Current Macroeconomic Situation

(Based on the Three Months' Data of FY 2010/11)

Monetary Situation

Money Supply

1. Broad money (M2) increased by 1.1 percent during the first three months of FY 2010/11 compared to a growth of 5.0 percent in the corresponding period of the previous year. On the one hand, the possible adverse impact on economic activities on account of the delay in the presentation of the annual budget subdued the expansion in money demand, on the other, the attraction of deposit towards financial institutions other than commercial banks led to a marginal growth in time deposit mobilized by commercial banks. On account of these two factors, the growth in monetary aggregates remained subdued during the review period.
2. Net foreign assets (after adjusting foreign exchange valuation gain/loss) declined by Rs. 6.9 billion (3.2 percent) during the review period compared to Rs. 14.5 billion (6.5 percent) in the corresponding period of the previous year. The improvement in merchandise export and workers' remittances together with the compressed growth in import were the factors responsible for the lower deficit in balance of payments (BoP) during the review period relative to the corresponding period of the previous year.

Domestic Credit

3. Domestic credit increased by 3.6 percent during the review period. It had expanded by 4.8 percent in the corresponding period of the previous year. During the review period, claims on private sector increased by 4.1 percent compared to a growth of 5.7 percent in the corresponding period of the previous year. As a result of the impact of the delay in announcement of the annual budget and the deceleration in import growth, the bank credit to the private sector also witnessed a slower growth.

Deposit Mobilization and Credit Flow of Commercial banks

4. The gap between deposit mobilization and lending by commercial banks widened during the first three months of FY 2010/11. For example, the deposit mobilization of commercial banks declined by Rs. 6.8 billion during the first three months of 2010/11 as against a growth of Rs. 18.3 billion in the corresponding period of the previous year. The decline in deposit mobilization by commercial banks was due to the diversion of deposit to other financial institutions on account of relatively

higher interest rate offered by them. Contrary to the decline in deposit mobilization, the expansion in the bank credit to the private sector remained high.

5. The banks' credit to production sector increased by Rs. 4.9 billion during the review period compared to Rs. 2.9 billion in the corresponding period of the previous year. Similarly, banks' credit to agriculture, mining and wholesale and retail trade increased by Rs. 362.0 million, Rs. 229.0 million and Rs. 4.0 billion respectively. On the contrary, credit to transportation, communication and public services declined by Rs. 1.9 billion.

Liquidity Management

6. The NRB mopped up net liquidity of Rs. 18.0 billion through secondary market operation during the review period. Liquidity of Rs. 2.0 billion was mopped up through outright sale auction and Rs. 19.0 billion through reverse repo auction during the review period. On the other hand, liquidity of Rs. 3.0 billion was injected through repo auction during the review period. Liquidity of Rs. 8.4 billion was mopped up through outright sale auction and reverse repo auction while Rs. 1.0 billion was injected through repo auction in the corresponding period of the previous year.

7. The NRB injected net liquidity of Rs. 36.6 billion through the purchase of the USD 497 million from commercial banks during the review period. A net liquidity of Rs. 20.2 billion was injected through the purchase of the USD 261 million from commercial banks in the corresponding period of the previous year.

8. The NRB purchased Indian currency amounting to INR 25.8 billion through the sale of the USD 560 million in the Indian money market during the review period. INR 30.3 billion was purchased through the sale of the USD 630 million in the corresponding period of the previous year.

Inter Bank Transaction and Standing Liquidity Facility

9. Inter-bank transaction of commercial banks reached Rs. 74.2 billion during the first three months of FY 2010/11 compared to Rs. 65.5 billion in the corresponding period of the previous year. Liquidity injection through the standing liquidity facility (SLF) amounted to Rs. 20.8 billion during the review period. Liquidity injected through the SLF had amounted to Rs. 4.1 billion in the corresponding period of the previous year. Of the total SLF used during the review period, the outstanding amount was Rs. 7.6 billion as at mid October 2010. Such outstanding amount was Rs. 1.3 billion in mid October 2009.

Short-term Interest Rates

10. The short-term interest rates remained higher during the review period relative to those in the corresponding period of the previous year. For example, the weighted monthly average 91-day Treasury bill rate stood at 5.63 percent in mid October

2010 compared to 2.73 percent a year ago. The weighted average inter-bank rate remained at 5.89 percent in mid October 2010 compared to 5.1 percent a year ago.

Securities Market

11. The year on year (y-o-y) NEPSE index declined by 31.0 percent to 420.30 points in mid-October 2010. This index had stood at 609.55 in the same period last year. The significant increase in the supply of securities and the sluggish economic activities are the factors driving down share prices.

12. The y-o-y stock market capitalization decreased by 17.2 percent to Rs. 356 billion in mid October 2010. The ratio of market capitalization to GDP stood at 26.9 percent in mid October 2010. This ratio was 36.3 percent a year ago. Of the total market capitalization, the share of bank and financial institutions became the largest which stood at 72.2 percent followed by manufacturing and processing companies (2.4 percent), hotels (1.5 percent), business entities (0.4 percent), hydropower (4.6 percent) and other sectors (19.0 percent).

13. Total paid-up capital of the listed companies stood at Rs. 88.32 billion in mid-October 2010, registering an increase of 37.6 percent over the period of one year. This increase was largely due to the additional listing of securities at the NEPSE. As at mid October 2010, additional securities worth Rs. 13.06 billion (ordinary share of Rs. 4.97 billion, bonus share of Rs. 0.5 billion, right share of Rs. 2.59 billion and government securities of Rs. 4.99 billion) were listed at the NEPSE.

14. Total number of companies listed at the NEPSE increased to 184 in mid-October 2010 from 159 last year. Among them, 152 were 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).

Inflation

Consumer Price Inflation

15. The y-o-y inflation as measured by the consumer price index (2005/06=100) increased to 8.9 percent in mid-October 2010 from 8.5 percent in the same period of the previous year. The price index of food and beverage group rose by 13.1 percent during the review period, whereas the price index of non-food and services group increased by 5.5 percent. The indices of these groups had increased by 15.7 percent and 2.8 percent respectively in the same period of the previous year.

16. During the review period, of the items in the food and beverage group, price indices of spices sub-group increased by a whopping rate of 41.1 percent compared to an increase of 12.5 percent in the same period of the previous year. The price indices of sugar and sweets, which had increased by 41.8 percent in the same period of the previous year, increased by 28.6 percent during the review period. Similarly, the price indices of cereals grains and their products, milk products and

egg and restaurant and hotel increased respectively by 17.1 percent, 14.9 percent and 14.8 percent during the review period compared to their respective increase of 5.2 percent, 8.3 percent and 25.3 percent in the same period of the previous year. The price index of vegetables, which had jumped by 43.7 percent in the previous year, increased moderately by 9.7 percent duirng review period. The price index of legume varieties and ghee and oil declined during the review period.

17. Within the group of non-food and services, the price index of clothing and footwear increased by 11.6 percent. The price index of this group had increased by 7.7 percent in the corresponding period of the previous year. Similarly, the indices of housing and utilities and transport increased by 10.4 percent and 8.2 percent respectively. The price indices of these groups had declined by 3.8 percent and 9.4 percent respectively last year. Duirng the review period, the price indices of communication and recreation and culture decreased by 9.6 percent and 3.7 percent respectively.

18. Region-wise, the price index of Kathmandu Valley rose by 12.1 percent followed by 10.3 percent in Hills and 5.8 percent in Terai during the review period. The respective growth rates were 9.5 percent, 7.8 percent and 8.3 percent in the same period of the previous year.

Wholesale Price Inflation

19. During the review period, the y-o-y wholesale price index increased to 8.0 percent compared to a rise of 14.7 percent in the same period of the previous year. The wholesale price indices of agricultural commodities and domestic manufactured commodities increased by 8.2 percent and 7.8 percent respectively duirng the review period compared to 33.9 percent and 5.1 percent in the same period of the previous year. The wholesale price index of imported commodities increased by 7.6 percent in the review period. The price index of this group had decreased by 7.7 percent in the corresponding period of the previous year.

20. Duirng the review period, within the group of agricultural commodities, the wholesale price index of spices increased by 48.5 percent compared to a rise of 27.8 percent in the same period of the previous year. Likewise, the wholesale price indices of food grains, fruits and vegetables and livestock production, increased by 22.5 percent, 12.9 percent and 18.6 percent respectively compared to an increase of 8.8 percent, 31.9 percent and 38.0 percent in the same period of the previous year. The wholesale price index of cash crops, however, declined by 32.9 percent in contrast to an increase by a whopping rate of 109.5 percent in the corresponding period of the previous year.

21. Within the group of domestic manufactured commodities, the wholesale price index of food related products increased by 8.9 percent compared to a rise of 4.8 percent in the same period of the previous year. Similarly, the index of beverages

and tobacco increased by 8.9 percent compared to a rise of 16.3 percent in the corresponding period of the previous year.

22. During the review period, within the imported commodities group, the wholesale price index of petroleum products and coal increased by 15.9 percent as against the decline of 20.3 percent in the corresponding period of the previous year. During the review period, the price index of electricity and electric goods, chemical fertilizer and chemical goods and transport and machinery rose by 5.7 percent, 3.7 percent and 2.8 percent respectively in contrast to a decrease by 4.6 percent, 7.9 percent and 6.5 percent respectively in the same period last year.

National Salary and Wage Rate

23. The overall y-o-y salary and wage rate index rose by 15.6 percent duirng the review period compared to an increase of 22.2 percent in the same period of the previous year. Of the salary and wage rate indices, the salary index remained unchanged in the review period as against the increase of 32.9 percent in the corresponding period of the previous year. However, duirng the review period, the overall salary and wage rate index increased mainly due to the increase in wage rate index. During the review period, the wage rate index increased by 21.0 percent compared to an increase of 18.8 percent in the same period of the previous year. The indices of wages of agricultural labors, industrial labors and construction laborers increased by 29.4 percent, 6.8 percent and 19.1 percent respectively during the review period. These wage rates had increased by 20.9 percent, 16.5 percent and 15.1 percent respectively in the corresponding period of the previous year.

Fiscal Situation *

Budget Deficit / Surplus

24. Duirng the first three months of FY 2010/11, government budget remained at a deficit of Rs. 3.95 billion. A high growth in expenditure relative to revenue mobilization accounted for such a government budget deficit duirng the review period. In the corresponding period last year, budget deficit had stood at Rs. 90.5 million.

Government Expenditure

25. During the review period, total government spending increased by 12.6 percent to Rs. 44.68 billion compared to an increase of 35.5 percent in the corresponding period of the previous year. The growth rate of total government expenditure

* Based on the data reported by 8 NRB offices, 60 RBB branches (out of 65 branches conducting government transaction), 35 NBL branches (out of 42 branches conducting government transactions), 5 Everest Bank branches, 1 from Nepal Bangladesh Bank Limited and 1 from Global Bank limited.

slowed mainly due to the decline in the growth rate of both recurrent and capital expenditures duirng the review period.

26. During the review period, revenue mobilization of the Government of Nepal (GoN) grew by 9.4 percent to Rs. 37.54 billion compared to an increase of 53.7 percent to Rs. 34.32 billion in the corresponding period of the previous year.

27. During the review period, the growth rate of value added tax accelerated. However, the growth rates of customs duties, income tax and excise revenue decelerated compared to that in the corresponding period of the previous year. Likewise, the non-tax revenue declined in the review period compared to that in corresponding period of the previous year.

Foreign Cash Loans and Grants

28. Duirng the three months of the FY 2010/11, foreign cash loans of Rs. 908.9 million and foreign cash grants of Rs. 2.85 billion were received by the GoN. The GoN had received foreign cash loans of Rs. 584.1 million and foreign cash grants of Rs. 3.78 billion in the corresponding period of the previous year.

External Sector Situation

Foreign Trade

29. Merchandise exports increased by 5.9 percent to Rs. 16.87 billion duirng the three months of the FY 2010/11. Such exports had declined by 16.5 percent to Rs. 15.94 billion in the same period last year. On a monthly basis, exports rose by 12.2 percent in September/October of the current fiscal year compared to the value of the previous month.

30. Exports to India increased by 11.8 percent duirng the three months of the FY 2010/11 in contrast to a drop of 11.3 percent in the same period last year. Likewise, exports to other countries dropped by 2.4 percent compared to a plunge of 22.7 percent in the same period last year. The increase in the exports to India was mainly ascribed to the increase in the exports of jute goods, zinc sheet, M.S. pipe, wire, plastic utensils, textiles, threads, ayurvedic medicine, juice, toothpaste and readymade garments, among others. Likewise, exports to other countries declined due mainly to the decrease in the export of pulses, pashmina, handicraft goods, Nepalese paper and paper products, woolen carpet and herbs, among others.

31. Merchandise imports, on the other hand, grew by 3.6 percent to Rs. 92.98 billion during the three months of the FY 2010/11. Such imports had grown by 31.9 percent to Rs. 89.72 billion in the same period last year. On a monthly basis, the merchandise imports increased by 4.4 percent in September/October 2010 compared to the value of the previous month.

32. Imports from India grew by 31.9 percent duirng the review period compared to a growth of 26.8 percent in the same period last year. Likewise, imports from other

countries declined by 29.1 percent in contrast to a growth of 38.3 percent in the same period last year. The import of hot rolled sheet in coil, sugar, chemical fertilizers, fruits, dry cell battery and vegetables among others increased from India whereas import of gold, polythene granules, electrical goods, betelnuts, crude soybean oil and other machinery and parts declined from other countries in the review period.

33. Total trade deficit during the three months of FY 2010/11 expanded by 3.2 percent to Rs. 76.11 billion. Trade deficit had risen by 50.7 percent in the same period last year. Trade deficit with India rose by 36.6 percent during the review period compared to a growth of 41.2 percent in the same period last year. On the contrary, trade deficit with other countries declined by 34.2 percent compared to a growth of 63.1 percent in the same period a year ago.

34. The improvement in exports coupled with deceleration in import growth contributed to an increase in the ratio of export to import to 18.1 percent in the review period from the ratio of 17.8 percent a year ago.

Balance of Payments

35. The overall BOP recorded a deficit of Rs. 6.88 billion during the first three months of FY 2010/11 compared to a deficit of Rs. 14.54 billion in the same period last year. The current account also registered a deficit of Rs. 2.17 billion compared to a deficit of Rs. 12.33 billion in the same period last year. The deceleration in the growth rate of trade deficit and a considerable growth of transfer income particularly grants, remittances and pension led to such a decline in the current account deficit.

36. The FOB-based merchandise trade deficit grew by 3.1 percent to Rs. 73.96 billion duirng the first three months of FY 2010/11. Such deficit had grown by 47.6 percent in the same period last year. The service account deficit witnessed a drop of 20.2 percent to Rs. 4.64 billion duirng the review period. Service account deficit had declined by 13.4 percent to Rs. 5.81 billion in the same period last year. The net transfer account registered a growth of 19.2 percent to Rs. 74.79 billion in the review period compared to that of a year ago. Under the transfers sub-group, grants increased by 39.7 percent to Rs. 6.71 billion while pension receipts rose by 22.8 percent to Rs. 8.64 billion. Likewise, the workers' remittances increased by 16.0 percent to Rs. 60.01 billion compared to its growth of 11.1 percent in the corresponding period of the previous year. On a monthly basis, the remittance inflows grew by 5.6 percent in September/October compared to the value of the pervious month of this year.

Foreign Exchange Reserves

37. The gross foreign exchange reserves declined by 4.4 percent to Rs. 257.06 billion in mid October 2010 from a level of Rs. 268.91 billion as at mid July 2010. Such reserves had decreased by 10.1 percent to Rs. 257.49 billion in the same period last

year. NRB's reserves declined by 4.9 percent to Rs. 195.34 billion in the review period from a level of Rs. 205.37 billion as at mid-July 2010. The gross foreign exchange reserves in US dollar terms increased marginally by 0.6 percent to USD 3.63 billion in mid October 2010 from a level of USD 3.61 billion as at mid-July 2010. Such reserves had decreased by 8.9 percent in the same period last year. Based on the trend of import during the three months of the current fiscal year, the current level of reserves is sufficient for financing merchandise imports of 8.4 months and merchandise and service imports of 7.2 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 went up by 12.3 percent to USD 84.1 per barrel in mid October 2010 from USD 74.92 per barrel in mid October 2009. Similarly, the price of gold also surged by 30.5 percent to USD 1367.5 per ounce in mid October 2010 from USD 1047.50 a year ago.

39. Nepalese currency vis-à-vis the US dollar appreciated by 5.25 percent in mid October 2010 from the level of mid July 2010. It had appreciated by 5.96 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 70.73 in mid October 2010 compared to Rs. 74.44 in mid July 2010.