Current Macroeconomic Situation

(Based on the First Four Months' Data of 2006/07)

Monetary and Credit Aggregates

1. During the first four months of 2006/07, broad money (M_2) grew by 3.0 percent compared to a growth of 4.6 percent last year. A deceleration in net foreign assets (NFA) contributed to a slow down in the growth of M_2 in the review period. Moreover, a substantial amount of liquidity absorption through secondary market operations conducted by Nepal Rastra Bank (NRB) also lowered the monetary expansion.

2. Both narrow money (M1) and quasi money witnessed a decelerating growth in the review period. M_1 increased by just 0.6 percent in the review period compared to a growth of 2.9 percent last year. Quasi money went up by 4.2 percent compared to a growth of 5.4 percent in the previous year. A lower growth of domestic credit in the review period compared to that of the previous year contributed to such a low growth of M_1.

3. NFA, a source of monetary expansion, after adjusting foreign exchange valuation gain/loss, increased by 0.1 percent (Rs 81.2 million) in the review period compared to a growth of 4.0 percent (Rs 4.35 billion) last year. A negative growth of export and an increase in payments to Indian Oil Corporation by Nepal Oil Corporation lowered the growth of NFA in the review period.

4. Domestic credit registered a growth of 2.5 percent in the review period compared to a growth of 3.5 percent last year. A higher rate of decline in net claims on government on account of higher revenue mobilization and a slowdown in the growth of private sector credit were attributed for the deceleration in the growth of domestic credit in the review period.

5. Of the credit aggregates, net claims on government declined by 4.3 percent due to a significant increase in government revenue in the review period.

6. Claims on non-financial government enterprises increased by 15.8 percent in the review period in contrast to a decline of 12.4 percent last year on account of the loan extended by commercial banks to some non-financial government corporations such as Nepal Food Corporation, Janakpur Cigarette Factory Ltd, National Trading Ltd. Janak Educational Material Centre and Nepal Telecom. In the review period, commercial banks also increased their short-term placement in non-government financial institutions.

7. Claims on private sector credit increased by a lower rate of 4.1 percent in the review period compared to a growth of 5.5 percent last year. During the first four months of current fiscal year, Nepal Bank Ltd.(NBL) wrote off the bad loan of Rs. 2.82 billion consisting of Rs. 820 million principal and Rs. 2.0 billion accrued interest, which lowered the claims on the private sector.

Money Market

8. Liquid funds of commercial banks stood at Rs. 63.5 billion as at mid-November, 2006 compared to Rs. 52.6 billion a year ago. As a result, the ratio of liquid funds to total deposit remained at 21.1 percent as at mid-November 2006 compared to 20.3 percent a year ago. Of the liquid funds, more than half (52.2 percent) was in foreign currency.

9. Net liquidity injection through foreign exchange interventions in the review period stood at Rs 22.0 billion compared to Rs 13.3 billion last year. Such a heavy injection of liquidity during the review period was attributed to continuous rise in workers' remittances on the one hand, and the commercial banks' interest to sell their foreign exchange to NRB rather than having short-term placement abroad because of nominal appreciation of Nepali currency (NC) against the US dollar on the other hand.

10. During the review period, net liquidity of Rs 15.01 billion was mopped up through secondary market operations compared to Rs 3.4 billion in the previous year (Table 1). Outright sale auction and reverse repo auction absorbed Rs 3.27 billion and Rs 11.74 billion respectively in the review

period compared to Rs 3.74 billion and Rs. 500 million in the previous year. Moreover, purchase auction had injected liquidity of Rs 830 million in the previous year.

Table 1: Open Market Operations
(The first four months)

(Rs. in billion)

	Instruments	2005/06	2006/07
A.	**Liquidity Mopped up**	**4.24**	**15.01**
	Sale Auction	3.74	3.27
	Reverse Repo Auction	0.5	11.74
B.	**Liquidity Injected**	**0.83**	**-**
	Purchase Auction	0.83	-
	Repo Auction	-	-
C.	**Net Liquidity Mopped up (A-B)**	**3.41**	**15.01**

11. In the review period, the use of standing liquidity facility (SLF) increased. Compared to the use of Rs 1.17 billion in the previous year, commercial banks availed Rs 4.05 billion loans under SLF in the review period (Table 2). However, inter bank transactions remained at Rs. 62.96 billion, lower than that of the previous year's level of Rs. 67.61 billion.

Table 2: SLF and Interbank Transactions

(In the first four months)

(Rs. in billion)

	2005/06	2006/07
SLF	1.17	4.05
Inter bank transactions	67.61	62.96

Short-term Interest Rate

12. On account of excess liquidity of commercial banks in the review period, short-term interest rate remained low compared to that of the previous year. For example, compared to 2.69 percent a year ago, the weighted average 91-day Treasury bill rate stood at 2.11 percent as at mid-November 2006. Likewise, the weighted average inter bank rate declined to 1.20 percent as at mid-November 2006 from 2.36 percent a year ago.

Securities Market Situation

Primary Issue

13. On the primary issue front, Nepal Securities Board granted permission to six financial institutions to issue ordinary shares amounting to Rs. 15 million and right shares amounting to Rs. 240 million in the first four months of 2006/07.

Secondary Market

14. With respect to the secondary market transactions, the year on year (y-o-y) NEPSE index remained buoyant showing an increase of 48.96 percent to 447.43 points at mid-November 2006. Stock market activities witnessed an expansion because of the rise in workers' remittances, lack of alternative investment opportunities and a boost in investors' confidence on account of the improved peace and security situation in the country. In addition, the recent rise in investors' expectations amid the release of the financial statements of the banks and financial institutions along with dividend declaration also contributed to the share market expansion.

15. The y-o-y market capitalization increased by 63.5 percent and reached Rs. 113.8 billion at mid-November 2006. Market capitalization to GDP ratio increased to 19.4 percent at mid-November 2006 from 13.0 percent a year ago. Of the total transactions, bank and financial institutions, production and processing companies, hotels, business entities, and entities belonging to other groups accounted for 82.7 percent, 5.1 percent, 2.1 percent, 0.7 percent, and 9.5 percent respectively.

16. The number of companies listed in the Nepal Stock Exchange Ltd reached 139 in mid-November 2006. This number was 125 a year ago. Of the total listed companies, 92 were banks and financial institutions. The number of production and processing industries, hotels, business entities, and entities belonging to other groups listed in Nepal Stock Exchange was 29, 4, 8, and 6 respectively.

17. Total paid up capital of the listed companies reached Rs. 20.5 billion at mid-November 2006, showing an increase of 16.7 percent over the period of one year. This increase was due to the additional listing of companies in the Nepal Stock Exchange Ltd, and the issuance of ordinary and right shares by some of the financial institutions.

18. The turnover to market capitalization ratio reached 0.63 percent at mid-November 2006 compared to 0.25 percent a year ago.

19. The twelve-month rolling standard deviation at mid-November 2006 recorded 43.6, compared to 22.7 a year ago.

Inflation and Wage Rates

Consumer Price Inflation

20. The y-o-y consumer price inflation moderated to 7.1 percent at mid-November 2006. The y-o-y consumer price inflation was 8.5 percent at mid-November 2005. The moderation of consumer price inflation was on account of the lower rate of rise in the prices of cereal products by 5.1 percent during the review period in comparison of 14.8 percent rise during the corresponding period last year.

21. A significant increase in the prices of pulses (21.1 percent), vegetables and fruits (10.1 percent) and spices (26.7 percent) during the review period accounted for consumer price inflation of 7.1 percent at mid-November 2006.

22. Group wise, the indices of food and beverages and non-food and services groups increased by 7.0 percent and 7.1 percent respectively. Regionwise, price level has remained high in Terai at 7.3 percent and relatively low in the Hills and Kathmandu Valley at 7.2 percent and 6.6 percent respectively. The respective inflation rates were 9.5 percent, 9.3 percent and 6.5 percent a year ago.

23. At mid-November 2006, the y-o-y core inflation edged up at 6.4 percent from 4.4 percent a year ago. Inflationary expectation accounted for a pick up in core inflation in the review period.

Wholesale Price Inflation

24. At mid-November 2006, the y-o-y wholesale price inflation moderated to 10.3 percent from 11.3 percent a year ago. A significant price rise in foodgrains, cash crops, pulses, construction materials and spices together with the pass through effect of the hike in prices of petroleum products in March 2006 accounted for wholesale price inflation at 10.3 percent. Groupwise, the indices of Agricultural Commodities registered an increase of 13.1 percent, domestic manufactured commodities at 8.5 percent and the imported commodities at 7.1 percent.

National Salary and Wage Rates

25. The y-o-y Salary and Wage Rate Index rose by 8.7 percent at mid-November 2006. The growth of such index was 3.2 percent a year ago. The surge in wage rate on account of shortage of labor owing to the Nepalese workers seeking foreign jobs and the 10.0 percent increment in the allowances of civil service contributed to the rise in the National Salary and Wage Rate Index in the review period. In the review period, the Wage Rate and the Salary group indices increased by 9.4 percent and 6.6 percent compared to the growth of 4.4 percent and zero percent respectively in the previous year.

Fiscal Situation

Government Expenditure

26. Total government expenditure (on a cash flow basis) grew by 9.9 percent to Rs 25.69 billion in the first four months of 2006/07. The government spending had increased by 10.3 percent in the same period of 2005/06. The decline in capital expenditure accounted for such a low growth of actual expenditure in the review period. The decline in capital expenditure is attributed to the sluggish development activities. Recurrent expenditure increased on account of increasing government administrative expenses as well as an increment in the allowances of government employees.

Government Revenue

27. The government revenue showed a significant growth of 20.3 percent to Rs 21.5 billion in the first four months of 2006/07. Revenue had grown by only 6.9 percent in the corresponding period of the previous year. A continuous rise in workers' remittance and resulting expansion in consumers' spending contributed to the increase in VAT revenue as well as excise revenue. Moreover, the adjustment in tariff rates through the budget of 2006/07 and resulting increase in customs revenue as well as a rise in income tax revenue contributed to such a high growth in revenue.

28. In the first four months of 2006/07, total foreign cash grants picked up a significant growth of 97.9 percent in contrast to a decline of 43.4 percent in the corresponding period of the previous year. Conversely, foreign loan depicted a decline of 22.8 percent in the review period in contrast to an increase of 18.5 percent in the corresponding period of the previous year.

Budget Deficit/Surplus

29. As a consequence of the significant growth of revenue and foreign cash grants as well as the growth of nonbudgetary receipts, the government's budget remained at a surplus of Rs 1.76 billion as opposed to deficits of Rs 3.18 billion in the corresponding period of the previous year.

Foreign Trade

30. In the first four months of 2006/07, total exports declined by 0.1 percent in contrast to an increase of 14.5 percent in 2005/06. Of the total exports, export to India declined by 1.1 percent in 2006/07 as against a significant growth of 29.4 percent in the same period of 2005/06. The continuation of the imposition of the additional duty of 4 percent by India on a number of products of Nepal was one of the factors responsible for the decline in the rate of growth of exports to that country. Exports to other countries, on the other hand, rose by 1.9 percent in comparison to a decline by 8.4 percent in the corresponding period of the previous year.

31. The decline in the exports to India was attributed to the decline in the exports of polyster yarn, plastic utensils, cattlefeed, copper wire & rod, G.I pipe, pashmina and chemicals (Table 3). Likewise, the rise in the rate of growth of exports to other countries was due to the increase in the export of woolen carpets, pulses, Nepalese paper & paper products, tea & tanned skin.

Table 3: Decline in Exports of Selected Commodities to India

First Four Months

(Rs. in million)

	$2005/06^P$	$2006/07^P$	Decline
Polyster yarn	1060.1	636.0	-424.1
Plastic utensils	448.2	118.1	-330.1
Cattlefeed	185.7	41.1	-144.6
Copper wire & rod	134.7	17.7	-117.0
G.I. Pipe	203.0	91.3	-111.7
Pashmina	118.1	13.8	-104.3
Chemicals	431.5	331.8	-99.7

Noodles	159.0	77.6	-81.4
Jute goods	850.0	777.5	-72.5
Wire	568.4	521.9	-46.5
Total	**4158.7**	**2626.8**	**-1531.9**

32. The growth of total imports decelerated to 9.9 percent in the first four months of 2006/07 compared to a growth of 21.1 percent in the same period of the previous year. While the rate of increase imports from India decelerated to 7.8 percent in the review period in comparison to a higher growth of 33.8 percent in the corresponding period of 2005/06, imports from other countries surged by 13.4 percent in comparison to a growth of 4.3 percent last year.

33. A rise in the import of petroleum products, vehicles & parts, thread, hot rolled sheet in coil and other machinery & parts from India and crude palm oil, computer parts, chemical fertilizer, copper wire & rod, computer parts and textiles from other countries led to the rise in total imports in the first four months of 2006/07.

Balance of Payments

34. The overall BOP registered a surplus of Rs. 81.1 million in the first four months of 2006/07 compared to a surplus of Rs. 4.35 billion in the corresponding period of 2005/06. Despite the increase in workers' remittances, the surplus in the BOP was lower than that of the previous year because of the decline in exports and net services income, among others.

35. Under the current account while receipts from travel increased by 4.9 percent to Rs. 2.90 billion in contrast to a decline of 25.5 percent in the previous year. Remittances registered a rise of 17.0 percent to Rs. 31.67 billion in the first four months of 2006/07 in comparison to the rise of 30.3 percent a year earlier.

36. Under the financial account, the government received Rs. 1.52 billion as foreign loan and repaid Rs. 2.61 billion in amortization.

Foreign Exchange Reserves

37. In comparison to mid-July 2006, gross foreign exchange reserves fell slightly by 0.4 percent to Rs. 164.44 billion at mid-November 2006 owing to the appreciation of the Nepalese rupees against the US dollar. Such reserves had risen by 7.2 percent in the corresponding period of the preceding year. On the basis of US dollar, gross foreign exchange reserves went up by 2.1 percent to US$ 2.27 billion at mid-November 2006. In the comparable period last year, such reserve had increased by 3.1 percent. The share of convertible reserves in the total reserves went up to 94.7 percent as at mid-November 2006 from 93.4 percent at mid-November 2005, resulting in the corresponding decline in the share of the non-convertible reserves to 5.3 percent from 6.6 percent. The current level of reserves is adequate for financing merchandise imports of 10.6 months and merchandise and service imports of 8.7 months.

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

38. The price of oil (Crude Oil Brent) in the international market rose by 4.9 percent to US$ 56.72 per barrel on November 15, 2006 from US$ 54.09 per barrel in mid-November 2005. The price of gold, on the other hand, rose by 33.4 percent to US$ 624.75 per ounce on November 15, 2006 from US$ 468.25 a year earlier.

39. In comparison to mid-July 2006, the Nepalese currency vis-à-vis the US dollar appreciated by 2.49 percent in the review period. It had depreciated by 3.81 percent in the corresponding period last year. The exchange rate of one US dollar stood at Rs. 72.30 at mid-November 2006 compared to Rs. 73.14 at mid-November 2005.