

# **Current Macroeconomic Situation**

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

## **Monetary Situation**

### **Money Supply**

1. In the first eleven months of 2007/08, broad money (M<sub>2</sub>) grew by 20.1 percent compared to an increase of 10.5 percent in the corresponding period of the previous year. Likewise, narrow money (M<sub>1</sub>) increased by 16.5 percent in the review period. In the same period of the previous year, M<sub>1</sub> had grown by 6.4 percent. An increase in both net foreign assets (NFA) and net domestic assets (NDA) contributed to the acceleration in monetary aggregates in the review period.
2. Time deposit increased by 21.9 percent in the review period compared to a growth of 12.5 percent in the previous year. The elevated level of remittances accounted for the significant growth in time deposits. Likewise, currency in circulation increased by 19.8 percent in the review period compared to a rise of 3.7 percent last year. A high inflow of remittances even to rural areas, a rise in government's relief related expenditure and expenses incurred on constituent assembly (CA) election were the factors behind the rise in currency in circulation in the review period.

### **Net Foreign Assets (NFA)**

3. NFA, after adjusting exchange valuation gain/loss, increased by Rs. 24.25 billion (18.4 percent) in the review period. In the same period last year, NFA had increased by Rs. 6.34 billion (4.5 percent). An elevated level of remittances and an increase in foreign assistance contributed to such a rise in NFA in the review period.

### **Domestic Credit**

4. Compared to a growth of 12.7 percent in the previous year, domestic credit increased by 17.6 percent in the review period on account of a higher bank credit to the private sector. Claims on private sector increased by 23.0 percent in the review period compared to an increase of 17.2 percent last year. In the review period, credit flows towards residential and non-residential construction, wholesale and retail trade, and real estate increased. Likewise, bank credit to iron and steel production, and to food processing also went up in the review period.

### **Liquidity of Commercial Banks**

5. Liquid assets of commercial banks increased by 7.07 percent amounting to Rs. 140.47 billion in the review period. Such assets had increased by 0.2 percent in the previous year. Out of total liquid assets, liquid fund increased by 17.4 percent to Rs. 76.23 billion and investment in government securities amounted to Rs. 64.26 billion as in mid-June 2008. The liquid assets of the commercial banks stood at 34.9 percent of the total deposits in the review period.

## **Liquidity Management**

6. In the review period, the NRB injected net liquidity of Rs. 89.11 billion by purchasing 1.38 billion US dollar from commercial banks. In the previous year, the NRB had injected Rs. 57.86 billion by purchasing 814.4 million US dollar. A higher level of remittances necessitated such a higher purchase of the US dollar in the review period.
7. The NRB purchased Rs. 89.55 billion equivalent Indian Currency (IC) by selling 1.39 billion US dollar in the review period compared to a purchase of Rs. 57.36 billion equivalent IC by selling 820 million US dollar in the previous year. A widening current account deficit with India and a higher payment by Nepal Oil Corporation (NOC) to Indian Oil Corporation (IOC) accounted for substantial IC purchase in the review period.
8. In the review period, the NRB mopped up of Rs.16.47 billion through the open market operations including Rs. 6.57 billion through reverse repo auction and Rs.9.90 billion through outright sale auction. The liquidity injection through repo auction amounted to Rs.9 billion in the review period. In the corresponding period of the previous year, the NRB had absorbed Rs.30.31 billion (Rs.14.06 billion through reverse repo auction and Rs.16.25 billion through outright sale auction). Last year, liquidity injected through repo auction had amounted to Rs 2.0 billion. As a result, net liquidity absorption was Rs 28.31 billion in the previous year compared to net liquidity absorption of Rs.7.47 billion in the review period.
9. During the review period, commercial banks' borrowing through standing liquidity facility (SLF) amounted to Rs 102.10 billion compared to Rs.31.29 billion in the corresponding period of the previous year.
10. Inter bank transactions cumulated to Rs. 242.38 billion in the first eleven months of 2007/08 compared to Rs. 156.20 billion in the corresponding period of the previous year. The relatively better cash management by commercial banks and the expansion of the bank credit to private sector contributed to such a higher inter-bank transactions in the review period.

## **Short-term Interest Rate**

11. The weighted average monthly 91-day Treasury Bill rate increased to 5.41 percent in mid-June 2008 from 2.17 percent a year ago. Similarly, the weighted average monthly inter-bank rate increased to 4.64 percent in mid-June 2008 from 2.72 percent in mid-June 2007.

## **Securities Market**

12. The year on year (y-o-y) NEPSE index increased by 61.84 percent to 930.65 points in mid-June 2008. This index was 575.04 a year ago.
13. The y-o-y market capitalization increased by 109.03 percent to Rs. 324 billion in mid-June 2008. Market capitalization to GDP ratio increased to 39.53 percent from 21.4 percent a year ago. Of the total market capitalization, bank and financial institutions held the largest share.
14. Total paid up capital of the listed companies stood Rs.26.61 billion in mid-June 2008, an increase of 24.04 percent over the period of one year. This increase was due to the additional listing of securities.

15. Total number of companies listed at the NEPSE reached 148 in mid-June 2008 compared to 134 a year ago. Among the currently listed companies, 113 are bank and financial institutions. Production and processing industries, hotels, business entities, hydro- power and companies in other groups are 21, 4, 5, 3 and 2 respectively.
16. Monthly turnover to market capitalization ratio stood at 0.69 percent in mid-June 2008 compared to 0.53 percent a year ago.
17. The twelve-month rolling standard deviation reflecting an increased volatility in the stock market stood at 109.2 in mid-June 2008 compared to 67.4 a year ago.
18. Nepal Securities Board (SEBON) granted permission for new issuance of Rs. 9.17 billion in the first eleven months of 2007/08. These consisted of ordinary shares of Rs.632.6 million to sixteen companies, right shares of Rs.6.14 billion to 41 companies and debentures of Rs.2.40 billion to three companies including Nepal Electricity Authority. Likewise the Nepal stock exchange listed the bonus share of Rs. 291.5 million to four companies.
19. Nepal Stock Exchange Ltd. (NEPSE) opened the Over-the-Counter (OTC) trade in the capital market since May 4, 2008. This provision has created venue for dealing in the shares of even delisted or unlisted companies.
20. The Government of Nepal (GON) issued Treasury Bills of Rs. 8.12 billion, Development Bonds of Rs. 3.90 billion, and Citizens Saving Certificate of Rs. 1.30 billion in the first eleven months of 2007/8.

## **Inflation and Wage Rate**

### **Consumer Price Inflation**

21. The y-o-y consumer inflation rose to 11.0 percent in mid-June 2008 from 4.5 percent a year ago. The inflation was driven by the significant rise in the price of food and beverage group (13.0 percent) as well as non-food and service group (9.0 percent) in the review period. The price rise of food and beverages and non-food and service group was 5.8 percent and 3.1 percent respectively a year ago.
22. Of the items showing double digit price rise, price indices of oil and ghee sub-group increased by a whopping rate of 29.3 percent on a y-o-y basis in June 2008 compared to an increase of 9.1 percent a year ago. The sub-group of grains and cereal products witnessed a y-o-y price rise of 21.2 percent in mid-June 2008 compared to an increase of 5.0 percent in June 2007. Prices of rice and rice products of this sub-group increased by 25.1 percent (y-o-y) compared to an increase of 3.2 percent a year ago. The price rise of meat, fish and eggs, pulses milk and milk products and restaurant meals stood at 12.6 percent, 11.1 percent, 10.5 percent and 11.2 percent respectively on a y-o-y basis in mid-June 2008 compared to a rise of 4.3 percent, 8.0 percent, 6.1 percent and 4.0 percent respectively in mid-June 2007.
23. Within the group of non-food and service, the index of housing goods and services as well as tobacco and related products rose by 16.7 percent and 10.5 percent in mid-June 2008 compared to a rise of 2.6 percent and 5.2 percent respectively last year.
24. Region-wise, the price rise in Terai region was 11.7 percent followed by 10.8 percent in the hills and 10.2 percent in the Kathmandu Valley. Last year, the respective rates were 4.2 percent, 4.3 percent and 4.9 percent.
25. In mid-June 2008, the y-o-y core inflation rose to 8.3 percent from 5.0 percent a year ago.

### **Wholesale Price Inflation**

26. The y-o-y wholesale price inflation increased to 12.9 percent in mid-June 2008 compared to 5.6 percent a year ago. The index of agriculture commodities, domestic manufactured commodities and imported commodities increased by 10.8 percent, 13.9 percent and 15.7 percent respectively in the reviewed period compared to 6.1 percent, 8.2 percent and 3.5 percent respectively a year ago.
27. Of agriculture commodities, the price index of food grains, pulses, livestock production and fruits and vegetables increased by 22.3 percent, 15.3 percent and 14.5 percent and 10.6 percent respectively in mid-June 2008 compared to a rise of 2.0 percent, 9.9 percent, 4.0 percent and 2.2 percent (negative) respectively a year ago. On the other hand, the price index of cash crops decreased by 16.3 percent in the reviewed period as against the rise by 26.2 percent in the same period of the previous year.
28. Within the group of domestic manufactured commodities, the price index of construction materials and food-related products increased by 19.7 percent and 16.1 percent respectively in mid-June 2008 compared to a rise of 12.7 percent and 9.5 percent a year ago.
29. Of imported commodities, the price index of petroleum products and coal increased by a whopping rate of 32.5 percent on a y-o-y basis in mid-June 2008 compared to an increase of 2.1 percent a year ago. Likewise, the price index of chemical fertilizers and chemical goods as well as transport vehicles and machinery goods also increased by 11.9 percent and 11.4 percent respectively in the reviewed period compared to a rise of 4.2 percent and 2.7 percent in the corresponding period of the previous year.

### **National Salary and Wage Rate**

30. The y-o-y salary and wage rate index rose by 8.1 percent in mid-June 2008 compared to a rise of 11.6 percent a year ago. Of the salary and wage rate indices the y-o-y salary index increased by 10.9 percent compared to a rise of 6.2 percent in the corresponding period of the previous year. Despite the pressure on salary index on account of the hike in salary of civil servants including security personnel, teachers and employees of public enterprise by 17.0 percent in July 2007, the pressure on wage rate index with a higher weight remained modest, resulting in a rise of national salary and wage index in the review period at the same rate as in the previous year. The y-o-y wage rate index increased by 7.2 percent in the review period compared to an increase of 13.6 percent in the same period of the previous year. Wages of agriculture, industrial and construction labor increased by 9.6 percent, 3.3 percent and 9.0 percent respectively in mid-June 2008. Last year, these wages had increased by 9.4 percent, 20.7 percent and 11.2 percent respectively.

## **Fiscal Situation**

### **Budget Surplus/Deficit**

31. The government budget deficit amounted to Rs 9.30 billion in the first eleven months of 2007/08. The deficit was Rs 6.93 billion in the corresponding period of the previous year. The higher growth of government expenditure relative to resource mobilization accounted for such a budget deficit in the review period.
32. The domestic financing of the budget deficit through the issuance of securities (excluding overdraft) amounted to Rs 13.33 billion in the review period. The Government of Nepal's (GON) cash balance with the NRB amounted to Rs 6.65 billion as at mid-June

2008. Including the cash balance of Rs 3.12 billion for the previous year, the cumulative cash balance of the GON reached Rs 9.77 billion in mid-June 2008.

33. However, the net domestic borrowing of the government remained at a negative of Rs 633.6 million on account of the repayment of Rs 7.31 billion domestic debt and cash balances with the NRB in the review period.
34. The outstanding domestic debt (including cash balance with NRB) of the government stood at Rs 95.55 billion in mid-June 2008. Such outstanding debt was Rs 96.18 billion in mid-July 2007.
35. The external financing of budget deficit amounted to Rs 3.18 billion, showing a 17.8 percent growth from the level of a year ago. In the previous year, the government had received foreign debt amounting to Rs 2.70 billion.

### **Government Revenue and Foreign Cash Grants**

36. In the first eleven months of 2007/08, revenue mobilization of the government soared by 25.5 percent amounting to Rs 90.17 billion compared to an increase of 20.8 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 and the resulting increase in customs duties, VAT revenue and excise duties, increase in income tax and increase in non tax revenue.
37. Of the total revenue mobilization, VAT revenue grew by 18.8 percent to Rs 28.7 billion in mid-June 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.
38. In the review period, customs revenue rose by 21.2 percent to Rs 18 billion compared to an increase of 11.4 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 review period, excise revenue increased by 24.6 percent to Rs 9.41 billion compared to an increase of 35.8 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.
40. Income tax revenue increased by 29.8 percent to Rs 14.54 billion in the first eleven months of 2007/08. The evolution of the corporate culture on account of the growth in banks and financial institutions contributed to such a higher growth of income tax collection. Last year such revenue had risen by 31.4 percent.
41. In the review period, non-tax revenue grew by 41.7 percent to Rs 15.55 billion compared to an increase of 19.7 percent in the same period of the preceding year. Such an increase in non-tax revenue was on account of the increase in dividend paid by some public enterprises including the NRB as well as the amount received by the government in the form of principal repayment from Nepal Telecom, Nepal Electricity Authority and Civil Aviation Authority.

42. In the review period, the government received foreign cash grants of Rs 14.68 billion compared to that of Rs 13.38 billion in the corresponding period of the previous year. In the review period, major assistance included supports provided by the Asian Development Bank for the Rural Reconstruction and Rehabilitation Sector Development Program (RRRSDP), ‘Germany for Middle Marsyangdi Hydroelectric Project, the World Bank for Poverty Alleviation Fund, Road Sector Development Project, Irrigation and water Resources Management Project and Education For all Project, the UNICEF for Decentralized Action for Children and Women, Health and Nutrition, and HIV/AIDs programme and Finland for Rural water Supply and Sanitation project.

### **Box 1: Budgetary Situation as of Mid-July, 2008**

- *The government revenue increased by 22.6 percent to Rs 107.53 billion as of mid-July 2008. The government revenue had increased by 21.3 percent a year ago.*
- *As of mid-July 2008, the government expenditure rose by 16.6 percent to Rs 146.08 billion compared to an increase of 23.3 percent a year ago. The budget deficit amounted to Rs 18.71 billion in the review period compared to the budget deficit of Rs 18.76 billion of the previous year. The government's cash surplus with the NRB stood at Rs 4.59 billion as of mid-July 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 7.71 billion.*
- *As of mid-July 2008, the capital expenditure reached Rs 40.84 billion. Capital expenditure had increased to Rs 32.31 billion, a year ago.*

### **Government Expenditure**

43. The government expenditure, on a cash basis, increased by 19.2 percent to Rs 117.35 billion in mid-June 2008 compared to an increase of 21.0 percent in the same period of the previous year. The increase in government expenditure was mainly on account of the rise in the recurrent as well as the capital expenditure.
44. In the review period, recurrent expenditure rose by 19.1 percent to Rs 73.0 billion compared to an increase of 15.4 percent in the corresponding period of the previous year. The rise in peace related expenditure, the salary hike of government employees, non-budgetary expenses on different items and expenditure on CA elections exerted a pressure on recurrent expenditure in the review period.
45. In the review period, the capital expenditure went up by 35.8 percent to Rs 28.2 billion compared to an increase of 51.3 percent in the same period last year. A pick up in capital spending was on account of the investment in public enterprises amounting to Rs 8.85 billion including the loan investment of Rs 5.60 billion in NOC for the clearance of arrears, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 1.05 billion in the Nepal Electricity Authority, the release of funds of Rs.1.2 billion to Poverty Alleviation Fund (PAF). Moreover, the disbursement of funds to local authorities for rural infrastructure development (such as expansion of transformer line,

small hydroelectricity, alternative energy development) also contributed to an increase of capital expenditure in the review period.

## **External Sector Situation**

### **Foreign Trade and Balance of Payments**

46. The external sector displayed a mixed performance in the first eleven months of 2007/08 as total exports rose by 0.4 percent in comparison to a decline by 1.6 percent in the corresponding period of the previous year. Out of the total exports, exports to India fell by 8.1 percent in 2007//08 in contrast to its growth of 1.8 percent in the same period of 2006/07. Exports to other countries, on the other hand, rose by 20.3 percent as against a decline of 8.6 percent in the comparable period of the previous year.
47. The decline in the exports to India was mainly because of the fall in the exports of vegetable ghee, textiles, chemicals, rosin and readymade garments. On the other hand, exports to other countries went up largely due to the increase in the exports of pulses, Nepalese paper and paper products, herbs, wheat, packing materials of paper, ceramic products, electric wire and stationary.
48. Total imports soared by 16.5 percent in the first eleven months of 2007/08 compared to a rise of 12.7 percent in the corresponding period of the previous year. While imports from India accelerated by 25.6 percent in the review period compared to a growth of 9.0 percent in the corresponding period of 2006/07, imports from other countries rose by just 3.2 percent compared to a rise of 18.7 percent in the previous year. As a result, the total trade deficit witnessed an expansion by 23.7 percent in the review period in comparison to its growth of 20.6 percent a year earlier.
49. The contributing factors for the upsurge in total imports in the first eleven months of 2007/08 were a rise in the import of petroleum products, M.S. billet, vehicles and spare parts, hot rolled sheet in coil and cold rolled sheet in coil, among others, from India as well as an increase in the import of telecommunication equipment & parts, other machinery & parts, transport equipment & parts, gold and video television & parts from other countries.
50. In the first eleven months of 2007/08, the overall BOP recorded a surplus of Rs. 24.25 billion in comparison to a surplus of Rs. 6.34 billion in the corresponding period of the previous year primarily due to the significant rise in travel receipts, workers' remittances and capital transfer. Likewise, the current account registered a surplus of Rs. 14.13 billion in the review period in contrast to a slight deficit of Rs. 206.9 million in the corresponding period of the preceding year.

### **Foreign Exchange Reserves**

51. In mid-June 2008, the gross foreign exchange reserves stood at Rs. 206.47 billion, a growth of 25.0 per cent from the level of Rs 165.13 billion in mid-July 2007. Such reserves had fallen by 1.6 percent in the corresponding period of the preceding year. In US dollar terms, gross foreign exchange reserves went up by 18.5 percent to US\$ 3.02 billion in mid-June, 2008. Such reserves had risen by 11.5 percent in the same period of the previous year. Based on the import figures for the first eleven months of 2007/08, the

current level of reserves is adequate for financing merchandise imports of 11.1 months and merchandise and service imports of 9.0 months.

### **Price of Oil and Gold in the International Market**

52. The price of oil (Crude Oil Brent) in the international market soared by 93.4 percent to US\$ 135.78 per barrel in mid-June, 2008 from US\$ 70.22 in mid-June, 2007. Similarly, the price of gold rose by 32.6 percent to US\$ 866.00 per ounce in mid-June, 2008 from US\$ 653.25 in the previous year.

### **Exchange Rate Movement**

53. In comparison to mid-July 2007, the Nepalese currency depreciated by 5.26 percent vis-à-vis the US dollar in mid-June 2008. It had appreciated by 13.30 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 68.45 in mid-June 2008 compared to Rs. 65.40 in mid-June 2007.