Current Macroeconomic Situation
(Based on The First Nine Months Data of 2005/06

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National Output and Income

1. Government of Nepal, Central Bureau of Statistics (CBS) has recently made public the preliminary estimate of National Accounts Statistics for the fiscal year 2005/06 along with the final estimates of 2003/04 and revised estimate of 2004/05. According to the CBS, the Gross Domestic Product (GDP) for the current fiscal year is expected to grow by 2.3 percent at factor cost and by 1.9 percent at producers' price. Except for the negative growth experienced in 2001/02, this is the lowest growth rate in the last ten years.
2. According to the preliminary estimate of the CBS, the GDP growth rate at constant price (1994/95 prices) for 2005/06 will marginally decelerate to 2.30 percent from last year's 2.33 percent. The agriculture sector, the largest single contributor (38.1 percent) to the GDP is estimated to grow by 1.7 percent. This works out to nearly half of the 3.0 percent growth observed in the preceding fiscal year, while non-agriculture sector is likely to expand by 2.8 percent, a bit above the 2.1 percent growth in 2004/05.
3. Due to decline in the production of principal food crops- paddy, wheat and barley by 1.9 percent, 3.6 percent, and 4.5 percent respectively, overall production of food crops is estimated to decline by 1.4 percent in the current fiscal year. Notwithstanding some decline in the production of oilseeds and tobacco; the overall cash crops production is estimated to grow significantly by 8.9 percent because of a surge in the production of potato, jute and sugarcane. Likewise, the growth rate of the production of other crops is expected to decelerate to 2.2 percent compared to an increase of 7.0 percent last year due mainly to a decrease in the production of fruits and pulses. The production of fisheries is estimated to witness a substantial growth of 7.7 percent, while forestry sub sector is expected to remain to grow by 2.2 percent in the current fiscal year.
4. On the basis of industrial production for the first six months of the current fiscal year, manufacturing production index is estimated to grow by 2.2 percent. In spite of the increase in the production of dairy products, vegetable oil and ghee and chemical product, continuous decline in garment production led to a marginal decline in the manufacturing growth rate this year. Among the eight sub sectors of the non-agriculture sector, the CBS expects electricity, gas and water and construction sub sectors to expand by 5.6 percent and 4.2 percent respectively for the current fiscal year. The growth rates of these sectors were 4.8 percent and –0.5 percent last year. A surge in imports as well as domestic production of construction materials is attributed to such a rise in the construction sector.
5. Likewise, trade, restaurant and hotels sub-sector is expected to expand by 3.9 percent in contrast to a 2.1 percent decline in the previous year. Mining and quarrying; transport, communication and storage and finance and real estate sub-sectors are reported to grow by the same rate of 2.2 percent this year too.

Likewise, community and social services sub-sector for the current fiscal year is estimated to grow only by 1.3 percent, well below that of 2.8 percent witnessed last year.

Consumption, Investment and Saving

6. The ratio of total consumption to gross domestic product is estimated to go up to 88.9 percent this year from 87.6 percent of last year. Investment to GDP ratio is expected to increase to 30.3 percent, while gross domestic saving will go down to 11.1 percent of the gross domestic product.

Gross National Disposable Income (GNDI)[1]

7. In an open economy like Nepal, the capacity to consume, save or invest cannot be measured by gross domestic product alone. The number of Nepali workers going abroad and the amount of pension of ex-British army have substantially increased in the last couple of years. As a result, a significant amount of income earned by Nepali has been flowing in into the country. However, such amounts, which help boost the spending capacity of Nepali people, are not included in gross domestic product. To incorporate such amount into national account statistics, Nepal Rastra Bank for the first time has attempted to estimate gross national disposable income (GNDI).[2]
8. GNDI is the total income available to residents for either final consumption or saving. As GNDI is the main basis to analyze the spending decision and flow of fund into the country, an attempt has been made to estimate GNDI.
9. The GNDI grew by 9.1 percent each at current price in the last two years. The growth rate is estimated to be 12.3 percent for the current fiscal year. The

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[1] Gross domestic product measures the income derived from domestic production, it does not cover overall income received from abroad. Gross National Disposable Income is obtained by adding net current transfers received from abroad (TR_f) to gross national income (GNI), which is equal to GDP plus net factor income from abroad. Factor incomes from abroad include (a) income/returns/interest from capital investment (b) labor income of seasonal workers (c) service income received from land and building rentals. Net transfer income is the difference between income earned from nonresident and transfers remitted abroad. Symbolically,

$$GDP = C + I + (X - M)$$

$$GNI = GDP + Y_f$$

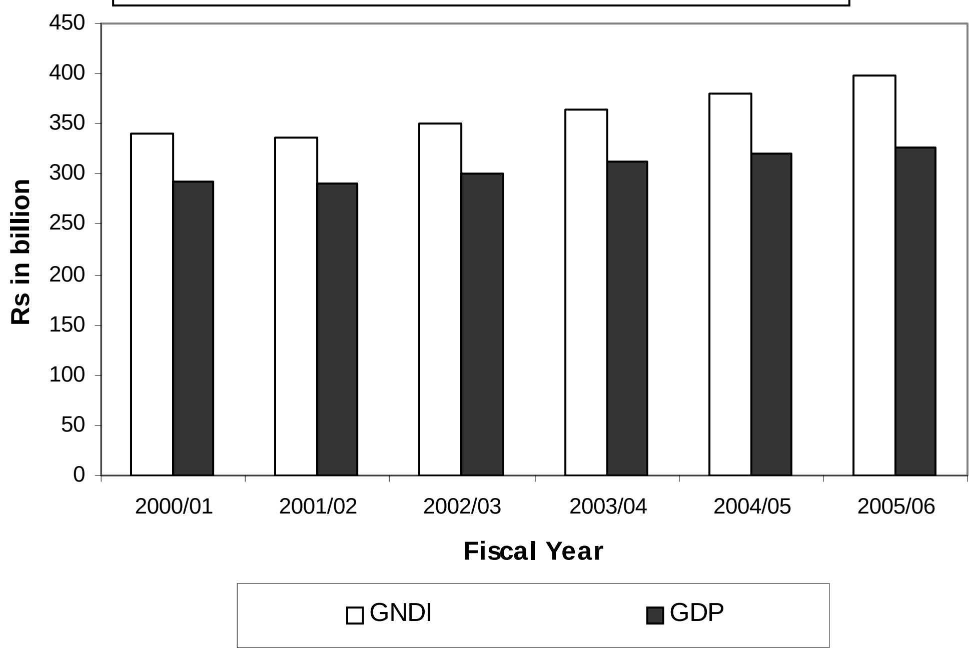
$$GNDI = GNI + TR_f$$

Where, Y_f - Net factor income, TR_f - Net transfers
Net transfers may be either private or public. Private transfers include mostly workers' remittances. Billions of rupees (in 2004/05 it was 65.54 billion) is being annually received from Nepali workers. Such a huge amount plays a dominant role in the spending decision and affects the economic activities of the country. Therefore, the estimation of GNDI and its comparison with macro economic variables is considered relevant and important as well.

[2] The GNDI is also a part of National Account Statistics. The SNA 1993 has redefined gross national income and gross national disposable income; however, the estimation of these aggregates has not yet been undertaken by the CBS. Realizing the importance of these aggregates, Nepal Rastra Bank, on the basis of theoretical concept given in the current national accounting system, has begun to estimate the GNDI for analyzing the economic activities of the country.

comparable GDP growth rate at current price was 7.4 and 9.3 percent in 2003/04 and 2004/05 respectively. Likewise, the ratio of GNDI to GDP is estimated to remain at 121.9 percent for the current fiscal year. Workers' remittance occupies a significant share in the net transfer income from abroad. Workers' inward remittance is estimated to surge by 45.3 percent; with the consequence that its ratio to GDP will remain at 16.3 percent. Gross national disposable income is expected to expand by 4.8 percent at 1994/95 prices. The comparative analysis of GDP and GNDI is presented in chart 1.

Chart 1: Gross Domestic Product and Gross National Disposable Income (Current Prices)



Monetary Development

10. In the first nine months of 2005/06, M_2 expanded by 9.7 percent compared to a growth of 5.8 percent in the previous year. The higher growth of net foreign assets (NFA) contributed to such a higher growth of M_2 in the review period.

11. The review period witnessed a growth of 15.9 percent (Rs 17.1 billion) in NFA (after adjusting foreign exchange valuation gain/loss) compared to a subdued growth of 7.6 percent (Rs. 8.3 billion) in the same time period of the previous year. The accelerated inflow of workers' remittances contributed to the accelerated growth of NFA in the review period.

12. The growth of domestic credit (DC) remained at 8.0 percent in the review period compared to a growth of 8.4 percent last year. Of the domestic credit, the net claims on government declined by 2.9 percent compared to a much larger decline of 4.5 percent last year due mainly to the increase in government's resources. This in turn is merely a result of classification of the local authorities' deposits with banks as resource base of the government.

13. In contrast to a growth of 53.3 percent last year, the claims on non-financial government enterprises declined by 8.2 percent in the review period due mainly to the loan repayment by Nepal Electricity Authority, Nepal Oil Corporation, National Trading Ltd and Hetauda Textile Industries Ltd.

14. Claims on private sector increased by 12.7 percent in the review period, which is almost equivalent to a previous year's growth of 12.8 percent. Because of political uncertainty in the review period, growth of private sector credit remained subdued. Moreover, a focus on loan recovery by Nepal Bank Limited and Rastriya Banijya Bank also contributed to slow down the growth of private sector credit in the review period.

15. In the review period, net non- monetary liabilities grew by a lower rate of 12.1 percent compared to the 16.6 percent growth of the previous year.

16. Time deposits, one of the dominant components of M_2, registered a growth of 10.3 percent as against the subdued growth of 5.8 percent last year; due to increased workers' remittance in the review period.

17. Reserve money posted a growth of 3.2 percent in the review period as against the negative growth of 1.4 percent last year. A growth of both net foreign assets and net domestic assets of monetary authority contributed to a rise in reserve money in the review period.

Foreign Exchange and Money Market

18. In the first nine months of 2005/06, NRB made 46 interventions in the foreign exchange market to purchase and sell the US dollar. A total of Rs 35.0 billion was injected through the purchase of the US dollar in the foreign exchange market in the review period compared to a purchase of Rs 28.0 billion in the same period of the previous year. Subsequently, the sale of the US dollar just mopped up Rs 650 million compared to Rs 2.8 billion last year. Thus, the net liquidity injected stood at Rs 34.3 billion in the review period. Most intervention was pursued to purchase the US dollar, necessitated by the increased inflow of remittances in the economy. Thus, injected liquidity was partly sterilized through open market operations (OMOs) based on the liquidity monitoring and forecasting framework.

19. In the review period, open market operation mopped up the net liquidity amounting to Rs 11.4 billion in the review period compared to Rs 8.7 billion in the same time period of last year. Of the monetary instruments, purchase and repo auctions injected the total liquidity of Rs 1.3 billion while sale and reverse repo auctions mopped up the total liquidity of Rs 12.6 billion in the review period (Table 1). Further, the issuance of fresh treasury bills in the primary market mopped up the liquidity of Rs 6.9 billion. In addition, development bonds worth Rs. 750 million was also issued through auction system in the review period. As a result, short-term interest rates remained stabilized between 2.20 to 3.38 percent in the review period, whereas such interest rates fluctuated between 0.617 to 3.109 percent in the same period of the previous year.

Table 1

Open Market Operations

Rs in million

		2004/05	2005/06
1.	Purchase Auction	1311.8	830.0
2.	Repo Auction	5760.0	450.0
A.	Total Liquidity Injection	7071.8	1280.0
3.	Sale Auction	10500.0	6140.0
4.	Reverse Repo Auction	5270.0	6500.0
B	Total Liquidity Mop up in Secondary market	15770.0	12640.0
B-A	Net Liquidity Mop up	869.9	1136.0

20. The review period witnessed a lower utilization of standing liquidity facility (SLF) by the commercial banks. Compared to Rs. 44.2 billion SLF used in the nine months of previous year, commercial banks utilized just Rs. 2.3 billion of SLF in the review period due to the increased deepening of inter bank transactions and lowering the maturity period of SLF from 5 days to 3 days in the beginning of this fiscal year through the monetary policy announcement. In the review period, inter bank transactions reached Rs 144.7 billion compared to Rs. 101.1 billion in the previous year.

Security Market Activities

Primary Issue of Securities

21. In the first nine months of 2005/06, Nepal Security Board approved 18 financial institutions to issue their ordinary shares, right shares and debentures worth Rs 877.5 million and Taragaon Regency Hotel to issue right share amounting to Rs. 446.5 million. Accordingly, seven financial institutions have been given approval to issue right shares amounting to Rs. 392.0 million, ten financial institutions for issuing ordinary share amounting to Rs. 285.5 million and Bank of Kathmandu to issue debentures worth of Rs. 200.0 million.

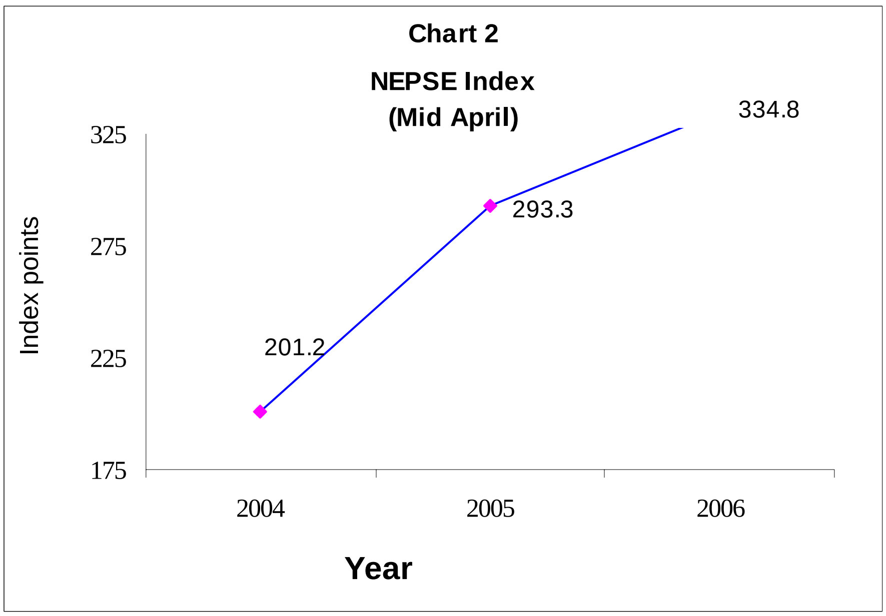
Secondary Security Market Development

22. Notwithstanding expansion in the size of stock market in the first nine months of 2005/06 compared to the same period last year, the stock market activities slowed down in terms of market capitalization and NEPSE as against the previous month.

23. The year on year NEPSE index increased by 41.51 points (14.2 percent) to 334.77 points in mid-April 2006. An effective regulation and supervision of NRB helped increase transparency of the financial reporting by financial institutions. Accordingly, these institutions have been adopting a good corporate governance culture, which has left a positive impact on their

financial health along with an increasing level of confidence of people towards these organizations. Hence, people's attraction towards the shares of such institutions has been increasing with an expectation of more financial returns and capital appreciation of shares of these institutions, creating an upward thrust on the NEPSE index. Moreover, the lack of alternative investment opportunities, persistent increase in the inflow of workers' remittances and low level of real interest rates has also created some upward pressure on the NEPSE index.

24. The year on year NEPSE index increased by 41.51 points (14.2 percent) to 334.77 points in mid-April 2006Of the 129 listed companies, 83 (64.3 percent) were financial institutions, 29 (22.5 percent) manufacturing and processing units, 4 (3.1 percent) hotels, 8 (6.2 percent) trading units and 5 (3.9 percent) others.



25. Market capitalization, on a y-o-y basis, increased by 27.0 percent to Rs. 79.5 billion in mid-April 2006. The market capitalization to GDP ratio increased by 1.9 percentage points to 13.6 percent in mid-April 2006. Of the total amount of market capitalization of the listed companies, financial institutions accounted for 83.5 percent, manufacturing and processing units 6.6 percent, hotel 3.0 percent, trading 0.9 percent and unclassified 6.0 percent.

26. Likewise, the total paid up value of listed shares on a y-o-y basis increased by 12.0 percent to Rs. 18.6 billion in mid-April 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.

27. Despite the growing tendency, the stock market witnessed a fall in liquidity of the shares listed in the stock exchange. Of the stock market liquidity indicators, the turnover to market capitalization ratio decreased to 0.35 percent

in mid-April 2006 from 0.47 percent a year ago. The high growth rate of market capitalization relative to turnover contributed to such decrease in the liquidity.

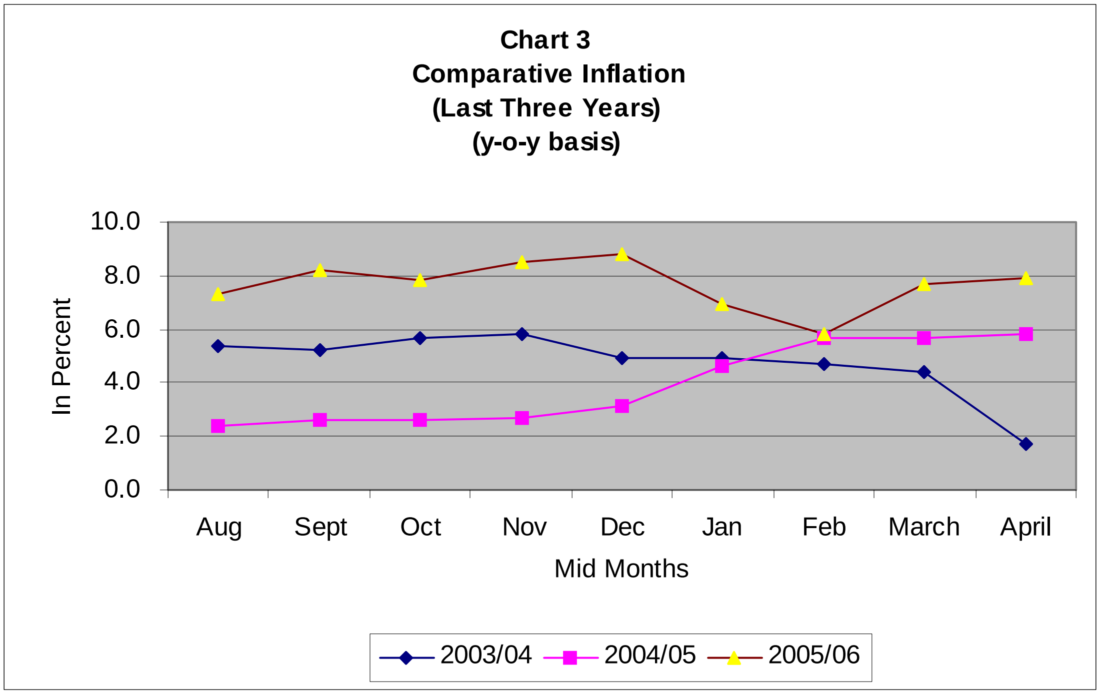
28. The Nepalese stock market continued to be highly concentrated and dominated by the stocks of commercial banks. For example, of the total turnover of Rs. 329.0 million, the share of commercial banks alone stood at 81.8 percent followed by finance companies (9.1 percent), insurance companies (5.6 percent) and development banks (2.1 percent) in mid-April 2006. In the comparable period of the preceding year, these entities occupied a share of 86.2 percent, 6.9 percent, 2.4 percent and 1.5 percent respectively. Clearly, the share of manufacturing and processing units, hotel and trading remained lower. In the absence of an effective monitoring and supervisory authority, investors do not have enough confidence towards the accounting and operational transparency of the companies listed under the production industries, service sector and business group. Hence, the trading volume of this group is negligible in comparison to the companies enlisted under financial institutions group.

29. Volatility, as measured by 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 18.9 in mid-April 2006 compared to 25.7 a year ago. As standard deviation is also a measurement of trading risk in the stock market, its subdued trend in the review period is a positive indication that the stock market is tending towards more efficiency in consequence of more transparency in the returns of some listed companies.

Price Situation

Consumer Inflation

30. The inflation based on the National Urban Consumer Price Index (1995/96 = 100), on year-to-year basis, increased by 7.9 percent as at mid-April 2006, compared to an increase of 5.8 percent in the same period of the preceding year. The higher growth in the price index is mainly attributable to the frequent rise in the prices of petroleum products as well as the increase in the prices of transportation services in the previous month together with the sharp rise in the prices of grains and cereal products, housing goods and services, pulses, vegetables and fruits and beverages. In the review period, the rise in the prices of education, reading and recreation, restaurant meals, medical and personal care and milk and milk products also contributed to rise in the price index. In the last week of the review month, the nationwide general strike interrupted the supply of some essential commodities, which also exerted an upward pressure in the price index. The overall price index, which was recorded at 163.1 points in mid-April 2005, rose to 176.0 points in mid-April 2006. The average growth rate of the price index from mid-May 2005 to mid-April 2006 stood at 7.4 percent. Such growth rate was 3.4 percent in the corresponding period of the previous year.



31. In the review period, on a point-to-point basis, the index of food and beverages group moved up by 6.9 percent compared to an increase of 4.8 percent in the same period last year. The rise in the prices of grains and cereal products, pulses, restaurant meals, beverages and milk and milk products pushed up the index of this group.

32. The index of non-food and services group increased by 9.0 percent compared to an increase of 6.8 percent in the same period last year. The higher rise in the price index of this group is mainly attributed to the rise in the prices of petroleum products as well as the accompanying increase in the prices of transportation services. This exerted an upward pressure on the indices of housing goods and services and transport and communication together with the rise in the price of education, reading and recreation, medical and personal care as well as the prices of cloth, clothing and sewing services.

33. Regionwise, the price indices of the Kathmandu Valley, Terai and Hills in the review period increased by 6.2 percent, 8.6 percent and 9.1 percent, respectively. In the corresponding period in the previous year, the indices of Kathmandu Valley, Terai and Hills had increased by 5.5 percent, 5.7 percent and 6.5 percent, respectively.

34. The y-o-y core inflation increased by 4.0 percent in mid-April 2006, compared to an increase of 3.6 percent in the same period last year.

Wholesale Inflation

35. The National Wholesale Price Index (1999/00=100) on a point-to-point basis as at mid-April 2006 stood at 133.1 registering a rise of 7.6 percent. Such index had increased by 8.4 percent in the corresponding period of the preceding year. The growth in the price index is mainly attributable to rise on the prices of foodgrains, transport vehicles and machinery goods, cash crops, pulses as well as the sharp rise in the prices of petroleum products that put an upward pressure in the index of petroleum products and coal. Howeverk, the decline in the prices of fruits and vegetables and livestock production in the review period helped to moderate the growth rate of the price index compared to last year. The indices of Agriculture Commodities, Domestic Manufacture Commodities and Imported Commodities increased by 7.8 percent, 2.7 percent and 10.1 percent respectively in the review period. The average National Wholesale Price Index from the mid-May 2005 to mid-April 2006 increased by 9.1 percent compared to a rise of 5.8 percent in the same period of the previous year.

Salary and Wage Rate Index (SWRI)

36. The National Salary and Wage Rate Index (2004/05 = 100), on a point-to-point basis, increased by 4.9 percent as at mid-April 2006. This increase is mainly attributable to the rise in the wage rate of all three categories laborers as well as a reflection of the rise in the salary of bank and financial institutions and public corporations. The indices of salary and wage rate increased by 0.4 percent and 6.6 percent, respectively.

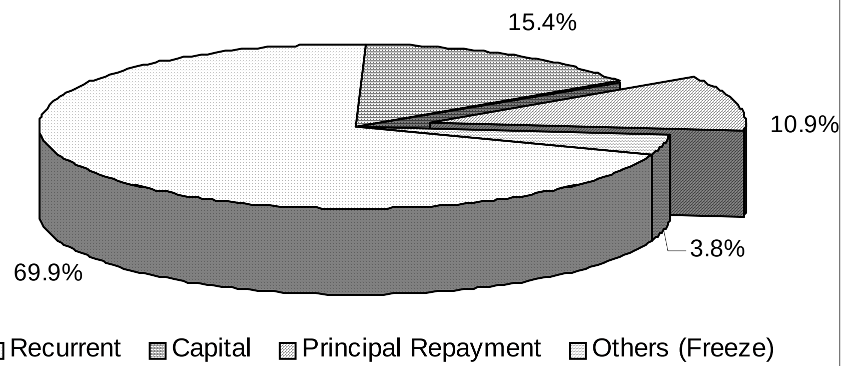
Government Budgetary Operation

37. In the first nine months of 2005/06, government budgetary situation on cash basis remained expansionary.

38. In the review period, total government expenditure (on cash basis) expanded by 13.3 percent compared to an increase of 8.9 percent in the corresponding period of the previous year. The uneasy situation in the country resulting an increase in recurrent expenditure accounted for such a high growth of total government expenditure in the review period.

39. Of the total government expenditure, the share of recurrent expenditure, capital expenditure, principal repayment and freeze expenditure remained at 70.0 percent, 15.4 per net, 10.9 percent and 3.8 percent respectively in the review period. Such ratios constituted at 72.5 percent, 13.0 percent, 12.0 percent and 2.5 percent respectively in the same period last year.

Chart 4
Structure of Total Government Expenditure
(First Nine Months)



40. In the first nine months of 2005/06, total government non-debt resources increased by 11.2 percent compared to an increase of 13.6 percent last year. Increase in foreign cash grants as well as classification of local authorities' deposits as resources accounted for such an increase in non-debt resources. However, the low growth rate of non-debt resources is attributed to the low growth of government revenue.

41. Total government revenue witnessed a marginal growth of 0.1 percent compared to a normal increase of 11.7 percent in the corresponding period last year. On the basis of first eight months' data of revenue details, a decline in customs duties, corporate income tax and decline in some other non tax revenues including dividends, principal repayment as well as non receipts of Indian Excise Refund accounted for such a low growth of revenue mobilization.

42. Compared to an increase of 46.7 percent last year, in the first nine months of 2005/06, foreign cash grants reported a growth of 70.6 percent

43. The overall government budgetary situation remained at a deficit of Rs 2.6 billion in the review period. Moreover, government budgetary situation, excluding local authorities' deposits with banks remained at a deficit of Rs 6.0 billion.

44. Of the sources financing the budget deficit, government mobilized additional domestic borrowings of Rs 7.1 billion by issuing treasury bills of Rs 6.1 billion and development bonds and citizen saving certificates of Rs 1.0 billion in the first nine months of 2005/06. Government had mobilized Rs 3.1 billion worth of domestic borrowings in the corresponding period of the previous year. In the review period, government mobilized Rs 2.8 billion foreign loans compared to the amount of Rs 1.6 billion in the same period last year.

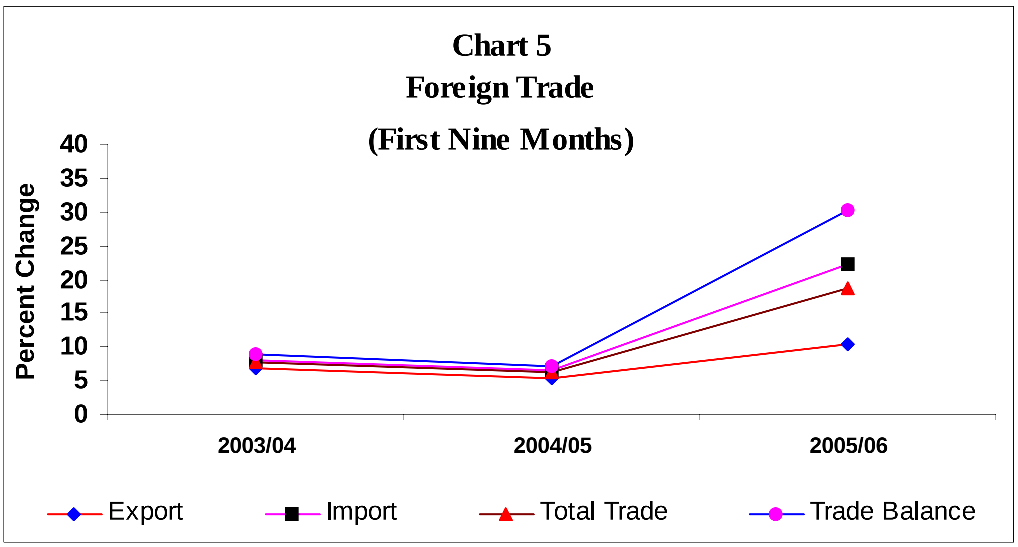
Foreign Trade

45. The foreign trade sector demonstrated a mixed performance in the first nine months of 2005/06. Exports went up by 10.4 percent compared to a rise of 5.4

percent in 2004/05. Of the total exports, export to India rose by 16.2 percent in 2005/06 in comparison to a growth of 20.0 percent in the same period in 2004/05. Exports to other countries declined by 0.3 percent in the review period compared to a decline of 14.1 percent in the corresponding period of the previous year.

46. The rise in the exports to India was attributed to the increase in the exports of polyster yarn, zinc sheet, readymade garments, wire and jute goods. Likewise, the slight decline in the exports to other countries.

47. Total imports increased by 22.2 percent in the first nine months of 2005/06 compared to an increase of 6.4 percent in the corresponding period of the previous year. Out of this, imports from India went up by 29.0 percent in the review period in comparison to a growth of 10.9 percent in the corresponding period of 2004/05. Imports from other countries, on the other hand, rose by 12.6 percent in comparison to a growth of just 0.6 percent a year earlier.



48. An augmentation in the import of petroleum products, rice, thread, medicine, hot rolled sheet in coil and M.S. billet, among others, from India and palm oil, crude palm oil, textile dyes, polythene granules and electrical goods, among others, from other countries led to the expansion in total imports in the first nine months of 2005/06.

49. There was an expansion in trade deficit by 30.2 percent in the first nine months of 2005/06 compared to an increase of 7.1 percent in the corresponding period of 2004/05.

Balance of Payments

50. On the basis of monetary data, the overall BOP registered a surplus of Rs. 17.1 billion in the first nine months of 2005/06 compared to a surplus of Rs. 8.3 billion in the corresponding period of 2004/05.

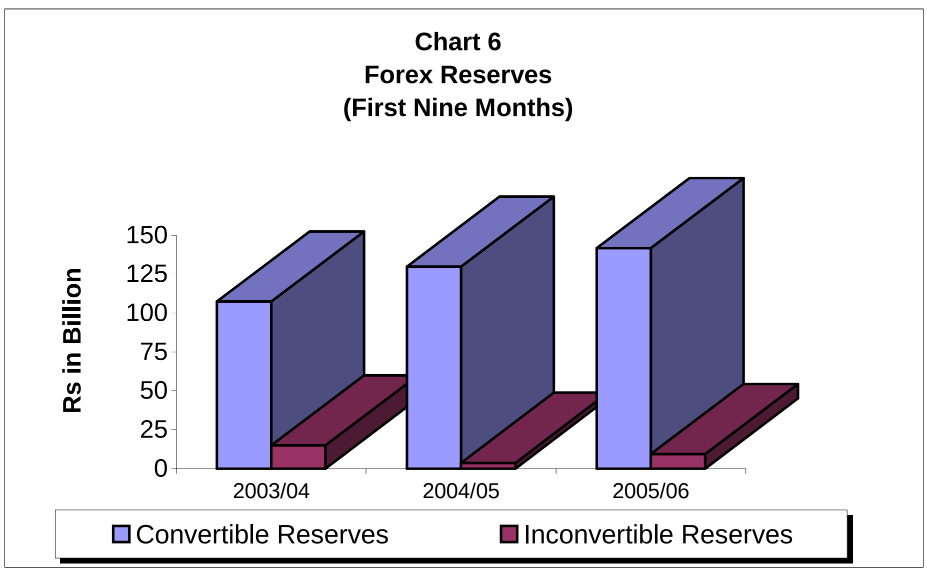
51. On the basis of the BOP statistics for the first eight months of 2005/06, current account recorded a surplus of Rs. 4.7 billion mainly owing to the

significant rise of workers remittances by 47.3 percent. Remittances had risen by 2.6 percent in the comparable period of 2004/05.

52. On the capital account front, capital transfer increased to Rs. 2.4 billion from the level of Rs. 724.6 million a year earlier. Under the financial account, the government received Rs. 3.7 billion as foreign loan and repaid Rs. 3.7 billion in amortization.

Foreign Exchange Reserves

53. Gross foreign exchange reserves rose by 16.2 percent to Rs. 150.9 billion in mid-April 2006 compared to mid-July 2005. It had risen by just 2.5 percent in the corresponding period of the previous year. The share of convertible reserves in the total reserves fell to 93.9 percent as at mid-April 2006 from 97.3 percent in mid-April 2005, leading to a corresponding increase in the share of the non-convertible reserves to 6.1 percent from 2.7 percent. The current level of reserves is adequate for financing merchandise imports of 10.6 months and merchandise and service imports of 8.9 months.



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

54. In the international market, the price of oil (Crude Oil Brent) rose by 32.2 percent to US$ 69.33 per barrel on April 15, 2006 from US$ 49.79 per barrel on the corresponding date of the previous year. Likewise, the price of gold soared by 39.7 percent to US$ 593.00 per ounce on April 15, 2006 from US$ 424.60 a year earlier.

55. In comparison to mid-July 2005, the Nepalese currency vis-à-vis the US dollar depreciated by 2.31 percent in mid-April 2006. It had appreciated by 4.94 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 72.01 in mid-April 2006 compared to Rs. 70.65 in mid-April 2005.