Nepal Rastra Bank

Research Department

Current Macroeconomic and Financial Situation of Nepal

(Based on Five Months' Data of 2017/18)

Macroeconomic Outlook

1. The available data indicate that the overall economic activities remain on track. A rise in the industrial capacity utilization, growth in the import of raw materials, rebound in tourist arrival and pick up in the reconstruction activity are reflective of this. However, agriculture is the key to determine the traction of growth outlook going forward. The farm output, in turn, hinges on the behavior of rain. While the incessant summer rains, boosted the summer maize production, as per the preliminary report of the Ministry of Agricultural Development, the resultant floods hit paddy productions, to some extent. The outlook of winter crops depends on winter rains, which so far have not occurred. Hence, the performance of agriculture is likely to anchor the growth momentum for the current fiscal year.
2. Consumer price inflation is mildly on an upward trend in recent months. The rise in domestic fuel prices and the recent hike in prices of construction materials pose upside risk to inflation outlook in the near term. However, the annual average rate of inflation is expected to remain moderate and below the annual forecast level.
3. Domestic financial market conditions have remained orderly, albeit relatively tighter, despite some hiccups seen in interest rates recently. Such hiccups are lately being stabilized on account of NRB's firm stance on the C-CD (credit to core-capital-cum-deposit) ratio and the proactive use of open market operations along with liquidity injection under the policy corridor. The strict adherence to the C-CD ratio, which caps overall credit risk and acts as the nominal anchor of financial stability, will help restore balance between credit and deposit growth. Although, there are idiosyncratic cases of liquidity stress faced by some banks, the system-wide liquidity remains at a comfortable level. Nevertheless, the expected pick up in government spending is likely to ameliorate the financial market condition in the days ahead.
4. Country's overall balance of payments has turned into a deficit of Rs. 9.27 billion in the first five months of 2017/18. While the proximate cause has been the widening current account

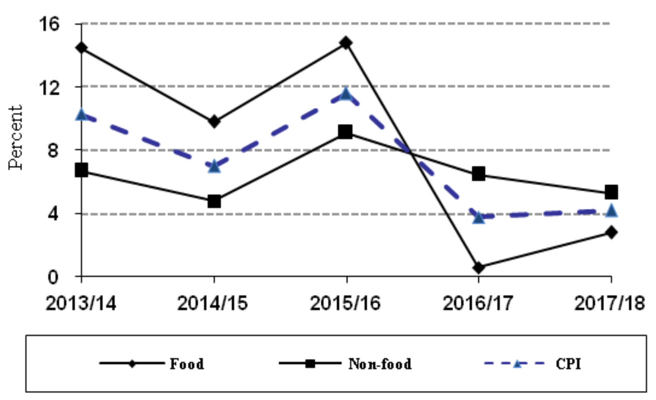
deficit of Rs. 41.95 billion, the underlying drivers of deficit have been the elevated level of imports and the decline in the migrant workers' remittances. However, the country has a comfortable level of international reserves which underpin the external sector stability.

Inflation, Salary and Wage Rate

Consumer Price Inflation

5. Consumer price inflation rose to 4.2 percent in mid-December 2017 from 3.8 percent a year ago. A pick up in prices of food and beverage items largely contributed to the rise in overall rate of inflation in the review period from that of last year.

Chart 1: Consumer Price Inflation (Five Months)



Food Inflation

6. Food inflation saw a growth of 2.8 percent in mid-December 2017 from the marginal rise of 0.6 percent in the corresponding period of the previous year. An upturn in food inflation was on account of a significant rise in prices of vegetables, milk and eggs.

Non-food Inflation

7. Non-food inflation moderated to 5.3 percent during the review period from 6.5 percent in the corresponding period of the previous year. Slower growth of prices of clothes and footwear, furnishing and household equipment, health, housing and utilities, among others, contributed to the moderation of non-food inflation in the review period.

Region-wise Consumer Price Inflation

8. The Mountain region witnessed a relatively higher rate of inflation of 5.5 percent followed by Hilly region of 4.8 percent, Terai region of 4.3 percent and the Kathmandu Valley of 3.4 percent in the review period. During the review period, the relatively higher inflation rate in Mountain region was on account of surge in prices of Chandannath market centre. In the corresponding period of the previous year, these regions had witnessed inflation rates of 3.7 percent, 5.6 percent, 3.7 percent and 2.5 percent respectively.

Inflation Differential between Nepal and India

9. The y-o-y consumer price inflation was 4.2 percent in Nepal in mid-December 2017 compared to 5.2 percent in India, showing an inflation wedge of 1 percent between the two countries. A

year ago, the rate of inflation was 3.8 percent in Nepal compared to 3.4 percent in India, reflecting an inflation differential of 0.4 percent.

Wholesale Price Inflation

10. The y-o-y wholesale price inflation moderated to 1.8 percent in the review period from 2.7 percent a year ago. The wholesale price indices of agricultural commodities grew by 1.6 percent, domestic manufactured commodities by 3.5 percent and imported commodities by 0.9 percent in the review period. In the corresponding period of the previous year, wholesale price indices of agricultural commodities and domestic manufactured commodities had observed the growth of 3.5 percent and 4.7 percent respectively, whereas the price index of imported commodities had declined by 0.6 percent.

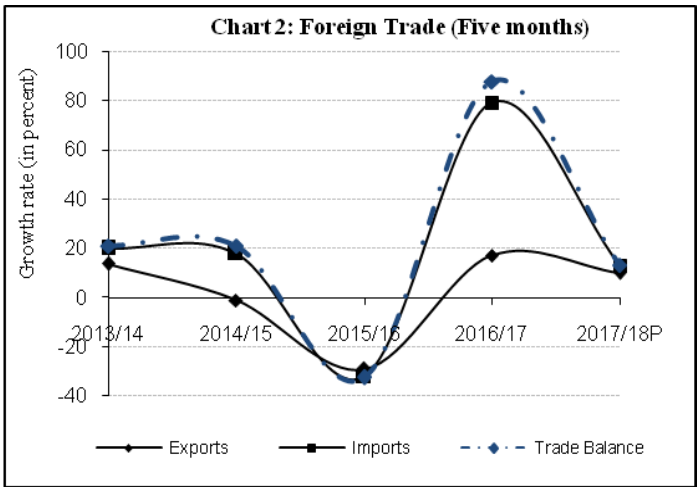
National Salary and Wage Rate

11. The y-o-y salary and wage rate index moderated 6 percent in the review period from 14.3 percent in the corresponding period of the previous year. In the review period, while the salary index saw an increase of 9.5 percent, the wage rate index witnessed relatively a lower growth of 5.1 percent.

External Sector

Merchandise Trade

12. In the first five months of 2017/18, merchandise exports increased 10 percent to Rs. 33.70 billion compared to an increase of 17.1 percent in the same period of the previous year. In the review period, exports to India, China and other countries increased 5.5 percent, 78.4 percent and 12 percent respectively. Commodity wise, exports of cattle feed, vegetable ghee, thread, zinc sheet, readymade garments, among others, increased whereas export of juice, cardamom, G.I. pipes, woolen carpet, copper wire rods, among others, decreased in the review period.



13. Merchandise imports increased 12.8 percent to Rs. 431.49 billion in the review period compared to an increase of 78.9 percent in the same period of the previous year. In the review period, imports from India, China and other countries increased 13.2 percent, 1.4 percent and 18.9 percent respectively. Commodity wise imports of petroleum products, vehicles and spare

parts, gold, M.S. billet, polythene granules, among others, increased whereas imports of agri. equip. & parts, electrical goods, edible oil, sanitaryware, dry cell battery, among others, decreased in the review period.

14. Based on customs points, the exports through Dry port Customs Office, Bhairahawa Customs Office, Biratnagar Customs Office, Tribhuwan International Airport Customs Office, Nepalgunj Customs Office, Mechi Customs Office, Kailali Customs Office, Kanchanpur Customs Office and Rasuwa Customs Office increased whereas exports from other customs points decreased in the review period. On the import side, imports through Tribhuwan International Airport Customs Office, Kanchanpur Customs Office and Rasuwa Customs Office decreased whereas imports through other customs points increased in the review period.
15. Total trade deficit in the review period expanded 13 percent to Rs 397.79 billion. As a result, the export-import ratio fell from 8 percent in the corresponding period of the previous year to 7.8 percent in the review period.

Export-Import Price Index

16. The y-o-y unit value export price index based on customs data decreased 0.4 percent while import price index increased 4.9 percent in the fifth month of 2017/18. Consequently, the TOT index decreased 5.3 percent compared to an increase of 12.6 percent in the corresponding period of the previous year. Decrease in price of export items such as carpet, pasmina, cardamom, Desi ghee, musuri dal caused the decrease in export price index in the review period whereas increase in the price of petroleum products, vehicles, tyre, refrigerator, laptop resulted an increase in import price index in the review period.

Services

17. The total services receipt increased 3.9 percent and expenses rose 17.1 percent in the review period. As a result, net services receipt turned into a deficit of Rs. 3.90 billion in the review period as against a surplus of Rs. 3.59 billion in the same period of the previous year.
18. Under the services account, travel receipt increased 29.5 percent to Rs. 29.33 billion in the review period. Such receipt had increased 30.5 percent in the same period of the previous year.

Workers' Remittances

19. The workers' remittances decreased 0.8 percent to Rs. 285.48 billion in the review period in contrast to a rise of 6 percent in the same period of the previous year. Consequently, net transfer receipt decreased 0.2 percent to Rs. 331 billion in the review period. Such receipt had increased 5.2 percent in the same period of the previous year.
20. The number of Nepalese workers seeking foreign employment decreased 2.5 percent in the review period. It had decreased 8.9 percent in the same period of the previous year. In the review period, the number of workers outbound to Malaysia jumped up while that to Saudi Arabia and Qatar shrank significantly.

Box 1: Outflow of Nepalese Workers for Foreign Employment (First Five Months)

a) Institutional and Individual (New and Legalized)

Country	**(No. of Labor)**		**Percentage Share**	
	2016/17	**2017/18**	**2016/17**	**2017/18**
Malaysia	31877	49057	20.0	31.6
Qatar	52188	39593	32.7	25.5
U.A.E.	22509	26999	14.1	17.4
Saudi Arabia	38898	19499	24.4	12.5
Kuwait	4542	6578	2.8	4.2
South Korea	800	2433	0.5	1.6
Bahrain	1567	2145	1.0	1.4
Oman	1153	1156	0.7	0.7
Afghanistan	402	691	0.3	0.4
Japan	1395	320	0.9	0.2
Israel	65	66	0.0	0.0
Lebanon	65	3	0.0	0.0
Others	3970	6841	2.5	4.4
Total	**159431**	**155381**	**100.0**	**100.0**
Percentage Change	-8.9	-2.5	-	-

b) Renew Entry

Renew Entry	**108269**	**104575**	-	-
Percentage Change	22.2	-3.4	-	-

Source: *Department of Foreign Employment*.

Current Account and BOP Position

21. The current account registered a deficit of Rs. 41.95 billion in the review period in contrast to a surplus of Rs. 3.49 billion in the same period of the previous year. Similarly, the overall BOP remained at a deficit of Rs. 9.27 billion in contrast to a surplus of Rs. 28.78 billion in the same period of the previous year.
22. In the review period, Nepal received capital transfer amounting to Rs. 8.86 billion and Foreign Direct Investment (FDI) inflows of Rs. 11.12 billion. In the same period of the previous year, capital transfer and FDI inflows had amounted to Rs. 5.15 billion and Rs. 6.84 billion respectively.

Box 2: External Sector (USD)*

(USD Million)

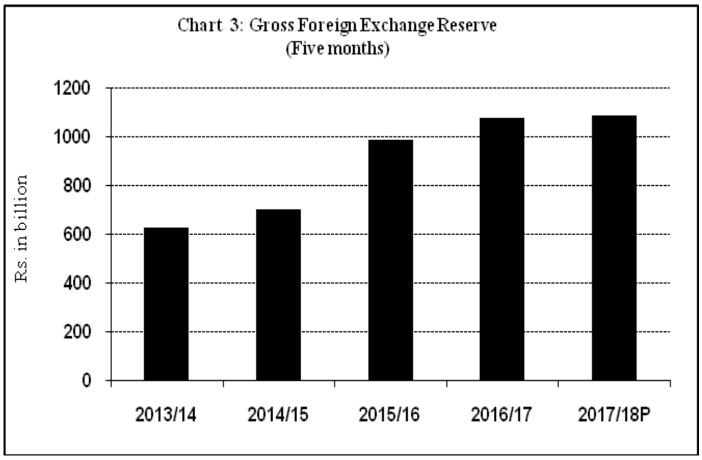
Particulars	2015-16		2016-17		2017-18	Percent Change in Five month	
	Five Months	Annual	Five Months	Annual	Five Months	2016/17	2017/18
Goods Exports (FoB)	269.2	703.9	319.2	773.7	366.0	18.6	14.7
Goods Imports (FoB)	2007.7	7092.5	3498.8	9219.3	4101.8	74.3	17.2
Trade Balance	-1738.5	-6388.6	-3179.6	-8445.6	-3735.7	82.9	17.5
Total Trade	2276.9	7796.3	3818.0	9993.0	4467.8	67.7	17.0
Travel Receipts	165.2	392.7	210.9	552.3	283.6	27.6	34.5
Workers' Remittances	2587.5	6253.4	2680.1	6556.3	2764.7	3.6	3.2
Current Account Balance	1417.7	1338.8	32.6	-93.5	-406.9	-	-
BOP (-Surplus)	-1214.1	-1779.8	-268.4	-777.1	90.6	-	-

** Data from BOP Presentation*

1. In the US dollar terms, total merchandise exports and imports increased 14.7 percent and 17.2 percent respectively in the first five months of 2017/18. Exports had increased 18.6 percent whereas imports had risen 74.3 percent in the corresponding period of the previous year.
2. In the review period, travel receipts and workers' remittance increased 34.5 percent and 3.2 percent respectively. Travel receipts and workers' remittances had increased 27.6 percent and 3.6 percent respectively in the corresponding period of the previous year.
3. Current account recorded a deficit of USD 406.9 million in the review period in contrast to a surplus of USD 32.6 million in the corresponding period of the previous year. Likewise, Balance of Payments (BOP) recorded a deficit of USD 90.6 million in the review period in contrast to a surplus of USD 268.4 million in the corresponding period of the previous year.

Foreign Exchange Reserves

23. The gross foreign exchange reserves increased 0.6 percent to Rs. 1085.74 billion as at mid-December 2017 from Rs. 1079.52 billion as at mid-July 2017. Of the total foreign exchange, reserves held by NRB increased 1.2 percent to Rs. 938.07 billion as at mid-December 2017 from Rs. 927.27 billion as at mid-July 2017. The reserves of banks and financial institutions (except NRB) decreased 3 percent to Rs. 147.68 billion as at mid-December 2017 from Rs. 152.26 billion as at mid-July 2017. The share of Indian currency in total reserves stood at 22.9 percent as at mid-December 2017.



Foreign Exchange Adequacy Indicators

24. Based on the imports of five months of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 12.8 months, and merchandise and services imports of 11 months. The ratio of reserve-to-GDP, reserve-to-

imports and reserve-to-M2 stood at 41.8 percent, 92.1 percent and 40.3 percent respectively as at mid- December 2017. Such ratios were 41.5 percent, 95.3 percent and 41.7 percent as at mid-July 2017.

Price of Oil and Gold

25. The price of oil (Crude Oil Brent) in the international market increased 23.4 percent to USD 63.81 per barrel in mid-December 2017 from USD 51.72 per barrel a year ago. The price of gold increased 11.3 percent to USD 1254.60 per ounce in mid-December 2017 from USD 1126.95 per ounce a year ago.

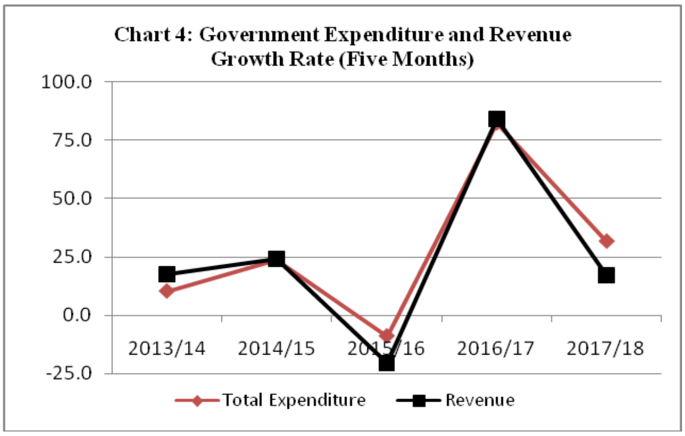
Exchange Rate

26. Nepalese currency vis-à-vis US dollar appreciated 0.2 percent in mid-December 2017 from mid-July 2017. It had depreciated 0.9 percent in the same period of the previous year. The buying exchange rate per US dollar stood at Rs. 102.65 in mid-December 2017 compared to Rs. 102.86 in mid-July 2017.

Fiscal Situation*

Budget Deficit/ Surplus

27. In the first five months of 2017/18, the Government of Nepal (GoN) was at a surplus of Rs. 4.93 billion in its budget. Such surplus was Rs. 17.65 billion in the corresponding period of the previous year.



Government Expenditure

28. In the review period, total government expenditure on a cash basis stood at Rs. 256.30 billion. Such expenditure was just Rs. 194.61 billion in the corresponding period of the previous year.
29. In the review period, recurrent expenditure stood at Rs. 222.62 billion, which was Rs. 160.99 billion in the corresponding period of the previous year. In the review period, capital expenditure increased 19.9 percent to Rs. 24.79 billion. Such expenditure was Rs. 20.67 billion in the corresponding period of the previous year.

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* Based on the data reported by 1 NRB office, 79 branches of Rastriya Banijya Bank Limited, 50 branches of Nepal Bank Limited, 29 branches of NIC Asia Bank Limited, 25 branches of Agricultural Development Bank Limited, 12 branches of Everest Bank Limited, 10 branches of Nepal Investment Bank Limited, 9 branches of Global IME Bank Limited, 5 branches of NMB Bank Limited, 3 branches of Bank of Kathmandu Limited and 2 branches of Prabhu Bank Limited and 1 branch each from Prime Commercial Bank Limited and Century Commercial Bank Limited, Sanima Bank Limited and Civil Bank Limited conducting government transactions and released report from 81 DTCOs and payment centers.

Government Revenue

30. In the review period, the government revenue collection increased 17 percent to Rs. 242.97 billion. Such revenue had increased 84 percent to Rs. 207.60 billion in the corresponding period of the previous year. The government revenue collection has been less than the target. The growth in the government revenue continues to remain sensitive to high tariff rate related imports.

Box 3: The Budget Performance of 2017/18
(Rs. in million)

Heads	Budget Estimates	Outturns in Five Months*	As percent of Budget Estimates
Total Expenditure	**1278994.9**	**256299.0**	**20.04**
Recurrent	803531.5	222616.4	27.70
Capital	335176.0	24790.9	7.40
Financial	140287.4	8891.7	6.34
Revenue	**730055.6**	**242972.2**	**33.28**

* On cash basis

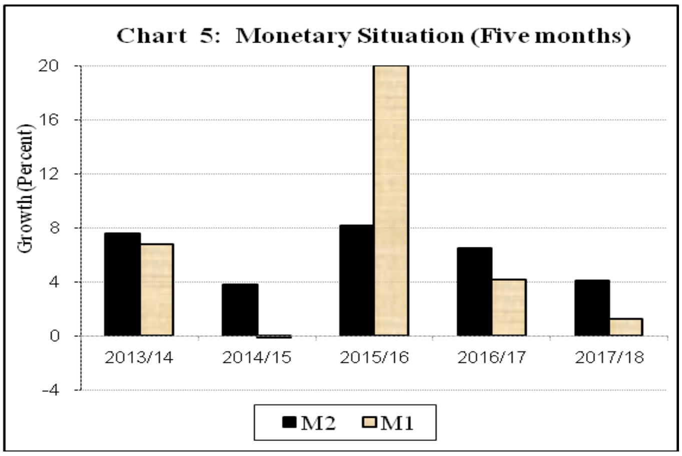
Treasury Position of the GoN

31. Due to a slow pace of government expenditure relative to resource mobilization, the treasury surplus amounted to Rs. 348.99 billion (including Rs. 88.24 billion balances on Local Authorities' Accounts) as of mid-December 2017.

Monetary Situation

Money Supply

32. Broad money (M2) increased 4.1 percent in the review period compared to a rise of 6.5 percent in the corresponding period of the previous year. On y-o-y basis, M2 expanded 12.9 percent in mid-November 2017.



33. The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) decreased Rs. 9.27 billion (0.9 percent) in the review period as against an increase of Rs. 28.78 billion (3.0 percent) in the corresponding period of the previous year.
34. Reserve money decreased 16.1 percent in the review period in contrast to an increase of 2.8 percent in the corresponding period of the previous year. On y-o-y basis, reserve money increased 2.1 percent in mid-December 2017.

Domestic Credit

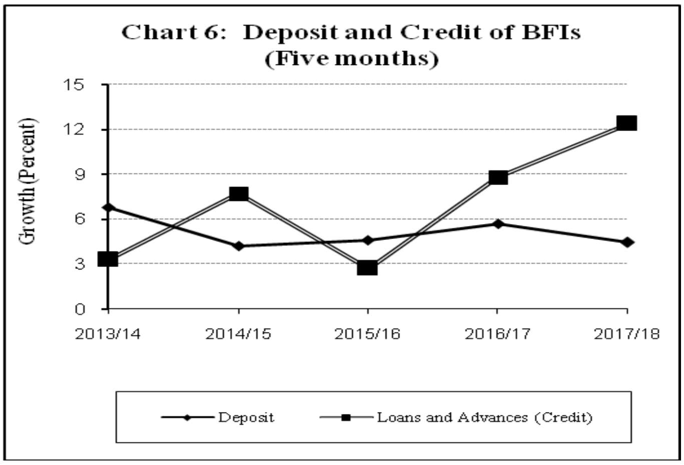
35. Domestic credit increased 2.7 percent in the review period compared to an increase of 5.5 percent in the corresponding period of the previous year. On y-o-y basis, domestic credit increased 16.2 percent in mid-December 2017.
36. Claims of monetary sector on the private sector increased 8.7 percent in the review period compared to a growth of 10.3 percent in the corresponding period of the previous year. The y-o-y growth in such claims was 16.3 percent in mid-December 2017.

Deposit Collection

37. Deposits at Banks and Financial Institutions (BFIs) increased 4.4 percent in the review period compared to a growth of 5.7 percent in the corresponding period of the previous year. On y-o-y basis, deposits at BFIs expanded 12.7 percent in mid-December 2017.
38. Out of the total deposits at the BFIs, the share of demand deposits increased from 8.1 percent to 8.2 percent and fixed deposits from 31.8 percent to 41.6 percent in mid-December 2017 compared to a year ago. However, the share of saving deposits decreased to 36.5 percent from 42.9 percent a year ago.
39. The share of institutional deposits in total deposit of Bank and Financial Institutions (BFIs) declined to 45.5 percent in mid-December 2017 from 47.4 percent a year ago.

Credit Disbursement

40. Credit to the private sector from BFIs increased 7.6 percent in the review period compared to a rise of 9.6 percent in the corresponding period of the previous year. In the review period, private sector credit from commercial banks, development banks and finance companies increased 7.2 percent, 12.2 percent and 1.9 percent respectively. On y-o-y basis, credit to the private sector from BFIs increased 16.1 percent in mid-December 2017.



41. Of the total outstanding credit of BFIs, 61.9 percent is against the collateral of land and building and 14.0 percent against the collateral of current assets (such as agricultural and non-agricultural products). Such ratios were 60.9 percent and 14.6 percent respectively in the corresponding period of the previous year.

42. Trust receipt loan extended by commercial banks increased 48.9 percent (Rs. 31.58 billion) to Rs. 96.11 billion in the review period compared to an increase of 7.9 percent in the corresponding period of the previous year.
43. In the review period, hire purchase loan increased 4.7 percent and overdraft loan rose 4.3 percent. Similarly, real estate loan (including residential personal home loan) increased 5.1 percent in the review period.

Liquidity Management

44. In the review period, NRB mopped up Rs. 127.20 billion through open market operations. Of which, Rs. 42.45 billion was mopped up under deposit collection auction (90 days, 30 days and 14 days) and Rs. 84.75 billion through reverse repo auction on a cumulative basis. Likewise Rs. 44.05 billion was injected through repo auction in the review period. In the corresponding period of the previous year, Rs. 94.25 billion liquidity was absorbed and Rs. 10.01 billion liquidity was injected through repo auctions.
45. In the review period, BFIs utilized Rs. 20.58 billion standing liquidity facility (SLF). In the corresponding period of the previous year, BFIs had utilized such facility of Rs. 10.05 billion.
46. In the review period, NRB injected net liquidity of Rs. 167.19 billion through the net purchase of USD 1.62 billion from foreign exchange market. Net liquidity of Rs. 175.77 billion was injected through the net purchase of USD 1.64 billion in the corresponding period of the previous year.
47. NRB purchased Indian currency (INR) equivalent to Rs. 186.67 billion through the sale of USD 1.76 billion and Euro 40 million in the review period. INR equivalent to Rs. 178.67 billion was purchased through the sale of USD 1.56 billion and Euro 95 million in the corresponding period of the previous year.

Refinance

48. NRB has been providing refinance facility aimed at expanding credit to the productive sector along with promoting export. As of mid-December 2017, the outstanding refinance amounted to Rs. 8.91 billion including general refinance of Rs. 8.12 billion and export refinance of Rs. 790.3 million.
49. A sum of Rs. 1.03 billion housing loan at a concessional interest rate of 2 percent has been extended by BFIs to the earthquake victims as of mid-December 2017. NRB provides refinance facility to BFIs at a zero percent interest to extend housing loan to earthquake victims.
50. As of mid-October 2017, the number of beneficiaries of the 5 percent interest subsidized lending scheme of the Government of Nepal stood at 5974. They availed subsidized loans for selected agriculture and livestock businesses. Under this provision, the total outflow of loans stood at Rs. 6.46 billion and interest subsidy provided amounted to Rs. 311 million.

Inter-bank Transaction

51. In the review period, inter-bank transactions among commercial banks stood at Rs. 443.33 billion and among other financial institutions (excluding transactions among commercial banks) amounted to Rs. 7.18 billion. Such transactions were Rs. 486.70 billion and Rs. 151.88 billion respectively in the corresponding period of the previous year.

Interest Rates

52. The weighted average 91-day Treasury bill rate increased to 5.51 percent in the fifth month of 2017/18 from 2.34 percent a year ago. The weighted average inter-bank transaction rate among commercial banks, which was 2.67 percent a year ago, increased to 4.83 percent in the review month. Likewise, the average base rate of commercial banks increased to 9.87 percent in the review month from 6.78 percent a year ago.

Merger/Acquisition

53. The number of BFIs involved in merger and acquisition has been increasing after the introduction of merger/acquisition policy aimed at strengthening financial stability. So far, 158 BFIs (including 'D' class) were involved in merger and acquisition, out of which, the license of 118 BFIs was revoked, thereby forming 40 BFIs.

Financial Access

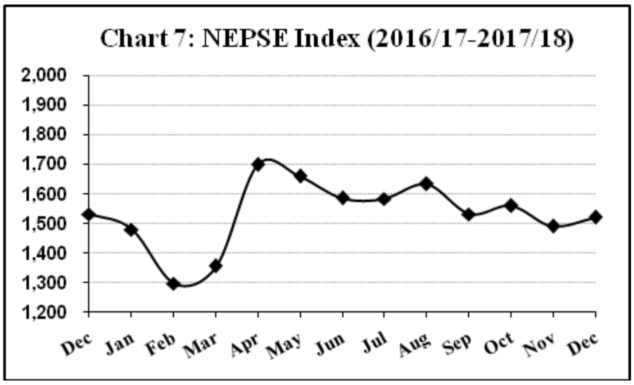
54. Of the total 753 local levels, commercial banks have presence in 332 local levels as of mid-December 2017. Province wise presence of commercial banks in local levels is presented in Box 4.

Box 4: Presence of Commercial Banks at Local Level as of mid–December 2017

Province	No. of Local Level	Presence of Commercial Banks in Local Level
Province 1	137	64
Province 2	136	57
Province 3	119	63
Province 4	77	35
Province 5	133	68
Province 6	63	15
Province 7	88	30
Total	**753**	**332**

Capital Market

55. The NEPSE index on y-o-y basis decreased 0.6 percent to 1,520.2 points in mid-December 2017. This index had increased 36.5 percent to 1530.1 points in mid-December 2016. Such index was 1582.7 points in mid-July 2017.



56. The stock market capitalization on y-o-y basis increased 3.8 percent to Rs. 1767.56 billion in mid-December 2017. This had increased 43.2 percent a year ago. The ratio of market capitalization to GDP of 2016/17 stood at 68 percent in mid-December 2017, which was 75.8 percent a year ago. In the total market capitalization, the share of banks, financial institutions and insurance companies stood at 81.9 percent, hydropower 5.1 percent, manufacturing and processing companies 2.5 percent, hotels 1.6 percent, trading 0.1 percent, and others 8.8 percent respectively.
57. On y-o-y basis, the total turnover of the securities decreased 43.5 percent to Rs. 10.65 billion. The turnover of the securities had substantially increased 212.7 percent to Rs. 18.83 billion in the corresponding period of the previous year.
58. Due to the merger and acquisitions of BFIs, total number of companies listed at the NEPSE decreased to 194 in mid-December 2017 from 221 in mid-December 2016. Of the listed companies, 148 were BFIs (including insurance companies), 18 manufacturing and processing industries, 17 hydropower companies, 4 hotels and trading institutions and 3 other sectors.
59. On y-o-y basis, total paid-up value of the listed shares increased 33.6 percent to Rs. 309.36 billion in mid-December 2017. Total additional securities worth Rs. 60.6 billion were listed in the NEPSE during the review period. These consisted of ordinary shares of Rs. 1.6 billion, right shares of Rs. 21.1 billion, bonus shares of Rs. 2.8 billion and government securities of Rs. 35.1 billion.