Current Macroeconomic Situation

(*Based on Data of the First Ten Months of FY 2004/05*)

Nepal Rastra Bank

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Monetary Situation

1. **Monetary Aggregates:-** During the first ten months of FY 2004/05, the growth rate of broad money (M_2) declined while the growth rate of narrow money (M_1) increased compared to the same period last year. M_2 expanded by 6.6 percent to amount Rs. 295.7 billion this year, while its growth rate was higher (8.4 percent) last year. Lower growth in net foreign assets is mainly responsible for such a deceleration in M_2. M_1 increased at a rate of 5.9 percent to Rs. 99.5 billion this year compared to a growth of 4.9 percent last year. Low growth in time deposits contributed to such an acceleration in M_1. Time deposits increased at a lower rate of 7.1 percent to Rs. 196.3 billion compared to an increase of 10.2 percent last year. Lower level of foreign exchange inflows and declining rate of real interest are mainly responsible for such a deceleration in time deposits.

Factors Affecting Monetary Aggregate:

2. **Reserve Money:-** Reserve money (RM) in contrast to an increase of 9.6 percent during first ten months of last year, declined by 2.1 percent to Rs. 92.4 billion during the same period this year. This decline was attributed to the decline in commercial banks' balance with NRB and sharp deceleration in net foreign assets (NFA) of NRB.

3. **Money Multiplier:-** Both money multipliers (M_1 and M_2) showed an upward trend this year. M_1 multiplier went up to 1.076 this year from 0.990 last year. Similarly, M_2 multiplier rose to 3.200 this year from 3.004 last year. Increase in private sector credit and resulting reduction in excess reserves of commercial banks contributed to a rise in both money multipliers.

4. **Net Foreign Assets:-** Net Foreign Assets of the monetary sector (after adjusting the foreign exchange valuation gain/loss) increased by 5.1 percent to Rs.108.6 billion this year compared to much higher increase of 15.0 percent last year. The decline in foreign loans and low growth of foreign grants were mainly responsible for such a deceleration in NFA this year.

5. **Net Claims on Government:-** Monetary sector's net claims on government declined by 2.7 percent to Rs. 60.6 billion this year compared to the decline of 11.2 percent last year. The cash balance maintained by the government with NRB contributed to the decline in such claims.

6. **Claims on Government Enterprises:-** Monetary sector's claims on non-financial government enterprises increased at a higher rate of 72.7 percent to Rs.5.0 billion this year compared to an increase of 11.3 percent last year. Increase in credit flow to the

Nepal Oil Corporation, Royal Nepal Airlines Corporation and National Trading Limited from the commercial banks contributed to the increase in such claims. However, monetary sector's claims on financial institutions declined by 6.3 percent to Rs.12.5 billion this year in contrast to an increase of 11.1 percent last year, due mainly to the decline in the cash balance maintained by the branches of Agriculture Development Bank performing commercial banking transactions with their head office.

7. **Claims on Private Sector:-** Monetary sector's claims on private sector increased by 14.4 percent to Rs.197.3 billion this year compared to the increase of 11.3 percent last year. Expansion of private sector credit by the commercial banks such as Rastriya Banijya Bank, Nepal Arab Bank Ltd., Standard Chartered Bank Nepal Ltd., Nepal Industrial and Commercial Bank Ltd, Nepal Bank Ltd. and Himalayan Bank Ltd. contributed to this increase.

8. **Domestic Credit:-** Although net claims on government and claims on financial institutions declined, total domestic credit increased by 9.7 percent to Rs 275.5 billion mainly due to the increase in the claims on non-financial institutions and claims on private sectors. Last year such credit had increased by 5.1 percent. The share of government in total domestic credit declined to 22.0 percent this year from 23.2 percent last year.

9. **Net Non-monetary Liabilities and Net Domestic Assets:-** Net non-monetary liabilities (after adjusting the foreign exchange valuation gain/loss) increased by 14.0 percent to Rs. 88.4 billion this year compared to a rise of 6.3 percent last year due mainly to an increase in loan loss provisioning by Rastriya Banijya Bank, Himalayan Bank Ltd. and Nepal Bangladesh Bank Ltd. and rise in paid up capital by Nepal SBI Bank Ltd., Everest Bank Ltd., Nepal Credit and commerce Bank Ltd., Himalayan Bank Ltd., Lumbini Bank Ltd., Laxmi Bank Ltd. and Nepal Bangladesh Bank Ltd. The NDA increased by 7.6 percent to Rs.187.1 billion this year compared to an increase of 4.5 percent last year. Higher growth in total domestic credit accounted for such an acceleration in NDA.

Implementation of Monetary Policy Instruments

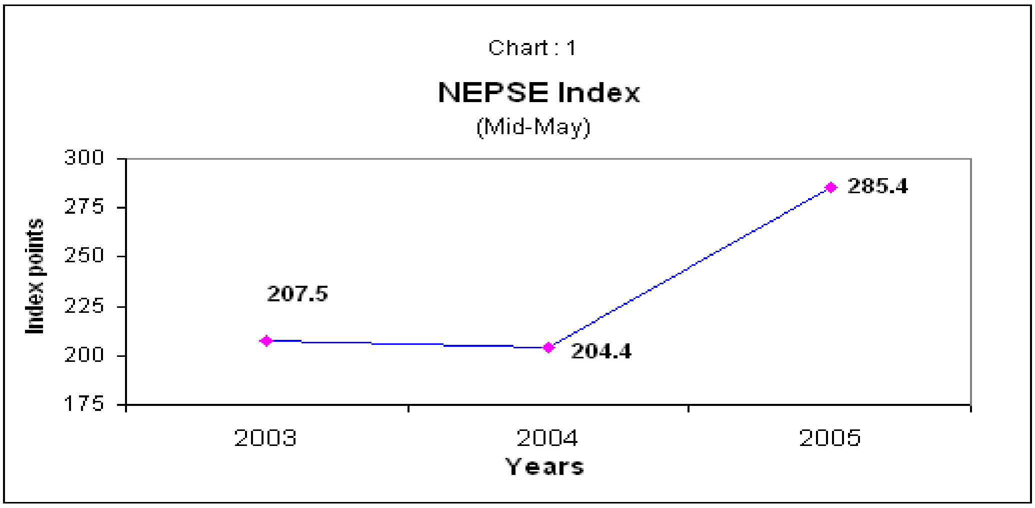
10. During the first ten months of the current fiscal year, NRB mopped up Rs. 10.5 billion liquidity by sale auction and injected Rs. 1.3 billion by purchase auction. NRB released liquidity of Rs. 6.4 billion through repo auction and mopped up liquidity amounting to Rs. 5.3 billion through reverse repo auction. Thus, liquidity amounting to Rs. 15.8 billion was mopped up and that of Rs. 7.7 billion was released resulting in a net withdrawal of liquidity amounting to Rs. 8.1 billion through money market operations. NRB also provided standing liquidity facility amounting to Rs. 45.2 billion in cumulative terms to the commercial banks.

11. NRB intervened in the foreign exchange market by purchasing US $ equivalent of Rs.31.7 billion and by selling Rs.3.6 billion, injecting net liquidity of Rs.28.1 billion this year.

12. However, during the ten months of the current fiscal year, expansion in bank credit to private sector brought down the excess reserves of commercial banks. As a result, 91 days weighted (average treasury bills rate) increased to 3.7 percent in mid May 2005 from 0.6 percent in mid August 2004.

Share Market Transactions

13. Total share transactions in terms of both value and number declined substantially during mid-May 2005 compared to the same month last year. However, among the other share market indicators, the share price, the number of companies listed and the market capitalization increased simultaneously. The secondary market transaction of all the groups of companies has decreased except Insurance and Trading companies. The total amount of listed shares increased by 40.1 percent to Rs 16.8 billion due to new listing and issue of bonus shares by some Banks, Finance Companies and Insurance Companies in the review month. The market capitalization of the listed companies rose by 61.3 percent to Rs 61.1 billion compared to that of last year. The NEPSE index increased by 81.1 index points (39.7 percent), from 204.35 in mid-May 2004 to 285.42 in mid-May 2005. The number of companies listed increased to 124 in mid-May 2005 from 114 in mid-May 2004. Similarly, the number of companies traded increased to 83 from 71 last year.
14. In the review month, the value of share transactions declined to Rs. 233.5 million as 644 thousand shares exchanged through 7718 transactions. The total value of share transaction was Rs 1.3 billion when 2862 thousand shares were traded through 7794 transactions in the same month last year. Thus, the total transactions in terms of value and number of shares declined substantially by 81.7 percent and 77.5 percent respectively in the review month compared to the same period last year. The substantial decline in the transaction in terms of number of shares and the value is mainly due to the share transfer of the manufacturing and processing group company namely the Coca Cola Company of South Africa in the same month last year. The number of share was 19,13,296 and the amount of share was Rs. 1.0 billion. Of the total exchanged value in the review month, the sectoral contribution of Commercial Banks (86.7 percent), Insurance Companies (6.4 percent) and Finance Companies (4.9 percent) was significant while Manufacturing and Processing Companies (80.3 percent) and Commercial Banks (16.1 percent) played important role last year.



Price Situation

15. During the mid-May 2005, the National Urban Consumer Price Index (CPI), on a point-to-point basis, increased by 6.4 percent compared to an increase of 1.3 percent during the same period last year. The sharp rise in the rate of price of grains and cereal products as a result of price rise of rice and rice products along with the increase in the prices of housing goods and services, transport and communication, and restaurant meals resulting from the upward revision in the prices of petroleum products since February 2005

attributed to this rise. The overall price index rose from 154.1 points in mid-May 2004 to 164.0 points in mid-May 2005.

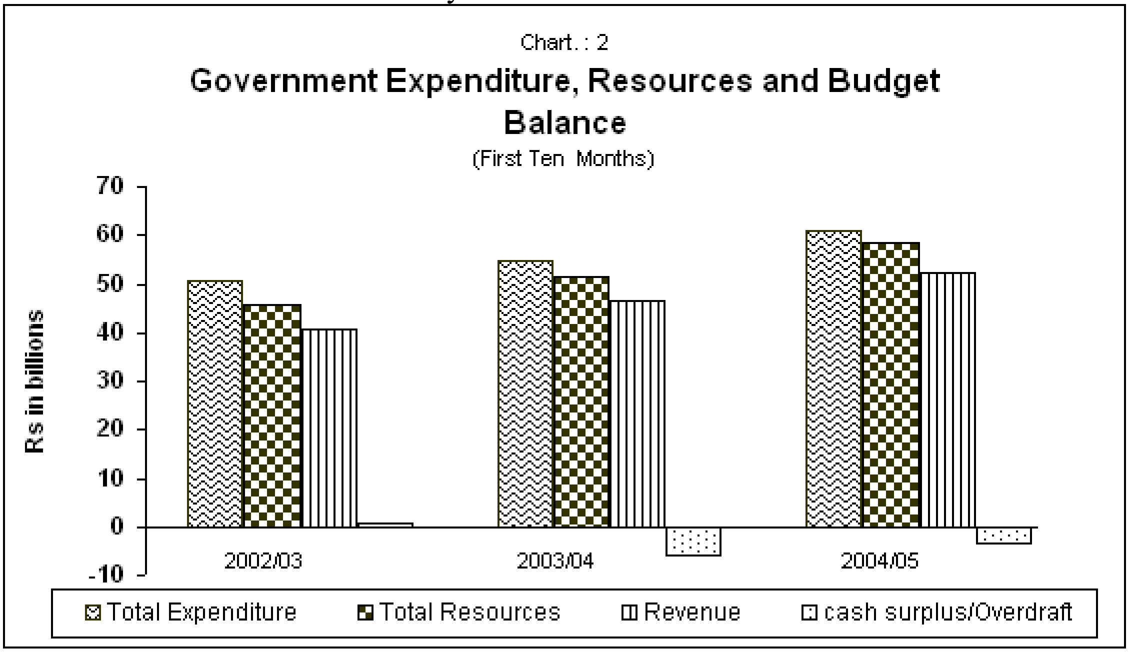
16. However, the average growth rate of price index for the first ten months of this year remained at 4.2 percent compared to a rise of 4.4 percent last year.
17. On a point-to-point basis, the index of food and beverages group moved up by 5.8 percent compared to an increase of 0.6 percent last year. The rise in the prices of vegetables and fruits; meat, fish and eggs; restaurant meals; grains and cereals products; and sugar and related products pushed up this index of this group. The index of sugar and related products shot up by 20.3 percent. Products that recorded an increase in indices are vegetables and fruits (9.3 percent), restaurant meals (8.2 percent), grains and cereal products (7.1 percent), meat, fish and eggs (5.5 percent), beverages (4.4 percent), pulses (1.5 percent) and milk and milk products (0.8 percent). However, the indices that declined were those of oil and ghee (3.1 percent), and spices (2.0 percent).
18. The price index of non-food and services group increased at a higher pace of 7.0 percent compared to a much slower pace of 2.2 percent last year. The rise in the price index of this group is mainly attributable to the rise in the prices of petroleum products, which exerted an upward pressure in the price of transport and communication as well as housing goods and services. The indices of all the items in this group rose including transport and communication (14.3 percent); housing goods and services (12.3 percent); education, reading and recreation (4.8 percent); tobacco and related products (4.3 percent); and cloth, clothing and sewing services (2.7 percent).
19. Region-wise, the price indices of the Kathmandu Valley increased by 5.6 percent while that of the Terai rose by 6.8 percent and Hills by 6.9 percent. Such indices had increased in the Kathmandu Valley by 4.4 percent and in Hills by 0.3 percent whereas the index of the Tareai had unchanged during the corresponding period last year.
20. The National Wholesale Price Index as at mid-May, 2005 stood at 125.2 depicting a rise of 9.5 percent on point-to-point basis, compared to an increase of 1.7 percent during the corresponding period last year. The higher growth in the wholesale price index is mainly attributable to the rise in the prices of food grains, cash crops (potato and jute), chemical fertilizer and chemical goods together with the sharp rise in the prices of petroleum products, in spite of the decline in the prices of spices, textile related products and pulses. In a group wise basis prices of imported commodities increased by 11.8 percent while that of agricultural commodities and domestic manufactured commodities rose by by 9.9 percent and 5.4 percent respectively. The average National Wholesale Price Index for the first ten months of this year increased by 6.8 percent compared to a rise of 4.0 percent last year.

Government Budgetary Operation

21. In the absence of previous fiscal year's data as per the new expenditure classification into recurrent, capital and principal repayment from this fiscal year, only the current year's data have been presented. Based on the cash flow data of first ten months of this fiscal year, the total expenditure of the government increased by 11.1 percent to Rs. 61.0 billion compared to a rise of 8.3 percent last year. Of the total expenditure comprised, recurrent expenditure stood at Rs. 43.2 billion (70.7 percent), whereas the capital expenditure at Rs. 8.2 billion (13.4 percent) and principal repayment at Rs. 8.3 billion (13.6 percent). Expenditure under freeze account which recorded a fall of 12.2 percent to Rs. 1.4 billion accounted for 2.3 percent of the total expenditure.
22. Total non-debt resources (revenue, non-budgetary receipts and others, and foreign grants) increased by 13.3 percent to Rs. 58.4 billion compared to a rise of 13.1 percent last year. Revenue, the major source (89.4 percent) of government resources, grew by 12.3 percent

to Rs. 52.1 billion compared to a rise of 13.4 percent last year. Foreign grants recorded slower growth of Rs. 4.3 billion compared a substantial increased last year.

23. Due to the higher growth in non-debt resources compared to that of total government expenditure, the budget deficit this period declined by 21.9 percent to Rs. 2.7 billion compared to a higher deficit last year. HMG mobilized Rs. 1.8 billion through foreign cash loans and internal borrowing amounted to Rs. 4.4 billion (Treasure Bills Rs.4.1 billion and National saving certificates Rs.0.2 billion). As a result, HMG's cash transactions in mid-May 2005 recorded a surplus of Rs. 3.4 billion while such surplus stood at Rs. 6.0 billion in mid-May 2004.



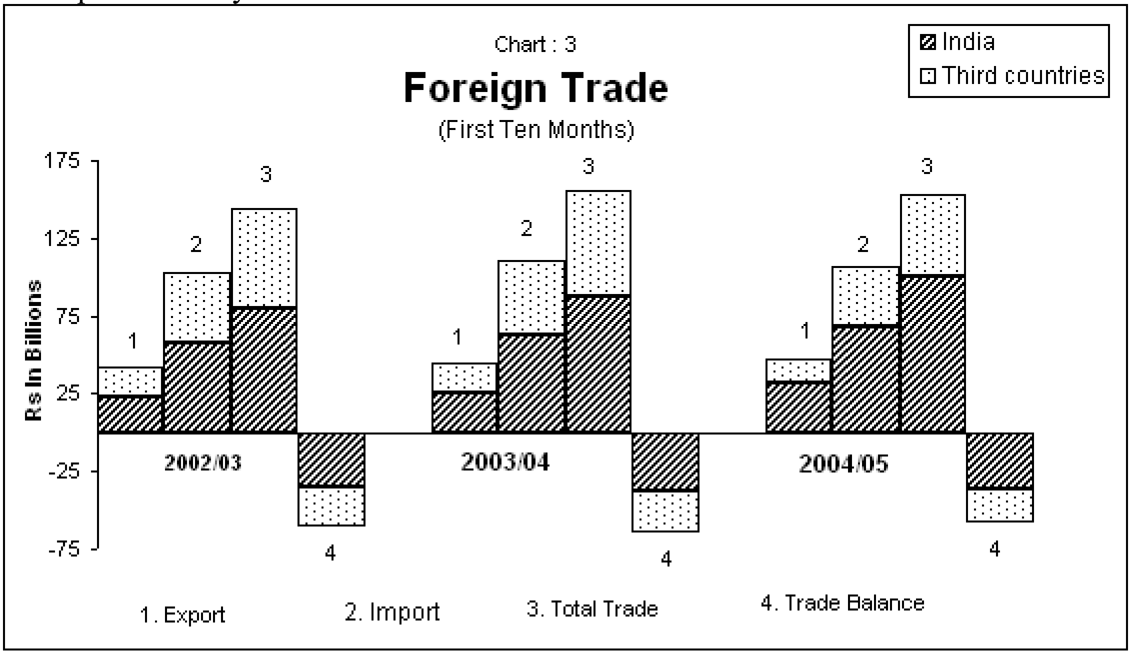
24. The total net outstanding domestic debt of the government declined to Rs. 83.2 billion in mid-May 2005 from Rs. 85.4 billion in mid-July 2004, as reflected in the surplus treasury position of Rs. 4.1 billion in mid-May 2005 compared to the surplus of Rs. 753 million in mid-July 2004 This was principally attributed to a higher rise in non-debt resources compared to the total government expenditure.

Foreign Trade

25. Based on customs data, of the first ten months of the current fiscal year, total exports increased by 5.3 percent to Rs. 47.5 billion while total imports declined by 4.0 percent to Rs. 106.1 billion resulting in the corresponding decline in trade deficit by 10.4 percent to Rs. 58.6 billion. Despite the increase in exports, total trade declined by 1.3 percent mainly because of the decline in the large import base. In the corresponding period of the previous year, exports had risen by 7.2 percent and imports by 7.8 percent leading to a 8.2 percent growth in trade deficit while the total trade had gone up by 7.6 percent.

26. Exports to India rose significantly by 25.4 percent to Rs. 32.0 billion this year compared to a rise of 13.9 percent last year. However, exports to other countries decelerated sharply 20.8 percent to Rs. 15.6 billion this year. Among the principal exportable commodities, the exports of cardamom, vegetable ghee, catechu, jute goods, noodles, plastic utensils, juice, polyester yarn, copper wire and rod, chemicals and textiles to India have increased. while the exports of toothpaste, ginger, ricebran oil, G.I. pipe, M.S. pipe, readymade garments and pashmina goods to India have declined. Similarly, the exports of woollen carpets and jewellery to other countries went up slightly while that of readymade garments, pulses and pashmina declined substantially.

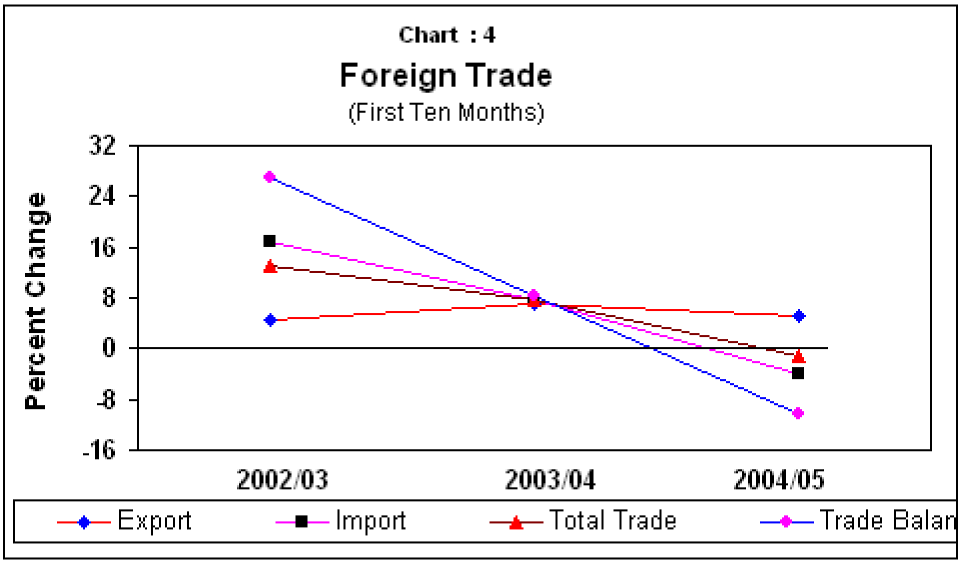
27. With respect to the composition of total exports to India, primary goods and manufactured goods formed 29.1 percent and 70.9 percent respectively while their respective shares were 28.6 percent and 71.4 percent last year. Likewise, the shares of primary products and manufactured goods in total export to other countries were 9.4 percent and 90.6 percent this year compared to the respective shares of 8.9 percent and 91.1 percent last year.



28. Imports from India increased by 9.6 percent compared to a rise of 8.0 percent last year. However, imports from other countries fell by 21.7 percent as against a growth of 7.4 percent last year. Imports of chemicals, thread, petroleum products, medicine, cold-rolled sheet, plastic granules and polyester yarn from moved up while imports of wheat, rice, hot-rolled sheet, M.S. billet, MS wire rod and cement went down. Similarly, the imports of sugar, transport vehicles and parts, MS billet, medicine, medical equipments and crude coconut oil from other countries rose while imports of thread, textiles, raw wool, crude soybean oil, crude palm oil, chemical fertilizer, plastic granules, telecommunication equipments and parts, aircraft equipment and electrical goods declined.

29. In terms of the structure of imports from India, industrial raw materials & capital goods and petroleum products constituted 43.5 percent and 31.1 percent respectively, while the miscellaneous goods including consumer items comprised the rest 25.4 percent. Last year their respective shares were 50.1 percent, 25.6 percent and 24.3 percent. Similarly, the share of industrial raw materials and capital goods in total imports from other countries went down to 53.9 percent from 61.7 percent last year.

30. Because of the increase of import from, and export to, India and their declines with respect to other countries, the share of India in total trade went up to 65.4 percent from 56.5 percent last year while the share of other countries decreased correspondingly to 34.6 percent from 43.5 percent last year.



31. The overall export/import ratio rose to 44.8 percent this year from 40.8 percent last year. The export/import ratios for India increased to 46.6 percent compared to 40.8 percent last year while the same for other countries slightly rose to 41.4 percent from 41.0 percent last year.

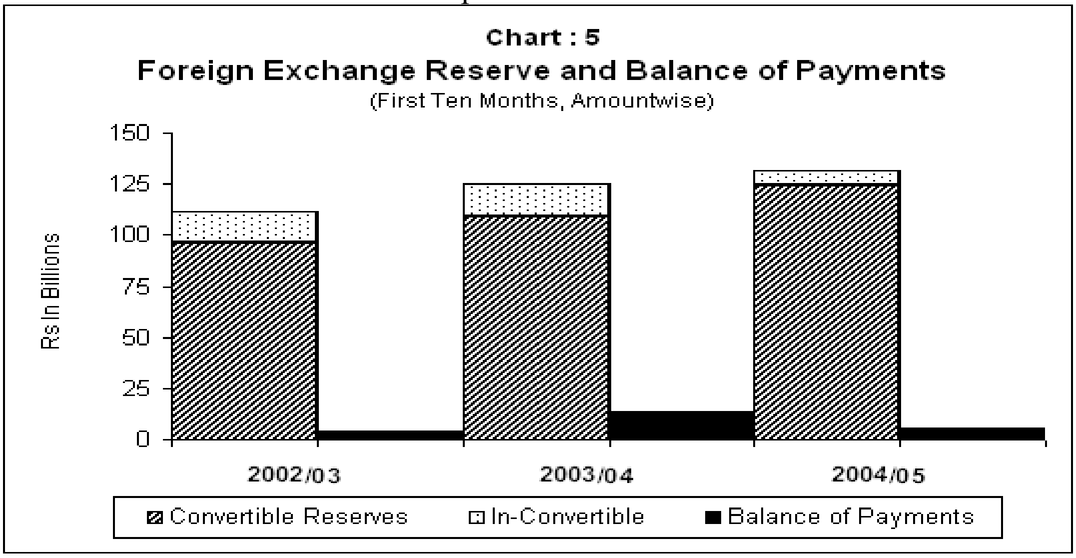
Balance of Payments

32. On the basis of the BOP statistics for the first ten months of FY 2004/05, the overall BOP posted a lower surplus of Rs. 5.6 billion in comparison to a higher surplus of Rs. 13.7 billion last year. The lower surplus in the BOP, this year, is mainly attributable to the lower in flow of net government loans.
33. Current account recorded a higher surplus of Rs. 25.9 billion this year in comparison to a surplus of Rs. 14.5 billion last year. Despite substantial declines of 80.9 percent and 77.8 percent in net service and net income, substantial decline in trade deficit along with steep rise (16.8 percent) in transfer net, contributed to the surplus of current account. Under the transfer receipts, the workers' remittances went up by 7.9 percent to Rs. 53.0 billion compared to the rise of 3.0 percent last year.
34. Under the capital account, capital transfer stood at Rs. 866.5 million in comparison to the level of Rs. 1.2 billion last year. Capital account declined due mainly to the slow down in the development activities.
35. Under the financial account, other investment assets increased to Rs. 22.2 billion compared to Rs. 31.3 billion last year. Trade credits comprised Rs. 2.5 billion of this amount. Compared to an increment of Rs. 10.8 billion last year, other investment liabilities declined to Rs. 3.1 billion this year. Of this amount, Rs.4 .0 billion stood at the account for trade credits. HMG received Rs. 5.6 billion as foreign loan and repaid Rs. 5.0 billion in amortization. As a result, the net government borrowing stood at Rs. 564.1 million. HMG had borrowed a sum of Rs. 4.2 billion as net foreign loans last year. Foreign currency and deposit liabilities rose only by Rs. 819.9 million. Consequently, the financial account resulted into a negative sum of Rs. 25.3 billion.

Foreign Exchange Reserves

36. The gross foreign exchange reserves rose by 5.2 percent to Rs.131.7 billion in mid-May 2005 compared to an increase of 12.2 percent to Rs. 125.1 in mid-May 2004. Of this the convertible currency reserve rose steeply y 13.8 percent mainly due to the decline in imports from other countries and the rise in remittances through the banking system but the inconvertible reserves went down sharply by 53.8 percent this year. The share of

convertible reserves in the total reserves went up to 94.5 percent as at mid-May 2005 from to 87.4 percent in the same point of time last year, resulting in the corresponding fall in the share of the non-convertible reserves to 5.5 percent from 12.6 percent. The current reserve has a comfortable position to finance merchandise imports of 12.4 months and merchandise and service imports of 10.4 months.



Price of Oil and Gold in the International Market

37. In the international market, the price of oil (Crude Oil Brent) soared by 18.7 percent to US$ 46.4 per barrel on May 15, 2005 from US$ 39.1 per barrel during the same period last year. Similarly, there was an increase in the price of gold by 11.4 percent to US$ 419.2 per ounce on May 15, 2005 from US$ 376.5 in the corresponding period of the previous year.

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