Current Macroeconomic Situation of Nepal

(*During the First Five Months of FY 2004/05*)

Nepal Rastra Bank

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Major Highlights

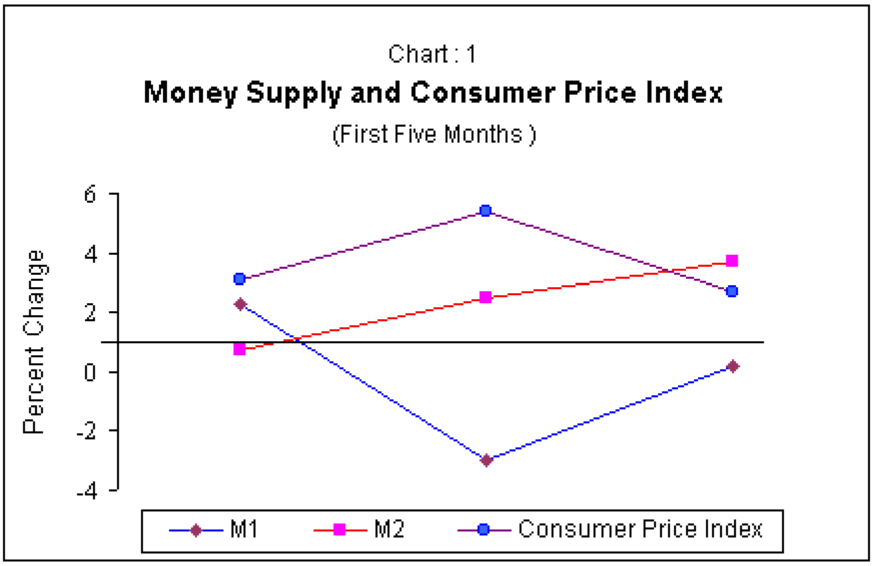
- Both broad money and narrow money accelerated.
- Time deposits continued to grow.
- Deceleration in the net claims on government slowed.
- Weighted average treasury bills rates declined.
- Stock exchange transactions as well as the NEPSE index increased.
- Inflation decelerated.
- Government expenditure, on cash basis, increased.
- Resources mobilization increased much faster than the expenditure, resulting in the substantial decline in the budget deficit.
- Exports accelerated as against the decline in imports, resulting in the contraction in the trade deficit.
- Balance of payments (BOP) recorded surplus.
- Gross foreign exchange reserve increased to Rs.128.2 billion, enough to cover merchandise imports of 12.1 months and merchandise and service imports of 10.5 months.

Current Macroeconomic Situation of Nepal

(*During the First Five Months of FY 2004/05)*

Monetary Situation

1. During the first five months of FY 2004/05, compared to the same period last year, broad money (M_2) increased by 3.7 percent to Rs. 287.5 billion. Broad money had risen by 2.5 percent last year. Narrow money (M_1), went up by 0.2 percent to Rs. 94.2 billion as against a decline of 3.0 percent last year. The increase in monetary aggregares was attributed to the rise in both net domestic assets (NDA) and net foreign assets (NFA). Time deposits went up by 5.4 percent to Rs. 193.3 billion in comparison to the rise of 5.3 percent last year. The broad money liquidity ($M_3 = M_2$ and foreign currency deposits) increased by 3.4 percent to Rs. 308.8 billion compared to an increase of 2.7 percent last year.
2. The NFA of the banking sector (adjusting the foreign exchange valuation) increased by 1.1 percent to Rs. 106.1 billion as against a decline of 0.1 percent last year. An increase in exports, the loan assistance provided by the World Bank for the voluntary retirement scheme (VRS) in Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL) and negetive growth of imports were the main causes behind the increment of NFA.
3. Domestic credit of the banking sector increased by 4.3 percent to Rs. 261.8 billion compared to the 2.3 percent increase last year. Although the banking sectos's claims on financial institutions and net claims on government declined, the growth on the claims on private sector as well as that on the non-financial government institutions led to such a rise in the domestic credit. The claims on non-financial government institutions went up by 39.2 percent to Rs. 4.1 billion this year due mainly to the increase in the credit flow to the Nepal Oil Corporation (NOC) from the commercial banks. Such claims had declined by 3.3 percent last year. The claims on financial institutions declined by 4.2 percent to Rs. 12.8 billion compared to an increase of 10.4 percent last year. The claims on financial institutions declined due mainly to the refinance repayment to NRB by Rural Development Banks and Development Banks. The net claims on government declined by 2.8 percent to Rs. 60.6 billion compared to a decline of 3.7 percent last year. Such claims declined due mainly to the rise in the government deposits with NRB. The claims on private sector increased by 6.9 percent to Rs. 184.3 billion compared to the 4.3 percent increase last year. Increased consumption loans, housing loans, vehicle loans as well as private construction activities in major urban areas led to such a rise.



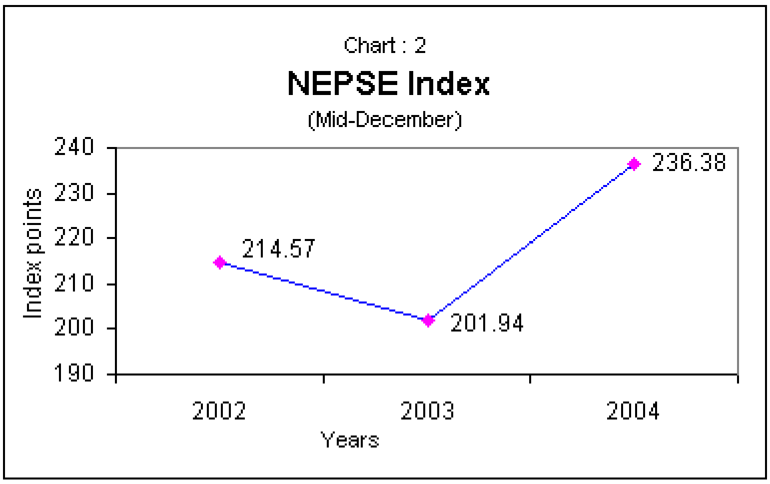
4. Net non-monetary liabilities (adjusting the foreign exchange valuation) increased by 2.0 percent to Rs. 80.4 billion, compared to the decline of 1.2 percent last year. The NDA (adjusting the foreign exchange valuation) increased by 5.3 percent to Rs. 181.4 billion compared to an increase of 4.0 percent last year. The expansion in domestic credit accounted for a relatively higher NDA growth this year.

5. NRB mopped up Rs. 9.6 billion liquidity by sale auction and injected Rs. 0.5 billion liquidity by purchase auction. NRB released Rs. 2.7 billion liquidity by repo auction and mopped up Rs.1.5 billion liquidity by reverse repo auction. Standing Liquidity Facility (SLF) of Rs. 22.3 billion was provided to commercial banks. In the secondary market, liquidity amounting to Rs. 11.1 billion was mopped up and Rs. 25.1 billion was released. Consequently, net injection of liquidity remained at Rs.14.0 billion. Injection of liquidity, among others, drove down the short-term interest rates. For instance, the 91-day waited average Treasury bills rate declined to 2.4 percent in mid-December 2004 from 3.9 percent in mid-December 2003. The inter-bank interest rate declined to 3.5 percent in mid-December 2004 from 4.1 percent in mid-December 2003.

Share Market Transactions

6. Total share transactions in terms of both value and number increased significantly during the month ending in mid-December 2004 compared to the same month last year. Among the other share market indicators, the share price, number of companies listed and market capitalization increased. The secondary market transactions of the commercial banks and finance companies increased. The total amount of listed shares increased by 2.9 percent to Rs 13.2 billion due to new listing and issue of bonus shares of some banks and insurance companies in the review month compared to the same month last year. The market capitalization of the listed companies rose by 27.8 percent to Rs 46.5 billion compared to that of last year. The NEPSE index increased by 34.4 index points (17.1 percent), from 201.9 in mid-December 2003 to 236.4 in mid-December 2004. The number of companies listed increased to 118 in mid-December 2004 from 109 in mid-December 2003. Similarly, the number of companies traded increased to 75 from 61 last year.

7. In the review month, the value of share transactions increased to Rs 156.4 million as 596 thousand shares were exchanged through 10,830 transactions. In the same month last year, the total value of share transaction was Rs 59.4 million when 211 thousand shares were exchanged through 5182 transactions. Thus, the total transactions in terms of value and number of shares increased by 2.6 times and 2.8 times respectively in the review month compared to the same period last year.



8. Of the total exchanged value in the review month, the share components were: commercial banks (85.3 percent), finance companies (11.2 percent), insurance companies (2.2 percent), development banks (0.8 percent), manufacturing and processing companies (0.2) percent) and hotels groups (0.1 percent) as compared to the componants in the same period last year, which

were: commercial banks (73.3 percent), finance companies (12.7 percent), insurance companies (7.6 percent), trading companies (3.8 percent), hotels group (0.6 percent) and development banks (0.5 percent)

Price Situation

9 The National Urban Consumer Price Index depicted a rise of 3.1 percent as at mid-December 2004 compared to an increase of 4.9 percent during the same period last year. The slow growth in the price index is mainly attributable to the decline in the prices of oil and ghee, milk and milk products as well as footwear in spite of the sharp rise in the price of sugar and related products. The overall price index, which was recorded at 154.2 in mid-December 2003, rose to 159.0 in mid-December 2004.The average overall price index increased by 2.7 percent compared to the rise of 5.4 percent last year.

10 On point-to-point basis, the prices of food and beverages group moved up by 3.0 percent compared to an increase of 3.9 percent last year. The prices of sugar and related products shot up by 30.5 percent. Prices that rose were those of meat, fish and eggs (7.3 percent), pulses (6.7 percent), vegetables and fruits (2.8 percent), spices (2.7 percent), restaurant meals (2.6 percent), grains and cereal products (2.1 percent) and beverages (0.2 percent. However, the prices that declined were those of oil and ghee (1.5 percent) and milk and milk products (0.2 percent).

11 The prices of non-food and services group increased by 3.2 percent compared to an increase of 6.0 percent last year. The prices that increased were those of housing goods and services (5.7 percent), education, reading and recreation (4.0 percent), medical and personal care (2.3 percent), cloth, clothing and sewing services (1.9 percent), tobacco and related products (1.3 percent) as well as transport and communication (0.1 percent) while that of the footwear declined by 0.4 percent.

12 Regionwise, the prices in the Kathmandu Valley, Terai and Hills increased by 4.6 percent, 2.6 percent and 2.3 percent respectively. Such prices had increased by a relatively higher pace at 6.4 percent, 4.2 percent and 4.6 percent respectively last year. The prices of food and beverages group rose in Kathmandu Valley, Terai and Hills by 5.1 percent, 2.3 percent and 2.0 percent respectively. Similarly, the prices of non-food and services group increased in Kathmandu Valley, Terai and Hills by 4.1 percent, 2.9 percent and 2.5 percent respectively.

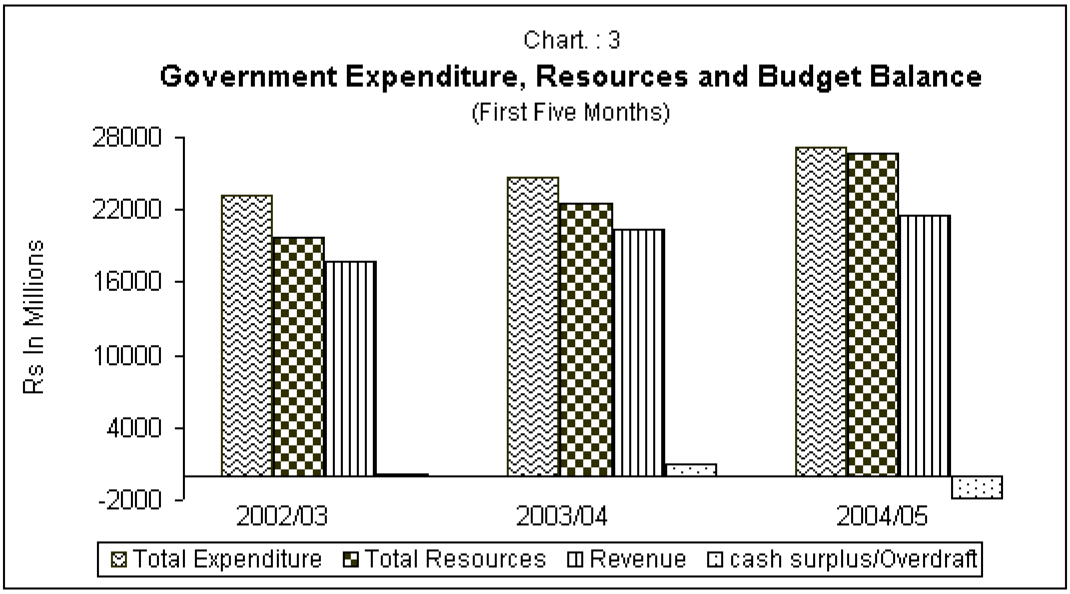
13 The National Wholesale Price Index, on point-to-point basis, increased by 4.4 percent compared to an increase of 5.9 percent last year. This slow growth in the prices was mainly attributable to the sharp decline in the prices of fruits and vegetables, in spite of the rise in the prices of construction materials, cash crops, petroleum products and coal as well as transport vehicles and machinery goods. The prices for imported commodities, domestic manufactured commodities and agricultural commodities increased by 8.1 percent, 7.6 percent and 0.8 percent respectively. The average National Wholesale Price Index increased by 5.6 percent compared to the rise of 4.0 percent last year.

Government Budgetary Operation

14. In the absence of previous fiscal year's data according to the new expenditure classification into recurrent, capital and principal repayment, only the current year's data have been presented. Based on the cash flow data, the total expenditure of the government increased by 9.9 percent to Rs. 27.1 billion compared to the rise of 6.2 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 19.9 billion (73.4 percent), capital expenditure at Rs.2.1 billion (7.9 percent) and principal repayment Rs. 3.7 billion (13.6 percent). Freeze account recorded Rs. 1.4 billion (5.1 percent).

15. Total non-debt resources (revenue, non-budgetary receipts and others, and foreign grants) increased by 18.0 percent to Rs. 26.7 billion compared to the rise of 14.8 percent last year. Revenue, the major source (80.8 percent) of the government resources, grew at a lower rate of

5.9 percent to Rs. 21.5 billion compared to the rise of 15.3 percent last year. Foreign grants increased to Rs. 3.5 billion as against Rs. 1.1 billion received last year.



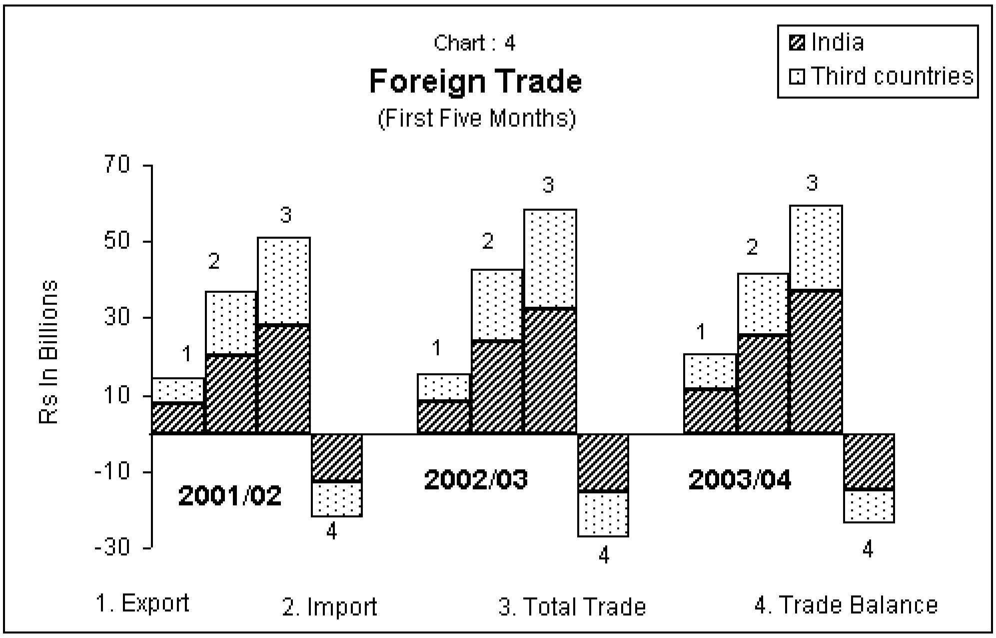
16. Due to the higher growth in non-debt resources compared to the total expenditure, the budget deficit shrunk substantially by 77.9 percent to Rs.461.8 million, to bridge which HMG mobilized Rs. 937.4 million through foreign cash loans and borrowed Rs.1.3 billion through internal loans. HMG's cash transactions in mid-December 2004 resulted in a surplus of Rs. 1.8 billion compared to the overdraft of Rs. 937.6 million used in mid-December 2003.

17. Due mainly to the rise in non-debt resources compared to the government expenditure, the total net outstanding domestic debt of HMG declined to Rs. 83.7 billion in mid-December 2004 from its level of Rs. 85.4 billion in mid-July 2004, as reflected in the Treasury position of Rs. 2.6 billion surplus in mid-December 2004 compared to the surplus of Rs. 753 million in mid-July 2004.

Foreign Trade

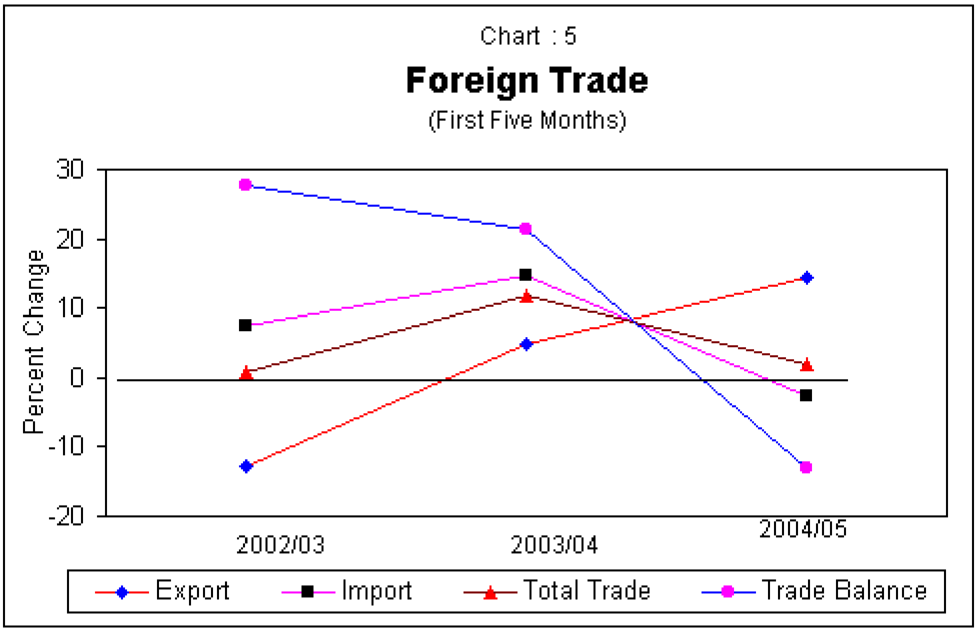
18. Total exports went up by 14.4 percent to Rs. 23.4 billion compared to the rise of 5.0 percent last year. Exports to India widened by 31.6 percent to Rs. 15.0 billion compared to the rise of 10.9 percent last year. Exports to other countries declined by 7.4 percent to Rs. 8.4 billion. Among the major exportable commodities, the exportsto India of pulses, cardamom, vegetable ghee, tea, polyester yarn, jute goods, aluminium section, copper wire and rod, chemicals, juice, cattle feed, footwear, textiles, catechu, rosin, buckwheat increased. The exports to India of toothpaste, ginger, ricebran oil, G.I. pipe, M.S. pipe and readymade garments declined. The exports to other countries of woollen carpets, pashmina, jewellery and cardamom went up while that of pulses, tea, tanned skin Nepali paper and paper products and readymade garments declined.

19. Total imports declined by 2.7 percent to Rs. 52.9 billion as against the rise of 14.7 percent last year. Imports from India increased by 9.0 percent compared to the rise of 15.4 percent last year. However, imports from other countries fell by 17.6 percent as against the growth of 13.7 percent last year. Imports of pulses, fruits and vegetables, thread, chemicals, transport vehicles and parts, chemical fertilizers, petroleum products, medicine cold-rolled sheet and plastic granules from India and that of edible oil, betle nut, clove, television, telecommunication equipment and parts, transport vehicles and parts, other machinery and parts, steel wire, crude coconut oil, copper wire and sheets from other countries augmented. However, the imports of wheat, rice, common salt, hot-rolled sheet, M.S. billet and cement from India and that of thread, crude soybean oil, crude palm oil, plastic granules, aircraft equipment, electrical goods and textiles from other countries declined.



20. The higher growth of exports as against the decline in imports led to a decline in the trade deficit by 13.0 percent to Rs. 29.5 billion. The trade deficit had increased by 21.4 percent last year. Trade deficit with India, which had recorded a rise of 18.3 percent last year, declined by 4.6 percent. Trade deficit with other countries narrowed down by 23.7 percent in contrast to the rise of 25.6 percent last year. Total trade, which had risen by 11.8 percent last year, grew by just 2.0 percent. Because of the increase in import from, and export to, India and their declines with respect to other countries, the share of India in total trade went up to 63.1 percent from 55.9 percent last year, with the share of other countries in total trade decling to 36.9 percent from 44.1 percent last year.

21. The overall export/import ratio, which was 37.6 percent last year, rose to 44.2 percent this year primarily due to the rise in exports and the fall in imports. The export/import ratios for India and other countries stood at 45.3 percent and 42.3 percent respectively compared to the respective ratios at 37.5 percent and 37.7 percent last year.



Balance of Payments

22. According to the BOP statistics for the first four months of FY 2004/05, trade deficit went down by 14.2 percent to Rs. 22.3 billion because of the decline in imports and the growth in exports. Trade deficit had expanded by 24.2 percent last year. On the services front, receipts from government service increased by 32.5 percent to Rs. 2.2 billion. While travel receipts declined by 17.4 percent to Rs. 3.7 billion, other receipts fell by 10.0 percent to Rs. 2.2 billion. As a result, service receipts declined by 5.6 percent in contrast to the rise of 16.1 percent last year. Similarly, on the payments side, because of the increase in travel expenses by 25.6 percent and the decline in transportation expenses and other expenses by 8.6 percent and 2.8 percent respectively, total expenses rose by 2.6 percent to Rs. 6.9 billion

23. Income receipts (credit) and the income payments (debit) increased by 31.0 percent to Rs. 1.1 million and 19.3 percent to Rs. 1.8 billion respectively. As a result, the total deficit under goods, services and income decreased by 12.1 percent to Rs. 21.7 billion as against a rise of 24.0 percent last year.

24. Under transfer receipts, foreign grants declined by 15.1 percent to Rs. 6.1 billion in contrast to a surge of 57.8 percent last year. The workers' remittances declined by 17.6 percent to Rs. 19.2 billion compared to the rise of 11.0 percent last year. Pension receipts increased by 94.9 percent to Rs.3.9 billion. Similarly, the other transfer receipts (Indian excise refund) increased by 25.5 percent to Rs. 674.1 million. At the same time, the transfer payments increased by 35.7 percent to Rs.1.1 billion compared to the decline of 43.1 percent last year.

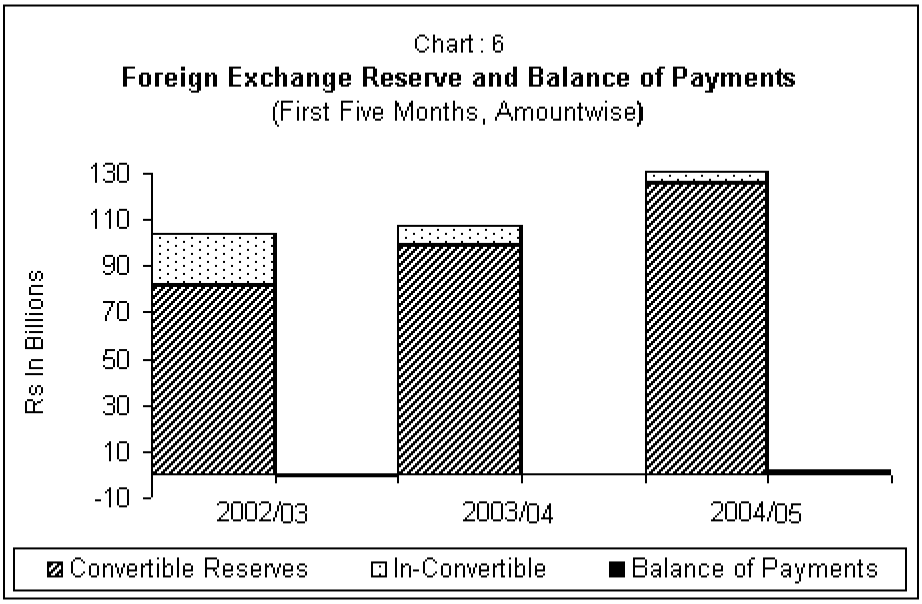
25. During the first four months of FY 2004/05, the current account recorded a surplus of Rs. 7.1 billion compared to the surplus of Rs.7.5 billion last year. Capital transfer stood at Rs. 471.9 million in comparison to the level of Rs. 718.6 million last year.

26. Under the financial account, other investment assets reached Rs. 8.5 billion compared to Rs. 17.7 billion last year. Of this amount, Rs. 1.3 billion was on account of trade credits. Compared to Rs. 7.3 billion last year. Other investment liabilities were negative by Rs. 1.8 billion, of which Rs. 672.7 million was on account of trade credits. The government received Rs. 820.5 million in loans and repaid Rs. 2.3 billion in amortization. As a result, the net government borrowing was Rs. 1.4 billion negative. Currency and deposit liabilities went up by Rs. 364.0 million. Consequently, the financial account was negative by Rs. 10.3 billion. As a result of the surplus in the current account and the inflow of miscellaneous capital, the BOP posted a surplus of Rs. 1.9 billion in comparison to a deficit of Rs. 585.0 million last year. Based on the monetary statistics, a BOP surplus of Rs. 1.2 billion was recorded in mid-December 2004 in contrast to the deficit of Rs. 105.2 million in mid-December 2003.

Foreign Exchange Reserve

27. The gross foreign exchange reserve rose by 16.0 percent to Rs.128.2 billion in mid-December 2004 compared to an increase of 5.7 percent to Rs. 110.5 billion in mid-December 2003. In US dollar terms, total reserves increased by 2.1 percent in mid-December 2004 from mid-July 2004 level. The decline in reserve level (in NC terms) to Rs. 128.2 billion in mid-December 2004 from Rs. 130.2 billion in mid-July 2004 was due to the nominal appreciation of NC vis-à-vis US dollar, from Rs. 73.14 in mid-July 2004 to Rs. 71.49 in mid-December 2004. The decline in imports from other countries and the rise in remittances through the banking mechansim were the factors responsible for the 21.1 percent growth in the convertible reserve. Inconvertible reserve, however, fell by 54.9 percent due to the decline in both remittances and net services income from India. Last year, the convertible reserve had increased by 27.2 percent while the inconvertible reserve had declined by 68.4 percent. The share of convertible reserve in the total reserve rose to 97.4 percent in mid-December 2004 from 93.3 percent in mid-December 2003, resulting in the corresponding fall in the share of non-convertible reserve to 2.6 percent from

6.7 percent. Sufficient to finance merchandise imports of 12.1 months and merchandise and service imports of 10.5 months, the current reserve position is at a comfortable level.



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