Executive Summary

Monetary Developments

1. The monetary (M2) growth was higher at 4.8 percent in the first five months of 2005/06 compared to a rise of 2.5 percent in the comparable period of 2004/05.

2. Higher level of NFA originating from a significant increase in workers' remittance caused money supply to go up.

3. The banking sector's claims on the government remained subdued. So was the case with claims on the private sector. Imports grew but it was largely financed by overseas trade credit. Emphasis on loan recovery by large commercial banks also contributed to the lower rate of growth of credit taken by the private sector.

4. As a result of the open market operation of the NRB, excess liquidity remained at a minimum level in the first five months of 2005/06, despite significant increase in workers' remittances. In mid-December 2006, the short-term interest rates remained lower compared to the same period last year.

5. The volume of inter bank transaction increased significantly, reflecting a deepened money market. As a result, SLF borrowing by the commercial banks remained at a low level of Rs1.17 million in the first five months of 2005/06 compared to a significantly higher level of Rs. 22.3 billion in the comparable period of 2004/05.

Securities Market

6. Nepal Securities Board gave approval to six financial institutions to issue ordinary shares, right shares and debentures. A total of Rs. 378.5 million equivalent shares and debentures were issued in the primary market.

7. In terms of the number of companies listed, market capitalization, the total number of listed shares and the growth of NEPSE index, the size of stock market expanded in the first five months of 2005/06. The y-o-y NEPSE index increased by 67.74 points (28.2%) and stood at 303.12 points in mid-December 2005.

8. The ratio of market capitalization of stocks to GDP stood at 13.0 percent in mid-December 2005 compare to 9.4 percent a year ago. The liquidity of shares listed, as measured by the turnover to market capitalization ratio, increased to 0.47 percent in mid-December 2005 from 0.34 percent a year ago. The stock market remained concentrated, dominated by the stocks of commercial banks. Volatility measured as a twelve-month rolling standard deviation of NEPSE index increased. This reflects a rise in the risk in the stock market.

Headline Inflation

9. The y-o-y headline inflation increased by 8.8 percent in mid-December 2005 compared to a growth of 3.1 percent a year ago. The unexpected rise in food inflation by 17.6 percent in mid-December caused headline inflation to go up to 8.8 percent. The rise in vegetables and fruits prices also played a part, along with the effect of an upward revision made in the administered prices of petroleum products in January and September 2005 and VAT rate hike from 10 percent to 13 percent in February 2005. Annual average revised inflation is expected to be around 7.0 percent in 2005/06.

Core Inflation

10. The y-o-y core inflation calculated from headline inflation by excluding rice and rice products, vegetables and fruits, fuel, light and water and transport remained at 4.6 percent as against the 8.8 percent headline inflation in mid-December 2005. The core inflation had increased by 3.1 percent in mid-December 2004. The impact of heightened inflationary expectations rising from global oil prices, and the pass through effect of the hike in VAT could not be isolated from the calculation of core inflation. This resulted in a relatively higher rate of core inflation this year compared to that of the preceding year.

Government Budgetary Operations

11. The overall budgetary stance, on a cash basis, remained expansionary in the first five months of 2005/06 compared to that of the previous year. However, the budgetary performance in terms of three indicators of budgetary balance remained mixed.

12. The size of fiscal deficit expanded to 1.9 percent of total expenditure in the first five months of 2005/06 compared to 1.7 percent during the same period last year. If one excludes the balances of local authority with the banks, the fiscal deficit increases significantly to 10.5 percent. The expansion in capital expenditure widened the fiscal deficit.

13. The revenue growth remained encouraging at 9.8 percent in mid-December 2005 compared to a rise of 5.9 percent a year ago. The revenue deficit showed an improvement because of lower level of principal repayment.

14. Primary balance as percent of total government expenditure remained at a surplus of 4.2 percent in the first five months of 2005/06 compared to a surplus of 6.0 percent of a year ago. Exclusion of local authority account pushes up the magnitude of primary deficit to 4.5 percent of total government expenditure.

Foreign Trade

15. The deficit under merchandise trade increased by 20.2 percent in the first five months of 2005/06 as compared to an increase of 8.5 percent in the comparable period of 2004/05.

16. A surge in total imports by 14.8 percent relative to a rise of total exports by 6.8 percent widened the merchandise trade deficit in the first five months of 2005/06. While total imports had increased by 10.4 percent, total exports had increased by 13.2 percent in the comparable period of 2004/05.

17. Of total imports, imports from India surged by 21.2 percent in the first five months of 2005/06 compared to a 18.1 percent rise in the comparable period of 2004/05. Imports from overseas countries also registered a growth of 5.6 percent in the first five months of 2005/06 as compared to a slight increase of 0.9 percent in the same period last year.

18. While the growth of exports to India remained significant, albeit lower than that of 2004/05, the growth of exports to overseas countries remained negative by 8.5 percent.

19. An increase in exportable items such as vegetable ghee, polyester yarn, zinc sheet, wire, readymade garments and GI pipe contributed to the growth of exports to India.

20. As per monetary statistics, the overall BOP surplus stood at Rs.5.3 billion in the first five months of 2005/06 compared to a surplus of Rs.1.8 billion in the comparable period of 2004/05. A significant increase in workers' remittances contributed to this magnitude of rise in BOP surplus in the review period.

21. Total international reserves continued to accumulate in the review period. In mid-December 2005, international reserves were sufficient to cover 10.4 months equivalent of merchandise imports and 8.8 months worth of merchandise and service imports.

Current Macroeconomic Situation

(Based on First Five Months' Data of 2005/06)

Monetary Development

1. Monetary aggregates recorded a higher rate of growth in the first five months of 2005/06, compared to corresponding period in the previous year. Broad money (M2) expanded by 4.8 percent during the review period compared to an increase of 2.5 percent last year. Narrow money (M_1) increased by 2.6 percent in contrast to a decline of 0.9 percent last year. A higher growth of net foreign assets (NFA) and net domestic assets (NDA) during the review period contributed to upward movement the in the monetary aggregates during the first five months of 2005/06.

2. NFA, an expansionary factor of money supply, expanded by 4.9 percent (Rs.5.33 billion) during the review period. Such assets had increased by 1.7 percent (Rs. 1.80 billion) in the previous year. A significant increase in workers' remittance can be ascribed to such a growth in NFA during the review period.

3. Another expansionary factor of money supply, total domestic credit increased by 3.6 percent during the review period compared to a rise of 4.1 percent in the preceding year. Of the components of domestic credit, net claims on the government registered a decline of 1.5 percent during the review period compared to a slightly higher decline of 3.0 percent in the previous year. Claims on non-financial government enterprises declined by a higher magnitude of 13.6 percent in the first five months of 2005/06 in contrast to a significant growth of 39.8 percent in the corresponding period of 2004/05. Partial loan repayment by non-financial government enterprises such as Nepal Oil Corporation, Nepal Electricity Authority, Janak Educational Material Center and National Trading Limited to commercial banks contributed to decline in such claims during the review period. Similarly, claims on financial enterprises also declined by 1.5 percent during the review period.

4. The most important component of the domestic credit, claims on private sector witnessed a lower growth of 6.1 percent in the first five months of 2005/06 compared to an increase of 6.4 percent last year. Improvement in loan recovery of some banks and the increased imports financed by the trade credit accounted for such a deceleration in claims on private sector during the review period.

5. Net non-monetary liabilities, a contractionary factor of money supply, increased only by 1.2 percent during the review period, compared to a higher growth of 6.4 percent last year. Improvement in loan recovery, subsequent reduction in loan loss provisioning as well as reduction in commercial banks' profit contributed to such a deceleration in net non-monetary liabilities of the banking sector.

6. Net domestic assets of the monetary sector increased by 4.6 percent in the review period compared to an increase of 3.0 percent in the corresponding period of the previous year. The growth of net non-monetary liabilities by only 1.2 percent in the review period as compared to the rise of 6.4 percent last year is mainly responsible for the relatively higher growth of net domestic assets during the review period.

7. During the review period, time deposit went up by 5.8 percent compared to a growth of 4.2 percent last year. A satisfactory increase in workers' remittance was attributed to a relatively higher rate of growth of time deposit in the review period.

8. During the review period, reserve money registered a decline of 0.6 percent compared to a higher decline of 7.0 percent last year. Notwithstanding a reduction in commercial banks' balances with Nepal Rastra Bank, increase in currency in circulation contributed to a relatively lower reduction in reserve money during the review period.

9. During the review period, the growth of both money multipliers decelerated compared to the previous year. Narrow money multiplier increased only by 3.28 percent to 1.072 compared to an increase of 6.5 percent last year. Broad money multiplier went up only by 5.43 percent to 3.281 compared to an increase of 10.2 percent last year. Increase in currency in circulation accounted for such a lower growth of money multipliers.

Foreign Exchange and Money Market

10. NRB intervened 23 times in the foreign exchange market in the first five months of 2005/06. Through these interventions, NRB purchased US dollar 22 times amounting to Rs. 18.67 billion and sold US dollar one time amounting to Rs. 522.7 million thereby injecting a net liquidity of Rs.18.15 billion into the economy. Some of the liquidity injected through foreign exchange intervention was mopped up through the open market operations of treasury bills, outright sale auction and reverse repo auction.

11. During the review period, NRB mopped up Rs. 4.74 billion liquidity through outright sale auction and injected Rs. 830 million liquidity through outright purchase auction. In addition, Rs. 2 billion liquidity was mopped up

through the reverse repo auction. Consequently, net liquidity withdrawal by NRB during the review year stood at Rs. 5.91 billion.

Table No. 1

Open Market Operation in the First Five Months of 2005/06

(Rs. in million)

Instruments	**2004/05**	**2005/06**
Purchase Auction	494.6	830.0
Sale Auction	9550.0	4740.0
Repo Auction	2660.0	0.0
Reverse Repo Auction	1500.0	2000.0
Standing Liquidity Facility	22340.6	1170.0

12. In the first five months of current fiscal year, short-term interest rates declined compared to the corresponding period of the previous year due mainly to an increase in the excess liquidity of the commercial banks. For example, the weighted average 91–day treasury bills rate and weighted average inter bank rate declined to 2.20 percent and 0.96 percent respectively as at mid-December 2005 compared to 2.40 percent and 3.54 percent respectively as at mid-December 2004. Taking this fact into consideration, NRB mopped up liquidity amounting to Rs. 830 million through outright sale auction and Rs. 1.50 billion through reverse repo auction between mid-November 2005 and mid-December 2005.

Table No. 2

Short-Term Interest Rates

(During the First Five Months of 2005/06)

in percent

Months	**Weighted Average 91-day Treasury Bills rate**		**Weighted Average Inter Bank Transaction Rate**	
	2004/05	2005/06	2004/05	2005/06
Mid-Aug	0.62	2.26	1.02	2.47
Mid-Sep	0.63	3.38	0.39	3.87
Mid-Oct	1.34	3.10	0.83	3.18
Mid-Nov	1.97	2.69	2.24	2.36
Mid-Dec	2.40	2.20	3.54	0.96

13. During the review period, the volume of inter-bank transaction increased further. For example, the amount of inter bank transaction stood at Rs. 83.15 billion during the review period compared to Rs. 49.69 billion in the previous year. Consequently, the utilization of standing liquidity facility by commercial banks from NRB declined. For instance, commercial banks

borrowed just Rs1.17 billion from NRB in the first five months of 2005/06 compared to the borrowing of Rs. 22.34 billion in the corresponding period of 2004/05.

Movement of Short-term Interest Rates

(In the First Five Months of 2005/06)

Chart No. 1

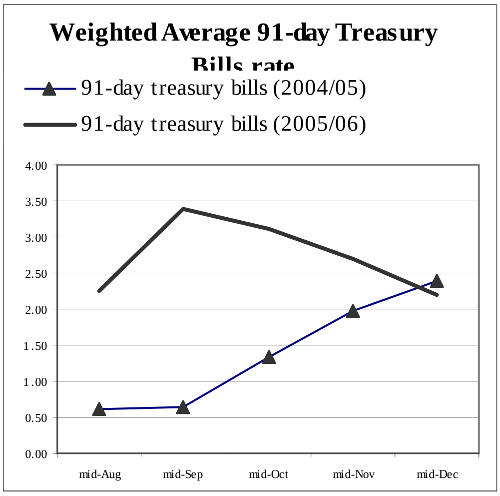
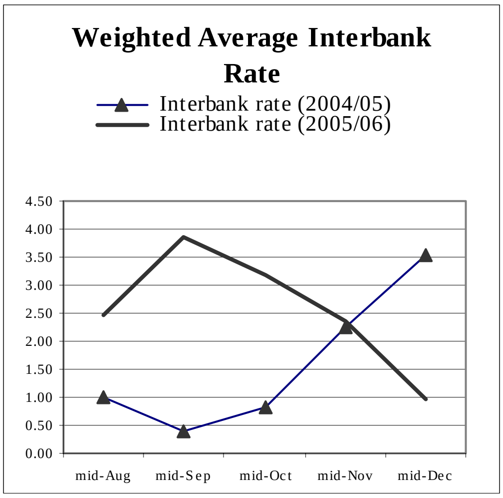


Chart No. 2



14. The outstanding refinance facilities utilized by commercial banks from NRB declined during the review period. The amount of such facilities remained at Rs. 58.80 million in the first five months of 2005/06 compared to the amount of Rs. 249.7 million in the corresponding period last year.

15. As a result of financial sector reform, the non-performing loan of commercial banks declined to some extent. For example, the ratio of NPA to total credit was 30.4 percent in 2001/02, which declined to 18.8 percent at the end of 2004/05.

Securities Market Activities

Primary Issue of Securities

16. During the first five months of 2005/06, Nepal Securities Board gave approval to six financial institutions to issue ordinary shares, right shares and debentures. Accordingly, Siddhartha Bank Limited issued ordinary shares amounting to Rs. 150.0 million. Likewise, Srijana Finance Limited and Prudential Financial Institute Limited issued ordinary share amounting to Rs. 4 million and Rs. 24.5 million respectively. Bank of Kathmandu issued debentures amounting to Rs. 200.0 million. Kumari Bank Limited has got approval from Nepal Securities Board in order to issue right share amounting to Rs. 125.0 million during review period. Altogether, ordinary

shares and debentures amounting to Rs. 378.5 million were issued in the primary market. Merchant Finance Company although given permission, is yet to issue its ordinary share amounting to Rs. 12.0 million.

Secondary Stock Market Development

17. The size of stock market witnessed a continuous growth in the first five months of 2005/06. The growth in stock market is reflected in the NEPSE index, the number of companies listed, market capitalization and the total number of listed shares.

18. The year-on-year (y-o-y) NEPSE index increased by 66.74 points (28.2 percent) to 303.12 points in mid-December 2005. The increased workers' remittances, lack of alternative investment opportunities and low level of real interest rates contributed to the growth of NEPSE index in the first five months of 2005/06.

19. The number of listed companies in the Nepal Stock Exchange Limited increased to 127 in mid-December 2005 from 118 a year ago. Of 127 listed companies, 81 (63.8 percent) were financial institutions, 29 manufacturing and processing units, 4 hotels, 8 trading units and 5 others.

20. Market capitalization, on a y-o-y basis, increased by 49.2 percent to Rs. 69.3 billion in mid-December 2005. The market capitalization to GDP ratio stood at 13.0 percent in mid-December 2005 from 9.4 percent a year ago. Of the total market capitalization of listed companies, financial institutions accounted for 82.3 percent, manufacturing and processing units 7.1 percent, hotel 3.3 percent, trading 1.0 percent and unclassified 6.3 percent.

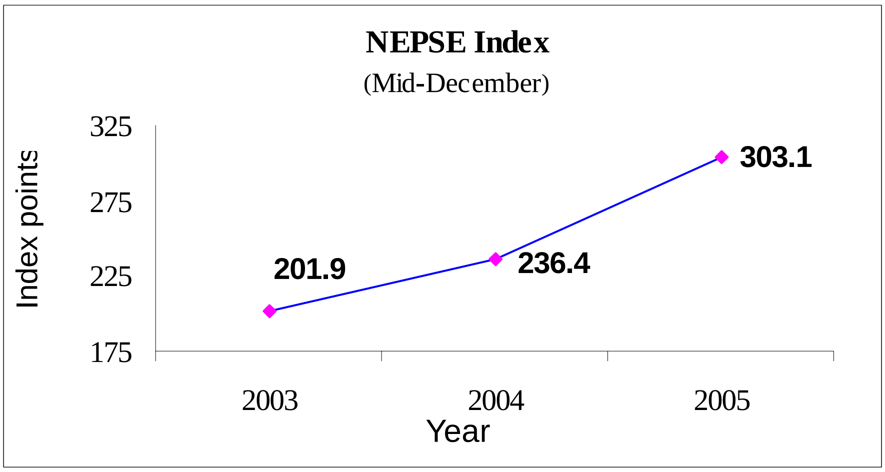
21. Likewise, the total paid up value of listed shares on a y-o-y basis increased by 32.7 percent to Rs. 17.5 billion in mid-December 2005. Listing of some new companies in NEPSE and the issuance of shares by financial institutions mostly accounted for the growth of total paid up value of listed shares.

22. Besides the growth, the stock market also witnessed a rise in liquidity of shares listed in the stock exchange. Of the stock market liquidity indicators, the turnover to market capitalization ratio increased to 0.47 percent in mid-December 2005 from 0.34 percent a year ago.

23. The Nepalese stock market remained highly concentrated and dominated by the stocks of commercial banks. For example, of the total turnover of Rs. 326.9 million, the share of commercial banks stood at 73.3 percent followed by finance companies at 12.4 percent in mid-December 2005. Clearly, the share of manufacturing and processing units, hotel and trading remained lower. Finance companies gained vis-à-vis commercial banks as the share of

the former was 11.2 percent in total turnover and that of latter was 85.3 percent in mid-December 2004.

Chart No. 3



24. Volatility, as measured as a twelve-month rolling standard deviation of NEPSE index increased during the last twelve-months compared to that of corresponding period last year. For example, the twelve-month rolling standard deviation of NEPSE index stood at 19.2 in mid-December 2005 compared to 15.1 a year ago, indicating an increased risk in the Nepalese stock market.

Price Situation

(a) Headline Inflation

25. The headline inflation based on the National Urban Consumer Price Index (1995/96 = 100), on year-to-year basis, increased at a higher rate of 8.8 percent as at mid-December 2005, compared to an increase of 3.1 percent during the same period in the preceding year. The higher growth in the price index is mainly attributable to the steep rise in the prices of transport and communication, housing goods and services and restaurant meals resulting from the upward revision in the prices of petroleum products together with the sharp rise in the price of rice and rice related products and fruits and vegetables. In the review period, the rise in the prices of pulses, beverages as well as education, reading and recreation also exerted an upward pressure on the price index. The overall price index, increased from 159.0 in mid-December 2004 to 173.0 points in mid-December 2005. The average growth rate of the price index from mid-January 2005 to mid-December 2005 stood at 6.8 percent. Such growth rate was 2.9 percent during the same period in the previous year.

26. In the review period, on a point-to-point basis, the index of food and beverages group sharply increased moved up by 9.3 percent compared to an increase of 3.0 percent during the same period last year. The rise in the prices of grains and cereal products, vegetable and fruits, restaurant meals, pulses and beverages pushed up the index of this group. The indices of grains and cereal products (14.9 percent), vegetables and fruits (11.2 percent), pulses (9.5 percent), beverages and restaurant meals (8.6 percent each), sugar and related products (6.2 percent), milk and milk products (4.5 percent), meat, fish and eggs (3.6 percent) as well as spices (1.1 percent) increased in the review period. However, in the review period, the index of oil and ghee declined by 2.3 percent.

27. The index of non-food and services group increased by 8.3 percent compared to an increase of 3.2 percent during the same period previous 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 prices of transport and communication as well as housing goods and services. The indices of transport and communication (16.9 percent), housing goods and services (13.6 percent), education, reading and recreation (5.5 percent), tobacco and related products (5.1 percent), cloth, clothing and sewing services (3.3 percent), footwear (3.1 percent), and medical and personal care (2.2 percent) all increased in the review period.

28. Region-wise, the price indices of the Kathmandu Valley, Terai and Hills in the review period increased by 6.9 percent, 9.7 percent and 9.5 percent, respectively. During the corresponding period in the previous year, the indices of Kathmandu Valley, Terai and Hills had increased by 4.6 percent, 2.6 percent and 2.3 percent, respectively.

(b) Core Inflation[*]

29. The y-o-y core inflation increased by 4.6 percent in mid-December 2005 compared to an increase of 3.1 percent in mid-December 2004.

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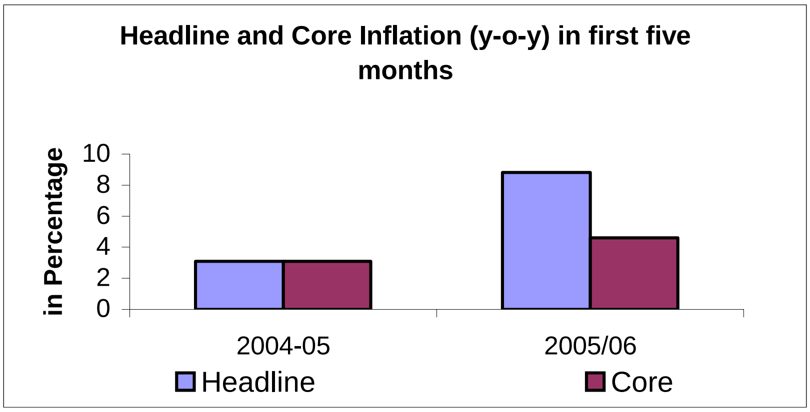
[*] With a view to isolate the effects of volatile food prices, energy prices, administered prices and indirect taxes on inflation from those emanating from the monetary impulses, many central banks have started calculating core inflation. Popular methods applied for the calculation of core inflation are exclusion method, weighted median method and trimmed mean method (outlier method). For calculating core inflation for Nepal, exclusion method has been applied. The items excluded are rice and rice products, vegetables and fruits, fuel, light and water, and transport.

Chart No. 4



(c) National Wholesale Price Index

30. The National Wholesale Price Index (1999/00=100) as at mid-December 2005 stood at 134.3 points registering a rise of 12.9 percent on a point-to-point basis. Such index had increased by 4.4 percent during the corresponding period in the preceding year. The higher growth in the price index in the review period is mainly attributable to the rise in the prices of food grains, fruits and vegetables, cash crops as well as chemical fertilizer and chemical goods together with the sharp rise in the prices of petroleum products and coal, despite a decline in the prices of textile related products. The indices of agricultural commodities, domestic manufactured commodities and imported commodities increased by 16.8 percent, 4.4 percent and 12.4 percent respectively in the review period. The average National Wholesale Price Index from the mid-January 2005 to mid-December 2005 increased by 9.3 percent compared to a rise of 4.8 percent during the same period in the previous year.

(d) Salary and Wage Rate Index (SWRI)

31. National Wage Rate Index (2000/01 = 100) was compiled for the internal use of Nepal Rastra Bank since 2001.The data on salaries has been added to the revised data of wage rate to construct National Salary and Wage Rate Index (2004/05 = 100).

32. The National Salary and Wage Rate Index (2004/05 = 100), on a point-to-point basis, increased by 3.6 percent as at mid-December 2005.The increase in the salary and wage rate index is mainly attributable to the rise in the wage rate of agricultural labourer and industrial labourer as well as the rise in the salary of bank and financial institutions and public corporation. However, the wage rate of other manual workers declined. The indices of salary and wage rates increased by 0.4 percent and 4.7 percent respectively.

Government Budgetary Operation

33. The overall government budgetary stance, on a cash basis, remained expansionary in the first five months of 2005/06 compared to that of the corresponding period of 2004/05. However, the budgetary balances/imbalances produced mixed results in the review period.

34. Of the three indicators of budgetary balances/imbalances, fiscal deficit (total expenditure less total non-debt resources) stood at 1.9 percent of total government expenditure in the first five months of 2005/06 compared to 1.7 percent in the corresponding period of 2004/05. Exclusion of local authority account amounting to Rs. 2.7 billion would push up the fiscal deficit to 10.5 percent of total government expenditure in first five months of 2005/06. The surge in capital expenditure (including freeze account) contributed to the significant expansion in the fiscal deficit in the review period.

Table No. 3

Government Budgetary Stance

(During the first five months)

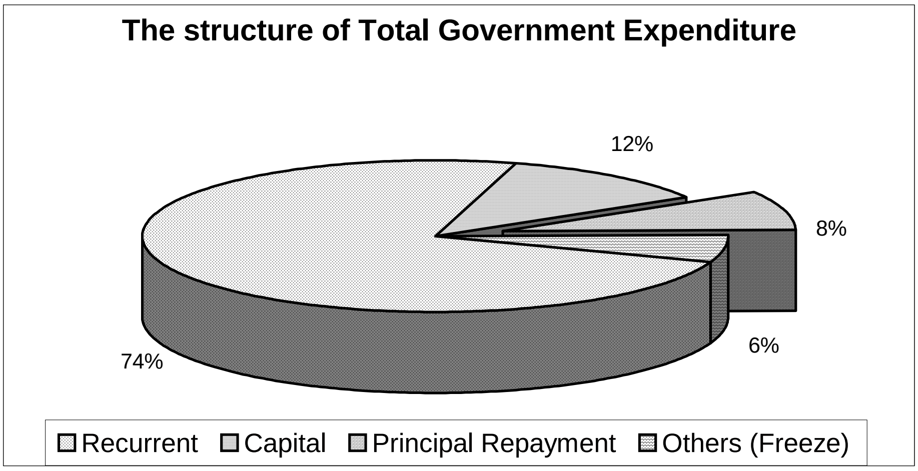
(Rs. in million)

		2004/05	2005/06
1	**Revenue balance** (revenue-current expenditure)	**-2062.7**	**-1747.8**
	Current expenditure	23612.4	25400.5
	Recurrent expenditure	*19911.9*	*22728.2*
	Principal repayment	*3700.5*	*2672.3*
	Revenue	21549.7	23652.7
2	**Fiscal balance** (total non-debt resources-total expenditure)	**-461.8**	**-569.7**
	Total expenditure	*27132.1*	*30598.2*
	Total non-debt resources	*26670.3*	*30028.5*
	Fiscal deficit excluding local authority account	-461.8	-3224.0
	Local authority account	0.0	2654.3
3	Interest payment	2077.6	1852.2
	Internal	*881.0*	*988.4*
	External	*1196.6*	*863.8*
4	Primary balance (fiscal deficit-interest payment)	1615.8	1282.5
	Primary balance excluding local authority account	1615.8	-1371.8
5	**Total government expenditure**	**27132.1**	**30598.2**
	As % of total expenditure		
1	Revenue balance	-7.6	-5.7
2	Fiscal balance	-1.7	-1.9
3	Fiscal balance excluding local authority account	-1.7	-10.5
4	Primary balance	6.0	4.2
5	Primary balance excluding local authority account	6.0	-4.5

35. The share of capital expenditure (including freeze account) in total government expenditure increased to 17.0 percent in the first five months of 2005/06 compared to 13.0 percent in the corresponding period of 2004/05. Conversely, the share of current expenditure (including principal repayment) in total government expenditure declined to 83.0 percent in the review period from 87.0 percent last year. A significant rise in capital expenditure (including freeze account) pushed up the growth of total expenditure to 12.8 percent in the first five months of 2005/06 compared to a growth of 9.9 percent in the corresponding period last year.

36. Revenue deficit (revenue less recurrent and principal repayment), the another indicator of budgetary imbalance, however, showed an improvement in the first five months of 2005/06. Revenue deficit as the percent of total expenditure decelerated to 5.7 percent in the first five months of 2005/06 from 7.6 percent in the corresponding period of 2004/05. Improvement in revenue growth, at 9.8 percent in the first five months of 2005/06 compared to a rise of 5.9 percent in the preceding year, and the decline in principal repayment contributed to the improvement in revenue deficit relative to that of last year.

Chart No. 5



37. Primary balance (fiscal deficit less interest payment), the important indicator of the current fiscal stance posted a surplus of 4.2 percent of total expenditure in the first five months of 2005/06 compared to a higher magnitude of 6.0 percent in the corresponding period of 2004/05. Primary balance, excluding local authority account amounting to Rs. 2.7 billion, remained at a deficit of 4.5 percent of total government expenditure in the first five months of 2005/06.

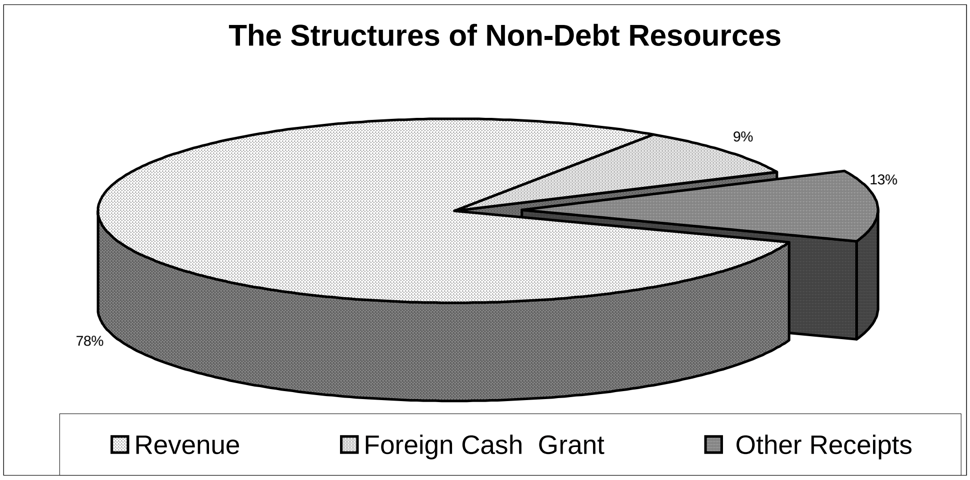
38. During the review period foreign loans amounting to Rs. 1.68 billion was mobilized. After offsetting the deficit there was a surplus of Rs. 2.27 billion in the government treasury. Consequently, the total net outstanding domestic debt of the government decreased by 1.2 percent to Rs. 89.3 billion in mid-December 2005.

Revenue Mobilization

39. During the first five months of FY 2005/06, tax revenue increased by 9.5 percent to Rs. 30.3 billion. In the review period, the non-tax revenue increased by 11.3 percent to Rs. 3.4 billion. In the same period last year, while tax revenue had increased by 15.4 percent, non-tax revenue had declined by 30.9 percent. The increase in the tax revenue during this period was due to significant increase in the revenue mobilization from value added tax (VAT).

40. Of the total revenue mobilization from tax sources, revenue from direct tax sources increased at a slower pace of 5.3 percent to Rs. 3.4 billion and that from indirect tax sources at 10.4 percent to Rs. 16.9 billion. In the same period last year, revenue mobilization from direct and indirect tax had increased by 21.6 percent and 14.2 percent respectively. Despite the rise in revenue receipt from house and land registration, the revenue receipt from direct tax decreased due mainly to the substantial decline in all of the main headings under corporate income tax. The higher growth in revenue mobilization from indirect tax is attributable mainly to the significant growth in VAT. Revenue receipt from VAT showed a substantial rise of 40.4 percent this year compared to an increase of 16.2 percent last year. A reason for such a phenomenal growth in VAT revenue is the upward adjustment in the VAT rate of 3-percentage point in mid-January 2006. During the period, revenue mobilization from customs duties declined by 7.6 percent. Since no amount was received from Indian excise refund till the review period of this fiscal year, there was a decline in custom revenue.

Chart No. 6



Revenue Composition

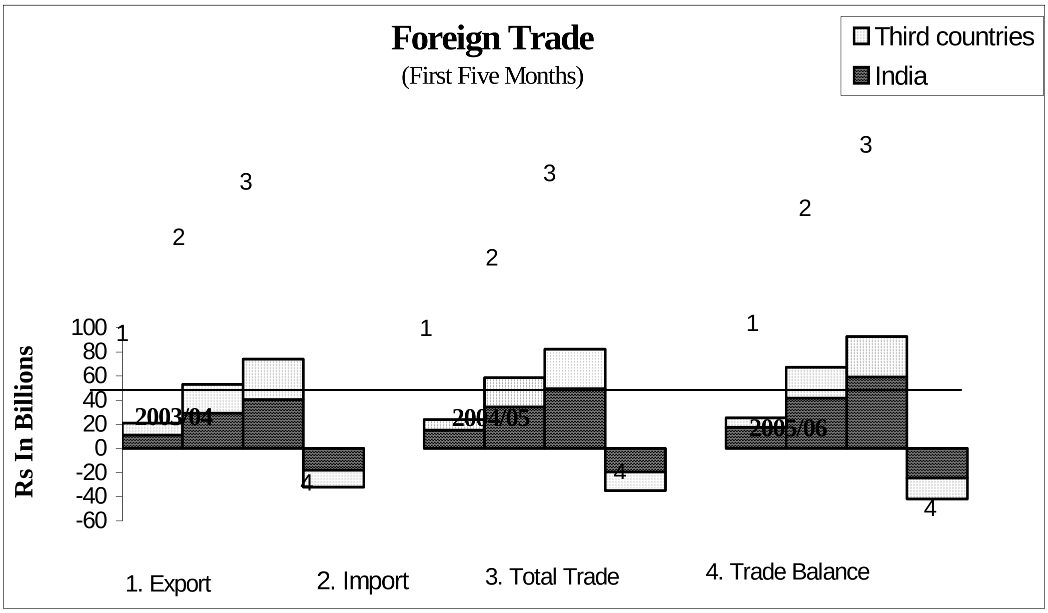
41. Of the total government revenue mobilized during the first five months of the current fiscal year, the composition of tax and non-tax revenue constituted 85.7 percent and 14.3 percent respectively. Such composition during the same period last year was 85.9 percent and 14.1 percent. The share of direct tax and indirect tax in total tax revenue was 16.6 percent and 83.4 percent as against the composition of 17.3 percent and 82.7 percent during the same period last year. Of the total revenue mobilization, revenue from VAT constituted major share of 36 percent where as customs duty contributed 24.7 percent and income tax revenue constituted 9.7 percent. Such composition during the last fiscal year was 28.2 percent, 29.3 percent and 12.2 percent respectively.

Foreign Trade

42. In the first five months of 2005/06, the structure of foreign trade experienced some changes in comparison to the corresponding period of the preceding year.

43. Exports grew by 6.8 percent in the first five months of 2005/06 compared to a rise of 13.2 percent in 2004/05. Of the total exports, export to India soared by 15.6 percent in the first five months of 2005/06 compared to a growth of 34.1 percent in the same period in 2004/05. Exports to other countries declined by 8.5 percent in the review period compared to a decline of 10.8 percent in the same period of 2004/05.

Chart No. 7



44. With regard to changes in absolute amount, an increase in the exportable items of vegetable ghee, polyester yarn, zinc sheet, wire, readymade garment and G.I. pipe, among others contributed to the growth of exports to India. The decline in the exportable items of woolen carpet, readymade garments and Nepalese paper and paper products, among others, caused the decline in the exports to other countries.

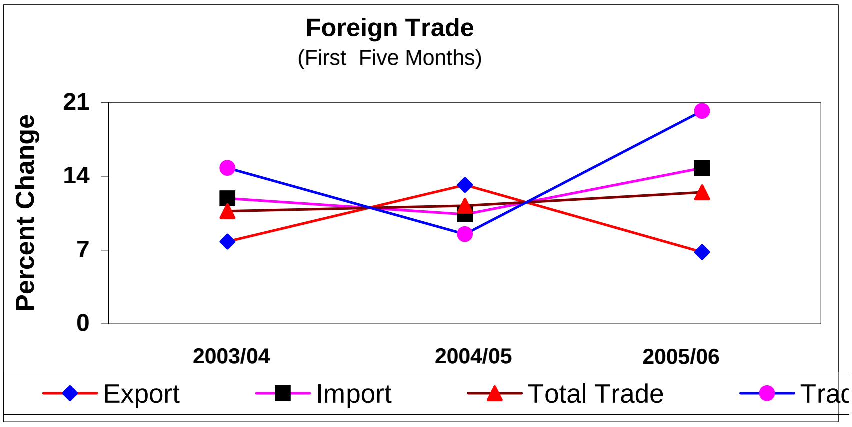
45. There was an increase of total imports by 14.8 percent in the first five months of 2005/06 as compared to an increase of 10.4 percent in the corresponding period of 2004/05. Of the total imports, imports from India rose significantly by 21.2 percent in the first five months of 2005/06 in comparison to a growth of 18.1 percent in the corresponding period of 2004/05. Imports from other countries also increased by 5.6 percent in the review period as compared to a slight increase of 0.9 percent in the comparable period of the preceding year.

46. An upsurge in the import of petroleum products, rice, chemicals, MS billet, medicine, thread and cement, among others, from India and crude palm oil, textile dyes, palm oil, M.S. billet, electrical goods, polythene granules, crude soybean oil and M.S. wire rod, among others, from other countries fostered the growth of overall imports in the first five months of 2005/06.

47. During the first five months of 2005/06, three additional items (furnace oil, plastic pet chips/pet resin and newsprint paper) have been included in the list of items that can be imported on payment of convertible currency from

India. Accordingly, the share of imports on the basis of payment of convertible currency in total imports from India increased to 30.7 percent this year from 16.1 percent in the preceding year.

Chart No. 8



48. The increase in imports relative to exports led to a significant expansion in trade deficit by 20.2 percent in the first five months of 2005/06 as compared to an increase of 8.5 percent in the comparable period of 2004/05.

Balance of Payments

49. Based on the monetary statistics, the overall BOP posted a surplus of Rs. 5.3 billion compared to a surplus of Rs. 1.8 billion in the corresponding period of 2004/05 primarily due to the higher inflow of remittances.

50. On the basis of the BOP statistics for the first four months of 2005/06, current account registered a deficit of Rs. 2.4 billion in contrast to a surplus of Rs. 8.6 billion a year earlier. Inflow of workers' transfer increased significantly by 30.3 percent in the first four months of 2005/06 as against a decline of 7.4 percent in the comparable period of 2004/05. Despite the surge in the workers' remittances, a rise in imports relative to exports led to a deficit in the current account this year.

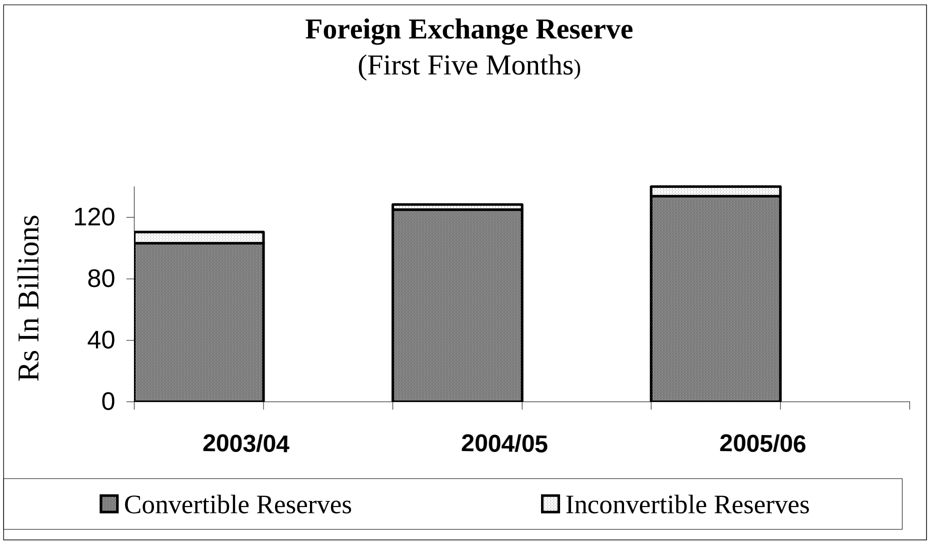
51. Under the capital account, capital transfer went up to Rs. 1.2 billion from the level of Rs. 471.9 million in the previous year.

52. Under the financial account, HMG received Rs. 1.2 billion as foreign loan and repaid Rs. 1.8 billion in amortization, resulting in a net outflow of Rs. 565.3 million in the first four months of this fiscal year. HMG had borrowed a sum of Rs. 820.6 million as foreign loans in the comparable period of 2004/05. Foreign currency and deposit liabilities increased by Rs. 1.8 billion this year.

Foreign Exchange Reserves

53. In comparison to mid-July 2005, gross foreign exchange reserves rose by 7.8 percent to Rs. 140.0 billion in mid-December 2005 as against a decline of 1.4 percent in the corresponding period of the previous year. The share of convertible reserves in the total reserves declined to 95.5 percent as at mid-December 2005 from 97.4 percent in mid-December 2004, resulting in a corresponding increase in the share of the non-convertible reserves to 4.5 percent from 2.6 percent. The current level of reserves is sufficient to finance merchandise imports of 10.4 months and merchandise and service imports of 8.8 months.

Chart No. 9



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

54. The price of oil (Crude Oil Brent) in the international market soared by 47.3 percent to US$ 59.89 per barrel on December 15, 2005 from US$ 40.67 per barrel during the same period last year. Likewise, the price of gold rose by 15.3 percent to US$ 506.25 per ounce on December 15, 2005 from US$ 439.00 in the corresponding period of the previous year.

While the Nepalese currency vis-à-vis US dollar appreciated by 3.7 percent in mid-December 2004 compared to mid-July 2004, it depreciated by 4.6 percent in the corresponding period of 2005/06. The exchange rate of one US dollar was Rs. 73.75 in mid-December 2005 compared to Rs. 71.49 in mid-December 2004.

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