Current Macroeconomic Situation

(Based on First Four Months Data of 2005/06)

Nepal Rastra Bank
January 2006
www.nrb.org.np

Executive Summary

The Real Sector

1. The system of computing GDP on higher frequency is not yet developed in Nepal. This impedes the realistic analysis of economic activities on an occasional basis.
2. However, the real sector data on a piece meal basis are available. For example, the data on manufacturing index of the first quarter of 2005/06, estimates of production of some agricultural crops and tourism related data of the first four months of 2005/06 are available.
3. The manufacturing production index increased by a lower rate of 2.4 percent in the first quarter of 2005/06 compared to a growth of 4.0 percent in the comparable quarter of 2004/05. The decline in the production of garment, sawn wood, newspaper, books and paper and paper products lowered the manufacturing production index this year compared to that of the preceding year.
4. Food grains production is estimated to register a negative growth in 2005/06 as well. Paddy production is estimated to decline by 1.9 percent in 2005/06 compared to a decrease of 3.7 percent in 2004/05.
5. Tourist arrival showed an encouraging growth of 21.1 percent in the first four months of 2005/06 as against a decline of 12.3 percent in 2004/05. Improved security situation played a role but the same situation may not continue in the rest of the fiscal year.
6. These lead indicators portend that the growth of real GDP is likely to remain modest in 2005/06 as well.

Monetary Developments

7. The monetary growth was higher at 4.9 percent (M_2) in the first four months of 2005/06 compared to a rise of 2.1 percent in the comparable period of 2004/05.
8. Higher level of NFA accumulation emanating from a significant increase in workers' remittance caused money supply to go up.
9. The banking sector loan to the government remained subdued. So was the case with claims on the private sector. Imports grew significantly but it was largely financed by overseas trade credit. Emphasis on loan recovery by large commercial banks also contributed to the lower rate of growth of credit off take by the private sector.
10. Despite the increase in workers' remittances, excess liquidity remained at a minimum level in the first four months of 2005/06, albeit it surged a little bit towards the end of the period. Nonetheless, short-term interest rates remained higher compared to that of last year.
11. The volume of inter bank transaction increased significantly, reflecting a deepened money market. As a result, SLF borrowing by the commercial banks remained at a low level of Rs.315 million in the first four months of 2005/06 compared to a significantly higher level of borrowing level of Rs.20 billion in the comparable period of 2004/05.

Securities Market

12. Nepal Securities Board gave approval to five financial institutions to issue ordinary shares and debentures. Of these five, four issued ordinary shares and debentures amounting to Rs.278.5 million.

13. The size of stock market, in terms of the number of companies listed, market capitalization, the total number of listed shares and the growth of NEPSE index, expanded in the first four months of 2005/06. The y-o-y NEPSE index increased by 67.3 points (28.6%) to stand at 302.4 in mid-November 2005.

14. The market capitalization of stocks to GDP increased to 13.1 percent in mid-November 2005 from 9.1 percent a year ago. The liquidity of shares listed, as measured by the turnover to market capitalization ratio, increased to 25 percent in mid-November 2005 from 12 percent a year ago. The stock market remained concentrated, dominated by the stocks of commercial banks. Volatility measured as a twelve-month rolling standard deviation of NEPSE index increased reflecting a rise in the risk in the stock market.

Headline Consumer Inflation

15. The y-o-y headline consumer inflation showed a surge of 8.5 percent in mid-November 2005 compared to a growth of 2.7 percent a year ago. The unexpected rise in food inflation by 17.8 percent in mid-November caused headline consumer inflation to go up to 8.5 percent. The rise of vegetables and fruits prices also played a part, not to mention of the effect of upward revision made in the administered prices of petroleum products in January and September 2005 and VAT rate hike from 10 percent to 13 percent in February 2005. Annual average revised inflation is expected to be around 7.0 percent in 2005/06.

Core CPI Inflation

16. The y-o-y core inflation calculated from headline CPI inflation by excluding rice and price products, vegetables and fruits, fuel, light and water and transport remained at 4.4 percent as against the 8.5 percent headline inflation in mid-November 2005. The core inflation was at 3.0 percent as against the 2.7 percent headline CPI inflation in mid-November 2004. The heightened inflationary expectation from rising global oil prices, and the passthrough effect of the hike in VAT, whose effect could not be isolated from the calculation of core inflation caused a relatively higher rate of core inflation this year compared to that of the preceding year.

17. A build up in inflationary pressure was expected at the time of the formulation of monetary policy for 2005/06. But the rise in prices of food inflation was unexpected. In response to the expected rise in inflation, the bank rate was hiked from 5.5 percent to 6.0 percent. Should inflationary build up continues, appropriate monetary policy measures would be initiated.

Government Budgetary Operations

18. The overall budgetary stance, on a cash basis, remained expansionary in the first four months of 2005/06 compared to that of the previous year.

19. However, the budgetary performance in terms of three indicators of budgetary balance remained mixed.

20. The size of fiscal deficit as the ratio of total government expenditure expanded by 5.0 percent in mid-November 2005 compared to a negligible 0.2 percent in the comparable period of 2004/05. Excluding the local authority account, such fiscal deficit increased significantly by 13.6 percent. The expansion in capital expenditure widened the fiscal deficit.

21. The revenue growth remained modest at 6.9 percent in mid-November 2005 compared to a rise of 4.7 percent a year ago.

22. The revenue deficit showed an improvement because of lower level of principal repayment.

23. Primary balance as percent of total government expenditure remained at a surplus of 0.7 percent in the first four months of 2005/06 compared to a surplus of 7.4 percent of a year ago. Exclusion of local authority account pushed primary deficit up at 7.9 percent of total government expenditure.

Foreign Trade

24. The merchandise trade deficit increased significantly by 51.0 percent in the first four month of 2005/06 as against a decline of 8.3 percent in the comparable period of 2004/05.

25. A significant surge in total imports by 36.5 percent relative to a rise of 17.2 percent in total exports widened the merchandise trade deficit in the first four months of 2005/06. While total imports had declined by 0.8 percent, total exports had increased by 11.3 percent in the comparable period of 2004/05.

26. Of total imports, imports from India surged by 38.3 percent in the first four months of 2005/06 compared to the 11.6 percent rise in the comparable period of 2004/05. Imports from overseas countries also increased significantly by 33.5 percent in the first four months of 2005/06 as against a decline of 16.0 percent in the comparable period of 2004/05.

27. While the growth of exports to India remained significant, albeit lower than of 2004/05, the growth of exports to overseas countries remained negative by 1.2 percent.

28. Basically, imports of industrial raw materials and capital goods caused the overall imports to go up. An increase in exportable items of vegetable ghee, polyester yarn, zinc sheet, wire and GI pipe contributed to the growth of exports to India. The decline in the exports of woolen carpet and readymade garments continued.

29. The overall BOP surplus stood at Rs.4.1 billion in the first four months of 2005/06 compared to a surplus of 1.2 billion in the comparable period of 2004/05. A significant increase in workers' remittances contributed to this magnitude of a rise in BOP surplus in the review period.

30. Total international reserves continued to rise. In mid-November 2005, international reserves were sufficient to cover 9.8 months equivalent of merchandise imports and 8.3 months worth of merchandise and service imports.

Current Macroeconomic Situation

(Based on First Four Months' Data of 2005/06)

The Real Sector

1. The system of computation of quarterly GDP is not yet developed in Nepal. This has impeded the analysis of the real sector on a quarterly basis.
2. However, some information on agricultural production, quarterly manufacturing index and tourism related data of first quarter and the first four months of 2005/06 are available.
3. On the agricultural production, food grain production is estimated to register a negative growth of 0.3 percent in 2005/06 compared to a negative growth of 0.2 percent in 2004/05. Of food grain production, the production of paddy, which has a share of 19.75 percent in agricultural GDP, is estimated to decline by 1.9 percent in 2005/06. The decline in paddy production was 3.7 percent in 2004/05. The production of maize with the share of 6.87 in agricultural GDP is estimated to rise by 1.1 percent in 2005/06 compared to a growth of 7.9 percent in 2004/05. The production of millet is estimated to rise marginally by 0.4 percent in 2005/06 compared to an increase of 2.3 percent in 2004/05.
4. The manufacturing production index increased by 2.4 percent in the first quarter of 2005/06 compared to a growth of 4.0 percent in 2004/05. A significant decline in manufacture of garment followed by a decline in wood sawn (5.1 percent), newspaper (3.1 percent), bricks (3.1 percent) and manufacture of paper and paper products (2.9 percent) caused the growth of manufacturing production index at a low level of 2.4 percent in the first quarter of 2005/06.
5. Tourist arrival increased by 21.1 percent in the first four months of 2005/06 as against a decline of 12.3 percent in 2004/05. Relatively improved security situation contributed to the growth of tourist arrival in the first four months of 2005/06.
6. The analysis of these lead indicators shows that the real GDP growth is likely to remain a modest in 2005/06.

Monetary Development

7. Monetary aggregates posted a higher rate of growth in the first four months of 2005/06, relative to that of corresponding period in the preceding year. Broad money (M2) expanded by 4.9 percent during the review period compared to an increase of 2.1 percent last year. Narrow money (M1) increased by 3.7 percent in contrast to a decline of 0.4 percent last year. Relatively higher rate of growth of both net foreign assets (NFA) and net domestic assets (NDA) of the monetary sector contributed to the acceleration in monetary aggregates in the first four months of 2005/06.
8. NFA, an expansionary factor of money supply went up by 3.8 percent during the review period. Such assets had increased by 1.1 percent in the previous year. A significant increase in workers' remittance contributed to the growth in NFA
9. Total domestic credit, the other expansionary factor of money supply, registered a growth of 3.8 percent during the review period compared to a rise of 4.4 percent in the preceding year. Of the components of domestic credit, net claims on the government

showed a decline albeit, marginal. In the previous year, net claims on the government had decreased by 2.4 percent. This reflected a slowly building up pressure on budgetary resources in the review period compared to that of the previous year. Claims on non-financial government enterprises showed a decline of 9.3 percent in the first four months of 2005/06 in contrast to a significant growth of 35.8 percent in the corresponding period of 2004/05. Partial loan repayment by non-financial government enterprises such as Nepal Oil Corporation, Nepal Electricity Authority, Janak Educational Material Center and Gorkhapatra Sansthan to commercial banks contributed to a decline in such claims. Similarly, claims on financial enterprises went down by 2.2 percent during the review period. A decline in cash balance of ADB/N branches performing commercial banking transactions with their headquarters caused to a decrease in claims on financial institutions in the review period.

10. The most important component of the claims of monetary sector, claims on private sector recorded an increase of 6.0 percent in the first four months of 2005/06 compared to an increase of 6.8 percent last year. Improvement in loan recovery of some banks and increased trade credit accounted for a lower rate of pick up in the private sector credit growth in the review period.

11. Net non-monetary liabilities increased marginally by 0.2 percent in the first four months of 2005/06 compared to a growth of 7.8 percent in the corresponding period of the previous year. The recovery of past loans resulting a reduction in loan loss provisioning contributed to such a marginal increase in net non-monetary liabilities. As a result, net domestic assets increased by 5.4 percent in the first four months of 2005/06 compared to a growth of 2.7 percent in the comparable period of 2004/05.

12. During the review period, time deposit increased by 5.6 percent compared to a growth of 3.3 percent last year. A significant increase in workers' remittance contributed to a relatively higher rate of growth of time deposit in the review period.

13. Of the two proximate determinants of money supply, reserve money registered a growth of 2.5 percent during the review period in contrast to a decline of 5.9 percent last year. Remittance led increase in NFA of Rastra Bank accounted for a growth in reserve money in the review period.

14. During the review period, both money multipliers recorded an upward trend. Narrow money multiplier increased by 1.1 percent and stood at 1.049 as at mid November 2005 whereas broad money multiplier went up by 2.4 percent and reached 3.187 as at mid November 2005.A fall in excess reserves contributed to the growth of money multipliers in the review period.

Foreign Exchange and Money Market

15. NRB intervened 16 times in the foreign exchange market in the first four months of 2005/06. Through these interventions, NRB purchased US dollar, amounting to Rs 13.51 billion, injecting the liquidity of equivalent amount in the economy. Some of the liquidity injected through foreign exchange intervention was mopped up through the open market operations of treasury bills, outright sale auction and reverse repo auction.

16. NRB mopped up Rs 4.3 billion liquidity through outright sale auction and injected Rs 830 million liquidity through outright purchase auction. Consequently, net liquidity withdrawal by NRB amounted to Rs 3.5 billion.

17. Excess liquidity of the commercial banks remained at a minimum level in the review period. As a result, short-term interest rates remained higher during the review period compared to those of the previous year. For example, the weighted average 91-day treasury bills rate and weighted average inter bank rate stood at 2.69 percent and 2.36 percent respectively for the month ending mid November 2005. Such rates were 1.97 percent and 2.24 percent respectively in the corresponding month of 2004/05.

18. During the review period, the volumes of inter bank transaction further increased. For example, this amount stood at Rs 67.6 billion during the review period compared to the volume of transaction of Rs 38.7 billion in the previous year. As a result of increased inter bank transactions, the standing liquidity facility (SLF) borrowing by the commercial banks remained at a low level of Rs 315 million in the first four months of 2005/06 compared to a borrowing level of Rs 20.0 billion in the corresponding period of 2004/05.

19. The outstanding refinance facilities utilized by commercial banks from NRB remained at a lower level of Rs 36 million in the first four months of 2005/06 compared to the amount of Rs 279.6 million in the same period last year.

Securities Market Activities

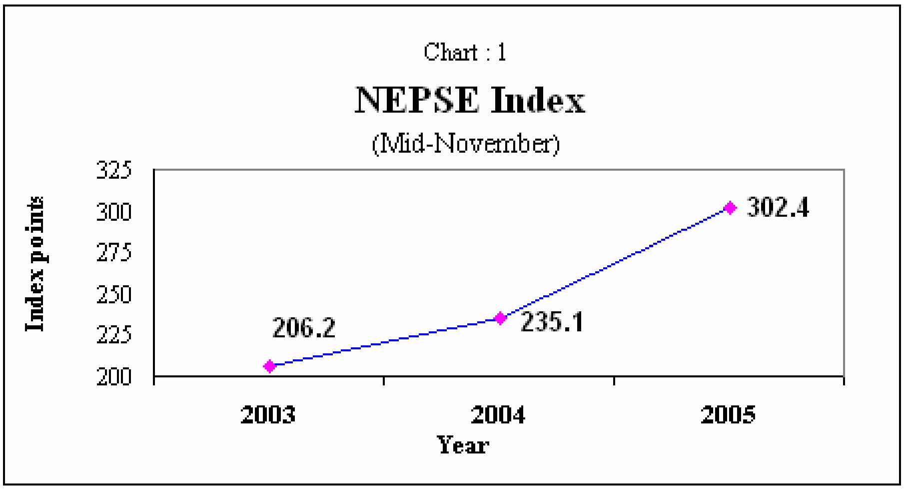
Primary Issue of Securities

20. During the first four months of 2005/06, Nepal Securities Board gave approval to five financial institutions to issue ordinary shares and debentures. Accordingly, Siddhartha Bank Limited issued ordinary shares amounting to Rs. 150.0 million. Likewise, Srijana Finance Limited and Prudential Financial Institute Limited issued ordinary share amounting to Rs. 4 million and Rs. 24.5 million respectively. Bank of Kathmandu issued debentures amounting to Rs. 200 million. Altogether, ordinary shares and debentures amounting to Rs. 278.5 million were issued in the primary market. Merchant Finance Company although given permission, is yet to issue its ordinary share amounting to Rs. 12.0 million.

Secondary Stock Market Development

21. The size of stock market witnessed a significant growth in the first four months of 2005/06. The growth in stock market is reflected in the NEPSE index, the number of companies listed, market capitalization and the total number of listed shares.

22. The year-on-year (y-o-y) NEPSE index increased by 67.3 points (28.6 percent) and reached 302.4 in mid-November 2005. The increase workers' remittances, lack of investment opportunities, low level of real interest rates, an increased profit levels of banks and financial institutions contributed to the growth of NEPSE index in the first four months of 2005/06.



23. The number of listed companies in the Nepal Stock Exchange Limited increased to 125 in mid-November 2005 from 118 a year ago. Of 125 listed companies, 79 (63.2 percent) were financial institutions, 29 manufacturing and processing units, 4 hotels, 8 trading units and 5 others.

24. Market capitalization, on a y-o-y basis, increased by 53.0 percent and reached Rs. 69.2 billion in mid-November 2005. The market capitalization to GDP ratio stood at 13.1 percent in mid-November 2005 from 9.1 percent a year ago. Of the total market capitalization of listed companies, financial institutions accounted for 81.6 percent, manufacturing and processing units 7.6 percent, hotel 3.3 percent, trading 1.0 percent and unclassified 6.5 percent.

25. Likewise, the total paid up value of listed shares on a y-o-y basis increased by 32.2 percent and reached Rs 17.5 billion in mid-November 2005. The issuance of shares by financial institutions mostly accounted for the growth of total paid up value of listed shares.

26. Besides the growth, the stock market also witnessed a rise in liquidity of shares listed in the stock exchange. Of the stock market liquidity indicators, the turnover to market capitalization ratio increased to 25.0 percent in mid-November 2005 from 12.0 percent a year ago. Likewise, the turnover to GDP ratio also increased to 3.3 percent in mid-November 2005 from 2.7 percent a year ago.

27. The Nepalese stock market remained highly concentrated and dominated by the stocks of commercial banks. For example, of the total turnover of Rs. 175.6 million, the share of commercial banks stood at 80.2 percent followed by finance companies at 17.8 percent in mid-November 2005. Clearly, the share of manufacturing and processing units, hotel and trading remained almost negligible. Finance companies gained vis-à-vis commercial banks as the share of the former increased to 17.8 percent in total turnover and that of latter declined to 80.2 percent in mid-November 2005 from the respective levels of 10.0 percent and 83.6 percent a year ago.

28. Volatility, measured as a twelve-month rolling standard deviation of NEPSE index increased during the last twelve-months compared to that of corresponding period of the preceding period. For example, the twelve-month rolling standard deviation of NEPSE index stood at 22.7 in mid-November 2005 compared to 15.0 a year ago, indicating an increased risk in the Nepalese stock market.

Headline Consumer Inflation

29. The y-o-y headline consumer inflation picked up to 8.5 percent in mid-November 2005 compared to a growth of 2.7 percent a year ago. Inflationary pressure unexpectedly emanated from a significant increase in price index of rice and rice product subgroup as against the decline in the price index of this subgroup last year. Vegetables and fruits prices also picked up this time. A significant hike in energy prices in January 2005 and September 2005 continued to exert pressure on overall price level. Likewise, the impact of VAT rate hike to 13.0 percent from 10.0 percent in February 2005 persisted.

30. Of these factors driving headline consumer inflation, the y-o-y rise in prices of rice and rice products by 17.8 percent in mid-November 2005 as against the decline by 1.6 percent in the corresponding month last year was the most unexpected. The rise in prices of rice and rice products alone contributed 2.5 percentage points increase to the 8.5 percent surge in overall headline consumer inflation in mid-November 2005.

31. The y-o-y price index of food and beverages group increased by 8.6 percent in mid-November 2005 compared to a rise of 2.2 percent a year ago. As indicated above, a significant increase in prices of rice and rice products taken with a rise in prices of pulses, vegetables and fruits, beverages and restaurant meals drove up the price index of food and beverages groups.

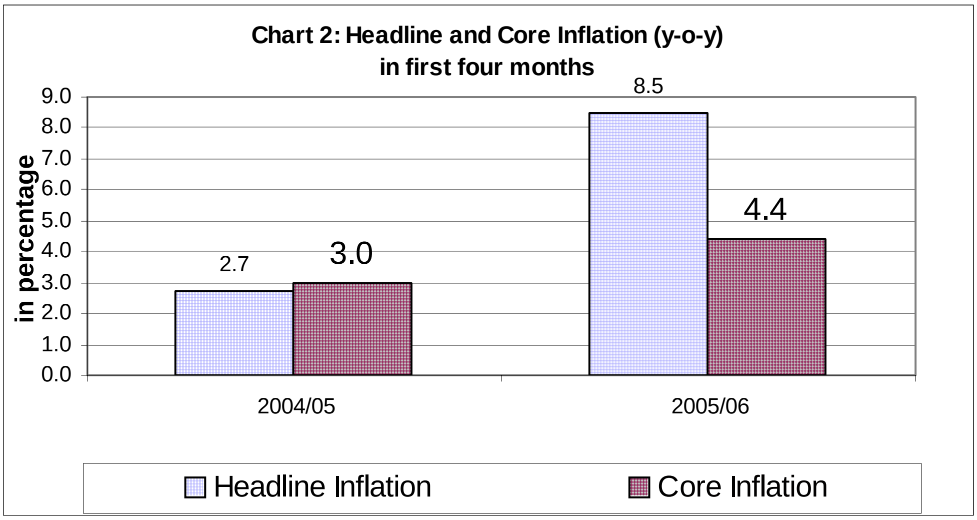
32. The y-o-y price index for nonfood and services group surged by 8.3 percent in mid-November 2005 compared to the 3.3 percent rise in the corresponding month of 2004. Key factors driving up the price index for nonfood and services group were the hike in fuel prices in January 2005 and September 2005 and the increase in VAT rate to 13.0 percent from 10.0 percent in February 2005. The direct impact of these two factors was visible in the price index for housing goods and services subgroup which surged to 13.6 percent (y-o-y) in mid-November 2005 compared to the 5.7 percent growth in mid-November 2004 and transport and communication subgroup which soared to 16.9 percent in mid-November 2005 compared to a negligible growth of 0.1 percent (y-o-y) a year ago.

33. The decline in paddy production coupled with the delay in the arrival of paddy harvest to the market kept pressure on food inflation. In a month or two, food inflation is expected to ease. The effect of the hike in the prices of petroleum products in January 2005 on overall prices is expected to taper of only after January 2006. The pass-through effect of the hike in petroleum products in September 2005 on overall prices will continue till September 2006. The proposed reduction in the customs duties in the half yearly budget ordinance is also expected to dampen import prices. Other things remaining the same, the current rate of inflation is expected to decelerate after a month or two. Annual average revised inflation is expected to be around 7 percent in 2005/06.

34. Inflation, based on the wholesale price Index, remained at 11.3 percent (y-o-y) during the review period compared to 4.6 percent in the same period of the previous year.

Core CPI Inflation*

35. The y-o-y core CPI inflation remained contained below the 5.0 percent level at 4.4 percent as against 8.5 percent headline CPI inflation in mid-November 2005. In mid-November 2004, core inflation was 3.0 percent as against 2.7 percent headline CPI inflation. Two factors contributed to the surge in core inflation relative to that of last year. First, the pass-through effect of the hike in VAT rate, which could not be isolated from the calculation of core inflation, continued to keep up pressure on overall prices. However, the pass-through effect of the hike in VAT rate is expected to taper off from February 2006. Second, failure of monsoon, unease situation and the rise in international oil prices heightened inflationary expectations.



36. A slight build up in inflationary pressure was expected at the time of the formulation of monetary policy. As the monetary policy response to expected pressure on prices, the bank rate was hiked to 6.0 percent from 5.5 percent. However, food inflation of the current magnitude (contributing more than 2.5 percentage points to CPI inflation) was not expected. To curb inflationary pressure, the tight bias monetary policy stance will be continued. Appropriate monetary policy response will be initiated, should inflationary buildup continues.

Government Budgetary Operation

37. The overall government budgetary stance, on a cash basis, remained expansionary in the first four months of 2005/06 compared to that of the corresponding period of 2004/05. However, the budgetary balances/imbalances produced mixed results in the review period.

38. Of the three indicators of budgetary balances/imbalances, fiscal deficit (total expenditure less total non-debt resources) stood at 5.0 percent of total government expenditure in the first four months of 2005/06 compared to a negligible 0.2 percent in the corresponding period of 2004/05. Exclusion of local authority account amounting to Rs. 2.0 billion would push up the fiscal deficit to 13.6 percent of total

* With a view to isolate the effects of volatile food prices, energy prices, administered prices and indirect taxes on inflation from those emanating from the monetary impulses, many central banks have started calculating core inflation. Popular methods applied for the calculation of core inflation are exclusion method, weighted median method and trimmed mean method (outlier method). For calculating core inflation for Nepal, exclusion method has been applied. The items excluded are rice and rice products, vegetables and fruits, fuel, light and water, and transport.

government expenditure in first four months of 2005/06. The surge in capital expenditure (including freeze account) contributed to the significant expansion in the fiscal deficit in the review period.

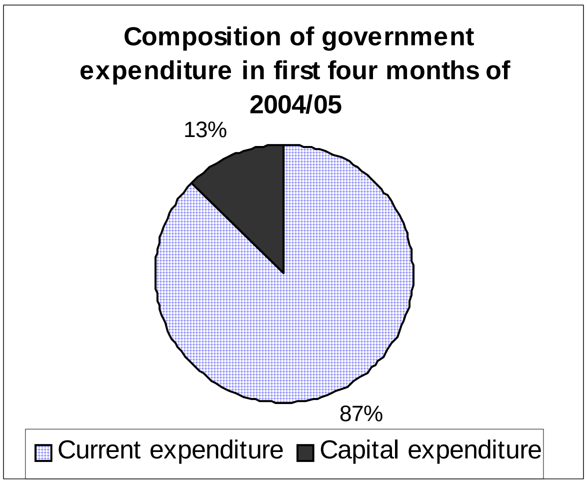
Table 2: Government Budgetary Stance

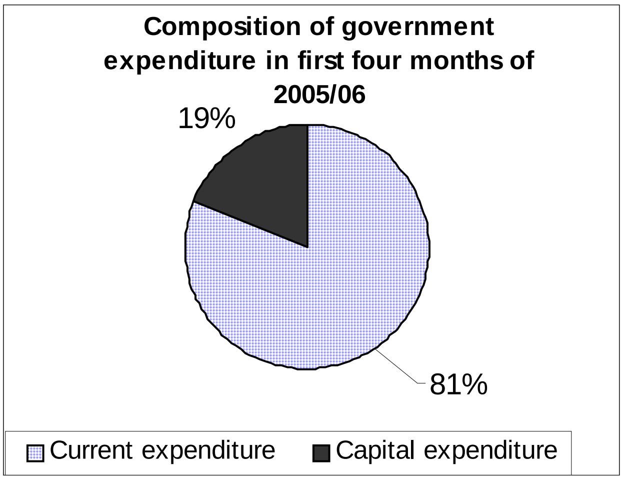
(During the first four months)

Rs. in million

		2004/05	2005/06
1	**Revenue balance** (revenue-current expenditure)	**-1756.6**	**-1042.1**
	Current expenditure	18490.3	18936.3
	Recurrent expenditure	*15293.6*	*17159.6*
	Principal repayment	*3196.7*	*1776.7*
	Revenue	16733.7	17894.2
2	**Fiscal balance** (total non-debt resources-total expenditure)	**-50.1**	**-1178.6**
	Total expenditure	*21197.0*	*23377.8*
	Total non-debt resources	*21146.9*	*22199.2*
	Fiscal deficit excluding local authority account	-50.1	-3184.0
	Local authority account	0.0	2005.4
3	Interest payment	1628.3	1341.8
	Internal	*1008.1*	*801.6*
	External	*620.2*	*540.2*
4	Primary balance (fiscal deficit-interest payment)	1578.2	163.2
	Primary balance excluding local authority account	1578.2	-1842.2
5	**Total government expenditure**	**21197.0**	**23377.8**
	As % of total expenditure		
1	Revenue balance	-8.3	-4.5
2	Fiscal balance	-0.2	-5.0
3	Fiscal balance excluding local authority account	-0.2	-13.6
4	Primary balance	7.4	0.7
5	Primary balance excluding local authority account	7.4	-7.9

39. The share of capital expenditure (including freeze account) increased to 19.0 percent in the total government expenditure in the first four months of 2005/06 compared to 12.8 percent in the corresponding period of 2004/05. Conversely, the share of current expenditure (including principal repayment) declined to 81.0 percent in the review period from 87.2 percent last year. A significant rise in capital expenditure pushed up the growth of total expenditure at 10.3 percent in the first four months of 2005/06 compared to a marginal growth of 2.2 percent in the corresponding period last year.





40. Revenue deficit (revenue less recurrent and principal repayment), the other indicator of budgetary imbalance, however, showed an improvement in the first four months of 2005/06. Revenue deficit as percent of total expenditure decelerated to 4.5 percent in the first four months of 2005/06 from 8.3 percent in the corresponding period of 2004/05. Improvement in revenue growth, albeit subdued, at 6.9 percent in the first four months of 2005/06 compared to a rise of 4.7 percent in the preceding year and the decline in principal repayment contributed to the improvement in revenue deficit relative to that of last year.

41. Primary balance (fiscal deficit less interest payment), the important indicator of the current fiscal stance posted a surplus of 0.7 percent of total expenditure in the first four months of 2005/06 compared to a significant level of surplus of 7.4 percent in the corresponding period of 2004/05. Primary balance excluding local authority account amounting to Rs. 2.0 billion remained at a deficit of 7.9 percent of total government expenditure in the first four months of 2005/06.

42. Of the fiscal deficit amounting to Rs. 1,178.6 million, net internal financing remained negligible at Rs. 48.2 million and foreign loan financing stood at Rs. 1,130.4 million. Consequently, the total net outstanding domestic debt of the government remained at Rs. 90.0 billion in mid-November 2005 more or less at the level of mid-July 2005.

Foreign Trade

43. The Structure of foreign trade witnessed some changes in the first four months of 2005/06 compared to that of the preceding year.

44. A significant increase of total imports by 36.5 percent in the first four months of 2005/06 as against the decline of 0.8 percent in the corresponding period of 2004/05 was the notable development. Of total imports, imports from India increased significantly by 38.3 percent in the first four months of 2005/06 compared to a growth of 11.6 percent in the corresponding period of 2004/05. Imports from other countries also increased significantly by 33.5 percent in the review period as against a negative growth of 16.0 percent in the comparable period of the preceding year.

45. In terms of changes in absolute amount, a significant increase of import of petroleum products, rice, chemicals, MS billet, medicine, thread, cement, vegetables, sugar, fruits, M.S. wire rod and cosmetics among others from India and crude palm oil, textile dyes, palm oil, M.S. billet, electrical goods, polythene granules, crude soybean

oil, M.S. wire rod, aircraft and spare parts, writing and printing paper, transport equipment and parts and telecommunication equipment parts, among others, from other countries boosted the growth of overall imports in the first four months of 2005/06. Of the increase in importable items, imports of industrial raw materials and capital goods remained significant.

46. The growth of exports also remained higher at 17.2 percent in the first four months of 2005/06 compared to a rise of 11.3 percent of 2004/05. Of total exports, export to India increased by 28.2 percent in the first four months of 2005/06 compared to a growth of 34.6 percent in the comparable period of 2004/05. Exports to other countries declined albeit marginally, by 1.2 percent in the review period compared to a significant decline of 13.7 percent in the comparable period of 2004/05.

47. In terms of changes in absolute amount, an increase in the exportable items of vegetable ghee, polyester yarn, zinc sheet, wire, readymade garment and G.I. pipe, among others contributed to the growth of exports to India. The decline in the exportable items of woolen carpet, readymade garments and handicrafts, among others caused exports to other countries fall, albeit marginally.

48. The significant increase in imports relative to exports widened trade deficit by 51.0 percent in the first four months of 2005/06 as against the decline of 8.3 percent in the comparable period of 2004/05.

Balance of Payments

49. As per monetary statistics, the overall BOP remained in surplus of Rs. 4.1 billion for the first four months of 2005/06 compared to a surplus of Rs. 1.2 billion in the corresponding period of 2004/05. The higher inflow of remittances contributed to the increased level of surplus in the BOP this year.

50. On the basis of the BOP statistics for the first three months of 2005/06, current account recorded a deficit of Rs. 2.9 billion as against a surplus of Rs. 5.8 billion in the previous year. Inflow of workers' transfer increased significantly by 17.9 percent in the first three months of 2005/06 as against the decline of 9.0 percent in the comparable period of 2004/05. Despite the increased workers' remittances, a significant increase of imports of merchandise goods relative to exports caused a deficit in the current account this year.

51. Under the capital account, capital transfers increased to Rs. 952.1 million from the level of Rs. 281.9 million last year.

52. Under the financial account, HMG received Rs. 531.4 million as foreign loan and repaid Rs. 1.0 billion in amortization, resulting in a net outflow of Rs. 474.7 million in the first three months of this fiscal year. HMG had borrowed a sum of Rs. 620.1 million as foreign loans in the comparable period of 2004/05. Foreign currency and deposit liabilities decreased by Rs. 810.3 million this year.

Foreign Exchange Reserves

53. The y-o-y gross foreign exchange reserves rose by 6.1 percent to Rs. 139.2 billion in mid-November 2005 compared to an increase of 21.9 percent in mid-November 2004. The share of convertible reserves in the total reserves declined to 93.4 percent as at mid-November 2005 from 96.1 percent in mid-November 2004, resulting in a corresponding increase in the share of the non-convertible reserves to 6.6 percent from 3.9 percent in the corresponding month last year. The current reserve has a

comfortable position to finance merchandise imports of 9.8 months and merchandise and service imports of 8.3 months.

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

54. In the international market, the price of oil (Crude Oil Brent) increased by 32.9 percent to US$ 54.09 per barrel on November 15, 2005 from US$ 40.69 per barrel during the same period last year. Similarly, the price of gold increased by 7.0 percent to US$ 468.25 per ounce on November 15, 2005 from US$ 437.64 in the corresponding period of the previous year.

55. The Nepalese currency vis-à-vis US dollar depreciated by 3.8 percent in mid-Nov, 2005 from the July's level but appreciated by 0.14 percent (Rs. 73.14 per US dollar) in mid-November 2005 from the level of (Rs. 73.24 per US$) a year ago.

Developments in Regional and Multilateral Trade

SAFTA

56. The Thirteenth SAARC Summit held in Dhaka on November 12-13, 2005 decided to establish SAARC Poverty Alleviation Fund, (SPAF) and expedite efforts to remove obstacles in setting up free-trade area by January 1, 2006. The SAARC member nations agreed to grant full membership to Afghanistan and also awarded Japan and China the status of observers in the regional organization.

57. The Agreement on South Asian Free Trade Area (SAFTA) was signed on January 6, 2004 during the Twelfth SAARC Summit in Islamabad.

58. As per the SAFTA agreement, developing countries (India, Pakistan and Sri Lanka) will reduce their customs tariff to 20 percent while least developed countries (LDCs) (Bangladesh, Bhutan, Maldives and Nepal) will bring it down to 30 percent during the first phase between 2006-2008. Moreover, India and Pakistan are required to reduce tariffs to 5 per cent or below by 2013 and Sri Lanka by 2014. The LDCs are to reduce tariffs to 5 per cent or below by 2016.

59. Though the agreement came into force from January 1, 2006, Nepal has to reduce its customs tariffs from August 2006 as the Nepalese fiscal year begins from mid-July.

60. Implementation of the agreement will create more investment opportunities in the region. However, it is important for Nepal to identify the products of comparative advantage and special areas to penetrate regional market.

61. All member countries have their own lists of sensitive goods; this will be reviewed every four years to help generate confidence between the trading partners and boost intra regional trade.

BIMSTEC

62. The Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC), a regional trading bloc, was established in June 1997 to strengthen socio-economic cooperation among Bangladesh, India, Sri Lanka and Thailand. While Myanmar was admitted as a full member in December 1997 Bhutan and Nepal joined in February 2004.

63. Accordingly, the Framework Agreement on BIMSTEC Free Trade Area (FTA) was signed on February 8, 2004 at Bangkok during the Sixth BIMSTEC Economic Ministers' Meeting. The FTA Agreement would first start on trade in goods from July

2006 while the FTA Accord on trade in services and investment would start from July 2007.

64. Member countries of the BIMSTEC constituted the Trade Negotiating Committee (TNC) to carry forward the program. Ten rounds of the BIMSTEC TNC meetings have taken place so far. During the 10 th TNC meeting, that concluded in Kathmandu on December 26, member countries agreed for the involvement of third party arbitration (third country) in dispute settlement mechanisms on trade issues. Third party involvement is required in discussing the import surge, countervailing duty and other issues that directly affect foreign trade.

65. The 10th Meeting also focused attention on issues such as the rules of origin. Under the rules of origin, valuation and product specification rules are yet to be settled.

66. The issues of investment promotion and protection would be taken up in the forthcoming meeting of TNC to be held in Bangkok in February 2006.

WTO's Hong Kong Ministerial Meeting

67. The Hong Kong Ministerial Meeting of the WTO held during December 13-18, 2005 addressed crucial development aspirations of poor and needy countries like Nepal.

68. Developed and developing countries agreed to provide a sustainable duty- and quota-free market access to 97 percent of total exportable products of poorer countries starting form 2006 to no later than 2008.

69. The developed countries promised to pledge more effective technical assistance for capacity building. They also announced new program like 'aid for trade' in which Japan committed US$ 10 billion for 3 years, and EU and US promised € 2.7 billion and US$2.5 billion for a year respectively. Such aid is to be provided not only on building technical capacities but also to develop trade related physical infrastructure and institutions that facilitate expansion of trade. How the aid will be distributed and how much will Nepal obtain will become clear by July 2006, when aid plan will be finalized.

70. Developed and emerging developing countries agreed to negotiate on possibility of liberalizing cross-border movement of persons for work, which is encompassed under mode 4 of service trade.

71. The WTO members also agreed to simplify and make transparent rules of origin conditions, making it more liberal to support poorer countries.

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