

Current Macroeconomic Situation

(Based on the First Three Months Data of 2007/08)

Monetary Situation

Monetary Aggregate

1. Monetary aggregates registered a higher growth in the first quarter of 2007/08, compared to that of the previous year. Broad money (M2) grew by 5.5 percent in the review period compared to a growth of 3.9 percent in the previous year. Likewise narrow money (M1) and time deposit registered a growth of 4.0 percent and 6.1 percent respectively in the review period compared to a growth of 1.7 percent and 5.0 percent respectively in the previous year.
2. Net Foreign Asset (NFA), after adjusting exchange valuation gain/loss, declined by Rs. 5.88 billion (4.5 percent) in the review period, compared to a growth of Rs. 1.13 billion (0.8 percent) in the previous year. The decline in NFA was on account of widening trade deficit due to fall in exports amidst rising import.
3. Despite a decline in NFA, a substantial rise in net domestic assets (NDA) contributed to monetary expansion in the review period.

Domestic Credit

4. Domestic credit increased by 6.7 percent in the review period compared to a growth of 3.3 percent in the previous year. An increase in both net claim on government and private sector credit contributed to such a rise in domestic credit in the review period. Against a decline by 1.5 percent in the previous year, net claim on government increased by 8.9 percent in the review period. Likewise, claims on private sector increased by 6.4 percent in the review period compared to a rise of 3.9 percent in the previous year. An increase in consumer loans by commercial banks contributed to a rise in the private sector credit.

Net Liquidity Injection through Foreign Exchange Intervention

5. The net US dollar purchase from the commercial banks remained lower than that of the Indian currency (IC) purchase by way of selling US dollar in the review period compared to that of the previous year. Correspondingly, the net liquidity injection by way of foreign exchange intervention remained lower in the review period. For example, the NRB injected net liquidity of Rs 14.03 billion through a net purchase of 217.4 million US dollar from commercial banks by way of foreign exchange intervention in the review period. In the previous year, a net liquidity of Rs 16.9 billion was injected through the net purchase of 227.6 million US dollar from the commercial banks.
6. Indian currency equivalent to Rs 20.58 billion was purchased through the sale of 320 million US dollar in the review period compared to a purchase of Rs 13.32 billion by way of selling 180 million US dollar in the same period last year. The rise in the

purchase of IC was on account of widening trade deficit with India in the review period.

Open Market operations

7. In the first three months of 2007/08, net liquidity of Rs 5.57 billion was absorbed through reverse repo auction. During the same period in the previous year, net liquidity of Rs 8.86 billion was absorbed through a sale auction of Rs 3.27 billion and reverse repo auction of Rs 5.59 billion. A deficit in balance of payments (BOP), and consequently lower level of US dollar purchase compared to that of the previous year and relative to IC purchase compressed the liquidity. As a result, liquidity absorption through the open market operations was lower than that of the previous year.

Inter Bank Transactions

8. Commercial banks' inter bank transactions amounted to Rs 101.87 billion in the review period compared to Rs 48.08 billion last year. In addition to an increase in inter bank transaction, the use of standing liquidity facility (SLF) also increased in the review period. The SLF borrowing by the commercial banks amounted to Rs 13.75 billion in the review period compared to Rs 1.95 billion in the corresponding period of the preceding year. A higher level of credit off take by the private sector resulted in the increase of inter-bank transactions and the use of SLF in the review period.

**Table . 1 : Inter Bank Transactions and Standing Liquidity Facility
(In the first three months)**

Rs in billion

	2006/07	2007/08
Standing liquidity facility	1.95	13.75
Inter bank transaction	48.08	101.87

Short-term Interest Rates

9. The movement of short-term interest rates remained mixed in the review period. For example, weighted average monthly 91-day Treasury bill rate stood at 2.16 percent in mid-October 2007 compared to 2.54 percent a year ago. But, the weighted average monthly inter bank rate remained at 3.35 percent in mid-October 2007 compared to 2.11 percent in mid-October 2006.

Securities market

10. The year on year (y-o-y) NEPSE index increased by 116.2 percent to 861.4 points in mid-October 2007. This index was 398.4 a year ago.
11. The y-o-y market capitalization increased by 163.8 percent to Rs 265.3 billion in mid-October 2007. Market capitalization to GDP ratio increased to 36.9 percent from 15.6 percent a year ago. Of the total market capitalization, bank and financial institutions held the largest share.

12. Total paid up capital of the listed companies stood Rs. 23.22 billion in mid-October 2007, an increase of 14.0 percent over the period of one year. This increase was due to the additional listing of securities.
13. Total number of companies listed at the NEPSE reached 141 in mid-October 2007 compared to 139 a year ago. Of the listed companies, bank and financial institutions were 106 followed by production and processing industries 21, hotels 4, business entities 5, hydro power 3 and other groups 2.
14. Monthly turnover to market capitalization ratio increased to 0.76 percent in mid-October 2007 compared to 0.24 percent a year ago. Although this reflected an increase in liquidity relative to last year, the liquidity of stocks remained much to be desired.
15. The twelve-month rolling standard deviation reflecting a volatility in the stock market stood at 136.3 in mid-October 2007 compared to 38.0 a year ago.
16. Nepal Securities Board (SEBON) granted permission for the issuance of ordinary shares of Rs. 274.4 million to seven companies, and right shares of Rs. 303.5 million to 3 companies in the first three months of 2007/08.
17. A total number of 28 new bank and financial institutions came into operation in the first three months of 2007/08. These included 3 commercial banks, 20 development banks and 5 finance companies (Table 2).

Table 2: Number of Financial Institutions

Bank and financial institutions	Mid-July 2007	Mid-October 2007	Increase
Commercial Banks	20	23	3
Development Banks	38	58	20
Finance Companies	74	79	5
Micro Finance Institutions	12	12	0
NRB Licensed Cooperatives (undertaking limited banking transactions)	17	17	0
NRB Licensed NGOs (undertaking micro finance transactions)	47	47	0
Total	208	236	28

Inflation

Consumer Inflation

18. The (y-o-y) inflation moderated to 6.3 percent in mid-October 2007 from 7.5 percent in the corresponding period of the preceding year. The deceleration was on account of the base-effect of the hike in prices of petroleum products in March 2006 and the appreciation of the Nepalese currency against the US dollar.

19. Group-wise, the index of food and beverages group rose by 9.5 percent compared to a rise of 7.8 percent a year ago. A significant rise in the prices of vegetables and fruits by 17.7 percent, pulses 14.6 percent, oil and ghee 12.8 percent, and grains and cereal products 11.2 percent exerted a pressure on the prices of this group compared to that of the previous year. However, the prices of sugar and sugar-related products declined by 18.4 percent during this period. The index of non-food and services group rose by 2.9 percent compared to a rise of 7.2 percent last year.
20. Region-wise, the price level in Kathmandu Valley, Terai and the Hills rose by 6.1 percent, 6.5 percent and 6.1 percent respectively in the review period. Last year, the respective inflation rates were 6.7 percent, 7.8 percent and 7.8 percent. The impact of frequent general strikes in the Terai region was one of the major reasons for a relatively higher inflation in Terai, compare to other regions.
21. In mid-October, 2007, the y-o-y core inflation decelerated to 4.7 percent from 6.2 percent a year ago

Wholesale Inflation

22. The y-o-y wholesale price inflation slightly declined to 10.3 percent in mid-October 2007 from the level of 10.4 percent a year ago. The moderation in the wholesale price inflation was on account of a decline in the prices of imported commodities. The price of agriculture commodities slightly declined to 14.1 percent from 14.6 percent last year. In this group, the price of fruits and vegetables rose significantly by 41.7 percent, followed by pulses 13.0 percent, cash crops 8.3 percent and food grains 7.4 percent. The wholesale prices of domestic manufactured commodities group rose by 8.0 percent during the review period compared to a growth of 6.7 percent in the previous year. Within this group, the prices of construction material rose by 15.5 percent, food-related products by 5.9 percent and that of beverages and tobacco by 5.4 percent. The upward pressure on prices of this sub-group was on account of the hike in the excise as well as customs duties of cigarettes, liquors, cement and paints by the government through the budget of 2007-08. The wholesale price index of imported commodities moderated to 5.1 percent in the review period from 6.1 percent a year ago. This deceleration was on account of the nominal appreciation of Nepalese rupee against the US dollar.

National Salary and Wage Rate

23. The y-o-y salary and wage rate index rose by 11.9 percent in mid-October 2007 compared to a rise of 8.0 percent a year ago. Such an increase in this index was mainly due to net increment in the salaries of civil servants by 17 percent, including security personnel, teachers and employees of public enterprises from mid-July 2007. The rise in the wages of laborers in the recent months also exerted an upward pressure on this index. In the review period, both salary and wage rate indices rose by 10.9 percent and 12.4 percent respectively compared to the respective increase of 6.6 percent and 8.4 percent. Within the wage rate index, the index of industrial labor increased by a higher rate of 19.5 percent, followed by 10.3 percent of construction laborers and 8.3 percent of agriculture laborers.

Fiscal Situation

Budget Deficit / Surplus

24. The government budget showed a deficit at the significant level of Rs.9.40 billion in the first three months of 2007/08 as against the surplus of Rs.352.9 million in the corresponding period of the previous year. A whopping rise in government expenditure on the one hand and the significant deceleration in the growth of non-debt resources on the other resulted in a budget deficit at a significant level in the review period. Of the total budget deficit, the total gross borrowing amounted to Rs. 8.56 billion in the review period as against the internal budget balance of Rs. 97.0 million in the corresponding period of the previous year. Of the total gross domestic borrowing, the fresh issuance of treasury bills amounted to Rs. 1.88 billion. In the corresponding period of the previous year, fresh issuance of treasury bills did not take place. Total overdraft borrowing amounted to Rs. 6.73 billion in the review period as against the government cash balance of Rs. 988 million in the previous year. However, the government overdraft borrowing net of the cash balance of the last fiscal year stood at Rs. 3.56 billion as at mid-October 2007. The foreign debt financing of budget deficit amounted to Rs. 846 million in the review period compared to Rs. 617 million last year.

Government Expenditure

25. In the first three months of 2007/08, total government spending increased significantly by 53.7 percent to Rs.30.03 billion. The government expenditure had increased by 17.7 percent in the corresponding period of the previous year. The upsurge in total government expenditure was on account of substantial increase in all forms of government expenditure including principal repayment.
26. In the first three months of 2007/08, recurrent expenditure rose by 35.6 percent to Rs.21.32 billion compared to an increase of 28.5 percent in the corresponding period of the previous year. The high growth of recurrent expenditure was on account of increased expenditure on relief-related activities, the salary-hike of government employees, a rise in peace related expenditure and additional expenditure relating to the preparation for the election of constituent assembly.
27. In the review period, capital expenditure increased to Rs.2.84 billion compared to that of Rs.1.29 billion in the same period last year. The loan of Rs.500 million to Nepal Oil Corporation and disbursement of funds to Poverty Alleviation Fund and local authorities contributed to a significant rise in capital expenditure in the review period.
28. In the review period, expenditure on principal repayments increased to Rs.3.49 billion compared to that of Rs.417.5 million in the corresponding period of the previous year. The principal repayment of Rs.2 billion of domestic debt and Rs.1.49 billion of the external debt accounted for such a high growth of the total principal repayments in the review period.

Government Revenue and Foreign Cash Grants

29. In the first three months of 2007/08, revenue mobilization of the Government of Nepal (GON) grew by 18.8 percent to Rs.19.26 billion compared to a higher growth of 26.7 percent in the corresponding period of the previous year. The low growth of revenue was on account of frequent bandhs and strikes in Terai, problems in revenue collection in bordering customs offices and closure of some customs offices. Furthermore, low growth of value added tax and income tax also accounted for the deceleration in the growth of revenue in the review period.
30. In the first three months of 2007/08, the GON received foreign cash grants of Rs.1.17 billion. The GON had received foreign cash grants of Rs.2.31 billion in the corresponding period of the previous year.

External Sector Situation

Foreign Trade

31. In the first three months of 2007/08, exports declined by 0.6 percent compared to a decrease of 0.3 percent in the corresponding period of the previous year. Of the total exports, export to India decreased by 0.2 percent in 2007//08 compared to a decrease of 3.8 percent in the same period of 2006/07. Exports to other countries declined by 1.2 percent in contrast to a rise of 7.1 percent in the comparable period of the previous year.
32. Total imports increased by 8.1 percent in the first three months of 2007/08 compared to a slightly higher increase of 9.9 percent in the corresponding period of the previous year. While imports from India went up by 7.2 percent in the review period compared to a growth of 13.1 percent in the corresponding period of 2006/07, imports from other countries rose by 9.5 percent compared to a growth of just 4.9 percent in the previous year.

Balance of Payments

33. The overall balance of payments (BOP) recorded a deficit of Rs. 5.88 billion in the first three months of 2007/08. In the corresponding period of the previous year, the BOP surplus had amounted to Rs. 1.13 billion

Foreign Exchange Reserves

34. The gross foreign exchange reserves stood at Rs. 158.08 billion in mid-October 2007, a decline by 4.3 percent from the level of Rs 165.11 billion in mid-July 2007. Such reserves had declined by 0.2 percent in the corresponding period of the preceding year. In terms of US dollar, gross foreign exchange reserves declined by 1.8 percent to US\$ 2.50 billion in mid-October 2007. In the same period of the previous year, such reserves had gone up by 1.9 percent. Based on the import figures of the first three months, the current level of reserves is sufficient for financing merchandise imports of 9.6 months and merchandise and service imports of 7.5 months.

Price of Oil and Gold in the International Market

35. The price of oil (Crude Oil Brent) in the international market increased by 43.8 percent to US\$ 84.14 per barrel in mid-October 2007 from US\$ 58.50 per barrel in mid- October 2006. Likewise, the price of gold rose by 28.1 percent to US\$ 762.50 per ounce in mid-October 2007 from US\$ 595.10 a year earlier.

36. In comparison to mid-July 2007, the Nepalese currency appreciated by 2.61 percent vis-à-vis the US dollar in mid-October 2007. It had appreciated by 2.08 percent in the corresponding period of the previous year. The exchange rate of one US dollar remained at Rs. 63.20 in mid-October 2007 compared to Rs. 72.59 in mid-October 2006.