AFGHANISTAN DEVELOPMENT UPDATE

April 2016

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Preface

The Afghanistan Development Update, which is published twice a year, covers recent economic developments and the medium-term outlook for Afghanistan. Each edition includes a more in-depth analysis on a specific focus topic. While the lack of high-frequency data in the country makes detailed analysis challenging, efforts are made to use reliable sources of data as comprehensively as possible. The Afghanistan Development Update is intended for a wide audience, including policy makers, the donor community, the private sector, and the community of analysts and professionals engaged in Afghanistan's economy.

This report was prepared by Omar Joya, Claudia Nassif, Aman Farahi and Tobias Haque (all GMFDR). The authors gratefully acknowledge the useful inputs provided by Silvia Redaelli (Senior Economist, GPVDR) and other members of the country team. Ehsanullah Nasiree (SACKB) contributed to the formatting and design of the document. This report was prepared under the overall guidance of Shubham Chaudhuri (Practice Manager, GMFDR) and Robert Saum (Country Director). The authors also gratefully acknowledge the cooperation and suggestions received from the International Monetary Fund staff.

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Executive summary

The withdrawal of international security forces since 2014 and continuing political uncertainties have resulted in a significant deceleration to economic growth, with fiscal pressures increasing as security threats mount. However, to a significant extent, Afghanistan has successfully managed the immediate challenges resulting from the Transition. It has maintained macroeconomic stability and established the conditions for a slow recovery of the economy. Risks to the economy remain significant, and it is vital that the Government identify new sources of growth to replace the declining donor inflows over the longer-term.

In 2015, Afghanistan recorded an estimated economic growth rate of 1.5 percent, a marginal increase from the figure of 1.3 percent recorded in 2014. Overall growth was largely driven by growth in the industry (1.4 percent) and services (2.8 percent) sectors, offsetting the contraction in the agriculture sector (-2 percent). There was a slight recovery in the level of investment after several years of decline, with the number of new business registrations increasing slightly over the year. However, the number of these registrations is still significantly lower than the figures recorded in 2012-2013, with security challenges continuing to constrain investment. In 2015, consumer price inflation dropped to -1.5 percent, down from the figure of 4.5 percent recorded in 2014. This decline was primarily due to a decline in the level of private consumption and to low global commodity prices.

As a result of reforms to both revenue collection and expenditure, the fiscal position improved significantly over the year. Domestic revenues increased to 10.4 percent of GDP in 2015, significantly higher than the figure of 8.7 percent recorded in 2014. This increase was largely the result of improvements in the area of tax policy reforms, arrears collection, and administration. The Government has also continued to manage expenditures carefully, with total expenditures increasing only marginally over the year, from 26.2 percent of GDP in 2014 to 27 percent in 2015.

The Afghani depreciated by 7 percent against the US dollar in 2015. This decline was driven by the decline in aid inflows, an increasing preference among consumers to retain their savings in US dollar and – possibly – capital outflows associated with out-migration.

With the population growth rate estimated to stand at 3 percent per year, sluggish GDP growth and the deteriorating security situation resulted in increases to poverty, with the poverty rate increasing from 35.8 percent in 2011-12 to 39.1 percent in 2013-14. The increase in poverty also reflects the limited number of employment opportunities. The estimated unemployment rate almost tripled in the period from 2011-12 to 2013-14, reaching a staggering 22.6 percent of the labor force in 2013-14. Increasing poverty, a decrease in employment opportunities, and the deteriorating security situation have been the main drivers of increased out-migration.

The medium-term outlook points towards a slow recovery over the next three years. The rate of growth is projected to reach 1.9 percent in 2016, assuming adjustments in firms and households' behavior in the context of the deteriorating security environment. Growth is projected to gradually increase from 1.9 percent in 2016 to 3.6 percent in 2018, if the political situation stabilizes and planned reforms are successfully implemented. On the other hand, any deterioration in the security environment could weaken growth prospects, with this risk being the most significant faced by the country.

A. Recent Economic Development

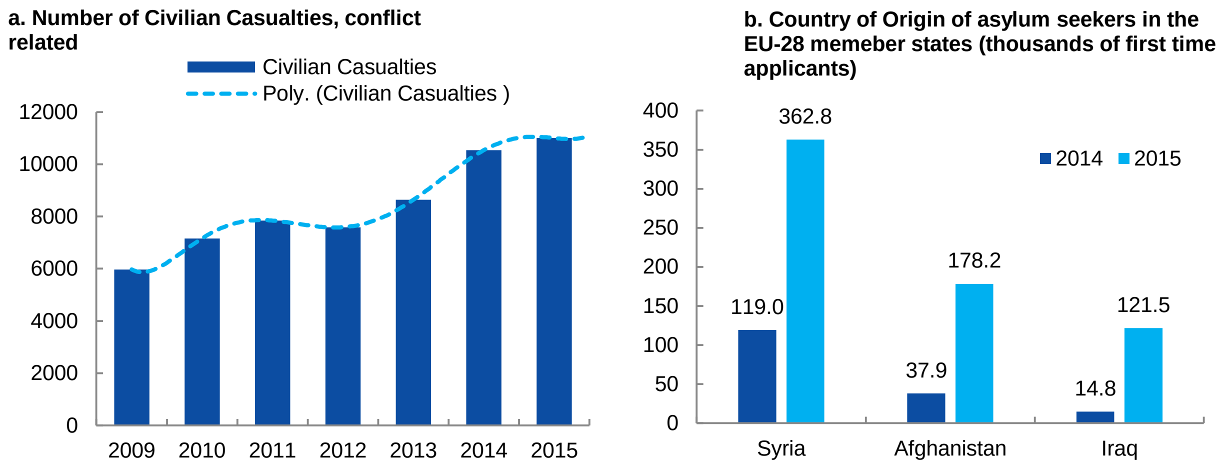
1. Background

The political and security context continues to shape Afghanistan's economic and social development

During 2015, the new National Unity Government (NUG) advanced an ambitious reform agenda that focused on combating pervasive corruption, strengthening political and economic relationships with neighboring countries, and restoring peace. However, progress has been impeded by increasingly intense security challenges, including emerging threats from ISIS and an increasing number of attacks by the Taliban following a change in its leadership.

These security challenges pose critical threats to personal safety, the delivery of public services, and private investment. In 2015, the number of civilian casualties reached record levels, with the situation having continued to worsen since 2012. The deterioration in the security situation and the lack of sufficient employment opportunities have driven increased levels of emigration. In particular, in 2015, the number of first-time Afghan asylum seekers in EU-28 member states more than quadrupled, with Afghans now constituting the second largest group of asylum seekers in Europe after Syrians. However, Pakistan and Iran remain the host countries for the majority of Afghan refugees, with the combined total number of refugees in these countries amounting to 2.5 million.

Figure 1: Growing insecurity poses risks to growth and investment



Source: United Nations Assistance Mission in Afghanistan (UNAMA) and EuroStat

2. Real Sector Activity

Insecurity continues to weigh heavily on growth and investment

Economic growth has remained slow since the withdrawal of international security forces. The rate of real GDP growth increased marginally over the year, from 1.3 percent in 2014 to an estimated 1.5 percent in 2015. However, this is still dramatically lower than the average rate of 6.8 percent recorded in the preceding five years. Domestic demand remains weak, growing by an estimated 1.8 percent in 2015, as compared to the average annual growth rate of 7 percent in the preceding five years. Business and consumer confidence levels remain subdued as a result of the persistent political uncertainty, with no signs of recovery in private consumption or investment.

In 2015, the rate of growth in Government consumption was also modest, standing at only 2.3 percent, as compared to a rate of 8 percent recorded in the previous year.

Table 1: Real GDP growth, by expenditure components
(in percent)

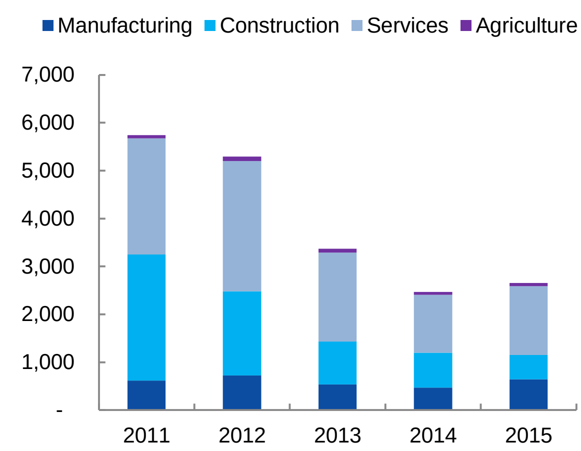
	2010	2011	2012	2013	2014	2015
Real GDP growth	8.4	6.1	14.4	3.7	1.3	1.5
Gross domestic expenditure (domestic demand)	7.0	7.8	12.4	3.8	4.4	1.8
Private consumption	17.4	8.0	18.0	2.0	1.5	-0.2
Government consumption	4.9	19.3	4.7	3.7	8.0	2.3
Gross fixed capital investment	-10.1	-7.2	9.0	9.4	7.5	6.5
Exports of goods & services	30.9	-0.9	-3.5	22.1	6.8	4.8
Imports of goods & services	12.0	6.8	4.9	35.7	-5.6	2.4

Source: World Bank staff estimates based on data from the Central Statistics Organization for nominal GDP expenditure components

New firm registrations suggest limited new investment

While high-frequency data related to the level of private investment is unavailable, the number of registrations of new firms can be used as a proxy indicator. In 2015, this number increased marginally compared to 2014, but remained considerably lower than the levels recorded in 2011 and 2012, reflecting the decline in confidence due to the worsening security environment. Only a few large-scale investment projects were launched in 2015, with the most significant of these involving the construction of a steel mill in Kabul, with a total domestic investment value of US$ 25 million. The mill is expected to start production in mid-2016. The level of foreign direct investment remains very low, at a value of 0.7 percent of GDP, or less than US$ 150 million. The largest and most visible public infrastructure projects currently under preparation include the TAPI gas pipeline; the CASA-1000 electricity project; and the Trans-Hindukush road connectivity project.

Figure 2: Number of new firm registration
(in units)

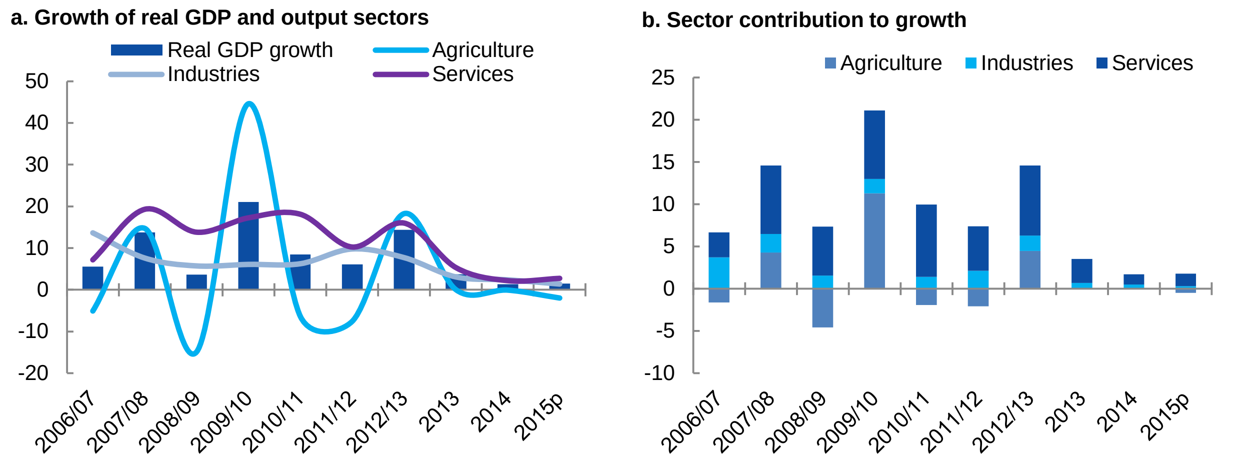


Source: Afghanistan Investment Support Agency (AISA)

Industries and services led growth in 2015

On the supply-side, growth in the industry and services sectors offset the contraction in the agriculture sector, with industry growing by 1.4 percent and services by 2.8 percent over the year. However, this was still considerably lower than the average growth rates recorded in the period from 2008 to 2012 (7.1 percent for industry, 15.1 percent for services).

Figure 3: GDP growth, albeit low, has been driven by industries and services
(percent)

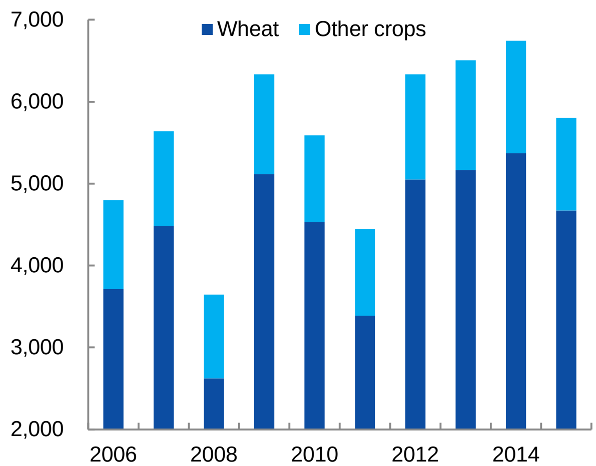


Sources: Central Statistics Organization (CSO) and Bank staff projections

Agriculture production declined, particularly due to lower cereals output

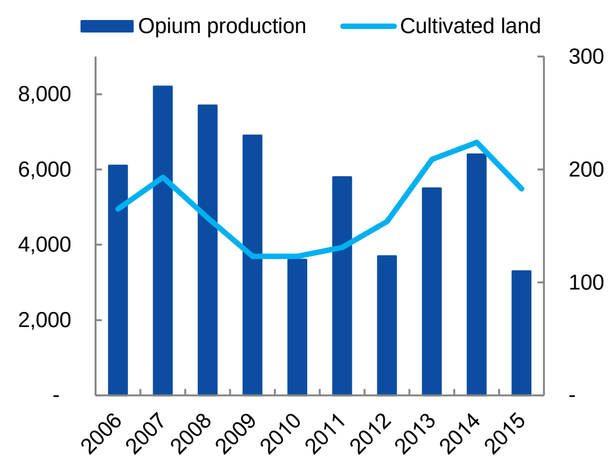
In 2015, agricultural production declined by an estimated 2 percent. Preliminary estimates by the Ministry of Agriculture, Irrigation and Livestock (MAIL) show that the volume of production of cereals (including wheat) declined by around 14 percent. The area of land cultivated for rain-fed wheat declined by around one-third, largely due to the lower levels of rainfall recorded throughout the country. Given that approximately one third of Afghanistan's overall wheat production is rain fed, output is highly sensitive to weather shocks. The output from horticulture, including fruit production, is estimated to have increased, despite drier conditions.

Figure 4: Cereals production declined after 3 consecutive years with strong harvest
(thousand metric tons)



Source: Ministry of Agriculture, Irrigation and Livestock

Figure 5: Opium production and the area under poppy cultivation declined in 2015
(metric tons (LHS); thousand hectares (RHS))



Source: UNODC

Opium production declined in 2015

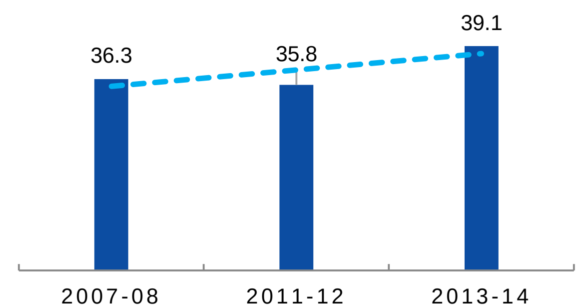
The latest survey by the United Nations Office on Drugs and Crime (UNODC) estimates that in 2015, the volume of production of opium stood at 3,300 tons, while the area under poppy cultivation stood at 183,000 hectares. A major change in the survey methodology makes a comparison with previous years difficult. However, it appears that both the area under cultivation and the volume of production declined in 2015. This was partly due to lower yields in the Southern and Western regions and partly to the decline in opium prices across the country due to an oversupply after two years of a high level of production.[1] The reduction in area under cultivation may also reflect several years of crop failures in desert areas, with farmers relocating production to these areas over recent years to avoid more strongly enforced opium bans in the well-irrigated, central areas.[2]

Poverty is on the rise, driven by the slowdown in growth and deteriorating security situation

The economic slowdown and the deteriorating security environment have had a tangible negative impact on livelihoods throughout the country. The most recent Afghanistan Living Condition Survey (ALCS) indicates an increase in the poverty rate from 35.8 percent in 2011-12 to 39.1 percent in 2013-14.[3] While economic growth in Afghanistan in recent years has not been very inclusive and has had only a limited impact in terms of reducing the poverty rate, the recent increase in poverty reflects the fact that GDP growth has been lower than the population growth rate.[4] It also reflects the limited number of available employment opportunities, with the unemployment rate estimated to have almost tripled in the period from 2011-12 to 2013-14, to reach the staggering figure of 22.6 percent of the labor force.[5]

Figure 6: Poverty has increased substantially over its pre-transition levels

(poverty headcount, in percent of population)



Source*:* Afghanistan Living Conditions Survey, 2007/08, 2011/12 and 2013/14 surveys

Inflation slipped into negative territory

In 2015, the consumer price inflation rate declined to −1.5 percent (period average) from the rate of 4.6 percent recorded in 2014, with this decline driven by the fall in global commodity prices and weak domestic demand. The exchange rate depreciation was insufficient to offset the deflationary impacts of lower world prices for grains and energy, with grains declining by 14 percent and energy by 41 percent over the year. The total value of imports amounts to around 40 percent of GDP, and thus global prices tend to have a significant impact on domestic prices.

Deflationary pressures were apparent in both food and non-food prices

Food consumer prices fell by 1.9 percent and non-food consumer prices by 1.2 percent (period average). Specifically, the prices of vegetables, which constitute the second largest food item in the consumer basket, fell by 12.4 percent. Among non-food items, the decline in the prices for housing, transportation, and communication services, which together account for more than a quarter of the consumer basket, was

[1] "Afghanistan Opium Survey 2015", UNODC, December 2015

[2] "Helmand on the move: Migration as a response to crop failure." Afghanistan Research and Evaluation Unit. October 2015

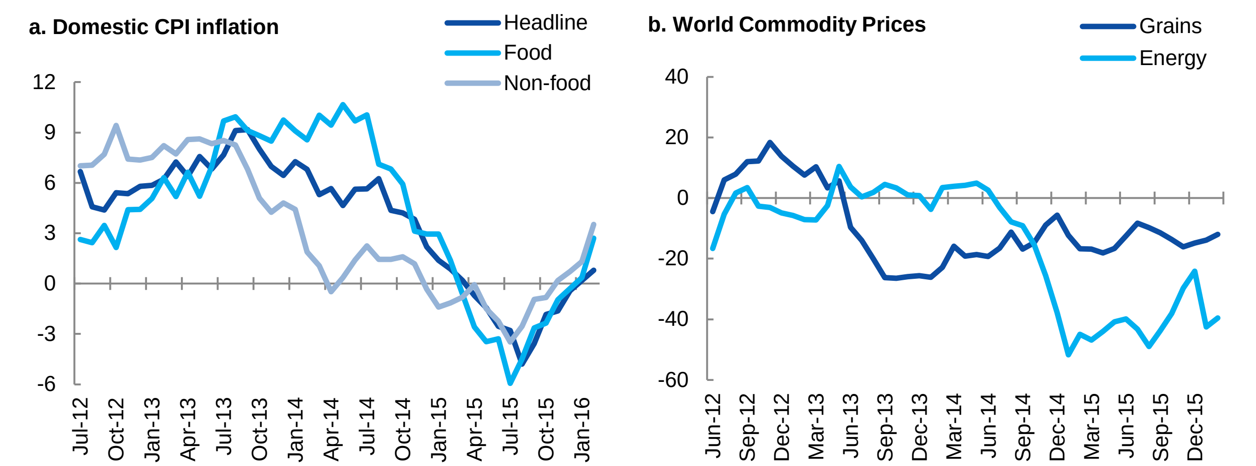
[3] "Afghanistan Living Conditions Survey 2013-14", Central Statistical Organization. December 2015.

[4] The annual population growth rate averaged 3 percent between 2010 and 2015, reflecting persistently high fertility rate (5.13). Because of these high growth rates, the total population of Afghanistan is expected to double over the next 35 years, reaching approximately 56 million in 2050. "World Population Prospects: the 2015 revision – key findings and advance tables", UNDESA, 2015.

[5] "Afghanistan Living Conditions Survey 2013-14", Central Statistical Organization. December 2015.

particularly pronounced. However, prices recovered in the first two months in 2016, with these increases primarily driven by a rebound in global commodity prices, with the headline inflation rate reaching 3.1 percent by February 2016.

Figure 7: Consumer prices are declining, but less steeply than global commodity prices
(12-month percentage change)



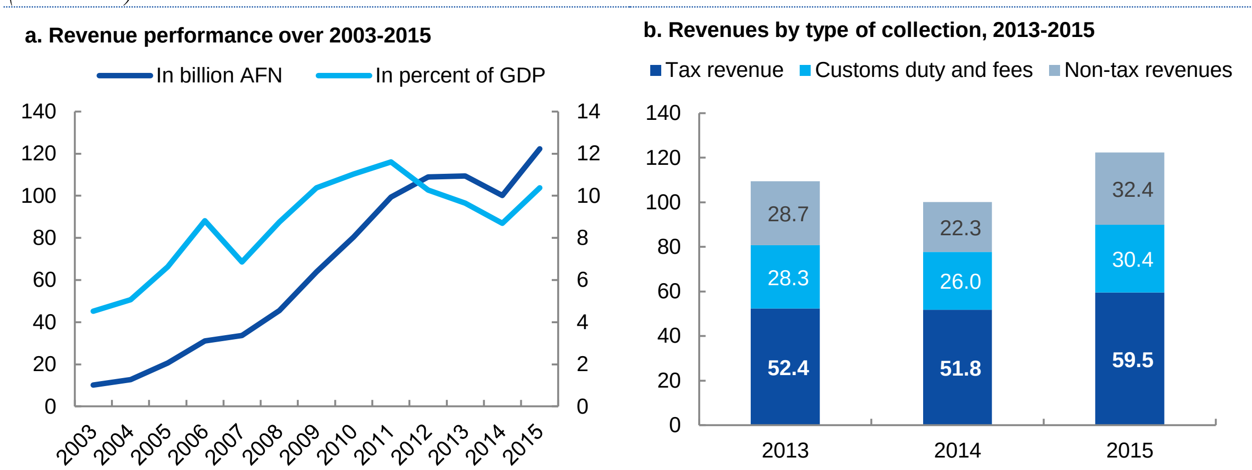
Source*:* Central Statistics Organization, and World Bank Global Economic Monitor (GEM)

3. Fiscal developments

Revenues increased substantially after three years of poor performance

Domestic revenues increased by around 22 percent in 2015. As a proportion to GDP, this value amounted to 10.4 percent. This was an increase from the figure of 8.7 percent of GDP recorded in 2014, but still slightly lower than the figure of 11.6 percent recorded in 2011. In 2015, performance improved for all sources of revenues, with tax revenues increasing by 14 percent and customs duties by 17.2 percent. Non-tax revenues recorded the most significant increase, growing by about 46 percent.

Figure 8: Revenues increased in 2015 both in nominal values and as a proportion to GDP, with increases in all sources of revenue
(billion AFS)



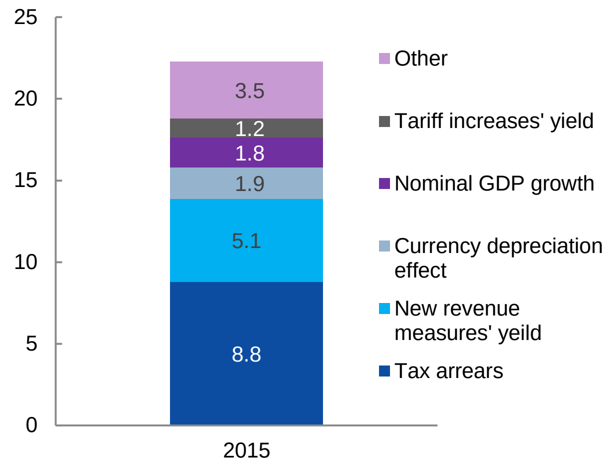
Source: Ministry of Finance (Afghanistan Financial Management Information System [AFMIS], data extracted on March 15, 2016)

Revenue collection has been supported by policy and administration reforms and collection of tax arrears

The increase in revenues amounted to around Af 22 billion and reflected improvements in the areas of tax policy, tax administration and the collection of tax arrears. Specifically, the Government implemented a number of new policy measures in the second and third quarters of 2015, including: (i) an increase in the business receipts tax rate from 2 percent to 4 percent; (ii) the introduction of a 10-percent telecommunications fee on mobile phone top-ups; (iii) an increase in the fuel fee from Af 1 per liter to Af 2 per liter; and (iv) an increase in over-flight fees for traffic passing through Afghanistan's airspace. The implementation of these new measures generated revenues of approximately Af 5 billion. An additional sum of Af 8.8 billion of tax arrears was collected,[6] including around 2 billion of tax arrears from state-owned enterprises. After discounting the effects of the depreciation in the exchange rate (Af 2.8 billion); of the nominal growth of the economy, including real economic growth and inflation (Af 1.8 billion); and of tariff increases (Af 1.2 billion), Af 2.5 billion (or 11 percent of the total value of the revenue increase) can be attributed to the improvements in tax and customs administration.

Figure 9: Tax arrears and new measures accounted for more than half of the revenue increase in 2015

(in billion Afghanis, approximate estimates only)



Source: Bank staff estimates

Expenditures slightly increased driven by higher security and discretionary development spending

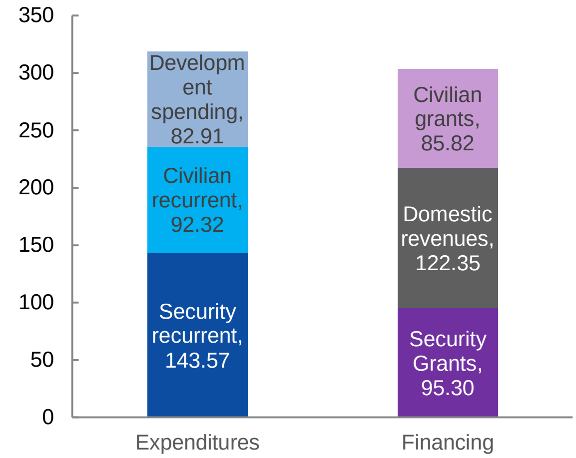
As a proportion of GDP, the total value of expenditures increased from 26.2 percent in 2014 to 27 percent in 2015, with the increase in nominal terms standing at 6 percent. Increases to the recurrent security and discretionary development budget expenditure accounted for the slight overall increase. While recurrent security expenditure increased from 11.9 percent of GDP in 2014 to 12.2 percent in 2015, recurrent civilian expenditure declined slightly from 7.9 percent in 2014 to 7.8 percent in 2015. Lower recurrent civilian spending was partially due to a 2 percent cut in allotments, and partially due to delays in budget execution. Nevertheless, this had a pro-cyclical impact, which weakened domestic demand at a time of a deceleration in economic growth. The operations and maintenance costs for civilian assets are already severely under-budgeted in Afghanistan due to the increasingly tight fiscal space. Any further expenditure cuts have the potential to hinder core service delivery.

[6] "*Afghanistan's Revenue Turnaround in 2015*" by W. Byrd and K. Payenda, United States Institute of Peace, February 2016

Overall budget execution improved in 2015

More realistic budgeting led to improvements to budget execution, with the overall execution rate increasing to 73 percent in 2015, up from 66 percent in 2014. The execution rate for the operating budget – including both security and civilian spending – improved from 79 percent in 2014 to 83 percent in 2015. While the execution of the development budget improved from 44 percent to 55 percent over the same period, the improvement was primarily due to higher execution in the *discretionary* development budget, which also included payments of arrears of about Af 7 billion. The execution of the non-discretionary development budget did not improve in 2015. While there have been significant improvements in the areas of budget preparation and payment processing over the past decade, the limited capacities of line ministries in the areas of financial planning and procurement continued to impede execution.

Figure 10: Expenditures and financing in 2015
(Af billion)



Source: Ministry of Finance (AFMIS, data extracted on Mar 15, 2016)

The fiscal balance showed a small deficit

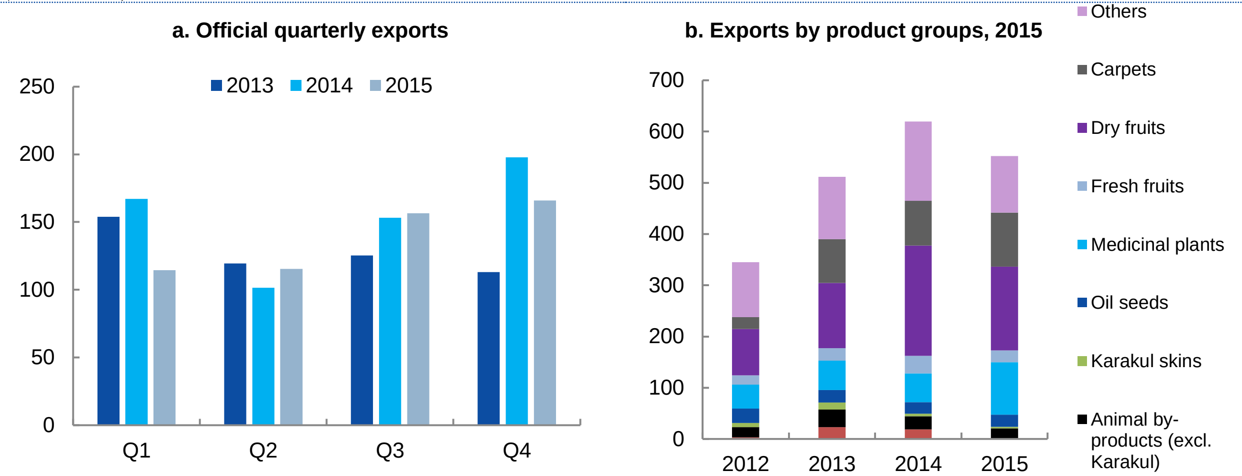
In 2015, the fiscal deficit amounted to 1.3 percent of GDP (or US$ 250 million). However, a deficit of this order of magnitude is benign and mostly the result of the use of a cash-based accounting system in the preparation of the budget. Unlike the accrual approach, the cash-based accounting system records receivables and expenditures at the time when they are actually received and paid. These can occur with some delays with respect to the time of commitments/obligations. Since there is often a time lag between donor grant commitments and the actual receipt of the associated funds, the budget could show a deficit towards the end of the year before fiscal accounts are closed.

4. External sector

Official exports have dropped

In 2015, the total value of official exports stood at about US$ 550 million, a decline from the figure of US$ 620 million recorded in 2014. In particular, the value of exports of dried fruits, fresh fruits, animal by-products (such as skins and wool) and cotton declined, while that of medicinal plants and carpets increased. The decline in the value of exports, despite the depreciation in the currency over 2015 and the high levels of agricultural production in the preceding year, reflects the impact of binding structural constraints. Specifically, these constraints include poor infrastructure, limited access to finance, and, most significantly, the deteriorating security environment.

Figure 11: Exports declined in 2015, following several years of increases
(US$ million)

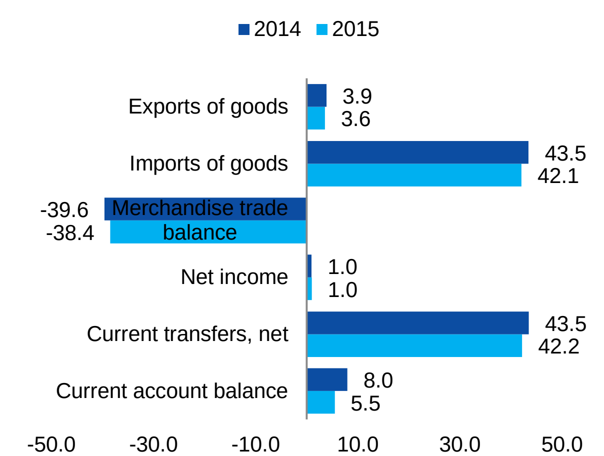


Source: CSO

Imports have declined due to weakening domestic demand

Approximately 15-20 percent of the total value of Afghanistan's trade is estimated to be unrecorded, generally involving smuggled goods. Thus, official statistics do not capture all trade flows and tend to show a higher level of discrepancy. The balance of payments estimates indicate that the total value of imports declined in 2015, most likely due to weakening domestic demand. Thus, the overall trade deficit narrowed slightly from an estimated value of US$ 7.9 billion (39.6 percent of GDP) in 2014 to an estimated US$ 7.4 billion (38.4 percent of GDP) in 2015. As in previous years, the trade deficit has been financed by foreign aid and remittances. The improvement in the balance of trade offset the decline in aid inflows, driving a current account surplus of a value of 5.5 percent of GDP.

Figure 12: The large trade deficit is financed by foreign aid (current transfers)
(percent of GDP)

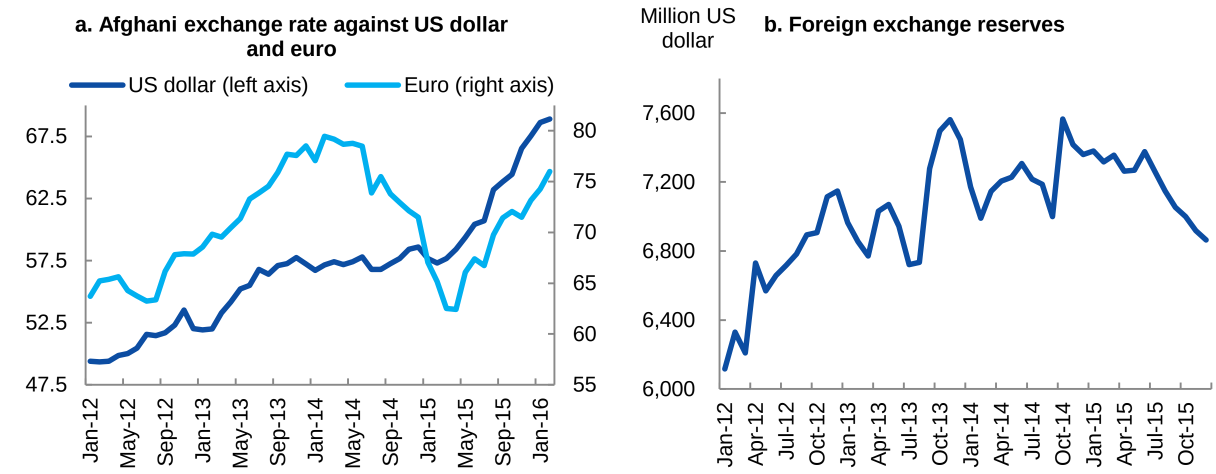


Sources: Bank staff estimates

The exchange rate depreciated by around 7 percent

In 2015, the value of the Afghani depreciated by 7 percent against the US dollar (period average). A comparison of the end-on-year rates (December 2015 compared to December 2014) shows a depreciation of around 15 percent. This depreciation reflects: (i) a decline in foreign exchange inflows associated with the decline in foreign aid (security and civilian); (ii) a decline in foreign direct investment and associated capital inflows; (iii) an increased tendency for households to hold their savings in US dollar; and: (iv) possibly, capital outflows associated with the increased levels of outward migration.

Figure 13: The Afghani depreciated throughout the year, with foreign exchange reserves declining in the second half of 2015



Source: Da Afghanistan Bank

Foreign exchange reserves declined slightly but remain at a comfortable level, equivalent to eight months of imports

Gross international reserves declined to US$ 6.9 billion by December 2015, down from US$ 7.4 billion recorded in December 2014. However, this level is still comfortable, at around 8 months of import cover. The decline in these reserves is mainly the result of currency depreciation over 2015, which resulted in an increase to the import bill without triggering any offsetting increase in exports. The decline was also exacerbated by the reduction in external aid and the associated decline in foreign exchange inflows. The exchange rate has stabilized over the first three months of 2016 and foreign exchange reserves are likely to remain adequate for the short-term. However, the decline in the value of aid inflows is expected to continue over the medium-term, which will place pressure on foreign exchange reserves unless new sources of foreign exchange earnings can be mobilized.

5. Monetary and financial sector developments

Money demand weakened in 2015

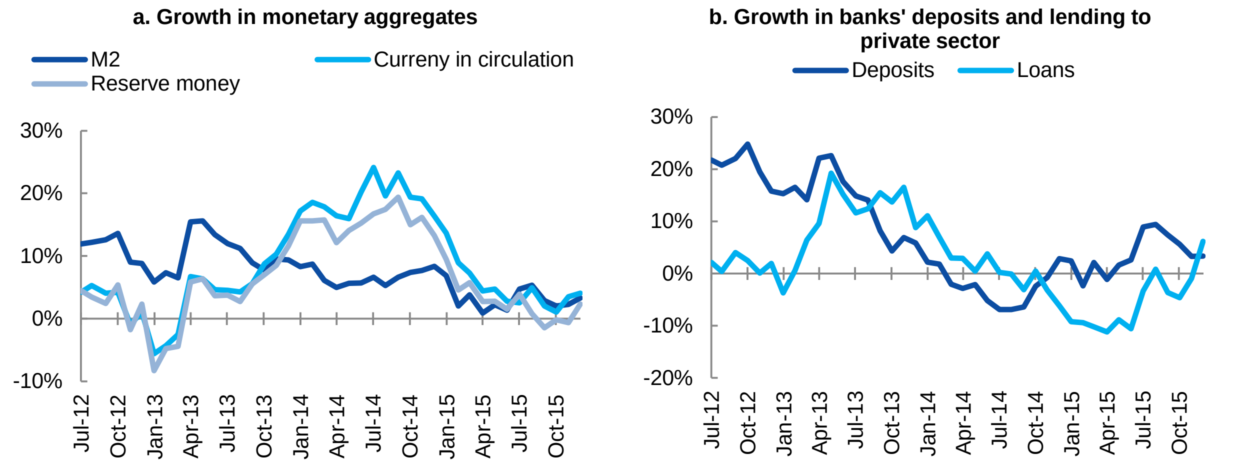
The growth rate of broad money (M2), which includes currency-in-circulation and deposits in commercial banks, declined to 3.3 percent in December 2015 (year-on-year), down from the rate of 8.3 percent recorded at the same point in 2014. The growth rate of currency-in-circulation (year-on-year) also declined to 4.1 percent in December 2015, down from the rate of 16.4 percent recorded in the same month in 2014, with this decline indicating weakening money demand and the deceleration in economic activity. Deposits in commercial banks grew at an annualized rate of 3.4 percent in December 2015. Although this is higher than the rate of 2.8 percent recorded in the same month in 2014, it remains significantly lower than the double digit rates recorded in previous years.

Bank lending increased towards the end of 2015

Commercial bank loans to the private sector declined during the second half of 2014 and throughout most of 2015. However, they recovered towards the end of the year, recording a growth rate of 6.2 percent (year-on-year) by December 2015. In December 2015, the total value of banking sector loans stood at Af 47 billion (US$ 685 million, or 3.6 percent of GDP), an increase from the figure of Af 44 billion recorded at the same point in the previous year. Weak commercial bank lending can be attributed to a number of factors, including overall economic slowdown, low levels of investor confidence, banks' reduced appetite for risk following the 2011 Kabul

Bank crisis, and the stricter implementation of regulations on foreign exchange denominated loans. With the economic deceleration, the quality of banks' assets has deteriorated and their profitability has declined. The ratio of nonperforming loans increased from 8 percent in December 2014 to 12.6 percent in December 2015. With the return on assets falling from 0.9 percent to 0.45 percent over the same period, the net profit of the banking sector declined from Af 2.2 billion to Af 1.1 billion. Substantial increases to the level of bank lending to the private sector ultimately depend on an expansion of access to financial services and on an increased level of savings.

Figure 14: Bank lending to the private sector increased in the second half of 2015, and slowing economic activity has weakened money demand
(year-on-year percent change)



Source: Da Afghanistan Bank

The Central Bank restored the overnight deposits facility

In mid-2014, the Central Bank suspended the overnight deposits facility to encourage bank lending. However, this facility was restored on May 30, 2015, with the overnight rate set at a figure 1 percent lower than the 28-day capital notes cut-off rate. On March 8, 2016, the 28-day capital notes cut-off rate stood at 3.54 percent. Capital notes are short-term securities issued by the Central Bank to commercial banks and certified money dealers with different periods of maturity (7 days, 28 days, 91 days, 182 days, and 364 days) and are used as a monetary policy instrument. As of March 15, 2016, the total outstanding value of these capital notes stood at Af 32 billion (equivalent to around US$ 470 million). The Central Bank also continues to utilize its weekly foreign exchange auction to manage liquidity in the market.

B. Outlook and Medium-Term Prospects

Growth in 2016 will remain sluggish

In 2016, real GDP growth is projected to reach 1.9 percent. At this level, it would mark the third consecutive year for which Afghanistan has recorded a rate below 2 percent. While business and consumer confidence remain weak, private investment is expected to remain stable as firms adjust to the new economic environment. In 2016, the rate of inflation is expected to rebound to around 3 percent, with the depreciation in the exchange rate over 2015 exerting upward pressure on domestic prices. While the exchange rate is expected to remain roughly stable from this point, the depreciation in the value of the Afghani over the past year has been sufficiently high to result in a depreciation of 11 percent to the period average for 2016.

Fiscal pressures will ease in 2016

If the authorities continue with their efforts to improve the performance of revenue collection, domestic revenues are projected to increase by around 9 percent in nominal terms to reach 10.7 percent of GDP in 2016. With total expenditures projected to increase by a value of 2 percent of GDP (including carried forward expenditures from the previous year), the overall deficit is expected to narrow to about US$ 130 million, or around 0.7 percent of GDP. On-budget donor grants are expected to increase to 17.9 percent of GDP in 2016, up from the figure of 15.4 percent recorded in 2015.

Table 2: Medium-term macroeconomic framework, 2012–18

	2012	2013	2014	2015	2016	2017	2018
		Actuals/estimates			*---- Tentative staff projections ----*		
Real GDP growth (%)	14.4	3.7	1.3	1.5	1.9	2.9	3.6
Nominal GDP (Af billion)	1,061	1,133	1,151	1,179	1,241	1,329	1,440
CPI inflation (period average, in %)	6.4	7.4	4.6	-1.5	3.0	3.5	4.0
Fiscal				*In Percent of GDP*			
Revenues and grants	23.2	24.1	24.4	25.7	28.6	30.5	32.6
Domestic revenues	10.3	9.7	8.7	10.4	10.7	11.0	11.6
Foreign grants	13.0	14.4	15.7	15.4	17.9	19.5	21.0
Total core expenditures	23.8	24.6	26.2	27.0	29.4	31.5	33.5
Recurrent expenditures	17.1	17.5	19.8	20.0	21.6	23.4	25.0
Development expenditures	6.7	7.1	6.3	7.0	7.8	8.1	8.5
Overall balance (incl. grants)	− .5	−0.5	-1.8	- .3	-0.7	-1.0	-0.9
Overall balance (excl. grants)	− 3.5	−14.9	-17.5	- 6.7	-18.6	-20.5	-21.9
External							
Trade balance	−45.8	−41.6	-39.6	38.	-41.1	-40.6	-41.3
Current account balance (incl. grants)	6.2	7.4	8.0	5.5	4.6	4.2	4.5

Source: World Bank staff estimates, tentative and subject to revision

Post-transition recovery is expected to be slow

Economic growth is projected to increase to 2.9 percent in 2017 and to 3.6 percent in 2018. However, these increases are conditional on improvements to the security environment and on a continuation of reforms to restore confidence in the economy. With an average annual rate of population growth of 3 percent and with an estimated 400,000 individuals entering the labor market each year, much higher growth rates are, however, required to improve per capita income and create sufficient number of productive employment opportunities to meet the needs of the expanding workforce. The poverty rate is expected to remain high due to weak demand for labor and to security-related constraints to service delivery, despite some offsetting positive impacts from improvements to the performance of the agriculture sector and lower food prices.

The output gap is widening

Projections for the output gap in Afghanistan show that as the economy slows down, this gap will widen over the next three years. This implies that economic resources will remain underutilized. Security challenges are expected to remain significant in the medium-term, with these challenges likely to act as constraints on the efficient use of resources (capital and labor). Thus, the output gap is projected to increase from -2.1 percent in 2015 to -7.1 percent by 2018 (see Box 1).

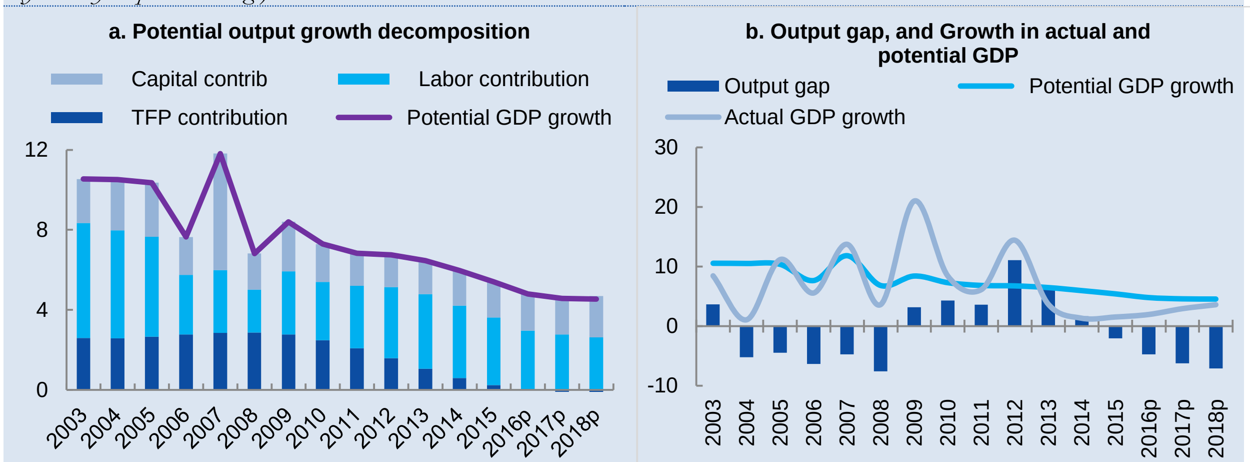
Box 1: Output gap is projected to increase over the medium-term

The output gap is a measure of the difference between the *actual* output of an economy (usually measured in terms of GDP) and its long-term *potential* output. The potential output is the maximum amount of goods and services that could be produced when an economy utilizes its full production capacity. Full capacity is achieved when all resources (including labor and capital) are fully utilized. While labor and capital are the two principal factors of production, improvements to technology may also have a positive impact on growth, as they determine how efficiently the labor and capital are utilized in the production process. Hence, a third element is *total factor productivity* (TFP) growth, which captures the portion of economic growth that cannot be explained in terms of improvements to the utilization of capital and labor.

The output gap can be positive or negative. If demand increases to a level in excess of potential output, then demand exceeds supply and the output gap is positive. In these circumstances, capacity constraints begin to bind and inflationary pressures typically intensify. On the other hand, if the output gap is negative, resources are under-utilized and inflationary pressures subside. Normally, actual GDP (growth) will fluctuate around its estimated potential (growth) path.

The output gap is an important measure for policymaking, as it is not only an indicator for how inflationary pressures build in the economy, but also for how the *unemployment gap* evolves. If the economy produces at its maximum level – with actual output equaling the potential output – all resources will be fully utilized and the economy will move towards full employment. Nonetheless, some level of unemployment – which economists call *non-accelerating inflation rate of unemployment* (NAIRU) – will persist in the economy.

Figure 15: Output gap is projected to increase over the medium-term, as expected security challenges may limit full utilization of capital and labor
(year-on-year percent change)



Source: Bank staff estimates.[7] Output gap (difference between potential and actual output) is expressed in percentage of potential output.

Looking at the potential growth decomposition for Afghanistan over the past decade, total factor productivity (TFP) started to decline from 2011 as the security situation began to deteriorate. This implies that improved security

[7] For methodological explanations, see *Burns et al. 2014. "Estimating potential output in developing countries." Journal of Policy Modeling. Vol. 36: 700-716*

provides a basis for improvements to institutional capital (better governance, enhanced administration, etc.), technological progress, and/or improvements in economic efficiency to materialize. While TFP's contribution to projected potential output in the period from 2016-2018 is expected to be null, the widening output gap over the next few years primarily points towards the underutilization of labor and capital. Thus, in the absence of an economic stimulus, such as through tax cuts or a substantial increase in public spending, the unemployment gap is likely to increase and an increasing number of workers will be under-employed. However, any economic stimulus needs to carefully designed, as not all public expenditure generates employment and not all types of tax cuts boost economic activity.

The medium-term growth outlook is subject to serious risks, which will need to be carefully managed

The fragile political and security environment has constrained private investment and growth to a significant extent. Economic crime and systemic corruption have also often undermined progress towards the achievement of Afghanistan's governance and state-building agenda. Therefore, significant improvements will depend on the degree to which Afghanistan achieves peace, stability, and reconciliation. Poor and vulnerable households are subject to an increasing degree of risk as a result of a number of factors. Firstly, the sharp decline in growth in the period from 2013 to 2015 has exacerbated underemployment and therefore resulted in lower levels of consumption across the board. Secondly, although the agriculture sector recorded excellent performance in 2012 (growing by 18.2 percent), the rate of growth in the sector in 2013–14 remained relatively flat, with unfavorable weather conditions resulting in a decline in output in 2015. In the medium term, Afghanistan faces challenges related to the declining level of aid and a demographic youth bulge. With these challenges, the achievement of significant further poverty reduction will require progress in a number of areas, including accelerated overall growth; an increase in productivity in the agriculture sector; a reduction in underemployment; measures to mitigate the impact of climactic shocks; and measures to address regional disparities.

Agriculture and mining offer large growth potential

The agriculture and services sectors are likely to be significant drivers of economic growth in the future. Agriculture accounts for about a quarter of GDP and is also closely linked to other economic sectors, including the food and beverages sub-sector (which accounts for almost all of manufacturing) and a range of activities in the transport and retail sectors. At present, exports are heavily dependent on agricultural outputs. Afghanistan has the potential to increase its output of fruits, nuts and vegetables and to develop supply chains for higher value-added products. However, the development of these supply chains will require investments to develop and improve irrigation and extension services and to build downstream agro-processing capacities. In addition, there is also a significant potential to develop extractive industries, which currently contribute to a very small share of GDP. Unlocking this potential will require progress to develop the legislative framework and re-engagement with potential investors.

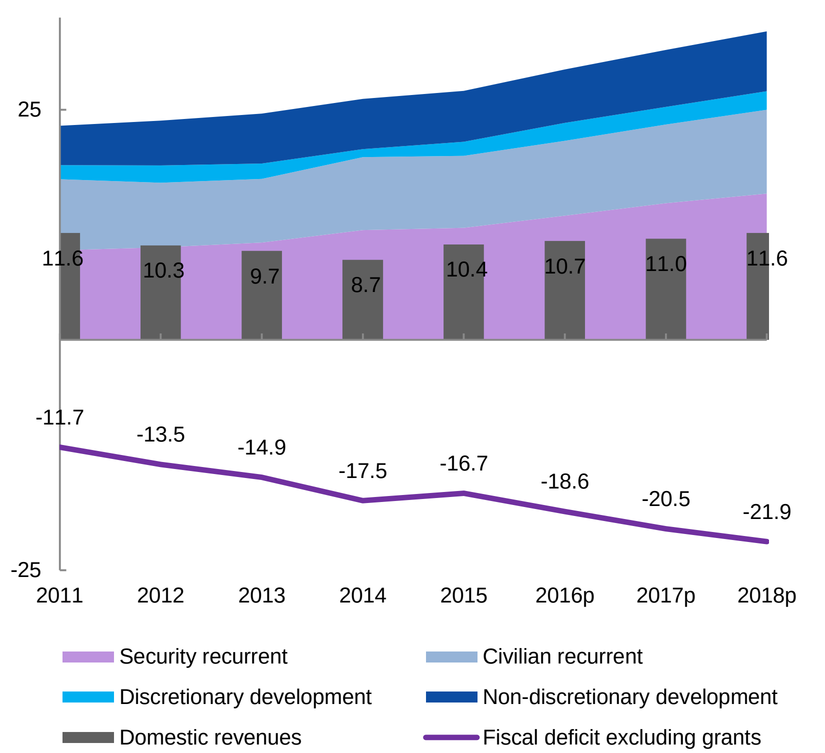
Budget expenditures are projected to rise, with higher security spending and growing pressures on O&M needs and social transfers

Total budget expenditures are projected to increase from a value of 27 percent of GDP in 2015 to 33.5 percent in 2018. This increase will largely be the result of security spending previously undertaken directly by international partners being moved on budget. Afghanistan also faces considerable public expenditure needs to improve service delivery; to build essential infrastructure; and to conduct operations and maintenance. The achievement of goals related to improving service delivery will require increased public expenditure in the social sectors. Developing new sources of growth will require significant improvements to infrastructure. With the Government's limited resource envelope, the appropriate prioritization of these expenditure needs will be critically important to the achievement of improved economic and social development outcomes. The appropriate prioritization of these needs is likely to require careful ongoing analysis. With expenditure on social benefits for martyrs and the disabled having increased since 2014 due to changes in the law resulting in increased benefits, the Government will need to consider reforms to the pension and social benefit scheme into the future.

Restoring fiscal stability will require accelerating revenue-enhancing reforms, additional discretionary budget support, and prioritizing expenditures

In the second half of 2015, reforms to the revenue collection system gained momentum, with the implementation of new tax measures and with important institutional reforms in customs and revenue administration. The increases in revenue collection exceeded expectations, providing the Government with a strong cash position (Af 21 billion, or US$ 310 million) at the start the FY 2016. Looking to the medium-term future, if revenue enhancing reforms continue to be implemented successfully, domestic revenues are projected to increase from 10.4 percent of GDP in 2015 to 11.6 percent by 2018, which is about the level recorded in 2011. While the unfinanced fiscal deficit is projected to reach less than 1 percent of GDP, the fiscal deficit excluding donor grants is forecast to increase to 22 percent of GDP by 2018, up from the figure of 16.7 percent recorded in 2015. If donor grants are not forthcoming to cover this gap, more aggressive expenditure consolidation efforts will need to be implemented, which would compromise development prospects and undermine measures to improve social outcomes.

Figure 16: The fiscal deficit (excluding donor grants) is projected to increase in the medium term
(percent of GDP)



Source: Bank staff tentative projections

A multi-year capital budgeting system would help

Given Afghanistan's large infrastructure development and operations and maintenance needs, it is critically important that the Government develops a multi-year public investment program and implements measures to improve the capital

Afghanistan better prioritize its overall development spending

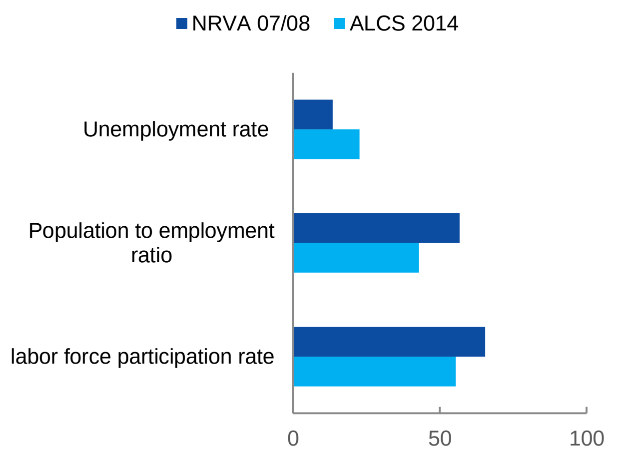
budgeting processes. At present, a significant portion of infrastructure development is implemented off-budget and is neither coordinated within a coherent public investment program nor integrated with the annual budget cycle. The capital budget is essentially a medium-term public investment plan, consistent with (but more detailed than) capital expenditures in the annual budget. As most investment projects are implemented over several years, improvements to capital budgeting can help to improve the overall planning and management of investment projects and measures to monitor their efficiency.

Demographic pressures are expected to compound Afghanistan's job challenge

The deteriorating security situation, increasing political uncertainty, stagnating growth and the overall reduction in demand have resulted in job losses, especially in sectors that provided services to NATO and ISAF. These factors are exacerbating Afghanistan's already significant challenges in the area of employment creation. The limited employment opportunities are exacerbating conflict pressures and leading thousands of young Afghans to seek better opportunities overseas. These problems will be further compounded by Afghanistan's demographic youth bulge, with an estimated 400,000 people entering the labor market each year. Roughly 55 percent of the population is aged under 20, making Afghanistan one of the youngest countries in Asia. In 2014, the Afghanistan Living Conditions Survey found that the unemployment rate stood at 22.6 percent and the underemployment rate stood at 16.4 percent.

Figure 17: Employment trends have worsened over the years

(in percent)



Source: Central Statistics Organization (National Risk and Vulnerability Assessment survey, and Afghanistan Living Conditions Survey)

The Government launched a countrywide emergency program to stimulate job creation and promote stability

In November 2015, the National Unity Government launched the emergency "Jobs for Peace" program as a response to the widening unemployment gap (see Box 1 on the projected output gap and its underlying impact on unemployment). The program aims to increase the number of employment opportunities by scaling up existing projects in the areas of agriculture, rural development, public works and cash transfers, and by proposing new projects (Urban National Solidarity Program, and Housing Finance) for consideration for donor funding. However, insufficient funding may limit the scale of these interventions and subsequently reduce their impact.

Box 2: The National Unity Government has launched a Jobs for Peace initiative to address the jobs crisis

Jobs for Peace Initiative: Stimulate aggregate demand and job creation through a 24-30 month job focused stimulus which will provide short-term labor intensive employment in rural and urban areas.

Target Group	1. Vulnerable families and the poor 2. Job Seekers 3. Conflict Affected Groups 4. Returnees and IDPs
Proposal	**1. Rehabilitating Agriculture Infrastructure:** Providing block grants to Community Development Councils (CDC) to rehabilitate agricultural infrastructure, in particular water resource management, and field leveling. Estimate cost to cover 15,000 communities is approximately US$ 350 million. **2. Labor-Intensive Urban Cleanup and Repair:** Providing small block grants for urban committees to provide labor-intensive cleanup, drainage, and re-greening programs in poor urban neighborhoods. Total costs are approximately US$ 200 million. **3. Fortifying Urban Peripheries:** Setting up a civilian conservation corps to plant trees, form parks and patrol the mountains around all of Afghanistan's large cities to employ large numbers of at risk youth. Preliminary estimated cost US$ 80 million. **4. Micro-grants for Female Heads of Households:** Female head of households, would be given employment maintaining community public infrastructure. Market-based purchasing to increase demand for high labor content products produced will be included. Estimated cost US$ 50 million. **5. Housing Finance:** The program's overall objective is to produce 200,000 units of affordable housing for returning refugees, with partial financing coming from non-traditional donors providing parallel funds. Total cost is US$ 500 million. **6. Cash transfers against stunting and malnutrition:** This program would provide a cash transfer and a health packet or (in urban areas) food vouchers for providing nutrition to stunted or malnourished children. Costs yet to be estimated. **7. Rebuilding the Civil Service:** Under this program, the Government would work with international specialists to package out poor performers and offer quality entry training to new recruits. Budget yet to be estimated. **8. Voucher Systems for Refugee Return and Reintegration:** Under this program, returning refugees would be given a voucher that can only be cashed by a host community development council on the basis of an agreement to absorb the refugee or IDP. Budgets allocations would be of approximately US$ 200/refugee.
Implementation	**Step One:** Scale up existing programs that has job creation potential. **Step Two:** Address implementation bottlenecks of the on-going projects **Step three:** Mobilize funds in Trust Fund Programs **Step Four:** Prioritize 2-3 programs

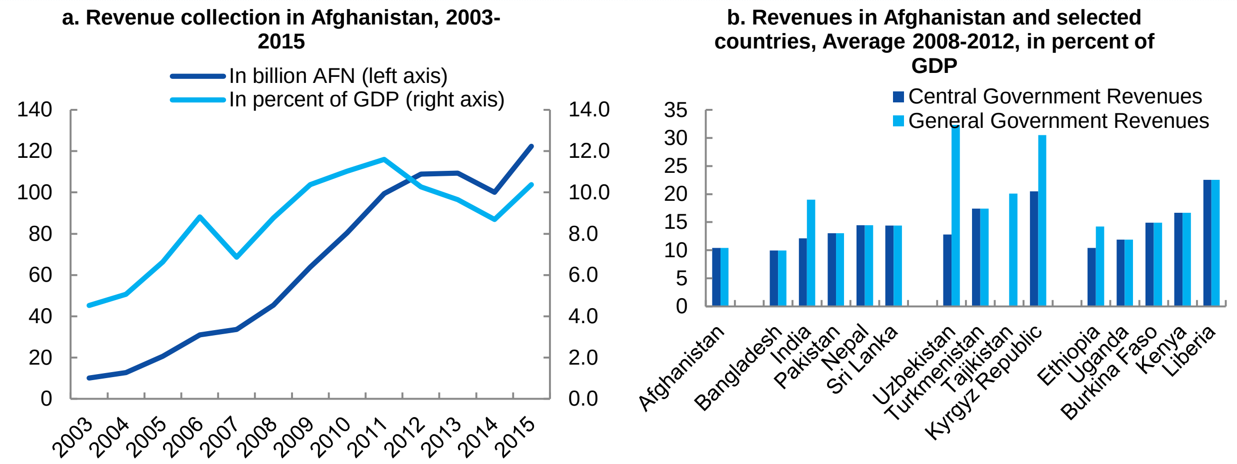
The information is taken from the latest update available by MoF on Jobs for Peace – January 2016. It is expected that more accurate costing and implementation details will emerge in the coming months.

Source: Ministry of Finance's presentation on Jobs for Peace – January 2016. More accurate costing and implementation details are expected to emerge in the coming months.

C. Focus Section: Revenue Potential in Afghanistan

Since the end of the conflict in 2001, domestic revenues in Afghanistan have increased fourfold in proportion to GDP. This increase is largely the result of significant improvements in the tax code and of the successful efforts to modernize the revenue and customs administration. However, Afghanistan still collects significantly lower levels of revenue than most South Asian and Central Asian countries and low-income, fragile countries around the world. Domestic revenues are still significantly lower than the Government needs to cover its expenditures and to invest in development. Decreasing the level of dependence on external support will require concerted efforts to mobilize revenue. But how much can the Government expect to collect? What is the potential to achieve higher levels of revenue mobilization by improving tax policy and compliance?

Figure 18: Despite significant increase in revenues, Afghanistan collects much less revenue than most South Asian, Central Asian, and low-income, fragile countries



Source: Ministry of Finance (Afghanistan), World Development Indicators (World Bank), and Government Finance Statistics (IMF)

Different countries record widely varying levels of performance in the area of revenue collection. These differences are visible both across and within regions and income levels. The empirical literature shows that the level of revenue collection is determined by countries' economic, demographic and institutional characteristics. For instance, countries in which the agriculture sector contributes to a larger proportion of GDP tend to collect lower levels of revenue, because the taxable income and/or transactions is lower in the agriculture sector than in other sectors. Similarly, import levels, trade openness, industrial development, financial depth, size of the extractives sector, age dependency ratios, and the extent of urbanization are all significant factors in determining how much revenue a country can collect. Finally, the quality of institutions also plays an important role, both in determining the effectiveness of government revenue agencies and in determining levels of compliance, with countries with weaker rule of law and higher levels of corruption facing more significant challenges in the area of revenue collection.

A country's revenue potential can be estimated on the basis of a comparison with other countries, taking into account and controlling for differences in the macroeconomic, demographic and institutional characteristics that influence revenue collection. The authors of this update employed this method to estimate Afghanistan's revenue potential using panel data for 108 countries for the period from 2000-2012. Afghanistan's revenue potential is estimated on the basis of an econometric model with revenue-to-GDP ratio as the dependent variable, regressed over a number of determinants including GDP per capita, share of agriculture, share of industries, imports, financial development, oil and mineral rents, age dependency, control of corruption index (from World Governance Indicators), weighted average tariff rate, and top marginal income tax rate.

Box 3: Definition and measures of revenue potential

A country's revenue performance can be measured in either absolute or relative terms. In absolute terms, the ratio of actual revenues to GDP (also called tax/revenue effort) is the single best indicator of revenue performance.

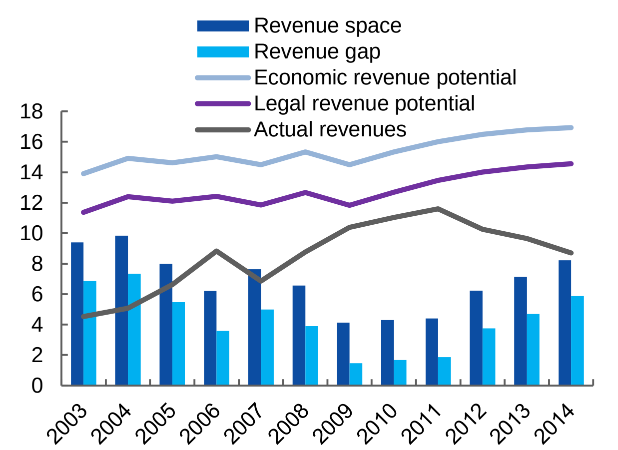
However, relative revenue performance is measured in relation to the ***revenue potential***. "Revenue potential," or "taxable capacity," is the amount of revenues that a country should collect given its macroeconomic, demographic and institutional characteristics. Hence, the relative tax/revenue effort is defined as the ratio between actual and potential revenues.

The literature also distinguishes between "economic" and "legal" revenue potential. The *economic* revenue potential refers to how much the country can collect given its inherent economic capacity; while the *legal* revenue potential refers to how much revenues can be collected with the prevailing tax regime.

The difference between economic revenue potential and actual revenues is called **revenue space**, and the difference between legal revenue potential and actual revenues is called **revenue gap**.

Estimates show that Afghanistan could collect revenues to a value of up to 17 percent of GDP given its inherent economic capacity (i.e., its economic revenue potential). This means that Afghanistan has a revenue space of around 7 percent of GDP (the amount by which revenue could be increased by strengthening tax compliance and improving tax policy). Without changes to the tax regime, Afghanistan could collect revenues to a value of about 14 percent of GDP, simply by improving administration and compliance (i.e., its legal revenue potential). Therefore, this analysis implies that the losses in revenues due to poor compliance and enforcement stand at about 5 percent of GDP.

Figure 19: Afghanistan collected close to its revenue potential between 2009 and 2011, but is collecting much lower since then
(percent of GDP)



Source: Bank staff analysis

Afghanistan's revenue potential has evolved over time in Afghanistan. As shown in Figure 19, as revenues increased in the period from 2003 to 2011, the revenue space narrowed. This means that the Government seized more opportunities for revenue collection. However, the revenue gap and revenue space has since widened. A number of factors may explain this widening, including a deterioration in levels of compliance, potentially linked to a weakening of governance in the context of the security transition.

What would it take to close the revenue space?

A number of structural deficiencies in Afghanistan's revenue administration currently limit the level of tax mobilization. These include deficiencies related to a narrow tax base, low compliance rates, low levels of efficiency in the areas of tax administration and management, and the large number of exemptions and deductions. These are exacerbated by weak institutional capacities. To improve revenue mobilization, a number of measures could be implemented, including the following:

- **The introduction of a value-added tax (VAT) to broaden the tax base:** Analysis shows that the introduction of a 10-percent VAT could generate revenues to a value of around US$ 350 million in the first year of roll-out, with this value projected to increase to US$ 1.6 billion, or 2.8 percent of GDP, by 2030. The VAT was expected to be implemented in 2014, but it has since been delayed.
- **The implementation of tax administration reforms to improve revenue collection:** The Afghanistan Revenue Department is working to implement a new set of reforms to improve revenue collection, with these reforms including the introduction of e-filing and e-payment of taxes; enhancing the audit function; improving reporting lines and tax payer services; and modernizing the IT infrastructure and HR management. In the medium term, a number of measures, including integrating the Afghanistan Revenue Department and the Provincial Tax Offices into a single national revenue body; re-organizing tax administration according to a functional model; and granting this administration semi-autonomous powers in the areas of human resource and budgeting, could result in further improvements to the performance of revenue administration.
- **Improvements to the operational performance of the Afghanistan Customs Department (ACD):** While substantial gains have been achieved in the area of customs administration over the years, a number of factors, including a limited customs infrastructure; difficult border controls; low capacity at customs; and political economy factors, still inhibit the ACD's revenue generation potential. Further improvements in the areas of entity management; declaration processing; risk management and inspections could improve this potential. Improvements in the level of operational performance of the ACD could shrink the current compliance and revenue gap by increasing revenue and by generating efficiency gains. In the short term, the ACD could benefit by developing a risk matrix to balance revenue collection, trade facilitation and enforcement**.**

Moving beyond potential

With Afghanistan's long-term financing needs, a revenue potential of 17 percent of GDP seems grossly inadequate. In 2014, total core expenditures amounted to about 26 percent of GDP, with these projected to increase to 36 percent of GDP by 2020. This is more than double the value of the estimated revenue potential. The large gap between expenditure and potential revenue reflects both exceptionally high expenditures, due to elevated security needs, and also various economic, demographic and institutional features of the Afghan economy that constrain revenue potential. For instance, Afghanistan remains heavily dependent on agriculture, a sector in which taxable transactions are limited and compliance is difficult to enforce, with the country yet to develop a more easily taxable manufacturing sector. Similarly, Afghanistan is ranked among the top five countries in the world in terms of its age dependency ratio, with nearly as many people inactive as active within the Afghanistan economy. Age dependency is the ratio of those typically not in the labor force (the dependent part) and those typically in the labor force (the productive part), and this is used to measure the pressure on productive population of those typically inactive. This demographic pattern results in lower levels of economic activity and thus lower taxable income. Therefore, concerted efforts are needed to increase revenues beyond the current potential of 17 percent of GDP to unleash new sources of growth that could yield high revenues.

Two important structural transformations offer good prospects to improve Afghanistan's revenue potential. Firstly, the development of value chains could be expected to increase this potential. Economies with a greater proportion of firms operating higher up the value chain benefit from a greater number of taxable transactions, higher levels of productivity (generating greater revenues as sales, salaries and profits), and typically a larger proportion of firms within the formal sector and therefore included in the tax base. In Afghanistan, progress in this direction could begin with measures to encourage the development of agriculture-based processing industries, such as fruit juice production, food processing industries and carpet production. The development of these industries would facilitate the transformation of agricultural commodities into higher value-added products. Secondly, given Afghanistan's extensive mining potential, it should implement measures to develop the mining and extractives sector. With the right policy and regulatory framework, the development of the mining sector could provide a substantial boost to revenues from the collection of royalties and taxes and from the indirect impacts of this development on other sectors, such as construction and services.

Nevertheless, while Afghanistan has viable prospects to increase revenue collection in the long run, it would be unrealistic to expect that even if this potential is realized in all sectors, it will be able to match the current level of public expenditures, which are expected to reach 36 percent of GDP by 2020. Therefore, it is vital that the Government focuses not just on improving revenues, but also on expenditure consolidation, especially in the security sector. The achievement of this goal remains a critical challenge for the achievement of fiscal sustainability.

APPENDIX: WORLD BANK GROUP PROGRAM IN AFGHANISTAN

1. The World Bank Group's program in Afghanistan is governed by the joint Interim Strategy Note (ISN) for FY 2012–FY 2014, which focuses on 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—the Country Partnership Framework for Afghanistan (CPF)—has been launched, and the Systematic Country Diagnostic (SCD) which informs the CPF by identifying the development challenges and opportunities has been completed.

2. Since 2002, the International Development Association (IDA) has committed a total of US$ 3.60 billion in grants (86 percent) and credits (14 percent) in Afghanistan. Thirty seven development and emergency-reconstruction projects and a budget support operation have been committed as of March 2016. In addition, the Afghanistan Reconstruction Trust Fund (ARTF) has generated US$ 8.94 billion of funding from 34 donors, and committed US$ 3.93 billion for the Government's recurrent costs and US$ 4.15 billion for government investment programs. As of end February 2016, the active IDA portfolio was worth US$ 1.27 billion and the active ARTF investment portfolio was worth US$ 2.8 billion.

3. The Bank also administers the ARTF—the World Bank Group's largest single-country multi-donor trust fund. The ARTF provides grant support to Afghanistan based on a three-year rolling financing strategy. Together, the IDA and the ARTF provide close to US$ 1 billion per year in grant resources (about US$ 150 million from IDA and about US$ 800–US$ 900 million from the ARTF). The ARTF is a key vehicle for providing the Government with predictable and transparent on-budget financing and provides a platform for policy dialogue between Government and donors.

4. In FY 2016, the World Bank Board approved the Trans-Hindukush Road Connectivity Project in the amount of US$ 250 million, as well as additional financing for an existing project—the Second Customs Reform and Trade Facilitation Project—in the amount of US$ 21.5 million. Under the ARTF, three new projects were approved including US$ 83 million for Naghlu Hydropower Rehabilitation Project, US$ 6 million for DABS TA, and US$ 50 million for Higher Education Development Project. Additional financing for existing projects included US$ 41 million for the Second Public Financial Management Project and US$ 45 million for the On-farm Water Management Project. As of March 27, 2016, US$ 368 million has disbursed under the Recurrent Cost Window for the FY 2016.

5. The World Bank continues to engage in rigorous analytical work and places large emphasis on policy dialogue. These non-lending activities have been supportive of the Bank's lending program and have played a crucial role in informing government of its strategic choices and advancing dialogue between the Government of Afghanistan and its international development partners. In the last fiscal year, the ARTF Steering Committee endorsed the Research and Analysis Program (RAP) which aims to support government policy reform agenda and decision-making. The program provides an opportunity to introduce innovative ways of working with the Government, universities and local research institutions to introduce analysis and generate knowledge. As part of the RAP, the Bank is currently engaged in a series of analytical work to enhance understanding of Afghanistan's growth and fragility challenges and to inform development response by Government and international development partners. The initial results of this work will be presented at the 2016 Ministerial Conference on Afghanistan in Brussels.

6. IFC's committed investment portfolio in Afghanistan has more than doubled between FY08 and FY14 -- from around US$ 58 million to about US$ 135 million in FY14. Currently, IFC's portfolio stands at about US$ 54 million and includes one investment in the telecommunication (Roshan), one investment in the hotel sector (TPS), and two operations in financial markets (First Microfinance Bank, Afghanistan International Bank -- trade facility). IFC's investments have had a transformational impact (in terms of access to finance and outreach), particularly in the microfinance and telecommunication sectors. IFC's Advisory Services program has been supporting the investment program in the areas of access to finance, small and medium enterprises (SMEs) capacity development, horticulture/agribusiness and investment

climate. At present, the focus of IFC's advisory work is on improving the investment climate through reforms in licensing, construction permit and other areas that result into improvements in Doing Business Indicators. IFC has also launched the pre-implementation phase of the Lighting Afghanistan Program which aims to expand the off gird market and facilitate access of 180,000 households to affordable and sage solar lighting solutions. Furthermore IFC is increasing the supply of fresh and processed fruits, through improved compliance with market standards and integration of farmers into the value chain of leading agribusinesses, giving them access to wider market opportunities. IFC will continue to seek new investment opportunities and engage with local players in order to support the development of Afghanistan's private sector, particularly in the areas of infrastructure, finance and microfinance, manufacturing, agribusiness, and services.

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

Appendix Table 1: Selected economic indicators

	2012	2013	2014	2015	2016	2017	2018
Income Levels				Prel. estimates	Proj.	Proj.	Proj.
Nominal GDP (billion Af) /1	1,061	1,133	1,151	1,179	1,241	1,329	1,440
Nominal GDP (billion US$) /1	20.5	20.5	20.0	19.2	18.3	19.2	20.4
GDP per capita (US$)	651	643	632	624	620	623	631
Population (million)	29.7	30.7	31.6	32.5	33.4	34.2	34.9
Real Economy (% growth)							
Real GDP growth /1	14.4	3.7	1.3	1.5	1.9	2.9	3.6
Agriculture	18.2	0.0	−0.1	−2.0	−0.5	0.8	1.1
Industry	7.8	3.1	2.4	1.4	1.6	2.2	4.1
Services	10.3	5.3	2.2	2.8	3.5	4.0	4.2
Output gap (% of potential GDP)	11.1	6.4	1.7	−2.1	−4.7	−6.2	−7.1
GDP Composition (% of GDP)							
Agriculture	24.6	24.1	23.5	22.6	22.0	21.6	21.1
Industry	21.8	21.2	22.3	22.4	22.3	22.1	22.3
Services	53.5	54.7	54.2	55.0	55.7	56.3	56.7
Prices (%, 12-month percent change)							
CPI inflation (period average)	6.4	7.4	4.6	−1.5	3.0	3.5	4.0
Core inflation (excl. fuel & cereals; p.a.)	6.6	7.0	2.4	−1.3	4.0	..	..
CPI inflation (end period)	5.8	7.3	1.4	0.2	3.5	..	..
External Sector (% of GDP, unless otherwise indicated)							
Exports of goods (million US$) /2	640	729	783	694	712	722	740
Imports of goods (million US$) /3	10,054	9,244	8,711	8,074	8,208	8,520	9,185
Trade balance	−45.8	−41.6	−39.6	−38.4	−41.1	−40.6	−41.3
Net current transfers	47.0	41.7	43.5	42.2	44.5	43.9	45.6
Current account balance	6.2	7.4	8.0	5.5	4.6	4.2	4.5
Gross foreign exchange reserves (million. US$)	6,771	7,447	7,360	6,864	7,150	7,400	7,800
Gross foreign exch. res. (months of imports)	7.2	7.8	9.1	8.3	8.3	8.2	8.0
External debt /4	6.6	6.7	6.4	6.4	7.3	7.4	7.4
Exchange rate (AFN/USD, period average)	51.7	55.4	57.4	61.4	..	..	..
Exchange rate (AFN/USD, end period)	52.1	56.6	58.1	63.9	..	..	..
Real effective exchange rate (decrease=depreciation)	127.0	125.5	121.1	126.6	115.7	114.8	114.3
Monetary and Financial Statistics (% of GDP)							
Broad money (M2)	32.0	33.0	34.9	35.2	36.1	37.0	37.9
Total deposits	17.6	17.6	17.7	17.8	18.0	18.6	19.5
Share of dollar deposits (%)	70.2	68.0	66.0	71.5	..	..	..
Credit to private sector, commercial banks	4.1	4.2	3.8	4.0	4.2	5.0	6.8
Loan-to-deposit ratio (%)	23.0	23.7	21.6	22.2	23.3	26.9	34.9

Note:
1/ National Accounts data exclude opium value added.
2/ Exclude sales of goods to nonresidents in the country. 3/ Include estimated unofficial trade or smuggling.
4/ Incorporates committed but not yet delivered debt relief; excludes Russian Federation's loan.
Sources: Central Statistics Organization, Central Bank, World Development Indicators, IMF staff estimates, and Bank staff projections.

Appendix Table 2: Selected fiscal indicators

	2012	2013	2014	2015	2016	2017	2018
In Billion Afghanis, unless otherwise indicated					Proj.	Proj.	Proj.
Domestic revenues	108.9	109.4	100.1	122.4	133.4	146.1	167.1
Tax revenue	51.7	52.4	51.8	59.5	64.5	70.4	79.2
Customs duty and fees	28.5	28.3	26.0	30.4	33.5	38.5	46.1
Nontax revenues	28.7	28.7	22.3	32.4	35.3	37.2	41.8
Donor grants	137.8	163.0	180.7	181.1	221.9	259.2	302.5
Discretionary grants	85.9	105.2	119.1	123.7	151.1	178.0	210.3
Non-discretionary grants	51.9	57.8	61.6	57.4	70.8	81.1	92.2
Total expenditures	252.5	278.3	301.0	318.8	364.5	418.5	482.5
Recurrent expenditures	181.1	198.0	228.3	235.9	268.2	310.9	360.1
Security	106.6	119.8	137.4	143.6	167.6	197.2	229.0
Civilian	74.5	78.3	91.0	92.3	100.6	113.7	131.1
Wages and salaries	43.5	47.9	52.7	54.5	57.1	62.4	67.7
Operations and maintenance	20.1	18.0	16.3	17.3	19.1	22.6	27.4
Capital expenditures	1.2	1.7	1.9	2.3	3.7	5.3	5.8
Social transfers	9.8	10.5	19.2	17.0	18.6	20.7	26.0
Interest payment	0.2	0.5	0.9	1.2	2.1	2.7	4.3
Discretionary development	20.1	19.0	9.9	18.0	24.1	25.2	28.8
Non-discretionary development	51.4	61.3	62.8	64.9	72.3	82.4	93.6
Discretionary balance (Recurrent + Disc dev.)	−6.3	−2.4	−19.1	−7.9	−7.9	−12.0	−11.5
Overall balance	−5.8	−6.0	−20.2	−15.3	−9.3	−13.2	−12.9
Overall balance excluding grants	−143.6	−169.0	−200.9	−196.4	−231.2	−272.4	−315.5
Revenues to recurrent spending ratio (%)	60.2	55.2	43.8	51.9	49.7	47.0	46.4

Sources: Ministry of Finance (AFMIS), and Bank staff projections

Appendix Table 3: Selected fiscal indicators

	2012	2013	2014	2015	2016	2017	2018
In Percent of GDP, unless otherwise indicated					Proj.	Proj.	Proj.
Domestic revenues	10.3	9.7	8.7	10.4	10.7	11.0	11.6
Tax revenue	4.9	4.6	4.5	5.0	5.2	5.3	5.5
Customs duty and fees	2.7	2.5	2.3	2.6	2.7	2.9	3.2
Nontax revenues	2.7	2.5	1.9	2.7	2.8	2.8	2.9
Donor grants	13.0	14.4	15.7	15.4	17.9	19.5	21.0
Discretionary grants	8.1	9.3	10.3	10.5	12.2	13.4	14.6
Nondiscretionary grants	4.9	5.1	5.4	4.9	5.7	6.1	6.4
Total expenditures	23.8	24.6	26.2	27.0	29.4	31.5	33.5
Recurrent expenditures	17.1	17.5	19.8	20.0	21.6	23.4	25.0
Security	10.0	10.6	11.9	12.2	13.5	14.8	15.9
Civilian	7.0	6.9	7.9	7.8	8.1	8.6	9.1
Wages and salaries	4.1	4.2	4.6	4.6	4.6	4.7	4.7
Operations and maintenance	1.9	1.6	1.4	1.5	1.5	1.7	1.9
Capital expenditures	0.1	0.1	0.2	0.2	0.3	0.4	0.4
Social transfers	0.9	0.9	1.7	1.4	1.5	1.6	1.8
Interest payment	0.0	0.0	0.1	0.1	0.2	0.2	0.3
Discretionary development	1.9	1.7	0.9	1.5	1.9	1.9	2.0
Nondiscretionary development	4.8	5.4	5.5	5.5	5.8	6.2	6.5
Discretionary balance (Recurrent + Disc dev.)	−0.6	−0.2	−1.7	−0.7	−0.6	−0.9	−0.8
Overall balance	−0.5	−0.5	−1.8	−1.3	−0.7	−1.0	−0.9
Overall balance excluding grants	−13.5	−14.9	−17.5	−16.7	−18.6	−20.5	−21.9
Revenues to recurrent spending ratio (%)	60.2	55.2	43.8	51.9	49.7	47.0	46.4

Sources: Ministry of Finance (AFMIS), and Bank staff projections