Current Macroeconomic Situation of Nepal

(During the First Seven Months of FY 2004/05)

Nepal Rastra Bank

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Major Highlights

- Both narrow and broad money have expanded further.
- Time deposits continued to grow.
- Continuted deceleration in the net claims on government.
- The weighted average of treasury bills rates is on the rise.
- Upward movement in the stock exchange transactions correspondingly increased in NEPSE index .
- Upward trend in the rate of inflation, on a point-to-point basis.
- Increased in the cash flow based government expenditure.
- The increase in the resource mobilization outpaced the pace of increase in the government expenditure, resulting in the budget surplus.
- Decline in imports results in the contraction of trade deficit.
- Balance of payments (BOP) recorded a surplus.
- Gross foreign exchange reserve increased to Rs.128.6 billion, which is sufficient to cover merchandise imports of 12.3 months and merchandise and service imports of 10.4 months.

Current Macroeconomic Situation of Nepal

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

Monetary Situation

1. **Monetary Aggregates:** During the first seven months of FY 2004/05, broad money (M_2) increased by 5.1 percent to Rs. 291.4 billion, compared to a 6.8 percent growth in the corresponding period last year. This year, narrow money (M_1), increased by 4.0 percent to Rs. 97.7 billion compared to an increase of 2.8 percent last year. The increase in monetary aggregates this year is attributable to the rise in net domestic assets (NDA). Time deposits went up by 5.7 percent to Rs. 193.7 billion this year in comparison to the rise of 8.9 percent last year. The broad money liquidity M_3 (M_2 and foreign currency deposits) increased by 4.7 percent to Rs. 312.6 billion this year compared to an increase of 7.0 percent last year.

2. **Factors Affecting Monetary Aggregates:**

a) Net Foreign Assets: The NFA of the monetary sector (adjusting the foreign exchange valuation) went up by 2.7 percent to Rs. 106.9 billion this year compared to an increase of 11.8 percent last year. The receipt of Rs. 5.5 billion PRSP loan last year and the decline in remittance income, service income and foreign grants this year were responsible for slowdown in the NFA.

b) Claims on Government: Due to the rise in the government deposits with NRB, the net claims on government declined by 5.9 percent to Rs. 58.6 billion this year compared to a much larger decline of 13.0 percent last year.

c) Claims on Government Enterprises: In contrast to a 12.8 percent fall last year, monetary sector's claims on non-financial institutions increased by 21.0 percent to Rs. 3.5 billion this year, due mainly to the upsurge in credit to the Nepal Oil Corporation (NOC) from commercial banks. Monetary sector's claims on financial institutions declined by 4.9 percent to Rs. 12.7 billion compared to an increase of 8.9 percent last year, due mainly to the repayment of refinance to NRB by rural development banks and development banks.

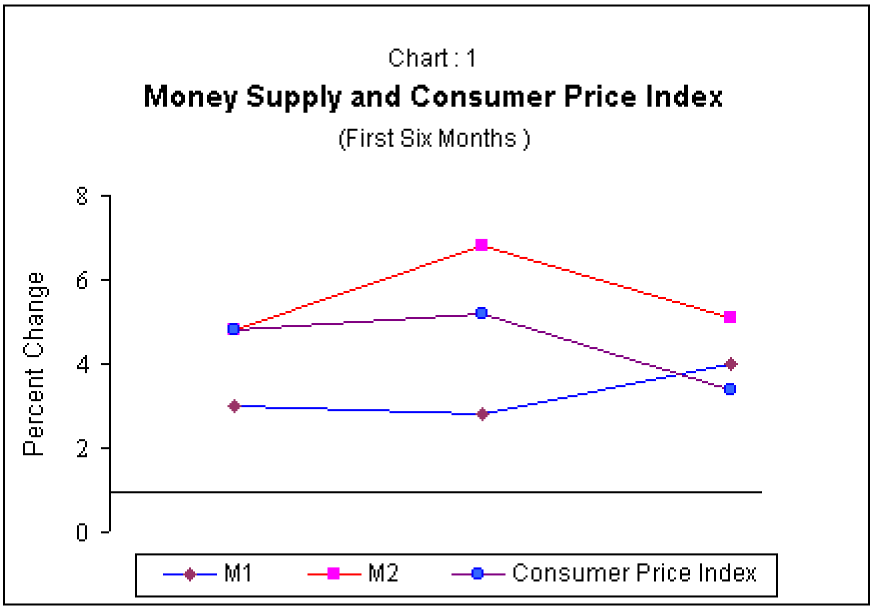
d) Claims on Private Sector: Monetary sector's claims on private sector increased by 8.7 percent to Rs. 187.6 billion this year, compared to an increase of 8.0 percent last year. Intensified flow of consumption loans by commercial banks as well as construction activities in major urban areas led to the rise in the claims on private sector.

e) As a result domestic credit of the monetary sector increased by 4.5 percent to Rs. 262.4 billion this year compared to an increase of 2.0 percent last year. The share of the government in total domestic credit this year decreased by 1.1 percentage points to 22.3 percent.

f) Net non-Monetary Liabilities and Net Domestic Asset: Net non-monetary liabilities (adjusting the foreign exchange valuation) increased marginally by 0.1 percent to Rs. 77.8 billion this year compared to the decline of 1.9 percent last year. The NDA (adjusting the foreign exchange valuation) increased by 6.6 percent to Rs. 184.5 billion compared to an increase of 3.9 percent last year. The expansion in domestic credit accounted for a relatively higher growth of NDA this year compared to the preceding year.

3. **Money multipliers:** Both narrow and broad money multipliers depicted slightly upward movements in the review period of this year in comparison to the last year. Narrow money multiplier went up to 1.117 this year from 1.072 last year. Broad money multiplier rose to 3.330

this year from 3.270 last year. The reduction in the Cash Reserve Ratio (CRR) as well as lowering down of excess liquidity ratio by commercial banks explain the rise in both money multipliers.

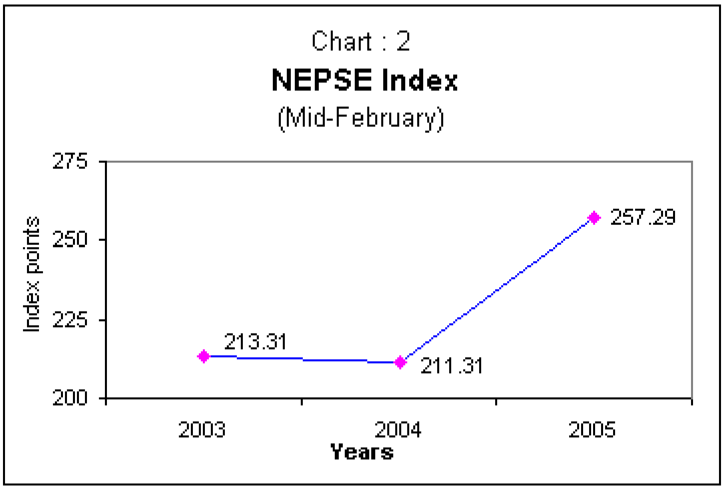


4. **Open Market Transactions:** NRB mopped up Rs.10.5 billion liquidity by means of sale auction and injected Rs.1.1 billion byway of purchase auction this year. NRB released the liquidity of Rs.5.5 billion by repo auction this year. During the same period, NRB mopped up the liquidity of Rs.4.1 billion by reverse repo. Similarly, NRB provided Rs. 28.8 billion standing liquidity facilityin cumulative terms to the commercial banks. Thus, the liquidity amounting to Rs.14.6 billion was mopped and Rs 35.4 billion released resulting in the release of net liquidity amounting to Rs.20.8 billion through secondary open market opretions.

   NRB intervened in the foreign exchange market to purchase US$ equivalent of Rs.20.9 billion, and sell Rs. 2.8 billion injecting net liquidity of Rs.18.1 billion this year. However, the excess liquidity of commercial banks declined due to the open market operation and expansion in banking credit to private sector. As a result, the 91-day weighted average treasury bills increased to 2.94 percent in mid-February 2005 from 0.62 percent in mid-August 2004.

Share Market Transactions

5 Total share transactions in terms of both value and number increased significantly during the month ending mid-February 2005 compared to the same month last year. Among the share market indicators, the share price, the number of companies listed and market capitalization all increased simultaneously. The secondary market transaction is the scrips of commercial banks, development banks and finance companies as well as the manufacturing and processing companies increased. The total amount of listed shares increased by 20.0 percent to Rs 15.4 billion due to new listing and issue of bonus shares by some banks, manufacturing and processing companies and insurance companies in the review month compared to the same month last year. The market capitalization of the listed companies rose by 36.0 percent to Rs 53.2 billion. The NEPSE index increased by 46.0 index points (21.8 percent), from 211.3 at the closing of the exchange market in mid-February 2004 to 257.3 in mid-February 2005. The number of companies listed increased to 123 in mid-February 2005 from 111 in mid-February 2004. Similarly, the number of companies traded increased to 83 from 68 last year.



6. In the review month, the value of share transactions increased to Rs. 145.7 million, with 672 thousand shares exchanged through 7802 transactions. In the same month last year, the total value of share transaction was Rs 67.8 million when 284 thousand shares were traded through 7485 transactions. Thus, the total transactions in terms of value and number of shares increased by 1.4 times and 2.2 times respectively in the review month.

7. Of the total exchanged value in the review month, the share components were: commercial banks (70.3 percent), finance companies (24.0 percent), insurance companies (2.0 percent), development banks (0.7 percent), hotels (0.5 percent), manufacturing and processing companies (0.1) percent) and other groups of companies (2.4 percent), as compared to the components in the same period last year, which were: commercial banks (57.9 percent), finance companies (31.4 percent), insurance companies (5.3 percent), manufacturing and processing companies (3.3 percent) development banks (0.9 percent), hotels (0.3 percent) and other groups companies (0.9 percent)

Price Situation

8. The National Urban Consumer Price Index (CPI), on point-to-point basis, rose by 5.6 percent in mid-February 2005 compared to an increase of 4.7 percent last year. Despite the decline in the price indices of spices, vegetables and fruits, oil and ghee and milk and milk products, the overall CPI increased further due to the growth in the price index is mainly attributable to the upward revision in the prices of petroleum products together with the sharp rise in the price of sugar and related products, housing goods and services, transport and communication, meat, fish and eggs. The overall price index, increased from 152.7 in mid-February 2004, to 161.3 in mid-February 2005. The average growth rate for the first seven months slowed down to 3.4 percent compared to the rise of 5.2 percent last year.

9. On point-to-point basis, the prices of food and beverages group moved up by 4.1 percent. This is comparable to an increase of 4.0 percent last year. The prices of sugar and related products shot up by 39.1 percent. Products that recorded increased prices are meat, fish and eggs (9.8 percent), restaurant meals (6.1 percent), pulses (5.2 percent), grains and cereal products (4.7 percent) and beverages (3.1 percent). However, the prices that declined were those of spices (3.9 percent) vegetables and fruits (2.7 percent), oil and ghee (1.4 percent) and milk and milk products (0.3 percent).

10. The prices of non-food and services group increased at a faster pace of 7.2 percent compared to an increase of 5.7 percent last year. The prices that increased were those of housing goods and services (14.2 percent), transport and communication (12.4 percent), education, reading and

recreation (4.5 percent), tobacco and related products (2.7 percent), cloth, clothing and sewing services (2.6 percent), footwear (1.3 percent) and medical and personal care (1.0 percent).

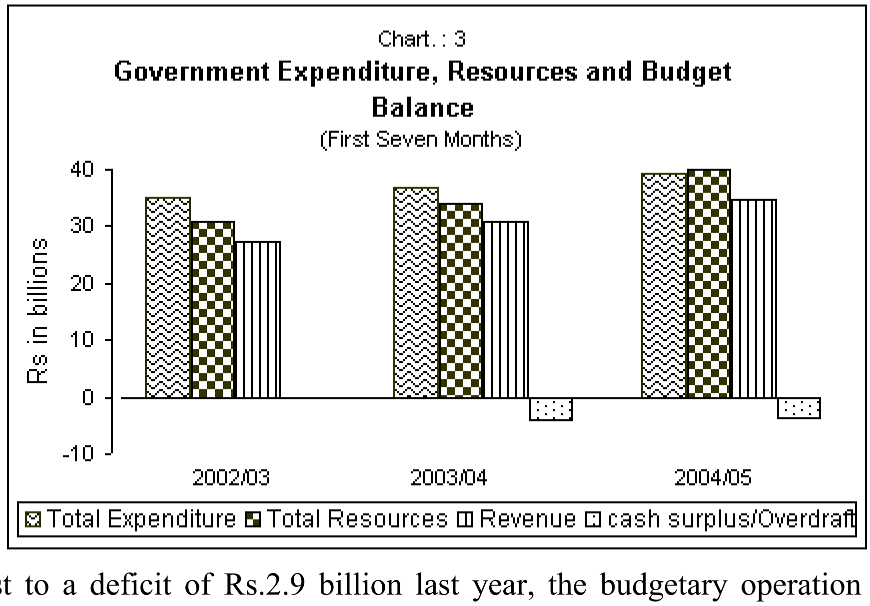
11. Regionwise, the prices in the Kathmandu Valley, Terai and Hills increased by 6.3 percent, 5.9 percent and 5.1 percent respectively. Such prices had increased by 6.8 percent, 3.8 percent and 3.9 percent respectively last year. The prices of food and beverages group rose in Kathmandu Valley, Terai and Hills by 5.6 percent, 3.1 percent and 4.1 percent respectively. Similarly, the prices of non-food and services group increased in the Kathmandu Valley, Terai and Hills by 6.9 percent, 7.1 percent and 7.9 percent respectively.

12. The National Wholesale Price Index, on point-to-point basis, increased by 7.2 percent compared to an increase of 5.2 percent last year. The growth in the prices were mainly attributable to the rise in the prices of petroleum products and coal, chemical fertilizer and chemical goods, construction materials as well as foodgrains in spite of the decline in the price of fruits and vegetables, spices as well as pulses. The prices for imported commodities, domestic manufactured commodities and agricultural commodities increased by 13.7 percent, 5.6 percent and 3.5 percent respectively. The average National Wholesale Price Index for the first seven months of this year increased at a relatively faster pace of 6.0 percent compared to the rise of 4.5 percent last year.

Government Budgetary Operation

13. In the absence of previous fiscal year's data according to the new expenditure classification into recurrent, capital and principal repayment, only the current year's data have been presented. Based on the cash flow data, the total expenditure of the government increased by 6.6 percent to Rs. 39.5 billion compared to the rise of 5.9 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 28.6 billion (72.4 percent), capital expenditure at Rs. 4.3 billion (10.9 percent) and principal repayment at Rs. 5.2 billion (13.2 percent). Expenditure under freeze account recorded a fall of 3.5 percent to Rs. 1.4 billion.

14 Total non-debt resources (revenue, non-budgetary receipts and others, and foreign grants) increased by 16.9 percent to Rs. 39.8 billion compared to the rise of 10.6 percent last year. Revenue, the major source (87.4 percent) of the government resources, grew by 13.1 percent to Rs. 34.8 billion compared to the rise of 12.6 percent last year. Foreign grants increased to Rs. 3.9 billion compared to Rs. 2.2 billion received last year.



15. In contrast to a deficit of Rs.2.9 billion last year, the budgetary operation in the review period resulted in a surplus of Rs. 362.1 million. HMG mobilized Rs. 1172.2 million

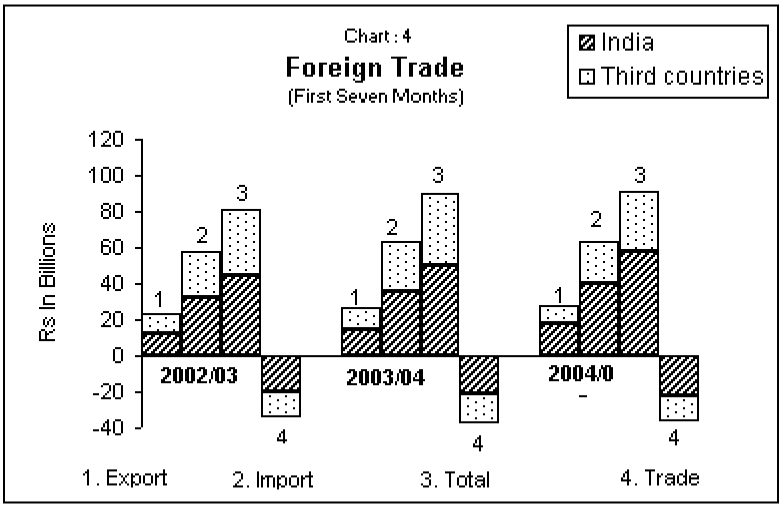
through foreign cash loans and internal borrowing amounting to Rs. 2.2 billion. HMG's cash transactions in mid-Fabruary 2005 resulted in a surplus of Rs. 3.8 billion compared to a surplus of Rs. 4.2 billion in mid-Feruary 2004.

16. Due mainly to the faster rise in non-debt resources compared to the total government expenditure, the total net outstanding domestic debt of the government declined to Rs. 82.0 billion in mid-Fabruary 2005 from Rs. 85.4 billion in mid-July 2004, as reflected in the Treasury position of Rs. 4.5 billion surplus in mid-Fabruary 2005 compared to the surplus of Rs. 753 million in mid-July 2004.

Foreign Trade

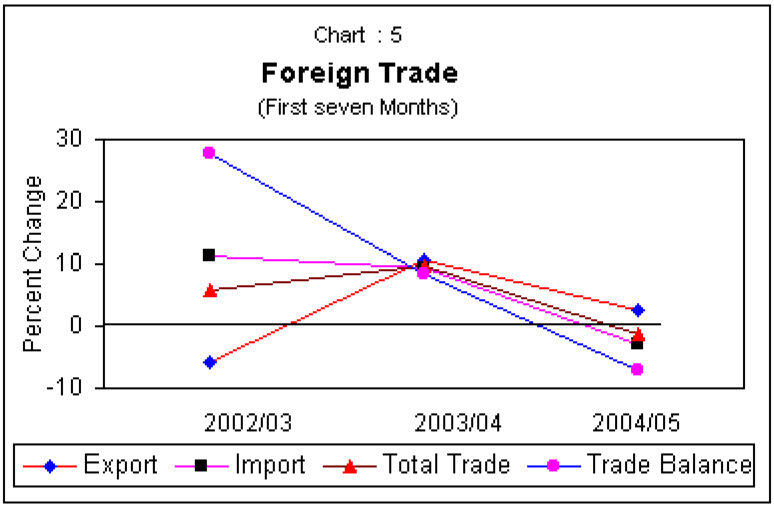
17. Total exports increased by 2.7 percent to Rs. 32.2 billion compared to a much larger rise of 10.5 percent last year. Exports to India increased considerably by 21.7 percent to Rs. 21.5 billion compared to the rise of 15.2 percent last year. Exports to other countries declined substaintially by 21.8 percent to Rs. 10.7 billion this year in contrast to the rise of 5.1 percent last year. Among the major exportable commodities, the exports of pulses, cardamom, vegetable ghee, tea, thread, jute goods, aluminium section, copper wire and rod, chemicals, juice, cattle feed, footwear, textiles, catechu and rosin to India increased. The exports to India of toothpaste, ginger, ricebran oil, G.I. pipe, M.S. pipe, zinc sheet and readymade garments declined. The exports to other countries of woollen carpets, tanned skin and cardamom went up while that of readymade garments, pulses, tea and jewellery declined.

18. Total imports fell by 3.0 percent to Rs. 72.9 billion as against the rise of 9.2 percent last year. Imports from India increased by 9.6 percent compared to the rise of 11.1 percent last year. However, imports from other countries registered a fall of 19.2 percent as against the growth of 6.9 percent last year. Imports of pulse, thread, chemicals, transport vehicles and parts, petroleum products, medicine, cold-rolled sheet, and plastic granules from India and that of edible oil, betel nut, telecommunication equipment and parts, transport vehicles and parts, other machinery and parts, steel wire, crude coconut oil, copper wire and sheets from other countries increased. However, the imports of wheat, rice, hot-rolled sheet, M.S. billet and cement from India and that of thread, crude soybean oil, crude palm oil, chemical fertilizers, plastic granules, aircraft equipment, electrical goods and textiles from other countries declined.



19. The growth of exports in comparison to the decline of imports led to a drop in the magnitude of trade deficit by 7.1 percent to Rs. 40.7 billion. The trade deficit had increased by 8.3 percent last year. Trade deficit with India, which had recorded a rise of 8.2 percent last year, increased marginally by 0.9 percent this year. Trade deficit with other countries declined by 17.4 percent in contrast to the rise of 8.3 percent last year**.** Total trade flows, which had increased by 9.6

percent last year, declined marginally by 1.3 percent this year. Because of 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 64.5 percent from 56.2 percent last year while the share of other countries in total trade decreased to 35.5 percent from 43.8 percent last year.



20. The overall export/import ratio, which was 41.8 percent last year, rose to 44.2 percent this year primarily due to the rise in exports and the fall in imports. The export/import ratios for India and other countries stood at 46.5 percent and 40.3 percent respectively compared to the respective ratios at 41.9 percent and 41.6 percent last year.

Balance of Payments

21. According to the BOP statistics for the first six months of FY 2004/05, trade deficit went down by 2.2 percent to Rs. 34.2 billion because of a relatively higher growth in exports. Trade deficit had expanded by 9.5 percent last year. On the services front, receipts from government service increased by 22.5 percent to Rs. 3.2 billion. While travel receipts declined by 17.0 percent to Rs. 6.0 billion, other receipts increased by 5.6 percent to Rs. 3.9 billion. As a result, service receipts declined by 3.1 percent in contrast to the rise of 15.5 percent last year. Similarly, on the payments side, because of the increase in expenses on travel, transportation, and others by 43.3 percent, 4.2 percent and 23.7 percent, respectively, total expenses rose by 21.1 percent to Rs. 11.9 billion.

22. Income receipts (credit) soared by 55.4 percent to Rs. 2.2 billion while the income payments (debit) increased by 8.0 percent to Rs. 2.9 billion. As a result, the total deficit on goods, services and income increased by 3.5 percent to Rs. 33.7 billion as against a rise of 9.6 percent last year.

23. Under transfer receipts, foreign grants declined by 9.9 percent to Rs. 9.4 billion in contrast to a surge of 52.6 percent last year. Pensions receipts increased by cent percent to Rs. 5.8 billion. Similarly, other transfer receipts (Indian excise refund) increased by 17.8 percent to Rs. 1.0 billion. At the same time, the transfer payments increased by 26.3 percent to Rs.1.6 billion compared to the decline of 19.3 percent last year.

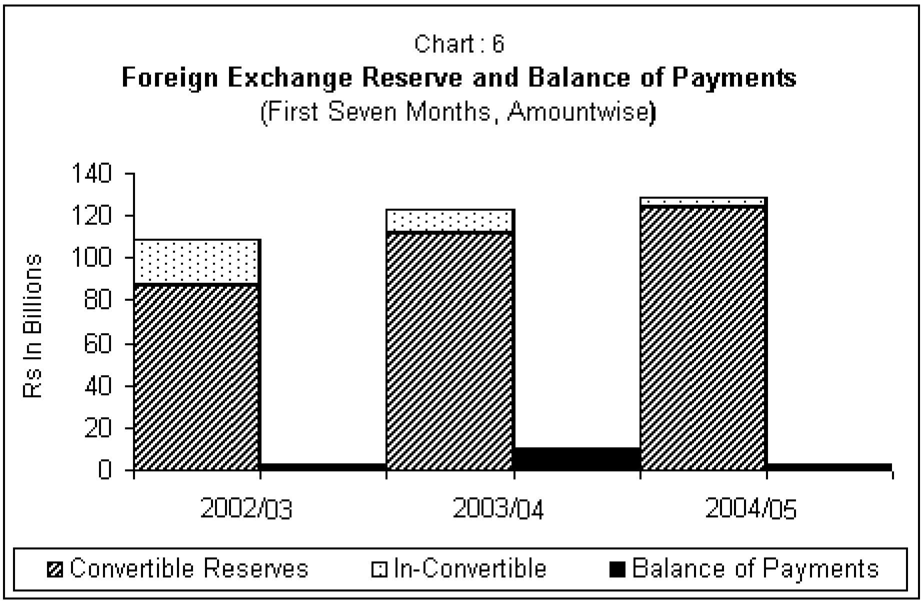
24. Current account continued to record a surplus of Rs. 10.8 billion compared to the surplus of Rs. 11.4 billion last year. Capital transfer stood at Rs. 671.4 million in comparison to the level of Rs. 969.9 million last year.

25. Under the financial account, other investment assets stood at Rs. 13.4 billion compared to the sum of Rs. 21.1 billion last year. Of this amount, Rs. 893.2 million was on account of trade credits. Compared to Rs. 11.2 billion last year, other investment liabilities turned into a

negative sum of Rs. 2.2 billion this year. Of this amount, Rs. 426.9 million was on account of trade credits. HMG received Rs. 1.4 billion as loan and repaid Rs. 3.2 billion in amortization. As a result, the net government borrowing stood at a negative of Rs. 1.7 billion. Currency and deposit liabilities dropped by Rs. 21.3 million. Consequently, the financial account resulted into a negative sum of Rs. 15.7 billion. Because of the surplus in the current account and the inflow of miscellaneous capital, the overall BOP continued to remain in surplus to the extent of Rs. 5.6 billion in comparison to a surplus of Rs. 8.6 billion last year. Based on the monetary statistics, a BOP surplus squeezed down to Rs. 2.9 billion in mid-February 2005 compared to a much larger surplus of Rs. 10.8 billion in mid-February 2004.

Foreign Exchange Reserve

26. The rate of growth of gross foreign exchange reserve slowed down to 5.0 percent (Rs.128.6 billion) in mid-February 2005 compared to an increase of 12.3 percent to Rs. 122.5 billion in mid-February 2004. The decline in imports from other countries and the rise in remittances through the banking system were the factors responsible for the 11.2 percent growth in the convertible currency reserves. Inconvertible reserve fell by 55.6 percent in consequence to the decline in both remittances and net services income from India. Last year, the convertible reserve had increased by 27.7 percent while the inconvertible reserve had declined by 48.6 percent. The share of convertible reserve in the total reserve rose to 96.1 percent in mid-February 2005 from 90.8 percent in mid-February 2004, resulting in the corresponding fall in the share of the non-convertible reserve to 3.9 percent from 9.2 percent. Sufficient to finance merchandise imports of 12.3 months and merchandise and service imports of 10.4 months, the current reserve position is at a comfortable level.



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