

Current Macroeconomic Situation

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

Monetary Situation

Money Supply

1. Broad money (M_2) registered a growth of 10.8 percent in the first seven months of 2007/08 compared to a growth of 9.4 percent in the same period last year. A significant increase in credit to private sector accounted for the growth in M_2 in the review period.
2. Time deposits increased by 12.9 percent in the review period compared to a growth of 10.6 percent in the previous year. A significant increase in worker's remittances and an upsurge in deposits of contractual institutions contributed to such an increment of time deposits in the review period.
3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, increased by Rs 270.9 million in the review period compared to an increase of Rs 6.43 billion in the previous year. Despite the substantial inflow of workers' remittances, a significant increase in imports leading to a compression in current account balance and a negative net external borrowing accounted for such a marginal growth in NFA in the review period.

Domestic Credit

4. Domestic credit increased by 12.6 percent in the review period compared to a growth of 2.3 percent in the previous year. A significant rise in domestic credit was on account of a pick up in bank credit to the private sector.
5. Net claims on government declined by 1.6 percent in the review period compared to a decline of 7.8 percent in the previous year. A lower level of the decline in net claims on government relative to that of last year was on account of a higher level of government expenditure in the review period.

6. Compared to a growth of 9.4 percent last year, private sector credit grew by 16.3 percent in the review period. The growth of private sector credit was on account of credit expansion of Rs 6.27 billion to wholesale and retail business, Rs 6.71 billion to construction and Rs 4 billion to the real estate. Furthermore, a significant expansion in light vehicle loans and margin lending for share purchase also contributed to the acceleration in bank credit to the private sector.

Reserve Money

7. Reserve money grew by 4.0 percent in the review period compared to a rise of 1.9 percent in the previous year. A rise in the NRB's investment in government securities and loans to commercial banks contributed to the growth in reserve money in the review period.

Foreign Exchange Transactions

8. A net liquidity of Rs 42.16 billion was injected by way of net purchase of 660.6 million US dollar from commercial banks through foreign exchange intervention in the review period. A net liquidity of Rs 37.17 billion had been injected through the net purchase of 510.8 million US dollar from commercial banks in the previous year.
9. Indian currency equivalent to Rs 50.23 billion was purchased through the sale of 790 million US dollar in the first seven months of 2007/08. During the same period in the previous year, a total of Rs 30.49 billion was purchased through the sale of 420 million US dollar. A higher payment by NOC to IOC in the review period compared to the previous year and a widening current account deficit with India increased the purchase of IC in the review period.

Open Market operations

10. During the first seven months of 2007/08, a net liquidity amounting to Rs 190 million was injected compared to absorption of Rs 19.45 billion in the same period last year. During the review period, liquidity injection through repo auction amounted to Rs 7 billion, while reverse repo auction and outright sale auction mopped up Rs 5.57 billion and Rs 1.24 billion respectively. During the same period in the previous year, net

liquidity of Rs 19.45 billion was absorbed through outright sale auction of Rs 5.89 billion and reverse repo auction of Rs 13.56 billion.

**Table 1: Monetary Operations
(In the first seven months)**

Heads	Rs in million	
	2006/07	2007/08
Liquidity Absorption	19450.0	6810.0
Sale Auction	5890.0	1240.0
Reverse Repo Auction	13560.0	5570.0
Liquidity Injection	0.0	7000.0
Purchase Auction	0.0	0.0
Repo Auction	0.0	7000.0
Net Liquidity absorption (-)/injection (+)	-19450.0	+190.0

Inter Bank Transactions and SLF

11. Inter bank transactions among commercial banks cumulated to Rs 180.38 billion in the review period compared to Rs 103.50 billion in the previous year. Likewise, commercial banks' borrowing through standing liquidity facility (SLF) cumulated to Rs 72.50 billion in the review period compared to Rs. 8.19 billion in the previous year. A higher demand for private sector credit and shortfall in liquidity mainly in the seventh month of the fiscal year 2007/08 increased both inter-bank transaction and the use of SLF in the review period.

**Table 2: Status of Inter Bank Transaction and SLF
(In the first seven months)**

	Rs in million	
	2006/07	2007/08
Standing Liquidity Facility	8191.0	72502.0
Inter Bank Transaction	103499.0	180375.0

Short-term Interest Rates

12. The short-term interest rates increased in the review period. The weighted average monthly 91-day Treasury bill rate increased to 7.79 percent as in mid-February 2008 compared to 2.59 percent a year ago. Similarly, the weighted average monthly inter bank rate rose to 7.55 percent as in mid-February 2008 compared to 2.01 percent a year ago. Likewise, interest rates on the deposits of commercial banks also increased in the review period. For example, the maximum interest rate on saving deposits offered by commercial banks increased to 5.25 percent as in mid-February 2008 from 5 percent a year ago. Interest rates on time deposits of two or more than two years increased to 6.75 percent as in mid-February 2008 from 5.5 percent a year ago. Aggressive lending by commercial banks, leading to a fall in excess liquidity created pressure in short-term interest rates in the review period.

**Table 3: Weighted Average 91-day Treasury Bill Rate and Inter bank Rate
(In percent)**

Mid-month	91-day Treasury Bill Rate		Weighted Average Inter bank Rate	
	2006/07	2007/08	2006/07	2007/08
Aug	2.99	4.25	2.07	4.10
Sep	2.78	2.14	1.83	2.18
Oct	2.54	2.35	2.11	3.35
Nov	2.11	3.03	1.20	3.73
Dec	1.98	3.59	1.34	4.73
Jan	2.67	3.68	3.03	4.93
Feb	2.60	5.79	2.01	7.55

Securities market

13. The year on year (y-o-y) NEPSE index increased by 55.4 percent to 814.43 points in mid-February 2008. This index was 523.94 a year ago.
14. The y-o-y market capitalization increased by 90.3 percent to Rs. 260.50 billion in mid-February 2008. Market capitalization to GDP ratio increased to 32.9 percent from 19

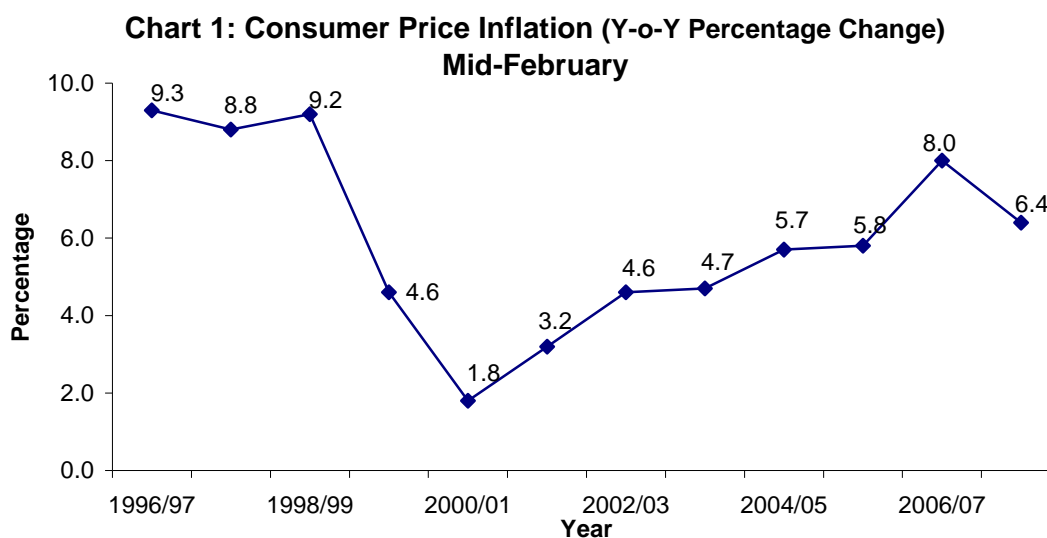
percent a year ago. Of the total market capitalization, bank and financial institutions held the largest share.

15. Total paid up capital of the listed companies stood at Rs.24.35 billion in mid-February 2008, an increase of 15.03 percent over the period of one year. This increase was due to the additional listing of securities.
16. Total number of companies listed at the NEPSE reached 145 in mid-February 2008 compared to 141 a year ago. Among the currently listed companies, 110 were bank and financial institutions, 21 were production and processing industries, 4 were hotels, 5 were business entities, 3 were hydro power and 2 companies were in other groups.
17. Monthly turnover to market capitalization ratio stood at 0.45 percent in mid-February 2008 compared to 0.44 percent a year ago.
18. The twelve-month rolling standard deviation stood at 187.8 in mid-February 2008 compared to 70.1 a year ago. This reflected an increase volatility in the stock market.
19. Nepal Securities Board (SEBON) granted permission to issue ordinary shares of Rs.402.4 million to eight companies, and right shares of Rs.2.68 billion to fifteen companies and debenture of Rs. 1.50 billion to Nepal Electricity Authority in the first seven months of 2007/08.
20. Nepal Electricity Authority (NEA) issued debentures of five years maturity with face value of Rs.1000 each amounting to Rs.1.5 billion. The coupon rate of these debentures is 7.75 percent. Of this, Rs.150 million was allotted for public placement and Rs.1.35 billion for private placement. The subscription for these debentures was higher than the issued amount totalling Rs.1.65 billion (Rs.690 million from public placement and Rs.960 million from private placement).
21. The government-owned Nepal Telecom Ltd. issued 7.5 million shares of Rs.100 each out of 15 million shares planned for public subscription in the process of divesting the government ownership. The minimum bid price was fixed at Rs.600 each share.

Inflation

Consumer Price Inflation

22. The y-o-y inflation moderated to 6.4 percent in mid-February 2008 from 8.0 percent in the corresponding period of the previous year. The minimal pass-through effect of the hike in the prices of petroleum products in October 2007 accounted for the moderation in the overall price index. Likewise, the appreciation of the Nepalese currency against the US dollar also dampened the inflationary pressure.



23. Group-wise, the index of food and beverages group rose by 7.9 percent compared to a rise of 8.8 percent a year ago. Within this sub-group, the prices of oil and ghee rose by 18.8 percent, grains and cereal products by 13.5 percent, pulses by 13.4 percent, restaurant meals by 7.3 percent, milk and milk products by 6.6 percent, and meat, fish and eggs by 6.4 percent. However, the prices of sugar and sugar-related products and vegetables and fruits declined by 10.7 percent and 4.9 percent respectively during this period. Following the same trend, the increment on the index of non-food and services group moderated to 4.8 percent compared to a growth of 7.3 percent last year. Within this group, the price of tobacco and tobacco related products increased by 8.3 percent, housing goods and services by 6.0 percent, medicine and personal care by 5.8 percent, and education, reading materials and recreation by 5.4 percent. The low pressure in

price index is due to the low increment in the prices of transport and communication, housing goods and services, etc. compared to the previous year.

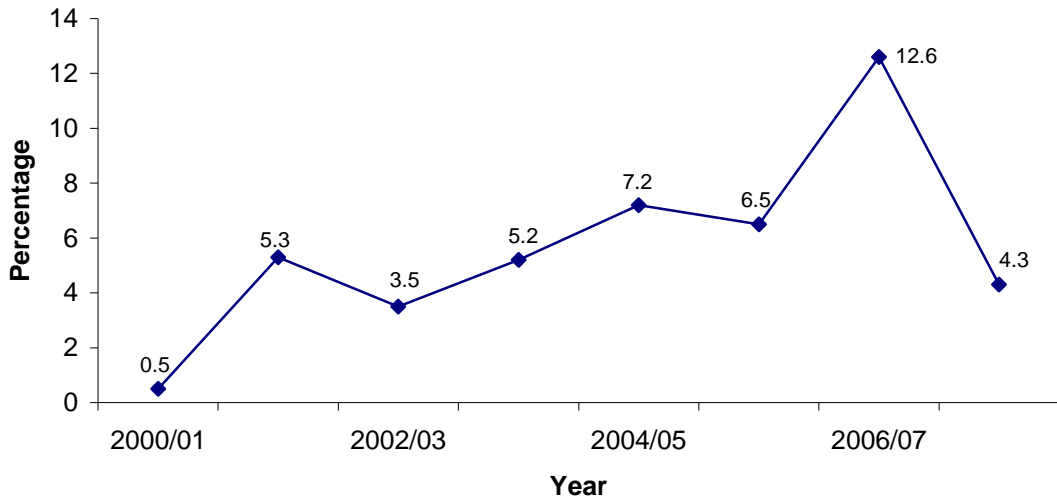
24. Region-wise, the price level in Kathmandu Valley, Terai and the Hills rose by 6.2 percent, 6.4 percent and 6.5 percent respectively. Last year, the respective rates were 7.4 percent, 8.9 percent and 6.9 percent.
25. In mid-February 2008, the y-o-y core inflation moderated to 5.5 percent from 6.5 percent a year ago.
26. The average rate of inflation during the first seven months (mid-August to mid-February) of 2007/08 remained at 6.3 percent compared to 7.3 percent in the corresponding period of the previous year.

Wholesale Price Inflation

27. The y-o-y wholesale price inflation decreased to 4.3 percent in mid-February 2008 from the level of 12.6 percent a year ago. The significant moderation in the wholesale price inflation was on account of the lower rate of price increase in the agricultural commodities group and domestic manufactured commodities group compared to that of last year. The price of agriculture commodities moderated to 1.7 percent from 17.5 percent last year. In this group, the price of cash crops, food grains, pulses, and livestock increased by 12.4 percent, 10.0 percent, 9.5 percent, and 5.6 percent respectively in the review period compared to a respective rise of 2.9 percent, 15.0 percent, 24.6 percent and 9.2 percent last year whereas, the price indices of fruits and vegetables and spices declined in review period by 19.6 percent and 15.9 percent respectively compared to the rise of 38.5 percent and 23.5 percent respectively last year. Similarly, the wholesale prices of domestic manufactured commodities group rose by 6.6 percent during the review period compared to a growth of 9.8 percent in the previous year. Within this group, the prices of construction material and food-related products rose by 9.5 percent and 8.0 percent respectively in the review period compared to the last year's increase of 19.7 percent and 9.7 percent respectively. The wholesale price index of imported commodities rose by 6.9 percent in the review period, compared to 7.3 percent in the previous year.

28. The average rate of wholesale price inflation during the first seven months (mid-August to mid-February) of 2007/08 remained at 8.1 percent compared to 9.8 percent in the corresponding period of the previous year.

**Chart 2: Wholesale Price Inflation (Y-o-Y Percentage Change)
Mid-February**



National Salary and Wage Rate

29. The y-o-y salary and wage rate index rose by 8.8 percent in mid-February 2008 compared to a rise of 9.9 percent a year ago. Such moderation was mainly on account of low pressure on wage rate index despite a 17.0 percent net increment in the salaries of civil servants including security personnel, teachers and employees of public enterprises announced in mid-July 2007. The wage rate index rose by 8.2 percent in the review period compared to a rise of 11.2 percent last year. Within the wage rate index, the index of agriculture labourers rose by 6.3 percent compared to 10.5 percent increase in the preceding year. In the review period, the index of industrial labourers and construction labourers increased by 10.2 percent and 11.1 percent respectively.

Fiscal Situation

Budget Surplus/Deficit

30. In the first seven months of 2007/08, the government budget remained at the deficit of Rs 6.18 billion. In the same period of the previous year, the budget was at the surplus of Rs 1.82 billion. The budget deficit was on account of relatively higher growth of government expenditure in the current year.
31. Of the sources of deficit financing, the government mobilized domestic borrowing of Rs 9.20 billion (except overdraft). In the review period, the GON's cash surplus with the NRB amounted to Rs 5.17 billion. Including the cash surplus of Rs 3.12 billion of the previous year, the cumulative cash surplus of the GON amounted to Rs 8.29 billion.
32. In the review period, the net domestic borrowing of the government remained at a negative of Rs 212.06 million as the government retired domestic borrowing worth Rs 3.81 billion.
33. The external financing of budget deficit amounted to Rs 2.45 billion.

Government Expenditure

34. In the first seven months of 2007/08, the government expenditure, on a cash basis, increased by 31.1 percent to Rs 68.12 billion compared to an increment of 13.0 percent in the same period of the previous year. The increase in government expenditure was on account of the rise in all forms of government expenditures i.e. recurrent, capital and principal repayments.
35. In the review period, the recurrent expenditure rose by 20.6 percent to Rs 44.27 billion compared to an increase of 10.2 percent in the corresponding period of the previous year. The higher growth of recurrent expenditure was on account of increased expenditure on relief-related activities, the salary hike of government employees, the rise in peace-related expenditure and additional expenditure relating to the preparation of CA elections.

36. In the review period, the capital expenditure went up by 79.1 percent to Rs 13.93 billion compared to an increase of 30.2 percent in the same period last year. A pick up in capital spending was on account of the loan investment of Rs 2.55 billion in NOC, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 520 million in the Nepal Electricity Authority, the release of fund of Rs 1.2 billion to Poverty Alleviation Fund (PAF) and the disbursement of funds to local authorities for rural infrastructure development (such as expansion of transformer line, small hydroelectricity, alternative energy development).

Government Revenue and Foreign Cash Grants

37. In the first seven months of 2007/08, the revenue mobilization of the government rose by 29.0 percent to Rs 54.52 billion compared to an increase of 17.9 percent in the corresponding period of the previous year.
38. In the review period, customs revenue rose by 28.3 percent to Rs 11.62 billion compared to an increase of 12.7 percent in the same period of the previous year. Reforms in customs administration, the increase in imports of high tax yielding vehicles and spare parts as well as a rise in the amount of Indian excise refund contributed to such a high growth of customs revenue.
39. In the first seven months of 2007/08, Value Added Tax (VAT) revenue grew by 24.2 percent to Rs 17.31 billion compared to an increase of 16.3 percent in the corresponding period of the previous year. The growth in VAT revenue was on account of the rise in remittances and reforms in VAT administration such as establishment of Large Taxpayers Unit, strengthening of billing system and non-filers management.
40. In the review period, excise revenue increased by 28.7 percent to Rs 5.58 billion compared to an increase of 21.5 percent in the same period last year. Reforms in excise administration, identification of new excisable goods and increase in the imports of high tax yielding vehicles contributed to such an acceleration of the excise revenue.
41. In the first seven months of 2007/08, income tax increased by 40.6 percent to Rs 9.63 billion. Last year, such revenue had grown by 29.6 percent. The increase in the income

of some public enterprise and private enterprises as well as the rise in investment income accounted for a higher growth of income tax.

42. In the review period, non-tax revenue increased by 22.8 percent to Rs 8.09 billion compared to an increase of 18.6 percent in the same period last year. Such an increase in non-tax revenue was on account of dividend paid by some public enterprises including NRB¹.
43. In the review period, the government received foreign cash grants of Rs 5.43 billion. The GON had received foreign cash grants of Rs 8.01 billion in the corresponding period of the previous year.
44. The outstanding domestic debt of the government stood at Rs 96.39 billion as in mid-February 2008. Such outstanding debt had stood at Rs 96.18 billion at the beginning of the current fiscal year.

External Sector Situation

Foreign Trade and Balance of Payments

45. In the first seven months of 2007/08, total exports declined by 3.0 percent, the same rate of the decline in the corresponding period of the previous year. Of the total exports, export to India fell by 5.5 percent in 2007//08 in comparison to a decline of 4.6 percent in the same period of 2006/07. Exports to other countries, on the other hand, posted a growth of 2.5 percent in comparison to an increase of 0.7 percent in the comparable period of the previous year.
46. The drop in the exports to India was mainly on account of the decrease in the exports of vegetable ghee, chemicals, textiles, toothpaste and wire. Similarly, exports to other countries went up due to the rise in the exports of pulses and herbs under the category of 'major commodities' and plants, handmade Nepalese paper, stationary and ceramic products under the category of 'other commodities'.

¹ Of the total dividend of Rs 3.43 billion for 2006/07 appropriated by the NRB to the GON, NRB has disbursed Rs 1.50 billion as of mid January 2008.

47. In the first seven months of 2007/08, total imports rose by 11.9 percent compared to a rise of just 1.6 percent in the corresponding period of the previous year. Of the total imports, imports from India went up by 14.6 percent in the review period compared to a growth of 5.1 percent in the corresponding period of 2006/07; likewise, imports from other countries rose by 7.3 percent in the review period in contrast to a decline of 3.7 percent in the previous year.
48. An increase in the import of M.S. billet, vehicles and spare parts, hot rolled sheet in coil, other machinery & parts and electrical equipment, among others, from India and the increase in the import of gold, transport equipment & parts, telecommunication equipment & parts, electrical goods and other machinery & parts, among others, from other countries accounted for the surge in total imports in the first seven months of 2007/08.
49. The overall BOP posted a surplus of Rs. 270.9 million in the first seven months of 2007/08. The BOP had registered a surplus of Rs. 6.43 billion in the corresponding period of the previous year. Because of the rise in travel receipts and workers' remittances by 72.0 percent and 23.2 percent respectively in the review period, the current account recorded a surplus of Rs. 3.60 billion. In the corresponding period of the previous year, the current account had recorded a surplus of Rs. 6.01 billion.

Foreign Exchange Reserves

50. The gross foreign exchange reserves aggregated Rs. 167.06 billion in mid-February 2008, an increment by 1.2 percent from the level of Rs 165.11 billion in mid-July 2007. Such reserves had risen by 3.4 percent in the corresponding period of the preceding year. In terms of US dollar, the gross foreign exchange reserves went up by 3.6 percent to US\$ 2.64 billion in mid-February 2008. In the same period of the previous year, such reserves had increased by 9.0 percent. On the basis of the import figures for the first seven months of 2007/08, the current level of reserves is adequate for financing merchandise imports of 10.2 months and merchandise and service imports of 8.1 months.

Price of Oil and Gold in the International Market

51. The price of oil (Crude Oil Brent) in the international market soared by 75.3 percent to US\$ 95.80 per barrel in mid-February 2008 from US\$ 54.66 per barrel in mid-February 2007. Similarly, the price of gold went up by 38.0 percent to US\$ 917.00 per ounce in mid-February 2008 from US\$ 664.55 in the previous year.

Exchange Rate Movement

52. In comparison to mid-July 2007, the Nepalese currency appreciated by 2.37 percent vis-à-vis the US dollar in mid-February 2008. It had appreciated by 5.33 percent in the corresponding period of the previous year. The exchange rate of one US dollar remained at Rs. 63.35 in mid-February 2008 compared to Rs. 70.35 in mid-February 2007.