Current Macroeconomic Situation

(*Based on Data of the First Nine Months of FY 2004/05*)

Nepal Rastra Bank
June 2005

www.nrb.org

Current Macroeconomic Situation

(*Based on Data of the First Nine Months of FY 2004/05*)

Monetary Situation

1. **Monetary Aggregates:-** During the first nine months of FY 2004/05, the growth of broad money (M_2) decelerated whereas the growth of narrow money (M_1) accelerated. M_2 expanded by 6.2 percent to amount Rs.294.4 billion as at mid April 2005 compared to a rise of 9.1 percent last year. Deceleration in net foreign assets caused relatively lower growth of M_2. Narrow money (M_1) increased at a rate of 7.0 percent to Rs.100.5 billion, which is more than the growth rate of 6.4 percent observed last year. Deceleration in time deposits contributed to such an acceleration in M_1. During the review period, time deposits increased at a lower rate of 5.8 percent compared to an increase of 10.5 percent last year.

Factors Affecting Monetary Aggregate:

2. **Reserve Money:-**Of the two proximate determinants of money supply, reserve money (RM) in contrast to an increase of 8.8 percent last year, declined by 1.4 percent and stood at Rs.93.1 billion as at mid April 2005. The decline in reserve money is attributed to the fall in the demand for reserve by commercial banks as evidenced by the decrease of bank balance with NRB. Three factors explain the fall in demand for reserves by the commercial banks. First, a cut in CRR in the beginning of the fiscal year lowered the demand for required reserves. Second, provision of a transparent system of standing liquidity facility (SLF) provided instilled a sense of confidence in commercial banks in managing their excess reserve. Third, commercial bank competed for consumer lending with other financial institutions. All these factors helped to expand financial intermediation in terms of increased growth of bank credits to the private sector. This also boosted the profitability of commercial banks this year compared to that of previous year. On sources front, net foreign assets (NFA) of the NRB (after adjusting the foreign exchange valuation gain/loss) increased at a lower rate of 7.8 percent this year compared to a much higher rate of growth of 15.1 percent last year. Such a deceleration in NRB's NFA contributed to the decline in RM.

3. **Money Multiplier:-** Money multipliers, the other determinants of money supply, showed an upward trend this year. For example, M_1 multiplier went up to 1.080 this year from 1.011 last year. Similarly, M_2 multiplier rose to 3.163 this year from 3.044 last year. The increase in bank credit to the private sector resulting in a reduction of excess reserves of commercial banks contributed to a rise in both money multipliers.

4. **Net Foreign Assets:-** As per monetary survey, NFA of the monetary sector (after adjusting the foreign exchange valuation gain/loss) increased by 7.8 percent to Rs.112.8 billion this year compared to much higher increase of 15.1 percent last year. The decline in foreign loans is mainly responsible for such a deceleration in NFA this year.

5. **Net Claims on Government:-** Monetary sector's net claims on government declined albeit by lower rate of 4.1 percent to Rs.59.7 billion this year compared to a much sharper decline of 11.8 percent last year. The cash balance maintained by the government with NRB contributed to the decline in such claims this year too.

6. **Claims on Government Enterprises:-** Monetary sector's claims on non financial government enterprises increased by 4.1 percent to Rs.3.0 billion this year compared to an increase of 3.1 percent last year. The increase in credit flow to the Nepal Oil Corporation (NOC), Nepal Food Corporation and National Trading Limited from the commercial banks contributed to the increase in such claims. However, monetary sector's claims on financial institutions declined by 7.3 percent to Rs.12.4 billion this year in contrast to an increase of 11.5 percent last year, due mainly to the repayment of refinance to NRB by rural development banks and development banks.

7. **Claims on Private Sector:-** Monetary sector's claims on private sector increased by 13.2 percent to Rs.195.4 billion this year compared to a rise of 11.7 percent last year. Competitive expansion of credit by the commercial banks such as Nepal Bank Ltd, Himalayan Bank Ltd, Nepal Investment Bank Ltd, Everest Bank Ltd, Bank of Kathmandu and Machhapuchhre Bank Ltd contributed to an increase in such claims.

8. **Domestic Credit:-** As a result of factors discussed above, domestic credit of the monetary sector increased by 7.7 percent to Rs.270.5 billion compared to a rise of 5.1 percent last year. The share of the government in total domestic credit this year decreased by 1.0 percentage point to 22.1 percent.

9. **Net Non-monetary Liabilities and Net Domestic Assets:-** Net non-monetary liabilities (after adjusting the foreign exchange valuation gain/loss) increased by 13.1 percent to Rs.89.0 billion this year compared to a lower increase of 4.2 percent last year due mainly to an increase in loan loss provisioning by Rastriya Banijya Bank, Nepal Credit and Commerce Bank Ltd, Himalayan Bank Ltd and Nepal Bangladesh Bank Ltd, and a rise in paid up capital by Nepal Credit and commerce Bank Ltd, Himalayan Bank Ltd and Nepal Bangladesh Bank Ltd. The Net Domestic Assets (NDA) (after adjusting the foreign exchange valuation gain/loss) increased by 5.1 percent to Rs.181.6 billion this year compared to an increase of 5.6 percent last year. Higher increase in net non-monetary liabilities accounted for such a deceleration in NDA.

Implementation of Monetary Policy Instruments

10. During the first nine months of the current fiscal year, NRB mopped up liquidity to the extent of Rs. 10.5 billion by means of sale auction and injected Rs.1.3 billion by way of purchase auction. NRB released liquidity of Rs.5.8 billion through repo auction and mopped up liquidity amounting to Rs.5.3 billion through reverse repo auction. Thus, liquidity amounting to Rs.15.8 billion was mopped up and that of Rs.7.1 billion was released resulting in a net withdrawal of liquidity amounting to Rs.8.7 billion through money market operations. NRB also provided standing liquidity facility amounting to Rs.44.2 billion in cumulative terms to the commercial banks.

11. NRB intervened in the foreign exchange market to purchase US $ equivalent of Rs.28.0 billion and sell Rs.2.8 billion, resulting a net injection of liquidity of Rs.25.1 billion this year.

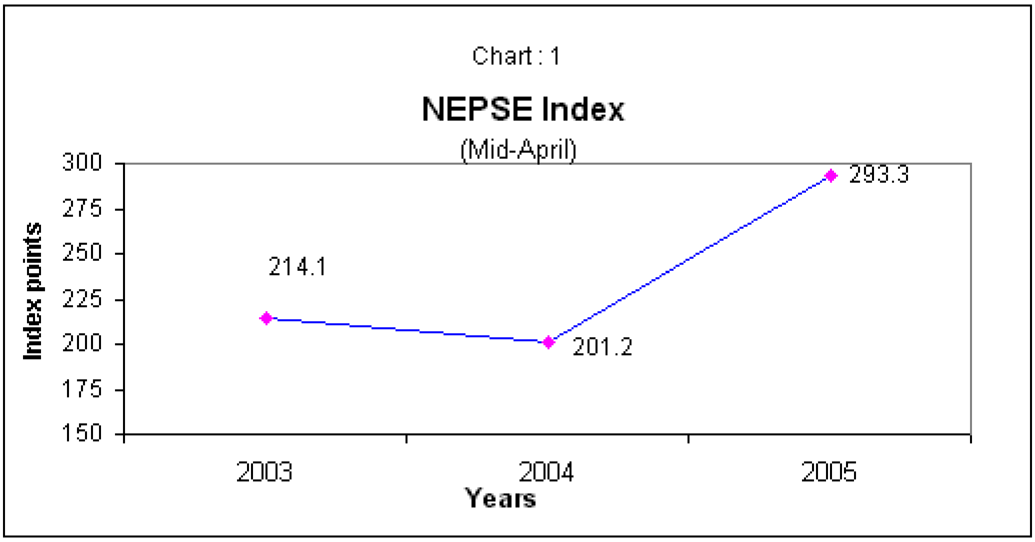
12. However, a significant increase in bank credit to private sector brought down the excess reserves of commercial banks. As a result, weighted average of 91 days treasury bills rate increased to 3.11 percent in mid April from 0.62 percent in mid August 2004.

Share Market Transactions

13. Total share transactions in terms of both value and number increased substantially during mid-April 2005 compared to the same month last year. Among the other share market indicators, the share price, the number of companies listed and market capitalization also increased simultaneously. The secondary market transaction of all the groups of companies except Finance Companies and Hotels have increased among which

Commercial Banks and Development Banks increased substantially. The total amount of listed shares increased by 28.3 percent to Rs 16.7 billion due to new listing and issue of bonus shares by some Banks, Finance Companies and Insurance Companies in the review month compared to the same month last year. The market capitalization of the listed companies rose by 62.7 percent to Rs 62.6 billion compared to that of last year. The NEPSE index increased by 92.04 index points (45.7 percent), from 201.22 at the closing of the exchange market in mid-April 2004 to 293.26 at the same point of time in mid-April 2005. The number of companies listed increased to 123 in mid-April 2005 from 112 in mid-April 2004. Similarly, the number of companies traded increased to 87 from 67 last year.

14. In the review month, as 858 thousand shares exchanged through 13747 transactions, the value of share transactions increased to Rs. 295.5 million. The total value of share transaction was Rs 87.5 million when 342 thousand shares were traded through 13417 transactions in the same month last year. Thus, the total transactions in terms of value and number of shares increased by 3.4 times and 2.5 times respectively in the review month compared to the same period last year.



Sectoral Contribution to Total Transitions

15. Of the total exchanged value in the review month, the share components were: Commercial Banks (86.2 percent), Finance Companies (6.9 percent), Insurance Companies (2.4 percent), Development banks (1.5 percent), Trading Companies (0.5 percent), Manufacturing and Processing Companies (0.4) percent), Hotels' contribution remained insignificantly whereas other groups' contribution amounted to 2.0 percent of the total exchange value. In the same period last year, the respective contributions were: Commercial Banks (60.6 percent), Finance Companies (30.8 percent), Insurance Companies (3.8 percent), Development Banks (0.6 percent), Hotels (0.5 percent) Manufacturing and Processing Companies (0.1 percent) and Trading other groups companies (2.2 percent).

Price Situation

16. The National Urban Consumer Price Index (CPI), on a point-to-point basis, increased by 5.8 percent in mid-April 2005 compared to an increase of 1.7 percent last year. The sharp rise in the price index was mainly attributable to the rise in the prices of housing goods and services, transport and communication, and restaurant meals resulting from the upward revision in the prices of petroleum products since February 2005. The rise in the price of grains and cereals products, vegetables and fruits, meat, fish and eggs as well as sugar and related products also contributed to the upward pressure in price index this year. The overall price index, increased to 163.1 in mid-April 2005 from 154.1 a year ago.

17. The average growth rate of price index for the first nine months of this year remained at 3.9 percent compared to a rise of 4.7 percent last year. The slow growth of prices prior to the hike in the prices of petroleum products during the first half of the current fiscal year accounted for a lower level of average rate of inflation this year compared to that of last year.
18. On a point-to-point basis, the index of food and beverages group moved up by 4.8 percent compared to an increase of 2.4 percent last year. The rise in the prices of vegetables and fruits; meat, fish and eggs; restaurant meals; grains and cereals products; and sugar and related products pushed up the index of this group. The index of sugar and related products shot up by 28.2 percent. Products that recorded an increase in indices are vegetables and fruits (8.5 percent), restaurant meals (7.5 percent), meat, fish and eggs (6.1 percent), grains and cereal products (4.7 percent), beverages (3.5 percent), pulses (1.9 percent) and milk and milk products (0.1 percent). However, the indices that declined were those of oil and ghee (5.6 percent), and spices (3.1 percent).
19. The price index of non-food and services group increased at a higher pace of 6.8 percent compared to a much slower pace of 1.1 percent last year. The rise in the price index of this group is mainly attributable to the rise in the prices of petroleum products, which exerted an upward pressure in the price of transport and communication as well as housing goods and services. The indices that increased were those of transport and communication (14.1 percent); housing goods and services (12.2 percent); education, reading and recreation (4.8 percent); cloth, clothing and sewing services (2.6 percent); tobacco and related products (2.5 percent); footwear (1.3 percent); and medical and personal care (1.1 percent).

National Urban Consumer Price Index

(Base Year 1995/96 = 100)

	If prices of petroleum products and VAT rate were unchanged		If VAT rate was increased keeping the prices of petroleum products unchanged		If prices of petroleum products were increased keeping the VAT rate unchanged		When prices of petroleum products and VAT rate are changed (Current Situation)	
	1		2		3		4	
Period	Index	Percentage change	Index	Percentage change	Index	Percentage change	Index	Percentage change
2004/05*	159.4	3.0	159.7	3.2	161.2	4.1	161.5	4.3

* Estimated

The current fiscal year experienced a rise in the prices of petroleum products by an average of 35.7 percent. Likewise, the rate of Value Added Tax also increased from 10.0 to 13.0 percent. Consequently, the upward revision in the price of petroleum products and in the rate of Value Added Tax have exerted an upward thrust of 1.33 percent in the National Consumer Price Index. The individual contribution of price change in petroleum products and change in Value Added Tax is worked out at 1.15 percent and 0.18 percent respectively.

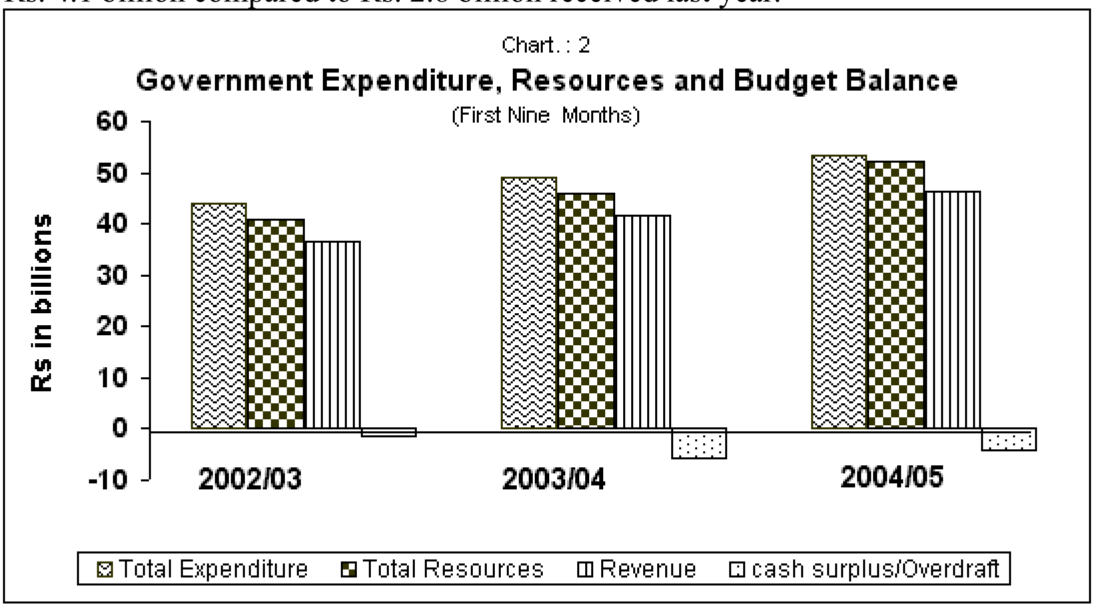
The aforementioned table depicts four scenarios; the first (no change in the prices of petroleum products and VAT) depicts a rise in the overall price index by 3.0 percent pushing the index to stand at 159.4 points. The second scenario (VAT rate increased and the prices of petroleum products unchanged) shows a rise in price index by 3.2, pushing the index to 159.7 points. The third scenario (change in the prices of petroleum products, keeping the VAT rate unchanged) depicts a rise in overall price index by 4.1 percent pushing the overall index to remain at 161.2 point. Finally, the fourth scenario (changes in the price of petroleum products and VAT rate) shows an increment of 4.3 percent in the overall price index, pushing it to record at 161.5 points.

20. Region-wise, the price indices of the Kathmandu Valley increased by 5.5 percent, in the Terai by 5.7 percent and in Hills by 6.5 percent. Such indices had increased in the Kathmandu Valley by 5.3 percent, in the Terai by 0.1 percent and in Hills by 0.8 percent last year. The prices of food and beverages group rose in the Kathmandu Valley by 4.2 percent, in the Terai by 4.9 percent and in Hills by 5.7 percent. Similarly, the prices of non-food and services group increased in the Kathmandu Valley by 6.9 percent, in the Terai by 6.6 percent, and in Hills by 7.4 percent.

21. On a point-to-point basis, National Wholesale Price Index increased by 8.4 percent compared to an increase of 2.6 percent last year. The higher growth in the wholesale price index is mainly attributable to the rise in the prices of cash crops (potato and jute), chemical fertilizer and chemical goods and food grains together with the sharp rise in the prices of petroleum products, in spite of the decline in the prices of spices, fruits and vegetables and pulses. The prices of imported commodities increased by 12.2 percent, agricultural commodities by 7.7 percent and domestic manufactured commodities by 4.0 percent. The average National Wholesale Price Index for the first nine months of this year increased at a relatively higher rate of 6.5 percent compared to a rise of 4.2 percent last year.

Government Budgetary Operation

22. In the absence of previous fiscal year's data as per 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 8.9 percent to Rs. 53.5 billion compared to a rise of 11.8 percent last year. Of the total expenditure, recurrent expenditure stood at Rs. 38.8 billion (72.5 percent), capital expenditure at Rs. 6.9 billion (13.0 percent) and principal repayment at Rs. 6.4 billion (12.0 percent). Expenditure under freeze account recorded a fall of 12.2 percent to Rs. 1.4 billion.
23. Total non-debt resources (revenue, non-budgetary receipts and others, and foreign grants) increased by 13.6 percent to Rs. 52.1 billion compared to a rise of 12.4 percent last year. Revenue, the major source (88.8 percent) of government resources, grew by 11.7 percent to Rs. 46.3 billion compared to a rise of 13.8 percent last year. Foreign grants increased to Rs. 4.1 billion compared to Rs. 2.8 billion received last year.



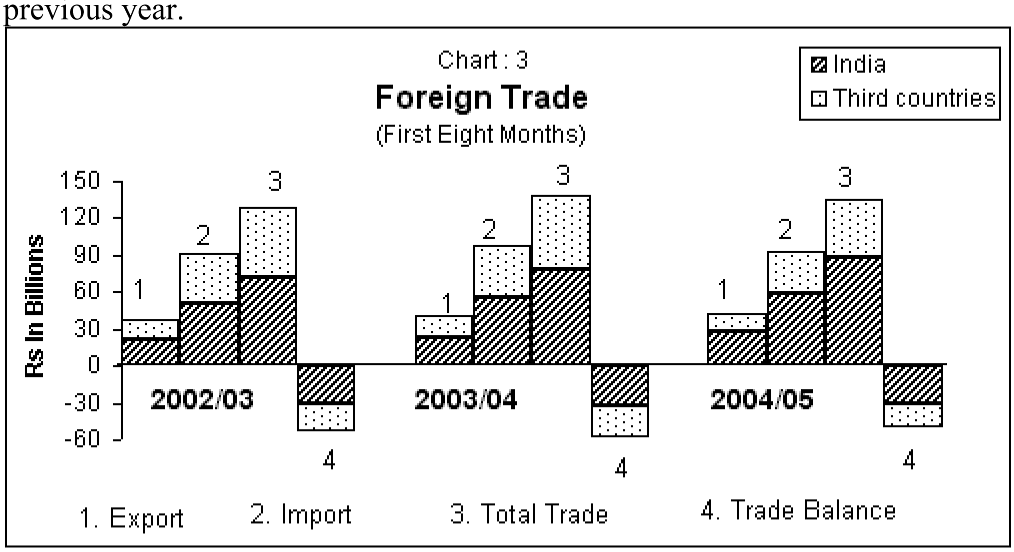
24. Due to the higher growth in non-debt resources compared to that of total government expenditure, the budget deficit declined by 58.3 percent to Rs. 1.4 billion. HMG mobilized Rs. 1.6 billion through foreign cash loans and while internal borrowing

amounted to Rs. 3.9 billion. HMG's cash transactions in mid-April 2005 resulted in a surplus of Rs. 4.0 billion compared to a surplus of Rs. 5.8 billion in mid-April 2004.

25. Due mainly to a higher rise in non-debt resources compared to the total government expenditure, the total net outstanding domestic debt of the government declined to Rs. 82.7 billion in mid-April 2005 from Rs. 85.4 billion in mid-July 2004, as reflected in the surplus treasury position of Rs. 4.8 billion in mid-April 2005 compared to the surplus of Rs. 753 million in mid-July 2004.

Foreign Trade

26. Based on customs data, during the first nine months of the current fiscal year, total exports increased by 3.6 percent to Rs. 41.9 billion while total imports declined by 5.7 percent to Rs. 93.0 billion resulting in the corresponding decline in trade deficit by 12.2 percent to Rs. 51.1 billion. Despite the increase in exports, total trade declined by 3.0 percent due mainly to the decline in imports. In the corresponding period of the previous year, exports had gone up by 6.7 percent and imports by 8.0 percent leading to a 9.0 percent growth in trade deficit. Consequently, total trade had gone up by 7.6 percent in the previous year.



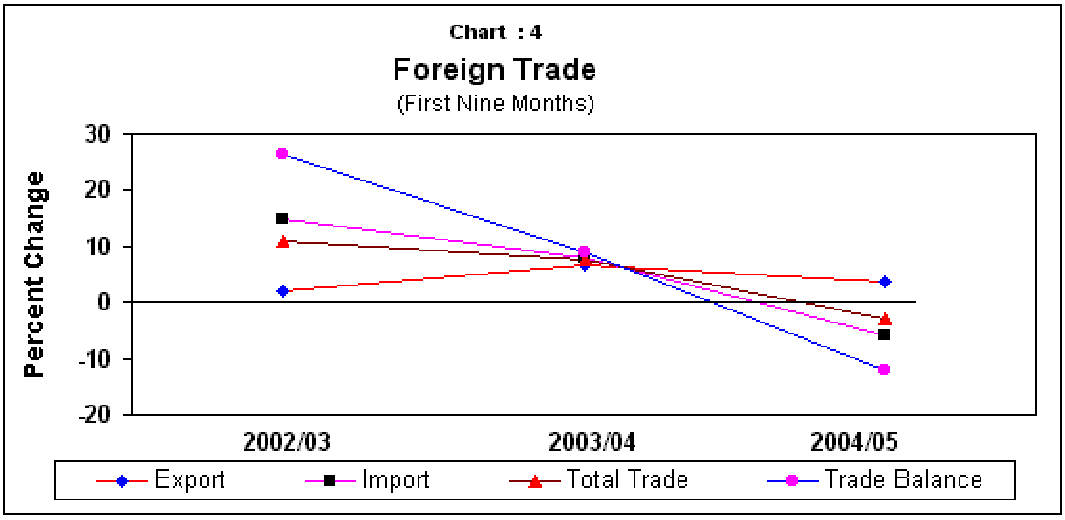
27. Exports to India rose significantly by 21.4 percent to Rs. 28.1 billion this year compared to a rise of 12.4 percent last year. Exports to other countries declined by 20.2 percent to Rs. 13.8 billion this year in comparison to a decline of 0.2 percent last year. Among the principal exportable commodities, the exports of cardamom, vegetable ghee, tea, thread, jute goods, aluminum section, copper wire and rod, chemicals, and textiles to India have increased while the exports of toothpaste, ginger, ricebran oil, G.I. pipe, M.S. pipe and readymade garments to India fell. Similarly, the exports of woollen carpets and jewellery to other countries slightly went up while that of readymade garments, tanned skin and pashmina declined.

28. With respect to the structure of exports to India, primary goods and manufactured goods formed 28.6 percent and 71.4 percent of total exports to India compared to their respective shares of 29.7 percent and 70.3 percent in the corresponding period of the previous year. Likewise, with regard to exports to other countries, primary goods and manufactured goods constituted 8.7 percent and 91.3 percent of total exports to other countries while their respective shares were 7.1 percent and 92.9 percent in the corresponding period of the previous year.

29. Imports from India increased by 7.4 percent compared to a rise of 7.8 percent last year. However, imports from other countries fell by 22.6 percent as against a growth of 8.3 percent last year. Imports of pulse, thread, chemicals, petroleum products, medicine, cold-rolled sheet, and plastic granules from India and that of sugar, transport vehicles and parts, steel wire, and crude coconut oil from other countries augmented. However, the imports of wheat, rice, hot-rolled sheet, M.S. billet and other machineries and parts from India and that of thread, raw wool, crude soybean oil, crude palm oil, chemical fertilizers,

plastic granules, telecommunication equipment and parts, aircraft equipment and electrical goods from other countries declined.

30. With regard to the structure of imports from India, industrial raw materials & capital goods and petroleum products constituted 43.5 percent and 30.7 percent, respectively, of total imports from India while their respective shares in the corresponding period of the previous year were 50.6 percent and 25.2 percent. Similarly, the share of industrial raw materials and capital goods in total imports from other countries was 54.2 percent in comparison to 61.4 percent in the corresponding period of the previous year.



31. Owing 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 65.0 percent from 56.5 percent last year while the share of other countries in total trade decreased to 35.0 percent from 43.5 percent last year.

32. The overall export/import ratio, which stood at 41.0 percent last year, rose to 45.1 percent this year. The export/import ratios for India and other countries stood at 47.2 percent and 41.3 percent respectively compared to their respective ratios at 41.8 percent and 40.1 percent last year.

Balance of Payments

33. According to the BOP statistics for the first eight months of FY 2004/05, the overall BOP continued to remain in surplus to the extent of Rs. 4.4 billion compared to a surplus of Rs. 11.0 billion last year due principally to the substantial surplus in the current account.

34. Current account recorded a surplus of Rs. 20.6 billion compared to a surplus of Rs. 14.5 billion last year. Among the major components of current account, trade deficit declined by 10.2 percent to Rs. 42.2 billion which is a reflection of decline in imports and a slight increase in exports. Trade deficit had risen by 8.1 percent last year.

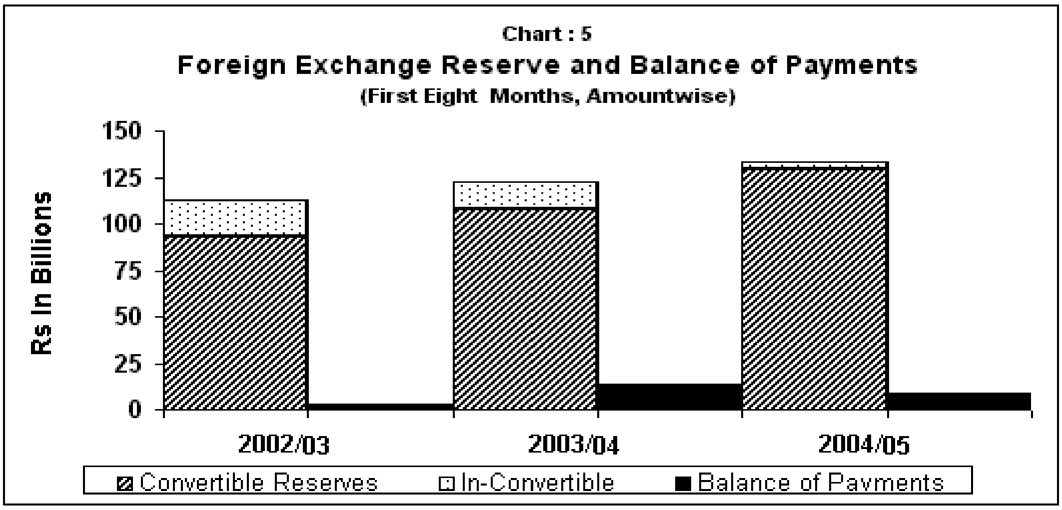
35. On the services front, receipts from government services went up by 9.2 percent to Rs. 4.4 billion. On the other hand, travel receipts and other receipts declined by 32.8 percent and 5.8 percent to Rs. 7.4 billion and Rs. 5.2 billion respectively. As a result, total service receipts declined by 17.3 percent this year in contrast to a significant rise of 26.8 percent last year. Similarly, on the payments side, despite a decline in transportation by 4.4 percent, total expenses rose by 11.7 percent to Rs. 15.9 billion primarily due to the upsurge in expenses on travel and others by 27.5 percent and 19.5 percent, respectively.

36. Income receipts (credit) soared by 44.1 percent to Rs. 2.9 billion while the income payments (debit) went up by 13.1 percent to Rs. 4.0 billion. As a result, the total deficit on goods, services and income went down by just 0.1 percent to Rs. 42.1 billion compared to a rise of 6.7 percent last year.

37. Under the transfer front, foreign grants rose by 10.6 percent to Rs. 13.9 billion compared to a considerable increment of 53.8 percent last year. Workers' remittances increased by 2.6 percent to Rs. 41.5 billion this year compared to a growth of 4.0 percent last year. Pension receipts increased substantially by 84.2 percent to Rs. 8.3 billion. Other transfer receipts (Indian excise refund), on the other hand, fell by 0.8 percent to Rs. 1.3 billion. Meanwhile, the transfer payments increased by 3.8 percent to Rs. 2.3 billion compared to an increase of 22.8 percent last year.
38. Under the capital account, capital transfer stood at Rs. 724.6 million compared to the level of Rs. 1,098.0 million last year.
39. Under the financial account, other investment assets stood at Rs. 20.5 billion this year compared to Rs. 26.7 billion last year. Of this amount, Rs. 2.2 billion was on account of trade credits. Compared to Rs. 17.5 billion last year, other investment liabilities turned into a negative sum of Rs. 1.8 billion this year. Of this amount, Rs. 1.3 billion was on account of trade credits. HMG received Rs. 5.3 billion as loan and repaid Rs. 3.6 billion in amortization. As a result, the net government borrowing stood at Rs. 1.7 billion. Foreign currency and deposit liabilities dropped by Rs. 2.0 billion. Consequently, the financial account resulted into a negative sum of Rs. 22.3 billion.

Foreign Exchange Reserves

40. In comparison to an increase of 8.0 percent last year, the gross foreign exchange reserves rose by 9.2 percent to Rs.133.5 billion as at mid-April 2005. The decline in imports from other countries and the rise in remittances through the banking system were the factors responsible for the 20.9 percent growth in the convertible currency reserves. Inconvertible reserves went down sharply by 75.4 percent due to the decline in remittances and the net services income from India that turned out negative. Last year, the convertible reserves had risen by 15.2 percent while the inconvertible reserves had declined by 25.6 percent. The share of convertible reserves in the total reserves rose to 97.3 percent as at mid-April 2005 from 87.8 percent as at mid-April 2004, resulting in the corresponding fall in the share of the non-convertible reserves to 2.7 percent from 12.2 percent. The current reserves level is adequate to finance merchandise imports of 12.9 months and merchandise and service imports of 10.8 months. Thus, the current reserves position is at a comfortable level.



Price of Oil and Gold in the International Market

41. The price of oil (Crude Oil Brent) rose by 47.8 percent to US$ 49.8 per barrel on April 15, 2005 from US$ 33.7 per barrel during the same period last year. Similarly, the price of gold increased by 6.6 percent in the international market to US$ 424.6 per ounce on April 15, 2005 from US$ 398.3 in the corresponding period of the previous year.

***