Current Macroeconomic Situation

(Based on Data of the First Quarter of 2005/06)

Nepal Rastra Bank
December 2005
www.nrb.org.np

Executive Summary

1. During the first Quarter of fiscal year 2005/06, broad money registered a growth of 3.1 percent compared to a rise of 1.5 percent in the same period last year.
2. In contrast to a decline of 1.3 percent last year, net foreign assets of monetary sector increased by 1.4 percent (Rs. 1.5 billion) during the first Quarter of 2005/06, contributing to the expansion of broad money.
3. The growth rate of monetary sector's claim on private sector decelerated to 3.2 percent in the first Quarter of 2005/06 from 5.7 percent in the same period last year. The recovery of overdue loans of commercial banks limited the stock of credit growth to some extent.
4. Time deposits grew by 3.4 percent in the first Quarter of 2005/06 compared to a rise of 2.2 percent in the same period last year. Some increment on deposit interest rates and various schemes launched by the commercial banks for mobilizing time deposits contributed to such a growth of time deposit.
5. Short-term interest rates remained stabilized compared to that of last year. Increased transparency in the conduct of monetary policy as reflected in the monetary policy statement of 2005/06 and reduction in the borrowing period for Standing Liquidity Facility (SLF) from 5 to 3 days contributed to a rise in transactions in the inter bank market. This limited the access of commercial banks to SLF borrowing from the Nepal Rastra Bank.
6. On the stock market, the NEPSE index increased by 28.5 percent to 297.34 points as at mid-October 2005 from the level of 231.31 points as at mid-October, 2004. The number of listed companies increased to 125 as at mid-October 2005 from 116 as at mid-October 2004. The paid-up capital of listed companies also increased to Rs. 17.5 billion as at October 2005 from Rs. 12.5 billion a year ago.

7. Market capitalization in share market increased to Rs. 68 billion as at mid-October 2005 compared to Rs. 44.5 billion a year ago. Correspondingly, during this period, market capitalization to GDP ratio also increased to 12.9 percent as at mid-October, 2005 from 9.0 percent a year ago.

8. The year-on-year consumer price inflation surged to 7.8 percent as at October 2005 compared to 2.6 percent in the same period last year. Annual average rate of inflation surge up by three fold to 7.8 percent in the first Quarter of 2005/06 compared to 2.5 percent in the same period of 2005/06.

9. On the fiscal front, the government budget deficit, on the cash basis, declined by 88.0 percent to Rs. 50.3 million in the first Quarter of 2005/06 compared to a budget deficit of Rs. 419.2 million in the same period of 2005/06. A higher growth of resource mobilization relative to the government expenditure contributed to such a decline in the budget deficit.

10. The government expenditure increased by 12.4 percent in the first Quarter of 2005/06 in contrast to a decline of 3.1 percent in the same period of 2005/06. Of the total expenditure (Rs. 16.61 billion), current expenditure accounted for 73.7 percent (Rs. 12.2 billion) while the share of capital expenditure stood at 8.7 percent (Rs. 1.4 billion). Loan repayment occupied 3.7 percent (Rs 611 million) and freeze expenditure accounted for 13.9 percent (Rs. 2.3 billion) of total expenditure. During the corresponding period last year, of the total government expenditure recurrent expenditure accounted for 78.0 percent, capital expenditure for 5.6 percent, principal repayment for 7.1 percent and freeze expenditure occupied 9.4 percent.

11. Non-debt resources of government increased by 15.3 percent in the first Quarter of 2005/06 compared to a growth of 16.7 percent in the same period of 2005/06. Of the total non-debt resources (Rs. 16.6 billion), revenue increased marginally by 0.6 percent compared to an impressive growth of 17.3 percent growth achieved in the corresponding period of last year. Revenue contributed 77.3 percent of the non-debt resources mobilization.

12. On the external front, balance of payments showed a surplus of Rs. 1.5 billion as per the monetary statistics of the first Quarter of 2005/06. Balance of payments had recorded a deficit of Rs. 1.4 billion in the same period of 2005/06 year. Increased remittances contributed to the surplus in balance of payments in the first Quarter of 2005/06.

13. Export increased by 7.9 percent in the first Quarter of 2005/06 compared to a rise of 11.4 percent in the same period of 2005/06. Of the total export, export to India increased by 31.2 percent while export to third countries declined by 2.5 percent.

14. Total imports, in contrast to a decline of 1.4 percent last year, increased by 34.8 percent. Of the total import, import from India increased by 35.2 percent and that from third countries rose by 34.2 percent.

15. In the first Quarter of 2005/06, total foreign exchange reserves stood at Rs. 134.3 billion. This reserve is sufficient to cover 9.6 months equivalent of import of goods and 8.1 months imports of both goods and services.

Current Macroeconomic Situation

(*Based on Data of the first Quarter of 2005/06*)

Monetary Situation

1. Broad money (M_2) recorded a relatively higher growth of 3.1 percent in the first quarter of 2005/06 compared to a rise of 1.5 percent in the comparable period last year. Growth of net foreign assets (NFA), in contrast to a decline in the preceding year and coupled with higher growth of net domestic assets (NDA) relative to that of the previous year contributed to a higher rate of increase in M_2 in the first quarter of 2005/06 compared to that of 2004/05.
2. Of the 3.1 percent growth in $M_{2,}$ NFA contributed to 0.5 percentage points and NDA accounted for the rest 2.5 percentage points in the first quarter of 2005/06. Clearly, the growth in M_2 originated basically from the domestic source.
3. Accounting monetary growth from the demand side, reserve money played a contractionary role, as it continued to decline by 3.0 percent in the first quarter of 2005/06 compared to the 6.5 percent decline in the comparable period of 2005/06. Obviously, the growth in money multiplier contributed wholly to the monetary expansion in the first quarter of 2005/06. Increased foreign placement by the commercial bank and the significant reduction in excess reserves contributed to the decline in reserve money and consequently, an increase in money multiplier.
4. Domestic credit, an expansionary factor of money supply, registered a lower growth of 1.2 percent in the first quarter of 2005/06 compared to a growth of 4.1 percent in 2004/05. Of the components of domestic credit, claims on the private sector credit increased by 3.2 percent in the first quarter of 2005/06 compared to a higher growth of 5.7 percent in the corresponding quarter of 2004/05. A satisfactory loan recovery contributed to the decelerated growth of credit off-take. On the other hand, claims on the government declined, albeit marginally by 1.4 percent. Likewise, claims on both financial and non-financial government enterprises also declined due to the repayment of outstanding loans by some enterprises.
5. Despite the lower growth of domestic credit in the first quarter of 2005/06, a decline in net non-monetary liabilities by 4.8 percent contributed to the rise in NDA by 4.0 percent. A fall in loan loss provisioning amount due to loan recovery to some extent and a rise in non-banking assets could be ascribed for the decline in non-monetary liabilities in the first quarter of 2005/06.

6. Time deposits, a component of M_2, registered a higher growth of 3.4 percent compared to a rise of 2.2 percent in the same period of the previous year. A satisfactory remittance inflow, increase in deposit rates, albeit marginally, by some commercial banks and various deposit schemes launched by them to mobilize time deposits were the reasons behind the rise in time deposits.

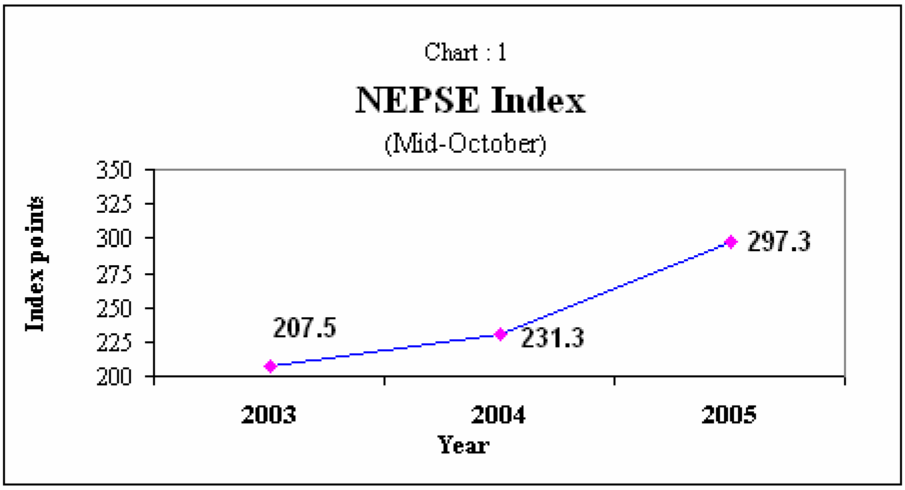
Money Market

7. With a view to managing liquidity in local currency and also facilitating orderly movement in exchange rate, NRB intervened 11 times in the foreign exchange market in the first quarter of 2005/06. Through these interventions, NRB purchased US dollar, amounting to Rs. 7.6 billion, injecting the liquidity of equivalent amount in the economy. To sterilize the impact of such liquidity on money supply, some of the liquidity injected through the foreign exchange intervention was mopped up through the sale auction of treasury bills.
8. In the first quarter of 2005/06, NRB conducted the open market operations with sale auction of Rs. 4.0 billion and a purchase auction of Rs. 530 million. Consequently, net liquidity withdrawal by NRB amounted to Rs. 3.5 billion.
9. With these open market operations, excess liquidity of the commercial banks remained at a minimum level. As a result, short-term interest rates did not decline heavily as they did in the first quarter of last year. The weighted average 91-day Treasury bill rate remained at 3.129 percent and weighted average inter-bank rate stood at 3.177 percent for the month ending mid-October 2005. Such rates were 1.34 percent and 0.826 percent respectively in the corresponding point of time in 2004/05.
10. The volume of inter-bank transaction increased significantly in the first quarter of 2005/06 and stood at Rs. 57.3 billion compared to the transaction level of Rs. 29.6 billion in the first quarter of 2004/05. Consequently, commercial banks resorted to a very small amount of Standing Liquidity Facility (SLF) borrowing of Rs. 315 million from the NRB compared to a borrowing level of Rs. 4.1 billion in the corresponding period of 2004/05.
11. The use of refinance facility for sick industry remained at a lower level in the first quarter of 2005/06 compared to that of last year. Consequently, the outstanding refinance for sick industries in the first quarter of 2005/06 remained at just Rs. 36 million compared to Rs. 320 million in the same period last year.

Stock Market

12. The NEPSE index increased by 66.03 points (28.5 percent) to 297.34 in mid-October 2005 from 231.31 points in mid-October 2004. Inadequate alternative investment opportunities, increase in profit of commercial banks and continuous increment of inward remittances contributed to the growth in the NEPSE index.

13. Total transactions in terms of number and value of the share decreased by 43.8 percent and 45.9 percent in the review month from the level of a year ago. Due to the transaction of huge number of block shares of commercial banks and manufacturing and processing companies in the first quarter of 2004/05 led to the decline in the number and transaction value of shares during the review period. The secondary market transaction of trading, finance and hotel groups increased while, that of commercial banks, development banks and manufacturing and processing companies decreased.



14. The number of listed companies in Nepal Stock Exchange increased to 125 in mid-October 2005 from 116 in mid-October 2004. The paid up capital of listed companies increased by 39.2 percent to Rs. 17.5 billion in the review month due to new listing and issuance of bonus shares by some banks, finance companies and insurance companies. The number of companies traded in NEPSE rose to 82 in the review period from 74 in last year. The market capitalization of the listed companies increased by 52.9 percent to Rs. 68.0 billion compared to the same period of last year. Consequently, the market capitalization /GDP ratio also rose to 12.9 percent in mid-October 2005 from 9.0 percent a year ago.

Inflation

Consumer Inflation

15. The National Urban Consumer Price Index (1995/96 = 100), on a year-on-year basis, increased at a much higher rate of 7.8 percent as at mid-October 2005, compared to an increase of 2.6 percent in a corresponding period a year ago. The rise in the prices of transport and communication, housing goods and services and restaurant meals resulting from the upward revision in the prices of petroleum products together with the sharp rise in the price of rice and rice related products accounted for a higher growth of price index. In the review period, the rise in the prices of meat, fish and eggs; beverages; pulses as well as education, reading and recreation also exerted an upward pressure on the price index. The annual average growth rate of the price index for the period ending mid-October 2005

stood at 7.8 percent. Such growth rate was 2.5 percent in the comparable period of 2004/05.

16. In the review period, on year-on-year basis, the index of food and beverages group moved up by 7.5 percent compared to an increase of 2.1 percent in the same period of the previous year. The rise in the prices of grains and cereal products; restaurant meals; meat, fish and eggs; beverages; pulses and sugar and related products pushed up the index of this group. The index of grains and cereal products (14.6 percent), sugar and related products (11.7 percent), beverages (8.8 percent), restaurant meals (8.5 percent), pulses (6.0 percent), milk and milk products (4.3 percent), meat, fish and eggs (4.2 percent) and vegetables and fruits (0.9 percent) increased in the review period. However, the indices of oil and ghee (3.6 percent) and spices (1.4 percent) declined in the review period.

17. The index of non-food and services group increased by 8.3 percent compared to an increase of 3.0 percent in the same period of the previous year. The rise in the price index of this group is mainly attributable to the rise in the prices of petroleum products, which exerted an upward pressure in the price of transport and communication as well as housing goods and services. The indices of transport and communication (16.5 percent), housing goods and services (13.7 percent), education, reading and recreation (5.7 percent), tobacco and related products (5.6 percent), cloth, clothing and sewing services (2.8 percent), footwear (2.6 percent) and medical and personal care (2.2 percent) all increased in the review period.

18. Regionwise, the highest price rise was recorded at 8.6 in Terai and the lowest at 6.4 percent in Kathmandu Valley. During the review period the price rise was recorded at 8.5 percent in Hills. During the same period last year the highest price rise was recorded at 3.6 percent in Kathmandu Valley and the lowest at 2.0 percent in Terai. At the same time the price rise was recorded at 2.3 percent in Hills.

Wholesale Price Inflation

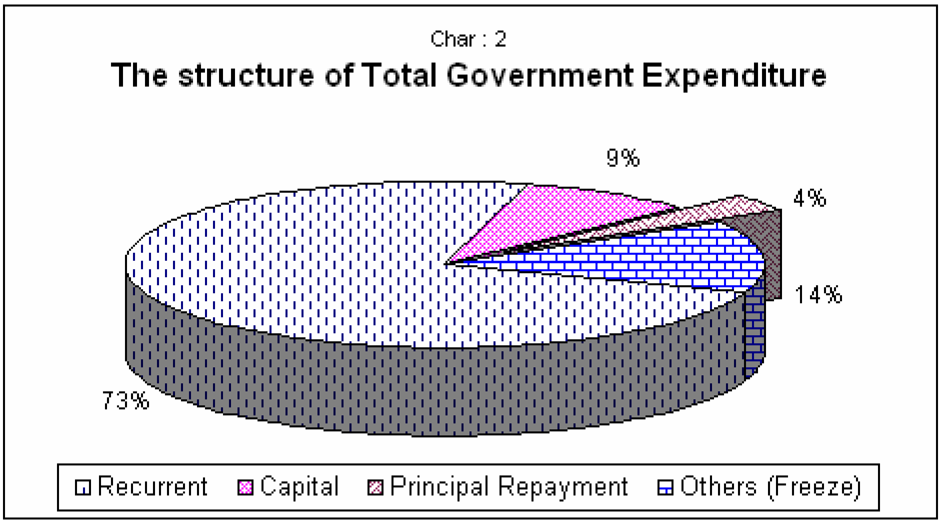
19. The National Wholesale Price Index (1999/00=100) on a year-on-year basis, increased by 9.4 percent for the period ending mid-October 2005. Such index had increased by 6.0 percent in the corresponding period of the preceding year. Despite a decline in the prices of cash crops and textile related products, the higher growth in the price index in the review period is mainly attributable to the rise in the prices of food grains, fruits and vegetables, livestock production as well as chemical fertilizer and chemical goods together with the sharp rise in the prices of petroleum products. The indices of agricultural, domestic manufactured and imported commodities increased by 10.0 percent, 4.3 percent and 11.8 percent respectively. The annual average National Wholesale Price Index, for the first

quarter increased by 8.1 percent compared to a rise of 4.9 percent in the comparable period of the preceding year.

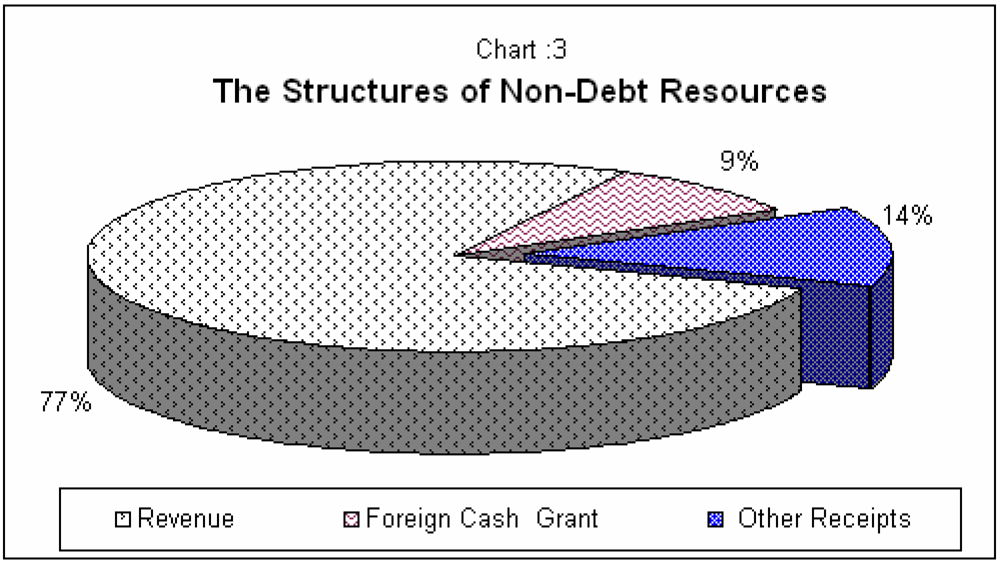
Government Budgetary Operation

20. The government budget deficit, 0n cash basis, decline by 88.0 percent to Rs. 50.3 million in the first quarter of 2005/06. In comparable period last year, the government budgetary position was at a much higher level of deficit of Rs. 419.2 million. The significant increase of non-debt resources relative to the growth of government expenditure accounted for the decline in the budget deficit.

21. The total expenditure of the government increased by 12.4 percent to Rs. 16.6 billion in the first quarter of 2005/06 contrast to a decline of 3.1 percent in the same period last year. Of the total expenditure, recurrent expenditure stood at Rs. 12.2 billion (73.7 percent), capital expenditure at Rs. 1.4 billion (8.7 percent) and principal repayment at Rs. 610.9 million (3.7 percent). Expenditure under freeze account, which recorded a rise of 66.0 percent to Rs. 2.3 billion accounted for 13.9 percent of the total expenditure. During the corresponding period last year, of the total government expenditure recurrent expenditure accounted for 78.0 percent, capital expenditure for 5.6 percent, principal repayment for 7.1 percent and freeze expenditure occupied 9.4 percent.



22. Total non-debt resources (revenue, foreign grants, non-budgetary receipts and others) increased by 15.3 percent to Rs. 16.6 billion compared to a rise of 16.7 percent last year. Revenue, the major source (77.3 percent share) of government resources, increased marginally by 0.6 percent to Rs. 12.8 billion compared to an increase of 17.3 percent last year. Foreign grants recorded a decline of 8.5 percent to Rs. 1.5 billion compared to Rs. 1.7 million received last year.



23. The total net outstanding domestic debt of the government declined to Rs. 89.3 billion as at mid-October 2005 from Rs. 90.2 billion a year ago, as reflected in the surplus in the treasury position. This was principally attributed to a higher rise in non-debt resources compared to the total government expenditure.

Foreign Trade

24. Based on customs data, in the first quarter of 2005/06, total exports increased by 17.9 percent to Rs. 15.8 billion and total imports increased by 34.8 percent to Rs. 41.9 billion. As a result, trade deficit increased by 47.6 percent to Rs. 26.1 billion. Similarly, total trade flows expanded by 29.7 percent. In the corresponding period of the previous year, exports had risen by 11.4 percent and imports had declined by 1.4 percent resulting in a 9.3 percent decline in trade deficit. Total trade had increased by 2.1 percent.

25. Exports to India rose by 31.2 percent to Rs. 10.6 billion this year on top of a rise of 32.3 percent last year. However, exports to other countries fell by 2.5 percent to Rs. 5.2 billion this year. Among the principal commodities exported to India, the exports of cardamom, vegetable ghee, noodles, G.I. sheet, G.I. pipes, polyester yarn and readymade garments have increased, while the exports of toothpaste, threads, ricebran oil and M.S. pipe have declined. Similarly, the exports of pulses, tea and jewelry to other countries went up while that of readymade garments, Pashmina and carpets have declined.

26. With respect to total exports to India, primary goods and manufactured goods constituted 30.2 percent and 69.8 percent respectively while their respective shares were 21.6 percent and 78.4 percent last year. Likewise, the shares of primary products and manufactured goods in total export to other countries were 6.4 percent and 93.6 percent during the first

quarter of 2005/06 compared to the respective shares of 5.4 percent and 94.6 percent in the corresponding period of last year.

27. Imports from India expanded substantially by 35.2 percent to Rs. 26.1 billion compared to a rise of 12.8 percent last year. Imports from other countries increased by 34.2 percent to Rs. 15.8 billion in contrast to a decline of 18.2 percent in the previous year. Imports of rice, chemicals, chemical fertilizer, thread, petroleum products, MS billet, hot-rolled sheet, readymade garments and electrical equipment & goods from India moved up while imports of medicine, textiles, transport vehicles & parts, other machinery & parts, MS wire rod, and cold-rolled sheet went down. Similarly, the imports of sugar, textile dyes, textiles, polythene granules, crude soybean oil, crude palm oil, steel wire, computer & parts, telecommunication equipment & parts and transport vehicles & parts from other countries rose while imports of chemical fertilizer, raw wool and television, deck & parts declined.

28. In terms of the structure of imports from India, industrial raw materials & capital goods and petroleum products constituted 47.2 percent and 29.3 percent respectively, while the miscellaneous goods including consumer items comprised the rest 23.5 percent. Last year their respective shares were 44.4 percent, 27.1 percent and 28.5 percent. Similarly, the share of industrial raw materials and capital goods in total imports from other countries went up to 61.3 percent from 50.4 percent last year.

29. The share of India in total trade went up to 63.6 percent from 61.6 percent last year while the share of other countries dropped correspondingly to 36.4 percent from 38.4 percent last year.

30. The overall export/import ratio declined to 37.7 percent this year from 43.1 percent last year. The export/import ratio for India decreased to 40.8 percent from 42.1 percent last year while the same for other countries fell sharply to 32.5 percent from 44.8 percent last year.

Balance of Payments

31. On the basis of available monetary statistics, the overall BOP remained in surplus of Rs. 1.5 billion in the first quarter of 2005/06 in contrast to a deficit of Rs. 1.4 billion in the corresponding period of the previous year. The higher inflows of foreign loans and remittances accounted for a surplus in BOP this year.

32. Based on BOP statistics for the first two months of 2005/06, current account recorded a deficit of Rs. 3.0 billion in comparison to a surplus of Rs. 4.0 billion in the previous year. Despite the increase in net transfer, the significant decline in net services and the upsurge in trade deficit were responsible for the deficit in the current account. Under the transfer

receipts, the workers' remittances increased by 12.8 percent to Rs. 12.0 billion in contrast to a decline by 11.4 percent in the previous year.

33. Under the capital account, capital transfers increased to Rs. 779.9 million from a level of Rs.139.5 million last year.

34. Under the financial account, during the first two months of this fiscal year, HMG received Rs. 531.4 million as foreign loan and repaid Rs. 564.0 million in amortization, resulting in a net outflow of Rs. 32.6 million. HMG had borrowed a sum of Rs. 221.6 million as foreign loans last year. Foreign currency and deposit liabilities decreased to Rs. 55.9 million this year.

Foreign Exchange Reserves

35. The gross foreign exchange reserves went up by 4.2 percent to Rs. 134.3 billion in mid-October 2005 compared to an increase of 20.5 percent in mid-October 2004. Of this, the convertible currency reserve rose by 4.8 percent mainly due to the rise in remittances through the banking channel whereas the inconvertible reserves plummeted by 5.0 percent this year. The share of convertible reserves in the total reserves moved up to 94.4 percent as at mid-October 2005 from 93.8 percent in mid-October 2004, resulting in a corresponding fall in the share of the non-convertible reserves to 5.6 percent from 6.2 percent in the corresponding month last year. The current reserve has a comfortable position to finance merchandise imports of 9.6 months and merchandise and service imports of 8.1 months.

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

36. In the international market, the price of oil (Crude Oil Brent) increased by 13.9 percent to US$ 58.24 per barrel on October 15, 2005 from US$ 51.15 per barrel during the same period last year. Similarly, the price of gold increased by 10.8 percent to US$ 466.00 per ounce on October 15, 2005 from US$ 420.40 in the corresponding period of the previous year.

37. The Nepalese currency vis-à-vis US dollar appreciated by 3.6 percent (Rs. 71.65 per US dollar) in mid-October 2005 from the level of (Rs. 74.25 per US$) a year ago.

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