Current Macroeconomic Situation of Nepal

(*During the First Three Months of FY 2004/05)*

Nepal Rastra Bank

December 2004

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Major Highlights

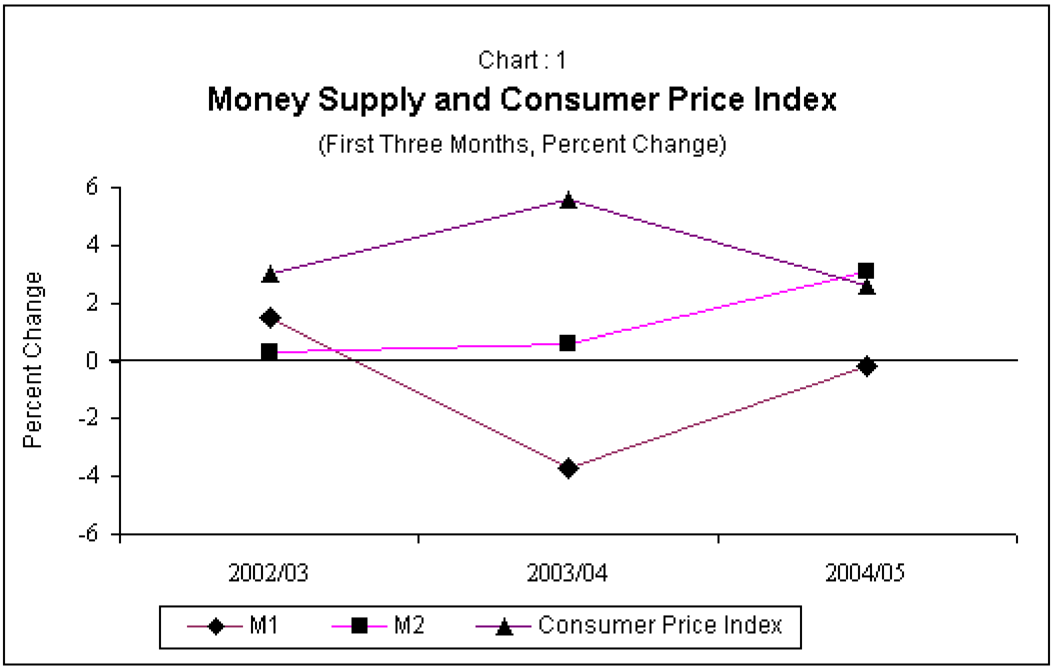
- During the first three months of FY 2004/05, broad money increased while narrow money decreased.
- Time deposits continued to grow.
- Net claims on government decreased.
- Weighted average treasury bills rates declined.
- Stock exchange transactions as well as the NEPSE index increased.
- Total government expenditure decreased.
- Resource mobilization increased as against the decline in government expenditure, resulting in a budget surplus.
- Inflation decelerated.
- Exports rose as against the decline in imports, resulting in the compression in the trade deficit.
- Balance of payments (BOP) deficit decreased.
- The gross foreign exchange reserve increased by 20.6 percent to Rs.128.9 billion in mid-October 2004 from Rs. 106.9 billion in mid-October 2003, enough to cover merchandise imports of 12.4 months and merchandise and service imports of 10.5 months.

Current Macroeconomic Situation of Nepal

(*During the First Three Month of FY 2004/05)*

Monetary Situation

1. During the first three months of FY 2004/05, broad money (M_2) increased by 3.1 percent to Rs. 285.6 billion compared to the marginal growth of 0.8 percent during the same period last year. M_2 increased this year due mainly to the rise in the net domestic assets (NDA). Time deposits went up by 4.7 percent to Rs. 192.0 billion in comparison to the rise of 2.8 percent last year. A continuous increase in workers' remittances led the time deposits to rise. Narrow money (M_1), a component of broad money, declined by 0.2 percent to Rs. 93.6 billion compared to the decline of 3.7 percent last year. The decline in M_1 resulted due mainly to the deceleration in demand deposits, one of the componants of $M_{1,}$ by 13.4 percent to Rs. 26.5 billion compared to a decline of 16.0 percent last year. The broad money liquidity (M_3) increased by 2.6 percent to Rs. 306.1 billion compared to a marginal growth of 0.8 percent last year.
2. The net foreign assets (NFA) of the banking sector (adjusting the foreign exchange valuation) declined marginally by 1.0 percent to Rs. 106.7 billion compared to the decline of 1.6 percent last year. Increased import bills of petroleum products (paid in Indian currency) led to a fall in Indian currency reserves leading to a decline in the NFA during mid-July 2oo4 through mid-October 2004 at a rate lower than that in the same period last year.



3. During the review period, domestic credit of the banking sector increased by 3.5 percent to Rs. 260.0 billion this year compared to the rise of 2.0 percent last year. Although the claims on financial institutions and net claims on government declined, increase in the claims on private sector as well as the non-financial institutions led to the rise in domestic credit. Banking sector's claims on non-financial institutions rose significantly by 34.9 percent to Rs. 3.9 billion due mainly to the increase in the credit to the Nepal Oil Corporation (NOC). Such claims had declined by 13.9 percent last year. Banking sector's claims on financial institutions declines by 2.1 percent to Rs.13.1 billion compared to the rise of 4.7 percent last year. The decline in the deposits made by the commercial bank branch offices of the ADB to its central office led to the decline in the claims on financial institutions. The net claims on government declined by 1.3

percent to Rs. 61.5 billion compared to the decline of 0.2 percent last year. Such claims declined due mainly to the rise in the government deposits in NRB. Banking sectors' claims on private sector increased by 5.2 percent to Rs. 181.5 billion compared to the rise of 3.0 percent last year. Increased consumption as well as the housing loan led to the significant rise in the claims on the private sector.

4. Net non-monetary liabilities declined by 0.7 percent to Rs. 81.1 billlion as against the rise of 2.4 percent last year. Net domestic assets (adjusting the foreign exchange valuation) increased by 5.7 percent to Rs. 178.9 billion compared to the increase of 1.8 percent last year. Despite the decline in net non-monetary liabilities, NDA increased significantly due mainly to the rise in domestic credit.

5. NRB intervened in the foreign exchange market and injected Rs.8.41 billon liquidity this year. Inadequate demand for bank credit due mainly to the security problem caused the short-term interest rate to fall. For instance, the 91-day average treasury bills rate decreased significantly from 3.7 percent in mid-October 2003 to 1.3 percent in mid-October 2004.

Government Budgetary Operation

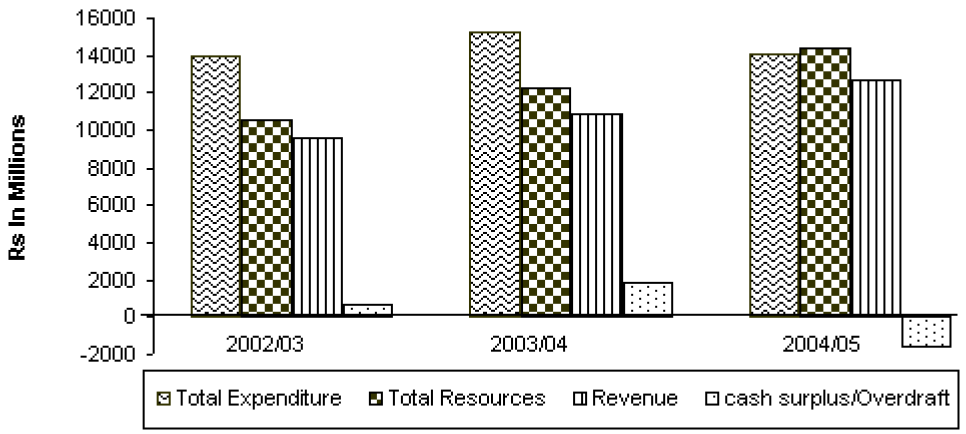
6. The previous classification of government's expenditure into regular and development has been reclassified into new three categories through the public statement on income and expenditure of FY 2004/05: recurrent, capital and principal repayment. In the absence of previous fiscal year's data according to the new classification, only current year's data are presented. Based on the cash flow data, the total expenditure of the government decreased by 8.0 percent to Rs. 14.0 billion in contrast to the rise of 8.9 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 11.5 billion (82.1 percent), capital expenditure Rs. 819.9 million (5.8 percent) and principal repayment Rs. 1044.1 million (7.4 percent). Freeze account is recorded at Rs. 647.8 million (4.6 percent).

7. Total non-debt resources (revenue, non-budgetary and other receipts, and foreign grants) increased by 16.7 percent to Rs. 14.4 billion compared to the rise of same rate last year. Revenue, the major source (88.6 percent) of the government resources, increased by 17.4 percent to Rs. 12.7 billion compared to the rise of 13.2 percent last year. Foreign grants increased to Rs. 1.7 billion as against Rs. 621.9 million received last year.

Chart. : 2

Government Expenditure, Resources and Budget Balance

(First Three Months, Amountwise)



8. The decline in total expenditure in relation to the growth of non-debt resources resulted in Rs. 324.3 million budget surplus compared to the deficit of Rs. 2.9 billion last year. HMG mobilized Rs. 763.4 million as foreign cash loans and borrowed Rs. 500.0 million as internal

loans.. HMG's cash transactions resulted in a surplus of Rs. 1.6 billion in mid-October 2004. HMG had used Rs. 1.9 billion as an overdraft from Nepal Rastra Bank last year.

9. Due mainly to the rise in non-debt resources and the decline in government expenditure, the total net outstanding domestic debt of HMG declined to Rs. 84.3 billion in mid-October 2004 from Rs. 85.4 billion in mid-July 2004. This is as reflected by the treasury position which totaled Rs. 2.3 billion surplus in mid-October as compared to the surplus of Rs. 753 million in mid-July 2004.

Price Situation

10. The National Urban Consumer Price Index, on point-to-point basis, depicted a rise of 2.6 percent in mid-October 2004 compared to an increase of 5.6 percent during the same period last year. The slow growth in the price index is mainly attributable to the decline in the price index of grains and cereal products, milk and milk products, beverages, transport and communication as well as oil and ghee in spite of the rise in the prices of suger and related products and petroleum products. The overall price index recorded 161.2 points in mid-October 2004 from 157.1 in mid-October 2003.

11. The index for food and beverages group increased by 2.1 percent compared to the rise of 4.8 percent last year. The indices that showed an increasing trend were for sugar and related products (22.9 percent), vegetables and fruits (5.8 percent), pulses (5.8 percent), meat, fish and eggs (5.4 percent), restaurant meals (2.5 percent) and spices (1.2 percent) while the indices that declined were for milk and milk products (0.4 percent), beverages (0.4 percent) and oil and ghee (0.1 percent).

12. The index for non-food and services group increased by 3.0 percent compared to an increase of 6.5 percent last year. The indices that increased were for housing goods and services (5.4 percent), education, reading and recreation (4.1 percent) cloth, clothing and sewing services (2.5 percent), and medical and personal care (1.8 percent) and while the indices that declined were for footwear (0.7 percent), transport and communication (0.3 percent) and tobacco and related products (0.1 percent).

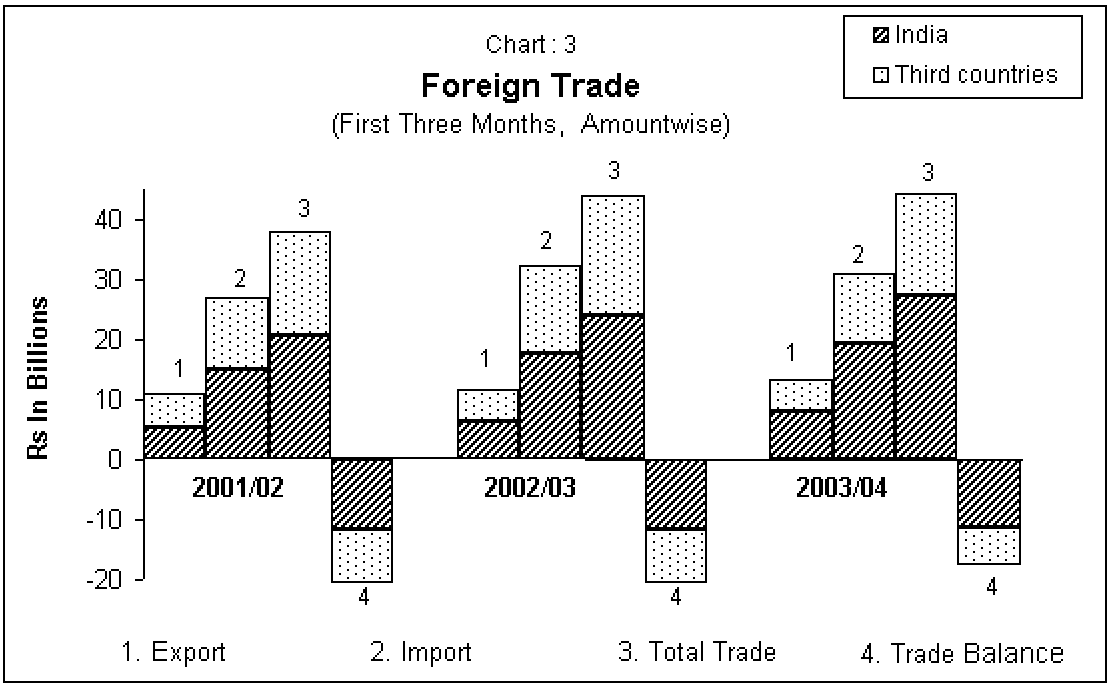
13. Regionwise, the price indices of the Kathmandu Valley, Terai and Hills increased by 3.6 percent, 2.3 percent and 1.9 percent respectively. These indices last year had increased by 7.0 percent, 5.1 percent and 4.8 percent respectively. The indices for food and beverages group rose in Kathmandu Valley, Terai and Hills by 2.7 percent, 1.9 percent and 2.1 percent respectively. Similarly, the price indices for non-food and services group increased in Kathmandu Valley, Terai and Hills by 4.4 percent, 2.7 percent and 1.9 percent respectively.

14. The National Wholesale Price Index, on point-to-point basis, increased by 6.0 percent this year compared to an increase of 3.5 percent last year. Higher prices of cash crops, construction materials and petroleum products and coal as well as transport vehicles and machinery goods pushed up the price index during this year. The indices for imported, domestic manufactured and agricultural commodities increased by 8.6 percent, 7.7 percent and 3.7 percent respectively.

Foreign Trade

15. Total exports increased by 14.6 percent to Rs. 13.4 billion compared to the rise of 6.4 percent last year. Exports to India increased substantially by 30.2 percent to Rs. 8.1 billion compared to the rise of 14.2 percent last year. Exports to other countries, which had fallen by 1.3 percent last year, declined further by 3.2 percent to Rs. 5.3 billion this year. Among the major exportable commodities, the exports of pulses, cardamom, vegetable ghee, tea, polyester yarn, pashmina, aluminium section, copper wire and rod, chemicals, juice, oil cakes, cattle feed, footwear, textiles, catechu, rosin, buckwheat to India have increased. Similarly, the exports of woollen carpets, pashmina and tanned skin to other countries increased while that of pulses

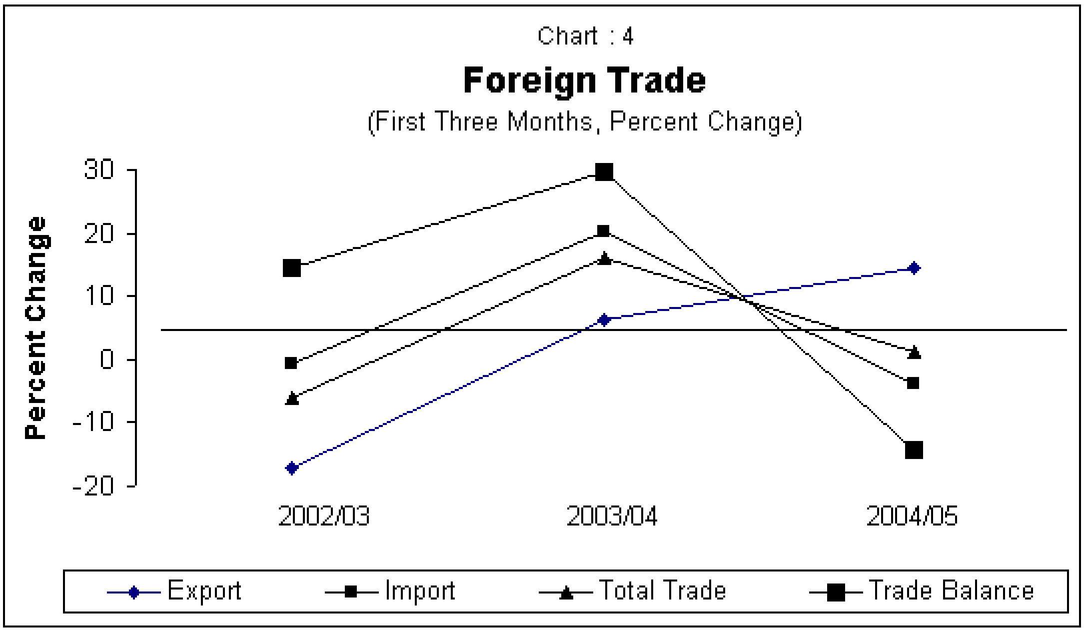
and readymade garments declined. The exports of toothpaste, dried ginger, ginger, ricebran oil, G.I. pipe, M.S. pipe, paper and readymade garments to India declined.



16. Total imports declined by 3.8 percent to Rs. 31.1 billion as against the rise of 20.2 percent last year. Imports from India increased by 8.7 percent compared to the rise of 17.4 percent last year. However, imports from other countries declined by 19.1 percent as against the growth of 23.8 percent last year. Imports of thread, chemicals, transport vehicles and parts, chemical fertilizers, petroleum products, medicine cold-rolled sheet, M.S. wire rod and plastic granules from India and that of edible oil, betle nut, clove, raw wool, television, transport vehicles and parts, copper wire and sheets from other countries augmented. However, the imports of wheat, rice, hot-rolled sheet, M.S. billet and cement from India and that of yarn, crude soybean oil, crude palm oil, plastic granules, tire and tubes, telecommunications equipment and parts, aircraft equipment, electrical goods, medicine and textiles from other countries declined.

17. The higher growth of exports as against the decline in imports resulted in a compression in the trade deficit by 14.3 percent to Rs. 17.7 billion. The trade deficit had increased by 29.7 percent last year. Trade deficit with India, which had recorded a rise of 19.2 percent last year, declined by 2.9 percent this year. Trade deficit with other countries narrowed down by 28.6 percent in contrast to the rise of 46.0 percent last year. Total trade, which had increased by 16.2 percent last year, grew by 1.1 percent this year. Due to the increase of import from, and export to, India and their declines with respect to other countries, the share of India in total trade went up to 61.6 percent from 54.5 percent last year while the share of other countries in total trade decreased to 38.4 percent from 45.5 percent last year.

18. The overall export/import ratio, which was 36.2 percent last year, rose to 43.1 percent this year owing mainly to the rise in exports and the fall in imports. The export/import ratios for India and other countries stood at 42.1 percent and 44.8 percent respectively compared to the respective ratios at 35.2 percent and 37.4 percent last year.



Balance of Payments

19. According to the BOP statistics for the first two months of FY 2004/05, trade deficit narrowed down by 17.8 percent to Rs. 10.4 billion due to the decline in imports and the growth in exports. Trade deficit had expanded by 22.0 percent last year. On the services front, receipts from government service increased by 25.6 percent to Rs. 1.1 billion. While travel receipts declined by 17.5 percent to Rs. 1.6 billion, other receipts fell by 2.9 percent to Rs. 1.0 billion. As a result, service receipts declined by 3.9 percent in contrast to the rise of 27.4 percent last year. Similarly, on the payments side, because of the increase in travel expenses and other expenses by 9.3 percent and 3.9 percent respectively and the decline in the tansportation expenses by 0.2 percent, total expenses rose by 3.8 percent to Rs. 3.6 billion

20. Income receipts (credit) increased by 3.5 percent to Rs. 425 million while the income payments (debit) increased by 5.5 percent to Rs. 654.7 millon. As a result, the total deficit on goods, services and incomes decreased by 15.7 percent to Rs. 10.4 billion as against a rise of 21.1 percent last year.

21. Under transfer receipts, foreign grants declined by 45.0 percent to Rs. 2.3 billion in contrast to a surge of 122.8 percent last year. The workers' remittances declined by 16.0 percent to Rs. 10.5 billion compared to the rise of 79.9 percent last year. The decline in remittances was associated with the situation following the September 1st incident when 12 Nepalese workers were murdered in Iraq. Pensions receipts increased by 91.1 percent to Rs.1.9 billion. Similarly, the other transfer receipts (Indian excise refund) increased by 93.3 percent to Rs. 220.6 million. At the same time, the transfer payments increased by 27.7 percent to Rs.565.1 million compared to the substantial rise of 198.8 percent last year.

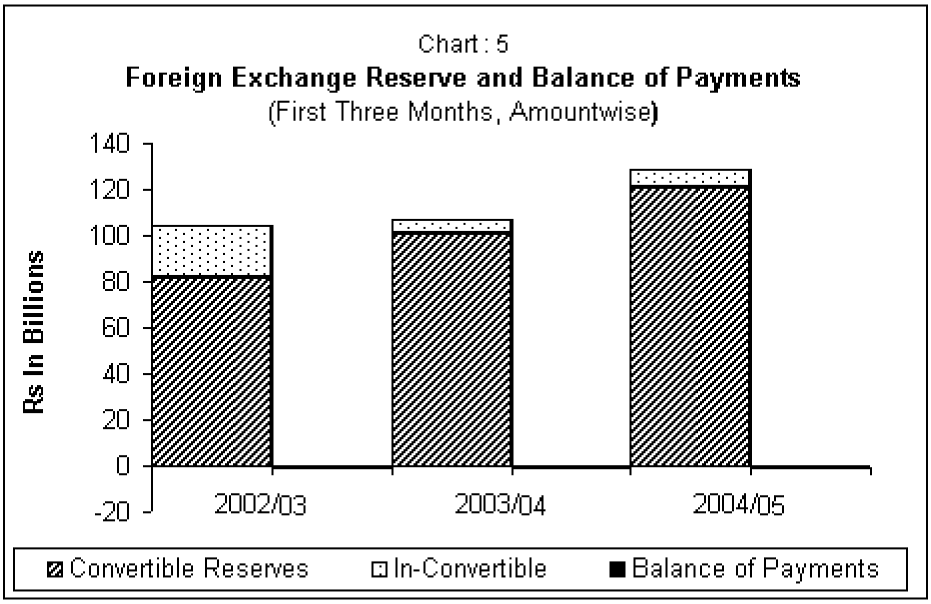
22. During the first two months of FY 2004/05, the current account recorded a surplus of Rs. 3.9 billion compared to the surplus of Rs.5.0 billion last year. Capital transfer stood at Rs. 139.5 million compared to the level of Rs. 460.0 million last year.

23. Under the financial account, other investment assets reached Rs. 3.0 billion compared to the amount of Rs. 10.4 billion last year. Of this amount, Rs. 96.8 million was on account of trade credits. Compared to Rs.4.9 billion last year, other investment liabilities reached Rs. 1.7 billion this year. Of this amount, Rs. 1.2 billion was on account of trade credits. The government received Rs. 221.6 million as loan and repaid Rs. 375.7 milion in amortization. As a result, the net government borrowing stood at negative Rs. 154.1 million. Currency and deposit liabilities went up by Rs. 611.8 million. Consequently, the financial account was negative by Rs. 1.4

billion. Despite the surplus in the current account, the BOP deficit was Rs. 4.2 billion, compared to a deficit of Rs. 2.6 billion last year, becouse of the substantial outflow of miscellaneous capital. On the basis of the monetary statistics for the first three months of FY 2004/05, the BOP recorded a deficit of Rs. 1.0 billion compared to the Rs. 1.5 billion deficit last year.

Foreign Exchange Reserve

24. The gross foreign exchange reserve increased by 20.6 percent to Rs.128.9 billion in mid-October 2004 compared to an increase of 2.8 percent to Rs. 106.4 billion in mid-October 2003. The decline in imports from other countries' and the rise in remittances through the banking channel were the factors responsible for the 19.9 percent growth in the convertible reserve. Similarly, inconvertible reserve increased by 30.7 percent due to the rise in exports to India. Last year, the convertible reserve had increased by 23.0 percent while the inconvertible reserve had declined substantially by 72.3 percent. However, the share of convertible reserve in the total reserve fell to 93.8 percent in mid-October 2004 from 94.3 percent in mid- October 2003, resulting in the corresponding rise in the share of non-convertible reserve to 6.2 percent from 5.7 percent. Sufficient to finance merchandise imports of 12.4 months and merchandise and service imports of 10.5 months, the current reserve position is at a comfortable level.

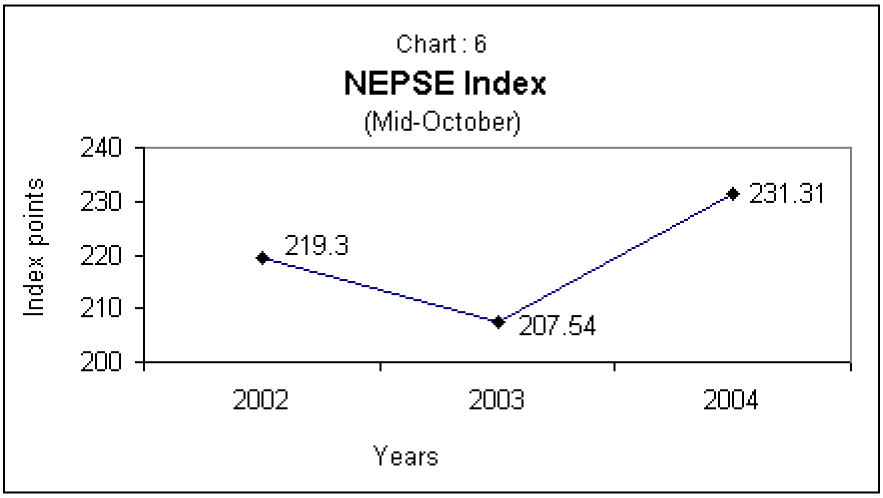


Share Market Transactions

25. Total share transactions in terms of both value and number increased significantly during the month ending in mid-October 2004 compared to the same month last year. Share market indicators like share price, number of companies listed and traded, and market capitalization also increased. The secondary market transactions of the commercial banks and manufacturing industries increased. Despite the new listing and issue of bonus shares of commercial banks and finance companies, the total value of listed shares declined by 1.2 percent to Rs. 12.5 billion. The market capitalization of the listed companies rose by 20.5 percent to Rs. 44.5 billion. The NEPSE index increased by 23.77 index points (11.5 percent) from 207.54 in mid-October 2003 to 231.31 in mid-October 2004. The number of companies listed increased to 116 in mid-October 2004 from 109 in mid-September 2003. Similarly, the number of companies traded increased to 74 from 59 last year.

26. In the review month, the value of share transactions increased to Rs. 208.1 million as 707 thousand shares were exchanged through 15971 transactions. The total value of share transactions last year was Rs. 24.7 million when 122 thousand shares were exchanged through 3655 transactions. Thus, total transactions in terms of value and number of shares increased by

7.1 times and 4.8 times respectively in the review month compared to the same period last year.



Sectoral Contribution inTotal Transactios

27. Commercial banks, finance companies, insurance companies, manufacturing and processing companies, development banks and hotel groups contributed 92.4 percent, 4.2 percent, 2.0 percent, 0.5 percent, 0.5 percent, 0.3 percent respectively to the total exchanged value in the review month while such shares were 55.0 percent, 28.5 percent, 8.9 percent, 0.6 percent, 0.9 percent and 1.1 percent respectively in the same period last year.

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