Current Macroeconomic Situation of Nepal

(*During the First Two Months of FY 2004/05*)

Nepal Rastra Bank

November 2004

Major Highlights

- During the first two months of FY 2004/05, broad money increased, while narrow money decreased.
- Time deposits continued to grow.
- Net claims on government decreased.
- Weighted average treasury bills rates declined.
- Stock exchange transactions as well as the NEPSE index increased.
- Total government expenditure, on cash basis, decreased.
- Resource mobilization increased as against the decline in government expenditure, resulting in a budget surplus.
- Inflation decelerated.
- Exports rose as against the decline in imports, resulting the compression in the trade deficit.
- Sharp rise in grants and increase in the services (net) resulted in a current account surplus.
- During FY 2003/04, the balance of payments (BOP) stood favourable due to current account surplus, high inflow of loans and miscellaneous income.
- The gross foreign exchange reserve increased to Rs.125.3 billion in mid-September 2004 from Rs. 105.4 billion in mid-September 2003, enough to cover merchandise imports of 12.6 months and merchandise and service imports of 10.5 months.

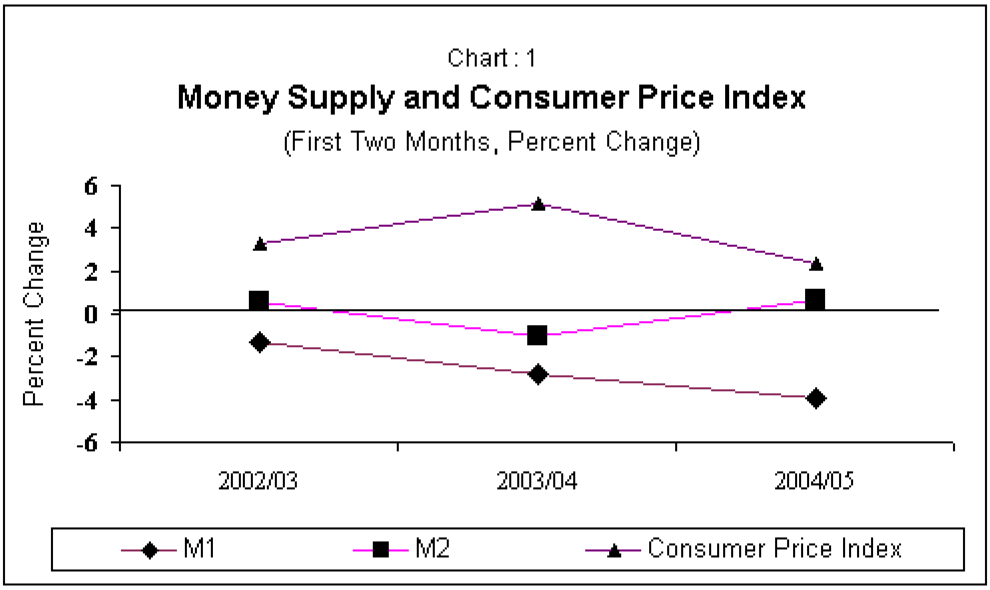
Current Macroeconomic Situation of Nepal

(*During the First Two Month of FY 2004/05)*

Monetary Situation

1. During the first two months of FY 2004/05 over the same period in FY 2003/04, broad money (M2) increased by 0.7 percent to Rs. 281.0 billion compared to the negative growth of 1.0 percent last year. M2 increased this year due mainly to the rise in the net domestic assets (NDA). Time deposits went up by 4.3 percent to Rs. 192.8 billion in comparison to the rise of 1.3 percent last year. A continuous increase in workers' remittances led the time deposits to rise. Narrow money (M1), a component of broad money, declined by 6.4 percent to Rs. 88.2 billion compared to the decline of 5.5 percent last year. M1 declined due mainly to the rise in time deposits. The broad money liquidity (M3) increased by 0.9 percent to Rs. 302.2 billion compared to a negative growth of 0.7 percent last year.

2. The net foreign assets (NFA) of the banking sector (adjusting the foreign exchange valuation) declined by 3.9 percent to Rs. 104.2 billion compared to the decline of 2.8 percent last year. Global rise in oil prices increased the import bill of petroleum products leading to a fall in Indian currency reserves. This, together with principal repayment of foreign loans, led to the decline in the NFA of the banking sector.



3. Domestic credit of the banking sector declined by 0.5 percent to Rs. 248.7 billion compared to the fall of 0.5 percent last year. Although the claims on non-financial institutions and the private sector increased, reduction in the net claims on government as well as the financial institutions led to the decline in the domestic credit. Banking sectors' claims on non-financial institutions rose significantly by 72.8 percent to Rs. 3.9 billion. Increased borrowing by the Nepal Oil Corporation (NOC) from the commercial banks led to the rise in the claims on non-financial institutions. Such claims had declined by 9.1 percent last year. Banking sectors' claims on financial institutions declines by 6.8 percent to Rs.13.3 billion compared to the fall of 0.2 percent last year. The decline in the deposited made by ADB's commercial bank branch offices

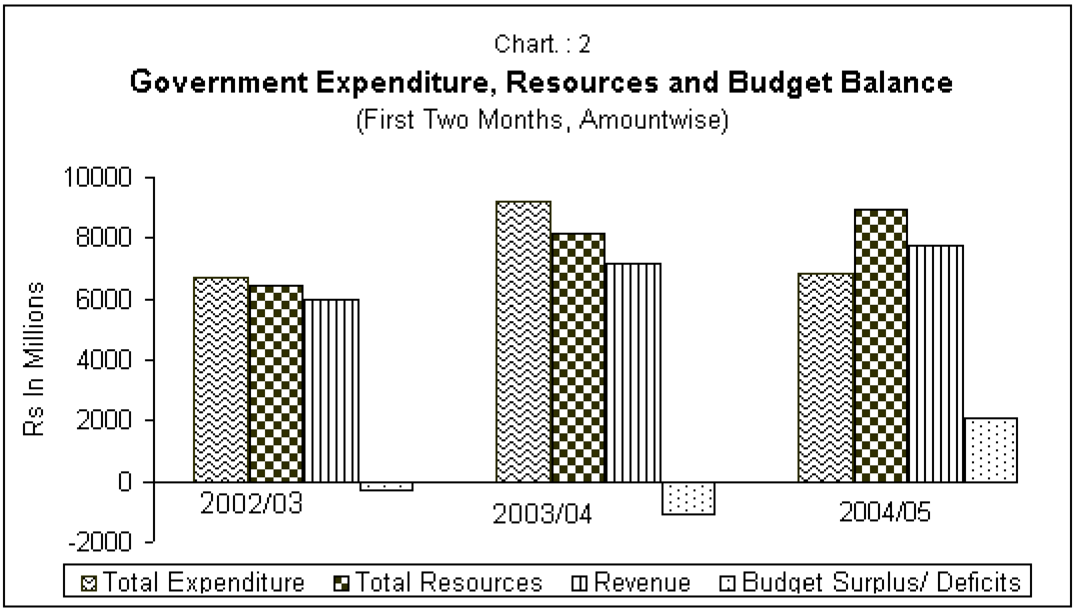
to its central office led to the decline in the claims on financial institutions. The net claims on government declined by 6.5 percent to Rs. 58.3 billion compared to the decline of 1.7 percent last year. Such a claims declined due mainly to the rise in the government deposits in NRB. Banking sectors' claims on private sector increased by 1.3 percent to Rs. 173.3 billion compared to the marginal rise of 0.2 percent last year. Increased consumption as well as the housing loan led to the rise in the claims on private sector, albeit marginally.

4. Net non-monetary liabilities declined by 9.2 percent to Rs. 71.9 billlion compared to the fall of 1.6 percent last year. The settlement of government transactions led to the decline in net non-monetary liabilities. Net domestic assets (adjusting the foreign exchange valuation) increased by 3.6 percent to Rs. 176.9 billion as against the marginal increase of 0.1 percent last year. Despite the decline in domestic credit, net domestic assets increased due mainly to the decrease in net non-monetary liabilities.

5. NRB intervened in the foreign exchange market and injected Rs.207 billon liquidity. Factors such as inadequate demand for bank credit both from the government and the private sector coupled with liquidity overhang caused the short-term interest rate to fall. For instance, the 91-day average treasury bills rate decreased significantly from 3.66 percent in mid-September 2003 to 0.63 percent in mid-September 2004.

Government Budgetary Operation

6. The old classification of governments' expenditure into regular and development has been reclassified into new three categories through the public statement on income and expenditure of FY 2004/05: recurrent, capital and principal repayment. In the absence of previous fiscal year's data according to the new classification, only current year's data is presented. Based on the cash flow data, the total expenditure of the government decreased substantially by 25.8 percent to Rs. 6.8 billion in contrast to the rise of 7.4 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 4845.6 million (70.8 percent), capital expenditure at Rs.229.0 million (3.3 percent) and principal repayment Rs.375.7 million (5.5 percent). Freeze account is recorded at Rs. 1.4 billion (20.3 percent).



7. Total non-debt resources (revenue, non-budgetary and other receipts, and foreign grants) increased by 9.7 percent to Rs. 8.9 billion compared to the rise of 26.0 percent last year.

Revenue, the major source (87.6 percent) of the government resources, grew by 8.4 percent to Rs. 7.8 billion compared to a significant growth of 19.0 percent last year. Foreign grants increased to Rs. 677 million as against Rs. 408.2 million received last year. However, non-budgetary receipts (net) declined by 63.3 percent to Rs. 153.6 million.

8. The decline in total expenditure in relation to the growth of non-debt resources resulted in Rs. 2.1 billion budget surplus of compared to the deficit of Rs. 1.1 billion last year. HMG mobilized Rs. 323.2 million foreign cash loans. HMG's cash transactions resulted in a surplus of Rs. 2.4 billion in mid-September 2004. HMG had used Rs. 792.6 million as an overdraft from the Nepal Rastra Bank last year.

9. Due mainly to the rise in non-debt resources and the decline in government expenditure, the total net outstanding domestic debt of HMG declined to Rs. 81.6 billion in mid-September 2004 from the level of Rs. 85.4 billion in mid-July 2004. This is as reflected by the treasury position which totaled Rs. 4.6 billion surplus in mid-September as compared to the surplus of Rs. 753 million in mid-July 2004.

Price Situation

10. The National Urban Consumer Price Index, on point-to-point basis, increased by 2.3 percent in mid-September 2004 compared to the rise of 5.2 percent during the same period last year. Despite the rise in the price of vegetables and fruits, the decline in the price of grains and cereal products led to the deceleration in the price index this year. The overall price index recorded in 159.7 points in mid-September 2004 from 156.1 in mid-September 2003.

11. The index for food and beverages group increased by 3.3 percent compared to the rise of 3.9 percent last year. The indices that showed an increasing trend were for sugar and related products (22.1 percent), vegetables and fruits (12.2 percent), pulses (5.1 percent), meat, fish and eggs (5.0 percent), oil and ghee (2.3 percent), restaurant meals (2.1 percent), spices (1.6 percent) as well as milk and milk products (0.1 percent) while the indices that declined were for beverages (0.6 percent) and grains and cereals products (0.4 percent).

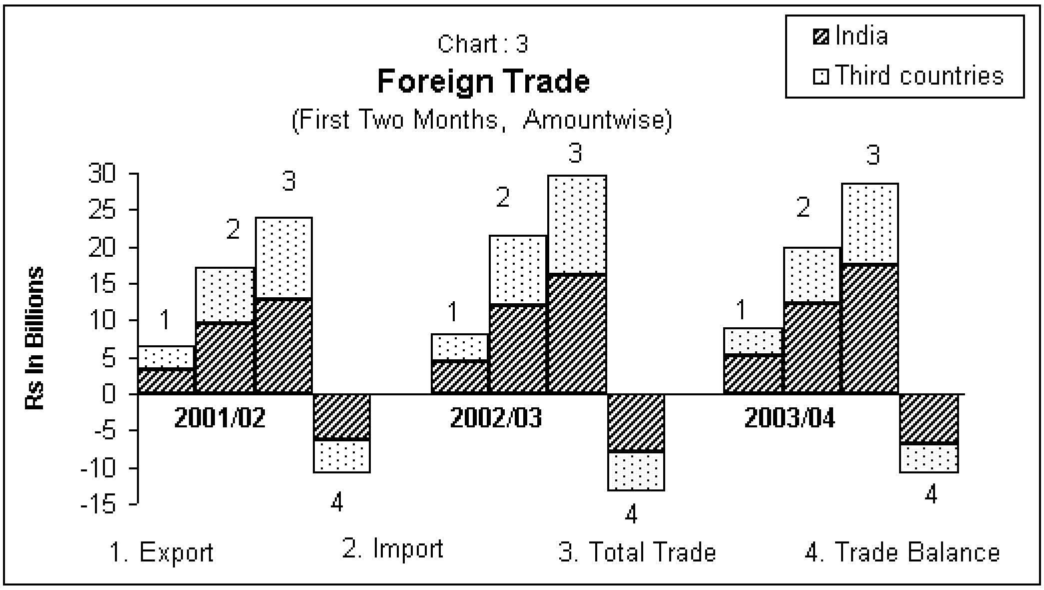
12. The index for non-food and services group increased by 1.4 percent compared to an increase of 6.5 percent last year. The indices that increased were for cloth, clothing and sewing services (2.3 percent), housing goods and services (1.9 percent), medical and personal care (1.8 percent) and education, reading and recreation (0.6 percent) while the indices that declined for footwear (0.7 percent), transport and communication (0.3 percent) that tobacco and related products (0.1 percent).

13. Regionwise, the price indices of the Kathmandu valley, Terai and Hills increased by 4.1 percent, 1.8 percent and 0.9 percent respectively. These indices last year had increased by 5.6 percent, 5.2 percent and 5.0 percent respectively. The indices for food and beverages group rose in Kathmandu Valley, Terai and Hills by 5.5 percent,2.6 percent and 1.6 percent respectively. Similarly, the price indices for non-food and services group increased in Kathmandu Valley, Terai and Hills by 2.7 percent, 1.0 percent and 0.2 percent respectively.

14. The National Wholesale Price Index, on point-to-point basis, increased by 6.1 percent during this year compared to an increase of 3.2 percent last year. Higher prices of cash crops, construction materials and transport vehicles and machinery goods pushed up the price index during the year. The indices for domestic manufactured, imported and agricultural commodities increased by 7.3 percent, 6.5 percent and 5.4 percent respectively.

Foreign Trade

15. According to the data received from the customs points, total exports increased by 8.4 percent to Rs. 8.8 billion compared to the rise of 24.8 percent last year. Exports to India increased by 24.1 percent to Rs. 5.3 billion compared to the growth of 30.4 percent last year. Exports to other countries, which had gone up by 19.2 percent last year, decreased by 8.9 percent to Rs. 3.5 billion. Among the major exportable commodities, the exports of pulses, vegetable ghee, polyester yarn, pasmina, copper wire and rod, chemicals, juice, oil cake, cattle feed, footwear, cloth, catechus, rosin, buckwheat to India has increased. Similarly, the exports of woollen carpets and jeweler to other countries increased while that of pulses, readymade garments, pashmina, readymade leather goods, and tanned skin declined. The export of toothpaste, dried ginger, cardamom, rice barn oil, turpentine, G.I. pipe, M.S. pipe, paper and readymade garments to India declined.

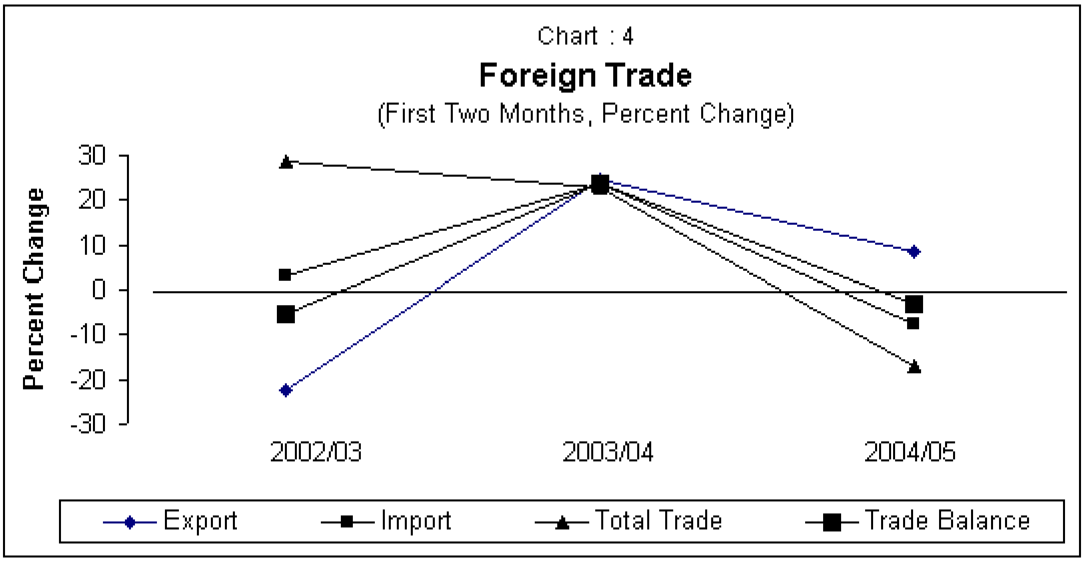


16. Total imports declined by 7.5 percent to Rs. 19.8 billion as against the rise of 23.6 percent last year. Imports from India increased by 1.5 percent compared to the rise of 24.3 percent last year. However, imports from other countries declined by 18.9 percent as against the growth of 22.7 percent last year. Imports of yarn, industrial chemicals, vehicles and spare parts, chemical fertilizer, petroleum products, medicine, plastic utensils and cold-rolled sheets, plastic granules from India and that of edible oil, nut, raw wool, and chemical fertilizers from other countries went up this year. Imports of wheat, rice, pulses, common salt, other machine and parts, hot rolled sheet, M.S. billet, cloths, cement, electric equipments, and vehicles from India and that of yarn, raw soybean oil, raw palm oil, plastic granules, tire and tubes, tele-com equipments and parts, aircraft equipments, other machine and spare parts, electrical goods, medicine, cloth, and computer parts from other countries declined.

17. The higher growth of exports as against the decline in imports resulted in a compression in the trade deficit by 17.2 percent to Rs. 11.0 billion. The trade deficit had increased by 22.8 percent last year. Trade deficit with India, which had recorded a rise of 21.2 percent last year, declined by 11.0 percent this year. Trade deficit with other countries narrowed down by 25.8 percent in contrast to the rise of 25.2 percent last year. Total trade, which had increased by 23.9 percent last year, declined by 3.1 percent this year. Due to the increase of import from and export to India and their declines with respect to other countries, the share of India in total trade went up

to 60.9 percent this year from 54.9 percent last year. Corollary, the share of other countries in the total trade decreased to 39.1 percent this year from 45.1 percent last year.

18. The overall export/import ratio, which was 38.0 percent last year, went up to 44.5 percent this year due mainly to the rise in exports and the decline in imports. The export/import ratios for India and other countries stood at 43.6 percent and 45.8 percent respectively compared to the respective level of 35.7 percent and 40.8 percent last year.



Balance of Payments

19. According to the BOP statistics for FY 2003/04, trade deficit expanded by 16.3 percent to Rs. 81.7 billion due to the higher growth of imports vis-à-vis the exports. Trade deficit had expanded by 31.7 percent in the previous year. Due to increased travel receipts by 53.7 percent to Rs. 18.1 billion, government services by 7.8 to Rs. 7.1 billion and other services by 9.7 percent to Rs. 8.9 billion, service receipts surged by 28.7 percent to Rs. 34.1 billion in FY 2003/04 compared to the 12.8 percent rise in the previous year. Similarly, on the payments side, the service expenses increased on travel by 58.6 percent, transportation by 8.2 percent and other expenses by 21.6 percent which led the total expanses to rise by 27.4 percent to Rs. 2.5 billion in FY 2003/04.

20. Income credit receipts decreased by 14.6 percent to Rs. 3.8 billion whereas the income payments (debit) increased by 6.3 percent to Rs. 5.5 billon. As a result, the total deficit on goods, services and incomes increased by 15.9 percent to Rs. 74.0 billion in FY 2003/04 compared to the rise of 27.8 percent in the previous year.

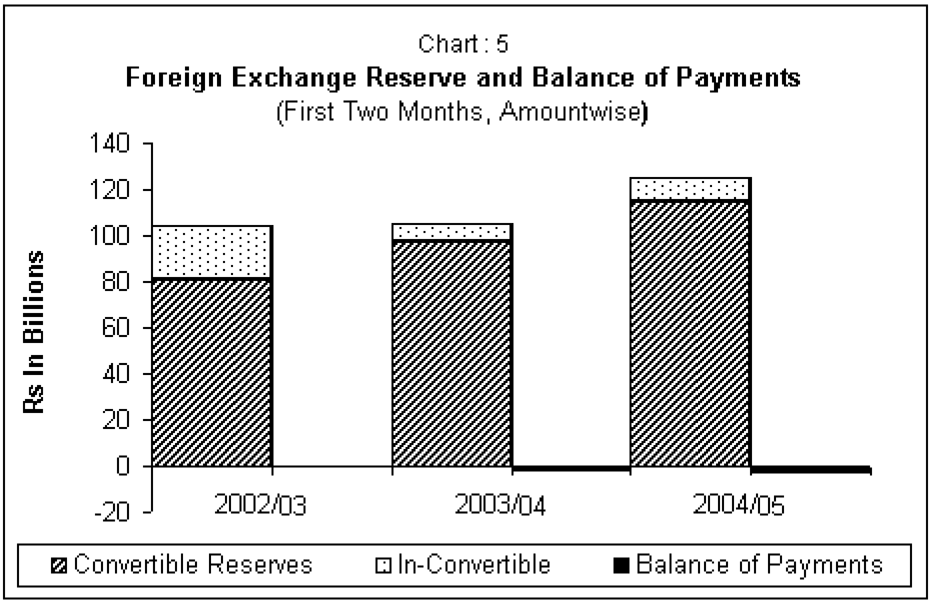
21. In FY 2003/04, foreign grants increased substantially by 41.3 percent to Rs. 19.6 billion compared to a rise of 9.4 percent in the previous year. The workers' remittances increased by 10.0 percent to Rs. 59.6 billion compared to the rise of 14.0 percent in the previous year. Pensions receipts increased by 7.9 percent to Rs.7.9 billion. Similarly, the other transfer receipts (Indian Excise Refund) increased by 30.0 percent to Rs. 3.1 billion. At the same time, the transfer payments increased substantially by 83.6 percent to Rs.4.1 billion this year compared to the rise of 13.2 percent in the previous year.

22. In FY 2003/04, the current account recorded a surplus of Rs. 12.0 billion this year compared to a surplus of Rs.11.6 billion in the previous year. Capital transfer stood at Rs. 1.5 billion which was at Rs. 5.4 billion in the previous year.

23. On the financial account side, other investment assets reached Rs. 36.6 billion in FY 2003/04 compared to the receipts of Rs. 34.6 billion in the previous year. Of this amount, Rs. 4.8 billion was on account of trade credits. Due to the surplus in the current account and substantial inflow of miscellaneous capital, the BOP was in surplus by Rs. 16.5 billion compared to a surplus of Rs. 4.4 billion in the previous year. On the basis of the monetary statistics for the first two months of FY 2004/05, the BOP recorded a deficit of a Rs. 4.2 billion compared to the deficit of Rs. 2.6 billion last year.

Foreign Exchange Reserve

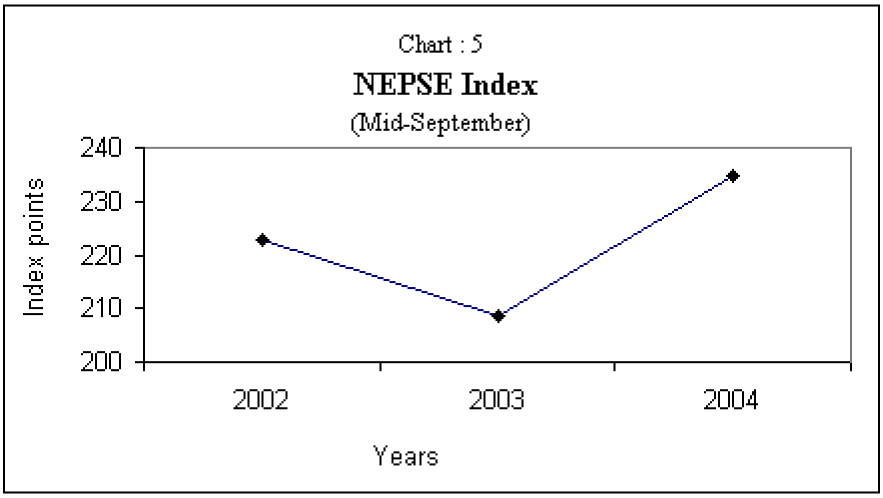
24. The gross foreign exchange reserve increased by 18.9 percent to Rs.125.3 billion in mid-September 2004 from Rs. 105.4 billion in mid- September 2003. Such a reserve had risen by by 1.2 percent during the same period last year. The increase in foreign grants and loan as well as the payments of petroluem products in inconvertible currency led the convertible reserve to rise by 18.4 percent. Similarly, inconvertible reserve increased by 24.7 percent due to the rise in export and decline in import from India. Last year, the convertible reserve had increased 19.9 percent and that of inconvertible reserve had declined substantially by 64.3 percent. The share of convertible reserve in the total reserve fell to 91.8 percent in mid-September 2004 from 92.2 percent in mid- September 2003, resulting in a corresponding rise in the share of non-convertible reserve to 8.2 percent. The overall reserve position is at a comfortable level as it is sufficient to finance merchandise imports of 12.6 months and merchandise and service imports of 10.5 months.



Share Market Transactions

25. Both the number of share transactions and their value increased significantly during the month ending in mid-September 2004 compared to the same month last year. Among the other indicators of share market, share price, number of companies listed, number of companies traded, market capitalization also increased. The secondary market transactions of the commercial banks and manufacturing industries increased. Despite the increase in the number of listed companies, the total amount of listed shares declined by 1.4 percent to Rs. 12.5 billion

compared to that of last year. The market capitalization of the listed companies rose by 21.3 percent to Rs. 44.9 billion compared to that of last year. The NEPSE index increased by 26.12 index points (12.5 percent); from 208.46 in mid-September 2003 to 234.58 in mid-September 2004. The number of companies listed increased to 115 in mid-September 2004 from 109 in mid-September 2003. Similarly, the number of companies listed increased to 74 from 66 last year.



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