Current Macroeconomic Situation
(Based on the First Seven Months' Data of 2009/10)

Monetary Situation

Money Supply

1. Broad money (M_2) expanded by 6.1 percent in the first seven months of 2009/10. M_2 expanded by 11.6 percent in the corresponding period of the previous year. Narrow money (M_1), which had grown by 10.8 percent during the first seven months of 2008/9, grew by 6.5 percent in the review period. Decline in net foreign assets accounted for such a deceleration of monetary aggregates despite a high growth of net domestic assets.

2. Of the components of narrow money, currency in circulation increased by 10.9 percent in the review period compared to a growth of 18.4 percent during the same period of the previous year. Time deposits increased by 5.9 percent in the review period compared to a growth of 12 percent during the same period of the previous year. Demand deposits, which had declined by 3.4 percent in the first seven months of 2008/09, declined by 1.5 percent in the review period.

3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, declined substantially by 9.9 percent (Rs.21.8 billion) in the review period. It had increased by 15 percent (Rs.25.7 billion) in the same period of the previous year. An acceleration of trade account deficits in the review period contributed to such a significant decline in net foreign assets.

Domestic Credit

4. In the first seven months of 2009/10, domestic credit expanded by 11.4 percent compared to a growth of 6.2 percent in the corresponding period of the previous year. Domestic credit increased at a higher rate on account of a significant increase in the credit to private sector.

5. Claims on government declined by 11.2 percent (Rs.11.8 billion) in the review period compared to a decline of 20.2 percent (Rs.17.6 billion) in the corresponding period of the previous year. An increase in resource mobilization relative to government expenditure contributed to such a decline in claims on government in the review period. The government deposits as at mid-February 2010 stood at Rs. 3.4 billion.

6. In the review period, credit to private sector increased by 17.3 percent (Rs. 75.6 billion) compared to a growth of 12.9 percent (Rs. 44 billion) in the same period a year ago.

7. Claims on non-government financial enterprises declined by 26.1 percent in the review period in contrast to a growth of 5.6 percent in the corresponding period

of the previous year. The decline in investments of commercial banks on pension funds and insurance companies in the review period contributed to such a decline in claims on non-government financial enterprises.

8. In the first seven months of 2009/10, claims on non-financial government enterprises increased by 10.8 percent compared to a growth of 8.3 percent in the corresponding period of the previous year. Among the institutions, additional loans taken by Gorkhapatra Sasthan and Nepal Electricity Corporation contributed to such an increase in the review period.

Deposits Mobilization and Credit Flow of Commercial banks

9. In the first seven months of 2009/10, the deposits mobilization of commercial banks increased by 3.9 percent (Rs.21.6 billion) amounting to Rs. 571.4 billion as at mid-February 2010. The total deposits had increased by 12.2 percent (Rs.51.3 billion) in the corresponding period of the previous year. Similarly, private sector credit of commercial banks grew by 18.2 percent (Rs.73.4 billion) compared to a growth of 14.2 percent (Rs 43.6 billion) in the corresponding period of the previous year.

10. Of the private sector credit, credit to the production sector increased by 11.3 percent (Rs.9.9 billion) in the review period compared to a growth of 10.3 percent (Rs.7.7 billion) in the same period of the previous year. Credit to agriculture sector increased by Rs. 2.1 billion in the review period. In the review period, credit to wholesale and retail business as well as finance, insurance and fixed assets; and service sectors increased by 25 percent (Rs.17.2 billion), 41.1 percent (Rs.16 billion), and 19.8 percent (Rs 4.6 billion) respectively. Credit to these sectors during the corresponding period in the previous year had increased by 8.8 percent (Rs.4.9 billion), 24.1 percent (Rs.6 billion), and 10.7 percent (Rs.2.3 billion) respectively. Credit to real estate sector increased to Rs.15 billion in the first seven months of 2009/10 compared to Rs.7.2 billion in the same period a year ago.

Liquidity position of Commercial Banks

11. In the review period, the liquid assets of the commercial banks declined substantially by 10.4 percent to Rs 168.5 billion in contrast to a growth of 3.4 percent in the corresponding period of the previous year. Of the components of liquid assets, liquid fund declined by 11.6 percent in the review period in contrast to an increase of 11.8 percent in the same period last year. A decline in commercial banks' balance with the NRB and balance held abroad accounted for such a contraction of liquid funds of commercial banks.

12. The higher growth of commercial banks' credit relative to their deposit mobilization changed their liabilities/assets structure by increasing the credit-deposit ratio to 91.3 percent in mid February 2010 from 81.2 percent in mid

July 2009. On the other hand the liquidity-deposit ratio declined to 29.5 percent in mid-February 2010 from 34.2 percent in mid-July 2009.

Liquidity Management

13. In the first seven months of 2009/10, NRB injected net liquidity amounting to Rs.53.9 billion. During this period, Rs.7.4 billion and Rs.1.0 billion were mopped up through outright sale auction and reverse repo auction respectively, while Rs. 58.9 billion and Rs. 3.4 billion were injected through repo and outright purchase auction respectively. In the same period of the previous year, net liquidity amounting to Rs.16.7 billion was mopped up. Of the total liquidity mopped up, Rs.7.5 billion and Rs. 13.2 billion were mopped up through outright sale auction and reverse repo auction respectively, while Rs. 4 billion was injected through outright purchase auction.

14. In the first seven months of 2009/10, NRB injected net liquidity amounting to Rs. 46.2 billions through net purchase of USD 611.5 million from commercial banks. A net liquidity of Rs. 85.3 billion was injected through the net purchase of USD 1.1 billion in the same period last year.

15. The NRB purchased Indian currency equal to 58.1 billion through the sale of USD 1.2 billion in the Indian money market during the review period. Indian currency equal to 40.2 billion was purchased through the sale of USD 850 million in the corresponding period of the previous year. An accelerated trade deficits with India accounted for such a higher volume of Indian currency purchase in the review period.

Standing Liquidity Facility and Inter Bank Transactions

16. Inter-bank transactions of commercial banks stood at Rs.175.5 billion in the first seven months of 2009/10 compared to Rs.174 billion in the corresponding period of the previous year. Likewise, commercial banks used standing liquidity facility (SLF) amounting to Rs.83.8 billion in the review period. The use of the SLF by commercial banks amounted to Rs.53.8 billion in the corresponding period of the previous year.

17. The decline in liquidity position of commercial banks resulting from a huge balance of payment deficits, the surplus of government deposits in NRB and commercial banks' credit expansion relative to deposits led to the heavy liquidity injection through open market operation as well as the significant use of SLF.

Interest Rates

18. The weighted average 91-day Treasury bill rate stood at 9.01 percent in the seventh month of 2009/10 compared to 6.64 percent in the seventh month of the previous year. Similarly, the weighted average inter-bank rate increased to 11.64 percent in the seventh month of 2009/10 compared to 8.32 percent in the seventh month of the previous year. In addition to the short-term interest rates,

the deposits rate of commercial banks also increased in the review period. In the seventh month of 2009/10, maximum limit of one-month, three-month, six-month, one-year, and two-year and above time deposit annual rates increased respectively by 2.0, 3.5, 2.25, 2.0 and 2.0 percentage points to 7.25, 9.5, 9.75, 11 and 11.5 percents. The decline in liquidity of the commercial banks in the review period contributed to such an increase in the interest rates.

Securities Market

19. The year on year (y-o-y) NEPSE index declined by 25.1 percent to 497.24 points in the first seven months of 2009/10. This index stood at 663.52 in the same period last year. Likewise, NEPSE sensitive index (based on July 2006) stood at 119.32 points in mid February, 2010, which was 171.95 in in the same period last year. The NEPSE float index, calculated on the basis of final transaction as of August 24, 2008 (as base market value), remained at 46.54 in mid February 2010, a contraction of 27.5 percent compared to the same period last year.

20. The y-o-y market capitalization declined by 4.0 percent to Rs.383.91 billion in mid February 2010. The ratio of market capitalization to GDP stood at 35.4 percent in the review period. It was 41.6 percent in the same period last year. Of the total market capitalization, bank and financial institutions accounted for 72.4 percent followed by manufacturing and processing companies (2.0 percent), hotels (1.3 percent), business entities (0.4 percent), hydropower (4.7 percent) and other economic sectors (19.2 percent).

21. Total paid up capital of the listed companies stood at Rs. 73.47 billion in mid February 2010, an increase of 43.1 percent over the period of one year. This increase was largely due to the additional listing of securities at the NEPSE. As at the seventh month of 2009/10, additional securities worth Rs.15.73 billion (ordinary share of Rs.3.50 billion, bonus share of Rs. 2.41 billion, right share of Rs.4.07 billion and government securities of Rs.5.75 billion) were listed at the NEPSE.

22. Total number of companies listed at the NEPSE increased to 167 in mid February 2010 compared to 149 last year. Among them, 135 are banks and financial institutions (including insurance companies), followed by production and processing industries (18), hotels (4), business entities (4), hydropower (4) and companies in other groups (2).

Inflation

Consumer Price Inflation

23. The year on year (y-o-y) inflation as measured by the consumer price index moderated to 12.0 percent in mid-February 2010 compared to 13.7 percent increase in the same period last year. In the review period, the price index of food and beverages group increased by 17.8 percent whereas the index of non-

food and services group rose only by 5.3 percent. The index of food and beverages and non-food and services group had risen by 18.1 percent and 9.1 percent respectively in the same period last year.

24. Of the items in the food and beverage group, price indices of sugar and sugar related products increased by 77.6 percent compared to an increase of 46.7 percent in the same period last year. Similarly, the price indices of spices, pulses, meat, fish and eggs as well as vegetables and fruits sub-groups increased in the review period by 36.7 percent, 36.4 percent, 22.7 percent and 18.8 percent respectively compared to their respective increase of 9.4 percent, 26.5 percent, 22.9 percent and 19.4 percent in the same period last year. The index of grains and cereal products subgroup also witnessed an increase of 13.0 percent compared to an increase of 14.7 percent in the corresponding period of the previous year.

25. Within non-food and services group, the index of both tobacco and related products as well as education, reading and recreation increased by 11.1 percent during the review period compared to their respective rise of 16.3 percent and 8.5 percent during the same period last year.

26. Region-wise, the price index of Hills rose by 13.0 percent followed by 12.3 percent in Terai and 10.8 percent in Kathmandu Valley in the review period. The respective rates were 13.2 percent, 13.8 percent and 13.9 percent during the same period last year.

27. In the review period, the y-o-y core inflation rose to 12.9 percent, a moderation from 13.1 percent a year ago.

Wholesale Price Inflation

28. During the review period, the y-o-y wholesale price inflation increased by 14.2 percent compared to a rise of 15.0 percent a year ago. The indices of agricultural commodities and domestic manufactured commodities increased by 25.0 percent and 11.2 percent respectively in the review period compared to 18.8 percent and 11.2 percent increase, a year ago. The price index of imported commodities declined by 0.5 percent in the review period whereas it had increased by 11.8 percent during the same period last year.

29. Within the agricultural commodities group, the price index of pulses, livestock production and spices respectively increased by 36.4 percent, 35.2 percent and 33.8 percent compared to an increase of 19.0 percent, 24.0 percent and 10.3 percent respectively during the same period last year.

30. Within the group of domestic manufactured commodities, the price index of food-related products increased by 18.9 percent compared to a rise of 11.8 percent a year ago. Within the imported commodities group, the price indices of chemical fertilizers and chemical goods declined by 11.9 percent in the review

period as compared to an increase of 8.1 percent in the corresponding period of the previous year.

National Salary and Wage Rate

31. The overall y-o-y salary and wage rate index rose by 16.7 percent in the review period compared to a rise of 16.5 percent a year ago. Of the salary and wage rate indices, the salary index increased by 13.8 percent in the review period compared to a rise of 16.8 percent in the same period of the previous year. The increase in basic salary and allowances by the government of Nepal for civil servants and its simultaneous effect on salary of the private sector contributed to such an increase in salary index. The wage rate index increased by 17.6 percent in the review period compared to an increase of 16.4 percent in the same period of the previous year. Wages of agricultural, industrial and construction laborers increased by 20.7 percent, 13.8 percent and 12.9 percent respectively in the review period. These wage rates had increased by 23.0 percent, 7.0 percent and 15.3 percent respectively in the same period last year.

Fiscal Situation*

Budget Deficit / Surplus

32. In the first seven months of 2009/10, government budget surplus on cash basis stood at Rs.8.42 billion compared to a surplus of Rs 8.79 billion in the corresponding period of the previous year. A high growth in the resource mobilization relative to total government expenditure accounted for such a budget surplus during the review period.

Government Expenditure

33. In the review period, total government spending increased by 31.9 percent to Rs.103.38 billion compared to an increase of 15.1 percent in the corresponding period of the previous year. The high growth in recurrent as well as capital expenditure accounted for such an increase in the government expenditure.

34. In the review period, recurrent expenditure increased by 36.4 percent to Rs.70.95 billion. In the corresponding period of the previous year, the recurrent expenditure had increased by 17.5 percent. An upward revision in the salary and allowances of the civil servants and teachers by the Government of Nepal mainly attributed to such a rise in the recurrent expenditure. Likewise, increasing expenditure on special security plan, growing amount of subsidies to public school and increment in the distribution of economic assistance expenditure accounted to such a rise in the recurrent expenditure.

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* Based on the reports of 32 and 16 branches of RBB and NBL out of their 65 and 42 respective branches performing government transaction in addition to the Nepal Rastra Bank, Everest Bank Ltd. and Nepal Bangladesh Bank Ltd.

35. In the review period, capital expenditure increased by 40.9 percent to Rs.15.69 billion in contrast to a decline of 20.1 percent in the corresponding period of the previous year. However, such amount of capital expenditure accounted for only 14.8 percent of the budget estimate. Delay in the approval of budget, lingering in the contract process, absence of representatives in local bodies as well as weak law and order situation in the country are mainly responsible for the lower than expected performance of capital expenditure in the review period.

36. In the first seven months of 2009/10, principal repayment expenditure declined by 32.0 percent to Rs.6.55 billion. In the corresponding period of the previous year, such expenditure had increased by 27.9 percent.

Government Revenue

37. In the review period, revenue mobilization of the government grew by 30.5 percent to Rs.94.28 billion compared to an increase of 32.5 percent in the corresponding period of the previous year. A positive impact of "Tax Compliance year", increase in PAN number holders, mobilization of tax volunteers, growth in imports, control in revenue leakages and tax administration reforms mainly contributed to such an increase in the revenue mobilization.

38. Of the total revenue mobilization, Value Added Tax (VAT) grew by 42.6 percent to Rs.29.22 billion in mid February 2009. It had increased by 18.4 percent in the corresponding period of the previous year.

39. In the review period, custom revenue rose by 42.8 percent to Rs.19.17 billion compared to an increase of 18.6 percent in the same period of the previous year. Reforms in custom administration and the increase in imports of high tax yielding vehicles and spare parts contributed to such a high growth of customs revenue.

40. In the review period, excise revenue increased by 66.9 percent to Rs.12.92 billion compared to an increase of 38.7 percent in the same period of the previous year. Reforms in excise administration and increase in the imports of high excise tax yielding vehicles accounted for such a growth of excise revenue in the review period.

41. Income tax revenue increased by 25.2 percent to Rs.16.59 billion in the review period. In the corresponding period last year such revenue had risen by 37.7 percent. A positive impact of tax compliance year and increase in PAN number holders accounted for such an increase in the income tax revenue mobilization.

42. In the review period, non-tax revenue decreased by 14.0 percent to Rs.11.22 billion compared to an increase of 61.1 percent in the same period of the preceding year.

Foreign Cash Loans and Grants

43. The government received foreign cash loans amounting to Rs.2.18 billion and foreign cash grants amounting to Rs.13.24 billion in the first seven months of 2009/10. In the corresponding period of the previous year, the government had received foreign cash loans and foreign cash grants amounting to Rs.2.84 billion and Rs.12.86 billion respectively.

External Sector Situation

Foreign Trade

44. Nepal's merchandise exports during the first seven months of 2009/10 declined by 9.8 percent to Rs. 35.80 billion in contrast to a growth of 18.3 percent in the corresponding period of 2008/09. On a monthly basis, the merchandise exports dropped by 1.2 percent during Jan/Feb as against a growth of 3.2 percent in the corresponding month of the previous year. The merchandise exports after witnessing a continuous decline for three months had registered a growth during Nov/Dec and Dec/Jan.

45. In terms of destination, exports to India dropped by 4.6 percent in the first seven months of 2009/10 as against a growth of 2.4 percent in the corresponding period of the previous year. Likewise, exports to other countries plummeted by 17.7 percent as against a growth of 54.4 percent in the same period of the previous year. The drop in the exports to India was mainly ascribed to the decrease in the exports of readymade garments, zinc sheet, shoes and sandals, pulses and thread among others. Likewise, exports to other countries decreased considerably due mainly to the decline in the export of woolen carpet, pulses, readymade garments, silverware and jewelleries and herbs among others.

46. The merchandise imports, on the other hand, grew by 42.2 percent to Rs. 222.07 billion in the first seven months of 2009/10 compared to a growth of 25.8 percent in the corresponding period of the previous year. The growing trend of the merchandise imports continued during the month of Jan/Feb. During this month, the merchandise imports soared by 54.3 percent compared to a growth of 22.0 percent in the same month of the previous year.

47. Imports from India grew by 36.1 percent in the review period compared to a growth of 11.4 percent in the corresponding period of the previous year. Likewise, imports from other countries witnessed a growth of 50.0 percent compared to a growth of 50.7 percent in the same period of the previous year. The growth in the import of M.S. billet, vehicles and spare parts, M.S. wire and rods, other machinery and parts and electrical equipment among others, from India and gold, telecommunication equipment and parts, other machinery and parts, steel rod and sheet and polythene granules among others, from other countries contributed significantly to the rise of total imports in the review

period. The import of gold, which had increased significantly in the preceding months, has however dropped substantially during Jan/Feb.

48. Total trade deficit during the first seven months of 2009/10 expanded by 59.9 percent to Rs. 186.27 billion. Trade deficit had risen by 28.6 percent in the corresponding period of the previous year. Trade deficit with India rose by 51.3 percent in the review period compared to a growth of 15.2 percent in the corresponding period of the previous year. Likewise, trade deficit with other countries expanded by 70.4 percent compared to a growth of 49.6 percent in the corresponding period of the previous year.

49. As a result of the slowdown in exports and accelerated import growth, the ratio of export to import dropped to 16.1 percent in the first seven months of 2009/10 from 25.4 percent a year earlier.

Balance of Payments

50. In the first seven months of 2009/10, the overall BOP recorded a deficit of Rs. 21.83 billion as against a surplus of Rs. 25.68 billion in the corresponding period of the previous year. The current account also registered a deficit of Rs. 30.76 billion as against a surplus of Rs. 20.32 billion in the corresponding period of the previous year. The increase in trade deficit and the slowdown in the growth of remittance inflows resulted in a huge current account deficit.

51. In the first seven months of 2009/10, the f.o.b.-based merchandise trade deficit grew by 62.0 percent to Rs. 180.20 billion compared to a growth of 27.8 percent in the corresponding period of the previous year. The transfer account registered a surplus of Rs. 150.93 billion in the review period compared to a surplus of Rs. 133.80 billion a year ago. Under the transfers subgroup, grants declined by 23.3 percent to Rs. 12.73 billions while pension receipts rose by 77.7 percent to Rs. 15.57 billion. Likewise, the workers' remittances increased only by 13.6 percent to Rs. 124.31 billion compared to its significant growth of 58.6 percent in the corresponding period of the previous year.

Foreign Exchange Reserves

52. The gross foreign exchange reserves dropped by 13.5 percent (Rs. 37.77 billion) to Rs. 242.22 billion in mid-February 2010 from a level of Rs. 279.99 billion as at mid-July 2009 as against a growth of 18.4 percent (Rs. 39.17 billion) in the corresponding period of the previous year. Of which, NRB's reserve declined by 14.8 percent to Rs. 190.96 billion from a level of Rs. 224.19 billion a year earlier. The gross foreign exchange reserves in dollar terms declined by 8.7 percent to USD 3.27 billion in mid- February 2010 as against a growth of 4.4 percent in the corresponding period of the previous year. The widening of the current account deficit resulted in the drawdown of foreign exchange reserves in the review period. The current level of reserves is sufficient for financing

merchandise imports of 7.8 months and merchandise and service imports of 6.7 months.

Price of Oil and Gold in the International Market and Exchange Rate Movement

53. The price of oil (Crude Oil Brent) in the international market went up by 64.2 percent to USD 71.22 per barrel in mid-February 2010 from USD 43.38 per barrel in mid-February 2009. Similarly, the price of gold also surged by 15.7 percent to USD 1082 per ounce in mid- February 2010 from USD 935.50 a year earlier.

54. Compared to mid-July 2009, the Nepalese currency vis-à-vis the US dollar appreciated by 5.49 percent in mid-February 2010. It had depreciated by 11.84 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 73.99 in mid-February 2010 compared to Rs. 78.05 in mid-July 2009.