Current Macroeconomic Situation

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

Monetary Situation

Money Supply

1. Broad money (M_2) grew by 6.8 percent in the first four months of 2008/09 compared to a growth of 7.3 percent in the corresponding period of the previous year. Despite a significant growth of net foreign assets and expansion of non-monetary liabilities, decline in net claims on government by 5.8 percent in the review year compared to a growth of 4.7 percent in the previous year contributed to lower the growth of M2 in the review period.

2. Narrow money (M_1) grew by 3.1 percent in the review period compared to a growth of 3.7 percent during the corresponding period a year ago. Notwithstanding the substantial growth of currency in circulation (10.9 percent) in the review period, a higher rate of decline in the demand deposits was attributed to a slower growth of M_1 in the review period compared to that of the pervious year. Time deposits grew by 8.5 percent in the review period compared to that of 8.9 percent in the corresponding period of the previous year.

3. Net foreign assets–NFA (after adjusting for foreign exchange valuation gain/loss) increased by Rs. 11.9 billion (6.9 percent) in the review period against a decline of Rs. 3.6 billion (4.2 percent) in the same period of the previous year. A significant growth of NFA was attributed to an elevated level of remittance inflows accompanied by an expansion in the foreign assistance of the review period.

Domestic Credit

4. In the first four months of 2008/09, domestic credit expanded by 6.5 percent compared to a growth of 8.1 percent in the corresponding period last year. The Government has cash deposits of Rs. 6.3 billion with Nepal Rastra Bank (NRB) in the review period. This was accumulated on account of a higher resource mobilization relative to the government expenditure. A decline in banking sector's net claims on government by 5.8 percent on account of the high level of deposits with the NRB and repayment of some banking sector's loans by the government accounted for such a slower growth of domestic credit in the review period.

5. Private sector credit increased by 9.4 percent in the review period compared to a growth of 8.3 percent in the previous year. In the review period, the private sector credit to agriculture, transportation equipment production and fittings, wholesale and retail trade and consumable sectors remained high. In addition, the claims on non-government financial institutions increased in the review period on account of an increase in commercial banks' short-term investment in finance companies and other financial institutions.

6. Claims on non-financial government enterprises increased by 14.9 percent (Rs. 843.7 million) in the review period in contrast to a decline of 9.6 percent (Rs 490.5 million) in the corresponding period of the previous year. A higher use of credit by Janakpur Cigarette Factory Ltd., Nepal Oil Corporation, Nepal Airlines Corporation, Janak Education Material Center Ltd. and Nepal Electricity Authority contributed to such an increase in the claims on such enterprises in the review period.

Deposits Mobilization and Credit Flow of Commercial Banks

7. In the first four months of 2008/09, deposit mobilization of commercial banks increased by Rs 26.8 billion (6.4 percent) amounting to Rs 448.4 billion. The total deposits had increased by Rs 23.5 billion (7.0 percent) in the corresponding period last year. Notwithstanding the significant inflows of remittances, an increase in the currency in circulation accompanied by a higher level of revenue mobilization of the government relative to the expenditure, contributed to the slowdown in the rate of deposit mobilization during the review period. In the review period, saving and fixed deposits increased by 10.7 percent and 6.1 percent respectively. Such deposits had increased by 7.4 and 9.2 percent respectively in the corresponding period of the previous year.

8. In the review period, credit to private sector expanded by Rs 32.7 billion (9.7 percent) compared to an increase of Rs 23.8 billion (9.0 percent) in the same period of the previous year. Credit to agriculture, iron and steel based industries of production sector, transportation equipment production and fittings, wholesale and retail business, real estate, services and consumer sectors respectively remained higher in the review period. A higher credit flow relative to the deposit mobilization of commercial banks, increased the credit-deposit ratio from 82.6 percent in mid-July 2007 to 85.3 percent in mid-November 2008.

9. The liquid funds of commercial banks grew by 12.1 percent in the review period compared to a growth of 2.1 percent in the same period of the previous year. Of the components of liquid funds, commercial banks' balance held with the NRB increased by 15.3 percent as against a decline of 13.1 percent in the corresponding period of the previous year. The increase in CRR in the monetary policy of 2008/09 also contributed to a higher growth of commercial banks's balance held with the NRB. Such a balance had declined by 13.1 percent in the previous year. Likewise, the balance held abroad by commercial banks increased by 14.7 percent to Rs 47.1 billion in mid-November 2008 compared to a growth of 5.6 percent to Rs 41.1 billion during the corresponding period of previous year.

Liquidity Management

10. In the first four month of 2008/09, the NRB mopped up net liquidity of Rs 11.2 billion through the open market operations. Of the total liquidity mopped up, Rs 5.5 billion was mopped up from outright sale auction and Rs 5.5 billion from reverse repo auction. A total of 6.1 billion liquidity (Rs. 500 million from outright sale auction and Rs. 5.6 billion through reverse repo auction) was mopped up in the

corresponding period of the previous year. However, as in the previous year, liquidity was not injected through the instruments of open market operations in the review period.

11. In the review period a higher amount of liquidity was injected through the NRB's intervention in the foreign exchange market. In the first four months of 2008/09, the NRB injected net liquidity of Rs 42.2 billion by net purchase of 569.6 million US dollar from commercial banks through foreign exchange intervention. A net liquidity of Rs 20.6 billion had been injected in the corresponding period of the previous year through the net purchase of 321.5 million US dollar from commercial banks. Such a higher intervention in the foreign exchange market in the review period was on account of elevated level of remittance inflows in the review period.

12. The NRB purchased Indian currency (IC) of 22.5 billion through the sale of 490 million US dollar in the review period. Indian currency of 16.8 billion was purchased through the sale of 420 million US dollar in the corresponding period a year ago. A higher amount of payment made by Nepal Oil Corporation to Indian Oil Corporation in the review period necessitated a higher IC purchase against sale of US dollar.

Standing Liquidity Facility and Inter Bank Transactions

13. In the first four months of 2008/09, commercial banks used standing liquidity facility (SLF) of Rs 32.2 billion compared to that of Rs. 26.9 billion in the corresponding period last year. Likewise, the inter bank transactions of commercial banks stood at Rs 105.1 billion in the review period compared to that of Rs 123.3 billion in the previous year. Adequate liquidity with commercial banks on account of the significant remittance inflows slowed down the interbank transactions in the review period.

Short-term Interest Rates

14. The weighted average monthly 91-day Treasury bills rate stood at 5.55 percent in mid-November 2008 compared to 3.03 percent a year ago. The weighted average monthly inter bank rate increased to 5.34 percent in mid-November 2008 from 3.73 percent last year. A higher amount of liquidity absorption through secondary market operations in the review year compared to that of the previous year contributed to such an increase in the short-term interest rate.

Securities Market

15. The year on year (y-o-y) NEPSE index decreased by 11.8 percent to 806.90 points in mid-November 2008. This index was 915.38 a year ago. Likewise NEPSE sensitive index (based on July 2006) stood at 210.31 point in mid-November 2008. This index was 256.01 in the previous month.

16. Nepal Stock Exchange Limited started to calculate NEPSE Float Index based on final transaction of August 24,2008. Such index stood at 76.88 point in mid-November.

17. The y-o-y market capitalization increased by 49.1 percent to Rs. 428.7 billion in mid-November 2008. Market capitalization to GDP ratio increased to 45.4 percent from 35.0 percent a year ago. Of the total market capitalization banks and financial institutions, manufacturing and processing companies, hotels, business entities, hydropower and other economic sector accounted for 69.2 percent, 1.8 percent, 1.1 percent, 0.3 percent, 4.8 and 22.8 percent respectively.

18. Total paid up capital of the listed companies stood at Rs. 46.6 billion in mid-November 2008 with a y-o-y increase of 95.6 percent. This increase was due to the listing of additional securities in the stock market. The total share of Rs. 20.9 billion in mid-November 2008/09 was listed in Nepal Stock Exchange Ltd. This amount can be broken down into components namely bonus share, right share, ordinary share and bonds which are of Rs. 556.3 million, Rs. 2.3 billion, Rs.15.5 billion and Rs. 2.7 billion respectively. A large portion (73.91%) of ordinary share increased due to the listing of Nepal Telecom share.

19. Monthly turnover to market capitalization ratio remained at 0.6 percent in the review period compared to 0.3 percent a year ago.

20. Total number of companies listed at the NEPSE increased to 144 in mid-November 2008 compared to 141 a year ago. Among the currently listed companies, 113 are banks and financial institutions (including insurance companies). Moreover, production and processing industries, hotels, business entities, hydropower and other companies remained at 18, 4, 4, 3 and 2 respectively.

21. The twelve-months rolling standard deviation reflected an increased volatility in the stock market and stood at 115.9 in mid-November 2008 compared to 155.2 a year ago.

Consumer Price Inflation

22. The y-o-y inflation as calculated by the consumer price index rose to 14.5 percent in mid- November 2008 from 6.3 percent in the previous year. The inflation, in the review period, was driven both by the significant rise in food and beverages (17.0 percent) as well as non-food and services (11.7 percent) group. Last year's price rise of food and beverages and non-food and services group, was 8.4 percent and 4.1 percent respectively.

23. Of the items in the food and beverages group, price indices of sugar and sugar related products as well as oil and ghee sub-groups increased on a y-o-y basis in mid-November 2008, by a whopping rate of 37.6 percent and 31.6 percent respectively. This was in sharp contrast to last year's increase by a change of -18.0 percent and 14.8 percent respectively. The subgroup of grains and cereal products witnessed a y-o-y price rise of 19.1 percent in the review period compared to an increase of 11.4 percent in the corresponding period of previous year. Prices of rice

and rice products of this sub-group increased with a higher rate of 22.3 percent compared to an increase of 13.0 percent a year ago. The indices of pulses, restaurant meals, meat, fish and eggs, milk and milk products, beverages and spices rose up by 26.0 percent, 22.2 percent, 20.1 percent, 17.1 percent, 12.5 percent and 11.5 percent respectively in the review period compared to a rise of 14.1 percent, 4.5 percent, 7.0 percent, 5.8 percent, 0.7 percent and 3.3 percent respectively in mid-November 2007.

24. Within the group of non-food and services, the index of transport and communication, housing goods and services as well as tobacco and related products rose by 22.0 percent, 15.2 percent and 15.1 percent respectively in mid-November 2008. In the previous year, the index of transportation and communication remained constant whereas the indices of housing goods and services and tobacco and related products had increased by 5.4 percent and 7.5 percent respectively during the same period of the last year.

25. Region-wise, the price rise in Kathmandu valley was 16.8 percent followed by 14.2 percent in Hills and 13.3 percent in Terai. Last year, the respective rates were 6.1 percent, 5.7 percent and 6.6 percent.

26. In the review period, the y-o-y core inflation rose to 13.5 percent from 4.9 percent a year ago.

Wholesale Price Inflation

27. The y-o-y wholesale price inflation increased to 9.2 percent in mid-November 2008 compared to 7.2 percent a year ago. The index of imported commodities, domestic manufactured commodities and agricultural commodities increased by 17.5 percent, 13.4 percent and 2.7 percent respectively in the review period compared to 6.3 percent, 5.2 percent and 8.5 percent a year ago.

28. Of the agricultural commodities, the price index of pulses and livestock production increased by 24.9 percent and 22.2 percent respectively in the review period compared to a rise of 11.2 percent and 4.6 percent a year ago. On the other hand, the price index of cash corps declined by 23.3 percent in the review period compared to a decline of 1.5 percent in the corresponding period of previous year.

29. Within the group of domestic manufactured commodities, the price index of food-related products, beverage and tobacco related products and construction materials increased by 20.2 percent, 12.4 percent and 10.7 percent respectively in mid-November 2008 compared to a rise of 1.8 percent, 4.9 percent and 11.9 percent a year ago.

30. Of the imported commodities, the price index of petroleum products and coal increased by a whopping rate of 25.0 percent on a y-o-y basis in mid- November 2008 compared to an increase of 6.7 percent a year ago. Likewise, the price indices of transport vehicles and machinery goods as well as textile related products also increased by 22.4 percent and 13.7 percent respectively in the review period

compared to a rise of 4.6 percent and -2.4 percent in the corresponding period of previous year.

National Salary and Wage Rate

31. The overall y-o-y salary and wage rate index rose by 10.0 percent in mid-November 2008 compared to a rise of 10.1 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 13.3 percent in the review period compared to an increase of 9.9 percent in the same period of the previous year. Wages of agricultural, industrial and construction labourers increased by 20.2 percent, 2.5 percent and 15.2 percent respectively in the review period. Last year, these wage rates had increased by 6.8 percent, 14.6 percent and 10.3 percent respectively.

Fiscal Situation

Budget Deficit/Surplus

32. In the first four months of 2008/09, the government budget remained at a surplus of Rs.1.3 billion in contrast to a deficit of Rs 7.4 billion in the corresponding period of the previous year. An increase in revenue and foreign cash grants accounted for such a budget surplus in the review period.

Government Expenditure

33. In the first four months of 2008/09, the total government spending increased by 7.3 percent to Rs. 37.1 billion compared to an increase of 34.5 percent in the corresponding period of the previous year. The deceleration of such spending was due to a decline in both recurrent as well as capital expenditure.

34. In the first four months of 2008/09, recurrent expenditure declined by 2.5 percent to Rs.23.8 billion. In the corresponding period of the previous year, recurrent expenditure had increased by 26.1 percent. A significant amount spent for the preparation of the Constitution Assembly Election in the previous year, but no occurrence of such expenditure in the current year accounted for such a decline in recurrent expenditure in the review period.

35. In the review period, capital expenditure declined by 17.5 percent to Rs 2.8 billion in contrast to an increase of 85.5 percent in the corresponding period of the previous year.

36. In the first four months of 2008/09 principal repayment expenditure increased by 26.7 percent to Rs.5.6 billion mainly on account of the payment of treasury bills amounting to Rs.2.8 billion.

Government Revenue

37. In the first four months of 2008/09, revenue mobilization of the government grew by 35.4 percent to Rs.33.0 billion compared to an increase of 13.2 percent in the corresponding period of the previous year. Such an impressive revenue mobilization was ascribed on the high growth of income tax, VAT revenue, customs, excise, vehicle tax and registration fee as well as a high growth of non-tax revenue.

38. Of the total revenue mobilization, VAT revenue grew by 31.2 percent to Rs 12.0 billion in mid-November 2008. It had increased by 13.4 percent in the corresponding period of the previous year. The growth in VAT revenue was on account of growing imports and consumption induced by the rise in remittances and reforms in VAT administration.

39. In the review period, customs revenue rose by 22.7 percent to Rs 7.2 billion compared to an increase of 9.4 percent in the same period of the previous year. Reforms in customs administration and the increase in imports of high tax yielding vehicles and spare parts contributed to such a high growth of customs revenue.

40. In the review period, excise revenue increased by 32.4 percent to Rs 4.2 billion compared to an increase of 32.3 percent in the same period of the previous year. Reforms in excise administration and increase in the imports of high tax yielding vehicles accounted for such a growth of excise revenue in the review period.

41. Income tax revenue increased by 25.9 percent to Rs 3.7 billion in the first four months of 2008/09. The evolution of the corporate culture on account of the growth in banks and financial institutions contributed to such a higher growth of income tax collection. Last year such revenue had risen by 15.4 percent.

42. In the review period, non-tax revenue grew by 73.9 percent to Rs 3.4 billion in contrast to a decline of 12.0 percent in the same period of the preceding year. Such an increase in non-tax revenue was on account of the increase in dividend paid by some public enterprises including Nepal Telecom.

Foreign Cash Loans and Grants

43. The government received foreign cash loans of Rs 1.2 billion and foreign cash grants of Rs 3.4 billion in the first four months of 2008/09. The government had received foreign cash loans of Rs 1.4 billion and foreign cash grants of Rs 2.3 billion in the corresponding period of the previous year.

44. The government did not mobilize any domestic borrowing in the review period.

Foreign Trade

45. Exports soared by 39.9 percent in the first four months of 2008/09 in contrast to a decline by 3.3 percent in the corresponding period of the previous year. While

exports to India went up by 24.4 percent in 2008/09 as against a decline by 7.4 percent in the corresponding period of the previous year, exports to other countries rose significantly by 70.8 percent in comparison to an increase of 6.2 percent in the same period of the previous year.

46. The rise in the exports to India was attributed to the upsurge in the exports of readymade garments, shoes & sandles, G.I. pipe, tooth paste and cooper wire rod. Similarly, the rise the exports to other countries can be attributed to the increase in the exports of pulses, woolen carpets, pashmina, readymade garments and herbs.

47. In the first four months of 2008/09, total imports rose by 38.9 percent compared to a lower increase of 6.3 percent in the corresponding period of the previous year. While imports from India went up by 22.1 percent in the review period compared to a growth of 8.9 percent in the corresponding period of 2007/08, imports from other countries expanded by 65.3 percent compared to a growth of just 2.3 percent a year earlier.

48. An increase in the import 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, MS billet, other machinery & parts, electrical goods and computer & parts, among others, from other countries, were responsible for such a significant rise in total imports in the first four months of 2008/09.

Balance of Payments

49. In the first four months of 2008/09, the overall BOP recorded a surplus of Rs. 11.9 billion in contrast to a deficit of Rs. 3.6 billion in the corresponding period of the previous year. The current account also posted a surplus of Rs. 9.5 billion in the first four months of 2008/09 compared to a deficit of Rs. 4.5 billion in the corresponding period of the previous year. Such surplus in the current account was primarily attributed to the surge in net transfers by 62.5 percent in the first four months of 2008/09. Under transfers, workers' remittances soared by 65.9 percent in the first four months of 2008/09 compared to a growth of 20.8 percent in the corresponding period of the previous year.

Foreign Exchange Reserves

50. In mid-November 2008, the gross foreign exchange reserves stood at Rs. 231.3 billion, an increment of 8.8 percent compared to the level as at mid-July 2008. Such reserves had fallen by 1.2 percent in the corresponding period of the preceding year. On the basis of US dollar, gross foreign exchange reserves declined by 5.3 percent to US$ 2.94 billion in mid-November 2008. In the same period in the previous year, such reserves had risen by 1.6 percent. The current level of reserves is adequate for financing merchandise imports of 9.9 months and merchandise and service imports of 8 months.

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

51. The price of oil (Crude Oil Brent) in the international market plummeted by 39.0 percent to US$ 57.04 per barrel in mid-November, 2008 from US$ 93.53 per barrel in mid-November, 2007. Likewise, the price of gold fell by 5.3 percent to US$ 747.50 per ounce in mid-November, 2008 from US$ 789.75 per ounce a year earlier.

52. Compared to mid-July 2008, the Nepalese currency *vis-à-vis* the US dollar depreciated by 12.96 percent in mid-November 2008. It had appreciated by 2.85 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 78.70 in mid-November 2008 compared to Rs. 68.50 in mid-July 2008.