Monetary Aggregates

1. In the first seven months of 2005/06 (as at mid February 2006), broad money (M_2) grew by 7.3 percent to Rs 322.4 billion. In the same period of 2004/05, it had grown by 4.0 percent. A substantial increase in net foreign assets (NFA) contributed to such a higher growth rate of M_2 in the review period.

2. The growth of NFA* in the review period remained high. It grew by 12.1 percent (Rs. 13.0 billion) compared to a growth of 5.3 percent (Rs. 5.7 billion) in the previous year. A persistent increase in workers' remittances through banking channels accompanied with an increased inflow of foreign aid accounted for a significant rise in NFA in the review period.

3. Total domestic credit grew by 5.2 percent in the first seven months of 2005/06. Such credit had increased by an equivalent pace of 5.2 percent in the corresponding period of the last fiscal year. Of the various components of domestic credit, net claims on government declined by 4.0 percent compared to a larger decline of 6.5 percent last year. The decline in net claims on government this year is a reflection of the classification of local authorities' deposits as a resource. Likewise claims on non-financial government enterprises declined by 26.2 percent, in contrast to a substantial rise of 34.3 percent last year. Loan repayment by some non-financial government enterprises such as Nepal Electricity Authority (NEA), Nepal Oil Corporation (NOC), National Trading Ltd, and Hetauda Textile Industries Ltd accounted for such a decline

4. Private sector credit, a crucial component of domestic credit, registered a growth of 9.7 percent compared to an increase of 9.3 percent in the previous year. Comparatively higher imports in the review period contributed to a rise in off take of credit by the private sector.

5. Time deposits, a component of M_2, registered a substantial growth in the review period. Compared to a growth of 4.7 percent last year, time deposit increased by 8.6 percent in the review period due mainly to an encouraging inflow of workers' remittances.

6. Reserve money grew by 1.3 percent in contrast to a decline of 7.2 percent last year. A rise in NFA of monetary authority contributed to spur the growth of reserve money in the review period

* After adjusting exchange valuation gain/loss

Foreign exchange and Money Market

7. With a view to facilitating orderly movement in exchange rate, NRB made 33 interventions in the foreign exchange market in the review period. Consequently, NRB injected the net liquidity of Rs 25.4 billion into the economy through the foreign exchange intervention in the review period compared to a net liquidity injection of Rs 16.8 billion last year. Most of the intervention in the foreign exchange market was carried out to purchase the US dollar in the review period, which was necessitated particularly by the increasing inflow of foreign remittances. The injected liquidity through foreign exchange intervention was partly sterilized through open market operation (OMOs).

8. Review period experienced the net liquidity withdrawal of Rs 11.6 billion through OMOs from the banking system, which is higher by 13.8 percent over the last year's level (Table 1). Such withdrawal of liquidity contributed to stabilize the short-term interest rates and sterilized the impact of remittance inflows on money supply.

Table 1 : Open Market Operations

(In First Seven Months)

Rs in million

		2004/05	2005/06
	Total Liquidity Withdrawal	**16770.0**	**12875.0**
	Sale Auction	10500.0	4740.0
	Reverse Repo Auction	4070.0	5000.0
	Fresh Treasury Bills	2200.0	3135.0
	Total Liquidity Injection	**6581.8**	**1280.0**
	Purchase Auction	1121.8	830.0
	Repo Auction	5460.0	450.0
	Net Liquidity Withdrawal (A-B)	**10188.2**	**11595.0**

9. The use of standing liquidity facility (SLF), provisioned to help commercial banks tide over their short term payments difficulties, declined sharply to Rs 2.1 billion over the past seven months of 2005/06 from the amount of Rs 28.8 billion in the same period of the previous year. The increased inter bank transactions resulted into the decline of the use of SLF borrowing by commercial banks in the review period. Inter bank transactions in the seven months stood at Rs 108.9 billion compared to Rs 73.4 billion last year (Table 2).

Table 2: Standing Liquidity Facility and Inter Bank Transaction

(In theFirst Seven Months)

Rs in million

	2004/05	**2005/06**
Standing Liquidity Facility	28765.4	2123.5
Inter- bank Transaction	73433.0	108944.2

10. Because of open market operations, short-term interest rate remained stable in the review period. Weighted average 91-day treasury bill rate hovered around 2.20 to 3.38 percent in the review period. Weighted average inter bank rate, which had tended to decline in the fifth and sixth month of 2005/06 due mainly to inflow of remittances, rose up to 2.48 percent in the seventh month of 2005/06.

Security Market Activities

Primary Issue of Securities

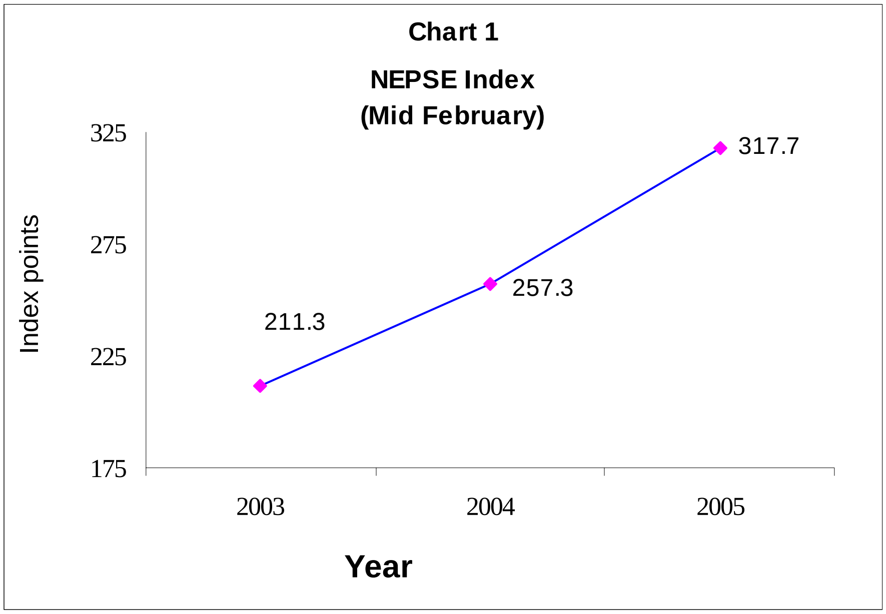
11. In the first seven months of 2005/06, Nepal Security Board approved 15 financial institutions to issue their ordinary shares, right shares and debentures worth Rs 827.5 million and Taragaon Regency Hotel to issue rights share amounting Rs. 446.5 million. Accordingly, six financial institutions have been given approval to issue right shares amounting to Rs. 382.0 million, eight financial institutions for issuing ordinary share amounting to Rs. 245.5 million and Bank of Kathmandu obtained approval to float debentures worth Rs. 200.0 million.

Secondary Security Market Development

12. The size of stock market witnessed a continuous growth in the first seven months of 2005/06. The bullish trend in the stock market is reflected in the NEPSE index, the number of companies listed and the size of market capitalization.

13. The y-o-y NEPSE index increased by 60.4 points (23.5 percent) to 317.69 points in mid-February 2006. The lack of alternative investment opportunities, persistent

increase in the inflow of workers' remittances and low level of real interest rates contributed to the growth of NEPSE index in the first seven months of 2005/06.



14. The number of listed companies in the Nepal Stock Exchange Limited increased by four to 127 in mid-February 2006. Of the 127 listed companies, 81 (63.8 percent) were financial institutions, 29 manufacturing and processing units, 4 hotels, 8 trading units and 5 others.

15. Market capitalization, on a y-o-y basis, increased by 39.2 percent to Rs. 74.1 billion in mid-February 2006. The market capitalization to GDP ratio increased by 3.9 percentage points to 13.9 percent in mid-February 2006. Of the total amount of market capitalization of the listed companies, financial institutions accounted for 82.6 percent, manufacturing and processing units 6.7 percent, hotel 3.2 percent, trading 1.0 percent and unclassified 6.5 percent.

16. Likewise, the total paid up value of listed shares on a y-o-y basis increased by 16.5 percent to Rs. 18.0 billion in mid-February 2006. Listing of some new companies in NEPSE and the issuance of additional shares by the existing financial institutions contributed to the growth in the total paid up value of listed shares.

17. Alongwith the growth, the stock market 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 0.30 percent in mid-February 2006 from

0.27 percent a year ago. The high growth rate of turnover than that of market capitalization contributed to such increase in the liquidity.

18. Nevertheless, the Nepalese stock market continued to be highly concentrated and dominated by the stocks of commercial banks. For example, of the total turnover of Rs. 222.4 million, the share of commercial banks stood at 79.7 percent followed by development banks (8.6 percent) and finance companies (6.0 percent) in mid-February 2006. In the comparable period of the preceding year, these entities occupied a share of 70.3 percent, 24.0 percent and 0.1 percent respectively. Clearly, the share of manufacturing and processing units, hotel and trading remained lower.

19. Volatility, as measured as a twelve-month rolling standard deviation of NEPSE index decreased in 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 11.5 in mid-February 2006 compared to 17.3 a year ago.

Capital Growth and NPL Level of Financial Institutions

20. Total number of financial institutions (excluding NGOs), licensed by Nepal Rastra Bank (NRB), stood at 139 in mid-Feb compared to 133 in the mid July 2005. There is no change in the number of commercial banks in the review period. The number of development banks and finance companies reached 40 and 63 respectively in the review period. However, due to cancellation of operating license of Makalu Transport Cooperative, Biratnagar for its non-compliances of the NRB directives, the number of financial cooperatives declined to19.

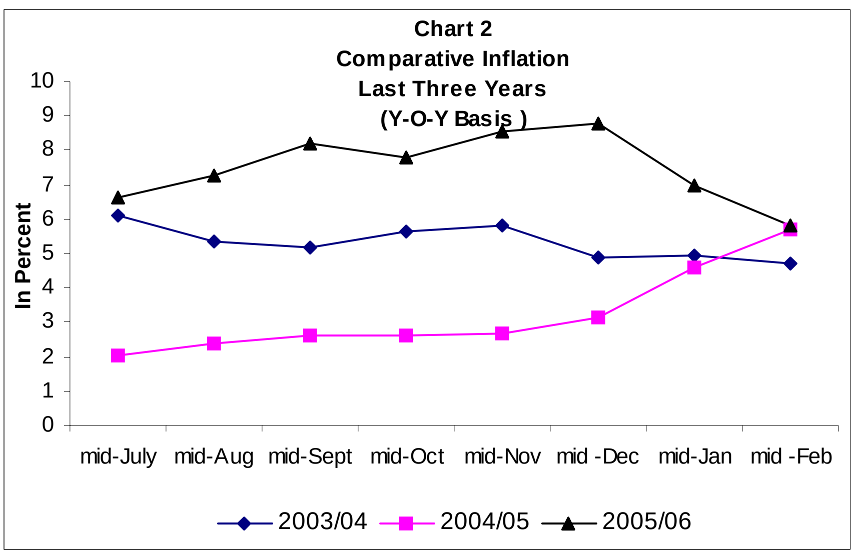
21. Compared to July 2005, paid-up capital of financial institutions increased by 7.1 percent to Rs.16.5 billion. Finance companies recorded the highest growth (16.3 percent) in paid-up capital followed by commercial banks (7.2 percent), financial cooperatives (5.0 percent) and development banks (0.6 percent). The rise in paid-up capital in the review period is a manifestation of the increasing number of financial institutions along with the issuance of bonus and right shares by some of the financial institutions. The overall increase in paid-up capital in the review period is the indication of an additional availability of resources for the private sector investment.

22. As of July 2005, average non-performing loan (NPL) of Commercial banks, finance companies and development banks stood at 16.6 percent (Table 3). Commercial bank group depict the highest ratio of NPL accounting for 18.8 percent of the total loan followed by development banks (6.7 percent) and finance

companies (5.2 percent). This high ratio of overall NPL of financial sector indicates a deterioration in the assets quality of financial institutions. In the review period total NPL of commercial banks stood at 18.04 percent, depicting a slight improvement in the assets quality of the commercial banks.

Consumer Inflation

23. The headline inflation based on the National Urban Consumer Price Index (1995/96 = 100), on year-to-year basis, increased by 5.8 percent in mid-February 2006, compared to an increase of 5.7 percent in the same period of the preceding year. The base effects of petroleum price hike in January 2005, an increase in transportation fare and a rise in VAT in February 2006 accounted for the lower rate of increase in consumer inflation in the seventh month of 2005/06 relative to growth in the preceding months. Though inflation rate remained low in February 2006 compared to that of the previous months, owing to base effects, pressure on price remained high in the first seven months of 2005/06, compared to that of the previous year. For example, the average growth rate of the price index from mid-March 2005 to mid-February 2006 stood at 7.0 percent. Such growth rate was 2.9 percent in the same period in the previous year.



24. In the review period, pressure on price index of food group remained high compared to nonfood group. For example, on a y-o-y basis, the index of food and beverages group surged up by 7.1 percent compared to an increase of 4.1 percent in the same period last year. The rise in the prices of grains and cereal products, restaurant meals, pulses, beverages and milk and milk products pushed up the index of this group. The pace of increase in the index of non-food and services group subdued to 4.4 percent compared to an increase of 7.4 percent in the same

period last year. Removal of the base effects of petroleum price hike (in January 2005) in February 2006 is mainly responsible for such low price growth of this group.

25. Regionwise, Hills experienced the highest (6.5 percent) incidence of inflation. It was followed by Terai (6.3 percent) and the Kathmandu Valley (4.2 percent). In contrast, in the corresponding period in the previous year, the Kathmandu Valley had experienced the highest burden (6.7 percent) of inflation followed by Hills (5.8 percent) and Terai (5.1 percent).

26. The y-o-y core inflation remained at 3.9 percent in mid-February 2006, compared to that of 4.0 percent in the same period last year.

Wholesale Inflation

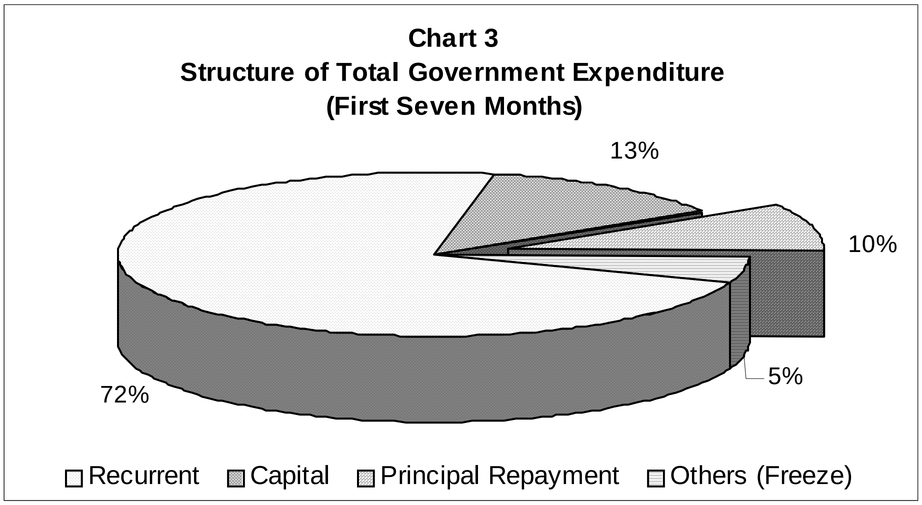
27. The y-o-y National Wholesale Price Index (1999/00=100) registered an increase of 6.5 percent in mid February 2006. Such index had increased by 7.2 percent in the corresponding period of the preceding year The base effects of petroleum price hike (in January 2005) accounted for the deceleration in wholesale inflation relative to that of preceding months of 2005/06. However, the average inflation remained high at 9.4 percent in the first seven months 2005/06 compared to a rise of 4.9 percent in the same period in the previous year.

Salary and Wage Rate Index (SWRI)

28. The National Salary and Wage Rate Index (2004/05 = 100), on y-o-y basis, increased by 4.3 percent in mid-February 2006. Despite a decline in the wage rate of other manual workers, the rise in the wage rate of agricultural laborer and industrial laborer as well as the rise in the salary of bank and financial institutions and public corporations accounted for the rise in National Salary and Wage Rate Index The indices of salary and wage rate increased by 0.4 percent and 5.7 percent, respectively.

Government Budgetary Operation

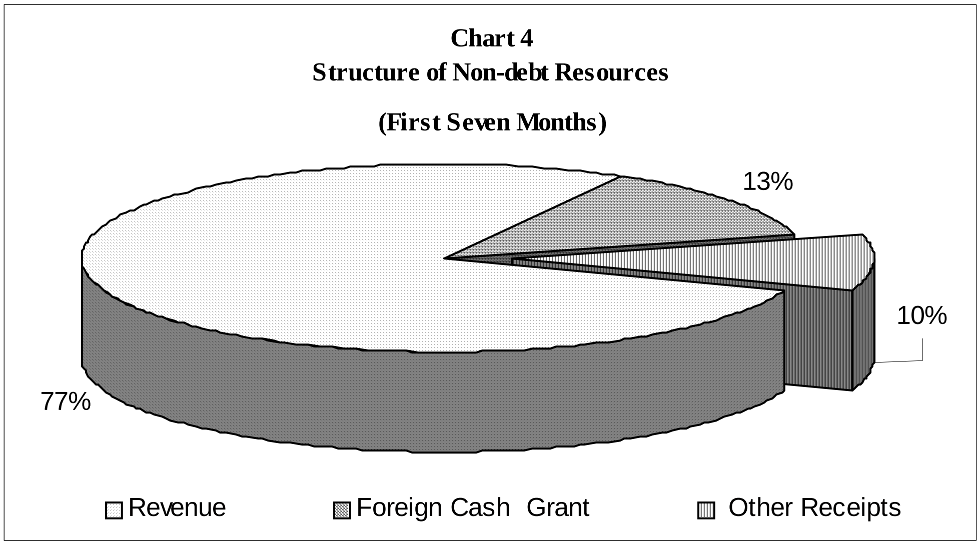
29. In the first seven months of 2005/06, total government expenditure (on a cash basis) witnessed a growth of 16.5 percent compared to a moderate growth of 6.6 percent last year. Pressure on recurrent expenditure due to conflict and an increase in capital expenditure contributed to such a surge in total government expenditure in the review period.



30. Of the total government expenditure, the share of capital expenditure (including freeze account) increased to 18.0 percent in the review period compared to 14.4 percent last year. Conversely, the share of recurrent expenditure (including principal repayment) in total government expenditure dropped down to 82.0 percent compared to 85.6 percent in the corresponding period last year.

31. In the first seven months of 2005/06, total government revenue increased by a lower rate of 2.9 percent to Rs 35.8 billion compared to a higher growth rate of 13.1 percent in the same period of the previous year. On the basis of first six months' data of revenue details, a decline in customs duties, corporate income tax, and dividend receipt as well as non receipts of Indian Excise Refund contributed to such a low growth rate of revenue mobilization. The underlying factors of low growth of revenue mobilization were mainly low economic growth rate, industrial sluggishness, increase in import of industrial raw material and consumer goods attracting lower customs duty.

32. In the first seven months of 2005/06, foreign cash grants increased by 50.9 percent to Rs 5.9 billion compared to an increase of 80.3 percent in the corresponding period of the previous year.



33. The government budgetary situation remained at a surplus of Rs 174.7 million in the review period. But government budgetary situation, excluding local authorities' deposits with banks remained at a deficit of Rs 3.22 billion.

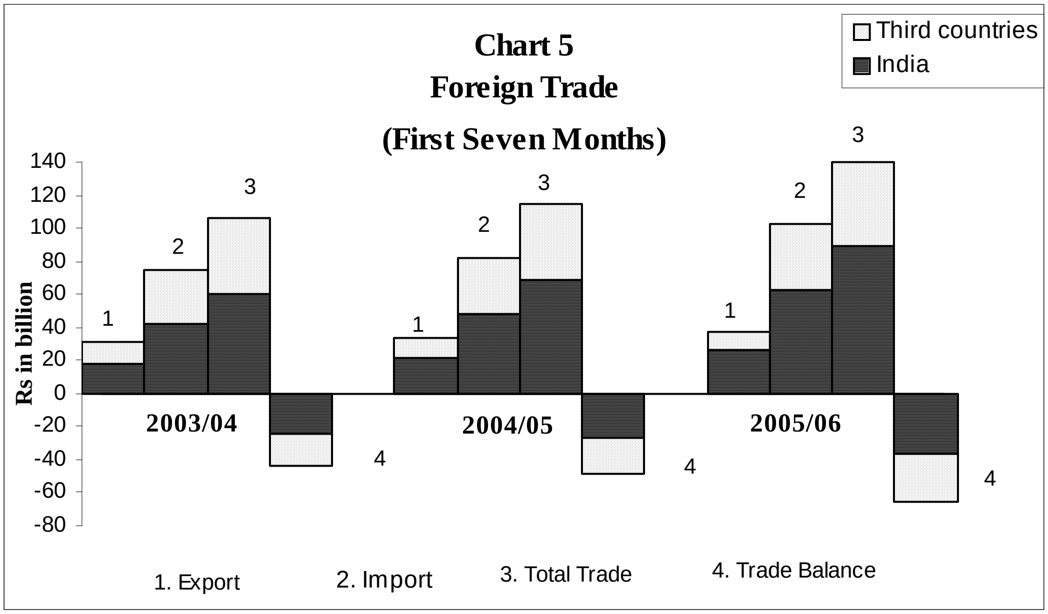
34. Of the sources financing the budget deficit, government mobilized additional domestic borrowings of Rs 3.1 billion by issuing treasury bills in the first seven months of 2005/06 . In the corresponding period of the previous year government had mobilized Rs 2.2 billion worth of domestic borrowings. Similarly, government mobilized foreign loans amounting to Rs 2.4 billion in the review period compared to Rs 1.2 billion in the corresponding period of the previous year.

Foreign Trade

35. The foreign trade sector depicted a mixed performance in the first seven months of 2005/06. Total exports increased because of the rise in the exports to India. An increase in imports both from India and overseas led to the rise in overall imports. Consequently, trade deficit expanded owing to the higher rate of growth of imports relative to exports. Likewise, total trade also increased considerably.

36. The rate of growth of exports more than doubled to 12.2 percent in the first seven months of 2005/06 compared to a rise of 5.5 percent in 2004/05. Of the total exports, export to India rose by 22.8 percent in 2005/06 in comparison to a growth of 20.3 percent in the same period in 2004/05. Exports to other countries declined

by 7.0 percent in the review period compared to a much sharper decline of 13.6 percent in the corresponding period of the previous year.



37. An increase in the exports of vegetable ghee, juice, noodles polyester yarn, aluminum section, jute goods, readymade garments, wire and zinc sheet was primarily responsible for the overall increase in the exports to India. The decline in exports to other countries was basically due to the decline in exports of readymade garments, handicrafts, silverware, jewelries, skin and tea.

38. An upsurge of 25.1 percent in total imports was witnessed in the first seven months of 2005/06 compared to an increase of 9.0 percent in the corresponding period of 2004/05. Out of the total imports, imports from India rose considerably by 31.3 percent in the review period in comparison to a growth of 13.1 percent in the corresponding period of 2004/05**.** The share of imports against the payment of convertible currency in total imports from India went up to 26.1 percent this year from 17.0 percent a year earlier. Imports from other countries rose by 16.4 percent in the review period compared to a growth of just 3.8 percent in the corresponding period of the previous year.

39. In the first seven months of 2005/06, a rise in the import of cement, chemical fertilizer, machinery, petroleum products, rice, chemicals, MS billet, medicine, thread and electrical equipment, aircraft, spare parts, copper wire, rod and sheet, textiles, *inter alia*, from India and crude palm oil, crude soybean oil, textile dyes,

M.S. billet, transport vehicles & parts and polythene granules, *inter alia*, from other countries resulted in the growth of total imports.

40. The increase in the rate of growth of imports relative to exports resulted in considerable widening of trade deficit by 33.8 percent in the first seven months of 2005/06 compared to an increase of 11.6 percent in the corresponding period of 2004/05.

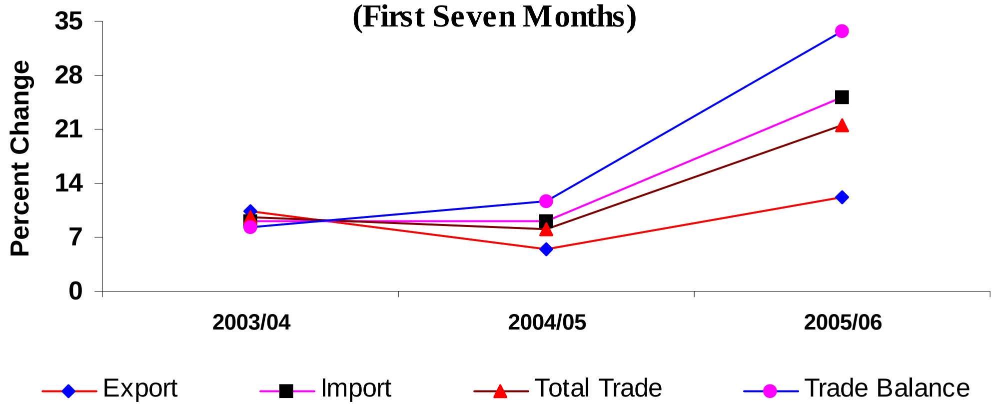
Balance of Payments

41. On the basis of monetary data, the overall BOP posted a surplus of Rs. 13.0 billion in the first seven months of 2005/06 compared to a surplus of Rs. 5.7 billion in the corresponding period of 2004/05.

42. Based on the BOP statistics for the first six months of 2005/06, current account registered a surplus of Rs. 5.9 billion in comparison to a surplus of Rs. 4.2 billion a year earlier. Though trade deficit expanded, the current account posted a surplus primarily due to the increase in workers' remittances. Inflow of workers' remittances rose significantly by 48.7 percent in the first six months of 2005/06 in contrast to a slight decline of 0.6 percent in the comparable period of 2004/05.

43. On the capital account front, capital transfer rose to Rs. 2.0 billion from the level of Rs. 671.4 million a year earlier.

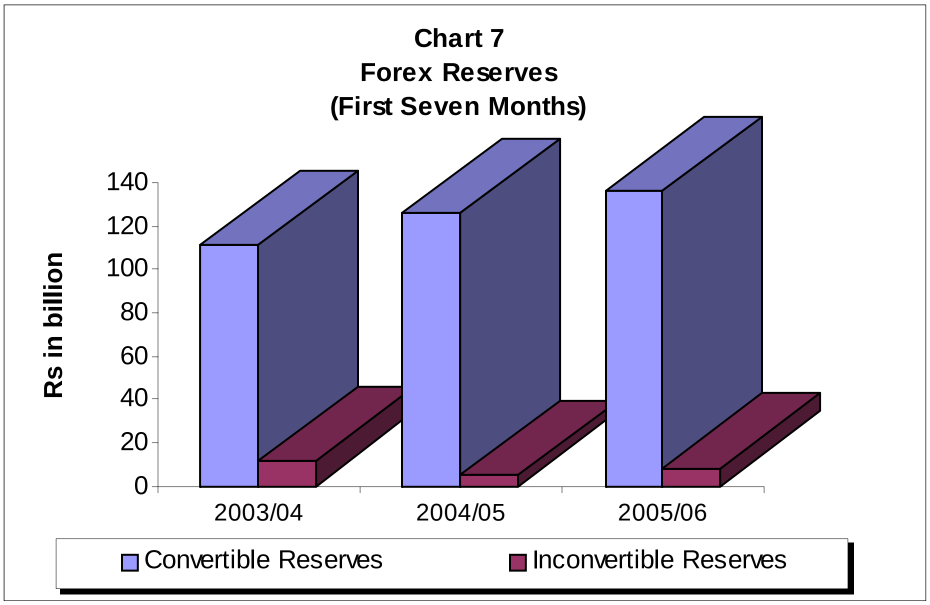
Chart 6
Foreign Trade
(First Seven Months)



44. Under the financial account, HMG received Rs. 2.3 billion as foreign loan and repaid Rs. 3.2 billion in amortization, resulting in a net outflow of Rs. 986.4

million in the first six months of this fiscal year. In the comparable period of 2004/05, HMG had borrowed a sum of Rs. 1.4 billion. Foreign currency and deposit liabilities went up by Rs. 1.6 billion this year.

Foreign Exchange Reserves



45. From the level of mid-July 2005, gross foreign exchange reserves rose by 10.7 percent to Rs. 143.8 billion in mid-February 2006 compared to an increase of just 0.4 percent in the corresponding period of the previous year. The share of convertible reserves in the total reserves declined to 94.5 percent as at mid-February 2006 from 96.2 percent in mid-February 2005, resulting in a corresponding increase in the share of the non-convertible reserves to 5.5 percent from 3.8 percent. The current level of reserves is adequate to finance merchandise imports of 9.8 months and merchandise and service imports of 8.3 months.

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

46. In the international market, the price of oil (Crude Oil Brent) rose by 29.0 percent to US$ 57.61 per barrel on February 15, 2006 from US$ 44.67 per barrel in the corresponding period of the previous year. Analogously, the price of gold rose by 27.4 percent to US$ 540.50 per ounce on February 15, 2006 from US$ 424.40 in the comparable period of the previous year.

47. While the Nepalese currency *vis-à-vis* US dollar appreciated by 5.03 percent in mid-February 2005 compared to mid-July 2004, it depreciated by 0.92 percent in

the corresponding period of 2005/06. The exchange rate of one US dollar was Rs. 71.00 in mid-February 2006 compared to Rs. 70.59 in mid-February 2005.