Current Macroeconomic Situation

(Based on the First Six Months' Data of 2009/10)

Monetary Situation

Money Supply

1. Broad money (M_2) expanded by 6.4 percent in the first six months of 2009/10. M_2 expanded by 11 percent in the corresponding period of the previous year. Narrow money (M_1), which had grown by 9.2 percent during the first six months of 2008/9, grew by 5.1 percent in the review period. Although the net domestic assets increased at a higher rate, decline in net foreign assets owed to the slowdown in the growth of monetary aggregates during the review period.

2. Of the components of narrow money, currency in circulation increased by 9.2 percent in the review period compared to a growth of 12.7 percent during the same period of the previous year. Demand deposits, which had increased by 2.6 percent in the same period a year ago, declined by 2.2 percent in the review period. Time deposits increased by 7.0 percent in the review period compared to a growth of 11.9 percent during the same period of the previous year.

3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, declined substantially by Rs.19.8 billion (9.0 percent) in the review period. It increased by Rs.28.5 billion (16.6 percent) in the same period of the previous year. An acceleration of current account deficits in the review period contributed to such a significant decline in net foreign assets.

Net Domestic Asset

4. In the first six months of 2009/10, net domestic assets expanded by 14.7 percent compared to a growth of 8.1 percent in the corresponding period of the previous year. Domestic credit increased at a higher rate on account of a significant increase in the claims of private sector.

5. Claims on government declined by Rs.13.0 billion (12.4 percent) in the review period compared to a decline of Rs.16.3 billion (18.8 percent) in the corresponding period of the previous year. A slower increase in government expenditure relative to resource mobilization contributed to a decline in claims on government in the review period. The government deposits as on mid-January 2010 stood at Rs. 3.4 billion.

6. In the review period, the claims on private sector increased by 15.5 percent (Rs. 67.5 billion) compared to a growth of 11.4 percent (Rs. 38.8 billion) in the same period a year ago.

7. Claims on non-government financial enterprises declined by 2.7 percent in the review period compared to a growth of 75.6 percent in the corresponding period of the previous year. The decline in investments of commercial banks on pension funds and

insurance companies in the review period contributed to such a slowdown in the growth of claims on non-government financial enterprises.

8. In the first six months of 2009/10, claims on non-financial government enterprises increased by 11.7 percent compared to a growth of 6.2 percent in the corresponding period of the previous year. Among the institutions, additional borrowing by Nepal Food Corporation and Nepal Electricity Authority contributed to a growth of such claims in the review period.

Deposits Mobilization and Credit Flow of Commercial banks

9. In the first six months of 2009/10, the deposits mobilization of commercial banks increased by Rs. 25.9 billion (4.7 percent) amounting to Rs. 575.8 billion. The total deposits had increased by Rs.54.6 billion (13 percent) in the corresponding period of the previous year. Similarly, the loan and advances of commercial banks grew by 16.6 percent (Rs. 67.0 billion) compared to a growth of 12.5 percent (Rs. 38.4 billion) in the corresponding period of the previous year.

10. Of the private sector credit, credit to the production sector increased by 9.6 percent (Rs.8.4 billion) in the review period compared to a growth of 7.6 percent (Rs.5.7 billion) in the same period of the previous year. The credit to agriculture sector increased by Rs. 1.4 billion in the review period. The credit to wholesale and retail business; finance, insurance and fixed assets; and service sectors increased by 24.5 percent (Rs.16.8 billion), 38.4 percent (Rs.14.9 billion), and 16.3 percent (Rs 3.8 billion) respectively. The credit to these sectors during the corresponding period in the previous year had increased by 6.9 percent (Rs.3.9 billion), 22.6 percent (Rs.5.6 billion), and 8.3 percent (Rs.1.8 billion) respectively. Although the growth of the credit to real estate sector marginally declined, the volume of such credit flow is high in the review period. The credit to such sector increased to Rs.14.2 billion in the first six months of 2009/10 compared to Rs.6.5 billion in the same period a year ago.

Liquidity position of Commercial Banks

11. The liquid assets of the commercial banks declined substantially in the review period. In the first six months of previous year, such assets had grown by 8.8 percent amounting to Rs.164.4 billion as on mid-January 2009, while it declined by 12.3 percent from mid-July 2009 amounting Rs. 188.1 billion to mid-January 2010 amounting Rs.164.9 billion. Of the components of liquid assets, liquid fund declined by 13.1 percent in the review period. A decline in commercial banks balance with the NRB and that held abroad led to such a reduction in liquid fund of commercial banks. In the review period, balance held abroad by commercial banks declined by Rs. 5.1 billion to Rs.48.3 billion, and the balances with NRB declined by Rs. 11.6 billion. In the review period, the investments on government securities declined by 11.0 percent (Rs. 7.9 billion).

12. The higher expansion of loan and advances relative to the deposit mobilization led to change in portfolio of the commercial banks. In the review period, the loan and advances of commercial banks increased by 11.5 percent (Rs. 59.5 billion). The higher expansion of loan and advances relative to deposit mobilization of commercial banks increased the credit-deposit ratio to 89.3 percent in mid-January 2010 from 81.2 in

mid-July 2009. On the other hand, the liquidity-deposit ratio declined to 28.6 percent in mid-January 2010 from 34.2 percent in mid-July 2009.

Liquidity Management

13. In the first six months of 2009/10, NRB injected net liquidity amounting to Rs.34.9 billion. During this period, Rs.7.4 billion and Rs.1.0 billion was mopped up through outright sale auction and reverse repo auction respectively, while Rs. 40.0 billion and Rs. 3.4 billion was injected through repo and outright purchase auction. In the same period of the previous year, liquidity amounting to Rs.20.7 billion was mopped up. Of the total liquidity mopped up, Rs.7.5 billion was through outright sale auction and Rs.13.2 billion from reverse repo auction.

14. In the first six months of 2009/10, NRB injected net liquidity amounting to Rs. 37.6 billions through net purchase of USD 494.8 million from commercial banks. A net liquidity of Rs. 73.2 billion was injected through the net purchase of USD 963.6 million in the same period last year.

15. The NRB purchased Indian currency equal to 49.8 billion through the sale of USD 1.1 billion in the Indian money market during the review period. Indian currency equal to 33.9 billion was purchased through the sale of USD 720 million in the corresponding period of the previous year. An accelerated trade deficits with India contributed to such a higher volume of Indian currency purchase in the review period.

Standing Liquidity Facility and Inter Bank Transactions

16. Inter-bank transactions of commercial banks stood at Rs.150.9 billion in the first six months of 2009/10 compared to Rs.146.8 billion in the corresponding period of the previous year. Likewise, commercial banks used standing liquidity facility (SLF) amounting to Rs.65.3 billion in the review period. The use of the SLF by commercial banks amounted to Rs.41.5 billion in the corresponding period of the previous year.

17. The higher volume of liquidity injection through open market operation and the use of SLF is attributed to the decline in liquidity owing to the deficit in balance of payments, cash deposit of government with the NRB and sharp increase in loan and advances of commercial banks relative to their deposit mobilization.

Interest Rates

18. The weighted average 91-day Treasury bill rate stood at 8.74 percent in the sixth month of 2009/10 compared to 4.32 percent in the six month of the previous year. Similarly, the weighted average inter-bank rate increased to 12.83 percent in the sixth month of 2009/10 compared to 3.37 percent in the six month of previous year. In addition to short-term interest rates, the deposits rate of commercial banks has also increased in the review period. In the sixth months of 2009/10, one-month, three-month, six-month, one-year, and two-year and above time deposits rates increased respectively by 1.5, 0.75, 1.75, 1, and 1 percentage points to 7.25, 7.25, 8.75, 11, and 11.5 percents. The decline in liquidity situation of the banks in the review period contributed to such increments in the interest rates.

Securities Market

19. The year on year (y-o-y) NEPSE index declined by 19.5 percent to 530.96 points in mid January, 2010. This index was 659.81 in the same period last year. Likewise, NEPSE sensitive index (based on July 2006) stood at 129.60 point in mid January 2010 as against 173.11 in mid January 2009. The NEPSE float index, calculated on the basis of final transaction as of August 24, 2008 (at base market value), remained at 50.39 in mid January 2010, a contraction of 22.2 percent compared to the same period last year.

20. The y-o-y market capitalization increased by 12.7 percent to Rs.407.78 billion in mid January 2010. The ratio of market capitalization to GDP stood at 37.6 percent in the review period. It was 37.7 percent in the same period last year. Of the total market capitalization, bank and financial institutions accounted for 73.8 percent followed by manufacturing and processing companies (1.9 percent), hotels (1.2 percent), business entities (0.4 percent), hydropower (4.4 percent) and other economic sectors (18.4 percent).

21. Total paid up capital of the listed companies stood at Rs. 71.71 billion in mid January 2010, an increase of 48.8 percent over the period of one year. This increase was largely due to the additional listing of securities at the NEPSE. As at the sixth month of 2009/10, additional securities worth Rs.15.03 billion (ordinary share of Rs.3.33 billion, bonus share of Rs. 2.18 billion, right share of Rs.3.77 billion and government securities of Rs.5.75 billion) were listed at the NEPSE.

22. The monthly turnover to market capitalization ratio remained at 0.24 percent in mid January 2010, compared to 0.39 percent a year ago.

23. Total number of companies listed at the NEPSE increased to 165 in mid January 2010 compared to 149 last year. Among them, 133 are banks and financial institutions (including insurance companies), followed by production and processing industries (18), hotels (4), business entities (4), hydropower (4) and companies in other groups (2).

24. The twelve-month rolling standard deviation which reflect the volatility in the stock market, stood at 66.7 in mid January 2010 compared to 128.2 during the same period last year.

Inflation

Consumer Price Inflation

25. The year on year (y-o-y) inflation as measured by the consumer price index moderated to 11.8 percent in mid January 2010 compared to the 14.4 percent increase in the same period last year. In the review period, the price index of food and beverages group increased by 18.1 percent whereas the index of non-food and services group rose only by 4.5 percent. The index of food and beverages and non-food and services group had risen by 18.3 percent and 10.3 percent respectively in the same period last year.

26. Of the items in the food and beverage group, price indices of sugar and sugar related products has the highest increased rate of 77.5 percent compared to an increase of 37.3 percent in the same period last year. Similarly, the price indices of pulses, spices, vegetables and fruits as well as meat, fish and eggs sub-groups increased in the review

period by 36.7 percent, 34.8 percent, 29.2 and 22.8 percent respectively compared to an increase of 25.6 percent, 8.1 percent, 13.3 percent and 22.5 percent in the same period last year. The index of grains and cereal products subgroup also witnessed an increment of 11.7 percent compared to 16.5 percent increase in the corresponding period of the previous year.

27. Similarly, within the group of non-food and services, the index of tobacco and related products has the highest increased rate of 11.6 percent during the review period compared to a rise of 15.1 percent during the same period last year. The price index of transport and communication declined by 7.5 percent in the review period. However, it had increased by 20.7 percent during the same period last year.

28. Region-wise, the price index of Terai rose by 12.5 percent and followed by 11.8 percent in Hills and 10.6 percent in Kathmandu Valley in the review period. The respective rates were 13.6 percent, 14.2 percent and 15.8 percent in the corresponding period last year.

29. In the review period, the y-o-y core inflation rose to 12.6 percent, a moderation from 13.2 percent a year ago.

Wholesale Price Inflation

30. During the review period, the y-o-y wholesale price inflation increased by 16.0 percent compared to a rise of 14.7 percent a year ago. The indices of agricultural commodities and domestic manufactured commodities increased by 30.2 percent and 10.4 percent respectively in the review period compared to 17.0 percent and 11.8 percent a year ago. The price indices of imported commodities declined by 1.8 percent in the review period whereas it had increased by 13.0 percent during the same period of last year.

31. Within the agricultural commodities group, the price index of cash crops increased by 64.7 percent in the review period, as against the decline of 7.7 percent a year ago. In the same way, the price index of spices, pulses and livestock production increased by 50.3 percent, 34.0 percent and 33.8 percent compared to an increase of 7.2 percent, 20.0 percent and 27.9 percent during the same period last year. Within the group of domestic manufactured commodities, the price index of food-related products increased by 15.1 percent compared to a rise of 12.0 percent a year ago.

32. Within the imported commodities group, the price indices of chemical fertilizers and chemical goods declined by 11.9 percent in the review period compared to an increase of 8.3 percent in the corresponding period of previous year.

National Salary and Wage Rate

33. The overall y-o-y salary and wage rate index rose by 17.7 percent in the review period compared to a rise of 15.4 percent a year ago. Of the salary and wage rate indices, the salary index increased by 18.0 percent in the review period compared to a rise of 12.6 percent in the same period of the previous year. The increase in basic salary and allowances by the government of Nepal for civil servants and its simultaneous effect on salary of the private sector contributed to such an increase in salary index. The wage rate index increased by 17.6 percent in the review period compared to an increase of 16.4 percent in the same period of the previous year. Wages of agricultural, industrial and construction laborers increased by 20.7 percent, 13.8 percent and 13.0 percent

respectively in the review period. These wage rates had increased by 22.7 percent, 7.1 percent and 15.5 percent respectively in the same period of last year.

Fiscal Situation

Budget Deficit / Surplus

34. In the first six months of 2009/10, government budget surplus stood at Rs.10.16 billion compared to a surplus of Rs7.42 billion in the corresponding period of the previous year. A high growth of resource mobilization relative to total government expenditure accounted for such a budget surplus during the review period.

Government Expenditure

35. In the first six months of 2009/10, total government spending increased by 31.8 percent to Rs.86.29 billion compared to an increase of 12.3 percent in the corresponding period of the previous year. The high growth of recurrent as well as capital expenditure accounted for such an increase in the government expenditure.

36. In the review period, recurrent expenditure increased by 40.2 percent to Rs.60.64 billion. In the corresponding period of the previous year, the recurrent expenditure had increased by 13.1 percent. An upward revision in the salary and allowances of the civil servants and teachers by the Government of Nepal mainly attributed to such a rise in the recurrent expenditure. Likewise, increasing expenditure on special security plan, growing amount of subsidies to public school, increment in the distribution of economic assistance and increasing foreign traveling expenditure accounted to such a rise in the recurrent expenditure.

37. In the review period, capital expenditure increased by 33.9 percent to Rs.10.55 billion in contrast to a decline of 23.4 percent in the corresponding period of the previous year. Such amount of capital expenditure was only 9.9 percent of the budgeted estimate. Delay in the approval of budget, lingering contract process, absence of representatives in local bodies as well as weak peace and security situation of the country are mainly responsible for the lower than expected performance of capital expenditure in the review period.

38. In the first six months of 2009/10, principal repayment expenditure declined by 47.7 percent to Rs.4.92 billion. In the corresponding period of the previous year, such expenditure had increased by 27.6 percent.

Government Revenue

39. In the first six months of 2009/10, revenue mobilization of the government grew by 34.0 percent to Rs.79.68 billion compared to an increase of 25.5 percent in the corresponding period of the previous year. Impact of "Tax Compliance year", increase in PAN number holders, mobilization of tax volunteers, growth in imports, control in revenue leakages and tax administration reforms mainly contributed to such an increase in revenue mobilization.

40. Of the total revenue mobilization, Value Added Tax (VAT) grew by 43.5 percent to Rs.24.62 billion in mid January 2009. It had increased by 14.9 percent in the corresponding period of the previous year.

41. In the review period, custom revenue rose by 45.1 percent to Rs.16.12 billion compared to an increase of 14.8 percent in the same period of the previous year. Reforms in custom administration and the increase in imports of high tax yielding vehicles and spare parts contributed to such a high growth of customs revenue.

42. In the review period, excise revenue increased by 67.6 percent to Rs.11.06 billion compared to an increase of 33.2 percent in the same period of the previous year. Reforms in excise administration and increase in the imports of high excise tax yielding vehicles accounted for such a growth of excise revenue in the review period.

43. Income tax revenue increased by 32.0 percent to Rs.14.92 billion in the review period. In the corresponding period last year such revenue had risen by 34.6 percent.

44. In the review period, non-tax revenue decreased by 11.0 percent to Rs.8.44 billion compared to an increase of 31.2 percent in the same period of the preceding year.

Foreign Cash Loans and Grants

45. The government received foreign cash loans amounting to Rs.1.98 billion and foreign cash grants amounting to Rs.13.06 billion in the first six months of 2009/10. In the corresponding period of the previous year, the government had received foreign cash loans and foreign cash grants amounting to Rs.2.79 billion and Rs.10.96 billion respectively.

External Sector Situation

Foreign Trade

46. In the 2009. In the first six months of 2009/10, the merchandise exports declined by 12.1 percent contrary to a growth of 22.3 percent in the corresponding period of 2008/09. The declining trend in merchandise export, which began in Aug/Sep, continued for three months up to Oct/Nov, 2009. However, the reversal in the trend was witnessed during Nov/Dec and Dec/Jan with exports turning around sharply by exhibiting growth of 9.2 percent and 37.5 percent respectively.

47. In terms of destination, exports to India dropped by 4.0 percent in the first half of 2009/10 as against a growth of 1.3 percent in the corresponding period of the previous year. Likewise, exports to other countries decelerated by 23.0 percent contrary to a growth of 70.5 percent in the same period of the previous year.

48. A fall in the exports of readymade garments, thread, pulses, brans and zinc sheet among others was largely responsible for the decline in the exports to India. Likewise, exports to other countries declined considerably due mainly to the decline in the export of woolen carpet, pulses, readymade garments, silverware and jewelleries and herbs.

49. The merchandise import registered a growth of 40.8 percent in the first six months of 2009/10 compared to a growth of 25.9 percent in the corresponding period of the previous year. In terms of destination, the imports from India grew by 33.3 percent in the review period compared to a growth of 12.4 percent in the corresponding period of the previous year. Likewise, the imports from other countries witnessed a growth of 50.2 percent compared to a growth of 47.9 percent in the same period of the previous year.

50. A growth in the import of M.S. billet, vehicles and spare parts, M.S. wire and rods, other machinery and parts and cement among others, from India and gold, telecommunication equipment and parts, polythene granules, steel rod and sheet and computer and parts among others, from other countries contributed significantly in the rise of total imports in the review period.

Balance of Payments

51. In the first six months of 2009/10, the overall BOP recorded a deficit of Rs. 19.79 billion contrary to a surplus of Rs. 28.53 billion in the corresponding period of the previous year. The current account also registered a deficit of Rs. 24.39 billion in the first six months of 2009/10 as against a surplus of Rs.16.73 billion in the corresponding period of the previous year. The increase in trade deficit and the slowdown in the growth of remittance inflows resulted in a huge current account deficit. In the first six months of 2009/10, the F.O.B-based merchandise trade deficit grew by 60.7 percent to Rs. 153.06 billion compared to a growth of 27.5 percent in the corresponding period of the previous year. Under the transfers subgroup; while grants declined by 18.7 percent in the first six months of 2009/10, workers' remittances went up only by 12.6 percent compared to its significant growth of 65.3 percent in the corresponding period of the previous year.

Foreign Exchange Reserves

52. The gross foreign exchange reserves dropped by 14.0 percent to Rs. 240.83 billion in mid-January 2010 from a level of Rs. 279.99 billion as at mid-July 2009 as against an accretion of 19.7 percent (Rs. 41.87 billion) in the corresponding period of the previous year. The gross foreign exchange reserves in dollar terms declined by 7.5 percent to USD 3.32 billion in mid-January 2010 as against a growth of 5.5 percent in the corresponding period of the previous year. The widening of the current account deficit resulted in the drawdown of foreign exchange reserves in the review period. The current level of reserves is sufficient for financing merchandise imports of 7.8 months and merchandise and service imports of 6.7 months.

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

53. The price of oil (Crude Oil Brent) in the international market went up by 79.5 percent to US$ 77.73 per barrel in mid-January, 2010 from US$ 43.31 per barrel in mid-January, 2009. Similarly, the price of gold also surged by 37.7 percent to US$ 1138.25 per ounce in mid- January 2010 from US$ 826.50 a year earlier.

54. Compared to mid-July 2009, the Nepalese currency vis-à-vis the US dollar appreciated by 7.51 percent in mid- January 2010. It had depreciated by 11.90 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 72.60 in mid- January 2010 compared to Rs. 78.05 in mid-July 2009.