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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/104-1

9:30 a.m., December 7, 2018

1. Islamic Republic of Afghanistan—Fourth Review Under the Extended Credit Facility Arrangement, Request for Modification of Performance Criteria, and Request for Extension and Rephasing of the Arrangement

Documents: EBS/18/101 and Supplement 1

Staff: Duenwald, MCD; Sommer, SPR

Length: 33 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	**Alternate Executive Directors**
	I. Mannathoko (AE)
M. Raghani (AF)	
	J. Di Tata (AG)
N. Ray (AP)	
	P. Fachada (BR)
	K. Lok (CC), Temporary
	J. Rojas (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
H. de Villeroché (FF)	
S. Meyer (GR)	
S. Gokarn (IN)	
	T. Persico (IT), Temporary
	H. Mori (JA), Temporary
J. Mojarrad (MD)	
	P. Al-Riffai (MI), Temporary
	T. Manchev (NE), Temporary
	K. Virolainen (NO)
	A. Tolstikov (RU), Temporary
M. Mouminah (SA)	
	U. Latu (ST), Temporary
	P. Trabinski (SZ)
S. Riach (UK)	
	M. Svenstrup (US), Temporary

H. Al-Atrash, Acting Secretary
P. Cirillo, Summing Up Officer
E. Mannefred, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Finance Department: M. Mohlala. Legal Department: K. Chen, H. Pham. Middle East and Central Asia Department: C. Duenwald, M. Sumlinski, F. Talishli. Office of Executive Directors: at the table Anwar. Strategy, Policy, and Review Department: K. Nakatani, M. Sommer. World Bank Group: A. Alexandrova.

Alternate Executive Director: V. Rashkovan (NE), P. Rozan (FF), P. Sun (CC). Senior Advisors to Executive Directors: Z. Abenoja (ST), A. Muslimin (ST), W. Kuhles (GR), T. Nguema-Affane (AF), C. Sassanpour (MD). Advisors to Executive Directors: K. Badsi (MD), J. Corvalan (AG), J. Essuvi (AE), U. Latu (ST), K. Osei-Yeboah (MD), I. Skrivere (NO), A. Zaborovskiy (EC), S. Alavi (MD), A. Tola (SZ).

1. ISLAMIC REPUBLIC OF AFGHANISTAN—FOURTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT, REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA, AND REQUEST FOR EXTENSION AND REPHASING OF THE ARRANGEMENT

Mr. Mojarrad, Mr. Sassanpour and Mr. Alavi submitted the following statement:

Our Afghan authorities would like to thank Mr. Duenwald and his able team for a concise report, and for their candid and constructive engagement and sound policy advice. Staff participation in the recent Geneva Ministerial Conference on Afghanistan (November 27-28) was also well received and highly appreciated. The authorities would also like to thank the Management and the Executive Board for their continued support for Afghanistan's economic reform program.

Program Implementation

Afghanistan maintained its good track record in program implementation under the Extended Credit Facility (ECF). All eight end-June 2018 quantitative performance criteria and all seven structural benchmarks for this review were met, albeit one with some delay owing to its political sensitivity. The authorities request Executive Board approval of the completion of the Fourth Review and the modification of two end-December 2018 performance criteria—in line with the updated macroeconomic framework—and a re-phasing and extension of the arrangement to end-December 2019.

As further reaffirmed in the Geneva Conference, the Afghan authorities remain fully committed to program implementation and believe that their steady progress has been critical in maintaining macrofinancial stability, facilitating institution building and catalyzing donor support. Their resolve is continuously tested by social and political tensions and on-going conflict, but they continue to firmly believe that the reforms are essential in laying the foundation of a stable, self-reliant economy, with high sustained growth contributing to poverty alleviation, economic equity and job creation. The authorities' reform efforts have also been recognized by Afghanistan's ranking as the top reformer in the World Bank's Doing Business ranking.

Overview of Political and Security Situations

Afghanistan continues to face strong headwinds and unrelenting challenges as it proceeds with its economic and political reforms. The escalation of the conflict continues to take a heavy toll on security forces and civilians, as well as the economy. The violence has recently become indiscriminate with attacks on educational, cultural and religious targets adding a new dimension to the hostilities. Nevertheless, the Afghan government is committed to a negotiated peace, and in an attempt to kick-start the process of ending decades of violence and destruction, unveiled a roadmap during the Geneva Conference towards an enduring peace and establishing a democratic and inclusive society. With the recent participation of regional and global powers, there is renewed optimism for a lasting peace. In the meantime, democracy is taking stronger roots in Afghanistan. The October 2018 parliamentary election was a major step towards consolidating the democratic process, a process that for the first time in decades was owned and led by Afghans, with the strong participation of women, and a relatively high overall turnout despite intimidation and harassment and security and operational difficulties. Presidential election is scheduled for April 2019. Afghanistan is also facing a devastating drought—the worst in a decade—affecting two thirds of the country and over 3 million people, undermining agriculture and livestock production and causing large-scale internal displacement, adding to the conflict related displacement and large number of Afghans returning from neighboring countries.

Recent Economic Developments and Outlook

After picking up in 2017, growth is expected to have moderated in 2018, reflecting the adverse security situation compounded by the drought, and inflation has been barely positive in recent months, mainly because of declining food prices. Amid turbulence in regional currencies, weak confidence and political uncertainty in the run up to the presidential election, Afghani experienced a period of volatility in mid-2018 and weakened by about 9 percent by early October versus end-2017. Still, Afghani's nominal depreciation was more subdued than those of the regional currencies, and given Afghanistan's low inflation relative to its neighbors, REER slightly depreciated. The flexibility of Afghani over the years in face of a myriad of pressures has supported exports and helped preserve foreign reserves. Afghanistan is a large net importer of goods and services and its current account deficits continue to be financed by donor grants. Exports surged by 30 percent in the first half of 2018, boosted primarily by the government's export promoting efforts, including establishing air corridors to link the land-locked Afghanistan to major markets in Asia and Europe.

Despite subdued economic activity in 2018, fiscal performance was satisfactory and, by September, revenues grew by 9 percent (yoy)—well ahead of nominal GDP growth—and Treasury cash buffer (government deposits at the central bank) substantially exceeded the program targets. Large security spending—financed by foreign grants—has dominated current outlays, and while other current expenditures have been contained, development spending has increased due to an improving project execution rate (49 percent this year compared to 32 percent last year). Growth of monetary aggregates was maintained below the program ceilings helping to contain inflation. To spur the sluggish credit growth to the private sector, Da Afghanistan Bank (DAB) reduced the interest rate on central bank's capital notes held by banks close to zero, without much impact however, as banks remain highly risk averse and there is a general lack of viable projects.

Staff's projection of accelerating growth over the coming years is reasonable, but is also highly conditional on internal security conditions, global and regional risks, generous donor support, and the weather. An enduring peace would carry a large dividend by boosting confidence. Meanwhile, economic progress, ultimately depends on the success of program implementation, but at the same time it is important to bear in mind that economic policies are being implemented in the face of a complex set of constraints and uncertainties largely beyond the authorities' control. What is certain is that after decades of destruction and human suffering, even after peace prevails, nation-building and reconstruction will take time and must involve substantial donor support.

Macroeconomic Policies

Macroeconomic policies will continue to focus on strengthening macro-financial stability, supporting inclusive growth and job creation, reducing poverty, protecting competitiveness, and preserving a comfortable international reserve buffer. Fiscal policy will be set and executed with prudence, targeting, from 2020, an overall balanced position (including grants) and gradually shifting to the operating budget (excluding grants) as the fiscal anchor. For 2019, at 0.8 percent of GDP, the overall budget deficit (including grants) will be double the projected deficit in 2018 in terms of GDP, reflecting expectations of a 3 percentage points of GDP drop in on-budget grants, while the operating deficit (excluding grants) will be lower than in 2018. The authorities are putting in place contingency plans to cut current spending in 2019 by a further 0.5 percent of GDP to ensure compliance with the program target if revenue and/or grants fall short of expectations. Within these parameters, preserving priority social spending is an imperative and poverty reduction remains a key priority. Development spending will be scaled up gradually, with proper evaluation, execution and monitoring, keeping in mind the limited fiscal space and implementation capacity.

Monetary policy will continue to focus on maintaining moderate inflation, with reserve money growth remaining the DAB's operational target given the weak monetary policy transmission mechanism. The authorities intend to strengthen the effectiveness of monetary policy—that currently mainly relies on DAB foreign exchange auctions—by promoting a greater use of domestic currency; setting up the legal and institutional framework for issuing sharia-compliant Sukuk to promote the use of domestic currency denominated instruments; and strengthening coordination between the Ministry of Finance (MoF) and the DAB. The authorities are fully committed to DAB independence and its operational autonomy. The Afghani will be managed flexibly to preserve external competitiveness and serve as the economy's main shock absorber. International reserves will be maintained at a fairly high level, given the unpredictability of foreign aid, elevated levels of dollarization—of the financial sector, in particular—and the country's high import bill.

Fiscal Reforms

Fiscal reforms will be guided by a five-year rolling fiscal performance improvement plan, focused on strengthening public finance management, making efficient use of grants and improving the quality of spending. The reforms will aim at improving budget preparation, streamlining budget management and improving budget execution as well as enhancing budget transparency, accountability and credibility. On the revenue side, the authorities plan to broaden the tax base by consolidating all large tax payers and establishing a modern single national LTO (by end-October 2019) and introducing a VAT (by January 2021) in a process overseen by a dedicated implementation team and supervised by a steering committee. In the area of customs, a 5-year Strategic Plan (2018-2022) has been developed, with the support of World Customs Organization, seeking to improve customs collection while enhancing institutional efficiency and automation, fighting corruption, and improving compliance. Interfaces between official databases are also being strengthened to facilitate information sharing on taxpayers to improve collection efficiency and prevent tax avoidance and leakages. Afghanistan's rich mineral resources—a key source of future government revenue—is largely untapped, and with that in mind, an EITI-compliant transparent fiscal regime for natural resources is being developed. The oversight of state-owned corporations (SOCs) has also been intensified and the scope of the new SOC law that monitors potential fiscal risks, including contingent liabilities, will be expanded in line with Fund TA recommendations. Similarly, the new PPP law—that is in line with good international practices—will be able to assess potential contingent liabilities.

Financial Sector Reforms

Significant progress is being made to improve the stability and integrity of the financial sector as DAB continues to firmly enforce the regulatory requirements to address the weaknesses in the banking system. The implementation of corrective action plans for weak banks is on track, and a small non-systemic bank was liquidated after its liabilities were repaid. To enhance the credibility of the banking system and strengthen DAB's balance sheet, the authorities are in final stages of closing the chapter on the failed Kabul Bank. DAB's lender of last resort exposure to Kabul Bank will be fully eliminated by end-2019, and asset recovery will be accelerated with the help of a reputable international forensic accounting firm. Further, with the assistance of the World Bank, a strategy is being implemented for state-owned commercial banks to revamp their business models, restructure their operations and improve governance. As part of a robust crisis preparedness and response framework, a joint DAB-MoF financial stability council will be formed by end-2018 to serve as the coordination platform for managing and resolving banking crisis, where, in line with each institutions' legal mandate, DAB will be responsible for mitigating and managing risks to financial stability, while the MoF will decide on the use of public funds when crises are deemed to be of a systemic nature. A comprehensive national Financial Inclusion Strategy will serve as a roadmap for improving access to formal financial services—particularly by women and in rural areas—promoting financial literacy, and developing a framework for consumer protection. Authorities are strictly enforcing the AML/CFT requirements to preserve the integrity of the financial sector, and a World Bank-supported national risk assessment is underway.

Economic Governance

Despite significant improvements in recent years, corruption is still widespread and remains a major deterrent to donor confidence and private sector investment. In response, the authorities are redoubling their multi-pronged efforts: Afghanistan's legal framework for improving governance and combating corruption is being upgraded, including by the enactment of a new Penal Code, adoption of the National Strategy on Combating Corruption, and the enactment of the Law on Declaration and Registration of Assets of Official and Government Employees. The implementation of the enhanced framework for asset declaration by high-level public officials is progressing in line with the commitments under the ECF.

Concluding Remarks

Few countries have gone through decades of conflict, violence, instability and destruction as Afghanistan. Few countries have had to deal with returning refugees, internal displacement and human suffering on such a massive scale as Afghanistan. And yet, even fewer countries have been able to, not to attempt, but to make steady progress in institution building and economic reforms against such odds. There is clear recognition by the authorities that this is the only path forward, with the ultimate aim of establishing a stable, self-reliant economy and an inclusive society benefitting all Afghans. Enduring peace and stability on the one hand, and sustained economic development and nation building on the other hand, are intrinsically linked in Afghanistan, and the authorities are determined to push ahead vigorously on both fronts. The achievements so far would not have been possible without the generous support of donors and our international partners and the authorities are hopeful that the high level of engagement and support will continue until Afghanistan achieves its dream of self-reliance. Our Afghan authorities are very appreciative of the continue support of Fund management and staff and, in turn, commit to maintaining close cooperation during the implementation of the program.

Ms. Levonian, Ms. McKiernan and Mr. Weil submitted the following statement:

We support the completion of the fourth review of the Extended Credit Facility (ECF) arrangement. We also support the modification of the performance criteria relating to international reserves and net credit to government in light of higher than expected grants and higher government spending, as well as the re-phasing and extension of the ECF.

Meeting all quantitative performance criteria and all but one structural benchmark during a period of violence, renewed political instability, and a severe drought is remarkable. We fully agree with staff that the Afghan authorities are deserving of the international community’s sustained support. Under such trying circumstances, in addition to security and the rule of law, the authorities’ focus should be on protecting the vulnerable, tackling corruption, and building resilient institutions.

We welcome that the authorities have stated poverty reduction as a top priority. Sufficient public spending must be allocated to address the unfolding humanitarian crisis. The High Council for Poverty Reduction should be convened regularly to develop home-grown strategies to address poverty, such as the national program for women’s empowerment. It is especially important for social spending to be maintained entering a fiscally trying year given uncertain revenue projections and a push to reduce overall deficits. Staff can perhaps best support these efforts through technical assistance to enhance public financial and investment management, building on the progress made to control fiscal risk in the areas of state-owned enterprises and public-private partnerships.

The authorities should sustain their fight against corruption and focus on implementation. By tackling corruption, the authorities can enhance the efficiency and effectiveness of all policies and programs. As such, we were encouraged by the numerous examples of anti-corruption activities highlighted in the staff report and the transparency with which they were executed. With no shortage of frameworks and legislation, including a new anti-corruption law pending enactment, the authorities should prioritize the implementation of anti-corruption reforms. In particular, now that sanctions against officials who failed to meet their asset declaration obligations have been disclosed (albeit too late to meet the related benchmark), the authorities should make every effort to keep disclosures current.

Efforts are encouraged to make the banking sector more resilient. There are clear signs of weakness among private banks, including a failure since the third review. It is therefore crucial to take steps to foster public confidence in the banking sector. The authorities should dedicate the necessary capacity to continue working with the World Bank on modernizing the governance and operations of state-owned commercial banks. We would also recommend that Da Afghanistan Bank closely monitor capital and liquidity levels, both of which have declined of late. Given the enduring vulnerabilities, have staff and the authorities discussed the appropriateness of a structural benchmark related to bank regulation or supervision?

Mr. Rashkovan and Mr. Manchev submitted the following statement:

We thank staff for the focused report. Afghanistan has made some progress under the ECF arrangement so far, but the poor security situation, electoral uncertainties, draught and external factors outside the authorities’ reach are undermining growth and pose sizable development risks. We welcome the intensified peace efforts and authorities’ continuous cooperation with the IMF. Given the complex domestic and external environment for future structural reforms, we support completion of the Fourth Review, and can go along with the proposed way forward including extension of the arrangement, modification of the PCs and suggested new structural benchmarks for the remaining two reviews.

Fiscal policy, debt management and anti-corruption reforms

Further fiscal consolidation is warranted to preserve financial integrity and public debt sustainability. We note that revenue growth has moderated and the end-of-June revenue targets under the program have been broadly supported by the extended grants from the World Bank. The revised expenditure for this year and the 2019 government spending should remain within the envelop financed by grants, and the authorities should not deviate from the agreed deficit targets unless emergency expenditure occur which cannot be ad-hoc grant-financed. We support the program focus to remain on the structural fiscal reforms, provided in the paragraph 15. Special attention should also be given to strengthen the public debt monitoring and management system. Although the public debt is currently very low, the authorities need to build the necessary capacity to carefully assess implications of external borrowing and PPP on debt sustainability. Given the limited export capacity of the Afghani economy and sizable external imbalances without grants, a full compliance of the prospective concessional borrowing terms with the ECF program conditionality is warranted when the authorities seek concessional financing for their development projects. Can staff update us on the recently provided TA on debt management and their work with the authorities to build the necessary capacity for sound public finance management?

We welcome the strong ECF support to the authorities' anti-corruption efforts and the recent progress. The increased transparency of assets acquired by the country officials and government employees have been a step in the right direction. We also note the government's approval of the draft anti-corruption law and DAB's support to these efforts through implementation of a risk-based AML/CFT framework. However, we believe that an integrated anti-corruption strategy may help the authorities to better integrate efforts and increase effectiveness of the anti-corruption measures. The strategy should also become an integral part of the efforts for enhancing the revenue mobilization, fiscal structural reforms and financial stability. Staff comments are welcome. Going forward, we would also welcome an in-depth analysis on macro-criticality of the anti-corruption measures agreed under the ECF arrangement.

Monetary and financial policies

In the current juncture, sound monetary policy and flexible exchange rate regime remain critical to preserve reserve adequacy and competitiveness of the Afghani economy in the medium-term. These policies should be supported by expedited efforts to revive the system-wide correspondent banking relations and establish strict financial supervision. We note the increased exchange rate volatility in the recent months and the monetary policy limitations to respond with other instruments than foreign exchange interventions and/or administrative measures. However, the observed lack of pass-through effect into consumer prices needs further analysis, as well as a comprehensive set of measures to deepen the domestic financial markets and mitigate this risk in the future.

The Afghani's banking sector is highly vulnerable, and we welcome the DAB's persistent efforts to address these shortcomings. Strict enforcement of the corrective action should continue to address financial risks both in the public and private banks and prevent sovereign-bank spillovers. We welcome the new structural benchmark set for the sixth review on recovery of stolen assets from the Kabul Bank and wonder why the benchmark was not extended to the asset recovery of the Afghanistan Commercial Bank? A sound governance framework should be established for the state-owned commercial banks by end-2018 and we urge the authorities to timely implement it. Adoption of the legislative and institutional framework, for issuance of sukuk and modernization of the payment system as a part of the authorities' National Financial Inclusion Strategy supported by the World Bank - due next May - will be important milestones to deepen the domestic financial market and strengthen liquidity management.

Mr. Fachada and Mr. Coronel submitted the following statement:

Despite a particularly complex environment, characterized by widespread violence and political instability, program performance in Afghanistan remains relatively satisfactory. We support the completion of the fourth review under the Extended Credit Facility (ECF) and the modification of two performance criteria for end-December. Given the challenging circumstances, we also support staff's flexible approach, and the ECF re-phasing and extension to end-December 2019. The 6-month extension will be particularly helpful to support the authorities during the Presidential transition.

Violence and political instability pose significant risks to the program. The poor security situation and political uncertainties—aggravated by parliamentary elections this year and presidential elections next year—continue to represent the main risks to Afghanistan's development prospects. We commend staff's engagement with the authorities under fragile conditions. We also praise the authorities for their adherence to the program's objectives and their commitment to reforms. Both staff and authorities have been persistent and effective, and the program has yielded moderate positive results: the fiscal accounts have remained under control, international reserves have slightly increased, and financial stability has been preserved. The program's catalytic role also deserves to be emphasized. In our view, recent program implementation in Afghanistan represents a good example of the "humility and patience approach" that the IEO referred to in the work of the Fund with fragile states in its March 2018 evaluation.

Poverty in Afghanistan has increased significantly in recent years, and we support the goal to preserve priority social spending in 2019. According to the Afghanistan Living Conditions Survey (ALCS), it is estimated that 55 percent of the population now lives below the national poverty line, as compared to 38 percent in 2011-12 and 34 percent in 2007-08.[1] Additionally, extremely high unemployment and illiteracy, and low school attendance—particularly among girls— remain endemic. Internal displacement, return of migrants from abroad, adverse weather conditions (illustrated by the recent drought that affected two-thirds of the country), and acute governance and capacity issues have compounded to the worsening of social conditions. That said, recent peace talks could be a game-changer to Afghanistan. Can staff provide an update on the main takeaways from the recent Geneva conference, as well as medium-term implications to the country?

Afghanistan must prepare for an eventual phase-out of external aid. According to the Debt Sustainability Analysis (DSA), Afghanistan's risk of debt distress remains high. We agree with staff that the authorities should continue their efforts to mobilize revenue and implement structural reforms, as they prepare for the pashing-out of grants. In the context of decreasing aid, economic development will rely on the country's own capacity to support growth, job creation, export expansion, and diversification. This will require a sustainable growth strategy, including development of infrastructure and human capital, as well as continued progress on the anti-corruption front.

[1] https://cso-of-afghanistan.shinyapps.io/ALCS_Dashboard/

Mr. Tan and Mr. Anwar submitted the following statement:

We thank staff for the comprehensive analysis. Given the very challenging environment, marked by prolonged conflict, heavy dependence on donor support and weak social indicators, we commend the authorities' visible progress on economic transformation. We also note that program implementation has been satisfactory as all quantitative performance criteria and six of the seven structural benchmarks were met. Going forward, while the medium-term outlook appears favorable, risks are tilted to the downside. Against this background, we encourage the authorities to recalibrate its policy measures to current realities as rightly noted by staff, anchored by the prevailing objectives of raising inclusive growth, boosting job creation, and reducing aid dependency. In this light, we support the completion of the fourth review under the ECF Arrangement and the authorities' request for a modification of two performance criteria for end-December 2018 and an extension and re-phasing of the arrangement to end-December 2019.

Well-designed fiscal policy is crucial to achieve and maintain full employment and reach a robust rate of economic growth. We note that Afghanistan's fiscal performance has remained adequate with the help of aid from donors to bring the deficit below the indicative target. We concur with staff that the authorities should focus on sustainability, considering risks to revenue and grants, and limited financing options. We encourage the authorities to make further progress in improving fiscal performance, especially in ensuring strong revenue performance and strengthening public financial and investment management, through structural fiscal reforms. In this regard, we note staff's projection that growth will rise to 3 percent in 2019 and accelerate to 5 percent by 2023, assuming sustained inflows of aid, continued implementation of reforms, and improvements in security and confidence. Beside services and agricultural, could staff share what other economic sectors will be accounted as the main contributors of this increasing growth? With these increasing growth, what would be the impact on job creation, as well as poverty and unemployment reduction?

Monetary and exchange rate policies play important and complementary roles in maintaining macroeconomic and financial system stability. We note that inflation will increase from 3 percent in 2018 to 4.5 percent on average during 2019-2020 and be maintained at 5 percent on average in the medium-term. Against this background, the monetary policy stance should remain vigilant and be clearly communicated to enhance its credibility and effectiveness. The authorities should also continue to formulate monetary policy that is well-calibrated and dependent on the balance of risks to the economic outlook. Could staff explain what is the growth of reserve money in local currency during 2019-2020 and in the medium-term to maintain inflation around these levels? We would also like staff to elaborate what are the potential factors driving inflation to exceed its desirable level in the medium-term and how the authorities can mitigate the risks evolved? We support staff's recommendation that Da Afghanistan Bank should remain committed to exchange rate flexibility while targeting a moderate inflation rate. We welcome the authorities' continuing efforts to reduce dollarization and broaden the use of domestic currency-denominated instruments to enhance the effectiveness of monetary policy transmission.

Advancing structural reforms delivered tangible outcomes to the people of Afghanistan. The authorities made positive progress in implementing structural reforms despite many obstacles and vulnerabilities. According to the World Bank annual ratings, Afghanistan's ranking in terms of the ease of doing business improved to 167 among 190 economies in 2018 (from 183 in 2017). This is evident of the impact of structural reforms to strengthen the business climate in collaboration with international partners. Hence, we support the authorities' strong commitment to persist with structural reforms to improve the business environment and to continue tackling corruption.

With these comments, we wish the authorities all the success in their future endeavors.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the well-written set of reports. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We support the completion of the fourth review under the ECF arrangement and the associated decision. In this regard, we commend the Afghan authorities for the satisfactory program implementation in very difficult circumstances with the meeting of all quantitative performance criteria and six of the seven structural benchmarks. We also support the request for modification of December 2018 performance criteria as well as rephasing and extension of the arrangement until end-December 2019 for the reasons noted in the staff report. We are particularly encouraged that the authorities have diligently implemented their reform program supported by the ECF and continue to lay the foundations for strong, sustainable, and inclusive growth.

We encourage the authorities to continue maintaining a prudent fiscal position in 2019 and beyond and advancing structural fiscal reforms. In this regard, we are reassured that in case of unfavorable revenue or grant developments, the authorities are ready to implement the necessary spending cuts while preserving priority social spending. This is important to ensure fiscal sustainability. We also take positive note of the strong fiscal reform efforts, including the plan to adopt the VAT at end-2020 and the reforms of large taxpayers' offices, which would be important steps toward raising domestic revenue. We also welcome the authorities' intention to strengthen public investment management, including effective project appraisal and selection. We urge the authorities to continue their efforts toward strengthening debt management capacity, including the monitoring of contingent liabilities.

Efforts to safeguard financial stability should continue. While staff assess financial soundness indicators to be broadly stable, we note that a few private banks are facing problems. In this context, we welcome the tight monitoring and enforcing of the corrective action plans by Da Afghanistan Bank. We look forward to the establishment of the Financial Stability Committee, which will strengthen coordination among the relevant authorities for crisis preparedness and management. On AML/CFT, we join the staff in encouraging the authorities to ensure effective application of risk-based AML/CFT measures. This may also help in reviving system-wide correspondent relationships with global banks.

Finally, we commend the authorities for strengthening the legal framework for fighting corruption. In this regard, we encourage sustained efforts to implement the framework.

With these remarks, we wish the authorities further success.

Mr. Ray and Mr. Amor submitted the following statement:

Afghanistan continues to face challenging security and political conditions, and the challenges are compounded by drought-induced humanitarian crisis and returning refugees. We commend the authorities for their success in meeting the program goals, and their strong efforts in progressing reforms and achieving modest growth amidst the daunting environment. The Extended Credit Facility has served the authorities well in supporting their reform agenda and catalyzing much needed donor support.

We support the completion of the fourth review under the Extended Credit Facility arrangement and the authorities' requests for modification of performance criteria on net international reserves and net credit to government, and for a re-phrasing and extension of the arrangement to end-December 2019. We note positively that despite the highly challenging environment, program performance has been satisfactory to date. All quantitative performance criteria and all structural benchmarks have been met, including the delayed implementation of structural benchmark on asset declaration. Development in fragile states requires time and patience and the extension of the ECF until end-December 2019 appears necessary to provide time for reform implementation.

Domestic security remains key to growth prospects. We welcome the recent peace efforts, including the Government's offer of talks, as well as people's peace march and the unprecedented ceasefire in June. As noted in the report, violence and armed struggle continue and insurgents are showing no signs of easing. The poor security situation is undermining confidence and growth, and further deterioration can risk eroding the significant progress that's been achieved. If the current security conditions continue or intensify, what will be the likely impact on program outcomes? And what are possible measures to safeguard program success?

Sustained donor support is needed to help Afghanistan navigate through the development challenges. The authorities' commitment to full implementation of reforms, including fighting corruption, enhancing public financial management, and reducing poverty should be sustained to safeguard macroeconomic stability and maintain donors' appetite for support. We welcome the ECF-supported anti-corruption measures including the asset declaration laws and efforts to criminalize corruption. We encourage staff to work closely with the authorities to ensure that sufficient technical and capacity building support are provided to support implementation and enforcement of the new anti-corruption and PFM measures. Can staff provide updates on the outcome of the recently concluded Geneva Conference on Afghanistan?

We encourage continued support to the authorities to further enhance the effectiveness of their AML/CFT regime. The progress on AML/CFT is commendable, including the exit from Financial Action Task Force's monitoring. Despite FATF de-listing, correspondent banking relationships remain challenging due to concerns about the low profitability of transactions and regional cross-border risks. Given these concerns, can staff comment on practical solutions that can help Afghanistan revive correspondent relationships with global banks?

Mr. Kaya and Mr. Zaborovskiy submitted the following statement:

We thank staff for the informative papers and Messrs. Mojarrad, Sassanpour and Alavi for their candid buff statement. The economic situation in Afghanistan is fragile amidst intensifying domestic and global risks. Nevertheless, the overall program performance remains satisfactory and all quantitative performance criteria and six of the seven structural benchmarks have been met. Against this backdrop and taking into account the staff's appraisal, we support the completion of the fourth review under the ECF arrangement, and the authorities' requests for a modification of two performance criteria for end-December 2018 and a re-phasing and extension of the arrangement to end-December 2019. We would also like to provide the following comments for emphasis.

Prudent fiscal policies to offset the potential fiscal risks on the revenue side, including foreign aid volatility, are critical to ensure macroeconomic stability and strong program performance. We positively note the authorities' progress in strengthening their ability to control fiscal risks, but we see scope for further advancement in generating domestic revenues and improving spending efficiency. Fiscal reforms should focus on broadening the tax base and upgrading public financial and investment management. The contingency budget planning is a right step to ensure fiscal sustainability should downside risks materialize. Could staff elaborate more on the composition of the fiscal adjustment should developments deteriorate? The debt sustainability analysis paints a very challenging picture as Afghanistan remains at a high risk of debt distress. We encourage the authorities to carefully select projects to be financed by external borrowing and seek as concessional terms as possible.

Monetary policy should target the increasing inflationary risks with exchange rate flexibility as a tool for absorbing external shocks. We take positive note that monetary aggregates have grown in line with the program. The Central Bank's primary objective should be to maintain price stability and foster confidence in the domestic currency, and we agree that targeting monetary aggregates should support achieving these goals. To strengthen the monetary policy transmission mechanism, the further development of Afghanistan's financial system is critical, which remains vulnerable to adverse shocks. We urge the authorities to address weaknesses in public banks, improve financial soundness indicators and inclusion. Staff's comments on the progress achieved in the Kabul Bank case so far, including the status and financial details of asset recovery, are welcome. The flexible exchange rate regime remains an important tool to alleviate the exchange rate pressures. We echo staff's call on the authorities to avoid resorting to administrative measures at the FX-market and positively note the Central Bank's commitment to exchange rate flexibility while targeting a moderate inflation rate.

A durable peace agreement underpinned by a strong anti-corruption framework and comprehensive structural reforms are of paramount importance for unlocking the economic potential and raising inclusive growth. Afghanistan's economic development critically hinges on a stable domestic environment as presented in last year's selected issues paper. Staff estimated that US$1 billion would be the potential annual fiscal dividend for Afghanistan if the security situation significantly improved, which amounts to more than the current financing from the IMF. In addition, continued macroeconomic policy discipline and decisive structural reforms would help lay the foundations for sustainable and inclusive growth. We therefore encourage the authorities to accelerate reforms, forcefully fight corruption, strengthen the AML/CFT framework, and decisively move forward with the implementation of measures envisaged in the ECF arrangement. Could staff elaborate more on the results of the Geneva Ministerial Conference on Afghanistan that took place on November 27–28, 2018 as well as on the amount of grants committed by the international community for Afghanistan in 2019 and 2020 in comparison with 2018.

With these remarks we wish the authorities well in their endeavors ahead.

Mr. Beblawi and Ms. Choueiri submitted the following statement:

We thank staff for the well-written papers and Messrs. Mojarrad, Sassanpour, and Alavi for their informative buff statement. We welcome the important progress achieved on fiscal, financial, and governance reforms, despite an increasingly challenging security situation, which continued to take a heavy toll on civilian life and economic activity. We support the proposed decision, given the good performance under the ECF and the authorities' commitment to the program's objectives. We broadly concur with the staff appraisal and will limit the remainder of our comments to risks, the international community's support, and capacity development.

We take note of the significant downside risks in the period ahead, including from political instability, the ongoing drought, and mounting external pressures. We share staff's assessment that Afghanistan could, however, benefit from a tangible peace dividend if a durable domestic agreement were to be reached. In this context, continued macroeconomic policy discipline and decisive reforms would help to preserve macroeconomic stability and promote growth. Continued timely and generous donor support would be essential in supporting the authorities' efforts. In this connection, we welcome the Geneva Ministerial Conference on Afghanistan that took place in late November and would appreciate an update from staff on disbursement of the $15.2 billion of grants committed in 2016 by the international community. Alongside financial support and policy advice, continued technical assistance and training from the Fund would also be essential. We wonder in this regard whether an assessment of the effectiveness of Fund capacity development in Afghanistan is envisaged.

With these remarks, we wish the authorities every success.

Mr. Psalidopoulos and Mr. Persico submitted the following statement:

We thank staff for the informative report and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi for their helpful buff statement. We agree with the thrust of staff's appraisal and support the completion of the Fourth Review Under the ECF Arrangement, the Modification of Performance Criteria, as well as the extension and re-phasing of the Arrangement. We would like to limit our comments as follows.

The recent drought, which has impacted agricultural production, and persisting security concerns lead to a weakened growth outlook. As the authorities emphasized the uncertainties related to the next presidential election, we consider the projected growth rebound as well as the medium-term GDP forecast somewhat optimistic. The good fiscal performance is largely related to the disbursement by the donors Fund administered by the World Bank with the main risk related to the revenue projection. In this regard, we welcome the authorities' commitment to preserve social spending from potential expenditure cuts.

Timely reform implementation is paramount to promote inclusive growth. The authorities should step-up their efforts to reduce poverty and improve the living standards of the population. In order to face downside risks, it is key to support economic diversification, governance improvements, infrastructural development and financial inclusion. The adoption of the implementation of Extractive Industries Transparency Initiative standards (EITI) is highly recommended. Moreover, the fight against corruption and the promotion of effective AML/CFT measures (also to maintain a viable channel for remittances' inflow) should remain a priority.

Despite a highly challenging environment, the authorities have made continued progress in reforms' implementation and recorded a satisfactory performance under the ECF. The country has made relevant progress with the support from the international community and a key role of the Fund. For this reason, we see merit in the requested extension to provide both additional time for reforms implementation and continued engagement with the Fund until the end of the election year.

We concur with staff on the need to update the performance criteria (PCs) on the net international reserves and the net credit to government. We noted that the schedule of donors' disbursement had a relevant effect on the overall program performance. We wonder whether the future reviews could consider their role to avoid a potential vicious cycle in the case of delays in program execution or in donors' contributions. Staff comments are welcome.

As noted by staff the recent Geneva Ministerial Conference (November 27–28, 2018) lead international efforts to promote reforms and secure continued donor support. Among the Conference deliverables (i. e. Geneva Mutual Accountability Framework, short-term deliverable n. 6) there are the completion of the ECF's reviews and the release of all the disbursements. Moreover, the Conference call for a successor arrangement with the objective of obtaining IMF approval of a new arrangement by mid-2020. Could staff provide details on the Fund's role in this outcome and their view on future engagement?

Debt sustainability is at high risk of debt distress and is connected to the continued donors' support. However, public debt remains low and is characterized by high concessional terms. Both authorities and staff concur on the long-term "high risks" assessment, but the mechanical result of the analysis signaling a moderate risk in the medium-term is a positive step. We invite authorities to further build up debt management and monitor capacity in order to gradually shift from grants to concessional financing and domestic resources mobilization.

Mr. Di Tata and Mr. Corvalan Mendoza submitted the following statement:

We thank staff for a well-written report and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi for their informative buff statement.

Program implementation under the Islamic Republic of Afghanistan's Extended Credit Facility (ECF) arrangement has been satisfactory, even under severe domestic pressures (violence, elections) and diverse shocks (drought, regional difficulties, tighter financial conditions). All the quantitative performance criteria and six of the seven structural benchmarks were met, and the seventh benchmark on asset declaration was implemented with delay. In view of the satisfactory performance, we support the completion of the fourth review under the ECF. We also support the authorities' request for modification of the December 2018 performance criteria on net international reserves and net credit to the government, as well as the proposed rephrasing and extension of the arrangement to end-December 2019.

The ECF arrangement continues to support the government's reform agenda, as stated in the Afghanistan National Peace and Development Framework, which seeks to lay the foundations for higher growth and catalyze continued donor support. The main problem faced by Afghanistan is violence, which hurts confidence and private sector development. This has been compounded by the devastating drought and political uncertainty in the run-up to the April 2019 presidential elections. Real GDP growth is projected to slow to 2.3 percent in 2018 and experience a modest rebound to 3 percent in 2019 as agricultural output recovers and political uncertainty declines following the presidential elections. Staff envisages a gradual increase in growth to 5 percent by 2023, but these projections might be optimistic as they are contingent on internal security conditions, continued implementation of reforms, and sustained donor support. We notice that opium production nearly doubled in 2017 (footnote 2). Could staff comment on the main reasons behind this sharp increase and the efforts underway to address this problem? Could it also provide some estimates of the size of the informal economy in terms of exports and GDP?

Although a durable peace agreement would be the most important factor contributing to stronger growth, we agree with staff on the need to persevere with continued macroeconomic discipline and deeper structural reforms. Fiscal performance has been satisfactory so far, but revenue could fall short of expectations in 2018 due to political tensions and increased violence. Moreover, as noted by staff, the fiscal situation in 2019 will be challenging because the presidential elections are likely to adversely affect revenue collections and donor support is expected to decline significantly. Under these circumstances, expenditures are projected to be almost 3 percentage points of GDP lower than in 2018 and the authorities have identified additional spending cuts in case they become necessary. Could staff comment on the political feasibility of these expenditure reductions as well as pressing ahead with other reforms such as the adoption of the value added tax, establishment of a single LTO, improvements in public financial management, and strengthened monitoring of fiscal risks arising from state-owned corporations?

As noted in the Debt Sustainability Analysis, Afghanistan's risks of external/public debt distress are high, with debt sustainability hinging upon continued donor grant inflows. Table 2 shows that more than half of central government total revenue is accounted by on-budget grants. In this regard, could staff comment on the results of the recent Geneva Ministerial Conference? With respect to the debt, could staff elaborate on the efforts underway to strengthen the monitoring of contingent liabilities emanating from state-owned entities and PPPs?

The financial system presents several vulnerabilities that need to be addressed. These include weaknesses affecting some private and publicly-owned banks, a still high (though declining) non-performing loan ratio, and loss of correspondent banking relationships owing to concerns about low profitability, and regional cross-border risks. We agree with staff on the need for continued close supervision of the corrective measures being implemented in the weak banks, renewed efforts to recover Kabul Bank's stolen assets, and the strengthening of the crisis prevention framework with Fund technical assistance. Regarding the latter, we welcome the forthcoming establishment of the Financial Stability Committee. We also encourage the authorities to ensure an effective application of risk-based AML/CFT measures and to maintain a close engagement with foreign regulators to help address the challenge of reviving system-wide correspondent relationships. Could staff comment on the pros and cons of improving the performance of state-owned banks versus a possible privatization of these institutions?

Finally, as recognized in the buff statement, corruption is still a major deterrent to donor confidence and private investment. In this regard, we take positive note of the authorities' efforts to address corruption, including through the enactment of a new Penal Code and the strengthening of asset declaration requirements for public officials. We also encourage the authorities to seek prompt approval of the draft anti-corruption law.

With these comments, we wish the Afghan authorities every success in their future endeavors.

Mr. Meyer and Ms. Kuhles submitted the following statement:

We thank staff for the report and Mr. Mojarrad, Mr. Sassanpour and Mr. Alavi for their informative buff statement. We concur with staff's analysis and recommendations. We are encouraged by the program's overall satisfactory performance, despite the difficult circumstances under which it operates. Against this background, we support the completion of the fourth review under the ECF and agree to the requested modification of two performance criteria and to the re-phasing and extension of the arrangement to end-December 2019.

We commend the Afghan authorities for the progress in implementing structural reforms and preserving macro-financial stability in a severely strained environment. We take positive note that the international community has recently reaffirmed its pledges of development cooperation during the Geneva Conference on Afghanistan, based on the Afghan authorities' reform commitments.

The authorities' efforts to improve the business environment are laudable and need to be continued. We share staff's view that – while progress in the peace process would be the biggest contributor to prosperity – prudent macroeconomic policies and decisive reforms are instrumental in building the basis for a sustainable economic development. Economic progress hinges critically on policies that maintain macroeconomic stability and mobilize the sectors with greatest capacity to support inclusive growth, job creation, exports, and government revenues.

We share staff's view that prudent fiscal policies are warranted, considering the uncertainties with respect to domestic revenues. We support staff's call for more conservative assumptions underlying the current budget as well as contingency planning to deal with unexpected shortfalls, should downside risks materialize. For the time being, the authorities should continue to seek support in the form of grants to finance their sizable development needs. At the same time, sustained efforts are required to improve the operating balance and reduce grant dependence, including through domestic revenue mobilization, to compensate for the expected decline in grants in the long run. Furthermore, it remains crucial to enhance public financial management capacity to better control for fiscal risks and improve the allocation of public resources, including by prioritizing investments with the highest value-added for the development agenda, while preserving priority social spending.

We welcome the upgraded legal framework, which is an important signal of the authorities' commitment to resolutely combatting corruption. It remains of utmost importance to properly enforce the anti-corruption strategy and to proceed decisively with integrity and accountability measures that address remaining shortcomings. We strongly encourage the authorities to engage constructively with the Fund on the draft anti-corruption law and look forward to staff's assessment of the proposed measures.

We concur with staff's advice on the priorities with respect to safeguarding financial stability. Swift action is needed to address shortcomings among private banks and to promote effective AML/CFT measures. Risk-based supervision should focus on the financial sector's major vulnerabilities regarding profitability, asset quality and corporate governance frameworks. On the latter, we welcome the inclusion of a structural benchmark for the sixth review aiming at accelerating the process of asset recovery of Kabul Bank's stolen assets with the help of an internationally reputable forensic auditor.

Mr. Guerra, Mr. Rojas Ramirez and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for its comprehensive report and Messrs. Mr. Mojarrad, Sassanpour, and Alavi for their helpful buff statement.

We support the completion of the fourth review under the Extended Credit Facility

(ECF), the request for modification of performance criteria and the re-phasing and extension of the arrangement to end-December 2019. Afghanistan is in the path of building peace, confronting severe natural disasters and external risks factors. In this context, the authorities have achieved a strong performance under the ECF program. We take positive note that all the quantitative performance criteria and most of the structural benchmarks were met. While program performance has been strong, Afghanistan faces a challenging near-term outlook. We note that downside risks in the current juncture include the drought, political tensions, and a humanitarian crisis. Growth scenarios have been adjusted once again. Could staff elaborate on the main factors behind this? Are there any additional uncertainties in the growth scenario?

Progress on structural fiscal reforms is welcome but, amidst a challenging context for public finances, we encourage authorities to continue committed to a sound medium-term fiscal strategy. We note the constraints that authorities have stated regarding the potential lower revenue collections and grants in 2019 and agree with staff that contingency plans should be put in place. We would appreciate comments on new developments regarding the 2019 budget. We note that program benchmarks have been met in implementing VAT, including the establishment of the VAT Steering Committee, the actions needed to enhance revenues by the large taxpayers' office (LTO), and the approval of the State-Owned Corporation Law. We join staff's recommendations for encouraging authorities to continue working on the program direction by enhancing budget management and execution, developing a Public Private Partnership (PPP) framework in Public Finance Administration, and improving debt management.

DAB should remain committed to allowing the exchange rate to act as a shock absorber. The monetary stance is in line with the program. Indicative targets have been met in reserve money and reducing DAB credit to the central government. On the financial sector, we agree with staff that further efforts are necessary for enhancing system soundness. Improving the performance of state-owned commercial banks (SOCBs) and enhancing the crisis prevention framework is advancing. We note that authorities are working on the implementation of the Financial Stability Committee and completing a corporate governance framework for SOCBs within the project benchmarks for end 2018.

We welcome the efforts made on strengthening the legal framework and governance, particularly the reforms to fight corruption and the Anti Money Laundering and Combating the Financing of Terrorism.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for their report. Given the Afghani Government strong commitment to reform in the face of a difficult outlook and security challenges, we would like to express our support to the completion of the fourth review of the Extended Credit Facility arrangement, the modified performance criteria, as well as the extension and rephrasing of the arrangement.

Afghanistan is facing a very complex array of difficulties, in the face of protracted security issues, electoral year uncertainties, and the recovery from a severe drought. This has severely weighed on the economic outlook, with GDP plateauing at 2.3 percent in 2018, which appears insufficient to prevent poverty and unemployment from rising, given that the demographic growth is around 3 percent per year. In this regard, we would like to commend the authorities for sticking to the reforms they committed to. The recent Geneva Ministerial Conference on Afghanistan is a testimony to the international community's trust. Geopolitical tensions and the ramping up of sanctions on Iran are additional difficulties.

In the face of these strong difficulties, we wish to commend the authorities for their satisfactory implementation of the extended credit facility arrangement agreed in Summer 2016. This fourth review acknowledge progress on public financial management, the macroeconomic framework, the financial regulatory framework, public governance and the fight against corruption. All quantitative performance criteria and all but one of the structural benchmarks were met. The IMF engagement remains key to support macroeconomic and structural reform, and to send a positive signal to the donor community. We therefore support the extension of the program to end-December 2019, in an electoral context.

Efforts should be maintained to ensure a stable macroeconomic environment. We agree with staff that a modest loosening of the fiscal stance for next year is adequate, given the expected lower inflow of donor support and the uncertainties linked with revenue collection in an election year. We welcome the ongoing work to develop a VAT framework in the medium term, which will help broaden the tax base. We also commend the authorities for improving the execution of the budget compared with last year. Regarding the new framework for PPP, could staff elaborate on the safeguard put in place to ensure proper financial and legal management of the PPP projects?

Sound monetary policy as well as a flexible exchange rate regime will help to enhance the stability and competitiveness of the Afghani economy. We take note of the efforts done by the authorities to address shortcomings in the financial regulatory framework, and the declining level of the NPL since Q2 2017. We encourage authorities to continue to engage with the Fund in this regard through adequate technical assistance. We also encourage the authorities to renew their commitment to recover the Kabul Bank's stolen assets, which would bring in additional liquidity to the state's budget. In addition, sustained efforts in implementing the AML/CFT and anticorruption frameworks should continue to be a priority.

Finally, given low capacity of the country, technical assistance continues to be very important for the successful implementation of the reform. In this regard, we would like to ask staff to more systematically take stock of ongoing technical assistance and its coordination with the technical assistance provided by the WBG (as was done in the previous ECF review) to inform on the alignment of country priorities and international financial organization's support.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

The Afghan authorities continue to make laudable progress implementing their economic reform agenda and strengthening domestic institutions, despite the highly challenging security and socio-political environment. We thus support the completion of the fourth review under the ECF arrangement and commend the authorities for meeting all the quantitative performance criteria and implementing the structural benchmarks. We also support the proposed re-phasing and extension of the program to end-2019, which are reasonable to sustain Fund engagement through the upcoming electoral cycle. We broadly agree with staff's analysis and policy recommendations and offer a few comments for emphasis.

Afghanistan faces significant downside risks from continued violence, natural disasters, and uncertainty related to the election. In this context, continued macroeconomic policy discipline and sustained progress on the structural reform agenda are critical to build confidence and support private sector development. Could staff discuss which areas of the program they see as key risks in the coming months? Could staff also provide views on the outcomes of the Geneva Ministerial Conference, including how discussions of growth prospects differ from staff forecasts?

We commend the authorities' commitment to fiscal discipline as demonstrated in the implementation of the 2018 supplementary budget. We agree with staff that there are substantial downside risks to the revenue forecast and welcome the authorities' view that any necessary cuts to discretionary spending will preserve priority social spending. Given challenges to public finances in coming years, it will be important for the authorities to continue to make progress on key structural fiscal reforms, including the implementation of the VAT, reform of the large taxpayers' office, and the strengthened legal framework for state-owned enterprises and corporations. The program sensibly includes incremental benchmarks to help lay the foundation for these structural reforms. We agree with staff that debt management capacity, including the capacity to monitor contingent liabilities from state-owned enterprises and PPPs, should be strengthened.

Da Afghanistan Bank (DAB) has made sustained efforts to address weaknesses in private banks, as exemplified by the smooth liquidation of Afghanistan Commercial Bank. We urge the DAB to diligently work to conclude corrective action plans with the remaining weak banks and continue to make progress with state-owned commercial banks. We look forward to the establishment of the Financial Stability Committee by the end of the year, which will be a useful tool to facilitate coordination on crisis preparedness and management.

The authorities continue to make solid progress in strengthening their anti-corruption efforts under their National Strategy for Combatting Corruption. The enhanced framework for asset declaration by public officials is a significant step to increase transparency and hold high-ranking public officials accountable, and remedial actions taken per the structural benchmark in this review are a demonstration of the authorities' commitment to this reform. We welcome the renewed and accelerated efforts to recover Kabul Bank's stolen assets, which will support fiscal efforts and are another strong signal of the authorities' ongoing commitment to fight corruption. Further, measures to improve economic governance under the fiscal framework – including the roll out of the customs control risk profiles and the PPP law – are also a welcome step to increase transparency and reduce corruption.

Finally, we commend the authorities' sustained efforts to strengthen the AML/CFT framework and look forward to the completion of the national ML/TF risk assessment by the end of next year.

Mr. Trabinski and Mr. Tola submitted the following statement:

We welcome the progress achieved by Afghanistan in economic reforms, and in rebuilding institutions and infrastructure under exceptionally difficult circumstances. Growth picked up in 2017, although only marginally, while international reserves and the revenue targets were exceeded. Program performance has been solid, with all the quantitative performance criteria and six of seven structural benchmarks met. Hence, we support the completion of the review and the extension of the arrangement to end-December 2019. The ECF arrangement, although with low access, plays a critical catalyst role in attracting and maintaining donor support. The challenges ahead include enhancing inclusive growth, reducing poverty, creating employment and fighting corruption.

Efforts to increase revenues should be complemented with measures to strengthen public financial management. We encourage the authorities to continue to broaden the revenue base, and we agree with staff's proposed measures to achieve this goal. The creation of the VAT Steering Committee and the VAT Implementation Team, as well as the establishment of a fully functional Single Large-Taxpayers Office would create the conditions for a gradual and steady increase in revenues. These efforts should go hand-in-hand with the enhancement of budget execution and management. At the same time, the authorities should stand ready to reduce spending in case of the revenue shortfall or grant development.

The authorities should continue to rely on concessional borrowing, given the high risk of debt distress. In this context, it is important to record and monitor debt transactions and to assess their impact on debt sustainability. Contingent liabilities associated with PPPs should also be carefully monitored. Debt management capacity will need to be enhanced in anticipation of decreasing grant inflows and the possibility of increased external borrowing over the longer term. Increased domestic borrowing through sukuk should be preceded by the creation of an adequate supervisory framework, as recommended by staff.

Further financial sector reform is needed. We take note of staff's recommendations to strengthen the crisis prevention framework and welcome the coverage of the establishment of the Financial Stability Committee by a structural benchmark for the fifth review. At the same time, we would like to reiterate that, given the early stage of development of the Afghan financial sector, measures to improve governance at the state-owned commercial banks and to secure access by households and SMEs to minimal financial services should be a priority. We encourage the authorities to continue their work on developing the National Financial Inclusion Strategy.

The fight against corruption is critical, also to generate continued donor support. We welcome the recent progress, both in terms of the legal framework and institutional reform, such as the results of the activities undertaken by the Anti-Corruption Judicial Center. Moreover, the implementation of the enhanced asset declaration framework is bearing fruit and should be continued. Also, we encourage the authorities to continue to strengthen the AML/CFT regime. Progress in this field is necessary to facilitate the access of Afghan banks to correspondent banking and help direct remittance inflows to official channels. Finally, could staff comment in more detail on the implications of the new Framework for Enhanced Engagement on Governance for further program design?

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the informative report, and Messrs. Mojarrad, Sassanpour, and Alavi for their useful buff statement. The Afghan authorities continue to face tremendous challenges stemming from a difficult security and political environment. At the same time, Afghanistan is also dealing with a devastating drought. We commend the authorities for their commitment to pursuing various reforms to promote sustainable and inclusive growth, and their satisfactory program performance despite these difficult conditions. Overall, we support the completion of the fourth review under the Extended Credit Facility Arrangement, as well as the authorities' requests for the modification of two performance criteria and the re-phasing and extension of the arrangement to end-December 2019.

On the fiscal side, we support having a contingency plan in place for the year 2019 to cut expenditures further if necessary, while preserving priority social spending. Meanwhile, the continuation of structural fiscal reforms is crucial for better mobilizing revenue and improving public financial management. The success of the value-added tax (VAT) would hinge on effective implementation. Reforming Large Taxpayers' Offices (LTOs) would improve tax administration and complement the implementation of the VAT, enhancing overall revenue intake. Could staff provide an update on the outcomes of the recent Geneva Conference on Afghanistan in terms of securing donor support?

Productive infrastructure investment would help support Afghanistan's longer-term development. We note the authorities' plan to increase reliance on the Public Private Partnerships (PPPs) for infrastructure projects. While bringing the PPP legislation in line with good international practices was a welcome step, further efforts would be needed to strengthen management and safeguards to ensure effective project appraisal, selection, and implementation. Meanwhile, we note that the authorities are considering taking on concessional loans amounting to some US$250 million in the medium term to finance key infrastructure and social sector projects. In doing so, we encourage the authorities to adopt a cautious approach, while strengthening debt management capacity to ensure sustainability. We take positive note that technical assistance is being requested in this regard.

We welcome the authorities' continued efforts in tackling the vulnerabilities in the financial sector, including the enforcement of corrective action plans agreed with weak banks. We encourage the authorities to make further progress in addressing remaining issues, including strengthening the governance of state owned commercial banks, recovering Kabul Bank's assets, implementing an effective AML/CFT framework, and enhancing crisis management.

On the structural front, we take positive note of the authorities' efforts to strengthen governance and combat corruption. In the meantime, better oversight and management of state-owned corporations and enterprises would help reduce contingent liabilities and contribute to the economy's overall development.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Virolainen and Ms. Skrivere submitted the following statement:

We thank staff for the comprehensive report and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi for their candid buff statement. We positively note the authorities' continued commitment to their reform agenda despite a highly challenging social, political, and economic environment. We support the proposed decision to complete the fourth review under the Extended Credit Facility, modify two December 2018 performance criteria, and re-phase and extend the arrangement to end-December 2019. While resolving the conflict and ensuring peace is a necessary condition for sustainable economic growth and improved living conditions, determined reform implementation can further add to the prospects of the Afghan economy. We broadly share staff's appraisal and offer the following comments for emphasis.

Afghanistan remains dependent on donor aid, and the Fund's arrangement plays an important catalytic role. We positively note the authorities' progress on structural fiscal reforms, including on the improvements to the legal framework, as well as the progress towards the introduction of a VAT and the establishment of a single large taxpayers' office. However, 2019 might be a challenging year given the uncertainties surrounding the political cycle, and the lack of clarity on the prospects of some of the donor programs that ended in 2018 to be replaced with new commitments. Additionally, we share staff's views that debt sustainability over the medium-term hinges on significant and continued donor support. We would appreciate staff's comments on their views regarding the outcome of the Geneva Ministerial Conference on Afghanistan held on November 27-28.

Corruption and governance-related challenges remain as a major obstacle to public and international trust. We welcome the strengthening of the legal framework; however, we stress that effective implementation and enforcement is key to fully addressing the governance issues. Progress in this area, together with an effective application of risk-based AML/CFT measures, can serve as a step towards a revival of correspondent banking relationships.

For fragile and conflict-affected countries like Afghanistan, the Fund's capacity development (CD) activities would be critically needed. However, there are understandable practical challenges in the CD delivery before the resumption of Fund missions to Afghanistan. Staff's comments on the extent of the Fund's current CD activities with Afghanistan are welcome.

Mr. Mahlinza, Mr. Raghani, Mr. Nguema-Affane, and Mr. Essuvi submitted the following statement:

We thank staff for the set of interesting papers and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi for their informative buff statement.

We commend the authorities for the steadfast implementation of the Fund-supported program for Afghanistan despite a challenging domestic environment characterized by political instability, violence and a severe drought. In particular, we are encouraged by the improved macroeconomic situation in 2017 and the first half of 2018 with growth slightly improving, inflation subdued and over performance in international reserves. The recent strengthening of the anti-corruption frameworks is particularly commendable, and we support efforts to pursue reforms in this area.

The country's economic prospects remain contingent on further progress towards political stability, improved weather conditions, economic developments in neighboring countries and external aid. In that connection, we welcome the presentation of a roadmap for an enduring peace at the donor conference in Geneva as indicated in the buff statement. We would like staff to present the main outcomes of that conference. Given the significant challenges facing the economy, donors' continued support is needed to help the authorities make further strides in the implementation of their reform agenda, notably in rebuilding institutions and strengthening macroeconomic stability.

We commend the authorities for their prudent fiscal policy stance. We welcome the 2018 supplementary budget which is consistent with the program and the progress made in the implementation of fiscal reforms, notably in strengthening the legal framework for the state-owned corporations(SoCs) and PPPs. The projected fiscal tightening in 2019 due to a decline in grants from donors highlights the need to pursue reforms to control fiscal risks. The timely adoption of the VAT in 2020 and further improvement in budget execution and management will be essential to mobilize domestic revenue and preserve fiscal sustainability. Could staff elaborate on the potential revenue impact of VAT? We welcome the preparation of a contingency plan to deal with unfavorable revenue developments and the authorities' intention to preserve social spending during the fiscal tightening.

We note the authorities' continued commitment to exchange rate flexibility as well as the continued soundness of the banking system and ongoing efforts to further strengthen financial stability. We welcome the actions taken to revolve private banks in difficulty and improve the performance of State-owned commercial banks. We agree with staff that efforts going forward, focus should be on strengthening crisis prevention and management. The establishment of the Financial Stability Committee by end-2018 would be a step in the right direction. The authorities' plan to introduce mobile banking is welcome and will certainly help advance financial inclusion in the country. In this regard, we would suggest to staff to support the government's efforts in this direction by using international best practices and experiences in mobile banking, notably in Sub-Saharan Africa. Finally, the difficulty to restore correspondent banking relationships (CBRs) one year after exiting the FATF monitoring list is a matter of concern. We wonder whether other countries that have exited the FATF experience a similar challenge. Staff's comments are welcome.

With these remarks, we support the proposed decision and wish the Afghani authorities every success in their endeavors.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for the well-written report on the fourth review under the Extended Credit Facility Arrangement and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi for their informative and candid buff statement.

Against all odds and multiple challenges emanating from the political situation, violence and drought, the authorities have remarkably implemented the reform program supported by the ECF. Growth in Afghanistan has picked up at 2.7 percent, 0.5 percent above 2016 even as downside risks make it vulnerable to a weaker growth outlook. Notably, staff has mentioned an upside scenario, with progress on peace and pro-growth investments potentially spurring accelerated growth. We positively welcome the satisfactory program implementation where all quantitative performance criteria and six of the seven structural benchmarks were met. Recognizing the achievements, the authorities' resolute commitment and the importance of

Fund engagement, we support the completion of the fourth review under the ECF arrangement and the related requests of the authorities.

The buff has emphasized macroeconomic policies for strengthening macro-financial stability, supporting inclusive growth and job creation, reducing poverty and protecting competitiveness. We support this approach and assurance. On the fiscal side, a sustainable fiscal policy would need to remain mindful of the fiscal space and the challenges to financing. So far, the fiscal performance has remained encouraging, driven by improvements in revenue performance. Cognizant of risky headwinds for revenue materialization, the authorities have developed a prudent contingency plan which reassuringly preserves priority social spending. Efforts on fiscal reforms encompassing public finance management, making efficient use of grants, VAT, broadening the tax base and the five-year strategic plan for customs are noteworthy. We encourage the authorities to make steadfast progress on deeper fiscal reforms, especially the quality of spending, budget management and improvement of legal frameworks of state owned corporations. On development of a Public Private Partnership Framework and debt management, we fully support the staff's views. The staff report mentions a request for TA in debt management. Meanwhile, have staff held discussions with the authorities on the terms and scale of proposed external debt or long-term loans?

On monetary policy, commitment to exchange rate flexibility, a moderate inflation rate target and higher reserves would help maintain stability. We are encouraged by the authorities efforts on this, as well as for developing robust safeguards in the financial sector and addressing banking system weaknesses. The implementation of plans for weak banks and action on the failed Kabul Bank, including on asset recovery, are demonstrative of operative supervision and regulation. Could staff comment on the challenges in dealing with weak banks in the prevailing political and security circumstances? Going forward, we expect beneficial results from the strategy for state-owned commercial banks on restructuring of operations and governance. We look forward to advancements on the financial inclusion strategy and formation of the Financial Stability Council. Beyond this, the authorities must continue to strictly enforce the AML/CFT requirements to preserve the integrity of the financial sector.

Finally, we laud the multi-pronged initiatives of the authorities for fighting corruption. Prominent are the upgrade of Afghanistan's legal framework, the enactment of a new Penal Code, adoption of the National Strategy on Combating Corruption, and the enactment of the Law on

Declaration and Registration of Assets of Official and Government Employees. Like staff, we would urge for their effective enforcement. In the same vein, we would urge prioritized action on data quality.

With these comments, we wish the authorities the best in their endeavors.

Ms. Riach and Mr. Clark submitted the following statement:

We thank Staff for their informative work and Mr. Mojarrad, Mr. Sassanpour and Mr. Alavi for their informative buff statement. We broadly share Staff's assessment of the outlook for the Afghan economy, with growth remaining slow given weak confidence and ongoing political uncertainty. We share the Staff's assessment that the medium-term outlook has weakened with new and emerging risks, especially any further impacts of the ongoing drought on agricultural output, and political uncertainly with forthcoming elections.

We agree with Staff's assessment that growth prospects face considerable downside risks. Over the longer term these will center around the outcome of the political elections and whether there is a durable peace scenario. Equally any further drought and failure of the agriculture sector to recover is likely to impact growth prospects, as well as having a significant human cost. Prospects of external risks such as sanctions and economic difficulties in neighboring countries are also likely to have a negative impact on exports and remittances. Poverty data has highlighted increasing rates of poverty, and under current projections those trends are likely to continue. We would therefore encourage efforts by the authorities to focus on how growth policies and external finance can contribute more fully to poverty reduction within the Government's new growth strategy.

We welcome measures taken to meet the quantitative performance criteria and progress against all the structural benchmarks and support the completion of the Fourth Review and modification of the end-December Performance Criteria. We also commend the authorities on continued good fiscal performance given the context, especially the ongoing efforts around revenue mobilization. We encourage the Government to continue to focus on revenue enhancement and fiscal discipline during and post the elections. We agree that any expenditure cuts should protect priority social spending.

Progress towards VAT implementation is positive, and we encourage the authorities to ensure implementation without delay. We agree with Staff that strengthening debt management procedures should be prioritised and that consideration of additional concessional funds must take account of implications for overall debt sustainability.

On monetary and financial sector policies we agree with Staff that Da Afghanistan Bank (DAB) should remain committed to exchange rate flexibility. Continuing to target moderate inflation and safeguarding financial stability remain key policy priorities. Within this context we strongly support the authorities efforts to push on anti-corruption reforms and promote effective AML/CFT measures. We particularly support the focus on efforts including criminalization of corruption and strengthen the asset declaration requirement for public officials. We support the proposed benchmarks in the 5th Review in this regard. Ensuring implementation and enforcement of these frameworks will be key. Equally we encourage the authorities to ensure quick and effective implementation of risk based AML/CFT efforts.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for a well-written report and Mr. Mojarrad, Mr. Sassanpur and Mr. Alavi for their helpful buff statement. We commend the Afghan authorities for their efforts in maintaining macroeconomic stability and implementing reforms despite the extremely challenging environment. The armed conflict continues unabated and security situation remains very difficult. On top of the destruction brought by many years of conflict, the country was recently hit by the heavy drought, the authorities have to deal with the inflow of returning refugees and the spillovers from the economic shocks in the neighboring countries. The fact that under such conditions all eight end-June quantitative performance criteria and all seven structural benchmarks were met, is a substantial achievement. It confirms the authorities' strong commitment to the program. We, therefore, support the completion of the forth review under the ECF arrangement and proposed re-phasing and extension of the program. As we broadly agree with the staff assessment and recommendations, we will make only a few points for emphasis.

Continued violence presents the main obstacle for economic development in Afghanistan, while peace dividends could be very substantial. The country is also well endowed with yet untapped natural resources. Under the existing circumstances, the authorities should maintain macroeconomic stability and continue their reform efforts to lay the foundation for private sector-led growth. Aside from its own efforts, Afghanistan depends heavily on continued support from donors. We note with concern that in 2019 donors are likely to reduce their funding. At the Geneva Ministerial Conference donors reaffirmed their commitment to provide, in 2016-2020, $15.2 billion for development goals. Could staff update us on the status of implementation of these commitments and on expected outcomes?

We welcome the authorities' sound fiscal performance and their commitment to fiscal discipline. Taking into account the uncertainties related to foreign aid, the authorities need to accelerate progress towards increasing reliance on internal sources of revenue. In this regard, steady implementation of structural fiscal reforms is essential, including increasing efficiency of the large taxpayers' office and gradual transition to the VAT. On the expenditure side, further efforts are needed for improving budgetary process, increasing spending efficiency and amending the legal framework for the SOEs and PPPs. Given the recent increase in poverty and slow progress on other development indicators, it is also important to protect priority social spending.

We note the continued efforts to address weaknesses in the banking system, including corrective action plans agreed with the weak private banks. The governance of state-owned commercial banks should be also strengthened through implementation of the operational reform plans. It is also important to reinvigorate efforts aimed at recovering of Kabul Bank's stolen assets. Effective implementation of the AML/CFT framework is essential for the revival of correspondent relationships with global banks.

We welcome the authorities' efforts to strength anti-corruption framework, in particular, the adoption of a legislation criminalizing corruption and strengthening asset declaration requirements by public employees. We look forward to further progress in this area, notwithstanding difficulties in implementation of anti-corruption measures in a challenging political and security situation.

With these remarks, we wish the authorities success.

The Acting Chair (Mr. Furusawa) noted that the authorities had made commendable efforts to implement the fiscal, financial, and governance reforms in the face of extremely difficult circumstances. Directors had stressed the importance of continued macroeconomic policy discipline and decisive reforms to build sustainable and inclusive growth and to reduce poverty. The international community's support was essential, and he was happy that the Board had expressed strong support for the program.

Mr. Meyer made the following statement:

We thank the staff for the informative report and Mr. Mojarrad for his buff statement.

We support the completion of the fourth review. We welcome the program's overall satisfactory performance despite difficult circumstances and commend the Afghan authorities for their progress in implementing structural reforms and preserving macro-financial stability.

As highlighted by many Directors in their gray statements, the Fund's arrangement plays an important catalytic role. This being said, there is no doubt that durable peace would be the most important factor for enhancing confidence, investment, and economic growth. However, prudent macroeconomic policies and decisive reforms are instrumental in building the foundation for sustainable economic development. In particular, we share the staff's view that prudent fiscal policies are warranted, including conservative assumptions and contingency planning. Moreover, to reduce dependency on donor support, it will be key to increase reliance on internal revenue sources by strengthening domestic revenue mobilization.

Second, we encourage the authorities to sustain their fight against corruption. We welcome that the respective legal framework has been strengthened. However, as emphasized by Mr. Virolainen, Ms. Levonian, Mr. Mouminah, and others, effective implementation and enforcement are key for increasing trust and confidence. In this context, we also encourage the authorities to ensure an effective application of risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) measures. As several Directors pointed out in their gray statements, this might also help in reviving correspondent banking relationships (CBRs).

With this, I wish the authorities all the best.

Ms. Levonian made the following statement:

I thank the staff for the report. As outlined in our gray statement, we agree that Afghanistan is deserving of the international community's sustained support, and we remain supportive of the Fund's activities to help Afghanistan build a more stable, secure, and democratic country.

We were pleased to see that poverty reduction was identified as a top priority in the authorities' memorandum of economic and financial policies

(MEFP). However, we also note that there were no details provided regarding the poverty reduction programs implemented in 2018 or plans outlined for 2019. We would welcome the inclusion of more current information on the authorities' poverty reduction strategy as part of future reviews.

The Fund's capacity development activities are critical for a country such as Afghanistan. We took note of the wide scope of technical assistance provided during a September 2018 Fiscal Affairs Department (FAD) mission.

The Fund's lending, capacity development, and surveillance activities are supporting Afghanistan directly but also indirectly by catalyzing donors. For this reason, the Fund's ongoing public communications are essential to promoting transparency and to meet demand on the part of donors for high-quality information on the macroeconomic progress that is being made.

We would encourage the staff and the authorities to think of ways to further enhance public communication in a way that could mobilize donor support.

On that topic, like Ms. Pollard and Ms. Svenstrup, and others, we ask if staff could share the key outcomes of the recent Geneva Conference, which showcased the progress being made in Afghanistan to the donor community.

I wish authorities all the best.

Mr. Raghani made the following statement:

We have issued a joint gray statement with Mr. Mahlinza, but we would like to make a few additional remarks.

We again commend the authorities for the satisfactory implementation of their economic program, despite a difficult environment. We welcome their continued commitment to prudent macroeconomic policies and to fostering a more stable environment, which will speed up institutional building and increase private sector confidence.

We are pleased that poverty reduction remains a top priority in their reform agenda, as indicated in the MEFP. Like many Directors, we are hopeful that the peace talks will succeed, which, together with continued external assistance, will be a determining factor in reversing the deterioration of social conditions observed over the past years.

Mr. Anwar made the following statement:

We thank the staff for the comprehensive report and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi, for their informative buff statement.

We have issued a gray statement, where we commend the authorities' fiscal progress on economic transformation, despite the challenging environment. We also note that program implementation has been satisfactory.

While the medium-term outlook appears preferable, risks are tilted to the downside. Against this background, we encourage the authorities to recalibrate their policy measures to the current realities, as rightly noted by staff, anchored by the prevailing objective of raising inclusive growth, boosting job creation, and reducing aid dependency.

In this light, we support the completion of the fourth review under the Extended Credit Facility (ECF) arrangement and the authorities' request for a modification of two performance criteria for end-December 2018 and an extension, rephasing the arrangement to end-December 2019.

We would like to make the following comments for emphasis. We note in the staff's written responses to Directors' technical questions that the extent of job creation likely to accompany the increasing growth path is highly uncertain. Over time, extractive industries and regional trade integration could support growth and job creation and would translate into a decline of unemployment and poverty.

Still, under the current projections, Afghanistan would not make much progress in reducing poverty. We agree with the staff that the authorities should continue to improve the quality and the timeliness of economic data in support of evidence-based policymaking. Real and external sector statistics, as well as intersectoral data consistency, need improvement. It would be useful for the next report to include an analysis of this issue in order to see the impact of the program in bringing down poverty and unemployment.

With these comments, we wish the authorities success in their future endeavors.

Mr. Kaya made the following statement:

We thank the staff for the informative report and answers to our questions, as well as Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi, for their comprehensive buff statement.

We issued a gray statement but would like to add a few points. The staff's analysis gives a broadly positive and reassuring view of the macroeconomic policies and performance under the ECF-supported program, and we welcome this progress. Based on the staff appraisal, we support the completion of the fourth review and the authorities' request for the modification of two performance criteria. Nevertheless, the challenges require ambitious policy measures to offset the potential risks.

We encourage the authorities to move forward with the contingency planning as the uncertainty around the tax revenues and spillovers from the regional situation is high. A cautious operational debt management and the careful selection of investment projects to be financed by external borrowing are also of paramount importance.

Afghanistan's economic development critically hinges on a stable domestic environment. In this regard, a durable peace agreement remains the most important pro-growth factor. A specific action plan to sustain peace and growth for the Afghan economy following a political settlement would be beneficial for the country.

Continued macroeconomic policy discipline and structural reforms would help lay the foundation for sustainable and inclusive growth. Therefore, we encourage the authorities to accelerate reforms, forcefully fight corruption, strengthen the AML/CFT framework, and decisively move forward with the implementation of measures envisaged in the ECF arrangement.

We wish the authorities well in their endeavors.

Mr. Trabinski made the following statement:

We thank the staff for an interesting report, and Mr. Mojarrad, Mr. Sassanpour, and Mr. Alavi, for their candid buff statement.

We support the completion of the fourth review under the ECF arrangement, the modification of the performance criteria, and the rephasing and extension of the ECF. Given the country's adverse conditions of protracted violence, political instability, and the challenging weather conditions, we commend the authorities' efforts aimed at rebuilding institutions, achieving more inclusive growth, reducing poverty, and tackling corruption and unemployment.

Let me emphasize two additional points. First, many chairs, like Mr. Meyer, encouraged the authorities' further commitment to fight corruption. While we note that addressing this issue in countries which experience long-lasting conflicts might be more difficult than in other places, we would like to ask the staff about the reviews and the efficiency of implemented anti-corruption measures, including the activities of the Anti-Corruption Judicial Center and enhanced asset declaration framework.

Second, the risks stemming from the financial sector are significant, both in the private and public sectors. Therefore, we encourage the authorities to develop and implement a national financial inclusion strategy which aims to deepen their domestic financial market, and strengthen the financial sector and liquidity management.

Last, but not least, we are also looking forward to the staff's answer to our question on the implications of the framework for enhanced engagement on governance for further program design.

The staff representative from the Middle East and Central Asia Department (Mr. Duenwald), in response to questions and comments from Executive Directors, made the following statement:[2]

I thank Directors for their helpful comments and the questions raised in the gray statements.

Directors will have seen the staff's responses to the technical questions. I will provide an update on recent developments, provide some takeaways on the Geneva Conference, and address a few other non-technical questions from the gray statements.

The latest macroeconomic developments are largely in line with the staff's projections. Fiscal performance through October has been good, with revenues appearing firmly on track to meet the end-December performance criterion. Reserves have remained ample. Inflation remains low. The monetary

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[2] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

aggregates have evolved as in the program. The exchange rate has been broadly stable since the depreciation peaked in October.

Regarding the ongoing implementation of the program, the authorities are committed to the program and are actively engaged in policy discussions with the staff. This has been key to successful program implementation. As illustrated by the approval of the 2019 budget—which is a fifth review structural benchmark, as required by and in line with the program—he remaining benchmarks covered by the fifth review appear on track and will be further evaluated during a staff visit in January 2019. That being said, given the country's difficult circumstances and upcoming presidential election, the risks to reform implementation are significant and call for intense engagement with the authorities.

Many Directors asked about the outcome and the implications of last week's donor conference on Afghanistan in Geneva. Let me first note that this was not a pledging conference, so there are no discernible near or medium-term implications, including for the staff's view on donor grants, which are so far broadly in line with the US$15.2 billion pledged in Brussels in 2016 for the period of 2017 to 2020.

The main takeaway of the conference is that donors emphasized the progress made in governance toward creating a functioning, accountable, and increasingly sustainable state, despite the considerable security and political challenges. They, therefore, pledge their continued support for Afghanistan, including adherence to the financial pledges made in Brussels in 2016. A few countries also pledged additional humanitarian assistance in light of the drought and the rise in internally displaced people. To this broader point, I would add three more takeaways.

First, a key theme running through the conference was the interconnectedness between peace and development. That was reiterated a few moments ago by several Directors. In this context, President Ghani outlined a roadmap for peace and announced the formation of a negotiation team and a peace advisory board with a diverse composition.

Second, the conference adopted a set of deliverables for the government and donors under the Geneva Mutual Accountability Framework. The 24 deliverables are aligned with the Afghanistan National Peace and Development Framework and will be assessed during the next conference, expected in 2020, which will be a pledging conference. As mentioned in one of the gray statements, one of the deliverables is a commitment by the government to conduct discussions with the Fund, with a view to having a successor ECF arrangement in place by mid-2020. The staff was consulted in the process of formulating this deliverable. Of course, the final decision on a new arrangement rests with the Executive Board. The key point is that donors see continued program engagement with Afghanistan as critical after the current arrangement expires in about a year’s time.

Third, the authorities outlined their reform agenda. They committed to make further progress in anti-corruption reforms, women’s empowerment, and private sector participation in the economy. They outlined their medium-term growth agenda, featuring the development of agriculture and horticulture, the mobilization of extractives investment, the implementation of regional connectivity projects, and developing sectors to supply domestic markets. Their vision is of an economy led by the private sector and enabled by the public sector, delivering higher and inclusive economic growth.

There was a question on which areas of the program the staff see as key risks in the coming month. At a general level, as in any country, policy implementation may slip during the electoral cycle. With a presidential election currently scheduled for April 2019, there is a possibility of policy slippage, slowdown in reform over the next few months. However, these concerns are mitigated by the fact that the authorities continued to adhere to prudent policies and reforms, leading up to the October 2018 parliamentary election.

Looking specifically at the structural benchmarks for the fifth review, we see risks for the benchmark on the corporate governance framework for the state-owned commercial banks, where progress has only recently picked up, and for the end-January 2019 benchmark on publishing the Anti-Corruption Justice Center’s activities, which could be politically sensitive.

Finally, there was a question about how the Fund’s new framework for enhanced engagement on governance might affect further program design. Conditionality under the current ECF arrangement for Afghanistan has included a few key governance measures reflected in the new framework, including anti-corruption and fiscal governance. The design of governance-related conditionality for the remaining two reviews of the current ECF-supported program will build upon these earlier measures following a logical sequence. In other words, starting with putting the legal framework in place to implementing it. The design of a possible successor program will benefit from comprehensive and detailed guidance, including a systematic review of the vulnerabilities across the six state functions, as covered by the new framework.

In response to the question on the effectiveness of anti-corruption measures, I would repeat what Directors have emphasized, that with the legal framework largely in place, now is the time for implementation and effective enforcement. Hopefully we will be able to continue to report good progress on that in the upcoming reviews.

Mr. Mojarrad made the following concluding statement:

I thank Directors for their helpful comments, which I will faithfully convey to my Afghan authorities.

We have issued a fairly lengthy buff statement, and the staff has provided comprehensive answers to Directors' questions, so I will briefly focus on a few key issues and concerns expressed by Directors.

First, Directors recognize the difficult circumstances under which program implementation is progressing and the strong headwinds that Afghanistan is facing from a complex set of factors, most of which are beyond the authorities' control. The security conditions probably pose the most serious challenge to economic development and nation building. But for the first time in several years, the prospects of a negotiated peaceful solution to the conflict provide a glimpse of optimism. President Ghani's unveiling of a roadmap to peace in Geneva and the formation of a negotiation team are important milestones. Lasting peace and sustained progress on the economic front and institution building are interlinked, and peace dividends would be substantial.

Second, generous donor support has been critical in meeting Afghanistan's extensive security and development requirements. The authorities, however, are also aware of the need to reduce aid dependency, a point raised by some Directors. To that end, their reform program is aimed at laying the foundations of a self-sustaining and self-reliant economy. But the weaning-off process has to be at a measured pace and in a predictable manner in order not to jeopardize the gains already achieved at a high cost or, worse still, derail the reforms. Reducing aid dependency would need to proceed in tandem with realistic efforts to mobilize domestic resources and in parallel with improvements in the security situation.

Third, the authorities believe that strengthening governance, fighting corruption, and enhancing the AML/CFT framework are critical elements in garnering donor confidence, facilitating private and foreign investment, and increasing the credibility of the reform process. The authorities' commitment to fighting corruption was stressed further at the recent Geneva Conference. As recognized by many Directors, important progress is being made on a number of fronts within the comprehensive National Strategy for Combating Corruption.

Fourth, after decades of destruction, human suffering, and economic dislocation, poverty is widespread, accentuated by internal displacements, the return of millions of refugees from neighboring countries, and this year by a drought not seen in a decade. The commitment for humanitarian support by donors in Geneva for drought-stricken areas and for the internally displaced was much appreciated by the Afghan authorities. The authorities firmly believe that social protection is an imperative and reducing poverty is a key national priority. They continue to rely on donor support in these areas.

Fifth, a number of Directors remarked on the stability of the financial sector. Key efforts in this area are: rigorous action plans underway for weak private banks, improvements in the governance and performance of public banks, and firm enforcement of the regulatory requirements. The World Bank is providing considerable assistance in this area.

In conclusion, let me, once again, express my appreciation and that of my Afghanistan's authorities to Mr. Duenwald and his excellent team for their constructive engagement and sound policy advice. I would also like to express my Afghan authorities' appreciation to Fund's management and the Executive Board for their continuous support.

The following summing up was issued:

Executive Directors commended the authorities for sustained reform efforts in the face of difficult circumstances. The unrelenting insurgency, regional risks, and political uncertainty during the electoral cycle compounded by a devastating drought and returning refugees weigh heavily on the outlook. While recognizing the importance of securing a lasting peace, Directors underlined the need to continue macroeconomic policy discipline and decisive structural reforms to strengthen inclusive growth and poverty reduction prospects, improve the impact of public expenditures, fight corruption, and strengthen the financial sector and financial inclusion.

Directors encouraged greater efforts toward fiscal sustainability, given the risks to revenues and grants and the limited financing options. In view of the challenging circumstances, they considered a modest fiscal loosening in 2019 appropriate. The authorities should also have contingency plans ready for downside risks, ensuring that pro-poor spending is protected. Looking ahead, Directors stressed the need for continued fiscal consolidation and decreasing reliance on grants. Moreover, any scaling up of public investment should be gradual considering limited debt management capacity, significant macroeconomic risks, and limited fiscal space. Raising domestic revenue in a fair and sustainable manner for development needs while protecting pro-poor and pro-growth spending remains a priority.

Directors welcomed the recently adopted state-owned corporations and public-private partnership laws, which strengthen the government's ability to manage fiscal risks. They encouraged continued close consultation with the Fund on policy initiatives and objectives to ensure overall policy coherence.

Directors agreed that monetary policy should target moderate inflation and a flexible exchange rate. The central bank should seek to dampen excessive volatility while allowing the exchange rate to act as a shock absorber.

Directors recognized the need to safeguard financial stability, including strengthening crisis preparedness, strict monitoring of weak private banks, and state-owned banks' reform. They welcomed the authorities' intention to foster financial intermediation and inclusion. Directors encouraged reinvigorated efforts to recover the stolen assets of Kabul Bank, while continuing to reduce the central bank's lender-of-last-resort exposure.

Directors welcomed the strengthening of the anti-corruption legal framework by criminalizing corruption and adopting a law on asset declarations by public officials. They urged strong implementation and enforcement of these measures to boost stakeholders' confidence.

Directors called for improving economic data for sound economic policy-making, with support of Fund technical assistance.

The Executive Board took the following decision:

Islamic Republic of Afghanistan—Fourth Review Under the Extended Credit Facility Arrangement, Request for Modification of Performance Criteria, and Request for Extension and Rephasing of the Arrangement

1. The Islamic Republic of Afghanistan has consulted with the Fund in accordance with paragraph 4.B.(b) of the arrangement for the Islamic Republic of Afghanistan under the Extended Credit Facility (EBS/16/65, 07/06/2016) ("ECF Arrangement") to review program implementation and to reach understandings regarding the conditions for further disbursements under the ECF Arrangement.

2. The letter dated November 19, 2018 (the "November 2018 Letter") from the Minister of Finance of Afghanistan and the Governor of Da Afghanistan Bank, together with its attached Memorandum of Economic and Financial Policies (the "November 2018 MEFP") and Technical Memorandum of Understanding (the "November 2018 TMU"), shall be attached to the ECF Arrangement, and the letter dated June 30, 2016 from the Minister of Finance of Afghanistan and the Governor of Da Afghanistan Bank, together with its attachments, as supplemented and modified, shall be read as further supplemented and modified by the November 2018 Letter and its attachments.

3. Accordingly, the ECF Arrangement shall be amended as follows:

a. In the introductory paragraph of the ECF Arrangement, the references to "three-year arrangement" shall be revised to refer to "arrangement", and the reference to "three-year period of the arrangement" shall be revised to refer to "period of the arrangement".

b. In paragraph 1(a) of the ECF Arrangement, the reference to "For a period of three years from the date of the effectiveness of this arrangement" shall be revised to refer to "For a period from July 20, 2016 through December 31, 2019".

c. A new paragraph 2(g) shall be included in the ECF Arrangement to read as follows:

"(g) the seventh disbursement, in an amount equivalent to SDR 5.38 million, will be available on or after November 22, 2019, at the request of the Islamic Republic of Afghanistan and subject to paragraphs 4.D and 5 below;"

d. A new paragraph 4.D shall be included in the ECF Arrangement to read as follows:

"4. D. The Islamic Republic of Afghanistan will not request the seventh disbursement under this arrangement specified in paragraph 2(g):

(a) if the Managing Director of the Trustee finds that the data as of June 21, 2019 indicate that:

(i) the floor on the revenue of the central government; or

(ii) the ceiling on net central bank credit to the central government; or

(iii) the ceiling on reserve money; or

(iv) the floor on net international reserves of the central bank;

as set out in Table 1 of the November 2018 MEFP and further specified in the November 2018 TMU was not observed;
(b) until the Trustee has determined that, the sixth program review referred to in paragraph 43 of the November 2018 MEFP has been completed."

e. In paragraph 4.C.(a) of the ECF Arrangement, with respect to sixth disbursement, the references to "the May 2018 MEFP" and "the May 2018 TMU" shall be revised to refer to "the November 2018 MEFP" and "the November 2018 TMU", respectively.
f. The references to "the May 2018 MEFP" and "the May 2018 TMU" in paragraph 5 of the ECF Arrangement shall be revised to refer to "the November 2018 MEFP" and "the November 2018 TMU", respectively.

4. The Fund decides that the fourth review specified in paragraph 4.B.(b) of the ECF Arrangement is completed, and that the Islamic Republic of Afghanistan may request the fifth disbursement referred to in paragraph 2(e) of the ECF Arrangement. (EBS/18/101, 11/20/18).

Decision No. 16449-(18/104), adopted
December 7, 2018

APPROVAL: April 8, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Financial Sector

1. We welcome the new structural benchmark set for the sixth review on recovery of stolen assets from the Kabul Bank and wonder why the benchmark was not extended to the asset recovery of the Afghanistan Commercial Bank?

- We are not aware of the need for an asset recovery procedure in the case of the Afghanistan Commercial Bank (ACB). The ACB is a small bank whose resolution process is proceeding smoothly and is well under the liquidator's (i.e. DAB) control. The repayment of depositors as well as other liabilities is almost complete. On the assets side, sufficient recoveries on the outstanding net loans of around US$ 5 million are expected to ensure that all losses are borne by the former shareholders.

2. Given the enduring vulnerabilities, have staff and the authorities discussed the appropriateness of a structural benchmark related to bank regulation or supervision?

- Banking regulation and supervision weaknesses were largely addressed in the 2015-16 staff-monitored program with structural benchmarks that were satisfactorily completed. On-going progress in this area is assured through a program of technical assistance supported by the World Bank.

3. Despite FATF de-listing, correspondent banking relationships remain challenging due to concerns about the low profitability of transactions and regional cross-border risks. Given these concerns, can staff comment on practical solutions that can help Afghanistan revive correspondent relationships with global banks?

- The difficulties are attributable to multiple factors. These include, in addition to weaknesses in AML/CFT measures, the overall ML/TF risk profile of the country, low profitability of transactions, and regional cross-border risks. Consequently, there is no easy solution to resolve the difficulties. Staff has encouraged the authorities to continue their engagement with international banks as well as key regulators to facilitate communication and to understand the specific concerns. In any event, continued efforts to promote effective implementation of risk-based AML/CFT measures will be needed (albeit they may not be enough) to facilitate revival of correspondent relationships.

4. ***We urge the authorities to address weaknesses in public banks, improve financial soundness indicators and inclusion. Staff's comments on the progress achieved in the Kabul Bank case so far, including the status and financial details of asset recovery, are welcome.***

- There has been much progress in dealing with the legacies of the Kabul Bank case. DAB's lender of last resort exposure to Kabul Bank has been reduced in line with program conditionality. Regarding asset recovery, as mentioned in the MEFP (paragraph 26), by September 2018, recoveries and settlements from the Kabul Bank collapse had reached US$ 451 million including US$ 257 million in cash. The balance of the reported recoveries consists of assets that have remained frozen in Dubai for years, of close to US$ 50 million, of various settlements and nettings of more than US$ 100 million, and of agreed upon extended term loans for about US$ 30 million. The repayment of the latter is very slow, and no discernible progress has been made over the last two years to recover the still large pending claims of US$ 591 million.

5. ***Could staff comment on the pros and cons of improving the performance of state-owned banks versus a possible privatization of these institutions?***

- None of the three Afghan SOCBs is currently in a condition that would make its sale to fit and proper private owners conceivable. Two of them—New Kabul Bank and Pashtani Bank—are narrow banks that do not extend any loans. The first, preliminary step in reforming the SOCBs is to address their deep-rooted corporate governance issues. This is a key component of the strategy adopted by the authorities and supported by both a World Bank program and a December 2018 structural benchmark under the ECF. While progress will continue to take place on governance during 2019, individualized operational reform programs (MEFP paragraph 29) will be developed, including to address shortcomings in their information technology systems that are so severe as to threaten their capacity to remain operational, making them unsaleable to rational investors. Finally, once sufficient progress will have been achieved on both fronts, each bank will need to develop a currently missing viable business model, before its privatization could be envisaged.

6. ***Finally, the difficulty to restore correspondent banking relationships (CBRs) one year after exiting the FATF monitoring list is a matter of concern. We wonder whether other countries that have exited the FATF experience a similar challenge. Staff's comments are welcome.***

- Yes, there are other cases where a member's exit from the FATF's listing did not lead to significant restoration of CBRs. One such example is Sudan. This suggests that there may be other factors at work such as general ML/TF risk profile, economic sanctions, in addition to weaknesses in the AML/CFT regime.

7. ***The implementation of plans for weak banks and action on the failed Kabul Bank, including on asset recovery, are demonstrative of operative supervision and regulation. Could staff comment on the challenges in dealing with weak banks in the prevailing political and security circumstances?***

- The particularly challenging political and security circumstances in Afghanistan are complicating the task of the banking supervisors, who are facing not only difficult logistical challenges but also frequent and credible physical threats. Staff is impressed by the dedication of the DAB officers in charge, who on a daily basis resolutely enforce the action plans agreed with the weak banks to correct their deficiencies.

Debt Management

8. ***Can staff update us on the recently provided TA on debt management and their work with the authorities to build the necessary capacity for sound public finance management?***

- Regarding debt management, building on earlier assistance provided by the Fund and the World Bank, staff will deliver LIC DSF training for the authorities during the forthcoming staff visit in January, as well as a debt management training event in Manila in February 2019. Regarding public financial management, the Fund has provided substantial TA and training on PFM to improve fiscal management. Recent examples include a workshop on cash management and forecasting, and training to build capacity to identify and disclose fiscal risks related to PPPs. In addition, two structural benchmarks for this review requiring adoption of the laws consistent with good international practice on PPPs and state-owned corporations will support sound public finance management.

9. ***As noted in the Debt Sustainability Analysis, Afghanistan's risks of external/public debt distress are high, with debt sustainability hinging upon continued donor grant inflows. Table 2 shows that more than half of central government total revenue is accounted by on-budget grants. […] With respect to the debt, could staff elaborate on the efforts underway to strengthen the monitoring of contingent liabilities emanating from state-owned entities and PPPs?***

   Regarding the new framework for PPP, could staff elaborate on the safeguard put in place to ensure proper financial and legal management of the PPP projects?

- In their ongoing effort to strengthen the monitoring of contingent liabilities from state-owned entities and PPPs, the authorities, supported by Fund TA, adopted a new legal framework on the state-owned corporations and PPPs, in which the governance structure is aligned with international good practices and the MoF is provided with a mandate to monitor and oversee potential fiscal risks from them.

10. The staff report mentions a request for TA in debt management. Meanwhile, have staff held discussions with the authorities on the terms and scale of proposed external debt or long-term loans?

- As in every review, staff discussed with the authorities the terms and scale of proposed external debt or long-term loans. The authorities are considering external borrowing on concessional terms (60 percent grant element) of some US$ 250 million over the next few years to finance key infrastructure and social sector projects.

Fiscal Policy

11. However, we believe that an integrated anti-corruption strategy may help the authorities to better integrate efforts and increase effectiveness of the anti-corruption measures. The strategy should also become an integral part of the efforts for enhancing the revenue mobilization, fiscal structural reforms and financial stability. Staff comments are welcome.

- The Afghan authorities adopted a National Anti-Corruption Strategy on 28 September 2017, which features five pillars: political leadership in anti-corruption reforms; ending corruption in the security sector; replacing patronage with merit; prosecuting the corrupt; and tracking money flows. The Strategy encompasses several measures, including on public financial management, fiscal transparency and those supported by the ECF. At the Geneva Conference held in late November 2018, the authorities committed to developing new indicators for the Strategy and a concrete and time-bound action plan by June 2019 to enhance its implementation.

12. The contingency budget planning is a right step to ensure fiscal sustainability should downside risks materialize. Could staff elaborate more on the composition of the fiscal adjustment should developments deteriorate?

- The contingency measures for 2019 (spending cuts amounting to 0.5 percent of GDP) would comprise cuts to non-essential operating expenditures as well as bonuses.

13. ***Moreover, as noted by staff, the fiscal situation in 2019 will be challenging because the presidential elections are likely to adversely affect revenue collections and donor support is expected to decline significantly. Under these circumstances, expenditures are projected to be almost 3 percentage points of GDP lower than in 2018 and the authorities have identified additional spending cuts in case they become necessary. Could staff comment on the political feasibility of these expenditure reductions as well as pressing ahead with other reforms such as the adoption of the value added tax, establishment of a single LTO, improvements in public financial management, and strengthened monitoring of fiscal risks arising from state-owned corporations?***

- While not easy politically, the cut in expenditure is necessitated by the expected reduction in operating and development grants compared to 2018, and a lack of other financing options would tend to prevent overruns. In addition, the expenditure cuts are supported by the adoption of expenditure efficiency measures. More specifically, the budget allocates a lower amount to the pension payments due to biometric registration of the pensioners, pensions for "martyrs and disabled" are cut as the line ministry was not able to accurately justify their requests, and capital expenses are saved as most of them have been screened using enhanced concept notes and detailed analysis. The commitment to contingency measures is politically feasible as the measures would comprise cuts to non-essential operating expenditures. Beyond these envisaged measures for 2019, structural fiscal reforms (adoption of a new SOC law to strengthen monitoring of the related fiscal risks, preparing for the implementation of a VAT, and strengthening PFM) are continuing, and progress will be assessed through structural benchmarks.

14. ***We note the constraints that authorities have stated regarding the potential lower revenue collections and grants in 2019 and agree with staff that contingency plans should be put in place. We would appreciate comments on new developments regarding the 2019 budget.***

- Parliament approved the 2019 budget on November 27, 2018. The targeted overall deficit including grants (0.8 percent of GDP) is in line with the program. Relative to the 2018 revised budget, domestic revenues are higher by 0.1 percentage point of GDP, grants are lower by 2.8 percentage points of GDP, operating expenditures are lower by 1.9 percentage point of GDP, and development expenditures are lower by 0.5 percentage point of GDP.

15. ***The timely adoption of the VAT in 2020 and further improvement in budget execution and management will be essential to mobilize domestic revenue and preserve fiscal sustainability. Could staff elaborate on the potential revenue impact of VAT?***

- The revenue impact of the VAT will be positive, but the exact amount is sensitive to the choice of various parameters (rate, exemptions), which have not yet been decided.

Program Design

16. We concur with staff on the need to update the performance criteria (PCs) on the net international reserves and the net credit to government. We noted that the schedule of donors' disbursement had a relevant effect on the overall program performance. We wonder whether the future reviews could consider their role to avoid a potential vicious cycle in the case of delays in program execution or in donors' contributions. Staff comments are welcome.

- We agree that a high predictability of aid flows is important. Donors have increasingly moved towards a results-based framework for aid disbursements to properly calibrate expectations and minimize risks of aid disbursements falling short of expectations. The overriding goal of the program is to achieve self-reliance and minimize dependence on aid. With that in mind, the authorities maintain sizeable foreign exchange cash balances to manage unexpected shocks. Indeed, the program incorporates adjustors to capture the possibility that aid disbursements fall short of projected amounts.

Real Sector

17. Beside services and agricultural, could staff share what other economic sectors will be accounted as the main contributors of this increasing growth? With these increasing growth, what would be the impact on job creation, as well as poverty and unemployment reduction?

- The pickup in growth for 2019 is largely driven by a rebound in agriculture from the 2018 drought. Beyond next year, the baseline scenario assumes growth reaching 5 percent in 2023 conditional on no significant deterioration in security, and continued reforms and aid inflows. The extent of job creation likely to accompany this growth path is highly uncertain. Over time, extractive industries and regional trade integration (included as well in the authorities' growth strategy presented at the Geneva conference) could support growth and job creation and would translate into decline of unemployment and poverty.

18. We notice that opium production nearly doubled in 2017 (footnote 2). Could staff comment on the main reasons behind this sharp increase and the efforts underway

to address this problem? Could it also provide some estimates of the size of the informal economy in terms of exports and GDP?

- The opium production estimate cited in the staff report comes from the UN Office on Drugs and Crimes (UNODC). UNODC cites increased insecurity, political instability and lack of government presence as the main reasons behind the sharp rise in opium production in 2017. Estimated opium production is highly volatile: for example, the 2015 production was reported at about half of the 2014 production. The government, with help from international partners, continues to address this problem via eradication of poppy fields and persecution of drug trafficking. In 2018, UNODC reported a 30 percent decrease in opium production. The statistics office reports the narcotic economy at 8.1 percent of GDP. Export estimates are not available.

19. While program performance has been strong, Afghanistan faces a challenging near-term outlook. We note that downside risks in the current juncture include the drought, political tensions, and a humanitarian crisis. Growth scenarios have been adjusted once again. Could staff elaborate on the main factors behind this? Are there any additional uncertainties in the growth scenario?

- Given Afghanistan's circumstances, the outlook for growth is highly uncertain, and risks are tilted to the downside. Even forecasting the current year is difficult due to the lack of high frequency indicators. Thus, staff's projections are akin to conditional scenarios that depend on certain assumptions. The central scenario assumes continued inflows of aid, implementation of reforms, and no significant deterioration in security, implying a gradual increase from current growth rates to an estimated long-run growth potential of 6 percent per year. As for adjustments of growth scenarios, relative to the third review, only the forecast for 2018 was revised down modestly, the medium-term path remains the same.

Monetary Policy

20. We note that inflation will increase from 3 percent in 2018 to 4.5 percent on average during 2019-2020 and be maintained at 5 percent on average in the medium-term. Against this background, the monetary policy stance should remain vigilant and be clearly communicated to enhance its credibility and effectiveness. The authorities should also continue to formulate monetary policy that is well-calibrated and dependent on the balance of risks to the economic outlook. Could staff explain what is the growth of reserve money in local currency during 2019-2020 and in the medium-term to maintain inflation around these levels?

- Staff projects the growth of reserve money in domestic currency at 12 and 11 percent for 2019 and 2020, respectively, moderating to 8 percent in the medium term to support inflation levelling off at 5 percent.

21. We would also like staff to elaborate what are the potential factors driving inflation to exceed its desirable level in the medium-term and how the authorities can mitigate the risks evolved?

- Owing to the high dollarization of the economy and the high import content, exchange rate fluctuations are the main contributor to inflation alongside demand and supply factors, including weather related shocks. To mitigate the risks of inflation exceeding its desirable level in the medium term, staff advised continued progress with de-dollarization, prudent monetary expansion, and central bank independence allowing it to implement credible policies.

Capacity Development

22. Alongside financial support and policy advice, continued technical assistance and training from the Fund would also be essential. We wonder in this regard whether an assessment of the effectiveness of Fund capacity development in Afghanistan is envisaged.

- We are not aware of an impending assessment of the effectiveness of Fund capacity development in Afghanistan. Most recently, the 2015 “Ex-Post Assessment of Longer-Term Program Engagement” (SM/15/150) provided a review and evaluation of capacity development in Afghanistan. The current TA is evaluated by the functional departments before the provision of the subsequent TA continues. The cross-cutting publications by the functional departments such as FAD’s “Building Fiscal Capacity in Fragile States” of April 2017 evaluate effectiveness of the targeted TA provision.

23. For fragile and conflict-affected countries like Afghanistan, the Fund’s capacity development (CD) activities would be critically needed. However, there are understandable practical challenges in the CD delivery before the resumption of Fund missions to Afghanistan. Staff’s comments on the extent of the Fund’s current CD activities with Afghanistan are welcome.

- TA allocation to Afghanistan has significantly increased in 2018 (by 55 percent relative to average of 2015-2017). TA covered PFM, PPP, external sector and price statistics, as well as bank restructuring and crisis preparedness, and is provided from both HQ and METAC. Extensive CD is also being delivered in FY 2019.