

## **Current Macroeconomic Situation** *(Based on the data of first seven months of 2006/07)*

### **Money, Credit, Liquidity and Interest Rates**

#### **Money supply rises**

1. In the first seven months of 2006/07, broad money ( $M_2$ ) registered a growth of 9.5 percent compared to an increase of 7.3 percent in the same period of 2005/06. The higher level of increase in net domestic assets (NDA) of the monetary sector contributed to the growth of  $M_2$ .
2. Similarly, narrow money ( $M_1$ ) increased by 7.1 percent in the review period compared to a growth of 4.8 percent in the same period of the preceding year. Likewise, time deposits, another component of  $M_2$ , increased by a higher rate of 10.6 percent compared to a growth of 8.6 percent in the same period of the preceding year. The overbidding of shares issued by Gorkha Development Bank, resulting a significant increase in the deposits collection by it accounted for a pick up in deposits with commercial banks in the review period.
3. Net Foreign Assets (NFA), after adjusting exchange valuation gains/loss increased by 4.5 percent (Rs. 6.34 billion) in the review period. NFA had risen by 12.1 percent (Rs. 12.1 billion) in the previous year. The lower level of growth in NFA was on account of a slowdown in workers' remittances and a decline in exports in the review period.

#### **Domestic credit expands**

4. Domestic credit increased by 7.3 percent in the review period, which had risen by 5.2 percent last year. Such a higher growth of domestic growth was due to an increase in short-term investment by commercial banks in development banks and finance companies.

#### **Net claims on Government continues to decline**

5. Of the credit aggregates, monetary sector's net claims on the government declined by 7.8 percent in the review period compared to a decline of 4.0 percent last year. A substantial increase in the government balances with Nepal Rastra Bank (NRB) on account of lower level of government expenditure relative to non-debt resource

mobilization contributed to the decline in net claims on the government in the review period.

6. Claims on government non-financial enterprises registered a decline of 12.3 percent in the review period compared to a decrease of 19.5 percent in the previous year, due mainly to loan repayment by some government non-financial enterprises such as Nepal Oil Corporation, Nepal Airlines Corporation, Gorkhapatra Corporation and Nepal Electricity Authority.

#### **Commercial banks expand credit to other financial Institutions**

7. Claims on financial institutions, particularly non-government, increased substantially in the review period as against a decline of 1.3 percent last year. This was due to the increase in short-term placement by commercial banks in finance companies and development banks. Such a placement increased on account of higher deposit collection following the issuance of primary shares by Gorkha Development Bank in the review period.

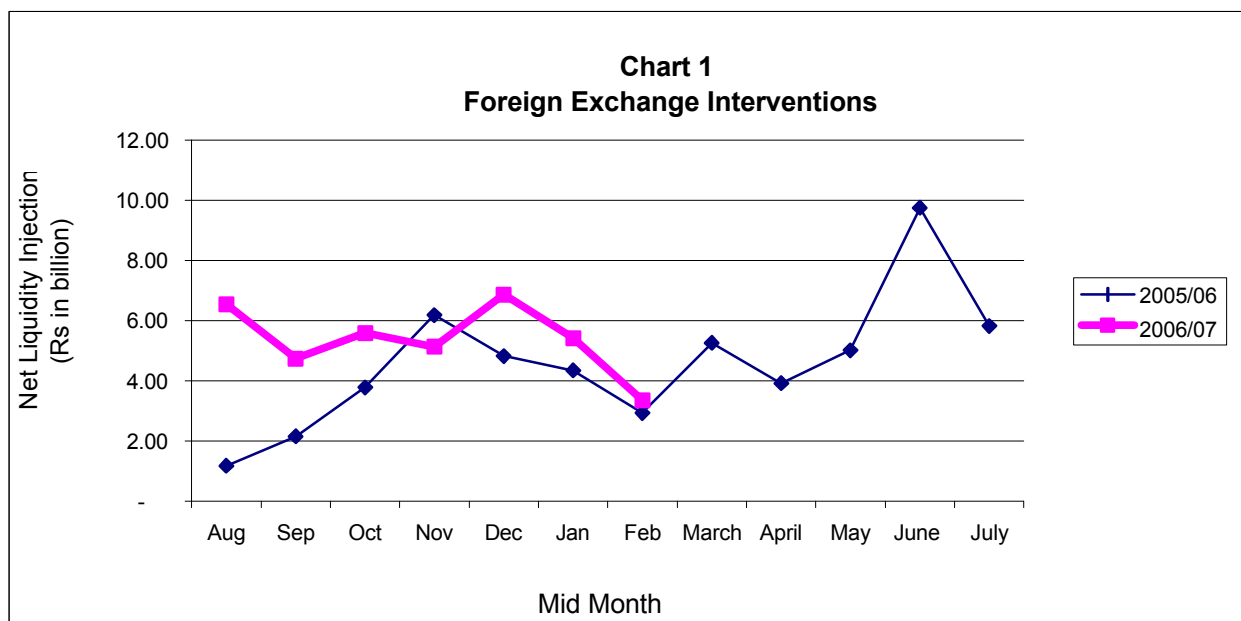
#### **Credit expansion to private sector remains sluggish**

8. Credit flow to private sector, a major component of domestic credit, remained subdued in the review period. Compared to a growth of 9.5 percent in the previous year, claims on the private sector increased by 9.4 percent in the review period. Private sector credit off-take remained sluggish on account of a slowdown in import growth and disturbance in industrial sector in the review period. If the volume of credit amounting to Rs 16 billion written off by Nepal Bank Ltd (NBL) and Rastriya Banijaya Bank (RBB) were to be deducted, the growth of private sector credit would remain at 2.8 percent.
9. Growth of net non-monetary liabilities declined by 16.4 percent in the review period as against a growth of 6.5 percent last year. This was due to the decline in loan loss provision and interest suspense account following the credit write off by NBL and RBB in the review period.

#### **Liquidity injection through forex intervention increases**

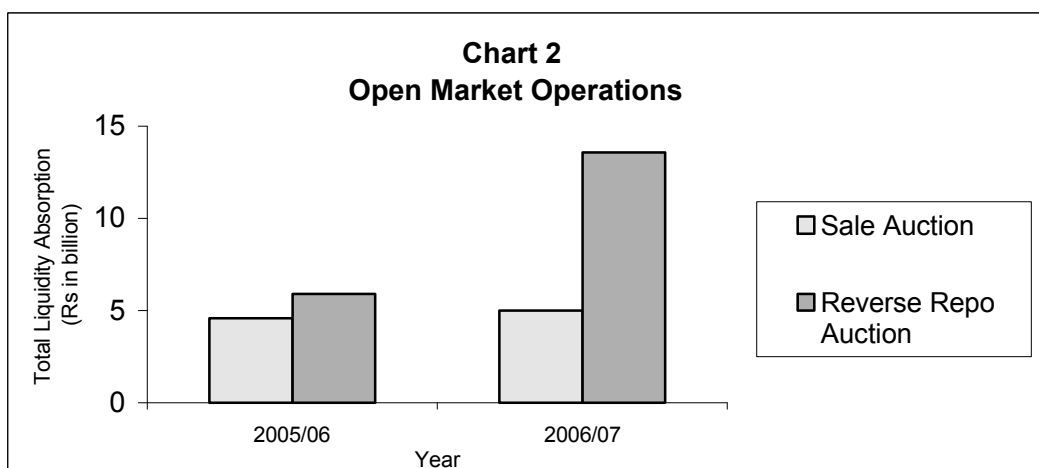
10. The intervention in the foreign exchange market by way of purchase of the US dollar equivalent to Rs 37.68 billion and sale of Rs 0.51 billion, resulted in net liquidity injection of Rs 37.17 billion in the review period. Net liquidity of Rs 25.43 billion had

been injected in the previous year through the purchase and sale intervention in the foreign exchange market. A higher level of liquidity injection through the intervention in the foreign exchange market was on account of elevated level of workers' remittances and marginal growth of imports.



### **Liquidity absorption through OMOs increases significant**

11. A higher level of liquidity of Rs 19.45 billion on cumulative basis was absorbed through open market operations in the review period compared to the absorption of Rs 8.29 billion in the same period of the previous year. Liquidity absorbed through reverse repo auction stood at Rs 13.56 billion in the review period compared to Rs 5 billion last year. Likewise, liquidity absorption through sale auction stood at Rs 5.89 billion in the review period compared to Rs 4.57 billion in the preceding year.



### Use of SLF remains significant

12. Commercial banks availed a higher level of standing liquidity facility (SLF) amounting to Rs 8.19 billion in the review period compared to Rs 2.12 billion in the preceding year. The increased use of SLF was on account of liquidity problem in some commercial banks in the review period. Inter bank transactions stood at Rs 103.50 billion in the review period compared to Rs 108.94 billion last year.

**Table 1**  
**Standing Liquidity Facility and Inter Bank Transactions**  
(In the first seven months)

	Rs in billion	
	2005/06	2006/07
Standing Liquidity Facility	2.12	8.19
Inter Bank Transaction	108.94	103.50

### Short-term interest rate stabilizes

13. Of the short-term interest rates, weighted average 91-day Treasury bill rate stabilised at 2.60 percent in mid-February 2007 compared to 2.20 percent a year ago. The weighted average inter bank rate stabilised at 2.01 percent in mid-February 2007 from 2.48 percent a year ago.

**Table 2**  
**Short-term Interest Rate (in percent)**

<b>Months</b>	<b>Weighted Average 91-day TB</b>		<b>Weighted Average Inter bank rate</b>	
	2005/06	2006/07	2005/06	2006/07
Jul/Aug	2.26	2.99	2.47	2.07
Aug/Sep	3.38	2.78	3.87	1.83
Sept/Oct	3.10	2.54	3.18	2.11
Oct/Nov	2.69	2.11	2.36	1.20
Nov/Dec	2.20	1.98	0.96	1.34
Dec/Jan	2.46	2.67	1.22	3.03
Jan/Feb	2.20	2.60	2.48	2.01

## **Securities Market**

### **SEBO grants permission to issue primary shares**

14. On the primary issue front, Nepal Securities Board (SEBO) granted permission to issue ordinary shares of Rs. 148.5 million to six financial institutions and right shares of Rs. 525 million to seven financial institutions in the first seven months of 2006/07.

### **NEPSE index and market capitalization rise**

15. With respect to the secondary market transaction, the year on year (y-o-y) NEPSE index witnessed buoyancy with an increase of 64.92 percent to 523.94 points in mid-February 2007.

16. The y-o-y market capitalization increased by 84.9 percent to Rs 136.91 billion in mid-February 2007. Market capitalization to GDP ratio reached 21.2 percent from 12.7 percent a year ago. Of the total transactions, bank and financial institutions, manufacturing and processing companies, hotels, business entities, and other groups accounted for 83.8 percent, 4.3 percent, 1.9 percent, 0.6 percent, and 9.5 percent respectively.

### **The number of listed companies and paid of capital increase**

17. The number of companies listed in the Nepal Stock Exchange Ltd. reached 141 by mid-February 2007. This number was 127 a year ago. Out of the total listed companies, 94 were bank and financial institutions. Production and processing industries, hotels, business entities, and other groups consisted of 29, 4, 8 and 6 companies respectively.

18. Total paid up capital of the listed companies stood Rs. 21.17 billion in mid-February 2007, showing an increase of 17.7 percent over the period of one year. This increase was due to the additional listing of the companies in the Nepal Stock Exchange Ltd, and the issuance of ordinary and right shares by some of the financial institutions.

## **Inflation**

### **Consumer inflation remains high**

19. The y-o-y consumer inflation reached 8.0 percent in mid-February 2007 compared to the level of 5.8 percent a year ago. A significant rise in the prices of five consumer sub sectors' goods and services drove up inflation in the review period. Of the five sub sectors, three were belonged to food and beverage group and the remaining two were of non-food and services group.

### **Terai unrest fuels prices**

20. Of the food and beverage group, the y-o-y price of spices increased significantly by 26.6 percent in February 2007. The growth of prices of spices was 4.2 percent a year ago. Similarly in February 2007, the y-o-y increase in prices of vegetables and fruits sub-sector was 22.1 percent compared to that of 2.1 percent in the previous year. Moreover, the y-o-y price increase of pulses was 17.1 percent in February 2007 compared to that of 10.1 percent in February 2006. Domestic production of agricultural produce remained unsatisfactory in 2006/07. Furthermore, the supply of spices and pulses remained lower than the demand in international market. In addition to this, Terai resulted in supply shortages driving the prices of vegetables and fruits significant up in the review period.
21. In the non-food sector, the y-o-y increase in prices of fuel and transportation sub sector remained at a higher level in the review period. For example, in February 2007, the y-o-y price increase of fuel, light and water sub sector was 13.7 percent. The price rise of such commodities was 6.4 percent in February 2006. Similarly, the y-o-y increase in the price index of transportation and communication sub sector was 15.7 percent in February 2007 compared to that of 5.3 percent in the previous year. A significant increase in prices of petroleum products and transportation fare generated such a pressure on inflation.

### **Inflationary pressure expected to ease**

22. As base effect of petro-price hike in February 2006 is expected to elapse from February 2007, the inflationary pressure is likely to ease from next month.

**Table 3**  
**Consumer Inflation of Selected Commodities**

	Wt. in %	Year	Month ending mid of						
			Aug	Sept	Oct	Nov	Dec	Jan	Feb
Pulses	2.73	2005/06	5.3	6.4	6.0	7.6	9.5	9.2	10.1
		2006/07	23.6	22.0	24.2	21.1	18.3	16.6	17.1

Vegetables and Fruits	7.89	2005/06	2.1	0.4	0.9	7.6	11.2	8.1	2.1
		2006/07	4.3	6.8	16.3	10.1	9.2	13.7	22.1
Spices	1.85	2005/06	-4.8	-3.2	-1.4	-0.6	1.1	3.9	4.2
		2006/07	10.5	14.9	22.4	26.7	29.4	26.9	26.6
Meat, Fish and Eggs	5.21	2005/06	4.3	5.8	4.2	3.6	3.6	3.8	1.0
		2006/07	5.2	4.5	6.6	7.1	7.2	6.5	6.9
Milk and Milk Products	4.05	2005/06	3.8	3.9	4.3	4.7	4.5	4.7	5.3
		2006/07	6.2	7.7	8.5	8.3	8.3	8.1	7.8
Oil and Ghee	3.07	2005/06	-2.7	-3.9	-3.6	-2.6	-2.3	-2.6	-2.8
		2006/07	1.0	2.0	2.0	1.8	5.5	7.9	8.0
Fuel, Light and Water	5.92	2005/06	22.1	30.3	22.4	22.4	22.4	7.3	6.4
		2006/07	22.2	14.6	14.1	13.8	13.9	13.8	13.7
Transport and Communication	4.03	2005/06	16.0	16.5	16.5	16.9	16.9	16.1	5.3
		2006/07	17.9	17.4	17.4	16.6	16.6	16.6	15.7

Overall Index	100	2005/06	7.3	8.2	7.8	8.5	8.8	7.0	5.8
		2006/07	7.3	6.6	7.5	7.1	7.3	7.6	8.0
Food and Beverages	53.2	2005/06	6.6	7.1	7.5	8.6	9.3	8.2	7.1
		2006/07	6.1	6.0	7.8	7.0	7.3	8.0	8.8
Non-Food	46.8	2005/06	8.0	9.3	8.3	8.3	8.3	5.8	4.4
		2006/07	7.8	7.4	7.2	7.1	7.3	7.1	7.3

### **Inflation remains high in Terai**

23. Region-wise, Terai saw a higher level of inflation at 8.9 percent followed by Hills and Kathmandu Valley at 6.9 percent and 7.4 percent respectively. The respective inflation rates were 6.5 percent, 6.3 percent and 4.2 percent a year ago. The effect of a long strike and Bandh (closure) programme in Terai region accounted for such a high price rise especially in Terai in the review period.

24. In mid-February 2007, the y-o-y core inflation remained at 6.5 percent from 3.9 percent a year ago. This reflected a rise in inflationary expectation in the review period.

### **Wholesale inflation remains high**

25. In mid-February 2007, the y-o-y wholesale inflation remained high at 12.6 percent from 6.5 percent a year ago. The continuation of the lag-effect of last year's increased petroleum prices, a significant rise in the prices of agro-products like pulses (24.6 percent), fruits and vegetables (38.5 percent), spices (23.2 percent), food-grains (15.0 percent), and construction materials (19.7 percent), domestic manufactured commodities, accounted for the rise in wholesale prices during the review period. The effect of 3-week long general strike in the Terai region also accounted for a pick up in inflation in the review period. Group-wise, the indices of agricultural commodities registered the highest increase of 17.5 percent, whereas the category of imported

commodities and domestic manufactured commodities witnessed a relatively low increase of 7.3 percent and 9.8 percent, respectively.

### **National salary and wage rate index expands**

26. The y-o-y salary and wage rate index (2004/05=100) showed a rise of 9.9 percent in mid-February 2007. The growth of such index was 4.3 percent a year ago. The Wage Rate and the Salary group Indices showed a rise of 11.2 percent and 6.2 percent respectively in the review period. The effect of 10.0 percent increment in the allowances of civil service from mid-July 2006, the rise in the wage rates of industrial labours due to the pressures created by the trade unions in the recent months, the surge in wage rates of domestic agricultural as well as construction labours on account of short-supply due to Nepalese workers' tendency to seek foreign jobs, were the major reasons for the rise in the National Salary and Wage Rate Index in the review period.

### **Fiscal Situation**

#### **Budget remains at surplus**

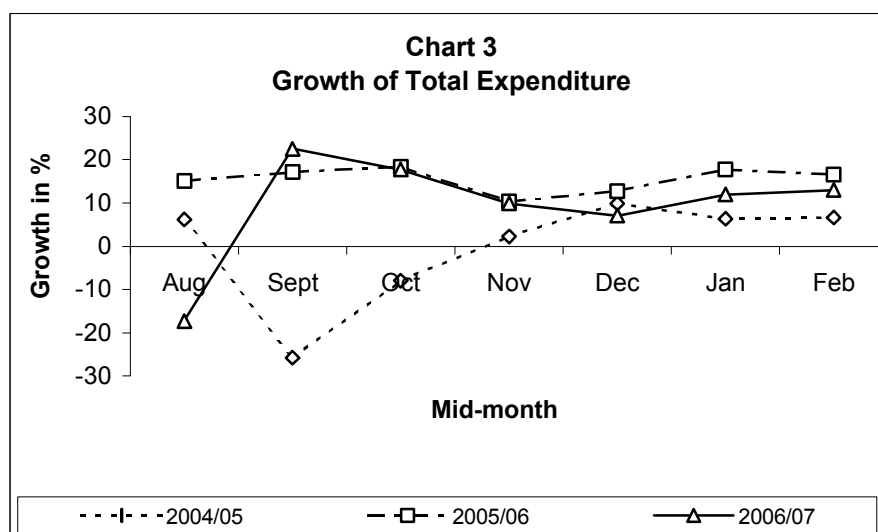
27. In the first seven months of 2006/07, the budget of the Government of Nepal remained at a surplus of Rs 263.5 million. In the same period of the previous year, budget was at a deficit of Rs 3.21 billion. A higher growth of non- debt resources compared to government expenditure contributed to such a budget surplus. However the decelerated growth of capital expenditure is not a positive indication.

#### **Government expenditure decelerates**

28. In the first seven months of 2006/07, total government expenditure increased by 13.0 percent to Rs 51.6 billion compared to a growth of 19.6 percent in the corresponding period of the previous year. The lower rate of growth in total government expenditure was on account of deceleration in capital expenditure as well as control in recurrent expenditure.

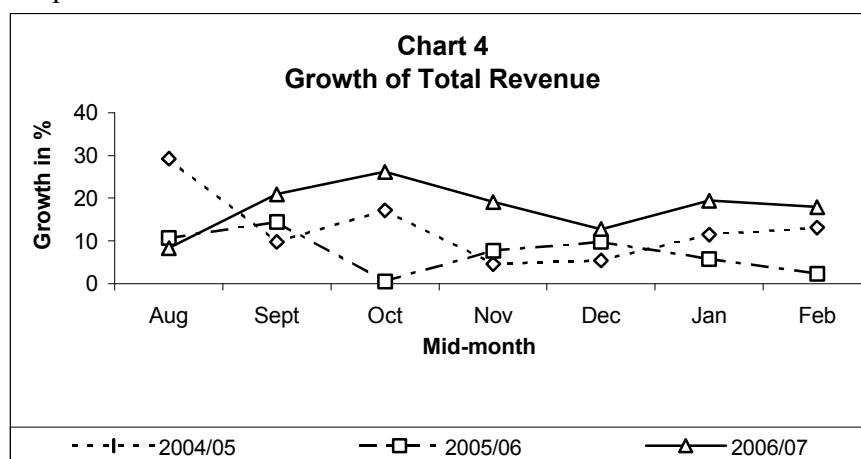
29. Of the total government expenditure, recurrent expenditure went up by 10.2 percent to Rs 36.70 billion in mid February 2007. Such expenditure had increased by 16.5 percent in the same period of the previous year. In the first seven months of 2006/07, capital expenditure rose by 30.2 percent to Rs 7.78 billion in mid February 2007 compared to a growth of 81.7 percent in the same period of the previous year. While the controlled growth of recurrent expenditure may have good implications, the deceleration in capital expenditure is likely to impede the economic growth in the future.





### Government revenue exceeds the targeted growth rate

30. In the first seven months of 2006/07, government revenue showed a higher growth of 17.9 percent to Rs 42.25 billion compared to a lower growth of 2.9 percent in the corresponding period of the previous year. An increase in consumption due mainly to elevated level of remittances, growing consumers' confidence and resulting expansion in VAT revenue, adjustment in customs and excise rates, improvement in customs valuation, increased tax compliance as well as an increase in non-tax revenue mainly from dividend receipts contributed to such an acceleration in revenue mobilization in the review period.



31. In the first seven months of 2006/07, foreign cash grants received by the GON showed an increase of 36.6 percent to Rs 8.01 billion compared to an increase of 50.9 percent in the corresponding period of the previous year. On the other hand, foreign cash loans declined by 18.6 percent to Rs 1.97 billion in the review period.

## Foreign Trade, Balance of Payments and Foreign Exchange Reserves

### Exports declines

32. In the first seven months of 2006/07, total exports fell by 3.9 percent in contrast to an increase of 12.2 percent in the corresponding period of 2005/06. Of the total exports, export to India declined by 5.4 percent in 2006/07 as against a sharp increase of 22.8 percent in the same period of 2005/06. Likewise, exports to other countries fell by 0.4 percent in comparison to a decline of 7.0 percent a year earlier. The slowdown in external demand for Nepalese goods, long hours of load shedding, and the Terai bandh, among others accounted for the poor performance of the export sector in the review period.
33. The decline in exports to India was attributed to the decline in the exports of polyester yarn, cattle-feed, plastic utensils, G.I. pipe, pulses and noodles. Likewise, the decline in exports to other countries was due to the decrease in the export of woollen carpets, readymade garments, pashmina, handicraft and jewelleryes.

### **Imports decelerates**

34. Total imports decelerated to 0.3 percent in the first seven months of 2006/07 compared to a significant growth of 25.1 percent in the same period of the previous year. While imports from India increased by 2.7 percent in the review period compared to a higher growth of 31.3 percent in the corresponding period of the previous year, imports from other countries registered a decline of 3.6 percent in contrast to a growth of 16.4 percent a year earlier.
35. A slight rise in the import of vehicles & parts, hot rolled sheet in coil, electrical equipment, thread and agricultural equipment & parts from India combined with a significant decline in the import of palm oil, polythene granules, other machinery & parts, M.S. billet, and electrical goods from other countries led to the deceleration in total imports in the first seven months of 2006/07.

### **BOP remains at surplus**

36. The overall BOP registered a surplus of Rs. 6.3 billion in the review period compared to a higher level of Rs. 13.0 billion in the corresponding period of 2005/06. The deceleration in the growth of remittance and rise in deficits under net services were some of the factors responsible for the lower level of BOP surplus in the review period.
37. The current account recorded a surplus of Rs. 5.8 billion in the review period compared to a surplus of Rs. 4.8 billion in the corresponding period of the previous year. An increase in net transfers contributed to the rise in current account surplus.
38. 7. Under the financial account, the government received Rs.5.0 billion as foreign loan and repaid Rs. 3.9 billion in amortization.

### **Forex reserves remains at the comfortable level**

39. The gross foreign exchange reserves rose by 3.4 percent from the level of mid July 2006 and reached Rs. 170.7 billion in mid-February 2007. Such reserves had risen by

10.7 percent in the corresponding period of the previous year. In terms of US dollar, gross foreign exchange reserves went up by 8.9 percent to US\$ 2.4 billion in mid-February 2007. In the same period of the preceding year, such reserves had increased by 9.7 percent. The share of convertible reserves in the total reserves rose marginally to 95.3 percent as at mid-February 2007 from 94.5 percent in mid-February 2006, resulting in a corresponding decline in the share of the non-convertible reserves to 4.7 percent from 5.5 percent. On the basis of the first seven months of imports of goods and services, the current level of reserves is adequate for financing merchandise imports of 11.6 months and merchandise and service imports of 9.6 months.

### **Oil price declines and gold price increases in international market**

40. The price of oil (Crude Oil Brent) in the international market declined by 5.1 percent to US\$ 54.66 per barrel at mid-February 2007 from US\$ 57.61 per barrel in mid-February 2006. The price of gold, on the other hand, rose by 23.0 percent to US\$ 664.55 per ounce at mid-February 2007 from US\$ 540.50 a year earlier.

### **Nepalese currency appreciates vis-à-vis US dollar**

41. The Nepalese currency vis-à-vis the US dollar appreciated by 5.3 percent in mid-February 2007 from the level of mid-July 2006. It had depreciated by 0.9 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 70.35 mid-February 2007 compared to Rs. 71.00 in mid-February 2006.