IMF Country Report No. 17/377

ISLAMIC REPUBLIC OF AFGHANISTAN

December 2017

2017 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE ISLAMIC REPUBLIC OF AFGHANISTAN

In the context of the staff report for the 2017 article iv consultation and second review under the extended credit facility arrangement, and request for modification of performance criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its December 8, 2017 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 8, 2017, following discussions that ended on October 7, 2017, with the officials of the Islamic Republic of Afghanistan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 21, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for the Islamic Republic of Afghanistan.

The document listed below will be separately released:

Selected Issues

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

Copies of this report are available to the public from
International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 17/476
FOR IMMEDIATE RELEASE
December 8, 2017

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

IMF Executive Board Concludes 2017 Article IV Consultation and Completes the Second Review Under the ECF for the Islamic Republic of Afghanistan

On December 8, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Islamic Republic of Afghanistan and completed the second review of the arrangement under the Extended Credit Facility (ECF) for Afghanistan.[2]

Since 2002, with financial and security support from the international community, Afghanistan has made important strides in rebuilding its economy. Nonetheless, important challenges remain as the country remains conflict-affected, poor, and aid-dependent. While macroeconomic policies have been broadly successful in maintaining fiscal and external sustainability, over time they need to prepare for lower external support. The authorities should support growth by strengthening institutions, addressing corruption, building up physical and human capital, developing the financial sector, making access to financial services more inclusive, and improving the business climate.

Real GDP grew by 2.4 percent in 2016 thanks to higher agricultural output, up from 1.3 percent in 2015. For 2017, growth is projected at 2.5 percent and at 3 percent for 2018. This is below the rate of growth needed to reduce unemployment, and is contingent on an improvement in confidence, implementation of reforms, and continued strong donor support. Consumer price inflation remains moderate and is expected to average 6 percent in 2018. Afghanistan has made progress in strengthening the country's anti-corruption framework and its efforts in anti-monetary laundering and counter financing of terrorism (AML/CFT) resulted in the recent exit from the Financial Action Task Force's (FATF) monitoring process.

[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.

[2] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems. Details on Islamic Republic of Afghanistan's arrangement are available at www.imf.org/external/country/AFG.

Executive Board Assessment[3]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' commitment to economic transformation in pursuit of their objective of raising inclusive growth, boosting job opportunities for the rapidly rising population, and reducing aid dependency. Directors welcomed the authorities' steps to rebuilding institutions, maintaining macroeconomic and external stability, strengthening economic buffers, and continuing to implement structural reforms. However, Directors stressed the many obstacles and vulnerabilities to achieving these objectives, including the prolonged conflict, the heavy dependence on aid, and the impact of corruption and political uncertainty. Against this challenging backdrop, they emphasized that continued strong program ownership and steadfast reform efforts remain essential to help mitigate program implementation risks, particularly given the coming electoral cycle.

Directors urged the authorities to maintain low debt levels and ensure debt sustainability, including through the continued limits on new external debt and the elevated concessional borrowing rate. They agreed that the overall budget balance including grants should remain the fiscal anchor, and that the authorities should target a broadly balanced budget. Raising domestic revenue in a fair and sustainable manner remains a priority to meet pressing needs while shifting toward pro poor and pro-growth spending. Fiscal sustainability needs to be underpinned by a strong fiscal reform effort, including enhanced tax administration and the adoption of a VAT by 2021, while avoiding tax concessions.

Directors urged the authorities to improve public financial and investment management to make better use of existing resources and lay the foundation for a gradual scaling up of infrastructure investment. They advised developing and implementing a sound strategy to manage state owned corporations and enterprises—beginning with improving transparency.

Directors welcomed the progress with financial sector reforms for banking system stability, financial inclusion, and economic development. They stressed the importance of continued improvement of regulatory and supervisory frameworks, deposit insurance infrastructure, and crisis preparedness. Directors encouraged the authorities to strengthen the independence of the central bank and implement a sound strategy for the state owned commercial banks. They also welcomed the progress in restoring the central bank's balance sheet, while encouraging ongoing determined efforts to recover Kabul Bank assets.

While welcoming the authorities' progress with anti-corruption measures, most notably by criminalizing corruption in line with the United Nations Convention Against Corruption and

[3] 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.

requiring asset declarations by public officials, Directors urged strong enforcement to boost stakeholders' confidence. They welcomed the FATF de listing, and encouraged further steps to strengthen the implementation of AML/CFT measures to protect financial stability and to detect and deter corruption and other crimes such as illicit drug production and trafficking.

Directors encouraged continued improvement in the quality and timeliness of economic data for sound economic policy making, with the support of IMF technical assistance.

It is expected that the next Article IV consultation with Islamic Republic of Afghanistan will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

With respect to the second review under the ECF arrangement for Afghanistan, all quantitative performance criteria and indicative targets were met. Of the seven structural benchmarks, five were met, and the two that were not met on time, were implemented with delay. The first review under the ECF arrangement was completed in May 2017 (see Press Release No. 17/192). The ECF arrangement for Afghanistan was approved on July 20, 2016 for a total amount equivalent to SDR 32.38 million (see Press Release No. 16/348).

The review completion allows for a disbursement of SDR 4.5 million (about US$6.2 million), bringing total disbursements under the ECF arrangement to SDR 13.5 million (about US$18.6 million). The Executive Board also approved the authorities' request for modification of two performance criteria approved by the Executive Board in May 2017, reflecting updates to the macroeconomic framework.

Continued strong ownership of the program by the government remains vital to its success. Reforms in the financial sector (turning the page on the Kabul Bank crisis), improved economic governance, and revenue mobilization combined with strengthened public financial management are critical. Sustained reform implementation will continue to be challenging in the context of fragile security and political uncertainty. In this environment, sustained backing by donors remains vital as well. The IMF remains committed to playing its role in the collective international effort to help Afghanistan.

Following the Executive Board's discussion, Mr. Mitsuhiro Furusawa, First Deputy Managing Director and Acting Chair, said:

"The Government of Afghanistan remains committed to implementing sound macroeconomic policies and structural reforms to boost inclusive growth and employment for the country's rapidly rising population, and reduce aid dependency. In pursuing these objectives, the authorities are guided by the Afghanistan National Peace and Development Framework and supported by the IMF Extended Credit Facility.

“The difficult security situation has reduced confidence, thwarted investment, and undermined growth and job creation. Poverty remains high, and the country continues to be dependent on external grants for external and fiscal sustainability.

“The authorities’ macroeconomic policy mix, aimed at maintaining fiscal and external stability with low inflation and a flexible exchange rate, is appropriate going forward. These policies can help mitigate the impact of insecurity and political uncertainty.

“Fiscal policy should continue to focus on fair and sustainable domestic revenue mobilization, while resources should shift toward growth-supportive development spending with adequate social safety nets. Public financial and investment management need further strengthening to ensure that resources are put to best use and to prepare for an eventual gradual scaling up of infrastructure investment.

“Further financial sector reforms are critical to ensure a resilient banking system. Key priorities remain overcoming the Kabul Bank crisis legacy, implementing a sound strategy for state-owned commercial banks to reduce fiscal and financial stability risks, and strengthening the independence of the central bank.

“The anti-corruption and AML/CFT agenda has advanced, and strong enforcement of these measures is needed to build confidence.

“Continued strong political will and program ownership by the government remains vital to the success of the reforms. The IMF continues to assist Afghanistan, including through the provision of technical assistance.”

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2014–18
(Quota: SDR 323.8 million)
(Population: approx. 33.4 million)
(Per capita GDP: approx. US$582; 2016)
(Poverty rate: 39.1 percent; 2014)
(Main exports: opium, US$2.0 billion; carpets, US$92.8 million; 2015)

	2014	2015	2016	2017	2018
				Proj.	
Output and prices 1/	(Annual percentage change, unless otherwise indicated)				
Real GDP	2.7	1.3	2.4	2.5	3.0
Nominal GDP (in billions of Afghanis)	1,183	1,228	1,320	1,429	1,561
Nominal GDP (in billions of U.S. dollars)	20.6	20.1	19.5	21.0	22.5
Consumer prices (period average) 2/	4.7	-0.7	4.4	5.5	6.0
Public finances (central government) 3/					
Domestic revenues and grants	23.7	24.5	26.1	24.0	25.4
Domestic revenues	8.5	10.0	10.7	10.7	10.9
On-budget grants (excl. donors' direct spending outside the budget)	15.2	14.6	15.4	13.3	14.6
Expenditures	25.4	25.9	26.0	23.9	25.4
Operating 4/	19.3	19.2	18.9	17.7	18.6
Development	6.1	6.8	7.1	6.2	6.8
Operating balance (excluding grants) 5/	-10.8	-9.2	-8.2	-7.0	-7.8
Overall balance (including grants)	-1.7	-1.4	0.1	0.1	0.0
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)				
Reserve money	13.2	2.3	11.8	9.7	10.8
Broad money	8.1	3.1	9.8	7.8	8.1
External sector 1/	(In percent of GDP, unless otherwise indicated)				
Exports of goods (in millions of U.S. dollars)	643	580	619	723	847
Exports of goods (annual percentage change)	26.8	-9.8	6.8	16.7	17.2
Imports of goods (in millions of U.S. dollars)	6,532	7,666	6,160	7,065	7,139
Imports of goods (annual percentage change)	-19.0	17.4	-19.6	14.7	1.1
Current account balance					
Excluding official transfers	-31.9	-30.1	-31.2	-30.8	-30.2
Including official transfers	5.5	7.5	7.1	4.5	3.3
Foreign direct investment	0.2	0.8	0.5	0.5	0.5
Total external debt 6/	6.4	6.8	6.3	6.1	6.1
Gross international reserves (in millions of U.S. dollars)	7,311	6,808	7,357	7,627	7,725
Import coverage of reserves 7/	10.2	10.9	10.4	10.5	10.0
Exchange rate (average, Afghanis per U.S. dollar)	57.4	61.2	67.9	…	…

Sources: Afghan Authorities, United Nations Office on Drug and Crime, WITS database, and IMF staff estimates and projections.
1/ Excluding the narcotics economy.
2/ Revised with improved coverage.
3/ For comparison, 2012 is recalculated from data reported on the solar fiscal year basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is more aligned with the Gregorian calendar year.
4/ Comprising mainly current spending.
5/ Defined as domestic revenues minus operating expenditures.
7/ In months of next year's import of goods and services.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

November 21, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Context: Despite the sharp drawdown of NATO troops in 2014 and the deteriorated security situation, the National Unity Government (NUG) is making good progress in economic reforms and growth has picked up modestly. The coming electoral cycle is expected to usher in a period of political uncertainty, leading to a more difficult environment for reform implementation. The donor community continues to actively support Afghanistan, as demonstrated by the successful donor conference in October 2016, while the U.S. government recently reaffirmed its continued military support.

Outlook and risks: The baseline scenario envisages growth at 2.5 to 3 percent in 2017–18, too low to prevent unemployment from rising further. Inflation is expected to be modest, and buffers should remain comfortable. The outlook is subject to significant downside risks, including a possible further deterioration in the security environment, a shortfall in grants, or stalled reforms. The key upside risk is lasting peace, which would boost inclusive growth.

Article IV discussions: Staff recommended: (i) preserving macroeconomic buffers (low debt, comfortable FX reserves), low inflation, and the flexible exchange rate regime; (ii) undertaking structural reforms in support of private sector-led inclusive growth, including increasing financial inclusion; (iii) fighting corruption; (iv) improving budgetary processes to ensure efficient and high quality spending; and (v) strengthening the financial sector including by restructuring public banks.

Program issues: Program performance has been satisfactory. All end-June performance criteria (PCs) have been met. Of the seven structural benchmarks (SBs), five were met and two were implemented with delay. Understandings were reached on the fourth review structural benchmarks. The authorities request the modification of two PCs for December 2017 that were revised due to updates of the macroeconomic framework.

Staff supports the completion of the second review under the Extended Credit Facility arrangement and the authorities' request for a modification of two performance criteria on the net credit to government and the net international reserves.

Approved By
Daniela Gressani and Bob Traa

Discussions took place in Baku during September 27–October 7, 2017. The staff team comprised Mr. Duenwald (head), Messrs. Sumlinski, Talishli, Tchaidze (all MCD), Mr. Barrett (FAD), Ms. Chen (LEG), Mr. Gitton (SPR), Mr. Pysaruk (MCM), and Mr. Muzaffari (local economist). Mr. Mojarrad (OED) and Ms. Gressani (MCD) joined the policy discussions. The team met with Governor Sediq, Deputy Finance Minister Payenda, and other senior officials. Ms. Sydorenko (MCD) provided research assistance and Ms. Orihuela (MCD) was responsible for document processing.

CONTENTS

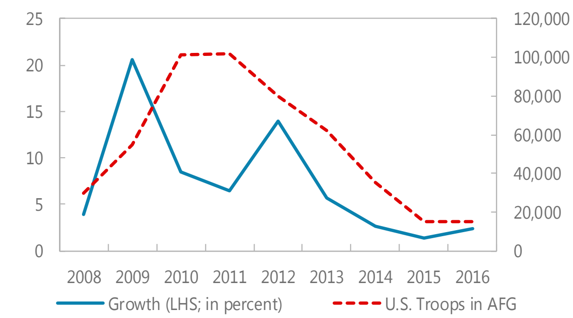
ANNEXES

APPENDIX

CONTEXT

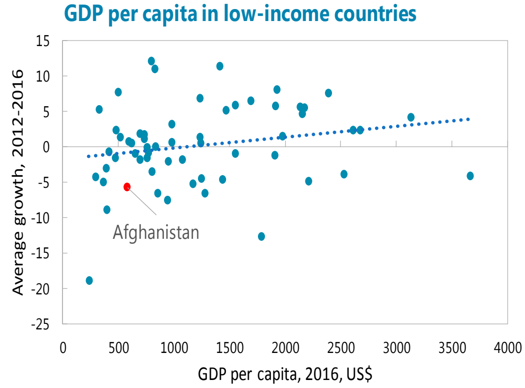
1. **Afghanistan is a conflict-affected and aid-dependent country**. It has been in conflict for the last 35 years. Security spending amounts to over 11 percent of GDP, and more than 60 percent of operating spending. Social indicators are weak: a literacy rate of 31 percent, life expectancy of 60 years, and the second highest infant mortality in the world. Afghanistan is ranked 169th globally in terms of perception of corruption (out of 176 countries). A grey economy, driven by multi-billion-dollar production of opium and cannabis, deprives the country of much needed tax revenue and finances the insurgency. There is a massive infrastructure gap.[1] GDP per capita is US$582, the lowest in the immediate region and declining in recent years, and the poverty rate was 39 percent in 2014. Large fiscal and current account deficits are financed by external aid of nearly 40 percent of GDP. After a strong, even if volatile, aid-driven economic growth performance combined with improved social indicators following the fall of Taliban in 2001, growth dropped sharply after the withdrawal of international troops starting in 2012 and a reduction in aid of some 24 percent over 2012–16.

Growth and U.S. Troops



Source: IMF staff calculations and Defense Manpower Data Center via FT

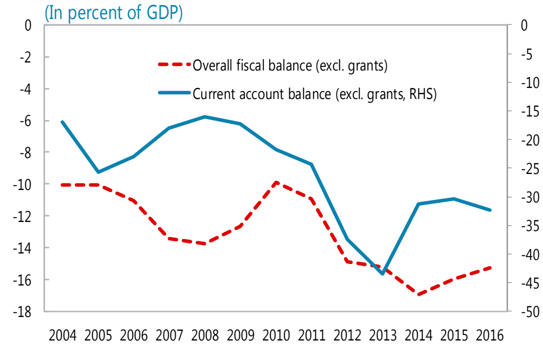
GDP per capita in low-income countries



Sources: Afghan authorities and IMF staff calculations.

Fiscal and External Deficits

(In percent of GDP)



[1] The 2017–21 National Infrastructure Plan contains projects worth US$6 billion (more than 30 percent of 2016 GDP) in the areas of energy, transport, water, urban development, and regional connectivity.

Text Table 1. Authorities' Response to Past Policy Recommendations

Overall Assessment	The authorities have been following recommendations of the 2015 Article IV consultations as well those made in the context of the 2015 SMP and the ongoing ECF-supported arrangement.	
	Key Recommendations	**Implemented Policies**
Fiscal Policy	Staff called for the overall fiscal balance to remain broadly balanced to ensure sustainability, stepped-up efforts to mobilize domestic revenue, prioritization of expenditures, and further improvements in budget management. (¶49, ¶50)	Fiscal policy has aimed at ensuring sustainability, and the overall fiscal balance, including grants, turned to surplus in 2016-17, helped by efforts to mobilize revenues through improvements in revenue administration and introduction of tax measures.
Monetary Policy	Staff called for flexible monetary policy that remains committed to a flexible exchange rate regime, maintains orderly market conditions, and fosters confidence in the domestic currency. Staff also encouraged development of domestic-currency denominated instruments. (¶49)	Monetary policy has focused on fostering confidence in the domestic currency, while allowing for flexibility in the nominal exchange rate. CPI inflation has remained in single digits, while nominal depreciation has supported competitiveness of the nascent exporting industries.
Financial Sector Policies	Staff called for strengthening of vulnerable and weak banks and privatization of (or other viable options regarding) NKB; for strong efforts to implement vigorously the new banking, AML, and CFT laws and regulations, and to enhance further DAB's supervision capacity. (¶51)	The authorities continued bolstering the financial sector, including strengthening its anti-money laundering and combating the financing of terrorism (AML/CFT) framework. As a result, the Financial Action Task Force (FATF) removed Afghanistan from its monitoring process in June 2017. Work on resolving the legacies of the Kabul Bank crisis and strengthening the independence of the central bank is on track.
Governance and Anti-Corruption	Staff called for reducing incentives and opportunities for corruption, sustained progress to improve the anti-corruption and AML/CFT framework, and improved enforcement (¶52).	The authorities have enhanced the anti-corruption efforts notably by taking steps to criminalize corruption and establishing the sub-council on anti-corruption under the High Council on Governance, Justice, and Anti-Corruption. Nonetheless, the anti-corruption framework needs further strengthening with respect to asset declaration by senior public officials. Implementation and enforcement need to be enhanced.

2. **Afghanistan has made good progress in economic reforms despite difficult circumstances**. Since 2002, with financial and security support from the international community, the country has made important strides in rebuilding its economy, infrastructure, and institutions. The government's policy priorities are laid out in the Afghanistan National Peace and Development Framework (ANPDF) issued in 2016. The international community has reiterated its support for the government at a successful donor conference in October 2016 and more recently

in Kabul, at the Senior Officials Meeting (SOM). During the SOM, donors called for channeling more aid through the budget and pushed for greater use of performance based aid disbursements, while urging the authorities to increase accountability and transparency.

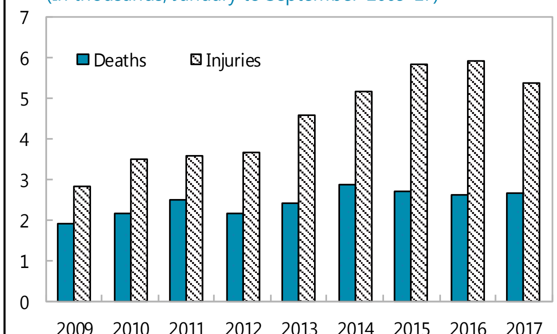
3. **In July 2016, the Executive Board approved a three-year Extended Credit Facility (ECF) arrangement for Afghanistan**. The arrangement makes SDR 32.38 million (10 percent of quota) available to help raise growth by consolidating progress on the macroeconomic and structural fronts and catalyzing continued support from donors. The arrangement follows a nine-month 2015–16 Staff Monitored Program (SMP) that aimed at establishing a track record of policy implementation and addressing immediate fiscal and banking vulnerabilities. The first ECF review was completed in May 2017 on a lapse-of-time basis. Donors pay close attention to developments under the ECF arrangement and are keen to coordinate reform recommendations.

RECENT DEVELOPMENTS

4. **The security and political situation remains tense, but peace talks have been re-launched**.

- The security situation remains difficult, with civilian deaths and injuries in the first nine months of 2017 nearly as high as a year ago. Recent attacks by insurgents have targeted government forces, and non-state actors control part of the country.[2]

Civilian Deaths and Injuries
(In thousands, January to September 2009-17)



Source: United Nations Assistance Mission in Afghanistan.

- Afghanistan will soon enter an election cycle, with parliamentary elections planned for July 2018 and presidential elections for 2019. The political situation—already strained due to internal divisions and factionalism—is likely to become more uncertain in the lead-up to the elections.

- After a 16-month pause, Afghanistan's peace process has been re-launched with talks held in Oman with US, Pakistan, and China as mediators. The U.S. government announced its new Afghanistan strategy in August reaffirming its commitment to help the government fight the insurgency. According to media reports, the strategy will see troop numbers increase by early 4,000. Some analysts have expressed concern that the strategy's focus on security and shift away from nation-building may imply a reduction in civilian assistance.

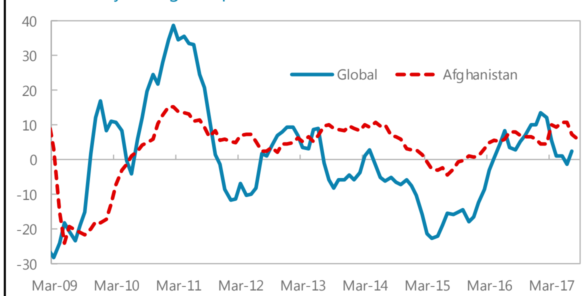
[2] A recent report by the Special Inspector-General for Afghanistan Reconstruction (SIGAR) noted that nearly 60 percent of the country's districts is under the government's control or influence.

- The influx of returning refugees from neighboring countries has slowed significantly, partly reflecting deteriorating security in Afghanistan. The authorities expect no more than 400,000 returnees in 2017 (compared to one million in 2016). The returning refugees add to the humanitarian strains on the country coming from the existing, and rapidly rising, internally displaced people fleeing violence.

- Illicit production and trafficking of drugs remains an important but unmonitorable component of the economy. Per the United Nations Office on Drugs and Crime (UNODC), opium production in 2016 increased by 43 percent relative to 2015 reflecting both increased cultivation area and yield. The farm gate value of opium in 2016 was estimated at about US$1 billion or around 5 percent of GDP.

5. **Growth remains low but picked up modestly in 2016, and inflation has been moderate**. Powered by agriculture, real GDP grew by 2.4 percent in 2016, up from 1.3 percent in 2015. Inflation picked up to 7½ percent y/y earlier in 2017, in part due to a recovery of global food prices and pass-through from the Afghani's depreciation (which staff estimates to have a short lag), but moderated to 3.8 percent in September as global food price inflation eased.

Food inflation
(Y-o-y change, in percent)

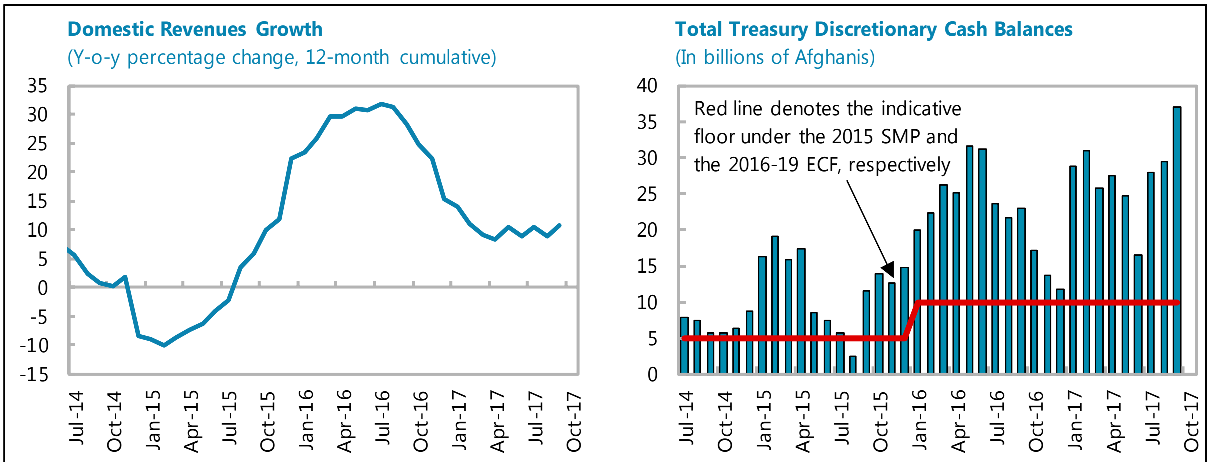


Source: Afghan authorities and IMF staff calculations.

6. **In the first nine months of 2017, the Afghani depreciated slightly against the U.S. dollar, while international reserves increased by a small margin**. The currency appreciation observed in 2016 was short-lived and the ongoing depreciation is mainly attributable to a slowdown in aid inflows. The trade and current account deficits (before grants) remain very large despite some import substitution for agricultural products, food processing, and capital goods. At end-September gross international reserves covered more than ten months of imports.

7. **Performance on the fiscal front has generally been good**. The June revenue target under the ECF arrangement was exceeded by 20 percent, reflecting improved tax administration and compliance. Development budget execution, at 21 percent in the first half of 2017, remains low but in line with past performance. Grant-funded purchases of fuel for the security services, worth some Af 30 billion, were taken off-budget by donors. The treasury's discretionary cash balance was replenished with the disbursement of $189 million from the World Bank-administered Afghan Reconstruction Trust Fund (ARTF) and reached Af 37 billion at end-September, comfortably above the program floor of Af 10 billion. With revenue collections remaining strong, the end-September indicative revenue target was exceeded by about Af 10 billion.

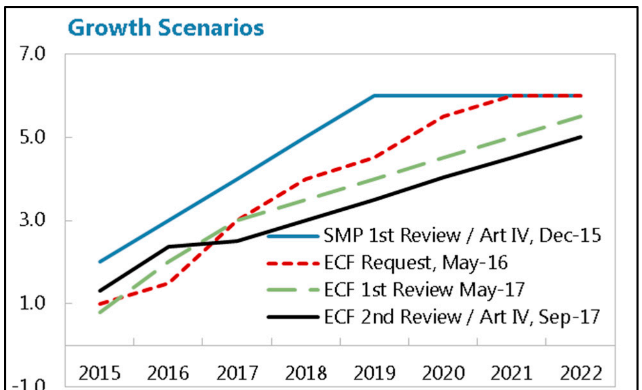
8. **Financial soundness indicators deteriorated**. Credit to the private sector remains weak, reflecting lower demand for trade credit and Da Afghanistan Bank (DAB) mandated NPL write-offs. NPL ratio increased to 17.9 percent in 2017Q2 from 10.8 percent in 2016Q4, mainly reflecting a deterioration in loan portfolios at one public and several private banks, against the background of weak economic conditions. Consequently, profitability indicators weakened, also reflecting the DAB-imposed increase of loan loss provisions, aimed at guarding against accumulation of bad assets. Capital adequacy and liquidity ratios are adequate.



Sources: Afghan authorities and IMF staff calculations.

OUTLOOK AND RISKS

9. **The outlook for growth is highly uncertain**. Thus, staff's projections are akin to conditional scenarios. The central scenario assumes continued inflows of aid, implementation of reforms, and improvements in security, implying a gradual increase from current growth rates to an estimated long-run growth potential of 6 percent per year.[3] Over 2015–16, growth exceeded staff's forecasts by about ½ percentage point largely because of good agricultural output. However, underlying growth remains hampered by weak confidence in the context of insecurity, and staff has therefore modestly scaled back the medium-term growth path.



Source: IMF staff calculations.

[3] This assumption is based on growth accounting and is consistent with the analysis by the World Bank that emphasizes development of agriculture and extractive industries, public investment in education and health, and regional integration.

10. **The outlook is subject to significant risks** (Annex I). If aid falls short, security deteriorates, global risks intensify, or reforms stall, growth would be lower with attendant effects on unemployment and poverty. In addition, to the extent the coming elections increase political uncertainty, business confidence may weaken, dampening new investment. Alternatively, lasting peace would boost private sector confidence and facilitate a shift in public spending from security to development, boosting inclusive growth and longer-term prospects.

ARTICLE IV DISCUSSIONS: RAISING INCLUSIVE GROWTH IN A SEVERELY CONSTRAINED ENVIRONMENT

11. **The overarching theme of the Article IV consultation discussions was the need to raise inclusive growth in a severely constrained environment**. With limited policy space to stimulate demand, staff recommended policies focused on macroeconomic stability, maintaining robust policy buffers, and ensuring a strong social safety net for returning refugees, internally displaced people, and the neediest. For the foreseeable future, insecurity will remain the major impediment to a recovery in confidence and private investment and consumption. However, the authorities can support growth by addressing corruption, building up physical and human capital, strengthening the financial sector, making access to financial services more inclusive, and improving the business climate. Indeed, structural transformation is required to prepare for a long-term normalization of aid flows at lower levels.

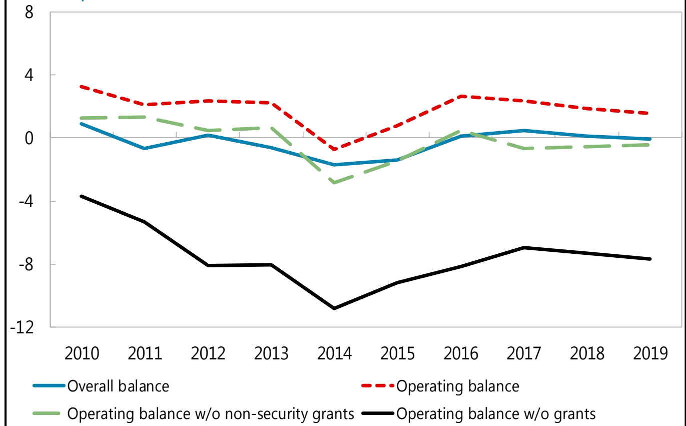
Macroeconomic Management

12. **The macroeconomic policy mix is conditioned by aid inflows management and structural constraints**. Macroeconomic policies have been broadly successful in maintaining fiscal and external sustainability in the context of aid dependency. Low absorptive and institutional capacities and the difficult security situation have constrained development spending and pro-growth structural reforms. Over time, macroeconomic policies and frameworks need to prepare for lower external support and refocus on domestic economic conditions.

13. **The government's ability to flexibly manage its finances is limited**. The budget currently collects about 11 percent of GDP in revenues, covering only half of its recurrent expenditures. Short-run options to boost revenues via tax measures are limited, particularly

given security developments[4] and concerns about the potential growth impact.[5] In the absence of debt financing, donor grants and the Treasury's cash position determine the overall spending envelope and, to some extent, its composition. This keeps the overall budget including grants broadly balanced and prevents a build-up in debt, while a robust cash balance insures against liquidity risks. However, given large recurrent security spending, the operating balance before grants remains persistently negative. Hence, a key fiscal risk is unexpected shortfalls in donor aid, which would imply scaling back spending, including on security, endangering private sector and consumer confidence and growth prospects.

Fiscal Balances
(In percent of GDP)



Source: IMF staff calculations.

14. **Staff noted that the overall balance including grants should remain the fiscal anchor targeting a broadly balanced budget with the cash balance remaining above the program floor**. Eventually, fiscal policy will need to focus on reducing the operating deficit before grants while shifting the expenditure composition toward pro-growth and pro-poor spending. In anticipation of this, the authorities should look for ways to reduce dependence on external financing by expanding the tax base and further strengthen revenue including by: boosting non-tax revenue, selling 4G phone licenses, introducing a minimum corporate income tax, and increasing corporate income tax withholding at customs. The reform of indirect taxes levied on large firms and the planned introduction of VAT in 2021 are key measures to achieve this. To anchor this strategy, staff recommended targeting a modest rise in the revenue-to-GDP ratio over time, starting with an increase of 0.2 percentage points in 2018 to 10.9 percent GDP (Af 169.5 billion), up from 10.7 percent in 2017. In late October, the lower house of parliament voted to remove the 10 percent tax on mobile telecommunications.[6] However, for the reasons given in the authorities' views paragraph below, the tax is unlikely to be removed.

Authorities' views: The authorities broadly argeed with the fiscal strategy of keeping the overall balance at or near zero, while slowly increasing revenues to reduce dependence on foreign funds. To this end they are planning an overhaul of indirect taxes as described in the "Structural Fiscal Reforms" section, below. However, the authorities consider that efficiency gains in revenue

[4] To make the link between economic conditions and insecurity more concrete, staff analyzed the correlation between revenue and conflict based on a provincial data set. See *Selected Issues Paper*, "Measuring the Fiscal Revenue Cost of Conflict in Afghanistan".

[5] That is a conclusion of the February 2017 FAD TA mission. Nevertheless, the World Bank estimates that greater effort to reduce leakages and improve administration of the tax regime could raise revenues to 17 percent of GDP (See "Afghanistan Development Update," May 2017).

[6] The telecom tax netted about Af 4.3 billion last year.

collection are nearing a point of diminishing returns and that continued pressure on collection may begin to adversely impact private sector activity. That said, the 2018 budget would target another small increase in the revenue-to-GDP ratio. Regarding the mulled telecom tax removal, the authorities said that this is unlikely to be implemented as a tax measure cannot be removed without offset.

15. **Staff noted that Afghanistan remains at a high risk of debt distress**. Afghanistan's public debt is low and only a limited amount of concessional borrowing is planned. Thus, the country's debt outlook, under the baseline scenario, is benign. However, given large underlying fiscal and external current account deficits, even a modest shift to loan financing would quickly lead to an unsustainable debt burden and require significant fiscal adjustment (Debt Sustainability Analysis (DSA)). Afghanistan's debt sustainability hinges on continued ample grant inflows, combined with sound policies and reforms, and improving security. The debt sustainability challenges underscore the need to expand the tax base and sustain efforts to mobilize domestic revenues while raising the capacity and efficiency of public spending. The authorities need to enhance their capacity to evaluate prospective financing and to monitor and analyze debt and fiscal risks to properly identify and mitigate risks to debt sustainability. This includes proper accounting for government guarantees stemming from future private-public partnerships, and establishing a live database of infrastructure projects financed with public debt and guarantees.

Text Table 2. Public and Publicly Guaranteed Debt (PPG)

	Jun-17	
	(In US$ million)	(In percent)
Total PPG	**1,552**	**100**
Multilateral	**1,176**	**76**
Bilateral	**40**	**3**
Paris Club	1	0
Non Paris Club	39	3
Commercial	**0**	**0**
Domestic	**336**	**22**

Source: Afghan authorities.

Authorities' views: The authorities agreed with the conclusions of the DSA. For the foreseeable future, they remain committed to relying on grants to finance their development needs. They agreed that borrowing should remain at an elevated concessionality rate (60 percent) and limited to the most critical projects with the highest social and economic returns. Nonetheless, they emphasized the country's very large financing needs. They recognized that going forward, the prospects of diminishing aid inflows will require careful contracting of financing for their development priorities. In that context, they welcomed technical assistance on recording and monitoring public debt and fiscal risks.

16. **Monetary policy is constrained by high dollarization**. DAB's main objective is maintaining domestic price stability, with reserve money as an operational target, and foreign exchange intervention and the sale of capital notes as instruments. However, DAB's ability to control inflation is limited by several factors: weak transmission of monetary policy to inflation owing to high dollarization and inability to influence market interest rates; the high share of

imported goods and services in the CPI basket; the difficulty of forecasting liquidity in the presence of volatile aid inflows; and the lack of effective instruments. Over the medium term, with aid flows falling and downward pressure on the Afghani likely to rise, the price stability objective may be compromised. Staff encouraged DAB to continue efforts to de-dollarize the economy, and to support broader use of domestic currency denominated instruments, noting the recent change in the reserve requirement framework is a step in the right direction. These instruments should strengthen the transmission mechanism of monetary policy. DAB should also continue to develop its communication strategy and the transparency of its operations by disseminating the main objectives of monetary policy and the strategy through various media.

Authorities' views: The authorities stressed their commitment to maintaining price stability through targeting of monetary aggregates. They noted that the high import component of domestic consumption compelled them to resort to foreign exchange interventions to mitigate pass-through of imported inflation. They agreed that enhancing transparency and communication was important but noted that the high illiteracy rate, limited media penetration, and unsophisticated financial education level of the public would limit the impact of such measures.

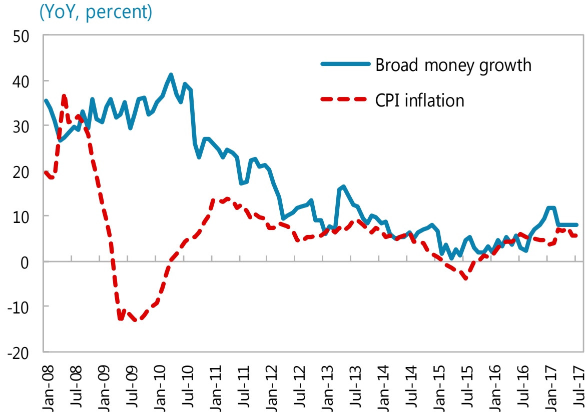
17. **External stability hinges on external aid disbursements** (Annex II). The current account is dominated by official transfers and imports related to security and donor-funded projects largely financed by grants and transfers. Afghanistan's external position appears stronger than implied by fundamentals but the large inflows of aid overwhelms the impact of other variables. The analysis is also hampered by data shortcomings, a mostly cash-based economy, and a high share of the informal economy. The country's International Investment Position is positive due to aid inflows which allow foreign reserve accumulation beyond levels suggested by applicable metrics. Exchange rate volatility primarily depends on foreign aid disbursements and the extent of dollarization, while FX auctions aim to limit short-term volatility against the U.S. dollar. The real effective depreciation observed since 2015 has not produced a significant improvement in export performance[7] as the latter is primarily constrained by nonprice factors, including production capacity, trade logistics, infrastructure, and security conditions. The country has taken important steps towards greater regional integration which could substantially boost Afghanistan's trade performance if accompanied by supportive policies.[8]

Authorities' views: The authorities concurred with staff's analysis. They agreed that foreign reserves are high but they consider this justified by high import needs and high dollarization of banks' and households' balance sheets. They also see high reserves as a safety buffer to be used when unforeseen security or economic developments take place.

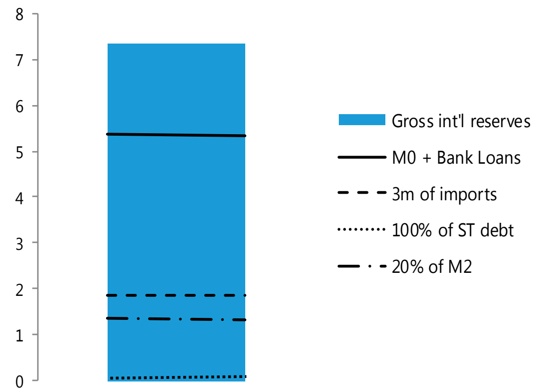
[7] Export data do not account for smuggled products and transit trade.

[8] See *Selected Issues Paper*, "Afghanistan's Integration in Regional Trade: A Stocktaking."

Broad money and Inflation
(YoY, percent)



Reserve Adequacy, 2016
(In billions of U.S. dollars)



Sources: Afghan authorities and IMF staff calculations.

Governance

18. **Progress has been made in strengthening the anti-corruption framework but further efforts are needed** (Box 1). According to Transparency International, Afghanistan's corruption perception index has improved significantly since 2013. Nevertheless, corruption continues to be a key obstacle to security, political stability, and economic growth. The authorities have criminalized acts of corruption (generally in line with the United Nations Convention Against Corruption (UNCAC)) by enacting a new Penal Code that will come into force in February 2018. Afghanistan published in Dari and English the asset declarations made by top officials when they were appointed[9] which is a welcome step and should be made a regular exercise and cover declarations made by top officials when they step down. Legislation on asset declaration by other senior public officials was also enacted in September 2017 in line with the end-December 2017 SB. The names and functions of senior officials of law enforcement agencies, revenue authorities, and customs who have declared their assets for the previous year will be made available on the official website in Dari and in English by end-April 2018. This information will be updated annually. The website will also have information on how the declarations can be accessed (structural benchmark). Also, the authorities recently formulated a National Strategy for Combating Corruption resting on five pillars: (i) national leadership; (ii) ending corruption in the security sector; (iii) replacing patronage with merit; (iv) prosecution of corruption; and (v) tracing the money. The strategy will guide a review of the anti-corruption institutional framework aiming to increase its effectiveness.

Authorities' views: The authorities pointed out that the formulation of the national strategy for combating corruption demonstrates their commitment to continue implementing anti-corruption policies. They noted that the Anti-Corruption Justice Center secured 21 convictions—including 12 for corruption involving public officials—as of end-August 2017.

[9] These also include the ex-Minister of Defense, ex-Minister of Communication and IT, and ex-Ministers of Mines and Petroleum, who stepped down earlier in 2017. See: http://anti-corruption.gov.af/en/page/test/14010.

Box 1. Afghanistan's Anti-Corruption Efforts: The Important Role of Asset Declaration

Anti-corruption remains high on the authorities' agenda. Realizing that corruption is a key obstacle to security, political stability, and economic growth, the authorities have made the fight against corruption a policy priority, as outlined for example in the "Realizing Self-Reliance" strategy paper issued in December 2014. A High Council on Governance, Justice, and Anti-Corruption chaired by the president was established in April 2016 to coordinate high-level dialogue and policy-making. The Anti-Corruption Justice Center (ACJC) was established in June 2016, which provides a venue for investigators, prosecutors and judges to work together on corruption cases and selected other offences[1] committed by senior officials. A National Strategy for Combating Corruption was also recently issued.

Under the ECF arrangement, progress has been made to strengthen the legal framework with respect to criminalization of corruption. A new penal code prepared with the assistance of the United Nations was enacted in May 2017 and will come into force in February 2018. The new penal code criminalizes acts of corruption generally in line with United Nations Convention against Corruption. Effective implementation of these provisions requires that investigators, prosecutors and judges have necessary knowledge and skills, operate independently in a collaborative manner, and be able to pursue potential corrupt high-ranking officials.

Asset declaration by public officials is a powerful tool for tackling corruption in the challenging environment of Afghanistan and should be pursued as a priority. In post-conflict countries faced with deeply-rooted corruption, asset declaration of key public officials and their family members helps bolster public as well as international partners' confidence in the integrity of the government and prepares the ground for reconstruction and growth. With generally weak institutions, insufficient resources and capacity, leveraging civil society and international cooperation would help tackle the challenges. This requires public (domestic and foreign) access to asset declaration information to facilitate financial institutions' detection of suspicious transactions conducted by Afghan politically exposed persons, allow civil society to flag potential omissions or false declarations, and effective international cooperation for the investigation of corruption and associated money laundering and for confiscation of the ill-gotten assets.

Going forward, Afghanistan should further enhance transparency of senior officials' assets including by effective enforcement. The Constitution of Afghanistan requires that asset declarations be made by the President, Vice-Presidents, Ministers, members of the Supreme Court and the Attorney General, reviewed and published prior to and after their term of service. The legal framework has recently been strengthened by the enactment of the Law on Declaration and Registration of Assets of Officials and Government Employees with respect to: (i) ensuring mandatory publication of assets declarations of top officials before and after their terms of service; (ii) requiring senior officials (including the top ones) to declare their assets annually; (iii) requiring that assets that are beneficially owned be declared; (iv) prescribing sanctions for non-compliance; and (v) enhancing transparency including by making required asset declarations available to law enforcement agencies and the financial intelligence unit. The authorities should ensure effective implementation and enforcement of these requirements.

1/ These include: money laundering, destruction, theft, or sale of historical and cultural monuments, and unlawful extraction of minerals.

19. **The extractive industries have a significant potential to contribute to growth and government revenues**. However, this potential is undermined by weak management of the sector. Since 2012, Afghanistan has been implementing the Extractive Industries Transparency Initiative (EITI), one of only 52 countries in the world to do so. The July 2017 assessment identified weak government systems for licensing and collecting revenue as the greatest EITI challenge. More generally, implementation of the EITI standard is hindered by insufficient participation in the process by government and other members of the multi-stakeholder group.[10]

Authorities' views: The authorities agreed with the importance of advancing the implementation of EITI to increase transparency and prepare the mining sector for the future. They will work with the EITI secretariat to prioritize the recommendations of the recent evaluation of EITI compliance and focus on implementation of the recommendations with the highest impact.

Structural Fiscal Reforms

20. **The government's ability to build the basis for future growth and fill infrastructure gaps is constrained by poor control over spending, lack of capacity in public investment management, and limited fiscal space**. Given numerous weaknesses in the formulation and execution of the budget and corruption concerns, most development spending is undertaken by donors off-budget and often reflects agendas not fully aligned with the government's priorities. Public investment management, including project selection and oversight, is weak. Limited fiscal space—since most donor assistance is earmarked while the government's own resources cover only half of recurrent spending—curtails the government's ability to embark on development projects of its own. The government may try to overcome these constraints through public-private partnership (PPP) arrangements but the legal and institutional framework is weak and may lead to abuses.

21. **Budget execution rates, particularly for development projects, remain low**. This is due to unrealistic and inflexible budgeting, but also weak capacity to deliver budgeted spending. A scheduled mid-year review of the 2017 budget aimed to improving execution by reallocating funds to better-performing projects, but the revised budget was only approved in late October. Staff encouraged the authorities to make progress with improving the budgetary process. The concurrent FAD TA mission proposed, inter alia: strengthening and rationalizing budget prioritization mechanisms; adopting a commitment control system; and overhauling the public investment management system.

22. **The authorities are developing a strategy to manage state-owned corporations and enterprises (SOCs and SOEs), which are outside the fiscal perimeter monitored by staff**. There are about 40 active SOEs in Afghanistan.[11] They do not receive explicit budgetary support,

---

[10] EITI standards are implemented by national multi-stakeholder groups, comprising of representatives from industry, civil society organizations, and government.

[11] These operate mainly in public security, construction, transport, agriculture, and extractive industries.

relying on non-core operations to finance core public functions, and their financial position and accounting remain weak. There are about 13 SOCs that have independent boards of management, are not directly supervised by the government, and are understood to have a larger economic impact. Staff proposed to monitor SOEs and SOCs including by requiring them to develop accounting capabilities allowing them to submit regular financial statements and reports to the Ministry of Finance. As a first step to enhance monitoring, the authorities are amending the law on SOEs, but in staff's view the changes are process-oriented rather than substantive. Meanwhile, there has been little visible progress with implementing changes to laws that could bring SOCs under the supervision of the MOF. An increasing number of infrastructure projects will likely involve sovereign financing and guarantees, particularly in the electricity sector. Progress on debt recording and monitoring, including on-lending by the government, is required to effectively record and monitor these exposures.

Authorities' views: The authorities agreed with the recommendations of staff and the parallel PFM mission. They welcomed recommendations leading to: strengthened Cabinet oversight of public investment management and responsibility for setting policies; implementation of a commitment control system (third review benchmark) and overhauling of the entire public investment management process including review and amendment of the relevant legislation (third review benchmark). They showed keen interest in strengthening of the nascent legal framework for PPPs to better manage fiscal risks and ensure full fiscal costing of financial incentives offered to investors. They agreed with staff to enhance the monitoring of SOEs, SOCs, and the related implicit and explicit exposures of the public sector.

23. **The authorities are planning a major overhaul of indirect taxes as part of their WTO accession commitment to introduce a VAT in January 2021**. This includes a replacement of the business receipts tax (BRT) and a reform of the Large Taxpayers' Office (Box 2). A successful VAT implementation will be key to achieving the government's aim of raising the revenue ratio further in pursuit of self-reliance over the medium term. This will require substantial investments in revenue administration and public awareness. The authorities are planning these reforms in line with international best practices and staff's advice. Staff discussed the status of these plans and encouraged the authorities to design a single rate VAT with few exemptions and the same eligibility threshold as the LTO, and fully replace the BRT. Staff also initiated discussion on assessment of the revenue implications of the proposed reforms and will continue those within the framework of the on-going ECF arrangement.

Authorities' views: The authorities broadly agreed with the staff's recommendations. They look forward to continued engagement with staff and TA providers to design and implement the VAT system that will avoid revenue losses in the transitional period, be efficient to administer, fair in its application, and encouraging registration and compliance. However, there are differences of views on the specifics of the policy, most notably on the exemptions, and status of the BRT.

Box 2. Strategy for VAT Implementation and LTO Reform

Despite impressive progress in recent years, the Afghan government has a pressing need to increase revenues sustainably to meet its development goals and security needs. Two complementary policies stand out as ways to achieve higher revenues: establishing a modern Large Taxpayers Office (LTO) and replacing the current Business Receipts Tax (BRT) with a value-added tax (VAT) levied on LTO firms, at least initially; the VAT could be extended to other firms in the future.

The share of revenues raised by the current LTO is very small by international standards, at only 27 percent of tax revenues in 2016 (the IMF's Fiscal Information Tool survey found that, on average, Low Income Country LTOs collect 45 percent of domestic tax revenues). The current low yield reflects the organizational shortcomings of the LTO: it has a fragmented, regional structure; and firms are included on criteria other than size. This hinders the ability of the LTO to focus its most qualified staff on providing high-quality services to a small number of high-value firms. Meanwhile, staff estimates that a reformed LTO could raise revenues closer to 45 percent of all domestic tax revenues.[1]

The main indirect tax in Afghanistan is a BRT, which is levied on the turnover of all firms. A VAT, in contrast, applies only to firms above a set turnover threshold and is levied only on their value added (the difference between the value of their inputs and outputs). Both taxes have an important international trade dimension; VAT is charged on imports, and importers must pay a levy which can be later offset against BRT liabilities.

A VAT has several benefits over the BRT: improved compliance; lower administrative burden on small firms below the filing threshold; fewer distortions; and meeting Afghanistan's WTO commitments.[2] One cost of the VAT is that its administrative burden is higher, which is one reason why the tax is typically focused on large firms.

The introduction of the VAT and modernization of the LTO are complementary reforms. Restricting the VAT to only the firms in the LTO increases the efficiency of tax administration by further freeing up resources to focus on the firms which generate the most tax revenue. To this end, the authorities' plan to modernize the LTO entails: the LTO be consolidated nationally, have a single turnover-based criterion for entry with no exceptions, improve the taxpayers' registration database, and improve planning and monitoring of core enforcement actions (including audit and recovery of arrears).

In staff 's view, key steps in implementing the VAT include: the preparation of a VAT transition plan setting a threshold for eligibility in line with the LTO threshold; computing likely revenue implications and related statutory rate to ensure no revenue loss; training and staffing the VAT unit of the Revenue Department; replacement of the BRT; developing procedures for providing refunds in a timely and transparent fashion; and ensuring a long-enough transition process during which staff, businesses, and the public can be informed on the changes.

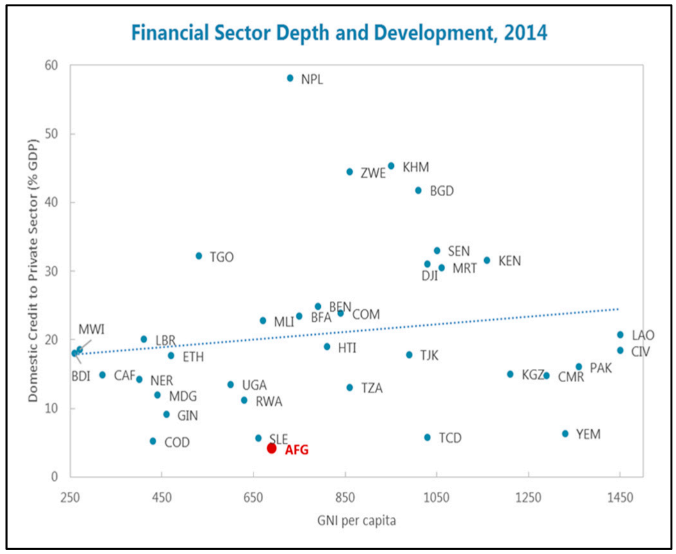
There is no single approach which will guarantee Afghanistan's fiscal self-reliance. But if well-designed and effectively implemented, combined LTO and VAT reforms have the potential to markedly improve Afghanistan's government revenues and business climate.

1/ A recent study (Baum, Gupta, Kimani, and Tapsoba, "Corruption, Taxes and Compliance", IMF Working Paper, 2017) suggests that improved fiscal institutions, particularly LTOs, can also reduce (perceived) corruption.

2/ Overview of Afghanistan's commitments, WTO, 29 June 2016, https://www.wto.org/english/news_e/news15_e/afgancommitmentsmc10_e.pdf

Financial Sector Reforms

24. **Afghanistan's financial sector remains shallow and narrow, constraining growth with one of the lowest credit-to-GDP ratios in the world**. Credit growth is constrained by the challenging operating environment, inefficient business models, poor management and controls. The use of overdrafts is preferred over standard loans which increases the attendant repayment risks. Staff advised to modify the DAB regulations to limit excessive reliance on overdrafts and promote term lending while supporting financial stability.



Authorities' views: DAB stressed that the implementation of the "Program and Strategy Dealing with Weak Banks" helped enhance the accountability of bank managers and shareholders, improve corporate governance, develop bank control functions, and gradually improve the banks' CAMEL ratings. DAB will consider modifications of the prudential framework, to facilitate bank lending while maintaining enhanced supervision.

25. **Staff suggested the enhancement of crisis preparedness and management tools**. The resolution provisions of the Banking Law should be updated to include: (i) clear objectives and scope of the resolution regime; (ii) distinction between early intervention and resolution; (iii) revision of grounds for appointing a conservator and petitioning for receivership; (iv) strengthening the powers of DAB and the conservator in resolution; and (v) introduction of recovery and resolution planning.

26. **Staff recommended developing DAB's emergency liquidity assistance framework (ELA), including changes to the DAB Law and DAB's new ELA regulation**. The authorities should upgrade the legal framework, governance, institutional capacity, and financing arrangements of the Afghanistan Deposit Insurance Corporation (ADIC). The Financial Stability Committee (FSC) should be established as a crisis preparedness and coordination platform, where the Ministry of Finance and DAB share responsibility for crisis preparedness and management, and rely on their existing legal powers. Amendments to the DAB law will be submitted to Parliament in line with the recommendations of the IMF's 2017 Safeguards Assessment, especially with regards to DAB's mandate, institutional and personal autonomy, as well as the rules of profit distribution, recapitalization and foreign reserves management.

Authorities' views: DAB confirmed the intention to develop the ELA framework and enact changes to the Banking Law, aimed at upgrading the resolution framework. DAB considers introduction of the deposit insurance scheme as a priority from the financial stability perspective, and agrees that ADIC legal and operational framework should be upgraded. MoF and DAB agreement is needed for institutionalizing the FSC.

27. **The authorities are working with World Bank staff on a reform strategy for the three state-owned commercial banks (SOCBs)**. Staff supports the SOCBs' consolidation leading to their commercial viability through restructuring of their operations. Upgrade of the SOCBs' procurement rules and staffing and management capacity should be implemented without delay. Longer-term strategic approach should envisage crowding-in private equity. Staff advised against turning the SOCBs into sectoral development banks and urged speedy adoption of the reform strategy.

Authorities' views: The authorities agree that SOCB consolidation is necessary, but believe that it should be preceded by the restructuring of the banks' operations as well as their human resources. This may take some time to accomplish. The authorities agreed with staff that sector based SOCBs would be neither viable nor helpful for Afghanistan's development goals. The authorities concurred that the SOCBs' reform strategy should be speedily implemented.

28. **The authorities are continuing the efforts to advance the Kabul Bank liquidation and recover the remaining assets**. However, asset recoveries and settlements have become more difficult over time as outstanding claims involve more complicated ownership structures requiring lengthy legal procedures. Staff encouraged continued efforts to reactivate the recovery process, improve its transparency, and find ways to advance the legal proceedings.

29. **DAB and the World Bank staff are preparing a financial inclusion strategy**. Staff recommended focusing on increasing access to ATMs, branches, and transaction accounts, while being mindful of the potential risks to financial stability from an unchecked broadening of access to credit including for microfinance institutions.[12] Staff welcomed the decision to expand DAB's supervisory coverage to microfinance institutions. It would require further enhancement of DAB's capacity, extensive TA, and development of the regulatory framework for microfinance institutions.

Authorities' views: The authorities expect to finalize the "National Financial Inclusion Strategy" before the end of 2018. A dedicated department within DAB is coordinating the preparation of the strategy with the World Bank and other stakeholders.

[12] See *Selected Issues Paper*, "Financial Inclusion and Access in Afghanistan."

30. **The authorities are working on a "Sukuk law" which will provide the legislative framework for issuance of the Sharia compliant financial products**. A first draft of the law may be ready in early 2018. Staff encouraged a measured approach to the introduction of sukuk and other Sharia complaint financial products and suggested that due consideration be given to the experience of the relevant comparators. Currently, the authorities are guided by Malaysia's experience. Staff cautioned that there would be a need to establish the relevant infrastructure before launching the new financial instruments and that the prospective projects which the issuance would finance need to be supportive of macro-fiscal stability and sustainability.

Authorities' views: The authorities noted that the plans to issue Sharia compliant financial instruments are at a very preliminary stage. They hoped that when developed, sukuks could be used to finance the budget, primarily development spending. The authorities believe availability of Sharia compliant financial products would attract customers who currently remain outside of the formal banking sector as they do not approve of interest based financial products. They agreed that the development of Islamic finance needs to preserve financial and fiscal stability. They expected that Sharia compliant banking will thrive alongside interest based conventional banking.

31. **The authorities continue to strengthen the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework**. Afghanistan has completed the action plan agreed with the Financial Action Task Force (FATF) to address the strategic deficiencies in its AML/CFT framework. As a result, Afghanistan exited FATF's monitoring process in June 2017. Building on this momentum, the authorities are taking steps to improve the effectiveness of AML/CFT measures. With the assistance of the World Bank, Afghanistan has started preparation for its first national money laundering and financing of terrorism risk assessment, which will inform the formulation of a national AML/CFT strategy. AML/CFT supervision of banks as well as money service providers remains a priority for DAB, including with respect to the identification of domestic politically exposed persons and detection of proceeds of corruption. DAB's effective supervision, supported with technical assistance provided by donors, will facilitate Afghan banks' access to foreign correspondent banking services and may reduce reliance on the informal hawala system for money transfers.

Authorities' views: The authorities confirmed their unwavering commitment to the implementation of the AML/CFT measures including through: banking supervision to ensure that shareholders, beneficial owners, and senior managers of financial institutions are fit and proper, stepping up off-site and on-site supervision using a risk-based approach, imposing proportionate and dissuasive sanctions for non-compliance, building the capacity of examiners, and providing more training and guidance to financial institutions supervised by DAB. They are making efforts to establish correspondent banking relationships following the FATF de-listing.

Other Issues

32. **The business environment needs improvement**. Afghanistan ranks 183rd out of 190 in the World Bank's 2018 Doing Business index, with particularly low rankings in areas such as enforcing contracts, registering property, protecting minority investors, trading across borders, and paying taxes.

Authorities' views: The authorities agreed that the business environment does not support investor confidence and noted that economic fragility, conflict, and mounting insecurity posed formidable obstacles to their efforts to improve conditions for doing business. Nevertheless, guided by the ANPDF, they are committed to continue combatting corruption and undertake structural reforms that would improve the business environment and support private sector development.

33. **Following the authorities' request, IMF staff have initiated a general review of Afghanistan's exchange system to prepare for the authorities' acceptance of obligations under Article VIII**, Sections 2(a), 3, and 4 of the IMF's Articles of Agreements. The authorities are committed to collaborate closely with IMF staff during this process.

34. **Data quality and availability needs to continue to improve**. Shortcomings in the quality of data continue to hamper analysis. The national accounts, the external sector data, and price statistics suffer from weaknesses in coverage, consistency, and frequency. Staff encouraged improving the accuracy of recording of aid flows, their allocation to the current and capital accounts, and improved recoding and analysis of the balance of payments data.

Authorities' views: The authorities confirmed their on-going interest in follow-up TA in these areas.

SECOND ECF REVIEW

35. **Program performance has been satisfactory**. All June 2017 PCs and indicative targets as well as continuous PCs have been met (Text Table 3). Of the seven SBs (Text Table 5), five were met and two were implemented with delay. Regarding the structural benchmarks:

- **Anti-corruption (two end-June SBs)**: A presidential decree was announced on May 15, 2017 introducing a new penal code in accordance with Article 79 of the Constitution. Articles 370–421 criminalize acts of corruption including bribery, embezzlement, trade in influence, abuse of function and illicit enrichment generally in line with UNCAC. With this, the relevant end-June SB is met, as is the third review SB to enact such legislation by end-November. The asset declarations made by the President, Vice-Presidents, Ministers, members of the Supreme Court and the Attorney General when appointed have been published on an official website. The end-June SB on asset declaration is also met.

Text Table 3. Quantitative Performance Criteria, June 21, 2017

	Target	Adjusted	Actual	Status
Revenues of the central government (floor, bn Afs)	61.2	61.2	74.1	**Met**
Net credit to the central government from DAB (ceiling, bn Afs)	-11.1	18.1	-10.2	**Met**
Reserve money (ceiling, bn Afs)	15.3	15.3	-3.8	**Met**
Net international reserves of DAB (floor, mn USD)	0.0	-345.0	56.5	**Met**
Non-concessional external debt, new (ceiling)	0.0	0.0	0.0	**Met**
Short-term external debt, new (ceiling)	0.0	0.0	0.0	**Met**
External payments arrears, new (ceiling)	0.0	0.0	0.0	**Met**
Borrowing by public enterprises in need of restructuring - from DAB or state-owned banks, or government-guaranteed, new (ceiling)	0.0	0.0	0.0	**Met**

Sources: Afghan Authorities and IMF staff calculations.

- **Two end-June SBs on information sharing between Afghanistan Customs Department (ACD) and Afghanistan Revenue Department (ARD) and staffing and training in ACD were met**.

- **EITI (June SB)**: All four requirements of the benchmark have been met. A newly appointed Minister of Mines was also appointed the EITI "champion", tasked with coordinating EITI-related activities fulfilling the first requirement. The LTO has assumed responsibility for all the major mining and oil and gas companies meeting the second requirement, and the LTO and the Ministry of Mines and Petroleum are maintaining the live register of these same companies thus fulfilling the third requirement of the benchmark. The fourth requirement was met with the submission of the required legislation to the Ministry of Justice.

- **Revised 2017 budget (July SB)**: The revised budget was approved by Parliament on October 23. This benchmark was intended to secure financing for the repayment to DAB as the original budget, while broadly in line with the program, did not identify correctly the required resources. Nevertheless, the payments to DAB were made with only a small delay and at the correct amount, thus demonstrating that the goal of the benchmark was met.

- **A payment to Kabul Bank Receivership (KBR) and DAB (August SB)** was made on September 5, 2017 thus missing the benchmark's deadline by five days. The authorities are on track to eliminate DAB's lender of last resort exposure by 2019 (Text Table 4) and progressed towards this goal by making an Af 4.5 billion payment that was due at end November 2017 (third review conditionality) on October 28, 2017 in addition to AF 3.6 billion made in September.

Text Table 4. Repayment of the DAB Promissory Note
(end of period stock, in Af billions)

	Dec-15	Dec-16	Nov-17	Dec-18	Dec-19
		Actual		Commitment under the ECF	
Outstanding amount	**28.3**	**23.0**	**15.3**	**7.7**	**0.0**
Principal payment		5.3	7.7	7.6	7.7
Memo item					
Interest payment		0.8	0.4	0.3	0.2
Total payment		**6.1**	**8.1**	**7.9**	**7.9**

Sources: DAB and IMF staff calculations.

- **The authorities request the modification of two end-December 2017 PCs** (net credit to the central government from DAB and net international reserves), which were approved by the Board in May 2017, owing to an update of the macroeconomic framework.

36. **Staff inquired about the status of the third review SBs (Text Table 6) and reached preliminary agreement on PCs and SBs for the fourth review** (MEFP Table 3). The fourth review SBs—in the areas of strengthening the legal framework for PPPs and SOEs/SOCs, LTO reform, further reduction in DAB's lender of last resort exposure to Kabul Bank, improved customs administration, and anti-corruption—will be also discussed with donors to ensure complementarity with the authorities' broader reform program and donor initiatives and conditionality.

37. **The January 2017 safeguards assessment update found significant capacity constraints and operational issues**. DAB has taken steps to implement several recommendations, including to strengthen the external audit arrangements and internal audit function, and the audit committee's composition and reporting practices. However, work remains in progress in some areas such as the reform of the central bank law and resolution of DAB's Kabul Bank exposure. The draft amendments to the central bank law are being reviewed by the relevant stakeholders in accordance with local jurisdiction, and the authorities are seeking staff's input during this process. Amendments to the DAB law will be submitted to Parliament in line with the recommendations of the IMF's 2017 safeguards assessment, especially with regards to DAB mandate, institutional and personal autonomy, as well as the rules of profit distribution, recapitalization and foreign reserves management. While DAB's Kabul Bank exposure remains significant, the authorities reiterated their commitment for the balance to be repaid by 2019 (structural benchmark), and have made all 2017 programmed transfers to DAB. Staff will continue to monitor this and other safeguards developments closely.

38. **The capacity to repay the Fund remains adequate**. The current and projected levels of reserves remain adequate and the public debt outlook is sustainable contingent on continued donor support. Upon completion of the second review, a disbursement of SDR 4.5 million would be made.

39. **Risks to the program remain high**. They include security conditions including geopolitical risks (Annex I), the strength of domestic revenues and aid, and political cohesion. Maintaining domestic revenue collection in line with program targets will be key to sustain donors' confidence in the country's ability to move towards self-reliance. Political cohesion, particularly the NUG's ability to convince parliament of the need for reforms, will be critical to program success.

STAFF APPRAISAL

40. **The Government of Afghanistan is courageously advancing along the path of progress set in motion 15 years ago**. It remains committed to economic transformation in its pursuit of eventual self-reliance, with the objective of raising inclusive growth and boosting job opportunities for its rapidly rising population. In pursuing these objectives, many obstacles lie in its way, the primary one being the conflict that has plagued Afghanistan for several decades. And while there has been progress, the country remains among the poorest in the world and dependent on the generosity of other countries. The effects of the sharp drawdown of NATO troops in 2014, violence and insecurity, political uncertainties, and the upcoming elections in 2018 and 2019 add to the challenges going forward.

41. **After a sharp slowdown reflecting the troop withdrawal and cut in aid, growth recovered modestly in 2015-16 but is too slow to reduce poverty and unemployment**. With an estimated 400,000 people entering the labor market every year, unemployment is likely to have risen further. This highlights the continued need for and firm commitment to economic reforms, improving governance, and fighting corruption to advance inclusive growth and reduce poverty, which is particularly vital in a security constrained environment. Policies should be focused on safeguarding macroeconomic stability, sustaining robust policy buffers, implementing structural reforms as outlined in the ANPDF, and ensuring that the fruits of reforms are shared equitably across society.

42. **Steadfast reforms should deliver a continued pickup in growth in 2017 and over the medium term, conditional on improvements in security**. This outlook is subject to significant risks. On the upside, a lasting improvement in security conditions would provide a game-changing boost to confidence and the economy. On the other hand, if security conditions worsen further, aid falls short, or reforms stall, growth would be lower with attendant effects on unemployment and poverty. The approaching electoral cycle may complicate implementation of needed reforms and policies.

43. **The macroeconomic policy mix focused on maintaining fiscal and external stability with low inflation and a flexible exchange rate has served the economy well and remains appropriate going forward**. The authorities' commitment to policies aimed at strengthening confidence in economic management provides a counterweight to insecurity and political uncertainty, which threaten to impede a recovery in confidence and private investment. The authorities can support growth by addressing corruption, building up physical and human capital, strengthening the financial sector, making access to financial services more inclusive, and improving the business climate.

44. **The overall balance including grants should remain the fiscal anchor and target a broadly balanced budget, with robust cash balances in case of liquidity shocks**. In the future, fiscal policy will need to focus on reducing the operating deficit before grants while shifting the expenditure composition toward pro-growth and pro-poor spending. In addition, a strong structural fiscal reform effort is essential to increase self-reliance and prepare for an eventual normalization of aid flows. Following up on the successful collection efforts of the last few years, which saw revenue rise by 50 percent, the authorities should strive to further broaden the tax base and raise revenue intake in a fair and sustainable manner. Any tax concessions or tax expenditures should be avoided. The adoption of a VAT before January of 2021 in line with the WTO commitment is a key measure in achieving this objective.

45. **Staff supports the authorities' efforts to increase the execution rate of development spending and urges donors to increase on-budget aid delivery**. Control over spending, capacity in public investment management (PIM), and fiscal space should be improved to build the basis for future growth. Given the large development needs of the economy, infrastructure investments should be gradually scaled up, but this needs to be preceded by improved budget planning and capacity building in the management of public investment and PPPs, especially in a high-corruption environment with PFM systems that still need strengthening. PPPs offer the promise of improving public services but are not a substitute to improving institutional capacity and governance which would help ensure that related fiscal costs are controlled.

46. **Improving public investment management, including project selection and oversight, is also an urgent priority**. These improvements are also prerequisites for considering concessional borrowing to complement available grants. Staff encourages the authorities to develop a strategy to manage state-owned corporations and enterprises, which are currently outside the fiscal perimeter. As a first step, the Ministry of Finance should collect the data that would allow for a preparation of the consolidated financial position in the sector, and in turn for a transparent accounting and regular reporting of financial statements including direct and contingent liabilities in this sector. It is important to establish a harmonized PIM system including PPP portfolio, involving screening for a strategic fit, proper feasibility analysis to identify public investment projects to be financed by the budget, donors, and PPP. This process will be supported by TA from the IMF and other international partners.

47. **Financial sector reforms have progressed and are critical to banking system stability and economic development**. It is important to continue strengthening DAB's regulatory and supervisory frameworks (including in the areas of risk-based supervision, implementation of AML/CFT and fit-and-proper measures, and consolidated supervision including MFIs), develop the ELA framework and deposit insurance infrastructure, and boost crisis preparedness. The authorities should closely monitor financial risks given poor asset quality, connected lending, capital shortfalls, weak profitability, and management deficiencies in several banks. A key priority remains overcoming the Kabul Bank crisis legacy and restoring DAB's balance sheet. The authorities are encouraged to pursue the remaining asset recoveries related to this crisis. Staff urges the authorities to implement without delay a strategy for state-owned commercial banks prepared with World Bank support to reduce fiscal and financial stability risks.

48. **The authorities made important progress with implementing strong and credible anti-corruption measures, most notably by criminalizing acts of corruption in line with UNCAC**. This should be backed by strong enforcement, which is critical to boost stakeholders' confidence that the fight against corruption produces results on the ground. The regime for asset declaration by public officials and publication of declarations is a critical tool in improving transparency and accountability of the public sector and should continue to follow the implementation schedule as agreed under the program. The implementation of the AML/CFT measures to protect financial stability and enable effective detection and deterrence of corruption and other macro-critical economic crimes such as illicit drug production and trafficking needs to continue.

49. **The quality and timeliness of economic data is an impediment to proper analysis. Reliable statistics are critical for sound economic policy-making**. There are particular deficiencies in real and external sector statistics, and IMF TA will continue to be available in these and other areas.

50. **Staff supports the completion of the second review under the Extended Credit Facility arrangement**. Staff welcomes the satisfactory performance under the ECF arrangement and encourages continued efforts to maintain this positive momentum by implementing structural benchmarks in line with the agreed schedules. Finally, staff also supports the authorities' request for a modification of two December 2017 quantitative performance criteria on the net credit to government and net international reserves, reflecting updates of the macroeconomic framework.

51. **It is proposed that the next Article IV consultation with Afghanistan takes place on the 24-month cycle in accordance with the Executive Board decision on the consultation cycles for members with Fund arrangements**.

Text Table 5. Islamic Republic of Afghanistan: Second Review Structural Benchmarks		
Measure	**Date**	**Status**
Declarations of officials listed in Article 154 of the Constitution for 2016 will be published freely available and easily searchable on an official website in Dari and in English.	End-June 2017	**Met**
Submit draft legislation to Parliament aiming to criminalize acts of corruption in line with the UNCAC.	End-June 2017	**Met**
ARD and ACD to operationalize an automated interface for information sharing between the SIGTAS and ASYCUDA systems by June 2017, after developing the content (e.g. business receipt taxes collected at customs) and format of information to be shared through the interface.	End-June 2017	**Met**
ACD to complete staffing and training of its specialized risk management unit in Customs headquarters, which will be responsible for preparing, testing, and updating comprehensive risk profiles to effectively identify and prioritize high-risk traders/shipments for physical examination and post release verification in all border crossing points and inland customs depots.	End-June 2017	**Met**
Demonstrate progress in implementing the EITI Standard. In particular, 1. Appoint a senior individual who has the confidence of all stakeholders, the authority and freedom to coordinate action across relevant ministries and agencies, and can mobilize resources for EITI implementation. 2. Give LTO responsibility for all major corporate mining and oil and gas taxpayers. 3. LTO and MoMP to prepare and maintain a list of all major corporate mining and oil and gas companies. 4. MoMP with assistance of MoF will submit to MoJ legislation requiring all major extractive companies to produce annually accounts audited by a certified public or independent chartered accountant.	End-June 2017	**Met**
Approval by parliament of the revised 2017 budget that: (i) includes a transfer to DAB of Af7.7 billion, plus interest to be agreed between the MoF and DAB, to further reduce DAB's lender of last resort exposure to Kabul Bank, and (ii) specifically provides for the allocation of $50 million from this amount payable first to the Kabul Bank Receivership before being transferred to DAB.	End-July 2017	**Not met** Implemented Oct. 23, 2017
Ministry of Finance to pay the Kabul Bank Receivership the $50 million mentioned in the end-July 2017 structural benchmark, and the full amount of which is in turn transferred to DAB.	End-August 2017	**Not met** Implemented on Sep. 5, 2017

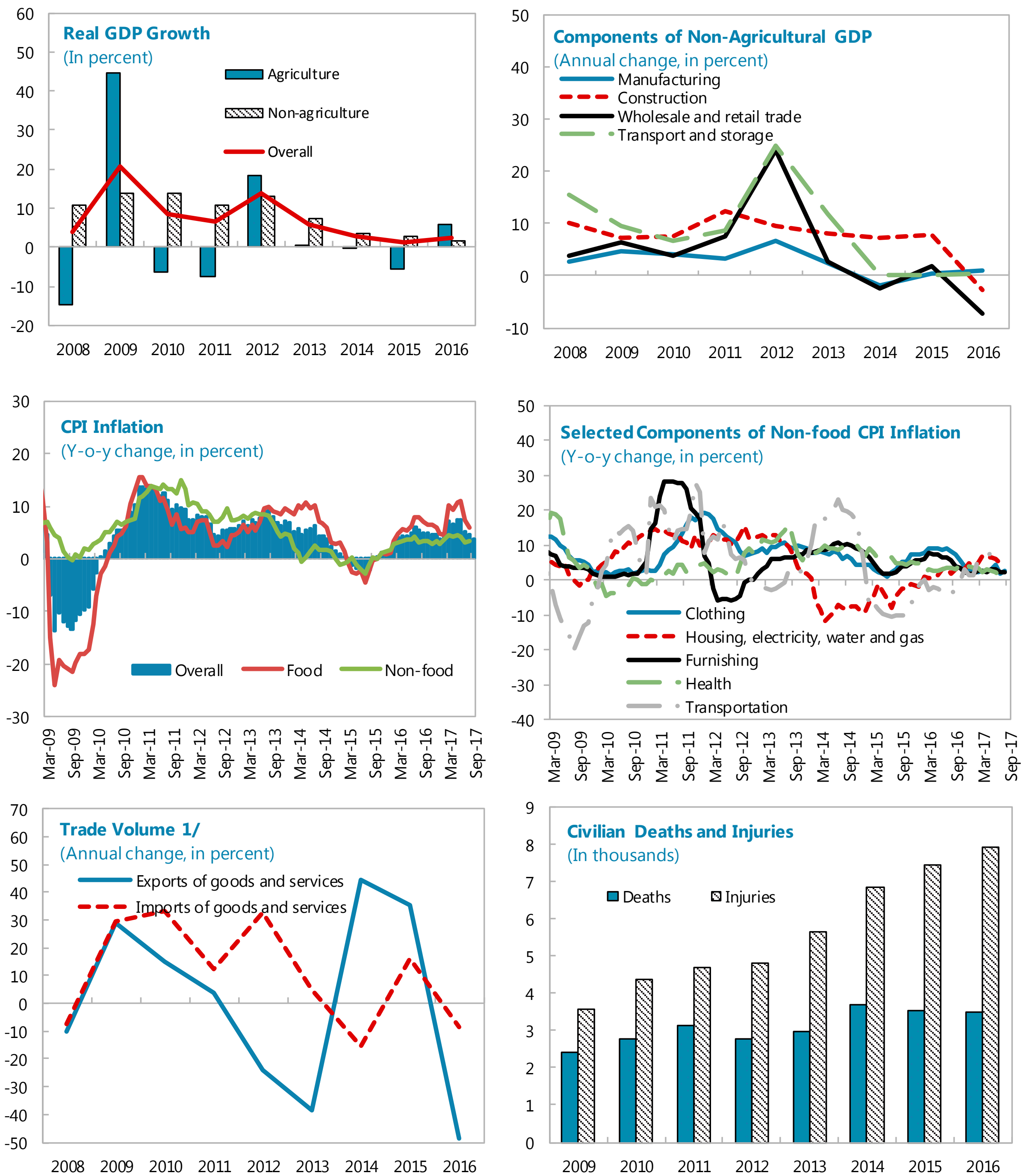
Text Table 6. Islamic Republic of Afghanistan: Third Review Structural Benchmarks

Measure	Date	Status
Cabinet to approve and submit to Parliament a 2018 draft budget in line with the macroeconomic framework agreed under the ECF arrangement. The budget will include a transfer to further reduce DAB's lender of last resort exposure to Kabul Bank, consistent with repaying the remaining balance in full by end-2019. The budget will include an appendix that lists carried-over expenditures per each ministry.	End-November 2017	**Met**. The budget was submitted to parliament on November 7, 2017.
Reduction in DAB's lender of last resort exposure to Kabul Bank ($343 million as of December 2016,) in line with the amount stipulated in the revised 2017 budget.	End-November 2017	**Met**. Payment made on October 28, 2017.
Amendments to the DAB law submitted to Parliament in line with the recommendations of the IMF's 2017 Safeguards assessment, especially with regards to DAB mandate, institutional and personal autonomy, as well as the rules of profit distribution, recapitalization and foreign reserves management.	End-November 2017	Draft to be finalized.
MoF, in coordination with DAB and with World Bank support, will prepare a strategy for state-owned commercial banks, addressing their business model and governance deficiencies, and minimizing their operational risk. The strategy will be finalized by High Economic Council (HEC).	End-November 2017	The draft strategy has been presented to the HEC, which has asked for revisions. A new version to be finalized.
Enact legislation to criminalize acts of corruption in line with UNCAC.	End-November 2017	**Met**
MoF to prepare and publish a plan to implement a VAT, including a VAT-specific excess credit reimbursement system, unique positive rate, unique threshold, and limited exemptions, in replacement of the Business Receipt Tax, and prepare its implementation through a transition and communication plan to be made publicly available and posted on the MoF website.	End-December 2017	The authorities' VAT plan seems broadly in line with the benchmark requirements, although some details (particularly on thresholds, exemptions, and BRT replacement) will need to be changed.

Text Table 6. Islamic Republic of Afghanistan: Third Review Structural Benchmarks (concluded)

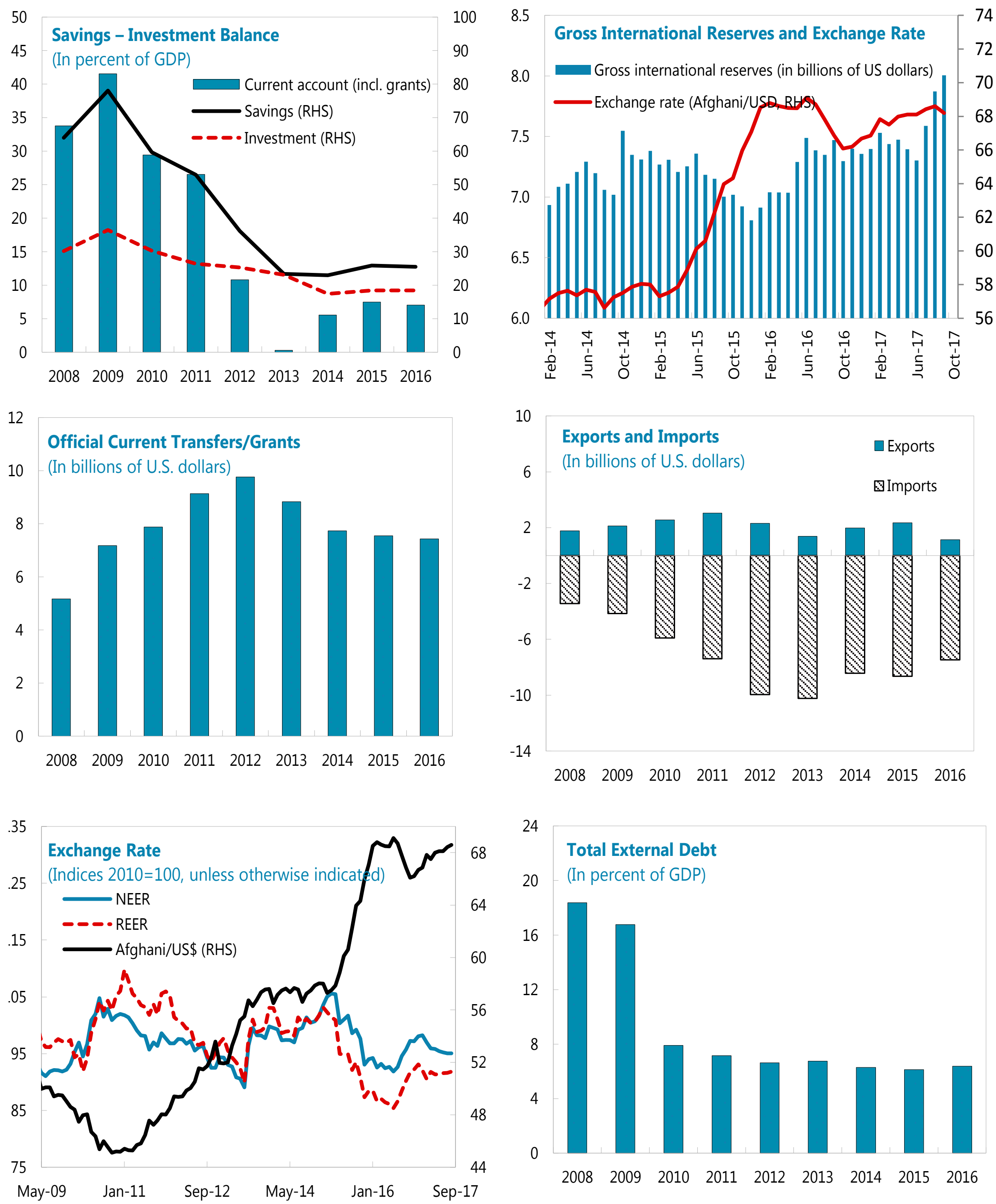
Budget Department in consultation with line ministries/agencies to submit allotment and annual financial plans in AFMIS. The Treasury Department to: (i) register their contractual commitments against allotment in the AFMIS; (ii) control payments against the respective pre- registered commitments and authorized financial plans in the system/AFMIS starting in FY 2018; and (iii) produce quarterly commitment reports for each ministry/agency starting in FY 2018.	End-December 2017	It is proposed that the timing for completion of this measure be pushed back by two months to February 2018.
Enact legislation on asset declaration in line with the specifications of the end-October 2016 structural benchmark.	End-December 2017	The SB may not be met on time as the amendment to the existing HOO law (submitted to parliament in November 2016) has been rejected by the lower house. The amendment has been incorporated into the draft anti-corruption law being prepared by MoJ with assistance from the donors which may take longer to be enacted.
Publish on http://anti-corruption.gov.af/en, both in Dari and in English: names and positions and asset declarations of officials not listed in the constitution who have declared their assets as of 2017 in line with the asset declaration legislation enacted consistent with the end-December 2017 structural benchmark, and mechanisms to access their declarations.	End-March 2018	Depends on adoption of the anti-corruption law (see above). It is proposed that the timing for completion of this measure be pushed back by one month to April 2018.

Figure 1. Islamic Republic of Afghanistan: Real Sector



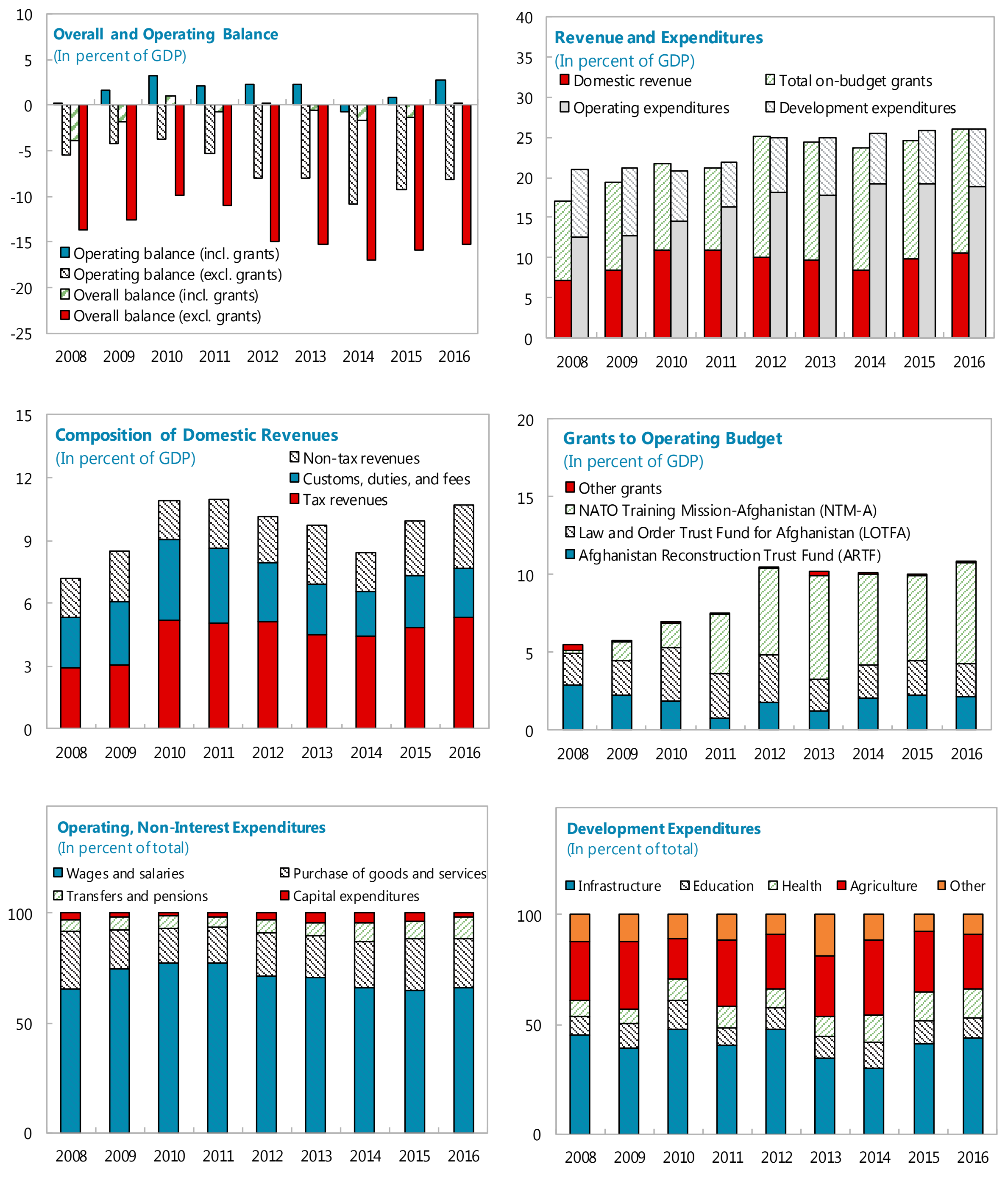
Sources: Afghan authorities, United Nations Assistance Mission in Afghanistan, and IMF staff calculations.
1/ In 2016, the decline in exports volumes reflects a fall in growth of services exports for two reasons: the fall in imports growth (insurance and freight are recorded as service exports) and in service exports to foreigners (transport, communication, financial services, issuance of visas, other) due to the security situation.

Figure 2. Islamic Republic of Afghanistan: External Sector



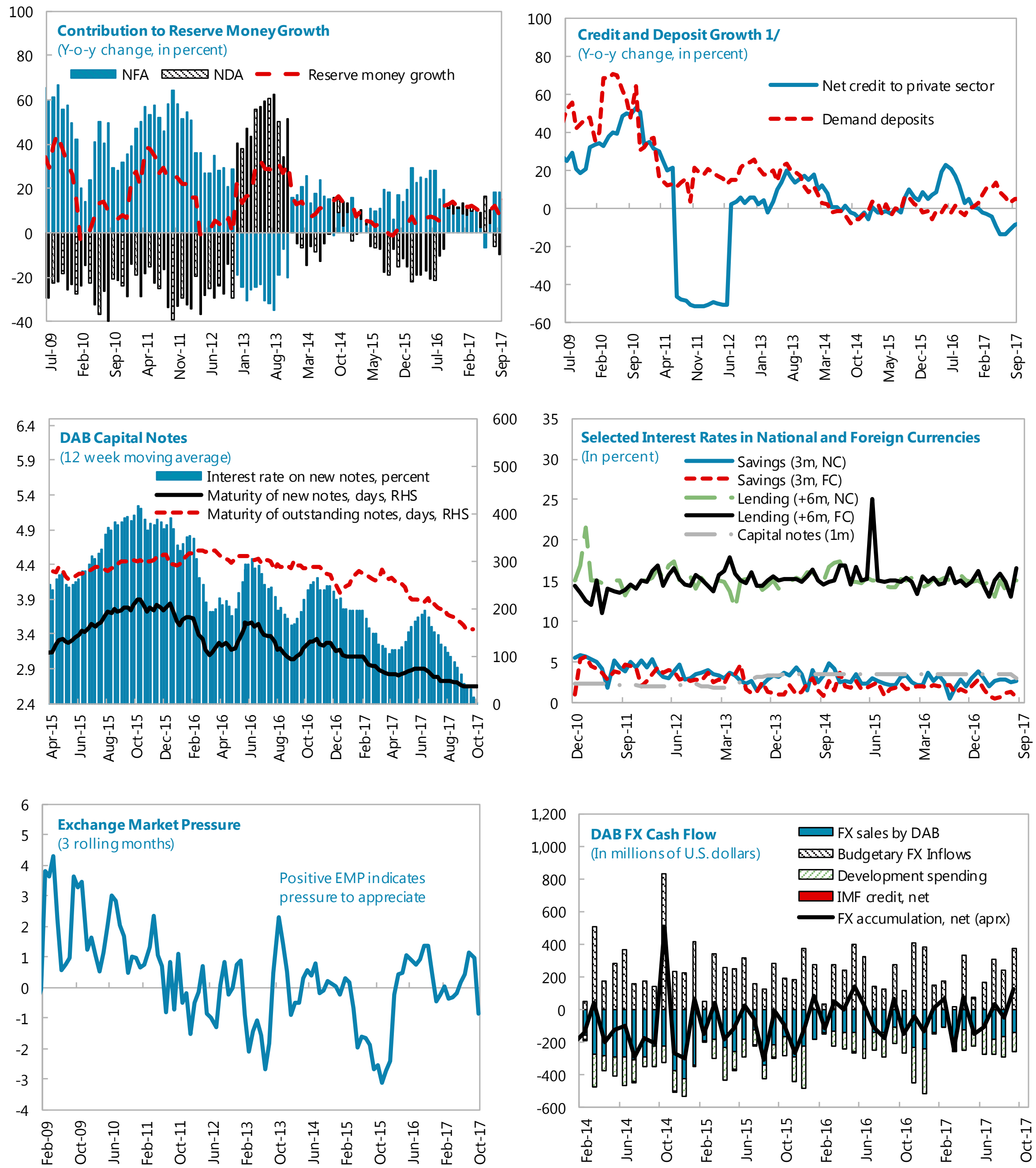
Sources: Afghan authorities and IMF staff calculations.

Figure 3. Islamic Republic of Afghanistan: Fiscal Sector



Sources: Afghan authorities and IMF staff calculations.

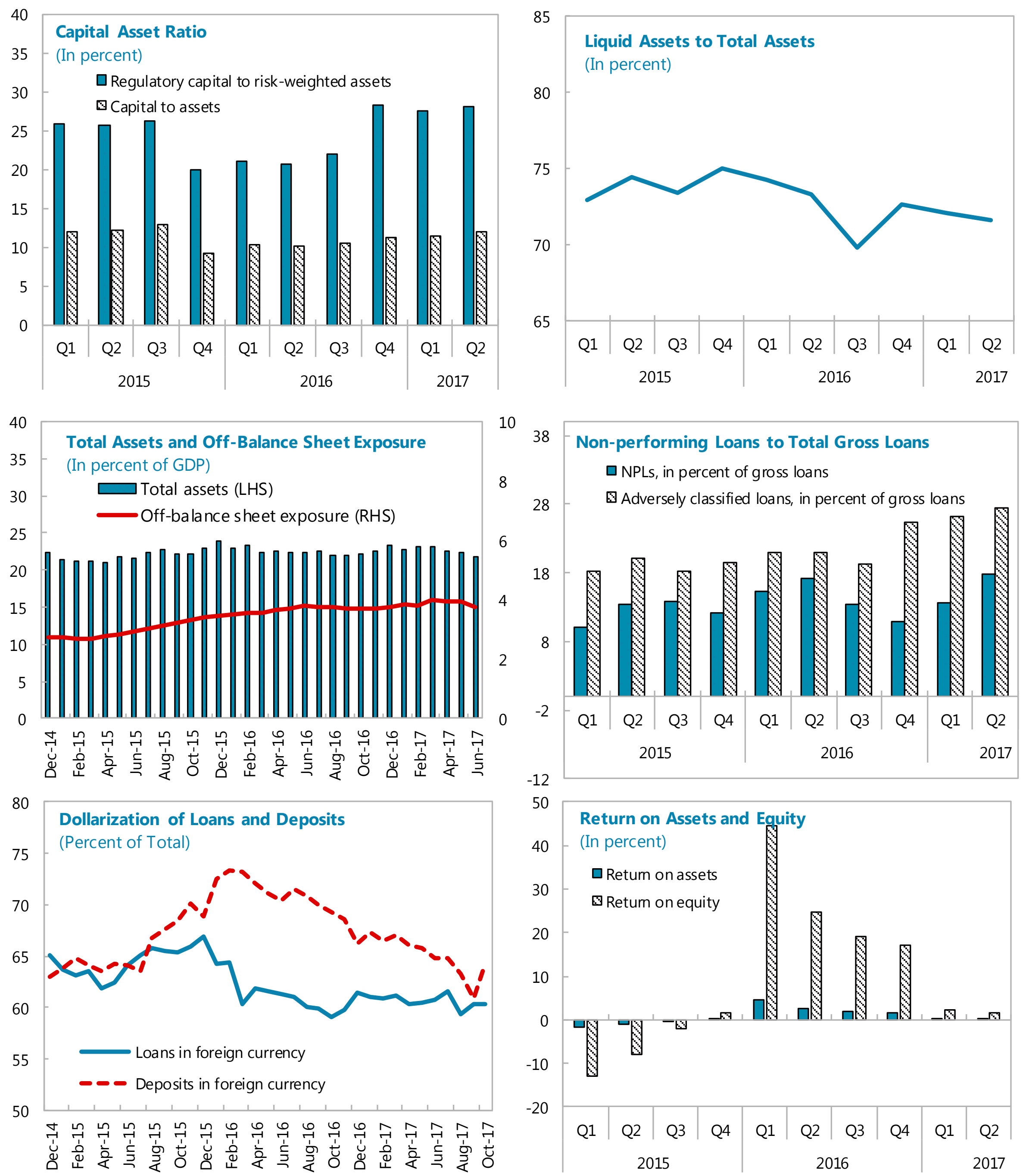
Figure 4. Islamic Republic of Afghanistan: Monetary Sector



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 5. Islamic Republic of Afghanistan: Banking Sector



Sources: Afghan authorities and IMF staff calculations.

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2015–18

(Quota: SDR 323.8 million)
(Population: approx. 33.4 million)
(Per capita GDP: approx. US$582; 2016)
(Poverty rate: 39.1 percent; 2014)
(Main exports: opium, US$2.0 billion; carpets, US$92.8 million; 2015)

	2015	2016	2017		2018	
	Act		Prog. CR/17/144	Proj.	Prog. CR/17/144	Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)					
Real GDP	1.3	2.4	3.0	2.5	3.5	3.0
Nominal GDP (in billions of Afghanis)	1,228	1,320	1,399	1,429	1,535	1,561
Nominal GDP (in billions of U.S. dollars)	20.1	19.5	20.6	21.0	21.8	22.5
Consumer prices (period average)	-0.7	4.4	6.0	5.5	6.0	6.0
Food	-0.8	5.7	...	...	...	...
Non-food	-0.6	3.2	...	...	...	...
Consumer prices (end of period)	1.1	4.6	7.2	6.2	6.0	6.0
Investment and savings	(In percent of GDP)					
Gross domestic investment	18.4	18.5	18.5	18.5	18.0	18.5
Of which: Private	5.8	5.5	6.4	8.0	6.8	7.7
Gross national savings	25.9	25.5	23.3	23.0	20.7	21.9
Of which: Private	14.6	12.4	10.7	12.4	9.3	11.0
Public finances (central government)						
Domestic revenues and grants	24.5	26.1	26.3	24.0	26.9	25.4
Domestic revenues	10.0	10.7	10.9	10.7	11.3	10.9
On-budget grants (excl. donors' direct spending outside the budget)	14.6	15.4	15.4	13.3	15.7	14.6
Expenditures	25.9	26.0	25.8	23.9	26.8	25.4
Operating 2/	19.2	18.9	18.1	17.7	18.8	18.6
Development	6.8	7.1	7.7	6.2	8.0	6.8
Operating balance (excluding grants) 3/	-9.2	-8.2	-7.2	-7.0	-7.5	-7.8
Overall balance (including grants)	-1.4	0.1	0.5	0.1	0.1	0.0
Public debt 4/ 5/	9.1	8.0	7.8	7.2	6.4	6.6
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)					
Reserve money	2.3	11.8	10.5	9.7	9.1	10.8
Reserve money in domestic currency	1.4	7.5	12.0	12.0	10.0	12.0
Currency in circulation	2.6	10.6	10.5	10.5	9.5	10.0
Broad money	3.1	9.8	8.2	7.8	8.5	8.1
Interest rate, 28-day capital note (in percent)	3.5	3.0	...	...	...	...
External sector 1/	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in millions of U.S. dollars)	580	619	708	723	822	847
Exports of goods (annual percentage change)	-9.8	6.8	14.6	16.7	16.1	17.2
Imports of goods (in millions of U.S. dollars)	7,666	6,160	6,510	7,065	6,681	7,139
Imports of goods (annual percentage change)	17.4	-19.6	5.8	14.7	2.6	1.1
Merchandise trade balance	-35.3	-28.5	-28.2	-30.2	-26.1	-39.7
Current account balance						
Excluding official transfers	-30.1	-31.2	-30.8	-30.8	-29.7	-30.2
Including official transfers	7.5	7.1	4.8	4.5	2.7	3.3
Foreign direct investment	0.8	0.5	1.1	0.5	0.5	0.5
Total external debt 4/	6.8	6.3	6.7	6.1	6.4	6.1
Gross international reserves (in millions of U.S. dollars)	6,808	7,357	7,541	7,627	7,544	7,725
Import coverage of reserves 6/	10.9	10.4	11.0	10.5	10.5	10.0
Exchange rate (average, Afghanis per U.S. dollar)	61.2	67.9	...	...	...	...
Real exchange rate (average, percentage change) 7/	-6.9	-7.1	...	...	...	...

Sources: Afghan authorities, United Nations Office on Drugs and Crime, WITS database, and IMF staff estimates and projections.

1/ Excluding the narcotics economy.
2/ Comprising mainly current spending.
3/ Defined as domestic revenues minus operating expenditures.
4/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at tim
5/ Public debt (including 2016 program number) was revised to include promissory note issued by MoF to settle DAB's Kabul Bank exposure.
6/ In months of next year's import of goods and services.
7/ CPI-based, vis-a-vis the U.S. dollar. Positive - real appreciation of the Afghani.

Table 2. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2015–22

	2015	2016	2017	2018	2019	2020	2021	2022
					Proj.			
Output and prices 1/			(Annual percentage change, unless otherwise indicated)					
Real GDP	1.3	2.4	2.5	3.0	3.5	4.0	4.5	5.0
Nominal GDP (in billions of U.S. dollars)	20.1	19.5	21.0	22.5	23.9	25.6	27.4	29.6
Consumer prices (period average)	-0.7	4.4	5.5	6.0	6.0	6.0	6.0	6.0
Investment and savings			(In percent of GDP, unless otherwise indicated)					
Gross domestic investment	18.4	18.5	18.5	18.5	18.6	18.6	18.6	19.1
Of which: Private	5.8	5.5	8.0	7.7	7.6	7.6	7.8	8.8
Gross national savings	25.9	25.5	23.0	21.9	21.1	20.2	18.9	17.8
Of which: Private	14.6	12.4	12.4	11.0	10.1	9.1	8.0	7.5
Public finances (central government)								
Domestic revenues and grants	24.5	26.1	24.0	25.4	26.7	27.8	28.9	29.6
Domestic revenues	10.0	10.7	10.7	10.9	11.2	11.5	12.4	13.2
On-budget grants (excl. donors' direct spending outside the budget)	14.6	15.4	13.3	14.6	15.5	16.3	16.5	16.5
Expenditures	25.9	26.0	23.9	25.4	26.6	27.7	28.9	29.6
Operating 2/	19.2	18.9	17.7	18.6	19.2	19.6	20.2	20.9
Development	6.8	7.1	6.2	6.8	7.4	8.1	8.7	8.7
Operating balance (excluding grants) 3/	-9.2	-8.2	-7.0	-7.8	-8.0	-8.1	-7.8	-7.7
Overall budget balance (including grants)	-1.4	0.1	0.1	0.0	0.1	0.1	0.1	0.1
External sector 1/								
Merchandise trade balance	-35.3	-28.5	-30.2	-27.9	-27.1	-26.4	-25.3	-24.5
Current account balance, excluding official grants	-30.1	-31.2	-30.8	-30.2	-29.4	-28.7	-27.3	-26.4
Current account balance, including official grants	7.5	7.1	4.5	3.3	2.6	1.6	0.3	-1.3
Gross reserves (in millions of U.S. dollars)	6,808	7,357	7,627	7,725	7,723	7,721	7,720	7,718
Import coverage of reserves 4/	10.9	10.4	10.5	10.0	9.3	8.7	8.1	7.5
Memorandum items:								
Total public debt 5/	9.1	8.0	7.2	6.6	6.1	6.1	6.0	5.9
Of which: External debt	6.8	6.3	6.1	6.1	6.1	6.1	6.0	5.9
Domestic debt	2.3	1.7	1.1	0.5	0.0	0.0	0.0	0.0
Sukuk	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Promissory note	2.3	1.7	1.1	0.5	0.0	0.0	0.0	0.0
GDP per capita (in U.S. dollars) 6/	627	582	612	640	663	691	731	779
Donors' direct spending outside the budget	23.0	22.8	21.9	19.0	16.5	14.0	11.0	8.6

Sources: Afghan authorities and Fund staff estimates and projections.

1/ Excluding the narcotics economy.
2/ Comprising mainly current spending. It is assumed that donors' recurrent expenditure off-budget, mostly in the security sector, is being moved onto the budget by 2031.
3/ Defined as domestic revenues minus operating expenditures.
4/ In months of next year's import of goods and services.
5/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.
6/ Incorporates the 2012 revision to the UN World Population Prospects.

Table 3a. Islamic Republic of Afghanistan: Central Government Budget, 2015–22

(In billions of Afghanis)

	2015	2016	2017		2018	2019	2020	2021	2022
	FY	FY	FY		FY				
			Prog.	Proj.	Proj.				
Revenues and grants	301.4	344.3	368.1	343.4	397.4	457.7	525.1	606.3	691.5
Domestic revenues	122.3	141.1	153.0	153.0	169.5	192.3	217.4	260.3	307.6
Tax revenues	89.7	101.2	108.4	109.0	121.5	139.4	158.8	192.2	232.0
Income, profits, and capital gains	32.3	36.4	…	…	…	…	…	…	…
International trade and transactions	30.4	31.1	…	…	…	…	…	…	…
Goods and services	21.1	27.9	…	…	…	…	…	…	…
Other	5.9	5.8	…	…	…	…	…	…	…
Nontax revenues	32.6	39.9	44.6	44.0	48.0	52.9	58.6	68.0	75.7
Grants to operating budget 1/	122.8	143.1	134.3	129.3	150.4	166.0	181.0	200.2	221.5
ARTF	27.4	28.9	…	…	…	…	…	…	…
LOTFA	27.5	27.4	…	…	…	…	…	…	…
CSTC-A	67.8	86.8	…	…	…	…	…	…	…
Other grants	0.2	0.1	…	…	…	…	…	…	…
Grants to development budget	56.2	60.1	80.8	61.1	77.5	99.4	126.6	145.8	162.3
Total expenditures	318.3	342.8	361.2	342.1	397.0	456.3	523.9	605.1	689.8
Operating expenditures	235.3	248.9	253.5	253.5	290.9	328.8	371.3	422.8	486.9
Of which: Security	145.1	149.9	141.5	141.5	167.5	194.6	218.5	250.4	285.7
Wages and salaries	152.3	164.5	…	…	…	…	…	…	…
Purchases of goods and services 2/	55.8	55.0	…	…	…	…	…	…	…
Transfers, subsidies, and other	1.3	2.2	…	…	…	…	…	…	…
Pensions	17.6	21.5	…	…	…	…	…	…	…
Capital expenditures	7.8	4.9	…	…	…	…	…	…	…
Interest	0.6	0.8	0.3	0.3	0.4	0.5	0.4	0.5	0.7
Development expenditures:	82.9	93.9	107.8	88.6	106.2	127.4	152.6	182.3	202.9
o/w discretionary 3/	18.0	4.4	26.9	27.5	…	…	…	…	…
Infrastructure and natural resources	33.9	40.8	…	…	…	…	…	…	…
Education	8.7	8.7	…	…	…	…	…	…	…
Health	11.2	12.4	…	…	…	…	…	…	…
Agriculture and rural development	22.7	23.4	…	…	…	…	…	…	…
Other	6.4	8.6	…	…	…	…	…	…	…
Operating balance excluding grants	-113.0	-107.8	-100.5	-100.5	-121.4	-136.5	-153.9	-162.5	-179.3
Overall budget balance including grants	-16.9	1.6	6.8	1.3	0.3	1.5	1.2	1.2	1.6
Float and discrepancy 4/	11.2	8.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	5.7	-9.7	-6.8	-1.3	-0.3	-1.5	-1.2	-1.2	-1.6
Sale of nonfinancial assets	0.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	0.6	-0.3	6.3	1.7	6.2	5.7	6.6	7.6	8.8
Domestic (net)	5.0	-11.6	-13.2	-3.0	-6.5	-7.2	-7.8	-8.9	-10.4
Central bank, change in	5.0	-11.6	-13.2	-3.0	-6.5	-7.2	-7.8	-8.9	-10.4
Government deposits	2.7	-4.5	-5.7	4.2	1.3	0.2	-7.2	-8.3	-10.0
Claims on government	2.3	-7.1	-7.5	-7.2	-7.9	-7.4	-0.6	-0.5	-0.4
Credit from DAB (IMF accounts)	1.7	-1.8	0.2	0.5	-0.3	0.3	-0.6	-0.5	-0.4
Promissory note (- = repayment)	0.6	-5.3	-7.7	-7.7	-7.6	-7.6	0.0	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Promissory note (end-of-period stock)	28.3	23.0	15.3	15.3	7.6	0.0	0.0	0.0	0.0
Pro-poor spending 5/	32.9	38.6	42.1	42.1	…	…	…	…	…

Sources: Afghan authorities and Fund staff estimates and projections.

1/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan;
CSTC-A: Combined Security Transition Command - Afghanistan (now NTM-A: NATO Training Mission - Afghanistan)
2/ 2015 figure includes about Af 2.85 billion arrears, which are repaid.
3/ 2015 figure includes about Af 7 billion discretionary development arrears, which are repaid.
4/ Positive number indicates that expenditures have been recorded, but not yet executed.
5/ Pro-poor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

Table 3b. Islamic Republic of Afghanistan: Central Government Budget, 2015–22

(In percent of GDP)

	2015	2016	2017		2018	2019	2020	2021	2022
	FY	FY	FY		FY				
			Prog.	Proj.	Proj.				
Revenues and grants	24.5	26.1	26.3	24.0	25.4	26.7	27.8	28.9	29.6
Domestic revenues	10.0	10.7	10.9	10.7	10.9	11.2	11.5	12.4	13.2
Tax revenues	7.3	7.7	7.7	7.6	7.8	8.1	8.4	9.2	9.9
Income, profits, and capital gains	2.6	2.8	...	...	...	...	...	...	...
International trade and transactions	2.5	2.4	...	...	...	...	...	...	...
Goods and services	1.7	2.1	...	...	...	...	...	...	...
Other	0.5	0.4	...	...	...	...	...	...	...
Nontax revenues	2.7	3.0	3.2	3.1	3.1	3.1	3.1	3.2	3.2
Grants to operating budget 1/	10.0	10.8	9.6	9.0	9.6	9.7	9.6	9.6	9.5
ARTF	2.2	2.2	...	...	...	...	...	...	...
LOTFA	2.2	2.1	...	...	...	...	...	...	...
CSTC-A	5.5	6.6	...	...	...	...	...	...	...
Other grants	0.0	0.0	...	...	...	...	...	...	...
Grants to development budget	4.6	4.6	5.8	4.3	5.0	5.8	6.7	7.0	7.0
Total expenditures	25.9	26.0	25.8	23.9	25.4	26.6	27.7	28.9	29.6
Operating expenditures	19.2	18.9	18.1	17.7	18.6	19.2	19.6	20.2	20.9
Of which: Security	11.8	11.6	10.1	9.9	10.7	11.4	11.6	12.0	12.2
Wages and salaries	12.4	12.5	...	...	...	...	...	...	...
Purchases of goods and services 2/	4.5	4.2	...	...	...	...	...	...	...
Transfers, subsidies, and other	0.1	0.2	...	...	...	...	...	...	...
Pensions	1.4	1.6	...	...	...	...	...	...	...
Capital expenditures	0.6	0.4	...	...	...	...	...	...	...
Interest	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development expenditures:	6.8	7.1	7.7	6.2	6.8	7.4	8.1	8.7	8.7
o/w discretionary 3/	1.5	2.2	1.9	1.9	...				
Infrastructure and natural resources	2.8	3.1	...	...	...	...	...	...	...
Education	0.7	0.7	...	...	...	...	...	...	...
Health	0.9	0.9	...	...	...	...	...	...	...
Agriculture and rural development	1.8	1.8	...	...	...	...	...	...	...
Other	0.5	0.7	...	...	...	...	...	...	...
Operating balance excluding grants	-9.2	-8.2	-7.2	-7.0	-7.8	-8.0	-8.1	-7.8	-7.7
Overall budget balance including grants	-1.4	0.1	0.5	0.1	0.0	0.1	0.1	0.1	0.1
Float and discrepancy 4/	0.9	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	0.5	-0.7	-0.5	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Sale of nonfinancial assets	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	0.0	0.0	0.5	0.1	0.4	0.3	0.4	0.4	0.4
Domestic (net)	0.4	-0.9	-0.9	-0.2	-0.4	-0.4	-0.4	-0.4	-0.4
Central bank, change in	0.4	-0.9	-0.9	-0.2	-0.4	-0.4	-0.4	-0.4	-0.4
Government deposits	0.2	-0.3	-0.4	0.3	0.1	0.0	-0.4	-0.4	-0.4
Claims on government	0.2	-0.5	-0.5	-0.5	-0.5	-0.4	0.0	0.0	0.0
Credit from DAB (IMF accounts)	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Promissory note (- = repayment)	0.0	-0.4	-0.6	-0.5	-0.5	-0.4	0.0	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Promissory note (end-of-period stock)	2.3	1.7	1.1	1.1	0.5	0.0	0.0	0.0	0.0
Pro-poor spending 5/	2.7	2.9	3.0	2.9	...	...	...	...	...

Sources: Afghan authorities and Fund staff estimates and projections.

1/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan;
CSTC-A: Combined Security Transition Command - Afghanistan (now NTM-A: NATO Training Mission - Afghanistan)
2/ 2015 figure includes about Af 2.85 billion arrears, which are repaid.
3/ 2015 figure includes about Af 7 billion discretionary development arrears, which are repaid.
4/ Positive number indicates that expenditures have been recorded, but not yet executed.
5/ Pro-poor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

Table 4a. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2015–22

(In billions of Afghanis, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022
	Dec. 21	Dec. 20	Dec. 21	Dec. 21	Dec. 21	Dec. 20	Dec. 21	Dec. 21
					Proj.			
Net foreign assets	447.5	478.1	508.0	532.3	548.7	567.0	584.5	601.8
Net international reserves	423.8	438.9	469.9	492.7	507.6	524.3	540.3	555.9
Gross international reserves	463.3	491.7	521.1	545.5	561.8	580.1	597.7	614.9
Foreign liabilities	39.5	52.9	51.2	52.7	54.2	55.9	57.4	59.0
IMF accounts (loans and SDR allocation)	5.8	4.6	4.1	4.1	4.1	4.1	4.1	4.1
Foreign currency reserves of commercial banks	33.7	48.3	47.1	48.6	50.1	51.7	53.3	54.9
Other foreign assets	-9.9	-9.0	-9.0	-9.0	-9.0	-9.0	-9.0	-9.0
Net domestic assets	-169.8	-167.5	-167.1	-154.6	-143.2	-131.4	-116.7	-99.2
Domestic assets	-65.8	-88.2	-88.8	-95.1	-102.5	-109.8	-118.1	-128.1
Net claims on government	-38.1	-48.1	-50.2	-56.5	-63.9	-71.2	-79.5	-89.5
Gross claims on government	40.2	34.7	28.4	20.7	13.1	13.1	13.1	13.1
MoF promissory note 1/	28.3	23.0	15.3	7.6	0.0	0.0	0.0	0.0
IMF accounts 2/	11.9	11.7	13.1	13.1	13.1	13.1	13.1	13.1
Liabilities to government	78.2	82.8	78.5	77.2	77.0	84.2	92.6	102.6
Domestic currency deposits	10.9	14.2	22.6	22.2	22.2	24.2	26.6	29.5
Foreign currency deposits	67.3	68.5	55.9	55.0	54.8	60.0	66.0	73.1
Net credit to state and local government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net credit on financial corporations	-30.1	-41.5	-40.2	-40.2	-40.2	-40.2	-40.2	-40.2
DAB's capital notes	-30.9	-41.9	-40.6	-40.6	-40.6	-40.6	-40.6	-40.6
Net credit to public nonfinancial corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	2.3	1.4	1.6	1.6	1.6	1.6	1.6	1.6
Other items net	-104.0	-79.3	-78.3	-59.5	-40.6	-21.6	1.4	28.9
DAB's capital	116.7	93.6	116.6	116.6	116.6	116.6	116.6	116.6
Reserve money	277.7	310.6	340.9	377.7	405.5	435.6	467.9	502.6
Reserve money in domestic currency	244.0	262.3	293.8	329.1	355.4	383.8	414.5	447.7
Currency in circulation	202.2	223.6	247.1	271.8	293.5	317.0	339.2	363.0
Bank deposits in domestic currency	33.4	32.2	40.8	51.3	55.9	60.8	69.3	78.8
Bank deposits in foreign currency	33.7	48.3	47.1	48.6	50.1	51.7	53.3	54.9
Other deposits	8.4	6.5	6.0	6.0	6.0	6.0	6.0	6.0
Memorandum items:								
International reserves, in millions of U.S. dollars 3/								
Net	6,227	6,566	6,878	6,978	6,978	6,978	6,978	6,978
Gross	6,808	7,357	7,627	7,725	7,723	7,721	7,720	7,718
Interest rate, 28-day capital notes (percent)	3.5	3.0	...	...	...	...	...	...
Exchange rate (eop, Afghanis per U.S. dollar)	68.1	66.8	...	...	...	...	...	...

Sources: Afghan authorities and Fund staff estimates and projections.

Note: Monetary indicators are calculated based on modified methodology and, thus, differ from the numbers reported in the previous staff reports.

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

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

3/ International reserves for Dec 2016 were revised relative to June 2017 report.

Table 4b. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2014–18

(At program exchange rates) 1/

	2014	2015	2016	2017				2018			
	Dec. 21	Dec. 21	Dec. 20	March 20	June 21	Sep. 22	Dec. 21	March 20	June 21	Sep. 22	Dec. 21
							Proj.	Proj.			
Net foreign assets	481.5	459.9	506.2	507.3	495.4	536.3	510.9	510.9	514.3	514.3	517.7
Net international reserves	455.1	435.9	465.7	469.9	469.6	497.9	472.6	472.6	476.0	476.0	479.5
Gross international reserves	498.6	476.0	521.0	521.7	508.9	549.3	524.0	523.9	527.4	527.4	530.8
Foreign liabilities	43.5	40.2	55.3	51.9	39.3	51.4	51.5	51.4	51.3	51.4	51.3
IMF accounts (loans and SDR allocation)	7.3	5.9	4.9	4.3	4.5	4.1	4.1	4.0	4.0	4.1	4.0
Foreign currency reserves of commercial banks	36.2	34.2	50.4	47.6	34.8	47.3	47.3	47.3	47.3	47.3	47.3
Other foreign assets	-9.8	-10.2	-9.9	-10.1	-9.0	-8.9	-9.0	-9.0	-9.0	-9.0	-9.0
Net domestic assets	-204.8	-181.6	-193.5	-214.5	-202.1	-225.5	-169.7	-169.7	-173.2	-164.7	-141.4
Domestic assets	-85.0	-66.2	-89.3	-110.1	-95.9	-119.4	-89.0	-102.2	-107.2	-103.1	-94.0
Net claims on government	-52.0	-38.5	-49.1	-72.4	-59.3	-80.8	-50.4	-63.6	-68.6	-64.5	-55.4
Gross claims on government	39.9	40.5	35.7	35.6	36.0	32.4	28.4	28.1	24.3	24.5	20.4
MoF promissory note 2/	27.7	28.3	23.0	23.0	22.9	19.4	15.3	15.3	11.5	11.5	7.6
IMF accounts 3/	12.1	12.2	12.7	12.6	13.2	13.0	13.1	12.8	12.8	13.1	12.7
Liabilities to government	91.9	79.0	84.8	108.0	95.4	113.2	78.9	91.7	92.9	89.0	75.7
Domestic currency deposits	20.4	10.9	14.2	28.2	34.9	32.5	22.6	26.7	27.1	25.6	22.2
Foreign currency deposits	71.5	68.1	70.5	79.8	60.5	80.7	56.3	65.0	65.8	63.4	53.5
Net credit to state and local government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net credit on financial corporations	-35.5	-30.1	-41.5	-39.1	-38.1	-40.2	-40.2	-40.2	-40.2	-40.2	-40.2
DAB's capital notes	-35.9	-30.9	-41.9	-39.5	-38.5	-40.6	-40.6	-40.6	-40.6	-40.6	-40.6
Net credit to public nonfinancial corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	2.5	2.3	1.4	1.4	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Other items net	-119.7	-115.4	-104.2	-104.3	-106.2	-106.1	-80.7	-67.5	-65.9	-61.6	-47.4
DAB's capital	74.8	116.7	93.6	104.1	107.8	116.6	116.6	116.6	116.6	116.6	116.6
Reserve money	276.7	278.3	312.7	292.9	293.3	310.8	341.1	341.1	341.1	349.6	376.4
Reserve money in domestic currency	240.6	244.0	262.3	245.3	258.5	263.5	293.8	293.8	293.8	302.3	329.1
Currency in circulation	197.0	202.2	223.6	210.1	218.2	221.5	247.1	253.0	259.2	265.4	271.8
Bank deposits in domestic currency	33.5	33.4	32.2	30.7	36.3	36.0	40.8	34.8	28.7	30.9	51.3
Bank deposits in foreign currency	36.2	34.2	50.3	47.6	34.8	47.3	47.3	47.3	47.3	47.3	47.3
Other deposits											
Memorandum items:											
Net international reserves (mn. USD) 4/	6,624	6,343	6,778	6,838	6,834	7,246	6,878	6878	6928	6928	6978

Sources: Afghan authorities and Fund staff estimates and projections.

Note: Monetary indicators are calculated based on modified methodology and, thus, differ from the numbers reported in the previous staff reports.

1/ Program exchange rates as of May. 21, 2016 are applied to value foreign currency-denominated components.

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

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

4/ International reserves for Dec 2016 were revised relative to June 2017 report.

Table 5. Islamic Republic of Afghanistan: Monetary Survey, 2015–22 1/

	2015	2016	2017	2018	2019	2020	2021	2022
					Proj.			
				(In billions of Afghanis)				
Net foreign assets	534.2	570.9	593.0	620.2	639.2	660.5	680.9	700.9
Foreign assets	564.2	600.5	625.4	653.0	672.4	694.2	715.0	735.5
Foreign liabilities	-30.0	-29.7	-32.4	-32.8	-33.2	-33.7	-34.1	-34.6
Central bank	-20.5	-18.6	-19.2	-19.2	-19.2	-19.2	-19.2	-19.2
Commercial banks	-9.5	-11.1	-13.2	-13.6	-14.0	-14.5	-14.9	-15.4
Net domestic assets	-119.2	-115.1	-101.7	-89.1	-60.3	-29.5	6.9	54.3
Net domestic credit	4.8	-5.8	-3.5	-7.5	-10.0	-11.7	-14.0	-17.1
Nonfinancial public sector	-42.5	-52.1	-50.1	-56.4	-63.8	-71.1	-79.4	-89.4
Net credit to central government	-42.6	-52.2	-50.2	-56.5	-63.9	-71.2	-79.5	-89.5
Central bank	-38.1	-48.1	-50.2	-56.5	-63.9	-71.2	-79.5	-89.5
Commercial banks	-4.5	-4.2	0.0	0.0	0.0	0.0	0.0	0.0
Net credit to public nonfinancial corporatior	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net credit to private sector	48.9	47.8	47.8	50.1	55.2	60.7	66.7	73.7
Net credit to other financial corporations	-1.6	-1.4	-1.2	-1.2	-1.3	-1.3	-1.4	-1.4
Other items net	-124.0	-109.4	-98.1	-81.6	-50.3	-17.7	21.0	71.4
Broad money M2	415.0	455.8	491.3	531.1	578.9	631.0	687.8	755.2
Broad money M2 in domestic currency	264.3	297.2	335.1	369.7	406.2	449.5	486.6	528.6
Narrow money M1	389.6	423.8	441.9	479.6	518.9	565.3	605.2	650.0
Currency outside banks	196.1	216.3	238.8	263.5	285.3	308.8	331.0	354.7
Currency in circulation	202.2	223.6	247.1	271.8	293.5	317.0	339.2	363.0
Currency held by banks	6.0	7.3	8.3	8.3	8.3	8.3	8.3	8.3
Demand deposits	193.5	207.5	203.1	216.0	233.6	256.5	274.3	295.3
Other deposits	25.4	31.9	49.4	51.6	60.1	65.7	82.6	105.2
				(12-month percentage change)				
M2	3.1	9.8	7.8	8.1	9.0	9.0	9.0	9.8
M1	1.2	8.8	4.3	8.5	8.2	8.9	7.1	7.4
Currency outside banks	4.1	10.3	10.4	10.3	8.3	8.2	7.2	7.2
Net credit to private sector	5.3	-2.3	0.0	5.0	10.0	10.0	10.0	10.4
				(In percent of GDP)				
M2	33.8	34.5	34.4	34.0	33.8	36.8	40.1	44.1
M1	31.7	32.1	30.9	30.7	30.3	33.0	35.3	37.9
Net credit to the private sector	4.0	3.6	3.3	3.2	3.2	3.2	3.2	3.2
Memorandum items:								
M2 velocity	3.0	2.9	2.9	2.9	3.0	3.0	3.0	3.1
Reserve money multiplier	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Banking sector								
Loan dollarization (percent)	66.9	61.4	60.2	59.4	59.0	58.8	58.5	58.5
Deposit dollarization (percent)	68.8	66.2	61.9	60.3	58.8	56.3	56.4	56.6
Currency-to-deposit ratio (percent)	92.4	93.4	97.9	101.6	100.0	98.4	95.1	90.6
Loans-to-deposit ratio (percent)	22.3	19.9	18.9	18.7	18.8	18.8	18.7	18.4

Sources: Afghan authorities and Fund staff estimates and projections.

Note: Monetary indicators are calculated based on modified methodology and, thus, differ from the numbers reported in the previous staff reports
1/ End of period (Dec.21). Data underlying the survey are not fully consistent because DAB and the public banks use the solar calendar, while commercial banks use the Gregorian calendar.

Table 6. Islamic Republic of Afghanistan: Balance of Payments, 2015–22 1/

(In millions of U.S. dollars, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022
					Proj.			
Current account	1,503	1,372	937	750	610	402	73	-372
Excluding official grants	-6,046	-6,061	-6,921	-6,809	-7,036	-7,338	-7,485	-7,811
Trade balance of goods	-7,086	-5,541	-6,342	-6,292	-6,482	-6,749	-6,948	-7,264
Export of goods and services	2,351	1,135	1,265	1,518	1,865	2,190	2,641	3,131
Goods	580	619	723	847	1,090	1,289	1,527	1,813
Services	1,771	516	542	671	776	901	1,114	1,318
Import of goods and services	8,634	7,471	8,528	8,691	9,295	9,953	10,591	11,449
Goods	7,666	6,160	7,065	7,139	7,571	8,038	8,475	9,077
Services	968	1,311	1,463	1,552	1,723	1,916	2,116	2,372
Income, net	180	52	115	120	120	119	121	122
Of which: Interest on official loans	6	5	5	5	6	7	8	9
Current transfers, net	7,606	7,656	8,086	7,803	7,920	8,045	7,901	7,824
Of which: Official /2	7,549	7,433	7,858	7,559	7,646	7,740	7,558	7,439
Capital account	0	0	0	0	0	0	0	0
Financial account, net	53.5	138	-659	-648	-616	-396	-67	376
Foreign direct investment	163	100	108	115	122	131	140	270
Portfolio investment	-82	-91	-87	-92	-97	-102	-107	-112
Official loans 3/	-8	-4	25	90	80	90	100	111
Disbursement	10	8	50	115	105	116	126	146
Amortization	18	12	25	26	26	26	26	35
Debt relief ('-' = forgiveness)	0	0	0	0	0	0	0	0
Other investment	-20	132	-705	-762	-722	-516	-202	105
Errors and omissions	-2,039	-946	0	0	0	0	0	0
Overall balance	-482	563	278	102	-6	6	5	4
Financing	482	-563	-278	-102	6	-6	-5	-4
Central bank's gross reserves ('-' = accumulation)	503	-549	-270	-98	2	2	2	1
Use of Fund resources, net	-20	-15	-8	-4	4	-8	-7	-5
Disbursements 4/	0	6	13	13	14	0	0	0
Repayments	20	21	21	16	10	8	7	5
Debt relief ('-' = forgiveness)	0	0	0	0	0	0	0	0
Memorandum items:								
Gross international reserves, central bank	6,808	7,357	7,627	7,725	7,723	7,721	7,720	7,718
Import coverage of reserves 5/	10.9	10.4	10.5	10.0	9.3	8.7	8.1	7.5
External debt stock, official 6/	1,231	1,242	1,283	1,359	1,442	1,524	1,618	1,723
in percent of GDP	6.8	6.3	6.1	6.1	6.1	6.1	6.0	5.9
Current account, in percent of GDP	7.5	7.1	4.5	3.3	2.6	1.6	0.3	-1.3
Trade balance, in percent of GDP	-35.3	-28.5	-30.2	-27.9	-27.1	-26.4	-25.3	-24.5
Export of goods and services, in percent of GDP	11.7	5.8	6.0	6.7	7.8	8.6	9.6	10.6
Import of goods and services, in percent of GDP	43.0	38.4	40.6	38.6	38.9	38.9	38.6	38.6
Official grants, in percent of GDP	37.6	38.2	37.4	33.6	32.0	30.3	27.5	25.1

Sources: Afghan authorities and Fund staff estimates and projections.

1/ BoP data exclude the narcotics economy.
2/ As the breakdown between capital grants and current grants is difficult to identify, all grants are included in current transfers.
3/ Excluding IMF.
4/ Disbursements in 2017-19 are conditional on the board approval of ECF reviews.
5/ In months of next year's import of goods and services.
6/ Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.

Table 7. Islamic Republic of Afghanistan: Financial Soundness Indicators

	2015	2016				2017	
		Q1	Q2	Q3	Q4	Q1	Q2
Capital adequacy							
Regulatory Capital to Risk-weighted Assets	19.9	21.1	20.6	22.0	28.3	27.5	28.1
Capital to Assets	9.2	10.3	10.1	10.5	11.3	11.4	11.9
Asset quality							
Non-performing Loans to Total Gross Loans	12.1	15.2	17.1	13.4	10.8	13.6	17.9
Non-performing Loans Net of Provisions to Capital	8.3	11.5	15.4	9.9	2.2	8.8	12.2
Earnings and profitability							
Return on Assets	0.2	4.4	2.5	1.9	1.7	0.2	0.2
Return on Equity	1.7	44.5	24.7	19.1	17.1	2.2	1.5
Liquidity							
Liquid Assets to Total Assets (Liquid Asset Ratio)	75.0	74.3	73.3	69.8	72.6	72.1	71.6
Liquid Assets to Short-term Liabilities	90.4	91.9	90.6	87.1	93.5	90.7	92.0

Source: Afghan authorities.

Table 8. Islamic Republic of Afghanistan: Proposed Schedule of Reviews and Disbursements Under the ECF Arrangement

	Amount of Disbursements		
Availability date	Millions of SDRs	Percent of Quota	Conditions
July 20, 2016	4.50	1.4	Approval of arrangement
April 21, 2017	4.50	1.4	First review and December 20, 2016 performance criteria
October 23, 2017	4.50	1.4	Second review and June 21, 2017 performance criteria
April 23, 2018	4.50	1.4	Third review and December 21, 2017 performance criteria
October 22, 2018	4.50	1.4	Fourth review and June 21, 2018 performance criteria
April 22, 2019	4.50	1.4	Fifth review and December 21, 2018 performance criteria
July 15, 2019	5.38	1.7	Sixth review and March 20, 2019 performance criteria
Total	32.38	10.0	

Source: International Monetary Fund.

Table 9. Islamic Republic of Afghanistan: External Financing Requirement and Sources, 2016–20

(In millions of U.S. dollars)

	2016	2017	2018	2019	2020
		Proj.			
Gross financing requirement	6,650	7,237	6,949	7,070	7,369
Current account balance (excluding grants)	-6,061	-6,921	-6,809	-7,036	-7,338
Amortization	40	46	42	36	33
Of which: IMF	21	21	16	10	8
Change in reserves (increase = +)	549	270	98	-2	-2
Reduction in arrears	0	0	0	0	0
Available financing	6,643	7,225	6,936	7,056	7,369
Official transfers (grants)	7,433	7,858	7,559	7,646	7,740
Foreign direct investment	100	108	115	122	131
Official medium- and long-term loans (net)	-4	25	90	80	90
Accumulation of arrears	0	0	0	0	0
Debt forgiveness	0	0	0	0	0
Debt rescheduling	0	0	0	0	0
Other flows	-886	-766	-828	-792	-591
Financing gap	6	13	13	14	0
Identified financing (provisional)	6	13	13	14	0
Of which: IMF 1/	6	13	13	14	0
Remaining gap	0	0	0	0	0

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

1/ Disbursements in 2017-19 are conditional on the board approval of ECF reviews.

Table 10. Islamic Republic of Afghanistan: Projected Payments and Indicators of Capacity to Repay the Fund 1/

(In millions of SDRs)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Obligations from existing drawings															
1. Principal															
GRA repurchases	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
PRGT repayments	1.2	11.6	7.1	5.4	4.8	3.8	1.8	1.8	1.8	1.8	0.5	0.0	0.0	0.0	0.0
2. Charges and interest 2/															
PRGT interest	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
SDR assessments	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
SDR net charges	0.1	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total obligations	1.3	12.2	7.7	6.0	5.4	4.4	2.4	2.4	2.4	2.4	1.1	0.6	0.6	0.6	0.6
(percent of quota)	0.4	3.8	2.4	1.8	1.7	1.3	0.7	0.7	0.7	0.7	0.3	0.2	0.2	0.2	0.2
Obligations from prospective drawings 3/															
1. Principal															
PRGT repayments	0.0	0.0	0.0	0.0	0.0	0.0	1.4	3.2	4.7	4.7	4.7	3.3	1.5	0.0	0.0
2. Charges and interest 2/															
PRGT interest	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
Total obligations	0.0	0.0	0.0	0.0	0.0	0.0	1.4	3.2	4.7	4.7	4.7	3.3	1.5	0.0	0.0
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	0.4	1.0	1.4	1.5	1.5	1.0	0.5	0.0	0.0
Cumulative obligations (existing and prospective) 3/															
1. Principal															
GRA repurchases	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
PRGT repayments	1.2	11.6	7.1	5.4	4.8	3.8	3.2	5.0	6.5	6.5	5.1	3.3	1.5	0.0	0.0
2. Charges and interest 2/															
PRGT interest	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
SDR assessment and net charges	0.1	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total obligations	1.3	12.2	7.7	6.0	5.4	4.3	3.7	5.5	7.1	7.1	5.7	3.9	2.1	0.6	0.6
Outstanding Fund credit, end of period	44.7	42.1	45.0	39.6	34.8	31.0	27.9	22.9	16.5	10.0	4.9	1.5	0.0	0.0	0.0
Memorandum items:															
Outstanding Fund credit, in percent of															
Exports of goods and services 4/	5.0	3.9	3.4	2.6	1.9	1.4	1.1	0.8	0.5	0.3	0.1	0.0	0.0	0.0	0.0
External public debt	4.9	4.4	4.4	3.7	3.0	2.5	2.0	1.6	1.0	0.6	0.3	0.1	0.0	0.0	0.0
Gross official reserves	0.8	0.8	0.8	0.7	0.6	0.6	0.5	0.4	0.3	0.2	0.1	0.0	0.0	0.0	0.0
GDP	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Quota	13.8	13.0	13.9	12.2	10.7	9.6	8.6	7.1	5.1	3.1	1.5	0.5	0.0	0.0	0.0
Total Obligations, in percent of															
Exports of goods and services 4/	0.1	1.1	0.6	0.4	0.3	0.2	0.1	0.2	0.2	0.2	0.2	0.1	0.0	0.0	0.0
External public debt	0.1	1.3	0.7	0.6	0.5	0.4	0.3	0.4	0.4	0.4	0.3	0.2	0.1	0.0	0.0
Gross official reserves	0.0	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
GDP	0.0	0.1	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
Quota	0.4	3.8	2.4	1.8	1.7	1.3	1.2	1.7	2.2	2.2	1.8	1.2	0.7	0.2	0.0
Quota	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8

Source: Fund staff estimates and projections.

1/ As of October 31, 2017. Years refer to Gregorian calendar years (January 1 to December 31).
2/ Projections are based on current interest rates for PRGT loans.
3/ Based on the proposed level and phasing of access, and subject to the approval of the IMF's Executive Board.
4/ Excluding reexports.

Table 11. Islamic Republic of Afghanistan: Millennium Development Goals 1/

	Baseline value	Latest available	Target 2/ 2015	Target 2/ 2020
	(In percent, unless otherwise indicated)			
Goal 1: Eradicate extreme poverty and hunger				
Population below US$1 (PPP) a day	...	...	...	...
Population below national poverty line 3/ 4/ 5/	33.0	36.5	24.0	21.0
Prevalence of underweight children under 5 years of age	41.0	25.0	15.0	...
Population below minimum level of dietary energy consumption 5/ 6/	30.0	30.1	11.0	9.0
Goal 2: Achieve universal primary education				
School enrolment rate (age 7-12) 5/	37.0	54.4	...	100
Literacy rate of 15- to 24-year-olds	34.0	47.0	50.0	100
Goal 3: Promote gender equality and empower women				
Ratio of girls to boys in primary education	60.0	67.0	83	100.0
Ratio of girls to boys in secondary education	33.0	54.0	70	100.0
Proportion of seats held by women in national, provincial and district representative bodies	25.0	27.0	25.0	30.0
Goal 4: Reduce child mortality				
Under 5 mortality rate (per 1000 live births)	257	102.0	85	65
Infant mortality rate (per 1000 live births)	165	74.0	60	45
Immunization, measles, children under 12 months	35.0	59.0	70.0	90
Goal 5: Improve maternal health				
Maternal mortality ratio (per 100,000 births)	1600	327	270	200
Proportion of births attended by skilled personnel	14.0	47.0	50.0	75.0
Fertility rate (live births per woman) 4/ 7/	6.3	5.1	4.7	3.1
Goal 6: Combat HIV/AIDS, malaria, TB and other diseases				
Contraceptive prevalence rate, national	10.3	13.8	40.0	60.0
Incidence rates associated with malaria	1.5	1.1	0.7	0.2
Prevalence rates associated with tuberculosis (per 100,000 population)	671	340	224	143
Goal 7: Ensure environmental sustainability				
Population with access to safe drinking water	23.0	67.3	...	61.5
Population with access to improved sanitation	12.0	14.9	...	66.0
Goal 8: Develop a Global Partnership for Development				
ODA received as a proportion of GDP	49.0	18.0	...	...
Export to countries having a preferential trade agreement with Afghanistan	11.8	41.5	...	100
Goal 9: Enhance security 7/				
Professional training of the ANA (% of personnel having undergone a full training)	42.0	90.0	100	100
Afghans directly affected by emplaced antipersonnel mines (in millions)	4.2	1.6	1.7	0.2
Afghans dependent on opium for their livelihoods (in millions)	1.70	1.25	0.60	0.20

Source: UNDP *Millennium Development Goals, Islamic Republic of Afghanistan, 10 years Report 2005–15*

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

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

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

4/ Figures may not be directly comparable.

5/ Data is from World Bank (2014) *Poverty in Afghanistan assessment*, rather than the UNDP MDG *Progress Report*.

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

7/ Afghanistan-specific, additional goal/indicator.

Annex I. Risk Assessment Matrix[1]

Source of Risks and Likelihood	Impact if Realized	Policy Recommendations Mitigation/Response
High Geopolitical uncertainties/ Deterioration of the security situation	High Reduced investor and consumer confidence, lack of spending for development Lower growth resulting in a decline in domestic revenue and higher fiscal deficit, and adverse effects on unemployment and poverty High volatility of the exchange rate leading to further dollarization, capital flight and inflationary pressures	Strengthen fiscal and monetary policies to safeguard macroeconomic stability
Medium Structurally weak growth in emerging market economies, particularly in China and India, which are key stakeholders in the development of Afghanistan's natural resources	Medium Delays in investments to develop extractive industries postpone the projected pick-up in growth and result in lower exports Lower than expected revenues from natural resources lead to higher budget deficits Fiscal deficits and lower export receipts lead to exchange rate depreciation and higher inflation Lack of progress in developing natural resources strengthens reliance on narcotics	Maintain macro stability and improve business climate, including a sound fiscal regime for natural resources
High Weak fiscal policy implementation: setbacks in revenue mobilization efforts and continued weaknesses in expenditure and cash management	High Lower than expected yields from revenue mobilization efforts lead to spending cuts depletion of the treasury cash balances and unfunded allotments lead to arrears	Continue to improve tax compliance, revenue mobilization, spending prioritization, and coordination between the treasury and budget department
Medium Decline in aid inflows	High Lower public spending especially in infrastructure, lower growth, increased unemployment, and/or exchange rate pressures	Speed up structural reform, and improve economic governance, including fight against corruption, stronger institutional and regulatory frameworks, and law enforcement to support growth and revenue collection

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within one year and three years, respectively.

Source of Risks and Likelihood	Impact if Realized	Policy Recommendations Mitigation/Response
Financial conditions: High Lack of progress in banking sector restructuring compromising financial sector's soundness Medium Reduced financial services by correspondent banks ("de-risking"). Significant curtailment of cross-border financial services	High Constrained intermediation results in lower availability and inefficient allocation of credit to the economy, lower access to finance, and slower growth Undermined confidence in banks could lead to banking liquidity challenges Lax or ineffective enforcement could undermine financial discipline and governance, risk management including AML result in bank failure(s) and need for bailouts High Access by Afghan banks to global financial system is impeded	Enhance crisis preparedness and management tools, strengthen central bank independence, implement the World Bank's proposed commercial banking sector consolidation plan Intensify fight against corruption and banks' governance

Annex II. External Sector Assessment

Afghanistan's external position is determined by the sizable foreign aid inflows and is stronger than implied by fundamentals. An eventual decline of these inflows will need to be compensated with increased exports and higher FDI inflows. Both will benefit from competitiveness gains and strengthened business environment. The latter can be bolstered now through more efficient aid absorption and implementation of reforms to improve productivity. The assessment of the external position relative to fundamentals is hampered by data shortcomings and by the two-pronged and opposite impact of aid inflows which finance both high reserve accumulation and large trade deficits.

1. **Foreign reserve accumulation, driven by substantial aid inflows, makes the IIP positive**. The size of Afghanistan's foreign exchange reserves makes the country a net creditor in terms of net International Investment Position (IIP) by about US$5.3 billion (about 27 percent of GDP). In addition to international reserves (US$7.4 billion), currency and deposits in deposit-taking institutions are the largest IIP assets (US$1.2 billion). Liability positions are mainly general government external debt (US$2.1 billion, including some US$900 million pending pledged debt relief commitments) and direct investment (US$1.4 billion). However, significant data uncertainties pertain to direct investment (assets and liabilities), other assets and liabilities of the private sector, and trade credits.[1]

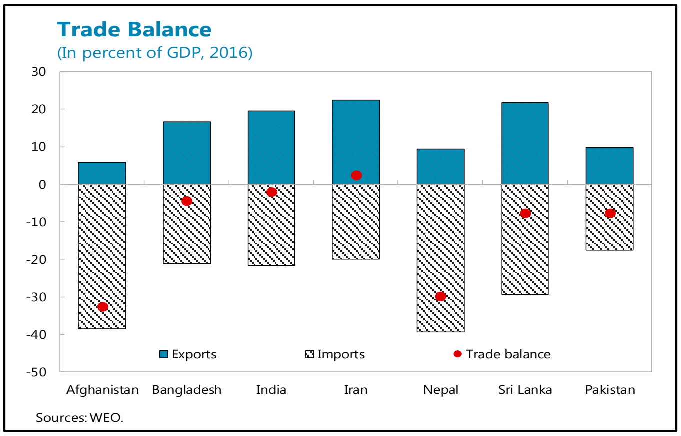
2. **The current account remains largely determined by two exogenous factors: foreign security and aid-related imports, and official foreign aid inflows**. Excluding aid, the current account deficit was estimated at nearly 32 percent of GDP in 2016. Considerable uncertainties surround the estimates of the current account after grants as the breakdown between capital account grants and current account grants is only approximate due to data deficiencies.

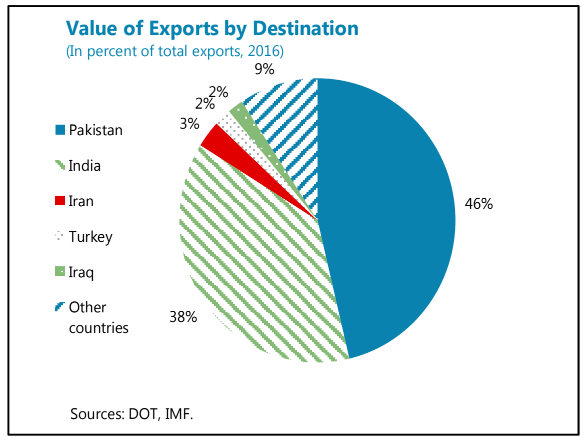
Current Account Balance, excl. Grants
(in percent of GDP)

Source: Afghan authorities and IMF staff calculations.

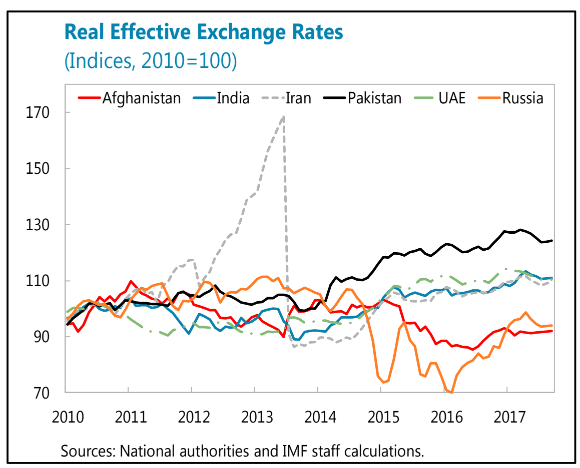
[1] An enterprise survey recommended by IMF technical assistance would help to fill these data gaps. Such a survey is expected to be undertaken in 2019.

3. **Afghanistan's external trade performance reflects very low recorded exports combined with import dependency**. The country's trade balance has been negative for the last two decades. It compares poorly with its neighbors especially with respect to the low value of its official exports (about 6 percent of GDP)[2] while the magnitude of imports largely reflects foreign security and aid-related demand. Afghanistan's external trade comprises mostly agricultural products (nearly 45 percent of exports). This reflects the small manufacturing base and a recent decline in specialized production such as carpets and textiles, which were better integrated into global value chains, and which used higher levels of labor and capital. Furthermore, the country's high export concentration (Pakistan and India) expose the country to demand shocks in its neighbors. Pakistan is the main destination country and the main transit country for Afghanistan's exports.





4. **The current account has been broadly unaffected by the trend real exchange rate depreciation in recent years**. Exchange rate developments primarily depend on the level of foreign aid disbursements, the related spending by foreign troops, and the degree of dollarization. The real effective depreciation observed since 2012 and more prominently since early 2015 has not been reflected in a noticeably improved export performance. The potential impact on competitiveness of price rises of non-tradable goods and services including wages stemming from drug trade—and aid—related inflows is more than offset by non-price factors (investor confidence, access to finance and energy, quality of infrastructure, and



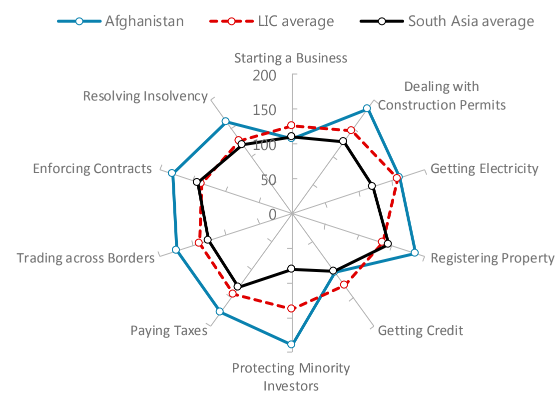
[2] Official data capture only part of the country's external trade. Afghanistan is the world's largest source of opiate production which is mainly intended for export. The value of exported opiates ranges from 10 to 15 percent of GDP.

investment climate). A quantitative assessment of the long run alignment of the exchange rate's level is however hindered by lack of historical balance of payments data, the multi-year conflict, very large aid flows, high dollarization, and the large informal sector including narcotics production.

5. **Foreign direct investment (FDI) and capital flows do not significantly contribute to exchange rate developments**. FDI flows into Afghanistan—mostly originating from the United Arab Emirates and China—were less than 1 percent of GDP per year on average during 2011–16. Moreover, the revised FDI data, dating back to 2009, resulted in a decrease of approximately 30 percent of the value of direct investment. Afghanistan does not have access to international capital markets.

6. **The economy is facing structural impediments to competitiveness**. Non-price competitiveness is a major issue. The security situation, the cost of electricity, and the lack of infrastructure impede the development of the tradable sector. The business environment is weak even when compared with IDA-eligible countries (see World Bank Doing Business indicators).[3] Afghanistan was ranked 183rd out of 190 countries, in the 2018 World Bank doing business rankings. Weaknesses are spread across all areas, including access to finance and trading across borders.

Doing Business Report
(Rank, 2018)



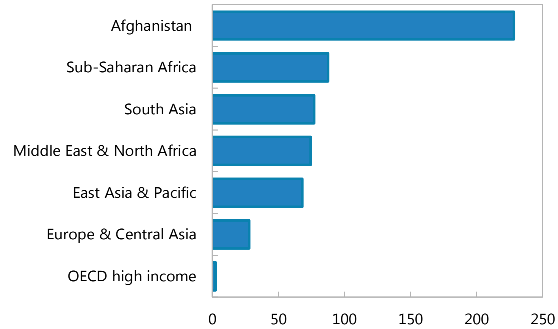
Source: World Bank Doing Business Report 2018.

7. **The country's trade performance is related to its underdevelopment, nearly 35 years of constant conflict, being landlocked, and other country specific factors**. The costs of being landlocked are well-documented. Distance to be travelled overland and poor road infrastructure are major factors of costly transport. The World Bank's Logistics Performance Index (LPI) shows that delays and cost for importing and exporting are far higher for landlocked countries than their coastal neighbors. This difference is amplified for low-income countries. In the case of Afghanistan, a range of factors includes domestic supply-side constraints, costs due to security challenges, and poor logistics and trade infrastructure generating delays and hampering the country's export capacity. As Afghanistan depends on coastal neighbors for access to the sea, its integration into regional and global markets necessitates international cooperation.

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

Time to Export

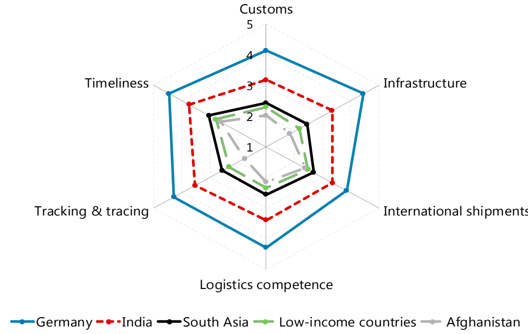
Documentary compliance (hours)



Sources: World Bank Doing Business Report 2018.

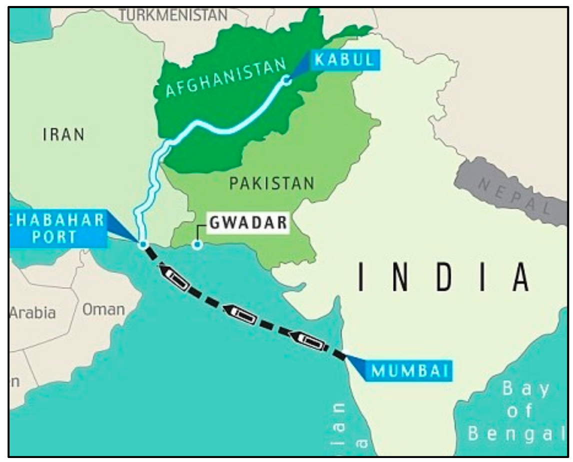
Logistics Performance Index

(Components of the overall index, 2016; 1=low to 5=high)



Sources: World Bank.

8. **Regional integration can help the country alleviate its competitiveness challenges**.[4] In addition to its recent WTO accession, Afghanistan is intensifying regional cooperation and investment in trade, transport, and energy. This includes a trilateral sea and land transit agreement with Iran and India, the establishment of an air corridor with India, and participation in transit and trade corridors such as the "Five Nations Railway Corridor" (AFG, CHN, IRN, TJK, KGZ) and the "Lapis Lazuli Corridor" (AFG, TKM, AZE, GEO, TUR). Finally, the inclusion in cross-border electricity transmission networks will boost Afghanistan's trade and transit activities between Central and South Asia.

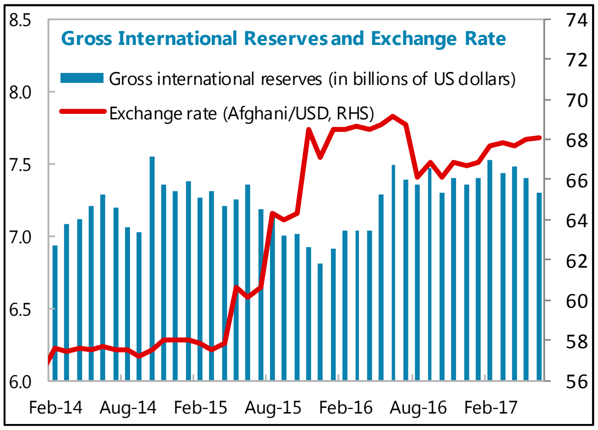


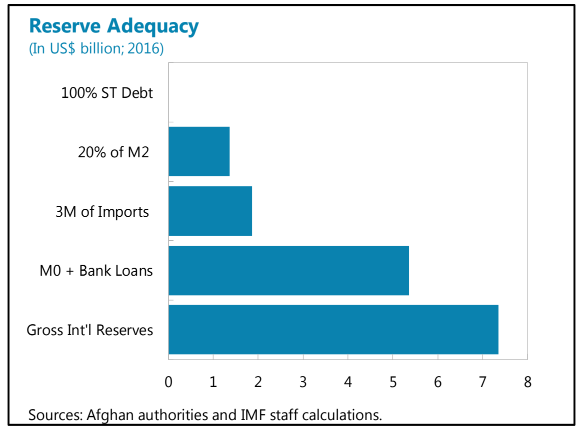
9. **The stock of gross FX reserves exceeds all traditional metrics of reserve adequacy**.[5] This accumulation is largely the counterpart of low absorptive and institutional capacities, which, combined with the difficult security situation, have constrained development spending. It also reflects the authorities' preference for building precautionary buffers in the presence of large uncertainties. The de jure exchange rate arrangement is managed floating. The exchange rate regime is classified by the Annual Report on Exchange Arrangements and Exchange Restrictions

[4] See *Selected Issues Paper,* "Afghanistan's Integration in Regional Trade: A Stocktaking."

[5] The methodology for "Assessing Reserve Adequacy in Credit-Constrained-Economies (ARA-CC)" does not produce meaningful results because of data limitations and the absence of relevant proxies to quantify the cost of holding reserves (e.g. market yields, output to capital ratio).

(AREAER) as de facto floating. DAB intervenes regularly in the foreign exchange market through twice-weekly selling auctions to smooth out excessive volatility of the exchange rate against the U.S. dollar. Gross reserves appear adequate as they amount to more than ten months of imports and 35 percent of GDP. Reserves exceed by a wide margin total external debt, which is long-term and highly concessional.





Appendix I. Letter of Intent

Kabul, November 19, 2017

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

Dear Ms. Lagarde:

Much progress has been made by the Afghan government and its people with strong support from the international community, even in circumstances of continued difficulties on the security, economic, and political fronts. Nevertheless, our government is determined to press ahead with reforms needed to address the difficulties Afghanistan faces and build prosperity for current and future generations of Afghans.

We would like to thank the International Monetary Fund (IMF) for its support in recent years, including in the context of the Extended Credit Facility (ECF) arrangement, approved by the Executive Board in July 2016. Having addressed the immediate fiscal and banking vulnerabilities with the help of the 2015 staff-monitored program (SMP), we are now aiming to build on these achievements by laying the foundations for a vibrant economy through macroeconomic stability and structural reforms promoting sustainable and inclusive growth. We plan for a future where we will have put behind us dependence on donor aid, even if this new reality will take decades to arrive at, and we see the ECF-supported arrangement as playing a critical catalytic role.

The Government of Afghanistan believes that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) will support achieving the objectives of its program, and represent an ambitious set of reforms, but it will take any further measures that may become appropriate for this purpose. We will continue to consult with the IMF on the adoption of these measures and in advance of any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We intend to remain in close consultation with the IMF staff and provide timely information necessary for monitoring economic developments and implementation of policies under the ECF-supported program; and are grateful for support the IMF staff have offered in the past.

The government requests that the IMF Executive Board approves the completion of the second review and the disbursement of an amount equivalent to SDR 4.50 million under the ECF arrangement.

The government also requests modification of two December 2017 performance criteria on the net credit to government and net international reserves, necessitated by an update of the macroeconomic framework.

In line with our commitment to transparency, we hereby request that the staff report, this Letter of Intent (LOI), and the attached MEFP and Technical Memorandum of Understanding (TMU), including all annexes and attachments, as well as the selected issues papers, be published on the IMF website.

Sincerely yours,

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

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies for 2017–19

A. Introduction

1. **This memorandum reviews recent economic developments and lays out our economic objectives and policy framework for the period through July 19, 2019, supported by a three-year Extended Credit Facility (ECF) arrangement with the IMF staff**.

2. **We, the government of Afghanistan and its central bank, are committed to reinvigorate economic reform and address structural weaknesses in the economy**. We have started to address economic vulnerabilities and are pressing ahead with the reform program through a series of policy and legislative actions. These actions signal our commitment to reform, building economic confidence, and raising economic growth.

3. **The ECF arrangement supports our macroeconomic policy and reform agenda for the period through 2019**. It helps the government address economic vulnerabilities and facilitates our engagement with the international community to sustain donor support and help us make progress on the deliverables under the Self-Reliance Mutual Accountability Framework (SMAF). The ECF arrangement assists us in preserving macroeconomic stability, improving economic governance, and laying the basis for stronger private sector activity.

B. Recent Economic Developments

4. **Economic activity continues to be weak, with confidence negatively impacted by the recent deterioration in security, but there are signs of nascent recovery**.

- Following the withdrawal of the international troops, uncertainties related to security and political transition sapped private sector confidence and reduced domestic demand. The growth rate bottomed out in 2015 and has only been slowly picking up, with favorable weather and limited solar powered irrigation supporting agriculture and activity revival in industry and services in 2017.

- Inflation increased but remains low. We expect inflation to be below 6 percent on average in 2017, up from 4.4 percent in 2016, reflecting the lagged effects of the Afghani's depreciation and a pickup in food prices late in the year.

- International reserves remain comfortable, while the large trade and current account deficits continue to be financed by donor grants.

- Exchange rate developments continue to primarily depend on the level of foreign aid disbursements and the extent of dollarization. The slight nominal appreciation observed since mid-2016, likely because of the return of refugees, has reversed in mid-2017. The real effective exchange rate remains below its five-year average.

5. **On the fiscal side, revenues remained stable in 2017, and are expected to meet the end-year program target**. By September, domestic revenues increased by 13 percent, following growth of 15 percent in the preceding year. The revenue-to-GDP ratio is expected to remain at 10.7 percent, up from a low of 8.5 percent in 2014.

6. **Contrary to expectations, development spending execution did not improve in 2017, resulting in lower-than-expected development spending**. As this in turn leads to lower grant disbursements, there is no impact on the overall fiscal balance, and a small surplus is expected for the year. Treasury cash balances remained above their program floor of Af10 billion.

7. **The President has tasked the Ministry of Finance to facilitate a five-year rolling plan of reforms to public financial management with an emphasis on improving performance by teams moving towards the goal of self-reliance**. The first rolling five-year plan for the 2015–19 period (Implementation of the Public Financial Management (PFM) Roadmap II) sets out detailed major actions for each team within the Ministry of Finance (MOF) and within other technical agencies related to the PFM reform agenda including the National Procurement Authority and the Afghanistan Extractive Industries Transparency Initiative (AEITI) Secretariat to be implemented under a performance management system. The goal is more effective and efficient investment of public money through a budget that is more responsive to the priorities of the government and more accountable to the Afghan public and the donors.

8. **While the inaugural five-year plans have set out a vision for the future, many reforms are already under way**. We have implemented substantial reforms in tax and customs administrations to improve enforcement and compliance, and to reduce leakages with the help of World Bank technical assistance. The Government dismissed forty senior staff in the revenue (ARD) and customs (ACD) departments as part of a drive to reduce corruption and improve efficiency. We transferred the customs police from the Ministry of Interior to the MOF to improve customs enforcement, and approved a human resource reform policy, including establishment of a customs and tax academy, to improve staff professionalism. We upgraded our Automated Systems for Customs Data (ASYCUDA) to improve oversight of import taxes. We operationalized the large and medium taxpayer offices, and rolled out our Standardized Integrated Tax Administration System (SIGTAS) in five large provinces. We also introduced risk-based compliance audits in all taxpayer offices in Kabul.

9. **Despite improvements in the financial sector, it remains vulnerable to adverse shocks**. Asset quality remains a concern and nonperforming loans increased in the first half of 2017. We have put fragile banks under a watchful monitoring regime and Da Afghanistan Bank's (DAB) Financial Supervision Department (FSD) continues to monitor closely the weaker banks. As part of the "Program and Strategy Dealing with Weak Banks" (Program), DAB conducted in-depth examinations of each of them, issued numerous corrective orders and injunctions, and produced a comprehensive plan on dealing with weak banks, specifying necessary actions to be taken as

needed. DAB will assess the implementation of the Program and decide on the next steps in November 2018.

10. **We have made progress in improving the financial position of the state-owned commercial banks (SOCBs)**. All of them became profitable in 2016 and have continued to be profitable in 2017 while the capital adequacy of all of them exceeds DAB minimum requirements. With the help of the World Bank, we are working out a strategy for all the SOCBs (November 2017 structural benchmark).

11. **We have continued our efforts to advance the Kabul Bank liquidation, however, asset recoveries and settlements stalled**. That is due to the lengthy legal process that needs to be followed to assure irreversibility of judgements and settlements. Most of the cases are awaiting the Court's clearance and decision which takes time. In addition, an investigative work to identify the beneficial owners of hidden assets have become more difficult owing to interference from people under the investigation and their use of off-shore location to hide their assets. The continued prosecutorial efforts are thwarted by the intransigence of the parties under arrest and investigation. We remain undeterred and are taking additional steps to reactivate the recovery process and improve its transparency.

12. **Support from our international partners remains vital as aid flows help meet immediate financing requirements and reduce fiscal vulnerability**. The Brussels Conference in October 2016 reconfirmed our international partners' commitment to finance our development needs, with pledges of US$15.2 billion over 2017–20 surpassing best-case scenarios. In addition, at the earlier Warsaw NATO summit in July US$5.1 billion in annual military assistance was pledged. Afghanistan's National Peace and Development Framework (ANPDF) makes explicit the government's goals of weaning the country away from aid dependency. Achieving this goal requires a collective effort to overcome fragmentation, defeat corruption, and introduce proper policies for sustainable growth. However, we also draw attention to the risks attendant in overly rapid or not well thought through reductions in support for the reform agenda. We believe that the sequencing described in this framework will succeed in achieving its objectives, but a pre-condition for its success is sustaining the partnerships that are still needed to embed the reforms and follow them through.

13. **At the Senior Officials Meeting (SOM) in Kabul October 4–5, 2017, we outlined the progress made under the ANPDF**. This includes holding free and fair parliamentary and district council elections in 2018, ensuring the human rights of all citizens including women, fostering the equal participation of women, and creating an enabling environment for the private sector to thrive. Since it launched seven months ago, the Women's Economic Empowerment Plan (WEEP) has supported 67,000 women in agriculture activities and another 35,000 in the livestock sector. The WEEP is recruiting 3,000 female teachers and training 900 community midwives and nurses who will return to serve their own communities in 2018. The nationwide Citizen's Charter Program, which builds on the 2002-2015 National Solidarity Community Development Program is now working in 78 districts and four cities in 32 provinces. It has sent 2,400 teachers to schools across Afghanistan. By the end of 2017 the program will reach 2,500 communities.

14. **Also at the SOM, the Government launched the National Strategy for Combatting Corruption, which is as an important step in establishing the rule of law and ending corruption**. The fight against corruption is one of our top priorities, with some 1,100 cases of corruption tried by the Attorney General's office leading to 468 people sentenced to prison and more than US$14 million of fines. National Procurement Authority's (NPA) compliance with the publication of high-value/above-threshold contract stands at 77.5 percent. The NPA is working to increase delivery to 100 percent publication for high-value contracts by the end of 2017. Work on consolidating the national budget is proceeding one year ahead of schedule. Afghanistan is set to have a consolidated national budget in 2018. For the first time, we will be able to show a complete and coherent picture of how our national resources are invested for 2018 and for three years thereafter. Over the past three years, our revenues have gone from strength to strength and currently stand at Af153 billion.

C. Economic Program for 2018–19

15. **Our program seeks to create conditions for higher, more inclusive, growth through structural reforms, while maintaining macro-financial stability**. The macroeconomic policy mix will maintain policy buffers, low inflation and public debt, and protect competitiveness. Fiscal policy will support growth by mobilizing domestic revenue and catalyzing continued donor support to finance projected higher security and development expenditure, maintain the treasury's cash balance, while avoiding debt accumulation. Monetary policy will aim to preserve low inflation and we will continue with the flexible exchange rate regime to protect the international reserves position and competitiveness. The structural reform agenda will focus on: (i) fiscal reforms to boost revenue and the quality of spending; (ii) strengthening the financial sector and its contribution to growth; and (iii) fighting corruption. In addition, we will pursue reforms that strengthen the business climate in collaboration with our international partners, especially the World Bank.

16. **We are cautiously optimistic about growth, but there are downside risks**. We expect that growth continues to recover as political transition uncertainties subside, reforms advance, and confidence recovers. With sustained reform and donor support, growth is projected to increase further in 2018 and beyond, and inflation to remain in single digits. However, while we continue to invest heavily in the peace process, continued uncertainty about the security situation will continue to restrain private demand and is a significant source of downside risk.

17. **Poverty reduction is a top priority**. Our policies are guided by Realizing Self-Reliance (2014) and the ANPDF (2016). They focus on low inflation, pro-poor budgeting, and inclusive economic growth propelled by investment in agriculture, more regional economic integration, the fight against corruption, and greater gender equality. Although security outlays will increase, we will ensure that we allocate adequate resources to increase opportunities for the poor. To provide sufficient political impetus for a strategic approach to poverty reduction, in August 2017, the President formed a High Council for Poverty Reduction, whose purpose is to oversee and accelerate pro-poor budgeting, policy reform, and investment. The second phase of the Jobs for Peace Program is currently launched. The above mentioned nationwide "Citizen's Charter" Program is

active in 3,000 rural and urban communities, which is 500 more communities than originally scheduled. Covering basic health, education, and rural development service delivery, the program is expected to reach 14,000 communities (approximately 35 percent of the national total), but if funds become available, its scale-up can be accelerated. On March 8, this year, a national program for women's economic empowerment was also launched that will similarly provide labor-intensive jobs for women in female friendly occupations. Over 75,000 women have already received training in horticultural and small livestock production. Both, a policy framework and an action matrix for returnees were passed by Cabinet in February, 2017 to assist with absorption of returning migrants and internally displaced people ("IDPs") expected to arrive by the end of 2018 and thereafter. On- and off-budget short- and medium-term financing to absorb this potentially destabilizing and impoverished population is expected to total approximately US$500 million, of which 55 percent has been secured from the budget and donor sources, including US$35 million for emergency winterization. This leaves US$270 million still unsecured. A medium to long-term growth and jobs focused program to absorb these returnees without disrupting their host communities is currently being developed in conjunction with the Afghanistan Reconstruction Trust Fund (ARTF) for a mid-2018 appraisal but some off-budget fund raising will still be needed to cover their needs. The Central Statistics Office is collaborating with FlowMinder and other international statistical specialists to improve the quality of government poverty statistics and analysis.

Macroeconomic Policies

18. **Our macroeconomic policy framework is designed to preserve macroeconomic stability and promote growth**. It will target a further gradual pick-up in GDP growth and single-digit inflation. It will also maintain buffers of low debt (less than 10 percent of GDP) and a comfortable international reserves position (above 9 months of import cover). It will protect competitiveness, with the current account in surplus or modest deficit after grants. We will target overall budget balance after grants and over time the operating balance excluding grants will become the fiscal anchor. Reserve money remains the monetary anchor, with a view to maintaining moderate inflation. We will remain dependent on donor support to meet our fiscal and external financing needs, which is expected to decline in percent of GDP.

19. **We expect a balanced overall budget in 2018 after grants, and will maintain a prudent fiscal position in 2019 and beyond**. Domestic revenues as a share of GDP are expected to pick up by about 0.2 percent of GDP, as the continued fight against corruption continues to yield efficiency gains. We will continue to prepare for the introduction of a value-added tax (VAT) before January 2021 in line with our WTO commitment. The strengthening of public financial management will be pursued in line with the Five-Year Plan, starting with the introduction of a commitment control system (an end-February 2018 benchmark), a review of Public-Private Partnership (PPP) regulations, and a clarification of the governance framework for state-owned enterprises and corporations (SOE/SOCs) to eliminate conflict of interest in line with our fight against corruption. Further fiscal reforms (including those required to meet the structural benchmarks) are expected to yield higher revenues in coming years. We expect the treasury's discretionary cash balance to remain well above the indicative target in the program (Af10 billion). Over the medium term, we will continue to target

a zero-overall balance including grants and a gradual decline in the operating deficit excluding grants. Our program aims to mobilize additional revenue for growth-enhancing development spending and to continue the long process of reducing aid dependence. We will only borrow on a highly concessional basis for specific projects in consultation with international partners. We will set aside any revenues earned from extraordinary currency exchange gains for building the government's cash reserves and will allocate these gains in the budget for spending by budgetary units when needed.

20. **We plan to carefully manage money growth, continue exchange rate flexibility, and safeguard international reserves**. Reserve money will continue to be the operational target for monetary policy, with the objective of containing inflation to 5–7 percent. The growth of reserve money in local currency for 2017 is projected at 12 percent but we stand ready to tighten money growth in case inflation exceeds projected levels on a sustained basis. Our program envisages increasing net international reserves by US$100 million (at the program exchange rate), resulting in international reserves covering more than 9 months of imports during the term of the arrangement. We will let the Afghani move with market trends and will only intervene to avoid excessive exchange rate volatility. We remain committed to an independent central bank that sets monetary policy with a view to maintaining moderate inflation and managing prudently shocks including persistent changes in foreign exchange flows. We will improve coordination between DAB and the MOF to strengthen the conduct of monetary policy, facilitate fiscal cash management, and promote market development by finalizing legislation to set up a sukuk (Sharia compliant treasury bill) market. We will continue our efforts to reduce dollarization. We have already revised our reserve requirements framework for commercial banks and moved to a new regime in which reserve requirements for deposits are held in the currency of denomination (domestic and foreign), unlike previous practice where reserve requirements for all deposits denominated in domestic and foreign currencies were maintained in domestic currency.

Structural Reforms

21. **We will reinvigorate structural reforms**. Fiscal reforms have been set out in detail in the government's five-year rolling Fiscal Performance Improvement Plan and will focus on improving the performance of teams delivering core budget functions. Flagship reforms include strengthening priority setting by Cabinet through improved forecasts, establishment of rolling forward estimates with robust costing of existing policy, streamlined budget management with improved program and project preparation to reduce over-budgeting and carryovers, improved budget execution and streamlining project spending, improved cash management and accounting and increased accountability through improved annual reporting and audit. The reforms will also gradually be extended to key line ministries over the course of the next few years focusing on improved budget credibility, better budget execution and annual reports comparing outcomes to budgets. We will further approve regulations that will lay the basis for PPPs to finance key projects and initiatives that will create jobs and contribute to economic growth while safeguarding government finances. The amended legislation will ensure that our SOEs and SOCs will operate under clear governance and management frameworks.

22. **Financial sector reforms will focus on turning the page on the Kabul Bank collapse and its legacies, dealing with weak banks, and further strengthening bank supervision**. Regarding economic governance, our reforms focus on strengthening the legal and institutional framework to combat corruption and enhancing implementation of the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime. In addition, as outlined in the ANPDF, we will focus on supporting a business enabling environment by improving access to credit, reducing red tape, improving infrastructure and trade logistics, and implementing regulatory reforms (for example, creating a level playing field for private and state enterprises).

Fiscal Reforms

23. **The focus of our fiscal reform agenda will be the complementary VAT and LTO reforms**. The only changes to tax policy in 2018 we envisage are a small increase in some fees totaling around Af 800 million. Instead, our revenue improvement efforts will be directed towards a major reform of the large taxpayers' office (LTO) and to the introduction of a VAT—a WTO commitment—both of which will be fully functioning by 2020 and 2021 respectively. The LTO reform will follow the suggestions of the IMF's recent tax policy TA (fourth review benchmark). In Afghanistan, the LTO produced only 27 percent of 2016 domestic tax revenues. We aim to increase this figure to 45 percent by the end of 2021. In 2017, we established a unique threshold for LTO firms, independent of sector, and are producing a detailed implementation action plan to establish a single national LTO in Kabul by end-2018. In 2019 and in 2020, we will start to implement this plan and the national LTO will be operating and fully functional by end-December, 2020. We anticipate that the LTO will include some 400–500 firms and all the major mining companies. We aim to introduce a VAT before January 2021. To simplify the tax structure, the VAT, which will replace the BRT[1] on firms that are registered for the VAT, will have the same threshold as the LTO.

24. **The Legislative Committee of the cabinet has approved a new income tax law**. This will include introducing a three-year tax holiday for new manufacturing firms to encourage investment. The tax losses from the perceived holidays are expected to be small as only a few firms will be eligible for this exemption.

25. **We will continue to improve administration in ACD**. The two-way interface between the customs and revenue databases is complete (end-June 2017 structural benchmark). The risk management unit, which will be insulated from outside interference, will report to senior management, provide a monthly report of results, direct risk management activities in field units and liaise with field units to obtain feedback, and will have the power to update risk profiles in real time. The unit will also maintain contacts with other agencies, particularly the Tax Administration. Its activities will come under a global compliance policy involving: (i) physical inspection and

[1] When VAT is introduced, the BRT should be replaced, except possibly for taxpayers not registered for VAT that have business receipts above the threshold for BRT (in line with previous IMF TA recommendations). The case for retaining BRT for medium-sized taxpayers that are not voluntarily registered for VAT may be that the large taxpayers required to register and charge VAT will argue that smaller taxpayers should also be subject to VAT or at least something that brings them into the tax net. Retaining BRT for medium-sized taxpayers would not likely be a major revenue producer.

reporting guidelines; (ii) post-release verification and audit; (iii) inter-agency cooperation; and (iv) an annual plan of control prepared by ACD. We will also roll out implementation of the multi-criteria risk profiles to at least Herat, Nangarhar and Nimroz by June 2018 (fourth review benchmark), which we expect will improve clearance times and detection of fraud (both in number and value of cases). We will also link Afghanistan Central Business Registry (ACBR) and Afghanistan Payments System (APS) interfaces over the next three years to facilitate automated information sharing on taxpayers and taxpayer transactions, which will help improve revenue collection efficiency and reduce leakages. In addition, we will introduce an identity verification program to combat fraud and misreporting of customs declarations by customs brokers or their subordinates. To do this, we will introduce fingerprint scanners to the computer terminals in customs houses which are used to submit declarations. This will restrict submission of customs declarations to trained and licensed agents, deterring fraud and misreporting.

26. **The development of the natural resource sector and reform of the fiscal regime for extractive industries remain essential for domestic revenue mobilization over the medium term**. While the development of extractive industries has been hampered by ongoing security problems, inadequate infrastructure, and declining international commodity prices, we are amending the mining law, and developing an Extractive Industries Transparency Initiative (EITI) compliant, effective, and transparent fiscal regime for natural resources. We will submit the revised mining law to parliament, and work together with the IMF and the World Bank to fully develop the mineral fiscal regime over the next 1–2 years. To demonstrate our commitment to transparency in the extractive industries, we have appointed the Minister for Mines and Petroleum as an EITI "Champion" who will lead our efforts in this area. In July 2017, Afghanistan underwent a validation that tests our compliance against each of the requirements in the EITI standard that will guide our future reforms and we will follow up on the recommendations of the EITI report.

27. **As outlined in the five-year rolling fiscal performance improvement plans, public financial management will be strengthened along several lines**. The overall objective is to improve the quality of spending, make better use of donor resources, better manage public investments, strengthen treasury's cash planning, and enhance fiscal reporting and transparency:

- The government has adopted a policy of working towards a consolidated national budget. The split between the operational budget and the development budget results in budget fragmentation and a proliferation of projects in the development budget. In addition, the development budget is in multiple currencies, subject to multiple donor conditionality. We believe that the low execution rate of the development budget is mainly due to unrealistic expenditure forecasts. Other factors include poor project preparation, imprecise project costing, premature inclusion of projects in the budget, ambitious multi-year spending plans (with large carry-overs of unspent allocations from previous years), incentives for the donors and line ministries to "front-load" the budget, capacity constraints with procurement planning and execution, slow approval of spending requests (bureaucracy) and centralized procurement processes, poor contract management, earmarked donor funding that cannot be reallocated, worsening security situation preventing the execution of projects in some regions, and capacity constraints at line ministries.

- We plan to address these issues through reforms outlined in the Public Financial Management Road Map II. As noted, MOF is engaging with line ministries with planned support from the World Bank to be part of the 5-year plan to enhance their budget execution capacity and we will continue to engage with donors to increase flexibility of funding per their bilateral and multilateral commitments.

- The lack of consistent information on the total cost, year-wise phasing, contractual commitments, and expenditure incurred on various development projects also hampers the monitoring of performance of the development budget. Unspent budgeted amounts are routinely carried over into the next year with little or no discussions with donors and line ministries on the possibility of shifting resources from low performing or low priority investment/development projects to high performing or high priority ones.

- The government recognizes the importance of a consolidated national budget and it will therefore start consolidating the 2018 national budget. With improved budget costing under robust forward estimates and some flexibility, execution of the development budget should improve noticeably over the next 2 to 3 years.

- We will strengthen development budget management by maintaining a development projects database for the 50 largest (in terms of value) projects. This database will be maintained by the MOF's Budget Department and will contain specific information. This development projects database will help inform the medium-term fiscal framework and the framework of rolling forward estimates to protect the allocations needed in future years (as per project phasing) to complete the ongoing projects, identify the remaining fiscal space for new projects, and systematically take account of required recurrent allocations (in future year budgets/forward estimates framework) for operation and maintenance of capital assets created. By tracking the key milestones of large projects, it will also help us to prepare more realistic development budget estimates. The database will be shared with the IMF on a regular basis.

- We will strengthen commitment control and cash management by tracking commitments during budget execution and requiring financial plans from ministries/agencies as a basis for issuance of in-year allotments (structural benchmark). We will track contractual commitments (including forward year commitments under multi-year contracts) by ministries/agencies through the Afghanistan Financial Management Information System (purchasing module) (AFMIS) starting with transactions valued above Af500,000. The Budget Department of the MOF in consultation with line ministries/agencies will issue phased allotments and financial plans in AFMIS (i.e. annual allocations at budget minor head level divided into quarterly tranches based on financial plans submitted by a ministry/agency) to ministries/agencies based on procurement plans and financial plans submitted by them. The financial plans of individual ministries/agencies, backed by allotments by the Budget Department, would be uploaded into the AFMIS and linked to the consolidated cash plan of the Treasury. Line ministries will enter their payment requests directly into AFMIS without additional approval from the Budget Directorate unless they are above their financial plans. The Treasury will control payments by the ministries/agencies during budget execution against their respective authorized financial plans and cash availability. Any in-year revisions to the ministries/agencies' financial plans would be subject to review and approval by the Budget and Treasury Departments of MoF.

- We are implementing a new budget process based on rolling forward year estimates of the costs of existing policy and any policy changes and identification of fiscal space for new policies and programs/projects. This will guide the development and issuance of ceilings by the MOF to ministries/agencies. The ministries/agencies are also initiating plans to establish systems for preparing medium-term costed development strategies with a portfolio of costed development projects with an output orientation and forward estimates (these will be called Portfolio Budget Statements). These medium-term development strategies of ministries/agencies will be clearly linked to the medium-term ceilings issued to them by the MOF. These will be prepared starting with key priority sectors (such as infrastructure, energy, and agriculture) and all ministries will be covered by 2020. The sequencing plan for ministries to undertake costing reviews of existing policies will be developed this year. Portfolio Budget Statements will be developed to ensure comparability with the Portfolio Annual Reports of financial and non-financial performance.

- We will improve development projects management by taking concrete measures, both in the near- and medium terms, to strengthen development project planning and preparation and streamline the process of project implementation. In the near term, the measures will include: (i) developing and enforcing a procedure that no project will be funded in the budget unless all preparatory steps—e.g., project feasibility study, technical design of the project, project costing and appraisal, environmental and social impact assessment, etc.—have been completed establishing its readiness for implementation after funding; and (ii) issuing a decree/instruction requiring ministries/agencies to ensure that clearances/approvals at various stages of project implementation don't pass through more than two levels in the administrative hierarchy. We will be supported in these efforts by a World Bank public investment management mission planned for late 2017. Over the medium term, we would also develop and approve by Cabinet an action plan to address identified gaps/weaknesses based on a comprehensive assessment of the public investment management cycle and associated institutional framework. We also have been drafting PPP regulation to supplement our new PPP law. To ensure that the PPP legal framework is consistent with international best practice and that approved PPP projects do not create undue fiscal risks, we will ask that the IMF or the World Bank staff to review the proposed regulation (4th review benchmark).

- In 2013, we proposed amendments to the laws governing public enterprises (Tassady Law). We will work with the Parliament to pass these amendments promptly. We will review the capacity of the department of state owned corporations and enterprises (SOCEs) to assess needed staffing, and seek technical assistance to improve staff's capacity for operational and financial oversight of the SOCEs. The department will then start collecting information on financial flows between the government and the SOCEs, and prepare annual analytical reports on their financial performance which will be annexed to the budget starting in FY 2019.

28. **We will improve monitoring and management of SOEs and SOCs**. To this end, we are amending the current law on SOEs and adopting a new law on SOCs and engaging with the World Bank in a project that will allow us to properly evaluate their financial position and scope of their activities. Having done so, we will work on a strategy to modernize SOEs and improve their efficiency with an aim to eventually corporatize many of them. We will consult with the IMF or the World Bank staff on these laws to ensure that the governance framework addresses potential conflicts of interest and conforms to international practices (4th review benchmark).

29. **We will strengthen public debt monitoring and management to implement critical investment projects while preserving fiscal and external sustainability in the medium term**.

- Criteria used to determine the criticality and yield of any such future projects financed by external borrowing will be robust with respect to the macroeconomic and political risks facing Afghanistan as well as to the project specific risks.

- We will not contract non-concessional borrowing. The government will continue to prioritize grants and concessional financing (60 percent of grant element under the current conditionality of the program) to finance high-yield and properly evaluated development projects.

- As approved by the IMF Executive Board at the first review of the ECF arrangement concluded in May, 2017, we have nonetheless excluded from the program's zero ceiling on non-concessional borrowing two loans from the Islamic Development Bank of ID53.2 million (approximately US$75 million). This is to provide for part of the financing of the construction of the Kabul City Ring Road, a critical infrastructure project integral to our development program and the improvement of local link roads and social infrastructure. We had sought donor co-financing to bring the grant element of the loans to the 60 percent program threshold but it had not proved feasible.

- Adequate capacity to monitor and manage public debt will be increasingly critical as grant financing will become more uncertain and as the country may need to borrow externally. The government will also implement PPP projects in infrastructure which require some sovereign guarantees. Building on the ongoing technical assistance from the World Bank, the government aims at strengthening its debt management framework.

- Debt recording and monitoring will be enhanced. This includes an active approach to preparing, verifying and authorizing borrowing, ensuring the accuracy and timeliness of the recording of all debt transactions, and projecting debt service. The Ministry of Finance will also monitor and record contingent liabilities stemming from PPP agreements. We will seek appropriate technical assistance in these areas. The authorities provide the IMF staff with detailed quarterly reports on external debt, in accordance with article 23 of the TMU.

- The government will consult with the IMF staff on the terms and concessionality of any proposed new debt in advance of contracting. This will ensure that the performance criterion on non-concessional borrowing is applied on a continuous basis.

- The government will prepare an investment strategy with a list of investment projects; the sources of financing; the use of financing; and a debt management strategy, considering fiscal and external sustainability. The list of projects with the sources and use of financing will be shared with the IMF staff on a semi-annual basis, or upon request.

- In parallel, the government will continue to negotiate with its bilateral creditors on debt relief delivery.

Financial Sector Reform

30. **Our financial sector strategy is two-pronged**. Our first priority is to further consolidate financial stability, by addressing the remaining weaknesses in the banking system, to strengthen public confidence and prevent contingent fiscal liabilities to materialize again. This will provide the sound foundation required for our second priority, the deployment of a range of growth-friendly initiatives in the financial sector.

Consolidating Financial Stability

31. **We are entering the final phase of the resolution of the 2011 Kabul Bank collapse**. Recoveries and settlements have reached a respectable US$448 million by September 2017, including US$257 million in cash, but they have slowed down. Nevertheless, our recovery efforts for the remaining US$594 million of claims will continue unabated, in particular, against the two former shareholders who still owe US$460 million.

32. **We are taking steps to relieve both DAB and the New Kabul Bank (NKB) from any further exposure to the results of the liquidation of Kabul Bank, with a view to improve the transparency and the quality of their balance sheets and transition NKB towards becoming a sound financial institution**. DAB's lender-of-last-resort (LoLR) exposure to Kabul Bank of US$825 million was underwritten in 2012 by a Promissory Note from the MOF that also included a repayment schedule. However, since 2014 the schedule has not been adhered to, and, with interest accruing, the balance started to rise again, reaching US$415 million by end-2015. We have made progress on this front in 2016–17, and by end-October 2017 we had reduced the LoLR exposure of DAB to Af 15.3 billion. In 2017, we made two payments: Af 3.6 billion on September 5 (end-August structural benchmark) and Af 4.5 billion on October 28 (end-November structural benchmark).

33. **We recognize the need to move forward with the settlement of this incident and to improve the quality of DAB's balance sheet**. It is our intention to eliminate the LoLR balance by end-2019 through four equal biannual payments in 2018–19.

34. **The NKB has transitioned from a temporary bridge bank without capital to a depositor-oriented, adequately capitalized institution in terms of regulatory capital ratios**.

When the NKB was established in 2011, it was granted regulatory forbearance to act as a bridge bank for up to 18 months without any capital and assume the remaining liabilities of Kabul Bank, while refraining from any lending activity. The balancing items included tangible assets, but also commitments to receive the proceeds of recoveries from the failed bank that did not materialize in full, a shortage valued at US$41 million at end-2015. By that time, it had also accumulated US$50 million in current losses, because of its role as the safe haven successor to Kabul Bank, but it has gradually improved its performance and is now profitable. To turn the page of the negative legacy of the Kabul Bank incident, we completed the recapitalization of the NKB by end-December 2016 (structural benchmark) for an amount of US$91 million plus a US$15 million capital cushion. We will inject any additional amount of capital if required. We will continue to consider the future of the NKB, taking into account the main recommendations of the World Bank technical assistance project (see below).

35. **We are establishing a new unit to monitor and report on the fiscal risk posed by SOCBs**. This will involve setting up additional reporting requirements in accordance with good international practice for accounting and disclosures. Annual fiscal risk reports will be produced and narratives included in the annual budget papers starting in FY 2020.

36. **The three SOCBs will continue to give priority to prudent management while their remaining issues are being addressed**. These include serious governance shortcomings being identified by DAB and will be addressed by Banks and their shareholder. We requested World Bank technical assistance to develop a SOCBs strategy and align corporate governance with global best practices. During a transitory period, while all its identified weaknesses are addressed, the NKB will not change its current lending policy. Pashtany Bank, which has only recently recognized in its books the large losses on its loan portfolio accumulated over the years, will continue focusing on improving its governance, including installing fit and proper managers, and on demonstrating its financial viability before considering a resumption of its lending activities. In the meantime, the Bad Debt Commission will pursue its mission. We requested the World Bank's support to enhance SOCBs' efficiency through automation of major banking functions and modernization of payment systems to minimize operational risks. The SOCBs business model will thus temporarily consist in focusing on safety, governance, and efficiency.

37. **Our capacity building efforts in the field of prudential regulation and supervision are progressing**. The 2014–2018 Strategic Action Plan (SAP) developed with the Middle East Technical Assistance Center (METAC) continues to be implemented, with the assistance of a range of donors, and will be further supported by a new World Bank project that was recently finalized. We plan to augment our banking law with required changes, aimed at upgrading the resolution framework to meet international best practice. Those changes should include: (i) clear objectives and scope of the resolution regime; (ii) distinction between early intervention and resolution; (iii) revision of grounds for appointing a conservator and petitioning for receivership; (iv) strengthening DAB's and conservator's powers in resolution; and (v) introduction of recovery and resolution planning. The IMF's targeted technical assistance, in support of the SAP implementation, has been requested in the area of crisis preparedness and management, and stress-testing.

38. **We will establish a Financial Stability Council (FSC) as a crisis preparedness mechanism to facilitate the operational coordination among the authorities**. The FSC mandate will be spelled out in a presidential decree and a Memorandum of Understanding between the MoF and DAB. The MOU will stipulate that: (i) MoF and DAB share responsibility for crisis preparedness and management through the FSC, with each relying on their existing legal powers; (ii) DAB should have the primary operational responsibility for mitigating and managing risks to financial stability; (iii) planning for the potential use of public funds falls within the MoF's remit. The FSC will develop contingency plans and perform crisis simulations to test the capacity of the authorities to respond to severe scenarios.

Toward a More Growth-Friendly Financial Sector

39. **We are in the process of developing a comprehensive National Financial Inclusion Strategy with the technical support of the World Bank**. We started this effort at the national level in 2016 and will finalize the strategy towards the end of 2018. A dedicated department has been established at DAB to lead and coordinate and align all efforts aimed at expansion of financial inclusion. The strategy will encourage the promotion of formal channels and will include a comprehensive "access to finance" agenda, including for women, and remote areas of country. It will also target underserved sectors like agriculture where the diverse grass root initiatives will be coordinated with the action of the Agriculture Development Fund to leverage their impact. The strategy will target an improvement in the financial sector infrastructure, introduce a wider range of financial instruments, facilitate financial intermediation and support innovative financing for the private sector. Key components of the strategy will also consider strengthening consumer protection and improving financial literacy.

40. **We are also coordinating with the banking profession to prudently foster intermediation**. The banking system's particularly low loan-to-deposit ratio of 19.9 percent is an impediment to growth in the private sector. While the SOCBs focus on the resolution of their pending issues, the most robust of the private banks have room to prudently and gradually expand their loan portfolios and the range of funding techniques that they offer to their customers. DAB will adjust its communication with them and review regulations that might be overly demanding, discouraging intermediation even by the strongest banks. We will promote broader use of the public credit registry and collateral registry by banks and we will take measures to encourage term lending instead of bank overdrafts. We are also working to expand and modernize the retail payment infrastructure.

Safeguards Assessment

41. **We are committed to meeting all the requirements of the IMF's Safeguards Assessments Policy**. We have provided the IMF staff with all requested information and documentation, and have held discussions with the IMF staff concerning the results of the most recent external audits of DAB. We will submit amended DAB Law to Parliament in line with recommendations of the IMF's 2017 safeguard assessment mission which will include provisions on DAB's mandate, institutional and personal autonomy, rules of profit distribution, recapitalization,

and foreign reserve management (end-November 2017 structural benchmark). We are also committed to implementing any other safeguards related recommendations, including in the legal area, under the deadlines agreed with the IMF staff.

Economic Governance

42. **Our government remains committed to determined and robust anti-corruption efforts in particular to strengthen the legal framework and ensure effective implementation and enforcement**. We have made good progress to strengthen the legal framework notably by criminalizing corruption in line with UNCAC in the new Penal Code enacted in May 2017. We are also working on a draft law to prescribe annual asset declaration requirements that cover heads and deputies of law enforcement agencies, customs and tax directorates, in addition to officials mentioned in Article 154 of the Constitution, covering both assets legally owned and beneficially owned, with sanctions for non-compliance. We will seek its enactment by end-December 2017 (third review structural benchmark). In addition, we have published asset declarations made by top-rank officials (ministers and above)[2], when they assumed office, in Dari and English on an official website. Once the legislation is enacted, the declarations of officials not listed in Article 154 of the Constitution will be available in a timely manner upon request to, at a minimum, domestic law enforcement agencies and the Financial Intelligence Unit. Information in Dari and in English on the name and functions of such other senior officials who have declared their assets for the previous year, will be made available by end-April 2018 (third review structural benchmark) on a relevant official website, updated on an annual basis, and on the mechanisms to access their declarations. We will also publish on the same website sanctions imposed on officials who did not comply with the requirements on asset declarations for the year 2017 in accordance with Article 154 of the Constitution or the legislation enacted in line with the end-December 2017 structural benchmark by end-June 2018 (fourth review structural benchmark). As a broader policy initiative, we have developed a national strategy on anti-corruption in consultation with international partners. Guided by this strategy, we will conduct a review with the help of the IMF and the World Bank staff of the anti-corruption institutional framework to inform reforms to streamline the framework.

43. **We will continue to strengthen the AML/CFT framework including to ensure effective implementation of AML/CFT measures in the financial sector**. We have completed the action plan agreed with the Financial Action Task Force (FATF) and as a result, the FATF's monitoring process ended in June 2017. Building upon the momentum of this positive development, we will continue efforts to strengthen the AML/CFT framework. With assistance from the World Bank, we have launched the national AML/CFT risk assessment and expect to conclude the exercise by end of 2019. We will continue to ensure effective implementation of AML/CFT measures including by stepping up off-site and on-site supervision, imposing proportionate and dissuasive sanctions for non-compliance, and providing training and guidance. These measures, together with technical assistance provided by donors, will help facilitate Afghan banks' access to foreign correspondent

[2] These include the ex-Minister of Defense, ex-Minister of Communication and IT, and ex-Ministers of Mines and Petroleum, who stepped down earlier in 2017.

banking services and reduce the risks of driving transfers into the informal hawala system. Building on the pilot exercise we conducted with two banks, we will apply the risk-based AML/CFT off-site analysis and on-site inspections tools to the whole banking sector by January 2018. Regarding the implementation of fit and proper regulation in the banking sector, DAB has updated information on significant shareholders, beneficial owners and senior managers. As a result, DAB has required removal of senior managers that are not considered fit and proper. The review of beneficial owners and managers of banks is ongoing. To help detect potential proceeds of corruption, we will strengthen supervision of measures related to domestic politically exposed persons including by conducting pilot thematic on-site inspections of three banks in 2018. With respect to AML/CFT supervision of money service providers (MSP), DAB' on-site inspections have covered all provinces. We will continue to ensure adequate implementation of AML/CFT measures by MSPs. In addition, we have proactively taken enforcement actions and have revoked the licenses of 52 money remitters and 136 foreign exchange dealers. We will continue to take such efforts forward.

44. **We will work to improve the timeliness and quality of our statistics**. We recognize the importance of reliable statistics for sound policy making. There are several deficiencies we plan to correct, particularly in the area of national accounts and balance of payments data. To help us with this effort, we are requesting technical assistance and training from our international partners, including the IMF.

D. Program Modalities

45. **We will closely monitor the implementation of the three-year ECF arrangement through July 19, 2019 with the help of quantitative targets and structural benchmarks**. The proposed performance criteria, indicative targets and structural benchmarks are attached to the memorandum of economic and financial policies in Tables 1 and 2. The ECF arrangement is monitored based on performance through the following test dates: December 20, 2016; June 21, 2017; December 21, 2017; June 21, 2018; December 21, 2018; and March 20, 2019. The third and fourth reviews of the program are scheduled to be completed on April 23, 2018, and October 22, 2018 respectively. The performance criteria, indicative targets, and the benchmarks are defined in the Technical Memorandum of Understanding.

46. **Commitments regarding exchange and imports measures**. During the program period, we will not impose or intensify restrictions on the making of payments and transfers for current international transactions, or introduce or modify multiple currency practices, or conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments purposes. While the exchange rate regime is classified as managed float *de jure*, we do not have any predetermined path for the exchange rate. We are interested in completing necessary steps towards accepting the obligations under Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement and stand ready to collaborate closely with the IMF staff in this process.

47. **Engagement with the IMF**. We will work with our international partners, especially the IMF and the World Bank, to successfully implement the reforms outlined above. We also look forward to our continued engagement with the IMF and to an eventual resumption of the IMF missions to Afghanistan.

Table 1. Islamic Republic of Afghanistan: Quantitative Performance Criteria and Indicative Targets Under the Extended Credit Facility December

(Cumulative, unless otherwise indicated 2016-June 2018) 1/

	2016	2017							2018		
	Dec. 20	Jun.21			Sep.22	Dec.21			Mar.20	Jun.21	
	Beginning stocks	Target	Adjusted target	Actual	Indicative targets	Performance criteria Original	Performance criteria Revised 2/	Year-end stocks	Indicative targets	Performance criteria	June-end stocks
					(In billions of Afghanis, unless otherwise indicated)						
Performance criteria:											
Revenues of the central government (floor)	...	61.2	61.2	74.1	116.0	153.0	153.0	...	37.8	76.3	...
Net credit to the central government from DAB (ceiling) 3, 4/	-49.1	-11.1	18.1	-10.2	-31.7	-11.1	-1.3	-50.4	-13.2	-18.2	-68.6
Reserve money (ceiling) 3, 4/	262.3	15.3	15.3	-3.8	1.2	31.5	31.5	293.8	0.0	0.0	293.8
Net international reserves of DAB (floor; in millions of U.S. dollars) 3, 4/	6,778	0.0	-345.0	56.5	468.5	0.0	100.0	6,878	0.0	50.0	6,928
Non-concessional external debt, new (ceiling, in millions of Islamic Dinars) 5, 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0
Short-term external debt, new (ceiling) 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0
External payments arrears, new (ceiling) 5, 7/	...	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, new (ceiling) 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0
Indicative targets:											
Operating budget deficit, excluding grants (ceiling)	...	44.4	44.4	33.7	56.1	100.5	100.5	...	10.1	42.5	...
Treasury cash balance, discretionary (floor)	...	10.0	10.0	16.5	10.0	10.0	10.0	...	10.0	10.0	...
Currency in circulation (ceiling) 3, 4/	223.6	11.4	11.4	-5.4	-2.1	23.5	23.5	247.1	6.0	12.1	259.2
Social and other priority spending (floor)	...	17.1	17.1	18.6	28.4	42.1	42.1	...	8.7	21.3	...
Memorandum items:											
Nominal external concessional borrowing (in millions of U.S. dollars) 5/	...	0.0	0.0	0.0	18.0	0.0	0.0	...	0.0	0.0	...
Reference values for the adjustors:											
Core budget development spending	...	27.3	27.3	31.0	54.1	107.8	88.6	...	9.4	30.4	...
External financing of the core budget and sale of non-financial assets 8/	...	84.0	84.0	61.8	125.3	221.4	192.1	...	33.8	92.2	...

Source: Afghan authorities and IMF staff estimates/projections.

1/ The quantitative targets, indicative targets, their adjustors, and program exchange rates are defined in the Technical Memorandum of Understanding (TMU).
2/ Performance criteria and indicative targets were revised based on an updated macroframework.
3/ Cumulative from the beginning of the year.
4/ Monetary indicators are calculated based on modified methodology and, thus, differ from the numbers reported in the previous staff reports.
5/ These quantitative targets were applied on a continuous basis.
6/ Excludes IsDB loan (53.2 million Islamic Dinars) to be disbursed in 2017.
7/ Afghanistan owes a small amount (US$10 million) of pre-HIPC Initiative arrears to a non-Paris Club creditor, which continue to be deemed away under the revised arrears policy for official creditors.
8/ Includes operating and development donor assistance, external loans, and sale of non-financial assets.

Table 2. Islamic Republic of Afghanistan: Third Review Structural Benchmarks

Measure	Date	Rationale
Amendments to the DAB law submitted to Parliament in line with the recommendations of the IMF's 2017 Safeguards assessment, especially with regards to DAB mandate, institutional and personal autonomy, as well as the rules of profit distribution, recapitalization and foreign reserves management.	End-November 2017	Strengthen independence of DAB
MoF, in coordination with DAB and with World Bank support, will prepare a strategy for state-owned commercial banks, addressing their business model and governance deficiencies, and minimizing their operational risk. The strategy will be finalized by High Economic Council.	End-November 2017	Preserve financial stability
MoF to prepare and publish a plan to implement a VAT, including a VAT-specific excess credit reimbursement system, unique positive rate, unique threshold, and limited exemptions, in replacement of the Business Receipt Tax, and prepare its implementation through a transition and communication plan to be made publicly available and posted on the MoF website.	End-December 2017	Preserve macroeconomic stability by improving revenue collection
Budget Department in consultation with line ministries/agencies to submit allotment and annual financial plans in AFMIS. The Treasury Department to (i) register their contractual commitments against allotment in the AFMIS; (ii) control payments against the respective pre- registered commitments and authorized financial plans in the system/AFMIS starting in FY 2018; and (iii) produce quarterly commitment reports for each ministry/agency starting in FY 2018.	End-February 2018	Strengthen cash planning and commitment control and prevent emergence of arrears
Enact legislation on asset declaration in line with the specifications of the end-October 2016 structural benchmark.	End-December 2017	Improve governance and fight corruption
Publish on http://anti-corruption.gov.af/en, both in Dari and in English: names and positions and asset declarations of officials not listed in the constitution who have declared their assets as of 2017 in line with the asset declaration legislation enacted consistent with the end-December 2017 structural benchmark, and mechanisms to access their declarations.	End-April 2018	Improve governance and fight corruption

Table 3. Islamic Republic of Afghanistan: Fourth Review Structural Benchmarks

Measure	Date	Rationale
Roll out implementation of the multi-criteria risk profiles for customs control to at least Herat, Nangarhar and Nimroz, with improvements in clearance times and in detection of fraud (both in number and value of cases)	End-June 2018	Improve trader compliance and reduce corruption
Preparation of a strategic implementation plan for the establishment of a single national LTO with a unique revenue threshold for firms, equal to the VAT threshold, and high enough that the LTO covers around 500 firms (excluding the mining firms)	End-June 2018	Improve revenue collection
Reduction in DAB's lender of last resort exposure to Kabul Bank by Af 3.994 billion	End-June 2018	Preserve financial stability
Publish on http://anti-corruption.gov.af/en, in Dari and in English: sanctions imposed against officials who did not comply with the requirements on asset declarations for the year of 2017 in accordance with Article 154 of the Constitution or the legislation enacted in line with the end-December 2017 SB	End-June 2018	Improve governance and fight corruption
PPP Law and Regulations to be reviewed against international best practice by the World Bank or the IMF staff. Submit to parliament proposed amendments to the PPP Law and Regulations that address the shortcomings identified by the review.	End-July 2018	Improve governance and reduce corruption
SOE & SOC laws and their charters of conduct to be reviewed against international best practice by the World Bank or the IMF staff. Submit to parliament proposed amendments to the SOE and SOC laws and their charters of conduct that address the shortcomings identified by the review.	End-September 2018	Improve governance of public assets

Attachment II. Technical Memorandum of Understanding

This memorandum reflects understandings between the Afghan authorities and the IMF staff in relation to the Extended Credit Facility (ECF) during July 2016–July 2019. It specifies valuation for monitoring quantitative targets under the program (Section A), quantitative targets and indicative targets (Section B), adjustors (Section C), and data reporting (Section D).

A. Program Exchange Rates and Gold Valuation

1. **Program exchange rates are used for formulating and monitoring quantitative targets**. All foreign assets and liabilities denominated in U.S. dollars will be converted into Afghanis at a program exchange rate of 68.711 Afghanis per U.S. dollar, which corresponds to the cash rate of May 21, 2016. Gold holdings will be valued at US$1252.15 per troy ounce, the price as of May 21, 2016. Assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at their respective exchange rates of May 21, 2016, as reported in the following table.

Exchange Rate	Program Rate
U.S. dollars / Euro	1.1224
U.S. dollars / Swiss Franc	1.0098
U.S. dollars / Pounds Sterling	1.4502
U.S. dollars / SDR	1.4058
U.S. dollars / Canadian Dollar	0.7626
U.S. dollars / U.A.E. Dirham	0.2723
U.S. dollars / Indian Rupee	0.0148
U.S. dollars / Pakistani Rupee	0.0095
U.S. dollars / Egyptian Pound	0.1127
U.S. dollars / Hong Kong Dollar	0.1288
U.S. dollars / Russian Ruble	0.0150
U.S. dollars / Iranian Real	0.00003
U.S. dollars / Saudi Arabian Riyal	0.2665
U.S. dollars / China Yuan Renminbi	0.1527

B. Quantitative Performance and Indicative Targets

2. **The quantitative targets for December 2017 and June 2018, specified in Table 1 of the Memorandum of Economic and Financial Policies, are**:[1]

- Floors on revenue of the central government and net international reserves (NIR); and
- Ceilings on reserve money; net central bank credit to the central government (NCG); contracting and/or guaranteeing new medium- and long-term non-concessional external debt by the public sector, (continuous); contracting and/or guaranteeing new short-term external debt by the public sector (continuous); accumulation of external payment arrears, excluding interest on preexisting arrears (continuous); lending from state-owned banks or the central bank to, or government guaranteed borrowing by, public enterprises in need of restructuring (continuous).

3. **The above variables also constitute indicative targets for March 2018**. In addition, the program includes the following indicative targets for the four above-mentioned dates:

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

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

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

[1] Definitions of indicators mentioned in paragraphs 2 and 3 are provided in paragraphs 4–17.

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

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

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

- Reserve assets of the DAB, as defined in the sixth edition of the Balance of Payments Manual (BPM6), are claims on nonresidents denominated in foreign convertible currencies controlled by DAB, and are readily and unconditionally available for DAB to meet balance of payments financing needs, intervention in exchange markets, and other purposes. They include DAB holdings of monetary gold, SDRs, Afghanistan's reserve position in the IMF, foreign currency cash (including foreign exchange banknotes in the vaults of the DAB, and deposits abroad (including balances on accounts maintained with overseas correspondent banks). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

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

7. **Reserve money in domestic currency** is defined as currency in circulation plus Afghani-denominated commercial bank deposits at the central bank including balances maintained by the commercial banks in the DAB's overnight facility. Reserve money also includes Afghani-denominated deposits of other institutional units at the central bank in line with recommendations of *Monetary and Financial Statistics Manual and Compilation Guide*.

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

9. For program purposes, the definition of **external debt** is set out in the "Guidelines on Public Debt Conditionality in Fund Arrangements" as set forth in the Attachment to the IMF Executive Board Decision No. 15688–(14/107), adopted December 5, 2014.

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

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

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

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

b. Under the definition of debt set out in paragraph 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

10. **Long-term and medium-term external debt**. A zero ceiling applies, on a continuous basis, to the nominal value of new non-concessional borrowing debt contracted or guaranteed by the public sector with nonresidents with original maturities of one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from the limits are refinancing credits, rescheduling operations, credits extended by the IMF, and credits on concessional terms as defined below, and ID53.2 million in non-concessional borrowing from the Islamic Development Bank to finance the construction of the Kabul City Ring Road and the improvement of local link roads and

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

- The definition of "government" includes the budgetary central government, extra-budgetary central government, local government (including government departments), as well as official agencies that do not seek profit and whose budgets are issued independent of the annual operational or development budgets. The public sector comprises the government as defined above, the DAB, and nonfinancial public enterprises. Public enterprises are defined below in paragraph 13.[2]

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

- For program purposes, a debt is concessional if it includes a grant element of at least 60 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[3] The discount rates used is 5.0 percent.

11. The zero ceiling on **short-term external debt** applies on a continuous basis to the contracting or guaranteeing of new external debt by the public sector (as defined in paragraph 10 of this memorandum) with nonresidents, with an original maturity of up to and including one year.

- It applies to debt as defined in paragraph 9 of this memorandum.

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

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

12. A continuous performance criterion applies to the **non-accumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or the DAB. External payment arrears consist of external debt service obligations (principal and interest)

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

[3] The calculation of concessionally will consider all aspects of the loan agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

falling due after July 1, 2016 and that have not been paid at the time they are due, as specified in the contractual agreements. Excluded from the prohibition on the accumulation of new arrears are (i) arrears arising from interest on the stock of arrears outstanding as of July 1, 2016; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

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

- For the purposes of this performance criterion: (i) "state-owned banks" refers to those banks that are wholly or majority owned by the government (as defined in paragraph 10 of this memorandum), including Bank-e-Millie Afghan, Pashtany Bank, and New Kabul Bank; (ii) "public enterprises in need of restructuring" refers to enterprises that meet either of the following: (a) public enterprises that have not had an audited balance sheet in the past two fiscal years; (b) public enterprises that have been identified by the Ministry of Finance for liquidation, or (c) public enterprises subject to restructuring plans that do not have cabinet-approved restructuring plans; and (iii) "public enterprises" refers to enterprises wholly or majority owned by the government, including state-owned enterprises covered by the State-Owned Enterprise (Tassady) Law, state-owned corporations covered by the Corporations and Limited Liability Companies Law, and other government entities (e.g., Microfinance Investment Support Facility for Afghanistan) and government agencies (e.g., Afghanistan Investment Support Agency) engaged in commercial activities but not covered by the Tassady Law.

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

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

15. **Treasury's discretionary cash balance** is defined as the total discretionary cash balance at the treasury single account in DAB, including balance in the main TSA account in Kabul and unspent funds in provincial expenditure accounts, plus the funds in the discretionary development budget account.

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

17. **Social and other priority spending** is defined as the sum of pro-poor spending identified in accordance with the ANDS poverty profile by the Ministry of Education, Ministry of Public Health,

and Ministry of Labor, Social Affairs, Martyrs, and Disabled within the central government's operating budget for a particular fiscal year.

C. Adjustors

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

Date	Accumulative over the Respective Year (Billion Afghani)
December 21, 2017	88.6
June 21, 2018	30.4

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

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

Date	Accumulative over the Respective Year (Billion Afghani)
December 21, 2017	192.1
June 21, 2018	92.2

Should external financing of the core budget (including that associated with off-budgetary spending coming on budget) and the receipts from the sale of nonfinancial assets collectively exceed (fall short of) these projections, the NIR floor will be adjusted upward (downward) and the NCG ceiling will be adjusted downward (upward) by the difference between their actual level and the projected level. The downward adjustment to the NIR floor for these projections will be capped at US$600 million and the upward adjustment to the NCG ceiling for these projections will be capped at Af41.2 billion.

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

21. Should some **expenditure currently financed directly by donors outside the budget** be moved on to the operating budget, the NIR floor will be adjusted downward, and the NCG ceiling and the indicative targets (ceilings) for the operating budget deficits of the central government, excluding grants, will be adjusted upward, by the actual amount of these expenditures on the

conditions that (i) the moving on budget of these expenditures is justified by a statement from donors indicating their decision to stop financing them outside the budget; and (ii) they are subject to a supplementary appropriation approved by parliament. The downward adjustment to the NIR floors for these conditions will be capped at US$300 million.

D. Provision of Information to the IMF

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

23. Actual outcomes will be provided with the frequencies and lags indicated below, provided that any data and information indicating the non-observance of the continuous performance criteria will be provided immediately.

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

- Monetary statistics, including exchange rates, government accounts with the DAB, currency in circulation, reserve money, and a monetary survey: biweekly and no later than 10 days after the end of the two-week period (four weeks in the case of the monetary survey). The monetary survey will include the balance sheet of the DAB and a consolidated balance sheet of the commercial banking sector.

- Detailed cash flow on gross and net international reserves biweekly and no later than 10 days after the end of the two-week period.

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

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

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

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

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

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

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

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

- Monthly activity and cost reports from the Kabul Bank receiver, including the status and financial details of asset recovery.
- Monthly detailed balance sheet and income statement for New Kabul Bank (with a two weeks' lag) as well as monthly reports on bank's progress against its business and financial plans (staffing, branches, etc.)
- Monthly, transactions on the Kabul Bank loan account, Kabul Bank receivership accounts and any other accounts related to the bank or asset recovery from the bank.
- Copies of documents related to asset recovery, such as mutual legal assistance requests (evidence and banking and property information redacted) to foreign jurisdictions, copies of MOUs which cover international cooperation with said jurisdictions.
- Monthly details of the discretionary cash balances held in the Ministry's AFS and U.S. dollar-denominated TSA accounts, and the discretionary development 27232 account. In addition, an update of the monthly summary report of financial flows under operating budget and development budget (discretionary and nondiscretionary), and the updated monthly cash projections for the next 12-months, annual cash projections for the current and following fiscal year.
- Treasury cash balance: weekly report on the treasury (discretionary and nondiscretionary) cash balance.
- Banking sector: Monthly CAMEL rating for all the banks, monthly income statements and balance sheets for all the banks, consolidated IS and BS for all the banks.
- Copies of documents related to the progress on structural benchmarks under the program, such as draft legislation, memoranda of understanding, strategies, implementation plans, transmittal letters, etc.

The Ministry of Finance and the Da Afghanistan Bank will send to the IMF reports by the end of each quarter documenting progress in implementing structural benchmarks under the program. These reports will include appropriate documentation and explain any deviations relative to the initial reform timetable, specifying expected revised completion date. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent).

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

November 21, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

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

CONTENTS

RELATIONS WITH THE FUND

(As of October 31, 2017)

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

General Resources Account

	SDR Million	Percent Quota
Quota	323.80	100.00
Fund holdings of currency (Exchange Rate)	323.61	99.94
Reserve Tranche Position	0.19	0.06

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	155.31	100.00
Holdings	61.36	39.51

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF Arrangements	41.41	12.79

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	July 20, 2016	July 19, 2019	32.38	9.00
ECF	November 14, 2011	November 13, 2014	85.00	24.00
ECF[1/]	June 26, 2006	September 25, 2010	81.00	75.35
Stand-By	July 16, 1975	July 15, 1976	8.50	8.50

[1/] Formerly PRGF.

Projected Payments to Fund[1/]

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

	Forthcoming				
	2017	**2018**	**2019**	**2020**	**2021**
Principal	1.20	11.58	7.06	5.37	4.80
Charges/Interest	0.13	0.60	0.60	0.60	0.60
Total	**1.33**	**12.18**	**7.66**	**5.96**	**5.40**

Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	July 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	January 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 cannot be added.

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

Implementation of MDRI Assistance: Not Applicable

Implementation of PCDR: Not Applicable

[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.

Nonfinancial Relations:

Exchange Arrangement

Afghanistan is an Article XIV-member country. Afghanistan maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions. Following the authorities' request, the IMF staff has initiated a general review of Afghanistan's exchange system to prepare for the authorities' acceptance of obligations under Article VIII Sections 2(a), 3, and 4 of the IMF's Articles of Agreements. The authorities are committed to stand ready to collaborate closely with IMF staff during this process. The *de jure* exchange rate regime is classified as managed floating, although the authorities have been implementing a *de facto* float system with no predetermined path for the exchange rate. On October 31, 2017, the average of the buying and selling exchange rates in cash transactions on the Kabul money exchange market was 67.4 Afghanis per U.S. dollar.

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

Article IV Consultation

The last Article IV consultation with Afghanistan was discussed by the Executive Board on November 18, 2015. Article IV consultations with Afghanistan takes place on a 24-month cycle in accordance with the provisions of Decision No. 14747, as amended.

Safeguards Assessment

An update safeguards assessment of the DAB was completed in January 2017. The assessment found that the DAB continues to face significant capacity constraints and operational risks in light of the difficult security situation. Governance and external audit arrangements are nonetheless broadly sound. Weaknesses were noted in the legal provisions on the DAB's mandate, institutional and personal autonomy, rules of profit distribution, recapitalization, and foreign reserve management. The authorities are making efforts to resolve the Kabul Bank exposure, and have made progress in strengthening the internal audit function. Submission to Parliament of draft amendments to the DAB Law in line with safeguards recommendations is outstanding.

Technical Assistance, 2011–18

Department	Dates	Purpose
FAD	January 2–12, 2011	PFM Assessment
	January 22–February 4,2011	Customs Administration
	April 1–13, 2011	Customs Administration
	September 15–22, 2011	Program Budgeting Reform
	January 14–18, 2012	Visit to Support SIGTAS Preparations
	January 14–25, 2012	VAT Introduction
	January 14–28, 2012	Customs Administration
	April 4–14, 2012	Follow-up mission (different TA topics)
	April 6–14, 2012	Follow-up mission to review PFM Roadmap
	April 4–14, 2012	Advancing Public Financial Management Reforms
	April 13–May 1, 2013	Customs Administration
	April 29–May 6, 2013	Public Financial Management Reform
	April 29–May 8, 2013	Follow-up mission PFM
	September 26–October 4, 2013	Reform of the Fiscal Regimes for the Extractive Industries
	April 15–21, 2015	Tax Policy for Extractive industries
	May 18–26, 2016	Public Financial Management
	February 20–24, 2017	Tax policy: Developing options for revenue mobilization (jointly with METAC)
	September 28–October 7, 2017	Public Financial Management
LEG	September 21–26, 2013	Diagnostic Review of AML/CFT regime
	February 5–6, 2014	Awareness raising workshop for Parliamentarians (Dubai)
	April 28–May 2, 2014	AML/CFT training for DAB and FinTRACA officials
	November 10–14, 2014	TA on AML/CFT issues
	February 9–13, 2015	AML/CFT training for DAB and FinTRACA officials
	September 6–10, 2015	AML/CFT training for DAB and FinTRACA officials
	August 14–19, 2016	AML/CFT training for Afghan officials at STI in Singapore

MCD	August 29, 2011–August 2013	Resident monetary policy and banking advisor
MCM	July 3–5, 2012	Sukuk TA mission
	August 27–29, 2012	Follow-up TA on Sukuk
	November 11–13, 2012	Sukuk TA mission
	February 11–13, 2013	Sukuk Issuance
	May 11–19, 2013	Strengthening the Central Bank's Operations
	September 7–22, 2013	Strengthening the Central Bank's Operations: Update on Monetary Policy Implementation
	December 7–11, 2013	Strengthening the Central Bank's Operations
	March 1–March 20, 2015	Problem bank management
	September 8–21, 2015	Problem bank management
	December 4–18, 2015	Problem bank management
	February 24–March 6, 2016	Problem bank management
	March 8–April 6, 2016	Problem banks and resolution
	August 1–12, 2017	Monetary policy implementation and operations
	November 1–12, 2017	FOREX Reserves Management
	January 14–18, 2018	Crisis Preparedness and Management Workshop
METAC[1]	January 2–11, 2011	Financial Planning, Budget Classification
	January 10–14, 2011	Tax Information Systems (workshop)
	April 7–12, 2012	Developing Regulations
	May 22–26, 2011	Sukuk Workshop and TA in Dubai
	October, 2011	General banking supervision issues
	December 10–19, 2011	Consumer price statistics
	January 14–18, 2012	Follow-up on tax administration reforms
	February 11–14, 2012	Sukuk TA Mission
	April 7–12, 2012	Developing regulations
	April 15–26, 2012	Consumer price statistics
	June 16–27, 2012	Enhancing the enforcement framework at DAB
	June 24–27, 2012	Balance of Payments and International Investment Position Statistics
	September 17–20, 2012	Study mission to Lebanon on VAT implementation
	November 3–12, 2012	Review of off-site function
	November 4–14, 2012	Cash Management / Financial Plans
	January 15–22, 2013	Follow-up on Enforcement Framework

	February 16–20, 2013	Balance of Payments and International Investment Position Statistics
	March 30–April 8, 2013	Action Plan for Strengthening Banking Supervision
	November 2–20, 2013	Customs Administration
	January 5–16, 2014	External Sector Statistics
	November 3–7, 2014	External Sector Statistics
	September 8–12, 2014	VAT implementation / study tour in Beirut
	February 2–25, 2015	Tax and Customs administration
	September 7–11, 2015	External Sector Statistics
	May 8–12, 2016	National Accounts
	Aug 29–Sep 1, 2016	Training on Dealing with Weak Banks
	Feb 12–21, 2017	External Sector Statistics
	April 16–20, 2016	Stress Testing
	July 9–13, 2017	Framework for Dealing with Weak Banks
	July 16–20, 2017	National Accounts
STA	October 24–November 3, 2011	Monetary and financial statistics
	February 6–17, 2012	National accounts statistics
	April 29–May 12, 2012	National accounts statistics
	January 25–February 5, 2014	Price Statistics
	February 8–12, 2016	Price Statistics
	July 31–August 11, 2016	Monetary and financial statistics

[1] 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 October 2017)

1. The World Bank Group's Program in Afghanistan is governed by Country Partnership Framework (CPF), for the four-year period from FY 2017 through FY 2020. Prior to the CPF the World Bank engagement was defined by Interim Strategy Notes. The CPF is aligned with country priorities as outlined in the Government's Afghanistan National Peace and Development Framework. The CPF also builds on the findings and recommendations of the Systematic Country Diagnostic (SCD), completed in February 2016.

2. Since 2002, the International Development Association (IDA) has committed a total of US$3.73 billion in grants (88 percent) and credits (12 percent) in Afghanistan. In addition, the Afghanistan Reconstruction Trust Fund (ARTF) has generated over US$10 billion from 34 donors, making it the largest contributor to the Afghan budget, with disbursement of US$4.5 billion for the government's recurrent costs and US$4.6 billion for government investment programs. As of October 2016, there were 36 projects in the portfolio in key sectors including agriculture and rural development, health, education, infrastructure, and public financial management, including one budget support operation.

3. The Bank also administers the ARTF—the World Bank Group's largest single-country multi-donor trust fund. The ARTF provides grant support to Afghanistan based on a three-year rolling financing strategy. Together, the IDA and the ARTF provide close to US$1 billion per year in grant resources (about US$200 million from IDA and about US$800–US$900 million from the ARTF). The ARTF is a key vehicle for providing the Government with predictable and transparent on-budget financing and provides a platform for policy dialogue between Government and donors.

4. The World Bank continues to engage in rigorous analytical work and places large emphasis on policy dialogue. These non-lending activities have been supportive of the Bank's lending program and have played a crucial role in informing government of its strategic choices and advancing dialogue between the Government of Afghanistan and its international development partners. The ARTF Research and Analysis Program (RAP) was recently established to support the government's policy reform agenda and decision-making. The program provides an opportunity to introduce innovative ways of working with the government, universities and local research institutions to undertake analysis and generate knowledge. As part of the RAP, the Bank is currently engaged in a series of analytical work to enhance understanding of Afghanistan's growth and fragility challenges and to inform development response by Government and international development partners. The initial results of this work were presented at the 2016 Brussels Conference on Afghanistan. The Bank also launched a comprehensive and programmatic advisory and analytic program to support the full breadth of the Fiscal Performance Improvement Plan (FPIP)—Government's flagship fiscal and PFM reform program.

5. The International Finance Corporation (IFC), the World Bank Group's private sector development arm, continues to work with its investment and advisory service partners in Afghanistan. IFC's cumulative committed portfolio stood at $52 million as of end-FY 2017 and its advisory services portfolio stood at $8.8 million. IFC's Investment portfolio includes investments in the telecommunication sector and financial markets. The investment pipeline includes further investments in the financial markets as well as investments in the power sector and agribusiness. IFC's Advisory Services program has been supporting the Investment program in access to finance, Small and Medium Enterprises (SMEs) capacity development, job creation, strengthening horticulture export, access to renewable energy, corporate governance structure enhancement, and investment climate reform interventions.

6. The Multilateral Investment Guarantee Agency (MIGA) has $116.5 million of gross exposure for three projects in Afghanistan. MTN is a joint effort with IFC in the country's critical telecommunication sector. The other two projects support dairy and cashmere production. Among MIGA's global priorities for FY 2018–2021 are support for Foreign Direct Investment (FDI) with high developmental impact in IDA countries and fragile and conflict affected situations. Afghanistan is a key country for MIGA in terms of delivering on these objectives. In 2013, MIGA launched its 'Conflict Affected and Fragile Economies Facility' that uses donor partner contributions and guarantees as well as MIGA guarantees to provide an initial loss layer to insure investment projects in difficult contexts. This facility could be used to boost the agencies' exposure in Afghanistan.

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

(As of October 2017)

1. The Afghanistan country teams of the World Bank (led by Mr. Chaudhuri, country director) and the IMF (led by Mr. Duenwald) held several consultations in 2016 and 2017. The teams regularly exchanged views on the recent economic developments and outlook, identified the macroeconomic priorities and challenges facing Afghanistan, and discussed ways to coordinate their respective work programs.

2. As noted, the Bank's work program is guided by the Country Partnership Framework (CPF) for 2017–20. The new CPF envisages that the Bank will continue to expand its support to expanding education and health services, energy, rural infrastructure, as well as institutions and processes associated with transparent economic and financial management. Regarding economic management, in 2016 and continuing into 2017, the Bank has supported the government with technical assistance in the areas of customs reforms, revenue administration, public financial management, debt management, public investment management, and economic statistics. The Bank will also continue to support the Government's efforts towards greater financial inclusion. Under the ARTF, the Incentive Program (IP) provides funds for achievements in revenue mobilization, strengthening PFM and revenue administration systems (including customs), improving tax policy, the investment climate, and land administration. Since January 2013, the IP has also supported the government's operation and maintenance expenditures. The IP provides a total financing envelope of US$900 million for 2015–17. The Bank also approved a US$100 million Development Policy Grant in May 2017 supporting a range of policy and legislative reforms to expand opportunities for the vulnerable and enable private sector development.

3. The Fund's work program focused on close engagement through the Extended Credit Facility (ECF) arrangement approved in July 2016. The arrangement supports a program which sets out a structural reform agenda that focuses on institution building, fiscal and financial reforms, and measures to combat corruption to lay foundations for scaled up private sector development. The program aims to preserve macroeconomic and financial stability by implementing prudent fiscal, monetary, and financial policies, and by maintaining external buffers and a flexible exchange rate regime. The program's major elements are: fiscal reforms, including revenue mobilization and improved public financial management; anti-corruption measures; and safeguarding the financial sector. The ECF includes a set of performance criteria as well as structural benchmarks that are assessed semi-annually. As part of the cooperation effort, the World Bank team participates in ECF missions as observer.

7. To help the authorities build on past achievements, the Fund provides continuous advice on macro-financial policies, structural reforms in its areas of comparative, and delivers technical assistance and training. Technical assistance has been provided to the central bank on problem bank management, and monetary, financial and external sector statistics. It has also provided TA to the Ministry of Finance, mainly in the areas of tax policy and administration, and public financial management. The Fund will continue its close engagement with Afghanistan.

Table 1. Islamic Republic of Afghanistan: Bank and Fund Planned Activities in Areas of Joint Interest

	Products	Preparations/Mission Timing [1]	Delivery [1]
Fund	ECF Arrangement	2016–19	July 2016
	Article IV Consultation and Second Review under ECF	September 2017	December 2017
	Third Review under ECF	February/March 2018	May 2018
	Areas of Technical Assistance: Bank restructuring and problem bank management, 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	Inclusive Growth Development Policy Grant	June 2016–June 2017	June 2017
	Support to Fiscal Performance Improvement Plan implementation	January 2017–December 2020	continuous
	ARTF IP Program (2018–2020), Preparation of MoU	April–December 2017	February 2018
	Support to PIM Reform	January 2017—continuous	Continuous
	Economic Monitoring	Continuous	Continuous
	Debt Management Assistance	February 2016–June 2018	continuous
	Growth and Fragility Report	January 2016–December 2017	December 2017
	Sukuk Market and Pension Reform TA	May 2016–June 2018	Continuous
	Fiscal Sustainability Analysis (long-term)	January 2016–September 2016	September 2016
Joint	AML/CFT follow-up	Continuous	
	Dialogue on revenue mobilization	Continuous	
	Dialogue on macro-fiscal stability	Continuous	
	Strengthening of the banking sector	Continuous	
	Debt management	Continuous	

[1] Timing is tentative

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of October 2017)

1. Afghanistan is a founding member of the Asian Development Bank (ADB), established in 1966. Resuming its partnership with Afghanistan, after a hiatus from 1980 to 2001, ADB supports the country's Afghanistan National Peace and Development Framework (ANPDF) which was presented by the Government of Afghanistan at the Brussels Conference on Afghanistan in October 2016 as country's new development strategy document. ADB has demonstrated strong commitment to Afghanistan's development priorities through participation in the London, Kabul, Chicago and Tokyo conferences and reaffirmed its medium- to long-term partnership at the 2014 London conferences, the 2016 Brussels Conference on Afghanistan and at the subsequent meetings of senior officials in 2015 and 2017 in Kabul.

2. Current ADB operations in Afghanistan are based on the Country Operations Business Plan (COBP) 2017–19 that extends the priorities under new Country Partnership Strategy (CPS) 2017–21. The COBP is aligned with new CPS which was endorsed by the Government of Afghanistan on September 12, 2017. The new CPS 2017–21 is based on the ANPDF, National Infrastructure Plan (NIP), and other relevant National Priority Programs (NPPs). The current COBP is fully aligned with ANPDF, NIP, and relevant NPPs—the backbone documents for economic and social development—with ADB's investments contributing to Afghanistan's socio-economic development. The COBP continues ADB's focus on Afghanistan's energy, transport, and agriculture and natural resources sectors and will promote inclusive economic growth, regional integration, governance, and capacity development.

3. ADB is one of the largest donors to the government of Afghanistan. By end-October 2017, ADB's total assistance comprising grants, loans, and technical assistance (TA) reached US$5.0 billion. Since 2002, ADB has provided all of its public-sector assistance on a 100 percent grant basis. Grants make up around 74 percent of ADB's overall assistance to Afghanistan. In 2017, ADB plans to approve $485.59 million in funding for Afghanistan, including $406.59 million from the Asian Development Fund (ADF) and $75 million in cofinancing. While part of the ADF funds will come from cancellation of an existing project, ADB is trying to increase financing envelope by utilizing innovative sources of financing such as disaster risk reduction and climate change funds, especially for innovative projects like solar energy development.

4. ADB supports co-financing of its projects to increase synergies by combining the strengths of development partners, governments, multilateral financing institutions, commercial organizations, and ADB itself. As of October 31, 2017, the cumulative direct value-added official co-financing for Afghanistan amounted to US$903.10 million for 27 investment projects and US$28.11 million for 18 TA projects. ADB manages the Afghanistan Infrastructure Trust Fund (AITF)—a financing modality for development partners and private sector who are interested in pooling resources to finance infrastructure projects in Afghanistan. The AITF allows development partners to meet the pledge of 50 percent on-budget and 80 percent alignment with NPPs as agreed in the 2010 Kabul Conference.

As of October 31, 2017, the total amount pledged by AITF donors was $797 million, total amount committed was $656 million and the total amount received was $507.5 million from the governments of Japan ($127.5 million), United States ($153.7), United Kingdom ($85.7 million out of total commitment of $235 million), and the NATO Trust Fund (comprising five governments; $140 million out of a total pledged of $200 million). Kreditanstalt fuer Wiederaufbau (KfW) has also pledged €75 million ($81 million).

5. ADB is the largest on-budget donor in the transport sector. As of October 31, 2016, ADB has provided US$2.85 billion to construct or upgrade over 1,700 km of regional and national roads across Afghanistan. This includes US$808 million for the Transport Network Development Investment Program, which has more than halved travel times on 570 km of regional and national roads. ADB is also financing the rehabilitation of 232 km of the ring road, as well as supporting a feasibility study and engineering design for the Salang Tunnel, as part of the Central Asia Regional Economic Cooperation (CAREC) Corridors 5 and 6. ADB has also helped rehabilitate four regional airports, increasing passenger volumes now more than double the pre-upgrade levels. ADB funded Afghanistan's first railway line between Mazar-e-Sharif and the border of Uzbekistan, which became fully operational in 2012.The line carries around 3 million tons of freight per year. ADB supported the establishment of the Afghanistan Railway Authority to regulate and ensure the sustainability of the railway sector.

6. As the largest on-budget donor for Afghanistan's energy sector, ADB has helped deliver electricity to more than 5 million people. To date, ADB has provided nearly US$1.44 billion to support energy infrastructure in Afghanistan. An additional $1 billion is planned for 2016–24, to support energy infrastructure in Afghanistan. These projects include construction of 1,500 km of power transmission lines, 16 substations, 143,000 new power distribution connections to electricity grid and system and 10 gas wells, to strengthen country's energy supply chain. The technical assistance projects have provided policy and analytical support through the Inter-Ministerial Commission (IEC), Renewable Energy Roadmap, Gas Sector Development Master Plan, and Energy Sector Master Plan. ADB is also contributing to policy dialogue and donor coordination in the sector, including the financing of master plans for the power and gas subsectors. Key regional projects for Afghanistan are being supported under the Central Asia-South Asia Regional Electricity Markets including the Turkmenistan, Afghanistan, Pakistan, and India (TAPI) gas pipeline project and the Turkmenistan, Uzbekistan, Tajikistan, Afghanistan, and Pakistan (TUTAP) electricity project.

7. The natural resources sector is another government priority sector assisted by ADB. As of October 31, 2017, total investment reached US$584 million to rehabilitate and establish new irrigation and agricultural infrastructure, and strengthen the institutional environment to facilitate economic growth and improve water resources management. Around 260,000 hectares of irrigated land have been rehabilitated and upgraded, with work continuing on an additional 360,000 hectares. The investments have led to a more efficient use of water resources, a rise in agricultural productivity, and improved farm livelihoods.

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

9. ADB's private sector operations in Afghanistan began in 2004. As of October 31, 2017, cumulative approvals in six projects have amounted to US$198.1 million. Total outstanding balances and undisbursed commitments to private sector projects amounted to US$3.5 million. One of the major private sector projects is the lending to Roshan Cellular Telecommunications Project. ADB provided financial assistance in the form of direct loans totaling US$70 million for Phases 1 and 2 of the project, as well as B loans and a political risk guarantee. In 2008, ADB approved a direct loan of US$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 invested US$2.6 million in Afghanistan International Bank (AIB), thus establishing the first private commercial bank in the post-Taliban regime. Awarded by The Banker Magazine of Financial Times Newspaper as the best bank in Afghanistan for four straight years (2012, 2013, 2014, and 2015), it is the largest and most profitable bank in Afghanistan with a balance sheet just short of US$1 billion. In January 2016, ADB divested its last shares of AIB but had received US$11.2 million from dividends and put options.

10. ADB is an active member of the Joint Coordination and Monitoring Board (JCMB) and the Afghanistan Reconstruction Trust Fund Management Committee. Furthermore, ADB takes the lead in the infrastructure sector and regional cooperation-related policy dialogues. The ADB supported the preparation of NIP and Senior Office Meeting (SOM) 2017 in Kabul. ADB is a member of the 5+3+3 donor group 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 November 2017)

I. Assessment of Data Adequacy for Surveillance
General: 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 on an annual basis by the production and expenditure approaches (the latter in current prices only). The regular GDP estimates are derived as extrapolated volumes and values from the 2002/03 base year. GDP follow-up series rely mostly on indicator's extrapolation. The reliability of the indicator series is uncertain since the coverage for various economic activities is limited. Data gaps are severe for some provinces and some activities. Informal activities are only partially measured. Foreign trade data should be improved in terms of coverage, concepts, and timeliness. The 2002/03 base year is more than 10 years old and needs to be updated. The Central Statistics Office (CSO) of Afghanistan has already started work on the introduction of 2014/15 as a new base year, incorporating new sources, such as household surveys, business surveys, and administrative data. In rebasing the GDP, CSO is supported by the IMF and the World Bank, The CSO staff aim to finish the initial version of the 2014/15 base year by December 2017 after which it will be ready for discussions and review.
Price Statistics: The CSO compiles and publishes monthly consumer price based on data collected from 20 cities/provinces, including the capital city Kabul (covering 80 percent of population). Data from the 2011/12 Afghan Living Condition Survey was used to update the index weights and to expand its coverage. Base year was changed from March 2011 to April 2015. Significant improvements are required to align the CPI to international standards and best practices: improving the index calculation, treatment of missing prices, data collection methods, and quality adjustment methods. The CSO faces resource and capacity constraints, and data collection issues tend to results in significant delays. There is currently no PPI for Afghanistan, but there are plans to develop one (dependent on staff and budgetary resources).
Government Finance Statistics: Fiscal data are compiled for the central and general government on cash basis, based on the Government Finance Statistics Manual 2001 (GFSM 2001). The timeliness and quality of the central and general government core budget data have been improving, particularly after completion of the roll out and connectivity of the Afghanistan Financial Management Information System (AFMIS) to all central government line ministries and agencies in Kabul and all provincial offices. With IMF support, the Ministry of Finance is implementing GFSM 2001, with annual data for both above and below the line transactions being reported. The authorities are reporting monthly GFS data to the IMF for the central government core budget and the ministry is also working on expanding the coverage of monthly and quarterly GFS data to general government.

Monetary and Financial Statistics: Da Afghanistan Bank (DAB) reports the Standardized Report Forms (SRFs) 1SR for DAB, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of two months. Data reporting issues arising from the restructuring of the Kabul Bank have been addressed by the authorities.	
Financial Soundness Indicators: Afghanistan reports 11 of the 12 core financial soundness indicators (FSIs), 9 of the 13 encouraged FSIs for deposit takers, and 2 FSIs for real estate markets—on a quarterly basis—for posting on the IMF's FSI website with one quarter lag.	
External sector statistics: Balance of payments and international investment position (IIP) statistics have been compiled according to the sixth edition of the Balance of Payments and International Investment Position Manual since 2016, and are revised back to 2008. Several TA missions provided by METAC have assisted the DAB in improving external accounts compilation in the past years, the last one having been conducted in February 2017. Although net errors and omissions remain considerable in size, they have decreased over time and data coverage has improved. A direct investment survey is needed as well as a closer tracking of the informal channels for remittances.	
II. Data Standards and Quality	
Afghanistan, which has been a GDDS participant since June 2006, is currently in its successor data dissemination initiative, e-GDDS.	No data ROSC has been conducted.

Table of Common Indicators Required for Surveillance

(As of November 2, 2017)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Nov/2017	11/12/2017	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	October/2017	10/7/2017	M	M	M
Reserve/Base Money	October/2017	10/7/2017	M	M	M
Broad Money	Sep/2017	10/7/2017	M	M	M
Central Bank Balance Sheet	Oct/2017	10/7/2017	M	M	M
Consolidated Balance Sheet of the Banking System	Sep/2017	10/7/2017	M	M	M
Interest Rates[2]	Aug 2017	9/26/2017	D	M	M
Consumer Price Index	Sep 2017	10/5/2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	--	--	--	--	--
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Oct/2017	11/15/2017	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2017Q2	09/10/2017	Q	Q	Q
External Current Account Balance	2017Q1	8/29/2017	Q	Q	Q
Exports and Imports of Goods and Services	2017Q1	8/29/2017	Q	Q	Q
GDP/GNP	2016	9/16/2017	A	A	A
Gross External Debt	…	…	…	…	…
International Investment Position[6]	2017Q1	9/25/2017	A	A	A

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

ISLAMIC REPUBLIC OF AFGHANISTAN

November 21, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—DEBT SUSTAINABILITY ANALYSIS

Approved By
Daniela Gressani and Bob Matthias Traa (IMF), John Panzer (IDA)

International Monetary Fund[1]
International Development Association

This debt sustainability analysis (DSA)[2] concludes that the country's external debt sustainability continues to be assessed at high risk of external debt distress. Although public debt remains modest at below 7 percent of GDP, Afghanistan's debt sustainability hinges on continued donor grants' inflows (estimated at 39 percent of GDP in 2016 for on and off-budget grants) against substantial fiscal and external deficits and downside risks to the economic outlook. Even a gradual replacement of donor grants with loan financing (a customized illustrative scenario) would quickly lead to an unsustainable debt burden. Other significant downside risks include the fragile security situation, political uncertainty, domestic revenue shortfalls, and the potential more rapid exchange rate depreciation. Accordingly, the authorities should continue their efforts to mobilize revenue and press ahead with their reform efforts, while donors should continue to provide financing in the form of grants.

[1] This DSA was prepared by IMF and World Bank staff, 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". 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 2014–16 CPIA of 2.69, Afghanistan is classified as having "weak performance" under the LIC-DSF.

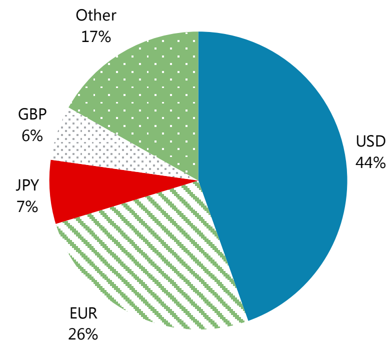
[2] This joint International Monetary Fund (IMF) and World Bank (WB) DSA updates the May 2017 DSA update prepared for the first review of the three-year Extended Credit Facility (ECF) arrangement.

BACKGROUND

1. **Over the past years, Afghanistan's government has relied mainly on grant financing and limited concessional borrowing to finance its development needs**. At end-2016, Afghanistan's total reported public external debt stood at US$1,240 million or 6.3 percent of GDP. The low level of debt is the result of past debt relief under the Enhanced HIPC Initiative, additional debt cancellation from Paris Club creditors, and little borrowing since then.[3] The borrowing comes mostly from multilateral institutions and is mainly denominated in U.S. dollars and euros. There is no borrowing from the domestic market, except for outstanding debt to DAB that is related to the resolution of the Kabul Bank crisis. In addition to the Asian Development Bank (ADB) and the International Development Agency (IDA), other multilateral creditors include the International Monetary Fund (IMF), and the Islamic Development Bank (IsDB). Among the bilateral creditors, the Saudi Fund was the main creditor (5 percent of total debt outstanding) followed by the Kuwait Fund (2 percent).

2. **The overall risk is somewhat mitigated by the maturity structure of the portfolio**. Overall, the cost of the reported loan portfolio is manageable. The current annual interest payment is lower than 0.1 percent of GDP. The entire portfolio bears fixed interest rates. The average time to maturity is 14 years. The redemption profile shows stable principal payments throughout the period. The main risk is the exchange rate depreciation since the entire portfolio is denominated in foreign currency. But this risk is mitigated by the long repayment periods of the concessional borrowing.

External Public Debt by Currency
(End-2016; In percent)



Sources: Afghan authorities.

3. **Public debt recording and monitoring needs to be strengthened**. The latest IMF assessment of public debt recording and monitoring capacity, made in consultation with the World Bank (November 2016), pointed to the need to build stronger capacity in this area. The scope of the current DSA is the central government debt. The financial balance of some thirty-six state-owned enterprises (SOEs) and sixteen state-owned corporations (SOCs) and the associated risks for the government are not centrally and effectively monitored, as their operational functions are supervised through their respective line ministries. The government provides support to SOEs and SOCs in the form of loans, guarantees, concessions, tax expenditures, subsidies, and recapitalizations.[4] An increasing number of infrastructure projects will likely involve sovereign financing and guarantees, particularly in the electricity sector. Progress on debt recording and monitoring, including on-lending by the government, would require further technical assistance and training with the aim to ensure full consistency between debt servicing and budget and liquidity planning.

[3] This debt stock is after delivery of the already-pledged debt relief commitments. Afghanistan is still following up with one Paris Club creditor on its debt relief commitments (US$900 billion). The delay with the Paris Club creditor is due to a technical reason and the debt relief is expected to be finalized by the end of the year.

[4] Conversely, anecdotal information indicates that the government runs some arrears vis-à-vis SOEs & SOCs.

Some progress is expected to come from the rolling out of a Medium-Term Debt Strategy (MTDS) for 2017–19, supported by World Bank assistance. The World Bank is also involved in a project on assessing SOEs' financial position.

UNDERLYING DSA ASSUMPTIONS

4. **The DSA's baseline macroeconomic scenario 2017-2037 assumes a gradual increase from the near-term projection of 3–4 percent to the estimated growth potential of 6 percent beyond a five-year projection period**.[5]

- Staffs projects lower average growth over 2016–20 than in the May 2017 update owing to downward revisions of growth in 2017–18 reflecting the short- and medium-term uncertainties. Given persistent security challenges, the point at which this growth potential is assumed to be reached has been pushed into the future. Post–2024 growth is assumed to remain at its potential of 6 percent.[6]

- Over time, stronger growth and job creation are assumed to be supported by extractive industries, agricultural development, public investment in education and health, and regional trade integration. If security conditions worsen, aid falls short, or reforms stall, growth would be lower with attendant effects on unemployment and poverty. Alternatively, lasting peace with insurgents would boost private sector confidence and facilitate a shift in public spending from security to development, leading to higher and more inclusive growth.

Macroeconomic Assumptions Comparison Table

	DSA update May 2017		DSA October 2017		Current vs. previous	
	2016-20	2021-37	2016-20	2021-37	Medium term	Long term
Real growth (%)	3.4	5.0	3.1	5.8	-0.3	0.8
Inflation (GDP, deflator, %)	5.7	4.5	5.8	4.7	0.0	0.2
Nominal GDP (Billions of Afghanis)	1,557	4,973	1,583	5,529	27	556
Revenue and grants (% GDP)	27.1	26.8	26.0	26.7	-1.1	-0.1
Grants (% GDP)	15.8	11.1	15.0	10.9	-0.8	-0.2
Primary expenditure (% GDP)	27.0	28.3	25.9	27.0	-1.1	-1.3
Primary deficit (% GDP)	-0.1	1.5	-0.1	0.3	0.0	-1.2
Exports of G&S (% GDP)	6.5	9.7	7.0	11.8	0.5	2.0
Noninterest current account balance (%GDP)	3.8	-3.1	3.8	-6.9	0.0	-3.8

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

[5] This assumption is based on growth accounting and is consistent with the analysis by the World Bank that emphasizes development of agriculture and extractive industries, public investment in education and health, and regional integration.

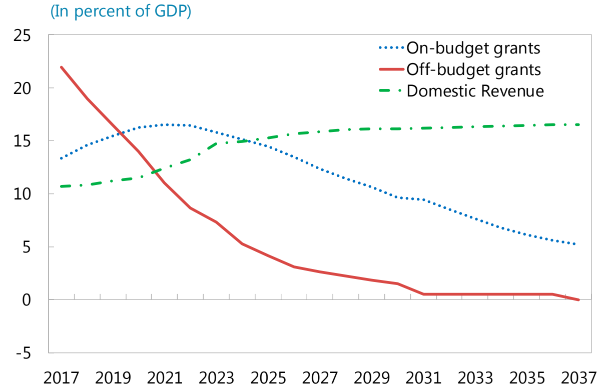
[6] The DSA is based on the medium-term baseline scenario of the second review of the arrangement under the ECF.

- As in the previous DSA, the scenario incorporates a gradual decline in donor aid with an increasing share being disbursed through the budget and provided to the civilian sector. Higher GDP growth results in lower grant-to-GDP ratios with a corresponding decrease in expenditure-to-GDP ratios, thus keeping positive primary balances. The underlying assumption of this scenario is long-run improvements of security and political stability.

- Export growth is slightly higher in the revised long-term scenario based on completion of the ongoing regional infrastructure/trade projects. The long-term agenda aiming at diversifying the economy as well as progress with regional integration should result in attracting FDIs into tradable sectors. Growing FDIs (mining, services—transport infrastructure, banking, communication, distribution) will contribute to covering the widening current account deficit stemming from declining grants.

5. **The potential for increased domestic revenue is strengthening**. Despite impressive progress in recent years, the Afghan government has a pressing need to increase revenues to meet its security and development goals. Further improvements are possible; the World Bank estimates that the revenue potential is around 60 percent above current levels. Two complementary policies stand out as ways to achieve higher revenues: establishing a modern Large Taxpayers Office (LTO) and replacing the current Business Receipts Tax (BRT) with a value-added tax (VAT) levied on LTO firms. In addition, transit fees could be collected from Afghanistan's participation in major regional energy trade projects.

Grants and Domestic Revenue 2017-37
(In percent of GDP)



Sources: Afghan authorities and IMF projections.

EXTERNAL DSA

6. **Assuming continued donor support in the form of grants, Afghanistan's debt outlook is benign**. Afghanistan's public debt remains modest. External public and publicly guaranteed debt, mostly to multilateral creditors, amounted to 6.3 percent of GDP in 2016. A limited amount of concessional borrowing (US$18 million from a bilateral creditor) and a non-concessional loan from the Islamic Development Bank (US$75 million) linked to large infrastructure projects with potentially high rates of economic and social returns were contracted in 2017.

External Debt Contracted in 2017[1/]

PPG external debt contracted or guaranteed	Volume of new debt, USD million
Sources of debt financing	
Multilateral, semi-concessional debt [2/]	75
Bilateral, concessional	18
Uses of debt financing	
Infrastructure	93
Budget financing	0

1/ As of end-October 2017.

2/ Debt with a positive grant element which does not meet the minimum grant element of 60 percent.

7. **Moderate external borrowing is planned in the short run.** The authorities have not yet established an annual borrowing plan. They expect a moderate amount of additional net concessional borrowing to take place during 2017–19 including two loans of EUR 7 million for road construction and EUR 65 million for railway construction from a Paris Club creditor in line with the current policy of borrowing only for infrastructure projects.

8. **A change in the structure of financing with a shift of 15 percent of grants towards concessional lending from 2020 onward would put Afghanistan at a high risk of external debt distress**. Under such a scenario, the threshold for the present value of debt to exports ratio is breached and the dynamics for other solvency and liquidity indicators deteriorate post-2020.[7]

PUBLIC DSA

9. **The baseline scenario assumes that the government will issue domestic public debt in the mid-2020s**. The only domestic component of public debt (1.7 percent of GDP in 2016) is currently a promissory note issued by the Ministry of Finance in 2012 to underwrite DAB's lender-of-last-resort exposure to Kabul Bank; consistent with the structural conditionality of the ECF, it is expected to be fully repaid through capital transfers to DAB by end-2019. The country is assumed to start issuing domestic public debt (sukuk) during the forthcoming decade at moderate levels (about 0.2 percent of GDP) before gradually increasing this source of financing along the forecast period. A sukuk law and operational framework is under preparation with the help of the IsDB.

AUTHORITIES' VIEWS

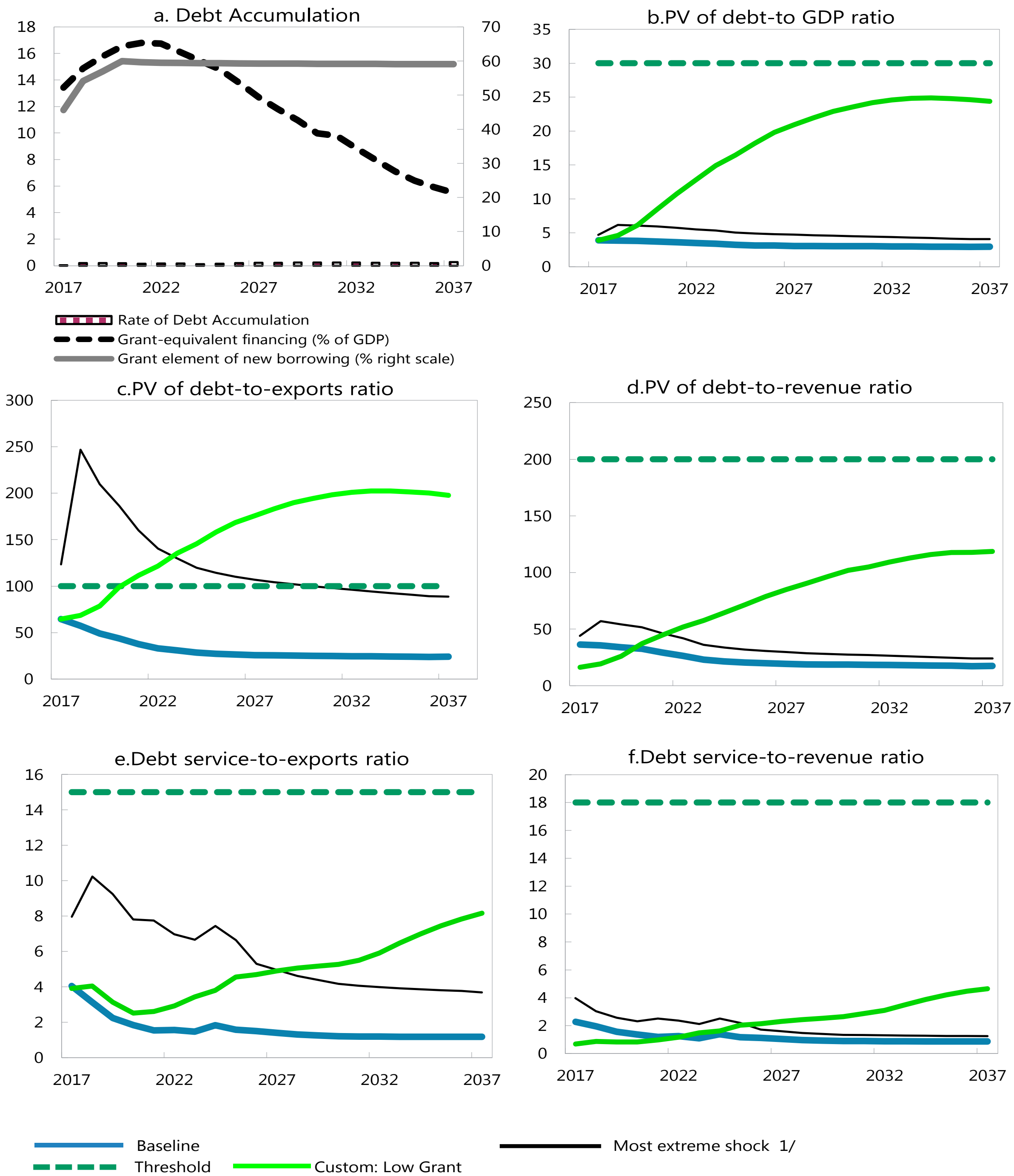
10. **The authorities agreed with the conclusions of the DSA.** They remain committed to ensuring debt sustainability and to relying on donor grants and limited concessional borrowing. They nonetheless emphasized the country's very large financing needs to boost growth and job creation. The authorities would welcome targeted TA on recording and monitoring public debt and fiscal risks in the context of the implementation of PPPs, as well as assistance for the introduction of sukuk. The government intends to use sukuks as a liquidity management instrument, to finance its development and possibly recurrent spending.

[7]The scenario is subject to high uncertainties regarding the sources and uses of grants and concessional borrowing.

CONCLUSIONS

11. **Afghanistan's debt sustainability hinges on continued donor grant inflows**. The debt outlook under the baseline scenario is benign. However, a change in the structure of donor financing with a shift to loans as shown in the customized scenario would quickly lead to an unsustainable debt burden. Hence, Afghanistan remains at a high risk of external debt distress. Reducing dependence on external financing requires expanding the tax base and further strengthening revenue collection. The authorities' capacity to plan, evaluate and contract borrowing, and to monitor debt and fiscal risks needs to be strengthened. This includes adequate accounting of government guarantees which may emerge from private-public partnerships. Establishing a database of ongoing and potential infrastructure projects that may involve public debt and guarantees is also needed. For the time being, Afghanistan's financing needs need to be met with donor grants and highly concessional external borrowing (grant element of at least 60 percent) to meet foreign-currency denominated obligations.

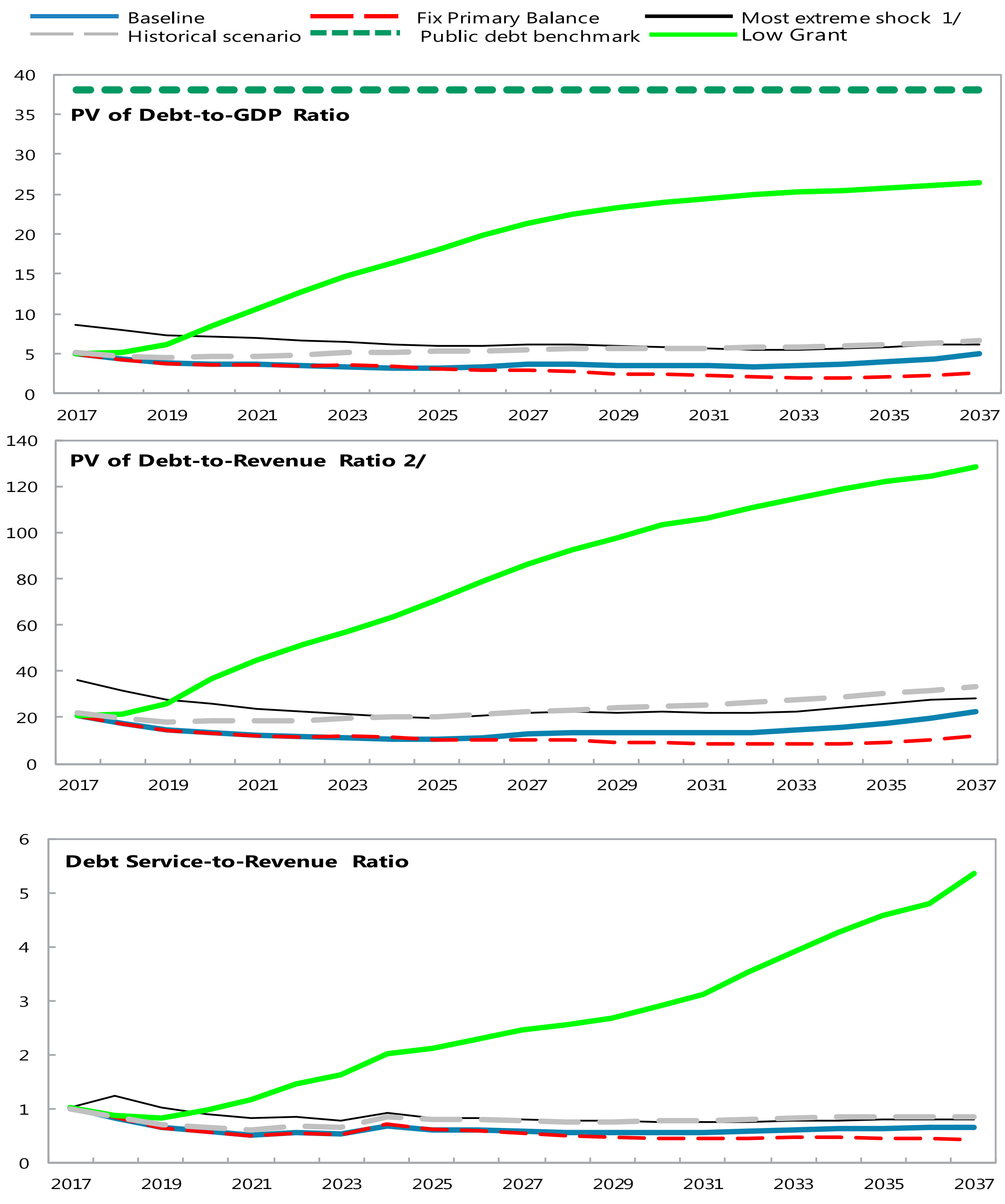
Figure 1. Afghanistan: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2017–37 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.

Figure 2. Afghanistan: Indicators of Public Debt Under Alternative Scenarios, 2017–37 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2027
2/ Revenues are defined inclusive of grants.

Table 1a. Afghanistan: External Debt Sustainability Framework, Baseline Scenario, 2014–37 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2017-2022			2023-2037
	2014	2015	2016			2017	2018	2019	2020	2021	2022	Average	2027	2037	Average
External debt (nominal) 1/	6.4	6.8	6.3	11.6	8.4	6.1	6.1	6.1	6.1	6.0	5.9	6.1	5.9	5.9	5.9
of which: public and publicly guaranteed (PPG)	6.4	6.8	6.3	10.4	5.7	6.1	6.1	6.1	6.1	6.0	5.9	6.1	5.9	5.9	5.9
Change in external debt	-0.6	0.5	-0.5	-1.7	6.6	-0.2	0.0	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0
Identified net debt-creating flows	-5.9	-8.1	-7.3	-25.3	22.4	-5.1	-4.0	-3.3	-2.3	-1.0	0.1	-2.6	4.9	2.8	3.9
Non-interest current account deficit	-5.6	-7.5	-7.1	-22.7	20.1	-4.5	-3.4	-2.6	-1.6	-0.3	1.2	-1.8	8.3	7.9	7.7
Deficit in balance of goods and services	31.3	31.3	32.6	27.5	9.3	34.6	31.9	31.1	30.4	29.0	28.1	30.8	25.1	14.2	21.6
Exports	9.6	11.7	5.8	13.4	4.9	6.0	6.7	7.8	8.6	9.6	10.6	8.2	11.9	12.3	12.0
Imports	40.9	43.0	38.4	40.8	5.6	40.6	38.6	38.9	38.9	38.6	38.6	39.0	37.1	26.6	33.6
Net current transfers (negative = inflow)	-36.9	-37.9	-39.4	-49.9	13.2	-38.5	-34.7	-33.1	-31.5	-28.8	-26.4	-32.2	-16.5	-6.2	-13.6
of which: official	-37.5	-37.6	-38.2	-50.1	13.7	-37.4	-33.6	-32.0	-30.3	-27.6	-25.1	-31.0	-15.0	-5.2	-12.2
Other current account flows (negative = net inflow)	0.0	-0.9	-0.3	-0.2	0.4	-0.6	-0.6	-0.5	-0.5	-0.5	-0.4	-0.5	-0.3	-0.2	-0.3
Net FDI (negative = inflow)	-0.2	-0.8	-0.5	-0.9	0.6	-0.5	-0.5	-0.5	-0.5	-0.5	-0.9	-0.6	-3.1	-4.9	-3.6
Endogenous debt dynamics 2/	-0.1	0.2	0.2	-1.7	2.0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3
Denominator: 1+g+r+gr	1.0	1.0	1.0	1.1	0.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Contribution from nominal interest rate	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	0.1	0.0
Contribution from real GDP growth	-0.2	-0.1	-0.2	-1.2	1.7	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.2	-0.3	-0.3	-0.3
Contribution from price and exchange rate changes	0.0	0.3	0.4	-0.6	1.3	...	...	...	...	...	...	...	...	...	
Residual (3-4) 3/	5.3	8.6	6.8	23.6	21.7	5.0	4.0	3.2	2.3	1.0	-0.2	2.5	-4.9	-2.8	-3.9
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	0.0	0.0	0.0
PV of external debt 4/	...	4.3	4.1	4.2	0.2	3.9	3.9	3.8	3.7	3.6	3.5	3.7	3.1	3.0	3.1
In percent of exports	...	37.1	70.2	53.7	23.4	64.6	57.4	49.0	43.7	37.6	33.1	47.6	25.8	24.0	25.7
PV of PPG external debt	...	4.3	4.1	4.2	0.2	3.9	3.9	3.8	3.7	3.6	3.5	3.7	3.1	3.0	3.1
In percent of exports	...	37.1	70.2	53.7	23.4	64.6	57.4	49.0	43.7	37.6	33.1	47.6	25.8	24.0	25.7
In percent of government revenues	...	43.6	38.3	41.0	3.8	36.4	35.7	34.1	32.6	29.2	26.5	32.4	19.3	17.5	19.0
Debt service-to-exports ratio (in percent)	3.9	1.9	3.9	1.4	1.5	4.0	3.1	2.2	1.8	1.5	1.6	2.4	1.4	1.2	1.3
PPG debt service-to-exports ratio (in percent)	3.9	1.9	3.9	1.4	1.5	4.0	3.1	2.2	1.8	1.5	1.6	2.4	1.4	1.2	1.3
PPG debt service-to-revenue ratio (in percent)	4.4	2.2	2.1	1.4	1.3	2.3	1.9	1.6	1.4	1.2	1.3	1.6	1.0	0.9	1.0
Total gross financing need (Billions of U.S. dollars)	-1.1	-1.6	-1.4	-2.7	1.9	-1.0	-0.8	-0.7	-0.5	-0.2	0.1	-0.5	2.3	2.9	2.5
Non-interest current account deficit that stabilizes debt ratio	-5.0	-8.0	-6.5	-21.0	19.5	-4.3	-3.4	-2.6	-1.5	-0.2	1.3	-1.8	8.3	7.9	7.7
Key macroeconomic assumptions															
Real GDP growth (in percent)	2.7	1.3	2.4	7.9	6.3	2.5	3.0	3.5	4.0	4.5	5.0	3.8	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	-0.5	-3.9	-5.4	3.3	8.8	5.3	4.1	2.7	2.7	2.7	2.9	3.4	1.4	1.8	1.8
Effective interest rate (percent) 5/	0.4	0.5	0.4	0.3	0.1	0.4	0.4	0.5	0.5	0.5	0.6	0.5	0.9	1.0	0.9
Growth of exports of G&S (US dollar terms, in percent)	42.7	18.8	-51.7	0.8	30.3	11.4	20.1	22.9	17.4	20.6	18.6	18.5	8.8	8.3	9.0
Growth of imports of G&S (US dollar terms, in percent)	-17.6	2.4	-13.5	9.8	20.1	14.2	1.9	6.9	7.1	6.4	8.1	7.4	5.7	4.0	5.2
Grant element of new public sector borrowing (in percent)	...	...	...	...		45.6	54.1	56.9	60.0	59.6	59.5	56.0	59.3	59.1	59.2
Government revenues (excluding grants, in percent of GDP)	8.5	10.0	10.7	9.5	1.3	10.7	10.9	11.2	11.5	12.4	13.2	11.6	16.0	16.9	16.2
Aid flows (in Billions of US dollars) 7/	3.2	2.9	3.0	2.3	0.9	2.9	3.4	3.8	4.3	4.7	5.0	4.0	5.6	5.2	5.5
of which: Grants	3.1	2.9	3.0	2.2	0.9	2.8	3.3	3.7	4.2	4.5	4.9	3.9	5.3	4.8	5.2
of which: Concessional loans	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.4	0.3
Grant-equivalent financing (in percent of GDP) 8/	...	...	15.5	15.5		13.4	14.9	15.8	16.5	16.8	16.8	15.7	12.7	5.5	10.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	99.0	99.0		99.0	98.4	98.7	98.9	98.9	98.8	98.8	98.2	96.5	97.7
Memorandum items:															
Nominal GDP (Billions of US dollars)	20.6	20.1	19.5	16.5	4.6	21.0	22.5	23.9	25.6	27.4	29.6	25.0	43.0	92.2	57.1
Nominal dollar GDP growth	2.2	-2.6	-3.1	11.4	11.4	8.0	7.2	6.3	6.9	7.3	8.0	7.3	7.5	8.0	7.9
PV of PPG external debt (in Billions of US dollars)		0.8	0.8	0.8	0.0	0.8	0.9	0.9	0.9	1.0	1.0	0.9	1.3	2.7	1.7
(PVt-PVt-1)/GDPt-1 (in percent)						0.0	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.3	0.2
Gross workers' remittances (Billions of US dollars)	0.1	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1
PV of PPG external debt (in percent of GDP + remittances)	...	4.3	4.1	4.2	0.2	3.9	3.9	3.8	3.7	3.6	3.5	3.7	3.1	3.0	3.1
PV of PPG external debt (in percent of exports + remittances)	...	33.8	65.0	49.4	22.1	60.2	54.0	46.5	41.8	36.2	32.0	45.1	25.2	23.7	25.1
Debt service of PPG external debt (in percent of exports + remittances)	...	1.7	3.6	2.7	1.4	3.8	2.9	2.1	1.8	1.5	1.5	2.3	1.4	1.2	1.3

Sources: Country authorities; and 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 1b. Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of debt-to GDP ratio								
Baseline	4	4	4	4	4	3	3	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	-3	-10	-17	-24	-31	-38	-70	-110
A2. New public sector loans on less favorable terms in 2016-2036 2	4	4	4	4	4	4	4	5
A3. Alternative Scenario: Low Grant	4	5	6	8	11	13	21	24
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	4	4	4	4	4	4	3	3
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	5	6	6	6	6	6	5	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	4	5	5	5	4	4	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	5	4	4	4	4	4	3	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	2	2	2	2	2	2	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	5	5	5	5	5	5	4	4
PV of debt-to-exports ratio								
Baseline	65	57	49	44	38	33	26	24
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	-54	-156	-224	-284	-323	-359	-589	-895
A2. New public sector loans on less favorable terms in 2016-2036 2	65	59	53	49	43	40	37	43
A3. Alternative Scenario: Low Grant	65	69	79	99	112	122	176	198
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	64	56	48	43	37	33	26	24
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	123	247	210	186	160	140	107	89
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	64	56	48	43	37	33	26	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	77	58	50	44	38	34	26	24
B5. Combination of B1-B4 using one-half standard deviation shocks	70	62	54	48	42	37	30	33
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	64	56	48	43	37	33	26	24
PV of debt-to-revenue ratio								
Baseline	36	36	34	33	29	26	19	18
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	-30	-97	-155	-211	-251	-287	-439	-653
A2. New public sector loans on less favorable terms in 2016-2036 2	37	37	37	36	34	32	28	31
A3. Alternative Scenario: Low Grant	16	19	26	37	45	52	85	119
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	37	36	34	33	29	27	19	18
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	44	57	54	52	46	42	30	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	40	43	41	39	35	32	23	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	44	36	34	33	30	27	20	18
B5. Combination of B1-B4 using one-half standard deviation shocks	32	23	22	21	19	18	13	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	51	49	47	45	40	37	27	24

Table 1b. Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (continued)

(In percent)

Debt service-to-exports ratio								
Baseline	4	3	2	2	2	2	1	**1**
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	5	1	-2	-4	-5	-6	-12	**-18**
A2. New public sector loans on less favorable terms in 2016-2036 2	5	3	3	2	3	2	2	**1**
A3. Alternative Scenario: Low Grant	5	4	3	3	3	3	3	**7**
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	5	3	3	2	2	2	2	**1**
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	8	10	9	8	8	7	5	**4**
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	5	3	3	2	2	2	2	**1**
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	5	4	3	2	2	2	2	**1**
B5. Combination of B1-B4 using one-half standard deviation shocks	7	6	4	3	4	3	2	**2**
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	5	3	3	2	2	2	2	**1**
Debt service-to-revenue ratio								
Baseline	2	2	2	1	1	1	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	3	0	-1	-3	-4	-5	-9	-13
A2. New public sector loans on less favorable terms in 2016-2036 2	3	2	2	2	2	2	1	0
A3. Alternative Scenario: Low Grant	3	2	2	2	2	2	2	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	3	2	2	2	2	2	1	1
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	3	2	2	2	2	2	1	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	3	3	2	2	2	2	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	3	2	2	2	2	2	1	1
B5. Combination of B1-B4 using one-half standard deviation shocks	3	2	2	1	2	2	1	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	4	3	3	2	3	2	2	1
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	62	62	62	62	62	62	62	62

Sources: Country authorities; and staff estimates and projections.

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

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

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

4/ Includes official and private transfers and FDI.

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

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

Table 2a. Afghanistan: Public Sector Debt Sustainability Framework, Baseline Scenario, 2014–37

(In percent of GDP, unless otherwise indicated)

	Actual					Projections									
	2014	2015	2016	Average 5/	Standard Deviation 5/	2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	8.7	9.1	8.0			7.2	6.6	6.1	6.1	6.0	5.9		6.4	8.0	6.5
of which: foreign-currency denominated	6.4	6.8	6.3			6.1	6.1	6.1	6.1	6.0	5.9		5.9	5.9	
Change in public sector debt	-0.8	0.4	-1.1			-0.8	-0.6	-0.5	-0.1	-0.1	-0.1		0.4	0.5	
Identified debt-creating flows	1.1	2.1	-1.0			-0.6	-0.4	-0.5	-0.4	-0.5	-0.5		0.3	0.4	
Primary deficit	1.7	1.3	-0.1	1.1	1.4	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	0.7	0.9	0.4
Revenue and grants	23.7	24.5	26.1			24.0	25.4	26.7	27.8	28.9	29.7		28.4	22.1	
of which: grants	15.2	14.6	15.4			13.3	14.6	15.5	16.3	16.5	16.5		12.4	5.2	
Primary (noninterest) expenditure	25.4	25.9	25.9			23.9	25.4	26.6	27.7	28.9	29.6		29.1	23.0	
Automatic debt dynamics	-0.3	0.8	-0.7			-0.5	-0.4	-0.4	-0.4	-0.4	-0.4		-0.4	-0.5	
Contribution from interest rate/growth differential	-0.4	-0.1	-0.4			-0.4	-0.4	-0.3	-0.3	-0.3	-0.4		-0.4	-0.5	
of which: contribution from average real interest rate	-0.2	0.0	-0.2			-0.2	-0.2	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	
of which: contribution from real GDP growth	-0.3	-0.1	-0.2			-0.2	-0.2	-0.2	-0.2	-0.3	-0.3		-0.3	-0.4	
Contribution from real exchange rate depreciation	0.1	0.9	-0.3			-0.1	0.0	-0.1	0.0	0.0	-0.1		...	...	
Other identified debt-creating flows	-0.2	0.0	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.2	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	
Residual, including asset changes	-1.9	-1.7	-0.1			-0.3	-0.1	0.0	0.4	0.4	0.4		0.1	0.2	
Other Sustainability Indicators															
PV of public sector debt	...	6.7	5.8			5.0	4.4	3.8	3.7	3.6	3.5		3.6	5.0	
of which: foreign-currency denominated	...	4.3	4.1			3.9	3.9	3.8	3.7	3.6	3.5		3.1	3.0	
of which: external	...	4.3	4.1			3.9	3.9	3.8	3.7	3.6	3.5		3.1	3.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	2.1	1.6	0.1			0.1	0.2	0.1	0.1	0.1	0.1		0.9	1.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	27.1	22.4			20.6	17.1	14.3	13.5	12.5	11.8		12.9	22.7	
PV of public sector debt-to-revenue ratio (in percent)	...	66.8	54.6			46.3	40.2	34.1	32.6	29.2	26.5		22.8	29.7	
of which: external 3/	...	43.6	38.3			36.4	35.7	34.1	32.6	29.2	26.5		19.3	17.5	
Debt service-to-revenue and grants ratio (in percent) 4/	1.6	0.9	0.9			1.0	0.8	0.7	0.6	0.5	0.6		0.6	0.7	
Debt service-to-revenue ratio (in percent) 4/	4.4	2.2	2.1			2.3	1.9	1.6	1.4	1.2	1.3		1.0	0.9	
Primary deficit that stabilizes the debt-to-GDP ratio	2.5	0.9	1.0			0.7	0.5	0.4	0.0	0.0	0.0		0.4	0.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	2.7	1.3	2.4	7.9	6.3	2.5	3.0	3.5	4.0	4.5	5.0	3.9	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	0.4	0.5	0.4	0.3	0.1	0.4	0.4	0.5	0.5	0.5	0.6	0.5	0.9	1.0	0.9
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	1.0	14.5	-4.6	-0.9	7.8	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.1	2.5	5.0	6.3	5.4	5.6	6.1	6.1	6.0	6.0	6.0	6.0	4.5	4.0	4.5
Growth of real primary spending (deflated by GDP deflator, in percent)	4.5	3.3	2.6	1.7	2.1	-5.5	9.4	8.3	8.3	8.9	7.6	6.4	3.0	4.9	4.2
Grant element of new external borrowing (in percent)	...	...	38.7	38.7	...	45.6	54.1	56.9	60.0	59.6	59.5	56.5	59.3	59.1	59.2

Sources: Country authorities; and staff estimates and projections.

1/ Covers central government gross debt.

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 2b. Afghanistan: Sensitivity Analysis for Key Indicators of Public Debt, 2017–37

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	5	4	4	4	4	3	4	5
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	5	5	4	5	5	5	6	7
A2. Primary balance is unchanged from 2016	5	4	4	4	4	3	3	3
A3. Permanently lower GDP growth 1/	5	5	4	4	5	5	9	23
A4. Alternative Scenario: Low Grant	5	5	6	8	11	13	21	26
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	5	4	4	4	4	4	4	5
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	6	6	6	6	5	5	5	5
B3. Combination of B1-B2 using one half standard deviation shocks	6	6	5	4	4	4	3	1
B4. One-time 30 percent real depreciation in 2017	7	6	5	5	5	4	4	4
B5. 10 percent of GDP increase in other debt-creating flows in 2017	9	8	7	7	7	7	6	6
PV of Debt-to-Revenue Ratio 2/								
Baseline	21	17	14	13	13	12	13	23
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	22	20	18	18	18	19	23	33
A2. Primary balance is unchanged from 2016	21	17	14	13	12	11	10	12
A3. Permanently lower GDP growth 1/	21	18	16	16	16	16	28	95
A4. Alternative Scenario: Low Grant	21	21	26	37	44	52	86	128
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	21	17	15	14	13	13	15	24
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	25	25	21	20	19	17	18	24
B3. Combination of B1-B2 using one half standard deviation shocks	23	22	18	17	15	13	9	7
B4. One-time 30 percent real depreciation in 2017	27	23	19	17	16	14	13	18
B5. 10 percent of GDP increase in other debt-creating flows in 2017	36	31	28	26	24	22	22	28
Debt Service-to-Revenue Ratio 2/								
Baseline	1	1	1	1	1	1	1	1
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	1	1	1	1	1	1	1	1
A2. Primary balance is unchanged from 2016	1	1	1	1	1	1	1	0
A3. Permanently lower GDP growth 1/	1	1	1	1	1	1	1	2
A4. Alternative Scenario: Low Grant	1	1	1	1	1	1	2	5
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	1	1	1	1	1	1	1	1
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	1	1	1	1	1	1	1	1
B3. Combination of B1-B2 using one half standard deviation shocks	1	1	1	1	1	1	1	0
B4. One-time 30 percent real depreciation in 2017	1	1	1	1	1	1	1	1
B5. 10 percent of GDP increase in other debt-creating flows in 2017	1	1	1	1	1	1	1	1

Sources: Country authorities; and 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 Jafar Mojarrad, Executive Director for the Islamic Republic of Afghanistan, Mohammed Daïri, Alternate Executive Director, and Abdelali Jbili, Senior Advisor to Executive Director
December 5, 2017

On behalf of our Afghan authorities, we thank staff for a set of well-written papers, and for their close cooperation, candid and professional assessment, and sound policy recommendations. The authorities also thank the Board for its continuous support, including in the context of the current Extended Credit Facility (ECF).

Program implementation.

Program implementation was satisfactory and the authorities' commitment remains strong. All performance criteria of end-June were met and five of seven structural benchmarks for this review were met, with two of the benchmarks implemented with a delay. The authorities believe that the ECF-supported program will help preserve macroeconomic stability and lay the foundation for sustained inclusive growth that will ultimately wean the country off foreign aid. Afghanistan's economic outlook is fraught with many risks and challenges, but the authorities are determined to address them with their steadfast commitment to economic reform and support of the international community. The authorities request Executive Board approval of the completion of the second review and the disbursement of the third tranche under the arrangement. They also request approval of the modification of two end-December 2017 performance criteria in line with the updated macroeconomic framework.

Recent Economic Developments and Outlook

The difficult security and political situation continues to take a heavy toll on civilian life and economic activity. For decades, security concerns have been a major impediment to confidence, investment and growth, but they have become more challenging with the withdrawal of international forces starting 2012 and the pick-up in hostilities. The authorities are hopeful that the peace discussions that were recently reactivated can lay the grounds for a lasting end to hostilities, permitting reconstruction and nation-building to accelerate in earnest. The upcoming parliamentary elections in 2018 and the presidential elections in 2019 also offer hopes of national reconciliation and the end of political factionalism that has plagued Afghanistan for years.

Under these difficult circumstances, growth has picked up slowly since 2015, mostly due to good agricultural output, and is projected to reach 2.5-3.0 percent in 2017-2018, which would be a welcome development, even though it would hardly keep pace with population growth. Unemployment and poverty remain areas of serious concern, with the ranks of unemployed and poor swelled by returning refugees and the internally displaced. Inflation has been modest due to weak domestic demand despite the recovery of global food prices and the pass-through effects of the *Afghani* depreciation. Exchange rate flexibility, especially since early 2015, has allowed the build-up of a comfortable external buffer, as large current account gaps are more than covered by foreign grants.

Fiscal revenue performance has been very strong, well exceeding the June program target, reflecting important strides made in strengthening tax administration and compliance. Since 2014, in a period of weak economic activity, the revenue-to-GDP ratio has increased by 2.2 percentage of GDP. Expenditure levels, and to some extent composition, are largely governed by foreign aid. Large security outlays continue to dominate current spending, while development spending has been weak because of security concerns and low capacity. Overall, the fiscal position including grants is comfortable, with a small surplus expected in 2017 and with Treasury discretionary cash balances well above the program floor during 2016-17.

Staff projection of real growth reaching 5 percent over the medium term seems reasonable, given the balance of risks, but clearly higher growth rates on a sustained basis are needed to tackle Afghanistan's entrenched poverty, unemployment, and human development needs. The medium-term outlook is heavily dependent on the security and political situation, the level of foreign aid, global and regional risks, and the pace and success of implementation of the economic reform agenda. Favorable developments in these risk factors could boost domestic demand and growth significantly, but durable improvements in the security conditions are likely to be gradual and, therefore, economic policies would have to be implemented within this constraint, even if the other risk factors turn out to be benign. The uncertainties about the level and timing of foreign aid are also important factors going forward, not only for recurrent budgetary outlays dominated by security needs, but also for financing on-and off-budget development needs, which will remain substantial for some time.

Macroeconomic Policy Framework

Macroeconomic policies will focus on preserving macrofinancial stability, promoting growth and inclusiveness, and reducing poverty, within the overarching limitations of an aid-dependent economy, security concerns, and serious structural constraints.

Monetary policy will aim to contain inflation close to mid-single digits by controlling the growth of reserve money, which will continue to serve as the operational target. The conduct of monetary policy will be strengthened by increasing central bank autonomy and greater coordination between the MOF and Da Afghanistan Bank (DAB), and enhancing its effectiveness by reducing dollarization and greater use of domestic currency denominated instruments. The *Afghani* will be managed flexibly to serve as the economy's main external shock absorber and to preserve external competitiveness, although the export supply response is expected to be limited because of infrastructure gaps and physical constraints on production and trade. Foreign exchange reserves will be maintained at a fairly high level, given the unpredictability of foreign aid, elevated dollarization, and high imports.
As for fiscal policy, the authorities will continue to target a gradual decline in the operating deficit (excluding grants) and a balanced overall position (including grants), as

the economy prepares for diminishing foreign aid. The Treasury discretionary cash balances will be maintained at high levels. These fiscal objectives will be met predominately by boosting revenue through new taxes, expanding the tax base, and strengthening tax and customs administration. Over time, security conditions permitting, it would be possible to gradually shift current spending towards pro-growth and pro-poor programs and address the serious gaps in infrastructure and human capital, financed increasingly by own revenue sources as foreign grants normalize. The government is cognizant that the scaling-up of development spending would need to be preceded by capacity building and significant improvements in project planning, execution, and monitoring. Given that borrowing might be needed to meet development needs, it will be carried out at highly concessional terms for priority projects in consultation with the Fund and other international partners.

Fiscal Reforms

One of the authorities' key priorities is to build on the recent strong revenue performance and broaden the revenue base by reforming the large tax payers' office (LTO) and introducing a Value-Added Tax (VAT). A modern national LTO, based on a unique threshold for some400-500 firms and including all the major mining companies, will be fully functional by end-2020. Staff estimates that the new LTO would raise close to 45 percent of all domestic tax revenue, compared to 27 percent under the current LTO. A new VAT—consistent with the WTO commitment—will be introduced effective January 2021 with the same threshold as the LTO, and levied initially on LTO firms, to replace the current Business Receipts Tax (BRT). The authorities intend to work closely with Fund staff to design a simple and efficient VAT system, possibly with a single rate and limited exemptions.

Afghanistan's rich mineral resource base presents a significant potential source of revenue that is largely untapped due to security issues, inadequate infrastructure, and weak management. Looking forward, and as constraints ease and the extractive sector develops, the authorities are planning to design and put in place a mineral fiscal regime with help from the Fund and the World Bank staff. They are submitting a revised mining law to parliament and are forging ahead with implementing the recommendations of the July 2017 evaluation of Extractive Industries Transparency Initiative (EITI) in close cooperation with the EITI secretariat.

Wide-ranging structural fiscal reforms are set out in the government's Fiscal Improvement Plan, with the core objective of strengthening public finance management by making better use of donor resources and improving the quality of spending in line with the country's priorities. Weak budget preparation, execution, transparency, monitoring, and follow-up are multi-faceted issues that the authorities are determined to address through various initiatives, as outlined in the MEFP (PP 26). The government is also planning to extend its monitoring and supervisory authority over the state-owned corporations and enterprises by properly evaluating their financial exposures and activities, and preparing annual reports on their financial performance, which will be annexed to the budget from FY 2019. The nascent private-public-partnerships (PPPs) are expected to grow, especially as development spending is scaled up. The authorities are drafting PPP regulation to supplement the new PPP law, and cognizant of potential contingent liabilities that PPP financing could create, they are planning to increase monitoring and recording of public guarantees and control of related fiscal costs.

Financial Sector Reforms

Afghanistan has made important strides in addressing the legacies of the failed Kabul Bank and the remaining weaknesses in the banking system; reinforcing the AML/CFT framework and governance; and strengthening the regulatory and supervisory capacity. With public confidence in financial institutions being gradually restored, the authorities are increasingly focusing on financial inclusion and improving financial sector infrastructure in support of private sector activity.

The authorities are intensifying their efforts to recover the remaining claims of Kabul Bank, the bulk of which is against two former shareholders, and advance its liquidation. The New Kabul Bank, which has made a successful transition from a “bridge bank” to a full-fledged bank, is adequately capitalized and is now profitable. The three State Owned Commercial Banks (SOCB), however, continue to suffer from inefficiency and weaknesses in governance. With assistance from the World Bank, the authorities are developing a reform strategy to restructure the banks’ operations, build up their staff and management capacity, and improve governance in line with international best practice. The authorities feel it is important to address these shortcomings before the SOCB could expand their full range of banking activities. In the meantime, private banks will be expected to pick up the slack and prudently expand their lending activity to the private sector, and lead the way in broadening the range of financial instruments offered to the public. Progress has also been made in reducing the DAB’s lender of last resort exposure with the intention of eliminating the outstanding balance by end-2019.

In coordination with the World Bank, the authorities are developing a National Financial Inclusion Strategy, to be finalized by end-2018, to expand banking services to remote areas and underserved sectors and population groups, notably women, while being mindful of potential associated financial stability risk. Also with the intention of improving the acceptability of financial instruments and facilities, they are drafting a Sukuk law to establish the legislative framework for issuing sharia-compliant financial instruments, drawing on the experience of a number of countries that have been successfully operating Islamic banking in parallel with conventional banking. With the growth of banking services, including microfinance institutions, the DAB’s regulatory and supervisory capacity and coverage are also being expanded. An amended DAB Law, with provisions on its mandate and institutional autonomy, and in line with the recommendations of the IMF 2017 safeguard assessment update, will be submitted to parliament soon. The authorities are also planning to establish a joint DAB-MOF Financial Stability Council (FSC) for crisis preparedness and management, with responsibilities delineated along each institution’s legal powers and competence.

Important progress has been made in strengthening the AML/CFT framework. The successful exit from the monitoring process of the Financial Action Task Force in June 2017 has created a momentum that the authorities are planning to build on and intensify their efforts to ensure effective implementation of the AML/CFT measures—including risk-based off-site analysis and on-site inspection—that, in turn, would help facilitate access to correspondent banking relationships.

Reducing Poverty

Poverty reduction, especially among the most vulnerable and women, is one of the government's top priorities. In August 2017, the High Council for Poverty Reduction was launched to oversee pro-poor budgeting and investment. Earlier in March 2017, a national program for economic empowerment of women was launched to provide training and employment for women. The authorities hope that their poverty-reduction efforts will continue to be supported by international donors and partners even as aid might taper off in other areas.

Fighting Corruption

Despite the significant improvement in Afghanistan's rating under the Transparency International Corruption perception index since 2013, corruption continues to be a major impediment to public and donor confidence, political cohesion, and investment and growth. Fighting corruption remains high on the authorities' agenda; the country's robust anti-corruption efforts are described in Box 1 of the staff report. Important among them is the criminalization of corruption in line with the United Nations Convention Against Corruption in a new Penal Code that was enacted in May 2017 and will come into force in February 2018. Legislation on assets declaration by public officials was enacted in September 2017 in line with the end-December 2017 structural benchmark. Further, at the October 2017 Senior Official Meeting in Kabul, the government launched a national strategy for combating corruption, under which a review of the anti-corruption institutional framework will be conducted with the help of the Fund and World Bank staff.

Conclusion

Probably not many countries have gone through a sustained period of nation building and economic reform and modernization against strong headwinds as Afghanistan. The authorities have persevered against all odds and are committed to stay the course by implementing the ECF-supported economic reform program with vigor and addressing the many challenges facing the economy. The generous support of donors and international partners has been critical, and the authorities hope that the high level of engagement will continue as economic reform and modernization, and capacity and nation building, advance in tandem with greater financial self-sufficiency. Our Afghan authorities are grateful to Fund management and staff for their continued strong support and are committed to maintaining this close cooperation during the implementation of the ECF-supported program and beyond.