

Current Macroeconomic Situation

(Based on the Data of the First Eleven Months of 2006/07)

Monetary Aggregates

1. Compared to a growth of 12.6 percent in the first eleven months of 2005/06, broad money (M_2) registered a growth of 10.6 percent in the same time period of 2006/07. Notwithstanding the higher growth of net domestic assets (NDA) of the monetary sector, a deceleration of net foreign assets (NFA) slowed the growth of monetary aggregates in the review period.
2. Of the components of M_2 , narrow money (M_1) grew by 6.6 percent in the review period compared to a growth of 10.2 percent in the preceding year. Similarly, growth of time deposits also remained marginally lower in the review period. Time deposits increased by 12.5 percent in the review period compared to a growth of 13.8 percent in the corresponding period of the previous year. A lower growth of export and remittance inflow contributed to such a slowdown in the growth of time deposits.
3. Compared to a growth of 20.3 percent (Rs 21.86 billion) in 2005/06, NFA (adjusting exchange valuation gain/loss) increased by 4.5 percent (Rs 6.24 billion) in the first eleven months of 2006/07. The growth of NFA remained muted on account of a lower growth of export and remittance inflow compared to that of the previous year.

Domestic Credit

4. Domestic credit of the monetary sector registered an expansion of 12.7 percent in the review period. Such credit had increased by 9.8 percent in the previous year. Compared to the previous year, commercial banks' claims on non-financial government enterprises and non-government financial enterprises have increased. In addition, an improvement in credit expansion to the private sector in the review period contributed to such a higher growth of domestic credit in the review period.
5. Of the credit aggregates, net claims on government declined by 5.3 percent in the review period against the growth of 2.6 percent last year. This was due to the cash balance of Rs 6.17 billion maintained by the government with Nepal Rastra Bank in the review period.
6. Claims on non-financial government enterprises increased by 55.4 percent in the review period. In contrast to a decline by 10.6 percent in the previous year, additional bank loan availed by Nepal Oil Corporation, National Trading Ltd, Janak Education Material Center Ltd and Nepal Food Corporation contributed to such an increase in the claims on non-financial government enterprises.
7. Credit to the private sector, a major component of domestic credit, grew by 17.2 percent in the review period compared to a growth of 13.5 percent in the previous

year. Lower interest rates and diversified loan portfolio by private sector's banks boosted the private sector credit flow in the review period.

8. Net non-monetary liabilities grew by 9.1 percent in the review period compared to a growth of 13.0 percent in the previous year. Net non-monetary liabilities increased at a lower rate due to the decline in loan loss provisioning for non-performing loans and interest suspense account following the credit write-off by NBL and RBB in the review period

Foreign Exchange Transaction

9. Compared to the net liquidity injection of Rs 49.40 billion through the net purchase of the US dollar 691.0 million in the previous year, net liquidity of Rs 57.86 billion has been injected through the net purchase of the US dollar 814.50 million in the review period through the foreign exchange intervention. Such a higher level of purchase of the US dollar in the review period was due to the elevated level of remittance (though the growth rate is decelerating) and the slowdown in import growth.
10. In the process of managing Indian Currency (IC) reserves, the IC equivalent of Rs 57.36 billion was purchased by selling the US dollar 820 million in the review period. In the same period of 2005/06, a total Rs 39.27 billion equivalent of Indian Currency was purchased through the sale of 550 million US dollar.

Table 1

**Net purchase of the US dollar from commercial banks and IC purchase from Indian Money Market through the sale of the US dollar
(In the first eleven months of 2006/07)**

(Rs in billion)

Months	2005/06		2006/07	
	Net Purchase of US dollar from commercial banks	Net Purchase of IC through the Sale of US dollar	Net Purchase Of US dollar from commercial banks	Net Purchase of IC through the Sale of UD dollar
Aug	1.18	4.18	6.55	3.74
Sep	2.16	3.51	4.75	4.46
Oct	3.78	4.24	5.59	5.13
Nov	6.20	2.90	5.13	5.76
Dec	4.83	3.66	6.88	4.30
Jan	4.36	2.16	5.42	4.98
Feb	2.93	3.54	2.85	2.12
Mar	5.26	4.97	7.26	4.95
Apr	3.92	5.00	3.53	5.53
May	5.02	0.72	4.50	7.92
Jun	9.75	4.39	5.40	8.47
Total	49.40	39.27	57.86	57.36

Open Market Operations

11. In addition to managing liquidity through the foreign exchange intervention and IC purchase, the remaining liquidity was modulated through open market operations. In the review period, a total liquidity of Rs 30.31 billion (on a turnover basis) was absorbed through the sale auction (Rs 16.25 billion) and reverse repo auction (Rs 14.06 billion). By adjusting liquidity of Rs 2 billion injected through repo auction, net liquidity absorption stood at Rs 28.31 billion. In the previous year, total liquidity of Rs 15.86 billion was absorbed through the sale auction of Rs 9.36 billion and reverse repo auction of Rs 6.50 billion while the liquidity of Rs 830 million and Rs 450 million was injected through the purchase auction and repo auction respectively, resulting in net liquidity absorption of Rs 14.58 billion.

Table 2
Open Market Operations
(In the first eleven months)

(Rs in billion)

	2005/06	2006/07
A. Liquidity Absorption	15.86	30.31
Sale Auction	9.36	16.25
Reverse Repo Auction	6.5	14.06
B. Liquidity Injection	1.28	2
Purchase Auction	0.83	-
Repo Auction	0.45	2
C. Net Liquidity Absorption (A-B)	14.58	28.31

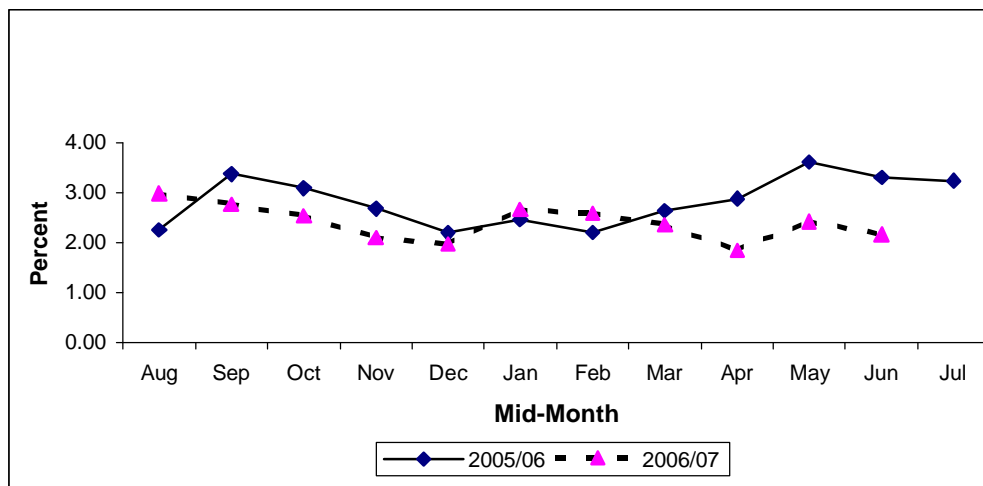
Standing Liquidity Facility

12. Compared to Rs 8.03 billion in the previous year, commercial banks availed a total of Rs 31.29 billion under SLF in the review period. The higher level of SLF borrowing was on account of the beginning of short-term financing by commercial banks to finance companies and development banks.

Short-term Interest Rates

13. Short-term interest rates did not observe large fluctuation in the review period on account of modulation of liquidity. The weighted average 91-day Treasury bill rate ranged from minimum of 1.85 percent to maximum of 2.29 percent in the review period. Similarly, inter bank rate remained in between 1.20 percent and 3.35 percent in the review period.

Chart 1: Average weighted 91-day Treasury bill rate (in percent)



Securities Market

14. The year on year (y-o-y) NEPSE index increased by 54.6 percent to 575.04 points in mid-June 2007. This index was 372.01 a year ago.
15. The NEPSE Sensitive Index, calculated taking 16 July 2006 as the base period, stood at 145.58 in mid-June 2007. This index was 128.59 a month ago.
16. The y-o-y market capitalization increased by 67.2 percent to Rs 155.24 billion in mid-June 2007. Market capitalization to GDP ratio increased to 21.58 percent from 14.4 percent a year ago. Of the total market capitalization, bank and financial institutions, manufacturing and processing companies, hotels, business entities, and other groups accounted for 84.2 percent, 3.9 percent, 2.0 percent, 0.5 percent, and 9.4 percent respectively.
17. Total paid up capital of the listed companies stood Rs. 21.45 billion in mid-June 2007, an increase of 8.1 percent over the period of one year. This increase was due to the additional listing of securities.
18. Monthly turnover to market capitalization ratio remained at 0.58 percent in mid-June 2007 compared to 0.67 percent a year ago.
19. Total number of companies listed at the NEPSE increased to 134 in mid-June 2007 compared to 131 a year ago. Among the currently listed companies, 99 were bank and financial institutions. Production and processing industries, hotels, business entities, and companies in other groups were 21, 4, 5 and 5 respectively.
20. The twelve-month rolling standard deviation reflecting an increased volatility in the stock market stood at 67.4 in mid-June 2007 compared to 31.9 a year ago.
21. Nepal Securities Board (SEBON) granted permission to issue ordinary shares of Rs. 278.25 million to thirteen financial institutions, right shares of Rs. 1817.25

million to fifteen financial institutions, and debenture worth Rs. 250 million to a financial institution during the first eleven months of 2006/07.

22. Nepal Investment Bank issued seven year “Nepal Investment Bank Bond 2071” with an interest rate of 6.25 percent. Of the total bonds issued, bonds of Rs. 200 million were for private placement (institutional) and bonds of Rs. 50 million were for public placement (general subscription). There was 38.4 percent excess subscription for the bonds allotted for public placement
23. A total number of 264,000 government bonds amounting to Rs. 30.51 million were traded in the secondary market on two different occasions in May/June 2007.

Increase in the Number of Bank and Financial Institutions

24. Number of banks and financial institutions established in the first eleven months of the current fiscal year is shown in Table 3. It includes 2 commercial banks, 9 development banks, and 3 finance companies. In the same period, Nepal Rastra Bank revoked license of the two cooperatives.

Table 3

Bank and Financial Institutions	Mid-July 2006	Mid-June 2007
Commercial banks	18	20
Development banks	29	38
Finance companies	70	73
Micro finance institutions	11	11
NRB licensed cooperatives (undertaking limited banking transactions)	19	17
NRB licensed NGOs (undertaking micro finance transactions)	47	47

Inflation

Consumer Price Inflation

25. The y-o-y inflation was 4.5 percent in mid-June 2007 compared with 9.1 percent in corresponding period of the previous year. This was on account of elapse of the base-effect of hike in prices of petroleum products in March 2006 on the one hand and the moderation in the prices of both food and beverage group as well as non-food and services group, as compared to that of the previous year, on the other. Besides, the impact of recent appreciation of the Nepalese currency against the US dollar also eased the consumer prices of imported commodities in the review period.
26. Group-wise, the index of food and beverages group rose by 5.8 percent in the review period compared to a rise of 9.1 percent a year ago. A significant decline in the prices of sugar and related products by 18.0 percent as well as the lower rise in the prices of pulses (8.0 percent), grains and cereal products (5.0 percent) and milk and milk products (6.1 percent) contributed for slowing the inflation of this group

compared to that of the previous year. However, some commodities with in this group were observed significant rise in the prices, such as spices (21.4 percent), oil and ghee (9.1 percent) and vegetables and fruits (9.6 percent). The index of non-food and services group rose by 3.1 percent compared to a rise of 9.0 percent last year.

27. Region-wise, the price level in Kathmandu Valley, Terai and the Hills rose by 4.9 percent, 4.2 percent and 4.3 percent respectively in the review period. Last year, the respective rates were 7.9 percent, 9.9 percent and 9.0 percent.
28. The period average inflation was 6.6 percent during the review period (mid August 2006 - mid June 2007) compared to 7.9 percent in the corresponding period of the previous year.
29. In mid-June 2007, the y-o-y core inflation also eased to 5.0 percent compared to 5.3 percent a year ago.

Wholesale Price Inflation

30. The y-o-y wholesale price inflation recorded at 5.5 percent in mid-June 2007. The wholesale price inflation was 9.2 percent a year ago. Group-wise, the wholesale price of agricultural commodities rose by 5.8 percent compared to a rise of 10.9 percent a year ago. Despite a 26.2 percent rise in the price of cash crops, the price of fruits and vegetables declined by 2.2 percent compare to last year while the other agriculture commodities like food grains (2.0 percent), livestock (4.0 percent) spices (4.0 percent) and pulses (9.9 percent) also recorded a moderate price rise during the period. The price of domestically manufactured commodities, however, recorded a higher growth of 8.2 percent compared to that of 2.7 percent a year ago. In this group, construction material (12.7 percent) and food-related products (9.5 percent) witnessed a higher rise in prices during the period. The group of imported commodities observed a significant fall in the prices from 10.7 percent last year to 3.5 percent this year. This fall is attributed to the end of the base effect of last year's hike in the petroleum prices in the one hand and the positive impact (on imported commodities) of the recent appreciation of Nepalese currency against the US dollar on the other hand.

National Salary and Wage Rate

31. The y-o-y salary and wage rate index rose by 11.6 percent in mid-June 2007, compared to a rise of 5.7 percent a year ago. Such an increase in this index was on account of ten percent increase in the allowances of civil servants in mid-July 2006; rise in the wages of industrial laborers in the recent months; and labor supply constraints in the rural areas due mainly to the migration of youths to urban areas along with the increasing trend of seeking employment abroad. In the review period, both salary and wage rate indices rose by 6.2 percent and 13.6 percent respectively, compared to an increase of 0.4 percent and 7.7 percent respectively last year. Among the wage rate index, the index of industrial labor increased by a higher rate of 20.7 percent during the review period, followed by 11.2 percent of construction labor and 9.4 percent of agriculture labor.

Fiscal Situation

Government Expenditure

32. In the first eleven months of 2006/07, total expenditure of the Government of Nepal (GON) on cash basis rose by 21.0 percent to Rs.98.42 billion compared to an increase of 19.3 percent in the corresponding period of the previous year. Acceleration in both the recurrent as well as capital expenditure contributed to such a high growth in total government expenditure.
33. In the first eleven months of 2006/07, recurrent expenditure of the GON increased by 15.4 percent to Rs.61.30 billion. Such expenditure had increased by 10.6 percent in the corresponding period of the previous year. Reimbursement to the victims of conflicts, reestablishment of police post, Maoist cantonment management as well as maintaining peace and security exerted a pressure on recurrent expenditure.
34. In the review period, capital expenditure went up by 51.3 percent to Rs.20.63 billion compared to an increase of 38.2 percent in the corresponding period of the previous year. The tendency to incur a large amount of capital expenditure on development works at the end of the fiscal year continued in the review period. Besides this, the GON's loan investment of Rs.1 billion to Nepal Oil Corporation (NOC) contributed to such a high growth of capital expenditure in the review period.

Resource Mobilization

35. In the first eleven months of 2006/07, total resources of the GON grew by 26.2 percent to Rs.91.49 billion. In the corresponding period of the previous year, total resources had grown by 10.8 percent. A significant rise in revenue and foreign grants contributed to such an acceleration of the total resources.

Government Revenue

36. In the first eleven months of 2006/07, total revenue of GON increased by 20.8 percent to Rs.71.29 billion compared to a very low growth of 0.5 percent in the corresponding period of the previous year. Increase in value added taxes as a result of increasing flow of remittance and improvement in consumer confidence, increase in income tax revenue generated mainly by the increase in corporate tax revenue and rise in customs and excise as a result of significant increase in the import of high tax yielding vehicles and spare parts contributed for such a significant growth of revenue.

Table 4
Revenue Collection (First Eleven Months)

	Amount Rs in million			Growth (%)		Composition	
	2004/05	2005/06	2006/07	2005/06	2006/07	2005/06	2006/07
Value Added Tax	16275.3	19390.9	23632.9	19.1	21.9	32.9	33.2
Customs	13795.4	13329.0	14846.2	-3.4	11.4	22.6	20.8
Income Tax	8060.3	8525.8	11202.5	5.8	31.4	14.4	15.7
Excise	5576.7	5562.8	7555.8	-0.3	35.8	9.4	10.6
Registration Fee	1494.0	2341.9	2393.7	56.8	2.2	4.0	3.4
Vechile Tax	752.2	702.1	678.0	-6.7	-3.4	1.2	1.0
Non-Tax Revenue	12750.7	9172.5	10975.9	-28.1	19.7	15.5	15.4
Total Revenue	58704.6	59024.9	71285.0	0.5	20.8	100.0	100.0

Foreign Cash Grants

37. In the first eleven months of 2006/07, foreign cash grants rose by 66.2 percent to Rs.13.38 billion compared to an increase of 65.7 percent in the corresponding period of the previous year.

Budget Deficit/Surplus

38. In the first eleven months of 2006/07 the GON's budget remained expansionary. The growth of government expenditure relative to resources accounted for a budget deficit in the previous year. In the review period, budget remained at a deficit of Rs.6.93 billion. In the corresponding period of the previous year, budget had remained at a deficit of Rs.8.84 billion. .

Deficit Financing

39. Of the total estimated domestic borrowing of Rs.17.90 billion (in the budget), the GON mobilized Rs.10.03 billion in the first eleven months of 2006/07
40. Foreign cash loan declined by 21.1 percent to Rs.2.70 billion. Foreign cash loan of Rs.3.43 billion was received in the corresponding period of the previous year.
41. In the review period, the GON maintained a cash surplus of Rs.6.17 billion with Nepal Rastra Bank

Foreign Trade and Balance of Payments

42. Nepal's external sector displayed a mixed performance in the first eleven months of 2006/07. Exports went up just by 0.8 percent in the first eleven months of 2006/07 compared to a growth of 2.9 percent in the corresponding period of the previous year. The deceleration in the growth rate of exports was ascribed to a number of factors such as the lack of improvement in the investment climate and security condition, regular bandhs and power shortages. While exports to India rose by 2.1 percent in 2006/07 in comparison to a higher growth of 5.5 percent in the same

period of 2005/06, exports to other countries declined by 2.0 percent in comparison to a similar decline of 2.1 percent in the preceding year.

43. The rise in the exports of thread, zinc sheet, textiles, M.S. pipe and juice was responsible for the slight increase in the exports to India. On the other hand, exports to other countries declined owing to the decline in exports of readymade garments, pashmina, handicrafts, woolen carpets and Nepalese paper and paper products.
44. In the first eleven months of 2006/07, total imports rose by 11.0 percent in comparison to a higher growth of 16.6 percent in the same period last year. Imports from India increased by 10.8 percent in the review period compared to a significant growth of 20.8 percent in the corresponding period last year. Likewise, imports from other countries rose by 11.3 percent in comparison to a growth of 10.4 percent a year earlier.
45. The rise in total imports in the first eleven months of 2006/07 was attributed to the rise in imports of vehicles & spare parts, cold-rolled sheet in coil, hot-rolled sheet in coil, electrical equipment and petroleum products, among others, from India and the rise in imports of crude palm oil, gold, computer parts, telecommunication equipment & parts and medicine, among others, from other countries.
46. The overall BOP recorded a surplus of Rs. 6.24 billion in the first eleven months of 2006/07. Of this surplus, the current account surplus was Rs. 3.35 billion and the remaining Rs. 2.89 billion was ascribed to the capital and financial account. In the corresponding period of 2005/06, the current account and BOP registered a surplus of Rs. 12.98 billion and Rs. 21.86 billion respectively. The inflow of remittances increased by 3.9 percent in the review period as compared to the substantially higher growth of 48.4 percent in the corresponding period of last year. In dollar terms, remittances rose by 5.7 percent.

Foreign Exchange Reserves

47. In comparison to mid-July 2006, gross foreign exchange reserves declined by 1.6 percent to Rs. 162.41 billion in mid-June, 2007. Such reserves had gone up 23.3 percent in the corresponding period of the previous year. The nominal appreciation of the currency accounted for the decline in the reserves. In terms of US dollar, gross foreign exchange reserves went up by 11.4 percent to US\$ 2.48 billion in mid-June, 2007. In the same period in the previous year, such reserves had gone up by 18.1 percent. The share of convertible reserves in the total reserves rose to 95.0 percent as at mid-June 2007 from 93.4 percent in mid-June 2006, resulting in a corresponding decline in the share of the nonconvertible reserves to 5.0 percent from 6.6 percent. Based on the first eleven months of imports of goods and services, the current level of reserves is sufficient for financing merchandise imports of 10.3 months and merchandise and service imports of 8.5 months.

Oil and Gold Prices

48. In the international market, the price of oil (Crude Oil Brent) increased by 6.3 percent to US\$ 70.22 per barrel in mid-June 2007 from US\$ 66.08 per barrel in

mid-June 2006. Likewise, the price of gold rose by 14.7 percent to US\$ 653.25 per ounce in mid-June 2007 from US\$ 569.50 a year earlier.

Exchange Rate

49. In comparison to mid-July 2006, the Nepalese currency vis-à-vis the US dollar appreciated by 13.30 percent in mid-June 2007. It had depreciated by 4.22 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 65.40 in mid-June 2007 compared to Rs. 73.45 in mid-June 2006.