

Current Macroeconomic Situation

(Based on the First Six Months' Data of 2007/08)

Monetary Situation

Money Supply

1. Broad money (M2) registered a growth of 10.4 percent in the first six months of 2007/08 compared to a growth of 6.0 percent in the same period of the previous year. Likewise, narrow money (M1) increased by 6.3 percent in the review period compared to a growth of 4.5 percent in the previous year. An increase in credit to the private sector contributed to the acceleration in monetary aggregates in the review period.
2. Time deposits increased by 12.3 percent (Rs 31.91 billion) to Rs 301.54 billion in the review period compared to a growth of 6.8 percent in the previous year. Besides the elevated level of remittances, commencements of banking transactions by three new commercial banks and branch expansion by the existing commercial banks accounted for the significant rise in time deposits in the review period.
3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, decreased by Rs 1.93 billion in the review period in contrast to a rise of Rs 5.49 billion (3.9 percent) in the previous year. Despite the elevated level of remittances and a boom in tourism, NFA declined on account of a deceleration in foreign assistance, a higher level of payment to Indian Oil Corporation (IOC) by Nepal Oil Corporation (NOC) and an unsatisfactory performance of export in the review period.

Domestic Credit

4. Compared to a growth of 0.1 percent in the previous year, domestic credit increased by 10.2 percent in the review period. An increase in private sector credit including an increase in claims on government contributed to such a rise in domestic credit.
5. Net claims on government decreased by 5.2 percent in the review period compared to a decline of 10.2 percent in the previous year. A higher growth of revenue relative to expenditure accounted for the decline in claims on government in the review period.
6. Claims on financial institutions increased significantly by 68.9 percent in the review period. Such claims had grown by 16.9 percent in the previous year. Commercial banks' short-term placement at finance companies, development banks and other financial institutions accounted for such a rise in the claims on financial institutions in the review period.
7. Compared to a growth of 9.3 percent last year, private sector credit showed a rise of 14.0 percent in the review period. A pick up in the growth of private sector credit was on account of credit expansion in areas such as production of iron rod, textiles, cement, transport equipments, real estate and residential construction..

Purchase and Sale of Foreign Exchange

8. The intervention in foreign exchange market by way of net purchase of US dollar 558.2 million from the commercial banks resulted in the injection of liquidity of Rs 35.67 billion in the review period. Last year, such net purchase was US dollar 471.0 million leading to the liquidity injection of Rs 34.32 billion.
9. The purchase of Indian currency (IC) by way of selling US dollar 660 million amounted to Rs 42.03 billion in the review period. During the same period in the previous year, the purchase of IC had amounted to US dollar 390 million, an equivalent of Rs 283.7 billion. A higher level of payment by NOC to IOC in the review period compared to the previous year and a widening current account deficit with India resulted in the rise of the purchase of IC in the review period.

Open Market Operations

10. For modulating short-term liquidity, the NRB undertook reverse repo auction of Rs 5.57 billion and outright sale auction of Rs 1.24 billion. Both of these instruments were used to absorb liquidity. The net liquidity absorption through these operations amounted to Rs 4.81 billion in the review period. Liquidity injection of Rs. 2.0 billion took place through repo auction. During the same period in the previous year, net liquidity of Rs 19.45 billion was absorbed through outright sale auction of Rs 5.89 billion and reverse repo auction of Rs 13.56 billion. Compared to the previous year, a higher level of private sector credit off-take and the increased purchase of IC through the sell of US dollar lowered the absorption of liquidity in the review period.

Table 1: Secondary Market Operation

(In the first six months)

Heads	2006/07	2007/08	Rs. in million
Liquidity Absorption	19450.0	6810.0	
Sale Auction	5890.0	1240.0	
Reverse Repo Auction	13560.0	5570.0	
Liquidity Injection	0.0	2000.0	
Purchase Auction	-	-	
Repo Auction	-	2000.0	
Net Liquidity Absorption	19450.0	4810.0	

Inter Bank Transactions

11. Inter bank transactions of commercial banks amounted to Rs 168.14 billion in the review period compared to Rs 94.54 billion in the previous year. In addition, the use of standing liquidity facility (SLF) availed by the commercial banks from the NRB cumulated to Rs 46.07 billion in the review period compared to Rs 8.19 billion last year. A significant acceleration in the private sector credit off-take resulted in the rise of both inter-bank transaction and the use of SLF in the review period.

Table 2: Status of Inter Bank Transaction and Standing Liquidity Facility

(In the first six months)

	2006/07	2007/08	Rs in million
Standing Liquidity Facility	8190.0	46070.0	
Inter Bank Transaction	94537.0	168139.0	

Short-term Interest Rates

12. The short-term interest rates increased in the review period. The weighted average monthly 91-day Treasury bill rate stood at 3.86 percent as in mid-January 2008 compared to 2.67 percent a year ago. Similarly, the weighted average monthly inter bank rate remained at 4.93 percent as in mid-January 2008 compared to 3.03 percent a year ago. Interest rates on the deposits of commercial banks remained constant in the review period. A decline in excess liquidity as a result of an increase in private sector credit drove up the short-term interest rates in the review period.

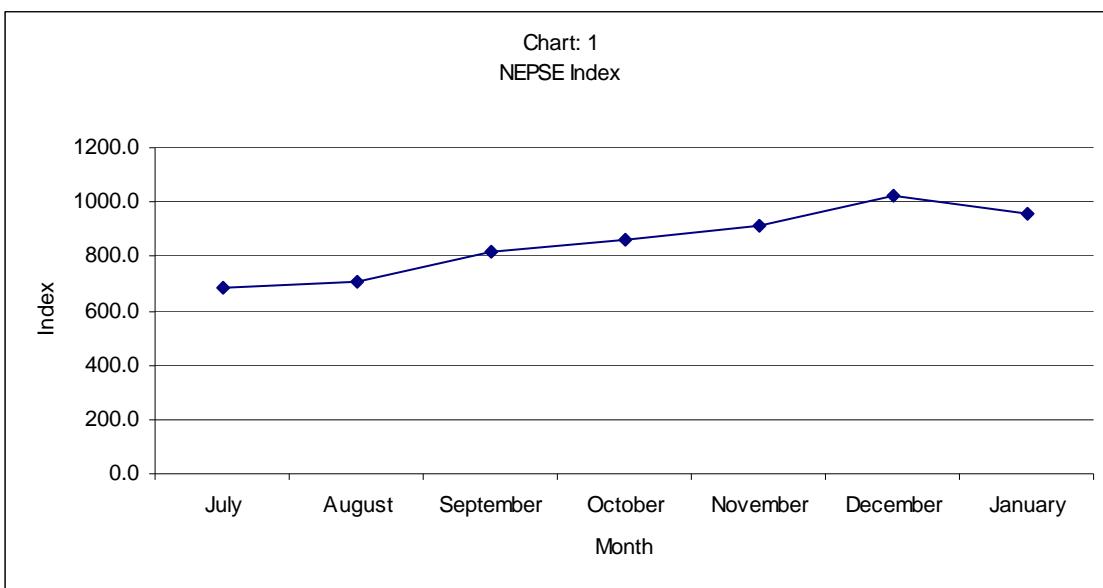
Table 3: Weighted Average 91 day Treasury Bills and Inter Bank Rate

(Percent)

Mid-month	91-day Treasury Bills Rate		Weighted Average Inter Bank Rate	
	2006/07	2007/08	2006/07	2007/08
August	2.99	4.25	2.07	4.10
September	2.78	2.14	1.83	2.18
October	2.54	2.16	2.11	3.35
November	2.11	3.03	1.20	3.73
December	1.98	3.59	1.34	4.73
January	2.67	3.86	3.03	4.93

Securities Market

13. The year on year (y-o-y) NEPSE index increased by 78.5 percent to 958.91 points in mid-January 2008. This index was 537.09 a year ago.



14. Nepalese share market witnessed a significant growth in the first five months of the current fiscal year. However, the expansion was neither supported by fundamentals nor by technical analysis. Further, shares of some of the companies having negative net worth were being traded far higher than their face value. The flip side of this share price ballooning was reflected in the increased margin lending by banks and financial institutions (BFIs). Such lending stood at Rs. 10.54 billion as of January 4, 2008, compared to Rs. 4.6 billion a year ago. Considering the risk that the increased margin lending could create for the BFIs and ultimately to the depositors, NRB, in the end of December 2007, directed such institutions to halt margin lending for one month. Subsequently, owing to the protest of a few investors, no transactions took place at the NEPSE for some days. But, after a few days, the market took the corrective course.
15. The NRB issued directive to effectively manage margin lending on January 22, 2008. The directive says that margin lending could be provided up to 50 percent of the average value of the market price of the share for the last 180 trading days or up to 50 percent of the prevailing market price, whichever is less. Further, no additional lending be made revaluing the pledged shares, and if there is lending beyond the above mentioned limit of 50 percent, such lending

should be regularized by mid-July 2007 or within the payment period, whichever is earlier. In addition, the directive contains some more provisions to regulate the margin lending.

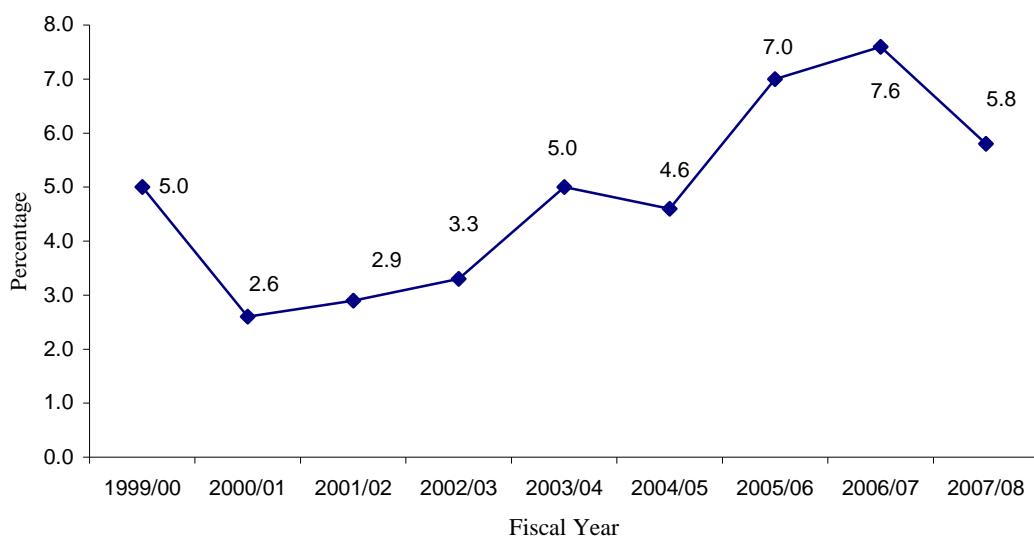
16. The y-o-y market capitalization increased by 58.35 percent to Rs. 301.86 billion in mid-January, 2008. Market capitalization to GDP ratio increased to 38 percent from 19 percent a year ago. Of the total market capitalization, bank and financial institutions hold the largest share.
17. Total paid up capital of the listed companies stood at Rs. 23.90 billion in mid-January 2008, an increase of 14.6 percent over the period of one year. This increase was due to the additional listing of securities.
18. Total number of companies listed at the NEPSE reached 145 in mid-January 2008 compared to 141 a year ago. Among the currently listed companies, 110 are bank and financial institutions. Production and processing industries, hotels, business entities, hydro power and companies in other groups are 21, 4, 5, 3 and 2 respectively
19. Monthly turnover to market capitalization ratio stood at 1 percent in mid-January 2008 compared to 0.79 percent a year ago.
20. The twelve-month rolling standard deviation reflecting an increased volatility in the stock market stood at 195.7 in mid-January 2008 compared to 66.8 a year ago.
21. Nepal Securities Board (SEBON) granted permission to issue ordinary shares of Rs. 274.4 million to seven companies, and right shares of Rs. 2.43 billion to twelve companies in the first six months of 2007/08.

Inflation

Consumer Price Inflation

22. The y-o-y inflation declined to 5.8 percent in mid-January 2008 from 7.6 percent of the corresponding period of the previous year. The moderation in consumer price index was on account of lower pass-through effect of the hike in the prices of petroleum products in October 2007. The appreciation of the Nepalese currency against the US dollar also helped contain the inflation rate at a moderate level.

Chart 2
Consumer Price Inflation (Y-o-Y Percentage Change) Mid-January



23. Group-wise, the index of food and beverages group rose by 7.3 percent compared to a rise of 8.0 percent a year ago. Within this sub-group, the prices of pulses rose by 15.0 percent, oil and ghee

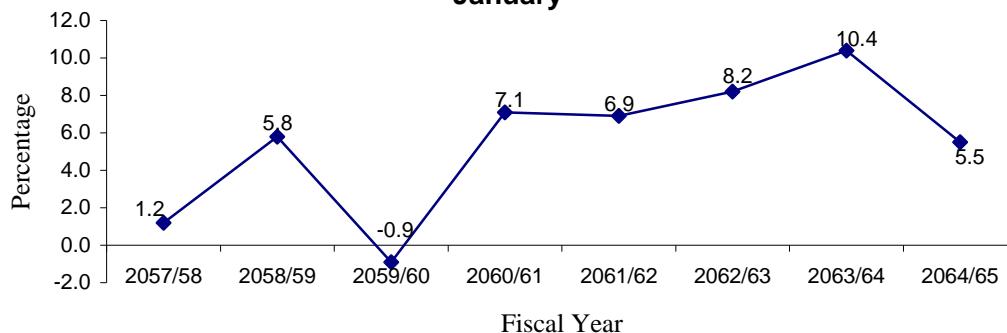
by 12.6 percent, grains and cereal products by 11.3 percent, milk and milk products by 6.6 percent, and meat, fish and eggs by 5.1 percent. However, the prices of sugar and sugar-related products declined by 14.2 percent during this period. The index of non-food and services group rose by 4.1 percent compared to a rise of 7.1 percent last year.

24. Region-wise, the price level in Kathmandu Valley, Terai and the Hills rose by 5.3 percent, 6.0 percent and 5.6 percent respectively. Last year, the respective rates were 6.5 percent, 8.5 percent and 7.2 percent. The impact of repeated general strikes in the Terai region was one of the major reasons for a relatively higher level of inflation in Terai.
25. In mid-January, 2008, the y-o-y core inflation moderated to 4.7 percent from 6.5 percent a year ago.
26. The average rate of inflation during the first six months (mid-August to mid-January) of 2007/08 remained at 6.2 percent compared to 7.2 percent in the corresponding period of the previous year.

Wholesale Price Inflation

27. The y-o-y wholesale price inflation declined to 5.5 percent in mid-January 2008 from the level of 10.4 percent a year ago. The moderation in the wholesale price inflation was on account of a decline in the prices of agricultural commodities group and domestic manufactured commodities group compared to last year. The price of agriculture commodities declined to 4.0 percent from 13.1 percent last year. In this group, the price of pulses has increased by 9.4 percent in the review period compared to a rise of 24.6 percent last year. Similarly, the price of spices and fruits and vegetables declined by 15.2 percent and 10.2 percent respectively compared to the last year's rise of 23.9 percent and 20.2 percent respectively. The price of food grains increased by 6.9 percent, which had increased by 18.3 percent last year. Likewise, the price of cash crops increased by 24.8 percent whereas it had declined by 10.8 percent in the same period of the previous year.
28. Similarly, the wholesale prices of domestic manufactured commodities group rose by 5.9 percent during the review period compared to a growth of 9.7 percent in the previous year. Within this group, the prices of construction material and food-related products rose by 7.4 percent and 7.8 percent respectively in the review period compared to the last year's increase of 19.4 percent and 8.1 percent respectively. The wholesale price index of imported commodities rose by 7.2 percent in the review period. The same rate of growth of this group was observed last year.
29. In this way, the average rate of wholesale price inflation during the first six months (mid-August to mid-January) of 2007/08 remained at 8.8 percent compared to 9.3 percent in the corresponding period of the previous year.

Chart 3
Wholesale Price Inflation (Y-o-Y Percentage Change) mid-January



National Salary and Wage Rate

30. The y-o-y salary and wage rate index rose by 9.1 percent in mid-January 2008 compared to a rise of 9.7 percent a year ago. Such moderation was mainly on account of low pressure on wage rate index despite a 17.0 percent net increment in the salaries of civil servants, including security personnel, teachers and employees of public enterprises effective from mid-July 2007. The wage rate indices rose by 8.5 percent in the review period compared to a rise of 10.9 percent last year. Within the wage rate index, the index of agriculture laborers rose by 6.5 percent compared to 10.6 percent increase last year. In the review period, the index of industrial laborers and construction laborers increased by 11.1 percent and 10.4 percent respectively.

Fiscal Situation

Budget Surplus/Deficit

31. In the first six months of 2007/08, the government budget remained at the deficit of Rs 3.26 billion. In the same period of the previous year, the budget was at the surplus of Rs 3.95 billion. The budget deficit was on account of relatively higher growth of government expenditure in the current year.
32. Of the sources of deficit financing, the government mobilized domestic borrowing of Rs 8.20 billion (except overdraft). In the review period, the GON's cash surplus with the NRB amounted to Rs 7.07 billion. Including the cash surplus of Rs 3.12 billion of the previous year, the cumulative cash surplus of the GON amounted to Rs 10.19 billion.
33. In the review period, the net domestic borrowing of the government remained at a negative figure of Rs 2.69 billion as the government retired domestic borrowing worth Rs 3.81 billion.
34. Of the total budget deficit, remaining Rs 2.36 billion was financed through external borrowing.

Government Expenditure

35. In the first six months of 2007/08, the government expenditure on a cash basis, increased by 30.2 percent to Rs 58.28 billion compared to an increment of 11.9 percent in the same period of the previous year. The increase in government expenditure was on account of rise in all forms of government expenditures i.e. recurrent, capital and principal repayments.
36. In the review period, the recurrent expenditure rose by 21.8 percent to Rs 38.24 billion compared to an increase of 10.0 percent in the corresponding period of the previous year. The higher growth of recurrent expenditure was on account of increased expenditure on relief-related activities, the salary hike of government employees, the rise in peace-related expenditure and additional expenditure relating to the preparation of constituent assembly elections.
37. In the review period, the capital expenditure went up by 66.3 percent to Rs 10.28 billion compared to an increase of 25.9 percent in the same period last year. The loan investment of Rs 500 million to the NOC, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 520 million in the Nepal Electricity Authority, the release of fund of Rs 1.2 billion to Poverty Alleviation Fund (PAF) and the disbursement of funds to local authorities contributed to the significant rise in capital expenditure.

Government Revenue and Foreign Cash Grants

38. In the first six months of 2007/08, the revenue mobilization of the government rose by 25.4 percent to Rs 47.39 billion compared to an increase of 19.7 percent in the corresponding period of the previous year.
39. In the review period, customs revenue rose by 23.7 percent to Rs 9.68 billion compared to an increase of 11.3 percent in the same period of the previous year. Reforms in customs administration, the increase in imports of high tax yielding vehicles and spare parts as well as a rise in the amount of Indian excise refund contributed to such a high growth of customs revenue.

40. In the first six months of 2007/08, Value Added Tax (VAT) revenue grew by 18.8 percent to Rs 14.93 billion compared to an increase of 20.1 percent in the corresponding period of the previous year. The rise in remittances and reforms in VAT administration such as establishment of Large Taxpayers Unit, strengthening of billing system and non filers management are mainly responsible for such an increase in VAT revenue.
41. In the review period, excise revenue increased by 31.3 percent to Rs 4.96 billion compared to an increase of 18.8 percent in the same period last year. Reforms in excise administration, identification of new excisable goods and increase in the imports of high tax yielding vehicles contributed to such an acceleration of the excise revenue.
42. In the first six months of 2007/08, income tax increased by 39.8 percent to Rs 8.40 billion. Last year, such revenue had grown by 28.9 percent. The increase in the income of some public enterprise and private enterprises as well as increase in investment income accounted for such a high growth of income tax.
43. In the review period, non-tax revenue increased by 16.7 percent to Rs 7.23 billion compared to an increase of 24.9 percent in the same period last year. Such increase in non tax revenue is mainly on account of dividend paid by some public enterprises including NRB¹
44. In the review period, the government received foreign cash grants of Rs 5.22 billion. The GON had received foreign cash grants of Rs 7.93 billion in the corresponding period of the previous year.

External Sector Situation

Foreign Trade and Balance of Payments

45. In the first six months of 2007/08, total exports fell by 5.8 percent in comparison to a decline of 2.7 percent in the corresponding period of the previous year. Of the total exports, export to India fell by 7.6 percent in 2007/08 compared to a decline of 3.0 percent in the same period of 2006/07. Exports to other countries also registered a decline by 1.7 percent in comparison to a decline of 1.9 percent in the comparable period of the previous year.
46. The drop in the exports to India was mainly ascribed to the decrease in the exports of vegetable ghee, textiles, chemicals, toothpaste and wire. Similarly, exports to other countries also declined emanating from the fall in exports of woolen carpet, pashmina, readymade garments, Nepalese paper & paper products and tanned skin.
47. In the first six months of 2007/08, total imports rose by 6.2 percent compared to a rise of 7.7 percent in the corresponding period of the previous year. While imports from India went up by 6.5 percent in the review period compared to its higher growth of 10.1 percent in the corresponding period of 2006/07, imports from other countries rose by 5.7 percent in the review period in comparison to a lower growth of 4.0 percent in the previous year.
48. An increase in the import of M.S. billet, vehicles and spare parts, hot rolled sheet in coil, other machinery & parts and pipe & pipe fittings, among others, from India and the rise in the import of gold followed by telecommunication equipment & parts, electrical goods, transport equipment & parts and other machinery & parts, among others, from other countries were responsible for the upsurge in total imports in the first six months of 2007/08.
49. The overall BOP recorded a deficit of Rs. 1.93 billion in the first six months of 2007/08. The BOP had registered a surplus of Rs. 5.49 billion in the corresponding period of the previous year. Despite the increase in travel receipts and workers' remittance by 65.3 percent and 18.2 percent respectively in the review period, the current account registered a deficit of Rs. 1.21 billion due to the increase in trade deficit and the decline in grants. In the corresponding period of the previous year, travel receipts had declined by 4.9 percent and workers' remittances had

¹ Of the total dividend of Rs 3.43 billion for 2006/07 appropriated by the NRB to the GON, NRB has already paid Rs 1.50 billion as of mid January 2008.

increased by 5.1 percent with the current account registering a small surplus of Rs. 976.4 million.

Foreign Exchange Reserves

50. The gross foreign exchange reserves aggregated Rs. 164.95 billion in mid-January 2008, declining by 0.1 percent from the level of Rs 165.11 billion in mid-July 2007. Such reserves had gone up by 2.5 percent in the corresponding period of the preceding year. In terms of US dollar, gross foreign exchange reserves increased by 3.0 percent to US\$ 2.62 billion in mid-January 2008. In the same period of the previous year, such reserves had gone up by 6.9 percent. On the basis of the import figures for the first six months of 2007/08, the current level of reserves is sufficient for financing merchandise imports of 10.0 months and merchandise and service imports of 7.9 months.

Price of Oil and Gold in the International Market

51. The price of oil (Crude Oil Brent) in the international market surged by 83.2 percent to US\$ 93.97 per barrel in mid-January 2008 from US\$ 51.30 per barrel in mid-January 2007. Likewise, the price of gold rose by 43.9 percent to US\$ 902.00 per ounce in mid-January, 2008 from US\$ 627.00 in the previous year.

Exchange Rate Movement

52. In comparison to mid-July 2007, the Nepalese currency appreciated by 3.10 percent vis-à-vis the US dollar in mid-January 2008. It had appreciated by 4.22 percent in the corresponding period of the previous year. The exchange rate of one US dollar remained at Rs. 62.90 in mid-January 2008 compared to Rs. 71.10 in mid-January 2007.