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November 2015

2015 ARTICLE IV CONSULTATION CONSULTATION AND FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE ISLAMIC REPUBLIC OF AFGHANISTAN

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Islamic Republic of Afghanistan, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 18, 2015 consideration of the staff report that concluded the Article IV consultation with the Islamic Republic of Afghanistan.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 18, 2015, following discussions that ended on September 21, 2015, with the officials of the Islamic Republic of Afghanistan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 3, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Islamic Republic of Afghanistan.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

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December 1, 2015

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Islamic Republic of Afghanistan

On November 18, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Islamic Republic of Afghanistan.

Since 2002, Afghanistan has made important strides in building its economy, infrastructure and institutions, supported by large aid flows. Afghanistan's Human Development Index (HDI) increased by about 2.5 percent annually between 2000 and 2013, higher than average HDI growth in South Asia and Sub-Saharan Africa. Afghanistan has also established and maintained macroeconomic stability, implemented important structural reforms, and built policy buffers—namely a comfortable international reserves position, low debt, and inflation. Nonetheless, Afghanistan remains a poor fragile state far from self-reliance; donor grants finance the budget and external current account deficits. Afghanistan ranks 194 out of 213 countries by GNI per capita in 2013 (World Bank Atlas method). A large illicit narcotics sector, difficult security conditions, corruption and weak institutions undermine development, constrain growth, and weigh on poverty reduction.

Afghanistan had its first democratic transfer of political power in 2014 and the new national unity government wishes to tackle Afghanistan's challenges. At the December 2014 London Conference, the international community welcomed plans to enhance productivity, stimulate private sector-led growth and mobilize domestic revenue, and reaffirmed their engagement with Afghanistan. Donors and the authorities also agreed on a Self-Reliance through Mutual Accountability Framework (SMAF) in September 2015, which will help sustain international support.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Significant fiscal and banking vulnerabilities emerged in 2014. Domestic revenue collection fell below its 2013 level because of lower growth, declining imports, and lower compliance, while operating expenditure increased. The treasury cash balance fell to dangerously low levels in the second half of 2014 and domestic payment arrears and unfunded allotments emerged. In addition, the financial positions of some banks deteriorated in early 2014. Two important banks were in a hazardous condition.

IMF management approved a Staff-Monitored Program (SMP) in May 2015. The SMP (April–December 2015) aims at addressing fiscal and banking vulnerabilities, preserving macroeconomic stability, laying the ground for inclusive growth, and building a track record for a future IMF financial arrangement. The first review of the SMP was approved by IMF management earlier this month.

Donor support and policy actions under the SMP helped address these vulnerabilities in 2015. Despite weak economic activity and limited revenues from new measures, domestic revenues increased in the first nine months of 2015 because of improved compliance and the treasury's cash balance improved. Corrective measures against all weak banks started to be implemented in 2015 and decisive actions were taken to strengthen the two vulnerable banks. More generally, important progress was made in structural reform, with some delays. A new banking law and amendments to the anti-money laundering law were adopted while steps were taken to improve capacity of revenue and customs departments and the sale of New Kabul Bank has been re-started.

Nevertheless, political and security uncertainties have been a drag on economic activity in 2015. The delays in appointing a new government have delayed policy decisions and attacks by insurgents have slowed the economic recovery. Apart from agriculture, economic activity has been subdued. In 2014, real GDP growth declined to 1.3 percent and end-period inflation fell to 1.4 percent y-o-y. Inflation declined further to -1.9 percent y-o-y in September 2015, reflecting soft economic activity and lower global fuel and food prices.

The future path of the economy is highly dependent on the authorities' delivering on their economic reform commitments, continued donor support, and improvements in security. Although the initial impact of the drawdown of international troops is over, economic activity remains subdued. The authorities' ability to navigate this new landscape will determine the development path in the transformation decade (2015–2024). The government has expressed a strong commitment to reform and building a healthy economy to benefit all Afghans. It is paramount that reform policies are implemented to avoid compromising the hard-worked achievements to date, strong efforts will yield high returns, and inaction carries major risks.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the important strides Afghanistan has made toward raising living standards, rebuilding infrastructure and institutions, establishing and maintaining macroeconomic stability, and implementing structural reforms. Directors noted the country's first democratic transfer of political power and welcomed the new national unity government's resolve to tackle the country's challenges. They were encouraged by the good progress in policy implementation under the staff-monitored program despite continued security challenges, weak confidence, and fragile institutions, which hold back economic performance. Directors commended the authorities' commitment to reform and economic transformation, but stressed that strong and sustained efforts, together with better security conditions and continued donor support, are needed to ensure high and inclusive growth.

Directors considered the macroeconomic policy mix to be appropriate and emphasized the need to improve confidence by strengthening policy implementation. They agreed that the fiscal position, including grants, should continue to remain broadly balanced to ensure sustainability, and that budget management should be improved to increase pro-poor and development expenditures. Directors underscored the need for monetary policy to continue to foster confidence in the domestic currency, including by developing domestic-currency denominated instruments, and welcomed the authorities' continued commitment to a flexible exchange rate regime.

Considering Afghanistan's high dependence on donor grants, Directors underscored the need to improve revenue mobilization. They recommended introducing new taxes, strengthening revenue administration, and improving the tax policy mix. Over the medium term, introducing a VAT, additional excises and property taxes, developing a fiscal regime for natural resource taxation, and improving enforcement and compliance will be important. Directors also noted the need to prioritize and increase the efficiency of spending. A few Directors saw room for financing high-return infrastructure projects, while a few others recommended caution in acquiring new debt, in order to preserve debt sustainability.

Directors welcomed the progress in bank restructuring, improvements of the regulatory and supervisory framework, and passage of the new banking law and the anti-money laundering and countering the financing of terrorism (AML/CFT) laws. They noted that continued efforts are needed to strengthen the banking system and promote financial deepening. They welcomed the offer for sale of New Kabul Bank and stressed the need for a swift strengthening of vulnerable and weak banks. Directors encouraged vigorous implementation of the new banking and

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

AML/CFT laws and regulations, and a further strengthening of the central bank's supervision capacity.

Directors stressed the importance of sustained governance reforms to boost confidence and improve the business environment, including through stepping up anti-corruption measures, enhancing institutional capacity, and continued strengthening of the AML/CFT regime. Directors urged the authorities to advance key aspects of their plan to promote inclusive growth.

Directors welcomed the candid ex post assessment of Fund long-term work in Afghanistan. They noted that Fund engagement has facilitated the establishment and maintenance of macroeconomic stability and donor support. However, security challenges have led to higher-than-projected security expenditure, delaying the attainment of fiscal sustainability. Volatile aid flows have also complicated policymaking. Looking ahead, Directors stressed the need to focus on macro-critical structural reforms while being mindful of implementation capacity and institutional constraints. They also emphasized the need for realistic assumptions for aid flows and security, stronger donor coordination, continued capacity building, and stronger ownership of reforms.

It is expected that the next Article IV consultation with the Islamic Republic of Afghanistan will be held on the standard 12-month cycle.

Islamic Republic of Afghanistan: Selected Economic Indicators, 2012–15

(Quota: SDR 161.9 million)
(Population: approx. 30.6 million)
(Per capita GDP: approx. US$654; 2014)
(Poverty rate: 35.8 percent; 2011)
(Main exports: opium, US$2.0 billion; carpets, US$86.3 million; 2013)

	2012	2013	2014	2015
	Act.	Act.	Act.	Proj.
Output and prices[1]	(Annual percentage change, unless otherwise indicated)			
Real GDP	14.0	3.9	1.3	2.0
Nominal GDP (in billions of Afghanis)	1,034	1,117	1,173	1,184
Nominal GDP (in billions of U.S. dollars)	20.3	20.2	20.4	19.4
Consumer prices (period average)[2]	6.4	7.4	4.7	-1.3
	(In percent of GDP)			
Public finances (central government)[3]				
Domestic revenues and grants	25.2	24.3	23.9	28.5
Domestic revenues	10.1	9.8	8.5	9.7
Grants	15.1	14.6	15.4	18.8
Expenditures	25.0	25.0	25.6	28.5
Operating[4]	18.2	17.8	19.4	21.5
Development	6.8	7.2	6.2	7.0
Operating balance (excluding grants)[5]	-8.1	-8.0	-10.9	-11.8
Overall balance (including grants)	0.2	-0.6	-1.7	0.0
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)			
Reserve money	3.9	12.4	13.3	7.0
Broad money	8.8	9.4	8.3	5.7
External sector[1]	(In percent of GDP, unless otherwise indicated)			
Exports of goods (in U.S. dollars)	609	714	775	811
Exports of goods (annual percentage change)	20.5	17.2	8.5	4.7
Imports of goods (in U.S. dollars)	10,079	9,242	8,881	8,746
Imports of goods (annual percentage change)	-1.3	-8.3	-3.9	-1.5
Current account balance				
Excluding official transfers	-42.1	-35.5	-37.0	-40.9
Including official transfers	6.0	7.4	6.3	4.5
Foreign direct investment	0.9	0.5	0.6	0.3
Total external debt[6]	6.8	6.9	6.4	7.0
Gross international reserves (in millions of U.S. dollars)	6,867	6,886	7,248	7,110
Import coverage of reserves[7]	7.3	7.6	8.2	7.7
Exchange rate (average, Afghanis per U.S. dollar)	50.9	55.4	57.4	...
Memorandum items[8]	2012/13	2013/14	2014/15	2015/16
Opium production (in tons)	3,700	5,500	3,700	.

Sources: Afghan authorities; United Nations Office on Drugs and Crime; and Fund staff estimates and projections.
[1] Excluding the narcotics economy.
[2] Revised with improved coverage.
[3] For comparison, 2012 is recalculated from data reported on the solar fiscal year basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is moved aligned with the Gregorian calendar year.
[4] Comprising mainly current spending.
[5] Defined as domestic revenues minus operating expenditures.
[6] Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.
[7] In months of next year's import of goods and services.
[8] Items presented on the Afghan solar year basis.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

November 3, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND THE FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM

KEY ISSUES

Context. Since 2002, Afghanistan has made important strides in building its economy, infrastructure and institutions, supported by large aid flows and despite security challenges. The first democratic transfer of political power that occurred in late 2014 provided a distinct chance to renew impetus in economic reforms on the basis of a clear and ambitious agenda proposed by the new national unity government. However, security challenges and delays in policy implementation during the new government's settling-in period have held back a recovery in economic confidence, which has weakened economic growth performance, and, more recently, spurred an acceleration in migrant outflows. The IMF is supporting Afghanistan through technical assistance and a staff monitored program.

Outlook and risks. The authorities have a clear plan for the "transformation decade" (2015–24), which is within reach, providing they implement economic reforms to build confidence in the economy, donors continue their support, and security improves. The main challenge is to boost confidence and co-operation among all stakeholders and thus solidify the hard-won achievements to date and build reform momentum to improve living standards for all Afghans. Risks are mostly on the downside and are related to adverse domestic or regional security developments, political instability, inadequate implementation of economic policies, and donor fatigue.

Policy recommendations. The macroeconomic policy mix remains appropriate. The fiscal balance including grants should continue to remain broadly balanced to ensure sustainability; efforts should be stepped up to mobilize domestic revenue, prioritize spending and further improve budget management. Monetary policy needs to continue to foster confidence in the domestic currency, including by pursuing its commitment to a flexible exchange rate regime while maintaining orderly market conditions. Strong efforts are needed to implement vigorously the new banking, AML, and CFT laws and their regulations. Efforts to strengthen the business climate to pave the way for private sector-led, inclusive and gender-balanced growth need to continue.

Approved By
Adnan Mazarei and Dhaneshwar Ghura

Discussions were held in Dubai during September 8–21, 2015. The staff team comprised Paul Ross (head), Ozgur Demirkol, Marco Rossi, (all MCD), Elif Ture (FAD), Ke Chen (LEG), and Carel Oosthuizen (MCM consultant). The team met with Governor Sediq, Finance Minister Hakimi, and other senior officials. Kusay Alkhunaizi (MCD), Abdul Naseer (MCM), and Ichiro Fukunaga (SPR) also contributed to this report, Yi Liu provided research assistance and Norma Cayo and Maria Orihuela (all MCD) were responsible for word processing and document management.

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Af	Afghani
AML	Anti Money Laundering
CASA-100	Central Asia South Asia Transmission and Trade Project
CFT	Countering the Financing of Terrorism
CGO	Comptroller General Office
DAB	Da Afghanistan Bank
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
EITI	Extractive Industries Transparency Initiative
FAD	IMF Fiscal Affairs Department
FSD	Financial Supervision Department
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
LEG	IMF Legal Department
LICs	Low Income Countries

FSD	Financial Supervision Department
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
LEG	IMF Legal Department
LICs	Low Income Countries

MCD	IMF Middle East and Central Asia Department
MCM	IMF Monetary and Capital Markets Department
MDG	Millennium Development Goals
MEFP	Memorandum of Economic and Financial Policies
NKB	New Kabul Bank
O&M	Operations and Maintenance
REER	Real Effective Exchange Rate
SDG	Sustainable Development Goals
SMAF	Self-Reliance through Mutual Accountability Framework
SMP	Staff Monitored Program
SOE	State-Owned Enterprise
SOM	Senior Officials Meeting
TA	Technical Assistance
TAPI	Turkmenistan-Afghanistan-Pakistan-India Natural Gas Pipeline

UNHCR	United Nations High Commission for Refugees
U.K.	United Kingdom
U.S.	United States
VAT	Value Added Tax
y-o-y	Year On Year

CONTEXT

1. **Afghanistan is at an inflection point that will shape the country's landscape for the years ahead**. Since 2002, large aid flows supported reconstruction and growth and Afghanistan has made important strides in building its economy, infrastructure and institutions. Afghanistan's Human Development Index (HDI) increased by about 2.5 percent annually between 2000 and 2013, above average HDI growth in South Asia and Sub-Saharan Africa. Notwithstanding this strong progress, Afghanistan has experienced an extended period of political and security uncertainty, which has held back economic activity and, more recently, led to increased emigration.

2. **Afghanistan remains a poor fragile state far from self-reliance; donor grants finance the budget and external current account deficits**. Afghanistan ranks 194 out of 213 countries by GNI per capita in 2013 (World Bank Atlas method). A large illicit narcotics sector, difficult security conditions, corruption and weak institutions undermine development, constrain growth, and weigh on poverty reduction.

3. **Afghanistan had its first democratic transfer of political power in 2014.** The new national unity government wishes to tackle Afghanistan's challenges. At the December 2014 London Conference, the international community welcomed plans to enhance productivity, stimulate private sector-led growth and mobilize domestic revenue, and reaffirmed their engagement with Afghanistan. The authorities committed to deliver on their commitments ahead of the September 5, 2015 Senior Officials Meeting (SOM).[1]

4. **IMF management approved a Staff-Monitored Program (SMP) for Afghanistan in May 2015**. The SMP (April–December 2015) aims at addressing fiscal and banking vulnerabilities, preserving macroeconomic stability, laying the ground for inclusive growth, and building a track record for a future IMF financial arrangement.

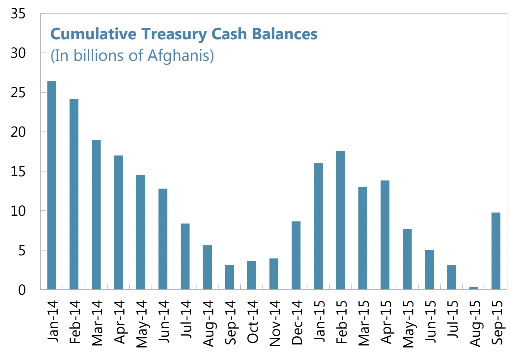
RECENT DEVELOPMENTS

5. **Political and security uncertainties have been a drag on economic activity**. The security situation has become increasingly difficult. At the same time, there were delays in the formation of a full administration. These developments made policy making harder, slowed the economic recovery, and contributed to increased emigration in recent months. Apart from agriculture, economic activity has been subdued. In 2014, real GDP growth declined to 1.3 percent and end-period inflation fell to 1.4 percent y-o-y. Inflation declined further to -1.9 percent y-o-y in September 2015, reflecting soft economic activity and lower global fuel and food prices.

[1] This SOM was held on September 5, 2015 in Kabul. The meeting was a continuation of the high-level meetings held every year to follow up on the Tokyo Conference (July 2012). This was the first high level meeting since the December 2014 London Conference on Afghanistan. The purpose of the meeting was to review progress since the presentation of the Self-Reliance reform program, discuss key policy issues, and to jointly decide the way forward.

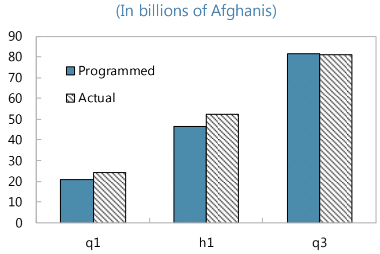
6. **Significant fiscal vulnerabilities emerged in 2014.** Domestic revenue collection fell below its 2013 level because of lower growth, declining imports, and lower compliance. Operating expenditure increased, as off-budget security-related spending was moved on budget (with donor grant financing), and because of new benefits for families of martyrs and disabled people. The government had to reduce discretionary development and operating and maintenance (O&M) spending. The treasury cash balance fell to dangerously low levels in the second half of 2014 and domestic payment arrears and unfunded allotments emerged.

7. **Donor support and policy actions under the SMP helped address these vulnerabilities in 2015**. Despite weak economic activity and limited revenue from new measures, domestic revenues increased by 15 percent (to Af 81 billion) in the first 9 months of 2015 because of improved domestic tax and customs compliance. Tariff increases introduced in April, however, yielded less than projected as traders cut back their import orders. While the operating budget execution underperformed, owing to delays in budget approval and centralization of procurement, development expenditure was as programmed, with 2014 arrears repaid. As a result, the operating deficit, before grants, was lower than projected, but with lower-than-projected grant financing, the overall balance recorded a smaller than projected surplus at end-September. The treasury's cash balance was boosted above Af 10bn by grants from the U.S. and U.K.

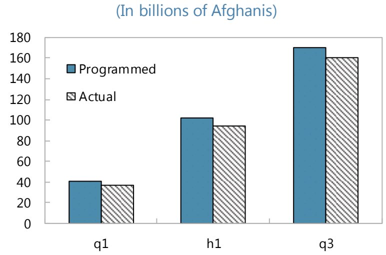


Sources: Afghan authorities; and IMF staff calculations.

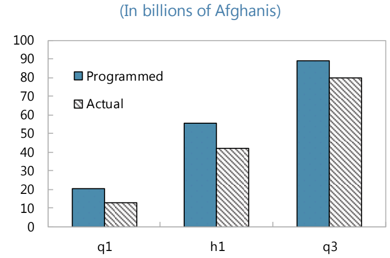
Domestic Revenue, 2015
(In billions of Afghanis)



Operating Expenditure, 2015
(In billions of Afghanis)

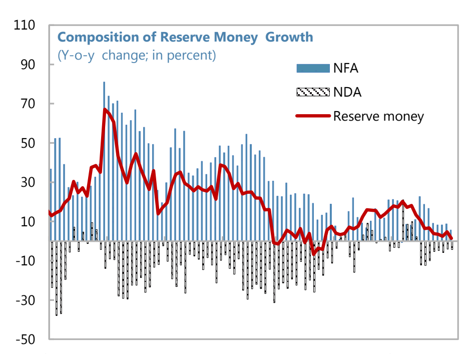


Operating Deficit, 2015
(In billions of Afghanis)



Sources: Afghan Authorities and IMF Staff calculations.

8. **After accommodative monetary policy in 2014, monetary growth declined in 2015**. In 2014, the Da Afghanistan Bank (DAB) did not sterilize the substantial drawdown of government deposits. In 2015, the accumulation of government deposits at DAB, lower confidence (and associated capital outflows), and seasonal factors reduced reserve money growth. Broad money growth was also low, due to weak confidence and the impact of bank restructuring measures. DAB maintained a comfortable reserve buffer, at 7½ months of imports. In July and August, downward pressure on



the Afghani increased and reserves were lost, as higher emigration boosted foreign exchange demand.

Box 1. The Impact of Accelerating Emigration

Background. According to the 2014 UNHCR Regional Overview, after more than three decades of displacement, Afghan refugees still constituted over 21 per cent of the global refugee population and 40 percent of the world's protracted caseload. In addition, there are a large number of undocumented Afghans residing abroad, of which at least 2 million in Iran and Pakistan. Since 2002, over 5.8 million Afghan refugees have returned home voluntarily, but, in recent years, voluntary return has decreased significantly, hitting a historical low in 2013–14.

Recent developments. The difficult economic and security conditions and uncertainties continue to affect the decision to return by Afghan refugees and, in some cases, induce reverse movements. Whereas attacks by insurgents have been ongoing during past years, they have recently escalated, especially in the north of the country. Moreover, there are reports of criminal activity (particularly kidnapping). Anecdotal evidence indicates the number of emigrants to countries in the region and beyond has risen in 2015, accelerating over the past few months. There are reports of a sharp increase in the number of passport applications from the start of the year, of coaches reaching the Iranian borders, and of asylum requests in EU countries.

Policy challenges. The most visible short-term challenge results from emigrants' attempts to liquidate their assets before leaving Afghanistan, which has increased substantially the demand for foreign currency; DAB has met this increased demand partly through sale of foreign exchange and partly vented through depreciation of the exchange rate. While data on the level of extra demand for hard currency cash are not available, it is likely that each migrant nucleus would seek to gather between $5,000 and $10,000 on average. This higher demand for foreign exchange, if sustained, will likely put downward pressure on DAB's international reserves position, with the risk of eroding confidence in macroeconomic stability. Further, it may give rise to pressure for additional budget expenditure to incentivize potential migrants to stay in Afghanistan. In addition, departures of emigrants, especially if well educated, will affect Afghanistan's human capital base and labor force skills. In the context of inelastic public expenditure due to large security and development spending needs, budget revenue losses related to emigrants may also create fiscal pressures.

IMF's role. By assisting the authorities to maintain economic stability, reduce vulnerabilities, improve the business climate, and promote inclusive growth, the IMF is working with the Afghan authorities to create conditions for a sustainable and voluntary reintegration of those who have left and an incentive to stay for those who have not. In this context, the Fund will continue to be flexible with program design to reflect unanticipated shocks and speed of policy implementation, and partner with the donor community with a view to supporting the authorities' efforts to build a resilient, vibrant, and successful economy and, if needed, to mobilize donor financing to the budget to help deal with fiscal costs of emigrants.

9. **Banking sector vulnerabilities emerged in 2014**. Weak governance and regulatory forbearance in 2014 led to a deterioration in the financial positions of some banks. Seven of the 15 banks were classified as weak (rated 4 or 5 according to CAMEL methodology) and hold 50 percent of bank assets. Two important banks were in hazardous conditions. In late 2014, corrective measures started to be implemented and in 2015, enforcement actions against all weak banks were in place and decisive actions were taken to strengthen the two vulnerable banks.

Box 2. The Authorities' Response to Past IMF Advice

Past IMF advice has focused on the overall macroeconomic policy mix, tax policy and tax administration, strengthening banking supervision, exchange rate flexibility, and improving economic governance by enacting anti-money laundering (AML), countering financing of terrorism (CFT), banking and central bank legislation. While the main economic strategy has not changed, Fund staff has been willing to delay meeting some of the structural benchmarks because of capacity constraints. The authorities have been broadly responsive to Fund advice, but the prolonged political transition resulted in delayed or incomplete implementation of some macroeconomic policies and reforms.

The authorities have maintained macroeconomic stability but fiscal and monetary policy advice was not fully followed. As a result, fiscal performance deteriorated and reserve money targets were missed in 2014. Operating expenditures increased despite the deterioration in domestic revenue collection, and the treasury cash balance dropped to dangerously low levels while domestic budgetary arrears emerged. The authorities have increased their reserve buffers in 2014 and the exchange rate against the U.S. dollar was broadly stable. The authorities allowed for more exchange rate flexibility in 2015.

Domestic revenue collection fell short of targets in 2014 but recovered in the first half of 2015. Domestic revenue collection slipped to 8.5 percent of GDP in 2014 from 11 percent in 2011. Budget revenue has started to recover in the 2015, as compliance efforts were stepped up. On tax reform, the authorities have implemented revenue measures under the SMP, but the introduction of some measures was delayed. VAT introduction was postponed in response to the authorities' concerns and staff's assessment that the tax administration needed time to prepare for a successful VAT introduction.

The authorities have taken action to strengthen the financial sector. DAB stepped up its supervision efforts in the second half of 2014 and took action against weak banks including enforcement actions against two vulnerable banks. DAB also approved a strategy of dealing with weak banks with a view to improve banking sector's CAMEL ratings by February 2016. The authorities have cut losses in New Kabul Bank and initiated its resale. The new banking law has been enacted. Further, DAB continues to implement Financial Supervision Department's (FSD) five-year strategic plan, launched in July 2013. FSD is also revising banking regulations to implement the new banking law. Amendments to the DAB law are being reviewed by the Ministry of Justice.

The authorities have strengthened the AML/CFT legal framework and reopened Kabul Bank investigation. Amendments to the AML and CFT laws were introduced by presidential decree to improve compliance with Financial Action Task Force (FATF) standards and regulations on AML/CFT measures and fit and proper requirements for the financial sector were issued by DAB. The authorities have also taken measures to improve the regulatory regime to monitor the cross border transportation of currency. A presidential decree was issued to reinvigorate asset recovery efforts and initiated a review of criminal cases in October 2014 that resulted in increased jail terms and fines for two large Kabul Bank shareholders.

10. **Kabul Bank asset recovery has continued**. A presidential decree was issued in October 2014 to expedite asset recovery and review criminal cases. Between January 31 and August 31, 2015, cash recoveries amounted to $16.9 million bringing total cash recoveries to $191 million.[2] The authorities continue to follow up on the requests for mutual legal assistance that were sent to a number of foreign jurisdictions to facilitate asset recovery.

[2] Other recoveries have also been made, totaling $114 million from sale of assets to the government and noncash recoveries.

11. **Important legal reforms for the financial sector were enacted**. Amendments to the anti-money laundering (AML) and countering the financing of terrorism (CFT) laws were approved by the President in April 2015.[3] The banking law was enacted in August 2015. Further, DAB issued two regulations on AML/CFT measures and fit and proper requirements for the financial sector.

OUTLOOK AND RISKS

12. **The macroeconomic outlook is uncertain.** The future path of the economy depends highly on the authorities delivering on their economic reform commitments, continued donor support, and improvements in security. The new government presented its Self-Reliance through Mutual Accountability Framework (SMAF) to donors in September 2015, which puts restoring fiscal sustainability through increasing revenues as one of the main priorities.[4] Although the initial impact of the drawdown of international troops has ended, economic activity is subdued and investor confidence remains low.

13. **The medium-term macroeconomic framework projects a recovery in growth.** This path, however, reflects a slower recovery in economic confidence and later implementation of mining projects than projected earlier. Growth is expected to gain steam, with mining related activity, from 2018 onwards, bringing average annual GDP growth to 5 percent during 2016–20. Delivering on commitments under the SMAF and associated donor support should help cover fiscal and external gaps. Inflation is expected to stay in single digits with stable international prices and prudent monetary policy.

[3] By virtue of Article 79 of Afghan Constitution, laws passed by Presidential Decree have to be submitted to Parliament and remain in force unless rejected.

[4] See http://www.embassyofafghanistan.org/document/afghanistans-road-to-self-reliance-report.

Islamic Republic of Afghanistan: Risk Assessment Matrix			
Nature/Source of Risk	**Likelihood[1]**	**Expected Economic Impact if Realized**	**Possible Mitigating Measures**
Near-Term Risks			
Deteriorating security situation. Stalemate in peace talks with the Taliban.	**Medium**	**High** -Increasing security concerns sap investor and consumer confidence with lower growth and excessive volatility of the exchange rate. -Lower growth results in a decline in domestic revenue and a higher fiscal deficit. - High volatility of the exchange rate leads to further dollarization, capital flight and inflationary pressure.	Strengthen fiscal and monetary policies to maintain macroeconomic stability.
A long lasting political agreement is reached with insurgents.	**Low**	**High** - A peace settlement will lead to higher confidence, investment, and growth.	Adjust the policy mix to take into account likely higher budget revenue, foreign exchange inflows by allowing for higher spending and possible exchange rate appreciation.
Weak fiscal policy implementation, particularly setbacks in revenue mobilization efforts and difficulties in expenditure and cash management.	**High**	**High** - Lower than expected yield from revenue mobilization efforts leads to spending cuts. - Pressing spending needs result in depletion of the treasury cash balances and unfunded allotments lead to arrears.	Increase tax compliance, take measures to mobilize additional revenue, prioritize spending, and improve coordination between the treasury and budget departments.
Acceleration in outflows of migrants.	**Medium**	**Medium** **-** High demand for foreign exchange and downward pressure on the Afghani, with a risk of eroding confidence in the authorities' ability to maintain macroeconomic stability and lift growth. - Pressure for budget expenditure to incentivize potential emigrants to stay in Afghanistan and/or to encourage refugees to return.	Continue to manage the exchange rate flexibly, seek to improve security, and mobilize donor financing to incentivize potential emigrants to stay in Afghanistan and/or to encourage refugees to return.

Nature/Source of Risk	Likelihood[1]	Expected Economic Impact if Realized	Possible Mitigating Measures
Medium-Term Risks			
Decline in donor inflows to the budget and to finance development projects.	**Medium**	**High** - Lack of progress in implementing reforms agreed under the Self-Reliance through Mutual Accountability Framework or donor fatigue result in decline in donor inflows, especially to the budget. - The decline in inflows leads to lower public spending, lower growth, increased unemployment, and/or exchange rate pressures.	Strengthen policy implementation to maintain macro stability, speed up structural reform, and improve economic governance, including stronger legislative, institutional, and regulatory frameworks, and law enforcement.
Structurally weak growth in emerging market economies, particularly in China and India which are key stakeholders in development of Afghanistan's natural resources, results in a delay in investment plans in extractive industries.	**Medium**	**Medium** - Delays in investments to develop natural resources postpone the projected pick-up in growth and result in lower exports. - Lower than expected revenues from natural resources could lead to increasing budget deficits as spending envelope continues to increase. - Fiscal deficits and lower export receipts may lead to exchange rate depreciation and higher inflation. - Lack of progress in developing natural resources could result in higher narcotics production.	Strengthen policy implementation to maintain macro stability and improve business climate, including a sound fiscal regime for natural resources.
Heightened risk of security dislocation in the Middle East having negative spillovers in Afghanistan, aggravating security concerns.	**Medium**	**Medium** - Deteriorating security reduces confidence and results in lower growth and excessive volatility of the exchange rate. - Lower growth results in a decline in domestic revenue and a higher fiscal deficit. - Excessive volatility of the exchange rate leads to further dollarization, capital flight and inflation.	Strengthen fiscal and monetary policies to maintain macroeconomic stability.

Nature/Source of Risk	Likelihood[1]	Expected Economic Impact if Realized	Possible Mitigating Measures
Medium-Term Risks			
Lack of progress in banking sector and strengthening anti-money laundering and combating the financing of terrorism (AML/CFT) reforms, compromising financial sector's soundness.	**Medium**	**Medium** - Banking sector constrained in fulfilling its intermediation role results in less credit to the economy, inefficient allocation, lower access to finance, and slower growth. - Confidence in banking sector could dissipate, leading to banking sector liquidity challenges. - Lax or ineffective enforcement could undermine financial discipline, bank governance, risk management, financial controls and money laundering controls and result in bank failure(s) and need for bailouts. - Access by Afghan banks to global financial system is impeded.	Ensure that prudential and AML/CFT preventive (including fit and proper) standards are strictly observed and supervision enforcement actions are implemented promptly. Implement the action plan as agreed upon with the Financial Action Task Force to exit the monitoring process.
[1] Staff assessment of the likelihood of realization in the next three years.			

14. **Staff discussed with the authorities interconnections and spillovers for Afghanistan.** The principal connection between the Afghan economy and the rest of the world are donor inflows. These inflows finance most imports and dwarf (licit) exports, financial sector, and foreign direct investment. Regional developments affecting security and trade have a more limited impact on the Afghan economy. However, outward spillovers from Afghanistan are possible if a political impasse led to internal conflict, and a displaced population, internally and in neighboring countries, with lower trade and costs for countries receiving Afghan refugees. Recent signs of acceleration in migrant outflows are therefore of concern for the potential impact both on the stability of the local economy and on the number of refugees in the region. Looking forward, the authorities would need to assess how this recent acceleration of outflows, if unabated, could affect the fiscal position.

15. **Afghanistan's economy faces risks; many, but not all, are on the downside**. The principal near- and medium-term risks stem from security, inadequate policy implementation and lack of progress in reform, slower growth in emerging market economies, especially China and India, or donor fatigue (see the accompanying debt sustainability analysis (DSA) paper). If realized they would reduce inflows and budget revenue, causing lower growth, employment, and investment, as well as possible exchange rate pressures. An upside risk is a political agreement with insurgents that results in higher confidence, investment, and economic activity. Also, the lifting of economic sanctions on Iran could benefit the Afghan economy through a boost to exports and an increase in remittances.

POLICY DISCUSSIONS: STRENGTHENING CONFIDENCE NOW FOR ECONOMIC TRANSFORMATION

16. **The overarching theme of the Article IV consultation is for Afghanistan to build confidence in its economy now**. Afghanistan faces landmark transition challenges. The number one priority and challenge for the government is to convince their people that their economic strategy is viable, that it will yield the envisaged results, and that it requires collaboration and perseverance from all Afghans. Confidence is required to foster domestic demand and foreign investment, to help DAB deliver price stability, and, more generally, to manage Afghanistan's transformation into a self-reliant, inclusive, and growing modern economy. The authorities' ability to navigate this new landscape will determine the development path in the transformation decade (2015–24). It is paramount that reform policies are implemented to maintain the hard-won achievements to date: strong efforts will yield high returns and inaction carries major risks.

17. **The authorities are well aware of these challenges and remain committed to their reform agenda.** They noted that the new government's structure and clarification of roles and responsibilities had resulted in a settling-in period to assure broad-based support for reforms within government and the population. At the recent SOM, the President and Chief Executive Officer reiterated their commitment to proceed, including in the period before the 2016 Brussels donor meeting, with the political, economic, governance, and social reforms to take Afghanistan towards peace, stability, and self-reliance. Reform implementation will be monitored by the President, Chief Executive Officer, Cabinet of Ministers, and civil society. Further, the government plans to prepare a medium-term reform plan by December 2015 based on its 12 national priority programs. The authorities and staff agreed that reforms need to be tailored to institutions' capacity and the macro framework based on realistic assumptions, while continued IMF engagement and support from donors will remain critical.[5]

A. Inclusive Growth and Productivity

18. **Afghanistan has made progress toward Millennium Development Goals, but more is needed.** Access to primary healthcare has increased from 9 percent to 57 percent of population and over nine million students have been enrolled. Maternal health, child mortality and universal primary education indicators are at or close to 2015 targets. Pro-poor spending doubled between 2011 and 2014, reaching above 3 percent of GDP. However, poverty reduction remains a priority.[6] Experience shows that growth has been more successful in reducing poverty when policies have been in place to deal with the risks, vulnerabilities and market failures that hold back participation, which are constraints in Afghanistan. In this regard, the authorities plan to review how fiscal policy contributes to inclusive growth and poverty reduction, and tailor policies to boosting growth well above the

[5] Total donor support is projected to stay near current levels this decade. An increasing share of donor support will be provided on-budget, as the government takes over management of donor-financed projects that were earlier donor-managed.

[6] Poverty was estimated at 35.8 percent in 2011.

population growth rate while protecting the poor by shifting the composition of expenditures towards civilian spending and making taxes more equitable and growth friendly.

19. **There was a shared vision of private sector-led, inclusive, and gender balanced growth based on a business-friendly environment.** The political transition limited progress in 2014, but the authorities are determined to push ahead with reforms. They noted that policies to develop the private sector should focus on providing incentives that generate pro-poor outcomes and create jobs, which, unlike subsidies, can offer a sustainable source of income. They shared staff views that pro-poor policies should be directed to eliminate regulatory and administrative barriers for businesses, improve infrastructure, provide key business services, while strengthening governance, as signaled in the papers they prepared for the December 2014 conference and the September 2015 SOM. They flagged the initial steps taken included a younger, more professional Cabinet of Ministers, Public Financial Management Reform, and plan to reform the public administration. In addition, a policy on sub-national governance will be presented to Cabinet before the end of 2015 and the Cabinet will review concept notes on National Women's Economic Empowerment Plan, Citizens' Charter, Urban Development Program, and Rural Development by mid-2016. The authorities plan to reform licensing and registration, unify the system for trade and investment licenses, and establish a one-stop-shop for private businesses, and clarify the roles of the Afghanistan Investment Support Agency and Ministry of Commerce and Industry. They plan to amend the Land Management and Land Acquisition Laws to introduce orderly land markets and prepare a national infrastructure development plan to build domestic and regional connectivity. They have established a national procurement board to manage all high value contracts and conducted a review of customs and revenue staffing. Staff will continue to discuss TA needs to support implementation of the authorities' ambitious reform agenda.

20. **Over the medium term, potential growth will depend on the authorities' ability to develop strategic sectors.** The authorities wish to increase productivity, build institutions to regulate and enable markets, use private public partnerships and development policy to ensure government activities promote inclusive economic development. They consider agriculture, extractive industries, and transport as the main pillars of their inclusive and sustainable growth strategy, which, over time, should be private sector led. Staff concurs. Raising agricultural productivity by reforming land management, developing sectoral strategies for irrigation, and removing barriers that prevent farmers from selling their products are the main priorities as agriculture is the largest source of job creation.[7] Further, the authorities believe that investing in infrastructure to strengthen Afghanistan's position at the centre of South and Central Asia will allow it to benefit from increased trade, investment, and connectivity. The mining sector has the potential to attract foreign investment, raise revenues, and lift the local economy. In this context, staff welcomed the authorities' indication that they, after clarification of the legal and strategic

[7] A significant part of the agricultural production consists of opium, counting for 4 percent of GDP that results in production of opiates (such as heroin and morphine) and domestic trafficking estimated to account for another 9 percent of GDP. The magnitude of the illicit opiate sector and the volatility of prices and production make it a source of shocks to the economy.

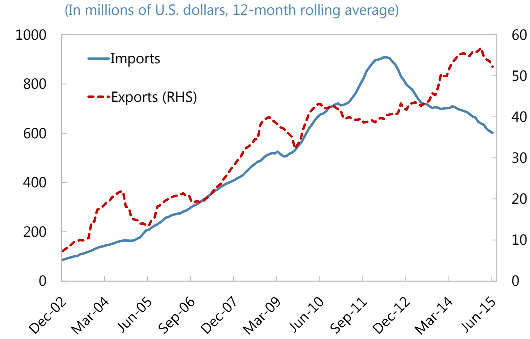
framework, wish to proceed with the appropriate exploitation of Afghanistan's mineral resources, to ensure that these resources benefit all Afghans.

21. **Staff agreed that sustained, inclusive, and gender-balanced growth will require improved competitiveness and productivity.** Afghanistan's exports need to be raised significantly and diversified; the discipline imposed by having to export will provide the necessary stimulus for innovation and good management practices. At the same time, unrelenting progress in structural reforms to strengthen governance and foster private sector development and investment remains crucial. This should contribute to investment and job creation to allow Afghanistan to absorb new labor market entrants over the medium term and support stronger domestic demand. To complement these efforts, the authorities also plan to support Afghans, who wish to explore employment opportunities abroad.

B. External Stability and Exchange Rate

22. **The current account is dominated by imports and official transfers; licit exports are low**. Excluding grants, the current account deficit was 37 percent of GDP in 2014. Official transfers more than financed this deficit.[8] Exports of goods (excluding opium and internal sales to nonresidents), after stagnating, have increased noticeably in the past two years.[9] Afghanistan's imports have been driven mostly by the presence of foreign troops and donor activity. The foreign troop drawdown led to a decline in imports. The authorities wish to increase and diversify exports. They see potential for development of exports of agricultural products and developing light industry to compete with some imports and recognize that measures to facilitate private sector development are needed for export growth and diversification. Further, they see scope for higher remittances from Afghans working abroad and expect to receive revenue from the Central Asia South Asia Electricity Transmission and Trade Project (CASA-1000) and Turkmenistan-Afghanistan-Pakistan-India Natural Gas Pipeline (TAPI) later this decade. Staff noted that revenue from these sources would strengthen the external current account (before grants), but the timing and amount of these receipts were subject to some uncertainty depending on demand for Afghans to work abroad and speed of CASA-100 and TAPI implementation.

Exports and Imports of Goods
(In millions of U.S. dollars, 12-month rolling average)



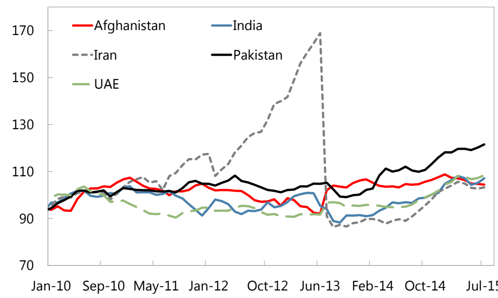
Sources: IMF Direction of Trade Database; and IMF staff calculations.

[8] The external accounts exclude the illicit economy.

[9] A large part of services exports were linked to foreign troops' presence and these services exports have declined as this presence was drawn down.

23. **The exchange rate's level appears in line with medium-term fundamentals, but data limitations make a robust assessment difficult.** The de facto exchange regime is classified as floating. Compared to main developing country trading partners, Afghanistan's currency has seen the least depreciation until recently which resulted in an appreciation of the real effective exchange rate (REER). However, the Afghani has depreciated by 11.7 percent against the US dollar between March 21 and October 21, inflation has been negative, bringing real effective exchange rate towards its equilibrium levels. A further quantitative assessment of the exchange rate's level is hindered by inadequate balance of payments data, the multi-year civil conflict, very large aid flows, high dollarization, and a large informal sector including narcotics production. Structural impediments weigh heavily on Afghanistan's competitiveness (see below). The authorities noted that the high level of dollarization and inadequate balance of payments data made the exchange rate assessment difficult.

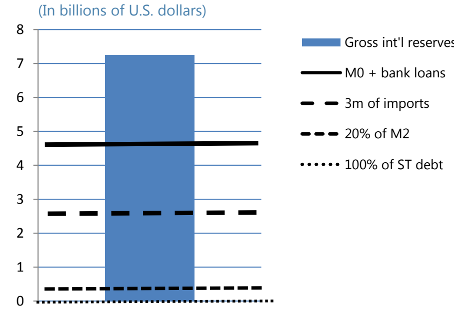
Real Effective Exchange Rates
(Indices, 2010=100)



Sources: National authorities; and IMF staff calculations.

24. **Afghanistan's reserves are comfortable**. Gross reserves exceed seven months of imports, exceed total debt by a large margin, and are close to the level of broad money. External stability will continue to hinge on continued donor inflows. A decline in the donor footprint will need to be met with competitiveness gains, both through exchange rate adjustment and strengthening the business environment. DAB views the current reserve level as adequate and monitors closely aid, investment and remittance inflows to ensure reserves remain adequate and to be proactive in managing any shocks.

Reserve Adequacy, 2014
(In billions of U.S. dollars)



C. Fiscal Outlook and Debt Sustainability

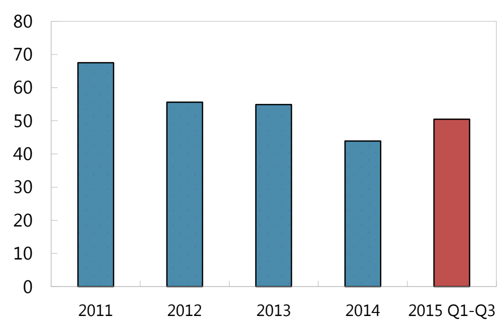
25. **Afghanistan needs to mobilize domestic revenue to ensure fiscal sustainability and reduce donor dependence.** Low compliance has taken a toll on domestic revenue in recent years. Domestic revenues peaked at 11 percent of GDP in 2011 and subsequently declined to 8.5 percent of GDP in 2014 (covering only about one third of spending), remain significantly lower than regional and low-income countries (LICs) averages. Donors' grants finance the bulk of security expenditure and part of spending related to service delivery, infrastructure development, and operations and maintenance. Staff highlighted that spending to support strong and inclusive growth will need success in revenue mobilization and that the country's development and growth-and-welfare-enhancing reforms necessitate a sustainable fiscal framework. Staff noted that the authorities' ability to implement countercyclical fiscal policy remains contingent on strengthening debt service capacity and, while this capacity remains limited in the medium to long term, the overall budget balance needs to remain close to zero.

26. **Mobilizing domestic revenue requires introducing new taxes, strengthening revenue administration, and improving the tax policy mix.** Staff stressed that continued medium-term revenue mobilization efforts will be needed by introducing VAT, additional excises and property taxes, developing natural resources, reducing exemptions, and improving enforcement and compliance. Staff projects the revenue measures introduced in 2015 to mobilize revenue of around 1 percent of GDP per year in the medium term. With continued improvement in revenue administration, VAT introduction, and development of the mining sector towards the end of the decade, staff projects revenues to reach 13 percent of GDP by 2020. Enhanced anti-corruption efforts in revenue collection will be critical to minimize leakages, improve compliance, and boost public confidence.

27. **The mining sector presents a promising source of fiscal revenue.** Mining projects have been delayed as contracts wait to be signed or renegotiated in light of declining international prices. The development of the sector has also been hampered by ongoing instability, and inadequate infrastructure, impeding exports. Despite the delays, the authorities are working to develop a transparent fiscal regime for extractive industries in full compliance with the EITI, including with the support of FAD TA. Staff supported the authorities' objective to ensure a sound fiscal regime is in place while the sector develops, and underscored the need to develop the mining sector in an environmentally friendly manner and in consultation with civil society.

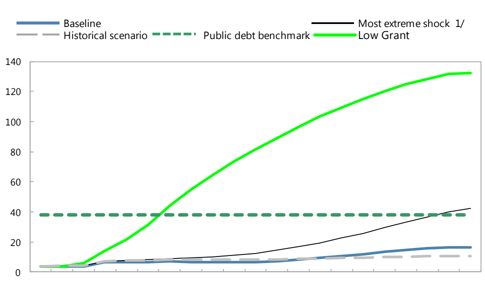
28. **Prioritizing growing spending needs is also essential.** Operating expenditures have doubled over the past decade to reach 20 percent of GDP in 2014. Operating costs are projected to stay elevated in the medium term because of continued security needs, payments for civil servants, teachers, health workers, and maintenance of public infrastructure. In addition, development outlays are expected to increase by 1 percent of GDP in this decade to meet Afghanistan's human development and infrastructure needs. Thus, total expenditures are projected to increase from 26 percent of GDP in 2014 to close to 35 percent in 2020. Security spending is projected to decline gradually after 2020 with a reduction in the size of security forces, while non-security spending is projected to increase gradually, and development outlays are expected to be stable as a share of GDP. The authorities are seeking to increase the efficiency of spending through reducing ghost workers by use of electronic payments (with an initial focus on four ministries that are the largest employers), improving procurement, while at the same time increasing execution of

Domestic Revenue Coverage of Operating Expenditures
(In percent)



Sources: Afghan Authorities and IMF Staff calculations.

PV of Debt to GDP Ratio under Alternative Scenarios, 2015–35



Sources: Afghan authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

donor-financed capital spending. They noted their limited discretion over spending because a large part of donor-financed outlays were directed to specific purposes, which constrained their ability to make spending poverty reducing, growth and employment generating. Staff discussed with the authorities ways to prioritize spending and make it more efficient, especially in the civil service sector, and stressed the need to reverse the declining trend in the coverage of operating expenses by domestic revenue.

29. **Debt remains modest but Afghanistan's reliance on grants to meet its expenditure needs poses sustainability risks.** The Afghan government does not have domestic debt and its external public and publicly guaranteed debt amounted to $1.3 billion, or 6.4 percent of GDP, at end-2014, most of which is owed to multilateral creditors. Under the baseline scenario, with strong reform effort and donor support, improved security and reduced uncertainty, debt is sustainable. However, there are significant vulnerabilities; should reforms stall, security deteriorate, or grant financing fall short of the projected levels, Afghanistan will need to implement significant compensatory measures or the debt burden would quickly become unsustainable. Under a scenario of low grant financing, the present value of public debt reaches over 130 percent of GDP by the end of the projection period. Afghanistan's external debt is low, but given its heavy reliance on grant financing, according to the IMF-World Bank framework, public external debt is judged to remain at high risk of distress (See DSA).[10]

30. **The authorities agreed with the need to mobilize revenue and prioritize spending to move towards fiscal sustainability and self-reliance.** They reaffirmed their commitment to continue to mobilize revenue with revenue measures and customs and revenue administration reforms, and noted that they wished to use growth-friendly tax measures and were concerned that higher tax rates could result in a surge in evasion and, hence, lower revenues. They noted building a revenue base requires growth and revenue generating strategic sectors, such as energy and transportation. They are preparing a borrowing policy to finance high return projects, to maintain a low level of debt, and plan to seek staff views on the policy, as it is prepared. They believe public sector investment in strategic sectors can yield high economic and social returns and wish to consider use of loans, private public partnerships, and build operate transfer arrangements. Staff cautioned about contracting loans and contingent liabilities given Afghanistan's very limited debt service capacity, the risk of crowding out grants and, poverty-reducing and development outlays. Further, staff indicated that an independent appraisal of projects, their transparent inclusion in the budget and associated liabilities, and an assessment of their impact on debt sustainability are crucial.

D. Monetary and Exchange Rate Policy

31. **Reserve money continues to be the nominal anchor for monetary policy**. Political and security uncertainty have taken a toll on the conduct of monetary policy too. Lack of confidence in

[10] The accompanying Debt Sustainability Analysis also presents the standard shocks generated by the Debt Sustainability Framework, which result in benign debt dynamics. However, these results using the standard shocks may not be representative as they are mostly driven by the past ten years, when Afghanistan averaged real GDP growth of 8.9 percent per year and received official transfers averaging 53.3 percent of GDP.

the Afghani and the high degree of dollarization of the economy make it harder for DAB to project money demand and to conduct its open market operations. DAB considered that the current monetary and exchange rate regime, which aims at delivering low inflation, while ensuring orderly conditions in the foreign exchange market, has served well, despite recent pressures. DAB is also considering how to increase use of the Afghani. Staff encouraged DAB to strengthen its communication strategy to clarify the monetary policy framework (objective and instruments) with a view to fostering public understanding of and confidence in DAB's actions. DAB indicated it plans to continue regular communications including press releases after Supreme Council meetings and its quarterly bulletin.

32. **Monetary operations are also hindered by limited instruments.** At present, capital notes are the only domestic currency-denominated instruments issued by the DAB to steer monetary conditions, but their absorption is limited by banks' liquidity. The need for DAB both to provide U.S. dollar liquidity to the economy to finance current account transactions and to sell U.S. dollars at its regular auctions to mop up liquidity, in the absence of a deep market for capital notes, risks blurring monetary policy signals. Moving forward, and as confidence in the Afghani improves, the DAB should gradually increase its use of domestic currency-denominated instruments for open market operations. Staff discussed the scope for developing such instruments, including sukuk, and further TA. The authorities signaled their desire to broaden the range of monetary instruments (see below) and asked the IMF to provide TA in this area.

E. Financial Sector

33. **Financial intermediation needs to become more efficient and broad-based**. The authorities wish to build a strong financial sector to increase access to finance, assure safety for depositors, enhance trade finance, and improve intermediation. They are cognizant of the need to improve banking sector profitability.[11] As banking system weaknesses are addressed, the authorities expect that credit availability should increase from its low base, though they recognize that the low private credit reflects the scarcity of profitable and appropriately collateralized lending opportunities and structural challenges. Staff recommended that policies to promote credit should address structural issues rather than interventions aimed at forcing banks to lend. The authorities wish to promote lending to small and medium enterprises (SMEs) and agriculture while developing microfinance to support growth and job creation. They wish to increase the types of financial instruments available, including Islamic ones for which they see considerable scope, to promote development of capital markets and the trading of financial products, for use as risk management tools, and to attract investment. To this end, the authorities are finalizing some Islamic banking regulations. Further, DAB is preparing a registry of immovable property collateral and the Supreme Court has recently approved simplified procedures to auction collateral. DAB is also promoting use

[11] For the year to July 2015, banks turned in an aggregate loss ($13.6 million) due to large provision expenses and continuing losses of state-owned banks. At end-July 2015, the banking system—comprised twelve licensed commercial banks and three licensed branches of foreign banks, with 197 full-service and 213 limited-service bank branches throughout the country—had total assets of $4.3 billion and deposits of $3.7 billion. Net loans constituted 16.8 percent of total assets and the loan-to-deposit ratio was 19.9 percent. The broad liquidity ratio was at 69.2 percent of total assets (against a minimum requirement of 15 percent).

of mobile banking to increase financial inclusion and noted that consumer protection is available and consumers have recourse to DAB, the Financial Disputes Resolution Commission, and the courts. Staff welcomed these initiatives, and encouraged greater financial inclusion over the medium term by continuing to promote mobile banking and microfinance lending, bank penetration in rural areas, and financial literacy.

34. **The banking sector is undergoing an important restructuring process that is intended to signal a break with the past.** Much has been done to strengthen the supervision, regulatory and legislative frameworks, including enhancing on- and off-site supervision, improving information exchange, assertive enforcement, and passage of the banking law that will strengthen bank governance. Also, the restructuring of weak banks continues, in accordance with agreed action plans. Further, the newly-established Bad Debt Commission is facilitating recovery of non-performing loans: participation is mandatory for public banks and voluntary for private banks. Staff praised DAB for this important progress and underscored the need to continue with the reform agenda, that bank restructuring should occur within a sound governance framework, and that *ad hoc* institutions should have clear sunset clauses to avoid undermining institutions formally mandated for such purposes. Staff and authorities agreed on the need to push ahead with the planned strengthening of vulnerable and weak banks and privatization of New Kabul Bank, implementing vigorously the new banking, AML, and CFT laws, their regulations, and guidelines, and continuing to enhance DAB's supervision. DAB noted the need to strengthen the performance of some of the state banks.

F. Business Environment

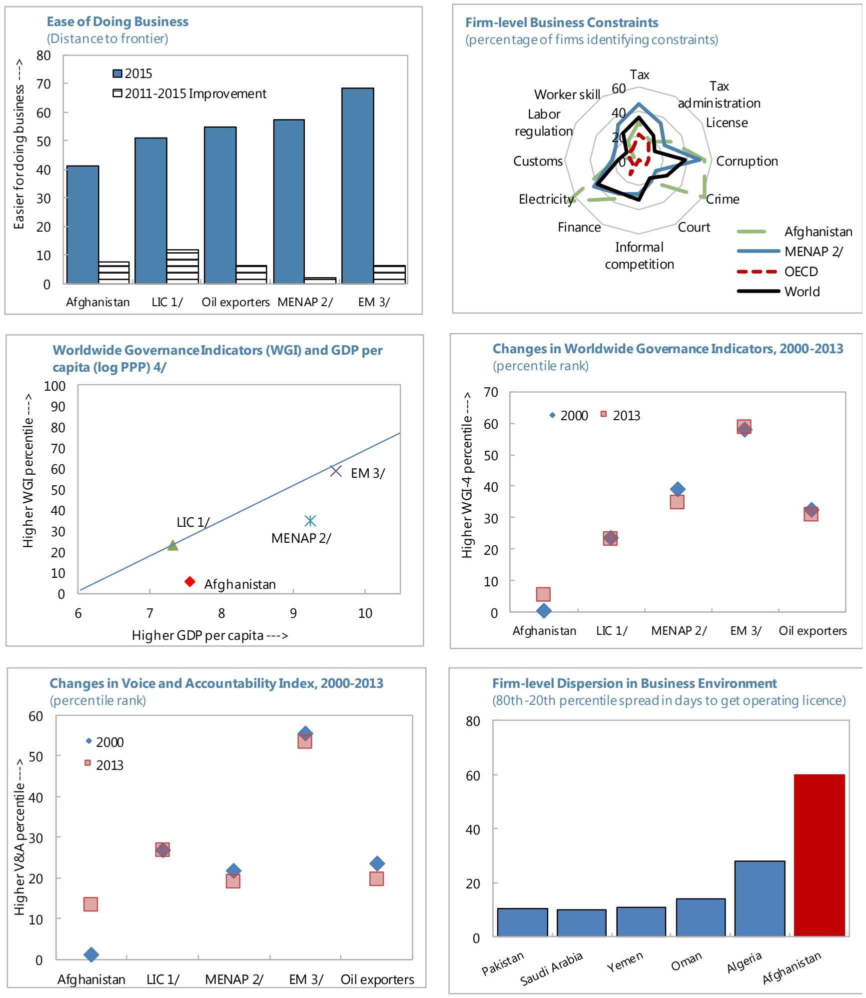
35. **The business environment remains very difficult.** Afghanistan is at the bottom decile of World Bank Doing Business 2015 index and its ranking declined to 183 (out of 189 economies), primarily owing to the increasing time and cost of starting a business, dealing with construction permits, getting credit, and paying taxes. Afghanistan faces significant challenges to improve business environment ranging from licensing procedures, protection of minority investors to contract enforcement and property registration notwithstanding the very difficult security environment.[12] Afghanistan was also in the bottom 20 percent in the World Bank's 2013 *Country Performance Ratings,* which assesses the policy and institutional framework that more strongly fosters growth and poverty reduction among 76 IDA-eligible countries. Corruption remains high, with a rank of 172 out of 175 countries in Transparency International's Corruption Perceptions Index in 2014.

36. **To support a business-friendly environment, the authorities will strengthen anti-corruption and AML/CFT frameworks.** As noted, the authorities are determined to improve the business environment. They have implemented measures to strengthen the anti-corruption and AML/CFT frameworks. The October 2014 presidential decree on Kabul Bank signaled the intentions of the new administration, which has zero tolerance for corruption and tax evasion. The authorities have

[12] These indicators should be interpreted with caution due to a limited number of respondents, limited geographical coverage, and standardized assumptions on business constraints and information availability.

made progress since May 2015 to strengthen the AML/CFT legal framework notably through the issuance of two DAB regulations on preventive measures in the financial sector and fit and proper requirements. They also are implementing an AML/CFT Action Plan. Staff welcomed the progress and noted that continued efforts and enhanced implementation are needed for Afghanistan to exit the FATF's monitoring process, to help detect and disrupt the receipt and use of, and to confiscate the proceeds of crimes, including corruption and drug trafficking. The authorities have initiated asset declarations by senior officials and plan to broaden their scope. Staff welcomed the authorities' efforts to improve asset declarations and emphasized the importance of reducing incentives and opportunities for corruption as well as improving enforcement, while noting that more is needed to facilitate audit and publication of asset declarations. Staff underscored the role of well-trained staff, capacity building and efficient use of the information technology, particularly in customs, to fight against corruption.

Islamic Republic of Afghanistan: Business Environment and Governance



Sources: World Bank Doing Business Database; World Bank Worldwide Governance Indicators; World Bank Business Environment and Enterprise Performance Survey; and IMF staff calculations.

1/ Low income countries;

2/ Middle East, North Africa, and Pakistan;

3/ Emerging market economies;

4/ Worldwide Governance Indicators include government effectiveness, regulatory quality, rule of law, and control of corruption; trend line is based on cross-country regression.

G. Protecting the Poor

37. **Pro-poor spending peaked in 2014 as a result of higher payments to families of martyrs and disabled.** Pro-poor spending stood at 3.1 percent of GDP in 2014 compared to 2.3 percent in 2013. Owing to challenges in securing donor support to finance operations and maintenance spending on health and education, and better targeting of pensions to families of martyrs and disabled, the budgeted pro-poor spending is projected to amount to 2.7 percent of GDP in 2015, a floor in the SMP. The authorities are committed to continue supporting families of martyrs and disabled and improving the targeting of these payments. They reiterated that the definition of pro-poor spending in the budget was rather narrow, since it comprised only the ministries of education, health, and social affairs (about 40 percent of non-security/non-development outlays), and indicated that most government spending favored the poor.

38. **The authorities have a plan to foster inclusion and reduce poverty in the context of the SMAF.** This plan includes specific short-term actions to provide impetus to their inclusive growth strategy. To provide security and end land-grabbing affecting the urban poor, the government will launch a national program to survey informal settlements and provide 100 percent coverage of land tenure certificates in main cities by the end of December 2015. Further, a program will be launched by December 2015 to provide at least 5,000 rural communities with funds for labor-intensive works to repair agricultural infrastructure. By year-end, the government will launch a pilot program for market gardening in urban peripheries to promote food self-sufficiency, and complete new power distribution systems to provide electricity to 40,000 poor households. In the first half of 2016, the government will form a commission to review use of child labor in the carpet industry and provide reform and compliance recommendations to meet Afghanistan's commitments to end the use of child labor.

J. Other Issues

39. **Data provision has shortcomings but is broadly adequate for surveillance**. The quality and timeliness of monetary, fiscal, and price data are broadly adequate, although coverage could be improved. Fiscal accounts cover only the central government. Limited data on the public enterprises are available, but qualitative information suggests that some of the largest enterprises are operating at a loss and represent a potential fiscal risk (Annex I). Data on national accounts, balance of payments, and social indicators also suffer from weaknesses in coverage and consistency. Recording and monitoring of debt statistics could be strengthened. The authorities have been working to improve compilation of debt statistics on a regular basis. They reached out to their creditors to enhance recording of disbursements and debt repayments and are working to improve data entry mechanism in Commonwealth Secretariat Debt Recording and Management Software (CS-DRMS). In addition, they plan to reconcile treasury debt data with DAB, AFMIS, and Client Connections. Fund technical assistance, including from the IMF’s Middle East Regional Technical Assistance Center, is also being provided to strengthen statistical data systems.

PERFORMANCE UNDER THE STAFF-MONITORED PROGRAM

40. **Performance under the SMP has been satisfactory**. Worse-than-expected security conditions and delays in forming a government have complicated policy implementation.

- **All June 2015 quantitative targets and September indicative targets have been met except, for social and other priority spending for June and September and the budget revenue target for September.** Revenues fell short of the target by Af 0.5 billion during the first nine months of 2015, as over-performance in the first half was reversed by under-performance in the third quarter due to delays in implementation of revenue measures. Pro-poor spending so far was below target due to delays in budget execution, but the year-end target is unchanged with higher execution expected in the fourth quarter. The treasury's cash balance was depleted in August but grants received in September raised the cash balance above the indicative target. Monetary targets were also met, including that on the adjusted NIR, reflecting a deliberate reduction in foreign exchange auctioned by the DAB in late May and June.

- **Progress on end-June structural benchmarks was slower than planned**. Revenue measures, including the increase in the business receipts tax, introduction of a telecommunications fee, and increases in the fuel fees collected at customs, originally planned to be introduced in June, were implemented by decree on August 17.[13] The telecommunications fee entered into effect on September 23, but this measure was rejected by the lower house of parliament on October 14, but remains in effect, unless rejected by the upper house of parliament, since it was mentioned in 2015 budget law approved by parliament. If the fee is rejected by the upper house, the authorities will take compensatory measures. Further, they plan legislation to maintain the fee in and after 2016. The banking law was enacted by decree on August 19. The structural benchmark on hiring an independent party to audit bad debt recoveries at a state bank was met in September. The regulation on currency reporting has been issued and need strengthening in a few areas, which will be done by end-December 2015.

- **Follow-through on earlier financial sector reforms has proceeded, but progress has been slower than planned in a few areas**. DAB did communicate its enforcement actions to the vulnerable systemic bank, which has increased its capital above minimum levels and is working to reduce its large exposures and foreign exchange open position. For the other vulnerable bank, a five-year operating strategy has been prepared and is being reviewed by DAB. Chief Operating and Credit Officers have been hired, but a Chief Executive Officer has not, because it

[13] Although the increase in the fuel fee was less than planned (raising it to Af 2 per liter rather than to Af 3), the effect on the tax base was offset by the introduction of the fuel fee on LPG and higher axel fees.

has not been possible to identify a qualified candidate. The end-June capital target for this bank was met.

- **Progress on structural reforms to be completed later in the year continues at various speeds.** Structural benchmarks to strengthen the revenue administration have been implemented and new banking regulations are being prepared.

41. **The strengthening of weak banks has proceeded as envisaged in the agreed action plans**.[14] The cabinet decided in August to proceed with the sale of NKB, and the sale of NKB was initiated on October 28, 2015. Further, the newly-established Bad Debt Commission is facilitating recovery of nonperforming loans. Nonetheless, weaknesses remain in the banking system and the authorities are committed to continue with strengthening of vulnerable and weak banks, implementing vigorously the new banking law and its regulations. They revised the banking regulations on asset classification and provisioning in September, the section on credit risk exposure needs strengthening; and a regulation on corporate governance and related-party lending is being prepared. DAB is determined to enhance its supervision capacity and make a transition to a risk-based bank supervision regime.

42. **The SMP's macroeconomic framework has been revised compared to the original program projecting lower growth and inflation in 2015.** Real GDP growth is now projected at 2 percent, down from 3.5 percent in the original program, and inflation for 2015 has been revised down from 5 percent to 1.0 percent on a year-on-year basis. Lower nominal GDP growth is projected to lower demand for real balances with lower reserve and broad money growth. Further, a revised budget revenue projection takes into account lower nominal GDP growth, the delay in implementing revenue measures, and the measures to offset the impact of this delay. Grant-financed development budget expenditures were also revised down reflecting the mid-year budget review. Grants to the operating budget, however, are higher than earlier projected, reflecting new donor pledges made recently some of which were linked to the SMP.

43. **A significant increase in revenue performance remains a cornerstone of the program, supported by expenditure control.** Domestic revenue is projected to increase by more than 1 percentage points of GDP (to 9.6 percent of GDP) in 2015. The delay in implementation of revenue measures is projected to result in about Af 3.3 billion (0.3 percent of GDP) less revenue in 2015 and lower nominal GDP growth is expected to reduce revenue by Af 3 billon. To offset this loss, the authorities started to implement expenditure contingency measures by reducing allotments by 2 percent to yield Af 1.7 billion and plan to take revenue measures of Af 1.6 billion, including collection of tax arrears and vehicle registration fees. The latter revenue measures are projected to offset any further legal and capacity constraints encountered in the introduction of new revenue measures. On the expenditure side, the authorities continued to contain nonpriority spending and implement strict control of other nonsecurity related spending. They limited increases in wages and pensions, bonuses, and conducted a review of the targeting of payments to martyrs and disabled.

[14] Action plans were prepared by DAB last year and are discussed in IMF Country Report No. 15/140.

44. **Reserve money continues as the nominal anchor for monetary policy.** The pick-up in money demand has been slower than anticipated so far this year reflecting real growth and inflation well below programmed levels. As a result, the end-December year-on-year target for reserve money growth has been revised down to 7 percent. The acceleration of emigration has put pressures on the foreign exchange market. This development and the revision to the reserve money growth target also called for a revision of the December year-on-year net international reserves accumulation target down to zero. DAB reiterated its commitment to a flexible exchange rate policy, while maintaining orderly market conditions.

45. **The SMP also aims at helping create a business friendly environment.** The authorities plan to reform licensing and registration, unify the system for trade and investment licenses, and establish a one-stop-shop for private businesses. They will clarify the roles of the Afghanistan Investment Support Agency and the, Ministry of Commerce and Industry to improve service to the private sector. They will also amend the Land Management and Land Acquisition Laws to introduce orderly land markets and prepare a national infrastructure development plan to build domestic and regional connectivity.

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46. **Despite its enormous progress over the past decade, Afghanistan remains one of the poorest countries in the world**. Security and political uncertainties, the drawdown of international troops, and weak institutions have held back growth and weighed on social outcomes. The national unity government, which started work in late 2014, is committed to economic transformation to assure durable and inclusive growth over the medium term.

47. **Afghanistan is at a critical juncture; early and decisive action is needed to ensure strong economic performance.** The envisaged recovery in the real economy is slow with projected growth in 2015 only slightly above 2014. The authorities have expressed strong commitment to reform, have tackled key vulnerabilities, and made a determined start to implement structural reforms, though the pace was slower than planned because of a settling-in period, resistance from interest groups, and unexpected shocks. Better economic performance will require strong and sustained reforms and improved security conditions, without which risks to the economy and the country are important and potentially far-reaching.

48. **The economic outlook for 2016 and beyond continues to depend on political and security stability, steadfast economic reform, and donor support**. Peace dividends for a country like Afghanistan would be truly significant. The authorities' economic strategy would benefit from strengthened implementation, particularly with regard to removing obstacles to boosting private sector activity, a better understanding of linkages between the opiate sector and the rest of the economy, and assuring continued donor flows. The latter will be needed to help maintain macroeconomic stability, support economic reforms, and finance security and development needs to allow Afghanistan to make the transition to self-reliance. Reforms need to be tailored to institutions' capacity and the macro framework based on realistic assumptions. Over the medium

term, inclusive growth will depend on the ability to develop strategic sectors, enhance the business climate, and consolidate Afghanistan's position at the centre of the region.

49. **The macroeconomic policy mix remains appropriate and the need to strengthen confidence in economic management and policies is paramount.** Dissemination of the medium-term reform plans that will be completed later this year will explain policy intentions and should help build confidence. The fiscal balance including grants should continue to remain broadly balanced to ensure sustainability, and efforts should be stepped up to mobilize domestic revenue and further improve budget management. These actions are required to ensure pro-poor and development expenditure are increased to help achieve the millennium development goals (MDGs) and sustainable development goals (SDGs). Monetary policy will need to adjust to changing conditions and continue to foster confidence in the domestic currency. To this end and to facilitate monetary policy implementation, further development of domestic-currency denominated instruments will be helpful. DAB should continue to pursue its commitment to a flexible exchange rate regime and maintain orderly market conditions.

50. **Mobilizing domestic revenues and prioritizing expenditure need strengthening**. Revenue mobilization requires introducing new taxes, strengthening revenue administration, and improving the tax policy mix. Over the medium term the authorities should introduce VAT, additional excises and property taxes, develop natural resources, reduce exemptions, and improve enforcement and compliance. Higher revenue is essential to finance needed development and security outlays and reduce reliance on donor funding. At the same time, prioritizing growing spending needs and making sure that scarce resources are spent efficiently are crucial tasks for the authorities.

51. **The banking system needs to play its role in fostering economic development**. The central bank's strengthened monitoring of the banking system and insisting on prudential standards and implementing enforcement actions, especially for banks that are loss-making or have weak financial positions, and passage of the banking law have been welcome developments since the previous consultation. However, the banking system remains vulnerable to adverse shocks, bank credit is low, and determined efforts continue to be needed to assure effective banking supervision (including AML/CFT supervision). The planned strengthening of vulnerable and weak banks and privatization of (or other viable options regarding) NKB need to proceed expeditiously. Strong efforts are needed to implement vigorously the new banking, AML, and CFT laws and their regulations, and to enhance further DAB's supervision capacity. Full implementation of the action plan agreed with the FATF will ensure that the banking sector maintains its international correspondent relationships.

52. **Reducing incentives and opportunities for corruption, sustained progress to improve the anti-corruption and AML/CFT framework, and improved enforcement are needed.** The authorities' plans to improve revenue administration, bank governance, the business environment, and progress in strengthening the AML/CFT regime are welcome and should be supported by effective implementation and enforcement, capacity building and efficient use of the information

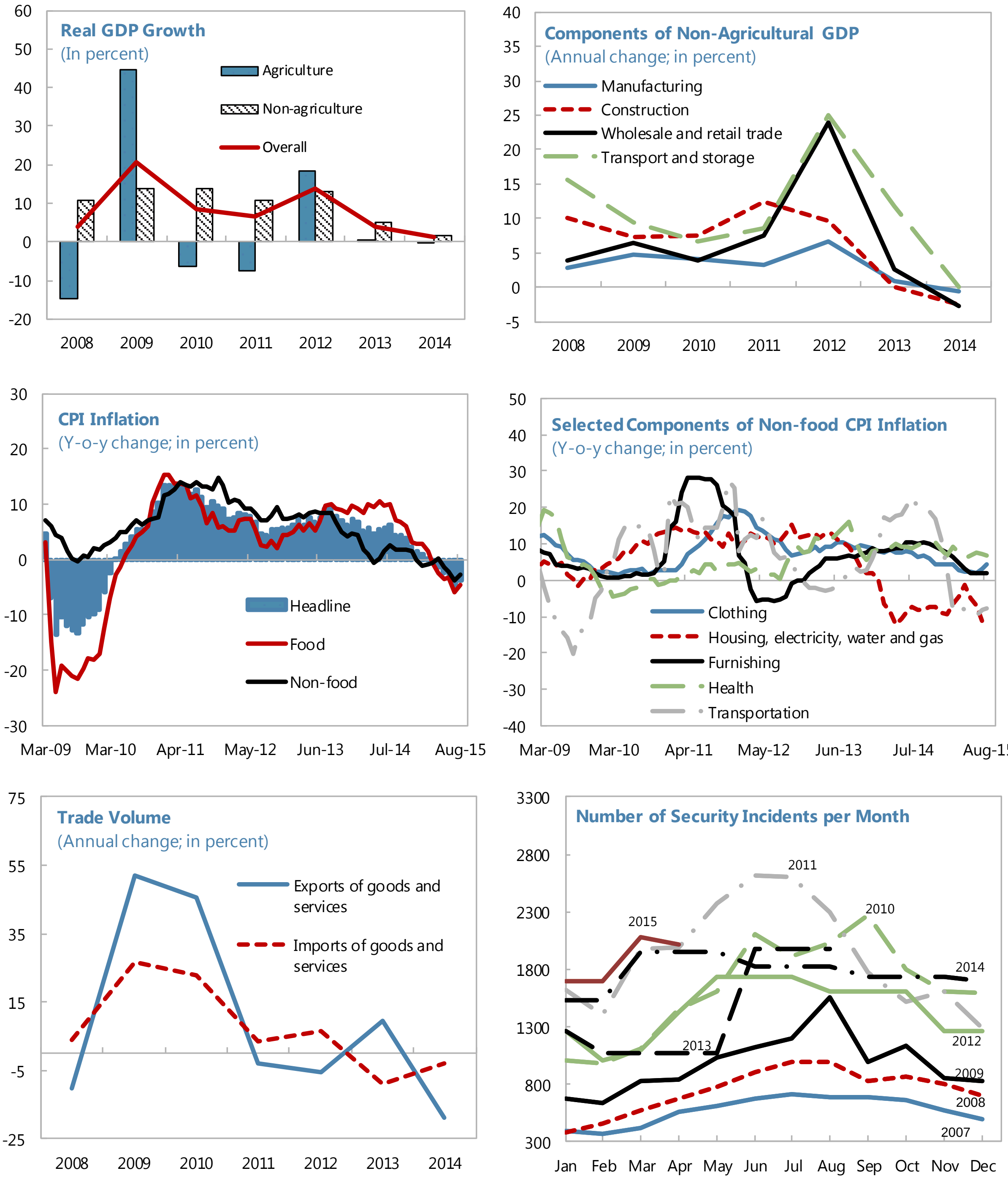
technology, particularly in customs, to fight against corruption. These actions will be critical to supporting private sector-led growth.

53. **The outlook remains subject to significant risks, most are on the downside**. Recent security developments are casting a shadow over the outlook. Heightened security risks weaken public confidence and undermine a sustainable pick-up in economic activity. Dependence on donor financing, large expenditure needs, and a limited domestic revenue capacity, and a still fragile banking system are important vulnerabilities. As the DSA shows, while under a benign baseline scenario the present value of public external debt would remain low in the longer term, this outcome depends on the financing gap being covered by grants. Adverse domestic or regional security developments, political instability, inadequate implementation of economic policies, and donor fatigue remain the main potential threats to the economy.

54. **Staff has continued its close engagement through policy advice and technical assistance, including in the context of the SMP**. The SMP aims at addressing fiscal and banking vulnerabilities, preserving macroeconomic stability, while laying the ground for sustainable inclusive growth. Staff supports the proposed modification to the December targets for reserve money growth, net international reserves and budget revenue, which take into account lower nominal GDP growth, lower demand for real balances, the increase in emigration, and delays in policy implementation. The nine-month SMP was also designed to build a track record; successful performance would support a request for an extended credit facility (ECF) arrangement.

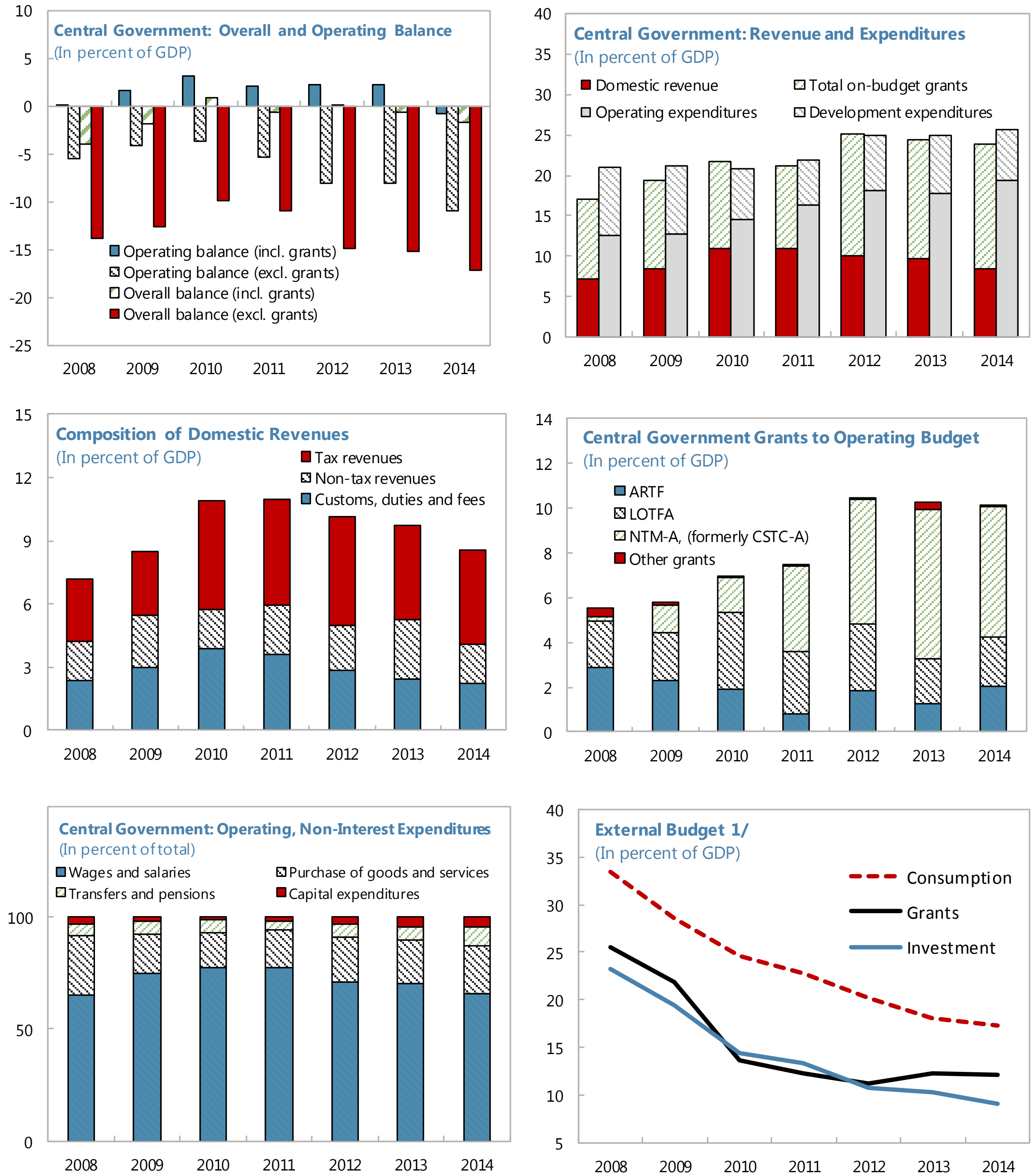
55. **It is proposed that the next Article IV consultation with Afghanistan take place on the standard 12-month cycle.**

Figure 1. Islamic Republic of Afghanistan: Real Sector



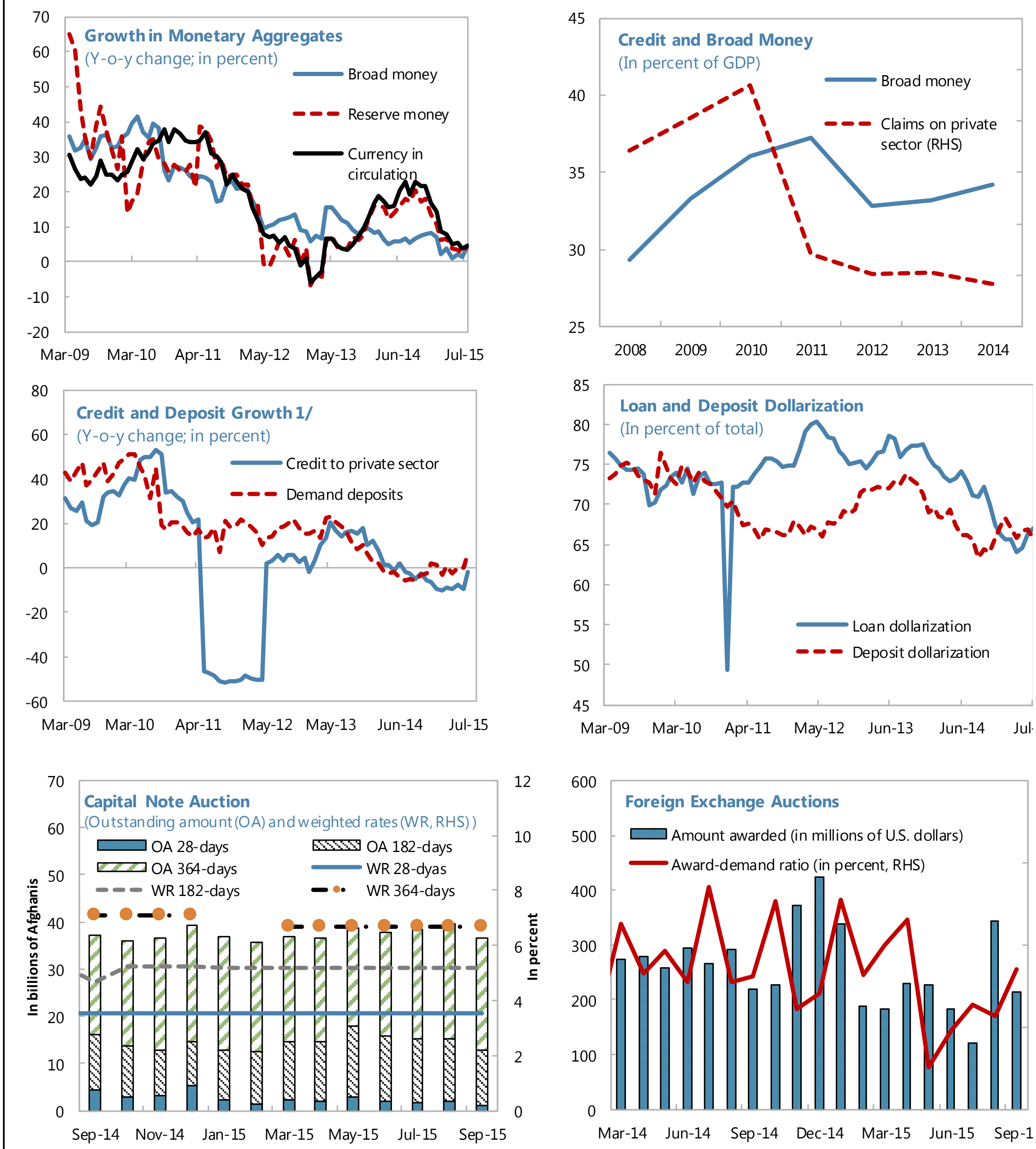
Sources: Afghan authorities; United Nations Department of Safety and Security; and IMF staff calculations.

Figure 2. Islamic Republic of Afghanistan: Fiscal Sector



Sources: Afghan authorities; and IMF staff calculations.
1/ Estimated activity off-budget by international community.

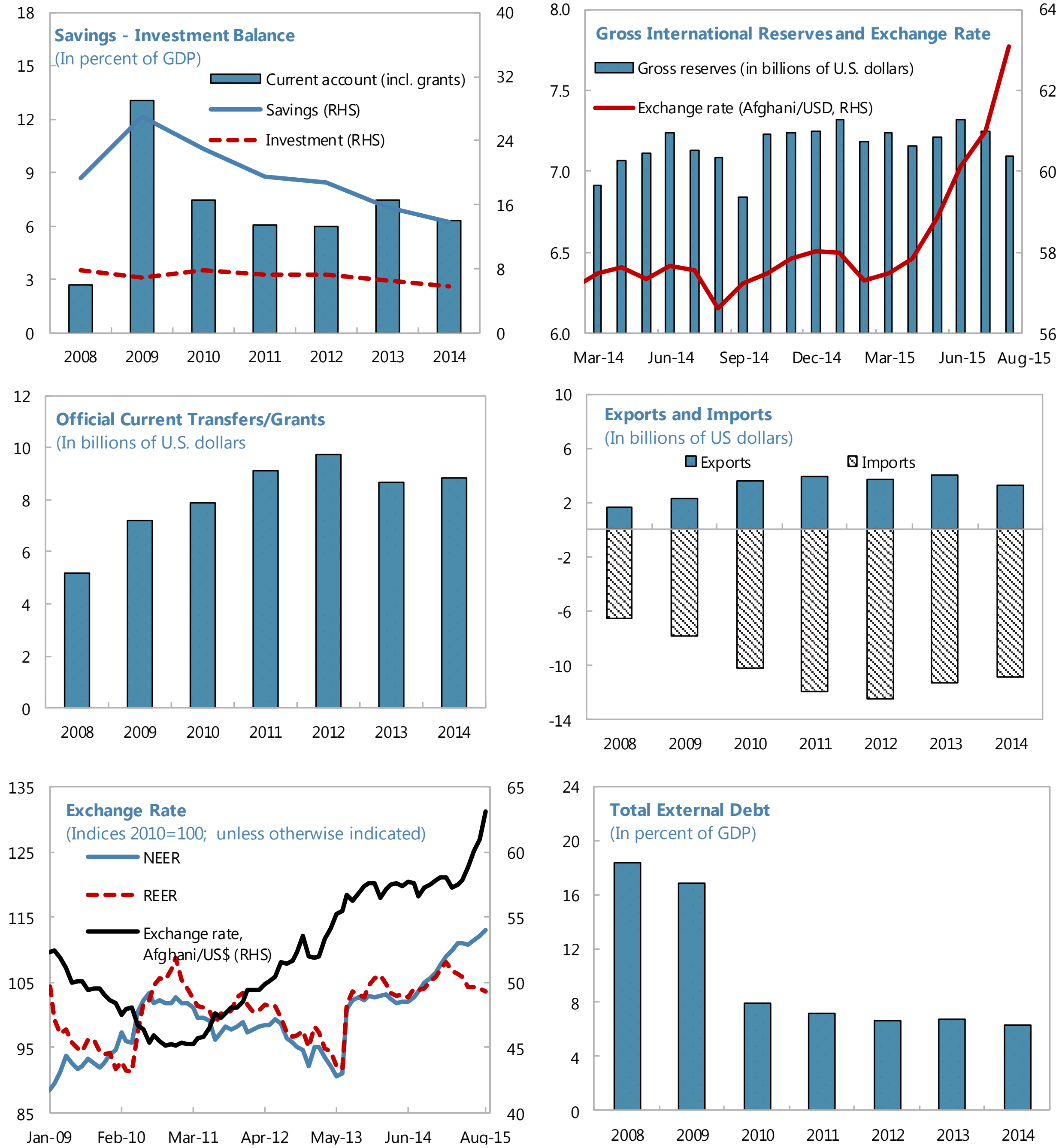
Figure 3. Islamic Republic of Afghanistan: Monetary Sector



Sources: Afghan authorities; and IMF staff calculations.

1/ The drop in credit to the private sector in 2011 reflects the write-off of Kabul Bank loans.

Figure 4. Islamic Republic of Afghanistan: External Sector



Sources: Afghan authorities; and IMF staff calculations.

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2012–15

(Quota: SDR 161.9 million)
(Population: approx. 30.6 million)
(Per capita GDP: approx. US$654; 2014)
(Poverty rate: 35.8 percent; 2011)
(Main exports: opium, US$2.0 billion; carpets, US$86.3 million; 2013)

	2012	2013	2014	2015
	Act.	Act.	Act	Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)			
Real GDP	14.0	3.9	1.3	2.0
Nominal GDP (in billions of Afghanis)	1,034	1,117	1,173	1,184
Nominal GDP (in billions of U.S. dollars)	20.3	20.2	20.4	19.4
Consumer prices (period average) 2/	6.4	7.4	4.7	-1.3
Food	4.7	7.6	7.7	-1.7
Non-food	8.7	7.2	1.4	-0.9
Consumer prices (end of period) 2/	5.9	7.2	1.5	1.0
Investment and savings 2/	(In percent of GDP)			
Gross domestic investment	25.8	22.9	21.5	21.9
Of which: Private	7.2	6.6	5.9	5.7
Gross national savings	31.8	30.4	27.8	26.4
Of which: Private	13.1	14.7	13.9	10.2
Public finances (central government) 3/				
Domestic revenues and grants	25.2	24.3	23.9	28.5
Domestic revenues	10.1	9.8	8.5	9.7
Grants	15.1	14.6	15.4	18.8
Expenditures	25.0	25.0	25.6	28.5
Operating 4/	18.2	17.8	19.4	21.5
Development	6.8	7.2	6.2	7.0
Operating balance (excluding grants) 5/	-8.1	-8.0	-10.9	-11.8
Overall balance (including grants)	0.2	-0.6	-1.7	0.0
Public debt 6/	6.6	6.7	6.4	6.7
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)			
Reserve money	3.9	12.4	13.3	7.0
Currency in circulation	1.1	12.5	16.7	7.0
Broad money	8.8	9.4	8.3	5.7
Interest rate, 28-day capital note (in percent)	2.0	3.4	3.5	...
External sector 1/	(In percent of GDP, unless otherwise indicated)			
Exports of goods (in U.S. dollars)	609	714	775	811
Exports of goods (annual percentage change)	20.5	17.2	8.5	4.7
Imports of goods (in U.S. dollars)	10,079	9,242	8,881	8,746
Imports of goods (annual percentage change)	-1.3	-8.3	-3.9	-1.5
Merchandise trade balance	-46.7	-42.3	-39.6	-40.9
Current account balance				
Excluding official transfers	-42.1	-35.5	-37.0	-40.9
Including official transfers	6.0	7.4	6.3	4.5
Foreign direct investment	0.9	0.5	0.6	0.3
Total external debt 6/	6.8	6.9	6.4	7.0
Gross international reserves (in millions of U.S. dollars)	6,867	6,886	7,248	7,110
Import coverage of reserves 7/	7.3	7.6	8.2	7.7
Exchange rate (average, Afghanis per U.S. dollar)	50.9	55.4	57.4	...
Real exchange rate (average, percentage change) 8/	-4.3	-2.7	-0.6	...
Memorandum items 9/	2012/13	2013/14	2014/15	2015/16
Nominal GDP, incl. opium (in billions of Afghanis)	1,086	1,197	...	...
Real GDP, incl. opium (annual percentage change)	10.9	6.5	...	...
Price (in U.S. dollars per kilogram)	163	163	…	...

Sources: Afghan authorities; United Nations Office on Drugs and Crime; and Fund staff estimates and projections.
1/ Excluding the narcotics economy.
2/ Revised with improved coverage.

3/ For comparison, 2012 is recalculated from data reported on the solar fiscal year basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is more aligned with the Gregorian calendar year.
4/ Comprising mainly current spending.
5/ Defined as domestic revenues minus operating expenditures.
6/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.
7/ In months of next year's import of goods and services.
8/ CPI-based, vis-a-vis the U.S. dollar.
9/ Items presented on the Afghan solar year basis.

Table 2. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2012–20

	2012 Act.	2013 Act.	2014 Act.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)								
Real GDP	14.0	3.9	1.3	2.0	3.0	4.0	5.0	6.0	6.0
Nominal GDP (in billions of U.S. dollars)	20.3	20.2	20.4	19.4	19.6	20.9	22.2	23.8	25.4
Consumer prices (period average) 2/	6.4	7.4	4.7	-1.3	3.1	5.0	5.0	5.0	5.0
Investment and savings 2/	(In percent of GDP, unless otherwise indicated)								
Gross domestic investment	25.8	22.9	21.5	21.9	21.7	22.3	23.0	25.5	24.2
Of which: Private	7.2	6.6	5.9	5.7	6.5	7.8	9.4	13.0	13.3
Gross national savings	31.8	30.4	27.8	26.4	23.7	21.6	20.7	20.6	19.5
Of which: Private	13.1	14.7	13.9	10.2	8.6	7.0	7.1	8.2	8.7
Public finances (central government) 3/									
Domestic revenues and grants	25.2	24.3	23.9	28.5	30.2	31.8	32.6	33.5	34.5
Domestic revenues	10.1	9.8	8.5	9.7	10.6	11.3	11.9	12.5	13.0
Grants	15.1	14.6	15.4	18.8	19.6	20.5	20.7	21.1	21.5
Expenditures	25.0	25.0	25.6	28.5	30.3	31.6	32.6	33.6	34.6
Operating 4/	18.2	17.8	19.4	21.5	22.9	24.0	25.0	25.8	26.6
Development	6.8	7.2	6.2	7.0	7.4	7.6	7.6	7.8	8.0
Operating balance (excluding grants) 5/	-8.1	-8.0	-10.9	-11.8	-12.2	-12.7	-13.1	-13.3	-13.6
Overall budget balance (including grants)	0.2	-0.6	-1.7	0.0	-0.1	0.2	0.0	-0.1	0.0
External sector 1/									
Merchandise trade balance	-46.7	-42.3	-39.6	-40.9	-41.9	-41.3	-39.8	-38.7	-34.2
Current account balance, excluding official grants	-42.1	-35.5	-37.0	-40.9	-42.0	-41.4	-39.7	-38.6	-34.6
Gross reserves (in millions of U.S. dollars)	6,867	6,886	7,248	7,110	7,500	7,650	7,700	7,700	7,800
Import coverage of reserves 6/	7.3	7.6	8.2	7.7	7.6	7.4	6.9	6.8	6.7
Memorandum items:									
Total public debt 7/	6.8	6.9	6.4	7.0	6.8	6.7	9.4	9.4	9.3
Of which: External debt	6.8	6.9	6.4	7.0	6.8	6.7	6.5	6.3	6.1
Domestic debt	0.0	0.0	0.0	0.0	0.0	0.0	2.8	3.1	3.2
GDP per capita (in U.S. dollars) 8/	680	660	654	606	597	625	650	681	713

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ Excluding the narcotics economy.
2/ Revised with improved coverage.
3/ For comparison, 2012 is recalculated from data reported on the solar fiscal year basis.
4/ Comprising mainly current spending. It is assumed that donors' recurrent expenditure off-budget is moved onto the budget by 2020. The actual rate of transfer on-budget is uncertain.
5/ Defined as domestic revenues minus operating expenditures.
6/ In months of next year's import of goods and services.
7/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.
8/ Incorporates the 2012 revision to the UN World Population Prospects.

Table 3a. Islamic Republic of Afghanistan: Central Government Budget, 2013–15

(In billions of Afghanis)

	2013	2014	2015							2015	
	FY	FY	Q1	Q2		Q3		Q4		FY	
	Act.	Act.	Est. 1/	SMP	Est.	SMP	Est.	SMP	Proj.	SMP 1/	Proj.
Revenues and grants	271.9	280.2	70.5	61.4	76.8	93.7	64.5	115.7	125.3	341.3	337.1
Domestic revenues	109.0	100.0	24.1	22.6	28.2	34.9	28.8	38.8	33.2	120.4	114.3
Tax revenues	77.4	78.1	14.2	20.3	22.7	26.7	21.1	26.5	32.3	87.8	90.3
Income, profits, and capital gains	27.4	29.5	4.6	7.8	8.4	9.0	8.0	7.2	11.8	28.7	32.8
International trade and transactions	27.3	26.0	5.6	6.2	8.0	7.5	7.5	8.1	8.0	27.4	29.1
Goods and services	17.3	16.6	3.3	4.4	4.7	8.2	4.6	9.2	9.8	25.1	22.4
Other	5.4	5.9	0.7	1.9	1.6	2.0	1.1	2.1	2.7	6.6	6.1
Nontax revenues	31.6	22.0	9.8	2.3	5.6	8.3	7.7	12.3	0.9	32.6	23.9
Grants to operating budget 2/	114.7	119.1	38.7	18.5	35.2	41.0	24.6	49.7	57.5	147.9	156.1
ARTF	14.2	24.2	2.0	4.2	5.7	2.9	11.4	6.2	14.7	15.2	33.8
LOTFA	22.4	25.9	7.1	10.3	7.2	12.3	6.4	20.9	6.0	50.7	26.7
CSTC-A	74.5	68.4	29.5	2.2	22.3	21.4	6.8	19.6	36.8	72.8	95.4
Other grants	3.6	0.6	0.1	1.7	0.0	4.4	0.0	2.9	0.0	9.2	0.2
Grants to development budget	48.2	61.1	7.7	20.3	13.3	17.8	11.1	27.2	34.6	73.0	66.7
Total expenditures	278.9	300.5	44.3	83.7	82.2	92.3	82.5	121.6	127.9	342.0	336.8
Operating expenditures	198.6	227.9	37.0	65.2	57.2	68.4	66.6	81.4	93.3	252.0	254.0
Of which: Security	128.7	138.1	…	…	…	…	…	…	…	162.2	160.9
Wages and salaries	139.5	150.2	31.4	39.7	37.3	42.1	40.8	43.9	50.5	157.2	160.0
Purchases of goods and services 3/	38.2	48.2	4.7	14.0	10.7	17.9	17.5	27.1	30.8	63.8	63.7
Transfers, subsidies, and other	0.0	0.7	0.3	0.8	0.3	0.5	0.3	0.5	1.2	2.1	2.1
Pensions	11.5	18.9	0.2	8.4	7.6	4.5	5.1	4.3	4.6	17.5	17.5
Capital expenditures	8.4	9.4	0.3	2.2	0.9	3.2	2.8	5.4	6.2	11.1	10.2
Interest	1.0	0.4	0.1	0.0	0.3	0.1	0.1	0.1	0.0	0.3	0.4
Development expenditures:	80.4	72.6	7.3	18.5	25.0	23.9	15.9	40.3	34.6	90.0	82.9
Infrastructure and natural resources	27.6	21.8	…	…	…	…	…	…	…	27.4	24.9
Education	8.5	8.7	…	…	…	…	…	…	…	10.4	9.9
Health	7.2	9.1	…	…	…	…	…	…	…	10.8	10.3
Agriculture and rural development	22.4	24.9	…	…	…	…	…	…	…	32.1	28.5
Discretionary 4/	…	9.9	…	…	…	…	…	…	…	17.0	16.2
Operating balance excluding grants	-89.5	-127.9	-12.9	-42.6	-29.0	-33.5	-37.7	-42.6	-60.1	-131.6	-139.7
Overall budget balance including grants	-7.0	-20.3	26.2	-22.3	-5.4	1.4	-18.0	-6.0	-2.6	-0.7	0.2
less: Kabul Bank bailout cost	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Augmented overall budget balance	-7.0	-18.4	26.2	-22.3	-5.4	1.4	-18.0	-6.0	-2.6	-0.7	0.2
Float and discrepancy 5/	10.5	-0.7	-6.4	0.0	11.5	0.0	-2.3	0.0	0.0	-6.4	2.8
Financing	-3.5	19.1	-19.8	14.9	-6.1	-1.4	20.3	6.0	2.6	-0.4	-3.0
Sale of nonfinancial assets 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	1.4	1.8	0.2	0.2	0.2	0.4	0.0	0.4	0.8	1.2	1.2
Domestic (net)	-4.9	17.2	-20.0	14.7	-6.3	-1.8	20.3	5.6	1.8	-1.5	-4.3
Central bank, change in	-4.9	17.2	-20.0	14.7	-6.3	-1.8	20.3	5.6	1.8	-1.5	-4.3
Government deposits	-4.7	20.3	-18.7	14.8	-7.7	-1.5	19.4	5.6	2.1	0.2	-4.9
Claims on government	-0.2	-3.1	-1.4	-0.1	1.3	-0.3	0.9	0.0	-0.3	-1.8	0.6
Memorandum items:											
Promissory note (end-of-period stock)	29.1	27.7	27.9	28.0	28.0	28.2	28.2	28.3	28.3	28.3	28.3
Propoor spending 7/	25.1	36.6	6.5	8.1	7.3	8.1	8.7	8.1	10.0	32.4	32.4

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ Slight differences in the financing and memorandum items from the SMP staff report are due to updated quarter 1 data on claims on government and pro-poor spend

2/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan;

CSTC-A: Combined Security Transition Command - Afghanistan (now NTM-A: NATO Training Mission - Afghanistan)

3/ 2015 figure includes about Af 2.85 billion arrears.

4/ 2015 figure includes about Af 7 billion discretionary development arrears.

5/ Positive number indicates that expenditures have been recorded, but not yet executed.

6/ Includes signature bonus payments for the Aynak copper mine.

7/ Propoor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

Table 3b. Islamic Republic of Afghanistan: Central Government Budget, 2013–15

(In percent of GDP)

	2013	2014	2015								2015	
	FY	FY	Q1		Q2		Q3		Q4		FY	
	Act.	Act.	SMP Est.	Est. 1/	SMP	Est.	SMP	Est.	SMP	Proj.	SMP	Proj.
Revenues and grants	24.3	23.9	5.6	6.0	4.9	6.5	7.5	5.4	9.3	10.6	27.3	28.5
Domestic revenues	9.8	8.5	1.9	2.0	1.8	2.4	2.8	2.4	3.1	2.8	9.6	9.7
Tax revenues	6.9	6.7	1.1	1.2	1.6	1.9	2.1	1.8	2.1	2.7	7.0	7.6
Income, profits, and capital gains	2.5	2.5	0.4	0.4	0.6	0.7	0.7	0.7	0.6	1.0	2.3	2.8
International trade and transactions	2.4	2.2	0.5	0.5	0.5	0.7	0.6	0.6	0.6	0.7	2.2	2.5
Goods and services	1.5	1.4	0.3	0.3	0.4	0.4	0.7	0.4	0.7	0.8	2.0	1.9
Other	0.5	0.5	0.1	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.5	0.5
Nontax revenues	2.8	1.9	0.8	0.8	0.2	0.5	0.7	0.7	1.0	0.1	2.6	2.0
Grants to operating budget 2/	10.3	10.2	3.1	3.3	1.5	3.0	3.3	2.1	4.0	4.9	11.8	13.2
ARTF	1.3	2.1	0.2	0.2	0.3	0.5	0.2	1.0	0.5	1.2	1.2	2.9
LOTFA	2.0	2.2	0.6	0.6	0.8	0.6	1.0	0.5	1.7	0.5	4.1	2.3
CSTC-A	6.7	5.8	2.4	2.5	0.2	1.9	1.7	0.6	1.6	3.1	5.8	8.1
Other grants	0.3	0.0	0.0	0.0	0.1	0.0	0.4	0.0	0.2	0.0	0.7	0.0
Grants to development budget	4.3	5.2	0.6	0.6	1.6	1.1	1.4	0.9	2.2	2.9	5.8	5.6
Total expenditures	25.0	25.6	3.5	3.7	6.7	6.9	7.4	7.0	9.7	10.8	27.4	28.5
Operating expenditures	17.8	19.4	3.0	3.1	5.2	4.8	5.5	5.6	6.5	7.9	20.2	21.5
Of which: Security	11.5	11.8	...	...		...	...	...	...	...	13.0	13.6
Wages and salaries	12.5	12.8	2.5	2.6	3.2	3.2	3.4	3.4	3.5	4.3	12.6	13.5
Purchases of goods and services 3/	3.4	4.1	0.4	0.4	1.1	0.9	1.4	1.5	2.2	2.6	5.1	5.4
Transfers, subsidies, and other	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.2	0.2
Pensions	1.0	1.6	0.0	0.0	0.7	0.6	0.4	0.4	0.3	0.4	1.4	1.5
Capital expenditures	0.7	0.8	0.0	0.0	0.2	0.1	0.3	0.2	0.4	0.5	0.9	0.9
Interest	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development expenditures:	7.2	6.2	0.6	0.6	1.5	2.1	1.9	1.3	3.2	2.9	7.2	7.0
Infrastructure and natural resources	2.5	1.9	...	...	...	...	...	...	...	...	2.2	2.1
Education	0.8	0.7	...	...	...	...	...	...	...	...	0.8	0.8
Health	0.6	0.8	...	...	...	...	...	...	...	...	0.9	0.9
Agriculture and rural development	2.0	2.1	...	...	...	...	...	...	...	...	2.6	2.4
Discretionary 4/	...	0.8	...	...	...	...	...	...	...	...	1.4	1.4
Operating balance excluding grants	-8.0	-10.9	-1.0	-1.1	-3.4	-2.4	-2.7	-3.2	-3.4	-5.1	-10.5	-11.8
Overall budget balance including grants	-0.6	-1.7	2.1	2.2	-1.8	-0.5	0.1	-1.5	-0.5	-0.2	-0.1	0.0
less: Kabul Bank bailout cost	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Augmented overall budget balance	-0.6	-1.6	2.1	2.2	-1.8	-0.5	0.1	-1.5	-0.5	-0.2	-0.1	0.0
Float and discrepancy 5/	0.9	-0.1	-0.6	-0.5	0.0	1.0	0.0	-0.2	0.0	0.0	-0.6	0.2
Financing	-0.3	1.6	-1.5	-1.7	1.2	-0.5	-0.1	1.7	0.5	0.2	0.1	-0.3
Sale of nonfinancial assets 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Domestic (net)	-0.4	1.5	-1.5	-1.7	1.2	-0.5	-0.1	1.7	0.4	0.2	0.0	-0.4
Central bank, change in	-0.4	1.5	-1.5	-1.7	1.2	-0.5	-0.1	1.7	0.4	0.2	0.0	-0.4
Government deposits	-0.4	1.7	-1.5	-1.6	1.2	-0.6	-0.1	1.6	0.5	0.2	0.0	-0.4
Claims on government	0.0	-0.3	0.0	-0.1	0.0	0.1	0.0	0.1	0.0	0.0	-0.1	0.1
Memorandum items:												
Promissory note (end-of-period stock)	2.6	2.4	2.2	2.4	2.2	2.4	2.3	2.4	2.3	2.4	2.3	2.4
Propoor spending 7/	2.2	3.1	0.7	0.5	0.6	0.6	0.6	0.7	0.7	0.8	2.6	2.7

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ The difference between the current and SMP quarter 1 estimates are due to lowered nominal GDP projection for 2015, and updated quarter 1 data on claims on government and pro-poor spending.

2/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan;
CSTC-A: Combined Security Transition Command - Afghanistan (now NTM-A: NATO Training Mission - Afghanistan)

3/ 2015 figure includes about Af 2.85 billion arrears.

4/ 2015 figure includes about Af 7 billion discretionary development arrears.

5/ Positive number indicates that expenditures have been recorded, but not yet executed.

6/ Includes signature bonus payments for the Aynak copper mine.

7/ Propoor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

Table 4a. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2013–15

(At current exchange rates)

	2013	2014	2015							
	Dec. 21	Dec. 21	March 19	March 19	June 21	June 21	Sep. 22	Sep. 22	Dec. 21	Dec. 21
	Act.	Act.	SMP	Prel.	SMP	Prel.	SMP	Prel.	SMP	Proj.
	(In billions of Afghanis, unless otherwise indicated)									
Net foreign assets	382.5	409.4	412.7	408.0	413.9	433.1	416.1	445.0	418.3	446.4
Foreign assets	403.8	429.0	430.8	426.0	432.8	452.4	434.6	465.0	436.6	466.1
Foreign exchange reserves	390.0	420.9	422.7	418.3	424.6	444.7	426.4	454.0	428.4	455.0
Other foreign assets	13.8	8.1	8.1	7.8	8.2	7.7	8.2	11.0	8.3	11.1
Foreign liabilities	-21.2	-19.5	-18.1	-18.1	-19.0	-19.3	-18.5	-20.0	-18.3	-19.6
Net domestic assets	-183.8	-184.2	-193.5	-200.8	-185.7	-224.7	-170.8	-226.0	-168.3	-205.5
Domestic assets	-110.8	-105.5	-117.1	-122.8	-117.5	-132.1	-109.8	-106.7	-100.6	-90.1
Net claims on government	-58.9	-41.6	-61.7	-61.6	-45.9	-68.0	-47.7	-47.7	-42.1	-46.0
Gross claims on government	50.3	47.3	45.9	45.9	46.9	47.2	46.6	48.1	46.6	47.9
Of which: MoF promissory note 1/	29.1	27.7	27.9	27.9	28.0	28.0	28.2	28.2	28.3	28.3
Domestic currency deposits	-18.3	-20.0	-24.6	-21.3	-20.9	-27.1	-21.3	-16.8	-19.9	-16.5
Foreign currency deposits 2/	-90.9	-68.9	-83.0	-86.3	-71.9	-88.1	-73.0	-79.0	-68.8	-77.4
Other claims	-52.0	-63.9	-55.3	-61.1	-71.6	-64.1	-62.1	-59.0	-58.5	-44.2
Other items net	-73.0	-78.7	-76.5	-78.0	-68.3	-92.6	-61.0	-119.2	-67.7	-115.3
Reserve money	198.8	225.2	219.2	207.2	228.2	208.5	245.3	219.0	250.0	241.0
Currency in circulation	168.8	197.0	193.0	182.4	203.6	187.4	216.6	195.5	218.6	210.8
Bank deposits (Afghani denominated)	30.0	28.2	26.2	24.8	24.6	21.1	28.7	23.5	31.3	30.2
Memorandum items:										
International reserves, in millions of U.S. dollars										
Net	6,382	6,694	6,737	6,706	6,769	6,816	6,806	6,583	6,844	6,675
Gross	6,886	7,248	7,278	7,238	7,313	7,324	7,342	7,022	7,377	7,110
Interest rate, 28-day capital notes (percent)	3.4	3.5	...	3.4	...	...	...	...	...	...
Exchange rate (Afghanis per U.S. dollar)	56.6	58.1	...	57.8	...	...	...	...	...	...

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ A nonmarketable security issued to DAB by the ministry of finance for the cost of a lender of last resort assistance to Kabul Bank.

2/ Includes Afghanistan's SDR holdings (MoF is the fiscal agent for the IMF).

Table 4b. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2013–15

(At program exchange rates)[1/]

	2013	2014	2015							
	Dec. 20	Dec. 21	March 19	March 19	June 21	June 21	Sep. 22	Sep. 22	Dec. 21	Dec. 21
	Act.	Act.	SMP	Est.	SMP	Est.	SMP	Prel.	SMP	Proj
	(In billions of Afghanis, unless otherwise indicated)									
Net foreign assets	387.6	409.4	411.7	415.1	413.9	415.0	416.1	400.6	418.3	406.1
Foreign assets	408.2	429.0	430.8	434.3	432.8	434.0	434.6	419.1	436.6	424.4
Foreign exchange reserves	394.1	420.9	422.7	426.5	424.6	426.6	426.4	409.2	428.4	414.3
Other foreign assets	14.0	8.1	8.1	7.8	8.2	7.4	8.2	9.9	8.3	10.1
Foreign liabilities	-20.6	-19.5	-19.1	-19.1	-19.0	-19.0	-18.5	-18.5	-18.3	-18.3
Net domestic assets	-188.8	-184.2	-192.4	-208.0	-185.7	-206.6	-170.8	-181.6	-168.3	-165.1
Domestic assets	-113.3	-105.5	-116.0	-123.3	-117.5	-128.0	-109.8	-98.5	-100.6	-82.8
Net claims on government	-60.9	-41.6	-60.6	-61.7	-45.9	-64.9	-47.7	-41.6	-42.1	-40.5
Gross claims on government	49.7	47.3	47.0	47.0	46.9	46.9	46.6	46.6	46.6	46.6
Of which: MoF promissory note 2/	29.1	27.7	27.9	27.9	28.0	28.0	28.2	28.2	28.3	28.3
Domestic currency deposits	-18.3	-20.0	-24.6	-21.3	-20.9	-27.1	-21.3	-16.8	-19.9	-16.5
Foreign currency deposits 3/	-92.3	-68.9	-83.0	-87.5	-71.9	-84.7	-73.0	-71.4	-68.8	-70.6
Other claims	-52.3	-63.9	-55.3	-61.6	-71.6	-63.2	-62.1	-56.9	-58.5	-42.3
Other items net	-75.5	-78.7	-76.5	-84.6	-68.3	-78.5	-61.0	-83.1	-67.7	-82.3
Reserve money	198.8	225.2	219.2	207.2	228.2	208.5	245.3	219.0	250.0	241.0
Currency in circulation	168.8	197.0	193.0	182.4	203.6	187.4	216.6	195.5	218.6	210.8
Bank deposits (Afghani denominated)	30.0	28.2	26.2	24.8	24.6	21.1	28.7	23.5	31.3	30.2
Memorandum items:										
Net international reserves										
(At program rates, in millions of U.S. dollars)	6,293	6,694	6,731	6,800	6,769	6,831	6,806	6,602	6,844	6,694
Money growth (year-on-year, in percent)										
Reserve money	12.4	13.3	12.9	6.7	12.1	2.4	11.1	-0.8	11.0	7.0
Currency in circulation	12.5	16.7	14.1	7.8	12.7	3.7	11.4	0.6	11.0	7.0

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ Program exchange rates as of Dec. 21, 2014 are applied to value foreign currency-denominated components.

2/ A nonmarketable security issued to DAB by the ministry of finance for the cost of a lender of last resort assistance to Kabul Bank.

3/ Includes Afghanistan's SDR holdings (MoF is the fiscal agent for the IMF).

Table 5. Islamic Republic of Afghanistan: Monetary Survey, 2013–15[1/]

	2013	2014	2015							
	Dec. 21	Dec. 21	Mar. 19	Mar. 19	June 21	June 21	Sep. 22	Sep. 22	Dec. 21	Dec. 21
	Act.	Act.	SMP	Est.	SMP	Est.	SMP	Prel.	SMP	Proj.
	(In billions of Afghanis)									
Net foreign assets	465.9	488.4	492.5	484.2	494.5	511.3	495.9	533.8	498.4	540.4
Foreign assets	495.6	516.1	519.4	510.3	521.2	539.0	522.7	563.1	525.3	569.7
Central bank	403.8	429.0	430.8	426.0	432.8	452.4	434.6	465.0	436.6	466.1
Commercial banks	91.9	87.1	88.6	84.3	88.4	86.6	88.1	98.1	88.7	103.7
Foreign liabilities	-29.7	-27.7	-26.9	-26.1	-26.7	-27.8	-26.8	-29.3	-27.0	-29.4
Central bank	-21.2	-19.5	-19.1	-18.1	-19.0	-19.3	-18.5	-20.0	-18.3	-19.6
Commercial banks	-8.5	-8.2	-7.7	-8.1	-7.8	-8.5	-8.3	-9.2	-8.6	-9.7
Net domestic assets	-95.3	-86.8	-102.0	-110.4	-84.9	-130.2	-70.1	-132.2	-74.9	-116.1
Net domestic credit	-13.8	0.5	2.3	-22.0	1.6	-26.7	-1.0	-2.1	4.5	-1.0
Nonfinancial public sector	-59.8	-42.5	-43.9	-62.5	-46.8	-68.7	-48.6	-48.6	-43.0	-46.9
Central bank	-58.9	-41.6	-43.0	-61.6	-45.9	-68.0	-47.7	-47.7	-42.1	-46.0
Commercial banks	-1.0	-0.9	-0.9	-0.8	-0.9	-0.8	-0.9	-0.9	-0.9	-0.9
Private sector	46.1	43.0	46.2	40.5	48.3	42.0	47.6	46.5	47.5	45.9
Other items net	-81.5	-87.3	-104.3	-88.4	-86.4	-103.5	-69.2	-130.1	-79.4	-115.1
Broad money M2	370.7	401.6	390.5	373.8	409.6	381.1	425.7	401.6	423.4	424.3
Narrow money M1	350.7	384.2	368.7	354.0	387.2	358.2	405.4	381.5	403.2	406.1
Currency outside banks	161.9	188.5	185.9	174.2	195.4	177.7	208.8	187.8	210.9	201.9
Currency in circulation	168.8	197.0	193.0	182.4	203.6	187.4	216.6	195.5	218.6	210.8
Currency held by banks	6.9	8.5	7.0	8.2	8.2	9.6	7.8	7.7	7.8	8.9
Demand deposits	188.8	195.7	182.8	179.8	191.9	180.5	196.6	193.7	192.3	204.2
Other deposits	20.0	17.4	21.8	19.8	22.4	22.8	20.4	20.1	20.2	18.2
	(12-month percentage change)									
M2	9.4	8.3	8.5	3.8	9.0	1.4	10.6	4.4	10.0	5.7
M1	9.9	9.5	8.8	4.4	9.2	1.0	10.7	4.2	10.1	5.7
Currency outside banks	13.4	16.4	14.5	7.3	13.0	2.8	11.5	0.3	11.1	7.1
Net credit to the private sector	10.1	-6.6	3.1	-9.1	4.2	-9.3	5.9	-5.0	7.0	-5.0
	(In percent of GDP)									
M2	33.2	34.2	31.2	31.5	32.8	32.2	34.1	33.9	33.9	35.8
M1	31.4	32.7	29.5	29.9	31.0	30.2	32.4	32.2	32.3	34.3
Memorandum items:										
M2 velocity	3.0	2.9	3.0	3.1	2.9	3.1	2.9	2.9	3.0	2.8
Reserve money multiplier	1.9	1.8	1.8	1.8	1.8	1.8	1.7	1.8	1.7	1.8
Banking sector										
Loan dollarization (percent)	75.9	67.4	73.5	65.7	74.2	66.3	71.1	71.1	71.1	67.4
Deposit dollarization (percent)	69.0	65.8	68.3	67.1	66.3	66.9	63.4	63.4	63.4	65.8
Currency-to-deposit ratio (percent)	80.9	92.4	94.3	91.4	95.0	92.2	99.8	91.5	102.9	94.8
Loans-to-deposit ratio (percent)	22.1	20.2	22.6	20.3	22.6	20.7	22.0	21.8	22.3	20.6

Sources: Afghan authorities; and Fund staff estimates and projections.

[1/] End of period. Data underlying the survey are not fully consistent because the central bank and the public banks use the solar calendar, while commercial banks use the Gregorian calendar.

Table 6. Islamic Republic of Afghanistan: Balance of Payments, 2013–20[1]

	2013	2014	2015		2016		2017		2018		2019		2020	
	Act.	Act.	SMP	Proj.	SMP	Proj.	SMP	Proj.	SMP	Proj.	SMP	Proj.	SMP	Proj.
	(In millions of U.S. dollars, unless otherwise indicated)													
Export of goods and services	4,014	3,225	2,749	2,611	2,769	2,793	3,207	3,080	3,859	3,459	4,585	3,930	5,534	4,684
Goods	714	775	949	811	1,007	1,029	1,356	1,275	1,979	1,593	2,659	1,989	3,636	2,621
Services	3,300	2,450	1,800	1,800	1,762	1,764	1,852	1,804	1,881	1,866	1,926	1,941	1,897	2,062
Import of goods and services	11,338	10,840	11,375	10,617	11,763	11,111	13,110	11,859	13,722	12,442	13,989	13,322	13,275	13,633
Goods	9,242	8,881	9,377	8,746	9,777	9,224	11,050	9,912	11,638	10,447	11,849	11,210	11,048	11,313
Services	2,096	1,959	1,998	1,871	1,986	1,887	2,059	1,947	2,084	1,995	2,140	2,112	2,227	2,320
Income, net	297	180	179	192	199	203	173	213	41	220	-89	226	-181	153
Of which: Interest on official loans	5	5	5	7	6	5	7	5	8	6	9	6	11	7
Current transfers, net	8,530	8,723	9,108	8,686	8,910	8,511	9,058	8,424	8,886	8,258	8,449	8,004	7,369	7,600
Of which: Official /2	8,658	8,851	9,239	8,806	9,025	8,615	9,163	8,511	8,967	8,322	8,493	8,037	7,352	7,589
Current account	1,502	1,288	660	872	115	397	-671	-143	-935	-506	-1,045	-1,161	-553	-1,196
Excluding official grants	-7,156	-7,563	-8,579	-7,934	-8,910	-8,219	-9,834	-8,654	-9,902	-8,828	-9,538	-9,198	-7,905	-8,785
Capital account	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Financial account, net	-14	123	-508	-970	-8	-20	708	280	984	555	1,105	1,171	610	1,303
Foreign direct investment	108	123	123	58	297	189	1,022	353	1,432	644	1,354	829	1,018	845
Portfolio investment	-67	-52	-57	-57	-62	-62	-67	-67	-72	-72	-77	-77	-82	-82
Official loans 3/	17	-79	21	20	43	26	67	34	87	43	112	52	136	61
Disbursement	29	26	32	35	54	42	79	53	105	63	130	73	155	84
Amortization	11	54	11	15	11	17	12	19	18	20	18	21	19	23
Debt relief ('-' = forgiveness)	0	50	0	0	0	0	0	0	0	0	0	0	0	0
Other investment	-72	131	-595	-992	-285	-173	-314	-40	-463	-59	-284	367	-462	480
Errors and omissions	-1,159	-982	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance	328	429	150	-98	110	377	37	137	49	49	60	10	58	108
Financing	-328	-429	-150	98	-110	-377	-37	-137	-49	-49	-60	-10	-58	-108
Central bank's gross reserves ('-' = accumulation)	-316	-459	-129	119	-123	-390	-50	-150	-50	-50	-50	0	-50	-100
Use of Fund resources, net	-13	-20	-21	-20	13	13	13	13	1	1	-10	-10	-8	-8
Disbursements 4/	0	0	0	0	35	34	35	34	17	17	0	0	0	0
Repayments	13	20	21	20	22	21	22	21	17	16	10	10	8	8
Debt relief ('-' = forgiveness)	0	50	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:														
Gross international reserves, central bank	6,886	7,248	7,377	7,110	7,500	7,500	7,550	7,650	7,600	7,700	7,650	7,700	7,700	7,800
Import coverage of reserves 5/	7.6	8.2	7.5	7.7	6.9	7.6	6.6	7.4	6.5	6.9	6.9	6.8	6.2	6.7
External debt stock, official 6/	1,361	1,299	1,350	1,295	1,405	1,333	1,486	1,380	1,573	1,424	1,675	1,466	1,804	1,520
in percent of GDP	6.7	6.4	6.3	6.7	6.5	6.8	6.3	6.6	6.2	6.4	6.1	6.2	6.2	6.0
Trade balance	-8,528	-8,106	-8,429	-7,935	-8,770	-8,195	-9,695	-8,637	-9,659	-8,855	-9,190	-9,221	-7,411	-8,692
in percent of GDP	-42.3	-39.6	-39.2	-40.9	-40.5	-41.9	-41.1	-41.3	-38.0	-39.8	-33.6	-38.7	-25.4	-34.2
Current account, in percent of GDP	7.4	6.3	3.1	4.5	0.5	2.0	-2.8	-0.7	-3.7	-2.3	-3.8	-4.9	-1.9	-4.7

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ BoP data exclude the narcotics economy.

2/ Capital transfers are difficult to identify and are thus included in current transfers.

3/ Excluding IMF.

4/ Disbursements in 2016-18 are conditional on the board approval for a Fund financial arrangement following a succsessful SMP.

5/ In months of next year's import of goods and services.

6/ Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.

Table 7. Islamic Republic of Afghanistan: External Financing Requirement and Sources, 2013–20

	2013 Act.	2014 Act.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
	(In millions of U.S. dollars)							
Gross financing requirement	7,380	7,987	7,752	8,564	8,778	8,867	9,207	8,936
Current account balance (excluding grants)	-7,028	-7,435	-7,814	-8,115	-8,567	-8,764	-9,166	-8,796
Amortization	24	74	36	38	40	36	31	30
Of which: IMF	13	20	20	21	21	16	10	8
Change in reserves (increase = +)	316	459	-119	390	150	50	0	100
Reduction in arrears		0	0	0	0	0	1	2
IMF repayments	13	20	20	21	21	16	10	8
Available financing	7,380	7,987	7,752	8,564	8,778	8,867	9,207	8,936
Official transfers (grants)	8,658	8,851	8,806	8,615	8,511	8,322	8,037	7,589
Foreign direct investment	108	123	58	189	353	644	829	845
Official medium- and long-term loans (net)	29	26	35	42	53	63	73	84
Accumulation of arrears	0	0	0	0	0	0	0	0
IMF disbursements /1	0	0	0	34	34	17	0	0
Other flows	-1,414	-1,012	-1,148	-317	-173	-179	269	418
Financing gap	0	0	0	0	0	0	0	0

1/ Disbursements in 2016-18 are conditional on the board approval for a Fund financial arrangement following a successful SMP.
Sources: Afghan authorities; and Fund staff estimates and projections.

Table 8. Islamic Republic of Afghanistan: Millennium Development Goals[1/]

	Baseline value	Latest available	Target 2/ 2015	Target 2/ 2020	Sources and years for baseline and latest 3/
	(In percent, unless otherwise indicated)				
Goal 1: Eradicate extreme poverty and hunger					
Population below US$1 (PPP) a day	...	...	...	...	...
Population below national poverty line 4/ 5/ 6/	33.0	35.8	24.0	21.0	NRVA (2005), WB (2011)
Prevalence of underweight children under 5 years of age	41.0	39.0	15.0	...	UNICEF (2002, 2010)
Population below minimum level of dietary energy consumption 5/ 7/	30.0	29.0	11.0	9.0	NRVA (2005, 2010)
Goal 2: Achieve universal primary education					
Net enrollment ratio in primary education	54.0	77.0	82.0	100	MoE (2003, 2012)
Literacy rate of 15- to 24-year-olds	34.0	47.0	50.0	100	MICS (2003), NRVA (2011/12)
Goal 3: Promote gender equality and empower women					
Ratio of girls to boys in primary education	60.0	71.0	83.0	100	MICS (2003), CSO (2012)
Ratio of girls to boys in secondary education	33.0	57.0	70.0	100	MICS (2003), CSO (2012)
Proportion of seats held by women in national, provincial and district representative bodies 6/	25.0	27.7	25.0	30.0	Constitution (2004), WB (2014)
Goal 4: Reduce child mortality 6/					
Under 5 mortality rate (per 1000 live births)	257	97.3	93	76	MoPH (2002), WB (2013)
Infant mortality rate (per 1000 live births)	165	70.2	70	46	MoPH (2002) WB (2013)
Immunization, measles, children under 12 months	35.0	75.0	90.0	100	MoPH (2002), WB (2013)
Goal 5: Improve maternal health					
Maternal mortality ratio (per 100,000 births)	1600	327	315	400	MoPH (2003, 2010)
Proportion of births attended by skilled personnel	6.0	42.0	43.0	75.0	MoPH (2003, 2012)
Fertility rate (live births per woman) 5/ 6/ 8/	6.2	4.9	4.7	3.1	UNICEF (2003), WB (2013)
Goal 6: Combat HIV/AIDS, malaria, TB and other diseases					
Contraceptive prevalence rate, national	10.0	21.0	50.0	60.0	MoPH (2005, 2012)
Incidence rates associated with malaria (routine reporting) %	1.48	1.53	0.7	0.2	MoPH (2005, 2012)
Prevalence rates associated with tuberculosis (per 100,000 population)	671	351	224	143	MoPH (2005, 2012)
Goal 7: Ensure environmental sustainability					
Proportion of total area protected to maintain biological diversity	0.34	0.50	0.50	...	NEPA (2004, 2012)
Energy use (kg oil equivalent per US$1,000 GDP, PPP)	...	...	...	...	...
Population with access to safe drinking water	23.0	31.0	...	61.5	MRRD (2003, 2012)
Population with access to improved sanitation	12.0	8.0	...	66.0	MRRD (2003, 2012)
Goal 8: Develop a Global Partnership for Development					
ODA received as a proportion of GDP	49.0	32.6	...	...	MoF (2003), WB (2012)
Export to countries having a preferential trade agreement with Afghanistan	11.8	27.7	...	100	CSO (2006, 2010)
Goal 9: Enhance security 8/					
Professional training of the ANA (% of personnel having undergone a full training)	42.0	90.0	100	100	MoD (2008, 2012)
Afghans directly affected by emplaced antipersonnel mines (in millions)	4.2	1.0	0.4	0.2	UNMACCA (2005, 2012)
Afghans dependent on opium for their livelihoods (in millions)	1.7	1.0	0.6	0.2	UNODC (2003, 2012)

Source: Islamic Republic of Afghanistan, UNDP Millennium Development Goals Report 2012 (April 2014 update).

1/ Only selected indicators within selected targets have been reported.

2/ Recognizing the capacity constraints, and acknowledging that for Afghanistan the 1990s was a "lost decade" for development, the Technical Working Groups recommended that the Government extend the time period for meeting the MDG targets from 2015 to 2020 so as to have a realistic chance of meeting the targets.

3/ For baseline value and latest available value, respectively. Sources as reported by UNDP. Where sources for baseline value and latest available value differ, reported figures may not be comparable. Additionally, figures based on 2005 NRVA survey may not be directly comparable due to seasonality and methodological changes. Years may sometimes refer to a time of publication of the data rather than data itself. Constitution: The Afghan constitution, approved in 2004, guarantees that at least a quarter of all elected representatives should be female; CSO: Central Statistical Office; MICS: Multi-indicator Cluster Survey; MoE: Ministry of Education; MoF: Ministry of Finance; MoPH: Ministry of Public Health; MRRD: Ministry of Rural Rehabilitation and Development; NEPA: National Environmental Protection Agency; NRVA: National Risk and Vulnerability Assessment; UNICEF: United Nation International Children's Emergency Fund; UNMACCA: United Nations Mine Action Coordination Centre for Afghanistan; UNODC: United Nations Office for Drugs and Crime; WB: World Bank/Data on Millennium Development Goals.

4/ National poverty line calculated with Cost of Basic Needs method.

5/ Figures may not be directly comparable.

6/ Latest data is from World Bank, rather than from the UNDP MDGs Report.

7/ Minimum level of dietary energy consumption at 2100 Cal./day.

8/ Afghanistan-specific, additional goal/indicator.

Table 9. Projected External Borrowing Program, 2015

PPG external debt contracted	Volume of new debt in 2015, US million 1/	Present Value of new debt in 2015, US million 1/
By sources of debt financing	33.1	12.4
Concessional debt, of which 2/	33.1	12.4
Bilateral debt	33.1	12.4
Non-concessional debt, of which	0.0	0.0
By Creditor Type	33.1	12.4
Bilateral - Paris Club	33.1	12.4
Uses of debt financing	33.1	12.4
Infrastructure	33.1	12.4
Memo Items		
Indicative projections		
Year 2	0.0	0.0
Year 3	0.0	0.0

1/ Contracting of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate.
2/ Debt with a grant element that exceeds a minimum threshold, typically 35 percent, but 60 percent for Afghanistan.

Annex I. Performance and Oversight of SOEs in Afghanistan[1]

1. **Non-financial public companies in Afghanistan consist of around 35 State Owned Enterprises (SOEs) and 15 State-Owned Corporations (SOCs).** The SOEs are set up under the State-Owned Enterprise (Tassady) Law of November 2005, and operate with 100 percent state ownership under the control of the relevant line ministry.[2] The SOCs, on the other hand, are set up under the Corporations and Limited Liability Companies Law, and operate under varying degree of state ownership and control depending on the level of state shareholding. The state shares of SOCs are held by the relevant line ministries. The SOCs report to their board of directors and a representative of the Ministry of Finance (MoF) has a membership in the majority of SOCs' board.

2. **A large share of these SOE and SOCs were either unprofitable or made little profit in 2014 (Table 1).** The total profits of the nonfinancial public companies, for which data are available were around Af 2.5billion or 2.5 percent of total government revenues in 2014.[2] Total profits have been declining nominally for the past 3 years. Enterprises operating in the energy and transportation sectors, including Shamal Coal, Afghan Gas, Mazar Electricity, and Millie Bus, have employed a significant part of the workforce in the public enterprise sector, and those in the energy sector have accounted for most of the profits earned, with 80 percent of all profits coming from one SOE: Shamal Coal. Ariana Airlines, however, have been running deficits for the past 3 years, and together with the National Insurance Company, experienced the largest losses in 2014.[3]

3. **Effective financial and operational oversight of SOEs and SOCs could contribute to strengthening public finances and moving toward fiscal sustainability.** While SOEs and SOCs are a source of non-tax domestic revenue—with the former yielding less than 0.1 percent of GDP in dividends annually between 2012-2014, the amount of government support provided to the sector—in the form of loan guarantees, concessions, tax expenditures, subsidies, and recapitalizations—is poorly understood or accounted for. As low dividends to government arising from poor financial management in these entities, and implicit and explicit government obligations to assist them in case of failure could create large budgetary costs, the fiscal risks arising from SOEs and SOCs operations should be identified in a timely manner and monitored closely.

4. **Currently financial oversight of SOEs is undertaken by the SOE department within the MoF, but needs strengthening.** This oversight task includes (i) the approval of an annual financial

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[1] Prepared by Elif Ture (FAD).

[2] The MoF owns the SOEs and has a representative on the SOE's Supreme Council (Board) serving as the vice chairman, while the minister or the chief of the agency, which supervises the enterprise, chairs the Supreme Council.

[2] The Central Statistics Organization (CSO) publishes quarterly revenue and expenditure data on SOEs and SOCs that submit their financial statements to the MoF regularly. CSO currently publishes quarterly data on 38 of 50 SOEs and SOCs.

[3] Another loss making SOC, which is not included in the CSO reports, is Afghan Water Supply and Sewerage, which has been running deficits of around Af250mn annually between 2011 and 2013 according to the records of MoF Department of SOCEs.

plan submitted by the SOE in the first quarter of the fiscal year; and (ii) the review of subsequent quarterly reports submitted to show the progress on implementing the approved plan. However, the oversight of fiscal risks is hampered by the lack of accounting capacity within SOEs, which means they are not able to report their financial operations and positions adequately and in a timely way, and the lack of analytical capacity within the SOE department to monitor the reports effectively.[4] Although, the SOE Law requires annual external audits of SOE financial statements, capacity constraints have prevented undertaking such audits being conducted regularly.

5. **There is limited financial oversight over SOCs.** In 2013, the SOE Department established a unit for channeling the instructions of MoF to SOCs and monitoring and assessing the financial performance of SOCs ex-post. After the creation of this new unit, the name of the SOE department was changed to the SOCE department; however, until the SOCs law is amended, it does not have a supervisory mandate or enforcement authority.

6. **The government proposed amendments to the laws governing SOE and SOCs that aim to unify and strengthen the state ownership and oversight function within the MoF.** While the amendment to the SOE Law will enhance the MoF's role in financial oversight of SOEs by establishing a robust framework of monitoring their performance, the amendment to the Companies Law aims to bring the SOCs under MoF oversight officially.[5] The draft amendments to SOEs Law and Corporations Law have been sent to Ministry of Justice for processing in 2013, and no progress has been achieved since then.

7. **Staff recommends the amendments to the SOE and SOC Laws, which were committed to as part of the previous ECF-supported Program, be passed promptly.** After enactment of the amendments and transfer of legal ownership to the MoF of all state shares in SOCEs,[6] and following the 2012-2013 FAD-led PFM TA recommendations:

i) the MoF should review the capacity of the SOE department to assess needed staffing and seek technical assistance, including through IMF, to improve the capacity for operational and financial oversight of the SOCEs by ensuring regular external audits, preparing quarterly and annual analytical reports on financial performance and position of SOCEs, and assessing their fiscal impact and risks within the medium-term fiscal framework, with particular attention to identifying the financial flows between the MoF and SOCEs, the latter's quasi-fiscal activities and associated contingent liabilities;

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[4] See Afghanistan Public Financial Management and Accountability Assessment, August 2013, http://treasury.gov.af/Content/files/PEFA%20Afghanistan%202013.pdf.

[5] The proposed amendment to the Companies Law does not have an explicit requirement for SOCs to submit their annual financial plan and quarterly progress reports to the MoF. However, these plans and reports are required to be submitted to the Board of Directors of the SOC, and the Minister of Finance as the majority shareholder can bring the SOC under MoF oversight (See "Public Financial Management Reforms: Next Steps," June 2013 IMF TA report on Afghanistan).

[6] Recently some ministries have thought more shares in SOCEs, for example the Ministry of Agriculture, Irrigation and Livestock asked for approval to increase its holdings in Baghlan Sugar Company and Nangarhar Canal.

ii) the board of directors of the SOCEs should review the Articles of their entities to strengthen the merit based hiring practices and capacity development operations to contribute to the strengthening of fiscal performance and service delivery of SOCEs.

Table 1. State Owned Enterprise and Corporations, Employment and Profits

	Name	Ministry	Type	GoA Share (%)	Employees (#)	Year 1/	Profit (in million Afs) 2/		
							2012	2013	2014
	Production sector						**2,029**	**2,080**	**2,311**
1	Shamal Coal	Ministry of Mines and Petroleum	SOE	100	512	2014	1,543	1,745	1,963
2	Afghan Gas	Ministry of Mines and Petroleum	SOE	100	950	2015	113	96	106
3	Coin Manufacture / Sukuk Printing Co.	Ministry of Finance	SOE	100	76	2014	107	93	99
4	Mazar Fertilizers & Electricity	Ministry of Mines and Petroleum	SOE	100	1795	2014	202	61	81
5	Banai Construction Co.	Ministry of Urban Development	SOE	100	267	2010	34	46	17
6	Pharmacy Co.	Ministry of Public Health	SOE	100	217	2014	4	10	12
7	Spinzer Cotton & Oil Co.	Ministry of Commerce and Industries	SOE	100	222	2014	12	4	9
8	Housing Construction Co.	Ministry of Urban Development	SOE	100	209	2015	6	3	9
9	Helmand Construction Co.	Ministry of Energy and Water	SOE	100	75	2014	6	4	6
10	Azady Printing Co.	Ministry of Information and Culture	SOE	100	299	2014	9	10	6
11	Balkh Cotton &Veg.Oil Co.	Ministry of Commerce and Industries	SOE	100	44	2015	8	4	5
12	Construction & Material Process Co.	Ministry of Defense	SOE	100	90	2013	3	4	2
13	Balkh Textiles Co.	Ministry of Commerce and Industries	SOE	100	25	2015	(0)	1	2
14	Kabul Silo	Ministry of Agriculture, Irrigation and Livestock	SOE	100	301	2014	(1)	7	2
15	Balkh Silo	Ministry of Agriculture, Irrigation and Livestock	SOE	100	40	2014	1	1	2
16	Helmand Bost Co.	Ministry of Commerce and Industries	SOE	100	116	2015	5	3	2
17	Afghani Construction Co.	Ministry of Urban Development	SOE	100	230	2015	(23)	(10)	1
18	Polekhomry Silo	Ministry of Agriculture, Irrigation and Livestock	SOE	100	45	2014	0	1	1
19	Education Printing Co.	Ministry of Education	SOE	100	142	2014	2	4	(1)
20	Center of Handicraft Development Co.	Ministry of Commerce and Industries	SOC	40	…	…	(0)	(1)	(2)
21	Steel Material Process Co.	Ministry of Energy and Water	SOE	100	84	2014	1	(2)	(4)
22	Jabulsaraj Cement Co.	Ministry of Mines and Petroleum	SOE	100	52	2015	(2)	(4)	(6)
23	Afghan Textiles Co.	Ministry of Commerce and Industries	SOC	90	…	…	…	…	…
24	Aftanto	Ministry of Commerce and Industries	SOC	30	…	…	…	…	…
25	New Baghlan Sugar	Ministry of Commerce and Industries	SOC	100	…	…	…	…	…
26	Prisons Industries	Ministry of Internal Affairs	SOE	100	26	2012	…	…	…
27	Sher khan Port	Ministry of Commerce and Industries	SOE	100	157	2014	…	…	…
	Service sector						**917**	**423**	**179**
28	Petroleums Co. (FLGE)	Ministry of Commerce and Industries	SOE	100	1767	2015	874	575	300
29	Hotel Co.	Ministry of Information and Culture	SOE	100	129	2013	30	33	42
30	Makroraian Maintenance Co.	Kabul Municipality	SOE	100	526	2014	25	26	26
31	Maslakh Co.(Slaughterhouse)	Ministry of Defense	SOE	100	107	2014	45	34	22
32	Afsotr Transportation Co.	Ministry of Commerce and Industries	SOC	51	…	…	39	7	11
33	Afghan Tour Co.	Ministry of Information and Culture	SOE	100	92	2014	11	11	10
34	Afghan Birds/Poultry Co.	Ministry of Commerce and Industries	SOC	70	…	…	9	8	8
35	Afghan Cart Co.	Ministry of Commerce and Industries	SOC	51	…	…	25	23	7
36	Food and Public Needs Provision Co.	Ministry of Commerce and Industries	SOE	100	519	2014	1	1	4
37	Central Transport Co.	Ministry of Transportation and Civil Aviation	SOE	100	331	2014	7	(9)	3
38	Karakul Export Co.	Ministry of Commerce and Industries	SOE	100	…	…	9	9	(1)
39	Trade/Union of Animal Products Co.	Ministry of Commerce and Industries	SOE	100	…	…	3	2	(1)
40	Agricultural Seed Co.	Ministry of Agriculture, Irrigation and Livestock	SOE	100	204	2015	5	7	(3)
41	Mille/Public Bus Co.	Ministry of Transportation and Civil Aviation	SOE	100	873	2015	(11)	35	(6)
42	National Insurance Co.	Ministry of Finance	SOC	100	…	…	85	61	(51)
43	Ariana Afghan Airline Co.	Ministry of Transportation and Civil Aviation	SOC	100	…	…	(239)	(401)	(191)
44	Afghan Telecom	Ministry of Telecommunication and IT	SOC	100	…	…	…	…	…
45	Afghan Water Supply and Sewerage	Ministry of Urban Development	SOC	100	…	…	…	…	…
46	Afghan Wireless Telecom (AWCC)	Ministry of Telecommunication and IT	SOC	20	…	…	…	…	…
47	Afghanistan Electricity Co. (DABS)	Ministry of Energy and Water	SOC	100	…	…	…	…	…
48	Esteras (Heratan Port)	Ministry of Commerce and Industries	SOC	51	…	…	…	…	…
49	Intercontinental Hotel	Ministry of Information and Culture	SOC	100	…	…	…	…	…
50	Security Protection Force (APPF)	Ministry of Internal Affairs	SOE	100	…	…	…	…	…
	Total						**2,947**	**2,503**	**2,490**

Source: Central Statistics Organization (CSO), Ministry of Finance State Owned Corporations and Enterprises (SOCE) Department.

1/ Solar year is used, e.g. 2012 refers to March 22nd, 2012 - March 21st, 2013.

2/ Profit data is from CSO, and number of employees and other data are from SOCE Department. Dotted cells indicate data is not available or comparable.

Appendix I. Letter of Intent

Kabul, November 1, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde,

We value the International Monetary Fund's (IMF) continued support to our economic reforms through the Staff-Monitored Program (SMP) and its capacity building assistance. We have made important progress in addressing vulnerabilities and advancing our structural reform agenda despite delays in the formation of a new government and increasingly challenging security environment. This letter updates our May 2015 Letter of Intent and Memorandum of Economic and Financial Policies (MEFP), which remain valid, and proposes revisions to some December quantitative targets and the technical memorandum of understanding.

We have met all the end-June quantitative targets set for the first review of the SMP except for the target on social and priority spending. Structural reform implementation, however, was slower than planned; three of four structural benchmarks were implemented, with delays, because technical preparations and building the needed consensus in favor of these measures took longer than earlier envisaged. Budget revenue measures, including the increase in the business receipts tax, and fuel fees collected at customs, were implemented by decree on August 17 as was the telecommunications fee, which entered into effect on September 23. The telecommunications fee was rejected by the lower house of parliament on October 14, but remains in force, as this fee was in the 2015 budget law approved by parliament. We plan to submit legislation to parliament so this fee remains in effect in and after 2016 and expect its approval. Although the increase in the fuel fee was less than planned (we doubled the fee instead of tripling it), we introduced fuel fees on LPG and raised vehicle fees to more than offset the effect on the tax base. The risk based audit case selection process has been implemented, meeting the end-October target date. The banking law was issued by decree on August 19. The structural benchmark on hiring an independent party to audit bad debt recoveries at a state bank has been met. The regulation on currency reporting has been issued and needs strengthening in a few areas, which will be done by December 2015.

Security uncertainties and weak domestic demand have held back growth, which together with lower commodity prices, contributed to the decline in 12-month inflation to -1.9 percent year-on-year in September 2015. Downward pressures on the Afghani's exchange rate have increased in recent months and it depreciated by 11.7 percent between March 21 and October 21, because of delays in donor inflows and as higher emigration boosted demand for foreign exchange. Money

growth declined in 2015. The accumulation of government deposits in DAB, lower confidence, net inflows, and seasonal factors reduced reserve money growth to -0.8 percent year-on-year in September. Broad money growth was low due to the impact of bank restructuring measures. DAB maintained a comfortable reserve buffer, at over 7½ months of imports.
Fiscal performance was better than expected in the first half of 2015. Domestic revenues increased by 12 percent because of improved compliance. Tariff increases, however, yielded less than projected as traders cut their import orders. While operating expenditure was lower than planned, owing to delays in budget approval and centralization of the public procurement, development expenditures increased, as 2014 arrears were repaid. As a result, the operating deficit (before grants) was 25 percent below the mid-year target, and, with larger than expected grant financing, the overall balance was in surplus at mid-year.

We continued to strengthen the banking sector. In late 2014, corrective measures started to be implemented. In 2015, enforcement actions against all weak banks have been issued and decisive actions were taken to strengthen the two vulnerable banks. The vulnerable systemic bank increased its capital above minimum levels and is reducing its large exposures and foreign exchange open position. For the other vulnerable bank, a five-year operating strategy has been prepared and is being reviewed by DAB. Chief Operating and Credit Officers have been hired, but it has not yet been possible to identify a qualified candidate for Chief Executive Officer (CEO) and the government has initiated a public process to hire a new CEO. The end-June capital target for this bank was met. The new banking law is in effect and is expected to improve banking regulation and supervision and bank governance.

We project a lower growth and inflation path in 2015 compared to the original program targets. A slower than earlier projected recovery in economic confidence has resulted in economic activity and domestic demand being lower than earlier anticipated. Further, international fuel and food prices in 2015 are lower than projected earlier. As a result, we have revised down projected real GDP growth (to 2 percent) and inflation for 2015 (average and end-period inflation are projected to be -1.3 percent and 1.0 percent y-o-y, respectively). Lower nominal GDP growth is projected to lower demand for real balances with lower reserve and broad money growth. Further, a revised budget revenue projection takes into account lower nominal GDP growth, the delay in implementing revenue measures, and the measures to offset the impact of this delay. Projected grants, however, are higher than earlier envisaged, reflecting new donor pledges made recently.

Against this backdrop, we propose revising the macroeconomic framework for the remainder of 2015, updating some of the December 2015 quantitative targets and indicative targets. The December 2015 targets for budget revenue, the fiscal operating balance, net credit to government, reserve money, currency in circulation, and net international reserves are adjusted as are projected external financing to the budget and development spending in the attached table (Table 1).

The SMP's key policy objectives remain unchanged. We remain committed to implement the agreed policies to preserve macroeconomic stability, address vulnerabilities, lift inclusive growth through structural reform, while sustaining donor flows. We will continue our efforts to: (i) mobilize domestic revenue and catalyze continued donor support to finance higher security and development expenditure, and maintain the treasury's cash balance, while limiting carefully debt accumulation, with careful appraisal of debt creating projects to assure debt sustainability; (ii) protect the international reserves position and competiveness by continued exchange rate flexibility; and (iii) strengthen the financial sector and improve economic governance. These principles will also guide our preparations for our 2016 economic program and budget.

A significant increase in revenue performance remains an important target under the program. Domestic revenue is projected to increase by over 1 percentage points of GDP (to 9.6 percent of GDP) in 2015. We are pressing ahead with the implementation of the recently approved revenue measures as well as improving compliance. The delay in implementation of revenue measures outlined in the May MEFP is projected to result in about Af 3.3 billion (0.3 percent of GDP) less revenue in 2015. To offset this loss we started to implement expenditure contingency measures by reducing allotments by 2 percent to yield Af 1.7 billion and plan to take revenue measures of Af 1.6 billion including collection of tax arrears and vehicle registration fees. We also have made progress in strengthening tax administration including updating the taxpayer and arrears registries and establishing a Risk Analysis and Case Selection Unit. Development of ARD's five-year strategic plan and implementation of structural benchmarks to strengthen the revenue administration is on track.

On the expenditure side, we continue to contain nonpriority spending and implement strict control of other nonsecurity related spending. We will improve cash management to ensure that the government's payment obligations remain within projected cash availability to avoid arrears and ensure the treasury's discretionary cash balance does not fall below Af 5 billion at end-2015. We will also settle arrears incurred lawfully in 2014. Implementation will be through fortnightly meetings of a cash management committee chaired by the minister of finance. Pro-poor spending is projected at 2.7 percent of GDP in 2015 and we expect to meet the target for 2015 as a whole. At the mid-year review of the budget, we revised up by Af 3.1 billion operating expenditure financed by discretionary sources, expenditure financed by security grants was revised down by Af 15.1 billion, and development budget outlays were revised down by Af 2 billion. We limited increases in wages and pensions, bonuses, and conducted a review of the targeting of payments to martyrs and disabled. We are also strengthening public financial management as outlined in the May MEFP, working on improving the medium-term framework including the recently endorsement of the PFM Roadmap II on which there was extensive consultation with development partners and stakeholders, better identifying recurrent and capital expenditures, either discretionary or nondiscretionary, to inform budget ceilings, and setting up a database for capital projects (in eight line ministries for projects above Af 0.5 million). We are establishing a cabinet-level committee to conduct quarterly reviews of budget execution.

Reserve money continues as the nominal anchor for monetary policy. The pick-up in money demand has been slower than anticipated. Slower reserve money growth, well below programmed levels, led us to propose adjusting end-December target for reserve money growth to 7 percent between December 2014 and December 2015. We also propose revising down our net international reserves accumulation to zero to take account of the revised reserve money target. We will continue to mop up any excess liquidity and carefully manage money growth with a flexible exchange rate policy while maintaining orderly market conditions. We will strengthen our communication strategy to foster public confidence in the DAB's actions.

With the technical assistance of the Fund, we will work to develop domestic currency-denominated instruments, including sukuk, which will facilitate gradually moving away from foreign exchange auctions toward using domestic currency-denominated instruments for open market operations. This move will make monetary policy signals more transparent, which are presently blurred as DAB provides U.S. dollar liquidity to the economy to finance current account transactions, but also sells U.S. dollars at its regular auctions to mop up liquidity.

We made a good start in strengthening the banking sector and will build on this momentum. The strengthening of weak banks has proceeded as envisaged in the agreed action plans, the cabinet has decided in August to proceed with the sale of New Kabul Bank (NKB), and the sale of NKB was initiated on October 28, 2015, as planned. Further, the newly-established Bad Debt Commission is facilitating recovery of nonperforming loans. Nonetheless, weaknesses remain in the banking system and we are determined to continue to push ahead with the strengthening of vulnerable and weak banks, implementing vigorously the new banking law and its regulations. We have revised the banking regulations on asset classification and provisioning in September and are preparing a regulation on corporate governance and related-party lending. We will continue to enhance DAB's supervision capacity and transition to a risk-based bank supervision regime. We are committed to building robust institutions and strongly support the independence of the DAB.

We are also strengthening the fit and proper framework in the financial sector, notably with the issuance of a DAB Regulation in June 2015. Furthermore, a regulation on currency reporting at the border was issued in April 2015. We will amend this regulation by end-December 2015 to bring it in line with FATF Recommendation 32. A DAB regulation on preventive measures for financial institutions was adopted by DAB's supreme council in June 2015. We will follow up on the legislative reforms to submit by end-December 2015 draft legislation to parliament to criminalize corruption-related crimes in line with the UN Convention against Corruption and amend the Law on Overseeing the Implementation of the Anti-Administrative Corruption Strategy to provide for the review and publication of the asset declarations in accordance with the constitution.

We are determined to improve governance and create a business friendly environment. We plan to reform licensing and registration, unify the system for trade and investment licenses, and establish a one-stop-shop for private businesses. We will clarify the role of the Afghanistan Investment Support Agency and the Ministry of Commerce and Industry to improve service to the private sector. We will also amend the Land Management and Land Acquisition Laws to introduce orderly land markets and prepare a national infrastructure development plan to build domestic and regional connectivity. We have established a national procurement board to manage all high value contracts and conducted a review of customs and revenue administration staffing.

We believe that the policies set forth herein and in the above-mentioned MEFP are sufficient to achieve the objectives of our program, and we stand ready to take any additional measures that may become necessary for this purpose. We will consult with Fund staff in advance of any revision of the policies described here and in the May MEFP, in accordance with the Fund's policies. We will remain in close contact with Fund staff and provide timely information required for monitoring economic developments and implementation of policies under the SMP. We authorize the IMF to publish this letter and the policy documents related to this Article IV consultation and the first review under the SMP, subject to the removal of market-sensitive information.

Sincerely yours,

/s/	/s/
Eklil Ahmad Hakimi	Khalil Sediq
Minister of Finance	Governor
Government of Afghanistan	Da Afghanistan Bank

Attachments (3)

Attachment I. Technical Memorandum of Understanding

This memorandum reflects understandings between the Afghan authorities and Fund staff in relation to the Staff Monitored Program (SMP) during April 2015–December 2015. It specifies valuation for monitoring quantitative targets under the program (Section I), quantitative targets and indicative targets (Section II), adjustors (Section III), and data reporting (Section IV).

A. Program Exchange Rates and Gold Valuation

1. Program exchange rates are used for formulating and monitoring quantitative targets. All foreign assets and liabilities denominated in U.S. dollars will be converted into Afghanis at a program exchange rate of 58.07 Afghanis per U.S. dollar, which corresponds to the cash rate of December 21, 2014. Gold holdings will be valued at US$1,196.35 per troy ounce, the price as of December 21, 2014. Assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at their respective exchange rates of December 21, 2014, as reported in the following table.

Exchange Rate	Program Rate
U.S. dollars / Canadian dollar	0.861900
U.S. dollars / U.A.E. dirham	0.272300
U.S. dollars / Egyptian pound	0.139700
U.S. dollars / euro	1.222900
U.S. dollars / Hong Kong dollar	0.128980
U.S. dollars / Indian rupee	0.015783
U.S. dollars / Pakistani rupee	0.009940
U.S. dollars / Polish zloty	0.286800
U.S. dollars / Iranian rial	0.000037
U.S. dollars / Saudi Arabian riyal	0.266400
U.S. dollars / Russian ruble	0.016800
U.S. dollars / Swiss franc	1.016200
U.S. dollars / pounds sterling	1.562600
U.S. dollars / SDR	1.453550

B. Quantitative Performance and Indicative Targets

2. The quantitative targets for June 2015, and December 2015, specified in Table 7 of the Memorandum of Economic and Financial Policies, are:

- Floors on revenue of the central government and net international reserves (NIR); and
- Ceilings on reserve money; net central bank credit to the central government (NCG); contracting and/or guaranteeing new medium- and long-term nonconcessional external debt by the public sector, (continuous); short-term external debt owed or guaranteed by the public sector

(continuous); accumulation of external payment arrears, excluding interest on preexisting arrears (continuous); lending from state-owned banks or the central bank to, or government guaranteed borrowing by, public enterprises in need of restructuring (continuous).

3. **The above variables also constitute indicative targets for March and September 2015.** In addition, the program includes the following indicative targets for the four above-mentioned dates:

- Ceiling on the operating budget deficit of the central government excluding grants; and
- Floor on treasury cash balance and social and other priority spending.

4. The **central government** consists of the Office of the President, the ministries and other state administrations and governmental agencies, including the attorney general's office; the National Assembly; and the judiciary, including the Supreme Court.

5. **Reserve money** is defined as currency in circulation plus Afghani-denominated commercial bank deposits at the central bank, excluding deposits held at the DAB's branches (because of the unavailability of reliable and timely data from the DAB's branches), but including balances maintained by the commercial banks in the DAB's overnight facility.

6. **Treasury cash balance** is defined as the total discretionary cash balance at the treasury account in DAB, including balance in the main TSA account in Kabul, funds in provincial expenditure accounts (unexecuted allotments), and unrealized foreign exchange gain using the current exchange rate.

7. **Rerouting of treasury's IMF accounts to central bank's balance sheet.** For program purposes, the government's financial positions arising from dealing with the IMF is treated as if these functions were performed by DAB on behalf of the treasury that is as if DAB have assumed these positions and have established corresponding counterpositions vis-à-vis the treasury.

8. **Net central bank credit to the government** is defined as the difference between the central bank's claims on the government and government deposits at the DAB, excluding deposits held at the DAB's branches. Claims include the so-called "promissory note", in the amount outstanding (at face value) of DAB's claim on a bank in liquidation that has been guaranteed by the ministry of finance though issuance of a promissory note, and up to the amount specified therein.

9. **Net international reserves** are defined as reserve assets minus reserve liabilities of the DAB, both of which are expressed in U.S. dollars.

- Reserve assets of the DAB, as defined in the fifth edition of the Balance of Payments Manual (BPM5), are claims on nonresidents denominated in foreign convertible currencies controlled by DAB, and are readily and unconditionally available for DAB to meet balance of payments financing needs, intervention in exchange markets, and other purposes. They include DAB holdings of monetary gold, SDRs, Afghanistan's reserve position in the IMF, foreign currency cash (including foreign exchange banknotes in the vaults of the DAB, but excluding cash held in the DAB's branches), and deposits abroad (including balances on accounts maintained with overseas correspondent banks). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

- Reserve liabilities are defined as short-term (original maturity) foreign exchange liabilities of DAB to nonresidents (held at DAB headquarters); all credit outstanding from the IMF; foreign currency reserves of commercial banks held at DAB headquarters; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies.

10. **Revenues** of the central government are defined in line with the Government Financial Statistics Manual (GFSM 2001) but on a cash accounting basis, excluding grants. Revenue is an increase in net worth of the central government (including its units in the provinces and agencies) resulting from a transaction.

- Revenues of the central government include taxes and other compulsory transfers imposed by central government units, property income derived from the ownership of assets, sales of goods and services, social contributions, interest, fines, penalties and forfeits and voluntary transfers received from nongovernment other than grants. The definition for program monitoring excludes grants and other noncompulsory contributions received from foreign governments and international organizations; such transfers between central government units would be eliminated in the consolidation of the fiscal reports and not recorded as revenue. Receipts collected by central government on behalf of noncentral government units should not be counted as revenue (e.g., Red Crescent fees). Receipts from the sale of nonfinancial assets (e.g., privatization and signature bonuses from natural resource contracts), and transactions in financial assets and liabilities, such as borrowing but excepting interest payments, are also excluded from the definition of revenue.

- Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The official Afghanistan Government Financial Management Information System (AFMIS) reports will be used as the basis for program monitoring; in particular, the monthly financial statements prepared by the Treasury department based on AFMIS data. Exceptional advanced payments will be treated as if received on the normal due date.

11. **Social and other priority spending** is defined as the sum of pro-poor spending identified in accordance with the ANDS poverty profile by the Ministry of Education, Ministry of Public Health, and Ministry of Labor, Social Affairs, Martyrs, and Disabled within the central government's operating budget for a particular fiscal year.

12. For program purposes, the definition of **external debt** is set out in Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (Decision No. 14416-(09/91).

(a) The term "debt" will be understood to mean a current (i.e., not contingent) liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans (i.e., advances of money) to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits (i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided); and

(iii) leases (i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property), while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in paragraph 13 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

13. **Long-term and medium-term external debt.** A ceiling applies, on a continuous basis, to the contracting and guaranteeing by the public sector of new nonconcessional borrowing debt with nonresidents with original maturities of one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from the limits are refinancing credits and rescheduling operations, credits extended by the IMF, and credits on concessional terms as defined

below. Consistent with the Public Finance and Expenditure Management (PFEM) Law, the MOF should have sole responsibility for the contracting and guaranteeing of external debt on behalf of the government.

- The definition of "government" includes the central government (including government departments), as well as official agencies that do not seek profit and whose budgets are issued independent of the annual operational or development budgets. The public sector comprises the government as defined above, the DAB, and nonfinancial public enterprises. Public enterprises are defined below in paragraph 17.[1]

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any a shortfall incurred by the debtor.

- For program purposes, a debt is concessional if it includes a grant element of at least 60 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[2] The discount rates used is 5.0 percent.

14. The zero ceiling on **short-term external debt** applies on a continuous basis to the stock of short-term external debt owed or guaranteed by the public sector (as defined in paragraph 13 of this memorandum), with an original maturity of up to and including one year.

- It applies to debt as defined in paragraph 13 of this memorandum.

- Excluded from the limit are rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits.

- Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

15. A continuous performance criterion applies to the **nonaccumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or the DAB. External payment arrears consist of external debt service obligations (principal and interest) falling due after March 20, 2015 and that have not been paid at the time they are due, as specified in the contractual agreements. Excluded from the prohibition on the accumulation of new arrears

[1] Government control of an entity can be established based on the following criteria: (i) ownership of the majority of the voting interest; (ii) control of the board or other governing body; (iii) control of the appointment and removal of key personnel; (iv) control of key committees of the entity; (v) golden shares and options; (vi) regulation and control; (vii) control by a dominant public sector customer or group of public sector customers; and (viii) control attached to borrowing from the government.

[2] The calculation of concessionality will take into account all aspects of the loan agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

are (i) arrears arising from interest on the stock of arrears outstanding as of March 20, 2015; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

16. **Lending to, or guaranteeing borrowing by, public enterprises.** The zero ceiling on new lending from state-owned banks or the central bank to, or government guaranteed domestic borrowing by, public enterprises in need of restructuring applies on a continuous basis.

- For the purposes of this performance criterion (i) "state-owned banks" refers to those banks that are wholly or majority owned by the government (as defined in paragraph 14 of this memorandum), including Bank Millie, Bank Pashtany and New Kabul Bank; (ii) "public enterprises in need of restructuring" refers to enterprises that meet either of the following: (a) public enterprises that have not had an audited balance sheet in the past two fiscal years, (b) public enterprises that have been identified by the Ministry of Finance for liquidation, or (c) public enterprises subject to restructuring plans that do not have cabinet-approved restructuring plans; and (iii) "public enterprises" refers to enterprises wholly or majority owned by the government, including those covered by the State-Owned Enterprise (Tassady) Law, and all state-owned corporations and any other public entities and government agencies engaged in commercial activities but not covered by the Tassady Law.

- It applies to any new loans (or financial contributions) extended directly from the central bank or state-owned banks to public enterprises in need of restructuring, and also to any explicit government guarantees for borrowing undertaken by these public enterprises (including loan agreements and guarantees for which value has not been received).

17. **Operating budget deficit of the central government** excluding grants is defined as revenues of the central government minus operating budget expenditure recorded in AFMIS and reported in monthly financial statements.

C. Adjustors

18. The floor on NIR and the ceiling on the NCG are consistent with the assumption that **core budget development spending** will amount, on a cumulative basis from the beginning of the respective fiscal year, to:

Date	Accumulative over the Respective Year (Billion Afghani)
March 20, 2015	8.0
June 21, 2015	25.8
September 22, 2015	49.7
December 21, 2015	82.8

Should core budget development spending exceed these projections, the NIR floor will be adjusted downward and the NCG ceiling will be adjusted upward by the difference between the actual level (up to the appropriated amount) and the projected level of development spending.

19. The NIR floor and NCG ceiling are defined consistent with the assumption that the **external financing of the core budget and receipts from the sale of nonfinancial assets** will amount, on a cumulative basis from the beginning of the respective fiscal year, to:

Date	Accumulative over the Respective Year (Billion Afghani)
March 20, 2015	29.6
June 21, 2015	85.6
September 22, 2015	144.8
December 21, 2015	224.0

Should external financing of the core budget (including that associated with off-budgetary spending coming on budget) and the receipts from the sale of nonfinancial assets collectively exceed (fall short of) these projections, the NIR floor will be adjusted upward (downward) and the NCG ceiling will be adjusted downward (upward) by the difference between their actual level and the projected level. The overall downward adjustment to the NIR floor will be capped at $500 million and the overall upward adjustment to the NCG ceiling will be capped at Af 29 billion.

20. Should **the ministry of finance recapitalize (receive dividend from) DAB**, the NCG ceiling will be adjusted upward (downward) by the amount of this recapitalization (dividend).

21. Should Afghanistan receive an **SDR allocation** the NIR floor will be adjusted upwards by the amount of this allocation.

22. Should some **expenditure currently financed directly by donors outside the budget** be moved on to the operating budget, the NIR floor will be adjusted downward, and the NCG ceiling and the indicative targets (ceilings) for the operating budget deficits of the central government, excluding grants, will be adjusted upward, by the actual amount of these expenditures on the conditions that (i) the moving on budget of these expenditures is justified by a statement from donors indicating their decision to stop financing them outside the budget; and (ii) they are subject to a supplementary appropriation approved by parliament. The overall downward adjustment to the NIR floors will be capped at $300 million.

D. Provision of Information to the Fund

23. To facilitate monitoring of program implementation, the government of Afghanistan will provide the Fund through the office of the Resident Representative of the IMF in Afghanistan, the information specified below and summarized in the list of reporting tables provided to the Technical Coordination Committee.

24. Actual outcomes will be provided with the frequencies and lags indicated below.

- DAB net international reserves: weekly, no later than two weeks after the end of each week.

- Monetary statistics, including exchange rates, government accounts with the DAB, currency in circulation, reserve money, and a monetary survey: monthly and no later than three weeks after the end of the month (six weeks in the case of the monetary survey). The monetary survey will include the balance sheet of the DAB and a consolidated balance sheet of the commercial banking sector.

- Core budget operations and their financing: monthly and no later than four weeks after the end of the month. The official reports for program monitoring will be the monthly financial statements from the Afghanistan Financial Management Information System. The structure of financing (grants and loans should be separately identified) and expenditure data should be on a consistent cash basis, with separate identification of direct payments by donors that are included in budget development spending, with a counterpart grant figure. Core operating expenditures should be reported on a monthly basis using the budget appropriation economic and administrative classification in addition to the program and functional classification as reported in the budget documents. Core development expenditures should also be reported separately on a monthly basis using the budget program classification in addition to the economic, administrative and functional classification consistent with the operating budget. All the data should also compare outturns against the approved budget. Core operating and development revenues and expenditures should also be reported by province, separately on the same monthly basis.

- External budget operations and their financing (i.e., donor funded spending outside the core budget treasury systems): semiannually (more frequently if possible) and no later than eight weeks after the end of the period. External development expenditures should be reported on a disbursement basis (as currently defined in budget documents) using the budget program classification (and an administrative, functional and provincial classification where possible).

- External debt data: quarterly and no later than six weeks after the end of the quarter. These will include: (i) details of new loans contracted or guaranteed during the quarter, including the terms of each new loan; (ii) the stock of debt at the end the quarter, including short-term debt, and medium- and long-term debt; (iii) loan disbursements and debt service payments (interest and amortization) during the quarter; (iv) debt relief received during the quarter; (v) information on all overdue payments on short-term debt, and on medium- and long-term debt, including new external arrears (if any); and (vi) total outstanding amount of arrears.

- National accounts data: annually and no later than three months after the end of the year. Merchandise trade data should be reported quarterly and no later than eight weeks after the end of the quarter.

- Monthly consumer price indexes (CPIs) for Kabul and other major cities ("national" CPI) with a lag of four weeks after the end of each month.

- Four-monthly and with a three-month lag, financial flows and other key variables of the state electricity company (DABS), aggregated as well as disaggregated by regional hubs, for the preceding 12 months and (in the last four-monthly period of the year) a forecast for the following fiscal year. The report will use the template agreed with Fund staff, with all lines filled in, but excluding the disaggregation of losses into technical and nontechnical for regions outside Kabul.

- Financial Stability Indicators for each commercial bank: quarterly and with a one-month lag after the end of each quarter. These indicators will include banks' prudential ratios, capital adequacy ratio, liquidity ratio, portfolio quality indicators (e.g., nonperforming loans, provisions as percentage of classified loans), concentration ratio, related loan ratio, information on open foreign exchange positions, large loan and deposits statistics, income and expense information such as net income to total assets ratio (ROA), rate of return on capital, and net interest margin, and other relevant information. Monthly, balance sheet and income statement for each bank compiled from supervisory submissions, as well as the *Summary Analysis of Condition and Performance of the Banking System*.

- Lending to public enterprises from each commercial bank: quarterly with a one-month lag after the end of each quarter share a report on the following balance sheet items and operations for each bank: (i) aggregate value of outstanding loans to all public enterprises; (ii) disaggregated value of outstanding loans by public enterprise for each bank's top 10 borrowers; and (iii) indicators of the quality of these loans. For this reporting requirement, public enterprises refer to those defined in point (iii) in the first bullet of paragraph 17.

- Monthly activity and cost reports from the Kabul Bank receiver, including the status and financial details of asset recovery.

- Monthly detailed balance sheet and income statement for New Kabul Bank (with a two weeks lag) as well as quarterly reports on bank's progress against its business and financial plans (staffing, branches, etc.)

- Quarterly, transactions on the Kabul Bank loan account, Kabul Bank receivership accounts and any other accounts related to the bank or asset recovery from the bank.

- Copies of documents related to asset recovery, such as mutual legal assistance requests (evidence and banking and property information redacted) to foreign jurisdictions, copies of MOUs which cover international cooperation with said jurisdictions.

- Monthly details of the discretionary cash balances held in the Ministry's AFS and U.S. dollar-denominated TSA accounts, and the discretionary development 27232 account. In addition, an update of the monthly summary report of funds under operating budget, summaries of expenditure for both the operating budget and discretionary development budgets, and the updated cash projections for the current and following fiscal years.

- Treasury cash balance: weekly report on the treasury cash balance.

- Banking sector: Monthly CAMEL rating for all the banks, monthly income statements and balance sheets for all the banks, consolidated IS and BS for all the banks.

- Copies of documents related to the progress on structural benchmarks under the program, such as draft legislation, memoranda of understanding, strategies, implementation plans, transmittal letters, etc.

25. The Technical Coordination Committee (TCC) will send to the IMF reports by the end of each quarter documenting progress in implementing structural benchmarks under the program. These reports will include appropriate documentation and explain any deviations relative to the initial reform timetable, specifying expected revised completion date. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent document) will be sent in a timely manner to IMF staff for consultation or information.

Attachment II. Quantitative Targets, 2015

Table 1. Quantitative Targets, 2015[1/]

(Cumulatively from the beginning of the fiscal year, unless otherwise indicated)

	SMP 3/														
	Dec. 21, 2014	Mar. 20, 2015				June 21, 2015				Sep. 22, 2015				Dec. 21, 2015	
	Beginning stocks	Indicative targets				Quantitative targets				Indicative targets				Quantitative targets	
		Prog.	Adj.	Act.		Prog.	Adj.	Act.		Prog.	Adj.	Act.		SMP	Prog.
	(In billions of Afghanis, unless otherwise indicated)														
Revenues (floor)	…	20.8	…	24.1	✓	46.7	…	52.3	✓	81.6	…	81.1	✗	120.4	114.4
Operating budget deficit, excluding grants (indicative target: ceiling)	…	20.3	…	12.9	✓	55.5	…	41.9	✓	89.0	…	79.6	✓	131.6	139.6
Treasury cash balance (indicative target: floor)	…	5.0	…	13.6	✓	5.0	…	7.0	✓	5.0	…	11.5	✓	5.0	5.0
Net credit to government from DAB (ceiling)	-41.6	-1.3	-18.4	-20.1	✓	-4.3	-7.6	-23.2	✓	-6.2	7.5	0.1	✓	-0.6	-1.2
Reserve money (ceiling)	225.2	-6.0	…	-18.0	✓	2.9	…	-16.7	✓	20.1	…	-6.2	✓	24.8	15.8
Currency in circulation (indicative target: ceiling)	197.0	-4.0	…	-14.6	✓	6.6	…	-9.6	✓	19.6	…	-1.4	✓	21.7	13.8
Social and other priority spending (indicative target: floor)	…	8.1	…	6.5	✗	16.2	…	13.8	✗	24.3	…	22.5	✗	32.4	32.4
International reserves of DAB (floor; in millions of U.S. dollars)	6,694	38	331	106	✗	75	132	138	✓	112.5	-123	-92	✓	150	0
Nonconcessional external debt, new (ceiling) 2/	…	0.0	…	0.0		0.0	…	0.0		0.0	…	0.0		0.0	0.0
Short-term external debt (ceiling) 2/	…	0.0	…	0.0		0.0	…	0.0		0.0	…	0.0		0.0	0.0
External payments arrears, new (ceiling) 2/	…	0.0	…	0.0		0.0	…	0.0		0.0	…	0.0		0.0	0.0
Borrowing by public enterprises in need of restructuring—from DAB or state-owned banks, or government-guaranteed (ceiling) 2/	…	0.0	…	0.0		0.0	…	0.0		0.0	…	0.0		0.0	0.0
Memorandum items:															
Nominal external concessional borrowing (volume of new debt in 2015, USD million) 2/	…	…	…	…		…	…	…		…	…	…		…	33.1
<u>Reference values for the adjustors</u>			<u>Diff.</u>				<u>Diff.</u>								
Core budget development spending	…	8.0	-0.7	7.3		25.8	6.5	32.3		49.7	-1.5	48.2		90.0	83.0
External financing of the core budget and sale of nonfinancial assets 4/	…	29.6	17.0	46.6		85.6	9.8	95.4		144.8	-13.7	131.1		222.1	224.1

Source: Afghan authorities.

1/ The quantitative targets, indicative targets, their adjustors, and program exchange rates will be defined in the Technical Memorandum of Understanding (TMU). Program exchange rates as of December 21, 2014 are used.

2/ These quantitative targets apply on a continuous basis. Concessional borrowing of $33.1 million is projected in 2015 and, currently, borrowing is not planned in 2016-2017, see Table 9.

3/ Program performance will be monitored based on the quantitative targets for the test dates in June 21, 2015, and December 21, 2015.

4/ Includes operating and development donor assistance, external loans, and sale of non-financial assets.

Attachment III. Structural Benchmarks

Table 2. Structural Benchmarks			
Measure	**Date**	**Status as of October 31, 2015**	**Rationale**
The other vulnerable (non-systemic) bank will hire an independent external party by end-June 2015 to audit bad debt recoveries in respect of delinquent amounts that exceed the equivalent of $0.5 million.	End-June 2015	Met. Independent external party been hired on September 12, 2015.	Address banking vulnerability.
Promulgate the banking law	End-June 2015	Met. Implemented by Presidential decree on August 19, 2015.	Strengthen financial sector and legal framework for dealing with weak banks.
Implement revenue measures proposed in the 2015 budget that require parliamentary approval to yield Af 8.9 billion in 2015.	End-June 2015	Met. Implemented by Presidential decree on August 17, 2015, one measure was modified. Expected yield in 2015 of Af 4.8 billion. Implementation started immediately, except for the telecommunications tax, which was implemented on September 23, 2015. The telecommunications fee was rejected by the lower house of parliament on October 14, but remains in force, as this fee was in the 2015 budget law approved by parliament. Legislation will be submitted to parliament to keep the fee remain in effect in and after 2015.	Mobilize budget revenue.

Table 2. Structural Benchmarks (continued)

The Council of Ministers will issue a revised Regulation under Article 7 of the AML Law on currency reporting at the border, in line with FATF recommendation 32, to strengthen the regulatory regime to monitor the cross border transportation of currency and bearer negotiable instruments and to enable electronic transmission of information from the Customs Department to FinTRACA.	End-June 2015	Not met. Regulation issued in April 2015 but further revisions are needed that will be adopted by December 2015.	Strengthen measures to detect and combat economic crime.
Revise the banking regulations on asset classification and provisioning. The revisions to the asset classification and provisioning should include: (i) clear and objective definition for the different classification categories of loans in line with international standards and best practices; (ii) minimum general provision to be established on performing loans including standard loans; (iii) changes in the treatment of collateral so that it can be considered in computing the adjusted loan exposures rather than warranting an upgrade in the loan classification if the loan is classified as doubtful or better; however, if the loan is classified as loss, collateral cannot affect classification; (iv) detailed rules and criteria for writing-off loans; and (v) strict measures to be enforced against noncomplying banks.	End-September 2015	Not met. Draft regulation was approved by DAB Supreme Council on September 30, 2015, section on credit risk exposure needs strengthening.	Align key regulations with international standards and best practices.

Table 2. Structural Benchmarks (concluded)

Implement reform plan and re-start sale of NKB. NKB should be offered for sale either through a public announcement of a new tender or by a written letter inviting the bidders that made approved bids in early 2014, requesting them to indicate whether they remain interested in purchasing the bank and to respond by November 15, 2015.	End-September 2015	Met. NKB offered for sale on October 28, 2015.	Address banking vulnerability.
Afghanistan Revenue Department to implement a data-driven risk-based audit case selection process. Develop and implement a data driven process to effectively identify and prioritize high-risk areas. Based upon high-risk areas identified, implement ARD audit plan to effectively allocate available resources to accelerate revenue collections. Establish key performance indicators to continuously assess performance of the risk-based audits. Based upon performance results, update existing audit policies, procedures and guidelines.	End-October 2015	In progress. Developed a risk-based compliance model and established cross-functional compliance committees in LTO, MTO and STO to identify and prioritize high-risk areas, implement and assess risk-based audits, and enhance risk criteria. The establishment of a centralized Risk Analysis and Case Selection Unit was approved in early September 2015. Implementation of risk based audits started in MTO, LTO, and STO.	Improve the effectiveness of revenue collection.
Revise the banking regulation on related party lending. The revisions to the regulation on related party lending limits should include: (i) revising the definition of related parties according to international standards; (ii) confirming the limit on related party aggregate exposures to a maximum of 15 percent of the bank's unimpaired capital and reserves; and (iii) in case of any exposure over the limit prescribed in the regulation, deduct such exposure from capital when assessing capital adequacy, unless sufficiently and satisfactorily collateralized.	End-December 2015	In progress. The revision of the regulation on related party lending is under way.	Align key regulations with international standards and best practices.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

November 3, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM—INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Asia Department
(In collaboration with other departments, the World Bank, and the Asian Development Bank)

CONTENTS

RELATIONS WITH THE FUND

(As of September 30, 2015)

Membership Status: Joined July 14, 1955; Article XIV**.**

General Resources Account

	SDR Million	Percent Quota
Quota	161.90	100.00
Fund holdings of currency (Exchange Rate)	161.92	100.01
Reserve Tranche Position	0.00	0.00

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	155.31	100.00
Holdings	93.96	60.50

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF Arrangements	64.69	39.95

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	Nov 14, 2011	Nov 13, 2014	85.00	24.00
ECF[1]	Jun 26, 2006	Sep 25, 2010	81.00	75.35
Stand-By	July 16, 1975	July 15, 1976	8.50	8.50

[1] Formerly PRGF.

Projected Payments to Fund[1]

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2015	**2016**	**2017**	**2018**	**2019**
Principal	1.13	15.07	15.02	11.58	7.06
Charges/Interest	0.01	0.03	0.03	0.03	0.07
Total	**1.14**	**15.10**	**15.05**	**11.61**	**7.13**

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	Jul 2007
Assistance committed by all creditors (US$ million, NPV) 1/	582.40
Of which: IMF assistance (US$ million)	--
(SDR equivalent in millions)	--
Completion point date	Jan 2010
II. Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	--
Interim assistance	--
Completion point balance	--
Additional disbursement of interest income 2/	--
Total disbursements	--

1/ Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

2/ Under the enhanced framework, and additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

Implementation of MDRI Assistance: Not Applicable

Implementation of PCDR: Not Applicable

Nonfinancial Relations

Exchange Arrangement

Afghanistan is an Article XIV member country. The authorities confirmed that there are no restrictions on current account transactions and maintain an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. The authorities confirmed their desire to move to Article VIII status. The *de jure* exchange rate regime is classified as floating, although the authorities have been implementing a *de facto* managed float system with no predetermined path for the exchange rate. On August 17, 2015, the average of the buying and selling exchange rates in cash transactions on the Kabul money exchange market was 63.78 Afghanis per U.S. dollar.

To conduct monetary policy, the authorities have used foreign exchange auctions since May 2002 and capital note auctions since September 2004. The foreign exchange auctions were initially open only to licensed money changers, but since June 2005, they are also open to commercial banks. The capital note auctions are open to commercial banks. Auctions are linked to the overall monetary program and are held on a regular basis.

Article IV Consultation

The last Article IV consultation with Afghanistan was discussed by the Executive Board on May 16, 2014. Article IV consultations with Afghanistan are held in accordance with Decision No. 14747-(10/96) on consultation cycles adopted on September 28, 2010, as amended.

Safeguards Assessment

Under the Fund's safeguards assessment policy, the Da Afghanistan Bank (DAB) was subject to a safeguards assessment with respect to the ECF arrangement approved on November 13, 2011. An initial safeguards assessment of the DAB was completed on June 12, 2006, updated on March 18, 2008, and then in December 2011. The latest update for the safeguards assessment found that while most of the previous safeguards recommendations had been implemented, an effective internal audit mechanism had still not been established and governance oversight was weak. The assessment also made recommendations to address new risks emerging as a result of the Kabul Bank crisis including with respect to central bank autonomy. Since the assessment, some recommendations have been implemented, albeit with delay. In particular, a Memorandum of Understanding on central bank capitalization has been signed and an external auditor has been appointed. DAB is committed to implementing the remaining safeguards recommendations, with priority assigned to development of the internal audit function (with external support) and strengthening of Audit Committee oversight. Following IMF advice, DAB has prepared, in accordance with IFRS, interim semiannual balance sheet and income statement, which will be submitted to the Supreme Council. The third quarter Financial Accounts have been submitted to the Supreme Council. Also, as per its Law, DAB has started preparing a pro-forma balance sheet to be submitted to the Ministry of Finance. Since February 2013, the Comptroller General's Office (CGO) has been successful in implementing all the activities related to internal audit. To structure and implement a suitable Risk Based Internal Audit (RBIA) model, DAB considers it important (and has requested TA under the World Bank's FSRRP project) to provide training to CGO staff and hire an expert adviser to assist CGO amend existing policies and procedures and develop new ones.

Technical Assistance, 2011–15

Department	Dates	Purpose
FAD	January 2–12, 2011	PFM Assessment
	January 22–February 4,2011	Customs Administration
	April 1–13, 2011	Customs Administration
	September 15–22, 2011	Program Budgeting Reform
	January 14–18, 2012	Visit to Support SIGTAS Preparations
	January 14–25, 2012	VAT Introduction
	January 14–28, 2012	Customs Administration
	April 4–14, 2012	Follow-up mission (different TA topics)
	April 6–14, 2012	Follow-up mission to review PFM Roadmap
	April 4–14, 2012	Advancing Public Financial Management Reforms
	April 13–May 1, 2013	Customs Administration
	April 29–May 6, 2013	Public Financial Management Reform[1]
	April 29–May 8, 2013	Follow-up mission PFM
	September 26–October 4, 2013	Reform of the Fiscal Regimes for the Extractive Industries
	April 15-21, 2015	Tax Policy for Extractive industries
LEG	September 21–26, 2013	Diagnostic Review of AML/CFT regime
	February 5–6, 2014	Awareness raising workshop for Parlimentarians (Dubai)
	April 28–May 2, 2014	AML/CFT training for DAB and FinTRACA officials
	November 10–14, 2014	TA on AML/CFT issues
	February 9–13, 2015	AML/CFT training for DAB and FinTRACA officials
	September 6–10, 2015	AML/CFT training for DAB and FinTRACA officials
MCD	August 29, 2011–present	Resident monetary policy and banking advisor
MCM	July 3–5, 2012	Sukuk TA mission
	August 27–29, 2012	Follow-up TA on Sukuk
	November 11–13, 2012	Sukuk TA mission
	February 11–13, 2013	Sukuk Issuance
	May 11–19, 2013	Strengthening the Central Bank's Operations
	September 7-22, 2013	Strengthening the Central Bank's Operations: Update on Monetary Policy Implementation
	December 7–11, 2013	Strengthening the Central Bank's Operations

	September 8–21, 2015	Problem bank management
METAC[2]	January 2–11, 2011	Financial Planning, Budget Classification
	January 10–14, 2011	Tax Information Systems (workshop)
	April 7–12, 2012	Developing Regulations
	May 22–26, 2011	Sukuk Workshop and TA in Dubai
	October 2011	General banking supervision issues
	December 10–19, 2011	Consumer price statistics
	January 14–18, 2012	Follow-up on tax administration reforms
	February 11–14, 2012	Sukuk TA Mission
	April 7–12, 2012	Developing regulations
	April 15–26, 2012	Consumer price statistics
	June 16–27, 2012	Enhancing the enforcement framework at DAB
	June 24–27, 2012	Balance of Payments and International Investment Position Statistics
	September 17–20, 2012	Study mission to Lebanon on VAT implementation
	November 3–12, 2012	Review of off-site function
	November 4–14, 2012	Cash Management / Financial Plans
	January 15–22, 2013	Follow-up on Enforcement Framework
	February 16–20, 2013	Balance of Payments and International Investment Position Statistics
	March 30–April 8, 2013	Action Plan for Strengthening Banking Supervision
	November 2–20, 2013	Customs Administration
	January 5–16, 2014	External Sector Statistics
	November 3–7, 2014	External Sector Statistics
	September 8–12 , 2014	VAT implementation / study tour in Beirut
	February 2–25, 2015	Tax and Customs administration
	September 7–11, 2015	External Sector Statistics
STA	February 6–17, 2012	National accounts statistics
	May 7–18, 2012	National accounts statistics

[1] METAC Advisor participated to the mission.

[2] Afghanistan is a participant in the Middle East Technical Assistance Center.

Resident Representatives

Mr. de Schaetzen; August 2002–June 2005

Mr. Charap; June 2005–June 2008

Mr. Abdallah; June 2008–January 2014

RELATIONS WITH THE WORLD BANK

(As of September 2015)

1. The World Bank Group's program in Afghanistan is governed by the joint Interim Strategy Note (ISN) for FY12-FY14, which focuses on three themes: (i) building the legitimacy and capacity of institutions; (ii) equitable service delivery; and (iii) inclusive growth and jobs. The process for preparing the next country strategy––Country Partnership Framework for Afghanistan—has been launched, with work on the Systematic Country Diagnostics (SCD) in progress.

2. Since 2002, IDA has committed a total of $3.12 billion in grants (86 percent) and credits (14 percent) in Afghanistan. Thirty-seven development and emergency-reconstruction projects and four budget-support operations have been committed as of end-August 2015. In addition, the ARTF has generated $7.99 billion from 33 donors, and committed $3.61 billion for the government's recurrent costs and $3.79 billion for government investment programs. At end of August 2015, the active IDA portfolio was worth $725.98 million and the active ARTF investment portfolio was worth $2.5 billion.

3. The Bank also administers the Afghanistan Reconstruction Trust Fund (ARTF) – the World Bank Group's largest single-country multi-donor trust fund. The ARTF provides grant support to Afghanistan based on a 3-year rolling financing strategy. Together, International Development Association (IDA) and the Afghanistan Reconstruction Trust Fund (ARTF) provide close to $1 billion per year in grant resources (about $150 million from IDA and about $800–$900 million from the ARTF). The ARTF is a key vehicle for providing Government with predictable and transparent on-budget financing and provides a platform for policy dialogue between Government and donors.

4. In fiscal year 2015, the World Bank Board approved additional financing for an existing project— the Second Customs Reform and Trade Facilitation Project—in the amount of $21.5 million. No new projects were approved under the ARTF during the political transition period. Funds were, however, allocated to ongoing projects for a total of $450 million, which includes $50 million for the National Horticulture and Livestock Project, $100 million for National Solidarity Program III, $100 million for the Rural Access Program, and $200 million for the System Enhancement for Health in Transition Project. In fiscal year 2015, $419.56 million was disbursed under the Recurrent Cost Window, including the baseline financing ($125 million), Incentive Program ($132.5 million, of which $65 million was through the O&M Facility), and additional donor grants through the ad-hoc mechanisms of $146.9 million.

5. The World Bank continues to engage in rigorous analytical work and places large emphasis on policy dialogue. These non-lending activities have been supportive of the Bank's lending program and have played a crucial role in informing government of its strategic choices and advancing dialogue between the Government of Afghanistan and its international development partners. In recent years, four pieces of analytical work stand-out: Transition Economics, Resources Corridors, Poverty Analysis, and Agriculture Sector Review. The Bank also prepared Policy Notes on

key sectors of the economy to help guide its policy dialogue with the new administration and launched the preparation of a comprehensive revenue analysis.

6. IFC's portfolio in Afghanistan has increased to about $135 million. IFC is following an integrated advisory and investment strategy focused on improving the investment climate, building capacity, and supporting selective investments in sectors with high development impact and job creation. Currently, IFC's portfolio includes two investments in the telecommunication sector and two operations in the financial markets. Going forward, IFC is looking to expand its investment program in Afghanistan, in the areas of infrastructure, finance, manufacturing, agribusiness and services.

7. MIGA has $154 million of gross exposure in Afghanistan, supporting telecoms and agri-business projects. In 2013 MIGA launched its "Conflict Affected and Fragile Economies Facility," which is supporting the agency's exposure in Afghanistan. MIGA is currently supporting three projects in Afghanistan, of which one is a joint effort with IFC in the telecoms sector (MTN). The other two are MIGA-only dairy and cashmere production projects.

IMPLEMENTATION OF THE JOINT MANAGEMENT ACTION PLAN ON BANK-FUND COLLABORATION

(August 17, 2015)

1. Joint Management Action Plan (JMAP). The Afghanistan country teams of the World Bank (led by Mr. Saum, country director) and the IMF (led by Mr. Ross, mission chief) held several consultations in 2014 and 2015. The teams regularly exchanged views on the recent economic developments and their outlook, identified the macroeconomic priorities and challenges facing Afghanistan and discussed ways to coordinate their respective work programs. As part of the cooperation effort, the World Bank team participated in SMP missions as observer.

2. 2015 showed a small improvement in economic activity and a number of economic reforms. The security transition and the protracted elections affected confidence and considerably slowed down reform progress in 2014. The SMP program provided a macroeconomic framework for a swift recovery in economic activity and structural reforms. The following areas are critical from the macroeconomic perspective in the short and medium terms:

- ***Sustaining macroeconomic stability.*** Policies should focus on revenue mobilization, improving the effectiveness of public expenditures, containing non-priority spending and controlling the money growth to manage inflation. A flexible exchange rate and international reserves should help accommodate shocks. The success of this strategy is predicated to a large extent on the continued donor flows, as pledged at the 2012 conferences in Chicago and Tokyo. The government's delivery on its commitments under the IMF-supported program as well as the ARTF Incentive Program and the IDA-financed Development Policy Grant will be critical towards sustaining donors' confidence.

- ***Advancing fiscal sustainability and strengthening efforts to mobilize domestic revenues.*** The revenue effort faltered further in 2014 and it will be critical to restoring Afghanistan's revenue trajectory. Teams therefore agree on the need to emphasize revenue-enhancing measures in their dialogue with authorities. In order to improve our understanding for the scope of reforms, especially in the medium-term, the teams agree to cooperate on relevant analysis.

- ***Safeguarding the financial sector.*** Macroeconomic policies must be complemented by prudential measures to safeguard financial stability. The banking sector is weak and should be strengthened to be able to meaningfully contribute to economic development. Improving banking supervision at the central bank is critical to this effort.

- ***Strengthening economic governance.*** The high level of corruption and deficiencies in the rule of law are serious constraints on growth and—in the case of Afghanistan—have the potential to destabilize the economy.

- ***Improving absorption capacity and government effectiveness.*** Budget execution rates linger around 50 percent. Increasing on-budget aid, especially through the transfer on-budget of security expenditures previously managed by donors, is challenging absorption capacity. More efforts need to be undertaken in advancing public financial management (PFM) reforms, improving the capabilities of the civil service and lifting constraints to service delivery and the implementation of public infrastructure projects.

3. Prioritizing reforms. Teams agreed that policy recommendations for 2015 should focus on revenue mobilization, improved expenditure management, better coordination between the fiscal and monetary policies, and addressing vulnerabilities in the financial sector.

4. The Bank's work program is guided by the Interim Strategy Note (ISN). The ISN, approved by the Bank's Board in March 2012 and spanning 2012–14, envisages that the Bank will continue to expand its support to institutions and processes associated with transparent economic and financial management and community-level governance, especially through the National Solidarity Program. Regarding economic management, in 2014 and continuing into 2015, the Bank has supported the government with technical assistance in the areas of customs reforms, mineral resource management, and economic statistics. Under the ARTF, the bank's team is preparing a new Incentive Program (IP) that will provide funds for achievements in revenue mobilization, strengthening PFM and revenue administration systems (including customs), and improving tax policy, investment climate and , land administration. Since January 2013, the IP has also supported the government's operation and maintenance expenditures. The new Incentive Program will provide a total financing envelope of $900 million for 2015–2017. The Bank will also initiate consultations with the government toward the end of 2015 on designing a new Development Policy Grant (Table 1).

5. The Fund's work program focuses on close engagement through the SMP program approved in March 2015. The first SMP program review will take place in September 2015. The program has two test dates, June and December 2015. The SMP includes a set of informal quantitative targets and structural measures for 2015. These targets and measures aimed at maintaining macroeconomic stability and structural reform momentum. The authorities met all the quantitative targets for June test date. However, some structural benchmarks took longer than anticipated to implement.

6. The Fund focuses its efforts on helping the authorities maintain economic stability, manage the economic transition, and advance important pieces of legislation, including the new banking law, the central bank law, and AML and CFT laws. The Fund has also provided advice on the monetary policy, banking supervision, and customs reform. Technical assistance has been provided to the central bank on problem bank management and external sector statistics. In 2015, the Fund, through the SMP, is helping the authorities build on these achievements, including through strengthening economic governance, advancing structural reforms, central bank capitalization framework, developing a fiscal regime for natural resources, revenue mobilization, further strengthening banking supervision, and improving macroeconomic statistics. The Fund will continue its close engagement with Afghanistan to ensure the stability of macroeconomic framework.

Table 1. Afghanistan: Bank and Fund Planned Activities in Areas of Joint Interest, 2011–16			
	Products	**Preparations/Mission Timing[1]**	**Delivery[1]**
Fund	ECF program	2011–14	November 2011
	Staff Monitored Program (SMP, new agreement)	February 2015	May 2015
	Article IV Consultation and First Review under the SMP	September 2015	November 2015
	Second and last review under the SMP	December 2015	February 2016
	Areas of Technical Assistance: Banking restructuring, financial sector supervision, revenue administration, customs and border management, tax policy, public financial management, foreign exchange regulation, AML/CFT, banking law, treasury securities, statistics (national accounts, prices, government finance, monetary, balance of payments, GDDS)		
Bank	Development Policy Grant	November–March 2015	April 2015
	Financial Sector Rapid Response Project, Supervision	November 2011–November 2016	October 2013
	ARTF IP Program (2015–2017), Preparation of MoU	April–August 2015	September 2015
	Study: Revenue Review	April–September 2015	October 2015
	Economic Monitoring	Continuous	
	Study: Financial Sector Review	May–November 2015	November 2015
Joint	AML/CFT follow-up	Continuous	
	Dialogue on revenue mobilization	Continuous	
	Dialogue on macro-fiscal stability	Continuous	
	Strengthening of the banking sector	Continuous	
	Strengthening of the banking sector	Continuous	

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of August 31, 2015)

1. Afghanistan is a founding member of the Asian Development Bank (ADB), established in 1966. After a hiatus from 1980 to 2001, ADB resumed its partnership with the Government of Afghanistan. In the London and Kabul conferences in January and July 2010, respectively, and in the Chicago (May 2012), Tokyo (July 2012), and London (December 2014) conferences, ADB reaffirmed its long-term development partnership with Afghanistan. This included the transition period (2012-14) and the transformation period (2015–2024) based on the government's development strategies, which along with national priority programs (NPPs) will remain the agreed basis for partnership in the next decade.

2. Current ADB operations in Afghanistan are based on the Country Operations Business Plan (COBP), 2015–2017. The COBP is fully aligned with NPPs and the government's priorities in the infrastructure sector—the backbone of economic and social development—with ADB's investments contributing to Afghanistan's socio-economic development in the transformation period. The COBP continues ADB's focus on Afghanistan's energy, transport, and agriculture and natural resources sectors, including management, governance, and further institutional and human capacity development. From 2009 to 2013, ADB's operations were underpinned by the Country Partnership Strategy (CPS), which was aligned with the Afghanistan National Development Strategy (2008–2013). At present, ADB's operations are based on the Interim CPS 2014–2015, which extends the strategic focus of the CPS 2009-2013. The Interim CPS is aligned with NPPs and the government's development strategy—Towards Self Reliance—A Strategic Vision Beyond 2025.

3. ADB is one of the largest donors to the government of Afghanistan. By end-December 2014, ADB's total assistance comprising grants, loans and technical assistance (TA) reached $4.03 billion. Since 2007, ADB has provided all of its public sector assistance on a 100 percent grant basis. Grants make up around 74 percent of ADB's overall assistance to Afghanistan. In the July 2012 Tokyo Conference, ADB committed another $1.2 billion to support Afghanistan through 2016.

4. ADB supports co-financing of its projects to increase synergies by combining the strengths of development partners, governments, and ADB itself. As of August 31, 2015, the cumulative direct value-added official co-financing amounted to $518.6 million for 22 investment projects and $14.7 million for 14 TA projects. ADB manages the Afghanistan Infrastructure Trust Fund (AITF)—a financing modality for development partners and private sector who are interested in pooling resources to finance infrastructure projects in Afghanistan. AITF allows development partners to meet the pledge of 50 percent on-budget and 80 percent alignment with NPPs as agreed in the 2010 Kabul Conference. As of 30 June 2015, the total amount received in AITF was $350.65 million, with total commitments of $490.55 million, including funds from Japan (Embassy of Japan, $126.0 million), United States (USAID, $105.0 million), and United Kingdom (DFID, $119.6 million out of a total commitment of $259.55 million).

5. ADB is the largest on-budget donor in the transport sector. As of December 31, 2014, ADB has provided $2.2 billion to construct or upgrade over 1,700 km of regional and national roads and to rehabilitate four regional airports. All four are fully operational, with usage more than doubled. Travel times on selected national roads decreased by more than half as a result of ADB-assisted projects. ADB funded Afghanistan's first railway line between Mazar-e-Sharif and the border of Uzbekistan, which became fully operational in 2012. To date, about 9 million tons of goods have been transported. ADB supported the establishment of the Afghanistan Railway Authority to regulate and ensure the sustainability of the railway sector.

6. ADB is the largest on-budget donor in the energy sector. As of 31 December 2014, ADB has invested $921.31 million in Afghanistan's energy sector, and committed an additional $750 million to strengthen the country's energy supply chain. ADB-assisted projects have added 590 km of transmission lines, providing electricity to more than 5 million people. Ongoing projects will generate an additional 4.5 megawatts of power, add 500 km of transmission lines, and provide 100,000 new power connections. ADB financed the power master plan of the government and is currently working on the gas sector master plan. ADB also supports the Turkmenistan, Afghanistan, Pakistan and India (TAPI) gas pipeline project as well as the Turkmenistan, Uzbekistan, Tajikistan, Afghanistan and Pakistan (TUTAP) electricity project.

7. The natural resources sector is another government priority sector assisted by ADB. As of December 31, 2014, total investment reached $545.48 million to rehabilitate and establish new irrigation and agricultural infrastructure, and strengthen the institutional environment to facilitate economic growth and improve water resources management. Around 140,000 hectares of irrigated land have been rehabilitated and upgraded. The investments have led to a more efficient use of water resources, a rise in agricultural productivity, and improved farm livelihoods.

8. ADB assistance has improved fiscal management through policy, institutional and capacity-building reforms covering expenditure and revenue management, civil service management, provincial administration, and transparency and accountability in the public sector.

9. ADB's private sector operations in Afghanistan began in 2004. As of August 31, 2015, cumulative approvals in six projects have amounted to $198.1 million. Total outstanding balances and undisbursed commitments to private sector projects amounted to $3.5 million. One of the major private sector projects is the lending to Roshan Cellular Telecommunications Project. ADB provided financial assistance in the form of direct loans totaling $70 million for Phases 1 and 2 of the project, as well as B loans and a political risk guarantee. In 2008, ADB approved a direct loan of $60 million to finance Roshan's Phase 3 expansion. In 2012, this project received an award for Excellence in Fragile States Engagement from the US Treasury. In the financial sector, ADB invested $2.6 million in Afghanistan International Bank (AIB), thus establishing the first private commercial bank in the post-Taliban regime.

10. ADB is an active member of the Joint Coordination and Monitoring Board (JCMB) and the Afghanistan Reconstruction Trust Fund Management Committee. ADB plays an active part in other donor coordination activities, including the JCMB Social and Economic Development Standing

Committee, the Ministry of Finance's High Level Committee on Aid Effectiveness, and the Inter-Ministerial Committee on Energy. ADB strongly supports all international policy dialogues on Afghanistan. Furthermore, it takes the lead in the infrastructure sector and regional cooperation-related policy dialogues. ADB is a member of the core donor group (5+3) to ensure coordination and harmonization among donors and the government over policy reforms and development programs. ADB consults continuously with civil society and non-governmental organizations with regard to project design and implementation.

ISLAMIC REPUBLIC OF AFGHANISTAN: STATISTICAL ISSUES

(As of October 17, 2015)

I. Assessment of Data Adequacy for Surveillance
Data provision has some shortcomings, but is broadly adequate for surveillance. The key data shortcomings are in national accounts and in the external sector mainly due to organizational weaknesses and difficult security situation.
National Accounts. The compilation broadly follows the *System of National Accounts 1993 (1993 SNA)*. GDP is compiled by the production and expenditure approaches. Key expenditure aggregates (household consumption, gross fixed capital formation, imports and exports) are available, while changes in inventories are derived residually. Coverage of economic activities is limited due to data gaps which are severe for some provinces and some activities. Foreign trade data should be improved in terms of coverage, concepts, and timeliness. The 2002–2003 base year is more than 10 years old and needs to be updated.
Price Statistics. The CSO compiles and publishes monthly consumer price indexes for the nation, the capital city Kabul, and nine other major cities. Overcoming severe security and resource constraints, CSO has recently undertaken a major overhaul of the CPI, including (i) implementation of full, five-digit Classification of Individual Consumption by Purpose (COICOP); (ii) update of consumer basket weights using data from a recent household survey (previous weights dated back to 1987); and (iii) expansion of coverage from six to ten cities/provinces (out of 34). While concepts and compilation practices attempt to follow good practices, there is a scope for additional improvement including further expanding coverage, upgrading the IT system and communication channels with remote provinces, strengthening quality control and field supervision of price collectors, as well as hiring and training more staff.
Government Finance Statistics. Fiscal data are compiled for the central and general government on cash basis based on the Government Finance Statistics Manual 2001 (GFSM 2001). The timeliness and quality of the central and general government core budget data have been improving, particularly after completion of the roll out and connectivity of the Afghanistan Financial Management Information System (AFMIS) to all central government line ministries and agencies in Kabul and all provincial offices. With IMF support, the Ministry of Finance is implementing GFSM 2001, with annual data for both above and below the line transactions being reported. The authorities are reporting monthly GFS data to the IMF for the central government core budget and the ministry is also working on expanding the coverage of monthly and quarterly GFS data to general government.

Monetary and Financial Statistics. Da Afghanistan Bank (DAB) reports the Standardized Report Forms (SRFs) 1SR for DAB, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of one month. However, there are data reporting issues arising from the restructuring of the Kabul Bank. **Financial Sector Surveillance:** Afghanistan reports 11 of the 12 core financial soundness indicators (FSIs) and 9 of the 13 encouraged FSIs for deposit takers, and 2 FSIs for real estate markets on a quarterly basis for posting on the IMF's FSI website.
External Sector Statistics. Balance of payments and international investment position (IIP) statistics have been compiled according to the fifth edition of the *Balance of Payments Manual*. Steps to convert the data into the sixth edition of Balance of Payments and International Investment Position Manual format are underway. Several TA missions provided by METAC have assisted the DAB in improving international accounts compilation in the past years, the most recent during November 3–7, 2014. In spite of this technical assistance (TA), progress in some areas—such as foreign trade, estimation of informal trade transactions, collection, and classification of data on current and capital transfers, and direct investment survey implementation—is still slow. Progress in those areas would require stronger commitment by the authorities to implement former missions' recommendations, strengthening inter-institutional and inter-departmental cooperation, and leveraging resources. The compilation of external debt arrears and reserve assets, as well as the consistency across external sector datasets and with monetary and financial statistics also need further improvement. In September 2015, METAC will provide further TA mission to DAB staff.

II. Data Standards and Quality	
Afghanistan has been a GDDS participant since June 2006, but its metadata has not been updated since then.	No data ROSC has been published

III. Reporting to STA
The authorities are reporting data for the Fund's *International Financial Statistics, Government Finance Statistics Yearbook*, and the *Balance of Payments Statistics Yearbook*.

Afghanistan: Table of Common Indicators Required for Surveillance (As of August 17, 2015)					
	Date of Latest Observation	**Date Received**	**Frequency of Data**[3]	**Frequency of Reporting**[3]	**Frequency of Publication**[3]
Exchange Rates	August. 2015	08/17/15	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	August. 2015	08/12/15	M	M	M
Reserve/Base Money	August. 2015	08/12/15	M	M	M
Broad Money	June. 2015	07/27/15	M	M	M
Central Bank Balance Sheet	July. 2015	08/02/15	M	M	M
Consolidated Balance Sheet of the Banking System	June. 2015	07/27/15	M	M	M
Interest Rates[2]	August. 2015	08/12/15	D	M	M
Consumer Price Index	June. 2015	07/20/15	M	M	M
Revenue, Expenditure, Balance and Composition of Financing – General Government	--	--	--	--	--
Revenue, Expenditure, Balance and Composition of Financing– Central Government	July. 2015	08/03/15	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt	2015Q2	08/02/2015	Q	Q	Q
External Current Account Balance	2015Q1	08/02/15	Q	A	A
Exports and Imports of Goods and Services	2015Q1	08/02/15	Q	Q	Q
GDP/GNP	2014/15	06/15/15	A	A	A
Gross External Debt	2015Q1	02/17/2015	Q	Q	Q
International Investment Position	2015Q2	07/27/15	A	A	A

[1] Any reserve assets that are pledged or otherwise encumbered are specified separately.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

ISLAMIC REPUBLIC OF AFGHANISTAN

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM—DEBT SUSTAINABILITY ANALYSIS

November 13, 2015

Approved By
Adnan Mazarei and Dhaneshwar Ghura (IMF), and Satu Kahkonen (IDA)

International Monetary Fund[15]
International Development Association

Afghanistan's external debt is low after extensive debt relief, but given its heavy reliance on grant financing (43 percent of GDP in 2014, including both on and off-budget grants), public external debt is judged to remain at high risk of distress according to the IMF-World Bank framework. Under the baseline scenario, with strong reform effort and donor support, improved security and reduced uncertainty, debt is sustainable. However, under a scenario assuming a plausible grant-financing shortfall, debt burden indicators quickly become unsustainable. If security and macroeconomic conditions improve, an improvement of the risk rating could be considered in a future assessment. Accordingly, the authorities should continue their efforts to mobilize revenue, raise the efficiency of public spending through careful prioritization, and press ahead with their reform efforts, while donors should continue to provide financing in the form of grants.

[15] This DSA was prepared by IMF staff with input from World Bank, using the standard debt sustainability framework for low-income countries (LIC-DSA); see "Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries" http://www.imf.org/external/np/pp/eng/2013/110513.pdf. The LIC-DSA compares the evolution over the projection period of debt-burden indicators against policy-dependent indicative thresholds, using the three-year average of the World Bank's Country Policy and Institutional Assessment (CPIA). With an average 2012–14 CPIA of 2.7, Afghanistan is classified as having "weak performance" under the LIC-DSF.

MACROECONOMIC OUTLOOK

8. **The DSA's baseline macroeconomic scenario assumes a gradual improvement of security with continued reform and donor support during the Transformation Decade (2015–24)**. This scenario is similar to the previous DSA of April 2014 (Box 1). The baseline also assumes political stability with regular election cycles and continued economic reform with governments delivering on Afghanistan's development goals and priorities that improve the business environment and governance to support private-sector-led inclusive growth. The baseline scenario also assumes continued donor support, in line with donors' statements at the December 2014 London Conference, namely, their Tokyo commitment of providing $16 billion through 2015, and sustaining support, through 2017, at or near the levels of the past decade. Going forward, donors committed to significant and continuing support that would decline.[16] This support for Afghanistan's social and economic development priorities through the Transformation Decade is predicated on the Afghan government delivering on its commitments under the Mutual Accountability Framework. At the same time, donors expect that Afghanistan will gradually increase its contribution and, over time, assume financial costs of the security sector.

Box 1. Macroeconomic Assumptions Comparison Table 1/

	DSA February 2014		DSA October 2015		Current vs. previous	
	2014-18	2019-33	2014-18	2019-33	2014-18	2019-33
Real growth (%)	4.6	4.6	3.1	5.0	-1.6	0.4
Inflation (GDP, deflator, %)	5.3	4.9	3.1	5.0	-2.2	0.0
Nominal GDP (Billions of Afghanis)	1539	4314	1298	3619	-241	-695
Revenue and grants (% GDP)	31.5	34.1	29.4	32.4	-2.1	-1.7
Grants (% GDP)	19.5	17.0	19.0	15.9	-0.5	-1.1
Primary expenditure (% GDP)	32.0	35.2	29.7	33.2	-2.3	-2.0
Primary balance (% GDP)	-0.6	-1.1	-0.3	-0.7	0.3	0.3
Exports of G&S (% GDP)	13.3	25.0	14.8	23.3	1.4	-1.6
Imports of G&S (% GDP) 2/	49.0	45.0	55.4	44.7	6.4	-0.2
Noninterest current account balance (%GDP)	-1.4	0.7	2.0	-0.2	3.5	-0.9

Sources: Afghan authorities; and IMF staff estimates and projections.
1/ The differences between the base period exports and imports in the current and previous DSAs are explained by having new and improved data as well as new mining sector projections.
2/ Change in imports in 2014-18 between the current and previous DSAs is due to higher grant related imports.

9. **In this scenario, growth is projected to recover and the external current account (before grants) to improve gradually**. GDP growth is projected to average about 5 percent in the

[16] In the baseline, total off budget and on budget grants are projected to decline as a share of GDP, from 45 percent in 2015 to 30 percent in 2020, and 12 percent in 2035, with an increasing share provided to the civilian sector.

medium term (2016–20), supported by investment and production in the mining industry later in the decade, and to stabilize at about 4½ percent in the long run (Table 1), similar to the projection in the previous DSA. The main change relative to the previous DSA relates to lower growth rates in the near term. This lower growth is due to a slower recovery in economic confidence than projected earlier, because the political transition was longer than expected and some delays in planned implementation of mining projects as well as lower commodity prices. This lower growth is expected to be temporary, as the political transition has been completed. Growth is expected to gain steam with a recovery in confidence, increasing mining and energy related activity from 2018 onwards and the impact of continued reform, although there is downside risk that mining development could be delayed with renegotiation of several contracts and weaker commodity prices. The external current account deficit before grants is expected to improve gradually over the projection period as a whole. The initial deterioration of the external current account reflects the import of mining-related capital goods in minerals extraction. Non-mineral exports are projected to increase progressively from a low level. At the same time, imports are projected to stabilize in outer years with donor-financed imports slowing. Accordingly, the current account deficit excluding grants should narrow gradually from about 37 percent of GDP in 2014 to about 10 percent of GDP at the end of the projection horizon (Figure 1).

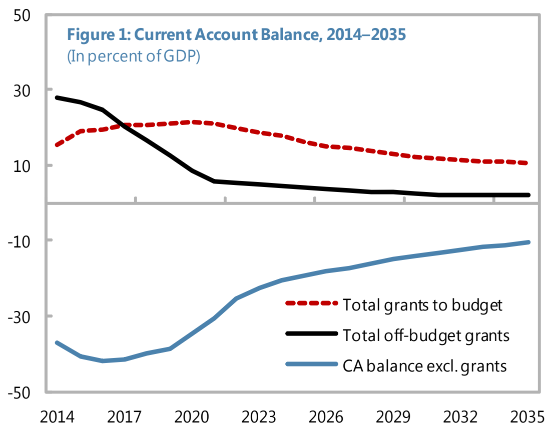

Figure 1: Current Account Balance, 2014–2035
(In percent of GDP)

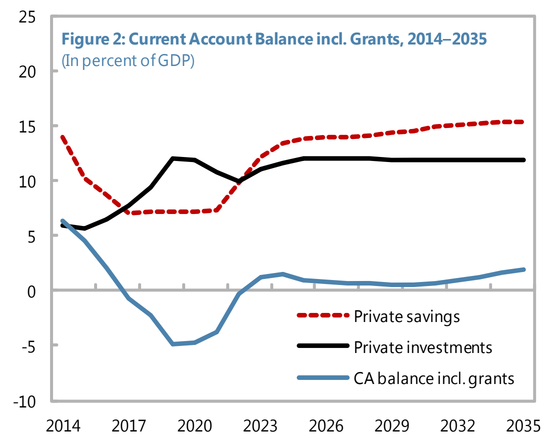

Figure 2: Current Account Balance incl. Grants, 2014–2035
(In percent of GDP)

Sources: Afghan authorities; and IMF staff calculations.

10. **Expenditures would decline marginally as a share of GDP over the coming decade.** Expenditures are driven by three factors: security, development, and the civilian operating costs, including wages, pension contributions, and operating and maintenance costs of public infrastructure. Security spending will remain substantial and is projected to reach 17 percent of GDP by 2020, decline to 13 percent by 2025, and stabilize at about 7–8 percent in the outer years, as security conditions improve and with some reduction in the size of security forces that will start toward the end of this decade. Non-security operating spending is expected to grow as the on-budget transfer of spending that was previously donor-managed and the associated large

operations and maintenance costs related to donor-funded infrastructure projects continues.[17] Finally, public spending will also rise on account of increases in the size of the civil service, particularly in health and education, to facilitate a meaningful progress towards the Sustainable Development Goals, and a gradual rise in pensions.[18] Given Afghanistan's large development needs, development spending, including off budget spending, is projected to be about 10 percent of GDP, an increase of 1 percent of GDP on budget in this decade to meet Afghanistan's human development and infrastructure needs.

11. **Significant growth in domestic revenues is projected in the medium term, despite the VAT introduction and mining revenue coming on stream only later.** Domestic revenues declined by 2.5 percentage points of GDP during 2011–2014, reflecting lower compliance and enforcement as well as lower import growth and economic activity due to political and security uncertainties. Furthermore, VAT implementation planned for 2015 has been postponed. Other revenue measures were introduced in 2015, to help mitigate the revenue impact of the postponement of the VAT introduction, and are expected to mobilize revenue of around 1 percent of GDP per year in the medium term. The impact of mining and energy projects on the medium-term revenue outlook remains substantial notwithstanding the delay compared to the 2014 DSA. The introduction of VAT by the end of decade and a sustained effort to improve compliance will also be needed. The baseline scenario assumes that: (i) the VAT introduction in 2019 will yield around 1 percent of GDP in its initial years and above 2 percent of GDP in the long term; (ii) the tax policy mix is improved, e.g. through the introduction of excise and property taxes, and rationalization of exemptions will yield up to 1 percent of GDP in additional revenues after 2020; (iii) tax and customs administration reforms will be forcefully implemented; and (iv) revenues from mining and energy projects will start flowing in 2018. As a result, by 2025 the ratio of domestic revenues to GDP will reach 16-17 percent of GDP, similar to the previous DSA, and 20 percent of GDP by 2035, a level that is typical for a low-income country.

12. **Given these revenue and expenditure trends, Afghanistan's total financing needs are expected to remain significant.** Over the long term, the overall budget deficit (excluding grants) will remain at above 12 percent of GDP, as in the previous DSA. A small share could be financed from external concessional loans, and there is also some limited scope for domestic financing through a sukuk— projected to be introduced in 2018—mainly for market development and liquidity management purposes. This will leave a projected financing gap of over 10 percent of GDP in 2020 and beyond. Fiscal sustainability—defined as domestic revenues covering operating spending—will likely only to be reached after 2035.

[17] The recurrent operation and maintenance costs for all assets built in Afghanistan since 2002, excluding the security sector, are estimated at about $1 billion annually or more—and growing as new assets are being built. Sustainment costs in the security sector are harder to estimate, but could be as high as $2 billion per year.

[18] Wage restraint is assumed, with the wage growth rate indexed to inflation until 2020 and limited to 3 percentage points over inflation until 2025, and equal to nominal GDP growth rate after 2025.

Table 1. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2014–35

	Act.	Projections								
		Medium-term						Long-term Averages		
	2014	2015	2016	2017	2018	2019	2020	2021-25	2026-30	2031-35
	(Annual percentage change, unless otherwise indicated)									
Output and prices 1/										
Real GDP	1.3	2.0	3.0	4.0	5.0	6.0	6.0	5.1	4.6	4.7
Nominal GDP (in billions of U.S. dollars)	20.4	19.4	19.6	20.9	22.2	23.8	25.4	30.8	42.0	58.2
Consumer prices (period average) 2/	4.7	-1.3	3.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0
	(In percent of GDP, unless otherwise indicated)									
Public finances (central government)										
Domestic revenues and grants	23.9	28.5	30.2	31.8	32.6	33.5	34.5	34.3	31.3	30.3
Domestic revenues	8.5	9.7	10.6	11.3	11.9	12.5	13.0	15.6	17.6	19.3
Grants	15.4	18.8	19.6	20.5	20.7	21.1	21.5	18.7	13.7	11.0
Expenditures	25.6	28.5	30.3	31.6	32.6	33.6	34.6	34.6	32.8	32.4
Operating 3/	19.4	21.5	22.9	24.0	25.0	25.8	26.6	26.6	24.8	24.4
Development	6.2	7.0	7.4	7.6	7.6	7.8	8.0	8.0	8.0	8.0
Operating balance (excluding grants) 4/	-10.9	-11.8	-12.2	-12.7	-13.1	-13.3	-13.6	-11.0	-7.2	-5.1
Overall budget balance (including grants)	-1.7	0.0	-0.1	0.2	0.0	-0.1	0.0	-0.3	-1.5	-2.0
External sector 1/										
Exports of goods (in U.S. dollars, percent change)	8.5	4.7	26.8	24.0	24.9	24.9	31.8	18.0	5.3	5.8
Imports of goods (in U.S. dollars, percent change)	-3.9	-1.5	5.5	7.5	5.4	7.3	0.9	2.5	3.8	5.5
Merchandise trade balance	-39.6	-40.9	-41.9	-41.3	-39.8	-38.7	-34.2	-23.9	-17.9	-15.6
Current account balance, including official transfers	6.3	4.5	2.0	-0.7	-2.3	-4.9	-4.7	-0.1	0.6	1.2
Excluding official transfers	-37.0	-40.9	-42.0	-41.4	-39.7	-38.6	-34.6	-23.7	-16.1	-11.8
Gross reserves (in millions of U.S. dollars)	7,248	7,110	7,500	7,650	7,700	7,700	7,800	7,850	8,100	8,350
Public Debt										
Total public debt	6.4	7.0	6.9	6.7	9.4	9.5	9.4	9.2	12.2	18.3
of which: Public external debt 5/	6.4	7.0	6.9	6.7	6.5	6.3	6.1	5.9	6.0	6.4

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ Excluding the narcotics economy.
2/ Revised with improved coverage.
3/ Comprising mainly current spending. It is assumed that donors' recurrent expenditure off-budget is moved onto the budget by 2020. The actual rate of transfer on-budget is uncertain.
4/ Defined as domestic revenues minus operating expenditures.
5/ After HIPC and MDRI debt relief, as well as debt relief beyond HIPC relief from Paris Club creditors.

DEBT SUSTAINABILITY ANALYSIS

13. **Afghanistan's public debt remains modest.** Afghanistan passed the HIPC completion point and received debt relief in 2006. External public and publicly guaranteed debt amounted to $1.3 billion, or 6.4 percent of GDP in 2014, mostly to multilateral creditors.[19] It is equivalent to 3.4

[19] This debt stock is after delivery of the already-pledged debt relief commitments and excluding some minimal amounts of non-yet-reconciled or disputed debt. Afghanistan is still following up with one Paris Club creditor on its debt relief commitments, as well as with several non-Paris Club creditors on debt relief on comparable terms. In terms of debt structure and composition: apart from a small amount of legacy debt (less than 1 percent of total), most of the external debt is owed to multilateral institutions, mainly regional and international financial institutions.

percent of GDP in present value (PV) terms, and to about 22 percent of exports and 40 percent of government revenues (Table 2a). Under the baseline scenario—in which Afghanistan's financing gap, net of domestic financing, is entirely met by grants—the present value of public external debt would be about 3.3 percent of GDP by the end of the projection period, while total public debt would be 19.7 percent of GDP, both below the indicative debt-burden threshold applicable to a country like Afghanistan.[20]

14. **Although the debt burden is modest, potential risks to grant financing put Afghanistan at high risk of external debt distress.** Risks to this baseline include an abrupt decline in grants (an alternative scenario) combined with a shift towards debt financing, a deterioration in the security situation, which would put upward pressure on spending, or slow or reverse revenue mobilization reforms. These factors could put Afghanistan's debt burden on an unsustainable path. While donors have reconfirmed their financial support in the short to medium term at the 2014 London Conference, the longer-term prospects are less certain and will be discussed in 2016 at the Warsaw and Brussels conferences.

15. **The standard Debt Sustainability Framework shocks result in benign outcomes**. They result only in three breaches of the debt thresholds (the present value (PV) of external debt to exports and PV of external debt to revenue during this decade and PV of public debt to GDP ratio by the end of the projection period).[21] However, the standard shocks generated by the Debt Sustainability Framework are mostly driven by the economic performance over the past ten years. While for many countries the recent past might be a useful guide for projections, this is less so in the case of Afghanistan—with average annual real GDP growth of 8.9 percent and official transfers of 53 percent of GDP. The high GDP growth represented a catch-up from a low post-conflict base, and while large grant financing has been committed for the medium term, its projected magnitude is less (as a share of GDP) than grants received over the past decade, which were exceptionally large and front-loaded to finance post-conflict rehabilitation and reconstruction. Therefore, to ensure the risks are correctly captured, a customized illustrative scenario, which examines debt sustainability with plausible downside risks that are Afghanistan-specific, is developed.

16. **The customized illustrative scenario takes into account Afghanistan's circumstances and possible downside risks and indicates that Afghanistan faces significant risks, which if realized, would breach debt thresholds and result in a high risk of debt distress.**[22] The customized scenario focuses on the debt dynamics generated by a downward shift in the grant path. This scenario does not take into account second round effects on trade, security, interest rates, and

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[20] Under the DSA framework, the external debt thresholds for countries with similar economic performance and income level as Afghanistan are: for the PV of debt—30 percent of GDP, 100 percent of exports, and 200 percent of revenues; for debt service, 15 percent of exports and 18 percent of revenues.

[21] The PV of debt to exports and PV of debt to revenue ratio thresholds are breached when net official transfers and net FDI are one standard deviation below their historical average (Figure 3). The shock is applied to two years (2016-2017) and thereafter the PV of debt to exports declines.

[22] This treatment is in line with paragraphs 63 and 74 of the LIC-DSF Guidance Note.

growth. However, on the upside, if security stabilizes, and macroeconomic conditions continue to improve, the external risk rating may be lowered in future DSAs.

17. **The customized illustrative scenario assumes a gradual drop in grants starting in 2017**. This scenario assumes that lack of progress in reforms, donor fatigue, and/or a shift in donors' priorities lead to a gradual reduction in aid beginning in 2017 and reaching a level of 50 percent of the baseline by 2021 and beyond. At the same time, it is assumed that the nominal GDP levels are similar to the baseline, the level of public services envisaged in the baseline scenario is preserved, and additional revenue is not mobilized. 80 percent of the resulting financing gap is covered with concessional external loans, and the remainder with domestic non-concessional borrowing. Under this scenario, debt burden indicators deteriorate rapidly, breaching virtually every threshold. The PV of external debt would reach over 90 percent of GDP, or about 375 percent of exports, by the end of the projection period. The PV of total public debt would reach over 130 percent of GDP, around 660 percent of revenues, and the debt-service-to-revenue ratio will rise to about 35 percent (Figure 4).

AUTHORITIES' VIEWS

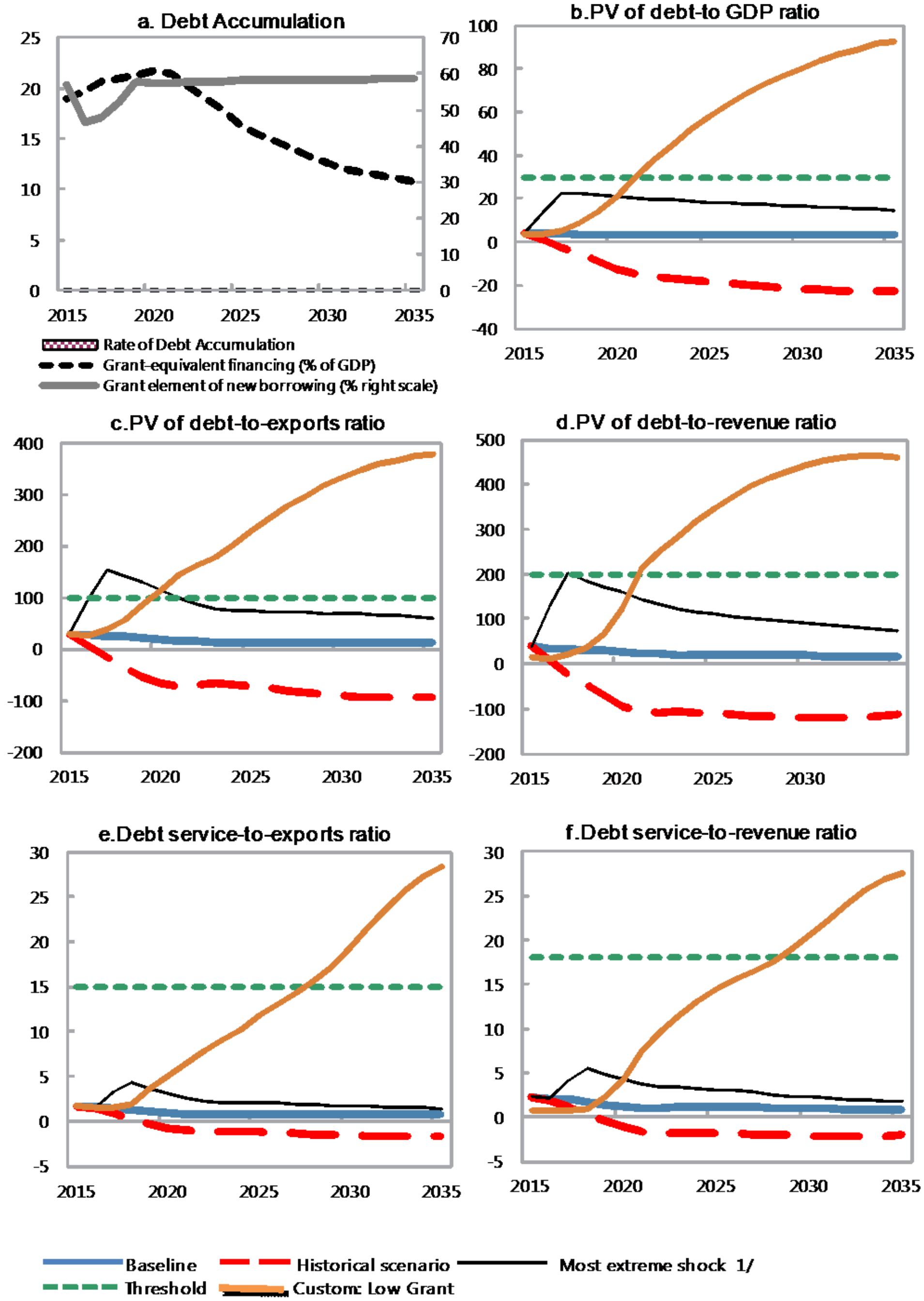
18. **The authorities broadly agreed with the conclusions of the DSA**. They emphasized that continued donor financing is critical to ensure debt sustainability, while delivering on their commitments to the donor community, and that they wished to keep the debt level low. They recognized substantial risks going forward, including potential donor fatigue and underscored the importance of prudent fiscal policy. The authorities also pointed out Afghanistan's large upfront expenditure needs, particularly big infrastructure projects with potentially high rates of economic and social returns, which could support regional integration and growth, and were open to exploring options to mobilize other types of financing in addition to existing donor grants, including concessional loans. They also acknowledged the IMF's advice that contracting concessional loans would require careful project selection and an independent technical appraisal of expected returns to maintain debt sustainability, given the limited debt service capacity, and for transparent recording of its financial impact. They shared staff's view that sukuks (domestic borrowing) should be used as a liquidity management instrument and to build up the treasury's cash balance, rather than to finance projects or recurrent fiscal deficits. They underscored that further aligning donor support with Afghan priorities and channeling more funds through the budget could potentially result in expenditure savings.

CONCLUSIONS

19. **Afghanistan's debt sustainability will hinge on improved security, and continued donor grant inflows.** After extensive debt relief and substantial medium-term pledges from donors, Afghanistan's debt outlook, under the baseline scenario, is benign. However, this is predicated on continued economic growth, progress in reforms, improvements in security as well as all donor assistance being provided in the form of grants. The outlook is subject to three main risks. First, an escalated and prolonged conflict would dampen or stop economic growth and would imply limited

economic reforms and a highly constrained ability by the central government to generate budget revenues. Second, mining revenues may be delayed, lower than hoped for, or highly volatile, leading to additional financing needs, and potentially spending cuts that would impact growth. And third, donor grants may not be forthcoming in the amounts needed, also leading to spending cuts and lower growth. Under any of these scenarios, Afghanistan would need to implement compensatory measures and, in the event of a sustained drop in grants (customized illustrative scenario), its debt burden would quickly become unsustainable and could threaten, in the extreme case, the continuity of government functions. This analysis underscores the need to redouble efforts to mobilize domestic revenue—with new policy measures as well as through administrative reforms to improve compliance—prioritize spending carefully, pursue expenditure rationalization, and raise the efficiency of public spending. In addition, maintaining macroeconomic stability and vigorous economic reform efforts will continue to be needed to improve economic governance, strengthen the financial sector, and spur future growth.

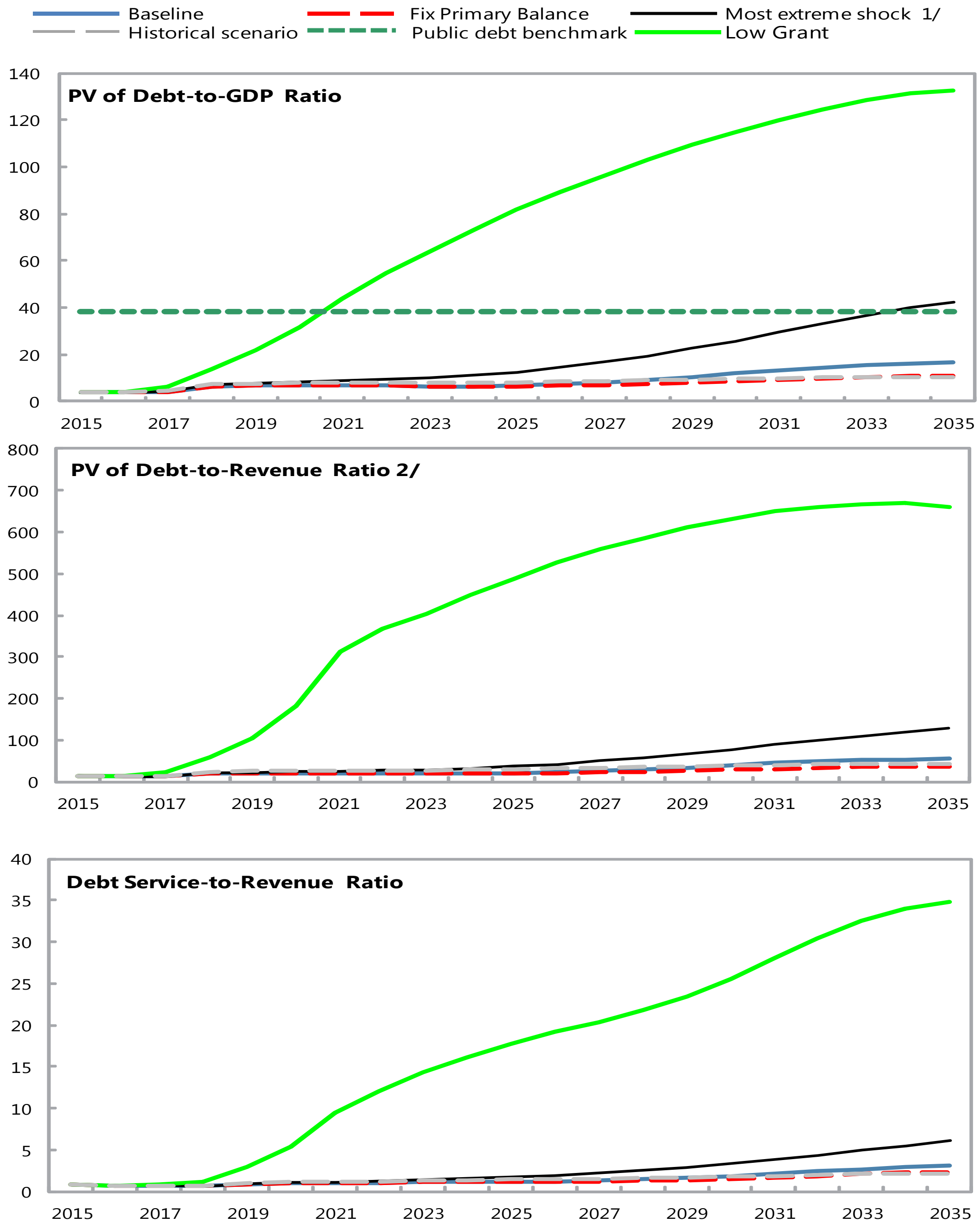
Figure 3. Islamic Republic of Afghanistan: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015–35 1/



Sources: Afghan authorities; and IMF staff estimates and projections.

1/ The most extreme stress test (under the standardized stress tests) is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a Non-debt flows shock; in c. to a Non-debt flows shock; in d. to Non-debt flows shock; in e. to a Non-debt flows shock and in figure f. to a Non-debt flows shock

Figure 4. Islamic Republic of Afghanistan: Indicators of Public Debt Under Alternative Scenarios, 2015–35 1/



Sources: Afghan authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
2/ Revenues are defined inclusive of grants.

Table 2a. Islamic Republic of Afghanistan: External Debt Sustainability Framework, Baseline Scenario, 2012–35 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	6.8	6.9	6.4			7.0	6.9	6.7	6.5	6.3	6.1		5.8	6.4	
of which: public and publicly guaranteed (PPG)	6.8	6.9	6.4			7.0	6.9	6.7	6.5	6.3	6.1		5.8	6.4	
Change in external debt	-0.7	0.1	-0.5			0.6	-0.2	-0.1	-0.2	-0.2	-0.2		0.0	0.0	
Identified net debt-creating flows	-7.8	-7.9	-7.0			-5.0	-3.2	-1.3	-1.0	1.0	1.0		-2.8	-3.5	
Non-interest current account deficit	-6.0	-7.5	-6.3	-8.6	10.6	-4.6	-2.1	0.6	2.2	4.8	4.7		-1.0	-1.9	-0.7
Deficit in balance of goods and services	43.1	36.3	37.2			41.2	42.5	42.0	40.4	39.4	35.2		19.7	12.2	
Exports	18.5	19.9	15.8			13.5	14.3	14.7	15.6	16.5	18.4		25.1	24.6	
Imports	61.6	56.2	53.0			54.7	56.8	56.7	56.0	56.0	53.6		44.8	36.8	
Net current transfers (negative = inflow)	-47.6	-42.3	-42.7	-42.2	24.9	-44.8	-43.5	-40.3	-37.2	-33.6	-29.9		-20.7	-14.1	-18.7
of which: official	-48.1	-42.9	-43.3			-45.4	-44.1	-40.7	-37.4	-33.8	-29.9		-20.1	-12.4	
Other current account flows (negative = net inflow)	-1.5	-1.5	-0.9			-1.0	-1.1	-1.1	-1.0	-1.0	-0.6		0.0	-0.1	
Net FDI (negative = inflow)	-0.9	-0.5	-0.6	-0.9	0.7	-0.3	-1.0	-1.7	-2.9	-3.5	-3.3		-1.5	-1.3	-1.6
Endogenous debt dynamics 2/	-0.9	0.1	-0.1			-0.1	-0.2	-0.2	-0.3	-0.3	-0.3		-0.2	-0.2	
Contribution from nominal interest rate	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.1	
Contribution from real GDP growth	-0.9	-0.3	-0.1			-0.1	-0.2	-0.3	-0.3	-0.4	-0.4		-0.3	-0.3	
Contribution from price and exchange rate changes	0.0	0.3	0.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	7.1	8.1	6.5			5.6	3.1	1.2	0.8	-1.3	-1.2		2.8	3.5	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	3.4			3.8	3.7	3.7	3.6	3.5	3.5		3.3	3.3	
In percent of exports	...	...	21.6			27.9	26.1	25.1	23.3	21.4	18.7		13.0	13.3	
PV of PPG external debt	...	...	3.4			3.8	3.7	3.7	3.6	3.5	3.5		3.3	3.3	
In percent of exports	...	...	21.6			27.9	26.1	25.1	23.3	21.4	18.7		13.0	13.3	
In percent of government revenues	...	...	40.0			39.0	35.1	32.8	30.5	28.3	26.6		19.6	16.4	
Debt service-to-exports ratio (in percent)	0.3	0.7	2.4			1.7	1.6	1.5	1.3	1.0	0.9		0.8	0.7	
PPG debt service-to-exports ratio (in percent)	0.3	0.7	2.4			1.7	1.6	1.5	1.3	1.0	0.9		0.8	0.7	
PPG debt service-to-revenue ratio (in percent)	0.5	1.5	4.5			2.3	2.2	2.0	1.7	1.3	1.2		1.2	0.8	
Total gross financing need (Billions of U.S. dollars)	-1.4	-1.6	-1.3			-0.9	-0.6	-0.2	-0.1	0.4	0.4		-0.8	-2.1	
Non-interest current account deficit that stabilizes debt ratio	-5.3	-7.6	-5.8			-5.2	-1.9	0.8	2.4	5.1	4.8		-1.0	-1.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	14.0	3.9	1.3	8.9	5.9	2.0	3.0	4.0	5.0	6.0	6.0	4.3	4.6	4.7	4.8
GDP deflator in US dollar terms (change in percent)	-0.5	-4.4	0.1	5.8	7.5	-7.0	-2.1	2.8	1.2	1.0	0.7	-0.6	1.5	3.2	1.8
Effective interest rate (percent) 5/	0.2	0.4	0.4	0.2	0.1	0.6	0.5	0.5	0.6	0.6	0.7	0.6	0.9	1.1	0.9
Growth of exports of G&S (US dollar terms, in percent)	-4.0	7.2	-19.6	12.1	25.3	-19.1	7.0	10.3	12.3	13.6	19.2	7.2	4.1	8.5	8.8
Growth of imports of G&S (US dollar terms, in percent)	4.4	-9.3	-4.4	10.7	14.3	-2.1	4.7	6.8	4.9	7.1	2.3	3.9	2.3	6.7	4.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	57.1	46.7	47.8	52.4	57.8	57.5	53.2	58.1	58.5	58.2
Government revenues (excluding grants, in percent of GDP)	10.1	9.8	8.5			9.6	10.6	11.3	11.9	12.5	13.0		16.7	20.0	17.5
Aid flows (in Billions of US dollars) 7/	3.1	3.0	3.2			3.7	3.8	4.3	4.6	5.0	5.5		5.6	7.1	
of which: Grants	3.1	2.9	3.1			3.6	3.8	4.3	4.6	5.0	5.5		5.5	6.9	
of which: Concessional loans	0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			18.9	19.7	20.7	20.9	21.2	21.7		16.3	10.7	14.8
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			99.6	99.0	99.0	99.2	99.4	99.4		98.7	97.9	98.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	20.3	20.2	20.4			19.4	19.5	20.9	22.2	23.8	25.4		34.6	66.6	
Nominal dollar GDP growth	13.4	-0.6	1.4			-5.2	0.8	7.0	6.3	7.1	6.8	3.8	6.2	8.0	6.6
PV of PPG external debt (in Billions of US dollars)			0.7			0.7	0.7	0.8	0.8	0.8	0.9		1.1	2.2	
(PVt-PVt-1)/GDPt-1 (in percent)						0.0	0.2	0.2	0.2	0.1	0.2	0.1	0.2	0.2	0.2
Gross workers' remittances (Billions of US dollars)	0.3	0.4	0.4			0.4	0.5	0.5	0.5	0.5	0.5		0.6	0.8	
PV of PPG external debt (in percent of GDP + remittances)	...	...	3.3			3.7	3.6	3.6	3.6	3.5	3.4		3.2	3.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	19.1			23.9	22.5	21.8	20.5	19.0	16.9		12.2	12.7	
Debt service of PPG external debt (in percent of exports + remittance	...	...	2.2			1.4	1.4	1.3	1.1	0.9	0.8		0.8	0.7	

Sources: Afghan authorities; and IMF staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of debt-to GDP ratio								
Baseline	4	4	4	4	4	3	3	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	4	1	-2	-5	-9	-12	-18	-23
A2. New public sector loans on less favorable terms in 2015-2035 2	4	4	4	4	4	4	4	5
Customized 1: Lower Grants	4	4	5	9	14	21	58	92
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	4	4	4	4	3	3	3	3
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	4	5	7	6	6	6	6	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	4	4	4	4	4	4	3	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	4	14	23	22	21	21	18	15
B5. Combination of B1-B4 using one-half standard deviation shocks	4	8	12	11	11	11	10	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	4	5	5	5	5	5	5	5
PV of debt-to-exports ratio								
Baseline	28	26	25	23	21	19	13	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	28	6	-16	-35	-55	-66	-74	-92
A2. New public sector loans on less favorable terms in 2015-2035 2	28	27	26	25	23	21	17	22
Customized 1: Lower Grants	28	26	37	57	85	114	230	376
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	28	26	25	23	21	18	13	13
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	28	41	70	65	59	52	35	32
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	28	26	25	23	21	18	13	13
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	28	97	154	142	129	112	73	60
B5. Combination of B1-B4 using one-half standard deviation shocks	28	65	103	95	87	76	50	42
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	28	26	25	23	21	18	13	13
PV of debt-to-revenue ratio								
Baseline	39	35	33	31	28	27	20	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	39	8	-21	-46	-73	-94	-111	-113
A2. New public sector loans on less favorable terms in 2015-2035 2	39	36	34	32	30	29	25	27
Customized 1: Lower Grants	13	12	20	36	67	122	347	461
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	39	35	33	30	28	26	19	16
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	39	44	59	54	50	47	33	25
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	39	35	34	31	29	27	20	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	39	131	201	186	171	160	110	74
B5. Combination of B1-B4 using one-half standard deviation shocks	39	76	104	96	89	83	58	40
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	39	50	47	43	40	38	28	23

Table 2b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 (concluded)

(In percent)

Debt service-to-exports ratio								
Baseline	2	2	2	1	1	1	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	2	1	1	0	0	-1	-1	-2
A2. New public sector loans on less favorable terms in 2015-2035 2	2	2	2	1	1	1	1	1
Customized 1: Lower Grants	2	2	2	2	4	5	12	28
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	2	2	2	1	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	2	2	3	3	2	2	2	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	2	2	2	1	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	2	2	3	4	4	3	2	1
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	3	3	3	2	2	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	2	2	2	1	1	1	1	1
Debt service-to-revenue ratio								
Baseline	2	2	2	2	1	1	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	2	2	1	0	0	-1	-2	-2
A2. New public sector loans on less favorable terms in 2015-2035 2	2	2	2	2	1	1	1	2
Customized 1: Lower Grants	1	1	1	1	2	4	14	28
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	2	2	2	2	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	2	2	2	2	2	2	2	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	2	2	2	2	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	2	2	4	6	5	4	3	2
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	3	3	3	3	2	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	2	3	3	2	2	2	2	1
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	62	62	62	62	62	62	62	62

Sources: Afghan authorities; and IMF staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3a. Islamic Republic of Afghanistan: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–35

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate				Projections					
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	6.8	6.9	6.4			7.0	6.9	6.7	9.4	9.5	9.4		9.3	19.7	
of which: foreign-currency denominated	6.8	6.9	6.4			7.0	6.9	6.7	6.5	6.3	6.1		5.8	6.4	
Change in public sector debt	-0.7	0.1	-0.5			0.6	-0.2	-0.1	2.7	0.0	-0.1		0.4	0.2	
Identified debt-creating flows	-1.9	0.7	1.3			0.6	-0.3	-0.5	-1.7	-0.6	-0.7		0.2	-0.1	
Primary deficit	-0.2	0.6	1.7	1.0	1.5	-0.1	0.1	-0.2	-0.1	-0.1	-0.2	-0.1	0.6	0.8	0.9
Revenue and grants	25.2	24.3	23.9			28.5	30.2	31.8	32.6	33.5	34.5		32.7	30.4	
of which: grants	15.1	14.6	15.4			18.8	19.6	20.5	20.8	21.1	21.5		16.0	10.4	
Primary (noninterest) expenditure	25.0	25.0	25.6			28.4	30.3	31.6	32.6	33.5	34.4		33.3	31.3	
Automatic debt dynamics	-1.1	0.1	-0.1			0.6	-0.3	-0.3	-0.4	-0.5	-0.5		-0.4	-1.0	
Contribution from interest rate/growth differential	-1.0	-0.3	-0.2			-0.2	-0.3	-0.4	-0.4	-0.6	-0.6		-0.4	-0.9	
of which: contribution from average real interest rate	-0.1	-0.1	-0.1			-0.1	-0.1	-0.1	-0.1	-0.1	0.0		0.0	0.0	
of which: contribution from real GDP growth	-0.9	-0.3	-0.1			-0.1	-0.2	-0.3	-0.3	-0.5	-0.5		-0.4	-0.9	
Contribution from real exchange rate depreciation	0.0	0.4	0.0			0.9	0.0	0.0	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	-0.6	0.0	-0.2			0.0	0.0	0.0	-1.3	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.6	0.0	0.0			0.0	0.0	0.0	-1.3	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.2	-0.5	-1.8			0.0	0.1	0.4	4.4	0.7	0.5		0.2	0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	3.4			3.8	3.7	3.7	6.5	6.7	6.7		6.7	16.5	
of which: foreign-currency denominated	...	...	3.4			3.8	3.7	3.7	3.6	3.5	3.5		3.3	3.3	
of which: external	...	...	3.4			3.8	3.7	3.7	3.6	3.5	3.5		3.3	3.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	-0.1	0.7	2.1			0.2	0.3	0.1	0.1	0.2	0.2		1.0	1.8	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	14.3			13.2	12.3	11.7	20.0	20.0	19.4		20.6	54.3	
PV of public sector debt-to-revenue ratio (in percent)	...	...	40.0			39.0	35.1	32.8	54.9	53.7	51.5		40.3	82.4	
of which: external 3/	...	...	40.0			39.0	35.1	32.8	30.5	28.3	26.6		19.6	16.4	
Debt service-to-revenue and grants ratio (in percent) 4/	0.2	0.6	1.6			0.8	0.8	0.7	0.6	0.9	1.0		1.2	3.1	
Debt service-to-revenue ratio (in percent) 4/	0.5	1.5	4.5			2.3	2.2	2.0	1.7	2.5	2.6		2.3	4.6	
Primary deficit that stabilizes the debt-to-GDP ratio	0.5	0.5	2.2			-0.6	0.2	0.0	-2.8	-0.1	0.0		0.2	0.6	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	14.0	3.9	1.3	8.9	5.9	2.0	3.0	4.0	5.0	6.0	6.0	4.3	4.6	4.7	4.8
Average nominal interest rate on forex debt (in percent)	0.2	0.4	0.4	0.2	0.1	0.6	0.5	0.5	0.6	0.6	0.7	0.6	0.9	1.1	0.9
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...		0.5	1.4	0.9	1.7	0.3	1.3
Real exchange rate depreciation (in percent, + indicates depreciation	-0.2	6.0	0.5	-2.9	5.2	13.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.5	4.0	3.7	7.6	5.1	-1.1	3.0	5.0	4.9	4.9	4.9	3.6	5.0	6.2	5.0
Growth of real primary spending (deflated by GDP deflator, in percer	30.2	3.7	3.9	3.9	9.4	13.3	9.6	8.6	8.3	8.9	8.8	9.6	2.3	3.6	4.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	57.1	46.7	47.8	52.4	57.8	57.5	53.2	58.1	58.5	...

Sources: Afghan authorities; and IMF staff estimates and projections.

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public Debt 2015–35

		Projections						
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	4	4	4	7	7	7	7	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	4	4	7	8	8	8	10
A2. Primary balance is unchanged from 2015	4	4	4	7	7	7	6	11
A3. Permanently lower GDP growth 1/	4	4	4	7	8	8	12	43
A4. Alternative Scenario : Low Grant	4	4	6	14	22	32	82	132
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	4	4	4	7	7	7	7	18
B2. Primary balance is at historical average minus one standard deviations in 2016-201	4	5	6	9	9	9	9	18
B3. Combination of B1-B2 using one half standard deviation shocks	4	4	5	8	7	7	5	12
B4. One-time 30 percent real depreciation in 2016	4	5	5	8	8	8	7	16
B5. 10 percent of GDP increase in other debt-creating flows in 2016	4	9	9	11	11	11	10	19
PV of Debt-to-Revenue Ratio 2/								
Baseline	13	12	12	20	20	19	21	54
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	13	14	15	24	25	25	30	42
A2. Primary balance is unchanged from 2015	13	12	12	20	20	20	20	35
A3. Permanently lower GDP growth 1/	13	13	12	22	22	23	36	128
A4. Alternative Scenario : Low Grant	13	12	22	58	103	182	489	661
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	13	12	12	20	21	20	22	58
B2. Primary balance is at historical average minus one standard deviations in 2016-201	13	16	19	27	27	26	26	58
B3. Combination of B1-B2 using one half standard deviation shocks	13	15	17	24	23	21	17	39
B4. One-time 30 percent real depreciation in 2016	13	17	16	24	23	22	22	54
B5. 10 percent of GDP increase in other debt-creating flows in 2016	13	29	27	34	33	32	31	62
Debt Service-to-Revenue Ratio 2/								
Baseline	1	1	1	1	1	1	1	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	1	1	1	1	1	1	1	2
A2. Primary balance is unchanged from 2015	1	1	1	1	1	1	1	2
A3. Permanently lower GDP growth 1/	1	1	1	1	1	1	2	6
A4. Alternative Scenario : Low Grant	1	1	1	1	3	5	18	35
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	1	1	1	1	1	1	1	3
B2. Primary balance is at historical average minus one standard deviations in 2016-201	1	1	1	1	1	1	1	3
B3. Combination of B1-B2 using one half standard deviation shocks	1	1	1	1	1	1	1	2
B4. One-time 30 percent real depreciation in 2016	1	1	1	1	1	1	1	3
B5. 10 percent of GDP increase in other debt-creating flows in 2016	1	1	1	1	1	1	2	3

Sources: Afghan authorities; and IMF staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Statement by the Staff Representative on Islamic Republic of Afghanistan
November 18, 2015

This statement updates information in the staff report and does not alter the thrust of the staff appraisal.

The recent **earthquake** in Afghanistan affected about 1,500 villages, resulting in 110 fatalities with hundreds injured and 18,500 houses damaged or destroyed. Preliminary assessments by the UN Office for the Coordination of Humanitarian Affairs indicate that 129,000 people are in need of humanitarian assistance. The Afghan National Disaster Management Authority and NGOs have been delivering emergency aid to people affected by the earthquake. President Ghani has established a committee to assess the damages from the earthquake. Further, the authorities have doubled contingency funds for emergencies (to over $20 million) in the 2016 budget. Staff is in touch with the authorities to assess the potential impact on the budget and stands ready to help respond to this tragic event.

Opium production declined in 2015. The UN Office on Drugs and Crime 2015 opium survey indicates that opium poppy cultivation area decreased for the first time since 2009. It also indicates that potential opium production halved in 2015 compared to the 2014 though some of this decline may reflect a methodology change incorporated in the 2015 survey. While opium production is not part of the GDP in the staff report, this drop must have contributed to the slowdown in economic activity in 2015 through its spillover effects on the services sector.

The overall **budget** recorded a small surplus for first ten months of this fiscal year. Revenue collection amounted to about 8 percent of annual GDP, 0.2 percent of GDP higher than projected. Operating expenditures, however, were 0.8 percent of GDP lower than projected, while development spending was in line with projections. With total grant inflows to the budget lower than expected (in large part linked to lower operating expenditure), the overall budget balance was in small surplus for first ten months of this fiscal year. The discretionary cash balance was Af 13 billion, above the indicative target of Af 5 billion.

The cabinet submitted the **2016 budget** to parliament on November 8, 2015. Domestic revenues are budgeted at 10.2 percent of GDP. Operating expenditure remains constant in nominal terms, whereas the development expenditure is planned to increase by 17 percent, the bulk of which will be financed through nondiscretionary donor funds. The envisaged budget surplus is 0.7 percent of GDP. Staff will discuss the 2016 budget and medium-term fiscal framework with the authorities during a staff visit in December.

Following a news report about a memorandum of understanding (MOU) between the authorities and ex-chief executive of **Kabul Bank**, the President's office issued a press statement. The news report indicated that there was a MOU related to building a new township in Kabul. The statement from the President's office indicated that the Kabul Bank verdicts still stand, that the MOU is not valid, and that the Attorney General’s office will monitor full enforcement of the court’s verdicts.

Statement by Jafar Mojarrad, Executive Director for Islamic Republic of Afghanistan and Abdelalil Jbili, Advisor to Executive Director
November 18, 2015

On behalf of our Afghan authorities, we thank staff for the high quality reports and Executive Directors and management for their continued support to Afghanistan. The authorities are highly appreciative of the Fund's continued engagement with them in these challenging circumstances, and agree with staff analysis and recommendations.

Overview

The Afghan authorities have made significant progress over the last decade in rebuilding the economy and institutions, achieving macroeconomic stability, and improving human development indicators. As documented in the report, access to primary health, maternal health, child mortality rates, school enrollment, and universal primary education are close to the 2015 targets. However, adverse external and domestic conditions have not allowed the economy to fully reap the benefits of these advances. The drawdown of international troops, increased security concerns, and political uncertainty in the aftermath of the 2014 presidential election adversely affected confidence and held back the recovery.

Notwithstanding these challenges, the new administration of President Ghani and Chief Executive Abdullah, which took office in late 2014, moved forward to address vulnerabilities and advance the structural reform agenda in close collaboration with the Fund under a Staff Monitored Program (SMP), and other development partners. Following up on the Tokyo conference in July 2012 and the London conference in December 2014, the authorities reaffirmed their strong commitment to addressing the many challenges facing Afghanistan in the context of the Senior Officials Meeting (SOM) of September 2015.

Recent economic developments and outlook

The sharp growth deceleration that started in 2013 continued into 2014, with real GDP growth falling further to 1.3 percent, reflecting the difficult security situation and weak private investment during the political transition. In turn, subdued economic activity and rising unemployment contributed to increasing emigration. The fiscal situation also deteriorated owing to the decline in domestic revenue collection and higher operating expenditure, leading to a sharp fall in cash balances and the emergence of domestic payment arrears. Inflation fell to 1.4 percent by end–2014 and to -1.9 percent in September 2015, reflecting weak economic activity and lower global fuel and food prices. The external current account deficit, excluding official transfers, rose to 37 percent of GDP in 2014, but was more than covered by official transfers. Gross official reserves exceeded 8 months of imports and the exchange rate remained in line with medium-term fundamentals.

Afghanistan's medium-term outlook hinges critically on lasting improvement in the security situation, steadfast implementation of reforms to address current fragilities, continued donor assistance, and execution of important mining projects. Developments in these areas going forward can tilt the balance of risks to the downside as well as the upside. In 2015, the recovery is expected to remain modest with growth picking up to 2 percent, as uncertainty dissipates, before gradually increasing to 3-5 percent from 2016 onward.

Performance under the SMP

Staff indicates that performance under the SMP for end-June and end-September 2015 has been satisfactory. All quantitative PCs have been met, except for social and other priority spending for June and September and the budget revenue target for September. The Treasury's cash balance was replenished following the disbursement of grants in September and was above the indicative target. Pro-poor spending was below the target, but the pace of execution is expected to pick up during the last quarter. Implementation of structural reforms has been slower than expected given the time needed for technical preparation and to build consensus around these measures. Nonetheless, three out of four structural benchmarks were observed.

Against the background of lower-than-envisaged growth and inflation in 2015, and given the increasing pressure on the foreign exchange market emanating from the migration outflow, reserve money growth and international reserve accumulation targets for end-December 2015 under the SMP were revised.

Fiscal policies and debt sustainability

The fiscal situation remains challenging against the background of low revenue collection as a result of weak economic activity, high security risks, and rising spending needs. While the authorities agree with the need to strengthen revenue mobilization and prioritize spending, donor financing of development spending and part of operating expenditure will be needed for several years to come.

The authorities have taken important steps toward enhancing revenue mobilization. A number of revenue measures were introduced in 2015 under the SMP, including an increase in tariffs, overflight fees, the business receipt tax, and fuel fees collected at the customs, as well as the introduction of a telecommunications fee. These, together with improved tax compliance, are projected to yield additional revenue of about 1 percent of GDP per year in the medium-term. The authorities also made progress in strengthening tax administration and plan to enhance collection of tax arrears. While the VAT was postponed pending better preparation to ensure its successful introduction, the authorities are confident that it will help strengthen the revenue base over the medium-term, together with taxation of future mineral activities, for which a transparent fiscal regime is being developed in line with the EITI.

On the expenditure side, efforts have been directed toward containing non-priority spending, limiting increases in wages, pensions, and bonuses, and reviewing the targeting of payments to families of martyrs and disabled persons. Pro-poor spending will be maintained at 2.7 percent of

GDP in line with the SMP target. Public Finance Management is being strengthened in consultation with donors and stakeholders.

Afghanistan’s debt is very low (6.4 percent of GDP at end-2014) and is sustainable under the baseline scenario of continued reform and donor financing of the gap through grants, although it would be vulnerable to security or political instability shocks.

Monetary and financial sector policies

Monetary policy will continue to adjust to an environment of slower-than-anticipated growth in money demand, weak economic activity, and lower-than-programmed inflation. DAB remains committed to a flexible exchange rate policy and intends to enhance its communication strategy to strengthen confidence. In parallel, efforts are under way to develop domestic currency-denominated instruments, including sukuks, to be used for open market operations.

Notable progress has been made in banking sector reform. The sale of New Kabul Bank (NKB) was initiated in October 2015, while asset recovery by the Bad Debt Commission has continued. The banking law was enacted in August 2015, and will help address remaining weaknesses in the banking system. Regulations on asset classification and provisioning have been revised in September 2015, and work is underway to introduce regulations on corporate governance and related-party lending. Banking supervision has been stepped up and the authorities are determined to build robust institutions and strengthen the independence of DAB. Moreover, amendments to the AML/CFT laws were approved by the President in April 2015.

Fostering high and inclusive growth

As presented at the recent donor conference and the September SOM, the authorities’ strategy to promote inclusive growth and raise productivity involves wide-ranging reforms, including reforming the public administration, strengthening governance and combating corruption, unifying trade and investment licenses, establishing one-stop shop for private businesses, and reforming land management and acquisition laws. The authorities also plan to develop strategic sectors, such as agriculture and mining, which can boost growth and increase job opportunities and tax revenue. Investment in infrastructure through PPPs could also allow Afghanistan to benefit from its position at the confluence of South and Central Asia. The authorities look forward to technical assistance from the Fund and development partners in support of their reform strategy.

Ex-post assessment of longer-term program engagement

The authorities share the candid assessment and conclusions of the EPA, which provides useful lessons for future Fund engagement with Afghanistan. Of particular interest is the report's emphasis on the need for strong program ownership, realistic assessment of implementation capacity, well-prioritized and macro-critical structural conditionality, and effective coordination among donors, along with scaled-up capacity building. The authorities are committed to do their part in this joint effort and look forward to a follow up Fund-supported program after the expiration of the current SMP.