

Current Macroeconomic Situation

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

Gross Domestic Product

1. As per the agriculture related statistics recently released by the Ministry of Agriculture and Co-operatives, the production of paddy showed a substantial growth of 16.8 percent in the current year. The production of paddy had declined for the last three consecutive years. Likewise, the production of wheat, maize and millet is likely to increase by 3.8 percent, 3.2 percent and 2.2 percent respectively in the current year. While the vegetable production is expected to grow by 9.6 percent in the current year compared to a growth of 6.7 percent last year, the fruits and spice production is reported to grow by 8.4 percent in the current year compared to a 5.4 percent growth last year. As a result of significant increase in the production of paddy, which contributes 21 percent to total agricultural production and a satisfactory growth in the production of vegetable (that has a share of around 10 percent in total agriculture production), and fruits and spice (that has a share of 7.04 percent), the real agricultural GDP is expected to record a growth of 6.0 percent in 2007/08. The growth in real agricultural GDP was 0.7 percent in 2006/07.
2. According to the Central Bureau of Statistics, the manufacturing production, as measured by Manufacturing Production Index declined by 0.2 percent in the first six months from the growth of 2.1 percent in the corresponding period of the preceding year. The sluggish performance of the manufacturing sector was on account of the decline in the production of vegetable ghee, readymade garments, carpet and plastic goods.
3. The inflow of foreign tourists via air surged by 16.7 percent to 292.6 thousand in the first nine months of the current fiscal year compared to a 10 percent growth in the corresponding period of the previous year. The third country tourists' arrival witnessed an encouraging growth of 26.8 percent in the review period compared to a growth of 10.5 percent in the corresponding period of the preceding year. Indian tourists, however, witnessed a slump of 10.5 percent in the review period compared to a decline of 3.1 percent in the same period of the preceding year.
4. Following the improvement in the security situation in the country, some new airlines have started their services while some existing airlines have increased their flight frequency in Nepal. This is expected to further boost the inflow of foreign tourists in the days to come.
5. Based on the performance of agriculture, industrial, tourism and other services sector, the overall real GDP is expected to hover around 4.0 percent in 2007/08. The real GDP growth was 2.5 percent in 2006/07.

Monetary Situation

Money Supply

6. In the first nine months of 2007/08, broad money (M_2) grew by 16.5 percent compared to a growth of 9.6 percent in the same period of the previous year. Likewise, narrow money (M_1) increased by 10.8 percent in the review period compared to a growth of 6.4 percent in the previous year. The higher growth in monetary aggregates was on account

of the expansion in net foreign assets (NFA) and the acceleration in the private sector credit in the review period.

7. Of the components of M₂, time deposits grew by 19.1 percent in the review period compared to a growth of 11.2 percent in the previous year. A higher inflow of private sector remittances and a deposit of substantial amount with the commercial banks collected from the over-subscription of shares by Ace Development Bank, an issue manager of initial public offering of shares of Nepal Development and Employment Promotion Bank resulted in a higher growth of time deposits in the review period.
8. Currency in circulation increased significantly by 14.6 percent in the review period compared to a growth of 6.9 percent in the previous year. Such a rise in currency in circulation was on account of higher government expenditure for conflict management and constituent assembly election in the review period.

Factors Affecting Money Supply

9. The NFA, after adjusting foreign exchange valuation gain/loss, increased by Rs 13.68 billion (10.4 percent) in the review period compared to an increase of Rs 10.88 billion (7.8 percent) in the previous year. An elevated level of private sector's remittances along with an inflow of foreign aid accounted for such an increase in NFA in the review period.

Liquidity of Commercial Banks

10. In the first nine months of 2007/08, the liquid funds of commercial banks increased by 11.8 percent amounting to Rs 72.90 billion. Such funds had increased by 3.6 percent amounting to Rs 65.20 billion in the same period of the previous year. Of the liquid funds, commercial banks' balance held abroad increased by 4 percent to Rs 35.28 billion in the review period. Likewise, commercial banks' cash in hand stood at Rs 9.38 billion and balances with the NRB increased by 2.2 percent to Rs 23.37 billion in the review period.
11. Including commercial banks' holding of government securities of Rs 64.79 billion, total liquid assets of commercial banks reached Rs 137.70 billion in mid-April, 2008, showing a growth of 13.3 percent. Such liquid assets were Rs 121.50 billion in mid-April 2007. Considering the public deposit of Rs 390 billion with the commercial banks, the liquid assets/deposits ratio of the commercial banks stood at 35.3 percent in the review period.

Liquidity Management

12. A net liquidity of Rs 65.98 billion was injected through a net purchase of 1.03 billion US dollar from commercial banks through foreign exchange intervention in the review period. A net liquidity of Rs 47.96 billion had been injected through the net purchase of 664.2 million US dollar from commercial banks in the previous year.
13. Indian Currency (IC) purchase has been increasing. In the first nine months of 2007/08, the NRB purchased 41.82 billion IC equivalent to Rs 66.9 billion by selling 1.05 billion US dollar. During the same period of the previous year, a total of Rs 40.97 billion equivalent IC was purchased through the sale of 570 million US dollar. A widening current account deficit with India along with a higher payment by Nepal Oil Corporation (NOC) to Indian Oil Corporation (IOC) accounted for such an increase in purchase of IC in the review period. The sale of the US dollar to purchase IC remained higher than the purchase of the US dollar from commercial banks in the review period.

14. In the course of monetary management, the NRB absorbed a total liquidity of Rs 11.04 billion including Rs 6.57 billion through reverse repo and Rs 4.47 billion through outright sale auction in the review period. In the same period of the previous year, a total liquidity of Rs 22.96 billion was absorbed through outright sale auction of Rs 8.9 billion and reverse repo auction of Rs 14.06 billion.
15. The use of standing liquidity facility (SLF) by the commercial banks from the NRB and inter-bank transactions increased in the review period. Inter bank transactions stood at Rs 203.40 billion in the review period compared to Rs 118.51 billion in the previous year. The SLF borrowing by the commercial banks reached Rs 76.35 billion in the review period compared to Rs 17.12 billion last year.

Total Domestic Credit

16. Compared to a growth of 4.2 percent in the previous year, domestic credit increased by 14.6 percent in the review period. A significant increase in private sector credit contributed to such an acceleration in domestic credit in the review period.
17. Net claims on government declined by 4.1 percent in the review period compared to a decrease of 16.9 percent in the previous year. A higher government expenditure relative to resource mobilisation contributed to such a lower level of decline in net claims on government in the review period.
18. Claims on government non-financial corporations declined by 10.1 percent in the review period in contrast to a growth of 13.0 percent in the previous year. The decline was on account of some loans payment by Nepal Oil Corporation, Nepal Food Corporation, Nepal Airline Corporation and National Trading Limited in the review period.

Commercial Banks' Deposit Mobilization and Credit Flows

19. The total deposit mobilised by the commercial banks expanded by Rs 55.96 billion in the review period to Rs 390.42 billion in mid-April 2008. The increase was on account of higher call deposit of Issue Manager with the commercial banks because of substantial money collection at the time of initial public offering of Nepal Development and Employment Promotion Bank's share.
20. The credit off-take by the private sector from the commercial banks expanded by 19.9 percent (Rs 52.78 billion) in the review period compared to a growth of 14.6 percent (Rs 37.14 billion) in the previous year. As a result, credit-deposit ratio increased to 86.1 percent in mid-April 2007 from 84.9 percent a year ago.
21. Of the total credit off-take, residential and non-residential construction accounted for Rs 8.69 billion, wholesale and retail business Rs 6.78 billion and real estates Rs 5.44 billion. Likewise, the credit to iron and steel plants increased by Rs. 3.30 billion and food processing industries by Rs. 2.21 billion. The margin lending including trust receipt loans amounted to Rs. 11.58 billion.

Interest Rates

22. The short-term interest rates increased in the review period. Compared to the previous year, the weighted average monthly 91-day Treasury Bill rate stood at 4.07 percent in mid-April 2008. Such a rate was 1.85 percent in mid-April 2007. Similarly, the weighted average monthly inter bank rate remained at 2.69 percent in mid-April 2008 compared to 1.69 percent a year ago.

23. The review period also witnessed some changes in the interest rates of deposits and credit. Maximum interest rate on saving deposits increased to 6.5 percent in mid-April 2008 from 5 percent in mid-July 2007. However, some commercial banks are still providing interest rate of 2.0 percent on such deposits. The interest rates on fixed deposits have also increased in the review period. The interest rate on fixed deposits of more than two years increased to 6.75 percent in mid-April 2008 from 5.5 percent in mid-July 2007. The minimum interest rates on such deposits increased to 2.75 percent in mid-April 2008 from 2.5 percent in mid-July 2007.
24. Interest rates on lending have also changed marginally in the review period. Minimum interest rates on loans to the industrial sector declined to 7.0 percent in mid-April 2008 from 8.0 percent in mid-July 2007 along with a decline in its maximum interest rates by 50 basis points to 13.0 percent in mid-April 2008. Likewise, maximum interest rates on agriculture credit declined by 100 basis points to 12.0 percent. Interest rates on commercial credit and overdraft declined by 50 basis points to 13.5 percent in mid-April 2008.

Securities market

25. The year on year (y-o-y) NEPSE index increased by 50.9 percent to 746.69 points in mid-April 2008. This index was 494.59 a year ago.
26. The y-o-y market capitalization increased by 80.7 percent to Rs. 241.13 billion in mid-April 2008. Market capitalization to GDP ratio increased to 30.4 percent from 18.5 percent a year ago. Of the total market capitalization, bank and financial institutions held the largest share.
27. Total paid up capital of the listed companies increased to Rs. 24.59 billion in mid-April 2008, with an increase of 2.6 percent over the period of one year. This increase was due to the additional listing of securities.
28. Total number of companies listed at the NEPSE reached 146 in mid-April 2008 compared to 131 a year ago. Among the listed companies, 111 were bank and financial institutions. Production and processing industries, hotels, business entities, hydropower and companies in other groups were 21, 4, 5, 3 and 2 respectively.
29. Monthly turnover to market capitalization ratio stood at 0.45 percent in mid-April 2008 compared to that of 0.38 percent a year ago.
30. The twelve-month rolling standard deviation of share prices stood at 151.7 in mid-April 2008 compared to that of 64.3 a year ago.
31. Nepal Securities Board (SEBON) granted permission for primary issuance of Rs 5.44 billion, consisting of ordinary shares of Rs.402.4 million to eight companies, right shares of Rs.3.53 billion to 21 companies and debentures of Rs. 1.50 billion to Nepal Electricity Authority in the first nine months of 2007/08.
32. The Government of Nepal (GON) issued Treasury Bills of Rs. 8.12 billion, Development Bonds of Rs. 3.90 billion and Citizens Saving Certificates of Rs. 1.30 billion in the first nine months of 2007/8.

Inflation and Wage Rate

Consumer Price Inflation

33. The y-o-y consumer inflation stood at 8.9 percent in mid-April 2008 compared to that of 5.6 percent in the corresponding period last year. The inflation was mainly driven by the significant rise of 12.6 percent in prices of food and beverages in the review period. The price rise of food and beverages was 7.9 percent last year.
34. Of the items in the index of food and beverages group, the prices of oil and ghee, grains and cereal product and pulses increased by double digit. For example, the price indices of oil and ghee sub-group increased by a whopping rate of 33.8 percent on a y-o-y basis. The sub-group of grains and cereal products witnessed a y-o-y price rise of 19.7 percent in mid-April 2008 compared to an increase of 8.7 percent a year ago. Prices of rice and rice products of this sub-group increased by 25 percent (y-o-y) compared to an increase of 4.9 percent a year ago. The price rise of pulse stood at 14.9 percent on y-o-y basis in mid-April 2008 compared to a rise of 17.2 percent in mid-April 2007.
35. The index of non-food and services group rose by 4.9 percent in mid-April 2008 compared to a rise of 3.2 percent last year.
36. Region-wise, the price indices of Kathmandu Valley, Terai and the Hills in the review period rose by 8.6 percent, 9.2 percent and 8.5 percent respectively. Last year, the respective rates were 5.4 percent, 6.4 percent and 3.5 percent.
37. In mid-April 2008, the y-o-y core inflation went up to 7.0 percent from 6.6 percent a year ago.

Wholesale Price Inflation

38. The y-o-y wholesale price inflation increased to 9.3 percent in mid-April 2008 compared to 7.6 percent a year ago. Of the items showing double digit price rise, the price of food grains increased by 20.2 percent compared to a rise of 7.6 percent a year ago. Likewise, the prices of chemical fertilizer and chemicals increased by 17.6 percent on y-o-y basis compared to a rise of 5.1 percent last year.
39. Of the other sub-groups with double digit rise in prices, a y-o-y price rise of pulses stood at 12.9 percent in mid-April 2008 compared to an increase of 22.6 percent a year ago. The price of food related products and construction materials, under the domestic manufactured commodities group, increased by 10.0 percent and 18.5 percent respectively in mid-April 2008 compared to a rise of 13.6 percent and 10.5 percent respectively a year ago.

National Salary and Wage Rate

40. The y-o-y salary and wage rate index rose by 9.2 percent in mid-April 2008 compared to a rise of 9.4 percent a year ago. Despite the pressure on salary index on account of hike in salary of civil servants including security personnel, teachers and employees of public enterprise by 17 percent in mid-August 2007, the pressure on wage rate index with a higher weight remained modest, resulting in rise of national salary and wage index in the review period at the same rate as in the previous year. Compared to a rise of 6.2 percent and 10.5 percent respectively in the previous year, the salary and wage rate index increased by 10.9 percent and 8.7 percent respectively in the review period. Wages of agriculture, industrial and construction labour increased by 6.0 percent, 12.0 percent and 11.0 percent respectively in mid-April 2008. Last year, these wages had increased by 11.0 percent, 11.3 percent and 5.7 percent respectively.

Fiscal Situation

Budget Surplus/Deficit

41. The government budget remained at the deficit of Rs 5.29 billion in the first nine months of 2007/08. The budget was at the surplus of Rs 4.2 billion in the same period of the previous year. The relatively higher growth of government expenditure resulted in the budget deficit in the review period.
42. The domestic financing of the budget deficit through the issuance of security (excluding overdraft) amounted to Rs 13.33 billion in the review period. The GON's cash balance with the NRB amounted to Rs 10.30 billion in mid-April 2008. Including the cash balance of Rs 3.12 billion of the previous year, the cumulative cash balances of the GON reached Rs 13.42 billion in mid-April 2008.
43. However, the net domestic borrowing of the government remained at a negative of Rs 2.38 billion on account of repayment of Rs 5.40 billion domestic debt and cash balances with the NRB in the review period.
44. The external financing of budget deficit amounted to Rs 2.77 billion, showing a 16.5 percent growth from the level of a year ago. In the previous year, the government had received foreign debt amounting to Rs 2.38 billion.

Government Expenditure

45. The government expenditure, on a cash basis, increased by 31.5 percent to Rs 90.32 billion in mid-April 2008 compared to an increase of 13.3 percent in the same period of the previous year. The increase in government expenditure was on account of the rise in all three heads of government expenditures i.e. recurrent, capital and principal repayments.
46. In the review period, recurrent expenditure rose by 21.4 percent to Rs 57.97 billion compared to an increase of 12.7 percent in the corresponding period of the previous year. Increased expenses on conflict-related activities, the salary hike of government employees, non-budgetary expenses on different items and expenditure on CA election and administration expenses accounted for a rise in recurrent expenditure in the review period.
47. In the review period, the capital expenditure went up by 69.0 percent to Rs 19.72 billion compared to an increase of 25.0 percent in the same period last year. A pick up in capital spending was on account of loan investment of Rs 3.5 billion in NOC, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 1.05 billion in the Nepal Electricity Authority, and the release of Rs 1.2 billion to Poverty Alleviation Fund (PAF).

Box 1: Budgetary Situation as of May 30, 2008

- *The government revenue increased by 27.3 percent to Rs 85.77 billion as of May 30, 2008. The government revenue had increased by 21.0 percent in the same period of the previous year.*
- *As of May 30, 2008, the government expenditure rose by 17.6 percent to Rs. 107.19 billion. Such expenditure had increased by 18.4 percent in the comparable period of the preceding year. The budget deficit amounted to Rs 5.00 billion in the review period compared to the budget deficit of Rs 4.64 billion in the same period of the previous year. The government's cash surplus with the NRB stood at Rs 10.82 billion on May 30, 2008. Including previous year's cash balance of Rs 3.12 billion, the total cash balance of the government with the NRB cumulated to Rs 13.94 billion.*
- *As of May 30, 2008, the capital expenditure reached Rs 25.34 billion. This is for less than the budget estimates of Rs 55.26 billion for 2007/08. On the one hand capital expenditure grew by lower than expected, the government maintained a hefty sum of cash balance with NRB on the other hand.*

Government Revenue and Foreign Cash Grants

48. In the first nine months of 2007/08, revenue mobilization of the government rose by 25.1 percent amounting to Rs 70.85 billion compared to an increase of 22.2 percent in the corresponding period of the previous year. Such an impressive growth of revenue was on account of substantial increase in the import of merchandise goods.
49. Of the total revenue mobilization, VAT revenue grew by 23.2 percent to Rs 22.22 billion in mid-April 2008. The growth in VAT revenue was on account of growing imports and consumption induced by the rise in remittances and reforms in VAT administration such as establishment of Large Taxpayers Unit, strengthening of billing system and non-filers management.
50. In the review period, customs revenue rose by 23.6 percent to Rs 14.68 billion compared to an increase of 22.0 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.
51. In the review period, excise revenue increased by 23.0 percent to Rs 7.29 billion compared to an increase of 31.6 percent in the same period of the previous year. Reforms in excise administration, identification of new excisable goods and increase in the imports of high tax yielding vehicles accounted for such a higher excise revenue in the review period.
52. Income tax revenue increased by 33.8 percent to Rs 12.84 billion in the first nine months of 2007/08. The increase in the income of some public enterprises and private enterprises as well as the rise in investment income accounted for a higher growth of income tax collection. Last year, such revenue had grown by 34.3 percent.
53. In the review period, non-tax revenue increased by 20.0 percent to Rs 10.42 billion compared to an increase of 28.2 percent in the same period of the preceding year. Such an increase in non-tax revenue was on account of dividend paid by some public enterprises including the NRB.

54. In the review period, the government received foreign cash grants of Rs 11.61 billion. The GON had received foreign cash grants of Rs 11.43 billion in the corresponding period of the previous year.
55. The outstanding domestic debt (excluding overdraft) of the government stood at Rs 93.80 billion as in mid-April 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

56. On the external front, the declining merchandise exports has been a matter of concern. In the first nine months of 2007/08, total exports went down by 2.6 percent compared to a decline of 2.9 percent in the corresponding period of the previous year. In the review period, exports to India plummeted by 8.3 percent and to other countries increased by 10.3 percent. In the previous year, exports to India had declined by 2.3 percent and to other countries by 4.2 percent.
57. In the first nine months of 2007/08, total imports increased significantly by 19.5 percent compared to a rise of 7.4 percent in the corresponding period of the previous year. Of the total imports, imports from India soared by 22.6 percent in the review period compared to a growth of 9.5 percent in the corresponding period of 2006/07. Similarly, imports from other countries went up by 14.3 percent compared to a rise of 4.0 percent in the previous year.
58. The overall BOP posted a surplus of Rs. 13.68 billion in the first nine months of 2007/08. The BOP had registered a surplus of Rs. 10.89 billion in the corresponding period of the previous year. Despite the rise in trade deficit, the increase in the workers' remittances and capital transfers accounted for surplus in the BOP.

Foreign Exchange Reserves

59. The gross foreign exchange reserves reached Rs. 182.27 billion in mid-April 2008, by increasing at a rate of 10.4 percent from the level of Rs 165.11 billion in mid-July 2007. Such reserves had gone up by 5.2 percent in the corresponding period of the preceding year. In terms of US dollar, gross foreign exchange reserves went up by 12.1 percent to US\$ 2.85 billion in mid-April, 2008. In the same period of the previous year, such reserves had increased by 14.0 percent. On the basis of the import figures for the first nine months of 2007/08, the current level of reserves is adequate for financing merchandise imports of 10.1 months, and merchandise and service imports of 8.1 months.

Price of Oil and Gold in the International Market

60. The price of oil (Crude Oil Brent) in the international market accelerated by 59.9 percent to US\$ 109.86 per barrel in mid-April 2008 from US\$ 68.71 per barrel in mid-April, 2007. Likewise, the price of gold went up by 36.1 percent to US\$ 927.75 per ounce in mid-April, 2008 from US\$ 681.75 in the previous year.

Exchange Rate Movement

61. In comparison to mid-July 2007, the Nepalese currency appreciated by 1.57 percent vis-à-vis the US dollar in mid-April 2008. It had appreciated by 8.33 percent in the corresponding period of the previous year. The exchange rate of one US dollar was Rs. 63.85 in mid-April 2008 compared to Rs. 68.40 in mid-April 2007.