Nepal Rastra Bank

Research Department

Current Macroeconomic and Financial Situation of Nepal

(Based on Ten Months' Data of 2015/16)

Growth Outlook

1. The available data of the first ten months of the fiscal year 2015/16 indicate a gradual improvement in economic outlook going forward. A pick up in credit offtake of banks and fianancial institutions, government revenue and capital spending is reflective of the rebound in economic activities following the end of the trade routes distruption in the southern parts of the country.

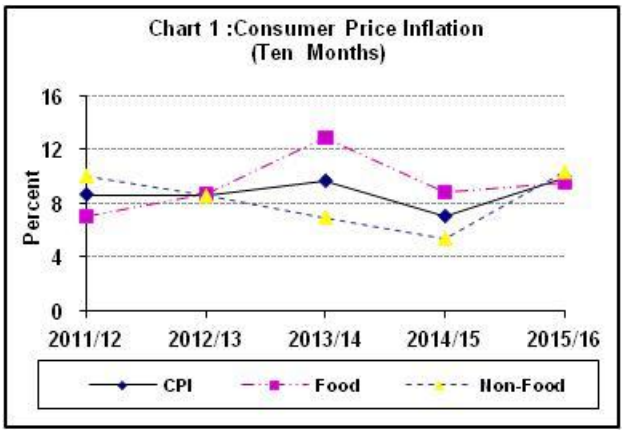
2. Given the low base of real GDP growth of 0.56 percent at producers' price of the current fiscal year, the current rebound in economic activities including a pick up in construction activities is expected to underpin the growth target of 6.5 percent as set in the annual budget for the fiscal year 2016/17.

3. Notwithstanding the compression of the import, the main revenue base, the weekly revenue collection data, if they are of any guide, signal that the revenue collection will surpass the expected target of Rs. 475 billion for the current fiscal year 2015/16.

4. On the external front, the growth in inward remmittances is tapering off. This is worrysome for the external sector stability going forward.

Inflation, Salary and Wage Rate

5. The consumer price inflation returned to a double digit mark of 10 percent in mid-May 2016, belying the general expectations that inflation rate would follow the trend of continuous moderation seen from its peak of 12.1 percent in mid January 2016. Despite the improved supply of fuel and other consumable items following the return of normalcy in the southern customs points, the reversal in the inflation trend occurred on account of rise in housing rent and education related expenses in the review month.



6. Of the overall inflation, non-food and services group inflation of 10.4 percent exceeded the food and beverage group inflation of 9.6 percent in mid-May 2016.

7. Of prices of food and beverage items, the growth in price indices of pulses and legumes sub-group and vegetable sub-group continued to remain at a higher level by 23.4 percent and 20.1 percent respectively in the review period. Likewise, prices of clothes and footwear sub-group, housing and utilities sub-group and alcoholic drinks sub-group increased by 17 percent, 16.4 percent and 15.9 percent respectively.

8. Geographically, the Kathmandu Valley witnessed a relatively higher rate of inflation at 11.5 percent followed by Hilly region at 11 percent, Mountain region at 9.1 percent and Terai region at 8.6 percent in the review period. Last year, the Kathmandu Valley, Hilly region and Terai region had experienced the inflation rate of 6.8 percent, 7.7 percent and 6.9 percent respectively.

Inflation Wedge between Nepal and India

9. The y-o-y consumer price inflation of Nepal in the tenth month of 2015/16 continued to remain at a higher level of 10 percent compared to that of India at 5.8 percent showing inflation wedge of 4.2 percent. A year ago, such inflation in Nepal was 7.1 percent compared to 5 percent in India reflecting a narrower inflation wedge of 2.1 percent. The rise in inflation wedge between Nepal and India was on account of lingering impact of April/May 2015 earthquakes and the obstruction on southern trade routes. However, the inflation differential is narrowing down on account of improved supply situation in Nepal following the return of normalcy in the Southern trade routes.

Wholesale Price Inflation

10. The y-o-y wholesale price inflation remained at 5.8 percent in the review period compared to 5.1 percent in the corresponding period of the previous year. The wholesale price indices of agricultural commodities and domestic manufactured commodities registered a growth of 9.6 percent and 6 percent respectively, whereas such index of imported commodities showed a decline of 2.8 percent in the review period. In the corresponding period of the previous year, the increments in wholesale price indices of agricultural commodities and domestic manufactured commodities were 8.8 percent and 4.5 percent respectively whereas the price index of imported commodities had seen a decline of 2.1 percent.

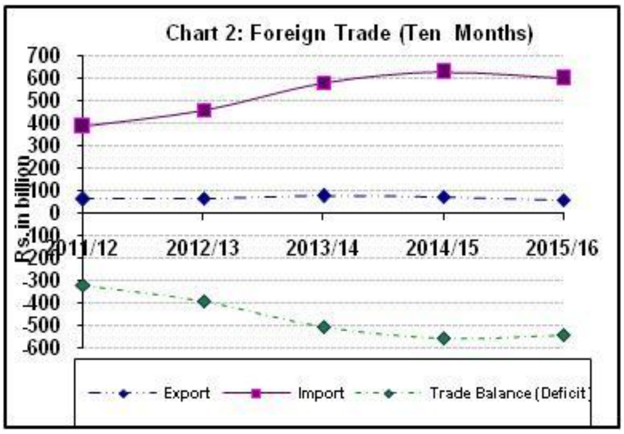
National Salary and Wage Rate

11. The y-o-y salary and wage rate index increased 5.3 percent in the review period compared to 7.2 percent in the corresponding period of the previous year. Within the salary and wage rate index, while the salary index increased 0.8 percent, the wage rate index rose 6.3 percent. The salary indices of bank and financial institutions, education and public corporations sub-groups increased 2.3 percent, 1.5 percent and 0.7 percent respectively in the review period. Likewise, wage rate indices of construction labourer, agricultural labourer and industrial labourer witnessed a growth of 11.3 percent, 6.2 percent and 5 percent respectively in the review period.

External Sector

Merchandise Trade

12. In ten months of 2015/16, merchandise exports decreased 21.7 percent to Rs. 55.60 billion compared to a drop of 5.5 percent in the same period of the previous year. Exports to India and China decreased 33.4 percent, and 35.6 percent respectively whereas exports to other countries increased 4.1 percent in the review period. Commodity wise, exports to other countries increased mainly due to the rise in exports of woolen carpets, readymade garments, pashmina, tea, among others whereas the fall in export of zinc sheet, GI pipe, juice, polyester yarn , among others resulted in a decrease in exports to India and a decline in exports of tanned skin, noodles, readymade garments, among others led to a fall in exports to China.



13. Merchandise imports dropped 4.6 percent to Rs. 599.36 billion in the review period as against a growth of 8.1 percent in the same period of the previous year. Imports from China increased 9.5 percent whereas imports from India and other countries decreased 7.8 percent and 4.1 percent respectively in the review period. Commodity-wise, import from China increased mainly due to the increase in imports of chemical fertilizer, telecommunication equipments and parts, readymade garments, among others whereas a decrease in imports of petroleum products, mild steel (M.S.) billet, chemical fertilizer, hotrolled sheet in coil among others caused a fall in imports from India; and a decrease in imports of silver, aircraft spare parts, edible oil among others resulted in a fall in imports from other countries.

14. Based on customs points, the exports through Tribhuwan International Airport and Dry Port customs office, Birgunj increased whereas exports through other customs points decreased. On the import side, imports through Birgunj customs point decreased whereas imports through other customs points increased in the review period. Trade is not resumed through the Tatopani customs point yet.

15. Total trade deficit in the review period contracted 2.4 percent to Rs. 543.76 billion compared to an expansion of 10.1 percent in the same period of the previous year. The export-import ratio dropped to 9.3 percent in the review period compared to 11.3 percent in the corresponding period of the previous year.

Export-Import Price Index

16. The y-o-y unit value export price index based on customs data increased 20.3 percent while import price index decreased 4.6 percent in the tenth month of 2015/16. Consequently, the TOT index increased 26.1 percent compared to an increase of 16 percent in the corresponding period of the previous year. Increase in price of export items such as carpet, yarsagumba (ophiocordyceps sinensis) herbs caused the export price index to rise in the review period. Fall in the price of petroleum products resulted in a decline in import price index in the review period.

Services

17. The total services receipt declined 6 percent and expenses increased 4.6 percent in the review period. As a result, net services receipt decreased 57.4 percent to Rs. 8.77 billion in the first ten months of 2015/16. The net services receipt was Rs. 20.57 billion in the same period of previous year.

Workers' Remittances

18. The workers' remittances grew 10.2 percent to Rs. 538.87 billion in the review period compared to a growth of 10 percent in the previous year. Consequently, net transfer receipt increased 11.8 percent to Rs. 628.07 billion in the review period. Such receipt had increased 8 percent in the same period of the previous year.

19. The number of workers going abroad for foreign employment, which directly affect the flow of inward remittances, decreased in the review period. The number of Nepalese workers seeking foreign employment, based on final approval, decreased 22.2 percent in the review period. It had increased 8.9 percent in the same period of the previous year.

Box 1: Number of Nepalese Workers Going Abroad for Foreign Employment *

Mid-Month/Year	2013/14	2014/15	2015/16
August	45937	42309	37756
September	24214	51551	40275
October	31959	35550	35484
November	31949	43213	23061
December	41634	53354	38350
January	50032	45362	35389
February	37285	48941	34219
March	48552	44460	35701
April	45854	52210	31615
May	54173	31375	36778
June	54926	37962	-
July	61717	26600	-
Total	**528232**	**512887**	**348328**
Percentage Change (first ten months)	24.5	8.9	-22.2

* Based on final approval for foreign employment.
Source:- Department of Foreign Employment, GoN

Box 2: Dividend Payment to FDI Companies*

(Rs. in millions)

Sectors	2014/15 Annual	2015/16 Jul.- May.
Financial Sector	1794.43	8.3
Communication Sector	4.00	1692.8
Hydro Power Sector	2874.48	3154.3
Industry Sector	2299.19	1264.5
Services Sector	238.61	4.1
Total	**7210.71**	**6124.0**

**Based on approval from NRB*

Current Account and BOP Position

20. The current account registered a surplus of Rs. 134.30 billion in the review period compared to Rs. 71.39 billion surplus in the same period of the previous year. Similarly, the overall BOP recorded a significant surplus of Rs. 166.83 billion in the

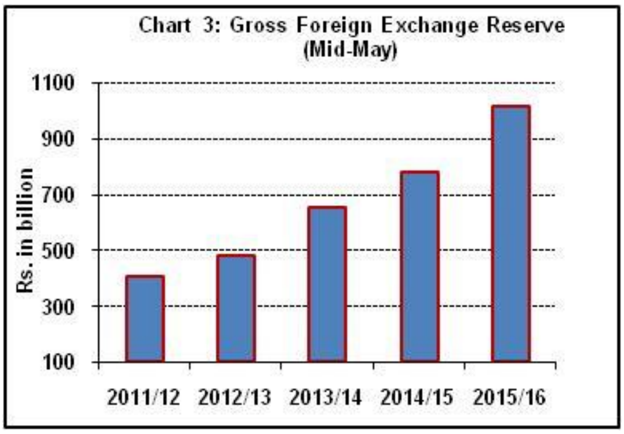
review period compared to a surplus of Rs. 101.15 billion in the same period of the previous year.

21. In the review period, Nepal received capital transfer amounting to Rs. 11.59 billion and Foreign Direct Investment (FDI) inflow of Rs. 4.64 billion. In the same period of the previous year, capital transfer and FDI inflow had amounted to Rs. 11.56 billion and Rs. 3.15 billion respectively.

22. Dividend payment to FDI companies, based on approval from Nepal Rastra Bank, amounted to Rs. 6.12 billion in the review period compared to the annual dividend payment of Rs. 7.21 billion in 2014/15.

Foreign Exchange Reserves

23. The gross foreign exchange reserves stood at Rs. 1013.44 billion as at mid-May 2016, an increase of 23 percent from Rs. 824.06 billion in mid-July 2015. Of the total foreign exchange, reserves held by NRB increased 23.9 percent to Rs. 870.99 billion as at mid-May 2016 from the level of reserves as at mid-July 2015. Similarly, the reserves of banks and financial institutions (except NRB) increased 17.7 percent to Rs. 142.45 billion in the same period. The share of Indian currency in total reserves stood at 22.5 percent as at mid-May 2016.



Foreign Exchange Adequacy Indicators

24. Based on the imports of ten months of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 17.3 months, and merchandise and services imports of 14.6 months. The ratio of reserve-to-GDP based on the revised estimate of 2014/15 and preliminary estimate of 2015/16, reserve-to-imports and reserve-to-M2 increased to 45.1 percent, 122 percent and 48.1 percent respectively as at mid-May 2016. Such ratios were 38.9 percent, 93.3 percent and 43.9 percent as at mid-July 2015.

Price of Oil and Gold in the International Market and Exchange Rate Movement

25. The price of oil (Crude Oil Brent) in the international market decreased 28.3 percent to USD 47.05 per barrel in mid-May 2016 from USD 65.58 per barrel a year ago. The price of gold increased 3.3 percent to USD 1265.90 per ounce in mid-May 2016 from USD 1225 per ounce a year ago.

26. Nepalese currency vis-à-vis the US dollar depreciated 4.8 percent in mid-May 2016 from mid-July 2015. It had depreciated 6.1 percent in the same period of the previous year. The buying exchange rate per US dollar stood at Rs. 106.27 in mid-May 2016 compared to Rs. 101.14 in mid-July 2015.

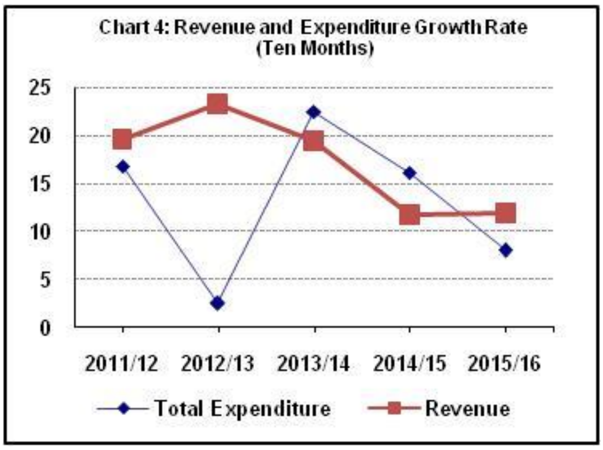
Fiscal Situation *

Budget Deficit / Surplus

27. In ten months of 2015/16, government budget on a cash basis remained surplus of Rs. 64.82 billion. Such surplus was Rs. 53.90 billion in the corresponding period of the previous year.

Government Expenditure

28. In the review period, total government expenditure on a cash basis increased 8 percent to Rs. 333.14 billion. This amount accounts for 40.7 percent of annual budget estimate of Rs. 819.47 billion. Such expenditure had increased 16.2 percent to Rs. 308.35 billion in the corresponding period of the previous year.



29. In the review period, recurrent expenditures increased 8.2 percent to Rs. 240.99 billion. Such expenditures had increased 4.1 percent in the corresponding period of the previous year. In the review period, capital expenditures increased only 18.8 percent to Rs. 42.99 billion as works at various important projects remained stalled and the post- earthquake reconstruction works remained affected on account of the shortage of fuel and construction materials. Such expenditures had increased 18 percent in the corresponding period of the previous year. The capital expenditure in the review period is only 20.6 percent of annual budget estimate of Rs. 208.88 billion

Government Revenue

30. The revenue growth which was in the negative territory from two month to nine month of the current fiscal year returned to a positive growth path in ten month. In the review period, the government revenue collection increased 11.9 percent to Rs. 350.27 billion. Such revenue had

Box 3: The Budget Performance

Heads	Budget Estimates (Rs. in millions)	Outturns in ten months	
		Rs. in million	As percent of budget estimates
Total Expenditure	**819468.9**	**333144.9**	40.7
Recurrent Expenditure	484266.4	240994.9	49.8
Capital Expenditure	208877.2	42986.8	20.6
Financial Expenditure	126325.3	49163.2	38.9
Revenue	**475012.1**	**350266.8**	**73.7**

* Based on the data reported by 8 NRB offices, 69 branches of Rastriya Banijya Bank Limited, 46 out of 49 branches of Nepal Bank limited, 19 out of 22 branches of Agriculture Development Bank limited, 9 branches of Everest Bank Limited, 4 branches of Global IME Bank Limited and, 1 branch each from Nepal Bangladesh Bank limited, NMB Bank Limited, and Bank of Kathmandu Limited conducting government transactions and released report from 79 DTCOs and payment centers.

risen 11.7 percent in the corresponding period of the previous year. If the current trend of revenue collection persists, the revenue collection is likely to exceed the revenue target of Rs. 475 billion set for 2015/16 .

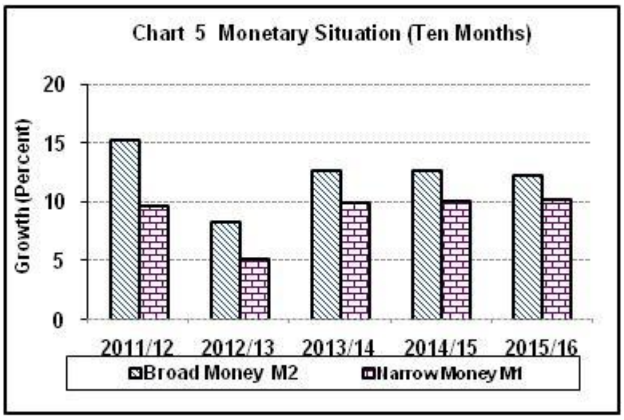
Public Debt and Cash Balance of the GON

31. In the review period, the GoN has mobilized Rs. 82.66 billion domestic debt and made principal repayment of Rs. 26.30 billion of domestic debt. As a result, outstanding domestic debt increased to Rs. 253.15 billion in mid-April 2016 from Rs. 196.79 billion in mid-July 2015. Because of a slow pace of government expenditure relative to resource mobilization, the GoN accumulated cash balance of Rs. 210.22 billion at Nepal Rastra Bank as of mid-April 2016.

Monetary and Financial Situation

Money Supply

32. Broad money (M2) increased 12.3 percent in ten months of 2015/16 compared to an increase of 12.6 percent in the corresponding period of the previous year. On y-o-y basis, M2 expanded 19.7 percent in mid-May 2016.

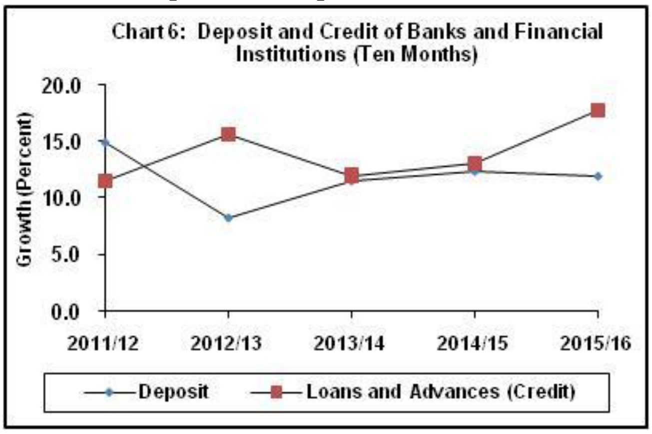


33. Net foreign assets (after adjusting foreign exchange valuation gain/loss) increased Rs. 166.83 billion in the review period compared to an increase of Rs. 101.15 billion in the corresponding period of the previous year.

34. Reserve money, which had increased 6 percent in the corresponding period of the previous year, declined 2.1 percent in the review period. On y-o-y basis, reserve money increased 10.7 percent in mid-May 2016.

Domestic Credit

35. Domestic credit expanded 6.4 percent in the review period compared to an increase of 8.1 percent in the same period of the previous year. An increase in the government deposits at this Bank resulted in a slower growth of domestic credit in the review period. On y-o-y basis, domestic credit increased 14.4 percent in mid-May 2016.



36. Claims of monetary sector on the private sector increased 16.5 percent in the review period compared to a growth of 15.4 percent in the corresponding period of the previous year. On y-o-y basis, claims on the private sector increased 20.6 percent in mid-May 2016.

Deposit Collection

37. Deposits at BFIs increased 11.9 percent in the review period compared to a growth of 12.4 percent in the same period of the previous year. Deposits at commercial banks and development banks increased 12 percent and 7.3 percent respectively in the review period. On y-o-y basis, deposits at BFIs expanded 19.5 percent in mid-May 2016.

Credit Disbursement

38. Credit to the private sector from Banks and Financial Institutions (BFIs) increased 16.2 percent in the review period compared to an increase of 15 percent in the same period of the previous year. In the review period, private sector credit from commercial banks, development banks and finance companies increased 17.6 percent, 12.9 percent and 3.2 percent respectivley. On y-o-y basis, credit to the private sector from BFIs increased 21.1 percent in mid-May 2016.

39. Credit disbursement in major sectors such as agriculture, productions, construction and service industries remained lower than that of the previous year. Credit to the agriculture sector increased 13.6 percent, industrial production sector 12.5 percent, construction sector 12.3 percent, service industries 10.9 percent, wholesale and retail trade sector 18 percent, transport, communication and public sector 27.5 percent in the review period.

40. Of the total outstanding credit of banks and financial institutions, 61.5 percent is against the collateral of land and building and 14.2 percent against the collateral of current assets (such as agricultural and non-agricultural products). Such ratios were 59.6 percent and 12.9 percent respectively in the same period of the previous year.

41. The credit from BFIs to real estate sector amounted to Rs. 233.80 billion (including Rs. 133.91 billion residential home loans less than Rs. 10 million each) in mid-May 2016. This is 14.8 percent of total credit exposure of BFIs. As at mid-May 2016, the BFIs' total margin lending extended against the collateral of shares stood at 2 percent (Rs. 32.21 billion) of their total credit exposure. Of the total lending of the commercial banks, the credit to small and medium enterprises is only 2.5 percent (Rs. 32.92 billion) in the review period.

42. T. R. (Trust Receipt) loan extended by commercial banks increased 27 percent (Rs. 14.88 billion) in the review period compared to a growth of 21.1 percent in the same period of the previous year.

Liquidity Management

Box 5: Cost of Liquidity Absorption (Rs. in million)

Liquidity Absorption Instruments	2014/15 (Annual)		2015/16 (Ten Months)	
	Amount	Interest Expenses	Amount	Interest Expenses
Deposit Collection Auction	155000	170.5	297500	621.2
Reverse Repo Auction	315800	2.8	170950	8.6
Outright Sale Auction	6000	17.3	9100	29.0
Total	**476800**	**190.6**	**477550**	**658.8**

43. In ten months of 2015/16, the NRB mopped up Rs 477.55 billion liquidity, on a turnover basis, through various instruments. These consist of Rs. 297.50 billion liquidity absorption through deposit collection auctions, Rs. 170.95 billion through reverse repo auction and Rs. 9.10 billion through outright sale auction on a cumulative basis. In the corresponding period of the previous year,

Rs. 105 billion was mopped up through deposit collection auction, Rs. 279.80 billion through reverse repo auction and Rs. 6 billion through outright sale auction.

44. In the review period, the NRB injected net liquidity of Rs. 392.25 billion through the net purchase of USD 3.71 billion from foreign exchange market (commercial banks). Net liquidity of Rs. 299.65 billion was injected through the net purchase of USD 3.08 billion in the corresponding period of the previous year.

45. The NRB purchased Indian currency (INR) equivalent to Rs. 308.44 billion through the sale of USD 2.80 billion and Euro 110 million in the review period. INR equivalent to Rs. 284.77 billion was purchased through the sale of USD 2.88 billion in the corresponding period of the previous year.

Refinance and Productive Sector Lending

46. The NRB has been providing a refinance facility aimed at expanding credit to the productive sector. In the review period, the use of such facility has decreased. In the review period, a total refinance of Rs. 5.74 billion including general refinance of Rs. 4.57 billion and export refinance of Rs. 1.17 billion was availed. In the corresponding period of the previous year, a total refinance of Rs. 6.06 billion including general refinance of Rs. 4.08 billion and export refinance of Rs. 1.98 billion was utilized. Moreover, the bank has introduced a provision of refinance facility at zero percent interest rate to the BFIs with an objective of providing concessional housing loan to earthquake victims. Under this scheme, a sum of Rs. 16.5 million has been extended as of mid-May 2016.

47. There is a policy-provision for commercial banks to disburse 20 percent of their total credit in the productive sector. Such credit of commercial banks out of their total loans and advances stood at 15.99 percent in mid-May 2016. BFIs have extended 5.53 percent credit to deprived sector in mid-April 2016 compared to 5.08 percent in the same period of previous year.

48. As of mid-April 2016, a total number of 2323 farmers obtained Rs. 1.96 billion loan under the 6 percent interest subsidized lending scheme for selected agro-businesses. Under this provision, Rs. 31.1 million interest subsidy has already been provided and Rs. 6.54 million is in the process of reimbursement.

Inter-bank Transaction and Standing Liquidity Facility

49. In the review period, inter-bank transactions of commercial banks stood at Rs. 777.72 billion and those of other financial institutions (excluding transactions among commercial banks) amounted to Rs. 73.13 billion. Such transactions were Rs. 346.32 billion and Rs. 186.32 billion respectively in the corresponding period of the previous year. The BFIs used the standing liquidity facility (SLF) of Rs. 8.55 billion in the review period compared to Rs. 7.87 billion in the same period of previous year.

Interest Rates

50. The weighted average of 91-day Treasury Bill rate and inter-bank transaction rate of commercial banks increased in the tenth month of 2015/16 compared to a year ago. The weighted average 91-day Treasury Bill rate increased to 1.34 percent in the review month from 0.59 percent a year ago. Similarly, the weighted average inter-bank transaction rate among commercial banks, which was 0.44 percent a year ago, increased to 3.44 percent in

the review month. Likewise, the weighted average inter-bank rate among other financial institutions decreased to 2.75 percent from 3.91 percent a year ago.

51. In the tenth month of 2015/16, the weighted average interest rate spread between deposit and lending rate of commercial banks inched up to 4.75 percent from 4.62 percent a year ago and the average base rate came down to 6.29 percent from 7.76 percent a year ago.

Merger/Acquisition and Resolution

52. The number of BFIs opting for merger has been increasing after the introduction of merger policy aimed at strengthening financial stability. After the issuance of the "Bank and Financial Institutions Merger By-law, 2011", 89 BFIs have merged with each other resulting in the formation of 33 BFIs as of mid-May 2016. Likewise, 2 finance companies were acquired by a commercial bank and one development bank was acquired by another development bank.

53. As of mid April 2016, eleven institutions including 2 development banks and 9 finance companies are under resolution process. Total deposits and loans of such institutions stood at Rs. 3.43 billion and Rs. 6.77 billion respectively. The overall capital fund of these institutions is negative by 38 percent and non-performing loan stood at 95 percent.

Regulatory Measures

54. In the review period, the NRB issued directives pertaining to branch acquisition of problematic bank by another bank under specified provisions, special refinance facility up to Rs. 0.5 million for extending credit to agriculture and small enterprises in the specified 10 districts of high poverty incidence and bordering VDCs and municipalities of specified districts in the Southern regions and opening branches in these areas without prior approval from the NRB. Likewise, additional directives relate to the credit extended to the organized sector operating public city transport services under productive sector lending and replacing magnetic strip cards by chip-based card.

55. NRB also issued directives addressing unusual situation caused by the unrest in Terai region and trade-transit disturbances in Indo-Nepal Transit points. Such directives include the continuation of deferred loans as pass loans until mid-April 2016 and exemption from penalty for such loans, rescheduling or restructuring of loan up to one year for one time if borrowers of service sector (industry, trade, education, health, tourism and energy) submit work-plan within mid-April 2016, provision for including accrued interest received by mid-February 2016 in income statement of the second quarter and extension of time period of T.R. loans (import loans) from 120 days to 180 days, among others.

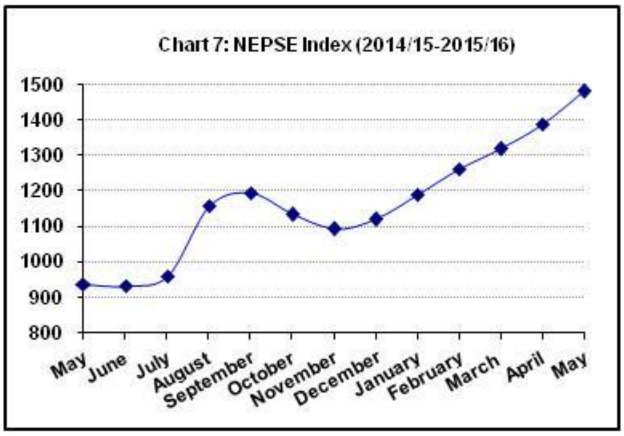
56. In order to enhance the confidence of public in banking system through minimizing risk of banking transaction, this bank has introduced "New Capital Adequacy Framework-2015"based on BASEL III. Commercial banks are required to implement it in parallel run since mid-January 2016 and fully since mid-August 2016.

57. A "Rehabilitation Fund" of Rs. 100 billion, to be operationalized by this Bank, has been established. The fund can be used to provide interest subsidy of 4 percent up to the credit of Rs. 100 million and 2 percent for more than Rs.100 million for the specified sectors to revive economic activities contracted by the disruption in border points and the unrest in southern plain. Likewise, the fund can be used to provide credit from BFIs to earthquake

victims up to 5 percent interest rate for specified business and for which refinance facility from this bank is provided at 1.5 percent interest rate.

Capital Market

58. The NEPSE index reached 1,481.9 points in mid-May 2016. The stock market has been continously gaining a momentum on account of issuance of bonus and right shares by banks and financial institutions in the wake of the time frame set for the hike in the paid-up capital, as well as the introduction of full dematerialized transactions from mid-January 2016 and enhanced confidence among investors with an expectation of the end of political transition.



59. The total turnover of the securities traded reached Rs. 17.99 billion in mid-May 2016. Likewise, the total paid-up capital of the listed companies reached Rs. 258.94 billion in mid-May 2016. Total additional securities worth Rs. 21.68 billion were listed in the NEPSE during mid-July 2015 to mid-May 2016. These consist of ordinary shares of Rs. 1.95 billion, right shares of Rs. 3.20 billion, bonus shares of Rs. 14.83 billion and the debentures of Rs. 1.70 billion.