Current Macroeconomic Situation

(Based on Data of the First Two Months of FY 2005/06)

Nepal Rastra Bank
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www.nrb.org

Executive Summary

1. During the first two months of 2005/06, broad money registered a marginal growth of 0.8 percent in contrast to a decrease by 0.5 percent in the same period last year.
2. In contrast to the decrease last year, net foreign assets of monetary sector increased by 2.0 percent (Rs. 2 billion) during the review period, contributing to an expansion of broad money, albeit marginal.
3. Monetary sector's claim on private sector witnessed a marginal growth of 0.8 percent in the first two months of 2005/06. In the same period last year, such a claim had gone up by 2.9 percent. Additional provision on black listing procedure contributed to the recovery of overdue loans of commercial banks. As such, outstanding credit to private sector grew marginally.
4. Growth of time deposits improved marginally by 2.8 percent in the review period compared to the rise of 2.4 percent in the same period last year. Some increment on deposit interest rates and various schemes launched by the commercial banks for mobilizing time deposits contributed to such a marginal rise in growth of time deposit.
5. Short-term interest rates remained stabilized compared to last year and inter bank transactions increased and deepened significantly during the review period. Increased transparency in the conduct of monetary policy as also reflected in the monetary statement of 2005/06 and reduction in the borrowing period for Standing Liquidity Facility (SLF) to 3 days from 5 days contributed to a rise in transactions in inter bank market. It is a positive development for the efficient conduct of monetary policy.
6. In share market, NEPSE index increased by 25 percent to 293.35 as at mid-September 2005 from the level of mid-September, 2004. A number of factors contributed to the improvement in the stock market. Of these contributing factors, number of listed companies increased to 125 as at mid-September 2005 from 115 as at mid-September 2004. Paid-up capital of listed companies also went up to Rs. 17.4 billion from Rs. 12.5 billion during the same period. Increase in listed companies, mainly of banks and financial institutions and increase in distribution of rights share and bonus share contributed to the improvement in share market.
7. Market capitalization in share market increased to Rs. 67 billion as at mid-September, 2005 compared to Rs. 45 billion as at mid-September, 2004. During this period, market capitalization to GDP ratio increased to 11.4 percent as at mid-September, 2005 from 8.5 percent a year ago.

8. Consumer price inflation, on year-on-year basis, surged to 8.2 percent in the first two months of 2005/06 on point-to point basis compared to 2.6 percent in the same period last year. Annual average inflation stood at 7.8 percent during the review year compared to 2.5 percent in the same period last year.

9. During the review period, government budgetary operation, on the cash flow basis, recorded a surplus of Rs. 4 billion. Such a budget surplus was Rs. 2 billion in the same period last year. A higher growth of resource mobilization relative to the government expenditure contributed such a higher budget surplus in the review period.

10. During the review period, government expenditure increased by 17.1 percent compared to a decline 25.8 percent in the same period last year. Of the total expenditure (Rs. 8.0 billion), current expenditure accounted for 65.9 percent (Rs. 5.3 billion) while the share of capital expenditure was marginal at 0.6 percent (Rs. 50 million). Loan repayment occupied 5.0 percent (Rs 400 million) and freeze expenditure accounted for 28.5 percent (Rs. 2.3 billion) of total expenditure.

11. During the review period, non-debt resources of government increased by 35.1 percent compared to a growth of 9.7 percent in the same period last year. Of the total non-debt resources (Rs. 12 billion), revenue increased by 13.4 percent compared to a growth of 8.4 percent last year. Revenue contributed 73.0 percent of the non-debt resources mobilization.

12. On external front, balance of payments stood a surplus of Rs. 2.1 billion as per the monetary statistics of the first two months of 2005/06. Such a balance of payments had recorded a deficit of Rs. 821 million in the same period last year. A Growth in remittance inflow contributed to the surplus in balance of payments during the review period.

13. During the review period, export increased by 10.8 percent compared to a rise of 5.5 percent in the same period last year. Of the total export, export to India increased by 20.6 percent while export to third countries declined by 3.8 percent.

14. During the review period, total imports, in contrast to a decline by 6.0 percent last year, increased by 25.2 percent. Of the total import, import from India increased by 27.3 percent and import from third countries rose by 21.9 percent.

15. In the first two months of 2005/06, total foreign exchange reserve reached Rs. 133.6 billion. This reserve is sufficient to cover 10.8 months import of goods and 8.6 months imports of both goods and services.

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

Monetary Situation

1. Broad money (M_2) witnessed a marginal rise of 0.8 percent in the first two months of 2005/06 in contrast to a marginal fall in the corresponding period of the previous year. A rise in net foreign assets (NFA) accounted for the most of the growth in M_2. NFA registered a growth of Rs. 2.1 billion. A satisfactory inflow of remittance contributed to such a growth in NFA during the review period. On demand side, a rise in money multiplier contributed to an increase in M_2 during the review period.

2. Reserve money, the monetary base, followed a declining trend as in the previous year, however. Commercial banks maintained a minimum level of excess reserve with Nepal Rastra Bank (NRB), contributing to a decline of reserve money and a rise in money multiplier.

3. Domestic credit witnessed a decline of 1.5 percent during the review period in contrast to a marginal growth of 0.5 percent last year. Almost all components of domestic credit either showed a deceleration or a decline. For example, credit to private sector, remained subdued on account of loan recovery following the changes made in black listing procedure recently. Government also maintained a cash surplus with NRB owing to a decline in capital expenditure. Credit to non-financial government corporations as well as government financial institution declined. Some non-financial government corporations such as Nepal Oil Corporation, Nepal Electricity Authority and Janak Education Material Centre repaid some part of their overdue loan during the review period.

4. Of the components of M_2, narrow money (M_1) followed a declining trend as in the first two months of the previous year, albeit at a lower rate, due to a decline in both currency held by public and demand deposits. This is a reflective of the slackness in economic activities at the beginning of the fiscal year. However, a marginal growth was observed in time deposit, another component of M_2, due mainly to an increased inflow of remittance.

5. In contrast to an increase last year, other items, net recorded a decline in the review period owing to a decline in interest suspense and some increase in non-banking assets of commercial banks. Despite the reduction in domestic credit, a decline in other items (net) contributed to a marginal rise in net domestic assets (NDA) during the review period. However, the contribution of NDA remained below the one-tenth of M2.

Money market

6. In order to maintain stability in the foreign exchange market and external sector, NRB intervened a couple of times in the foreign exchange market during the first two months of 2005/06. It purchased US dollar amounting to Rs.3.9 billion thereby injecting the liquidity of the said amount. A half of this liquidity injected through foreign exchange market was sterilized through open market operation in treasury bills. Commercial banks, as such, resorted to standing liquidity facility (SLF) of nearly 95 million.

7. A lower excess liquidity in the banking system, even in the slack seasons due to the appropriate management of liquidity, prevented the short-term interest rates from falling heavily as in the previous year. The weighted average 91-day treasury bills rate as well as weighted average inter bank rate remained higher compared to that of the corresponding period in the previous year. The weighted average 91-day treasury bills rate and weighted average inter bank rate remained at 3.38 percent and 3.87 percent respectively as at mid-September 2005, while such interest rates were 0.63 percent and 0.39 percent respectively as at mid-September 2004.

8. Following the provision of transparency in the conduct of monetary policy as evidenced in the announcement of monetary policy for 2005/06 and changes made especially for SLF borrowing period from 5 days to 3 days, contributed to a significant rise in inter bank transactions during the review period. For example, the turnover in inter bank transactions amounted to Rs. 45.2 billion during the first two months of 2005/06 compared to Rs 17.5 billion in the corresponding period of 2004/05. As a result, a cumulative SLF borrowing by commercial banks in review period remained lower at Rs.95 million than the amount of Rs. 774.0 million in the corresponding period of 2004/05.

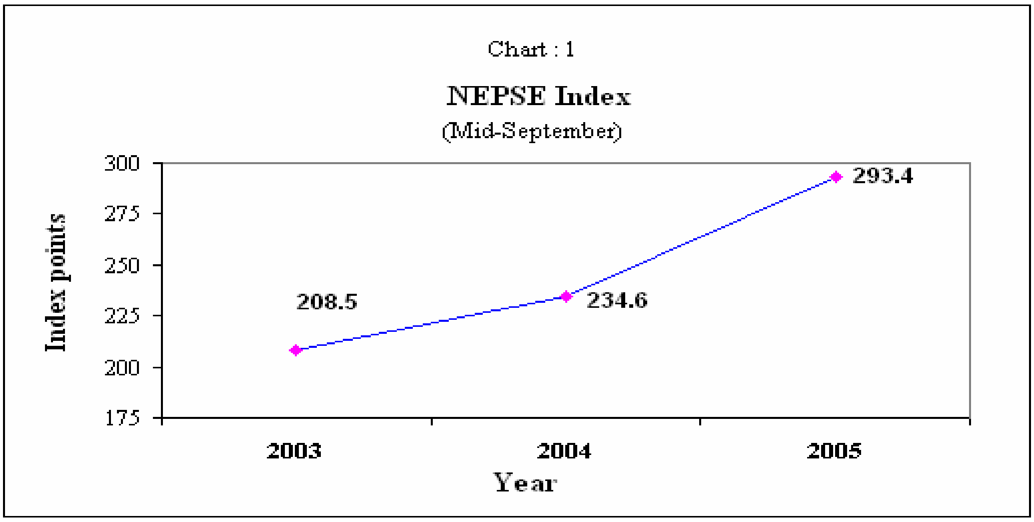
9. The outstanding sick industries loans stood at Rs. 56 million at mid-September 2005 compared to Rs. 190.3 million a year ago.

Share Market Transactions

10. The NEPSE index increased by 25.1 percent to 293.35 points as at mid-September 2005 from the level of 234.58 points in mid-September 2004. A number of factors accounted for

a growth of NEPSE index during the review period. The increase in the profitability of listed companies especially of banks and financial institutes, which have dominant share in the NEPSE index contributed to the growth. Likewise, the low level of interest rate offered by banks and financial institutions played a part. Lack of alternative investment opportunity and the increase in the number of listed companies, which in the process boosted the confidence of investors in the stock market also helped to increase the index.

11. Of the other capital market indicators, the number of listed companies increased to 125 as at mid-September 2005 from 115 a year ago. The paid up capital of listed companies increased by 39 percent to Rs. 17.4 billion as at mid-September 2005 from the level of Rs. 12.5 billion a year ago. Most of the increase in the number and paid up capital of listed companies were of financial institutions.



12. The market capitalization of listed companies increased significantly by 49 percent to Rs. 67 billion as at mid-September 2005 from the level of Rs. 44.9 billion a year ago. Market capitalization to GDP ratio increased to 11.4 percent as at mid-September, 2005 from 8.5 percent a year ago. However, the capital market liquidity ratio, indicated by the ratio of turnover to market capitalization fell to 0.3 percent as at mid-September 2005 from 4.0 percent a year ago. The increase in the amount of rights share and bonus share of banks and other financial institutions contributed to such a decline in the liquidity ratio during the review period compared to the previous year which had witnessed the transaction of block shares of commercial banks and manufacturing companies.

Inflation

Consumer Inflation

13. The year-on-year consumer inflation grew significantly by 8.2 percent during the period ending mid-September 2005 compared to a lower level of 2.6 percent in the preceding year.

14. The higher growth in the consumer inflation was mainly caused by the rise in the prices of housing goods and services, transport and communication and restaurant meals that resulted in from the upward revision in the prices of petroleum products together with the sharp rise in the price of rice and rice related products as well as sugar and related products. In the review period, the rise in the prices of beverages, pulses as well as meat, fish and eggs also exerted an upward pressure on consumer prices. The 12-month average growth rate of consumer price was 7.8 percent during the period ending mid-September 2005. The growth of consumer price inflation was 2.5 percent in the previous year.

15. In the review period, the index of food and beverages group, on a year-on-year basis, moved up by 7.1 percent in mid-September 2005 compared to an increase of 3.3 percent in the previous year. The rise in the prices of grains and cereal products, sugar and related products, beverages, restaurant meals, pulses, meat, fish and eggs, milk and milk products pushed up the index of this group.

16. The index of non-food and services group increased by 9.3 percent during the review period compared to an increase of 1.9 percent during the same period of the previous year. The rise in the prices of petroleum products, which exerted an upward pressure in the prices of housing goods and services as well as transport and communication sub-groups accounted for the growth of the price index of non-food and services groups during the review period.

17. Region wise, the price indices of the Kathmandu Valley, Terai and Hills in the review period increased by 6.8 percent, 8.8 percent and 9.1 percent, respectively. During the corresponding period in the previous year, the indices of Kathmandu Valley, Terai and Hills had increased by 4.4 percent, 2.1 percent and 1.3 percent, respectively.

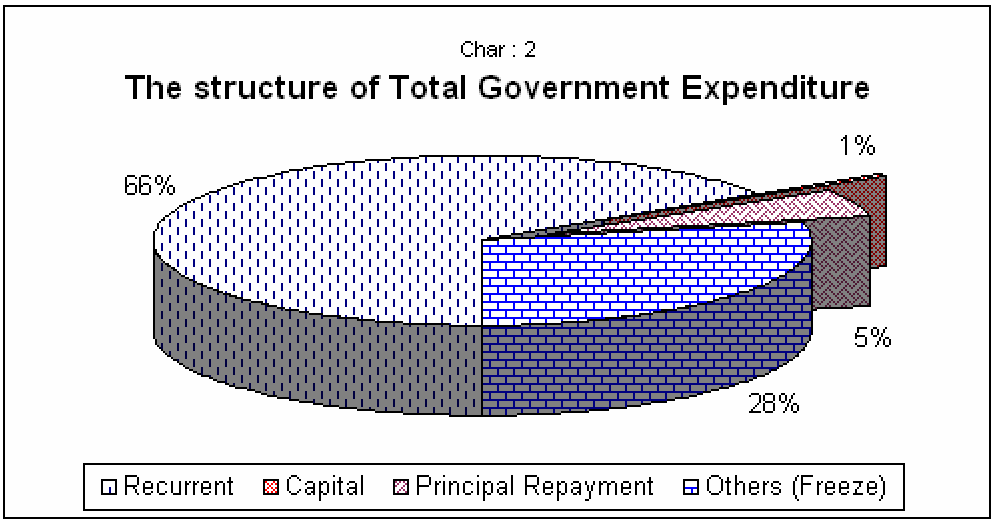
Wholesale Inflation

18. The National Wholesale Price Index, on a year-on -year basis, increased by 9.5 percent as at mid-September 2005. Such an index had increased by 6.1 percent in the preceding year. The rise in the prices of food grains, chemical fertilizer and chemical goods as well as livestock production together with the sharp rise in the prices of petroleum products, accounted for a significant increase in wholesale price index during the review period. The indices of Agricultural Commodities, Domestic Manufactured Commodities and Imported Commodities increased by 8.6 percent, 4.3 percent and 14.3 percent respectively in the review period. The 12-month average National Wholesale Price Index, increased by 9.4 percent during the period ending mid-September 2005 compared to a rise of 6.5 percent in the preceding year.

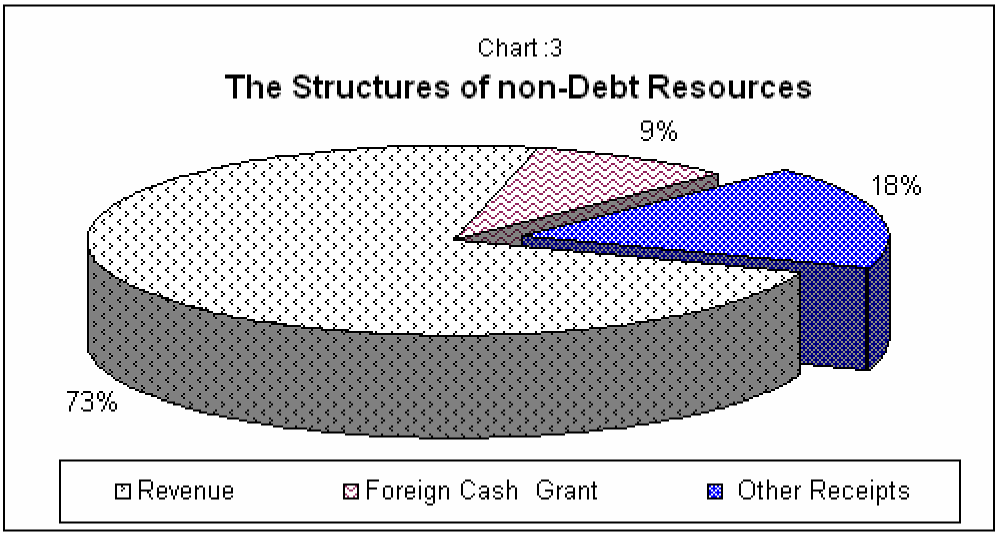
Government Budgetary Operation

19. The government budgetary position, on the cash flow basis, remained at a surplus level of Rs. 4 billion, an increase by 94.1 percent during the first two months of 2005/06. During the comparable period last year, the government budgetary position was also at a surplus position of Rs. 2.1 billion. The significant increase of non-debt resources relative to the growth of government expenditure accounted for the rise in the budgetary surplus.

20. During the first two months of 2005/06, the total expenditure of the government increased by 17.1 percent to Rs. 8.0 billion in contrast to a decline of 25.8 percent during the same period last year. Of the total expenditure, recurrent expenditure stood at Rs. 5.3 billion (65.9 percent), capital expenditure at Rs. 51.1 million (0.6 percent) and principal repayment at Rs. 403.3 million (5.0 percent). Expenditure under freeze account, which recorded a rise of 64.0 percent to Rs. 2.3 billion accounted for 28.5 percent of the total expenditure.



21. Total non-debt resources (revenue, foreign grants, non-budgetary receipts and others) increased by 35.1 percent to Rs. 12.0 billion compared to a rise of 9.7 percent last year. Revenue, the major source (73.0 percent share) of government resources, increased by 13.4 percent to Rs. 8.8 billion compared to an increase of 8.4 percent last year. Foreign grants recorded a higher growth of 65.8 percent to Rs. 1.1 billion compared to Rs. 677.1 million received last year.



22. The total net outstanding domestic debt of the government declined to Rs. 85.5 billion in mid-September 2005 from Rs. 90.0 billion in mid-July 2005, as reflected in the cumulative surplus treasury position of Rs. 2.0 billion in mid-September 2005 compared to a 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

23. Based on customs data, in the first two months of 2005/06, total exports increased by 10.8 percent to Rs. 9.8 billion and total imports increased by 25.2 percent to Rs. 24.8 billion. As a result, trade deficit increased by 36.7 percent to Rs. 15.1 billion. Similarly, total trade flows expanded by 20.8 percent. In the corresponding period of the previous year, exports had risen by 5.5 percent and imports had declined by 6.0 percent resulting in a 13.6 percent decline in trade deficit. Total trade had declined by 2.7 percent.

24. Exports to India rose by 20.6 percent to Rs. 6.4 billion this year in comparison to a rise of 26.4 percent last year. However, exports to other countries fell by 3.8 percent to Rs. 3.4 billion this year. Among the principal commodities exported to India, the exports of tea, cardamom, vegetable ghee, noodles, G.I. sheet, polyester yarn and readymade garments have increased, while the exports of toothpaste, plastic utensils, threads, ricebran oil, M.S. pipe, and pashmina goods to India have declined. Similarly, the exports of pashmina and pulses to other countries went up while that of readymade garments and carpets have declined.

25. With respect to total exports to India, primary goods and manufactured goods constituted 27.8 percent and 72.2 percent respectively while their respective shares were 23.2 percent and 76.8 percent last year. Likewise, the shares of primary products and manufactured goods in total export to other countries were 7.0 percent and 93.0 percent during the first two months of 2005/06 compared to the respective shares of 5.8 percent and 94.2 percent in the corresponding period of last year.

26. Imports from India expanded by 27.3 percent to Rs. 15.5 billion compared to a rise of 5.1 percent last year. Imports from other countries increased by 21.9 percent to Rs. 9.4 billion in contrast to a decline of 19.5 percent in the previous year. Imports of rice, chemicals, thread, polythene granules, hot-rolled sheet, readymade garments, polyester yarn, electrical equipment & goods from India moved up while imports of medicine, textiles, petroleum products, transport vehicles & parts, other machinery & parts, chemical fertilizer, MS billet, MS wire rod, and cold-rolled sheet went down. Similarly, the imports of sugar, textile dyes, polythene granules, thread, crude soybean oil, crude palm oil, steel wire, computer & parts and telecommunication equipment & parts from other countries rose while imports of crude coconut oil, chemical fertilizer, raw wool, textiles, transport vehicles & parts, electrical equipment & goods and television, deck & parts declined.

27. With respect to the structure of imports from India, industrial raw materials & capital goods and petroleum products formed 28.7 percent and 21.0 percent respectively, while the miscellaneous goods including consumer items comprised the rest 50.2 percent. Last year their respective shares were 43.3 percent, 27.6 percent and 29.1 percent. Likewise, the share of industrial raw materials and capital goods in total imports from other countries rose to 52.7 percent from 50.7 percent last year.

28. The share of India in total trade went up to 63.1 percent from 60.9 percent last year while the share of other countries dropped correspondingly to 36.9 percent from 39.1 percent last year.

29. The overall export/import ratio declined to 39.4 percent this year from 44.5 percent last year. The export/import ratios for India decreased to 41.3 percent from 43.6 percent last year while the same for other countries fell sharply to 36.2 percent from 45.8 percent last year.

Balance of Payments

30. On the basis of monetary survey, the overall BOP recorded a surplus of Rs. 2.1 billion for the first two months of 2005/06 in contrast to a deficit of Rs. 821 million in the corresponding period of the previous year. The higher inflows of foreign loans and remittances accounted for a surplus in BOP this year.

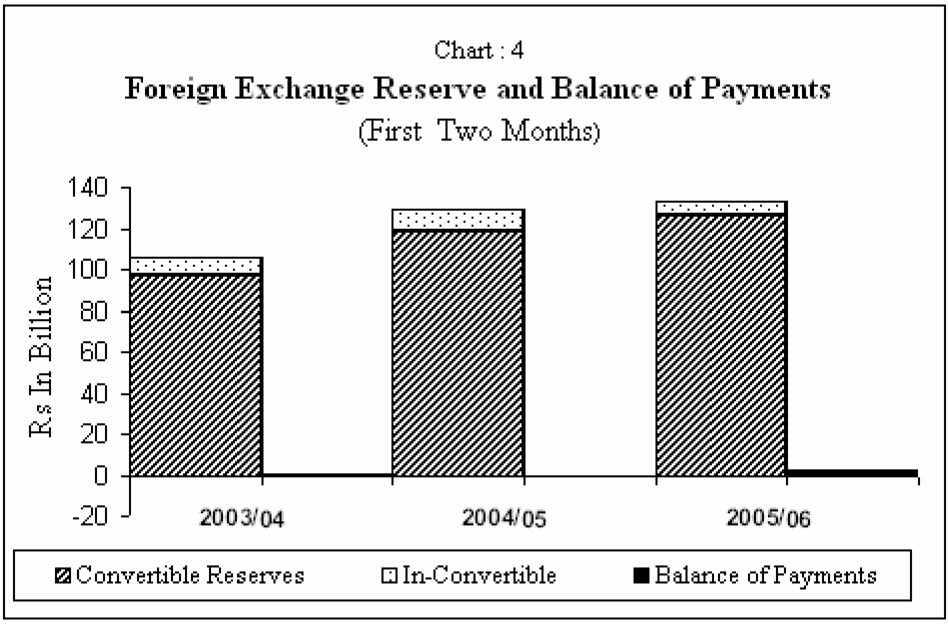
31. Based on BOP statistics current account witnessed a deficit of Rs. 1.1 billion in the first month of 2005/06 in comparison to a surplus of Rs. 2.0 billion in the corresponding period of the previous year. Despite the increase in net transfer, the significant decline in net services and the upsurge in trade deficit were responsible for the deficit in the current account. Under the transfer receipts, the workers' remittances went up by 10.8 percent to Rs. 5.9 billion in contrast to a decline by 3.6 percent in the previous year.

32. Under the capital account, capital transfers increased to Rs. 686.6 million from a level of Rs.91.4 million last year.

33. Under the financial account, during the first month of 2005/06, HMG received Rs. 531.4 million as foreign loan and repaid Rs. 163.5 million in amortization. HMG had borrowed a sum of Rs. 39.4 million as foreign loans last year. Foreign currency and deposit liabilities increased by Rs. 1.2 billion.

Foreign Exchange Reserves

34. The gross foreign exchange reserves went up by 3.4 percent to Rs 133.5 billion in mid-September 2005 compared to an increase of 22.5 percent in mid-September 2004. Of this, the convertible currency reserve rose by 6.4 percent mainly due to the rise in remittances through the banking mechanism whereas the inconvertible reserves plummeted by 31.3 percent this year. The share of convertible reserves in the total reserves moved up to 94.7 percent as at mid-September 2005 from 92.0 percent a year ago resulting in a corresponding fall in the share of the non-convertible reserves to 5.3 percent from 8.0 percent in the corresponding month last year. The current reserve level is sufficient to cover merchandise imports of 10.8 months, and merchandise and service imports of 8.6 months.



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

35. In the international market, the price of oil (Crude Oil Brent) soared by 45.3 percent to US$ 61.25 per barrel on September 15, 2005 from US$ 42.15 per barrel during the same period last year. Similarly, the price of gold increased by 12.5 percent to US$ 454.80 per ounce on September 15, 2005 from US$ 404.40 in the corresponding period of the previous year.

36. The Nepalese currency vis-à-vis US dollar appreciated by 4.6 percent in mid-September 2005 (Rs. 71.00 per US dollar) from the level of a year ago (Rs. 74.24 per US$).

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