Da Afghanistan Bank

Economic & Statistical Bulletin

Second Quarter, FY 1399

Monetary Policy Department

Da Afghanistan Bank

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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 second quarter of fiscal year 1399, which starts from March 20th, 2020 to June 20th, 2020.

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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

The COVID-19 outbreak took a significant toll on Afghan economy, the exiting political turmoil and security uncertainties amplified the negative economic effects of the Corona outbreak and restrictive measures taken to contain the outbreak. The economic growth has declined to more than 5% (DAB), with the worst impact on the livelihoods of the vulnerable and poor population of the country by increasing poverty rates from 54% to 61%, and unemployment increased in the country from 23% to 40% (Ministry of Economy) due to the lockdown and closure of international borders and neighboring countries.

Afghan Economy remained under strict lockdown during second quarter of fiscal year 1399 and begin to ease restriction with the dawn of third quarter of 1399. The lockdown in the country and closure of borders led to significant decrease in the economic activity, domestic consumption, exports, imports, and remittances in the second quarter of 1399.

Da Afghanistan Bank uses quantitative theory of money to determine Reserve Money (RM) with the aim to keep domestic prices stable. The primary goal of Da Afghanistan Bank is to maintain domestic prices stable, where reserve money is the main operational target while Currency in Circulation is the indicative target for liquidity.

Reserve Money growth is 0.42% standing at Af 322,978.27 million at the end of the first half of FY 1399, on the other hand, Currency in Circulation being the major component of RM, stands at Af 279,989.89 with 7.96% growth rate. Both, reserve money and currency in circulation were below the targets. Narrow money growth was 14% stood at Af 510,630 million, while broad money stood at Af 540,921.32 million with 11.89% growth at the end of the first half of FY 1399. For the purpose of absorbing surplus liquidity from the market and to smooth Afghani exchange rate fluctuations against foreign currencies, Da Afghanistan auctioned 956.11 millions of US dollar during the first half of FY1399.

Consumer Price Index (CPI) is calculated on the basis of April-2015 base prices. During the second quarter of FY 1399 (2020), based on Y-o-Y measure, average inflation increased to 7.10% (overall index) higher than average rate of 4.18% in the second quarter of the previous year (Y-o-Y). To measure the index based on Q-to-Q basis, inflation rate reached to 7.10% from 3.54% on average in the first quarter of FY 1399.

Balance of payment recorded a deficit of USD 593 million at the end of the second quarter. Current account deficit reduced to USD 412.99 million (decreased by 47%) during the second quarter of FY 1399 due to decrease in merchandize trade (by 28%) and services account deficit, and increase in grants to the government during the covid-19 pandemic. Compensation employee and inflow of investment income decreased by 71% (USD 29.75 million) while official grants along with the personal transfer increased by 7% (USD 588.06 million) in the second quarter of FY 1399. Capital account inflow decreased to USD 99.92 million (reduced by 35%) in the second quarter of FY 1399, in the meantime, due to covid-19 outbreak together with political and security concerns, direct investment reduced to USD 0.4 million and Financial account balance recorded USD 280.08 million at the end of the second quarter of FY 1399.

Fiscal sector of the economy also affected by covid-19 pandemic, where budgeted expenditures which was set Af 428.38 billion at the start of the year, raised to Af 449 billion in the second quarter of FY 1399. Total revenue recorded Af 83 billion in the second quarter of FY 1399 against Af 103 billion in the second quarter of previous year which indicated 19% decrease, on the other hand, total expenditure decreased by 7% and recorded Af 104 billion against Af 112 billion in the same period of the last year. Donor grants were Af 44 billion (with Af 7 billion decrease) in the second quarter of FY 1399, while domestic revenue registered Af 39 billion (with Af 24 billion decrease). Government spent 36% of the total core budget of Af 449 billion (revised due to covid-19) which comprises of Af 118 billion execution in operating expenditure and Af 43 billion execution in development expenditure during the second quarter of FY 1399.

Banking sector performance unlike the other sectors performed well regardless of the covid-19 pandemic. Main indicators in the banking sector showed upward trend and no liquidity dearth is highlighted in the second quarter of FY 1399. Assets of the banking sector was Af 316.22 billion with 11% increase, while total liabilities were Af 279.45 billion with increase of Af 28.66 billion (11.43%). Meanwhile, capital of the banking sector made 11.63% of the system total assets which indicated the banking sector well capitalized.

Banking sector had Af 783.39 million net profit (on cumulative basis) with ROA of 0.52% and ROE of 4.46% during the second quarter of FY 1399 which was as a result of FX gains and non-interest income. Data on distribution of credit (sector-wise) shown that Trade sector received the highest portion (41.42%) among all, service sector had the second highest share (25.31%), manufacturing & industry listed in third with 10.08% share, while other sectors' share are small.

Islamic Banking on the hand had increasing trend for its main financial indicators. Assets of the Islamic banking increased to Af 37.03 billion due to increase in deposits in the second quarter of FY 1399. Deposits were the main funding source for the Islamic banking sector and the major component of the liabilities of the sector (91.37% share) which stood at Af 30.61 billion. At the meantime, Islamic banks liquidity shown to be above the set limit, while the capital of the Islamic banking sector decreased to Af 4.02 billion (by 1.65%) during the second quarter of FY 1399. In terms of profitability, Islamic banks incurred Af 7.59 billion net profit in the second quarter of FY 1399 where the profit earned in the first quarter amounted to Af 146.47 million and the increase in profit of the sector was mainly due to reintegration of provision.

1

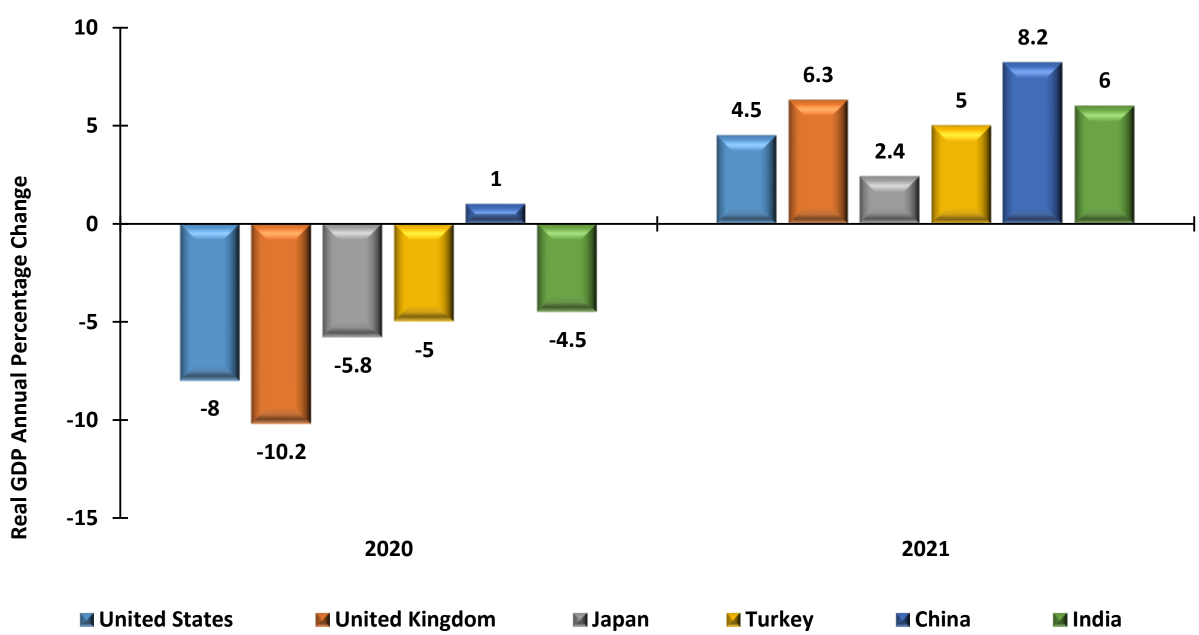
Global Economic Environment

1
GLOBAL ECONOMIC ENVIRONMENT

The global outlook is highly uncertain as a result of COVID-19 pandemic which is a global health crisis. It has triggered the most severe economic recession in nearly a century and is causing enormous damage to people's health, jobs and well-being. Global growth is projected at –4.9% in 2020, 1.9 percentage points below the April 2020 World Economic Outlook (WEO)[1] forecast. Growth in the advanced economy group is projected at –8.0% in 2020, 1.9 percentage points lower than the April 2020 WEO. Therefore, synchronized deep downturns are foreseen in the United States –8.0%, Japan –5.8%, the United Kingdom –10.2%, Germany –7.8%, France –12.5%, Italy, and Spain –12.8%.

In 2021 the advanced economies growth rate is projected to strengthen to 4.8%, leaving 2021 GDP for the group about 4% below its 2019 level. Growth in emerging market and developing economies group is forecasted at –3.0% in 2020, 2 percentage points below the April 2020 WEO forecast. The downward revision to growth prospects for emerging market and developing economies over 2020–21 2.8 percentage points exceeds the revision for advanced economies 1.8 percentage points. Excluding China, the downward revision for emerging market and developing economies over 2020–21 is 3.6 percentage points.

Figure 1.1: Growth Projection for Advanced and Emerging Economies, WEO



Source: IMF, World Economic Outlook Update June 2020/MPD Staff Calculation

[1] World Economic Outlook Report June, 2020

The COVID-19 pandemic has had a more negative impact on activity in the first half of 2020 than anticipated, and the recovery is projected to be more gradual than previous forecast. Overall, this would leave 2021 GDP some 6½ percentage points lower than in the pre-COVID-19 projections of January 2020. The adverse impact on low-income households is particularly critical, revealing the significant progress made in reducing extreme poverty in the world since the 1990s.

GDP in the first quarter was generally worse than expected with few exceptions including, Chile, China, India, Malaysia, and Thailand among emerging markets, and Australia, Germany, and Japan among advanced economies. Moreover, according to the International Labor Organization, the global decline in work hours in the first quarter of 2020 compared to first quarter of 2019 was equivalent to the loss of 130 million full-time jobs.

The decline in the first quarter of 2020 is likely to be equivalent to more than 300 million full-time jobs. Furthermore, Trade contracted by close to –3.5% (year over year) in the first quarter, reflecting weak demand, the collapse in cross-border tourism, and supply dislocations related to shutdowns (exacerbated in some cases by trade restrictions). Beside that weaker inflation. Average inflation in advanced economies had dropped about 1.3 percentage points since the end of 2019, to 0.4% (year over year) as of April 2020, while in emerging market economies it had fallen 1.2 percentage points, to 4.2%. Downward price pressure from the decline in aggregate demand, together with the effects of lower fuel prices, seems to have more than offset any upward cost-push pressure from supply interruptions so far. Global trade will suffer a deep contraction this year of –11.9%, reflecting considerably weaker demand for goods and services, including tourism. Consistent with the gradual pickup in domestic demand next year, trade growth is expected to increase to 8%.

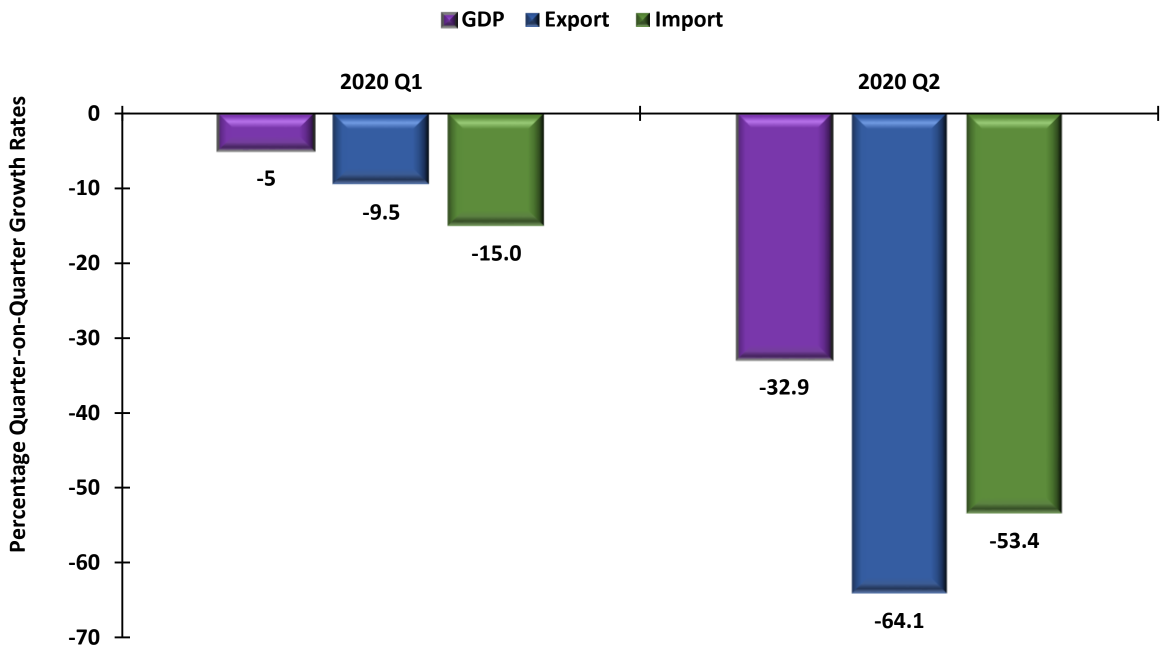
1.1. Advanced Economies:

1.1.1 United States' Economy:

Real GDP decreased 32.9% (annual rate) in the second quarter of 2020, following a 5.0% decrease in the first quarter. The decline in second quarter GDP reflected the response to COVID-19, as "stay-at-home" orders issued in March and April were partially lifted in some areas of the country in May and June, and government pandemic assistance payments were distributed to households and businesses. Meanwhile, this led to rapid shifts in activity, as businesses and schools continued remote work and consumers and businesses canceled, restricted, or redirected their spending.

Furthermore, the full economic effects of the COVID-19 pandemic cannot be quantified in the GDP estimate for the second quarter of 2020 because the impacts are generally embedded in source data and cannot be separately identified. It is worth mentioning that the decline in second-quarter real GDP reflected decreases in consumer spending, exports, private inventory investment, nonresidential fixed investment, residential fixed investment, and state and local government spending that were partly offset by an increase in federal government spending. In addition to this, the price index for gross domestic purchases decreased 1.5% in the second quarter, compared with a 1.4% increase in the first quarter while, excluding food and energy, gross domestic purchases prices decreased 1.0%, after increasing 1.6%.

Figure 1.2: US, Comparison of Quarterly GDP Export and Import



Source: Bureau of Economic Analysis US/MPD Staff Calculation

Furthermore, the price index for personal consumption expenditures (PCE) decreased 1.9% in the second quarter, after increasing 1.3% in the first quarter. Excluding food and energy, the PCE price index decreased 1.1%, after increasing 1.6%. The decrease in the PCE price index excluding food and energy primarily reflected declines in prices for clothing and footwear as well as financial services.

Beside that Exports and imports increased in June following monthly declines since March that were, in part, due to the impact of COVID-19, as many businesses were operating at limited capacity or ceased operations completely, and the movement of travelers across borders was restricted. On the other hand, the U.S. current account deficit, which reflects the combined balances on trade in goods and services and income flows between U.S. residents and residents of other countries, narrowed by $0.1 billion, or 0.1%, to $104.2 billion in the first quarter of 2020. The narrowing mainly reflected a reduced deficit on goods that was largely offset by a reduced surplus on primary income and an expanded deficit on secondary income. The first quarter deficit was 1.9% of current dollar gross domestic product, up less than 0.1 percentage point from the fourth quarter.

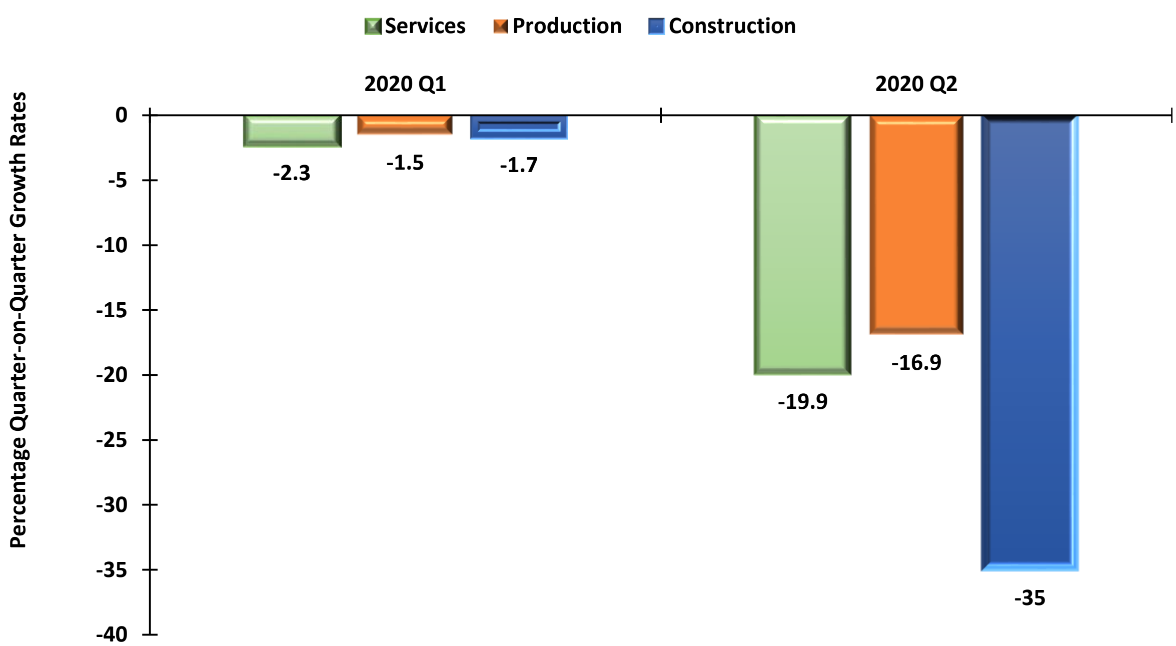
1.1.2 The Economy of UK:

GDP estimates for the first quarter of 2020 and for the second quarter of 2020 are subject to more uncertainty than usual as a result of the challenges faced in collecting the data under government imposed public health restrictions. Forecasters expect the coronavirus (COVID-19) pandemic to lead to a contraction in the UK and global economy this year, reflecting how it has led to a reduction in the demand for goods and services and the impact on the ability of businesses to supply those products.

The impact is expected to reflect the length of the pandemic as well as the public health restrictions imposed and other voluntary social distancing measures. The response to COVID-19 will also impact on the ability of National Statistical Institutes (NSIs) to compile estimates of gross domestic product (GDP), inflation and the labor market. UK gross domestic product (GDP) is estimated to have fallen by a record 20.4% in the second quarter of 2020, marking the second consecutive quarterly decline after it fell by 2.2% in the first quarter of 2020.

Meanwhile, compared with the fourth quarter of 2019, UK GDP decreased by 22.1% in the second quarter of 2020. Meanwhile, Nominal GDP fell by 15.4% in the second quarter of 2020, its largest quarterly contraction on record. In addition, to it there have been record quarterly falls in services, production and construction output in the second quarter of 2020, which have been particularly prevalent in those industries that have been most exposed to the restrictions imposed because of the coronavirus (COVID-19) pandemic.

Figure 1.3: Comparison of Quarterly GDP



Source: Office for National Statistics UK/MPD Staff Calculation

Services output decreased by 19.9% in the second quarter of 2020, while production output fell by 16.9%, and construction output contracted by 35.0%. Meanwhile, there have been large movements in all types of expenditure in the second quarter of 2020, most notably private consumption, which accounted for more than 70% of the fall in gross domestic product (GDP) in the second quarter.

On the other hand, the impact of the coronavirus pandemic on the global economy has led to large falls in gross trade flows in and out of the UK, reflecting a marked fall in global trade demand as well as how restrictions have disrupted international supply chains. The total trade surplus, excluding non-monetary gold and other precious metals, widened by £8.6 billion to £8.6 billion in the second quarter of 2020, as imports fell by £35.2 billion and exports fell by a lesser £26.7 billion; falling imports and exports in the second quarter of 2020 were largely seen in trade in goods, excluding non-monetary gold and other precious metals, where imports and exports fell by £21.4 billion and £14.0 billion respectively, while for trade in services they fell by £13.9 billion and £12.7 billion respectively.

The largest falls in both imports and exports of goods in the second quarter of 2020 were seen in machinery and transport to the sharp drop in demand for road vehicles and oil because of coronavirus-related restrictions. Beside that the Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 0.8% in June 2020, up from 0.7% in May 2020. The largest contribution to the CPIH 12-month inflation rate in June 2020 came from recreation and culture (0.32 percentage points). Rising prices for games and clothing resulted in the largest upward contributions to the change in the CPIH 12-month inflation rate between May and June 2020.

1.1.3 Economy of Japan:

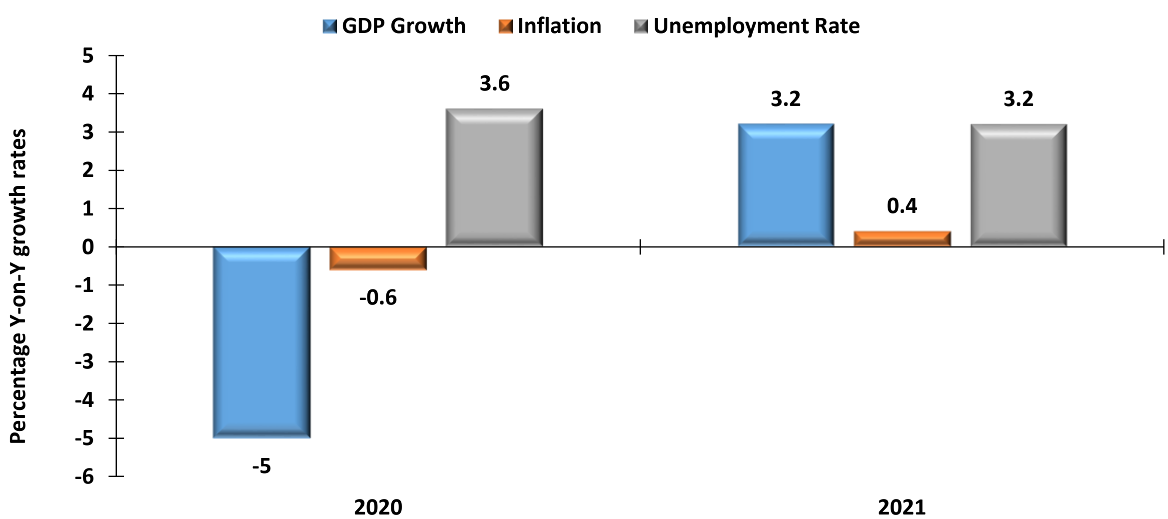
The Japanese economy is significantly below the growth path that was assumed in the “Fiscal year 2020 Economic Outlook and Basic Stance for Economic and Fiscal Management”2 owing to the impact of the Novel Coronavirus. The economy was in an extremely severe condition from April to May as economic activities were suppressed under the state of emergency to prevent the spread of the infectious disease. Moreover, economic activity has gradually resumed since the state of emergency was lifted in late May, and private consumption is picking up and exports are bottoming out, although the influence of the infectious disease remains. As a whole, although the Japanese economy is still in a severe condition, it is showing movements of picking up. Meanwhile, concerning future prospects, it is expected that the economy will continue to show movements of picking up supported by the effects of government policies, while socio-economic activities will resume gradually with measures to prevent the spread of the infectious disease. However, full attention

[2] (Cabinet Decision on January 20, 2020)

should be paid to the impact of the infectious disease on domestic and overseas economies. It is worth mentioning that under these circumstances, GDP for FY 2020 is projected to contract by approximately 4.5% in real terms and 4.1% in nominal terms, while for FY 2021 is projected to grow by approximately 3.4% in real terms and 3.5% in nominal terms. The effects of the consumption tax hike in October 2019 on the consumer price index (all items) and GDP deflator for FY 2020 are estimated to be approximately 0.5% points and 0.4% points, respectively. The effects of free early childhood education and free tertiary education on the consumer price index (all items) for FY2020 are estimated to be approximately 0.3% points and 0.1% points, respectively.

Furthermore, the exchange rate is assumed to stay constant at 107.6 yen/dollar (monthly average from June 1 to June 30, 2020) from July 2020 onward. Moreover, Private consumption respectively in the month of May, 2020 is decreasing rapidly, due to the influence of the infectious disease, June, 2020 is showing movements of picking up recently as the state of emergency was lifted and in July, 2020 Private consumption is picking up. On the other hand, business investment respectively shows in May, 2020 a weak tone recently while in the months of June and July, 2020 no changes are observed.

Figure 1.4: Annual Comparison of GDP, Inflation, and Unemployment, Japan



Source: Fitch Ratings/MPD Staff Calculation

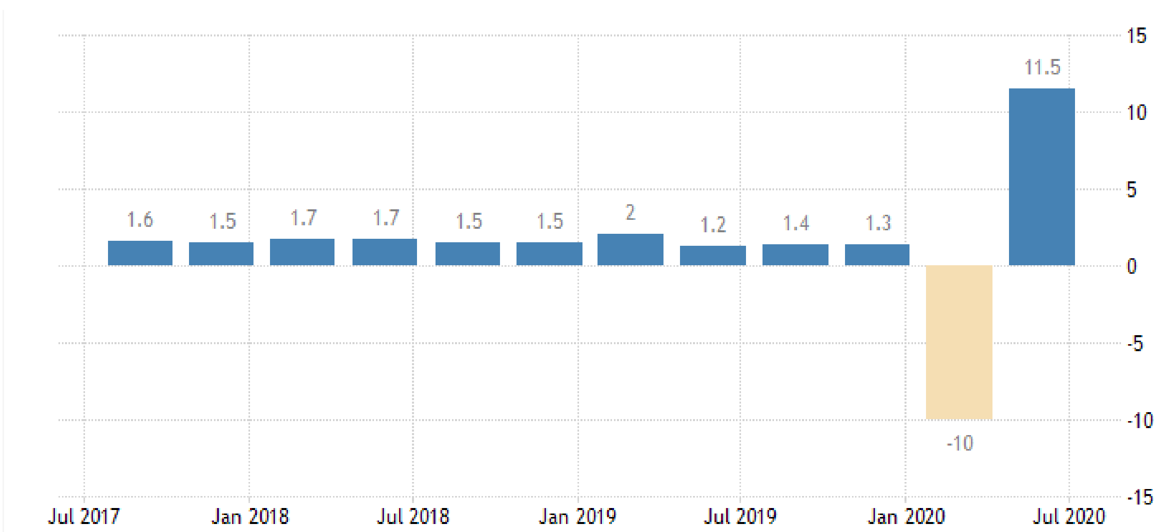
Beside that export respectively shows in May, 2020 are decreasing rapidly, due to the influence of the infectious disease, meanwhile, no changes are visible in the month of June, 2020 while in July, 2020 exports are bottoming out, although the influence of the infectious disease remains. Furthermore, respectively industrial production is decreasing, due to the influence of the infectious disease in May,2020 no changes are visible in the June, 2020 while, industrial production shows signs of picking up recently in some sectors, although it is decreasing as a whole. In addition, to this employment situation respectively in May, 2020 shows some weak movements further, due to the influence of the infectious disease while, in June, 2020 employment situation is showing weakness, due to the influence of the infectious disease while, no changes are observed in the month of June, 2020. Last, but not the least prices respectively show in the month of May, 2020 are flat while no changes are observed in the month of June and July, 2020.

1.2. Emerging Economies:

1.2.1. China:

The economy of China grew by a seasonally adjusted 11.5% in second quarter in June 2020, following a revised 10.0% decrease in the previous quarter and compared with market expectations of a 9.6% increase. This was a high pace of quarterly expansions on record, boosted by high demand at domestic level and at foreign market following the easing of COVID-19 lockdown restrictions. Yearly inflation in China increased to 2.5% in June 2020 from 2.4%. Food inflation increased to 11.1% from 10.6% in May as pork prices rise to 81.7% from 81.6%. On the other hand, nonfood categories' prices slowed down to 0.3% from 0.4% in May, Healthcare (1.9% vs 2.1%), education, culture & recreation (1.9% vs 2.2%), and other goods & services (5.1% vs 5.3%). In the meantime, cost fell for transport (-4.6% vs -5.1%), rent, fuel, and utilities (-0.6% vs -0.5%) and clothing (-0.4%, the same as in May). On a monthly basis, consumer prices decreased to 0.1%, after a 0.8% decline in May.

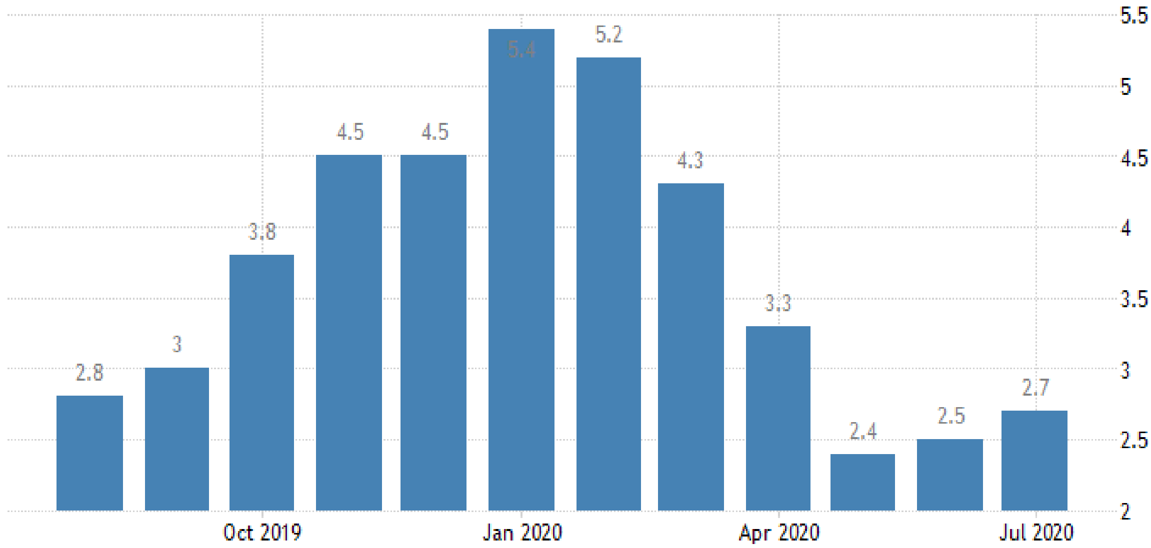
Figure 1.5: China's Growth Rate for the 2nd Quarter, 2020



Source: General Administration of Customs of the People's Republic of China

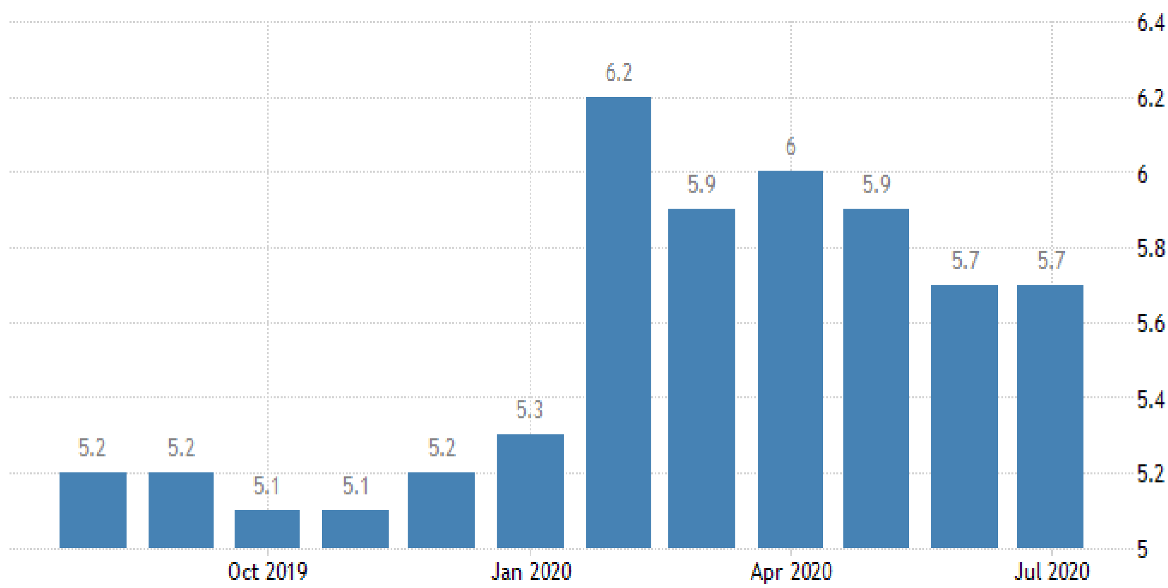
The unemployment survey conducted by China in urban areas shows that unemployment rate decreased to 5.9% in May 2020 from 6.0% in the previous month. China's trade surplus decreased to 46.42 billion in June 2020 from 49.60 billion in the same month of the previous year and far less than market expectations of a 58.6 billion surpluses. Exports unexpectedly increased to 0.5% on y-o-y basis. China politically sensitive trade surplus with the US widened to USD 29.41 billion in June from USD 27.89 billion in May. Considering the first six months of the year, the trade surplus narrowed to USD 168.02 billion from USD 176.69 billion in the corresponding period of 2019. Exports were 6.2% lower than in 2019, while imports were down 7.1%.

Figure 1.6: China's Inflation Rate for the 2nd Quarter, 2020



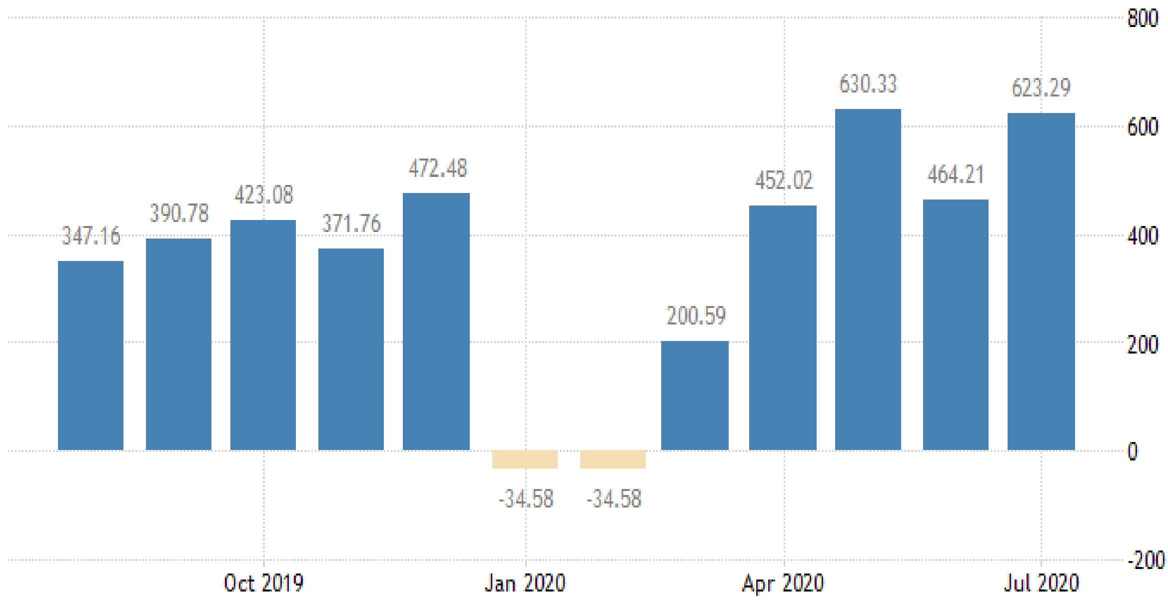
Source: General Administration of Customs of the People's Republic of China

Figure 1.7: China's Unemployment Rate for the 2nd Quarter, 2020



Source: General Administration of Customs of the People's Republic of China

Figure 1.8: China's Trade Balance for the 2nd Quarter, 2020



Source: General Administration of Customs of the People's Republic of China

1.2.2. The Economy of India:

- **Investment outlook**

While COVID-19 impact on the economy is rapidly evolving, it is driving market volatility on daily basis, as reflected in movements of volatility index of domestic equity market and economic policy uncertainty index. With huge uncertainty around the pandemic stemming from the unknown, and the inability to plan for or know what next, such uncertainty is expected to adversely affect business climate and make firm delay their investment plans.

- **Trade**

Amid covid-19 induced supply chain disruptions, weak external demand and persistent global trade tensions and adverse impact on trade is expected. For highly import dependent countries like India, the overall affection on net exports may be positive on the bank of relatively sharper decline in imports and lower oil prices. India trade deficit stood at USD 3.1 billion in May 2020, the lowest recorded trade deficit since February 2009. Compared to April 2020, trade deficit narrowed during May with exports in May improving more than imports.

- **Exports**

India merchandise exports contracted by a lower 36.5% in May. Iron ore, drugs and pharmaceuticals, chemicals, spices and rice were positive contributors to exports growth in May. Compared to April, major commodities which recorded a lower negative growth contribution included engineering goods, marine products, coffee, oilseeds and carpets amongst others. However, India top exports in term of overall share in exports i.e. petroleum products and gems and jewelry continued to be major negative contributors from March to May. While garment industry exports have suffered in both pre and post covid-19 scenarios, exports of electronic goods have consistently deteriorated since February, possibly reflecting and additional trade impact of an earlier China outbreak.

- **Imports**

India top five imports, namely petroleum crude and products, electronic goods, gold, pearls precious and semi-precious stones and coal were positive contributors to import growth prior to covid-19 outbreak. After recording 59.6% y-o-y decline in April, India imports continued to contract by 5.1% in May 2020. Sharply negative contribution of imports of crude oil and petroleum products accentuated from -27% in April to -37% in May. The fall in imports came despite a rise in the average price of Indian basket of crude oil from USD 20.5 per barrel in April to USD 29.7 per barrel in May, reflecting weak domestic demand for petroleum products. Imports of gold and electronic goods showed a similar trend of contraction continuing in May. Iron and steel and wood product imports, however, moved into positive territory in May, with consistent improvement since January.

- **Inflation**

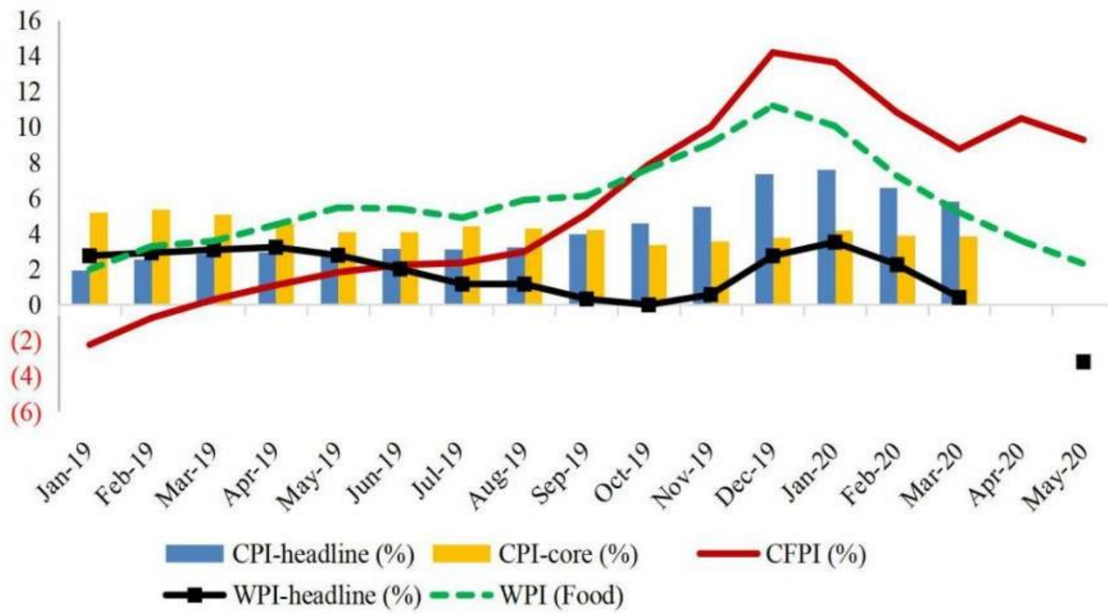
COVID-19 induced lock down has caused a massive supply shock that may possible drive inflation when demand reemerges back after the crises. However, with phased reopening of the economy, supply and demand are expected to rise gradually. However, as seen in previous sections, the intensity of supply and demand shocks strongly varies across sectors. Such mismatches are expected to cause variations in inflation for different goods.

Amid supply chain constraints in agricultural markets during lock-down, consumer food and beverages inflation excluding meat and fish increased by 0.8 percentage points from March 2020 (7.82%) to 8.61% in April 2020. However, it eased to 7.4% in May 2020, declining both, in rural and urban areas by 94 bps and 172 bps respectively, mainly due to a high base effect. Average price level of food and beverages, measured by the CPI, at 151.3 in May 2020, was almost unchanged from April 2020.

- **Consumer and wholesale price inflation**

Among the food items, vegetables inflation reduced by 10.7% in May as compared to April 2020, possibly due to improving mandi arrivals and reductions in supply disruptions while sugar prices declined by 3.1%. Prices of fish and meat, however, rose sharply by 21% in May compared to April. Pulses and cereals inflation continued to remain elevated at above 20% (y-o-y) and 7% (y-o-y) respectively, both in April and May. Daily retail prices data of 22 essential commodities for 1st to 26th June 2020 suggested moderation in retail prices of these commodities as compared to May 2020 with onion, wheat, pulses, sugar, soya oil and sugar prices witnessing declines. Tomato, however, has shown 16% rise in retail price in June as compared to May 2020.

Figure 1.9: India's Consumer and wholesale price inflation for the 2nd Quarter, 2020



Source: Ministry of Commerce and Trade India

- **Agriculture**

Agriculture activities contribution to growth is significant on the back of increase of 3.7% in food production to a new record. Procurement of wheat from farmers by government agencies has touched an all-time record figure of 388.3 lakh Metric Tons on 30th June, 2020 surpassing the earlier record of 381.48 Lakh Metric Tons achieved during 2012-13. This has been accomplished during the trying times of covid-19 pandemic under social distancing restrictions.

- **Growth Outlook**

India real GDP growth rate was 4.2% in 2019-20 as per the provisional estimate released by the national statistical office, compared to 6.1% recorded in previous year. Nominal GDP estimated at Rs. 203.4 crore, lower as compared to the budget estimates. This may be contributed to lower growth in Q4 of 2019-20 due to the global pandemic since January 2020and subsequent lock down across India.

Given the immense uncertainty associated with infection and macroeconomic recession curves of countries across the world, IMF, in its world economic outlook (June 2020) report, has downward revised global growth to -4.9% in 2020, 1.9 percentage points lower than its April 2020 forecast. All the countries of the world will experience negative growth in 2020, the first time in history. Some of the advanced economies contract by 8% in 2020, 1.9% points lower than the April forecast, growth in emerging market and developing economies has been forecast at -3.0%, a downward revision of 2 percentage points, in line with downward revision of global growth, India growth has been forecast at -4.5% in 2020, a 6.4 percentage point downward revision compared to the April 2020 forecast.

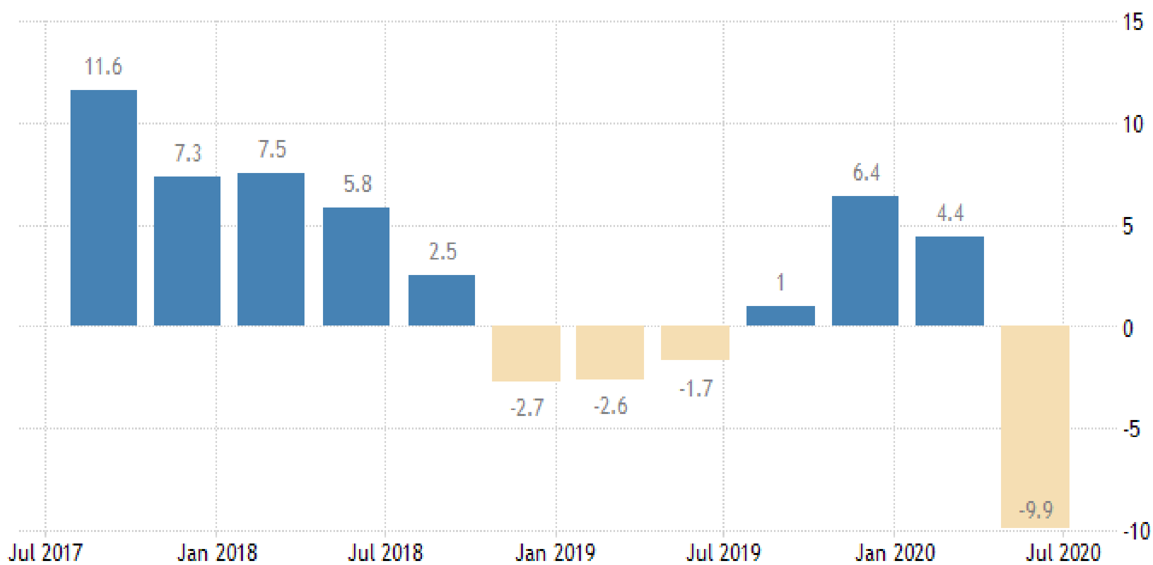
1.2.3. Turkey:

Turkey economy contract by 11% q-o-q basis in the second three months to June 2020, following a slight decrease in the previous period. It was the sharpest contraction on record, as the corona virus pandemic hit the economy.

- **Turkey GDP Annual Growth Rate**

Turkey economy shrank 9.9% on the y-o-y basis in second quarter of 2020, after downwardly revised 4.4% growth in the first quarter of 2020. It was the sharpest contraction since the first quarter of 2019, as the covid-19 pandemic hit the economy. Household consumption reduced to 8.6%, government expenditure reduced by 0.8%, fixed investment reduced to 6.1%, export shrank to 35.3% and imports decreased to 6.3%. On seasonally adjusted quarterly basis, the economy shrank 11%, the most on record.

Figure 1.10: Turkey's GDP Growth Rate for 2nd Quarter, 2020



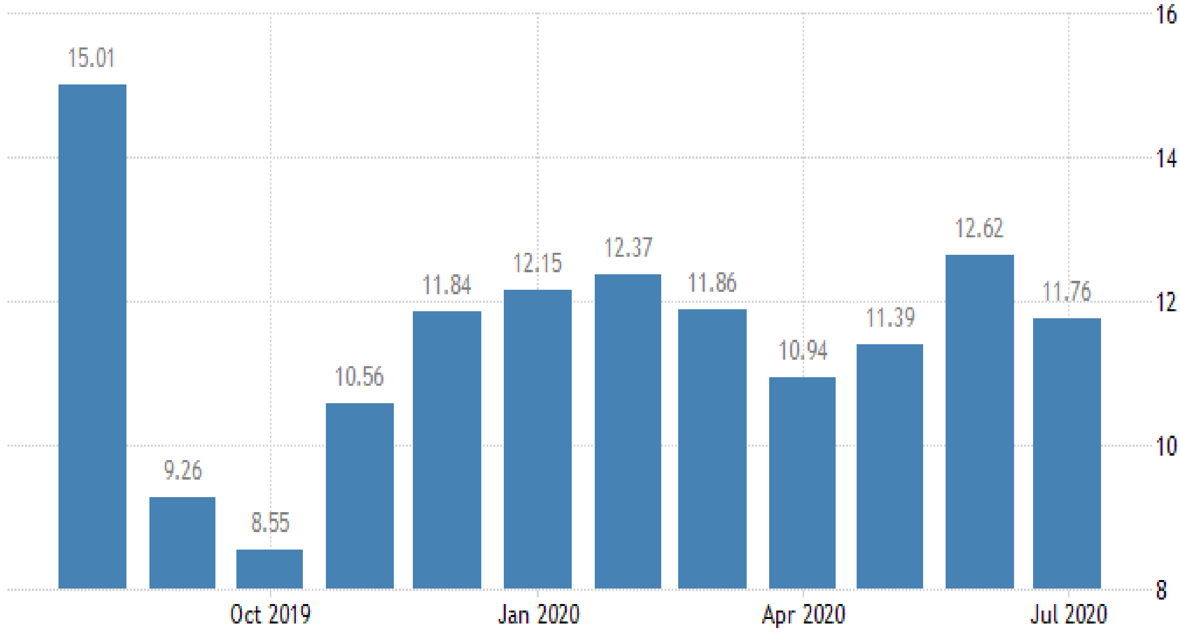
Source: Turkish Statistical Institute

- **Inflation rate**

Turkey consumer price inflation rate decreased to 11.76% on y-o-y basis in June 2020, from ten months high of 12.62% in the previous month and below market expectations of 12.1%, as the economy continued to emerge from the corona virus impose lockdown. Cost slightly decreased for food and nonalcoholic beverages (12.73% from 12.93%), transportation (8.81% from 10.96%), housing and utilities (12.53% from 14.59%), hotels and restaurants (10.92% from 11.13%), clothing and footwear (10.34%

from 10.66%), and nonalcoholic beverages (21.78% from 22.41%), and miscellaneous up to (21.90% from 19.80%).

Figure 1.11: Turkey's Employment Rate for the 2nd Quarter, 2020

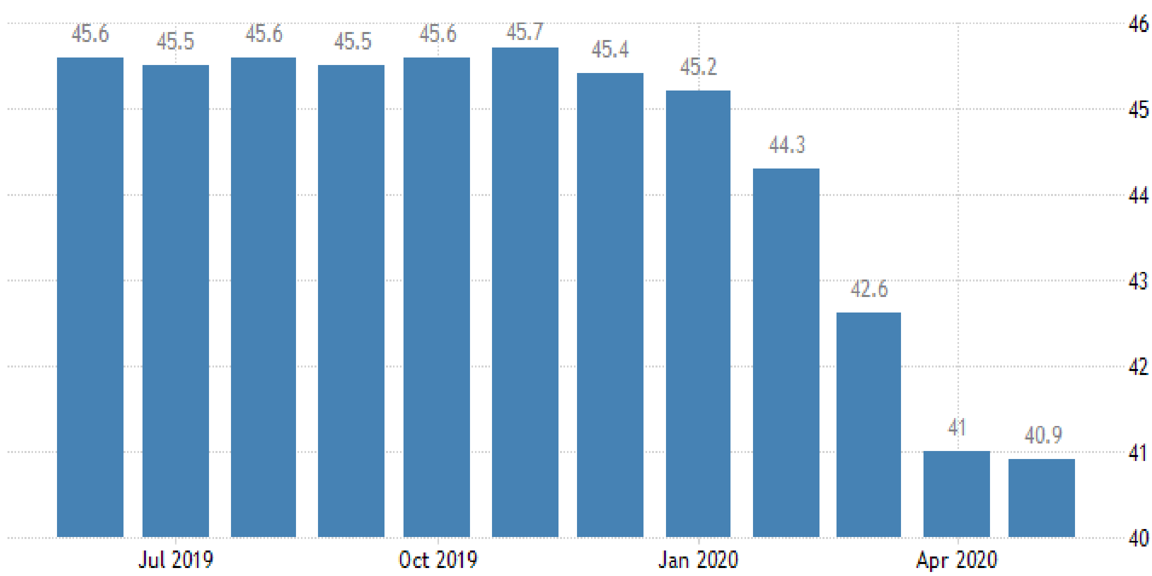


Source: Turkish Statistical Institute

- **Employment Rate**

Employment rate in Turkey dropped to 40.90% in May from 41% in April 2020.

Figure 1.12: Turkey's Inflation Rate for the 2nd Quarter, 2020

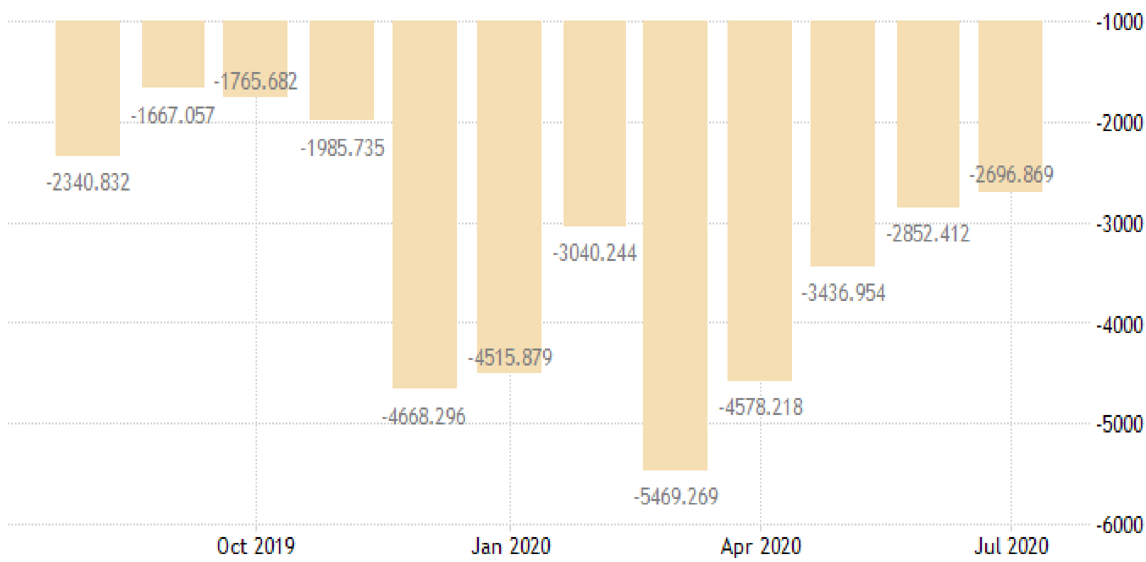


Source: Turkish Statistical Institute

- **Trade**

Turkey trade deficit decreased to USD 2.69 billion in July of 2020 from USD 3.29 billion in the corresponding month of the previous year. Exports decreased to 5.8%, manufacturing -6.3%, mining -11.8%, sales of agriculture, forestry and fishing jumped to 21.5%. Imports declined to 7.9% to USD 17.7 billion, intermediate -11.1%, capital goods -4% while purchase of consumption goods increased to 10.3%. Considering the first seven months of the year, the trade deficit widened sharply to USD 26.6 billion from USD 17.1 billion as exports decrease to 13.7% and imports fell at a slower 3.9%.

Figure 1.13: Turkey's Trade Balance for the 2nd Quarter, 2020



Source: Turkish Statistical Institute

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
Cabinet Office, Government of Japan	www.esri.cao.go.jp
Global Economic Outlook/Fitch Ratings	www.fitchratings.co
General Administration of Customs of the People's Republic of China	www.oecd.org
Ministry of Statistics Program Implementation India	www.mospi.gov.in
Turkish Statistical Institute	www.turkstat.gov.tr

2

Money and Capital Market Development

2
MONETARY AND CAPITAL MARKET DEVELOPMENT

Based on the monetary and financial statistics table, reserve money (RM) had slightly positive growth by 0.42% due to COVID-19 pandemic which results in low CNs sales, decline in Over Night Deposit Facility(ONDF) and Current account amount of commercial banks within the central bank Besides high governmental expenditure during the first half of the FY 1399 (2020), greater than negative growth of 3.9% at the end of the same period in previous year.

Currency in circulation (CiC) as a major component of RM, had positive growth of 7.96% during the first half of the FY1399 (2020). Reserve money (RM) growth, remained well below the target due to collecting additional liquidity from the market and banks during the first half of FY under review.

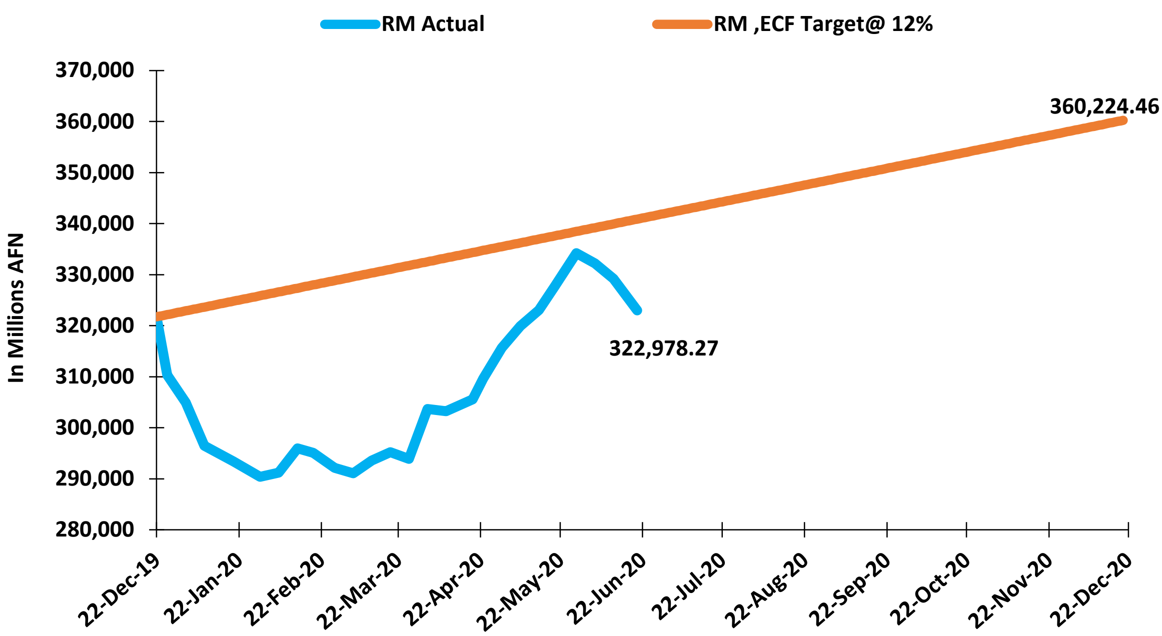
Narrow money (M1), stood at Af 510,630 million at the end of the first half of the year, registering a growth of 14%. Broad money (M2) demonstrated similar behavior, representing a growth rate of 11.89%, standing at Af 540,921.32million, main reason for M1 growth was decline in revenue collection and high expenditures (this increase in expenditure was financed by grants not from revenue collection) due to Covid-19 and quarantine during the first half of FY 1399 (2020). In order to mitigate excessive fluctuations of Af exchange rate against foreign currencies and manage liquidity in the market, DAB uses FX and CNs auctions under the open market operations.

During the first half of FY 1399 (2020), DAB has auctioned a total amount of USD 956.11 million to absorb the excess liquidity from the market and as well as to smoothen sharp fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at Af 34.49 billion at the end of the first half of FY 1399 (2020). Meanwhile, Afghani appreciated 1.75% against the US dollar during the first half of the fiscal year under review.

2.1. Monetary Program:

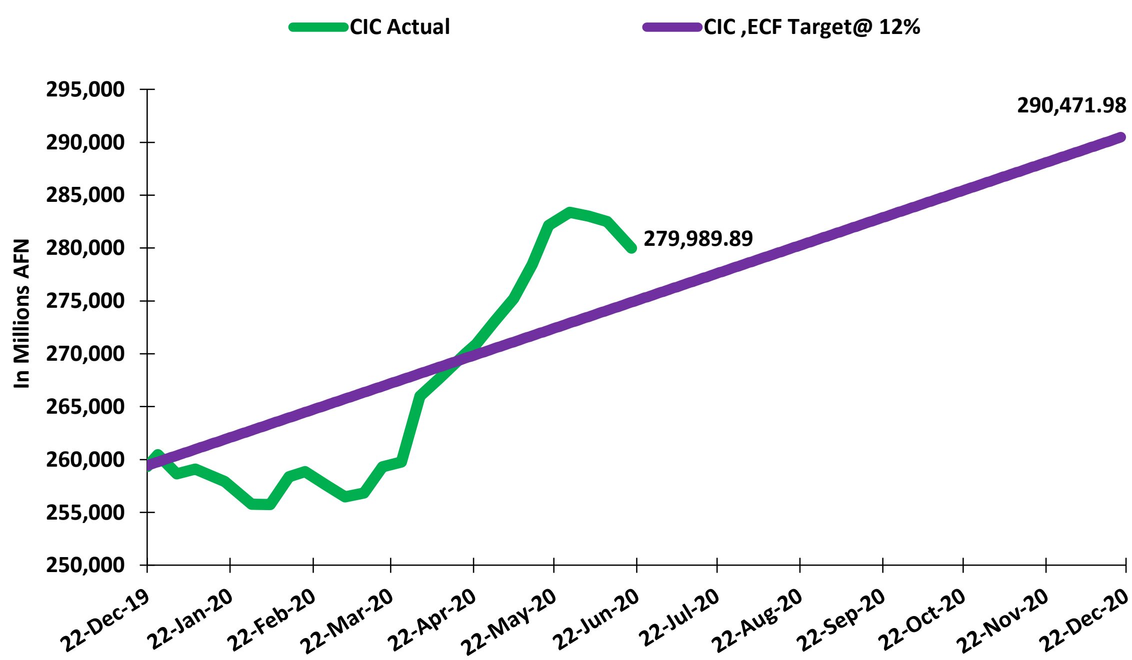
Reserve money remained the operational target of the monetary policy during the first half of FY of 1399 (2020), while currency in circulation remained as indicative target. DAB applies quantitative theory of money to determine the amount of reserve money (RM) for the purpose of maintaining domestic 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 1399 (2020), the ceilings for reserve money and currency in circulation growth is 12%.

Figure 2.1: Reserve Money during the first half of FY 1399



Source: Monetary Policy Department/DAB

Figure 2.2: Currency in Circulation during the first half of FY 1399



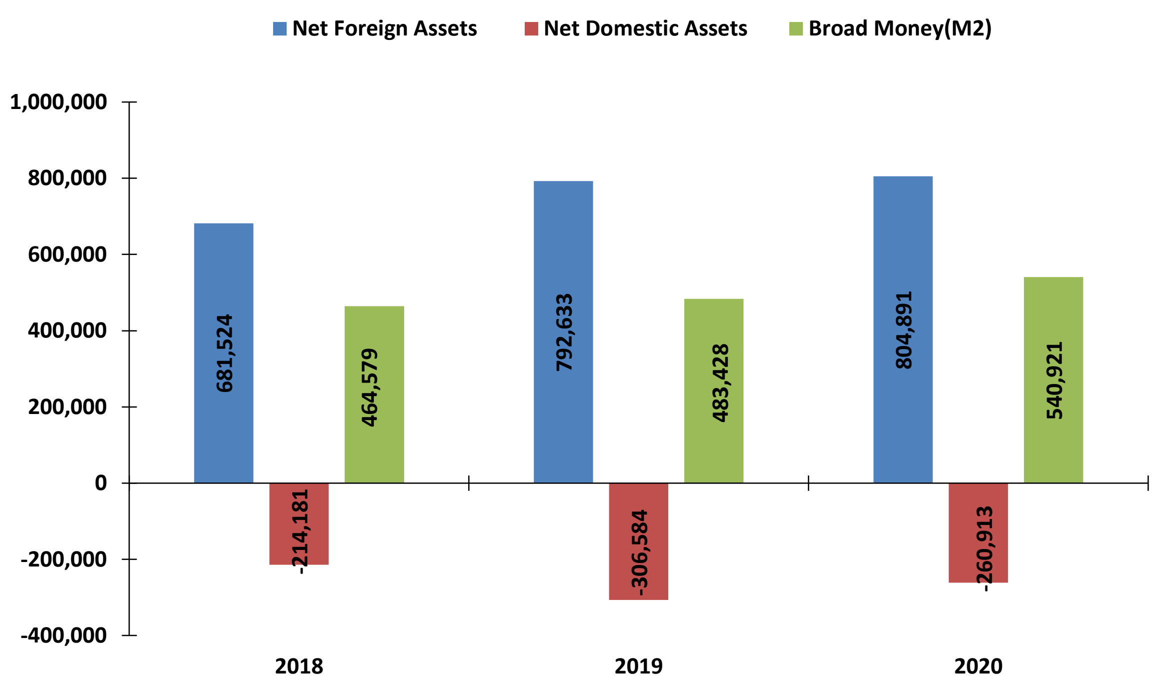
Source: Monetary Policy Department/DAB

2.2. Monetary Aggregates:

Narrow money and broad money are compiled based on Monetary and Financial Statistics Manual and Compilation Guide (MFS 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 2.3, narrow money (M1) grew 14% at the end of the first half of fiscal year 1399 (2020), almost higher growth in the same period of FY 1398 (2019).

Currency outside depository corporations, which accounts for 50% of M2, grew by 21.04%, higher than 2.1% growth of the same period in the previous year, showing difference of Af 46,645 million. The reason for this growth is high government disbursements and decline in revenue collection during quarantine. Demand deposits, which are other components of M1, experienced 6.63% growth at the end of the first half of FY 1399 (2020), while its growth rate was 7.9% in the same period of previous year. Demand deposit in comparison with the previous year in same quarter shows a difference of Af 15,066 million.

Figure 2.3: Net Foreign Assets, Net Domestic Assets, and M2 for the first half of FY 1399



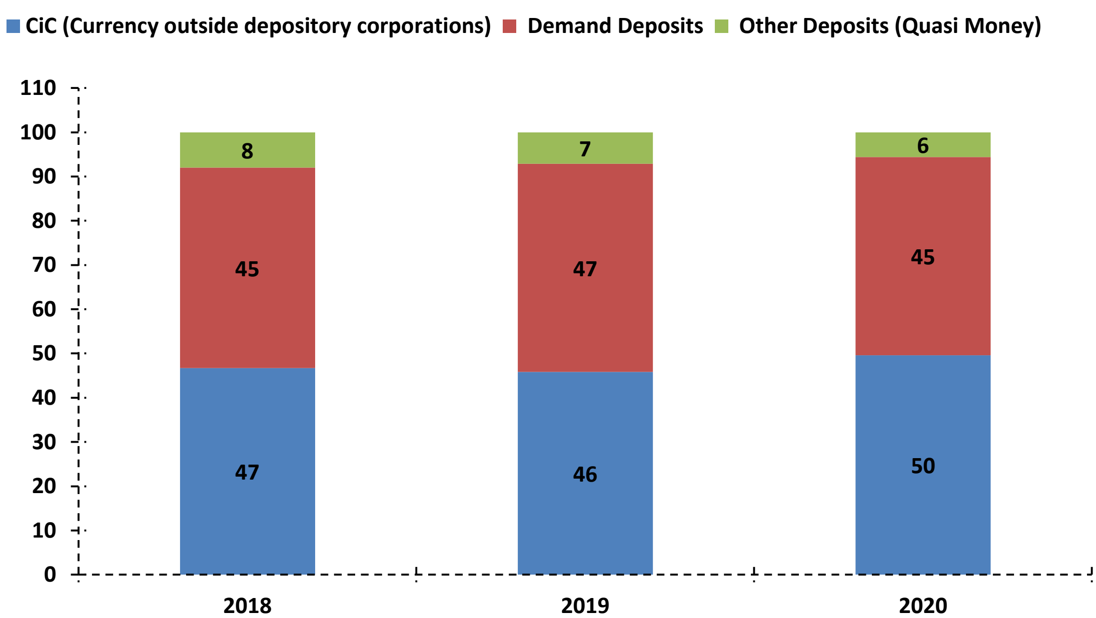
Source: Monetary Policy Department/DAB

Broad money (M2) expanded by Af 540, 921.32 million in the period under review from Af 483, 428.40 million in the previous year, showing an increase of 11.89%, greater than 4.1% growth of the same period in the previous year the reason already discussed in the above paragraph. The data shows that M1 with a share of 94.40% remained the main contributing component of M2.

Quasi money (other deposits), which is the other component of M2, had negative growth of 12.22% at the end of the period under review. This decline is because of low investment and economic activities during quarantine. Quasi money constitutes 5.60% of broad money at the period under review, which is lower than 7.14% at the end of the first half of FY 1398 (2019). Therefore, the impact of changes in quasi money on M2 is negligible.

The year-on-year quarterly change of Afghani denominated time deposits stood at Af 8,148 million, showing a negative growth of 14.04%, while the foreign currency denominated time deposits negatively rose by 11.53% due to low deposits of Commercial banks in Af and foreign currencies during the lockdown period, reaching Af 22,143 million. Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 1.51% and 1.96% of M2 respectively. Demand deposits as a share of broad money stood at 45% at the end of the first half of the year under review (Figure 2.4).

Figure 2.4: Quasi Money and Demand Deposits for the first half of FY 1399



Source: Monetary Policy Department/DAB

Table 2.1: Monetary Aggregates for the first half of FY 1399

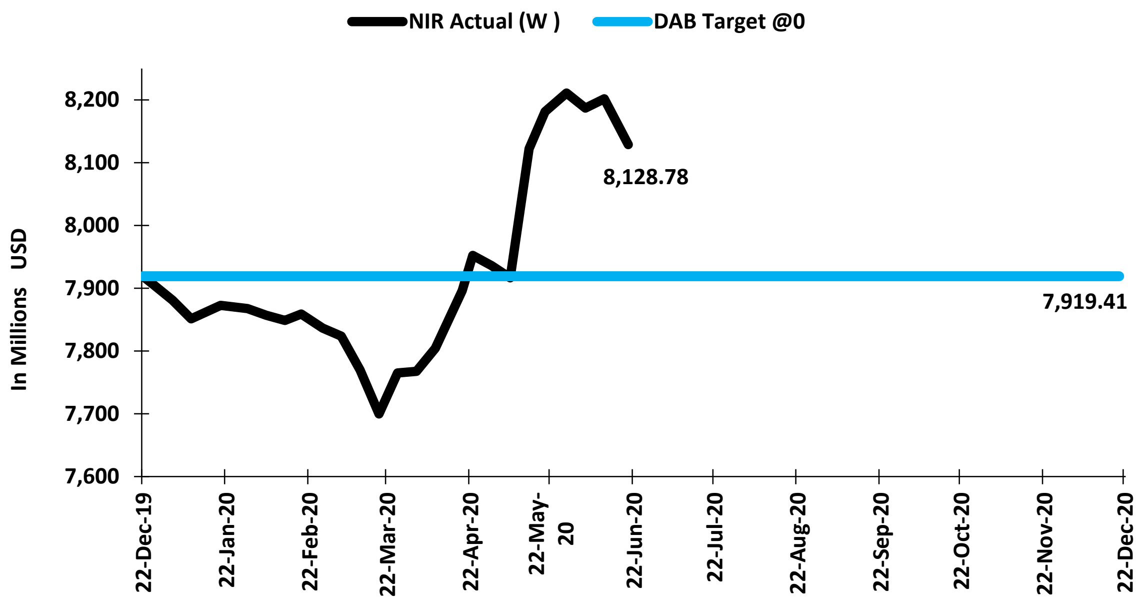
In Millions AFN	June-18 Amount	June-19 Amount	Y-o-Y Δ	Difference	June-20 Amount	Y-o-Y Δ	Difference
1- Net Foreign Assets	681,524	792,633	16.3%	111,110	804,891	1.55%	12,258
(a) Foreign Assets	696,607	804,388	15.5%	107,781	814,504	1.26%	10,116
DAB Foreign exchange reserves	580,747	667,752	15.0%	87,005	686,604	2.82%	18,852
Gold	64,160	78,342	22.1%	14,182	92,468	18.03%	14,126
Other	516,587	589,410	14.1%	72,823	594,136	0.80%	4,727
Other foreign assets	115,860	136,636	17.9%	20,777	127,900	-6.39%	-8,736
(b) Foreign Liabilities	15,083	11,755	-22.1%	-3,328	9,612	-18.22%	-2,142
2- Net Domestic Assets	-214,180.73	-306,584.25	43.1%	- 92,404	-260,913.23	-14.90%	45,671
(a) Net Domestic Credit	-71,718	-95,554	33.2%	-23,835	-74,308	-22.23%	21,246
Net Credit to Nonfinancial Public Sector	-118,597	-144,854	22.1%	-26,257	-120,847	-16.57%	24,006
Net Credit to Central Government	-118,691	-144,948	22.1%	-26,257	-121,127	-16.43%	23,821
Credit to Central Government	15,059	7,185	-52.3%	-7,874	181	-97.49%	-7,004
Liabilities to Central Government	133,750	152,133	13.7%	18,383	121,308	-20.26%	-30,825
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	280	196.51%	186
Credit to Private Sector	48,068	50,033	4.1%	1,966	47,082	-5.90%	-2,951
Net Credit to Other Financial Corporations	-1,189	-733	- 38.3%	456	-543	-25.95%	190
(b) Capital Accounts	169,282	232,545	37.4%	63,263	209,220	-10.03%	-23,325
(c)Other Items Net	26,820	21,514	-19.8%	-5,305	22,615	5.11%	1,100
3- Broad Money(M2)	464,578.789	483,428.409	4.1%	18,850	540,921.32	11.89%	57,493
Narrow Money(M1)	427,609	448,920	5%	21,311	510,630	14%	61,710
CiC (Currency outside depository corporations)	217,067	221,724	2.1%	4,658	268,369	21.04%	46,645
Demand Deposits	210,543	227,196	7.9%	16,653	242,262	6.63%	15,066
Other Deposits (Quasi Money)	36,969.638	34,508.488	-6.7%	-2,461	30,290.966	-12.22%	-4,218
In Afghani	12,594	9,479	- 24.7%	-3,115	8,148	-14.04%	-1,330
In Foreign currency	24,376	25,030	2.7%	654	22,143	-11.53%	-2,887
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 consists of monetary gold, reserve position and holdings of Special Drawing Rights (SDR) with the IMF, as well as major foreign exchange such as US dollars, Euro, Great British Pound and other currencies. 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 2.64% and had accumulation of USD 209.37 million at the end of the first half of FY 1399 (2020). NIR target was set at USD 7,919.41 million, while in actual case, NIR in ECF program rate compiled weekly, reached to USD 8,128.78 million for the mentioned period under review.

Figure 2.5: Actual and target NIR the first half of FY 1399



Source: Monetary Sector, Monetary Policy Department/ DAB

2.4. Foreign Exchange Market

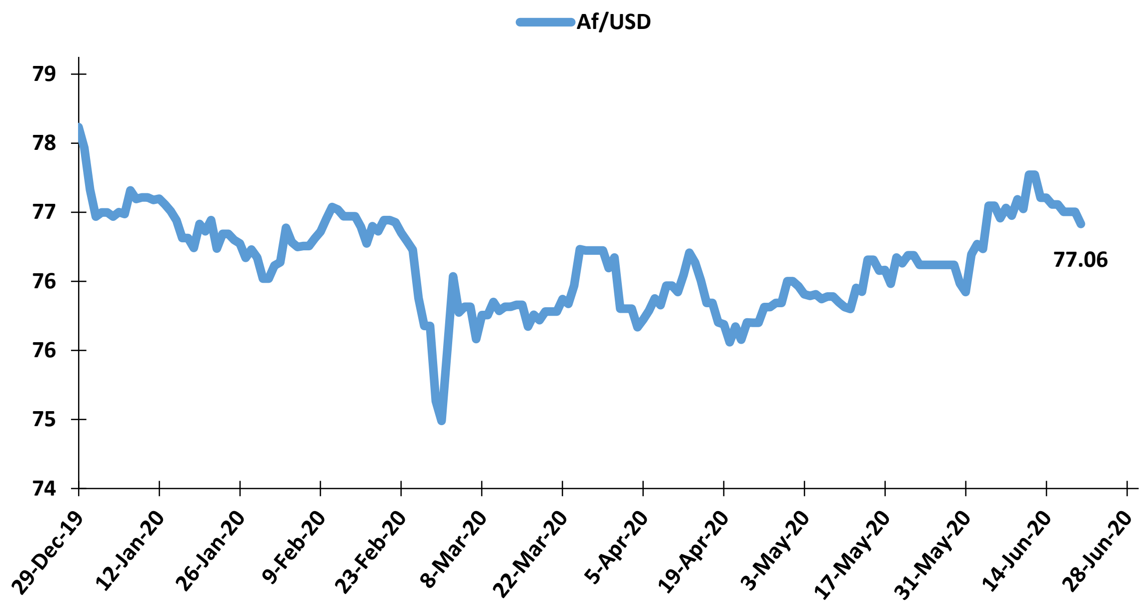
2.4.1. Foreign Exchange Rates

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 first half of FY 1399 (2020), Afghani relatively depreciated against the Great British pound, Euro and Swiss France, United States Dollar, United Arab Emirates dirham and Saudi Riyal, and also appreciated against Indian rupee, Pakistani Rupee, Chinese Yuan and Iranian Toman.

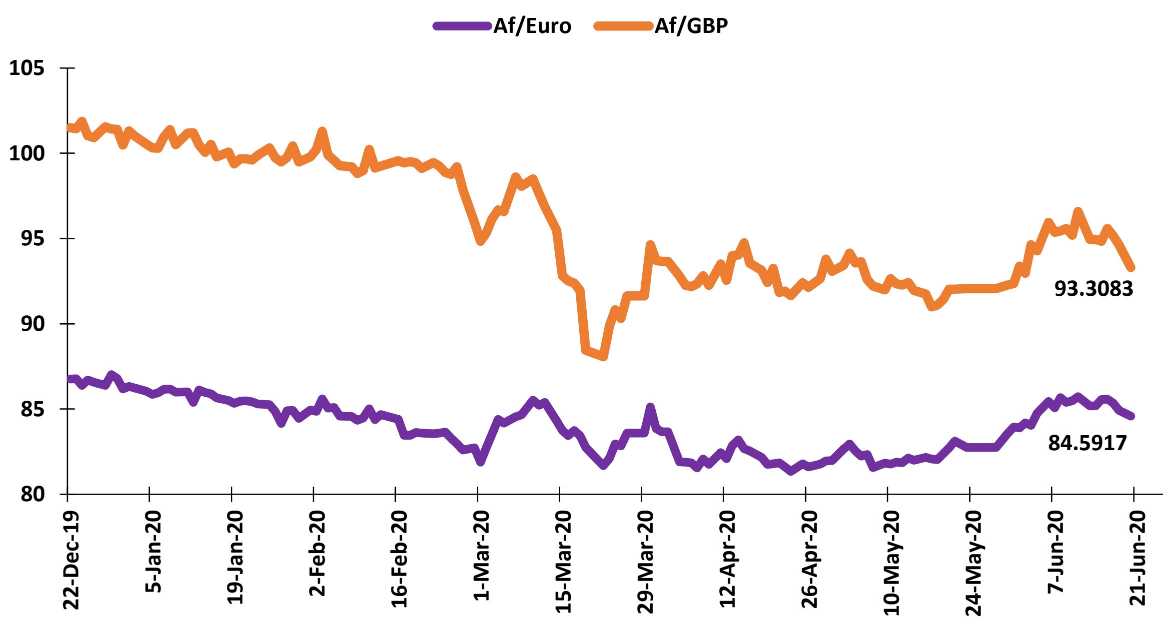
The daily historic review of the average exchange rate of Afghani against the U.S. dollars and other foreign currencies during first half of FY 1399 (2020) are shown in below figures.

Figure 2.6: Daily average ex- rate of Afghani against USD during the first half of FY 1399



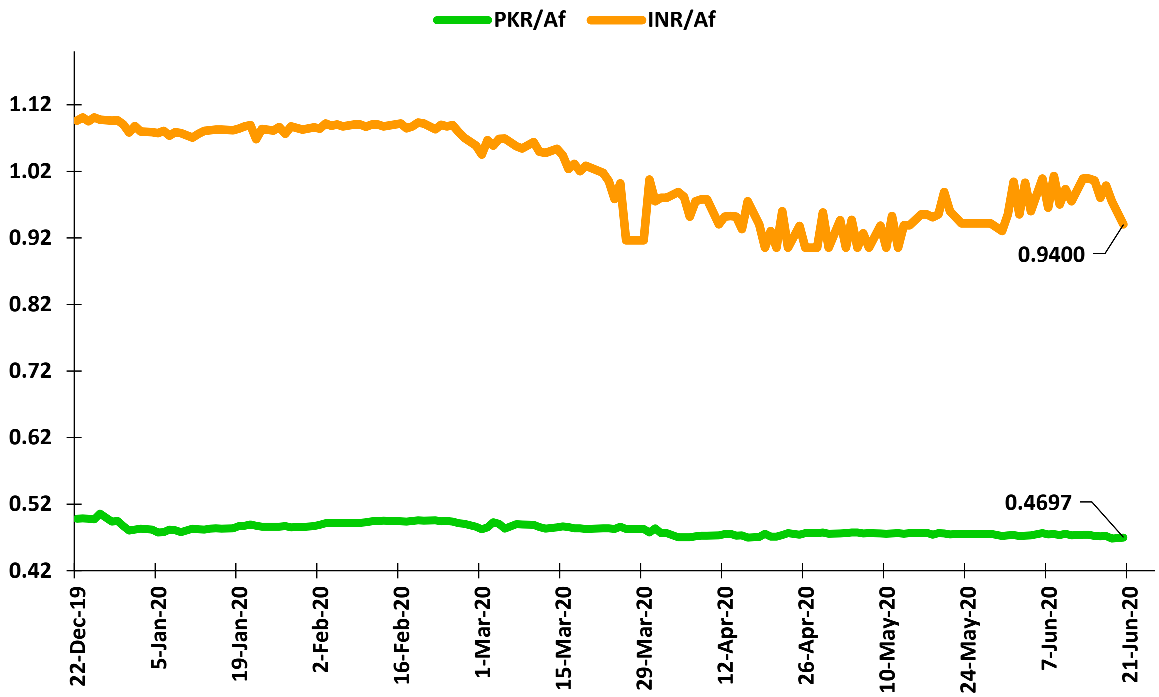
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.7: Daily average ex- rate of Afghani against GBP and Euro during the first half of FY 1399



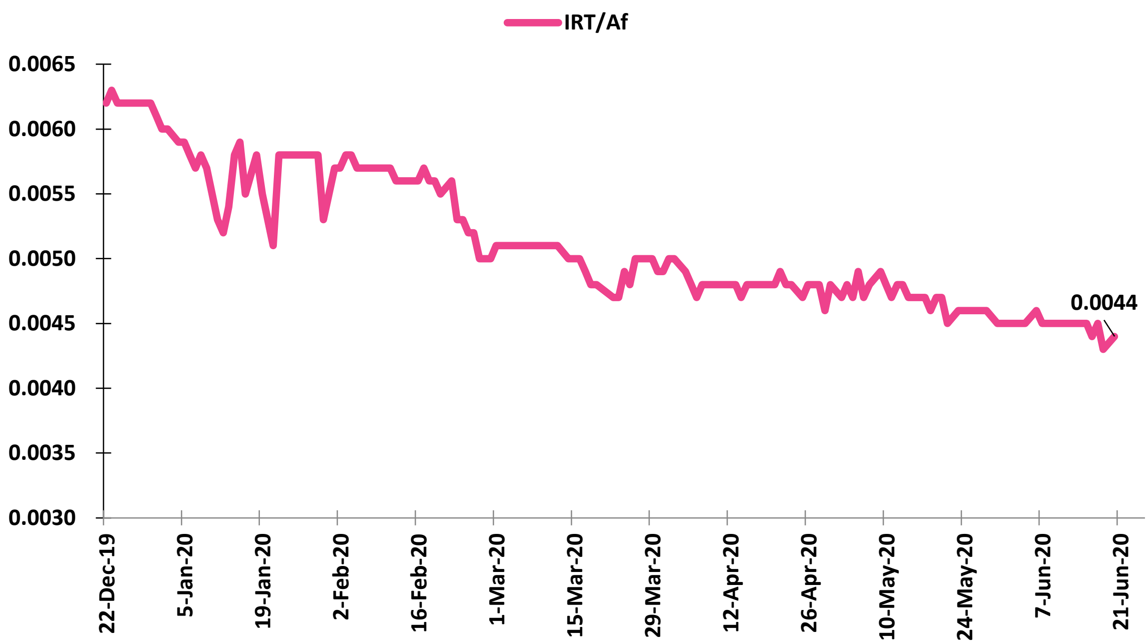
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.8: Daily avarage ex-rate of Afghani against INR and PKR during the first half of FY 1399



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.9: Dailly average ex- rate of Afghani against IRT during the first half of FY 1399



Source: Monetary Sector, Monetary Policy Department/ DAB

2.4.2. Foreign Exchange Auction

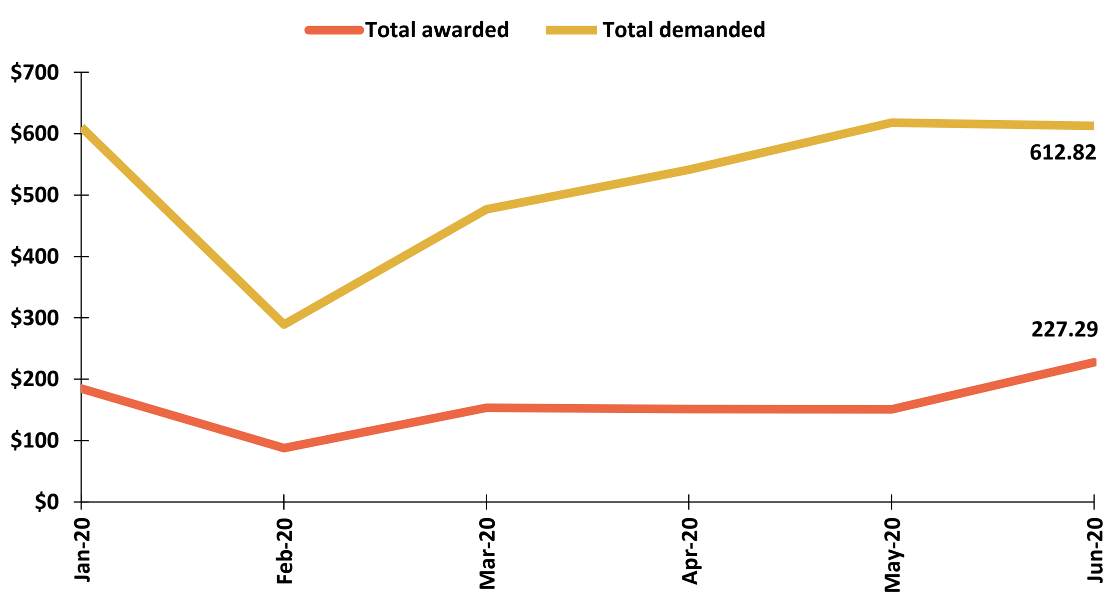
In order to control the money supply and maintain price stability in domestic market, DAB manages the reserve money growth close to its ceiling by conducting FX (USD) auctions three times a week and a weekly capital notes auctions. DAB continued the FX auction to mop up excess liquidity from the market and to smooth out excessive volatility of the exchange rate of Afghani against foreign currencies, especially the US dollar.

During the first half of FY 1399 (2020), DAB auctioned a total amount of USD 956.11 million, while the total demand was USD 3,193.50 million. On average, 53 bidders participated in each auction and 38 bids were announced as the winning bids with the average amount of USD 13.60 million sold in each auction and the total withdrawal is recorded Af 73.31 billion.

The data for the end of the first half of FY 1398 (2019) recorded a total auctioned amount of USD 1,206.93 million, with a total demand of USD 2,807.21 million. On average, 58 bidders participated in each auction and 42 bids were awarded with an average amount of USD 16.76 million in each auction and the total withdrawal is recorded Af 92.90 billion.

According to the approval of DAB executive board members on 6th March, 2020, DAB sold US dollar to Da Afghanistan Brishna Sherkat (Afghan Electricity Company) USD 103 million during first half of year under review.

Figure 2.10: US Dollar awarded and demanded amount during the first half of FY 1399



Source: Monetary Policy Department/DAB

2.5. Capital Market &Liquidity Conditions

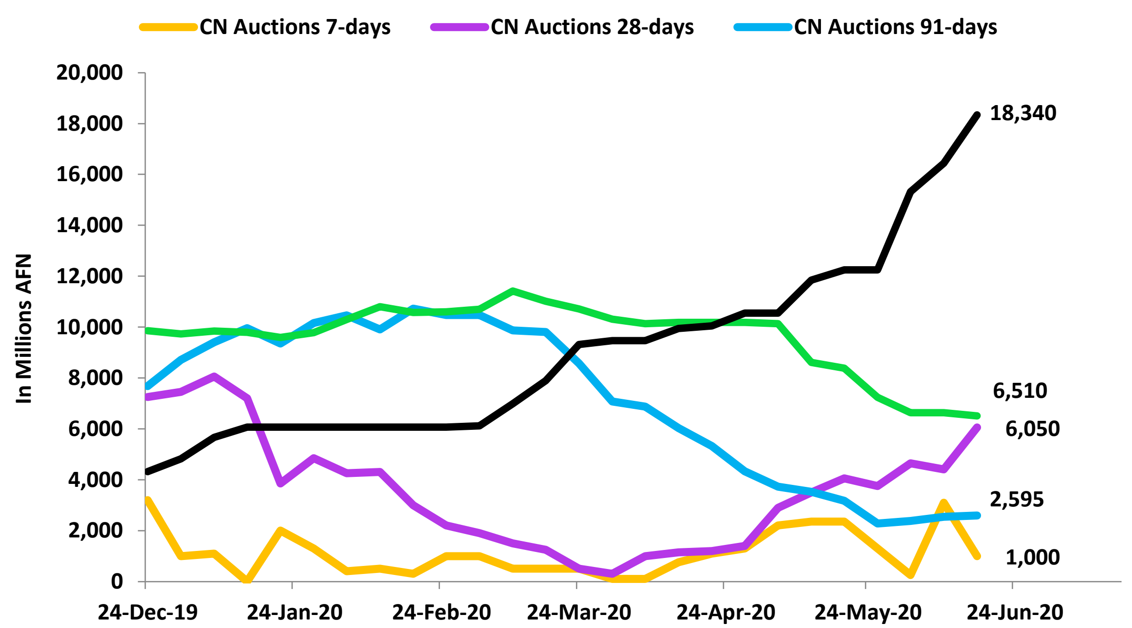
2.5.1. Capital Notes Auction

Capital notes are Afghani denominated short–term securities offered by DAB to licensed commercial banks on weekly basis. Da Afghanistan Bank uses Capital Notes (CNs) as a monetary tool to manage the money supply growth and absorb the excess liquidity of the commercial banks. Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months and one year.

Total outstanding stock of capital notes reached Af 34.47 billion at the end of the first half of FY 1399 (2020), which shows an increase of Af 7.45 billion compared to Af 27.02 billion at the end of the same period of FY 1398 (2019). The main reason for the increase in outstanding compared to the same period of last year is the higher CNs sales.

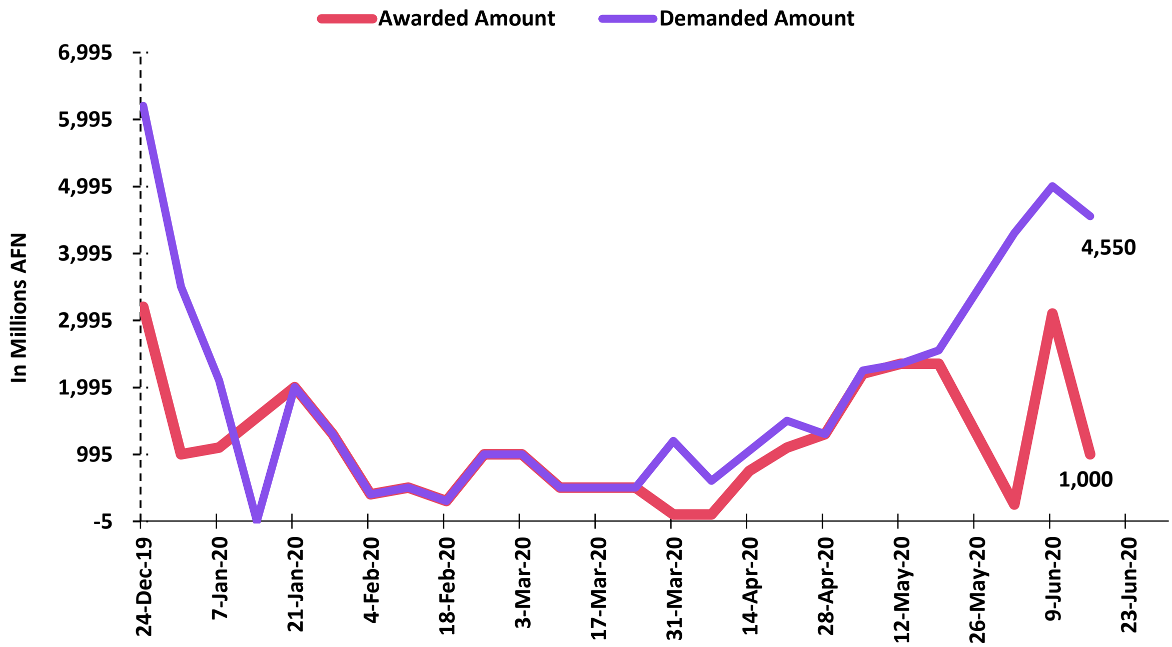
The outstanding stock of 7-days, 28-days, 91-days, 182-days and 364-days capital notes stood at Af 1 billion, Af 6.05 billion, Af 2.59 billion, Af 6.51 billion and Af 18.32 billion. Total interest paid to CNs figured out to Af 90.55 million till the end of the period under review. In addition, the weighted average interest rate for 7-days, 28-days, 91-days, 182-days and 364-days capital note were 0.63%, 0.93%, 1.45%, 1.75% and 2.98% from the beginning to the end of the first half of FY 1399 (2020).

Figure 2.11: Stock of outstanding Capital Notes during the first half of FY 1399



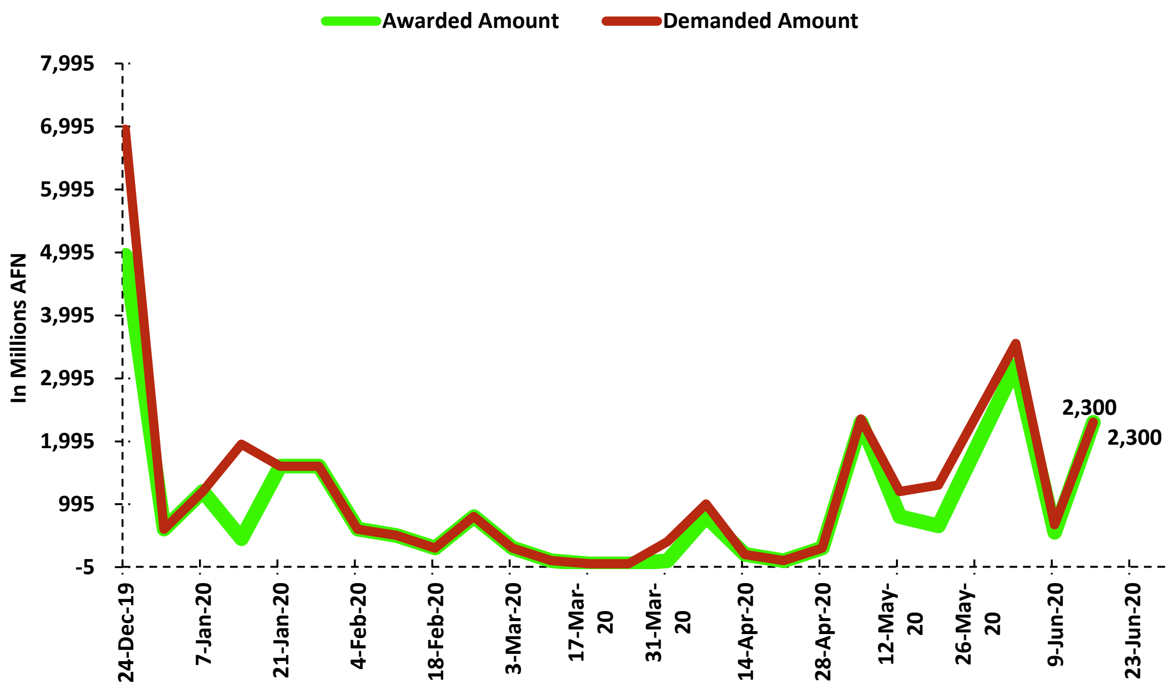
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.12: 7-days CNs demanded and awarded amount during the first half of FY 1399



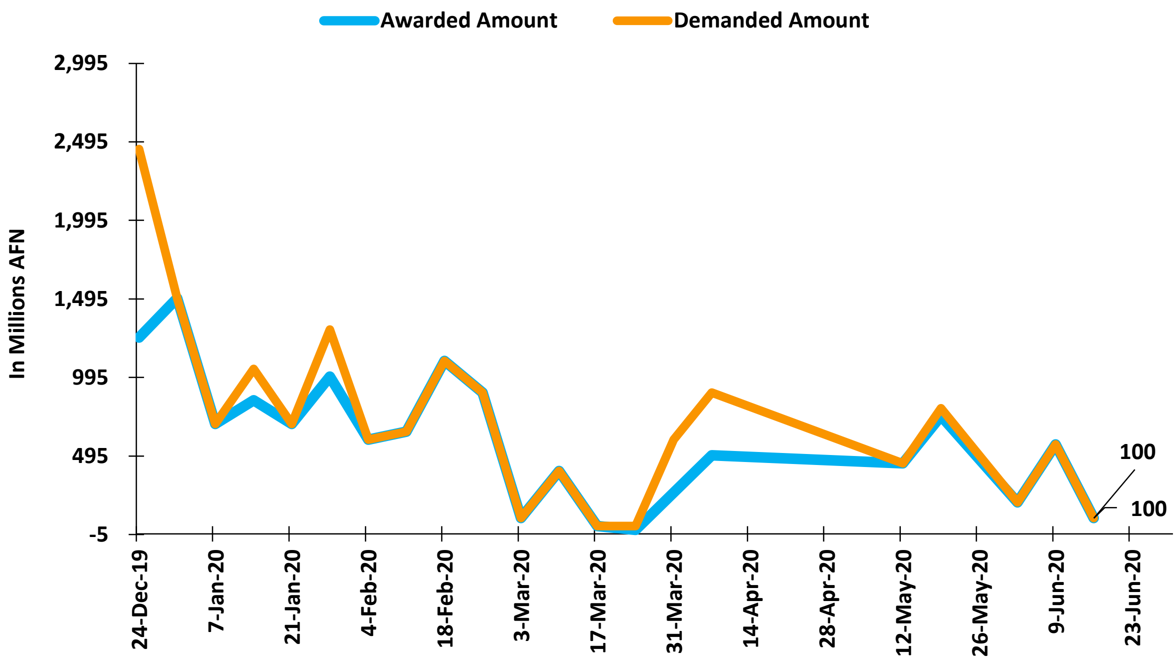
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.13: 28-days CNs demanded and awarded amount during the first half of FY 1399



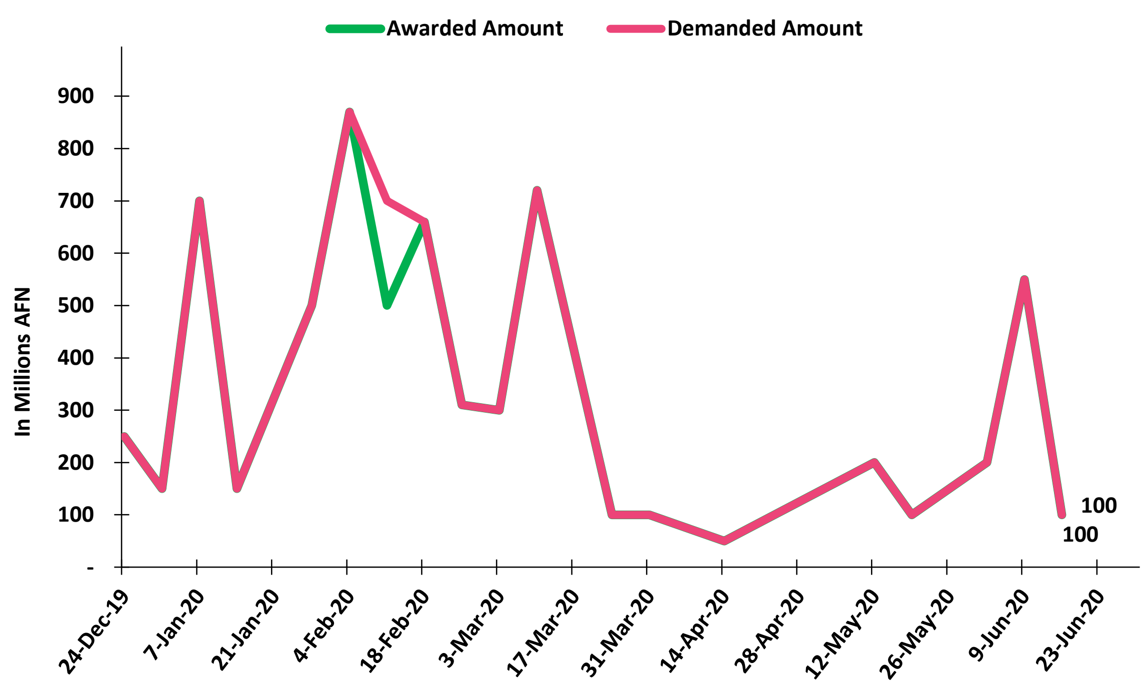
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.14: 91-days CNs demanded and awarded amount during the first half of FY 1399



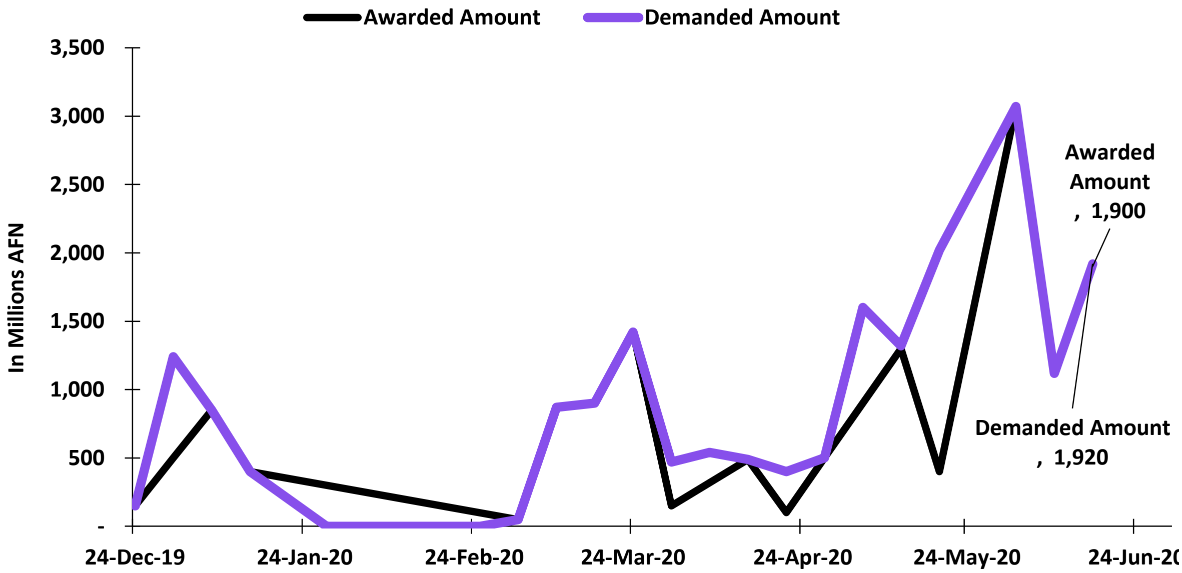
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.15: 182-days CNs demanded and awarded amount during the first half of FY 1399



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.16: 364 -days CNs demanded and awarded amount during the first half of FY 1399



Source: Monetary Sector, 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, in which required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. It shows Af 6,271.67 million, USD 214.58 million and Euro 13.48 million recorded at the end of period under review.

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, based on a circular to all banks, approved by DAB Supreme Council on September 11, 2017, is now 10 basis points. The outstanding amount of overnight deposit facility recorded Af 12,060.17 million at the end of the first half of FY 1399 (2020) and the payment of interest rate to the mentioned facility reached to Af 3.72 million for the same period.

Overnight Credit Facility (OCF)

This facility is used by banks for short term cash needs. The facility allows banks to borrow Afghani from Central Bank on an overnight basis when they face a shortfall in cash flow. The rate that the commercial banks are charged for this facility is 3.5% above the last 28-days CNs auction interest rate. This borrowing is collateralized with outstanding capital notes only. During the period under review, no bank has used from the credit facility.

3

Inflation Trend and Outlook

3

INFLAITON TREND AND OUTLOOK

3.1. Global Commodity Review

3.1.1. Executive Summary

The outbreak of COVID-19 has been accompanied by widespread decline in global commodity prices in the first quarter of 2020, followed by slight recovery in the second quarter of 2020. The pandemic represents a unique shock that has major impact on both the demand and supply of commodities. Oil markets have been most affected, given the collapse in travel arising from mitigation measures, and have seen an unprecedented collapse in demand and steepest one-month decline in oil prices on record. Metals prices have also fallen, albeit less than oil, while agricultural prices have been much less affected so far given their indirect relationship with economic activity.

3.1.2. Recent Trends

Energy prices have dropped since the start of the year, led by crude oil, which has fallen 70% since its peak in January. Mitigation measures taken to slow the spread of COVID-19 have resulted in a sudden plunge in transport activities around the world, and oil demand is expected to fall by an unprecedented 9% in 2020. Production cuts by OPEC+ are likely to be insufficient to offset this decline.

Oil prices are forecasted to average $35/bbl in 2020 and recover to $42/bbl in 2021. Risks to the forecast are to the downside and chiefly relate to the duration and severity of the pandemic. Natural gas prices are forecasted to decline by 25% in 2020, reflecting their links to oil prices, as well as weaker demand for electricity and industrial uses. Raw Materials Price Index experienced a modest recovery in May after registering large declines in early 2020.

The index is projected to drift lower in the second half of 2020 before picking up in 2021. Coal prices are expected to fall 17% in the third quarter of 2020. Gold prices rose for the seventh consecutive quarter and stood at $19,50 per ounce. The gold price climbed 9.2% during the second quarter of 2020, driving its year-to-date increase to 14%.

3.2. Consumer Prices in Afghanistan

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

Headline inflation based on the year-on-year measure showed an increase of 7.10% on average in the second quarter of 2020 from 4.18% recorded in the second quarter of the previous year. National inflation measured on quarter-on-quarter basis also indicates incline in the period under review. Observing the data, the average inflation rate reached to 7.10% in the second quarter of 2020, higher than the average rate of 3.54% in the first quarter of 2020. Observing the Kabul headline CPI, inflation rate on year-over-year basis increased to 4.95% on average in the second quarter of 2020 from 4.27% in the same quarter of the previous year. This index also increased on quarter-to-quarter basis reaching to 4.95% on average in the second quarter of 2020 from 3.27% in the first quarter of 2020.

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

The headline consumer price index increased on year-on-year basis in the second quarter of 2020. As per the available data, the headline inflation by this measure increased to 7.10% on average in the second quarter of 2020 from 4.18% in the same period of the previews year while on monthly basis, the inflation rate was recorded at 8.67%, 6.26%, and 6.36% in the months of April, May and June 2020 respectively.

In the food index, inflation increased to 14.12% on average in the second quarter of 2020 from 6.00% in the same quarter of the previous year. In the above mentioned index, the inflationary pressures came from higher prices of bread and cereals meat, oil and fats, fresh and dried fruits, and vegetables. The highest increase in the index was recorded in the prices of vegetables, and oils & fats which increased to 27.54% and 18.06% on average from 4.26% and -3.49% respectively. Inflation in non-food category declined to average 0.31% from 2.48% in the second quarter of 2020 compared to same quarter of previous year. This decrease was due to lower prices of tobacco, housing, furnishing and household goods, transportation, information and culture, and restaurants and hotel declined over the one-year period. In the mentioned category, the highest decrease was noted in price index of transportation and furnishing and household goods, which decreased to -8.01% and 0.84% on average from 4.29% and 4.63% respectively.

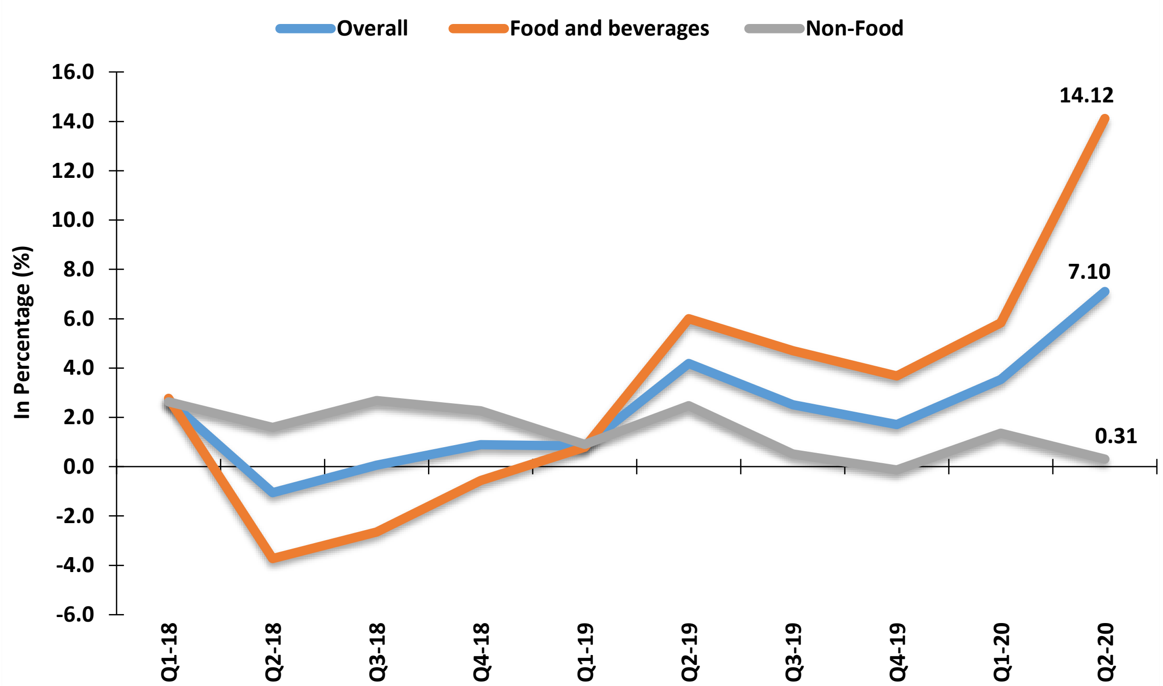
Core inflation showed upward slope in the second quarter of 2020 compared to the second quarter of 2019. Trimmed mean which is the most common measure of core inflation, jumped to 5.94% from 3.85%. In addition, the CPI inflation, excluding bread and cereals, oil and fats and transportation, increased to 5.75% in the second quarter of 2020 from 3.68% 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 also reflected upward trend. The national headline inflation on quarter to quarter basis increased to 7.10% on average in the second quarter of 2020 from 3.54% recorded in the previous quarter. Food items represented higher price during the review period but non-food items represented lower prices. Food inflation increased to 14.12% in the second quarter of the current year from 5.83% in the first quarter of the current year. Except spices, all other food components represented higher prices during the review period, which pushed the food inflation up. On the other hand, non-food inflation decreased in the second quarter of 2020 from the previous quarter.

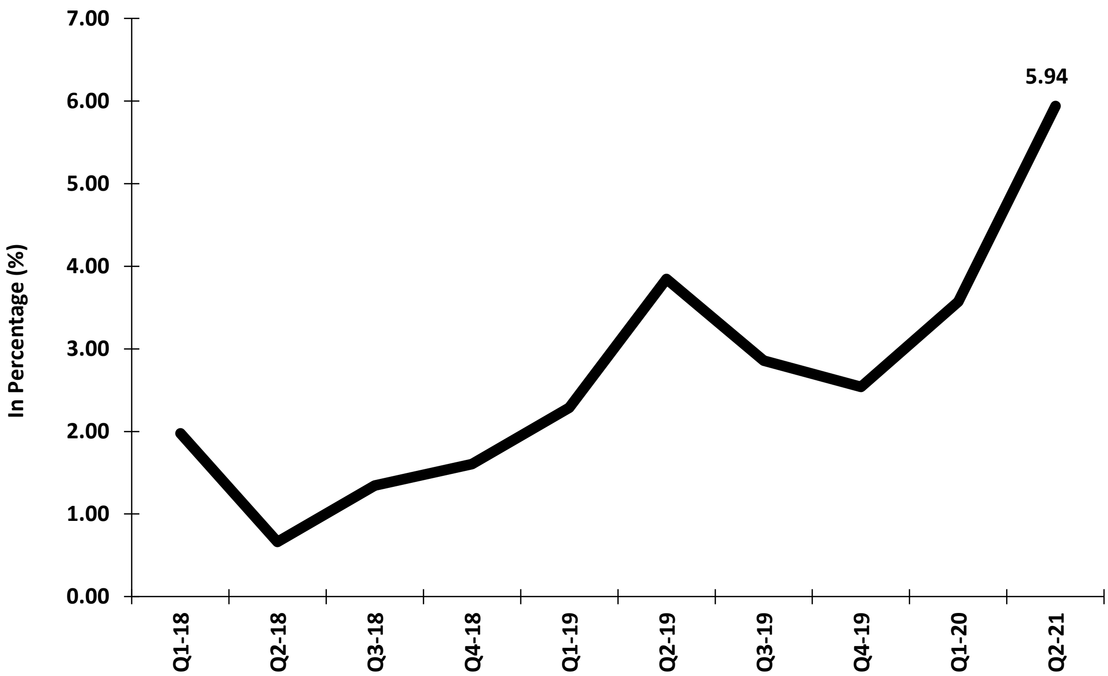
Observing the data, inflation in this index dropped to 0.31% from 1.36%. In this category, the prices of transportation, and restaurant and hotel decreased with big margin compared to the other non-food items. On the other hand, prices increased in some other sub-components of non-food category, such as health, tobacco, and education.

Figure 3.1: National average CPI (Q-o-Q) for the 2nd Quarter of FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Figure 3.2: National average CPI, 30% Trimmed mean (Q-o-Q) for the 2nd Quarter of FY 2020



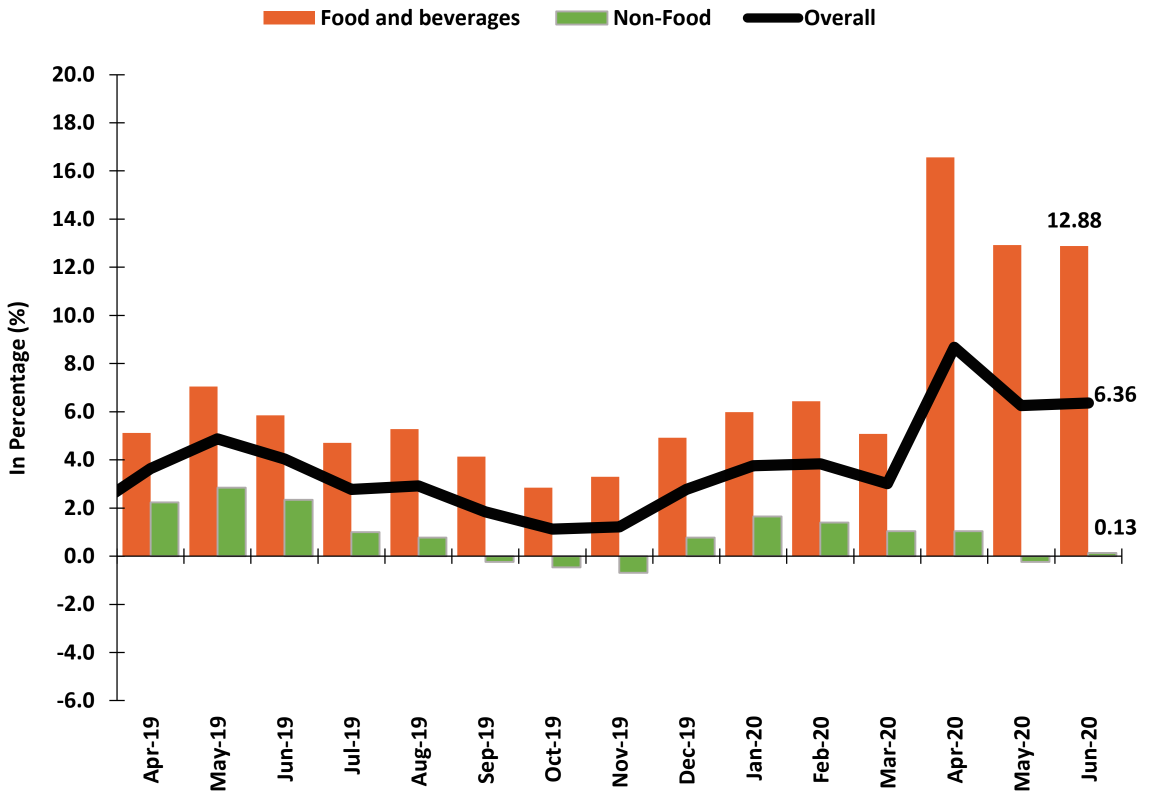
Source: NSIA/Monetary Policy Department, DAB staff calculation

Table 3.1: National Headline Inflation for the 2nd Quarter of FY 2020

Period	2019					2020							
	Based on Apr 2015												
	Weight	Apr-2019	May-2019	Jun-2019	Average (3 months)	Jan-2020	Feb-2020	Mar-2020	Average (3 months)	Apr-2020	May-2020	Jun-2020	Average (3 months)
Overall Index	100.0	3.63	4.88	4.03	4.18	3.75	3.84	3.02	3.54	8.67	6.26	6.36	7.10
Food & Non-Alcoholic Beverages	47.8	5.12	7.04	5.86	6.00	5.99	6.43	5.07	5.83	16.56	12.92	12.88	14.12
Bread and Cereals	14.6	8.19	9.94	10.16	9.43	3.45	4.29	3.76	3.83	15.19	14.76	15.78	15.24
Meat	7.5	1.43	4.92	5.53	3.96	8.63	9.28	8.67	8.86	12.03	10.70	12.49	11.74
Milk, cheese and eggs	4.7	3.06	2.61	2.28	2.65	-3.21	-2.63	-3.27	-3.04	0.02	4.04	3.58	2.55
Oils and fats	4.6	-4.32	-3.28	-2.87	-3.49	5.10	6.27	7.22	6.20	13.41	19.15	21.62	18.06
Fresh and dried fruits	5.0	9.70	11.91	9.01	10.21	3.58	3.06	4.50	3.72	14.32	10.35	10.88	11.85
Vegetables	6.0	6.84	6.67	-0.73	4.26	16.44	15.90	8.17	13.50	43.46	23.02	16.15	27.54
Sugar and sweets	2.7	3.11	7.35	7.36	5.94	5.05	6.30	1.08	4.14	7.40	3.66	3.59	4.88
Spices	1.3	11.15	22.64	19.93	17.91	20.78	17.68	18.78	19.08	30.82	9.59	11.57	17.33
Non-alcoholic beverages	1.4	5.45	5.65	5.51	5.54	4.01	4.18	3.45	3.88	3.72	4.13	4.08	3.98
Non-Food Items, Tobacco & Services	52.2	2.24	2.85	2.35	2.48	1.65	1.39	1.04	1.36	1.03	-0.24	0.13	0.31
Tobacco	0.3	4.12	4.42	3.68	4.07	-1.65	-0.73	0.04	-0.78	1.11	1.12	1.40	1.21
Clothing	4.6	4.78	5.93	5.17	5.29	6.89	8.42	7.97	7.76	7.47	10.08	7.54	8.36
Housing	19.1	-0.21	0.00	-0.37	-0.19	0.89	-1.23	-1.63	-0.66	-1.78	-4.38	-4.02	-3.39
Furnishing and household goods	11.9	4.37	4.89	4.62	4.63	1.02	1.42	1.08	1.18	0.35	1.39	0.78	0.84
Health	6.2	2.57	5.24	5.30	4.37	4.41	5.60	5.83	5.28	6.50	4.36	8.86	6.57
Transportation	4.3	5.68	4.30	2.91	4.29	-4.69	-3.86	-5.14	-4.56	-3.44	-10.14	-10.44	-8.01
Communication	1.7	-3.32	-2.73	-4.58	-3.54	-3.93	-3.60	-4.42	-3.98	-3.89	-4.22	-2.40	-3.50
Information and Culture	1.1	2.67	2.11	1.18	1.98	4.34	3.66	2.07	3.36	0.87	1.77	3.15	1.93
Education	0.4	-4.50	0.21	0.29	-1.34	-0.85	0.80	0.26	0.07	6.55	1.24	0.83	2.87
Restaurants and Hotels	1.1	3.58	4.04	4.56	4.06	3.61	3.12	3.09	3.27	2.03	1.76	0.97	1.59
Miscellaneous	1.4	2.15	3.97	1.59	2.57	9.79	10.82	12.35	10.99	13.23	12.40	14.17	13.27
CPI ex. B & C, O & F, and T		3.17	4.48	3.39	3.68	4.22	4.05	3.10	3.79	7.84	4.82	4.61	5.75
30% trimmed mean		3.54	4.45	3.54	3.85	3.46	3.89	3.35	3.57	6.36	5.47	5.99	5.94

Source: NSIA/Monetary Policy Department, DAB staff calculation

Figure 3.3: National Headline Inflation (Y-o-Y) for the 2nd Quarter of FY 2020



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) has increased to 4.95% on average in the second quarter of 2020 from 4.27% 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 upward movement in one-year period. In the food category, higher prices of meat, oils and fats, and vegetables pushed the inflation rate to 10.71% on average in second quarter of 2020, while it was calculated 7.16% in the second quarter of 2019.

Inflation in non-food item, which comprises 62.8% weight of the whole index, has decreased to 1.14% on average in the second quarter of 2020 from 2.45% in the same period of the previous year. This decrease is attributed to lower prices of tobacco, housing, furnishing and household goods, and transportation. In this category tobacco decreased to -2.34% from 4.39%, housing lessened to -3.80% from -0.25%, furnishing and household goods stood at -1.13% from 5.06%, transportation fell off to -1.62% from 3.16% in the second quarter of 2020 compared to the same quarter of previews year.

Core inflation excluding bread & cereals, fats and oils, and transportation also indicates increase in the period under review and stood at 4.29% on average, while the rate was recorded 3.98% in the same quarter of the previous year. The 30% trimmed mean also reflected higher inflation rate standing at 5.44% in the second quarter of 2020 compared to 3.88% in same quarter of 2019.

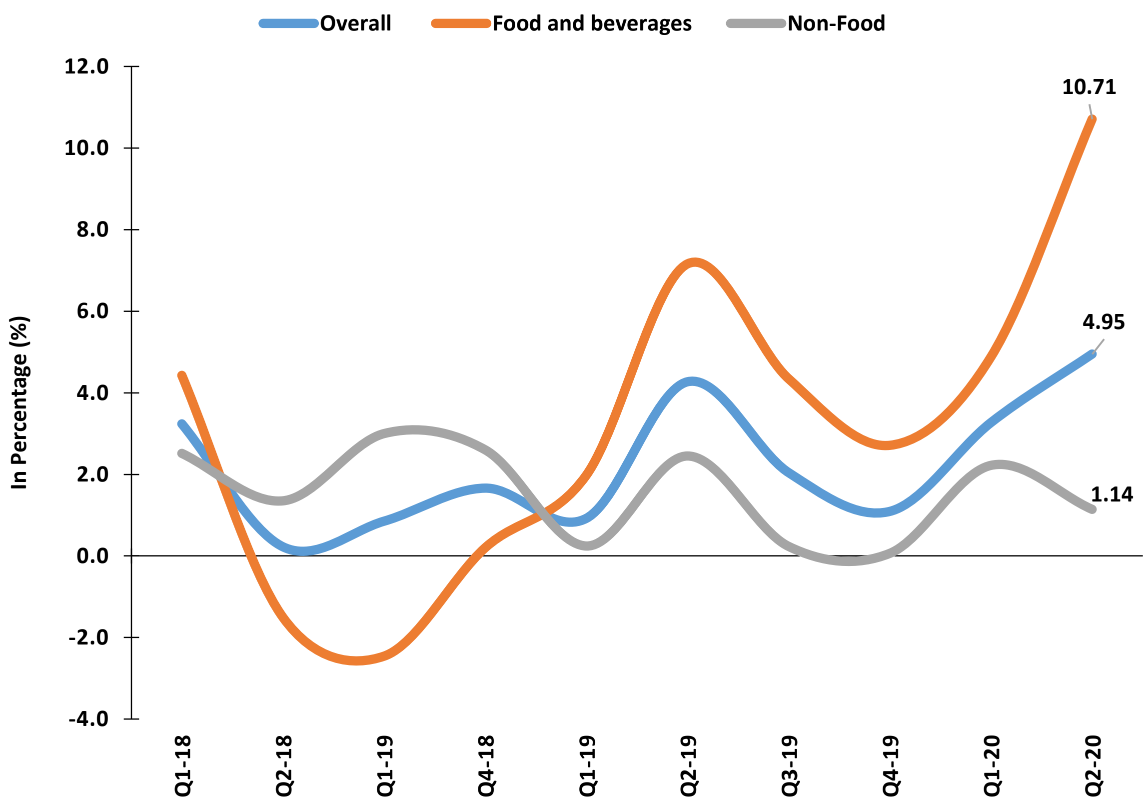
3.2.4. Development in the Kabul Headline Inflation (Quarter on Quarter Changes)

The quarter on quarter measure of headline inflation in Kabul indicated upward movement which reflects higher inflation in foods item of the CPI. The headline inflation in Kabul surged up to 4.95% on average in second quarter of 2020 from 3.27% recorded in the first quarter.

Inflation in the food index increased to 10.71% on average from 4.88%. In this category, the prices of bread and cereals, meat, oil and fats, fresh and dried fruits, and vegetables increased which led to higher inflation rate during the period under review. The highest increase was observed in the price index of vegetables which dramatically increased to 29.10% from 15.02% in the first quarter of 2020. On the other hand, few other food sub-items showed decrease on quarterly basis such as sugar and sweets, spices, and non-alcoholic beverages which eased to 0.82%from 5.78%, 15.84% from 17.55%, and 4.33% from 5.18% respectively.

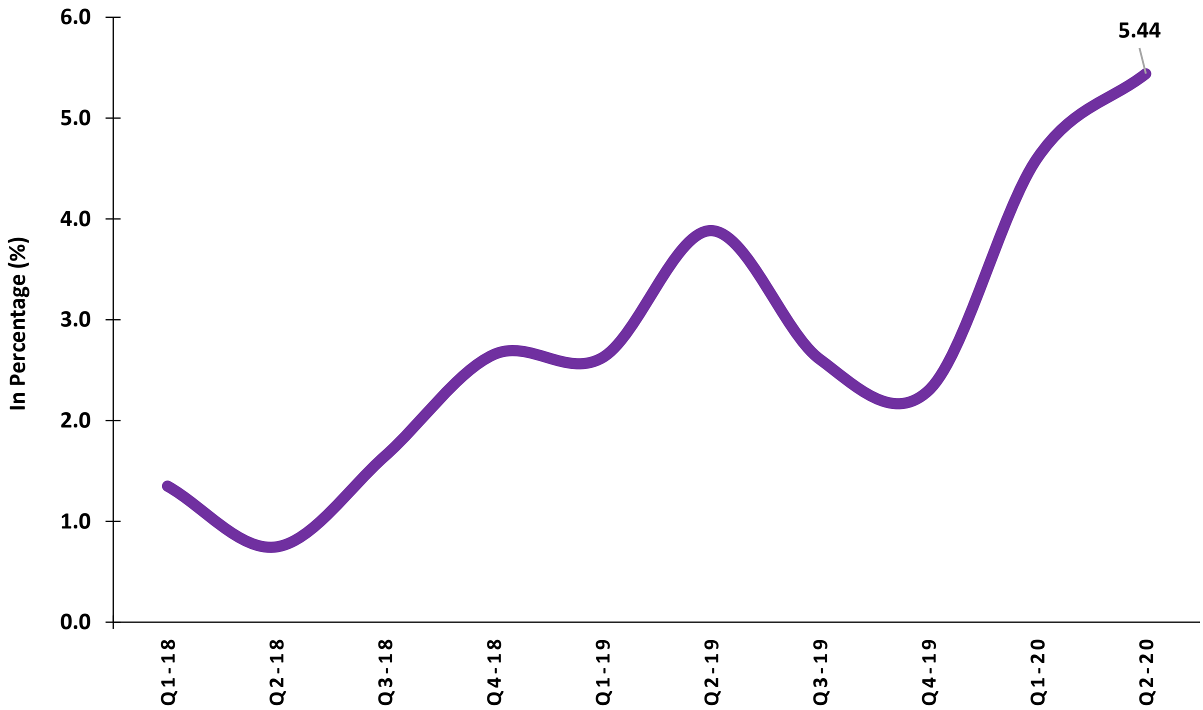
The Non-food category of the CPI showed decrease in inflation rate during the second quarter of 2020 compared to the first quarter of 2020. Inflation in this category dropped down to 1.14% on average from 2.22%. The decrease in non-food inflation is driven by lower prices tobacco, housing, furnishing and household goods, health, information and culture, and restaurants and hotels which the largest decrease was observed in the price of housing items going down to -3.80% from -0.22%.

Figure 3.4: Kabul average CPI (Q-o-Q) for the 2nd Quarter of FY 2020



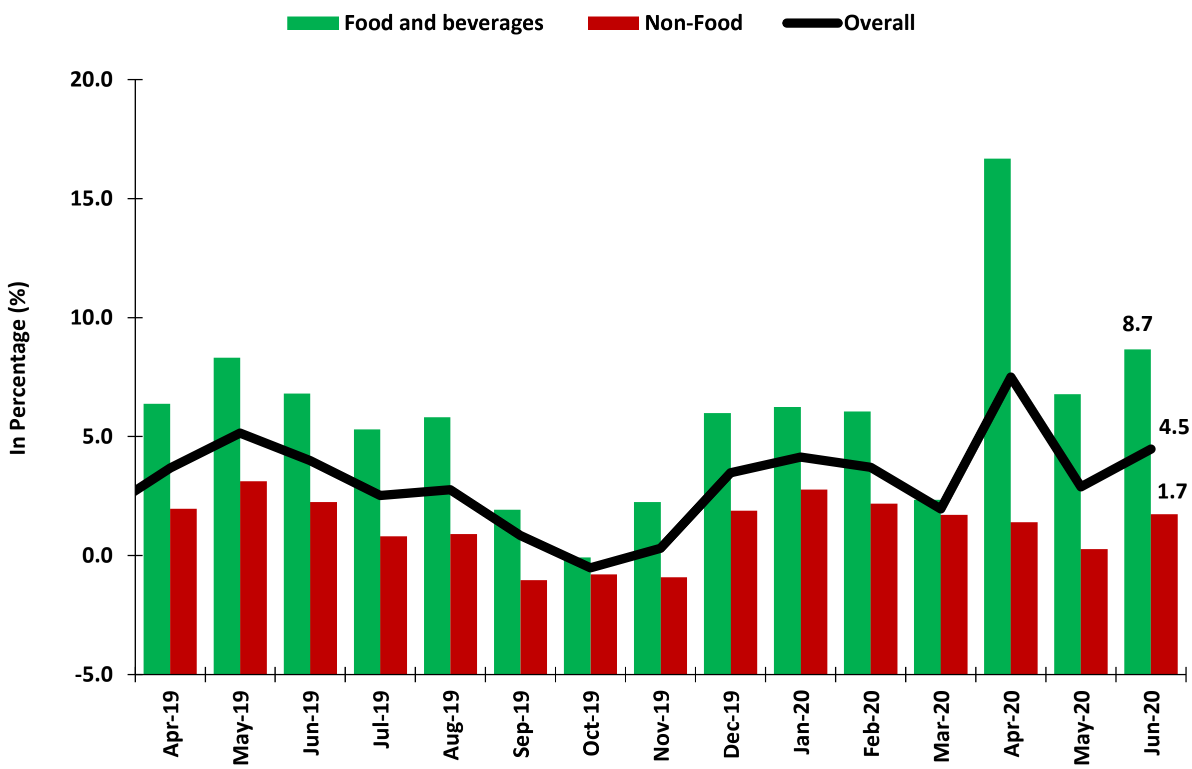
Source: NSIA/Monetary Policy Department, DAB staff calculation

Figure 3.5: Kabul average CPI, 30% Trimmed Mean (Q-o-Q) for the 2nd Quarter of FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Figure 3.6: Kabul Headline Inflation for the 2nd Quarter of FY 2020



Source: NSIA/Monetary Policy Department, DAB staff calculation

Table 3.2: Kabul Headline Inflation for the 2nd Quarter of FY 2020

Period	2019					2020							
	Based on Apr 2015												
	Weight	Apr-2019	May-2019	Jun-2019	Average (3months)	Jan-2020	Feb-2020	Mar-2020	Average (3months)	Apr-2020	May-2020	Jun-2020	Average (3months)
Overall Index	100.0	3.68	5.14	3.99	4.27	4.14	3.70	1.96	3.27	7.50	2.88	4.47	4.95
Food & Non-Alcoholic Beverages	37.2	6.38	8.31	6.80	7.16	6.24	6.05	2.35	4.88	16.68	6.78	8.67	10.71
Bread and Cereals	9.8	10.93	11.71	12.46	11.70	4.85	2.90	2.23	3.33	11.87	9.60	8.59	10.02
Meat	6.4	2.79	5.25	6.71	4.92	2.69	1.58	1.04	1.77	5.93	8.10	9.56	7.87
Milk, cheese and eggs	3.2	3.59	2.29	1.78	2.55	-6.99	-5.82	-6.78	-6.53	-1.55	0.97	-2.32	-0.97
Oils and fats	3.6	-5.91	-6.05	-6.13	-6.03	4.86	2.79	6.87	4.84	8.26	13.72	26.29	16.09
Fresh and dried fruits	5.2	8.13	11.76	12.34	10.74	5.90	6.48	8.23	6.87	16.42	7.49	6.44	10.12
Vegetables	4.2	9.63	3.68	-8.18	1.71	22.69	25.10	-2.73	15.02	63.34	9.29	14.67	29.10
Sugar and sweets	2.8	5.06	13.22	13.30	10.53	6.10	11.11	0.15	5.78	5.50	-2.81	-0.23	0.82
Spices	1.0	21.27	48.57	23.08	30.97	20.11	14.41	18.12	17.55	41.11	-3.44	9.83	15.84
Non-alcoholic beverages	0.9	5.34	6.29	4.49	5.37	6.47	4.82	4.25	5.18	3.58	2.74	6.66	4.33
Non-Food Items, Tobacco & Services	62.8	1.97	3.13	2.25	2.45	2.77	2.18	1.71	2.22	1.40	0.28	1.74	1.14
Tobacco	0.3	3.36	4.54	5.26	4.39	-1.23	-0.05	0.38	-0.30	-1.77	-2.31	-2.95	-2.34
Clothing	4.8	2.14	3.15	2.05	2.45	9.38	13.15	11.37	11.30	10.13	16.67	10.11	12.30
Housing	23.5	-0.76	0.42	-0.41	-0.25	2.70	-1.37	-1.98	-0.22	-2.69	-5.85	-2.87	-3.80
Furnishing and household goods	17.6	4.84	5.47	4.88	5.06	-1.10	-0.83	-1.17	-1.04	-2.12	-0.38	-1.40	-1.30
Health	5.3	1.87	8.32	8.12	6.11	12.29	14.03	14.57	13.63	14.74	6.46	19.36	13.52
Transportation	4.6	5.06	2.88	1.53	3.16	-4.47	-2.67	-3.67	-3.60	1.96	-3.30	-3.51	-1.62
Communication	2.0	-0.73	0.67	-1.61	-0.55	-0.21	0.75	0.16	0.23	0.15	-0.50	1.74	0.46
Information and Culture	1.7	1.67	0.86	-0.82	0.57	7.77	8.50	7.24	7.84	4.92	5.88	9.10	6.63
Education	0.7	-7.16	-0.99	-0.63	-2.93	-4.06	-2.04	-2.77	-2.95	5.63	-1.38	-2.35	0.63
Restaurants and Hotels	1.0	1.72	1.27	1.27	1.42	9.94	10.73	12.10	10.92	8.12	8.74	10.71	9.19
Miscellaneous	1.3	6.70	6.48	2.07	5.08	16.04	17.40	20.70	18.05	17.99	18.44	20.38	18.94
CPI ex. B & C, O & F, and T		3.25	5.04	3.65	3.98	4.50	4.18	2.04	3.57	7.27	2.03	3.57	4.29
30% trimmed mean		3.68	4.49	3.48	3.88	5.03	5.33	3.44	4.60	6.83	3.71	5.79	5.44

Source: NSIA/Monetary Policy Department, DAB staff calculation

3.3. Afghanistan Inflation Outlook for The End of FY 1399

The near-term outlook of inflation is likely to move slightly upward gradually due to COVID-19 pandemic. Monetary policy department forecasts inflation rate 4% to 6% for the third quarter of 2020. The forecast is based on the following course of factors.

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 from Iran, Pakistan, China, Turkey and other countries in the region. There are so many factors which affect inflation rate, but most importantly, Afghanistan inflation is correlated with its trade partner countries inflation rate and Afghani currency exchange rate against the US dollar.

Regional inflation forecast may have some effects on Afghanistan inflation rate. Looking into the inflation reports of the country's major trading partners, and their forecast for the third quarter of 2020, inflation in most of those countries has been increasing in the second quarter, and their forecast show slight increase for the third quarter compared to the second quarter's actual rate.

Inflation forecast in Afghanistan may also be conditional to the further spread of COVID-19 pandemic. Continuity of restrictive measures may cause to supply shortage which may result in higher commodity prices. Also, security is another concern that increases the uncertainty level in forecasting inflation for the third quarter.

4

External Sector Developments

4

EXTERNAL SECTOR DEVELOPMEN

4.1. Summary:

The COVID -19 pandemic and the imposition of a partial lockdown in Afghanistan the external sector performance affected during the second quarter of the FY 1399. Breakdown in supply and demand chains along with the interruption of domestic production processes resulted in a notable decline in merchandise exports as well as merchandise imports. However, with a greater decline in the earnings of merchandise exports compared to the decline in expenditure on imports, the trade deficit narrowed over the same period in 1398.

The services sector activities were severely affected particularly travel, transportation, construction and other related services largely due to imposition of travel restriction globally and implement lockdown and border control policy in the second quarter of the FY 1399.

Worker remittances declined notably, with the return of migrant workers from the affected countries especially from (Iran and Pakistan), as well as job termination of some workers abroad because of COVID-19 pandemic. Official grants (Operating and development) demonstrated upward trend, because of the grants inflow for supporting critical food supply chains and healthcare for afghan households during the pandemic.

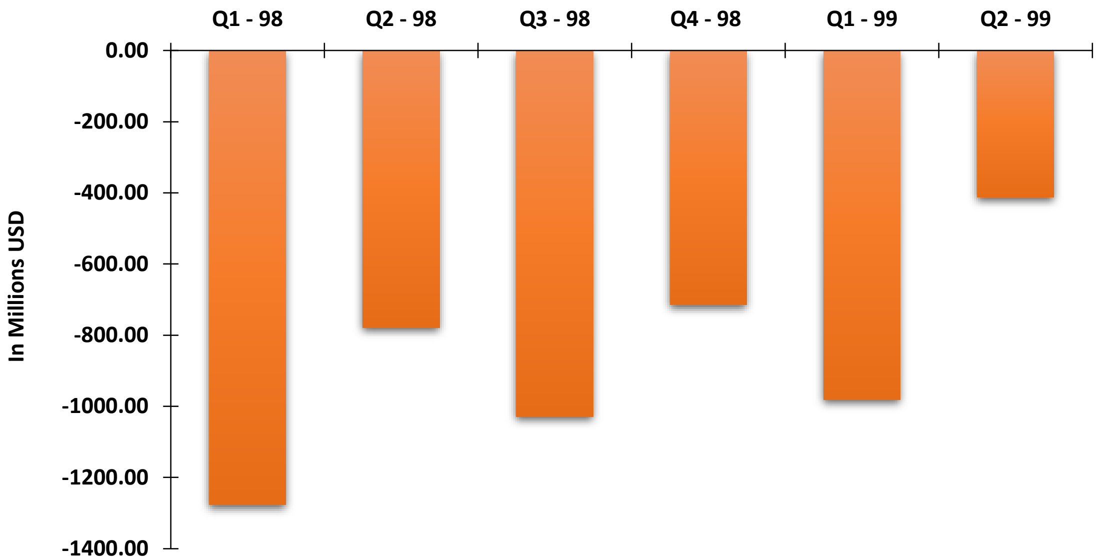
However, in the financial account net foreign direct investment (FDI) inflows showed remarkable decline in the second quarter of the FY 1399. Meanwhile, the level of gross official reserves indicated a considerably increase because of the grants inflows to the government sector. Reflecting these developments, the BOP recorded an overall deficit of around USD 593 million at end of the second quarter of the FY 1399.

4.2. Balance of Payments:

4.2.1. Current Account:

The balance of payments (BOP's) current account deficit significantly decreased by 47% to a value of USD 412.99 million in the second quarter of the FY 1399 from a value of USD 778.30 million recorded in the second quarter of the FY 1398, (table 4.1 and figure 4.1). This decline was mainly on account of a contraction in merchandise trade deficit as a result of a notable decline in merchandise exports as well as merchandise imports, contraction in services account deficit as a result of service sector related activities impression during COVID – 19 pandemics and increasing official grant to the government sector for Supporting critical food supply chains and healthcare for Afghan household during the COVID-19 pandemic.

Figure 4.1: Current account balance for the 2nd Quarter of FY 1399



Source: NSIA/Monetary Policy Department, DAB staff calculation

Base on quarter to quarter compression the deficit of merchandise trade account contracted by 28% in the second quarter of the FY 1399 as a result of a notable decline in merchandise exports as well as merchandise imports. Considering the statistics, the value of total export of goods declined by 78% to a value of USD 32 million in the second quarter of the FY 1399 from a value of USD 143.29 million recorded in the second quarter of the FY 1398. At the time, the value of total import of goods declined by 33% to a value of USD 984.61 million in the second quarter of the FY 1399 from a value of USD 1466.34 million recorded in the second quarter of the FY 1398.

The breakdown in supply and demand chains along with the interruption of domestic production processes in the country resulted in a notable decline in all merchandise exports and merchandise imports component in the second quarter of the FY 1399.

Meanwhile, compensation of employees together with investment income inflows declined by 71% to a value of USD 29.75 million in the second quarter of the FY 1399 from a value of USD 101.08 million recorded in the similar quarter of the last year. As well as, official grants to the government sector and personal transfers from foreign countries increased by 7% and stood at a value of USD 588.06 million in the second quarter of the year under review from a value of USD 547.83 million recorded in the similar quarter of the last year.

4.2.2. Capital Account:

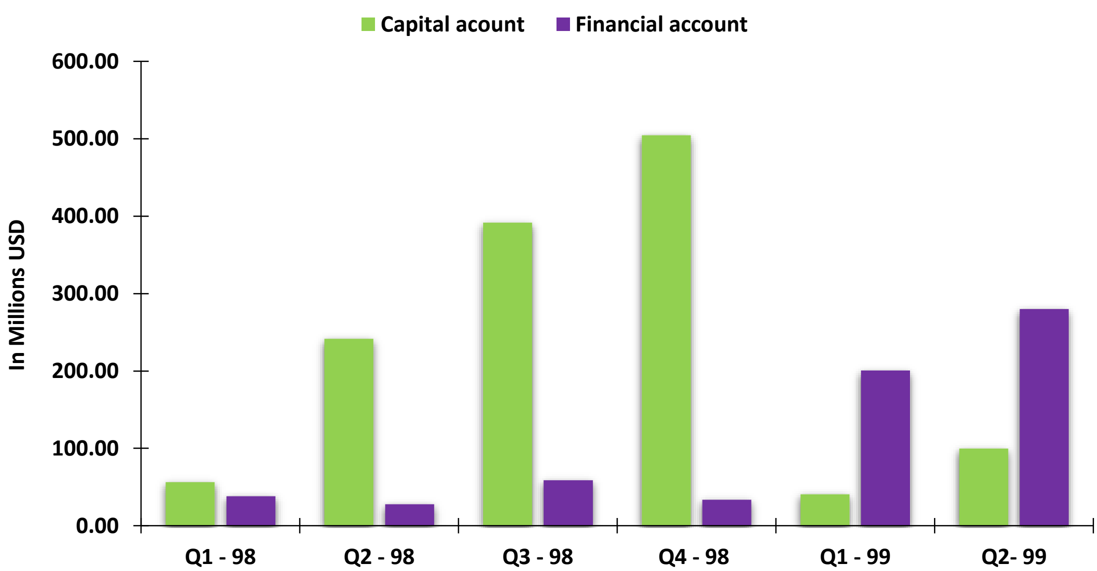
Inflow to the capital account decreased by 59% to a value of USD 99.92 million in the second quarter of the FY 1399 from a value of USD 241.57 million recorded in the second quarter of the FY 1398, as a result of lower inward of capital transfers to the government sector.

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. During the quarter under review, COVID 19 pandemic together with Sustained security and political concerns hit the level Net FDI inflows in the country.

Considering the statistics, FID net inflows stood at USD 0.4 million in the second quarter of the FY 1399 from a net inflows of USD 6.28 million recorded in the second quarter of the FY 1398. In the meantime, portfolio investment exhibits USD 41.19 million which reflects insertion of Afghanistan investment in foreign countries during the second quarter of the FY 1399 from the value of USD 15.42 million registered in the second quarter of the FY 1398.

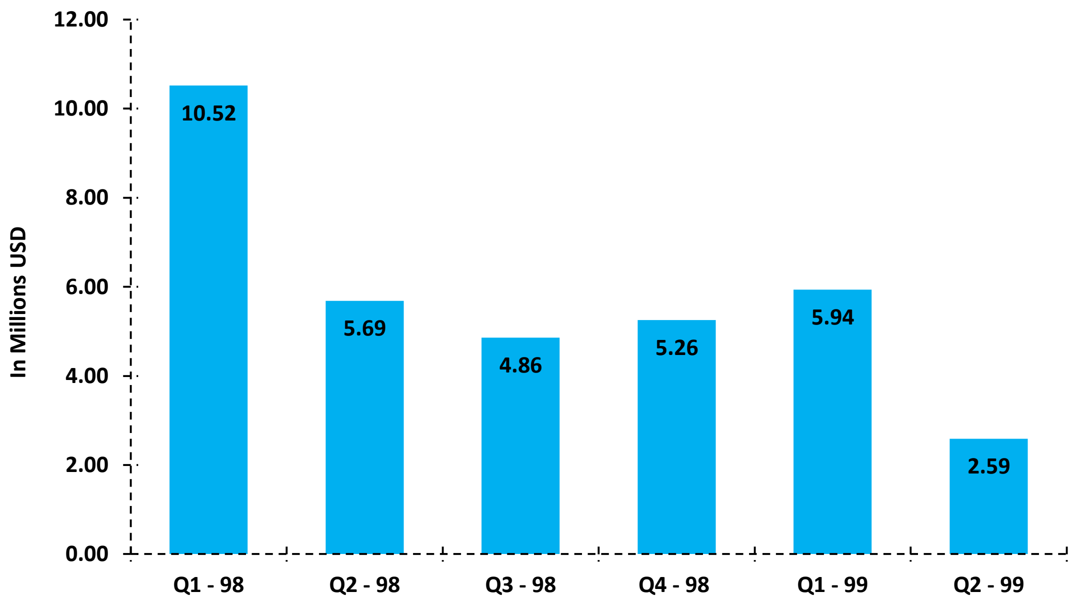
Figure 4.2: Capital and Financial Account for the 2nd Quarter of FY 1399



Source: Monetary Policy Department, DAB staff calculation

Further analysis reveals that the country's other aggregated financial assets abroad dropped significantly to a value of USD −143.13 million in the second quarter of the FY 1399 from a value of USD −23.13 million that was captured in the second quarter of the FY 1398. Unlikely, other aggregated financial liabilities, followed upward trend and stood at a value of USD 213.79 million in the second quarter of the FY 1399 from a value of USD -13.71 million recorded in the similar quarter of the previews year. The financial account balance as a total stood at USD 280.08 million in the second quarter of the FY 1399 which is well above the value of USD 27.9 million recorded in the second quarter of the FY 1398, (see table 4.1 and figures 4.2, and 4.3).

Figure 4.3: FDI inflows for the 2nd Quarter of FY 1399



Source: Monetary Policy Department, DAB staff calculation

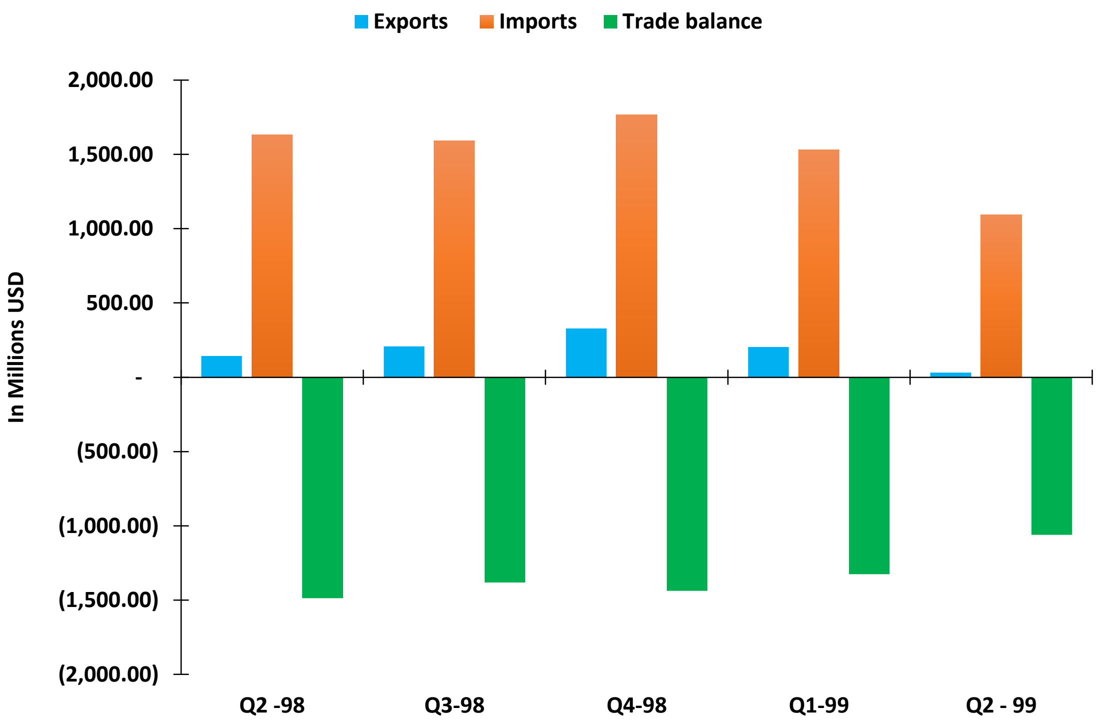
4.3. Merchandise Trade:

Base on the available data the merchandise trade deficit narrowed by 29% and stood at USD 1,061.23 million in the second quarter of the FY 1399 from a deficit of USD 1,487.95 million recorded in the second quarter of the FY 1398 (see table 4.3, figure 4.4). In comparison to the same quarter of the preceding year earnings from merchandise exports declined significantly by 78% to a value of USD 32 million in the second quarter of the FY 1399 from a value of USD 143.29 million recorded in the similar quarter of the previous year with all export components recording significant decline.

Disruptions to domestic production processes, disruption to export related services due to the imposition of curfew and disturbances to both domestic and global supply and demand chains due to the outbreak of the COVID 19 pandemic were the main reasons for this sharp decline in the earnings from exports.

Looking to export components, the exports of food item (oil seeds, fresh and dry fruit), and medical seeds which is counted as the major exporting products of the country in the recent period are the main driver of decreasing in exports. Expenditure on merchandise import declined notably, on quarter to quarter basis, by 33% to a value of USD 1,093.24 million in the second quarter of the FY 1399 compared to a value of USD 1,631.24 million recorded in the second quarter of the previous year mainly led by the significant decline in consumer goods, industrial supplies and capital goods as a result of breaking down supply and demand chains during the outbreak of the COVID 19 pandemic.

Figure 4.4: Trade performance and Trade balance for the 2nd Quarter of FY 1399



Source: NSIA /DAB staff calculation

4.4. Direction of Trade:

Trade between Afghanistan and its trading partners are categorized; as export destinations and import origins. Figure 4.5 and 4.6 shows Afghanistan's direction of trade with its trading-partners during the second quarter of the FY 1399. Based on the statistics, Commonwealth of Independent States (CIS), Iran, China, Pakistan and India remained the major trading partners with Afghanistan. Out of the total exports to the trading partners the major recipients of Afghanistan's exports are India, Pakistan, Iran and China.

4.4.1. Direction of Exports:

In the second quarter of the FY 1399 **India ranked as the first and top export destination for Afghanistan.**

The share of total exports to India reached to 51 % which is well the same 51% registered in the second quarter of the FY 1398. In terms of value, total exports to India diminished by 78% to a value of USD 16.33 million in the second quarter of the FY 1399 from a value of USD 73.28 million recorded in the second quarter of the previous year.

United Arab Emirates (UAE) ranked the second largest buyer of Afghanistan export during the second quarter of the FY 1399. Share of the total exports to UAE increased by 12% which is well above from 2% registered in the second quarter of the FY 1398. In term of value total exports to UAE also grew by 70% to a value of USD 4 million in the second quarter of the FY 1399 compared to a value of USD 2.3 million recorded in the second quarter of the FY 1398.

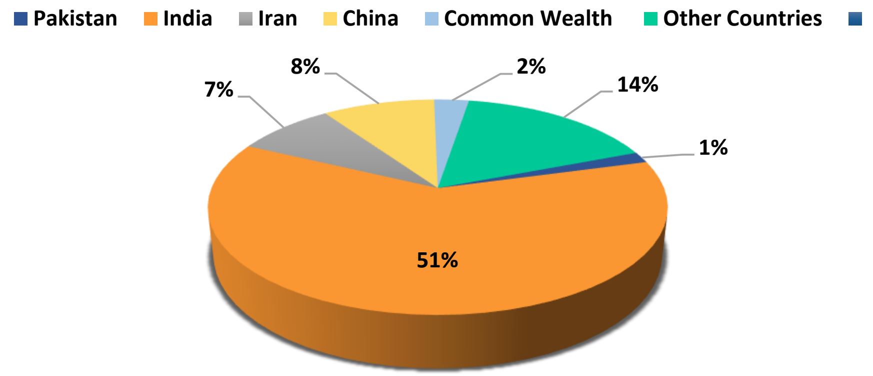
China ranked the third largest buyer of Afghanistan export during the second quarter of the FY 1399. The share of Afghanistan's exports to China rose to 8% in the second quarter of the FY 1399 from 2% that was recorded in the similar quarter of the last year. In respect of value, Afghanistan's total exports to China decreased by 24% to a value of USD 2.50 million in the second quarter of the FY 1399 compared to a value of USD 3.27 million recorded in the second quarter of the FY 1398.

The next two largest export destinations are Iran and Pakistan countries during the second quarter of the FY 1399. The share of total exports to Iran increased to 7% in the second quarter of the FY 1399 from 2% registered in the second quarter of the FY 1398.

Total exports to Iran dropped by 5% to a value of USD 2.19 million in the second quarter of the FY 1399 from a value of USD 2.31 million captured in the second quarter of the FY 1398.

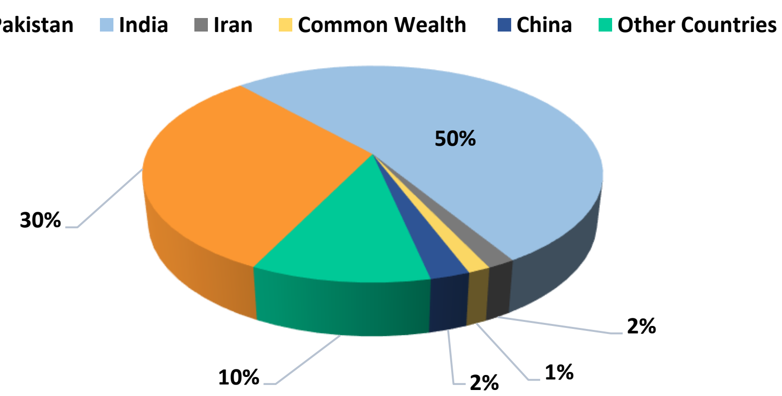
While, the share of total exports to Pakistan declined significantly to 1% in the second quarter of the FY 1399 from 30% which recorded in the second quarter of the FY 1398. In respect of value, total exports to Pakistan in the quarter under review shows a notable decline of 99% to a value of USD 0.44 million from a value of USD 43.22 million recorded in the second quarter of last year. (see tables 4.4 -4.5 and figures 4.5-4.6)

Figure 4.5: Direction of Exports (share in %) for the 2nd Quarter of FY 1399



Source: NSIA /DAB staff calculation

Figure 4.6: Direction of Exports (share in %) for the 2nd Quarter of FY 1398



Source: NSIA /DAB staff calculation

4.4.2. Direction of Imports:

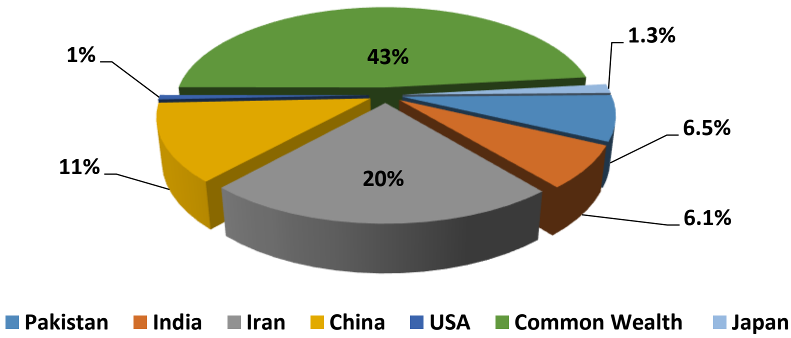
CIS countries were the first largest sources of imports for Afghanistan during the second quarter of the FY 1399. Base on the statistics the total Imports from CIS countries indicated a rise of 29% to a value of USD 464.97 million with share of 43% in the second quarter of the FY 1399 from a value of USD 361.23 million with share of 22% in the second quarter of the FY 1398.

Iran ranked the second largest source of imports for Afghanistan in the second quarter of the FY 1399. The total Imports from Iran declined by 29% to a value of USD 219.57 million with share of 20% in the second quarter of the FY 1399 from a value of USD 310.45 million with shares of 19% registered in the second quarter of the FY 1398.

China graded the third largest imports origin for Afghanistan in the second quarter of the FY 1399. The total imports from china decreased notably by 52% and stood at a value of USD 121.48 million with share of 11% in the second quarter of the FY 1399 from a value of USD 252.63 million with share of 15% recorded in the second quarter of the FY 1398.

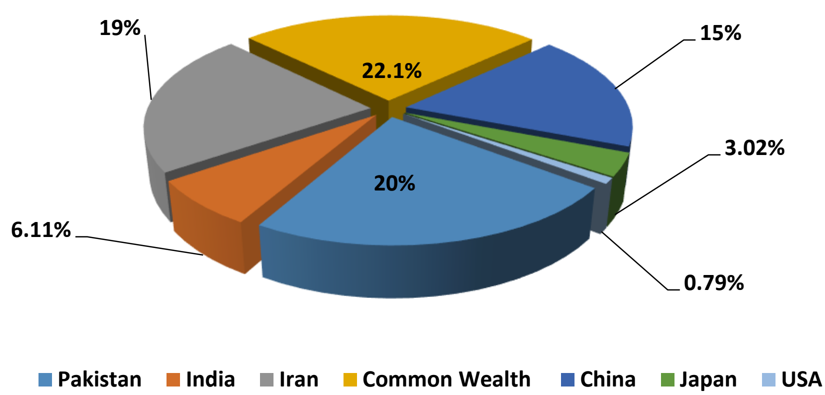
Pakistan graded the fourth largest import origin to Afghanistan in the second quarter of the FY 1399. As per the statistics, imports from Pakistan significantly declined by 78% to a value of USD 70.75 million with share of 6.5% in the second quarter of the FY 1399 from a value of USD 325.46 million with share of 20% in the second quarter of the FY 1398.

Figure 4.7: Direction of Imports (share in %) for the 2nd Quarter of FY 1399



Source: NSIA /DAB staff calculation

Figure 4.8: Direction of Imports (share in %) for the 2nd Quarter of FY 1398



Source: NSIA /DAB staff calculation

India was the fifth largest import origin to Afghanistan in the second quarter of the FY 1399. Total Imports from India decreased by 33% to a value of USD 66.68 million with share of

6.1% in the second quarter of the FY 1399 from a value of USD 99.72 million with share of 6.11% in the second quarter of the FY 1398.

UAE, Japan and USA were the last largest sources of imports for Afghanistan in the second quarter of the FY 1399. The shares of each source in the total imports were accounted as 2%, 1.3% and 1% respectively (see figure 4.7 & 4.8).

4.5. Composition of Trade:

4.5.1. Composition of Imports:

The total imports of Afghanistan in the second quarter of the FY 1399 are classified into four categories which are described below:

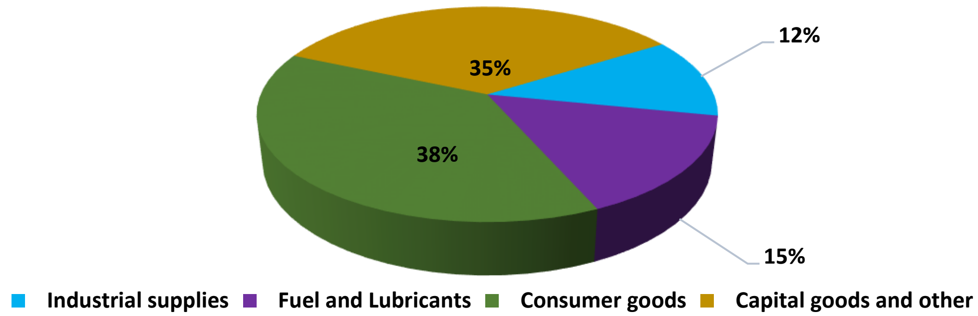
Imports of Capital goods had the first largest share in the basket of imports during the second quarter of the FY 1399, which expanded to 38% from 35% recorded in the second quarter of the preceding year. At the same time, the import value of such goods faded by 25% to a value of USD 420.43 million in the second quarter of the FY 1399 from a value of USD 564.18 million registered in the second quarter of the FY 1398.

Imports of consumer goods dropped and hold the second largest share in the imports basket. Observing the data, the share of consumer goods decreased from 38% to 35%. In terms of value, imports of consumer goods significantly declined by 39% to a value of USD 378.75 million in the second quarter of the FY 1399 from a value of USD 622 million recorded in the same quarter of the previous year.

Imports of fuel and lubricants (petroleum oil) hold the third largest share in the basket of Afghanistan's imports which is increased to 22% in the second quarter of the FY 1399 from 15% recorded in the second quarter of the FY 1398. In terms of value, imports of fuel and lubricants in total imports declined slightly by 2% to a value of USD 242.33 million in the second quarter of the FY 1399 from a value of USD 248.53 million recorded in the second quarter of the FY 1398.

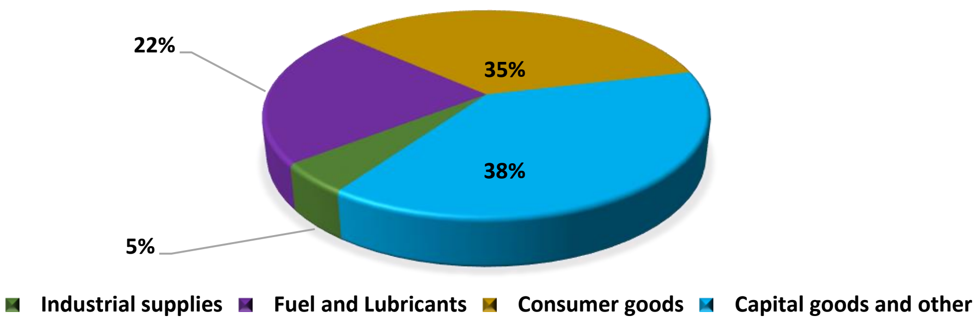
In the import category the industrial supplies hold the smallest share in the basket of Afghanistan's imports which is decreased to 5% in the second quarter of the FY 1399 from 12% recorded in the second quarter of the FY 1398. In term of value it exhibits that the imports of such goods contracted notably by 74% and stood at a value of USD 51.73 million in the second quarter of the FY 1399 compared to a value of USD 196.47 million captured in the second quarter of the FY 1398 (see table 4.2, and figure 4.9 & 4.10).

Figure 4.9: Composition of Imports (share in %) for the 2nd Quarter of FY 1398



Source: NSIA/DAB staff calculation

Figure 4.10: Composition of Imports (share in %) for the 2nd Quarter of FY 1399



Source: NSIA/DAB staff calculation

4.5.2. Composition of Exports:

The total merchandise exports of the country have been categorized and analyzed as bellow:

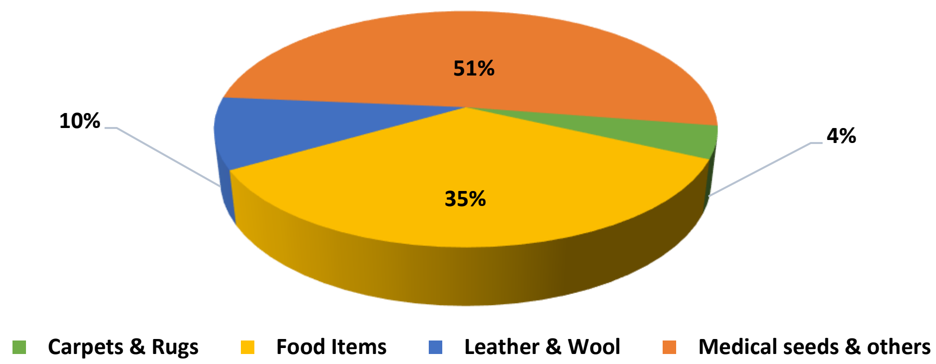
Exports of medical seeds had the largest share in the category of total basket of Afghanistan's exports, which rose to 59% in the second quarter of the FY 1399 from 51% recorded in the similar quarter of the previous year. At the same time, Earnings from exports of medical seeds declined significantly by 74% to a value of USD 18.86 million in the second quarter of the FY 1399 from a value of USD 73.22 million recorded in the same quarter of the previous year.

The decrement was mainly due to reduction in the exports of medical seeds and saffron to USD 14 million and USD 2 million in the second quarter of the FY 1399 from USD 36 million and USD 6 million recorded in the second quarter of the FY 1398 respectively.

The food items (oil seeds, fresh and dry fruits) had the second largest share in total exports during the quarter under review. Based on statistics, share of the mentioned items slightly increased to 41% in the second quarter of the FY

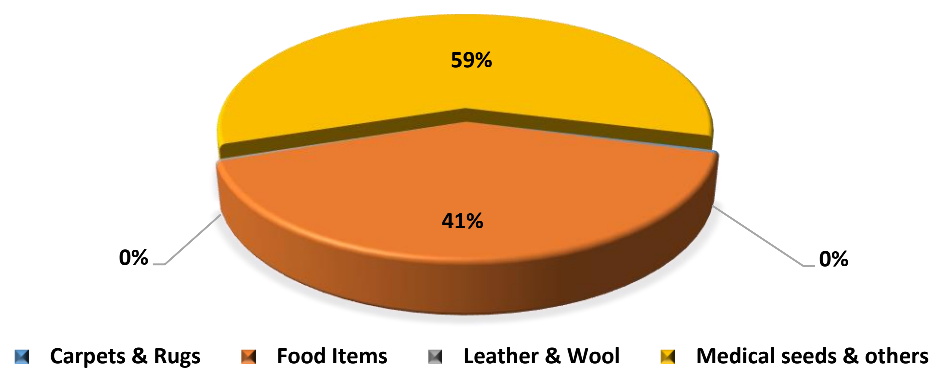
1399 from 35% recorded in the comparable quarter of the last year. At the same time the export value of food items decreased remarkably by 74% to a value of USD 12.96 million in the second quarter of the FY 1399 from a value of USD 49.72 million registered in the second quarter of the FY 1398. The same has occurred mainly due to decrement in harvesting of oil seeds and fruits all over the country.

Figure 4.11: Composition of Exports (share in %) for the 2nd Quarter of FY 1399



Source: NSIA/DAB staff calculation

Figure 4.12: Composition of Exports (share in %) for the 2nd Quarter of FY 1398



Source: NSIA/DAB staff calculation

Carpet and rugs which are considered as a main component of Afghanistan's exports in the past decades had the third largest share in total exports which is declined to 0.3% in the second quarter of the FY 1399 as compared to 4% registered in the second quarter of the FY 1398. The total value of exports on carpet and rugs had a downward movement and stood to USD 0.10 million which showed a noticeable decrement of 98% as compared to the value of USD 6.35 million recorded in the second quarter of the last year.

The Leather and wool products had the last largest share in the basket of total exports. Share of this item recorded 0.26% in the quarter under review and which is down from 10% recorded in the same quarter of the previous year. In term of value, the earning from exports of leather and wool declined considerably by 99% and reached a value of USD 0.08 million in the second quarter of the FY 1399 from a value of USD 14 million recorded in the corresponding quarter of the preceding year (see figures 4.11 and 4.12).

4.6. External Debt:

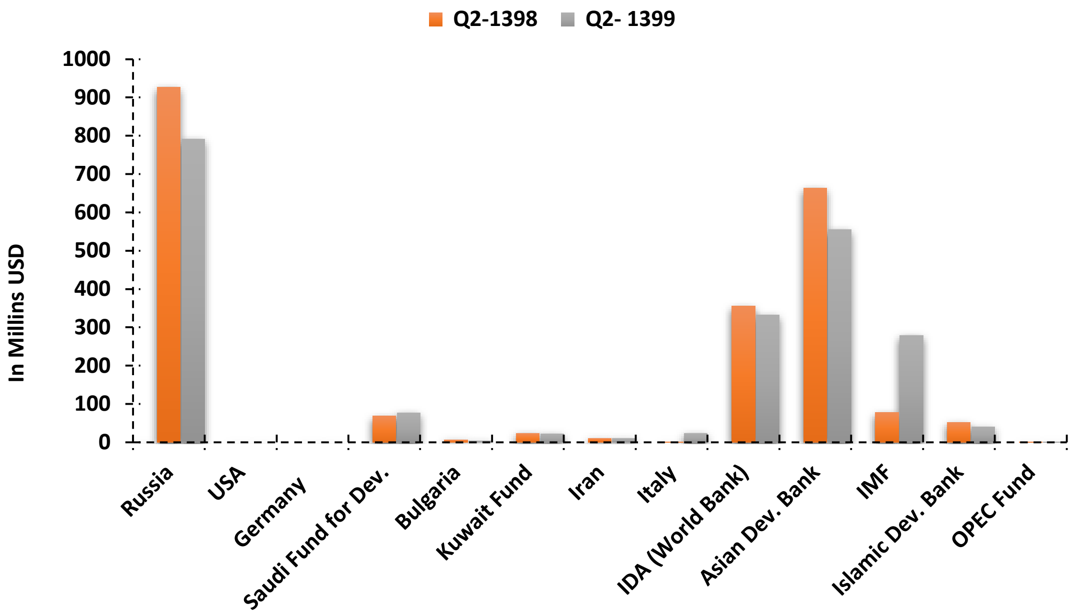
Afghanistan's total public external debt stood at USD 2,137.63 million at the end of second quarter of the FY 1399, which showed USD 48.21 million reductions from the value of USD 2,185.85 million recorded in second quarter of the previous year. Considering the statistics, the total public external debt shrank by 2% during the quarter under review. The reduction was not only due to repayment of the loan principle and the accumulated interest of the previous periods but it was also due to the exchange rate fluctuations during the period under review (see figure 4.13).

Among all, the World Bank, Asian Development Bank, and Bulgaria were the creditors received their loan principles, while service charges were paid to the World Bank, Asian Development Bank and Kuwait Fund during the quarter under review. The World Bank and Asian Development Bank as a major multilateral creditor to Afghanistan made USD 122.60 million debt release on principle as well as USD 4.40 million as services charge only by World Bank during the quarter under review.

Bilateral loan is segregated into two parts: Paris club and Non-Paris Club creditors. The total amount of loan payable to Paris Club creditors especially Russian federation stood at a value of USD 791.26 million at the end of second quarter of the FY 1399 from the amount of USD 926.70 million recorded in the same quarter of last year. Based on quarter-on-quarter comparison, it registered 15% decline to debt stocks to the mentioned creditor.

Total debt from Non-Paris Club members (Saudi Fund for Development, Bulgaria, Kuwait fund, Iran and Italy) rose by 24% to a value of USD 137.33 million in the second quarter of the FY 1399 from a value of USD 110.49 million recorded in the second quarter of the FY 1398. On the other hand, total debt from multilateral creditors to Afghanistan increased by 5% and stood at a value of USD 1,209.04 million in the second quarter of the FY 1399 from a value of USD 1,148.66 million recorded in the second quarter of the FY 1398 which shows USD 60.37 million increase in the total debt during the quarter under review.

Figure 4.13: External Debt Comparison for the 2nd Quarter of FY 1398 (2019) & 1399



Source: NSIA/DAB staff calculation

4.7. Net International Reserves:

International reserves are external assets, in the form of gold, reserve position in the fund, SDRs (special drawing rights of the IMF) and foreign currency assets accumulated by Afghanistan and controlled by the central Bank of Afghanistan (Da Afghanistan Bank).

The Afghanistan Net International Reserve (NIR) is measured as country Gross International Reserves (GIR) minus reserve related liabilities. The total GIR of Afghanistan stood at USD 8,783.50 million at the end of the second quarter of the FY 1399 from the amount of USD 8,337.53 million registered in the similar quarter of the previous year. Based on the figure, the country GIR jumped by a record of USD 445.97 million during the quarter under review.

The NIR has followed upward trend during the second quarter of the FY 1399 and surged to the value of USD 7,947.21 million from a value of USD 7,680.28 million recorded in the second quarter of the last year, it showed the increment of about USD 266.93 million in NIR during the quarter under review (see figure 4.14).

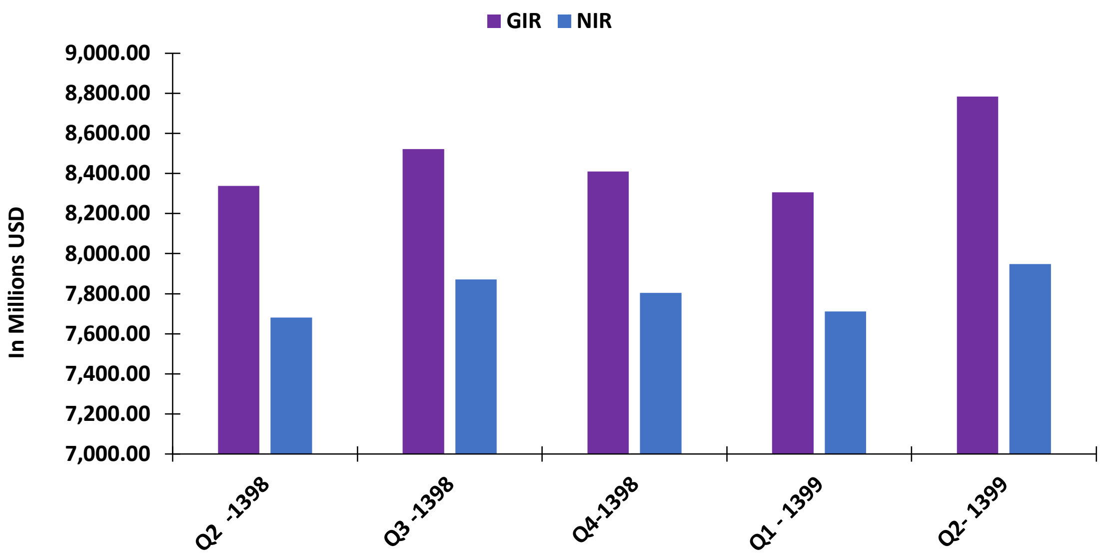
At the time, Reserve related liabilities increased by 27.2% to a value of USD 836.29 million in the second quarter of the FY 1399 from a value of

USD 657.25 million recorded in the second quarter of the FY 1398. The increment in reserve related liabilities was mainly due to insertion of foreign currency in commercial bank deposits here with DAB which jumped up by 29% to a value of USD 778.82 million in the second quarter of the FY 1399 from a value of USD 603.65 million recorded in the similar quarter of the previous year.

The Use of Fund Resources grew by 7.2% to the value USD 57.33 million in the second quarter of the year under review from a value of USD 53.46 million recorded in the second quarter of the previous year.

The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the second quarter of the FY 1399. The current position of Afghanistan Net International Reserves (NIR) is best cushion for conducting a sound and appropriate monetary policy in the country.

Figure 4.14: Gross and Net Internation Reserves during the 2nd quarter of FY 1399



Source: DAB staff calculations

Table 4.1: Afghanistan Balance of Payments for the 2nd Quarter of FY 1399 (in Millions USD)

Items / Years	Q1 - 98	Q2 - 98	Q3 - 98	Q4 - 98	Q1 - 99	Q2 - 99	% change
Current Account	-1276.90	-778.30	-1028.38	-714.89	-980.95	-412.99	-47%
Credit	807.14	1013.86	851.64	1273.71	801.82	842.32	-17%
Debit	2084.04	1792.16	1880.02	1988.60	1782.77	1255.30	-30%
Goods and Services Account	-1620.47	-1427.22	-1438.50	-1375.16	-1274.39	-1030.80	-28%
Credit	370.50	283.90	344.64	510.21	396.32	141.23	-50%
Debit	1990.96	1711.12	1783.14	1885.36	1670.72	1172.03	-32%
Goods Account	-1458.59	-1323.05	-1252.91	-1259.63	-1185.43	-952.61	-28%
Credit	182.57	143.29	208.77	329.21	203.64	32.00	-78%
Debit	1641.16	1466.34	1461.67	1588.84	1389.07	984.61	-33%
Services Account	-161.88	-104.17	-185.59	-115.53	-88.96	-78.20	-25%
Credit	187.93	140.61	135.87	181.00	192.69	109.22	-22%
Debit	349.81	244.78	321.47	296.53	281.65	187.42	-23%
Primary Income Account	75.91	101.08	68.84	60.84	62.56	29.75	-71%
Credit	93.56	111.98	75.79	71.25	74.36	41.67	-63%
Debit	17.66	10.89	6.95	10.40	11.80	11.92	9%
Secondary Income Account	267.66	547.83	341.27	599.43	230.89	588.06	7%
Credit	343.08	617.99	431.21	692.26	331.13	659.42	7%
Debit	75.42	70.15	89.93	92.83	100.25	71.36	2%
Current transfers (Official grants)	167.4	432.9	233.1	497.7	167.7	504.7	17%
Credit	167.40	432.91	233.1	497.7	167.7	504.7	17%
Debit	0.00	0.00	0.0	0.0	0.0	0.0	
Personal transfers	141.80	145.36	142.51	139.87	95.89	107.71	-26%
Credit	175.68	185.08	198.08	194.51	163.47	154.75	-16%
Debit	33.88	39.72	55.57	54.64	67.58	47.04	18%
Capital account	56.13	241.57	391.57	504.68	40.49	99.92	-59%
Credit	56.13	241.57	391.57	504.68	40.49	99.92	-59%
Debit	0.00	0.00	0.00	0.00	0.00	0.00	
Capital transfers	56.13	241.57	391.57	504.68	40.49	99.92	-59%
Credit	56.13	241.57	391.57	504.68	40.49	99.92	-59%
Debit	0.00	0.00	0.00	0.00	0.00	0.00	

Items / Years	Q1 - 98	Q2 - 98	Q3 - 98	Q4 - 98	Q1 - 99	Q2 - 99	% change
Financial account	-37.8	27.9	59.0	10.92	-147.66	280.06	906%
Direct investment	1.71	-6.28	9.04	-1.55	2.7	-0.4	-93%
Net acquisition of financial assets	10.52	5.69	4.86	5.26	5.94	2.59	-54%
Net incurrence of liabilities	8.81	11.97	-4.18	6.81	3.19	3.02	-75%
Portfolio investment	-16.46	15.42	-33.74	20.16	-18.20	41.19	167%
Net acquisition of financial assets	-16.46	15.42	-33.74	20.16	-18.20	41.19	167%
Net incurrence of liabilities	0.00	0.00	0.00	0.00	0.00	0.00	
Other investment	-70.88	-9.42	-72.99	124.26	-22.54	-356.92	3690%
Assets	-85.46	-23.13	-17.86	89.24	-38.22	-143.13	519%
Liabilities	-14.58	-13.71	55.14	-35.02	-15.67	213.79	-1659%
Reserve Assets	47.81	28.13	156.66	-131.94	-109.67	596.22	2019%
Net errors and omissions	1183	565	696	221	793	593	5%

Source: NSIA and DAB staff calculations

Table 4.2: Merchandise Trade for the 2nd Quarter of FY 1399 (in Million USD)

Years	Q2- 1398		Q3- 1398		Q4- 1398		Q1 - 1399		Q2- 1399	
	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)	Total	Share (%)
Imports	1,631.24	100%	1,591.20	100%	1,767.33	100%	1,530.05	100%	1,093.24	100%
Industrial supplies	196.47	12%	233.23	15%	212.28	12.0%	158.35	10.3%	51.73	5%
Fuel and Lubricants	248.53	15%	266.85	16.8%	260.29	14.7%	261.60	17.1%	242.33	22%
Consumer goods	622.05	38%	493.56	31.0%	632.84	35.8%	510.61	33.4%	378.75	35%
Capital goods and other	564.18	35%	597.56	38%	661.92	37.5%	599	39.2%	420.43	38%
Exports	143.29	100%	208.77	100.0%	329.21	100%	203.64	100%	32.00	100%
Carpets & Rugs	6.35	4%	5.93	2.8%	6.05	1.8%	4.5	2.2%	0.10	0.3%
Food Items	49.72	35%	89.91	43.1%	172.97	52.5%	94.61	46.5%	12.96	41%
Leather & Wool	14.00	10%	5.70	2.7%	13.78	4.2%	9.39	4.6%	0.08	0.26%
Medical seeds & others	73.22	51.1%	107.24	51.4%	136.41	41.4%	95.09	46.7%	18.86	59%
Trade Balance	-1,487.95		-1,382.43		-1,438.12		-1,326.42		-1,061.23	

Source: NSIA and DAB staff calculations

Table 4.3: Direction of External Trade for the 2nd Quarter of FY 1399 (in Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	0.44	1%	70.75	6.5%	-70.31
India	16.33	51.01%	66.68	6.1%	-50.35
Iran	2.19	7%	219.57	20%	-217.38
Germany	0.63	2.0%	6.30	0.6%	-5.67
China	2.50	8%	121.48	11%	-118.98
England	0.00	0.01%	1.00	0.09%	-1.00
Saudi Arabia	0.25	0.78%		0.00%	0.25
United Arab Emirates	4	12%	22.77	2%	-18.94
Turkey	0.63	2%	6.68	0.61%	-6.06
USA	0.02	0.1%	7.13	1%	-7.11
Common Wealth	0.77	2%	464.97	43%	-464.20
Japan	0.01	0.02%	14.31	1.3%	-14.30
Other Countries	4.41	14%	91.59	8%	-87.18
Total	**32.01**	**100%**	**1,093.24**	**100%**	**(1,061.23)**

Source: NSIA and DAB staff calculations

Table 4.4: Direction of External Trade for the 2nd Quarter of FY 1398 (in Million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	43.22	30%	325.46	20%	-282.24
India	73.28	50%	99.72	6.11%	-26.44
Iran	2.31	2%	310.45	19%	-308.15
Germany	2.84	1.9%	16.76	1.03%	-13.92
Common Wealth	1.84	1%	361.23	22.1%	-359.39
China	3.27	2%	252.63	15%	-249.36
United Arab Emirates	2.3	2%	38.18	2%	-35.93
Saudi Arabia	1.85	2%		2.34%	-35.93
Turkey			16.88	1.03%	
Japan		0.00%	49.27	3.02%	-49.27
England		0.0%	1.08	0%	-1.08
USA		0.00%	12.87	0.79%	-12.87
Other Countries	14.68	10%	146.70	8.99%	-132.02
Total	**145.54**	**100%**	**1,631.24**	**102%**	**(1,506.60)**

Source: NSIA and DAB staff calculations

Table 4.5: External Debt for the 2nd Quarter of FY 1399 (in million USD)

Description	Q2 2019	% share	Q2 2020	% share
Total external debt	2,185.85	100.00	2,137.63	100.00
Bilateral	1,037.18	47.45	928.59	43.44
Paris Club	926.70	42.40	791.26	37.02
Russian Federation	926.70	42.40	791.26	37.02
United States		0.00	-	0.00
Germany		0.00	-	0.00
Non-Paris Club	110.49	5.05	137.33	6.42
Multilateral	1,148.66	52.55	1,209.04	56.56
of which: IDA (World Bank)	355.06	16.24	332.53	15.56
Asian Development Bank	663.42	30.35	555.32	25.98
International Monetary Fund	77.01	3.52	278.67	13.04
Islamic Development Bank	51.43	2.35	41.00	1.92
OPEC Fund	1.74	0.08	1.51	0.07

Source: MOF and DAB staff calculations

Table 4.6: Net International Reserves for the 2nd Quarter of FY 1399 (in million USD)

Changes on the previous quarter	Q2-1398	% change	Q1-1399	% change	Q2-1399	% change
Net international Reserves (million USD)	7,680.28	-0.21	7,711.85	-1.19	7,947.21	3.5
Reserve Assets	8,337.53	-0.09	8,306.47	-1.23	8,783.50	5.3
Reserve Liabilities	657.25	1.33	594.62	-1.71	836.29	27.2
Commercial bank deposits in foreign currency	603.65	2.01	533.78	-2.81	778.82	29.0
Nonresident deposits in foreign currency	0.14	1.31	0.14	0.00	0.14	0.0
Use of Fund resources	53.46	-5.78	60.70	9.14	57.33	7.2
Gross Intl. Reserves (in months of import)	15.33		16.29		24.10	
Net Intl. Reserves (in months of import)	14		15		22	

Source: DAB staff calculation

5

Fiscal Developments

5

FISCAL SECTOR DEVELOPMENT

Fiscal sector of monetary policy directorate is responsible to coordinate between fiscal and monetary policy implementation by the Ministry of Finance (MOF) and Da Afghanistan Bank (DAB). 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; improvement in public expenditure management, fiscal policy formulation, efficiency in public enterprises, taxes and customs administration. While monetary policy is responsible to maintain price stability by smoothing Afghani (AFN) exchange rate volatility.

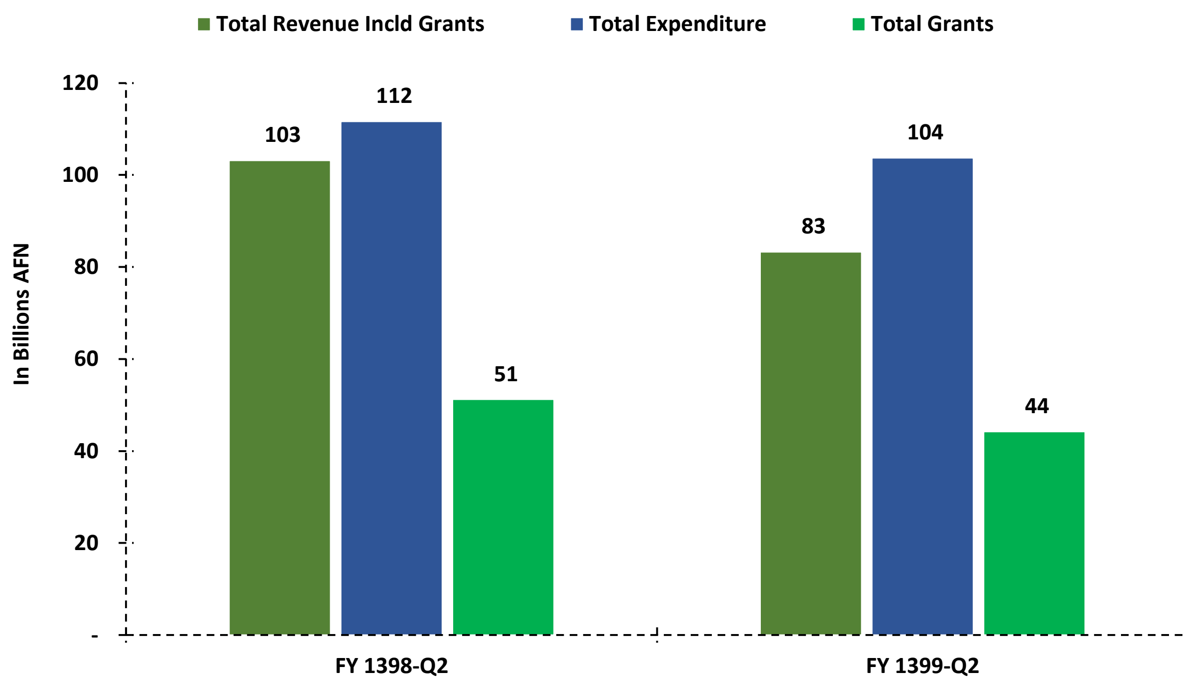
Resembling the other emerging and under developing economies around the world, Afghanistan continuously faces budget deficit and this time it is sever due to the effect of COVID-19 pandemic on both expenditure and mostly revenue generation. The total core expenditure reduced about Af 7.92 billion in the second quarter of FY 1399 and there was a substantial fall in total revenue collection. Domestic revenue in the second quarter of the fiscal year 1399 decreased which led to Af 64.68 billion budget deficits, and by including other revenue and grants Af 20.46 billion budget deficit is being observed. Meanwhile as a result of the reallocation of budget due to COVID-19 pandemic, budget for the fiscal year 1399 raised to Af 449 billion.

Table 5.1: Actual and Estimated budget for the 2nd Quarter of FY 1398 and 1399

National Budget (Amounts in billions of Af)			
	Estimated FY- 1399	Actual Q1- FY- 1398	Actual Q2 FY- 1399
Total Expenditures	449.41	111.64	103.72
Operating	295.63	71.19	69.36
Development	153.78	40.45	34.36
Total Revenue	401.28	103.13	83.26
Internal Sources	175.80	51.91	39.04
External Sources	225.48	51.22	44.22
Budget Deficit/Surplus	48.13	-8.51	-20.46

Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.1: Comparison of Total Revenue including grants, Total Expenditure, Total Grants between 2nd Quarter of FY 1398 & FY 1399



Source: MoF Financial Statement/MPD Staff Calculation

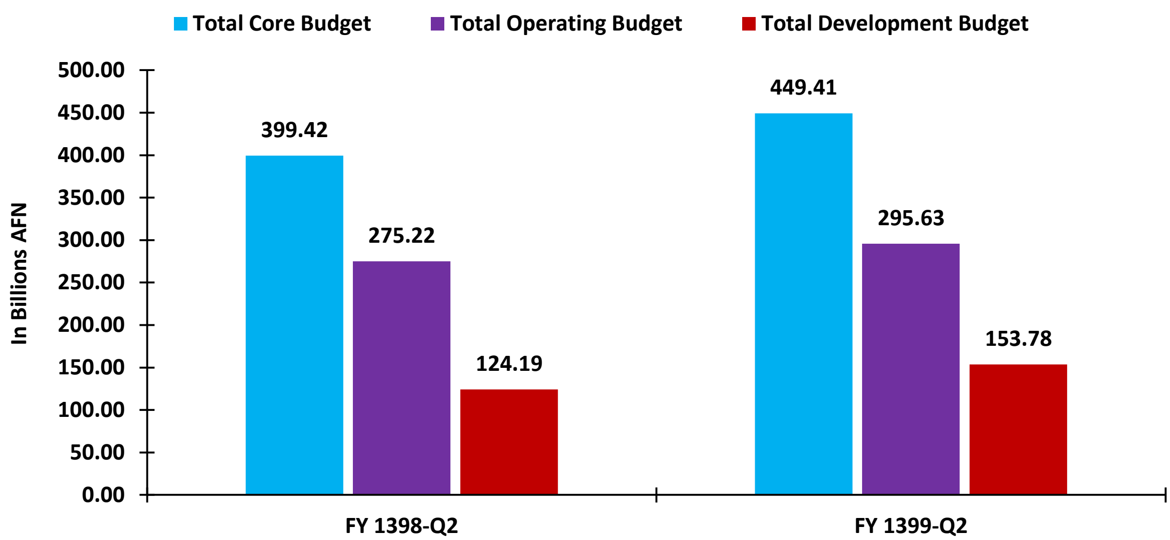
Donor contributions are used to finance both operating and development expenditure, the main donor contributors to the government is ARTF, LOTFA, and CSTC-A. The total donor contribution (grants) allocated to operating and development expenditure represented a mild decrease ofAf5.9 billion.

5.1. Budget Execution Rate:

During the reference period, government spent 36% from the total allocated budget of Af 449 billion, while compared to 40% execution from the total Af 391 billion allocated budget in the second quarter of FY 1398, it represented average decrease of 4% in overall budget execution rate relatively, and it is attributed to several factors particularly due to increase in overall budget reallocation, late processing of expenses by the National Procurement Authority, security condition in provinces and weak performances by the budgetary units due to pandemic.

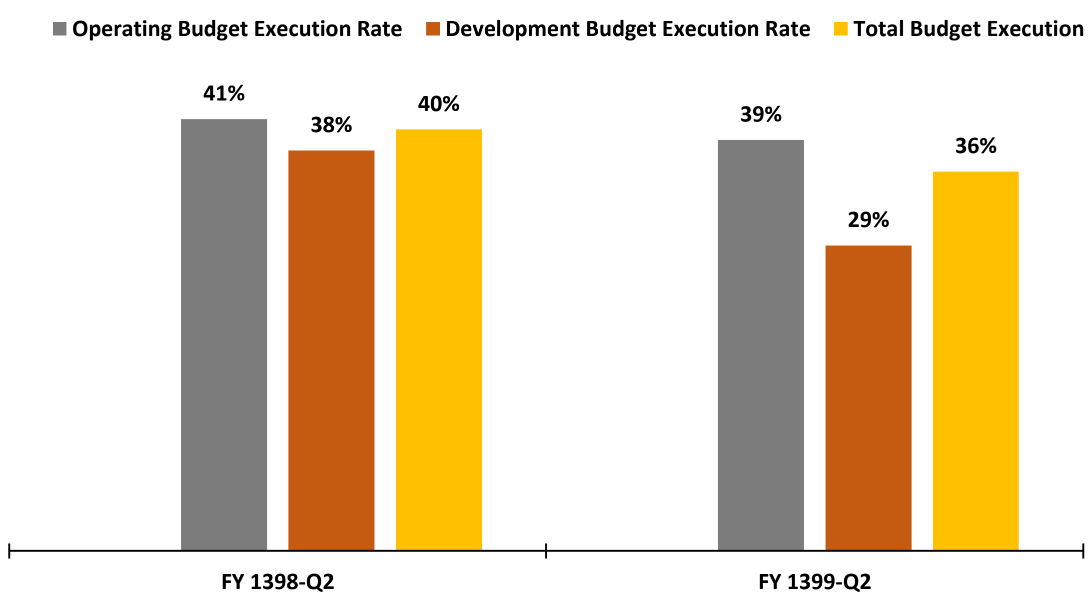
Operating budget execution indicates 3.5% increase from Af 114 billion in the second quarter of FY 1398 to Af 118 in the quarter under review, moreover the allocated budget was Af 399 billion for FY 1398 and Af 449 Billion for FY 1399. The development budget execution rate evidently represents decrease of 13% when comparing both Af 50 billion in the second quarter of FY 1398 and Af 43 billion in the quarter under review.

Figure 5.2: Comparison of Total core budget, Operation Budget, and Development budget for the 2nd Quarter of FY 1398 and FY 1399



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.3: Comparison of Core Budget, Operating Budget, & Development Budget Execution Rates for the 2nd Quarter of FY 1398 and FY 1399



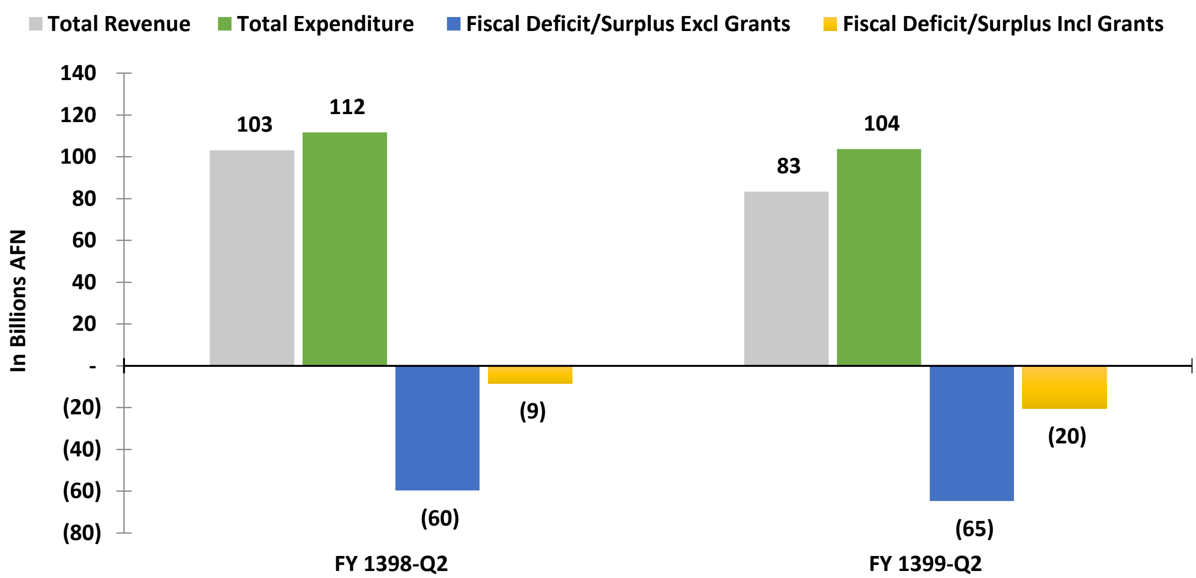
Source: MoF Financial Statement/MPD Staff Calculation

5.2. Core Budget (Deficit & Surplus):

The total core budget is calculated Af 428 billion at the beginning of the FY 1399 but, due COVID-19 pandemic it reallocated and increased to Af 448 billion that showed 12% (Af 48 billion) increased form Af 399.42 billion in FY 1398. Moreover, operating budget increased from Af 275.22 billion for FY 1398 to Af 295.63 billion for FY 1399 which signified 7.4% of increment. Similarly, development budget is showing a significant increase from Af 124.19 billion for FY 1398 to Af 153.78 billion for FY 1399, representing 23.82% rise that is as a result of high budget approval and reallocation for FY 1399 due to COVID-19 pandemic.

The overall budget prior to donor's contribution had a deficit of Af 65 billion in the second quarter of FY 1399 compared to Af 59 billion deficit in the second quarter of FY 1398 that shows Af 5 billion increase compared. Meanwhile, donor contributions decreased from Af 51 billion in the second quarter of FY 1398 to Af 49 billion in the quarter under review. The total annual external source funding amount in FY 1399 represents an increase of 13% or Af 26 billion, from Af 199 billion in FY 1398 to Af 225 billion in FY 1399 in annual planed external sources and it is as a result of COVID-19 pandemic and commitments from the donors on annual basis.

Figure 5.4: Comparison of Total Budget between 2nd Quarter of FY 1398 & FY 1399



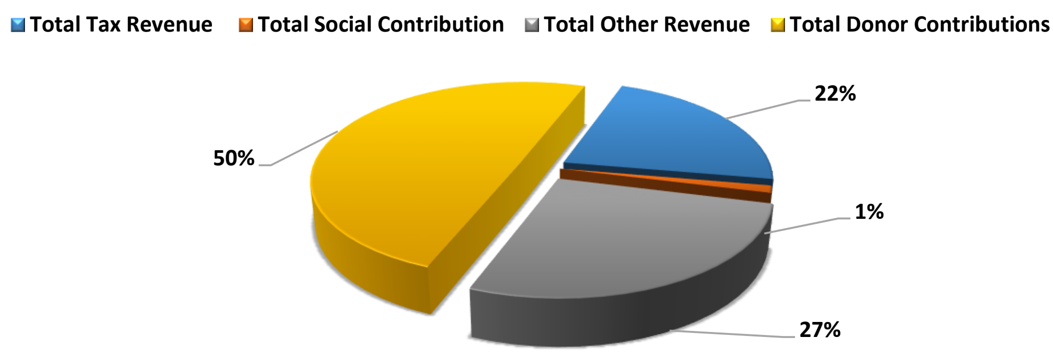
Source: MoF Financial Statement/MPD Staff Calculation

5.3. Total Revenue:

With reference period of FY 1399 total revenues including grants decreased considerably with total collection of Af 83 billion in the second quarter of FY 1399 compared to Af 103 billion in the second quarter of the previous year, which presented a mild decrease of Af 20 billion (19%) as compared to same quarter of previous year. Annual collection of planed domestic sources indicates Af 12 billion decrease, from Af 188.01 billion in FY 1398 to Af 176 billion in FY 1399 leading to 6% decrease comparably.

To meet FY 1399 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 in FY 1399 was as a result of momentous COVID-19 pandemic which affected income taxes, sales tax, property tax, miscellaneous revenues, retirement contributions, royalties, administrative fees and extractive industries, however, there had been increment in sale of goods and services, non-tax fine and penalties, sale of land and buildings and mostly positive gain from the custom duties during the second quarter of FY 1399.

Figure 5.5: Components of Total Revenue for the 2nd Quarter of FY 1399



Source: MoF Financial Statement/MPD Staff Calculation

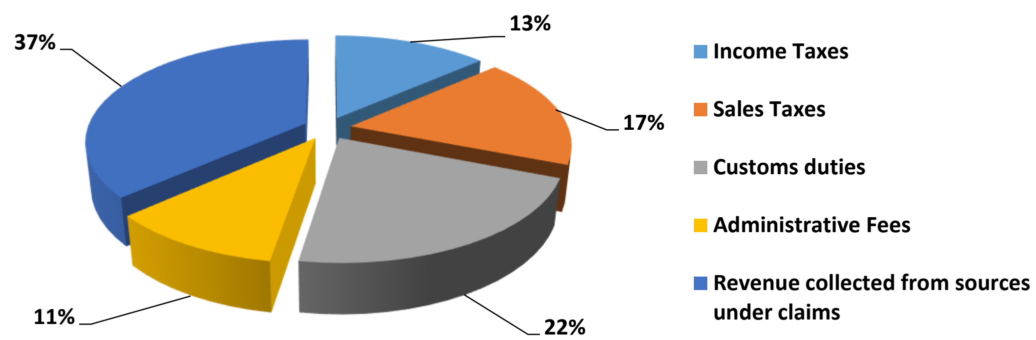
5.3.1. Domestic Revenue:

The total collection of domestic revenue performance felt down and due to pandemic overall revenue collection affected negatively in the second quarter of fiscal year 1399, however it was sophisticated compared to the second quarter of 1398. domestic revenue measures are deemed sufficient by the government to ensure the achievement in terms of the GDP deficit in FY 1399.

The decrement in domestic revenue collection was attributed to fall in income taxes, sales tax, property tax, notable change in miscellaneous revenues, retirement contributions, royalties' administrative fees and extractive industries. Total domestic revenue is decreased from Af 60 billion in the second quarter of FY 1398 to Af 39 billion in the quarter under review, that shown decrease ofAf24 billion or 13% in domestic revenue collection compared. Beside, breakdown of the total revenue collection showed a mild deceleration in various domestic revenue components such as income from capital property that showed a momentum decrease of 74% from Af 0.45 billion in the second quarter of FY 1398 to Af 0.12 billion in the second quarter of FY 1399, the income tax showed decrease of 41% from Af 8 billion in the second quarter of FY 1398 to Af 5 billion in the quarter under review, retirement contribution showed significant decrease of 99% from Af 1.02 billion in the second quarter of FY 1398 to Af 0.01 billion in the concerned period, and a remarkable decrease of 119% is shown in miscellaneous revenue , from

AFN 12 billion in the second quarter of FY 1398 toAf2 billion in the quarter under review.

Figure 5.6: Major Components of Domestic Revenue for the 2nd Quarter of FY 1399

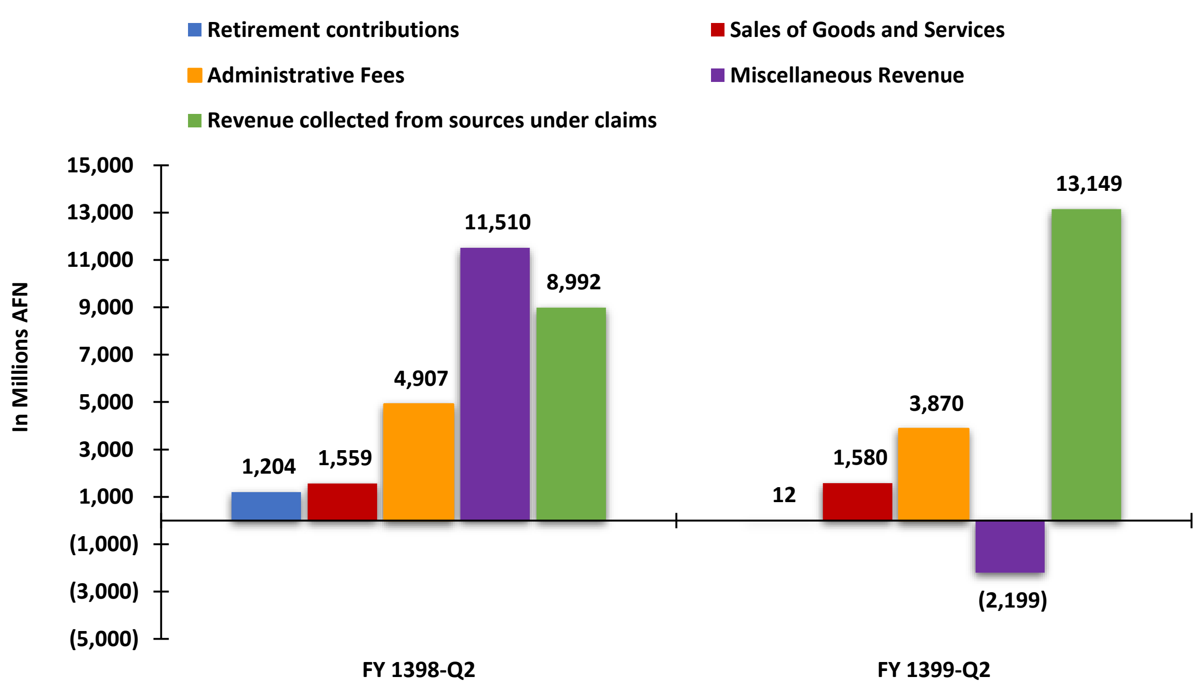


Source: MoF Financial Statement/MPD Staff Calculation

- **Non Tax Revenue:**

One of the initial components of domestic revenues is non tax revenue that represents a notable decrease of 40% from Af 28 billion in the second quarter of FY 1398 to Af 17 billion in the quarter under review, which is as a result of revenue collection performance from retirement contribution, a notable change in miscellaneous return and administrative fees.

Figure 5.7: Major Components of Non-Tax Revenue for the 2nd Quarter of FY 1398 (2019) & FY 1399 (2020)



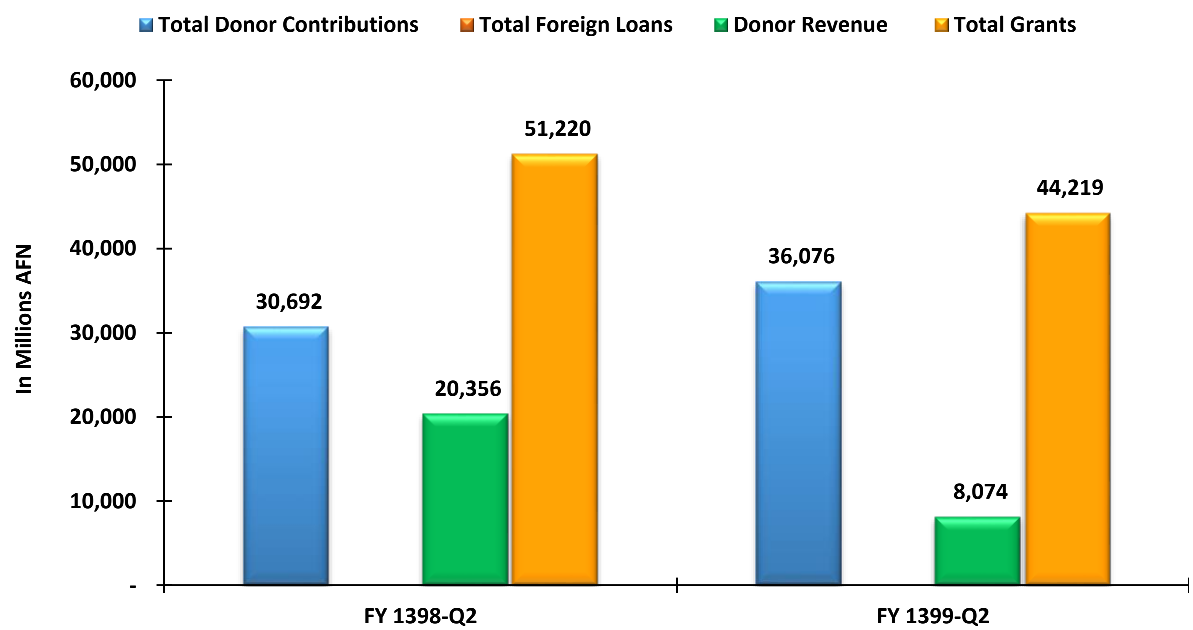
Source: MoF Financial Statement/MPD Staff Calculation

The main contributors of the non-tax revenues were retirement contributions that decreased to Af 0.01 billion, administrative fees decreased from Af 5 billion in the second quarter of FY 1398 to Af 4 billion in the quarter under review which signified 21% decline, however miscellaneous revenue decreased from Af 12 billion in the second quarter of FY 1398 to Af 2 billion in the second quarter of FY 1399.

5.3.2. Grants:

The donor contribution comprises an important part of the national budget; donor grants finance major expenditure items in both operating and development budgets. Government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures. In Afghanistan's context, fiscal sustainability is defined as the ability of the government to finance its domestic expenditures without making any stark changes in the fiscal policy i.e. total domestic expenditure equates total domestic revenue. Afghanistan remains heavily dependent on international assistance to finance its operating and development expenditures.

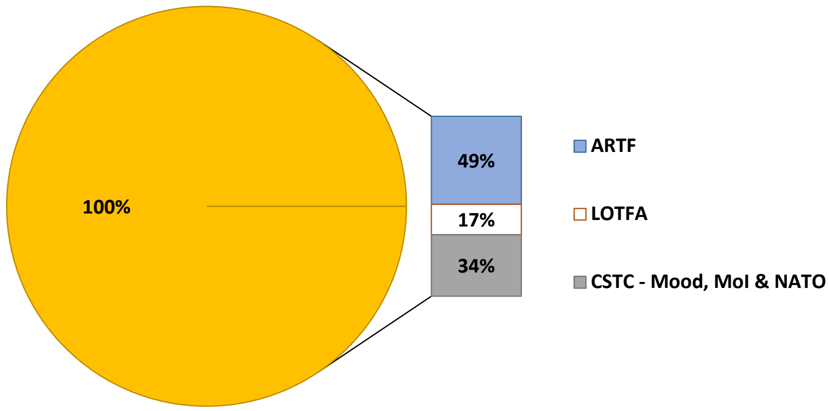
Figure 5.8: Total Annual Grants Analysis for 2nd Quarter of FY 1398 & 1399



Source: MoF Financial Statement/MPD Staff Calculation

The total development and operating grants represents significant decrease of Af 7 billion from Af 51 billion in the second quarter of FY 1398 to Af 44 billion in the quarter under review comparatively.

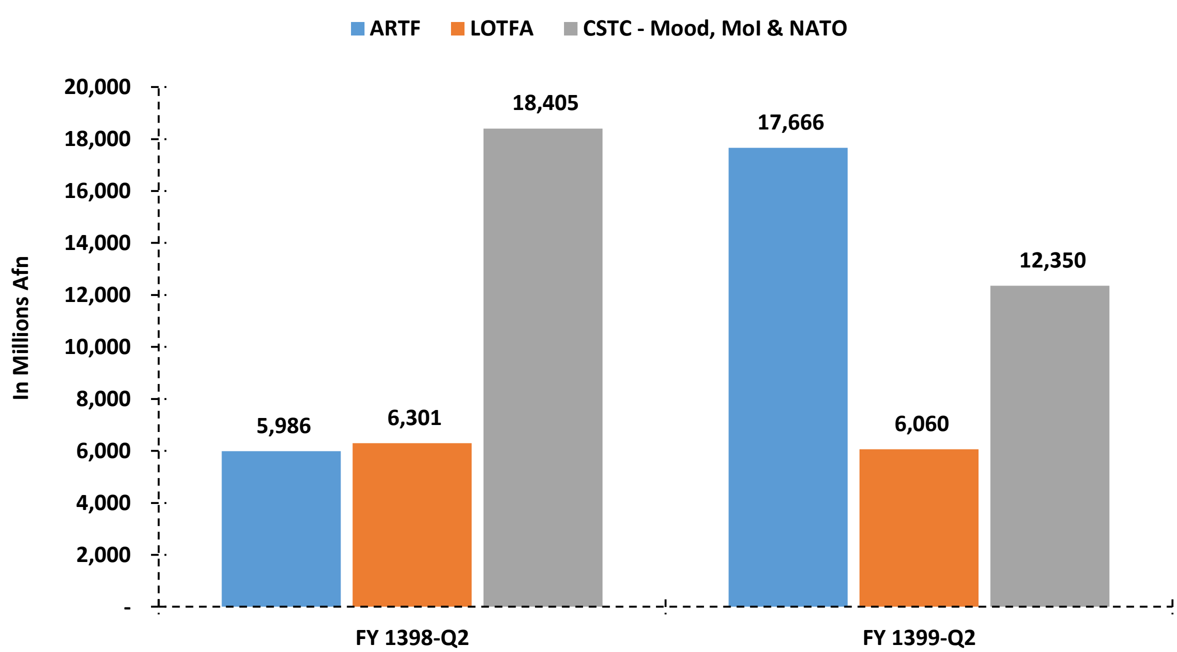
Figure 5.9: Components of Donor Contribution for the 2nd Quarter of FY 1399



Source: MoF Financial Statement/MPD Staff Calculation

The main donor contributors to operating and development expenditures were grants from ARTF that rose by 195% from Af 5.98 billion in the second quarter of FY 1398 to Af 17.67 billion in the quarter under review. CSTC-A MoD, MoI & NATO contributed Af 18.41 billion in the second quarter of FY 1398 compared to Af 12.35 billion in the second quarter of FY 1399 that showed 33% decrease. LOTFA contributed Af 6.06 billion in the quarter under review compared to Af 6.30 billion in the second quarter of FY 1398 that showed a minor change.

Figure 5.10: Comparison of Donor Contributions for the 2nd Quarter of FY 1398 & 1399



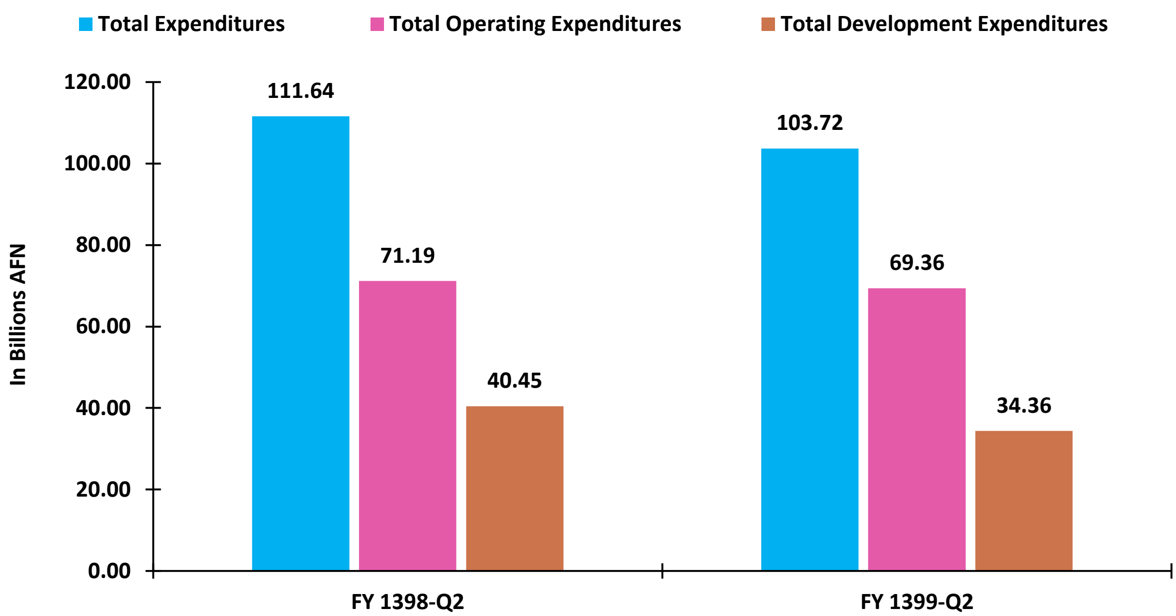
Source: MoF Financial Statement/MPD Staff Calculation

5.4. Expenditure:

The 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.

The sector wise expenditure is provided for both operating and development budget, while increased expenditure on infrastructure, economic governance, and agriculture sectors are in line with the ANPDF priority. Furthermore, total core expenditure presents 7% decrease from Af 112 billion in the second quarter of FY 1398 to Af 104 billion in the second quarter of FY 1399 indicating Af 8 billion decrease in overall Development and operating expenditures. and the decrease is as a result of COVID-19 pandemic. In addition, operating expenditure indicates decrease of 3% from Af 71 billion in the second quarter of FY 1398 to Af 69 billion in the quarter under review., meanwhile development expenditure shows 15% decrease from Af 40 billion in the second quarter of the previous year to Af 34 billion in the second quarter of FY 1399 which indicates Af 6 billion decrease in development expenditure compare to same period of last year. Decrease in overall expenditures are indicated by the effect of COVID-19 on project application.

Figure 5.11: Comparison of Total Expenditures for the 2nd Quarter of FY 1398 & 1399



Source: MoF Financial Statement/MPD Staff Calculation

6

Banking Systems Performance

6

BANKING SYSTEM PERFORMANCE

(Data for first quarter is revised)

Overall the banking sector performed well during pandemic rendering necessary operating service to the public and remained well liquid, as no liquidity short fall was observed in any of the banks during the pandemic. Main financial indicators had an increasing trend during the second quarter of FY 1399. Total Assets increased due to increase in deposits, Capital positions remained stable, and capital adequacy ratio of all banks were above the set regulatory threshold. Profitability increased, but the loan quality still remained weak and NPLs increased significantly due to implementation of IFRS9 in one of the banking institutions.

Despite the above developments, the banking sector may experience more NPLs, high provisions leading to declining in profitability, capital and financial ratios in the months ahead due to Covid-19 impact on the economic condition. Therefore, banks have to opt for precautionary measures to cope with the expected financial down turn. To this end DAB has developed time bound post Covid-19 improvement plan. The main points of the plan include expansion of activities such as disbursement of new credit facilities, cost reduction measures and suspension of dividend payments, electronic reporting, renewal of loans and relaxation in classification and risk weighting of loans collateralized by third party as ACGF, IFC, USAID etc.

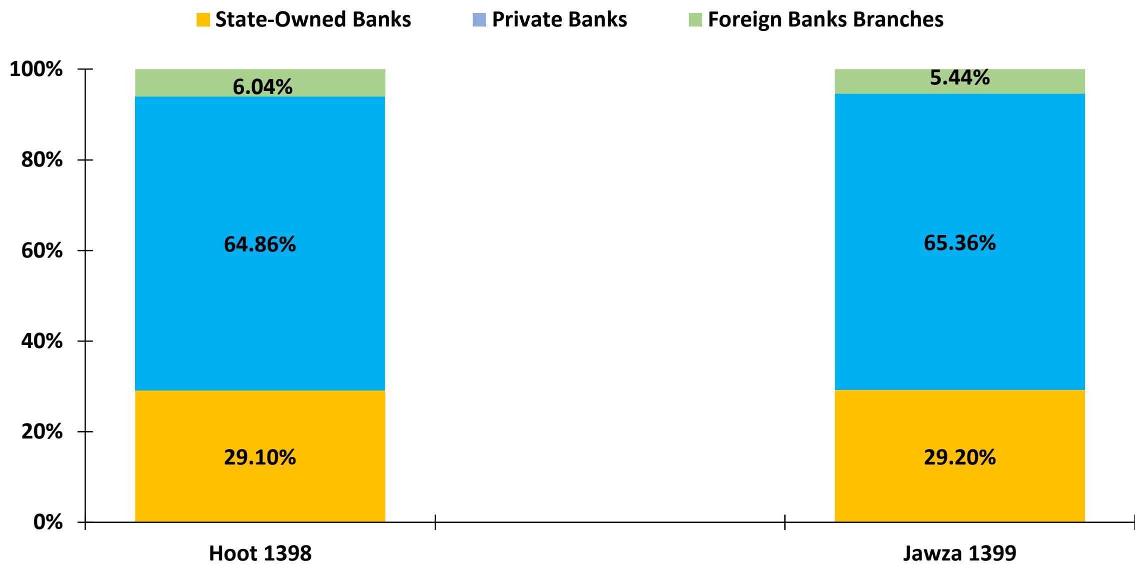
6.1. Assets of The Banking System:

The total assets of the banking sector registered 11% increase over the quarter, and reached to Af 316.22 billion, while in previous quarter it recorded 9.08% decrease (see table 6.1).

The above mentioned increase in the total assets was mainly contributed by increase in total deposits (dominant in customer demand deposits), Disaggregated analysis of total assets showed that top increasing item were cash in vault and claims on DAB and investments, while net interbank claims and net loans witnessed slight decrease over the quarter.

The most important components of the system's total asset portfolio were cash in vault and claims on DAB (44.61%), net interbank claims (23.41%), net loans (10.98%), investments (11.68%), net other assets (5.37%) and fixed assets was 3.33% of the total assets, while the share of the repossessed assets and intangible assets were negligible (see table 6.1). Private Banks are the leading player in the banking sector accounting for 65.36% of total banking sector assets (Islamic bank makes 6.6% of the sector's total assets); state-owned banks with 29.2% are at the second place while branches of foreign banks contributed 5.44% in the system's total asset.

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



Source: Banking Supervision Department, DAB

Table 6.1: Assets, Liabilities, and Capital of the Banking Sector

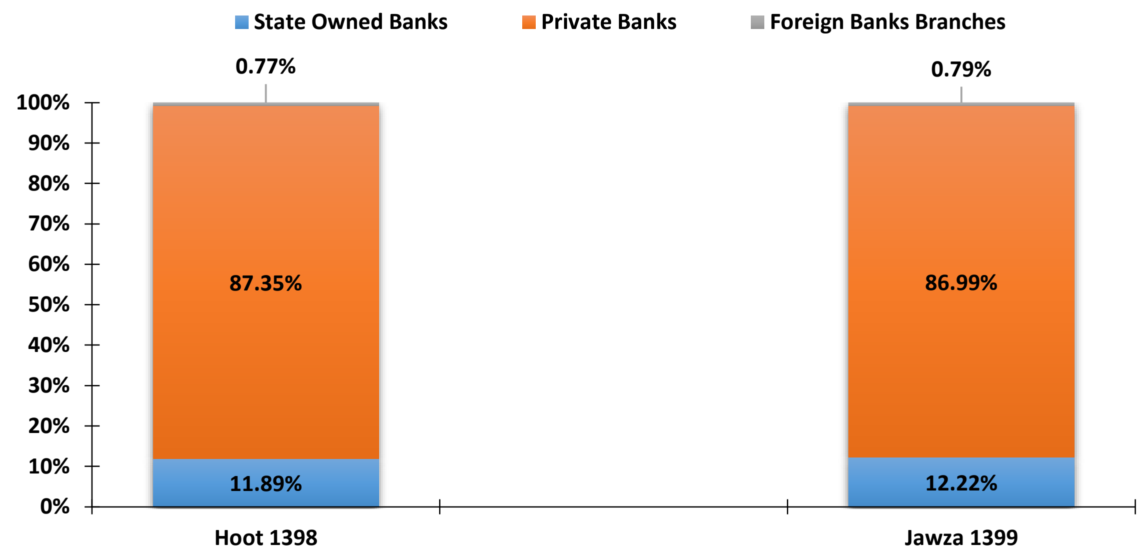
Amount in million Af	20-Mar	20-Jun	% of Total Asset/liabilities	Growth
Assets				
Cash in vault and claims on DAB	109,008	141,078	44.61%	29.42%
Interbank claims(Net)	78,843	74,043	23.41%	-6.09%
Investments (Net)	33,403	36,921	11.68%	10.53%
Loans (Net)	35,508	34,736	10.98%	-2.17%
Repossessed Assets	1,018	1,019	0.32%	0.11%
Other Asset (Net)	16,340	16,979	5.37%	3.91%
Intangible assets	939	916	0.29%	-2.49%
Fixed Assets	9,597	10,531	3.33%	9.73%
Total Asset	284,655	316,222	100%	11.09%
Liabilities				
Total Deposits	238,937	267,730	95.80%	12.05%
Borrowings	4,875	3,989	1.43%	-18.17%
Other Liability	6,974	7,734	2.77%	10.90%
Total Liability	250,786	279,454	100%	11.43%
Financial Capital	33,870	36,768		8.56%
Total liability and capital	284,655	316,222		11.09%

Source: Banking Supervision Department, DAB

6.1.1. Gross Loans:

The gross loan portfolio of the banking sector recorded decrease of 2.87% over the quarter, stood at Af 39.45 billion, constituted 12.48% of the total assets, whereas it was Af 40.62 billion at the end of the second quarter, made 14.27% of the total assets. The decreases in total gross loans mainly come from settlement, repayment, less OD utilizations and charge-off of loans.

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



Source: Banking Supervision Department

six banking institutions recorded increases in their loan portfolio, while six other registered decrease. Disaggregated analysis among the banking groups showed that State Owned banks with 12.22% of the total banking sector loan portfolio demonstrated 0.18% decrease and private banks with major share (86.99%) in the banking sector portfolio registered 3.27% decrease, while branches of foreign banks with 0.79% share showed 0.75% increase compared to the previous quarter.

Gross loans are mostly concentrated in Af denominations and made 51% of the total portfolio followed with USD denominated loans at 49% of the sector total loans, while the loans designated in other currencies remained negligible (0.12% of portfolio).

- **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. Assets classification and provisioning regulation require banks to make reserves on non-standard assets, while on standard assets it is optional, in order to mitigate their credit risk.

By the end the second quarter of FY 1399, total provision cover of the system was 11.97% of total gross loans as opposed to 12.59% recorded at the end of Mar, 2020. The decrease comes from implementation of IFRS-09 taking the collateral marketability in one of the banking institutions.

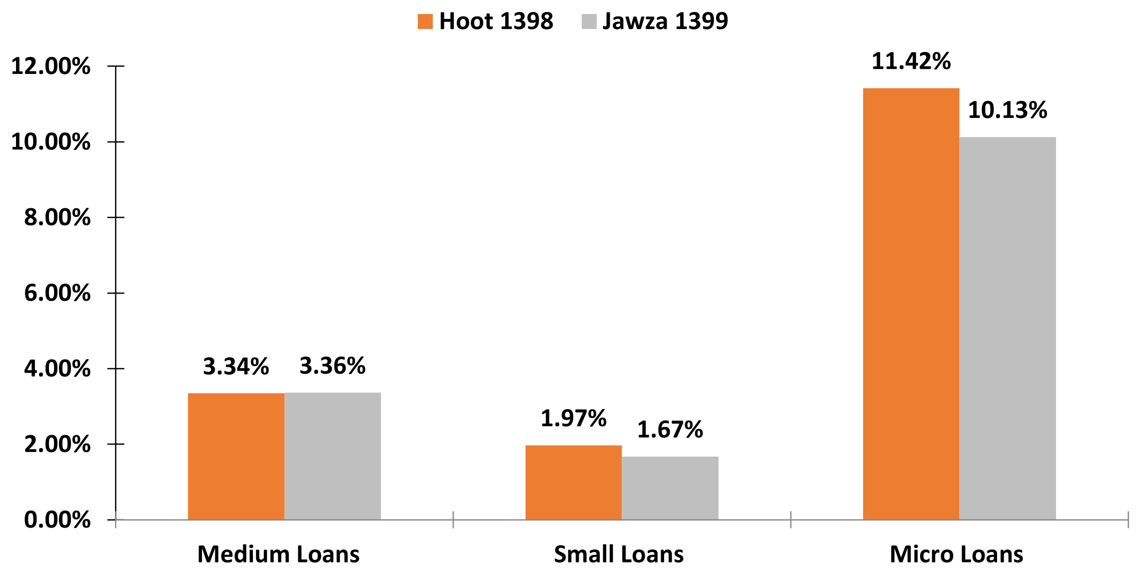
- **Distribution of Credit:**

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 was 41.42% against 43.91% in the second quarter which is decreased by 2.49% (mostly in food items, Petroleum and Lubricants and in wholesale); other main sectors include: Services sector constitutes 25.31% against 23.89% mainly increased in Telecommunication/Scratch cards Distributers, Hotel and Restaurant and in All Other Services.

Manufacturing and Industry sector making 10.08% against 9.76%, Infrastructure Projects constitute 9.05% against 8.73%, Commercial real estate and Construction sector make 8.11% against 7.27%, Agricultural, livestock and farms and consumer loan altogether constitute 6% in the second quarter against 6.4% in first quarter of FY 1399.

Increases were observed in five sectors such as Commercial Real Estate and Construction, Infrastructure Projects, Manufacturing and Industry, Services and in Residential Mortgage Loans to Individuals, while Trade, Livestock and Farming, Consumer and Agriculture sectors witnessed decrease compared to previous quarter.

Figure 6.3: Share of medium, small and micro loans in total gross loans



Source: Banking Supervision Department-DAB

Loans designated to medium, small and micro sectors decreased over the quarter, provided by nine banking institutions in the banking sector (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 with the high NPL ratio. 73% of the loans were designated in Kabul while Balkh and Herat provinces are in the second and third places with Badghis and Kandahar provinces are at fourth and fifth places respectively.

Table 6.2: Sectors wise distribution of Credit

Sectors	Qaws 1398 (Dec, 2019)	Hoot 1398 (Mar, 2020)	Jawza 1399 Jun, 2020
Commercial Real Estate and Construction	**7.51%**	**7.27%**	**8.11%**
Construction and Buildings	7.51%	7.27%	8.11%
Infrastructure Projects	**8.75%**	**8.73%**	**9.05%**
Power	0.12%	0.10%	0.10%
Road and Railway	2.84%	2.69%	3.07%
Dames	0.38%	0.37%	0.39%
Mines	0.49%	0.48%	0.47%
Other infrastructure projects	4.92%	5.09%	5.03%
Manufacturing and Industry	**11.03%**	**9.76%**	**10.08%**
Manufacturing &Products of Metal wood plastic rubber leather paper	5.38%	4.38%	3.91%
Manufacturing handmade and machine products	3.63%	3.41%	4.24%
Cement and Construction Materials	2.01%	1.97%	1.93%
Trade	**44.36%**	**43.91%**	**41.42%**
Textile	1.90%	1.95%	1.70%
Wholesale	4.74%	5.90%	5.68%
Machineries	0.37%	0.39%	0.29%
Petroleum and Lubricants	11.30%	11.98%	11.05%
Spare parts	1.89%	1.75%	1.73%
Electronics	2.66%	2.76%	2.97%
Cement and other construction Material	3.99%	3.93%	3.86%
Food Items	8.21%	8.31%	7.10%
All other Items	6.36%	4.03%	4.24%
Retail trading	2.94%	2.91%	2.81%
Service	**22.15%**	**23.89%**	**25.31%**
Education	0.03%	0.09%	0.04%
Hotel and Restaurant	2.44%	2.34%	2.62%
Telecommunication/Scratch cards Distributers	6.57%	6.90%	7.42%
Ground Transportation	4.13%	4.88%	5.15%
Air Transportation	0.91%	0.90%	0.93%
Health and Hygienic	1.66%	1.65%	1.57%
Media, Advertisements, Printer	1.92%	1.92%	2.01%
All other Services	4.50%	5.22%	5.55%
Livestock and farms	**0.50%**	**0.51%**	**0.45%**
Livestock and farming	0.50%	0.51%	0.45%
Agricultural Loans	**3.07%**	**3.31%**	**3.21%**
Consumer Loans	**2.63%**	**2.62%**	**2.35%**
Residential Mortgage Loans to Individuals	**0.00%**	**0.00%**	**0.02%**
All Other Loans	0.00%	0.00%	0.00%

Source: Banking Supervision Department-DAB

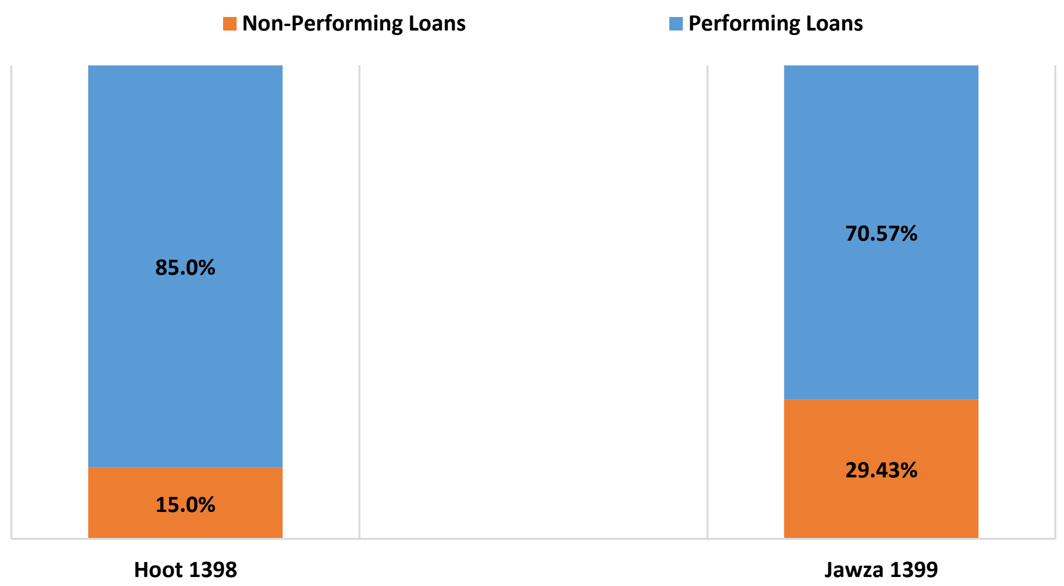
The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that with time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify lending services and properly perform their role in financial intermediation.

- **Classification of Loans:**
  - **Non-performing loans[3]:**

Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs. Moreover, it can be inferred that quality of risk management in banks with poor credit performance is demonstrated 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 second quarter of FY 1399, non-performing loans recorded at Af 11.61 billion or 29.43% of the total gross loans and 35.47% of the system's regulatory capital, increased by Af 5.51 billion. The increase is mostly attributed to one bank in the system owing to classification of loans as per implementation of IFRS-9.

Figure 6.4: Quality of Loan Portfolio



Source: Banking Supervision Department, DAB

Group wise analysis showed that out of Af 11.61 billion total NPLs, Af 10.91 billion NPL came from private banks which made 27.65% of the banking sector' total gross loans (93.97% of banking sector

[3] 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).

total NPLs) and Af 700 million is attributed to one state-owned bank constituted 1.77% of the banking sector total gross loans (6.03% of banking sector total NPLs).

Sectorial analysis of the NPLs show that major portion of the NPLs originate from trade sector which constitute 42.66% (dominant increment and other construction material and in Petroleum and Lubricants, 8.69% and 6.99% respectively), the next major portion relates to services sector with 19.03% (mostly in ground transportation, 8.82%), infrastructure projects hold 18.15%, commercial real estate and construction, manufacturing and industry constitute 12.66% and 6.49% of the sector's NPLs respectively.

Banking Supervision Department (BSD) is closely working with banks with poor loan performance to design and implement plans to improve their asset quality. This situation requires regulatory oversight and prompt remedial action to improve governance of credit risk to avoid negative impact over the profitability and capital adequacy of the banks with poor credit quality.

○ Adversely-classified loans:

Adversely classified loans (substandard, doubtful, Loss)[4] depicts Af 5.79 billion increase over the quarter, reaching Af 13.79 billion, constituting 34.97% of the total gross loans and 42.15% of regulatory capital, and the increase is due to classification of loans in one banking institution due to IFRS-9 implementation. 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 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 to mitigate further deterioration and distress in the banking system.

○ Loans classified Watch:

Loans classified in the "watch"[5] category at the end of the second quarter, stood at Af 4.43 billion, which made 11.23% of total gross loans and decreased by 1.18% compared with the previous period.

The decrease is mostly attributed to two banks in the system resulted from less OD utilizations. This category of loans requires close monitoring as it may lead to more adversely classified loans (substandard, doubtful and losses) in the future.

[4] An asset for which the principal and /or interest remains outstanding for 61-120 days - (Substandard), 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

[5] 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)

○ Charged-off Loans[6]:

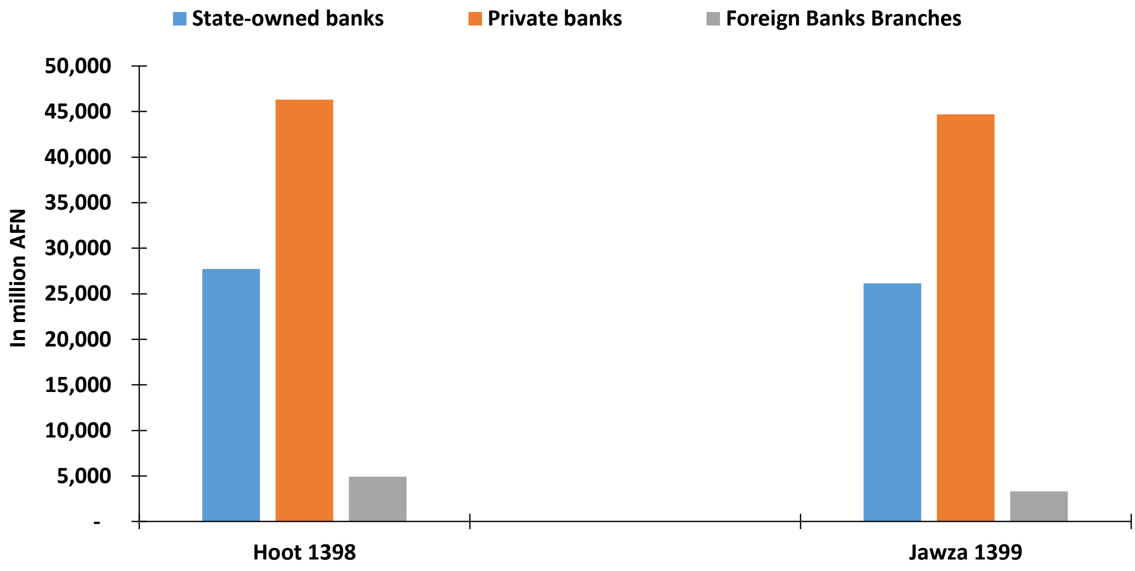
Loans charged-off at the end of the second quarter stands at Af 10.67 million, which makes 0.03% of total gross loans attributed to two banks in the sector.

6.1.2. Interbank Claims:

Gross Interbank Claims are the second largest among various asset categories, which stands at Af 74.15 billion (23.45% of total assets), registering Af 4.81 billion or 6.1% decrease compare to the previous quarter. This decrease is attributed to nine banking institutions mainly in USD accounts.

In the meantime, Afghani and other currency placements indicates slight decrease as well. It's worth mentioning that, banks should not only appropriately measure risks associated with individual bank but also country or countries in which they have placed funds (see figure 6.4).

Figure 6.5: Share of Interbank Claims among banking groups



Source: Banking Supervision Department, DAB

6.1.3. Investment:

The net-investment[7] portfolio of the banking sector comprised of bonds, Government Securities, investment in associated companies; which is increased by 10.53% or Af 3.51 billion compared to the previous quarter, currently stood at Af 36.92 billion or 11.68% of total assets, the increase mostly came from four banking institutions. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, four private banks and a branch of foreign banks.

[6] 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.

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

6.1.4. Cash in Vault and Claims on DAB:

Cash in vault and claims on DAB remains the largest category making 44.61% of the total assets, shows increase of Af 32 billion. The increase came in both, absolute as well as in percentage of total assets compared to the previous quarter, which Stood at Af 141.07 billion at the end of the second quarter. The increase was observed mostly in correspondent accounts with DAB and in overnight deposits accounts with DAB. 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 increased by Af 28.66 billion or 11.43% stood at Af 279.45 billion against Af 250.78 billion in the first quarter of FY 1399. The mentioned increase in total liabilities was mainly contributed by increase in total deposits (dominant in customer demand deposits mostly in Afghani currency). The majority of liabilities are made up of deposits (95.8%), followed by other liabilities (2.77%) and borrowings in third place (1.43%), see table 6.1.

Figure 6.6: Share of Total Liabilities among banking groups

Source: Banking Supervision Department, DAB

6.2.1. Deposits:

Deposits was the main funding source in the banking sector comprised of interbank and customer deposits, amounted to Af 267.73 billion at the end of the second quarter of FY 1399, which increased by Af 28.79 billion or 12.05% over the quarter. The total deposits cover Af 4.62 billion interbank and Af 263.1 billion customer deposits. The increase in deposit base of the banking sector is attributed to customer demand deposits mainly in Af and in USD accounts. Currency wise analysis showed that Afghani denominated deposits increased by 23.46% accounted for 33.63% of the total deposits, while US dollar denominated deposits increased by 7.14% made 64.6% of the total deposits, and other currency deposits increased by 3.61% accounted for 1.77% of the total deposits of the banking sector.

Figure 6.7: Afghani Denominated Deposits

Source: Banking Supervision Department, DAB

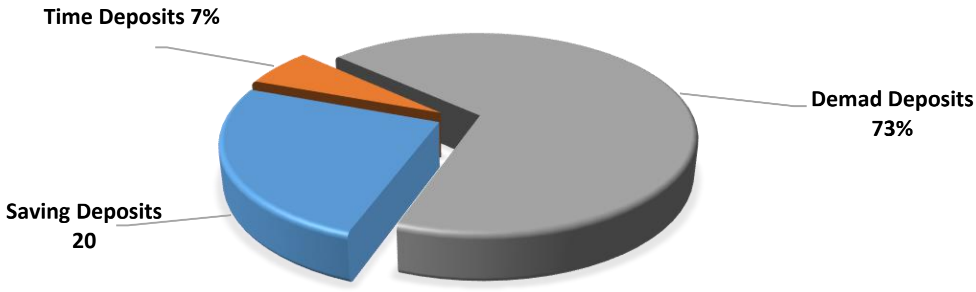
Figure 6.8: Currency Composition of Deposits

Source: Banking Supervision Department, DAB

Figure 6.9: Deposits among banking groups

Source: Banking Supervision Department, DAB

Figure 6.10: Types of deposits



Source: Banking Supervision Department, DAB

6.2.2. Borrowings:

The share of borrowings in total funding structure of the system decreased by 18.17%, stood at Af 3.98 billion at the end of the second quarter of FY 1399, which made 1.43% 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, etc. according to policies of the bank.

6.3.1. Liquidity Ratio (broad measure):

Overall, all banking institutions 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 61.38% against 56.09% in the preceding period, showing an increase of 5.29%, (see table 6.3).

Table 6.3: Liquidity Ratio of the Banking Sector

Ratio in %	Jun, 2019	Sep, 2019	Dec, 2019	Mar, 2020	Jun, 2020
Total Capital Adequacy Ratio	26.99%	25.81%	25.93%	25.97%	26.69%
Tier 1 Capital Adequacy Ratio	27.45%	25.24%	24.50%	26.69%	26.34%
Non-Performing Loans to Total Gross Loans	10.91%	13.15%	14.47%	15%	29.43%
Return on Assets (ROA) Quarterly	0.38%	0.05%	0.42%	-0.08%	0.52%
Return on Equity (ROE) Quarterly	3.30%	0.41%	3.62%	-0.57%	4.46%
liquidity Ratio (Broad Measure Median)	76.55%	60.68%	55.89%	56.09%	61.38%
liquid Assets to Total Assets	70.92%	67.73%	68.63%	66.04%	68.06%

Source: Banking Supervision Department, DAB

6.4. Capital:

The banking sector is well capitalized, making 11.63% of total assets. The net equity position of the sector recorded at Af 36.76 billion, increased by 8.56% Q-o-Q basis, mainly attributed to the gain in Revaluation-Available for Sale Investments and profit in the current quarter. CAR of the sector was 26.69% against 25.97% in the first quarter of FY 1399, showed 0.72% increase over the quarter (see table 6.3). Disaggregated analysis shows that the financial capital of all banks are above the regulatory limits and the regulatory capital ratio of all banks are above the set regulatory threshold (12% of the risk weighted assets). The Basel benchmark for capital to risk weighted assets is 8%.

6.5. Profitability:

In terms of the profitability, on cumulative basis the banking sector recorded Af 783.39 million net profit for the quarter under review against Af 71.31 million net-losses recorded in the previous quarter, showed an improvement over the quarter, which resulted in ROA and ROE of 0.52% and 4.46% in current quarter as compared to -0.08% and -0.57% respectively in previous quarter.

The factors contributed towards the profitability of the banking sector in the second quarter of FY 1399 were, increase in non-interest income owing to recovery of loans and funds in two banking institutions and FX gains. Major profitability components are interest and non-interest income, while main expanses are non-interest expenses and salary expanses.

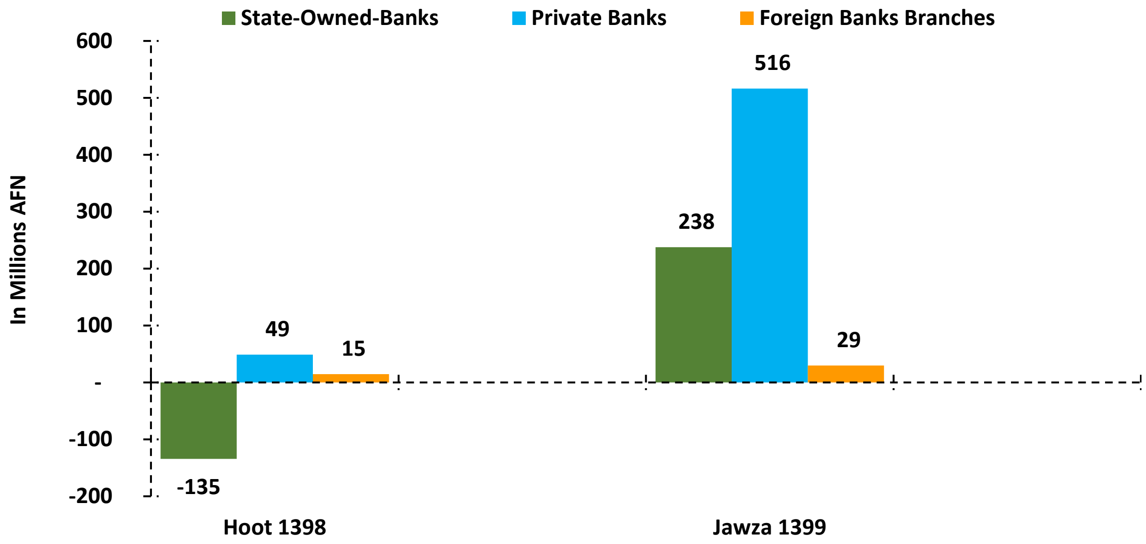
Table 6.4: Profit & Loss Schedule (cumulative)

Items	Mar, 2020	Jun, 2020	Growth
	Amount in million Af		
Interest income	1,770	1,644	-7.11%
Interest expense	231	240	3.83%
Net interest income	1,538	1,404	-8.75%
Non-interest income	1,601	2,076	29.73%
Non-interest expenses (except salary)	1,472	1,543	4.81%
Salary expense	1,181	1,075	-8.99%
Net credit provisions	376	196	-48.03%
Gain/Loss on Investments	(11)	(27)	157.19%
Income before Tax & FX gain/loss	99	640	545.83%
FX gain/loss	(108)	258	-338.48%
TAX	62	114	83.96%
Net profit	-71	783	-1198.49%

Source: Banking Supervision Department, DAB

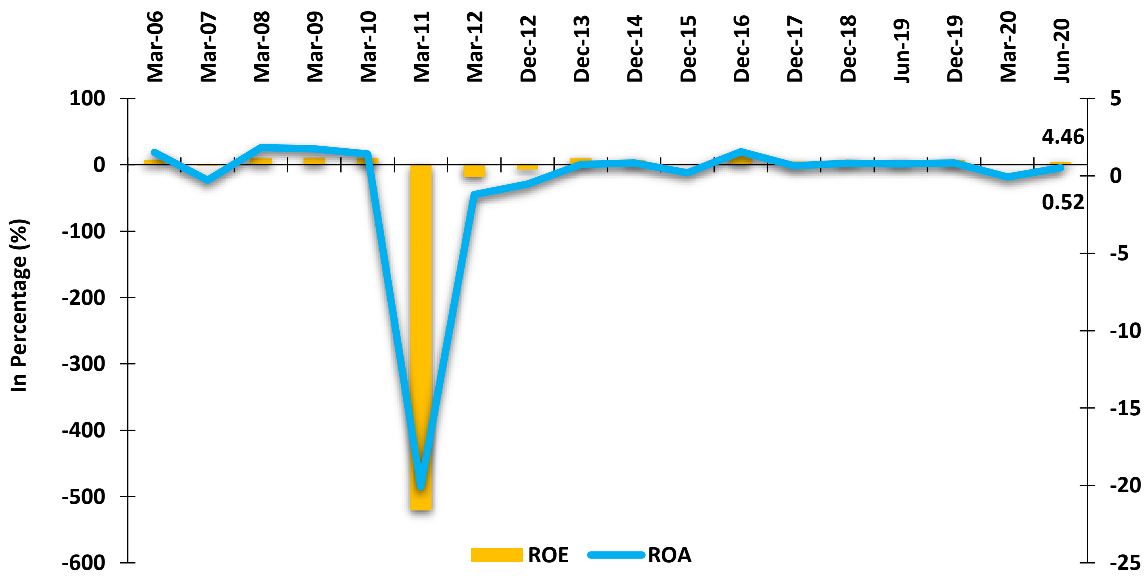
Group wise analysis revealed that State-Owned Banks (SOB), Private Banks (PB) and Branches of foreign banks (BFB) ended with profits (see figure 6.10). Profitability of the banking sector mostly came from Private Banks stood at Af 516 million (65.9% of the sector net-profit), with ROA of 3.67%, State Owned Banks earned net-profits amounted to Af 238 million (30.34% of the sector net-profit) with ROA of 1.64%, while profit for Branches of Foreign Banks were Af 29 million (3.76% of the sector net-profit) with ROA of 0.68% in the period under review. Four banks incurred Af 65 million losses against Af 395 million losses in the previous comparable period with four banks at loss. On core income basis five banks ended with losses against four banks in the previous period.

Figure 6.11: Profitability of the Banking Sector



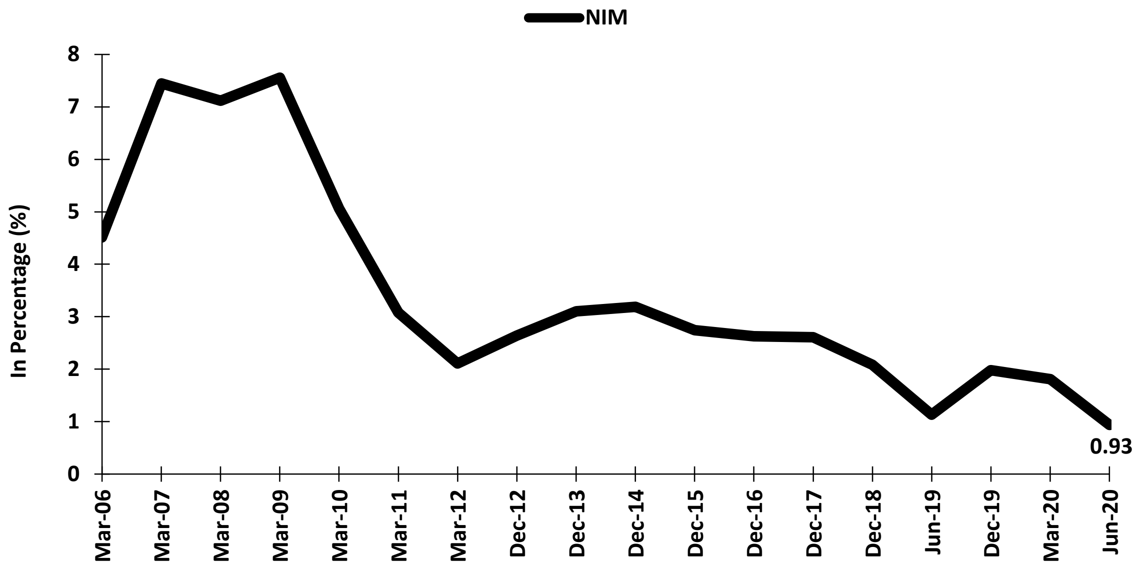
Source: Banking Supervision Department-DAB

Figure 6.12: ROA and ROE



Source: Banking Supervision Department, DAB

Figure 6.13: Net Interest Margin



Source: Banking Supervision Department/ DAB

6.6. Foreign Exchange Risk:

All banking institutions are within the set regulatory threshold for overall open FX position (± 40%) and on an individual currency (± 20%) basis except for five banks, which have violated the limits on overall and on an individual currency basis (USD long position). 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 Af 2.83 billion and vice versa. Similarly, a 4% change would correspond to Af 567 million increase in the regulatory capital of the system 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 revealed that, the net-interest income of the system over the next 12 months may increase by Af 119 million in the event of increase in the market interest rate (upward interest rate shock) by 3%. Conversely, if the interest rate decreases by 3% (downward interest rate shock) interest income will decline by Af 119 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 large excess of interest earning assets over interest bearing liabilities. Although it may improve the net interest margin and overall profitability of banks, this situation makes the banks more vulnerable to a sudden decrease in the market rates.

6.8. ISLAMIC BANKING PERFORMANCE

6.8.1. Executive Summary:

The Islamic banking sector recorded a positive trend for its main financial indicators in the second quarter of FY 1399, as apparent from the increase in total assets, which was mostly due to deposits upturn. The equity capital of four windows out of six windows was negative and the equity capital of one full fledge bank was maintained at healthy levels attributed to rise in the profitability along with adequate level of liquidity position. However, gross financing has upward trend due to new financing and FX gain and meanwhile settlement of financing taken place also. Investment has growth trend mainly due to new investment in Sukuk.

The assets base of the sector during the second quarter of FY 1399, demonstrated 4.38% increase compared to the previous quarter stood at Af 37.03 billion at the end of the second quarter as compared to Af 35.48 billion in the same preceding quarter. The increase in total assets mostly originates from increase in investment, cash in vault and in other assets.

Total gross financing and investment portfolio of the sector shows increase of 10.57% over the quarter, currently stands at Af 14.58 billion. The increase in total gross financing and investment over the quarter was mainly due to investment in Sukuk during the quarter under review, at the same time the new Murabaha financing taken place as well in the second quarter of FY 1399. It is worth to be mentioned that the settlement of Murabaha financing over the period also has reported. The percentage increase of total gross financing portfolio of the sector is 0.61% and the Sukuk investment is 16.3%.

Deposits, the main source of funding in the Islamic banking sector witnessed 5.79% upturn over the quarter and stood at Af 30.16 billion. The increase in total deposits was due to increase in the customers' demand and saving deposits. Time and saving deposits make 62.22% of the overall deposits, while individually, saving deposits make 40.94%, demand deposits make 37.77% and time deposits make 21.27% of the total deposits. On the other hand, the appreciation rate of USD currency against Af also has attributed in the increase of total deposits of the sector. While the time deposits of the sector faced downturn for the current quarter.

There is no statutory requirement for Islamic banking windows to maintain a separate limit of financial capital. The capital of one full-fledged bank stands above regulatory limit. The total equity capital of the sector decreased by 1.65% compared to the last quarter, which resulted from some adjusted entries in the capital of an Islamic banking window over the quarter under review. The equity capital of four windows out of six is negative; however, the regulatory capital ratio (CAR) of full-fledged bank shows improvement during the second quarter of FY 1399, which stands at 14.7% of the risk weighted assets.

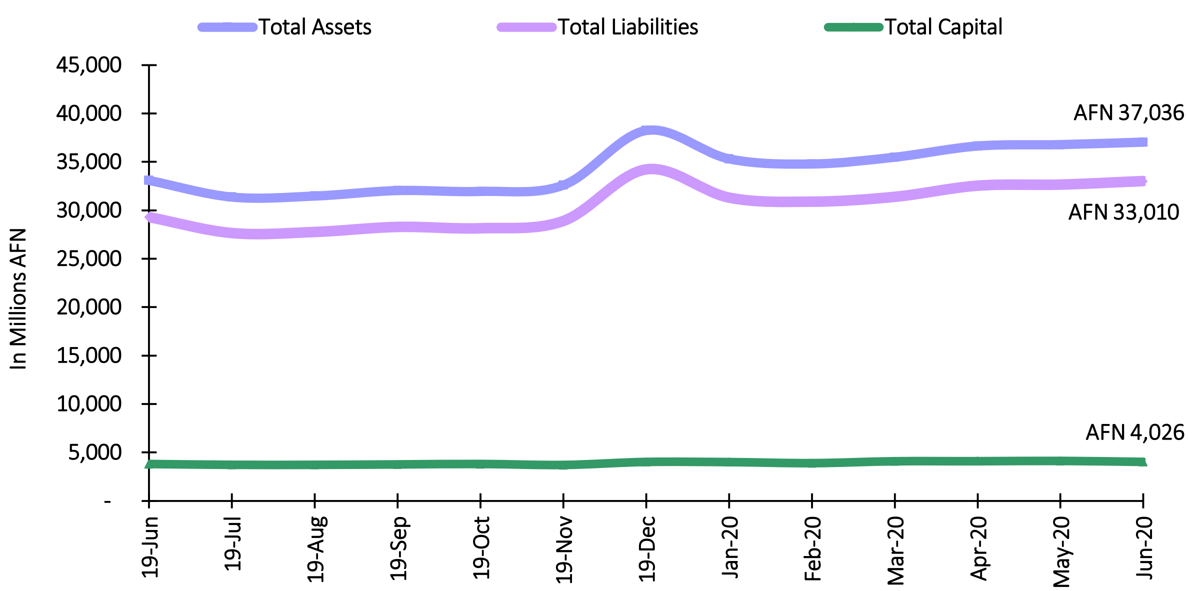
On a cumulative basis from Jan to June 2020, the Islamic banking sector makes Af 154.06 million net-profit against Af 267.9 million net-losses in the same preceding period (June, 2019), resulting in ROA of 1.17% and ROE of 8.12% annualized comparing to ROA of -2.2% and ROE of -14.7% in June, FY 2019. 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 Da Afghanistan Bank.

6.8.2. Total Assets:

Assets base of the Islamic banking sector registered growth of 4.38%, stood at Af 37.03 billion (USD 478.99 Million) in the second quarter of FY 1399, against 7.15% downturn in the first quarter of FY 1399. The increase in total assets was mostly due to increase in deposits. The analysis of total assets shows that most obvious increase was recorded in investment and cash in vault.

Looking at the increase in total assets across the sector, the 76.92% growth taken place in full-fledged Islamic bank and meanwhile the assets of Islamic banking windows showed increase of 23.07% as compared to last quarter. The percentage share of full-fledged bank in the sector's total assets is reported 56.26%; state-owned banks windows with 11.878% and while the four windows of private commercial banks had 31.86% shares in the sector's total assets. The trend of assets of the Islamic Banking Sector from June 2019 to June 2020 is depicted in figure 6.14.

Figure 6.14: Trend of assets of the Islamic Banking Sector



Source: IBFD, Islamic Banking and Finance Department, DAB

The fluctuation in the assets of Islamic banking sector during the month of Dec and Jan 2019 was mainly due to variation 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 (42.03%), interbank claims (10.29%), net Murabaha financing (10.59%), investment (Sukuk and assets acquired for leasing) had 26.27% share, and other assets made 9.03% of the total assets.

Table 6.5: Total Assets and Liabilities of Islamic banking sector

Description	Hoot,1398 March, 2020	Jawza,1399 June, 2020	% of Total Assets/Liability	Quarterly Growth/Decline
Assets	**Amount in million Af**			
Cash in vault and claims on DAB	15,157.12	15,566.4	42%	2.07%
Interbank claims	4,711.10	3,737.21	10%	-20.67%
Financing Murabaha (Net)	3,954.16	3,923.21	11%	-0.78%
Investment (Sukuk and other)	8,376.37	9,727.97	26%	16.14%
Other Assets	2,671.20	3,345.61	9%	25%
Fixed and Intangible Assets	755.54	735.26	2%	-5.2%
Total Assets	35,480.28	37,035.68	100%	4.38%
Liabilities				
Deposits	28,510.39	30,161.5	91%	5.79%
Other liabilities	2,876.67	2,848.39	9%	-3%
Total liabilities	31,387.06	33,009.9	100%	5.17%
Financial Capital	4,093.21	4,025.77		-1.65%
Total Liabilities + Capital	35,840.28	37,035.68		4.38%

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 at the end of the second quarter stands at Af 14.584 billion (USD 188.62 million), constituting 39.38% of the total assets, which depicts 10.57% or Af 1.394 billion increase since end of the first quarter of FY 1399, whereas the gross Murabaha financing is Af 4.813 billion (USD 62.7 million) or 13.57% of total assets and investment (Sukuk and other) is Af 8.376 billion (USD 109.25 million) constituting 24.61% of total assets. The 97.89% increase in Gross Murabaha financing and investments (Sukuks and others) took place in Sukuk investment and remaining 2.11% has recorded in Murabaha financing.

Total Afghani denominated financing and investment recorded Af 3.83 billion (USD 49.65 million), which made 26.32% of total Gross financing and investment and 10.37% of total assets. While the US Dollar denominated financing and investment are Af 10.74 billion (USD 138.97 million), and makes 73.67% of total gross financing and investment and

29.01% of total assets. The increase in total financing and investment portfolio is mainly due to new investment in Sukuk and Murabaha financing. Investment in Sukuk shows increase of Af 1.365 billion over the quarter. The increase in total gross investment is mainly attributed to new investment of Sukuk during the reviewed period. At the same time, settlement and instalment of Murabaha financing have been collected during the quarter.

Table 6.6: Product wise Islamic Banking Sector Financing and investment (gross)

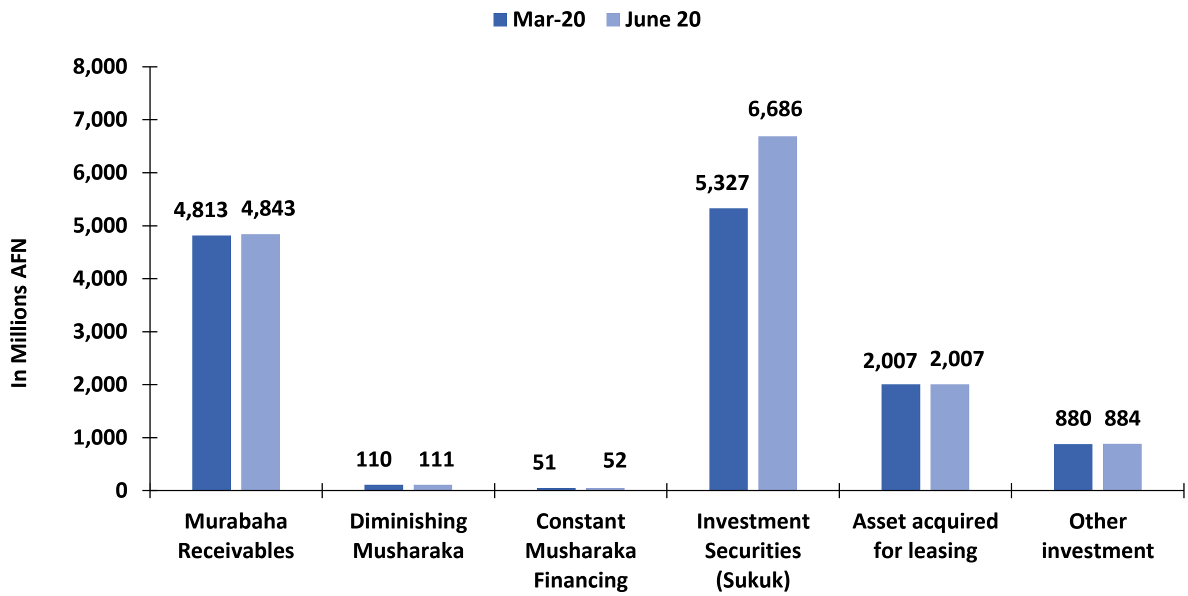
No	Product	Mar-20	June-20	Difference in Amount	Difference in %	Products as % of Gross Investment & Financing
		Amount in million Af				
1	Investment in Sukuk	5,327	6,686	1,359	26%	45.85%
2	Murabaha Receivables	4,813	4,843	29.37	1%	33.2%
3	Asset acquired for leasing	2,007.48	2,007.48	0	0%	13.76%
4	Other investment	879.98	884.37	(4.39)	-05%	6.1%
5	Diminishing Musharaka	110	111	1.3	1%	0.76%
6	Constant Musharaka	51	52	0.6	1%	0.36%
	Grand Total	13,189.63	14,584.20	1,394.56	10.57%	100%

Source: IBFD, Islamic Banking and Finance Department, DAB

The sector wise lending of Murabaha financing in Afghanistan is dominated by Islamic banking windows, constituted 84.84% of total gross Murabaha financing of the sector, while the share of full-fledged bank in total Murabaha financing was 15.15%. Whereas the total overseas investment in Sukuk of the sector is dominated 88.44% by full-fledged bank and remaining 11.56% by an Islamic banking window of commercial bank.

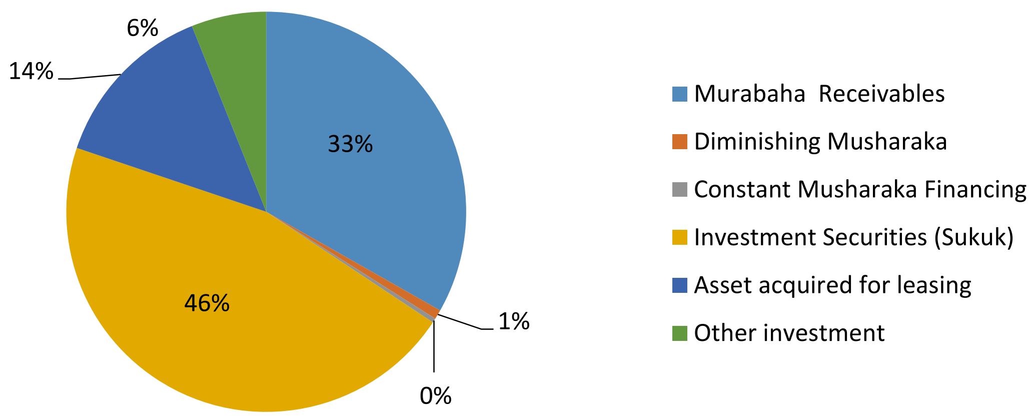
The breakup of total gross financing and investment of the sector consists of investment in Sukuk (Af 6.686 billion which shows increase of Af 1.358 billion making 45.85% of total gross financing and investment), Murabaha receivables (Af 4.84 billion, that show increase of 0.61% and makes 33.2% of the gross financing and investment), asset acquired for leasing (Af 2.007 billion, comprising 13.8% of the gross financing and investment), other investment (Af 884.37 million, making 6.06% of the total gross financing and investment), Diminishing Musharaka (Af 111.33 million, which makes 0.76% of the total gross financing and investment), and constant Musharaka (Af 51.89 million) during the second quarter of FY 1399. Increase in investment (Sukuk) portfolio was observed at full-fledged bank, and it worth mentioning that one out of six Islamic banking windows had no financing and investment activities due to DAB restriction.

Figure 6.15: Product wise Investment and Financing of the Islamic Banking Sector



Source: IBFD, Islamic Banking and Finance Department, DAB

Figure 6.16: Product wise investment and financing as Percentage as per June, 2020



Source: IBFD, Islamic Banking and Finance Department, DAB

- **Financing & Investment Loss Reserve:**

At the end of the second quarter of FY 1399, total provision of Islamic banking sector stands at Af 1.03 billion and shows increase Af 81.84 million comparing to previous quarter. The increase amount recorded Af 60.32 million for Murabaha financing, Af 13.58 million for investment financing and Af 6.94 million for account receivable, and the increase in total provision mainly reported in one of the Islamic banking windows.

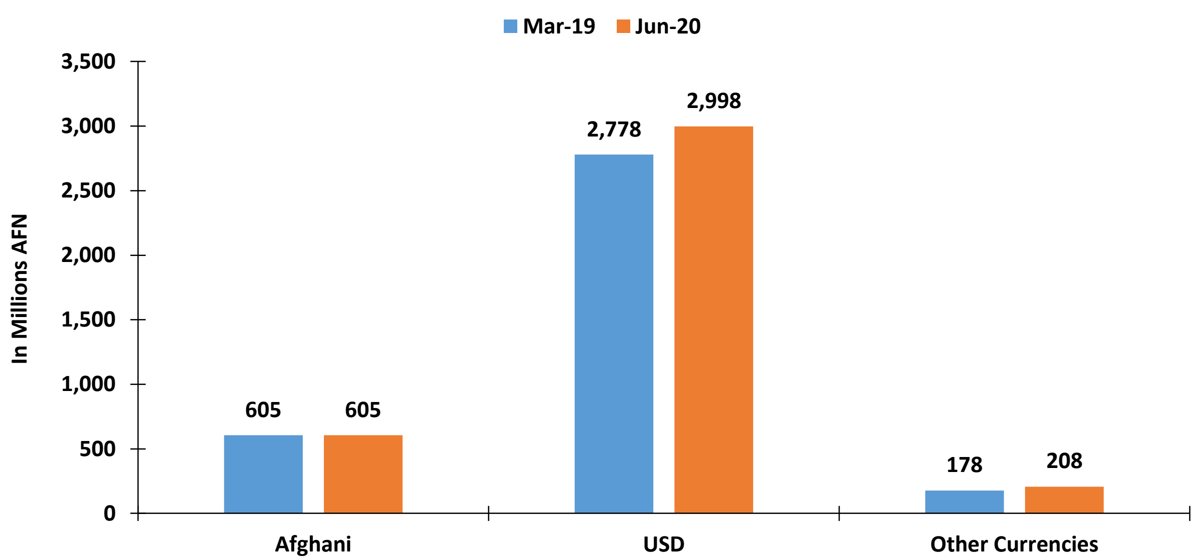
The provision of the sector is comprised of Af 919.42 million for Murabaha financing, Af 73.57 million for interbank claims, Af 13.59 for investment and Af 25.73 million for account receivable. The provision for Murabaha financing encompasses 89.06% of total gross financing of Islamic banking sector in the second quarter of FY 1399 as against 90.38% recorded in the previous quarter.

- **Interbank Claims:**

The Interbank Claims of the Islamic Banking Sector are the fourth largest among various asset categories, which at the end of second quarter of FY 1399, stands at Af 3.81 billion (USD 49.28 million) constituting 10.29% of total assets, and shows decrease of Af 900.3 million comparing to previous quarter March 2020. Interbank claims denominated by Afghani 15.87%, USD 78.67% and other currencies 5.44% (see figure 6.17).

Two out of six Islamic banking windows and one Islamic bank have interbank claims which consist of Af 417 million time deposits (make 10.94% of total interbank claims), and Af 3.39 billion demand deposits (make 89.05% of total interbank claims of the sector). The interbank claims used as commodity Murabaha and internal bank transferring and settlement transactions with other banks.

Figure 6.17: Interbank claims



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 second quarter of FY 1399 stands at Af 15.566 billion (USD 201.32 million) and shows increase of Af 409.27 million or 2.7% comparing to preceding quarter. The cash in vault and claims on DAB is the largest item and makes 42.03% of total assets of the sector. The increase in cash in vault and claims on DAB mainly showed in both items cash in vault and claims on DAB. The reason for the increase in above items is mainly due to upturn in total deposits of sector over the quarter under review. Cash in vault and claims on DAB consists of Af 5.08 billion cash in vault, Af 7.72 billion non-interest bearing current account with

DAB and Af 2.76 billion required reserve account with DAB.

6.8.3. Total Deposits:

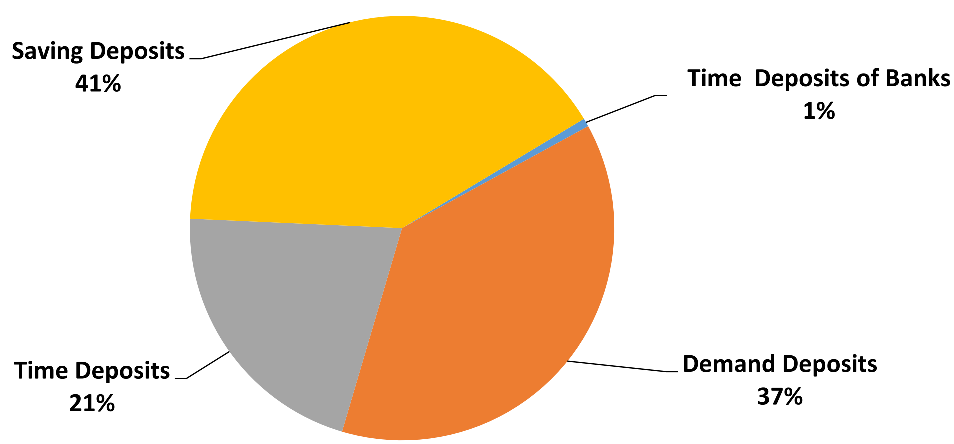
Deposits are the main source of funding and the larger component of liabilities, stand at Af 30.61 billion (USD 390.08 million), making 91.37% of total liabilities, which show increase of 5.79% since end of the first quarter, against Af 28.51 billion (USD 371.85 million) with 9.2% decrease in previous quarter.

The increase in total deposits was most obvious in demand deposits (Af 1.68 billion or 17.45%), saving deposits (Af 1.168 billion or 10.52%) of the customers in full-fledged bank during the second quarter of FY 1399. On the other hand, time deposits of the sector showed decrease of Af 1.201 billion or 15.68% in the quarter under review.

Furthermore, the increase is mostly occurred in Af deposits, as well as USD deposits registered positive trend in its position. Af-denominated deposits of the sector are Af 11.202 billion (USD 144.98 million), or 37.14% of the total deposits, which show increase of 12.93%, while the USD-denominated deposits of the sector stand at Af 18.95 billion (USD 245.19 million), or 62.85% of total deposits that indicate increase of 1.98%. Full-fledged Islamic bank has the highest percentage share in total deposits of the sector, standing at 59.39% following by Islamic banking windows with 40.61% share.

The total customers' deposits of the sector consist of Af 11.32 billion of demand deposits (with 37.54% share), Af 12.27 billion of saving deposits (with 40.68% share), and Af 6.56 billion of time deposits (with 21.78% share). Total deposits of the sector are comprised of Af 29.97 billion of customers deposits and Af 191.56 million of banks deposits which made 0.64% of the total deposits of the sector).

Figure 6.18: Breakdown of Deposits



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

6.8.4. Liquidity:

The liquidity position of all Islamic banking windows and full-fledged Islamic bank is above the set minimum for the broad liquidity ratio (15%) and the quick liquidity ratio (20%). Broad liquidity ratio of the Islamic banking sector as a median stand at 49.94% against 51.97% in the preceding quarter, showing decrease of 2.03%. 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.

Table 6.7: Key Financial Soundness Indicators of the Islamic Banking Sector

Ratio in %	(March, 2019)	(June,2020)
Liquid Assets to Total Assets	55.99%	52.32%
Liquid assets to short term liabilities	206%	171%
Total financing to Total Assets	37.17%	39.38%
Total financing to Total Time & Saving deposits	69.90%	77.41%
Time & Saving deposits to Total deposits	66.18%	62.42%
Foreign-Currency denominated funding to total funding	65.21%	62.86%
Foreign- Currency denominated financing to total financing	70.86%	73.68%
Return on Assets (ROA) Cumulative	3.7	1.17
Return on Equity (ROE) Cumulative	16.6	8.12

Source: IBFD, Islamic Banking & Finance Department, DAB

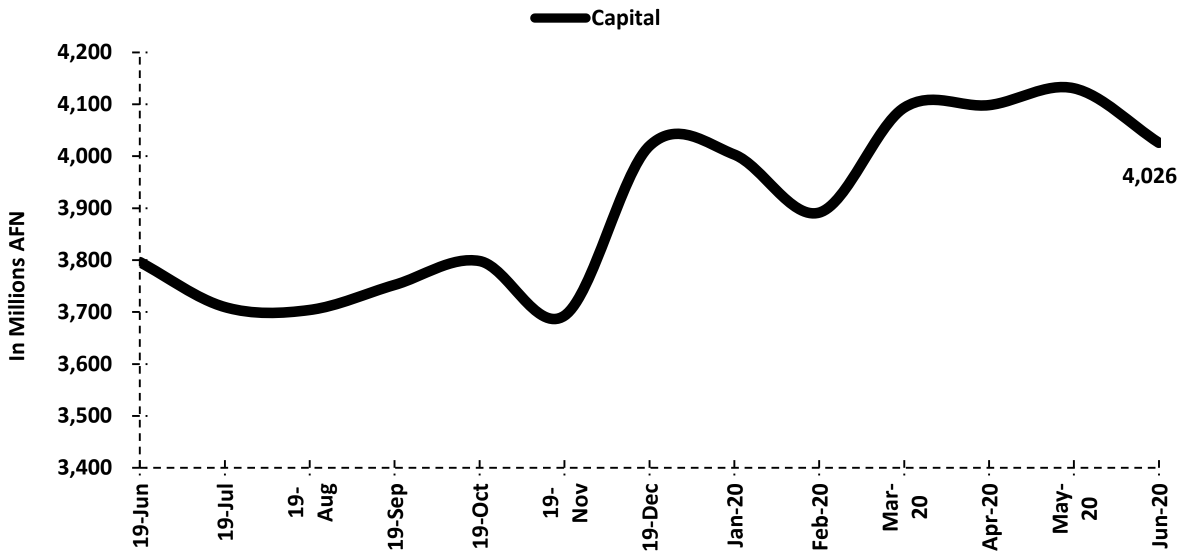
6.8.5. Capital:

The equity capital of the sector stood at Af 4.02 billion (USD 52.06 million), decreased by 1.65% since previous quarter, where it was Af 4.093 billion. The decrease in the total equity capital is due to adjusted entries in an Islamic banking window during the quarter under review. CAR of the Islamic Bank of Afghanistan remains above the regulatory limit.

The equity 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 equity capital as described above is given in the figure 6.19.

One of commercial banks' Islamic banking windows has the highest share in total equity capital of the sector which is 73.09% and the second one is the full-fledged bank with 34.38% contributions in total equity capital of the sector.

Figure 6.19: Tend of the equity capital in Islamic Banking sector



Source: IBFD, Islamic Banking & Finance Department, DAB

6.8.6. Profitability:

- **Quarter – to – Quarter:**

The Islamic banking sector earned Af 7.59 million net profit in the second quarter of FY 1399, against Af 146.47 million net profit of the last quarter. The increase in the profit of the sector in the previous quarter was mainly due to reported Af 367 million as reintegration of provisions, while in the current quarter, sector reported only Af 46.38 million as reintegration of provisions. Moreover, the Islamic banking sector reported Af 112.97 million as FX revaluation gain for the second quarter of FY 1399, which showed Af 70.99 million decrease compared to last quarter.

- **Cumulative: (Jan - June, 2020- Jadi 1398 – Jawza 1399):**

Despite showing decline in net profit income and nonprofit income over the period, the profitability of the sector on cumulative basis from starts till end of the second quarter of FY 1399, the Islamic banking sector ended with Af 154.06 million net-profit for the first two quarters of financial year 1399 against Af 267.9 million net-losses recorded in the same period of the last year, which resulted in ROA of 1.17% and ROE 8.12% annualized against -2.17% and -14.74% annualized in the second quarter of FY 1398.

The main reason for increase in the profit of the sector is mainly due to calculated Af 413.44 million as reintegration provisions. The other contributing factors in the profit of the sector are the decrease of Af 48 million in non-profit expenses (operating expense) and increase of Af 19 million in FX gain. Three out of six Islamic windows ended with profit of Af 171.33 million against Af 312.85 million net losses in the previous period, where all Islamic banking windows were at loss for that period.

Table 6.8: Profit and Loss Schedule of the Islamic Banking Sector

Profit and loss Schedule (Amount in millions Af)			
Item	**March-19**	**June-20**	**Difference**
Profit income	152.76	132.52	(20.24)
Profit expense	55.513	61.33	5.82
Net profit income	97.254	71.18	(26.06)
Net Credit provisions	(163.3)	(20.02)	(143.28)
Other nonprofit income	84.08	102.45	18.6
Other nonprofit expense	342.15	289.67	(52.47)
Income (Loss) before FX revaluation	2.49	(96.003)	(98.49)
FX revaluation Gain/loss	183.97	112.97	(70.99)
Tax	39.99	9.38	(30.6)
Net profit income/Loss after Tax	146.477	7.588	(138.88)

Source: IBFD, Islamic Banking & Finance Department, DAB

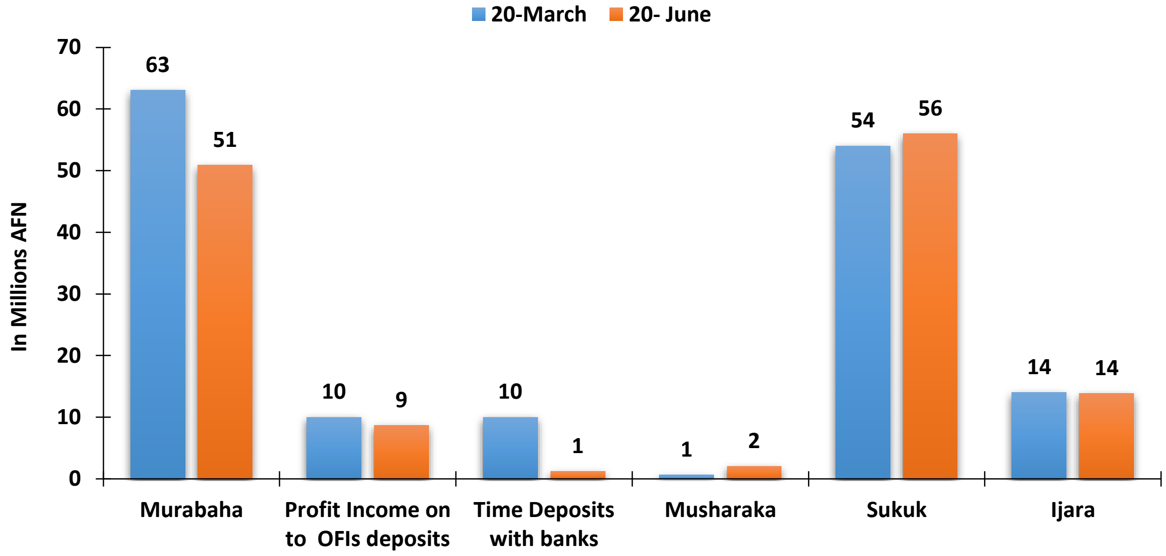
In general, the Islamic banking sector was offering six types of financial products. The returns from financing and investment for the quarter under review are shown in table 6.9.

Table 6.9: Returns by Major Types of Shariah Compliant Products

Value of returns by major type of Shariah-compliant contract (Amount in million Af)			
Product	**March-20**	**June-20**	**Difference**
Time Deposits with banks	10.206	1.2	(9.007)
Profit Income on to OFIs deposits	10.083	8.655	(1.42)
Murabaha financing	62.76	50.867	(11.89)
Musharaka and Diminishing Musharaka	0.635	2.02	1.39
Sukuk investment	54.802	55.94	1.73
Ijara	14.87	13.832	(1.04)
Total Profit Income	152.76	132.52	(20.24)

Source: IBFD, Islamic Banking & Finance Department, DAB

Figure 6.20: Return by Major Types of Shariah Complaint Products



Source: IBFD, Islamic Banking & Finance Department, DAB

Total number of employees, borrowers and depositors of the Islamic banking sector at the end of the second quarter of FY 1399 across the country are shown in table 6.10.

Table 6.10: Total number of employees, borrowers, and depositors of the Islamic banking sector

Particulars	No.
Full-time all Employees	1,025
Present Borrowers	825
Present Depositors	542,550

Source: IBFD, Islamic Banking & Finance Department, DAB

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