Current Macroeconomic Situation

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

Monetary Situation

Money Supply

1. Broad money (M2) has not increased during the five months of FY 2010/11 contrary to a growth of 6.2 percent in the corresponding period of the previous year. The broad money has not expanded in the review period on account of decline in net foreign assets of the banking system and only a marginal growth in net domestic assets. However, the narrow money (M1) declined by 3.4 percent in the review period.

2. Net foreign assets (after adjusting foreign exchange valuation gain/loss) declined by Rs. 3.35 billion (1.6 percent) during the review period compared to Rs. 14.55 billion (6.5 percent) in the corresponding period of the previous year. The improvement in merchandise export and workers' remittances together with the remarkable deceleration in import growth were the factors responsible for the lower deficit in balance of payments (BoP) thereby the lower decline in net foreign assets of the monetary sector during the review period relative to that of the corresponding period of the previous year.

Domestic Credit

3. Domestic credit increased by 2.2 percent during the review period. It had expanded by 8.6 percent in the corresponding period of the previous year. During the review period, claims on private sector increased by 6.0 percent compared to a growth of 12.7 percent in the corresponding period of the previous year. The policy measures initiated to curb the excessive credit flow to unproductive sector and **a marginal growth in import** contributed to slower growth in the bank credit to the private sector during the review period.

Deposit Mobilization and Credit Flow of Commercial Banks

4. The gap between deposit mobilization and lending by commercial banks continued during the five months of FY 2010/11. The deposit mobilization of commercial banks declined by Rs. 2.65 billion while the loan and advances increased by Rs. 34.94 billion in the review period. The deposit mobilization had increased by Rs. 24.25 billion and loan and advances had increased by Rs. 56.43 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 and cooperatives on account of relatively higher interest rate offered by them. Contrary to the decline in deposit mobilization, the bank credit to private sector increased by Rs. 23.98 billion during the review period. However, the credit growth to private sector in the review period is much lower as compared to Rs. 52.14 billion in the corresponding period of the previous year.

5. Of the total bank credit to private sector, the credit to production sector increased by Rs. 10.71 billion during the review period compared to Rs. 7.23 billion in the corresponding period of the previous year. Similarly, banks' credit to wholesale and retail trade, construction and mining sectors increased by Rs. 5.34 billion, Rs. 1.57 billion and Rs. 0.20 billion respectively during the review period. On the contrary, credit to transportation, communication and public services declined by Rs. 1.7 billion.

Liquidity Management

6. The NRB mopped up net liquidity of Rs. 16.0 billion through secondary market operation during the review period. Liquidity of Rs. 21.0 billion was mopped up through outright sale auction of Rs. 2.0 billion and reverse repo auction of Rs. 19.0 billion during the review period. On the other hand, liquidity of Rs. 5.0 billion was injected through repo auction during the review period. Liquidity of Rs. 8.44 billion was mopped up through outright sale auction and reverse repo auction while Rs. 16.0 billion was injected through repo auction in the corresponding period of the previous year.

7. The NRB injected net liquidity of Rs. 68.75 billion through the purchase of the USD 946.0 million from foreign exchange market (commercial banks) during the review period. A net liquidity of Rs. 33.76 billion was injected through the purchase of USD 443.3 million from foreign exchange market in the corresponding period of the previous year.

8. The NRB purchased Indian currency equivalent to Rs. 74.45 billion through the sale of the USD 1.02 billion in the Indian money market during the review period. INR equivalent to Rs. 66.40 billion was purchased through the sale of USD 870.0 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. 165.14 billion during the first five months of FY 2010/11 compared to Rs. 118.93 billion in the corresponding period of the previous year. Liquidity injection through the standing liquidity facility (SLF) amounted to Rs. 81.68 billion during the review period. Of the total SLF used during the review period, the outstanding amount was Rs. 1.74

billion as at mid December 2010. Liquidity injected through the SLF had amounted to Rs. 45.46 billion in the corresponding period of the previous year. The outstanding amount of SLF was Rs. 2.87 billion as at mid December 2009.

Short-term Interest Rates

10. The short-term interest rates in the review period remained similar to those in the corresponding period of the previous year. For example, the weighted monthly average 91-day Treasury bill rate stood at 6.82 percent in mid December 2010 compared to 6.35 percent in mid-December 2009. The weighted average inter-bank rate remained at 8.59 percent in mid December 2010 compared to 9.93 percent in mid December 2009.

Securities Market

11. The year on year (y-o-y) NEPSE index declined by 28.2 percent to 394.17 points in mid-December 2010. This index had stood at 548.61 in the same period last year. The decline in share prices was on account of the significant increase in the supply of securities.

12. The y-o-y stock market capitalization decreased by 15.8 percent to Rs. 338.0 billion in mid-December 2010. The ratio of market capitalization to GDP stood at 25.6 percent. This ratio was 34.0 percent a year ago. Of the total market capitalization, the share of bank and financial institutions stood at 70.1 percent followed by manufacturing and processing companies (2.7 percent), hotels (1.6 percent), business entities (0.4 percent), hydropower (4.7 percent) and other sectors (20.5 percent).

13. Total paid-up capital of the listed companies stood at Rs. 91.62 billion in mid-December 2010, registering an increase of 34.9 percent over the period of one year. This increase was largely due to the listing of additional securities with Nepal Stock Exchange Limited (NEPSE). As at mid December 2010, additional securities worth Rs. 16.64 billion (ordinary share of Rs. 5.71 billion, bonus share of Rs.1.25 billion, right share of Rs. 4.69 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 190 in mid-December 2010 from 165 last year. Among them, 158 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) moderated to 9.6 percent in mid-December 2010 from 10.2 percent in the same period of the previous year. During the review period, the price index of food and beverage group increased by 15.2 percent, and the price index of non-food and services group increased by 5.0 percent. The indices of these groups had increased by 18.1 percent and 4.1 percent respectively in the same period of the previous year.

16. During the review period, of the items under food and beverage group, price index of vegetables sub-group increased by 33.7 percent compared to an increase of 43.4 percent in the same period of the previous year. The price indices of sugar and sweets and spices, which had increased by 56.6 percent and 28.3 percent respectively in the same period of the previous year, increased by 26.3 percent and 26.4 percent respectively during the review period. Similarly, the price indices of fruits and restaurant and hotel increased by 22.9 percent and 18.3 percent respectively during the review period, compared to their respective increase of 26.1 percent and 18.8 percent in the same period of the previous year. During the review period the price indices of cereals grains, milk products and soft drinks increased respectively by 15.6 percent, 15.2 percent and 10.8 percent. The respective rates were 9.4 percent, 8.9 percent and 19.5 percent during the same period of the previous year. Similarly, the price indices of meat and fish, hard drinks and tobacco products increased by 10.5 percent, 7.5 percent and 8.1 percent respectively. The respective rates were 21.8 percent, 13.4 percent and 11.7 percent during the same period of the previous year. The index of ghee and oil which had decreased by 4.9 percent last year, increased marginally by 0.5 percent during the review period. The price index of legume varieties declined by 12.8 percent during the review period as against the increase of 34.4 percent in the same period of the previous year.

17. Within the group of non-food and services, the price index of housing and utilities increased by 10.2 percent. The price index of this group had increased marginally by 1.2 percent in the corresponding period of the previous year. Similarly, the price index of clothing and footwear increased by 9.8 percent as compared to the increase of 7.7 percent in the same period of the previous year. The price index of transportation increased by 8.7 percent in the review period as against the decline of 8.5 percent in the corresponding period of the previous year. Similarly, the price index of communication which had remained constant in the corresponding period previous year declined by 9.5 percent during the review period.

18. Region-wise, the price index increased highest in Kathmandu Valley by 14.0 percent followed by 9.3 percent in Hills and 6.6 percent in Terai during the review

period. The respective growth rates were 9.2 percent, 10.9 percent and 10.6 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 by 11.2 percent compared to a rise of 18.9 percent in the same period of the previous year. The wholesale price indices of agricultural commodities and domestic manufactured commodities increased by 14.3 percent and 6.8 percent respectively during the review period compared to the increase of 38.7 percent and 8.6 percent in the same period of the previous year. The wholesale price index of imported commodities increased by 8.0 percent during the review period, as against the decrease of 3.1 percent in the corresponding period of the previous year.

20. During the review period, within the group of agricultural commodities, the wholesale price index of spices increased by 36.4 percent compared to the increase of 54.9 percent in the same period of the previous year. Likewise, the wholesale price indices of fruits and vegetables, food grains and livestock production increased by 31.1 percent, 17.9 percent and 16.0 percent respectively compared to an increase of 32.8 percent, 23.1 percent and 34.5 percent in the same period of the previous year. The wholesale price index of cash crops, however, declined by 11.7 percent as against the whopping increase rate of 114.4 percent during the corresponding period of the previous year.

21. Within the group of domestic manufactured commodities, the wholesale price index of beverages and tobacco, construction materials and food related products increased by 9.5 percent 6.8 percent and 5.2 percent compared to the increase of 13.2 percent, 4.6 percent and 13.0 percent respectively during the same 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 17.9 percent as against the decline of 9.4 percent in the corresponding period of the previous year. Similarly, the price indices of electric and electronic goods, chemical fertilizers and chemical goods and textile related products increased by 6.4 percent, 6.3 percent and 2.9 percent respectively as against the decline of 6.2 percent, 11.9 percent and 1.0 percent respectively in the same period of the previous year. The wholesale price index of drugs and medicine which had increased by 6.1 percent in the corresponding period of the previous year rose marginally by 1.6 percent during the review period.

National Salary and Wage Rate

23. The overall y-o-y salary and wage rate index increased by 14.9 percent during the review period compared to an increase of 17.4 percent in the same period of the

previous year. In the salary and wage rate indices, the salary index remained unchanged during the review period as against the increase of 18.0 percent in the corresponding period of the previous year. However, during 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 20.0 percent compared to an increase of 17.3 percent in the same period of the previous year. The indices of wages of agricultural labourers, industrial labourers and construction labourers increased by 27.3 percent, 7.7 percent and 17.1 percent respectively during the review period. These rates had increased by 20.0 percent, 14.1 percent and 12.1 percent respectively in the corresponding period of the previous year.

Fiscal Situation [*]

Budget Deficit / Surplus

24. During the five months of FY 2010/11, government budget remained at a surplus of Rs. 13.13 billion. A high growth of revenue mobilization relative to total expenditure accounted for such a government budget surplus during the review period. In the corresponding period of the previous year, budget surplus had stood at Rs. 7.28 billion.

Government Expenditure

25. During the review period, total government spending decreased by 5.7 percent to Rs. 59.55 billion compared to an increase of 30.3 percent in the corresponding period of the previous year. During the review period, the negative growth rates of recurrent and capital expenditure attributed for such a decline in the government expenditure.

26. During the review period, recurrent expenditure declined by 6.8 percent to Rs. 42.51 billion. In the corresponding period of the previous year, such expenditure had increased by 41.0 percent. Likewise, capital expenditure declined by 13.8 percent to Rs. 4.77 billion in contrast to an increase of 13.3 percent in the corresponding period of the previous year. Delay in the announcement of the annual budget also attributed for such a decline in the growth of recurrent and capital expenditures.

Revenue

27. During the review period, revenue mobilization of the Government of Nepal (GoN) grew by 11.1 percent to Rs. 65.10 billion compared to an increase of 36.1 percent

[*] Based on data reported by 8 offices of NRB, 45 out of total 65 branches of Rastriya Banijya Bank Limited, 24 out of total 42 branches of Nepal Bank Limited, 5 branches of Everest Bank Limited and 1-1 branch each from Nepal Bangladesh Bank Limited and Global Bank limited conducting government transactions.

to Rs. 58.60 billion in the corresponding period of the previous year. The impact of the delay in announcement of the annual budget coupled with low growth of import compared to the same period of the previous year affected the growth rate of revenue of the government.

28. Of the total revenue mobilization, VAT revenue grew by 19.8 percent to Rs.24.20 billion in mid-December 2010. It had increased by 42.5 percent in the corresponding period of the previous year.

29. During the review period, custom revenue rose by 6.0 percent to Rs.14.04 billion compared to an increase of 48.1 percent in the same period of the previous year.

30. During the review period, excise revenue increased by 21.9 percent to Rs. 10.88 billion compared to an increase of 64.2 percent in the same period of the previous year. The growth rate of excise revenue declined due mainly to the low growth rate of imports of high excise tax yielding vehicles.

31. Income tax revenue increased by 31.3 percent to Rs.8.50 billion during the review period. Such revenue had risen by 41.5 percent in the corresponding period of the previous year.

32. During the review period, non-tax revenue decreased by 22.7 percent to Rs.4.72 billion compared to a decrease of 8.8 percent in the same period of the previous year.

Foreign Cash Loans and Grants

33. During the first five months of the FY 2010/11, the Government of Nepal received foreign cash loans amounting to Rs. 1.90 billion and foreign cash grants amounting to Rs. 8.72 billion. Such receipts were respectively Rs. 1.80 billion and Rs. 9.74 billion in the corresponding period of the previous year.

External Sector Situation

Foreign Trade

34. Merchandise exports increased by 8.5 percent to Rs. 27.25 billion during the five months of FY 2010/11. Such exports had declined by 17.8 percent to Rs. 25.12 billion in the same period last year. On a monthly basis, exports increased by 17.6 percent in November/December of the current fiscal year compared to the value of the previous month.

35. Exports to India increased by 11.7 percent during the five months of FY 2010/11 in contrast to a drop of 12.3 percent in the same period last year. Likewise, exports to other countries increased by 3.2 percent in contrast to a plunge of 25.5 percent in the same period last year. The increase in the exports to India was mainly ascribed to the increase in the exports of thread, jute goods, wire, cardamom, plastic utensil and M.S. pipe, among others. Likewise, exports to other countries increased

primarily due to the rise in the export of pulses, woolen carpet, tanned skin, pashmina, readymade leather and tea goods, among others.

36. Merchandise imports, on the other hand, grew marginally by 0.6 percent to Rs. 154.27 billion during the five months of FY 2010/11. Such imports had grown by 32.2 percent to Rs. 153.39 billion in the same period last year. On a monthly basis, the merchandise imports declined by 16.0 percent in November/December 2010 compared to the value of the previous month.

37. Imports from India grew by 27.1 percent during the review period compared to a growth of 33.0 percent in the same period last year. Likewise, imports from other countries declined by 30.0 percent in contrast to a growth of 31.3 percent in the same period last year. The import of petroleum product, M.S. billet, chemical fertilizers, cold rolled sheet in coil, hot rolled sheet in coil and other machinery and parts, among others increased from India whereas import of gold, betelnuts, steel rod and sheet, other machinery and parts, threads and crude soybean oil declined from other countries in the review period.

38. Total trade deficit during the five months of FY 2010/11 declined marginally by 1.0 percent to Rs. 127.02 billion. Trade deficit had risen by 50.1 percent in the same period last year. Trade deficit with India rose by 30.7 percent during the review period compared to a growth of 51.2 percent in the same period last year. On the contrary, trade deficit with other countries declined by 35.2 percent compared to a growth of 48.9 percent in the same period a year ago.

39. The improvement in exports coupled with deceleration in import growth contributed to an increase in the ratio of export to import to 17.7 percent in the review period from the ratio of 16.4 percent a year ago.

Balance of Payments Situation

40. The overall BOP recorded a deficit of Rs. 3.35 billion during the five months of FY 2010/11 compared to a deficit of Rs. 14.55 billion in the same period last year. The current account also registered a deficit of Rs. 4.61 billion compared to a deficit of Rs. 20.63 billion in the same period last year. The decline in trade deficit and an improvement in the growth rate of transfer income, particularly grants and remittances, led to such a decline in the current account deficit.

41. The FOB-based merchandise trade deficit dropped marginally by 1.4 percent to Rs. 122.66 billion during the five months of FY 2010/11. Such deficit had grown by 52.8 percent in the same period last year. The net service account deficit declined significantly by 24.8 percent to Rs. 4.75 billion during the review period. It had declined by 3.4 percent to Rs. 6.31 billion in the same period last year. The net transfer account registered a growth of 13.1 percent to Rs. 120.08 billion in the review period compared to that of a year ago. Under the transfers sub-group, grants

increased by 24.0 percent to Rs. 10.67 billion while pension receipts rose by 11.5 percent to Rs. 13.61 billion. Likewise, workers' remittances increased by 11.3 percent to Rs. 96.59 billion compared to its growth of 10.4 percent in the same period last year. On a monthly basis, the remittance inflows increased by 11.0 percent in November/December compared to the value of the previous month of this fiscal year. Likewise, under the financial account foreign direct investment of Rs 3.58 billion was recorded in the review period compared to the level of Rs 802 million in the same period a year ago.

Foreign Exchange Reserves

42. The gross foreign exchange reserves declined by 2.2 percent to Rs. 262.90 billion in mid-December 2010 from a level of Rs. 268.91 billion as at mid July 2010. Such reserves had decreased by 11.2 percent to Rs. 254.47 billion in the same period last year. On a monthly basis, foreign exchange reserve of Rs 1.46 billion increased in the month of November/December from the level of the previous month of this year. Out of total reserve, NRB's reserves declined marginally by 0.8 percent to Rs. 203.72 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 1.6 percent to USD 3.67 billion in mid-December 2010 from a level of USD 3.61 billion as at mid-July 2010. Such reserves had decreased by 6.9 percent in the same period last year. Based on the trend of import during the five months of the current fiscal year, the current level of reserves is sufficient for financing merchandise imports of 8.7 months and merchandise and service imports of 7.4 months.

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

43. The price of oil (Crude Oil Brent) in the international market went up by 28.9 percent to USD 92.06 per barrel in mid December 2010 from USD 71.43 per barrel in mid December 2009. Similarly, the price of gold also surged by 23.8 percent to USD 1388.75 per ounce in mid December 2010 from the level a year ago.

44. Nepalese currency vis-à-vis the US dollar appreciated by 3.89 percent in mid December 2010 from the level of mid July 2010. It had appreciated by 4.85 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 71.65 in mid December 2010 compared to Rs. 74.44 in mid July 2010.