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ISLAMIC REPUBLIC OF AFGHANISTAN

May 2015

STAFF-MONITORED PROGRAM—PRESS RELEASE; AND STAFF REPORT

In the context of the Staff Monitored Program, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's information following discussions that ended on February 28, 2015, with the officials of the Islamic Republic of Afghanistan on economic developments and policies underpinning the IMF arrangement. Based on information available at the time of these discussions, the staff report was completed on May 7, 2015.
- An **Informational Annex** prepared by the IMF staff.

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 *
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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June 2, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Managing Director Approves a Staff-Monitored Program for the Islamic Republic of Afghanistan

The Managing Director of the International Monetary Fund (IMF) has approved a Staff-Monitored Program (SMP) for the Islamic Republic of Afghanistan covering the period of April-December, 2015.[1]

Afghanistan completed a peaceful transfer of power in September 2014, with the conclusion of the presidential elections and establishment of the national unity government. The new government is resolved to push ahead with economic reforms and improve governance to promote economic growth and development that benefits all Afghans. The international community and key donors have reaffirmed their partnership and commitment to Afghanistan at the London Conference held in December 2014. They welcomed the new government's commitment to macroeconomic stability and reforms that will promote sustainable and inclusive growth.

The SMP is designed to support the authorities' reform agenda with a framework to address economic vulnerabilities and facilitate engagement with the international community to sustain donor support. The SMP will foster continued close engagement with Afghanistan, address immediate fiscal and banking vulnerabilities, and help manage risks. The SMP will also preserve buffers (low debt and a comfortable international reserves position), maintain low inflation and competitiveness, and lay the basis for high and inclusive growth. The budget and external deficits are projected to be financed by donor grants.

Under the SMP, fiscal policy will focus on mobilizing domestic budget revenue to finance projected expenditure and rebuild the treasury's cash balance. Monetary policy will aim to preserve low inflation, and exchange rate policy will protect international reserves and competiveness. Structural reforms will focus on: (i) budget revenue mobilization, expenditure control and repayment of arrears; (ii) financial sector reform to promulgate and implement the new banking law, amend the central bank law, strengthen banking supervision to deal with weak banks; and (iii) better economic governance by strengthening anti-corruption, anti-money laundering and countering the financing of terrorism regimes.

[1] An SMP is an informal agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic program. SMPs do not entail financial assistance or endorsement by the IMF Executive Board.

The IMF has assisted Afghanistan in strengthening economic institutions and in providing advice to the government on economic policies and reforms for more than a decade. IMF staff will work closely with the authorities to monitor progress in the implementation of their economic program. In addition, the IMF will continue to provide technical assistance to support Afghanistan's capacity-building efforts and its reform program. The SMP is designed to build a track record and successful performance will catalyze donor flows and support a future request for an Extended Credit Facility (ECF) arrangement.

ISLAMIC REPUBLIC OF AFGHANISTAN

May 7, 2015

STAFF-MONITORED PROGRAM

EXECUTIVE SUMMARY

Context: Political and security uncertainties and an inadequate policy response led to lower growth and emergence of important fiscal and banking vulnerabilities in 2014. The establishment of a national unity government and the December 2014 London Conference has helped build confidence and reconfirmed donor support for Afghanistan. The proposed staff-monitored program (SMP) will foster continued close engagement with Afghanistan, address vulnerabilities, and help manage risks. An independent staff team is preparing an ex post assessment of the Funds' engagement with Afghanistan since 2006 and its report will be sent to the Executive Board separately.

Focus of the SMP: In the attached Letter of Intent, dated May 6, 2015, the authorities requested a new SMP covering the period April 1, 2015–December 31, 2015. The SMP will aim to mobilize revenue and address urgent banking vulnerabilities. Successful performance under the SMP would support a future request for an IMF financial arrangement, foster macroeconomic stability and inclusive growth.

Policy recommendations: Fiscal policy will focus on mobilizing domestic revenue and rebuilding the treasury's cash balance. Monetary policy will aim to preserve low inflation and maintain exchange rate flexibility to protect international reserves and competiveness, and avoid excessive volatility. Structural reforms will focus on: (i) revenue mobilization, expenditure control and repayment of arrears; (ii) financial sector reforms to deal with weak banks, promulgate the new banking law, amend the central bank law, strengthen banking supervision, and address weaknesses in state banks including New Kabul Bank; and (iii) improving economic governance by strengthening the anti-corruption, anti-money laundering, and countering the financing of terrorism regimes.

Risks to the SMP: Risks, mostly on the downside, are related to adverse security developments, inadequate implementation of economic policies, political instability, and donor fatigue. Large security and development expenditure needs mean that Afghanistan will remain dependent on donor financing for an extended period. On the upside, a political agreement that improves security conditions, stronger domestic demand and early development of mining projects would result in faster growth.

Approved By
Adnan Mazarei (MCD) and Dhaneshwar Ghura (SPR)

Discussions were held in Dubai during November 10–25, 2014 and February 18−28, 2015. The staff team consisted of Messrs. Ross (head), Demirkol, Alkhunaizi, (all MCD), Mr. Tudyka (FAD), Mr. Naseer (MCM), and Mr. Meyer-Cirkel (SPR). Mr. Esposito and Ms. Marian (LEG) joined the November mission; and Ms. Chen, Mr. El Khoury (LEG), and Mr. Moore (MCM) supported the mission from headquarters and Ms. Elif Ture (FAD) contributed to the staff report. The missions met with Minister of Finance Eklil Hakimi, and his predecessor and National Economic Advisor Omar Zakhilwal, Acting Governor of the Central Bank Khan Afzal Hadawal and his predecessor Noorullah Delawari, and other senior officials. Yi Liu provided research assistance and Norma Cayo, Maria Orihuela, Vanessa Panaligan, and Danielle Bieleu (all MCD) were responsible for word processing and document management.

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APPENDIX

BACKGROUND AND RECENT DEVELOPMENTS

1. **Presidential elections were completed in late-September with the inauguration of President Ghani and Chief Executive Abdullah, but formation of the new government was prolonged and a central bank governor has not been confirmed**. President Ghani and Chief Executive Abdullah introduced a new cabinet of ministers and candidate for Da Afghanistan Bank (DAB) governor in January. Parliament confirmed nine of 25 ministerial candidates in January, including the new finance minister, and another 16 nominees in mid-April. The appointment of the DAB governor is pending.

2. **Political and security uncertainties in 2014 resulted in lower economic activity and the emergence of significant fiscal and banking vulnerabilities**. Those uncertainties peaked during the second round of presidential elections in 2014. The withdrawal of international troops, the prolonged political transition, and inadequate policy response resulted in lower economic confidence and activity. Fiscal vulnerabilities emerged as spending pressures increased, despite a significant revenue shortfall. The treasury cash balance was eroded and payment arrears and unfunded allotments emerged in 2014. Banking sector vulnerability increased because of lax enforcement and delays in financial sector reforms. Dangerous weaknesses emerged in two banks, including a systemic one, while six other banks' financial condition remained weak.

3. **In early 2015, donor support and policy actions helped to redress these vulnerabilities**. Additional donor financing was used to clear part of the arrears[2] and the treasury cash balance has recovered. Moreover, the authorities prepared credible revenue measures as part of a revised 2015 budget and committed to contain expenditures. The authorities also acted to address banking sector vulnerabilities and weaknesses.

4. **Donors reaffirmed their support at the December 2014 London Conference**. They welcomed the government's plans to strengthen revenue collection and the banking sector, to prioritize expenditure and to improve the investment climate. The authorities committed to deliver on their plans ahead of the Senior Officials Meeting (SOM) in 2015.[3] Donors reaffirmed their Tokyo commitments. In March 2015, the U.S. announced a slower withdrawal of its noncombatant troops and reconfirmed its support.

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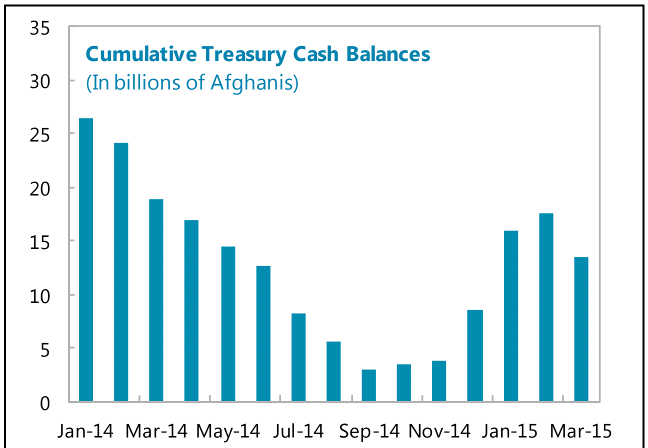
[2] These arrears are domestic.

[3] See paragraph 16 of The London Conference on Afghanistan Communiqué. Available via the Internet: https://www.gov.uk/government/publications/communique-from-the-london-conference-on-afghanistan.

ECONOMIC PERFORMANCE IN 2014 AND EARLY 2015

5. **The Extended Credit Facility (ECF) arrangement expired in November 2014**. The first program review was completed in June 2012 but subsequent reviews were delayed, because performance was not in line with the targets set at the first review, due to unanticipated shocks, an inadequate policy response, and delays in structural reform implementation. In late 2013, the authorities and staff agreed on a set of informal quantitative targets and structural measures for 2014. These targets and measures aimed at maintaining macroeconomic stability and structural reform momentum. The authorities' adherence to the quantitative framework was uneven and structural reforms were delayed (Table 1).

6. **Economic performance in 2014 suffered from political and security uncertainties**. Growth is estimated to have declined to 1.5 percent in 2014 from 3.7 percent in 2013. While agricultural output remained close to the bumper level of 2012, nonagricultural growth slowed significantly as uncertainties sapped private sector confidence. Inflation declined to 1.4 percent year-on-year in December, supported by lower fuel and food prices and a sharp decline in housing prices, despite accommodative monetary policy. Lower imports helped contain the pressure on international reserves. The exchange rate depreciated slightly against the U.S. dollar. Net international reserves increased somewhat and import cover remained comfortable.

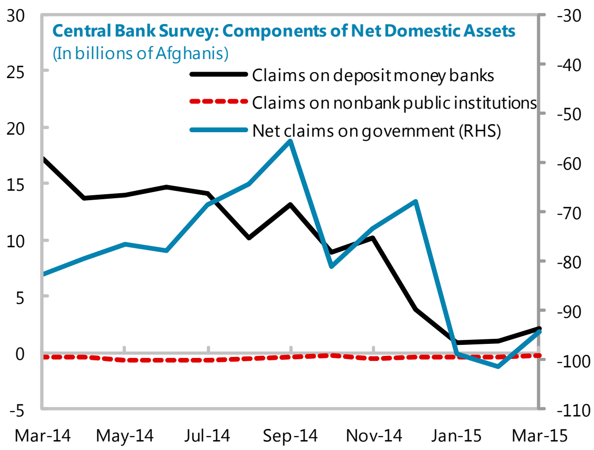


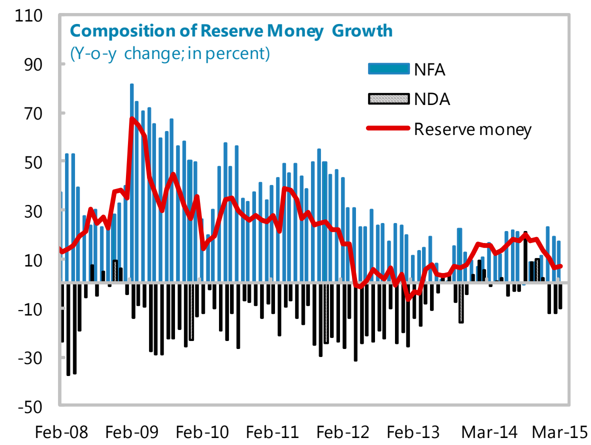
Sources: Afghan authorities; and IMF staff calculations.

7. **Revenue underperformance coupled with increasing expenditures eroded the treasury's cash balance**. Weak growth, declining imports, and lower compliance resulted in lower domestic revenue collection in 2014, which was Af 100 billion, below Af 109 billion collected in 2013 and the 2014 target of Af 128.8 billion. Operating budget expenditure increased, because off-budget security-related spending was moved on budget (with donor grant financing), and because of higher social spending resulting from new benefits for martyrs and disabled people. Lower revenue and higher expenditures eroded the treasury's discretionary cash position in the second half of 2014.

8. **Monetary policy was accommodative, but the exchange rate and international reserves remained broadly stable**. A notable change in 2014 was that the contribution of net foreign assets to reserve money growth declined substantially, and net domestic assets contributed to money creation as the government drew down its deposits to finance spending. DAB did not sterilize the

drawdown of government deposits, caused by the erosion of the treasury's cash balance. The money multiplier also declined, indicating declining confidence in banks. The exchange rate depreciated by 4.1 percent in nominal terms in 2014 and the central bank maintained a comfortable reserve buffer, gross international reserves were $7.2 billion at the end of 2014 or 7½ months of imports. Notwithstanding accommodative monetary policy, inflation remained low.





Sources: Afghan authorities; and IMF staff calculations.

9. **Financial sector vulnerability increased during 2014**. Weak governance and regulatory forbearance early in 2014 led to a deterioration in the financial positions of some banks (lower asset stock quality and capital), which was partly mitigated by stepped-up enforcement in late 2014. Eight of the 15 banks are classified as weak (rated 4 or 5 according to CAMEL methodology). In late 2014, corrective measures started to be implemented.

10. **Some progress was made with important economic reform laws**. New anti-money laundering (AML) and countering the financing of terrorism (CFT) laws were enacted in late June and early July 2014, respectively, and CFT regulations to implement the relevant United Nations Security Council Resolutions finalized in October 2014, based on IMF Legal Department technical assistance. However, the introduction of a VAT was postponed. In response to the authorities' concerns, staff reviewed the tax administration's readiness for a VAT introduction, concluded that it is not in a position to facilitate a successful introduction in the near term, and VAT introduction should be postponed while the tax administration is strengthened. The banking law is in parliament and amendments to the DAB law are being reviewed by the ministry of justice.

11. **Kabul Bank asset recovery has been limited**. Between February 28, 2014 and January 31, 2015 cash recoveries amounted to $4 million bringing total cash recoveries to $179 million. The new president has issued a decree to reinvigorate asset recovery efforts and

review criminal cases in October. Following the completion of judicial review, the two largest former shareholders were sentenced to repay about $375 million and their jail sentences were increased from 5 to 15 years each. Also, the authorities sent requests for mutual legal assistance to a number of foreign jurisdictions to facilitate asset recovery.

12. **Fiscal and monetary developments in the first quarter of 2015 were affected by a larger than expected external inflows to the budget**. Discussion of the revised 2015 budget delayed its approval to January 28, 2015. Revenue was higher than targeted, expenditure lower (in part due to the delay in budget approval), and grants exceeded their projected level substantially. As a result, the budget recorded a substantial surplus in the first quarter of 2015 (2 percent of annual GDP higher than projected). The government accumulated substantial deposits in DAB, which together with seasonal factors, reduced reserve money in the first quarter by 7.8 percent. Although NIR increased during the first quarter, because of the large external financing to the budget, they increased less than planned, because of foreign exchange market intervention, particularly in January when there was high demand for foreign exchange. As a result, the authorities met the all end-March indicative targets, except the adjusted NIR target. Inflation moved into negative territory in the first quarter falling to -0.7 percent year-on-year in March, driven by declines in housing, transportation, and food prices.

MACROECONOMIC OUTLOOK 2015–16

13. **Growth is projected to recover to 3.5 percent in 2015 and increase to 5–6 percent per year in the medium term**. The projected recovery in 2015 is based on declining political uncertainty. With continued reform, donor support and increased confidence, growth is projected to pick up in 2016 and inflation to remain in single digits, supported by favorable global food prices. The recovery of growth over the medium term will depend on a recovery in domestic demand, large mining projects, and security conditions.

14. **The outlook is subject to significant downside risks**. If domestic or regional security conditions deteriorate, the anticipated recovery in economic confidence could be delayed, which would slow investment and growth. If agricultural output were to decline, it would affect growth and might cause food price pressures. Also, the recovery in economic confidence will depend on consistent implementation of reform policies, which is needed to facilitate donor support. A continued and predictable flow of donor assistance will support macroeconomic stability. Further delays in large mining projects could reduce growth prospects. On the upside, a political agreement that results in a rapid improvement in security conditions, a faster recovery in domestic demand, and early development of large mining projects could result in higher confidence, and economic activity.

THE STAFF-MONITORED PROGRAM

A. The 2015 Program

15. **The authorities are determined to improve the economy and living conditions of all Afghans**. Their vision for the Afghan economy, their program, and policy priorities were laid out in their *Realizing Self-Reliance* paper prepared for the December 2014 London Conference.[4] Discussions on an SMP were initiated at the 2014 Annual Meetings and continued over the past months. The authorities started to address economic vulnerabilities through enforcement actions in banking sector and a revised 2015 budget. The authorities consider the successful implementation of the SMP as being critical to increase economic confidence and generate support for their reforms. Good performance under the SMP will help sustain donor flows and the SMP's reforms will inform the updating of the Tokyo Mutual Accountability Framework at the 2015 SOM.

16. **The SMP will address immediate fiscal and banking vulnerabilities, preserve macroeconomic stability, and seek to lift growth**. The macroeconomic policy mix will maintain buffers (of low debt and international reserves), low inflation and protect competitiveness. Fiscal policy will support growth by mobilizing domestic revenue (and catalyze donor support) to finance projected expenditure, and build the treasury's cash balance, while avoiding debt accumulation. Monetary policy will aim to preserve low inflation and exchange rate policy will protect international reserves and competitiveness. Structural reform will focus on: (i) fiscal revenue mobilization and expenditure control; (ii) the financial sector; and (iii) economic governance. The nine-month SMP is designed to build a track record and successful performance would support a future request for an extended credit facility (ECF) arrangement from the authorities. A possible future ECF supported program would maintain macroeconomic stability, improve the business environment and economic governance to foster private sector activity and facilitate broad-based inclusive growth and an improvement in social indicators.

Macroeconomic Framework

17. **The macroeconomic framework aims at preserving macroeconomic stability and promoting growth**. It projects a pick-up in real GDP growth to 3.5 percent and average inflation of about 4 percent in 2015. It will maintain low debt and protect international reserves position. It also envisages protecting competitiveness, with the overall budget in broad balance and the current account in surplus initially and moving to a deficit over the medium term. The operating balance excluding grants remains the fiscal anchor to assess the need for donor support to finance operating outlays, while reserve money remains the monetary anchor. The budget and external deficits are projected to be financed by donor grants.

[4] The authorities' reform program is presented in the paper "Realizing Self-Reliance: Commitments to Reforms and Renewed Partnership." Available via the Internet: http://www.afghanistan-un.org/2014/12/realizing-self-reliance-commitments-to-reforms-and-renewed-partnership/.

18. **Improving revenue performance is a critical objective**. Domestic revenue is projected to increase by 1 percentage point of GDP (to 9.6 percent of GDP) supported by both measures and improved compliance. Additional revenue measures in 2015 are projected to raise about Af 10 billion (0.8 percent of GDP). These measures include an increase in the business receipts tax rate, higher import tariffs, introducing a telecommunications tax, tripling the fuel fee collected at customs, and increasing overflight fees for using Afghanistan's airspace. Improvements in compliance are projected to increase revenues by Af 4 billion (0.3 percent of GDP). The authorities have already increased import tariffs and overflight fees, which are projected to yield Af 1.5 billion in 2015. They plan to implement the other measures in June 2015, which are projected to yield Af 8.9 billion in 2015 and need parliamentary approval. In addition, the authorities have identified contingency measures totaling Af 4 billion that can be deployed swiftly, if budget execution is not in line with their plans.

19. **The revenue measures to be introduced in 2015 will support medium-term revenue mobilization**. These measures will mobilize extra revenue of over 1 percent of GDP per year in the medium term and so mitigate the revenue impact of the postponement of the VAT introduction. In addition, a strengthening of the tax administration will also help build revenue, improve governance, and facilitate VAT introduction in the medium term.

20. **The SMP will target strict expenditure control and reducing waste**. Operating spending is expected to increase slightly from 19.5 percent of GDP in 2014 to 20.2 percent in 2015, as the move of security-related expenditures on-budget (with grant financing) adds to operating spending, but not the overall deficit. Capacity constraints are expected continue to limit execution of grant-financed budget outlays. The rationalization of nonsecurity spending is expected to proceed while protecting pro-poor spending, which will be maintained at 2.6 percent of GDP, close to its 2014 level. In particular, payments to martyrs and disabled—currently at 66 percent of total pension spending—will be better targeted, while safeguarding spending on health and education. The operating deficit, excluding grants, is projected to decline to 10.5 percent of GDP in 2015 from 11.0 percent in 2014. Discretionary development spending will be higher than in 2014.

21. **Improved coordination of the ministry of finance's budget and treasury departments is a priority**. The ministry will link in-year allotments to cash availability to ensure that the government's payment obligations remain within projected cash availability to avoid arrears and ensure the treasury's discretionary cash balance does not fall below Af 5 billion during 2015. Implementation will start with weekly meetings of a cash management committee chaired by the minister of finance. All arrears lawfully incurred in 2014 will also be settled.

22. **Monetary policy will aim to preserve low inflation and exchange rate policy will protect international reserves and strengthen competitiveness**. DAB will carefully manage money growth with continued exchange rate flexibility to ensure it meets its net international reserves targets going forward. More active coordination between the ministry of finance and DAB on expected amounts and timing of revenue and external financing to the budget and expenditure execution will help manage reserve money. To improve further monetary policy operations, the authorities have introduced shorter maturity, seven-day, capital notes and plan to make further

improvements that could include reserve requirement averaging and reinvigorating DAB's standing credit and deposit facilities, which were little used recently.[5] A modest pick-up in money demand is anticipated in 2015 as economic confidence recovers. The monetary program envisages a modest accumulation of net international reserves (NIR) ($150 million). International reserve cover will remain at 7½ months of imports. The authorities will intervene to avoid excessive exchange rate volatility.

Structural Reforms

23. **The SMP aims to reinvigorate structural reform**. Fiscal reforms will focus on revenue mobilization, efficient use of public resources, and avoiding pressures on the cash balance. Financial sector reforms will address immediate vulnerabilities in the banking sector, deal with weak banks, and strengthen banking supervision. Economic governance reform will strengthen the AML/CFT regime and legislative and institutional framework to combat corruption.

Fiscal Reforms

24. **Better tax administration will mobilize revenue and improve governance**. The SMP will strengthen the capacity of the Afghan Revenue and Customs Departments (ARD and ACD). The taxpayer register for Kabul will be updated by end-May 2015 and extended to provinces as soon as feasible, which in some areas will depend on security conditions. This updating will facilitate effective revenue collection and compliance. ARD will implement its Strategic Plan and establish a Risk Analysis and Case Selection Unit by end-May 2015 also to improve compliance. Further, tax arrears records will be reviewed to distinguish between collectible and uncollectible amounts. ARD will also establish performance indicators to assess risk-based audits and update audit policies, procedures, and guidelines. The authorities will continue to implement their action plan to strengthen customs administration with the capacity development assistance from donors.

25. **A strengthening of public financial management is planned**. The authorities will improve the medium-term fiscal framework (MTFF), work to identify better recurrent and capital expenditures, and associated output targets. Further, they plan electronic registration of invoices across all ministries and provinces and a database for ongoing capital projects. The authorities will prepare quarterly reports on financial performance of state-owned enterprises and companies, their fiscal impact and risks in the MTFF. In addition, they will carry out quarterly reviews (by a cabinet-level committee) of budget execution and prioritization of next quarter's expenditure, and if needed, reduce budget allocations in light of the previous quarter's budget performance.

[5] Any lending to weak banks, if needed, should only be extended at DAB's discretion under its emergency liquidity assistance arrangement. Strict controls should be applied to any collateralized lending to assure its repayment, with government guarantees to protect the central bank balance sheet.

26. **A sound and robust fiscal regime for natural resources is being designed**. This regime should help attract investment and ensure the government receives a reasonable share of the economic rents. The Fund has provided capacity development assistance to review the current framework and will provide recommendations on tax administration for the fiscal regime for natural resources in full compliance with the Extractive Industries Transparency Initiative.

Financial Sector Reforms

27. **The authorities have acted to address banking vulnerabilities**. DAB has issued enforcement actions for the vulnerable systemic bank to ensure the bank recorded losses on its assets and restored capital levels and ratios. The bank has made significant progress in these areas. DAB will continue to monitor the bank closely and is ready to put the bank under conservatorship in the case of noncompliance. DAB has also issued enforcement actions against the other vulnerable state-owned bank, which needs improved management and additional capital. The bank has been prohibited from extending any further loans and its management positions will be filled with fit and proper bankers swiftly. An independent external party will be hired to audit bad debt recoveries. The authorities also committed to restore capital to required minimum levels by end-2015. The bank will also prepare a five-year operating strategy, which will be submitted to DAB by end-June 2015 and finalized by end-August 2015. Should the strategy not be effective, and the bank is not able to achieve an operational break-even within 18 months, i.e., by end-February 2017, the bank will be put into conservatorship followed by its liquidation or sale. For other weak banks, DAB has started to implement a plan to address their weaknesses and increase their CAMEL ratings significantly by end-February 2016.

28. **The sale of New Kabul Bank (NKB) will be re-started**. NKB's management has already cut losses significantly, from $22 million in 2012 to $6 million in 2014 and plans further measures to reduce losses that will make NKB profitable by end-2015. The authorities believe that NKB's improved profitability will attract more bidders and a higher sales price at its privatization, which they will initiate by end-September 2015. The World Bank is working on national payment system upgrades that over time will facilitate the transfer of the government salary function.

29. **The new banking law will be promulgated by June 2015**. The legislation drafted in consultation with Fund staff strengthens corporate governance, capital requirements, large and related parties lending exposures, enhances supervision and bank resolution provisions. Revised regulations and information circulars will be issued once the new banking law is enacted. The authorities will also submit to parliament amendments to the central bank legislation by end-December 2015 to make its new capitalization framework operational, a critical ingredient for central bank independence.

30. **The DAB's Financial Supervision Department (FSD) will continue to be strengthened**. DAB will continue to implement FSD's five-year strategic plan, launched in July 2013, to implement its new organizational structure, and approve the complete organizational file for the department, including duties and responsibilities, reporting lines and job description of each staff position by end-September 2015. DAB plans to enhance offsite supervision with a new manual and revised offsite reports. It also plans to enhance onsite supervision, with a new manual for inspections and training for its implementation. The Supervisory Enforcement Committee will continue its regular reviews of banks' compliance with FSD's supervisory orders. Furthermore, revised banking regulations will be prepared on (i) asset classification and provisioning by end-September 2015; and (ii) related party lending and corporate governance by end-December 2015.

31. **The authorities will promote financial market development**. Financial intermediation remains weak and is a constraint on growth. The authorities are preparing the sukuk law, along with supporting legislative infrastructure, and an implementation plan. They also intend to promote secondary trading with existing instruments, starting with capital notes and wish to foster the development of the interbank market. DAB will work with the Afghan Bankers Association to guide discussions with dealers on the protocol for agreeing a "Code of Conduct."

Governance

32. **The authorities are committed to strengthen further Afghanistan's AML/CFT legal framework**. Amendments to the AML Law have been approved by decree and will be published in the Official Gazette. Those amendments incorporate into the law: the inclusion of the proceeds of predicate offenses committed abroad in the law, increases in the fines for legal persons, and specify that imprisonment and fines are not alternative penalties but may be applied cumulatively. The authorities will finalize a new regulation on currency reporting by end-June 2015 to strengthen the monitoring of cross border transportation of currency and negotiable bearer instruments. Also, to mitigate the money laundering and terrorism financing risks, they plan to submit to DAB's Supreme Council by end-September 2015 the draft AML and Proceeds of Crime Regulation–Preventive Measures for Financial Institutions.

33. **The authorities are determined to tackle corruption**. They plan to submit to parliament by end-December 2015: (i) legislation to criminalize bribery of foreign public officials, trading in influence, illicit enrichment, bribery and embezzlement of property in the private sector, in line with the United Nations Convention against Corruption; and (ii) an amendment to Article 12 of the Law on Overseeing the Implementation of the Anti-Administrative Corruption Strategy to provide for the mandatory publication of asset declarations by public officials, to bring it in line with Article 154 of the Constitution, by end-December 2015.

B. Program Modalities and Monitoring

34. **The SMP will cover a 9-month period, April 1 to December 31, 2015 and will be monitored based on quantitative targets and structural benchmarks** (MEFP, ¶39 and Tables 1 and 3). Actions taken before approval of the SMP include issuance of enforcement action against the vulnerable systemic bank and implementation of revenue measures that do not require parliamentary approval. Structural benchmarks focus on strengthening revenue performance, addressing vulnerabilities in the banking sector, and improving the AML/CFT framework. Structural conditionality is targeted and takes into account implementation capacity. Quantitative targets reflect the program's main policy objectives. The SMP will be monitored based on performance at two test dates: June 21, 2015 and December 21, 2015 and indicative target for September 22, 2015.

STAFF APPRAISAL

35. **Afghanistan has maintained macroeconomic stability and is addressing the vulnerabilities that emerged in 2014**. Political and security uncertainties weighed on economic performance. These uncertainties, combined with an inadequate policy response, led to the emergence of fiscal and banking vulnerabilities. The authorities were able to contain these vulnerabilities with donor support and action in the banking sector.

36. **The new administration is resolved to lay the foundation of a vibrant economy that benefits all Afghans**. The conclusion of the presidential election, agreement on a national unity government, and appointment of a cabinet of ministers helped reduce uncertainties and restore confidence. The authorities are committed to maintain macroeconomic stability and implement reforms to promote sustainable, inclusive, and gender-balanced growth. To this end, they passed a revised 2015 budget, supported by revenue measures and contingency plans, and committed to contain expenditures. They have also taken enforcement actions against the vulnerable systemic private bank, started to implement a plan to deal with other weak banks, and are moving forward with their plans to reform public banks, including the sale of New Kabul Bank.

37. **The authorities' policy package could address the immediate macroeconomic vulnerabilities**. They have noted the importance of addressing resolutely the fiscal and banking vulnerabilities to assure continued macroeconomic stability. The SMP would support their macroeconomic policy and reform agenda for 2015, with a framework to address economic vulnerabilities, manage risks, and facilitate engagement with the international community to improve aid predictability. The SMP will focus on mobilizing revenue, strengthening financial sector enforcement and DAB independence, improving economic governance, and laying the basis for high growth in the period ahead. The SMP will strengthen the legal infrastructure for economic activity, be accompanied by capacity development assistance to strengthen economic institutions from the IMF and other donors, and facilitate private sector activity.

38. **Improving revenue performance and implementing agreed revenue measures will be critical**. Afghanistan's has one of the lowest revenue collections in its peer group and has lost ground over the past few years. Improved revenue performance is needed to finance security and development expenditures and will lessen Afghanistan's dependence on donor support. Staff welcomes the authorities' commitment to mobilize revenue including the adoption of new revenue measures that will also support revenue mobilization over the medium term. Staff also welcomes the commitment to manage expenditure carefully and recommends increasing the efficiency of social and infrastructure spending.

39. **Consistent monetary policy implementation is needed to preserve low inflation and protect international reserves**. DAB should manage money growth carefully and allow exchange rate flexibility to ensure it meets its net international reserves targets.

40. **Consistent implementation of actions to address banking vulnerabilities is vital for financial stability and financial sector development**. Staff is encouraged by DAB's recent enforcement actions that have reduced bank vulnerabilities, and its plan to deal with weak banks. Staff recommends that DAB continues to monitor weak banks closely and takes further actions if necessary, including the use of conservatorship in the case of noncompliance with enforcement actions. On the vulnerable state bank, staff welcomes the preparations for a new operating strategy, urge the authorities to fill management positions with fit and proper bankers swiftly, and restore its capital to required minimum levels by end of 2015. It will be critical that DAB takes necessary enforcement action if the new operating strategy is not effective and bank does not achieve an operational break-even by early 2017. Staff welcomes the authorities' plan to sell NKB after implementing measures to make it profitable. If it is not possible to sell NKB, it should not be merged with another state bank and wound up as soon as the government salary function has been transferred to other banks.

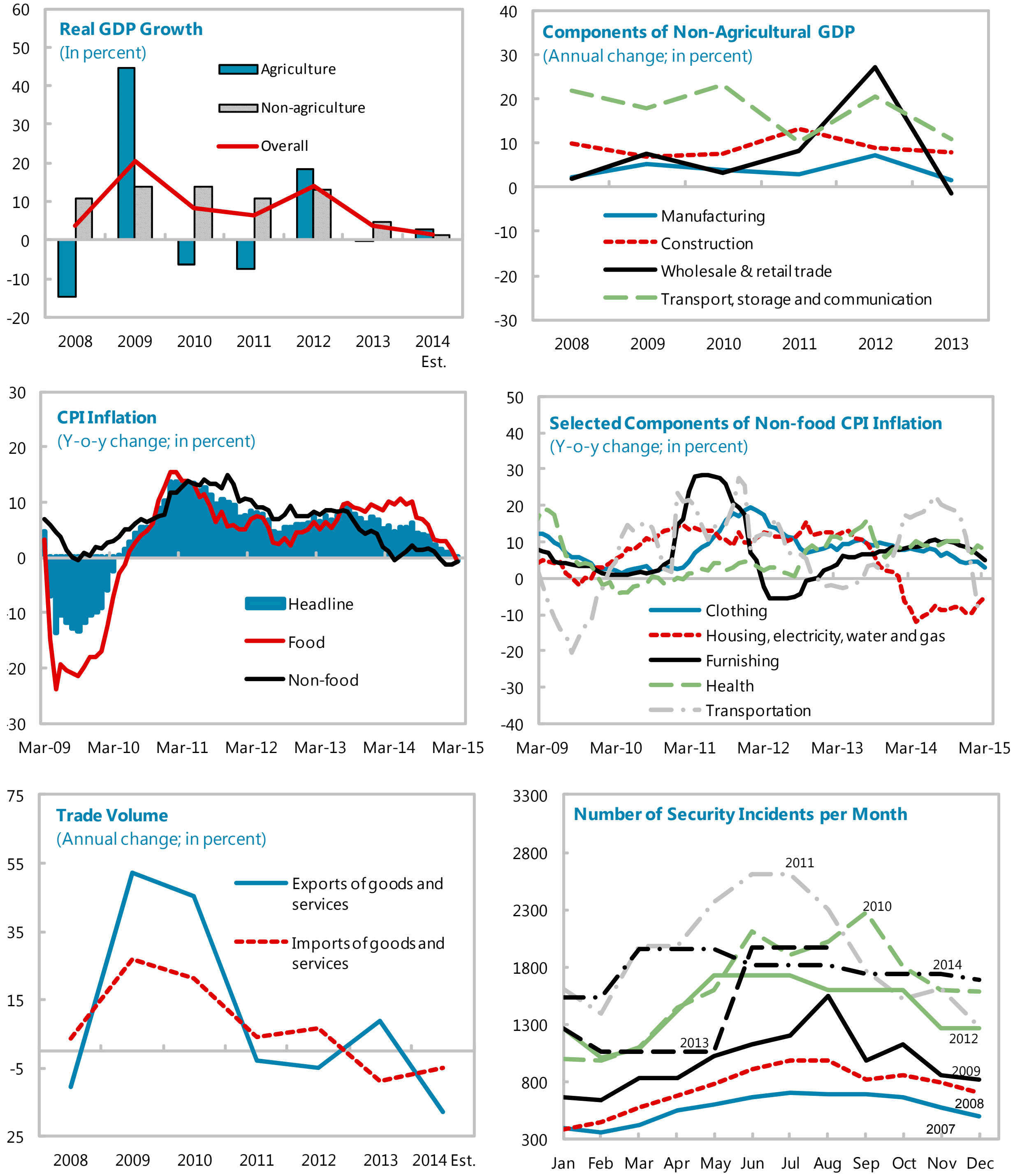
41. **Complementary financial sector reforms are needed**. Staff urges timely passage of the new banking law, which will strengthen corporate governance, capital requirements, large and related party lending exposures, and enhance supervision and bank resolution provisions. Once the law is passed, new banking regulations should be finalized promptly. Amendments to the DAB law are needed to buttress DAB's independence. Staff welcomes plans to strengthen DAB's FSD, which include implementation of new organizational structure and improvements in on and offsite supervision.

42. **Staff welcomes the commitment to strengthen further Afghanistan's AML/CFT legal framework and tackle corruption**. The recent amendment to the AML Law and progress made to finalize a new regulation on currency reporting at the border are important steps forward. Staff welcomes plans to submit to parliament legislation criminalizing bribery of foreign public officials, trading in influence, illicit enrichment, bribery and embezzlement of property in the private sector and the planned legislative amendment to provide for publication of public officials' asset declarations.

43. **The SMP faces significant risks**. These risks include domestic and regional security conditions and inadequate implementation of policies, political instability, unpredictability of aid flows, and donor fatigue. Spillovers from regional conflicts or stepped up attacks by insurgents could undermine security and set back reform efforts. A delay or partial parliamentary approval of revenue measures or their inadequate implementation could make achievement of the fiscal targets infeasible. Further regulatory forbearance and delays in implementation of enforcement actions and reforms in banking sector could weaken confidence. Any stalling of reforms could also affect the size and timing of donor support. On the upside, successful conclusion of peace talks, a faster recovery in domestic demand, and early development of large mining projects could result higher confidence and economic activity.

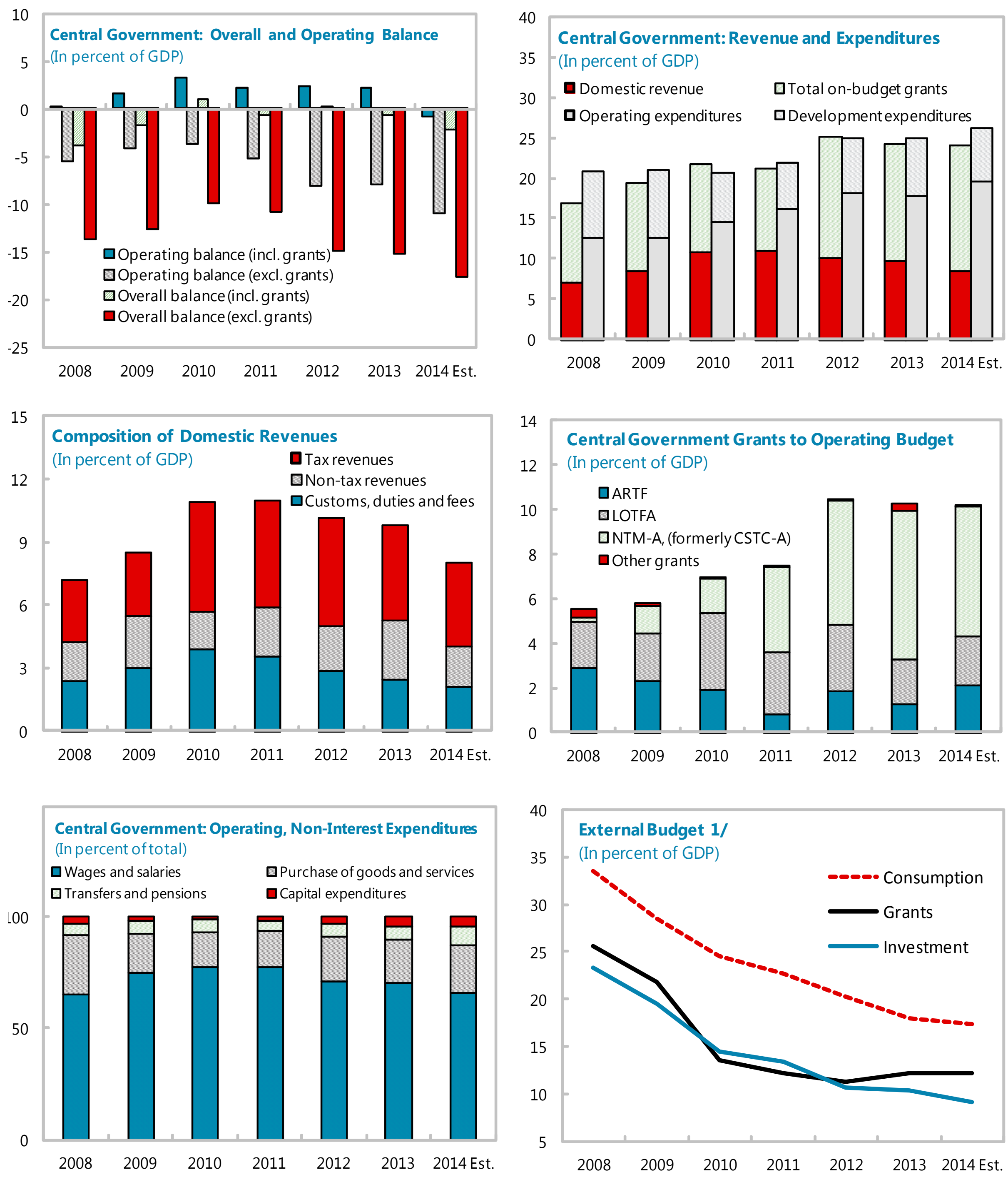
44. **The authorities recognize the SMP's implementation risks, but are committed to program objectives**. The authorities have started to stem important banking and fiscal vulnerabilities, agreed to measures that should address fully these vulnerabilities, and implemented some reforms earlier than envisaged. The overall policy package is solid and achievable as it takes into account Afghanistan's fragility and its limited administrative and institutional capacity. The SMP also provides a path forward with quick wins and pro-reform incentives to support a revival in economic confidence, a pick-up in activity and is an important step toward mitigating fragility.

Figure 1. Islamic Republic of Afghanistan: Real Sector



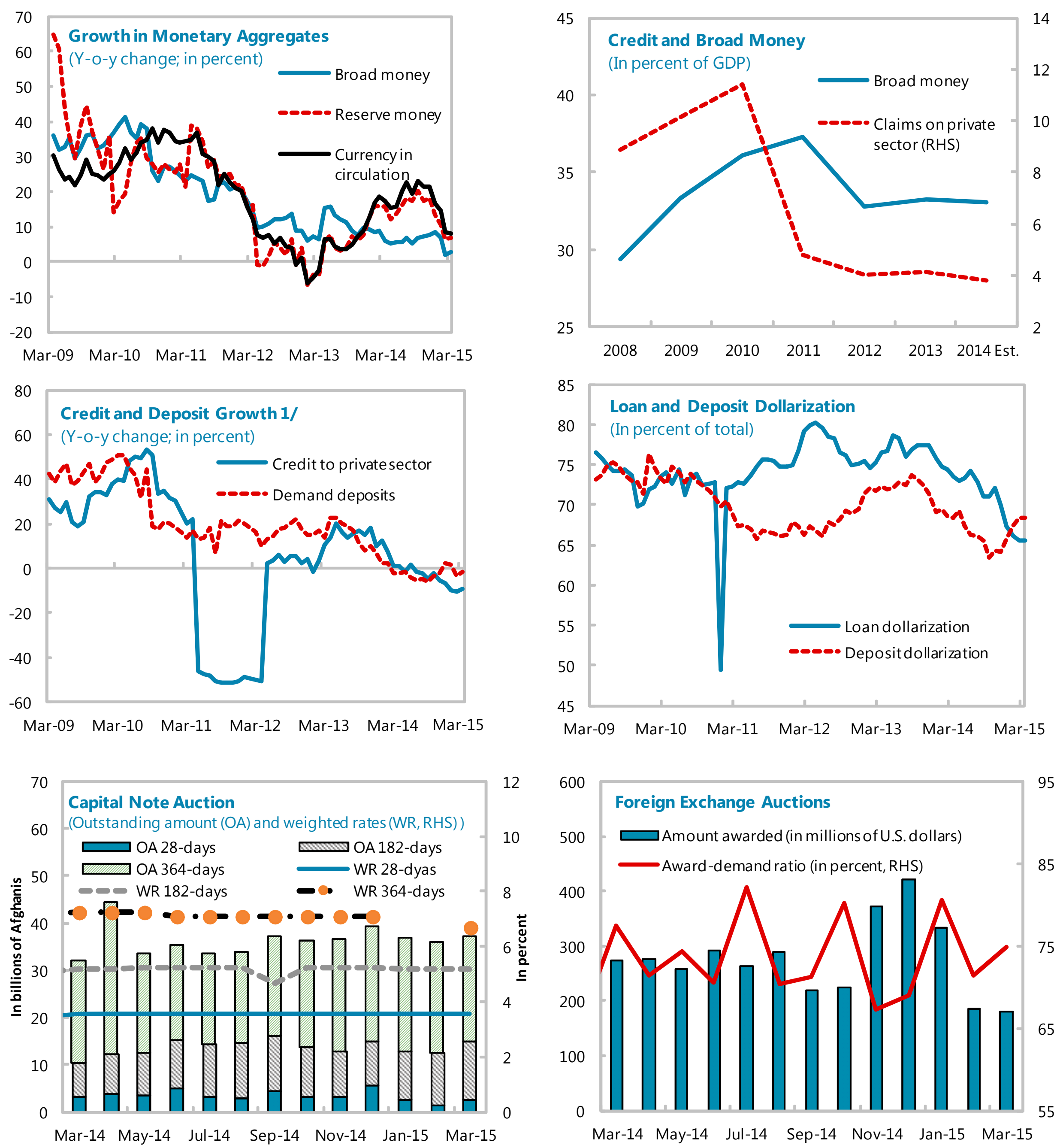
Sources: Afghan authorities; United Nations Department of Safety and Security; and IMF staff calculations.

Figure 2. Islamic Republic of Afghanistan: Fiscal Sector



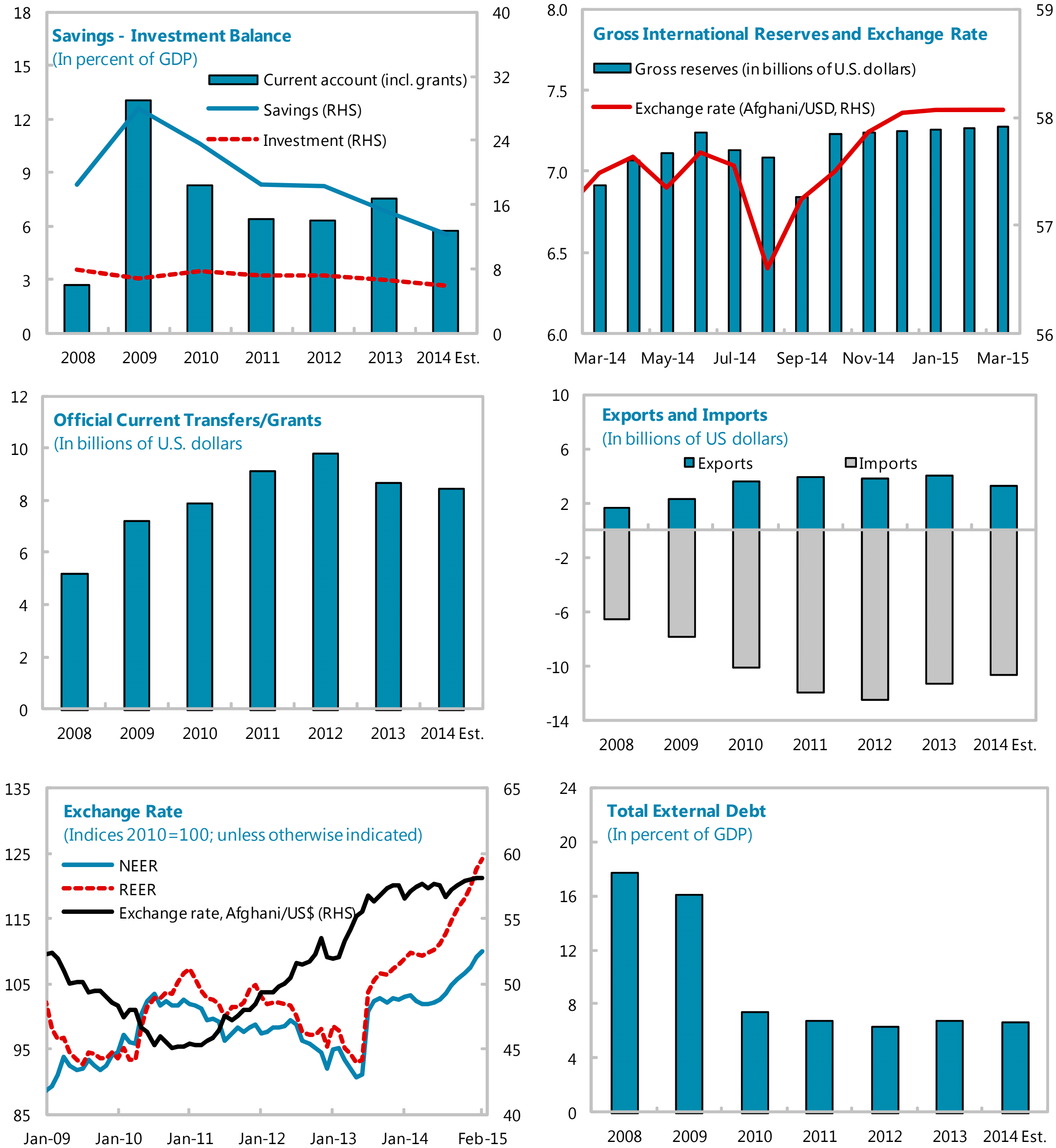
Sources: Afghan authorities; and IMF staff calculations.
1/ Estimated activity off-budget by international community.

Figure 3. Islamic Republic of Afghanistan: Monetary Sector



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

Figure 4. Islamic Republic of Afghanistan: External Sector



Sources: Afghan authorities; and IMF staff calculations.

Table 1. Islamic Republic of Afghanistan: Performance Under 2014 Informal Framework 1/

	Dec. 21, 2013 Stocks	Fiscal Year 2014: Mar. 20, Informal targets: Prog.	Adj.	Act.		June 21, Informal targets: Prog.	Adj.	Act.		Sep. 22, Informal targets: Prog.	Adj.	Act.		Dec. 21, Informal targets: Prog.	Adj.	Act.	
	(In billions of Afghanis, unless otherwise indicated)																
Revenues (floor)	…	26.1	…	23.4	×	56.4	…	47.7	×	85.6	…	70.8	×	128.8	…	100.0	×
Operating budget deficit, excluding grants (indicative target: ceiling)	…	18.9	…	15.2	✓	56.0	…	48.5	✓	94.5	…	84.9	✓	142.7	…	127.9	✓
Net credit to government from DAB (ceiling)	-55.0	-11.0	-6.1	2.4	×	-9.8	5.3	8.0	×	-7.0	19.4	33.7	×	-2.8	34.5	19.3	✓
Reserve money (ceiling)	198.8	0.0	…	-4.6	✓	1.3	…	4.8	×	9.5	…	22.1	×	25.2	…	26.5	×
Currency in circulation (indicative target: ceiling)	168.8	0.0	…	0.4	×	1.1	…	11.9	×	8.0	…	25.6	×	21.4	…	28.2	×
Social and other priority spending (indicative target: floor)	…	6.0	…	7.7	✓	13.1	…	16.3	✓	20.4	…	26.2	✓	27.8	…	36.5	✓
International reserves of DAB (floor; in millions of U.S. dollars)	6,679	25	-60	69	✓	100	-160	337	✓	175	-349	92	✓	250	80	401	✓
Nonconcessional external debt, new (ceiling) 2/	…	0.0	…	0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓
Short-term external debt (ceiling) 2/	…	0.0	…	0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓
External payments arrears, new (ceiling) 2/	…	0.0	…	0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓
Borrowing by public enterprises in need of restructuring—from DAB or state-owned banks, or government-guaranteed (ceiling) 2/	…	0.0	…	0.0	✓	0.0		0.0	✓	0.0	…	0.0	✓	0.0	…	0.0	✓
Reference values for the adjustors			Diff.				Diff.				Diff.				Diff.		
Core budget development spending	…	6.9	6.1	13.1		28.8	6.2	35.0		51.9	1.4	53.3		86.1	-13.5	72.6	
External financing of the core budget and sale of nonfinancial assets 3/	…	31.2	1.2	32.4		88.9	-8.9	80.0		147.8	-40.9	106.9		226.1	-44.1	182.0	

Source: Afghan authorities.

1/ The quantitative targets, indicative targets, their adjustors, and program exchange rates will be defined in the Technical Memorandum of Understanding (TMU). Program exchange rates as of December 20, 2012 are used.

2/ These quantitative targets apply on a continuous basis.

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

Table 2. Islamic Republic of Afghanistan: Selected Economic Indicators, 2012–15

(Quota: SDR 161.9 million)
(Population: approx. 30.6 million)
(Per capita GDP: approx. US$660; 2013)
(Poverty rate: 35.8 percent; 2011)
(Main exports: opium, US$2.0 billion; carpets, US$86.3 million; 2013)

	2012 Act.	2013 Act.	2014 Est.	2015 Proj.
	(Annual percentage change, unless otherwise indicated)			
Output and prices 1/				
Real GDP	14.0	3.7	1.5	3.5
Nominal GDP (in billions of Afghanis)	1,034	1,115	1,166	1,250
Nominal GDP (in billions of U.S. dollars)	20.3	20.1	20.3	21.5
Consumer prices (period average) 2/	6.4	7.4	4.6	3.7
Food	4.7	7.6	7.7	3.0
Non-food	8.7	7.2	1.3	3.9
Consumer prices (end of period) 2/	5.9	7.2	1.4	5.0
	(In percent of GDP)			
Investment and savings 2/				
Gross domestic investment	25.3	22.6	20.4	24.1
Of which: Private	7.2	6.6	5.9	8.1
Gross national savings	31.7	30.1	26.1	27.2
Of which: Private	13.3	14.8	13.8	11.2
Public finances (central government) 3/				
Domestic revenues and grants	25.2	24.4	24.0	27.3
Domestic revenues	10.1	9.8	8.6	9.6
Grants	15.1	14.6	15.4	17.7
Expenditures	25.0	25.0	25.8	27.4
Operating 4/	18.2	17.8	19.5	20.2
Development	6.8	7.2	6.2	7.2
Operating balance (excluding grants) 5/	-8.1	-8.0	-11.0	-10.5
Overall balance (including grants)	0.2	-0.6	-1.7	-0.1
Public debt 6/	6.3	6.7	6.6	6.3
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)			
Reserve money	3.9	12.4	13.3	11.0
Currency in circulation	1.1	12.5	16.7	11.0
Broad money	8.8	9.4	3.8	10.0
Interest rate, 28-day capital note (in percent)	2.0	3.4	3.5	…
	(In percent of GDP, unless otherwise indicated)			
External sector 1/				
Exports of goods (in million U.S. dollars)	640.1	728.7	826.0	948.7
Exports of goods (annual percentage change)	26.7	13.8	13.4	14.9
Imports of goods (in million U.S. dollars)	10,053.6	9,243.9	8,717.1	9,377.3
Imports of goods (annual percentage change)	-1.0	-8.1	-5.7	7.6
Merchandise trade balance	-46.4	-42.3	-38.8	-39.2
Current account balance				
Excluding official transfers	-41.8	-35.5	-35.8	-39.9
Including official transfers	6.3	7.5	5.7	3.1
Foreign direct investment	0.7	0.3	0.6	0.6
Total external debt 6/	6.3	6.7	6.6	6.3
Gross international reserves (in millions of U.S. dollars)	6,867	6,886	7,248	7,377
Import coverage of reserves 7/	7.3	7.8	7.6	7.5
Exchange rate (average, Afghanis per U.S. dollar)	50.9	55.4	57.4	…
Real exchange rate (average, percentage change) 8/	-4.3	-2.7	-0.7	…
Memorandum items 9/	2012/13	2013/14	2014/15	2014/15
Nominal GDP, incl. opium (in billions of Afghanis)	1,086	1,197	…	…
Real GDP, incl. opium (annual percentage change)	10.9	6.5	…	…
Price (in U.S. dollars per kilogram)	163	163	…	…

Sources: Afghan authorities; United Nations Office on Drugs and Crime; and Fund staff estimates and projections.

1/ Excluding the narcotics economy.
2/ Revised with improved coverage.
3/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is closer aligned with the Gregorian calendar year.
4/ Comprising mainly current spending.
5/ Defined as domestic revenues minus operating expenditures commitment.
6/ Public sector only. Incorporates committed but not yet delivered debt relief.
7/ In months of next year's import of goods and services.
8/ CPI-based, vis-a-vis the U.S. dollar.
9/ Items presented on the Afghan solar year's basis.

Table 3. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2012–19

	2012 Act.	2013 Act.	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)							
Real GDP	14.0	3.7	1.5	3.5	4.9	6.0	5.6	5.9
Nominal GDP (in billions of U.S. dollars)	20.3	20.1	20.3	21.5	21.6	23.6	25.5	27.3
Consumer prices (period average) 2/	6.4	7.4	4.6	3.7	5.5	5.0	5.0	5.0
Investment and savings 2/	(In percent of GDP, unless otherwise indicated)							
Gross domestic investment	25.3	22.6	20.4	24.1	24.0	25.7	25.8	24.9
Of which: Private	7.2	6.6	5.9	8.1	8.5	10.8	11.6	12.0
Gross national savings	31.7	30.1	26.1	27.2	24.5	22.8	22.1	21.1
Of which: Private	13.3	14.8	13.8	11.2	9.6	8.0	8.0	8.3
Public finances (central government) 3/								
Domestic revenues and grants	25.2	24.4	24.0	27.3	28.9	29.7	31.4	33.3
Domestic revenues	10.1	9.8	8.6	9.6	9.8	10.4	11.6	12.6
Grants	15.1	14.6	15.4	17.7	19.0	19.3	19.8	20.7
Expenditures	25.0	25.0	25.8	27.4	29.5	29.7	31.5	33.5
Operating 4/	18.2	17.8	19.5	20.2	22.1	22.2	23.8	25.6
Development	6.8	7.2	6.2	7.2	7.4	7.5	7.7	7.8
Operating balance (excluding grants) 5/	-8.1	-8.0	-11.0	-10.5	-12.3	-11.7	-12.2	-13.0
Overall budget balance (including grants)	0.2	-0.6	-1.7	-0.1	-0.6	0.0	-0.1	-0.2
External sector 1/								
Merchandise trade balance	-46.4	-42.3	-38.8	-39.2	-40.5	-41.1	-38.0	-33.6
Current account balance, excluding official grants	-41.8	-35.5	-35.7	-39.9	-41.2	-41.7	-38.9	-34.9
Gross reserves (in millions of U.S. dollars)	6,867	6,886	7,248	7,377	7,500	7,550	7,600	7,650
Import coverage of reserves 6/	7.3	7.8	7.6	7.5	6.9	6.6	6.5	6.9
Memorandum items:								
Total public debt 7/	6.3	6.7	6.6	6.3	6.5	6.3	6.2	6.1
Of which: External debt	6.3	6.7	6.6	6.3	6.5	6.3	6.2	6.1
Domestic debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP per capita (in U.S. dollars) 8/	680	659	649	673	661	705	744	782

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

1/ Excluding the narcotics economy.
2/ Revised with improved coverage.
3/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis.
4/ Comprising mainly current spending. It is assumed that donors' recurrent expenditure off-budget is moved onto the budget by 2020. The actual rate of transfer on-budget is uncertain.
5/ Defined as domestic revenues minus operating expenditures.
6/ In months of next year's import of goods and services.
7/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.
8/ Incorporates the 2012 revision to the UN World Population Prospects.

Table 4. Islamic Republic of Afghanistan: Central Government Budget, 2013–15

(In billions of Afghanis)

	2013	2014	2015					2015	
	FY	FY	Q1	Q1	Q2	Q3	Q4	FY	FY
	Act.	Est.	Prog.	Est.	Proj.	Proj.	Proj.	Budget	Proj. 5/
Revenues and grants	271.9	280.2	50.3	70.5	61.4	93.7	115.7	424.9	341.3
Domestic revenues	109.0	100.0	20.8	24.1	22.6	34.9	38.8	125.0	120.4
Tax revenues	77.4	78.1	11.3	14.2	20.3	26.7	26.5	…	87.8
Income, profits, and capital gains	27.4	29.5	3.9	4.6	7.8	9.0	7.2	…	28.7
International trade and transactions	27.3	26.0	3.9	5.6	6.2	7.5	8.1	…	27.4
Goods and services	17.3	16.6	2.7	3.3	4.4	8.2	9.2	…	25.1
Other	5.4	5.9	0.9	0.7	1.9	2.0	2.1	…	6.6
Nontax revenues	31.6	22.0	9.4	9.8	2.3	8.3	12.3	…	32.6
Grants to operating budget 1/	114.7	119.1	21.6	38.7	18.5	41.0	49.7	178.2	147.9
ARTF 8/	14.2	24.2	1.7	2.0	4.2	2.9	6.2	18.5	15.2
LOTFA	22.4	25.9	4.9	7.1	10.3	12.3	20.9	60.1	50.7
CSTC-A	74.5	68.4	14.2	29.5	2.2	21.4	19.6	91.5	72.8
Other grants	3.6	0.6	0.7	0.1	1.7	4.4	2.9	8.1	9.2
Grants to development budget	48.2	61.1	7.9	7.7	20.3	17.8	27.2	121.7	73.0
Total expenditures	278.9	300.5	49.1	44.3	83.7	92.3	121.6	432.5	342.0
Operating expenditures	198.6	227.9	41.1	37.0	65.2	68.4	81.4	282.4	252.0
Of which: Security	128.7	138.5	…	…	…	…	…	191.5	162.2
Wages and salaries	139.5	150.2	32.6	31.4	39.7	42.1	43.9	157.2	157.2
Purchases of goods and services 7/	38.2	48.2	5.3	4.7	14.0	17.9	27.1	91.9	63.8
Transfers, subsidies, and other	0.0	0.7	0.3	0.3	0.8	0.5	0.5	2.1	2.1
Pensions	11.5	18.9	2.7	0.2	8.4	4.5	4.3	17.5	17.5
Capital expenditures	8.4	9.4	0.1	0.3	2.2	3.2	5.4	12.2	11.1
Interest	1.0	0.4	0.1	0.1	0.0	0.1	0.1	1.5	0.3
Development expenditures*:*	80.4	72.6	8.0	7.3	18.5	23.9	40.3	150.1	90.0
Infrastructure and natural resources	27.6	21.8	…	…	…	…	…	51.6	27.4
Education	8.5	8.7	…	…	…	…	…	15.9	10.4
Health	7.2	9.1	…	…	…	…	…	13.5	10.8
Agriculture and rural development	22.4	24.9	…	…	…	…	…	41.8	32.1
Discretionary 6/	…	9.9	…	…	…	…	…	28.4	17.0
Operating balance excluding grants	-89.5	-127.9	-20.3	-12.9	-42.6	-33.5	-42.6	-157.4	-131.6
Overall budget balance including grants	-7.0	-20.3	1.2	26.2	-22.3	1.4	-6.0	-7.6	-0.7
less: Kabul Bank bailout cost	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Augmented overall budget balance	-7.0	-18.4	1.2	26.2	-22.3	1.4	-6.0	-7.6	-0.7
Float and discrepancy 2/	10.5	-0.7	0.0	-7.4	0.0	0.0	0.0	-9.5	-7.4
Financing	-3.5	19.1	-1.2	-18.8	14.9	-1.4	6.0	17.1	0.7
Sale of nonfinancial assets 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	1.4	1.8	0.1	0.2	0.2	0.4	0.4	7.4	1.2
Domestic (net)	-4.9	17.2	-1.3	-19.0	14.7	-1.8	5.6	9.7	-0.5
Central bank, change in	-4.9	17.2	-1.3	-19.0	14.7	-1.8	5.6	9.7	-0.5
Government deposits	-4.7	20.3	-1.0	-18.8	14.8	-1.5	5.6	12.6	0.2
Claims on government	-0.2	-3.1	-0.3	-0.3	-0.1	-0.3	-0.1	-2.8	-0.7
Memorandum items:									
Promissory note (end-of-period stock)	29.1	27.7	27.9	27.9	28.0	28.2	28.3	19.8	28.3
Propoor spending 4/	25.1	36.5	8.1	8.1	8.1	8.1	8.1	39.8	32.4

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

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

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

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

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

5/ Adjusted to include assessment of revenue, operating budget execution rates, restraint of discretionary development spending (taking into account expected revenue and donor disbursements).

6/ 2015 figure includes about Af 7 bn discretionary development arrears.

7/ 2015 figure contains about Af 2.85 bn arrears.

8/ 2015 figure includes USD 50 million which are contingent on agreement of a framework for meeting O&M spending needs with the World Bank; Af 93.6 billion of the Af 193.6 billion included in the budget were disbursed before December 21, 2014 and are therefore not included in 2015 grants but consistent with cash accounting as a financing item in the cash balance.

Table 5. Islamic Republic of Afghanistan: Central Government Budget, 2013–15

(In percent of GDP)

	2013	2014	2015					2015	
	FY	FY	Q1	Q1	Q2	Q3	Q4	FY	FY
	Act.	Est.	Prog.	Est.	Proj.	Proj.	Proj.	Budget	Proj. 5/
Revenues and grants	24.4	24.0	4.0	5.6	4.9	7.5	9.3	33.2	27.3
Domestic revenues	9.8	8.6	1.7	1.9	1.8	2.8	3.1	9.2	9.6
Tax revenues	6.9	6.7	0.9	1.1	1.6	2.1	2.1	6.7	7.0
Income, profits, and capital gains	2.5	2.5	0.3	0.4	0.6	0.7	0.6	2.3	2.3
International trade and transactions	2.5	2.2	0.3	0.5	0.5	0.6	0.6	2.3	2.2
Goods and services	1.6	1.4	0.2	0.3	0.4	0.7	0.7	1.4	2.0
Other	0.5	0.5	0.1	0.1	0.1	0.2	0.2	0.5	0.5
Nontax revenues	2.8	1.9	0.8	0.8	0.2	0.7	1.0	2.5	2.6
Grants to operating budget 1/	10.3	10.2	1.7	3.1	1.5	3.3	4.0	14.3	11.8
ARTF 8/	1.3	2.1	0.1	0.2	0.3	0.2	0.5	1.5	1.2
LOTFA	2.0	2.2	0.4	0.6	0.8	1.0	1.7	4.8	4.1
CSTC-A	6.7	5.9	1.1	2.4	0.2	1.7	1.6	7.3	5.8
Other grants	0.3	0.0	0.1	0.0	0.1	0.4	0.2	0.6	0.7
Grants to development budget	4.3	5.2	0.6	0.6	1.6	1.4	2.2	9.7	5.8
Total expenditures	25.0	25.8	3.9	3.5	6.7	7.4	9.7	34.6	27.4
Operating expenditures	17.8	19.5	3.3	3.0	5.2	5.5	6.5	22.6	20.2
Of which: Security	11.5	11.9	…	…		…	…	15.3	13.0
Wages and salaries	12.5	12.9	2.6	2.5	3.2	3.4	3.5	12.6	12.6
Purchases of goods and services 7/	3.4	4.1	0.4	0.4	1.1	1.4	2.2	7.4	5.1
Transfers, subsidies, and other	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.2	0.2
Pensions	1.0	1.6	0.2	0.0	0.7	0.4	0.3	1.4	1.4
Capital expenditures	0.7	0.8	0.0	0.0	0.2	0.3	0.4	1.0	0.9
Interest	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Development expenditures:	7.2	6.2	0.6	0.6	1.5	1.9	3.2	12.0	7.2
Infrastructure and natural resources	2.5	1.9	…	…	…	…	…	4.1	2.2
Education	0.8	0.7	…	…	…	…	…	1.3	0.8
Health	0.6	0.8	…	…	…	…	…	1.1	0.9
Agriculture and rural development	2.0	2.1	…	…	…	…	…	3.3	2.6
Discretionary 6/	…	0.8	…	…	…	…	…	2.3	1.4
Operating balance excluding grants	-8.0	-11.0	-1.6	-1.0	-3.4	-2.7	-3.4	-13.4	-10.5
Overall budget balance including grants	-0.6	-1.7	0.1	2.1	-1.8	0.1	-0.5	-1.4	-0.1
less: Kabul Bank bailout cost	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Augmented overall budget balance	-0.6	-1.6	0.1	2.1	-1.8	0.1	-0.5	-1.4	-0.1
Float and discrepancy 2/	0.9	-0.1	0.0	-0.6	0.0	0.0	0.0	0.1	-0.6
Financing	-0.3	1.6	-0.1	-1.5	1.2	-0.1	0.5	1.4	0.1
Sale of nonfinancial assets 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External loans (net)	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.6	0.1
Domestic (net)	-0.4	1.5	-0.1	-1.5	1.2	-0.1	0.4	0.8	0.0
Central bank, change in	-0.4	1.5	-0.1	-1.5	1.2	-0.1	0.4	0.8	0.0
Government deposits	-0.4	1.7	-0.1	-1.5	1.2	-0.1	0.5	1.0	0.0
Claims on government	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	-0.2	-0.1
Memorandum items:									
Promissory note (end-of-period stock)	2.6	2.4	2.2	2.2	2.2	2.3	2.3	1.6	2.3
Propoor spending 4/	2.3	3.1	0.7	0.7	0.6	0.6	0.7	3.2	2.6

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

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

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

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

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

5/ Adjusted to include assessment of revenue, operating budget execution rates, restraint of discretionary development spending (taking into account expected revenue and donor disbursements).

6/ 2015 figure includes about Af 7 bn discretionary development arrears.

7/ 2015 figure contains about Af 2.85 bn arrears.

8/ 2015 figure includes USD 50 million which are contingent on agreement of a framework for meeting O&M spending needs with the World Bank; Af 93.6 billion of the Af 193.6 billion included in the budget were disbursed before December 21, 2014 and are therefore not included

Table 6. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2012–15

(At current market exchange rates)

	2012	2013	2014	2015				
	Dec. 20	Dec. 21	Dec. 21	March 20	March 20	June 21	Sep. 22	Dec. 21
	Act.	Act.	Est.	Prog.	Est.	Proj.	Proj.	Proj.
	(In billions of Afghanis, unless otherwise indicated)							
Net foreign assets	352.7	382.5	409.4	412.7	408.5	413.9	416.1	418.3
Foreign assets	373.1	403.8	429.0	430.8	426.5	432.8	434.6	436.6
Foreign exchange reserves	358.0	390.0	420.9	422.7	418.3	424.6	426.4	428.4
Other foreign assets	15.0	13.8	8.1	8.1	8.2	8.2	8.2	8.3
Foreign liabilities	-20.4	-21.2	-19.5	-18.1	-18.1	-19.0	-18.5	-18.3
Net domestic assets	-175.9	-183.8	-184.2	-193.5	-200.9	-185.7	-170.8	-168.3
Domestic assets	-103.0	-110.8	-105.5	-117.1	-122.9	-117.5	-109.8	-100.6
Net claims on government	-53.9	-58.9	-41.6	-61.7	-61.7	-45.9	-47.7	-42.1
Gross claims on government	50.5	50.3	47.3	45.9	45.9	46.9	46.6	46.6
Of which: MoF promissory note 1/	30.2	29.1	27.7	27.9	27.9	28.0	28.2	28.3
Domestic currency deposits	-17.3	-18.3	-20.0	-24.6	-21.3	-20.9	-21.3	-19.9
Foreign currency deposits 2/	-87.1	-90.9	-68.9	-83.0	-86.4	-71.9	-73.0	-68.8
Other claims	-49.0	-52.0	-63.9	-55.3	-61.1	-71.6	-62.1	-58.5
Other items net	-72.9	-73.0	-78.7	-76.5	-78.0	-68.3	-61.0	-67.7
Reserve money	176.8	198.8	225.2	219.2	207.6	228.2	245.3	250.0
Currency in circulation	150.0	168.8	197.0	193.0	182.8	203.6	216.6	218.6
Bank deposits (Afghani denominated)	26.8	30.0	28.2	26.2	24.8	24.6	28.7	31.3
Memorandum items:								
International reserves, in millions of U.S. dollars								
Net	6,472	6,382	6,694	6,737	6,707	6,769	6,806	6,844
Gross	6,867	6,886	7,248	7,278	7,240	7,313	7,342	7,377
Interest rate, 28-day capital notes (percent)	2.0	3.4	3.5	…	…	…	…	…
Exchange rate (Afghanis per U.S. dollar)	52.1	56.6	58.1	…	…	…	…	…

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 7. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2012–15

(At program exchange rates) 1/

	2012	2013	2014	2015				
	Dec. 20	Dec. 20	Dec. 21	March 20	March 20	June 21	Sep. 22	Dec. 21
	Act.	Act.	Est.	Prog.	Est.	Proj.	Proj.	Proj.
	(In billions of Afghanis, unless otherwise indicated)							
Net foreign assets	371.1	387.6	409.4	411.7	415.7	413.9	416.1	418.3
Foreign assets	392.5	408.2	429.0	430.8	434.9	432.8	434.6	436.6
Foreign exchange reserves	375.8	394.1	420.9	422.7	426.5	424.6	426.4	428.4
Other foreign assets	16.7	14.0	8.1	8.1	8.3	8.2	8.2	8.3
Foreign liabilities	-21.3	-20.6	-19.5	-19.1	-19.1	-19.0	-18.5	-18.3
Net domestic assets	-194.4	-188.8	-184.2	-192.4	-208.1	-185.7	-170.8	-168.3
Domestic assets	-112.4	-113.3	-105.5	-116.0	-123.4	-117.5	-109.8	-100.6
Net claims on government	-62.1	-60.9	-41.6	-60.6	-61.8	-45.9	-47.7	-42.1
Gross claims on government	51.5	49.7	47.3	47.0	47.0	46.9	46.6	46.6
Of which: MoF promissory note 2/	30.2	29.1	27.7	27.9	27.9	28.0	28.2	28.3
Domestic currency deposits	-17.3	-18.3	-20.0	-24.6	-21.3	-20.9	-21.3	-19.9
Foreign currency deposits 3/	-96.2	-92.3	-68.9	-83.0	-87.6	-71.9	-73.0	-68.8
Other claims	-50.3	-52.3	-63.9	-55.3	-61.6	-71.6	-62.1	-58.5
Other items net	-82.0	-75.5	-78.7	-76.5	-84.7	-68.3	-61.0	-67.7
Reserve money	176.8	198.8	225.2	219.2	207.6	228.2	245.3	250.0
Currency in circulation	150.0	168.8	197.0	193.0	182.8	203.6	216.6	218.6
Bank deposits (Afghani denominated)	26.8	30.0	28.2	26.2	24.8	24.6	28.7	31.3
Memorandum items:								
Net international reserves								
(At program rates, in millions of U.S. dollars)	6,089	6,293	6,694	6,731	6,801	6,769	6,806	6,844
Money growth (year-on-year, in percent)								
Reserve money	3.9	12.4	13.3	12.9	6.9	12.1	11.1	11.0
Currency in circulation	1.1	12.5	16.7	14.1	8.1	12.7	11.4	11.0

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

1/ Program exchange rates as of Dec. 21, 2014 are applied to evaluate 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
3/ Includes Afghanistan's SDR holdings (MoF is the fiscal agent for the IMF).

Table 8. Islamic Republic of Afghanistan: Monetary Survey, 2012–15 1/

	2012 Dec. 21 Act.	2013 Dec. 21 Act.	2014 Dec. 21 Est.	2015 Dec. 21 Proj.
	(In billions of Afghanis)			
Net foreign assets	425.7	465.9	483.6	498.4
Foreign assets	456.1	495.6	511.1	525.3
Central bank	373.1	403.8	429.0	436.6
Commercial banks	83.0	91.9	82.1	88.7
Foreign liabilities	-30.3	-29.7	-27.5	-27.0
Central bank	-20.4	-21.2	-19.5	-18.3
Commercial banks	-10.0	-8.5	-8.0	-8.6
Net domestic assets	-86.9	-95.3	-98.7	-74.9
Net domestic credit	-13.2	-13.8	1.9	4.5
Nonfinancial public sector	-55.1	-59.8	-42.5	-43.0
Central bank	-53.9	-58.9	-41.6	-42.1
Commercial banks	-1.1	-1.0	-0.9	-0.9
Private sector	41.8	46.1	44.4	47.5
Other items net	-73.7	-81.5	-100.6	-79.4
Broad money M2	338.8	370.7	384.9	423.4
Narrow money M1	319.2	350.7	366.3	403.2
Currency outside banks	142.8	161.9	189.8	210.9
Currency in circulation	150.0	168.8	197.0	218.6
Currency held by banks	7.2	6.9	7.1	7.8
Demand deposits	176.4	188.8	176.5	192.3
Other deposits	19.7	20.0	18.6	20.2
	(12-month percentage change)			
M2	8.8	9.4	3.8	10.0
M1	9.8	9.9	4.4	10.1
Currency outside banks	1.1	13.4	17.2	11.1
Net credit to the private sector	4.3	10.1	-3.6	7.0
	(In percent of GDP)			
M2	32.8	33.3	33.0	33.9
M1	30.9	31.5	31.4	32.3
Memorandum items:				
M2 velocity	3.1	3.0	3.0	3.0
Reserve money multiplier	1.9	1.9	1.7	1.7
Banking sector				
Loan dollarization (percent)	75.4	75.9	71.1	71.1
Deposit dollarization (percent)	71.4	69.0	63.4	63.4
Currency-to-deposit ratio (percent)	76.5	80.9	101.0	102.9
Loans-to-deposit ratio (percent)	21.3	22.1	22.8	22.3
Net open forex position	…	…	…	

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

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

Table 9. Islamic Republic of Afghanistan: Balance of Payments, 2012–19

(In millions of U.S. dollars, unless otherwise indicated) 1/

	2012 Act.	2013 Act.	2014 Est.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Export of goods and services	3,776	4,028	3,276	2,749	2,769	3,207	3,859	4,585
Goods	640	729	826	949	1,007	1,356	1,979	2,659
Services	3,136	3,300	2,450	1,800	1,762	1,852	1,881	1,926
Import of goods and services	12,466	11,340	10,631	11,375	11,763	13,110	13,722	13,989
Goods	10,054	9,244	8,717	9,377	9,777	11,050	11,638	11,849
Services	2,412	2,096	1,914	1,998	1,986	2,059	2,084	2,140
Income, net	312	297	196	179	199	173	41	-89
Of which: Interest on official loans	2	4	5	5	6	7	8	9
Current transfers, net	9,661	8,530	8,317	9,108	8,910	9,058	8,886	8,449
Of which: Official /2	9,762	8,658	8,435	9,239	9,025	9,163	8,967	8,493
Current account	1,283	1,515	1,158	660	115	-671	-935	-1,045
Excluding official grants	-8,479	-7,143	-7,276	-8,579	-8,910	-9,834	-9,902	-9,538
Capital account	0	0	0	0	0	0	0	0
Financial account, net	-215	7	-730	-510	-5	708	984	1,106
Foreign direct investment	144	70	122	123	297	1,022	1,432	1,354
Portfolio investment	-19	-67	-52	-57	-62	-67	-72	-77
Official loans 3/	77	75	-35	21	43	67	87	112
Disbursement	78	82	26	32	54	79	105	130
Amortization	0	6	11	11	11	12	18	18
Debt relief ('-' = forgiveness)	0	0	50	0	0	0	0	0
Other investment	-306	-72	-764	-597	-282	-314	-463	-283
Errors and omissions	-477	-1,193	0	0	0	0	0	0
Overall balance	590	328	429	150	110	37	49	60
Financing	-590	-328	-429	-150	-110	-37	-49	-60
Central bank's gross reserves ('-' = accumulation)	-605	-316	-459	-129	-123	-50	-50	-50
Use of Fund resources, net	14	-13	-20	-21	13	13	1	-10
Disbursements	18	0	0	0	35	35	17	0
Repayments	4	13	20	21	22	22	17	10
Debt relief ('-' = forgiveness)	0	0	50	0	0	0	0	0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Gross international reserves, central bank	6,867	6,886	7,248	7,377	7,500	7,550	7,600	7,650
Import coverage of reserves 4/	7.3	7.8	7.6	7.5	6.9	6.6	6.5	6.9
External debt stock, official 5/	1,282	1,352	1,350	1,350	1,405	1,486	1,573	1,675
in percent of GDP	6.3	6.7	6.6	6.3	6.5	6.3	6.2	6.1
Trade balance	-9,413	-8,515	-7,891	-8,429	-8,770	-9,695	-9,659	-9,190
in percent of GDP	-46.4	-42.3	-38.8	-39.2	-40.5	-41.1	-38.0	-33.6
Current account, in percent of GDP	6.3	7.5	5.7	3.1	0.5	-2.8	-3.7	-3.8

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

1/ BoP data excludes the narcotics economy.

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

3/ Excluding IMF.

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

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

Appendix I. Letter of Intent

Kabul, May 6, 2015

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

Dear Ms. Lagarde:

The conclusion of the presidential election and the formation of a broad-based government of national unity demonstrated Afghanistan's commitment to peaceful political transition. Our government is resolved to move with energy and determination to address the difficult challenges Afghanistan faces, to press ahead with economic reforms to develop and grow our economy and build prosperity for current and future generations of Afghans.

Political and security uncertainties in 2013–14 hurt economic activity in Afghanistan. Although macroeconomic stability was maintained, the less than adequate policy response to these uncertainties resulted in the emergence of significant fiscal and banking vulnerabilities, and delayed reviews under the Extended Credit Facility (ECF) arrangement with the International Monetary Fund (IMF), which expired in November 2014. Nonetheless, the government of Afghanistan and Da Afghanistan Bank continued their close engagement with the IMF on macroeconomic policies and capacity building.

The formation of a national unity government has completed Afghanistan's peaceful political transition. The government has started to address economic vulnerabilities and is resolved to lay the foundation of a vibrant economy that benefits all Afghans, through macroeconomic stability and reforms to promote sustainable and inclusive growth. Initially, we will address fiscal and banking vulnerabilities by mobilizing revenue and strengthening financial sector supervision and enforcement. Our policies will also aim at lifting growth through structural reform, while sustaining donor flows. The attached Memorandum of Economic and Financial Policies (MEFP), for the period April 1, 2015 to December 31, 2015, and the Technical Memorandum of Understanding (TMU) provide a comprehensive description of our program and reform agenda.

In support of these policies, we request a nine-month IMF Staff Monitored Program (SMP), covering the period April 1, 2015 to December 31, 2015, which could pave the way for an IMF financial arrangement. We believe that the policies set out in the attached MEFP are adequate to achieve the overall objectives of our reform agenda and program, and we stand ready to take further measures that may become necessary to achieve our policy objectives. We will consult with IMF staff in accordance with the IMF's policies on such consultations and provide the IMF information it may request on implementing these policies.

We authorize the IMF to publish this Letter of Intent, the attached MEFP and TMU, and the related staff report, subject to the removal of market-sensitive information.

Sincerely yours,

/s/
Eklil Ahmad Hakimi
Minister of Finance
Government of Afghanistan

/s/
Khan Afzal Hadawal
Acting Governor
Da Afghanistan Bank

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies for 2015

A. Introduction

1. **This memorandum reviews the recent economic developments and lays out our economic objectives and policy framework for the period through December 31, 2015**, for which we are seeking support under a nine-month staff monitored program (SMP) with IMF staff.

2. **Afghanistan's three-year Extended Credit Facility (ECF) supported program expired in November 2014**. The first review of the ECF-supported program was completed in June 2012. The remaining reviews were delayed because of deteriorating macroeconomic conditions and program implementation. Despite delayed reviews, we kept in close contact with the IMF and strived to deliver on the agreed informal quantitative targets and structural measures for 2013–14. These informal targets and structural measures were designed to maintain macro stability and structural reform momentum.

3. **We are committed to reinvigorate economic reform and address structural weaknesses in the economy**. The new administration has started to address economic vulnerabilities and the establishment of the national unity government has helped reduce uncertainties and restore confidence. The government would like to jump start its 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 SMP will support our macroeconomic policy and reform agenda for 2015**. First, it will address economic vulnerabilities. Second, it will facilitate our engagement with the international community to sustain donor support and help us make progress on the deliverables under the Tokyo Mutual Accountability Framework (TMAF). The SMP will preserve macroeconomic stability, improve economic governance, and lay the basis for more private sector activity.

B. Recent Economic Developments

5. **Economic performance in 2014 was weaker than expected**. Growth is estimated to have declined to 1.5 percent in 2014 from 3.7 percent in 2013. Uncertainties related to security and political transition sapped private sector confidence and reduced domestic demand. Nonagricultural output growth is estimated to have decelerated to 1.2 percent in 2014 from 3.7 percent in 2013. The growth in agricultural output is estimated at 2.7 percent in 2014 after two years of exceptional harvests. Average inflation remained low at around 4½ percent, thanks to prudent monetary policy and supported by lower international food and energy prices. International reserves remained comfortable and the exchange rate has been broadly stable. The external current account and budget continued to be financed by donor grants.

6. **Fiscal vulnerabilities emerged; revenue underperformed, spending pressures increased, and eroded the treasury cash balance**. Weak growth, declining imports and lower compliance resulted in lower domestic revenue collection. Higher social and development outlays added to spending. Lower revenue and increased spending pressures, particularly from operating outlays, eroded discretionary treasury cash position, which after falling to zero in the second half of 2014, was rebuilt to Af 8.7 billion at the end of FY 2014, compared to Af 21 billion at the beginning of the year. Although we remained current on payment of wages and salaries, other payment arrears emerged in the second half of the year as the revenue shortfall worsened.

7. **In 2014, the banking sector's asset quality deteriorated**. Deteriorating loan quality raised vulnerabilities in the financial sector, with some banks already suffering from low capital, high credit risk and shortcomings in banks' governance. 8 out of 15 banks in the banking sector are classified as weak (rated 4 or 5 according to CAMEL methodology). Dangerous weaknesses emerged in two banks, including a systemic one. These weaknesses are being addressed actively; one bank has implemented measures to address its vulnerability. DAB has already approved a strategy of dealing with weak banks which envisages improving banking sector's CAMEL ratings by February 2016. The plan is being implemented and banks have submitted action plans to address their weaknesses and deficiencies with marked improvements in many areas.

8. **Support from our international partners helped ease the cash crunch and finance the budget**. These flows helped address immediate financing requirement and helped reduce fiscal vulnerability. Further, London Ministerial Conference in December reconfirmed our international partners' commitment to finance our security and development needs.

9. **Our policy response to the deterioration in macroeconomic conditions was not sufficient**. As a result, domestic revenue collection was much lower and credit to government was higher than planned in 2014. Reserve money and currency in circulation were also slightly higher than end-year targets. Although we took measures to respond to the widening fiscal gap, lower budget revenue and higher development spending depleted the treasury's cash balance and arrears emerged. Arrears and unfunded allotments amounted to Af 10 billion at the end of FY 14. Nevertheless, the operating deficit was contained during 2014 and targeted social and other priority spending was met. Further, gross international reserves remained comfortable ($7.2 billion at end FY 14), as Da Afghanistan Bank (DAB) managed the exchange rate flexibly and the exchange rate depreciated by 4.1 percent in nominal terms during the year.

10. **We continued to make progress on structural reforms in 2014**. Although progress in implementing structural reform slowed around the election, we passed the anti-money laundering (AML) and combating the financing of terrorism (CFT) laws, and the new banking law was discussed in parliament and the finance, budget and banking affairs commission incorporated IMF staff suggested amendments. Also, the DAB law amendments are in the legislative pipeline.

11. **DAB's Supreme Council promulgated on September 28, 2014 a regulation which includes provisions for adequate legal protection of its supervisory staff**. It took into account IMF staff comments. Although the DAB and the banking laws are clear about the legal protection of DAB staff, given the importance of the issue for supervisory performance and duties, further actions will be taken to ensure they are observed and respected.

12. **We reaffirm the importance of ensuring the independence and autonomy of DAB**. Amendments to the DAB law are being reviewed by the ministry of justice. The proposed amendments, drafted in consultation with IMF staff, will enhance DAB's independence and operational autonomy and will ensure that DAB can promote its objectives of domestic price and financial sector stability, which are central to our economic policy framework. DAB continued to strengthen its financial supervision department (FSD) by implementing FSD's strategic plan, launched in June 2013, to strengthen its effectiveness and capacity.

13. **We have strengthened our legal and institutional framework to respond to economic crimes**. In addition to the new AML and CFT laws, we also issued CFT Regulations in October 2014 to better comply with the relevant United Nations Security Council Resolutions. With the support of IMF capacity development (CD), we increased the capacity of our financial intelligence unit (FinTRACA) and expanded the registration of money service providers (MSPs). We have also taken measures to improve inter-agency coordination and information exchange between FinTRACA, the DAB's FSD, and law enforcement agencies. The DAB Supreme Council issued a new regulation, on July 6, 2014, on strengthening the legal framework of establishment and functionality of the FIU in line with FATF standards. The Economic Crimes Task Force (ECTF) has been formed to develop effective policies for combating complex economic crimes and to bring further coordination among the involved institutions. In April 2014, the ECTF submitted an advisory memo to the Criminal Law Review Working Group (CLRWG) on categories of economic offences set out in the Financial Action Task Force (FATF) 40 recommendations and other complex economic crimes to be included in the consolidated new Penal Code.

14. **We will delay introduction of the value added tax (VAT)**. After significant delays, parliament's lower and upper houses discussed the VAT law, but reduced the rate from 10 to 5 percent undermining the VAT's revenue potential. We believe that introducing a VAT should be postponed to ensure Afghanistan is ready for its implementation, because the tax administration is not yet in a position to facilitate a smooth transition, due to the fragility of the environment. In the meantime, we have prepared alternatives revenue-raising measures, discussed below, that would help offset part of the revenue impact of this delay. We believe that a VAT is needed and its introduction is an important part of our medium-term revenue mobilization strategy. We will consult with the Fund on the timing of the VAT. Accordingly, we will work to strengthen the tax administration so that it can be introduced in the future.

15. **We also worked on other economic legislation**. The new law on sukuk debt instruments is being prepared with IMF CD and the mining law was approved by the lower house. Amendments to the companies' law that would strengthen the framework for oversight by the ministry of finance over state owned corporations are in the legislative pipeline.

16. **We have continued our efforts to resolve Kabul Bank and asset recovery**. Between February 28, 2014 and January 31, 2015 cash recoveries amounted to $4 million bringing total cash recoveries to $179 million. Difficulties in finding buyers for domestic assets, ascertaining legal documentation of property ownership and slow progress in recovering assets held overseas continued to impede asset recovery. Major domestic assets (Pamir, Zakhira Hairatan, Isteqlal and Gulbahar center apartments) were sold to government for $48.8 million, after several attempts to attract buyers from the private sector failed. This, together with $97.8 million discounted interest brings the total outstanding claims to $663 million. A presidential decree was issued on October 1, 2014 to swiftly resolve Kabul Bank case and recover the stolen assets. On November 11, 2014, the appeal court included embezzlement and money laundering in the convictions against two largest former shareholders, tripled their jail sentences from 5 to 15 years, and sentenced them to repay a total of $374.6 million. The appellate court decision was affirmed by the Supreme Court and the Attorney General's Office was assigned to enforce these verdicts, freeze bank accounts and assets of Kabul Bank shareholders and borrowers until the status of Kabul Bank's receivership's claim against them are finalized. Requests for mutual legal assistance have been sent to a number of foreign jurisdictions, including the United Arab Emirates, United Kingdom, France, Switzerland, India, United States, and China, on which we are following up regularly. We will continue and accelerate our work to speed up Kabul Bank's asset recovery and make progress in implementing the recommendations of the Joint Anti-Corruption Monitoring and Evaluation Commission.

C. Economic Program for 2015

17. **Our program will address fiscal and banking vulnerabilities, preserve macroeconomic stability, and seek to lift growth through structural reform**. The macroeconomic policy mix will maintain buffers, low inflation 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, and maintain the treasury's cash balance, while avoiding debt accumulation. Monetary policy will aim to preserve low inflation and continue exchange rate flexibility to protect the international reserves position and competiveness. Structural reform will focus on: (i) fiscal revenue mobilization and strict expenditure control; (ii) financial sector reform; and (iii) economic governance reforms.

18. **We are cautiously optimistic about 2015 but there are downside risks**. Growth is expected to recover in 2015 with the new government in place and the expected improvement in security. The recovery of nonagricultural growth will remain constrained by weak domestic demand and delays in large mining projects. With continued reform and donor support, growth is projected to increase further in 2016 and inflation to remain in single digits. Security conditions, which affect economic confidence, are a significant source of risk.

19. **Poverty reduction remains an important priority**. Our policies will be based on the paper we prepared for the London Conference on Afghanistan *Realizing Self-Reliance*. They will 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 help the poor. To monitor results, we will continue to improve the collection and analysis of poverty indicators. Pro-poor operating spending in the 2015 budget is programmed to be about Af 32.4 billion (2.6 percent of GDP).

Macroeconomic Policies

20. **Our macroeconomic policy framework is designed to preserve macroeconomic stability and promote growth**. It will target a pick-up in GDP growth to 3.5 percent and average inflation of about 4 percent in 2015. It will also maintain buffers of low debt (less than 10 percent of GDP) and a comfortable international reserves position (7½ months of import cover). It will protect competitiveness, with the overall budget broadly balanced and the current account in surplus. The operating balance excluding grants remains the fiscal anchor, while reserve money remains the monetary anchor. We will remain dependent on donor support to meet our fiscal and external financing needs.

21. **We target a significant improvement in revenue performance in 2015**. Domestic revenue is projected to increase by 1 percentage point of GDP (to 9.6 percent of GDP). We are taking additional revenue measures in the 2015 budget to raise revenue by about Af 10 billion (0.8 percent of GDP). Additional revenue measures include an increase in the business receipts tax rate, increasing import tariffs, introducing a telecommunications tax, tripling the fuel fee collected at customs, and increasing overflight fees for using Afghanistan's airspace. The composition of the projected improvement in revenues also reflects an improvement in taxpayer compliance and reduction of leakages with collections increasing by Af 4 billion (0.3 percent of GDP). We have already increased import tariffs and overflight fees, which are projected to yield Af 1.5 billion in 2015 and we plan to implement the other measures by end-June 2015, which are projected to yield Af 8.9 billion in 2015 and need parliamentary approval. Further, we have identified contingency measures totaling Af 4 billion that can be deployed swiftly, if budget execution is not in line with our plans, i.e., revenue or grants are lower or expenditure is higher.

22. **We will contain nonpriority spending and implement strict control of other nonsecurity related spending**. Operating spending is expected to increase somewhat to 20.2 percent of GDP in 2015 as donor-financed security-related spending continues to be moved on budget as part of the security transition. The operating balance (deficit), excluding grants was 11.0 percent of GDP in 2014 and projected to moderate slightly to 10.5 percent of GDP in 2015. To contain nonsecurity operating spending in 2015, we will limit increases in wages and pensions, limit bonuses, and reduce the headcount and the number of highly paid positions in some ministries. We will also conduct a review of the targeting of payments to martyrs and disabled, which constitutes over 66 percent of total pension spending. Discretionary development spending will be strictly controlled in 2015, while ensuring repayment of arrears.

23. **We will improve coordination between budget and treasury departments and maintain pro-poor spending**. We will link in-year allotments to cash availability to ensure that the government's payment obligations remain within projected cash availability to avoid arrears and ensure the treasury's discretionary cash balance does not fall below Af 5 billion during 2015, a new quarterly indicative target under our program. We will also settle arrears incurred lawfully in 2014. Implementation will start with weekly meetings of a cash management committee chaired by the minister of finance. Pro-poor spending is projected at 2.6 percent of GDP in 2015.

24. **We plan to carefully manage money growth, continue exchange rate flexibility, and safeguard international reserves**. Reserve money will continue to be the monetary anchor. We will implement a more active policy and improve coordination with the ministry of finance to manage reserve money growth. A modest pick-up in money demand is anticipated in 2015 as political and security transition uncertainties subside. Reserve money growth of 11 percent is projected, as we expect some recovery in the demand for real balances. Our program envisages a moderate increase in NIR ($150 million). International reserve cover will remain at 7½ months of imports. We will let the Afghani move with market trends and only intervene to avoid excessive exchange rate volatility.

Structural Reforms

25. **We will reinvigorate structural reforms this year**. Fiscal reforms will focus on improving revenue mobilization, efficient use of public resources, and avoiding pressures on the cash balance. Financial sector reforms will focus on addressing immediate vulnerabilities in the banking sector, dealing with weak banks, and strengthening bank supervision. Economic governance reform will strengthen the AML/CFT regime and legislative and institutional framework to combat economic crime.

Fiscal Reforms

26. **The additional revenue measures introduced in 2015 will support building revenue over the medium term**. The measures that we have introduced (increased import tariffs and overflight fees for using Afghanistan's airspace) and will introduce by end-June (increased BRT rate, telecommunications tax, fuel fee, and user fees) will yield revenue of over 1 percent of GDP per year in the medium term. In addition we will strengthen tax administration to raise revenue, improve governance, and facilitate VAT introduction in the medium term.

27. **We will put in place a sound and robust fiscal regime for natural resources**. We are designing a fiscal regime for the natural resources sector to attract investment and ensure the government receives a reasonable share of the economic rents. The IMF has provided CD to review the current framework and recommendations to create an effective and transparent fiscal regime for natural resources in full compliance with the Extractive Industries Transparency Initiative.

28. **In parallel, we will strengthen tax administration to raise revenue and improve governance**. We will implement reforms to strengthen the capacity of the Afghan Revenue and Customs departments (ARD and ACD), based on IMF CD advice.

- We will improve the taxpayer registry to facilitate efficient revenue management and decisions on compliance management efforts. ARD will establish a reliable and up-to-date taxpayer registry by removing taxpayers, who have been dormant for a number of years or never commenced taxable operations. The taxpayer register for Kabul will be updated by end-May 2015 and be extended to the provinces as soon as feasible (there may be challenges in certain provinces because of security conditions).

- Further, we will review and update tax arrears records to distinguish between collectible and uncollectible amounts. For collectible amounts, by end-October 2015, ARD will set time-bound targets for the collection of collectible amounts, which will be prioritized as follows: (i) amounts owed by taxpayers covered by the Large Taxpayer Office (LTO); (ii) the top 100 debtors; (iii) the largest arrears outside the LTO and top 100 debtors; and (iv) arrears that are less than 12 months old.

- To implement ARD's new Strategic Plan, which includes organizational changes, we will establish a Risk Analysis and Case Selection Unit by end-May 2015 to improve compliance and ensure effective resource management. This unit will develop and implement a data driven process to effectively identify and prioritize high-risk areas. Based upon high-risk areas identified, ARD's audit plan will allocate available resources to accelerate revenue collections. ARD will also establish key performance indicators to continuously assess performance of the risk-based audits and based on these assessments we will update existing audit policies, procedures and guidelines by end-October 2015.

- We are implementing an action plan to enhance custom controls. Further, the IMF's Middle East Technical Assistance Center plans to provide ACD CD to strengthen customs administration, with a focus on valuation issues, tariffs, and mobile verification teams' performance measurement.

29. **Public financial management will be strengthened**. We will continue to elaborate the medium-term fiscal framework (MTFF), especially for development spending, to improve fiscal reporting, and commitment control. We will improve identification of recurrent and capital expenditures and information on output targets alongside ministry appropriations. Further, we will press for electronic registration of invoices across all ministries and provinces and to establish a database for ongoing capital projects, with information on expenditure incurred and expenditure planned to complete the project, and the funding source. We will also publish quarterly analytical reports on financial performance of state-owned enterprises and companies and an assessment of their fiscal impact and risks in the MTFF. In addition, we will establish a Cabinet-level committee to conduct quarterly reviews of budget execution. This committee will prioritize the next quarter's expenditure, and propose for approval by Cabinet, if needed, to reduce budget allocations in light of the previous quarter's revenue collection and donor disbursements.

Financial Sector Reform

30. **We have acted to address banking vulnerabilities and will take further action if needed**.

- DAB has issued enforcement actions for the vulnerable systemic bank to ensure the bank recorded losses on its assets and restore capital levels and ratios. The bank has made significant progress in these areas and DAB will continue to monitor the bank closely and is ready to put the bank under conservatorship in the case of noncompliance.

- DAB has also issued enforcement actions against the other vulnerable state-owned bank, which needs improved management and additional capital. This bank suffers from fundamental weaknesses in governance, risk management, internal controls and management, which led to a near 100 percent nonperforming loan ratio, capital dissipation and fraud. In response, the bank has been prohibited from extending any further loans. To this end, we will ensure management positions are filled with fit and proper bankers swiftly, and we commit to restore the capital required minimum levels by end of 2015 through a minimum aggregate capital injection of $20 million during 2015. The bank will also prepare a five-year operating strategy with projected financial statements, key performance objectives, and quarterly reporting to monitor performance, which will be submitted to DAB by end-June 2015 and finalized by end-August 2015. An independent external party will be hired to audit bad debt recoveries. Should the strategy not be effective, and the bank is not able to achieve an operational break-even within 18 months, i.e., by end-February 2017, the bank put into conservatorship followed by its liquidation or sale.

- DAB has prepared a plan to deal with the other weak banks and started to implement it. This plan envisages increasing CAMEL ratings significantly for all weak banks by end-February 2016. It will improve weak banks' CAMEL ratings by focusing on management, capital adequacy, and asset quality areas, and DAB will issue corrective action in case of no improvement as envisaged under its action plan for weak banks.

31. **We will re-start the sale of New Kabul Bank (NKB)**. When NKB was formed in 2011, it was not properly capitalized and since then it has incurred further losses. It is therefore imperative first to reduce and then eliminate further losses at NKB. NKB's management has already reduced losses significantly, from $22 million in 2012 to $6 million in 2014. Further, NKB management is implementing further measures that will make NKB profitable by end-2015. We believe reducing losses at NKB will make its privatization more attractive and result in a higher sale price. Accordingly, we wish to implement additional measures to reduce losses before initiating its privatization. We therefore plan to initiate NKB's privatization by end-September 2015. The World Bank is working on national payment system upgrades that will over time make the transfer of the government salary function to other banks possible.

32. **We will promulgate the new banking law by June 2015**. The legislation–drafted in consultation with IMF staff–strengthens corporate governance, capital requirements, large and

related parties lending exposures, and enhances supervision and bank resolution provisions. We have prepared revised regulations and information circulars, consistent with new legislation, which will be finalized and issued once the new banking law is enacted.

33. **We continue to strengthen the DAB's Financial Supervision Department (FSD)**. DAB will continue to implement the FSD's five-year strategic plan, launched in July 2013, to implement its new organizational structure. Specifically, DAB's supreme council will approve a detailed organizational file for FSD that includes: (i) the main duties and responsibilities of FSD and its relationship and reporting lines vis-à-vis other DAB departments; (ii) the main duties and responsibilities of FSD divisions and their relationship, reporting lines and coordination with each other and with FSD senior management; and (iii) a job description of each staff position within each of FSD's division/units/sections that includes the educational requirements, the requisite experience, skills needed, grade, main duties and responsibilities, and reporting lines by end-September 2015. We also plan to enhance the offsite supervision through adoption of a new manual and revision of the existing offsite reports, as well as prepare a new manual for the onsite inspection and training of FSD supervisors on its implementation. The Supervisory Enforcement Committee will continue its regular reviews of banks' compliance with FSD's supervisory orders. For on-site supervision, we will prepare a new manual for the onsite inspection and training of FSD supervisors on its implementation. Furthermore, we will revise the banking regulations on asset classification and provisioning by end-September 2015. We will also revise banking regulations on related party lending and corporate governance by end-December 2015 to bring them in line with international best practices and the new banking law. Our reform agenda also includes developing a risk-based supervisory framework and establishing an automated supervisory reporting system.

34. **We are also working to strengthen the independence and operations of DAB**. With the realized revaluation gains, the DAB is no longer undercapitalized and the new capitalization framework will ensure it remains so, so that monetary policy implementation is not affected by capital or income considerations. To make the new capitalization framework operational, we will submit to parliament amendments to the central bank legislation by end-December 2015—drafted in consultation with IMF staff—implementing the memorandum of understanding on the central bank's capitalization that aligns the provisions on the netting and allocation of net income with international good practice. DAB is also developing its operations report for parliament (to become part of its Annual Report), which will enable parliament to evaluate and monitor DAB's progress on implementation of its mandate as outlined in DAB Law. Further, we will resume timely publication of DAB's audited financial statements.

35. **We will continue to promote financial market development**. With IMF CD, we are preparing the sukuk law, a sukuk implementation plan, including identification of assets to back sukuk, and preparing, the necessary capital market and securities issuance legislation and regulations. To further improve monetary policy operations, we have introduced shorter maturity, seven-day, capital notes and will make further improvements that could include reserve requirement averaging and restarting DAB's standing deposit and credit facilities. We also intend to promote secondary trading with existing instruments, starting with capital notes. In this regard, DAB will work with the Afghan Bankers Association to guide discussions with dealers on the protocol for agreeing and executing trade, a "Code of Conduct." In addition, we will foster the development of the interbank market.

36. **We will take action to improve bank lending to strengthen intermediary role of the financial sector to support growth**. We plan to address deficiencies in the areas of contracts, collateral, company and insolvency laws to strengthen the rights of contracting parties (debtor and creditor) and address the rights of creditors in corporate insolvencies and household bankruptcies. We will also reform land laws to enable registration of land titles and transfers, and recognition of mortgages and other security interests.

Economic Governance

37. **We are committed to strengthen further Afghanistan's AML/CFT legal framework**. To this end, we have amended the AML Law, in particular to include the proceeds of predicate offenses committed abroad in the scope of the law; increase the amounts of the fines for legal persons; and ensure that imprisonment and fines are not alternative penalties but may be applied cumulatively. To strengthen the regulatory regime to monitor the cross border transportation of currency and bearer negotiable instruments, we will finalize a new regulation on currency reporting at the border by end-June 2015. Starting in September 2015, the Customs Administration will publish relevant statistics on an external website, including the number of declarations, the amounts reported and the currency, the countries of origin, and the number and type of enforcement actions taken. Guided by IMF CD, and to mitigate the money laundering and terrorism financing risks posed by the potential misuse of financial institutions, we are committed to submit to the Supreme Council of the DAB, by end-September 2015, the draft AML and Proceeds of Crime Regulation–Preventive Measures for Financial Institutions in line with FATF recommendations 1, 10, 12, 14, and 16.

38. **We are determined to take resolute action to tackle corruption in our country**. To this end, we will by end-December 2015 submit to parliament (i) legislation to criminalize bribery of foreign public officials, trading in influence, illicit enrichment, bribery and embezzlement of property in the private sector, in line with the United Nations Convention against Corruption (ratified by Afghanistan on August 25, 2008); and (ii) an amendment to Article 12 of the Law on Overseeing the Implementation of the Anti-Administrative Corruption Strategy to provide for the publication of the asset declarations made pursuant to Article 154 of the Constitution.

D. Program Modalities

39. **We will closely monitor the implementation of the nine-month SMP through December 31, 2015 with the help of quantitative targets and structural benchmarks**. The proposed quantitative targets and structural benchmarks are attached to the memorandum of economic and financial policies in Tables 1 and 3. The SMP will be monitored based on performance through two test dates: June 21, 2015 and December 21, 2015. The quantitative variables and the benchmarks are defined in the Technical Memorandum of Understanding.

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

Table 1. Islamic Republic of Afghanistan: Quantitative Targets, 2015 1/

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

	SMP 3/							
	Dec. 21, 2014	Mar. 20, 2015				June 21, 2015	Sep. 22, 2015	Dec. 21, 2015
	Beginning stocks for SMP	Indicative targets				Quantitative targets	Indicative targets	Quantitative targets
		Prog.	Adj.	Est.		Prog.	Prog.	Prog.
	(In billions of Afghanis, unless otherwise indicated)							
Revenues (floor)	…	20.8	...	24.1	✓	46.7	81.6	120.4
Operating budget deficit, excluding grants (indicative target: ceiling)	…	20.3	...	12.9	✓	55.5	89.0	131.6
Treasury cash balance (indicative target: floor)	…	5.0	...	13.6	✓	5.0	5.0	5.0
Net credit to government from DAB (ceiling)	-41.6	-1.3	-18.4	-20.2	✓	-4.3	-6.2	-0.6
Reserve money (ceiling)	225.2	-6.0	...	-17.6	✓	2.9	20.1	24.8
Currency in circulation (indicative target: ceiling)	197.0	-4.0	...	-14.2	✓	6.6	19.6	21.7
Social and other priority spending (indicative target: floor)	…	8.1	...	8.1	✓	16.2	24.3	32.4
International reserves of DAB (floor; in millions of U.S. dollars)	6,694	38	331	108	✗	75	112.5	150
Nonconcessional external debt, new (ceiling) 2/	…	0.0	...	0.0	✓	0.0	0.0	0.0
Short-term external debt (ceiling) 2/	…	0.0	...	0.0	✓	0.0	0.0	0.0
External payments arrears, new (ceiling) 2/	…	0.0	...	0.0	✓	0.0	0.0	0.0
Borrowing by public enterprises in need of restructuring—from DAB or state-owned banks, or government-guaranteed (ceiling) 2/	…	0.0	...	0.0	✓	0.0	0.0	0.0
Reference values for the adjustors			Diff.					
Core budget development spending	...	8.0	-0.7	7.3		25.8	49.7	90.0
External financing of the core budget and sale of nonfinancial assets 4/	...	29.6	17.0	46.6		85.6	144.8	222.1

Source: Afghan authorities.

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

2/ These quantitative targets apply on a continuous basis.

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

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

Table 2. Islamic Republic of Afghanistan: Structural Reforms Implemented in Early 2015

Measure	Date	Status/Rationale
DAB to communicate its enforcement actions to the vulnerable systemic bank including time bound instructions on: i. Recording losses on bank's assets (as required by DAB), ii. Restoring capital levels and ratios to required minimum levels under the banking law by injecting fresh capital by March 2015, and iii. Should the actions under i) and ii) above not be implemented, implementing enforcement actions under Chapter VII of the Banking Law of Afghanistan.	Implemented.	Address banking vulnerability.
Implement tax policy measures that do not require parliamentary approval (increasing import tariffs and increasing fees for using Afghanistan's airspace) to yield Af 1.5 billion in 2015.	Implemented.	Mobilize Budget Revenue.
DAB to communicate its enforcement actions to the other vulnerable bank including time bound instructions on: i. Recording losses on bank's assets, ii. Prepare a five-year operating strategy with projected financial statements, key performance objectives (profitability, meeting regulatory capital requirements, return on equity, return on assets, NPL ratio, net interest income and noninterest income to total assets, and liquidity), and quarterly reporting to the Board and DAB to monitor performance. A draft five-year operating strategy will be submitted to DAB by end-June 2015, finalized by end-August 2015, and its implementation will be monitored quarterly by the bank's Board and DAB, iii. Ensure management positions are filled with qualified bankers by appointing a new CEO and CFO by end-April 2015, new Board members by end-June 2015, and a Chief Operating Officer by end-September 2015, iv. Restoring capital levels and ratios to required minimum levels by December 2015 with capital injections of $10 million in June 2015, and $5 million each in September and December 2015.	Implemented.	Address banking vulnerability.
Recapitalize the vulnerable systemic bank, so it meets prudential requirements for capital and if the recapitalization does not take place, implement enforcement actions under Chapter VII of the Banking Law of Afghanistan.	Implemented.	(Capital position is being verified, may be met.) Address banking vulnerability.

Table 2. Islamic Republic of Afghanistan: Structural Reforms Implemented in Early 2015 (concluded)

Measure	Date	Status/Rationale
DAB to complete an action plan to deal with weak banks in the system aiming at enhancing the enforcement framework and with the objective of reducing sharply the number of weak banks within one year (after taking into consideration any unrecorded losses required by DAB). This action plan should be based on a study of the main reasons underlying the continued presence of a substantial number of weak banks in the sector, the main enforcement actions taken against them, the main gaps and the recommendations to enhance their resolution.	Implemented.	Plan completed in December 2014. Addressing banking vulnerabilities to safeguard financial stability.
Enact amendments to the AML Law, in particular to (i) include the proceeds of predicate offenses committed abroad in the scope of the law; (ii) increase the amounts of the fines for legal persons in Article 50.2 to bring them in line with the fines for natural persons (Article 52); and (iii) ensure that imprisonment and fines are not alternative penalties but may be applied cumulatively (Article 50).	Amendments approved and will be enacted when published in the Official Gazette.	Strengthen regulatory and transparency measures, improve business climate.

Table 3. Islamic Republic of Afghanistan: Structural Benchmarks

Measure	Date	Status/Rationale
The other vulnerable (non-systemic) bank will hire an independent external party by end-June 2015 to audit bad debt recoveries in respect of delinquent amounts that exceed the equivalent of $0.5 million.	End-June 2015	Address banking vulnerability.
Promulgate the banking law	End-June 2015	Strengthen financial sector and legal framework for dealing with weak banks.
Implement revenue measures proposed in the 2015 budget that require parliamentary approval to yield Af 8.9 billion in 2015.	End-June 2015	Mobilize budget revenue.
The Council of Ministers will issue a revised Regulation under Article 7 of the AML Law on currency reporting at the border, in line with FATF recommendation 32, to strengthen the regulatory regime to monitor the cross border transportation of currency and bearer negotiable instruments and to enable electronic transmission of information from the Customs Department to FinTRACA.	End-June 2015	Strengthen measures to detect and combating economic crime.
Revise the banking regulations on asset classification and provisioning. The revisions to the asset classification and provisioning should include: (i) clear and objective definition for the different classification categories of loans in line with international standards and best practices; (ii) minimum general provision to be established on performing loans including standard loans; (iii) changes in the treatment of collateral so that it can be considered in computing the adjusted loan exposures rather than warranting an upgrade in the loan classification if the loan is classified as doubtful or better; however, if the loan is classified as loss, collateral cannot affect classification; (iv) detailed rules and criteria for writing-off loans; and (v) strict measures to be enforced against noncomplying banks.	End-September 2015	Align key regulations with international standards and best practices.

Table 3. Islamic Republic of Afghanistan: Structural Benchmarks (concluded)

Measure	Date	Status/Rationale
Afghanistan Revenue Department to implement a data driven risk based audit case selection process. Develop and implement a data driven process to effectively identify and prioritize high-risk areas. Based upon high-risk areas identified, implement ARD audit plan to effectively allocate available resources to accelerate revenue collections. Establish key performance indicators to continuously assess performance of the risk-based audits. Based upon performance results, update existing audit policies, procedures and guidelines.	End-October 2015	Strengthen tax administration and mobilize budget revenue.
Revise the banking regulation on related party lending. The revisions to the regulation on related party lending limits should include: (i) revising the definition of related parties according to international standards; (ii) confirming the limit on related party aggregate exposures to a maximum of 15 percent of the bank's unimpaired capital and reserves; and (iii) in case of any exposure over the limit prescribed in the regulation, deduct such exposure from capital when assessing capital adequacy, unless sufficiently and satisfactorily collateralized.	End-December 2015	Align key regulations with international standards and best practices.

Attachment II. Technical Memorandum of Understanding

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

A. Program Exchange Rates and Gold Valuation

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

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

B. Quantitative Targets and Indicative Targets

3. The quantitative targets for June 2015, and December 2015, specified in Table 1 of the Memorandum of Economic and Financial Policies, are:

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

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

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

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. **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.

7. **Treasury cash balance** is defined as the total discretionary cash balance at the treasury account in DAB.

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

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

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

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

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

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

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

- Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The official Afghanistan Government Financial Management Information System (AFMIS) reports will be used as the basis for program monitoring. Exceptional advanced payments will be treated as if received on the normal due date. All revenue must be supported by the relevant documentation and revenue receivables, where a cash sum has been recorded but the revenue item has not yet been accounted for, and revenues payable, where the revenue has been reported but the cash has yet to be recorded should be separately reported on a gross basis.

12. **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.

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

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

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

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

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

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

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

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

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

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

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

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

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

- It applies to debt as defined in paragraph 13 of this memorandum.
- Excluded from the limit are rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits.
- Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

16. A continuous quantitative target applies to the **nonaccumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or the DAB. External payment arrears consist of external debt service obligations (principal and interest) falling due after March 20, 2015 and that have not been paid at the time they are due, as specified in the contractual agreements. Excluded from the prohibition on the accumulation of new arrears are (i) arrears arising from interest on the stock of arrears outstanding as of March 20, 2015; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

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

- For the purposes of this quantitative target (i) "state-owned banks" refers to those banks that are wholly or majority owned by the government (as defined in paragraph 14 of this memorandum), including Bank Millie, Bank Pashtany and New Kabul Bank; (ii) "public enterprises in need of restructuring" refers to enterprises that meet either of the following: (a) public enterprises that have not had an audited balance sheet in the past two fiscal years, (b) public enterprises that have been identified by the Ministry of Finance for liquidation, or (c) public enterprises that do not have cabinet-approved restructuring plans; and (iii) "public enterprises" refers to enterprises wholly or majority owned by the government, including those covered by the State-Owned Enterprise (Tassady) Law, and all state-owned corporations and any other public entities and government agencies engaged in commercial activities but not covered by the Tassady Law.
- It applies to any new loans (or financial contributions) extended directly from the central bank or state-owned banks to public enterprises in need of restructuring, and also to any explicit government guarantees for borrowing undertaken by these public enterprises (including loan agreements and guarantees for which value has not been received).

18. **Operating budget deficit of the central government** excluding grants is defined as revenues of the central government minus operating budget expenditure recorded in AFMIS.

C. Adjustors

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

Date	Accumulative over the Respective Year (Billion Afghani)
December 21, 2014	77.9
March 20, 2015	8.0
June 21, 2015	25.8
September 22, 2015	49.7
December 21, 2015	90.0

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.

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

Date	Accumulative over the Respective Year (Billion Afghani)
December 21, 2014	182.2
March 20, 2015	29.6
June 21, 2015	85.6
September 22, 2015	144.8
December 21, 2015	222.1

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

Should such asset recovery 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 the actual recovery and its projected level.

21. 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).

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

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

D. Provision of Information to the Fund

24. 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.

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

- DAB net international reserves: weekly, no later than two weeks after the end of each week.
- Monetary statistics, including exchange rates, government accounts with the DAB, currency in circulation, reserve money, and a monetary survey: monthly and no later than three weeks after the end of the month (six weeks in the case of the monetary survey). The monetary survey will include the balance sheet of the DAB and a consolidated balance sheet of the commercial banking sector.
- Core budget operations and their financing: monthly and no later than four weeks after the end of the month. The official reports for program monitoring will be the monthly financial statements from the Afghanistan Financial Management Information System. The structure of financing (grants and loans should be separately identified) and expenditure data should be on a consistent cash basis. 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 loses into technical and nontechnical for regions outside Kabul.

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

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

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

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

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

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

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

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

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

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

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

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

STAFF-MONITORED PROGRAM—INFORMATIONAL ANNEX

May 7, 2015

Prepared By

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

CONTENTS

RELATIONS WITH THE FUND

(As of March 31, 2015)

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

General Resources Account:

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

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	155.31	100.00
Holdings	99.25	63.90

Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
ECF Arrangements	69.96	43.21

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	Nov 14, 2011	Nov 13, 2014	85.00	24.00
ECF[1]	Jun 26, 2006	Sep 25, 2010	81.00	75.35

[1] Formerly PRGF.

Projected Payments to Fund[2] (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	**2016**	**2017**	**2018**	**2019**
Principal	8.67	15.07	15.02	11.58	7.06
Charges/Interest	0.02	0.03	0.03	0.03	0.07
Total	**8.69**	**15.10**	**15.05**	**11.61**	**7.13**

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

Implementation of HIPC Initiative:

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

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

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

Implementation of MDRI Assistance: Not Applicable

Implementation of PCDR: Not Applicable

Nonfinancial Relations

Exchange Arrangement

Afghanistan is an Article XIV member country. The authorities are implementing a liberal exchange system. Based on information currently available to the staff, no exchange restrictions and multiple currency practices are in place. The authorities have provided documents to Fund staff related to laws and regulations on the exchange regime and have requested technical assistance from the Fund to formalize the current liberal regime. They have been implementing a managed float system with no predetermined path for the exchange rate. On April 21, 2015, the average of the buying and selling exchange rates in cash transactions on the Kabul money exchange market was 57.88 Afghanis per U.S. dollar.

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

Article IV Consultation

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

Safeguards Assessment

Under the Fund's safeguards assessment policy, the Da Afghanistan Bank (DAB) was subject to a safeguards assessment with respect to the ECF arrangement approved on November 13, 2011. An initial safeguards assessment of the DAB was completed on June 12, 2006, updated on March 18, 2008, and then in December 2011. The latest update for the safeguards assessment found that while most of the previous safeguards recommendations had been implemented, an effective internal audit mechanism had still not been established and governance oversight was weak. The assessment also made recommendations to address new risks emerging as a result of the Kabul Bank crisis including with respect to central bank autonomy. Since the assessment, some recommendations have been implemented, albeit with delay. In particular, a Memorandum of Understanding on central bank capitalization has been signed and an external auditor has been appointed. The authorities plan to submit amendments to the DAB law to parliament by end-December 2015 to implement the Memorandum of Understanding and make new capitalization framework operational. The DAB is committed to implementing the remaining safeguards recommendations, with priority assigned to development of the internal audit function (with external support) and strengthening of Audit Committee oversight.

Technical Assistance, 2011–15

Department	Dates	Purpose
FAD	January 2–12, 2011	PFM Assessment
	January 22–February 4,2011	Customs Administration
	April 1–13, 2011	Customs Administration
	September 15–22, 2011	Program Budgeting Reform
	January 14–18, 2012	Visit to Support SIGTAS Preparations
	January 14–25, 2012	VAT Introduction
	January 14–28, 2012	Customs Administration
	April 4–14, 2012	Follow-up mission (different TA topics)
	April 6–14, 2012	Follow-up mission to review PFM Roadmap

	November 2–14, 2012	Advancing Public Financial Management Reforms*
	April 13–May 1, 2013	Customs Administration
	April 29–May 6, 2013	Public Financial Management Reform[6]
	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 and Administration for Extractive Industries
LEG	September 21–26, 2013	Diagnostic Review of AML/CFT regime
	February 5–6, 2014	Awareness raising workshop for Parlimentarians (Dubai)
	April 28–May 2, 2014	AML/CFT training for DAB and FinTRACA officials
	November 10–14, 2014	TA on AML/CFT issues
	February 9–13, 2015	AML/CFT training for DAB and FinTRACA officials
MCD	August 29, 2011–April 5, 2013	Resident monetary policy and banking advisor
MCM	February 7–14, 2011	Banking crisis management (with MCD)
	July 24–27, 2011	Islamic Finance (sukuk workshop)
	October 1–12, 2011	Banking supervision
	November 13–17, 2011	Islamic Banking
	December 10–15, 2011	Banking regulations
	February 11–14, 2012	Sukuk TA mission
	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
METAC	January 10–14, 2011	Tax Information Systems (workshop)
	May 22–26, 2011	Sukuk Workshop and TA in Dubai
	December 10–19, 2011	Consumer price statistics
	January 14–18, 2012	Follow-up on tax administration reforms
	April 7–12, 2012	Developing regulations
	April 15–26, 2012	Consumer price statistics
	June 16–27, 2012	Bank Enforcement Framework / Enhance the enforcement framework at DAB
	June 24–27, 2012	Balance of Payments and International Investment Position Statistics

[6] METAC Advisor participated to the mission

	September 17–20, 2012	Study mission to Lebanon on VAT implementation
	November 3–12, 2012	Off-Site Analysis 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
	September, 2014	VAT implementation/study tour in Beirut
	November 3–7, 2014	External Sector Statistics
	February 19–22, 2015	Review the Current situation in Tax and Customs Administration/Joint Mission with MCD in Dubai
	April 6–10, 2015	Dealing with weak banks—Banking Supervision/delivered in Beirut
STA	February 6–17, 2012	National accounts statistics
	May 7–18, 2012	National accounts statistics

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

Resident Representatives

Mr. de Schaetzen; August 2002–June 2005

Mr. Charap; June 2005–June 2008

Mr. Abdallah; June 2008–January 2014

RELATIONS WITH THE WORLD BANK

(As of March 25, 2015)

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

2. Since 2002, IDA has committed a total of $2.77 billion in grants (83 percent) and credits (17 percent) in Afghanistan. In addition, the Afghanistan Reconstruction and Trust Fund (ARTF) has generated $7.99 billion from 33 donors, and committed $3.61 billion for the government's recurrent costs and $3.79 billion for government investments programs. At end of January 2015 the active IDA portfolio totaled $835.98 million and the active ARTF investment portfolio totaled $2.46 billion.

3. The Bank 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 3-year rolling financing strategy. Together, International Development Association (IDA) and the Afghanistan Reconstruction Trust Fund (ARTF) provide close to $1 billion per year in grant resources (about $150 million from IDA and about $800–US$900 million from the ARTF). The ARTF is a key vehicle for providing government with predictable and transparent on-budget financing and provides a platform for policy dialogue between government and donors.

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

5. In fiscal year 2014, the World Bank Board approved two new IDA-financed projects and additional financing for an existing project totaling $106.7 million, plus the CASA-1000 regional project. The new projects included $50 million for the Development Policy Grant and $50 million for Access to Finance; the Financial Sector Rapid Response project received $6.7 million in additional financing. CASA-1000 was approved in March 2014 by the World Bank Group's Board of Executive Directors for total grant and credit financing of $526.5 million. Of the total project financing for CASA-1000, Afghanistan receives $316.5 million in the form of an IDA grant. The FY14 IDA commitments fully utilized IDA-16.

6. In addition, in fiscal 2014 the ARTF approved $419.56 million in recurrent cost financing (of which $125 million was for recurrent cost baseline financing, $113.70 million for the Incentive Program, $146.96 million for AHP payment and O&M $33.90 million, and $580 million for Investment Window financing, including the Second Education Quality Improvement Program ($125 million), the Third Emergency National Solidarity Project ($200 million), the CASA Community Support Project ($40 million), the Nonformal Approach to Training, Education and Jobs in Afghanistan ($15 million), Kabul Municipal Development Project ($110 million), and Kabul Urban Transport Efficiency Improvement Project ($90.50 million).

7. The World Bank has continued to engage in rigorous analytical work and placed increased emphasis on policy dialogue. These nonlending 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 this regard, four pieces of analytical work stand-out; Transition Economics, Resources Corridors, Poverty Analysis, and Agriculture Sector Review. The Bank also prepared Policy Notes on key sectors of the economy to help guide its policy dialogue with the new administration.

8. IFC's portfolio in Afghanistan has more than doubled since FY08—from around $8 million to about $135 million to date. IFC is following an integrated advisory and investment strategy focused on improving the investment climate, building capacity, and supporting selective investments in sectors with high development impact and job creation. Currently, IFC's portfolio includes two investments in the telecommunication sector and two operations in the financial markets. Going forward, IFC is looking to expand its investment program in Afghanistan, in the areas of infrastructure, finance, manufacturing, agribusiness and services.

9. MIGA has $155 million of gross exposure in Afghanistan, supporting telecoms and agri-business projects. MIGA recently launched its "Conflict Affected and Fragile Economies Facility," which will boost the agency's exposure in Afghanistan. MIGA is currently supporting three projects in Afghanistan, of which one is a joint effort with IFC in the telecoms sector (MTN). The other two are MIGA-only dairy and cashmere production projects.

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

(As of March 25, 2015)

1. **Joint Management Action Plan (JMAP)**. The Afghanistan country teams of the World Bank (led by Mr. Saum, country director) and the IMF (led by Mr. Ross, mission chief) have been in constant touch and teams held formal consultations in June, September, October, and December 2014, as well as March 2015. The teams exchanged views on the recent economic developments and their outlook, identified the macroeconomic priorities and challenges facing Afghanistan and discussed ways to coordinate their respective work programs.

2. **2014 was a challenging year for economic management**. Political and security uncertainties resulted in lower economic activity and important vulnerabilities**.** Fiscal vulnerabilities emerged as the authorities acquiesced to spending pressures, despite a significant revenue shortfall. The treasury cash balance was eroded with payment arrears and unfunded allotments emerging during the second half of 2014. Banking sector vulnerability increased because of lax enforcement, forbearance, and delays in financial sector reforms. The following areas are critical from the macroeconomic perspective in the short and medium terms:

- ***Sustaining macroeconomic stability***. Policies should focus on revenue mobilization, improving the effectiveness of public expenditures, containing nonpriority spending and controlling the money growth to manage inflation. A flexible exchange rate and international reserves should help accommodate shocks. The success of this strategy is predicated to a large extent on the continued donor flows, as pledged at the 2012 conferences in Chicago and Tokyo, and reaffirmed in September at the Wales Summit and December 2014 London Conference. The government's delivery on its commitments under the Staff-Monitored Program well as the ARTF Incentive Program and the IDA-financed Development Policy Grant will be critical towards sustaining donors' confidence.

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

- ***Safeguarding the financial sector***. Macroeconomic policies must be complemented by prudential measures to safeguard financial stability. The banking sector is weak and should be strengthened to be able to meaningfully contribute to economic development. Improving banking supervision at the central bank, implementation of the authorities' plan to deal with weak banks including public banks and the planned sale of the New Kabul bank are critical to this effort.

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

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

3. **Prioritizing reforms**. Teams agreed that policy recommendations for 2015 should focus on revenue mobilization, addressing vulnerabilities in the financial sector, and strengthening AML/CFT framework as well as tackling corruption.

4. **The Bank's work program is guided by the Interim Strategy Note (ISN)**. The ISN, approved by the Bank's Board in March 2012 and spanning 2012–14, envisages that the Bank will continue to expand its support to institutions and processes associated with transparent economic and financial management and community-level governance, especially through the National Solidarity Program. Regarding economic management, in 2014 and continuing into 2015, the Bank has supported the government with technical assistance in the areas of customs reforms, mineral resource management, and economic statistics. Under the ARTF, the Bank's team is preparing a new Incentive Program (IP) that will provide funds for achievements in revenue mobilization, strengthening of PFM systems, investment climate improvements, and custom reforms. Since January 2013, the IP has also supported the government's operation and maintenance expenditures. This support will continue during 2015 with financing amounting to up to $300 million. A Development Policy Grant Series ($100 million, half of which was disbursed in August 2013) focusing on strengthening sources of economic growth and fiscal revenues is currently under implementation (Table 1).

5. **The Fund's work program focuses on close engagement following the ECF-supported economic program expiration**. The first ECF program review was completed in June 2012. Subsequent reviews were delayed. In late 2013, the authorities and the Fund agreed on a set of informal quantitative targets and structural measures for 2014. These targets and measures aimed at maintaining macroeconomic stability and structural reform momentum. However, performance under the agreed quantitative framework in 2014 was mixed. The Fund focused its efforts on helping the authorities advance important pieces of legislation, including AML and CFT laws. It has also provided advice on the monetary policy and banking supervision. Technical assistance was provided on VAT implementation, external sector statistics and AML/CFT issues. In 2015, the Fund plans to help the authorities with revenue mobilization, further strengthening banking supervision, improving economic governance, advancing structural reforms, central bank capitalization framework, new

banking law, developing a fiscal regime for natural resources, , and improving macroeconomic statistics. The Fund will continue its close engagement with Afghanistan to ensure the stability of macroeconomic framework and lay the ground for sustainable inclusive growth.

Table 1. Afghanistan: Bank and Fund Planned Activities in Areas of Joint Interest
(October 2012–December 2015)

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

[1] Timing is tentative.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of March 24, 2015)

1. **Afghanistan is a founding member of Asian Development Bank (ADB), established in 1966**. After a hiatus from 1980 to 2001, ADB resumed partnership with the Government of Afghanistan in 2001. In the London and Kabul conferences in January and July 2010, respectively, and in the Chicago (May 2012) and Tokyo (July 2012) conferences, ADB reaffirmed its long-term development partnership with Afghanistan. This included the transition period (2012–14) and in the transformation period (2015–24) based on the government's development strategies, which along with national priority programs (NPPs) will remain the agreed basis for partnership in the next decade.

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

3. **By end-December 2014, ADB's total assistance comprising grants and loans reached $4.03 billion, of which $3.8 billion for the public sector, and $198.1 million for the private sector**. As of December 31, 2014, total cumulative lending stood at $920.28 million consisting of sovereign ($722.18 million) and nonsovereign ($198.10) loans. ADB is one of the largest donors to the government of Afghanistan. Since 2007, ADB has provided assistance for the public sector on a 100 percent grants basis. Grants make more than 70 percent of ADB's overall assistance to Afghanistan. In the July 2012 Tokyo Conference, ADB committed another $1.2 billion to support Afghanistan through 2016.

4. **ADB supports co-financing of its projects to increase synergies by combining the strengths of development partners, governments, and ADB itself**. As of December 31, 2014, the cumulative direct value-added official co-financing since 2002 amounted to $76.7 million for six investment projects and $10.5 million for 11 TA projects. The ADB managed the Afghanistan Infrastructure Trust Fund (AITF)—a co-financing modality that allows development partners to meet the pledge of 50 percent on-budget and 80 percent alignment with NPPs as agreed in the 2010 Kabul Conference. As of December 31, 2014, the total amount received was $300.92 million from Japan (Embassy of Japan, $123.0 million), United States (USAID, $105.0 million out of a total commitment of $180.3 million), and United Kingdom (DFID, $72.92 million).

5. **ADB is one of the largest donors in the transport sector**. As of December 31, 2014, ADB has provided $2.1 billion to construct or upgrade over 1,500 km of regional and national roads and to rehabilitate four regional airports. All four are fully operational, with usage more than doubled. Travel times decreased by more than half as a result of ADB-assisted projects completed in 2014. ADB funded the first ever railway line between Uzbekistan and Afghanistan, which became fully operational in 2012. To date, about 7.5 million tons of goods have been transported. ADB supported the establishment of the Afghanistan Railway Authority to regulate and ensure the sustainability of the railway sector.

6. **ADB is the largest on-budget donor in the energy sector**. To date, ADB has invested around $921.31 million in Afghanistan's energy sector, and committed an additional $950 million to strengthen the country's energy supply chain. ADB-assisted projects have added 590 km of transmission lines, providing electricity to more than 5 million people. Ongoing projects will generate an additional 4.5 megawatts of power, add 500 km of transmission lines, and provide 100,000 new power connections. ADB is financing the power and gas sector master plans of the government. ADB also supports the Turkmenistan, Afghanistan, Pakistan and India (TAPI) gas project as well as the Turkmenistan, Uzbekistan, Tajikistan, Afghanistan and Pakistan (TUTAP) electricity project.

7. **The natural resources sector is another government priority sector assisted by ADB**. In 2014, total investment reached $600 million to rehabilitate and establish new irrigation and agricultural infrastructure, and strengthen the institutional environment to facilitate economic growth and improve water resources management. Around 140,000 hectares of irrigated land have been rehabilitated and upgraded. The investments have led to a more efficient use of water resources, a rise in agricultural productivity, and improved farm livelihood.

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 end-2014, cumulative approvals in 6 projects have amounted to $198.1 million. Total outstanding balances and undisbursed commitments to private sector projects amounted to $9.3 million, representing 0.1 percent of ADB's total nonsovereign portfolio as of December 31, 2014. One of the major private sector projects is the Roshan Cellular Telecommunications Project. ADB provided financial assistance in the form of direct loans totaling $70 million for Phase 1 and 2 of the project, as well as B loans and a political risk guarantee. In 2008, ADB approved a direct loan of $60 million to finance Roshan's Phase 3 expansion. In 2012, this project received an award for Excellence in Fragile States Engagement from the U.S. Treasury. In the financial sector, ADB has invested $2.6 million in Afghanistan International Bank (AIB), thus establishing the first private commercial bank in the post-Taliban regime.

10. **ADB is an active member of the Joint Coordination Management Board (JCMB) and the Afghanistan's Reconstruction Trust Fund Management Committee**. ADB plays an active part in other donor coordination activities, including the JCMB Social and Economic Development Standing Committee, the Ministry of Finance's High Level Committee on Aid Effectiveness, and the Inter-Ministerial Committee on Energy. ADB strongly supports all international policy dialogues on Afghanistan. Furthermore, it takes the lead in the infrastructure sector and regional corporation-related policy dialogues. ADB is a member of the core donor group (5+3) to ensure coordination and harmonization among donors and the government over policy reforms and development programs. ADB consults continuously with civil society and nongovernmental organizations with regard to project design and implementation.

STATISTICAL ISSUES

(As of March 19, 2015)

I. Assessment of Data Adequacy for Surveillance
Data provision has some shortcomings, but is broadly adequate for surveillance. The key data shortcomings are in national accounts and in the external sector mainly due to organizational weaknesses and difficult security situation.
National Accounts. The compilation broadly follows the *System of National Accounts 1993 (1993 SNA)*. GDP is compiled by the production and expenditure approaches. Key expenditure aggregates (household consumption, gross fixed capital formation, imports and exports) are available, while changes in inventories are derived residually. Coverage of economic activities is limited due to data gaps. Foreign trade data should be improved in terms of coverage, concepts, and timeliness. The 2002–03 base year is more than 10 years old and needs to be updated.
Price Statistics. The Central Statistics Organization (CSO) compiles and publishes monthly consumer price indices for the nation, the capital city Kabul, and nine other major cities. Overcoming severe security and resource constraints, CSO has recently undertaken a major overhaul of the CPI, including (i) implementation of full, five-digit Classification of Individual Consumption by Purpose (COICOP); (ii) update of consumer basket weights using data from a recent household survey (previous weights dated back to 1987); and (iii) expansion of coverage from six to ten cities/provinces (out of 34). While procedures generally follow good practices, there is a scope for additional improvement including further expanding coverage, upgrading the IT system and communication channels with remote provinces, strengthening quality control and field supervision of price collectors, as well as hiring and training more staff.
Government Finance Statistics. Fiscal data are compiled for the central and general government on cash basis based on the *Government Finance Statistics Manual 2001 (GFSM 2001)*. The timeliness and quality of the central and general government core budget data have been improving, particularly after completion of the roll out and connectivity of the Afghanistan Financial Management Information System (AFMIS) to all central government line ministries and agencies in Kabul and all provincial offices. With IMF support, the Ministry of Finance is implementing *GFSM 2001,* with annual data for both above and below the line transactions being reported. The authorities are reporting monthly GFS data to the IMF for the central government core budget and the ministry is also working on expanding the coverage of monthly and quarterly GFS data to general government.

Monetary and Financial Statistics. Da Afghanistan Bank (DAB) reports the Standardized Report Forms (SRFs) 1SR for DAB, 2SR for the other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics (IFS)* on a monthly basis with a lag of one month.	
Financial Sector Surveillance. Afghanistan reports 11 of the 12 core financial soundness indicators (FSIs) and 9 of the 13 encouraged FSIs for deposit takers, and 2 FSIs for real estate markets on a quarterly basis for posting on the IMF's FSI website.	
External Sector Statistics. Balance of payments statistics are compiled according to the fifth edition of the *Balance of Payments Manual*. The quality of data has improved and was accepted in 2013 for publication and dissemination in the IMF's Balance of Payments Statistics Yearbook and *International Financial Statistics*. Several TA missions provided by METAC have assisted the DAB in improving international accounts compilation in the past years, the most recent during November 3–7, 2014. In spite of this technical assistance (TA), progress in some areas—such as foreign trade, estimation of informal trade transactions, collection, and classification of data on current and capital transfers, and direct investment survey implementation—is still slow. Progress in those areas would require stronger commitment by the authorities to implement former missions' recommendations, strengthening inter-institutional and inter-departmental cooperation, and leveraging resources. The compilation of external debt arrears and reserve assets, as well as the consistency across external sector datasets and with monetary and financial statistics also need further improvement. With support from METAC, DAB has also started compiling international investment position (IIP) statistics.	
II. Data Standards and Quality	
Afghanistan has been a GDDS participant since June 2006, but its metadata has not been updated since then.	No data ROSC has been published
III. Reporting to STA	
The authorities are reporting data for the Fund's *International Financial Statistics, Government Finance Statistics Yearbook*, and the *Balance of Payments Statistics Yearbook*.	

Afghanistan: Table of Common Indicators Required for Surveillance

(As of April 20, 2015)

	Date of latest observation	Date received	Frequency of Data[3]	Frequency of Reporting[3]	Frequency of publication[3]
Exchange Rates	Mar. 2015	Apr. 20, 2015	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar. 2015	Apr. 5, 2015	M	M	M
Reserve/Base Money	Mar. 2015	Apr. 5, 2015	M	M	M
Broad Money	Feb. 2015	Mar. 14, 2015	M	M	M
Central Bank Balance Sheet	Feb. 2015	Apr. 5, 2015	M	M	M
Consolidated Balance Sheet of the Banking System	Jan. 2015	Jan. 14, 2015	M	M	M
Interest Rates[2]	Mar. 2015	Mar. 19, 2015	D	M	M
Consumer Price Index	Mar. 2015	Apr. 20, 2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing – General Government[4]	--	--	--	--	--
Revenue, Expenditure, Balance and Composition of Financing– Central Government	Mar. 2015	Apr. 5, 2015	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt	2014Q1	Feb. 28, 2015	Q	Q	Q
External Current Account Balance	2014Q3	Mar. 15, 2015	Q	A	A
Exports and Imports of Goods and Services	2014Q2	Nov. 13, 2014	Q	Q	Q
GDP/GNP	2013/14	Jul. 31, 2014	A	A	A
Gross External Debt	2014Q4	Feb. 17, 2015	Q	Q	Q
International Investment Position	2012Q4	Mar. 10, 2014	A	A	A

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

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

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

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.