INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/252

THE ISLAMIC REPUBLIC OF AFGHANISTAN

July 2016

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE ISLAMIC REPUBLIC OF AFGHANISTAN

In the context of the Extended Credit Facility Arrangement, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 20, 2016, following discussions that ended on June 15, 2016, with the officials of the Islamic Republic of Afghanistan on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on July 1, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for the Islamic Republic of Afghanistan.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the Islamic Republic of Afghanistan*
Memorandum of Economic and Financial Policies by the authorities of the Islamic Republic of Afghanistan*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

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FOR IMMEDIATE RELEASE
July 20, 2016

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves A US$44.9 million Extended Credit Facility Arrangement to Support the Islamic Republic of Afghanistan

The Executive Board of the International Monetary Fund (IMF) today approved a three-year Extended Credit Facility (ECF) arrangement for the Islamic Republic of Afghanistan for SDR 32.38 million (US$44.9 million, or 10 percent of quota) to help raise growth by consolidating progress on the macroeconomic and structural fronts and catalyzing continued support from donors.

Following the Board's decision, SDR 4.5 million (about US$6.2 million) is available for immediate disbursement; the remaining amount will be phased in over the duration of the program, subject to semi-annual reviews.

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

"Afghanistan is undergoing a difficult political, security, and economic transition. Against this background, the authorities' successful completion of the 2015 staff-monitored program has provided the needed track record for a financial arrangement with the Fund. The authorities' program supported under the Fund's Extended Credit Facility aims to consolidate recent gains on the macroeconomic and structural fronts, and catalyze donor support. It will focus on institution building, fiscal and financial reforms, and measures to combat corruption. These reforms will help lay the foundation for private sector development, in line with the goal of Afghanistan's forthcoming National Development Framework.

"On the fiscal side, the program aims to raise revenue and reduce reliance on aid through tax administration and policy reforms; improve the formulation, execution, and reporting of the budget; ensure a pro-growth re-composition of public spending over time; and strengthen commitment controls and cash management.

"The program envisions bolstering financial stability and the central bank's regulatory and supervisory frameworks to address remaining financial risks, including the need to complete the resolution of the 2010 Kabul Bank crisis.

"The reform agenda also includes strong anti-corruption measures and implementation of further reforms of the AML/CFT framework, which are critical to protecting financial stability, deterring corruption, and exiting the Financial Action Task Force's monitoring process.

"The program will support a policy mix that aims to preserve macro-financial stability by strengthening fiscal and external balances, keeping inflation low, and maintaining exchange rate flexibility and strong buffers.

"In view of the challenging circumstances, full ownership of the program and buy-in from stakeholders will help mitigate implementation risks and raise the likelihood of program success."

ANNEX

Recent Developments

Afghanistan is undergoing a challenging political, security, and economic transition. Continued insecurity, political uncertainty, weak institutions and corruption are salient factors preventing robust and inclusive economic growth.

Against this background and following the sizable reduction of the International Security Assistance Force stationed in the country, real GDP growth declined from 11.5 percent in 2007-12 to 1.5 percent in 2013-15 and was 0.8 percent in 2015. While an uptick of growth to 2 percent is projected for 2016, it remains far below the level needed to ensure increased employment and improved living standards. Large fiscal and external deficits continue to be financed by donor aid. Risks, related to uncertain security conditions and potential shortfalls in external support, are tilted to the downside.

The nine-month Staff Monitored Program (SMP) approved in May 2015 was successfully completed in April 2016. The SMP aimed at addressing fiscal and banking vulnerabilities, preserving macroeconomic stability, improving prospects for inclusive growth, and building a track record for a future IMF financial arrangement.

Program Summary

The authorities' program supported by the ECF sets out a structural reform agenda that focuses on institution building, fiscal and financial reforms, and measures to combat corruption to lay the foundations for scaled up private sector development. The envisaged reforms, which are in the areas of the Fund's comparative advantage and complementary to reforms supported by donors, dovetail with Afghanistan's National Development Framework currently being finalized. The program aims to preserve macro-financial stability by implementing prudent fiscal, monetary, and financial policies, and by maintaining external buffers and a flexible exchange rate regime. The program's major elements are as follows:

Fiscal reforms: *On the revenue side***,** the priorities include strengthening current tax policies and administration, and customs revenue collection control and capacity. *On the expenditure side,* priorities include improving formulation, execution, and reporting of the budget; ensuring a pro-growth re-composition of public spending while safeguarding social and other priority spending; and strengthening commitment control and allotment processes to better manage cash and improve transparency.

Anti-corruption measures and financial governance: Strong anti-corruption measures are crucial for Afghanistan to build trust and accountability, minimize revenue leakages, and improve the business environment. The authorities have taken steps to improve the anti-corruption framework since 2014, and plan to align the legal framework for anti-corruption with international standards as well as improve enforcement and transparency—notably by strengthening the asset declaration regime and its implementation. The authorities plan to enhance implementation of the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework, in particular the regulation on currency reporting at borders and the fit and proper regulation.

Policies to preserve macro-financial stability: The ECF arrangement will aim to gradually reduce underlying fiscal and external imbalances to prepare for a time when donor aid declines. Buffers—low public debt and ample international reserves—will remain strong to absorb adverse shocks. The budget will increasingly favor development spending to support a recovery in growth, while financial sector policies will aim to strengthen vulnerable and weak banks and reform the state-owned commercial banks. On the latter, the program incorporates measures to complete the resolution of the 2010 Kabul Bank crisis through recapitalizing New Kabul Bank and reducing the central bank's lender of last resort exposure to Kabul Bank. Monetary policy will continue to be focused on maintaining price stability and a flexible exchange rate regime, while fostering confidence in the domestic currency in the context of high dollarization.

Additional Background

The Islamic Republic of Afghanistan, which became of member of the IMF on July 14, 1955, has an IMF quota of SDR 323.80 million

For additional background on the IMF and the Islamic Republic of Afghanistan, see:

http://www.imf.org/external/country/AFG/index.htm

Islamic Republic of Afghanistan: Selected Economic Indicators, 2014–17

(Quota: SDR 323.8 million)
(Population: 32 million)
(Per capita GDP: US$615; 2015)
(Poverty rate: 35.8 percent; 2011)
(Main exports: opium, US$2.7 billion; carpets, US$83.4 million; 2014)

	2014	2015	2016	2017
	Act.	Est.	Proj.	
Output and prices[1]	(Annual percentage change, unless otherwise indicated)			
Real GDP	1.3	0.8	2.0	3.4
Nominal GDP (in billions of Afghanis)	1,168	1,204	1,283	1,406
Nominal GDP (in billions of U.S. dollars)	20.4	19.7	18.4	19.3
Consumer prices (period average)	4.7	-1.5	4.5	6.0
Public finances (central government)	(In percent of GDP)			
Domestic revenues and grants	24.0	25.0	27.8	28.1
Domestic revenues	8.6	10.2	10.3	10.7
On budget grants (excl. donors' direct spending outside of budget)	15.4	14.9	17.5	17.4
Expenditures	25.7	26.4	27.6	28.2
Operating[2]	19.5	19.6	20.1	20.5
Development	6.2	6.9	7.5	7.7
Operating balance (excluding grants)[3]	-10.9	-9.4	-9.8	-9.7
Overall balance (including grants)	-1.7	-1.4	0.1	0.0
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)			
Reserve money	13.3	3.2	10.0	10.0
Broad money	8.3	3.3	7.5	9.6
External sector[1]	(In percent of GDP, unless otherwise indicated)			
Exports of goods (in U.S. dollars)	783	667	687	769
Exports of goods (annual percentage change)	8.9	-14.8	3.0	12.0
Imports of goods (in U.S. dollars)	8,711	7,867	7,985	8,261
Imports of goods (annual percentage change)	-5.0	-9.7	1.5	3.5
Current account balance				
Excluding official transfers	-35.6	-33.5	-36.6	-35.8
Including official transfers	2.4	4.7	4.5	1.1
Foreign direct investment	0.6	0.9	0.3	1.1
Total external debt[4]	6.5	7.0	6.9	7.0
Gross international reserves (in millions of U.S. dollars)	7,230	6,764	6,900	6,900
Import coverage of reserves[5]	9.8	9.0	8.8	8.4
Exchange rate (average, Afghanis per U.S. dollar)	57.4	61.1	…	...

Sources: Afghan authorities; United Nations Office on Drugs and Crime; 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] In months of next year's import of goods and services.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

July 1, 2016

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

KEY ISSUES

Context. Afghanistan is a fragile highly aid dependent state undergoing a difficult political, security, and economic transition that is posing difficult challenges for the government. Insecurity, political uncertainty, endemic corruption, weak institutions, an infrastructure deficit, weak human capital, and a large narcotics sector are the salient factors preventing robust and inclusive economic development.

Program objectives and modalities. Following the successful completion of the 2015 staff-monitored program, the authorities have requested a financial arrangement under the Extended Credit Facility to help consolidate progress on the macroeconomic and structural fronts and catalyze continued support from donors, helping to raise growth. The program's structural reforms focus on areas of the Fund's comparative advantage and are complementary to reforms supported by donors. While there are protracted medium-term balance of payments pressures, there is no immediate balance of payments need, given grants of about 40 percent of GDP and a comfortable international reserves position. Hence, a three-year program is envisaged with access at 10 percent of quota (SDR 32.38 million, about US$45 million), that can be augmented if adverse shocks were to cause international reserves to drop below an adequate level. Capacity to repay is assessed as adequate, although the country's fragility and fluid political context imply some risks.

Program policies. The program sets out a structural reform agenda that focuses on institution building, fiscal and financial reforms, and measures to combat corruption to lay the foundations for scaled up private sector development. The envisaged reforms dovetail with Afghanistan's National Development Framework currently being finalized. The program aims to preserve macro-financial stability by implementing prudent fiscal, monetary, and financial policies, and by maintaining external buffers and a flexible exchange rate regime.

Staff views. Staff supports the authorities' request for an ECF arrangement under a Fund-supported program. The Letter of Intent and Memorandum of Economic and Financial Policies provide for appropriate policies to pursue the objectives of the program. The program, however, carries some risks including (i) a deterioration in the security situation; (ii) a shortfall in donor aid; and (iii) increased political uncertainty, particularly with regard to elections scheduled for the fall. These risks, were they to materialize, could lead to lower growth, unexpected financing gaps, and problems with program implementation.

Approved By
Daniela Gressani and Bob Traa

Discussions were held in Delhi during May 18–26, 2016. The staff team comprised Christoph Duenwald (head), Robert Tchaidze, Farid Talishli (all MCD), Ke Chen (LEG), Olivier Frecaut (MCM), Ichiro Fukunaga (SPR), Sailendra Pattanayak, Elif Ture (both FAD). Daniela Gressani (MCD) joined the conclusion of the mission. The team met with Finance Minister Hakimi, Governor Sediq, and other senior officials. Yi Liu (MCD) provided research assistance and Norma Cayo (MCD) document management.

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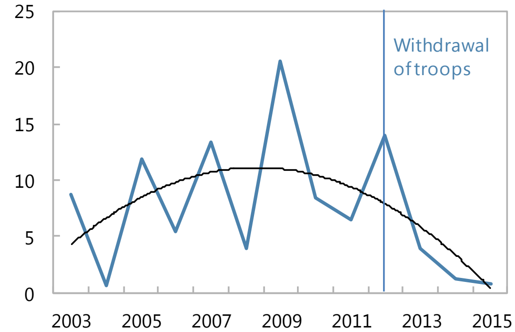
CONTEXT

1. **Afghanistan is undergoing a political, security, and economic transition that is posing difficult challenges for the government.** Continued insecurity, political uncertainty, endemic corruption, weak institutions, an infrastructure deficit, weak human capital, and a large illicit narcotics sector are the salient factors preventing robust and inclusive economic development.

- Growth, having averaged 11½ percent in 2007-12, collapsed to 1½ percent in 2013–15 as the size of the International Security Assistance Force stationed in the country fell from 130,000 to 13,000. An estimated 500,000 jobs were lost in recent years following the troop withdrawal. Political uncertainty and rising insecurity compounded this drag on economic activity.

Real Growth Rate
(Actual and trend, in percent)



Sources: Afghan authorities and IMF staff calculations.

- Prospects for a peace agreement with insurgents are uncertain and violence is on the rise.

- Political uncertainty persists as the power sharing arrangement between President Ghani and Chief Executive Abdullah, and therefore the government's cohesion, continues to be tested.

- Emigration emerged as a major issue in 2015, with violence and weak economic conditions being the main push factors.[1] These pressures have recently abated.

2. **The nine-month Staff-Monitored Program (SMP) approved in May 2015 was successful.** The SMP aimed at addressing fiscal and banking vulnerabilities, preserving macroeconomic stability, improving prospects for inclusive growth, and building a track record for a future IMF financial arrangement. All quantitative targets and most structural benchmarks were met, while remaining benchmarks were completed by the end of the SMP.

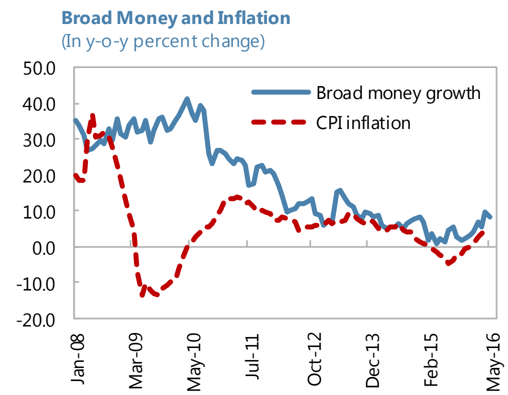
3. **The authorities have requested an ECF arrangement** to help address low revenue, financial sector vulnerabilities, and governance gaps, and thus, assist in improving the conditions for sustainable growth and in catalyzing support from donors. Donors are supportive of this intensified Fund engagement, and view an ECF arrangement as important in building confidence and support ahead of the Brussels donors' conference in early October, 2016.

[1] Afghanistan was the second largest source of migrants to the EU in 2015, after Syria.

ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

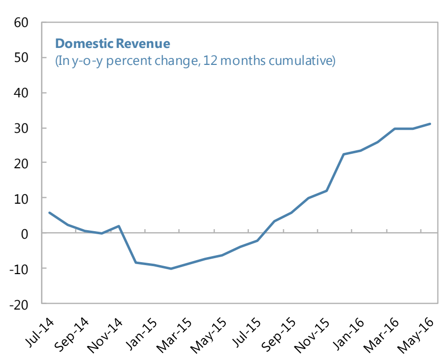
A. Recent Developments

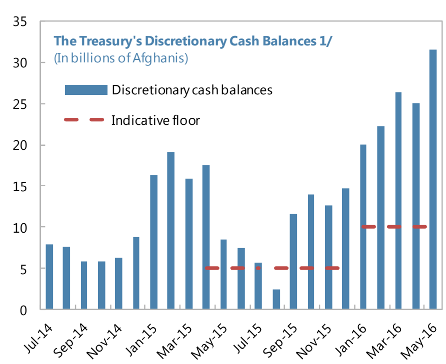
4. **Economic activity is weak.** GDP growth continued to decline in 2015, reaching 0.8 percent after 1.3 percent and 3.9 percent in 2014 and 2013, respectively. A further deterioration in security conditions, the continued impact of the troop withdrawal, delays in budget execution, and unfavorable weather lowering agricultural output were the major factors behind low growth. Inflation, after remaining in negative territory for some time in 2015, rose to 5 percent year-on-year in May due to the Afghani's depreciation.[2] Money growth and credit to the private sector recently accelerated as well, but from a low base.



Sources: Afghan authorities and IMF staff calculations.

5. **Budget indicators are improving.** Domestic revenues increased by 28 percent year-on-year in the first five months of 2016, on account of measures introduced in the second half of 2015. Operating budget execution[3] improved owing to acceleration in procurement in the security sector and a pick-up in wage and pension payments. Development budget execution, however, has not picked up (despite the authorities' plans to increase it over time from 53 to 80 percent of the budgeted amount), reflecting delays in procurement and submission of invoices. The overall budget recorded a surplus of about 2.5 percent of annual GDP after grants, and the treasury's discretionary cash balance increased to over Af 30 billion (2.5 percent of GDP), equivalent to 1.5 months of operating spending.





Sources: Afghan authorities and IMF staff calculations.
1/ Total discretionary cash balances at the Treasury Single Account and discretionary development account in DAB.

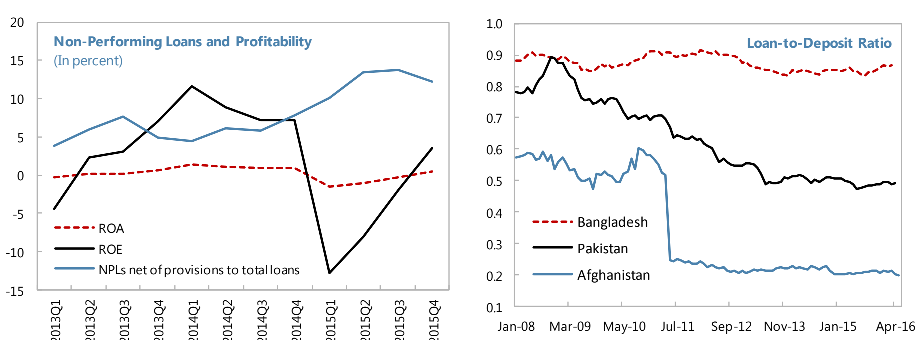
[2] The Afghani depreciated by 17 percent in 2015.

[3] Budget allocations and spending execution tend to differ substantially, especially with regard to the development budget. Discussions between the authorities, donors, and international financial institutions (IFIs) refer extensively to improvements in execution rates.

6. **The trade and current account (before official grants) deficits remain large, although data deficiencies complicate an assessment.** Staff estimates the former at about 37 percent of GDP and the latter at about 33 percent of GDP in 2015. While imports of goods declined by about 10 percent in 2015, exports of goods, consisting mainly of agricultural products and excluding opium and internal sales to nonresidents, declined by about 15 percent on account of unfavorable weather and disruptions in transportation as well as falling prices. Anecdotal evidence suggests some improvements in these factors since the beginning of 2016,[4] but given Afghanistan's large dependence on imports,[5] the impact on the trade deficit will be limited. The current account deficit continues to be more than fully covered by official grants.

7. **Exchange rate pressures decreased in the first five months of 2016 as emigration and related capital outflows have decelerated.** The Afghani depreciated slightly against the U.S. dollar, by one percent relative to end-2015. Da Afghanistan Bank (DAB) continues to supply foreign exchange to the domestic FX markets,[6] but its sales volumes have fallen: US$0.7 billion in the first five months against US$1.2 billion in the same period a year ago. Gross international reserves cover almost nine months of imports.

8. **The financial sector remains vulnerable and plays a limited role in financial intermediation.** The sector is marked by lingering governance concerns, deteriorating asset quality, and weak profitability. Public confidence, shattered by the 2010 Kabul Bank fraud and collapse, has not fully recovered yet. The high liquidity and solvency ratios are misleading and reflect the fact that banks do not play their intermediation role, with an average system-wide loan-to-deposit ratio of only 19.2 percent and 4.6 percent for the three state-owned commercial banks (SOCBs) as of December 2015.



Sources: Afghan authorities, IMF STA database, and IMF staff calculations.

[4] Besides favorable weather, improvements in storage facilities are making Afghanistan's exports of goods more resilient to disruptions in transport. Moreover, exporters' confidence has improved somewhat due to the World Trade Organization's approval of Afghanistan's membership and an agreement between Afghanistan, India, and Iran on developing the Chabahar port in Iran, the only Iranian port with direct ocean access.

[5] Afghanistan's exports of goods are less than one-tenth of imports (less than 4 percent of GDP). A substantial part of goods imports (40 percent) is assumed to be closely linked to official grants.

[6] DAB operates under a *de facto* managed floating exchange rate regime. It adjusts its FX sales (which is the primary tool for monetary operations in the absence of an effective alternative) to avoid excessive exchange rate volatility that may affect price stability.

B. Outlook and Risks

9. **The outlook remains challenging.** The perilous security situation and political uncertainties remain the key constraints to improved economic outcomes, crowding out development spending, undermining private investment, and complicating the implementation of reforms. Endemic corruption reduces economic efficiency, undermines institutions, and fosters inequality.

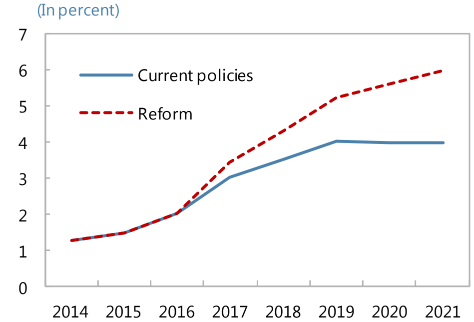
10. **Potential for medium-term growth is likely to be resource-based.** Past work by the World Bank identified agriculture and mining as core to a development strategy.[7] With supportive policy reforms, the agricultural sector could contribute to growth and employment relatively soon. Development of the mining sector is more distant, as it depends on an improvement in the investment climate, renegotiation of several existing contracts, and a robust fiscal regime for extractive industries to assuage investor concerns over corruption. The impending construction of the CASA line will provide for transmission corridors and the potential for exporting electricity.[8] The authorities have noted that trade and regional integration could be a growth driver and aim to develop Afghanistan into a trade and transportation hub for the region. However, such integration is likely slow to materialize.

11. **Staff noted that a critical mass of reforms is needed to lay the foundation for robust and inclusive growth.** The payoff from reforms is likely to be gradual, based on the experience of other fragile countries, and difficult to forecast, particularly given high insecurity. Growth has shown high volatility in the past, and the distorting effect of drug production and trafficking is an additional source of uncertainty.

The Reform Scenario

12. **Given high output volatility in the past and the inherent uncertainties going forward, staff relies on scenarios rather than projections to quantify the outlook.** In particular, the macroeconomic framework in this report assumes implementation of comprehensive structural reforms, including in the context of the ECF arrangement. This "reform" scenario builds on a "current policies scenario" presented in the May 2016 staff report[9] and incorporates the policies described in the Memorandum of Economic and Financial Policies

Growth under "Current Policies" and "Reform" Scenarios
(In percent)



Sources: Afghan authorities and IMF staff calculations.

[7] The analysis is currently being updated. Focus is on four strategies: natural resources (agriculture, mining, and renewable energy); trade and regional integration; investment into human capital, particularly adult literacy and quality of education; and capitalization on migrants' resources.

[8] CASA is the Central Asia-South Asia Electricity Transmission and Trade Project, which aims to enable sustainable electricity trade between Kyrgyz Republic, Tajikistan, Afghanistan, and Pakistan by 2020.

[9] Staff Report for the Second Review under the Staff-Monitored Program.

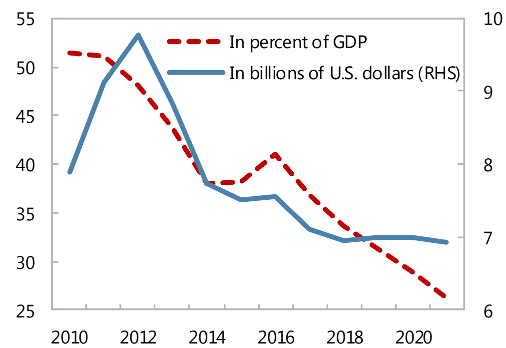
(MEFP), in addition to the assumptions of increased political stability and unchanged security situation.

- The reform package, combined with other broader reforms outside the ECF arrangement (e.g., business climate and financial inclusion), is assumed to raise private demand and public investment financed by higher domestic revenues. As a supply response kicks in, these factors are assumed to improve the growth trajectory, leading to a gradual upward shift that begins in 2017 and has an impact of 2 percentage points by 2021.[10]

- Broad money is assumed to grow around 8 percent yearly in the medium term, consistent with the inflation forecast of 7 percent.

- Grant inflows are anticipated to remain significant but gradually fall, from a projected 41 percent of GDP in 2016 to 26 percent by 2021. Approximately half will be disbursed outside the budget, while the composition of on-budget support will shift towards non-security spending as implementation of donor-funded development projects improves.

Actual and Projected Donor Aid



Sources: Afghan authorities and IMF staff estimates.

- The overall current account balance is expected to deteriorate in step with the projected decline of donor aid, turning into deficit possibly as early as 2018.

- Given the challenging economic environment and the pressures on the foreign exchange market in late 2015, DAB is cautious about accumulating foreign reserves over the medium term. Thus, the macro framework envisages gross international reserves to be flat at the existing comfortable level of US$6.9 billion (almost nine months of 2017 imports).

13. **The overall budget including grants is set to remain broadly balanced, while the operating deficit excluding grants is set to decline over the medium term.**

- In 2016, domestic revenues are projected to increase to 10.3 percent of GDP reflecting the full year effect of revenue measures introduced in mid-2015, while budget grants are projected to increase by about 2.6 percent of GDP on account of a re-phasing from 2015. Operating budget execution is projected to pick up in 2016, with operating spending reaching 20 percent of GDP, while development budget execution is expected to increase only modestly, due to capacity constraints in planning and execution, with development spending projected at 7.5 percent of

[10] The 6 percent growth assumption is in line with the reform scenario presented in the 2015 Article IV/First SMP Review Staff Report.

GDP. The treasury's discretionary cash balance is expected to remain above the indicative target of Af 10 billion (0.8 percent of GDP).

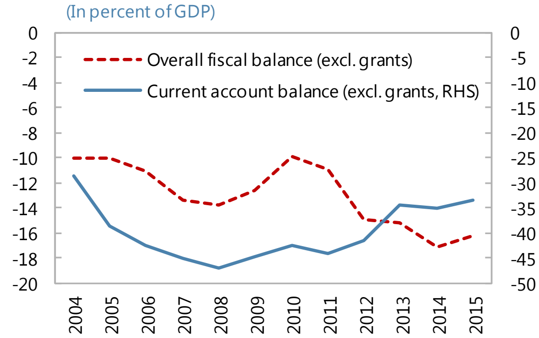
- By 2021, domestic revenues are projected to increase to 12.3 percent of GDP on account of ongoing and new administrative and nontax measures (MEFP ¶21) as well as CASA transit fees.[11] Operating spending is expected at around 20 percent of GDP over the medium term as security outlays and non-security recurrent costs remain high, and pro-poor operating spending is maintained above 3 percent of GDP.[12] Development spending is projected to increase by 1.5 percentage points of GDP with reform-driven improvements in development budget execution (MEFP ¶25) and an increase in discretionary development spending in line with higher revenues. The 2017 budget will include a transfer to the Kabul Bank Receivership (0.3 percent of GDP), and 2018–2019 budget balances are projected to record a small surplus to meet the remaining obligations under the promissory note issued to DAB (MEFP ¶28).

Risks

14. **This outlook is subject to significant risks (Annex I).** If security conditions worsen, aid falls short, or migrant outflows accelerate, exchange rate pressures could re-emerge, and growth would decelerate with attendant effects on unemployment. On the other hand, lasting peace provides an upside to the medium-term trajectory because it would boost private sector confidence and facilitate a growth-friendly shift in public spending from security to development.

15. **Afghanistan remains at a high risk of debt distress even under the reform scenario (see Debt Sustainability Analysis).** Afghanistan's public debt remains low and only a limited amount of concessional borrowing is planned. However, given large underlying fiscal and external current account deficits, a modest change in the structure of donor financing with a gradual shift to loan financing would quickly lead to an unsustainable debt burden. Afghanistan's debt sustainability will critically hinge on continued donor grant inflows, combined with sound policies and reforms.

Fiscal and External Deficits
(In percent of GDP)



Sources: Afghan authorities and IMF staff calculations.

THE AUTHORITIES' PROGRAM

A. Broad Strategic Issues

16. **The authorities are working on a development strategy that sets a roadmap for reform over the next several years, and are seeking development partners' assistance to jump-start**

[11] These are cautious projections pending tax policy measures to be identified through technical assistance.

[12] Spending on "ghost" public workers, pensioners, and projects is to be reduced through advancements in the electronic payment systems and procurement processes.

the economy while preserving macro-financial stability. The authorities see the troop withdrawal and rising insecurity as the main reasons for the recent sharp slowdown in growth, which in turn has put upward pressure on unemployment and poverty, and contributed to the alienation of poorer segments of the population. These dynamics undermine efforts to secure peace and may stimulate emigration, creating a downward spiral. While peace and political stability are critical to achieving sustainable and inclusive growth, addressing Afghanistan's economic problems needs to go hand-in-hand with the resolution of the political-security problems: not only because low growth feeds the insurgency and emigration, but also because prospects of, and a timeline for, resolving these problems remain highly uncertain.

17. **A Fund-supported arrangement could play a catalytic role and would focus on the Fund's areas of comparative advantage.** In a context where donors provide the bulk of financial and capacity building support, the Fund should take the lead in providing a macroeconomic framework and helping with fiscal reforms and strengthening the financial sector, while relying on development partners in other areas. This division of labor calls for close coordination with authorities, donors, and IFIs, which promotes ownership of the reform agenda by the authorities and major stakeholders.

B. Design of the Program

18. **The program will rest on two pillars: structural reforms for private sector led growth, and policies for macroeconomic and financial stability.** Reviving growth requires a critical mass of structural reforms that address numerous structural obstacles to growth (Annex II). At the same time, the potential to boost demand directly through fiscal or monetary stimulus is very limited. While reserve buffers are relatively strong, transmission channels are impaired. A fiscal stimulus in the form of a debt-driven infrastructure investment program would be fraught with risks given the limited capacity to carry and manage debt, the history of corruption and need for strong complementary policies, yet likely ineffective in boosting growth and employment. A monetary stimulus would likely be ineffective in this highly dollarized economy with the credit channel not functioning properly and risking further capital outflows.

19. **Program conditionality will concentrate on areas of the Fund's comparative advantage to complement policies supported by development partners in other areas.**

- *To facilitate private sector development* in order to boost jobs and growth, mutually reinforcing reforms will target a subset of the growth inhibitors, including weak institutional structures in the fiscal area and endemic corruption. These reforms would create better conditions for the private sector to play its role as engine of growth.

- *To preserve macroeconomic and financial stability*, policies will aim to put underlying fiscal and external imbalances on a downward trajectory while maintaining strong buffers. The budget will favor development spending while maintaining fiscal sustainability (revenue mobilization, expenditure rationalization, and improving budget execution). Financial sector policies will aim to clean up the banking system in a durable way, strengthen vulnerable and weak banks and reform the SOCBs. Ensuring effective implementation of the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime is also important to preserve the integrity and stability of the financial system. Monetary policy will focus on price stability and a flexible exchange rate regime in the context of high dollarization.

20. **The program internalizes the lessons from the mixed track record of past IMF-supported and staff-monitored programs (Annex III).** Between 2004 and 2011, Afghanistan went through a two-year SMP, and PRGF and ECF-supported programs, with the ECF-supported program going off-track after the first review. Key problems were a lack of ownership and unrealistic underlying assumptions. But the performance under the 2015 SMP was good, demonstrating the authorities' willingness and capacity to undertake sound policies and providing the track record for a financial arrangement.

C. First Pillar: Structural Reform Priorities

Fiscal Reforms

21. **Structural fiscal reforms should contribute to reducing aid dependence and addressing pressing social and infrastructure needs.** Revenue collection remains far below potential,[13] while development needs are large, pro-poor spending is low and economy-wide capital spending is declining. The budget is too inaccurate and opaque to serve as a useful tool for fiscal policy. The tax administration lacks the capacity to deal with a largely noncompliant and unidentified taxpayer population and there is a need to develop a tax policy framework that matches the capacity of both the tax administration and the business community. Structural fiscal reforms will thus aim at boosting revenues, strengthening budget planning, execution, and commitment control processes to improve the quality and efficiency of public spending, and management of cash.

22. **On the revenue side, reforms will focus on raising the intake through selective and focused administrative and policy reforms in Afghan Revenue and Customs Departments (ARD and ACD).** The priorities include strengthening customs revenue collection control and capacity on goods that cross the border and optimization of the current tax and non-tax policies (MEFP ¶¶21–23).

- To improve trader compliance and reduce corruption, ACD will update its *risk management policy* to implement multi-criteria risk profiles in all border crossings and inland customs depots, and staff and train its risk management unit to effectively identify and prioritize high-risk traders and shipments for physical examination and post-release verification.

- To improve revenue collection efficiency and reduce leakages, ARD and ACD will *operationalize an automated interface for information sharing* between the tax and customs administration systems (Standardized Integrated Tax Administration System, SIGTAS, and Automated Systems

[13] Afghanistan's revenue collection (10 percent of GDP) currently covers only half of its operating expenditures. The World Bank estimates that improved enforcement and compliance could raise the intake to 14 percent of GDP.

for Customs Data, ASYCUDA) to make sure all significant businesses are filing income tax returns. The automated information sharing will be rolled out gradually to include Afghanistan Central Business Registry (ACBR) and Afghanistan Payments System (APS) to ensure better taxpayer identification and compliance.

- The authorities will also continue to implement their action plan to *strengthen the capacity of ARD and ACD* with the help of capacity development and financial assistance from donors, including the World Bank.

- IMF technical assistance (TA) is planned in FY2017 to conduct *a diagnostic study of the current tax and nontax revenue system* to unlock additional sources of revenue over the program period. It would focus on reviewing exemptions and potential to introduce excises on select goods and services such as beverages, tobacco and petroleum products, and automobiles.

- In the meantime, the authorities plan to *review and update a set of government fees* to bring them in line with the current service costs and introduce additional fees in selected services (an estimated yield of 0.2 percent of GDP from 2017 onwards).

- While the introduction of a *VAT* remains a medium-term objective, staff concurred that a VAT is not feasible over the program period given technological and human capacity constraints in the tax administration as documented by a recent World Bank diagnostic study.

- Reform of *the mining fiscal regime* should be completed by end-2017 with the help of IMF TA to ensure a sound and transparent fiscal regime for extractive industries in full compliance with the Extractive Industries Transparency Initiative (EITI) requirements is in place as the mining sector develops, notwithstanding security challenges, infrastructure gaps, and low commodity prices. Progress in this area will be monitored by a June 2017 structural benchmark that sets out remedial steps towards compliance with EITI requirements (MEFP ¶24).

23. **On the expenditure side, priorities include improving formulation, execution, and reporting of the budget; ensuring a pro-growth re-composition of public spending; and strengthening commitment control and allotment processes to better manage cash and improve transparency (MEFP ¶25).**

- *To improve budget costing and align public spending with national priorities*, the authorities will cost existing policies/projects and identify available fiscal space for new policies/projects. In line with the government's pro-growth and pro-poor priorities, the Ministry of Finance (MOF) will issue indicative expenditure ceilings for three years (budget year plus two forward years) to line ministries to develop a portfolio of costed development projects and forward estimates based on these expenditure ceilings.

- The sequencing plan for line ministries to undertake costing reviews of their existing policies will be developed this year, and the authorities plan to have medium-term forward estimates starting with priority sector ministries in the next 2–3 years and for all ministries by 2020.

- The authorities have also adopted a policy of working towards a consolidated national budget to integrate the operational and development budgets and systematically take account of allocations needed for operation and maintenance of capital assets created under development projects.

- *To improve development budget planning and execution,* the authorities envisage a three-pronged approach.

  - First, they will establish a database to track information (total cost, year-wise required funding, funding sources, expenditures incurred, and current implementation status) on the 50 largest projects to monitor the performance of the development budget, secure future allocations needed to complete the ongoing projects, and (in consultation with donors) reallocate resources from low to high-performing projects.

  - Second, they will ensure that no project is funded in the budget unless all preparatory steps have been completed, establishing its readiness for implementation.

  - Third, they will streamline the process of administrative clearances/approvals at various stages of project implementation.

  - In addition, the MOF is engaging with line ministries to enhance their budget execution capacity, and with donors to increase flexibility of development projects funding.

- *To strengthen commitment control and cash management*, high value and multi-year contractual commitments should be tracked through the Afghanistan Financial Management Information System (AFMIS) and in-year allotments to line ministries should be based on annual financial plans submitted by them. These financial plans will inform the cash plan of the Treasury, which will control payments by the line ministries during budget execution against their authorized financial plans and pre-registered commitments.

Financial Sector Reforms

24. **Afghanistan needs to develop financial intermediation.** In addition to preserving financial stability, a key objective of the program is to help foster growth-friendly financial sector policies, as the banking system's low loan-to-deposit ratio limits private sector growth. While the SOCBs focus on the resolution of their pending issues, the most robust of the private banks have room to expand prudently and gradually their loan portfolios and the range of funding techniques that they offer to their customers, beyond the current over-reliance on overdrafts. The DAB will adjust its communication with them and review regulations that might be overly demanding (particularly regarding collateral requirements) to avoid discouraging intermediation even by the strongest banks. Progress on judicial processes for collateral recovery is also a priority.

25. **The Afghan government is developing an ambitious "National Financial Inclusion Strategy" with the World Bank's assistance.** It is expected to start at the national level by 2016Q3 and to be finalized towards end-2017. The strategy covers an "access to finance" agenda, including

for agriculture, where diverse grass root initiatives will be coordinated with the Agriculture Development Fund to leverage their impact. The strategy will target an improvement in financial sector infrastructure, introduce a wider range of financial instruments, facilitate financial intermediation, and support innovative financing for the private sector. Key components of the strategy will also include strengthening consumer protection, improving financial literacy, and building capacity for the commercial banks' staff.

Governance Issues

26. **Anti-corruption measures are crucial to build trust and accountability, minimize revenue leakages, and improve the business environment.** The authorities have taken steps to improve the anti-corruption framework. A presidential decree was issued in October 2014 to clarify that the High Office of Oversight and Corruption (HOO)'s main functions are to administer the regime of asset declaration by public officials instead of supervising and inspecting other government agencies. A National Procurement Authority was established to strengthen transparency and accountability of the procurement process. A High Council for Good Governance, Justice, and Anti-Corruption, chaired by the President, was established earlier in 2016 to coordinate the development of a national strategy on anti-corruption, facilitate inter-agency collaboration, and consolidate anti-corruption enforcement efforts. Asset declarations of most top officials listed in Article 154 of the Constitution[14] were published in November 2015. In addition, a call center was set up in the Attorney General Office (AGO) in May 2016 to receive citizens' complaints related to corruption.

27. **The legal framework for anti-corruption will be aligned with international standards as well as enhance enforcement and improve transparency.** The authorities have prepared a draft Appendix 4 to the Criminal Law and a draft new law on anti-corruption and will submit the draft legislation to parliament by end October 2016 (structural benchmark for the first review, MEFP ¶37) and pursue its prompt adoption. The legislation aims, among others, to:

i) Criminalize acts of corruption in line with the United Nations Convention against Corruption (UNCAC); and,

ii) Ensure that annual asset declaration requirements are extended to cover heads and deputies of law enforcement agencies, customs and tax administrations, covering both assets legally owned and beneficially owned, with proportionate and dissuasive sanctions for non-compliance. For the aforementioned officials not listed in the Constitution, their declarations will be available in a timely manner upon request to, at a minimum, domestic law enforcement agencies and the Financial Intelligence Unit.

[14] According to Article 154 of the Constitution, "the wealth of the President, Vice-Presidents, Ministers, members of the Supreme Court as well as the Attorney General, shall be registered, reviewed and published prior to and after their term of office by an organ established by law."

28. **Building upon these measures, the authorities plan to implement the strengthened asset declaration regime.** As a first step, they plan to publish by end-June 2017 the declarations for 2016 by officials listed in Article 154 of the Constitution in Dari and in English on an official website freely available and easily searchable. The website will also include information in Dari and in English on the name and functions of other senior officials mentioned above who have declared their assets for the previous year, updated on an annual basis, and on the mechanisms to access their declarations (structural benchmark for the 2nd review, MEFP ¶37).

Business Climate

29. **Strengthening the business climate is an important element of the government's broader reform strategy.** Afghanistan is at the bottom decile of the World Bank Doing Business index and faces significant challenges in areas such as licensing procedures, property registration, resolving insolvency, enforcing contracts, getting credit and electricity, and trading across borders—areas that empirical analysis[15] shows are associated with spurring productivity growth in low-income countries. Fund staff will support other donors, such as the World Bank, that are working with the authorities to improve the business climate.

D. Second Pillar: Preserving Macro-Financial Stability

30. **Macro-financial stability requires strengthening fiscal and external balances while maintaining strong buffers.** With large underlying imbalances, macro stability has been maintained with donor aid, but this is likely to decline over the medium term. Quantitative performance criteria on a number of indicators (Appendix I, Table 1) will be used to monitor progress.

31. **Over the medium term, the operating budget balance excluding grants should become an anchor for fiscal policy.** Currently, operating spending, and hence the operating balance before grants, are affected by the unpredictable process of donors moving their support (activities and financing, including security-related) on-budget, which results in hard-to-predict changes in the indicator. Until it is possible to make this target fully operational, the overall budget balance including grants should be maintained close to zero, keeping public debt low.

32. **The current monetary and exchange rate regime has served Afghanistan well.** With weak monetary transmission channels, reserve money will continue to be the nominal anchor for monetary policy, with the objective of keeping inflation low; however, some pickup in inflation over time is likely, with demand picking up before reforms elicit a supply response. The flexible exchange rate regime should be maintained to facilitate the absorption of frequent shocks. The central bank should aim to reduce dollarization and increase the use of the Afghani; this would strengthen monetary policy transmission to the real economy. For that, low inflation and enhanced communications by DAB to clarify its objectives and operations via regular publications are

[15] SDN "Anchoring Growth. The Importance of Productivity-Enhancing Reforms in Emerging Market and Developing Economies" https://www.imf.org/external/pubs/ft/sdn/2013/sdn1308.pdf.

important elements. In addition, a broadening of the range of domestic currency-denominated instruments to include sukuk should also help monetary operations.

33. **To consolidate financial stability, the authorities will complete the resolution of the 2010 Kabul Bank crisis (Annex IV).** As a first step, the authorities will recapitalize the New Kabul Bank (NKB) by end-December 2016 (structural benchmark) for an amount of US$91 million plus an adequate amount of capital as determined by the Banking Law of Afghanistan (MEFP ¶29). Next, the FY2017 budget will include an explicit allocation for a transfer to the Kabul Bank Receivership of the funds that the MOF owes for the Kabul Bank assets taken over by various government entities (structural benchmark, MEFP ¶28). By June 2017, these funds, together with other assets of the receivership, will be applied to the reduction of DAB's remaining lender-of-last-resort (LLRF) exposure. Finally, starting in 2017 and by end-2019, the remaining LLRF balance on DAB's books will be fully eliminated with capital transfers. Thus, the DAB will be relieved from its lingering exposure to the results of the liquidation of the Kabul Bank, while the New Kabul Bank will transition from a temporary bridge bank without capital to a depositor-oriented, adequately capitalized institution. The authorities continue to consider the future of the NKB, including its possible privatization.

34. **The three SOCBs will continue to give priority to prudent management while their remaining serious governance shortcomings are being addressed resolutely by the supervision department of DAB.** The authorities started a dialogue with the World Bank to request TA to align corporate governance of SOCBs with global best practices. During a transition period, while all its identified weaknesses are addressed, NKB will not change its current lending policy. Pashtany Bank, which has only recently recognized in its books the large losses on its loan portfolio accumulated over the years, will focus on improving its governance and demonstrating its financial viability before giving consideration to a resumption of its lending activities. In the meantime, the Bad Debt Commission will pursue its mission. The authorities are also seeking the World Bank's support to enhance SOCBs' efficiency through automation of major banking functions and modernization of payment systems to minimize operational risks. The SOCBs' business model thus temporarily consists of focusing on prudence, governance and efficiency.

35. **DAB will continue capacity building efforts in the area of prudential regulation and supervision.** The 2014–2018 Strategic Action Plan (SAP) developed with the Middle East Technical Assistance Center is being implemented and will be further supported by a new World Bank project under preparation and soon to be finalized. An update of the SAP will take place by mid-2017, including incorporating a bank resolution framework. The special reviews of the weaker private banks are progressing as expected and the results will become available during the 3rd quarter of 2016. Some IMF TA, targeted to support of the SAP implementation, has been requested in the area of prudential regulations and stress-testing.

36. **Good progress has been made over the past two years in establishing a legal framework for AML/CFT measures.** The AML and CFT laws were amended in 2015 and a few regulations were issued to implement them, including the CFT regulation, the regulation on currency reporting at borders (as revised in December 2015), the Fit and Proper Regulation for banks (re-

issued under the Banking Law), and the AML and Proceeds of Crime Regulation–Preventive Measures for Financial Institutions.

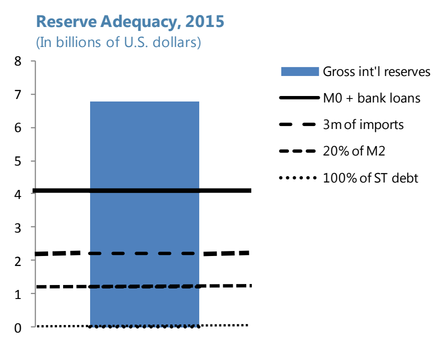
37. **The authorities plan to enhance implementation of the AML/CFT framework, in particular the regulation on currency reporting at borders and the fit and proper regulation.** ACD has started implementing at the Kabul airport the revised regulation on currency reporting at borders. To step up implementation in order to allow for detecting and deterring physical cross-border movement of illegal proceeds, ACD will, with DAB's support, adopt a revised declaration form template and working procedures and plan to publish quarterly implementation reports. DAB will start implementing the Fit and Proper Regulation for the existing banks by completing collection of relevant information from all banks by September 2016 (MEFP ¶39).

38. **Afghanistan has been subject to the Financial Action Task Force (FATF)'s monitoring since 2012 for its "strategic deficiencies" in the AML/CFT regime.** The authorities are committed to completing the action plan agreed with the FATF by September 2016 aiming at exiting FATF's monitoring process in February 2017.

PROGRAM MODALITIES

39. **Level of access, BOP need, capacity to repay:**

- The current and projected level of reserves is deemed comfortable. As a result, there is no immediate residual BOP need. However, there are protracted BOP pressures over the medium term reflecting underlying current account imbalances.[16] In addition, high aid dependence and the risk of renewed outflows resulting from emigration, call for an adequate level of foreign reserves.



Sources: Afghan authorities and IMF staff calculations.

- In the absence of an immediate balance of payments need, access is set at 10 percent of quota (SDR 32.38 million, about US$45 million), phased in seven disbursements over three years (Table 8). However, in case of adverse shocks that create BOP needs, the arrangement could be augmented.

- The disbursements under the ECF are to be kept at DAB as gross reserves.

- Capacity to repay is adequate. Debt service obligations to the Fund, including the new program disbursements, will remain moderate (Table 10).

[16] The projected cumulative current account deficit excluding grants in 2016–19 amounts to US$ 28 billion.

- Program performance will be monitored through quantitative performance criteria and indicative targets similar to the 2015 SMP as well as structural benchmarks (Appendix I).

40. **Financial assurances and donor support.** Aid flows in the next few years are likely to be maintained at or near the current levels, with a shift toward on-budget financing and strengthened conditionality to ensure results. Donors would welcome the Fund's continuing engagement through a financial arrangement, seeing the Fund as a catalyst both for advancing the reform agenda and for building confidence and support ahead of the October 2016 donor conference.

41. **Afghanistan's capacity development needs are substantial.** A number of TA missions to strengthen fiscal reforms and policies, financial sector policies, and the quality of macroeconomic statistics have been delivered by the Fund in recent years, complementing important efforts by international donors. IMF missions have been conducted off-site given weak security, which limited their effectiveness. Going forward, and to support policies and reforms under the ECF arrangement, TA delivery will need to be ramped up, including in the financial (supervision, bank restructuring), fiscal (revenue administration, tax policy, and public financial management), and macroeconomic and financial statistics areas. Close coordination with the donor community—especially those present on the ground—will be important in delivering some of the TA and assessing program implementation.

42. **The Fund-supported program can proceed under the new policy on non-toleration of arrears to official creditors.**[17] 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, as the underlying Paris Club agreement was adequately representative and the authorities have made best efforts to resolve the arrears. Staff will follow up on this issue in future reviews.

43. **The most recent safeguards assessment of DAB was finalized in 2011 against the background of the Kabul Bank fraud, which had impacted DAB's financial position.** The recommendation related to the recapitalization of DAB through a government promissory note at that time has been implemented, but some lingering DAB exposure to this incident still needs to be addressed. DAB will resume publishing on its website the Kabul Bank receivership's annual financial statements audited by an international audit firm. Controls in some safeguards areas have also improved, but capacity constraints remain an issue. Amending the DAB law has proven a challenge, and, as a result, the recommendation concerning the DAB's legal structure remains outstanding. With a new program, an updated safeguards assessment of DAB will need to be conducted ahead of the first review, and is expected to take place at an offsite location for security reasons. Recommendations will be taken up in future reviews, as necessary.

[17] See "Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors" https://www.imf.org/external/np/pp/eng/2015/101515.pdf.

STAFF APPRAISAL

44. **Afghanistan is facing difficult challenges and remains fragile and heavily aid dependent.** Political uncertainties and insecurity, international troop drawdown, and weak institutional capacity have weighed on economic performance and social outcomes. To reverse these trends, the national unity government is looking for ways to transform the ailing economy to achieve durable and inclusive growth. The authorities recognize that better economic performance requires sustained reforms as well as improved security conditions.

45. **The economic outlook remains highly dependent on political and security stability, steadfast reform efforts, and donor support.** Growth has declined sharply in the past few years, reaching only 0.8 percent last year. In 2016, a modest pickup to 2 percent is expected, and over the medium term, assuming political stability and implementation of good policies, growth should gradually rise to the 4–6 percent range. Downside risks to this scenario are significant, and relate mostly to deterioration in security conditions and shortfalls in donor aid. On the upside, a lasting improvement in security conditions would provide a game changing boost to confidence and the economy.

46. **Against this background, the authorities are seeking the international community's support for their reform agenda aimed at moving towards self-reliance.** A long and challenging reform agenda lies ahead and the authorities seek the Fund's support through a three-year ECF arrangement. The Fund-supported program would catalyze continued donor support by providing a macroeconomic framework anchor and a time bound roadmap for reform. The program's structural reforms focus on areas of the Fund's comparative advantage and are complementary to reforms supported by donors and partner IFIs.

47. **The authorities' new Fund-supported program addresses the challenges at hand, in the broader context of Afghanistan's National Development Framework.** Over the next three years, the program will aim to support a rebound in growth, modest inflation, and low public debt with a comfortable international reserves buffer. To this end, the program put forward by the authorities rests on two pillars—first, structural reforms to facilitate private sector development, and second, policies aimed at preserving macroeconomic and financial stability.

48. **A strong fiscal structural reform effort is essential.** In particular, determined efforts are needed to raise the revenue intake through selective and focused administrative and policy reforms in the revenue and custom departments; improve formulation, execution, and reporting of the budget; ensure a pro-growth composition of public spending; and strengthen commitment control and cash management. Establishing a strong fiscal anchor and gradually expanding the fiscal perimeter should be important development objectives under the program.

49. **Strong anti-corruption measures are critical to boost stakeholders' confidence, and prepare the ground for economic recovery.** The authorities need to strengthen the legal and institutional framework for anti-corruption to ensure that acts of corruption are criminalized in line

with the UNCAC, and focus AGO's anti-corruption directorates and the special anti-corruption court on investigating, prosecuting and convicting perpetrators of these offences. The regime for asset declaration by public officials and publication of declarations, supported by strong implementation and enforcement, should be strengthened further, being a critical tool in improving transparency and accountability of the public sector.

50. **Financial sector reforms to durably clean up the banking sector will be critical to banking system stability and to economic development.** While there has been progress in bank supervision, regulation, and legislation, financial stability and DAB's regulatory and supervisory frameworks require further bolstering to address the remaining issues (including risk-based supervision, implementation of AML/CFT measures, and consolidated supervision). The authorities should closely monitor financial risks given rising NPLs and weak profitability. They will also need to proceed with the allocation of the burden inherited from the 2010 Kabul Bank crisis, restoring DAB's balance sheet and NKB's solvency position.

51. **Staff commends the progress made by Afghanistan in strengthening the AML/CFT framework.** Nonetheless, implementation needs to be stepped up to protect financial stability and enable effective detection and deterrence of illegal proceeds from corruption and other macro-critical economic crimes such as illicit drug production and trafficking. The authorities are also urged to take actions promptly in order to exit the FATF's monitoring process.

52. **The program's policy mix is aimed at preserving macro-financial stability.** The overall fiscal balance after grants is targeted to remain close to zero, preventing a build-up in public debt. Over time, the operating balance before grants should become the fiscal policy anchor, with the program targeting a declining deficit over the medium term. Monetary policy is programmed to deliver moderate inflation, while fostering confidence in the domestic currency. The flexible exchange rate regime is a shock absorber and has served Afghanistan well and should remain in place.

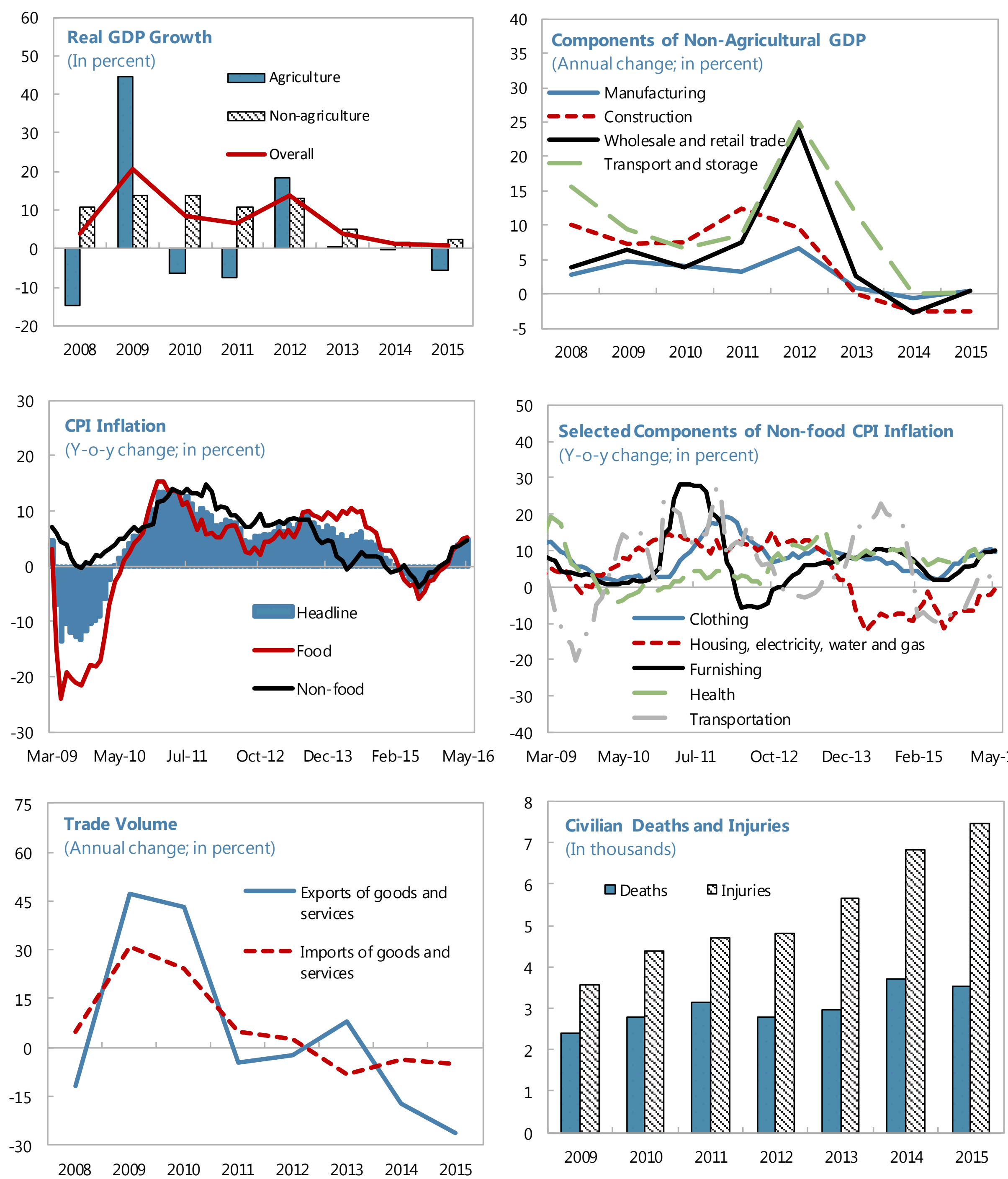
53. **The authorities should make progress in strengthening the quality and timeliness of economic data.** Reliable statistics are critical for sound economic policy-making. TA from the Fund is available to support this effort.

54. **The proposed program would carry substantial implementation risks.** The fragile security situation and political uncertainty could undermine reform implementation and derail the program, as could governance gaps and a lack of transparency. Expectations must therefore remain realistic: there are likely to be setbacks, making recovery and achieving self-reliance, the authorities' ultimate goal, an extended process. While major donors have expressed their intention to continue aid at or near current levels, others have taken a more cautious position and may choose to exit if reforms stall.

55. **Hence, strong program ownership will be critical.** The Fund-supported program can play an important role in supporting the government's reform agenda, but experience in Afghanistan and elsewhere shows that successful programs typically have broad based buy-in from key stakeholders.

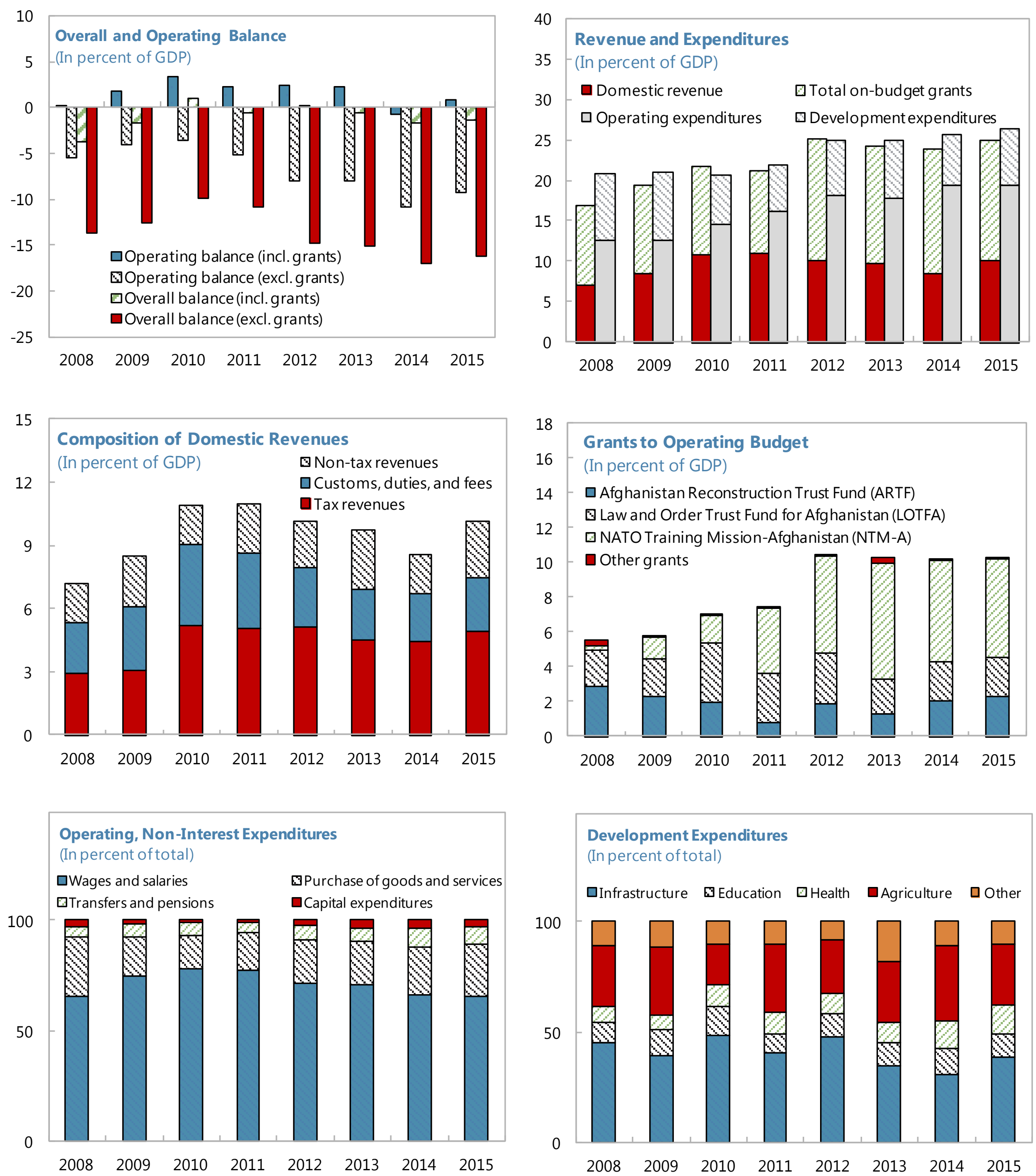
56. **Staff supports the authorities' request for a three-year arrangement under the ECF, with access in the amount equivalent to SDR 32.38 million (10 percent of Afghanistan's quota).**

Figure 1. Islamic Republic of Afghanistan: Real Sector



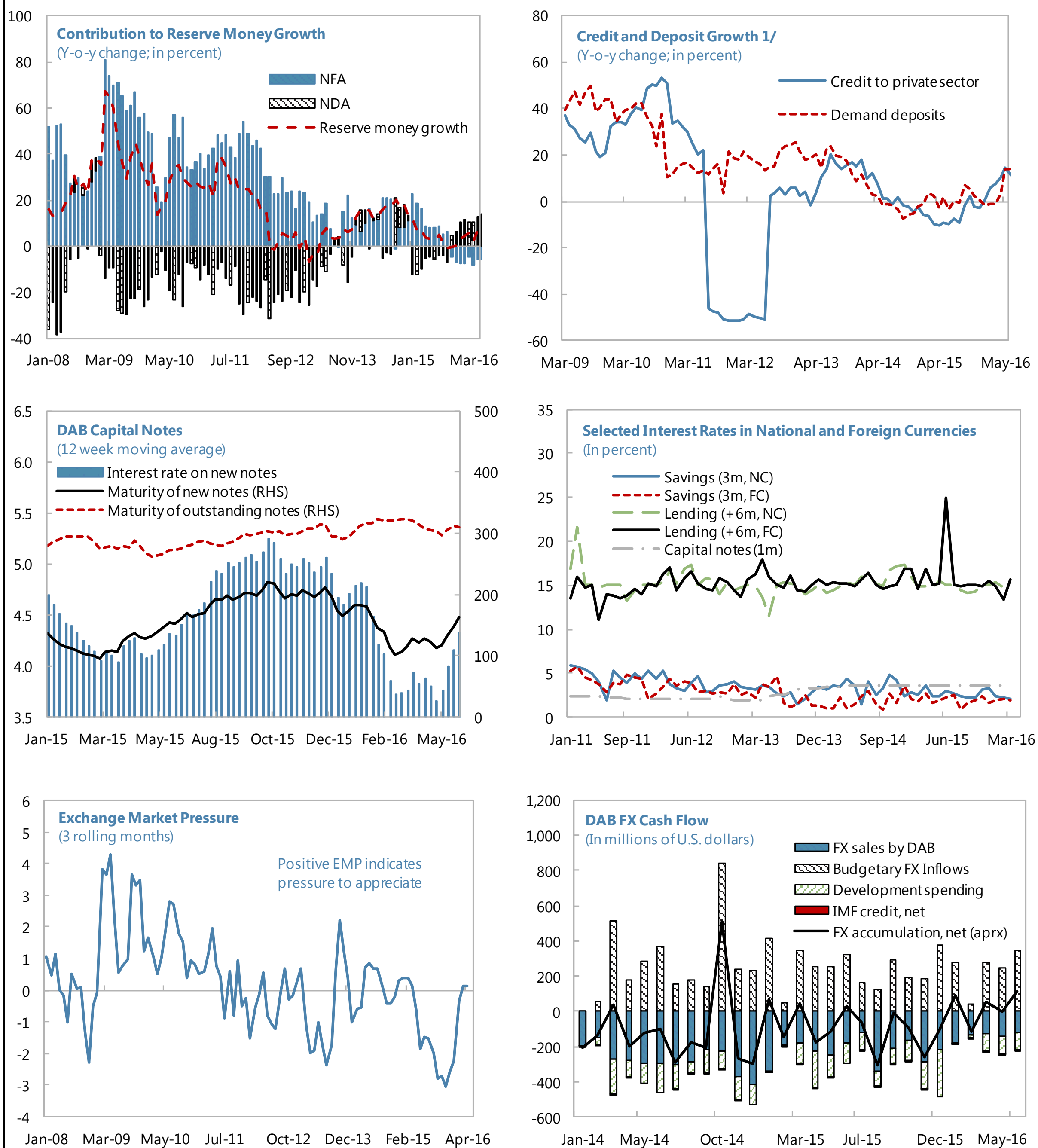
Sources: Afghan authorities, United Nations Assistance Mission in Afghanistan, and IMF staff calculations.

Figure 2. Islamic Republic of Afghanistan: Fiscal Sector



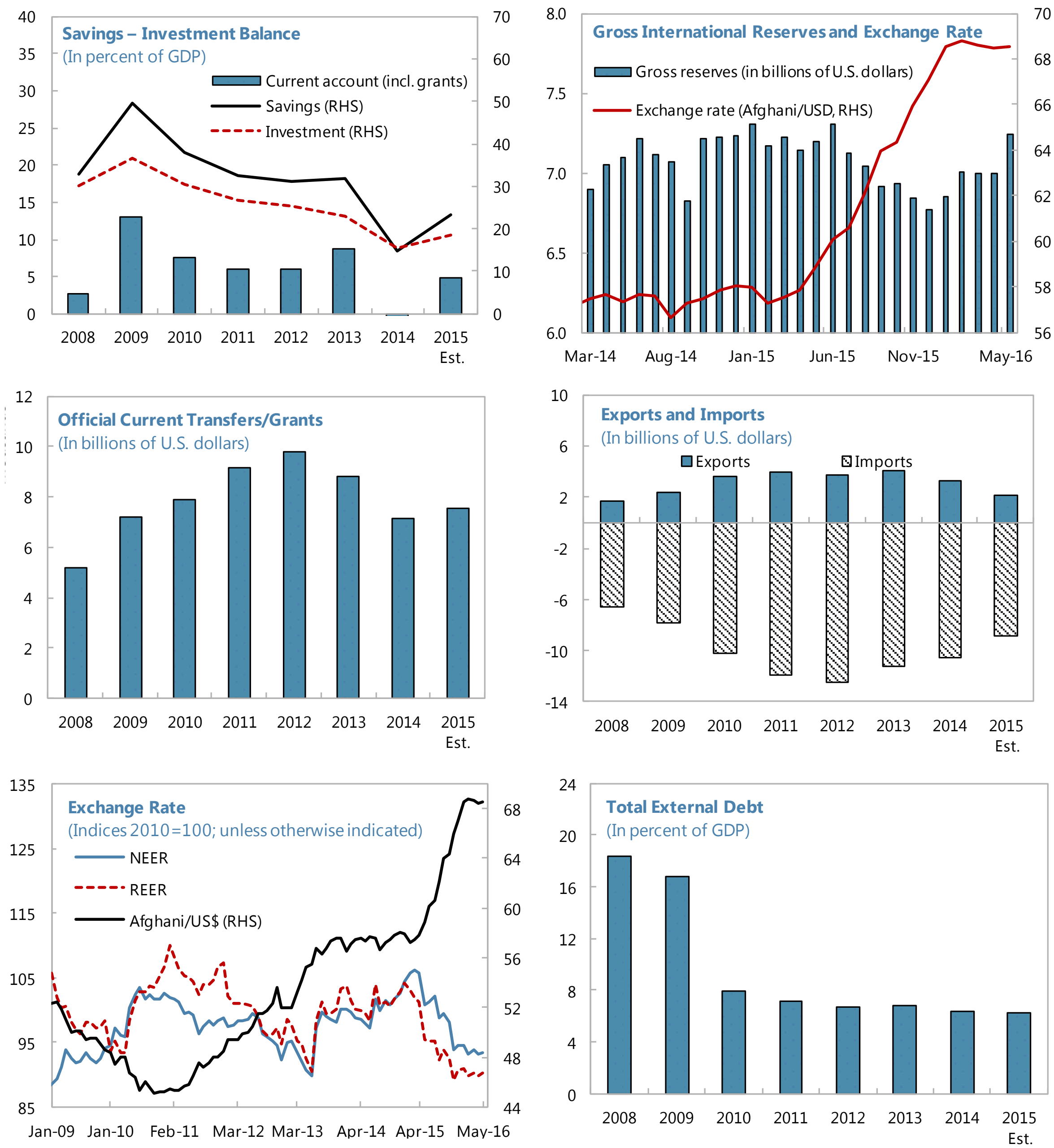
Sources: Afghan authorities and IMF staff calculations.

Figure 3. Islamic Republic of Afghanistan: Monetary Sector



Sources: Afghan authorities and IMF staff calculations.
1/ The drop in credit to the private sector in 2011 reflects the write-off of Kabul Bank loans.

Figure 4. Islamic Republic of Afghanistan: External Sector



Sources: Afghan authorities and IMF staff calculations.

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2013–17

(Quota: SDR 323.8 million)
(Population: approx. 32.0 million)
(Per capita GDP: approx. US$615; 2015)
(Poverty rate: 35.8 percent; 2011)
(Main exports: opium, US$2.7 billion; carpets, US$83.4 million; 2014)

	2013	2014	2015	2016	2017
			Est.	Proj.	
Output and prices 1/	(Annual percentage change, unless otherwise indicated)				
Real GDP	3.9	1.3	0.8	2.0	3.4
Nominal GDP (in billions of Afghanis)	1,117	1,168	1,204	1,283	1,406
Nominal GDP (in billions of U.S. dollars)	20.2	20.4	19.7	18.4	19.3
Consumer prices (period average)	7.4	4.7	-1.5	4.5	6.0
Food	7.6	7.7	-1.9	...	...
Non-food	7.2	1.4	-1.2	...	...
Consumer prices (end of period)	7.2	1.5	0.1	4.7	7.2
Investment and savings	(In percent of GDP)				
Gross domestic investment	23.1	17.6	18.6	19.0	18.7
Of which: Private	6.6	5.9	5.8	5.3	6.5
Gross national savings	31.8	20.0	23.3	23.4	19.7
Of which: Private	16.0	10.0	11.9	9.7	7.5
Public finances (central government)					
Domestic revenues and grants	24.3	24.0	25.0	27.8	28.1
Domestic revenues	9.8	8.6	10.2	10.3	10.7
On-budget grants (excl. donors' direct spending outside the budget)	14.6	15.4	14.9	17.5	17.4
Expenditures	25.0	25.7	26.4	27.6	28.2
Operating 2/	17.8	19.5	19.6	20.1	20.5
Development	7.2	6.2	6.9	7.5	7.7
Operating balance (excluding grants) 3/	-8.0	-10.9	-9.4	-9.8	-9.7
Overall balance (including grants)	-0.6	-1.7	-1.4	0.1	0.0
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)				
Reserve money	12.4	13.3	3.2	10.0	10.0
Currency in circulation	12.5	16.7	2.6	10.5	10.5
Broad money	9.4	8.3	3.3	7.5	9.6
Interest rate, 28-day capital note (in percent)	3.4	3.6	3.5	...	...
External sector 1/	(In percent of GDP, unless otherwise indicated)				
Exports of goods (in millions of U.S. dollars)	719	783	667	687	769
Exports of goods (annual percentage change)	18.0	8.9	-14.8	3.0	12.0
Imports of goods (in millions of U.S. dollars)	9,168	8,711	7,867	7,985	8,261
Imports of goods (annual percentage change)	-9.3	-5.0	-9.7	1.5	3.5
Merchandise trade balance	-41.9	-39.0	-36.6	-39.6	-38.8
Current account balance					
Excluding official transfers	-35.0	-35.6	-33.5	-36.6	-35.8
Including official transfers	8.7	2.4	4.7	4.5	1.1
Foreign direct investment	0.5	0.6	0.9	0.3	1.1
Total external debt 4/	6.9	6.5	7.0	6.9	7.0
Gross international reserves (in millions of U.S. dollars)	6,873	7,230	6,764	6,900	6,900
Import coverage of reserves 5/	7.8	9.8	9.0	8.8	8.4
Exchange rate (average, Afghanis per U.S. dollar)	55.4	57.4	61.1	...	...
Real exchange rate (average, percentage change) 6/	-2.7	-0.6	-7.7	...	...

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/ In months of next year's import of goods and services.
6/ CPI-based, vis-a-vis the U.S. dollar.

Table 2. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2015–21

	2015	2016	2017	2018	2019	2020	2021
	Est.			Proj.			
Output and prices 1/	(Annual percentage change, unless otherwise indicated)						
Real GDP	0.8	2.0	3.4	4.3	5.2	5.6	6.0
Nominal GDP (in billions of U.S. dollars)	19.7	18.4	19.3	20.6	22.3	24.2	26.4
Consumer prices (period average)	-1.5	4.5	6.0	7.0	7.0	7.0	7.0
Investment and savings	(In percent of GDP, unless otherwise indicated)						
Gross domestic investment	18.6	19.0	18.7	18.1	18.3	18.6	18.5
Of which: Private	5.8	5.3	6.5	6.8	7.1	7.4	7.6
Gross national savings	23.3	23.4	19.7	17.4	15.5	15.2	14.6
Of which: Private	11.9	9.7	7.5	5.9	3.9	3.9	3.7
Public finances (central government)							
Domestic revenues and grants	25.0	27.8	28.1	28.5	28.8	29.1	29.3
Domestic revenues	10.2	10.3	10.7	11.0	11.5	12.0	12.3
On-budget grants (excl. donors' direct spending outside the budget)	14.9	17.5	17.4	17.4	17.3	17.1	17.0
Expenditures	26.4	27.6	28.2	28.2	28.5	29.0	29.4
Operating 2/	19.6	20.1	20.5	20.2	20.2	20.3	20.4
Development	6.9	7.5	7.7	8.0	8.3	8.7	9.0
Operating balance (excluding grants) 3/	-9.4	-9.8	-9.7	-9.1	-8.7	-8.3	-8.0
Overall budget balance (including grants)	-1.4	0.1	0.0	0.3	0.3	0.1	0.0
External sector 1/							
Merchandise trade balance	-36.6	-39.7	-38.8	-37.3	-37.0	-35.2	-33.2
Current account balance, excluding official grants	-33.5	-36.6	-35.8	-34.3	-34.2	-32.3	-30.2
Current account balance, including official grants	4.7	4.5	1.1	-0.6	-2.9	-3.4	-3.9
Gross reserves (in millions of U.S. dollars)	6,764	6,900	6,900	6,900	6,900	6,900	6,900
Import coverage of reserves 4/	9.0	8.8	8.4	7.7	7.3	6.9	6.7
Memorandum items:							
Total public debt 5/	7.0	6.9	7.0	6.7	6.3	6.9	6.6
Of which: External debt	7.0	6.9	7.0	6.7	6.3	6.0	5.6
Domestic debt	0.0	0.0	0.0	0.0	0.0	0.9	1.0
GDP per capita (in U.S. dollars) 6/	615	562	576	602	638	679	724
Donors' direct spending outside the budget	23.3	23.6	19.4	16.3	14.1	11.8	9.3

Sources: Afghan authorities and Fund staff estimates and projections.

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

Table 3a. Islamic Republic of Afghanistan: Central Government Budget, 2013–21

(In billions of Afghanis)

	2013	2014	2015	2016				2016		2017	2018	2019	2020	2021
	FY	FY	FY	March 19	June 20	Sep. 21	Dec. 20	FY		FY				
			Est.	Est.		Proj.		Budget	Proj. 1/	Proj.				
Revenues and grants	271.9	280.2	301.4	72.6	90.2	87.2	106.5	432.1	356.6	395.7	446.5	508.9	579.8	663.3
Domestic revenues	109.0	100.0	122.3	32.4	32.1	33.0	35.2	131.0	132.6	150.6	173.4	203.3	238.8	279.1
Tax revenues	77.4	78.1	89.7	15.5	28.0	28.0	28.5	…	100.0	114.8	133.1	157.4	183.1	215.4
Income, profits, and capital gains	27.4	29.5	32.3	5.3	9.4	10.9	8.9	…	34.5	…	…	…	…	…
International trade and transactions	27.3	26.0	30.4	4.8	9.3	9.0	9.4	…	32.5	…	…	…	…	…
Goods and services	17.3	16.6	21.1	4.8	7.5	6.1	8.4	…	26.8	…	…	…	…	…
Other	5.4	5.9	5.9	0.7	1.7	2.0	1.8	…	6.3	…	…	…	…	…
Nontax revenues	31.6	22.0	32.6	16.9	4.1	5.0	6.6	…	32.5	35.7	40.3	45.9	55.7	63.7
Grants to operating budget 2/	114.7	119.1	122.8	32.0	39.0	36.2	43.7	150.8	150.9	160.7	175.2	186.4	202.7	217.4
ARTF	14.2	24.2	27.4	4.4	16.1	5.4	11.7	17.0	37.7	…	…	…	…	…
LOTFA	22.4	25.9	27.5	6.9	4.7	4.8	8.2	27.9	24.5	…	…	…	…	…
CSTC-A	74.5	68.4	67.8	20.7	18.2	26.0	23.8	105.9	88.6	…	…	…	…	…
Other grants	3.6	0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	…	…	…	…	…
Grants to development budget	48.2	61.1	56.2	8.2	19.2	18.1	27.7	150.3	73.1	84.5	97.9	119.2	138.3	166.9
Total expenditures	278.9	300.5	318.3	48.9	83.3	96.5	126.1	444.6	354.7	395.9	442.0	504.0	577.6	663.8
Operating expenditures	198.6	227.9	235.3	41.4	62.4	71.1	83.5	276.1	258.5	287.6	316.4	356.8	404.7	460.3
Of which: Security	128.7	138.1	145.1	…	…	…	…	175.6	159.7	172.5	193.7	218.5	245.1	269.4
Wages and salaries	139.5	150.2	152.3	32.8	40.6	46.7	48.7	167.1	168.7	…	…	…	…	…
Purchases of goods and services 3/	38.2	48.2	55.8	6.4	12.2	17.4	26.4	67.9	62.4	…	…	…	…	…
Transfers, subsidies, and other	0.0	0.7	1.3	0.7	0.5	0.3	0.3	15.1	1.8	…	…	…	…	…
Pensions	11.5	18.9	17.6	1.3	7.7	5.1	4.8	18.9	18.9	…	…	…	…	…
Capital expenditures	8.4	9.4	7.8	0.1	1.3	1.6	2.7	6.2	5.8	…	…	…	…	…
Interest	1.0	0.4	0.6	0.1	0.1	0.0	0.6	0.9	0.9	0.8	0.7	0.5	0.4	1.1
Development expenditures:	80.4	72.6	82.9	7.5	20.9	25.3	42.6	168.6	96.2	108.3	125.5	147.2	172.9	203.5
Infrastructure and natural resources	27.6	21.8	31.6	…	…	…	…	84.5	36.6	…	…	…	…	…
Education	8.5	8.7	8.7	…	…	…	…	21.1	10.2	…	…	…	…	…
Health	7.2	9.1	11.2	…	…	…	…	18.3	13.0	…	…	…	…	…
Agriculture and rural development	22.4	24.9	22.7	…	…	…	…	27.1	26.3	…	…	…	…	…
Discretionary 4/	…	9.9	18.0	…	…	…	…	48.1	23.1	23.8	…	…	…	…
Operating balance excluding grants	-89.6	-127.9	-113.0	-9.0	-30.4	-38.2	-48.3	-145.1	-125.9	-137.1	-143.1	-153.5	-166.0	-181.1
Overall budget balance including grants	-7.0	-20.3	-16.9	23.7	6.9	-9.2	-19.6	-12.5	1.8	-0.2	4.5	4.9	2.1	-0.4
less: Kabul Bank bailout cost	0.0	-2.0	0.0	0.0	0.0	0.0	-5.1	0.0	-5.1	-7.3	-3.8	-4.0	0.0	0.0
Augmented overall budget balance	-7.0	-18.4	-16.9	23.7	6.9	-9.2	-14.5	-12.5	6.9	7.1	8.3	8.9	2.1	-0.4
Float and discrepancy 5/	10.8	-0.2	10.2	-0.2	-3.9	0.0	0.0	0.0	-4.1	0.0	0.0	0.0	0.0	0.0
Financing	-3.7	18.6	6.7	-23.5	-3.0	9.2	14.5	12.5	-2.9	-7.1	-8.3	-8.9	-2.1	0.4
Sale of nonfinancial assets	0.0	0.0	0.0	0.0	1.1	-0.8	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	1.2	1.3	0.6	-0.1	0.1	0.9	0.8	3.0	1.8	6.8	1.6	2.4	3.3	4.3
Domestic (net)	-5.0	17.2	6.1	-23.4	-4.2	9.0	14.0	9.5	-4.6	-13.8	-9.9	-11.3	-5.4	-3.9
Central bank, change in	-5.0	17.2	6.1	-23.4	-4.2	9.0	14.0	9.5	-4.6	-13.8	-9.9	-11.3	-23.5	-9.3
Government deposits	-4.7	20.3	4.5	-23.3	-4.3	8.7	19.3	9.4	0.4	-6.8	-2.0	-3.1	-22.8	-8.7
Claims on government	-0.2	-3.1	1.6	-0.1	0.1	0.4	-5.4	0.1	-5.0	-7.0	-7.8	-8.1	-0.6	-0.6
Credit from DAB (IMF accounts)	0.9	-1.7	0.9	-0.1	0.1	0.4	0.0	0.3	0.3	0.2	-0.3	0.3	-0.6	-0.6
Promissory note (- = repayment)	-1.1	-1.4	0.7	0.0	0.0	0.0	-5.3	-0.2	-5.3	-7.3	-7.6	-8.4	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.1	5.4
Memorandum items:														
Promissory note (end-of-period stock)	29.3	27.9	28.6	28.6	28.6	28.6	23.3	28.4	23.3	16.0	8.4	0.0	0.0	0.0
Pro-poor spending 6/	25.1	36.6	32.9	7.1	9.0	10.3	10.3	36.6	36.6	42.1	…	…	…	…

Sources: Afghan authorities and Fund staff estimates and projections.

1/ Adjusted to include assessment of revenue, operating budget execution rates, restraint of discretionary development spending, and expected donor disbursements.

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

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

3/ 2015 figure includes about Af 2.85 billion arrears, which are repaid.

4/ 2015 figure includes about Af 7 billion discretionary development arrears, which are repaid.

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

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

Table 3b. Islamic Republic of Afghanistan: Central Government Budget, 2013–21

(In percent of GDP)

	2013	2014	2015	2016				2016		2017	2018	2019	2020	2021
	FY	FY	FY	March 19	June 20	Sep. 21	Dec. 20	FY		FY				
			Est.	Est.		Proj.		Budget	Proj. 1/	Proj.				
Revenues and grants	24.3	24.0	25.0	5.7	7.0	6.8	8.3	33.7	27.8	28.1	28.5	28.8	29.1	29.3
Domestic revenues	9.8	8.6	10.2	2.5	2.5	2.6	2.7	10.2	10.3	10.7	11.0	11.5	12.0	12.3
Tax revenues	6.9	6.7	7.5	1.2	2.2	2.2	2.2	...	7.8	8.2	8.5	8.9	9.2	9.5
Income, profits, and capital gains	2.5	2.5	2.7	0.4	0.7	0.8	0.7	...	2.7	...	...	...	...	...
International trade and transactions	2.4	2.2	2.5	0.4	0.7	0.7	0.7	...	2.5	...	...	...	...	...
Goods and services	1.5	1.4	1.8	0.4	0.6	0.5	0.7	...	2.1	...	...	...	...	...
Other	0.5	0.5	0.5	0.1	0.1	0.2	0.1	...	0.5	...	...	...	...	...
Nontax revenues	2.8	1.9	2.7	1.3	0.3	0.4	0.5	...	2.5	2.5	2.6	2.6	2.8	2.8
Grants to operating budget 2/	10.3	10.2	10.2	2.5	3.0	2.8	3.4	11.8	11.8	11.4	11.2	10.6	10.2	9.6
ARTF	1.3	2.1	2.3	0.3	1.3	0.4	0.9	1.3	2.9	...	...	...	...	...
LOTFA	2.0	2.2	2.3	0.5	0.4	0.4	0.6	2.2	1.9	...	...	...	...	...
CSTC-A	6.7	5.9	5.6	1.6	1.4	2.0	1.9	8.3	6.9	...	...	...	...	...
Other grants	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...
Grants to development budget	4.3	5.2	4.7	0.6	1.5	1.4	2.2	11.7	5.7	6.0	6.2	6.7	6.9	7.4
Total expenditures	25.0	25.7	26.4	3.8	6.5	7.5	9.8	34.7	27.6	28.2	28.2	28.5	29.0	29.4
Operating expenditures	17.8	19.5	19.6	3.2	4.9	5.5	6.5	21.5	20.1	20.5	20.2	20.2	20.3	20.4
Of which: Security	11.5	11.8	12.1	...	...	...	...	13.7	12.4	12.3	12.3	12.4	12.3	11.9
Wages and salaries	12.5	12.9	12.7	2.6	3.2	3.6	3.8	13.0	13.1	...	...	...	...	...
Purchases of goods and services 3/	3.4	4.1	4.6	0.5	1.0	1.4	2.1	5.3	4.9	...	...	...	...	...
Transfers, subsidies, and other	0.0	0.1	0.1	0.1	0.0	0.0	0.0	1.2	0.1	...	...	...	...	...
Pensions	1.0	1.6	1.5	0.1	0.6	0.4	0.4	1.5	1.5	...	...	...	...	...
Capital expenditures	0.7	0.8	0.6	0.0	0.1	0.1	0.2	0.5	0.5	...	...	...	...	...
Interest	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Development expenditures:	7.2	6.2	6.9	0.6	1.6	2.0	3.3	13.1	7.5	7.7	8.0	8.3	8.7	9.0
Infrastructure and natural resources	2.5	1.9	2.6	...	...	...	...	6.6	2.9	...	...	...	...	...
Education	0.8	0.7	0.7	...	...	...	...	1.6	0.8	...	...	...	...	...
Health	0.6	0.8	0.9	...	...	...	...	1.4	1.0	...	...	...	...	...
Agriculture and rural development	2.0	2.1	1.9	...	...	...	...	2.1	2.1	...	...	...	...	...
Discretionary 4/	...	0.8	1.5	...	...	...	...	3.8	1.8	1.7	...	...	...	...
Operating balance excluding grants	-8.0	-10.9	-9.4	-0.7	-2.4	-3.0	-3.8	-11.3	-9.8	-9.7	-9.1	-8.7	-8.3	-8.0
Overall budget balance including grants	-0.6	-1.7	-1.4	1.8	0.5	-0.7	-1.5	-1.0	0.1	0.0	0.3	0.3	0.1	0.0
less: Kabul Bank bailout cost	0.0	-0.2	0.0	0.0	0.0	0.0	-0.4	0.0	-0.4	-0.5	-0.2	-0.2	0.0	0.0
Augmented overall budget balance	-0.6	-1.6	-1.4	1.8	0.5	-0.7	-1.1	-1.0	0.5	0.5	0.5	0.5	0.1	0.0
Float and discrepancy 5/	1.0	0.0	0.8	0.0	-0.3	0.0	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Financing	-0.3	1.6	0.6	-1.8	-0.2	0.7	1.1	1.0	-0.2	-0.5	-0.5	-0.5	-0.1	0.0
Sale of nonfinancial assets	0.0	0.0	0.0	0.0	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.2	0.1	0.5	0.1	0.1	0.2	0.2
Domestic (net)	-0.4	1.5	0.5	-1.8	-0.3	0.7	1.1	0.7	-0.4	-1.0	-0.6	-0.6	-0.3	-0.2
Central bank, change in	-0.4	1.5	0.5	-1.8	-0.3	0.7	1.1	0.7	-0.4	-1.0	-0.6	-0.6	-1.2	-0.4
Government deposits	-0.4	1.7	0.4	-1.8	-0.3	0.7	1.5	0.7	0.0	-0.5	-0.1	-0.2	-1.1	-0.4
Claims on government	0.0	-0.3	0.1	0.0	0.0	0.0	-0.4	0.0	-0.4	-0.5	-0.5	-0.5	0.0	0.0
Credit from DAB (IMF accounts)	0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Promissory note (- = repayment)	-0.1	-0.1	0.1	0.0	0.0	0.0	-0.4	0.0	-0.4	-0.5	-0.5	-0.5	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.9	0.2
Memorandum items:														
Promissory note (end-of-period stock)	2.6	2.4	2.4	2.2	2.2	2.2	1.8	2.2	1.8	1.1	0.5	0.0	0.0	0.0
Pro-poor spending 6/	2.2	3.1	2.7	0.5	0.7	0.8	0.8	2.9	2.9	3.0	...	...	...	...

Sources: Afghan authorities and Fund staff estimates and projections.

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

Table 4a. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2013–21

(In billions of Afghanis, at current exchange rates, unless otherwise indicated)

	2013	2014	2015	2016				2017				2018	2019	2020	2021
	Dec. 21	Dec. 21	Dec. 21	March 19	June 20	Sep. 21	Dec. 20	March 20	June 21	Sep. 22	Dec. 21	Dec. 21	Dec. 21	Dec. 20	Dec. 21
						Proj.									
Net foreign assets	381.8	408.4	446.7	463.8	470.9	467.2	478.7	483.7	488.9	493.7	499.0	523.6	539.9	566.3	585.4
Foreign assets	403.0	427.9	467.2	484.2	491.3	488.0	499.5	504.5	509.6	514.7	519.9	545.3	562.6	589.5	608.7
Foreign exchange reserves	389.3	419.8	460.3	478.4	485.1	481.6	493.0	498.0	503.0	508.0	513.0	538.1	555.1	581.6	600.6
Other foreign assets	13.8	8.1	6.9	5.8	6.3	6.4	6.4	6.5	6.6	6.6	6.9	7.2	7.5	7.8	8.1
Foreign liabilities	-21.2	-19.5	-20.5	-20.4	-20.4	-20.8	-20.7	-20.9	-20.7	-21.0	-21.0	-21.7	-22.7	-23.2	-23.3
Net domestic assets	-183.0	-183.2	-214.4	-251.6	-238.9	-221.4	-223.2	-221.9	-220.8	-219.2	-217.9	-214.4	-205.9	-205.6	-195.9
Domestic assets	-110.7	-105.4	-97.3	-121.7	-131.1	-122.9	-123.4	-130.1	-137.4	-139.5	-151.8	-167.5	-180.6	-189.2	-197.4
Net claims on government	-58.7	-41.5	-35.4	-58.8	-63.0	-54.0	-40.0	-41.7	-43.6	-45.2	-56.9	-69.7	-80.8	-86.4	-92.4
Gross claims on government	50.5	47.4	49.0	48.9	48.9	49.3	44.0	42.3	40.3	38.8	36.9	30.1	22.7	23.1	23.3
Of which: MoF promissory note 1/	29.3	27.9	28.6	28.6	28.6	28.6	23.3	21.5	19.6	17.8	16.0	8.4	0.0	0.0	0.0
Domestic currency deposits	-18.3	-20.0	-10.6	-19.9	-14.1	-12.9	-10.3	-10.3	-10.3	-10.2	-11.2	-11.4	-9.5	-6.8	-3.6
Foreign currency deposits 2/	-90.9	-68.9	-73.8	-87.8	-97.8	-90.4	-73.7	-73.7	-73.7	-73.7	-82.6	-88.4	-94.0	-102.8	-112.1
Other claims	-52.0	-63.9	-62.0	-63.0	-68.1	-68.9	-83.4	-88.5	-93.8	-94.3	-94.9	-97.8	-99.7	-102.8	-105.0
Other items net	-72.4	-77.8	-117.1	-129.8	-107.8	-98.5	-99.7	-91.8	-83.4	-79.6	-66.1	-46.9	-25.3	-16.4	1.5
Reserve money	198.8	225.2	232.3	212.3	232.0	245.8	255.6	261.7	268.0	274.5	281.1	309.2	334.0	360.7	389.5
Currency in circulation	168.8	197.0	202.2	189.3	203.2	212.7	223.4	229.0	234.8	240.8	246.9	272.8	300.1	327.1	353.2
Bank deposits (Afghani denominated)	30.0	28.2	30.2	22.9	28.8	33.1	32.2	32.7	33.2	33.7	34.3	36.4	33.9	33.6	36.3
Memorandum items:															
International reserves, in millions of U.S. dollars															
Net	6,369	6,676	6,252	6,472	6,400	6,201	6,171	6,109	6,048	6,047	6,050	6,054	6,050	6,057	6,064
Gross	6,873	7,230	6,764	6,998	7,000	6,800	6,900	6,900	6,900	6,900	6,900	6,900	6,900	6,900	6,900
Interest rate, 28-day capital notes (percent)	3.4	3.6	3.5	2.7	2.9	2.9	…	…	…	…	…	…	…	…	…
Exchange rate (Afghanis per U.S. dollar)	56.6	58.1	68.1	68.4	…	…	…	…	…	…	…	…	…	…	…

Sources: Afghan authorities and Fund staff estimates and projections.

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

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

Table 4b. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2013–17

(At program exchange rates)[1/]

	2013	2014	2015				2016				2017			
	Dec. 21	Dec. 21	March 20	June 21	Sep. 22	Dec. 21	March 19	June 20	Sep. 21	Dec. 20	March 20	June 21	Sep. 22	Dec. 21
					Proj.				Proj.			Proj.		
	(In billions of Afghanis, unless otherwise indicated)													
Net foreign assets	454.5	480.0	486.5	413.9	466.4	458.9	466.0	470.8	467.4	479.2	484.4	489.8	494.8	500.1
Foreign assets	478.1	502.4	508.4	432.8	487.6	479.8	486.5	491.1	487.6	499.1	504.2	509.3	514.4	519.4
Foreign exchange reserves	461.6	492.9	499.2	424.6	478.4	472.9	480.6	485.1	481.6	493.0	498.0	503.0	508.0	513.0
Other foreign assets	16.6	9.5	9.2	8.2	9.2	7.0	5.8	6.0	6.0	6.1	6.2	6.3	6.4	6.4
Foreign liabilities	-23.6	-22.4	-21.9	-19.0	-21.2	-21.0	-20.5	-20.2	-20.2	-20.0	-19.9	-19.5	-19.6	-19.4
Net domestic assets	-255.8	-254.8	-279.3	-185.7	-247.0	-226.5	-253.7	-238.8	-221.6	-223.6	-222.6	-221.7	-220.3	-219.0
Domestic assets	-130.2	-119.2	-140.4	-117.5	-112.0	-98.1	-122.2	-124.3	-113.8	-105.3	-105.8	-107.2	-108.2	-119.5
Net claims on government	-74.1	-50.8	-74.4	-45.9	-51.6	-35.8	-59.1	-62.4	-51.9	-38.7	-39.3	-40.6	-41.7	-52.9
Gross claims on government	52.9	50.2	49.8	46.9	49.0	49.5	49.0	48.8	48.7	43.2	41.3	39.1	37.4	35.3
Of which: MoF promissory note 2/	29.3	27.9	27.9	28.0	27.9	28.6	28.6	28.6	28.6	23.3	21.5	19.6	17.8	16.0
Domestic currency deposits	-18.3	-20.0	-21.3	-20.9	-16.8	-10.6	-19.9	-14.1	-12.9	-10.3	-10.3	-10.3	-10.2	-11.2
Foreign currency deposits 3/	-108.6	-81.0	-102.9	-71.9	-83.8	-74.7	-88.2	-97.0	-87.7	-71.6	-70.3	-69.5	-68.8	-77.1
Other claims	-56.1	-68.5	-66.0	-71.6	-60.4	-62.4	-63.1	-61.9	-61.9	-66.6	-66.6	-66.6	-66.6	-66.6
Other items net	-125.5	-135.6	-138.9	-68.3	-135.0	-128.4	-131.5	-114.6	-107.8	-118.4	-116.8	-114.6	-112.1	-99.5
Reserve money	198.8	225.2	207.2	228.2	219.4	232.3	212.3	232.0	245.8	255.6	261.7	268.0	274.5	281.1
Currency in circulation	168.8	197.0	182.4	203.6	195.9	202.2	189.3	203.2	212.7	223.4	229.0	234.8	240.8	246.9
Bank deposits (Afghani denominated)	30.0	28.2	24.8	24.6	23.5	30.2	22.9	28.8	33.1	32.2	32.7	33.2	33.7	34.3
Memorandum items:														
Net international reserves	6,229	6,626	6,729	6,769	6,525	6,367	6,470	6,454	6,392	6,417	6,417	6,417	6,480	6,547
Money growth (year-on-year, in percent)														
Reserve money	12.4	13.3	6.7	12.1	-0.7	3.2	2.5	11.3	12.1	10.0	23.3	15.5	11.7	10.0
Currency in circulation	12.5	16.7	7.8	12.7	0.8	2.6	3.8	8.5	8.6	10.5	21.0	15.5	13.2	10.5

Sources: Afghan authorities and Fund staff estimates and projections.

1/ Program exchange rates as of May. 31, 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).

Table 5. Islamic Republic of Afghanistan: Monetary Survey, 2013–21[1/]

(At current exchange rates)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Proj.			
	(In billions of Afghanis)								
Net foreign assets	465.2	487.3	532.1	570.2	596.0	627.4	649.1	683.0	708.3
Foreign assets	494.9	515.0	563.3	602.4	629.2	662.2	685.6	720.9	747.2
Central bank	403.0	427.9	467.2	499.5	519.9	545.3	562.6	589.5	608.7
Commercial banks	91.9	87.1	96.1	102.9	109.3	116.9	123.0	131.4	138.5
Foreign liabilities	-29.7	-27.7	-31.2	-32.3	-33.2	-34.8	-36.5	-37.9	-38.8
Central bank	-21.2	-19.5	-20.5	-20.7	-21.0	-21.7	-22.7	-23.2	-23.3
Commercial banks	-8.5	-8.2	-10.7	-11.5	-12.2	-13.1	-13.8	-14.7	-15.5
Net domestic assets	-94.5	-85.7	-117.3	-124.3	-115.8	-110.3	-92.4	-83.6	-63.0
Net domestic credit	-13.6	0.7	5.7	4.9	-6.3	-14.0	-18.6	-28.2	-37.2
Nonfinancial public sector	-59.7	-42.4	-39.8	-44.6	-62.2	-77.3	-90.2	-109.5	-129.3
Central bank	-58.7	-41.5	-35.4	-40.0	-56.9	-70.5	-80.8	-95.1	-105.7
Commercial banks	-1.0	-0.9	-4.4	-4.6	-5.3	-6.8	-9.4	-14.4	-23.5
Private sector	46.1	43.0	45.6	49.5	55.9	63.3	71.7	81.3	92.1
Other items net	-80.9	-86.4	-123.0	-129.2	-109.5	-96.3	-73.9	-55.4	-25.8
Broad money M2	370.7	401.6	414.8	445.8	480.2	517.1	556.7	599.4	645.4
Narrow money M1	350.7	384.2	389.9	419.8	452.9	488.5	526.6	567.5	611.2
Currency outside banks	161.9	188.5	196.1	217.1	240.2	265.8	292.8	319.3	344.9
Currency in circulation	168.8	197.0	202.2	223.4	246.9	272.8	300.1	327.1	353.2
Currency held by banks	6.9	8.5	6.0	6.3	6.6	6.9	7.3	7.7	8.3
Demand deposits	188.8	195.7	193.8	202.7	212.6	222.7	233.8	248.2	266.2
Other deposits	20.0	17.4	24.9	26.0	27.3	28.6	30.1	31.9	34.2
	(12-month percentage change)								
M2	9.4	8.3	3.3	7.5	7.7	7.7	7.7	7.7	7.7
M1	9.9	9.5	1.5	7.7	7.9	7.9	7.8	7.8	7.7
Currency outside banks	13.4	16.4	4.1	10.7	10.7	10.7	10.1	9.1	8.0
Net credit to the private sector	10.1	-6.6	5.9	10.0	13.0	13.2	13.3	13.4	13.3
	(In percent of GDP)								
M2	33.2	34.4	34.5	34.8	37.4	40.3	43.4	46.7	50.3
M1	31.4	32.9	32.4	32.7	35.3	38.1	41.1	44.2	47.6
Memorandum items:									
M2 velocity	3.0	2.9	2.9	2.9	2.9	3.0	3.2	3.3	3.5
Reserve money multiplier	1.9	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.7
Banking sector									
Loan dollarization (percent)	75.9	67.4	68.8	68.8	68.8	68.8	68.8	68.8	68.8
Deposit dollarization (percent)	69.0	65.8	72.0	72.0	72.0	72.0	72.0	72.0	72.0
Currency-to-deposit ratio (percent)	80.9	92.4	92.4	97.7	102.9	108.6	113.7	116.8	117.6
Loans-to-deposit ratio (percent)	22.1	20.2	20.8	21.6	23.3	25.2	27.2	29.0	30.7

Sources: Afghan authorities and Fund staff estimates and projections.

1/ End of period (Dec.21). Data underlying the survey are not fully consistent because DAB and the public banks use the solar calendar, while commercial banks use the Gregorian calendar.

Table 6. Islamic Republic of Afghanistan: Balance of Payments, 2013–21[1/]

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

	2013	2014	2015	2016	2017	2018	2019	2020	2021
			Est.			Proj.			
Current account	1,758	481	925	825	203	-131	-640	-816	-1,039
Excluding official grants	-7,069	-7,248	-6,588	-6,731	-6,906	-7,071	-7,633	-7,819	-7,977
Trade balance	-8,450	-7,928	-7,200	-7,299	-7,493	-7,678	-8,251	-8,534	-8,761
Export of goods and services	4,018	3,233	2,113	2,103	2,245	2,471	2,797	3,217	3,659
Goods	719	783	667	687	769	888	1,059	1,269	1,526
Services	3,300	2,450	1,446	1,416	1,476	1,583	1,738	1,948	2,133
Import of goods and services	11,256	10,532	8,859	9,042	9,392	9,811	10,726	11,365	12,004
Goods	9,168	8,711	7,867	7,986	8,262	8,566	9,310	9,803	10,287
Services	2,088	1,821	992	1,056	1,130	1,245	1,416	1,562	1,717
Income, net	297	180	180	221	233	241	246	252	258
Of which: Interest on official loans	5	5	6	5	5	5	5	5	6
Current transfers, net	8,699	7,600	7,492	7,544	7,118	6,968	7,042	7,081	7,047
Of which: Official /2	8,828	7,729	7,514	7,557	7,109	6,940	6,992	7,002	6,938
Capital account	0	0	0	0	0	0	0	0	0
Financial account, net	-14	123	-1,193	-675	-195	135	636	824	1,046
Foreign direct investment	108	123	169	55	216	103	111	121	132
Portfolio investment	-67	-52	-82	-87	-92	-97	-102	-107	-112
Official loans 3/	17	-79	-8	25	93	21	30	40	50
Disbursement	29	26	10	43	111	41	51	61	71
Amortization	11	54	18	18	19	20	21	21	21
Debt relief ('-' = forgiveness)	0	50	0	0	0	0	0	0	0
Other investment	-72	131	-1,273	-669	-413	107	596	769	976
Errors and omissions	-1,416	-175	0	0	0	0	0	0	0
Overall balance	328	429	-267	151	8	4	-4	8	7
Financing	-328	-429	267	-151	-8	-4	4	-8	-7
Central bank's gross reserves ('-' = accumulation)	-316	-459	288	-136	0	0	0	0	0
Use of Fund resources, net	-13	-20	-20	-15	-8	-4	4	-8	-7
Disbursements 4/	0	0	0	6	13	13	14	0	0
Repayments	13	20	20	21	21	16	10	8	7
Debt relief ('-' = forgiveness)	0	50	0	0	0	0	0	0	0
Memorandum items:									
Gross international reserves, central bank	6,873	7,230	6,764	6,900	6,900	6,900	6,900	6,900	6,900
Import coverage of reserves 5/	7.8	9.8	9.0	8.8	8.4	7.7	7.3	6.9	6.7
External debt stock, official 6/	1,361	1,299	1,230	1,241	1,325	1,342	1,377	1,409	1,452
in percent of GDP	6.9	6.5	7.0	6.9	7.0	6.7	6.3	6.0	5.6
Current account, in percent of GDP	8.7	2.4	4.7	4.5	1.1	-0.6	-2.9	-3.4	-3.9
Trade balance, in percent of GDP	-41.9	-39.0	-36.6	-39.6	-38.8	-37.3	-37.0	-35.2	-33.2
Export of goods and services, in percent of GDP	19.9	15.9	10.7	11.4	11.6	12.0	12.5	13.3	13.9
Import of goods and services, in percent of GDP	55.8	51.7	45.0	49.1	48.7	47.6	48.1	46.9	45.5
Official grants, in percent of GDP	43.8	38.0	38.2	41.0	36.9	33.7	31.4	28.9	26.3

Sources: Afghan authorities and Fund staff estimates and projections.

1/ BoP data exclude the narcotics economy.
2/ Capital transfers are difficult to identify and are thus included in current transfers.
3/ Excluding IMF.
4/ Disbursements in 2016-19 are conditional on the board approval of an ECF.
5/ In months of next year's import of goods and services.
6/ Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.

Table 7. Islamic Republic of Afghanistan: Financial Soundness Indicators, 2012–2015

(In percent)

	2012	2013	2014	2015			
				Q1	Q2	Q3	Q4
Capital adequacy							
Regulatory Capital to Risk-weighted Assets	21.8	26.2	26.5	25.8	25.6	26.3	28.3
Capital to Assets	7.6	11.6	11.9	12.0	12.2	12.9	13.5
Asset quality							
Non-performing Loans to Total Gross Loans	5.0	4.9	7.8	10.1	13.5	13.7	12.3
Non-performing Loans Net of Provisions to Capital	6.6	2.5	3.4	4.0	6.8	6.3	5.7
Earnings and profitability							
Return on Assets	-0.4	0.6	0.9	-1.5	-1.0	-0.2	0.4
Return on Equity	-5.5	7.1	7.2	-12.9	-8.0	-2.0	3.5
Liquidity							
Liquid Assets to Total Assets (Liquid Asset Ratio)	65.7	62.1	73.2	72.9	74.4	73.4	71.4
Liquid Assets to Short-term Liabilities	79.7	77.0	89.0	90.5	93.1	92.6	90.4

Source: Afghan authorities.

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

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

Source: International Monetary Fund.

Table 9. Islamic Republic of Afghanistan: External Financing Requirement and Sources, 2014–19

(In millions of U.S. dollars)

	2014	2015	2016	2017	2018	2019
		Est.		Proj.		
Gross financing requirement	7,781	6,339	6,906	6,946	7,107	7,663
Current account balance (excluding grants)	-7,248	-6,588	-6,731	-6,906	-7,071	-7,633
Amortization	74	38	39	40	36	31
Of which: IMF	20	20	21	21	16	10
Change in reserves (increase = +)	459	-288	136	0	0	0
Reduction in arrears	0	0	0	0	0	0
Available financing	7,781	6,339	6,900	6,933	7,094	7,649
Official transfers (grants)	7,729	7,514	7,557	7,109	6,940	6,992
Foreign direct investment	123	169	55	216	103	111
Official medium- and long-term loans (net)	-79	-8	25	93	21	30
Accumulation of arrears	0	0	0	0	0	0
Debt forgiveness	50	0	0	0	0	0
Debt rescheduling	0	0	0	0	0	0
Other flows	-41	-1,336	-737	-485	31	515
Financing gap	0	0	6	13	13	14
Identified financing (provisional)	0	0	6	13	13	14
Of which: IMF 1/	0	0	6	13	13	14
Remaining gap	0	0	0	0	0	0

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

1/ Disbursements in 2016-19 are conditional on the board approval for an ECF.

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

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	Total
	(In millions of SDRs, unless otherwise indicated)														
Obligations from existing drawings															
1. Principal															
GRA repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PRGT repayments	7.5	15.0	11.6	7.1	5.4	4.8	2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	53.8
2. Charges and interest 2/															
PRGT interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
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	0.1
SDR net charges	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	0.5
Total obligations	7.6	15.1	11.6	7.1	5.4	4.9	2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	54.5
(percent of quota)	2.3	4.7	3.6	2.2	1.7	1.5	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	16.8
Obligations from prospective drawings 3/															
1. Principal															
PRGT repayments	0.0	0.0	0.0	0.0	0.0	0.0	1.4	3.2	5.0	6.5	6.5	5.1	3.3	1.5	32.4
2. Charges and interest 2/															
PRGT interest	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.6
Total obligations	0.0	0.0	0.0	0.1	0.1	0.1	1.4	3.2	5.0	6.5	6.5	5.2	3.3	1.5	32.9
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	0.4	1.0	1.5	2.0	2.0	1.6	1.0	0.5	10.2
Cumulative obligations															
(existing and prospective) 3/															
1. Principal															
GRA repurchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PRGT repayments	7.5	15.0	11.6	7.1	5.4	4.8	3.8	3.2	5.0	6.5	6.5	5.1	3.3	1.5	86.1
2. Charges and interest 2/															
PRGT interest	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.6
SDR assessment and net charges	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.6
Total obligations	7.6	15.1	11.6	7.2	5.5	4.9	3.9	3.3	5.1	6.6	6.6	5.2	3.4	1.6	87.4
Outstanding Fund credit, end of period	50.7	44.7	42.1	45.0	39.6	34.8	31.0	27.9	22.9	16.5	10.0	4.9	1.5	0.0	…
Memorandum items:															
Outstanding Fund credit, in percent of															
Exports of goods and services 4/	3.4	2.8	2.4	2.3	1.7	1.3	1.1	0.8	0.6	0.4	0.2	0.1	0.0	0.0	…
External public debt	5.7	4.7	4.4	4.6	4.0	3.4	2.9	2.5	1.9	1.3	0.7	0.3	0.1	0.0	…
Gross official reserves	1.0	0.9	0.9	0.9	0.8	0.7	0.6	0.6	0.5	0.3	0.2	0.1	0.0	0.0	…
GDP	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	…
Quota	15.7	13.8	13.0	13.9	12.2	10.7	9.6	8.6	7.1	5.1	3.1	1.5	0.5	0.0	…
Total Obligations, in percent of															
Exports of goods and services 4/	0.5	0.9	0.7	0.4	0.2	0.2	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.0	…
External public debt	0.9	1.6	1.2	0.7	0.5	0.5	0.4	0.3	0.4	0.5	0.5	0.4	0.2	0.1	…
Gross official reserves	0.2	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	…
GDP	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	…
Quota	2.3	4.7	3.6	2.2	1.7	1.5	1.2	1.0	1.6	2.0	2.0	1.6	1.0	0.5	…
Quota	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8

Source: Fund staff estimates and projections.

1/ As of May 31, 2016. Years refer to Gregorian calendar years (January 1 to December 31).
2/ Projections are based on current interest rates for PRGT loans.
3/ Based on the proposed level and phasing of access, and subject to the approval of the IMF's Executive Board.
4/ Excluding reexports.

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

	Baseline value	Latest available	Target 2/ 2015	Target 2/ 2020
	(In percent, unless otherwise indicated)			
Goal 1: Eradicate extreme poverty and hunger				
Population below US$1 (PPP) a day	...	...	...	...
Population below national poverty line 3/ 4/ 5/	33.0	36.5	24.0	21.0
Prevalence of underweight children under 5 years of age	41.0	39.0	15.0	...
Population below minimum level of dietary energy consumption 5/ 6/	30.0	29.0	11.0	9.0
Goal 2: Achieve universal primary education				
School enrolment rate (age 7-12) 5/	37.0	52.0	...	100
Literacy rate of 15- to 24-year-olds	34.0	47.0	50.0	100
Goal 3: Promote gender equality and empower women				
Ratio of girls to boys in primary education	60.0	71.0	83	100.0
Ratio of girls to boys in secondary education	33.0	57.0	70	100.0
Proportion of seats held by women in national, provincial and district representative bodies	25.0	27.0	25.0	30.0
Goal 4: Reduce child mortality				
Under 5 mortality rate (per 1000 live births)	257	97.0	93	76
Infant mortality rate (per 1000 live births)	165	77.0	70	46
Immunization, measles, children under 12 months	35.0	62.0	90.0	100
Goal 5: Improve maternal health				
Maternal mortality ratio (per 100,000 births)	1600	327	312	400
Proportion of births attended by skilled personnel	6.0	47.0	50.0	75.0
Fertility rate (live births per woman) 4/ 7/	6.3	5.1	4.7	3.1
Goal 6: Combat HIV/AIDS, malaria, TB and other diseases				
Contraceptive prevalence rate, national	10.0	21.0	50.0	60.0
Incidence rates associated with malaria	1.5	1.5	0.7	0.2
Prevalence rates associated with tuberculosis (per 100,000 population)	671	351	224	143
Goal 7: Ensure environmental sustainability				
Proportion of total area protected to maintain biological diversity 4/	0.34	0.50	0.50	...
Energy use (kg oil equivalent per US$1,000 GDP, PPP)	...	...	...	...
Population with access to safe drinking water 5/	23.0	31.0	...	61.5
Population with access to improved sanitation 5/	12.0	8.0	...	66.0
Goal 8: Develop a Global Partnership for Development				
ODA received as a proportion of GDP	26.0	12.4	...	...
Export to countries having a preferential trade agreement with Afghanistan	11.8	27.7	...	100
Goal 9: Enhance security 7/				
Professional training of the ANA (% of personnel having undergone a full training)	42.0	90.0	100	100
Afghans directly affected by emplaced antipersonnel mines (in millions)	4.2	1.0	0.4	0.2
Afghans dependent on opium for their livelihoods (in millions)	1.70	1.00	0.60	0.20

Source: UNDP *Millennium Development Goals, Islamic Republic of Afghanistan, Annual Progress Report 2012*

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

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

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

4/ Figures may not be directly comparable.

5/ Data is from World Bank (2010) *Poverty in Afghanistan* and *NRVA 2007/8 assessment*, rather than the UNDP MDG *Progress Report*.

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

7/ Afghanistan-specific, additional goal/indicator.

Annex I. Risk Assessment Matrix

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

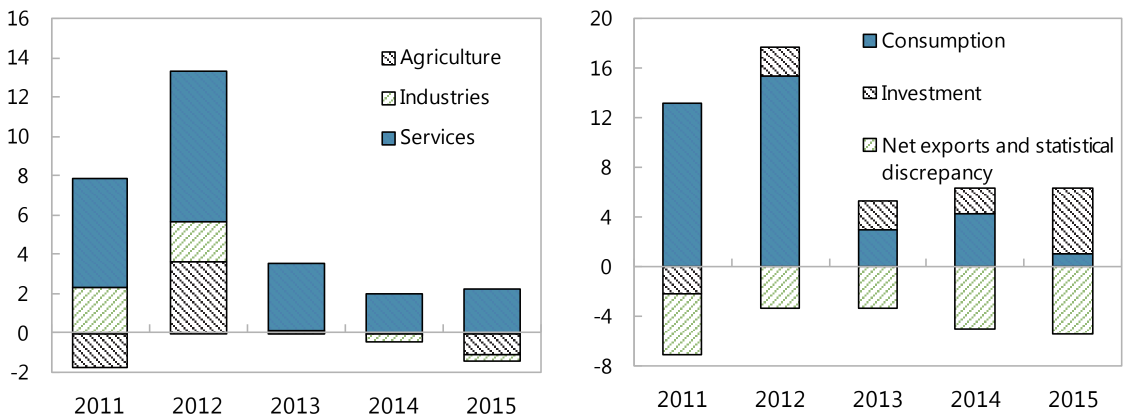
Nature/Source of Risk	Likelihood[1]	Expected Economic Impact if Realized	Possible Mitigating Measures
		Medium-Term Risks	
Decline in donor inflows to the budget and to finance development projects.	**Medium**	**High** - Lack of progress in implementing reforms agreed under the Self-Reliance through Mutual Accountability Framework or donor fatigue result in decline in donor inflows, especially to the budget. - The decline in inflows leads to lower public spending, lower growth, increased unemployment, and/or exchange rate pressures.	Strengthen policy implementation to maintain macro stability, speed up structural reform, and improve economic governance, including stronger legislative, institutional, and regulatory frameworks, and law enforcement.
Structurally weak growth in emerging market economies, particularly in China and India, which are key stakeholders in development of Afghanistan's natural resources, results in a delay in investment plans in extractive industries.	**Medium**	**Medium** - Delays in investments to develop natural resources postpone the projected pick-up in growth and result in lower exports. - Lower than expected revenues from natural resources could lead to increasing budget deficits as spending envelope continues to increase. - Fiscal deficits and lower export receipts may lead to exchange rate depreciation and higher inflation. - Lack of progress in developing natural resources could result in higher narcotics production.	Strengthen policy implementation to maintain macro stability and improve business climate, including a sound fiscal regime for natural resources.
Lack of progress in banking sector and strengthening anti-money laundering and combating the financing of terrorism (AML/CFT) reforms, compromising financial sector's soundness.	**Medium**	**Medium** - Banking sector constrained in fulfilling its intermediation role results in less credit to the economy, inefficient allocation, lower access to finance, and slower growth. - Confidence in banking sector could dissipate, leading to banking sector liquidity challenges. - Lax or ineffective enforcement could undermine financial discipline, bank governance, risk management, financial controls and money laundering controls and result in bank failure(s) and need for bailouts. - Access by Afghan banks to global financial system is impeded.	Ensure that prudential and AML/CFT preventive (including fit and proper) standards are strictly observed and supervision enforcement actions are implemented promptly. Implement the action plan as agreed upon with the Financial Action Task Force to exit the monitoring process.

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

Annex II. What Ails Afghanistan's Economy?

1. **Afghanistan has seen a sharp drop in growth in recent years**. Growth has collapsed in recent years, dropping from an average of 11½ percent in 2007–12 to 1½ percent in 2013–15 as the size of the International Security Assistance Force stationed in the country fell from 130,000 to 13,000, compounded by political uncertainty and rising insecurity. The withdrawal of international troops led to a sharp decline in in-country military spending and related demand spillovers to the broader economy (see charts below), which have led to significant job losses. Thus, growth in Afghanistan is now too low to absorb the estimated 400,000 labor market entrants each year, with unemployment already at 23 percent and the poverty rate at 36 percent as of 2011 and probably higher now.

Contributions to Growth
(In percent)

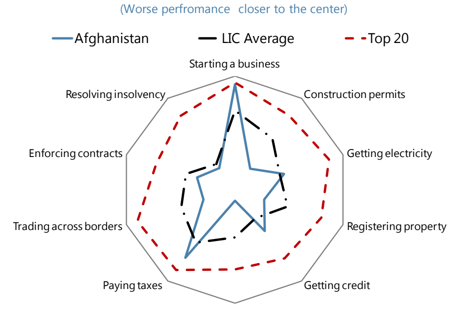


Sources: Afghan authorities, WB and IMF staff calculations.

2. **There are numerous growth inhibitors**. The primary one is insecurity, which, if resolved would put Afghanistan on a much steeper growth trajectory. Abstracting from this factor, there are a number of obstacles to growth, the relative importance of which is difficult to gauge:

- A weak business climate, reflecting not just insecurity but also weak institutions and excessive red tape;[1]
- A banking sector that does not contribute to financial intermediation and is plagued by weak banks, particularly those that are state owned;

Distance to the Frontier Scores on Doing Business Indicators
(Worse perfromance closer to the center)



Source: World Bank Doing Business 2016.

[1] Afghanistan is ranked 148th out of 150 by World Audit (2015); 166th out of 168 by Transparency International's. Corruption Perceptions Index (2015); and 177th out by Doing Business (2016).

- Endemic corruption, which causes inefficiencies, undermines growth, and boosts inequality;
- Government spending skewed toward current spending, which leaves little room for growth-enhancing capital spending;
- Infrastructure deficit, including transportation and energy, limiting investment; and,
- Weak human capital, limiting the potential for labor productivity-driven growth.

Annex III. Lessons from the Ex Post Assessment[1]

1. **Afghanistan has previously engaged in two Fund-supported programs that aimed at establishing macroeconomic stability and laying foundations for structural reforms.** Both programs faced the challenges of dealing with unprecedented inflows of international aid and scaling up of public investment against the background of increasing insecurity. Two Staff Monitored Programs were also put in place, in 2004-06 and, most recently, in 2015.

2. **The June 2006 PRGF-supported arrangement was a vehicle to implement a broad structural reform agenda and access debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative on the back of a 24-month SMP.** The program aimed at solidifying macroeconomic stability and creating conditions for private sector-led development. To this end, it aimed at sustaining real GDP growth of about 10 percent a year, reducing inflation to 5 percent, further strengthening the external position, and accelerating institutional and structural reforms, such as improvements to the fiscal and monetary policy frameworks, restructuring of state-owned banks, and improvement of the business environment. All six reviews were completed; a request for an ECF-supported arrangement was made in July of 2010.

3. **The November 2011 ECF-supported arrangement was approved against a background of the impending drawdown of international troops, the 2012 Tokyo donor conference, and the Kabul Bank crisis.** The overarching objective was to maintain macroeconomic stability as the troop withdrawal necessitated higher domestic security spending and smaller projected aid was expected to lower growth. A staff-level agreement was reached in 2010; however, the program was quickly recast in light of the Kabul Bank crisis, aiming at strengthening financial sector supervision and overall economic governance, and improving the transparency and efficiency of public spending. The first review was completed in June 2012 but the subsequent ones were delayed due to missed quantitative targets and slow implementation of structural reforms, with the program going off-track.

4. **While there were notable successes, both programs fell short of their initial goals.** Macroeconomic stability was maintained and some key reforms were advanced, but many others were left unfinished, including fiscal reforms. While foreign aid played a critical role in stabilizing the economy, significant aid-financed off-budget spending by donors contributed to the buildup of a better-paid "parallel" civil service, demotivating the regular civil service and weakening program ownership.

5. **A new program with the Fund is likely to carry substantial risks, related primarily to weak security and governance gaps**. But with long-term aid inflows set to decline to a lower level, Fund engagement can help manage the transition to reduced aid by maintaining macroeconomic

[1] http://www.imf.org/external/pubs/ft/scr/2016/cr1623.pdf.

stability and helping retain donor support. Past lessons that can improve the effectiveness of future program engagement include:

- Basing the macro framework on more realistic assumptions of aid flows and security and other expenditures;
- Focusing on macro-critical structural reforms while giving explicit consideration to the implementation capacity of the authorities;
- Strengthening coordination of policies and capacity building efforts;
- Improving governance including by strengthening targeted AML/CFT and anti-corruption measures; and,
- Increasing reliance on the Afghan civil service for public service delivery; promoting ownership of the reform agenda by key stakeholders.

Annex IV. The Kabul Bank Crisis: Completing the Burden Allocation Process

1. **The Kabul Bank fraud in 2010 severely damaged the credibility of Afghanistan's banking sector and of its supervisory framework**. At that time, the Kabul Bank had the largest branch network in the country and accounted for one third of domestic banking assets. The crisis emerged in September 2010 when media reports of massive lending abuses led to a large scale run on its deposits.

2. **The authorities reacted quickly and decisively to contain the run**. The authorities guaranteed all of the Kabul Bank's deposits. The DAB put the bank into conservatorship, and through its lender-of-last-resort facility (LLRF) met US$825 million of deposit withdrawals. In the spring of 2011, the bank was moved to receivership, after seventy percent of its total assets (almost US$1 billion) appeared doubtful. All remaining deposits (US$586 million, per the audited financial statements for the period ended December 31, 2011) and assets (US$567 million, ditto) deemed to be of good quality were transferred to the New Kabul Bank (NKB), an entity granted regulatory forbearance to act as a bridge bank without any capital and expected to be sold within 18 months. In 2012, DAB's LLRF exposure was underwritten by a Ministry of Finance (MOF) interest-bearing Promissory Note with a quarterly repayment schedule.

3. **Five years later, the burden allocation process remains incomplete**. Staff estimates the total financing needed to complete the process at US$571 million and identified resources at US$239 million. In absence of other resources, the remaining balance of US$332 million (1.8 percent of forecasted 2016 GDP) could be raised via a financial instrument issued by the Government.

Receivership: As of April 2016, total recoveries and settlements have reached US$362 million (including US$203 million in cash, used to repay part of the LLRF balance and cover administrative costs) and is due to receive a further US$33 million of fully collateralized receivables under new agreements with Kabul Bank's borrowers. The process, however, is now losing steam. Some of the remaining claims (amounting to US$658 million and including US$512 million owed by two former shareholders) targeted by the receivership are in foreign jurisdictions, pursued through legal and diplomatic channels with diminishing chances of success. The government has still to pay US$50 million for assets purchased from the receivership in 2013–14 (including US$24 million for airplanes and US$13 million for fuel facilities). The receivership currently has US$31 million in cash on its accounts. The government has taken responsibility for the final losses if not recovered.

NKB: Efforts to privatize the NKB have not been successful. It is now close to operating with costs fully covered but has accumulated over the years operating losses of US$50 million. Its balance sheet also includes commitments to receive the proceeds of recoveries from the failed Kabul Bank that did not materialize in full, a shortage valued at US$41 million at end-2015. Finally, if the NKB were to continue functioning as a bank, it would need to be allocated a minimum capital of US$15 million (AF 1 billion) as determined by the Banking Law of Afghanistan.

DAB: Since 2014, the Promissory Note repayment schedule has not been adhered to, and, with interest accruing, the outstanding LLRF balance started to rise again, reaching US$415 million at end 2015. This amount should be brought down in 2016-17 through payments from the MOF and the receivership, and the remainder should be fully repaid as quickly as possible and in any case by the end of 2019 at the latest.

The Kabul Bank Legacy: Fiscal Resolution

(In millions of U.S. dollars)

Total Financing Needs:	**571**
Receivership, Receivables from MoF in lieu of purchased assets	**50**
DAB, Outstanding balance on LLRF	**415**
New Kabul Bank	**106**
Receivables from MoF	41
Accumulated losses	50
Capital injection (approx.)	15
Identified Financing:	**240**
Receivership	**81**
Receivables from MoF in lieu of purchased assets	50
Remaining cash proceeds from recoveries	31
DAB's 2015 profits	**148**
To be retained against the LLRF balance	42
To be transferred via MoF to the NKB	106
Budgeted 2016 payment on the LLRF-related promissory note	**11**
Remaining Balance:	**331**

Sources: Afghan authorities; and IMF staff calculations.

Appendix I. Letter of Intent

Kabul, June 30, 2016

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

Dear Ms. Lagarde:

Much progress has been made by the Afghan government and its people with strong support from the international community, yet we continue to face difficult security, economic, and political challenges that threaten to undermine our achievements. Nevertheless, our government is determined to press ahead with reforms needed to address the difficult challenges Afghanistan faces and build prosperity for current and future generations of Afghans.

We would like to thank the International Monetary Fund (IMF) for its support in recent years, including in the context of the staff-monitored program (SMP), which was successfully completed and the last review of which was concluded in April. This demonstrated our commitment to sound policies and reform. Having addressed the immediate fiscal and banking vulnerabilities by mobilizing revenues and strengthening financial sector supervision and enforcement, we would now like to build on this by laying the foundations for a vibrant economy through macroeconomic stability and structural reforms promoting sustainable and inclusive growth. Indeed, we must plan for a future where we will have put behind us dependence on donor aid, even if this new reality will take decades to arrive at.

As we embark on this difficult path and in support of our reform agenda, we request a three-year IMF Extended Credit Facility (ECF) arrangement, covering the period July 20, 2016 to July 19, 2019, in an amount equivalent to SDR 32.38 million (10 percent of Afghanistan's quota). Such an arrangement would play a critical catalytic role, and be embedded in a broader multi-year development strategy that sets us on a path of self-reliance.

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

In line with our commitment to transparency, we hereby request that the staff report, this letter of intent, and the attached MEFP and TMU, including all annexes and attachments, as well as all other ECF-related documents, be published on the IMF website.

Sincerely yours,

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

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies for 2016–2019

A. Introduction

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

2. **Afghanistan's nine-month Staff-Monitored Program (SMP) ended in December 2015.** The second review of the SMP was completed by IMF management in April 2016. Despite difficult circumstances, we have implemented the program successfully and on schedule: all end-December quantitative targets and most structural benchmarks were met. The requirements of two unmet benchmarks were completed by the end of the SMP through approval of related regulations.

3. **We are committed to reinvigorate economic reform and address structural weaknesses in the economy.** We have started to address economic vulnerabilities and would like to press ahead with the reform program through a series of policy and legislative actions. These actions signal our commitment to reform, building economic confidence, and raising economic growth.

4. **The ECF arrangement will support our macroeconomic policy and reform agenda for 2016–19.** It will help the government address economic vulnerabilities and facilitate our engagement with the international community to sustain donor support and help us make progress on the deliverables under the Self-Reliance Mutual Accountability Framework (SMAF). The ECF arrangement will assist us to preserve macroeconomic stability, improve economic governance, and lay the basis for stronger private sector activity.

B. Recent Economic Developments

5. **Economic activity continues to be weak. Following the withdrawal of the international troops, growth continued to decline in 2015, reaching 0.8 percent.** Uncertainties related to security and political transition sapped private sector confidence and reduced domestic demand. Growth was driven by the services sector, with both industrial and agricultural output declining. Inflation averaged -1.5 percent in 2015 on account of low global oil and food prices, a suppressed housing market, and weak demand. However, inflation turned positive in late 2015, following a sharp depreciation of the Afghani (in a de facto floating exchange rate regime), and has continued to rise in 2016. International reserves remained comfortable and since early 2016 the exchange rate has been broadly stable. The external current account and budget continued to be financed by donor grants.

6. **On the fiscal side, 2015 was marked by a remarkable turnaround in domestic revenue.** After declining for three consecutive years, domestic revenue increased by about 20 percent

(1½ percentage points of GDP) in 2015. This was achieved despite the growth slowdown, and reflected the revenue measures introduced earlier in the year (0.4 percent of GDP), and, more importantly, increased collection efficiency, including of tax and nontax arrears (0.7 percent of GDP). On the expenditure side, operating budget execution was below projections. Together, this resulted in a lower-than-targeted operating deficit before grants. However, the overall balance including grants was in deficit of 1.4 percent of GDP, rather than zero as projected earlier, due to a shortfall in grants.

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

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

9. **Revenue, budget execution, and the treasury cash balance continued to improve in 2016.** In the first five months of 2016, revenue increased by 0.7 percent of GDP to 4.3 percent of GDP (Af 55.5 billion) compared to the same period last year, reflecting the measures introduced in 2015. Although development budget execution has not performed as planned due largely to delays in procurement and submission of invoices by budgetary units, operating budget execution exceeded last year's performance owing to acceleration in procurement in the security sector and a pick-up in wage and pension payments. The donor grants more than financed the overall budget, which recorded a surplus of about 2.5 percent of GDP, and the treasury's discretionary cash balance increased to 2.5 percent of GDP, equivalent to 1.5 months of operating spending.

10. **The financial sector remains vulnerable to adverse shocks.** Asset quality remains a concern, nonperforming loans have increased, and profitability is under pressure. We have put fragile private banks under a watchful monitoring regime and the Da Afghanistan Bank (DAB)

supervision directorate continues to monitor closely the weaker private banks. As part of a special review program, DAB is conducting in-depth examinations of each of them, issuing numerous corrective orders and injunctions, and will produce a comprehensive report on the results obtained upon completion of the exercise, expected by the third quarter of 2016, with necessary actions taken as needed.

11. **We have made some progress in improving the financial position of the state-owned commercial banks (SOCBs).** One of them remains profitable, while the breakeven point for the two others seems to be within reach in 2016. The capital adequacy of two of them has improved but the third one, the New Kabul Bank (NKB), remains in a precarious solvency situation that we are now addressing as an urgent priority. The two expressions of interest for its privatization received by the March 7 deadline have been both assessed as less than satisfactory and we are reassessing our strategy with regards to resolving the issues around this bank (see below). We have continued our efforts to advance the Kabul Bank liquidation and asset recovery and are taking additional steps to improve the transparency of the process.

12. **Support from our international partners remains vital. Aid flows help to meet immediate financing requirements and reduce fiscal vulnerability.** Further, the London Ministerial Conference in December 2014 reconfirmed our international partners' commitment to finance our security and development needs, and we look forward to a renewal of commitments at the Warsaw Summit and Brussels Conference this year. Afghanistan's National Development Framework (ANDF) makes explicit the government's goals of weaning the country away from aid dependency. Achieving this goal requires a collective effort to overcome fragmentation, defeat corruption, and introduce proper policies for sustainable growth. However, we also draw attention to the risks attendant in overly rapid or not well thought through reductions in support for the reform agenda. We believe that the sequencing described in this framework will succeed in achieving its objectives, but a pre-condition for its success is sustaining the partnerships that are still needed to embed the reforms and follow them through.

C. Economic Program for 2016–2019

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

14. **We are cautiously optimistic about 2016, but there are downside risks.** Growth is expected to recover as political transition uncertainties subside, reforms advance, and confidence recovers. With sustained reform and donor support, growth is projected to increase further in 2017 and beyond, and inflation to remain in single digits. However, while we continue to invest heavily in the peace process, continued uncertainty about the security situation will keep on restraining private demand and is a significant source of downside risk.

15. **Poverty reduction remains an important priority.** Our policies are guided by the ANDF as well as the paper we prepared for the London Conference on Afghanistan Realizing Self-Reliance. They focus on low inflation, pro-poor budgeting, and inclusive economic growth propelled by investment in agriculture, more regional economic integration, the fight against corruption, and greater gender equality. Although security outlays will increase, we will allocate adequate resources to increase opportunities for the poor. A Jobs for Peace program has already been rolled out and is showing results. The first phase of the program has created over 2.6 million labor days above and beyond already planned program activities, providing over half a million families living in rural areas with crucial cash inputs over the late winter months, when food insecurity is at its most severe. The second phase of the program is currently being launched and will include both a scale-up of the rural program to cover the remaining provinces and the introduction of a labor based clean-up program in Afghanistan's five largest cities, with an initial target of 10,000 new jobs. To monitor results, we will continue to improve the collection and analysis of poverty indicators. Pro-poor operating spending in 2016 is programmed to be Af 36.6 billion (about 3 percent of GDP).

Macroeconomic Policies

16. **Our macroeconomic policy framework is designed to preserve macroeconomic stability and promote growth.** It will target a pick-up in GDP growth to 4 percent over the next three years and inflation in single digits. It will also maintain buffers of low debt (less than 10 percent of GDP) and a comfortable international reserves position (above 7 months of import cover). It will protect competitiveness, with the current account in surplus or modest deficit after grants. We will target overall budget balance after grants, but over time the operating balance excluding grants will become the fiscal anchor. Reserve money remains the monetary anchor, with a view to maintaining moderate inflation. We will remain dependent on donor support to meet our fiscal and external financing needs, which is expected to decline in percent of GDP.

17. **We expect a balanced overall budget in 2016 after grants, and will maintain a prudent fiscal position in 2017 and beyond.** Domestic revenue is projected to increase to 10.3 percent of GDP (Af 132.6 billion) this year reflecting the full-year effect of revenue measures introduced in mid-2015. Adjusting for the large one-off collections in 2015, this reflects an increase of about 0.8 percent of GDP. Budget grants are projected to increase by about 2.6 percent of GDP on account of a re-phasing from 2015. We expect operating spending to pick up, after an unusually low operating budget execution in 2015, especially in the defense sector. We expect the treasury’s discretionary cash balance to remain well above the indicative target in the program (Af 10 billion). We project a limited increase in development budget execution due to ongoing difficulties with unrealistic over-budgeting of multi-year grant-financed projects. Our reform efforts over the coming

years will target quantifiable improvements in the credibility of the development budget and raising its execution rate. For 2017, we will submit to parliament by end-November (structural benchmark) a budget that is in line with the macroeconomic framework of the ECF-supported program. We will continue to target a gradual decline in the operating deficit excluding grants and a zero overall balance including grants. Our program aims to mobilize additional revenue for growth-enhancing development spending and to continue the long process of reducing aid dependence. Projections for domestic revenue over the program period are cautious pending identification of tax policy and administration measures with the help of our international partners, including the IMF. We will only borrow on a highly concessional basis for specific projects in consultation with international partners. We will set aside any revenues earned from extraordinary currency exchange gains for building the government's cash reserves and will not allocate these gains in the budget for spending by budgetary units.

18. **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 4–8 percent. Reserve money growth of 10 percent is projected for 2016. Our program envisages a moderate increase in net international reserves (about US$50 million) and international reserve cover will remain above 6 months of imports during the term of the arrangement. We will let the Afghani move with market trends and 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 or persistent changes in foreign exchange flows. We will improve coordination between DAB and the MOF to strengthen the conduct of monetary policy, facilitate fiscal cash management, and promote market development by finalizing legislation to set up a sukuk (Sharia compliant treasury bill) market with a view to submit the bill for parliamentary approval within six months after completion of the necessary technical assistance work by the IMF or the World Bank.

Structural Reforms

19. **We will reinvigorate structural reforms.** Fiscal reforms have been set out in detail in the government's five-year rolling Fiscal Performance Improvement Plan and will focus on improving the performance of teams delivering core budget functions. Flagship reforms include strengthening priority setting by Cabinet through improved forecasts, establishment of rolling forward estimates with robust costing of existing policy, streamlined budget management with improved program and project preparation to reduce over-budgeting and carryovers, improved cash management and accounting and increased accountability through improved annual reporting and audit. The reforms will also gradually be extended to key line ministries over the course of the next few years focusing on improved budget credibility, better budget execution and annual reports comparing outcomes to budgets. We will further approve regulations that will lay the basis for public private partnerships to finance key projects and initiatives that will create jobs and contribute to economic growth. The financial statements will be annually audited and published by the Supreme Audit Office no later than twelve months after the end of a fiscal year.

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

Fiscal Reforms

21. **After our successful efforts in 2015, we will continue to implement policies and reforms that help mobilize revenue.** Given weak economic conditions, we do not plan additional tax policy measures in 2016, and will instead focus on further improving tax administration. Nevertheless, we believe that further revenue potential exists, and will therefore conduct a diagnostic study of our tax and nontax revenue systems with the help of IMF TA with a focus on reducing exemptions, and expanding the revenue base by introducing excises on select goods and services. In 2017, we plan to raise selected government fees, which have not been updated for several years. We estimate that revisions to a basket of nontax revenue sources could yield about Af 2.5 billion revenue (0.2 percent of GDP) in 2017 and beyond. We are reviewing the current Income Tax Law, and will propose amendments aimed at simplifying the law and reducing tax evasion in consultation with the IMF and the World Bank staff. We expect these amendments to improve the equity and efficiency of our tax system. Finally, we believe that a VAT is needed and its introduction is an important part of our medium-term revenue mobilization strategy. However, introducing a VAT should be postponed to ensure Afghanistan is ready for its implementation, as the technological capacity of our tax administration is not yet sufficient for administering it. We will continue consulting with the Fund and the World Bank staff on the timing of the VAT and will work to strengthen the tax administration so that it can be introduced in the future.

22. **We target a continued improvement in revenue in 2017 and beyond, on account of ongoing and new revenue (ARD) and customs (ACD) administration reforms.** We conducted functional reviews of the ARD and ACD in 2015–2016, and prepared five-year rolling reform plans in consultation with our partners. To improve tax administration, ARD will streamline a number of tax payment procedures, gradually roll out SIGTAS and risk-based audits, and enhance internal audit functions. To improve customs administration, ACD will operationalize the Customs Academy and merit based recruitment, roll out ASYCUDA valuation module, and establish within ACD a Preventive and Enforcement Wing with power of search, investigation, and arrest throughout customs territory. To this end, ARD and ACD have anchored targets within the Afghanistan Reconstruction Trust Fund (ARTF) incentive program for 2016 and 2017.

23. **Under the ECF arrangement, we will strengthen risk management in ACD and access to taxpayer information in ARD.** ACD will review and update its risk management policy by end-December 2016 (structural benchmark) to implement multi-criteria risk profiles in all border crossing points and inland custom depots to effectively identify and prioritize high-risk traders and

shipments for physical examination and post-release verification. To this end, ACD will complete staffing and training of its specialized risk management unit in Customs headquarters by June-2017 (structural benchmark), which will be responsible for preparing and testing comprehensive risk profiles by end-2017 through (i) the analysis of past transactions and detection, and the identification of salient risk elements; (ii) simulations based on past detection; (iii) testing of pilot profiles; (iv) statistical review of detection with a view to identify and peg optimal levels of physical and post-release verifications; (v) frequent changes in risk profiles based on feedback; and (vi) close interaction with post-release verification and compliance units. Selection of declarations to inspect or review under risk management will also include a random selection through ASYCUDA. The risk management unit, which will be insulated from outside interference, will report to senior management, provide a monthly report of results, direct risk management activities in field units and liaise with field units to obtain feedback, and will have the power to update risk profiles in real time. The unit will also maintain contacts with other agencies, in particular the Tax Administration. Its activities will come under a global compliance policy involving (i) physical inspection and reporting guidelines; (ii) post-release verification and audit; (iii) inter-agency cooperation; and (iv) an annual plan of control prepared by ACD. We will also link SIGTAS to ASYCUDA (structural benchmark), Afghanistan Central Business Registry (ACBR), and Afghanistan Payments System (APS) interfaces over the next three years to facilitate automated information sharing on taxpayers and taxpayer transactions, which will help improve revenue collection efficiency and reduce leakages.

24. **The development of the natural resource sector and reform of the fiscal regime for extractive industries remain essential for domestic revenue mobilization over the medium term.** While the development of extractive industries has been hampered by ongoing security problems, inadequate infrastructure, and declining international commodity prices, we are amending the mining law, and developing an Extractive Industries Transparency Initiative (EITI) compliant, effective, and transparent fiscal regime for natural resources. To this end, we will take the remedial steps towards compliance with EITI requirements set out in the relevant benchmark in Table 2 (end-June 2017 benchmark). We will submit the revised mining law to parliament and work together with the IMF and the World Bank to fully develop the mineral fiscal regime by the end of 2017.

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

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

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

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

- While the government recognizes that the shift to a consolidated national budget will take some time, the foundations need to be laid now. With improved budget costing under robust forward estimates and some flexibility, execution of the development budget should aim at 57 percent in 2016 and rise to close to 100 percent over the next five years.

- We will strengthen development budget management by establishing a development projects database for the 50 largest projects (in terms of value). This database would be maintained by the MOF's Budget Department and would contain specific information (see Annex 1). This development projects database would help inform the MTFF and the framework of rolling forward estimates to protect the allocations needed in future years (as per project phasing) to complete the ongoing projects, identify the remaining fiscal space for new projects, and systematically take account of required recurrent allocations (in future year budgets/forward estimates framework) for operation and maintenance of capital assets created. By tracking the key milestones of large projects, it would also help us to prepare more realistic development budget estimates.

- We will strengthen commitment control and cash management by tracking commitments during budget execution and requiring financial plans from ministries/agencies as a basis for issuance of in-year allotments (structural benchmark). We will track contractual commitments (including forward year commitments under multi-year contracts) by ministries/agencies through the AFMIS (purchasing module) starting with transactions valued above Af 1,000,000. The Budget Department of the MOF will issue phased allotments (i.e. annual allocations at budget minor head level divided into quarterly tranches based on financial plans submitted by a ministry/agency) to ministries/agencies based on procurement plans and financial plans submitted by them. The financial plans of individual ministries/agencies, backed by allotments by the Budget Department, would be uploaded into the AFMIS and linked to the consolidated cash plan of the Treasury. The Treasury will control payments by the ministries/agencies during budget execution against their respective authorized financial plans. Any in-year revisions to the ministries/agencies' financial plans would be subject to review and approval by the Budget Department and Treasury.

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

- We will improve development projects management by taking concrete measures, both in the near- and medium term, to strengthen development project planning and preparation and streamline the process of project implementation. In the near term, the measures will include (i) developing and enforcing a procedure that no project will be funded in the budget unless all preparatory steps—e.g., project feasibility study, technical design of the project, project costing and appraisal, environmental and social impact assessment, etc.—have been completed establishing its readiness for implementation after funding; and (ii) issuing a decree/instruction requiring ministries/agencies to ensure that clearances/approvals at various stages of project implementation don't pass through more than two levels in the administrative hierarchy. Over the medium term, we would also develop and approve by Cabinet an action plan to address identified gaps/weaknesses based on a comprehensive assessment of the public investment management cycle and associated institutional framework. This assessment could be based on the IMF's Public Investment Management Assessment (PIMA) framework or a similar assessment.

- In 2013, we proposed amendments to the laws governing public enterprises (Tassady Law) and corporations (Corporations and Limited Liability Companies Law) to bring such entities under the ownership and effective oversight of the MOF. We will work with the Parliament to pass these amendments promptly. We will review the capacity of the department of state owned corporations and enterprises (SOCEs) to assess needed staffing, and seek technical assistance to improve staff's capacity for operational and financial oversight of the SOCEs. The department will then start collecting information on financial flows between the government and the SOCEs, and prepare annual analytical reports on their financial performance.

Financial Sector Reform

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

Consolidating Financial Stability

27. **We are entering into the final phase of the resolution of the 2011 Kabul Bank collapse.** Recoveries and settlements have reached a respectable US$364 million by April 2016, including US$203 million in cash, but they are now, as expected, losing steam. Our recovery efforts for the remaining US$658 million of claims will nevertheless continue unabated, in particular against the two former shareholders who still owe US$512 million.

28. **We are taking steps to relieve both DAB and NKB from any further exposure to the results of the liquidation of Kabul Bank, with a view to improve the transparency and the quality of their balance sheets and transition NKB towards becoming a sound financial institution.** DAB's lender-of-last-resort (LLRF) exposure to Kabul Bank of US$825 million was underwritten in 2012 by a Promissory Note from the MOF that also included a repayment schedule. However, since 2014 the schedule has not been adhered to, and, with interest accruing, the balance started to rise again, reaching US$415 million by end-2015. Given fiscal circumstances and risks, we are currently not in a position to meet the unpaid obligations that have accrued under the promissory note schedule since 2014. However, we recognize the need to move forward with the settlement of this incident and to improve the quality of DAB's balance sheet, and will therefore do the following:

- By end-December 2016 (structural benchmark), the LLRF exposure of DAB will be brought down by US$84 million (through the payments of US$31 million from the Kabul Bank Receivership; assignment of US$42 million from DAB's 2015 profits; and execution of the budget allocation of US$11 million);

- We will include in the FY2017 budget an explicit allocation for the transfer to the Kabul Bank Receivership of US$50 million that the MOF owes for Kabul Bank assets taken over by government entities. This amount will be applied to the further reduction of the LLRF balance by end-June 2017.

- Starting in 2017 and by end-2019, the remaining LLRF balance will be fully eliminated by means of capital transfers to DAB that will be transparently reflected in the budget.

29. **New Kabul Bank is transitioning from a temporary bridge bank without capital to a depositor-oriented, adequately capitalized institution.** When NKB was established in 2011, it was granted regulatory forbearance to act as a bridge bank for up to 18 months without any capital and

assume the remaining liabilities of Kabul Bank, while refraining from any lending activity. The balancing items included tangible assets, but also commitments to receive the proceeds of recoveries from the failed bank that did not materialize in full, a shortage valued at US$41 million at end-2015. By that time, it had also accumulated US$50 million in current losses, as a result of its role as the safe haven successor to Kabul Bank, but it has gradually improved its performance and is now close to the break-even point on profitability. To turn the page of the negative legacy of the Kabul Bank incident, we will complete the recapitalization of NKB by end-December 2016 (structural benchmark) for an amount of US$91 million plus a US$15 million capital cushion. We will continue to consider the future of NKB, including its possible eventual privatization.

30. **We are establishing a new unit to monitor and report on the fiscal risk posed by state-owned commercial banks (SOCBs).** This will involve setting up additional reporting requirements in accordance with good international practice for accounting and disclosures. Annual fiscal risk reports will be produced and narratives included in the annual budget papers.

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

32. **Our capacity building efforts in the field of prudential regulation and supervision are progressing.** The 2014–2018 Strategic Action Plan (SAP) developed with the Middle East Technical Assistance Center (METAC) continues to be implemented, with the assistance of a range of donors, and will be further supported by a new World Bank project under preparation and soon to be finalized. An update of the SAP will take place by mid-2017, including an extension to incorporate a bank resolution framework. IMF targeted technical assistance, in support of the SAP implementation, has been requested in the area of prudential regulations and stress-testing.

Toward a More Growth-Friendly Financial Sector

33. **We are in the process of requesting the World Bank to provide support to develop a "National Financial Inclusion Strategy."** We expect to start this effort at the national level by the third quarter of 2016 and finalize the strategy towards the end of 2017 under the leadership of DAB. The strategy will include a comprehensive "access to finance" agenda, including for agriculture

where the diverse grass root initiatives will be coordinated with the action of the Agriculture Development Fund to leverage their impact. The strategy will target an improvement in the financial sector infrastructure, introduce a wider range of financial instruments, facilitate financial intermediation and support innovative financing for the private sector. Key components of the strategy will also consider strengthening consumer protection, improving financial literacy, and building capacity for the commercial banks' staff.

34. **We are also coordinating with the banking profession to prudently foster intermediation.** The banking system's particularly low loan-to-deposit ratio of 19 percent is an impediment to growth in the private sector. While the SOCBs focus on the resolution of their pending issues, the most robust of the private banks have room to prudently and gradually expand their loan portfolios and the range of funding techniques that they offer to their customers. DAB will adjust its communication with them and review regulations that might be overly demanding, discouraging intermediation even by the strongest banks.

Safeguards Assessment

35. **We are committed to meeting all the requirements of the Fund's Safeguards Assessments Policy and will take all the necessary steps to facilitate the completion of an assessment of Da Afghanistan Bank (DAB) by the first review of the program.** DAB's audited annual financial statements will be published without delay, and we will provide Fund staff with all requested information and documentation. Moreover, we will instruct DAB's external auditors to provide copies of audit related reports and management letters, and hold discussions with Fund staff concerning the results of the most recent external audits of DAB. We are also committed to implementing any safeguards related recommendation, including in the legal area, under the deadlines agreed with Fund staff.

Economic Governance

36. **Our government puts anti-corruption efforts high on its agenda and has taken steps to improve the legal framework, strengthen the institutional framework.** A High Council for Good Governance, Justice, and Anti-Corruption has been established and chaired by the President to coordinate the development of a national strategy on anti-corruption, facilitate inter-agency collaboration, and consolidate anti-corruption enforcement efforts. We are drafting a national anti-corruption strategy to be endorsed by the high council on governance, justice and anti-corruption. We have taken steps to strengthen the legal framework notably by preparing a draft appendix to the criminal law in the regard of corruption and a draft new law on anti-corruption. In the judicial system, we plan to establish a special court for financial crimes, the jurisdiction of which will to be defined by the Supreme Court. In addition, we have published asset declarations of top-rank officials (ministers and above).

37. **As corruption remains a significant challenge, we are fully committed to further strengthening legal and institutional anti-corruption frameworks and enforcement.** Specifically, we will criminalize acts of corruption in line with the United Nations Conventions against

Corruption (UNCAC). We will also ensure that annual asset declaration requirements cover heads and deputies of law enforcement agencies, customs and tax administrations, in addition to officials mentioned in Article 154 of the Constitution, covering both assets legally owned and beneficially owned, with proportionate and dissuasive sanctions for non-compliance. For the aforementioned officials not listed in Article 154 of the Constitution, their declarations will be available in a timely manner upon request to, at a minimum, domestic law enforcement agencies and the Financial Intelligence Unit. To this end, we will submit to parliament related laws/amendments by end-October 2016 (structural benchmark) and will work with parliament to adopt them promptly. By end-June 2017 (structural benchmark), declarations of officials listed in Article 154 of the Constitution for 2016 will be published freely available and easily searchable on an official website in Dari and in English. The website will also include information in Dari and in English on the name and functions of other senior officials mentioned above who have declared their assets for the previous year, updated on an annual basis, and on the mechanisms to access their declarations.

38. **Building on the progress made in establishing the AML/CFT legal framework, we will focus on stepping up the implementation.** In the past two years, we revised the AML Law and CFT Law respectively and issued a few regulations toward better complying with international standards. The priority going forward is to ensure effective implementation of these measures.

39. **We remain committed to completing the action plan agreed with the Financial Action Task Force (FATF) by September 2016 with a view to exiting FATF's monitoring process in February 2017.** Furthermore, we will ensure effective implementation of the revised regulation on currency reporting (which has started at the Kabul airport) to allow detection and deterrence of physical cross-border movement of illegal proceeds. We plan to adopt a revised declaration form template and working procedures by October 2016 and publish quarterly implementation reports starting from January 2017. We will also ensure effective implementation of the Fit and Proper Regulation including on existing directors, beneficial owners and senior management of banks. As a first step, we plan to complete collection of information required in Annexes of the Regulation from all banks by September 2016. In addition, we will strengthen risk-based AML/CFT supervision of banks and will regularly monitor money service providers (MSPs) to ensure adequate implementation of AML/CFT measures by these entities. We are expecting to complete the AML/CFT off-site analysis and on-site inspections of all banks using the risk-based tools by June 2017. With respect to MSPs, in addition to effective implementation of the recently amended Money Service Providers Regulation that requires identification of customers, record keeping, and reporting transactions to FINTRACA, we will hold workshops for MSP managers based in Kabul on their AML/CFT responsibilities by December 2016.

40. **We will work to improve the timeliness and quality of our data.** We recognize the importance of reliable statistics for sound policy making. There are a number of deficiencies we plan to correct, particularly in the area of national accounts and balance of payments data. To help us with this effort, we plan to request technical assistance and training from our international partners, including the IMF. In order to improve the predictability of data provision to the public, we will introduce an advance data release calendar by the end of 2016.

D. Program Modalities

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

42. **Commitments under the Article VIII.** During the program period, we will not impose or intensify import restrictions on the making of payments and transfers for current international transactions, or introduce or modify multiple currency practices, or conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify restrictions for balance of payments purposes.

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

Table 1. Islamic Republic of Afghanistan: Quantitative Performance Criteria and Indicative Targets Under the Extended Credit Facility, December 2015-June 2017 1/

(Cumulative, unless otherwise indicated)

	2015	2016					2017	
	Dec.21	Mar.19	Jun.20	Sep. 21	Dec.20		Mar.20	Jun.21
	Beginning stocks	Est.	Proj.	Indicative targets	Performance criteria	Year-end stocks	Indicative targets	Performance criteria
	(In billions of Afghanis, unless otherwise indicated)							
Performance criteria:								
Revenues of the central government (floor)	...	32.4	64.4	97.4	132.6	...	32.7	68.9
Net credit to the central government from DAB (ceiling) 2/	-35.8	-23.3	-26.6	-16.1	-2.9	-38.7	-0.6	-1.9
Reserve money (ceiling) 2/	232.3	-20.1	-0.3	13.5	23.2	255.6	6.2	12.5
Net international reserves of DAB (floor; in millions of U.S. dollars) 2/	6,367	102.8	87.5	24.9	50.0	6,417	0.0	0.0
Nonconcessional external debt, new (ceiling) 3/	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
External payments arrears, new (ceiling) 3, 4/	...	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
Indicative targets:								
Operating budget deficit, excluding grants (ceiling)	...	9.0	39.4	77.6	126.0	...	14.7	48.6
Treasury cash balance, discretionary (floor)	...	10.0	10.0	10.0	10.0	...	10.0	10.0
Currency in circulation (ceiling) 2/	202.2	-12.9	1.1	10.5	21.2	223.4	5.6	11.4
Social and other priority spending (floor)	...	7.1	16.0	26.3	36.6	...	8.1	18.4
Memorandum items:								
Nominal external concessional borrowing (USD million) 3/	...	0.0	0.0	20.0	23.0	...	0.0	0.0
Reference values for the adjustors:								
Core budget development spending	...	7.5	28.3	53.6	96.2	...	9.6	31.1
External financing of the core budget and sale of nonfinancial assets 5/	...	40.1	99.4	153.9	225.7	...	35.4	101.0

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 were applied on a continuous basis.
4/ 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.
5/ Includes operating and development donor assistance, external loans, and sale of non-financial assets.

Table 2. Islamic Republic of Afghanistan: Structural Benchmarks

Measure	Date	Rationale
First Review		
Submit draft amendments to related legislation to Parliament aiming to: (i) criminalize acts of corruption in line with the UNCAC; and (ii) ensure that annual asset declaration requirements cover heads and deputies of law enforcement agencies, customs and tax administrations, in addition to officials mentioned in Article 154 of the Constitution, covering both assets legally owned and beneficially owned, with proportionate and dissuasive sanctions for non-compliance, for officials not covered by the Constitution, declarations will be available on a timely basis upon request to, at a minimum, domestic law enforcement agencies and the financial intelligence unit.	End-October 2016	Improve governance and fight corruption
Council of Ministers to approve and submit to Parliament a 2017 draft budget in line with the macroeconomic framework of the ECF-supported program. The budget will transparently reflect a capital transfer to further reduce DAB's lender of last resort exposure to Kabul Bank, consistent with repaying the remaining balance in full by end-2019. Budget to include an explicit allocation for the settlement of a Ministry of Finance obligation to the Kabul Bank Receivership amounting to US$50 million.	End-November 2016	Preserve macroeconomic stability
Reduction in DAB's lender of last resort exposure to Kabul Bank (US$415 million as of December 2015) through payments totaling US$84 million.	End-December 2016	Preserve financial stability
Recapitalization of New Kabul Bank by US$106 million (a capital cushion of US$15 million and compensation for accumulated losses of US$91 million, as of December 2015) to be completed.	End-December 2016	Preserve financial stability
Afghanistan Customs Department (ACD) to review and update by end-December 2016 its risk management policy to implement multi-criteria risk profiles in all border crossing points and inland custom depots to effectively identify and prioritize high-risk traders/shipments for physical examination and post-release verification.	End-December 2016	Improve trader compliance and reduce corruption.

Table 2. Islamic Republic of Afghanistan: Structural Benchmarks (concluded)

Measure	Date	Rationale
Second Review		
Declarations of officials listed in Article 154 of the Constitution for 2016 will be published freely available and easily searchable on an official website in Dari and in English. The website will also include information in Dari and in English, updated on an annual basis, on the name and functions of other senior officials mentioned in the Oct 2016 benchmark, who have declared their assets for the previous year and on the mechanisms to access their declarations.	End-June 2017	Improve governance and fight corruption
ARD and ACD to operationalize an automated interface for information sharing between the SIGTAS and ASYCUDA systems by June 2017, after developing the content (e.g., business receipt taxes collected at customs) and format of information to be shared through the interface.	End-June 2017	Improve revenue collection efficiency and reduce leakages.
Complete the following key remedial actions suggested by the EITI Board and demonstrate progress towards compliance with the EITI accreditation requirements: 1. LTO will be given responsibility for all major corporate mining and oil and gas taxpayers; 2. LTO and MoMP will prepare and maintain a list of all major corporate mining and oil and gas companies 3. The government will further introduce legislation requiring all major extractive companies to produce annually accounts audited by a certified public or independent chartered accountant.	End-June 2017	Improve transparency in the mineral sector of the economy
Line ministries/agencies to submit their annual financial plans for issuance of allotments and register their contractual commitments (including commitments under multi-year contracts) in the AFMIS. The Treasury to (i) control payments against the respective pre-registered commitments and authorized financial plans in the system/AFMIS starting June 2017, and (ii) produce quarterly commitment reports for each ministry/agency starting January 2018.	End-June 2017	To strengthen cash planning and commitment control and prevent emergence of arrears.
ACD to complete staffing and training of its specialized risk management unit in Customs headquarters, which will be responsible for preparing, testing, and updating comprehensive risk profiles to effectively identify and prioritize high-risk traders/shipments for physical examination and post release verification in all border crossing points and inland customs depots.	End-June 2017	Improve trader compliance and reduce corruption.

Attachment II. Technical Memorandum of Understanding

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

A. Program Exchange Rates and Gold Valuation

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

Exchange Rate	Program Rate
U.S. dollars / euro	1.1224
U.S. dollars / Swiss franc	0.1.0098
U.S. dollars / pounds sterling	1.4502
U.S. dollars / SDR	1.4058
U.S. dollars/Canadian Dollar	0.7626
U.S. dollars / U.A.E. dirham	0.2723
U.S. dollars / Indian rupee	0.0148
U.S. dollars / Pakistani rupee	0.0095
U.S. dollars / Egyptian pound	0.1127
U.S. dollars / Hong Kong dollar	0.1288
U.S. dollars / Russian Ruble	0.015
U.S. dollars / Iranian real	0.000033
U.S. dollars / Saudi Arabian riyal	0.2665

B. Quantitative Performance and Indicative Targets

2. **The quantitative targets for December 2016 and June 2017, specified in Table 1 of the Memorandum of Economic and Financial Policies, are[1]:**

- Floors on revenue of the central government and net international reserves (NIR); and

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

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

3. **The above variables also constitute indicative targets for June and September 2016.** In addition, the program includes the following indicative targets for the four above-mentioned dates:

- Ceiling on the operating budget deficit of the central government excluding grants; and

- Floor on treasury discretionary cash balance and social and other priority spending.

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

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

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

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

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

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

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

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

8. **Net central bank credit to the central government** is defined as the difference between the central bank's claims on the central government and the central government deposits at the DAB, excluding deposits held at the DAB's branches (see paragraph 12). Claims include the so-called "promissory note", in the amount outstanding (at face value) of DAB's claim on a bank in liquidation that has been guaranteed by the ministry of finance though issuance of a promissory note, and up to the amount specified therein.

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

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

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

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

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

b. Under the definition of debt set out in paragraph 11 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

10. **Long-term and medium-term external debt.** A ceiling applies, on a continuous basis, to the contracting and guaranteeing by the public sector of new non-concessional borrowing debt with nonresidents with original maturities of one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from the limits are refinancing credits and rescheduling operations, credits extended by the IMF, and credits on concessional terms as defined below. Consistent with the Public Finance and Expenditure Management (PFEM) Law, the MOF should have sole responsibility for the contracting and guaranteeing of external debt on behalf of the government.

- The definition of "government" includes the budgetary central government, extra-budgetary central government, local government (including government departments), as well as official agencies that do not seek profit and whose budgets are issued independent of the annual operational or development budgets. The public sector comprises the government as defined above, the DAB, and nonfinancial public enterprises. Public enterprises are defined below in paragraph 15.[2]

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

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

11. The zero ceiling on **short-term external debt** applies on a continuous basis to the contracting or guaranteeing of new external debt by the public sector (as defined in paragraph 12 of this memorandum) with nonresidents, with an original maturity of up to and including one year.

- It applies to debt as defined in paragraph 11 of this memorandum.

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

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

12. A continuous performance criterion applies to the **non-accumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or the DAB. External payment arrears consist of external debt service obligations (principal and interest) falling due after July 1, 2016 and that have not been paid at the time they are due, as specified in the contractual agreements. Excluded from the prohibition on the accumulation of new arrears are (i) arrears arising from interest on the stock of arrears outstanding as of July 1, 2016; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

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

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

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

- For the purposes of this performance criterion (i) "state-owned banks" refers to those banks that are wholly or majority owned by the government (as defined in paragraph 12 of this memorandum), including Bank Millie, Bank Pashtany and New Kabul Bank; (ii) "public enterprises in need of restructuring" refers to enterprises that meet either of the following: (a) public enterprises that have not had an audited balance sheet in the past two fiscal years, (b) public enterprises that have been identified by the Ministry of Finance for liquidation, or (c) public enterprises subject to restructuring plans that do not have cabinet-approved restructuring plans; and (iii) "public enterprises" refers to enterprises wholly or majority owned by the government, including state-owned enterprises covered by the State-Owned Enterprise (Tassady) Law, state-owned corporations covered by the Corporations and Limited Liability Companies Law, and other government entities (e.g., Microfinance Investment Support Facility for Afghanistan) and government agencies (e.g., Afghanistan Investment Support Agency) engaged in commercial activities but not covered by the Tassady Law.

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

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

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

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

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

C. Adjustors

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

Date	Accumulative over the Respective Year (Billion Afghani)
December 20, 2016	96.2
June 21, 2017	31.1

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

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

Date	Accumulative over the Respective Year (Billion Afghani)
December 20, 2016	225.7
June 21, 2017	101.0

Should external financing of the core budget (including that associated with off-budgetary spending coming on budget) and the receipts from the sale of nonfinancial assets collectively exceed (fall short of) these projections, the NIR floor will be adjusted upward (downward) and the NCG ceiling will be adjusted downward (upward) by the difference between their actual level and the projected level. The downward adjustment to the NIR floor for these projections will be capped at US$600 million and the upward adjustment to the NCG ceiling for these projections will be capped at Af 29 billion.

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

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

22. Should some **expenditure currently financed directly by donors outside the budget** be moved on to the operating budget, the NIR floor will be adjusted downward, and the NCG ceiling and the indicative targets (ceilings) for the operating budget deficits of the central government, excluding grants, will be adjusted upward, by the actual amount of these expenditures on the conditions that (i) the moving on budget of these expenditures is justified by a statement from donors indicating their decision to stop financing them outside the budget;

and (ii) they are subject to a supplementary appropriation approved by parliament. The downward adjustment to the NIR floors for these conditions will be capped at US$300 million.

D. Provision of Information to the Fund

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

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

- DAB net international reserves: weekly, no later than one week after the end of each week.
- Monetary statistics, including exchange rates, government accounts with the DAB, currency in circulation, reserve money, and a monetary survey: biweekly and no later than 10 days after the end of the month (four weeks in the case of the monetary survey). The monetary survey will include the balance sheet of the DAB and a consolidated balance sheet of the commercial banking sector.
- Core budget operations and their financing: monthly and no later than four weeks after the end of the month. The official reports for program monitoring will be the monthly financial statements from the Afghanistan Financial Management Information System. The structure of financing (grants and loans should be separately identified) and expenditure data should be on a consistent cash basis, with separate identification of direct payments by donors that are included in budget development spending, with a counterpart grant figure. Core operating expenditures should be reported on a monthly basis using the budget appropriation economic and administrative classification in addition to the program and functional classification as reported in the budget documents. Core development expenditures should also be reported separately on a monthly basis using the budget program classification in addition to the economic, administrative and functional classification consistent with the operating budget. All the data should also compare outturns against the approved budget. Core operating and development revenues and expenditures should also be reported by province, separately on the same monthly basis.
- External budget operations and their financing (i.e., donor funded spending outside the core budget treasury systems): semiannually (more frequently if possible) and no later than eight weeks after the end of the period. External development expenditures should be reported on a disbursement basis (as currently defined in budget documents) using the budget program classification (and an administrative, functional and provincial classification where possible).
- External debt data: quarterly and no later than six weeks after the end of the quarter. These will include: (i) details of new loans contracted or guaranteed during the quarter, including the terms of each new loan; (ii) the stock of debt at the end the quarter, including short-term

debt, and medium- and long-term debt; (iii) loan disbursements and debt service payments (interest and amortization) during the quarter; (iv) debt relief received during the quarter; (v) information on all overdue payments on short-term debt, and on medium- and long-term debt, including new external arrears (if any); and (vi) total outstanding amount of arrears.

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

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

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

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

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

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

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

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

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

- Monthly details of the discretionary cash balances held in the Ministry's AFS and U.S. dollar-denominated TSA accounts, and the discretionary development 27232 account. In addition, an update of the monthly summary report of financial flows under operating budget and development budget (discretionary and nondiscretionary), and the updated monthly cash projections for the next 12-months, annual cash projections for the current and following fiscal year.

- Treasury cash balance: weekly report on the treasury (discretionary and nondiscretionary) cash balance.

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

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

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

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

July 1, 2016

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—INFORMATIONAL ANNEX

Prepared By

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

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RELATIONS WITH THE FUND

(As of May 31, 2016)

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	83.00	53.44

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF Arrangements	53.76	16.60

Latest Financial Arrangements

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

[1/] Formerly PRGF.

Projected Payments to Fund[1/]

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

			Forthcoming		
	2016	**2017**	**2018**	**2019**	**2020**
Principal	7.54	15.02	11.58	7.06	5.37
Charges/Interest	0.02	0.04	0.04	0.08	0.07
Total	**7.55**	**15.06**	**11.62**	**7.14**	**5.43**

Implementation of HIPC Initiative:

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

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

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

Implementation of MDRI Assistance: Not Applicable

Implementation of PCDR: Not Applicable

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

Nonfinancial Relations

Exchange Arrangement

Afghanistan is an Article XIV member country. Afghanistan maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions. The authorities confirmed their interest to move to Article VIII status. The *de jure* exchange rate regime is classified as managed floating, although the authorities have been implementing a *de facto* float system with no predetermined path for the exchange rate. On March 22, 2016, the average of the buying and selling exchange rates in cash transactions on the Kabul money exchange market was 68.36 Afghanis per U.S. dollar.

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

Article IV Consultation

The last Article IV consultation with Afghanistan was discussed by the Executive Board on November 18, 2015. Article IV consultations with Afghanistan are held in accordance with Decision No. 14747–(10/96) on consultation cycles adopted on September 28, 2010, as amended.

Safeguards Assessment

An updated safeguards assessment of Da Afghanistan Bank (DAB) was finalized in December 2011. It found that DAB had strengthened some elements of its safeguards framework since the previous assessment (2008), but an effective internal audit mechanism had not been established. The assessment made recommendations to address the risks emerging from the Kabul Bank fraud, including related to central bank autonomy and recapitalization. Since that time, some of the 2011 safeguards recommendations have been implemented, albeit with delay. Amending the law has been difficult, however, and the recommendation concerning the DAB's legal structure remains outstanding. DAB has continued to publish on its website DAB's financial statements audited by an international audit firm.

Technical Assistance, 2011–16

Department	Dates	Purpose
FAD	January 2–12, 2011	PFM Assessment
	January 22–February 4,2011	Customs Administration
	April 1–13, 2011	Customs Administration
	September 15–22, 2011	Program Budgeting Reform
	January 14–18, 2012	Visit to Support SIGTAS Preparations
	January 14–25, 2012	VAT Introduction
	January 14–28, 2012	Customs Administration
	April 4–14, 2012	Follow-up mission (different TA topics)
	April 6–14, 2012	Follow-up mission to review PFM Roadmap
	April 4–14, 2012	Advancing Public Financial Management Reforms
	April 13–May 1, 2013	Customs Administration
	April 29–May 6, 2013	Public Financial Management Reform[1]
	April 29–May 8, 2013	Follow-up mission PFM
	September 26–October 4, 2013	Reform of the Fiscal Regimes for the Extractive Industries
	April 15–21, 2015	Tax Policy for Extractive industries
	May 18-26, 2016	Public Financial Management
LEG	September 21–26, 2013	Diagnostic Review of AML/CFT regime
	February 5–6, 2014	Awareness raising workshop for Parliamentarians (Dubai)
	April 28–May 2, 2014	AML/CFT training for DAB and FinTRACA officials
	November 10–14, 2014	TA on AML/CFT issues
	February 9–13, 2015	AML/CFT training for DAB and FinTRACA officials
	September 6–10, 2015	AML/CFT training for DAB and FinTRACA officials
MCD	August 29, 2011–August 2013	Resident monetary policy and banking advisor
MCM	July 3–5, 2012	Sukuk TA mission
	August 27–29, 2012	Follow-up TA on Sukuk
	November 11–13, 2012	Sukuk TA mission
	February 11–13, 2013	Sukuk Issuance
	May 11–19, 2013	Strengthening the Central Bank's Operations
	September 7–22, 2013	Strengthening the Central Bank's Operations: Update on Monetary Policy Implementation
	December 7–11, 2013	Strengthening the Central Bank's Operations
	March 1–March20, 2015	Problem bank management
	September 8–21, 2015	Problem bank management
	December 4–18, 2015	Problem bank management
	February 22–April 1, 2016	Problem Bank management

METAC[1]	January 2–11, 2011	Financial Planning, Budget Classification
	January 10–14, 2011	Tax Information Systems (workshop)
	April 7–12, 2012	Developing Regulations
	May 22–26, 2011	Sukuk Workshop and TA in Dubai
	October, 2011	General banking supervision issues
	December 10–19, 2011	Consumer price statistics
	January 14–18, 2012	Follow-up on tax administration reforms
	February 11–14, 2012	Sukuk TA Mission
	April 7–12, 2012	Developing regulations
	April 15–26, 2012	Consumer price statistics
	June 16–27, 2012	Enhancing the enforcement framework at DAB
	June 24–27, 2012	Balance of Payments and International Investment Position Statistics
	September 17–20, 2012	Study mission to Lebanon on VAT implementation
	November 3–12, 2012	Review of off-site function
	November 4–14, 2012	Cash Management / Financial Plans
	January 15–22, 2013	Follow-up on Enforcement Framework
	February 16–20, 2013	Balance of Payments and International Investment Position Statistics
	March 30–April 8, 2013	Action Plan for Strengthening Banking Supervision
	November 2–20, 2013	Customs Administration
	January 5–16, 2014	External Sector Statistics
	November 3–7, 2014	External Sector Statistics
	September 8–12 , 2014	VAT implementation / study tour in Beirut
	February 2–25, 2015	Tax and Customs administration
	September 7–11, 2015	External Sector Statistics
	May 8–12, 2016	National Accounts
STA	October 24–November 3, 2011	Monetary and financial statistics
	February 6–17, 2012	National accounts statistics
	April 29–May 12, 2012	National accounts statistics
	January 25–February 5, 2014	Price Statistics
	February 8–12, 2016	Price Statistics

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

Resident Representatives

Mr. de Schaetzen; August 2002–June 2005

Mr. Charap; June 2005–June 2008

Mr. Abdallah; June 2008–January 2014

RELATIONS WITH THE WORLD BANK

(As of June 2016)

1. The new World Bank Group's Program in Afghanistan will be governed by Country Partnership Framework (CPF), which is currently under preparation and will cover a four-year period from FY 2017 through FY 2020. Prior to the CPF the World Bank engagement was defined by Interim Strategy Notes. The CPF will is aligned with country priorities as outlined in the Government; "Realizing Self Reliance: Commitments to Reforms and Renewed Partnership" paper presented to the London Afghanistan Conference in December 2014 as well as its more recent draft Country Development Strategy. The CPF also builds on the findings and recommendations of the Systematic Country Diagnostic (SCD), completed in February 2016.

2. Since 2002, the International Development Association (IDA) has committed a total of US$3.6 billion in grants (86 percent) and credits (14 percent) in Afghanistan. In addition, the Afghanistan Reconstruction Trust Fund (ARTF) has generated US$9 billion from 34 donors, and committed US$4.09 billion for the government's recurrent costs and US$4.32 billion for government investment programs. As of June 2016, there were thirty active investment projects in the portfolio in key sectors including agriculture and rural development, health, education, infrastructure, and public financial management.

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

4. In FY 2016, the World Bank Board approved the Trans-Hindukush Road Connectivity Project in the amount of US$250 million, as well as additional financing for an existing project—the Second Customs Reform and Trade Facilitation Project—in the amount of US$21.5 million. Under the ARTF, three new projects were approved including US$83 million for Naghlu Hydropower Rehabilitation Project, US$6 million for DABS TA, and US$50 million for Higher Education Development Project. Additional financing for existing projects included US$41 million for the Second Public Financial Management Project, US$70 million for the Irrigation Restoration and Development Project, and US$45 million for the On-farm Water Management Project. As of June 15, 2016, in FY2016 (July 1, 2015–June 15, 2016), US$593.7 million was disbursed under the Recurrent Cost Window.

5. The World Bank continues to engage in rigorous analytical work and places large emphasis on policy dialogue. These non-lending activities have been supportive of the Bank's lending program and have played a crucial role in informing government of its strategic choices and advancing dialogue between the Government of Afghanistan and its international development partners. In the last fiscal year, the ARTF Steering Committee endorsed the Research and Analysis

Program (RAP) which aims to support the government's policy reform agenda and decision-making. The program provides an opportunity to introduce innovative ways of working with the government, universities and local research institutions to introduce analysis and generate knowledge. As part of the RAP, the Bank is currently engaged in a series of analytical work to enhance understanding of Afghanistan's growth and fragility challenges and to inform development response by Government and international development partners. The initial results of this work will be presented at the 2016 Ministerial Conference on Afghanistan in Brussels.

6. IFC's committed Investment portfolio in Afghanistan has more than doubled between FY08 and FY14—from around US$58 million to about US$135 million in FY14. Currently, IFC's portfolio stands at about US$54 million and includes one investment in the telecommunication sector (Roshan), one investment in the hotel sector (TPS), and two operations in financial markets (First Microfinance Bank, Afghanistan International Bank—trade facility). IFC's investments have had a transformational impact (in terms of access to finance and outreach), particularly in the microfinance and telecommunication sectors. IFC's Advisory Services program has been supporting the Investment program in the areas of access to finance, Small and Medium Enterprises (SMEs) capacity development, horticulture/agribusiness, and investment climate. IFC will continue to seek new investment opportunities and engage with local players in order to support the development of Afghanistan's private sector, particularly in the areas of infrastructure, finance and microfinance, manufacturing, agribusiness, and services.

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

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

(As of June 2016)

1. The Afghanistan country teams of the World Bank (led by Mr. Saum, country director) and the IMF (led by Mr. Ross until November 2015, and Mr. Duenwald subsequently) held several consultations in 2015 and 2016. The teams regularly exchanged views on the recent economic developments and outlook, identified the macroeconomic priorities and challenges facing Afghanistan, and discussed ways to coordinate their respective work programs.

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

3. The Fund's work program focused on close engagement through the Staff-Monitored Program (SMP) approved in May 2015 and completed in December 2015. It concentrated on the following areas: sustaining macroeconomic stability; advancing fiscal sustainability and strengthening efforts to mobilize domestic revenues; safeguarding the financial sector and improving banking supervision; strengthening economic governance and fight with corruption; improving absorption capacity and government effectiveness. The SMP included a set of quantitative targets, which were met, as well as structural benchmarks which were met, albeit some with delay. As part of the cooperation effort, the World Bank team participated in SMP missions as observer.

4. The Fund focuses its efforts on helping the authorities maintain economic stability, manage the economic transition, and advance important pieces of legislation, including the new banking law, the central bank law, and AML and CFT laws. The Fund has also provided advice on monetary policy, banking supervision, and customs reform. Technical assistance has been provided to the central bank on problem bank management and external sector statistics. The Fund is helping the authorities build on these achievements, including through strengthening economic governance, advancing structural reforms, central bank capitalization framework, developing a fiscal regime for

natural resources, revenue mobilization, further strengthening banking supervision, and improving macroeconomic statistics. The Fund will continue its close engagement with Afghanistan to ensure macroeconomic stability.

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

	Products	Preparations/Mission Timing[1]	Delivery[1]
Fund	ECF program	2011–14	November 2011
	Staff Monitored Program (SMP)	February 2015	May 2015
	Article IV Consultation and First Review under the SMP	September 2015	November 2015
	Second and last review under the SMP	February-March, 2016	April 2016
	Areas of Technical Assistance: Bank restructuring, financial sector supervision, revenue administration, customs and border management, tax policy, public financial management, foreign exchange regulation, AML/CFT, banking law, treasury securities, statistics (national accounts, prices, government finance, monetary, balance of payments, GDDS)		
Bank	Financial Sector Rapid Response Project, Supervision	November 2011–November 2016	October 2013
	ARTF IP Program (2015–2017), Preparation of MoU	April–August 2015	September 2015
	Study: Revenue Review	April 2015–May 2016	May 2015
	Economic Monitoring	Continuous	
	Study: Financial Sector Review	May 2016–May 2017	May 2017
	TA to Fiscal Policy Unit	January 2016–June 2018	continuous
	Debt Management Assistance	February 2016–June 2018	continuous
	Growth and Fragility Report	January 2016–December 2016	December 2016
	Sukuk Market and Pension Reform TA	May 2016–June 2018	
	Fiscal Sustainability Analysis (long-term)	January 2016–September 2016	September 2016
Joint	AML/CFT follow-up	Continuous	
	Dialogue on revenue mobilization	Continuous	
	Dialogue on macro-fiscal stability	Continuous	
	Strengthening of the banking sector	Continuous	
	Debt management	Continuous	

[1] Timing is tentative

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of June 2016)

1. Afghanistan is a founding member of the Asian Development Bank (ADB), established in 1966. Resuming its partnership with Afghanistan, after a hiatus from 1980 to 2001, ADB supports the country's National Development Strategies (NDS) and National Priority Programs (NPPs) as the agreed foundations of the partnership. ADB has demonstrated strong commitment to Afghanistan's development priorities in the London and Kabul conferences in January and July 2010, respectively, and then at the 2012 Chicago and Tokyo conferences, reaffirming its medium- to long-term partnership at the 2014 London conferences and subsequent meetings of senior officials in 2015.

2. Current ADB operations in Afghanistan are based on the Country Operations Business Plan (COBP) 2015–2017 and the Interim Country Partnership Strategy (CPS) 2014–2015. A new COBP will be prepared, which will be aligned with the Interim CPS (extended to cover 2016) and a new CPS that will be prepared for the period 2017–2020. The COBP is fully aligned with NPPs and the government's priorities in the infrastructure sector—the backbone of economic and social development—with ADB's investments contributing to Afghanistan's socio-economic development in the transformation period. The COBP continues ADB's focus on Afghanistan's energy, transport, and agriculture and natural resources sectors and will promote inclusive economic growth, regional integration, governance, and capacity development. The Interim CPS is also aligned with NPPs and the government's development strategy—Towards Self Reliance—a Strategic Vision Beyond 2025.

3. ADB is one of the largest donors to the government of Afghanistan. By end-December 2015, ADB's total assistance comprising grants, loans, and technical assistance (TA) reached US$4.3 billion. Since 2007, ADB has provided all of its public sector assistance on a 100 percent grant basis. Grants make up around 74 percent of ADB's overall assistance to Afghanistan. In the July 2012 Tokyo Conference, ADB committed another US$1.2 billion to support Afghanistan through 2016.

4. ADB supports co-financing of its projects to increase synergies by combining the strengths of development partners, governments, multilateral financing institutions, commercial organizations, and ADB itself. As of December 31, 2015, the cumulative direct value-added official co-financing amounted to US$605.6 million for 24 investment projects and US$23.7 million for 16 TA projects. ADB manages the Afghanistan Infrastructure Trust Fund (AITF)—a financing modality for development partners and private sector who are interested in pooling resources to finance infrastructure projects in Afghanistan. AITF allows development partners to meet the pledge of 50 percent on-budget and 80 percent alignment with NPPs as agreed in the 2010 Kabul Conference. As of 15 March 2016, the total amount received in AITF was US$395.15 million, with total commitments of US$526.90 million, including funds from Japan (Embassy of Japan, US$127.5 million), United States (USAID, US$113.0 million), United Kingdom (DFID, US$119.6 million out of a total commitment of US$251.4 million), and NATO Trust Fund (US$35 million).

5. ADB is the largest on-budget donor in the transport sector. As of December 31, 2015, ADB has provided US$2.2 billion to construct or upgrade over 1,700 km of regional and national roads across Afghanistan. This includes US$808 million for the Transport Network Development Investment Program, which has more than halved travel times on 570 km of regional and national roads. ADB has also helped rehabilitate four regional airports, increasing passenger volumes now more than double the pre-upgrade levels. ADB funded Afghanistan's first railway line between Mazar-e-Sharif and the border of Uzbekistan, which became fully operational in 2012. To date, about 10 million tons of goods have been transported. ADB supported the establishment of the Afghanistan Railway Authority to regulate and ensure the sustainability of the railway sector.

6. As the largest on-budget donor for Afghanistan's energy sector, ADB has helped deliver electricity to more than 5 million people. To date, ADB has provided nearly US$1.2 billion to support energy infrastructure in Afghanistan. These projects include construction of 1,460 km of power transmission lines, 16 substations, 143,000 new power distribution connections to electricity grid and system. The technical assistance projects provide policy and analytical support through the Inter-Ministerial Commission (IMC), Renewable Energy, Gas Sector Development Master Plan, and Energy Sector Master Plans. ADB is also contributing to policy dialogue and donor coordination in the sector, including the financing of master plans for the power and gas subsectors. Key regional projects for Afghanistan are being supported under the Central Asia-South Asia Regional Electricity Markets including the Turkmenistan, Afghanistan, Pakistan, and India (TAPI) gas pipeline project as well as the Turkmenistan, Uzbekistan, Tajikistan, Afghanistan, and Pakistan (TUTAP) electricity project.

7. The natural resources sector is another government priority sector assisted by ADB. As of December 31, 2015, total investment reached US$502 million to rehabilitate and establish new irrigation and agricultural infrastructure, and strengthen the institutional environment to facilitate economic growth and improve water resources management. Around 160,000 hectares of irrigated land have been rehabilitated and upgraded, with work continuing on an additional 260,000 hectares. The investments have led to a more efficient use of water resources, a rise in agricultural productivity, and improved farm livelihoods. Over the coming three years, ADB planned to provide about US$400 million for improved water resources management and infrastructure construction that will led to water use efficiency and better agriculture productivity.

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

9. ADB's private sector operations in Afghanistan began in 2004. As of December 31, 2015, cumulative approvals in six projects have amounted to US$198.1 million. Total outstanding balances and undisbursed commitments to private sector projects amounted to US$3.5 million. One of the major private sector projects is the lending to Roshan Cellular Telecommunications Project. ADB provided financial assistance in the form of direct loans totaling US$70 million for Phases 1 and 2 of the project, as well as B loans and a political risk guarantee. In 2008, ADB approved a direct loan of US$60 million to finance Roshan's Phase 3 expansion. In 2012, this project received an award for

Excellence in Fragile States Engagement from the U.S. Treasury. In the financial sector, ADB invested US$2.6 million in Afghanistan International Bank (AIB), thus establishing the first private commercial bank in the post-Taliban regime. Awarded by The Banker Magazine of Financial Times Newspaper as the best bank in Afghanistan for four straight years (2012, 2013, 2014, and 2015), it is the largest and most profitable bank in Afghanistan with a balance sheet just short of US$1 billion. In January 2016, ADB divested its last shares of AIB but had received US$11.2 million from dividends and put options.

10. ADB is an active member of the Joint Coordination and Monitoring Board (JCMB) and the Afghanistan Reconstruction Trust Fund Management Committee. ADB plays an active part in other donor coordination activities, including the JCMB Social and Economic Development Standing Committee, the Ministry of Finance's High Level Committee on Aid Effectiveness, and the Inter-Ministerial Committee on Energy. ADB strongly supports all international policy dialogues on Afghanistan. Furthermore, it takes the lead in the infrastructure sector and regional cooperation-related policy dialogues. ADB is a member of the core donor group to ensure coordination and harmonization among donors and the government over policy reforms and development programs. ADB consults continuously with civil society and non-governmental organizations with regard to project design and implementation.

STATISTICAL ISSUES

(As of June 2016)

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 by the production and expenditure approaches (the latter in current prices only). 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 2002–2003 base year is more than 10 years old and needs to be updated.
Price Statistics: The CSO compiles and publishes monthly consumer price based on data collected from 10 cities/provinces and the capital city Kabul. Weights are based on the 2011/2012 Afghan Living Conditions Survey (ALCS); and data from the 2013/2014 ALCS will be used to update the index weights and to expand its coverage. Significant improvements are required to align the CPI to international standards and best practices: improving the index calculation, treatment of missing prices, data collection methods, and quality adjustment methods. The CSO faces resource and capacity constraints, and data collection issues tend to results in significant delays. There is currently no PPI for Afghanistan, but there are plans to develop one (dependent on staff and budgetary resources).
Government Finance Statistics: Fiscal data are compiled for the central and general government on cash basis based on the Government Finance Statistics Manual 2001 (GFSM 2001). The timeliness and quality of the central and general government core budget data have been improving, particularly after completion of the roll out and connectivity of the Afghanistan Financial Management Information System (AFMIS) to all central government line ministries and agencies in Kabul and all provincial offices. With IMF support, the Ministry of Finance is implementing GFSM 2001, with annual data for both above and below the line transactions being reported. The authorities are reporting monthly GFS data to the IMF for the central government core budget and the ministry is also working on expanding the coverage of monthly and quarterly GFS data to general government.
Monetary and Financial Statistics: Da Afghanistan Bank (DAB) reports the Standardized Report Forms (SRFs) 1SR for DAB, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of two months. However, the SRF 1SR is compiled manually and there are data reporting issues arising from the restructuring of the Kabul Bank. A mission on monetary and financial statistics, scheduled for August 2016, will assist in developing a classification scheme to automatically generate the SRF 1SR for the central bank and address data reporting issues, including those arising from the restructuring of the Kabul Bank.

Financial sector surveillance: Afghanistan reports 11 of the 12 core financial soundness indicators (FSIs) and 9 of the 13 encouraged FSIs for deposit takers, and 2 FSIs for real estate markets on a quarterly basis for posting on the IMF's FSI website with one quarter lag.

External sector statistics: Balance of payments and international investment position (IIP) statistics have been compiled according to the fifth edition of the *Balance of Payments Manual*. Recently, the DAB has sent the data converted into the sixth edition of Balance of Payments and International Investment Position Manual format to the STA and now the data is under STA's review. Several TA missions provided by METAC have assisted the DAB in improving international accounts compilation in the past years up to September 2015. Although net errors and omissions remain considerable, data coverage has improved and net errors and omissions have decreased. A direct investment survey is needed and consistently revised historical data should be compiled.

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 done.

Table of Common Indicators Required for Surveillance

(As of June, 2016)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	April 2016	6/13/2016	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2016	6/13/2016	M	M	M
Reserve/Base Money	April 2016	6/13/2016	M	M	M
Broad Money	April 2016	6/13/2016	M	M	M
Central Bank Balance Sheet	April 2016	6/13/2016	M	M	M
Consolidated Balance Sheet of the Banking System	April 2016	6/13/2016	M	M	M
Interest Rates[2]	April 2016	6/13/2016	D	M	M
Consumer Price Index	April 2016	6/14/2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	--	--	--	--	--
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	April 2016	6/15/2016	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2015Q2	08/02/2015	Q	Q	Q
External Current Account Balance	2015Q3	1/11/2016	Q	Q	Q
Exports and Imports of Goods and Services	2015Q3	6/15/2016	Q	Q	Q
GDP/GNP	2014/15	06/27/2016	A	A	A
Gross External Debt	...	...	...	...	...
International Investment Position[6]	2015Q2	07/27/2015	A	A	A

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

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

July 1, 2016

REQUEST FOR A THREE YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

Approved By
Daniela Gressani and Bob Matthias Traa (IMF), Satu Kähkönen (IDA)

International Monetary Fund[1]
International Development Association

Afghanistan continues to be at a high risk of debt distress. Although public debt remains modest, Afghanistan's debt sustainability will critically hinge on continued donor grant inflows (38 percent of GDP in 2015, including both on and off-budget grants) under substantial fiscal and external deficits and downside risks in the economic outlook.

Given continued donor support in the form of grants, Afghanistan's debt outlook, under the baseline scenario, is benign. However, a change in the structure of donor financing with a gradual shift to loan financing (a customized illustrative scenario) would quickly lead to an unsustainable debt burden.

Moreover, the outlook is subject to significant downside risks. In addition to aid shortfalls, risks include the fragile security situation, political uncertainty, domestic revenue shortfalls, migrant outflows, and exchange rate depreciation. Accordingly, the authorities should continue their efforts to mobilize revenue and press ahead with their reform efforts, while donors should continue to provide financing in the form of grants.

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

MACROECONOMIC OUTLOOK

1. **The DSA's baseline macroeconomic scenario assumes long-run improvements of security and political stability with continued reform and a gradual decline in aid dependence.** Compared with the November 2015 DSA, perspectives for growth have weakened over the near term. This reflects a deterioration in security conditions, the continued impact of the troop withdrawal, a slower recovery in economic confidence, and delays in budget execution and in implementation of mining projects (discussed below). In the medium and long term, the baseline scenario assumes political stability with regular election cycles and continued economic reform with governments delivering on Afghanistan's development goals and priorities that improve the business environment and governance to support private-sector-led inclusive growth. The scenario also assumes a more conservative (compared with the previous DSA) profile of donor aid disbursement. It is assumed to be sustained near current levels in this decade (averaging about $7 billion, or 35 percent of GDP, annually), and to be gradually declining afterwards, from about 30 percent of GDP in 2020 to 7 percent of GDP by 2035, with an increasing share being disbursed through the budget and provided to the civilian sector.[2]

Box 1. Macroeconomic Assumptions Comparison Table

	DSA November 2015		DSA July 2016		Current vs. Previous	
	2015–19	2020–34	2015–19	2020–34	2015–19	2020–34
Real growth (%)	4.0	4.9	3.1	5.0	-0.9	0.1
Inflation (GDP, deflator, %)	3.3	5.0	5.3	5.1	2.0	0.1
Nominal GDP (Billions of Afghanis)	1399	3980	1446	4467	46	487
Revenue and grants (% GDP)	31.3	32.2	27.6	28.2	-3.7	-4.0
Grants (% GDP)	20.1	15.2	16.9	12.8	-3.2	-2.4
Primary expenditure (% GDP)	31.3	33.0	27.8	28.8	-3.5	-4.3
Primary balance (% GDP)	0.1	-0.8	-0.1	-0.6	-0.2	0.2
Exports of G&S (% GDP)	14.9	23.9	11.7	16.9	-3.2	-7.0
Imports of G&S (% GDP)	56.0	43.5	47.7	39.2	-8.3	-4.3
Noninterest current account balance (%GDP)	-0.2	0.2	1.4	-4.3	1.6	-4.5

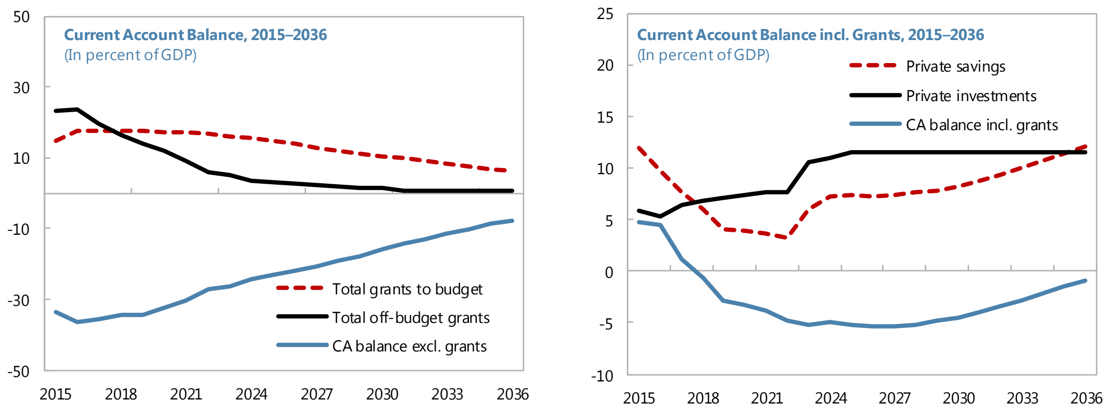
Sources: Afghan authorities; and IMF staff estimates and projections.

2. **Growth is assumed to recover gradually as political stability takes hold and structural reforms are implemented.** Given the highly uncertain environment, staff relies on scenarios rather than projections to quantify the outlook. The macroeconomic framework builds on a scenario presented in the May 2016 Staff Report[3] and assumes implementation of a comprehensive structural reform package. These reforms gradually raise private demand and public investment financed by higher domestic revenues over

[2] The assumptions on exports and imports of goods and services are substantially revised down from the previous DSA, partly reflecting the downward revision of the assumption on grants (with a particularly large impact on imports).

[3] Staff Report for the Second Review under the Staff-Monitored Program.

the medium term. Afterwards growth somewhat declines but is driven by the private sector helped by the strengthened business climate, the impact of continued reforms aimed at macroeconomic and financial stability, and developments across the economy, including mining[4] and large-scale electricity and gas transit projects (the Central Asia-South Asia Electricity Transmission and Trade Project, CASA-1000, and the Turkmenistan-Afghanistan-Pakistan-India natural gas pipeline, TAPI). Accordingly, the external current account deficit is expected to narrow gradually over the projection period.



Sources: Afghan authorities; and IMF staff calculations.

3. **On the fiscal side, the baseline scenario assumes gradual progress towards long-term fiscal sustainability, although the financing gap net of domestic financing remains above 7 percent of GDP over the projection horizon.**

- On the **revenue side**, continuous reforms in revenue and customs administrations, the CASA and TAPI transit fees,[5] and introduction of a VAT[6] in 2022 are assumed to bring the revenue ratio to 12 percent of GDP by 2020 and close to 17 percent of GDP over the projected horizon, in line with World Bank estimates.[7]

- **Development spending,** including the off-budget component, is projected to be about 10 percent of GDP over the transformation decade (2015–2024), with on-budget spending increasing by 2 percent of GDP to 9 percent of GDP, to address Afghanistan's large social and infrastructure needs. Beyond 2024, development spending on budget would wind down gradually and stabilize at about 6 percent of GDP.

[4] Big mining projects are not explicitly incorporated into the medium-term scenario, given that several contracts are being renegotiated and uncertainties stemming from low commodity prices.

[5] Transit fees are assumed at a magnitude of $40 million annually starting in 2020 for the CASA and $250 million annually starting in 2022 for the TAPI.

[6] The VAT is assumed to yield additional 2 percent of GDP over the current business receipt tax.

[7] In Afghanistan Development Update, April 2016, the World Bank estimates that simply by improving enforcement and compliance Afghanistan could collect revenues of up to 14 percent of GDP, and improved tax policy, e.g., introduction of a 10 percent VAT, could raise the revenue intake up to 17 percent of GDP.

- **Operating expenditures** are projected to increase as a share of GDP over the transformation decade, as operation and maintenance costs of existing and newly created capital rise,[8] and the size and compensation of civil service gradually grow after 2020, especially in the health and education sectors. Security spending on- and off-budget remain substantial but decline from about 20 percent of GDP in 2020 to 10 percent of GDP in 2030 and 7.5 percent of GDP by 2035, with the size of security forces gradually declining after the transformation decade as security conditions improve.[9] Thus, operating expenditures peak at around 23 percent of GDP by 2024 and decline to below 20 percent of GDP over the projection horizon as security outlays shrink.

- Given these revenue and expenditure trends, **the total budget balance excluding grants** remains above 17 percent of GDP in the next decade and gradually declines to 8 percent of GDP over the projected horizon.

- With limited scope for domestic financing through a sukuk, projected to be introduced towards the end of this decade for market development and liquidity management purposes, Afghanistan's **financing gap net of domestic financing** remains over 15 percent of GDP until 2024, then declines to 7 percent of GDP by 2035.

- While the **operating budget deficit excluding grants** is projected to fall gradually from more than 9 percent of GDP to less than 3 percent of GDP over the projection horizon, fiscal sustainability, defined as domestic revenues fully covering the operating spending, would not be reached before 2040.

DEBT SUSTAINABILITY ANALYSIS

4. **Afghanistan's public debt remains modest.** Afghanistan passed the HIPC completion point and received debt relief in 2006. External public and publicly guaranteed debt, mostly to multilateral creditors, amounted to $1.2 billion, or 7.0 percent of GDP, in 2015.[10] [11] It is equivalent to 4.0 percent of GDP in

[8] It is assumed that the operations and maintenance costs of civilian infrastructure projects that were previously funded and managed by donors off budget are by 2024 gradually transferred on budget and financed domestically.

[9] It is assumed that the off-budget donor-funded security spending is gradually moved on budget by 2031, with an increasing share financed domestically in line with the increase in domestic revenue.

[10] This debt stock is after delivery of the already-pledged debt relief commitments. Afghanistan is still following up with one Paris Club creditor on its debt relief commitments, as well as with several non-Paris Club creditors on debt relief on comparable terms. In terms of debt structure and composition, most of the external debt is owed to multilateral institutions, mainly regional and international financial institutions.

[11] 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, as the underlying Paris Club agreement was adequately representative and the authorities have made best efforts to resolve the arrears. See "Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors" (https://www.imf.org/external/np/pp/eng/2015/101515.pdf)

present value (PV) terms, about 38 percent of exports, and 40 percent of government revenues (Table 1a). Under the baseline scenario-in which Afghanistan's financing gap, net of domestic financing, is entirely met by grants-the present value of public external debt would be about 3 percent of GDP by the end of the projected period, while total public debt would be 15 percent (Table 2a), both below the indicative debt-burden thresholds applicable to a country like Afghanistan. [12]

5. **Assuming continued donor support in the form of grants, Afghanistan's debt outlook is benign.** In addition to the existing debt stock, a limited amount of highly concessional borrowing from multilateral institutions, which is explicitly linked to big infrastructure projects with potentially high rates of economic and social returns, is planned for 2016. In the subsequent years, limited amounts of similar borrowing are assumed under the baseline scenario.

6. **The standard DSA shocks do not result in very dramatic outcomes.** There is a near-breach of the debt threshold (the present value of external debt to exports ratio), which suggests a vulnerability to distress in the balance of payments (exports). Other debt burden indicators do not respond significantly to the standard DSA shocks. However, it should be noted that the high past GDP growth rates incorporated in the standard shocks reflect a catch-up from a low post-conflict base as well as spending by international troops, while aid flows have been exceptionally large and front-loaded to finance post-conflict rehabilitation and reconstruction.

7. **Potential risks to grant financing put Afghanistan at a high risk of external debt distress.** A customized illustrative scenario assumes a change in the structure of the donor financing with a shift to loan financing and from 2019 on, 15 percent of grants, assumed under the baseline, are replaced by concessional loans.[13] It is further assumed that the nominal GDP levels remain similar to those of the baseline, the level of public services envisaged in the baseline scenario is preserved, and no additional revenue is mobilized. Under such a scenario, two debt burden indicator thresholds (the present value of external debt to GDP and that to exports) are significantly breached.

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

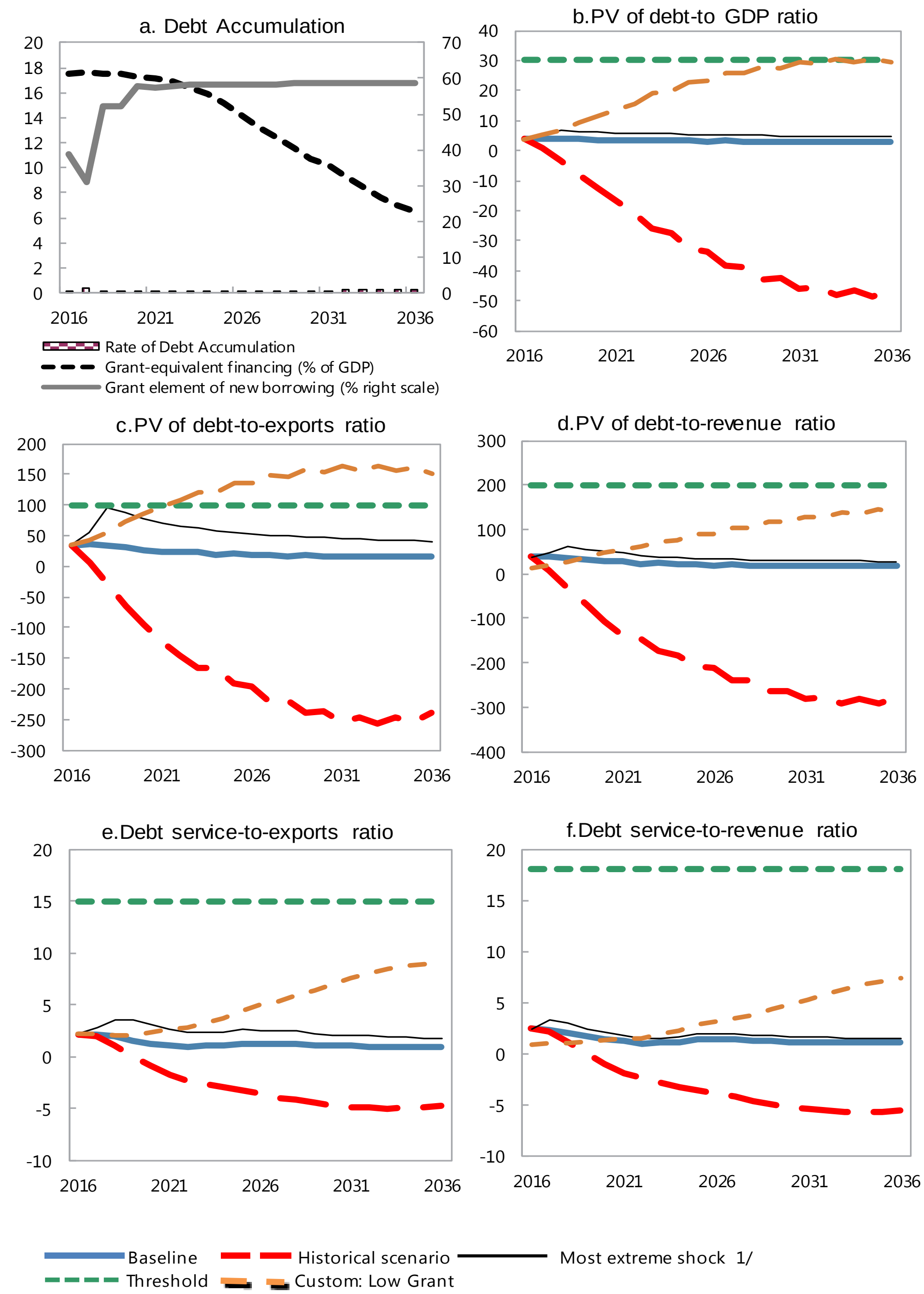
[13] The DSA published in November 2015 assumed a reduction in grants of 50 percent relative to the baseline.

CONCLUSIONS

8. **Afghanistan's debt sustainability critically hinges on continued donor grant inflows.** Afghanistan's public debt remains modest. Given continued donor support in the form of grants, Afghanistan's debt outlook, under the baseline scenario, is benign. However, a change in the structure of donor financing with a shift to loan financing (a customized illustrative scenario) would quickly lead to an unsustainable debt burden. Moreover, the outlook is subject to significant downside risks in addition to aid shortfalls, including the fragile security situation, political uncertainty, domestic revenue shortfalls, migrant outflows, and exchange rate depreciation. Given these risks and large underlying fiscal and external current account deficits, Afghanistan remains at a high risk of debt distress.

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

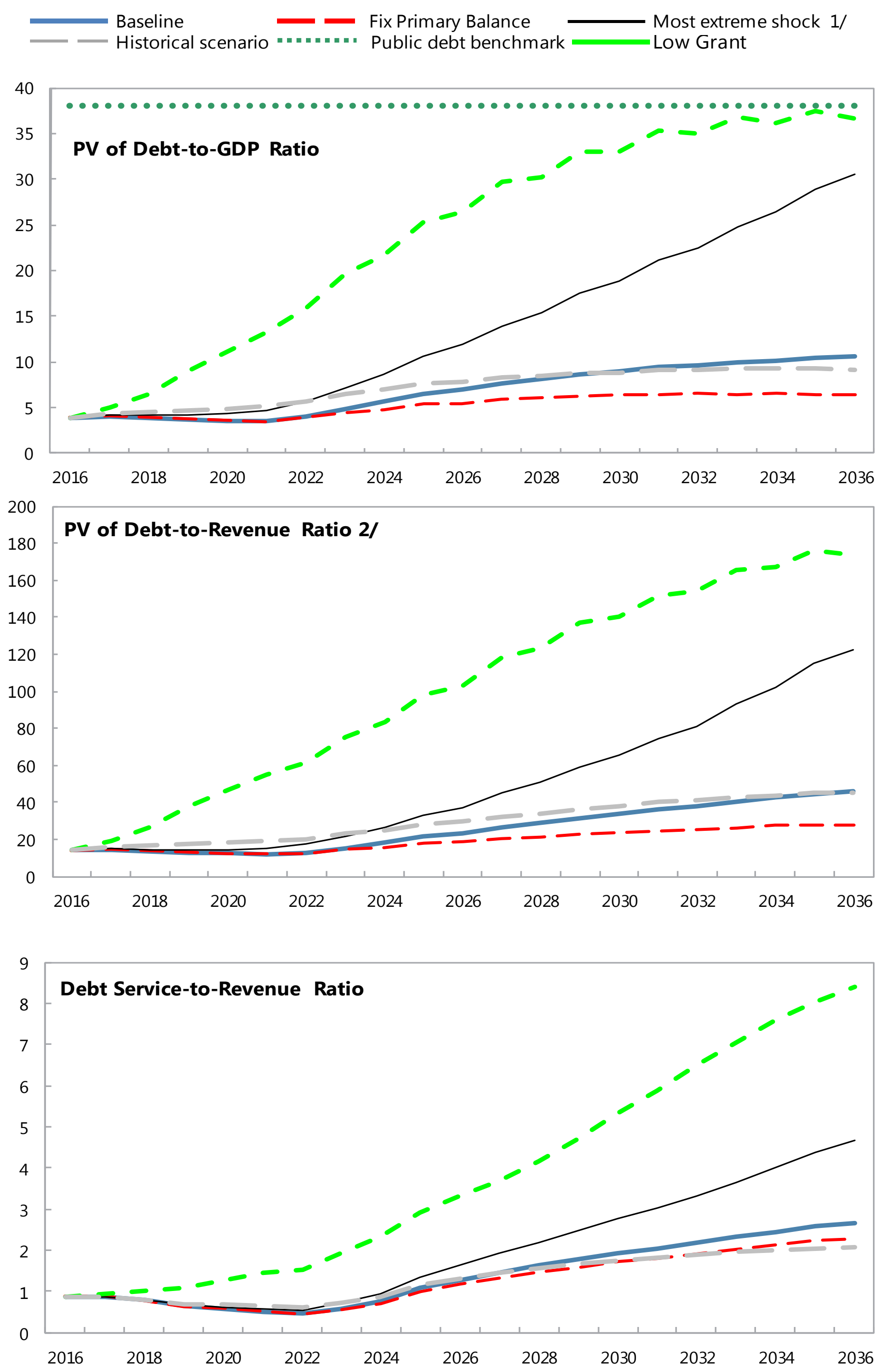
Figure 1. Islamic Republic of Afghanistan: Indicators of Public and Publicly Guaranteeed External Debt Under Alternative Scenarios, 2016–36[1/]



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

1/ The most extreme stress test (under the standardized stress tests) is the test that yields the highest ratio on or before 2025 among the six bound tests in Table 1b.

Figure 2. Islamic Republic of Afghanistan: Indicators of Public Debt Under Alternative Scenarios, 2016–36[1/]



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

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

Table 1a. Islamic Republic of Afghanistan: External Debt Sustainability Framework, Baseline Scenario, 2013–36[1/]

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2016-2021			2022-2036
	2013	2014	2015			2016	2017	2018	2019	2020	2021	Average	2026	2036	Average
External debt (nominal) 1/	**6.9**	**6.5**	**7.0**			**6.9**	**7.0**	**6.7**	**6.3**	**5.9**	**5.6**		**5.2**	**5.8**	
of which: public and publicly guaranteed (PPG)	6.9	6.5	7.0			6.9	7.0	6.7	6.3	5.9	5.6		5.2	5.8	
Change in external debt	0.1	-0.5	0.5			0.0	0.1	-0.3	-0.4	-0.3	-0.4		-0.3	-0.2	
Identified net debt-creating flows	-9.2	0.0	-5.3			-4.9	-2.4	-0.1	2.1	2.5	3.1		4.1	-0.4	
Non-interest current account deficit	**-8.7**	**0.7**	**-4.7**	**-8.7**	**10.6**	**-4.5**	**-1.1**	**0.6**	**2.8**	**3.3**	**3.9**		**5.3**	**0.8**	4.0
Deficit in balance of goods and services	35.9	35.9	34.3			37.7	37.1	35.6	35.6	33.6	31.6		23.7	10.1	
Exports	19.9	15.9	10.7			11.4	11.6	12.0	12.5	13.3	13.9		17.2	19.6	
Imports	55.8	51.7	45.0			49.2	48.7	47.6	48.1	46.9	45.5		40.8	29.7	
Net current transfers (negative = inflow)	-43.1	-34.3	-38.1	-49.7	13.1	-41.0	-36.9	-33.8	-31.6	-29.2	-26.7		-17.5	-8.7	-14.6
of which: official	-43.8	-34.9	-38.2			-41.1	-36.9	-33.7	-31.4	-28.9	-26.3		-16.6	-6.7	
Other current account flows (negative = net inflow)	-1.5	-0.9	-0.9			-1.2	-1.2	-1.2	-1.2	-1.1	-1.0		-0.9	-0.6	
Net FDI (negative = inflow)	**-0.5**	**-0.6**	**-0.9**	**-1.3**	**0.8**	**-0.3**	**-1.1**	**-0.5**	**-0.5**	**-0.5**	**-0.5**		**-1.0**	**-1.0**	-1.0
Endogenous debt dynamics 2/	**0.1**	**0.0**	**0.2**			**-0.1**	**-0.2**	**-0.2**	**-0.3**	**-0.3**	**-0.3**		**-0.2**	**-0.2**	
Contribution from nominal interest rate	0.0	0.0	0.0			0.0	0.0	0.1	0.0	0.0	0.0		0.1	0.1	
Contribution from real GDP growth	-0.3	-0.1	-0.1			-0.1	-0.2	-0.3	-0.3	-0.3	-0.3		-0.2	-0.3	
Contribution from price and exchange rate changes	0.3	0.0	0.3			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**9.3**	**-0.5**	**5.8**			**4.9**	**2.5**	**-0.2**	**-2.5**	**-2.9**	**-3.5**		**-4.4**	**0.2**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	3.8			3.9	4.1	3.9	3.7	3.6	3.4		3.1	3.0	
In percent of exports	...	...	35.7			34.0	35.0	32.6	29.6	26.8	24.3		17.8	15.1	
PV of PPG external debt	**...**	**...**	**3.8**			**3.9**	**4.1**	**3.9**	**3.7**	**3.6**	**3.4**		**3.1**	**3.0**	
In percent of exports	**...**	**...**	**35.7**			**34.0**	**35.0**	**32.6**	**29.6**	**26.8**	**24.3**		**17.8**	**15.1**	
In percent of government revenues	**...**	**...**	**37.7**			**37.6**	**38.0**	**35.4**	**32.3**	**29.7**	**27.3**		**19.3**	**17.7**	
Debt service-to-exports ratio (in percent)	**0.7**	**2.4**	**2.1**			**2.1**	**2.1**	**1.9**	**1.5**	**1.3**	**1.1**		**1.2**	**0.9**	
PPG debt service-to-exports ratio (in percent)	**0.7**	**2.4**	**2.1**			**2.1**	**2.1**	**1.9**	**1.5**	**1.3**	**1.1**		**1.2**	**0.9**	
PPG debt service-to-revenue ratio (in percent)	**1.5**	**4.5**	**2.2**			**2.4**	**2.3**	**2.0**	**1.6**	**1.4**	**1.2**		**1.3**	**1.0**	
Total gross financing need (Billions of U.S. dollars)	-1.8	0.1	-1.1			-0.8	-0.4	0.1	0.6	0.7	0.9		1.6	0.0	
Non-interest current account deficit that stabilizes debt ratio	-8.9	1.1	-5.2			-4.5	-1.2	0.9	3.2	3.6	4.3		5.6	1.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.9	1.3	0.8	7.8	6.3	2.0	3.4	4.3	5.2	5.6	6.0	4.4	4.8	4.8	4.9
GDP deflator in US dollar terms (change in percent)	-4.4	-0.4	-4.0	4.6	8.1	-8.4	1.5	2.4	2.8	2.8	2.8	0.6	1.6	1.9	1.7
Effective interest rate (percent) 5/	0.4	0.4	0.5	0.2	0.1	0.5	0.6	0.8	0.8	0.8	0.9	0.7	1.0	1.1	1.0
Growth of exports of G&S (US dollar terms, in percent)	7.3	-19.6	-34.6	10.0	26.6	-0.5	6.7	10.1	13.2	15.0	13.8	9.7	8.1	8.8	9.1
Growth of imports of G&S (US dollar terms, in percent)	-10.1	-6.4	-15.9	11.0	16.9	2.1	3.9	4.5	9.3	6.0	5.6	5.2	4.0	4.6	3.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	38.7	31.0	52.3	52.3	57.8	57.5	48.3	58.3	58.6	58.4
Government revenues (excluding grants, in percent of GDP)	9.8	8.6	10.2			10.3	10.7	11.0	11.5	12.0	12.3		15.9	16.8	16.0
Aid flows (in Billions of US dollars) 7/	3.0	3.2	2.9			3.2	3.4	3.6	3.9	4.2	4.5		5.1	4.5	
of which: Grants	2.9	3.1	2.9			3.2	3.4	3.6	3.9	4.1	4.5		5.0	4.3	
of which: Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			17.6	17.6	17.5	17.5	17.2	17.2		14.2	6.6	11.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			99.1	97.5	99.3	99.2	99.4	99.3		98.6	96.7	98.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	20.2	20.4	19.7			18.4	19.3	20.6	22.3	24.2	26.4		35.8	69.1	
Nominal dollar GDP growth	-0.6	0.9	-3.3			-6.6	4.9	6.8	8.2	8.6	9.0	5.2	6.4	6.8	6.6
PV of PPG external debt (in Billions of US dollars)			0.7			0.7	0.8	0.8	0.8	0.8	0.9		1.1	2.1	
(PVt-PVt-1)/GDPt-1 (in percent)						0.1	0.4	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Gross workers' remittances (Billions of US dollars)	0.4	0.1	0.2			0.2	0.2	0.3	0.3	0.3	0.3		0.3	0.4	
PV of PPG external debt (in percent of GDP + remittances)	...	...	3.8			3.8	4.0	3.9	3.7	3.5	3.3		3.0	2.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	32.2			30.5	31.5	29.6	27.1	24.7	22.6		16.9	14.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.9			1.9	1.9	1.7	1.4	1.2	1.0		1.1	0.8	

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

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 1b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36

(In percent)

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of debt-to GDP ratio								
Baseline	4	4	4	4	4	3	3	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	4	1	-4	-8	-13	-17	-34	-47
A2. New public sector loans on less favorable terms in 2016-2036 2	4	4	4	4	4	4	4	5
Customized 1: Lower Grants	4	5	7	9	11	14	23	30
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	4	4	4	4	4	3	3	3
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	4	5	7	6	6	6	5	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	4	4	4	4	4	4	3	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	4	4	3	3	3	3	3	3
B5. Combination of B1-B4 using one-half standard deviation shocks	4	2	-1	-1	-1	-1	0	0
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	4	6	5	5	5	5	4	4
PV of debt-to-exports ratio								
Baseline	34	35	33	30	27	24	18	15
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	34	6	-29	-65	-96	-122	-197	-239
A2. New public sector loans on less favorable terms in 2016-2036 2	34	36	34	31	29	27	24	26
Customized 1: Lower Grants	34	43	56	72	86	97	135	151
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	34	34	32	29	26	24	18	15
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	34	55	95	87	78	71	52	40
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	34	34	32	29	26	24	18	15
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	34	38	26	24	21	20	15	13
B5. Combination of B1-B4 using one-half standard deviation shocks	34	19	-8	-7	-7	-6	-3	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	34	34	32	29	26	24	18	15
PV of debt-to-revenue ratio								
Baseline	38	38	35	32	30	27	19	18
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	38	6	-32	-71	-106	-137	-213	-279
A2. New public sector loans on less favorable terms in 2016-2036 2	38	39	36	34	32	30	26	31
Customized 1: Lower Grants	14	19	27	38	48	56	90	140
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	38	38	36	33	30	28	20	19
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	38	47	61	56	51	47	33	28
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	38	39	39	35	32	30	22	20
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	38	41	28	26	24	22	16	16
B5. Combination of B1-B4 using one-half standard deviation shocks	38	19	-7	-6	-6	-5	-2	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	38	53	49	45	41	38	28	25

Table 1b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36 (concluded)

(In percent)

Debt service-to-exports ratio								
Baseline	2	2	2	1	1	1	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	2	2	1	0	-1	-2	-4	-5
A2. New public sector loans on less favorable terms in 2016-2036 2	2	2	2	2	1	1	1	1
Customized 1: Lower Grants	2	2	2	2	2	3	5	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	2	2	2	1	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	2	3	4	3	3	3	3	2
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	2	2	2	1	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	2	2	2	1	1	1	1	1
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	1	1	0	1	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	2	2	2	1	1	1	1	1
Debt service-to-revenue ratio								
Baseline	2	2	2	2	1	1	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	2	2	1	0	-1	-2	-4	-6
A2. New public sector loans on less favorable terms in 2016-2036 2	2	2	2	2	2	1	1	2
Customized 1: Lower Grants	1	1	1	1	1	1	3	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	2	2	2	2	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	2	2	2	2	2	2	2	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	2	2	2	2	2	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	2	2	2	1	1	1	1	1
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	1	1	0	1	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	2	3	3	2	2	2	2	1
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	60	60	60	60	60	60	60	60

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

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a. Islamic Republic of Afghanistan: Public Sector Debt Sustainability Framework Baseline Scenario, 2013–36

(In percent of GDP unless indicated)

	Actual					Estimate	Projections								
	2013	2014	2015	Average 5/	Standard Deviation 5/	2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average
Public sector debt 1/	6.9	6.5	7.0			6.9	7.0	6.7	6.3	5.9	5.7		9.1	13.4	
of which: foreign-currency denominated	6.9	6.5	7.0			6.9	7.0	6.7	6.3	5.9	5.6		5.2	5.8	
Change in public sector debt	0.1	-0.5	0.5			0.0	0.1	-0.3	-0.4	-0.3	-0.2		0.3	0.1	
Identified debt-creating flows	0.7	1.4	2.3			-0.2	-0.3	-0.7	-0.8	-0.6	-0.5		0.1	0.1	
Primary deficit	0.6	1.7	1.4	1.1	1.5	-0.2	0.0	-0.3	-0.3	-0.2	-0.1	-0.2	0.8	0.8	0.7
Revenue and grants	24.3	24.0	25.0			27.8	28.1	28.5	28.8	29.1	29.3		29.8	23.0	
of which: grants	14.6	15.4	14.9			17.5	17.4	17.4	17.3	17.1	17.0		13.9	6.2	
Primary (noninterest) expenditure	25.0	25.7	26.4			27.6	28.1	28.1	28.5	28.9	29.3		30.5	23.8	
Automatic debt dynamics	0.1	-0.1	0.9			-0.1	-0.3	-0.4	-0.5	-0.4	-0.5		-0.7	-0.7	
Contribution from interest rate/growth differential	-0.3	-0.2	0.0			-0.2	-0.3	-0.4	-0.4	-0.4	-0.4		-0.4	-0.5	
of which: contribution from average real interest rate	-0.1	-0.1	0.0			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1		0.0	0.1	
of which: contribution from real GDP growth	-0.3	-0.1	0.0			-0.1	-0.2	-0.3	-0.3	-0.3	-0.3		-0.4	-0.6	
Contribution from real exchange rate depreciation	0.4	0.1	0.9			0.2	0.0	0.0	-0.1	0.0	-0.1		...	...	
Other identified debt-creating flows	0.0	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.5	-1.8	-1.8			0.2	0.4	0.4	0.4	0.2	0.3		0.3	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	3.8			3.9	4.1	3.9	3.7	3.6	3.5		6.9	10.5	
of which: foreign-currency denominated	...	...	3.8			3.9	4.1	3.9	3.7	3.6	3.4		3.1	3.0	
of which: external	...	...	3.8			3.9	4.1	3.9	3.7	3.6	3.4		3.1	3.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	0.7	2.1	1.6			0.1	0.2	-0.1	-0.1	0.0	0.1		1.1	1.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	15.3			14.0	14.5	13.7	12.9	12.2	11.9		23.3	45.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	37.7			37.6	38.0	35.4	32.3	29.7	28.3		43.8	62.9	
of which: external 3/	...	...	37.7			37.6	38.0	35.4	32.3	29.7	27.3		19.3	17.7	
Debt service-to-revenue and grants ratio (in percent) 4/	0.6	1.6	0.9			0.9	0.9	0.8	0.6	0.6	0.5		1.3	2.7	
Debt service-to-revenue ratio (in percent) 4/	1.5	4.5	2.2			2.4	2.3	2.0	1.6	1.4	1.2		2.4	3.7	
Primary deficit that stabilizes the debt-to-GDP ratio	0.5	2.2	0.9			-0.1	-0.1	0.0	0.1	0.2	0.2		0.4	0.7	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.9	1.3	0.8	7.8	6.3	2.0	3.4	4.3	5.2	5.6	6.0	4.4	4.8	4.8	4.9
Average nominal interest rate on forex debt (in percent)	0.4	0.4	0.5	0.2	0.1	0.5	0.6	0.8	0.8	0.8	0.9	0.7	1.0	1.1	1.0
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...		...	...	...	0.9	2.6	1.2
Real exchange rate depreciation (in percent, + indicates depreciation	6.0	0.9	14.7	-1.1	7.6	2.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.0	3.3	2.3	6.7	5.3	4.5	6.0	7.0	7.0	6.9	6.9	6.4	5.0	4.0	4.7
Growth of real primary spending (deflated by GDP deflator, in percer	3.7	4.3	3.5	1.3	1.8	6.7	5.3	4.3	6.6	7.2	7.4	6.2	2.6	3.2	3.5
Grant element of new external borrowing (in percent)	...	...	...	...	...	38.7	31.0	52.3	52.3	57.8	57.5	48.3	58.3	58.6	...

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

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b. Islamic Republic of Afghanistan: Sensitivity Analysis for Key Indicators of Public Debt, 2016–36

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	4	4	4	4	4	3	7	11
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	4	5	5	5	5	8	9
A2. Primary balance is unchanged from 2016	4	4	4	4	4	3	5	6
A3. Permanently lower GDP growth 1/	4	4	4	4	4	5	12	31
A4. Alternative Scenario : Low Grant	4	5	7	9	11	13	26	37
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	4	4	4	4	4	5	9	15
B2. Primary balance is at historical average minus one standard deviations in 2017-201	4	5	6	6	5	5	8	12
B3. Combination of B1-B2 using one half standard deviation shocks	4	5	5	5	5	5	7	10
B4. One-time 30 percent real depreciation in 2017	4	6	5	5	5	5	7	10
B5. 10 percent of GDP increase in other debt-creating flows in 2017	4	8	8	7	7	7	10	13
PV of Debt-to-Revenue Ratio 2/								
Baseline	14	14	14	13	12	12	23	46
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	14	16	17	17	18	19	29	45
A2. Primary balance is unchanged from 2016	14	14	14	13	12	12	18	28
A3. Permanently lower GDP growth 1/	14	15	14	14	14	15	37	123
A4. Alternative Scenario : Low Grant	14	19	26	38	47	55	103	173
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	14	15	15	15	15	15	31	65
B2. Primary balance is at historical average minus one standard deviations in 2017-201	14	18	21	20	19	18	28	51
B3. Combination of B1-B2 using one half standard deviation shocks	14	17	19	18	16	16	25	44
B4. One-time 30 percent real depreciation in 2017	14	20	19	18	17	16	25	44
B5. 10 percent of GDP increase in other debt-creating flows in 2017	14	28	27	25	24	23	33	55
Debt Service-to-Revenue Ratio 2/								
Baseline	1	1	1	1	1	1	1	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	1	1	1	1	1	1	1	2
A2. Primary balance is unchanged from 2016	1	1	1	1	1	1	1	2
A3. Permanently lower GDP growth 1/	1	1	1	1	1	1	2	5
A4. Alternative Scenario : Low Grant	1	1	1	1	1	1	3	8
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	1	1	1	1	1	1	1	3
B2. Primary balance is at historical average minus one standard deviations in 2017-201	1	1	1	1	1	1	1	3
B3. Combination of B1-B2 using one half standard deviation shocks	1	1	1	1	1	1	1	3
B4. One-time 30 percent real depreciation in 2017	1	1	1	1	1	1	2	3
B5. 10 percent of GDP increase in other debt-creating flows in 2017	1	1	1	1	1	1	1	3

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

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

2/ Revenues are defined inclusive of grants.

Statement by Jafar Mojarrad, Executive Director for Islamic Republic of Afghanistan, and Abdelali Jbili, Alternate Executive Director
July 20, 2016

We thank staff for the concise report and the high quality engagement with the Afghanistan authorities during the negotiation of this program. The authorities are also appreciative of the continued support to Afghanistan by the Executive Board and management, and agree with staff analysis and recommendations.

Overview

Over the last decade, Afghanistan has made significant progress in rebuilding the economy and institutions, improving human development indicators, and achieving macroeconomic stability. Further progress, however, has run into strong headwinds stemming from the international troop withdrawal, continued security challenges, and political uncertainty. As a result, growth dropped from an average of 11 ½ percent in 2007-12 to 1 ½ percent in 2013-15, and unemployment, and emigration rose markedly.

The authorities are determined to address these challenges through wide-ranging reforms to promote higher and more inclusive growth, while maintaining financial stability and preparing the groundwork for reduced reliance on donor financing. Having successfully completed a nine-month Staff-Monitored Program (SMP) in December 2015, the authorities are now requesting Fund assistance under a three-year Extended Credit Facility in an amount of SDR 32.38 million, equivalent to 10 percent of quota. Given the absence of an immediate balance-of-payments need, once donor grants are taken into account, the program aims mainly at catalyzing donor support. The authorities welcome the indication that access under the arrangement could be augmented if a balance of payments need were to emerge.

Recent Economic Developments and Outlook

The growth slowdown that started in 2013, accelerated in 2015, with real GDP growth dropping to 0.8 percent. Low oil and food prices and weak domestic demand pushed inflation to negative territory last year (-4.9 percent y/y in July 2015), before it recovered to a positive reading late in that year on account of the sharp depreciation of the Afghani triggered by emigration-related capital outflows.

Despite the weak economic activity, fiscal performance was very strong, with a 22 percent increase in domestic revenue and contained operating budget expenditure, which significantly reduced the operating deficit before grants. The remarkable revenue performance reflected the impact of the tax and revenue administration measures introduced during the second half of 2015, as highlighted in the staff report on the second review of the

SMP. The current account deficit, excluding grants, declined, with lower exports more than offset by lower imports, but remained large at 3 ½ percent of GDP and was more than covered with official grants. Gross international reserves remained at a comfortable level of about nine months of imports.

Preliminary indications for 2016 point to some strengthening in economic activity, with growth estimated at 2 percent, inflation picking up to 4 ½ percent, and further improvement in revenue collection. While the current account deficit before grants will remain large, pressure on the exchange rate has eased in the first few months of 2016, in connection with a slowdown in emigration.

Economic prospects over the medium term are relatively favorable, depending on implementation of the reform agenda, good governance, security improvement, and continued donor support. Downside risks related to any one of these factors cannot be ruled out, and given the challenging tasks ahead, we agree with staff that the payoff of the reforms is likely to be gradual. Under the staff's medium-term scenario, growth would increase gradually to reach 6 percent in 2021, as enhanced governance and improved business climate boost private sector investment and growth. Trade integration and the development of Afghanistan as a hub for regional transportation also hold some growth potential over the medium term. Other quantitative indicators of the medium-term scenario seem sensible, notwithstanding the challenging environment and the high degree of uncertainty surrounding future security developments and donor assistance.

Macroeconomic Policies

Policies under the proposed program will be geared toward preserving macro-financial stability, supporting growth and employment, and maintaining a comfortable buffer of international reserves. Fiscal policy will be prudent to ensure that the overall budget, including grants is in balance in 2016 and beyond, with the bulk of the fiscal improvement coming from stronger revenue performance underpinned by wide-ranging structural fiscal reforms (see below). Over time, the operating budget balance, excluding grants, will become the fiscal anchor. Monetary policy will continue to focus on maintaining low inflation, with reserve money being the nominal anchor due to weak transmission channels, while the flexible exchange rate regime will be maintained to absorb exogenous shocks. The authorities will endeavor to reduce dollarization and strengthen confidence in the Afghani, and DAB will enhance its communication via regular publications.

Structural Reforms

The critical role of structural reforms in establishing solid foundations for growth has been recognized over the years, including by the Afghanistan National Development Framework, and re-confirmed at several donor meetings, including the London Conference in December

2014. Focusing on the areas in the Fund's purview, the proposed program puts emphasis on: (i) fiscal reforms to strengthen domestic revenue mobilization and raise the quality of government spending; (ii) completing financial sector restructuring and enhancing its contribution to growth; (iii) strengthening governance and the fight against corruption; and (iv) improving the business environment in collaboration with the World Bank and other development partners.

Fiscal reforms

Revenue mobilization will focus on further strengthening the revenue and customs departments along the lines of the five-year rolling reform plans established in consultation with development partners as detailed in the MEFP (¶22-23). Building on the important steps taken in recent years, key priorities going forward include improved cooperation and information sharing between the two administrations and strengthening their human and technical capacity, which will improve compliance and reduce corruption. While there is limited room for introducing new taxes, the authorities will explore the possibility of tapping other sources of revenue, including excises on selected goods and services, and reducing tax exemptions. They agree with staff that VAT introduction can be considered over the medium term after implementation capacity has been strengthened. They intend to develop by end-2017 an effective and transparent fiscal regime for natural resources in compliance with Extractive Industries Transparency Initiative (EITI) requirements, and with IMF technical assistance, which should help enhance and diversify the revenue base as the sector develops.

A strengthened public finance management system is necessary to enhance the efficiency of public spending, make a better use of diminishing donor resources, and ensure that budget allocations are aligned with national development priorities. Key priorities will be to improve the formulation and execution of the budget and follow up of development projects, strengthen commitment control and cash management, and enhance fiscal reporting and transparency. The authorities plan to address these issues through various reforms that are outlined in the Public Finance Management Road Map II and the MEFP (¶25), and will continue to work toward establishing a consolidated national budget to integrate the operational and development budgets while engaging donors to increase flexibility of funding. They will also improve monitoring of the performance of state-owned enterprises and strengthen the MOF's oversight over their finances. To this effect, they intend to work with Parliament to amend the laws governing public enterprises and corporations.

Financial sector reforms

The financial sector strategy under the program aims at bringing the resolution of Kabul Bank to an end, strengthening prudential regulations and bank supervision, and developing a more inclusive financial intermediation infrastructure. In this regard, preparatory work is underway to develop a National Financial Inclusion Strategy with World Bank assistance to improve access to finance, broaden the range of financial instruments available to the private sector, strengthen consumer protection, and improve financial literacy.

Progress has been achieved in asset recovery and settlements related to the defunct Kabul Bank, with the New Kabul Bank (NKB) now transitioning from a temporary bridge bank to a deposit-taking institution and close to becoming profitable. The authorities intend to recapitalize NKB by end-December 2016 and relieve it from any future exposure linked to the liquidation of Kabul Bank. Eventual privatization of NKB will be kept under review. Similarly, Da Afghanistan Bank's (DAB) balance sheet will be cleaned from the lender-of-last resort loan to Kabul Bank (US$ 825 million) in steps over the next three years involving budget transfers to the Kabul Bank receivership and assignment of DAB's 2015 profits (MEFP ¶28). The authorities are committed to facilitating completion of an updated assessment of DAB under the Fund's Safeguards Assessment Policy by the first program review.

Efforts will be made in cooperation with the World Bank to address governance and management shortcomings at the three state-owned commercial banks (SOCBs), and a newly established unit will monitor and report on the fiscal risk posed by SOCBs. More broadly, the authorities will continue to build capacity in the areas of prudential regulations and bank supervision by implementing the recommendations of the 2014-2018 Strategic Action Plan developed with assistance from the Middle East Technical Assistance Center. Building on the progress in establishing a legal framework for AML/CFT, the authorities will ensure its effective implementation, in particular with regard to the regulation on currency reporting at borders and the fit and proper regulation. They are committed to implementing the action plan agreed with the Financial Action Task Force (FATF) by September 2016 in order to exit the FATF's monitoring process promptly.

Economic governance and business climate

The authorities are aware of the significant challenge posed by corruption and its debilitating effect on the Afghan economy. They are putting together a comprehensive strategy to strengthen the anti-corruption framework, and have established a High Council for Good Governance, Justice, and Anti-Corruption chaired by the President to coordinate actions by various agencies and enforcement authorities. The authorities' plan under the ECF is to improve the legal framework to ensure that acts of corruption are criminalized in line with the UN Convention against Corruption, and there are plans to establish a special court for financial crimes. Moreover, while declarations of assets of top-ranking officials are already published, the authorities will strengthen the asset declaration regime including by improving transparency of asset declarations of other high level officials in customs and tax administrations and law enforcement agencies (MEFP ¶37). The authorities will continue to work with the World Bank to improve the business climate and address serious challenges related in particular to licensing procedures, property registration, enforcement of contracts, connecting to electricity, and trading across borders.

Conclusion

The authorities are determined to address the many challenges facing the economy, and are committed to implement the policies and reform agenda under the proposed-ECF-supported program. They are hopeful that the donor community will remain fully engaged with them during this difficult transition while they prepare for shouldering an increasing share of the financing and build adequate implementation capacity. The authorities are grateful for the Fund support and look forward to continued close cooperation under the new program.