Nepal Rastra Bank
Research Department

Current Macroeconomic and Financial Situation of Nepal

(Based on First Month's Data of 2016/17)

Economic Outlook

1. Agricultural production in Nepal is largely influenced by weather condition. The favourable monsoon is expected to support agricultural production this year. In addition, timely availability of chemical fertilizers and insecticides, and the containment of spread of epidemic diseases and insects in the standing crops is expected to produce positive impact on agriculture sector.

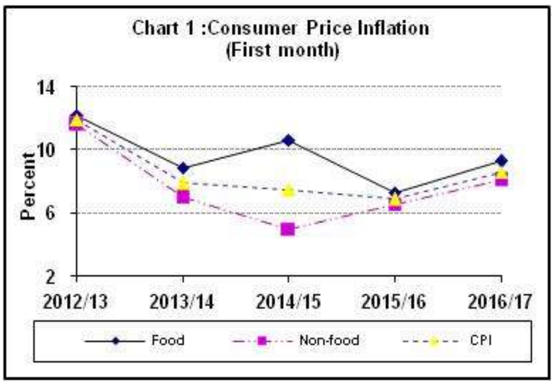
2. Increased government capital expenditure along with the emphasis on reconstruction related works and the disbursement of grants for rebuilding of houses destroyed by the earthquake of 2015 are expected to boost rural activities.

3. The tourism sector hit by the earthquake along with the strikes and the blockades of the previous year, has still to recover fully. According to the Hotel Association of Nepal, the bed occupancy rate in the tourist standard hotels is estimated to be around 30 percent in the review period.

4. The anemic growth in remittances is likely to pose downside risk to overall economic activities in general and service industry in particular.

Inflation, Salary and Wage Rate

Consumer Price Inflation



5. The consumer price inflation eased to 8.6 percent in mid-August 2016 from the level of 10.4 percent in mid-July 2016. A year ago consumer inflation was 6.9 percent.

6. The higher rate of increase in prices of sugar and sugar products, pulses and legumes,

vegetable, fruit, miscellaneous goods and services, clothes and footwear, housing and utilities exerted an upward pressure on the overall consumer price inflation in the review period compared to that of last year.

Food and Beverage Group

7. The food inflation rose to 9.3 percent in the review period from 7.3 percent in the corresponding period of the previous year. This is due mainly to the higher prices of sugar and sugar products (19.5%), pulses and legumes (18.7%), vegetable (17.9%), fruit (17.5%) among others.

Non-food and Services Group

8. The non-food inflation rose to 8.1 percent during the review period from 6.6 percent in the corresponding period of the previous year. The rise in non-food inflation was on account of increase in price indices of clothes and footwear (11.2%), housing and utilities (9.7%) among others.

Region-wise Consumer Price Inflation

9. The Hilly region witnessed a relatively higher rate of inflation at 10.9 percent followed by Terai region at 8.5 percent, Mountain region at 7.1 percent percent and the Kathmandu Valley at 7 percent in the review period. In the corresponding period of the previous year, Hilly region, Terai region, Mountain region and the Kathmandu Valley had experienced the inflation rate of 7.3 percent, 5.8 percent, 6.7 percent and 8.4 percent respectively.

Inflation Differential between Nepal and India

10. The y-o-y consumer price inflation was lower at 5.1 percent in India compared to 8.6 percent in Nepal in August 2016 showing inflation wedge of 3.5 percent. Such inflation was 3.7 percent in India and 6.9 percent in Nepal reflecting a narrower inflation differential of 3.2 percent in the corresponding period of the previous year.

Wholesale Price Inflation

11. The y-o-y wholesale price inflation rose to 5.9 percent in the review period from 5.4 percent a year ago. The wholesale price indices of agricultural commodities and domestic manufactured commodities showed a growth of 9.6 percent and 6 percent respectively, whereas such index of imported commodities declined by 2.8 percent in the review period. In the corresponding period of the previous year, the increments in wholesale price indices of agricultural commodities and domestic manufactured commodities were 9.4 percent and 5 percent respectively, whereas the price index of imported commodities had seen a decline of 2.9 percent.

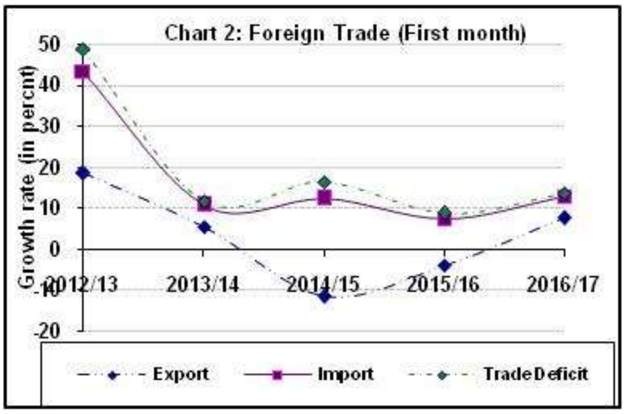
National Salary and Wage Rate

12. The y-o-y salary and wage rate index rose to 14.9 percent in the review period from 6.1 percent in the corresponding period of the previous year. In the review period, the salary index increased by 18.3 percent, while the wage rate index grew by 14 percent. The salary indices of civil service, army and police forces and education sub-groups increased by 24.2 percent, 23.6 percent and 20.7 percent respectively in the review period. Likewise, wage rate indices of construction labourer, agricultural labourer and industrial labourer witnessed a growth of 21.8 percent, 13.9 percent and 11.7 percent respectively in the review period. The hike in pay scale of civil service drove up national salary and wage rate in the review period.

External Sector

Merchandise Trade

13. In the first month of 2016/17, merchandise exports increased 7.7 percent to Rs. 6.96 billion compared to a drop of 3.9 percent in the same period of previous year. In the review period, exports to India, China and other countries increased 0.8 percent, 58.5 percent and 16.1 percent respectively. Commodity wise, exports of jute materials, juice, ayurvedic medicine, rosin, noodles among others increased whereas export of garments, polyester yarn, pulses, G.I. pipes among others decreased in the review period.



14. Merchandise imports increased 13 percent to Rs. 70.72 billion in the review period compared to a growth of 7.2 percent in the same period of the previous year. In review period, imports from India, China and other countries increased 9.5 percent, 10.5 percent and 26.2 percent respectively. Commodity wise, imports of vehicles and spare parts, edible oil, telecommunication equipment and parts, electrical goods, MS billet, among others, increased whereas imports of cold rolled sheet in coil, hot rolled sheet in coil, M.S. wires, rods, coils, bars, crude soybean oil, among others, decreased in the review period.

15. Based on customs points, exports through Tribhuwan International Airport, Dry Port customs office, Nepalgunj customs, Kailali customs and Birgunj customs office increased whereas exports through other customs points decreased. On the import side, imports through Birgunj customs point, Biratnagar customs point and Tribhuwan International Airport decreased whereas imports through other customs points increased in the review period.

16. Total trade deficit in the review period widened 13.6 percent to Rs. 63.76 billion compared to an expansion of 8.7 percent in the same period of the previous year. The export-import ratio fell to 9.8 percent in the review period from 10.3 percent in the corresponding period of the previous year.

Export-Import Price Index

17. The y-o-y unit value export price index based on customs data increased 16.5 percent while import price index decreased 4.5 percent in the first month of 2016/17. Consequently, the TOT index increased 22 percent compared to an increase of 21.8 percent in the corresponding period of the previous year. Increase in price of export items such as carpet, cardamom and Yarsagumba caused the export price index to rise in the review period. Fall in the price of petroleum products, animal feed, edible oil, tyres resulted in a decline in import price index in the review period.

Services

18. The total services receipt declined 1.5 percent and expenses increased 14.8 percent in the review period. As a result, net services receipt deficit increased to Rs. 3.21 billion in the review period from a deficit of Rs. 1.43 billion in the same period of previous year.

Box 1: External Sector (USD)*

(USD Million)

Particulars	2014-15		2015-16		2016-17	Percentage Change in first month	
	1st month	Annual	1st month	Annual	1st month	2015/16	2016/17
Goods Exports FoB	77.6	988.1	71.6	703.9	70.7	-7.8	-1.2
Goods Imports FoB	588.2	7657.6	596.2	7092.5	645.3	1.4	8.2
Trade Balance	-510.6	-6669.5	-524.6	-6388.6	-574.5	2.8	9.5
Total Trade	665.8	8645.6	667.8	7796.3	716.0	0.3	7.2
Current Account Balance	12.8	1067.3	79.5	1338.8	-21.6	-	-
Travel Credit	27.7	536.7	23.6	392.7	33.7	-14.7	42.7
Remittance	434.9	6192.0	520.1	6253.4	484.6	19.6	-6.8
BOP(-Surplus)	-28.6	-1437.0	-46.6	-1779.8	19.8	-	-

** Data from BOP Presentation*

1. In the US dollar terms, total merchandise exports decreased 1.2 percent and imports increased 8.2 percent in the first month of 2016/17. Exports had decreased 7.8 percent whereas imports had increased 1.4 percent in the corresponding period of the previous year.
2. Current account slipped into deficit by USD 21.6 million in the review period. It was in surplus of USD 79.5 million in the corresponding period of previous year. Likewise, Balance of Payments (BOP) slipped into deficit of USD19.8 million in the review period as against the surplus of USD 46.6 million in the corresponding period of previous year.
3. In the review period, travel receipt turnaround of 42.7 percent whereas worker's remittance dipped 6.8 percent. Travel receipt had decreased 14.7 percent and remittances had increased 19.6 percent in the corresponding period of previous year.

19. Under the services account, travel receipt increased 49.4 percent to Rs. 3.62 billion in the review period. Such receipt had decreased 9.9 percent in the same period of previous year.

Workers' Remittances

20. The workers' remittances declined 2.5 percent to Rs. 51.94 billion in the review period compared to a growth of 26.3 percent in the corresponding period of the previous year. Consequently, net transfer receipt decreased 2.5 percent to Rs. 59.79 billion in the review period. Such receipt had increased 29.7 percent in the same period of the previous year.

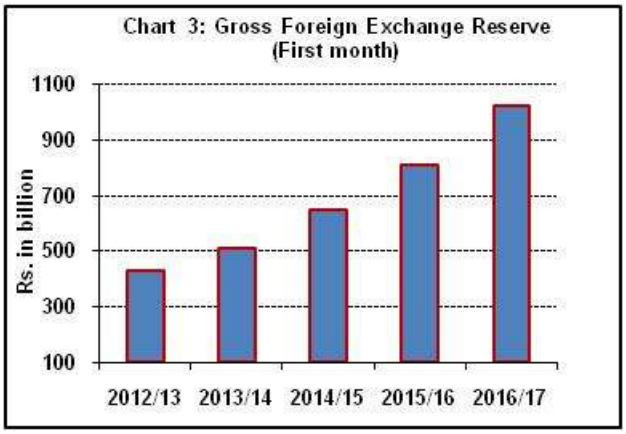
Current Account and BOP Position

21. The current account slipped into a deficit of Rs. 2.32 billion in the review period on account of a decline in remittance and foreign grants from a surplus of Rs. 8.15 billion in the same period of the previous year. Similarly, the overall BOP fell into a negative territory at Rs. 2.13 billion in the review period from a surplus of Rs. 4.77 billion in the same period of the previous year.

22. In the review period, Nepal received capital transfer amounting to Rs. 606 million and Foreign Direct Investment (FDI) inflow of Rs. 1.23 billion. In the same period of the previous year, capital transfer and FDI inflows were Rs. 754.6 million and Rs. 44.3 million respectively.

Foreign Exchange Reserves

23. The gross foreign exchange reserves stood at Rs. 1041.97 billion as at mid-August 2016, an increase of 0.3 percent from Rs. 1039.21 billion in mid-July 2016. Of the total foreign exchange, reserves held by NRB decreased 0.6 percent to Rs. 881.47 billion as at mid-August 2016 from the level of reserves of Rs. 887.01 billion as at mid-July 2016. Similarly, the reserves of banks and financial institutions (except NRB) increased 5.4 percent to Rs. 160.49 billion in the same period. The share of Indian currency in total reserves stood at 22 percent as at mid-August 2016.



Foreign Exchange Adequacy Indicators

24. Based on the imports of the first month of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 15.1 months, and merchandise and services imports of 12.7 months. The ratio of reserve-to-GDP, reserve-to-imports and reserve-to-M2 stood at 46.3 percent, 106 percent and 46.3 percent respectively as at mid-August 2016. Such ratios were 46.2 percent, 117.4 percent and 46.3 percent as at mid-July 2016.

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

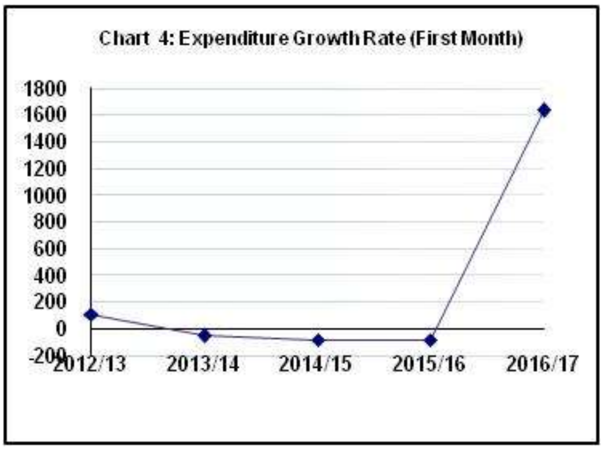
25. The price of oil (Crude Oil Brent) in the international market increased 1 percent to USD 48.27 per barrel in mid-August 2016 from USD 47.77 per barrel a year ago. The price of gold increased 20.1 percent to USD 1344 per ounce in mid-August 2016 from USD 1118.80 per ounce a year ago.

26. Nepalese currency vis-à-vis the US dollar remained nearly stable during mid-July 2016 and mid-August 2016. It had depreciated 2.5 percent in the same period of the previous year. The buying exchange rate per US dollar stood at Rs. 106.72 in mid-August 2016 compared to Rs. 106.73 in mid-July 2016.

Fiscal Situation *

Budget Deficit / Surplus

27. In the first month of 2016/17, the Government of Nepal (GoN) ran a surplus of Rs. 52.04 billion in its budget. Such surplus was Rs. 31.97 billion in the corresponding period of the previous year.



Government Expenditure

28. In the review period, total government expenditure on a cash basis increased to Rs. 2.31 billion. Such expenditure was Rs. 133 million in the corresponding period of the previous year.

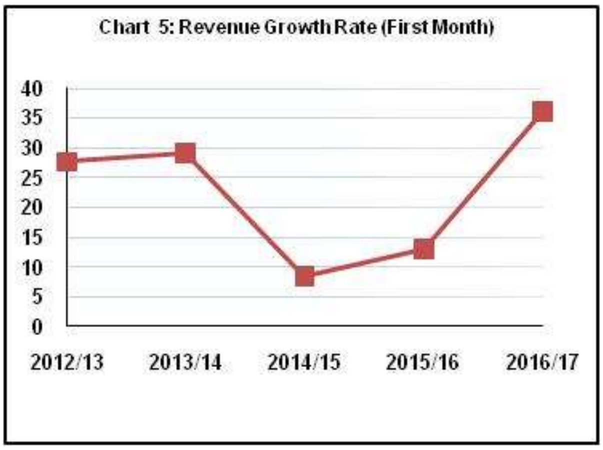
29. In the review period, recurrent expenditures increased to Rs. 2.30 billion. Such expenditures had remained at 111.4 million in the corresponding period of the previous year. In the review period, capital expenditures remained at Rs. 1 million. Such expenditures was Rs. 21.6 million the corresponding period of the previous year.

Box 2: The Budget Performance

Heads	Budget Estimates (Rs. in millions)	Outturns in First month	
		Rs. in million	As percent of budget estimates
Total Expenditure	**1048921.4**	**2305.4**	**0.2**
Recurrent Expenditure	617164.1	2304.4	0.4
Capital Expenditure	311946.3	1.0	0.0
Financial Expenditure	119810.9	0.0	-
Revenue	**565896.5**	**41065.9**	**7.3**

Government Revenue

30. In the review period, the government revenue collection increased 36 percent to Rs. 41.07 billion. Such revenue had risen 12.9 percent in the corresponding period of the previous year. Higher growth rate of value added tax, customs, income tax, excise duty and including others tax heads contributed to the overall rise in revenue collection in the review period.



* Based on the data reported by 8 NRB offices, 69 branches of Rastriya Banijya Bank Limited, 46 out of 49 branches of Nepal Bank limited, 22 out of 24 branches of Agriculture Development Bank limited, 9 branches of Everest Bank Limited, 4 branches of Global IME Bank Limited and, 1 branch each from Nepal Bangladesh Bank limited, NMB Bank Limited, and Bank of Kathmandu Limited conducting government transactions and released report from 79 DTCOs and payment centers.

Cash Balance of the GON

31. Because of a slow pace of government expenditure relative to resource mobilization, the GoN accumulated cash balance of Rs. 184.97 billion at Nepal Rastra Bank as of mid-Aug 2016.

Money Supply

32. Broad money (M2) increased 0.2 percent in the review period as against a decrease of 0.6 percent in the corresponding period of the previous year. On y-o-y basis, M2 expanded 20.5 percent in mid-August 2016.

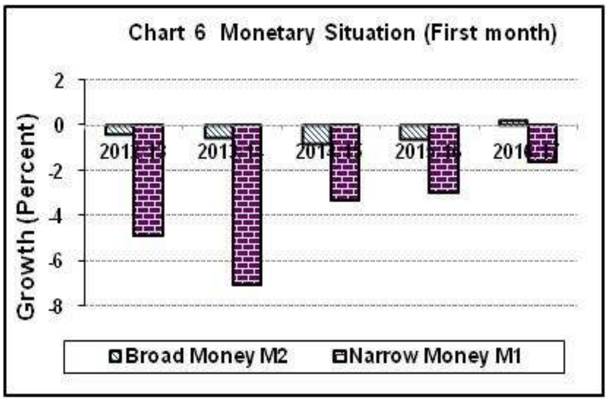


Chart 6 Monetary Situation (First month)

33. The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) decreased Rs. 2.13 billion in the review period compared to an increase of Rs. 4.77 billion in the corresponding period of the previous year. The decline in NFA was due to the rise in import in the review period.

34. Reserve money declined 4.8 percent in the review period compared to a decrease of 16.6 percent in the corresponding period of the previous year. On y-o-y basis, reserve money increased 19.5 percent in mid-August 2016.

Domestic Credit

35. Domestic credit contracted 2.1 percent in the review period compared to a decline of 2.7 percent in the same period of the previous year. On y-o-y basis, domestic credit increased 18.1 percent in mid-August 2016.

36. Claims of monetary sector on the private sector increased 1.1 percent in the review period. On y-o-y basis, claims on the private sector increased 24.5 percent in mid-August 2016.

Deposit Collection

37. Deposits at Banks and Financial Institutions (BFIs), which had declined 0.8 percent in the corresponding period of the previous year, increased 0.1 percent in the review period. Deposits at commercial banks and finance companies increased 0.3 percent and 2.1 percent respectively, while that at development banks decreased 0.3 percent in the review period. On y-o-y basis, deposits at BFIs expanded 20.5 percent in mid-August 2016.

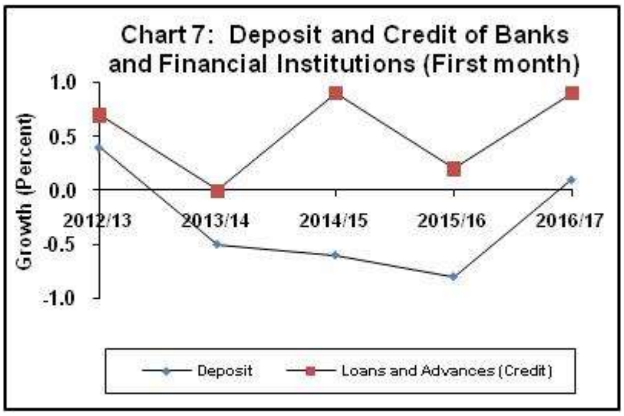


Chart 7: Deposit and Credit of Banks and Financial Institutions (First month)

Credit Disbursement

38. Credit to the private sector from BFIs increased 0.7 percent in the review period compared to a decline of 0.4 percent in the same period of the previous year. In the review period, private sector credit from commercial banks and finance companies increased 0.9 percent and 0.5 percent respectively, while that of development banks decreased 0.6 percent. On y-o-y basis, credit to the private sector from BFIs increased 25.1 percent in mid-August 2016.

39. Credit to the agriculture sector increased 0.6 percent, industrial production sector 0.3 percent, construction 1.4 percent, wholesale and retail trade sector 0.3 percent, service industries sector 1.7 percent and transport, communication and public sector 0.7 percent in the review period.

40. Of the total outstanding credit of BFIs, 60.7 percent is against the collateral of land and building and 15 percent against the collateral of current assets (such as agricultural and non-agricultural products). Such ratios were 59.3 percent and 12.9 percent respectively in the same period of the previous year.

41. The outstanding credit of BFIs to real estate sector amounted to Rs. 253.42 billion (including Rs. 145.88 billion residential home loans less than Rs. 10 million each) in mid-August 2016. This is 15 percent of total credit exposure of BFIs. As at mid-August 2016, the BFIs' total margin lending extended against the collateral of shares stood at 2.2 percent (Rs. 37.28 billion) of their total credit exposure. Of the total lending of commercial banks, the credit to small and medium enterprises was only 2.5 percent (Rs. 35.74 billion) in the review period.

42. Trust Receipt (T.R.) loan extended by commercial banks increased 5.7 percent (Rs. 4.15 billion) in the review period compared to a growth of 0.2 percent in the same period of the previous year.

Liquidity Management

43. In the first month of 2016/17, the NRB mopped up Rs 32.45 billion liquidity, on a turnover basis, through various instruments. These consist of Rs. 5 billion through deposit collection auction and Rs. 27.45 billion through reverse repo auction on a cumulative basis. In the corresponding period of the previous year, Rs. 57.25 billion was mopped up through deposit collection auction, Rs. 13 billion through reverse repo auction and Rs. 5.90 billion through outright sale auction.

44. In the review period, the NRB injected net liquidity of Rs. 23.63 billion through the net purchase of USD 220.8 million from foreign exchange market (commercial banks). Net liquidity of Rs. 34.04 billion was injected through the net purchase of USD 332.5 million in the corresponding period of the previous year.

45. The NRB purchased Indian currency (INR) equivalent to Rs. 36.83 billion through the sale of USD 260 million and Euro 75 million in the review period. INR equivalent to Rs. 32.80 billion was purchased through the sale of USD 320 million in the corresponding period of the previous year.

Refinance and Productive Sector Lending

46. The NRB has been providing refinance facility aimed at expanding credit to the productive sector along with promoting export. In the review period, the use of such facility has decreased. In the review period, a total refinance of Rs. 244.3 million was availed. In the corresponding period of the previous year, a total refinance of Rs. 600 million including general refinance of Rs. 580 million and export refinance of Rs. 20 million was utilized. Moreover, the bank has introduced a provision of refinance facility at zero percent interest rate to the BFIs with an objective of providing concessional housing loan to earthquake victims. Under this scheme, a sum of Rs. 79 million has been extended as of mid-August 2016.

47. There is a policy-provision for commercial banks to disburse 20 percent of their total credit in the productive sector. Such credit of commercial banks stood at 16.52 percent in mid-August 2016.

Inter-bank Transaction and Standing Liquidity Facility

48. In the review period, inter-bank transactions of commercial banks stood at Rs. 74.53 billion and those of other financial institutions (excluding transactions among commercial banks) amounted to Rs. 26.35 billion. Such transactions were Rs. 54.16 billion and Rs. 10.39 billion respectively in the corresponding period of the previous year. The BFIs did not use the standing liquidity facility (SLF) in the review period.

Interest Rates

49. The weighted average 91-day Treasury Bill rate decreased to 0.44 percent in the review month from 0.95 percent a year ago. The weighted average inter-bank transaction rate among commercial banks, which was 0.74 percent a year ago, increased to 0.82 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions increased to 3.16 percent from 3.09 percent a year ago.

50. The weighted average interest rate spread between deposit and lending rate of commercial banks increased to 4.68 percent in the review month from 4.55 percent a year ago. The average base rate of commercial banks came down to 6.10 percent in the review month from 7.18 percent a year ago.

Merger/Acquisition

51. The number of BFIs involved in merger and acquisition has been increasing after the introduction of merger/acquisition policy aimed at strengthening financial stability. As of mid-August 2016, 119 BFIs (including ‘D’ class) were involved in merger and acquisition. Of which, the license of 78 BFIs was revoked thereby forming 41 BFIs.

Capital Market

52. The NEPSE index reached 1,717.5 points in mid-August 2016 from 1,718.2 points in mid-July 2016. The index was 1,157.6 points in mid-August 2015. The stock market has been in a bullish trend as the capital hike plan of BFIs was found to be encouraging by investors, the reforms implemented in stock market as well as confidence among investors regarding the end of political transition.

53. The total turnover of the securities increased significantly by 231.2 percent to Rs. 35.78 billion during the first month of 2016/17. The increased liquidity of stocks due to the dematerialized transactions, the increment in the share trading time from this fiscal year as well as the bullish trend of the NEPSE index were the primary reasons of such upsurge in turnover.