

# Current Macroeconomic Situation

*(Based on the Eleven Months' Data of 2009/10)*

## Monetary Situation

### Money Supply

1. Broad money ( $M_2$ ) expanded by 8.2 percent in the eleven months of 2009/10.  $M_2$  had expanded by 21.1 percent in the corresponding period of the previous year. Narrow money ( $M_1$ ), which had grown by 21.8 percent during the eleven months of 2008/09, grew by 4.5 percent in the review period. A deceleration in the net domestic assets associated with the substantial decline in net foreign assets accounted for such a deceleration of monetary aggregates in the review period.
2. Of the components of narrow money, currency in circulation increased by 9.8 percent in the review period compared to an increase of 22.8 percent during the same period of the previous year. Demand deposits declined by 4.8 percent in the review period in contrast to its growth of 20.1 percent in the corresponding period of the previous year. Time deposits increased by 9.9 percent in the review period compared to a growth of 20.7 percent during the same period of the previous year.
3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, declined substantially by Rs.15.1 billion in the review period. It had increased by Rs.39 billion in the same period of the previous year. An acceleration of trade deficits in the review period contributed to such a significant decline in net foreign assets.

### Domestic Credit

4. In the eleven months of 2009/10, domestic credit expanded by 12.9 percent compared to a growth of 17 percent in the corresponding period of the previous year. Domestic credit increased at a lower rate on account of a decline in net claims on government and the lower growth in the private sector credit of the banking system.
5. Net claims on government declined by 3.9 percent (Rs.4.1 billion) in the review period compared to a 13.8 percent (Rs.12.0 billion) decline in the corresponding period of the previous year. Banking sector's claims on government registered a lower rate of decline in the review period on account of a higher growth in government expenditure relative to resource mobilization. The government deposits at Nepal Rastra Bank as at mid-June 2010 stood at Rs.588 million.

6. In the review period, claims on private sector increased by 17.4 percent (Rs. 75.8 billion) compared to a growth of 25.4 percent (Rs. 86.3 billion) in the same period a year ago. A contraction in the liquidity position of banking sector contributed to such a slowdown in the growth of claims on private sector in the review period.
7. Claims on non-government financial enterprises declined by 12.7 percent in the review period in contrast to a growth of 38.8 percent in the corresponding period of the previous year. The decline in investments of commercial banks on finance companies, saving and loan cooperatives, pension funds and insurance companies in the review period contributed to such a decline in claims on the non-government financial enterprises.
8. In the eleven months of 2009/10, claims on non-financial government enterprises declined by 2.5 percent compared to a decline of 13.2 percent in the corresponding period of the previous year. Partial repayment of loans by National Trading Ltd., Nepal Airlines Corporation, Janak Education Material Centre Limited and Nepal Food Corporation contributed to the slow down in the growth of claims on non-financial government enterprises in the review period.

#### **Deposits Mobilization and Credit Flow of Commercial banks**

9. In the eleven months of 2009/10, deposits mobilization of commercial banks increased by 6.3 percent (Rs.34.6 billion) amounting to Rs. 584.4 billion as at mid-June 2010. The total deposits had increased by 20.9 percent (Rs. 88.3 billion) in the corresponding period of the previous year.
10. Loan and advances of commercial banks increased by 14.1 percent (Rs. 73.2 billion) to Rs. 591.8 billion in the review period. Similarly, private sector credit of commercial banks grew by 17.2 percent (Rs.69.5 billion) compared to a growth of 27 percent (Rs. 83.1 billion) in the corresponding period of the previous year. Of the private sector credit, credit to the production sector increased by 12.1 percent (Rs.10.7 billion) in the review period compared to a growth of 14.2 percent in the same period of the previous year. Sugar, Cement, and Iron and Steel industries witnessed a significant credit expansion under the production sector credit. Similarly, credit to agriculture sector increased by Rs. 960 million in the review period. In the review period, credit to wholesale and retail business as well as finance, insurance and fixed assets; and service sectors increased by 24.9 percent (Rs.17.1 billion), 50.1 percent (Rs.19.5 billion), and 36.5 percent (Rs 8.5 billion) respectively. Credit to these sectors during the corresponding period in the previous year had increased by 17.5 percent, 49 percent, and 9 percent respectively. Credit to real estate sector increased to Rs.18.1 billion in the eleven months of 2009/10 compared to Rs.11.6 billion in the same period a year ago.

### **Liquidity position of Commercial Banks**

11. The liquid assets of the commercial banks stood at Rs. 178.5 billion as at mid-June 2010. Of the components of liquid assets, liquid fund declined by 8.2 percent. A decline in commercial banks' balance with the NRB as well as balance held abroad accounted for such a contraction in the liquid funds of the commercial banks. In the review period, the balance held abroad declined by Rs. 4.4 billion amounting to Rs. 49 billion while the balance with NRB declined by Rs. 5.7 billion. However, another component of liquid assets, commercial banks' investments in government securities remained unchanged during the review period which had declined by 5.8 percent in the same period a year ago.
12. On account of the higher credit disbursement relative to deposit mobilization, the credit-deposit ratio increased to 89 percent in mid-June 2010 from 81.2 percent in mid-July 2009. Similarly, the liquidity-deposit ratio declined to 30.6 percent in mid-June 2010 from 34.2 percent in mid-July 2009.

### **Liquidity Management**

13. In the eleven months of 2009/10, NRB injected net liquidity amounting to Rs.114 billion from the open market operations of government bonds. During this period, Rs.7.4 billion and Rs.1.0 billion were mopped up through outright sale auction and reverse repo auction respectively, while Rs. 119.1 billion and Rs. 3.4 billion were injected through repo and outright purchase auction respectively. In the same period of the previous year, net liquidity amounting to Rs.9.7 billion was mopped up from such operations. Of the total liquidity mopped up, Rs.7.5 billion and Rs. 13.3 billion were mopped up through outright sale auction and reverse repo auction respectively, while Rs. 11 billion was injected through repo auction.
14. In the eleven months of 2009/10, NRB injected net liquidity amounting to Rs. 101 billion through net purchase of USD 1.4 billion from commercial banks. A net liquidity of Rs. 130.2 billion was injected through the net purchase of USD 1.7 billion in the same period last year.
15. The NRB purchased Indian currency equal to 91.8 billion by selling of USD 2 billion in the Indian money market during the review period. Indian currency equal to 65.2 billion was purchased by selling of USD 1.4 billion in the corresponding period of the previous year. An accelerated trade deficits with India accounted for such a higher volume of Indian currency purchase in the review period.

### **Standing Liquidity Facility and Inter Bank Transactions**

16. Banks and Financial Institutions used standing liquidity facility (SLF) amounting to Rs.91.9 billion in the review period. The use of the SLF by commercial banks had amounted to Rs.107.8 billion in the corresponding period of the previous year. Likewise, Inter-bank transactions of commercial banks stood at Rs.245.8 billion in

the first eleven months of 2009/10 compared to Rs.271.9 billion in the corresponding period of the previous year.

### **Interest Rates**

17. The weighted average 91-day Treasury bill rate stood at 6.77 percent in the eleventh month of 2009/10 compared to 6 percent in the corresponding month of the previous year. Similarly, the weighted average inter-bank rate stood at 5.52 percent in the eleventh month of 2009/10 compared to 5.02 percent in the corresponding month of the previous year. In addition to the short-term interest rates, the deposits rate of commercial banks also increased in the review period. The maximum interest rate of two-year and more than two years' fixed deposits increased from 9.5 percent as at mid-July 2009 to 13 percent as at mid-June 2010. The shortfall of liquidity in the banking system contributed to such increments in the interest rates in the review period.

### **Securities Market**

18. The year on year (y-o-y) NEPSE index declined by 29.77 percent to 476.69 points in the first eleven months of 2009/10. This index stood at 678.74 in the same period last year. Likewise, NEPSE sensitive index (based on July 2006) stood at 116.69 point in mid June 2010, as against 182.32 in the same period last year. The NEPSE float index, calculated on the basis of final transaction as of August 24, 2008 (as base market value), remained at 44.29 in mid June 2010, a contraction of 32.44 percent compared to the same period last year. This index was 65.56 in the same period last year.
19. The y-o-y market capitalization declined by 17.21 percent to Rs.373 billion in mid June 2010. The ratio of market capitalization to GDP stood at 31.58 percent in the review period. It was 45.51 percent in the same period last year. Of the total market capitalization, bank and financial institutions accounted for 73.1 percent followed by manufacturing and processing companies (2.0 percent), hotels (1.4 percent), business entities (0.4 percent), hydropower (4.3 percent) and other economic sectors (18.6 percent).
20. Total paid up capital of the listed companies stood at Rs. 77.91 billion in mid June 2010, an increase of 31.36 percent over the period of one year. This increase was largely due to the additional listing of securities at the NEPSE. In the eleven months of 2009/10, additional securities worth Rs.25.93 billion (ordinary share of Rs.5.06 billion, bonus share of Rs. 3.71 billion, right share of Rs.9.90 billion and government securities of Rs.7.25 billion) were listed at the NEPSE.
21. Total number of companies listed at the NEPSE increased to 173 in mid June 2010 compared to 159 last year. Among them, 141 are banks and financial institutions (including insurance companies), followed by production and processing industries

(18), hotels (4), business entities (4), hydropower (4) and companies in other groups (2).

## **Inflation**

### **Consumer Price Inflation**

22. The year on year (y-o-y) inflation as measured by the consumer price index moderated to 9.6 percent in mid-June 2010 compared to 12.3 percent increase in the same period last year. In the review period, the price index of food and beverages group increased by 11.3 percent whereas the index of non-food and services group rose only by 7.3 percent. The index of food and beverages and non-food and services group had risen by 19.0 percent and 5.1 percent respectively in the same period last year.
23. Of the items in the food and beverage group, price indices of spices increased by 36.2 percent compared to an increase of 17.4 percent in the same period last year. Similarly, the price indices of sugar and sugar related products, restaurant meal, pulses as well as milk and milk products sub-groups increased in the review period by 20.6 percent, 18.8 percent, 15.8 percent and 14.8 percent respectively compared to their respective increase of 62.3 percent, 16.5 percent, 27.7 percent and 15.0 percent in the same period last year. The index of grains and cereal products subgroup also witnessed an increase of 14.1 percent compared to an increase of 6.6 percent in the corresponding period of the previous year.
24. Within non-food and services group, the index of education, reading and recreation, housing goods and services as well as tobacco and related products increased by 11.0 percent, 9.8 percent and 9.3 percent respectively in the review period. In the same period last year, the price index of education, reading and recreation as well as tobacco and related products had increased by 8.0 percent and 17.5 percent respectively. Whereas the price index of housing goods and services had declined by 1.0 percent.
25. Region-wise, the price index of Hills rose by 11.1 percent followed by 9.7 percent in Terai and 8.3 percent in Kathmandu Valley in the review period. The respective rates were 11.5 percent each in Hills and Terai and 14.5 percent in Kathmandu Valley during the same period last year.
26. In the review period, the y-o-y core inflation rose to 11.1 percent, a moderation from 12.6 percent a year ago.

### **Wholesale Price Inflation**

27. During the review period, the y-o-y wholesale price inflation increased by 6.3 percent compared to a rise of 17.0 percent a year ago. The indices of agricultural commodities, domestic manufactured commodities and imported commodities

increased by 6.0 percent, 8.5 percent and 5.7 percent respectively in the review period compared to their respective increase of 33.4 percent, 6.0 percent and 0.2 percent, a year ago.

28. Within the agricultural commodities group, the price index of spices, foodgrains, pulses and livestock production respectively increased by 56.6 percent, 23.0 percent, 21.7 percent and 17.4 percent compared to their respective increase of 14.0 percent, 3.8 percent, 21.4 percent and 39.2 percent during the same period last year.
29. Within the group of domestic manufactured commodities, the price index of food-related products increased by 14.5 percent compared to a rise of 3.9 percent a year ago. Within the imported commodities group, the price indices of petroleum products and coal increased by 12.0 percent in the review period compared to a decline of 16.2 percent in the corresponding period of the previous year.

#### **National Salary and Wage Rate**

30. The overall y-o-y salary and wage rate index rose by 13.4 percent in the review period compared to a rise of 21.5 percent a year ago. The increase in basic salary and allowances in mid-August 2009/10 by the government of Nepal for civil servants and its simultaneous effect on salary of the private sector contributed to such an increase in salary and wage rate index. Of the salary and wage rate indices, the salary index increased by 13.8 percent in the review period compared to a rise of 16.8 percent in the same period of the previous year. The wage rate index increased by 13.3 percent in the review period compared to an increase of 23.0 percent in the same period of the previous year. Wages of agricultural, industrial and construction laborers increased by 18.8 percent, 4.4 percent and 11.5 percent respectively in the review period. These wage rates had increased by 29.0 percent, 15.4 percent and 17.8 percent respectively in the same period last year.

### **Fiscal Situation** □

#### **Budget Deficit / Surplus**

31. In the eleven months of 2009/10, government budget deficit on cash basis stood at Rs.6.69 billion compared to a surplus of Rs.1.67 billion in the corresponding period of the previous year.

#### **Government Expenditure**

32. In the review period, total government spending increased by 29.1 percent to Rs.188.65 billion compared to an increase of 24.6 percent in the corresponding

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Figure includes the reports from 7 NRB district offices, 36 RBB branches (out of 65 branches conducting govt. transaction), 20 NBL branches (out of 42 branches conducting govt. transaction), 5 Everest Bank branches, and 1 from Nepal Bangladesh Bank Ltd.

period of the previous year. The high growth in recurrent as well as capital expenditure accounted for such an increase in the government expenditure.

33. In the review period, recurrent expenditure increased by 25.3 percent to Rs.116.31 billion. In the corresponding period of the previous year, the recurrent expenditure had increased by 27.1 percent. An upward revision in the salary and allowances of the civil servants and teachers by the Government of Nepal mainly attributed to such a rise in the recurrent expenditure. Likewise, increasing expenditure on special security plan, growing amount of subsidies to public schools and increment in the distribution of economic assistance accounted for such a rise in the recurrent expenditure.
34. In the review period, capital expenditure increased by 41.5 percent to Rs.46.58 billion as against a 17.5 percent increase in the corresponding period of the previous year. The trend of increasing public procurement process and construction of development projects in the later months of the year contributed to such a growth in the capital expenditure in the review period. However, such amount of capital expenditure accounted for only 43.82 percent of the annual budget estimate. Delay in the budget approval, lingering in the contract process, absence of representatives in local bodies as well as weak law and order situation in the country are mainly attributed for the lower performance of capital expenditure in the review period.
35. In the eleven months of 2009/10, the expenditure on principal repayment increased by 4.9 percent to Rs. 15.57 billion. In the corresponding period of the previous year, such expenditure had increased by 6.4 percent.

#### **Government Revenue**

36. In the eleven months of 2009/10, revenue mobilization of the government grew by 26.7 percent to Rs.153.59 billion compared to an increase of 34.4 percent to Rs.121.23 billion in the corresponding period of the previous year. A positive impact of "Tax Compliance year", increase in PAN number holders, mobilization of tax volunteers, growth in imports, control in revenue leakages and tax administration reforms mainly contributed to such an increase in the revenue mobilization.
37. Of the total revenue mobilization, Value Added Tax (VAT) grew by 36.2 percent to Rs.47.92 billion in mid June 2010. It had increased by 26.5 percent in the corresponding period of the previous year. Increase in the consumptions and reforms in VAT administration are attributed for such a growth in the VAT.
38. In the review period, custom revenue rose by 32.1 percent to Rs.30.9 billion compared to an increase of 29.9 percent in the same period of the previous year. Reforms in custom administration and the increase in imports of high tax yielding vehicles and spare parts contributed to such a high growth of customs revenue.

39. Income tax revenue increased by 22.7 percent to Rs.25.99 billion in the review period. In the corresponding period last year, such revenue had risen by 45.4 percent. A positive impact of tax compliance year and increase in PAN number holders accounted for such an increase in the income tax revenue mobilization.
40. In the review period, excise revenue increased by 51.8 percent to Rs.21.17 billion compared to an increase of 47.8 percent to 13.94 billion in the same period of the previous year. Reforms in excise administration and increase in the imports of high excise tax yielding vehicles accounted for such a growth of excise revenue in the review period.
41. In the review period, non-tax revenue increased by 2.5 percent to Rs.20.45 billion, compared to an increase of 24.9 percent in the same period last year.

#### **Foreign Cash Loans and Grants**

42. The government received foreign cash loans amounting to Rs.3.83 billion and foreign cash grants amounting to Rs.21.80 billion in the eleven months of 2009/10. In the corresponding period of the previous year, the government had received foreign cash loans and foreign cash grants amounting to Rs.3.50 billion and Rs.20.71 billion respectively.

### **External Sector Situation**

#### **Foreign Trade**

43. Nepal's merchandise exports declined by 9.8 percent to Rs. 55.37 billion in the eleven months of 2009/10. Such exports had grown by 15.8 percent to Rs. 61.40 billion in the same period last year. On a monthly basis, exports grew by 14.1 percent during the month of May-June as against the value of the previous month.
44. In terms of destination, exports to India declined by 4.5 percent in the eleven months of 2009/10 in contrast to a growth of 8.5 percent in the same period last year. Likewise, exports to other countries declined by 18.5 percent as against a growth of 29.7 percent in the same period last year. The decline in the exports to India mainly ascribed to the decrease in the exports of readymade garments, zinc sheet, GI pipe, pulses and plastic utensils among others. Likewise, exports to other countries declined considerably due mainly to the decrease in the export of woolen carpet, pulses, readymade garments, herbs as well as pashmina among others.
45. The merchandise imports, on the other hand, grew by 35.2 percent to Rs. 342.99 billion in the eleven months of 2009/10. Such imports had grown by 26.4 percent to Rs. 253.60 billion in the same period last year. On a monthly basis, the merchandise imports grew by 28.6 percent during May-June as against the value of the previous month.

46. Imports from India grew by 35.7 percent in the review period compared to a growth of 11.9 percent in the same period last year. Likewise, imports from other countries grew by 34.6 percent compared to a growth of 52.4 percent in the same period last year. The growth in the import of petroleum products, vehicles and spare parts, M.S. billet, M.S. wire and rods as well as electrical equipment among others, from India and gold, telecommunication equipment and parts, polythene granules, silver as well as steel rod and sheet among others, from other countries contributed significantly to the rise of total imports in the review period. The import of gold and vehicles, which had increased significantly in the earlier months, has however dropped substantially from Jan-Feb and Feb-March respectively.
47. Total trade deficit during the eleven months of 2009/10 expanded by 49.6 percent to Rs. 287.62 billion. Trade deficit had risen by 30.2 percent to Rs. 192.20 billion in the same period last year. Trade deficit with India rose by 50.1 percent in the review period compared to a growth of 13.1 percent in the same period last year. Likewise, trade deficit with other countries expanded by 49.1 percent compared to a growth of 60.1 percent in the same period last year.
48. As a result of the slowdown in exports and accelerated import growth, the ratio of export to import dropped to 16.1 percent in the eleven months of 2009/10 from 24.2 percent a year ago.

#### **Balance of Payments**

49. The balance of payments improved gradually from a record high deficit of Rs. 23.53 billion during the eight months of 2009/10. The balance of payment deficit went down to Rs. 15.07 billion during the eleven months of the current fiscal year as against a surplus of Rs. 39.06 billion in the same period last year. The current account also registered a deficit of Rs. 34.59 billion as against a surplus of Rs. 39.58 billion in the same period last year. The large deficit in goods and services trade led to such a huge current account deficit. Despite a huge current account deficit, a rise in the capital account surplus coupled with an inflow of huge trade credit liabilities largely contributed in bringing down the BOP deficit.
50. The FOB-based merchandise trade deficit grew by 50.5 percent to Rs. 278.15 billion in the eleven months of 2009/10. Such deficit had grown by 30.6 percent to Rs. 184.87 billion in the same period last year. Deficit in services trade grew by 157.3 percent to Rs. 21.26 billion compared to Rs. 8.26 billion in the same period last year. The transfer account registered a surplus of Rs. 257.98 billion in the review period compared to Rs. 221.95 billion a year ago. Under the transfers subgroup, grants increased by 13.1 percent to Rs. 24.72 billion while pension receipts rose by 51.8 percent to Rs. 24.06 billion. Likewise, the workers' remittances grew by 11.8 percent to Rs. 211.17 billion compared to its significant growth of 51.0 percent in the corresponding period of the previous year. On a

monthly basis, the remittance inflows grew by 25.5 percent to Rs. 24.72 billion in May-June, as against an increase of 20.6 percent to Rs. 19.71 billion in the same month of the previous year.

51. The capital account registered a surplus of Rs. 11.51 billion in the eleven months of 2009/10 compared to a surplus of Rs. 6.04 billion in the corresponding period of the previous year. Financial account also registered a surplus of Rs. 4.80 billion in the review period compared to a surplus of Rs. 17.68 billion in the corresponding period of the previous year. The inflow of foreign direct investment grew by Rs. 2.41 billion as against a growth of Rs. 1.82 billion in the corresponding period last year. The trade credit liabilities grew by Rs. 29.44 billion in the review period compared to a growth of Rs. 16.71 billion in the corresponding period of the previous year.

#### **Foreign Exchange Reserves**

52. The level of gross foreign exchange reserve improved gradually to Rs. 247.42 billion in mid-June 2010 from a level of Rs. 235.75 billion as at mid-April 2010. The gross foreign exchange reserve had increased by 27.8 percent to Rs. 271.68 billion at mid-June 2009 compared to the level as at mid-July 2008. NRB's reserves also improved gradually to Rs. 196.84 billion at mid-June 2010 from the level of Rs. 182.84 billion as at mid-April 2010. The gross foreign exchange reserves in dollar terms however dropped further to USD 3.32 billion in mid-June 2010 from a level of USD 3.33 billion as at mid-April 2010. This was mainly on account of the depreciation of Nepali currency against the US dollar. The present level of reserve in dollar terms is lower by 7.5 percent compared to the level as at mid-July 2009. Based on the trend of import in the eleven months of the current fiscal year, the current level of reserves is sufficient for financing merchandise imports of 8.1 months and merchandise and service imports of 6.8 months.

#### **Price of Oil and Gold in the International Market and Exchange Rate Movement**

53. The price of oil (Crude Oil Brent) in the international market went up by 6.7 percent to USD 75.15 per barrel in mid-June 2010 from USD 70.45 per barrel a year ago. Similarly, the price of gold also went up by 30.6 percent to USD 1223.75 per ounce in mid-June 2010 from USD 937.25 a year ago.
54. Nepalese currency vis-à-vis the US dollar appreciated by 4.62 percent in mid-June 2010 compared to mid-July 2009. It had depreciated by 9.39 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 74.60 in mid-June 2010 compared to Rs. 78.05 in mid-July 2009.