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May 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; 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 2014 Article IV consultation with Afghanistan, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 16, 2014, following discussions that ended on February 19, 2014, with the officials of Afghanistan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 22, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Staff Statement** of May 16, 2014 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its May 16, 2014 consideration of the staff report that concluded the Article IV consultation with Afghanistan.
- A **Statement by the Executive Director** for the Islamic Republic of Afghanistan.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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ISLAMIC REPUBLIC OF AFGHANISTAN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

April 22, 2014

This report is dedicated to all the victims of violence in Afghanistan and to our colleague K. Wabel Abdallah, the IMF's Resident Representative, who was killed in an attack in Kabul on January 17, 2014, along with 20 others. He was committed to improving the lives of the populations in countries where he worked, especially in Afghanistan.

KEY ISSUES

Context. Over the past decade, Afghanistan has made enormous progress in reconstruction, development and lifting per capita income. Security and political uncertainties, and weak institutions have constrained growth and weighed on social outcomes. With significant reform efforts and donor support, Afghanistan has maintained macroeconomic stability, implemented important structural reforms, and built policy buffers, but significant vulnerabilities remain. The IMF has been supporting Afghanistan through technical assistance and a three-year Extended Credit Facility (ECF) arrangement. Reviews under the ECF arrangement have been delayed.

Outlook and risks. 2014 is a crucial year in the political and security transitions and the run-up to the "transformation decade" (2015–24). Assuming smooth political and security transitions, continued reform and donor financing, the outlook should be positive. Large security and development expenditure needs and a limited domestic revenue capacity mean that Afghanistan will remain dependent on donor financing for an extended period. Macroeconomic stability, structural reforms, and political and security stability are needed to ensure inclusive growth. Risks, mostly on the downside, are related to adverse domestic or regional security developments, political instability, inadequate implementation of economic policies, and donor fatigue.

Policy recommendations. The authorities' economic strategy (maintaining macroeconomic stability, strengthening the financial sector, improving economic governance, and moving toward fiscal sustainability) remains appropriate and needs strengthened implementation. Sustained implementation of this strategy will safeguard growth and build buffers to help manage shocks. Policies should continue to aim at strengthening revenue collection, managing money growth to control inflation while preserving exchange rate flexibility, strengthening bank supervision, and quickly enacting anti-money laundering (AML), countering financing of terrorism (CFT), banking, central bank, and value-added tax legislation.

Approved By
Adnan Mazarei and Dhaneshwar Ghura

Discussions were held in Kabul, New Delhi, and Dubai during September 7–22, 2013, December 5–9, 2013, and February 15–19, 2014. The staff teams comprised Paul Ross (head), Kusay Alkhunaizi, Eric Mottu, Marcin Sasin, Renas Sidahmed (all MCD), Jeta Menkulasi, Andreas Tudyka (both FAD), Yugo Koshima, Cecilia Marian (both LEG), Rachid Awad, Aditya Narain (both MCM), Warren Coats (MCM consultant), Alexis Meyer-Cirkel (SPR), K. Wabel Abdallah (resident representative), and Roohul Amin (local economist). The team met with Governor Delawari, Finance Minister Zakhilwal, First Deputy Governor Hadawal, Deputy Finance Ministers Mastoor and Sabit, and other senior officials. Yi Liu provided research assistance and Norma Cayo (both MCD) was responsible for word processing and document management.

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CONTEXT

1. **Over the past decade, Afghanistan has made enormous progress in reconstruction and development, more than doubling its income per capita levels**. Important steps have been taken to lay the foundation for macroeconomic stability and growth, reduce poverty, and raise living standards, despite difficult security conditions and the challenges of rebuilding institutions. With significant reform efforts and donor support, Afghanistan has maintained macroeconomic stability, implemented important structural reforms, and built policy buffers: a comfortable international reserves position, low debt and inflation, and balanced budget and external current account positions, after grants. Progress has also been made toward achieving social and development objectives, including the Millennium Development Goals (MDGs)—Afghanistan is one of 20 fragile and conflict-affected states that have already met one or more MDG targets.

2. **Despite this progress, Afghanistan remains one of the poorest countries in the world**. Security conditions, political uncertainty, and weak institutions have limited growth and weighed on social outcomes. The national poverty rate was 36 percent in 2008 and the country ranked at the bottom 7 percent of countries in the 2012 UN Human Development Index. Poor governance and corruption remain endemic, and a sizable illicit narcotics sector further distorts incentives.

3. **In 2014, Afghanistan faces challenges related to uncertainties about the security and political transitions, which are slowing economic activity**. The international military presence is being drawn down and the government is gradually taking over the management of spending previously managed by donors; these outlays will be financed by donors. The outcomes of presidential and provincial elections in April are not clear and a source of uncertainty. Parliamentary elections are scheduled in 2015.

4. **The international community has delivered substantial financial support and pledged to continue it over the medium term**. At the May 2012 NATO summit in Chicago, Afghanistan's international partners provided assurances to finance security spending, estimated at $4 billion annually over the following decade, towards which the government is expected to make gradually increasing contributions. At the July 2012 conference in Tokyo, donors agreed to continue their support, pledging $16 billion to finance development through 2015, and to sustain aid at similar levels through 2017. Donors and the government adopted the Tokyo Mutual Accountability Framework (TMAF)—a set of principles, objectives, and reform commitments to promote aid effectiveness, reform, good governance, and inclusive, sustained growth. Donors indicated that their support would depend on Afghanistan meeting its TMAF commitments. The July 2013 Senior Officials meetings in Kabul reconfirmed donor support as did the Joint Coordination and Monitoring Board Meeting held in January 2014.

5. **The IMF has been supporting Afghanistan through technical assistance and a three-year, SDR 85 million (52.5 percent of quota) Extended Credit Facility (ECF) arrangement, approved in November 2011**. The authorities' economic reform program focuses on:

(i) maintaining macroeconomic stability; (ii) strengthening the financial sector; (iii) improving economic governance; and (iv) moving toward fiscal sustainability. The authorities' policies have broadly maintained macroeconomic stability. However, after the first program review in June 2012, subsequent reviews were delayed due to missed quantitative targets and slow implementation of structural reforms. The shortfall in budget revenue and delays in structural reform, as well as the limited expected term of the government means a review cannot be completed currently. The ECF arrangement is scheduled to end in November 2014 (Box 1). Staff and the authorities nevertheless maintained a close dialogue on economic policy and structural reform.

RECENT DEVELOPMENTS

6. **Confronted with the economic consequences of international troops withdrawal and rising political and security uncertainties, the authorities maintained macroeconomic stability and continued to implement structural reforms in 2013**. While growth slowed significantly, inflation remained in single digits, the overall budget deficit (including grants) was close to balance, and reserves remained above 7 months of imports. At the same time, structural reforms continued, even if the pace was slower than planned. Donor grants continued to finance the external and budget deficits (Figures 1–4).

7. **The drawdown of international troops continued, but post-2014 security arrangements have not been finalized**. Of about 142,500 foreign troops in mid-2011, about 57,000 remained as of early January 2014. The post-2014 security agreement with the U.S. has not been finalized. Insurgents continued to launch attacks aimed at the government and foreign interests, and attempts to hold discussions with the Taliban have not yielded results.

8. **The presidential and provincial elections were held in April 2014**. Provincial elections and the first round of the presidential election took place on April 5. The partial official results (from 49.7 percent of legible votes counted, released on April 20) indicate that none of the candidates secured 50 percent of the vote, which is needed to win outright. If the final results of the first round (scheduled for May 14) confirm that none of the candidates secured 50 percent or more of the vote, a second round of the presidential election will take place, with a runoff between the two candidates who secure the most votes in the first round.[1] A new government will be formed after the presidential election is completed. The run-up to the elections has coincided with a slowing of economic reform.

9. **Political and security uncertainties and the drawdown of international troops are weighing on economic activity.** These uncertainties reduced confidence, discouraged private investment, and held back economic activity. Growth slowed from 14 percent in 2012 (boosted by a bumper harvest) to an estimated 3.6 percent in 2013, resulting in lower import and limited budget revenue growth. Non-agricultural growth in particular, which averaged 11 percent in 2007–11 and

[1] See http://www.iec.org.af/results/en/elections.

helped generate rising government revenue, slowed to a little over 3 percent in 2013. Uncertainties also led to intermittent pressure on the exchange rate (especially in late 2012 and early 2013) and prompted a switch out of local currency-denominated assets. The central bank managed the exchange rate flexibly (through sales of foreign exchange in the twice-weekly auctions); it depreciated by 7.5 percent against the U.S. dollar in 2013, while international reserves remained at a comfortable level of $6.9 billion (7.1 months of imports). Inflation remained in single digits (5.3 percent year-on-year in February 2014) due to a good harvest and relatively benign international commodity prices.

Box 1. The Authorities' Response to Past Fund Advice

Past Fund advice has focused on the overall macroeconomic policy mix, tax policy and tax administration reform, strengthening the central bank and the financial sector, and economic governance. The authorities have been responsive to Fund advice, but in some cases with delayed or incomplete implementation.

The authorities have largely sought to follow the recommended macroeconomic policy mix and have maintained macroeconomic stability, but revenue performance has fallen short of budgetary needs. The authorities have managed the exchange rate flexibly, broadly maintained disciplined fiscal policies, and strengthened monetary policy operations. They also sought to build buffers through reserve accumulation.

The authorities initially improved revenue collections but later encountered some setbacks and delays. Budget revenue increased from 7 to 11 percent of GDP over 2006–11, but fell back to 9.5–10 percent of GDP in 2012–13 because of the negative impact of the international troops withdrawal and the decline in confidence linked to uncertainty about the security and political transitions, as well as lower compliance. On tax reform, the authorities have prepared a VAT law and submitted it to parliament, but implementation has been delayed relative to initial plans.

The authorities have worked to strengthen the central bank and the financial sector. A new banking law was submitted to parliament in February 2013 that would strengthen banking supervision, corporate governance, prudential requirements, enforcement, and bank resolution. Supervision efforts have been strengthened. The ten weakest commercial banks have been audited and are being monitored by the central bank. Further, the staffing of the supervision department has been increased and recruitment to fill the new positions is under way. A five-year strategic plan was adopted to further strengthen financial sector supervision. The authorities are working to amend the central bank law to strengthen its governance and are ensuring that it remains adequately capitalized. In contrast, progress in moving the government salary payments from New Kabul Bank (NKB) to other banks has proceeded more slowly than planned because of delays in developing a real-time gross settlement system.

Several initiatives have strengthened economic governance. The public inquiry into the Kabul Bank crisis was published, and the authorities have responded to its recommendations. To support economic governance efforts, the Economic Crimes Task Force (ECTF) has been established, although it now needs to be operationalized. Furthermore, criminal cases related to Kabul Bank have been heard and verdicts reached, although appeals are pending, while recent Kabul Bank asset recoveries have been limited and efforts to privatize NKB have progressed slower than planned initially. The authorities have moved ahead with drafting Financial Action Task Force (FATF)-consistent anti-money laundering/combating financing of terrorism (AML/CFT) legislation, but there have been significant delays.

10. **Revenue performance deteriorated significantly despite additional measures, requiring spending cuts during 2013**. Domestic revenue dropped to 9.5 percent of GDP in 2013 from 10.1 percent the previous year, far short of the initial program target of 11.3 percent. Revenue collection was affected by lower economic activity, slower dutiable import growth, a continued shift away from high-tariff imports, as well as lower compliance despite the authorities' efforts.[2] The authorities replaced personnel in the revenue and customs departments and increased effective tariffs and fees. Nevertheless, the revenue shortfall resulted in a tight cash position for the treasury, and required limiting non-priority discretionary expenditures. As a result—and also due to capacity constraints—expenditure as a share of GDP declined by 0.7 percentage points in 2013, despite the transfer of externally managed security spending to the budget and an increase in development spending, while wages remained under control. The operating deficit (before grants) was limited to 7.8 percent of GDP.

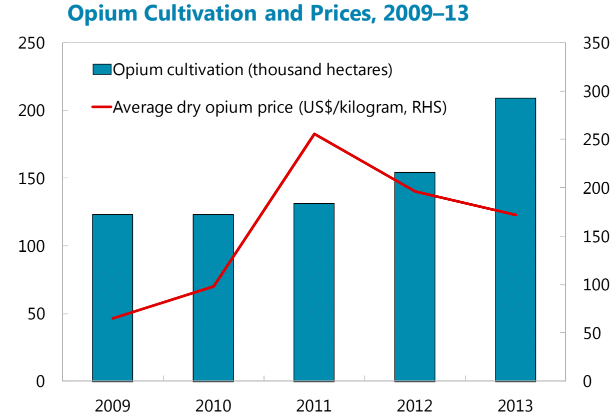
11. **Agricultural output, including opium production, was at historically high levels in 2012–13 due to good weather that affected virtually all crops**. According to the UN Office on Drugs and Crime, the opium poppy cultivation area increased raising the total farm-gate value of opium production from $0.7 billion to $0.95 billion (about 4 percent of GDP) (Box 2).

Box 2. The Drug Industry and its Impact on Economic Stability and Development

Drug production and trafficking are macro-relevant in Afghanistan. Production includes opium, heroin, morphine, and cannabis. In 2013, the farm-gate value of potential opium production was estimated at 4 percent of GDP. The potential net value of opiates and the value of opiates potentially available for export were estimated at 15 percent and 14 percent of GDP, respectively.[1] The combination of high opium prices and Afghanistan's significant involvement in its cultivation exposes the country to risks of economic instability, as a number of factors could trigger a shock to production and prices which would transmit to the formal economy, including through farmers' incomes. These include climate and water supply, eradication campaigns, external demand, change in policies (e.g., Taliban's ban in 2000), border controls, and conflicts in neighboring countries.

There could be significant distorting effect of the drug industry on the formal economy.[2] Resources devoted to drug cultivation and trafficking are diverted from other productive opportunities, decreasing activity in others sectors of the economy. It is also possible that spillovers from the drug sector may increase activity in other sectors.

Opium Cultivation and Prices, 2009–13



Source: United Nations Office on Drugs and Crime, Afghanistan Opium Surveys.

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[2] For example, imports of vehicles—a high-tariff item—declined by 45 percent in 2013.

Box 2. The Drug Industry and its Impact on Economic Stability and Development (Concluded)

Strengthening Afghanistan's statistical and analytical apparatus could enhance the understanding and forecasting of the economic impact of the drug industry. The ability to analyze available information on opium production with formal economic indicators at the regional level (e.g., agriculture, trade, employment, and finance) would assist in better understanding the impact of the drug industry on the economy, on the one hand, and mitigating potential shocks on the other. For example, this type of regional level information is available in Peru and Columbia. Detailed information on opium cultivation and prices is available but information on other economic linkages of the drug industry (e.g., trade and financial flows) remains scarce, in light of the post-conflict and development status of Afghanistan. At present, economic statistics do not currently cover regional employment rates, agricultural production, building permits, or car registrations, in part due to security issues. As a result, assessing the economic impact and linkages of the drug industry in the Afghan economy remains a challenge.

[1] United Nations Office on Drugs and Crimes (UNODC), www.unodc.org/documents/crop-monitoring/Afghanistan/Afghan_Opium_survey_2013_web_small.pdf. "Potential production" is estimated from the cultivated surface and the yield of primary plant material. "Potential net value" is estimated from income generated in the country after opium leaves the farm. The "value of opiates potentially available for export" estimates the trade across Afghanistan's borders, without further income from onward trafficking.

[2] See Pedroni and Verdugo (2011), "The Relationship Between Illicit Coca Production and Formal Economic Activity in Peru," IMF Working Paper No. 11/182; Buddenberg and Byrd (2006), Afghanistan's Drug Industry, UNODC and World Bank.

OUTLOOK AND RISKS

12. **The outlook will be determined by the success of managing the economic transition from aid dependency toward a more self-sustaining economy over the "transformation decade 2015–24."** At the July 2012 Tokyo conference, Afghanistan and the international community shared a vision to further consolidate their partnership in the areas of governance, security, peace process, economic and social development, and regional cooperation to help Afghanistan move from transition to attain sustainable economic growth and development and fiscal self-reliance through the transformation decade of 2015–24.[3] The TMAF, which is focused on the priorities of the Afghan Government as contained in its strategy paper *Towards Self-Reliance*, was established at that time to underpin the partnership of Afghanistan with its development partners for the Transformation Decade. Several factors will play a role. Initially, the drawdown of international troops has and will reduce aggregate demand while raising domestic spending needs for security. The resulting impact on growth has already been felt over the past two years. Security and political conditions will be important factors, as will maintaining macroeconomic stability, progressing structural reform, assuring continued donor support, and realizing improvements in

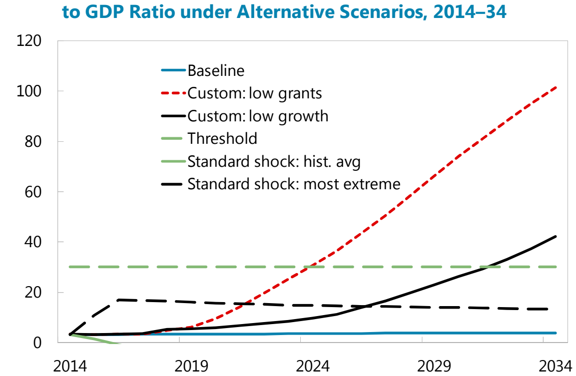
[3] See The Tokyo Declaration, http://www.mofa.go.jp/region/middle_e/afghanistan/tokyo_conference_2012/tokyo_declaration_en1.html.

governance that create a better business and investment environment. These factors will be important in determining growth and future living standards over the medium and long terms. Significant improvements in security could even generate a "peace dividend" for economic activity through higher activity across sectors, foreign direct investment, better regional transportation links, and the return of expatriates.

13. **The medium-term framework assumes a modest pick-up of growth during the transformation decade led by increased private sector activity and the development of the agriculture and natural resource sectors**. Although GDP growth is projected to slow to just over 3 percent in 2014 due to the impact of the international troop drawdown and political uncertainty in the first half of the year, it is expected to pick up thereafter, as activity and investment rebound. Continued reform efforts under the TMAF and donor support will ensure that fiscal and external gaps are covered. With stable international prices and prudent monetary policy, inflation should remain in single digits. In the longer term, an improved business environment and better economic governance are expected to facilitate private sector-led growth and the development of the natural resource sector (copper, iron ore, and oil). Accordingly, growth could accelerate to 6 percent as mining production comes on-stream, and converge thereafter to about 4 percent.

14. **Debt is modest, but large expenditure needs and limited domestic revenue capacity mean a high dependence on donor financing**. Following extensive debt relief starting in 2006, and ending in 2010 Afghanistan's debt burden was alleviated significantly—external public and publicly guaranteed debt amounted to $1.3 billion, or 6.1 percent of GDP, at end-2013, most of which owed to multilateral creditors. Under the baseline scenario and in light of donor pledges, debt is sustainable. However, there are significant vulnerabilities; should growth slow, reform stall, security deteriorate, or grant financing (43.4 percent of GDP in 2013) fall short of the projected levels, there will be a need for a large fiscal adjustment (higher revenues and cuts in expenditure that would negatively affect security, development, and growth) or, if debt finance replaced grants, debt could quickly move onto an unsustainable trajectory and debt sustainability would be jeopardized (see accompanying Debt Sustainability Analysis).[4]

Islamic Republic of Afghanistan: Present Value of Debt to GDP Ratio under Alternative Scenarios, 2014–34



Sources: Afghan authorities; and IMF staff calculations.

[4] 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 9.3 percent per year and received official transfers averaging 50.6 percent of GDP to support needed post-conflict rehabilitation and reconstruction.

Risk Assessment Matrix

Nature/Source of Risk	Likelihood[1]	Expected Economic Impact if Realized	Possible Mitigating Measures
Near-term risks			
Deteriorating political and security situation (regional and/or domestic). Disputed election results and/or the withdrawal of international troops lead to greater violence.	**High**	**High** - Political uncertainty is accompanied by higher violence levels leading to lower confidence and investment in the economy. - Worsening security results in lower growth and imports. - As imports account for half of government revenues, lower imports and growth lead to lower revenue and a higher fiscal deficit.	Continue to implement policies to maintain macroeconomic stability. If there is fiscal space, consider countercyclical policy.
Inadequate policy implementation, particularly in the fiscal and monetary sectors, and inconsistent exchange rate policy.	**High**	**Medium** - Slow growth or a decline in revenue leads to spending cuts and possible wage arrears and stagnating living standards. - Inconsistent monetary policy and/or intervention in foreign exchange market (i.e., an inappropriate mix of intervention and sterilization) results in exchange rate volatility and depreciation, capital flight, loss of reserves, and higher inflation.	Improve policy implementation through greater revenue mobilization, expenditure restraint, tighter monetary policy, and possibly more exchange rate flexibility.
Medium-term risks			
Inadequate policy implementation, deterioration in governance and in the investment and business climates lead to low growth.	**Medium**	**High** - Lower investment and slow growth or a decline in revenue leads to spending cuts and possible wage arrears. - Possible exchange rate volatility and depreciation, capital flight, loss of reserves, and higher inflation. - Low access to finance, ineffective resource allocation and intermediation by financial sector, and constrained access to global financial system, because of inadequate bank governance, legislative, institutional, and regulatory frameworks, and law enforcement to prevent and address economic crime.	Strengthen policy implementation to maintain macro stability and improve economic governance and the investment and business climates, including stronger legislative, institutional, and regulatory frameworks, and law enforcement.
Lower donor inflows to the budget and to finance development projects.	**Medium**	**High** - Lack of progress in implementing the Tokyo Mutual Accountability Framework or donors fatigue results in lower donor inflows, especially to the budget. - The decline in inflows leads to lower employment, public investment, confidence, and growth, stagnant living standards, and/or exchange rate pressures.	Take measures to mobilize additional revenue and reprioritize and reduce expenditure.
Deteriorating banking system soundness, associated with the stalling of banking supervision reforms.	**Medium**	**Medium** - Slower growth of financial sector, less access to finance, or decline in banking services (payments and lending). - Worse allocation of resources via banking sector, greater risk of inadequate governance, vulnerability to fraud and money laundering, and bank failure(s) and consequent need for government funds to cover bank losses. - Negative impact on economic development and growth and possible fiscal liability.	Recruit more supervisors, step-up training of existing supervisors, and ensure prudential regulations and enforcement actions are implemented promptly. Central bank to communicate its determination to strengthen banking supervision and publicize the measures taken.
Delays in developing natural resources and export capacity.	**Medium**	**Medium** - Lack of progress in developing natural resources results in lower fiscal revenue. - Fiscal pressure may ensue if these delays stymie revenue growth and the government does not cut spending. - Fiscal pressures 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.
Smooth security and political transitions.	**Low**	**High** - Smooth transitions result in higher confidence, investment, and growth.	Adjust the policy mix to take into account likely higher budget revenue, foreign exchange inflows, and investment by allowing for higher spending and possible exchange rate appreciation.

[1] Staff assessment of the likelihood of realization in the next three years.

15. **The outlook is subject to a wide range of risks; many on the downside** (see Risk Assessment Matrix). Afghanistan's links to the rest of the world are mainly linked to donor financing; private financial flows and licit trade are limited. On the upside, smooth security and political transitions could result in larger capital inflows and higher confidence, investment, and economic activity. On the downside in the near term, the principal risks are related to a potential deterioration in either domestic or regional security conditions, political instability during or following the elections, and inadequate implementation of economic policies. In the medium term, risks stem from insufficient progress in economic reforms including those in the TMAF, or donor fatigue, which would reduce inflows; a weakening of banking supervision that would fail to manage banking sector risks; or delays in developing natural resources. The large foreign exchange reserves provide a sizable buffer, at least in the short term.

16. **Potential economic spillovers to and from the rest of the world are limited**. The outlook depends heavily on inflows linked to donor assistance. The sizeable donor commitments should insulate the Afghan economy from the key sources of global risks, given the limited (non-donor) linkages and exposure to the global economy and financial markets. Regional developments affecting security and trade may impact the Afghan economy, in particular an economic slowdown in India or Pakistan, with which trade has intensified. Outward spillovers from Afghanistan depend on domestic political and security conditions; a deterioration could lead to displaced population, internally and to neighboring countries, with attendant lower trade and possible costs for countries receiving Afghan refugees.

POLICY DISCUSSIONS: MANAGING THE TRANSITION, REDUCING VULNERABILITIES, AND PROMOTING INCLUSIVE GROWTH

17. **Discussions focused on policies to maintain macroeconomic stability, reduce vulnerabilities, and promote inclusive, private-sector-led growth through the transformation decade and in the long term**. The authorities and staff discussed the short-term macroeconomic implications of the troop withdrawal, economic risks associated with political and security uncertainty, policies to navigate successfully through these events, and how the international community can best support Afghanistan. For the medium term, the discussion revolved around policies to reduce aid dependence and foster self-sustained, private-sector-led economic growth that is inclusive and equitable, while ensuring debt sustainability.

18. **There was broad agreement that the authorities' strategy remains appropriate to address the economic challenges and reduce vulnerabilities**. The main objectives include:

- *Maintaining macroeconomic stability*, which, along with security and an enabling political environment, is a precondition for growth and poverty reduction;

- *Moving toward fiscal sustainability* aimed at achieving self-reliance in the long run and addressing a potential decline in donor grants, to be achieved by redoubling revenue mobilization efforts through new taxes and measures to improve tax administration and improving expenditure management and service delivery;

- *Pursuing financial sector stability and development*, through banking sector reform and strengthened supervision (including AML/CFT supervision) to prevent banking sector troubles emerging and evolving into a macroeconomic crisis, while expanding credit for private sector development; and

- *Improving economic governance and the business environment* to foster private sector-led growth and investment by reducing corruption, rent-seeking, and skewed economic incentives.

A. Maintaining Macroeconomic Stability

19. **The macroeconomic policy mix remains appropriate, with fiscal policy supporting demand (financed by grants) and monetary policy focusing on inflation**. This is predicated on donor flows continuing to finance the fiscal and external deficits:

- *The authorities and staff agreed that fiscal policy should continue to aim at revenue mobilization and further improving budget implementation capacity*. The broadly balanced budget (including grants) and tight controls on non-priority expenditures ensure the continuation of government functions and preserve fiscal space for development spending. The operating balance excluding grants, which supports demand, remains the fiscal anchor.

- *There was agreement that monetary policy should continue to focus on maintaining low inflation.* The monetary base remains the nominal anchor and the exchange rate should be managed flexibly. The sizable international reserves (over 7 months of imports) provide the needed buffer in times of temporary volatility (Box 3).

20. **The authorities recognized that while buffers allowed accommodating macroeconomic shocks to some extent, policies needed to be proactive and flexible**. International reserves—deemed adequate by all measures used by the Fund—are large enough to accommodate even sizeable capital outflows. Nevertheless, in the case of more permanent pressures, the exchange rate would be managed flexibly to accommodate shocks, deliver the necessary adjustment, and protect reserves and need to be complemented by competitiveness gains from a strengthened business environment. Further control of non-priority expenditures, while protecting social and poverty-reduction spending, and greater revenue-raising efforts would be needed in case of a decline in grants to the budget. Policy implementation capacity, needed to mitigate risks and respond to shocks, would continue to be improved.

21. **The authorities called on donors to do their part in honoring their aid commitments**. They noted that fiscal space could be increased if donors intensified their efforts to further align their assistance with Afghan priorities, signed multi-year financing agreements, and channeled more funds through the budget, so they are spent more efficiently.

Box 3. External Stability and Exchange Rate Assessment

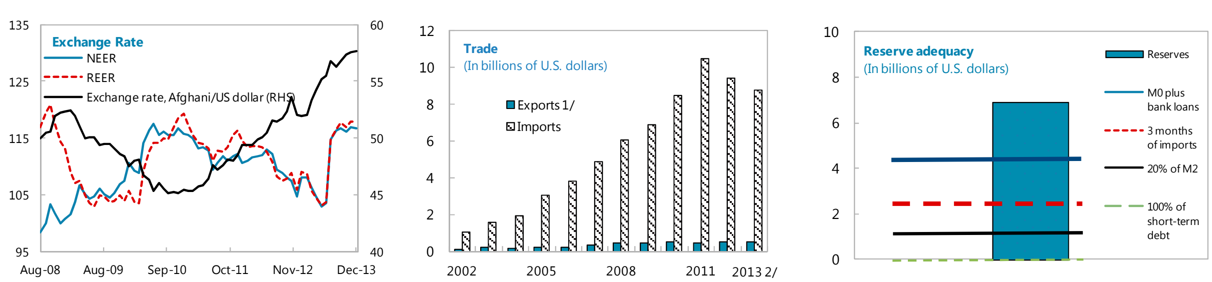
The current account is dominated by imports and official transfers, while licit exports are low. Excluding grants, the current account deficit was estimated at 41 percent of GDP in 2013. Official transfers more than financed this deficit, as they are generally spent on imports. Exports (excluding opium and internal sales to non-residents), after a catch up in the first half of the 2000s, stagnated at around $500 million, or a mere 2.5 percent of GDP. However, external accounts exclude the illicit economy, which is significant.

Afghanistan maintains a managed floating exchange rate regime. Monetary policy is anchored by targets on reserve money. The main instruments to implement the policy are sales of foreign exchange (previously purchased from the government, donors or other official entities) and sales of central bank marketable notes. Subject to meeting these targets, the central bank also seeks to minimize exchange rate volatility. Afghanistan has no access to international capital markets and relies on donors' inflows to cover the current account deficit. A flexible and floating exchange rate regime, combined with a relatively prudent fiscal policy, has been serving the country well, *inter alia* by contributing to a stable price environment while at the same time helping to absorb external and domestic shocks.

The exchange rate appears to be broadly in line with medium-term fundamentals, and foreign reserves—at 7 months of imports—comfortably exceed all traditional reserve adequacy metrics. Reserves help maintain exchange rate stability and provide much-needed buffers in case of external shocks. Several factors make it difficult to assess quantitatively the long-run alignment of the exchange rate, namely (i) years of civil conflict; (ii) large aid flows (official transfers and grants ranging from 30 to 70 percent of GDP over the past decade); (iii) high dollarization; and (iv) concerns over the coverage and reliability of balance of payments data. However, both a simple measure of the CPI-based real effective exchange rate (REER) as well as the REER calculated by the IMF's Institute for Capacity Development suggests that the rate is close to its medium-term average.

Structural impediments are more binding for Afghanistan's external competitiveness than the level of the exchange rate. Obstacles to improving competitiveness include deficiencies in the business environment, lack of investment and capacity in the tradables sectors, political and economic uncertainty, and corruption.

External Stability and Exchange Rate Assessment



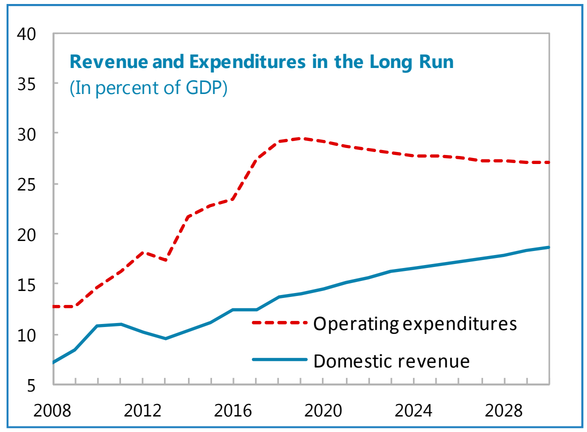
Sources: Afghan authorities; IMF Direction of Trade Database; and IMF staff calculations.

1/ Exports exclude sales of goods to international military forces in Afghanistan.

2/ Value expected.

B. Moving Toward Fiscal Sustainability

22. **Afghanistan needs to move toward fiscal sustainability to reduce its dependence on donor support**. This will entail revenue mobilization, and better expenditure management including better prioritization and service delivery to assure security and development. Domestic revenues have stagnated due to the economic slowdown, faltering efforts, and leakages, and are expected to rise only slowly, while operating budget expenditures, which were at 15 percent of GDP in 2010 are projected to increase to over 29 percent of GDP by 2018 as part of the security transition. The combination of these factors generates large fiscal vulnerabilities.



23. **To generate needed fiscal space, staff pressed for moving decisively to improve compliance, for pushing ahead with VAT introduction, and considering new tax revenue sources—excises in particular**. Afghanistan has one of the lowest domestic revenue collections in the world, with an average of about 9 percent of GDP in 2006–13 compared to about 21 percent in low-income countries. Factors behind this poor performance include a very low starting point, low compliance, opposition to new taxes, and a limited set of taxes. Afghanistan relies heavily on trade-related taxes, which represented 45 percent of total tax revenues in 2006–13. VAT, which is being discussed in parliament, and excise taxes in the medium term would broaden the tax base and rebalance the composition of revenues. The authorities agreed with the need to increase revenue and noted political and institutional challenges in raising compliance and implementing new taxes. Staff also cautioned against providing tax exemptions, because of the resulting distortions and fiscal costs. The authorities explained that consideration of incentives, which had not been enacted in tax laws, was designed to stimulate investment in 2014–15 to promote a smooth transition.

24. **Staff stressed the importance of establishing a fiscal regime for mining revenues that maximizes the share of economic rents for the government while preserving investment incentives**. Mining projects have been delayed and the ongoing oil project is unable to export due to the lack of a transit agreement with a neighboring country. The authorities are working to progress these projects and remove export hurdles, and noted that a legislative framework has been prepared for with IMF technical assistance to establish an effective and transparent fiscal regime for natural resources in full compliance with the Extractive Industries Transparency Initiative. They also requested follow-up technical assistance.

25. **Large spending needs (both development and security) are projected to continue**. Development outlays are needed to continue reconstruction and improve public services in order to progress towards MDGs. At the same time, high security spending (about 11 percent of GDP in

2013) accounts for just under half of budget expenditure and will rise sharply as off-budget expenditure managed by donors is transferred on-budget. Consequently, operating budget expenditures are projected to increase to over 29 percent of GDP by 2018.

26. **Security outlays are major and continued donor financing is critical**. The authorities welcomed the international community's commitment made in Chicago in 2012 to continue financing Afghanistan's security, estimated at $4.1 billion annually. The indicative target of government contribution to security outlays discussed in Chicago is set at $500 million for 2015—already $382 million is planned in the 2014 budget. The authorities indicated that if post-2014 international troop presence were to be lower than projected in 2012, it may not be possible to reduce the size of security forces from 352,000 currently as envisaged earlier. Staff noted this issue and pointed to the possibility that a higher donor envelope may not be forthcoming and that greater efficiency of security expenditures may be needed to prevent a crowding out of development spending.

27. **Non-security and development needs are expected to increase significantly**. The government plans to hire a large number of teachers and health workers to improve public service delivery—with a view to improving human development indicators in the medium term—and to continue expanding the currently scarce infrastructure. Moreover, donors plan to gradually transfer their off-budget recurrent expenditures onto the budget, to the extent that the budget can absorb them. These expenditures relate to the operation and maintenance costs of the large capital stock financed and built by donors since 2002 (and still being built), estimated at about $1 billion annually for the development sector and as high as $2 billion for the security sector—altogether close to 15 percent of GDP. The government noted its plans to improve expenditure management capacity in line ministries (with World Bank support) to improve expenditure execution and effectiveness.

28. **The key risks to the fiscal outlook are inadequate revenue mobilization, ineffective expenditure management, and donors' disengagement**. The possible responses to a shrinking resource envelope include expenditure restraint, additional tax policy and administration measures, and debt financing (see accompanying Selected Issues Paper). All these options are difficult to implement. While expenditure restraint may be easier to implement, cutting capital expenditure—in particular infrastructure investment—would negatively affect economic growth. Increases in tax rates or the broadening of tax bases could affect compliance and may be politically challenging to implement. Debt financing may jeopardize debt sustainability and may not be feasible as long as domestic capital markets remain dormant or small or if concessional external borrowing is not forthcoming.

C. Policies to Strengthen the Banking Sector and Promote Credit Provision and Access to Finance

29. **Strengthening the banking sector is needed to support growth**. A stronger banking sector is needed to promote credit provision, better access to finance, economic growth and

development. The legacy of the Kabul Bank crisis and governance framework weigh on the system, stymie credit provision and access to finance, and affect public confidence in banks.

- *Vulnerabilities are related to weak governance and institutional challenges—mainly supervision and the regulatory and legislative framework.* The absence of a comprehensive legal infrastructure, limited institutional capacity in the banking and legal systems, and inadequate corporate governance constrain financial sector development. It also leaves space for interest groups to lobby for regulatory forbearance (e.g., delaying examination reports and enforcement of supervisory actions) with attendant financial stability risks.

- *The banking system remains barely profitable and some banks show poor or negative capital ratios.*[5] In 2013, banks turned an aggregate profit of about $31 million for the first time in years despite large provision expenses and continued losses in state-owned banks. Despite the corrective measures the central bank has been taking with respect to weak banks, there were still seven weak banks (i.e., with a CAMEL rating of 4 or worse) out of the total of 12 banks. The assets of those weak banks represent around 51 percent of the total banking sector's assets. The main issues that these banks face are: (i) low or negative capital;[6] (ii) high credit risk; and (iii) inadequate management. While some of the banks have plans to increase capital and manage other financial issues, addressing management issues remains an important challenge, particularly for state-owned banks.

- *The banking system is highly liquid because of low lending.* From a financial stability perspective, the system's ample liquidity (liquid assets reached 62 percent of total at end 2013) and small loan portfolio (about $824 million or 19 percent of the total assets) provides some comfort. Moreover, international reserves are almost double total deposits.

30. **The authorities' strategy is to strengthen the banking sector's contribution to economic development**. This requires developing the financial infrastructure, improving banking and AML/CFT supervision and its enforcement. In addition, the authorities are planning to develop the interbank market by preparing for trading of financial products, risk management tools, and investment vehicles to strengthen financial transmission channels and help attract investment in financial instruments. The authorities should continue developing financial system infrastructure and services to allow further financial inclusion over the medium term by adopting policies that: (i) promote further use of mobile banking services and microfinance lending; (ii) encourage bank penetration in rural areas; (iii) increase financial literacy among the public; and (iv) assure adequate financial consumer protection. In addition, addressing the factors that may be restraining bank lending would enhance financial inclusion, which is discussed below.

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[5] As of end 2013, the banking system—comprising twelve fully licensed commercial banks and four branches of foreign banks with about 390 bank branches throughout the country—had assets of $4.3 billion total, deposits of $3.7 billion and an average loan-to-deposit ratio of 22.6 percent.

[6] One state-owned bank has negative capital, which is being addressed.

31. **The authorities are determined to strengthen the central bank's financial supervision department (FSD)**. The central bank adopted a five-year strategic plan and a new organizational structure for FSD. FSD has increased its staffing significantly and is now in the process of filling the remaining vacancies, streamlining internal procedures, enhancing on-site and off-site supervision (including AML/CFT supervision), and improving information exchange with the financial intelligence unit, Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA), to support improved economic governance. The central bank has also prepared policies and procedures to enhance its staff's legal protection against liability. Staff welcomed these developments and stressed the importance of protecting FSD staff performing their duties in good faith, transparent and merit-based recruitment, training, and implementation of the five-year strategic plan. Staff also noted that there remained scope to follow up more consistently on enforcement letters and monitor progress. The authorities concurred, while noting political pressures on central bank management to hire unqualified staff and stressing the need for continued technical assistance.

32. **The authorities expressed concern about banks' reluctance to lend**. Although credit to the private sector increased in 2013 for the first time since the Kabul Bank crisis, part of the increase reflected valuation changes on foreign exchange denominated loans and credit growth over the past few years has been low. Staff noted that the low level of private credit—equivalent to only 4 percent of GDP—reflected the scarcity of profitable lending opportunities, given limited information available on potential borrowers and the difficulty in realizing collateral or collecting loans from delinquent borrowers, rather than low supply of funds. Therefore, staff recommended that policies to promote credit should address structural issues that inhibit lending rather than forcing banks to lend (see Selected Issues Paper). Moving from traditional relationship-based lending to larger scale, market-oriented lending would require: (i) strengthening the legal infrastructure and contract enforcement;[7] (ii) enforcing prudential regulations to protect depositors' funds from excessive risk taking and conflicts of interest by banks; (iii) promoting transparent financial reporting by banks; (iv) instituting comprehensive and efficient credit information agencies; and (v) banks establishing sound lending practices that include a robust credit assessment of borrowers. It will also support improved access to finance, connect more people to the modern economy, and help spread the benefits of growth.[8] The central bank agreed with using market-based measures to promote efficient credit allocation and improve access to finance.

33. **The authorities wish to implement a deposit insurance program, but staff warned about risks of moral hazard given current weakness in banks and banking supervision**. Staff noted that deposit insurance would only improve confidence in the banking sector if accompanied

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[7] Priority areas include registration of titles to immovable property, improving security interests in collateral, securing priority interests in insolvency, and training the judiciary in banking issues.

[8] Bank penetration is low with less than 10 percent of the adult population holding an account at, or taking loans from, a formal institution. Furthermore, there were only 1.8 bank branches per 100,000 adults in Afghanistan in 2011, compared to 8.5 in Pakistan and 29.1 in Iran.

by robust banking supervision that ensured consistent adherence to prudential requirements and stronger corporate governance in the banking sector.

34. **The authorities were concerned about international correspondent banking relationships**. Some Afghan banks were encountering difficulties in establishing or maintaining international correspondent relationships, especially U.S. dollar accounts. Staff noted that passage of FATF-compliant AML/CFT legislation and stronger financial sector governance would help Afghan banks to maintain and establish correspondent relationships.

D. Business Environment

35. **The business environment remains challenging despite recent improvements, due to deficiencies in economic governance**. Afghanistan improved its World Bank Doing Business 2014 ranking to 164 (out of 189 economies), from an adjusted rank of 170 the previous year, by facilitating business licensing and improving access to credit thanks to a unified collateral registry. Significant challenges remain, though, across many dimensions such as protecting investors, trading across borders, registering property, enforcing contracts, and dealing with construction permits.[9] Corruption is reportedly high, with a rank of 175 out of 177 countries in Transparency International's Corruption Perceptions Index in 2013. Afghanistan scored only 2.7 on the World Bank's 2012 *Country Performance Ratings*—a scorecard assessing the policy and institutional development among IDA-eligible countries—about 1.5 standard deviations below the mean of 3.2. Hence, strengthening economic governance has been an important pillar of the Fund's engagement.

36. **Staff and the authorities saw improved governance as critical to raising growth and creating jobs**. A business environment conducive to private sector-led growth, a more efficient judicial system, and decisive steps to counter economic crimes would facilitate the entry of new businesses, improve access to finance, bolster investment and construction, help enforce contracts, and ease international trade. Over time, such an environment would reduce the economy's dependence on donor support and promote regional integration.

37. **Measures to improve governance have focused on establishing and enhancing institutions, legal reform, improving transparency and accountability, and capacity building, but progress has been slow**. The authorities see improved governance as critical to reduce the economy's dependence on donor support and to promote regional integration. An economic crimes road map setting out Afghanistan's economic governance framework was endorsed by cabinet in February 2013. Several laws seeking to improve economic governance—such as the banking, AML/CFT laws, and provisions on governance of state-owned enterprises—are advanced in the legislative process. Staff emphasized that concerted efforts to ensure effective and swift implementation of these laws, as well the economic crimes road map and other governance and transparency recommendations, including those set out in the Independent Monitoring and

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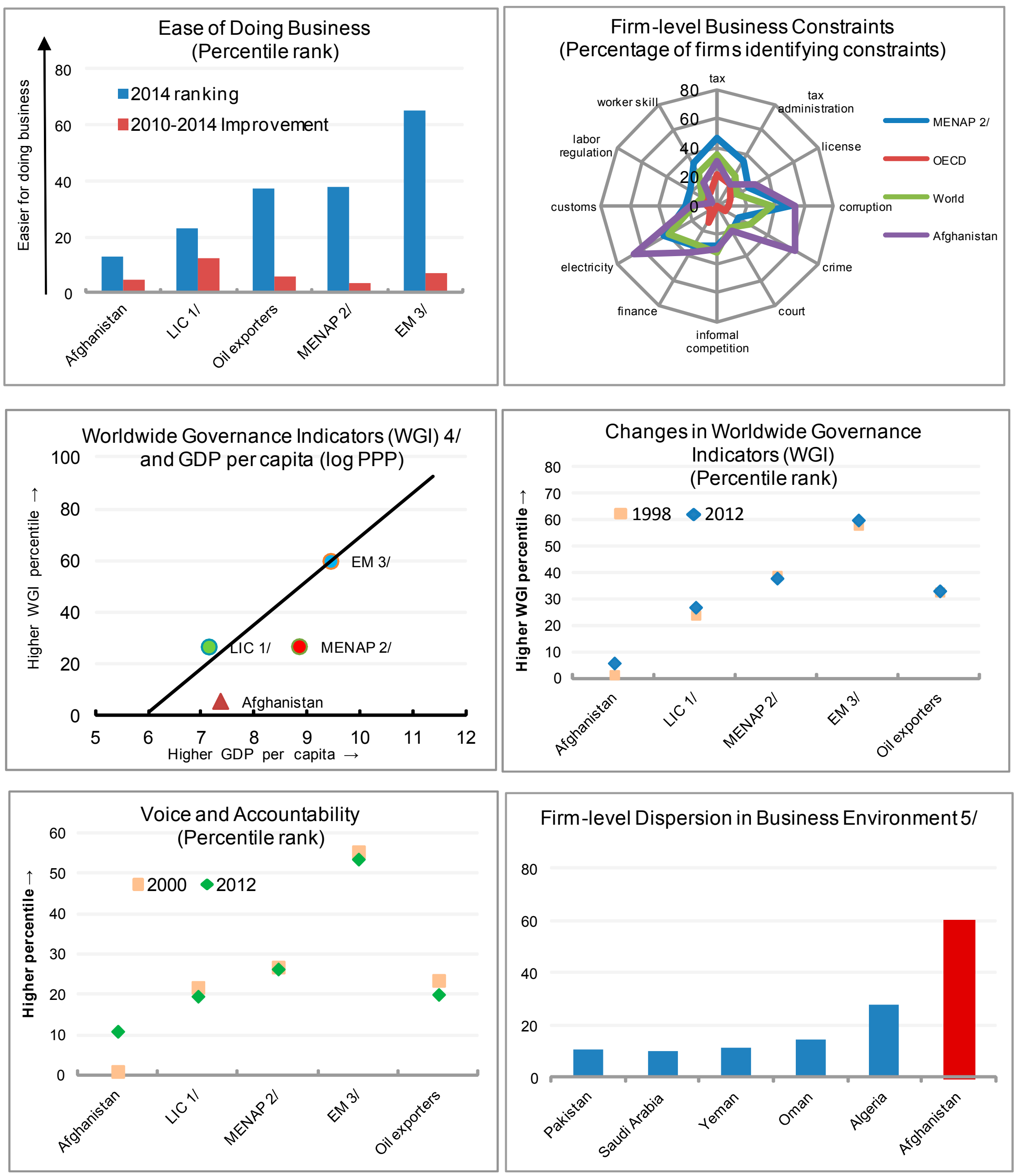
[9] These indicators should be interpreted with caution due to a limited number of respondents, limited geographical coverage, and standardized assumptions on business constraints and information availability.

Islamic Republic of Afghanistan: Business Environment and Governance



Sources: World Bank Doing Business Report (2014); 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.
5/ For each country, the number of days required to obtain an operating licence, the distances to the 80th and 20th percentile are calculated, and each bar shows the spread of these differences.

Evaluation Commission's (IMEC) report on the Kabul Bank crisis, is of paramount importance. Improved governance, along with macroeconomic stability and a better business environment, would open opportunities for all to take part in economic growth, leading to higher living standards, lower poverty, and improved social outcomes.

E. Promoting Inclusive Growth and Protecting the Poor

38. **As a resource-scarce economy, Afghanistan has relied so far on public sector spending and donor inflows to promote growth and development**. The strategy has consisted in investing in public goods to enable economic activity and in human capital to boost productivity. Large investments have been made in infrastructure; roads now connect major markets, and access to electricity, water, and communication has improved dramatically. Access to and use of education has expanded participation in a modernizing economy. While public infrastructure and social services have increased physical and human capital, there are limits to this public sector-led growth model.

39. **Sustained and inclusive growth will require continued progress on a broad structural reform agenda to foster private sector activity**. The authorities were confident that promising drivers of growth included agriculture and rural development, public infrastructure and services, extractive industries, and the energy sectors. They were keen to promote private sector growth and employment outside the security sector and government through further reforms focused on revenue generation, financial sector development, and the business environment.

40. **Several MDGs were met since 2010 while others are on track for 2015**. Along with increased spending on health, education, and irrigation, noteworthy progress was made to increase school enrollment for children, raise the ratio of girls to boys in secondary education, reduce infant and child mortality rates, increase the immunization rate against measles, and lower the rate of tuberculosis.

41. **Pro-poor spending has been rising, and the authorities remain committed to protecting such spending even as they weigh priorities within a limited resource envelope**. The ECF arrangement included a floor on pro-poor spending, which currently stands at about 2 percent of GDP. The authorities noted 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 in reality, almost all government spending favored the poor. The new law on martyrs and disabled will further increase pro-poor spending by 0.7 percent of GDP per year starting in 2014.

Pro Poor Spending

	FY2011/12	FY 2012	FY 2013
Pro poor spending (Af billion)	12.7	18.3	25.3
% GDP	1.5	1.8	2.2
% non-security operating spending	22.8	37.1	44.1

Sources: Afghan authorities; and staff estimates and projections.

F. Statistical Issues

42. **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. Data on national accounts, balance of payments, and social indicators also suffer from weaknesses in coverage and consistency. Fund technical assistance, including from the IMF's Middle East Regional Technical Assistance Center, is being provided to strengthen statistical data systems. Recent improvements include a launch of a new, updated CPI (Box 4) and publication in the IMF Balance of Payments Statistics yearbook 2013 of Afghanistan's official balance of payments compiled by the central bank.

POLICIES FOR 2014

43. **In 2014, the authorities intend to continue to maintain macroeconomic stability, bolster domestic revenues, safeguard the financial system, and enhance economic governance**. On the macroeconomic front, they plan to increase fiscal space, manage reserve money growth, maintain international reserves, and keep inflation in single digits. Fiscal reforms will focus on improving revenue administration and preparing for successful VAT implementation. Financial sector reforms will focus on strengthening bank supervision and promoting financial development, while governance reform will strengthen the AML/CFT regime and the legislative and institutional framework to combat economic crime.

A. Macroeconomic Policy Mix

44. **The adopted 2014 budget incorporates a sharp increase in operating expenditure, as donors transfer spending on budget as part of the security transition**. The increase (4.4 percentage points of GDP) will be largely financed by grants, as well as by higher expected domestic revenue (by 0.8 percent of GDP) on account of past tax policy measures, better administration, and revenue measures being introduced in 2014; nonetheless, revenue collection is expected to continue to be affected by low activity and investment, and a shift away from high tariff imports and additional revenue measures will likely be needed to achieve the 2014 revenue target, which are under consideration by the authorities. Pro-poor spending is projected to increase as a

share of GDP, as the new law on pensions for martyrs and the disabled is implemented. Management of spending brought on-budget (previously externally managed) will be improved by implementing IMF technical assistance recommendations on public financial management.

Islamic Republic of Afghanistan: Public Finances (Central Government), 2013–14

	2013	2014				
	Jan–Dec	Jan–Mar	Apr–Jun	Jul–Sep	Oct–Dec	Jan–Dec
	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In billions of Afghanis)					
Domestic revenue and grants	271.9	35.4	95.9	99.2	122.1	352.7
Domestic revenues	109.0	27.2	31.8	33.8	36.0	128.8
Grants	162.9	8.2	64.1	65.4	86.2	223.8
Expenditures	278.9	70.0	65.7	103.2	118.9	357.7
Operating balance (excluding grants)[1]	-89.5	-25.6	-23.4	-42.9	-50.9	-142.7
Overall balance (including grants)	-7.0	-34.6	30.2	-4.0	3.3	-5.0

Sources: Afghan authorities; and IMF staff calculations.

[1] Defined as domestic revenues minus operating expenditures.

45. **The authorities plan to manage money growth, safeguard international reserves, and continue with exchange rate flexibility**. A modest pick-up in money demand is anticipated after the April 2014 elections. Reserve money growth of 12.7 percent is projected, above the projected growth of nominal GDP, with a commensurate increase in NIR as credit growth is projected to be low. Reserve cover will remain above seven months of imports. The exchange rate will be allowed to move along with market trends, with interventions limited to avoiding excessive volatility.

Islamic Republic of Afghanistan: Central Bank Monetary Indicators, 2013–14

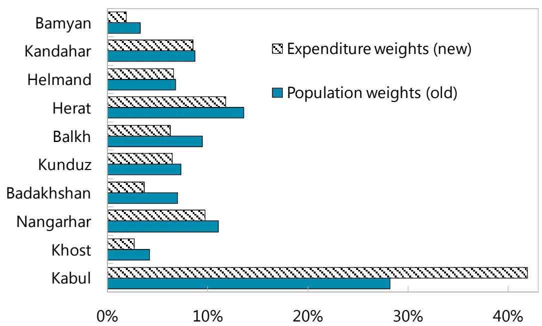
	2013	2014			
		Q1	Q2	Q3	Q4
	Est.	Proj.			
	(In billions of Afghanis, end of period)				
Net Foreign Assets	382.5	382.5	389.6	397.5	408.3
Net Domestic Assets	-183.8	-183.7	-189.6	-189.3	-184.3
Reserve Money	198.8	198.8	200.0	208.2	224.0
Net International Reserves (US$, millions)	6381.7	6407.5	6482.7	6557.9	6633.1

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

Box 4. Islamic Republic of Afghanistan's New Consumer Price Index

The introduction of a new Consumer Price Index (CPI) in 2012 was a major achievement. Along with the exchange rate, the CPI is a highly visible economic indicator. Overcoming many obstacles, the Central Statistical Organization (CSO) has been compiling and publishing price indices for the Kabul (since 2002), and five other major cities (since 2004). A national CPI was compiled by aggregating the city level indices. While broadly adequate for economic surveillance, this CPI suffered from numerous shortcomings. Because it was the most timely and reliable, the Kabul-city CPI was used to monitor the IMF-supported economic program.

Provincial Weights Under New and Old[1/] Method



Sources: Afghan authorities; and IMF staff calculations.
1/ Implied weights.

Over the past few years, the CSO strengthened price statistics and launched a new CPI in June 2012. With IMF technical assistance, the CSO has improved the index through a broader geographical coverage, updated weights, an enlarged consumer basket, and an updated compilation methodology. More specifically:

- ***Data collection has been extended to four additional provinces***—prices are now collected in 10 provinces. The CSO overcame numerous logistical challenges related to the identification and selection of outlets, training of data collectors, and establishment of communication channels.

- ***The weight structure has been updated***. The old index was based on a 1992 Kabul expenditure survey. This expenditure pattern was used in all provinces and the national index was constructed based on population weights. Taking advantage of detailed household expenditure data from the 2008 National Risk and Vulnerability Assessment (NRVA), the CSO updated and differentiated the weights, basing them on provincial-level household expenditure patterns. In compliance with international good practice, expenditure weights are now used to compile the national CPI.

- ***The consumer basket has been expanded and the Classification of Individual Consumption according to Purpose (COICOP) consistently applied***. 92 additional items were included in the basket, bringing the total to 290, and effort was made to clarify the specification of individual items and control for quality variations. The final index is now disseminated in the internationally-used COICOP classification. Detailed correspondence matrices had to be prepared from NRVA items to real-world basket item to COICOP categories.

- ***There is no break in the series linking the old and new CPIs***. The base of new CPI is March 2011 and April 2012 is the first month based on the new methodology. Between March 2011 and March 2012 the new index is chain-linked and scaled to make it comparable to the old one.

The CSO plans to continue to improve the index. It plans to expand its coverage, upgrade the IT system and communication channels with remote provinces, strengthen quality control, improve field supervision over price collectors and regional data validation, and hire and train more staff. In recognition of the quality of the new CPI, the Afghan government and the IMF started using it for ECF program monitoring.

B. Fiscal Reforms

46. **Fiscal reform in 2014 will be focused on preparing the VAT introduction by mitigating implementation risks and preparing the private sector**. By December 2014, the authorities plan to have advanced all mitigation activities to address the 20 risks rated "high" or above in the December 2011 VAT Implementation Risk Management Plan, and conducted all communication and training activities to publicize the VAT's introduction and operation, prepare taxpayers and other stakeholders, and obtain their buy-in in line with the March 2013 VAT Stakeholder Management Plan. They also plan to execute the pre-implementation compliance program, as laid out in the May 2013 VAT Compliance Strategy Action Plan. The authorities also will continue to move ahead in implementing a fiscal regime for the natural resources sector.

47. **The authorities will continue to strengthen customs administration**. They plan to improve the import valuation system and preserve its integrity by: (i) implementing the Tariff and Valuation Management Tool (TARVAL), including the identified vehicle value approach, with a view to covering 85 percent of imports; and (ii) linking it to the valuation module of ASYCUDA World to minimize interference with the valuation parameters. The valuation database has been updated successfully including the identified vehicle value approach. This has been transferred to TARVAL and the top 200 commodities that cover almost 85 percent of customs revenue. It is currently being implemented at Kabul customs and will be rolled out to all customs units in the coming weeks. To complement these changes, the authorities intend to centralize the jurisdiction over valuation issues in an appropriately resourced and trained unit. The customs department has recently recruited four local valuation specialists through a World Bank funded project to further improve the performance of the valuation unit.

48. **Several reforms are planned in budget management**. These include: (i) requiring line ministries to prepare and submit financial plans to the finance ministry (a process which started in December 2013 has been completed) and linking budget allotments to these plans; (ii) rolling out, by March 2014, a Purchasing Module to 11 additional ministries to enhance the capability to manage contracts and associated budgets, following a pilot in two large ministries in 2013; and (iii) using electronic transfers for salaries and contractual payments, for which preparations are well advanced.

C. Financial Sector Reforms

49. **The central bank intends to continue to strengthen the FSD**. The FSD's five-year strategic plan was approved in June 2013 and FSD management is establishing institutional arrangements to start the plan implementation. In line with the plan, increasing supervisory resources will continue with the aim of filling at least 95 percent of the 145 authorized staff positions in the department in full compliance with its human resources policies. Also, steps will be taken to strengthen off-site surveillance (including automation of supervisory reporting) and to enhance the on-site examination process. The Supervisory Enforcement Committee will continue its regular reviews of banks' compliance with FSD's supervisory orders, and performance indicators developed

for the central bank's operations report to parliament will help management monitor progress. Finally, in line with Afghanistan's laws, the central bank will strengthen its policies to protect central bank staff from civil damages and indemnification of legal costs when conducting their duties in good faith.

50. **The authorities will promote financial market development**. The draft sukuk law, currently reviewed by the ministry of justice, is expected to be submitted to parliament later in 2014. In the meantime, a sukuk implementation plan is to be developed, including identification of assets to back sukuks and preparation of the necessary legislation and regulations on capital market and securities issuance in line with international standards for Islamic finance. The central bank intends to promote secondary trading with existing instruments, starting with capital notes; in this regard, it plans to work with the Afghan Bankers Association to guide discussions with dealers on the protocol for agreeing and executing trades—a "code of conduct"—to be adopted by end-2014.

51. **Central bank operations will be strengthened**. With the recent revaluation gains, the central bank is no longer undercapitalized and the new capitalization framework (part of the amendments to the central bank law) is being reviewed and will be submitted to parliament to ensure it remains so, thereby preventing monetary policy from being affected by capital or income considerations. Proposed amendments to the central bank law will also enhance legal underpinnings of central bank operations. Separately, consistent with its by-laws, the Financial Disputes Resolution Commission is planning to publish the findings of financial disputes on its website to increase financial sector transparency. The central bank is developing its operations report to parliament (to become part of its annual report), which will enable legislators to evaluate and monitor progress, inter alia, in hiring, promoting, training, and remunerating staff in accordance with its human resources policies and deploying them efficiently.

52. **The authorities will continue efforts to resolve Kabul Bank cases and recover related assets**. Appeals against sentences against the two main persons indicted in the bank's collapse, as well as applications for additional and longer sentences and related confiscation orders, are being pursued. The appeals, if successful, will assist in asset recovery efforts. The authorities will also pursue resolution of the existing and new mutual legal assistance requests. After the authorities approve the successful bidder for NKB, the central bank will undertake fit and proper checks on the successful bidder and proceed with the privatization. Staff urged the authorities to step up Kabul Bank asset recovery efforts and privatize New Kabul Bank expeditiously or, if it cannot be sold, it should be liquidated, providing that government salary payments remain unaffected.

D. Economic Governance

53. **The authorities plan to take several economic governance measures**. The ECTF will coordinate and implement economic governance measures set out in the economic crimes roadmap. The authorities intend to enact FATF-consistent AML/CFT legislation and adopt a national strategy that will include money laundering and terrorist financing risk assessments; measures to investigate and confiscate the proceeds of crime; measures to enhance the transparency of legal persons and non-profit organizations; and implementation of a risk-based AML/CFT supervisory

regime. The authorities also plan to implement a regime for the declaration of cross-border transportation of currency, negotiable bearer instruments, and gold with the necessary enforcement mechanisms.

PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM[10]

54. **This section discusses program developments since the first review of the ECF arrangement was completed in June 2012**. Performance was not in line with the targets set at the first review, due to unanticipated shocks that hit the economy, an inadequate policy response, and delays in structural reform implementation caused by opposition to some reforms and capacity constraints. This delayed completion of program reviews. Discussions on the second review of the program were not concluded because key quantitative targets were missed, implementation of some structural benchmarks was delayed, and revenue targets for 2013 were not agreed. A January 2013 mission reached agreement on a path to complete the second and third ECF arrangement reviews. However, performance in early 2013 was significantly weaker than planned and not all prior actions were implemented, so completion of the reviews could not be recommended.

55. **Weaker economic conditions necessitated a revision of the policy framework in May 2013**. The revised informal framework recognized the larger economic shock resulting from the withdrawal of international troops and greater transition uncertainties. Accordingly, it envisaged a more gradual adjustment with lower revenue, expenditure, net international reserves (NIR), and money growth targets to help preserve macro-stability, while providing a framework to build a track record toward a possible review.

56. **Despite corrective measures taken by the authorities in the second half of the year, important targets under the revised informal framework were missed in 2013**. This performance, especially the shortfall in budget revenue and delays in structural reform, as well as the limited expected term of the government means a review cannot be completed currently and the ECF arrangement is scheduled to end in November 2014. Budget revenue was Af 5.1 billion (0.4 percent of GDP) below the target set in May. The end-year reserve money target was missed by 3 percent, although the excess corresponded to larger-than-programmed accumulation of NIR ($885 million above the adjusted target) and did not result in higher inflation.

57. **Progress was made in structural reform efforts, but implementation was slower than planned**. In particular, capacity constraints and opposition from groups that believed the reforms would hurt their interests continued to be an obstacle. Nevertheless, 20 of 25 structural

[10] The IMF Executive Board was informed about developments under the program in an Informal Country Matters meeting held on July 26, 2013 and through assessment letters circulated in June 2013 and January 2014.

benchmarks planned between June 2012 and December 2013 were completed, some with delays.[11] Noteworthy accomplishments included: publishing the inquiry into the Kabul Bank crisis; submitting the new banking, VAT, and tax administration laws to parliament; advancing preparations for implementation of the VAT; strengthening border control management; submitting a new sukuk debt instruments law to the ministry of justice for review; and adopting a strategic plan for financial supervision. The five outstanding benchmarks are: (i) submitting to parliament the laws on AML/CFT; (ii) submitting to parliament amendments to central bank legislation aligning provisions on the calculation and allocation of net income with international good practice; (iii) completing the transfer of taxpayers from the medium and small taxpayer offices to the large taxpayer office; (iv) strengthening the policies to inform central bank supervisory staff about their duties, functions, and protections from liability available; and (v) amending the Economic Crimes Task Force's advice to the Criminal Law Review Working Group on categories of economic offences to be included in the new consolidated penal code to include additional offenses.

58. **Preparations for the VAT are progressing more slowly than planned**. The draft law on the VAT, consistent with Fund advice, was submitted to parliament with a delay (in May 2013) but passage has been delayed and parliament is discussing possible changes to the draft law. These delays reflect opposition from within the government and parliament. As a result, the timing of introduction of the new tax remains uncertain and one year will be needed to prepare the VAT's introduction after parliament's approval of the law. In the meantime, the VAT implementation plan has been started, and the draft law on tax administration, which is necessary to administer the VAT, has been submitted to parliament.[12] Prospective taxpayers have been identified and moved to the large taxpayer office.

59. **In the financial sector, the authorities worked on privatization of New Kabul Bank (NKB), the new banking law, and strengthening financial supervision**. The new banking law was submitted to parliament in February 2013, but needs some amendments which it is hoped will be incorporated while the law is discussed by parliament. The law will help enhance supervisory oversight over the financial sector by strengthening corporate governance, prudential requirements, enforcement measures, and bank resolution. The higher minimum paid-in capital requirement for banks has been enforced. The DAB approved a five-year strategic plan to strengthen banking supervision in June 2013 and a new organizational structure is being implemented. The first attempt to privatize NKB was not successful and the one bid received did not meet the tender requirements. A second tender was conducted in late-2013 and two bids that met the tender requirements were received, and a recommendation for sale to the winning bid (which expires in mid-April) was

[11] In two cases, the authorities have indicated that the benchmark has been met and staff has requested information to confirm their implementation (completing the transfer of taxpayers from the medium and small taxpayer offices to the large taxpayer office and the Economic Crimes Task Force's advice to the Criminal Law Review Working Group on categories of economic offences to be included in the new consolidated penal code).

[12] The plan includes key tasks and milestone dates for system, procedural and personnel development, a governance structure, a change management strategy, a stakeholder management strategy, including taxpayer preparation, and an initial compliance strategy.

submitted to the cabinet. However, so far the sale has not been approved, because cabinet regarded the price offered as low and the political circumstances (elections) were not viewed as conducive to privatization.

60. **The program of asset recovery and resolution of Kabul Bank continued, but at a slow pace**.[13] The government reported that between June 30, 2013 and February 28, 2014, cash recoveries amounted to $6.6 million, which together with other and earlier recoveries increased total recoveries to $175 million—leaving $738.7 million in outstanding claims. Difficulties in finding buyers for domestic assets, ascertaining legal documentation of property ownership, appeals of the verdicts in criminal cases, and slow progress in recovering assets held overseas continued to impede asset recovery. Requests for mutual legal assistance were sent to six countries, with four more requests being planned (Box 5). In March 2013, the Special Tribunal of the Supreme Court established by the president convicted all 21 indicted individuals, including for misuse of property, abuse of authority, or failure to report irregularities. The government appealed to seek longer sentences and additional convictions and related confiscation orders to assist with the recovery of assets overseas. The Special Tribunal identified 29 additional suspects, not yet indicted, for investigation.

61. **Several measures were taken to improve economic governance**. The authorities prepared amendments to the company law to strengthen oversight by the finance ministry over state-owned corporations. The inquiry report of the IMEC into the Kabul Bank crisis was published. Revised AML/CFT legislation, designed to comply with the FATF standard, is being discussed by the cabinet, but has been delayed by the need for detailed discussion of the content of the laws. The authorities are considering approaching the international community to request time for this discussion to be completed. The capacity of FinTRACA was strengthened; registration and reporting by money service providers is being enforced; and inter-agency coordination through memoranda of understanding on information sharing between AML/CFT stakeholders was improved. An economic crimes roadmap setting out a comprehensive economic governance framework was endorsed by the cabinet in February 2013, and an ECTF under the chairmanship of the economy minister was established to oversee its implementation. The ECTF has advised on economic crimes to be included in the draft consolidated penal code, consistent with the FATF standard and the roadmap.

62. **Despite delays in program reviews, staff and the authorities agreed on a set of informal quantitative targets and policy actions for 2014 to facilitate close engagement and provide a policy framework during the election period**. Staff noted that adherence to the agreed framework would send a positive signal to domestic and international stakeholders and build a track record of implementing economic policies.

[13] Following the request made by Executive Directors at the time of the first ECF review, quarterly reports on Kabul Bank recovery have been prepared and published by the authorities and have been circulated to the IMF Board for its information. The most recent update was part of the assessment letter circulated to the Board in January 2014.

Box 5. Kabul Bank Asset Recovery and Resolution

This box reviews developments since June 2012 in asset recovery and resolution of Kabul Bank.

A public inquiry into the Kabul Bank crisis was published by the Independent Joint Anti-Corruption Monitoring and Evaluation Committee (IMEC) on November 15, 2012, see www.mec.af/files/knpir-final.pdf. The IMEC report made 48 recommendations to improve governance, the regulatory environment, supervision and enforcement, investigation and law enforcement, judicial proceedings, recoveries, the sale of New Kabul Bank, and on the monitoring and reporting requirements relating to the recommendations made by IMEC.

The government and the central bank have responded to the inquiry's recommendations. Recommendations directed to the central bank are almost fully reflected in the central bank FSD's Strategic Plan. Of the 18 recommendations that apply specifically to central bank, 14 have been implemented or largely implemented, 3 have been partially implement and fuller implementation is underway, and one was rejected as inappropriate (limiting shareholdings of a bank to no more than 10 percent). The preparation of new laws on anti-money laundering and countering the financing of terrorism (currently being considered by Cabinet) were designed to overcome some of the reporting and compliance issued identified by the report. The government's response included the creation of the Economic Crimes Task Force to implement the national strategy to combat economic crime, plans to sell New Kabul Bank and to consider other recommendations, where possible although some recommendations could not be commented on because there were pending or possible court cases.

Asset recovery has proceeded. Cash recoveries amounted to $46.7 million between June 4, 2012 and February 28, 2014. The bulk of these recoveries were the proceeds from the sale of villas in Dubai that were taken over by the Kabul Bank receivership. The Kabul Bank receivership had $1,011 million in potentially recoverable assets on August 31, 2010, of which $175 million had been recovered in cash or equivalent as of February 28, 2014.[1] In addition, assets with a book value of $59.6 million had been recovered and were available for sale and approved reduction amounted to $97.4 million. Starting in September 2012, the ministry of finance and central bank have published quarterly updates on asset recoveries and Kabul Bank resolution issues (see www.centralbank.gov.af and www.mof.gov.af).

The criminal trials related to Kabul Bank began in November 2012 and verdicts were issued in March 2013, which are being appealed. The Special Tribunal of the Supreme Court, established by President Karzai, began its deliberations at public hearings and issued verdicts in March 2013 convicting all 21 people charged with criminal offences. Two of the convicted received jail sentences of five years each and fines of about $800 million. The Government, unsatisfied with the sentences, is seeking lengthier sentences for two of those convicted and stronger confiscation orders to assist with the recovery of overseas assets and has filed an appeal. The other defendants charged with criminal offences were also convicted and received jail sentences of six months to four years. Further, the Special Tribunal noted there are 29 individuals identified (but not yet indicted) for investigation for suspected involvement in Kabul Bank crimes. Requests for mutual legal assistance were sent to six countries (France, India, Switzerland, United Arab Emirates, United Kingdom, and the United States), with four more requests planned.

Box 5. Kabul Bank Asset Recovery and Resolution (Concluded)

Efforts have been made to privatize New Kabul Bank (NKB), but progress has been limited. Kabul Bank and its successor NKB make the bulk of government salary payments and it has been essential to preserve this capacity until other banks are able to take them over, which is linked to strengthening the payments system. The first effort to sell NKB in early 2013 was not successful because the only bid received did not meet the technical requirements of the tender. A second tender was held in the autumn of 2013 and two bidders submitted bids that met the tender's technical requirements. So far cabinet has not approved the sale to the winning bid, which expires in mid-April. The sale of NKB to a fit and proper buyer would make an important contribution to strengthening Afghanistan's banking sector.

The experience with Kabul Bank resolution has been mixed. The Kabul Bank crisis underscored the need to reform financial sector governance and for the public to be convinced that the rule of law prevails in the financial sector to rebuild public confidence in the sector. Since 2011, the authorities' IMF-supported program has contained a wide set of measures to strengthen the financial sector, and institutional capacity to deal with economic crime, including improved or new legislation, strengthening the central bank's supervision capacity, and measures to increase transparency, reform institutions and improve accountability. The results have been mixed. There have been positive milestones, including strengthened supervision, a commitment to transparently communicating with the public, and an improvement in the institutional infrastructure to deal with economic crime. However, asset recovery, the sale of New Kabul Bank, and new legislation (banking, AML/CFT laws) have progressed more slowly than hoped earlier and some of the verdicts in the criminal cases were viewed by the government as inadequate.

[1] This includes cash recoveries ($157.1 million), collections (transfers scheduled but not made) during the conservatorship and a court ordered deposit offset and a rent payment offsetting part of a loan ($17.9 million).

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63. **Over the past decade, Afghanistan has made enormous progress in reconstruction and development, but remains one of the poorest countries in the world**. War, security concerns, political uncertainty, and weak institutions have limited growth and weighed on social outcomes. 2014 is a critical year in the political and security transitions, with presidential elections and completion of the drawdown of international troops.

64. **The authorities maintained macroeconomic stability and continued to implement structural reforms in 2013 despite the economic shock caused by security and political uncertainties**. Inflation remained in single digits, the overall budget deficit (including grants) was close to balance, reserves remained above 7 months of imports, and debt at a modest level. At the same time, structural reforms continued, even if the pace was slower than planned. Donor grants continued to finance the external and budget deficits.

65. **The economic outlook for 2014 and the transformation decade will depend on political and security stability, continued economic reform, and donor support**. The authorities need to continue efforts to deliver on their reform commitments both to promote inclusive and

sustained growth and assure continued donor flows. Continued substantial support from the international community will be needed to help maintain macroeconomic stability, support economic reforms, and finance security and development needs. While existing international reserves are sufficient to manage short-term pressures, in the long run, only continued prudent macroeconomic policies, sustained reform efforts, and political and security stability will ensure inclusive development.

66. **Despite the achievements made, vulnerabilities are high and the outlook is subject to significant risks, mostly on the downside**. Dependence on donor financing, large expenditure needs, and a limited domestic revenue capacity, and a fragile banking system are important vulnerabilities. Downside risks are related to adverse domestic or regional security developments, political instability, inadequate implementation of economic policies, and donor fatigue. On the upside, if uncertainties recede more swiftly than anticipated, growth would be higher and development more rapid.

67. **The authorities' economic strategy remains broadly appropriate and needs strengthened implementation**. Prudent macroeconomic policies and wide-ranging structural reforms are needed to realize Afghanistan's economic potential and to support successful political and security transitions, as well as assure continued donor support. Further they will support inclusive growth and mitigate risks by building buffers. The authorities' economic strategy would benefit from strengthened implementation.

68. **Sustained and inclusive growth is needed to provide job opportunities and reduce poverty**. Growth prospects hinge on implementing a prudent policy mix, enhancing service delivery, building infrastructure—particularly roads and power—and strengthening the business environment. This will require a radical and sustained improvement in governance. Boosting private sector activity is key, as the public sector-based employment model will soon reach its limits given fiscal constraints and dependence on donor financing.

69. **The macroeconomic policy mix remains appropriate, with fiscal policy (financed by grants) supporting demand and monetary policy focused on inflation**. The fiscal balance including grants should continue to remain broadly balanced to ensure sustainability while efforts should be stepped up to mobilize domestic revenue and further improve budget management to ensure pro-poor and development expenditure are increased to help achieve the MDGs. To maintain low inflation, monetary policy should continue to limit money supply growth and limit foreign exchange interventions to mitigating temporary volatility, while continuing to maintain the international reserves buffer.

70. **Raising domestic revenue is a priority for fiscal sustainability**. In addition to continued efforts to strengthen revenue and customs administration and increase compliance, swift passage of the VAT and tax administration laws is required to pave the way for the introduction of the VAT. Moreover, a fiscal regime for the natural resources sector should be promptly finalized to ensure the government's share of future economic rents and to attract investors into this sector. The authorities should refrain from granting investment incentives and tax exemptions. Higher revenue

is essential to finance needed development and security outlays and reduce reliance on donor funding.

71. **The banking system should be strengthened to ensure its soundness and enhance its contribution to economic development, and NKB should be sold as planned**. The banking system is vulnerable to adverse shocks, and bank credit remains low. The central bank should monitor the banking system closely and enforce robustly prudential standards and enforcement actions, especially for banks that are loss-making or have weak financial positions. While the regulatory framework and the central bank's supervision capacity have been strengthened, determined efforts continue to be needed to assure effective banking supervision (including AML/CFT supervision). In this regard, vigorous efforts are needed to pass and implement the new banking law and to ensure adequate protection of central bank supervisory staff performing their duties in good faith. Further, efforts to recover Kabul Bank assets continue to be needed to reduce the cost of the crisis to the population, to signal determination to improve governance, and to assure continued donor financing. Selling NKB to the highest bidder—after due diligence is completed—remains the best solution to ensure the bank's healthy future and to strengthen this sector.

72. **Economic governance reforms should continue to focus on improving the business environment and strengthening the AML/CFT regime**. These reforms will be critical to supporting private sector-led growth. In particular, the AML/CFT legislation should promptly be submitted to parliament and enacted to help combat economic crime and ensure that the banking sector maintains its international correspondent relationships.

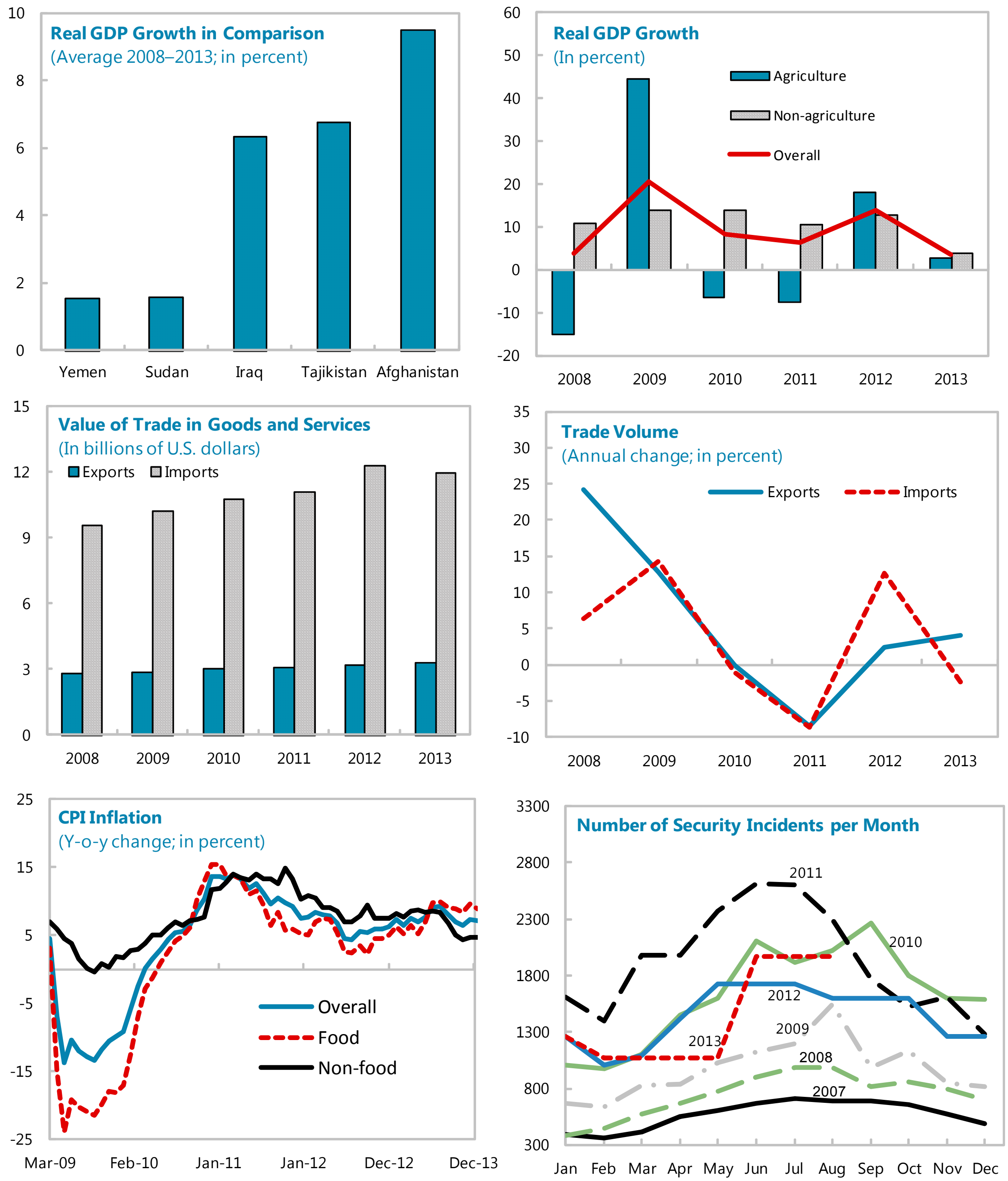
73. **Staff agreed with the authorities on an informal short-term policy framework for 2014**. The policy framework provides for continued macroeconomic stability, with monetary policy aimed at maintaining low inflation; fiscal policy focused on revenue mobilization; a flexible exchange rate policy; and measures to safeguard the financial sector and strengthen economic governance. Reaching the 2014 domestic revenue target, however, will be a challenge and will require renewed efforts and additional revenue measures. Adherence to the agreed framework would send a positive signal to all stakeholders.

74. **Staff intends to continue its close engagement through policy advice and technical assistance, including within the framework provided by the ECF arrangement**. The IMF has been supporting Afghanistan through technical assistance and a three-year ECF arrangement approved in November 2011. Although reviews were not completed since June 2012 because of an inadequate policy response and delays in structural reform, staff has maintained—and intends to maintain—a close dialogue with the authorities on economic policy and institution building.

75. **Afghanistan needs continued support from the international community to maintain macroeconomic stability and support its economic reforms**. The authorities need to continue their efforts to deliver on their reform commitments under the TMAF to maintain economic stability, lift growth, and facilitate donor flows to finance fiscal and external current account needs.

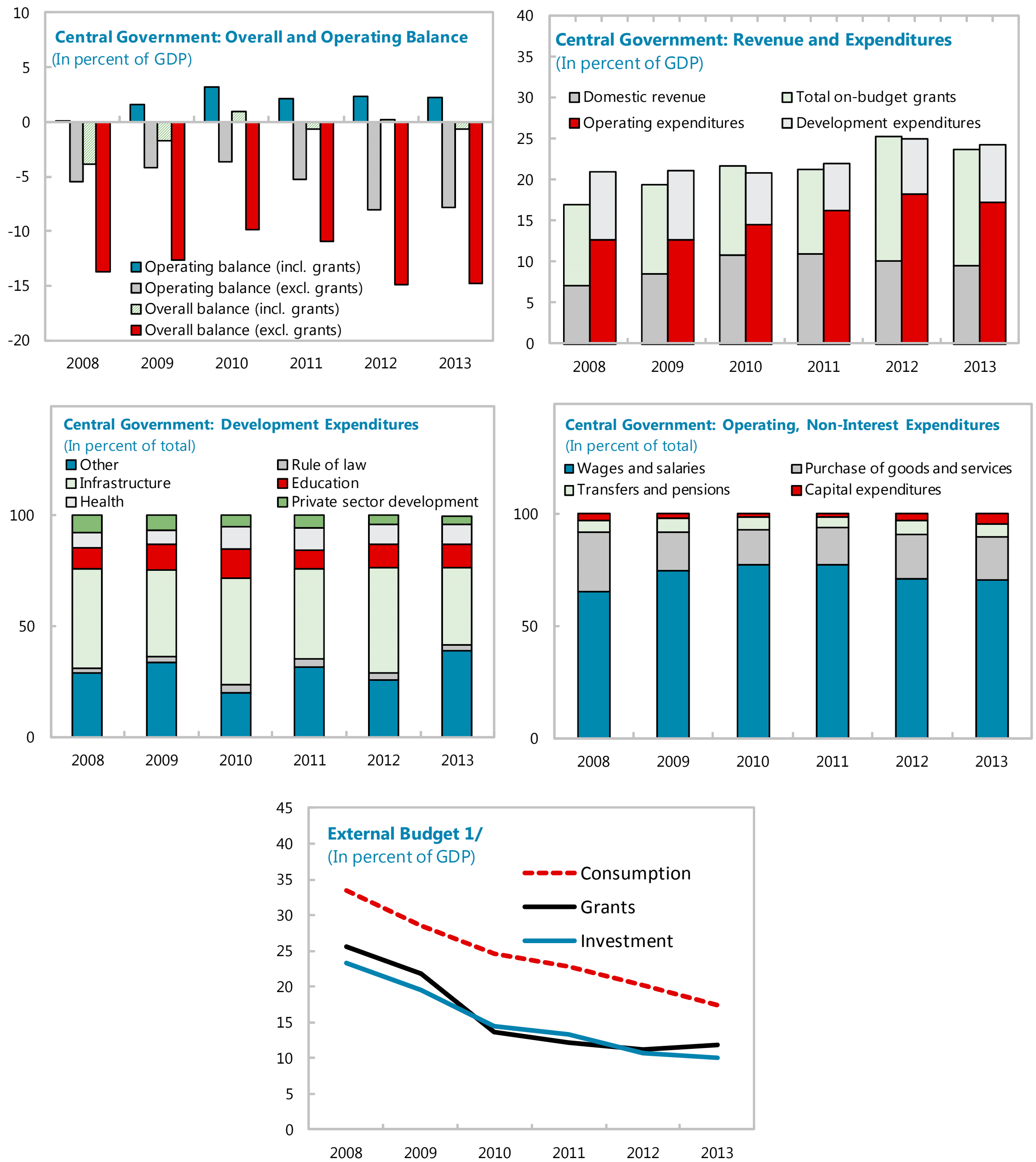
76. **It is proposed to hold the next Article IV consultation in accordance with the relevant decision** on the consultation cycle for members with a Fund arrangement.

Figure 1. Islamic Republic of Afghanistan: Real Sector



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

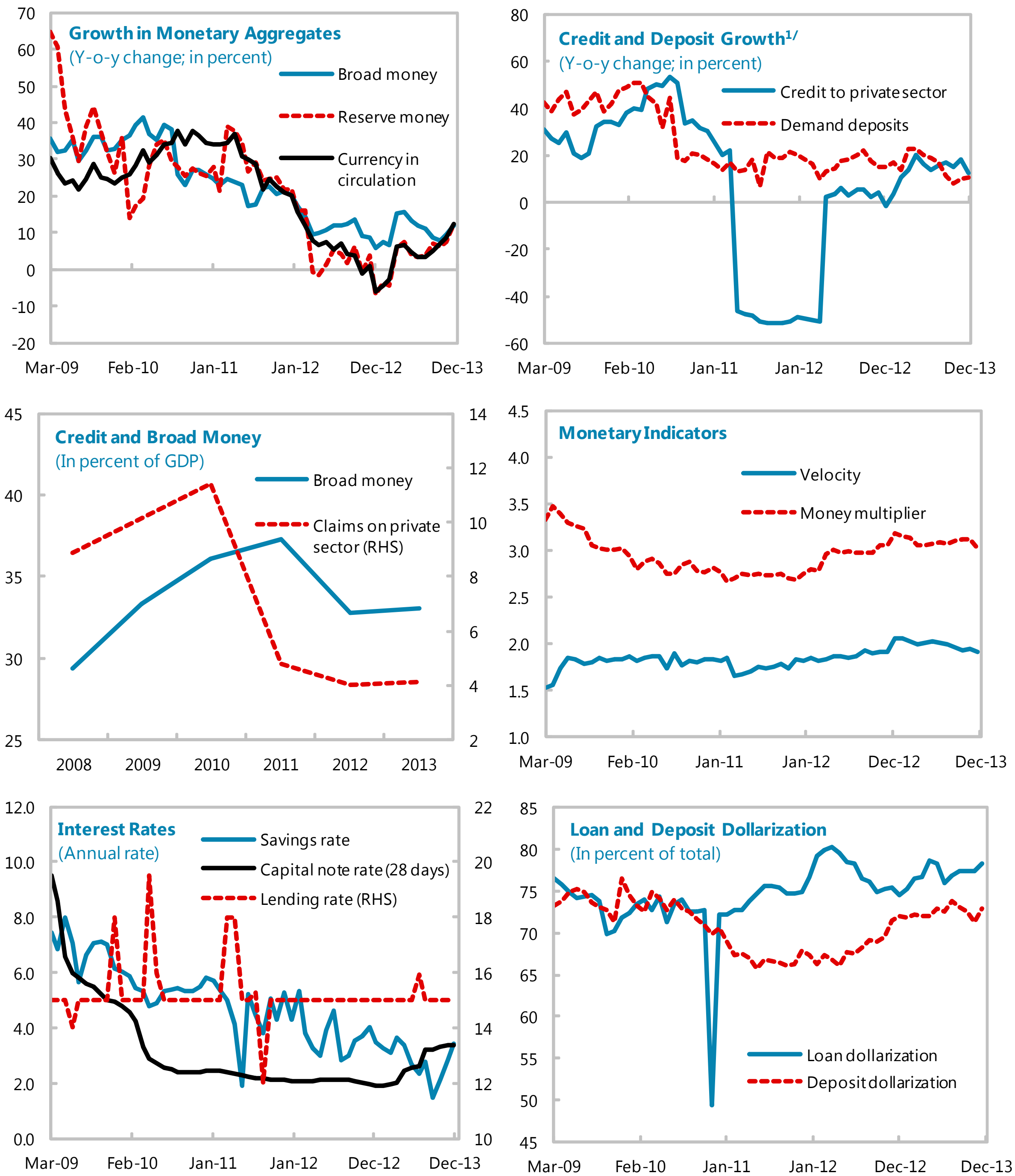
Figure 2. Islamic Republic of Afghanistan: Fiscal Sector



Sources: Afghan authorities; and IMF staff calculations.

1/ Estimated activity off-budget by international community.

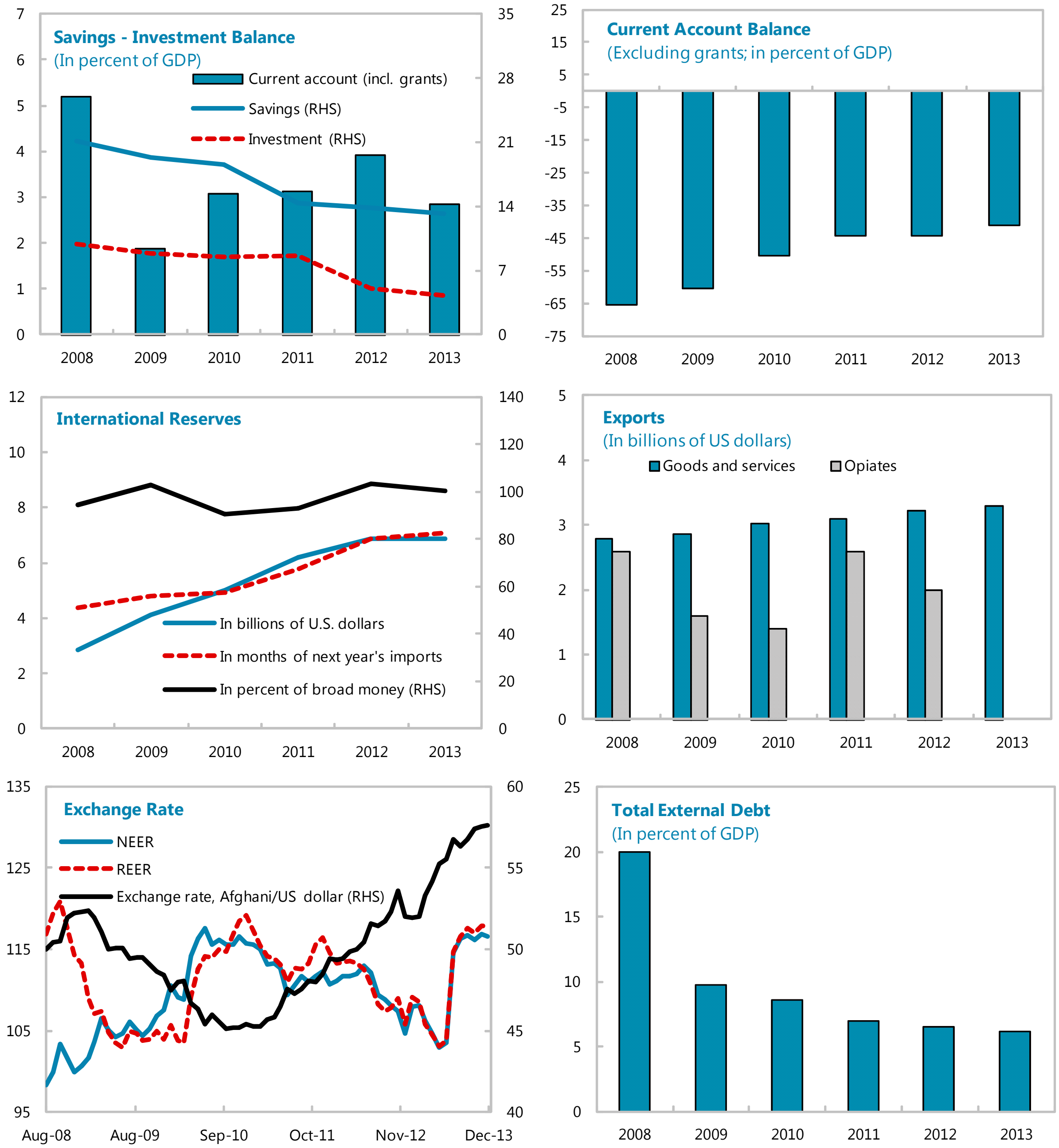
Figure 3. Islamic Republic of Afghanistan: Monetary Sector



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; United Nations Office on Drugs and Crime; and IMF staff calculations.

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2011–14

(Quota: SDR 161.9 million)
(Population: approx. 30 million)
(Per capita GDP: approx. US$680; 2012)
(Poverty rate: 36 percent; 2008)
(Main exports: opium, US$2.8 billion; carpets, US$155 million; 2010)

	2011	2012	2013			2014		
	Act.	Prel.	Prog. 10/	Prog.11/	Est.	Prog. 10/	Prog.11/	Proj.
	(Annual percentage change, unless otherwise indicated)							
Output and prices 1/								
Real GDP	6.5	14.0	6.5	1.5	3.6	5.9	3.2	3.2
Nominal GDP (in billions of Afghanis)	836	1,034	1,140	1,085	1,148	1,270	1,182	1,249
Nominal GDP (in billions of U.S. dollars)	17.9	20.3	22.0	19.9	20.7	23.7	20.7	21.7
Consumer prices (period average) 2/	11.8	6.4	6.7	6.2	7.4	5.0	5.8	6.1
Food	10.7	4.7	...	4.8	7.6	...	...	6.6
Non-food	13.2	8.7	...	7.2	7.2	...	...	5.1
Consumer prices (end of period) 2/	9.3	5.9	5.4	5.0	7.2	5.0	5.0	4.0
	(In percent of GDP)							
Investment and savings 2/								
Gross domestic investment	23.6	18.6	…	…	18.0	…	…	17.2
Of which: Private	8.6	5.0	…	…	4.2	…	…	4.2
Gross national savings	26.7	22.5	…	…	20.8	…	…	20.6
Of which: Private	12.3	8.8	…	…	7.7	…	…	7.9
Public finances (central government) 3/								
Domestic revenues and grants	21.3	25.2	23.4	27.5	23.7	25.4	…	28.2
Domestic revenues	11.0	10.1	11.3	10.5	9.5	13.4	…	10.3
Grants	10.3	15.1	12.1	16.9	14.2	12.0	…	17.9
Expenditures	21.9	25.0	24.1	28.7	24.3	25.2	…	28.6
Operating 4/	16.3	18.2	17.7	21.3	17.3	18.6	…	21.7
Development	5.6	6.8	6.4	7.3	7.0	6.6	…	6.9
Operating balance (excluding grants) 5/	-5.3	-8.1	-6.4	-10.8	-7.8	-5.2	…	-11.4
Overall balance (including grants)	-0.6	0.2	-0.8	-1.2	-0.6	0.2	…	-0.4
Public debt 6/	6.9	6.5	6.6	7.1	6.1	6.9	…	5.9
	(Annual percentage change, end of period, unless otherwise indicated)							
Monetary sector								
Reserve money	21.9	3.9	16.0	8.0	12.4	...	...	12.7
Currency in circulation	20.8	1.1	15.8	8.0	12.5	...	...	12.7
Broad money	21.3	8.8	15.4	9.3	11.9	...	...	12.4
Interest rate, 28-day capital note (in percent)	2.1	2.0	...	...	3.4	...	...	...
	(In percent of GDP, unless otherwise indicated)							
External sector 1/								
Exports of goods (in U.S. dollars, percentage change)	1.8	2.7	-3.8	-1.8	-5.2	7.2	…	-7.9
Imports of goods (in U.S. dollars, percentage change)	2.9	11.2	4.6	-1.3	-2.2	0.8	…	-2.1
Merchandise trade balance	-42.1	-42.4	-43.2	-42.4	-41.0	-39.6	…	-39.0
Current account balance							…	
Excluding official transfers	-42.1	-42.3	-43.0	-42.2	-40.6	-39.6	…	-38.1
Including official transfers	3.1	3.9	0.5	3.4	2.8	-0.8	…	3.3
Foreign direct investment	2.1	2.0	2.7	1.6	0.7	3.4	…	1.2
Total external debt 6/	6.9	6.5	6.6	7.1	6.1	6.7	…	5.9
Gross international reserves (in millions of U.S. dollars)	6,208	6,867	7,286	6,660	6,886	7,750	…	7,099
Import coverage of reserves 7/	6.0	6.9	7.3	7.5	7.1	7.7	…	7.2
Exchange rate (average, Afghanis per U.S. dollar)	46.7	50.9	…	…	55.4	…	…	…
Real exchange rate (average, percentage change) 8/	7.7	-4.3	...	...	-2.7	...	...	...
Memorandum items 9/	2011/12	2012/13			2013/14			2014/15
Nominal GDP, incl. opium (in billions of Afghanis)	896	1,086			...			...
Real GDP, incl. opium (annual percentage change)	8.7	10.9			...			...
Opium production (in tons)	5,800	3,700			5,500			...
Price (in U.S. dollars per kilogram)	180	163			143			...

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, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is closer 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's basis.
10/ Projected at the first review of the ECF, in June 2012.
11/ Informal agreement of May 2013.

Table 2. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2012–18

	2012 Prel.	2013 Est.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Output and prices 1/							
Real GDP	14.0	3.6	3.2	4.5	5.0	5.1	5.3
Nominal GDP (in billions of U.S. dollars)	20.3	20.7	21.7	23.2	24.8	26.4	28.1
Consumer prices (period average) 2/	6.4	7.4	6.1	5.5	5.5	5.0	5.0
Investment and savings 2/							
Gross domestic investment	18.6	18.0	17.2	18.5	20.3	22.5	23.8
Of which: Private	5.0	4.2	4.2	6.2	8.7	11.6	13.3
Gross national savings	22.5	20.8	20.6	18.3	17.9	18.5	20.0
Of which: Private	8.8	7.7	7.9	6.8	6.2	8.4	10.4
Public finances (central government) 3/							
Domestic revenues and grants	25.2	23.7	28.2	28.9	30.6	33.9	35.8
Domestic revenues	10.1	9.5	10.3	11.1	12.5	12.5	13.8
Grants	15.1	14.2	17.9	17.8	18.1	21.5	22.0
Expenditures	25.0	24.3	28.6	29.7	30.6	34.7	36.7
Operating 4/	18.2	17.3	21.7	22.8	23.4	27.4	29.2
Development	6.8	7.0	6.9	6.9	7.1	7.3	7.6
Operating balance (excluding grants) 5/	-8.1	-7.8	-11.4	-11.7	-11.0	-14.9	-15.4
Overall budget balance (including grants)	0.2	-0.6	-0.4	-0.8	0.0	-0.8	-1.0
External sector 1/							
Merchandise trade balance	-42.4	-41.0	-39.0	-37.8	-36.3	-34.6	-31.8
Current account balance, excluding official grants	-42.3	-40.6	-38.1	-36.7	-34.8	-32.5	-29.9
Gross reserves (in millions of U.S. dollars)	6,867	6,886	7,099	7,395	7,300	7,400	7,500
Import coverage of reserves 6/	6.9	7.1	7.2	7.3	7.2	7.1	6.8
Memorandum items:							
Total public debt 7/	6.5	6.1	5.9	6.6	7.8	9.9	9.8
Of which: External debt	6.5	6.1	5.9	5.8	5.8	5.7	5.6
GDP per capita (in U.S. dollars) 8/	680	679	695	726	757	788	822

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

1/ Excluding the narcotics economy.

2/ Revised with improved coverage.

3/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years 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, 2011–14

(In billions of Afghanis)

	2011 Year 5/ Act.	2012 Year 5/ Act.	2013 Q1 Act.	2013 Q2 Act.	2013 Q3 Act.	2013 Q4 Prel.	2013 FY Prel.	2014 Q1 Proj.	2014 Q2 Proj.	2014 Q3 Proj.	2014 Q4 Proj.	2014 FY Proj.	2014 Budget
Revenues and grants	177.8	260.6	30.4	60.1	94.1	87.3	271.9	57.1	87.6	87.2	120.8	352.7	355.9
Domestic revenues	91.9	104.7	22.3	25.5	27.8	33.4	109.0	26.1	30.4	29.2	43.2	128.8	128.8
Tax revenues	72.4	82.2	11.1	22.8	21.8	21.7	77.4	19.7	23.3	23.1	33.0	99.0	99.0
Income, profits, and capital gains	21.5	28.8	3.7	8.2	8.6	6.9	27.4	7.1	8.6	8.4	14.3	38.4	38.4
International trade and transactior	29.9	29.4	4.1	8.3	7.2	7.8	27.3	7.2	8.4	8.2	9.4	33.1	33.1
Goods and services	17.5	20.9	2.6	5.0	4.4	5.3	17.3	4.7	5.5	5.8	8.1	24.2	24.2
Other	3.5	3.2	0.7	1.3	1.6	1.7	5.4	0.7	0.7	0.7	1.2	3.3	3.3
Nontax revenues	19.6	22.4	11.2	2.7	6.0	11.7	31.6	6.4	7.1	6.1	10.2	29.8	29.8
Grants to operating budget 1/	62.0	107.5	1.6	27.1	52.0	33.9	114.7	24.9	41.8	44.4	56.8	167.9	171.1
ARTF	6.7	19.1	1.2	7.3	3.2	2.5	14.2	3.3	8.4	5.4	11.6	28.7	28.7
LOTFA	23.6	30.8	0.0	9.7	7.0	5.8	22.4	5.0	12.9	12.6	21.4	51.9	52.7
NTM-A	31.7	57.5	0.0	10.1	41.7	22.6	74.5	16.4	20.1	24.6	22.6	83.7	86.1
Other grants	0.1	0.1	0.4	0.0	0.1	3.0	3.6	0.3	0.4	1.7	1.2	3.6	3.6
Grants to development budget	23.8	48.4	6.5	7.5	14.2	20.0	48.2	6.1	15.4	13.6	20.9	56.0	56.0
Total expenditures	183.2	258.7	41.2	64.0	75.0	98.8	278.9	52.0	89.3	90.7	125.7	357.7	361.2
Operating expenditures	136.1	188.2	34.0	48.0	53.6	62.9	198.6	45.0	67.4	67.6	91.5	271.6	275.1
Of which: Security	…	…	…	…	…	…	128.7	…	…	…	…	177.1	180.6
Wages and salaries	104.7	133.6	28.9	34.2	37.4	39.0	139.5	27.9	39.4	37.8	48.5	153.6	153.6
Purchases of goods and services	22.6	36.6	3.2	8.0	10.7	16.3	38.2	10.8	20.5	22.5	32.5	86.3	89.5
Transfers, subsidies, and other	1.9	0.6	0.0	0.0	0.0	0.0	0.0	0.3	0.4	0.7	1.0	2.4	2.4
Pensions	4.2	11.3	1.8	3.9	3.0	2.8	11.5	4.3	5.7	5.1	4.7	19.7	19.7
Capital expenditures	2.1	5.4	0.1	1.8	2.4	4.0	8.4	1.6	1.2	1.2	4.7	8.7	9.1
Interest	0.6	0.8	0.1	0.0	0.1	0.8	1.0	0.2	0.2	0.2	0.2	0.8	0.8
Development expenditures	47.1	70.5	7.1	15.9	21.4	36.0	80.4	6.9	21.8	23.1	34.2	86.1	86.1
Operating balance excluding grants	-44.2	-83.6	-11.7	-22.5	-25.8	-29.5	-89.5	-18.9	-37.1	-38.4	-48.3	-142.7	-146.3
Overall budget balance including grant	-5.4	1.9	-10.7	-3.9	19.1	-11.5	-7.0	5.1	-1.7	-3.6	-4.9	-5.0	-5.3
less: Kabul Bank bailout cost	36.6	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Augmented overall budget balance	-42.0	3.9	-10.7	-3.9	19.1	-11.5	-7.0	5.1	-1.7	-3.6	-4.9	-5.0	-5.3
Float and discrepancy 2/	9.7	13.3	-6.7	3.6	-3.7	4.6	-2.2	0.0	0.0	0.0	0.0	0.0	0.0
Financing	32.3	-17.2	17.4	0.3	-15.4	6.9	9.3	-5.1	1.7	3.6	4.9	5.0	5.3
Sale of nonfinancial assets 3/	0.6	6.6	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)	1.8	3.4	0.3	0.1	0.5	0.5	1.4	0.2	0.5	0.9	0.7	2.3	2.1
Domestic (net)	29.9	-27.2	17.1	0.2	-15.9	6.4	7.8	-5.3	1.2	2.7	4.2	2.7	3.3
Central bank, change in	29.9	-27.2	17.1	0.2	-15.9	6.4	7.8	-5.3	1.2	2.7	4.2	2.7	3.3
Government deposits	-5.7	-23.5	17.1	0.2	-15.7	9.8	11.4	-4.1	2.1	3.9	5.2	7.1	7.7
Claims on government	35.5	-3.7	0.0	0.1	-0.2	-3.4	-3.6	-1.2	-0.9	-1.2	-1.0	-4.4	-4.4
Credit from DAB (IMF accounts)	0.9	0.7	-0.2	-0.1	-0.3	-0.1	-0.7	-0.4	-0.1	-0.4	-0.2	-1.1	-1.1
Promissory note (- = repaymer	34.6	-4.4	0.2	0.2	0.2	-3.3	-2.9	-0.8	-0.8	-0.8	-0.8	-3.3	-3.3
Domestic debt (sukuk)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:													0.0
Promissory note (end-of-period stock	34.6	30.2	30.4	30.5	30.7	27.3	27.3	26.5	25.7	24.9	24.0	24.0	24.0
Propoor spending 4/	18.3	18.3	5.5	6.4	6.7	6.7	25.2	6.0	7.1	7.3	7.3	27.8	27.8

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

1/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan; NTM-A: NATO Training Mission - Afghanistan

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

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

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

5/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is closer aligned with the Gregorian calendar year.

Table 3b. Islamic Republic of Afghanistan: Central Government Budget, 2011–14

	2011 Year 5/ Act.	2012 Year 5/ Act.	2013 Q1 Act.	2013 Q2 Act.	2013 Q3 Act.	2013 Q4 Prel.	2013 FY Prel.	2014 Q1 Proj.	2014 Q2 Proj.	2014 Q3 Proj.	2014 Q4 Proj.	2014 FY Proj.	2014 Budget
Revenues and grants	21.3	25.2	2.7	5.2	8.2	7.6	23.7	4.6	7.0	7.0	9.7	28.2	28.5
Domestic revenues	11.0	10.1	1.9	2.2	2.4	2.9	9.5	2.1	2.4	2.3	3.5	10.3	10.3
Tax revenues	8.7	8.0	1.0	2.0	1.9	1.9	6.7	1.6	1.9	1.8	2.6	7.9	7.9
Income, profits, and capital gains	2.6	2.8	0.3	0.7	0.7	0.6	2.4	0.6	0.7	0.7	1.1	3.1	3.1
International trade and transaction	3.6	2.8	0.4	0.7	0.6	0.7	2.4	0.6	0.7	0.7	0.8	2.7	2.7
Goods and services	2.1	2.0	0.2	0.4	0.4	0.5	1.5	0.4	0.4	0.5	0.6	1.9	1.9
Other	0.4	0.3	0.1	0.1	0.1	0.1	0.5	0.1	0.1	0.1	0.1	0.3	0.3
Nontax revenues	2.3	2.2	1.0	0.2	0.5	1.0	2.8	0.5	0.6	0.5	0.8	2.4	2.4
Grants to operating budget 1/	7.4	10.4	0.1	2.4	4.5	3.0	10.0	2.0	3.3	3.6	4.5	13.4	13.7
ARTF	0.8	1.8	0.1	0.6	0.3	0.2	1.2	0.3	0.7	0.4	0.9	2.3	2.3
LOTFA	2.8	3.0	0.0	0.8	0.6	0.5	2.0	0.4	1.0	1.0	1.7	4.2	4.2
NTM-A	3.8	5.6	0.0	0.9	3.6	2.0	6.5	1.3	1.6	2.0	1.8	6.7	6.9
Other grants	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.1	0.1	0.3	0.3
Grants to development budget	2.9	4.7	0.6	0.7	1.2	1.7	4.2	0.5	1.2	1.1	1.7	4.5	4.5
Total expenditures	21.9	25.0	3.6	5.6	6.5	8.6	24.3	4.2	7.1	7.3	10.1	28.6	28.9
Operating expenditures	16.3	18.2	3.0	4.2	4.7	5.5	17.3	3.6	5.4	5.4	7.3	21.7	22.0
Of which: Security	…	…	…	…	…	…	11.2	…	…	…	…	14.2	14.5
Wages and salaries	12.5	12.9	2.5	3.0	3.3	3.4	12.1	2.2	3.2	3.0	3.9	12.3	12.3
Purchases of goods and services	2.7	3.5	0.3	0.7	0.9	1.4	3.3	0.9	1.6	1.8	2.6	6.9	7.2
Transfers, subsidies, and other	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2
Pensions	0.5	1.1	0.2	0.3	0.3	0.2	1.0	0.3	0.5	0.4	0.4	1.6	1.6
Capital expenditures	0.3	0.5	0.0	0.2	0.2	0.4	0.7	0.1	0.1	0.1	0.4	0.7	0.7
Interest	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1
Development expenditures	5.6	6.8	0.6	1.4	1.9	3.1	7.0	0.6	1.7	1.9	2.7	6.9	6.9
Operating balance excluding grants	-5.3	-8.1	-1.0	-2.0	-2.2	-2.6	-7.8	-1.5	-3.0	-3.1	-3.9	-11.4	-11.7
Overall budget balance including grants	-0.6	0.2	-0.9	-0.3	1.7	-1.0	-0.6	0.4	-0.1	-0.3	-0.4	-0.4	-0.4
less: Kabul Bank bailout cost	4.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Augmented overall budget balance	-5.0	0.4	-0.9	-0.3	1.7	-1.0	-0.6	0.4	-0.1	-0.3	-0.4	-0.4	-0.4
Float and discrepancy 2/	1.2	1.3	-0.6	0.3	-0.3	0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financing	3.9	-1.7	1.5	0.0	-1.3	0.6	0.8	-0.4	0.1	0.3	0.4	0.4	0.4
Sale of nonfinancial assets 3/	0.1	0.6	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)	0.2	0.3	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.1	0.2	0.2
Domestic (net)	3.6	-2.6	1.5	0.0	-1.4	0.6	0.7	-0.4	0.1	0.2	0.3	0.2	0.3
Central bank, change in	3.6	-2.6	1.5	0.0	-1.4	0.6	0.7	-0.4	0.1	0.2	0.3	0.2	0.3
Government deposits	-0.7	-2.3	1.5	0.0	-1.4	0.9	1.0	-0.3	0.2	0.3	0.4	0.6	0.6
Claims on government	4.2	-0.4	0.0	0.0	0.0	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4
Credit from DAB (IMF accounts)	0.1	0.1	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	-0.1	-0.1
Promissory note (- = repaymen	4.1	-0.4	0.0	0.0	0.0	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1	-0.3	-0.3
Domestic debt (sukuk)	…	…	…	…	…	…	…	…	…	…	…	…	…
Memorandum items:													0.0
Promissory note (end-of-period stock	4.1	2.9	2.6	2.7	2.7	2.4	2.4	2.1	2.1	2.0	1.9	1.9	1.9
Propoor spending 4/	2.2	1.8	0.5	0.6	0.6	0.6	2.2	0.5	0.6	0.6	0.6	pending	pending

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

1/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan; NTM-A: NATO Training Mission - Afghanistan

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

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

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

5/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is closer aligned with the Gregorian calendar year.

Table 4a. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2011–14

(At current exchange rates)

	2011	2012	2013				2014			
	Dec. 21	Dec. 20	Mar. 20	June 21	Sep. 22	Dec. 21	Mar. 20	June 21	Sep. 22	Dec. 21
	Act.	Act.	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.
	(In billions of Afghanis, unless otherwise indicated)									
Net foreign assets	296.2	352.7	342.3	353.4	388.7	382.5	382.5	389.6	397.5	408.3
Foreign assets	314.6	373.1	362.4	374.6	410.3	403.8	403.5	410.6	418.2	428.9
Foreign exchange reserves 1/	305.1	358.0	347.0	360.4	396.0	390.0	388.7	395.6	402.9	413.2
Other foreign assets	9.5	15.0	15.4	14.2	14.2	13.8	14.7	15.0	15.3	15.8
Foreign liabilities	-18.4	-20.4	-20.1	-21.1	-21.6	-21.2	-21.0	-21.0	-20.7	-20.7
Net domestic assets	-126.0	-175.9	-174.3	-178.0	-205.1	-183.8	-183.7	-189.6	-189.3	-184.3
Domestic assets	-64.0	-103.0	-91.6	-92.5	-105.9	-103.5	-83.1	-86.5	-83.6	-76.0
Net claims on government	-23.4	-53.9	-38.9	-41.3	-58.5	-51.5	-56.7	-55.4	-52.6	-48.3
Gross claims on government	53.1	50.5	50.4	51.6	52.2	48.5	47.4	46.7	45.6	44.7
Of which: MoF promissory note 2/	34.6	30.2	30.4	30.5	30.7	27.3	26.5	25.7	24.9	24.0
Domestic currency deposits	-8.7	-17.3	-6.9	-15.7	-21.1	-18.0	-5.0	-5.2	-6.0	-7.5
Foreign currency deposits 1/	-67.8	-87.1	-82.4	-77.2	-89.6	-82.0	-99.1	-96.8	-92.2	-85.5
Other claims	-40.5	-49.0	-52.7	-51.2	-47.4	-52.0	-26.4	-31.1	-31.0	-27.7
Other items net	-62.0	-72.9	-82.7	-85.5	-99.1	-80.3	-100.6	-103.2	-105.7	-108.2
Reserve money	170.1	176.8	168.0	175.5	183.7	198.8	198.8	200.0	208.2	224.0
Currency in circulation	148.4	150.0	144.2	150.3	158.1	168.8	168.8	169.9	176.8	190.2
Bank deposits (Afghani denominated)	21.8	26.8	23.8	25.1	25.5	30.0	30.0	30.2	31.4	33.8
Memorandum items:										
International reserves, in millions of U.S. dollars										
Net	5,858	6,472	5,992	5,936	6,470	6,382	6,408	6,483	6,558	6,633
Gross	6,208	6,867	6,483	6,430	6,908	6,886	6,817	6,890	6,970	7,099
Interest rate, 28-day capital notes (percent)	2.1	2.0	2.0	2.5	3.2	3.4	...	...	...	...
Exchange rate (Afghanis per U.S. dollar)	49.2	52.1	53.5	56.0	57.3	56.6	...	...	...	...

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

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

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.

Table 4b. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2011–14

(At program exchange rates)[1/]

	2011	2012	2013					2014			
	Dec. 21	Dec. 20	Mar. 20	June 21	Sep. 22	Dec. 21		Mar. 20	June 21	Sep. 22	Dec. 21
	Act.	Act.	Act.	Act.	Act.	Prog. 2/	Act.	Proj.	Proj.	Proj.	Proj.
	(In billions of Afghanis, unless otherwise indicated)										
Net foreign assets	317.3	352.7	338.2	343.9	365.5	351.5	367.5	365.0	369.1	373.8	381.0
Foreign assets	336.9	373.1	358.4	363.9	385.2	374.0	387.2	384.3	388.3	392.6	399.6
Foreign exchange reserves 3/	326.9	358.0	343.3	350.7	372.3	359.5	374.5	370.9	374.7	378.8	385.5
Other foreign assets	10.0	15.0	15.0	13.2	12.9	14.6	12.7	13.4	13.6	13.8	14.1
Foreign liabilities	-19.6	-20.4	-20.1	-20.1	-19.8	-22.6	-19.7	-19.3	-19.2	-18.8	-18.7
Net domestic assets	-147.2	-175.9	-170.2	-168.4	-181.8	-160.2	-168.8	-166.2	-169.1	-165.6	-157.0
Domestic assets	-67.7	-103.0	-89.4	-87.0	-98.0	-71.9	-96.8	-82.5	-85.9	-82.9	-74.9
Net claims on government	-26.5	-53.9	-37.0	-37.2	-52.2	-45.8	-46.5	-57.6	-56.3	-53.6	-49.3
Gross claims on government	54.2	50.5	50.5	50.5	50.4	47.9	47.0	45.8	44.9	43.7	42.7
Of which: MoF promissory note 4/	34.6	30.2	30.4	30.5	30.7	25.4	27.3	26.5	25.7	24.9	24.0
Domestic currency deposits	-8.7	-17.3	-6.9	-15.7	-21.1	-14.6	-18.0	-5.0	-5.2	-6.0	-7.5
Foreign currency deposits 3/	-72.0	-87.1	-80.6	-72.1	-81.5	-79.1	-75.5	-98.3	-96.0	-91.2	-84.5
Other claims	-41.2	-49.0	-52.3	-49.8	-45.8	-26.1	-50.3	-25.0	-29.6	-29.3	-25.6
Other items net	-79.5	-72.9	-80.8	-81.4	-83.8	-88.4	-71.9	-83.7	-83.2	-82.7	-82.1
Reserve money	170.1	176.8	168.0	175.5	183.7	191.2	198.8	198.8	200.0	208.2	224.0
Currency in circulation	148.4	150.0	144.2	150.3	158.1	162.3	168.8	168.8	169.9	176.8	190.2
Bank deposits (Afghani denominated)	21.8	26.8	23.8	25.1	25.5	28.9	30.0	30.0	30.2	31.4	33.8
Memorandum items:											
Net international reserves											
(At program rates, in millions of U.S. dollar	5,919	6,472	6,089	6,229	6,702	6,272	6,679	6,704	6,779	6,854	6,929
Money growth (year-on-year, in percent)											
Reserve money	21.9	3.9	-4.2	4.0	7.1	8.0	12.4	18.3	14.0	13.4	12.7
Currency in circulation	20.8	1.1	-2.7	4.5	4.9	8.0	12.5	17.0	13.0	11.8	12.7

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

1/ Program exchange rates as of Dec. 20, 2012 applied to evaluate foreign currency-denominated components. The Afghani per U.S. dollar rate used is 52.1390.

2/ Under the May 2013 agreement. Program figures are unadjusted (see Table 7b for the adjusted targets).

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

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

Table 5. Islamic Republic of Afghanistan: Monetary Survey, 2008–14[1/]

	2008 Act.	2009 Act.	2010 Act.	2011 Act.	2012 Act.	2013 Proj.	2014 Proj.
			(In billions of Afghanis)				
Net foreign assets	168.5	217.5	254.4	348.9	425.7	466.3	502.9
Foreign assets	188.3	250.2	285.3	381.7	456.1	498.5	536.0
Central bank	157.4	207.8	233.1	314.6	373.1	403.8	428.9
Commercial banks	30.8	42.4	52.3	67.1	83.0	94.7	107.0
Foreign liabilities	-19.8	-32.6	-30.9	-32.8	-30.3	-32.2	-33.1
Central bank	-6.9	-17.2	-16.0	-18.4	-20.4	-21.2	-20.7
Commercial banks	-12.9	-15.4	-14.9	-14.4	-10.0	-11.0	-12.4
Net domestic assets	-16.5	-15.3	2.3	-37.5	-86.9	-87.1	-76.7
Net domestic credit	22.1	22.1	30.0	15.3	-13.2	-5.5	1.1
Nonfinancial public sector	-23.7	-39.5	-51.0	-24.8	-55.1	-52.7	-49.5
Central bank	-25.1	-37.2	-49.0	-23.5	-53.9	-51.5	-48.3
Commercial banks	1.4	-2.2	-2.0	-1.4	-1.1	-1.2	-1.2
Private sector	45.8	61.5	81.0	40.1	41.8	47.2	50.6
Other items net	-38.6	-37.4	-27.7	-52.7	-73.7	-81.5	-77.8
Broad money M2	152.0	202.2	256.7	311.4	338.8	379.2	426.2
Narrow money M1	147.4	192.2	240.3	290.7	319.2	355.0	399.1
Currency outside banks	70.1	85.9	116.9	141.2	142.8	162.2	182.8
Currency in circulation	72.8	89.8	122.8	148.4	150.0	168.8	190.2
Currency held by banks	2.7	3.9	5.9	7.1	7.2	6.6	7.4
Demand deposits	77.3	106.3	123.4	149.5	176.4	192.8	216.3
Other deposits	4.6	10.1	16.5	20.7	19.7	24.2	27.1
			(12-month percentage change)				
M2	31.4	33.0	26.9	21.3	8.8	11.9	12.4
M1	31.9	30.3	25.0	21.0	9.8	11.2	12.4
Currency outside banks	22.6	22.5	36.0	20.8	1.1	13.6	12.7
Net credit to the private sector 2/	37.9	41.1	34.9	-51.9	-0.2	3.0	5.0
			(In percent of GDP)				
M2	29.4	33.3	36.1	37.2	32.8	33.0	34.1
M1	28.5	31.6	33.8	34.8	30.9	30.9	32.0
Memorandum items:							
M2 velocity	3.4	3.0	2.8	2.7	3.1	3.0	2.9
Reserve money multiplier	1.7	1.8	1.8	1.8	1.9	1.9	1.9
Banking sector							
Loan dollarization (percent)	75.1	71.9	49.4	74.9	75.4	78.2	78.2
Deposit dollarization (percent)	78.6	76.4	69.8	67.9	71.4	72.8	72.8
Currency-to-deposit ratio (percer	89.0	77.2	87.8	87.2	76.5	77.8	78.2
Loans-to-deposit ratio (percent)	55.9	52.9	58.0	23.6	21.3	21.7	20.8

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, w hile commercial banks use the Gregorian calendar.

[2] At program rates, (i.e., excluding valuation changes of the foreign exchange component). The decline in 2011 reflects a w rite-dow n of bad loans at Kabul Bank.

Table 6. Islamic Republic of Afghanistan: Balance of Payments, 2011–14[1/]

	2011 Est.	2012 Est.	2013 Est.	2014 Proj.
	(In millions of U.S. dollars, unless otherwise indicated)			
Export of goods and services	3,090	3,223	3,288	3,112
Goods	2,684	2,757	2,614	2,408
Services	405	465	674	704
Import of goods and services	11,092	12,315	11,970	11,688
Goods	10,220	11,366	11,117	10,884
Services	873	949	853	804
Income, net	83	101	141	151
Of which: Interest on official loans	12	7	4	5
Current transfers, net	8,482	9,789	9,132	9,149
Of which: Official	8,097	9,378	9,008	9,012
Current account	562	798	591	725
Excluding official grants	-7,535	-8,580	-8,417	-8,287
Financial account, net	236	-320	-119	-492
Foreign direct investment	369	409	142	260
Portfolio investment	0	0	0	0
Official loans 2/	27	59	67	20
Other investment	-160	-789	-328	-772
Errors and omissions	219	116	-144	0
Overall balance	1,017	590	328	232
Financing	-1,017	-590	-328	-232
Central bank's gross reserves ('-' = accumulation)	-1,036	-605	-316	-213
Use of Fund resources, net	19	14	-13	-20
Financing gap	0.0	0.0	0.0	0.0
Memorandum items:				
Gross international reserves, central bank	6,208	6,867	6,886	7,099
Import coverage of reserves 4/	6.0	6.9	7.1	7.2
External debt stock, official 3/	1,242	1,317	1,268	1,287
in percent of GDP	6.9	6.5	6.1	5.9
Trade balance	-7,535	-8,609	-8,503	-8,476
in percent of GDP	-42.1	-42.4	-41.0	-39.0
Current account, in percent of GDP	3.1	3.9	2.8	3.3

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

1/ Excluding the narcotics economy.
2/ Excluding IMF.
3/ Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.
4/ In months of next year's import of goods and services.

Table 7. Islamic Republic of Afghanistan: External Financing Requirement and Sources, 2010–14

	2011 Est.	2012 Est.	2013 Est.	2014 Proj.
	(In millions of U.S. dollars)			
Gross financing requirement	8,572	9,194	8,764	8,549
Current account balance (excluding grants)	-7,535	-8,580	-8,417	-8,287
Amortization	2	6	19	29
Of which: IMF	0	4	13	20
Prepayment of debt	0	0	0	0
Change in reserves (increase = +)	1,036	605	316	213
Reduction in arrears	0	0	0	0
Available financing	8,572	9,194	8,764	8,549
Official transfers (grants)	8,097	9,378	9,008	9,012
Foreign direct investment	369	409	142	260
Short-term private financing flows				
Official medium- and long-term loans	29	61	86	50
Accumulation of arrears	0	0	0	0
IMF disbursements	19	18	0	0
Other flows	59	-673	-471	-772
Financing gap	0	0	0	0

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

Table 8a. Islamic Republic of Afghanistan: Quantitative Targets, 2012–13[1/]

	Mar. 19, 2012	Fiscal Year 2012 (interim, 9-months fiscal year)												Dec. 20	Fiscal Year 2013							
		June 20, 2012				Sep. 21, 2012				Dec. 20, 2012				2012	Mar. 20, 2013				June 21, 2013			
	Stocks	Indicative targets				Performance criteria				Performance criteria				Stocks	Indicative targets				Performance criteria			
		Prog.	Adj.	Act.		Prog.	Adj.	Act.		Prog.	Adj.	Act.			Prog.	Adj.	Act.		Prog.	Adj.	Act.	
	(In billions of Afghanis, unless otherwise indicated)																					
Revenues (floor)	...	23.8	...	22.9	×	50.4	...	48.6	×	85.1	...	76.4	×	...	28.2	...	22.3	×	59.7	...	47.9	×
Operating budget deficit, excluding grants (indicative target: ceiling)	...	10.1	10.1	8.0	✓	29.2	29.7	26.8	✓	45.3	46.3	60.1	×	...	16.0	16.0	11.7	✓	33.9	33.9	34.2	×
Net credit to government from DAB (ceiling)	-21.2	-9.5	-16.1	-5.3	×	-7.7	-17.7	-11.8	×	-4.8	-37.4	-24.0	×	-45.1	-2.2	23.4	16.1	✓	-1.3	24.8	14.8	✓
Reserve money (ceiling)	175.3	-4.0	...	-6.5	✓	9.8	...	-3.9	✓	26.7	...	1.5	✓	176.8	0.0	...	-8.8	✓	8.9	...	-1.3	✓
Currency in circulation (indicative target: ceiling)	148.2	1.5	...	-4.3	✓	18.6	...	2.5	✓	28.0	...	1.8	✓	150.0	3.5	...	-5.8	✓	13.9	...	0.3	✓
Social and other priority spending (indicative target: floor)	...	4.8	...	4.0	×	12.2	...	11.8	×	18.3	...	18.3	✓	...	6.0	...	5.5	×	12.0	...	11.9	×
International reserves of DAB (floor; in millions of U.S. dollars)	5,764	117	262	272	✓	434	654	379	×	550	1,268	576	×	6,340	137	-377	-382	×	275	-254	-241	✓
Nonconcessional external debt, new (ceiling) 2/	...	0.0	...	0.0	✓	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	✓	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	✓	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	✓	0.0	...	0.0	✓
Reference values for the adjustors			Diff.				Diff.				Diff.					Diff.				Diff.		
Core budget development spending	...	4.2	3.4	7.6		23.9	3.0	26.9		49.7	3.7	53.4		...	15.9	-8.8	7.1		33.7	-10.7	23.0	
External financing of the core budget and sale of nonfinancial assets	...	22.8	10.9	33.7		58.7	16.0	74.8		96.2	39.0	135.3		...	33.8	-25.4	8.4		67.8	-24.7	43.0	
Externally financed expenditures transferred to the core operating budge	...	0.0	0.0	0.0		0.0	0.5	0.5		0.0	1.0	1.0		...	0.0	0.0	0.0		0.0	0.0	0.0	
Asset recovery from banking sector institutions in liquidation	...	0.9	-0.9	0.0		2.5	-2.5	0.0		3.8	-1.8	2.0		...	0.6	-0.6	0.0		1.3	-1.3	0.0	
Recapitalization, net of dividend, and revaluation of MoF's promissory no	...	0.0	0.0	0.0		0.0	0.0	0.0		0.0	0.0	0.0		...	0.0	0.0	0.0		0.0	0.0	0.0	

Source: Afghan authorities.

1/ The performance criteria, indicative targets, their adjustors, and program exchange rates were set at the first review of the ECF supported program in June 2012 and are defined in the Technical Memorandum of Understanding (TMU) of June 18, 2012. (see IMF Country Report No. 12/245). Per the TMU, program exchange rates of March 20, 2011 are used.

2/ These performance criteria apply on a continuous basis.

Table 8b. Islamic Republic of Afghanistan: Quantitative Targets, 2013[1/]

	Dec. 20, 2012	Fiscal Year 2013											
		June 21, 2013				Sep. 22, 2013				Dec. 21, 2013			
	Stocks	Informal targets 1/			Status	Informal targets 1/			Status	Informal targets 1/			Status
		Prog.	Adj.	Act.		Prog.	Adj.	Act.		Prog.	Adj.	Act.	
	(In billions of Afghanis, unless otherwise indicated)												
Revenues (floor)	...	50.6	...	47.9	×	80.9	...	75.6	×	114.1	...	109.0	×
Operating budget deficit, excluding grants (indicative target: ceiling)	...	41.0	41.0	34.2	✓	67.9	67.9	60.0	✓	117.3	117.3	89.5	✓
Net credit to government from DAB (ceiling)	-53.9	9.8	25.0	16.8	✓	9.1	6.5	1.7	✓	8.2	33.1	7.4	✓
Reserve money (ceiling)	176.8	4.1	...	-1.3	✓	8.6	...	6.9	✓	14.2	...	22.0	×
Currency in circulation (indicative target: ceiling)	150.0	3.4	...	0.3	✓	9.0	...	8.1	✓	12.0	...	18.8	×
Social and other priority spending (indicative target: floor)	...	12.6	...	11.9	×	18.9	...	18.6	×	25.2	...	25.2	✓
International reserves of DAB (floor; in millions of U.S. dollars)	6,472	-149	-442	-242	✓	-174	-124	230	✓	-200	-678	207	✓
Nonconcessional external debt, new (ceiling) 2/	...	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	✓
External payments arrears, new (ceiling) 2/	...	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	✓
Reference values for the adjustors			Diff.				Diff.				Diff.		
Core budget development spending	...	27.3	-4.3	23.0		48.7	-4.3	44.4		79.7	0.7	80.4	
External financing of the core budget and sale of nonfinancial assets	...	57.7	-14.7	43.0		105.9	3.9	109.8		186.6	-22.3	164.3	
Externally financed expenditures transferred to the core operating budge	...	0.0	0.0	0.0		0.0	0.0	0.0		0.0	0.0	0.0	
Asset recovery from banking sector institutions in liquidation		0.6	-0.6	0.0		1.3	-1.3	0.0		1.9	-1.9	0.0	
Recapitalization, net of dividend, and revaluation of MoF's promissory note		0.0	0.0	0.0		0.0	0.0	0.0		0.0	0.0	0.0	

Source: Afghan authorities.

1/ These targets are part of the informal track record agreed during a staff visit in May 2013 and have not been set by the IMF Executive Board.
2/ These targets apply on a continuous basis.

Table 9. Islamic Republic of Afghanistan: Status of Agreed Structural Benchmarks

Measure	Date	Status as of March 30, 2014
The economic committee of the cabinet will approve the privatization plan for New Kabul Bank prepared by the privatization advisor in consultation with Fund staff. The plan includes clear criteria for bidders, precise determination of what is being sold, the procedures for sale, and public communication strategy.	End-August 2012	Completed in August 2012.
The bridge bank (New Kabul Bank) will be offered for sale in a transparent way, involving a pre-qualification process to ensure that controlling shareholders, beneficial owners, directors and management of intending bidders are fit and proper (which implies, inter alia, that an intending bidder is subject to a high standard of corporate governance, including risk management and internal controls, and that an intending bidder is in a sound financial and risk management state), and that the intending bidder controls adequate resources and has the necessary capacity and capability to ensure the ongoing provision of the relevant salary payments services. There will be a request for expressions of interest locally and internationally for the sale of the bridge bank. Interested parties will be given four weeks to respond with intention to participate in the bid. Once the central bank has vetted potential buyers, the ministry of finance will give them a deadline for sealed bids.	End-September 2012	Completed in September 2012.
The independent Monitoring and Evaluation Commission will conduct an ***in-depth public inquiry*** to examine the events leading to the Kabul Bank crisis, starting with the inception of the bank, and look into the operations of the bank, activities of its shareholders, the role of supervisory and auditing bodies, and the subsequent effectiveness of the government and the criminal justice system in dealing with any crimes committed.	End-September 2012	Completed in November 2012.
Submit to parliament the ***amended or new banking law***, prepared in consultation with the Fund that will strengthen provisions on corporate governance, capital, large exposures, related parties, consolidated supervision, early intervention, enforcement, and bank resolution, where appropriate in line with the Basel Core Principles. Specifically, the law should enable us to enforce upon a bank—going concern—all necessary resolution measures and strengthen corporate governance requirements for banks (including fit and proper requirements as set by the Financial Action Task Force standards).	End-September 2012	Completed in February 2013.

Table 9. Islamic Republic of Afghanistan: Status of Agreed Structural Benchmarks (Continued)

Measure	Date	Status as of March 30, 2014
Strengthen our AML/CFT regime by implementing an action plan based on the recommendations of the February 2011 assessment by: (i) submitting amendments to the AML/CFT law to parliament as necessary; (ii) increasing the capacity of FinTRACA, including by hiring additional staff as needed; (iii) expanding MSP registration and implementation of reporting to MSPs in areas currently inaccessible for security reasons if and when the security situation allows; and (iv) enforcing MSP reporting by dedicated software in all reporting areas where it is technically and logistically feasible.	End-September 2012	Partially met. Item (i) to be completed and items (ii)–(iv) completed.
Submit legislation to the ministry of justice ("Taqnin") for review with a view to submitting it to parliament by end-March 2013 ***for the introduction of marketable debt instruments*** by the ministry of finance.	End-September 2012	Completed in September 2012.
The Supreme Council of Da Afghanistan Bank to approve ***strategies for banks that fall short of the minimum paid-up capital*** to be merged or closed, with the process starting no later than December 2012.	End-September 2012	Completed in March 2013.
Following the approval by the cabinet ***submit draft law on VAT to the parliament***. The draft legislation will be prepared in consultation with Fund staff, limit exemptions, and require that new exemptions be introduced only through parliamentary approval in the VAT law.	End-December 2012	Completed in May 2013.
The Afghanistan Revenue Department within the ministry of finance to ***identify taxpayers*** in the medium taxpayer office and the small taxpayer office whose turnover exceeds the large taxpayer office threshold and revisit the thresholds for the large taxpayer office and the medium taxpayer office with a view to having an efficient allocation of taxpayers across the three offices. The findings and actions to be summarized in a report.	End-December 2012	Completed in January 2013.
Submit to the ministry of justice ("Taqnin") legislation bringing ***state-owned corporations*** under effective monitoring and oversight of the ministry of finance, including financial reporting to the ministry of finance and ministry of finance approving financial plans on an annual basis. The draft legislation will be prepared in consultation with Fund staff.	End-December 2012	Completed in January 2013.
Approval by the Supreme Council of Da Afghanistan Bank of the ***new organizational structure of the Financial Supervision Department*** developed in consultation with Fund staff.	End-December 2012	Completed in November 2012.

Table 9. Islamic Republic of Afghanistan: Status of Agreed Structural Benchmarks (Continued)

Measure	Date	Status as of March 30, 2014
Revise central bank regulations as well as prepare and issue informational circulars to ensure consistency with the revised banking law.	End-December 2012	Completed in December 2012.
Establish a senior official-led interagency steering committee (***Economic Crimes Task Force***) to oversee the passage and implementation of the new banking law, the anti-money laundering and terrorist financing laws and their provisions, and to function as a coordinating body for the implementation of the Economic Crimes Strategy and its action items.	End-March 2013	Completed in February 2013.
Submit to the ministry of justice ("Taqnin") amendments to the income tax law, minerals law, oil and gas (hydrocarbons) law and customs code—developed in consultation with Fund staff—related to the development of a sound and robust ***natural resources fiscal regime*** to attract investment and ensure the government has a reasonable share of the economic rent.	End-June 2013	2013 FAD TA concluded the regime is reasonably comprehensive and recommended a few changes.
Sign a ***memorandum of understanding between Financial Transactions and Reports Analysis Center of Afghanistan, the Financial Supervision Department of DAB, and competent law enforcement authorities*** on information sharing as described in the June 2012 MEFP.	End-June 2013	Completed in January 2014.
In the context of DAB's Financial Supervision Department's (FSD) new organizational structure, approved in November 2011, DAB's supreme council approves ***FSD's five-year strategic plan for the development and strengthening of the financial sector***, prepared in consultation with Fund staff.	End-June 2013[1]	Completed on July 2, 2013.
The Ministry of Finance will finalize a fully developed plan for the implementation of the VAT, based on the IMF FAD technical assistance report of January 2012. This plan will include comprehensive details on the following elements: (a) key tasks and milestone dates for system and procedural development, staff recruitment (if any) and training; (b) an implementation governance structure, including steering committee responsibilities; (c) a change management strategy including specific change management plans for the key elements of implementation; (d) a stakeholder management strategy, including taxpayer preparation; (e) an initial compliance strategy to address the implementation risks identified for the first 12 months of operation of the new tax; (f) resources for the implementation of a public campaign of information targeting private sector and cabinet officials, as well as Wolesi Jirga's budget and economic committees; and (g) any additional resourcing requirements for the VAT implementation including additional implementation budget for the VAT.	End-June 2013[1]	Completed in June 2013.

Table 9. Islamic Republic of Afghanistan: Status of Agreed Structural Benchmarks (Continued)

Measure	Date	Status as of March 30, 2014
Rationalization of border control agencies. ***Border Management Model (BMM) roll out to three of the four suggested additional Border Crossing Points (Aquina, Torkham, Weesh, Zaranj)***, the BMM, which has been already implemented at Hairatan, Islam Q'ala and Sher Khan Bandar Border Crossing Points. The Government of Afghanistan will: (i) extend the border management model (BMM) to three of the four following additional border points (Torkham, Aquina, Zaranj, Weesh) the BMM is based on a "two-agency" approach that ensures that all border control responsibilities are restricted to the Afghan Border Police (ABP) and the Afghan Customs Department (ACD). Under this model, the ABP will continue to fulfill immigration and security responsibilities, with ACD fulfilling all other commercial and trade-related duties; and (ii) the pilot border management model at Hairatan will be applied fully to the Hairatan railway border crossing. The ABP and the ACD will take full control of all railway border crossings and the ministry of commerce and industry will only provide logistical services at their facilities (Bandarwali).	End-June 2013[1]	Completed. The BMM roll-out to Aquina, Torkham and Weesh was completed in August 2013; and an agreement was signed between the ministries of finance and commerce and industry to apply the BMM model to railway border crossings.
Submit draft law on Tax Administration to the parliament. The draft legislation will contain administrative provisions (rights and obligations of taxpayers, filing tax returns, taxation decisions, appeals procedures, and penalties) and be prepared in consultation with Fund staff.	End-September 2013[1]	Submitted to parliament in December 2013.
Submit to parliament amendments to the central bank legislation—drafted in consultation with Fund staff—implementing the memorandum of understanding on the central bank's capitalization, that aligns the provisions on the netting and allocation of net income with international good practice.	End-December 2013[1]	Not met. Draft legislation is being reviewed by the ministry of justice.
Improve the collection, processing, and dissemination of valuation information based on the recommendations from the December 2012 FAD technical assistance mission, international valuation standards and best practices. (i) staff the HQ valuation unit adequately with trained and dedicated managers and officers; (ii) eliminate malpractices in the valuation process before, at and after the submission of customs declaration forms; (iii) ensure the upgraded valuation database will easily plug into and support the current and future customs declaration processing and risk management systems; (iv) ensure the integrity of the valuation system and processes; (v) start with the motors vehicle and the top 200 other goods categories that give about 85 percent of all imports into Afghanistan.	End-December 2013[1]	Completed.

Table 9. Islamic Republic of Afghanistan: Status of Agreed Structural Benchmarks (Concluded)

Measure	Date	Status as of March 30, 2014
The Economic Crimes Task Force advises the Criminal Law Review Working Group (CLRWG) of categories of ***economic offences to be included in the new consolidated penal code***. Categories of economic offences shall include those designated categories of offenses as set out in the revised Financial Action Task Force's 40 Recommendation and all other complex economic crimes as defined in the "Road-Map to Combat Economic Crime in Afghanistan" (National Priority Program 5, "And Justice for All," Sub-program 4) of the Afghan National Development Strategy.	End-December 2013[1]	The authorities have indicated the benchmark was met and staff has requested information to confirm.
Supreme council of DAB to approve and promulgate ***policies, guidelines and procedures reflecting provisions under the DAB and banking laws to inform DAB supervisory staff about their duties, functions, and protections from liability available under the DAB and banking laws and the duties of DAB management to protect them***. The policies, guidelines and procedures should also refer to the provisions in law reflecting the independence of the DAB.	End-December 2013[1]	Partially met. Policy approved in December 2013, but it needs some strengthening and to be made consistent with Afghan laws. A revised policy is scheduled to be submitted to the DAB Supreme Council in June 2014.
Complete ***transfer of taxpayers from the medium and small taxpayer offices to the large taxpayer office for taxpayers whose turnover exceeds the threshold for the large taxpayer office***. The findings and actions to be summarized in a report.	End-December 2013[1]	The authorities have indicated the benchmark was met and staff has requested information to confirm.
Line ministries to submit their financial plans for 2014 to the ministry of finance.	End-December 2013[1]	Completed in March 2014.

[1] These benchmark are targets are part of the informal track record agreed during a staff visit in May 2013 and have not been set by the IMF Executive Board. The other benchmarks have been set by the IMF Executive Board at the first review of the ECF in June 2012.

Table 10. Islamic Republic of Afghanistan: Millennium Development Goals

	1990	1995	2000	2005	2011	2012
Goal 1: Eradicate extreme poverty and hunger						
Employment to population ratio, 15+, total (%)	…	44.3	43.6	43.8	43.9	43.8
Employment to population ratio, ages 15-24, total (%)	…	32.1	30.7	30.3	30.3	30.2
GDP per person employed (constant 1990 PPP $)	…	…	…	…	…	…
Income share held by lowest 20%	…	…	…	…	…	…
Malnutrition prevalence, weight for age (% of children under 5)	…	…	…	…	…	…
Poverty gap at $1.25 a day (PPP) (%)	…	…	…	…	…	…
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	…	…	…	…	…	…
Vulnerable employment, total (% of total employment)	…	…	…	…	…	…
Goal 2: Achieve universal primary education						
Literacy rate, youth female (% of females ages 15-24)	…	…	…	…	…	…
Literacy rate, youth male (% of males ages 15-24)	…	…	…	…	…	…
Persistence to last grade of primary, total (% of cohort)	…	87.8	…	…	…	…
Primary completion rate, total (% of relevant age group)	…	28.8	…	…	…	…
Adjusted net enrollment rate, primary (% of primary school age children)	…	28.0	…	…	…	…
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliaments (%)	…	…	…	27.3	27.7	27.7
Ratio of female to male primary enrollment (%)	55.2	49.5	…	57.8	71.1	…
Ratio of female to male secondary enrollment (%)	…	36.3	…	31.7	54.9	…
Ratio of female to male tertiary enrollment (%)	48.6	…	…	…	33.2	…
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	…	…	…	25.9	…	…
Goal 4: Reduce child mortality						
Immunization, measles (% of children ages 12-23 months)	20.0	41.0	27.0	50.0	65.0	68.0
Mortality rate, infant (per 1,000 live births)	119.5	102.2	93.5	83.2	72.7	71.0
Mortality rate, under-5 (per 1,000 live births)	176.2	147.9	133.9	117.7	101.2	98.5
Goal 5: Improve maternal health						
Adolescent fertility rate (births per 1,000 women ages 15-19)	167.5	169.5	158.3	130.7	93.0	…
Births attended by skilled health staff (% of total)	…	…	12.4	…	38.6	…
Contraceptive prevalence (% of women ages 15-49)	…	…	4.9	13.6	21.2	…
Maternal mortality ratio (modeled estimate, per 100,000 live births)	1300.0	1300.0	1000.0	710.0	…	…
Pregnant women receiving prenatal care (%)	…	…	36.9	…	47.9	…
Unmet need for contraception (% of married women ages 15-49)	…	…	…	…	…	…
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	…	…	…	…	…	…
Condom use, population ages 15-24, female (% of females ages 15-24)	…	…	…	…	…	…
Condom use, population ages 15-24, male (% of males ages 15-24)	…	…	…	…	…	…
Incidence of tuberculosis (per 100,000 people)	189.0	189.0	189.0	189.0	189.0	189.0
Prevalence of HIV, female (% ages 15-24)	…	…	…	…	…	0.1
Prevalence of HIV, male (% ages 15-24)	…	…	…	…	…	0.1
Prevalence of HIV, total (% of population ages 15-49)	0.1	0.1	0.1	0.1	0.1	0.1
Tuberculosis case detection rate (%, all forms)	20.0	…	18.0	46.0	51.0	52.0
Goal 7: Ensure environmental sustainability						
CO2 emissions (kg per PPP $ of GDP)	…	…	…	0.0	…	…
CO2 emissions (metric tons per capita)	0.2	0.1	0.0	0.0	…	…
Forest area (% of land area)	2.1	2.1	2.1	2.1	2.1	…
Improved sanitation facilities (% of population with access)	…	21.0	23.2	25.5	28.5	…
Improved water source (% of population with access)	…	4.9	22.1	39.5	60.6	…
Marine protected areas (% of territorial waters)	0.2	…	1.0	…	…	2.4
Net ODA received per capita (current US$)	10.4	12.1	6.6	114.1	230.6	…
Goal 8: Develop a global partnership for development						
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	…	…	…	0.5	0.4	…
Internet users (per 100 people)	…	…	…	1.2	5.0	5.5
Mobile cellular subscriptions (per 100 people)	…	…	…	4.3	54.3	53.9
Telephone lines (per 100 people)	0.3	0.1	0.1	…	0.0	0.0
Fertility rate, total (births per woman)	7.7	7.8	7.7	6.9	5.4	…
Other						
GNI per capita, Atlas method (current US$)	…	…	…	250.0	570.0	680.0
GNI, Atlas method (current US$) (billions)	…	…	…	6.1	16.5	20.4
Gross capital formation (% of GDP)	…	…	…	21.6	16.6	16.8
Life expectancy at birth, total (years)	48.6	52.4	54.8	57.1	60.1	…
Literacy rate, adult total (% of people ages 15 and above)	…	…	…	…	…	…
Population, total (millions)	11.7	17.6	20.6	24.9	29.1	29.8
Trade (% of GDP)	…	…	…	104.9	50.3	44.7

Source: World Bank, World Development Indicators.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 23, 2014

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 February 28, 2014)

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	113.22	72.90

Outstanding Purchases and Loans

	SDR Million	Percent
Quota		
ECF Arrangements	83.90	51.82

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

[1] Formerly PRGF.

Projected Payments to Fund[1]
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2014	**2015**	**2016**	**2017**	**2018**
Principal	8.10	14.51	15.07	15.02	11.58
Charges/Interest	0.04	0.22	0.18	0.14	0.11
Total	**8.14**	**14.72**	**15.25**	**15.16**	**11.69**

[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, an 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, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, discriminatory currency arrangements or multiple currency practices. Staff is currently undertaking a review of government policies in the context of Afghanistan's future accession to Article VIII status. The authorities informed staff that no exchange restrictions imposed for security reasons were in place.

To conduct monetary policy, the authorities rely on 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 November 14, 2011. 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. The 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.

Technical Assistance, 2011–14

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 (various TA topics)
	April 6–14, 2012	Follow-up mission to review PFM Roadmap
	November 2April 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

Department	Dates	Purpose
	September 26–October 4, 2013	Reform of the Fiscal Regimes for the Extractive Industries
LEG	September 21–26, 2013	Diagnostic Review of AML/CFT regime
MCD	August 29, 2011–present	Resident monetary policy and banking advisor
MCM	February 7–14, 2011	Banking crisis management (with MCD)
	July 24–27, 2011	Islamic Finance (sukuk workshop)
	October 1–12, 2011	Banking supervision
	November 13–17, 2011	Islamic Banking
	December 10–15, 2011	Banking regulations
	February 11–14, 2012	Sukuk
	July 3–5, 2012	Sukuk
	August 27–29, 2012	Follow-up TA on Sukuk
	November 11–13, 2012	Sukuk
	February 11–13, 2013	Sukuk Issuance
	May 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
METAC	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
	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
	April 7–12, 2012	Developing regulations
	April 15–26, 2012	Consumer Price Statistics
	June 16–27, 2012	Bank Enforcement Framework
	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	Off-Site Analysis
	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
STA	February 6–17, 2012	National accounts statistics
	May 7–18, 2012	National accounts statistics

[1] METAC Advisor participated to the mission.

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 March 17, 2014)

1. IDA has committed a total of over $2.72 billion to Afghanistan since 2002. To date, 25 development and emergency reconstruction projects including 4 development policy grants have been implemented. IDA's active portfolio comprises 19 investment projects with combined net commitment of over $787 million, of which almost 40 percent has been disbursed.

2. The Bank's involvement in Afghanistan extends to its role as administrator of the Afghanistan Reconstruction Trust Fund (ARTF). The ARTF has developed into the primary multi-donor funding mechanism, financing part of the essential running costs of government as well as key investments, including national programs in health, education, rural access, irrigation rehabilitation, microfinance, and the National Solidarity Program. Since early 2002, 33 donors have contributed over $6.96 billion to this fund, making it the largest contributor to the Afghan budget for both operating costs and development programs.

3. In January 2010, the World Bank's IDA and the International Monetary Fund (IMF) agreed to support debt relief for Afghanistan. The Boards of both institutions agreed that Afghanistan had taken the necessary steps to reach the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. This will generate total debt service savings of $1.6 billion, which include $1.3 billion from the HIPC Initiative, $260 million from Paris Club creditors beyond HIPC, and $38.4 million from the Multilateral Debt Relief Initiative (MDRI).

4. The International Finance Corporation (IFC), the World Bank Group's private sector development arm, continues to work with its investment partners in Afghanistan. It is following an integrated advisory and investment strategy focused on the enabling environment for private sector activity and supporting selective investments in sectors with high development impact and job creation. On the investment side, IFC now has a portfolio totaling more than $131 million in five companies. This includes commitments in the financial, telecom, and hospitality sectors. The advisory services program, consisting of 8 active projects with a budget of $5.7 million, focuses on access to finance, investment climate, SME capacity development, agribusiness and Public–Private Partnerships (PPPs).

5. Next to investment in health, education, rural development and infrastructure, one of the primary focuses of the Bank's assistance has been to help the Afghan government with legal and regulatory reform, establishing fiscal authority (incl. customs), and developing systems and human resources for public financial management and the civil service as a whole. The performance of the Ministry of Finance regarding alignment of budgetary allocations with the country's priority needs, fiscal discipline, cash control, and aggregate transparency has contributed to macroeconomic stability and sustained external donor assistance.

6. ARTF and IDA projects are managed with the same attention. All projects are eligible for processing under the Bank's Special Considerations for fragile states and emergencies. In practice this has proved most useful to improve flexibility post-approval as all projects are processed under regular review procedures in order to ensure quality at entry. All Bank (IDA and ARTF) funds are channeled through the government's budget and project accounting and reporting occurs at the central level.

7. In fiscal year 2014, the World Bank Board has so far approved two IDA-financed projects totaling $100 million. The new projects included $50 million for the Development Policy Grant and $50 million for Access to Finance.

8. In addition, the ARTF approved $74.8 million in recurrent-cost financing and $325 million for Investment Window financing, including the Second Education Quality Improvement Program ($125 million) and Third Emergency National Solidarity Project ($200 million).

9. For fiscal year 2014, planned commitments are $200 million from IDA, ensuring that the full IDA-16 is fully utilized. The first project, Development Policy Grant for Promotion Economic Growth and Fiscal Sustainability, was approved on August 8, 2013 for $50 million. In addition, $1 billion are planned for operations under the ARTF including both the Investment and Recurrent Cost Windows.

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

(March 17, 2014)

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 consultations in January, May, and September 2013 and in March 2014. The teams 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.

2. **2014 will be a challenging year for economic management**. The uncertain security transition and the upcoming election could affect confidence, weigh on growth and slow or distract the reform agenda. 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 in 2013 and the momentum should be restored. Teams therefore agree on the need to emphasize the introduction of the VAT and more far-reaching customs reforms in their dialogue with authorities as measures to reverse the current trend. In the medium term, harnessing Afghanistan's mineral resources for development would be very important as the big mines come on stream—a robust fiscal framework for mineral revenues must already be in place.

- ***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 given the election year and the political uncertainties of transition, 2014 will be challenging for economic reform. Hence, reforms need to be consolidated and prioritized, along the lines discussed above.

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 2013 and continuing into 2014, 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 Incentive Program (IP) will provide funds ($175 million) for achievements in revenue mobilization, strengthening of PFM systems, investment climate improvements, and custom reforms. Since January 2013, the IP has also supported the government's operation and maintenance expenditures. This support will continue during 2014 with financing amounting to $80 million. A Development Policy Grant Series ($100 million, half of which was disbursed in August 2013) focusing on strengthening sources of economic growth and fiscal revenues is currently under implementation (Table 1).

5. **The Fund's work program focuses on close engagement in the context of the ECF-supported economic program**. Discussions on the second review of the program were not concluded because key program targets were missed and implementation of some structural benchmarks was delays. In addition, performance in early 2013 was significantly weaker than planned and not all prior actions were implemented, so completion of the reviews could not be recommended.

6. In 2013, the Fund focused its efforts on helping the authorities privatize New Kabul Bank, and advance important pieces of legislation, including the new banking law, the central bank law, the VAT law, AML and CFT laws, law on sukuk marketable securities, and companies' law. The Fund has also provided advice on the monetary policy, liquidity forecasting, VAT implementation, and customs reform. Extensive technical assistance has been provided to the central bank's supervision department, including to implement their new organizational structure and revise regulations. In 2014, the Fund plans to help the authorities build on these achievements, including through strengthening economic governance, central bank capitalization framework, developing a fiscal regime for natural resources, preparing for VAT implementation, 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, October 2011–March 2014

	Products	Preparations/Mission Timing[1]	Delivery[1]
Fund	Article IV Consultation	October 2011	November 2011
	Extended Credit Facility (ECF, new arrangement)	October 2011	November 2011
	First Review under the ECF	April 2012	May 2012
	Article IV Consultation	September 2013–February 2014	April 2014
	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 2011–May 2012	May 2012
	Financial Sector Strengthening Project, Supervision	November 2011–August 2012	October 2011
	ARTF IP Program (SY 1391), Preparation of MoU	November 2011–March 2012	March 2012
	Study: Transition and Sustainability in Afghanistan	Throughout 2010/11	December 2011
	Study: Long Term Sources of Economic Growth	Throughout 2012 and 13	March 2014
	Policy Notes: Sub-National Finance	January 2012–June 2013	June 2013
	Position Note: Management of Mineral Revenues	Throughout 2010/11	February 2013
	Economic Monitoring	Continuous	
Joint	Financial Sector Assessment Program	TBD	TBD
	AML/CFT follow-up and workshop	November 2011	
	Dialogue on Mineral Revenue and Expenditure Management	TBD	
	Dialogue on the transition process	Continuous	
	Strengthening of the banking sector	Continuous	
	Improving payment systems	Continuous	

[1] Timing is tentative.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of March 16, 2014)

1. **Afghanistan is a founding member of Asian Development Bank (ADB), established in 1966**. After a hiatus from 1980 to 2001, ADB resumed partnership with the Government of Afghanistan in 2001. In the London and Kabul conferences in January and July 2010, respectively, and in the Chicago (May 2012) and Tokyo (July 2012) conferences, ADB reaffirmed its long-term development partnership with Afghanistan in the transition period (2012–14) and in the transformation period (2015–2025) 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 Operational Business Plan (COBP), 2014–15**. 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 transition and transformation period. The COBP continues ADB's focus on Afghanistan's energy, transport, and agriculture and irrigation sectors, including economic management, sector governance, and further institutional and human capacity development. From 2009 to 2013, ADB's operations were underpinned by the Country Partnership Strategy, aligned with the Afghanistan National Development Strategy (2009–2013).

3. **By end-December 2013, ADB's total assistance comprising grants and loans reached $3.90 billion, of which $3.7 billion for the public sector, and $198.1 million for the private sector**. As of December 31, 2013, total cumulative lending stood at $1.02 billion consisting of sovereign ($817.28 million) and non-sovereign ($198.10) loans. ADB is the sixth largest donor according to the government's 2012 Donor Cooperation Report. Since 2007, ADB has provided assistance for the public sector on a 100 percent grants basis. Grants make more than 70 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 December 31, 2013, the cumulative direct value-added official co-financing since 2002 amounted to $76.7 million for six investment projects and $10.5 million for 11 TA projects. The ADB managed the Afghanistan Infrastructure Trust Fund (AITF)—a co-financing modality that 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 December 31, 2013, the total amount received was $271.2 million from Japan (Embassy of Japan, $110.0 million), United States (USAID, $105.0 million out of a total commitment of $180.3 million), and United Kingdom (DFID, $56.2 million).

5. **ADB is one of the largest donors in the transport sector.** As of December 31, 2013, it has provided $1.9 billion to construct or upgrade over 1,500 km of regional and national roads and $31 million to rehabilitate four regional airports. All four are fully operational, with usage more than doubled. Travel time decreased by more than half as a result of ADB-assisted projects completed in 2013. The ADB funded the first ever railway line between Uzbekistan and Afghanistan, which became fully operational in 2012. To date, over four million tons of goods have been transported through it. 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.** To date, ADB has invested around $883 million in Afghanistan's energy sector, and committed an additional $950 million to strengthen the country's energy supply chain. ADB-assisted projects have added 590 km of transmission lines, providing electricity to more than five million people. Ongoing projects will generate an additional 6.8 megawatts of power, add 470 km of transmission lines, and provide 99,320 new power connections. ADB is also financing the power and gas sector master plans of the government. ADB also supports the Turkmenistan, Afghanistan, Pakistan and India (TAPI) gas 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.** In 2013, total investment reached $543 million to rehabilitate and establish new irrigation and agricultural infrastructures, 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 and a rise in agricultural productivity.

8. **In economic management, ADB's 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 end 2013, cumulative approvals in 6 projects amounted to $198.1 million. Total outstanding balances and undisbursed commitments to private sector projects amounted to $9.3 million, representing 0.1 percent of ADB's total non-sovereign portfolio as of December 31, 2013. One of the major private sector projects is the Roshan Cellular Telecommunications Project. ADB provided financial assistance in the form of direct loans totaling $70 million for Phase 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 U.S. Treasury. In the financial sector, ADB has 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 Management Board (JCMB) and the Afghanistan's 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 corporation-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.

STATISTICAL ISSUES

(As of March 19, 2014)

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. 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 indices 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 procedures generally follow good practices and compilation methods adhere to internationally accepted standards, 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. The scope and quality of data reporting by the central bank have improved, and Da Afghanistan Bank (DAB) produces its balance sheet on a monthly basis. Since 2007, commercial banks have been reporting data to DAB regularly using templates developed for the purpose of supervision and monetary statistics compilation. The IMF is assisting DAB in bringing the reporting in compliance with the IMF's Monetary and Financial Statistics Manual. DAB is reporting the Standardized Report Forms for Monetary and Financial Statistics to the IMF for publication in the International Financial Statistics (IFS) database on a monthly basis. A country page for Afghanistan was reintroduced in IFS in March 2008.

External sector statistics. Balance of payments statistics are compiled according to the fifth edition of the *Balance of Payments Manual*. The quality of data has improved and was accepted in 2013 for publication and dissemination in the IMF's Balance of Payments Statistics Yearbook and *International Financial Statistics*. Still, the compilation process suffers from a paucity of source data, low organizational capacity, and limited resources. Customs coverage of overland foreign trade could be improved and there are no reliable estimates of unrecorded border trade, which is significant. A substantial part of donor aid is excluded from the coverage of capital transfers. Source data to estimate services, income, transfers, foreign direct investment, and other statistics are weak. Surveys of enterprises suffer from poor response. With support from METAC, DAB has also started compiling international investment position (IIP) statistics, but these are not yet provided in the TCIRS due to lack of capacity.

Regarding external debt, the reconciliation of records was completed in the context of Paris Club rescheduling, the completion of the HIPC initiative in 2010, and subsequent debt relief. Debt management and reporting systems are in place and functional at the Ministry of Finance.

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 March 31, 2014)

	Date of latest observation	Date received	Frequency of Data[3]	Frequency of Reporting[3]	Frequency of publication[3]
Exchange Rates	Dec. 2013	Mar. 2014	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec. 2013	Mar. 2014	M	M	M
Reserve/Base Money	Dec. 2013	Mar. 2014	M	M	M
Broad Money	Dec. 2013	Mar. 2014	M	M	M
Central Bank Balance Sheet	Dec. 2013	Mar. 2014	M	M	M
Consolidated Balance Sheet of the Banking System	Dec. 2013	Mar. 2014	M	M	M
Interest Rates[2]	Dec. 2013	Mar. 2014	D	M	M
Consumer Price Index	Dec. 2013	Mar. 2014	M	M	M
Revenue, Expenditure, Balance and Composition of Financing – General Government[4]	--	--	--	--	--
Revenue, Expenditure, Balance and Composition of Financing– Central Government	Feb. 2014	Mar. 2014	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt	2013Q3	Dec. 2013	Q	Q	Q
External Current Account Balance	2013Q3	Dec. 2013	Q	Q	Q
Exports and Imports of Goods and Services	2013Q3	Dec. 2013	Q	Q	Q
GDP/GNP	2012/13	Jul. 2013	A	A	A
Gross External Debt	2013Q3	Dec. 2013	Q	Q	Q
International Investment Position	--	--	--	--	--

[1] Any reserve assets that are pledged of 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).

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

April 23, 2014

Approved By
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Prepared by the staffs of the International Development Association and the International Monetary Fund[1]

Afghanistan continues to be at high risk of debt distress. Although debt is modest currently, after extensive debt relief, Afghanistan relies heavily on donor grants (43 percent of GDP in 2013, including both on and off-budget grants). Under the baseline scenario, with continued reform and donor support, and smooth political and security transitions, debt is sustainable. However, there are significant vulnerabilities; should growth slow, reform stall, security deteriorate, or grant financing fall short of the projected levels, there will be a need to implement significant compensatory measures or its debt burden would quickly become unsustainable and Afghanistan would be at a high risk of debt distress. Accordingly, the authorities should redouble their efforts to mobilize revenue, press ahead with their reform efforts and raise the efficiency of public spending through careful prioritization and expenditure rationalization where feasible. Donors should provide financing in the form of grants.

[1] 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" https://www.imf.org/external/nppp/eng/2013/110513.pdf. The updated debt sustainability analysis (DSA) contains a few changes relative to the one used in 2012 when the previous DSA was prepared. In particular, the updated DSF uses a higher discount rate (increased from 3 to 5 percent) and includes new benchmarks for total public debt, which did not exist previously. This DSA assumes a similar composition of external and domestic loan financing in the two alternative illustrative scenarios. 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 2010–12 CPIA of 2.7, Afghanistan is classified as "weak performance" under the LIC-DSF.

MACROECOOMIC OUTLOOK

1. **The outlook underlying the DSA is based on smooth security and political transitions, as well as continued reform and donor support**. This outlook is similar to the one presented in the previous DSA of June 2012 (Box 1). The baseline assumes that the 2014 elections, as well as subsequent ones, result in governments that pursue economic reforms and implement Afghanistan's development agenda, that Afghanistan's business environment and economic governance improve enabling private-sector-led growth, and that the security situation stabilizes. In 2012, donors announced substantial medium-term pledges. The NATO summit in Chicago resulted in pledges to finance Afghanistan's security spending, estimated at around $4 billion annually over the following decade. At the same time, donors expect that Afghanistan will make gradually increasing and substantial contributions toward security. A second conference in Tokyo mobilized pledges for development aid of $16 billion through 2015 and to sustain aid at similar levels through 2017. Development aid is linked to the progress in reforms under the Tokyo Mutual Accountability Framework. The baseline scenario assumes that the mining sector is developed, with some delays relative to the 2012 projections, and that business environment and economic governance improve.

Box 1. Macroeconomic Assumptions Comparison Table[1]

	DSA June 2012		DSA February 2014		(current vs. previous)	
	2012-16	2017-32	2012-16	2017-32	2012-16	2017-32
Real growth (%)	5.9	4.4	6.1	4.7	0.2	0.3
Inflation (GDP, deflator, %)	6.1	5.0	6.4	4.9	0.3	-0.1
Nominal GDP (Bln-Afs)	1298	3586	1267	3798	-31	212
Revenue and grants (%GDP)	29.9	35.1	27.3	34.2	-2.6	-0.9
Grants (%GDP)	17.4	18.5	16.6	17.8	-0.8	-0.7
Primary expenditure (%GDP)	30.3	36.4	27.6	35.2	-2.7	-1.2
Primary balance (%GDP)	0.4	1.2	0.3	1.0	-0.1	-0.2
Exports of G&S (%GDP)	14.8	24.5	14.5	23.1	-0.3	-1.4
Imports of G&S (% GDP)	54.8	47.4	54.5	44.9	-0.3	-2.5
Noninterest current account balance (%GDP)	1.3	2.0	1.5	0.0	0.2	-2.0

Sources: Country authorities; and IMF staff estimates and projections.
[1]The differences between the current and previous DSAs is explained by having new and improved data.

2. **Growth is projected to continue and the external current account (before grants) to improve gradually**. Under this scenario, GDP growth is projected to average about 4.7 percent in the medium term (2014–18), rise to around 6 percent in 2021 as mining production comes on-stream, and to converge to about 4 percent in the long run (Table 1 and 2a). The main change relative to the previous DSA relates to less buoyant foreign trade developments, due predominantly to lower projected mining activity, which drives import and export dynamics in the outer years. The risks related to developments of extractive industries have increased since the previous DSA because investors have signaled delays. The external

current account deficit before grants, while still large, is expected to improve gradually over the projection period. Export capacity should increase progressively—albeit from very low levels—and some import substitution is projected to take place. Development of the extractive industry should also contribute to exports. At the same time, donor-financed imports are projected to grow more slowly than in the past. Accordingly, the current account deficit should narrow gradually from about 40 percent of GDP in 2013 to about 12 percent of GDP at the end of the projection horizon (Figure 1).

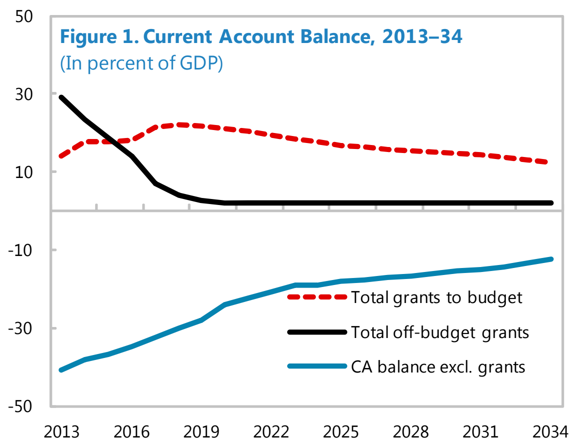


Figure 1. Current Account Balance, 2013–34
(In percent of GDP)

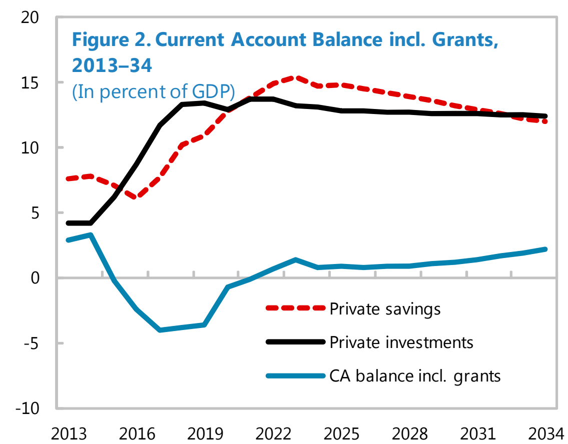


Figure 2. Current Account Balance incl. Grants, 2013–34
(In percent of GDP)

Sources: Afghan authorities; and IMF staff calculations.

3. **Given large spending needs and limited domestic revenue mobilization, total fiscal financing needs are expected to remain large but to decline as a share of GDP**. Afghanistan received substantial grants totaling 43 percent of GDP in 2013. In the medium term, the financing gap is projected to reach about $7.7 billion (33 percent of GDP) annually on average through 2018,[2] as expenditure pressures continue and domestic revenue mobilization remains limited. While donors have pledged financial support for the medium term at the 2012 Chicago and Tokyo conferences, the longer-term prospects of donor flows are less certain. In the long run, both spending needs (moderated by some expenditure rationalization) and revenue capacity rise along with economic growth, so that on balance, the financing gap is projected to remain at similar levels (about $7–8 billion at constant prices), but to fall relative to the size of the economy (from about 42 percent of GDP currently to about 19 percent in 2025, and to about 15 percent at the end of the projection horizon). Similarly, fiscal sustainability—defined as domestic revenues covering operating spending—is likely to remain low, because of the large grant-financed amounts being transferred on-budget (that were previously managed externally) as part of the security transition.

[2] The financing gap includes both on-budget and off-budget spending needs and is presented after residual domestic financing and a small amount of concessional loans from multilaterals.

Table 1. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2013–33

	Prel.	Projections							
		Medium Term					Long term averages		
	2013	2014	2015	2016	2017	2018	2019-23	2024-28	2029-33
Output and prices[1]	(Annual percentage change, unless otherwise indicated)								
Real GDP	3.6	3.2	4.5	5.0	5.1	5.3	5.6	4.1	4.0
Nominal GDP (in billions of U.S. dollars)	20.7	21.7	23.2	24.8	26.4	28.1	34.5	46.4	62.0
Consumer prices (period average)[2]	7.4	6.1	5.5	5.5	5.0	5.0	5.0	5.0	5.0
	(In percent of GDP, unless otherwise indicated)								
Public finances									
Domestic revenues and grants	23.7	28.2	28.9	30.6	33.9	35.8	35.3	33.7	33.3
Domestic revenues	9.5	10.3	11.1	12.5	12.5	13.8	15.1	17.2	19.0
Grants	14.2	17.9	17.8	18.1	21.5	22.0	20.2	16.5	14.2
Expenditures	24.3	28.6	29.7	30.6	34.7	36.7	36.6	35.2	34.3
Operating[3]	17.3	21.7	22.8	23.4	27.4	29.2	28.7	27.2	26.3
Development	7.0	6.9	6.9	7.1	7.3	7.6	8.0	8.0	8.0
Operating balance (excluding grants)[4]	-7.8	-11.4	-11.7	-11.0	-14.9	-15.4	-13.6	-10.0	-7.3
Overall budget balance (including grants)	-0.6	-0.4	-0.8	0.0	-0.8	-1.0	-1.3	-1.5	-1.1
External sector[1]									
Exports of goods (in U.S. dollars, percentage change)	-5.2	-7.9	-3.3	4.4	-3.1	18.5	22.7	6.1	7.2
Imports of goods (in U.S. dollars, percentage change)	-6.8	-1.6	2.4	3.3	1.3	2.1	4.9	4.3	4.8
Merchandise trade balance	-41.0	-39.0	-37.8	-36.3	-34.6	-31.8	-24.4	-20.3	-19.6
Current account balance, excluding grants	-40.6	-38.1	-36.7	-34.8	-32.5	-29.9	-22.8	-17.6	-14.8
Excluding official transfers	-40.6	-38.1	-36.7	-34.8	-32.5	-29.9	-22.8	-17.6	-14.8
Gross reserves (in millions of U.S. dollars)	6,886	7,099	7,395	7,300	7,400	7,500	7,640	8,132	9,430
Public Debt									
Total public debt	6.1	5.9	5.8	6.5	7.5	9.4	10.7	13.5	16.8
of which: Public external debt[5]	6.1	5.9	5.8	5.8	5.7	5.6	5.5	5.7	5.9

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

[1]Excluding the narcotics economy.

[2]Revised with expanded, national coverage.

[3]It is assumed that all recurrent expenditure is moved onto the budget during between 2012 and 2017. The actual rate of transfer on-budget is

[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.

4. **The reduction in the size of security forces is expected to take longer than projected in the 2012 DSA.**[3] The baseline assumes a delay in the reduction of army and police personnel relative to the previous DSA, but cost savings are expected to contain the overall level of security spending. As security accounts for more than 60 percent of recurrent spending, these outlays are projected to remain substantial, with security-related outlays projected to decline to 16.5 percent of GDP by 2018, to 13.7 percent by 2025, and stabilize at about 12 percent in the long term. Furthermore, with the on-budget transfer of previously donor-managed spending, as well as operations and maintenance costs related to the vast number of donor-funded projects implemented over the past decade, the growth in operating spending is projected to exceed the growth of domestic revenue capacity.[4] Finally, public spending will also rise on account of increases in the size of the civil service needed to provide public services at levels compatible with government ambitions to make meaningful progress towards the Millennium

[3] Relative to 2012, a lower (but not yet determined) number of international troops are expected to be stationed in Afghanistan after end-2014 and some delay in the reduction in the number of Afghan security forces.

[4] 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.

Development Goals.[5] Given Afghanistan's large development needs, development spending is projected to be about 10 percent of GDP.

5. **Revenue is expected to increase, but less rapidly than in the previous DSA in the medium term but thereafter to improve**. Lower revenue during 2012–13 was caused by lower compliance, enforcement, lower confidence, and lower import growth and economic activity due to political and security uncertainties. Furthermore, because of delays in the parliamentary submission and passage of the draft VAT law, the introduction of the VAT has been delayed relative to the March 2014 date envisaged in the previous DSA. As a result, by 2018 the ratio of domestic revenues to GDP may only reach 13.8 percent. Finally, delays in mining projects will negatively affect the medium-term revenue outlook. The revenue impact of these delays is expected to be made up in the long run as the delays are overcome and revenue efforts are bolstered; domestic revenues will reach the level envisaged in the previous DSA by 2025. Additional measures and/or improved compliance will be needed to catch up with the normative projection for domestic revenues of 17 percent of GDP by 2025, and of 20 percent of GDP by mid 2030s that would bring Afghanistan's revenue-to-GDP ratio to that of a typical low income country. Accordingly, the baseline scenario assumes that (i) there will be delays in VAT introduction with an initial yield of 1½-2 percent of GDP; (ii) excise taxes will be introduced in 2018 and yield 1 percent of GDP in additional revenues; (iii) tax and customs administration reforms will be adequately implemented; and (iv) a fiscal regime for natural resources will be implemented ensuring that the government receives a reasonable share of economic rents.

DEBT SUSTAINABILITY ANALYSIS

6. **Following extensive debt relief in 2006, Afghanistan's debt is modest currently**. Afghanistan's external public and publicly guaranteed debt is estimated to have amounted to $1.3 billion, or 6.1 percent of GDP, at the end of 2013 (Table 1), almost all owed to multilateral creditors.[6] It is equivalent to 3.1 percent of GDP in present value (PV) terms, and to about 20 percent of exports and 33 percent of government revenues (Table 2). Under the baseline scenario—in which Afghanistan's financing needs, net of residual domestic financing, are entirely met by grants—the present value of public external debt would be about 3.8 percent of GDP by the end of the projection period, while the total public debt would be 17 percent, both below the indicative debt-burden threshold applicable to a country like Afghanistan.[7]

[5] Wage restraint is also assumed, with the wage growth rate limited to 1 percentage point over inflation.

[6] 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.

[7] Under the DSA framework, the 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.

7. **However, Afghanistan remains at high risk of external debt distress because of risks to grant financing or because growth may be lower than projected**. As illustrated by the two customized illustrative scenarios below, Afghanistan faces significant risks and debt thresholds could be breached.[8] These two scenarios focus on the debt dynamics generated by one shock—a downward shift in either the growth or the grant path—to highlight the effects of these shocks. They do not take into account second round effects on trade, security, interest rates, and (in the lower grant scenario) growth. Consequently, the resulting debt dynamics as well as the overall assessment of Afghanistan's macroeconomic conditions and aid dependency lead to a rating of a high risk of debt.[9] However, if the political transition proceeds smoothly and macroeconomic conditions continue to improve, the external risk rating may be lowered in future DSAs.

8. **Customized illustrative scenarios are necessary to take into account Afghanistan's unique circumstances**. The two customized illustrative scenarios discussed in paragraphs 7, 9, and 10 are tailored to the specific circumstances of Afghanistan (see Table 2 for key scenario assumptions). In contrast, the standard shocks generated by the Debt Sustainability Framework are mostly driven by the past ten years. While for many countries the recent past might be a useful guide for projections, Afghanistan's recent history—with average real GDP growth of 9.3 percent and official transfers of 50.6 percent of GDP over the past ten years—may have less utility as a guide for the future. 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 frontloaded to finance post-conflict rehabilitation and reconstruction. Due to recent history, the standard shocks only result in one breach of the debt thresholds (the PV of debt to exports during this decade).[10] Hence, to examine debt sustainability with plausible downside risks, two customized illustrative scenarios and related frameworks were developed. While the standard DSF shocks are included in the accompanying figures and tables, they lead to benign debt dynamics. In this light, the external and overall risk ratings are guided by risks identified and laid out in the customized illustrative scenarios.

[8] This DSA assumes that, following introduction of domestic debt instruments (sukuks) expected in 2014–15, Afghanistan will have some (limited) domestic borrowing capacity. While under the baseline, sukuks are intended to be mainly for liquidity management and market development purposes, under the alternative scenarios, the government is assumed to borrow domestically up to the maximum level of 40 percent of GDP in the low grant scenario, after which government borrowing rates would increase exponentially while the exchange rate would start slipping as a result of current account imbalances and market pressures induced by the domestically financed fiscal deficit.

[9] This treatment is line with paragraph 73 of the LIC-DSF Guidance Note (footnote 1).

[10] The PV of debt to exports threshold is 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 (2015–2016) and thereafter the PV of debt to exports declines.

Table 2. Islamic Republic of Afghanistan: Key Series for Debt Sustainability Scenario Analysis

(In percent of GDP, unless otherwise indicated)

	2013 Prel	2018 Proj	2023 Proj	2028 Proj	2033 Proj
			Baseline		
Real GDP growth, percent	3.6	5.3	5.1	4.0	4.1
Domestic revenues	9.5	13.8	16.2	17.9	19.7
Total expenditures (incl. off-budget spending) 1/	53.6	40.8	38.0	37.2	36.4
External concessional loans	0.1	0.3	0.4	0.4	0.3
Net domestic financing 2/	0.7	0.7	1.1	1.5	1.1
Donor grants 3/	43.2	26.1	20.3	17.4	15.2
Public debt	6.1	9.4	12.5	17.0	17.3
Domestic	0.0	3.8	7.0	11.2	11.4
External	6.1	5.6	5.5	5.8	5.9
			Low grant scenario		
Real GDP growth, percent	3.6	5.3	5.1	4.0	4.1
Domestic revenues	9.5	13.4	15.0	16.6	18.2
Total expenditures (incl. off-budget spending) 1/ 4/	53.6	40.9	40.2	41.4	41.5
External concessional loans	0.1	2.4	9.4	10.7	9.5
Net domestic financing 2/	0.7	2.8	3.5	3.9	4.9
Donor grants 3/	43.2	22.4	12.2	10.3	8.8
Public debt	6.1	15.8	60.3	107.3	141.5
Domestic	0.0	6.2	16.8	27.3	37.9
External	6.1	9.6	43.5	80.0	103.6
			Low growth scenario		
Real GDP growth, percent	3.6	2.8	2.6	1.5	1.6
Domestic revenues	9.5	13.9	16.5	18.4	20.3
Total expenditures (incl. off-budget spending) 1/ 5/	53.6	43.5	43.6	45.5	46.7
External concessional loans	0.1	0.7	1.9	4.6	6.0
Net domestic financing 2/	0.7	1.1	1.8	1.6	2.0
Donor grants 3/	43.2	27.8	23.4	20.9	18.5
Public debt	6.1	12.6	23.4	44.9	71.3
Domestic	0.0	4.0	9.5	14.5	19.5
External	6.1	8.6	13.9	30.4	51.8

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

1/ It is assumed donors' off-budget spending is moved on budget by 2020, except for residual development spending, assumed to amount to 2 percent of GDP.
2/ Includes for treasury liquidity buffer, residual domestic debt issuance and sale of non-financial assets.
3/ Includes both on- and off-budget grants as well as projects managed directly by donors.
4/ Difference to baseline mostly due to higher interest payments.
5/ Lower growth in 2014-2033 results in nominal GDP in 2033 being about one third lower than in the baseline scenario. Differences with the baseline scenario are principally due to the limited compression of government expenditure despite lower GDP growth, reflecting an effort to maintain public services, and to higher interest payments.

9. **The "lower grants" customized illustrative scenario assumes a substantial drop in grants starting in 2017**. While donors are expected to follow through with their current pledges, this illustrative scenario assumes that lack of progress in reforms, subsequent donor fatigue, and/or a shift in donors' priorities lead to a gradual reduction in aid beginning in 2017 and reaching 50 percent by 2021 and beyond, compared to the baseline. At the same time, it is assumed that the level of public services envisaged in the baseline scenario is preserved[11], and additional revenue is not mobilized. In this illustrative scenario, nominal GDP levels are similar to the baseline scenario, imports are slightly lower because there is a shift in government expenditure away from imported goods resulting in a small decline in the domestic revenue to GDP ratio, and expenditure is higher because of additional interest payments. The resulting financing gap is covered with non-concessional external loans and domestic borrowing; the latter is capped at 40 percent of GDP.[12] Under this scenario, debt burden indicators deteriorate rapidly, breaching virtually every threshold. The PV of external debt would reach 94 percent of GDP, or over 340 percent of exports, by the end of the projection period. The PV of total public debt would reach 131 percent of GDP, around 525 percent of revenues, and the debt-service-to-revenue ratio more than 50 percent (Figure 4).

10. **The "low growth" customized illustrative scenario assumes a lower GDP output path**. This illustrative scenario assumes that economic governance and business environment reforms stall, while the political and security conditions remain uncertain, reducing confidence, discouraging investment, and resulting in lower growth. As a result, annual GDP growth is projected to be 2.5 percentage points lower than in the baseline during 2015–33—negatively affecting domestic revenues. Afghanistan's history over the past few decades suggests a risk of long-term political instability, which could durably impact growth, investment, capital inflows, and the development of the extractive resource sector. In this illustrative scenario, lower growth in 2014–2033 results in nominal GDP in 2033 being about two thirds lower than in the baseline scenario. Domestic revenue is projected to grow slightly faster than nominal GDP, while limited compression of government expenditure results in expenditure growing much faster than GDP, because it is assumed that the level of public services is broadly preserved, in particular the wage bill, and also higher interest payments add to expenditure. Borrowing (non-concessional external loans and domestic borrowing) is used to fill the financing gap. Domestic debt is assumed to increase by 1 percentage point of GDP each year, reaching 20 percent of GDP in 2033. While this scenario is less adverse than the outright cut in grants—the PV of external debt would reach about 41 percent of GDP in 2033—it would again lead to a breach of all but one threshold (Figure 3). Furthermore, the PV of total public debt-to-GDP would also be breached around the end of the next decade.

[11] It is also anticipated that government shifts expenditure away from imported goods to minimize the impact on the external sector of lower grants and because there would be more spending flexibility grants are often earmarked by donors.

[12] For domestic borrowing, an increase of about 2 percentage points of GDP per year starts in 2017, and the cap is reached in 2034.

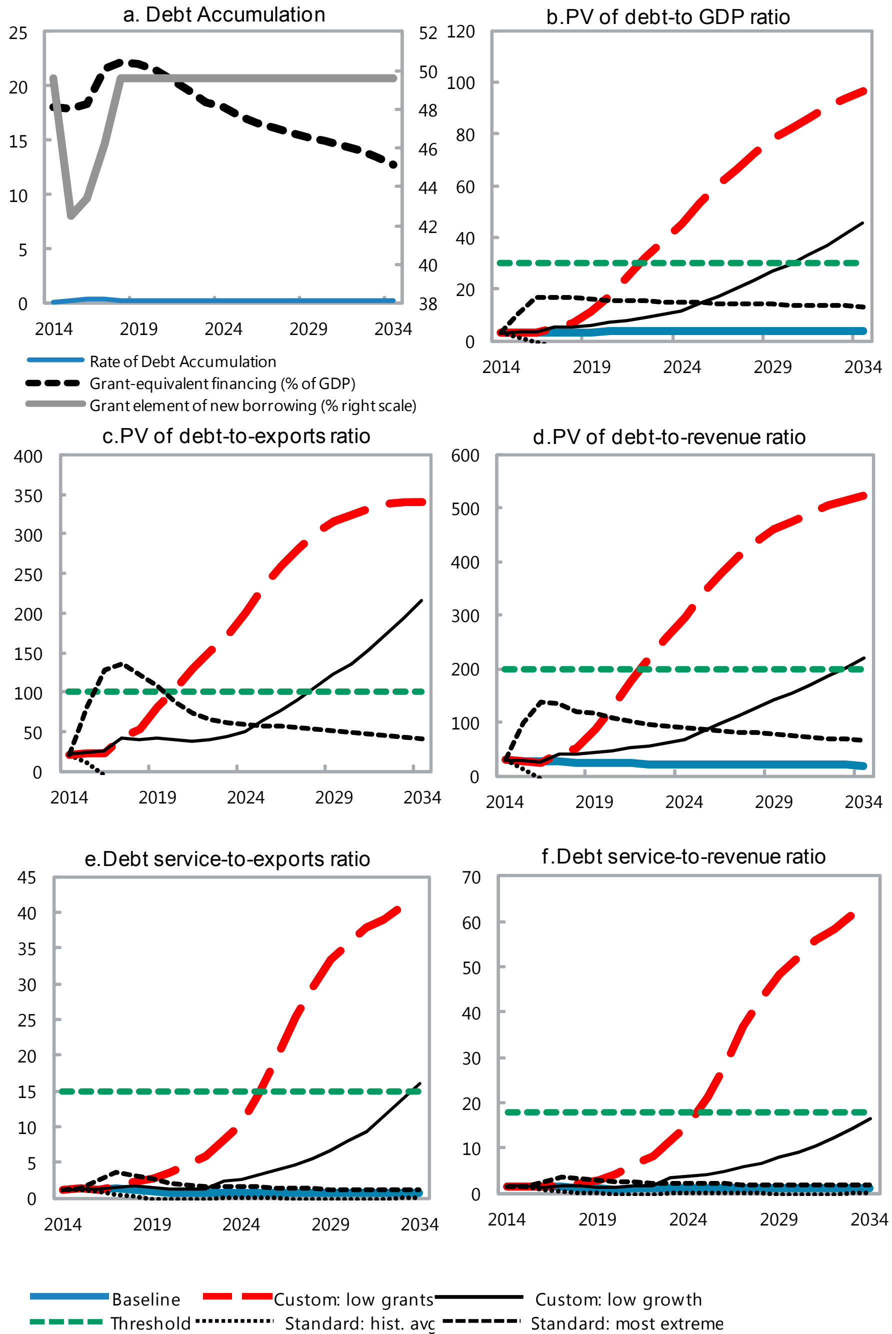
AUTHORITIES' VIEWS

11. **The authorities agreed with the conclusions of the DSA**. They recognized the risks and are committed to doing their part in ensuring debt sustainability, while looking to donors to continue their assistance at the pledged levels. They noted that Afghanistan's large expenditure needs and donor countries' domestic fiscal and political realities combined could create pressures and, at times, called for a need to experiment with more debt financing. In this respect, they welcomed continued support from donors so that they have access to grant financing. They also acknowledged Fund advice that sukuks (domestic borrowing) be used predominantly as a liquidity management instrument, rather than to finance projects or recurrent fiscal deficits. They added that expenditure savings could potentially be made if donors intensified their efforts to further align their aid with Afghan priorities and channeled more funds through the budget.

CONCLUSIONS

12. **Afghanistan will likely remain dependent on donor grant financing for years to come**. Security and development expenditure needs are large and the recently faltering domestic revenue effort is not matching the growth of spending. 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. If growth and reform falter, and security deteriorates; or if grant financing falls short of the projected levels or is provided in the form of loans, even if concessional, Afghanistan would need to implement compensatory measures or its debt burden would quickly become unsustainable and 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 reform 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.

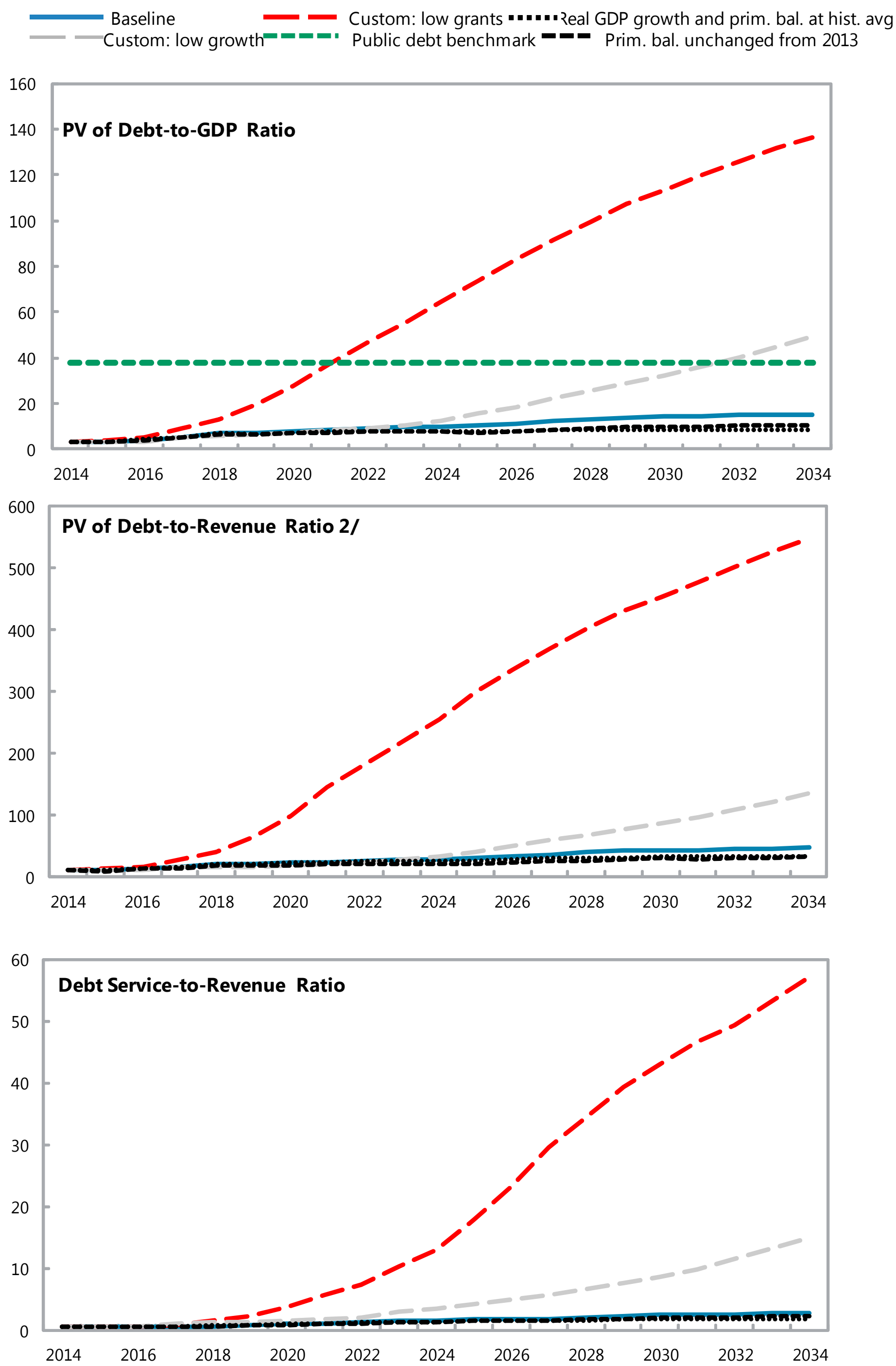
Figure 3. Islamic Republic of Afghanistan: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2014–34[1]



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

1/ Standard shock scenarios are added for informational purposes only; Custom scenarios should be regarded as realistic potential shocks. The most extreme standard stress test is the test that yields the highest ratio on or before 2023. In figure b. it corresponds to a nondebt flows shock; in c. to a nondebt flows shock; in d. to a nondebt flows shock; in e. to a nondebt flows shock and in figure f. to a nondebt flows shock.

Figure 4. Islamic Republic of Afghanistan: Indicators of Public Debt Under Alternative Scenarios, 2014–34[1]



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

1/ Standard shock scenarios are added for informational purposes only; Custom scenarios should be regarded as realistic potential shocks.

2/ Revenues are defined inclusive of grants.

Table 3a. Islamic Republic of Afghanistan: External Debt Sustainability Framework, Baseline Scenario, 2011–34[1]

	Actual		Estimate	Historical Average 6/	Standard Deviation 6/	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2033	2034
External debt (nominal) 1/	6.9	6.5	6.1			5.9	5.8	5.8	5.7	5.6	5.6		5.6	5.9	5.9
of which: public and publicly guaranteed (PPG)	6.9	6.5	6.1			5.9	5.8	5.8	5.7	5.6	5.6		5.6	5.9	5.9
Change in external debt	-1.6	-0.5	-0.4			-0.2	-0.1	-0.1	-0.1	-0.1	0.0		0.0	0.0	0.0
Identified net debt-creating flows	-6.4	-6.8	-3.7			-4.7	-1.4	0.1	-0.3	-1.7	-1.5		-3.7	-4.1	-4.3
Non-interest current account deficit	-3.2	-4.0	-2.9	-2.7	2.4	-3.4	0.2	2.4	4.0	3.8	3.6		-0.9	-1.9	-2.2
Deficit in balance of goods and services	44.7	44.8	41.9			39.4	37.9	36.1	34.0	31.0	28.9		20.0	16.5	15.8
Exports	17.3	15.9	15.9			14.3	13.3	13.2	12.4	13.5	14.9		24.8	30.6	31.5
Imports	62.0	60.7	57.7			53.7	51.3	49.3	46.3	44.5	43.8		44.8	47.1	47.3
Net current transfers (negative = inflow)	-47.4	-48.2	-44.0	-47.4	27.3	-42.1	-37.1	-33.2	-29.4	-27.1	-25.7		-21.7	-19.1	-18.6
of which: official	-45.3	-46.2	-43.4			-41.4	-36.4	-32.3	-28.5	-26.1	-24.5		-19.8	-15.2	-14.5
Other current account flows (negative = net inflow)	-0.5	-0.5	-0.7			-0.7	-0.6	-0.5	-0.6	-0.1	0.4		0.8	0.6	0.6
Net FDI (negative = inflow)	-2.1	-2.0	-0.7	-1.9	1.2	-1.2	-1.4	-2.1	-4.1	-5.3	-4.8		-2.6	-2.0	-1.9
Endogenous debt dynamics 2/	-1.2	-0.8	-0.1			-0.2	-0.2	-0.3	-0.2	-0.3	-0.3		-0.2	-0.2	-0.2
Contribution from nominal interest rate	0.1	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	-0.5	-0.9	-0.2			-0.2	-0.2	-0.3	-0.3	-0.3	-0.3		-0.2	-0.2	-0.2
Contribution from price and exchange rate changes	-0.7	0.0	0.1			...	...	...	...	...	...		...	...	...
Residual (3-4) 3/	4.8	6.3	3.3			4.5	1.3	-0.2	0.3	1.6	1.4		3.7	4.1	4.3
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	0.0
PV of external debt 4/	...	...	3.1			3.1	3.1	3.2	3.3	3.3	3.4		3.5	3.8	3.8
In percent of exports	...	...	19.8			21.5	23.3	24.5	26.8	24.8	22.5		14.2	12.5	12.1
PV of PPG external debt	...	...	3.1			3.1	3.1	3.2	3.3	3.3	3.4		3.5	3.8	3.8
In percent of exports	...	...	19.8			21.5	23.3	24.5	26.8	24.8	22.5		14.2	12.5	12.1
In percent of government revenues	...	...	33.0			29.8	28.1	25.9	26.6	24.3	24.1		21.2	19.4	19.1
Debt service-to-exports ratio (in percent)	0.4	0.4	0.7			1.1	1.2	1.2	1.3	1.2	0.9		0.7	0.7	0.6
PPG debt service-to-exports ratio (in percent)	0.4	0.4	0.7			1.1	1.2	1.2	1.3	1.2	0.9		0.7	0.7	0.6
PPG debt service-to-revenue ratio (in percent)	0.7	0.6	1.2			1.5	1.5	1.3	1.3	1.1	0.9		1.0	1.0	1.0
Total gross financing need (Billions of U.S. dollars)	-0.9	-1.2	-0.7			-1.0	-0.2	0.1	0.0	-0.4	-0.3		-1.4	-2.6	-2.9
Non-interest current account deficit that stabilizes debt ratio	-1.6	-3.5	-2.5			-3.2	0.3	2.5	4.1	3.9	3.7		-0.9	-1.9	-2.2
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.5	14.0	3.6	8.8	6.1	3.2	4.5	5.0	5.1	5.3	5.6	5.4	4.6	4.1	4.1
GDP deflator in US dollar terms (change in percent)	9.6	-0.5	-1.4	7.4	7.1	1.6	2.2	1.6	1.3	1.3	1.1	2.9	1.4	2.0	2.0
Effective interest rate (percent) 5/	0.9	0.6	0.3	1.0	0.8	0.4	0.4	0.4	0.5	0.6	0.7	0.6	0.8	1.0	1.0
Growth of exports of G&S (US dollar terms, in percent)	2.4	4.3	2.0	8.4	13.7	-5.3	-0.5	5.5	-0.1	16.1	18.3	7.0	7.4	9.1	9.1
Growth of imports of G&S (US dollar terms, in percent)	2.9	11.0	-2.8	8.0	7.3	-2.4	1.9	2.6	0.1	2.4	5.2	3.1	7.3	6.6	6.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	49.6	42.5	43.4	46.2	49.6	49.6	46.8	49.6	49.6	49.6
Government revenues (excluding grants, in percent of GDP)	11.0	10.1	9.5			10.3	11.1	12.5	12.5	13.8	14.0		16.6	19.7	20.0
Aid flows (in Billions of US dollars) 7/	1.9	3.1	3.0			3.9	4.1	4.5	5.7	6.2	6.5		7.3	9.2	9.2
of which: Grants	1.8	3.1	2.9			3.9	4.1	4.5	5.7	6.2	6.5		7.3	9.2	9.2
of which: Concessional loans	0.0	0.1	0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			18.0	18.0	18.3	21.7	22.2	22.0		18.0	13.5	12.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			99.4	98.7	98.6	99.0	99.2	99.1		98.7	98.3	98.2
Memorandum items:															
Nominal GDP (Billions of US dollars)	17.9	20.3	20.7			21.7	23.2	24.8	26.4	28.1	30.0		41.3		73.6
Nominal dollar GDP growth	16.7	13.4	2.2			4.9	6.8	6.7	6.4	6.6	6.8	6.4	6.1		6.1
PV of PPG external debt (in Billions of US dollars)			0.6			0.7	0.7	0.8	0.9	0.9	1.0		1.4		2.8
(PVt-PVt-1)/GDPt-1 (in percent)						0.1	0.2	0.3	0.3	0.2	0.2	0.2	0.2		0.2
Gross workers' remittances (Billions of US dollars)	0.4	0.4	0.3			0.3	0.3	0.3	0.3	0.3	0.3		0.4		0.5
PV of PPG external debt (in percent of GDP + remittances)	...	...	3.1			3.0	3.1	3.2	3.3	3.3	3.3		3.5		3.8
PV of PPG external debt (in percent of exports + remittances)	...	...	18.2			19.6	21.3	22.3	24.4	22.8	20.9		13.7		11.9
Debt service of PPG external debt (in percent of exports + remittances)	...	...	0.7			1.0	1.1	1.1	1.2	1.1	0.8		0.7		0.6

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 3b. Islamic Republic of Afghanistan: Sensitivity for Key Indicators of Public and Publicly Guarantee External Debt, 2013–34

(In percent)

	Estimate	Projections								
	2013	2014	2015	2016	2017	2018	2019	2024	2033	2034
PV of debt-to GDP ratio										
Baseline	3	3	3	3	3	3	3	4	4	4
A. Alternative Scenarios (Standard and Customized)										
A1. Key variables at their historical averages in 2014-2034 1/	3	3	1	-1	-2	-3	-4	-4	-3	-3
A2. New public sector loans on less favorable terms in 2014-2034 2	3	3	3	3	4	4	4	4	6	6
Customized 1. Lower real GDP growth	3	3	3	3	5	6	6	12	41	45
Customized 2. Lower grants	3	3	3	3	5	7	11	45	94	96
B. Bound Tests										
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	3	3	3	3	3	3	3	4	4	4
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	3	3	3	4	4	4	4	4	5	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	3	3	3	3	3	3	3	4	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	3	3	11	17	17	16	16	15	13	13
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	4	3	3	3	3	3	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	3	3	4	4	5	5	5	5	5	5
PV of debt-to-exports ratio										
Baseline	20	21	23	24	27	25	23	14	13	12
A. Alternative Scenarios (Standard and Customized)										
A1. Key variables at their historical averages in 2014-2034 1/	20	21	10	-6	-20	-26	-30	-14	-11	-10
A2. New public sector loans on less favorable terms in 2014-2034 2	20	21	23	25	28	27	25	18	18	18
Customized 1. Lower real GDP growth	20	22	24	25	41	41	42	51	194	215
Customized 2. Lower grants	19	21	23	24	43	54	82	202	340	340
B. Bound Tests										
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	20	21	23	24	26	24	22	14	12	12
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	20	21	26	38	41	38	34	21	17	17
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	20	21	23	24	26	24	22	14	12	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	20	21	81	129	135	122	108	59	44	42
B5. Combination of B1-B4 using one-half standard deviation shocks	20	21	30	27	29	27	24	15	13	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	20	21	23	24	26	24	22	14	12	12
PV of debt-to-revenue ratio										
Baseline	33	30	28	26	27	24	24	**21**	19	19
A. Alternative Scenarios (Standard and Customized)										
A1. Key variables at their historical averages in 2014-2034 1/	33	30	12	-6	-20	-25	-32	-22	-17	-15
A2. New public sector loans on less favorable terms in 2014-2034 2	33	30	28	27	28	26	27	27	28	28
Customized 1. Lower real GDP growth	32	29	28	27	41	40	43	68	203	219
Customized 2. Lower grants	32	29	27	25	42	52	85	295	514	522
B. Bound Tests										
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	33	30	28	26	27	25	25	22	20	20
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	33	30	30	34	35	31	31	26	23	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	33	30	28	26	27	25	24	22	20	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	33	30	97	136	134	119	115	89	68	66
B5. Combination of B1-B4 using one-half standard deviation shocks	33	30	36	26	27	24	24	21	19	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	33	30	39	36	37	34	33	30	27	27

Table 3b. Islamic Republic of Afghanistan: Sensitivity for Key Indicators of Public and Publicly Guarantee External Debt, 2013–34 (Continued)

(In percent)

	Estimate	Projections								
	2013	2014	2015	2016	2017	2018	2019	2024	2033	2034
Debt service-to-exports ratio										
Baseline	1	1	1	1	1	1	1	1	1	1
A. Alternative Scenarios (Standard and Customized)										
A1. Key variables at their historical averages in 2014-2034 1/	1	1	1	1	0	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2014-2034 2	1	1	1	1	1	1	1	1	1	1
Customized 1. Lower real GDP growth	1	1	1	1	2	2	1	3	14	16
Customized 2. Lower grants	1	1	1	1	2	2	3	10	41	42
B. Bound Tests										
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	1	1	1	1	1	1	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	1	1	1	1	2	2	1	1	1	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	1	1	1	1	1	1	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	1	1	1	2	4	3	3	1	1	1
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	1	1	1	1	1	1	1	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	1	1	1	1	1	1	1	1	1	1
Debt service-to-revenue ratio										
Baseline	1	2	1	1	1	1	1	1	1	1
A. Alternative Scenarios (Standard and Customized)										
A1. Key variables at their historical averages in 2014-2034 1/	1	2	1	1	0	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2014-2034 2	1	2	1	1	1	1	1	1	2	2
Customized 1. Lower real GDP growth	1	2	2	1	2	2	1	4	14	16
Customized 2. Lower grants	1	2	1	1	2	2	3	15	61	65
B. Bound Tests										
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	1	2	2	1	1	1	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	1	2	1	1	1	1	1	1	1	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	1	2	2	1	1	1	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	1	2	1	3	4	3	3	2	2	2
B5. Combination of B1-B4 using one-half standard deviation shocks	1	2	1	1	1	1	1	1	1	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	1	2	2	2	2	2	1	1	1	1
Memorandum item:										
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	57	57	57	57	57	57	57	57	57	57

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

1/ Applies only to standard DSA

2/ Applies only to standard DSA

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 4a. Islamic Republic of Afghanistan: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011–34

(In percent of GDP, unless otherwise indicated)

	Actual		Estimate			Projections								
	2011	2012	2013	Average 5/	Standard Deviation 5/	2014	2015	2016	2017	2018	2019	2024	2033	2034
Public sector debt 1/	6.9	6.5	6.1			5.9	5.8	6.5	7.5	9.4	9.3	12.0	17.3	17.4
of which: foreign-currency denominated	6.9	6.5	6.1			5.9	5.8	5.8	5.7	5.6	5.6	5.6	5.9	5.9
Change in public sector debt	-1.6	-0.5	-0.4			-0.2	-0.1	0.7	1.0	1.9	-0.1	0.4	0.2	0.2
Identified debt-creating flows	-0.1	-1.8	0.5			0.1	0.5	-0.4	0.0	-0.9	0.5	0.5	0.1	0.1
Primary deficit	0.6	-0.2	0.6	0.9	1.5	0.4	0.8	-0.1	0.7	0.9	1.3	1.0	0.7	0.7
Revenue and grants	21.3	25.2	23.7			28.2	28.9	30.6	33.9	35.8	35.8	34.4	33.0	32.5
of which: grants	10.3	15.1	14.2			17.9	17.8	18.1	21.5	22.0	21.8	17.8	13.2	12.5
Primary (noninterest) expenditure	21.8	25.0	24.3			28.6	29.7	30.5	34.7	36.6	37.1	35.4	33.6	33.2
Automatic debt dynamics	-0.6	-1.0	-0.1			-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.4	-0.5	-0.5
Contribution from interest rate/growth differential	-0.7	-0.9	-0.3			-0.3	-0.3	-0.4	-0.4	-0.5	-0.6	-0.5	-0.5	-0.5
of which: contribution from average real interest rate	-0.2	-0.1	-0.1			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.1	0.1
of which: contribution from real GDP growth	-0.5	-0.9	-0.2			-0.2	-0.3	-0.3	-0.3	-0.4	-0.5	-0.5	-0.7	-0.7
Contribution from real exchange rate depreciation	0.1	0.0	0.2			0.0	0.0	0.0	0.0	0.1	0.1	...	...	...
Other identified debt-creating flows	-0.1	-0.6	0.0			0.0	0.0	0.0	-0.4	-1.4	-0.3	0.0	0.0	0.0
Privatization receipts (negative)	-0.1	-0.6	0.0			0.0	0.0	0.0	-0.4	-1.4	-0.3	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	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	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	0.0
Residual, including asset changes	-1.5	1.4	-0.8			-0.3	-0.6	1.1	1.0	2.8	-0.5	-0.2	0.1	0.0
Other Sustainability Indicators														
PV of public sector debt	...	...	3.1			3.1	3.1	3.9	5.1	7.2	7.1	9.9	15.2	15.3
of which: foreign-currency denominated	...	...	3.1			3.1	3.1	3.2	3.3	3.3	3.4	3.5	3.8	3.8
of which: external	...	...	3.1			3.1	3.1	3.2	3.3	3.3	3.4	3.5	3.8	3.8
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...	...	...	...
Gross financing need 2/	0.7	-0.2	0.7			0.5	1.0	0.1	0.9	1.1	1.6	1.5	1.5	1.6
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	13.2			10.9	10.8	12.9	15.2	20.0	20.0	28.9	46.1	47.2
PV of public sector debt-to-revenue ratio (in percent)	...	...	33.0			29.8	28.1	31.7	41.2	52.0	51.1	59.9	77.0	76.6
of which: external 3/	...	...	33.0			29.8	28.1	25.9	26.6	24.3	24.1	21.2	19.4	19.1
Debt service-to-revenue and grants ratio (in percent) 4/	0.3	0.2	0.5			0.6	0.6	0.5	0.5	0.7	0.9	1.6	2.7	2.8
Debt service-to-revenue ratio (in percent) 4/	0.7	0.6	1.2			1.5	1.5	1.3	1.5	1.7	2.2	3.3	4.5	4.6
Primary deficit that stabilizes the debt-to-GDP ratio	2.2	0.2	1.0			0.6	0.9	-0.7	-0.3	-1.0	1.4	0.6	0.4	0.5
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	6.5	14.0	3.6	8.8	6.1	3.2	4.5	5.0	5.1	5.3	5.6	4.6	4.1	4.1
Average nominal interest rate on forex debt (in percent)	0.9	0.6	0.3	1.8	2.9	0.4	0.4	0.4	0.5	0.6	0.7	0.8	1.0	1.0
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...	-1.2	0.0	0.3	1.7	1.7	1.8
Real exchange rate depreciation (in percent, + indicates depreciation)	1.5	-0.2	2.8	-4.1	4.6	-0.9	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	10.3	8.5	7.2	8.7	4.8	5.3	5.7	5.4	4.9	4.9	4.9	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	12.2	30.4	0.6	4.5	9.9	21.7	8.4	8.0	19.3	11.2	6.8	3.9	2.8	2.8
Grant element of new external borrowing (in percent)	...	...	...	...	...	49.6	42.5	43.4	46.2	49.6	49.6	49.6	49.6	49.6

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

1/ Central government

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 4b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public Debt 2013–34

(In percent of GDP, unless otherwise indicated)

	Estimate	Projections								
	2013	2014	2015	2016	2017	2018	2019	2024	2033	2034
PV of Debt-to-GDP Ratio										
Baseline	3	3	3	4	5	7	7	10	15	15
A. Alternative scenarios (Standard and Customized)										
A1. Real GDP growth and primary balance are at historical averages	3	3	3	4	5	7	7	8	9	9
A2. Primary balance is unchanged from 2014	3	3	3	4	5	7	6	8	10	11
Customized 1. Lower real GDP growth	3	3	3	3	5	6	6	12	41	45
Customized 2. Lower grants	3	3	4	5	9	13	20	64	131	136
B. Bound tests										
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	3	3	3	4	6	8	9	13	21	21
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	3	3	4	6	7	9	9	12	16	17
B3. Combination of B1-B2 using one half standard deviation shocks	3	3	4	5	6	8	8	10	13	13
B4. One-time 30 percent real depreciation in 2015	3	3	4	5	6	8	8	11	15	16
B5. 10 percent of GDP increase in other debt-creating flows in 2015	3	3	8	9	10	12	12	14	18	18
PV of Debt-to-Revenue Ratio 2/										
Baseline	13	11	11	13	15	20	20	29	46	47
A. Alternative scenarios (Standard and Customized)										
A1. Real GDP growth and primary balance are at historical averages	13	11	11	14	17	21	20	27	33	34
A2. Primary balance is unchanged from 2014	13	11	10	13	15	19	18	22	32	32
Customized 1. Lower real GDP growth	13	11	11	11	15	15	16	30	112	124
Customized 2. Lower grants	13	11	13	17	29	42	66	256	525	548
B. Bound tests										
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	13	11	11	14	17	23	23	37	62	65
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	13	11	14	20	21	25	25	34	50	51
B3. Combination of B1-B2 using one half standard deviation shocks	13	11	12	17	18	23	22	28	41	41
B4. One-time 30 percent real depreciation in 2015	13	11	15	17	18	23	23	31	47	48
B5. 10 percent of GDP increase in other debt-creating flows in 2015	13	11	29	30	30	33	33	40	55	56
Debt Service-to-Revenue Ratio 2/										
Baseline	0	1	1	1	1	1	1	2	3	3
A. Alternative scenarios (Standard and Customized)										
A1. Real GDP growth and primary balance are at historical averages	0	1	1	1	1	1	1	1	2	2
A2. Primary balance is unchanged from 2014	0	1	1	1	1	1	1	1	2	2
Customized 1. Lower real GDP growth	0	1	1	1	1	1	1	3	11	13
Customized 2. Lower grants	0	1	1	1	1	1	2	13	53	57
B. Bound tests										
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	0	1	1	1	1	1	1	2	3	3
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	0	1	1	1	1	1	1	2	3	3
B3. Combination of B1-B2 using one half standard deviation shocks	0	1	1	1	1	1	1	2	2	3
B4. One-time 30 percent real depreciation in 2015	0	1	1	1	1	1	1	2	3	3
B5. 10 percent of GDP increase in other debt-creating flows in 2015	0	1	1	1	1	1	1	2	3	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
the Islamic Republic of Afghanistan
May 16, 2014

1. **This statement summarizes information that has become available since the issuance of the staff report on April 23.** The new information does not change the thrust of the staff appraisal, but does underscore the need to maintain the rate of 10 percent in the VAT law.

2. **The preliminary results from the April 5 presidential elections indicate a second round in late-May or June**. The April 26 preliminary results indicate that none of the candidates won an outright majority. Complaints will be adjudicated before the final results are announced, expected in May. The second round will be a runoff between the top two candidates from the first round and held within 15 days of final first round results.

3. **Money and international reserves were close to projected levels at the end of first quarter of 2014**. Inflation was 5.6 percent year-on-year in March. The Afghani depreciated by 2.2 percent since the beginning of 2014 and was Af 57.3 per U.S. dollar on May 7.

4. **The treasury's cash position is very constrained.** The cash position has deteriorated significantly recently, as lower revenue and higher expenditures around the election ran down cash balances. On May 5, the cash balance was Af 4.5 billion compared to Af 54.5 billion at end-April 2013 and Af 21 billion at the beginning of the fiscal year. Thus far, the treasury has remained current on wages and salaries. However, risks remain that arrears could be incurred. Moreover, President Karzai reportedly signed a decree providing bonus payments to security personnel amounting to Af 1.5 billion, which, if implemented, could pressure further the cash position.

5. **VAT legislation experienced a setback.** The VAT law has been approved by the lower house of parliament, but the VAT rate was reduced from 10 to 8 percent. This law will be discussed by the upper house. The tax administration law (needed to implement the VAT) is awaiting parliamentary approval.

6. **Further progress has been made in structural reform.** The anti-money

laundering and countering financing of terrorism laws were approved by the cabinet on May 5. The Economic Crimes Task Force (ECTF) has submitted its advice on categories of economic offences to be included in the penal code to the Criminal Law Review Working Group and the transfer of taxpayers from the small and medium taxpayer offices to the large taxpayer office has been completed. With the implementation of these two benchmarks, 21 of 24 structural benchmarks planned between June 2012 and December 2013 have now been completed. Efforts continue to implement other reforms. The mining law has also been approved by the lower house.

INTERNATIONAL MONETARY FUND

COM COMMUNICATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

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

On May 16, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Islamic Republic of Afghanistan.

Over the past decade, Afghanistan has made enormous progress in reconstruction, development, and lifting per capita income. Important steps have been taken to lay the foundation for macroeconomic stability and growth, to reduce poverty, and to achieve social and development objectives. However, security conditions, political uncertainty, and weak institutions continue to constrain growth and weigh on social outcomes. The international community has delivered substantial financial support and pledged to continue doing so over the medium term.

With significant domestic efforts and donor support, Afghanistan has maintained macroeconomic stability, implemented important structural reforms, and built policy buffers—namely a comfortable international reserves position, low debt and inflation, and balanced budget and external current account positions. Nonetheless, significant vulnerabilities remain and several reforms have been delayed. After the first review of Afghanistan's IMF-supported program in June 2012 (Press Release No. 12/245), subsequent reviews were delayed due to missed quantitative targets and slower than planned implementation of structural reforms.

Over the past two years, economic activity has been affected by political and security uncertainties and the drawdown of international troops. These uncertainties reduced confidence, discouraged private investment, and held back economic activity. Growth slowed from 14 percent in 2012 (boosted by a bumper harvest) to an estimated 3.6 percent in 2013. Inflation remained in single digits (5.6 percent year-on-year in March 2014). International reserves also remained at a comfortable level equivalent to over seven months of imports.

[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.

Partly reflecting weaker economic activity, budget revenue performance deteriorated significantly in 2012–13, despite additional measures, and was short of the targets established in June 2012. The revenue shortfall resulted in a tight cash position for the treasury and required limiting expenditure. As a result, expenditure as a share of GDP declined in 2013. Progress was made in structural reform efforts, but implementation was slower than planned. Noteworthy accomplishments included: publishing the inquiry into the Kabul Bank crisis; submitting the new banking, value added tax (VAT), and tax administration laws to parliament; strengthening border control management; preparing a new sukuk law; and adopting a strategic plan for financial supervision. However, delays have been encountered in introducing the value added tax and submitting to parliament the laws on anti-money laundering and countering of financing of terrorism, and amendments to the central bank law.

This year, 2014, is crucial in the political and security transitions and the run-up to the "transformation decade," which starts in 2015. Assuming smooth political and security transitions, continued reform and donor financing, the outlook should be positive. Large security and development expenditure needs and a limited domestic revenue capacity mean that Afghanistan will remain dependent on donor financing for an extended period. In addition to donor support, macroeconomic stability, structural reforms, and political and security stability are needed to ensure durable and inclusive growth. Risks to the outlook are mostly on the downside.

Executive Board Assessment[2]

The Executive Directors commended the authorities for the significant progress made over the past decade in reducing poverty and raising living standards, rebuilding infrastructure and institutions, maintaining macro stability, building up economic buffers, and continuing structural reform in a challenging security environment and in the context of weak administrative capacity. Strong support from the international community contributed to these achievements.

Nonetheless, Directors agreed that much more needs to be done to sustain high and inclusive growth, further alleviate poverty, and reduce outstanding vulnerabilities, including dependence on donor financing, limited domestic revenue capacity in the face of large public expenditure needs, and a fragile banking system. They noted that the growth outlook remains clouded by considerable downside risks, mainly related to possible adverse domestic or regional security developments, political instability, inadequate implementation of economic policies, and donor fatigue.

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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.

Directors supported the authorities' economic strategy, focused on maintaining macroeconomic stability, increasing domestic revenue mobilization, reinforcing the banking system, and strengthening economic governance. They underscored, however, the importance of strengthened implementation.

Directors stressed that raising domestic revenue is a priority for fiscal sustainability and meeting development and security needs. In this regard, they emphasized the importance of reaching the domestic revenue targets and looked forward to the swift enactment of the VAT law, with a rate consistent with the need to increase revenue mobilization over the medium term, and the tax administration law. Directors encouraged the authorities to promptly finalize a fiscal regime for the natural resources sector and refrain from granting investment incentives and tax exemptions.

Directors concurred that continued efforts are needed to strengthen the banking system and promote financial deepening. They encouraged the central bank to monitor the banking system closely and enforce prudential regulations decisively. They looked forward to the rapid implementation of the strategic plan for strengthening financial sector supervision and recommended the prompt passage and implementation of the new banking law, amendments to the central bank law, and provisions to assure adequate legal protection of central bank supervisory staff. They encouraged stronger efforts to recover Kabul Bank assets and finalize the privatization of New Kabul Bank.

Directors recommended that economic governance reforms continue to focus on improving institutional capacity and the business environment and strengthening the regime against money laundering and the financing of terrorism, for which legislation in line with international standards should be submitted promptly to parliament for approval.

Directors stated that the Fund should continue its close engagement with the authorities, including within the agreed informal short term framework for 2014, to ensure continued macroeconomic stability and reform. Continued support from donors will also be crucial.

Islamic Republic of Afghanistan: Selected Economic Indicators, 2011–14
(Population: approx. 30 million; 2012)
(Per capita GDP: approx. US$680; 2012)
(Poverty rate: 36 percent; 2008)

	2011	2012	2013	2014
	Act.	Est.	Est.	Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)			
Real GDP	6.5	14.0	3.6	3.2
Nominal GDP (in billions of U.S. dollars)	17.9	20.3	20.7	21.7
Consumer prices (period average) 2/	11.8	6.4	7.4	6.1
Public finances (central government) 3/	(In percent of GDP)			
Domestic revenues and grants	21.3	25.2	23.7	28.2
Domestic revenues	11.0	10.1	9.5	10.3
Grants	10.3	15.1	14.2	17.9
Expenditures	21.9	25.0	24.3	28.6
Operating 4/	16.3	18.2	17.3	21.7
Development	5.6	6.8	7.0	6.9
Operating balance (excluding grants) 5/	-5.3	-8.1	-7.8	-11.4
Overall balance (including grants)	-0.6	0.2	-0.6	-0.4
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)			
Reserve money	21.9	3.9	12.4	12.7
Broad money	21.3	8.8	11.9	12.4
External sector 1/	(In percent of GDP, unless otherwise indicated)			
Exports of goods (in U.S. dollars, percentage change)	1.8	2.7	-5.2	-7.9
Imports of goods (in U.S. dollars, percentage change)	2.9	11.2	-2.2	-2.1
Current account balance				
Excluding official transfers	-42.1	-42.3	-40.6	-38.1
Including official transfers	3.1	3.9	2.8	3.3
Foreign direct investment	2.1	2.0	0.7	1.2
Total external debt 6/	6.9	6.5	6.1	5.9
Gross international reserves (in millions of U.S. dollars)	6,208	6,867	6,886	7,099
Import coverage of reserves 7/	6.0	6.9	7.1	7.2
Exchange rate (average, Afghanis per U.S. dollars)	46.7	50.9	55.4	…
Memorandum items	2011/12	2012/13	2013/14	2014/15
Opium production (in tons)	5,800	3,700	5,500	...

Sources: Afghan authorities; United Nations Office on Drugs and Crime; and IMF staff estimates and projections.
1/ Excluding the narcotics economy.
2/ Revised with improved coverage.
3/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is closer 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 next year's import of goods and services.

Statement by Mr. Daïri, Alternate Executive Director for Islamic Republic of Afghanistan and Mr. Monajemi, Senior Advisor to Executive Director
May 16, 2014

On behalf of our authorities, we thank the Executive Directors and Management for their continued support to Afghanistan. We also thank staff for the high quality report and the constructive engagement with the authorities.

Overview

Afghanistan is undergoing important political and security transitions. The first round of presidential election was held in April 2014, and a run-off between the two leading candidates is scheduled for mid-June, 2014. A new government will be formed after completion of the presidential election, and parliamentary elections are scheduled in 2015. Transitional security arrangements are underway in connection with the drawdown of international troops in 2014. These important changes usher a new era for Afghanistan, even though related uncertainty has affected short-term economic performance.

Afghanistan has achieved major strides in improving per capita incomes, reducing poverty and reaching other MDGs, while stabilizing the economy, implementing important structural reforms, and rebuilding infrastructure. These achievements, which are well rendered in the report, have been made in a challenging political and security environment and in the context of weak administrative and institutional capacity, but also with strong support from donors and international institutions, including the Fund, for which the authorities are grateful. Yet, much remains to be done to sustain high and inclusive growth, further reduce poverty, strengthen the financial sector, improve governance, and reduce dependence on donor financing over the medium term. The authorities are determined to continue to address these challenges with support from the international community, along the lines of the principles, objectives, and reform commitments agreed in 2012 under the Tokyo Mutual Accountability Framework (TMAF).

Program implementation

Despite the difficult political and security environment, the authorities continued to show strong determination to implement their ECF-supported program. However, after successfully completing the first program review in June 2012, subsequent reviews were delayed due to unanticipated shocks that hit the economy, and non-implementation of some prior actions resulting from the authorities' efforts to reach consensus over some complex reforms and from capacity constraints, mainly in the preparation of draft legislation and the related review process.

As highlighted in the staff report, despite corrective actions taken by the authorities in the second half of 2013, the policy framework, which was revised in May 2013, could not be implemented due to much weaker than projected economic conditions, resulting from the withdrawal of international troops and greater transition uncertainties. Nonetheless, macroeconomic stability was preserved, and significant progress was made in the ambitious structural reform agenda, with 22 out of the 25 structural benchmarks planned between June 2012 and December 2013 implemented. As indicated in the staff supplement, staff was able to confirm that the benchmarks on categories of offences to be included in the new consolidated penal code, and on the transfer of some taxpayers to the large tax payer office, were met. The benchmark on the action plan for AML/CFT was partly met, with three out of the four requirements in place and the fourth, submission to parliament of amendments to the AML/CFT law, virtually met after the adoption of the new AML and CFT laws by the Cabinet. The policies, guidelines and procedures regarding the duties, functions, and protections of supervisory staff (also a benchmark) were adopted in December 2013, as required, but need some strengthening and also to be made consistent with Afghan laws. The revised policy will be submitted to the DAB Supreme Council in June 2014. Finally, the submission to parliament of amendments to the central bank legislation which was expected at end-December 2013 has been delayed, as the draft is being reviewed by the Ministry of Justice. Moreover, the authorities have maintained close dialogue with staff, as evidenced by the agreement reached on an informal short-term policy framework for 2014 aimed at maintaining macroeconomic stability and strengthening the financial sector.

Recent developments and outlook

Following an impressive growth performance of 14 percent in 2012, boosted by a bumper crop, economic activity is estimated to have decelerated to 3.6 percent in 2013. Growth was dampened by the uncertainty over the political and security transition leading to a decrease in private investment. As a result of their prudent policies, the authorities have successfully managed to contain inflation in comfort zone throughout 2013 and the first quarter of 2014. Inflation decelerated to 5.6 percent year-on-year in March 2014, and is expected to remain in single digits for the year as a whole. Despite the revenue shortfall from much weaker economic activity, the operating fiscal deficit, before grants, was limited to 7.8 percent of GDP in 2013, due to government’s efforts in curbing expenditures. The current account deficit, excluding official transfers, is estimated at 41 percent of GDP in 2013, or 2 percentage points lower than envisaged under the program.

The growth outlook for 2014 is also affected by lingering uncertainty and the adverse impact of the international troop withdrawal, with real GDP projected to grow by about 3 percent in 2014 before picking up to about 5 percent on average over the period 2015–18. The growth momentum could be strengthened by dissipation of political and security uncertainty, sustained reforms, and higher donor financing under the TMAF, as well as by the envisaged development of natural resources, as indicated in the report. Possible downside risks could emanate from significant shortcomings in these areas, as well as from adverse global or regional developments.

The short-term macroeconomic objectives and policies agreed with staff aim at increasing fiscal space through revenue mobilization and tight expenditure control, keeping inflation in single digits, maintaining international reserves buffer, and safeguarding the financial system while strengthening the AML/CFT regime.

Fiscal policies and reforms

The operating deficit, before grants, projected for 2014 increases by 3.8 percent of GDP, compared to the 2013 outcome. This results from an increase in operating expenditure to the tune of 4.4 percent of GDP, reflecting the cost of the security transition, a large part of which will be financed by donors, and a small part (0.8 percent of GDP) will be covered from higher domestic revenue. In this connection, although weak economic activity is likely to weigh down on revenue, the authorities will redouble efforts at revenue mobilization through new taxes and efforts to strengthen tax and customs administrations.

Major reforms are underway to strengthen revenue mobilization and expenditure control over the medium term. The draft VAT law was recently passed by the lower house of parliament and has been submitted to the senate for approval. Preparatory work is underway to implement the VAT upon its final adoption, including through provision of information to taxpayers and other stakeholders on the associated procedures. The tax administration law needed to implement the VAT has also been submitted to parliament. To strengthen customs administration, the import valuation system will be improved and the jurisdiction over valuation issues will be centralized in an appropriately resourced and trained unit. The customs department has recently recruited four local valuation specialists through a World Bank funded project to further improve the performance of the valuation unit. Furthermore, the authorities have prepared, with IMF technical assistance, a framework for an effective and transparent fiscal regime for mineral resources, which is compliant with the Extractive Industries Transparency Initiative. The draft mining law has been submitted to parliament and has been adopted by the lower house. Reforms in budget management are also underway, including enhancing line ministries' capacity to prepare financial plans and manage contracts and associated budgets. Moreover, electronic transfers for salaries and contractual payments will be used, for which preparations are well advanced.

Debt sustainability

Afghanistan's debt is currently very modest (6.1 percent of GDP at end-2013), and is sustainable under the baseline scenario of continued reform and donor support, as well as a smooth political and security transition. Vulnerabilities stemming from downside risks to the baseline assumptions, however, namely weaker growth, shortfalls in donor financing, faltering reform, and deterioration in the security situation could put Afghanistan at high risk of debt distress. This underscores the importance of continued reforms, including mobilization of domestic revenue, and adequate donor financing in the form of grants. While the authorities are committed to doing their part in ensuring debt sustainability and recognize the critical importance of revenue mobilization, continued donor assistance at pledged levels is crucial. The authorities are hopeful that donors will also intensify their efforts to further align their assistance with Afghan priorities, sign multi-year financing agreements, and channel more funds through the budget.

Financial sector reforms

The report and SIP usefully review the factors behind the difficulties faced by the financial system in Afghanistan. Against this background, reforms in the financial sector will be focused on strengthening bank supervision, enhancing the banking sector's contribution to growth, and developing financial markets. The central bank is taking steps to strengthen supervision and better enforce existing banking laws and regulations, while also reviewing and improving the regulatory framework, as needed. The new banking law, which was submitted to parliament in February 2013, will help enhance supervisory oversight over the financial sector by strengthening corporate governance, prudential requirements, enforcement measures, and bank resolution. The role of the financial supervision department (FSD) will be further reinforced with additional staff, off-site surveillance, including automation of supervisory reporting, and with enhanced on-site examination process. The Supervisory Enforcement Committee will continue its regular reviews of banks' compliance with FSD's orders, while the central bank's report to parliament will allow legislators to evaluate and monitor progress in this area.

The authorities remain committed to continuing their asset recovery efforts and completing the resolution of Kabul Bank, including the sale of New Kabul Bank (NKB) after due diligence is completed. They are aware that successful privatization of NKB will be important to strengthen the financial sector, mobilize donor support, restore investor confidence, and support growth. The central bank has reported that by end-February 2014, it had recovered a total of $175 million in assets, with additional assets of a book value of about $60 million also recovered and available for sale. The recovery process is complicated by several factors, including difficulties in finding buyers for domestic assets, ascertaining legal documentation of property ownership, appeals of the verdicts in criminal cases, and slow progress in recovering assets held abroad.

Governance

Governance reform has continued, including steps to strengthen the finance ministry's oversight over public enterprises, the publication of the inquiry report on the Kabul Bank crisis, and the endorsement by the cabinet of an economic crimes road map in February 2013. An Economic Crimes Task Force has been set up under the chairmanship of the economy minister to oversee and coordinate the implementation of the road map. In addition, the authorities intend to enact FATF-consistent AML/CFT legislation and adopt a national strategy that will include money laundering and terrorist financing risk assessments. Significant efforts are underway to strengthen capacity in the area of AML/CFT. The Cabinet passed the draft AML/CFT legislation on May 5, 2014; its submission to parliament should follow shortly.

Conclusion

The Afghan authorities highly value the Fund's continued support and policy advice over the past years, and are very appreciative of the valuable technical assistance they have received. They remain committed to economic and financial reforms needed to sustain high inclusive growth, reduce poverty, and achieve the MDGs. As they face important challenges during and after the political and security transition underway, they look forward to continued strong support from and close collaboration with their development partners.