Current Macroeconomic Situation of Nepal

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

Nepal Rastra Bank

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Major Highlights

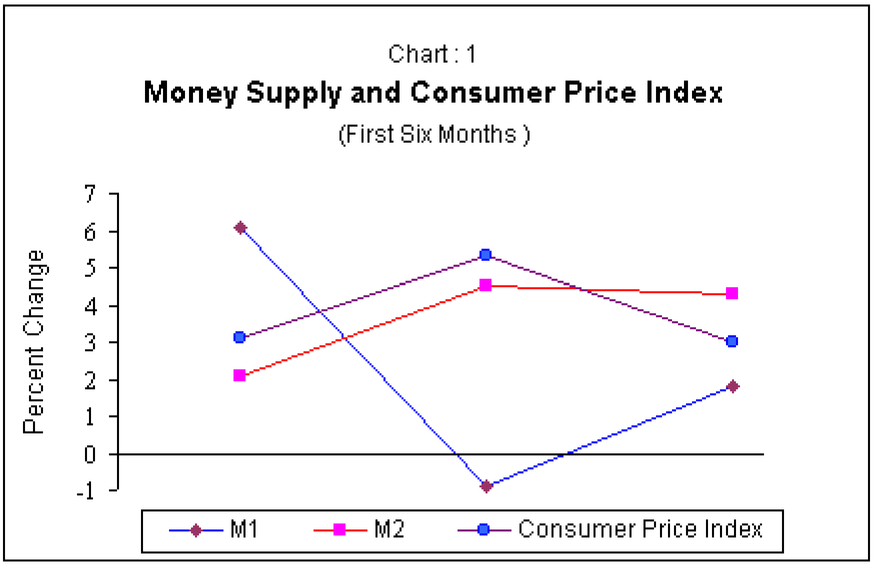
- Both narrow money and broad money increased.
- Time deposits continued to grow.
- Deceleration in the net claims on government slowed.
- Weighted average treasury bills rates declined.
- Stock exchange transactions as well as the NEPSE index increased.
- Inflation decelerated.
- Government expenditure, on cash basis, increased.
- Resource mobilization increased much faster than the expenditure, resulting in the surplus in the budget.
- Exports increased more than the imports, resulting in the contraction in the trade deficit.
- Balance of payments (BOP) recorded surplus.
- Gross foreign exchange reserve increased to Rs.131.1 billion, enough to cover merchandise imports of 12.3 months and merchandise and service imports of 10.6 months.

Current Macroeconomic Situation of Nepal

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

Monetary Situation

1. During the first six months of FY 2004/05, compared to the same period last year, broad money (M_2) increased by 4.3 percent to Rs. 289.3 billion. Broad money had risen by 4.5 percent last year. Narrow money (M_1) went up by 1.8 percent to Rs. 95.7 billion as against a decline of 0.9 percent last year. The increase in monetary aggregares was attributed to the rise in net domestic assets (NDA). Time deposits increased by 5.6 percent to Rs. 193.6 billion in comparison to the rise of 7.3 percent last year. The broad money liquidity (M_3 = M_2 and foreign currency deposits) increased by 3.8 percent to Rs. 309.7 billion compared to an increase of 4.9 percent last year.
2. The net foreign assets (NFA) of the banking sector (adjusting the foreign exchange valuation) increased by 5.2 percent to Rs. 108.9 billion compared to the rise of 9.4 percent last year. A normal increase in exports led to such an increment in NFA.
3. Domestic credit of the banking sector increased by 4.8 percent to Rs. 263.1 billion compared to the increase of 0.5 percent last year. Although the banking sectors's claims on financial institutions and net claims on government declined, the growth in the claims on private sector as well as that on the non-financial government institutions led to such a rise in the domestic credit. The claims on non-financial government institutions went up by 23.2 percent to Rs. 3.6 billion this year due mainly to the increase in the credit flow to the Nepal Oil Corporation (NOC) from the commercial banks. Such claims had declined by 4.1 percent last year. The claims on financial institutions declined by 2.0 percent to Rs. 13.1 billion compared to an increase of 9.3 percent last year. The claims on financial institutions declined due mainly to the refinance repayment to NRB by rural development banks and development banks. The net claims on government declined by 4.6 percent to Rs. 59.5 billion compared to a decline of 14.1 percent last year. Such claims declined due mainly to the rise in the government deposits with NRB. The claims on private sector increased by 8.4 percent to Rs. 187.0 billion compared to the 6.0 percent increase last year. Increased consumption loans, housing loans and vehicle loans led to such a rise.



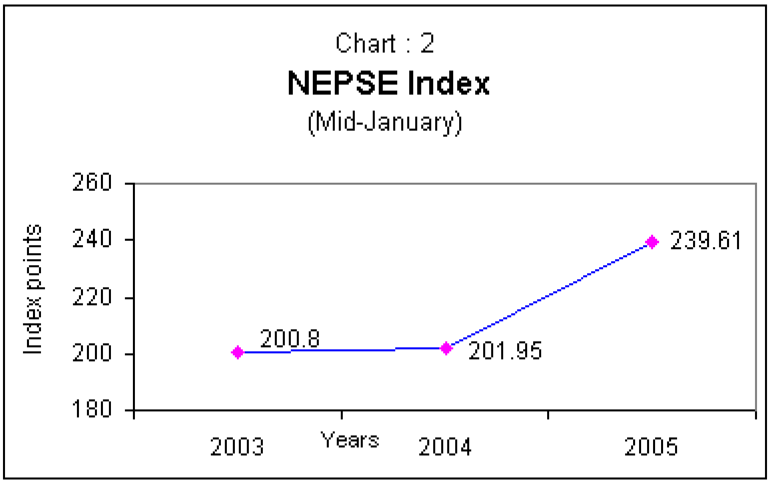
4. Net non-monetary liabilities (adjusting the foreign exchange valuation) increased by 6.9 percent to Rs. 82.8 billion compared to the decline of 1.8 percent last year. The NDA (adjusting the foreign exchange valuation) increased by 3.7 percent to Rs. 180.3 billion compared to an increase of 1.6 percent last year. The expansion in domestic credit accounted for a relatively higher NDA growth this year.

5. NRB mopped up Rs. 10.5 billion liquidity by sale auction and injected Rs. 0.5 billion liquidity by purchase auction. NRB released Rs. 2.7 billion liquidity by repo auction and mopped up Rs.4.1 billion liquidity by reverse repo auction. Standing Liquidity Facility (SLF) of Rs. 22.5 billion was provided to commercial banks. In the secondary market, liquidity amounting to Rs. 14.6 billion was mopped up and Rs. 25.3 billion was released. Consequently, net injection of liquidity remained at Rs.10.7 billion. Injection of liquidity, among others, drove down the short-term interest rates. For instance, the 91-day waighted average Treasury bills rate declined to 2.1 percent in mid-January 2005 from 3.9 percent in mid-January 2004.

Share Market Transactions

6. Total share transactions in terms of both value and number increased significantly during the month ending in mid-January 2005 compared to the same month last year. Among the other share market indicators, the share price, number of companies listed and market capitalization increased. The secondary market transactions of the commercial banks, development banks and finance companies as well as the manufacturing and processing companies increased. The total amount of listed shares increased by 13.2 percent to Rs 14.6 billion due to new listing and issue of bonus shares of some banks, manufacturing and processing companies and insurance companies in the review month compared to the same month last year. The market capitalization of the listed companies rose by 29.6 percent to Rs 47.1 billion compared to that of last year. The NEPSE index increased by 37.7 index points (18.6 percent), from 201.9 in mid-January 2004 to 239.6 in mid-January 2005. The number of companies listed increased to 121 in mid-January 2005 from 111 in mid-January 2004. Similarly, the number of companies traded increased to 76 from 63 last year.

7. In the review month, the value of share transactions increased to Rs 165.6 million, with 2293 thousand shares exchanged through 8427 transactions. In the same month last year, the total value of share transaction was Rs 55.7 million when 269 thousand shares were exchanged through 4700 transactions. Thus, the total transactions in terms of value and number of shares increased by 3.0 times and 8.5 times respectively in the review month compared to the same period last year.



8. Of the total exchanged value in the review month, the share components were: commercial banks (76.2 percent), finance companies (17.6 percent), insurance companies (3.2 percent), manufacturing and processing companies (1.9) percent), hotels (0.7 percent) and development

banks (0.4 percent) as compared to the components in the same period last year, which were: commercial banks (74.2 percent), finance companies (17.2 percent), insurance companies (3.4 percent), development banks (2.2 percent), trading companies (1.5 percent) and hotels (0.5 percent).

Price Situation

9 The National Urban Consumer Price Index, on point-to-point basis, depicted a rise of 4.6 percent in mid-January 2005 compared to an increase of 5.0 percent last year. The growth in the price index is mainly attributable to the upward revision in the prices of petroleum products together with the sharp rise in the price of sugar and related products in spite of the decline in the prices of vegetables and fruits. The overall price index, which was recorded at 152.5 in mid-January 2004, rose to 159.5 in mid-January 2005. The average overall price index increased by 3.0 percent compared to the rise of 5.3 percent last year.

10 On point-to-point basis, the prices of food and beverages group moved up by 3.4 percent compared to an increase of 4.1 percent last year. The prices of sugar and related products shot up by 37.3 percent. Prices that rose were those of meat, fish and eggs (8.0 percent), pulses (7.0 percent), grains and cereal products (5.2 percent), restaurant meals (3.5 percent), spices (0.1 percent) and beverages (0.1 percent. However, the prices that declined were those of vegetables and fruits (5.2 percent), oil and ghee (0.8 percent) and milk and milk products (0.1 percent).

11 The prices of non-food and services group increased by 5.7 percent compared to an increase of 5.9 percent last year. The prices that increased were those of housing goods and services (13.3 percent), education, reading and recreation (4.0 percent), medical and personal care (2.3 percent), cloth, clothing and sewing services (1.8 percent), tobacco and related products (1.3 percent) as well as transport and communication (0.7 percent) while that of the footwear declined by 0.4 percent.

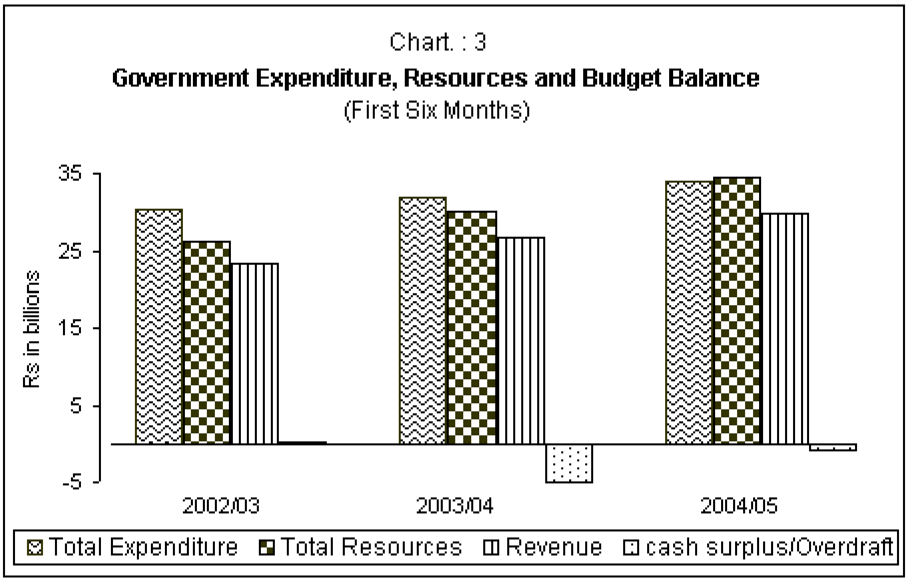
12 Regionwise, the prices in the Kathmandu Valley, Terai and Hills increased by 5.3 percent, 4.3 percent and 3.6 percent respectively. Such prices had increased by 6.9 percent, 4.1 percent and 4.4 percent respectively last year. The prices of food and beverages group rose in Kathmandu Valley, Terai and Hills by 4.0 percent, 3.4 percent and 2.5 percent respectively. Similarly, the prices of non-food and services group increased in Kathmandu Valley, Terai and Hills by 6.7 percent, 5.5 percent and 4.8 percent respectively.

13 The National Wholesale Price Index, on point-to-point basis, increased by 6.9 percent compared to an increase of 7.0 percent last year. The growth in the prices were mainly attributable to the rise in the prices of petroleum products and coal, construction materials, foodgrains as well as transport vehicles and machinery goods, in spite of the decline in the price of fruits and vegetables as well as spices. The prices for imported commodities, domestic manufactured commodities and agricultural commodities increased by 10.8 percent, 7.2 percent and 4.1 percent respectively. The average National Wholesale Price Index increased by 5.8 percent compared to the rise of 4.4 percent last year.

Government Budgetary Operation

14. In the absence of previous fiscal year's data according to the new expenditure classification into recurrent, capital and principal repayment, only the current year's data have been presented. Based on the cash flow data, the total expenditure of the government increased by 6.3 percent to Rs. 34.0 billion compared to the rise of 5.2 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 24.8 billion (73.1 percent), capital expenditure at Rs. 3.4 billion (10.0 percent) and principal repayment Rs. 4.4 billion (12.9 percent). Freeze account recorded Rs. 1.4 billion (4.1 percent).

15. Total non-debt resources (revenue, non-budgetary receipts and others, and foreign grants) increased by 15.0 percent to Rs. 34.5 billion compared to the rise of 14.7 percent last year. Revenue, the major source (86.4 percent) of the government resources, grew by 12.2 percent to Rs. 29.8 billion compared to the rise of 13.6 percent last year. Foreign grants increased to Rs. 3.7 billion compared to Rs. 2.1 billion received last year.



16. The decline in total expenditure in relation to the growth of non-debt resources resulted in Rs. 555.1 million budget surplus compared to the deficit of Rs.1.9 billion last year. HMG mobilized Rs. 1082.5 million through foreign cash loans and borrowed Rs. 2.2 billion through internal loans. HMG's cash transactions in mid-January 2005 resulted in a surplus of Rs. 3.8 billion compared to the surplus of Rs. 4.9 billion in mid-January 2004.

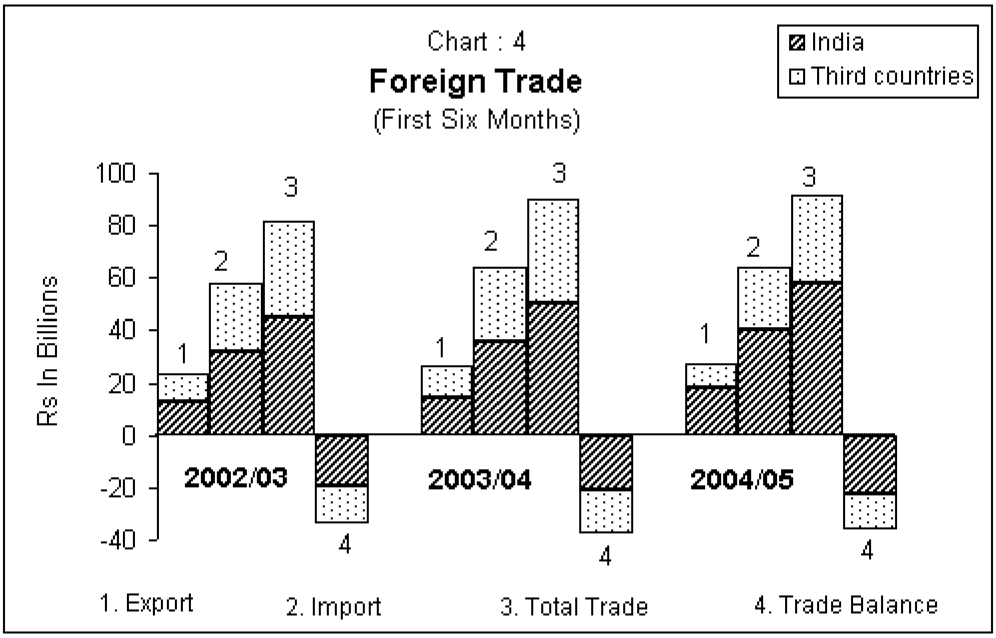
17. Due mainly to the rise in non-debt resources compared to the government expenditure, the total net outstanding domestic debt of HMG declined to Rs. 82.5 billion in mid-January 2005 from its level of Rs. 85.4 billion in mid-July 2004, as reflected in the Treasury position of Rs. 4.6 billion surplus in mid-January 2005 compared to the surplus of Rs. 753 million in mid-July 2004.

Foreign Trade

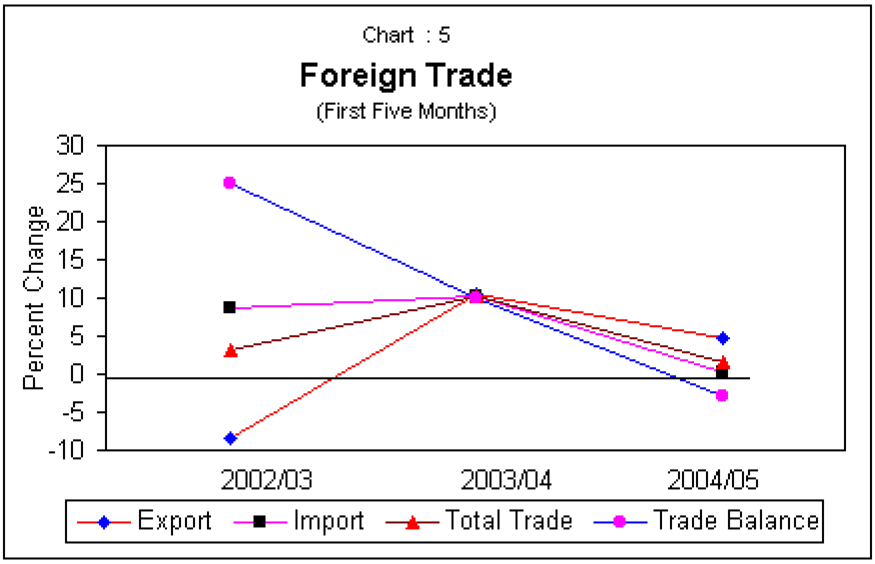
18. Total exports went up by 4.8 percent to Rs. 27.5 billion compared to the rise of 10.4 percent last year. Exports to India increased considerably by 24.1 percent to Rs. 18.0 billion compared to the rise of 14.1 percent last year. Exports to other countries declined by 18.9 percent to Rs. 9.5 billion this year in comparison to the rise of 6.2 percent last year. Among the major exportable commodities, the exports to India of pulses, cardamom, vegetable ghee, tea, polyester yarn, jute goods, aluminium section, copper wire and rod, chemicals, juice, cattle feed, footwear, textiles, catechu, rosin and buckwheat increased. The exports to India of toothpaste, ginger, ricebran oil, G.I. pipe, M.S. pipe and readymade garments to India declined. The exports to other countries of woollen carpets and cardamom went up while that of readymade garments, pulses, tea, tanned skin, jewellery, and Nepali paper and paper products declined.

19. Total imports rose just by just 0.2 percent to Rs. 63.8 billion as against the rise of 10.2 percent last year. Imports from India increased by 12.6 percent compared to the rise of 10.5 percent last year. However, imports from other countries fell by 15.5 percent as against the growth of 9.7 percent last year. Imports of pulse, thread, chemicals, transport vehicles and parts, chemical fertilizers, petroleum products, medicine, cold-rolled sheet, and plastic granules from India and

that of edible oil, betel nut, clove, television, telecommunication equipment and parts, other machinery and parts, steel wire, crude coconut oil, copper wire and sheets from other countries increased. However, the imports of wheat, rice, common salt, hot-rolled sheet, M.S. billet and cement from India and that of thread, crude soybean oil, crude palm oil, plastic granules, aircraft equipment, electrical goods and textiles from other countries declined.



20. The higher growth of exports in comparison to that of imports narrowed down the trade deficit by 3.0 percent to Rs. 36.3 billion. The trade deficit had increased by 10.0 percent last year. Trade deficit with India, which had recorded a rise of 8.2 percent last year, increased by 4.7 percent this year. Trade deficit with other countries declined by 13.0 percent in contrast to the rise of 12.4 percent last year**.** Total trade, which had risen by 10.2 percent last year, grew by just 1.6 percent this year. Because of 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 63.6 percent from 55.7 percent last year while the share of other countries in total trade decreased to 36.4 percent from 44.3 percent last year.



21. The overall export/import ratio, which was 41.2 percent last year, rose to 43.1 percent this year primarily due to the rise in exports and the fall in imports. The export/import ratios for India

and other countries stood at 44.9 percent and 40.1 percent respectively compared to the respective ratios at 40.7 percent and 41.8 percent last year.

Balance of Payments

22. According to the BOP statistics for the first five months of FY 2004/05, trade deficit went down by 7.7 percent to Rs. 27.8 billion because of the decline in imports and the growth in exports. Trade deficit had expanded by 14.7 percent last year. On the services front, receipts from government service increased by 30.4 percent to Rs. 2.8 billion. While travel receipts declined by 13.7 percent to Rs. 5.2 billion, other receipts fell by 3.0 percent to Rs. 3.0 billion. As a result, service receipts declined by 2.5 percent in contrast to the rise of 18.7 percent last year. Similarly, on the payments side, because of the increase in travel expenses and other expenses by 49.3 percent and 8.4 percent respectively, and the decline in transportation expenses by 7.0 percent, total expenses rose by 12.8 percent to Rs. 9.2 billion.

23. Income receipts (credit) soared by 36.1 percent to Rs. 1.5 billion while the income payments (debit) increased only by 8.7 percent to Rs. 2.4 billion. As a result, the total deficit on goods, services and income declined by 4.3 percent to Rs. 26.9 billion as against a rise of 13.0 percent last year.

24. Under transfer receipts, foreign grants declined by 11.7 percent to Rs. 8.0 billion in contrast to a surge of 52.1 percent last year. The workers' remittances declined by 12.6 percent to Rs. 23.4 billion compared to the rise of 8.2 percent last year. Pensions receipts increased by 96.7 percent to Rs.4.8 billion. Similarly, other transfer receipts (Indian excise refund) increased by 23.5 percent to Rs. 994.6 million. At the same time, the transfer payments increased by 17.0 percent to Rs.1.3 billion compared to the decline of 25.8 percent last year.

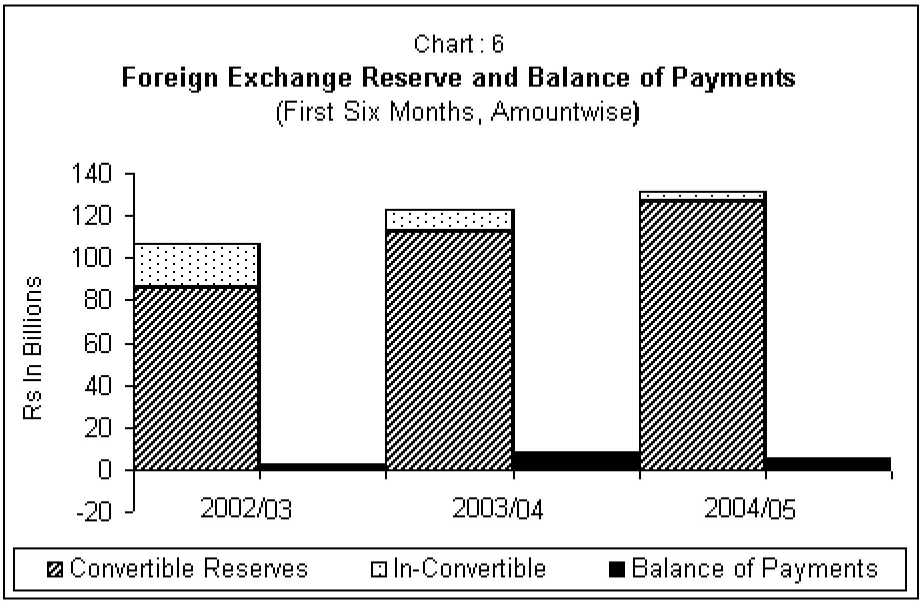
25. Current account recorded a surplus of Rs. 8.9 billion compared to the surplus of Rs. 9.8 billion last year. Capital transfer stood at Rs. 617.3 million in comparison to the level of Rs. 839.7 million last year.

26. Under the financial account, other investment assets reached Rs. 10.7 billion compared to the sum of Rs. 18.8 billion last year. Of this amount, Rs. 2.0 billion was on account of trade credits. Compared to Rs. 6.5 billion last year, other investment liabilities amounted negative to Rs. 2.7 billion this year. Of this amount, Rs. 690.6 million was on account of trade credits. HMG received Rs. 832.4 million as loan and repaid Rs. 2.6 billion in amortization. As a result, the net government borrowing stood at negative Rs. 1.8 billion. Currency and deposit liabilities dropped by Rs. 168.6 million. Consequently, the financial account resulted negative in a Rs. 13.4 billion. Because of the surplus in the current account and the inflow of miscellaneous capital, the BOP posted a surplus of Rs. 1.2 billion in comparison to a deficit of Rs. 105.2 million last year. Based on the monetary statistics, a BOP surplus of Rs. 5.6 billion was recorded in mid-January 2005 compared to the surplus of Rs. 8.6 billion in mid-January 2004.

Foreign Exchange Reserve

27 The gross foreign exchange reserve rose by 6.8 percent to Rs.131.1 billion in mid-January 2005 compared to an increase of 14.8 percent to Rs. 122.8 billion in mid-January 2004. The decline in imports from other countries and the rise in remittances through the banking system were the factors responsible for the 12.9 percent growth in the convertible reserve. Inconvertible reserve fell by 59.4 percent in consequence to the decline in both remittances and net services income from India. Last year, the convertible reserve had increased by 31.2 percent while the inconvertible reserve had declined by 51.1 percent. The share of convertible reserve in the total reserve rose to 96.8 percent in mid-January 2005 from 91.5 percent in mid-January 2004, resulting in the corresponding fall in the share of the non-convertible reserve to 3.2 percent

from 8.5 percent. Sufficient to finance merchandise imports of 12.3 months and merchandise and service imports of 10.6 months, the current reserve position is at a comfortable level.



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