Afghanistan
Country Partnership Strategy
2017-2018

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I. Main Economic Indicators

	2012	2013	2014	2015	2016
Population (mid-year; mln)	29.8	30.5	31.3	32	33.4
Average Exchange Rate (Local currency/USD)	50.9	55.4	57.4	61.1	67.8
Inflation rate (CPI average; %)	6.4	7.4	4.7	-1.5	4.5
GDP at current prices (Local curr. bln)	1033.5	1116.8	1183	1227.9	1320.2
GDP at current prices (USD bln)	20.3	20.2	20.6	20.1	19.5
GDP/Capita (in curr. Prices; USD)	680	660	659	627	582
Real GDP growth (%)	13.9	5.7	2.7	1.31	2.36
Unemployment rate (ILO definition; eop; %)	8.7	8	8.5	8.5	8.5
Direct foreign investment (USD mln)	27	47	37	163	100
Central Gov. Budget balance/GDP (%)	1.10	-0.60	-1.7	-1.4	0.1
Export (fob, USD bln)	0.42	0.51	0.57	0.57	0.59
Import (fob, USD bln)	8.93	8.55	7.7	7.72	6.53
Trade balance (exp. fo. - imp. fob.; USD bln)	-8.51	-8.04	-7.13	-7.15	-5.94
Current account balance (USD bln)	2.19	0.67	1.17	0.59	1.37
Current account / GDP (%)	10.8	0.33	5.7	2.93	7.05
Official reserves (incl. Gold.; eop; USD bln)	6.86	6.87	7.23	7	7.5

Source: IMF & ADB

II. Economic Overview and Outlook

Real Sector

Over the last decade, Afghanistan has made enormous progress in reconstruction and development as economic growth was averaging strongly around 8% in the pre-global crisis era which did not alter its performance in the post-crisis period as well. Even though the Afghan economy did not contract during the 2009 global crisis, it still displayed huge volatility in economic growth rates in the following years. Afghanistan's real GDP growth increased by 2.36% in 2016 following 1.31% growth recorded in 2015.

The acceleration in growth performance was mainly attributed to rebound in agriculture which grew by 2% followed by contraction of 5.7% in the previous year. Growth in the services and industrial sector slowed down to 1.4% and 3.1%, respectively because of protracted political uncertainty, challenging security, lack of access to finance and weaker investor confidence. Private and public investment also slowed down. In terms of value added, share of agriculture, industry, and services sector stood at 21.7%, 23.3% and 55%, respectively.

External Sector

Trade performance has been lackluster. Exports of goods picked up due to better harvest and improvement in shipment capacity but this was offset by decline realized in export of services. Imports declined slightly due to temporary border closings. Exports of the country are pretty much flat over the past years, not exceeding half a billion US dollars, but the same is not true for imports which have more than doubled since 2009 and in 2016 stood at USD 6.53 billion. The trade deficit declined by 17% in 2016 and stood at USD 5.9 billion mainly on account of drop in imports.

The current account deficit excluding grants is pretty much stable over the past few years but fell below forty percent of GDP in FY16. The current account surplus including grants was realized at 7.05% of GDP in 2016 on account of rising official transfers.

The countries exports are mainly agricultural products to neighboring countries and Europe. In the top-10 destination of exports, there are three ECO member countries: Pakistan, Iran, and Turkey while the Pakistan is the major buyer of Afghanistan goods with a share of nearly 50%. In the top-10 destination of imports, there are again three ECO member states where Pakistan leads the list again with 26%, followed by Kazakhstan, and Turkey.

Since the country is landlocked, it is vital to have easy access channels to improve trade relations with neighbors and rets of the world. Recently, Iran and Afghanistan have finalized a draft for a new transit trade agreement. The planned land route that has been completed will run through Iran connecting Afghanistan to the Persian Gulf. It will connect Afghanistan to Iran's Chabahar port which will facilitate the movement of goods from Afghanistan and Central Asia.

Fiscal Outlook

Afghanistan has one of the lowest domestic revenue collections in the world with an average of about 9% of GDP since 2006. There was a huge jump in budget revenues from 2006 to 2011 when the revenue to GDP ratio increased from 7% to 11%. The successful trend halted in 2012-2013 as the ratio dropped to 9.5%–10% of GDP because of the negative impact of the international troop's withdrawal. The economy relies heavily on trade related taxes, which represented 45% of total tax revenues.

Domestic revenues collected in FY16 grew by 25% and stood at USD 2.2 billion while the budget expense rose by 10% to USD 1.37 billion. The overall budget surplus including grants was realized at 0.1% of GDP in 2016 compared to deficit of 1.4% of GDP recorded last year. The improvement was due to rise in security grants and domestic revenue collection. The operating deficit excluding grants shrank by one percentage point to 8.4% of GDP compared to last year. Development budget execution was slower as 55% of the current year appropriation was spent.

Improved economic performance and reforms implemented in key areas enabled Afghanistan to qualify for debt relief under the Heavily Indebted Poor Country Initiative in January 2010, leading to a 96% reduction in Afghanistan's 2006 stock of external debt. Following this extensive debt relief, Afghanistan's debt burden was pulled down significantly to 6.7% of GDP at the end of 2016.

Inflation Dynamics and Monetary Policy

Afghanistan maintains a managed floating exchange rate regime. Monetary policy is anchored by targets on reserve money. Afghanistan has no access to international capital markets and relies on donors' inflows to cover the current account deficit to control its currency. The central bank managed the exchange rate flexibly (over the last years through sales of foreign exchange in the twice-weekly auctions.

The introduction of a new Consumer Price Index (CPI) in 2012 was a major achievement for the implementation of monetary policy in the economy. With the new index, the prices are gauged through a broader geographical coverage, updated weights, and an enlarged consumer basket.

Having reached an all-time high of 13.97% in April of 2011, inflation is continuing to cooled down and average CPI inflation has remained in single digits but rose sharply to 4.5% in 2016 from 1.1% deflation witnessed last year.

Future Outlook

Economic growth is expected to pick up to 2.5% and 3% in 2017 and 2018, respectively. The projection assumes good weather, continued support from international donors, implementation of reforms, regional integration and recovery in industrial and services sector.

Fiscal policy is expected to exhibit improvements with increased revenue collection and more efficient budget execution but fiscal performance will depend on support from official transfers. Inflation is forecasted to remain in single digits at 5.5% and 5.8% in 2017 and 2018, respectively. The government is expected to maintain the managed float of afghani to control inflation and to curtail unnecessary volatility in domestic currency.

III. Main Business Strategy

Within the framework of its business plan, the Bank continues to pursue a comprehensive program to encourage other ECO member states to become a member of the Bank. In this context, Afghanistan with paid-in capital contribution of SDR 15 million signed the Articles of Agreement establishing the Bank on March 12, 2012. Afterwards, the Central Bank of Afghanistan, informed the Bank on 15 March 2014 about the official acceptance of the Articles of Agreement as the authorized representative of Afghanistan in the matters related to the Bank. As the new shareholder of the Bank having 4.59% share Afghanistan continues its paid-in capital contribution payments through equal consecutive annual installments.

As a result of decades of conflicts, Afghanistan has lost most of its main social and economic infrastructure. However, the country has been undergoing fundamental transitions in its political, security, and socio-economic spheres over the past 15 years. Despite certain improvements, the country is still in need of comprehensive development efforts. Still 36 percent of the Afghan population lives below the national poverty line. Following the withdrawal of the international troops, uncertainties related to security need to be addressed adequately in order to improve private sector confidence and domestic demand. The continued implementation of reforms and international community support to Afghanistan remains vital as aid flows help meet immediate financing requirements and reduce fiscal vulnerability. The Brussels Conference in October 2016 reconfirmed international partners' commitment to finance development needs, with pledges of USD 15.2 billion over 2017–20.

Economic activity is expected to slowly pick up in the coming years after having bottomed out in 2015. Afghanistan became a member of the World Trade Organization in 2016. The post-accession support would remain critical for reform of the economy and improvement of business environment. Reforms in the financial sector and revenue mobilization combined with improved public financial management will be critical to ensure higher inclusive growth and self-reliance over the medium term.

Afghanistan's National Peace and Development Framework (ANPDF) issued in 2016 make explicit the government's goals of weaning the country away from aid dependency. The document sets out structural reforms propelled by private sector investment in developing agriculture, mineral and natural resource sectors, energy and infrastructure. Particularly, focusing on the development of agriculture and agribusiness sector would significantly contribute to economic growth, employment and food security.

Equally, encouraging investments in development of minerals and hydrocarbons resources such as copper, iron ore, gold, oil and gas would stimulate economic growth and prosperity for the Afghan people. As such, improvements in security and sustained reform implementation will be essential to diversify the economy and build competitiveness.

This country strategy document lays the foundation for a successful partnership between Afghanistan and ETDB. It is the primary analytical and planning tool that would enable ETDB to design, execute, monitor, review, and evaluate its operations in Afghanistan. ETDB would put all its efforts to foster partnership and contribute according to (i) country development priorities and (ii) available resources, strategies and policies of ETDB. More specifically, the ETDB will strive to provide support for implementation of development projects, foster interregional and global trade expansion and enhance access to finance for micro, small and medium-sized enterprises. The operations of the Bank in Afghanistan are expected to grow across following means i.e. lending through financial intermediaries, project and corporate finance loans. The Bank will also work with selected local financial institutions in Afghanistan where such delegation of responsibility will assist the Bank in serving a targeted market segment more efficiently and effectively than the Bank might be able to do directly. Supporting development of the financial sector would be aimed to enhance credit flow for development of real sector.

The international community plays an important role in helping the country to navigate this period from transition to transformation and achieve the goal of self-reliance. Therefore, in close coordination with government authorities, international financial institutions, donors and other development partners, the Bank would align its operations with the priorities of Afghanistan and foster a conducive and sustainable investment environment. While recognizing the challenges, the Bank would invest in opportunities that would deliver positive economic activities and prosperity for Afghanistan.

(i) Micro, Small and Medium Sized Enterprises (M-SMEs) Development Facility

Under this facility the Bank would provide loans to local banks and financial intermediaries for supporting development of loans to the M-SMEs. The main goal of these intermediated loans is to support growth and employment potential of the M-SMEs and poverty alleviation efforts. Thus, promoting the production and innovation capacity of vibrant SMEs in the member states remains a priority for the Bank. The expansion of healthy MSMEs is vital component of the Afghanistan economic development plan.

Excluding agriculture sector, SMEs and microenterprises make up approx. 80% of Afghan business, generate almost half of GDP and employ 75% of the labor force. Action plans have been developed for several of the priority sectors targeted in the SME Development Strategy that have the potential for economic expansion, export creation and bringing value-added manufacturing back from neighboring countries, including: agribusiness, carpets, marble, gemstones and jewelry, cashmere products, construction materials, and leather. Afghanistan is also investigating options for supporting SME development in other sectors with growth potential, such as medicinal and herbal products, pottery and stoneware products, and wood products.

The main challenges include limited access to finance and risk averseness of private funding sources for M-SME finance in Afghanistan. The ETDB would cooperate with relevant institutions and support programs such as AREDP (Afghanistan Rural Enterprise Development Program) and ARTF (Afghanistan Reconstruction Trust Fund) which are designed to provide financial services for development of SMEs.

The level of microfinance is also growing from a small base. For microfinance sector development, cooperation with the Ministry of Finance under specialized programs such as Microfinance Investment Support Facility for Afghanistan (MISFA) would enable the ETDB to channel its funds as per the requirements of the microfinance sector.

(ii) Short Term Trade Finance (STTF) Program

Trade finance is a distinct core business of the Bank. The STTF facility has been designed to strengthen the ability of local banks to support entrepreneurs throughout the member states to expand their trade transactions. The Bank offers a number of instruments designed to address funding needs of suppliers/exporters and /or buyers/importers.

Afghanistan is located at the cross-roads of Euro-Asian countries, offering an excellent hub for regional trade. In the last 14 years there has been an exponential rise in the export of domestic products such as dried fruits, wool, cotton, marble and stones. Particularly Afghan Rugs and Saffron are ranked as some of the best on the international market.

In coordination with EPAA (an executive branch of the Ministry of Commerce and Industries) and through selected Afghan banks, ETDB would promote private sector production and support financing requirements of Afghani exporters with particular emphasis on enhancing trade activities among ECO member states. ETDB would also facilitate importation of basic humanitarian needs and importation of capital and intermediary goods that are necessary to enhance production capacity of Afghani SMEs.

(iii) Corporate and Project Finance

The Corporate & Project Finance operations are aimed to contribute towards attainment of ETDB's primary objective of nurturing and promoting sustainable economic development, social progress and intra-regional trade, by providing a full range of financing and facilitation options to its clientele in member states, targeting both public and private sector enterprises in the designated/eligible business segments.

In this respect, the Bank would focus on identifying operations in Afghanistan closely matched with the national development priorities and Bank's mission. The primary objective is to maximize economic and developmental impact in a most efficient and effective manner from perspectives of risk, return and value addition.

On the other hand, positive contribution to development of fundamental sectors and promoting complementarities and reciprocity among member states tend to be a preferential factor in allocation of funds towards projects with the optimum risk/return ratio. Therefore, corporate and project finance operations in Afghanistan would primarily focus on priority sectors like energy, mining, manufacturing, agriculture and development of transport and communication infrastructure, and intra-regional trade facilitation.

IV. Conclusion

Afghanistan has a large amount of natural and human resources for sustainable growth. But as a result of security conditions, lack of necessary capital, technical knowledge, limitations of the social and economic organizations has not been able to use these resources properly. On the other hand, being a land locked country caused that development process to extend be difficult and costly.

For overcoming these challenges and expediting the development process and attaining sustainable growth, proper measures have been taken over the last decade. However, the country faces formidable development challenges in poverty reduction, job creation, and service delivery. Country's productions are very little and lack of production equipment is visible and aid dependency remains very high. Nevertheless, developmental challenges are vast, but they are not insurmountable. Current opportunities that face the country's economy should be capitalized by public and private sectors.

The current country strategy document is closely aligned with the ANPDF, National Infrastructure Plan (NIP) and other relevant National Priority Programs (NPPs). Bank's engagement will focus on helping Afghanistan to manage the critical transition from security and development dominated by the international community to self-sufficiency. In this context, sustainable job creation, building infrastructure, developing the country's human resource capacity through a robust system of education, fostering entrepreneurship in the society, and investment in the country's productive sectors, notably agriculture, energy, and mining are among Afghanistan's crucial needs if it is to achieve fiscal viability and ensure a sustainable economy. Particularly, development of the mining sector has clear benefits to the economy and provides first-mover advantages to investors. ETDB has a clear focus to support development projects in cooperation with ministries/agencies and other development partners. In the coming years, the major components of the country program would inter alia include:

Financial sector: Support improving capacity and competitiveness of the financial institutions to foster small and medium enterprise lending, trade finance and microfinance investment.

Energy: Support rehabilitation of power infrastructure and regional power trading. Development of indigenous energy resources such as micro, small, and medium hydropower, solar panels will be a specific focus area.

Agriculture: Agricultural supports will be structured for expanding the means of production, particularly irrigation networks, water resources management, quality seeds, plant protection increasing efficiency, productivity and quality in production. Support investments in modernizing agro-food processing to boost production and exports.

Mining: Being sensitive on environmental and social impact assessment, support development of extractive industries in line with international standards which will create revenue streams for development financing.

Infrastructure: Support implementation of projects that will enhance sustainability of the national road and railway network including links with neighboring countries.

Manufacturing: The Bank will seek to support development of fundamental manufacturing sectors, enhance productivity and exports. Support local entrepreneurs to produce input materials and products for the domestic market.