INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/382

ISLAMIC REPUBLIC OF AFGHANISTAN

December 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND THE SIXTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ISLAMIC REPUBLIC OF AFGHANISTAN

In the context of the staff report for the 2019 article iv consultation and the sixth review under the extended credit facility arrangement, 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 19, 2019 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 19, 2019, following discussions that ended on October 10, 2019, with the officials of 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 December 4, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Islamic Republic of Afghanistan.

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

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Press Release No. 19/479
FOR IMMEDIATE RELEASE
December 19, 2019

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

IMF Executive Board Concludes 2019 Article IV Consultation and Completes the Sixth and Final Review Under the Extended Credit Facility Arrangement for the Islamic Republic of Afghanistan

- Despite difficult circumstances, the Afghan authorities have continued to demonstrate strong commitment to the economic program supported by the Extended Credit Facility arrangement.
- Given the uncertain outlook dominated by downside risks, policies should focus on maintaining macroeconomic and financial stability and putting the conditions in place for stronger and more inclusive growth, led by the private sector.
- The authorities have made progress with their self-reliance agenda, yet strong financial support from donors is needed to help Afghanistan stay on the path to greater prosperity.

On December 19, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] and completed the sixth and final review under the Extended Credit Facility (ECF) arrangement[2] for the Islamic Republic of Afghanistan. Completion of this review enables the disbursement of SDR 5.38 million (about US$ 7.4 million). The three-and-half year ECF arrangement for SDR 32.38 million (about US$44.7 million or 10 percent of Afghanistan's quota in the IMF) was approved by the IMF Executive Board on July 20, 2016 (See Press Release No. 16/348), to support the government's reform efforts and to help catalyze donor funding.

A challenging political and security environment has constrained Afghanistan's real GDP growth to below 3 percent in recent years. Most vulnerability and social indicators show Afghanistan trailing other low-income countries, with the poverty rate having risen to almost 55 percent. The

[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.

authorities have focused on maintaining macroeconomic and financial stability and pursuing reforms, guided by the Afghanistan National Peace and Development Framework.
Despite the difficult circumstances, program implementation has remained satisfactory, with all quantitative performance criteria and all but one structural benchmark under the ECF arrangement met. The remaining structural benchmark, aimed at accelerating Kabul Bank asset recoveries, was implemented with delay in November.

Regarding the macroeconomic outlook, growth is projected at 3 percent in 2019, up from 2.7 percent in 2018, buoyed by a recovery in agriculture, and rising to 3.5 percent in 2020 before stabilizing at 4 percent in the medium term, assuming no significant security deterioration, continued reforms, and sustained aid inflows. Inflation is expected to rise from an average of 0.6 percent in 2018 to reach 2 percent this year and rise gradually to 5 percent in the medium term, reflecting a pickup in economic activity. Assuming continued grant inflows, fiscal and external balances are expected to remain sustainable. Risks to the outlook are tilted to the downside, and include a deterioration in security, heightened political tensions, a significant drop in aid, and reform slippages. On the upside, durable peace would boost confidence and economic activity, setting Afghanistan on a higher growth path.

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, made the following statement:

“The Afghan authorities are to be commended for successfully completing their ECF-supported program. They continue to implement their reform agenda consistent with Afghanistan’s National Peace and Development Framework, aimed at reducing poverty, raising inclusive growth, and boosting job opportunities for the growing labor force. However, insecurity and political uncertainty continue to affect confidence and discourage investment, thereby undermining economic growth and job creation. Poverty remains high, and the country continues to be dependent on external grants for fiscal and external sustainability.

“Given these challenging circumstances, continued macroeconomic policy discipline complemented by structural reforms is needed. Macroeconomic policies that instill fiscal discipline, stabilize inflation, support a flexible exchange rate, and safeguard financial stability will remain critical going forward.

“Fiscal policy should continue to target a broadly balanced budget, supported by fair and sustainable domestic revenue mobilization and strong financial support by donors. Resources should shift toward pro-growth and pro-poor outlays and create fiscal space to meet the country’s considerable development needs. The country’s economic development plan should be grounded in a robust and sustainable macro-fiscal framework reflecting Afghanistan’s still-limited debt-carrying capacity and high risk of debt distress.

"Financial sector reforms that address the shortcomings among the weak private banks, strengthen the framework for crisis prevention and resolution, and implement the strategy to reform the state-owned commercial banks are critical to ensure a resilient banking system.

"The anti-corruption agenda has advanced and needs to be cemented with implementation, supported by prioritization of the on-going anti-corruption efforts in cooperation with donors and guided by the National Strategy for Combatting Corruption. These efforts should go hand-in-hand with improvement of the business environment and the regulatory framework.

"The successful completion of the ECF arrangement demonstrates the authorities' strong ownership of their reform agenda. The Fund continues to stand ready to assist Afghanistan, including through the provision of technical assistance.

The Executive Board also concluded the 2019 Article IV consultation with Afghanistan.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' commitment to implement their reform program consistent with Afghanistan's National Peace and Development Framework, aimed at reducing poverty, raising inclusive growth, and boosting job opportunities for the growing labor force. However, insecurity and political uncertainty continue to undermine confidence and hinder investment and sustained growth. Directors stressed that policies should remain focused on preserving macroeconomic and financial stability, strengthening institutions, and accelerating the reform momentum to entrench sustainable private-sector-led growth. Continued financial support by donors will remain critical to help preserve macroeconomic stability, support reforms, and finance security and development needs.

Directors encouraged the authorities to continue to pursue fiscal discipline. They noted that the economic development plans currently under consideration should be grounded in a robust and sustainable macro-fiscal framework reflecting Afghanistan's still limited debt-carrying capacity and high risk of debt distress. The latter calls for continued reliance on grants and highly-concessional borrowing, supplemented by efforts to strengthen capacity in public financial and debt management and the assessment of investment projects and fiscal risks.

Directors agreed that the overall fiscal balance including grants should remain the fiscal anchor that preserves a broadly balanced budget, prudent cash buffer, and low public debt. This policy should be supplemented with a gradual reduction of the operating deficit before grants to prudently use domestic resources, shift expenditure toward pro-growth and pro-poor outlays, rationalize current spending, and create fiscal space to meet the country's considerable development needs. Directors supported the authorities' continued targeting of sustainable revenue collection through an expanding tax base, increased efficiency, and VAT adoption planned by early 2021.

Directors welcomed the authorities' commitment to price stability supported by exchange rate flexibility. They noted that further measures to reduce high dollarization can help improve monetary transmission. They highlighted the importance of safeguarding financial stability and welcomed the continued focus on addressing shortcomings in weak private banks, strengthening the framework for crisis prevention and resolution, and implementing the strategy to reform the state-owned commercial banks. They also took positive note of efforts to formalize the activities of unregulated financial institutions. Directors encouraged fostering financial intermediation through the implementation of the recently adopted National Financial Inclusion Strategy.

Directors were encouraged by the authorities' progress with anti-corruption legislation and institutions, but stressed the need to strengthen implementation by prioritizing anti-corruption efforts in cooperation with donors and guided by the National Strategy for Combatting Corruption. They urged swift progress in closing gaps in the criminalization of the remaining corruption offenses, and the staffing and operationalization of new anti-corruption institutions. These efforts should go hand-in-hand with improvement of the business environment, the regulatory framework, and the AML/CFT regime. Addressing poverty and gender inequality should also remain a top priority.

Directors encouraged continued improvement of economic data, with Fund technical assistance.

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

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2016–20

(Quota: SDR 323.8 million)

(Population: approx. 34.7 million; 2016)

(Per capita GDP: approx. US$547; 2018)

(Poverty rate: 54.5 percent; 2017)

(Main exports: dried and fresh fruits and vegetables, medical seeds, 2018)

	2016	2017	2018	2019	2020
				Proj.	
Output and prices 1/	(Annual percentage change, unless otherwise indicated)				
Real GDP	2.2	2.9	2.7	3.0	3.5
Nominal GDP (in billions of Afghanis)	1,318	1,356	1,426	1,500	1,612
Nominal GDP (in billions of U.S. dollars)	19.4	19.9	19.7	19.2	19.4
Consumer prices (period average) 2/	4.4	5.0	0.6	2.1	3.9
Public finances (central government) 3/					
Domestic revenues and grants	26.1	25.7	28.5	27.0	26.5
Domestic revenues	10.7	12.4	13.3	13.9	12.9
On-budget grants (excl. donors' direct spending outside the budget)	15.4	13.2	15.1	13.1	13.6
Expenditures	26.0	26.3	26.9	26.9	26.8
Operating 4/	18.9	18.7	18.1	19.3	17.7
Development	7.1	7.6	8.8	7.6	9.1
Operating balance (excluding grants) 5/	-8.2	-6.2	-4.8	-5.4	-4.8
Overall balance (including grants)	0.1	-0.6	1.5	0.1	-0.3
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)				
Reserve money	11.8	10.2	-2.7	10.3	9.9
Broad money	5.6	5.9	2.6	9.0	9.0
External sector 1/	(In percent of GDP, unless otherwise indicated)				
Exports of goods (in millions of U.S. dollars)	614	784	875	948	1,027
Exports of goods (annual percentage change)	6.3	27.6	11.6	8.3	8.3
Imports of goods (in millions of U.S. dollars)	6,263	6,737	6,596	6,817	6,914
Imports of goods (annual percentage change)	-14.2	7.6	-2.1	3.4	1.4
Current account balance					
Excluding official transfers	-29.9	-30.3	-27.5	-32.2	-32.2
Including official transfers	8.4	5.9	9.6	2.0	1.4
Foreign direct investment	0.4	0.2	0.4	0.5	0.5
Total external debt 6/	6.1	6.4	6.4	7.3	7.9
Gross international reserves (in millions of U.S. dollars)	7,357	8,139	8,273	8,298	8,297
Import coverage of reserves 7/	11.1	12.2	12.0	11.8	11.5
Exchange rate (average, Afghanis per U.S. dollar)	67.9	68.1	72.4	…	…

Sources: Afghan authorities, United Nations Office on Drugs 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.

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

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

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

December 4, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND THE SIXTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT

KEY ISSUES

Context: Afghanistan is a fragile, aid-dependent country where insecurity combined with episodes of political uncertainty and adverse weather events have kept real GDP growth below 3 percent in recent years. In early September, U.S.-Taliban talks on a U.S. troop withdrawal as a basis for peace negotiations were suspended, with uncertainty as to the timing of their resumption. Presidential elections were held at end-September, but results have yet to be announced. The international community continues to support Afghanistan with civilian and military assistance and is pressing for intra-Afghan peace talks and an immediate reduction in violence. The authorities have expressed an interest in a new financial arrangement to support reforms.

Outlook and Risks: Supported by a recovery in agriculture, growth is projected to reach 3 percent in 2019 and rise to 3.5 percent in 2020. Inflation is projected to average about 2 percent this year and rise gradually to 5 percent in the medium term. Reserves are ample at about 12 months of import cover. Risks to the outlook are tilted to the downside, and include a deterioration in security, heightened political tensions, a significant drop in aid, and reform slippages. On the upside, durable peace would boost confidence and economic activity.

Article IV discussions: Discussions focused on policies needed to preserve macroeconomic stability, secure sustainable inclusive growth, and attain self-reliance. There was broad agreement between staff and authorities on the policy mix needed to raise the pace of growth and make it more inclusive, with staff emphasizing the importance of macroeconomic policy discipline to sustain confidence in an uncertain environment complemented with structural reforms particularly in the governance area.

Program Performance: Program performance has been satisfactory. All end-June quantitative performance criteria and end-September 2019 indicative targets were met. Similarly, all but one of the seven structural benchmarks were met. Staff supports completion of the sixth and final review under the Extended Credit Facility arrangement and a disbursement of SDR 5.38 million, bringing the cumulative amount under the program to SDR 32.38 million (10 percent of quota).

Approved By
Subir Lall and Martin Sommer

Discussions took place in Dubai during October 3-10, 2019. The mission comprised Christoph Duenwald (head), Mariusz Sumliński, Boaz Nandwa (all MCD), Daisuke Ishikawa (FAD), Kathleen Kao (LEG), Keiichi Nakatani (SPR), and Gayon Hosin (MCM). Mr. Mojarrad (OED) joined the policy discussions. The team met with Acting Finance Minister Qayoumi, Acting Central Bank Governor Nosher, Deputy Finance Ministers Sarabi and Tamim, and other senior officials. Tetyana Sydorenko (MCD) provided research assistance and Maria Orihuela-Quintanilla (MCD) managed document production.

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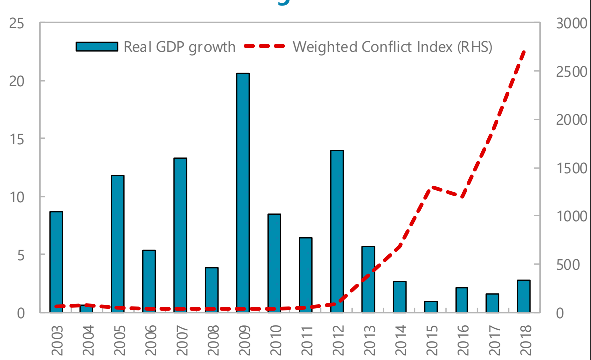
APPENDIX

CONTEXT

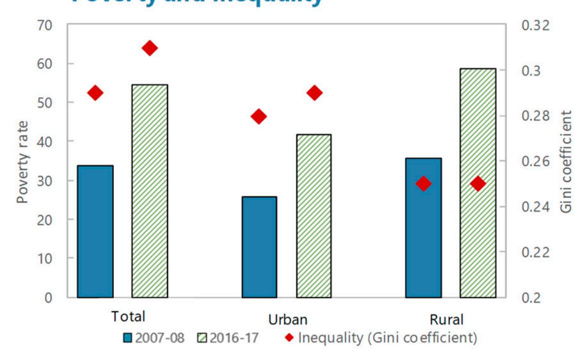
1. **Despite substantial gains against many indicators, Afghanistan, in conflict since the 1980s, remains a poor, fragile country**. The conflict of past decades has taken a large human and economic toll, and security requirements have imposed significant costs on the government, with total security spending estimated at 30 percent of GDP. Social development has been held back in general despite noticeable improvement in some indicators relative to 2001: GDP per capita has quadrupled, life expectancy is up to 64 years from 56 years, and maternal mortality declined to 396/100,000 births from 1,600. Nonetheless, GDP per capita is the lowest in the immediate region, and a recent household survey shows that the poverty rate increased from 33.7 percent in 2007/08 to 54.5 percent in 2016/17, while inequality as measured by the Gini coefficient rose from 0.28 to 0.33 during the same period. Most vulnerability and social indicators show Afghanistan underperforming other low-income countries (Table 3). Moreover, corruption is perceived as very high in a weak institutional environment. Per capita GDP growth has on average been negative during 2012–18 with growth falling after the withdrawal of international troops coupled with a spike in violence and a reduction in aid. Large fiscal and current account deficits are financed by aid of nearly 40 percent of GDP.

GDP Growth and Weighted Conflict Index



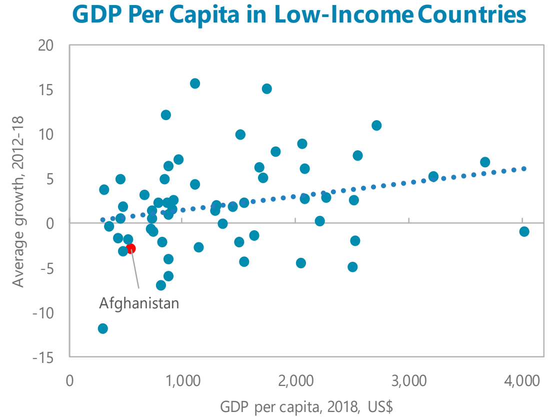
Source: Cross-National Time-Series Database; and Afghan authorities.

Poverty and Inequality



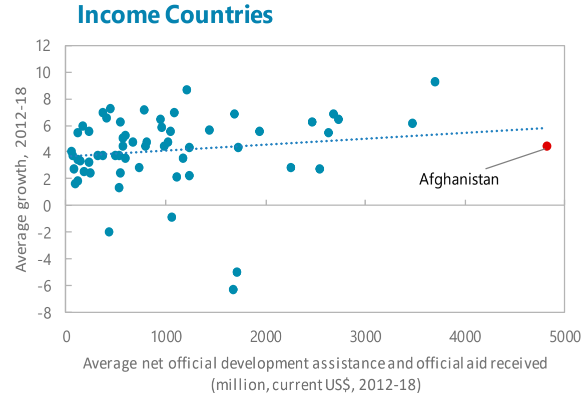
Source: Afghan authorities.

GDP Per Capita in Low-Income Countries



Sources: Afghan authorities and IMF staff calculations.

Official Aid and Real GDP Growth in Low Income Countries



Source: IMF WEO, WDI.

2. **The government has made good progress on economic reforms despite the difficult circumstances**. The reform agenda laid out in the Afghanistan National Peace and Development Framework 2017–21 (ANPDF) presented during the Brussels pledging conference in 2016, was recently supplemented by a post-settlement economic plan and the Afghanistan Self-Reliance Accelerator Package (ASAP) aiming to accelerate Afghanistan's progress toward economic self-reliance (Box 1). Donors have generally met their pledges from Brussels with the government effectively implementing its commitments. At the November 2018 Geneva donor conference, the government and donors agreed on deliverables for 2019–20, including on reaching agreement on a successor Fund-supported program by mid-2020 before the next pledging conference expected in late 2020.

3. **A challenging political and security environment complicates policymaking**. The last parliamentary elections took place in October 2018, and while voter turnout was good, it was marked by violence and unresolved disputes regarding the outcome. Presidential elections were held on September 28, 2019 without major disruptions but marked by low voter turnout. The election results have not been announced yet. U.S.-Taliban negotiations on a phased drawdown of U.S. troops in exchange for a Taliban crackdown on terrorist groups were suspended in September, with uncertainty as to the timing of their resumption.

4. **Traction of 2017 Article IV policy recommendations has been broadly satisfactory** (Table 13). The authorities have continued to make notable progress in enhancing fiscal discipline, strengthening the financial sector, and improving the business environment. Sustained efforts are needed to safeguard macro-financial stability, improve governance, and strengthen structural reforms to boost private sector participation in the economy and reduce poverty.

5. **A three-and-a-half-year Extended Credit Facility (ECF) arrangement, expiring at end-December 2019, has anchored macroeconomic stability**. The arrangement made available SDR 32.38 million (10 percent of quota) to support the government's reform efforts and to help catalyze donor funding. The authorities are interested in a successor arrangement in line with the Geneva commitment. They see the Fund program as a critical driver of reforms and as a tool to secure domestic support for reforms and lay the foundation for stronger private sector-led growth.

RECENT DEVELOPMENTS

6. **The security situation has remained strained**. In 2018, civilian deaths reached a new record and the high level of violence continued into the third quarter of 2019, with the UN Assistance Mission in Afghanistan (UNAMA) recording the highest quarterly number of overall civilian casualties since they were first documented in 2009. Afghanistan also remains the second highest source of refugees in the region. A protracted post-election political transition risks another increase in violence.

Box 1. Economic Development Plans 1/

There is broad recognition that any political settlement would require an economic development plan to sustain peace and to harness its dividends. Indeed, in November 2018, the Geneva Ministerial Conference on Afghanistan called on the international community to develop a "specific action plan, consistent with fundamental values and existing frameworks, in support of broad-based program of economic initiatives which would advance: a post-settlement return of Afghan overseas capital; increased Afghan and foreign investment; job creation; and, enhanced regional economic integration." The post-settlement initiatives should articulate potential economic benefits of peace to all parties and support economic priorities building on existing programs and institutions.

The World Bank, in consultation with the authorities and international partners, has outlined related initiatives. It focuses on the following areas for inclusive and sustainable development:

- *Protecting and investing in people.* More than half of the Afghan population lives below the poverty line. Poverty could be reduced through expansion of basic services, public works schemes, community development programs (Citizens Charter) and cash transfers to benefit the worst off.

- *Improving rural livelihoods.* Agriculture is key to reducing poverty and improving employment opportunities. The sector would benefit from investments to improve agricultural productivity and resilience to weather-related shocks, and to support infrastructure and irrigation networks.

- *Securing and attracting investment.* Private sector investment will be key to Afghanistan's economic success, and constraints (including a poor regulatory environment and limited access to infrastructure) and risks need to be addressed. Expanding access to finance, improving the legal and regulatory environment for investment, supporting private investment in infrastructure through public-private partnerships, and providing financial products to offset risks to investors would be critical.

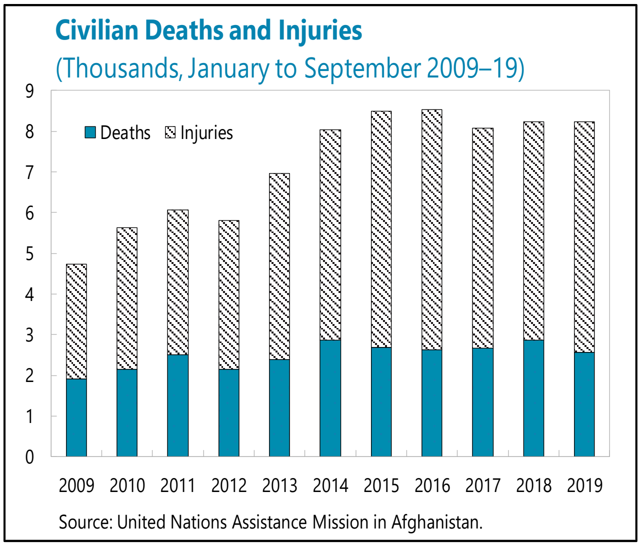
- *Strengthening international linkages.* Regional economic integration would increase exports, attract FDI including in the extractive sector, develop regional connectivity and infrastructure in energy, roads, and rail, and expand employment opportunities beyond national economies.

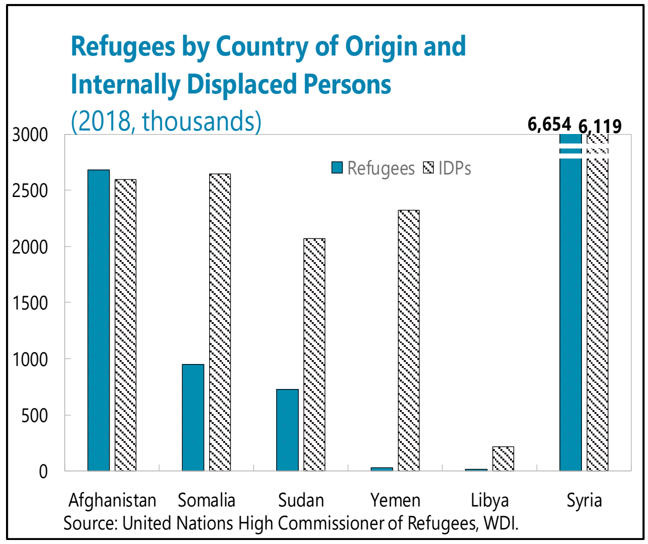
The authorities have also devised an investment package to strengthen growth in line with priorities identified in the Post-Settlement Economic Plan. The "Afghanistan Self-Reliance Accelerator Package" (ASAP) focuses on investments, both public and private, to accelerate economic growth. The sectors targeted for investment include energy, affordable housing, and agriculture. ASAP emphasizes the use of highly concessional financing and private sector involvement wherever possible.

Donor aid remains necessary to support such initiatives given Afghanistan's large financing needs. The authorities rightly remain focused on achieving self-reliance, but in the meantime, aid should continue to support basic services and infrastructure. Indeed, aid still finances around three-quarters of public service, infrastructure, and security needs, and, with pledges for civilian assistance timing out at the end of 2020, discussions are underway for a ministerial conference to consider pledges for 2021–24.

1/ Prepared by Keiichi Nakatani.

7. Domestic and regional shocks have affected the population. In 2018, a severe drought forced major internal displacements, with nearly 300,000 people migrating to urban areas. Humanitarian agencies assisted nearly 4 million people in 22 provinces. The economic slowdown in Iran due to re-imposition of U.S. sanctions caused about 0.8 million Afghans to return (about 0.4 million in 2019 to date)[1] straining public services. The return of Afghans from Pakistan has slowed as some 1.4 million Afghans residing in Pakistan were granted extension of residency until end-June 2020.[2]





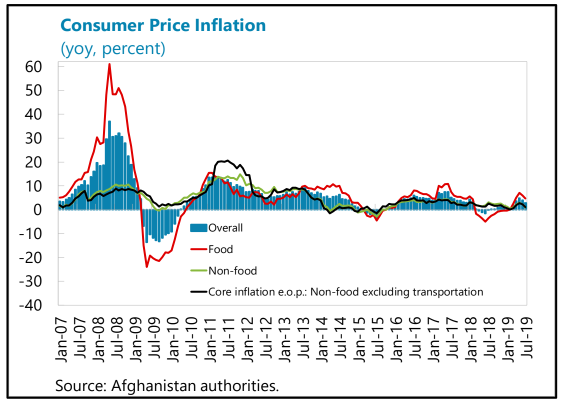
8. In 2018, GDP growth was muted owing to a drought. Constrained by persistently difficult security conditions and political uncertainty, real GDP growth has been below 3 percent in recent years. In 2018, estimated growth of 2.7 percent was lower than the 2.9 percent recorded in 2017, reflecting the impact of the drought (Figure 1). Inflation moderated from 3 percent y/y at end-2017 to 0.8 percent at end-2018, reflecting weak demand due to lower drought-affected rural incomes, lower priced imports compensating for domestic food shortages, and increased domestic vegetable production. In the first half of 2019, inflation increased to 4 percent reflecting the pass-through from the earlier exchange rate depreciation. The pass-through was somewhat limited by cheaper imports of consumer goods from Iran. In September, inflation eased to 1.8 percent helped by declining food prices due to a good harvest and modest appreciation of the Afghani. Core inflation also edged lower from 3.5 percent to 3 percent in September (Box 2).

[1] https://afghanistan.iom.int/

[2] See: UNHCR welcomes Pakistan cabinet's decision to extend stay of Afghan refugees.

Box 2. What Drives Inflation in Afghanistan? 1/

Historically, inflation in Afghanistan has been moderate but with high volatility. End-period average annual inflation over a 12-year period (Jan 2007–May 2019) was almost 6 percent y/y which is consistent with DAB's objective to keep inflation within a single digit corridor. However, over this period, Afghanistan experienced bouts of inflation volatility, with 12-month inflation ranging from –15 percent to nearly 37 percent, driven mainly by swings in food prices (which account for half of the CPI basket), exchange rate fluctuations, and foreign troop movements.



Source: Afghanistan authorities.

Understanding the main drivers of inflation is key to guiding monetary policy. There is considerable empirical literature on the determinants of inflation, incorporating both domestic and external factors,[2] and a broad consensus that low and stable inflation is conducive to healthy economic growth and improved welfare. For low income countries like Afghanistan, domestic supply shocks, typically related to the weather, and external shocks (e.g., commodity prices) are usually important factors driving inflation. The type of exchange rate regime and the degree of monetary policy credibility are also important institutional factors.

A single equation model (OLS) is estimated to analyze inflation developments in Afghanistan. The model is expressed as:

$$p = f(p_{t-1}, rm, cred, exr, compix, temp)$$

where *p* is CPI (dependent variable), *rm* is reserve money, *cred* is credit to the private sector, *exr* is the nominal exchange rate of Afghani versus USD, *compix* is the global commodity price index weighted by imports, and *temp* is temperature (a proxy for supply shocks to agriculture). Common to the literature, all the variables are in logarithms, differenced, and seasonally adjusted. A positive shock to the variables is expected to increase Afghanistan's inflation. Dummy variables are incorporated to account for NATO troops surge and withdrawal and a change in CPI methodology in 2010.

Variables	Coefficients
P_{t-1}	0.28 (3.55)
Exr_{t-1}	0.15 (2.11)
$Compix_{t-2}$	0.06 (2.70)
$Temp_{t-2}$	0.02 (5.33)
R^2	**0.39**
Adj.R^2	**0.31**
F-Stat.	**5.16**
Obs.	**146**
Durbin-Wat	**1.94**
Source: IMF staff estimates	

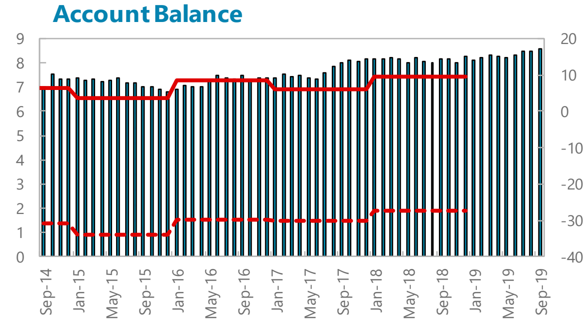
Estimated results provide elasticities of the impact of changes in the variables on Afghanistan's CPI. Monthly data over 2007M1–2019M05 is used to estimate the model. Coefficients of the estimated model are presented with t-statistics in brackets. The results should be interpreted with caution given data limitations and likely structural breaks in the series, a major constraint to modeling inflation developments in Afghanistan. Reserve money and credit to the private sector were found to be insignificant, likely owing to high dollarization (see ¶22, 24) and weak credit uptake due to insecurity and uncertainty, in addition to potentially long and variable lags between these variables and inflation not captured by the regression. For brevity, the results are not reported. All the other variables have expected signs and are significant at the 5 percent level. Inflation is persistent, with an increase in the previous month's inflation by 1 percent raising current inflation by almost 0.3 percent. Depreciation of the exchange rate in the previous month leads to a 0.2 percent increase in inflation in the current month. Similarly, an increase in commodity prices raises inflation by almost 0.1 percent. Shocks to agriculture, through adverse weather conditions, increases inflation by 0.02 percent.

1/ Prepared by Boaz Nandwa and Farid Talishli.

2/ For a recent comprehensive analysis see Ha, J., A. Kose and F. Ohnsorge (2019), *Understanding Inflation in Emerging and Developing Economies*, Policy Research Working Paper No. WPS 8761, World Bank.

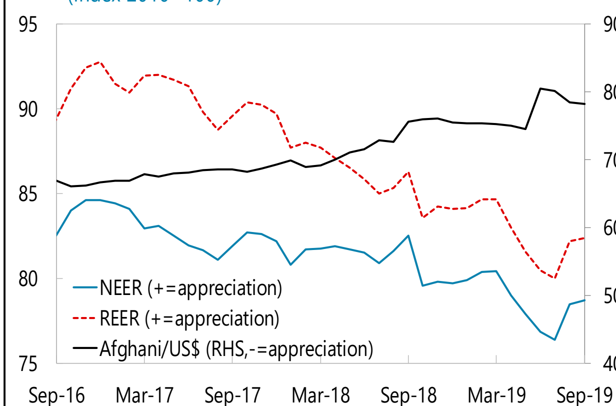
9. Grants continue to finance a large underlying current account deficit, while exchange rate pressures have eased recently, and international reserves remain ample. The current account deficit (excluding official transfers) remained large in 2018 despite import substitution of some consumption goods and strong export growth partly reflecting the establishment of subsidized "air corridors." The Afghani depreciated by almost eight percent versus the U.S. dollar in 2018. In the first half of 2019, the Afghani depreciated by eight percent. The pressure on the currency was mainly attributable to increased political risks prior to the presidential elections and outflows of U.S. dollars to take advantage of arbitrage opportunities in Iran. Since June, the outflows appear to have receded and the Afghani has appreciated by over 3 percent through end-September. Overall, on a nominal trade-weighted basis, the Afghani has been broadly stable given the appreciation against regional currencies.[3] International reserves increased slightly since the beginning of the year to nearly 12 months of imports.

Gross International Reserves and Current Account Balance



Source: Afghan authorities.

Exchange Rate
(Index 2010=100)

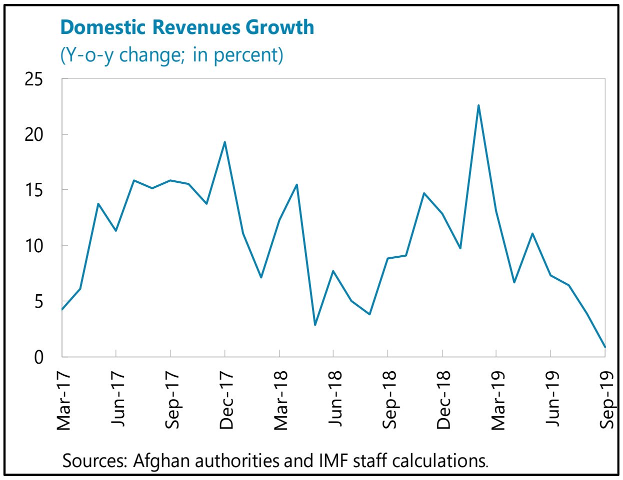


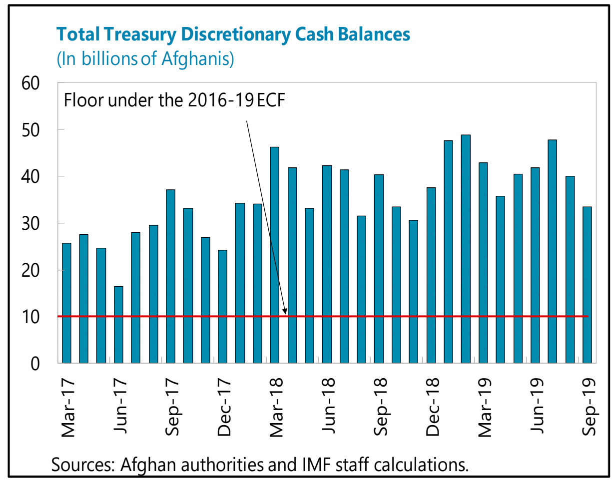
Source: Afghan authorities and IMF staff calculations.

10. The fiscal outturn in 2019H1 was strong, but revenue growth has slowed. In 2018, the overall fiscal balance including grants moved to a surplus of 1.5 percent of GDP, from a deficit of 0.6 percent of GDP in 2017 because of an increase in grants by nearly 2 percent of GDP and domestic revenues expanding by 1 percent of GDP. In 2019, rising (albeit at a declining rate) revenues benefitted from improved collection efficiency and increased customs revenue reflecting the Afghani's depreciation earlier in the year. However, revenue growth has declined significantly in recent months reflecting uncertainties stemming from the presidential elections, and hence the budget target for revenue is now likely to be undershot. The extent to which this revenue slowdown

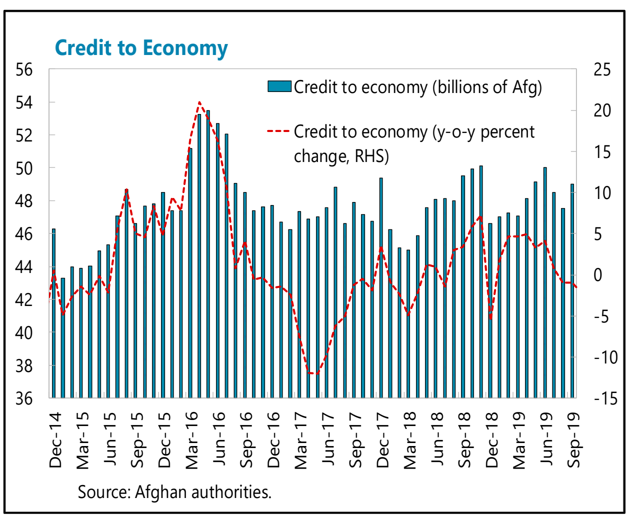
[3] The U.S. sanctions on Iran have likely reduced remittances given the number of returnees, but a lack of data prevents a quantitative assessment.

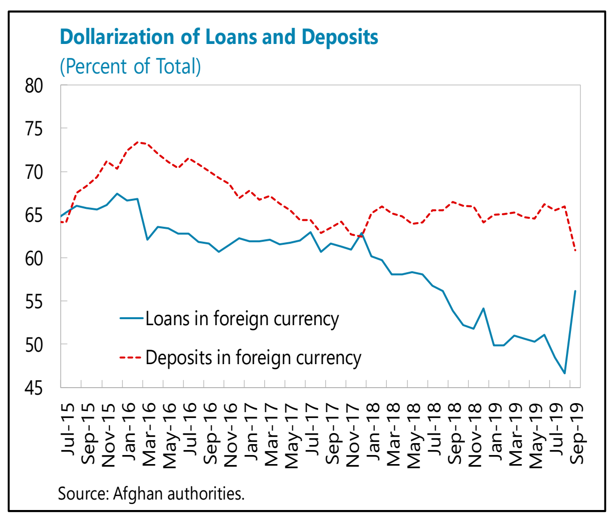
is temporary is uncertain.[4] Reflecting prudent management of budget resources, cash balances remain comfortably above the program floor of Af 10 billion, providing a liquidity buffer in case of revenue underperformance. Public debt remains low at around 7 percent of GDP.





11. Monetary aggregates have grown moderately but credit growth and financial inclusion remain weak. At end-September, reserve money in local currency grew by 8.5 percent y/y, reflecting an uptick in government spending partly offset by increased intervention by Da Afghanistan Bank (DAB). Credit to the economy contracted by almost 1 percent owing to lower demand for trade credit and DAB's mandated nonperforming loan (NPL) write-offs. Loan and deposit dollarization have fluctuated more noticeably in 2019 than previously, reflecting heightened political uncertainty and insecurity, but remain close to 60 percent. Despite some recent improvements, access to financial services has remained limited.

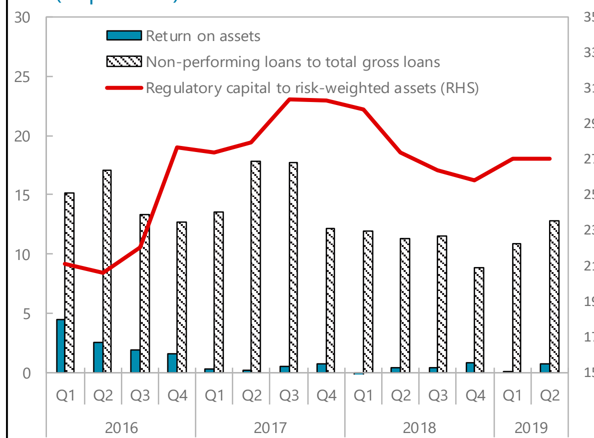




[4] The revenue slowdown in recent months needs to be seen in perspective. In 2014, the last election year, revenues fell around 33 percent below target, before rebounding the following year; the current slowdown, while concerning, is comparatively modest, and the government's cash buffers are stronger than in the earlier episode.

12. Rising strains in some banks since end-2018 have prompted intensified monitoring by the central bank. The banking system's financial soundness indicators show a mixed picture for the six months to June 2019 (Table 8a). The gross NPL ratio increased by four percentage points to 12.8 percent owing to an ongoing DAB mandated clean-up of the portfolio, while profitability remains weak. Liquidity and capital levels continue to be well above the minimum, and NPLs remain adequately provisioned although the ratio of NPLs net of provisions to capital ratio widened from 3.4 to 6.3 percent. Low profitability mainly reflects a challenging economic environment and the high business cost given the difficult security situation. The weak banks remain under intensified monitoring by DAB. In March 2019, DAB revoked the licenses of two foreign banks' branches since they did not perform financial intermediation services. In June 2019, a capital injection in one large private bank restored its capital adequacy ratio to the regulatory minimum capital adequacy ratio.

Financial Soundness Indicators
(In percent)



Source: Afghan authorities.

13. Structural reforms are advancing, despite a constrained environment. The government's five-year development plan, ANPDF, embodies a strong commitment to fighting corruption and strengthening the rule of law to achieve self-reliance and private sector-led sustainable growth. The impact of the reform efforts is already evident in tax administration and enactment of anti-corruption legislation.

OUTLOOK AND RISKS

14. The outlook envisages a modest pickup in growth and inflation. Supported by a recovery in agriculture, growth is expected to pick up modestly to 3 percent in 2019, although political uncertainty and insecurity continue to weigh on investment and growth prospects. In 2020, growth should strengthen modestly conditioned on a smooth political transition following the recent presidential elections. By 2024, growth may reach 4 percent assuming no significant security deterioration, continued reforms, and sustained aid. Over time, extractive industries and regional trade integration could support growth and job creation. Projected growth over the medium term has been revised down since the fifth review under the ECF arrangement in part reflecting a more conservative outlook for aid (and hence lower government spending). Inflation, forecast at 3.5 percent for end-2019, rises modestly thereafter as domestic demand picks up. Contingent on continued (albeit declining) aid inflows, the external position will remain comfortable with international reserves averaging about 10 months of imports cover during 2019–24.

15. Risks to the outlook remain tilted to the downside (Annex I). The outlook is clouded by significant uncertainty, especially with respect to the prospects for peace talks and the political transition after the September presidential elections; possible lapses in reforms, including fiscal slippages due to election-related disruptions to revenue collection and expenditure discipline; shortfalls in donor aid; and regional developments, especially the impact of sanctions on Iran on remittances and migrant movements. On the upside, a durable peace that spurs repatriation of overseas capital and boosts private sector confidence and investment, could improve economic prospects significantly.

16. The authorities broadly shared staff's perspective about the outlook and assessment of risks. Citing their strong record in policy implementation, the authorities reiterated their commitment to maintain policy discipline and advance structural reforms despite the difficult environment. They expressed concerns about possible adverse spillovers from insecurity and political uncertainty undermining the already subdued economic outlook and the pace of reforms.

ARTICLE IV POLICY DISCUSSIONS

Discussions focused on devising a robust development strategy that encompasses the safeguarding of macroeconomic stability and fostering inclusive growth and poverty reduction. While emphasizing the need for a robust peace agreement to boost the trajectory of growth, staff recommended maintaining policies that safeguard recent gains in macroeconomic stability. These need to be complemented with structural reform efforts that focus on strengthening governance, broadening financial inclusion, boosting the business environment, fostering increased human and physical capital formation, and deepening regional integration. A well-targeted social safety net that protects the most vulnerable would also be critical to help reduce poverty and nurture social cohesion.

A. Safeguarding Macroeconomic Stability

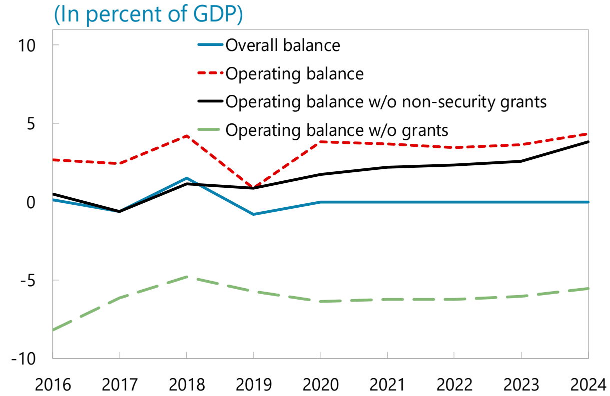
Development Strategy

17. Staff stressed that development plans and efforts should be embedded in a robust and sustainable medium-term macro-fiscal framework supported by disciplined policies. Regarding the ASAP investment package, staff supported the objective of boosting growth, while reiterating the need to first develop capacity to assess investment projects, their financing, and related debt sustainability. Developing debt management capacity is a first step in this process. Staff also cautioned against non-concessional borrowing and repeated previous calls to establish a database of potential infrastructure projects with government funding. The authorities indicated that they would resort only to highly concessionally loans to finance investment projects, which would be carefully selected based on priorities and rates of return.

Fiscal Policy

18. Staff noted that the overall balance including grants should remain the fiscal anchor targeting a broadly balanced budget, aligned with the medium-term fiscal framework (Annex II). The government's recent strategy of boosting prospects for self-reliance through domestic revenue mobilization—which increased the revenue-to-GDP ratio by 3 percentage points over 2016–18—combined with expenditure restraint and supported by aid has been successful. This strategy has preserved a broadly balanced budget, ample cash reserves, and low public debt. Going forward, fiscal policy should continue to target an overall fiscal balance at or near zero, supported by continued expenditure restraint and efforts to mobilize more domestic revenues. The operating deficit before grants should also be gradually reduced to reinforce prudent use of domestic resources, while allowing expenditure composition to shift toward pro-growth and pro-poor outlays. In this context, staff welcomed that pro-poor spending had risen from 2.9 percent of GDP in 2016 to 3.4 percent in 2019.[5]

Fiscal Balance
(In percent of GDP)



Source: Afghan authorities.

19. Prudent fiscal outcomes are envisaged in 2019–20, with contingency measures in place to offset a potential revenue shortfall. The revenue and spending forecast for 2019 generates a 0.1 percent of GDP surplus of the overall balance including grants.[6] However, domestic revenue growth has recently declined, implying that collections could well miss the 2019 budget target. In such an event, the authorities are prepared to cut up to 0.8 percent of GDP in non-essential spending and rationalize capital spending to achieve a near-balanced budget or a small deficit depending on the size of the revenue slippage. For 2020, a deficit of 0.3 percent of GDP is projected, as one-off revenue items from 2019 run out.[7] Projected on-budget grants have been revised downward relative to the fifth review after discussions with the authorities and the World Bank regarding the on/off budget split within the committed grants envelope. Expenditure has also been revised down in line with the lowered grants.

[5] See Annex II for a discussion of trends in social spending needs in the medium term.

[6] Projected revenues were raised during the mid-year budget review in July, based on the strong collections in 2019H1, including from customs reflecting the Afghani's depreciation and one-off revenues comprising of a transfer of central bank's profits to the Treasury received in May as well as tax arrears collections and one-off non-tax fees that are expected in Q4.

[7] Since the 2020 budget was still under preparation at the time of the mission, the discussion focused on broad parameters.

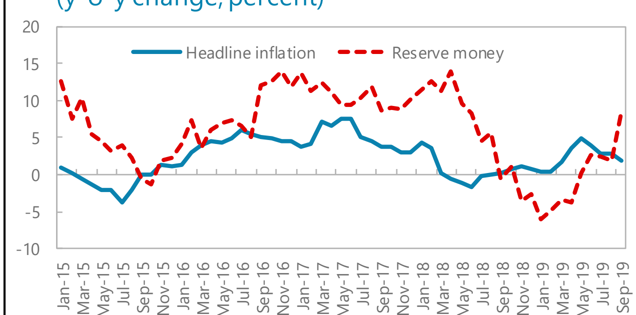
20. Over the medium term, a priority is to create fiscal space given Afghanistan's considerable spending needs. Domestic revenue mobilization is crucial to self-reliance as external assistance declines. Since 2016, revenue collection has increasingly relied on ad-hoc one-offs which are uncertain going forward. Building a sound and predictable domestic revenue base and reducing dependence on donor aid will be pivotal to realizing self-reliance. There is still scope to improve customs and tax administration and compliance. Immediate steps could involve embracing technology, reinforcing controls, and sanctioning non-compliance. On the spending side, much progress has already been made in raising expenditure execution, helped by improved public investment management reflecting the adoption of a unified process for project appraisal and the related technical committee. Staff encouraged further progress in these areas, including implementation of related TA recommendations, while bringing off-budget aid on budget given that off-budget spending is considerable and at times less transparent.

21. The authorities largely concurred with staff's views, emphasizing their commitment to a broadly balanced budget, moving Afghanistan towards self-reliance, and boosting the efficiency of spending. They are committed to making continued efforts to mobilize domestic resources, including by expanding the tax base. They observed that their domestic revenue mobilization strategy is focused on developing permanent revenue sources, away from one-offs. They highlighted intensification of anti-fraud measures and establishment of a Single Large Taxpayer Office (SLTO) and their commitment to adopt a value-added tax (VAT) by early 2021 as key elements in this strategy. They also plan to increase priority spending by progressively raising development budget execution rates and working with donors to bring off-budget aid on budget given considerable off-budget spending that is not always consistent with the government's priorities and lacks transparency. However, they acknowledged the need to strengthen resource management at their end and pointed out that limited capacity in the relevant line ministries reduces the scope for higher quality pro-growth spending.

Monetary and Exchange Rate Policies

22. DAB has delivered on its price stability objective, even though its policy toolkit is constrained by high dollarization. Inflation has been moderate in Afghanistan averaging about 3 percent per year since 2016, reflecting weak domestic demand and prudent monetary policy. Staff emphasized the need to strengthen monetary transmission, including by continued efforts to de-dollarize and broaden the use of domestic currency denominated instruments, to better control monetary conditions in the economy.

Headline Inflation and Reserve Money
(y-o-y change, percent)



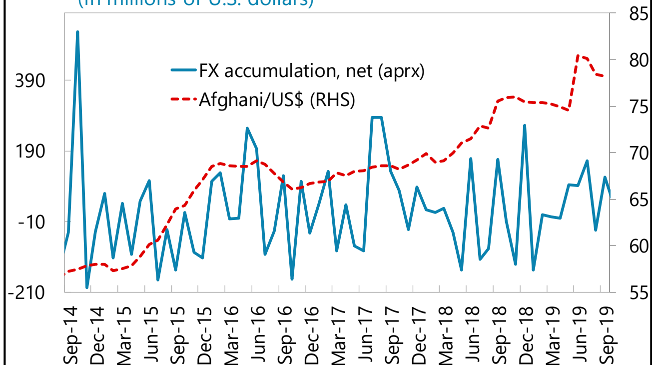
Source: Afghan authorities.

Over time, for effective control over inflation, building DAB's analytical capacity to forecast inflation and thereby promulgate credible inflation forecasts could help anchor inflation expectations. Finally, DAB should also continue to develop its communication strategy to help boost the transparency of its operations.

23. DAB has maintained its commitment to allowing the currency to move in response to market forces, in line with staff's recommendations. Foreign exchange intervention has declined significantly under the current ECF ($2–2.4 billion per year in 2016–18 versus $3.5 billion in 2012–14). In the last two years, DAB preferred to build its reserve buffers, mainly for precautionary reasons given aid volatility along a declining trend and the uncertain political context.

24. The authorities reiterated their commitment to price stability and a flexible exchange rate. DAB will continue to use reserve money and auctions of foreign exchange and the capital notes as instruments to achieve its price stability objectives. The authorities also reiterated their commitment to allow market forces to determine the exchange rate and maintain price stability. They noted that both insecurity and uncertainty had contributed to high exchange rate volatility, compelling DAB to resort to foreign exchange interventions to smooth volatility and mitigate pass-through of imported inflation, given the high import content of domestic consumption. The authorities noted that the proposed introduction of sukuk bonds will greatly contribute to development of domestic financial markets and raise the use of domestic currency. In addition, they agreed that enhancing transparency and communication was important to increase the use of domestic currency. However, they observed that this will take time as high illiteracy rates, limited media penetration, and low financial education would limit the impact of such measures.

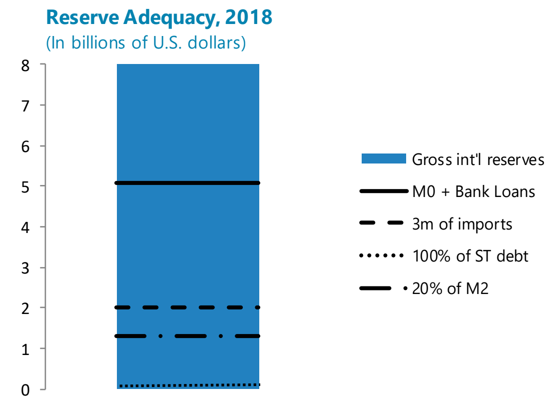
FX Intervention and Exchange Rate
(In millions of U.S. dollars)



Source: Afghan authorities.

External Sector Issues

25. Afghanistan's external position is broadly in line with fundamentals (Annex III). External stability hinges on continued aid inflows and requires steady resilience to external vulnerabilities. The large trade deficit including imports related to security and donor-funded projects has been financed by grants and transfers. Exchange rate developments are dominated by factors separate from competitiveness considerations, including ongoing violence, regional developments, the likelihood of civilian and military aid disbursements, spending by foreign troops, and dollarization developments. The analysis is also hampered by data shortcomings and a high share of the informal economy. Anecdotal evidence suggests that the economic sanctions on Iran had a substantial impact including through a drop in remittances and increased imports from Iran given the Afghani's appreciation against the rial. The authorities have been implementing measures to diversify export destinations (for instance, developing "air corridors") and increase import substitution. In the long term, increased regional integration could alleviate constraints due to the landlocked location and improve economic prospects. The stock of gross foreign reserves exceeds by a large margin all traditional metrics of reserve adequacy with its close to 12-month import coverage. Afghanistan is considered a large net creditor based on the latest International Investment Position due to high foreign reserves and low levels of external public debt.



Sources: Afghan authorities and IMF staff calculations.

26. Afghanistan remains at a high risk of debt distress. As shown in the debt sustainability analysis (DSA), at about 7 percent of GDP, Afghanistan's public debt is currently low and highly concessional, and with a limited amount of concessional borrowing going forward is not projected to become unsustainable under the baseline scenario. More broadly, Afghanistan's debt sustainability is predicated on continued grant inflows, combined with sound fiscal policies and economic reforms. A decline in grants and a shift to debt financing would breach one of the debt burden ratios (debt service-to-exports) in the long term. The debt sustainability challenges underscore the need to sustain efforts to mobilize domestic revenues while raising the efficiency of public spending. The authorities need to enhance their capacity to evaluate prospective financing and monitor/analyze risks to debt sustainability. More reliance on debt-financed investment should be preceded by adoption of a proper project selection process in terms of profitability and priorities. This also includes accounting for and evaluation of government guarantees stemming from future private-public partnerships (PPPs).

27. The authorities concurred with staff's analysis. They noted their intention to keep a high foreign reserve buffer given elevated political and aid uncertainty and import needs. They agreed with continued pursuit of a stronger external position in view of the expected gradual decline of grant inflows. The authorities agreed with the findings of the DSA, including on the need to rely on grants and highly concessional loans to finance their development needs. They emphasized their commitment to increase self-reliance given the prospects of diminishing aid in the long term. They also committed to implement TA advice on recording and monitoring public debt and fiscal risks.

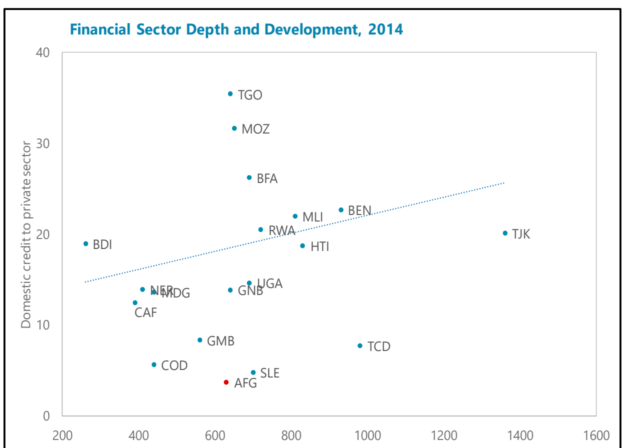
Financial Sector Policies

28. The financial sector remains vulnerable given the high-risk operating environment and capacity challenges. To mitigate risks, DAB is closely monitoring the weak banks in accordance with its weak banks plan. There have been improvements in capital adequacy, governance and liquidity, and NPL clean-up. Staff recommended an independent review of operations, information systems, and asset quality of the high-risk weak banks with the support of the World Bank, to strengthen the credibility of the plan.

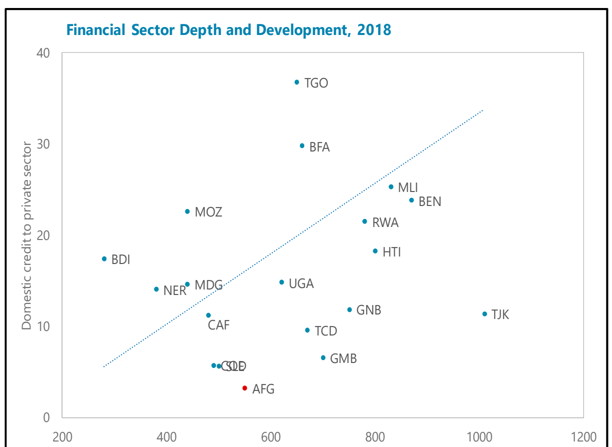
29. DAB is working to strengthen the supervisory framework and financial safety net arrangements. The authorities established the Financial Stability Committee to better manage risks. DAB is extending its supervision to non-bank institutions and plans to introduce prudential risk-based supervision, early warning and stress testing regimes, and improve the deposit insurance framework, as well as to strengthen the bank resolution framework in line with forthcoming IMF TA. While keeping in mind broader financial stability implications that might arise in a worst-case scenario, staff encouraged the development and implementation of coordinated contingency arrangements and strategies for crisis management, including funding that may be required and communication strategy with the public.

30. Unregulated financial institutions are joining the formal financial sector. Approximately 90 percent of financial transactions takes place through informal channels, mainly hawalas. The authorities are encouraging development of agent banking to bring hawalas into the formal sector. Similarly, DAB intends to corporatize money service providers (MSPs) and foreign exchange dealers (FXDs). DAB also plans to coordinate risk management capacity building for all supervised sectors and will be upgrading the collateral infrastructure and contract enforcement regime.

31. Boosting credit to the private sector and deepening financial intermediation are key enablers for higher and more inclusive growth. A "National Financial Inclusion Strategy" (NFIS) developed with World Bank support was launched in September (Box 3). The strategy includes a timebound results-based framework. Staff welcomed the strategy and emphasized the need to improve credit and financial services access for the traditionally disadvantaged groups, particularly women, and cautioned that boosting private sector credit would need to be mindful of financial stability considerations.



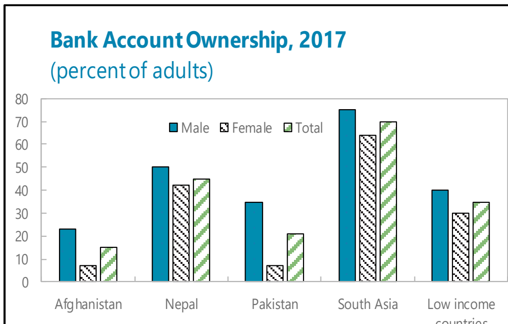
Source: World Bank WDI.



Source: World Bank WDI.

Box 3. Afghanistan's National Financial Inclusion Strategy, 2019–24 1/

Afghanistan is characterized by low financial intermediation and inclusion (FI). In 2017 (the latest year for which such data are available), only about 15 percent of the adult population had a bank account, compared to about 35 percent on average for low income countries. The ratio of loans to deposits was 19.7 percent, domestic deposits to GDP 17.4 percent, and private credit to GDP 3.6 percent—the lowest among peers. Most credit related services are handled by the informal sector through hawalas.

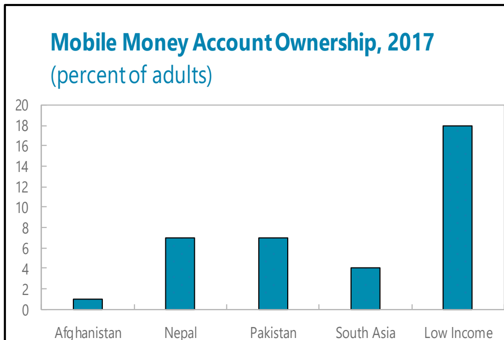


Source: Global Findex Database, World Bank.

The authorities are intensifying efforts to advance FI. FI increases access to finance, thereby raising opportunities for entrepreneurship which should help raise investment, inclusive growth, and employment. In September 2019, the government launched a National Financial Inclusion Strategy (NFIS) prepared with assistance from the World Bank. The government and stakeholders (development partners, public and private financial institutions) will work to agree on an implementation plan for the NFIS by end-2019. The NFIS will be implemented starting in early 2020. The strategy aims to: i) improve access to financial services for individuals, micro, small, and medium enterprises (MSME), ii) develop agriculture finance, iii) increase consumer protection and financial literacy, and iv) develop payment and digital financial services. The NFIS's implementation will be guided by an inter-agency group comprising NFIS Coordination Council, Secretariat, Technical Committee, and various working groups. DAB's Financial Inclusion Department, created in 2016, will head the group.

DAB had undertaken initiatives to improve FI even before the adoption of NFIS. DAB has promoted mobile banking services, relaxed conventional and Islamic banking regulations related to collateral for small and micro loans to lower the cost of lending and implemented prudent credit guarantee schemes to incentivize lending. In addition, DAB is monitoring the impact of its reserve requirements and interest rates and reviewing regulations of risk management, credit administration, and financing of MSME with a view of adjusting them as required to support prudent expansion of financial intermediation. DAB will also be introducing tiered know-your-customer account opening requirements to facilitate small, low risk accounts, improving the payments infrastructure, and continuing phased expansion of the credit information system.

The development of branchless banking and digital accounts could boost FI in Afghanistan. The development of traditional banking requires costly infrastructure. In many low-income countries, agent-based finance in rural regions and digital finance have been advancing FI. The access to mobile services in Afghanistan is one of the lowest in the region—50 mobile money accounts per 1,000 adults in 2018. Significant gains in FI in Afghanistan could therefore be achieved with the help of mobile money. Mobile money could also support equality in access to financial services. The traditional bank accounts display gender disparity as only 7 percent women have a bank account versus 23 percent of men.



Source: Global Findex Database, World Bank.

Significant risks, most notably the on-going conflict, present headwinds to successful NFIS implementation. The risks are present on the supply and demand sides, as was discussed in a workshop co-organized with the World Bank earlier this year that brought together DAB and private sector representatives. On the demand side, the high-risk business environment, low level of financial literacy, lack of collateral, and lack of Sharia compliant financial options have hampered growth of formal financial institutions. On the supply side, poor infrastructure, weak contract laws, and lack of information about creditworthiness of borrowers raise the cost of access to credit. These challenges must be overcome to ensure the success of NFIS implementation in Afghanistan.

1/ Prepared by Gayon Hosin and Boaz Nandwa.

32. The state-owned commercial banks (SOCBs) are being restructured to minimize related financial stability and fiscal risks. The SOCBs account for over one-quarter of the system's assets. The strategy, guided by the World Bank, was adopted in November 2017 and its implementation has progressed haltingly. The authorities have committed to accelerate its implementation including by adopting a new corporate governance framework and individualized operational reform plans. Staff noted that given the systemic importance of the SOCBs and quasi-fiscal risks, it is critical that the reform momentum be accelerated.

33. Staff commended the authorities for extinguishing DAB's lender-of-last resort exposure to the Kabul Bank crisis. With the last transfer to DAB executed at end-September 2019, a major chapter of the Kabul Bank crisis has been closed.[8] Staff emphasized the importance of reviving the recovery of assets stolen during the Kabul Bank crisis, which has stalled at about 40 percent of the estimated total. The acceleration of recoveries was adopted as a structural benchmark for the sixth ECF review (see below).

34. The authorities broadly agreed with staff's views and recommendations. They committed to continue efforts to contain risks in the weak banks and to consult and share information with staff. They agreed that the independent reviews with the World Bank's help would strengthen the effectiveness of the weak banks' plan and committed to continued vigilant enforcement of supervisory standards and adoption of supervisory corrective measures in line with good banking practices. In parallel, they considered that keeping in mind broader financial stability risks that might materialize in a worst-case scenario, development and implementation of coordinated contingency arrangements and strategies for crisis management including funding required and communication with the public was a prudent undertaking. They also reiterated their commitment to implement the SOBCs strategy and to recover the remaining Kabul Bank assets.

B. Structural Reforms: Strengthen the Foundation for Higher and More Inclusive Growth

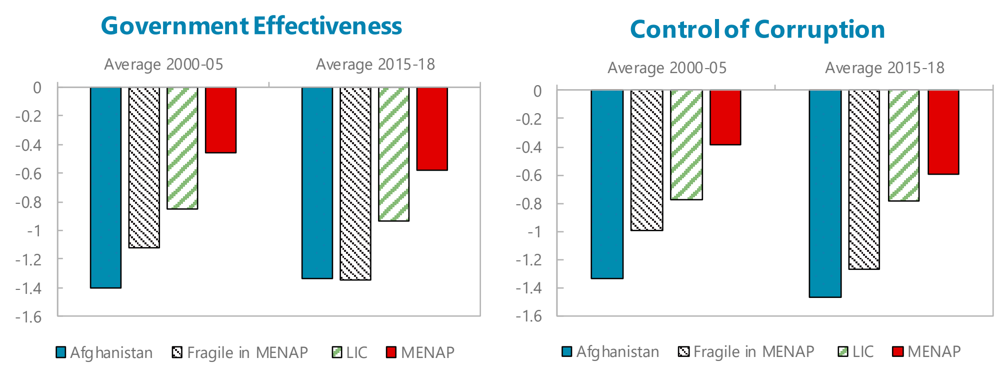
Governance and Corruption

35. Progress notwithstanding, corruption continues to impact confidence and prospects for economic growth (Annex IV). Afghanistan has made some progress, but corruption (particularly in the form of bribe-solicitation and giving) and weak governance continue to hinder the effectiveness of state bodies and undermine confidence in the government. The legal framework to

[8] A small residual amount (about Af 0.2 billion) of principal and accrued interest remains to be paid to the central bank in early 2020 (see MEFP ¶12).

combat corruption is relatively well developed, with the institutional framework still evolving.[9] The authorities have also made several high-level anti-corruption commitments including on asset declarations and the National Anti-Corruption Strategy. However, the multiple and partially overlapping plans and strategies may complicate their implementation and enforcement. Staff noted that enforcement has been progressing but still faces significant challenges and does not always target key corruption risks. The focus should be on implementation and prioritization of existing mechanisms and commitments. Strengthening the institutional structure and building the capacity of anti-corruption bodies should be a priority. Staff advised the authorities to mobilize anti-money laundering/combatting the financing of terrorism (AML/CFT) tools to help identify and recover proceeds of corruption.

Indicators of Governance, 2000–18
(Estimate range from -2.5 (weak) to 2.5 (strong))



Source: Worldwide Governance Indicators.
Note: Estimates of control of corruption are derived from perceptions-based data. Caution is needed when comparing these indicators across countries and over time.

36. The extent of proceeds from illicit activities poses a challenge for financial oversight. Illicit production and trafficking of drugs remains an important part of the economy, estimated by the UN at 6–11 percent of GDP.[10] The extent of illicit proceeds, coupled with the highly unstable environment and financial integrity risks from sanctions on Iran, have pressured correspondent banking relationships (CBRs). As a result, few domestic banks have CBRs, hampering formal cross-border transfers and remittances.

[9] The High Office of Oversight (the old anti-corruption agency) has been replaced by other bodies, including the High Council for Anti-Corruption and the Anti-Corruption Judicial Center (ACJC). A body dedicated to anti-corruption prevention in line with UNCAC article 6 (the Anti-Corruption Commission) has been established, but it has not yet become operational.

[10] 2018 Afghanistan Opium Survey, United Nations Office on Drugs and Crime (UNODC).

37. Strengthening the AML/CFT regime would help mitigate ML/TF risks and support the development of the formal financial sector. With the assistance of the World Bank, Afghanistan has finalized its first national ML/TF risk assessment, and an action plan is being developed for 2020–22. DAB should continue strengthening AML/CFT supervision, including by updating the regulatory framework applicable to banks, MSPs, and FXDs, stepping-up enforcement actions against unlicensed MSPs/FXDs, building supervisory capacity, and offering related training. In addition, the relevant capacity of law enforcement and customs agencies should be reinforced. An AML/CFT risk assessment guideline for banks and a related training needs have also been approved.

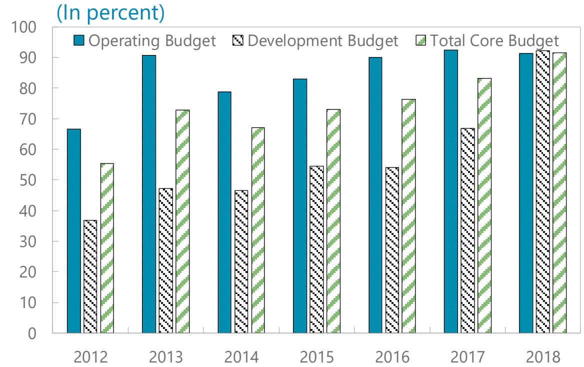
38. The authorities broadly agreed with staff's assessment and reiterated their dedication to fight corruption. They acknowledged the need to prioritize and develop viable benchmarks within realistic deadlines and recognized that capacity building and training (for instance, among law enforcement authorities) would be helpful for enforcement efforts. Efforts are underway to staff the Anti-Corruption Commission and the newly established Offices of the Ombudsman. The authorities noted that digitalization efforts are underway, both in the Administrative Office of the President, as well as other parts of the government. The authorities also confirmed their commitment to the implementation of the AML/CFT measures. They recognized the challenges posed by the illicit economy. DAB places strong emphasis on AML/CFT in its financial sector reform efforts. A three-year strategy, which contains an AML/CFT component, is underway. Staff and the authorities agreed that effectively fighting corruption would also require strengthening governance across a range of state functions (e.g., fiscal governance, financial sector governance, and the business climate) as elaborated below and in Annex IV.

Structural Fiscal Reforms and Fiscal Governance

39. Staff and the authorities discussed progress on fiscal reforms and governance.

- **Improvement in budget execution and project management**: Staff welcomed much improved execution rates in the development budget over the past few years.[11] The authorities have made the budget an effective policy tool, which requires sustaining improvements in execution rates and the commitment to a realistic multi-year development framework. The authorities have increased transparency in the budget execution process by tracking contractual commitments through the Afghanistan Financial Management Information System

Budget Execution Rates
(In percent)



Source: Afghan authorities.

[11] The execution rate in the development budget at end-2018 was about 93 percent.

(AFMIS) in line with the related third review structural benchmark. They have also bolstered customs administration in regional offices, a benchmark in the fourth review, by adopting risk-based customs clearance procedures to improve the detection of fraud. In addition, revenue developments are reported online in near-real time.[12] Staff also welcomed the authorities' intention to further strengthen public investment management, thereby improving the management of resources and boosting the government's ability to fill infrastructure gaps in the future.

- **Improvement in transparency and oversight of state-owned corporations (SOCs)**: There are about 54 active SOCs[13] including three SOCBs, nearly all of which need better accounting practices and reporting standards. The authorities adopted a new State-Owned Corporation Law in line with the benchmark in the fourth review to improve management of fiscal risks and strengthen the governance of public corporations. These efforts are advancing and recently the authorities shared with staff income statements and balance sheets of the five largest SOCs to illustrate their efforts to improve the governance and transparency of SOCs. Staff also encouraged the authorities to amend the relevant public financial management (PFM) law to strengthen fiscal risk oversight over SOCs. Regarding the extractive sector, Afghanistan is expecting the second Extractive Industries Transparency Initiative (EITI) validation to commence in July 2020. This follows its suspension in January 2019 when the first EITI validation concluded that Afghanistan had made "inadequate progress" implementing the EITI Standard. In the meantime, Afghanistan has advanced efforts in reporting on the mining industry as agreed with the EITI.

- **Development of PPPs**: The authorities adopted a new PPP Law in line with the fourth review structural benchmark to improve the identification and management of fiscal and contingent risks connected with PPP activities. The authorities plan to increase their reliance on PPPs to improve infrastructure financing and delivery. While it requires the Ministry of Finance to become a key player in supporting the development of PPPs, clear recognition of financial implications of PPPs seems lacking. Availability of detailed information on the contingent liabilities emanating from PPPs would support this development.

- **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 2020. 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.

[12] Revenue developments are available online at https://ard.gov.af/?s=english&c=fy-1398-current-revenue-collection-reports.

[13] In public security, construction, transport, agriculture, and extractive industries.

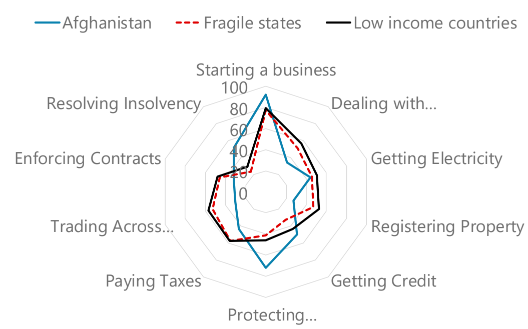
- **Afghanistan's budget, in its design and presentation, is approaching international standards**. Afghanistan had the best rating (49/100 compared to 21/100 in 2010) in the 2017 Open Budget Index among South Asian countries. Since 2018, the budget includes information of past performance and medium-term fiscal projections. It also includes details about the ministries, projects, and provinces. In 2018, the authorities abandoned carry-over of unspent amounts from year to year, thereby improving the realism of projections and the control of corruption. The budget also includes discussions of projections of major macroeconomic variables, the evaluation of contingent liabilities, contingency measures, and a critical review of the budget's gender responsiveness. The citizen's budget is available online.[14]

40. The authorities shared staff's views and noted that capacity constraints would likely limit progress in some areas and expressed interest in a related TA. The authorities noted that improved budget execution reflected their effort for more effective project appraisal and selection (e.g., dropping poorly performing projects in favor of those ready for execution), timely budget approval, adoption of a new digital disbursement system, and timely payment execution. They committed to improved transparency and oversight of the SOCs. However, amending the relevant PFM law by end-2019 would not be possible because of limited capacity amplified by the institutional changes and the constraints on legislative process due to the presidential elections. Finally, they explained that developing capabilities for quantification of contingent liabilities from PPP has not progressed so far due to capacity constraints.

Business Climate

41. The business environment needs improvement. Infrastructure gaps, insecurity, weak governance and institutions prevent Afghanistan from becoming a transit hub and attractive investment destination. In 2019, Afghanistan ranked 167th out of 190 in the World Bank's Doing Business index, a notable improvement from 183rd position in 2018.[15] However, areas such as starting business, enforcing contracts, registering property, and protecting minority investors still have particularly low rankings due to issues with timeliness and quality of judicial proceedings (e.g., case management). Judicial reform measures to streamline court proceedings and reduce corruption vulnerabilities are underway and should continue. Further, Afghanistan ranks poorly

Doing Business Indicators
(distance to frontier, 2019)



Source: World Bank Doing Business Database.

[14] See: https://www.budgetmof.gov.af/index.php/en/2012-12-06-22-51-13/national-budget.

[15] Similarly, The Heritage Foundation Index of Economic Freedom has shown an upward trend since 2017 when Afghanistan's economic freedom was graded for the first time. The 2019 improvement was led by advances in labor freedom, property rights protection, and judicial effectiveness.

relative to its peers in terms of quality of education and gender equality. Skills mismatch and gender inequality will thus increasingly become an obstacle to competitiveness and strong inclusive growth. Institutional reform is also needed to enhance the role of the private sector as a driver of strong and sustained private sector-led growth.

42. The authorities agreed with staff views. They noted economic fragility, conflict, and insecurity posed formidable obstacles to conditions for doing business. Nevertheless, they are committed to continue structural reforms to improve the business environment. Authorities also noted that they are working with development partners on reforms that would buttress investor protection laws.

Other Issues

43. Data quality and availability needs to continue to improve (Annex V). The national accounts, the external sector data, and price statistics suffer from weaknesses in coverage, consistency, and frequency. The authorities confirmed their on-going interest in follow-up TA in these areas.

SIXTH REVIEW UNDER THE ECF ARRANGEMENT

44. Program performance was satisfactory.

a. All end-June 2019 quantitative performance criteria and September indicative targets were met, some with notable overperformance (MEFP ¶12, Table 14).

b. Six out of seven structural benchmarks were met (MEFP ¶12, Table 15). The benchmark on reinvigorating the Kabul Bank asset recovery was not met because of difficulties in selecting the forensic audit firm. The authorities implemented it during October and November. On October 13, they contracted a major international accounting firm which, on November 15 delivered an interim report on their forensic audit of the Kabul Bank assets recovery process. On November 20, the firm delivered a final report with a list of SMART[16] recommendations. The timeline for implementation of recommendations ranges from an immediate implementable action to ones to be carried out in six months or more. The recommendations include measures to improve effectiveness and operation of the receivership unit. The authorities have already advanced the implementation of several recommendations and are committed to its speedy progress. The process is shepherded by DAB's senior management.

[16] SMART= Specific+Measurable+Achievable+Realistic+Timely.

45. The completion of the sixth review under the ECF arrangement would mark the first time that Afghanistan has successfully completed all reviews under a Fund financial arrangement since 2003 when it cleared its arrears to the Fund. The 2016-19 ECF arrangement contributed to preserving macroeconomic stability, improving economic governance, and laying the basis for stronger private sector activity. With four out of five success indicators met, as shown in the table, the program can be considered successful. It supported progress towards self-reliance and catalyzed donor assistance while helping to sustain reform momentum. Under the program: the domestic revenue intake has improved by more than 3 percentage points of GDP, contributing to near-zero fiscal balances and healthy cash reserves; inflation remained contained at below 5 percent; and the financial sector's resilience improved as DAB deployed its expanded supervisory and crisis management toolkits. The ECF supported the strengthening of the policy making framework, including through the adoption of anti-corruption legislation, legislation to manage state assets and control related risks, the establishment of the Financial Stability Committee to ensure MOF-DAB coordination, and relieving DAB from the impact of the 2011 liquidation of Kabul Bank by extinguishing the lender-of-last resort exposure. Similarly, fiscal institutions have been strengthened through a more transparent and realistic budget, supported by a medium-term fiscal framework. The ECF arrangement and ANPDF have established a good foundation to continue to tackle the challenges of lackluster growth and widespread poverty (see ¶1, 8 above). While growth and social development outcomes continue to disappoint, without a lasting cessation of violence it will be difficult to make significant inroads into poverty and unemployment. Afghanistan and the international community need to continue to work together to overcome these challenges.

Indicators of Program Success 1/

(In percent of GDP; unless otherwise indicated)

	2016	2017	2018	Average	Met
2016 program request projections					
Anti-poverty spending	IT	IT	IT	...	...
Capital expenditure	7.5	7.7	8.0	...	...
Domestic fiscal revenue	10.3	10.7	11.0	...	...
Inflation (average; in percent)	4.5	6.0	7.0	...	...
GDP growth (in percent)	2.0	3.4	4.3	...	...
Outcome					
Anti-poverty spending	IT met	IT not met	IT met	...	...
Capital expenditure	7.1	7.6	8.8	...	...
Domestic fiscal revenue	10.7	12.4	13.3	...	...
Inflation (average; in percent)	4.4	5.0	0.6	...	...
GDP growth (in percent)	2.2	2.9	2.7	...	...
Outcome less 2016 program request projection					
Anti-poverty spending	1.0	-1.0	1.0	0.3	yes
Capital expenditure	-0.4	-0.1	0.8	0.1	yes
Domestic fiscal revenue	0.4	1.7	2.3	1.5	yes
Inflation (average; in percent)	-0.1	-1.0	-6.4	-2.5	yes
GDP growth (in percent)	0.2	-0.5	-1.6	-0.6	no

Note: IT=indicative target. Indicators are considered met when the average projection error (actual minus projected) for 2016-18 has a favorable sign. ECF approved mid-2016. 1st program review considered end-2016 outcomes.

1/ See "2018 Review of Program Design Conditionality" for PRGT programs methodology.

46. The authorities agreed that the ECF arrangement achieved its objectives (LOI, MEFP ¶3, 12). Going forward, they remain committed to the policies that have supported macroeconomic stability and catalyzed donor support (MEFP ¶13, 15) and to structural reforms that advance their agenda to fight corruption, strengthen institutions, and boost self-reliance while laying the foundation for higher and more inclusive growth including for women and disadvantaged groups (MEFP Section D).

47. The calibration of the program and the capacity to repay the Fund remain adequate (Table 11). The program is fully financed. The current and projected levels of reserves are adequate, and the public debt outlook is sustainable contingent on continued donor support. Upon completion of the sixth review, a disbursement of SDR 5.38 million would be made.

STAFF APPRAISAL

48. Afghanistan continues to face deep-seated challenges in its transition to self-reliance. Sustained violence and political uncertainty continue to undermine confidence and investment, hindering the country's drive for self-reliance and development. Given the large development needs, policies should remain focused on preserving macroeconomic stability, strengthening institutions, and accelerating reform momentum to prepare the ground for sustainable private sector-led growth. Continued financial support by donors with multi-year commitments to facilitate budget planning is needed to help preserve macroeconomic stability, support reforms, and finance security and development needs.

49. Higher and more inclusive growth is required to create jobs and reduce poverty. Growth is projected at 3 percent in 2019, rising modestly to 4 percent in the medium term, insufficient to significantly reduce poverty and create enough jobs for the growing population. Risks to the outlook are on the downside, and include intensified violence, heightened political uncertainty due to a potentially long-drawn out political transition following the presidential elections, a significant drop in aid, and reform fatigue. If these risks materialize, gains made in recent years could be lost or even reversed. On the upside, durable peace would improve economic prospects significantly by increasing confidence needed to spur increased private sector activity.

50. Under these challenging circumstances, continued macroeconomic policy discipline complemented by structural reforms is needed. Macroeconomic policies that instill fiscal discipline, stabilize inflation, support a flexible exchange rate, and safeguard financial stability are critical to ensure credibility with domestic and international stakeholders. Reforms to strengthen institutions, build capacity, and fight corruption will be needed to strengthen the economy's resilience to continuing stress due to violence and to harness a possible peace dividend, should that opportunity present itself. At the same time, economic development plans currently being considered should be grounded in a robust and sustainable macro-fiscal framework that takes into account Afghanistan's still limited debt carrying capacity and its high risk of debt distress. The latter consideration argues for continued reliance on grants and highly concessional borrowing, supplemented by efforts to strengthen capacity in debt management and assessment of investment projects.

51. The government's strategy of attaining self-reliance through domestic revenue mobilization combined with expenditure restraint should continue going forward. The overall balance including grants should remain the fiscal anchor preserving a broadly balanced budget (including grants), a prudent cash buffer, and low public debt. This policy should be supplemented with a gradual reduction of the operating deficit before grants to prudently use domestic resources, shift expenditure composition toward pro-growth and pro-poor outlays and create fiscal space to meet the country's considerable development needs. Structural fiscal reforms should target sustainable revenue collection with an expanding tax base, increased efficiency, and VAT introduction as planned by early 2021. The authorities should also gain command over public assets, fully account for contingent and noncontingent liabilities, and develop the financial infrastructure, including Sharia compliant instruments, to harness domestic savings for development.

52. Monetary policy remains appropriately focused on price stability, supported by exchange rate flexibility. The current monetary policy framework, combined with exchange rate flexibility, continues to serve Afghanistan well in containing inflationary pressures while maintaining a high international reserves buffer. Foreign exchange intervention should be deployed only to help smooth out unexpected exchange rate volatility.

53. Safeguarding financial stability remains a key policy priority. DAB should continue to address the shortcomings among the weak private banks and strengthen the framework for crisis prevention and resolution. The implementation of the strategy to reform the SOCBs through both a new corporate governance framework and individualized operational reform plans should continue apace. The authorities' intention to foster financial intermediation through the implementation of the NFIS, including for disadvantaged groups such as women and rural populations, should remain on schedule. Unregulated financial entities should be brought fully under the supervision of DAB.

54. Progress on anti-corruption legislation and institutions is encouraging but needs to be cemented with implementation. Progress notwithstanding, corruption in the public sector is perceived as widespread and considered by both domestic and international stakeholders as one of the country's intractable challenges. The on-going anti-corruption efforts need to be properly prioritized in cooperation with donors and based on a solid institutional framework with independent agencies. The government has enacted an Anti-Corruption Law and updated the National Strategy for Combatting Corruption. The remaining gaps in the criminalization of corruption offences should be closed swiftly. The newly established institutions should be staffed and operationalized as a priority. The digitalization of records, processes, and procedures should be introduced as a priority to increase efficiency of anti-corruption measures.

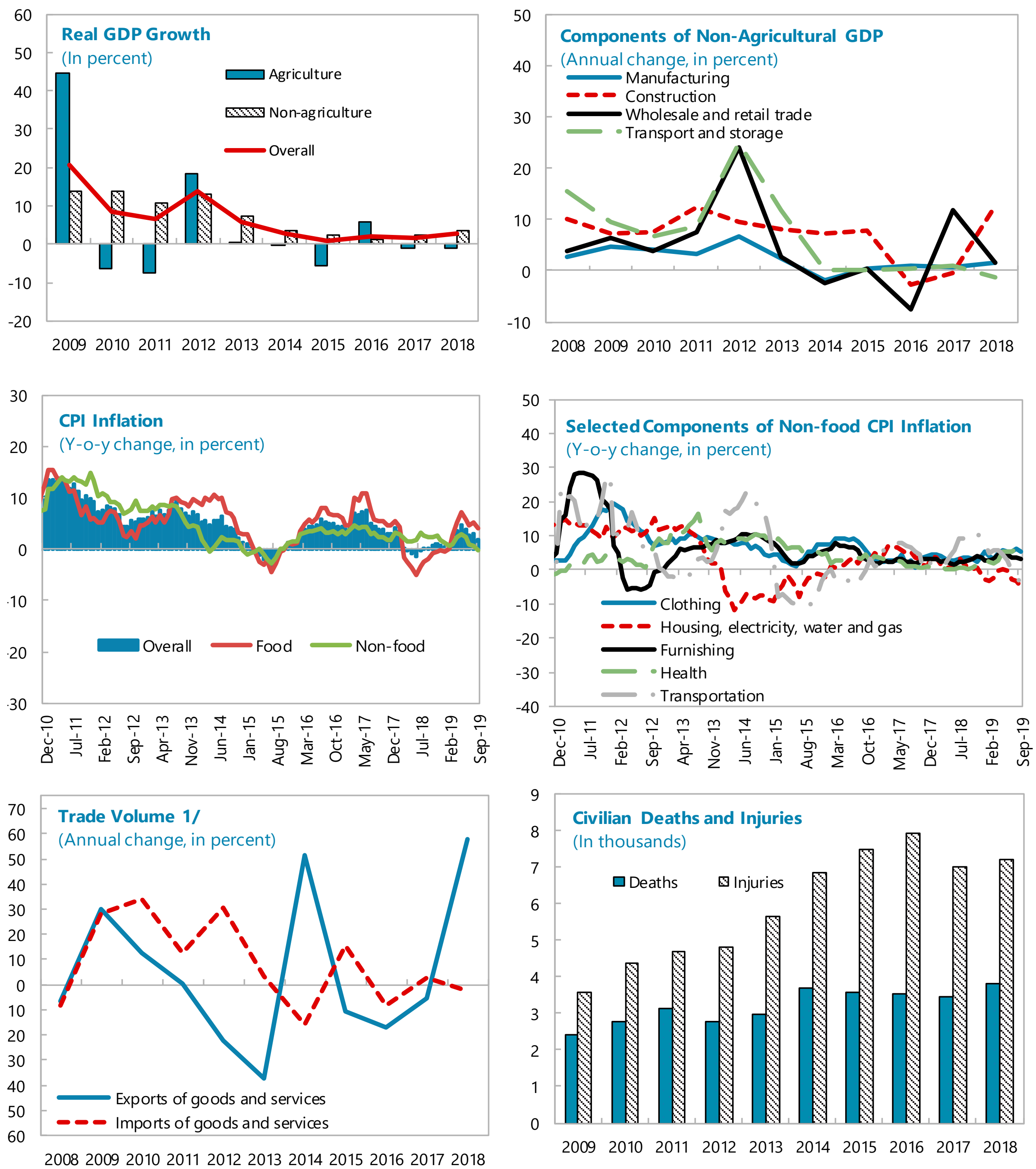
55. Addressing structural headwinds to improve business environment is important to catalyze private sector-led growth and achieve higher and more inclusive growth. Insecurity, large infrastructure gaps, lack of access to financial services, weak regulatory framework and institutions, and a dearth of skilled labor hamper Afghanistan's competitiveness and attractiveness as an investment destination. The authorities should redouble their efforts to improve the business environment by strengthening governance and the regulatory framework and implementing the NFIS to boost financial inclusion, especially for women.

56. The quality and timeliness of economic data hinders assessment of the economy and policies. Reliable statistics are critical for sound economic policy-making. There are deficiencies in real and external sector statistics, and IMF TA will continue to be available in these and other areas.

57. Staff supports the completion of the sixth (final) review under the ECF arrangement given the satisfactory performance. Staff welcomes the authorities' commitment to continue with disciplined policies and reforms following the expiration of the ECF at end-2019.

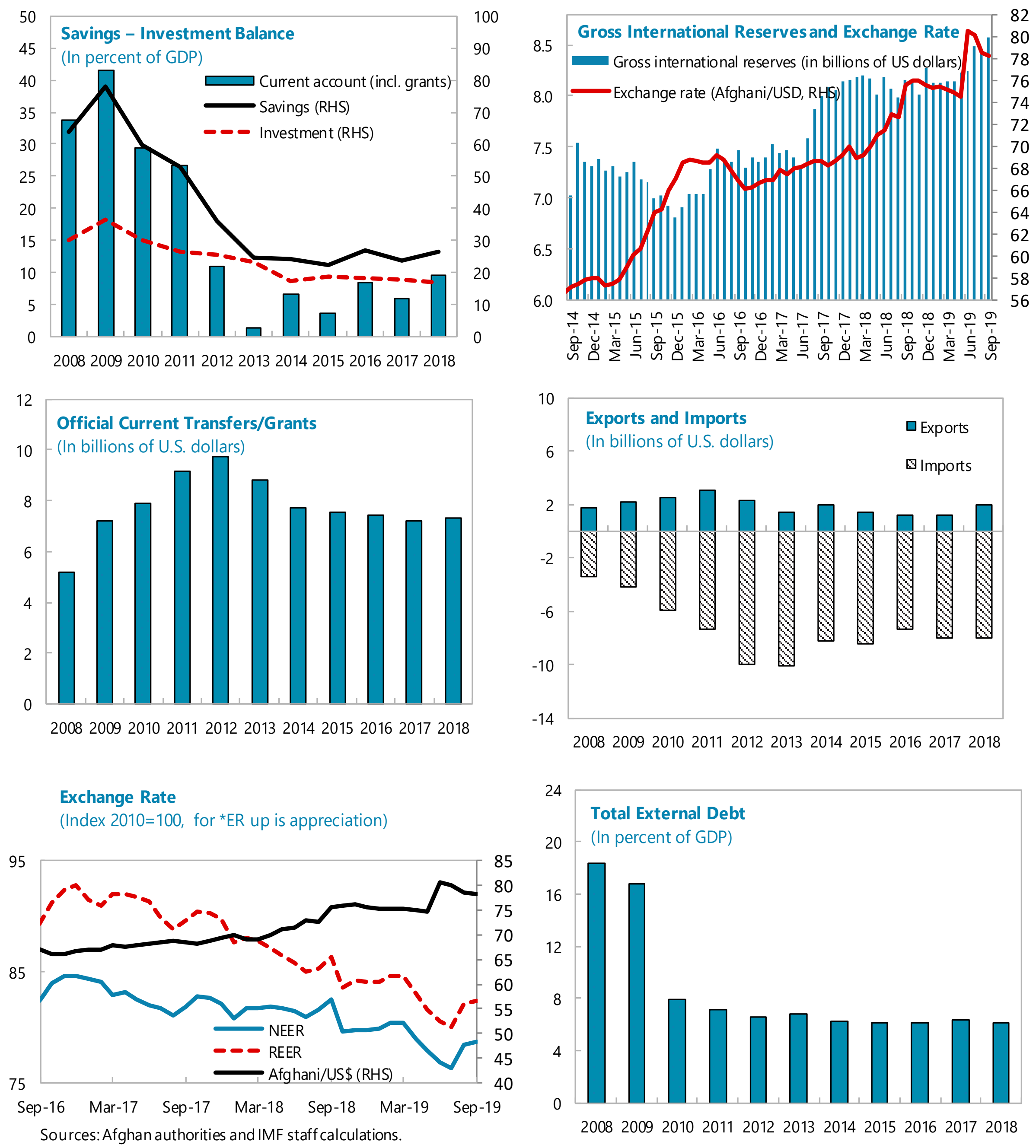
58. Staff proposes that the next Article IV consultation with Afghanistan take place on the standard 12-month cycle.

Figure 1. Islamic Republic of Afghanistan: Real Sector



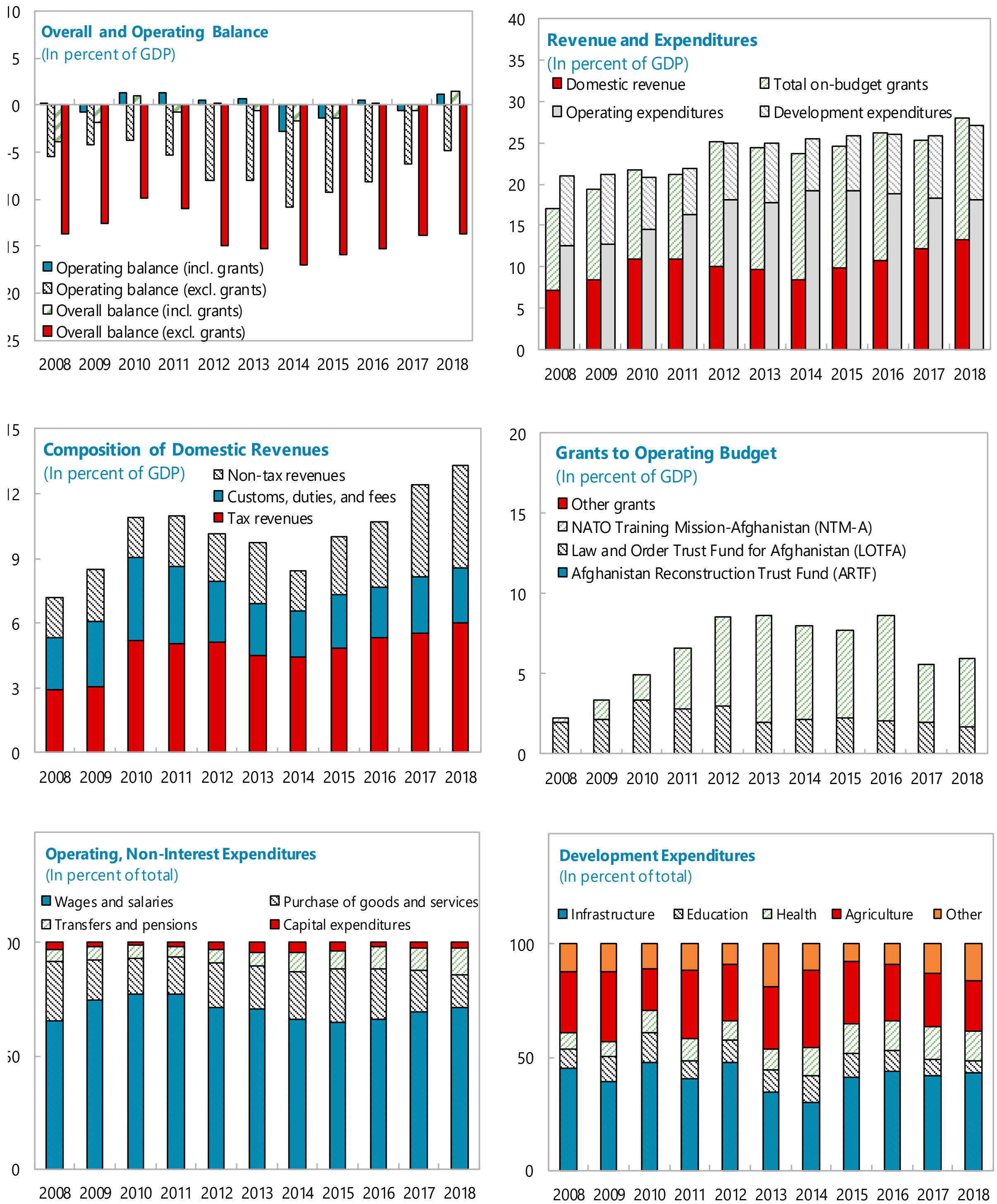
Sources: Afghan authorities, United Nations Assistance Mission in Afghanistan, and IMF staff calculations.
1/ In 2016, the decline in exports volumes reflects a fall in growth of services exports for two reasons: the fall in imports growth (insurance and freight are recorded as service exports) and in 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



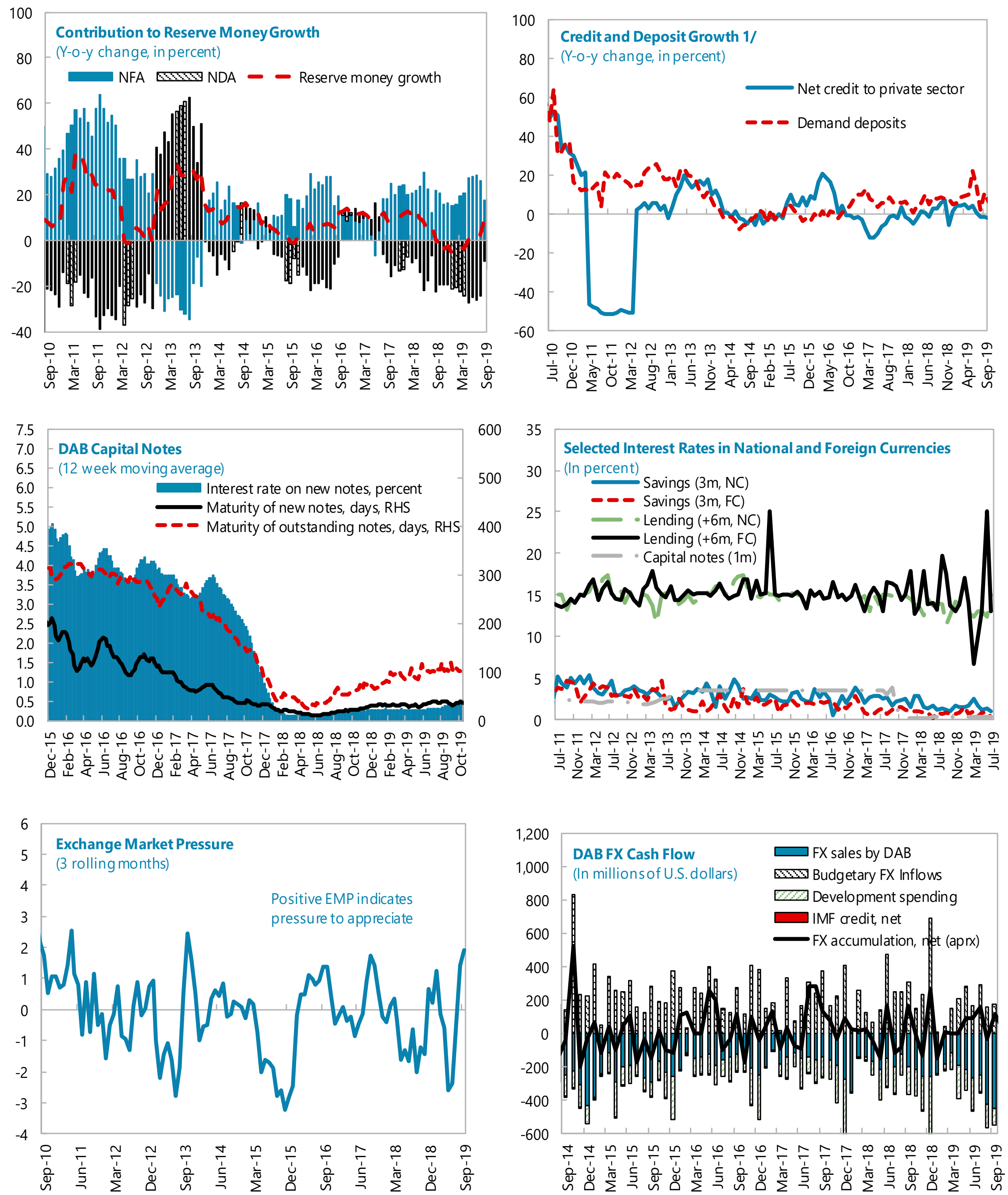
Sources: Afghan authorities and IMF staff calculations.

Figure 3. Islamic Republic of Afghanistan: Fiscal Sector



Sources: Afghan authorities and IMF staff calculations.

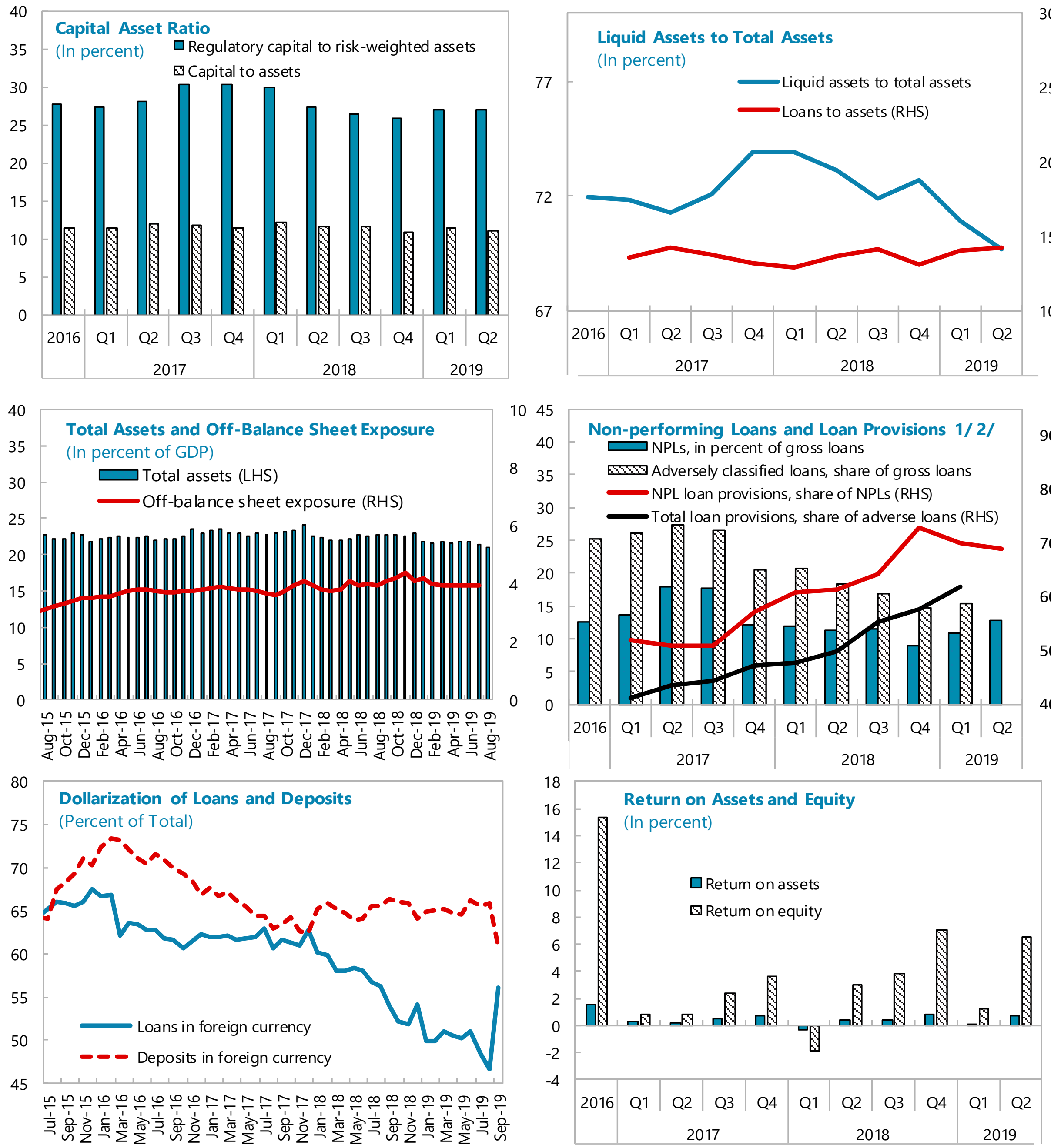
Figure 4. Islamic Republic of Afghanistan: Monetary Sector



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.

1/ NPL's include loans 121 to 481 days or more past due for payment of principal and/or interest. This differs from the IMF's FSI Guide which recognizes loans 90 days or more past due payment of interest or principal as NPLs.

2/ Adversely classified loans include loans classified as substandard, doubtful and loss - 60 to 481 days or more past due for payment of principal and/or interest.

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2016–20

(Quota: SDR 323.8 million)
(Population: approx. 34.7 million; 2016)
(Per capita GDP: approx. US$547; 2018)
(Poverty rate: 54.5 percent; 2016-2017)
(Main exports: dried and fresh fruits and vegetables, medical seeds, 2018)

	2016	2017	2018	2019	2020
				Proj.	Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)				
Real GDP	2.2	2.9	2.7	3.0	3.5
Nominal GDP (in billions of Afghanis)	1,318	1,356	1,426	1,500	1,612
Nominal GDP (in billions of U.S. dollars)	19.4	19.9	19.7	19.2	19.4
Consumer prices (period average)	4.4	5.0	0.6	2.1	3.9
Food	5.7	6.9	-0.3	…	…
Non-food	3.2	3.2	1.8	…	…
Consumer prices (end of period)	4.6	3.0	0.8	3.5	4.2
Investment and savings	(In percent of GDP)				
Gross domestic investment	18.4	17.7	17.0	16.6	17.7
Of which: Private	5.4	5.7	5.4	6.5	7.0
Gross national savings	26.8	23.6	26.5	18.6	19.1
Of which: Private	13.7	12.3	13.4	8.4	8.7
Public finances (central government)					
Domestic revenues and grants	26.1	25.7	28.5	27.0	26.5
Domestic revenues	10.7	12.4	13.3	13.9	12.9
On-budget grants (excl. donors' direct spending outside the budget)	15.4	13.2	15.1	13.1	13.6
Expenditures	26.0	26.3	26.9	26.9	26.8
Operating 2/	18.9	18.7	18.1	19.3	17.7
Development	7.1	7.6	8.8	7.6	9.1
Operating balance (excluding grants) 3/	-8.2	-6.2	-4.8	-5.4	-4.8
Overall balance (including grants)	0.1	-0.6	1.5	0.1	-0.3
Public debt 4/ 5/	7.8	7.6	6.9	7.3	7.9
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)				
Reserve money	11.8	10.2	-2.7	10.3	9.9
Currency in circulation	10.6	2.2	-0.2	8.0	8.0
Broad money	5.6	5.9	2.6	9.0	9.0
Interest rate, 28-day capital note (in percent)	3.0	3.0	3.0	…	…
External sector 1/	(In percent of GDP, unless otherwise indicated)				
Exports of goods (in millions of U.S. dollars)	614	784	875	948	1027
Exports of goods (annual percentage change)	6.3	27.6	11.6	8.3	8.3
Imports of goods (in millions of U.S. dollars)	6,263	6,737	6,596	6,817	6,914
Imports of goods (annual percentage change)	-14.2	7.6	-2.1	3.4	1.4
Merchandise trade balance	-29.1	-29.9	-29.0	-30.6	-35.0
Current account balance					
Excluding official transfers	-29.9	-30.3	-27.5	-32.2	-32.2
Including official transfers	8.4	5.9	9.6	2.0	1.4
Foreign direct investment	0.4	0.2	0.4	0.5	0.5
Total external debt 4/	6.1	6.4	6.4	7.3	7.9
Gross international reserves (in millions of U.S. dollars)	7,357	8,139	8,273	8,298	8,297
Import coverage of reserves 6/	11.1	12.2	12.0	11.8	11.5
Exchange rate (average, Afghanis per U.S. dollar)	67.9	68.1	72.4	…	…
Real exchange rate (average, percentage change) 7/	-7.1	2.5	-8.2	…	…

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 time of commitment.
5/ Public debt includes 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, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Proj.			
Output and prices 1/	(Annual percentage change, unless otherwise indicated)								
Real GDP	2.2	2.9	2.7	3.0	3.5	4.0	4.0	4.0	4.0
Nominal GDP (in billions of U.S. dollars)	19.4	19.9	19.7	19.2	19.4	20.6	22.1	23.9	25.9
Consumer prices (period average)	4.4	5.0	0.6	2.1	3.9	4.6	5.0	5.0	5.0
Investment and savings	(In percent of GDP, unless otherwise indicated)								
Gross domestic investment	18.4	17.7	17.0	16.6	17.7	17.1	18.5	19.8	19.9
Of which: Private	5.4	5.7	5.4	6.5	7.0	7.1	8.1	8.9	9.0
Gross national savings	26.8	23.6	26.5	18.6	19.1	17.7	16.0	16.3	15.8
Of which: Private	13.7	12.3	13.4	8.4	8.7	7.7	5.6	5.5	4.9
Public finances (central government)									
Domestic revenues and grants	26.1	25.7	28.5	27.0	26.5	27.7	29.2	30.7	31.0
Domestic revenues	10.7	12.4	13.3	13.9	12.9	14.0	15.3	16.6	16.9
On-budget grants (excl. donors' direct spending outside the budget)	15.4	13.2	15.1	13.1	13.6	13.7	13.9	14.1	14.1
Expenditures	26.0	26.3	26.9	26.9	26.8	27.7	29.2	30.7	31.0
Operating 2/	18.9	18.7	18.1	19.3	17.7	18.5	19.8	20.8	20.8
Development	7.1	7.6	8.8	7.6	9.1	9.2	9.4	9.9	10.2
Operating balance (excluding grants) 3/	-8.2	-6.2	-4.8	-5.4	-4.8	-4.5	-4.5	-4.2	-3.9
Overall budget balance (including grants)	0.1	-0.6	1.5	0.1	-0.3	0.0	0.0	0.0	0.0
External sector 1/									
Merchandise trade balance	-29.1	-29.9	-29.0	-30.6	-30.3	-28.8	-28.8	-27.2	-25.3
Current account balance, excluding official grants	-29.9	-30.3	-27.5	-32.2	-32.2	-30.7	-31.3	-29.7	-28.0
Current account balance, including official grants	8.4	5.9	9.6	2.0	1.4	0.6	-2.5	-3.4	-4.0
Gross reserves (in millions of U.S. dollars)	7,357	8,139	8,273	8,298	8,297	8,296	8,295	8,294	8,292
Import coverage of reserves 4/	11.1	12.2	12.0	11.8	11.5	10.6	10.3	9.9	9.5
Memorandum items:									
Total public debt 5/	7.8	7.6	6.9	7.3	7.9	8.2	8.5	8.8	9.2
Of which: External debt	6.1	6.4	6.4	7.3	7.9	8.2	8.5	8.6	8.9
Domestic debt	1.7	1.1	0.5	0.0	0.0	0.0	0.1	0.2	0.4
Sukuk	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.4
Promissory note	1.7	1.1	0.5	0.0	0.0	0.0	0.0	0.0	0.0
GDP per capita (in U.S. dollars) 6/	561	561	547	525	525	549	582	619	663
Donors' direct spending outside the budget	22.8	23.0	21.9	21.2	20.0	17.5	14.8	12.2	9.9

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 3. Islamic Republic of Afghanistan: Poverty, Vulnerability, Inequality, and Social Indicators

	Afghanistan	Somalia	DRC	Iraq	Sudan	LICs average
Poverty						
Working poor at PPP$3.10 a day (% of total employment)	98.2	71.3	90.5	31.6	23.2	69.8
Multidimensional poverty index (MPI)	0.273	0.518	0.378	0.059	0.280	0.362
Population in multidimensional poverty, headcount (%)	56.1	82.2	72.5	14.7	52.4	65.4
Population in multidimensional poverty, headcount (thousands) (for the year of the survey)	19442	8813	53417	4650	19773	13965
Population in multidimensional poverty, headcount (thousands) (projection for 2016)	19442	11773	57050	5453	20738	14742
Population in multidimensional poverty, intensity of deprivation (%)	48.7	62.9	52.2	40.0	53.4	54.0
Population in severe multidimensional poverty (%)	25.1	67.5	42.2	3.0	30.9	40.7
Population living below income poverty line, PPP $1.90 a day (%)	...	...	77.1	2.5	14.9	45.8
Internet users, total (% of population)	10.6	1.9	6.2	21.2	28.0	11.3
Mobile phone subscriptions (per 100 people)	62.3	46.5	36.7	81.2	70.3	64.1
Vulnerability						
Population vulnerable to multidimensional poverty (%)	18.0	8.7	17.7	7.9	17.6	16.9
Vulnerable employment (% of total employment)	66.1	72.3	53.5	35.2	40.5	75.3
Homeless people due to natural disaster (average annual per million people)	227	158	31	7	869	266
Refugees by country of origin (thousands)	2621.1	986.4	611.9	360.6	691.4	292.4
Young age (0-14) dependency ratio (per 100 people ages 15-64)	79.8	91.3	91.3	71.6	73.4	80.0
Inequality/Gender inequality						
Gender Inequality Index (GII)	0.653	...	0.652	0.506	0.564	0.584
Human Development Index (HDI), female	0.36	...	0.42	0.60	0.45	0.43
Human Development Index (HDI), male	0.583	...	0.493	0.733	0.537	0.498
Health						
Child malnutrition, stunting (moderate or severe) (% under age 5)	40.9	25.3	42.7	22.1	38.2	34.8
Infants lacking immunization, DPT (% of one-year-olds)	27	48	18	27	2	15
Infants lacking immunization, measles (% of one-year-olds)	38	54	20	29	10	25
Mortality rate, infant (per 1,000 live births)	53	83	72	26	45	52
Mortality rate, under-five (per 1,000 live births)	70.4	132.5	94.3	31.2	65.1	76.5
Malaria incidence (per 1,000 people at risk)	30.8	60.2	291.9	0.0	35.3	192.9
Mortality rate attributed to household and ambient air pollution (per 100,000 population)	211.1	212.8	163.9	75.1	184.9	190.0
Mortality rate attributed to unsafe water, sanitation and hygiene services (per 100,000 population)	13.9	86.6	59.8	3.0	17.3	46.8
Education						
Expected years of schooling (years)	10.4	...	9.8	11.0	7.4	9.5
Gross enrolment ratio, primary (% of primary school-age population)	105	24	108	108	74	101
Literacy rate, adult (% ages 15 and older)	32	...	77	44	54	49
Population with at least some secondary education (% ages 25 and older)	25.1	...	50.7	47.7	17.0	24.1
Government social ependitures						
Current health expenditure (% of GDP)	10.3	...	4.3	3.4	6.3	6.9
Government expenditure on education (% of GDP)	3.2	...	2.3	...	1.6	3.8
Ratio of education and health expenditure to military expenditure	13.6	...	5.1	...	1.3	7.9

Sources: UNDP Human Development Reports (2018) and IMF staff calculations.

Table 4a. Islamic Republic of Afghanistan: Central Government Budget, 2016–24

(In billions of Afghanis)

	2016	2017	2018	2019 Initial Budget	2019 Revised Budget	2019 ECF 5th Review	2019 Proj.		2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Revenues and grants	344.3	347.8	405.9	387.0	411.8	387.7	405.5	5/	427.6	486.0	562.0	651.0	727.9
Domestic revenues	141.1	168.3	189.9	188.0	209.0	188.0	209.0	5/	208.6	245.5	294.4	352.1	397.0
Tax revenues	101.2	110.5	121.8	127.1	115.1	118.7	121.6		132.2	159.8	201.2	224.0	258.3
Income, profits, and capital gains	36.4	38.7	48.4	45.7	41.9	…	…		…	…	…	…	…
International trade and transactions	31.1	35.7	36.3	40.8	37.6	…	…		…	…	…	…	…
Goods and services	27.9	32.8	34.2	37.4	33.7	…	…		…	…	…	…	…
Other	5.8	3.2	2.9	3.3	1.8	…	…		…	…	…	…	…
Nontax revenues	39.9	57.8	68.0	60.9	93.9	69.3	87.4	5/	76.4	85.7	93.2	128.1	138.7
Grants to operating budget 1/	143.1	76.1	84.6	98.8	98.8	98.8	98.8		107.7	119.5	133.0	148.3	164.1
ARTF	0.0	0.0	0.0	0.0	0.0	…	…		…	…	…	…	…
LOTFA	27.4	27.2	25.0	28.0	28.0	…	…		…	…	…	…	…
CSTC-A	86.8	48.9	59.6	70.8	70.8	…	…		…	…	…	…	…
Other grants	0.0	0.0	0.0	0.0	0.0	…	…		…	…	…	…	…
Grants to development budget 2/	89.1	103.5	131.4	100.2	104.0	100.8	97.7		111.2	121.0	134.7	150.6	166.8
Total expenditures	342.8	356.5	384.2	399.4	424.4	399.4	403.8		432.1	486.0	562.0	650.9	727.9
Operating expenditures	248.9	253.0	258.1	275.2	297.4	273.5	289.5		285.4	324.4	380.9	441.1	488.6
Of which: Security	153.0	138.9	139.6	159.5	156.2	…	…		…	…	…	…	…
Wages and salaries	164.5	174.2	183.6	195.6	200.8	…	…		…	…	…	…	…
Purchases of goods and services	55.0	47.9	37.6	53.6	60.7	…	…		…	…	…	…	…
Transfers, subsidies, and other	2.2	2.7	2.6	0.0	0.0	…	…		…	…	…	…	…
Pensions	21.5	22.1	27.4	17.4	24.9	…	…		…	…	…	…	…
Capital expenditures	4.9	5.3	6.2	6.3	8.2	…	…		…	…	…	…	…
Interest	0.8	0.9	0.8	2.3	2.8	0.7	0.8		0.7	1.0	1.4	2.0	2.9
Development expenditures:	93.9	103.5	126.1	124.2	127.0	126.0	114.3		146.7	161.6	181.1	209.8	239.3
o/w discretionary	29.6	42.4	52.9	61.2	64.0	…	…		…	…	…	…	…
Infrastructure and natural resources	40.8	43.4	54.6	52.8	46.2	…	…		…	…	…	…	…
Education	8.7	7.6	6.0	6.8	4.8	…	…		…	…	…	…	…
Health	12.4	14.5	17.1	12.9	12.3	…	…		…	…	…	…	…
Agriculture and rural development	23.4	24.7	27.9	28.1	28.3	…	…		…	…	…	…	…
Other	8.6	13.2	20.4	23.6	35.4	…	…		…	…	…	…	…
Operating balance excluding grants	-107.8	-84.7	-68.2	-87.2	-88.4	-85.5	-80.5		-76.8	-78.9	-86.6	-89.0	-91.6
Overall budget balance including grants	1.6	-8.7	21.7	-12.4	-12.6	-11.7	1.7		-4.5	0.0	0.0	0.0	0.0
Float and discrepancy 3/	8.2	22.6	16.5	…	…	0.0	0.0		0.0	0.0	0.0	0.0	0.0
Financing	-28.6	-13.9	-38.2	…	…	11.7	-1.7		4.5	0.0	0.0	0.0	0.0
Sale of nonfinancial assets	2.1	2.8	0.0	…	…	0.0	0.0		0.0	0.0	0.0	0.0	0.0
External loans (net)	-0.3	-0.2	-0.4	…	…	7.8	8.2		15.2	14.5	16.5	16.9	19.6
Domestic (net)	-30.4	-16.5	-37.8	…	…	3.9	-9.9		-10.7	-14.6	-16.5	-16.9	-19.6
Central bank, change in	-30.4	-16.5	-37.8	…	…	3.9	-9.9		-10.7	-14.6	-18.7	-21.4	-26.7
Government deposits	-4.5	-8.9	-29.3	…	…	10.8	-3.1		-10.1	-14.0	-18.3	-21.0	-26.1
Claims on government	-25.9	-7.7	-8.4	…	…	-6.9	-6.9		-0.6	-0.6	-0.5	-0.4	-0.6
Credit from DAB (IMF accounts)	-20.6	0.0	-0.3	…	…	0.3	0.3		-0.6	-0.6	-0.5	-0.4	-0.6
Promissory note (- = repayment)	-5.3	-7.7	-8.2	…	…	-7.2	-7.2		0.0	0.0	0.0	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.0	…	…	0.0	0.0		0.0	0.0	2.2	4.5	7.1
Promissory note (end-of-period stock)	23.0	15.3	7.2	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0
Pro-poor spending 4/	38.6	38.8	41.8	50.5	50.5	50.5	50.5		58.6	…	…	…	…

Source: Afghan authorities and Fund staff estimates and projections

Note: Government Finance Statistics Manual 1986 presentation

Overall budget balance including grants for 2018 revised budget excludes repayment to DAB and treasury cash balance.

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)
ARTF and other grants are reclassified into the grants to development budget.

2/ Some of the grants to development budget can finance operating expenditures.

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

4/ Pro-poor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

5/ Revenue includes an Af 9.0 billion transfer of DAB profits to the Treasury.

Table 4b. Islamic Republic of Afghanistan: Central Government Budget, 2016–24

(In percent of GDP)

	2016	2017	2018	2019				2020	2021	2022	2023	2024
				Initial Budget	Revised Budget	ECF 5th Review	Proj.			Proj.		
Revenues and grants	26.1	25.7	28.5	25.8	27.5	26.0	27.0 5/	26.5	27.7	29.2	30.7	31.0
Domestic revenues	10.7	12.4	13.3	12.5	13.9	12.6	13.9 5/	12.9	14.0	15.3	16.6	16.9
Tax revenues	7.7	8.1	8.5	8.5	7.7	8.0	8.1	8.2	9.1	10.5	10.6	11.0
Income, profits, and capital gains	2.8	2.9	3.4	3.0	2.8	…	…	…	…	…	…	…
International trade and transactions	2.4	2.6	2.5	2.7	2.5	…	…	…	…	…	…	…
Goods and services	2.1	2.4	2.4	2.5	2.2	…	…	…	…	…	…	…
Other	0.4	0.2	0.2	0.2	0.1	…	…	…	…	…	…	…
Nontax revenues	3.0	4.3	4.8	4.1	6.3	4.6	5.8 5/	4.7	4.9	4.8	6.0	5.9
Grants to operating budget 1/	8.7	5.6	5.9	6.6	6.6	6.6	6.6	6.7	6.8	6.9	7.0	7.0
ARTF	0.0	0.0	0.0	0.0	0.0	…	…	…	…	…	…	…
LOTFA	2.1	2.0	1.8	1.9	1.9	…	…	…	…	…	…	…
CSTC-A	6.6	3.6	4.2	4.7	4.7	…	…	…	…	…	…	…
Other grants	0.0	0.0	0.0	0.0	0.0	…	…	…	…	…	…	…
Grants to development budget 2/	6.8	7.6	9.2	6.7	6.9	6.8	6.5	6.9	6.9	7.0	7.1	7.1
Total expenditures	26.0	26.3	26.9	26.6	28.3	26.8	26.9	26.8	27.7	29.2	30.7	31.0
Operating expenditures	18.9	18.7	18.1	18.3	19.8	18.3	19.3	17.7	18.5	19.8	20.8	20.8
Of which: Security	11.6	10.2	9.8	10.6	10.4	…	…	…	…	…	…	…
Wages and salaries	12.5	12.8	12.9	13.0	13.4	…	…	…	…	…	…	…
Purchases of goods and services	4.2	3.5	2.6	3.6	4.0	…	…	…	…	…	…	…
Transfers, subsidies, and other	0.2	0.2	0.2	0.0	0.0	…	…	…	…	…	…	…
Pensions	1.6	1.6	1.9	1.2	1.7	…	…	…	…	…	…	…
Capital expenditures	0.4	0.4	0.4	0.4	0.5	…	…	…	…	…	…	…
Interest	0.1	0.1	0.1	0.2	0.2	0.0	0.1	0.0	0.1	0.1	0.1	0.1
Development expenditures:	7.1	7.6	8.8	8.3	8.5	8.4	7.6	9.1	9.2	9.4	9.9	10.2
o/w discretionary	2.2	3.1	3.7	4.1	4.3	…	…	…	…	…	…	…
Infrastructure and natural resources	3.1	3.2	3.8	3.5	3.1	…	…	…	…	…	…	…
Education	0.7	0.6	0.4	0.5	0.3	…	…	…	…	…	…	…
Health	0.9	1.1	1.2	0.9	0.8	…	…	…	…	…	…	…
Agriculture and rural development	1.8	1.8	2.0	1.9	1.9	…	…	…	…	…	…	…
Other	0.7	1.0	1.4	1.6	2.4	…	…	…	…	…	…	…
Operating balance excluding grants	-8.2	-6.2	-4.8	-5.8	-5.9	-5.7	-5.4	-4.8	-4.5	-4.5	-4.2	-3.9
Overall budget balance including grants	0.1	-0.6	1.5	-0.8	-0.8	-0.8	0.1	-0.3	0.0	0.0	0.0	0.0
Float and discrepancy 3/	2.0	1.7	1.2	…	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-2.2	-1.0	-2.7	…	…	0.8	-0.1	0.3	0.0	0.0	0.0	0.0
Sale of nonfinancial assets	0.2	0.2	0.0	…	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	0.0	0.0	0.0	…	…	0.5	0.5	0.9	0.8	0.9	0.8	0.8
Domestic (net)	-2.3	-1.2	-2.6	…	…	0.3	-0.7	-0.7	-0.8	-0.9	-0.8	-0.8
Central bank, change in	-2.3	-1.2	-2.6	…	…	0.3	-0.7	-0.7	-0.8	-1.0	-1.0	-1.1
Government deposits	-0.3	-0.7	-2.1	…	…	0.7	-0.2	-0.6	-0.8	-1.0	-1.0	-1.1
Claims on government	-2.0	-0.6	-0.6	…	…	-0.5	-0.5	0.0	0.0	0.0	0.0	0.0
Credit from DAB (IMF accounts)	-1.6	0.0	0.0	…	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Promissory note (- = repayment)	-0.4	-0.6	-0.6	…	…	-0.5	-0.5	0.0	0.0	0.0	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.0	…	…	0.0	0.0	0.0	0.0	0.1	0.2	0.3
Promissory note (end-of-period stock)	1.7	1.1	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pro-poor spending 4/	2.9	2.9	2.9	3.4	3.4	3.4	3.4	3.6	…	…	…	…

Source: Afghan authorities and Fund staff estimates and projections
Note: Government Finance Statistics Manual 1986 presentation
Overall budget balance including grants for 2018 revised budget excludes repayment to DAB and treasury cash balance.
1/ ARTF: Afghanistan Reconstruction Trust Fund; LOTFA: Law and Order Trust Fund for Afghanistan;
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3/ Positive number indicates that expenditures have been recorded, but not yet executed.
4/ Pro-poor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.
5/ Revenue includes an Af 9.0 billion transfer of DAB profits to the Treasury.

Table 5a. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2016–24

(In billions of Afghanis, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Proj.			
Net foreign assets	478.1	551.0	608.2	673.1	688.2	703.9	718.6	734.1	756.0
Net international reserves	438.9	508.3	570.7	636.9	651.0	665.7	679.4	693.9	714.3
Gross international reserves	491.7	565.6	620.1	685.9	701.0	716.8	731.4	747.0	768.8
Foreign liabilities	52.9	57.3	49.4	49.0	50.0	51.1	52.0	53.0	54.5
IMF accounts (loans and SDR allocation)	4.6	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Foreign currency reserves of commercial banks	48.3	52.8	45.0	44.6	45.6	46.7	47.6	48.6	50.1
Other foreign assets	-9.0	-10.1	-7.5	-8.4	-8.4	-8.4	-8.4	-8.4	-8.4
Net domestic assets	-167.5	-208.8	-275.0	-305.7	-284.3	-263.2	-245.4	-225.8	-209.4
Domestic assets	-88.2	-99.1	-130.6	-131.2	-141.3	-155.3	-173.6	-194.6	-220.7
Net claims on government	-48.1	-62.5	-98.2	-107.3	-117.4	-131.4	-149.7	-170.7	-196.8
Gross claims on government	34.7	29.2	22.7	16.7	16.7	16.7	16.7	16.7	16.7
MOF promissory note 1/	23.0	15.3	7.2	0.0	0.0	0.0	0.0	0.0	0.0
IMF accounts 2/	11.7	13.8	15.6	16.7	16.7	16.7	16.7	16.7	16.7
Liabilities to government	82.8	91.6	121.0	124.0	134.1	148.1	166.4	187.4	213.5
Domestic currency deposits	14.2	31.2	24.3	32.7	35.3	39.0	43.8	49.4	56.3
Foreign currency deposits	68.5	60.4	96.7	91.4	98.8	109.1	122.6	138.0	157.3
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
Net credit on financial corporations	-41.5	-38.3	-33.3	-25.0	-25.0	-25.0	-25.0	-25.0	-25.0
DAB's capital notes	-41.9	-38.7	-33.7	-25.4	-25.4	-25.4	-25.4	-25.4	-25.4
Net credit to public nonfinancial corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	1.4	1.7	0.9	1.1	1.1	1.1	1.1	1.1	1.1
Other items net	-79.3	-109.6	-144.4	-174.5	-143.0	-107.9	-71.8	-31.2	11.2
DAB's capital	93.6	120.2	155.5	191.0	191.0	191.0	191.0	191.0	191.0
Reserve money	310.6	342.2	333.2	367.4	403.9	440.8	473.3	508.3	546.5
Reserve money in domestic currency	262.3	289.4	288.2	322.8	358.3	394.1	425.6	459.7	496.5
Currency in circulation	223.6	228.6	228.2	246.5	266.2	284.8	304.7	326.1	348.9
Bank deposits in domestic currency	32.2	53.0	44.8	65.2	81.0	98.2	109.8	122.5	136.5
Bank deposits in domestic currency	13.8	45.6	39.1	59.3	75.1	92.3	103.9	116.6	130.6
Reserve requirements in domestic currency	18.4	7.4	5.7	5.9	5.9	5.9	5.9	5.9	5.9
Bank deposits in foreign currency	48.3	52.8	45.0	44.6	45.6	46.7	47.6	48.6	50.1
Other deposits	6.5	7.8	15.2	11.1	11.1	11.1	11.1	11.1	11.1
Memorandum items:									
International reserves, in millions of U.S. dollars 3/									
Gross	7,357	8,139	8,273	8,298	8,297	8,296	8,295	8,294	8,292
Interest rate, 28-day capital notes (percent)	3.0	3.0	3.0	…	…	…	…	…	…
Exchange rate (eop, Afghanis per U.S. dollar)	66.8	69.5	75.0	…	…	…	…	…	…

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 5b. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2015–19

(At program exchange rates) 1/

	2015	2016	2017	2018				2019		
	Dec.21	Dec.20	Dec.21	March.20	June.21	Sep.22	Dec.21	March.20	June.20	Sep.22
Net foreign assets	459.9	506.2	546.4	544.3	550.8	553.4	563.0	561.3	560.3	572.2
Net international reserves	435.9	465.7	504.7	505.1	514.8	517.7	529.4	528.9	527.7	541.0
Gross international reserves	476.0	521.0	560.6	558.7	565.3	566.3	574.6	573.4	572.9	585.6
Foreign liabilities	40.2	55.3	55.9	53.6	50.6	48.6	45.2	44.6	45.2	44.6
IMF accounts (loans and SDR allocation)	5.9	4.9	4.3	3.9	4.1	3.9	4.1	3.9	3.7	3.9
Foreign currency reserves of commercial banks	34.2	50.4	51.6	49.7	46.4	44.8	41.1	40.7	41.5	40.7
Other foreign assets	-10.2	-9.9	-9.9	-10.5	-10.4	-9.1	-7.5	-8.2	-8.9	-9.4
Net domestic assets	-181.6	-193.5	-205.1	-220.7	-235.1	-246.8	-232.2	-249.6	-239.2	-239.2
Domestic assets	-66.2	-89.3	-98.6	-115.2	-129.6	-141.2	-123.6	-137.3	-133.5	-130.0
Net claims on government	-38.5	-49.1	-61.9	-98.0	-93.0	-103.2	-91.3	-112.1	-107.9	-107.6
Gross claims on government	40.5	35.7	28.9	28.7	29.0	24.9	21.6	21.7	21.6	22.1
MoF promissory note 2/	28.3	23.0	15.3	15.2	15.0	10.9	7.2	7.2	7.2	7.2
IMF accounts 3/	12.2	12.7	13.6	13.5	14.0	14.0	14.5	14.5	14.5	14.9
Liabilities to government	79.0	84.8	90.8	126.7	122.0	128.1	112.9	133.7	129.6	129.7
Domestic currency deposits	10.9	14.2	31.2	49.2	34.7	40.5	24.3	35.5	43.2	42.3
Foreign currency deposits	68.1	70.5	59.6	77.5	87.4	87.6	88.6	98.2	86.3	87.3
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
Net credit on financial corporations	-30.1	-41.5	-38.3	-19.0	-37.5	-39.1	-33.3	-26.2	-26.6	-23.5
DAB's capital notes	-30.9	-41.9	-38.7	-19.4	-37.9	-39.5	-33.7	-26.6	-27.0	-23.9
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
Credit to private sector	2.3	1.4	1.7	1.9	1.0	1.0	0.9	1.0	1.0	1.0
Other items net	-115.4	-104.2	-106.6	-105.5	-105.5	-105.5	-108.5	-112.3	-105.7	-109.2
DAB's capital	116.7	93.6	120.2	123.4	133.5	156.1	155.5	166.1	196.9	189.1
Reserve money	278.3	312.7	341.3	323.6	315.7	306.6	330.8	311.7	321.1	333.0
Reserve money in domestic currency	244.0	262.3	289.4	273.6	268.5	260.1	288.2	269.4	276.8	290.2
Currency in circulation	202.2	223.6	228.6	215.7	226.6	225.3	228.2	222.1	231.6	244.5
Bank deposits in domestic currency	33.4	32.2	53.0	49.9	32.6	24.5	44.8	33.3	28.2	33.0
Bank deposits in foreign currency	34.2	50.3	51.9	49.9	47.1	46.5	42.6	42.3	44.3	42.8
Other deposits	8.4	6.5	7.8	8.0	9.3	10.3	15.2	13.9	17.0	12.7
Memorandum items:										
Net international reserves (mn. USD) 4/	6,343	6,778	7,345	7,351	7,492	7,534	7,705	7,697	7,680	7,873

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 6. Islamic Republic of Afghanistan: Monetary Survey, 2016–24 1/
(In billions of Afghanis)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Proj.			
Net foreign assets	576.9	637.4	722.3	791.6	809.3	827.8	845.0	863.2	888.9
Foreign assets	607.2	674.3	756.1	823.7	841.7	860.4	877.9	896.4	922.4
Central bank	496.7	570.9	628.8	694.3	709.4	725.2	739.8	755.4	777.2
Commercial banks	104.0	103.4	127.3	129.4	132.3	135.3	138.0	141.0	145.1
Foreign liabilities	-30.3	-36.9	-33.8	-32.2	-32.4	-32.7	-32.9	-33.1	-33.5
Central bank	-18.6	-19.9	-20.6	-21.2	-21.2	-21.2	-21.2	-21.2	-21.2
Commercial banks	-11.1	-17.1	-13.2	-10.9	-11.2	-11.4	-11.7	-11.9	-12.3
Net domestic assets	-129.6	-163.5	-236.3	-261.8	-231.8	-198.3	-153.9	-104.4	-55.7
Net domestic credit	-5.7	-22.2	-60.7	-56.5	-61.5	-69.8	-81.9	-96.1	-114.7
Nonfinancial public sector	-52.1	-70.2	-106.3	-107.2	-117.3	-131.3	-149.6	-170.6	-196.7
Net credit to central government	-52.2	-70.3	-106.4	-107.3	-117.4	-131.4	-149.7	-170.7	-196.8
Central bank	-48.1	-62.5	-98.2	-107.3	-117.4	-131.4	-149.7	-170.7	-196.8
Commercial banks	-4.2	-7.8	-8.2	0.0	0.0	0.0	0.0	0.0	0.0
Net credit to public nonfinancial corporations	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net credit to private sector	47.7	49.4	46.6	51.3	56.4	62.1	68.3	75.1	82.6
in national currency	18.0	18.3	21.4	21.0	23.2	25.8	28.3	31.2	34.3
in foreign currency	29.7	31.0	25.2	30.3	33.2	36.3	39.9	43.9	48.3
Net credit to other financial corporations	-1.3	-1.4	-1.0	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7
Other items net	-123.9	-141.4	-175.5	-205.3	-170.3	-128.5	-72.0	-8.2	59.1
Broad money M2	447.3	473.8	486.0	529.8	577.5	629.4	691.1	758.8	833.2
Broad money M2 in domestic currency	289.1	315.7	315.5	357.2	397.9	440.4	486.8	536.3	604.1
Narrow money M1	415.4	436.7	453.5	494.1	537.5	582.8	631.7	683.8	755.6
Narrow money M1 in domestic currency	277.7	302.9	305.7	347.8	387.9	429.9	475.6	524.4	591.5
Currency outside banks	210.9	220.5	219.9	238.7	258.4	277.0	296.9	318.3	341.1
Currency in circulation	223.6	228.6	228.2	246.5	266.2	284.8	304.7	326.1	348.9
Currency held by banks	12.7	8.1	8.3	7.8	7.8	7.8	7.8	7.8	7.8
Demand deposits	204.4	216.2	233.6	255.5	279.1	305.8	334.7	365.5	414.5
in national currency	66.7	82.4	85.8	109.1	129.5	152.9	178.6	206.1	250.4
in foreign currency	137.7	133.8	147.8	146.3	149.6	153.0	156.1	159.5	164.1
Other deposits	31.9	37.1	32.6	35.6	40.0	46.6	59.4	75.0	77.6
in national currency	11.4	12.8	9.8	9.4	9.9	10.6	11.2	11.9	12.6
in foreign currency	20.5	24.3	22.8	26.3	30.0	36.0	48.2	63.1	65.0
				(12-month percentage change)					
M2	5.6	5.9	2.6	9.0	9.0	9.0	9.8	9.8	9.8
M1	4.3	5.1	3.8	9.0	8.8	8.4	8.4	8.3	10.5
Currency outside banks	0.9	4.5	-0.3	8.5	8.3	7.2	7.2	7.2	7.2
Net credit to private sector	-1.6	3.5	-5.6	10.0	10.0	10.0	10.0	10.0	10.0
				(In percent of GDP)					
M2	33.9	34.9	34.1	35.3	38.5	42.0	46.1	50.6	55.5
M1	31.5	32.2	31.8	32.9	35.8	38.8	42.1	45.6	50.4
Net credit to the private sector	3.6	3.6	3.3	3.4	3.5	3.5	3.5	3.5	3.5
Memorandum items:									
M2 velocity	2.9	2.9	2.9	2.8	2.8	2.8	2.8	2.8	2.5
Reserve money multiplier	1.4	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Banking sector									
Loan dollarization (percent)	62.2	62.9	54.1	59.0	58.8	58.5	58.5	58.5	58.5
Deposit dollarization (percent)	66.9	62.4	64.1	59.3	56.3	53.6	51.8	50.5	46.6
Currency-to-deposit ratio (percent)	94.6	90.3	85.8	84.7	83.4	80.8	77.3	74.0	70.9
Loans-to-deposit ratio (percent)	20.2	19.5	17.5	17.6	17.7	17.6	17.3	17.0	16.8

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/ 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 7. Islamic Republic of Afghanistan: Balance of Payments, 2016–24 1/

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

	2016	2017	2018	2019	2020	2021	2022	2023	2024
			Est.			Proj.			
Current account	1,627	1,180	1,882	385	275	124	-564	-819	-1,046
Excluding official grants	-5,806	-6,038	-5,413	-6,182	-6,242	-6,313	-6,919	-7,097	-7,255
Trade balance of goods	-5,649	-5,953	-5,721	-5,869	-5,887	-5,935	-6,382	-6,486	-6,550
Exports of goods and services	1,140	1,156	1,974	1,527	1,602	1,730	1,843	1,897	2,074
Goods	614	784	875	948	1,027	1,122	1,240	1,299	1,480
Services	526	372	1,099	579	575	608	603	598	594
Imports of goods and services	7,328	7,960	7,985	8,294	8,456	8,678	9,421	9,678	10,038
Goods	6,263	6,737	6,596	6,817	6,914	7,057	7,622	7,786	8,030
Services	1,065	1,222	1,389	1,477	1,542	1,621	1,799	1,892	2,008
Income, net	180	254	212	172	175	174	172	170	167
Of which: Interest on official loans	5	5	5	8	9	12	16	21	27
Current transfers, net	7,635	7,729	7,681	6,980	6,953	6,898	6,842	6,792	6,751
Of which: Official 2/	7,433	7,217	7,295	6,567	6,517	6,437	6,355	6,278	6,209
Capital account	0	0	0	0	0	0	0	0	0
Financial account, net	23	165	-389	-364	-268	-118	568	822	1,051
Foreign direct investment	79	41	79	94	94	100	100	100	100
Portfolio investment	-99	29	-141	-146	-151	-156	-161	-166	-171
Official loans 3/	-4	-5	-20	105	184	171	190	190	216
Disbursement	8	20	2	132	212	199	218	232	262
Amortization	12	25	22	27	28	28	28	42	46
Debt relief ('-' = forgiveness)	0	0	0	0	0	0	0	0	0
Other investment	46	101	-307	-416	-394	-233	439	698	906
Errors and omissions	-1,087	-555	-1,355	0	0	0	0	0	0
Overall balance	563	790	138	21	6	6	4	3	5
Financing	-563	-790	-138	-21	-6	-6	-4	-3	-5
Central bank's gross reserves ('-' = accumulation)	-549	-782	-134	-25	1	1	1	1	1
Use of Fund resources, net	-15	-8	-4	4	-8	-7	-5	-4	-7
Disbursements 4/	6	13	13	14	0	0	0	0	0
Repayments	21	21	16	10	8	7	5	4	7
Debt relief ('-' = forgiveness)	0	0	0	0	0	0	0	0	0
Memorandum items:									
Gross international reserves, central bank	7,357	8,139	8,273	8,298	8,297	8,296	8,295	8,294	8,292
Import coverage of reserves 5/	11.1	12.2	12.0	11.8	11.5	10.6	10.3	9.9	9.5
External debt stock, official 6/	1,201	1,258	1,213	1,321	1,497	1,660	1,845	2,029	2,239
in percent of GDP	6.1	6.4	6.4	7.3	7.9	8.2	8.5	8.6	8.9
Current account, in percent of GDP	8.4	5.9	9.6	2.0	1.4	0.6	-2.5	-3.4	-4.0
Trade balance, in percent of GDP	-29.1	-29.9	-29.0	-30.6	-30.3	-28.8	-28.8	-27.2	-25.3
Export of goods and services, in percent of GDP	5.9	5.8	10.0	8.0	8.3	8.4	8.3	7.9	8.0
Import of goods and services, in percent of GDP	37.7	40.0	40.5	43.3	43.6	42.1	42.6	40.5	38.8
Official grants, in percent of GDP	38.3	36.2	37.0	34.3	33.6	31.3	28.7	26.3	24.0

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 8a. Islamic Republic of Afghanistan: Financial Soundness Indicators 1/

	2016	2017	2018	2019	
				Q1	Q2
Capital adequacy					
Regulatory Capital to Risk-weighted Assets (capital adequacy ratio – "CAR")	27.7	30.3	25.8	27.0	27.0
Total Capital to Total Assets	11.3	11.3	10.9	11.5	11.0
Asset composition and quality					
Total Loans to Total Assets	13.8	13.2	13.1	14.0	14.2
Non-performing Loans to Total Gross Loans	12.7	12.2	8.9	10.9	12.8
Non-performing Loans Net of Provisions to Capital	10.6	8.8	3.4	4.5	6.3
Earnings and profitability					
Return on Assets	2.6	0.4	0.3	0.1	0.7
Return on Equity	26.8	1.9	3.0	1.2	6.5
Liquidity					
Liquid Assets to Total Assets (Liquid Asset Ratio)	72.0	74.0	72.7	70.9	69.7
Liquid Assets to Short-term Liabilities	89.2	92.6	90.6	89.9	89.1
Sensitivity to Market Risk					
Net open position in foreign exchange to capital 2/	26.0	24.0	30.8	27.6	37.6
Foreign currency denominated liabilities to total liabilities	66.3	64.3	68.6	69.3	70.8
Foreign currency denominated loans to total loans	68.1	67.4	58.1	54.5	54.0

Source: Afghan authorities.

1/ NPLs include loans 121 to 481 days or more past due for payment of principal and/or interest. This differs from the IMF's FSI Compilation Guide which advises recognition of loans 90 days or more past due payment of interest or principal as NPLs.

2/ Net open positions are due to high and persistent dollarization.

Table 8b. Islamic Republic of Afghanistan: Financial System Structure

	Regulatory/ Supervisory Authority	2008			2013			2018		
		Count	Billion Afg	Percent of GDP	Count	Billion Afg	Percent of GDP	Count	Billion Afg	Percent of GDP
Total Assets of:										
Commercial Banks	DAB	**15**	**116.63**	**22.49**	**16**	**116.63**	**22.62**	**14**	**315.66**	**22.14**
Majority state owned		2	19.53	3.77	3	19.53	6.17	3	83.69	5.87
Domestic owned private banks		4	52.82	10.18	6	52.82	7.96	5	114.9	8.06
Foreign owned/controlled private banks, branches		9	44.28	8.54	7	44.28	8.49	6	117.07	8.21
Other non-deposit taking financial institutions										
Mobile/E-money service providers	DAB	0	...	...	2	...	...	3	1.06	0.07
Foreign exchange dealers	DAB	153	...	...	1500	...	...	1699	...	...
Money services providers	DAB	56	...	...	530	...	...	1285	...	...

Sources: DAB

Note: ...Stands for information not available.

Table 9. Islamic Republic of Afghanistan: Proposed Schedule of Reviews and Disbursements Under the ECF Arrangement

Availability date	Amount of Disbursements: Millions of SDRs	Amount of Disbursements: 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
November 22, 2019	5.38	1.7	Sixth review and June 20, 2019 performance criteria
Total	32.38	10.0	

Source: International Monetary Fund.

Table 10. Islamic Republic of Afghanistan: External Financing Requirements and Sources, 2016–20

(In millions of U.S. dollars)

	2016	2017	2018	2019	2020
					Proj.
Gross financing requirement	6,394	6,866	5,585	6,244	6,277
Current account balance (excluding grants)	-5,806	-6,038	-5,413	-6,182	-6,242
Amortization	40	46	38	37	36
Of which: IMF	21	21	16	10	8
Change in reserves (increase = +)	549	782	134	25	-1
Reduction in arrears	0	0	0	0	0
Available financing	6,388	6,853	5,572	6,230	6,277
Official transfers (grants)	7,433	7,217	7,295	6,567	6,517
Foreign direct investment	79	41	79	94	94
Official medium- and long-term loans (net)	11	3	-16	101	191
Accumulation of arrears	0	0	0	0	0
Debt forgiveness	0	0	0	0	0
Debt rescheduling	0	0	0	0	0
Other flows	-1,135	-408	-1,785	-531	-525
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 11. Islamic Republic of Afghanistan: Projected Payments and Indicators of Capacity to Repay the Fund 1/

(In millions of SDRs)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	Total
Obligations from existing drawings																
1. Principal																
PRGT repayments	1.2	5.4	4.8	3.8	3.2	5.0	5.4	5.4	4.1	2.3	0.5	0.0	0.0	0.0	0.0	40.8
2. Charges and interest 1/																
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	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	0.0
SDR net charges	0.3	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	15.8
Total obligations	1.5	6.4	5.9	4.8	4.2	6.0	6.5	6.5	5.1	3.3	1.5	1.1	1.1	1.1	1.1	56.6
(percent of quota)	0.5	2.0	1.8	1.5	1.3	1.9	2.0	2.0	1.6	1.0	0.5	0.3	0.3	0.3	0.3	17.5
Obligations from prospective drawings 2/																
1. Principal																
PRGT repayments	0.0	0.0	0.0	0.0	0.0	0.0	1.1	1.1	1.1	1.1	1.1	0.0	0.0	0.0	0.0	5.4
2. Charges and interest 1/																
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	0.0
Total obligations	0.0	0.0	0.0	0.0	0.0	0.0	1.1	1.1	1.1	1.1	1.1	0.0	0.0	0.0	0.0	5.4
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.3	0.0	0.0	0.0	0.0	1.7
Cumulative obligations (existing and prospective) 2/																
1. Principal																
PRGT repayments	1.2	5.4	4.8	3.8	3.2	5.0	6.5	6.5	5.1	3.3	1.5	0.0	0.0	0.0	0.0	46.2
2. Charges and interest 1/																
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	0.0
SDR assessment and net charges	0.3	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	15.8
Total obligations	1.5	6.4	5.9	4.8	4.2	6.0	7.5	7.5	6.2	4.4	2.6	1.1	1.1	1.1	1.1	62.0
Outstanding Fund credit, end of period	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	0.0	0.0	0.0
Memorandum items:																
Outstanding Fund credit, in percent of																
Exports of goods and services 3/	4.2	3.5	2.8	2.3	1.9	1.4	1.0	0.6	0.3	0.1	0.0	0.0	0.0	0.0	0.0	…
External public debt	4.8	3.9	3.2	2.6	2.1	1.5	0.7	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	…
Gross official reserves	0.8	0.7	0.6	0.5	0.5	0.4	0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	…
GDP	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	…
Quota	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	0.0	0.0	…
Total Obligations, in percent of																
Exports of goods and services 3/	0.1	0.6	0.5	0.4	0.3	0.4	0.5	0.4	0.3	0.2	0.1	0.0	0.0	0.0	0.0	…
External public debt	0.2	0.6	0.5	0.4	0.3	0.4	0.3	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	…
Gross official reserves	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	…
GDP	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	…
Quota	0.5	2.0	1.8	1.5	1.3	1.9	2.3	2.3	1.9	1.4	0.8	0.3	0.3	0.3	0.3	…
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	323.8

Source: Fund staff estimates and projections.

1/ Projections are based on current interest rates for PRGT loans.
2/ Based on the proposed level and phasing of access, and subject to the approval of the IMF's Executive Board.
3/ Excluding reexports.

Table 12. Islamic Republic of Afghanistan: Quantitative Performance Criteria and Indicative Targets Under the Extended Credit Facility, December 2017–September 2019 1/

(Cumulative in Af billion unless otherwise indicated)

	2017				2018											2019							
	Dec.21				Mar.20		Jun.21			Sep.22		Dec.21				Mar.20		June.20				Sep.22	
	Target	Adjusted target	Actual	Year-end stocks	Indicative target 2nd review	Actual	Target	Adjusted target	Actual	Indicative target	Actual	Target	Adjusted target	Actual	Year-end stocks	Indicative target Target	Actual	Target	Adjusted Target	Actual	End-period stocks	Indicative target	Actual
Performance criteria:																							
Revenues of the central government (floor)	153.0	153.0	168.3	...	37.8	37.9	77.0	77.0	79.9	122.2	126.2	172.0	172.0	189.9	...	41.6	42.9	77.1	77.1	85.7	...	122.2	127.4
Net credit to the central government from DAB (ceiling) 2/	-1.3	23.6	-12.8	-61.9	-13.2	-36.1	-9.9	-24.9	-31.1	-12.3	-41.2	6.9	35.6	-29.3	-91.3	-12.5	-20.8	-5.4	16.9	-16.7	-107.9	-5.3	-16.3
Reserve money (ceiling) 2/	31.5	31.5	27.1	289.4	0.0	-15.8	0.0	0.0	-20.9	14.0	-29.3	34.7	34.7	-1.2	288.2	-23.2	-19.2	17.3	17.3	-11.4	276.8	26.1	2.0
Net international reserves of DAB (floor; in U.S. dollars million) 2/	100.0	-363.0	567.5	7,345	0.0	5.6	-100.0	119.0	146.4	-100.0	189.1	200.0	-217.7	359.6	7705.0	0.0	5.6	0.0	-324.7	-24.7	7680.3	0.0	168.0
Non-concessional external debt, new (ceiling) 3, 4/	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	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term external debt, new (ceiling) 3/	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	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External payments arrears, new (ceiling) 3, 5/	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	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) 3/	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	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indicative targets:																							
Operating budget deficit, excluding grants (ceiling)	100.5	100.5	84.7	...	10.1	-0.1	26.2	26.2	29.1	52.5	42.7	109.5	109.5	68.2	...	13.2	-0.8	40.0	40.0	27.6	...	59.8	56.9
Treasury cash balance, discretionary (floor)	10.0	10.0	24.2	...	10.0	46.2	10.0	10.0	42.2	10.0	40.3	10.0	10.0	37.6	...	10.0	42.9	10.0	10.0	41.8	...	10.0	33.5
Currency in circulation (ceiling) 2/	23.5	23.5	5.0	228.6	6.0	-12.9	0.8	0.8	-2.0	14.0	-3.4	22.9	22.9	-0.4	228.2	-14.2	-6.1	13.7	13.7	-11.4	231.6	18.4	2.0
Social and other priority spending (floor)	42.1	42.1	38.8	...	8.7	7.3	18.0	18.0	18.1	28.0	28.5	40.6	40.6	41.8	...	9.0	6.3	18.2	18.2	21.9	...	32.3	36.8
Memorandum items:																							
Nominal external concessional borrowing (in U.S. dollars million) 2, 6/	0.0	0.0	119.6	...	0.0	0.0	0.0	132.0	0.0	132.0	0.0	132.0	132.0	0.0	...	205.0	65.0	205.0	205.0		...	205.0	205.0
Reference values for the adjustors:																							
Core budget development spending	88.6	88.6	103.5	...	9.4	1.5	23.9	23.9	32.7	53.8	65.7	107.0	107.0	126.1	...	8.4	9.7	47.8		50.2	...	76.5	77.1
External financing of the core budget and sale of non-financial assets 7/	192.1	192.1	182.1	...	33.8	27.5	52.0	52.0	75.8	114.5	135.7	216.3	216.3	215.6	...	35.8	14.4	85.1		65.2	...	132.6	114.3

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/ Cumulative from the beginning of the year.

3/ These quantitative targets are applied on a continuous basis.

4/ Excludes IsDB loan (53.2 million Islamic Dinars) contracted in 2017.

5/ 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.

6/ Prospective concessional borrowing.

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

Table 13. Islamic Republic of Afghanistan: Authorities' Response to Past Policy Recommendations

Overall Assessment	The authorities have followed recommendations of the 2017 Article IV consultations and of the ongoing (2016–19) ECF-supported arrangement	
	Key Recommendations	**Implemented Policies**
Fiscal Policy	Overall fiscal balance to remain broadly balanced and a fiscal anchor to ensure sustainability; step-up mobilization of domestic revenue, improve budget planning and capacity building, and budget management. (¶¶44, 45, 46)	Fiscal policy aimed at sustainability, and the overall fiscal balance, including grants, turned to surplus in 2018, helped by efforts to mobilize revenues through improvements in revenue administration, including computerized management system
Monetary Policy	Authorities committed to a flexible exchange rate regime, orderly market conditions, and fostering confidence in the domestic currency. Progress with financial inclusion. (¶43)	Monetary policy targeted low inflation with flexibility in the nominal exchange rate. Inflation has remained in single digits and DAB occasionally deploys FX interventions to smooth volatility. The launch of NFIS in September 2019 is expected to boost financial inclusion
Financial Sector Policies	Sustained strengthening of regulatory and supervisory frameworks, crisis preparedness and close monitoring of financial risks. Extinguish DAB's lender of last resort (LoLR) exposure because of Kabul Bank crisis, pursue the remaining asset recoveries related to Kabul Bank crisis, and implement a strategy for state-owned commercial banks prepared with World Bank support (¶47). Commission independent specialized reviews of the operations, information systems and asset quality of high-risk weak banks, with World Bank support. (¶37). Develop and implement coordinated crisis preparedness and management system and contingency arrangements and ensure proper structuring and prioritization of resolution strategies to address vulnerabilities and minimize contagion risk. (¶39)	The authorities have vigilantly handled weak private banks and implemented corrective plans including closure of non-viable banks. They extinguished DAB's LoLR exposure. Kabul Bank asset recoveries had stalled, but authorities have revived their commitment to increase recoveries. They are implementing the strategy for SOCBs agreed with the World Bank and will be engaging independent reviews of high-risk weak banks with the World Bank's support. The authorities are also developing a crisis management framework and will be working, with the IMF's TA, to develop an effective bank resolution framework
Governance and Anti-Corruption	Implementation of anti-corruption framework, including benchmarks relating to the asset declaration regime as agreed under the program. Implement 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 (¶48)	On anti-corruption measures, the authorities have published information on officials that have submitted their asset declarations and indicated where asset declarations are under verification. The authorities have also published statistics on the number of sanctions that have been imposed and the names and titles of non-complying officials. The legal basis for an agency responsible for anti-corruption prevention has been established, although such agency has not been operationalized. In general, the institutional framework for fighting corruption needs to be firmed. Corruption enforcement also needs to be enhanced. With respect to financial integrity, a national risk assessment for ML/TF has been finalized. DAB's AML/CFT supervision continues to be strengthened with specific focus on the MSP/FXD sector
See IMF Country Report No. 17/377, Afghanistan: 2017 Article IV Consultation Staff Report.		

Table 14. Islamic Republic of Afghanistan: Quantitative Performance Criteria, June 21, 2019 1/
(In Afghani billion, unless otherwise indicated)

	Target	Adjusted	Actual	Status
Revenues of the central government (floor)	77.1	…	85.7	**Met**
Net credit to the central government from DAB (ceiling) 2/	-5.4	16.9	-16.7	**Met**
Reserve money (ceiling) 2/	17.3	…	-11.4	**Met**
Net international reserves of DAB (floor; in millions of U.S. dollars) 2/	0.0	-324.7	-24.7	**Met**
Non-concessional external debt, new (ceiling) 3/, 4/	0.0	0.0	0.0	**Met**
Short-term external debt, new (ceiling) 3/	0.0	0.0	0.0	**Met**
External payments arrears, new (ceiling) 3/, 5/	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) 3/	0.0	0.0	0.0	**Met**

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/ Cumulative from the beginning of the year.
3/ These quantitative targets are applied on a continuous basis.
4/ Excludes IsDB loan (53.2 million Islamic Dinars) contracted in 2017.
5/ 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.

Table 15. Islamic Republic of Afghanistan: Sixth Review Structural Benchmarks

Measure	Date	Rationale	Status
Cabinet to approve and submit to Parliament 2020 draft budget in line with the macroeconomic framework agreed under the ECF arrangement.	Mid-November 2019	Preserve macroeconomic stability	**Met**
Publish on the dedicated official website, in Dari and in English, qualitative and quantitative information (using the templates defined in the TMU) on the implementation of the Law on Declaration and Registration of Assets of Officials and Government Employees and Article 154 of the Constitution, including enforcement and other procedural measures that have been applied to the officials mentioned in Art. 154 of the Constitution and other senior officials who, pursuant to the Anti-Corruption law, may be prosecuted for "major crimes of corruption".	End-October 2019	Improve governance and fight corruption	**Met**
Elimination of DAB's lender of last resort exposure to Kabul Bank by Af 7.1 billion.	End-September 2019	Preserve financial stability	**Met**
Hire an internationally reputable forensic accounting firm to review the Kabul Bank's assets recovery process, identify impediments, and propose practical ways to improve recoveries of the remaining assets. Implement the recommended actions.	End-September 2019	Strengthen financial stability	**Not Met** **[implemented Oct/Nov]**
Complete transfer of all large taxpayers to the Single Large Taxpayer Office (SLTO).	End-October 2019	Improve revenue collection	**Met**
Prepare, with support of the IMF staff, an internal technical guidance note for Debt Management Unit (DMU) staff on how to: a. Use the Commonwealth Secretariat Debt Recording and Management System including preparing inputs for the Medium-Term Debt Strategy and Debt Sustainability Analysis; b. Record, monitor, and report on debt related matters in accordance with the Public Finance Management law and other relevant laws and regulations.	End-October 2019	Strengthen the capacity of debt management unit to record and monitor public debt.	**Met**

Table 15. Islamic Republic of Afghanistan: Sixth Review Structural Benchmarks (Concluded)

Measure	Date	Rationale	Status
Purchase for: New Kabul Bank: (i) licenses for an upgraded core banking system; (ii) software and hardware supporting the core banking systems, including database server and data storage; and Pashtany Bank: (i) up-to-date licenses for the Relational Database Management System software required by core banking systems; (ii) database server hardware, and (iii) data storage hardware. Provide dated and signed contracts/invoices verifying the above purchases. Install the purchased IT equipment and software and make it operational.	Mid-November 2019	Eliminate risk of collapse of operational systems that may threaten system-wide spillovers	**Met**

Annex I. Risk Assessment Matrix[1] (Continued)

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Global Risks			
Rising protectionism and retreat from multilateralism.	High	Medium Lower investor and consumer confidence, trade impacting fiscal revenues, reserves and exchange rate.	Strengthen fiscal and monetary policies; safeguard macroeconomic stability.
Sharp rise in risk premia/Further build-up of financial vulnerabilities.	High/ High	Low/ Low Transmission through lower aid and remittances, external current and financial account.	Maintain macro stability and improve business climate, develop domestic financial intermediation.
Weaker-than-expected global growth.	Medium (US)/ High (Europe, China)	Low Transmission through external current and financial account, lower investments, lower remittances.	Improve business climate, foster competitiveness and domestic financial intermediation.
Intensification of geopolitical tensions and security risks.	High	High Intensified warfare, increased refugees' flows, pressure on currency and capital flight, growth down	Maintain macro-stability; support well-balanced expenditure outlays allowing to finance security, foster resilient domestic institutions.
Large swings in energy prices.	Medium	Low Transmission through trade account to higher domestic prices.	Maintain macro-stability and flexible exchange rate; allow transmission of shocks; protect the most vulnerable through social outlays.
Cyber-attacks on critical global financial systems.	Low	Low Low financial intermediation contains impact.	Educate financial community and the public about the risk. Build-up the relevant supervisory capacity.

[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 1 year and 3 years, respectively.

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Higher frequency and severity of natural disasters cause severe economic damage to smaller economies susceptible to disruptions.	Medium	Medium Weaker growth, investment, consumption, fiscal revenue, ambiguous inflation impact, internal displacements.	Strengthen fiscal and monetary policies; safeguard macroeconomic stability. Build-up contingency buffers improve business environment and infrastructure.
Country-specific Risks			
Retreat from sustainable macro-policy weakening domestic revenue mobilization, lowering reserve buffers, and weakening the central bank independence	Medium	High Deficit monetization, loss of reserves and confidence in domestic currency, rising inflation, downside risks to growth.	Solidify commitment to balanced policies; entrench macro-stability and the institutional set-up supporting it.
Decline in aid inflows	Medium	High Lower public spending, lower growth, increased unemployment, and/or exchange rate pressures	Continue structural reforms, improve governance, including anti-corruption, stronger institutional and regulatory frameworks, and law enforcement.
Lack of progress in banking sector restructuring compromising financial sector's soundness	Medium	High Loss of consumer confidence in the domestic financial system, increased dollarization, retreating financial intermediation	Enhance crisis preparedness including resolution and management tools, support central bank independence, implement the World Bank's SOCB strategy, advance consumer protection.

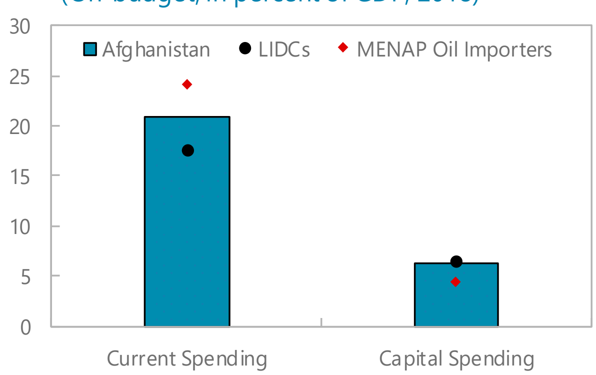
Annex II. Medium-Term Fiscal Challenges for Afghanistan[1]

The purpose of this annex is to discuss medium-term fiscal challenges for Afghanistan in the context of large spending needs and uncertainty about future aid flows. Compared to other low-income countries (LICs), expenditures are high (partly reflecting security needs) while the financing envelope is likely to fall over the medium term as aid flows normalize. This annex sets out different fiscal adjustment scenarios to a possible fall in donor aid and finds that a current, rather than development, spending-based adjustment may be less costly in terms of the growth impact. From a policy perspective, strong fiscal institutions, including a robust medium-term fiscal framework (MTFF), will help Afghanistan deal with the coming fiscal challenges and improve resource allocation in the face of uncertainty.

A. The Central Fiscal Challenge: Large Expenditure Needs but a Declining Resource Envelope

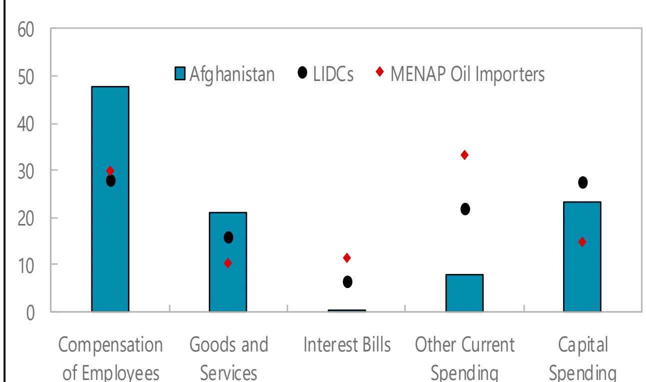
1. Afghanistan's public expenditure is high, partly reflecting conflict and fragility. Expenditure, especially current, is higher than in an average LIC. The compensation of employees and expenditure on goods and services is relatively high, reflecting the presence of a large security sector. Capital spending is broadly in line with LIC averages. Domestic revenue is lower than MENAP oil importers' and LICs' average by 6.8 and 2.0 percentage points of GDP, respectively. Aid is among the highest in the world, financing 75 percent of total on- and off-budget expenditure and 56 percent of on-budget spending.

Current and Capital Expenditures
(On-budget, in percent of GDP, 2018)



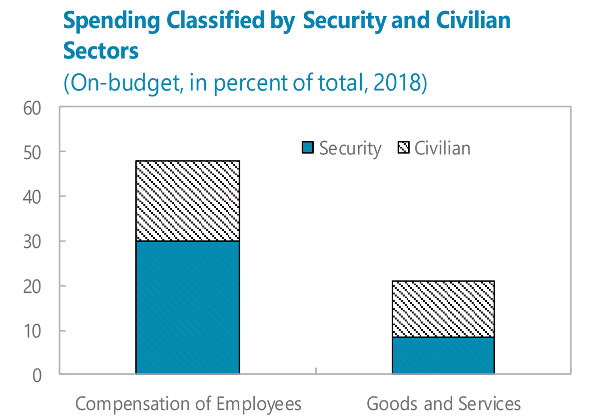
Source: IMF FAD Expenditure Assessment Tool (EAT), IMF staff estimates.

Breakdown of Spending
(On-budget, in percent of total, 2018)

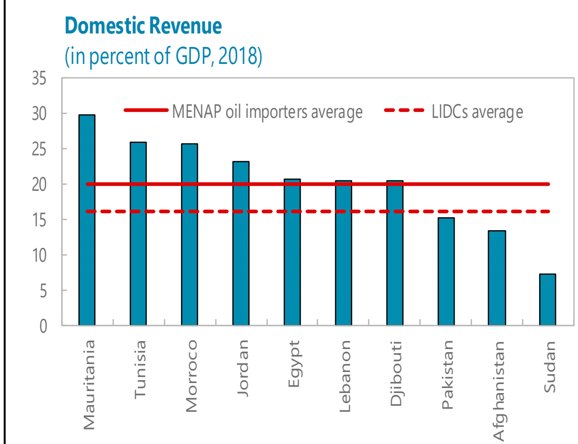


Source: IMF FAD Expenditure Assessment Tool (EAT), IMF staff estimates.

[1] Prepared by Daisuke Ishikawa and Mariusz Sumliński, with research support provided by Tetyana Sydorenko.

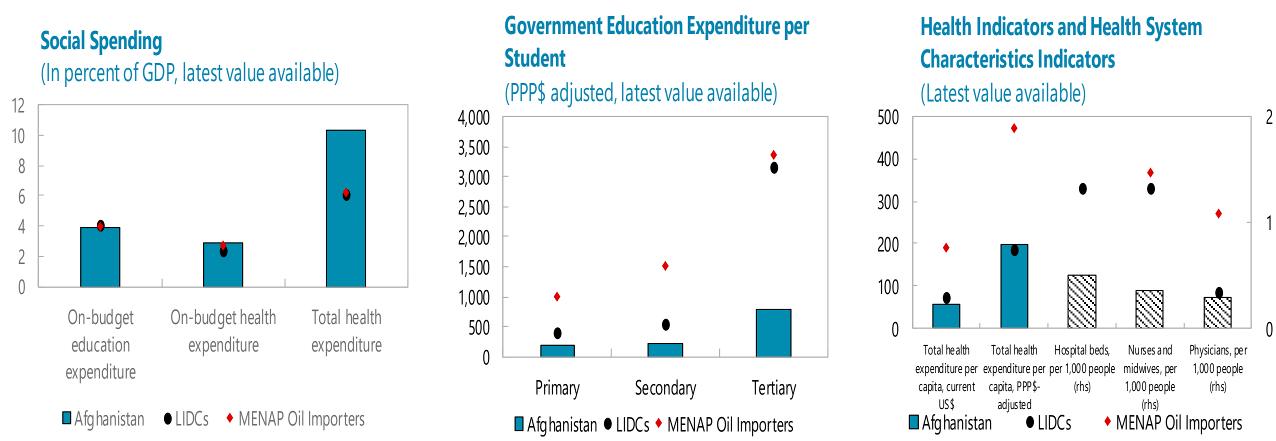


Source: IMF staff estimates.



Source: IMF staff estimates, WEO.

2. Expenditure needs are likely to rise over time. The share in GDP of total social expenditure is comparable to an average LIC's, but much lower in per capita terms. For example, education spending as a share of GDP is comparable to LICs, but on a per-student basis is much lower than comparators, especially tertiary. Similarly, on a per-capita basis, health spending is far below the comparators. This suggests that individual needs are not met by social spending and that higher social spending may be needed in the future.[2]



Sources: IMF FAD Expenditure Assessment Tool (EAT), IMF staff estimates.

[2] This is also indicated by other social indicators, such as higher malnutrition rate among children under age five (40.9 percent, vis-à-vis the LICs' average of 34.8 percent), and lower literacy rate among adults above 15 years old (32 percent, vis-à-vis the LICs' average of 49 percent). See Table 3 in the main text (Poverty, Vulnerability, Inequality, and Social Indicators in Afghanistan).

3. The resource envelope is likely to decline. While we expect domestic revenues to continue to rise from 13.3 percent in 2018 to 16.9 percent in 2024, on-budget grants are expected to stabilize at 14 percent of GDP by 2022, down from about 15 percent in 2018. Total on- and off-budget grants are assumed to fall by 13 percent of GDP over the medium term.[3] These projections are further elaborated in the next section.

B. The Baseline Fiscal Scenario

4. In the baseline scenario, we assume that the security situation will not deteriorate, reforms will continue, and aid will be sustained (albeit at declining levels). Specifically, we assume that:

- **The overall balance including grants will remain at or near balance**.
- **Domestic revenues** will increase to around 17 percent of GDP by 2024, which reflects both policy changes and improvement in revenue collection efficiency. In January 2021, the authorities are planning to introduce a value added tax (VAT), which may bring up to 1.8 percent of GDP of additional revenue.[4] Transit fees from a regional natural gas pipeline project (TAPI) could bring an additional 1.3 percent of GDP beginning in 2023.
- **On-budget grants** will stabilize at around 14 percent of GDP by 2022. Both security and civilian grants are envisaged to slightly increase as off-budget spending moves on-budget. The current donors' commitments for civilian assistance end in 2020 and security in 2021. Hence, figures from 2020/21 forward are staff's projections for the illustrative purposes of this analysis.
- **Operating expenditure** will increase to around 21 percent of GDP by 2024 due to increase in recurrent spending on social sectors and operation and maintenance outlays moving from off- to on-budget.
- **Development expenditure** will gradually increase to around 10 percent of GDP by 2024 in order to support pro-growth and social spending.
- **Operating deficit excluding grants** declines gradually reflecting the government’s commitment to create fiscal space for development expenditure in the medium- to long-run.

[3] In nominal terms, they are assumed to decrease from $7.2 billion in 2018 to $6.2 billion in 2024.

[4] The additional revenue gains are assumed to kick-in gradually as VAT administration improves

Baseline Fiscal Scenario							
	2018	2019	2020	2021	2022	2023	2024
		proj.					
	(Annual percentage change, unless otherwise indicated)						
Real GDP	2.7	3.0	3.5	4.0	4.0	4.0	4.0
Inflation	0.6	2.6	4.5	4.7	5.0	5.0	5.0
	(in percent of GDP, unless otherwise indicated)						
Domestic Revenues and Grants	28.5	26.9	26.5	27.7	29.2	30.7	31.0
Domestic Revenues	13.3	13.9	12.9	14.0	15.3	16.6	16.9
On-budget Grants	15.1	13.0	13.6	13.7	13.9	14.1	14.1
Expenditures	26.9	26.8	26.8	27.7	29.2	30.7	31.0
Operating	18.1	19.2	17.7	18.5	19.8	20.8	20.8
Development	8.8	7.6	9.1	9.2	9.4	9.9	10.2
Operating Balance (excluding grants)	-4.8	-5.3	-4.8	-4.5	-4.5	-4.2	-3.9
Overall Balance (including grants)	1.5	0.1	-0.3	0.0	0.0	0.0	0.0

Sources: Afghan Ministry of Finance and IMF staff estimates.

C. Estimation of Total Grant Needs

5. Given the above assumptions, the required total grants (on- and off-budget) are estimated at $6.4 billion on average, broadly at the current level.

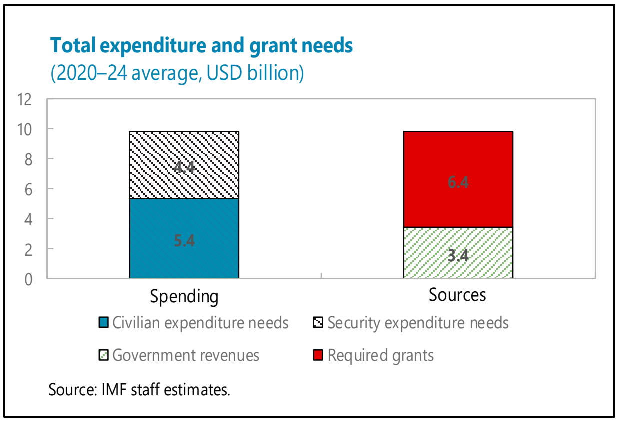
- Total expenditure (on- and off-budget) increases from $9.1 billion in 2020 to $10.6 billion in 2024. Security expenditure needs are broadly unchanged at $4.4 billion for 2020–24, as we assume that security will not deteriorate.[5] Civilian expenditure needs increase from $4.6 billion in 2020 to $6.3 billion, which reflects increasing demand for basic public services by the growing population.[6]

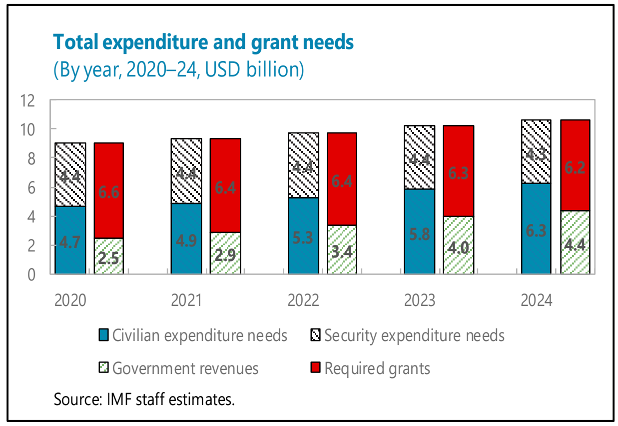
- Domestic revenues average $3.4 billion per year, rising over time.

- The required total grants (the difference between total expenditure needs and government revenues) amount to $6.4 billion per year on average.

[5] Total security expenditure needs are based on the Warsaw conference in 2016 which pledged to support an estimated total security outlays of around $5 billion. Actual execution could be lower than the one envisaged in Warsaw.

[6] Total civilian expenditure needs, in percent of GDP terms, are assumed to be broadly constant.





D. Illustrative Scenario Analysis of Adjustment to Lower Aid

6. There is considerable uncertainty about the levels of civilian and security assistance over the medium term. As outlined in the previous sections, Afghanistan will remain heavily dependent on grants for some time to come. At the same time, grants are likely to decline in the medium term, and may well be lower than current staff assumptions.

7. As a result, we examine two possible adjustment scenarios to lower-than-expected grants. We use fiscal multipliers (FMs) to assess the growth impact of fiscal adjustment in response to lower aid. We make the simplifying assumption that Afghanistan will not have additional domestic or external financing sources to fund a deficit, hence a cut in aid necessitates a cut in spending. As Afghanistan's dependence on aid, albeit diminished, continues post-2024 and with still limited external and domestic financing sources, we consider that a balanced overall budget together with a declining operating deficit (excluding grants) and low public debt is the best anchor for fiscal policy for the time being.

8. Fiscal multipliers for Afghanistan are likely low. For a country like Afghanistan, data constraints and short time series suggest using a "bucket approach" to estimate a fiscal multiplier.[7] The bucket approach is a heuristic method that determines a fiscal multiplier by identifying which of the six structural characteristics considered to impact the size of the fiscal multiplier are present in the economy in question. The more characteristics are present, the higher the multiplier. For Afghanistan, the bucket approach suggests a total spending multiplier of 0.2 (between 0.1 and 0.3) and a short-term tax multiplier of –0.1 (between –0.05 and –0.15). In line with the empirical

[7] N. Batini et. al., (2014), "Fiscal Multipliers: Size, Determinants, and Use in Macroeconomic Projections," Technical Notes and Manuals, Fiscal Affairs Department, International Monetary Fund find the following characteristics are associated with high fiscal multipliers: low trade openness, rigid labor market, small automatic stabilizers, fixed exchange rate, low public debt, and effective PFM (measured by PEFA assessment). For Afghanistan, only low public debt is unambiguously present.

literature, we also assume that the multiplier of government investment is higher than consumption due to positive and lasting impact of development expenditure on output. We assume multipliers for government consumption and investment of 0.13 and 0.28, respectively.[8]

9. Using the multipliers as determined above, we assess the impact from declining aid/expenditure on growth post-2025. For simplicity, we assume all fiscal variables, except expenditure which adjust to the assumed cut in aid, remain at their 2024 levels in percent of GDP. We assume that on-budget grants after 2025 gradually halve by 2030. The adjustment can happen by reduction in either current or development expenditure.

- **Scenario 1**: Aid declines by 7 percentage points of GDP through 2030 and only operating expenditures adjust. The annual effect on real growth is estimated to be –0.3 percent (2025–30 average), relative to the baseline.[9] Hence, the cumulative loss in output would be nearly 2 percent of GDP.

- **Scenario 2**: Aid declines by 7 percentage points of GDP through 2030 and only development expenditures adjust. The annual effect on real growth is estimated to be –0.6 percent (2025–30 average), relative to the baseline. Hence, the cumulative loss in output would be 4 percent of GDP.

Given that a cut in operating expenditures is less detrimental to growth, when adjusting to a cut in aid it would be advisable to protect development spending or rely on a combination of adjustment in current and development expenditure, while recognizing the importance of maintaining or even increasing social spending given its importance for inclusive growth and public support for reforms in the medium term. It is important to note that we trace only the fiscal impact on growth from the cut in aid; in a general equilibrium framework, the growth impact of a significant cut in aid would be much larger and run through multiple channels, with feedback effects on public finances (e.g., lower growth would imply lower domestic revenues via automatic stabilizers).

[8] M. Cerisola et. al., (2015), "Assessing the Impact of Fiscal Shocks on Output in MENAP Countries," Technical Notes and Manuals, Middle East and Central Asia Department, International Monetary Fund find that government consumption (including subsidy and transfer) and investment multipliers for the MENAP lower income countries (but excluding Afghanistan) are 0.5 and 1.1. We assume that (i) a total spending multiplier for the MENAP lower income countries is the average of these two at 0.8, and (ii) for Afghanistan, multipliers for government consumption and investment can be inferred by prorating the estimated total spending multiplier of 0.2 with the comparators' ones (i.e., 0.2*0.5/0.8=0.13, and 0.2*1.1/0.8=0.28)

[9] Here, we assume that cut in spending is identified as a fiscal shock (i.e., purely discretionary and exogenous change). We multiply the change in spending (i.e., fiscal shock) in a given year with the fiscal multiplier to obtain the first-year impact on growth. The fiscal shock has long-lasting effects on growth in later years but is assumed to decay at a rate of 0.6 per year. For technical details, see Batini et. al., (2014). Lower growth would also translate into lower domestic revenues. Assuming tax elasticity of one, decline in growth by 0.3 and 0.6 percent (2005–30 average) in scenario 1 and 2 would imply a reduction in domestic revenue by 0.3 and 0.6 percent of GDP, respectively.

Illustrative Scenario

	2019–24 Average	2025–30 Average		
		Baseline	Scenario1	Scenario2
	(Annual percentage change, unless otherwise indicated)			
Real GDP	3.7	4.5	4.2	3.9
Inflation	4.5	5.0	5.0	5.0
	(In percent of GDP, unless otherwise indicated)			
Domestic Revenues and Grants	28.7	31.0	26.9	26.9
Domestic Revenues	14.9	16.9	16.9	16.9
On-budget Grants	13.7	14.1	10.0	10.0
Expenditures	28.7	31.0	26.9	26.9
Operating	19.5	20.8	16.7	20.8
Development	9.2	10.2	10.2	6.1
Operating Balance (excluding grants)	-4.5	-3.9	0.2	-3.9
Overall Balance (including grants)	0.0	0.0	0.0	0.0

Sources: Afghan Ministry of Finance and IMF staff estimates

E. Conclusion

10. Given uncertainties about grant inflows and available debt financing, a prudent approach to fiscal planning is needed. Targeting a balanced budget (including grants) and a lower operating deficit (excluding grants) while planning for a reduction in aid levels is prudent given the uncertainties that lie ahead. More predictability in donor aid disbursements, including through multi-year commitments, would contribute significantly to reducing uncertainty. The adjustment to lower aid will need to comprise continued domestic revenue mobilization, including from the planned VAT, and expenditure rationalization while protecting the vulnerable and shifting the composition of spending to pro-growth outlays. The simulations in this paper suggest that adjustment to unexpected aid declines should occur through lower current rather than capital spending to minimize the growth impact. The authorities' fiscal strategy paper for the 2020 budget rightly touches on these key challenges, and the further development of an MTFF, in addition to strengthening public financial management that should help raise the efficiency of spending, will assist Afghanistan in planning effectively for an uncertain future and ensure that scarce resources are deployed effectively.[10]

[10] A detailed discussion of the role of fiscal institutions in the Middle East and Central Asia region can be found in Chapter 5 of the October 2019 Regional Economic Outlook for the region.

Annex III. External Sector Assessment[1]

Afghanistan's external position assessed with the updated EBA-lite methodology appears broadly in line with fundamentals. This assessment must be interpreted with caution as the sizeable external financing needs are filled with large foreign aid, equivalent to around 40 percent of GDP. The aid inflows have progressively declined alongside increasing self-reliance which will need to be supported by growing domestic resources, higher private capital inflows, and increased exports. These alternatives to aid would depend on a durable peace, spurring repatriation of overseas capital and boosting private sector confidence and pro-growth investment. In the meantime, while mindful of macroeconomic stability, the authorities should continue strengthening competitiveness and the business environment, including by improving key infrastructure.

1. **Afghanistan's external position assessed with updated EBA-lite methodology[2] appears broadly in line with fundamentals**. The current account balance is largely determined by security and aid-related imports financed by the equivalent grant inflows.[3] Since all grants are counted as current grants due to data deficiencies, the current account (CA) returned a surplus in recent years. The CA excluding grants was in deficit of nearly 30 percent of GDP in 2018. For the assessment with EBA-lite CA approach we assumed roughly 30 percent of aid inflows to be capital transfers and removed these from the CA. The CA approach shows that Afghanistan's current account deficit is in line with fundamentals with the negative current account gap within one percentage point of GDP and the REER approach showing a positive gap of a similar magnitude.

Current Account Approach
(In percent)

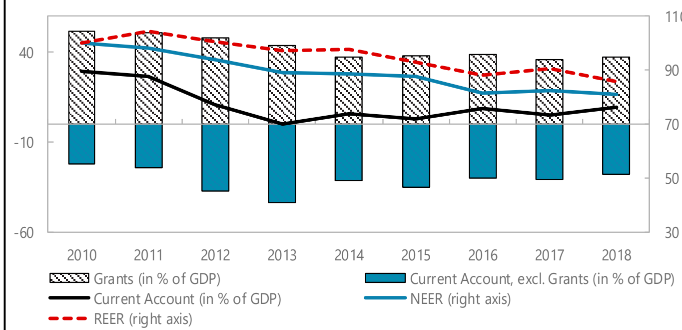
CA-Actual	**-1.9**
Cyclical Contributions (from model)	0.6
Cyclically adjusted CA	**-2.4**
CA-Norm	**-1.6**
Cyclically adjusted CA Norm	**-2.2**
Multilaterally Consistent Cyclically adjusted CA Norm	**-1.7**
CA-Gap	**-0.8**
of/which Policy gap	2.0
Elasticity	-0.2
REER Gap	**0.1**
CA-Fitted	0.4
Residual	-2.3
Natural Disasters and Conflicts	0.1

[1] Prepared by Keiichi Nakatani.

[2] For detailed methodological updates, please see "The revised EBA-Lite Methodology" https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/07/03/The-Revised-EBA-Lite-Methodology-47088

[3] International development partners pledged US$15.2 billion over 2017–20 at the Brussels Conference held in October 2016, while annual military assistance of US$4 billion was pledged at the Warsaw NATO summit in July 2016.

Current Account Balance (excl. Grants) and Effective Exchange Rates
(+=appreciation; 2010=100)



Source: Afghan authorities and IMF staff calculations.

2. Exchange rate developments are dominated by factors other than competitiveness considerations. They include risks due to ongoing violence and regional developments, the level of civilian and military aid disbursements, spending by foreign troops, and dollarization developments. The impact of real effective depreciation observed since 2012 on exports has been dominated by these factors.

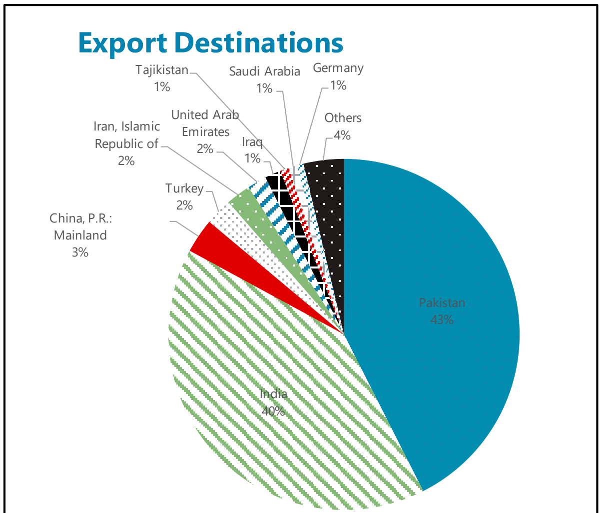
3. The authorities, in line with staff's advice, have allowed the exchange rate to balance the market and intervened only to dampen excessive exchange rate volatility. The 2018 Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) classified Afghanistan's de facto exchange arrangement as "crawl-like" while the *de jure* exchange rate arrangement is "managed floating." There is no target on real exchange rates, and the REER broadly mirrored the NEER in recent years with a gradual depreciation trend. The NEER has depreciated by around 1 percent in the first three quarters of 2019. DAB supplies the foreign exchange market through auctions conducted three times a week. In the first three quarters of 2019, the authorities sold around US$1.7 billion compared with US$1.6 billion in 2018.

4. A quantitative assessment of the impact on Afghanistan's external flows from U.S. sanctions on Iran is not possible due to a lack of data. Anecdotal evidence suggests a drop in remittances to Afghanistan,[4] increased imports from Iran, and increased round-tripping of foreign exchange taking advantage of arbitrage opportunities. The U.S. has exempted from sanctions Chabahar port (see map)—a joint infrastructure project between India, Iran, and Afghanistan, which allows marine transportation to and from India (one of a few trade partners against which Afghanistan runs a trade surplus).

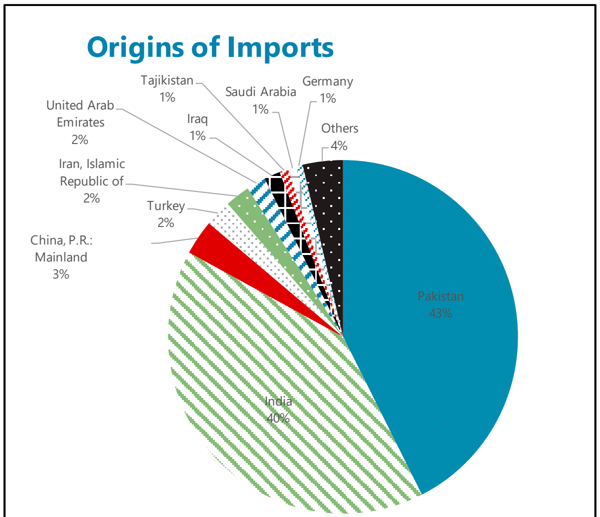
Note: The boundaries, colors, denominations, and any other information shown on the maps do not imply, on the part of the International Monetary Fund, any judgment on the legal status of any territory, or any endorsement of such boundaries

[4] A significant amount of remittances is sent through a money transmission scheme commonly used in this region (hawala), which is difficult for the authorities to fully capture under the BoP.

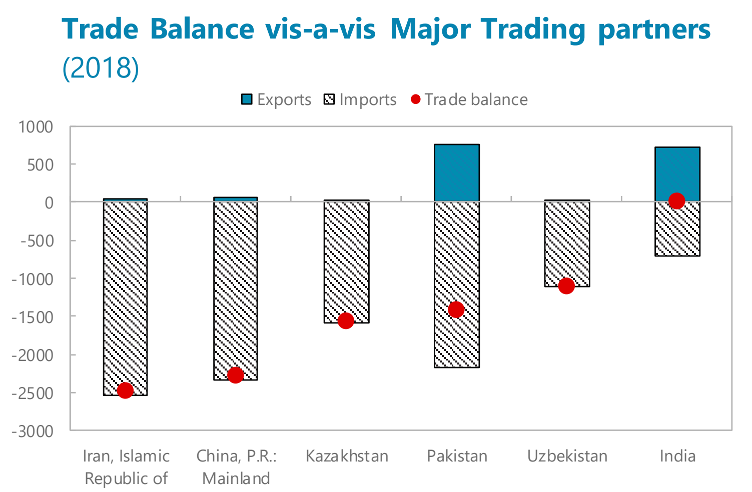
5. The authorities have been adopting measures to improve the trade balance. These include efforts to diversify export destinations and increase import substitution. Afghanistan's exports are very small at around 4.5 percent of GDP and dominated by agricultural products (nearly three quarters of exports). The origins of imports are more diverse than export destinations. Afghanistan has been running trade deficits against majority of its trading partners.



Source: DOT, IMF



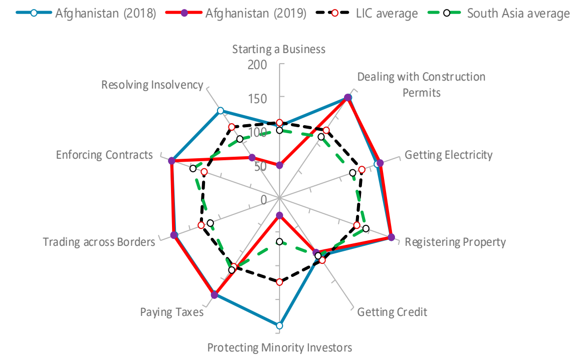
Source: DOT, IMF



Source: DOT, IMF

6. While the business environment has improved, the economy is still facing structural impediments to competitiveness primarily due to the on-going conflict. Afghanistan improved the most in the 2019 World Bank Doing Business indicators, with its ranking jumping to 167th from 183rd out of 190 countries. The improvement comprised simplified business registration, strengthened minority investor protections, corporate governance structure, and insolvency framework. Improvements in the business environment should continue.

Doing Business Report
(Rank, 2019)



Source: World Bank Doing Business Report 2019.

7. The country's trade competitiveness is weighed down by the conflict and landlocked location. This is reflected in Afghanistan’s poor score in the World Bank's 2018 Logistics Performance Index (LPI). To ease those constraints, the authorities have established air corridors including to India, China, Turkey and some European countries, which helped to increase exports over the past two years.

8. Regional integration could alleviate constraints due to the landlocked location.[1] Improved regional connectivity would be key to unlocking trade potential including of the natural resources. 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, 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). The inclusion in cross-border electricity transmission networks will boost Afghanistan's trade and transit activities between Central and South Asia. The completion of a regional natural gas pipeline project (TAPI) exporting natural gas (TUR, AFG, PAK, IND) would increase gas supply in Afghanistan and tax revenue from fees for the use of the pipeline by Pakistan and India.

9. Foreign direct investment (FDI) and capital flows are negligible due to high risk related to the ongoing conflict. Annual FDI flows into Afghanistan-mostly from the United Arab Emirates and China-were less than 1 percent of GDP per year during 2011–18. Afghanistan does not have access to international capital markets. While according to the Extractive Industries Transparency Initiative (EITI), Afghanistan's vast reserves of mineral wealth, including gold, copper, iron, rare-earth metals, and uranium-could exceed one trillion U.S. dollars, a poor regulatory framework and investment environment due in large part to political and security uncertainties have prevented meaningful investment in this area. In early 2019, Afghanistan's membership in EITI was suspended due to inadequate progress in implementing the EITI standard.

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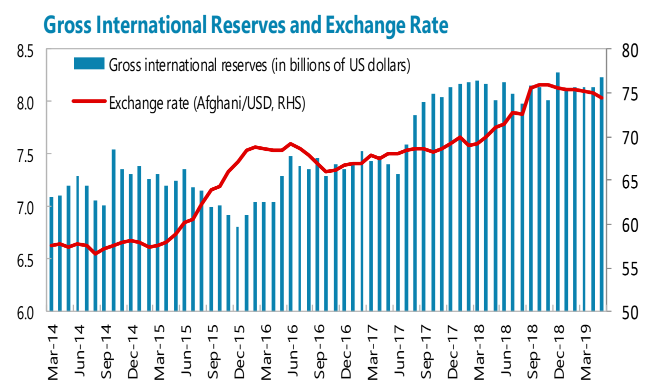
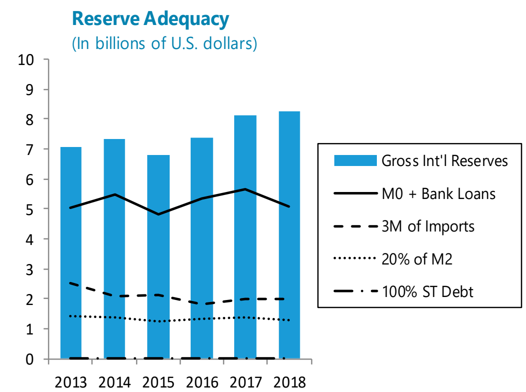
[5] See Selected Issues Paper included in 2017 Article IV, “Afghanistan’s Integration in Regional Trade: A Stocktaking.”

10. Errors and omissions have been persistently large despite some improvements in BoP statistics. Large negative errors and omissions might be attributable to unreported smuggled imports, overestimation of off-budget grants, and unrecognized cash holdings of foreign currencies by the private sector outside the formal financial system (which is recorded as an increase in assets under "other investment"). Other important flows missing in the current BoP statistics are remittances through the "hawala" scheme and opium exports. Both would rely on cash holdings. Anecdotal evidence suggests as much as US$1 billion could be passing through unrecorded hawalas, while the United Nations Office for Drugs and Crime (UNODC) estimated that Afghanistan's opium production (farm-gate value) would be US$ 0.6 billion in 2018, a significant decline by 56 percent relative to 2017.

11. The stock of gross FX reserves exceeds by a large margin all traditional metrics of reserve adequacy. With gross reserves close to 12 months of imports and 40 percent of GDP, reserves are adequate. Reserves are also a multiple of total external debt, which is long term and highly concessional, and exceed money supply by 28 percent. The methodology for "Assessing Reserve Adequacy in Credit-Constrained-Economies (ARA-CC)" does not produce meaningful results because of data limitations and very high levels of aid dependency (e.g., lack of a proxy for costs of holding reserves).



Sources: Afghan authorities and IMF staff calculations.



Sources: Afghan authorities and IMF staff calculations.

12. Afghanistan is a large net creditor based on its International Investment Position (IIP) due to large foreign reserves and low levels of external public debt. The net assets are about US$5.3 billion (about 30 percent of GDP). In addition to international reserves (US$8.3 billion), currency and deposits in deposit-taking institutions are the largest IIP assets (US$1 billion). Liability positions are mainly general government external debt (US$2.1 billion, including some US$900 million pending pledged debt relief commitments) and foreign direct investment (US$1.6 billion). Like the BoP, significant data uncertainties pertain to direct investment, and other assets and liabilities of the private sector.

13. The authorities agreed with the thrust of the assessment and policy recommendations which are broadly in line with their policies aimed at maintaining a sustainable external position and policy buffer preparing for the expected gradual decline of grant inflows.

Annex IV. Governance and AML/CFT[1]

The purpose of this annex is to discuss Afghanistan's legal and institutional framework, including enforcement mechanisms, to combat corruption and money laundering. Towards this end, the annex examines the main policy priorities and commitments made both domestically and internationally. Afghanistan's progress in addressing its significant and well documented corruption and governance weaknesses is encouraging. While institution building and adoption of laws and strategies are clear signs of commitment to fight corruption, results are still lagging intentions, and hence stepped up efforts are needed to make decisive inroads into strengthening governance.

A. Anti-Corruption

1. The detrimental effects of corruption on political and social stability and state building efforts are widely recognized.[2] In fragile states where institutions may be nascent or lacking capacity, and public confidence in government bodies is low, governance weaknesses can be even more damaging. In Afghanistan, corruption has long been linked to conflict and poses a challenge to reconstruction and peace efforts, the delivery of aid and public services, and an efficient security sector. Conversely, conflict is also recognized as a driver of corruption. Reducing the exposure of citizens to corruption in their daily lives, addressing corruption risks in vital sectors, and improving accountability in government will be instrumental to fostering trust and re-building a secure society. Likewise, the government's efforts towards peace are also an important aspect of its anti-corruption agenda.

2. In this difficult context, Afghanistan has had notable achievements strengthening its anti-corruption laws. Supported by the IMF's Extended Credit Facility (ECF) arrangement and other donors, Afghanistan has greatly improved its legislative framework, including by criminalizing corruption offences in line with the United Nations Convention Against Corruption (UNCAC). Laws were also passed to codify obligations of public officials to declare their assets, protect reporters of corruption, and improve access to information. Recent amendments to the Anti-Corruption Law have clarified the legal bases for the establishment and operations of key anti-corruption bodies.

3. Although important improvements have been made, Afghanistan's institutional framework for fighting corruption needs to be solidified with appropriate safeguards. The overarching institutional framework for combating corruption has been evolving.[3] The main bodies

[1] Prepared by Kathleen Kao.

[2] For an analysis focused on the Middle East and Central Asia, see "*Curbing Corruption through Better Economic Governance" IMF 2019, forthcoming.*

[3] Several agencies that were previously involved in anti-corruption (notably, the High Office for Oversight and Anti-Corruption and the Independent Joint Anti-Corruption Monitoring and Evaluation Committee) have been abolished and their functions absorbed into existing agencies.

currently involved in anti-corruption include the High Council for Rule of Law and Anti-Corruption,[4] the Administrative Office of the President (AOP), the Anti-Corruption Justice Center (ACJC), and the Office of the Attorney General (AGO) (which jointly investigate and prosecute corruption offences). Missing from the institutional framework is a body responsible for the development and implementation of preventive measures. To this end, an Anti-Corruption Commission is being established, but progress is slow. Further, due to the conditions in public service inherited by the current administration (weak capacity and high corruption vulnerabilities) many anti-corruption functions have been concentrated in the executive. The High Council—tasked with oversight of the National Strategy and the conduct of line ministries—is the main body generating anti-corruption policies and priorities. Further, the system of asset declarations is currently overseen by the AOP. While this arrangement arose from capacity and security concerns and was envisioned to be temporary (pending the operationalization of the Anti-Corruption Commission), vesting the office of the executive with oversight of the asset declarations of public officials has a significant potential for political interference.

4. The authorities recognize the country's corruption challenges, but a proliferation of commitments has resulted in difficulties in prioritizing. Afghanistan has made several high-level commitments, both domestically and internationally, to fight corruption. The government's main policy priorities are captured in the Afghanistan National Peace and Development Framework (ANPDF) 2017–2021, the Geneva Mutual Accountability Framework (GMAF), and Afghanistan's 2017 National Strategy for Combatting Corruption. While the priorities of the ANPDF have been integrated into the Anti-Corruption Strategy, less overlap exists with the GMAF. In addition, Afghanistan has agreed on other benchmarks with donors and international organizations. While these agreements demonstrate the government's commitment to governance reforms, they have resulted in an overambitious agenda of activities, which do not provide a clear roadmap for addressing the country's main corruption risks.

5. Afghanistan's asset declaration regime has significantly improved, but its utility is limited. The AOP has been recognized for its successes registering asset declarations, receiving 17,500 asset declarations in 2018 and 17,255 in the first seven and a half months of 2019 (of a total of about 22,000 positions[5] subject to disclosure).[6] Officials who do not file their asset declarations are subject to a salary freeze and restrictions on other liberties (such as travel). In 2019, 758 officials (including 12 former Ministers and one sitting Minister) are under such a sanction; all non-declarants sanctioned in 2018 have since filed to receive their salaries. Further, two Provincial Governors, two Members of Parliament, one Deputy Minster, and one former Minister have been forwarded to the prosecutor's office for submission of false declarations. However, a very small percentage of asset declarations have been verified. Submissions are vetted by the AOP's registration and analysis

[4] The High Council's membership is stipulated by the Decree and comprises the President, Vice-President, Chief Justice of the Supreme Court, National Security Advisory, AOP Chief of Staff, Ministries of Finance, Justice, and Internal Affairs, Attorney General, Director General of National Security, Advisor to the President on Transparency and Anti-Corruption Affairs, the Heads of various commissions and offices.

[5] Approximately 20 percent of these positions are vacant.

[6] Until 2018, the number of asset declarations submitted historically since 2009 totaled 11,000.

department, which has flagged approximately 3,600 declarations. Due to difficulties cross-checking and corroborating information, only 100 of these declarations have been verified. Resource limitations are compounded by shortcomings in Afghanistan's registries (e.g., land, property, municipality, transport, companies), which are often not digitalized (where they exist) or are incomplete or inaccurate. Verification of bank accounts, on the other hand, can be performed quickly with the assistance of FinTRACA (Afghanistan's financial intelligence unit). Declarations are also not digitalized, which does not allow for them to be published, linked to other databases, easily made available to other agencies. Although digitalization efforts are underway, at present, they are focused on storage (scanning of hard copies) starting with the oldest asset declarations.

6. Afghanistan has made progress in its efforts to pursue criminal cases of corruption. The ACJC was created in 2016 as a specialized structure[7] to handle cases of corruption and financial crime involving high-ranking officials and implicating amounts exceeding Af 10 million (approximately US$114,000).[8] The mandate and jurisdiction of the ACJC were recently clarified in the new Anti-Corruption Law passed in 2018. Cases falling outside of the ACJC's jurisdiction will be handled by the Deputy Attorney General for Anti-Corruption and progress through the regular court system. In all instances, the main responsibility for detecting corruption (and other criminal offences) lies primarily with police bodies (including the Major Crimes Task Force). From its establishment until May 2018, the ACJC Primary Court has tried a total of 57 cases involving 223 defendants, resulting in 177 convictions. Allegations against the President, Ministers, and sitting judges of the Supreme Court are investigated pursuant to special procedures; cases are heard before special courts established on an ad hoc basis. Cases against two Ministers are currently ongoing. Legislative updates are also underway to fully operationalize the Office of Asset Recovery situated in the Deputy Attorney General for Anti-Corruption. At present, only assets that have been seized as evidence during an investigation are able to be recovered, but new regulations are being developed to allow for more effective tracking, tracing, and freezing of assets related to corruption.

7. Enforcement actions still face significant obstacles and do not effectively target proceeds of corruption. Security concerns and capacity constraints are key impediments to corruption investigations in Afghanistan. In addition to direct threats to the personal safety of law enforcement, the security situation also poses evidentiary challenges (gathering information and securing witnesses in the provinces). Investigators also vary in their ability to identify and uncover criminal conduct giving rise to more complex offences. The timelines stipulated in the Criminal Procedure Code also constrain the ability of investigators to pursue more difficult cases. As a result, cases do not routinely forge links between acts of corruption and money laundering. The most frequently laid corruption charge is misuse of authority, for which investigators do not regularly identify a financial dimension. Most cases of misuse of authority are not accompanied by other

[7] The ACJC is comprised of three layers: (i) investigative (embedded in the police); (ii) prosecutorial (situated in the AGO); and (iii) adjudicative (specialized courts with final appeal heard by the Supreme Court).

[8] With the exception of the offences of bribery and money laundering, which will fall within the jurisdiction of the ACJC if the funds implicated exceed five (5) million Afs.

criminal charges; however, the authorities have been increasing their focus on connections with other corrupt acts (such as bribery and embezzlement).[9]

8. The authorities also face difficulties ensuring the presence of the accused resulting in a high number of cases being tried in absentia. The Criminal Procedure Code allows prosecutors to release defendants or without bail (which can be no less than the loss incurred by the offence), or upon the guarantee of another individual. Guarantors are required to pay the amount of bail only where they are not deemed to be "reliable and credible." The frequency of bail being conditioned upon the verbal guarantee of a reliable and credible guarantor and difficulties policing the borders has resulted in a large number of absconders

9. The authorities are working to align enforcement actions with priorities identified by the National Anti-Corruption Strategy. On the one hand, police corruption has been targeted (Ministry of Interior is the agency most frequently implicated in enforcement actions), but on the other, relatively few corruption cases reaching trial have involved officials from Ministry of Defense[10] despite the security sector being named as the most critical. Difficulties securing judgments against high-ranking officials may stem partly from above challenges as well as a need to raise capacity among judges and prosecutors.

Recommendations:

10. Prioritize policies and deliverables. In coordination with donors, focus policies and priorities around the most critical corruption risks with the understanding that establishing longer-term timeframes does not necessarily signal a diminishment of importance. Action plans and strategies need to be appropriately sequenced and reflect realistic timelines, manageable actions/deliverables, and the capacity of relevant agencies and stakeholders. Ministries and agencies should establish and manage their own action plans separate from but harmonized with national plans for more effective and measurable implementation.

11. Solidify the institutional framework and strengthen independence of agencies. The Anti-Corruption Commission should be operationalized as the preventive body and could absorb several functions now carried out by separate bodies. As overall capacity is strengthened, a strategy should be developed to gradually cede more anti-corruption responsibilities to relevant agencies.

12. Harmonize legal framework. Ensure that the legal framework does not contain conflicting provisions upon the establishment of the Anti-Corruption Commission. Ensure that the authority responsible for asset declarations is able to request and access information as needed for verification confidentiality or non-disclosure provisions in other laws notwithstanding.

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[9] Out of the 21 cases of misuse of authority that have been heard by the primary ACJC court, 11 were standalone, 3 were accompanied by a charge of forgery, and 7 were accompanied by a charge of bribery or embezzlement.

[10] In its 2019 report on Afghanistan's Fight Against Corruption, UNAMA reported that no Ministry of Defense officials were tried in 2018–2019, although several were indicated. A case involving 10 former Ministry of Defense officials is currently under appeal.

13. **Enhance system of asset declarations**. The AOP's capacity should be strengthened while it retains temporary responsibility over the asset declaration regime. The criteria for verification should be clarified and consideration could be given to separating the processes for verification and validation (addressing inconsistencies). Finally, digitalization efforts should focus on the creation of an electronic filing system that would provide a machine-readable database and allow for publication of declarations.

14. **Continue e-governance efforts and strengthen registries**. Strengthen the quality and comprehensiveness of land and property cadasters. "Zombie" entities should also be removed from the company registry.

15. **Improve the capacity of enforcement bodies**. The authorities should build the capacity of investigative bodies to better identify and detect specific corruption offences, which could lead to more complex cases of corruption. They should also improve the knowledge and abilities of investigators to conduct parallel financial investigations on a regular basis to facilitate the identification and recovery of corrupt proceeds. Law enforcement should be empowered and equipped to pursue cases against high-level officials, particularly those in sensitive sectors. Further training should be provided to prosecutors to improve their ability to try corruption cases.

16. **Strengthen pre-release procedures**. The Criminal Procedure Code should clearly stipulate bail conditions. The authorities should consider amendments requiring bail to be paid by either the defendant or a guarantor and to allow for more flexibility in setting the bail amount. The capacity of prosecutors and judges to determine bail and assess flight risk in corruption cases should be enhanced.

B. Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT)

17. **Afghanistan's economy is highly exposed to illicit flows, including those emanating from corruption**. According to the authorities, a significant (but unquantifiable) amount of the country's financial flows either originate from an illegal source or pass through illegal channels. In its 2018 Afghanistan Opium Survey, the United Nations Office on Drugs and Crime (UNODC) estimated that the opiate economy accounted for about 6–11 percent of GDP. Illegal drug production also represents a significant source of funding for insurgent forces. Corruption is both a significant source of illicit flows and an obstacle to the effective control of proceeds-generating crimes.

18. **Underground financial activities are also a channel for corrupt proceeds**. The Afghan economy is primarily cash-based with the majority of financial activities taking place through informal channels, such as hawalas and cash couriers. These entities include both unlicensed money service providers (MSPs) and foreign exchange dealers (FXDs) as well as entities operating outside the legal framework. This sector is therefore considered to pose a high risk of money laundering and terrorism financing (ML/TF). Afghan authorities estimate that unlicensed businesses account for

approximately 20–30 percent of financial flows and there are an unknown but considerable number of illegal operations.

19. The AML/CFT regime can be a powerful instrument in a country's anti-corruption efforts. Corruption and money laundering are intrinsically linked. As with other economic crimes, the Illicit origin of gains derived from corrupt acts generally needs to be disguised for such gains to be enjoyed. A country's AML/CFT regime not only can help shield the financial sector from such illicit flows but can be instrumental in the detection and enforcement of corruption offences and the identification and recovery of corrupt proceeds. It also provides an additional channel for international cooperation, which is critical as major proceeds of corruption are often laundered abroad. Pursuant to AML/CFT rules, individuals, such as politically exposed persons (PEPs), who are more exposed to corruption risks by virtue of their position or standing, should be subject to higher scrutiny. The AML/CFT regime also promotes transparency of corporate ownership and calls for the identification of the ultimate beneficiaries of assets and financial transactions. When properly operationalized, an asset declaration system can help detect illicit enrichment and the laundering of proceeds of corruption. Finally, financial investigations may yield evidentiary support for the underlying criminal conduct and can bolster the ability of investigative bodies to detect specific corruption offences.

20. At present, the Afghan AML/CFT regime is not sufficiently leveraged to tackle proceeds of corruption. The authorities are in the process of finalizing the National ML/TF Risk assessment, which has preliminarily identified MSPs/FXDs and the real estate sector as being the most vulnerable. This finding notwithstanding, AML/CFT supervision of non-financial sectors (notably, real estate) has not yet commenced. With the help of regulatory authorities, the understanding and application of preventive measures by Afghan financial institutions has been improving, but further strengthening is needed. Trends noted in DAB's latest cycle of inspections, included customer due diligence (CDD) deficiencies, incorrect risk profiling, and failure to identify domestic PEPs. Banks' transaction monitoring systems are also still being refined, which could be one reason red flags related to corruption are not frequently identified**.** Only seven suspicious transactions relating to corruption were flagged by banks in 2018 (constituting 1.9 percent of all transactions labelled suspicions). Understanding of beneficial ownership also varies across the financial sector. Non-bank financial institutions, such as MSPs and FXDs lag considerably further behind banks in their ability to identify and verify the identity of customers. Towards this end, DAB has intensified its supervisory activities, including by conducting targeted inspections (e.g., on PEPs). Likewise, FinTRACA has been conducting outreach activities specifically to raise awareness CDD/KYC rules among the MSP/FSD sector and has imposed sanctions (in the form of monetary penalties, suspension of activities, and revocation of license) where deficiencies have been identified.

21. Corruption enforcement could be better supported by parallel financial investigations. Although corruption is acknowledged as a significant source of illicit flows, only one corruption case has been accompanied by a money laundering charge. Investigative bodies do not regularly conduct financial investigations in parallel with investigations into the underlying criminal conduct, nor do money laundering investigations appear to reinforce criminal investigations. Authorities are not yet pursuing complex money laundering cases; all but one of the money laundering cases heard by the primary ACJC court to date have been standalone. These limitations also impact the ability of authorities to identify and recover proceeds of corruption.

Recommendations

22. **Improve coordination of national AML/CFT and anti-corruption priorities**. National AML/CFT and anti-corruption policies and priorities should be harmonized, and the respective national committees should coordinate. The findings of the National ML/TF Risk Assessment also should be reflected and disseminated to relevant stakeholders.

23. **Undertake targeted measures to reduce illicit financial channels**. Supervisory, intelligence, and enforcement agencies should work together to identify and shut down unlicensed entities providing financial services.

24. **Improve implementation of AML/CFT preventive measures**. The authorities should continue to improve the implementation of preventive measures among reporting entities, notably with respect to enhanced due diligence for politically exposed persons and beneficial ownership requirements through outreach and training. The overall legal framework (e.g., pertaining to the corporate registry) could be refined to improve the availability and accessibility of beneficial ownership information. Finally, the asset declaration regime should be mobilized to facilitate detection and investigation of the laundering of proceeds of corruption.

25. **Strengthen AML/CFT supervision over high risk sectors.** Efforts to strengthen AML/CFT supervision of financial entities, in particular over MSPs and FXDs, should be continued. The authorities should also initiate AML/CFT supervision over non-financial sectors at high risk of ML/TF, such as in the real estate sector. Penalties for compliance deficiencies should be effective, proportionate, and dissuasive.

26. **Enhance capabilities of law enforcement to allow for ML and corruption cases to complement each other**. Improve the understanding of investigative bodies of the importance of pursuing parallel investigations, particularly in corruption cases, and raise their capacity to do so on a routine basis. Pursuing more complex cases of corruption could advance such efforts. The priority of pursuing money laundering cases in conjunction with predicate offences (notably, corruption) should be elevated.

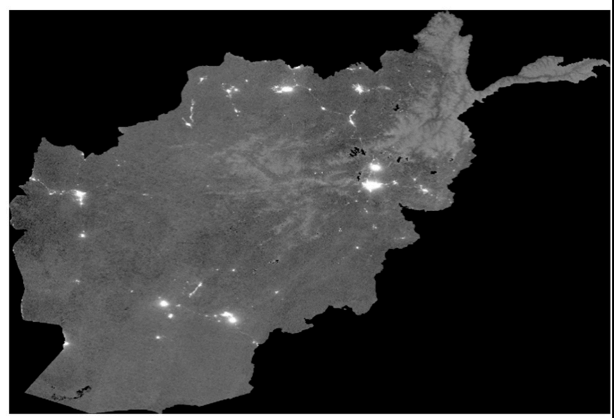
Annex V. Illuminating the Provinces: Estimating Subnational GDP in Afghanistan Using Satellite Imagery[1]

Afghanistan currently does not produce GDP estimates by province. In this paper, we estimate annual subnational GDP in Afghanistan employing an innovative method that uses publicly available, high frequency satellite nighttime lights data. The estimated subnational GDP levels are consistent with the distribution of major economic centers. We also estimate national level GDP using elasticities between nighttime lights and economic activity estimated for economies comparable to Afghanistan. We find that such estimates track the official estimates relatively closely.

1. **In this annex, we estimate annual subnational GDP in Afghanistan using satellite nighttime lights data**. In Afghanistan, official subnational GDP estimates are currently unavailable, and national level GDP data are published annually with a half-year lag. Alternative methods of estimating GDP, such as the one described here, are becoming increasingly popular in developing countries as they provide additional information in the absence of reliable official data (including due to conflict and lack of capacity), help to estimate aggregate output of the informal sector, and provide a comparator for the estimates that use traditional statistical methods.

2. **Satellite nighttime lights data have been shown to correlate with economic activity**. This correlation was first documented in Henderson, et al., (2012)[2] for all the countries with available nighttime light data. This work paved the way for the subsequent literature, including applications to conflict affected countries and estimations of subnational GDP, also at the IMF. For example, Debbich (2019)[3] uses nightlights to estimate the contraction of economic activity in Yemen throughout the ongoing conflict. Also, Beyer et al., (2018),[4] [5] propose a measure of monthly economic activity in South Asia at the district level based on nightlights data and rural population estimates. The above applications aimed at overcoming data

Satellite Nighttime Lights Image for Afghanistan



Source: National Oceanic and Atmospheric Administration, and IMF staff calculations.

[1] Prepared by Tetyana Sydorenko. Comments and guidance from Mariusz Sumliński gratefully acknowledged.

[2] Henderson, J. V., Storeygard, A., & Weil, D. N. (2012). Measuring economic growth from outer space. The American Economic Review, 102(2), 994–1028.

[3] Debbich, Majdi, 2019, "Assessing Oil and Non-Oil GDP Growth from Space: An Application to Yemen 2012–17" forthcoming IMF Working Paper.

[4] World Bank, 2017, "Growth Out of the Blue," South Asia Economic Focus.

[5] Beyer, T., Chhabra, E. & Galdo, V. (2018). Measuring Districts' Monthly Economic Activity from Outer Space (No. 8523). World Bank Policy Research Working Paper.

deficiencies due to conflict in largely rural economies suggest that this method may be usefully employed for Afghanistan.

3. We obtained nighttime lights data from the National Oceanic and Atmospheric Administration. Currently, the data are collected and managed by the Colorado School of Mines. Data, published monthly, and may be aggregated to any well-defined subnational geographical level, including for example provinces or districts.

4. To estimate GDP for Afghanistan using nightlight intensity we proceed as follows:

a) Noting that agriculture is largely unlit and its contribution to GDP would not be picked up by nighttime lights, we use the official estimates of agriculture's contribution to GDP,[6] [7] To obtain estimates of the provincial shares of agriculture we proxy the relevant GDP shares of each province using the provincial distribution of rural population.

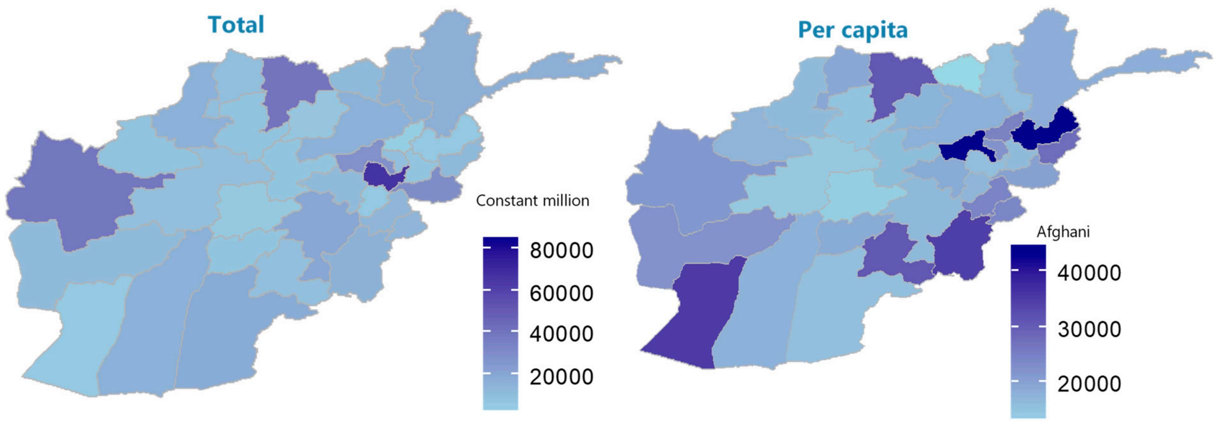
b) Non-agricultural GDP is estimated using nighttime light intensity and is allocated to each province per the distribution of nighttime lights. Nighttime light intensity clearly identifies the respective shares of each province in aggregate economic activity.

c) Next, we sum the estimates for agricultural and non-agricultural sectors for GDP per province. Below figure shows estimated total GDP and GDP per capita at province level in 2018. Economic centers like Kabul, Balkh and Herat are clearly recognizable with GDP over Af 40 billion (about 2 percent of total). In line with priors, per capita GDP figures are the highest in provinces neighboring Kabul, including Parwan and Nuristan with GDP per capita over USD 600. Panel titled "Afghanistan: Province Level GDP" shows time series of provincial GDP in Afghanistan for 2002–18 period (see also Table 1).

[6] The relationship between nightlight intensity and agricultural output is judged to be weak. See: Ghosh, T., Elvidge, C., Sutton, P. C., Baugh, K. E., Powell, R., & Anderson, S. (2010b). Shedding light on the global distribution of economic activity. The Open Geography Journal. 3, 147–160.

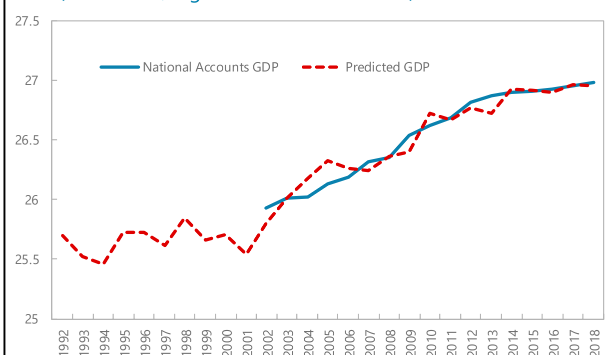
[7] Bundervoet, T., Maiyo, L., & Sanghi, A. (2015). Bright Lights, Big Cities—Measuring National and Sub-National Economic Growth from Outer Space in Africa, with an Application to Kenya and Rwanda (No. 7461). World Bank Policy Research Working Paper.

Afghanistan: Province Level GDP in 2018



Source: IMF staff calculations.

Official and Predicted Measures of Afghanistan's GDP
(1992-2018, log of GDP in constant Afs)



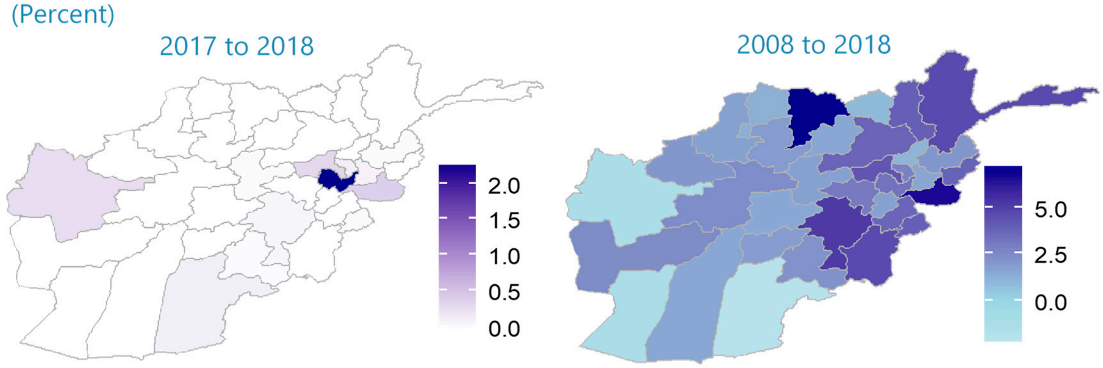
Source: Afghan authorities, and IMF staff calculations.

5. **National level GDP may also be estimated using nighttime lights to GDP elasticities estimated for other economies comparable to Afghanistan**. Such estimates provide another benchmark for our estimates or the official estimates, or a substitute for the latter should they be unavailable. In the figure to the right we plot official and estimated measures of Afghanistan's GDP for 1992–2018. The estimated and official GDP follow broadly similar trends. For 1992–2002 the estimated GDP (official estimates are not available) shows a largely stagnant economy, as expected for a country engulfed in a full-scale civil war.

6. **Subnational GDP estimates are used to calculate province-level contributions to the economy**. Unsurprisingly, Kabul had the highest contribution to growth from 2017 to 2018 at 2.3 percent (2.7 cumulative national growth), while Balkh and Nangarhar had the highest contribution to Afghanistan growth over the past decade at 7.2 and 6.7 percent respectively (87 cumulative national growth from 2008 to 2018).

Afghanistan: Provincial Contributions to GDP Growth

(Percent)



Source: IMF staff calculations.

7. **GDP estimation using satellite imagery has many potential applications**. One could estimate economic activity for various geographical aggregates to inform investigations of tax intake, shadow economy activities, or to evaluate the effect of economic shocks on GDP growth or a near-real time impact of various policy interventions. At the same time, the estimates based on satellite imagery should best be thought of as complementing GDP estimates based on traditional methods to maximize the informational benefits of both methods.

Afghanistan: Province Level GDP
(2002-18, constant million Afs)

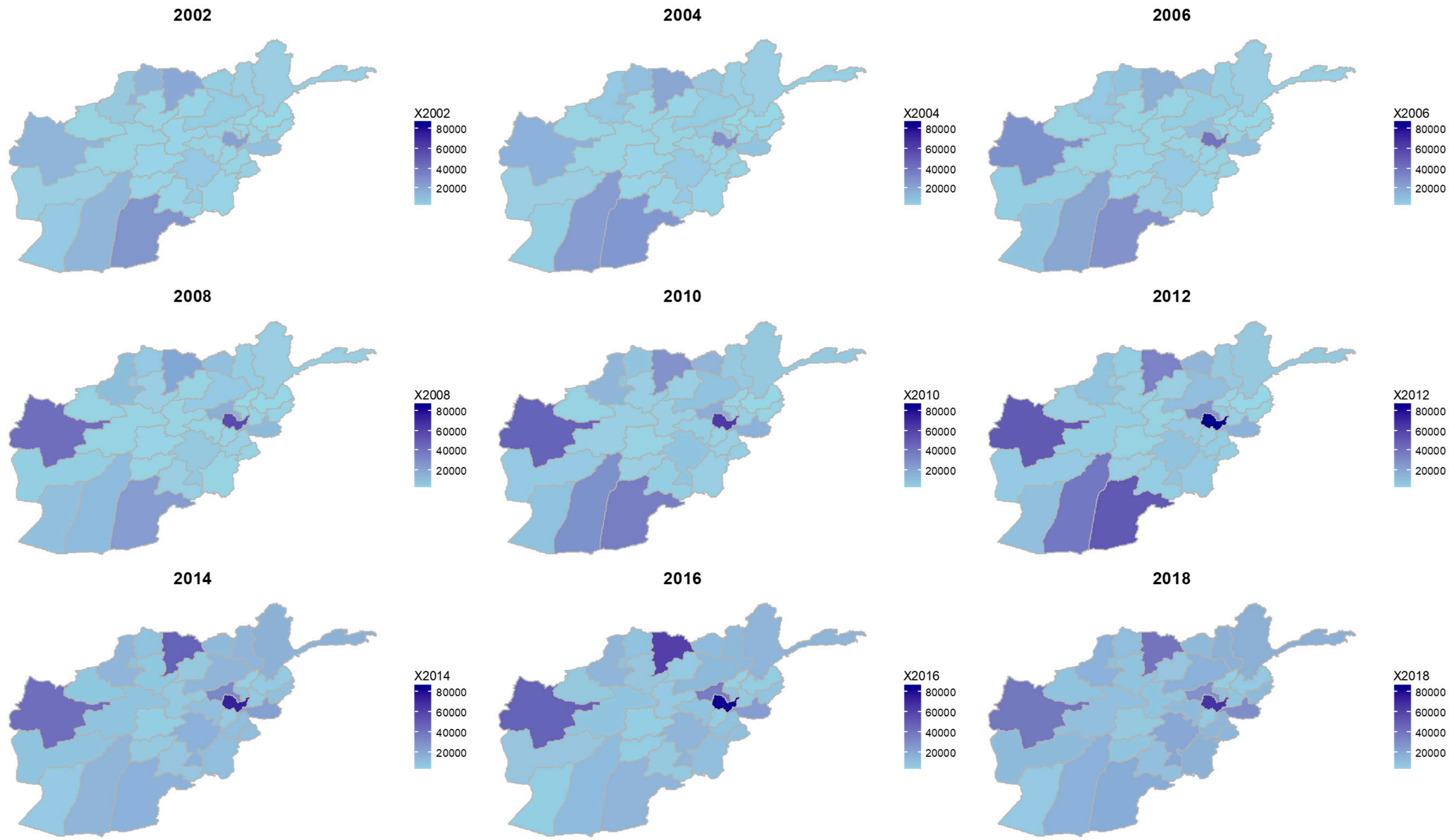


Table 1. Afghanistan Province Level GDP (constant Afs, million) 1/

Province	2002	2003	2004	2005	2006	2007
Badakhshan	3,399.96	3,849.35	3,192.45	3,579.94	3,500.28	4,402.81
Badghis	2,102.65	2,395.88	1,914.98	2,365.38	2,199.29	2,459.04
Baghlan	4,788.14	5,279.09	4,829.74	5,069.45	4,376.27	4,937.02
Balkh	18,890.24	13,484.46	20,119.61	18,247.31	16,765.32	19,336.38
Bamyan	1,503.46	1,768.84	1,618.01	1,993.46	1,897.22	2,363.26
Daykundi	1,468.98	1,546.69	1,236.75	1,447.91	1,404.00	1,672.92
Farah	3,148.40	4,449.79	3,535.68	4,748.39	4,200.63	4,071.29
Faryab	5,601.89	5,004.81	6,228.41	6,694.26	6,103.12	8,730.92
Ghazni	5,800.99	5,891.22	4,974.76	5,862.88	4,929.00	6,293.62
Ghor	2,364.79	2,585.47	2,101.02	2,454.62	2,403.03	2,963.95
Hilmand	13,186.52	21,241.15	23,923.75	22,766.84	20,335.74	15,176.34
Hirat	12,889.02	15,026.05	15,297.76	22,141.41	28,232.74	35,965.98
Jawzjan	13,239.76	8,176.61	10,303.02	9,923.01	7,789.40	7,923.82
Kabul	22,251.90	27,828.12	28,533.05	32,196.29	40,218.34	46,129.46
Kandahar	26,534.19	28,153.89	25,347.33	26,389.87	27,824.96	26,679.06
Kapisa	1,521.40	1,601.89	1,280.89	1,564.23	1,454.10	1,802.94
Khost	2,573.98	3,065.41	2,320.46	2,448.45	2,283.74	2,911.41
Kunar	1,511.55	1,591.52	1,272.59	1,504.65	1,623.81	1,804.74
Kunduz	4,298.27	6,200.26	6,583.54	7,349.81	9,317.48	11,259.64
Laghman	1,656.13	1,870.71	1,563.14	1,873.92	1,654.39	2,163.34
Logar	1,322.61	1,392.58	1,283.03	1,879.84	1,540.72	2,055.74
Nangarhar	8,962.21	10,248.57	7,983.02	9,069.66	9,156.43	11,171.30
Nimroz	4,919.79	4,236.90	4,438.41	4,811.99	7,157.66	7,785.28
Nuristan	512.30	539.40	431.31	527.11	489.63	583.42
Paktika	1,495.02	1,574.11	1,298.30	1,709.97	1,515.04	1,877.06
Paktya	1,889.05	2,322.48	2,082.49	2,570.84	2,336.09	2,716.48
Panjshir	531.30	559.40	447.30	551.38	689.18	844.65
Parwan	2,631.11	3,128.89	4,702.07	7,637.84	9,372.68	13,494.87
Samangan	1,449.70	1,762.15	1,528.22	1,866.68	1,872.08	2,250.65
Sari Pul	1,785.29	2,041.69	1,853.09	2,498.41	2,445.47	2,843.08
Takhar	3,667.76	4,184.52	3,294.17	4,026.21	3,863.16	4,657.40
Uruzgan	1,482.24	1,724.86	1,222.75	1,617.09	1,434.96	1,860.01
Wardak	2,053.40	2,249.64	1,854.26	2,125.53	2,175.70	2,919.24
Zabul	1,408.39	1,759.17	1,473.48	2,221.96	3,169.33	3,069.77
Total	**182,842.39**	**198,735.57**	**200,068.84**	**223,736.59**	**235,730.99**	**267,176.89**

Source: IMF staff estimates.

1/ GDP estimates are based on nighttime lights data.

Table 1. Afghanistan Province Level GDP (constant Afs, million) 1/ (Continued)

Province	2008	2009	2010	2011	2012	2013
Badakhshan	3,724.14	5,193.62	5,474.47	4,824.60	5,971.02	14,071.68
Badghis	2,544.86	2,765.56	2,921.95	2,903.41	3,653.54	6,279.43
Baghlan	5,257.50	7,394.63	8,643.74	8,316.77	10,299.76	13,094.97
Balkh	20,459.16	20,758.93	27,672.71	29,886.00	34,971.85	49,997.81
Bamyan	2,010.71	2,702.88	2,846.01	2,419.53	2,923.68	5,522.26
Daykundi	1,436.68	2,039.02	2,013.19	2,065.48	2,347.34	4,430.61
Farah	4,071.53	4,488.66	4,954.14	5,160.46	5,166.41	7,682.50
Faryab	10,730.79	11,268.13	12,912.15	9,762.63	8,849.59	13,145.01
Ghazni	5,494.30	7,133.15	7,127.40	6,945.91	8,076.61	15,100.70
Ghor	2,500.73	3,564.68	3,436.29	3,279.64	4,085.04	7,580.98
Hilmand	11,483.36	17,580.91	28,595.17	35,131.14	38,726.13	13,639.06
Hirat	42,577.39	43,528.30	47,260.27	44,027.07	50,540.95	47,533.73
Jawzjan	6,297.67	5,970.62	6,921.55	5,395.78	4,567.78	8,703.62
Kabul	57,133.35	71,798.94	63,970.31	73,767.79	87,127.22	67,499.31
Kandahar	23,970.17	32,735.87	36,156.26	45,313.96	52,093.97	16,289.34
Kapisa	1,624.21	2,290.94	2,822.84	3,329.41	4,618.74	7,297.29
Khost	2,549.03	3,330.02	4,019.02	3,265.23	3,957.98	9,565.36
Kunar	1,612.22	2,255.18	2,311.78	2,143.27	2,450.50	8,275.40
Kunduz	9,539.54	10,795.47	14,377.84	13,013.15	14,189.23	10,701.18
Laghman	2,430.71	3,306.46	3,674.57	3,721.51	3,439.52	5,172.90
Logar	1,528.45	2,343.86	2,419.25	2,477.03	3,479.93	5,216.66
Nangarhar	11,198.85	15,206.03	15,688.89	14,881.07	15,535.86	21,945.00
Nimroz	8,901.73	8,758.58	8,499.55	11,438.83	9,680.03	4,563.19
Nuristan	501.03	711.09	689.84	702.90	779.03	4,903.98
Paktika	1,870.90	2,843.32	3,077.43	3,966.14	4,985.51	10,306.86
Paktya	2,705.79	3,492.85	3,660.80	3,905.62	4,760.90	9,867.03
Panjshir	566.60	776.73	1,117.01	1,138.06	1,101.31	3,076.02
Parwan	16,690.33	19,092.19	17,097.15	20,891.90	26,192.86	29,244.64
Samangan	2,107.68	2,634.03	3,091.24	3,095.00	3,197.02	5,456.69
Sari Pul	2,645.76	3,577.55	3,575.19	2,933.67	3,533.88	6,556.07
Takhar	4,074.48	4,982.54	5,468.36	5,129.02	5,985.54	12,249.08
Uruzgan	1,802.17	2,352.92	2,667.31	2,871.70	3,661.23	5,128.77
Wardak	2,353.58	3,618.39	3,864.45	3,681.15	5,012.10	8,979.41
Zabul	3,102.18	3,328.69	3,829.36	4,582.82	4,373.95	6,281.66
Total	**277,497.58**	**334,620.74**	**362,857.49**	**386,367.65**	**440,336.01**	**465,358.20**

Source: IMF staff estimates.

1/ GDP estimates are based on nighttime lights data.

Table 1. Afghanistan Province Level GDP (constant Afs, million) 1/ (Concluded)

Province	2014	2015	2016	2017	2018
Badakhshan	15,169.84	14,601.89	14,398.81	17,082.53	16,832.89
Badghis	6,792.81	6,927.15	6,077.74	8,850.26	8,347.99
Baghlan	13,522.08	13,037.21	12,777.24	15,855.06	15,875.18
Balkh	48,047.46	53,922.47	60,932.11	40,878.79	40,329.57
Bamyan	6,009.77	5,839.69	5,165.63	6,844.79	6,930.79
Daykundi	4,488.99	4,310.74	4,141.06	5,624.22	5,571.30
Farah	7,962.23	7,976.13	6,669.81	11,500.59	11,039.58
Faryab	13,466.27	14,416.95	13,918.80	16,464.16	15,658.81
Ghazni	15,505.71	15,034.11	14,114.16	19,560.17	19,870.82
Ghor	7,572.91	7,396.65	7,009.98	9,646.32	9,405.05
Hilmand	13,850.87	12,380.34	11,270.75	16,219.81	15,948.61
Hirat	42,144.23	41,511.85	47,793.48	37,753.69	39,166.38
Jawzjan	8,761.82	9,159.37	8,762.76	10,733.48	10,055.58
Kabul	73,123.84	75,462.65	84,096.89	54,853.62	66,408.79
Kandahar	15,310.91	14,723.43	14,405.71	17,791.69	18,418.53
Kapisa	7,538.09	7,452.53	7,787.28	8,923.19	9,501.99
Khost	10,048.20	10,403.60	9,636.71	13,384.21	13,541.51
Kunar	9,224.18	9,414.13	7,768.99	12,526.26	12,337.73
Kunduz	11,744.23	10,684.63	11,404.16	12,039.26	11,934.88
Laghman	5,884.96	5,831.46	5,632.94	6,571.73	6,994.01
Logar	5,129.01	4,836.69	4,730.38	6,539.56	6,437.20
Nangarhar	22,582.49	24,998.00	23,859.00	27,777.29	29,758.66
Nimroz	5,008.19	5,111.19	4,604.17	5,773.81	5,706.01
Nuristan	5,286.42	5,402.87	4,627.54	6,342.63	6,406.57
Paktika	10,417.62	10,727.68	8,963.06	14,953.61	14,856.89
Paktya	10,126.53	9,892.78	8,719.24	13,240.08	13,102.69
Panjshir	3,323.16	3,191.67	3,056.52	3,799.35	3,748.87
Parwan	32,663.88	31,853.34	37,669.31	26,946.25	28,561.13
Samangan	5,625.27	5,554.95	5,165.15	6,694.91	6,588.39
Sari Pul	6,849.43	6,938.63	6,606.46	8,305.61	8,101.46
Takhar	13,410.95	12,931.11	12,635.86	15,606.59	15,158.91
Uruzgan	5,409.12	5,251.18	4,706.55	7,047.82	7,060.05
Wardak	9,415.40	8,863.60	8,359.97	10,939.16	10,951.23
Zabul	6,492.18	6,588.17	5,605.13	9,144.62	9,274.87
Total	**477,909.05**	**482,628.84**	**493,073.35**	**506,215.12**	**519,882.92**

Source: IMF staff estimates.

1/ GDP estimates are based on nighttime lights data.

Appendix I. Letter of Intent

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC 20431

Kabul, December 3, 2019

Dear Ms. Georgieva:

At its meeting on July 20, 2016, the Executive Board of the International Monetary Fund (IMF) approved a three-year Extended Credit Facility (ECF)-supported arrangement with the government of Afghanistan to help raise growth by consolidating progress on the macroeconomic and structural fronts and catalyzing continued support from donors. On December 7, 2018 the arrangement was extended until end-2019 and its final review rephased to be assessed based on June 20, 2019 data. The extension provided more time for the completion of the sixth review, enabled the implementation of additional reforms, and ensured uninterrupted engagement with the Fund through the election year of 2019.

The implementation of this agreement has supported our efforts to retain macroeconomic stability despite the challenges of insecurity, political transition, and adverse shocks while also laying the foundation for durable and inclusive economic growth.

The ECF-supported program has achieved its objectives. Consequently, the government is requesting the completion of the sixth review, and the disbursement of the final tranche in the amount of SDR 5.38 million based on overall performance and the government's policy intentions for the future.

In line with our commitment to transparency, we hereby request that the staff report, this Letter of Intent (LOI), the attached Memorandum of Economic and Financial Policies (MEFP), and all annexes and attachments, be published on the IMF website.

Sincerely yours,

/s/
Dr. Mohd Humayon Qayoumi
Minister of Finance (Acting)
Government of Afghanistan

/s/
Wahidullah Nosher
Governor (Acting)
Da Afghanistan Bank

Attachment (1)

Attachment I. Memorandum of Economic and Financial Policies

A. Introduction

1. **This memorandum reviews recent economic developments and lays out our economic objectives and policy framework following completion of an Extended Credit Facility (ECF) arrangement with the IMF**.

2. **We, the government of Afghanistan and its central bank, are committed to on-going implementation of economic reform and addressing structural weaknesses in the economy**. We are addressing economic vulnerabilities and pressing ahead with the reform program through a series of policy and legislative actions.

3. **The ECF arrangement supported our macroeconomic policy and reform agenda through 2019**. It addressed economic vulnerabilities and facilitated our engagement with the international community to sustain donor support and helped us make progress on the deliverables under the Self-Reliance Mutual Accountability Framework (SMAF). The ECF arrangement assisted 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**. We expect growth to reach about 3 percent in 2019, exceeding the last year's growth of 2.7 percent, as agriculture has rebounded from last year's drought.

5. **Inflation was low last year, at 0.8 percent at end-2018, but it picked up somewhat in 2019**. In the first half of 2019, inflation increased to 4 percent owing to the passthrough from the earlier exchange rate depreciation and seasonal effects. In September, inflation eased to 1.8 percent as food prices declined owing to a good harvest and some appreciation of the exchange rate.

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

7. **In the first half of 2019, the Afghani has depreciated by about 8 percent versus the U.S. dollar**. The recent depreciation was mainly attributable to increased political and security risks and outflows of U.S. dollars in part to take advantage of arbitrage opportunities in neighboring countries. Since June, the outflows have likely receded as the Afghani appreciated by 3.6 percent.

8. **Fiscal performance has been strong in 2019, although revenue growth has moderated recently**. Through June, domestic revenue increased by 7.3 percent y/y, as collection efficiency improved, and customs revenues were boosted by the Afghani's depreciation. Also, the treasury received from the central bank an Af 9 billion profit transfer. While we saw a slowdown in revenues through September we are focusing on increasing collection efficiency and remain confident that

the end-year revenue target remains well within our reach. Cash balances are high, and they are expected to remain above the Af 10 billion floor. We expect to achieve the agreed-upon small deficit including grants, and on current trends a small surplus appears likely, although we see some risk that revenues will undershoot the budget target. Public debt remains low at around 7 percent of GDP. Execution of the development budget improved to about 93 percent.

9. Despite some improvements, the financial sector remains vulnerable to adverse shocks. In 2019Q2, capital adequacy stood at more than twice the minimum, while the system's liquidity remained high. However, while profitability improved, the gross NPL ratio increased two percentage points to 12.8 percent (while NPLs net of provisions to capital increased from 4.5 to 6.3 percent), owing to an ongoing DAB mandated clean-up of the portfolio. The weak banks remain under a watchful monitoring regime of Da Afghanistan Bank.

10. Support from our international partners remains vital as aid flows help meet immediate financing requirements and reduce fiscal vulnerability. During the November 2018 Geneva conference, donors pledged sustained financial assistance in exchange for continued reforms. Most donors confirmed pledges made in 2016 in Brussels and a few (including Norway and Sweden) pledged additional resources for the drought. The government and donors adopted deliverables for 2019-20 including a commitment by the government to agree a successor ECF by mid-2020. Donors tasked the World Bank to work with the government and the international community to formulate a post-peace settlement development plan. We anticipate a donor pledging conference in the fall of 2020 and will work towards updating and extending our national development strategy to cover the pledging period 2021-24.

11. The fight against corruption is one of our top priorities, with some 1,635 cases of corruption tried by the Attorney General's office leading to 468 people sentenced to prison and more than US$14 million in fines. National Procurement Authority's (NPA) compliance with the publication of high-value/above-threshold contract has increased to 77.5 percent in 2018. These gains followed launching of the National Strategy for Combatting Corruption—a key step in establishing the rule of law and ending corruption—at a Senior Officials Meeting in October 2017.

C. Program Implementation

12. Performance under the sixth and final review of the ECF-supported program was satisfactory despite a challenging security environment, heightened political risks, and a difficult social environment. We met all the quantitative performance criteria at end-June and all indicative targets at end-September 2019. Progress on structural benchmarks for the sixth review was satisfactory as well. Out of the seven structural benchmarks, six were met. In particular, the measures related to improving governance were met, capitalizing on the progress made in previous reviews. We also made the last transfer to the budget to eliminate the outstanding lender of last resort balance related to the Kabul Bank crisis, which we consider a major achievement under the ECF given the country's difficult circumstances. A small amount (about Af 0.2 billion) of a residual principal and interest accrued remains to be paid to the central bank and we are committed to do that in Q1 2020. The benchmark on reinvigorating the Kabul Bank asset recovery process has been delayed by difficulties in selecting the forensic audit firm. We have already contracted one of the big-ten accounting firms to work with us and we intend to intensify efforts to implement this structural benchmark before end-November 2019.

D. Future Economic and Structural Policies

13. We reaffirm our commitment to the policies and reforms described below. Following the Presidential elections on September 28, 2019 we will be refining our development strategy that will serve as the basis for our request for a new arrangement with the Fund. We plan to conclude the negotiations with the Fund with the aim of having a new arrangement in place by mid-2020 in line with the commitment made during the Geneva November 2018 donor conference. We are strongly committed to maintaining sound policies and continuing reforms during the time between the expiration of the current and start of the new arrangement.

14. Poverty reduction is a top priority. Our policies are guided by the 2017-2021 ANPDF. 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. 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. On March 8, 2017, a national program for women's economic empowerment was also launched that provides labor-intensive jobs for women in female friendly occupations. Over 75,000 women have already received training in horticultural and small livestock production. A Gender Responsive Budgeting Policy was prepared to reiterate Afghan Government’s firm commitment to employ budget as a tool to advance gender equality, promote women development related programs, and more importantly to protect women’s rights as outlined in the ANPDF. 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). The Displacement and Returnees Executive Committee (DiREC) was established to implement the Matrix and EZ-KAR project that provides job opportunities for repatriates in 13 provinces. In addition, the President issued a decree on distributing residential land to returnees to integrate them in the economy. Although security outlays continue to burden the budget as conflict persists, we will ensure that we allocate adequate resources to increase opportunities for the poor.

Macroeconomic Policies

15. Our macroeconomic policy framework is designed to preserve macroeconomic stability and promote growth. It targets a gradual pick-up in GDP growth, single-digit inflation, low debt (less than 10 percent of GDP), and a comfortable international reserves position.

16. We expect a small overall budget deficit after grants in 2019 and will continue maintaining a prudent fiscal position afterwards. The 2019 budget implies a deficit of about 0.8 percent of GDP, in line with the program at the time of budget approval. We are prepared to implement additional spending cuts, while preserving priority social spending, as part of budget implementation mandate (particularly from lower bonuses and cuts in operation and maintenance expenditures), to counter any shortfalls in revenues or grants developments. We expect to maintain the treasury's discretionary cash balance at or above Af 10 billion which we consider to be a prudent buffer. Over the medium term, we will continue to target a zero-overall fiscal 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 reduce aid dependence. We will pursue our plan to implement a value-added tax (VAT) before January 2021 in line with our WTO commitment. We will only borrow on a concessional basis (60 percent of grant element) 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.

17. 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 percent on average in the medium term. We stand ready to tighten money growth in case inflation exceeds desirable levels on a sustained basis. 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 continue coordination between DAB and the MOF to strengthen the conduct of monetary policy, facilitate cash management, and promote market development by finalizing the institutional framework and supportive legislation to set up primary and secondary markets for Sharia compliant securities issued by the Ministry of Finance (sukuk). We will continue our efforts to reduce dollarization including by reducing use of foreign currencies in the border areas.

Structural Reforms

18. The focus of our fiscal reform agenda will be the complementary LTO reforms and VAT adoption, by 2019 and 2021, respectively. In line with the IMF's TA advice we consolidated all large taxpayers under a fully functional single LTO in October 2019 (sixth review benchmark). The LTO collected only about 28 percent of 2018 domestic tax revenues (or about 16 percent of domestic revenues including customs). We aim to increase this figure to 45 percent of domestic tax revenues by the end of 2021. We aim to introduce a VAT before January 2021. We appointed a VAT implementation team and established a VAT steering committee to carry out the plan. To simplify the tax structure, the VAT, which will eventually replace the BRT[1] on firms that are registered for the VAT, will have the same threshold as the LTO.

19. We will continue to improve administration in ACD. We are committed to comply with the World Trade Organization (WTO) Trade Facilitation Agreement (TFA) and the World Customs Organization's (WCO's) requirements to meet international obligations to facilitate trade. We have adopted 5-year Strategic Plan (2018-2022) which reflects priorities of the ACD and draws on international best practices guided by the TFA requirements and the WCO guidelines. Over the next three years, we will link Afghanistan Central Business Registry (ACBR) and Afghanistan Payments System (APS) interfaces to facilitate automated information sharing on taxpayers and taxpayer transactions to improve revenue collection efficiency. In addition, we will introduce an identity verification program to combat fraud and misreporting of customs declarations.

20. We will continue to strengthen public financial management.

- We will enhance existing budget software with an improved budget builder or procure the budget module associated with Afghanistan Financial Management Information System (AFMIS). In the medium term, we will move to a robust e-Governance solution.
- We are improving review of proposed projects with support of the technical committee established under the fifth review benchmark. We endorsed the Terms of Reference (TOR) for this committee under the signature of the competent authority and prepared a comprehensive set of guidelines that includes financial and economic appraisal with the World Bank assistance in April.
- We will develop new systems for fiscal space creation in key areas (e.g., revenue, expenditure, and aid). We aim to update and enhance donor and government financed project data so that estimates of fiscal space, utilized for better investment in high priority national programs, become more accurate. We began this process, during preparation of 2020 budget.
- To strengthen budget preparation, we adopted forward baseline estimation (FBE) methodology at end-2018. By end-March 2019, we prepared and carried out an FBE exercise for the top 15 budget units. The ministries/agencies are also initiating plans to establish systems for preparing medium-term costed development strategies with an output orientation and forward estimates (Portfolio Budget Statements). These will be linked to the forward estimates issued by the MOF. These will be prepared starting with key priority sectors (such as infrastructure, energy, and agriculture) and will be sequentially rolled out to all ministries. We plan to initiate this process with one ministry producing a Portfolio Budget Statement and preparing an annual report with

[1] The VAT should replace the BRT 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.

financial statements by the end of 2019. Based on this experience we will adopt these procedures in other ministries.

- We will review the capacity of the department of state-owned corporations to assess needed staffing and seek technical assistance to improve staff's capacity for operational and financial oversight of the SOCs. The department will then start collecting information on financial flows between the government and the SOCs and prepare annual analytical reports on their financial performance which will be annexed to the budget starting in FY 2020.

- We will not contract non-concessional loans. The government will consult with the IMF staff on the terms and concessionality of any proposed new external debt in advance of contracting it. The government will continue to use 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. We will continue strengthen project selection process for debt financing as well as debt recording, monitoring and managing capacity in consultation with development partners.

- The Ministry of Finance will also monitor and record contingent liabilities stemming from PPP agreements. We will seek appropriate technical assistance in these areas. Building on the ongoing technical assistance from the World Bank, the government aims to strengthen its debt management framework, measuring and properly recording and monitoring contingent liabilities of the PPP projects and state-owned entities.

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

Financial Sector Policies

21. The weaker commercial banks will continue to be tightly monitored and their corrective Action Plans decisively enforced, including closure when warranted. DAB will closely assess progress, including through regular rounds of in-depth on-site examinations, and specialized reviews by independent experts as may be necessary.

22. We will continue to implement the SOCBs reform strategy with World Bank support. We intend to comply with all legal covenants and deliver on all the actions required under the strategy. We will also foster a closer coordination between the team in charge of the project and the DAB supervisors in charge of the prudential monitoring of the SOCBs.

23. We will continue to strengthen the AML/CFT framework including to ensure effective implementation of AML/CFT measures in the financial sector. The national ML/TF risk assessment was concluded in mid-2019. DAB's Governor became the chair of the High-Level Coordination Commission for AML/CFT in early 2019 which is committed to promoting inter-agency coordination. DAB continues to strengthen its AML/CFT supervisory capacity over financial institutions, including through the development of internal procedures, protocols, and manuals.

We also continue to improve the resources for AML/CFT supervision. A full team of almost 60 AML/CFT examiners (covering banks and MSPs) will be in place by end of 2019. DAB has also developed an AML/CFT Action Plan for the financial sector aimed at improving the capacity and compliance systems in the industry. In 2019, DAB conducted 17 on-site examinations (including full-scope, targeted, and special inspections). Monetary penalties were imposed on 9 banks and 4 warning letters were issued for non-compliance with AML/CFT rules. FinTRACA has imposed AFN 300,000 financial penalties. DAB has also been active in promoting effective AML/CFT controls in money service providers (MSP) through inspections, enforcement actions (including revocation of licenses) and guidance. Fifty-two inspections of this sector have been carried out thus far and another 26 are envisioned. Monetary penalties in the amount of AF 20,078,000 were imposed on 847 licensees and 65 unlicensed individuals were referred to law enforcement agencies. In the future, we will develop a methodology for basic ML/TF risk assessment and risk profiling of MSPs. We expect to develop a strategic plan on MSPs by end of 2019 to guide regulatory reforms. Important components of this strategy include incentives to corporatize, capacity building of this sector, and further enhancing the regulatory framework.

Reinforcing the Crisis Prevention Framework

24. We will continue to upgrade our crisis preparedness and response capacity. We will advance our plan to introduce changes to our banking law to upgrade our resolution framework in line with good international practices. Those changes will 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. In addition, we are developing a roadmap to strengthen the deposit insurance system and reviewing the current framework of DAB's emergency liquidity assistance (ELA). We expect speedy implementation of these changes, supported by Fund TA.

Toward a More Inclusive and Growth-Friendly Financial Sector

25. We adopted the National Financial Inclusion Strategy with the technical support of the World Bank staff in August 2019 with implementation expected from January 2020. The strategy will encourage the promotion of formal channels and includes a comprehensive "financial inclusion" agenda, including for women, and the remote areas of country. It also targets underserved parts of the populations. The strategy targets an improvement in the financial sector infrastructure and credit information, introduction of a wider range of financial instruments, facilitation of financial intermediation and support for innovative financing for the private sector. The strategy will also consider strengthening consumer protection and improving financial literacy. We will also develop Islamic banking to offer access to financial products to untapped markets.

26. We are proceeding with development of digital finance. Our strategic vision is to leverage the high penetration of mobile devices and to make available to the public a wide range of core financial services that are efficient and safe, thereby gradually moving towards an economy not dependent on cash alone. In February 2019, under the auspices of the Ministry of Finance, the cross government working group in charge of public sector salaries payments through mobile money developed a comprehensive digital payments road map for mobile salary payments. With the support of the World Bank, we will be implementing the PAISA Project that will develop structures and mechanisms for digital salaries payment. Also, DAB will continue to expand and modernize the retail payment infrastructure.

27. **We are also coordinating with the banking profession to prudently foster intermediation and expand the range of financial instruments and techniques**. We will support prudent financial innovation to deepen financial intermediation. We will promote broader use of the publicly accessible credit and collateral registries by banks as well as encourage risk sharing and partial credit guarantee schemes. We will build on these measures to encourage term lending instead of bank overdrafts. We are also preparing a regulatory and institutional framework for issuance of government sukuk that will enable the mobilization of private funds for large scale infrastructure projects.

Economic Governance

28. **Our government will remain committed to determined and robust anti-corruption efforts**. We updated the National Strategy for Combating Corruption in November 2018 which includes benchmarks with specified timelines. The Anti-Corruption Law was enacted in September 2018. The government is committed to accelerating the fight against corruption and is developing an action plan for implementation in 2020.

29. **We have made progress in enforcing the Penal Code with respect to corruption offences, in particular through the Anti-Corruption Justice Center's operations**. Its activities since it became operational in June 2016 till end-2018 were published on the Attorney General's Office's website on April 8, which include the number of persons charged for corruption, the number of persons convicted for corruption by primary courts, appellate courts and the Supreme Court, the aggregated number of penalties imposed, and compiled decisions on corruption cases of primary courts, appellate courts and the Supreme Court respectively [1] (fifth review benchmark). We plan to continue this practice in 2020. Furthermore, we are considering amending the Penal Code to provide for mandatory publication of reasoned court judgements on individual corruption cases.

30. **We aim to fully implement and enforce the requirements on asset declaration in 2019**. By end-October 2019 we published on the AOP's official website qualitative and quantitative information (using the templates defined in the TMU), in Dari and in English, on implementation of the Law among officials mentioned in Article 154 of the Constitution and other senior officials (sixth review benchmark). We are committed to updating such information on the website annually.

31. **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

[2] See: https://ago.gov.af/en/statistics-prosecutions-and-convictions-corruption-cases and https://ago.gov.af/en/primary-appellate-and-supreme-court-decisions

to correct, particularly in the area of national accounts and balance of payments data. To help us with this effort, we are requesting continued technical assistance and training from our international partners, including the IMF.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

December 4, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND THE SIXTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Asia Department
(In collaboration with other departments)

CONTENTS

RELATIONS WITH THE FUND

(As of October 31, 2019)

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	40.80	26.27

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF Arrangements	40.77	12.59

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	July 20, 2016	December 31, 2019	32.38	27.00
ECF	November 14, 2011	November 13, 2014	85.00	24.00
ECF[1/]	June 26, 2006	September 25, 2010	81.00	75.35

[1/] Formerly PRGF.

Projected Payments to Fund[1/]

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

		Forthcoming			
	2019	**2020**	**2021**	**2022**	**2023**
Principal	1.20	5.37	4.80	3.75	3.15
Charges/Interest	0.26	0.93	0.93	0.93	0.93
Total	**1.46**	**6.30**	**5.73**	**4.68**	**4.08**

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 Multilateral Debt Relief Initiative (MDRI) Assistance: 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.

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable.
As of February 4, 2015, the Post-Catastrophe Debt Relief (PCDR) Trust has been transformed to CCR.

Nonfinancial Relations:

Safeguard Assessment

An update safeguards assessment of DAB was completed in January 2017. The assessment found that the DAB continued to face significant capacity constraints and operational risks considering the difficult security situation. In November 2017, the authorities amended the DAB Law per safeguards assessment recommendations strengthening the areas where weaknesses were noted. The authorities have implemented all the safeguards assessment recommendations, including resolving the Kabul Bank exposure, and strengthening the internal audit function.

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. However, owing to the electoral cycle that started in 2018 and the capacity constraints, the authorities need more time to prepare for the acceptance of Article VIII obligations. The *de jure* exchange rate regime is classified as "managed floating". However, the *de factor* exchange rate arrangement is classified as "other managed". On October 31, 2019, the average of the buying and selling exchange rates in cash transactions on the Kabul money exchange market was 78.2 Afghanis per U.S. dollar.

Last Article IV Consultation

The last Article IV consultation was discussed by the Executive Board on December 8, 2017. Suggested next Article IV Consultation is to be on a 12-month consultation cycle in accordance with the Executive Board decision on consultation cycles for members that have completed a Fund arrangement by drawing all amounts but perceived to be at some risk because of policy imbalances or particular threats from exogenous developments or facing pressing policy issues of broad interest to the Fund membership.

Technical Assistance, 2017–19

Department	Dates	Purpose
FAD	Feb 20–24, 2017 Sep 28–Oct 7, 2017	Developing options for revenue mobilization (jointly with METAC) Public Investment Reforms
	Sep 25 – Oct 2, 2018	Public Financial Management Reforms
MCM	Mar 8 – 16, 2018	Bank Restructuring
	Apr 16 – 20, 2017	Stress Testing
LEG	Aug 5 – 12, 2018	Fiscal Risk Oversight of Public Corporations
METAC[1] (MCM)	Jul 9–13, 2017	Framework for Dealing with Weak Banks
METAC[1] (STA)	Feb 12–19, 2017 Jul 16–20, 2017	External Sector Statistics National Accounts
	March 12–23, 2018 Dec 3-5, 2018	Balance of payments Statistics World Bank Workshop for Afghanistan CSO on National Accounts
	Mar 31– Apr 11, 2019 Apr 21–25, 2019	Balance of Payments Statistics Prices Index for Afghanistan
STA (HQ)	Sep 30–Oct 4, 2018 Oct 18-31, 2018	Consumer price Index for Afghanistan Government Finance 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 OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

The World Bank work program on Afghanistan can be found on the following website:

https://www.worldbank.org/en/country/afghanistan

The Asia Development Bank work program on Afghanistan can be found on the following website:

https://www.adb.org/countries/afghanistan/main

STATISTICAL ISSUES

(As of October 2019)

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.
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 result 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 has implemented GFSM 2001, with annual data for both above and below the line transactions being reported. The authorities are reporting monthly GFS data to the IMF for the central government core budget and the ministry is also working on expanding the coverage of monthly and quarterly GFS data to general government.

Monetary and Financial Statistics: Da Afghanistan Bank (DAB) reports the Standardized Report Forms (SRFs) 1SR for DAB, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of one month.
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. **Financial Access Survey**: Afghanistan reports data on several series and indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
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 has been revised back to 2008. Several TA missions provided by METAC have assisted the DAB in improving external accounts compilation in the past years. Despite the progress achieved, Afghanistan's balance of payments data has considerable discrepancies in the coverage of the current and financial accounts. The major data gaps are related to unrecorded personal remittances, military aid, and illegal exports.

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 13, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Nov/2019	11/02/2019	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct/2019	10/10/2019	M	M	M
Reserve/Base Money	Oct/2019	10/10/2019	M	M	M
Broad Money	Oct/2019	10/10/2019	M	M	M
Central Bank Balance Sheet	Oct/2019	10/10/2019	M	M	M
Consolidated Balance Sheet of the Banking System	Oct/2019	10/10/2019	M	M	M
Interest Rates[2]	Sep/2019	9/26/2019	M	M	M
Consumer Price Index	Sep/2019	10/29/2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	--	--	--	--	--
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Sep/2019	10/06/2019	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2019Q3	10/10/2019	Q	Q	Q
External Current Account Balance	2019Q2	10/10/2019	Q	Q	Q
Exports and Imports of Goods and Services	2019Q2	10/10/2019	Q	Q	Q
GDP/GNP	2018	10/03/2019	A	A	A
Gross External Debt	...	...	...	...	...
International Investment Position[6]	2019Q2	10/10/2019	Q	Q	Q

[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).

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

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STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND THE SIXTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—DEBT SUSTAINABILITY ANALYSIS

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Prepared by International Monetary Fund
International Development Association

Afghanistan Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	*High*
Overall risk of debt distress	*High*
Granularity in the risk rating	*n.a.*
Application of judgment	Yes: The projection period informing mechanical risk signals are extended to 20

Afghanistan's external and overall risk of debt distress continues to be assessed as high.[1] *Afghanistan's debt sustainability hinges on continued donor grants inflows (currently around 40 percent of GDP) which finance substantial fiscal and external gaps. A gradual replacement of grants by debt financing would lead to high risk of debt distress in the long-run extended 20-year period rather than the standard 10-year period. Significant downside risks include the political uncertainty, the fragile security situation, and regional risks. The authorities should continue their efforts to mobilize domestic revenue and implement structural reforms, while donors should continue to provide grants. Debt management capacity, including the quantification and monitoring of contingent liabilities arising from state-owned corporations (SOCs) and public-private partnerships (PPPs), should be strengthened before the authorities resort to debt-financed capital expenditures.*

[1] This DSA was jointly prepared by IMF and World Bank staff under the new debt sustainability framework (DSF) for low-income countries (LICs), implemented since July 2018.

BACKGROUND

Public Debt Coverage

1. **This DSA considers as public debt the central government's debt and Da Afghanistan Bank's (DAB, the central bank) debt owed to the IMF**. The central government has contracted external loans for important infrastructure projects and has not issued guarantees for other public entities' external borrowing (e.g., state /local governments and state-owned corporations (SoCs)). State and local governments do not borrow on their own. In September 2019, the government cleared the debt owed to DAB in line with the 2016–19 ECF structural benchmarks.[2] External and domestic debt is classified based on its currency denomination.

Coverage of Public Debt

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

2. **State-owned corporations and public-private partnerships (PPPs) are the largest potential sources of contingent liabilities**. The potential government exposure to the state-owned entities has not been systematically quantified and the government is working on collecting the necessary data.[3] The magnitude of the shock used for the contingent liability stress test reflects the coverage of public debt and other vulnerabilities in the public sector. So far, the government approved four PPPs with total project cost of about US$ 0.3 billion. The contingent liabilities arising out of approved projects are yet to be included in the budget.

Magnitude of Contingent Liability Shock

				Used for the	
1	The country's coverage of public debt	The central government, central bank			
		Default		Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0	percent of GDP	0.0	
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	2.0	
4	PPP	35	percent of PPP stock	0.0	
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
	Total (2+3+4+5) (in percent of GDP)			7.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

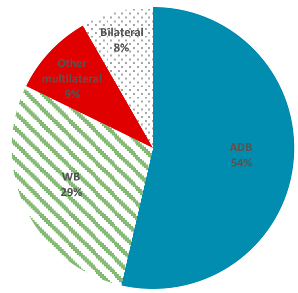
[2] This debt is due to the lender-of-last-resort exposure incurred by DAB during the resolution of Kabul Bank.

[3] There are 54 state-owned corporations (SOCs).

Background on Debt

3. Afghanistan's public debt is small and mainly owed to multilateral institutions on highly concessional terms. As of end-2018, Afghanistan's total public external debt stood at US$1,213 million or 6.4 percent of GDP. There is no domestic public debt. The low level of debt reflects past debt relief under the Enhanced HIPC Initiative, and limited borrowing since then. The external loans provided by multilateral and bilateral lenders have highly concessional terms. In line with their lending policies, given Afghanistan's high risk of debt distress, the World Bank and the Asian Development Bank (ADB) provide only grants. Main multilateral creditors are the ADB, the International Development Agency (IDA), the International Monetary Fund (IMF), and the Islamic Development bank (IsDB). Among bilateral creditors, the Saudi Fund was the main creditor (5 percent of total debt outstanding) followed by the Kuwait Fund (2 percent).

External Public Debt by Creditor
(Percent, end 2018)



Source: Afghan Ministry of Finance.

4. Continued reliance on concessional financing and grants is critical for debt sustainability. Given Afghanistan's high level of dependence on grants and limited capacity to raise foreign exchange (outside grants) and domestic revenue, it is imperative to continue to rely on concessional debt and grants for external financing. Currently, the prospect for imminent default are low owing to the low level of public debt, its long average maturity (14 years), and the evenly spread redemptions. The annual interest payments are fixed and very low at 0.1 percent of GDP. Further, foreign reserves are high at US$8.3 billion, fully covering external debt service coming due over the next decade.

5. Strengthening of debt management capacity is required before resorting to debt financing including domestic debt.[4] The authorities agree with staff that notwithstanding obvious investment needs, external borrowing should be preceded by strengthened debt management capacity and any investment plans should be considered only after a thorough assessment and prioritization of prospective projects in close consultation with donors.

6. There are on-going efforts to strengthen debt management capacity. In this context, the development partners have assisted with the development of a Medium-Term Debt Strategy (MTDS)[5] and preparation of a debt sustainability analysis through TA and training courses. The World Bank is also assisting with an assessment of SOCs' financial position. Further, supported by the IMF's 2016–19 ECF's structural benchmarks, the authorities have prepared an internal guidance note on debt management and provided internal technical training courses to improve own capacity for debt management. The authorities

[4] 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 up capacity in this area.

[5] The authorities are set to receive technical assistance on an MTDS from Asian Development Bank.

have been preparing for issuing sukuk to mobilize domestic resources, with technical assistance on legal infrastructure from the IsDB and the World Bank.

7. The authorities remain committed to contract only concessional loans. Under the ECF, concessional loans are those with a grant element of 60 percent or higher. In 2019, the government contracted external loans equivalent to US$130 million, with a grant element of 61 percent in line with its borrowing plan shared with the IMF.[6]

UNDERLYING ASSUMPTIONS AND COUNTRY CLASSIFICATION

Background on Macro Forecasts

8. The updated long-term macroeconomic framework assumes a lower long-term growth trajectory and somewhat worse current account balance than the December 2018 DSA given the lackluster growth performance since 2015 and persisting downside risks to growth (see Box 1). The baseline economic projections remain subject to downside security, political, and regional environment risks and to upside risks should there be a successful and lasting peace settlement.

Macroeconomic Assumptions Comparison Table

	DSA December 2018		Current DSA	
	2018–23	2024–38	2019–24	2025–39
Real GDP (%)	3.7	6.0	3.7	4.5
Inflation (GDP, deflator, %)	4.5	4.9	5.0	5.0
Nominal GDP (Billions of Afghanis)	21.8	49.6	21.9	48.6
Revenue and grants (% of GDP)	27.8	25.9	28.7	24.4
Grants (% GDP)	14.9	9.0	13.7	6.7
Primary expenditure (% GDP)	27.9	27.1	28.6	26.1
Primary deficit (% GDP)	0.1	1.2	0.0	1.7
Exports of G&S (% change)	8.6	6.9	1.7	6.3
Noninterest current account deficit (% GDP)	0.3	9.5	1.2	10.8

Sources: Afghan authorities and IMF staff estimates and projections

[6] Those loans are interest free with maturity of around 30 years.

Box 1. Baseline Macroeconomic Assumptions

- Staff projects lower long-term growth relative to the 2018 DSA given the lackluster growth performance since 2015. The economy is projected to deliver 4.5 percent growth rate from 2025 onwards.
- The baseline assumes no significant deterioration in security, continued reforms, and sustained aid. While the extractive industry could deliver a positive impact on the economy, this is currently not incorporated in economic growth or export projections due to uncertainty over the timing and size of production coming onstream. If security conditions worsen, aid falls short of expectations, or reforms stall, growth would be lower with attendant effects on unemployment and poverty.
- Long-term export growth will pick up as the authorities continue their efforts to diversify export destinations and support export-oriented sectors. The authorities should complete the ongoing regional infrastructure/trade projects that may increase exports in the long run. Goods imports are projected to be a bit lower reflecting the 2018 outcomes and lower growth assumptions. A downward revision of grant inflows worsens the current account. The long-term agenda aimed at diversifying the economy as well as progress with regional integration should result in attracting FDI. Growing FDI and other capital inflows will partly substitute for declining grants.
- In line with the new DSF guidance on grants,[1] the baseline scenario assumes a gradual decline in donor aid beyond the period over which the international community has pledged its financial assistance.[2] The grants-to-GDP ratio is assumed to decline by around 1.5 ppt of GDP per year. The additional financing needs due to a decline in grants are assumed to be financed by private inflows (including FDI), external concessional loans, and domestic revenue mobilization. Off-budget grants are assumed to gradually migrate on-budget reflecting an increase in the authorities' capacity to properly implement projects.
- The new external borrowing is assumed to carry the standard concessionality with a grant element of 35 percent.[3] This DSA assumes that the authorities issue a three-year local currency-denominated sukuk from 2022 onwards with an interest rate of 7 percent. Given the still-underdeveloped domestic financial market, issuance during the first year is assumed to be only 0.1 percent of GDP with very modest increases afterwards.

[1] See ¶37 of "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries."

[2] International development partners pledged US$15.2 billion over 2017–20 at the Brussels Conference held in October 2016, while annual military assistance of US$4 billion was pledged at the Warsaw NATO summit in July 2016.

[3] Typically, the 35 percent grant element is used by the IMF to define a loan as concessional.

9. The realism tools show that projections are in line with historical and peers' experiences.

- **Forecast errors**. In the past, given low levels of public debt, changes in both PPG external debt and public debt were small with small negative forecast errors. At the same time, factors contributing to historical debt dynamics varied widely, with a current account surplus acting to contain an increase in external debt/GDP, and primary deficit driving total public debt. Going forward, both PPG external debt and public debt are expected to stay low in the medium term, and real GDP growth will continue to contribute as a debt reducing factor (Figure 3).

- **Fiscal adjustment**. The projected primary balance suggests some loosening compared with a better-than expected primary surplus recorded in 2018. Growth projections for 2019 are below than the growth path suggested by a fiscal multiplier of 0.4 (LICs' average) due to political uncertainty and security risks despite recovery from drought (Figure 4).

- **Investment-growth**.[7] The contribution of public capital stock to growth is close to that shown in the previous DSA. Staff is of the view that the relatively high contribution of the public sector will gradually come down as infrastructure gaps are closed and private sector activities grow.

Country Classification and Determination of Scenario Stress Tests

10. Afghanistan is assessed to have a weak debt carrying capacity. Based on the October 2018 and April 2019 WEO macroeconomic framework, and update to the World Bank's CPIA measures through 2018, Afghanistan's composite indicator score[8] lies below the lower cut-off value of 2.69 and

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	2.6758	1.03	39%
Real growth rate (in percent)	2.719	3.0797	0.08	3%
Import coverage of reserves (in percent)	4.052	57.9628	2.35	90%
Import coverage of reserves^2 (in percent)	-3.990	33.5968	-1.34	-51%
Remittances (in percent)	2.022	0.5599	0.01	0%
World economic growth (in percent)	13.520	3.5586	0.48	18%
CI Score			2.613	100%
CI rating			Weak	

[7] Due to data limitations, the public capital stock is estimated using the average share of government investment in total investment over the past five years (69 percent) and the historical total capital stock estimated by the World Bank at 78 percent of GDP as of end-2017.

[8] The debt-carrying capacity is classified using the country-specific composite indicator (CI) composed of three macroeconomic indicators and the World Bank's Country Policy and Institutional Assessment (CPIA).

confirms the weak debt carrying capacity as past DSAs (see Table). The thresholds for a weak performer are used to derive mechanical risk signals. Given Afghanistan's economic characteristics, tailored stress tests (natural disasters, commodity prices, and market financing stress tests) are not applicable.

EXTERNAL DSA

11. The risk of external debt distress for Afghanistan remains high. Given the very high concessionality of existing external debt (with a long grace period) and the persistence of Afghanistan's economic and social challenges, a 20-year projection period is used for mechanical risk rating (rather than the standard 10-year projection period).[9] The external debt-to-GDP is projected to remain low in the medium term, but as grants are gradually replaced by loans, one of the debt sustainability indicators—the ratio of present value (PV) of debt to exports—breaches the threshold under the baseline and stays above the threshold over the projection period. Nevertheless, liquidity indicators remain strictly below the thresholds under the baseline provided the concessional loans continue in the long-run (Figure 1).

12. External debt sustainability is vulnerable to shocks to non-debt flows and exports. The most extreme impacts are due to the exports shock for the ratio of PV of debt to exports and the ratio of debt service-to-exports, and the non-debt flow shock (FDI and transfers) for the ratio of PV of debt to GDP (Table 3) reflecting large dependence on grants inflows. These results illustrate the importance of sustained donor support, and continued efforts to boost exports and mobilize domestic revenue.

OVERALL RISK OF PUBLIC DEBT DISTRESS

13. Total public debt remains low. Given the financing mix of large grants and highly concessional external loans, the PV of total public debt-to-GDP ratio is projected to stay below the benchmark with a wide margin under the baseline. The public DSA suggests that all three relevant debt sustainability indicators: PV-to-GDP ratio, PV-to-revenue ratio, and debt service-to-revenue ratio–are most vulnerable to the growth shock (Figure 2). Going forward, it is important to maintain primary surpluses and strengthen the capacity to manage debt and liquidity and to assure prudent issuance of domestic sukuk.

14. Afghanistan's overall risk of public debt distress is assessed to be high. Though both PPG external debt and total public debt are projected to remain low and mechanical signals over the first 10-year period suggest moderate risk of debt distress, staff is of the view that Afghanistan's overall risk of debt distress should be "high" consistent with 20-year mechanical signals because its debt sustainability largely hinges on significant and continued donor support which is uncertain in the long term and significant social, economic, regional, and other related risks persist into the longer term.

[9] See ¶87 of "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries."

CONCLUSIONS

15. Afghanistan remains at a high risk of external/overall debt distress as debt sustainability hinges upon continued donor grant inflows. Sound macroeconomic management, including proper use of public resources, would be key to keeping donors on board. While the authorities should continue efforts to gradually reduce reliance on grants, a sharp or rapid decline in grant inflows will deteriorate Afghanistan's debt sustainability. Externally, they should increase resilience by boosting exports, substituting imports by domestic production where viable, and maintaining sufficient foreign reserves buffers to effectively manage external shocks. Domestic revenue collection should continue to increase by continued broadening of the tax base and strengthening of tax compliance. Debt management capacity, including the monitoring of contingent liabilities emanating from state-owned entities and PPPs, needs to be strengthened before tapping less concessional debt financing. The authorities should strictly prioritize projects to be financed by external borrowing—through consultation with development partners and enhanced internal due diligence process—and seek as concessional terms as possible. Domestic borrowing through sukuk should be implemented cautiously after an adequate institutional framework and capacity is in place. Staff welcomed the authorities' recent efforts to strengthen the technical capacity of the debt management office in line with the ECF's structural benchmark.

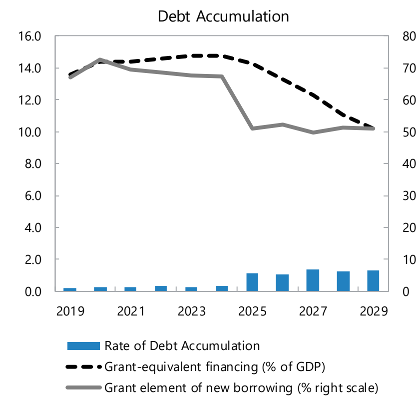
16. The authorities concurred with the conclusions of the DSA. While noting that they need to find a way to finance country's large developmental needs given that grant inflows are expected to gradually decline, they agreed that, for the time being, to ensure debt sustainability they should rely on grants and as concessional borrowing as possible. They recognized the need to enhance debt management and institutional capacity before using less concessional external loans and domestic sukuks. They agreed that such capacity enhancement should be accompanied by strengthening public financial management and resilience to external vulnerabilities. They would welcome targeted and continued TA in these areas.

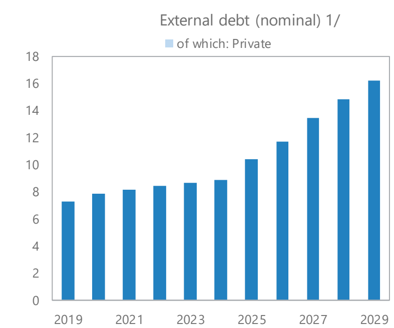
Table 1. Afghanistan: External Debt Sustainability Framework, Baseline Scenario, 2016-2039

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	6.1	6.4	6.4	7.3	7.9	8.2	8.5	8.6	8.9	16.2	18.3	7.7	10.5
of which: public and publicly guaranteed (PPG)	6.1	6.4	6.4	7.3	7.9	8.2	8.5	8.6	8.9	16.2	18.3	7.7	10.5
Change in external debt	-0.8	0.4	-0.1	0.9	0.6	0.3	0.3	0.2	0.2	1.4	0.1		
Identified net debt-creating flows	-8.6	-6.3	-9.9	-2.7	-2.1	-1.4	1.8	2.7	3.3	7.2	6.2	-15.8	2.7
Non-interest current account deficit	-8.4	-5.9	-9.6	-2.1	-1.5	-0.6	2.5	3.4	4.0	9.4	12.4	-14.4	3.7
Deficit in balance of goods and services	31.8	34.2	30.5	35.3	35.3	33.7	34.2	32.6	30.8	26.7	15.8	30.6	31.2
Exports	5.9	5.8	10.0	8.0	8.3	8.4	8.3	7.9	8.0	7.6	6.2		
Imports	37.7	40.0	40.5	43.3	43.6	42.1	42.6	40.5	38.8	34.4	22.0		
Net current transfers (negative = inflow)	-39.3	-38.8	-39.0	-36.4	-35.8	-33.5	-30.9	-28.4	-26.1	-16.9	-3.2	-44.5	-26.8
of which: official	-38.3	-36.2	-37.0	-34.3	-33.6	-31.3	-28.7	-26.3	-24.0	-14.4	-0.9		
Other current account flows (negative = net inflow)	-1.0	-1.3	-1.1	-0.9	-0.9	-0.9	-0.8	-0.8	-0.7	-0.5	-0.2	-0.5	-0.7
Net FDI (negative = inflow)	-0.4	-0.2	-0.4	-0.5	-0.5	-0.5	-0.5	-0.4	-0.4	-1.7	-5.7	-0.6	-0.8
Endogenous debt dynamics 2/	0.2	-0.1	0.1	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.5	-0.6		
Contribution from nominal interest rate	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2		
Contribution from real GDP growth	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.6	-0.8		
Contribution from price and exchange rate changes	0.4	0.0	0.3	...	...	...	...	...	...	...	...		
Residual 3/	7.8	6.6	9.8	3.6	2.7	1.7	-1.5	-2.5	-3.1	-5.9	-6.1	14.5	-1.8
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		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	3.7	4.1	4.3	4.3	4.3	4.3	4.2	8.2	10.1		
PV of PPG external debt-to-exports ratio	...	...	37.3	50.9	51.8	51.3	52.0	54.1	53.0	107.9	162.5		
PPG debt service-to-exports ratio	3.9	4.4	2.2	3.0	2.8	2.5	2.3	2.9	3.0	3.5	7.7		
PPG debt service-to-revenue ratio	2.1	2.1	1.7	1.7	1.8	1.5	1.3	1.4	1.4	1.5	2.7		
Gross external financing need (Million of U.S. dollars)	-1666.3	-1174.1	-1922.8	-442.1	-332.8	-188.9	497.3	764.3	997.6	2851.6	6004.6		
Key macroeconomic assumptions													
Real GDP growth (in percent)	2.2	2.9	2.7	3.0	3.5	4.0	4.0	4.0	4.0	4.5	4.5	6.7	4.1
GDP deflator in US dollar terms (change in percent)	-5.2	-0.4	-3.7	-5.5	-2.2	2.0	3.4	3.7	4.2	2.0	4.1	0.4	1.4
Effective interest rate (percent) 4/	0.4	0.4	0.4	0.6	0.6	0.6	0.5	0.5	0.5	0.8	1.0	0.3	0.6
Growth of exports of G&S (US dollar terms, in percent)	-20.3	1.4	70.7	-22.6	4.9	8.0	6.5	2.9	9.3	5.7	7.1	6.3	3.4
Growth of imports of G&S (US dollar terms, in percent)	-13.5	8.6	0.3	3.9	1.9	2.6	8.6	2.7	3.7	4.1	4.1	10.4	4.0
Grant element of new public sector borrowing (in percent)	...	...	...	67.0	72.5	69.6	68.6	67.5	67.2	51.1	54.3	...	60.7
Government revenues (excluding grants, in percent of GDP)	10.7	12.4	13.3	13.9	12.9	14.0	15.3	16.6	16.9	17.8	17.7	10.5	16.2
Aid flows (in Million of US dollars) 5/	3043.8	2670.2	2997.8	2599.6	2797.3	2943.0	3196.8	3476.2	3768.4	3809.1	1512.6		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	13.6	14.4	14.4	14.6	14.7	14.8	10.2	1.7	...	13.4
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	98.2	98.0	98.0	97.9	97.9	97.8	89.7	72.4	...	94.9
Nominal GDP (Million of US dollars)	19,428	19,917	19,696	19,171	19,408	20,593	22,132	23,877	25,886	35,657	83,012		
Nominal dollar GDP growth	-3.1	2.5	-1.1	-2.7	1.2	6.1	7.5	7.9	8.4	6.6	8.7	7.2	5.6
Memorandum items:													
PV of external debt 7/	...	...	3.7	4.1	4.3	4.3	4.3	4.3	4.2	8.2	10.1		
In percent of exports	...	...	37.3	50.9	51.8	51.3	52.0	54.1	53.0	107.9	162.5		
Total external debt service-to-exports ratio	3.9	4.4	2.2	3.0	2.8	2.5	2.3	2.9	3.0	3.5	7.7		
PV of PPG external debt (in Million of US dollars)			737.0	776.8	829.7	888.0	958.1	1025.6	1100.0	2938.8	8391.2		
(PVt-PVt-1)/GDPt-1 (in percent)				0.2	0.3	0.3	0.3	0.3	0.3	1.3	0.7		
Non-interest current account deficit that stabilizes debt ratio	-7.6	-6.3	-9.5	-3.0	-2.0	-1.0	2.2	3.2	3.8	8.0	12.3		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**





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

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

6/ 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).

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

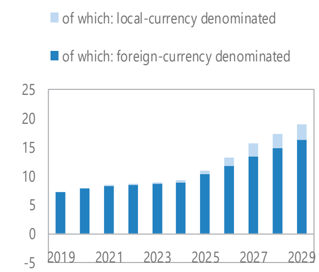
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 2. Afghanistan: Public Sector Debt Sustainability Framework, Baseline Scenario, 2016-2039
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
Public sector debt 1/	7.8	7.6	6.9	7.3	7.9	8.2	8.5	8.8	9.2	19.1	22.4	8.5	11.5
of which: external debt	6.1	6.4	6.4	7.3	7.9	8.2	8.5	8.6	8.9	16.2	18.3	7.7	10.5
Change in public sector debt	-1.3	-0.3	-0.7	0.4	0.6	0.3	0.3	0.3	0.4	1.7	0.2		
Identified debt-creating flows	-1.1	0.3	-1.4	0.2	-0.1	-0.5	-0.6	-0.7	-0.7	1.1	0.9	-1.3	0.1
Primary deficit	-0.2	0.6	-1.6	-0.2	0.2	-0.1	-0.1	-0.1	-0.1	2.0	1.9	0.4	0.6
Revenue and grants	26.1	25.7	28.5	27.0	26.5	27.7	29.2	30.7	31.0	26.8	18.7	24.0	28.7
of which: grants	15.4	13.2	15.1	13.1	13.6	13.7	13.9	14.1	14.1	9.0	0.9		
Primary (noninterest) expenditure	25.9	26.2	26.9	26.9	26.8	27.7	29.1	30.6	30.9	28.7	20.5	24.4	29.2
Automatic debt dynamics	-0.7	-0.1	0.2	0.3	-0.3	-0.4	-0.5	-0.6	-0.6	-0.9	-1.0		
Contribution from interest rate/growth differential	-0.4	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.9	-1.1		
of which: contribution from average real interest rate	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1		
of which: contribution from real GDP growth	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.7	-1.0		
Contribution from real exchange rate depreciation	-0.3	0.3	0.5	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.8	0.0
Privatization receipts (negative)	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (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		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-0.3	-0.6	0.7	0.9	0.7	0.8	0.8	0.8	1.0	0.6	-0.6	0.1	1.1
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	4.4	4.3	4.3	4.4	4.5	4.6	4.7	11.3	14.5		
PV of public debt-to-revenue and grants ratio	...	...	15.4	15.8	16.4	15.8	15.2	14.8	15.3	42.1	77.6		
Debt service-to-revenue and grants ratio 3/	8.4	3.2	2.9	2.7	0.9	0.8	0.7	0.8	0.8	4.5	9.9		
Gross financing need 4/	2.0	1.4	-0.7	0.6	0.5	0.2	0.1	0.1	0.1	3.2	3.7		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	2.2	2.9	2.7	3.0	3.5	4.0	4.0	4.0	4.0	4.5	4.5	6.7	4.1
Average nominal interest rate on external debt (in percent)	0.4	0.4	0.4	0.7	0.6	0.6	0.6	0.5	0.5	0.9	1.0	0.3	0.6
Average real interest rate on domestic debt (in percent)	-5.0	-1.2	-0.4	0.0	3.0	2.3	1.4	1.0	0.5	1.9	1.9	-3.2	1.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-4.8	4.8	7.5	...	...	...	...	...	...	...	...	1.5	...
Inflation rate (GDP deflator, in percent)	5.2	1.2	2.4	2.1	3.9	4.6	5.5	6.0	6.5	5.0	5.0	4.1	4.9
Growth of real primary spending (deflated by GDP deflator, in percent)	2.3	2.8	5.3	2.9	3.1	7.5	9.5	9.2	4.9	1.2	0.8	9.4	4.8
Primary deficit that stabilizes the debt-to-GDP ratio 5/	1.1	0.8	-0.9	-0.6	-0.3	-0.4	-0.4	-0.4	-0.5	0.3	1.6	0.4	-0.5
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

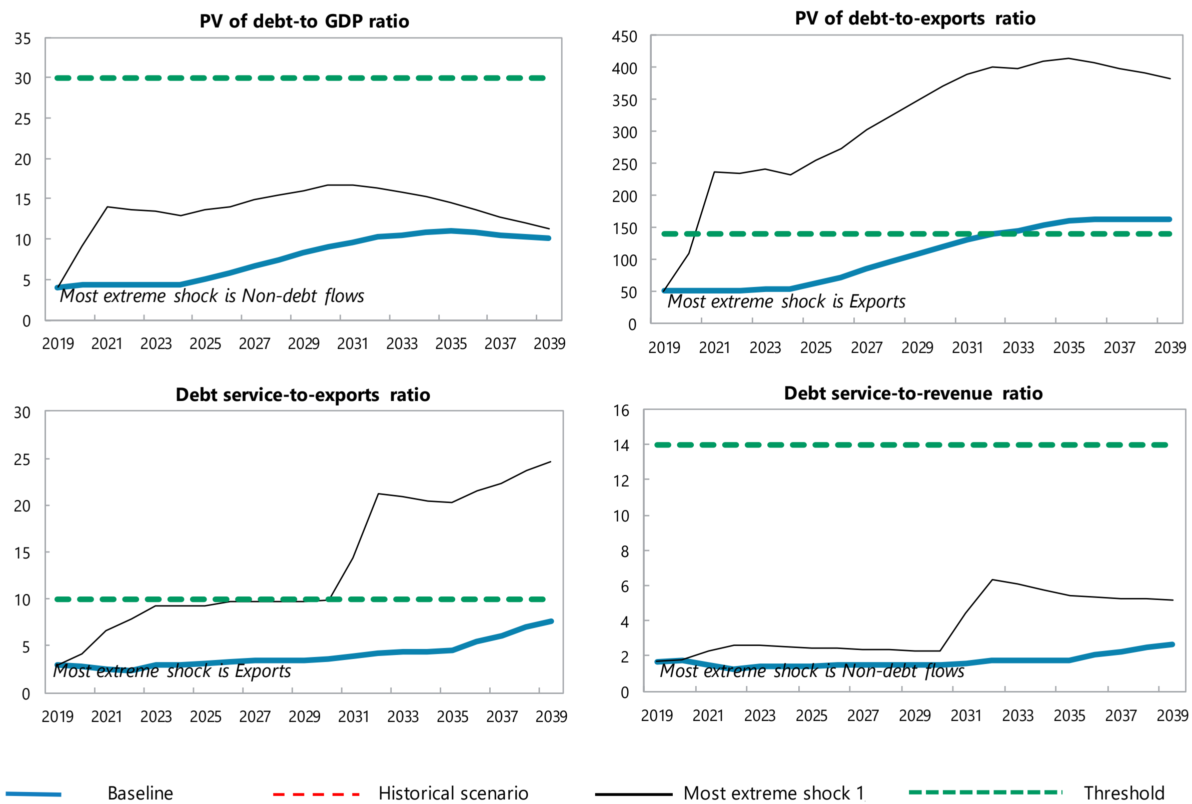
Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/



Sources: Country authorities; and staff estimates and projections.
1/ Coverage of debt: The central government, central bank. Definition of external debt is Currency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.
4/ 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 and other debt creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. Afghanistan: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2019-2039



Customization of Default Settings		
	Size	Interactions
Tailored Tests		
Combined CLs	No	
Natural Disasters	n.a.	n.a.
Commodity Prices 2/	n.a.	n.a.
Market Financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	0.8%	1.5%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	39	20
Avg. grace period	9	10

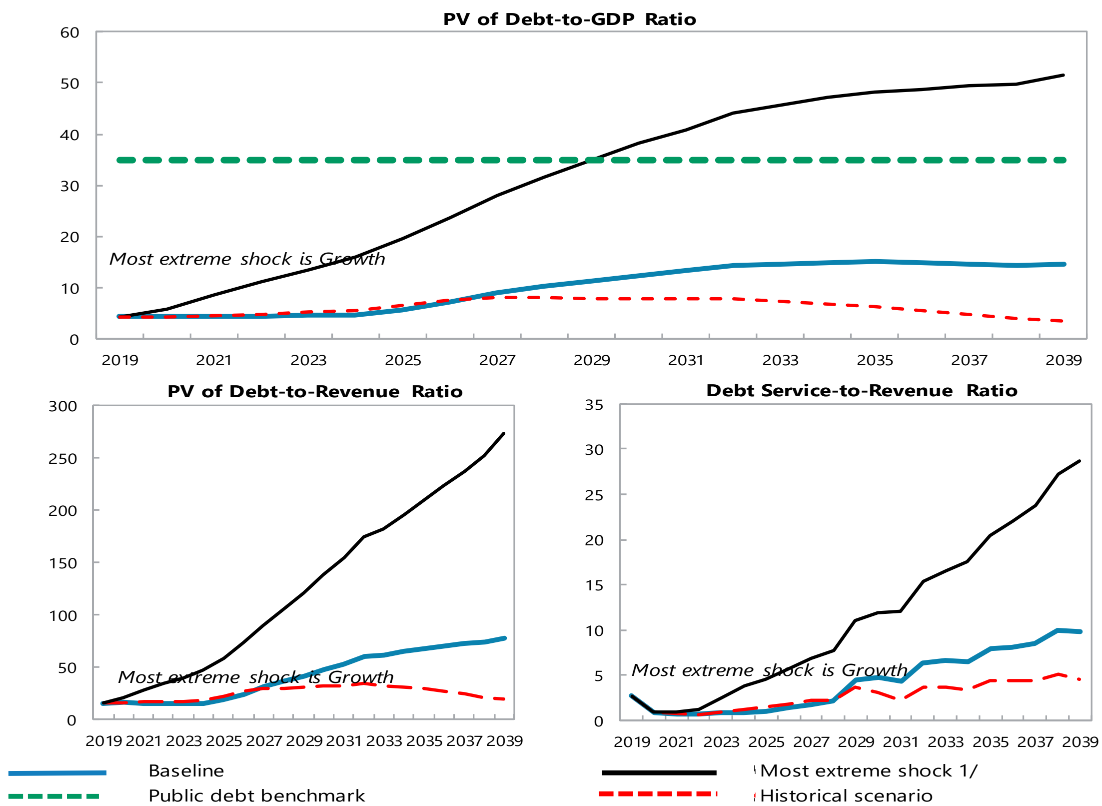
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Afghanistan: Indicators of Public Debt Under Alternative Scenarios, 2019-2039



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	71%	71%
Domestic medium and long-term	29%	29%
Domestic short-term	0%	0%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	0.8%	1.5%
Avg. maturity (incl. grace period)	39	20
Avg. grace period	9	10
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.1%	2.1%
Avg. maturity (incl. grace period)	3	3
Avg. grace period	2	2
Domestic short-term debt		
Avg. real interest rate	0%	0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019-2029

(In percent)

	Projections										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio											
Baseline	4.1	4.3	4.3	4.3	4.3	4.2	5.0	5.7	6.7	7.5	8.2
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	4.1	-4.2	-12.7	-22.9	-33.5	-44.2	-54.2	-64.4	-74.9	-85.6	-96.7
B. Bound Tests											
B1. Real GDP growth	4.1	4.7	5.3	5.3	5.2	5.2	6.2	7.0	8.1	9.1	10.1
B2. Primary balance	4.1	4.8	5.5	5.5	5.6	5.7	6.4	7.1	8.1	8.8	9.6
B3. Exports	4.1	6.1	9.2	9.1	8.9	8.7	9.4	10.0	10.9	11.6	12.3
B4. Other flows 2/	4.1	9.2	14.0	13.7	13.4	13.0	13.5	14.0	14.8	15.4	16.0
B6. One-time 30 percent nominal depreciation	4.1	5.4	-2.0	-1.7	-1.5	-1.3	-0.2	0.8	2.2	3.3	4.5
B6. Combination of B1-B5	4.1	9.9	11.8	11.6	11.4	11.1	11.8	12.4	13.4	14.2	14.9
C. Tailored Tests											
C1. Combined contingent liabilities	4.1	7.4	7.4	7.4	8.0	7.8	8.6	9.3	10.2	10.9	11.7
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	**30**	**30**	**30**	**30**	**30**	**30**	**30**	**30**	**30**	**30**	**30**
PV of debt-to-exports ratio											
Baseline	50.9	51.8	51.3	52.0	54.1	53.0	63.5	72.5	85.8	96.7	107.9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	50.9	-50.6	-150.8	-275.1	-421.3	-551.3	-683.8	-818.0	-963.2	-1111.5	-1266.2
B. Bound Tests											
B1. Real GDP growth	50.9	51.8	51.3	52.0	54.1	53.0	63.5	72.5	85.8	96.7	107.9
B2. Primary balance	50.9	58.4	65.8	66.4	70.4	70.7	81.0	90.2	103.8	114.5	125.6
B3. Exports	50.9	109.4	**236.5**	**235.2**	**241.2**	**233.3**	**255.0**	**273.2**	**301.8**	**324.5**	**348.1**
B4. Other flows 2/	50.9	111.0	**166.5**	**164.6**	**168.0**	**161.6**	**170.7**	**178.0**	**190.4**	**199.9**	**209.8**
B6. One-time 30 percent nominal depreciation	50.9	51.8	-18.6	-16.4	-15.1	-12.9	-1.6	8.5	22.3	34.1	46.2
B6. Combination of B1-B5	50.9	133.0	123.9	**176.2**	**180.4**	**174.1**	**187.8**	**199.2**	**217.4**	**231.8**	**246.7**
C. Tailored Tests											
C1. Combined contingent liabilities	50.9	89.9	88.6	89.0	100.8	97.9	108.1	118.5	131.5	**141.9**	**153.1**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	**140**	**140**	**140**	**140**	**140**	**140**	**140**	**140**	**140**	**140**	**140**
Debt service-to-exports ratio											
Baseline	3.0	2.8	2.5	2.3	2.9	3.0	3.1	3.4	3.4	3.4	3.5
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	3.0	2.6	0.2	-2.2	-4.6	-7.1	-10.0	-12.5	-15.5	-18.4	-21.4
B. Bound Tests											
B1. Real GDP growth	3.0	2.8	2.5	2.3	2.9	3.0	3.1	3.4	3.4	3.4	3.5
B2. Primary balance	3.0	2.8	2.7	2.6	3.3	3.4	3.4	3.7	3.7	3.8	3.8
B3. Exports	3.0	4.1	6.6	7.9	9.2	9.2	9.2	9.7	9.7	9.8	9.7
B4. Other flows 2/	3.0	2.8	3.8	4.9	5.4	5.3	5.3	5.5	5.4	5.4	5.4
B6. One-time 30 percent nominal depreciation	3.0	2.8	2.5	0.8	1.4	1.6	1.7	2.0	2.1	2.2	2.3
B6. Combination of B1-B5	3.0	3.3	5.5	5.6	6.4	6.4	6.4	6.7	6.7	6.7	6.7
C. Tailored Tests											
C1. Combined contingent liabilities	3.0	2.8	3.4	3.1	3.7	4.0	4.0	4.3	4.3	4.3	4.3
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	**10**	**10**	**10**	**10**	**10**	**10**	**10**	**10**	**10**	**10**	**10**
Debt service-to-revenue ratio											
Baseline	1.7	1.8	1.5	1.3	1.4	1.4	1.4	1.5	1.5	1.5	1.5
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	1.7	1.7	0.1	-1.2	-2.2	-3.4	-4.6	-5.6	-6.8	-7.9	-9.2
B. Bound Tests											
B1. Real GDP growth	1.7	1.9	1.9	1.5	1.7	1.8	1.7	1.8	1.8	1.8	1.8
B2. Primary balance	1.7	1.8	1.6	1.4	1.6	1.6	1.6	1.7	1.6	1.6	1.6
B3. Exports	1.7	1.8	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.9
B4. Other flows 2/	1.7	1.8	2.3	2.6	2.6	2.5	2.4	2.5	2.4	2.3	2.3
B6. One-time 30 percent nominal depreciation	1.7	2.2	1.9	0.5	0.9	1.0	1.0	1.2	1.2	1.2	1.2
B6. Combination of B1-B5	1.7	1.9	2.6	2.4	2.4	2.4	2.3	2.4	2.3	2.3	2.3
C. Tailored Tests											
C1. Combined contingent liabilities	1.7	1.8	2.0	1.7	1.8	1.9	1.8	1.9	1.9	1.9	1.8
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	**14**	**14**	**14**	**14**	**14**	**14**	**14**	**14**	**14**	**14**	**14**

Sources: Country authorities; and staff estimates and projections.

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

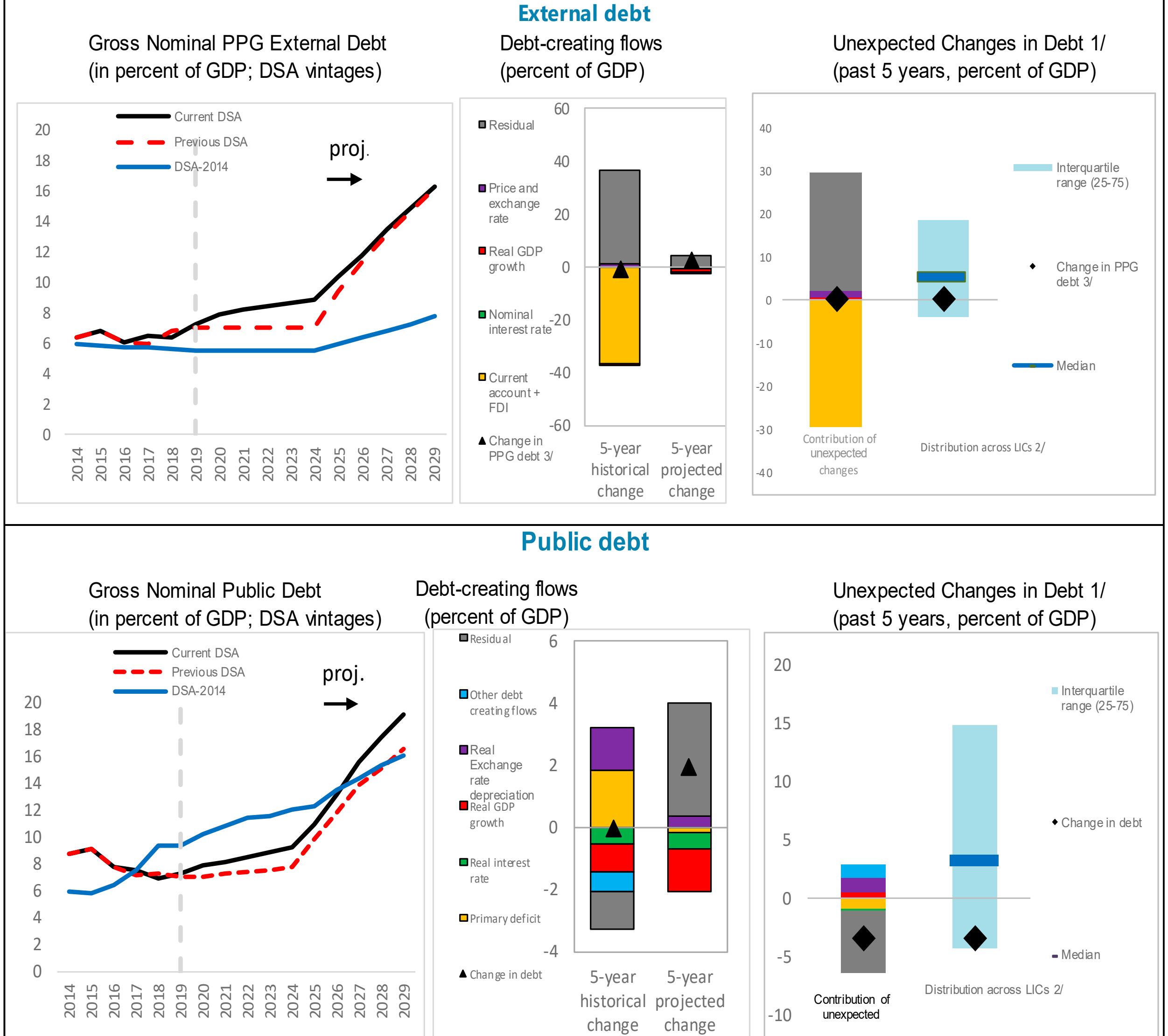
2/ Includes official and private transfers and FDI.

Table 4. Afghanistan: Sensitivity Analysis for Key Indicators of Public Debt , 2019-2029

	Projections										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of Debt-to-GDP Ratio											
Baseline	4.3	4.3	4.4	4.5	4.6	4.7	5.7	7.3	9.0	10.2	11.3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	4	4	5	5	5	6	7	8	8	8	8
B. Bound Tests											
B1. Real GDP growth	4	6	9	11	14	16	19	24	28	31	35
B2. Primary balance	4	5	6	6	6	6	7	9	10	12	13
B3. Exports	4	6	9	9	9	9	10	11	13	14	15
B4. Other flows 2/	4	9	14	14	14	14	14	16	17	18	19
B6. One-time 30 percent nominal depreciation	4	5	4	3	2	2	2	2	2	3	3
B6. Combination of B1-B5	4	5	5	5	5	5	6	8	10	11	12
C. Tailored Tests											
C1. Combined contingent liabilities	4	9	9	9	9	9	10	11	13	14	15
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public debt benchmark	**35**	**35**	**35**	**35**	**35**	**35**	**35**	**35**	**35**	**35**	**35**
PV of Debt-to-Revenue Ratio											
Baseline	15.8	16.4	15.8	15.2	14.8	15.3	18.8	24.5	31.4	36.7	42.1
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	15.8	16.5	16.8	17.1	17.5	18.8	22.6	26.6	29.4	30.1	30.9
B. Bound Tests											
B1. Real GDP growth	15.8	20.7	28.1	34.3	40.1	47.0	58.7	73.1	89.8	105.4	121.4
B2. Primary balance	15.8	19.8	22.9	21.8	20.6	20.5	24.1	29.7	36.5	41.9	47.3
B3. Exports	15.8	23.1	32.7	30.8	29.1	29.0	32.5	38.2	45.2	50.7	56.2
B4. Other flows 2/	15.8	35.1	51.2	47.8	44.7	43.9	47.5	53.2	60.3	66.0	71.7
B6. One-time 30 percent nominal depreciation	15.8	18.7	14.3	10.8	7.6	5.6	5.1	6.7	8.8	9.4	10.0
B6. Combination of B1-B5	15.8	18.8	19.3	16.3	16.2	16.9	20.8	26.7	33.8	39.3	44.9
C. Tailored Tests											
C1. Combined contingent liabilities	15.8	35.8	33.9	31.9	28.8	28.6	32.1	37.5	44.5	50.0	55.4
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	2.7	0.9	0.8	0.7	0.8	0.8	1.0	1.4	1.8	2.2	4.5
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	2.7	0.8	0.8	0.7	0.9	1.2	1.4	1.8	2.2	2.3	3.7
B. Bound Tests											
B1. Real GDP growth	2.7	0.9	1.0	1.1	2.5	3.8	4.5	5.6	6.8	7.8	11.0
B2. Primary balance	2.7	0.9	0.9	0.9	1.9	2.1	1.2	1.8	2.2	2.3	4.7
B3. Exports	2.7	0.9	0.9	1.0	1.1	1.1	1.3	1.6	2.0	2.4	4.8
B4. Other flows 2/	2.7	0.9	1.2	1.4	1.4	1.4	1.6	1.9	2.3	2.7	5.0
B6. One-time 30 percent nominal depreciation	2.7	1.0	1.0	0.7	0.8	0.0	0.9	1.2	1.5	1.8	3.9
B6. Combination of B1-B5	2.7	0.9	0.8	0.7	0.8	0.9	1.3	1.7	2.1	2.6	5.0
C. Tailored Tests											
C1. Combined contingent liabilities	2.7	0.9	1.5	1.4	6.4	1.4	1.5	3.0	2.2	2.6	5.2
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.
1/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
2/ Includes official and private transfers and FDI.

Figure 3. Afghanistan: Drivers of Debt Dynamics - Baseline Scenario



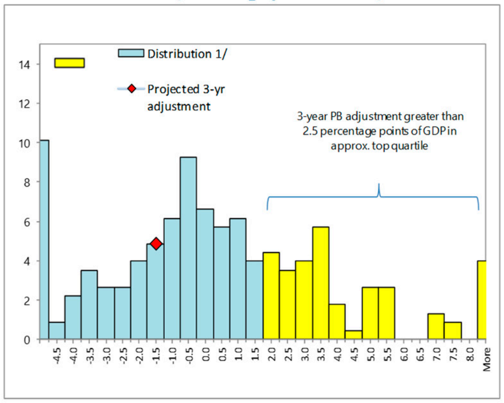
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

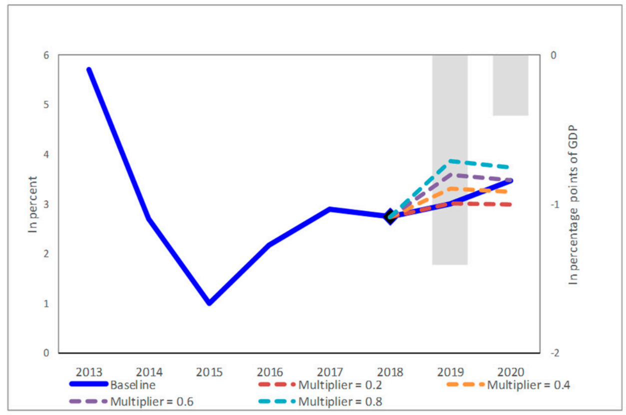
Figure 4. Afghanistan: Realism tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



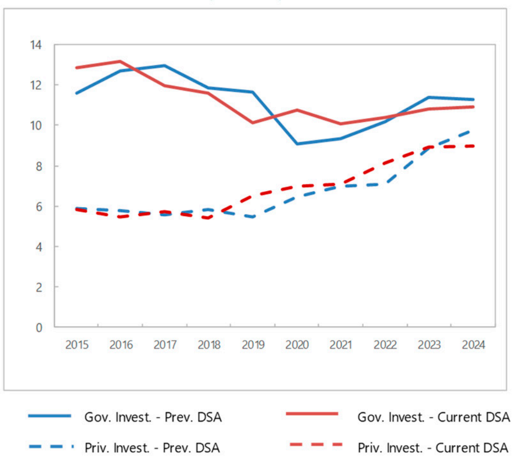
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/

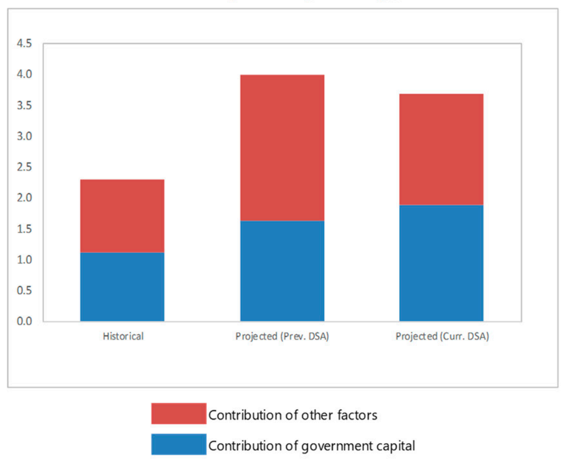


1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(% of GDP)



Contribution to Real GDP growth
(percent, 5-year average)



Statement by Jafar Mojarrad, Executive Director for Islamic Republic of Afghanistan and Syed Ishaq Alavi, Government Provided Advisor to Executive Director
December 19, 2019

Our Afghan authorities thank staff for constructive policy dialogue, and the Executive Board and management for their continuous support. The authorities are in broad agreement with staff recommendations on policy priorities going forward.

PERFORMANCE UNDER THE ECF ARRANGEMENT

All end-June quantitative performance criteria and all end-September indicative targets were met, as were all structural benchmarks, albeit one with a brief delay. The authorities believe that the economy's overall good performance under the ECF-supported program, the program's full implementation and its successful completion have established a strong track record and are requesting Board approval for the completion of the sixth and final review. The program has delivered on its three key objectives: (i) successfully anchoring macroeconomic and financial stability; (ii) advancing a comprehensive reform agenda; and (iii) catalyzing donor support. In the process, the authorities have demonstrated their unwavering commitment to reforms and solid program ownership in a very difficult environment and with serious capacity constraints.

RECENT ECONOMIC DEVELOPMENTS

The Afghan authorities have managed to preserve macroeconomic stability amid an extremely difficult security situation, elevated political uncertainties and successive climate- induced and adverse external shocks that hampered economic activity and eroded confidence. Now, as Afghans await the outcome of the recent presidential election, their aspirations for a lasting end to decades of violence seem closer to reality than at any time before. The government's Peace and Reconciliation Plan reaffirms its strong commitment to an enduring All-Afghan peace that would preserve, and build on, the hard-earned gains of the past two decades.

In 2019, economic growth is projected at 3 percent, with the growth uptick (from 2.7 percent in 2018) primarily driven by the agriculture sector's recovery from a severe drought. Inflation has picked up moderately but remains tame. In the first half of 2019, the *Afghani* depreciated by about 8 percent against the US dollar, reflecting the latter's strength, increased political uncertainties and sharp movements in regional currencies. The central bank—Da Afghanistan Bank (DAB)—increased its international reserves further, providing a healthy buffer against potential external shocks, to which Afghanistan is prone to. Exports in 2019 were boosted by the government's export promotion initiatives while the large current account deficit continued to be financed by donor grants.

The fiscal authorities maintained their strong performance and continued to press ahead with improvements in budgetary processes, stepped up revenue mobilization efforts, and maintained cash buffers (with DAB) well above the program targets. Revenue collection has continued to grow, albite recently at a reduced pace due to election related uncertainties. Reflecting improvements in project selection and appraisal, budget execution has improved with the execution of the development budget exceeding 90 percent. The government resisted spending pressures in the run-up to the September presidential election while preserving social and other priority spending above the program targets.

MACROECONOMIC POLICIES

Macroeconomic policies are guided by the authorities' self-reliance agenda and are geared at safeguarding macroeconomic stability, creating conditions for a high inclusive growth, protecting the vulnerable, and strengthening the economy's competitiveness.

1. FISCAL POLICY AND REFORMS

Going forward, the authorities remain firmly committed to prudent fiscal policies and, in line with staff advice, will target an overall balanced position (including grants) while gradually reducing the operating deficit excluding grants. Fiscal reforms are focused on aligning budgetary processes with best international practices and strengthening PFM to enhance efficiency and further improve the quality of spending. The authorities' budgetary reforms have already started bearing fruit, evidenced by Afghanistan's position in the latest ranking of the Open Budget survey. Further reforms are underway to enhance budget preparation and execution rates, improve accountability and transparency, and upgrade institutional capacity. As part of these reforms, in October 2019, all large taxpayers were consolidated under a single LTO, while a VAT steering committee was established, and a VAT implementation team was tasked to prepare the ground for the introduction of VAT by end-2020. In line with staff recommendations, debt management and debt monitoring capacities have been further upgraded. Even with significant infrastructure gaps and investment needs the authorities intend to refrain from non-concessional borrowing ((MEFP ¶ 19-20).

2. MONETARY, EXCHANGE RATE AND FINANCIAL SECTOR POLICIES

Monetary policy's effectiveness is constrained by low intermediation, weak transmission channels and high dollarization, and yet DAB's prudent monetary policy has successfully helped to maintain overall price stability. DAB has taken a number of measures to encourage credit growth, including by implementing extensive outreach programs to promote greater use of public credit information and collateral registries and lowering interest rates on DAB capital notes and overnight facilities. The exchange rate has been, and will be, managed flexibly with interventions targeted at containing excessive volatility (MEFP ¶17).

The authorities' financial sector policies are guided by three overarching objectives: (i) strengthening stability and enhancing the integrity of the sector; (ii) close monitoring and addressing pockets of vulnerability, especially the weaknesses associated with legacy issues; and (iii) increasing access to finance and promoting formal financial services by implementing the National Financial Inclusion Strategy (NFIS). Building on their significant progress so far, the authorities will continue to closely monitor and address the remaining vulnerabilities in the financial sector. As action plans for weak banks are being strictly enforced, the authorities will press ahead with implementation of the World Bank- supported strategy to reform state-owned commercial banks. An important element of the authorities' financial sector development strategy is to bring unregulated financial service providers under the formal umbrella, and gradually consolidate them under a manageable number of supervised and corporatized entities. A national AML/CFT risk assessment has been completed and its findings will inform the authorities' efforts to further strengthen the AML/CFT framework. DAB's balance sheet has been cleaned of Kabul Bank related LOLR exposure and the implementation of recommendations of an international auditor on Kabul Bank asset recovery is on track. The NFIS also has provisions for promoting the use of fintech and branchless banking to provide access to the underserved segments of the society (MEFP ¶21-25).

POVERTY REDUCTION

Addressing Afghanistan's widespread poverty has been a critical element of the authorities' Self-Reliance Strategy, and the Afghanistan National Peace and Development Framework. Significant improvements have already been achieved in key human development indicators including life expectancy, school enrollment and access to basic health services. But, clearly more needs to be done given the extent and depth of poverty after decades of conflict. Several national and subnational pro-poor programs have been- and are being- implemented to promote economic opportunities for women, returning refugees, internally displaced people and other vulnerable groups. Poverty reduction will continue to be a strategic priority in the country's post-election development efforts, with the High Council on Poverty Reduction, Service Delivery and Citizen's Engagement providing high-level commitment and support (MEFP ¶14).

FIGHTING CORRUPTION

The authorities have demonstrated their strong determination to combat corruption and improve governance on several fronts. The country's anti-corruption framework has been upgraded. An Anti-Corruption Law has been enacted, with the High Council on Rule of Law and Anti-Corruption mandated to supervise its implementation. In line with Afghanistan's commitments to international and donor communities—with particular reference to the 2018 Geneva Conference—the High Council has adopted a comprehensive National Anti-corruption Strategy with a dedicated secretariat to monitor its implementation. The new Penal Code has been aligned with the United Nations Convention against Corruption, including on criminalization of corruption. The

Asset Declaration regime has been strengthened, and the Law on Protecting the Whistleblower, and the Law on The Right to Access Information have been enacted.

STRUCTURAL REFORMS

Market-based, job-rich growth will be the focus of the authorities' medium-term economic strategy. Agriculture, mining, urban development, services, and regional connectivity have been identified as the five key high-return areas with significant potential to attract investment and transform the economy. The authorities intend to consolidate their hard-won progress in improving the business climate and fully harness the potential of the private sector for generating growth and employment. A number of pieces of legislation and amendments have been promulgated to provide the necessary legal foundation to improve enforcement and provide the right regulatory environment for business. The initiatives to improve women's economic empowerment and integrate Afghan returnees and internally displaced families should also result in better social inclusion and outcomes.

CONCLUDING REMARKS

Afghanistan has made steady and significant progress in building institutions, improving governance, and promoting gender inclusion in a burgeoning democracy. The generous support of the donor community and international organizations—and particularly the policy advice of the IMF staff have been pivotal, and yet the authorities fully recognize that Afghanistan's future rests squarely on Afghan shoulders. Much remains to be done. Complacency is neither desirable nor affordable. Moreover, Afghans recognize the need to steadily wean the economy off donor support, especially if an All-Afghan agreement brings lasting peace back to Afghanistan. The authorities are determined to solidify the economic and financial gains achieved so far, including those under the 2016-2019 ECF supported program, and look forward to starting discussions in early 2020 on a successor IMF-supported program, with high inclusive growth as its first building block. In the meantime, they are committed to maintain policy consistency and continuity between the two programs. The Afghan authorities have benefitted from constructive engagements with IMF staff and will continue to rely on them for policy advice and technical support. They also look forward to continued support of the Executive Board and Management.