Da Afghanistan Bank

Economic & Statistical Bulletin

Second Quarter, 2019

Monetary Policy Department

Da Afghanistan Bank

Ibn-e-Sina Watt

Kabul

Afghanistan

Telephone: +93-20-2103930

Internet: www.dab.gov.af

Email: mp@dab.gov.af

Note:

Afghanistan's fiscal year has changed effective from 2012 (1391). The new fiscal year begins on December 21st each year. This bulletin analyzes economic developments during the second quarter of fiscal year 2019, which covers March 21st, 2019 to June 20th, 2019.

CONTENTS

LIST OF FIGURES

LIST OF TABLES

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

Afghanistan is on the verge of successfully completing a three year IMF Extended Credit Facility Program. Under this program Da Afghanistan Bank has been given two quantitative targets; Net International Reserve and Reserve money. Da Afghanistan Bank has been successful in achieving both the quantitative targets; Reserve Money target was 12% (annual increase), and Net International Reserve target was zero (no change at year-end).

Da Afghanistan Bank maintains monetary aggregate targeting regime, under which Reserve Money is selected as the main operational target, and Currency in Circulation (CiC) as the indicative target for liquidity. To attain its operation target (reserve money target), DAB uses OMOs (Open Market Operations) for controlling and managing liquidity in the market.

Afghanistan has been successful in containing inflation at a favorable rate, however it experienced an increase of 3.4% compared to previous quarter of FY 1398 (2019) and 5.3% compared to the second quarter of FY 1397 (2018). Consumer price index showed an inflation rate of 4.2% on average in the second quarter of FY 1398 (2019), while in the second quarter of FY 1397 (2018) inflation was -1.1%, which is in line with increases in the price of commodities in the global markets.

From the start of the fiscal year 2019 till end of the second quarter, DAB has auctioned a total amount of USD 1,206.94 million, and during the quarter USD 665 million has been auctioned for absorbing excess liquidity from the market, and also to mitigate fluctuations in the exchange rate between Afghani and USD. The total amount of outstanding Capital Notes (CNs) stood at AFN 27.02 billion at the end of the second quarter, FY 1398 (2019). It has to be mentioned that Afghani is depreciated 6.61% and 7.23% during the second quarter and during first half of FY 1398 (2019) respectively.

The external sector of Afghan economy improved in the second quarter of FY 1398 (2019). Merchandize trade deficit is reduced by 6.7% due to lower imports, increase in receipts related to services account and worker's remittances. Current account had a deficit of USD 604.74 million in the second quarter of FY 1398 (2019). Capital account inflow increased by 32%, while FDI inflow declined by 87% but outflow of FDI increased by 81%. Overall the Balance of Payment (BOP) had a deficit of USD 517.12 million in the quarter under review.

In Government sector, Afghanistan had a budget deficit (excluding grants) of AFN 69 billion in the second quarter of FY 1398 (2019), while including grants in total revenue led to a budget surplus of AFN 2.69 billion. Domestic revenue increased in the second quarter due to increase in taxation and custom revenues, and DAB dividend income.

In the banking sector which makes 21.51% of the GDP of Afghanistan, the overall indicators shown an increase (total assets, gross loans, deposits, equity capital and profit),

However, liquidity remained adequate while the quality of loans yet remained low. Deposits being the main source of fund for the banking sector including the inter-bank and customer deposits. The Islamic Banking sector which consists of one bank and six windows constitutes 10.68% shares in assets, 27.92% share in gross loans and 10.30% share in deposits of the overall banking sector.

1

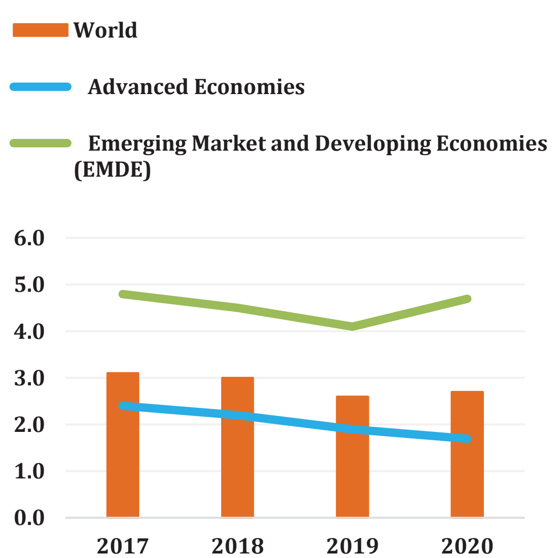
Global Economic Environment

1
GLOBAL ECONOMIC ENVIRONMENT

Global economic growth continued to remain low in the second quarter of 2019. Trade tensions, weak investment in emerging economies, low growth in many advanced economies, increasing debt, and tensions pertaining to Brexit have been major challenges for the global economy.

The IMF in its World Economic Outlook (WEO) has projected growth rate of 1.9% for 2019 and 1.7% for 2020 for advanced economies, 1.3% for 2019 and 1.6% for 2020 for euro areas and 4.1% in 2019 and 4.7% for 2020 for emerging market and developing economies.

Figure 1.1 Global growth, Advanced and Emerging economies



Source: IMF World Economic Outlook

Among advanced economies, the US economy grew at 2.1% in the second quarter of 2019, while the economies of the UK and Germany contracted by 0.2% and 0.1% respectively. Among the emerging economies, China's economy slowed to 6.2%, India's economy grew by 5% and Turkey's economy contracted by 1.5%.

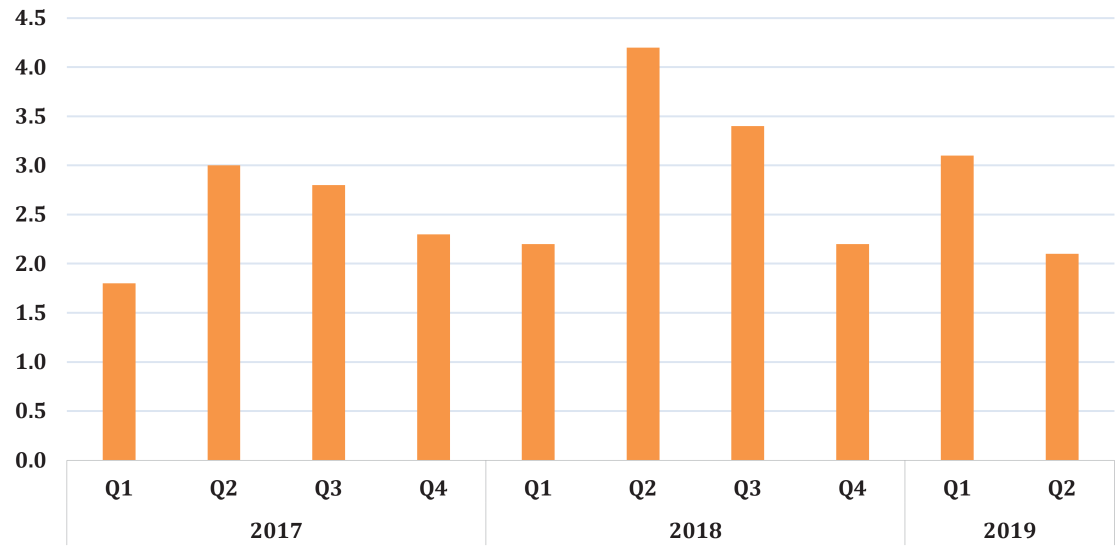
1.1 Advanced Economies

1.1.1 The Economy of the United States

According to the Commerce Department, growth slowed down in the second quarter of 2019. GDP increased 2.1% in this quarter compared to 3.1% growth in the first quarter of 2019, which is the lowest growth since Donald Trump took office.

The government and consumer spending contributed positively to the growth, while business investment had weighted down on growth. Personal consumption expenditure increase to 4.3%, government consumption expenditure and gross investment rose 5%, the fastest since Q2 of 2009. On the other hand, the gross private investment plunged 5.5% and the spending on structures fell by 10.6%. Uncertainties arising from trade tensions, which have been a major driver of business sentiment in this period.

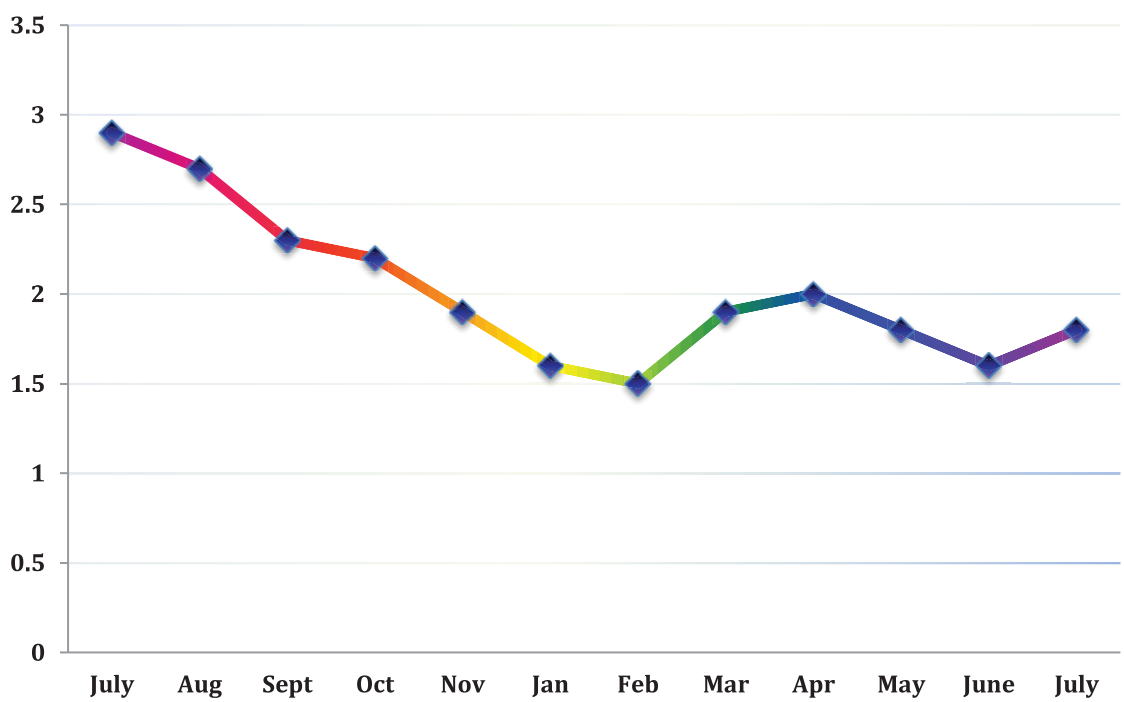
Figure 1.2: The United States GDP growth (percent change from previous quarter)



Source: US Bureau of Economic Analysis

CPI inflation averaged 1.73% in the second quarter of 2019 as illustrated in the table below. While central bankers worry over rates, corporate profits have proven to be more resilient than expected, and analysts believe that the economy, though slowing, remains strong enough to support earnings.

Figure 1.3: The United States Inflation Rate (CPI)



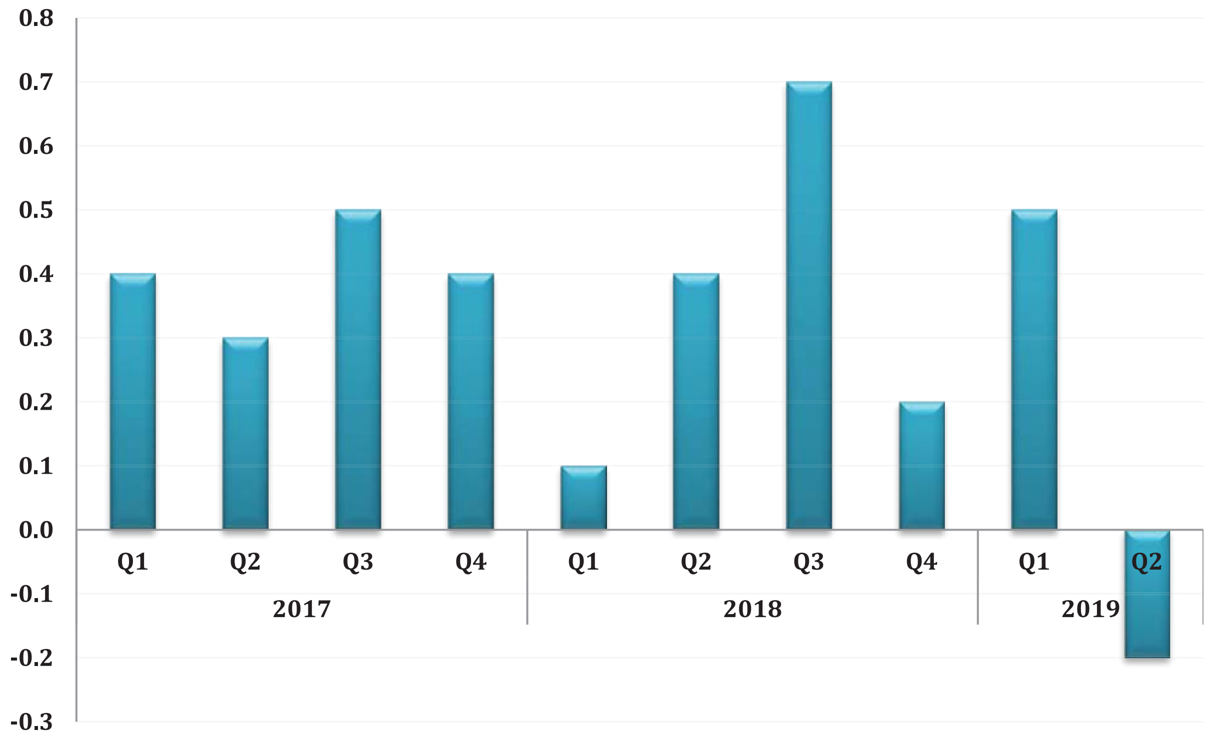
Source: The U.S. Bureau of Labour Statistics

1.1.2 The Economy of United Kingdom

Following a growth of 0.5 percent in the first quarter of the year, the GDP of the UK contracted by 0.2% in the second quarter of 2019.

The GDP grew 1.2% year on year in (Apr to June) basis against 1.8% (Jan-March) of 2019. Further-more, Nominal GDP increased by 0.4% down in this quarter from 0.9% in the first quarter of 2019.

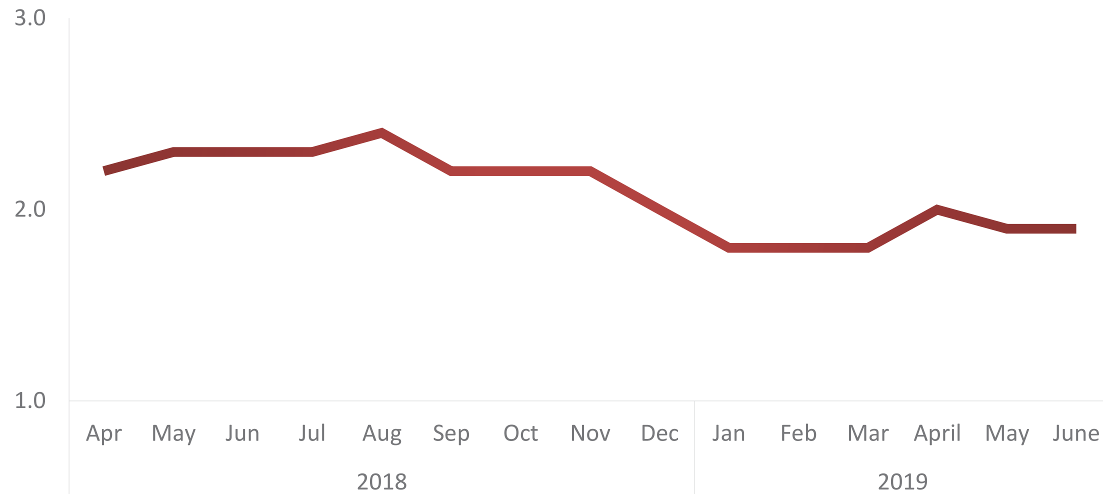
Figure 1.4: United Kingdom GDP growth rate (percent change from previous quarter)



Source: Office for National Statistics

Production, services and manufacturing outputs fell in this quarter. Production output declined by 1.4%, which was affected by a 2.3% decline in manufacturing output. Manufacturing output picked up sharply in the first quarter, however the decline in the second quarter is considered to be the sharpest decline since 2009. Further-more, services output growth slowed by 0.1%, which positively contributed to GDP growth, is the weakest in three years and lower than 0.4% of the first quarter. Construction output grew by 1.3% against a growth of 1.4% in the previous quarter.

Figure 1.5: UK CPI inflation rate (percent change over 12 months)



Source: Office for National Statistics U.K

The volatility mainly sources from changes in timing of activity related to the UK's original exit plan form European Union. Sterling has dropped by 3% against the US currency since Boris Johnson became prime minister.

1.1.3 The Economy of Germany

The economy of Germany, which is the largest economy in Europe, contracted to 0.3% in the second quarter from 0.4% growth in the first quarter of 2019. The contraction is attributed mainly to global and Brexit uncertainties and trade war. Industrial output for June dropped over 5% compared to the previous year and economic sentiment for August plunged sharply, hitting its lowest level since December 2011.

The German economy depends largely on exports to the United States and China. German auto industry has been hit by the U.S-China trade dispute and the uncertainties arising from it.

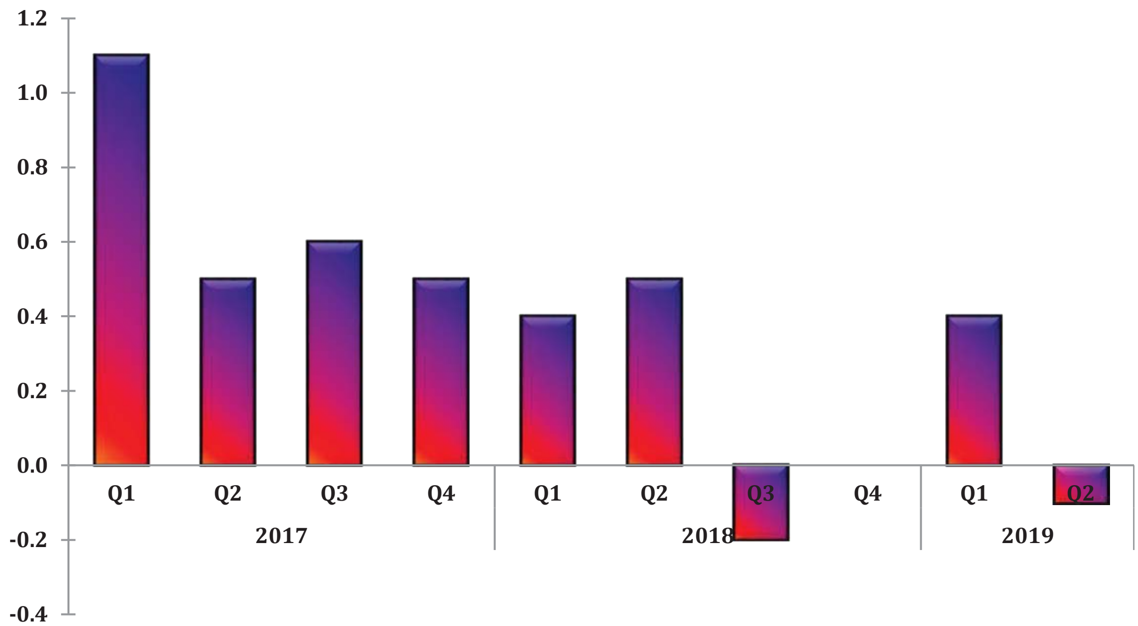
China, the largest market for German auto industry has experienced a thirteen months' decline in the sales of new cars in a row. Furthermore, there is a global decline in auto industry demand. Moreover, uncertainties pertaining to Brexit have also weakened the business sentiment in the second quarter.

1.1.4 The Economy of Japan

Japan GDP grew at 1.8% annualized rate in the second quarter against 2.2% growth of the first quarter of 2019, beating market expectations despite US-China continued trade war. The quarterly growth rate was 0.4% in this period against 0.1% forecasts. However, output is expected to shrink as the government is planning to increase sales tax.

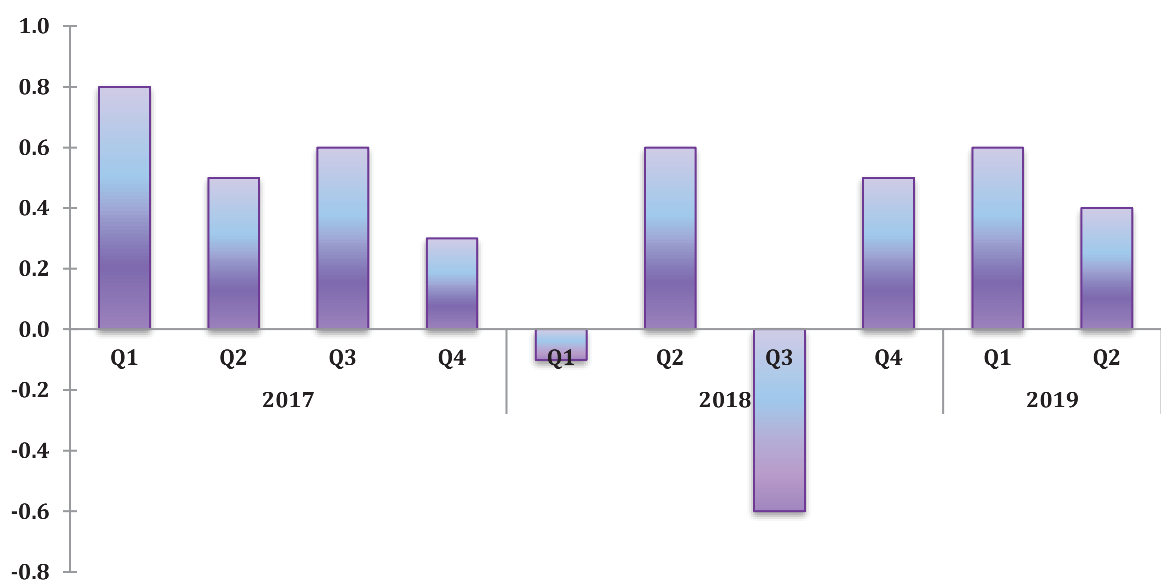
Despite a negative external demand as a result of slowdown in other trading partners, private consumption and capital investment have increased steadily resulting in gradual domestic demand recovery. Private consumption which accounts for more than half of gross domestic product played main role in GDP growth. However, spending increased 0.6% on quarter as consumers rushed to buy expensive items such as cars and air conditioners before the national consumption tax is raised in October to 10% from 8%.

Figure 1.6: Germany GDP growth rate (percent change from previous quarter)



Source: Federal Statistical Office and Organization for Economic Co-operation and Development

Figure 1.7: Japan's GDP growth rate



Source: Cabinet Office, Government of Japan

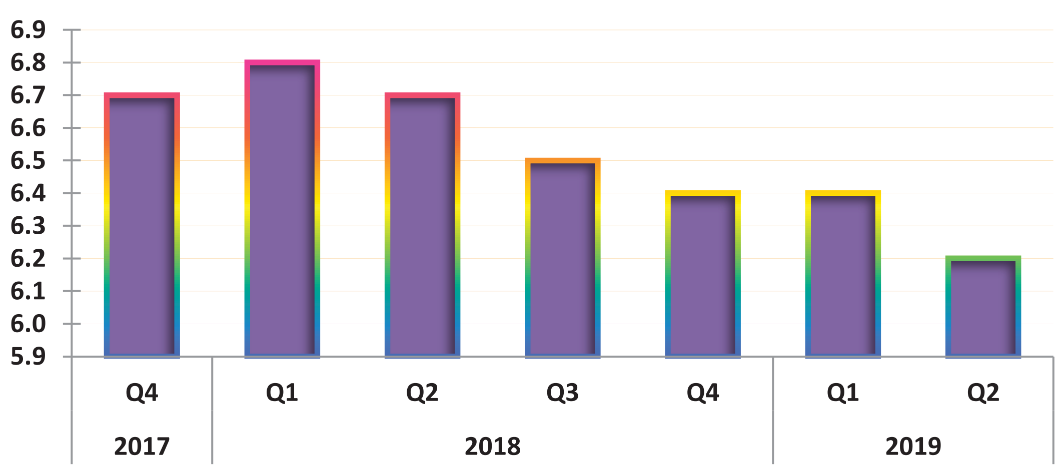
Likewise, capital expenditures rose 1.5% in the second quarter compared with the previous quarter as companies continued to make labour-saving investments, while exports declined 0.1% amid slowdowns in China and other Asian countries.

1.2 EMERGING Market Economies

1.2.1 The Economy of China

China's GDP growth slowed to 6.2% in the second quarter of 2019 as compared to the second quarter of 2018, the lowest in at least 27 years, as global and domestic demand declined and continued trade pressure from the US. The government has mainly focused on fiscal stimulus to support growth by introducing massive tax cuts around $291 billion and issued 2.15 trillion Yuan special bonds to boost infrastructure construction. Furthermore, the central bank is also planning to cut reserve requirement ratios (RRR) and use other financial tools to support small firms. However, the economy has been slow to respond to the stimulus and business investors have been cautious. However, recent data for industrial production, retail sales and fixed-asset investment on shows that the government's efforts may be starting to have an effect. However, recent data for industrial production, retail sales and fixed-asset investment shows that the government's efforts may be starting to have an ef--fect. In this period industrial output grew 6.3% from previous year; fixed-asset investment for the first half of the year rose 5.8% from a year earlier, beating analysts' 5.5% forecast. Retail sales for June rose 9.8%, sales of automobiles increased 17.2% in this month, increasing a 2.1% gain in May. Factory output and retail sales data depicts some signs of stabilization. On the other hand, financial markets and trading partners worry about US-China's trade war and fears global recession.

Figure 1.8: China's GDP growth rate (percent change from previous quarter)



Source: National Bureau of Statistics of China

1.2.2 The Economy of Turkey

According to the data released by Turkish Statistical Institute (TurkStat), Turkey's GDP at current price equalled to 1 trillion Turkish Liras (around $175 billion) in the second quarter of 2019. Following a contraction of 2.4 in the first quarter of 2019, Turkish GDP contracted by 1.5% compared to same quarter of 2018, less than 1.8 contraction projected by the economists. However, the growth on seasonally and calendar-adjusted basis from previous quarter was 1.2%.

This quarter, construction sector decreased by 12.7%, industrial output by 2.7%, an and services sector by 0.3% while, agriculture increased by 3.4% and net exports contributed 7.4% to the GDP growth.

However, the government projects stronger growth for the third and fourth quarter of 2019 and has targeted growth rate of 2.3% in the current year, 3.5% for 2020 and 5% growth rate for 2021.

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

Source: The Turkish Statistical Institute and Organization for Economic Co-operation and Development

1.2.3 The Economy of India

India's GDP grew by 5%, six years low, against 5.8% growth in previous quarter and 8% growth same period last year. The drop in GDP growth was mainly driven by low private consumption and slow growth in manufacturing sector.

In this quarter private consumption dropped to 3.1%, an 18-quarter low, manufacturing growth sharply declined to 0.6% against 12% growth in the same period in previous year. Agricultural growth also dropped to more than half. The data shows that Indian economy is experiencing a six-year low growth rate.

However, in service sectors trade hotels and communications grew at 7.1% against 6% growth in previous quarter while financial services and public administration services growth has declined in this quarter. Previously, RBI had projected the growth rate between 5.8% - 6.6% for the first half and 7.3%-7.5% for the second half of the fiscal year. The June quarter growth of 5% is way below RBI's 5.8% projection and this may cause the RBI to reduce the yearly projection. Furthermore, RBI has cut interest rate four times since the beginning of 2019, and the government has already announced several stimuli to boost the weak demand in the economy.

References:

Organization	**Websites**
International Monetary Fund	www.imf.org
Bureau of Economic Analysis, U.S. Department of Commerce, U.S.A.	www.bea.gov
Bureau of Labor Statistics, U.S. Department of Labor, U.S.A.	www.bls.gov
Office for National Statistics, U.K.	www.ons.gov.uk
Federal Statistical Office (DESTATIS), Germany	www.destatis.de
Cabinet Office, Government of Japan	www.esri.cao.go.jp
National Bureau of Statistics of China, People's Republic of China	www.stats.gov.cn
Ministry of Statistics and Program Implementation of India	www.mospi.gov.in
Turkish Statistical Institute	www.turkstat.gov.tr
Organization for Economic co-operation and Development	www.oecd.org

2

Money and Capital Market Development

2

MONETARY AND CAPITAL MARKET DEVELOPMENT

According to the monetary statistics, reserve money (RM) has experienced a positive growth of 2.76 percent at the end of the second quarter of FY 1398 (2019), but it had a negative growth of 3.95 percent from the beginning of the year till end of the second quarter of the FY 1398 (2019), greater than negative growth of 1.87 percent on quarterly basis and 7.22 percent from the beginning till end of the second quarter of the previous year. The reason for negative growth of RM was collection of more government revenues for the period under review. Currency in circulation (CiC) as a major component of RM recorded a growth of 4.25 percent in the second quarter and growth of 1.49 percent from beginning of FY 1398 (2019) to the end of second quarter.

Reserve Money (RM) and Currency in Circulation (CiC) growth, which are Da Afghanistan Bank's operational and indicative targets, remained well below the targets due to collecting additional liquidity from the market and banks during the course of the second quarter of FY under review.

Narrow money (M1), stood at AFN 448,920 million at the end of the second quarter of the year under review, registering a growth of 5 percent. Broad money (M2) demonstrated similar behavior, representing a growth rate of 4.06 percent, standing at AFN 483, 428.41 million at the end of the quarter under review.

In order to mitigate excessive fluctuations of AFN exchange rate against foreign currencies and manage liquidity in the market, DAB uses FX and CNs auctions under the open market operations. From the beginning to the end of second quarter of FY 1398 (2019), DAB has auctioned a total amount of USD 1,206.94 million and during second quarter DAB has auctioned USD 665 million to absorb the excess liquidity from the market and as well as to mitigate the sharp fluctuations in the exchange rate of Afghani against foreign currencies. The total outstanding amount of CNs stood at AFN 27.020 billion at the end of the second quarter of FY 1398 (2019).

Meanwhile, Afghani depreciated 6.61 percent against the USD during the second quarter and 7.23 percent during First half of FY 1398 (2019).

2.1 MONETARY PROGRAM

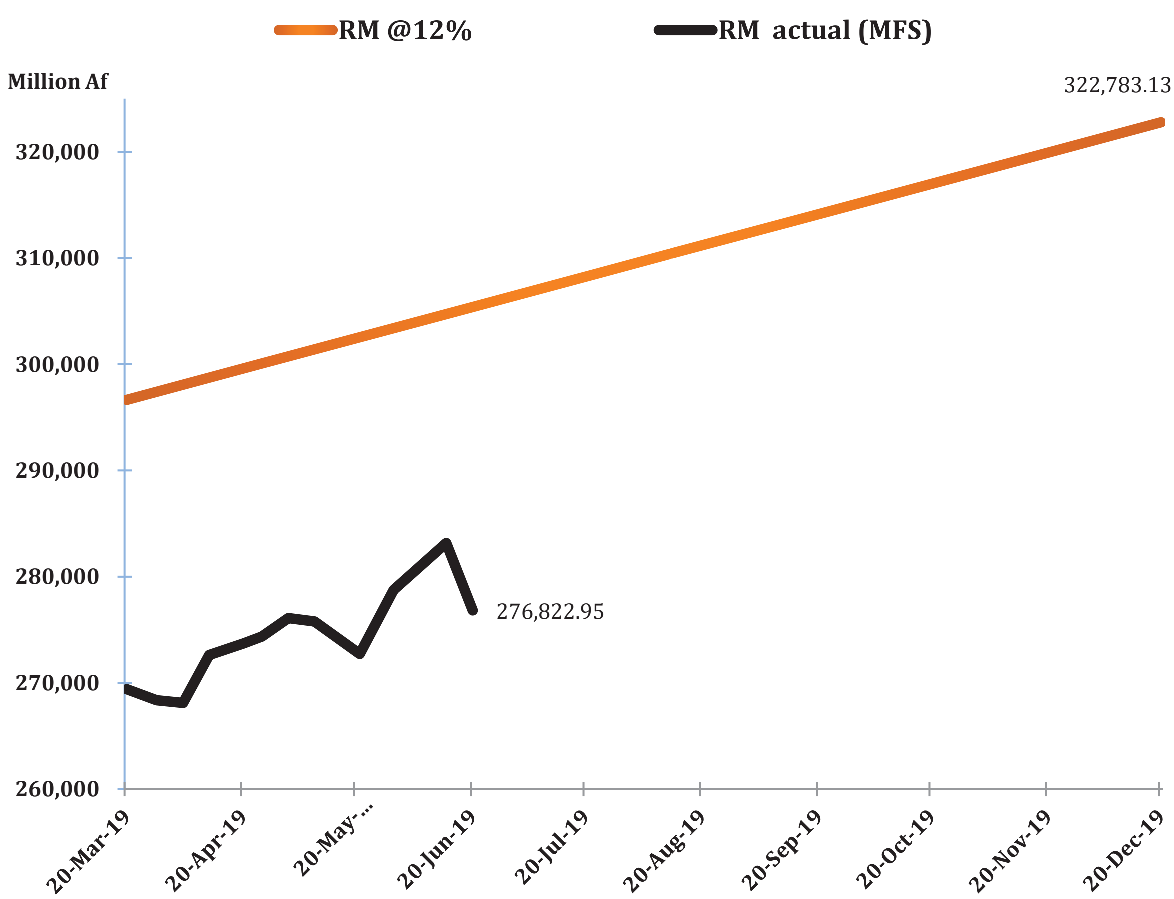
Reserve money remained the key operational target of the monetary policy during the second quarter of FY of 1398 (2019), while currency in circulation was set as the indicative target.

DAB applies quantitative theory of money to determine the amount of reserve money (RM) for 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 1398 (2019), the ceilings for reserve money and currency in circulation growth is 12 %. It is worth mentioning that in second quarter of the year actual RM and CIC respectively had growth by 2.76 and 25 percent, but they are still well below the targets during second quarter.

DAB has auctioned USD 1,206.94 million via open market operation to mop up the excess liquidity from the market and to prevent intense fluctuations of Afghani nominal exchange rate against foreign currencies, especially internationally convertible currencies.

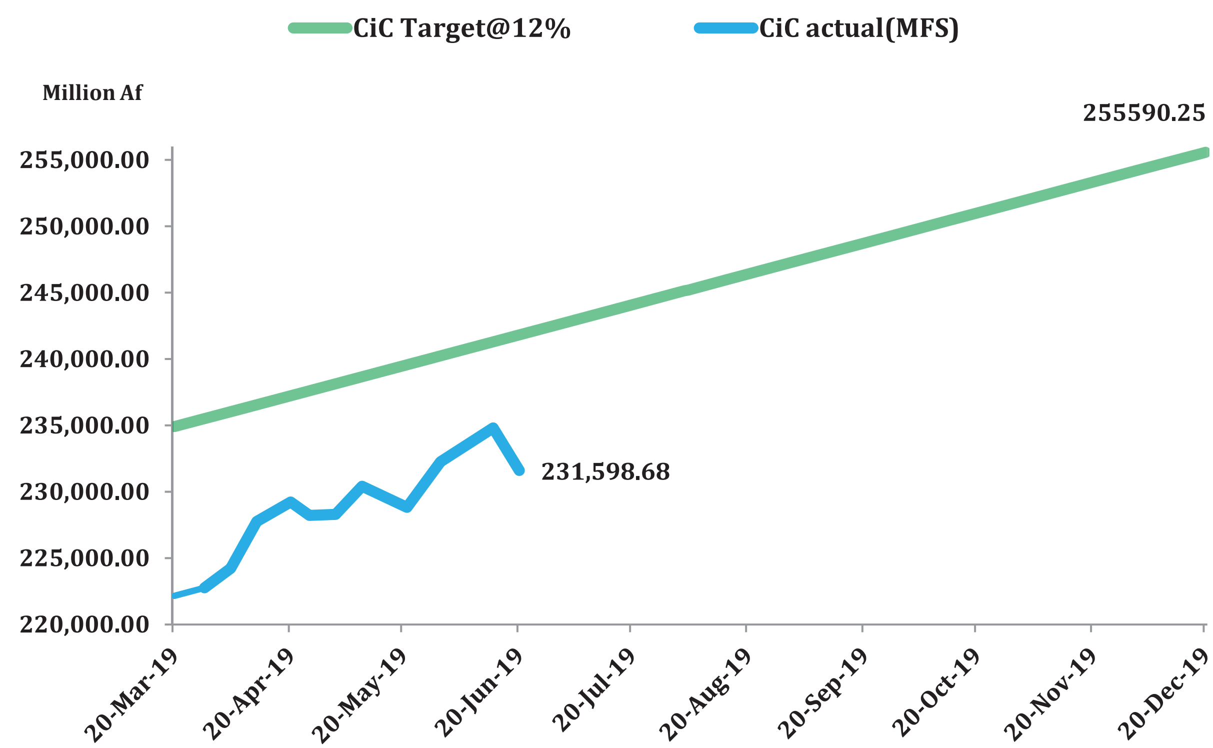
The Figures 2.1 and 2.2 illustrate the ceilings and the actual or reserve money and currency in circulation during the period under review.

Figure 2.1: Actual and Targeted Reserve Money for the 2nd Quarter of FY 1398 (2019)



Source: Monetary Policy Department/DAB

Figure 2.2: Currency in Circulation (CiC) for the FY 2019 (Mar, 22 - Jun, 21)



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. Narrow money (M1) includes currency outside depository corporations and demand deposits, while broad money (M2) includes narrow money components and other less liquid assets or quasi money.

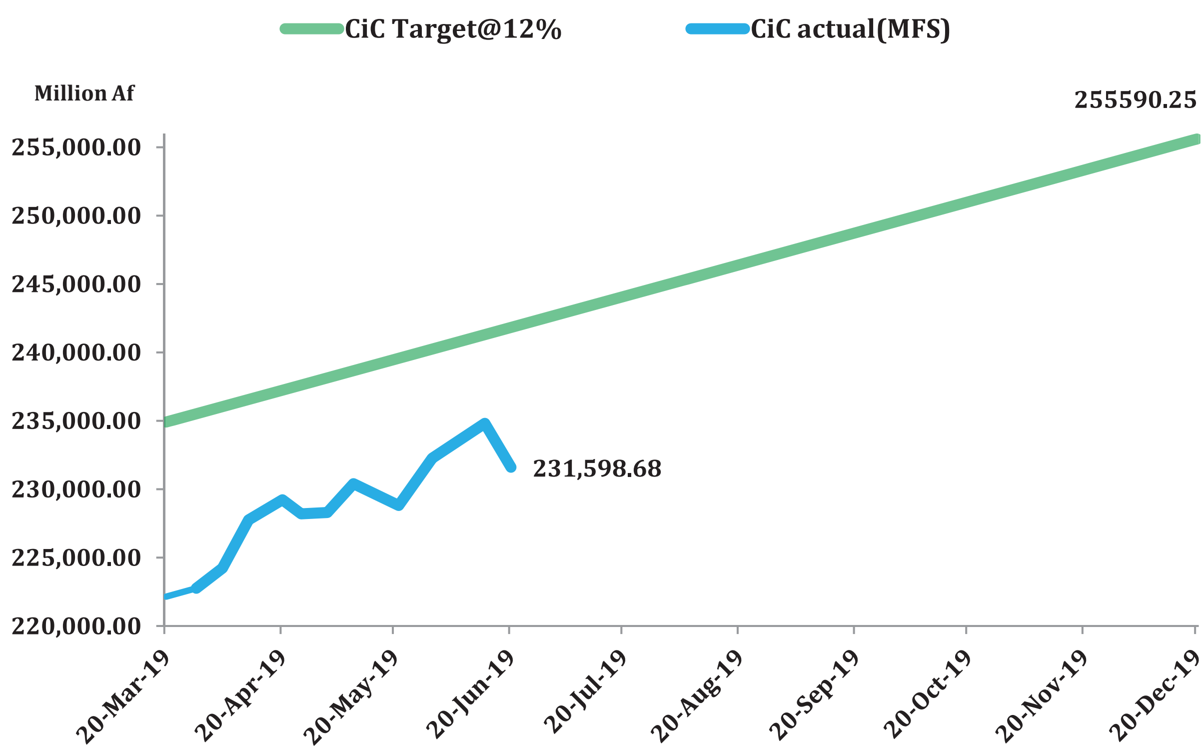
As shown in Table 2.1, narrow money (M1) grew by 5 percent at the end of the second quarter of fiscal year 1398 (2019), slight lower growth in the same period of FY 1397(2018), showing a difference of AFN 21,311 million. Currency outside depository corporations or CiC, which accounts for 46 percent of M2, grew by 2.15 percent, lower than 2.7 percent growth in the same period of the previous year, showing difference of AFN 4,658 million. Demand deposits, which are the other component of M1, experienced a growth of 7.91 percent at the end of second quarter of FY 1398(2019), while its growth rate was 11.3 percent in same period of previous year. Demand deposit in comparison with the same quarter of the previous year shows a difference of AFN 16,653 million.

Broad Money (M2) expanded by AFN 483,428.41 million in the quarter under review from AFN

464,578.79 million in the previous year, showing an increase of 4.06 percent, lower than 6.2 percent growth of the same period in the previous year.

Slower growth in broad money is mainly attributed to downward trend of other deposits. The data shows that M1 with a share of 92.86 percent remained the main contributing component of M2. Quasi money (other deposits), which is the other component of M2, had negative growth of 6.66 percent at the end of the second quarter of FY 1398 (2019). Quasi money constitutes 7 percent of broad money at the quarter under review, which is lower than 8 percent at the end of second quarter of FY 1398(2019). Therefore, the impact of changes in quasi money on M2 is negligible. The Afghani denominated time deposits stood at AFN 9,479 million, showing a negative growth of 24.74 percent, while the foreign currency denominated time deposits rose by 2.68 percent, reaching to AFN 25,030 million.

Figure 2.3: Net Foreign Assets, Net Domestic Assets and Broad Money

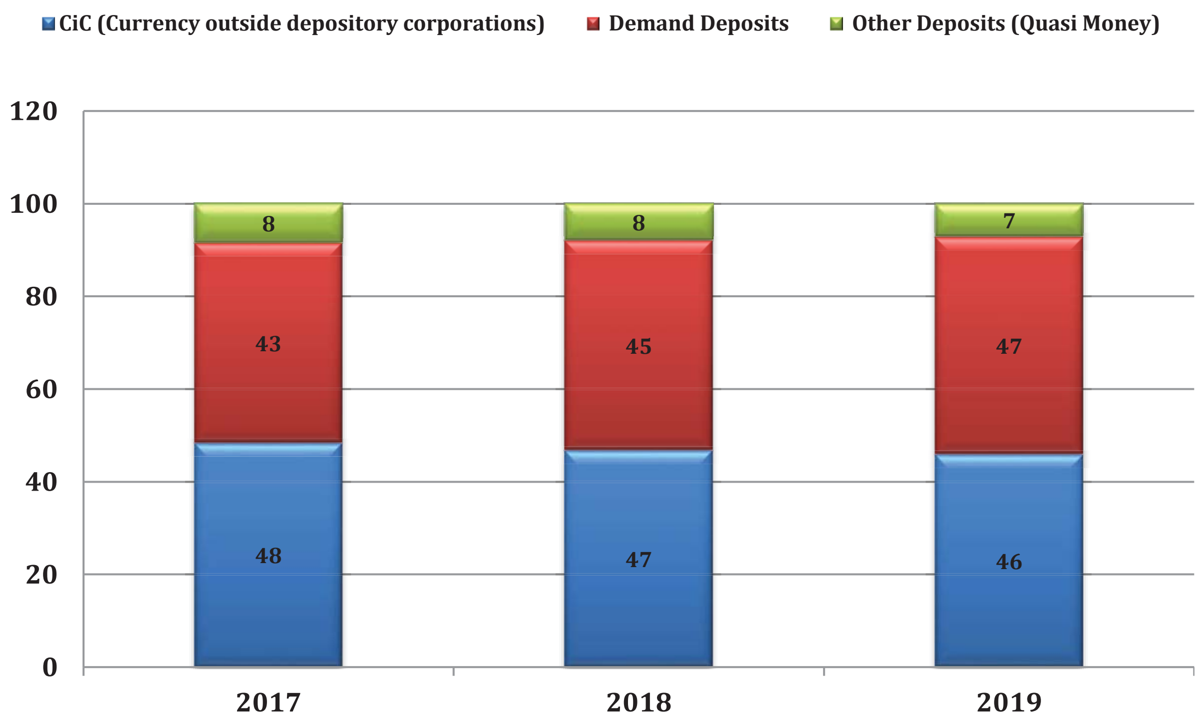


Source: Monetary Policy Department/DAB

Afghani-denominated time deposit decline and foreign currencies denominated time deposits incline attributed to downward trend of bank's AFN saving accounts and increase of foreign currency time deposits. Besides, depreciation of AFN exchange rate against USD also caused an increase in the converted amount of foreign currency time deposits. Data shows that in the period under review, one US dollar is exchanged at 80.87 AFN, while at the same period last year it was exchanged at 71.58 AFN. Afghani-denominated time deposits and foreign currencies denominated time deposits constituted 1.96 percent and 5.18 percent of M2 respectively.

Demand deposits as a share of broad money stood at 47 percent at the end of the second quarter of year under review (Figure 2.4)

Figure 2.4: Currency in Circulation (CiC), Demand Deposits and Quasi-money as Share of Broad Money (%)



Source: Monetary Policy Department/DAB

Table 2.1: Monetary aggregates for the second quarter of FY 1398

	Q2-17	Q2-18	Y-o-Y ∆	Difference	Q2-19	Y-o-Y ∆	Difference
Description	Amount in Million AFN			Amount in Million AFN			
1- Net Foreign Assets	591,422	681,524	15.2%	90,102	792,633	16.30%	111,110
(a) Foreign Assets	602,675	696,607	15.6%	93,931	804,388	15.47%	107,781
DAB Foreign exchange reserves	490,711	580,747	18.3%	90,036	667,752	14.98%	87,005
Gold	59,751	64,160	7.4%	4,409	78,342	22.10%	14,182
Other	430,961	516,587	19.9%	85,626	589,410	14.10%	72,823
Other foreign assets	111,964	115,860	3.5%	3,896	136,636	17.93%	20,777
(b) Foreign Liabilities	11,253	15,083	34.0%	3,830	11,755	-22.07%	-3,328
2. Net Domestic Assets	-151,356.13	-214,180.73	41.5%	-62,825	-306,582.36	43.14%	-92,402
(a) Net Domestic Credit	-30,071	-71,718	138.5%	-41,647	-95,554	33.23%	-23,835
Net Credit to Nonfinancial Public Sector	-76,438	-118,597	55.2%	-42,159	-144,854	22.14%	-26,257
Net Credit to Central Government	-76,532	-118,691	55.1%	-42,159	-144,948	22.12%	-26,257
Credit to Central Government	22,879	15,059	-34.2%	-7,821	7,185	-52.29%	-7,874
Liabilities to Central Government	99,411	133,750	34.5%	34,338	152,133	13.74%	18,383
Net Credit to State & Local Government	0.000	0.000	0.0%	0	0.000	0.00%	0
Net Credit to Public Nonfinancial Corporations	94	94	0.0%	0	94	0.00%	0
Credit to Private Sector	47,585	48,068	1.0%	483	50,033	4.09%	1,966
Net Credit to Other Financial Corporations	-1,219	-1,189	-2.4%	29	-733	-38.33%	456
(b) Capital Accounts	142,148	169,282	19.1%	27,134	232,552	37.38%	63,270
(c)Other Items Net	20,864	26,820	28.5%	5,956	21,523	-19.75%	-5,297
3- Broad Money(M2)	437,401.024	464,578.789	6.2%	27,178	483,428.41	4.06%	18,850
Narrow Money(M1)	400,621	427,609	7%	26,988	448,920	5%	21,311
CiC (Currency outside depository corporations)	211,412	217,067	2.7%	5,654	221,724	2.15%	4,658
Demand Deposits	189,209	210,543	11.3%	21,334	227,196	7.91%	16,653
Other Deposits (Quasi Money)	36,779.696	36,969.638	0.5%	190	34,508.488	-6.66%	-2,461
In Afghani	15,059	12,594	-16.4%	-2,465	9,479	-24.74%	-3,115
In Foreign currency	21,721	24,376	12.2%	2,655	25,030	2.68%	654
Securities Other Than Shares	0.000	0.000	0.000	0.000	0.000	0.000	0.000

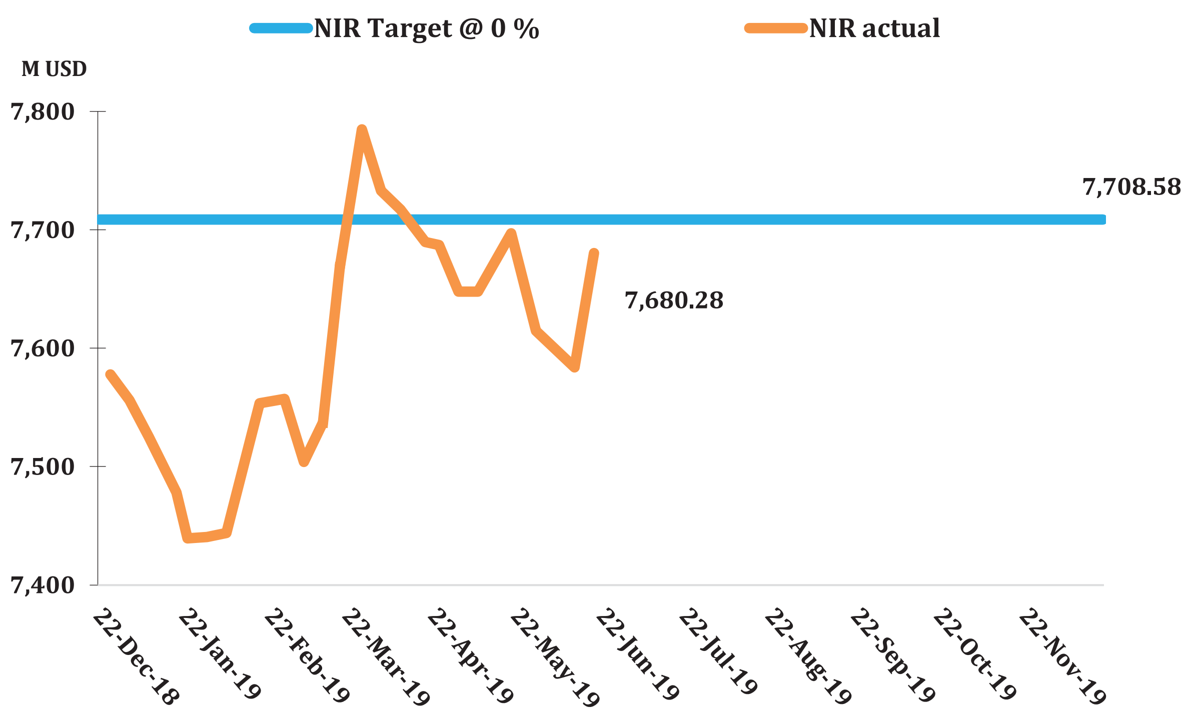
Source: Monetary Section, Monetary Policy Department/DAB

2.3 Net International Reserve (NIR)

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

NIR decreased slightly by 0.21 percent showing de-accumulation of USD 16.5 million at the end of the second quarter of FY 1398 (2019). NIR accumulation ceiling was set at USD 7,708.58 million, while in actual it reached to USD 7,680.3 million for the period under review.

Figure 2.5: Net International Reserve (NIR); Actual and target trend during 2nd quarter of FY 1398 (2019)



Source: Monetary Section, Monetary Policy Department/ DAB

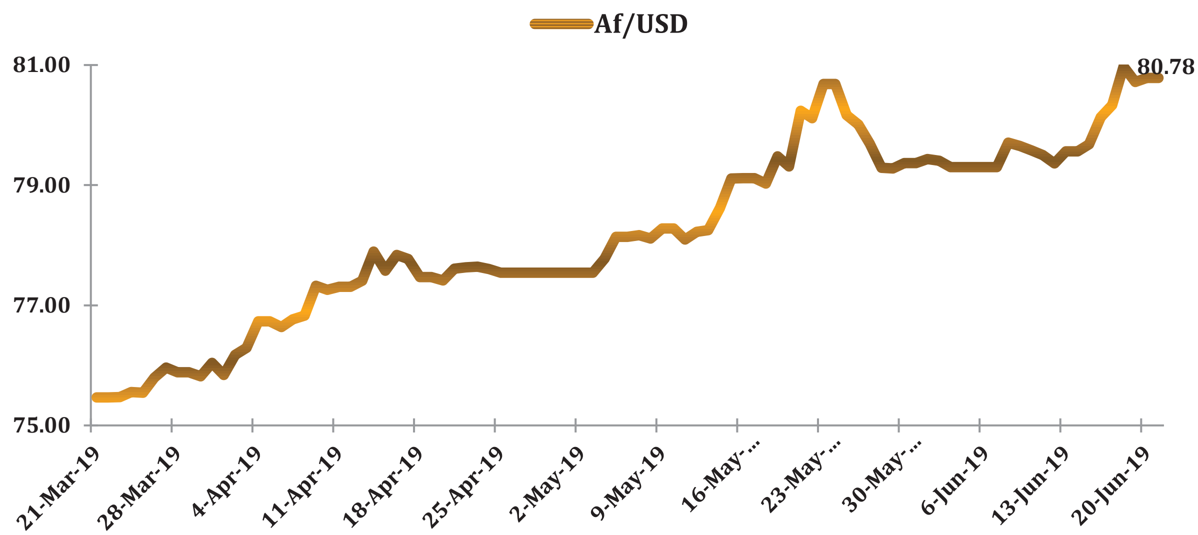
2.4 Foreign Exchange Market

➢ **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 second quarter of FY 1398 (2019), Afghani relatively depreciated against the Great

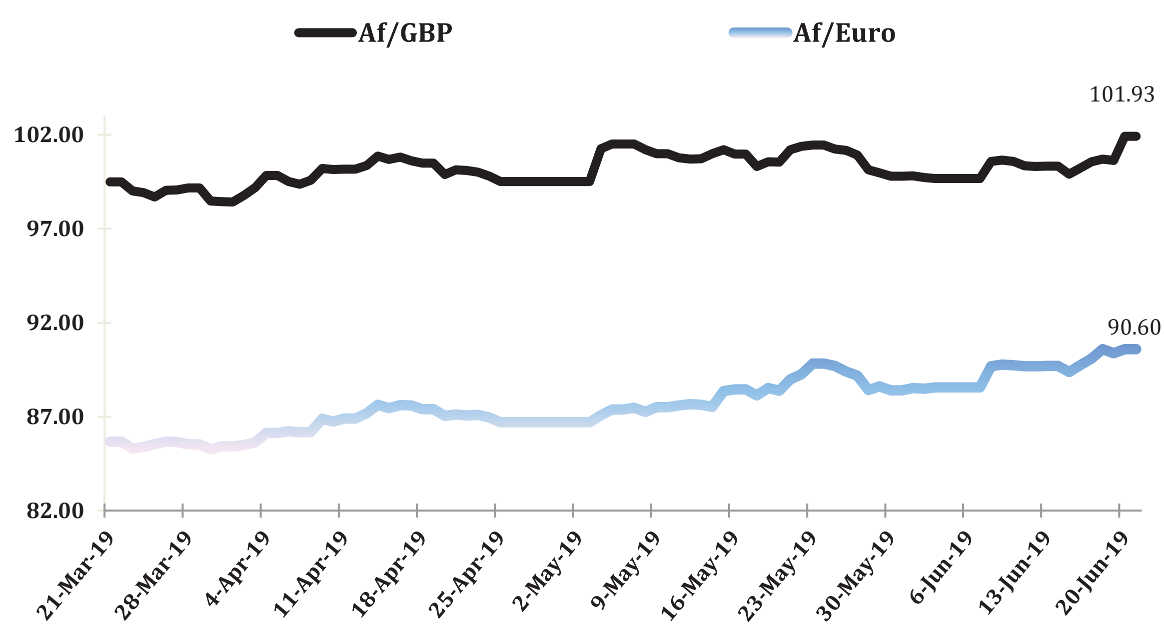
British Pound, Euro, Swiss Franc, United States Dollar, United Arab Emirates Dirham, Saudi Riyal and Indian Rupee, while it appreciated against Pakistani Rupee and Iranian Toman. The daily historic review of the average exchange rate of Afghani against the U.S. dollars and other foreign currencies during the review period are shown in figures below.

Figure 2.6: Daily average ex- rate of Afghani against USD during the 2nd quarter of FY 1398 (2109)



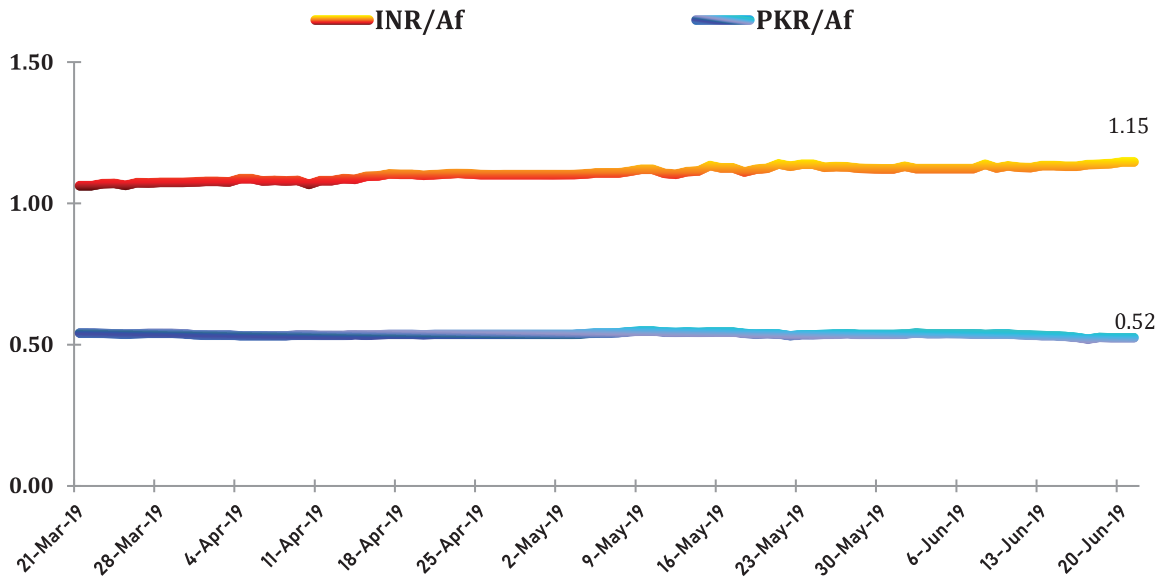
Source: Monetary Policy Department/DAB

Figure 2.7: Daily average ex- rate of Afghani against GBP and Euro during the 2nd quarter of FY 1398 (2019)



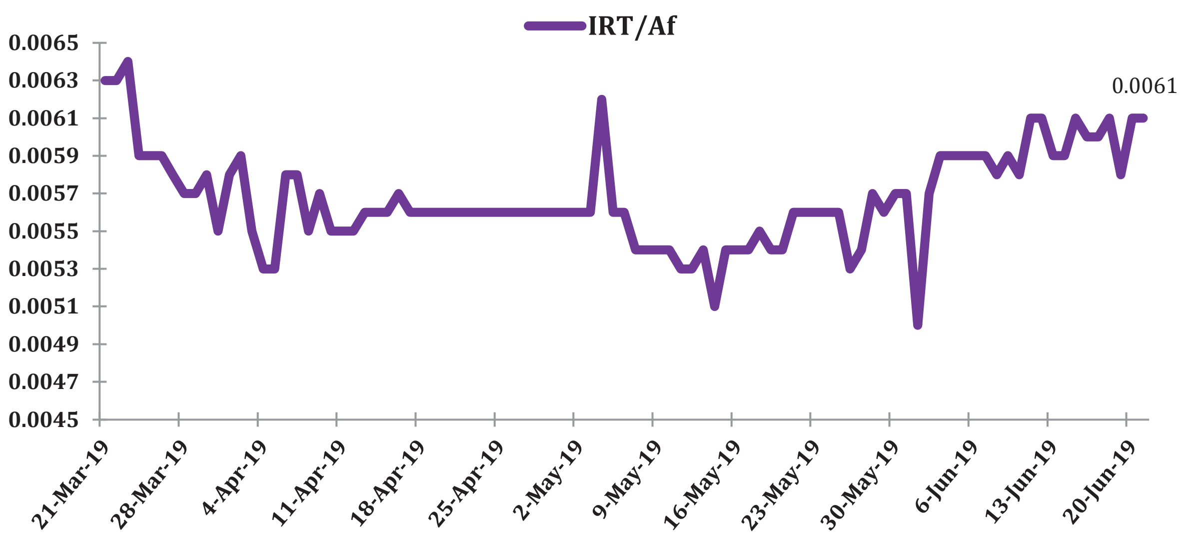
Source: Monetary Policy Department/DAB

Figure 2.8: Daily average ex-rate of Afghani against INR and PKR during the 2nd quarter of FY 1398 (2019)



Source: Monetary Policy Department/DAB

Figure 2.9: Daily average ex- rate of Afghani against IRT during the 2nd quarter of FY 1398 (2019)



Source: Monetary Policy Department/DAB

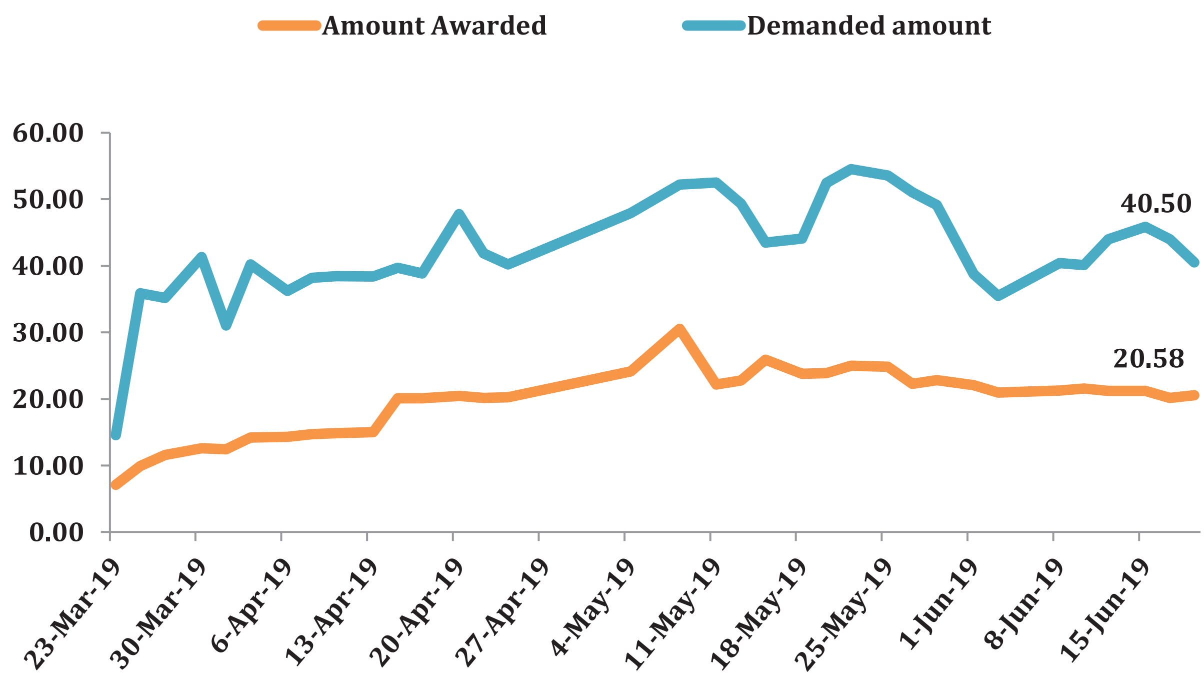
➢ Foreign Exchange Auction

In order to control the money supply and maintain price stability in domestic market, DAB manages the reserve money growth by conducting FX (USD) auction three times a week and a weekly capital notes auction, which are the primary monetary instruments. DAB continued the FX auction to mop up excess liquidity from the market and to smooth out excessive volatility of the exchange rate of Afghani against foreign currencies, especially the U.S dollar. During the second quarter of FY 1398(2019), DAB auctioned a total amount of USD 665 million, while the total demand was USD 1437.20 million. The main reason for higher demand for US Dollar was the AFN depreciation against US Dollar.

On average, 59 bidders participated in each auction and 43 bids were announced as the winning bids with the average amount of USD 19.56 million sold in each auction and the total withdrawal is recorded AFN 52.188 billion. The data for the second quarter of FY 1397(2018) recorded a total auctioned amount of USD 528.83 million, with a total demand of USD 753.44 million.

On average, 50 bidders participated in each auction and 38 bids were awarded with an average amount of USD 19.58 million in each auction and the total withdrawal is recorded AFN 37.306 billion. Figure 2.10, shows the total amount of USD awarded and demanded through auctions in the second quarter of FY 1398(2019).

Figure 2.10: USD awarded and demanded during the 2nd quarter of FY 1398 (in millions)



Source: Monetary Section, Monetary Policy Department/DAB

2.5 OPEN MARKET OPERATION & LIQUIDITY CONDITIONS

2.5.1 Capital Notes Auction

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

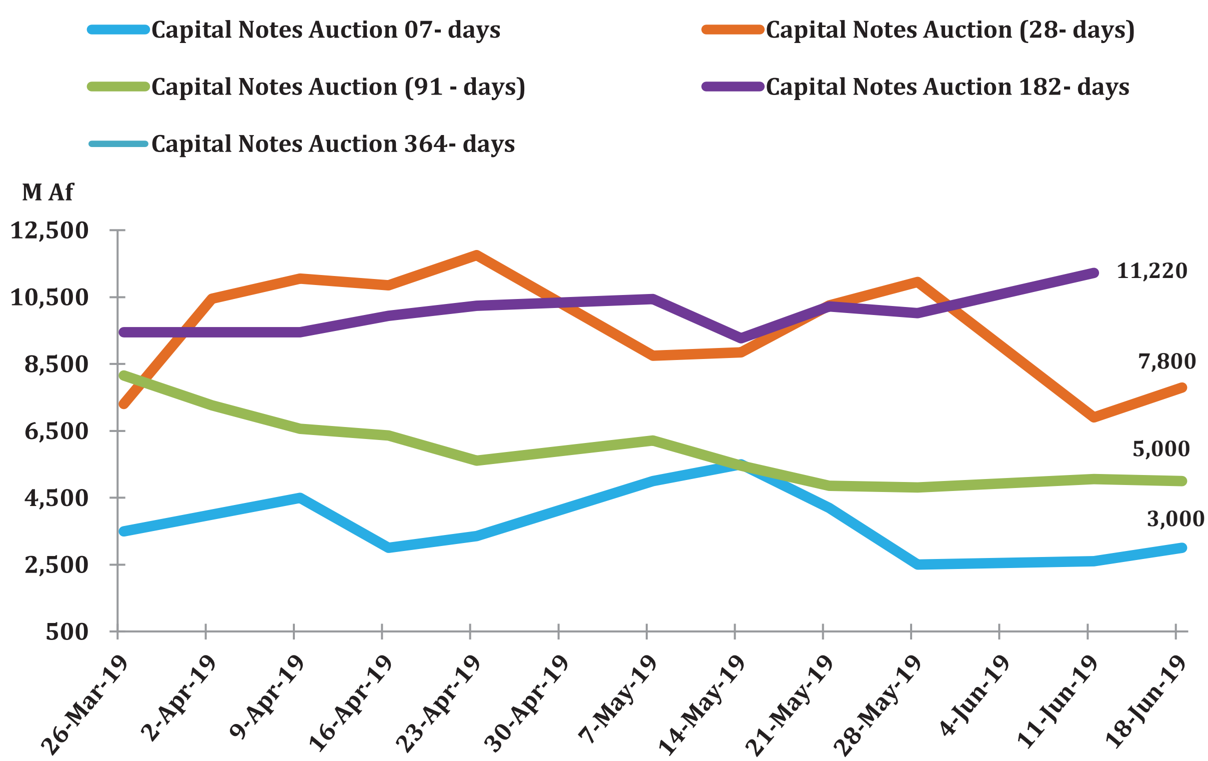
Da Afghanistan Bank uses Capital Notes (CNs) as a monetary tool to manage the money supply growth. Capital notes are used to absorb the excess liquidity of the commercial banks.

Currently, DAB offers capital notes with the maturities of one week, one month, three months, six months and one year. Total outstanding stock of capital notes reached AFN 27.020 billion at the end of the second quarter FY 1398 (2019), which shows a decrease of AFN 10.490 billion compared to AFN 37.960 billion the end of the second quarter of FY 1397 (2018). The main reason for the decrease of outstanding compared to same period of last year was less CNs sales. The

Outstanding stock of 7-days capital notes stood at AFN 3 billion, 28-days CNs outstanding amount stood at AFN 7.8 billion, and 91 days outstanding stock of CNs recorded the amount of AFN 5 billion.

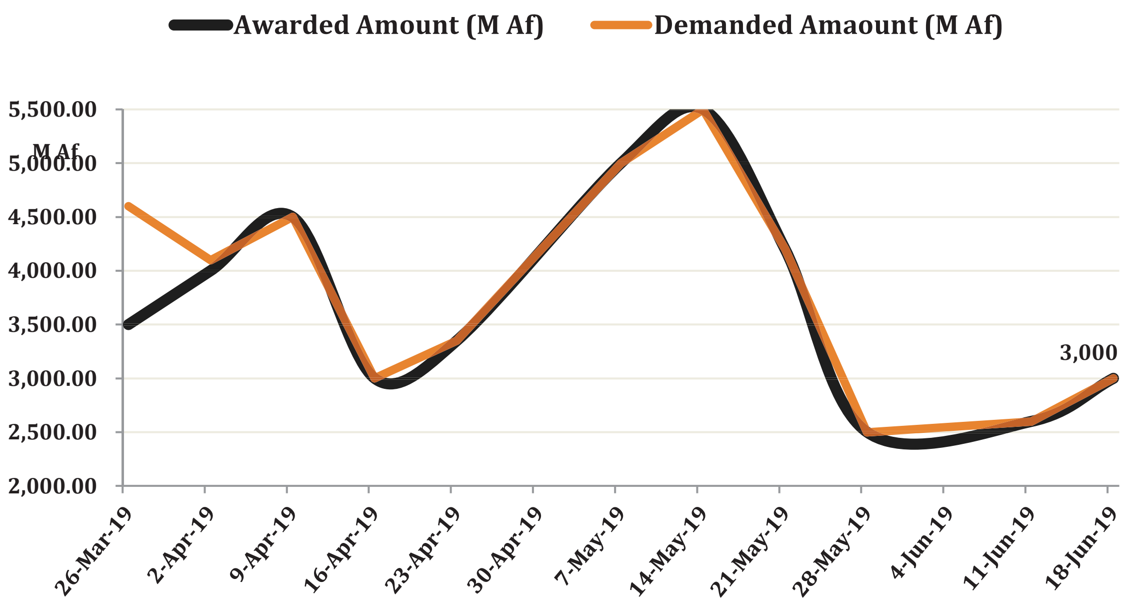
The stock of outstanding for 182 days stood at 11.22 billion and as there was no auction for the CNs of 364-days, therefore no outstanding amount is recorded for this period. Total interest paid to CNs figured out to AFN 55.17 million till the end of the second quarter under review. In addition, the weighted average interest rate for 7-days capital note was 0.16 percent, for 28 days' security recorded at 0.36 percent, for 91 days' notes were 0.53, for 182 days' notes were 0.73 and for 364 days there was no auction in capital notes from beginning to the end of the second quarter of FY 1398 (2019).

Figure 2.11: Stock of outstanding Capital Notes for the 2nd Quarter of FY 1398 (2019)



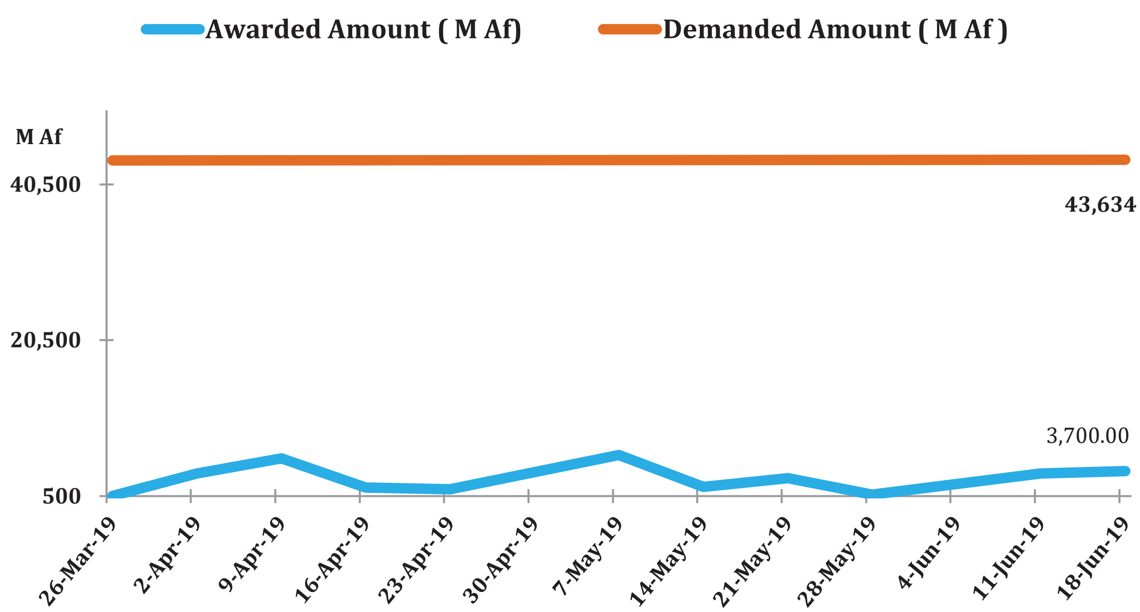
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.12: Demanded and awarded amount for 7-days Capital Notes during the 2nd quarter of FY 1398 (2019)



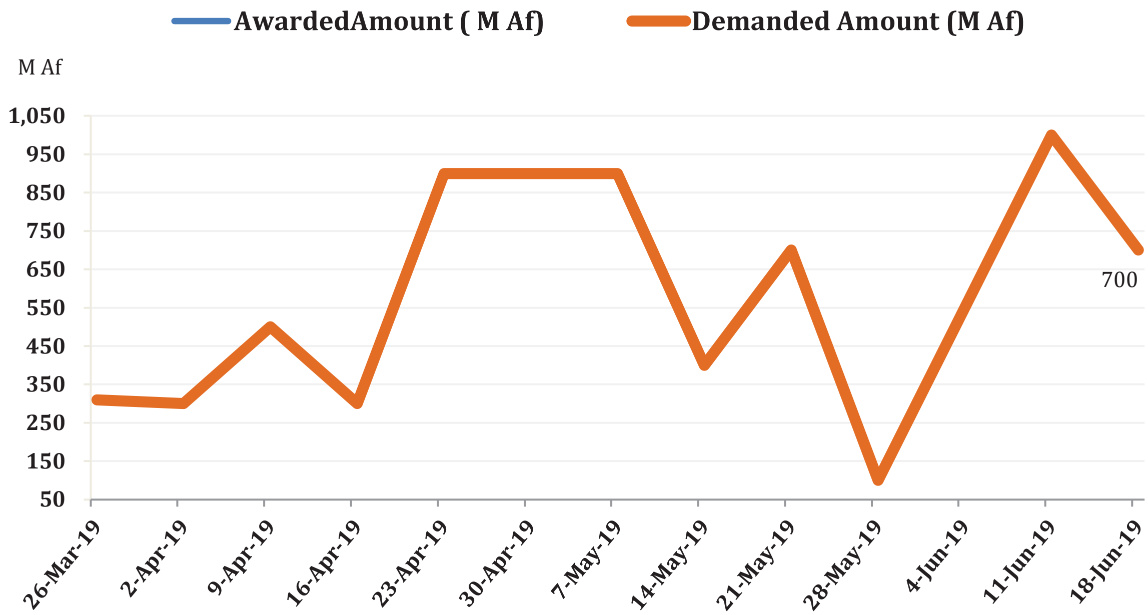
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.13: Demanded and awarded amount for 28-days Capital Notes during the 2nd quarter of FY 1398 (2019), in million AFN.



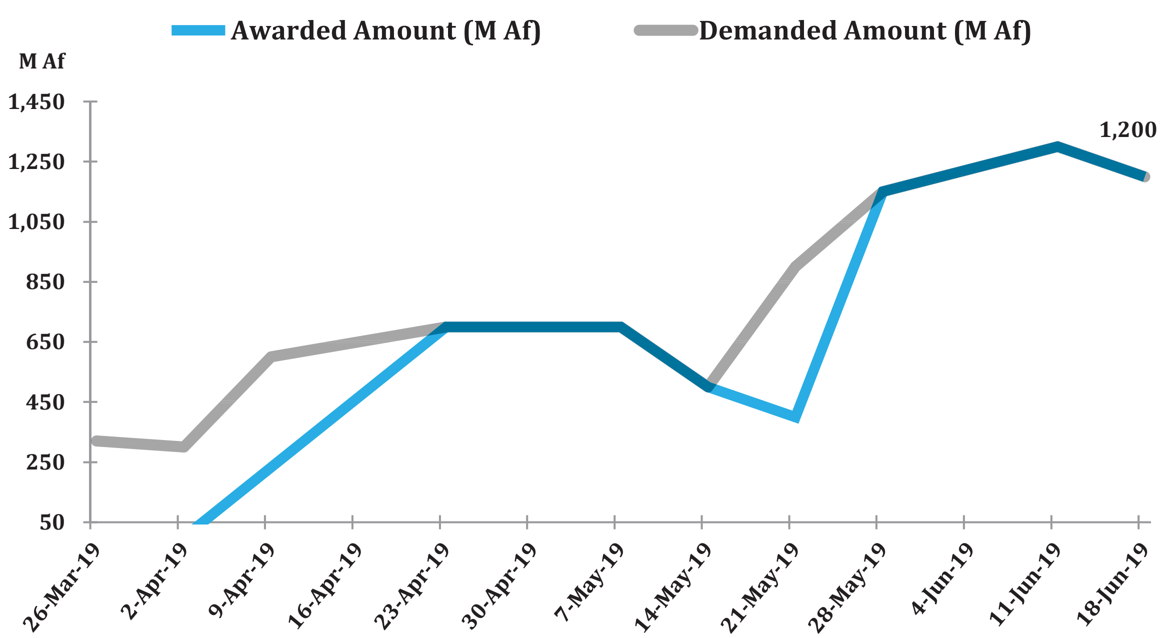
Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.14: Demanded and awarded amount for 91-days Capital Notes during the 2nd quarter of FY 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

Figure 2.15: Demanded and awarded amount for 182-days Capital Notes during the 2nd quarter of FY 1398 (2019)



Source: Monetary Sector, Monetary Policy Department/ DAB

2.5.2 Required and Excess Reserves

Commercial banks are required to hold 8 percent of their total deposits as obligatory reserves with DAB for their Afghani denominated accounts and 10 percent for foreign currency denominated accounts. Now the required reserves are held in the currency of denomination (Domestic and foreign), unlike the previous practice, which required reserves for all deposits were maintained in domestic currency. No interest is given for such deposits to commercial banks. It shows AFN 6,047.53 million, USD 209.427 million and Euro 19.231 million recorded during the first quarter of FY 1398 (2019).

- **Overnight Deposit Facility (ODF)**

This facility is available to all commercial banks to gain interest on their excess balances. The interest rate on the overnight deposit facility, 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 AFN 7,415.90 million at the end of the second quarter of FY 1398 (2019) and the payment of interest rate to the mentioned facility reached to AFN 2.235 million for the period under review.

- **Overnight Credit Facility (OCF)**

This facility is used by banks for short term cash needs. The facility allows banks to borrow Afghani from Central Bank on an overnight basis when they face a shortfall in cash flow. The rate that the commercial banks are charged for this facility is 10 basis points above the last 28 day CNs auction. This borrowing is collateralized with outstanding capital notes only. During the period under review, no bank had used from credit facility.

3

Inflation Trend and Outlook

3

INFLATION TREND AND OUTLOOK

Commodity prices gained momentum in the second quarter of 2019 following last year's declines, and many have recovered from the previous quarter's lows. The raw material markets posted a small loss in the second quarter of 2019 even though the dollar index moved lower as trade issues between the US and China remained unresolved on the final trading day of the first half of the year. The commodity asset classes consisting of 29 of the primary commodities that are traded on U.S and U.K exchanges moved 1.17% lower in Q2 but were still 5.23% higher over the first six months of this year. In 2018 the asset class had lost 6.82% of its value.

Natural gas prices fell sharply in March and April in part due to rising liquefied natural gas exports from the United States and Australia, which also weighed on the prices of coal as a close substitute to natural gas. Oil prices are expected to decline from recent highs and average $66/bbl. in 2019 and $65/bbl. in 2020, with risks around this outlook broadly balanced. Most agricultural commodity prices rose moderately in the first quarter of 2019, following considerable declines during the second half of last year. The World Bank's Agriculture Price Index increased 0.9 percent in the quarter (q/q), as a 3.4 percent decline in beverages was balanced by moderate gains in all other categories. The index was still 5.6 percent lower than a year ago. Most of the factors that depressed prices last year have moderated, including easing of trade tensions and lower prospective plantings in the U.S. for next season's crop. The index is expected to decline 2.6 percent in second quarter 2019.

Crude oil prices fell 6 percent in the first quarter of 2019 (q/q) following 11.5 percent decline in the previous quarter. Non-energy prices in 2019 are expected to remain below 2018 averages, before rising moderately in 2020 as the global economy emerges from its recent soft patch. A Special Focus section illustrates the adverse poverty implications of food price spikes that tend to be amplified by commonly used trade-related government responses.

Energy: Energy prices partially recovered in the first quarter of 2019, following a steep decline in almost all energy prices in the preceding quarter. However, there has been significant divergence between different energy commodities. Oil prices have risen 34 percent since the start of the year, amid production cuts by the Organization of the Petroleum Exporting Countries (OPEC) and other producers, and supply disruptions elsewhere. In contrast, natural gas prices fell sharply in March and April in part due to rising liquefied natural gas exports from the United States and Australia, which also weighed on the prices of coal as a close substitute to natural gas. Oil prices are expected to decline from recent highs and average $66/bbl. in 2019 and $65/bbl. in 2020, with risks around this outlook broadly balanced.

Non-energy: Having fallen or having remained subdued in the last quarter of 2018, most non-energy prices had recovered their losses by March, with particularly strong rebounds in metals and minerals. This recovery in metal prices reflected improving growth prospects for China—which accounts for half of global consumption—as well as a series of supply bottlenecks and concerns: The Vale dam accident in Brazil (iron ore, nickel); heavy floods in Chile (copper); protests in Peru (copper); smelter restrictions in response to environmental concerns in China (lead, zinc); and export restrictions in Indonesia (tin). Similarly, supply factors buoyed the return to 2018 levels for most agricultural commodity prices. These included weather-related planting delays for U.S. wheat and corn as well as lower expectations for U.S. soybean plantings on concerns about trade tensions.

Agriculture: Most agricultural commodity prices rose moderately in the first quarter of 2019, following considerable declines during the second half of last year. The World Bank's Agriculture Price Index increased 0.9 percent in the quarter (q/q), as a 3.4 percent decline in beverages was balanced by moderate gains in all other categories. The index was still 5.6 percent lower than a year ago. Most of the factors that depressed prices last year have moderated, including easing of trade tensions and lower prospective plantings in the U.S. for next season's crop. The index is expected to decline 2.6 percent in 2019 and increase 1.7 percent in 2020 due to lower production and higher fertilizer prices. Downside risks to the forecast emanate primarily from an escalation of trade tensions. On the upside, higher energy prices could lift the cost of energy-intensive crops, notably grains and oilseeds. Higher-than-projected demand for bio-fuels could also induce higher prices for some commodities.

3.1 CONSUMER PRICEs IN AFGHANISTAN

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

The year-on-year measure of changes in the consumer price index showed an inflation rate of 4.2 percent on average in the second quarter of 2019 higher than -1.1 percent recorded in the second quarter of the previous year on average bases. The increase in the inflation rate is in line with high prices of commodities in the global markets. Based on the reports, most items of the global commodity price index indicated high prices in second quarter of 2019.

Similar to the year-on-year comparison, the inflation measured on quarter-on-quarter basis, also indicated an upward incline in the period under review. Observing the previous quarter data, the average inflation rate increased to 4.2 percent in the second quarter of 2019, higher than average rate of 0.8 percent in the previous quarter.

The Kabul CPI also reflected inflation in the second quarter of 2019. Observing the Kabul headline CPI, the inflation rate increased to 4.27 percent on average in the second quarter of 2019 from 0.22 percent in the same quarter of the previous year. On quarterly basis, the index on average bases increased to 4.27 percent on average from 0.92 percent in the previous quarter.

3.2 Developments in National Headline Inflation

3.2.1 Annual Developments (Y/Y)

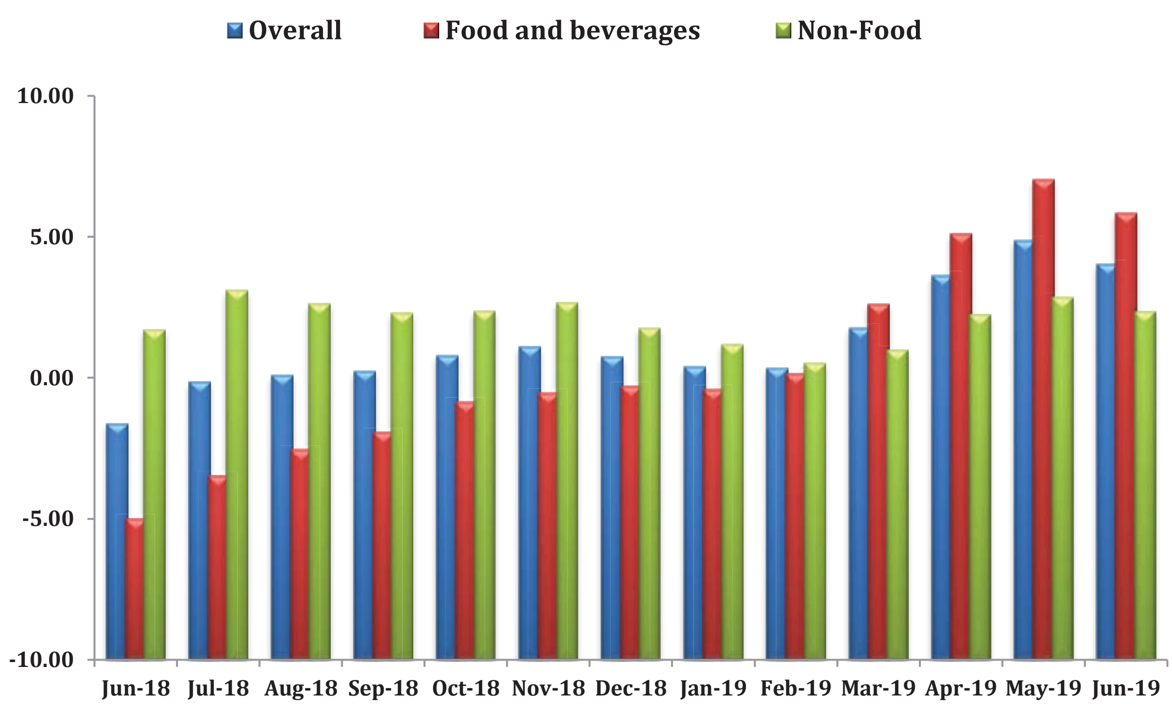
The headline consumer price index reflected an upward incline on year-on-year basis in the second quarter of 2019. As per the available data, the headline inflation measured on year-on-year basis, increased to 4.2 percent on average in the second quarter of 2019 from -1.1 percent in the same period of last year while on monthly basis 2019, the inflation rate was recorded at 3.63 percent, 4.88 percent, and 4.03 percent in the months of April, May, and June respectively.

In the food index, the inflation increased to 6.0 percent on average in the second quarter of 2019 from -3.7 percent in the same quarter of the previous year. In the above mentioned index, the inflationary pressures came from high prices of, milk cheese and eggs, sugar & sweets, spices and vegetables. The highest increased in the index was recorded in the prices of spices and vegetables which increased to 17.9 percent and 4.3 percent on average from -21.0 percent and -15.0 percent in the same quarter of the previous year. On the other hand, the decrease was only observed in the price index oil and fats which decreased to (-3.5) percent on average in the quarter under review from (-1.3) percent in same quarter of the previous year.

In the non-food category, the inflation was increased by higher prices of tobacco, clothing, furnishing & household goods, health, transportation information & culture and restaurants and hotels while inflation declined in the prices of housing, communication, education and miscellaneous goods. Overall inflation in non-food category increased to average 2.5 percent from 1.6 percent in the second quarter of 2019 compared to same quarter of previous year. In the mentioned category, the highest increase was noticed in price index of health, furnishing and household goods, and information and culture which increased to 4.4, 4.6 and 2.0 percent on average in the second quarter of 2019 from 0.2, 2.1 and -0.8 percent recorded in the second quarter of 2018. On the other hand, price index of education and communication decreased to -1.3

and -3.5 percent on average in the second quarter of 2019 from 10.2 and 0.1 percent in the same period of previous year respectively. The core inflation showed upward slope in the second quarter of 2019 compared to the second quarter of 2018. The trimmed mean which is the most common measure of core inflation, jumped to 3.8 percent on average in the second quarter of 2019 from 0.7 percent in the same period of last year. In addition, the CPI inflation, excluding bread and cereals, oil and fats and transportation, increased to 3.7 percent in the second quarter of 2019 up from -1.5 percent in the same period of previous year.

Figure 3.1: Yearly National Headline Inflation for FY 1398 (Y-o-Y)



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

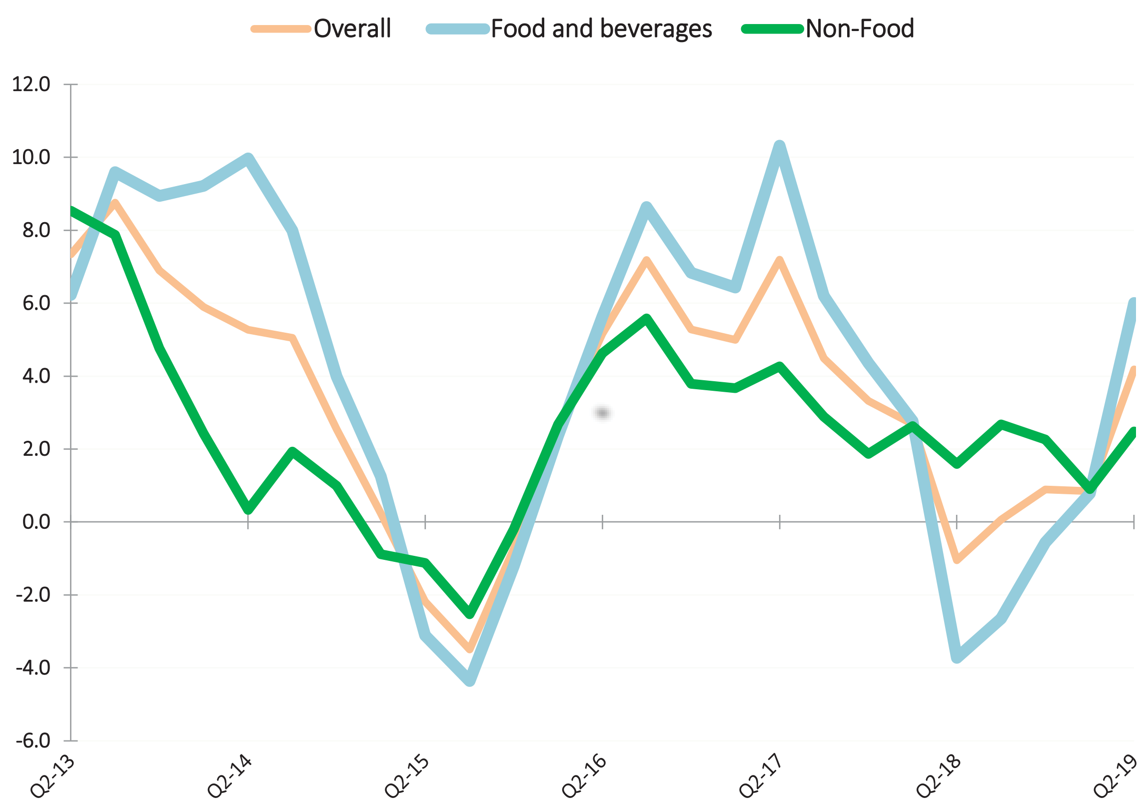
3.2.2 Quarterly Developments (Y/Y)

The short term measure of inflation reflected similar trend as the annual measure. The national headline inflation calculated on quarter on quarter basis decreased to 4.2 percent on average in the second quarter of 2019 from 0.8 percent recorded in the previous quarter. The main increased in the inflation rate was the result of prices increased in bread and cereals, meat, and fresh and dried foods items. In the meantime, the non-food category also showed higher rates compared to the first quarter of the same year.

On quarterly basis, the food inflation increased to 6.0 percent on average in the second quarter of 2019 from 0.8 percent in the first quarter of 2019. The price indices of food items such as bread and cereals, meat, milk, cheese and eggs, fresh and dried fruits and vegetables but nonalcoholic beverages were the only price which was decreased in second quarter of 2019 compared to the first quarter of 2019. However, in this category, the largest quarterly increases were recorded in bread and cereals, vegetables and spices prices indices which were 9.4 percent 4.3 percent and 17.9 percent respectively.

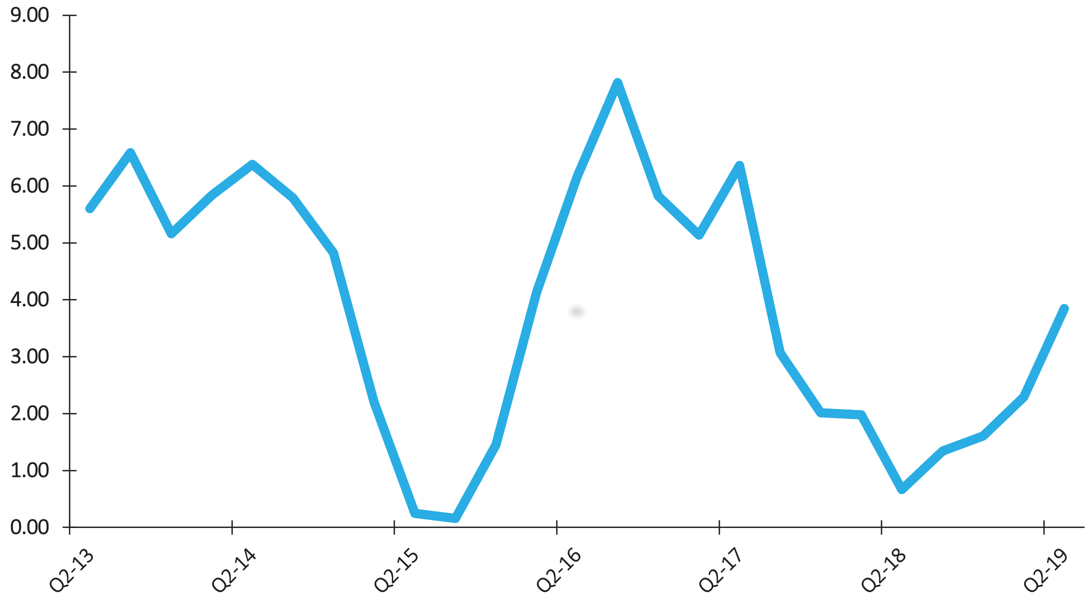
On the other hand, the non-food inflation also increased to 2.5 percent on average in the second quarter of 2019 from 0.9 percent in the previous quarter. In this category, the prices of furnishing and household and clothing items increased with big margins. On the other hand, prices decreased in few of the other sub items of non-food categories, such as tobacco, transportation, communication and education in second quarter of 2019.

Figure 3.2: Quarterly Average National Inflation for 2nd Quarter of FY 1398 (2019)



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

Figure 3.3: Quarterly Trimmed Mean for National Inflation 2nd Quarter of FY 1398 (2019)



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

Table 3.1: National Headline Inflation for FY 1398 (2019)

National Headline Inflation for FY 1398														
Based on Apr 2015														
Descriptions	Weight	FY 2018			Average (3 months)	FY 2019			Average (3 months)	FY 2019			Average (3 months)
		Apr	May	Jun		Jan	Feb	Mar		Apr	May	Jun	
Overall Index	100.0	-0.47	-1.05	-1.63	-1.1	0.41	0.34	1.77	0.8	3.63	4.88	4.03	4.2
Food & Non-Alcoholic Beverages	47.8	-2.56	-3.63	-5.00	-3.7	-0.41	0.14	2.62	0.8	5.12	7.04	5.86	6.0
Bread and Cereals	14.6	1.46	0.40	-1.40	0.2	6.14	5.65	6.88	6.2	8.19	9.94	10.16	9.4
Meat	7.5	0.00	0.05	-1.26	-0.4	1.39	1.37	1.16	1.3	1.43	4.92	5.53	4.0
Milk, cheese and eggs	4.7	-0.47	-0.41	-0.68	-0.5	1.38	1.35	1.92	1.6	3.06	2.61	2.28	2.7
Oils and fats	4.6	-0.17	-1.25	-2.54	-1.3	-2.81	-4.19	-5.46	-4.2	-4.32	-3.28	-2.87	-3.5
Fresh and dried fruits	5.0	1.12	2.48	-3.67	0.0	2.45	3.34	5.47	3.8	9.70	11.91	9.01	10.2
Vegetables	6.0	-10.52	-17.26	-17.29	-15.0	-17.44	-13.67	-2.40	-11.2	6.84	6.67	-0.73	4.3
Sugar and sweets	2.7	-11.26	-9.68	-9.38	-10.1	-0.85	-0.33	4.14	1.0	3.11	7.35	7.36	5.9
Spices	1.3	-22.42	-20.72	-19.81	-21.0	0.42	3.92	4.21	2.9	11.15	22.64	19.93	17.9
Non-alcoholic beverages	1.4	1.90	1.99	1.21	1.7	5.15	5.39	6.40	5.6	5.45	5.65	5.51	5.5
Non-Food Items, Tobacco & Services	52.2	1.57	1.49	1.71	1.6	1.19	0.53	0.97	0.9	2.24	2.85	2.35	2.5
Tobacco	0.3	3.21	2.79	3.38	3.1	5.56	4.96	4.04	4.9	4.12	4.42	3.68	4.1
Clothing	4.6	3.17	2.87	2.64	2.9	5.22	4.05	3.25	4.2	4.78	5.93	5.17	5.3
Housing	19.1	0.75	0.56	1.05	0.8	-2.73	-3.36	-2.31	-2.8	-0.21	0.00	-0.37	-0.2
Furnishing and household goods	11.9	2.65	2.06	1.63	2.1	2.59	2.71	3.20	2.8	4.37	4.89	4.62	4.6
Health	6.2	0.34	0.13	-0.01	0.2	3.04	2.14	1.89	2.4	2.57	5.24	5.30	4.4
Transportation	4.3	2.10	4.23	5.79	4.0	7.79	4.80	5.77	6.1	5.68	4.30	2.91	4.3
Communication	1.7	-0.08	0.10	0.14	0.1	-2.63	-2.39	-2.83	-2.6	-3.32	-2.73	-4.58	-3.5
Information and Culture	1.1	-1.68	-0.36	-0.44	-0.8	-0.24	0.95	0.35	0.4	2.67	2.11	1.18	2.0
Education	0.4	10.16	10.31	9.99	10.2	7.88	5.32	6.24	6.5	-4.50	0.21	0.29	-1.3
Restaurants and Hotels	1.1	2.10	2.07	2.13	2.1	3.06	3.62	3.20	3.3	3.58	4.04	4.56	4.1
Miscellaneous	1.4	2.85	2.13	3.49	2.8	1.74	0.69	0.35	0.9	2.15	3.97	1.59	2.6
CPI excluding B & C, O &F, & T		-0.97	-1.6	-2.0	-1.5	-0.85	-0.60	1.06	-0.1	3.17	4.48	3.39	3.7
30% trimmed mean		0.92	0.9	0.2	0.7	2.02	2.23	2.62	2.3	3.54	4.45	3.54	3.8

Source: National Statistics and Information Authority/Monetary Policy Department, DAB

3.3 Development in the Kabul Headline Inflation

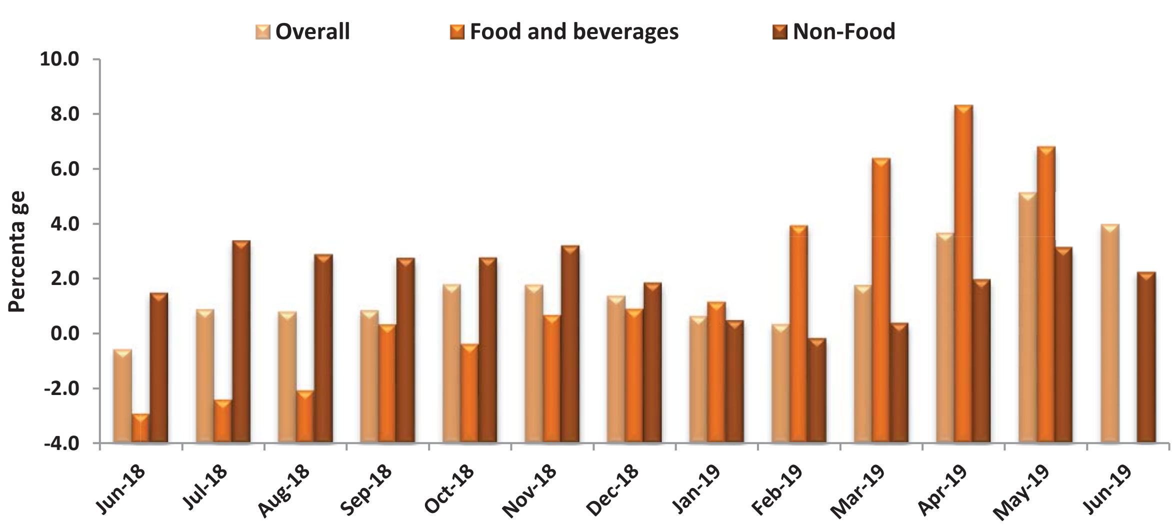
3.3.1 Annual Developments (Year on Year Changes):

The headline CPI inflation in Kabul increased to 4.27 percent on average in the second quarter of 2019 from 0.22 percent in the second quarter of the previous year. The food index, which is accounted for 37.2 percent of the overall weight of the overall index, reflected an inflation rate in one-year period. In this category, the inflationary pressures came from higher prices of bread and cereals, meat, milk, cheese and eggs, oil and fats, fresh and dried fruits, and vegetables. As a result, the food inflation increased to 7.16 percent on average in second quarter of 2019 from -1.51 percent in the same quarter of 2018.

The inflation of non-food items which comprise 62.8 percent weight of the whole index, increased to 2.45 percent on average in the second quarter of 2019 from 1.35 percent in the same period of last year. The increase is mainly attributed to higher prices of tobaccos, furnishing and household, health, transportation and housing items. However, in this category, the inflation in tobacco increased to 4.39 percent on average from 1.95 percent, transportation increased to 3.16 percent on average from 1.93 'percent and health increased to 6.11 from 2.44 percent on average in the same period of 2018.

On the other hand, the core inflation excluding bread & cereals, fats and oils and transportation also indicated an increase in the period under review compared to the same period previous year. In the second quarter of 2019, the core inflation rate increased to 3.98 percent on average while the rate was recorded -0.19 percent in the second quarter of 2018. The 30% trimmed mean reflected an inflation of 3.88 percent on average in the second quarter of 2019 compared to 0.75 percent in same quarter of 2018.

Figure 3.4: Kabul Annual Headline Inflation from June-2018 to June-2019



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

3.3.2 Quarterly Developments (Quarter on Quarter Changes):

The quarter on quarter measure of headline inflation in Kabul indicated upward movement which reflects inflation in both food and non-food items of the CPI. The headline inflation in Kabul increased to 4.27 percent on average in second quarter of 2019 from 0.92 percent recorded in the previous quarter.

Inflation in the food index increased to 7.16 percent on average in the second quarter of 2019 from 1.98 percent in the previous quarter. In this category, the prices of spices, bread and cereals, vegetables, sugar and sweets increased which led to increased inflation during the period under review. In this category, the highest increase was observed in the price index of spices which picked up to 30.97 percent on average in the second quarter of current year from 7.12 percent in previous quarter. On the other hand, the deflation in oils and fat showed a decline on quarterly basis which turned to -6.03 percent on average in the second quarter from -2.62 percent in the previous quarter 2018.

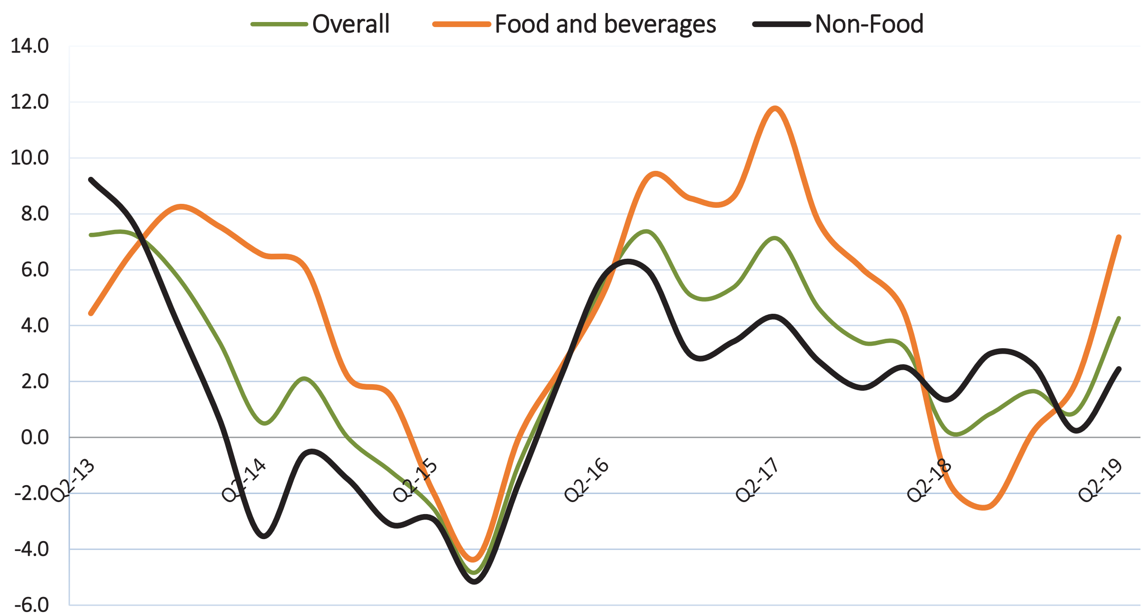
The Non-food category of the CPI also showed higher inflationary rate during the second quarter of 2019. Inflation in this category increased to 2.45 percent on average in the second quarter compared to 0.24 percent in the previous quarter. The increase in non-food inflation is driven by higher prices of non-food items such as tobacco, clothing, housing, furnishing and household, clothing, housing, health, information and culture, and miscellaneous items among which the largest increased was observed in the price of health item which increased to 6.11 percent in the second quarter of 2019 from 1.75 percent in the previous quarter 2018.

Base on second quarter 2019 statistics data the near-term outlook of inflation is likely to remain balanced and move upward gradually. Monetary policy of central bank Afghanistan forecasts inflation rate 2 to 4 percent for the third quarter of 2019. The forecast is based on the following course of factors.

First, according to 2019 figures Afghanistan has more than two billion dollars' trade in import and export with Iran since import are much higher in this regard. But recent U.S financial sanctions on Iran which include import-export of vehicles, vehicle-making machineries, oil and gas, gold and other precious metals as well as currency exchange that will have threatened vital Afghanistan trade projects, however Afghanistan is economically dependent on the dollar, and yet US banknotes are being smuggled out of the country.

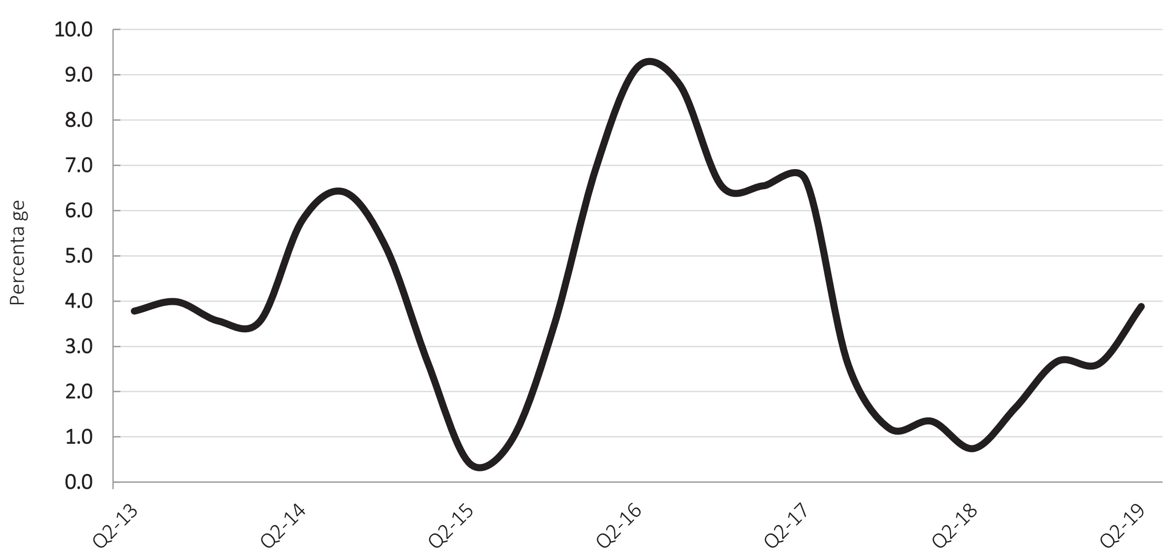
Second, according to Afghan Chamber of Commerce and Industries (ACCI), Millions of dollars in hard currency enter Iran via the Islam Qala border crossing in Herat Province daily, as a result illegal U.S dollars' flow from Afghanistan to Iran has also depreciated afghan currency which has huge impact on inflation. Keeping in mind the above facts and figures, U.S sanctions on Iran have been affecting Afghanistan economy in terms of exchange rate and inflation. Moreover, Afghanistan is a consuming country and imports are at a greater quantity from neighboring countries, national inflation rate is often influenced by imported inflation of Iran, Pakistan, China, Tajikistan and Uzbekistan. Additionally, the exchange rate of the local currency has been depreciating continuously. This case is not only in Afghanistan, but in the whole region especially with Afghanistan Trade partner countries.

Figure 3.5: Kabul Quarterly Headline Inflation for the 2nd Quarter of FY 1398 (2019)



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

Figure 3.6: Kabul Quarterly Average inflation for FY 1398 (2019)



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

Table 3.2: Kabul Headline Inflation for FY 1398 (2019)

Kabul Headline Inflation FY 1398													
Based on Apr 2015													
Amount in Million AFN													
Descriptions	Weight	FY 2018			Average (3 months)	FY 2019			Average (3 months)	FY 2019			Average (3 months)
		Apr	May	Jun		Jan	Feb	Mar		Apr	May	Jun	
Overall Index	100.0	0.80	0.42	-0.56	0.22	0.64	0.35	1.77	0.92	3.68	5.14	3.99	4.27
Food & Non-Alcoholic Beverages	37.2	-0.15	-0.71	-3.67	-1.51	0.88	1.14	3.93	1.98	6.38	8.31	6.80	7.16
Bread and Cereals	9.8	2.63	1.19	-0.18	1.21	7.35	8.07	8.35	7.92	10.93	11.71	12.46	11.7
Meat	6.4	3.28	2.28	-1.72	1.28	4.24	4.41	2.79	3.81	2.79	5.25	6.71	4.92
Milk, cheese and eggs	3.2	-2.89	-0.92	-0.87	-1.56	4.54	5.35	2.78	4.22	3.59	2.29	1.78	2.55
Oils and fats	3.6	-2.19	-2.06	-3.34	-2.53	-0.49	-1.81	-5.55	-2.62	-5.91	-6.05	-6.13	-6.03
Fresh and dried fruits	5.2	11.09	14.48	1.16	8.91	1.49	0.32	2.51	1.44	8.13	11.76	12.34	10.74
Vegetables	4.2	-9.45	-15.79	-15.24	-13.49	-17.64	-15.22	2.55	-10.10	9.63	3.68	-8.18	1.71
Sugar and sweets	2.8	-8.15	-6.80	-8.15	-7.70	0.53	-2.13	7.54	1.98	5.06	13.22	13.30	10.53
Spices	1.0	-16.25	-17.56	-14.76	-16.19	4.29	8.38	8.70	7.12	21.27	48.57	23.08	30.97
Non-alcoholic beverages	0.9	1.56	2.03	0.06	1.22	5.76	7.43	6.01	6.40	5.34	6.29	4.49	5.37
Non-Food	62.8	1.42	1.15	1.48	1.35	0.49	-0.16	0.39	0.24	1.97	3.13	2.25	2.45
Tobacco	0.3	2.29	1.44	2.10	1.95	3.85	3.87	3.19	3.64	3.36	4.54	5.26	4.39
Clothing	4.8	2.72	3.04	3.36	3.04	3.74	0.73	-0.59	1.29	2.14	3.15	2.05	2.45
Housing	23.5	0.20	-0.81	-0.27	-0.29	-3.80	-4.63	-3.42	-3.95	-0.76	0.42	-0.41	-0.25
Furnishing and household goods	17.6	2.82	1.82	1.61	2.08	2.79	3.31	4.01	3.37	4.84	5.47	4.88	5.06
Health	5.3	2.27	2.91	2.14	2.44	1.69	2.13	1.42	1.75	1.87	8.32	8.12	6.11
Transportation	4.6	-0.67	2.38	4.08	1.93	4.73	1.11	3.79	3.21	5.06	2.88	1.53	3.16
Communication	2.0	-0.25	0.21	0.15	0.03	-0.56	0.08	-0.99	-0.49	-0.73	0.67	-1.61	-0.55
Information and Culture	1.7	-2.83	-0.46	-0.94	-1.41	-1.77	-0.25	-2.20	-1.41	1.67	0.86	-0.82	0.57
Education	0.7	13.90	14.05	13.87	13.94	9.76	6.22	7.55	7.84	-7.16	-0.99	-0.63	-2.93
Restaurants and Hotels	1.0	2.95	3.25	3.58	3.26	1.99	3.33	0.75	2.02	1.72	1.27	1.27	1.42
Miscellaneous	1.3	1.25	1.59	5.65	2.83	5.80	3.99	3.02	4.27	6.70	6.48	2.07	5.08
CPI excluding B & C, O & F, and T		0.82	0.34	-0.72	-0.19	-0.26	-0.43	1.26	0.19	3.25	5.04	3.65	3.98
30% trimmed mean		0.70	1.04	0.49	0.75	2.76	2.34	2.77	2.62	3.68	4.49	3.48	3.88

Source: National Statistics and Information Authority/Monetary Policy Department, DAB

4

External Sector Developments

4

EXTERNAL SECTOR DEVELOPMENT

The highlights of some major developments in the external sector of the Afghan economy for the second quarter of the FY 1398 in comparison with the corresponded quarter of the previous year are captured in this report. The available data shows that the external sector of the economy improved in the second quarter of the FY 1398.

Merchandise trade deficit narrowed by 6.7 percent as a result of a moderate reduction in import expenditures during the second quarter of the FY 1398. This developments, together with an increase in receipts on respect of service account together with an increase of workers' remittances helped to reduce the external sector's current account deficit to a value of USD 604.74 million in the second quarter of the FY 1398 compared to a deficit of USD 784.58 million in the second quarter of the FY 1397.

Inflow to the capital account increased by 32 percent on account of capital transfers to the government sector.

Net Foreign Direct Investment (FDI), inflows declined by 87 percent while net Portfolio Investment outflows increased by 81 percent during the second quarter of the FY 1398.

percent to a value of USD 143.60 million in the second quarter of the FY 1398 from a value of USD 146.81 million recorded in the second quarter of the FY 1397.

In view of the improvement in the current, capital and financial account, the BOP recorded a deficit of USD 517.12 million in the second quarter of the FY 1398 compared to the deficit of USD 606.31 million recorded in the second quarter of the FY 1397. The estimated official reserve assets in the second quarter of the FY 1398 recorded at a value of USD 29.31 million.

Note: the mentioned reserve assets value will be revised when the actual data is received.

4.1 Balance of Payments

4.1.1 Current Account Balance

The balance of payments (BOP's) current account deficit decreased by 22.9 percent to a value of USD 604.74 million in the second quarter of the FY 1398 as compared to a value of USD 784.58 million recorded in the second quarter of the FY 1397, (Table 4.1 and figure 4.1).

This development was mainly due to a decrease in out-payments on respect of merchandize imports, and an increase in receipts on respect of construction, travel and government services.

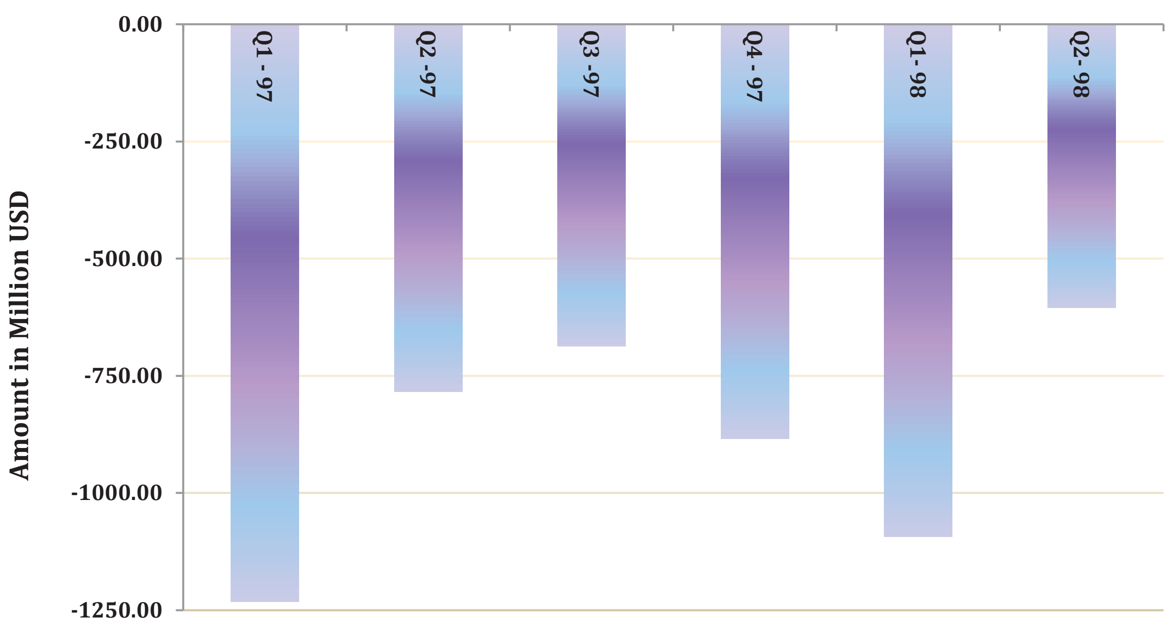
The deficit of merchandise trade (goods account) expanded at a moderate rate of 2.2

While, in the services account of the BOP's we turned from a deficit of USD 77.74 million recorded in the second quarter of the FY 1397 to a surplus of USD 95.72 million recorded in the second quarter of the FY 1398.

On the other hand, compensation of employees together with investment income inflows decreased by 11.2 percent to a value of USD 53.85 million in the second quarter of the FY 1398 from a value of USD 60.60 million recorded in the second quarter of the FY 1397.

As well as; official grants to the government sector and worker personal home remittances from foreign countries declined by 12.7 percent to a value of USD 568.43 million in the second quarter of the FY 1398 from a value of USD 651.03 million when compared with the similar quarter of the FY 1397.

Figure 4.1: The Current Account Balance



Source: CSO/DAB staff calculations

4.1.2 Capital Account

The surplus in the capital account of the balance of payments increased by 32.9 percent to a value of USD 228.51 million in the second quarter of the FY 1398 from a value of USD 171.93 million recorded in the second quarter of the FY 1397 as a result of higher inward of capital transfers to the government sector, corporations and households.

4.1.3 Financial Account

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

Net FDI inflows to the country decreased by 87.8 percent to a value of USD 6.05 million in the second quarter of the FY 1398 from a value of USD

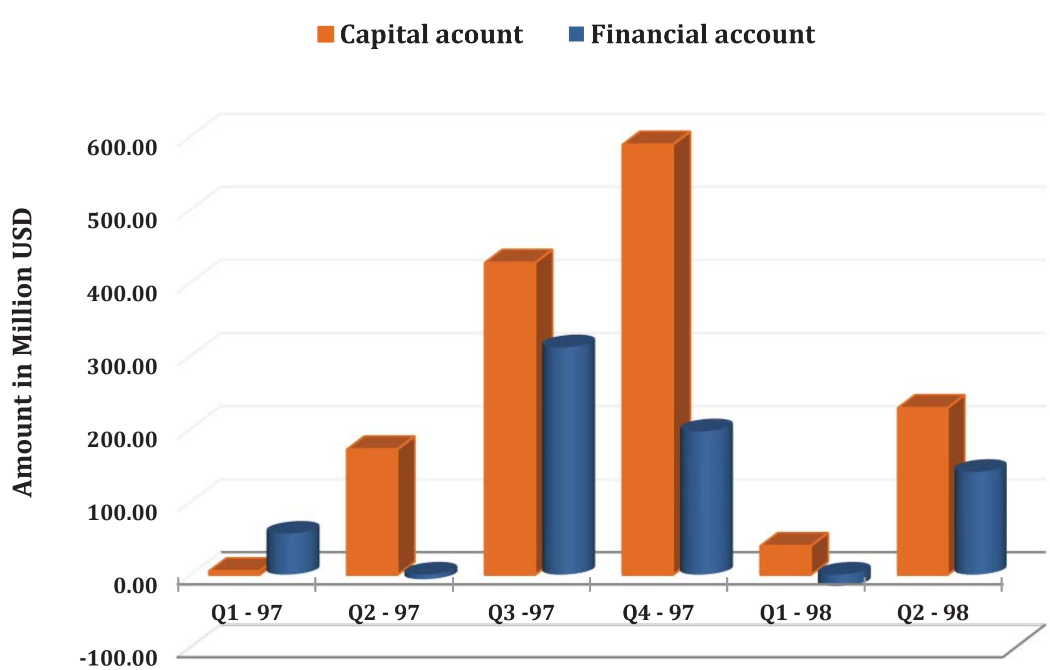
49.75 million recorded in the second quarter of the FY 1397. Whiles, net portfolio investment depicted an outflow of USD 20.45 million in the second quarter of the FY 1398 as against a net outflow of USD 11.25 million in the corresponding quarter of the last year with a sign of 81.8 percent increase.

Further analysis reveals that the country's other aggregate financial assets abroad increased by 83 percent to a value of USD 90.76 million in the second quarter of the FY 1398 from a value of USD 49.57 million that was recorded in the corresponding quarter of the FY 1397 (Table 4.1 figure 4.2 & 4.3).

On the other hand, total aggregate financial liabilities (only other investment?), decreased by 71.4 percent to a value of USD 6.43 million in the second quarter of the FY 1398 from a value of USD 22.44 million recorded in the same quarter of the previews year.

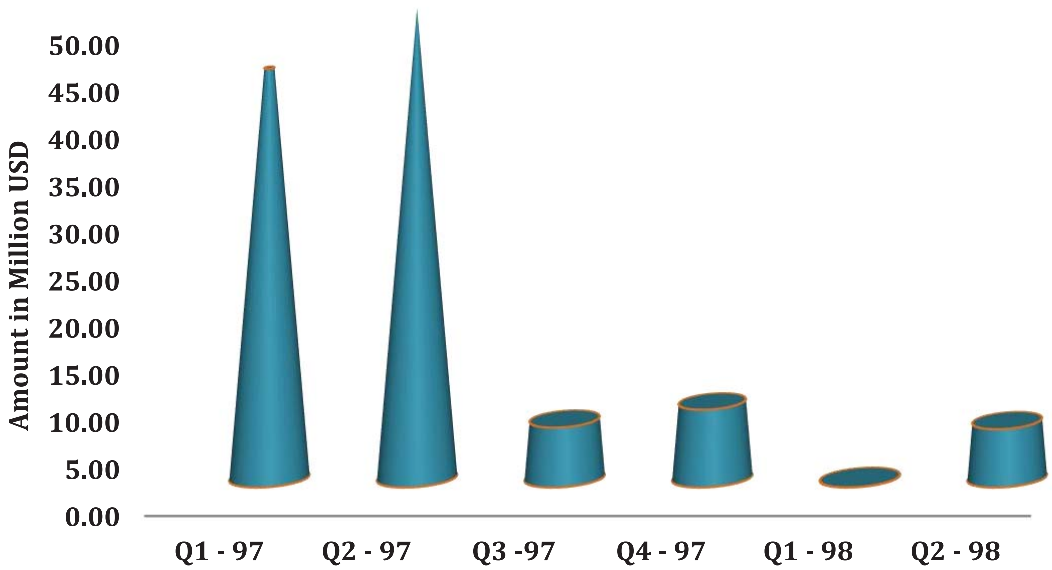
The financial account balance as a total recorded USD 140.90 million in the second quarter of the FY 1398 as against USD -6.3 million recorded in the second quarter of the FY 1397.

Figure 4.2: The Capital and Financial Account for 2nd Quarter of FY 1398 (2019)



Source: CSO/DAB staff calculations

Figure 4.3: Foreign Direct Investment Inflows for 2nd Quarter of FY 1398 (2019)



Source: CSO/DAB staff calculations

4.2 Merchandise trade

This part of the report presents an analysis of the Afghanistan's merchandise trade performance in the second quarter of the FY 1398 in comparison with their trade performance in the second quarter of the FY 1397.

Afghanistan's trade balance has been in a deficit position since long period. This means that the total value of imported goods has been greater than the total value of exported goods, (table 4.2 figures 4.4).

During the quarter under review the external merchandise trade deficit decreased by 8 percent to a value of USD 1,487.95 million in the second quarter of the FY 1398 from a value of USD 1,620.15 million recorded in the same quarter of the previous year.

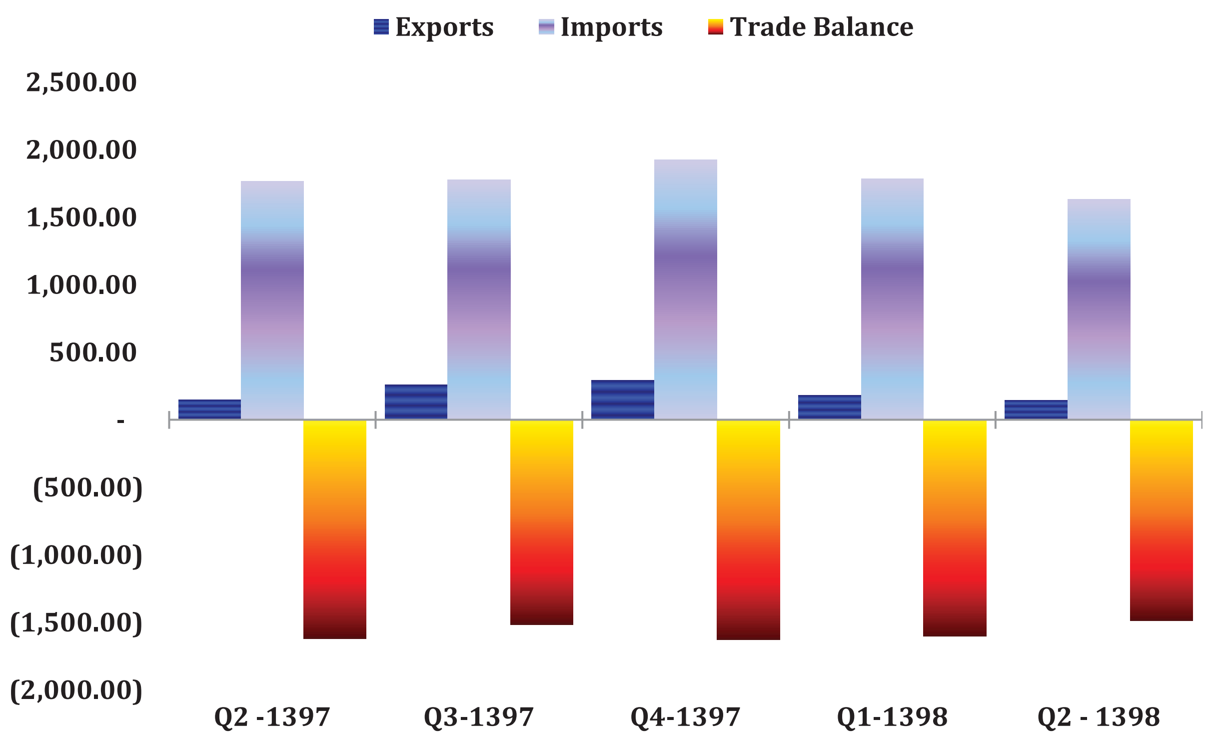
Aggregate exports of goods indicated a decline of 2 percent to a value of USD 143.29 million in the second quarter of the FY 1398, lower than a value of USD 146.81 million recorded in the second quarter of the FY 1397.

Among the exporting components, only exports of leather and wool shows upward trend, while carpet, rug and food items and medical seeds show downward trend during the quarter under review.

At the same time, aggregate imports decreased by 8 percent to a value of USD 1,631.24 million in the second quarter of the FY 1398 compared to a value of USD 1,766.96 million recorded in the similar quarter of the previous year.

Over the same period of comparison, decreases were registered in the values of imports of most principal commodity divisions, in particular imports of consumer goods declined by 16 percent, fuel and lubricant declined by 18 percent and capital goods declined by 1 percent during the second quarter of the FY 1398.

Figure 4.4: Trade performance and balance for the 2nd Quarter of FY 1398 (2019)



Source: CSO/DAB staff calculations

4.3 Direction of Trade

The main export destinations for Afghanistan are Pakistan, Iran, India, China, and Common Wealth of Independence States (CIS). According to the merchandize trade statistics, during the second quarter of the FY 1398 India remained the first largest buyer of Afghanistan's exports in the second quarter of the FY 1398.

The share of Afghanistan's exports to India increased to 51 percent in the second quarter of the FY 1398. But in terms of value, exports to India grew by 40 percent to a value of USD 73.28 million in the second quarter of the FY 1398 from a value of USD 52.45 million recorded in the second quarter of the FY 1397.

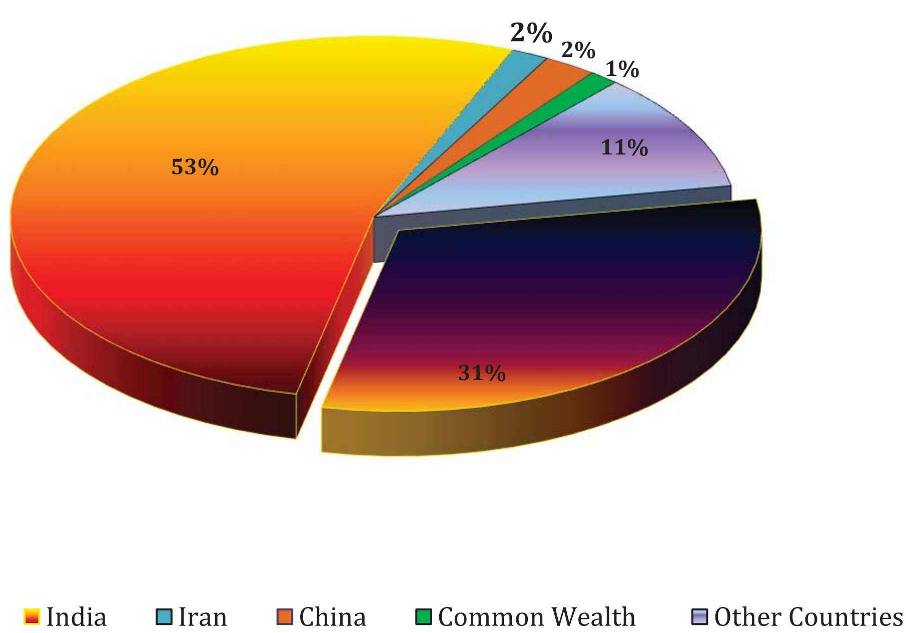
Pakistan ranked the second largest buyer of Afghanistan's exports during the second quarter of the FY 1398. The share of Afghanistan's exports to Pakistan dropped to 30 percent in the second quarter of the FY 1398 from 42 percent that was recorded in the second quarter of the last year. In terms of value Afghanistan's total exports to Pakistan decreased by 30 percent to a value of USD 43.22 million in the second quarter of the FY 1398 compared to a value of USD 62.18 million recorded in the second quarter of the FY 1397.

Germany and Iran graded the third and fourth largest buyer of Afghanistan's exports in the second quarter of the FY 1398. Share of exports to Germany increased to 2 percent in the second quarter of the FY 1398 from 0.77 percent recorded in the second quarter of the FY 1397.

While, the share of exports to Iran declined to 1.6 percent in the second quarter of the FY 1398 from 4 percent in the second quarter of the FY 1397.

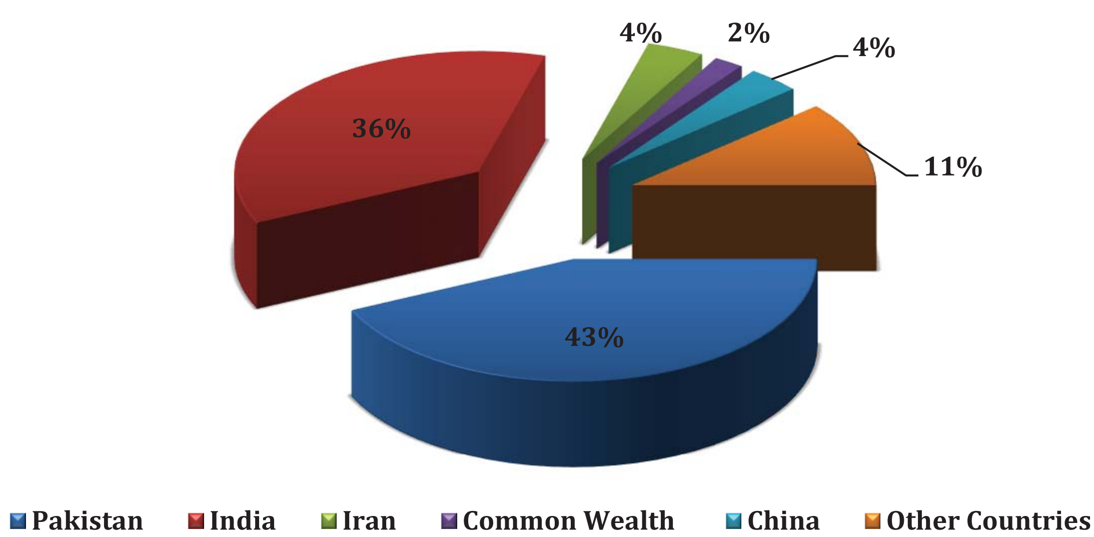
In terms of value, exports to Germany increased to a value of USD 2.84 million from a value of USD 1.13 million. whereas the value of exports to Iran declined to a value of USD 2.31 million in the second quarter of the FY 1398 from a value of USD 5.45 million recorded in the same quarter of the previous year, (table 4.3 & 4.4 and figure 4.5 & 4.6)

Figure 4.5: Direction of Exports (% Share) for the 2nd Quarter of FY 1398 (2019)



Source: CSO/DAB staff calculations

Figure 4.6: Direction of Exports (% Share) for the 2nd Quarter of FY 1397 (2018)



Source: CSO/DAB staff calculations

CIS countries were the first largest sources of imports for Afghanistan during the second quarter of the FY 1398. Total Imports from CIS countries decreased by 22 percent to a value of USD 361.23 million with share of 22 percent in the second quarter of the FY 1398 from a value of USD 462.49 million with share of 26.17 percent in the second quarter of the FY 1397.

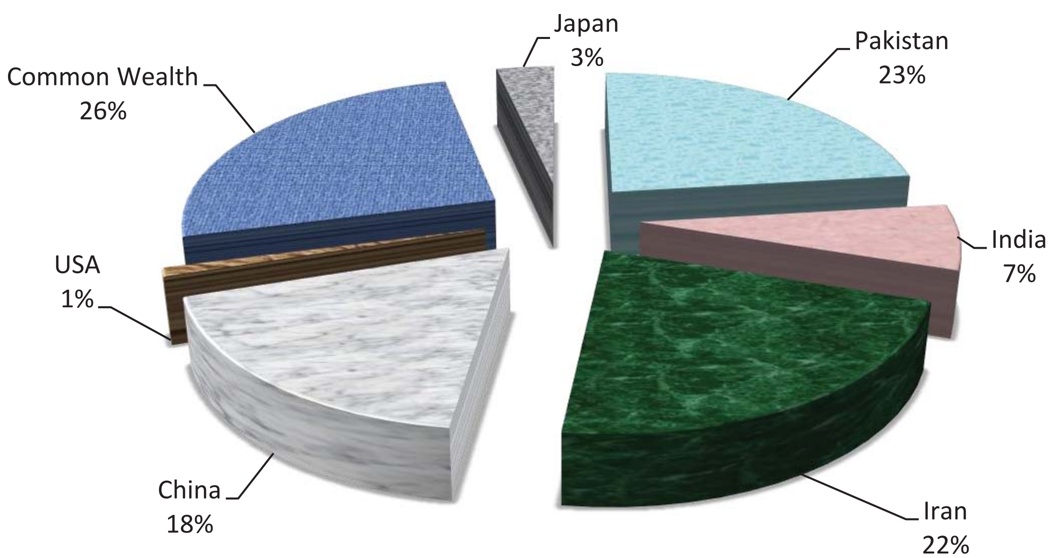
Pakistan ranked the second largest imports origin of Afghanistan in the second quarter of the FY 1398. The total imports from Pakistan remained unchanged (USD 325 million) but its share in total imports increased from 18.40 percent in the second quarter of the FY 1397, to 22 percent in the quarter under review.

Iran was the third largest origin of imports for Afghanistan in the second quarter of the FY 1398. Total Imports from Iran slightly increased by 3 percent to a value of USD 310.45 million with share of 19 percent in the second quarter of the FY 1398 from a value of USD 301.28 million with shares of 17.05 percent recorded in the second quarter of the FY 1397.

China was the fourth largest import origin to Afghanistan in the second quarter of the FY 1398. Total Imports from China increased to a value of USD 252.63 million with share of 15.5 percent in the second quarter of the FY 1398 from a value of USD 225.46 million with share of 12.76 percent in the second quarter of the FY 1397, registered 12 percent growth in total imports during the quarter under review.

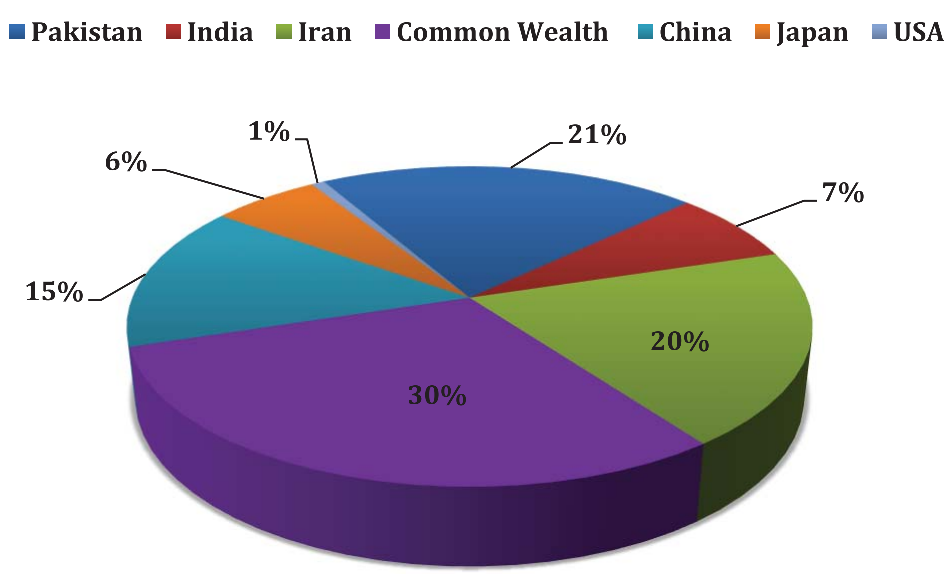
India, Japan and United Arab Emirates were the last largest import sources for Afghanistan in the second quarter of the FY 1398, accountable for 6.11 percent, 3.02 percent and 2.34 percent of total imports respectively (Figure 4.7 & 4.8).

Figure 4.7: Direction of Imports (% Share) for the 2nd Quarter of FY 1398 (2019)



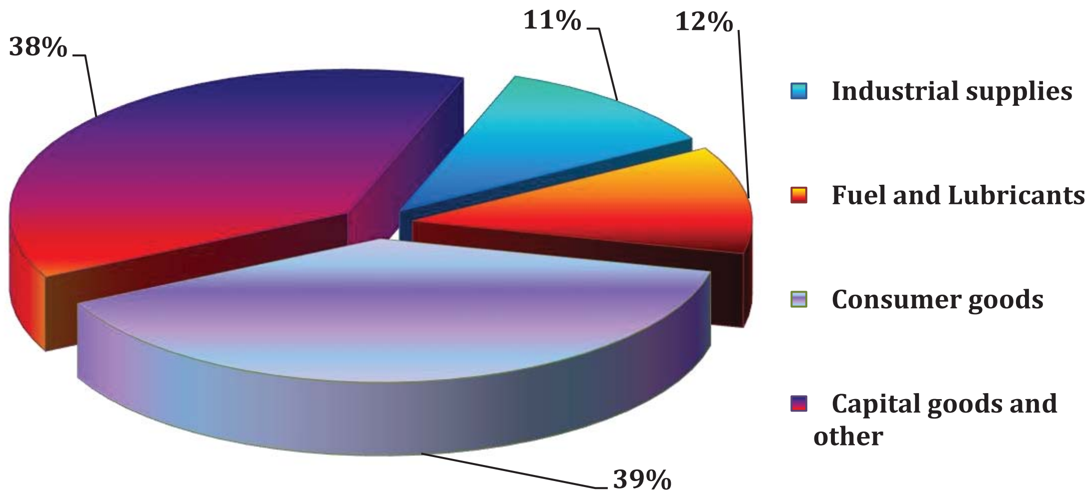
Source: CSO/DAB staff calculations

Figure 4.8: Direction of Imports (% Share) for the 2nd Quarter of FY 1397 (2018)



Source: CSO/DAB staff calculations

Figure 4.9: Composition of Imports (% Share) for the 2nd Quarter of FY 1397 (2018)



Source: CSO/DAB staff calculations

4.4 Composition of Trade

4.4.1 Composition of Imports

The composition of imports in the second quarter of the FY 1398 pointed out that;

Imports of consumer goods had the largest share in the basket of imports despite its share decreased slightly from 39 percent to 38 percent. In terms of value, imports of consumer goods also decreased by 10 percent to a value of USD 622.05 million in the second quarter of the FY 1398 from a value of USD 687.54 million recorded in the same quarter of the previews year.

The second largest share recorded for capital goods in the basket of imports during the second quarter of the FY 1398, which is decreased from 38 percent to 35 percent in the reporting quarter.

In terms of value, imports of such goods decreased by 16 percent to a value of USD 564.18 million in the second quarter of the FY 1398 from a value of USD 671.07 million recorded in the second quarter of the FY 1397.

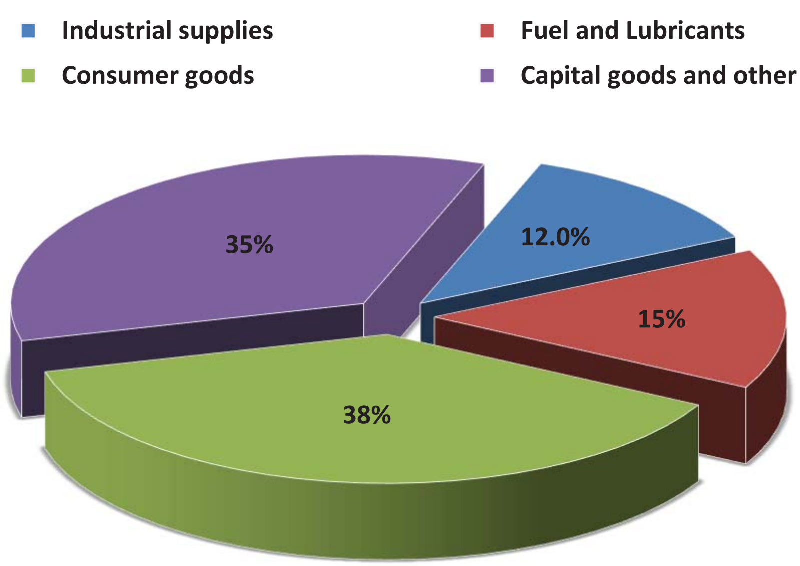
Imports of fuel and lubricants (petroleum oil) had the third largest share in the basket of Afghanistan's imports which is increased from 12.1 percent to 15 percent in the second quarter of the FY 1398.

In terms of value, imports of fuel and lubricants in total imports increased by almost 16 percent to a value of USD 248.53 million in the second quarter of the FY 1398 from a value of USD 214.21 million recorded in the second quarter of the FY 1397.

Industrial supplies had the smallest share in the basket of Afghanistan's imports during the reporting quarter which increased from 11 percent in the second quarter of the FY 1397 to 12 percent during the quarter under review.

In terms of value, imports of such goods increased by 1 percent, to a value of USD 196.47 million in the second quarter of the FY 1398 from a value of USD 194.14 million recorded in the second quarter of the FY 1397, (Table 4.2- and Figure 4.9 - 4.10)

Figure 4.10: Composition of Imports (% Share) for the 2nd Quarter of FY 1398 (2019)



Source: CSO/DAB staff calculations

4.4.2 Composition of Exports

The composition of exports in the second quarter of the FY 1398 reveals that;

Exports of medical seeds had the largest share in the basket of Afghanistan's exports even though it's decreased to almost 51 percent in the reporting quarter from 57.7 percent recorded in the preceding and corresponding quarter of the FY 1397.

Earnings from exports of medical seeds dropped by 14 percent to a value of USD 73.22 million in the second quarter of the FY 1398 from a value of USD 84.78 million recorded in the same quarter of the previous year.

The second largest share in total exports was recorded for food items (oil seeds, fresh and dry fruits), which is increased to 35 percent in the second quarter of the FY 1398 from 32.2 percent recorded in the preceding and corresponding quarter of the last year.

In term of value, exports of food items increased by 5 percent to a value of USD 49.72 million in the second quarter of the FY 1398 from a value of USD 47.30 million recorded in the preceding and corresponding of the FY 1397.

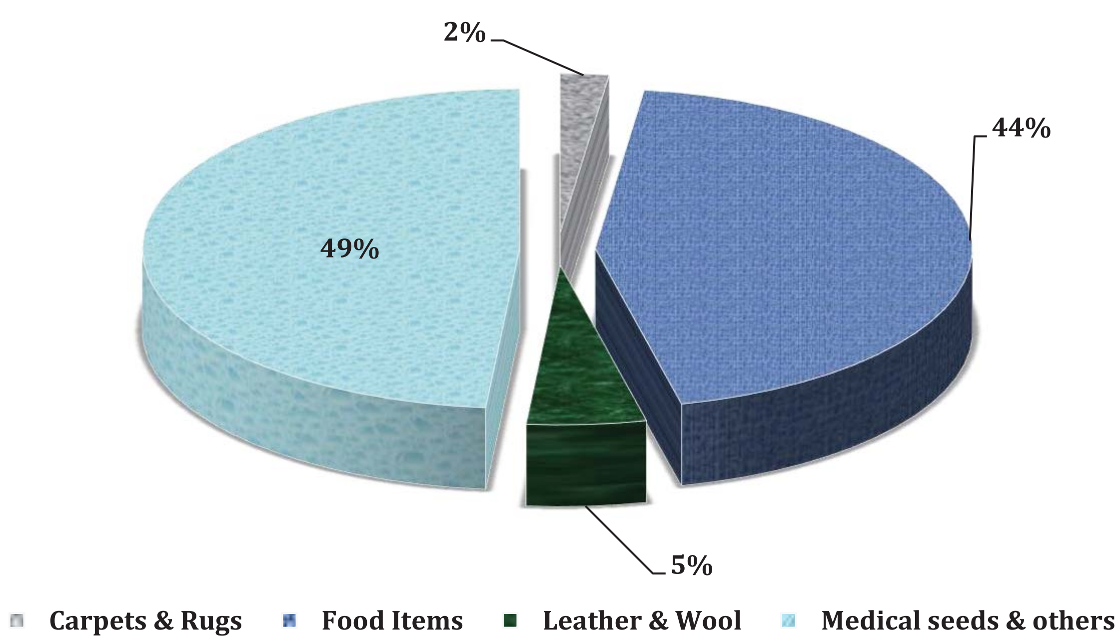
Leather and wool products had the third largest share in the total exports. The share of leather and wool which recorded 6.2 percent in the second quarter of the FY 1397, it's increased to 9.8 percent during the quarter under review.

Earning from exports of leather and wool increased by 55 percent to a value of USD 14 million in the second quarter of the FY 1398 from a value of USD 9.05 million recorded in the similar quarter of the last year.

Carpet and rugs which are considered the main component of Afghanistan's exports in the past decades had the smallest share in total exports, which is remained almost unchanged at 4 percent in the second quarter of the FY 1398.

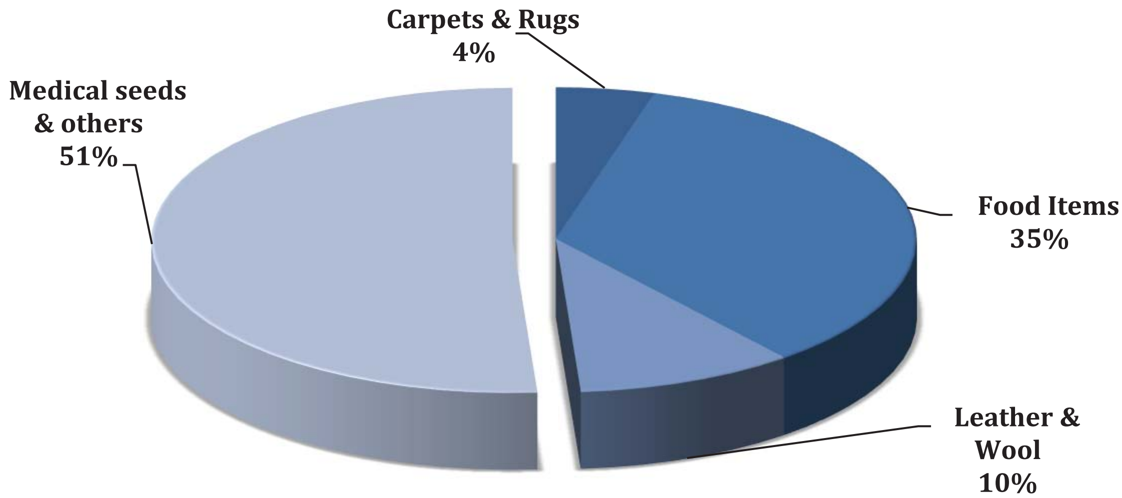
But earnings from exports of carpet and rugs increased by 12 percent to a value of USD 6.35 million during the quarter under review from a value of USD 5.68 million that was recorded in the same quarter of last year. (Figures 4.11 and 4.12) indicate composition of exports in the Q2 FY 1397 with Q2 FY 1398.

Figure 4.11: Composition of Exports (% Share) for the 2nd Quarter of FY 1397 (2018)



Source: CSO/DAB staff calculations

Figure 4.12: Composition of Exports (% Share) for the 2nd Quarter of FY 1398 (2019)



Source: CSO/DAB staff calculations

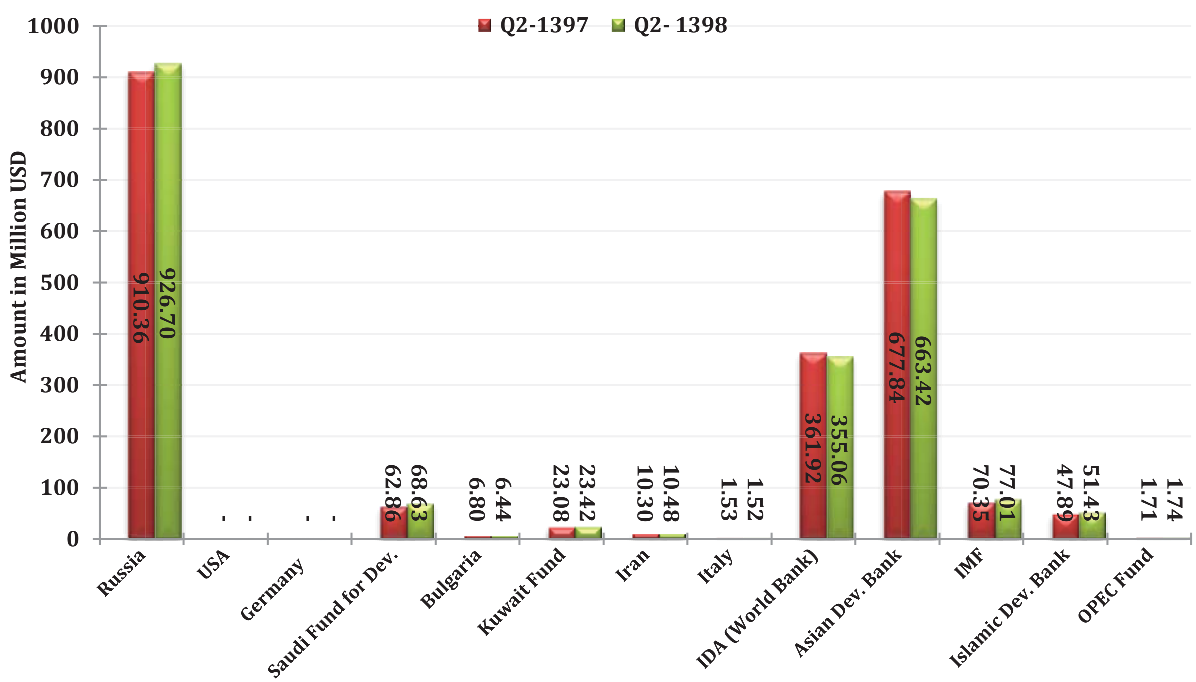
4.5 External Debt

Afghanistan's total external debt slightly increased by 1 percent to a value of USD 2,185.85 million in the second quarter of the FY 1398 from a value of USD 2,174.63 million recorded in the similar quarter of the FY 1397, which shows USD 11.22 million increases in the reporting quarter (table 4.5).

During the quarter under review, loan principal repayments made to the World Bank, Asian Development Bank, Saudi fund for development and Bulgaria, while service charges were paid to the World Bank, Asian Development Bank and Kuwait fund. World Bank and Asian Development Bank as a major multilateral creditor to Afghanistan, mad some debt release on principle and services charge during the quarter under review. The total loan amounts payable to the Paris Club creditors in the second quarter of the FY 1398 stood at USD 926.70 million which is payable to Russian federation. ***In other words, Afghanistan's total debt from the Paris club members stands at about 42.40 percent of total current external debt which has increased slightly by about 2 percent compared to the second quarter of the FY 1397.***

Furthermore, total debt from Non-Paris Club members which are including, (Saudi Fund for Development, Bulgaria, Kuwait fund and Iran) increased by 6 percent to a value of USD 110.49 million in the second quarter of the FY 1398 in comparison with a value of USD 104.5 million recorded in the second quarter of the FY 1397. On the other hand, total debt from multilateral creditors to Afghanistan decreased to a value of USD 1,148.66 million in the second quarter of the FY 1398 from a value of USD 1,159.70 million which shows USD 11.04 million decline in the total debt during the quarter under review.

Figure 4.13: External Debt Comparison for the 2nd quarter of FY 1397 & 1398



Source: CSO/DAB staff calculations

4.6 Net International Reserves

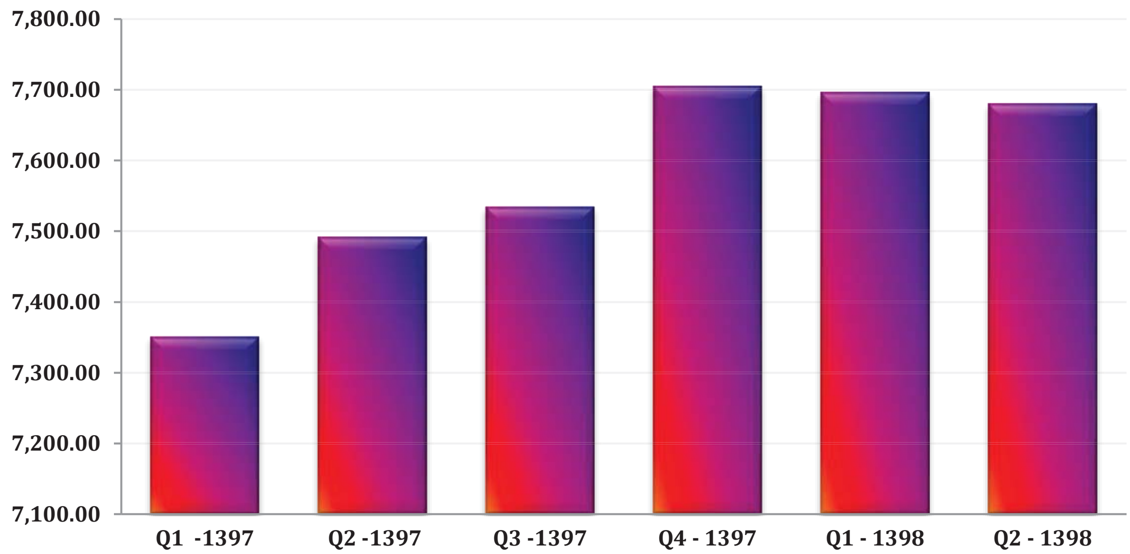
According to the latest available data the Net International Reserves (NIR), increased by 3 percent, standing at a value of USD 7,680.28 million in the second quarter of the FY 1398, up from a value of USD 7,491.80 million that was recorded in the corresponding quarter of the last year, (Table 4.6 and Figure 4.14).

Reserve assets slightly expanded by 1 percent to a value of USD 8,337.53 million in the second quarter of the FY 1398 from a value of USD 8,227.57 million recorded in the corresponding quarter of last year.

Reserve liabilities declined by 11 percent to a value of USD 657.25 million in the second quarter of the FY 1398 from a value of USD 735.76 million recorded in the second quarter of the FY 1397; this demonstrates that the reserve assets are higher than the reserve liabilities. The decrement in reserve liabilities was mainly due to decreases of commercial bank deposits in foreign currency which dropped by 11 percent to a value of USD 603.65 million in the second quarter of the FY 1398 from a value of USD 675.38 million recorded in the same quarter of the previous year.

The reserve liability of nonresident deposits in foreign currency almost remained unchanged in the reporting quarter. The current position of Afghanistan Net International Reserves (NIR) is providing a good cushion of the capacity of monetary policy and support of balance of payments.

Figure 4.14: Net International Reserve from Q1-1397 (2018) to Q2-1398 (2019)



Source: Monetary Policy Department, DAB

Table 4.1: Afghanistan Balance of Payments (in million USD)

Items/Years	Q1- 97	Q2- 97	Q3 - 97	Q4 - 97	Q1- 98	Q2- 98	%change
Current Account	**-1232.36**	**-784.58**	**-686.89**	**-884.88**	**-1093.83**	**-604.74**	**-22.9%**
Credit	942.35	1139.46	1356.95	1244.66	944.47	1162.36	2.0%
Debit	2174.71	1924.04	2043.83	2129.54	2038.30	1767.10	-8.2%
Goods and Services Account	-1756.54	-1496.22	-1295.88	-1462.44	-1452.39	-1227.01	-18.0%
Credit	355.20	378.07	649.44	591.07	536.12	489.63	29.5%
Debit	2111.75	1874.29	1945.32	2053.51	1988.51	1716.64	-8.4%
Goods Account	-1590.89	-1418.48	-1313.65	-1397.62	-1458.59	-1322.73	-6.7%
Credit	172.45	146.81	261.88	294.09	182.57	143.60	-2.2%
Debit	1763.35	1565.29	1575.53	1691.71	1641.16	1466.34	-6.3%
Services Account	-165.65	-77.74	17.77	-64.82	6.19	95.72	-223.1%
Credit	182.75	231.26	387.56	296.98	353.55	346.03	49.6%
Debit	348.40	309.00	369.79	361.81	347.36	250.31	-19.0%
Primary Income Account	29.87	60.60	66.34	55.60	53.97	53.85	-11.2%
Credit	40.31	71.72	116.44	78.32	69.88	64.66	-9.8%
Debit	10.45	11.11	50.11	22.72	15.91	10.81	-2.7%
Secondary Income Account	494.32	651.03	542.65	521.96	304.59	568.43	-12.7%
Credit	546.84	689.67	591.06	575.27	338.47	608.08	-11.8%
Debit	52.52	38.64	48.41	53.31	33.88	39.64	2.6%
Current transfers (Official grants)	408.0	530.6	404.4	365.5	162.8	426.7	-19.6%
Credit	408.0	530.6	404.4	365.5	162.8	426.7	-19.6%
Debit	0.0	0.0	0.0	0.0	0.0	0.0	0.0%
Personal transfers	86.36	120.42	138.22	156.44	141.80	141.70	17.7%
Credit	138.88	159.06	186.63	209.75	175.68	181.34	14.0%
Debit	52.52	38.64	48.41	53.31	33.88	39.64	2.6%
Capital account	**4.84**	**171.93**	**427.13**	**588.81**	**39.42**	**228.51**	**32.9%**
Credit	4.84	171.93	427.13	588.81	39.42	228.51	32.9%
Debit	0.00	0.00	0.00	0.00	0.00	0.00	
Capital transfers	4.84	171.93	427.13	588.81	39.42	228.51	32.9%
Credit	4.84	171.93	427.13	588.81	39.42	228.51	32.9%
Debit	0.00	0.00	0.00	0.00	0.00	0.00	
Financial account	**56.2**	**-6.3**	**311.3**	**196.34**	**-15.70**	**140.90**	**-2322.4%**
Direct investment	-43.45	-49.75	6.22	8.07	0.02	-6.05	-87.8%
Net acquisition of financial assets	-3.78	-4.08	31.18	17.21	8.83	5.84	-242.9%
Net incurrence of liabilities	39.67	45.67	24.96	9.14	8.81	11.89	-74.0%
Portfolio investment	44.21	11.25	107.08	1.18	-18.62	20.45	81.8%
Net acquisition of financial assets	44.21	11.25	107.08	1.18	-18.62	20.45	81.8%
Net incurrence of liabilities	0.00	0.00	0.00	0.00	0.00	0.00	
Other investment	32.63	72.01	85.33	114.49	-26.41	97.19	35.0%
Assets	-2.23	49.57	59.54	107.09	-40.94	90.76	83.1%
Liabilities	-34.86	-22.44	-25.79	-7.39	-14.54	-6.43	-71.4%
Reserve Assets	22.79	-39.85	112.68	72.60	29.31	29.31	-173.5%
Net errors and omissions	**1283.69**	**606.31**	**571.07**	**492.41**	**1038.70**	**517.12**	**-14.7%**

Source: Monetary Policy Department, DAB

Table 4.2: Merchandise Trade (in million USD)

Years	Q1- 1397		Q2- 1397		Q3 - 1397		Q4 - 1397		Q1- 1398		Q2 1398	
Description	*Total*	*Share ;(%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*	*Total*	*Share (%)*
Imports	1,936.84	100%	1,766.96	100%	1,777.29	100%	1,925.50	100%	1,786.34	100%	1,631.24	100%
Industrial supplies	200.38	10.3%	194.14	11.0%	210.96	11.9%	220.20	11.4%	173.92	9.7%	196.47	12.0%
Fuel and Lub-ricants	220.58	11%	214.21	12.1%	251.34	14.1%	263.66	13.7%	302.34	17%	248.53	15%
Consumer goods	828.96	43%	687.54	38.9%	676.65	38.1%	711.07	36.9%	741.35	42%	622.05	38%
Capital goods and other	686.91	35%	671.07	38.0%	638.34	35.9%	731	37.9%	568.74	32%	564.18	35%
Exports	172.45	100%	146.81	100.0%	261.88	100%	294.09	100%	182.57	100%	143.29	100%
Carpets & Rugs	5.62	3%	5.68	3.9%	5.45	2.1%	5.6	1.9%	6.57	4%	6.35	4%
Food Items	76.32	44%	47.30	32.2%	115.88	44.2%	178.19	60.6%	83.93	46%	49.72	35%
Leather & Wool	7.11	4%	9.05	6.2%	13.37	5.1%	12.79	4.3%	9.69	5.3%	14.00	9.8%
Medical seeds & oth-ers	83.41	48%	84.78	57.7%	127.18	48.6%	97.52	33.2%	82.37	45.1%	73.22	51.1%
Trade Bal-ance	- 1,764.38		-1,620.15		-1,515.41		- 1,631.42		- 1,603.77		- 1,487.95	

Source: Monetary Policy Department, DAB

Table 4.3: Direction of External Trade for the 2nd quarter of the 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	51%	99.72	6.11%	-26.44
Iran	2.31	1.6%	310.45	19%	-308.15
Germany	2.84	2.0%	16.76	1.03%	-13.92
China	3.27	2%	252.63	15.5%	-249.36
England		0.00%	1.08	0.07%	-1.08
Saudi Arabia	1.85	1.29%		0.00%	1.85
United Arab Emirates		0.00%	38.18	2.34%	-38.18
Turkey		0.00%	16.88	1.03%	-16.88
USA		0.00%	12.87	0.79%	-12.87
Common Wealth	1.84	1.3%	361.23	22%	-359.39
Japan		0.00%	49.27	3.02%	-49.27
Other Countries	14.68	10.25%	146.70	8.99%	-132.02
Total	143.29	100%	1,631.24	100%	(1,487.95)

Source: Monetary Policy Department, DAB

Table 4.4: Direction of External Trade: for the second quarter of the FY 1397 (in million USD)

Country Name	Exports	% Shares	Imports	% Share	Trade Balance
Pakistan	62.18	42%	325.07	18.40%	-262.90
India	52.45	36%	111.62	6.32%	-59.17
Iran	5.45	4%	301.28	17.05%	-295.83
Germany	1.13	0.77%	16.65	0.94%	-15.52
Common Wealth	2.83	1.93%	462.49	26.17%	-459.66
China	5.09	3.5%	225.46	12.76%	-220.37
Saudi Arabia	1.33	0.91%		0.00%	1.33
Japan		0.00%	92.45	5.23%	-92.45
England		0.00%	1.06	0.06%	-1.06
USA		0.00%	11.31	0.64%	-11.31
Other Countries	16.37	11.15%	219.57	12.43%	-203.20
Total	146.81	100.00%	1766.96	100.00%	-1620.15

Source: Monetary Policy Department, DAB

Table 4.5: External Debt for the second quarter of the FY 1397 & 1398 (In million USD)

Descriptions	Q2 1397	% share	Q2 1398	% share
Total external debt	2,174.63	100.00	2,185.85	100.00
Bilateral	1,014.92	46.67	1,037.18	47.45
Paris Club	910.36	41.86	926.70	42.40
Russian Federation	910.36	41.86	926.70	42.40
United States		0.00	-	0.00
Germany		0.00	-	0.00
Non-Paris Club	104.56	4.81	110.49	5.05
Multilateral	1,159.70	53.33	1,148.66	52.55
IDA (World Bank)	361.92	16.64	355.06	16.24
Asian Development Bank	677.84	31.17	663.42	30.35
International Monetary Fund	70.35	3.23	77.01	3.52
Islamic Development Bank	47.89	2.20	51.43	2.35
OPEC Fund	1.71	0.08	1.74	0.08

Source: Monetary Policy Department, DAB

Table 4.6: Net International Reserves from Q1-FY 1397 to Q2-FY 1398 (in millions of US dollars)

Changes on the previous quarter	Q1 - 1397	% change	Q2 - 1397	% change	Q3 - 1397	% change	Q4 - 1397	% change	Q1 - 1398	% change	Q2 - 1398	% change
Net international Reserves (million US Dollar)	7,350.92	23.22	7,491.80	1.92	7,534.42	0.57	7,704.98	2.26	7,696.40	5	7,680.28	3
Reserve Assets	8,131.13	22.71	8,227.57	1.19	8,241.90	0.17	8,362.42	1.5	8,345.46	3	8,337.53	1
Reserve Liabilities	780.21	10.91	735.76	-5.70	707.48	-3.84	657.44	-7	649.06	-17	657.25	-11
Commercial bank deposits in foreign currency	722.88	4.00	675.38	-6.57	651.17	-3.59	598.08	-8	591.98	-18	603.65	-11
Nonresident deposits in foreign currency	0.14	-89.57	0.14	-1.30	0.14	0.00	0.14	1.31	0.14	0	0.14	1
Use of Fund resources	57.19	17.53	60.24	5.33	56.17	-6.76	59.22	5	56.74	-1	53.46	-11
Gross Intl. Reserves (in months of import)	12.59		13.97		13.91		13.03		14.02		15.33	
Net Intl. Reserves (in months of import)	11		13		13		12		13		14	

Source: Monetary Policy Department, DAB

5

Fiscal Developments

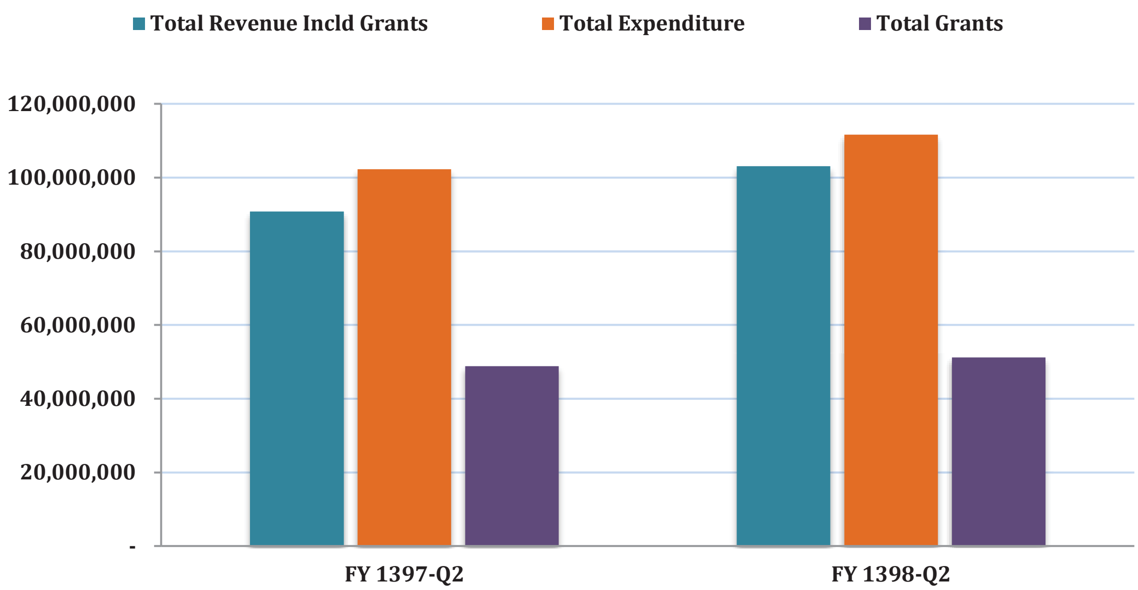
5

FISCAL DEVELOPMENTS

The key objective in the fiscal area is to achieve sustained increase in revenue collection and to permit the gradual takeover of externally financed operating &development spending and to ensure an expenditure allocation consistent with Afghanistan National Peace and Development Framework (ANPDF). The other goals include improvements in public expenditure management, fiscal policy formulation, efficiency in public enterprises, taxes and customs administration. Resembling the other emerging and developing economies around the world Afghanistan continuously faces budget deficit. The total core expenditure exceeded total domestic revenue up to the end of the second quarter of FY 1398, leading to AFN 69 billion budget deficits, and by including donor contributions (grants) a budget surplus of AFN 2.69 billion is being observed. Due to a notable raise in taxation and customs revenues and other revenues collected from the sources under claim (DAB dividend transfers), the total revenue increased from AFN 156.26 billion from the end of the second quarter 1397 to AFN 160.77 billion at the end of the FY 1398, showing an increment of 4.51 AFN billion leading to 2.88 percent growth in domestic revenue collections.

Meanwhile increase of employees spending, supplier expenditure and capital expenditure resulted to raise the total core expenditure from AFN 141.62 billion of second quarter FY 1397 to AFN 163.45 billion of second quarter FY 1398 that shows an increase of AFN 21.84 billion equivalents to 15.41 percent in expenditure comparatively. 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 represents considerable decreases from AFN 76.34 billion of second quarter FY 1397 to AFN 65.97 billion of second quarter FY 1398-Q1 indicating amount AFN 10.39 billion reduction that is equivalent to 13.61 percent decline in the level of grants comparably. It is worth mentioning that the total core budget is increased form AFN 377.19 billion of FY 1397 to AFN 399.42 billion of FY 1398 showing a notable increase of AFN 22.23 billion equivalents to 5.89% rise in total core budget accordingly, moreover operating budget increased from AFN 268.31 billion of FY 1397 to AFN 275.22 billion of FY 1398 signifying 3.4% percent of increment. Similarly development budget is showing a significant increase from AFN 111.06 billion of FY 1397 to AFN 124.19 billion of FY 1398 representing 11.83% raise that is as a result of high budget approval and allocation for the FY 1398 comparably

Figure 5.1: Comparison of Total Revenue Including Grants, Total Expenditure, Total Grants FY 1397-Q2 & FY 1398-Q2



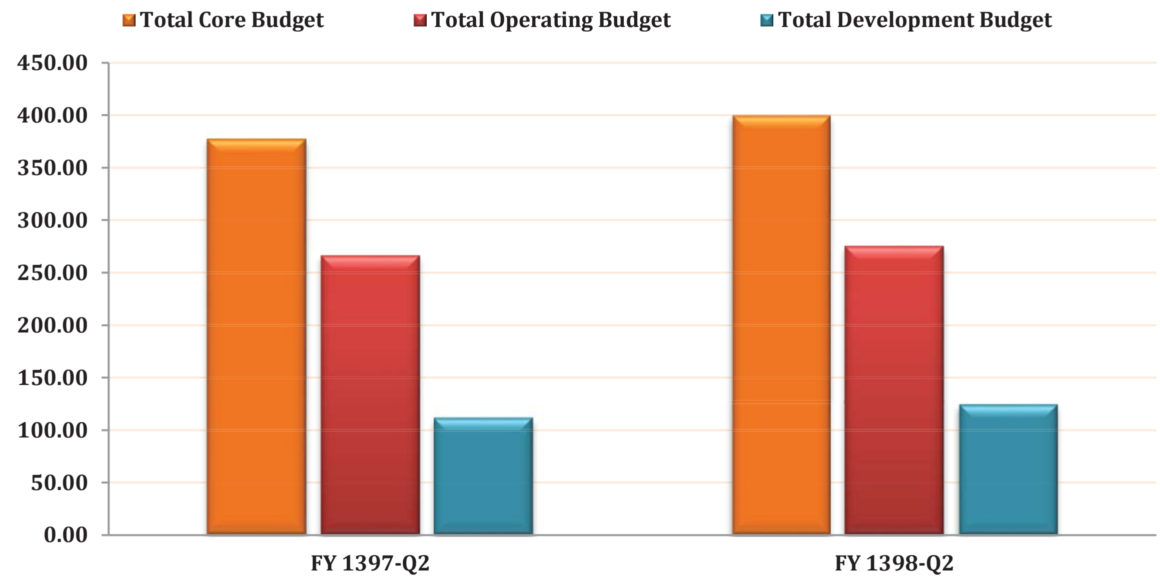
Source: MoF Financial Statement/MPD Staff Calculation

5.1 Budget Execution Rate

During the reference period of FY 1398-Q2, government spent 39.95 percent of the total core budget AFN 399.41 billion of allocated budget, while comparing to 36.06 percent of the total AFN 394.67 billion of allocated budget in FY 1397-Q2 representing increase of 3.90 percent rise in overall budget execution rate relatively. And it is attributed to several factors particularly timely processing and approval of expenses by the National Procurement Authority, security condition in provinces and improved performances by the budgetary units. Beside there is an increase in annual approved budget from AFN 377.19 billion of FY 1397 to AFN 399.42 billion of FY 1398 leading to 5.9 percent growth comparably.

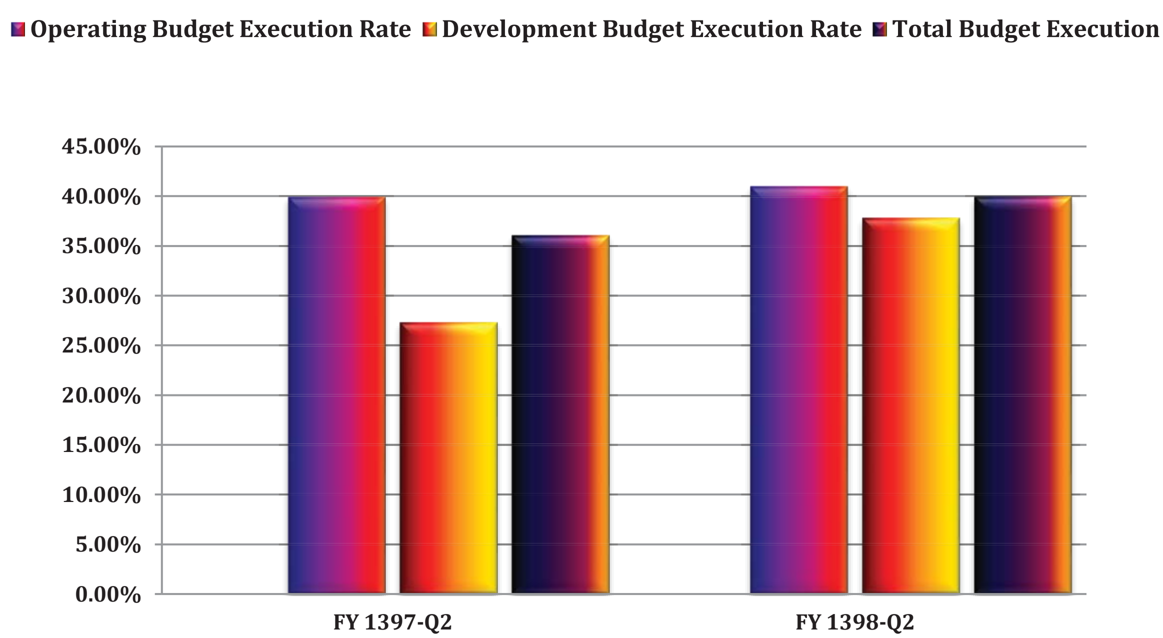
Operating budget execution rate indicates 4.2 percent increase from AFN 109.64 billion of FY 1397-Q2 to AFN 114.21 of FY 1398-Q2 moreover the allocated budget was AFN 362.42 billion in FY 1397 and AFN 391.51 billion in FY 1398. The development budget execution rate evidently represents increase of AFN 53.6 percent comparing both AFN 32.67 billion of the FY 1397-Q2 and AFN 50.18 billion of FY 1398-Q2.

Figure 5.2: Comparison of Total Budget for FY 1397-Q2 & FY 1398-Q2



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.3: Comparison of Operational Budget Execution & Development Budget Execution Rates for FY 1397-Q2 & 1398-Q2

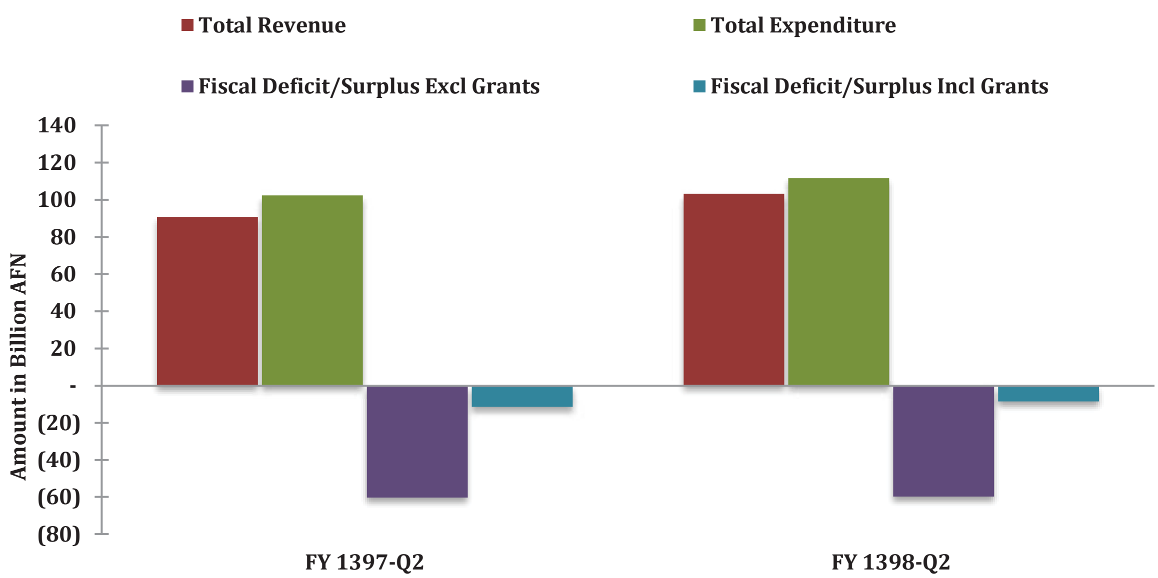


Source: MoF Financial Statement/MPD Staff Calculation

5.2 Core Budget (Deficit and surplus)

The overall budget prior to donor's contribution a deficit of AFN 59.73 billion has been indicated in the FY 1398-Q2 compared to AFN 60.27 billion deficit in FY 1397-Q2 that shows 0.54 billion decrease relatively. Meanwhile, external amount of funding represents increment from AFN 48.80 billion in FY 1397-Q2 comparing to AFN 51.22 billion of the same quarter of FY 1398. The total annual external planed funding amount in FY 1397 represents an increase from AFN 191.28 billion of FY 1397 to AFN 199.02 billion in FY 1398 indicating 4.04 percent increment in annual planed external source and it is as a result of pledge, commitment and disbursement from the donor's contribution on annual basis.

Figure 5.4: Core Budget Deficit/Surplus (including and excluding grants) for 2nd Quarter of FY 1397 and FY 1398&



Source: MoF Financial Statement/MPD Staff Calculation

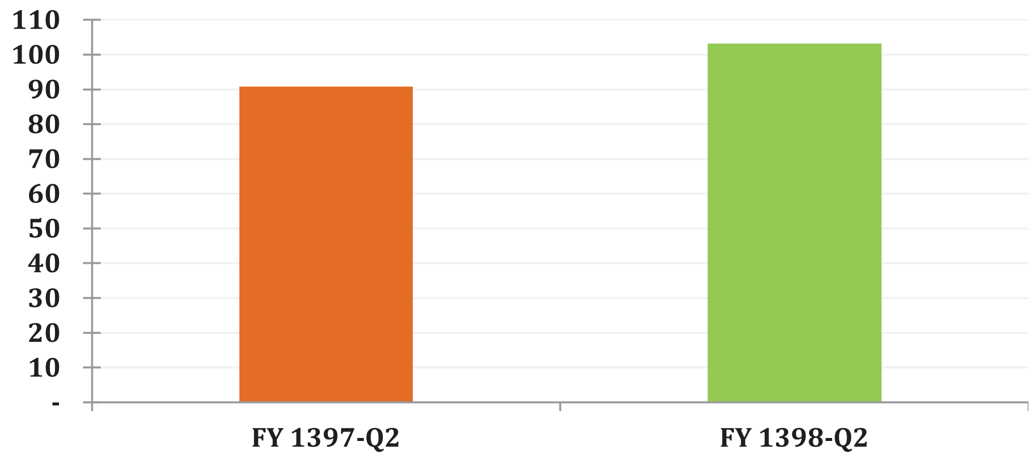
5.3 Revenue Collection

With reference period of FY 1398 total revenues including grants increased significantly with total collection of AFN 103.13 billion in FY 1398-Q2 compared to AFN 90.77 billion of FY 1397-Q2, presenting a mild raise of AFN 12.36 billion that shows 13.6 percent growth as compared to same quarter of previous year.

Annual collection of planed domestic sources indicates 19.29 billion of increment from AFN 171.62 billion of FY 1397 to AFN 190.91 billion of FY

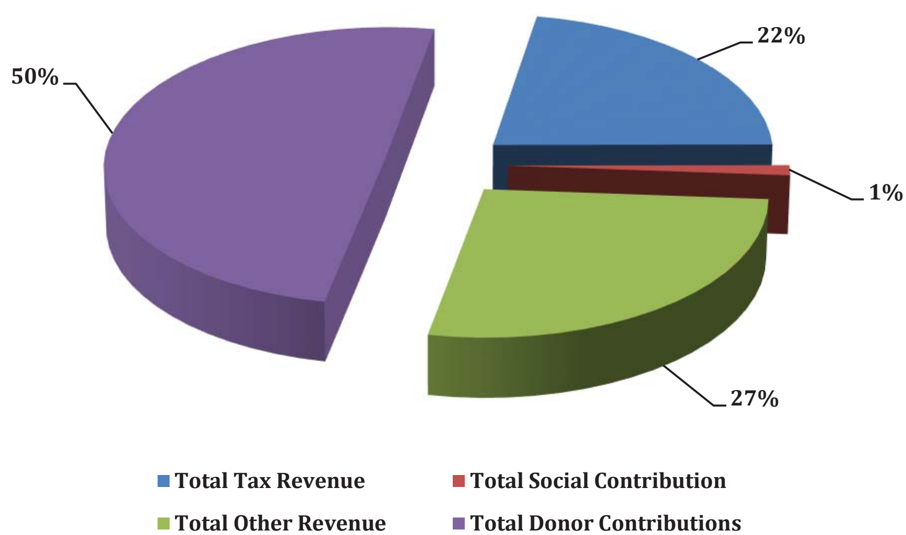
1398 leading to 11.24 percent increases comparably. To meet FY 1398 budget deficit total domestic revenue &donor contribution play a vital role and revenue collection that steer to annual budget surplus. Moreover, the positive gain in total revenue collection of FY 1398 was as a result of momentous improved in income taxes, sales of goods and services, sales of land and buildings, custom duties and administrative fees. However there had been decline in social contribution, administrative fees, royalties, income from capital property, extractive industry, tax penalties and fines and a notable difference in miscellaneous revenues during the second quarter of the year and negatively reflected retail activity from the low base last year comprise of property tax, fixed tax and custom duties.

Figure 5.5: Comparison of the revenue inflows b/w FY 1397-Q2 & FY 1398-Q2



Source: MoF Financial Statement/MPD Staff Calculation

Figure 5.6: Total Revenue Contribution for FY 1398-Q2

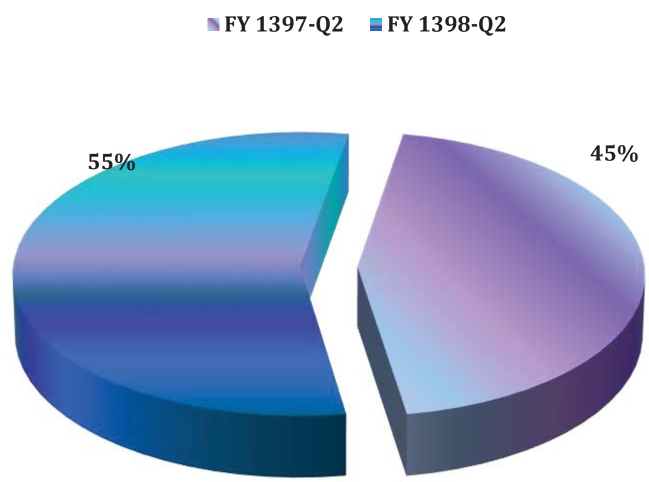


Source: MoF Financial Statement/MPD Staff Calculation

5.3.1 Domestic Revenue

The total collection the total collection of domestic revenue performance is enhanced in first quarter of fiscal year 1398, however it was significantly difficult compared to first quarter of 1397 while these measures are deemed sufficient by the government to ensure the achievement in terms of the GDP deficit in FY 1398. The increment in domestic revenue collection was attributed to enhanced receipts from taxations and custom revenue that include a notable change in income tax, sales tax, fixed tax.

Figure 5.7: Domestic Revenue Comparison for FY 1397-Q2 & FY 1398-Q2

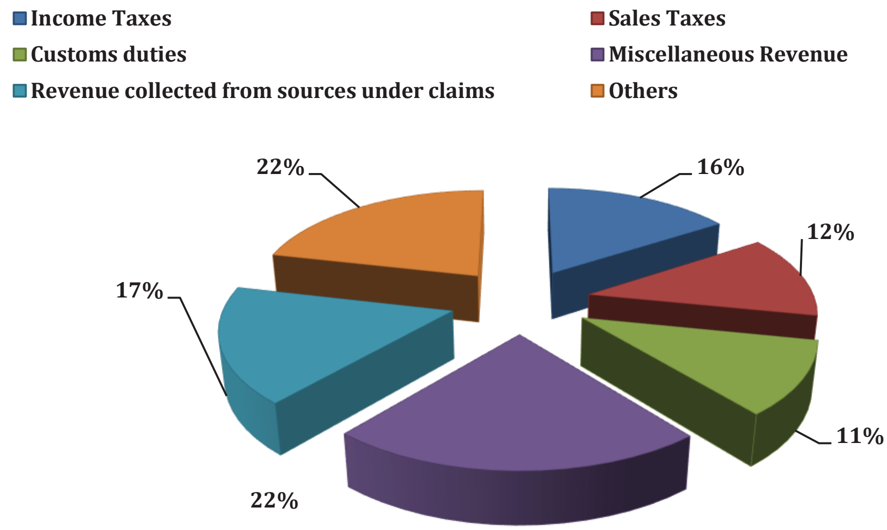


Source: MoF Financial Statement/MPD Staff Calculation

Total domestic revenue is increased from AFN 41.97 billion of FY 1397-Q2 to AFN 51.91 million of FY 1398-Q that shows an increase of AFN 9.94 AFN billion equal to 24 percent growth in domestic revenue collection compared.

A breakdown of the total revenue collection showed a mild acceleration in various domestic revenue components such as income taxes that shows a momentum increase of 8.1 percent from AFN 7.58 billion in FY 1397-Q2 to AFN 8.19 billion in FY 1398-Q2, sales of goods and services raised 24.32 percent from 1.25 billion FY 1397-Q2 to AFN 1.56 billion in FY 1398-Q2, non-tax fine and penalties raised 42.98 percent from 0.11 billion FY 1397-Q2 to AFN 0.16, miscellaneous revenue elevated 259.72 percent from 3.20 billion FY 1397-Q2 to AFN 11.51 billion in FY 1398-Q2 billion in FY 1398-Q2, revenue claimed from the sources under claim has a large increment of from 0.0013 billion FY 1397-Q2 to AFN 8.99 billion in FY 1398-Q2, however extractive industry represents a significant decrease of 30 percent from AFN 0.43 billion of 1398-Q2 to AFN 0.30 billion of 1397-Q2, and a mild decrease in administrative fees showing 23.39 percent from AFN 6.40 billion of 1397-Q2 to AFN 4.91 billion of 1398-Q2 comparably.

Figure 5.8: Major Components of Domestic Revenue for 2nd Quarter of FY 1398

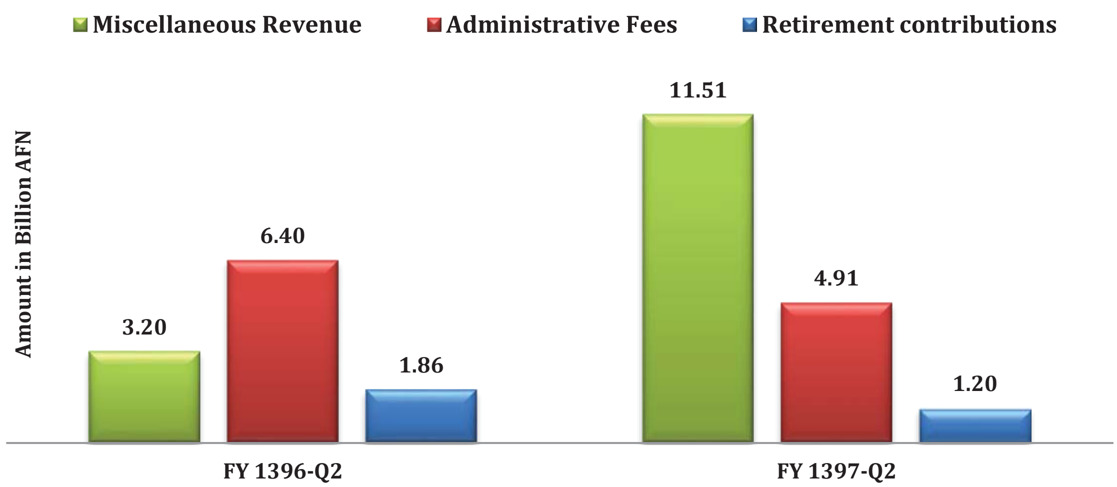


Source: MoF Financial Statement/MPD Staff Calculation

5.3.2 Non-Tax Revenues

One of the initial component of domestic revenues is non-tax revenues that represents a notable increase of 110.44 percent from AFN 13.80 billion of FY 1397-Q2 to AFN 29.05 billion of FY 1398-Q2 billion compared to same period last year, this increment is as a result of vital increase in non-tax fine and penalties, miscellaneous return and revenue collected from the sources under claims, and a notable change in sale of goods and services.

Figure 5.9: Comparison of Major Components for Non-Tax Revenues for the 2nd Quarter of FY 1397 & FY 1398



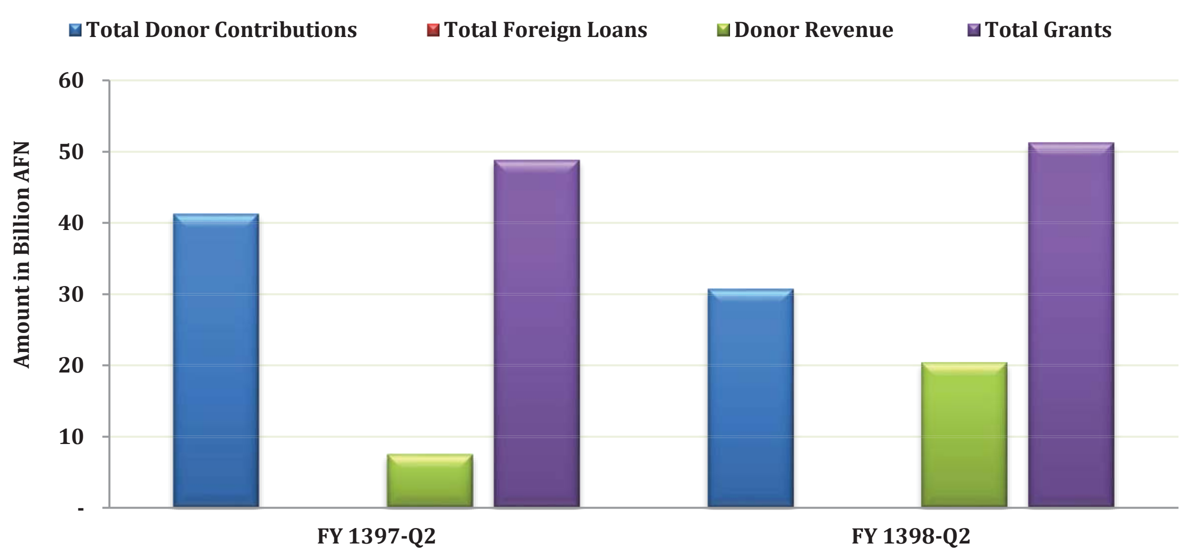
Source: MoF Financial Statement/MPD Staff Calculation

The main contributors of the non-tax revenues are sales of goods and services that increased from AFN 1.25 billion of FY 1397-Q2 to AFN 1.56 billion of FY 1398-Q2, reflecting a 24.32 percent rise. Non-tax fine and penalties increased from AFN 0.11 billion of FY 1397-Q2 to AFN 0.16 billion of FY 1398-Q2, showing 42.98 percent increase. Similarly, miscellaneous revenue increased from 3.20 billion of FY 1397-Q2 to 11.51 billion of FY 1398-Q2, showing a 259.72 percent increment. On the other hand, there components such as retirement contribution, income from capital property, extractive industry and administrative fees have decreased from AFN 6.40 billion of FY 1397-Q2 to AFN 4.90 billion of FY 1398-Q2

.5.4 Grants

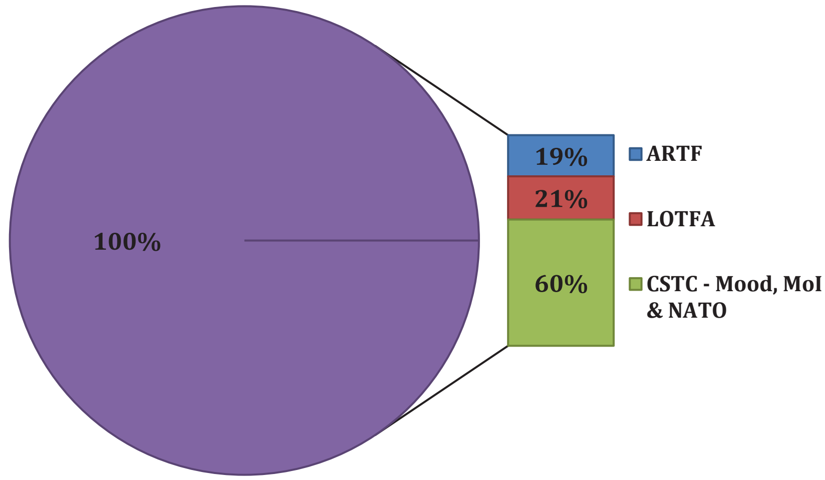
The donor contribution comprises an important part of the national budget, meantime donor grants finance major expenditure items in both operating and development budget likewise, the government receives grants and occasional loans from various donors, trusts and international committees to finance variety of programs in both operating and development expenditures. Moreover, In Afghanistan's context, fiscal sustainability is defined as total domestic expenditure and it should be financed by total domestic revenue where recently it is being financed partially by external sources, foreign loans and rest by domestic revenue. The total development and operating grants represents significant increase of AFN 2.42 billion from AFN 48.80 billion FY 1397-Q2 to AFN 51.22 billion of FY 1397-Q2, which clearly indicates 5 percent increase comparatively.

Figure 5.10: Grants Analysis for the 2nd Quarter of FY 1397 & 1398



Source: MoF Financial Statement/MPD staff calculation

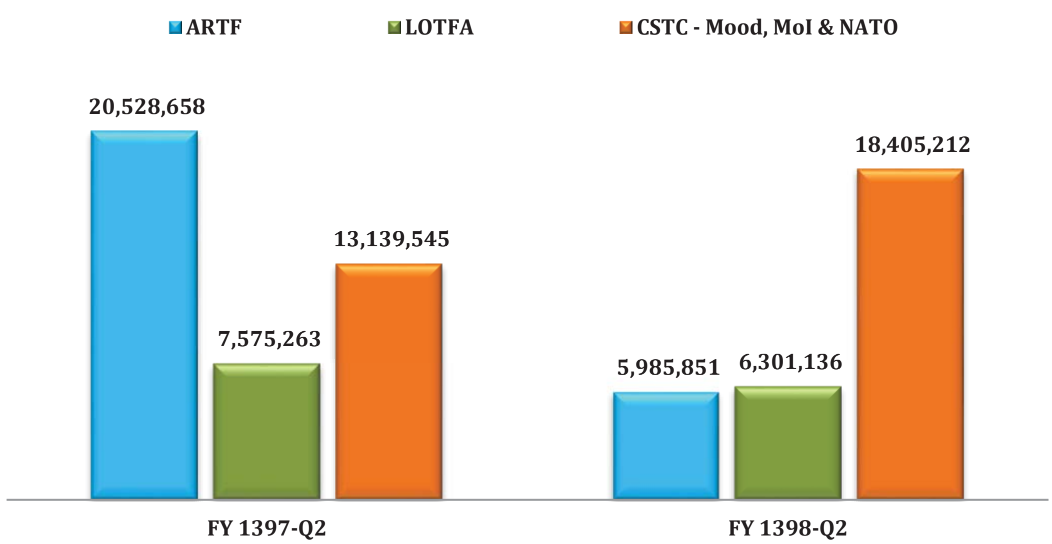
Figure 5.11: Components of Donor Contribution for the 2nd Quarter of FY 1398



Source: MoF Financial Statement/MPD Staff Calculation

The main grants donor or foreign contributors to operating and development expenditures are ARTF funds showing a decline of 71 percent from AFN 20.53 billion of FY 1397-Q2 to AFN 5.99 billion of FY 1398-Q2. Furthermore, CSTC-A MoD, MoI & NATO contributed AFN 18.41 billion in FY 1398-Q2 that shows 40% increase compared to AFN 13.14 billion of the same quarter FY 1397. Moreover, LOTFA contributed AFN 6.30 billion in FY 1398-Q1 compared to AFN 7.58 billion in FY 1397-Q2 that shows decrease of 17 percent relatively.

Figure 5.12: Comparison of Donor Contributions for the 2nd Quarter of FY 1397 &1398



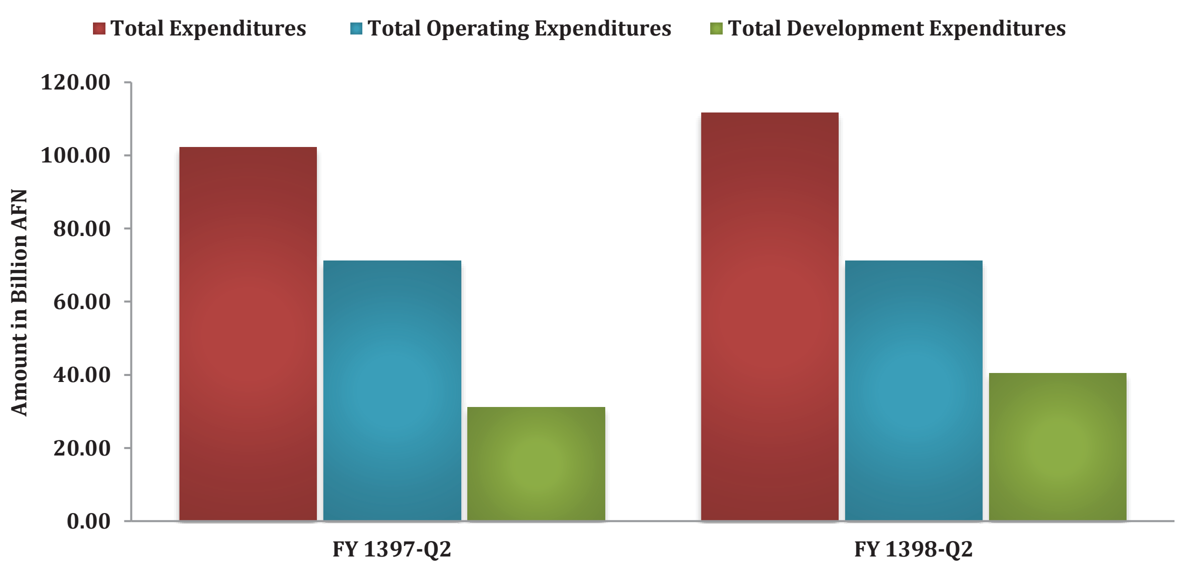
Source: MoF Financial Statement/MPD Staff Calculation

5.5 Expenditures

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, moreover, 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 9.19 percent increase from AFN 102.24 billion of FY 1397-Q2 to AFN 111.64 billion of FY 1398-Q2 indicating AFN 9.40 billion an increase in overall development and operating expenditure compared to same period of previous year and this is as a result of increase in (supplier expenditure and its components and capital expenditure).

In addition, operating expenditure indicates increase of 0.09 percent from AFN 71.12 billion of FY 1397-Q2 to AFN 71.19 billion of FY 1398-Q2 compared to same period of the previous year. Meanwhile, development expenditure shows 30 percent increase from AFN 31.12 billion of FY 1397-Q2 to AFN 40.45 billion of FY 1398-Q2 that shows AFN 9.33 billion speeding up in development expenditure compared to same period of last year. A mild increase in overall expenditure is indicated by increase in annual approved development budget as well increase in core annual expenditure.

Figure 5.13: Comparison of Total Expenditure for the 2nd Quarter of FY 1397 &1398



Source: MoF Financial Statement/MPD staff calculation

6

Banking System Performance

6

BANKING SYSTEM PERFORMANCE

The banking sector is making 21.51 percent of GDP, which comprises of 14 duly licensed and permitted banking organizations, out of which 3 are re-licensed state owned banks, 7 private commercial banks, 1[1] Islamic bank and 3 branches of foreign banks. The performance of the banking sector in the quarter ending June, 2019 is described below followed by analysis of the Islamic banking sector[2] in the given period.

The overall soundness indicators of the banking sector demonstrated an increase to various degrees compared to previous quarter. Total assets, gross loans, deposits, equity capital and profit increased, and liquidity remained adequate. However, the quality of loans still remains low.

- Asset base of the banking sector increased by 3.33 percent over the quarter reaching to AFN 309.55 billion. The increase in banking system assets apart from the exchange rate fluctuation has been noticed in net investments, net loans and net other assets.
- Total gross loan portfolio of the banking sector recorded an increase of 4.95 percent over the quarter, which currently stands at AFN 44.01 billion. The increase in total gross loans is mainly attributed to issuance of new loans, OD utilization and appreciation of USD rate.
- Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 265.81 billion, 97.03 percent of the total liabilities, increased by 3.12 percent coming from exchange rate fluctuation. Deposits were largely denominated in USD (66.31 percent) with Afghani denominated deposits lagging at 27.04 percent. AFN-denominated deposits indicated 2.92 percent decrease, while USD denominated deposits were up by 5.84 percent in the review quarter.
- The capital base of the banking sector remained strong increased by 3.83 percent stands at AFN 35.60 billion. The increase in capital base attributed cash injection and profitability. The capital adequacy ratio of all banks is above the set limit. The Basel benchmark for capital to risk weighted is 8 percent. Capital adequacy ratio (CAR) of the banking sector recorded at 26.55 percent.

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

[2] The Islamic banking sector consists of one bank and six windows

- For the quarter ending June, 2019 higher interest and non-interest income, lower loan provision and taxes collectively helped improve the banking sector net-income. Net income amounted to AFN 1.17 billion significantly improved since last quarter. Amid rising net income of the banking sector, ROA and ROE improved in June, 2019. ROA of the banking sector stands at 0.77 percent, while the returns on equity (ROE), recorded at 6.78 percent. All the banking institutions ended up with profits.

6.1 Assets of the Banking System

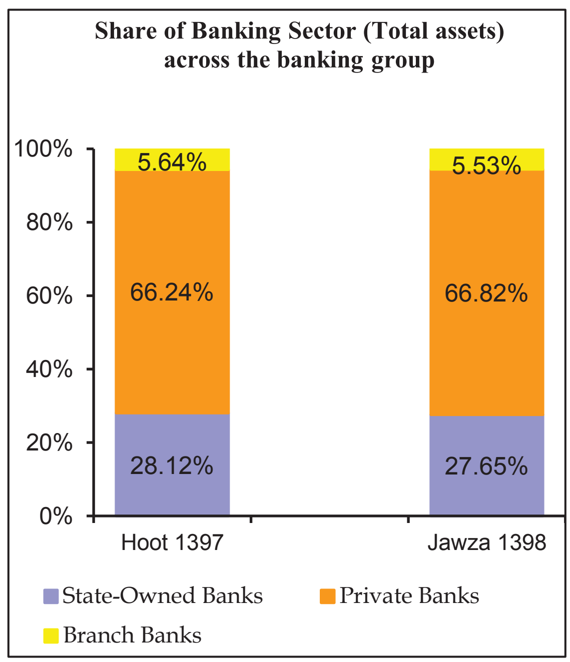
The assets size of the banking sector expended by 3.33 percent in the second quarter of the 2019 against 5.20 percent decline in March 2019. See Table 6.1

The expansion in total assets apart from the exchange rate fluctuation has been contributed by net investments, net loans and net other assets.

The most important components of the system's total asset portfolio were cash in vault and claims on DAB (39.37 percent), interbank claims (30.60 percent), net loans (12.66 percent), investments (9.19 Percent), "other assets" (4.85 percent) and fixed assets make 2.72 percent of the total assets. See table 6.1.

Private Banks is the leading player in the banking sector accounting for 66.82 percent of total banking sector assets (Islamic bank makes 5.26 percent of sector total assets) followed the State-owned banks with 27.65 percent share in the market, while branches of foreign banks held 5.53 percent of the total assets.

Figure 6.1: Share of Banking Sector (Total Assets) across the banking group for the 1st and 2nd Quarter of FY 1398



Source: Financial Supervision Department, DAB

Table 6.1: The assets size of the Banking Sector for the 1st & 2nd Quarter of FY 1398

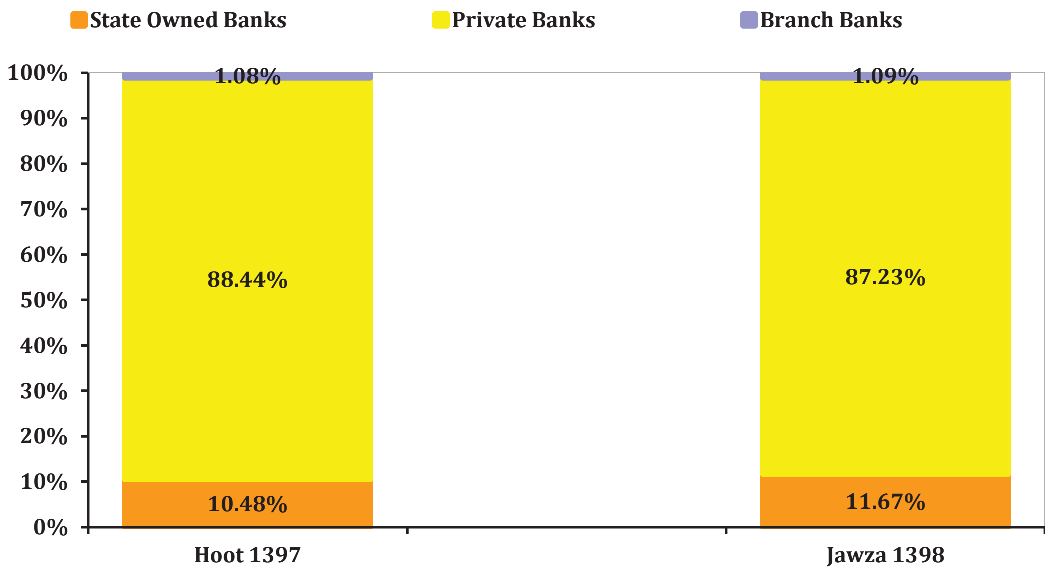
Description	Hoot 1397 Mar, 2019	Jawza 1398 June, 2019	% of Total Assets/Liability	Growth
Assets	**Amount in million AFN**			
Cash in vault and claims on DAB	122,625.35	121,863.56	39.37	-0.62
Interbank claims(Net)	89,752.85	94,708.24	30.60	5.52
Investments (Net)	26,725.25	28,456.35	9.19	6.48
Loans (Net)	37,435.07	39,200.68	12.66	4.72
Intangible assets	872.45	942.30	0.30	8.00
Repossessed Assets	896.04	944.40	0.31	5.39
Fixed Assets	8,290.76	8,414.31	2.72	1.49
Others (Net)	12,968.64	15,025.42	4.85	15.86
Total Assets	**299,566.41**	**309,555.26**		**3.33**
Liabilities				
Deposits	257,770.70	265,817.93	97.03	3.12
Borrowings	2,907.39	3,312.76	1.21	13.94
Other	4,596.69	4,819.28	1.76	4.84
Total Liabilities	265,274.78	273.949.97		3.27
Financial Capital	34,291.63	35,605.29		3.83

Source: Financial Supervision Department, DAB

6.1.1 Gross Loans

Total gross loans portfolio of the banking as of end of June, 2019 stands at AFN 44.01 billion, indicating AFN 2.07 billion or 4.95 % increase in the quarter, constituting 14.22 percent of the total assets and 3.06 percent of the GDP. The increase in total gross loans is mainly attributed to issuance of new loans, OD utilization and increase in USD rate.

Figure 6.2: Share of Gross Loans Portfolioamong banking group for the 1st and 2nd Quarter of FY 1398



Source: Financial Supervision Department, DAB

Six banking institutions recorded increase in their loan portfolio, while five other registered decrease, whereas three banks did not participate in lending.

Disaggregated analysis among the banking groups show that Private Banks with major share (87.23 percent) in the banking sector portfolio registered 3.6 percent increase, state owned banks with 11.67 percent of the total banking sector portfolio demonstrated 16.80 percent increase, while branches of foreign banks with 1.09 percent share in the banking sector showed 6.95 percent growth over the quarter.

❖ Loan Loss Reserves

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

By the end of June 2019, total provision cover of the system was 10.93 percent of total gross loans as opposed to 10.73 percent recorded as of end of March 2019

❖ Distribution of Credit

Breakup of gross loans across the various sectors indicates that some sectors are receiving greater credit while others witnessing a contraction. Noticeably loans to trade sector further increased (44.42 percent against 43.95 percent) mostly in food items

(8.62 percent against 6.00%); other main sectors include: Services sector (20.43 percent against 20.81 percent) mainly in telecommunications/ scratch cards distributers (6.60 percent), Manufacturing and Industry sector (11.89 percent against 11.24 percent), Infrastructure Projects (8.92 percent against 8.72 percent), Commercial real stat and Construction sector (8.45 percent against 8.52 percent), Agriculture livestock and farms sector (3.82 percent against 4.63 percent) and Consumer sector (2.17 percent against 2.13 percent). Increases were observed in all key sectors such as trade, Manufacturing and Industry, Commercial real estate and construction, Infrastructure Projects and Services, while Agriculture livestock and farms witnessed Decrease.

Loans designated to Medium, Small and Micro sectors decreased over the quarter, provided by ten banking institutions in the banking sector figure 6.3. Concentration of loans to a few sectors of the economy would expose banks to credit risk in the event of crises associated to that sector, inversely affecting the overall banking sectors.

Banks should closely monitor the potential risk associated with key sectors given the high NPL ratio. About 71 percent of the loans were designated in Kabul while Balkh and Heart provinces are in the second and third places with Badghis and Kandahar provinces are at fourth and fifth places respectively.

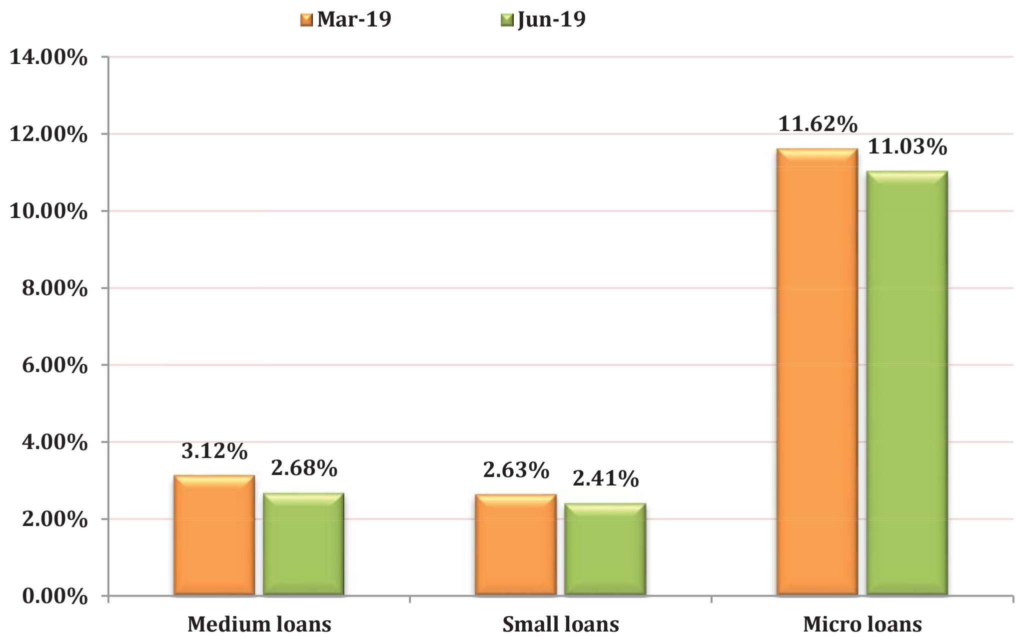
The proportions of loans in other provinces were negligible. The designation of loans by sector, geography and institution is not adequately diversified, but it is expected that with time the distribution of loans will improve. It is desirable that all banks take active part in lending, so as to diversify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

Table 6.2: Distribution of Credit Sector Wise form FY 1393 up to 2nd Quarter of FY 1398

	Qaws, 1393 (Dec, 2014)	Qaws, 1394 (Dec, 2015)	Qaws, 1395 (Dec, 2016	Qaws, 1396 (Dec 2017)	Qaws, 1397 (Dec, 2018)	Jawza,1398 (June, 2019)
Commercial Real Estate and Construction						
Construction and Buildings	14.32%	9.44%	11.12%	8.70%	9.03%	8.45%
Infrastructure Projects						
Power	0.35%	0.22%	0.38%	0.40%	0.48%	0.09%
Road and Railway	2.41%	1.17%	0.64%	1.32%	2.18%	2.54%
Dames	0.61%	0.09%	0.04%	0.00%	0.36%	0.36%
Mines	0.08%	1.48%	0.52%	0.48%	0.52%	0.49%
Other infrastructure projects	1.81%	2.44%	2.44%	3.46%	3.28%	5.34%
Manufacturing and Industry						
Manufacturing &Products of Metal wood plastic rubber leather paper	2.477%	4.423%	3.469%	2.671%	4.10%	3.76%
Manufacturing handmade and machine products	4.187%	4.239%	3.743%	3.164%	3.67%	4.02%
Cement and Construction Materials	2.864%	1.962%	1.274%	3.520%	4.42%	4.11%
Trade						
Textile	2.59%	0.52%	0.72%	1.54%	2.21%	1.98%
Wholesale	4.93%	9.89%	4.34%	4.67%	3.62%	4.17%
Machineries	0.12%	0.25%	0.13%	0.09%	0.41%	0.39%
Petroleum and Lubricants	8.74%	9.80%	11.08%	10.78%	11.48%	11.90%
Spare parts	0.24%	1.42%	0.26%	1.39%	1.78%	1.76%
Electronics	1.40%	1.58%	1.91%	2.76%	3.21%	2.67%
Cement and other construction Material	1.87%	2.73%	2.35%	2.57%	5.14%	3.01%
Food Items	4.52%	8.24%	7.80%	7.27%	6.44%	8.62%
All other Items	5.72%	3.47%	4.17%	3.28%	7.92%	6.91%
Retail trading	3.92%	3.28%	7.31%	8.15%	3.13%	3.01%
Service						
Education	0.00%	0.00%	0.00%	0.00%	0.03%	0.03%
Hotel and Restaurant	1.20%	1.46%	1.33%	2.04%	2.16%	2.49%
Telecommunication/Scratch cards Distributers	2.92%	5.70%	5.96%	5.52%	5.98%	6.60%
Ground Transportation	4.87%	5.31%	4.86%	1.86%	3.08%	3.39%
Air Transportation	4.18%	2.66%	2.35%	2.90%	1.21%	1.60%
Health and Hygienic	0.71%	1.16%	1.42%	1.73%	1.74%	1.49%
Media, Advertisements, Printer	0.04%	0.04%	0.05%	1.18%	1.28%	1.19%
All other Services	6.19%	11.36%	13.22%	12.26%	5.07%	3.64%
Livestock and farms						
Livestock and farming	0.043%	0.026%	0.059%	0.225%	0.30%	0.33%
Agricultural Loans	2.61%	2.67%	3.20%	3.94%	3.86%	3.49%
Consumer Loans	0.26%	0.30%	0.65%	0.86%	1.90%	2.17%
Residential Mortgage Loans to Individuals	7.14%	2.68%	2.78%	0.71%	0.00%	0.00%
All Other Loans	6.68%	0.00%	0.43%	0.57%	0.00%	0.00%

Source: Financial Supervision Department, DAB

Figure 6.3: Share of medium, small and micro loans in total gross loans for the 1st and 2nd Quarter of FY 1398 (2019)



Source: Financial Supervision Department, DAB

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

    Banks should strengthen credit risk management measures to significantly reduce the high level of NPLs, which is not a favorable situation. Moreover, it can be inferred that quality of risk management in banks with poor credit performance is demonstrating weak performance.

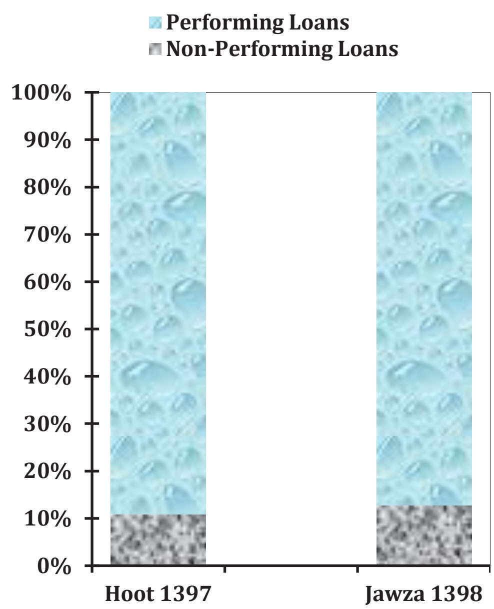
It is essential that banks with poor loan quality evaluate credit applications carefully, comply with all applicable laws, regulations, circulars, internal policies and procedures, and closely monitor financial condition of their borrowers to ensure that credit expansion will not pose a threat to the stability of the financial system.

In monetary terms, by the end of June 2019, non-performing loans recorded at AFN 5.63 billion or 12.80 percent of total gross loans and 17.91 percent of the system's regulatory capital, increased by AFN 1.05 billion owing to deterioration of loans. Out of 12.80 percent NPLs, 10.30 percent is coming from three private banks.

[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)

These banks hold 55.97 percent of the system's gross loans and 25.15 percent of system's regulatory capital.

Figure 6.4: Quality of Loan Portfolio at the end of 1st and 2nd Quarter of FY 1398



Source: Financial Supervision Department/DAB

- ✓ ***Adversely-classified loans***

Adversely classified loans (substandard, doubtful, Loss)[4] depicted AFN 1.01 billion increase over the year, reaching AFN 7.42 billion, constituting 16.88 percent of the total gross loans and 23.59 percent of regulatory capital, the increase is due to deterioration in the loan quality. These loans require strong board oversight and remedial actions by management to reduce the level of Adversely Classified loans to an acceptable level. In addition, more emphasis should be focused on strengthening corporate governance in banks with poor credit quality, enhancing effectiveness and efficiency of internal controls, and adequately managing inherent and unsystematic risk. Management should take appropriate measures to address issues and weaknesses that have resulted in poor credit performance as per prudential regulations. Though systematic risk and economic downturn may have affected, weak and systematically important bank's asset quality especially loans; however, banks management should have mechanisms to predict such risks, hedge their potential risk and take proper precautionary measures as per prudential regulations.

- ✓ ***Loan Classified as Watch***

Loans classified in the "watch"[5] category are AFN 3.75 billion, which makes 8.54 percent of total gross loans increased by 39.84 percent since last quarter. The increase is mostly attributed to one bank in the system coming from reclassification of loans. This category

[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)

of loans requires close monitoring as it may lead to more adversely classified loans (Sub-standard, Doubtful) and losses in the future.

- ✓ ***Loans classified loss***[6]

Loans charged-off as of end of June, 2019 amounts to AFN 7.73 million, 0.02 percent of total gross loans attributed to one bank in the sector.

6.1.2 Inter-bank Claims

Gross Interbank Claims are the second largest among various asset categories, currently comprising AFN 94.78 billion 30.62 percent of total assets registered AFN 4.95 billion or 5.51 percent increase since Mar, 2019, mostly attributed to four banking institutions and mainly contributed by exchange rate fluctuation. In the meantime, AFN placements increased indicating that, the banking sector has channeled a portion of its available funds to less interest earning assets in other banking institutions. Banks should not only appropriately measure risks associated with individual banks but also country or countries in which they have placed funds (see figure 6.4).

6.1.3 Investment

The net-investment[7] portfolio of the banking sector comprises of bonds, Gov. Securities, investment in associated companies; increased by 6.48 percent or AFN 1.73 billion since last quarter standing at AFN 28.45 billion or 9.19 percent of total assets, the increase mostly came from one banking institution. Major part of the sector's investment took place outside Afghanistan. The investment portfolio is attributed to two state owned banks, five commercial banks and two branches of foreign banks.

6.1.4 Cash in Vault and Claims on DAB

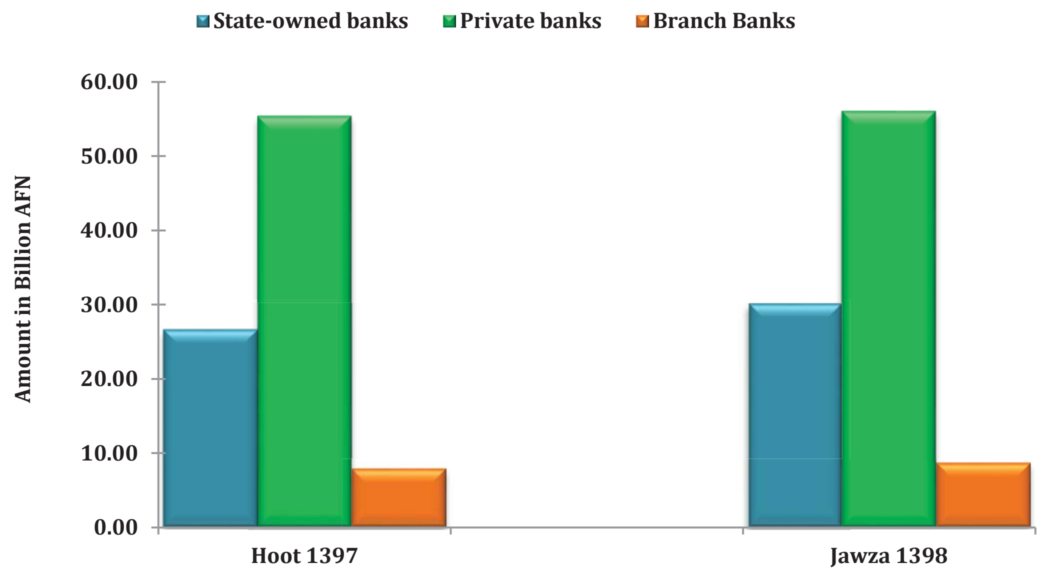
Cash in vault and claims on DAB remains the largest category making 39.37 percent of the total assets, showed a decrease of AFN 762 million, both in absolute as well as in percentage of total assets since Mar, 2019 standing at AFN 121.86 billion as of end of June, 2019. The decrease was observed in capital notes. Banking sector is fully compliant with required reserves regulations and is deploying slowly and prudently the attracted funds into other types of assets.

---

[6] 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

Figure 6.5: Share of Inter-bank claims among banking groups for the 1st and 2nd Quarter of FY 1398 (2019)

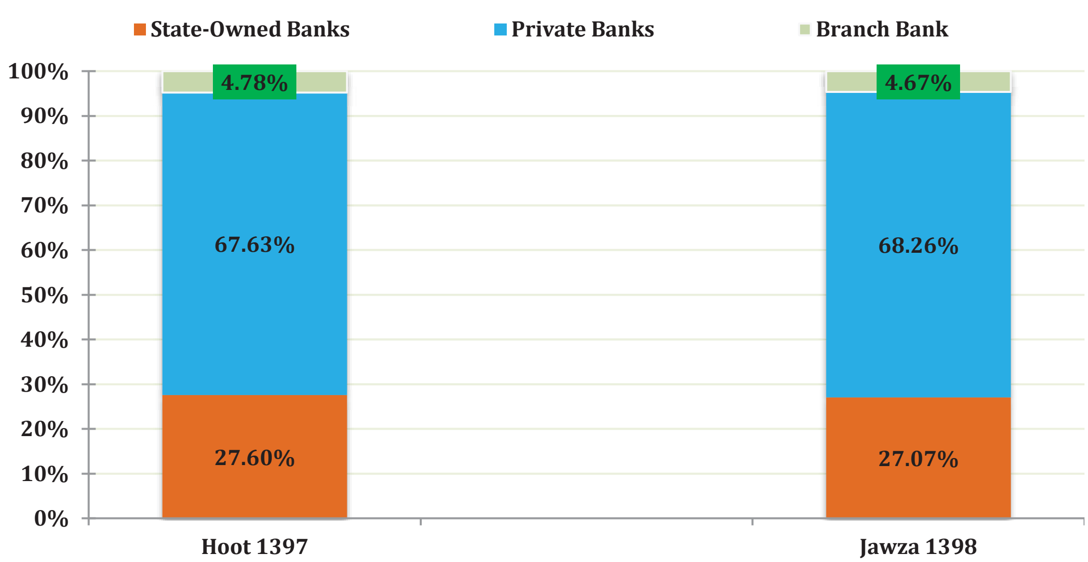


Source: Financial Supervision Department

6.2 Liabilities

Total liabilities of the banking sector increased by AFN 8.67 billion or 3.27 percent standing at AFN 273.94 billion against AFN 265.27 billion in Mar, 2019. All components of total liabilities climbed over the period under review. The majority of liabilities are made up of deposits (97.03 percent), with "other liabilities" at second and borrowings in third place. See table 6.1

Figure 6.6: Share of Liabilities among the banking group for the 1st and 2nd Quarter of FY 1398 (2019)



Source: Financial Supervision Department

6.2.1 Deposits

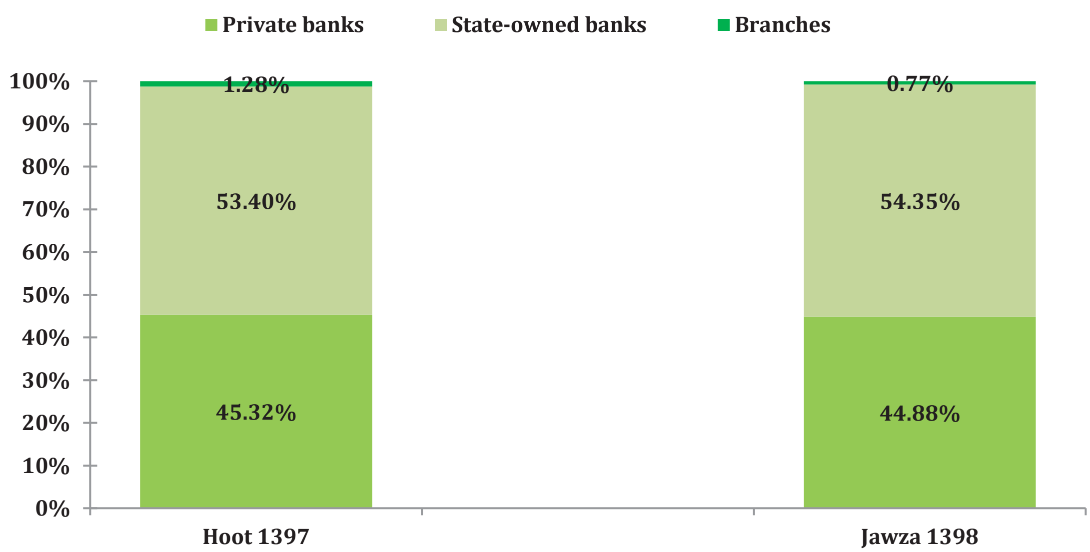
Deposits being the main funding source in the banking sector comprising of interbank and customer deposits, amounted to AFN 265.81 billion as of June, 2019 increased by AFN 8.04 billion or 3.12 percent, compared to Mar, 2019. The total deposits cover AFN 6.68 billion interbank and AFN 259.13 billion customer deposits. The increase in deposit base of the banking sector is attributed to exchange rate fluctuations. Currency wise analysis shows that Afghani denominated deposits indicated 2.92 percent decrease accounting for 27.04 percent of total deposits, while US dollar denominated deposits increased by 5.84 percent making 66.31 percent of the total deposits of the system, the increase in deposits is attributed to exchange rate fluctuation.

Private Banks attracted AFN 181.16 billion deposits, increased by 4.18 percent making up 68.15 percent of the system's deposits.

The share of state-owned banks amounted to AFN 71.10 billion, increased by 1.02 percent since Mar, 2019 accounted for 27.13 percent of the system's deposits. The share of branches of foreign banks stands at AFN 12.55 billion increased by 0.42 percent making up 4.72 percent of total deposits of the system.

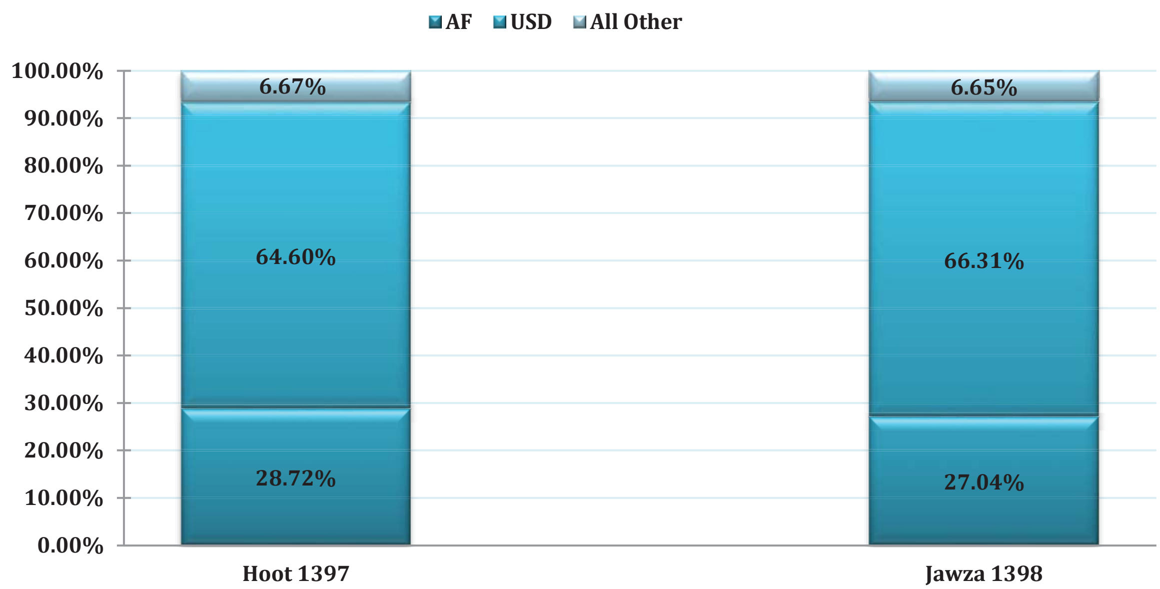
In terms of types of deposits, demand deposits accounted for 71.86 percent of the total deposit base, increased by 2.73 percent and time deposits with 8.48 percent of total deposits was in the second place, and depicted 5.42 percent increase, while saving deposit making up 19.66 percent of the total deposits portfolio was up by 3.59 percent since Mar, 2019.

Figure 6.7: Afghani Denominated Deposits for the 1st and 2nd Quarter of FY 1398



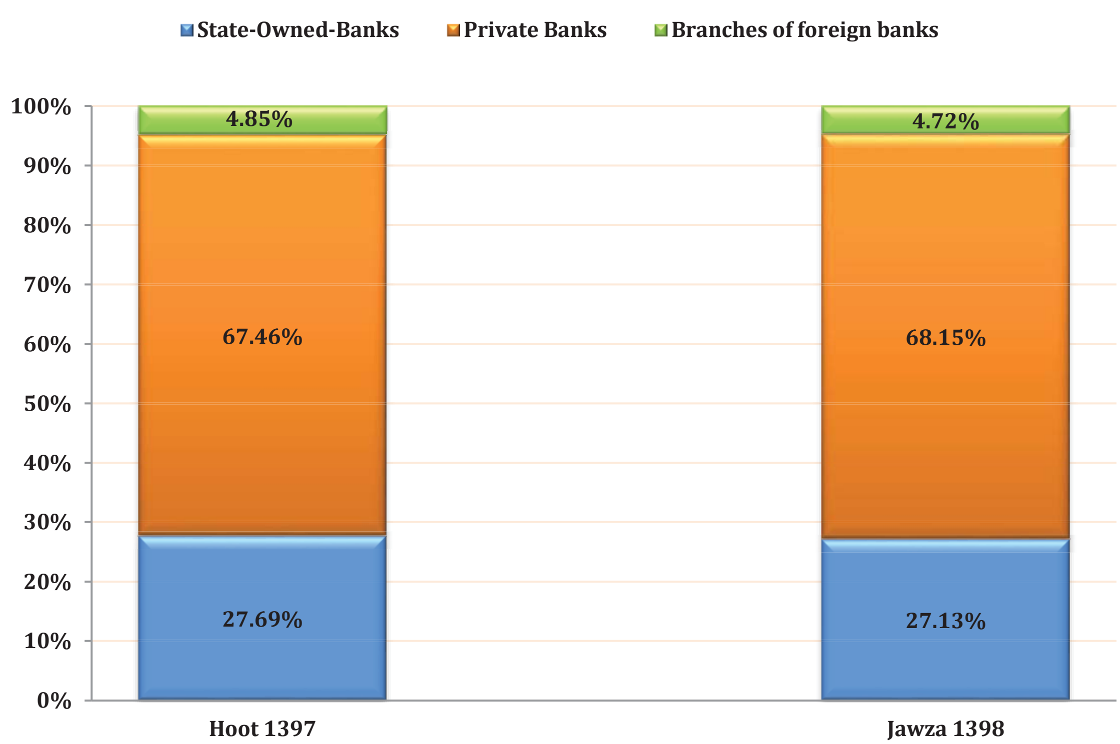
Source: Financial Supervision Department

Figure 6.8: Currency Composition of Deposits for the 1st and 2nd Quarter of FY 1398



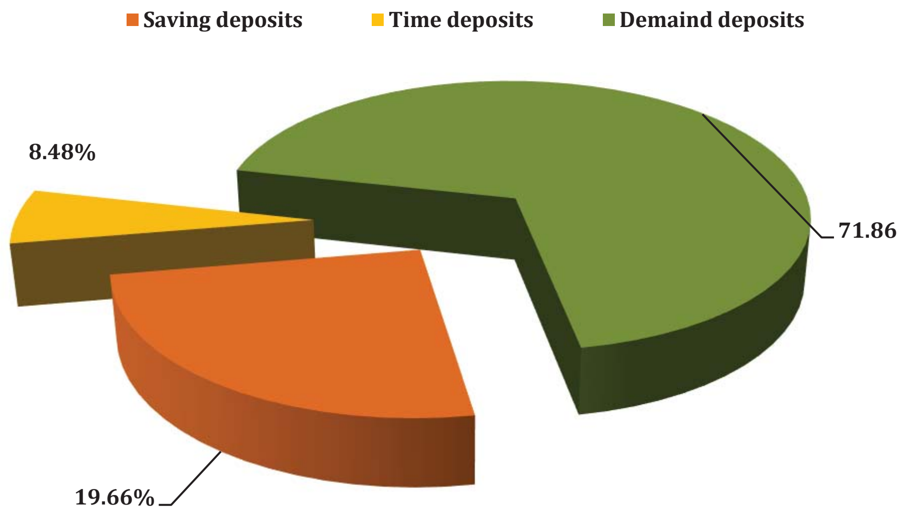
Source: Financial Supervision Department

Figure 6.9: Deposits among banking groups for the 1st and 2nd Quarter of FY 1398



Source: Financial Supervision Department

Figure 6.10: Breakdown of Deposits for the 2nd Quarter of FY 1398



Source: Financial Supervision Department

6.2.2 Borrowings

The share of borrowings in total funding structure of the system increased by 13.94 percent standing at AFN 3.31 billion at the end of June, 2019 making 1.21 percent 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.

Table 6.3: Liquidity ratios comparison in %from FY 1393 to 2nd Quarter of FY 1398

	(Dec, 2014)	(Dec, 2015)	(Dec, 2016)	(Dec, 2017)	(Dec, 2018)	June, 2019)
	Ratio in %					
Total Capital Adequacy Ratio	26.46	19.94	27.68	29.81	25.91	26.55
Tier 1 Capital Adequacy Ratio	26.09	19.66	22.93	28.17	24.56	26.12
Non-Performing Loans to Total Gross Loans	8.09	12.34	12.67	12.42	8.99	12.80
Return on Assets (ROA)	0.90	0.20	0.11	0.64	0.81	0.77
Return on Equity (ROE)	7.35	1.69	1.08	3.38	6.91	6.78
liquidity Ratio (Broad Measure Median)	73.6	68.22	67.74	65.92	76.62	74.00
liquidity Assets to Total Assets	73.28	75.05	71.98	73.95	72.88	69.99
*ROA, ROE June, 2019 based on quarterly data						

Source: Financial Supervision Department

6.3.1 Liquidity Ratio (Broad Measure)

Banks are required to maintain a liquid asset ratio not less than 15 percent. This should provide a comfortable safeguard against any liquidity shortfall. Generally, a surplus liquidity position was observed in the banking sector during this period. 69.99 percent of the sector's total assets are comprised of liquid assets. Ratio of the broad liquidity as a median for the whole system stood at 74.00 percent. All banking institutions were well above the minimum required level. See table 6.3.

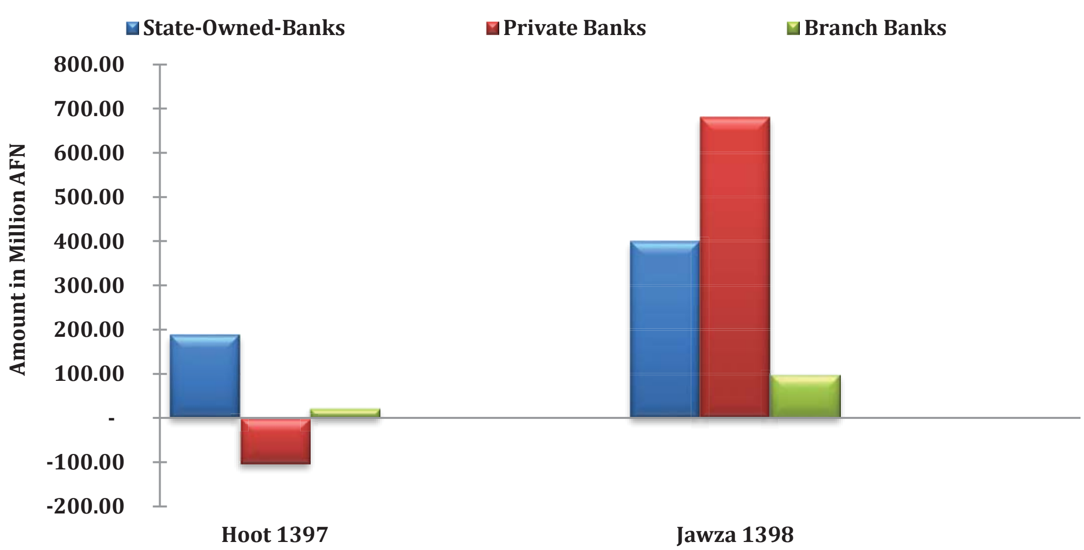
6.4 Capital

The system is well capitalized. The capital fund of the banking sector stands at AFN 35.60 billion; increased by 3.83 percentage points or AFN 1.31 billion since Mar, 2019. The increase in total financial capital is mainly attributed to cash injection and profitability. On an aggregate basis the Capital Adequacy Ratio of the banking sector stands at 26.55 percent. 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 is above the set regulatory threshold (12 percent of the risk weighted assets). The Basel benchmark for capital to risk weighted is 8 percent.

6.5 Profitability

For the quarter ending June 2019 higher interest and non-interest income, lower loan provision and taxes collectively helped improve the banking sector net-income. Net income amounted to AFN 1.17 billion significantly improved since last quarter. The mentioned increases are owing to new placements, issuance of new loans, investments in bonds leading to increase the net-interest income, recoveries from charged-off loans, fees and commissions on GBs and government employees' salaries boosted the noninterest income while recoveries from loss loans mainly contributed to low provisions. However, operating expenses increased over the quarter. The returns on assets (ROA), shows how well a bank is being managed by conveying how much profit the bank earns per unit of its assets. Amid rising net income of the banking sector, ROA and ROE improved in June 2019. ROA of the banking sector stands at 0.77 percent, while the returns on equity (ROE), which measures shareholders return on their invested equity in a bank recorded at 6.78 percent. Improvement in the return ratios was due to stronger growth in net income of the sector though the average assets and equity decreased since last quarter. The ROA of SOB[8] recorded at 0.93 percent, while PB[9] registered 0.67 percent, BOFB [1] recorded 1.16 percent at end of quarter June 2019. All banks ended with profits in the quarter ending June 2019, while on core income basis eight banks ended with losses, against seven banks in Mar 2019. Group wise analysis reveals that State-Owned Banks (SOB) and branches of foreign banks (BFB) ended up with profits, while Private Banks (PB) ended the quarter with losses. See figure 6.10. Major portion of the profitability of the banking sector is attributed to Private Banks recorded at AFN 681 million, State-Owned Banks are second in a row amounted to AFN 400 million, while branches of foreign banks earned AF 98 million net-profits during the quarter ending June, 2019.

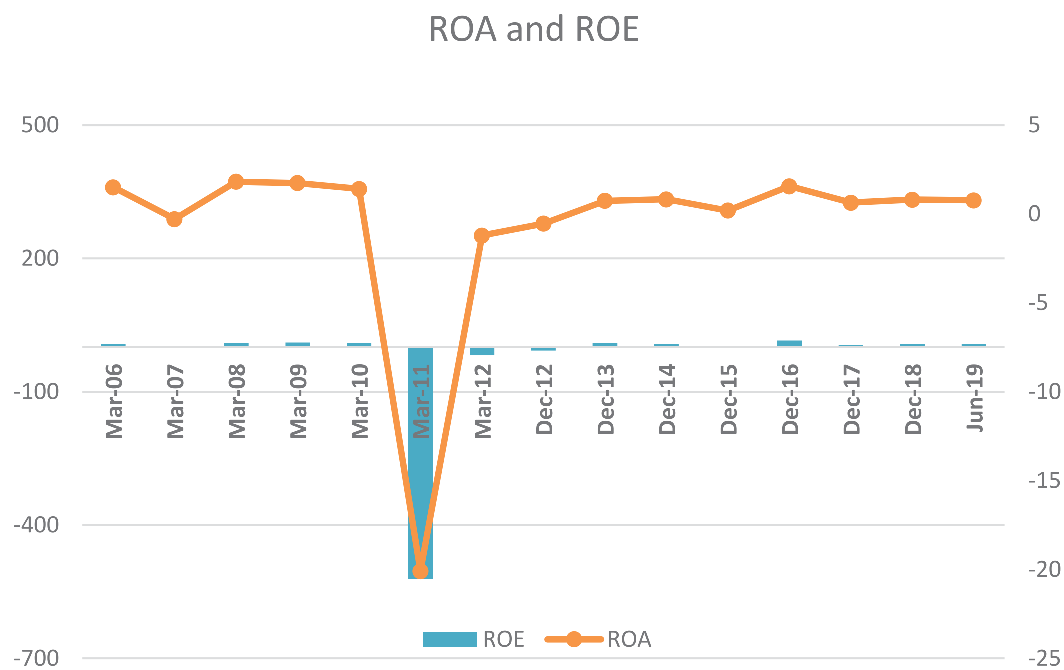
Figure 6.11: Profitability of the Banking Sector for 1st and 2nd Quarter of FY 1398



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

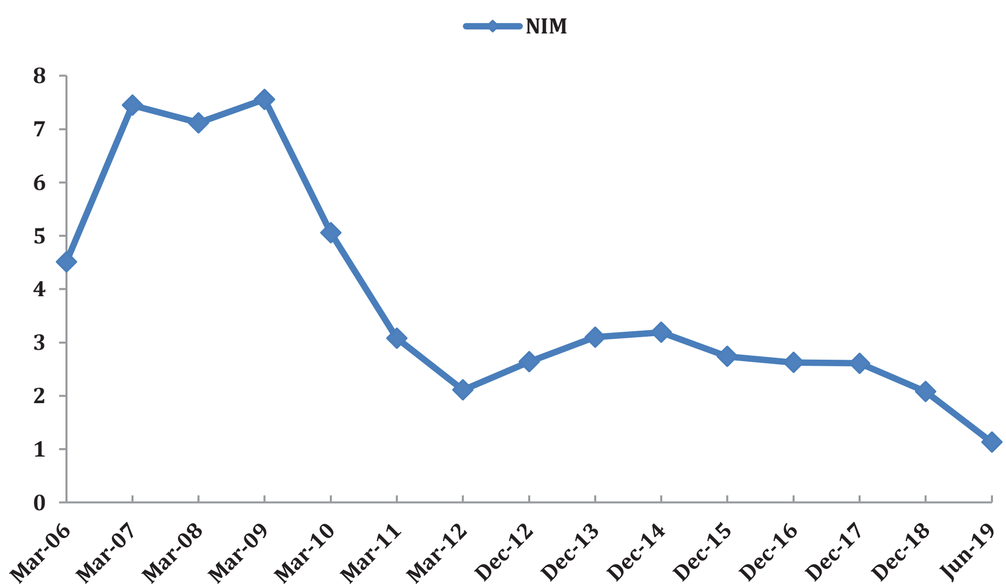
Source: Financial Supervision Department

Figure 6.12: Return on Assets and Return on Equity



Source: Financial Supervision Department

Figure 6.13: Net interest Margin



Source: Financial Supervision Department

Table 6.4: Profit and Loss Schedule for the 1st and 2nd Quarter of FY 1398 (2019)

P/L Schedule			
Items	Hoot 1397 (Mar, 2019)	Jawza 1398 (June, 2019)	%change
Interest income	1,823.81	2,033.07	11.47
Interest expense	278.89	311.18	11.57
Net interest income	1,544.92	1,721.89	11.45
Non-interest income	1,716.02	2,472.73	44.09
Non-interest expenses	1,447.73	1,556.30	7.50
Salary cost	1,062.60	1,158.05	8.98
Credit provisions	362.93	123.72	-65.91
P/L before tax	387.68	1,356.55	249.91
P/L After tax	106.6	1,179.07	1006.06

Source: Financial Supervision Department

6.6 foreign exchange risk

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

The impact of change in exchange rate upon regulatory capital of the system reveals that a 20 percent appreciation in exchange rate would increase the regulatory capital of the system by AFN 2.38 billion and vice versa.

Similarly, a 4 percent change would correspond to AFN 477 million and vice versa.

6.7 interest rate risk

Overall the banking system is in an interest-rate sensitive position. However, calculations made from the Interest Rate Sensitivity Schedules of all banks reveal that, the net-interest income of the system over the next 12 months may increase by AFN 853 million in the event of increase in the market interest rate (upward interest rate shock) by 3 percentage points. Conversely, if the interest rate decreases by 3 percentage points (downward interest rate shock) interest income will decline by AFN 853 million. For five banking institution, if the interest rate increases by 3 percentage points, it will decrease their net interest income over the next 12 months.

The major reason for the 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 Performance

Of the Islamic Banking Sector as of June, 2019/ Jawza, 1398

Summary:

Islamic Banking sector is consisted of 1 bank and six windows, and constitute 10.68 percent share in assets, 27.92 percent share in gross loans and 10.30 percent share in deposits of the overall banking sector.

The Islamic banking sector recorded a positive trend for its main financial indicators over the last quarter, as apparent from the growth in total assets, which is mostly funded by deposits upturn. The capital of four windows out of six windows is negative and the equity capital of one full fledge bank is maintained at healthy levels attributed to rise in the profitability along with adequate level of liquidity position. However, gross financing and investment has upward trend mainly due to issue of new financing and investment.

The asset base of the sector demonstrated 5.59 percent growth over the previous quarter reaching AF 33.08 billion at the end of June, 2019 as compared to AFN 31.33 billion in the same preceding quarter (Mar, 2019). The increase in total assets mostly originates from increase in cash in vault, investments and in all other assets.

Total gross financing and investment portfolio of the sector shows increase of 8.53 percent over the quarter, currently stands at AFN 12.29 billion. The increase in total gross financing and investment over the quarter is mainly attributed to new financing in Sukuk and in Murabaha financing, at the same time settlement of Murabaha financing has taken place as well.

The percentage increase of total gross financing and investment portfolio of the sector composes of 1.53 Percent in Murabaha Financing and 7 percent in Sukuk financing.

Deposits, the main source of funding in the Islamic banking sector witnessed 6 percent growth over the last quarter and currently stand at AFN 27.38 billion. The increase in total deposits was

due to increase in time and saving deposits that makes 65.26 percent of overall deposits.

Time deposits make 25.98 percent and saving deposits 39.28 percent of total deposits. On the other hand, the rising rate of USD currency against AFN also has attributed in the increment of total deposits of the sector. While the demand deposits faced down turn 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 fledges bank stands above regulatory limit. The total capital of the sector decreased by 1.06 percent over the last quarter (Mar, 2019) resulted from losses over the quarter.

The financial capital of four windows out of six windows is negative; however, the regulatory capital ratio (CAR) of full fledge bank is very close to the threshold (12 percent of the risk weighted assets). On a cumulative basis for the first two quarters of fiscal year 1398 (June, 2019) the Islamic banking sector suffers AFN 259 million net-losses against AF 111.35 million net-profits in the same preceding period (June, 2018). Resulting in ROA of (2.10) percent and ROE (14.26) percent annualized compared to that of 1 percent and 6 percent annualized in June, 2018, respectively.

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 percent for overall FX position and ± 20 percent on individual currency position) on overall and individual currency basis (USD long position). On the other hand, the full fledge bank lies in violation of both FX limits set by Central Bank.

6.8.1 TOTAL ASSETS:

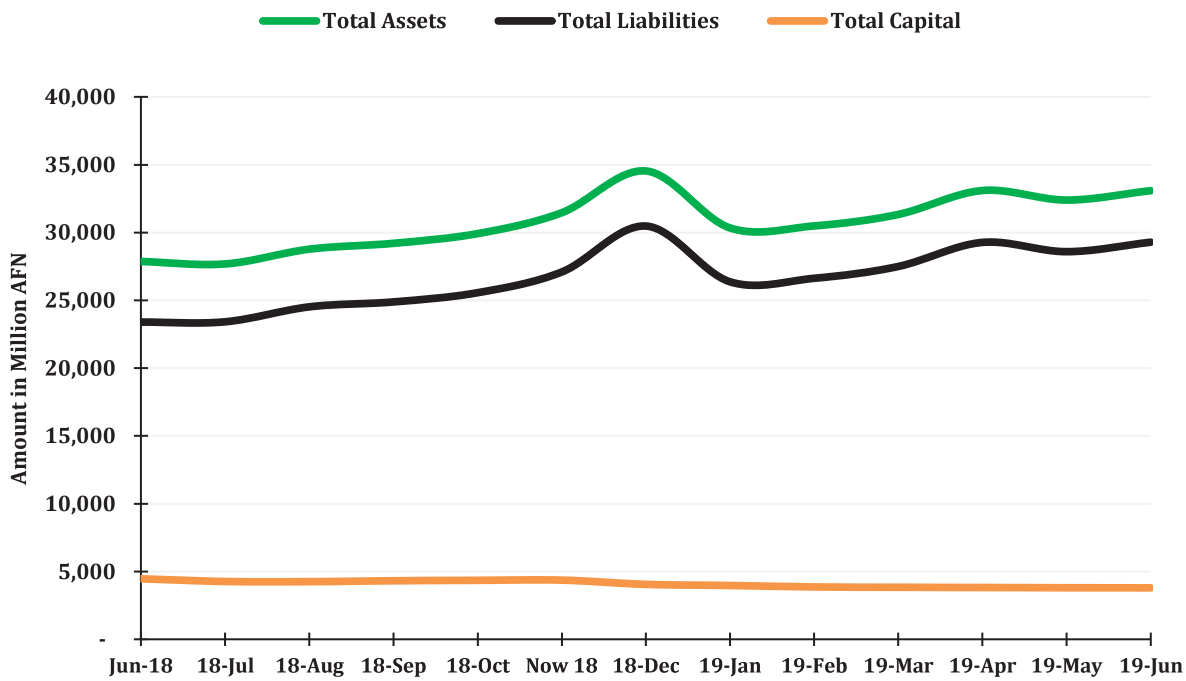
Assets base of the Islamic banking sector registered a growth of 5.59 percent over the last quarter, standing at AFN 33.08 billion (USD 412.40 Million), against 9.27 percent declined in the same preceding quarter (Mar, 2018). The increase in total assets was mostly funded by a growth in deposit base.

The analysis of total assets shows that most obvious increase was recorded in Cash in vault, investment account and in all other assets.

Looking at the increase in total assets across the sector, the growth rate for the one full-fledged Islamic bank by 81.89 percent as highest, as a peer group, the growth rate in 3 Islamic banking windows observed 18.10 percent while other 3 Islamic banking windows witnessed decline in their asset base over the quarter.

The percentage share of fully fledged bank in the sector's total asset is reported to be 49 percent; state-owned banks windows with 28 percent and while the four windows of private commercial banks have 37 percentage shares in the sector's total asset. The trend of assets of the Islamic Banking Sector from June 2018 to June, 2019 is depicted in graph 6.13.

Figure 6.14: Trend of Assets for Islamic Banking



Source: Financial Supervision Department

Table 6.5: Assets of Islamic Banks for the 2nd Quarter of FY 1398 (2019)

Assets of the Islamic Banking sector in descending order for the month of June, 2019			
Serial Number	Names of Banks	Assets in million AFN	Size of Individual Banks as % of Total Assets of the sector
1	Islamic Bank of Afghanistan	16,282.88	49.21
2	Islamic Banking window of AUB	4,620.31	14.96
3	Islamic Banking Window of BMA	4,554.73	13.76
4	Islamic Banking Window of GB	3,197.83	9.66
5	Islamic Banking Window of MB	3,124.94	9.44
6	Islamic Banking Window of AIB	1,185.58	3.58
7	Islamic Banking Window of NKB	121.04	0.36
Total		33,087.34	100.00

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 decline demand deposits of the customers during the mentioned period. The components of the Islamic banking sector assets portfolio were cash in vault and claims on DAB without interest (40.35 percent), interbank claims (15.52 percent), net Murabaha financing (16.46 percent), investment (Sukuk and assets acquired for leasing) 17.77 percent and other assets make (6.96 Percent) of the total assets.

Table 6.6: Total Assets and Liabilities of Islamic Banking Sector for the 1st and 2nd Quarter of FY 1398 (2019)

Descriptions	Hoot, FY 1398 March, 2019	Jawza, FY 1398 June, 2019	% of Total Assets/Liability	Quarterly Growth
Assets	**Amount in million AF**			
Cash in vault and claims on DAB	12,403	13,351	40%	7.65%
Interbank claims	5,139.87	5,136.68	15.52%	-0.06%
Financing Murabaha (Net)	5,521.56	5,449.04	16%	-1%
Investment (Sukuk and other)	5,504.47	5,880.60	18	7%
Other Assets Fixed and Intangible Assets	2,124.06 645.418	2,633.88 636.027	8% 2.1%	24% -2.9%
Total Assets	**31,335.56**	**33,087.34**		**5.59%**
Liabilities				
Deposits	25,832.03	27,382.73	93%	6. %
Other liabilities	1,762.92	1,762.92	5%	21%
Total liabilities	27,498.50	29,291.10		7%%
Financial Capital	3,837.05	3,796.24		-1.06%
Total Liabilities + Capital	**31,335.55**	**33,087.34**		**5.59%**

Source: IBFD, Islamic Banking and Finance Department, DAB

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

Gross Murabaha financing and investments (Sukuks and others) of the Islamic banking sectors of Jawza 1398 (June, 2019) stands at AFN 12.29 billion (USD 153.27 million), constituting 37.16 percent of the total assets, depicted 8.36 percent or AF 472.69 million increase since Hoot 1397 (Mar, 2019), whereas the gross Murabaha financing were AFN 6.31 billion (USD 78.77 million) or 16.46 percent of total assets and investment (Sukuk and other) were AFN 5.50 billion (USD 68.60 million) constituting 17.55 percent of total assets.

Total Afghani denominated financing and investment recorded at AFN 5.22 billion (USD 65.17 million), 42.52 percent of total Gross financing and investment or 15.77 percent of total assets. While the US Dollar denominated financing and investment are AFN 7.06 billion (USD 88.09 million), 57.47 percent of total gross financing and investment or 21.36 percent of total assets.

The increase in total financing and investment portfolio is mainly due to increase in investment securities (Sukuk) AFN 379.29 million and Murabaha financing AFN 96.56 million, meanwhile the net financing Murabaha shows decrease AFN 72.52 million over quarter due to increase in loss reserves.

The increase in total gross investment and financing is mainly attributed to new financing of Sukuk and Murabaha during the reviewed period. At the same time, settlement and installment of Murabaha financing have been collected during the quarter.

The sect oral lending of Murabaha financing in Afghanistan is dominated by Islamic Banking window, constituting 87.24 percent of total gross Murabaha financing of the sector, while the share of fully fledged bank in total Murabaha financing is 12.75 percent, as well as the total investment securities in Sukuk of the sector which is invested out of the country is dominated 81.14 percent of total investment by fully fledged bank and remaining 18.85 percent followed by two Islamic banking windows of commercial banks.

The breakup of total gross financing and investment of sector consists of Murabaha receivables AFN 6.41 billion that increased by 1.53 percent and makes 52.17 percent of the gross financing and investment, Diminishing Musharaka amounted AFN 117.63 million or 0.95 percent, constant Musharaka amounted AFN 53.80 million, Sukuk investment amounted AFN 3.750 billion increased by AFN 379.29 million making 30.49 percent of total gross financing and investment and asset acquired for leasing amounting AFN 1.95 billion ,comprising 15.92 percent of the gross financing and investment during the review quarter June, 2019.

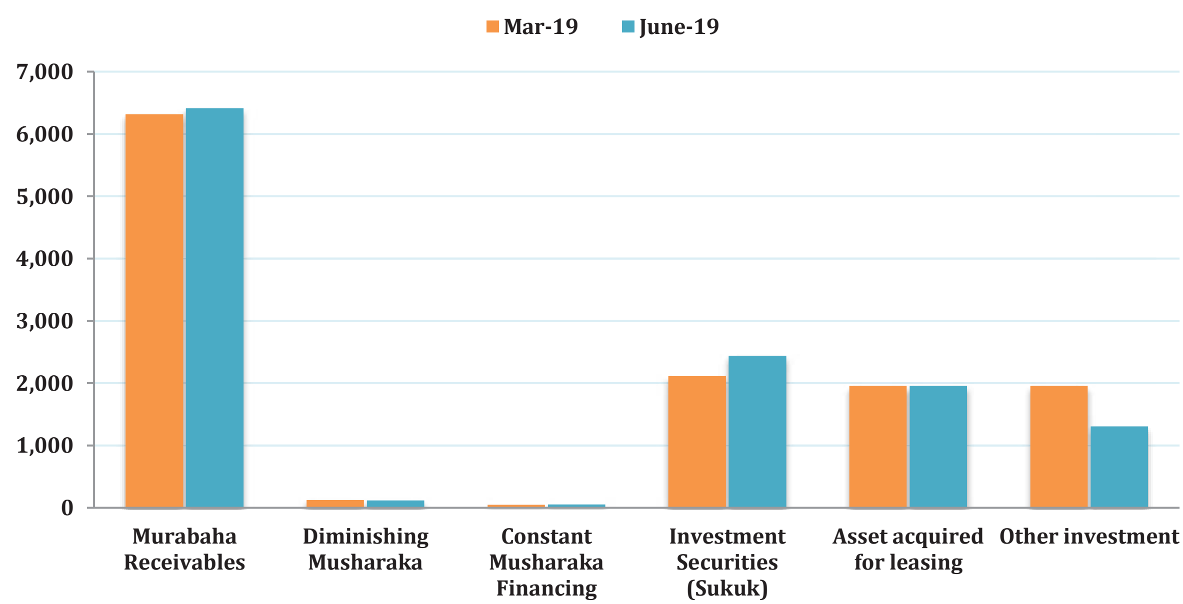
Increase in investment (Sukuk) portfolio was observed at one bank window and at full-fledged bank, and it is worth mentioning here that Islamic banking window of (NKB) has not financing and investment activities.

Table 6.7: Product wise Islamic Banking Sector Financing and investment (gross) for the 1st and 2nd Quarter of FY 1398 (2019)

No	Product	Mar-19	Jun-19	Difference in Amount	Difference %	Products as % Gross Investment & Financing
		Amount in million AFN				
1	Murabaha Receivables	6,319.72	6,416.29	96.56	1.53%	52.17%
2	Diminishing Musharaka	124.103	117.63	(6.46)	5%)	1%
3	Constant Musharaka Financing	50.503	53.80	3.30	7%	0.43%
4	Investment Securities (Sukuk)	2,114.77	2,444.12	329.35	16%	19.87%
5	Asset acquired for leasing	1,958.78	1,958.78	0	0%	16%
6	Other investment	1,256.30	1,306.24	49.94	4%	10.62%
Grand Total		11,824.19	12,296.89	472.7	3.99%	100%

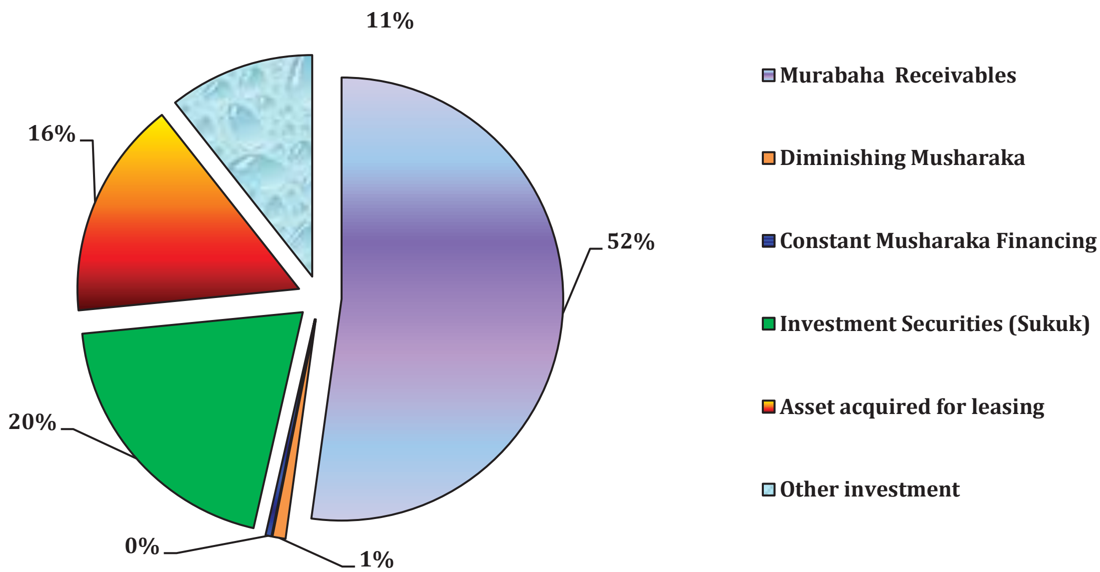
Source: IBFD, Islamic Banking and Finance Department, DAB

Figure 6.15: Product wise Investment and Financing of the Islamic Banking Sector: comparison between 1st and 2nd Quarter of FY 1398 (2019)



Source: IBFD, Islamic Banking and Finance Department, DAB

Figure 6.16: Product wise investment and financing as % for the 2nd Quarter of FY 1398 (2019)



Source: IBFD, Islamic Banking and Finance Department, DAB

➢ Financing & Investment Loss Reserve

At the end of June, 2019 (Jawza 1397), total provision of Islamic Banking sector stands at AFN 813.21 million and shows increase AFN 175.09 million as compared to previous quarter Mar 2019, reported AF 169.08 million provision for Murabaha financing and AF 6 million for account receivable.

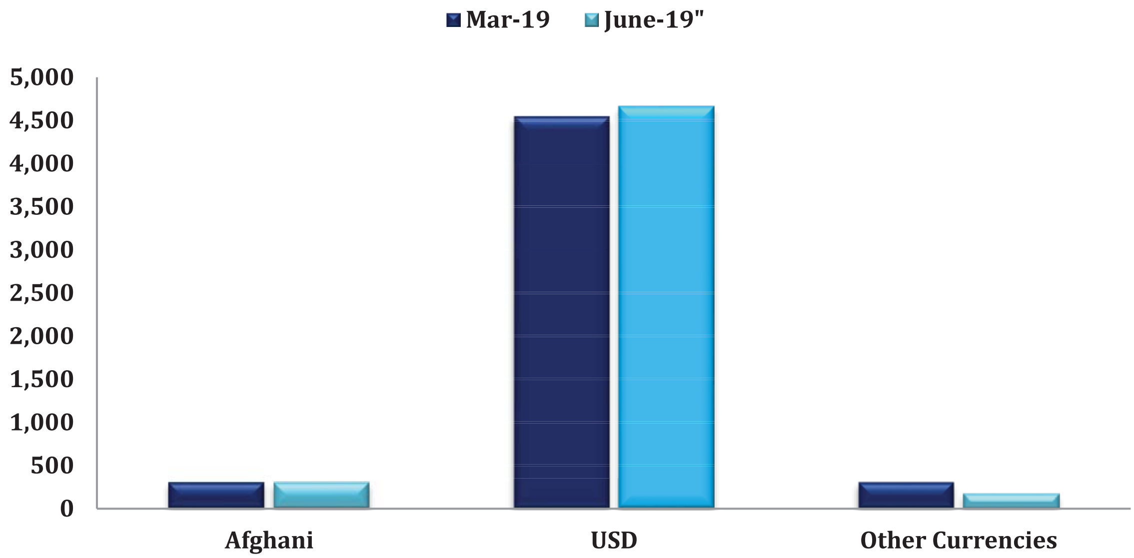
The provision of the sector is comprised of AFN 967.24 million for Murabaha financing and AFN 21 million for account receivable. The provision for Murabaha financing that encompasses 15.07 percent of total gross financing of Islamic banking sector as against to 12.62 percent recorded in the previous quarter ending Mar, 2019.

➢ 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 June, 2019, stands at AFN 5.13 billion (USD 64.02 million) constituting 15.52 percent of total assets. Similarly, no changes in component of the assets have been interbank claims denominated Afghani 5.84 percent, USD 90.75 percent and other currencies 3.4 percent, see figure 6.16.

Two out of six Islamic banking windows and one Islamic bank have interbank claims which consists of AFN 2.21-billion-time deposit and AFN 2.91 billion demand deposits, the interbank claims used as commodity Murabaha and internal bank transferring and settlement transactions with their banks.

Figure 6.17: Interbank claims for the 1st and 2nd Quarter of FY 1398 (2019)



Source: IBFD, Islamic Banking and Finance Department, DAB

➢ Cash in Vault & Claims on DAB

The Islamic Banking Sector's Cash in vault and claims on DAB at the end of Jun, 2019 stands at AFN 13.35 billion (USD 166.41 million) and increased AFN 948.26 million as compared to preceding quarter ended Mar, 2019. The cash in vault and claims on DAB is largest item and makes 40 percent of total assets of the sector. The increase in Cash in vault and claims on DAB mainly showed in cash in vault. The reason of increase in above item is mainly due to increase in total deposits of sector over the review quarter. Cash in vault and Claim on DAB consists of AFN 5.13 billion cash in vault, AFN 5.78 billion non-interest bearing current Account with DAB and AFN 2.42 billion Required Reserve Account with DAB.

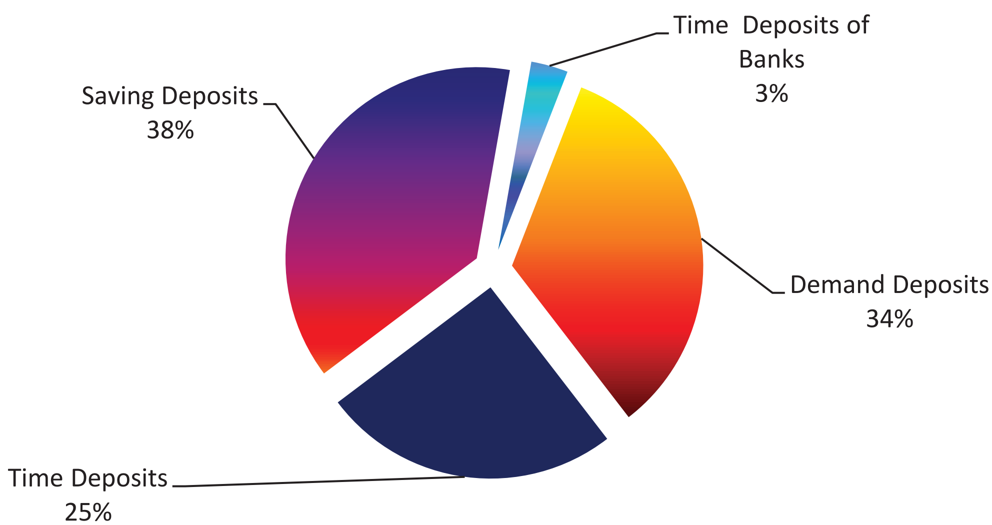
6.8.2 Total Deposits:

Deposits, the main source of funding and the major component of liabilities, stand at AFN 27.38 billion (USD 341.30 million), making 93 percent of total liabilities, increased by 6 percent since Hoot 1397 (Mar, 2019), against AF 25.83 billion (USD 321.97 million) with 10.66 percent growth in last quarter. The increase in total deposits was mostly obvious in time deposits (AFN 1.13 billion or 19.62 % increase) with saving deposits (AFN 781.26 million or 8.11% increases), while time and saving deposits showed an increase of (AFN 1.91 billion or 27.72% increase) over the last quarter, and the same time demand deposits of the sector showed decline by AFN 416.79 million or 4 percent.

Furthermore, the increase mostly occurred in AFN deposits, while USD deposits registered a million), or 33.45 percent of the total deposits, increased by 11.84 percent, while the USD-denominated deposits of the banking sector stands at AF 15.79 billion (USD 196.82 million), or 57.66 percent of total deposits decreased by 10 percent. Fully fledged bank has the highest percentage share in total deposits of the sector, standing at 51.04 percent followed by Islamic banking windows with 48.95 percent share. The total customers' depos-

decrease in its position. AFN-denominated deposits of the sector are AF 9.16 billion (USD 114.19 its of the sector consist of AFN 9.21 billion of demand deposits, AFN 6.89 billion of time deposits and AFN 10.42 billion of saving deposits. As well as the demand deposits make 34.73 percent, time deposits 25.98 percent and saving deposits make 39.28 percent of the total deposits of the sector, and comprises of AFN 26.52 billion of customers' deposit and AFN 855.36 million of banks deposits. The deposits of banks make only 3.12 percent of total deposits of sector.

Figure 6.18: Breakdown of Deposits for the 2nd Quarter of FY 1398 (2019)



Source: IBFD, Islamic Banking and Finance Department, DAB

6.8.3 Liquidity:

The liquidity position of all Islamic Banking Windows and fully fledged Islamic bank are above the set minimum for the broad liquidity ratio (15 percent) and the Quick Liquidity Ratio (20 percent). Broad liquidity ratio of the banking sector as a median stand at 51.57 percentage points against 54.44 percent in the preceding period (Mar, 2019), showing a decrease of 2.87 percent. Since there is no Capital Market inside Afghanistan, the banking sector remained highly liquid. Generally, the liquidity risk can be defined as the risk of not having sufficient liquid assets to meet the demand of borrowers and depositors. All banks are required to maintain a reasonable liquidity ratio level, in order to avoid any liquidity problem. For this reason, Islamic Bank and windows should maintain an asset liability committee (ALCO); one of its tasks is the liquidity management of the bank through gap analysis, stress testing, scenario analysis, cash flow analysis, etc. according to policies of the bank. See table 6.8 for more information.

Table 6.8: Key Financial Soundness Indicators of the Islamic banking sector for the 2nd Quarter of FY 1398 (2019)

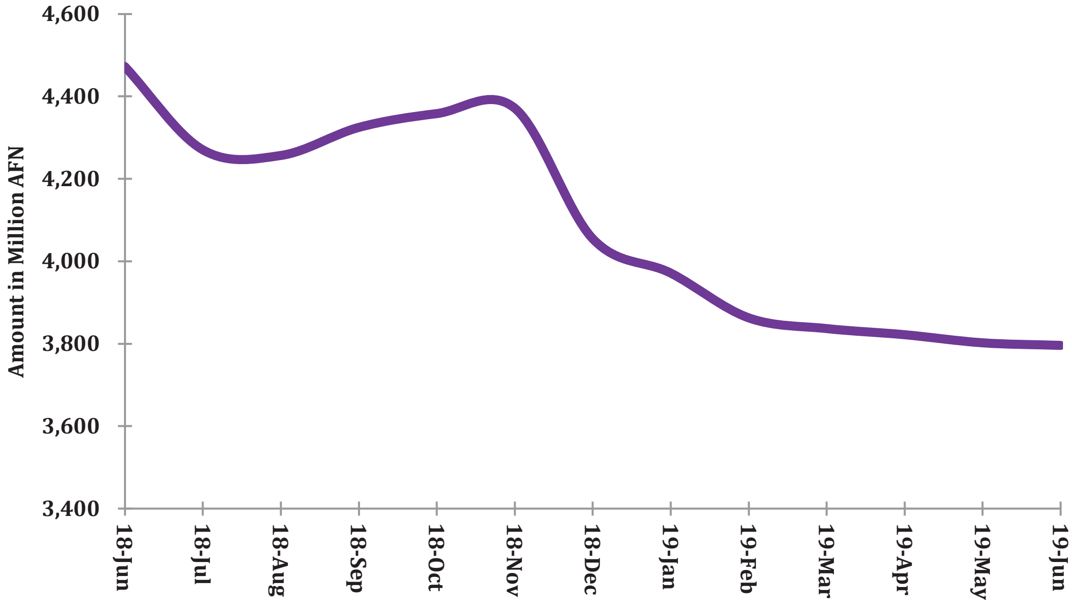
Ratio in %	Mar, 2019)	(June, 2019)
Liquid Assets to Total Assets	56%	55.87%
Liquid assets to short term liabilities	2194%	3271%
Foreign-Currency denominated funding to total funding	68%	58.67%
Foreign- Currency denominated financing to total financing	72%	70%
Return on Assets (ROA)	(5.21)	(0.212)
Return on Equity (ROE)	(26.06)	(1.831)

Source: IBFD, Islamic Banking & Finance Department, DAB

6.8.4 Capital:

The capital of the sector stands at AFN 3.7 billion (USD 47.31 million), decreased by 1.06 percent since previous period (Mar, 2019) when it was AFN 3.83 billion (USD 47.82 million). The decrease in the total equity capital is due to loss over the quarter. CAR of the Islamic Bank of Afghanistan remains above the regulatory limit. The capital of windows consists of owner's equity (which is not in the form of liquid assets, but it is the value of investment property which is transfer/given from the conventional bank to Islamic banking windows), Retained profit/loss of previous years, other comprehensive income (income from the revaluation of fixed assets) and profit/loss of current year. The trend of the sector financial capital as described above is given in the graph 6.18.

Figure 6.19: Trend of Financial Capital for the Islamic Banks for FY 1398 (2019)



Source: IBFD, Islamic Banking & Finance Department, DAB

One Banking window has highest 70.58 percent share in total capital of sector and second fully fledged bank has 34.72 contributions in total capital of the sector.

6.8.5 Profitability:

➢ **Quarter to Quarter Analysis**

The Islamic banking sector suffers AFN 69.73 million net losses in the current quarter (Second quarter) ending June, 2019 against AFN 218.21 million net losses in last quarter, showing a decrease over the quarter. Five out of six Islamic banking windows ended with net losses amounting to AFN 130.77 million as compared to AFN 245.35 million losses posted by five windows last quarter. The decrease in the losses of the sector in the current quarter is mainly attributed to decrease AFN 196.97 million in net credit provisions. The main reason of losses of the sector is reported AFN 217 million as gross credit provisions of two windows and one full-fledged bank.

The share of two windows in credit provisions is 200 million and fully fledged bank is AFN 17 million. Meanwhile the sector reported AFN 90 million as reintegration of provision which is AFN 70.56 million reported by three window and AFN 19.49 million by fully fledged bank.

The full-fledged bank reported AFN 42.81 million of net profits during the reviewed quarter. It is worth mentioning that the profit of bank in the current quarter is due to FX revaluation which in not core income for the bank, the loss of the bank before FX revaluation reported AFN 124.82 million.

➢ **Cumulative; from Jadi to Jawza, FY 1398 (Jan-June, 2019)**

In terms of the profitability on cumulative basis, (From Jan to June 2019) the Islamic banking sector ended with AFN 259.34 million (USD 3.232 million) net-loss for the first two quarters of financial year 1398 (June, 2018) against AFN 111.34 million net-profit recorded in the same period last year. Resulting in ROA of (2.10) percent annualized against 1.04 percent annualized in June, 2018.

The major part of the previous year net profit was from the profit income and nonprofit income related to five windows and one full Islamic bank. The reason the loses of the sector was mainly due to calculated AFN 453.73 million as net credit provisions reported 97.74 percent by 3 windows and remaining by one full-fledged bank and increase AFN 246 million in non-profit expenses (operating expense) is another contributing factors in the losses of sector. However, net-profit income, FX gain increased as well tax expense revised over the period. All six Islamic windows incurred losses of AFN 312.85 million, against AFN 177 million profits in the previous period (June, 2018) with three Islamic banking windows at loss at that period. The sole full fledge bank has net profit worth AFN 53.51 Million, due to significant FX revaluation gain worth AFN 308 during the six-month period.

Table 6.9: Profit and Loss Schedule of the Islamic Banking Sector for the 1st and 2nd Quarter of FY 1398 (2019)

Profit and loss Schedule (Amount in million AFN)			
Item	Mar-19	June-19	Difference
Profit income	196.84	220.46	23.62
Profit expense	80.56	95.30	14.74
Net profit income	116.28	125.16	8.87
Other nonprofit income	92.45	105.36	12.90
Other nonprofit expense	273.09	299.03	23.25
Income (Loss) before FX revaluation and	(393.38)	(195.89)	197.49
Net Credit provisions	326.35	127.38	(198.97)
FX revaluation Gain/loss	135.10	143.58	8.47
P/L before tax	(40.05)	(17.52)	22.63
Net profit income/Loss after Tax	(218.21)	(69.73)	148.48

Source: IBFD, Islamic Banking & Finance Department, DAB

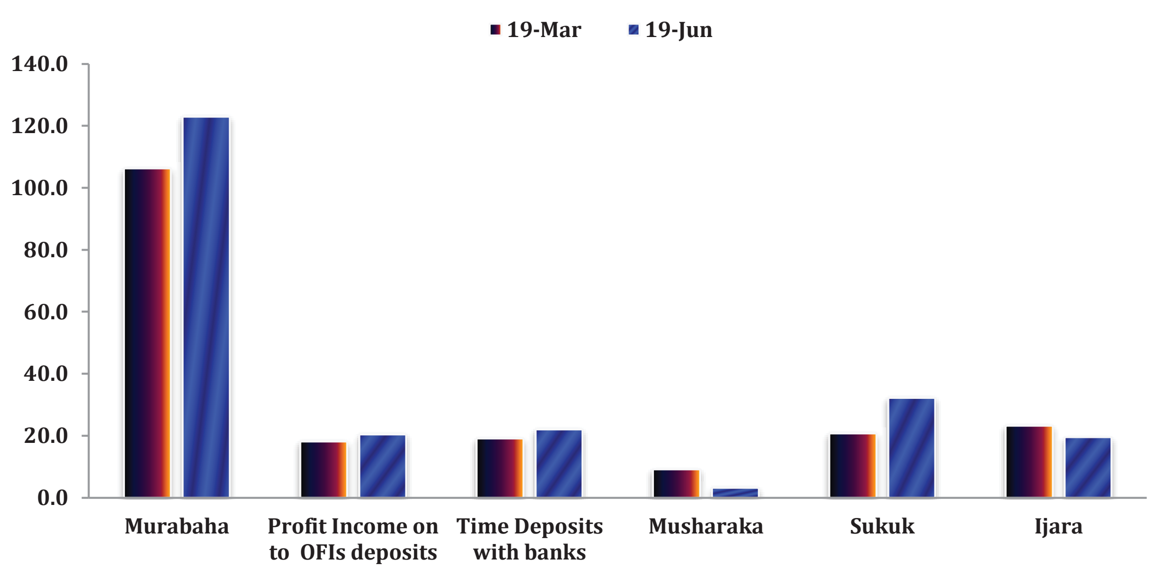
In general, the Islamic banking sector offering seven types of financial products. The returns from financing of the second quarter of the year (June, 2019) are shown in the following table

Table 6.10: Returns by Major Types of Shariah Compliant Products for the 1st and 2nd Quarter of FY 1398 (2019)

Value of returns by major type of Shariah-compliant contract (Amount in million AFN)			
Products	**Mar-19**	**June-19**	**Difference**
Time Deposits with banks	19.118	22.09	2.97
Profit Income on to OFIs deposits	18.183	20.39	2.21
Murabaha	106.235	122.95	16.71
Diminishing Musharaka	9.173	3.213	(5.96)
Sukuk	20.778	32. 35	11.45
Ijara	23.351	19.57	(3.77)
Total Profit Income	**196.847**	**220.46**	**23.62**

Source: IBFD, Islamic Banking & Finance Department, DAB

Figure 6.20: Return by Major Types of Shariah Complaint Products for the 1st and 2nd Quarter of FY 1398 (2019)



Source: IBFD, Islamic Banking & Finance Department, DAB

Table 6.11: Total number of employees, borrowers, and depositors of the Islamic Banking sector until 2nd Quarter of FY 1398 (2019)

Particulars	No
Full-time Afghan Employees	1,017
Full-time Foreign Employees	4
Present Borrowers	819
Present Depositors	346,023

Source: IBFD, Islamic Banking & Finance Department, DAB

Contact:

Telephone : +93 (0) 20 2103930
E-mail : mp@dab.gov.af
Website : www.dab.gov.af




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