Current Macroeconomic Situation

(Based on the First Two Months' Data of 2008/09)

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Monetary Situation

Money Supply

1. Broad money (M_2) increased by 2.9 percent in the first two months of 2008/09. M_2 had grown by 1.8 percent in the same period of the previous year. A higher growth of net domestic assets contributed to such an increase in M_2 in the review period. Narrow money M_1 declined by 4.3 percent in the review period compared to a decline of 3.2 percent in the corresponding period of the previous year. However, time deposits, which had grown by 4.1 percent in 2007/08, grew by 6.1 percent in the review period.

2. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, declined by 1.2 percent (Rs 2.1 billion) in the review period compared to a decline of 2.0 percent (2.7 billion) in the previous year. Widening trade deficits compared to the previous year contributed to a decline in NFA in the review period.

Domestic Credit

3. In the first two months of 2008/09, domestic credit expanded by 4.3 percent compared to a growth of 2.1 percent in the corresponding period of the previous year. Domestic credit increased due mainly to an increase in private sector credit by 5.9 percent compared to a growth of 3.8 percent in the previous year and the increase in claims on non-government financial institutions by Rs 2.9 billion compared to a growth of 1.3 billion in the previous year. Claims on non-government financial institutions increased on account of a higher credit flow to finance companies and other financial institutions by commercial banks in the review period.

4. Net claims on government declined by 5.3 percent in the review period compared to a decline of 3.8 percent in the previous year. A cash balance of Rs 7.9 billion with Nepal Rastra Bank on account of a higher level of resource mobilization relative to expenditure of the Government of Nepal (GON) contributed to such a decline in the net claims on government in the review period.

5. Claims on non-financial government enterprises increased by 8.1 percent (Rs 454.8 million) in the review period in contrast to a decline of 17.9 percent in the corresponding period of the previous year. A higher credit used by Janakpur Cigarette Factory Ltd, Nepal Food Corporation, Nepal Oil Corporation, Nepal Airlines Corporation, Janak

Education Material Center Ltd and Nepal Electricity Authority contributed to such an increase in claims on non- financial government enterprises in the review period.

Deposit Mobilization and Credit Flow of Commercial banks

6. Deposit mobilization of commercial banks increased by Rs 19.6 (4.6 percent) billion in the first two months of 2008/09 to Rs 441.1 billion. Similarly, credit to the private sector expanded by 6.1 percent (Rs 20.6 billion) in the review period. On account of a higher credit flow to the private sector, commercial banks, in addition to deposit mobilization, used cash in hand to meet the credit demand. Consequently, the liquid fund with commercial banks declined by 37.6 million in the review period. In the review period, credit to textile production and readymade garment, and iron and steel based industries of production sector, transportation equipment production and fittings, real estate, services and consumer sectors remained high. Liquidity-deposit ratio declined to 33.3 percent in mid-Septerber 2008 from 35.8 percent in mid-July 2007.

7. The investment of commercial banks on government securities declined by Rs 4.3 billion. An increase in short-term lending to finance companies as well as other financial institutions and more credit demand from the private sector contributed to such a decline in investment in the review period.

Liquidity Management

8. The NRB mopped up net liquidity of Rs 9.0 billion from the secondary market in the review period. Of the total liquidity mop up, Rs 3.5 billion was mopped up from outright sale auction and Rs 5.5 billion through reverse repo auction. However, liquidity has not been injected through open market operations (OMO_s) in the review period.

9. The NRB injected Rs 12.2 billion net liquidity through a net purchase of the US dollar of 174.9 million from commercial banks through foreign exchange intervention in the first two months of 2008/09. A net liquidity of Rs 6.6 billion was injected through the purchase of 101.5 million US dollar from commercial banks in the previous year. An elevated level of remittance inflows required more intervention in the foreign exchange market in the review period.

10. The NRB purchased Indian currency (IC) 8.6 billion through the sale of 200 million US dollar in the Indian money market in the review period. IC of 7.3 billion was purchased through the sale of 180 million US dollar in the same period of the previous year.

Standing Liquidity Facility and Inter Bank Transactions

11. In the review period, commercial banks used standing liquidity facility (SLF) of Rs 20.9 billion. In the corresponding previous period, the use of SLF by commercial banks was Rs 4.1 billion. Likewise, commercial banks' inter bank transactions stood at Rs 44.3 billion in the review period compared to that of Rs 66.8 billion in the previous year.

Short-term Interest Rates

12. In the first two months of 2008/09, the weighted average monthly 91-day Treasury bill rate stood at 3.73 percent compared to 2.14 percent in mid-September 2007. The weighted average monthly inter bank rate remained at 2.33 percent in mid-September 2008 compared to 2.18 percent in mid-September 2007.

Securities market

13. The year on year (y-o-y) NEPSE index increased by 19.5 percent to 976.01 points in mid-September 2008. This index was 817.08 a year ago. Likewise NEPSE sensitive index (based on July 2006) stood at 258.15. This index was 253.42 in Mid-July 2008.

14. Nepal Stock Exchange Limited has started to calculate NEPSE Float Index and Sensitive Float Index based on final transaction of August 24, 2008 as base market price. In that index, holdings by promoters, staffs and strategic shares are excluded and only holdings by public are included for calculation according to subsequent final market rate. Likewise, market halt procedures are also changed since August 25, 2008. After this procedure implementation the market will be halted for 15 minutes, if NEPSE index changes by 3 percent, then it will be halted for 30 minute, if index changes by 4 percent and remaining transaction time of that day will be halted, if index again changes by 5 percent. This contrasts with the previous system of postponing the transaction while NEPSE index point would change by 15, 20 and 25 minute respectively.

15. The y-o-y market capitalization increased by 126.5 percent to Rs. 509.8 billion in mid-September 2008. Market capitalization to GDP ratio increased to 53.9 percent from 27.4 percent a year ago. Of the total market capitalization, bank and financial institutions, manufacturing and processing companies, hotels, business entities, and hydropower constituted 68.9 percent, 1.5 percent, 0.9 percent, 0.2 percent, and 4.7 percent respectively.

16. Total paid up capital of the listed companies stood at Rs. 46.1 billion in mid-September 2008 with an increase of 107.8 percent over the period of one year. This increase was due to the additional listing of securities. Of the total listed share Rs. 19.2 billion upto mid-September 2008 in 2008/09, Rs. 99.2 million bonus share, Rs. 1.34 billion right share, Rs.15.16 billion Ordinary Share and Rs. 2.65 billion Bond were listed in Nepal Stock Exchange Ltd. The large portion (78.78%) of amount increased in ordinary share was due to the listing of the share of Nepal Telecom.

17. Monthly turnover to market capitalization ratio remained at 0.6 percent in mid-September 2008 compared to 0.64 percent a year ago.

18. Total number of companies listed at the NEPSE increased to 144 in mid-September 2008 compared to 138 a year ago. Among the currently listed companies, 113 are bank and

financial institutions (including insurance companies). The number of listed companies in the production and processing industries, hotels, business entities, hydropower groups are 18, 4, 4 and 3 and 2 respectively.

19. The twelve-month rolling standard deviation reflecting an increased volatility in the stock market stood at 112.8 in mid-September 2008 compared to 119.2 a year ago

Inflation and Wage Rate

Consumer Price Inflation

20. The y-o-y consumer inflation rose to 13.5 percent in mid-September 2008 from 7.0 percent in the corresponding period of the previous year. The inflation was driven by the significant rise in food and beverage (14.2 percent) as well as non-food and service (12.8 percent) group in the review period. The price rises of food and beverage and non-food and service group were10.9 percent and 2.8 percent respectively a year ago.

21. Of the items showing high price rise, price indices of sugar and sugar related products as well as oil and ghee sub-groups increased by a whopping rate of 38.9 percent and 36.5 percent respectively on a y-o-y basis in mid-September 2008 compared to an increase of -18.5 percent and 11.9 percent respectively a year ago. The sub-group of grains and cereal products witnessed a y-o-y price rise of 23.8 percent in the review period compared to an increase of 9.8 percent in the corresponding period of the previous year. Prices of rice and rice products of this sub-group increased with higher rate of 28.4 percent compared to an increase of 9.8 percent a year ago. The indices of pulses, restaurant meals, milk and milk products, meat, fish and eggs and spices rose up by 23.7 percent, 15.6 percent, 14.6 percent, 14.5 percent and 13.2 percent respectively in the review period compared to a rise of 17.8 percent, 4.2 percent, 8.1 percent, 7.8 percent and 13.2 percent respectively in mid-September 2007.

22. Within the group of non-food and service, the index of transportation and communication, housing goods and services as well as tobacco and related products rose by 23.1 percent, 18.1 percent and 12.7 percent respectively in mid-September 2008 compared to a rise of -0.5 percent, 2.5 percent and 3.2 percent respectively during the same period of last year.

23. Region-wise, the price rise in Kathmandu valley was 14.1 percent followed by 13.5 percent in Terai and 12.7 percent in the Hills. Last year, the respective rates were 6.3 percent, 7.5 percent and 6.8 percent.

Wholesale Price Inflation

24. The y-o-y wholesale price inflation moderated to 10.3 percent in mid-September 2008 compared to 11.1 percent a year ago. Such moderation was mainly due to the decline in the price of cash corps and fruits and vegetables under agricultural commodities group in

spite of a high increase in the price of imported commodities. The index of agricultural commodities, domestic manufactured commodities and imported commodities increased by 0.7 percent, 15.8 percent and 24.0 percent respectively in the review period as compared to 16.6 percent, 7.8 percent and 4.5 percent in the corresponding period of the previous year.

25. Of agricultural commodities, the price index of pulses, food grains, livestock production and spices increased by 22.2 percent, 21.5 percent and 13.3 percent and 10.0 percent respectively in the review period compared to a rise of 17.6 percent, 8.2 percent, 4.7 percent and 9.3 percent a year ago. On the other hand, the price index of cash corps and fruits and vegetables declined by 23.2 percent and 22.1 percent respectively in the review period compared to an increase of 20.2 percent and 37.2 percent respectively in the corresponding period of previous year.

26. Within the group of domestic manufactured commodities, the price index of construction materials and food-related products increased by 24.5 percent and 21.8 percent respectively in mid-September 2008 compared to a rise of 14.7 percent and 5.3 percent a year ago.

27. Of the imported commodities, the price index of petroleum products and coal increased by a whopping rate of 39.2 percent on a y-o-y basis in mid-September 2008 compared to an increase of 2.0 percent a year ago. Likewise, the price indices of transport vehicles and machinery goods as well as chemical fertilizers and chemical goods also increased by 30.8 percent and 11.7 percent respectively in the review period compared to a rise of 4.6 percent and 11.4 percent respectively in the corresponding period of previous year.

National Salary and Wage Rate and Core Inflation

28. The overall y-o-y salary and wage rate index rose by 9.2 percent in mid-September 2008 compared to a rise of 12.5 percent a year ago. Of the salary and wage rate indices, the salary index remained unchanged in the review period compared to a rise of 10.9 percent in the corresponding period of the previous year. The y-o-y wage rate index increased by 12.3 percent in the review period compared to an increase of 13.1 percent in the same period of the previous year. Wages of agricultural, industrial and construction laborers increased by 19.5 percent, 2.7 percent and 8.9 percent respectively in the review period. Last year, these wage rates had increased by 9.1 percent, 19.4 percent and 13.2 percent respectively.

29. In the review period, the y-o-y core inflation rose to 12.1 percent from 5.4 percent in the corresponding period of the previous year.

Fiscal Situation

Budget Deficit / Surplus

30. In the first two months of 2008/09, the government budget surplus stood at Rs.3.4 billion compared to a surplus of Rs 2.6 billion in the corresponding period of the previous year.

Government Expenditure

31. In the first two months of 2008/09, the total government spending increased by 40.4 percent to Rs.15.6 billion compared to an increase of 13.5 percent in the corresponding period of the previous year. The increase was due to a rise in the growth of recurrent expenditure, freeze expenditure and principal repayment expenditure.

32. In the first two months of 2008/09, recurrent expenditure rose by 11.9 percent to Rs.8.4 billion. In the corresponding period of the previous year, recurrent expenditure had increased by 5.7 percent. The rise in spending related to parliament management, regular government administrative expenses and conflict management accounted for such an increase in recurrent expenditure in the review period.

Government Revenue

33. In the first two months of 2008/09, revenue mobilization of the government grew by 17.5 percent to Rs.14.6 billion compared to an increase of 15.4 percent in the corresponding period of the previous year. A high rate of growth of income tax, customs duties and VAT revenue contributed to such an increase in revenue mobilization.

34. In the review period, income tax, customs duties, VAT revenue and registration fee recorded a higher growth compared to that of the corresponding period of the previous year. While revenue from the other sources decelerated in the review period. Non-tax revenue witnessed a decline of 52.4 percent.

Foreign Cash Loans and Grants

35. The government received foreign cash loans of Rs 625.1 million and foreign cash grants of Rs 2.1 billion in the first two months of 2008/09. The government had received foreign cash loans of Rs 413.5 million and foreign cash grants of Rs 776.9 million in the corresponding period of the previous year.

External Sector Situation

Foreign Trade

36. In the first two months of 2008/09, total exports rose by 36.1 percent in contrast to a decline of 3.1 percent in the corresponding period of the previous year. Of the total exports, exports to India rose by 12.2 percent in 2008/09 in contrast to a decline of 8.2

percent in the same period of 2007/08. Exports to other countries surged by 82.0 percent compared to an increase of 8.4 percent in the same period of the previous year.

37. The rise in the exports to India was attributed to the upsurge in the exports of readymade garments, copper wire rod, zinc sheet, tooth paste and catechue. Similarly, exports to other countries soared owing to the exports of pulses, woolen carpets, pashmina, herbs and tanned skin.

38. Total imports rose by 43.3 percent in the first two months of 2008/09 compared to a lower increase of 8.1 percent in the corresponding period of the previous year. While imports from India increased by 34.3 percent in the review period compared to a growth of 5.3 percent in the corresponding period of 2007/08, imports from other countries soared by 56.5 percent in comparison to a growth of just 12.4 percent in the corresponding period of the previous year.

39. A rise in the imports of petroleum products, vehicles & spare parts, cold rolled sheet in coil, hot rolled sheet in coil and other machinery & parts, among others, from India and gold, telecommunication equipment & parts, textiles, computer & parts, MS billet and other machinery & parts among others, from other countries, resulted in the rise in total imports in the first two months of 2008/09.

Balance of Payments

40. The overall BOP recorded a deficit of Rs. 2.1 billion in the first two months of 2008/09. In the corresponding period of the previous year, the BOP had registered a deficit of Rs. 2.7 billion. Despite surge in trade deficit, significant increase in travel receipts by 40.1 percent and workers' remittances by 73.9 percent led to current account surplus of Rs 454.1 million in the review period. Last year, travel receipts and workers' remittances had increased by 72.9 percent and 17.3 percent, respectively while the current account had posted a deficit of Rs. 4.0 billion.

Foreign Exchange Reserves

41. The gross foreign exchange reserves stood at Rs. 215.4 billion in mid-September 2008, a rise of 1.3 percent compared to the level as at mid-July 2008. Such reserves had fallen by 1.7 percent in the corresponding period of the preceding year. In terms of US dollar, gross foreign exchange reserves declined by 5.3 percent to US$ 2.9 billion in mid-September 2008. In the same period in the previous year, such reserves had gone down by 1.9 percent. The current level of reserves is sufficient for financing merchandise imports of 8.9 months and merchandise and service imports of 6.9 months.

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

42. The price of oil (Crude Oil Brent) in the international market increased by 13.7 percent to US$ 88.06 per barrel in mid-September, 2008 from US$ 77.47 per barrel in mid-

September, 2007. Likewise, the price of gold rose by 8.4 percent to US$ 779.50 per ounce in mid-September, 2008 from US$ 719.0 per ounce a year earlier.

43. In comparison to mid-July 2008, the Nepalese currency vis-à-vis the US dollar depreciated by 6.48 percent in mid-September 2008. It had depreciated by 0.23 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 73.25 in mid-September 2008 compared to Rs. 65.00 in mid-September 2007.