Current Macroeconomic Situation of Nepal

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

Nepal Rastra Bank

January 2005

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Major Highlights

- During the first four months of FY 2004/05, broad money accelerated while the contraction in narrow money decelerated.
- Time deposits continued to grow.
- Net claims on government further declined.
- Weighted average treasury bills rates declined.
- Stock exchange transactions as well as the NEPSE index increased.
- Inflation decelerated.
- Total government expenditure, on cash basis, decelerated.
- Though the revenue mobilization decelerated, total resource increased faster than the expenditure, resulting in the substantial decline in the budget deficit.
- Exports accelerated as against the decline in imports, resulting in the contraction in the trade deficit.
- Balance of payments (BOP) stood favourable at Rs. 2.0 billion.
- Gross foreign exchange reserve increased to Rs.131.1 billion, enough to cover merchandise imports of 12.6 months and merchandise and service imports of 10.8 months.

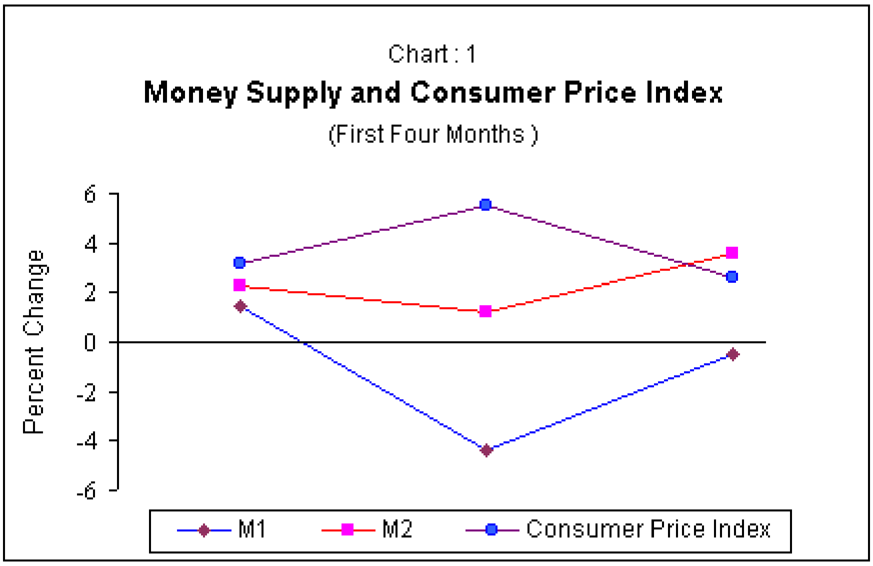
Current Macroeconomic Situation of Nepal

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

Monetary Situation

1. During the first four months of FY 2004/05, broad money (M_2) increased by 3.6 percent and reached Rs. 287.0 billion in mid-November 2004. During the same period last year, M_2 had recorded a growth of 1.2 percent. The higher increase in M_2 this year is attributed mainly to the rise in the net domestic assets (NDA) as well as the net foreign assets (NFA). Time deposits went up by 5.6 percent to Rs. 193.6 billion in comparison to the rise of 4.2 percent last year. Narrow money (M_1) declined by 0.5 percent to Rs. 93.4 billion compared to a decline of 4.4 percent last year. The decline in M_1 is due mainly to the rise in the time deposits. The broad money liquidity (M_3 = M_2 and foreign currency deposits) increased by 3.2 percent to Rs. 307.9 billion compared to an increase of 1.4 percent last year.

2. The NFA of the banking sector (adjusting the foreign exchange valuation) went up by 1.8 percent to Rs. 108.6 billion compared to a decline of 0.6 percent last year. The NFA increased due to the loan assistance of the World Bank for the voluntary retirement scheme (VRS) in Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL).



3. Domestic credit of the banking sector increased by 3.7 percent to Rs. 260.3 billion compared to the 2.6 percent increase last year. Although the claims on financial institutions and net claims on government declined, the increase in the claims on the private sector as well as the non-financial institutions led to the rise in the domestic credit. Banking sector's claims on non-financial institutions went up by 29.6 percent to Rs. 3.8 billion. The claims on non-financial

institutions went up due mainly to the increase in the credit to the Nepal Oil Corporation (NOC) from the commercial banks. Such claims had declined by 7.1 percent last year. Banking sector's claims on financial institutions declined by 2.7 percent to Rs. 13.0 billion compared to an increase of 9.9 percent last year. The net claims on government declined by 2.4 percent to Rs. 60.8 billion compared to a decline of 1.8 percent last year. Such claims declined due mainly to the rise in the government deposits with NRB. Banking sector's claims on private sector increased by 5.9 percent to Rs. 182.7 billion compared to the rise of 4.1 percent last year. Increased consumption loan, housing loan as well as export credit led to the rise in the claims on the private sector.

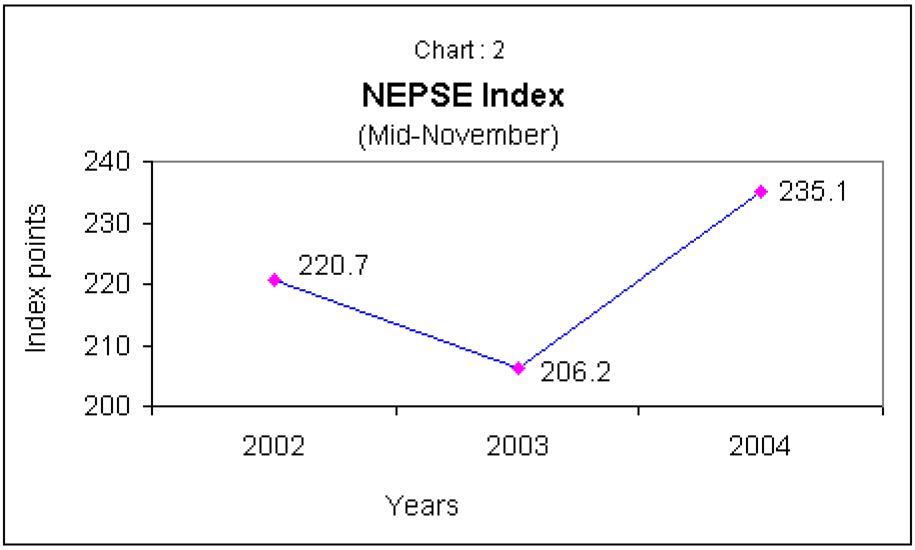
4. Net non-monetary liabilities increased by 1.5 percent to Rs. 81.8 billion this year compared to the rise of 3.2 percent last year. The NDA (adjusting the foreign exchange valuation) increased by 4.7 percent to Rs. 178.5 billion compared to an increase of 2.3 percent last year. The marginal increase in net non-monetary liabilities coupled with the expansion in domestic credit accounted for a higher growth of NDA this year.

5. NRB intervened in the foreign exchange market and purchased US$ equivalent to Rs. 8.3 billion and sold US$ equivalent to Rs. 1.9 billion, thus injecting liquidity for a net sum of Rs. 7.2 billion during the review month. The demand for fund from HMG could not increase as compared to the availability of liquidity, causing the short-term interest rates to fall. For instance, the 91-day average Treasury bills rate declined to 2.0 percent in mid-November 2004 from 3.7 percent in mid-November 2003.

Share Market Transactions

6. Total share transactions in terms of both value and number increased significantly during the month ending in mid-November 2004 compared to the same month last year. Among the other share market indicators, the share price, number of companies listed and market capitalization also increased. The secondary market transactions of the commercial banks and manufacturing industries increased. The total amount of listed shares increased by 4.0 percent to Rs 13.2 billion due to new listing and issue of bonus shares of some banks and insurance companies in the review month compared to the same month last year. The market capitalization of the listed companies rose by 23.0 percent to Rs 45.2 billion. The NEPSE index increased by 28.87 index points (14.0 percent), from 206.21 in mid-November 2003 to 235.08 in mid-November 2004. The number of companies listed increased to 118 in mid-November 2004 from 109 in mid-November 2003. Similarly, the number of companies traded decreased to 59 from 60 last year.

7. In the review month, the value of share transaction increased to Rs 55.2 million as 178,450 shares were exchanged through 2,871 transactions. In the same month last year, the total value of share transaction was Rs 30.6 million when 130,370 shares were exchanged through 2,598 transactions. Thus, the total transactions in terms of value and number of shares increased by 36.9 percent and 80.5 percent respectively in the review month compared to the same period last year.



Sectoral Contribution to Total Transactions

8. Of the total exchanged value in the review month, the share componants were Commercial bank (83.7 percent), finance companies (10.0 percent), manufacturing and processing companies (4.9 percent), insurance companies (0.9 percent), development bank (0.5 percent) and hotels groups (0.1 percent). The share componants were: commercial banks (64.4 percent), finance companies (22.8 percent), insurance companies (4.7 percent), trading companies (4.7 percent), development banks (2.7 percent), and hotels group (0.6 percent) in the same period last year.

Price Situation

9. The National Urban Consumer Price Index depicted a rise of 2.7 percent in mid-November 2004 compared to an increase of 5.8 percent during the same period last year. The slow growth in the price index is mainly attributable to the decline in the prices of grains and cereal products, oil and ghee, milk and milk products as well as footwear, in spite of the sharp rise in the price of sugar and related products. The overall price index, which was recorded in 156.6 in mid-November 2003 rose to 160.8 points in mid-November 2004.

10. The index for food and beverages group moved up by 2.2 percent compared to an increased of 5.3 percent last year. The index of sugar and related products shot up by 28.5 percent. The indicies that showed an increasing trend were pulses (5.7 percent), meat, fish and eggs (5.6

percent), vegetables and fruits (4.4 percent), spices (2.9 percent), restaurant meals (2.6 percent) and beverages (0.2 percent). However, the indices that declined were oil and ghee (1.9 percent), milk and milk products (0.5 percent) and grain and cereal products (0.3 percent).

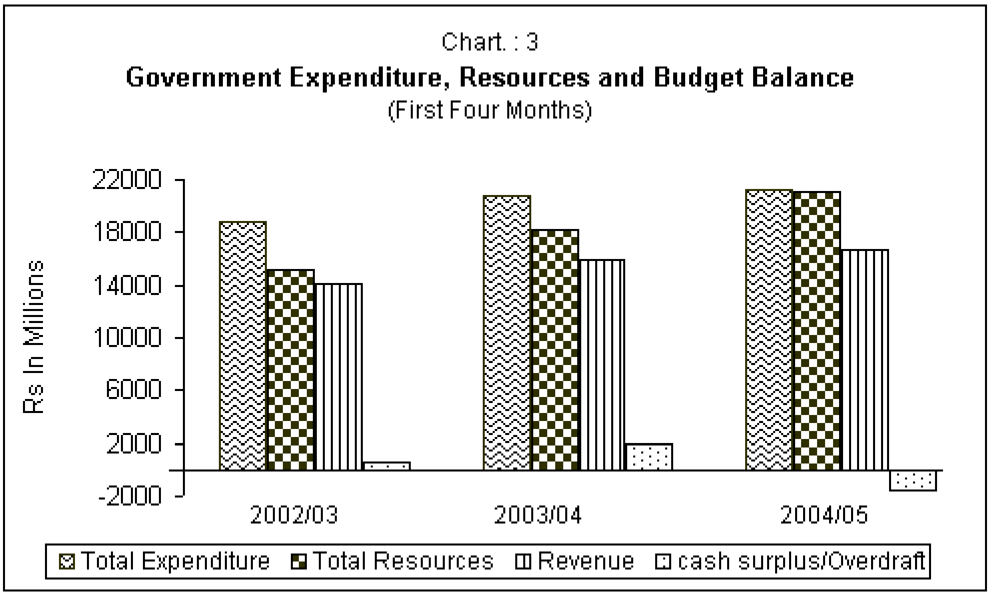
11. The index for non-food and services group increased by 3.3 percent compared to an increase of 6.3 percent last year. The indices that increased were housing goods and services (5.7 percent), education, reading and recreation (4.0 percent) cloth, clothing and sewing services (2.3 percent), medical and personal care (2.3 percent), tobacco and related products (1.3 percent) as well as transport and communication (0.1 percent), whereas the indicex for footwear (0.4 percent) declined.
12. Regionwise, the price indices of the Kathmandu Valley, Terai and Hills increased by 4.0 percent, 2.3 percent and 2.1 percent respectively. The indices last year had increased at a relatively higher pace of 7.4 percent, 5.0 percent and 5.1 percent respectively. The indices for food and beverages group rose in Kathmandu Valley, Terai and Hills by 3.7 percent, 1.5 percent and 1.6 percent respectively. Similarly, the price indices for non-food and services group increased in Kathmandu Valley, Terai and Hills by 4.3 percent, 3.0 percent and 2.6 percent respectively. The national urban consumer price index, on an average basis, increased by 2.6 percent during the first four months of this year compared to the rise of 5.5 percent during the same period last year.
13. The National Wholesale Price Index, on point-to-point basis, increased by 4.6 percent during this year compared to an increase of 4.1 percent last year. Higher prices of cash crops, construction materials, petroleum products and coal as well as transport vehicles and machinery goods pushed up the price index during the year. The indices for imported, domestic manufactured and agricultural commodities increased by 8.4 percent, 7.4 percent and 1.2 percent respectively. The average national wholesale price index, for the first four months of this year, increased by 5.9 percent compared to the rise of 3.5 percent during the same period last year.

Government Budgetary Operation

14. The old classification of the expenditure into regular and development has been reclassified into new three categories: recurrent, capital and principal repayment. In the absence of previous fiscal year's data according to the new classification, only current year's data have been presented. Based on the cash flow data, the total expenditure of the government increased by 2.2 percent to Rs. 21.2 billion compared to the rise of 10.0 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 15.3 billion (72.1 percent), capital expenditure at

Rs.1.3 billion (6.2 percent) and principal repayment Rs. 3.2 billion (15.1 percent). Freeze account recorded Rs. 1.4 billion (6.6 percent).

15. Total non-debt resources (revenue, non-budgetary and other receipts, and foreign grants) increased by 16.4 percent to Rs. 21.1 billion compared to the rise of 20.3 percent last year. Revenue, the major source (79.1 percent) of the government resources, grew at a lower rate of 4.7 percent to Rs. 16.7 billion compared to the rise of 14.0 percent last year. Foreign grants increased to Rs. 3.0 billion as against Rs. 1.1 billion received last year.



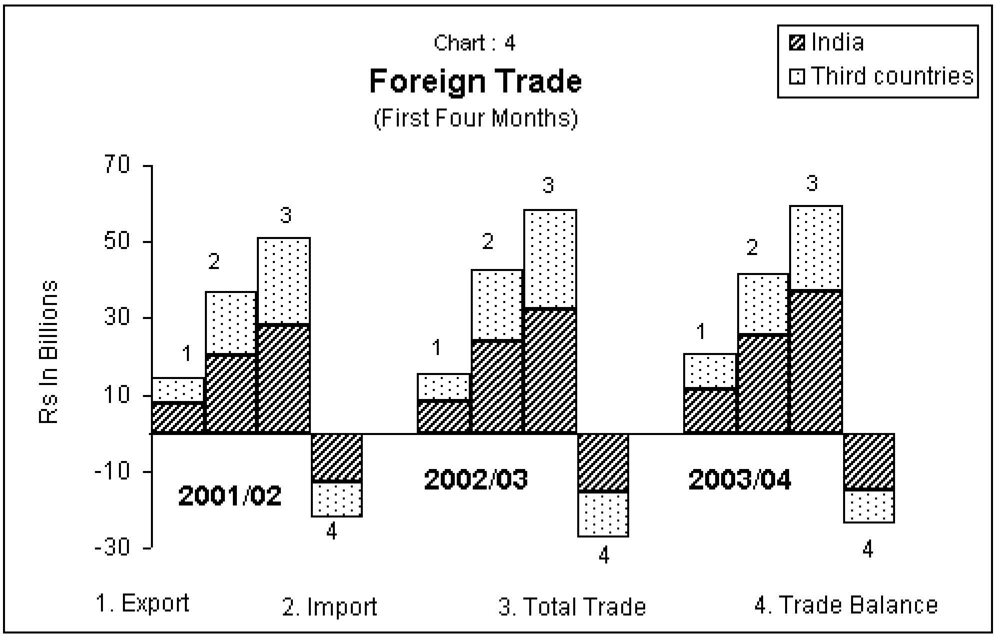
16. Due to the higher growth in non-debt resources compared to the total expenditure, the budget deficit declined substantaily by 98.0 percent to Rs.50.1 million, to bridge which HMG mobilized Rs. 953.8 million through foreign cash loans and borrowed Rs. 500.0 million through internal loans. HMG's cash transactions resulted in a surplus of Rs. 1.4 billion in mid-November 2004 compared to the overdraft of Rs. 1.5 billion in mid-November 2003.

17. Due mainly to the rise in non-debt resources and the low growth in government expenditure, the total net outstanding domestic debt of HMG declined to Rs. 83.6 billion in mid-November 2004 from its level of Rs. 85.4 billion in mid-July 2004, as reflected in the Treasury position at Rs. 2.2 billion surplus in mid-November 2004 compared to the surplus of Rs. 753 million in mid-July 2004.

Foreign Trade

18. Total exports went up by 15.1 percent to Rs. 17.8 billion compared to the rise of 6.0 percent last year. Exports to India increased sharply by 32.6 percent to Rs. 11.1 billion compared to the rise of 11.5 percent last year. Exports to other countries declined by 5.6 percent to Rs. 6.7 billion. Among the major exportable commodities, the exports to India of pulses, cardamom,

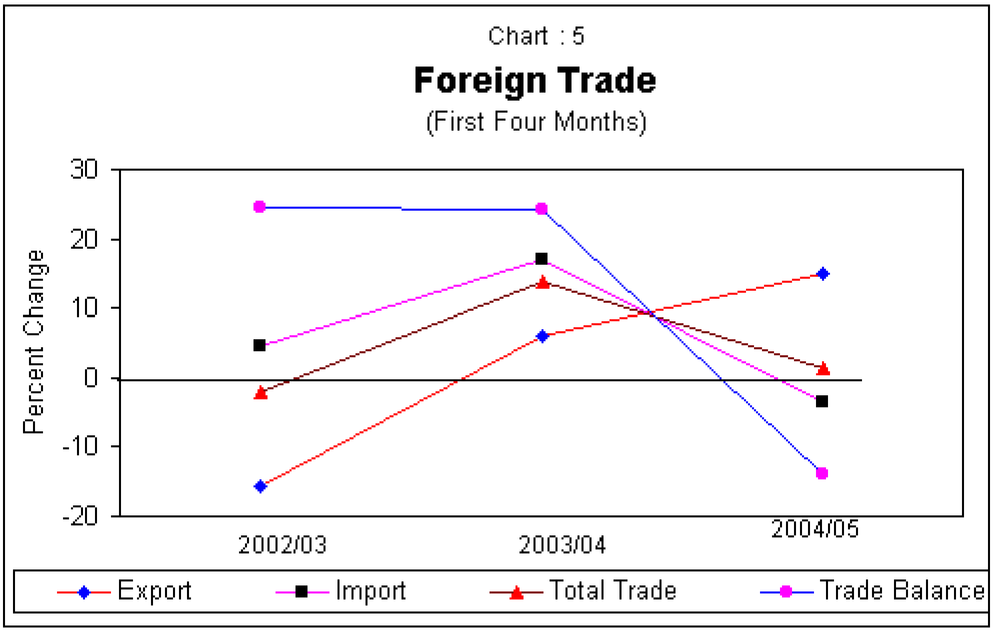
vegetable ghee, tea, polyester yarn, paper, aluminium section, copper wire and rod, chemicals, juice, cattle feed, footwear, textiles, catechu, rosin, buckwheat increased. The exports to India of toothpaste, dried ginger, ginger, ricebran oil, G.I. pipe, M.S. pipe and readymade garments declined. The exports to other countries of woollen carpets and tanned skin increased while that of pulses, tea, Pashmina, jewellery and readymade garments declined.



19. Total imports declined by 3.5 percent to Rs. 41.5 billion as against the rise of 16.9 percent last year. Imports from India increased by 7.2 percent compared to the rise of 17.5 percent last year. However, imports from other countries declined by 17.1 percent as against the growth of 16.2 percent last year. Imports from India of pulses, thread, chemicals, transport vehicles and parts, chemical fertilizers, petroleum products, medicine, cold-rolled sheet and plastic granules and imports from other countries of edible oil, betle nut, clove, television, transport vehicles and parts, other machinery and parts, steel wire, crude coconut oil, copper wire and sheets augmented. However, the imports from India of wheat, rice, hot-rolled sheet, M.S. billet and cement and imports from other countries of yarn, crude soybean oil, crude palm oil, plastic granules, telecommunications equipment and parts, aircraft equipment, electrical goods, medicine and textiles declined.

20. The higher growth of exports as against the decline in imports resulted in the reduction in the trade deficit by 14.0 percent to Rs. 23.7 billion. The trade deficit had increased by 24.2 percent last year. Trade deficit with India, which had recorded a rise of 21.1 percent last year, declined by 6.4 percent this year. Trade deficit with other countries narrowed down by 23.8 percent in contrast to the rise of 28.4 percent last year. Total trade, which had risen by 13.8 percent last year, grew by just 1.4 percent this year. Because of the increase in import from, and export to,

India and their declines with respect to other countries, the share of India in total trade went up to 62.2 percent from 55.4 percent last year. Correspondingly, the share of other countries in total trade decreased to 37.8 percent from 44.6 percent last year.



21.The overall export/import ratio, rose to 42.9 percent from 36.0 percent last year, reflecting the rise in exports and the fall in imports. The export/import ratios for India and other countries stood at 43.4 percent and 42.3 percent respectively compared to the respective ratios at 35.1 percent and 37.1 percent last year.

Balance of Payments

22. According to the BOP statistics for the first three months of FY 2004/05, trade deficit narrowed down by 14.2 percent to Rs. 16.7 billion due to the decline in imports and the growth in exports. Trade deficit had expanded by 28.8 percent last year. On the services front, receipts from government service increased by 34.8 percent to Rs. 1.8 billion. Travel receipts declined by 19.8 percent to Rs. 2.6 billion and other receipts fell by 17.8 percent to Rs. 1.5 billion. As a result, service receipts declined by 7.7 percent in contrast to the rise of 23.9 percent last year. Similarly, on the payments side, because of the increase in travel expenses and other expenses by 22.2 percent and 0.7 percent respectively and the decline in the transportation expenses by 5.2 percent, total expenses rose by 4.4 percent to Rs. 5.2 billion

23. Income receipts (credit) increased by 35.7 percent to Rs. 771.8 million while the income payments (debit) increased by 37.1 percent to Rs. 1.2 billion. As a result, the total deficit in goods, services and incomes accounts decreased by 10.5 percent to Rs. 16.4 billion as against a rise of 24.5 percent last year.

24. Under transfer receipts, foreign grants declined by 30.0 percent to Rs. 3.9 billion in contrast to a surge of 76.3 percent last year. The workers' remittances declined by 17.3 percent to Rs. 14.9 billion as against the rise of 13.7 percent last year. The decline in remittances resulted from the September 1st incident following the murdered of 12 Nepalese workers in Iraq. Pensions receipts increased by 97.7 percent to Rs.3.1 billion. Similarly, other transfer receipts (Indian excise refund) increased by 14.8 percent to Rs. 431.5 million. At the same time, transfer payments increased by 37.8 percent to Rs.862.9 million in contrast to the decline of 21.0 percent last year.

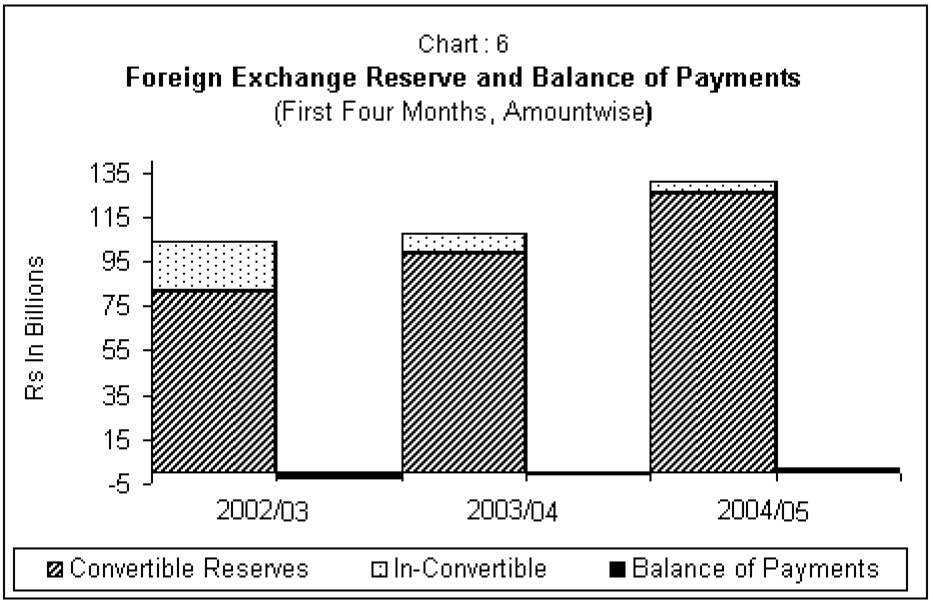
25. The current account recorded a surplus of Rs. 5.1 billion compared to the surplus of Rs. 6.5 billion last year. Capital transfer stood at Rs. 281.9 million compared to the sum of Rs. 592.1 million last year.

26. Under the financial account, other investment assets reached Rs. 5.9 billion compared to the sum of Rs. 13.9 billion last year. Of this amount, Rs. 857.3 million was on account of trade credits. Compared to Rs. 6.0 billion last year, other investment liabilities reached Rs. 818.9 million. Of this amount, Rs. 456.3 million was on account of trade credits. HMG received Rs. 620.1 million as loan and repaid Rs. 1.0 billion in amortization. As a result, the net government borrowing stood at negative Rs. 424.0 million. Currency and deposit liabilities went up by Rs. 815.6 million. Consequently, the financial account was negative by Rs. 5.1 billion. Despite the surplus in the current account, the BOP deficit was Rs. 1.0 billion, compared to a deficit of Rs. 1.5 billion last year, because of the negetive balance in financial account and outflow of miscellaneous capital. On the basis of the monetary statistics for the first four months of FY 2004/05, the BOP recorded a surplus of Rs. 2.0 billion in contrast to the deficit of Rs. 585.1 million last year.

Foreign Exchange Reserve

27. The gross foreign exchange reserve increased by 21.9 percent to Rs.131.1 billion in mid-November 2004 compared to an increase of 3.4 percent to Rs. 107.5 billion in mid-November 2003. The decline in imports from other countries and the rise in remittances through the banking channel were the factors responsible for the 27.8 percent growth in the convertible reserve. Inconvertible reserve fell by 42.6 percent due to the decline in both remittances and the net service income from India. Last year, the convertible reserve had increased by 20.4 percent while the inconvertible reserve had declined by 59.3 percent. The share of convertible reserve in the total reserve rose to 96.1 percent in mid-November 2004 from 91.6 percent in mid-November 2003, resulting in the corresponding fall in the share of

non-convertible reserve to 3.9 percent from 8.4 percent last year. The current reserve position is at a comfortable level sufficient to finance merchandise imports of 12.6 months and merchandise and service imports of 10.8 months.



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