Current Macroeconomic Situation
(Based on Data of the First Month of 2005/06)

Nepal Rastra Bank

October 2005

www.nrb.org

Executive Summary

Monetary Situation

1. During the first month of 2005/06, both monetary aggregates have declined. The decline in net borrowing of the government from the banking sector and fall in claims on non-financial government enterprises accounted for the decrease in monetary aggregates in the review period.

Share Market Transactions

2. The NEPSE index increased by 59.5 index points (24.2 percent) to 300.05 in mid August 2005. The other share market indicators such as the share price, the number of listed companies and market capitalization also increased.

Price Situation

3. The National Urban Consumer Price Index, on a point-to-point basis, increased at a higher rate of 7.3 percent in mid-August 2005, compared to an increase of 2.4 percent in the corresponding month of the previous year. The rise in the prices of rice and rice related products and upward revision in the prices of petroleum products since January 2005 were the factors responsible for the overall rise in the price index.

4. The National Wholesale Price Index (Base year 1999/00=100) on a point-to-point basis increased by 9.3 percent in mid-August 2005. Such index had increased by 6.8 percent in the corresponding month of the preceding year.

Government Budgetary Operation

5. Based on the cash flow data of first month of 2005/06, the total expenditure of the government increased by 15.0 percent to Rs. 3.5 billion. In the corresponding month of the previous year, such expenditure had risen by 6.2 percent.

6. Total non-debt resources (revenue, non-budgetary receipts, others, and foreign grants) increased by 27.7 percent to Rs. 6.7 billion in mid-August 2005 compared to a significant rise of 52.0 percent last year. Despite the satisfactory increase in foreign grants, the mobilization of non-debt resources decelerated primarily due to lower increment in revenue mobilization.

7. The government budget surplus, during this period increased by 45.3 percent to Rs. 3.2 billion. In the comparable period last year, budget surplus had increased by 279.4 percent to Rs. 2.2 billion.

8. The total net outstanding domestic debt of the government declined to Rs. 86.6 billion in mid-August 2005 from Rs. 90.0 billion in mid-July 2005. The cash balances of the government with NRB brought down the total net outstanding domestic debt during the review period.

Foreign Trade

9. Based on customs data, of the first month of 2005/06, total exports and total imports increased by 15.6 percent 34.4 percent respectively. In the comparable period last year, exports and imports had increased by 22.5 percent and 5.8 percent respectively. In the review month, trade deficit increased by 49.5 percent due to higher growth rate of imports than that of exports.

10. The share of India in total trade declined to 63.2 percent in mid-August 2005 from 64.3 percent a year ago.

Balance of Payments

11. On the basis of monetary survey, the overall BOP surplus stood at Rs. 427.5 million in the first month of 2005/06. In the comparable month, last year BOP deficit had amounted to Rs. 2.7 billion. The higher inflows of foreign assistance and remittances accounted for a surplus in BOP this year.

Foreign Exchange Reserves

12. The gross foreign exchange reserves went up by 4.0 percent to Rs.132.2 billion in mid-August 2005. Of this, the convertible currency reserve rose by 8.8 percent and non-convertible currency declined by 40.0 percent.

13. The current reserve has a comfortable position to finance merchandise imports of 9.8 months and merchandise and service imports of 8.5 months.

Price of Oil and Gold in the International Market

14. In the international market, the price of oil (Crude Oil Brent) reached US$ 66.70 per barrel on August 15, 2005 from US$ 45.13 a year ago. The price of gold increased to US$ 443.50 per ounce on August 15, 2005 from US$ 401.65 a year ago.

Current Macroeconomic Situation
(*Based on Data of the First Month of 2005/06*)

Monetary Situation

1. During the first month of 2005/06, both broad money (M_2) and narrow money (M_1) have declined. Despite a marginal increase in net foreign assets (NFA), which had shrunken during the first month last year, a faster decline in credit flow to the HMG as well as the financial and non-financial government enterprises than that in the corresponding month last year, coupled with a marginal decline in credit to private sector led to a reduction in monetary aggregates in the review period.

2. During the first month of 2005/06, M2 declined by 0.3 percent to Rs. 299.4 billion. M_2 had declined by 1.2 percent in the corresponding period of the previous year. Similarly, M_1 declined by 4.5 percent to Rs. 95.7 billion in the review period. The contraction in monetary aggregates in the review period was due to decline in monetary sector's claims on HMG's as well as government enterprises and private sector.

3. NFA, an expansionary factor of money supply, increased marginally by 0.4 percent (Rs. 427 million) in the review period as against a decline of 2.4 percent in the previous year. Increase in foreign grants and loans in the review period led to such an increase in net foreign assets.

4. Domestic credit of monetary sector witnessed a further decline relative to that of last year. In the review period, the net claims of monetary sector on government declined by 4.9 percent. Such a decline in claims on government was attributed to the cash surplus of HMG with Nepal Rastra Bank (NRB) due to increase in the government's non-debt resources relative to government expenditure. Similarly, the monetary sector's claims on non-financial government enterprises declined by 16.4 percent as against a significant increase of 35.1 percent last year. Monetary sector's claim on government financial enterprises declined by 4.1 percent compared to a decrease of 1.0 percent in the previous year. Such a decline in claims on government financial enterprises was attributed to the repayment of some loan by Nepal Industrial Development Corporation to NRB and by rural development banks to commercial banks.

5. The main component of the monetary sector credit, claims on private sector also observed a marginal decline of 0.2 percent to Rs. 196.7 billion as against an increase by 1.7 percent in the first month of the previous year. Such a decline in credit to private sector was attributed to the slowdown in demand for credit from private sector due to slackness in economic activities and an increase in credit recovery of commercial banks due to the new provisions introduced for black listing of the willful defaulters.

6. Due to the decline in claims on HMG as well as financial and non -financial government enterprises and a marginal decrease in claims on private sector, total

domestic credit expansion declined by 1.8 percent to Rs. 279.8 billion compared to a marginal decline of 0.1 percent in the previous year.

7. Time deposit of the banking system which has a dominant share in M2, increased by 1.7 percent compared to an increase of 1.6 percent in the previous year. The increased inflow of remittances contributed to such a marginal rise in time deposits.

8. Net non-monetary liability, a contractionary factor of money supply, decreased by 4.1 percent to Rs. 89.2 billion. Such liabilities had increased by 0.7 percent in the previous year. An increase in non-financial assets of commercial banks contributed to the decline in net non-monetary liabilities. Despite a decline in net non-monetary liabilities, net domestic assets declined by 0.8 percent in the review period due to the contraction in total domestic credit.

9. Of the two proximate determinants of money supply, the growth of reserve money decelerated slightly while the value of money multiplies increased in the first month of 2005/06. Reserve money decreased by 6.5 percent as compared to a decrease of 7.0 percent in the previous year. A decline in NFA of NRB on source side and demand for excess liquidity by commercial banks on demand side accounted for a decrease in reserve money.

10. The value of money multipliers increased in the review period as in the previous year. The narrow money multiplier increased by 2.2 percent to 1.06 and the broad money multiplier increased more sharply by 6.6 percent to 3.32 in the review period. The increase in multipliers was attributed to the decline in excess reserve of commercial banks.

11. The weighted average treasury bills rate increased to 2.3 percent compared to 0.6 percent in the pervious year. A significant decline in excess reserves of commercial banks led to a rise in treasury bills rate in the review period. Similarly, the weighted average inter bank transaction rate also rose to 2.468 percent in the first month of 2005/06 compared to 1.016 percent in the previous year. In response to these developments, NRB intervened in foreign exchange market and injected additional liquidity amounting to Rs 1.7 billion by purchasing equivalent amount of US dollar from the foreign exchange market.

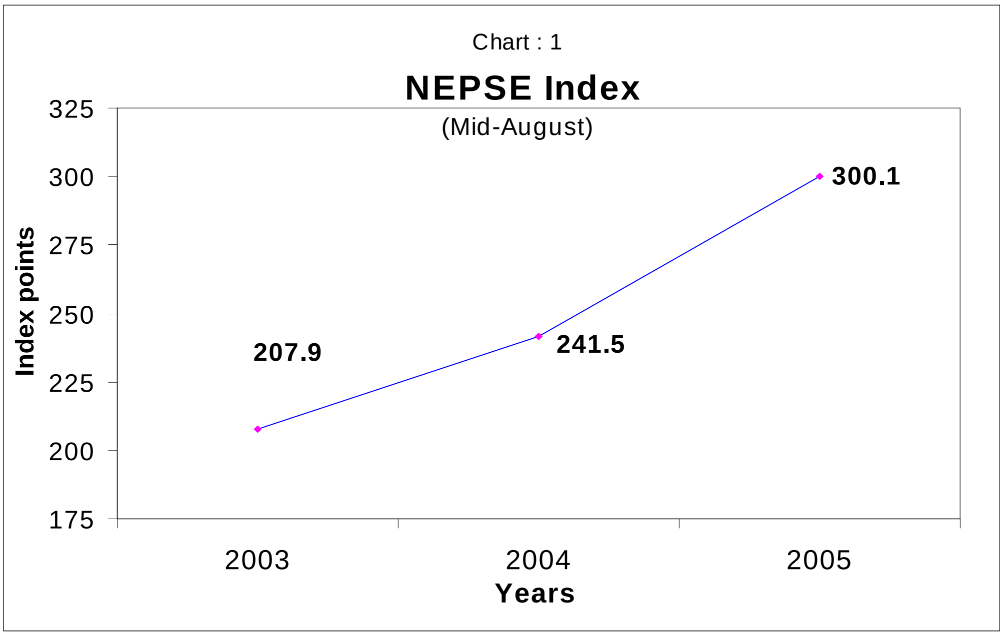
Share Market Transactions

12. The NEPSE index increased by 59.5 index points (24.2 percent) to 300.05 in mid August 2005. The index was 241.51 point in mid-August 2004. The share market indicators such as the share price, the numbers of listed companies and market capitalization have also increased.
13. Total transactions in terms of quantity of shares increased slightly, however, in terms of value it markedly decreased in mid-August 2005 compared to the same month last year. Total transactions in terms of value decreased by 57.2 percent while the number of share transacted increased by 5.2 percent in the review month compared to the same month last year. An increment in the transaction of the listed companies in NEPSE was attributable for the increment in the number of shares in the review year. Similarly, a decline in the transaction value is mainly due to the decline in

the share transaction of the commercial banks. The secondary market transaction of almost all the groups of companies increased except for commercial banks, trading and hotel group.

14. The number of listed companies in Nepal Stock Exchange increased to 125 in mid-August 2005 from 115 in mid-August 2004. Paid up capital of listed companies increased by 34.0 percent to Rs. 16.8 billion in the review month due to new listing and issuance of bonus shares by some banks, finance companies and insurance companies. The number of companies traded in NEPSE rose to 87 in the review year from 78 in last year. The market capitalization of the listed companies increased by 38.8 percent (Rs. 17.9 billion) to Rs. 64.2 billion compared to that of the same period last year.

15. In the review month, the value of share transaction declined to Rs. 289.3 million. During this month a total number of 887 thousand shares were exchanged through 10239 transactions. The total value of share transactions in August 2004 was worth Rs. 676.3 million when 843.2 thousand shares were traded through 6046 transactions in the same month of the last year.



Sectoral Contribution to Total Transaction

16. Of the total transacted share value in the review month, sectoral contribution of commercial banks, finance companies, insurance companies, development banks were found to be at the higher profile, i.e. 84.9 percent, 8.8 percent, 4.4 percent, and 1.3 percent respectively. However, manufacturing and processing companies, hotel and trading group's performance remained less satisfactory in this regard and thereby failed to contribute much in share market in the review month of this year. Commercial banks and finance companies had played a significant role in the share market transactions contributing 97.5 percent and 1.7 percent respectively of the total exchanged value in the same month last year.

Price Situation

(a) National Urban Consumer Price Index

17. The National Urban Consumer Price Index, on a point-to-point basis, increased at a higher rate of 7.3 percent as at mid-August 2005, compared to an increase of 2.4 percent during the same period last year. The sharp rise in the prices of grains and cereal products as a result of price rise in rice and rice related products, in conjunction with the increase of the prices of housing goods and services, transport and communication and restaurant meals resulting from the upward revision in the prices of petroleum products since January, 2005 are mainly attributable to the overall rise in the price index. In the review period, the rise in the prices of restaurant meals, education, reading and recreation, beverages, meat, fish and eggs as well as sugar and related products also exerted upward pressure upon the price index.

18. In the review period, on a point-to-point basis, the index of food and beverages group moved up by 6.6 percent compared to an increase of 2.8 percent during the same period last year. The rise in the prices of grains and cereals products, restaurant meals, beverages, meat, fish and eggs, sugar and related products and milk and milk product pushed up the index of this group. The indices of sugar and related products (13.3 percent), grains and cereal products (11.0 percent), beverages (10.1 percent), restaurant meals (8.6 percent), pulses (5.3 percent), meat fish and egg (4.3 percent), milk and milk products (3.8 percent) and vegetables and fruits (2.1 percent) increased in the review period. However, the indices of spices (- 4.8 percent) and oil and ghee (- 2.7 percent) declined in the review period.

19. The index of non-food and services group increased by 8.0 percent compared to an increase of 2.0 percent during the same period last year. The rise in the price index of this group is mainly attributable to the rise in the prices of petroleum products, which exerted an upward pressure in the price of transport and communication as well as housing goods and services. All of the subgroups under non-food and services group recorded an increase in the review period. The indices of transport and communication increased by 16.0 percent, housing goods and services by 13.3 percent, education, reading and recreation by 5.8 percent, tobacco and related products by 5.6 percent, cloth clothing and sewing services by 2.9 percent, footwear by 2.6 percent and medical and personal care by 2.2 percent in the review period.

20. Region wise, the price indices of the Kathmandu Valley, Terai and Hills in the review period increased by 6.1 percent, 7.4 percent and 8.7 percent, respectively. During the corresponding period last year, those indices had increased by 4.0 percent, 1.8 percent, and 1.3 percent, respectively.

(b) National Wholesale Price Index

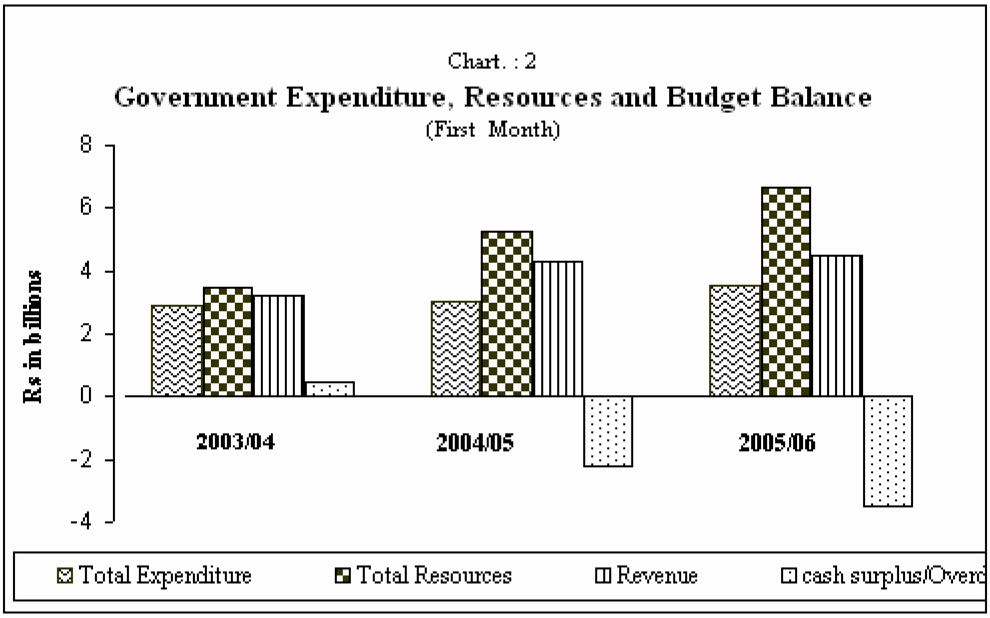
21. The National Wholesale Price Index (Base year 1999/00=100) as at mid-August 2005 stood at 133.5. This represented a rise of 9.3 percent on a point-to-point basis. Such index had increased by 6.8 percent during the corresponding period last year. The higher growth in the price index is mainly attributable to the rise in

the prices of food grains, livestock products, chemical fertilizer and chemical goods together with the sharp rise in the prices of petroleum products, as against the decline in the prices of spices and textile related products. The indices of agricultural, domestic manufactured and imported commodities increased by 9.9 percent, 4.0 percent and 11.7 percent respectively in the review period.

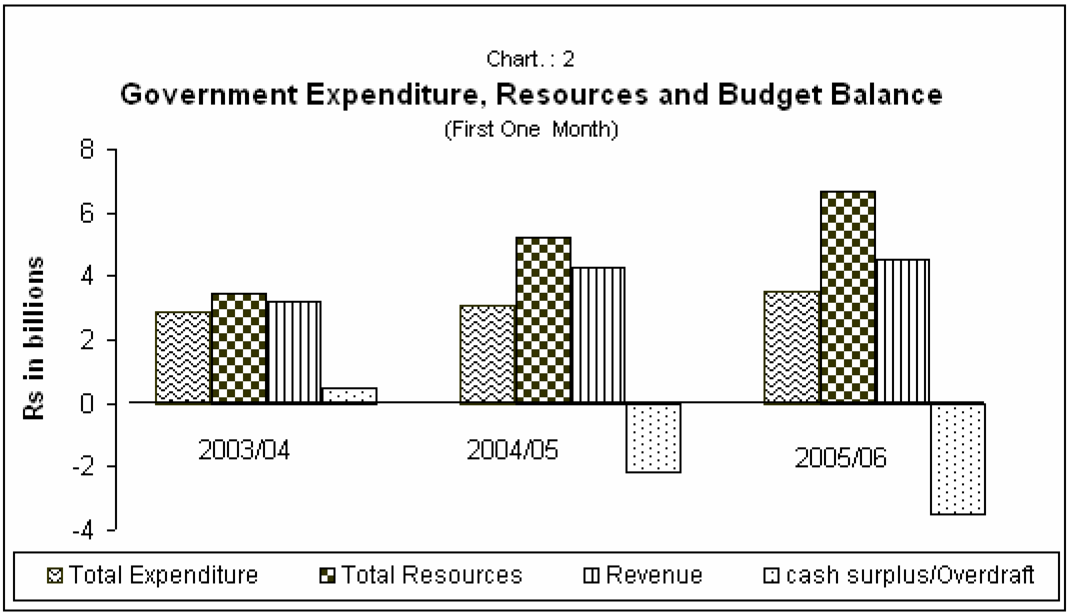
Government Budgetary Operation

22. Based on the cash flow data of first month of the 2005/06, the total expenditure of the government increased by 15.0 percent to Rs. 3.5 billion compared to a much lower rise of 6.2 percent during the same period last year. Of the total expenditure, recurrent expenditure stood at Rs. 1.1 billion (32.5 percent) and principal repayment at Rs. 163.4 million (4.7 percent). Expenditure under freeze account, which recorded a rise of 59.2 percent to Rs. 2.2 billion accounted for 63.1 percent of the total expenditure.

23. Total non-debt resources (revenue, non-budgetary receipts, others, and foreign grants) increased by 27.7 percent to Rs. 6.7 billion compared to a substantial rise of 52.0 percent last year. Revenue, the major source (67.3 percent share) of government resources, grew just by 5.5 percent to Rs. 4.5 billion compared to an impressive rise of 33.5 percent last year. Foreign grants recorded higher growth of more than five folds (405.2 percent) to Rs.1.2 billion compared to Rs. 242.8 million received last year.



24. Due to the higher growth in non-debt resources relative to government expenditure, the government budget surplus, during this period increased by 45.3 percent to Rs. 3.2 billion compared to that of last year. HMG mobilized Rs. 305.0 million funds through foreign cash loans. After adjusting Rs. 10.2 million on the other account of the government a cash surplus of Rs. 3.5 billion on the government account occurred. There was also a cash surplus of Rs. 2.2 billion on the government account during the same period last year.



25. The total net outstanding domestic debt of the government declined to Rs. 86.6 billion in mid-August 2005 from Rs. 90.0 billion in mid-July 2005, as reflected in the cumulative surplus treasury position of Rs. 1.0 billion in mid-August 2005 compared to the deficit of Rs. 2.5 billion in mid-July 2005. This was principally attributed to a higher rise in non-debt resources compared to the total government expenditure.

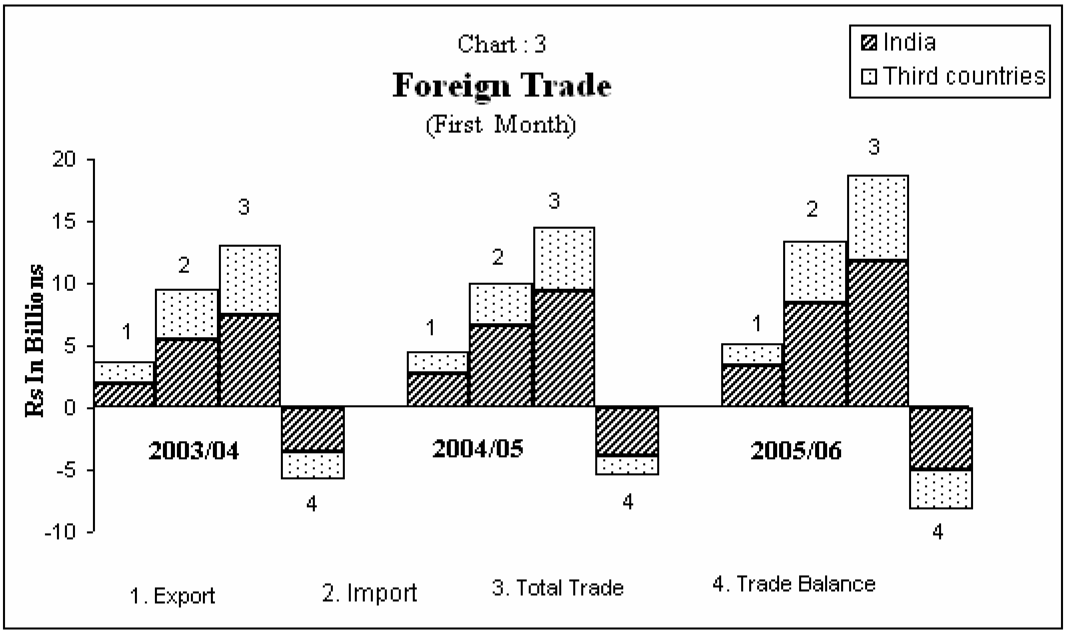
Foreign Trade

26. Based on customs data, in the first month the current fiscal year, total exports increased by 15.6 percent to Rs. 5.2 billion and total imports increased by 34.4 percent to Rs. 13.5 billion. As a result, imbalance worsened by 49.5 percent to Rs. 8.3 billion. Consequently, total trade flows expanded by 28.6 percent. In the corresponding period of the previous year, exports had risen by 22.5 percent and imports by 5.8 percent resulting in a 4.6 percent decline in trade deficit while the total trade had gone up by 10.5 percent.

27. Exports to India rose by 23.1 percent to Rs. 3.4 billion this year compared to a rise of 37.3 percent last year. However, exports to other countries rose by just 3.9 percent to Rs. 1.8 billion this year. Among the principal commodities exported to India; the exports of tea, cardamom, vegetable ghee, noodles, plastic utensils, juice, G.I. sheet, G.I. pipe, brass sheet, polyester yarn, readymade garments, chemicals and textiles have increased, while the exports of toothpaste, ginger, ricebran oil, M.S. pipe and pashmina goods to India have declined. Similarly, the exports of pashmina to other countries went up while that of readymade garments, carpets and jewelery has declined.

28. In terms of the composition of total exports to India, primary goods and manufactured goods constituted 30.3 percent and 69.7 percent respectively while their respective shares were 22.9 percent and 77.1 percent last year. Likewise, the shares of primary products and manufactured goods in total export to other countries were 8.1 percent and 91.1 percent during the first month of this year

compared to the respective shares of 7.0 percent and 93.0 percent in the corresponding period of last year.



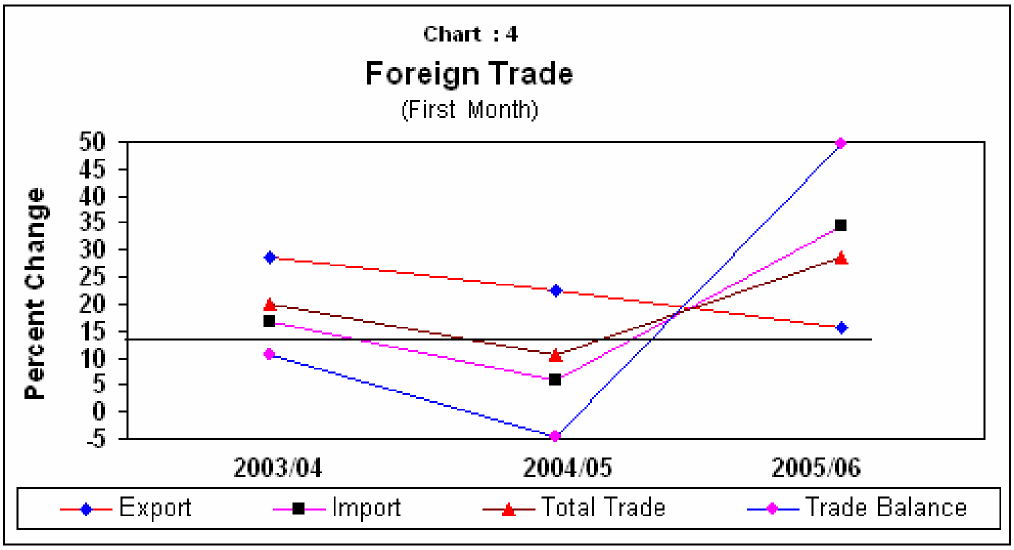
29. Imports from India accelerated by 28.1 percent compared to a rise of 19.8 percent last year. Imports from other countries surged by 46.4 percent in contrast to a decline of 13.3 percent in the previous year. Imports of rice, chemicals, thread, polythene granules, M.S. billet, MS wire rod, hot-rolled sheet, bitumen, readymade garments, and polyester yarn from India moved up while imports of medicine, textiles, transport vehicles & parts, electrical equipment & goods, chemical fertilizer and cold-rolled sheet went down. The imports of petroleum products remained at almost the same level as that of the previous year. Similarly, the imports of sugar, raw wool, textile dyes, polythene granules, thread, crude soybean oil, crude palm oil, steel wire, computer & parts, telecommunication equipment & parts, transport vehicles & parts, electrical equipment & goods, other machinery & parts and textiles from other countries rose while imports of crude coconut oil, chemical fertilizer, television, deck & parts and aircraft & parts declined.

30. With regard to the structure of imports from India, industrial raw materials & capital goods and petroleum products comprised 28.9 percent and 24.1 percent respectively, while the miscellaneous goods including consumer items comprised the rest (47 percent). Last year their respective shares were 41.2 percent, 30.7 percent and 28.1 percent, respectively. Similarly, the share of industrial raw materials and capital goods in total imports from other countries rose to 65.6 percent from 49.7 percent last year.

31. The share of India in total trade declined to 63.2 percent from 64.3 percent last year while the share of other countries increased correspondingly to 36.8 percent from 35.7 percent last year.

32. The overall export/import ratio dropped to 38.4 percent this year from 44.6 percent last year. The export/import ratios for India decreased slightly to 40.1

percent from 41.7 percent last year while the same for other countries fell sharply to 35.5 percent from 50.1 percent last year.



Balance of Payments

33. On the basis of monetary survey, the overall BOP surplus stood at Rs. 427 million in the first month of 2005/06. Last year BOP had witnessed a deficit of Rs. 2.7 billion. The higher inflows of foreign loans and remittances accounted for a surplus in BOP this year.

34. Fiscal year 2004/05 ended with a record current account surplus of Rs. 29.2 billion in comparison to a surplus of Rs. 14.6 billion in the previous year. Despite substantial declines of 94.9 percent and 206.7 percent in net service and net income, a significant decline in trade deficit along with steep rise (15.0 percent) in transfer net, contributed to the surplus in the current account. Under the transfer receipts, the workers' remittances went up by 11.7 percent to Rs. 65.4 billion compared to a rise of 8.1 percent in the preceding year.

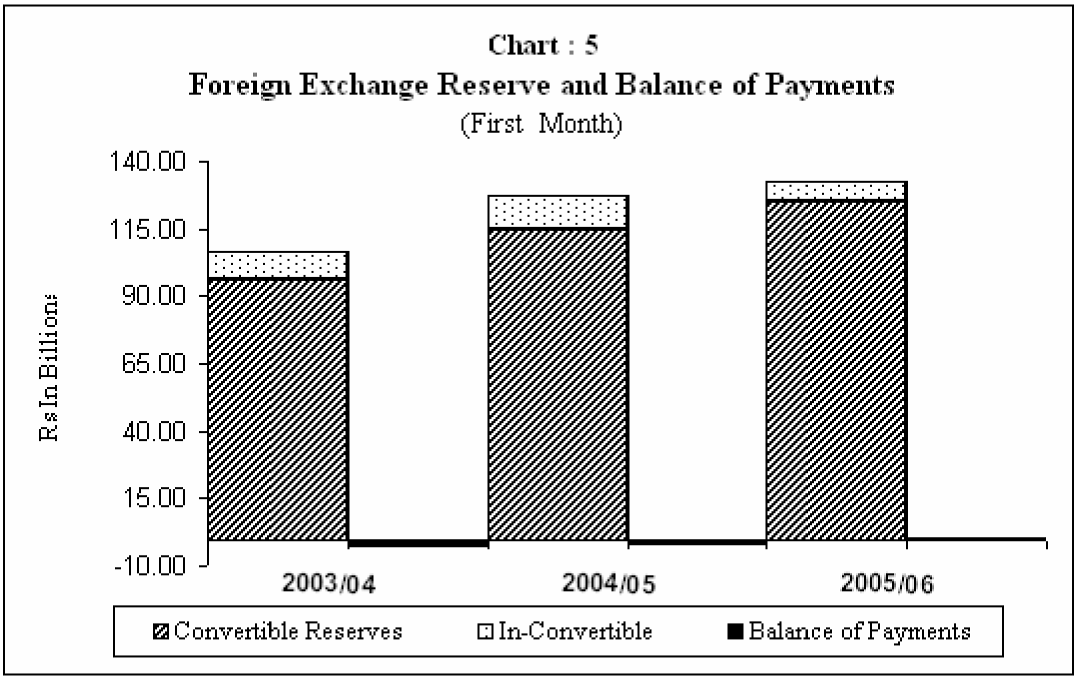
35. Under the capital account, capital transfers slightly increased to Rs. 1.6 billion from a level of Rs. 1.5 billion last year.

36. Under the financial account, the part trade credits included under the heading of other investment assets comprised Rs. 1.7 billion. On the liability side, trade credits decreased by Rs. 5.9 billion. HMG received Rs. 7.3 billion as foreign loan and repaid Rs. 6.0 billion in amortization. As a result, the net government borrowing stood at Rs. 1.3 billion. HMG had borrowed a sum of Rs. 9.2 billion as foreign loans last year. Foreign currency and deposit liabilities rose only by Rs. 65.1 million.

Foreign Exchange Reserves

37. The gross foreign exchange reserves went up by 4.0 percent to Rs.132.2 billion in mid-August 2005 compared to an increase of 19.2 percent to Rs. 127.1 in mid-August 2004. Of this, the convertible currency reserve rose by 8.8 percent owing primarily to the rise in remittances through the banking mechanism whereas the inconvertible reserves plummeted by 40.0 percent this year. The share of convertible reserves in the total

reserves moved up to 94.4 percent as at mid-August 2005 from 90.2 percent in mid-August 2004, leading to the corresponding fall in the share of the non-convertible reserves to 5.6 percent from 9.8 percent in the corresponding month last year. The current reserve has a comfortable position to finance merchandise imports of 9.8 months and merchandise and service imports of 8.5 months.



Price of Oil and Gold in the International Market

15. In the international market, the price of oil (Crude Oil Brent) soared by 47.8 percent to US$ 66.70 per barrel on August 15, 2005 from US$ 45.13 per barrel during the same period last year. Similarly, the price of gold increased by 10.4 percent to US$ 443.50 per ounce on August 15, 2005 from US$ 401.65 in the corresponding period of the previous year. The Nepalese currency vis-a-vis US dollar appreciated by 6.2 percent in mid-August 2005 (Rs. 70.25 per US dollar) from the level of (Rs. 74.64) a year ago.

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