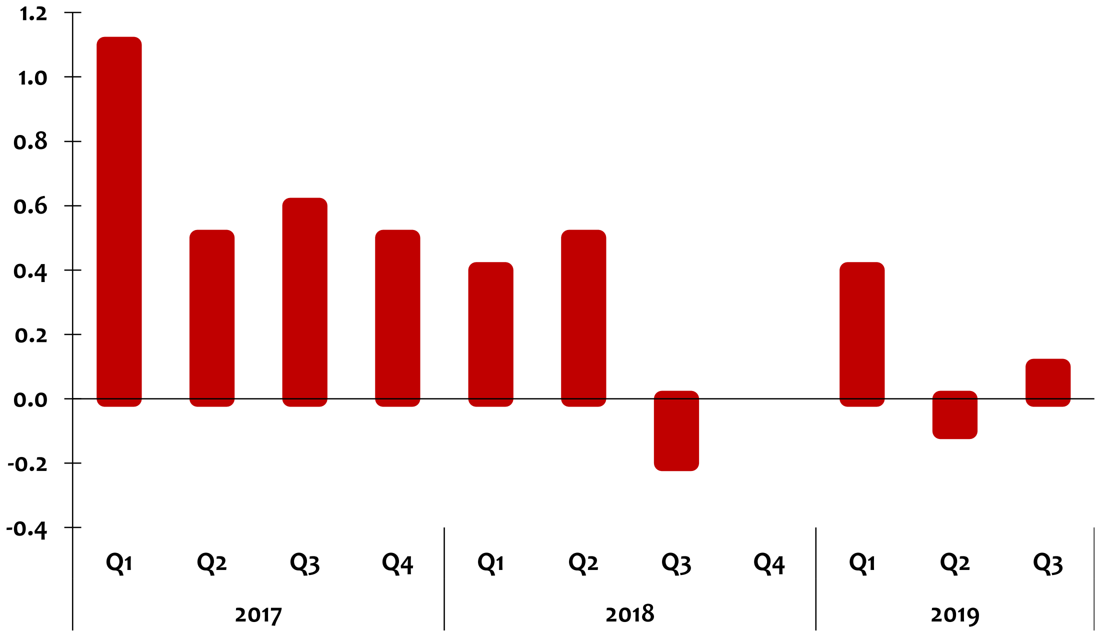

**Source:** Office for National Statistics

Furthermore, mining and quarrying products continued to decrease, falling by 1.7%. On the other hand, construction output experienced an increase of 0.6% in the third quarter, after a 1.2% decrease in the second quarter. Similarly, services output increased by 0.4% in the quarter under review, furthermore, private and public consumptions and net trade also contributed to the GDP growth, while Gross Capital Formation negatively affected growth. Growth in nominal GDP slowed by 0.5% from the slowdown of 0.7% recorded in the previous quarter.

### 1.1.3 Economy of Germany:

According to German Statistics Office (Destatis) the German GDP growth was 0.1% in the third quarter of FY 2019. The Germany GDP contracted by 0.2% in the second quarter of 2019 and 0.1% growth in the third quarter saved the economy from a recession.

**Figure 1.6:** Germany GDP growth rate (% change from last quarter)




**Source**: Federal Statistical Office

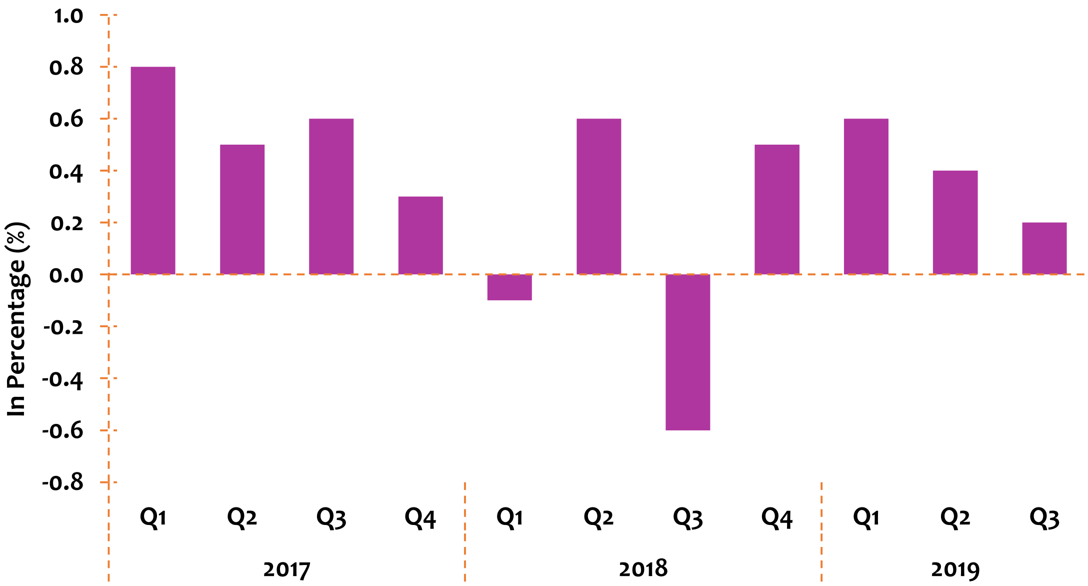
Manufacturing and auto sector is the backbone of German Economy, the trade war between China and the US and Brexit related uncertainties has hurt the industry. Furthermore, the global demand for manufacturing products has been sinking this also put pressure on the GDP growth. Consumer spending was the main driver for growth and exports figures also improved in this period.

### 1.1.4 Economy of Japan:

Japan which is the world's third largest economy, grew by 0.2% in the third quarter of FY 2019 which is lower than GPD growth of 1.8% experienced in the previous quarter. Private consumption's growth was 0.4% which cooled down from a 0.6% increase in the previous quarter. Strong private consumption was expected to offset the impact of global slowdown in demand. Capital spending, grew by 0.9% which shows it has improved from the previous quarter and contributed positively to the 0.2% growth.

On the other hand, external demand negatively contributed to the GDP growth. The external demand which is affected by the trade war between the US and China is deteriorating and it is pressing the government to use fiscal and monetary stimulus to maintain the economy in a good health. Furthermore, some experts believe the economy might lose momentum as a result of rise in sales tax from 8% to 10% which was put into effect in October, however the government believes the impact would be eased by the measures the government has already taken.

**Figure 1.7:** Japan GDP growth rate



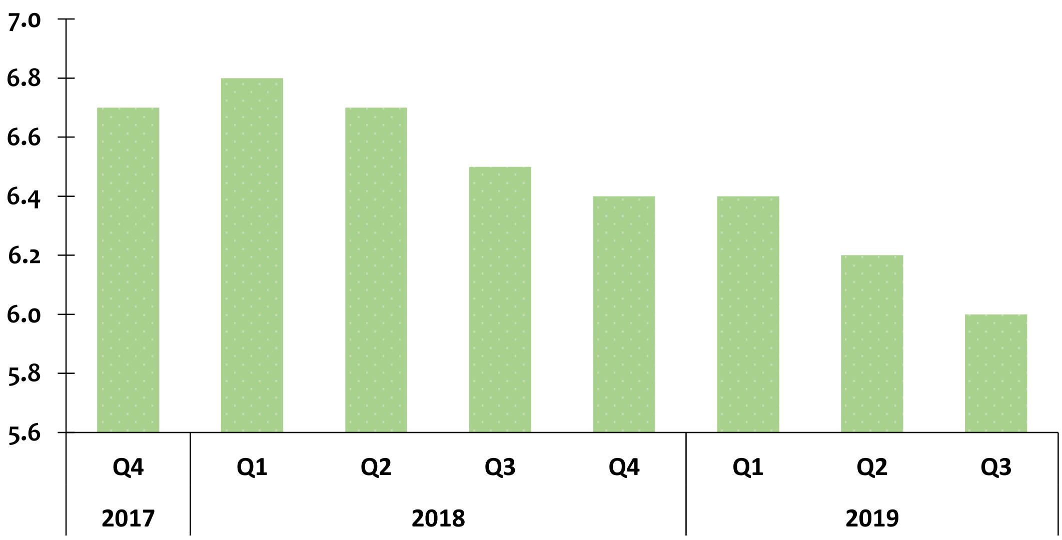

**Source:** Cabinet Office, Government of Japan

## 1.2 EMERGING ECONOMIES:

### 1.2.1 Economy of China:

The world's second largest economy's growth decelerated to 6% in the third quarter of 2019 from the same quarter a year ago, which is unprecedented in more than 27 years. The previous quarter growth was 6.2%. In this quarter total fixed asset investment expanded by 5.4% and total real estate investment increased by 10.5%. The growth of industrial added values was 5.6%, and total retail sales of consumer goods expanded by 8.2%, furthermore, the net imports and exports increased by 2.8%. The GDP slowdown begun in the first quarter of FY 2018 as a result of US and China's trade war, with each country introducing high tariffs on billions of dollars' worth of products of each other which slowed down exports and business activities.

**Figure. 1.8:** China's GDP growth rate (% change year-on-year)




**Source:** National Bureau of Statistics China

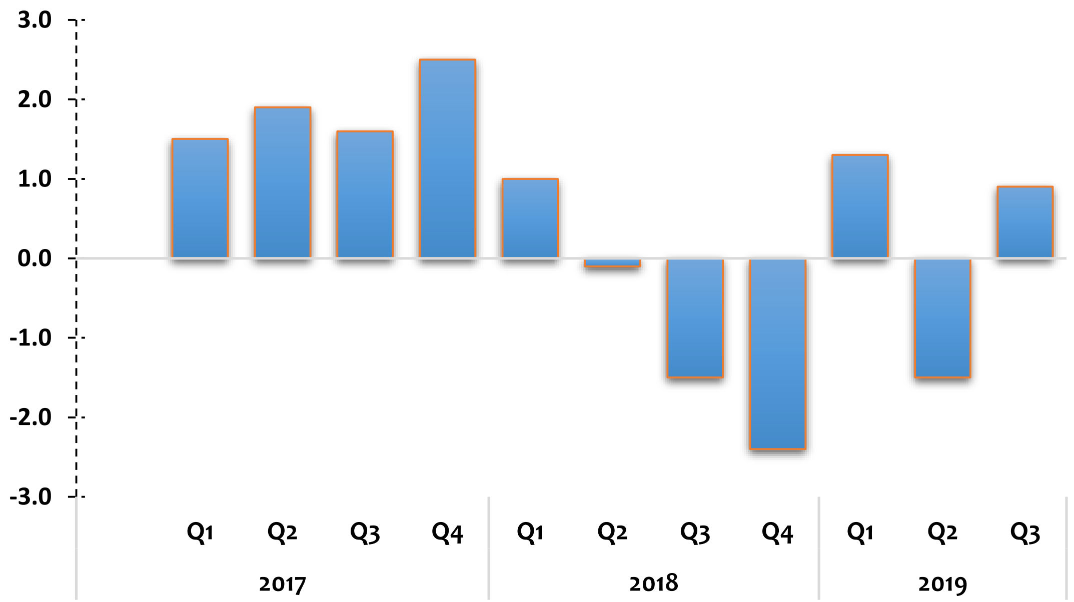
Additionally, the global economic growth is projected at 3% in this quarter by IMF, this in turn is weighting on China's export and GDP growth. The two largest economies have engaged in negotiations to reach a trade agreement. The US has agreed to suspend additional tariffs on Chinese products and in return, China agreed to purchase $40 - $50 billion worth of agricultural products from the US and also address intellectual property and financial services concerns.

In order to maintain growth, the government introduced several fiscal measures and stimulus packages to support consumption and investment this year, however, the effect is expected to fade away in the coming quarters. In the first nine months, the general public budget revenue increased by only 3.3% and this was caused by the policy measures of cutting taxes and fees. Moreover, the government also introduced several economic reform policies last year, subsequently there are significant improvement in the business climate ranking last year, rising from 78th to 46th, which made great progress again. According to the world bank annual report in Doing Business 2020, China now ranks 31st in terms of the ease of doing business after implementing eight business reforms during the year. However, some economist believes the slowdown is likely to continue in the next two quarters.

### 1.2.2 Economy of Turkey:

The Turkey's GDP grew by 0.9% in the third quarter of FY 2019 after suffering three consecutive quarters of contraction. Turkish economy is on the track of recovery following a recession and currency crisis and high inflation. In the quarter under review, the GDP at current price rose 11.5%, reaching $201.9 Billion from $189.8 billion.

**Figure 1.9:** Turkey's GDP growth rate (% change from previous quarter)




**Source:** Turkish Statistical Institute (TurkStats)

The growth was driven by agriculture, industry and service sectors while construction sector shrunk in the third quarter of FY 2019. The agricultural sector grew by 3.8%, industry sector grew by 1.6% and service sector expanded by 0.6%, on the other hand construction sector fell by 7.8% in the quarter under study.

Meanwhile, the government has lowered GPD growth forecast to 0.5% for 2019 and expects the GDP to grow 5% in 2020. In order to achieve 5% growth target, the government is aiming to strengthen sectors that increases investment, production and employment. The central bank has aggressively cut the interest rate to 14% from 24% since July to support loan growth and investment in order to revive the recession-hit economy. Lira has slightly weakened against dollars, however, the inflation also decreased to single digit in this quarter.

### 1.2.3. The Economy of India

According to the National Statistical Office, India's GDP grew by 4.5% in the third quarter of FY 2019. The GDP growth has been on decline for the past six quarters and this quarter's GDP growth is the slowest in six and a half years. The main reasons for the low growth are global economic slowdown, low private investment and low private consumption.

According to the data the GDP at constant price is estimated at R.s 36 lakh crore in this quarter compared to R.s 34.43 lakh crore in the same quarter previous year. This shows a growth of 4.5 percent. In this quarter, growth in most of the sectors fell as compared to the previous quarter. Manufacturing sector contracted by 1% against 0.6% growth in the previous quarter, trade, hotel, transport, communication grew by 4.8% in the quarter under review compared to 7.1% in the previous quarter.

Similarly, financial services sector grew by 5.8% against 5.9% of the previous quarter, meanwhile mining sector grew by 0.1% against 2.7% growth in the previous quarter. Electricity and other public utilities grew by 3.6% against 8.6% growth in the previous quarter. However, the agriculture sector grew at 2.1% against 2% of the previous quarter.

Some economists have predicted that the growth will continue to slowdown in the fourth quarter of FY 2019. Private consumption slowdown has halted investment and the economy has not shown any signs of revival. The government needs to use stimulus packages to generate employment opportunities and drive consumption which in turn will lead to increase in investment and stimulates growth. Furthermore, the Reserve Bank of India is expected to reduce its policy rate to facilitate loans and investment. On the other hand, IMF has projected a 6.1% GDP growth in FY 2019-2020 and 7% growth for FY 2020-2021 in its report (World Economic Outlook) for October.

**Sources:**

| | |
|---|---|
| International Monetary Fund | www.imf.org |
| Bureau of Economic Analysis, U.S. Department of Commerce, U.S.A. | www.bea.gov |
| Bureau of Labor Statistics, U.S. Department of Labor, U.S.A. | www.bls.gov |
| Office for National Statistics, U.K. | www.ons.gov.uk |
| Federal Statistical Office (DESTATIS), Germany | www.destatis.de |
| Cabinet Office, Government of 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 |
| Organization for Economic co-operation and Development | http://www.oecd.org |

# 2 Money and Capital Market Development

# 2

# MONETARY AND CAPITAL MARKET DEVELOPMENT

Based on monetary statistics, Reserve Money (RM) had 4.82% growth during the third quarter of FY 2019, but it had a growth of 0.68% from the beginning of the year till end of the third quarter of FY 2019.

The reason for positive growth of RM was the issuance of new banknotes that increased Currency in Circulation (CiC) which is the main component of RM. Currency in circulation recorded growth of 5.57% in the third quarter and 7.14% from the beginning of FY 2019 till the end of third quarter.

Reserve money and Currency in Circulation growth, which are Da Afghanistan Bank's operational and indicative targets, remained well below the targets due to collection of additional liquidity from the market and banks during the quarter under review. Narrow money (M1), stood at AFN 452,788 million at the end of the third quarter, registering 5% growth. Broad money (M2) demonstrated similar behavior, representing a growth rate of 4.33%, standing at AFN 486,875.50 million at the end of the third quarter.

In order to mitigate excessive fluctuations of Afghani exchange rate against foreign currencies and also to manage liquidity in the market, DAB uses Foreign Exchange (FX) and Capital Notes (CNs) auctions through the open market operations.

From the beginning of FY 2019 till the end of third quarter, DAB has auctioned a total amount of USD 1,781.29 million and only during the third quarter DAB has auctioned USD 574.35 million to absorb the excess liquidity from the market and as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies.

The total outstanding amount of CNs stood at AFN 23.92 billion at the end of the third quarter of FY 2019. Meanwhile, Afghani appreciated 3.20% against the US Dollar during the third quarter and depreciated 4.16% from the beginning of FY 2019 till the end of third quarter.

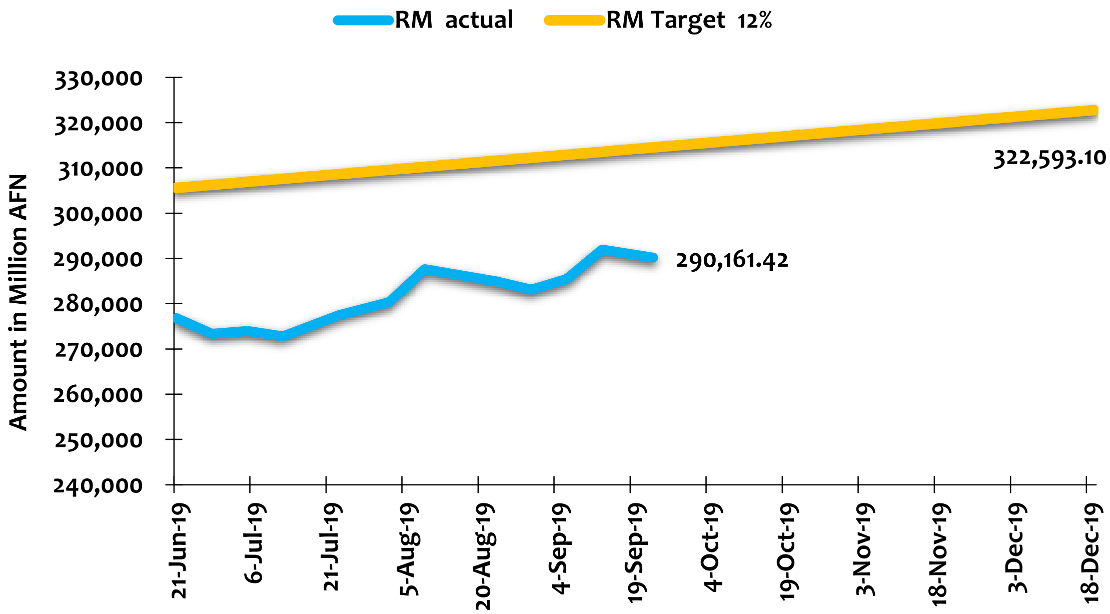
## 2.1. MONETARY PROGRAM

Reserve money remained the key operational target of the monetary policy during the third quarter of FY 2019, 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 maintaining domestic price stability, which is DAB's primary objective.

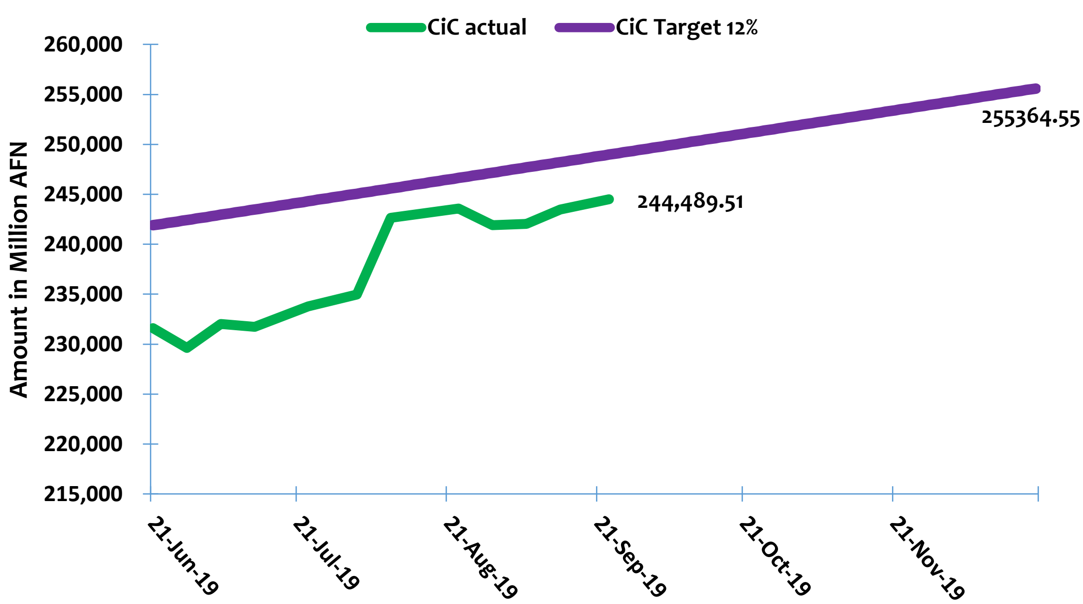
Hence, targets for RM and CiC are based on expected economic growth and expected inflation during the concerned period. For the fiscal year 2019, the ceilings for reserve money and currency in circulation growth is set as 12 %.

**Figure 2.1:** Reserve Money during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DAB

**Figure 2.2:** Currency in Circulation during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DAB

It is worth mentioning that in third quarter of the year actual RM and CIC respectively had grown by 4.82% and 5.57% respectively, but they are still well below the targets. DAB has auctioned USD 1,781.29 million via open market operation to mop up the excess liquidity from the market and to prevent intense fluctuations of Afghani nominal exchange rate against foreign currencies, especially the internationally convertible currencies. Target ceilings and the actual amounts for reserve money and currency in circulation during the period under review is illustrated in figures 2.1 and 2.2.

## 2.2. MONETARY AGGREGATES

Narrow money (M1) and broad money (M2) are compiled based on Monetary and Financial Statistics Manual and Compilation Guide.

Narrow money (M1) includes currency outside depository corporations and demand deposits, while broad money (M2) includes narrow money components and other less liquid assets or quasi money. As shown in Table 2.1, narrow money grew by 5% at the end of the third quarter of fiscal year 2019, slightly lower than the same period of FY 2018, showing a difference of AFN 22,739 million.

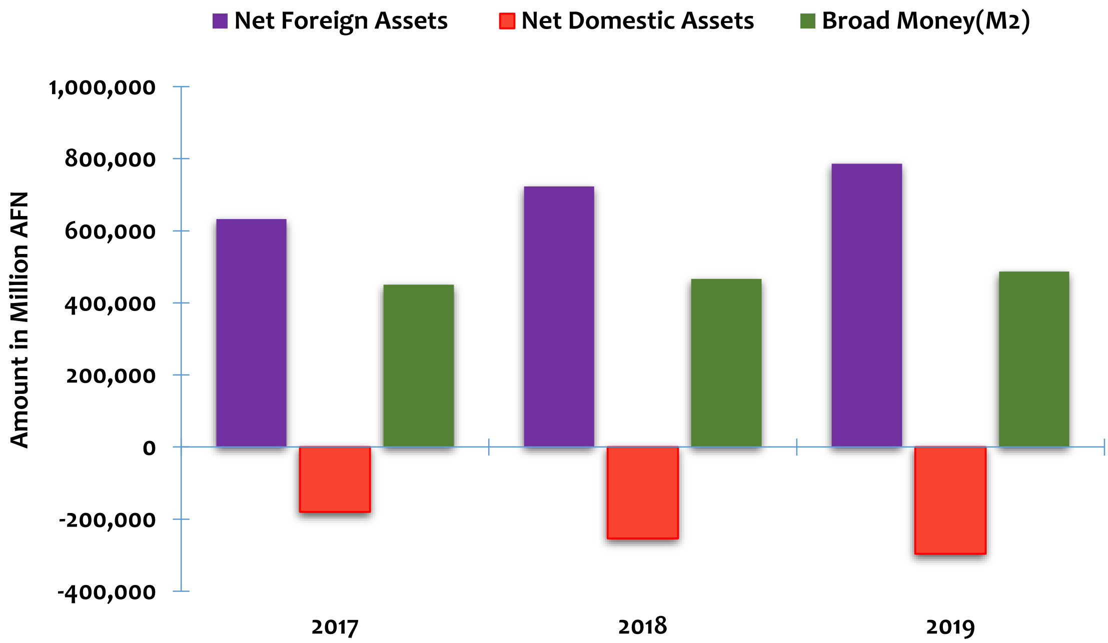
Currency outside depository corporations or CiC, which accounts for 49% of M2, grew by 9.73%, greater than 1.2% growth of the same period in the previous year, indicating AFN 20,988 million difference. Demand deposits, which is the other component of M1, experienced growth of 0.82% at the end of third quarter, while its growth rate was 7.3% in the same period of previous year. This change shows difference of AFN 1,751 million in comparison with the same quarter of FY 2018 (1397).

Broad money (M2) expanded by AFN 486,875.50 million in the quarter under review from AFN 466,660.094 million in the previous year, showing an increase of 4.33%, greater than 3.6% growth of the same period in FY 2018. The data shows that M1 with a share of 93% remained the main contributing component of M2.

Quasi money (other deposits), which is the other component of M2, had negative growth of 6.89% at the end of the third quarter of FY 2019. Quasi money constitutes 7% of M2 at the quarter under review, which is lower than 7.85% at the end of third quarter of previous year. Therefore, the impact of changes in quasi money on M2 is little. The Afghani denominated time deposits stood at AFN 9,233 million, showing a negative growth of 24.98%, while the foreign currency denominated time deposits rose by 2.27%, reaching to AFN 24,855 million. Afghani- denominated time deposits' decline and foreign currencies denominated time deposits' increase attributed to downward trend of bank's AFN saving accounts. Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 1.90% and 5.10% of M2 respectively.

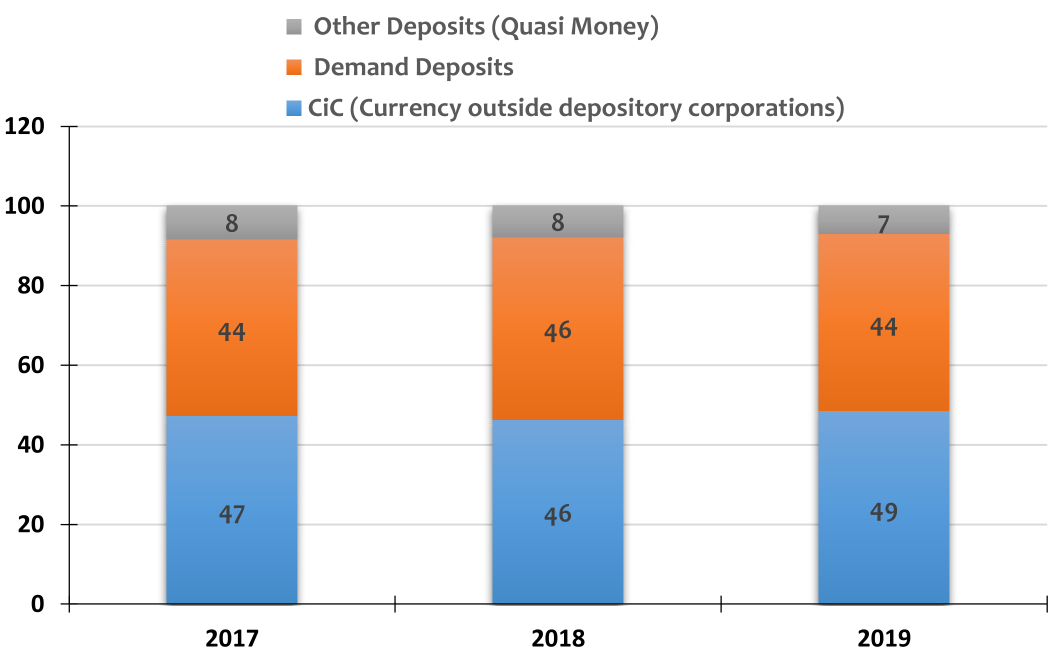
Demand deposits as a share of broad money stood at 41.38% at the end of the quarter under review (Figure 2.4)

**Figure 2.3:** Net Financial Assets, Net Domestic Assets, and M2 for 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DAB

**Figure 2.4:** Quasi Money and Demand Deposits for 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DAB

**Table 2.1:** Monetary Aggregates for the 3rd Quarter of FY 2019

| In Million AFN | Sep-17 Q3 Amount | Sep-18 Q3 Amount | Y-o-Y Δ | Difference | Sep-19 Q3 Amount | Y-o-Y Δ | Difference |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| **1- Net Foreign Assets** | 632,754 | 722,653 | 14.2% | 89,900 | 785,926 | 8.76% | 63,272 |
| (a) Foreign Assets | 645,612 | 736,722 | 14.1% | 91,110 | 796,332 | 8.09% | 59,610 |
| DAB Foreign exchange reserves | 541,629 | 610,646 | 12.7% | 69,018 | 665,818 | 9.03% | 55,171 |
| Gold | 62,533 | 64,078 | 2.5% | 1,545 | 82,580 | 28.87% | 18,502 |
| Other | 479,095 | 546,568 | 14.1% | 67,473 | 583,238 | 6.71% | 36,669 |
| Other foreign assets | 103,984 | 126,076 | 21.2% | 22,092 | 130,515 | 3.52% | 4,439 |
| (b) Foreign Liabilities | 12,858 | 14,069 | 9.4% | 1,210 | 10,407 | -26.03% | -3,662 |
| **2. Net Domestic Assets** | -179,833.27 | -253,404.66 | 40.9% | -73,571 | -296,407.27 | 16.97% | -43,003 |
| (a) Net Domestic Credit | -54,608 | -85,849 | 57.2% | -31,241 | -94,061 | 9.56% | -8,211 |
| Net Credit to Nonfinancial Public Sector | -101,228 | -134,258 | 32.6% | -33,030 | -141,932 | 5.72% | -7,674 |
| Net Credit to Central Government | -101,323 | -134,353 | 32.6% | -33,030 | -142,026 | 5.71% | -7,674 |
| Credit to Central Government | 19,457 | 10,918 | -43.9% | -8,539 | 7,185 | -34.19% | -3,733 |
| Liabilities to Central Government | 120,780 | 145,271 | 20.3% | 24,491 | 149,211 | 2.71% | 3,941 |
| Net Credit to State & Local Government | 0.000 | 0.000 | 0.0% | 0 | 0.000 | 0.00% | 0 |
| Net Credit to Public Nonfinancial Corporations | 94 | 94 | 0.0% | 0 | 94 | 0.00% | 0 |
| Credit to Private Sector | 47,771 | 49,506 | 3.6% | 1,736 | 48,434 | -2.17% | -1,072 |
| Net Credit to Other Financial Corporations | -1,150 | -1,098 | -4.6% | 53 | -563 | -48.70% | 535 |
| (b) Capital Accounts | 151,725 | 191,747 | 26.4% | 40,023 | 223,770 | 16.70% | 32,023 |
| (c)Other Items Net | 26,500 | 24,192 | -8.7% | -2,308 | 21,423 | -11.44% | -2,769 |
| **3- Broad Money(M2)** | 450,437.225 | 466,660.094 | 3.6% | 16,223 | 486,875.50 | 4.33% | 20,215 |
| Narrow Money(M1) | 412,843 | 430,049 | 4% | 17,206 | 452,788 | 5% | 22,739 |
| CiC (Currency outside depository corporations) | 213,170 | 215,703 | 1.2% | 2,533 | 236,691 | 9.73% | 20,988 |
| Demand Deposits | 199,673 | 214,346 | 7.3% | 14,673 | 216,097 | 0.82% | 1,751 |
| Other Deposits (Quasi Money) | 37,594.353 | 36,611.395 | -2.6% | -983 | 34,087.565 | -6.89% | -2,524 |
| In Afghani | 15,323 | 12,308 | -19.7% | -3,015 | 9,233 | -24.98% | -3,075 |
| In Foreign currency | 22,271 | 24,304 | 9.1% | 2,032 | 24,855 | 2.27% | 551 |
| Securities Other Than Shares | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |

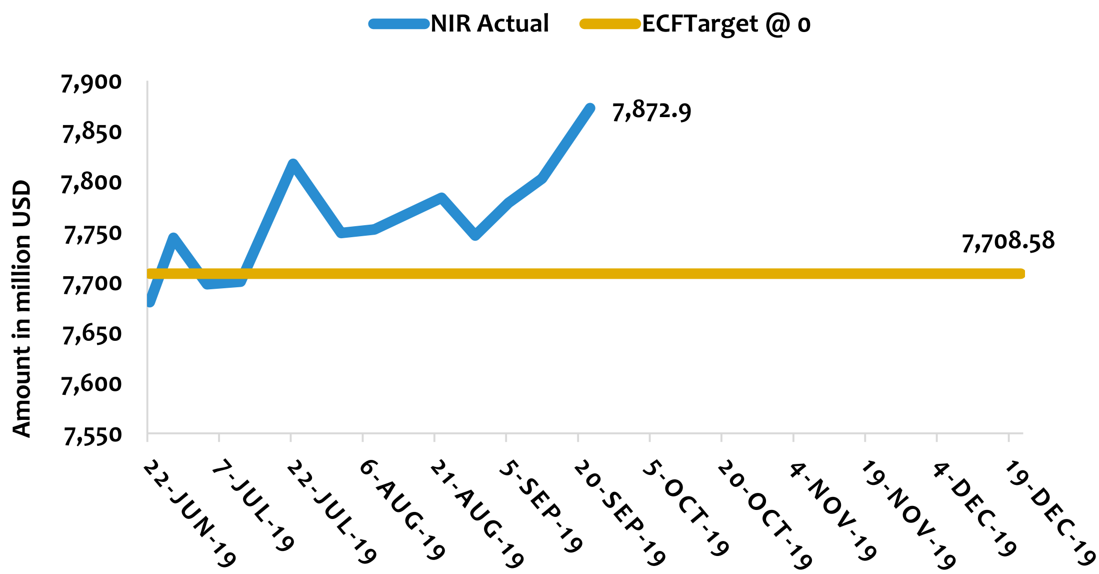
**Source:** Monetary Policy Department/DAB

## 2.3. 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, as well as major foreign exchanges such as US dollars, Euro, Great British Pound. The Net International Reserves (NIR) of Afghanistan, which expressed in terms of US dollar, is defined as reserve assets minus reserve liabilities.

NIR increased slightly by 1.66% showing accumulation of USD 128.8 million at the end of the third quarter of FY 2019. NIR accumulation ceiling was set at USD 7,708.58 million, while in actual, it reached to USD 7,872.9 million for the period under review. Figure 2.5 illustrates actual and target trend of NIR during the period under.

**Figure 2.5:** Actual and target NIR during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/ DAB

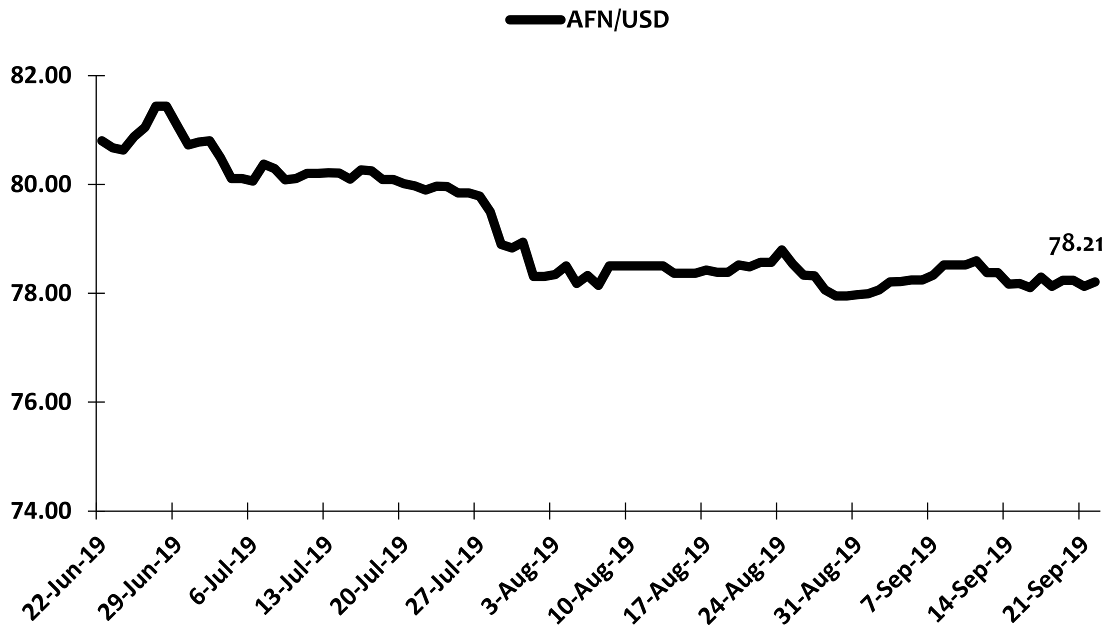
## 2.4. FROEIGN EXCHANGE MARKET

### 2.4.1. Foreign 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 via the open market operations, effectively with sound policy implementation. During the third quarter of FY 2019, Afghani relatively appreciated against the Great British pound, Euro, Swiss Franc, United States Dollar, United Arab Emirates Dirham, Pakistani Rupee, Saudi Riyal and Indian Rupee, while it depreciated against Iranian Toman.

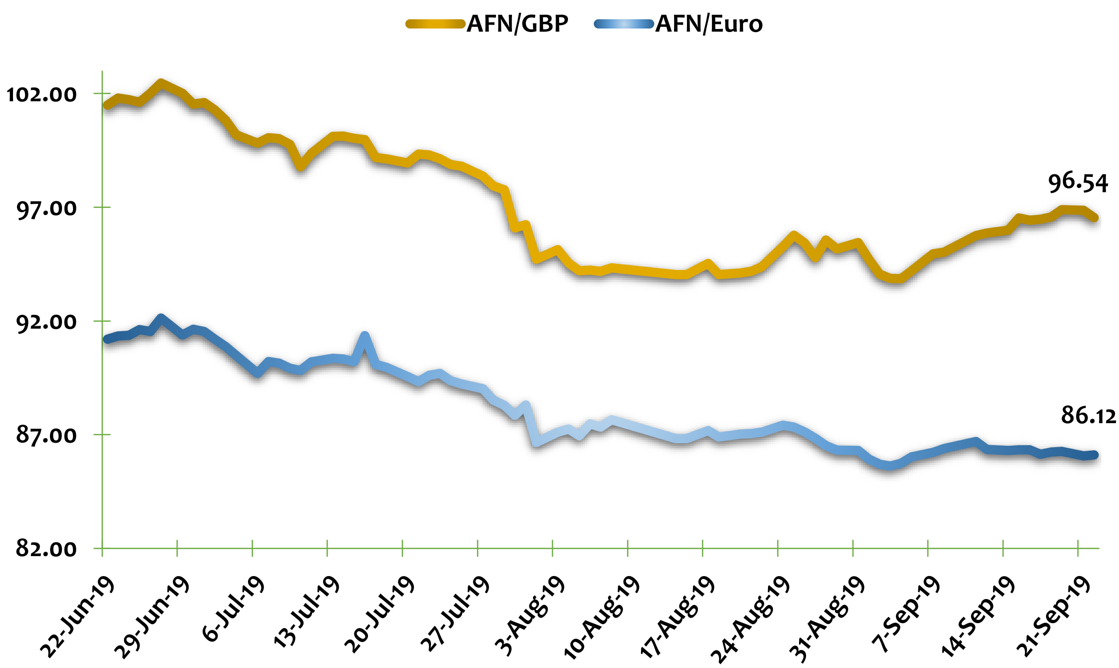
The daily historic review of the average exchange rate of Afghani against the US dollars and other foreign currencies in the third quarter of FY 2019 are shown in figures below:

**Figure 2.6:** Daily average ex- rate of Afghani against USD during the 3rd Quarter of FY 2019



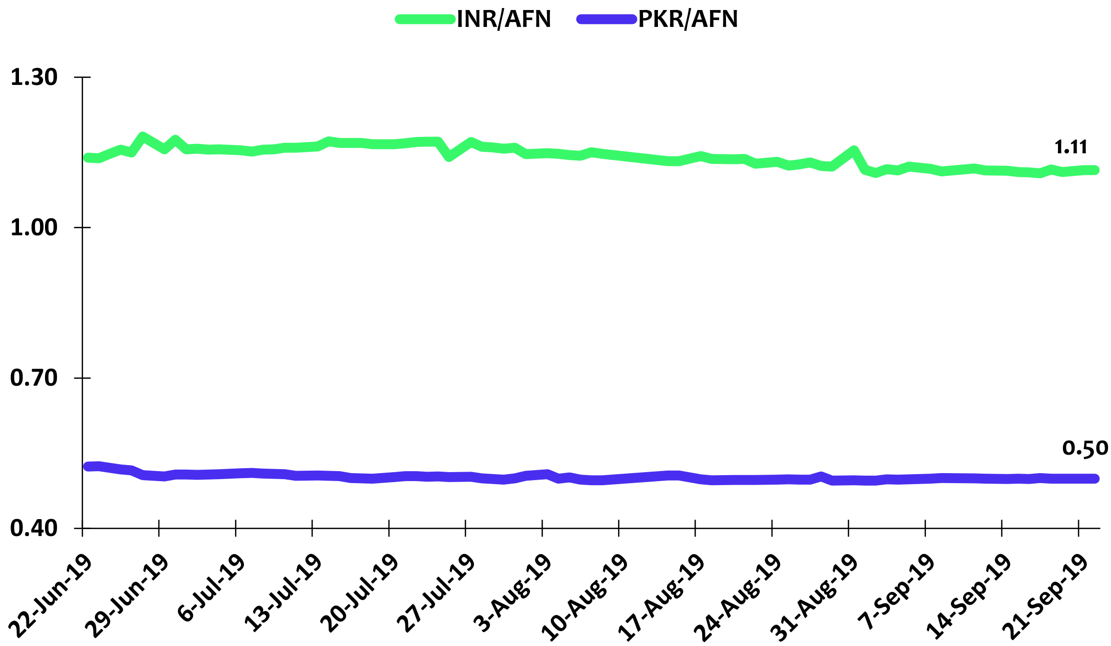

**Source:** Monetary Policy Department/ DAB

**Figure 2.7:** Daily average ex- rate of Afghani against GBP and Euro during the 3rd Quarter of FY 2019



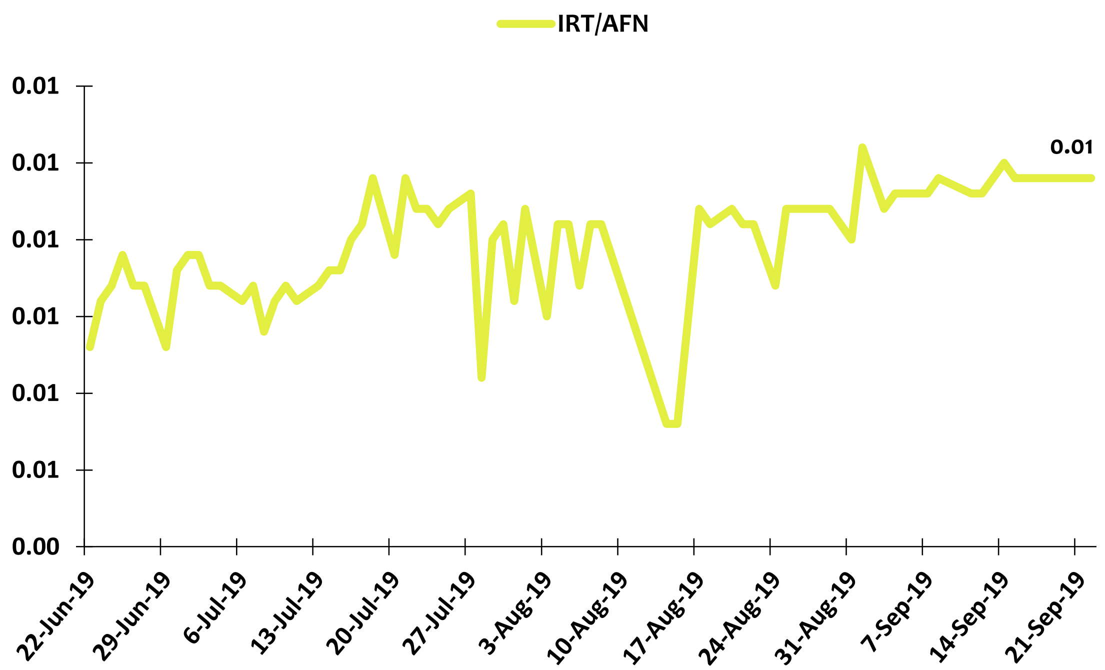

**Source:** Monetary Policy Department/ DAB

**Figure 2.8:** Daily avarage ex-rate of Afghani against INR and PKR during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DAB

**Figure 2.9:** Dailly average ex- rate of Afghani against IRT during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DAB

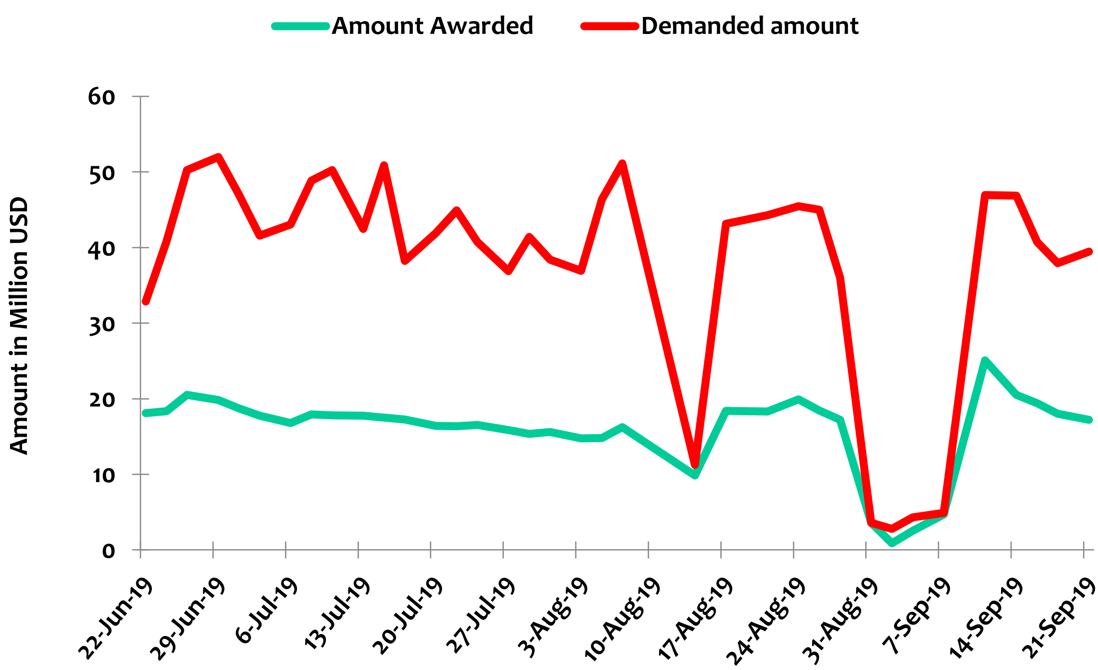
### 2.4.2. Foreign Exchange Auction

In order to control the money supply and maintain price stability in domestic market, DAB manages the reserve money growth by conducting Foreign Exchange (USD) auction three times a week and a weekly capital notes auction, 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 third quarter of FY 2019, DAB auctioned a total amount of USD 574.35 million, while the total demanded amount was USD 1,369.76 million. The main reason for higher demand for US Dollar was the AFN depreciation against US Dollar. On average, 52 bidders participated in each auction and 39 bids were announced as the winning bids with the average amount of USD 15.95 million sold in each auction and the total withdrawal is recorded AFN 45.534 billion.

The data from the beginning to the end of the third quarter of FY 2018 recorded a total auctioned amount of USD 1,781.285 million, with a total demand of USD 4,176.96 million. On average, 56 bidders participated in each auction and 42 bids were awarded with an average amount of USD 16.49 million in each auction and the total withdrawal is recorded AFN 1,38436.42 billion. Figure 2.10, shows the total amount of USD awarded and demanded through auctions in the third quarter of FY 2019.

**Figure 2.10:** US Dollar awarded and demanded amount during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/DA

## 2.5. CAPITAL MARKET &LIQUIDITY CONDITIONS

### 2.5.1. Capital Notes Auction

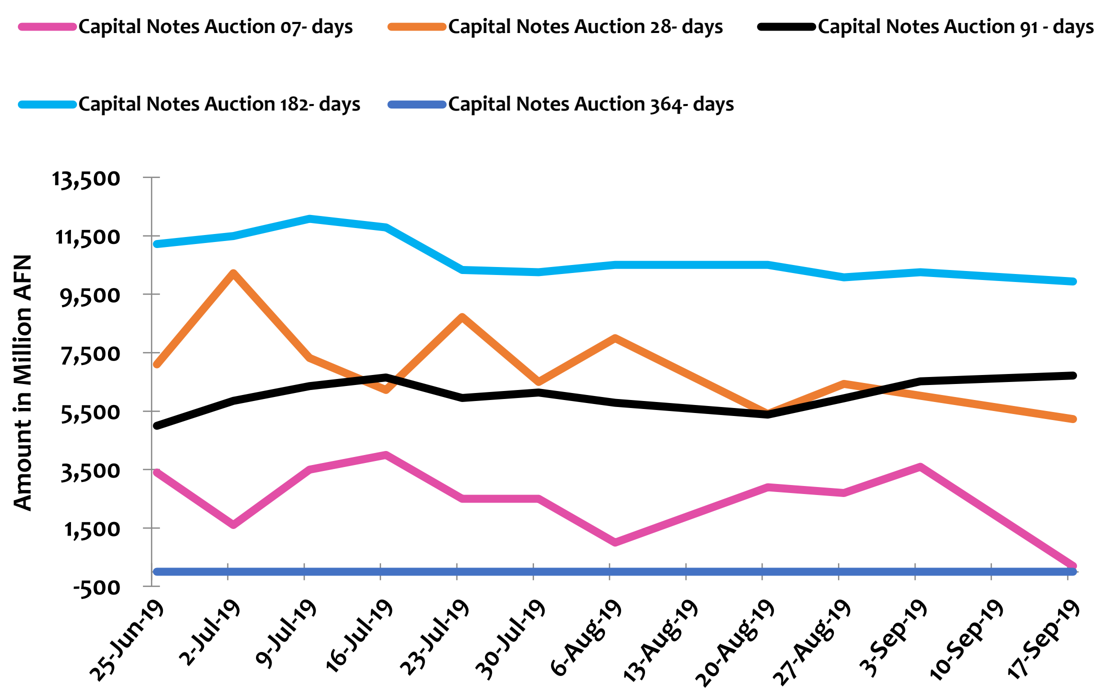
Capital notes are Afghani denominated short–term securities offered on weekly basis by DAB to primary market customers, which are licensed commercial banks. Da Afghanistan Bank uses Capital Notes (CNs) as a monetary tool to manage the money supply growth. Capital notes are used to absorb the excess liquidity 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 AFN 23.92 billion at the end of the third quarter, FY 2019, which is decreased by AFN 15.595 billion compared to AFN 39.515 billion at the end of the third quarter of FY 2018. This decrease was due to less CNs sales affected by the low interest rate offered.

During the first quarter of FY 2019, outstanding stock of 7-days, 28-days, 91-days, and 182-days capital notes stood at AFN 0.2 billion, 8.05 billion, 6.02 billion, and 9.65 billion respectively. As no auction took place for the 364-days CNs, so no outstanding amount is recorded for the concerned period. Total interest paid for CNs figured out to AFN 91.82 million till the end of the quarter under review.

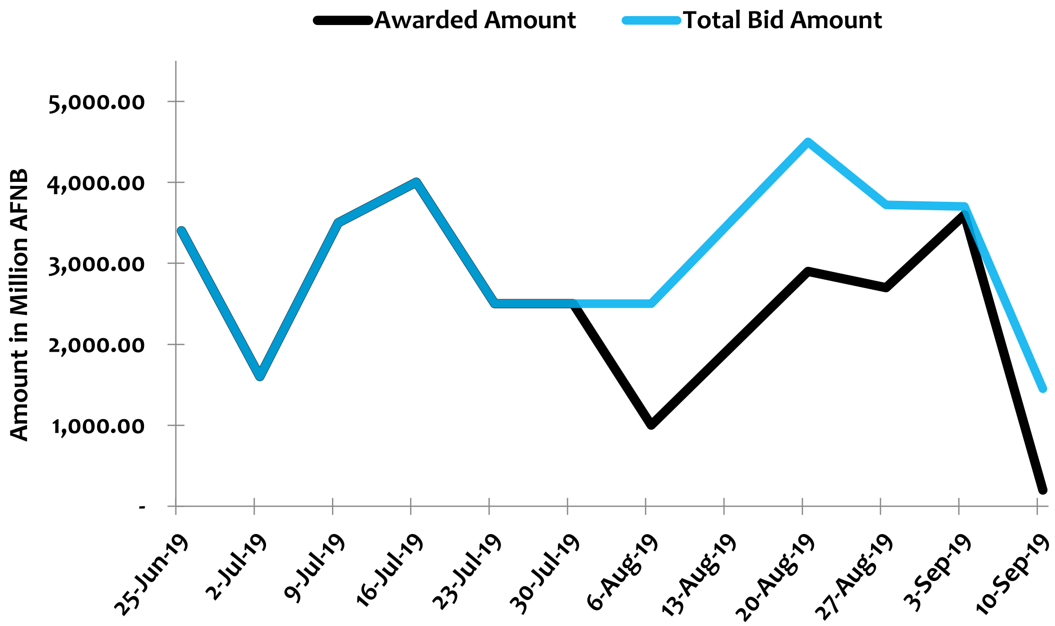
In addition, the weighted average interest rate for 7-days capital notes was 0.19%, for 28-days CNs 0.70%, for 91-days CNs 0.80%, for 182-days CNs 0.95%.

**Figure 2.11:** Stock of outstanding Capital Notes during the 3rd Quarter of FY 2019



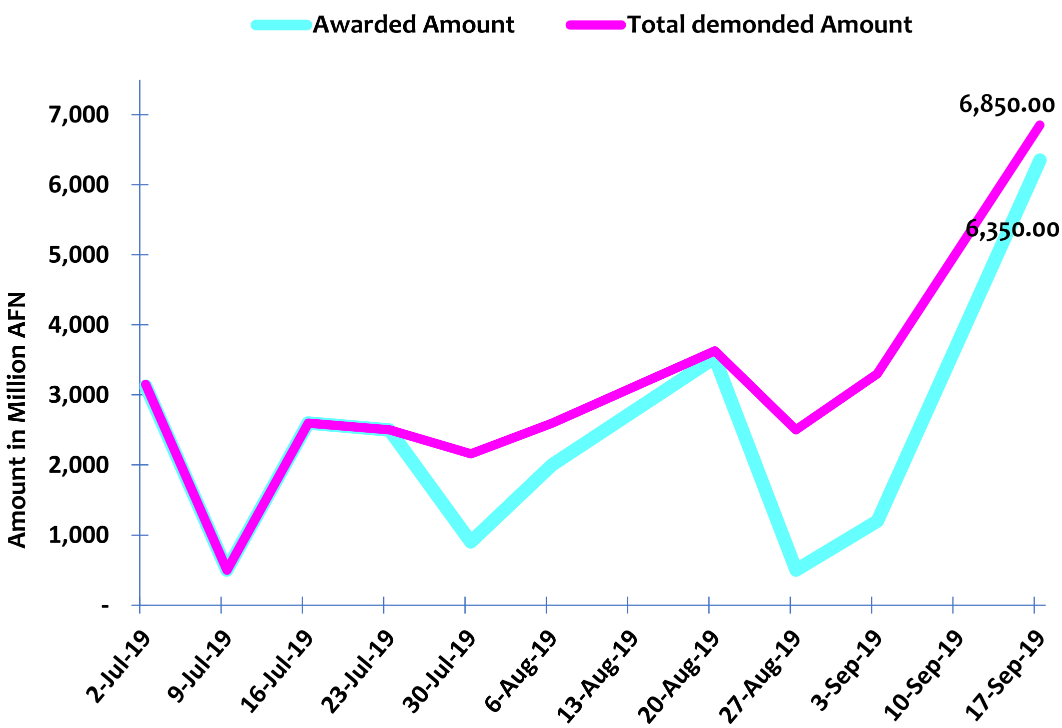

**Source:** Monetary Policy Department/ DAB

**Figure 2.12:** 7-days CNs demanded and awarded amount during the 3rd Quarter of FY 2019



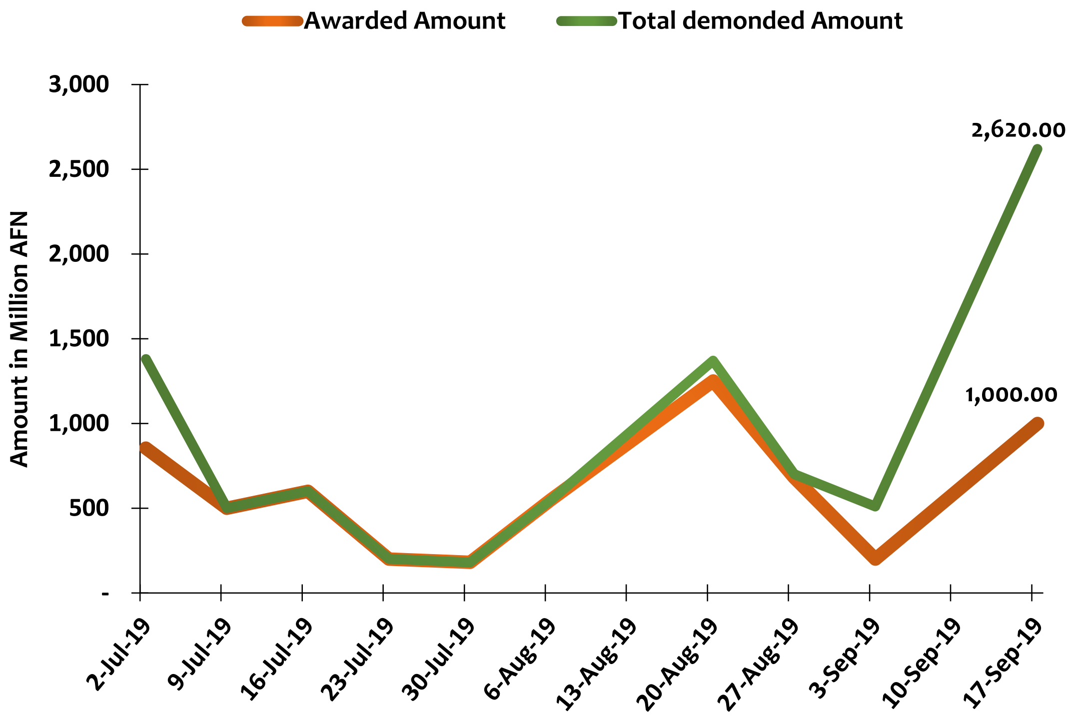

**Source:** Monetary Policy Department/ DAB

**Figure 2.13:** 28-days CNs demanded and awarded amount during the 3rd Quarter of FY 2019



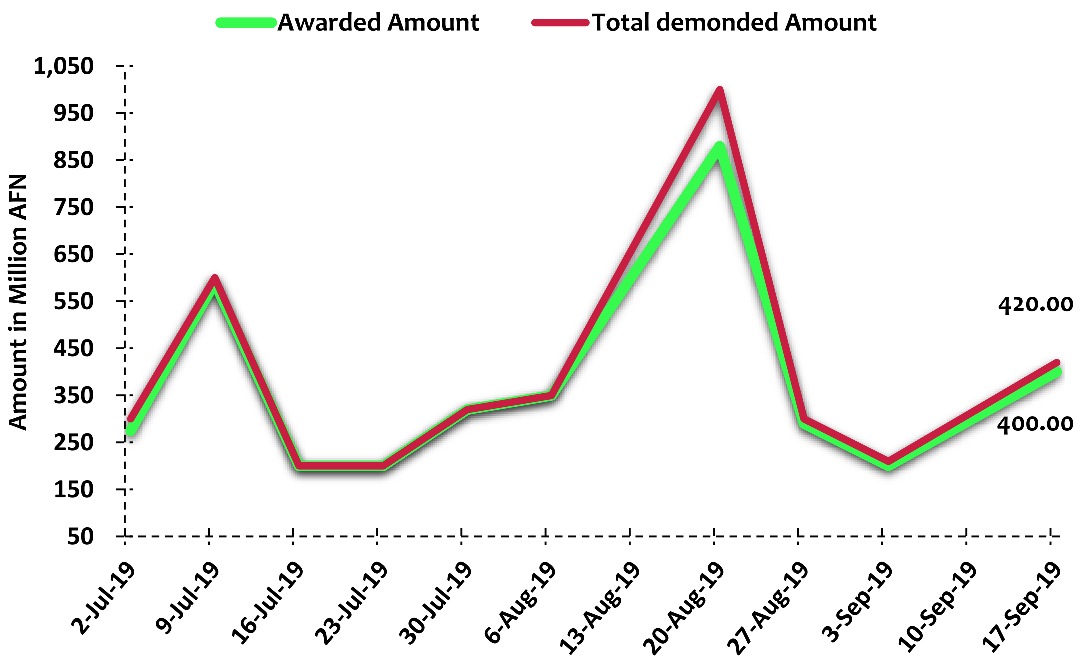

**Source:** Monetary Policy Department/ DAB

**Figure 2.14:** 91-days CNs demanded and awarded amount during the 3rd Quarter of FY 2019




Source: Monetary Policy Department/ DAB

**Figure 2.15:** 182-days CNs demanded and awarded amount during the 3rd Quarter of FY 2019




**Source:** Monetary Policy Department/ DAB

### 2.5.2. Required and Excess Reserves

Commercial banks are required to hold 8% of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10% 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 to be maintained in domestic currency. No interest is given for such deposits to commercial banks. It shows AFN 5,702.46 million, USD 209.561 million and Euro 17.689 million during the third quarter of FY 2019.

#### Overnight Deposit Facility (ODF)

This facility is available to all commercial banks to gain interest on their excess balances. The interest rate on the overnight deposit facility is 10 basis points approved by DAB's Supreme Council based on a circular to all banks, on September 11, 2017. The outstanding amount of overnight deposit facility recorded AFN 11,891.47 million at the end of the third quarter of FY 2019 and the payment of interest rate to the mentioned facility reached to AFN 6.539 million for the period under review.

#### 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 at which the commercial banks are charged for this facility is 10 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 used from this facility.

# 3 Inflation Trend and Outlook

# 3

# INFLATION TREND AND OUTLOOK

## 3.1. GLOBAL COMMODITY REVIEW

### 3.1.1. Executive Summary

Global commodity prices, almost all major commodity price indexes fell in the third quarter of FY 2019, Leading by energy prices (declined by more than 8% on q/q basis). Commodity demand affected by weakness in global trade, manufacturing, output growth, and trade tension. Price forecast for most items revised and reduced according to subdued global growth prospects.

Forecast for prices of crude oil on average was $60/bbl for FY 2019, and $58/bbl for FY 2020, which showed sharp downward revision since April 2019. Non-energy prices were forecasted to fall in FY 2019, and to be stabilized later in FY 2020.

### 3.1.2. Recent Trends

Prices of almost 60% of commodities fell in the third quarter of 2019 amid mounting concerns about slowing global growth. This was a marked turnaround relative to the April 2019 Commodity Markets Outlook report, according to which a series of commodity specific supply shocks were supposed to boost prices of many commodities, including oil.

The current deteriorating macroeconomic environment, including a sharp slowdown in manufacturing and goods trade, has weighed heavily on commodity demand. Energy prices fell more than 8% (q/q) in the third quarter, with similar declines across all three energy commodities. Crude oil prices averaged to $60/bbl in the third quarter, 8% weaker than in the previous quarter. The fall in prices occurred despite an attack on Saudi Arabia's oil infrastructure, which triggered the largest one-day price rise in Brent crude oil since 1988 (the year when Brent crude futures began trading on futures exchanges).

The spike unwound rapidly as market participants concluded that the impact would not be long-lasting. Also, on the supply side, growth in the United States has been much weaker than the record pace of 2018, and OPEC and its partners have agreed to continue with their production cuts. While oil production growth has slowed, the weakness in demand has been more severe.

Demand growth expectations have been repeatedly revised downward and are now around 1%, or 1 million barrels per day, the weakest growth rate since 2012. Price index of coal natural gas, and oil fell in the third quarter of 2019.

Trade tensions and weakness in global trade, manufacturing, and output growth are weighing on commodity demand. In line with subdued global growth prospects, most price forecasts have been revised downward.

Crude oil prices are forecasted to average $60/bbl in 2019 and $58/bbl in 2020, a sharp downward revision since April 2019. Amid heightened risks of a sharper-than-expected global downturn, the likelihood of a further slowdown in oil demand,

and therefore lower oil prices, has risen. Non-energy prices are projected to fall in 2019 before stabilizing in 2020, although metals prices are forecasted to be lower next year. A Special Focus examines the role of innovation and substitution in commodity consumption.

It shows that, historically, demand surges have been accompanied by investment and innovation, in turn causing substitution both within commodity groups (for example, from coal to natural gas for energy) and across commodity groups (such as between paper, metal, and plastic in packaging). Most non-energy prices fell in the third quarter of 2019.

Base metals and mineral prices fell 2%, largely reflecting concerns about demand and trade tensions. Iron ore prices fell sharply as supply bottlenecks resulting from the Vale dam accident in Brazil eased. Nickel prices, as an exception to the broader base metals price weakness, surged after Indonesia (the world's largest nickel ore producer) announced a ban on nickel exports from the start of 2020. Precious metal prices surged in response to trade tensions and monetary policy loosening in advanced economies.

Most agricultural commodity prices fell in the third quarter, as production expectations were revised upward and global stocks of key grains, notably rice and wheat, remained at multiyear highs. An exception was soybeans, whose prices rose on news that China had restarted purchasing U.S. crops, as a result of trade tensions, China had switched soybean purchases from the United States to alternative suppliers, and also to substitute commodities.

## 3.2. 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 National Statistics and Information Authority (NSIA) and analysis of Da Afghanistan Bank (DAB), the following results were observed in the consumer price index of Afghanistan.

The inflation measured on quarter-on-quarter basis, indicated a decline in the period under review. Observing the data, the average inflation rate decreased to 2.51% in the third quarter of 2019, lower than average rate of 4.18% in the second quarter of 2019. The decrease in the inflation rate is in line with lower prices of commodities in global markets. Based on the reports, most items of the global commodity price index indicated lower prices in the third quarter of 2019 compared to the second quarter.

The year-on-year measure of changes in the consumer price index showed an increase and reached to 2.51% on average in the third quarter of 2019 higher than 0.06% recorded in the third quarter of the previous year. The Kabul CPI (quarter-to-quarter) decreased, standing at 1.04% on average from 4.27% in the previous quarter of 2019. Observing the Kabul headline CPI, the inflation rate on year-over-year basis increased to 2.04% on average in the third quarter of 2019 from 0.60% in the same quarter of the previous year.

### 3.2.1. Developments in the National Headline Inflation (year-on-year changes)

The headline consumer price index increased year-on-year basis in the third quarter of 2019. As per the available data, the headline inflation measured on year-on-year basis, increased to 2.51% on average in the third quarter of 2019 from 0.06% in the same period of previews year. While on monthly basis, the inflation rate was recorded 2.7%, 2.9%, and 1.85% in the months of July, August, and September 2019 respectively.

In the food index, inflation increased to 4.71% on average in the third quarter of 2019 from -2.65% in the same quarter of the previous year. In the above mentioned index, the inflationary pressures came from higher prices of all food index. The highest increase in the index was recorded in the prices of spices, sugar and sweets which increased to 21.97% and 10.55% respectively from -15.58% and -6.50% in the same quarter of the previous year.

In non-food category, the inflation was decreased by lower prices of tobacco, housing, transportation, communication, education, and restaurant and hotels, while inflation raised in the prices of clothing, furnishing and household goods, health, information and culture, and miscellaneous. Overall inflation in non-food category declined to average 0.51% from 2.68% in the third quarter of FY 2019 compared to same quarter of previous year.

In the mentioned category, the highest decrease was noted in price index of transportation and housing, which decreased to -2.15% and -3.69% on average in the third quarter of FY 2019 from 9.40% and 2.10% recorded in the third quarter of FY 2018. On the other hand, price index of health, information and culture increased to 5.64% and 3.02% on average in the third quarter of FY 2019 from 0.48% and -0.57% respectively in the same period of previous year.

The core inflation showed upward slope in the third quarter of FY 2019 compared to the third quarter of FY 2018. The trimmed mean which is the most common measure of core inflation, jumped up to 2.86% on average in the third quarter of FY 2019 from 1.34% in the same quarter of the previous year. In addition, the CPI inflation excluding bread and cereals, oil and fats and transportation, increased to 4.32% in the third quarter of FY 2019 from -0.91% in the same period of the previous year.

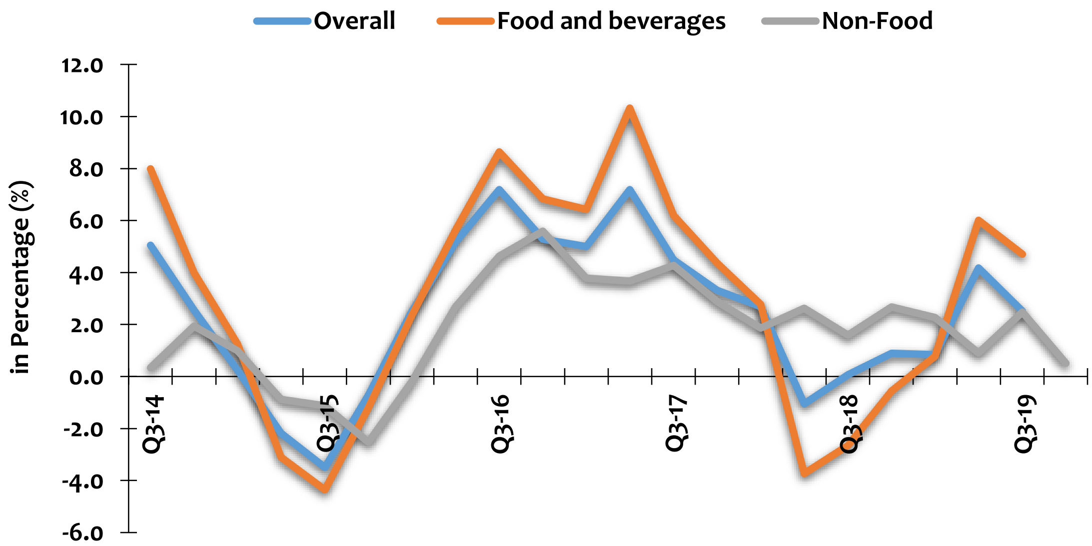
### 3.2.2. Developments in the National Headline Inflation (Quarter on Quarter Changes)

The short term measure of inflation reflected opposite trend compared to the year-on-year. The national headline inflation on quarter-on-quarter basis decreased to 2.51% on average in the third quarter of FY 2019 from 4.18% recorded in the previous quarter. This decrease was the result of price decrease in both, food and non-food items.

Food inflation declined to 4.71% in the third quarter from 6.00% in the previous quarter. This is in line with lower prices of bread and cereals, milk cheese and eggs, fresh and dried foods, vegetables, and non-alcoholic beverages items. In the meantime, the non-food category also showed lower rates in third quarter of FY 2019 compared to the second quarter of the same year. The price indices of food items such as meat, oil and fats, sugar and sweets, and spices items were among the index which their price were increased in third quarter of FY 2019 compare to the second quarter of 2019. However, in this category, the largest quarterly decrease was recorded in fresh and dried fruits, vegetables, and bread and cereals prices indices which were recorded 3.35%, -1.05% and 6.15% down from 10.2%, 4.2%, 9.43% respectively. On the other hand, the non-food inflation also decreased in the third quarter. According to the data, non-food inflation lessened to 0.51% on average in the third quarter of FY 2019 from 2.48% in the previous quarter of this year.

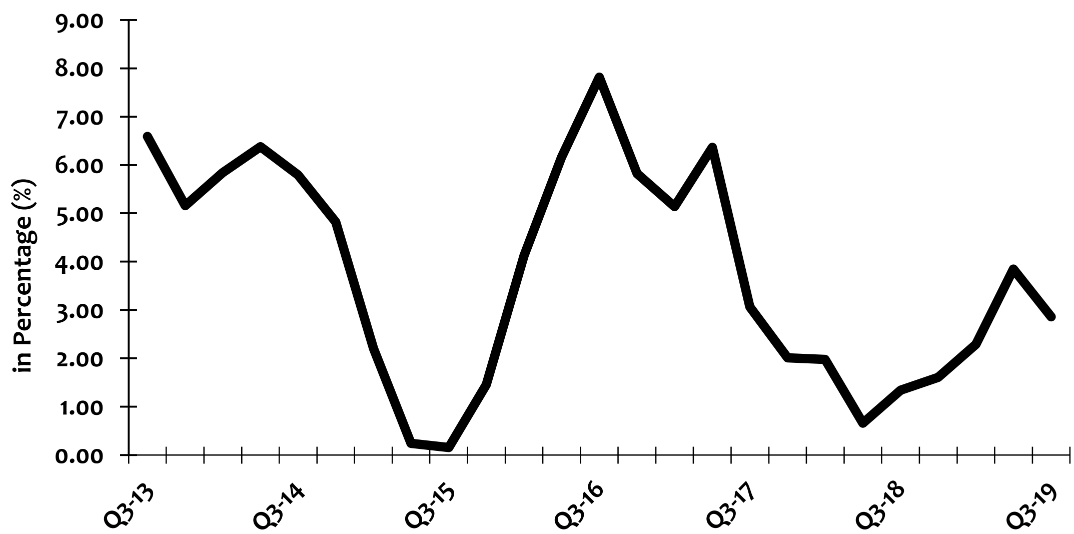
In this category, the prices of transportation and housing items decreased with big margins compared to the other non-food items. On the other hand, prices increased in some other sub items of non-food categories, such as health, education, and information and culture in third quarter of FY 2019 compare to the second quarter of 2019.

**Figure 3.1:** National CPI (Q-o-Q) for the 3rd Quarter of FY 2019




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

**Figure 3.2:** Trimmed mean (Q-o-Q) for the 3rd Quarter of FY 2019



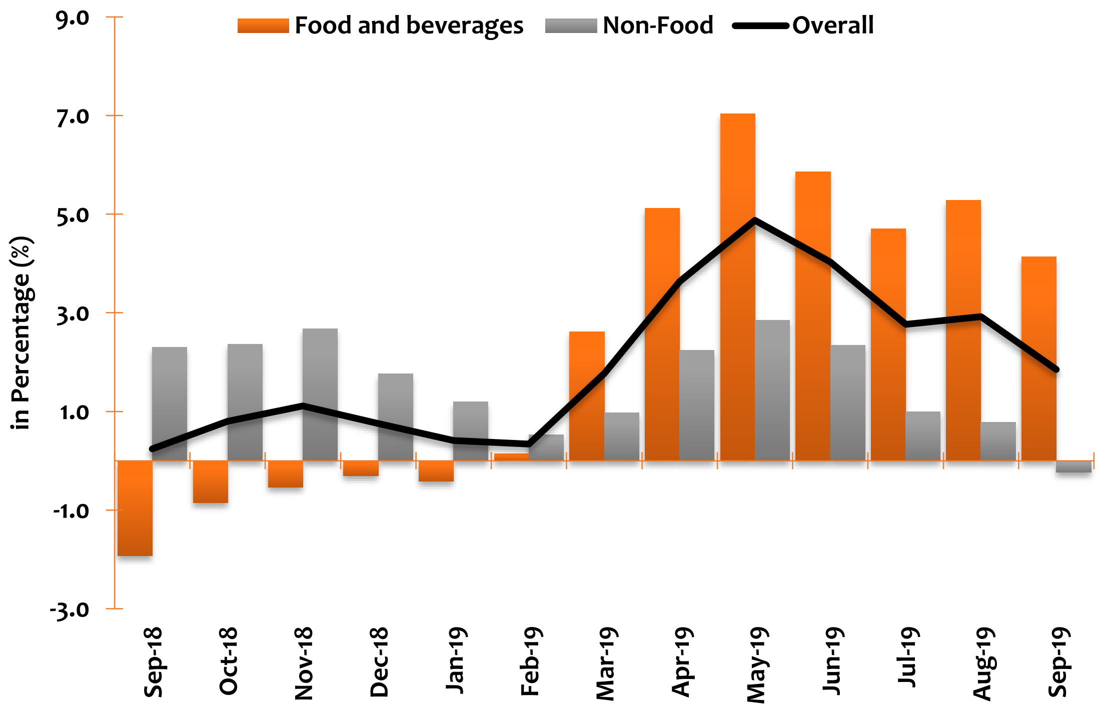

**Source:** NSIA/Monetary Policy Department, DAB staff calculation

**Table 3.1:** National Headline Inflation for the 3rd Quarter of FY 2019

| Period | 2018 | | | | | 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Based on April 2015 | | | | | | | | | | | | |
| | Weight | Jul-18 | Aug-18 | Sep-18 | Average (3 Months) | Apr-19 | May-19 | Jun-19 | Average (3 Months) | Jul-19 | Aug-19 | Sep-19 | Average (3 Months) |
| Overall Index | 100 | -0.14 | 0.09 | 0.24 | 0.06 | 3.63 | 4.88 | 4.03 | 4.18 | 2.77 | 2.92 | 1.85 | 2.51 |
| Food & Non-Alcoholic Beverages | 47.8 | -3.47 | -2.55 | -1.93 | -2.65 | 5.12 | 7.04 | 5.86 | 6.00 | 4.71 | 5.28 | 4.13 | 4.71 |
| Bread and Cereals | 14.6 | 0.59 | 0.99 | 3.28 | 1.62 | 8.19 | 9.94 | 10.16 | 9.43 | 8.33 | 6.05 | 4.08 | 6.15 |
| Meat | 7.5 | -0.81 | 0.10 | 1.10 | 0.13 | 1.43 | 4.92 | 5.53 | 3.96 | 6.68 | 9.23 | 8.79 | 8.23 |
| Milk, cheese and eggs | 4.7 | 0.94 | 1.05 | 1.04 | 1.01 | 3.06 | 2.61 | 2.28 | 2.65 | 2.11 | 0.95 | 0.27 | 1.11 |
| Oil and Fats | 4.6 | -1.60 | -2.16 | -2.16 | -1.97 | -4.32 | -3.28 | -2.87 | -3.49 | -1.94 | -2.70 | -0.91 | -1.85 |
| Fresh and dried fruits | 5.0 | 1.27 | 3.25 | -0.03 | 1.50 | 9.70 | 11.91 | 9.01 | 10.21 | 5.03 | 5.32 | -0.30 | 3.35 |
| Vegetables | 6.0 | -18.32 | -16.07 | -17.24 | -17.21 | 6.84 | 6.67 | -0.73 | 4.26 | -4.92 | 0.17 | 1.60 | -1.05 |
| Sugar and sweets | 2.7 | -8.33 | -7.58 | -3.58 | -6.50 | 3.11 | 7.35 | 7.36 | 5.94 | 8.32 | 13.05 | 10.28 | 10.55 |
| Spices | 1.3 | -17.20 | -15.69 | -13.87 | -15.58 | 11.15 | 22.64 | 19.93 | 17.91 | 19.27 | 23.03 | 23.59 | 21.97 |
| Non-alcoholic beverages | 1.4 | 2.00 | 2.62 | 2.22 | 2.28 | 5.45 | 5.65 | 5.51 | 5.54 | 4.42 | 4.22 | 4.28 | 4.31 |
| Non-Food Items, Tobacco & Services | 52.2 | 3.11 | 2.63 | 2.30 | 2.68 | 2.24 | 2.85 | 2.35 | 2.48 | 1.00 | 0.78 | -0.24 | 0.51 |
| Tobacco | 0.3 | 4.25 | 4.16 | 5.18 | 4.53 | 4.12 | 4.42 | 3.68 | 4.07 | 1.74 | 1.53 | 0.28 | 1.18 |
| Clothing | 4.6 | 3.29 | 3.63 | 3.81 | 3.58 | 4.78 | 5.93 | 5.17 | 5.29 | 5.44 | 6.30 | 5.36 | 5.70 |
| Housing | 19.1 | 3.45 | 2.08 | 0.76 | 2.10 | -0.21 | 0.00 | -0.37 | -0.19 | -2.83 | -3.25 | -5.00 | -3.69 |
| Furnishing and household goods | 11.9 | 2.12 | 2.21 | 2.80 | 2.38 | 4.37 | 4.89 | 4.62 | 4.63 | 3.61 | 3.47 | 2.97 | 3.35 |
| Health | 6.2 | 0.79 | 0.51 | 0.15 | 0.48 | 2.57 | 5.24 | 5.30 | 4.37 | 5.43 | 6.02 | 5.47 | 5.64 |
| Transportation | 4.3 | 9.18 | 9.36 | 9.67 | 9.40 | 5.68 | 4.30 | 2.91 | 4.29 | -0.33 | -2.27 | -3.86 | -2.15 |
| Communication | 1.7 | 0.17 | 0.17 | 0.45 | 0.26 | -3.32 | -2.73 | -4.58 | -3.54 | -5.10 | -5.84 | -6.63 | -5.86 |
| Information and Culture | 1.1 | -1.56 | -0.70 | 0.54 | -0.57 | 2.67 | 2.11 | 1.18 | 1.98 | 2.66 | 3.44 | 2.98 | 3.02 |
| Education | 0.4 | 8.50 | 5.63 | 4.47 | 6.20 | -4.50 | 0.21 | 0.29 | -1.34 | 0.45 | 3.07 | 1.84 | 1.79 |
| Restaurants and Hotels | 1.1 | 3.39 | 2.65 | 2.97 | 3.00 | 3.58 | 4.04 | 4.56 | 4.06 | 3.79 | 0.27 | 1.36 | 1.81 |
| Miscellaneous | 1.4 | 3.22 | 3.19 | 2.72 | 3.04 | 2.15 | 3.97 | 1.59 | 2.57 | 2.95 | 4.06 | 6.15 | 4.39 |
| CPI ex. B & C, O & F, and T | | -0.68 | -0.43 | -0.68 | -0.59 | 3.17 | 4.48 | 3.39 | 3.68 | 2.20 | 2.98 | 1.93 | 2.37 |
| 30% trimmed mean | | 1.23 | 1.40 | 1.40 | 1.34 | 3.54 | 4.45 | 3.54 | 3.85 | 3.00 | 3.04 | 2.53 | 2.86 |

**Source:** NSIA/Monetary Policy Department, DAB staff calculation

**Figure 3.3:** National Headline Inflation (Y-o-Y) for the 3rd Quarter of FY 2019




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

### 3.2.3. Development in the Kabul Headline Inflation (year-on-year changes)

The headline CPI inflation in Kabul (year on year) basis has inclined to 2.04% on average in the third quarter of FY 2019 from 0.60% in the same quarter of the previous year. The food index, which is accounted for 37.2% of the overall weight of the CPI, reflected a higher rate of inflation rate in one-year period. In this category, the inflationary pressures came from higher prices of bread and cereals, meat, vegetables, sugar and sweets, spices and non-alcoholic beverages. As a result, the food inflation increased to 4.34% on average in third quarter of FY 2019 from -2.46% in the same quarter of FY 2018.

On the other hand, the inflation of non-food item which comprises 62.8% weight of the whole index, has decreased to 0.23% on average in the third quarter of FY 2019 from 3.0% in the same period of last year. The decrease is attributed to lower prices of tobacco, clothing, housing, transportation, education, and restaurants and hotels items. However, in this category, the inflation in tobacco decreased to 0.16% on average from 5.03%, clothing decreased to 3.52% on average from 4.89%, housing decreased to -4.94% on average from 2.75%, transportation stood at -1.34% on average from 6.27%, education decreased to 0.80% on average from 8.87% and restaurants and hotels decreased to 0.63% on average from 2.93% in the third quarter of FY 2019 compared to the third quarter of FY 2018.

On the other hand, the core inflation excluding bread & cereals, fats and oils and transportation increased in the period under review compared to the same period of the previous year. In the third quarter of FY 2019, the core inflation rate increased to 1.87% on average while the rate was recorded 0.30% in the third quarter of FY 2018. The 30% trimmed mean also reflected a higher rate of inflation and reached to 2.61% on average in the third quarter of FY 2019 compared to 1.65% in same quarter of FY 2018.

### 3.2.4. Development in the Kabul Headline Inflation (Quarter on Quarter Changes)

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 2.04% on average in the third quarter of FY 2019 from 4.27% recorded in the second quarter of FY 2019.

Inflation in the food index decreased to 4.34% on average from 7.16%. In this category, the prices of bread and cereals, milk, cheese and eggs, fresh and dried fruits, vegetables, spices, and non-alcoholic beverages decreased which led to disinflation during the period under review.

In this category, the highest decline was observed in the price index of fresh and dried fruit which dropped down to 1.17% on average in the third quarter of FY 2019 from 10.74% in the second quarter of FY 2019. On the other hand, few other food index items showed an increase on quarterly basis such as sugar and sweets, and meat which surged up to 14.85% from 10.53% and 6.52% on average to 4.92% respectively in the third quarter of FY 2019 compare to the previous quarter.

The Non-food category of the CPI also showed decrease in inflation rate during the third quarter of FY 2019 compared to the second quarter. Inflation in this category decreased to 0.23% on average in the third quarter compared to 2.45% in the previous quarter. The decrease in non-food inflation is driven by lower prices of non-food items such as tobacco, housing, furnishing and household goods, transportation, communication, restaurant and hotels. which the largest decrease was observed in the price of housing item which decreased to -4.94% on average in the third quarter of FY 2019 from -0.25% in the previous quarter.

## 3.3. AFGHANISTAN INFLATION OUTLOOK FOR THE END OF FY 2019

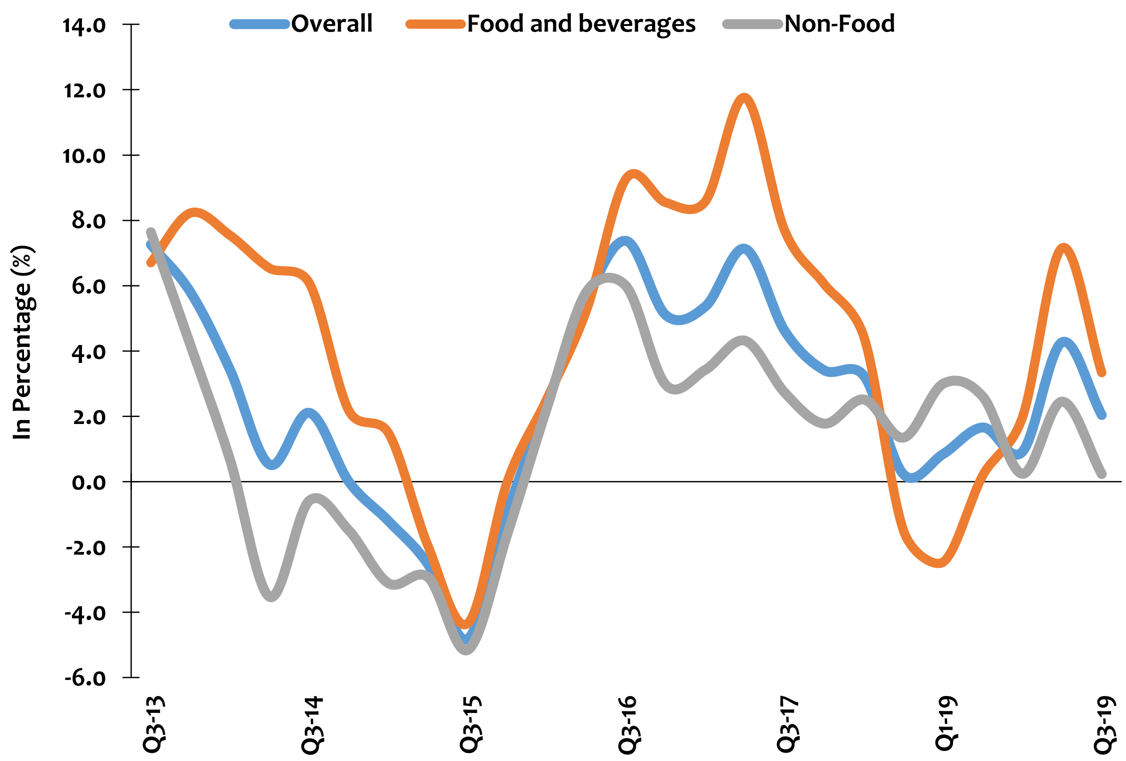
Based on third quarter FY 2019 statistic data, the near-term outlook of inflation is likely to remain balanced and slightly move upward gradually. Monetary policy of Da Afghanistan Bank forecasts inflation rate 2% to 4% for the end of FY 2019. The forecast is based on the following course of factors.

Looking at global commodity market almost all major commodity price indexes fell down in the third quarter of FY 2019 compared to the second quarter, led by energy, which declined more than 8% from second quarter to third quarter of FY 2019. Most of the commodity prices forecast have been revised down, this global commodity market almost is in line with Afghanistan third quarter report which shows most of the CPI items decreased from the previous quarter of FY 2019.

Based on the second quarter report, the average inflation rate was 4.18% and now the average inflation rate for the third quarter of FY 2019 is 2.5%, which shows decreased rate of 1.67%. There is possibility of a further slowdown in oil demand, which may affect the oil prices in near term outlook.

Since Afghanistan is an import oriented country and imports are at a greater quantity from neighboring countries, national inflation rate is often influenced by imported inflation of Iran, Pakistan, China, Turkey and other regional countries. There are so many other factors which may affect inflation rate in Afghanistan, but most importantly, national inflation is correlated with inflation in the country's trade partner's as well as the Afghani exchange rate against the US dollar.

**Figure 3.4:** Kabul CPI (Q-o-Q) for the 3rd Quarter of FY 2019




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

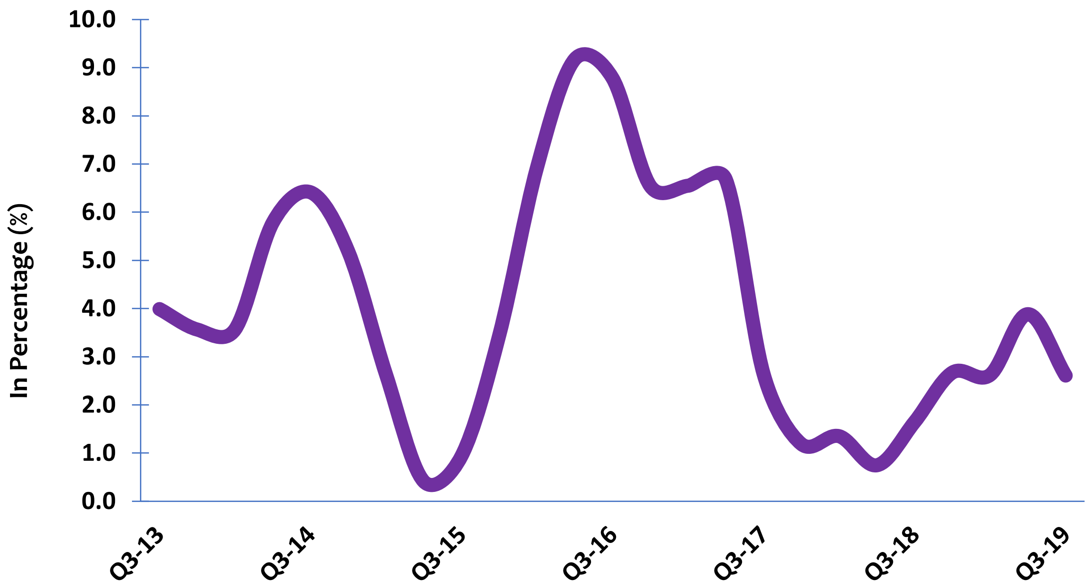
According to Pakistan Bureau of Statistic, annual inflation rate in this country dropped to 11.08% in October 2019 from 12.55% in the previous month. Inflation Rate in Pakistan is expected to be 12.50% by the end of FY 2019. If we look into the turkey annual inflation, the rate dropped to 8.55% in October 2019 from 9.26% in the previous month. It was the lowest rate since December 2016, mainly due to a slowdown in food and housing inflation.

According to economic analysts' expectations, inflation rate in Turkey is expected to be 11.50% by the end of fourth quarter. Also, the annual inflation rate in Iran declined to 28.3% in October 2019 from 35.0% in the previous month. This was the lowest inflation rate since August of the previous year, as prices increased softer for food & non-alcoholic beverages. Inflation Rate in Iran is expected to be 37.00% by the end of FY 2019.

Regional inflation forecast may have some effects on Afghanistan inflation rate. Looking into the Afghanistan trade partners' inflation report for the third quarter and their forecast for the fourth quarter of FY 2019. Inflation in most of the Afghanistan trade partners have been decreased for the third quarter, and their forecast are slightly higher for the fourth quarter compared to the third quarter of FY 2019 actual rate.

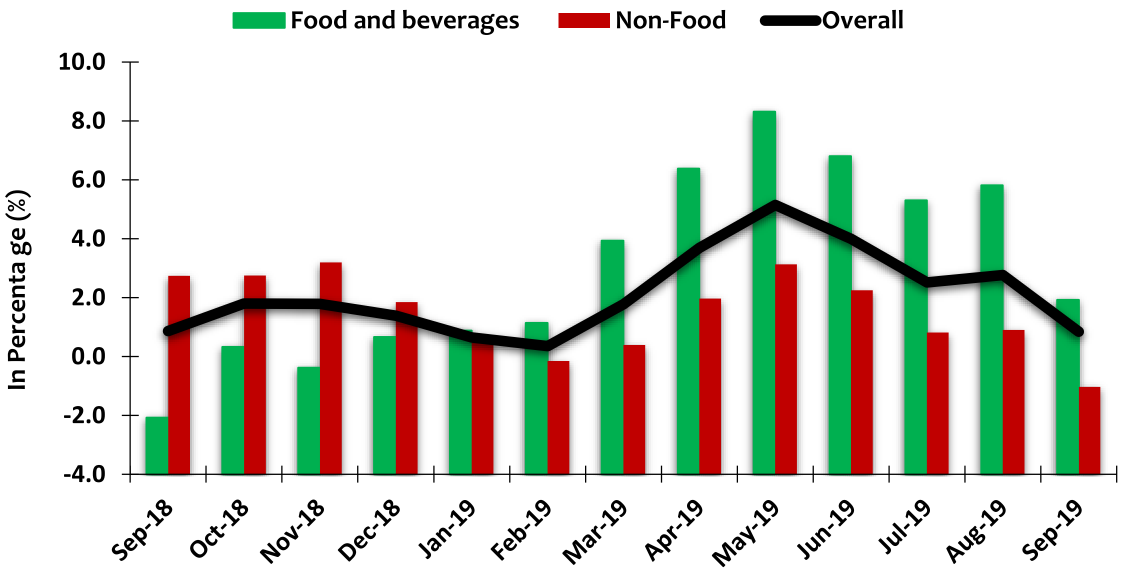
On the other hand, Afghani exchange rate trend against US dollar has been stable since the start of the second quarter of FY 2019, and the expectations for the upcoming months are optimistic. Supply shocks is another factor which can influence inflation forecast in Afghanistan, Negative supply shocks have many potential causes. It may increase the input costs which may lead to reduction of aggregate supply, that in turn may raise prices and reduce output. **One** of the concerns to be considered in Afghanistan is security situations that can create harden in transportation routes, which may lead to negative supply shocks. This may lay pressures on prices to scramble towards a new equilibrium level, which may disturb Da Afghanistan Bank inflation forecast figure for the end of FY 2019. It is also worth noting that political instability has effects on inflation forecast.

**Figure 3.5:** Kabul CPI 30% Trimmed Mean (Q-o-Q) for the 3rd Quarter of FY 2019




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

**Figure 3.6:** Kabul Headline Inflation for the 3rd Quarter of FY 2019




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

**Table 3.2:** Kabul Headline Inflation for the 3rd Quarter of FY 2019

| Period | 2018 | | | | | 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Based on Apr 2015 | | | | | | | | | | | | |
| | Weight | Jul - 18 | Aug - 18 | Sep - 18 | Average (3months) | Apr - 19 | May - 19 | Jun - 19 | Average (3months) | Jul - 19 | Aug - 19 | Sep - 19 | Average (3months) |
| Overall Index | 100 | 0.89 | 0.81 | 0.10 | 0.60 | 3.68 | 5.14 | 3.99 | 4.27 | 2.52 | 2.76 | 0.84 | 2.04 |
| Food & Non-Alcoholic Beverages | 37.2 | -2.92 | -2.40 | -2.08 | -2.46 | 6.38 | 8.31 | 6.80 | 7.16 | 5.31 | 5.81 | 1.92 | 4.34 |
| Bread and Cereals | 9.8 | 0.81 | 0.57 | 4.10 | 1.83 | 10.93 | 11.71 | 12.46 | 11.70 | 11.37 | 8.00 | 4.73 | 8.03 |
| Meat | 6.4 | -0.87 | 1.34 | 2.87 | 1.11 | 2.79 | 5.25 | 6.71 | 4.92 | 8.03 | 6.43 | 5.11 | 6.52 |
| Milk, cheese and eggs | 3.2 | 1.73 | 1.53 | 0.42 | 1.23 | 3.59 | 2.29 | 1.78 | 2.55 | 0.01 | -0.09 | -1.09 | -0.39 |
| Oils and fats | 3.6 | -3.13 | -2.54 | -1.10 | -2.26 | -5.91 | -6.05 | -6.13 | -6.03 | -5.23 | -6.33 | -2.78 | -4.78 |
| Fresh and dried fruits | 5.2 | 4.84 | 4.22 | -1.61 | 2.48 | 8.13 | 11.76 | 12.34 | 10.74 | 6.57 | 5.56 | -8.63 | 1.17 |
| Vegetables | 4.2 | -19.15 | -18.24 | -21.80 | -19.73 | 9.63 | 3.68 | -8.18 | 1.71 | -12.04 | -3.22 | -5.78 | -7.01 |
| Sugar and sweets | 2.8 | -6.83 | -5.39 | -0.48 | -4.23 | 5.06 | 13.22 | 13.30 | 10.53 | 11.66 | 19.09 | 13.80 | 14.85 |
| Spices | 1.0 | -14.06 | -16.75 | -15.30 | -15.37 | 21.27 | 48.57 | 23.08 | 30.97 | 24.66 | 32.32 | 28.09 | 28.36 |
| Non-alcoholic beverages | 0.9 | 2.14 | 1.92 | 2.23 | 2.09 | 5.34 | 6.29 | 4.49 | 5.37 | 4.49 | 4.37 | 0.37 | 3.08 |
| Non-Food Items, Tobacco & Services | 62.8 | 3.38 | 2.88 | 2.74 | 3.00 | 1.97 | 3.13 | 2.25 | 2.45 | 0.81 | 0.90 | -1.03 | 0.23 |
| Tobacco | 0.3 | 5.52 | 4.61 | 4.97 | 5.03 | 3.36 | 4.54 | 5.26 | 4.39 | -0.39 | 0.79 | 0.08 | 0.16 |
| Clothing | 4.8 | 4.31 | 4.71 | 5.65 | 4.89 | 2.14 | 3.15 | 2.05 | 2.45 | 4.30 | 5.20 | 1.08 | 3.52 |
| Housing | 23.5 | 4.21 | 2.77 | 1.27 | 2.75 | -0.76 | 0.42 | -0.41 | -0.25 | -4.15 | -4.16 | -6.49 | -4.94 |
| Furnishing and household goods | 17.6 | 2.06 | 2.32 | 3.34 | 2.57 | 4.84 | 5.47 | 4.88 | 5.06 | 3.45 | 3.10 | 1.99 | 2.85 |
| Health | 5.3 | 3.26 | 2.34 | 1.26 | 2.29 | 1.87 | 8.32 | 8.12 | 6.11 | 8.92 | 10.16 | 7.12 | 8.74 |
| Transportation | 4.6 | 6.07 | 5.90 | 6.83 | 6.27 | 5.06 | 2.88 | 1.53 | 3.16 | 0.03 | -0.82 | -3.23 | -1.34 |
| Communication | 2.0 | 0.17 | 0.15 | 0.81 | 0.37 | -0.73 | 0.67 | -1.61 | -0.55 | -0.47 | 0.27 | -1.62 | -0.60 |
| Information and Culture | 1.7 | -3.27 | -2.32 | -0.04 | -1.88 | 1.67 | 0.86 | -0.82 | 0.57 | 1.96 | 4.22 | 3.66 | 3.28 |
| Education | 0.7 | 11.83 | 8.18 | 6.61 | 8.87 | -7.16 | -0.99 | -0.63 | -2.93 | -0.17 | 2.42 | 0.16 | 0.80 |
| Restaurants and Hotels | 1.0 | 2.37 | 2.37 | 4.06 | 2.93 | 1.72 | 1.27 | 1.27 | 1.42 | 2.77 | -2.39 | 1.51 | 0.63 |
| Miscellaneous | 1.3 | 2.19 | 3.06 | 2.27 | 2.50 | 6.70 | 6.48 | 2.07 | 5.08 | 7.23 | 8.68 | 11.35 | 9.09 |
| CPI ex. B & C, O & F, and T | | 0.81 | 0.72 | -0.63 | 0.30 | 3.25 | 5.04 | 3.65 | 3.98 | 2.03 | 2.78 | 0.79 | 1.87 |
| 30% trimmed mean | | 1.49 | 1.60 | 1.86 | 1.65 | 3.68 | 4.49 | 3.48 | 3.88 | 3.34 | 3.27 | 1.22 | 2.61 |

**Source:** NSIA/Monetary Policy Department, DAB staff calculation

# 4 External Sector Developments

# 4

# EXTERNAL SECTOR DEVELOPMEN

## 4.1. SUMMARY

The performance of the Afghanistan's external sector for the third quarter of the FY 2019 in comparison with the third quarter of the FY 2018 is presented in this report, continued to be weak as a result of poor domestic and external conditions.

The available data reveals that the performance of the external sector witnessed severe pressure as the current account position posted 20% increase in deficit, which caused mainly from 20% decrease in earnings of merchandize trade in goods, 26% decrease in receipts on respect of services, and 49% decreased in net receipts of official grants to the government sector.

Inflow to the capital account decreased by 15% on account of capital transfers to the government sector. Net Foreign Direct Investment (FDI), inflows declined to USD -3.41 million and net Portfolio Investment outflows declined to USD -33.81 million during the third quarter of the FY 2019.

In view of the deterioration in current, capital and financial account, the BOP recorded a deficit of USD 569 million in the third quarter of the FY 2019 compared to the deficit of USD 680 million recorded in the third quarter of the FY 2018. 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.

## 4.2. BALANCE OF PAYMENTS

### 4.2.1. Current Account

Bas on quarter-over-quarter comparison the balance of payments (BOP's) current account deficit increased by almost 20% to a value of USD 995.81 million in the third quarter of the FY 2019 from a value of USD 824.67 million recorded in the third quarter of the FY 2018, (See table 4.1 and figure 4.1).

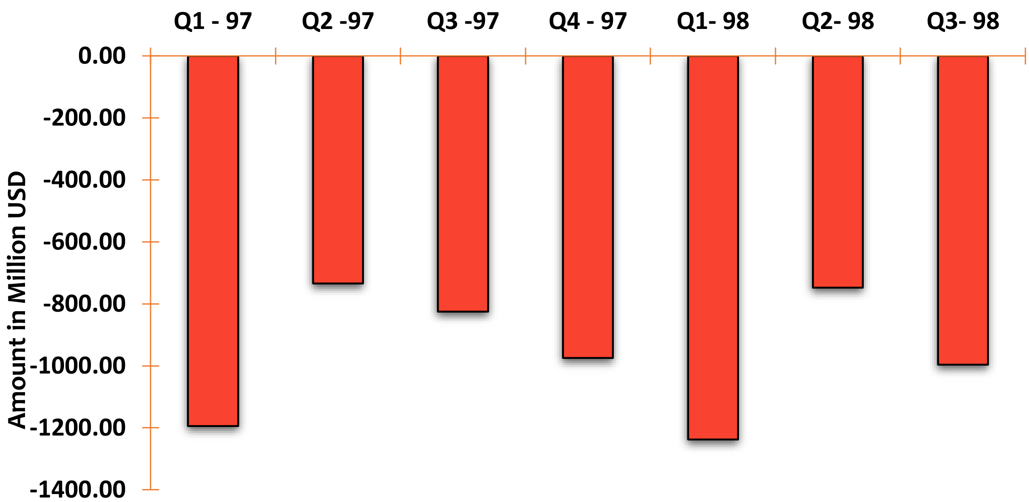
This development was mainly due to a decrease in earnings of merchandize trade in goods, as well as a decrease in receipts on respect of services, and official grants to the government sector during the quarter under review. The deficit of merchandise trade (goods account) slightly narrowed by almost 4 % to a value of USD 1,252.61 million in the third quarter of the FY 2019 from a value of USD 1,313.65 million recorded in the third quarter of the FY 2018.

While, in the deficit of the services account increased by 6% to a value of USD 186 million in the third quarter of the FY 2019 from a value of

USD 175.54 million recorded in the third quarter of the FY 2018. On the other hand, compensation of employees together with investment income inflows increased by 8.3% to a value of USD 68.57 million in the third quarter of the FY 2019 from a value of USD 63.34 million recorded in the similar quarter of the previews year.

Official grants to the government sector and worker personal home remittances from foreign countries declined by 37.7% to a value of USD 374.29 million in the third quarter of the FY 2019 from a value of USD 601.18 million when compared with the same quarter of the FY 2018.

**Figure 4.1:** Current account balance for the 3rd Quarter of FY 2019 (1398)




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

#### 4.2.2. Capital Account

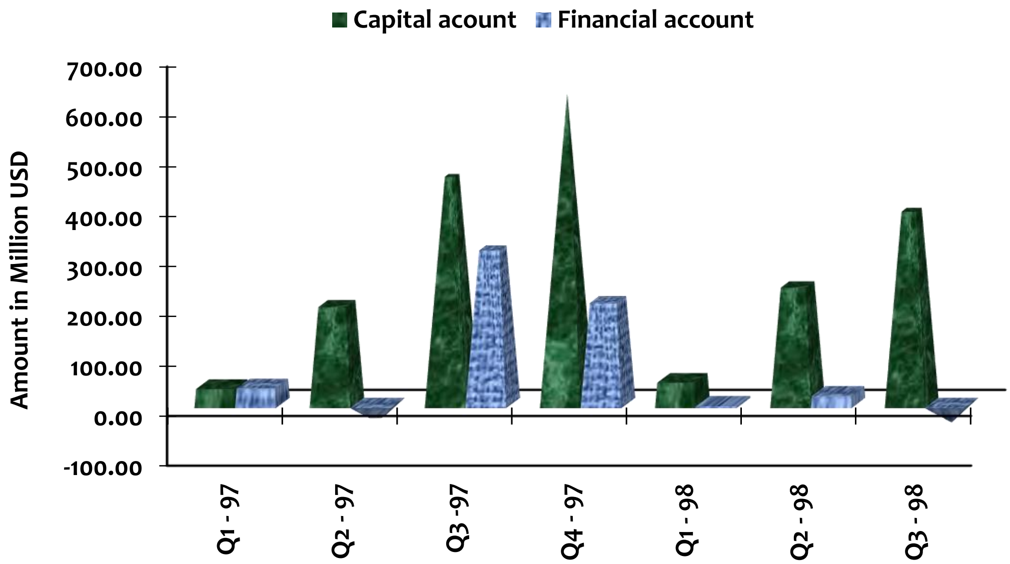
Inflow to the capital account of the balance of payments decreased by 15% to a value of USD 387.50 million in the third quarter of the FY 2019 from a value of USD 456.33 million recorded in the third quarter of the FY 2018 as a result of lower inward of capital transfers to the government sector, corporations and households.

#### 4.2.3. Financial account

Under financial account of the Balance of Payments (BOPs), foreign investment is an important component which consists of foreign direct investment (FDI), foreign portfolio investment (FPI) and Other Investments. Net FDI inflows to the country decreased to a value of USD -3.41 million in the third quarter of the FY 2019 from a value of USD 6.22 million recorded in the third quarter of the FY 2018.
Whiles, net portfolio investment depicted an outflow of USD -33.81 million in the third quarter of the FY 2019 as against an outflow of USD 107.0 million in the corresponding quarter of the last year. Further

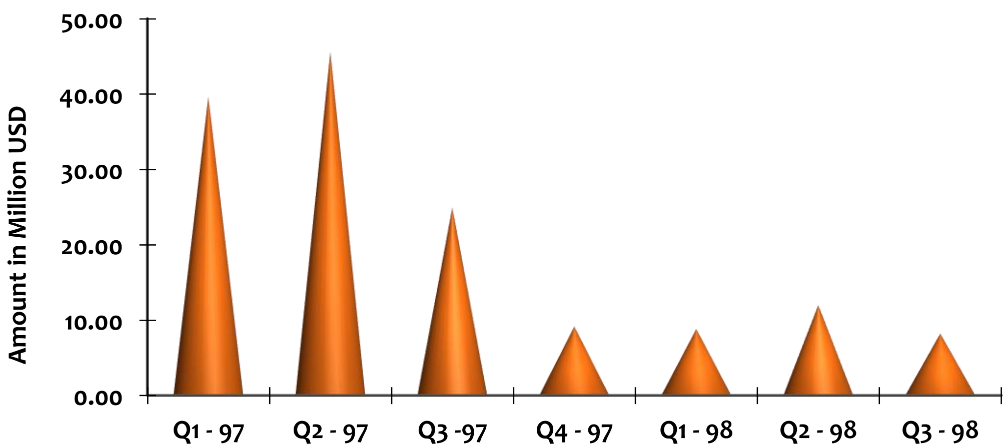
analysis reveals that the country's other aggregate financial assets abroad decreased to a value of USD -105.68 million in the third quarter of the FY 2019 from a value of USD 59.45 million that was recorded in the corresponding quarter of the FY 2018 (See table 4.1 and figures 4.2, and 4.3).

**Figure 4.2:** Capital and Financial Account for the 3rd Quarter of FY 2019 (1398)




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

**Figure 4.3:** FDI inflows for the 3rd Quarter of FY 2019 (1398)




**Source:** NSIA/Monetary Policy Department, DAB staff calculation

While other aggregate financial liabilities, increased to a value of USD 52.78 million in the third quarter of the FY 2019 from a value of USD -25.79 million recorded in the same quarter of the previews year.

The financial account balance as a total recorded USD -39.23 million in the third quarter of the FY 2019 as against USD 311.3 million recorded in the third quarter of the FY 2018.

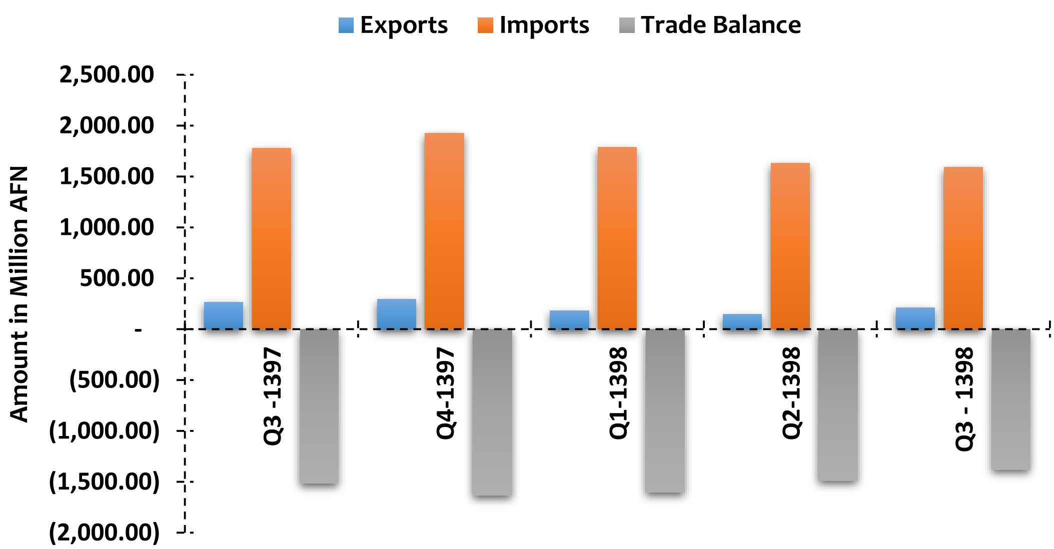
## 4.3. MERCHANDISE TRADE

Merchandise trade, covers all types of inward and outward movements of goods through a country or territory including movements through customs warehouses and free zones. Based on the data provided by the Central Statistics Office, Afghanistan's merchandise trade balance has been in a deficit position in the third quarter of FY 2019, which followed by a smooth decrease in import compared with the same quarter of the last year. (See table 4.2, and figure 4.4).

The deficit of merchandise trade balance declined to USD 1,382.43 million in the third quarter of the FY 2019 from a deficit of USD 1,515.41 million in the same quarter of the FY 2018, which shows approximately 9% decline in deficit compare to the same quarter of last year. Aggregate exports of goods decreased by 20% to a value of USD 208.77 million in the third quarter of the FY 2019, from a value of USD 261.88 million recorded in the third quarter of the FY 2018. Among the exporting components, only exports of carpet and rugs shows upward trend, while leather and wool, food items and medical seeds show downward trend during the quarter under review.

Aggregate import decreased smoothly by almost 10% to a value of USD 1,591.20 million in the third quarter of the FY 2019 compared to a value of USD 1,777.29 million recorded in the similar quarter of the previous year. Over the same period of comparison, the decreases were registered in the values of imports of some principal commodity divisions, in particular imports of consumer goods declined by 27% and capital goods declined by 6% during the third quarter of the FY 2019.

**Figure 4.4:** Trade performance and Trade balance for the 3rd Quarter of FY 2019 (1398)




**Source:** CSO/DAB staff calculation

## 4.4. DIRECTION OF TRADE

Direction of trade refers to a particular country or a group of countries, which a country's exports are sent to and from which the import are brought in, with contrast to the commodity composition of exports and import. Table 4.3, 4.4 and Figure 4.5, 4.6 shows Afghanistan's direction of trade with its trading-partners in the third quarter of FY 2019. Principally, Afghanistan's major trading-partners' are Pakistan, India, Iran, China and Commonwealth of Independent States (CIS).

### 4.4.1. Direction of Exports

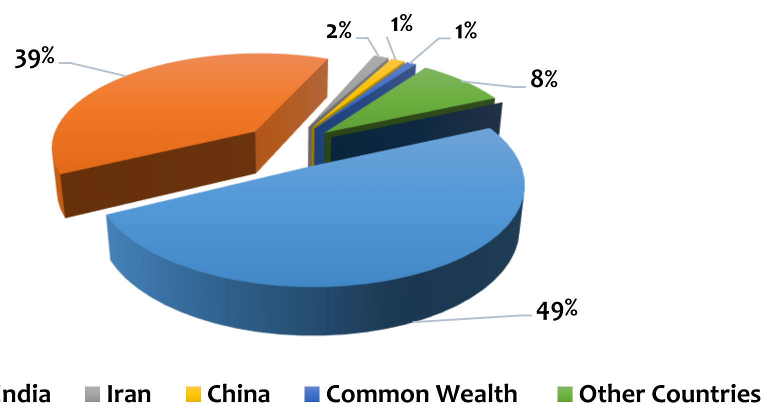
The merchandize trade statistics shows that; **Pakistan was the first largest buyer of Afghanistan's exports in the third quarter of the FY 2019.**

During the quarter under review the share of Afghanistan's exports to Pakistan decreased to 49% from 61% in the same quarter of FY 2018. in terms of value, exports to Pakistan dropped by 36% to a value of USD 101.52 million in the third quarter of the FY 2019 from USD 159.11 million recorded in third quarter of the FY 2018.

**India ranked the second largest buyer of Afghanistan's exports during the third quarter of the FY 2019.** The share of Afghanistan's exports to India grew by 38% in third quarter of the FY 2019 from 30% that was recorded in the same quarter of the last year. but in terms of value Afghanistan's total exports to India slightly increased by 2% to a value of USD 79.3 million in the third quarter of the FY 2019 compared to same quarter of FY 2018 which was USD 78.16.

**Iran and Germany graded the third and fourth largest buyer of Afghanistan's exports in the third quarter of the FY 2019.** Share of exports to Iran decreased to 1% in the third quarter of the FY 2019 from 2% recorded in the third quarter of the FY 2018.

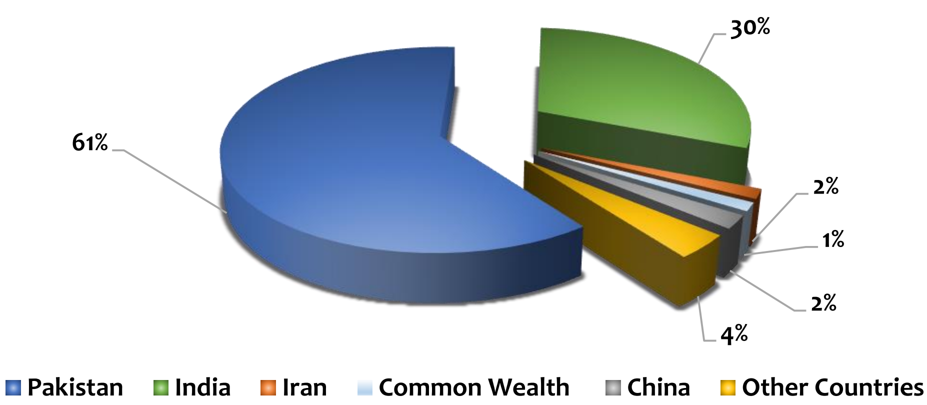
**Figure 4.5:** Direction of Exports (% share) for the 3rd Quarter of FY 2019




**Source:** CSO/DAB staff calculation

While, the share of exports to Germany increased to 1.1% in the third quarter of the FY 2019 from 0.3% in the same quarter of FY 2018. Total exports to Iran decreased to USD 2.86 million in the third quarter of the FY 2019 from USD 3.94 million in the third quarter of the FY 2018. whereas the total exports to Germany increased to a USD 2.20 million in the third quarter of the FY 2019 from USD 0.82 million recorded in the same quarter of the previous year, (See tables 4.3, 4.4 and figures 4.5, 4.6)

**Figure 4.6:** Direction of Exports (% share) for the 3rd Quarter of FY 2018




**Source:** CSO/DAB staff calculation

### 4.4.2. Direction of Imports

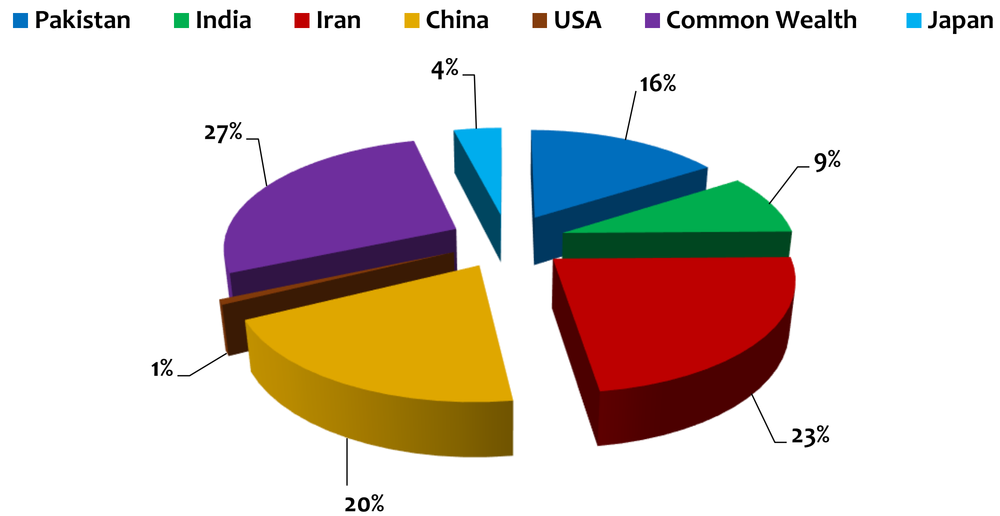
**CIS countries were the largest sources of imports for Afghanistan during the third quarter of the FY 2019.** Total Imports from CIS countries decreased by 15% to USD 373.54 million with share of 23% in total imports in the third quarter of the FY 2019 from USD 440.98 million (share of 25% in total import) in the same quarter of FY 2018.

**Iran ranked the second largest imports origin of Afghanistan in the third quarter of the FY 2019.** The total imports from Iran diminished by 9% to USD 311.89 million with share of 20% in the third quarter of the FY 2019 from USD 342.26 million (share of 19%) in the third quarter of FY 2018.

**The third largest origin of imports for Afghanistan was China.** Total Imports from China declined by 8% to USD 269.57 million with share of 17% in the third quarter of the FY 2019 from USD 293.11 million and shares of 16% in total imports in the same quarter of the last year.

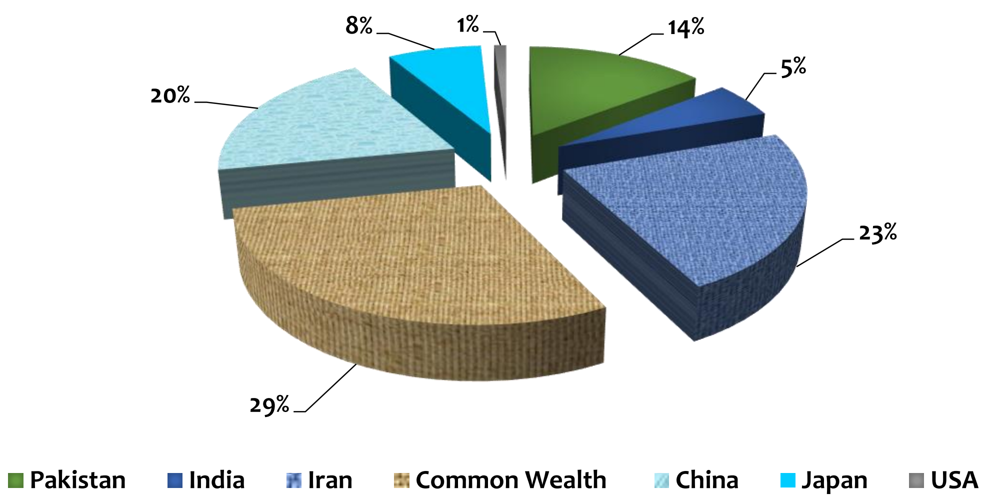
**Pakistan graded the fourth largest import origin for Afghanistan in the quarter under review.** Total Imports from Pakistan slightly declined by 1% to USD 215.67 million with share of 14% in in total imports in third quarter of FY 2019, from USD 217.27 million (share of 12%) in the third quarter of FY 2018. India, Japan, United Arab Emirates and Germany were the last largest import sources for Afghanistan in the third quarter of the FY 2019, sharing 8%, 3% 2% and 2% of total imports respectively. (Figures 4.7 & 4.8).

**Figure 4.7:** Direction of Imports (% share) for the 3rd Quarter of FY 2019




**Source:** CSO/DAB staff calculation

**Figure 4.8:** Direction of Imports (% share) for the 3rd Quarter of FY 2018




**Source:** CSO/DAB staff calculation

## 4.5. COMPOSITION OF TRADE

### 4.5.1. Composition of Imports

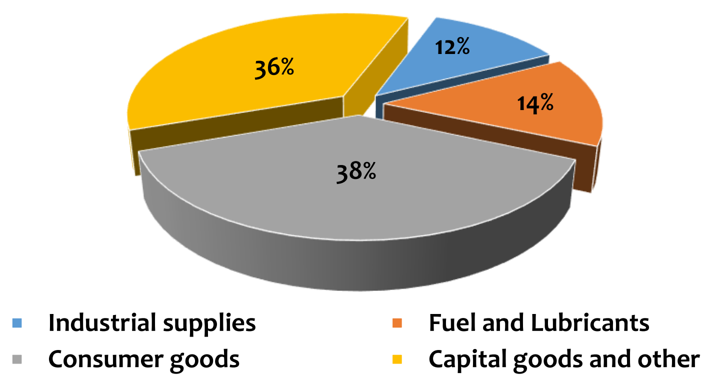
The composition of imports in the third quarter of the FY 2019 pointed out that;

- ✓ Imports of Capital goods had the largest share in the basket of imports during the third quarter of the FY 2019, which is increased to 38% from 36% that was recorded in the third quarter of the FY 2018. In terms of value, imports of such Capital goods decreased by 6% to USD 597.53 million from USD 638.34 million recorded in the same quarter of FY 2018.
- ✓ The second largest share recorded for consumer goods in the basket of imports during the quarter under review despite its share decreased from 38% to 31%. In terms of value, imports of consumer goods decreased significantly by 27% to USD 493.56 million in the third quarter of the FY 2019 from USD 676.65 million recorded in the same quarter of the previews year.
- ✓ Imports of fuel and lubricants (petroleum oil) had the third largest share in the basket of Afghanistan's imports which is increased from 14% to 17% in the third quarter of the FY 2019.

  In terms of value, imports of fuel and lubricants in total imports increased by almost 6% with a value of USD 266.85 million in the third quarter of the FY 2019 from USD 251.34 million recorded in the same quarter of the previous year.
- ✓ Industrial supplies had the smallest share in the basket of Afghanistan's imports during the quarter under review, which is increased to 15% from 12% in the third quarter of the previous year.

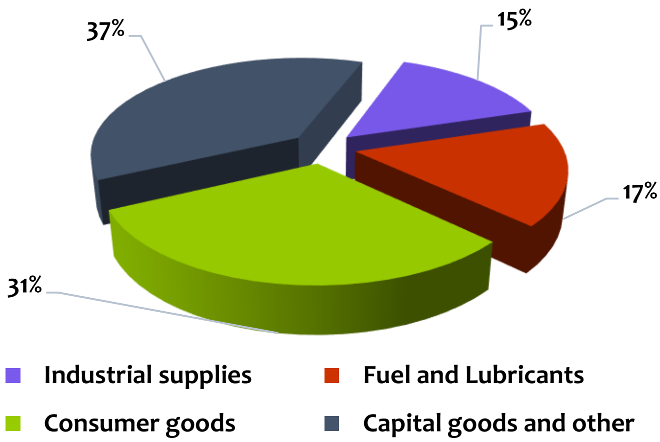
  In terms of value, imports of such goods increased by 11%, with a value of USD 233.23 million in the third quarter of the FY 2019 from USD 210.96 million recorded in the third quarter of the FY 2018 (Table 4.2, and Figures 4.9 & 4.10).

**Figure 4.9:** Composition of Imports (share%) for the 3rd Quarter of FY 2018




**Source:** CSO/DAB staff calculation

**Figure 4.10:** Composition of Imports (share%) for the 3rd Quarter of FY 2019




**Source:** CSO/DAB staff calculation

### 4.5.2. Composition of Exports

The composition of exports in the third quarter of FY 2019 reveals that;

- ✓ Exports of medical seeds had the largest share in the basket of Afghanistan's exports which is increased to almost 51% in the reporting quarter from about 48% recorded in the same quarter of FY 2018.

Earnings from exports of medical seeds dropped by 16% to USD 107.24 million in the third quarter of FY 2019 from USD 127.18 million recorded in the same quarter of the previous year.

- The second largest share in total exports was recorded for food items (oil seeds, fresh and dry fruits), which is a little decreased to almost 43% in the third quarter of FY 2019 from about 44% recorded in the preceding and corresponding quarter of the last year. In term of value exports of food items decreased by 22% to USD 89.91 million in the third quarter of FY 2019 from USD 115.88 million recorded in the same quarter of FY 2018.

- Carpet and rugs which are considered the main component of Afghanistan's exports in the past decades had the third largest share in total exports, which is increased slightly to almost 3% in the third quarter of the FY 2019 from 2% recorded in the same quarter of the previous year.

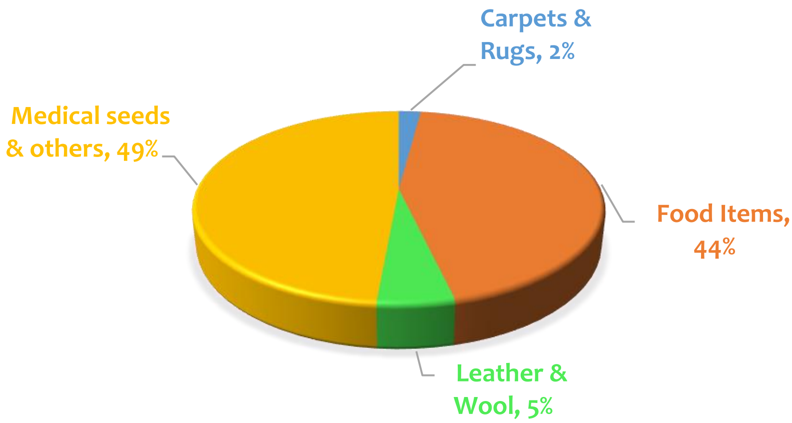
Earnings from exports of carpet and rugs increased by 9% to USD 5.93 million during the quarter under review from USD 5.45 million that was recorded in the same quarter of last year.

- Leather and wool products had the smallest share in the total exports. The

- share of leather and wool recorded 5% in the third quarter of FY 2018, which declined to 2.7% during the quarter under review.

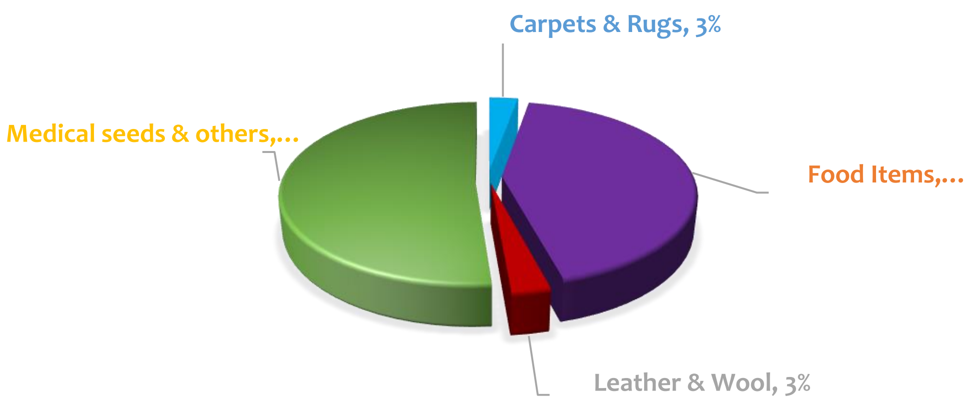
Earning from exports of leather and wool decreased by 57% to USD 5.70 million in the third quarter of the FY 2019 from USD 13.37 million recorded in the similar quarter of the last year. (See figures 4.11, and 4.12).

**Figure 4.11:** Composition of Exports (share in %) for the 3rd Quarter of FY 2018




**Source:** CSO/DAB staff calculation

**Figure 4.12:** Composition of Exports (share in %) for the 3rd Quarter of FY 2019



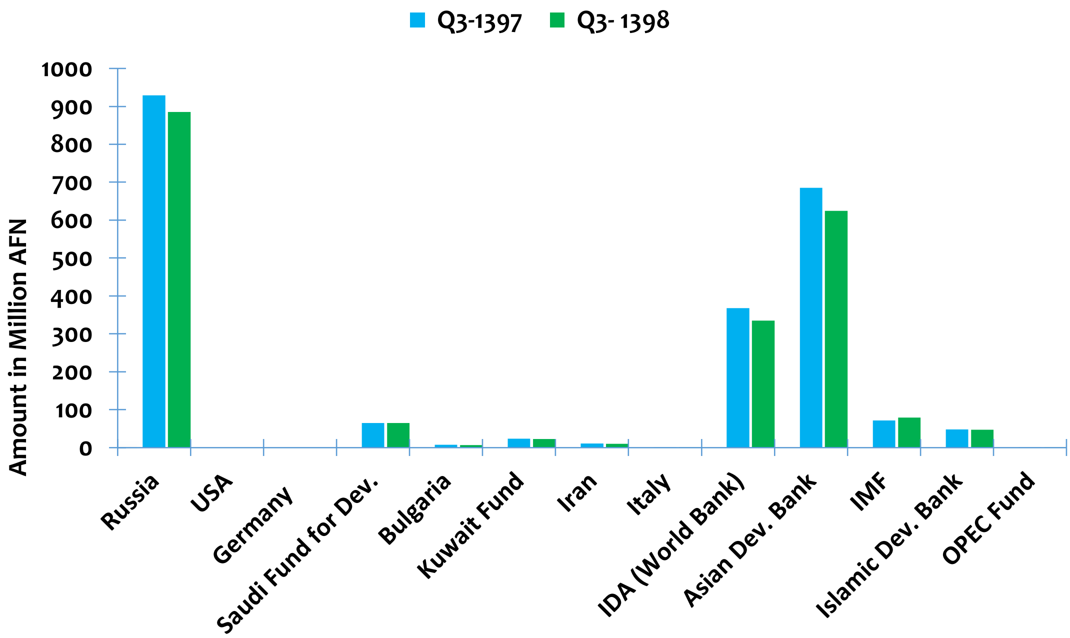

**Source:** CSO/DAB staff calculation

## 4.6. EXTERNAL DEBT

Afghanistan's total external debt decreased by 6% to USD 2,077.81 million in the third quarter of FY 2019 from USD 2,210.97 million recorded in the similar quarter of FY 2018, which shows USD 133.16 million decline in the reporting quarter (See table 4.5).

During the quarter under review, principle loan repayments made to the Asian Development Bank, Islamic Development Bank and OPEC Fund, while service charges were paid to the World Bank, Asian Development Bank and Islamic Development Bank. World Bank and Asian Development Bank as major multilateral creditors to Afghanistan, made some debt release on principle and services charge during the quarter under review.

**Figure 4.13:** External Debt Comparison for the 3rd Quarter of FY 2018 (1397) & 2019 (1398)




**Source:** CSO/DAB staff calculation

Total loan amounts payable to the Paris Club creditors in the third quarter of FY 2019 stood at USD 885.46 million which is payable to Russian federation. **In other words, Afghanistan's total debt from the Paris club members stands at about 42.62% of total current external debt which has decreased slightly by about 5% compared to the third quarter of FY 2018.**

Furthermore, total debt from Non-Paris Club members which are including, (Saudi Fund for Development, Bulgaria, Kuwait fund, Iran and Italy) decreased slightly by 2% to USD 105.36 million in the third quarter of FY 2019 in comparison with the third quarter of FY 2018 which was recorded USD 107.49 million. On the other hand, total debt from multilateral creditors to Afghanistan decreased by 7% to USD 1,086.99 million in the third quarter of FY 2019 from USD 1,174.04 million recorded in the same quarter of FY 2018. This change shows USD 87.04 million decline in the total debt during the quarter under review.

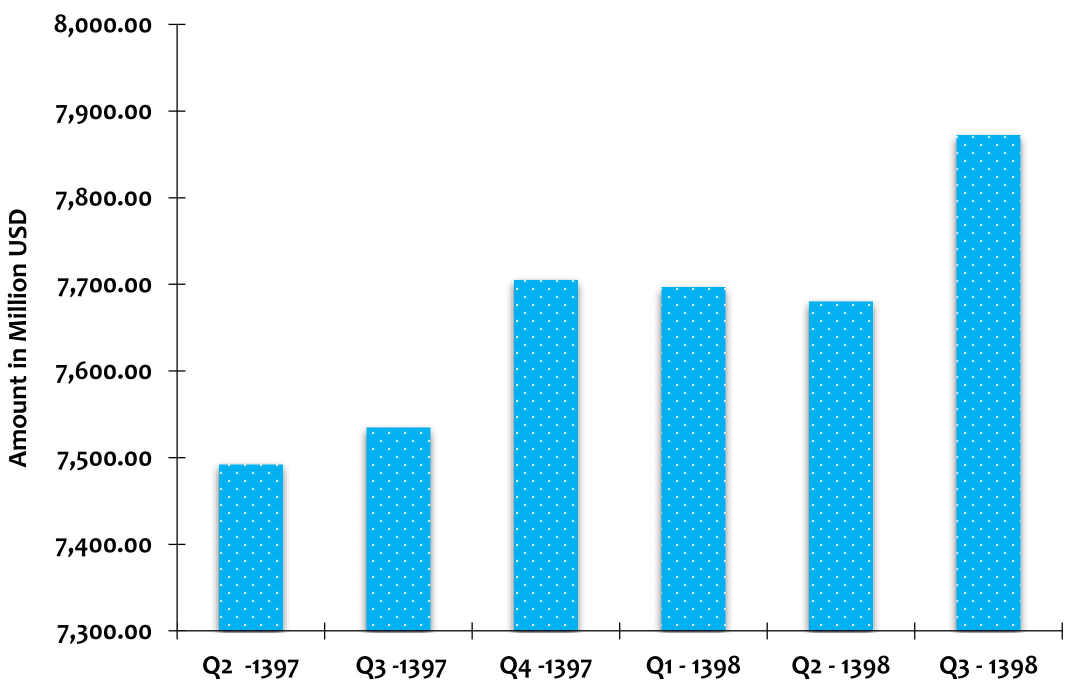
## 4.7. NET INTERNATIONAL RESERVES

The country Net International Reserves (NIR) increased by 4%, standing at a value of USD 7,871.89 million in the third quarter of FY 2019, up from a value of USD 7,534.49 million that was recorded in the corresponding quarter of the last year, (See table 4.6 and Figure 4.14). Reserve assets slightly expanded by 3% to USD 8,522.23 million in the third quarter of the FY 2019 from USD 8,241.90 million recorded in the third quarter of FY 2018.

Reserve liabilities declined by 8% to USD 650.34 million in the third quarter of FY 2019 from USD 707.48 million recorded in the same quarter of the last year; This demonstrates that the reserve assets are higher than the reserve liabilities. The decline in reserve liabilities was mainly due to decrease in commercial banks' deposits in foreign currency which is dropped by 9% to USD 592.37 million in the third quarter of FY 2019 from USD 651.17 million recorded in the same quarter of the previous year.

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

**Figure 4.14:** Net Internation Reserves during the past periods




**Source:** CSO and DAB staff calculations

**Table 4.1:** Afghanistan Balance of Payments in Million USD for the 3rd Quarter of FY 2019

| Items / Years | Q1- 18 | Q2- 18 | Q3 - 18 | Q4 - 18 | Q1- 19 | Q2- 19 | Q3-19 | % change |
|---|---|---|---|---|---|---|---|---|
| **Current Account** | -1194.09 | -734.57 | -824.67 | -974.93 | -1237.27 | -747.96 | -995.81 | 20.8% |
| *Credit* | 984.93 | 1190.51 | 1219.74 | 1151.99 | 805.23 | 1021.68 | 857.69 | -29.7% |
| *Debit* | 2179.02 | 1925.08 | 2044.41 | 2126.92 | 2042.50 | 1769.64 | 1853.50 | -9.3% |
| **Goods and Services Account** | -1776.51 | -1496.23 | -1489.19 | -1610.43 | -1619.95 | -1425.76 | -1438.67 | -3.4% |
| *Credit* | 335.24 | 378.06 | 456.13 | 442.06 | 371.01 | 293.25 | 352.31 | -22.8% |
| *Debit* | 2111.75 | 1874.29 | 1945.32 | 2052.49 | 1990.96 | 1719.01 | 1790.98 | -7.9% |
| Goods Account | -1590.89 | -1418.48 | -1313.65 | -2018.62 | -1458.59 | -1322.73 | -1252.61 | -4.6% |
| *Credit* | 172.45 | 146.81 | 261.88 | 294.09 | 182.57 | 143.60 | 209.06 | -20.2% |
| *Debit* | 1763.35 | 1565.29 | 1575.53 | 1691.71 | 1641.16 | 1466.34 | 1461.67 | -7.2% |
| Services Account | -185.62 | -77.75 | -175.54 | -212.81 | -161.36 | -103.03 | -186.06 | 6.0% |
| *Credit* | 162.78 | 231.25 | 194.24 | 147.97 | 188.45 | 149.64 | 143.25 | -26.3% |
| *Debit* | 348.40 | 309.00 | 369.79 | 360.79 | 349.81 | 252.67 | 329.31 | -10.9% |
| **Primary Income Account** | 22.26 | 54.54 | 63.34 | 50.14 | 75.48 | 100.55 | 68.57 | 8.3% |
| *Credit* | 37.01 | 66.69 | 114.03 | 71.26 | 93.13 | 111.46 | 75.53 | -33.8% |
| *Debit* | 14.75 | 12.15 | 50.69 | 21.11 | 17.66 | 10.91 | 6.95 | -86.3% |
| **Secondary Income Account** | 560.16 | 707.12 | 601.18 | 585.36 | 307.20 | 577.26 | 374.29 | -37.7% |
| *Credit* | 612.68 | 745.76 | 649.59 | 638.67 | 341.08 | 616.98 | 429.86 | -33.8% |
| *Debit* | 52.52 | 38.64 | 48.41 | 53.31 | 33.88 | 39.72 | 55.57 | 14.8% |
| Current transfers (Official grants) | 473.8 | 586.7 | 463.0 | 428.9 | 165.4 | 431.9 | 231.8 | -49.9% |
| *Credit* | 473.8 | 586.7 | 463.0 | 428.9 | 165.4 | 431.9 | 231.8 | -49.9% |
| *Debit* | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Personal transfers | 86.36 | 120.42 | 138.22 | 156.44 | 141.80 | 145.36 | 142.46 | 3.1% |
| *Credit* | 138.88 | 159.06 | 186.63 | 209.75 | 175.68 | 185.08 | 198.03 | 6.1% |
| *Debit* | 52.52 | 38.64 | 48.41 | 53.31 | 33.88 | 39.72 | 55.57 | 14.8% |
| **Capital account** | 37.70 | 199.92 | 456.33 | 620.45 | 50.53 | 238.12 | 387.50 | -15.1% |
| *Credit* | 37.70 | 199.92 | 456.33 | 620.45 | 50.53 | 238.12 | 387.50 | -15.1% |
| *Debit* | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | |
| Capital transfers | 37.70 | 199.92 | 456.33 | 620.45 | 50.53 | 238.12 | 387.50 | -15.1% |
| *Credit* | 37.70 | 199.92 | 456.33 | 620.45 | 50.53 | 238.12 | 387.50 | -15.1% |
| *Debit* | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | |
| **Financial account** | 39.1 | -27.3 | 311.3 | 208.00 | 3.49 | 23.86 | -39.23 | -112.6% |

| Items / Years | Q1- 18 | Q2- 18 | Q3 - 18 | Q4 - 18 | Q1- 19 | Q2- 19 | Q3-19 | % change |
|---|---|---|---|---|---|---|---|---|
| **Direct investment** | -43.45 | -49.75 | 6.22 | 8.07 | 0.02 | -6.15 | -3.41 | -154.9% |
| *Net acquisition of financial assets* | -3.78 | -4.08 | 31.18 | 17.21 | 8.83 | 5.84 | 4.79 | -84.6% |
| *Net incurrence of liabilities* | 39.67 | 45.67 | 24.96 | 9.14 | 8.81 | 11.98 | 8.20 | -67.2% |
| **Portfolio investment** | 44.21 | -11.25 | 107.08 | 1.18 | -18.15 | 15.57 | -33.81 | -131.6% |
| *Net acquisition of financial assets* | 44.21 | -11.25 | 107.08 | 1.18 | -18.15 | 15.57 | -33.81 | -131.6% |
| *Net incurrence of liabilities* | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | |
| **Other investment** | 32.63 | 72.01 | 85.33 | 114.49 | -26.41 | -15.97 | -158.45 | -285.7% |
| *Assets* | -2.23 | 49.57 | 59.54 | 107.09 | -40.94 | -28.73 | -105.68 | -277.5% |
| *Liabilities* | -34.86 | -22.44 | -25.79 | -7.39 | -14.54 | -12.76 | 52.78 | -304.6% |
| **Reserve Assets** | 5.70 | -38.35 | 112.65 | 84.26 | 48.03 | 30.40 | 156.44 | 38.9% |
| **Net errors and omissions** | 1195 | 507 | 680 | 562 | 1190 | 534 | 569 | -16.3% |

**Source:** CSO and DAB staff calculations

**Table 4.2:** Merchandise Trade in Million USD for the 3rd Quarter of FY 2019

| Years | Q2- 2018 | | Q3- 2018 | | Q4 - 2018 | | Q1 - 2019 | | Q2- 2019 | | Q3 2019 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Share (%) | Total | Share (%) | Total | Share (%) | Total | Share (%) | Total | Share (%) | Total | Share (%) |
| Imports | 1,766.96 | 100 | 1,777.29 | 100 | 1,925.50 | 100 | 1,786.34 | 100 | 1,631.24 | 100 | 1,591.20 | 100 |
| Industrial supplies | 194.14 | 11.0 | 210.96 | 12 | 220.20 | 11.4 | 173.92 | 9.7 | 196.47 | 12.0 | 233.23 | 15 |
| Fuel and Lubricants | 214.21 | 12% | 251.34 | 14.1 | 263.66 | 13.7 | 302.34 | 16.9 | 248.53 | 15 | 266.85 | 17 |
| Consumer goods | 687.54 | 39 | 676.65 | 38.1 | 711.07 | 36.9 | 741.35 | 41.5 | 622.05 | 38 | 493.56 | 31 |
| Capital goods and other | 671.07 | 38 | 638.34 | 36 | 730.57 | 37.9 | 569 | 31.8 | 564.18 | 35 | 597.56 | 38 |
| Exports | 146.81 | 100 | 261.88 | 100 | 294.09 | 100 | 182.57 | 100 | 143.29 | 100 | 208.77 | 100 |
| Carpets & Rugs | 5.68 | 4 | 5.45 | 2.1 | 5.60 | 1.9 | 6.6 | 3.6 | 6.35 | 4 | 5.93 | 2.8 |
| Food Items | 47.30 | 32 | 115.88 | 44.2 | 178.19 | 60.6 | 83.93 | 46.0 | 49.72 | 35 | 89.91 | 43 |
| Leather & Wool | 9.05 | 6 | 13.37 | 5.1 | 12.79 | 4.3 | 9.69 | 5.3 | 14.00 | 9.8 | 5.70 | 2.7 |
| Medical seeds & others | 84.78 | 58 | 127.18 | 48.6 | 97.52 | 33.2 | 82.37 | 45.1 | 73.22 | 51.1 | 107.24 | 51.4 |
| Trade Balance | -1,620.15 | | -1,515.41 | | -1,631.42 | | -1,603.77 | | -1,487.95 | | -1,382.43 | |

**Source:** CSO and DAB staff calculations

**Table 4.3:** Direction of External Trade for the 3rd Quarter of FY 2019 (in Million USD)

| Country Name | Exports | % Shares | Imports | % Share | Trade Balance |
|---|---|---|---|---|---|
| Pakistan | 101.52 | 49% | 215.67 | 14% | -114.15 |
| India | 79.53 | 38% | 119.84 | 8% | -40.31 |
| Iran | 2.86 | 1% | 311.89 | 20% | -309.03 |
| Germany | 2.20 | 1.1% | 24.14 | 2% | -21.94 |
| China | 2.65 | 1% | 269.57 | 16.9% | -266.93 |
| England | | 0.00% | 1.31 | 0.08% | -1.31 |
| Saudi Arabia | 0.99 | 0.47% | | 0.00% | 0.99 |
| United Arab Emirates | | 0.00% | 29.29 | 2% | -29.29 |
| Turkey | | 0.00% | 12.15 | 0.76% | -12.15 |
| USA | | 0.00% | 10.14 | 0.64% | -10.14 |
| Common Wealth | 1.88 | 0.9% | 373.54 | 23% | -371.66 |
| Japan | | 0.00% | 53.34 | 3% | -53.34 |
| Other Countries | 17.14 | 8.21% | 170.31 | 10.70% | -153.17 |
| Total | 208.77 | 100% | 1,591.20 | 100% | (1,382.43) |

**Source:** CSO and DAB staff calculations

**Table 4.4:** Direction of External Trade for the 3rd Quarter of FY 2018 (in Million USD)

| Country Name | Exports | % Shares | Imports | % Share | Trade Balance |
|---|---|---|---|---|---|
| Pakistan | 159.11 | 61% | 217.27 | 12% | -58.17 |
| India | 78.16 | 30% | 77.74 | 4.37% | 0.42 |
| Iran | 3.94 | 2% | 342.26 | 19% | -338.32 |
| Germany | 0.82 | 0.3% | 16.38 | 0.92% | -15.57 |
| Common Wealth | 3.44 | 1% | 440.98 | 24.8% | -437.54 |
| China | 5.43 | 2.07% | 293.11 | 16% | -287.68 |
| United Arab Emirates | | | 30.50 | | |
| Saudi Arabia | 1.27 | 0.00% | | 1.72% | -30.50 |
| Turkey | | | 15.64 | 0.88% | |
| Japan | | 0.00% | 113.70 | 6.40% | -113.70 |
| England | | 0.0% | 0.82 | 0% | -0.82 |
| USA | | 0.00% | 14.64 | 0.82% | -14.64 |
| Other Countries | 9.71 | 3.71% | 214.23 | 12.05% | -204.51 |
| Total | 261.88 | 100% | 1,777.3 | 100% | (1,501.03) |

**Source:** CSO and DAB staff calculations

**Table 4.5:** External Debt for the 3rd Quarter of FY 2019 (in million USD)

| Description | Q3 2018 | % share | Q3 2019 | % share |
|---|---|---|---|---|
| Total external debt | 2,210.97 | 100.00 | 2,077.81 | 100.00 |
| Bilateral | 1,036.93 | 46.90 | 990.81 | 47.69 |
| Paris Club | 929.44 | 42.04 | 885.46 | 42.62 |
| Russian Federation | 929.44 | 42.04 | 885.46 | 42.62 |
| United States | | 0.00 | - | 0.00 |
| Germany | | 0.00 | - | 0.00 |
| Non-Paris Club | 107.49 | 4.86 | 105.36 | 5.07 |
| Multilateral | 1,174.04 | 53.10 | 1,086.99 | 52.31 |
| of which: IDA (World Bank) | 367.80 | 16.64 | 334.93 | 16.12 |
| Asian Development Bank | 685.32 | 31.00 | 624.47 | 30.05 |
| International Monetary Fund | 71.67 | 3.24 | 78.92 | 3.80 |
| Islamic Development Bank | 47.51 | 2.15 | 47.01 | 2.26 |
| OPEC Fund | 1.74 | 0.08 | 1.66 | 0.08 |

**Source:** CSO and DAB staff calculations

**Table 4.6:** Net International Reserves for the 3rd Quarter of FY 2019 (in million USD)

| Changes on the previous quarter | Q3 -18 | % change | Q4 -18 | % change | Q1 - 19 | % change | Q2 - 19 | % change | Q3 - 19 | % change |
|---|---|---|---|---|---|---|---|---|---|---|
| Net international Reserves (million US Dollar) | 7,534.42 | 0.57 | 7,704.98 | 2.26 | 7,696.40 | -0.11 | 7,680.28 | -0.2 | 7,871.89 | 4 |
| Reserve Assets | 8,241.90 | 0.17 | 8,362.42 | 1.46 | 8,345.46 | -0.20 | 8,337.53 | -0.1 | 8522.23 | 3 |
| Reserve Liabilities | 707.48 | -3.84 | 657.44 | -7.07 | 649.06 | -1.27 | 657.25 | 1.3 | 650.34 | -8 |
| Commercial bank deposits in foreign currency | 651.17 | -3.59 | 598.08 | -8.15 | 591.98 | -1.02 | 603.65 | 2.0 | 592.37 | -9 |
| Nonresident deposits in foreign currency | 0.14 | 0.00 | 0.14 | 1.31 | 0.14 | 0.00 | 0.14 | 0.0 | 0.66 | 378 |
| Use of Fund resources | 56.17 | -6.76 | 59.22 | 5.43 | 56.74 | -4.19 | 53.46 | -5.8 | 57.31 | 2 |
| Gross Intl. Reserves (in months of import) | 13.91 | | 13.03 | | 14.02 | | 15.33 | | 16.07 | |
| Net Intl. Reserves (in months of import) | 13 | | 12 | | 13 | | 14 | | 15 | |

**Source:** CSO and DAB staff calculation

# 5

# Fiscal Developments

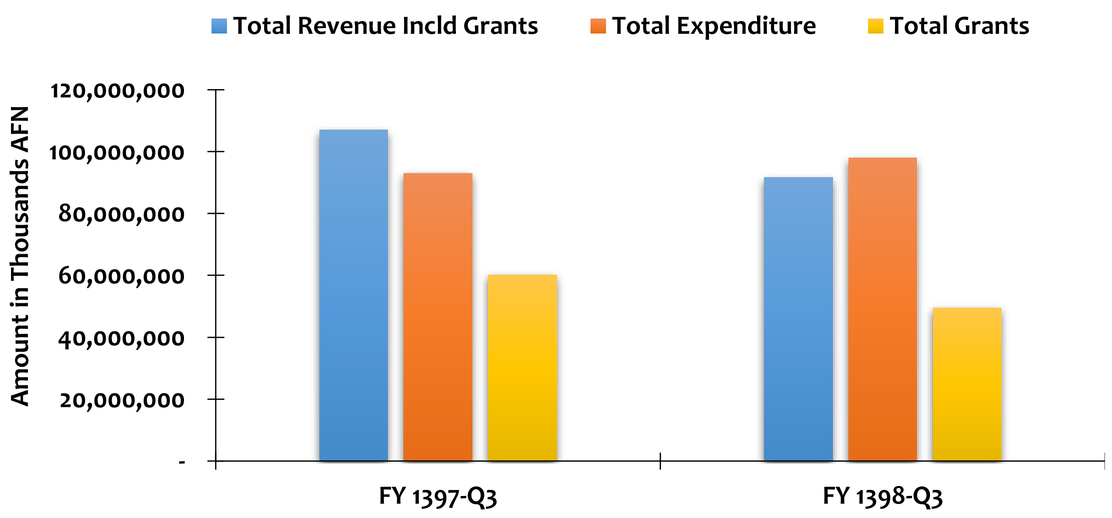
# 5

# FISCAL SECTOR DEVELOPMENT

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

Resembling the other emerging and under developing economies around the world Afghanistan continuously faces budget deficit, where total core expenditure exceeded total domestic revenue in the third quarter of FY 2019 leading to AFN 55.72 billion budget deficit, and by including other revenue (grants) a budget deficit of AFN 6.26 billion is observed comparably. Due to decrease in revenue from sales of goods and services, income tax, fixed tax, extractive industry, income from capital property and a large difference between miscellaneous return, the total domestic revenue is decreased from AFN 46.69 billion in the third quarter of FY 2018 to AFN 42.16 billion in quarter under review, which shows a decrement of AFN 4.53 billion or 9.70% reduction in domestic revenue collection. Meanwhile increase in employees spending, capital expenditure, subsidies, grants contributions and pension expenditures resulted to raise the total core expenditure from AFN 92.99 billion in third quarter of FY 2018 to AFN 97.88 billion in the third quarter of FY 2019, that shows an increase of AFN 4.89 billion or 4.89%.

**Figure 5.1:** Comparison of Total Revenue including grants, Total Expenditure, Total Grants between 3rd Quarter of FY 2018 (1397) & FY 2019 (1398)



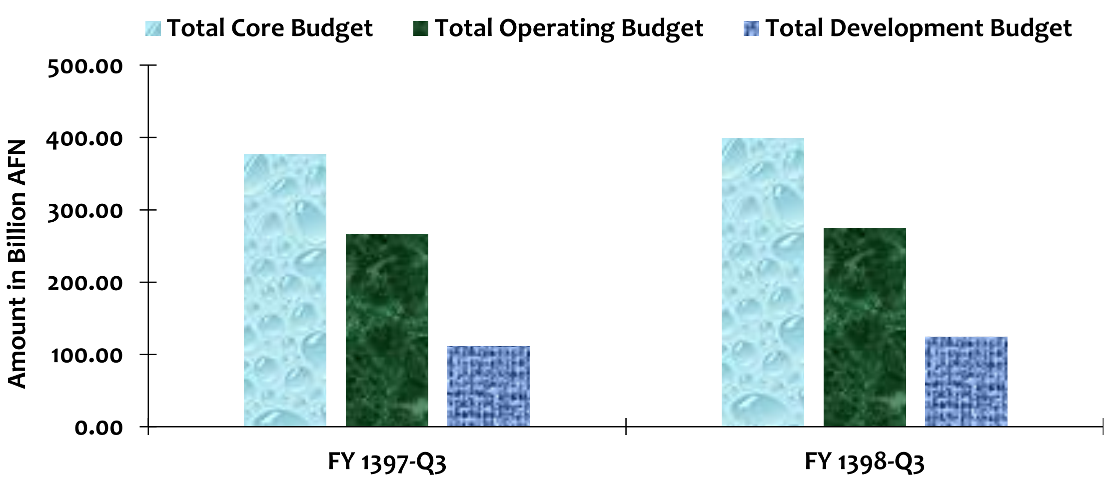

**Source:** MoF Financial Statement/MPD Staff Calculation

Furthermore, donor contributions are used to finance both operating and development expenditure. The total donor contribution (grants) allocated to operating and development expenditure represent a considerable increase to AFN 63.74 billion in the quarter under review from AFN 60.18 billion in the same quarter of the last year, indicating an increase of AFN 3.54 billion or 5.9% increase in the level of grants comparably and it is as a result of change in annual pledge, commitment and disbursement in which the main donor contributors are for ARTF, LOTFA, CSTC-A. Furthermore, total core budget is increased to AFN 399.42 billion in the third quarter of FY 2019 from AFN 377.19 billion in the third quarter of FY 2018, showing a vital increase of AFN 22.23 billion (5.89% raise) in total core budget. Moreover, operating budget is increased from AFN 266.13 billion in the third quarter of FY 2018 to AFN 275.22 billion in the third quarter of FY 2019, indicating 3.4% increase. Similarly, development budget is increased to AFN 124.19 billion in the third quarter of FY 2019 from AFN 111.06 billion in the same quarter of the previous year, representing 11.82% increment and it is as a result of high level of grants and budget allocation for the FY 1398 comparably.

## 5.1. BUDGET EXECUTION RATE

During the reference period, government spent 61% of AFN 424.98 billion (Total core budget) in FY 2019. To comparing with 59% execution rate of total core budget (AFN 391.37 billion) in FY 2018, it represents an increase of 12% in total core budget. This change is attributed to several factors particularly timely processing and approval of expenses by the National Procurement Authority, security condition in provinces and improved performances by the budgetary units, beside these, total core budget (annual) increased to AFN 399.41 billion in FY 2019 from AFN 377 billion in FY 2018, which represents 5.9% (AFN 22.22 billion) increase in annual budget (total core budget).

**Figure 5.2:** Comparison of Total Budget between 3rd Quarter of FY 2018 (1397) & FY 2019 (1398)

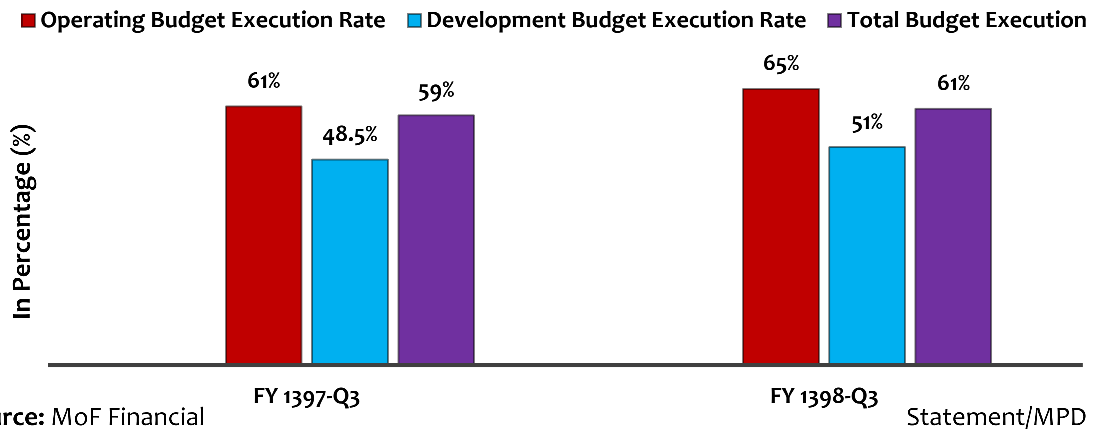



**Source:** MoF Financial Statement/MPD Staff Calculation

Operating budget has 14.7% execution rate, increasing to AFN 192.70 billion in the third quarter of FY 2019 from AFN 168.02 billion in the same quarter of FY 2018. Moreover, total allocated core budget was AFN 424.98 billion in the third quarter of FY 2019, and AFN 407.26 billion in the same quarter of FY 2018.

Development budget execution rate evidently represents increase of 4.35% comparing development expenditures of AFN 124.19 billion in third quarter of FY 2019 and AFN 111.06 billion in the third quarter of FY 2018.

**Figure 5.3:** Comparison of Operating Budget & Development Budget Execution Rates for the 3rd Quarter of FY 2019 (1398) and FY 2018 (1397)

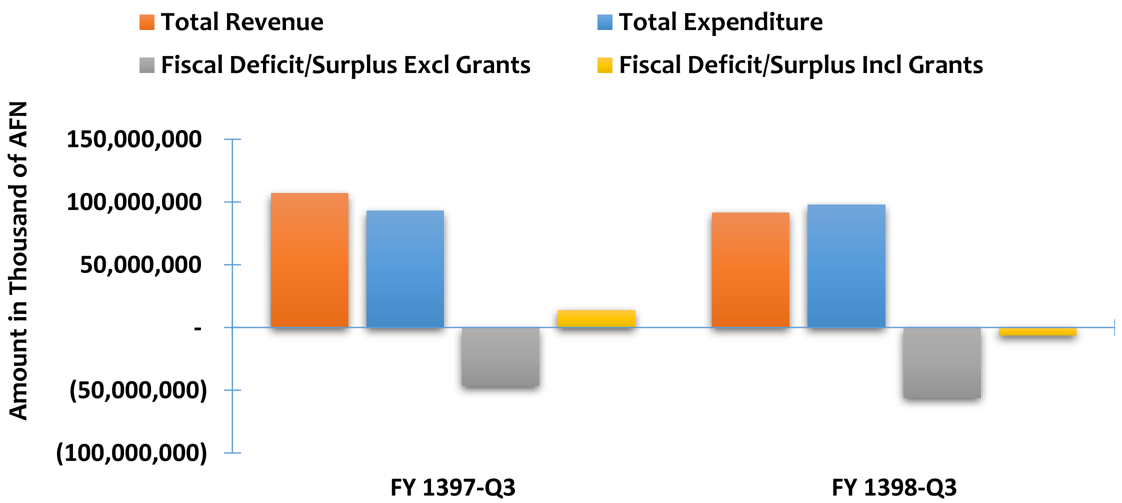



**Source:** MoF Financial Statement/MPD Staff Calculation

## 5.2. CORE BUDGET (DEFICIT & SURPLUS)

The overall budget prior to donor's contribution had a deficit of AFN 55.72 billion in the third quarter of FY 2019 compared to AFN 46.31 billion deficit in the same quarter of the previous year, which is increased by AFN 9.42 billion (22.3%). Meanwhile, donor contribution is declined to AFN 49.47 billion in the third quarter of FY 2019 from AFN 60.18 billion in the same quarter of the previous year. Total annual planned amount for external funding in FY 2019 represents an increase of 4.04% or AFN 7.73 billion (from AFN 191.28 billion in FY 2018 to AFN 199.02 billion in FY 2019) which is affected by pledge, commitment and disbursement in donor's contribution on annual basis.

**Figure 5.4:** Core Budget Deficit & Surplus (including & excluding grants) for the 3rd Quarter of FY 2018 (1397) & 2019 (1398)



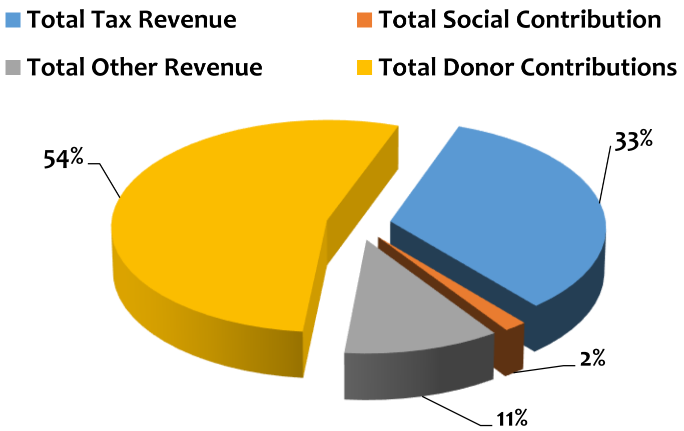

**Source:** MoF Financial Statement/MPD Staff Calculation

## 5.3. TOTAL REVENUE:

With reference period of FY 1398-Q3, total revenues including grants decreased significantly with total collection of AFN 106.87billion in FY 1397-Q3 compared to AFN 91.63billion of FY 1398-Q3, presenting a mild decrease of AFN 15.24 billion that shows14.3 percent decrease as compared to same quarter of previous year. Annual collection of planed domestic sources indicates 26.38 billion of increment from 161.62 billion of FY 1397 to 188.01 billion of FY 1398 leading to 16.32 percent increase comparably. To meet FY 1397 budget deficit total domestic revenue &donor contribution play a vital role and revenue collection that steer to annual budget surplus.

Moreover, the negative trend in total revenue collection of FY 1398 was as a result of momentous decrement in sales of goods and services, extractive industry, fixed tax, income tax, miscellaneous revenue, administrative fees and sale tax however there had been improvement in collecting in property taxes, tax penalties and fine, sale of land and building during the year and positively reflected retail activity from the low base last year comprise.

**Figure 5.5:** Components of Total Revenue for the 3rd Quarter of FY 2019




**Source:** MoF Financial Statement/MPD Staff Calculation

### 5.3.1. Domestic Revenue:

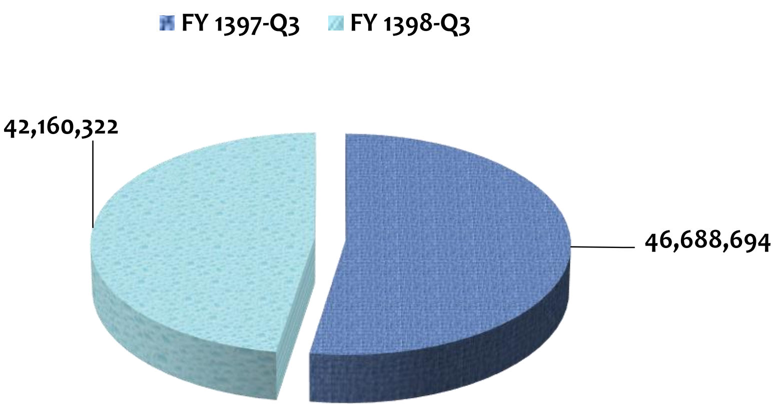
The total collection of domestic revenue is declined in the third quarter of fiscal year 2019, however it was significantly sophisticated compared to third quarter of FY 2018. Measures taken by the government are deemed to be sufficient by to ensure the achievement in terms of the GDP deficit in FY 2019.

The decrement in domestic revenue collection was due to lower receipts from fixed Income tax, income tax, and income from capital property, sales of goods and services, extractive industry, and a notable change in administrative fees. Total domestic revenue is decreased from AFN 46.69 billion in the third quarter of FY 2019 to AFN 42.16 billion in the third quarter of the previous year, which shows AFN 4.53 billion or 9.70% reduction in domestic revenue collection.

Beside, a breakdown of the total revenue collection showed a mild deceleration in various domestic revenue components such as fixed tax that showed a momentum decrease of 10.66% from AFN 4.09 billion in the third quarter of FY

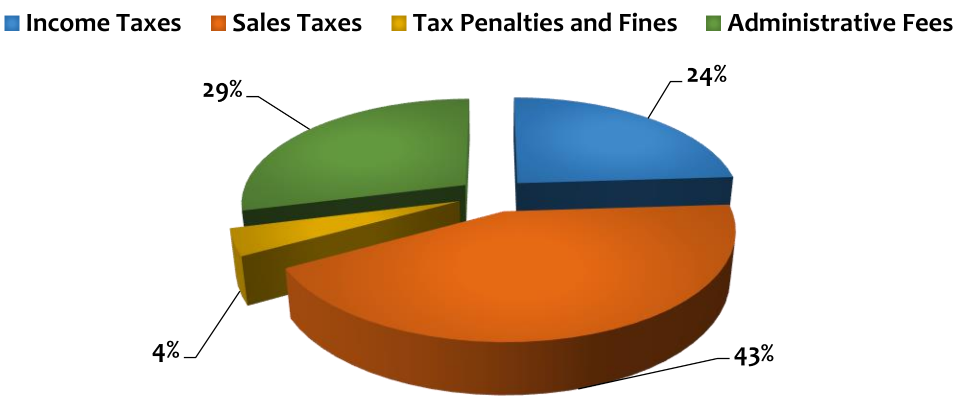
2018 to AFN 3.65 billion in the quarter of under review. Income tax shows decrease of 33.62% (from AFN 7.53 billion in the third quarter of FY 2018 to AFN 5 billion in the quarter under review), sales tax represents significant decrease of 9.55% (decreasing form AFN 9.90 billion in the third quarter of FY 2018 to AFN 8.95 billion in the third quarter of FY 2019), while customs and duties shows decrease of 2.13%, changing from AFN 12.26 billion in the third quarter of FY 2018 to AFN 12 billion in the third quarter of FY 2019 comparably.

**Figure 5.6**: Total Domestic Revenue Comparison between 3rd Quarter of FY 2018 (1397) & 2019 (1398), in Thousands of AFNs.




**Source:** MoF Financial Statement/MPD Staff Calculation

**Figure 5.7:** Major Components of Domestic Revenue for the 3rd Quarter of FY 2019




**Source:** MoF Financial Statement/MPD Staff Calculation

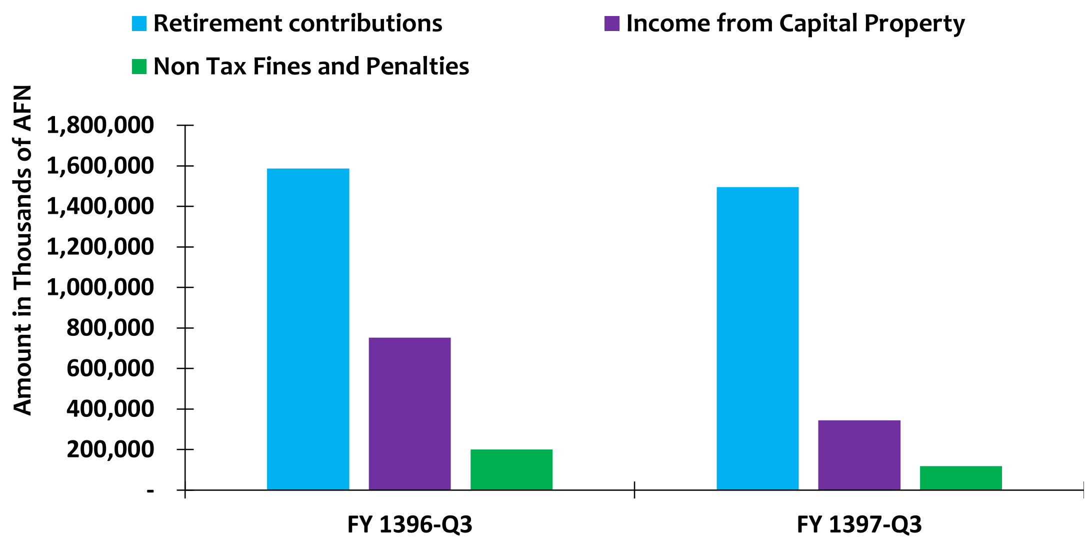
### 5.3.2. Non Tax Revenue

One of the initial component of domestic revenues is non-tax revenues that represents a notable decrease of 8.08%, decreasing from AFN 12.62 billion in the third quarter of FY 2018 to AFN 11.60 billion in the third quarter of FY 2019, which shows a decrease of AFN 1.02 billion. This is largely as a result of change in sale of goods and services, social contribution, extractive industry, royalties and a notable change in administrative fees.

The other contributors of the non-tax revenues are income from capital property which is decreased to AFN 0.34 billion in the third quarter of FY 2019 from AFN 0.75 billion in the same period of the last year, indicated 45.27% decrement, while non-tax fines and penalties decreased from AFN 0.20 billion in the quarter under review to AFN 0.12 billion in the third quarter of FY 2018, which showed 40.89%

decrease. However, miscellaneous revenue increased from -2.56 billion the third quarter of FY 2018 to 1.80 billion the third quarter of FY 2019, that signified 170% raise, on the other hand, sales of land and buildings increased to AFN 0.011 billion in the third quarter of FY 2019 from AFN 0.009 billion in the same quarter of the preview year.

**Figure 5.8:** Major Components of Non-Tax Revenue for the 3rd Quarter of FY 2018 (1397) & FY 2019 (1398)

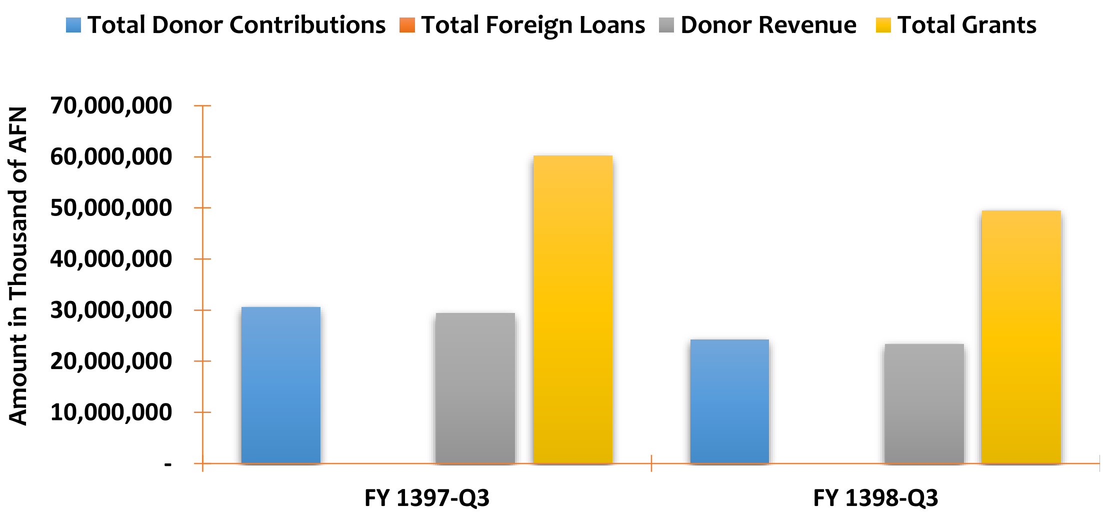



**Source:** MoF Financial Statement/MPD Staff Calculation

### 5.3.3. Grants

Donor contribution forms an important part of the national budget, at the meantime donor grants finance major expenditure items in both operating and development budget. 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 and it should be financed by total domestic revenue where recently it is being financed partially by external sources and rest by domestic revenue.

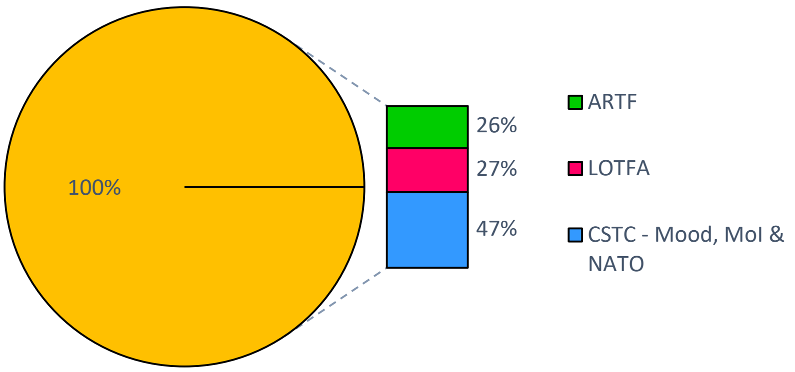
**Figure 5.9:** Analysis of Annual Grants and Loans for the 3rd Quarter of FY 2018 (1397) & 2019 (1398)




**Source:** MoF Financial Statement/MPD Staff Calculation

Total development and operating grants show significant increase of AFN 3.56 billion from AFN 60.18 billion in the third quarter of FY 2018 to AFN 63.74 billion in the third quarter of FY 2019, which clearly indicates a mild increase of 5.9%.

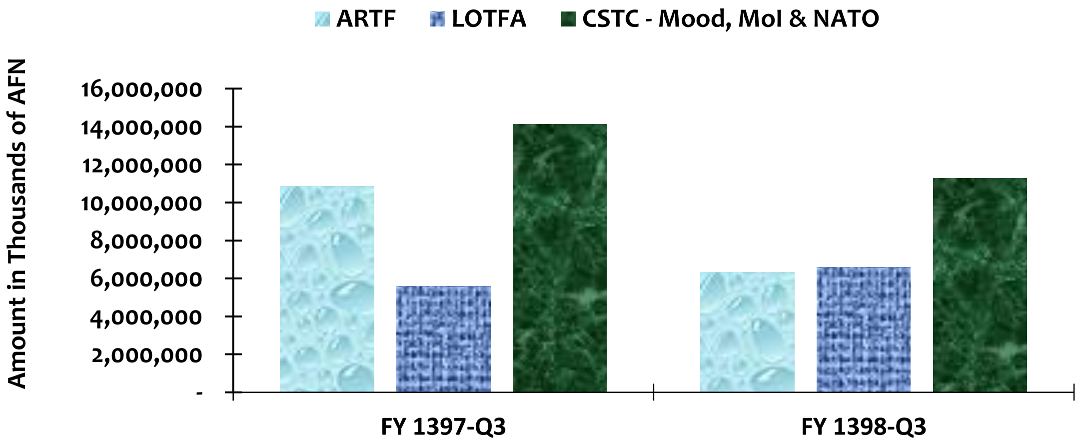
**Figure 5.10:** Components of Donor Contribution FY 1398-Q3




**Source:** MoF Financial Statement/MPD Staff Calculation

comparatively, LOTFA aid is raised by 18% from AFN 5.57 billion in the third quarter of FY 2018 to AFN 6.59 billion in the third quarter of FY 2019, while CSTC-A (MoD, MoI & NATO) contribution was AFN 11.28 billion in the third quarter of FY 2019 which is decreased from AFN 14.14 billion in the same quarter of the previous year (showed 20% decrease).

**Figure 5.11:** Comparison of Donor Contributions for the 3rd Quarter of FY 2018 (1397) & FY 2019 (1398)




**Source:** MoF Financial Statement/MPD Staff Calculation

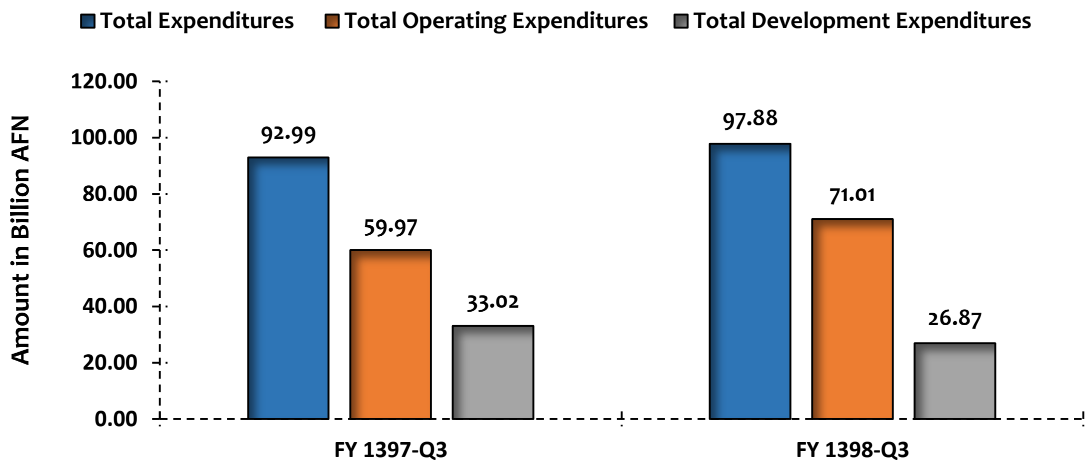
## 5.4. EXPENDITURE

Core expenditures are classified into development and operating expenditures which are allocated in 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 budget, while increase in expenditure on infrastructure, economic governance, and agriculture sectors are in line with the ANDS priority. The total core expenditure presents 5.26% increase from AFN

92.99 billion in the third quarter of FY 2018 to AFN 97.88 billion in the third quarter of FY 2019, indicating AFN 4.89 billion increase in overall development and operating expenditure compared to same period of previous year. This increase was as a result of increase in employee expenditure, grants contribution, pensions and capital expenditure.

In addition, operating expenditures increased to AFN 71.01 billion in the third quarter of FY 2019 from AFN 59.97 billion in the same quarter of the previous year, which represented AFN 11.04 billion (18.41%) increase in operating expenditures. Meanwhile development expenditure increased by 18.63%, changing from AFN 33.02 billion in the third quarter of FY 2018 to AFN 26.87 billion the third quarter of FY 2019, indicated AFN 6.15 billion down turn in development expenditures. A small increase in overall expenditure is indicated due to increase in annual approved development budget as well as due to increase in annual core expenditure.

**Figure 5.12:** Comparison of Total Expenditure between 3rd Quarter of FY 2018 (1397) & FY 2019 (1398)




**Source:** MoF Financial Statement/MPD Staff Calculation

# 6 Banking System Performance

# 6

# BANKING SYSTEM PERFORMANCE

The banking sector making 20.73% of GDP comprises of thirteen (13) duly licensed and permitted banking organizations, of which three (3) are re-licensed state owned banks, eight (8) private commercial banks, and one (1[1]) Islamic bank and two (2) are the branches of foreign banks.

The performance of the banking sector in the third quarter of FY 2019 is described below:
Overall the soundness indicators of the banking sector demonstrated decrease to various degrees compared to previous quarter. Total assets, gross loans, deposits, equity capital and profit decreased, Liquidity remained adequate, However, the quality of loans still remains low.

- Asset base of the banking sector decreased by 0.13% in the quarter under review, reaching to AFN 298.27 billion. The decrease in banking system assets apart from the exchange rate fluctuation has been noticed in cash in vault and claims on DAB, net interbank claims, net loans and net other assets.
- Total gross loan portfolio of the banking sector recorded a decrease of 3.73% in the third quarter of FY 2019, which currently stands at AFN 42.37 billion. The decrease in total gross loans is mainly attributed to settlement of loans, Less Over Draft utilization and Depreciation of USD exchange rate.
- Deposits being the main funding source in the banking sector comprising of interbank and customer deposits decreased to AFN 253.91 billion (96.34% of the total liabilities) or by 4.48% due to withdrawals and exchange rate fluctuation. Deposits were largely denominated in USD (64.69%) with Afghani denominated deposits lagging at 29.43%, while deposits in other currencies lagging at 5.88%. AFN-denominated deposits indicated 3.93% increase, while USD denominated deposits declined by 5.93% in the quarter under review.
- The capital base of the banking sector remained adequate but yet decreased by 2.39% or AFN 34.71 billion, which was as a result of decrease in banks' profitability. Capital adequacy ratio of all banks were above the set limit, on the meantime capital to risk weighted was 8% and Capital adequacy ratio (CAR) of the banking sector were 25.84% (based on Basel benchmark).
- During the quarter under review, higher amount of provision allocation as well as raise in losses from Foreign Exchange (FX) revaluation had impact on the profitability of the sector and is declined significantly as compared to the previous quarter of FY 2019. Return on Assets (ROA) and Return on Equity (ROE) declined in the quarter under review, where ROA stood at 0.05% and return on equity recorded as 0.47%. It has to be mentioned that all of the banking institutions ended the third quarter with profits.

[1] In the banking sector bulletin Islamic bank is a part of private banks.

## 6.1. ASSETS OF THE BANKING SYSTEM

The assets size of the banking sector decreased by 3.33% in the third quarter of FY 2019 against 3.35% increase in the second quarter of FY 2019 (see Table 6.1). The decline in total assets apart from the exchange rate fluctuation has been contributed by Cash in vault and Claims on DAB, net interbank claims, net loans and other assets (net).

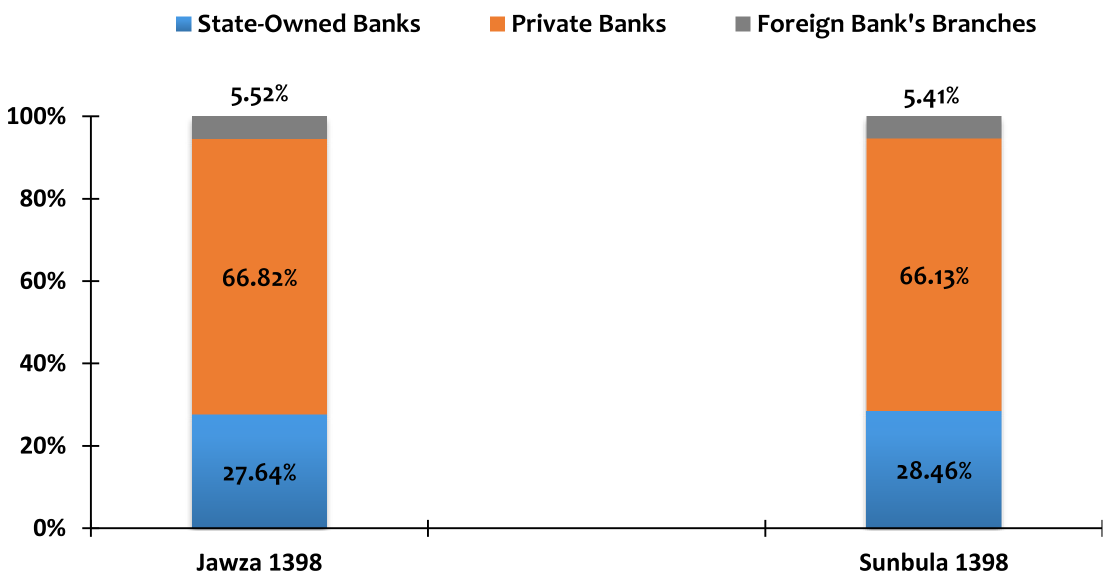
The most important components of the system's total asset portfolio were cash in vault and claims on DAB, interbank claims, net loans, investments, other assets, fixed assets with shares of 39.21%, 28.51%, 12.47%, 10.24%, 5.02%, and 2.93% in total assets respectively (these are the major components of the assets, minor components are not mentioned here), see table 6.1. Private Banks are the leading player in the banking sector accounting for 66.13% of total banking sector assets (Islamic bank makes 5.54% of the sector total assets) followed by State-owned banks with 28.46% share in the market, while branches of foreign banks held 5.41% of the total assets.

**Table 6.1:** Assets of the banking system

| Description | Q2-2019 (Q2-1397 ) | Q3-2019 (Q3-1398 ) | % of Total Assets/Liability | Growth |
|---|---|---|---|---|
| **Assets** | **Amount in million AFN** | | | |
| Cash in vault and claims on DAB | 121,863.56 | 116,947.86 | 39.21 | (4.03) |
| Interbank claims(Net) | 94,708.24 | 85,050.25 | 28.51 | (10.20) |
| Investments (Net) | 28,456.35 | 30,529.24 | 10.24 | 19.39 |
| Loans (Net) | 39,200.68 | 37,181.30 | 12.47 | (5.15) |
| Intangible assets | 942.30 | 1,003.51 | 0.34 | 6.50 |
| Repossessed Assets | 944.40 | 992.26 | 0.33 | 5.07 |
| Fixed Assets | 8,414.31 | 8,735.24 | 2.93 | 2.49 |
| Others (Net) | 15,025.42 | 14,958.61 | 5.02 | (0.13) |
| Total | 309,555.26 | 298,275.97 | | (3.66) |
| **Liabilities** | | | | |
| Deposits | 265,817.93 | 253,918.76 | 96.34 | (4.48) |
| Borrowings | 3,312.76 | 3,713.95 | 1.41 | 12.11 |
| Other | 4,819.28 | 5,929.10 | 2.25 | 20.34 |
| Total | 273.949.97 | 263,561.80 | | (3.83) |
| **Financial Capital** | 35,605.29 | 34,714.16 | | (2.39) |

Source: Financial Supervision Department, DAB

**Figure 6.1:** Share of Banking Sector (Total assets) across the banking group for the 2nd and 3rd Quarter of FY 2019 (1398)

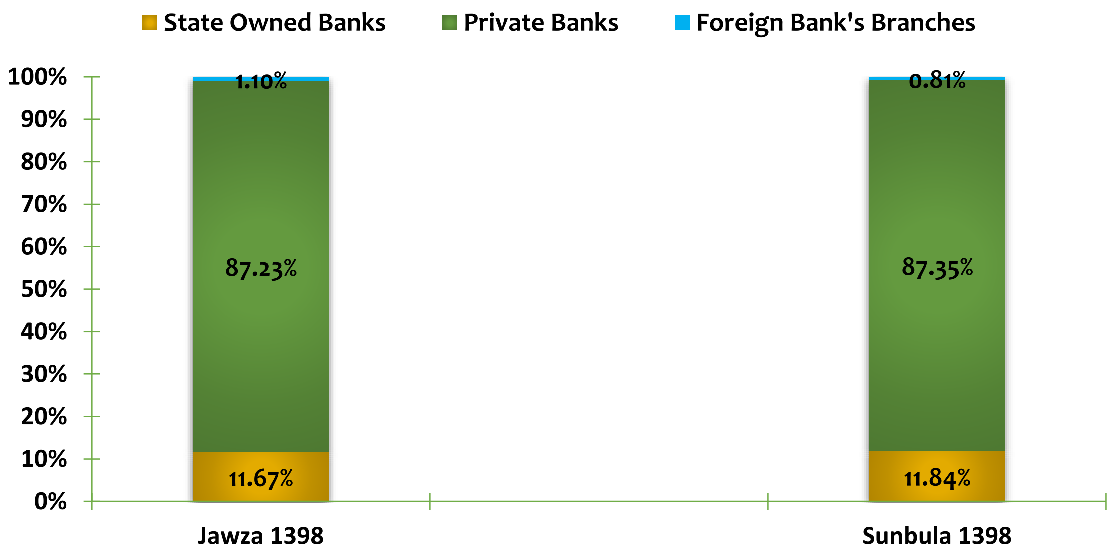



**Source:** Financial Supervision Department, DAB

### 6.1.1. Gross Loans

Total gross loans portfolio of the banking sector at the end of September 2019 stands at AFN 42.37 billion, indicating AFN 1.64 billion or 3.73% decrease over the quarter, constituting 14.21% of the total assets and 2.93% of GDP. The decrease in total gross loans is mainly attributed to recovery, less OD utilization, Recovery and USD rate decrease.

**Figure 6.2:** Share of Gross Loans Portfolio among banking group for the 2nd and 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department, DAB

Three banking institutions recorded increases in their loan portfolio, while ten other banks registered decrease, whereas two banks did not participate in lending. Disaggregated analysis among the banking groups show that Private Banks with major share of 87.35% in the banking sector portfolio registered 3.60% decrease, State Owned banks with share of 11.84% of the total banking sector portfolio demonstrated 2.31% decrease, while Branches of Foreign banks with 0.81% share in the banking sector showed 28.82% growth in the quarter under review.

- **Loan Loss Reserve**

While assessing the level of credit risk, banks must give due attention to credit risk mitigation tools within their risk management 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 the third quarter of FY 2019, total provision cover of the system was 12.25% from total gross loans as opposed to 10.93% recorded at the end of the second quarter of FY 2019.

- **Distribution of Credit**

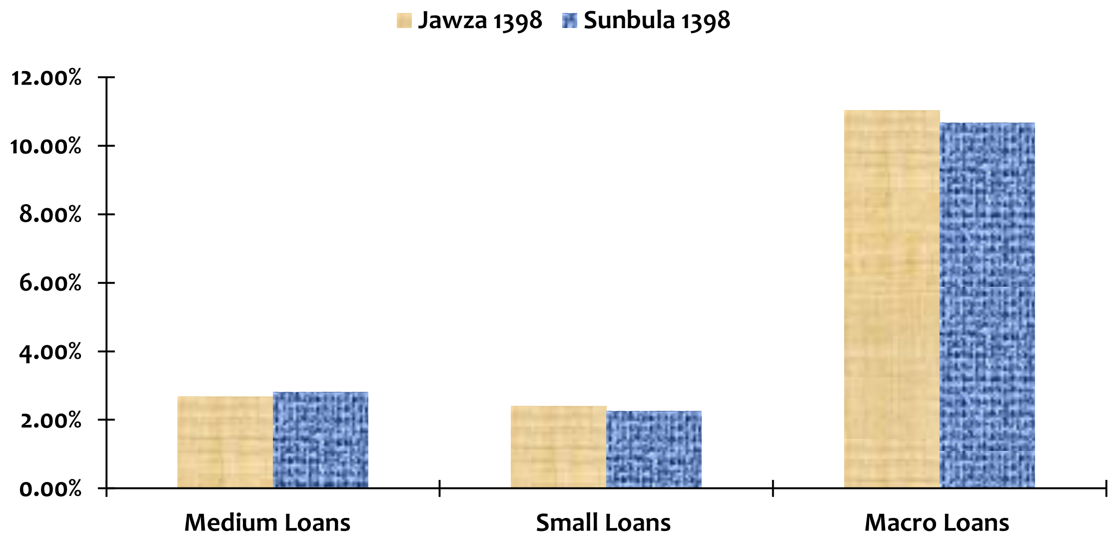
Breakup of gross loans across the various sectors indicates that some sectors are receiving greater credit while others witnessing a contraction. Noticeably loans disbursed to trade sector is making 46.15% in the third quarter of FY 2019 against 44.42% in the second quarter of FY 2019. Disbursement of loans in Cement and other construction material items was 3.78% in the quarter under review against 3.01% of the previous quarter; other main sectors include: Services sector (19.9% against 20.43%) in which disbursement was mainly in telecommunications/scratch cards distributers (6.49%), Manufacturing and Industry sector (10.82% against 11.89%), Infrastructure Projects (8.90% against 8.82%), Commercial real estate and Construction sector (8.21% against 8.45%), Agriculture livestock and farms sector (3.57% against 3.82%) and Consumer sector (2.40% against 2.17%). Increase were observed in three sectors such as trade**, livestock and farms** and consumer, while Commercial real estate and construction, Manufacturing and industry, Service and Agriculture sectors witnessed decrease. **Loan**s designated to Medium, Small and Micro sectors decreased in the quarter under review, which is provided by ten banking institutions (see figure 6.3). Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises situation associated to that sector, inversely affecting the overall banking sectors. Banks should closely monitor the potential risk associated with key sectors given the high Non-Performing Loans (NPL) ratio. About 71% of the loans were designated in Kabul while Balkh and Heart provinces are in the second and third places with Kandahar and Badghis provinces are at fourth and fifth places respectively. The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that over 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:** Distribution of credit sector wise for the 3rd Quarter of FY 2019 (1398)

| Sectors | Q4-2014 (Q4-1393) | Q4-2015 (Q4-1394) | Q4-2016 (Q4-1395) | Q4-2017 (Q4-1396) | Q4-2018 (Q4-1397) | Q3-2019 (Q3-1398) |
|---|---|---|---|---|---|---|
| **Commercial Real Estate and Construction** | | | | | | |
| Construction and Buildings | 14.32% | 9.44% | 11.12% | 8.70% | 9.03% | 8.21% |
| **Infrastructure Projects** | | | | | | |
| Power | 0.35% | 0.22% | 0.38% | 0.40% | 0.48% | 0.08% |
| Road and Railway | 2.41% | 1.17% | 0.64% | 1.32% | 2.18% | 2.74% |
| Dames | 0.61% | 0.09% | 0.04% | 0.00% | 0.36% | 0.37% |
| Mines | 0.08% | 1.48% | 0.52% | 0.48% | 0.52% | 0.49% |
| Other infrastructure projects | 1.81% | 2.44% | 2.44% | 3.46% | 3.28% | 5.23% |
| **Manufacturing and Industry** | | | | | | |
| Manufacturing &Products of Metal wood plastic rubber leather paper | 2.477% | 4.423% | 3.469% | 2.671% | 4.10% | 4.43% |
| Manufacturing handmade and machine products | 4.187% | 4.239% | 3.743% | 3.164% | 3.67% | 4.04% |
| Cement and Construction Materials | 2.864% | 1.962% | 1.274% | 3.520% | 4.42% | 2.35% |
| **Trade** | | | | | | |
| Textile | 2.59% | 0.52% | 0.72% | 1.54% | 2.21% | 1.85% |
| Wholesale | 4.93% | 9.89% | 4.34% | 4.67% | 3.62% | 4.66% |
| Machineries | 0.12% | 0.25% | 0.13% | 0.09% | 0.41% | 0.25% |
| Petroleum and Lubricants | 8.74% | 9.80% | 11.08% | 10.78% | 11.48% | 12.73% |
| Spare parts | 0.24% | 1.42% | 0.26% | 1.39% | 1.78% | 1.73% |
| Electronics | 1.40% | 1.58% | 1.91% | 2.76% | 3.21% | 2.68% |
| Cement and other construction Material | 1.87% | 2.73% | 2.35% | 2.57% | 5.14% | 3.78% |
| Food Items | 4.52% | 8.24% | 7.80% | 7.27% | 6.44% | 7.05% |
| All other Items | 5.72% | 3.47% | 4.17% | 3.28% | 7.92% | 8.48% |
| Retail trading | 3.92% | 3.28% | 7.31% | 8.15% | 3.13% | 2.95% |
| **Service** | | | | | | |
| Education | 0.00% | 0.00% | 0.00% | 0.00% | 0.03% | 0.03% |
| Hotel and Restaurant | 1.20% | 1.46% | 1.33% | 2.04% | 2.16% | 2.49% |
| Telecommunication/Scratch cards Distributers | 2.92% | 5.70% | 5.96% | 5.52% | 5.98% | 6.49% |
| Ground Transportation | 4.87% | 5.31% | 4.86% | 1.86% | 3.08% | 4.00% |
| Air Transportation | 4.18% | 2.66% | 2.35% | 2.90% | 1.21% | 0.98% |
| Health and Hygienic | 0.71% | 1.16% | 1.42% | 1.73% | 1.74% | 1.47% |
| Media, Advertisements, Printer | 0.04% | 0.04% | 0.05% | 1.18% | 1.28% | 1.85% |
| All other Services | 6.19% | 11.36% | 13.22% | 12.26% | 5.07% | 2.65% |
| **Livestock and farms** | | | | | | |
| Livestock and farming | 0.043% | 0.026% | 0.059% | 0.225% | 0.30% | 0.42% |
| **Agricultural Loans** | 2.61% | 2.67% | 3.20% | 3.94% | 3.86% | 3.15% |
| **Consumer Loans** | 0.26% | 0.30% | 0.65% | 0.86% | 1.90% | 2.40% |
| **Residential Mortgage Loans to Individuals** | 7.14% | 2.68% | 2.78% | 0.71% | 0.00% | 0.00% |
| **All Other Loans** | 6.68% | 0.00% | 0.43% | 0.57% | 0.00% | 0.00% |

**Source:** Financial Supervision Department, DAB

**Figure 6.3:** Shares of Small, Macro and Medium Loans as percentage of total gross Loans for the 2nd and 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department, DAB

- **Classification of Loans**

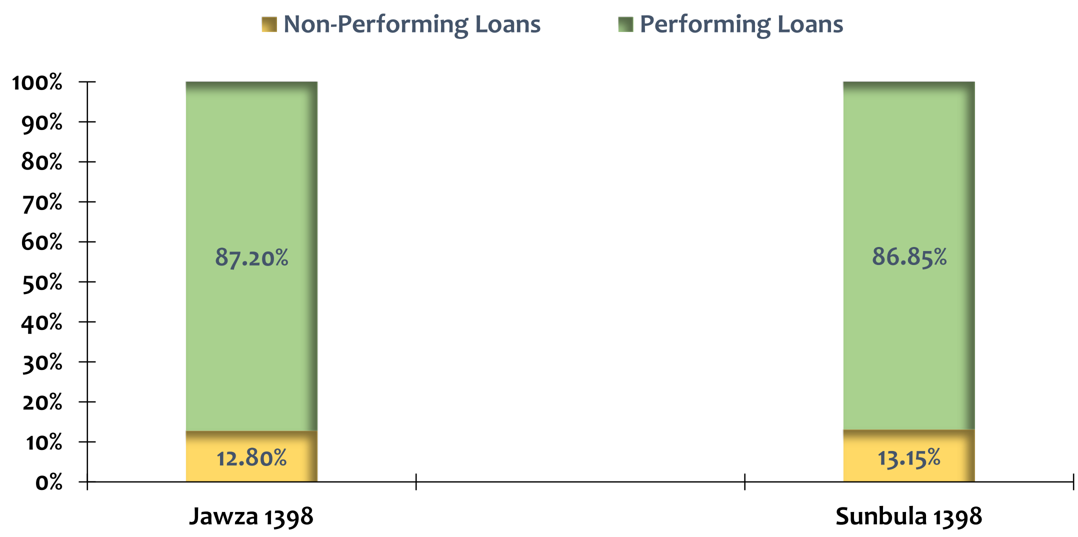
Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs, which is not a favorable situation. Moreover, it can be inferred that quality of risk management in banks with poor credit performance is demonstrating weak performance. It is essential that banks 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 the third quarter of FY 2019, non-performing loans recorded at AFN 5.57 billion or 13.15% of total gross loans and 18.22% of the system's regulatory capital, which is decreased by AFN 62 million owing to settlement and switching of some loans to upper classes. Out of 13.15% NPLs, 10.28% is coming from three private banks, and these banks hold 55.92% of the system's gross loans and 77.46% of system's regulatory capital. Sectoral analysis of the NPLs show that major portion of the NPLs originate from Trade sector (42.82%) with Spare Parts (11.39%) being the major item, also Services sector is in the second place with 19.60% of the sector NPLs, having ground transportation (10.66%) with highest share; Manufacturing and industry sector with 13.59% of total NPLs is in third place, while commercial real estate & construction, and Infrastructure projects sector held 12.40% and 9.23% of the sector NPLs respectively. 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

- Non-performing loans[2]

[2] Defaulted assets and advances for which the principal and/or interest is due and remains outstanding for 121-480 days and more as per the assets classification and provision regulation- (Doubtful and Loss).

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.

**Figure 6.4:** Quality of Loan Portfolio for the 2nd and 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department, DAB

○ **Adversely-classified loans**

Adversely classified loans (substandard, doubtful, Loss)[3] depicted AFN 758 million increase in the quarter under review, reached to AFN 8.1 billion, which is constituted 19.32% of the total gross loans and 26.76% of regulatory capital, and the increase was due to deterioration of the loan quality. These loans require 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.

○ **Loans classified Watch**

Loans classified in the "watch"[4] category amounted to AFN 5.39 billion, which makes 12.73% of total gross loans (increased by 43.60%

[3] An asset for which the principal and /or interest remains outstanding for 61-120 days - (Substandard), [3] Defaulted assets and advances for which the principal and/or interest is due and remains outstanding for 121-480 days - (Doubtful), An asset for which the principal and /or interest remains outstanding for 481 or more days - (Loss) as per the assets classification and provisioning regulation.

[4] An asset for which the principal and/or interest remains outstanding due for 31-60 days as per the assets classification and provisioning regulation-(Watch)

since last quarter). The increase is mostly attributed to one bank in the system coming from reclassification of loans. This category of loans requires close monitoring as it may lead to more adversely classified loans (Substandard, Doubtful and losses) in the future.

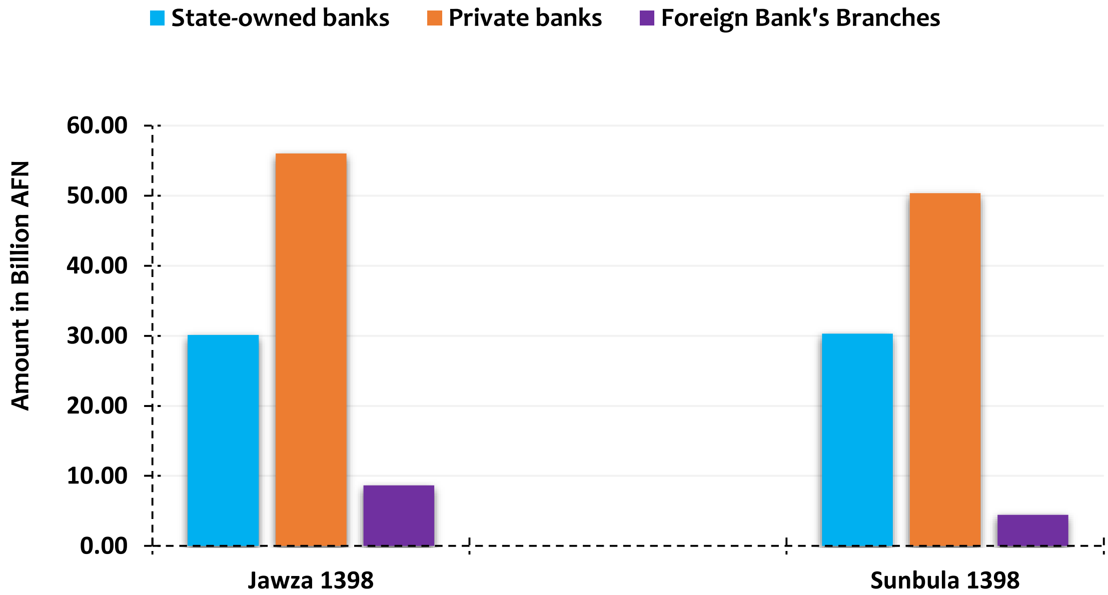
- **Charged-off Loans**[5]

Loans charged-off at the end of the third quarter of FY 2019 amounts to AFN 9.54 million, which makes 0.02% of total gross loans attributed to two banks in the sector.

### 6.1.2. Interbank Claims

Gross Interbank Claims are the second largest among various asset categories, currently comprising AFN 85.12 billion (28.54% of total assets) which registered AFN 9.66 billion or 10.19% decrease since the second quarter of FY 2019. The decrease was mostly attributed to five banking institutions and mainly contributed by exchange rate fluctuation. In the meantime, AFN placements increased which indicated that the banking sector has channeled a portion of its available funds to less interest earning assets in other banking institutions. Banks should not only appropriately measure risks associated with individual bank's but also country or countries in which they have placed funds (see figure 6.4).

**Figure 6.5:** Share of Inter-Bank Claims among banking groups for the 2nd and 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department, DAB

### 6.1.3. Investment

The net-investment[6] portfolio of the banking sector comprises of bonds, Government Securities, investment in associated companies which is increased by 17.40% or AFN 4.95 billion from the second quarter of FY 2019, standing at AFN 30.52 billion or 11.20% of total assets and the increase mostly came from one banking institution. Major part of the sector's investment took place outside Afghanistan, and investment

[5] Default assets and advances for which the principal and/or interest remains outstanding for 481 days or more days and retained on the books of banks for the period of 12 months (Loss), after 12 months they are immediately charged-off as per the assets classification and provisioning regulation.

[6] Investments include investment in bonds, securities, associated companies and in subsidiaries.

portfolio is attributed to two state owned banks, five commercial banks and a branch of foreign banks.

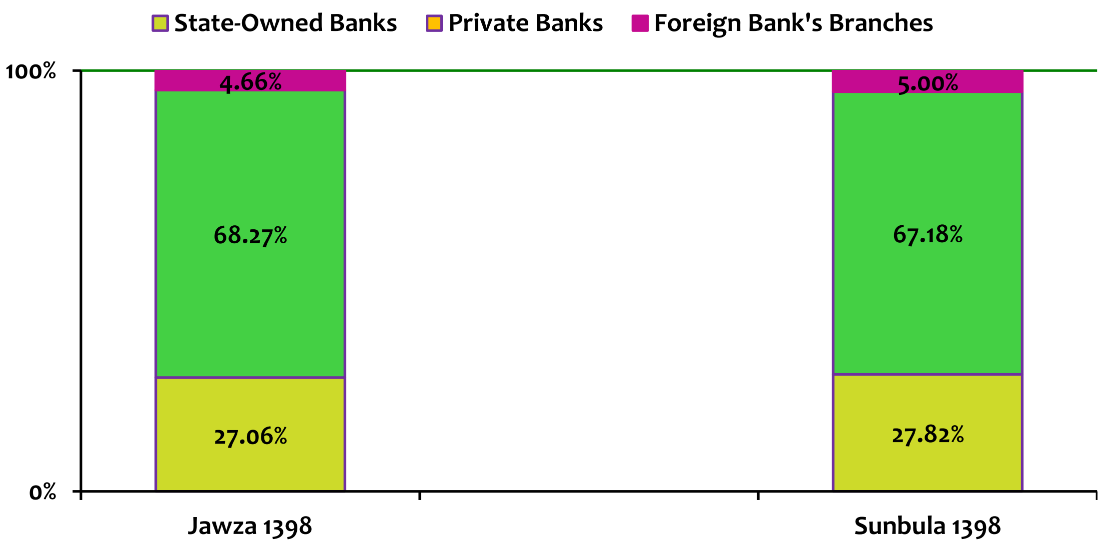
### 6.1.4. Cash in Vault and Claims on DAB

Cash in vault and claims on DAB remains the largest category making 39.21% of the total assets showing decrease of AFN 4.91 billion during the third quarter of FY 2019 standing at AFN 116.94 billion. The decrease was observed in Cash in vault, Correspondent Account with DAB, Required Reserve account with DAB and capital notes. Banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

## 6.2. LIABILITIES

Total liabilities of the banking sector decreased by AFN 10.49 billion or 3.83% standing at AFN 263.56 billion against AFN 8.73 billion in previous quarter of FY 2019. All components of total liabilities climbed in the quarter under review. The majority of liabilities are made up of deposits (96.34%), with "other Liabilities" at second and borrowings in third place (see table 6.1).

**Figure 6.6:** Share of Liabilities among banking groups for the 2nd and 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department, DAB

### 6.2.1. Deposits

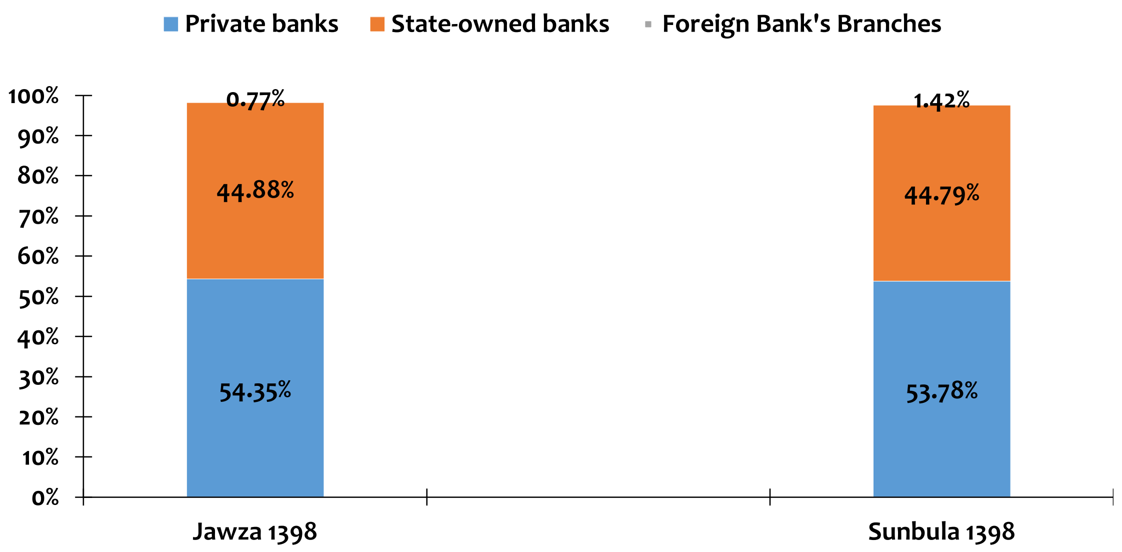
Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 253.91 billion during the quarter under review, which is decreased by AFN 11.89 billion or 4.48% compared to the second quarter of FY 2019. The total deposits cover AFN 4.86 billion interbank and AFN 249.05 billion customer deposits. The decrease in deposit base of the banking sector is attributed to exchange rate fluctuations.

Currency wise analysis shows that Afghani denominated deposits indicated 11.05% increase accounting for 28.36% of total deposits, while US dollar denominated deposits decreased by 39.85% making 62.32% of the total deposits of the system, the major portion of the decrease in deposits is attributed to exchange rate fluctuation. Private Banks attracted AFN 170.34 billion deposits, which is decreased by 5.97% making up 67.09% of the system's total deposits.

While share of state-owned banks amounted to AFN 70.56 billion, decreased by 1.54% since June 2019, accounted for 27.79% of the system's deposits.

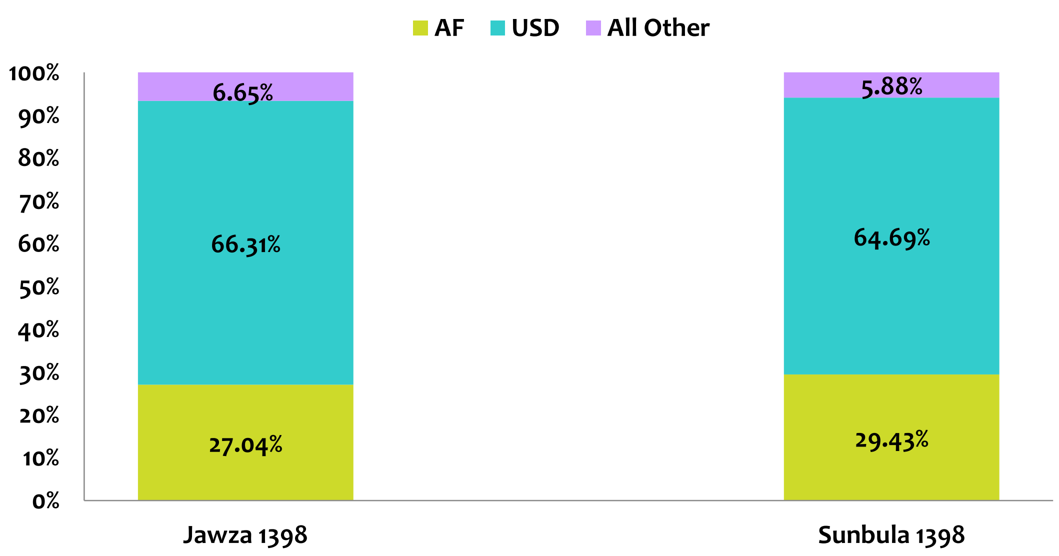
On the other hand, share of foreign banks' branches stands at AFN 13.01 billion increased by 3.65% making up 5.12% of total deposits of the system. In terms of types of deposits, demand deposits accounted for 71.63% of the total deposit base, decreased by 4.78% and saving deposits with 20.31% of total deposits was in the second place, and depicted 1.31% decrease, while time deposit making up 8.06% of the total deposits portfolio was reduced by 9.26% since the second quarter of FY 2019.

**Figure 6.7:** Afghani Denominated Deposits for the 2nd & 3rd quarter of FY 2019



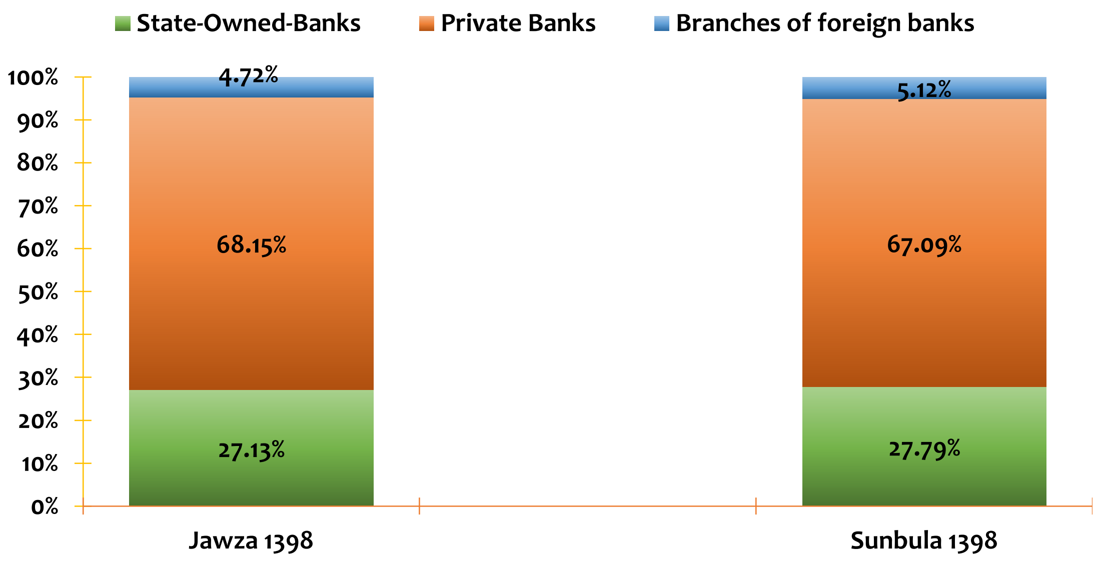

**Source:** Financial Supervision Department, DAB

**Figure 6.8:** Currency Composition of Deposits for the 2nd & 3rd quarter of FY 2019



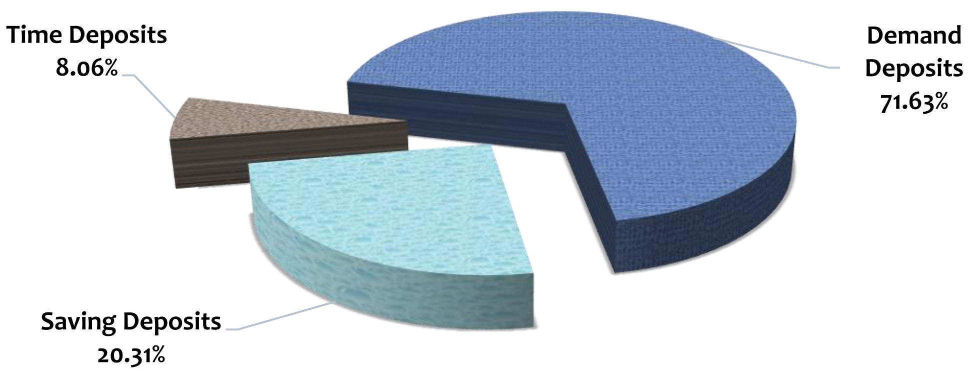

**Source:** Financial Supervision Department, DAB

**Figure 6.9:** Deposits among banking groups for the 2nd & 3rd quarter of FY 2019




**Source:** Financial Supervision Department, DAB

**Figure 6.10:** Breakdown of Deposits for the 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department, DAB

### 6.2.2. Borrowings

The share of borrowings in total funding structure of the system increased by 12.11% standing at AFN 3.71 billion at the end of the quarter under review, making 1.41% of total liabilities. The current borrowing position is attributed to four banking institutions.

## 6.3. LIQUIDITY

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

### 6.3.1. Liquidity Ratio (broad measure)

Banks are required to maintain a liquid asset ratio not less than 15%. This should provide a comfortable safeguard against any liquidity shortfall. Generally, a surplus liquidity position was observed in the banking sector during the period, where 76.47% 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 60.68% and all banking institutions were well above the minimum required level (see table 6.3).

**Table 6.3:** Important ratios of the banking system for the 3rd Quarter of FY 2019 (1398)

| Ratio in% | Q4-2014 | Q4-2015 | Q4-2016 | Q4-2017 | Q4, 2018 | Q2-2019 | Q3-2019 |
|---|---|---|---|---|---|---|---|
| Total Capital Adequacy Ratio | 26.46 | 19.94 | 27.68 | 29.81 | 25.91 | 26.51 | 25.84 |
| Tier 1 Capital Adequacy Ratio | 26.09 | 19.66 | 22.93 | 28.17 | 24.56 | 26.09 | 25.26 |
| Non-Performing Loans to Total Gross Loans | 8.09 | 12.34 | 12.67 | 12.42 | 8.99 | 12.80 | 13.15 |
| Return on Assets ( ROA) | 0.90 | 0.20 | 0.11 | 0.64 | 0.81 | 0.77 | 0.05 |
| Return on Equity ( ROE) | 7.35 | 1.69 | 1.08 | 3.38 | 6.91 | 6.78 | 0.47 |
| liquidity Ratio (Broad Measure Median) | 73.6 | 68.22 | 67.74 | 65.92 | 76.62 | 74.00 | 6.68 |
| liquidity Assets to Total Assets | 73.28 | 75.05 | 71.98 | 73.95 | 72.88 | 69.99 | 67.75 |

*ROA, ROE Sep, 2019 based on quarterly data

**Source:** Financial Supervision Department, DAB

## 6.4. CAPITAL

The system is well capitalized. The capital fund of the banking sector stands at AFN 34.71 billion which is decreased by 2.39% or AFN 849 million since the second quarter of FY 2019. The decrease in total financial capital is mainly attributed to losses. On an aggregate basis the Capital Adequacy ratio of the banking sector stands at 25.84% (see table 6.3).

Disaggregated analysis shows that the financial capital of all banks are above the regulatory limits. The regulatory capital ratio of all banks is above the set regulatory threshold (12% of the risk weighted assets) and the Basel benchmark for capital to risk weighted is 8%.

## 6.5. PROFITABILITY

For the quarter under review; Credit Provision, Interest income, Non-interest income and FX revaluation losses caused profitability of the system to reduce. Net income amounted to AFN 163 million significantly deteriorated since last quarter, on the other hand credit provision has revaluation activity incurred as well, which reduced profitability. The mentioned increases are owing to new placements, issuance of new loans, investments in bonds leading to increase the net-interest income, recoveries from charged-off loans, fees and commissions on BGs and Government Employee's salaries boosted the non-interest income while recoveries from loss loans mainly contributed to low provisions, however, operating expenses increased over the quarter. The return on assets (ROA), shows how well a bank is being managed by conveying how much profit the bank earns per unit of its assets been increased while interest income and non-interest income decreased compared to the previous quarter. This is also being pointed out that in the banking system, losses from FX used. Amid rising net income of the banking sector, ROA and ROE deteriorated in the third quarter of FY 2019. ROA of the banking sector stood at 0.05%, while the returns on equity (ROE) which measures shareholders return on their invested equity in a bank recorded at 0.47%. Deterioration in the return ratios were on account of significant decline in net income of the sector. The average assets and equity decreased since last quarter as well. The ROA of SOB[7] recorded at 0.17%, while PB[8] registered -0.04%, and BOFB[9] recorded 0.55% at end of the third quarter of FY 2019.

**Table 6.4:** Profit & Loss Schedule (P/L) for the 2nd and 3rd Quarter of FY 2019 (1398)

| Items | Q2-2019 (Q2-1398) | Q3-2019 (Q3-1398) | %change |
|---|---|---|---|
| interest income | 2,033.07 | 1,920.86 | -5.52 |
| interest expense | 311.18 | 256.97 | -17.42 |
| Net interest income | 1,721.90 | 1,664.88 | -3.37 |
| Non-interest income | 1,872.20 | 1,590.67 | -15.04 |
| Non-interest expenses | 1,561.02 | 1,558.87 | -0.14 |
| Salary cost | 1,158.02 | 1,067.68 | -7.80 |
| Credit provisions | 151.69 | 505.04 | 232.95 |
| P/L before tax | 747.55 | 248.36 | -66.78 |
| P/L After tax | 1,149.55 | 163.25 | -85.80 |

**Source:** Financial Supervision Department, DAB

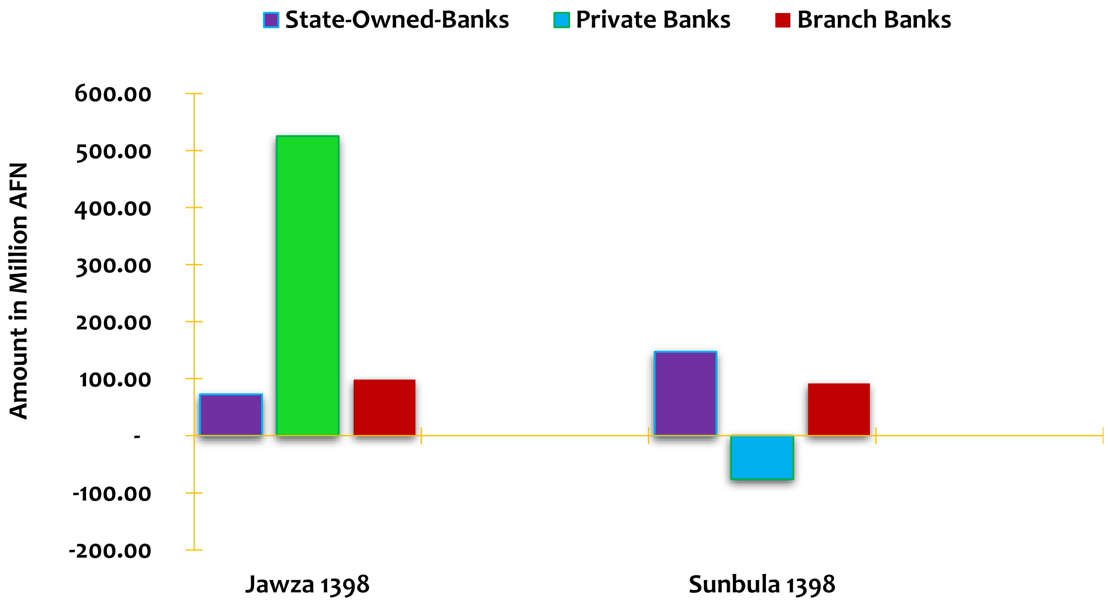
Except seven (7) banks, the rest all ended with profits in the quarter under review, while on core income basis five banks ended with losses against eight banks in the second quarter of FY 2019.

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

Group wise analysis reveals that only State-Owned and foreign banks branches ended up with profit, while Private Banks come up with losses (see figure 6.11).

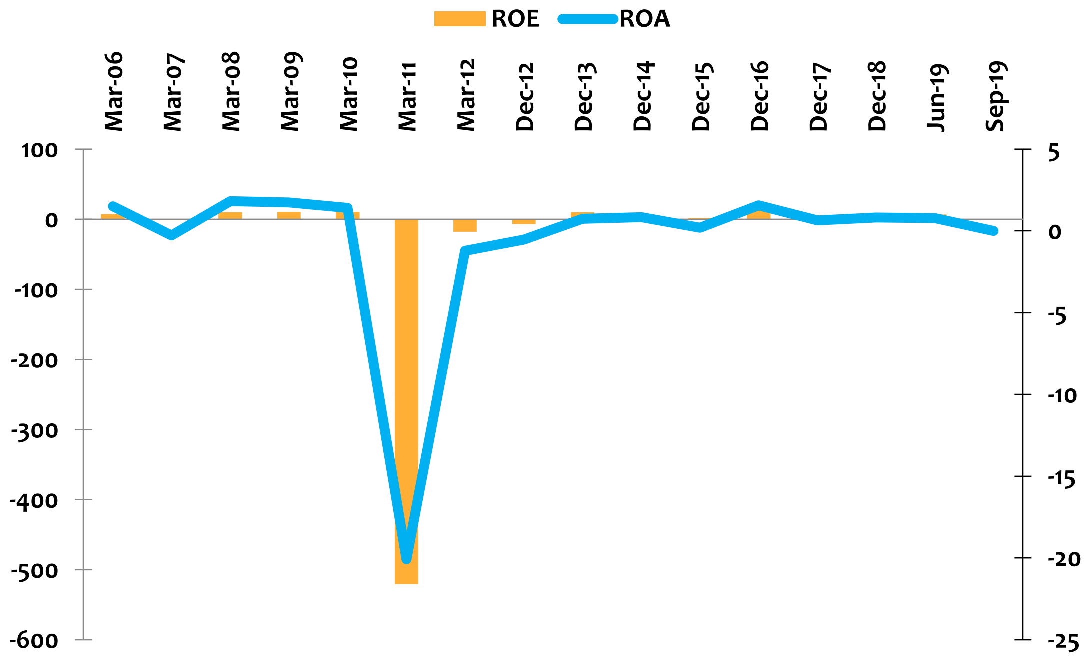
Major portion of the profitability of the banking sector is attributed to State-owned Banks which recorded AFN 147 million, Branches of Foreign banks earned AFN 92 million while Private banks have come up with losses of AFN 76 million during the quarter under review.

**Figure 6.11:** Profitability of the Banking Sector for the 2nd & 3rd Quarter of FY 2019 (1398)



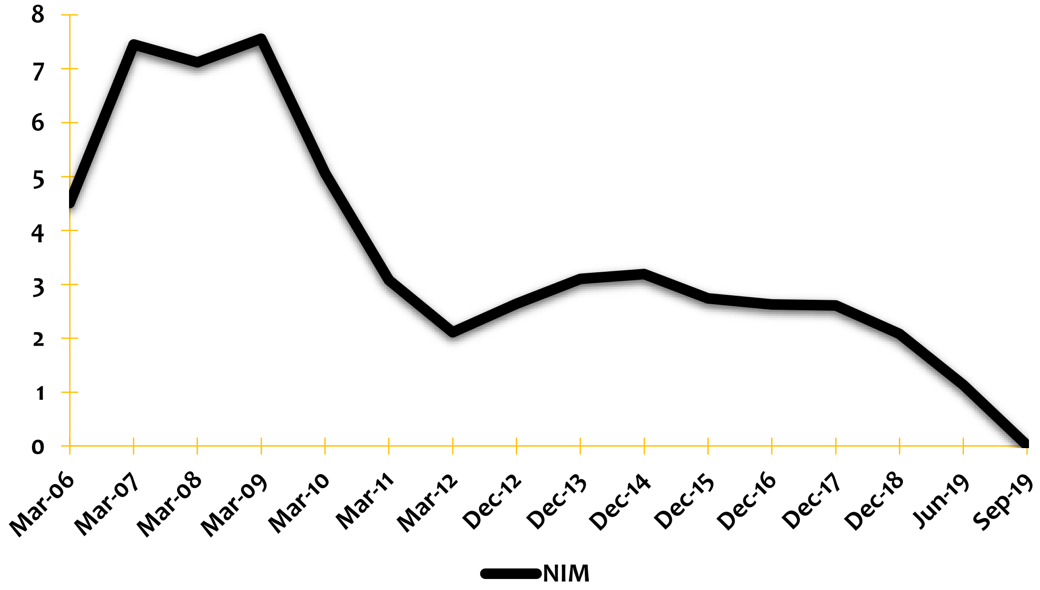

**Source:** Financial Supervision Department/ DAB

**Figure 6.12:** Return on Equity (ROE) and Return on Assets (ROA) of the Banks for the 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department/ DAB

**Figure 6.13:** Net Interest Margin (NIM) for the 3rd Quarter of FY 2019 (1398)




**Source:** Financial Supervision Department/ DAB

## 6.6. 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 and EURO 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% appreciation in exchange rate would increase the regulatory capital of the system by AFN 2.28 billion and vice versa. Similarly, a 4% change would correspond to AFN 458 million and vice versa.

## 6.7. 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 AFN 732 million in the event of 3% increase in the market interest rate (upward interest rate shock). Conversely, if the interest rate decreases by 3% (downward interest rate shock) interest income will decline by AFN 732 million. For five banking institution, if the interest-rate increases by 3%, it will decrease their net interest income over the next 12 months.

The major reason for the over whelming asset-sensitivity of the banks is the huge 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.

## 6.8. ANALYSIS OF FINANCIAL CONDITION AND PERFORMANCE OF THE ISLAMIC BANKING SECTOR

### 6.8.1. Executive summary

The Islamic banking sector recorded a downward trend for its main financial indicators in quarter under review, as apparent from the decrease in total assets, which is mostly due to deposits downturn. The capital of four windows out of six is negative and the equity capital of one full fledge bank is maintained at healthy levels attributed to rise in the profitability along with the adequate level of liquidity position. However, gross financing has downward trend due to settlement of financing of a window and meanwhile investment has upward trend mainly due to new investments.

The asset base of the sector during the third quarter of FY 2019, demonstrated 3.18% decline and stood at AFN 32.03 billion as compared to AFN 33.08 billion in the previous quarter. The decrease in total assets mostly originated from decrease in cash in vault, claims on banks and in Murabaha financing. Total gross financing and investment portfolio of the sector shows 2.17% decrease in the quarter under review which currently stands at AFN 12.02 billion.

The decrease in total gross financing and investment is mainly attributed to settlement in Murabaha financing and issue of new Sukuk investment. The percentage decrease of the total gross financing portfolio of the sector is 12.78% and vice versa the Sukuk investment shows 9% increase. Deposits being the main source of funding in the Islamic banking sector witnessed 3.81% decline in the second quarter of FY 2019 while currently it stood at AFN 26.33 billion, where the decrease in total deposits was due to decrease in the interbank time deposits.

Time and saving deposits make together make 67% of the overall deposits, where individually Time deposits and saving deposits make 27.53% and 39.46% of the total deposits respectively. On the other hand, the depreciation of USD against AFN also had an impact in the decrease of total deposits of the sector, while the time deposits of the customers faced up-turn trend for the quarter under review.

There is no statutory requirement for Islamic Banking windows to maintain a separate limit of financial capital. The capital of one full fledges bank stands above regulatory limit and the total capital of the sector shows decrease of 1.15% in the second quarter of FY 2019 which resulted from losses in the quarter. The financial capital of four windows out of six is negative; however, the regulatory capital ratio (CAR) of full fledge bank is very close to the threshold (12% of the risk weighted assets).

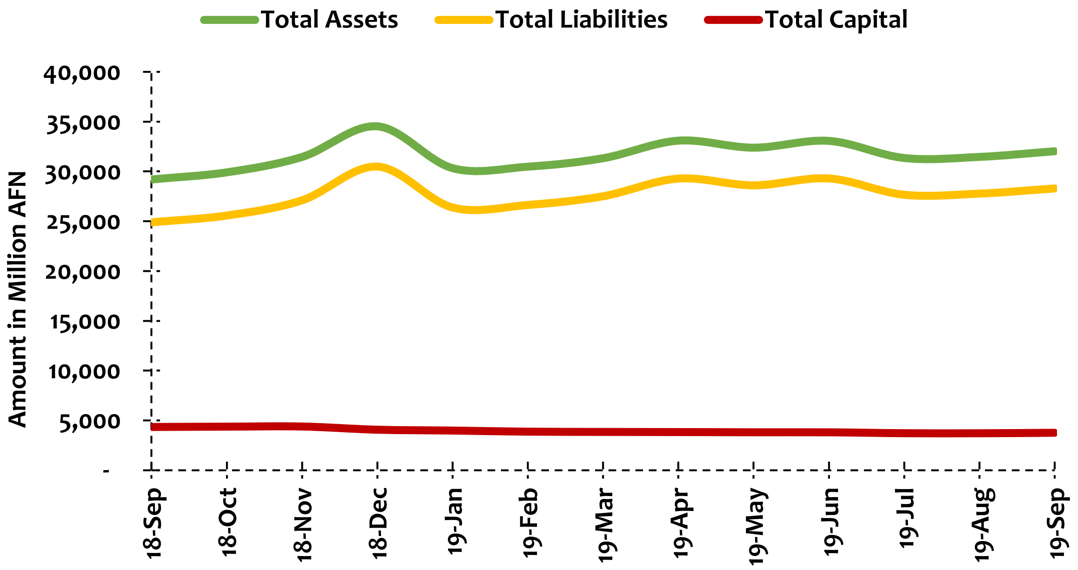
On a cumulative basis for the nine months of FY 2019 (January to September), the Islamic banking sector suffered net loss of AFN 302.38 million against AFN 267.90 million in the same period of FY 2018. As a result, the ROA and ROE stood at -2.2% and -14.7% on annual basis respectively, compared with the ROA of -1.49% and ROE of -11% (on annual basis) in the same period of FY 2018.

Liquidity and FX positions of windows are in accordance with the benchmarks set by the Central Bank (20% Quick and 15% Broad liquidity Ratios and ± 40% for overall FX position and ± 20% on individual currency position) on overall and individual currency basis (USD long position). On the other hand, the full fledge bank lies in violation of both FX limits set by Central Bank.

### 6.8.2. Total Assets

Assets base of the Islamic banking sector registered a decline of 3.18% over the last quarter, standing at AFN 32.03 billion (USD 409.49 Million), against 5.59% growth in the last quarter (June, 2019). The decrease in total assets was mostly due to decline in deposit base. The analysis of total assets shows that most obvious decrease was recorded in Cash in vault, interbank claims and in Murabaha financing.

**Figure 6.14:** Trend of Assets of the Islamic Banking Sector from 3rd Quarter of FY 2018 to 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking and Finance Department, DAB

Looking at the decrease in total assets across the sector, the decline took place in Islamic Banking windows' assets, meanwhile assets of one full-fledged Islamic bank had growth of 1.89% as compared to last quarter. The percentage share of fully fledged bank in the sector's total asset is reported 52%; state-owned banks windows with 12.32% and while the other four windows of private commercial banks have 36.14% shares in the sector's total assets. The trend of assets of the Islamic Banking Sector from September 2018 to September 2019 is depicted in figure 6.12 above.

**Table 6.5:** Assets of the Islamic Banking sector in descending order for the 3rd Quarter of FY 2019

| Serial No. | Names of Banks | Assets in million AFN | Size of Individual Banks as % of Total Assets of the sector |
|---|---|---|---|
| 1 | Islamic Bank of Afghanistan | 16,535.93 | 51.62 |
| 2 | Islamic Banking window of AUB | 4,458.35 | 13.92 |
| 3 | Islamic Banking Window of BMA | 3,820.89 | 11.93 |
| 4 | Islamic Banking Window of GB | 3,058 | 9.55 |
| 5 | Islamic Banking Window of MB | 2,867 | 8.95 |
| 6 | Islamic Banking Window of AIB | 1,169 | 3.73 |
| 7 | Islamic Banking Window of NKB | 125.18 | 0.39 |
| | Total | 32,034.60 | 100.00 |

**Source:** IBFD, Islamic Banking and Finance Department, DAB

The fluctuation in the assets of Islamic banking sector during the month of December and January 2019 was mainly due to decline in demand deposits of the customers during the mentioned period. The components of the Islamic banking sector assets portfolio were cash in vault and claims on DAB without interest (40.18%), interbank claims (14.02%), net Murabaha financing (17.47%), investment (Sukuk and assets acquired for leasing) at 20.08% and other assets make 9% of the total assets.

**Table 6.6:** Total Assets and Liabilities of Islamic Banking Sector for the 2nd & 3rd Quarter of FY 2019 (1398)

| Description | Q2-2019 (Q2-1398) | Q3-2019 (Q3-1398) | % of Total Assets/Liability | Quarterly Growth/Decline |
|---|---|---|---|---|
| **Assets** | **Amount in million AFN** | | | |
| Cash in vault and claims on DAB | 13,351 | 12,870 | 40% | -3.60% |
| Interbank claims | 5,136.68 | 4,492.39 | 14.02% | -12.54% |
| Financing Murabaha (Net) | 5,449.04 | 4,590.74 | 14% | -16% |
| Investment (Sukuk and other) | 5,880.60 | 6,432.66 | 20% | 9% |
| Other Assets | 2,633.88 | 3,025.57 | 9% | 15% |
| Fixed and Intangible Assets | 636.027 | 622.55 | 1.9% | -4.2% |
| Total Assets | 33,087.34 | 32,034.60 | | -3.18% |
| **Liabilities** | | | | |
| Deposits | 27,382.73 | 26,339.86 | 93% | -3.81% |
| Other liabilities | 1,762.92 | 207.71 | 5% | 15% |
| Total liabilities | 29,291.10 | 28,282.18 | | -3% |
| **Financial Capital** | 3,796.24 | 3,752.42 | | -1.15% |
| **Total Liabilities + Capital** | 33,087.34 | 32,034.60 | | -3.18% |

**Source:** IBFD, Islamic Banking and Finance Department, DAB

- **Gross Murabaha Financing and Investment (Sukuk)**

Gross Murabaha financing and investments (Sukuks and others) of the Islamic banking sector for the third quarter of FY 2019 stands at AFN 12.02 billion (USD 153.76 million), constituting 37.55% of the total assets, and indicates AFN 267.69 million (2.17%) decrease since the second quarter of FY 2019.

Gross Murabaha financing is AFN 5.59 billion (USD 71.73 million) which makes 17.47% of total assets, where investment (Sukuk and other) is AFN 6.43 billion (USD 82.22 million) constituting 20.08% of the total assets.

Total Afghani-denominated financing and investment recorded at AFN 3.38 billion (USD 43.25 million) which makes 28% of total Gross financing and investment or 10.56% of total assets. While the US Dollar denominated financing and investment is AFN 8.64 billion (USD 110.50 million), which makes 72% of total gross financing and investment or 26.98% of total assets. The decrease in total financing and investment portfolio is mainly due to settlement of Murabaha financing of AFN 909 million of a window during the quarter under review.

**Table 6.7:** Product wise Islamic Banking Sector Financing and investment (gross)

| No | Product | Q2-2019 | Q3-2019 | Difference in Amount | Difference in % | Products as % of Gross Investment & Financing |
|---|---|---|---|---|---|---|
| | | Amount in Million AFN | | | | |
| 1 | Murabaha Receivables | 6,416.29 | 5,596.46 | (819.82) | -12.78% | 46.52% |
| 2 | Diminishing Musharaka | 117.63 | 115.26 | (2.37) | -2%) | 44% |
| 3 | Constant Musharaka Financing | 53.80 | 52.72 | (1.08) | -2% | 0.16% |
| 4 | Investment Securities (Sukuk) | 2,444.12 | 3,654.68 | 1,210.55 | 50% | 30.38% |
| 5 | Asset acquired for leasing | 1,958.78 | 1,958.78 | 0 | 0% | 16.28% |
| 6 | Other investment | 1,306.24 | 651.204 | (655.04) | -50% | 40.40% |
| | Grand Total | 12,296.89 | 12,029.13 | (267.76) | (2.17)% | 100% |

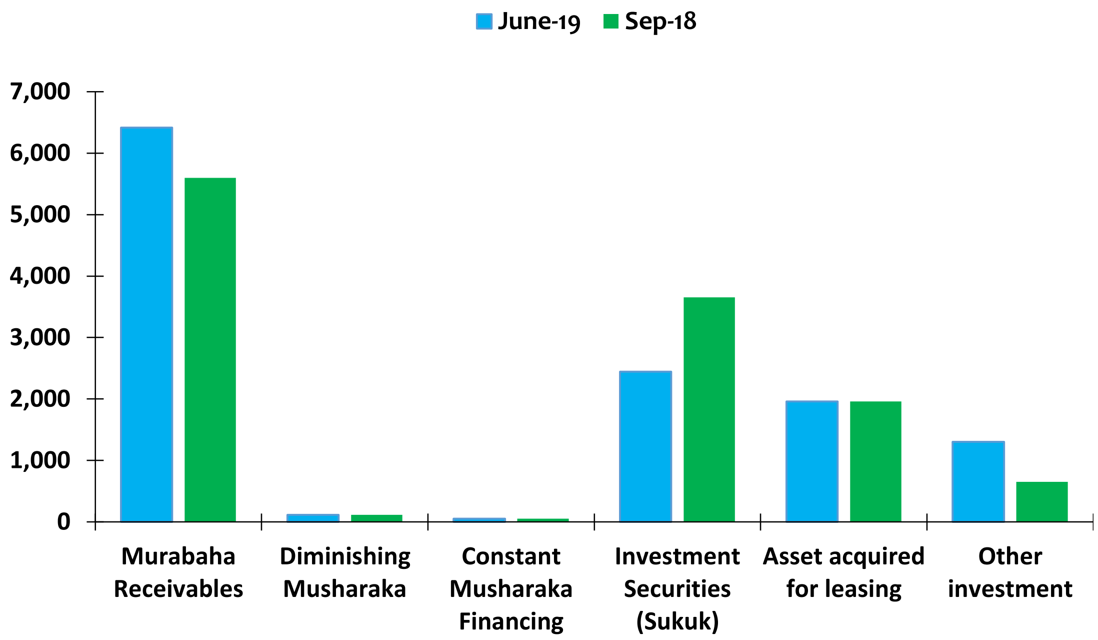
**Source:** IBFD, Islamic Banking and Finance Department, DAB

Meanwhile investment securities (Sukuk) showed increase of AFN 552.05 million in the third quarter of FY 2019, which was mainly attributed to the new financing of Sukuk. At the same time, settlement and installment of Murabaha financing have been collected during the quarter. The sectoral lending of Murabaha financing in Afghanistan is dominated by Islamic Banking window constituting 84.02% of total gross Murabaha financing of the sector, while share of fully fledged bank in total Murabaha financing is 15.97%, as well as the total investment securities in Sukuk of the sector which is invested out of the country is dominated by fully fledged bank with 84.98% share of the total investment and remaining 15.02% is shared between two Islamic banking windows of the commercial banks.

The breakup of total gross financing and investment of the sector included AFN 5.59 billion-Murabaha receivables, which is decreased by 12.48% and shared 46.52% of the gross financing and investment. Diminishing Musharaka amounted to AFN 115.26 million (0.96%), constant Musharaka was AFN 52 million, Sukuk investment was AFN 3.65 billion (30.38%) which is increased by AFN 1.21 billion, and Asset acquired for leasing amounted to AFN 1.95 billion (16.28% of the gross financing and investment) during the third quarter of FY 2019.

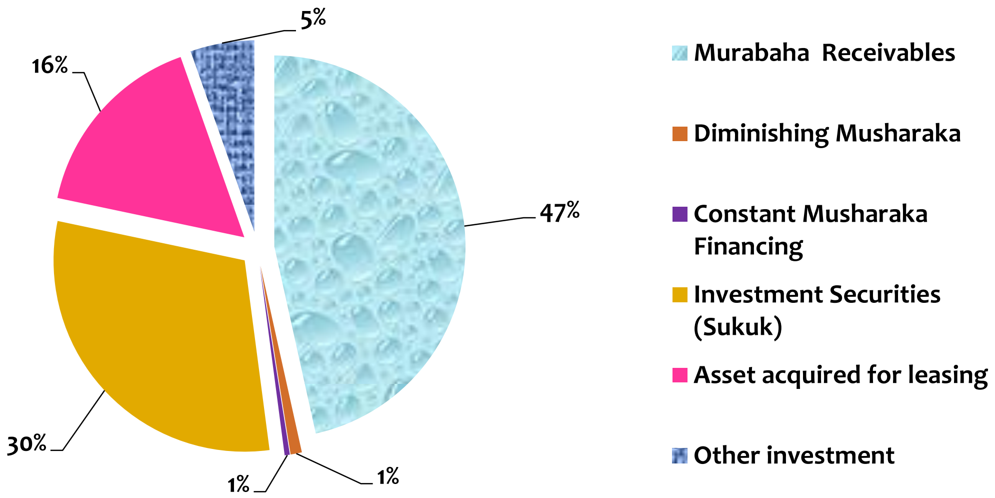
Increase in investment (Sukuk) portfolio was observed at one bank's window and at full-fledged bank, and it is worth mentioning here that Islamic banking window of NKB has no financing and investment activities.

**Figure 6.15:** Product wise Investment and Financing of the Islamic Banking Sector for the 2nd & 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking and Finance Department, DAB

**Figure 6.16:** Product wise investment and financing (%) for the 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking and Finance Department, DAB

- **Financing & Investment Loss Reserve**

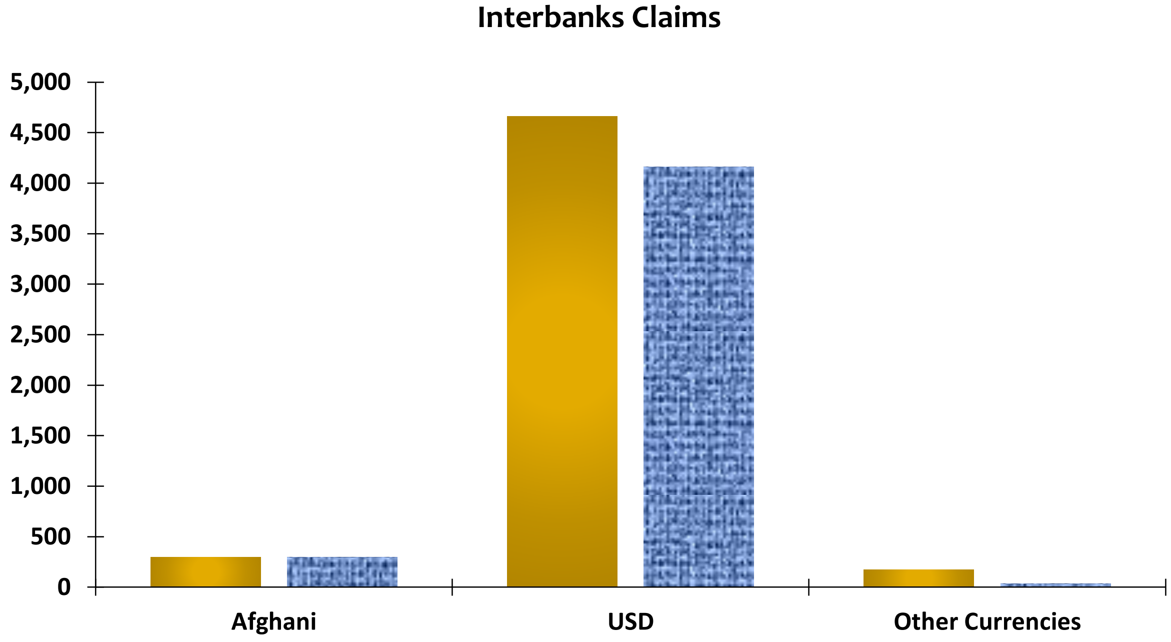
At the end of the quarter under review, total provision of Islamic Banking sector stands at AFN 1.02 billion and shows increase of AFN 38.48 million as compared to previous quarter, reported wholly for Murabaha financing. The provision of the sector is comprised of AFN 1 billion for Murabaha financing and AFN 20.36 million for account receivable. The provision for Murabaha financing for the third quarter of FY 2019 encompasses 17.97% of total gross financing of Islamic banking sector where it was 15.07% in the second quarter of FY 2019.

- **Interbank Claims**

The Interbank Claims of the Islamic Banking Sector are the fourth largest among various asset categories, which stands at AFN 4.49 billion (USD 57.42 million) at the end of third quarter of FY 2019, constituting 14.02% of total assets, and decreased AFN 644.29 million as compared to the second quarter of FY 2019. The decrease has reported in time deposits with banks due to maturity of contract. Interbank claims denominated Afghani 6.67%, USD 92.61% and other currencies 0.702% (see figure 6.15).

Two out of six Islamic banking windows and one Islamic bank have interbank claims which consists of AFN 1.51 billion time-deposit and AFN 2.97 billion demand deposits, the interbank claims used as commodity Murabaha and internal bank transferring and settlement transactions with their banks.

**Figure 6.17:** Interbank claims of the Islamic Banking Sector for the 2nd & 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking and Finance Department, DAB

- **Cash in Vault and Claims on DAB**

The Islamic Banking Sector's Cash in vault and claims on DAB at the end of the third quarter of FY 2019 stands at AFN 12.87 billion (USD 164.52 million) and decreased by AFN 480.42 million as compared to the second quarter of FY 2019. The cash in vault and claims on DAB is largest item and makes 40% of total assets of the sector. The decrease in Cash in vault and claims on DAB mainly showed in cash in vault. The reason of decrease in above item is mainly due to decline in total deposits of the sector in the quarter under review.

Cash in vault and Claim on DAB consists of AFN 4.01 billion cash in vault, AFN 6.47 billion non-interest bearing current Account with DAB and AFN 2.38 billion Required Reserve Account with DAB.

### 6.8.3. Total Deposits

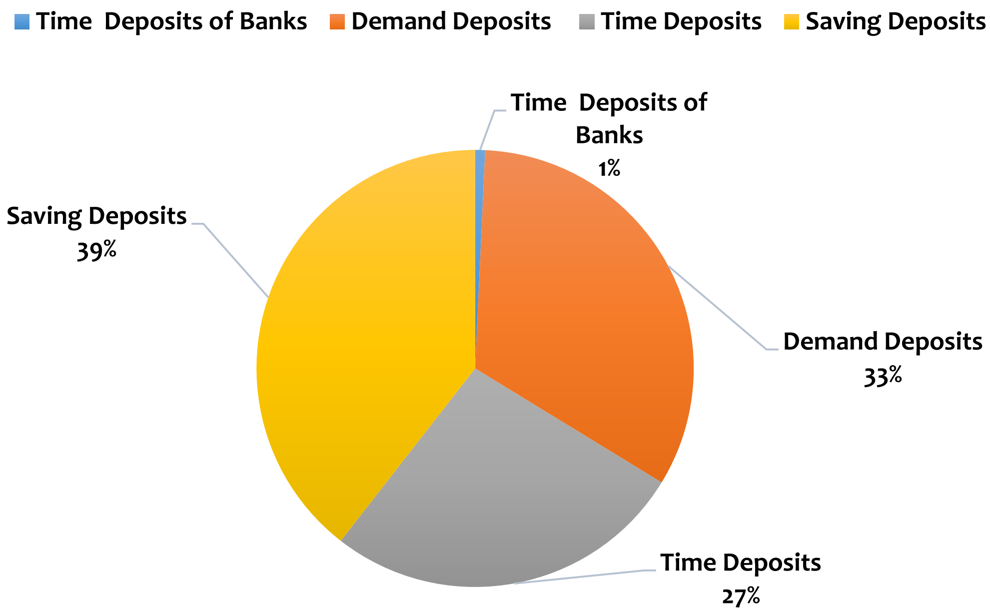
Deposits, the main source of funding and the major component of liabilities, stand at AFN 26.33 billion (USD 336.69 million), making 93.13% of total liabilities, decreased by 3.31% since June, 2019 (Jawza 1398), against AFN 27.38 billion (USD

341.30 million) with 6% growth in last quarter. The decrease in total deposits was mostly obvious in time deposits of a window with banks (AFN 658.44 million) with saving deposits decreased by AFN 24.37 million (0.23% decrease), and demand deposits of the sector decreased by AFN 522.86 million or 6%, while time deposits of customers showed an increase of AFN 165 million (2.40%) over the last quarter.

Furthermore, the decrease mostly occurred in AFN deposits, while USD deposits registered an increase in its position. AFN-denominated deposits of the sector were AFN 9.43 billion (USD 120.63 million) or 35.83% of the total deposits, decreased by 18.58%, while the USD-denominated deposits of the sector stood at AFN 16.902 billion (USD 216.05 million), or 64.17% of total deposits, which is increased by 7.04%. Full-fledged bank has the highest share in total deposits of the sector, standing at 53.98% followed by Islamic banking windows with 46.02% share.

The total customers' deposits of the sector consist of AFN 8.69 billion of demand deposits, AFN 7.05 billion of time deposits and AFN 10.39 billion of saving deposits. Demand deposits make 33.24%, time deposits 26.99% and saving deposits make 39.76% of the total deposits of the sector, and comprises of AFN 26.14 billion of customers' deposit and AFN 194.56 million of banks deposits. The deposits of banks make only 0.73% of total deposits in the sector.

**Figure 6.18:** Breakdown of Deposits for the 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking & Finance Department, DAB,

### 6.8.4. Liquidity

The liquidity position of all Islamic Banking Windows and fully fledged Islamic bank are above the set minimum for the broad liquidity ratio (15%) and the Quick Liquidity Ratio (20%). Broad liquidity ratio of the banking sector as a median stand at 49.86% points against 51.57% in the previous quarter, showing a decrease of 1.71%. Since there is no Capital Market inside Afghanistan, the banking sector remained highly liquid.

Generally, the 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 ratio level, in order to avoid any liquidity problem. For this reason, Islamic Bank and windows should maintain an asset liability committee (ALCO); one of its tasks is the liquidity management of the bank through gap analysis, stress testing, scenario analysis, cash flow analysis, etc. according to policies of the bank.

**Table 6.8:** Key Financial Soundness Indicators of the Islamic banking sector for the 3rd Quarter of FY 2019

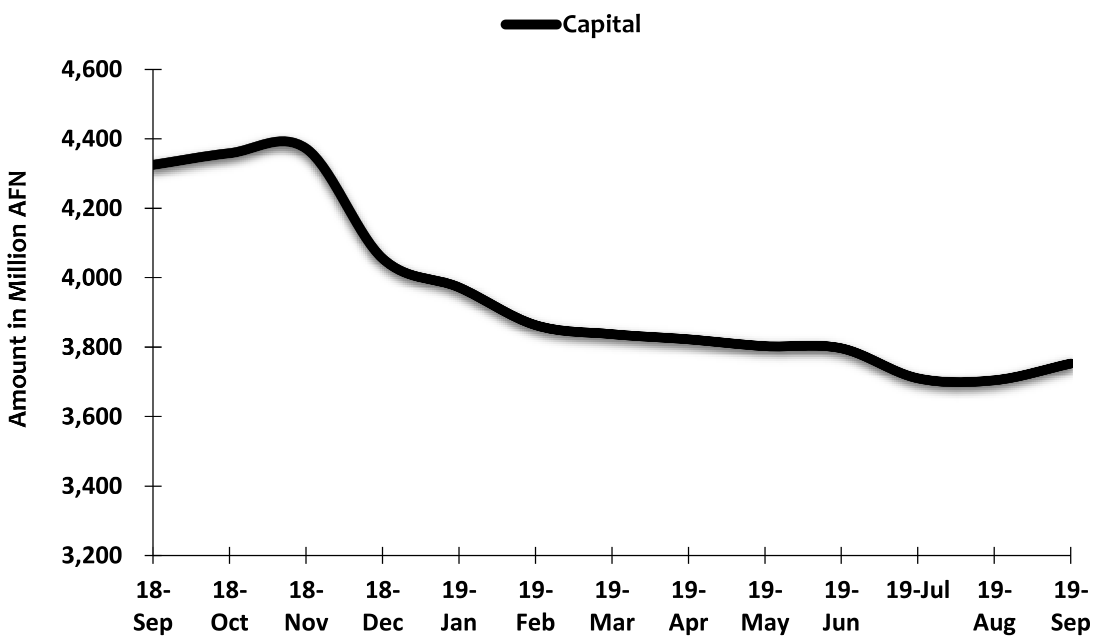
| Ratio in% | June, 2019) | (Sep, 2019) |
|---|---|---|
| Liquid Assets to Total Assets | 55.87% | 54.20% |
| Liquid assets to short term liabilities | 3271% | 200% |
| Foreign-Currency denominated funding to total funding | 58.67% | 64% |
| Foreign- Currency denominated financing to total financing | 57% | 72% |
| Return on Assets ( ROA) | (0.212) | (2.2) |
| Return on Equity ( ROE) | (1.831) | (14.7) |

**Source:** IBFD, Islamic Banking & Finance Department, DAB

### 6.8.5. Capital

The capital of the sector stands at AFN 3.75 billion (USD 47.96 million), decreased by 1.15% since previous period (June, 2019) when it was AFN 3.79 billion. The decrease in the total equity capital is due to loss over the quarter.

**Figure 6.19:** Capital Trend of the Islamic Banking Sector for the 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking & Finance Department, DAB

CAR of the Islamic Bank of Afghanistan remains above the regulatory limit. The capital of windows consists of owner's equity (which is not in the form of liquid assets, but it is the value of investment property which is transfer/given from the conventional bank to Islamic banking windows), Retained profit/loss of previous years, other comprehensive income (income from the revaluation of fixed assets) and profit/loss of current year. The trend of the sector financial capital as described above is given in figure 6.17 above.

One Banking window has the highest share (70.31%) in total capital of the sector and second fully fledged bank has 34.74% contributions in total capital of the sector.

### 6.8.6. Profitability

- **Quarter–to–Quarter:**

The Islamic banking sector suffers AFN 34.47 million net losses in the quarter under review against AFN 69.73 million net losses in last quarter, showing a decrease over the quarter. Four out of six Islamic banking windows ended with net losses amounting to AFN 46.25 million as compared to AFN 130.77 million losses reported by five windows in last quarter. The decrease in the losses of the sector in the current quarter is mainly attributed to decrease of AFN 61.1 million in net credit provisions. The main reason for the losses of the sector is due to gross credit provisions of two windows and one full-fledged bank, reported AFN 495.93 million. The share of two windows in credit provisions is AFN 475 million and fully fledged bank is AFN 18.36 million. Meanwhile the sector reported AFN 429.65 million as reintegration of provision which is AFN 417.54 million reported by four windows and AFN 12.1 million by fully fledged bank.

The full-fledged bank reported AFN 5.56 million of net loss during the reviewed quarter. It is worth mentioning that the loss of one full-fledged bank in the current quarter excluding FX revaluation gain reported AFN 189.04 million, but including FX revaluation gain it reached to AFN 183.47 million. The loss of the bank has decreased from AFN 189.04 million to AFN 5.56 million, the gain from FX revaluation is not core income of the bank, which was AFN 183.47.

- **Cumulative (Jan to Sep, FY 2019**

In terms of the profitability on cumulative basis, (From Jan to Sep 2019) the Islamic banking sector ended with AFN 302.38 million (USD 3.865 million) net losses for the three quarters of financial year 2019 against AFN 36.32 million net losses recorded in the same period of last year, resulting in ROA of -1.49% and ROE of -11% annualized, against -0.2% and -1% annualized in Sep, 2018.

The reason for loses of the sector was mainly due to gross credit provision of AFN 1.08 billion (95.07% reported by 4 windows and remaining by one full-fledged bank), in the meantime the sector reported AFN 560.62 million as reintegration of provision which constituted AFN 523.93 million by four windows and AFN 36.69 million by fully fledged bank. Decrease of AFN 82.36 million in net profit (net income) and increase of AFN 297.75 million in non-profit expenses (operating expenses) are the other contributing factors in the losses of the sector.

However, net-profit and FX gain increased, and tax expenses revised over the period. All six Islamic windows incurred losses of AFN 341.76 million in the quarter under review against AFN 36.32 million losses in the same quarter of FY 2018 with three Islamic banking windows in loss at that period. The sole full fledge bank ended with net profit of AFN 39.38 Million due to significant gain in FX revaluation worth of AFN 491.48 during the nine months' period.

**Table 6.9:** Profit and Loss Schedule of the Islamic Banking Sector during the 3rd quarter of FY 2019

| Profit and loss Schedule (Amount in million AFN) | | | |
|---|---|---|---|
| **Item** | **June-19** | **Sep-19** | **Difference** |
| Profit income | 220.46 | 149.15 | (71.31) |
| Profit expense | 95.30 | 84.83 | (10.47) |
| Net profit income | 125.16 | 64.32 | (60.83) |
| Other nonprofit income | 105.36 | 80.10 | (25.25) |
| Other nonprofit expense | 299.03 | 212.20 | 13.17 |
| Income (Loss) before FX revaluation and | (195.89) | (234.05) | (38.15) |
| Net Credit provisions | 127.38 | 66.27 | (61.10) |
| FX revaluation Gain/loss | 143.58 | 143.58 | 8.47 |
| Tax | (17.52) | (12.31) | 5.108 |
| Net profit income/Loss After Tax | (69.73) | (34.47) | 35.26 |

**Source:** IBFD, Islamic Banking & Finance Department, DAB

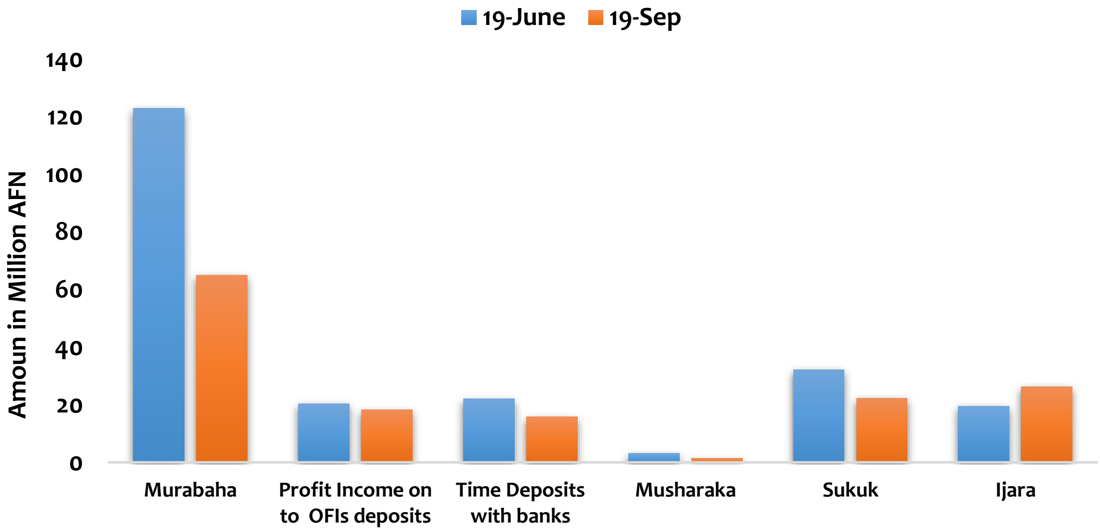
In general, the Islamic banking sector offering seven types of financial products. The returns from financing in third quarter of FY 2019 are shown in the following table

**Table 6.10:** Returns by Major Types of Shariah Compliant Products for the 3rd Quarter of FY 2019

| Value of returns by major type of Shariah-compliant contract (Amount in million AFN) | | | |
|---|---|---|---|
| **Product** | **June-19** | **Sep-19** | **Difference** |
| Time Deposits with banks | 22.09 | 15.80 | (6.29) |
| Profit Income on to OFIs deposits | 20.39 | 18.26 | (2.12) |
| Murabaha | 122.95 | 65.06 | (57.88) |
| Diminishing Musharaka | 3.213 | 1.38 | (1.82) |
| Sukuk | 32. 35 | 22. 34 | (9.89) |
| Ijara | 19.57 | 26.29 | 6.71 |
| Total Profit Income | 220.46 | 149.15 | (71.31) |

**Source:** IBFD, Islamic Banking & Finance Department, DAB

**Figure 6.20:** Return by Major Types of Shariah Complaint Products for the 3rd Quarter of FY 2019




**Source:** IBFD, Islamic Banking & Finance Department, DAB

Total number of employees, borrowers, depositors and other-clients of the Islamic banking sector at the end of the third quarter FY 2019 across the country are as follow:

**Table 6.11:** Number of employees, present borrowers and depositors of the Islamic Banking Sector for the 3rd Quarter of FY 2019

| Number of Employees, depositors and borrowers | |
|---|---|
| **Particulars** | |
| **Full-time Employees** | 871 |
| **Present Borrowers** | 712 |
| **Present Depositors** | 386362 |

**Source:** IBFD, Islamic Banking & Finance Department, DAB

## Conclusion:

The total assets of the Islamic banking sector at the end of third quarter, FY 2019 stands at AFN 32.03 billion (USD 409.49 million) showing 3.18% decrease compared to the previous quarter of FY 2019. The decrease in assets of the Islamic banking sector is mainly due to decline in deposits of the sector during the quarter. Net financing and investment portfolio of the Islamic banking sector decreased by 2.17% or AFN 267.69 million compared to the last quarter which was AFN 12.02 billion.

The decrease in the financing and investment portfolio of the sector during the quarter was mainly due to decrease in Murabaha financing. Deposits, the main funding source for the Islamic banking sector stands at AFN 26. 33 billion, comprising 93.13% of the total liabilities of the sector, and shows decrease of 3.31% or AFN 1.04 billion comparing with the previous quarter. The decrease in the deposits of the Islamic banking sector was affected by time deposits of a window of the banks.

The Islamic banking sector suffered AFN 34.47 million net losses for the third quarter of FY 2019, and the main reason for the losses was due to gross credit provision of AFN 495.93 million.




Monetary Policy Department
E-mail: mp@dab.gov.af
Tel: +93 20 210 3930