Current Macroeconomic Situation

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

Monetary Aggregates

1. During the first five months of 2006/07, broad money (M_2) expanded by 4.0 percent compared to a growth of 4.7 percent in the previous year. A lower growth both in net foreign asset (NFA) and net domestic assets (NDA) accounted for the deceleration in the growth of M_2 in the review period.
2. Of the components of M_2, narrow money (M_1) increased by 2.8 percent in the review period compared to a growth of 2.0 percent in the same period of the previous year. Growth of time deposits, another component of M_2, also remained lower at 4.6 percent compared to a growth of 6.0 percent last year. The deceleration in time deposit growth is attributed to the diversion of deposits towards other financial institutions because of lower rates of interest of the banking sector. The fall in the rate of growth of remittances also accounted for the deceleration in time deposits.
3. NFA, a main source of monetary expansion, after adjusting foreign exchange valuation gain/loss, increased by 4.1 percent (Rs 5.68 billion) in the review period compared to a growth of 5.3 percent (Rs 5.73 billion) last year. Despite the remarkable rise in foreign grants to the government, unsatisfactory export performance accounted for the deceleration in the growth of NFA in the review period.
4. Domestic credit registered a growth of 2.8 percent in the review period compared to a growth of 3.7 percent last year. The decline in net claims on government due to its substantial cash balance with Nepal Rastra Bank (NRB) following the higher revenue mobilization, and a relatively lower private sector credit growth accounted for the slowdown in domestic credit growth in the review period.
5. Of the credit aggregates, net claims on government declined by 11.1 percent in the review period compared to a decrease of 1.5 percent in the corresponding period of the previous year.
6. Claims on financial institutions increased by 29.5 percent in the review period in contrast to a decline of 1.2 percent last year due mainly to the increase in short-term placement by some commercial banks in finance companies, development banks and other financial institutions.
7. Claims on private sector, the main components of domestic credit, recorded a growth of 6.5 percent in the review period compared to a rise of 6.0 percent in the comparable period of the previous year. The growth of bank credit to the private sector, albeit marginally higher than that of the previous year could not pick up due to the deceleration in import growth and slowdown in the performance of manufacturing sector.
8. During the review period, Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) wrote off some of their bad loans amounting to Rs.16.03 billion. Of this, NBL wrote off Rs 2.87 billion (Rs. 0.82 billion principal and Rs 2.05 billion accrued interest) and RBB wrote off Rs 13.16 billion (Rs. 4.06 billion principal and Rs 9.10 billion interest).
9. The growth of net non-monetary liabilities remained marginal at 0.6 percent in the review period compared to a growth of 2.2 percent last year.

Monetary Operations

10. The net liquidity injection through foreign exchange intervention stood at Rs 28.90 billion in the review period compared to Rs. 18.14 billion last year. A higher level of foreign receipts relative to the growth of imports necessitated a substantial purchase interventions during the review period.
11. A higher level of liquidity injection through foreign exchange operation was mopped up through open market operations in treasury bills. As compared to the net liquidity absorption of Rs 5.74 billion last year, a total net liquidity of Rs 18.38 billion was mopped up in the review period. Of the instruments used for open market operation, outright sale auction and reverse repo auction absorbed Rs 5.89 billion and Rs 12.49 billion respectively in the review period compared to Rs 4.57 billion and Rs 2.0 billion respectively last year.

Table 1: Open Market Operations
(In the first five months)

Rs. in billion

	Instruments	2005/06	2006/07
A	**Total Liquidity Absorption**	**6.57**	**18.38**
	Sale Auction	4.57	5.89
	Reverse Repo Auction	2.00	12.49
B	**Total Liquidity Injection**	**0.83**	**0.0**
	Purchase auction	0.83	0.0
	Repo auction	0.0	0.0
C	**Net liquidity Absorption (A-C)**	**5.74**	**18.38**

12. Commercial banks resorted to the SLF borrowing amounting to Rs. 5.12 billion in the review period. Last year the SLF borrowing was low at Rs. 1.17 billion. Liquidity shortage with some commercial banks accounted for the relatively higher level of SLF borrowing in the review period. During the review period, inter bank transaction stood at Rs 77.14 billion, compared to Rs 83.15 billion in the corresponding period of the previous year.

Table 2: Standing Liquidity Facility and Inter Bank Transactions
(In the first five months)

Rs in billion

	2005/06	2006/07
Standing Liquidity Facility	1.17	5.12
Inter Bank Transactions	83.15	77.14

Short-term Interest Rate

13. On the whole, the pressure of excess liquidity remained in the money market in the review period. As a result, the weighted average 91-day Treasury bill rate decreased to 1.98 percent in mid-December 2006 from 2.20 percent a year earlier.

Securities Market Situation

14. 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 five months of 2006/07.

15. Regarding the secondary market transactions, the year on year (y-o-y) NEPSE index increased by 47.61 percent to 508.58 points in mid-December 2006. The lack of alternative investment opportunities, the low level of interest rates and an increase in the investors' confidence following the political settlement of the conflict accounted for the stock market resilience. Additionally, the release of the financial statements of the banks and financial institutions along with dividend declaration contributed to the share market expansion.

16. The y-o-y market capitalization increased by 85.4 percent to Rs. 128.54 billion in mid-December 2006. Market capitalization to GDP ratio reached 19.9 percent in mid-December 2006 from 11.9 percent a year ago. Of the total transactions, bank and financial institutions, production and processing companies, hotels, business entities, and other groups accounted for 83.1 percent, 4.5 percent, 1.9 percent, 0.6 percent, and 10 percent respectively.

17. The number of companies listed in the Nepal Stock Exchange Ltd reached 140 by mid-December 2006. This number was 127 a year ago. Of the total listed companies, 93 were banks and financial

institutions. Production and processing industries, hotels, business entities, and other groups consisted of 29, 4, 8 and 6 respectively.

18. Total paid up capital of the listed companies stood Rs. 20.51 billion in mid-December 2006, showing an increase of 17.5 percent over the period of one year. This increase was due to the additional listing of the companies in the Nepal Stock Exchange Ltd, and the issuance of ordinary and right shares by some of the financial institutions.

19. Monthly turnover to market capitalization ratio was 0.73 percent in mid-December 2006 compared to 0.47 percent a year ago.

20. The twelve-month rolling standard deviation in mid-December 2006 recorded 56.2, compared to 19.2 a year ago.

Secondary Market Transaction of Government Bonds

21. Secondary market transaction of Government bonds commenced at Nepal Stock Exchange Ltd. on December 15, 2006. Two transactions amounting to Rs. 700,000 took place on the same day.

Inflation and Wages

Consumer Price Inflation

22. The y-o-y consumer price inflation remained at 7.3 percent in mid-December 2006. Such inflation was 8.8 percent in the same period last year. A significant increase in the prices of spices (29.4 percent), pulses (18.3 percent) and vegetables and fruits (9.2 percent) as well as the continuation of the pass-through effect of increased petroleum prices in March 2006 accounted for consumer price inflation of 7.3 percent in mid-December 2006.

23. Group-wise, the indices of food and beverages and non-food and services groups increased by 7.3 percent each. Region-wise, Hill experienced the higher inflation of 7.6 percent followed by Terai (7.4 percent) and Kathmandu Valley (6.8 percent). The respective inflation rates were 9.7 percent, 6.9 percent and 6.5 percent a year ago.

24. In mid-December 2006, the y-o-y core inflation remained at 6.7 percent from 4.6 percent a year ago. This growth is mainly attributed to the price rise of wheat and wheat flour, spices and other grains and cereal products.

Wholesale Price Inflation

25. In mid-December 2006, the y-o-y wholesale price inflation moderated at 8.6 percent from 12.9 percent a year ago. A significant price rise in food grains, livestock production, pulses, construction materials and spices together with the pass-through effect of the hike in prices of petroleum products in March 2006 contributed to the rise in wholesale price inflation at 8.6 percent. Group-wise, the indices of agricultural commodities registered an increase of 9.5 percent, domestic manufactured commodities at 9.1 percent and the imported commodities at 7.0 percent.

National Salary and Wage Rate

26. The y-o-y salary and wage rate index rose by 10.2 percent in mid-December 2006. The growth of such index was 3.6 percent a year ago. The surge in wage rate on account of shortage of labors 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 same period last year, wage rate and the salary group indices increased by 6.2 percent and 11.7 percent respectively.

Fiscal Situation

Government Expenditure

27. Government expenditure, on a cash basis, increased by 7.0 percent in the first five months of 2006/07 compared to a growth of 12.8 percent in the corresponding period of the previous year. Total government expenditure stood at Rs 32.75 billion in mid-December 2006. Deceleration in

both recurrent and capital expenditure in the review period accounted for such a smaller growth of government expenditure.

Government Revenue

28. In the review period, government revenue recorded an increase of 13.0 percent compared to a growth of 9.8 percent in the same period last year. Total government revenue stood at Rs 26.73 billion in mid-December 2006. Increased consumers' confidence, the adjustment in tariff rates and improvement in custom's valuation, and increased tax compliance contributed to such a high growth of revenue.

29. In the review period, foreign cash-grants of the Government of Nepal (GON) recorded a robust growth of 177.2 percent in contrast to the decrease of 25.4 percent in the same period last year. Such amount stood at Rs 7.23 billion in mid-December 2006. The foreign cash loans of the government, on the other hand, recorded a modest growth of 5.7 percent compared to a significant growth of 79.8 percent in the corresponding period of the previous year.

Budget Deficit/Surplus

30. As the growth in resources outstripped the growth in expenditure, the cash budget of the GON recorded a surplus of Rs 4.27 billion in the review period as against the deficit of Rs 3.22 billion in the same period of the previous year.

Foreign Trade

31. In the first five months of 2006/07, total exports declined by 0.9 percent in contrast to an increase of 12.2 percent in 2005/06. Of the total exports, export to India declined by 0.3 percent in 2006/07 as against a significant growth of 24.6 percent in the same period of the previous year. The continuation of the imposition of the 4 percent additional duty by India on a number of Nepalese products and frequent problems of labor and management relationship in the industrial sector were the crucial factors responsible for the decline in the exports to that country. Similarly, exports to other countries also declined by 2.2 percent in comparison to a decline by 8.1 percent in the corresponding period of the previous year.

32. The decline in exports to India was attributed to the decline in the exports of polyester yarn, plastic utensils, cattle feed, copper wire and rod, G.I pipe, noodles, jute goods and bags (Table 3). Likewise, the decline in exports to other countries was due to the decline in the export of readymade garments, pasmina and woolen carpets.

Table 3: Decline in Exports of Selected Commodities to India

First Five Months

(Rs. in million)

	$2005/06^P$	$2006/07^P$	Decline
Polyester yarn	1476.7	944.9	-531.8
Plastic utensils	467.6	163.8	-303.8
Cattlefeed	246.0	52.4	-193.6
Copper wire and rod	159.8	26.8	-133.0
G.I. Pipe	203.0	92.7	-110.3
Pashmina	119.4	15.2	-104.2
Noodles	222.7	107.1	-115.6
Jute goods	1146.8	1079.4	-67.4
Bags	336.4	61.0	-275.4
Total	**4378.4**	**2543.3**	**-1835.1**

33. The growth of total imports decelerated to 8.5 percent in the first five months of 2006/07 compared to a growth of 22.8 percent in the same period of the preceeding year. While imports from India decelerated to 7.6 percent in the review period in comparison to a higher growth of 33.1 percent in the corresponding period of 2005/06, imports from other countries increased by 10.0 percent in comparison to a growth of 9.0 percent last year.

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

Balance of Payments

35. During the review period, the overall BOP registered a surplus of Rs. 5.68 billion, almost the same level of BOP surplus of Rs. 5.73 billion in the corresponding period of 2005/06.

36. Under the current account while the receipts from tourism declined by 3.6 percent to Rs. 3.85 billion compared to a decline of 23.4 percent in the previous year, remittances registered a rise of 9.5 percent to Rs. 40.28 billion in the first five months of 2006/07 in comparison to a rise of 42.5 percent a year earlier.

37. Under the financial account, the government received Rs. 2.89 billion as foreign loan and repaid Rs. 3.23 billion in amortization.

Foreign Exchange Reserves

38. In comparison to mid-July 2006, gross foreign exchange reserves of the banking system rose by 3.7 percent to Rs. 171.27 billion in mid-December 2006. Such reserves had risen by 7.6 percent in the corresponding period of the preceding year. Of the total reserves, the share of convertible reserves fell slightly to 95.3 percent as at mid-December 2006 from 95.5 percent in mid-December 2005, resulting in a corresponding increase in the share of the non-convertible reserves to 4.7 percent from 4.5 percent. The current level of reserves is adequate for financing merchandise imports of 10.8 months and merchandise and service imports of 8.9 months.

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

39. The price of oil (Crude Oil Brent) in the international market rose by 4.5 percent to US$ 62.58 per barrel on December 15, 2006 from US$ 59.89 per barrel in mid-December 2005. Like-wise, the price of gold rose by 23.2 percent to US$ 623.75 in mid-December 2006 from US$ 506.3 a year earlier.

40. In comparison to mid-July 2006, the Nepalese currency vis-à-vis the US dollar appreciated by 3.7 percent in mid-December 2006. It had depreciated by 4.6 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 73.75 in mid-December 2006 compared to Rs. 71.45 in mid-December 2005.