

Current Macroeconomic Situation

(Based on the Ten Months' Data of 2009/10)

Monetary Situation

Money Supply

1. Broad money (M_2) expanded by 7.3 percent in the ten months of 2009/10. M_2 had expanded by 17.5 percent in the corresponding period of the previous year. Narrow money (M_1), which had grown by 15.7 percent during the ten months of 2008/9, grew by 2.8 percent in the review period. Despite a high growth of net domestic assets in comparison to the last year's figure, a decline in net foreign assets accounted for such a deceleration of monetary aggregates in the review period.
2. Of the components of narrow money, currency in circulation increased by 9.8 percent in the review period compared to an increase of 23.2 percent during the same period of the previous year. Demand deposits declined by 9.6 percent in the review period in contrast to its growth of 1.9 percent in the corresponding period of the previous year. Time deposits increased by 9.4 percent in the review period compared to a growth of 18.2 percent during the same period of the previous year.
3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, declined substantially by Rs.17.4 billion in the review period. It had increased by Rs.43 billion in the same period of the previous year. An acceleration of trade deficits in the review period contributed to such a significant decline in net foreign assets.

Domestic Credit

4. In the ten months of 2009/10, domestic credit expanded by 10.2 percent compared to a growth of 13.9 percent in the corresponding period of the previous year. Domestic credit increased at a lower rate on account of a decline in net claims on government and the lower growth in the private sector credit of the banking system.
5. Net claims on government declined by 15.2 percent (Rs.15.9 billion) in the review period compared to a 18.2 percent (Rs.15.9 billion) decline 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-May 2010 stood at Rs.3.9 billion.
6. In the review period, claims on private sector increased by 16.8 percent (Rs. 73.4 billion) compared to a growth of 22.4 percent (Rs. 76.3 billion) in the same period a

year ago. A contraction in the liquidity position of banking sector contributed to a slowdown in the growth of claims on private sector in the review period.

7. Claims on non-government financial enterprises declined by 17.7 percent in the review period in contrast to a growth of 30.8 percent in the corresponding period of the previous year. The decline in investments of commercial banks on finance companies, pension funds, and insurance companies in the review period contributed to such a decline in claims on the non-government financial enterprises.
8. In the ten months of 2009/10, claims on non-financial government enterprises declined by 10.1 percent compared to a decline of 8.8 percent in the corresponding period of the previous year. Partial repayment of loans by National Trading Ltd., Nepal Airlines Corporation, Janak Education Material Centre Limited, Nepal Electricity Corporation and Nepal Food Corporation contributed in slowing down the growth of claims on non-financial government enterprises in the review period.

Deposits Mobilization and Credit Flow of Commercial banks

9. In the ten months of 2009/10, deposits mobilization of commercial banks increased by 5.6 percent (Rs.30.6 billion) amounting to Rs. 580.5 billion as at mid-May 2010. The total deposits had increased by 19.5 percent (Rs.82.1 billion) in the corresponding period of the previous year.
10. Loan and advances of commercial banks increased by 12.2 percent (Rs. 63.5 billion) to Rs. 582.1 billion in the review period. Similarly, private sector credit of commercial banks grew by 17.5 percent (Rs.70.8 billion) compared to a growth of 24.2 percent (Rs. 74.3 billion) in the corresponding period of the previous year. Of the private sector credit, credit to the production sector increased by 10 percent (Rs.8.8 billion) in the review period compared to a growth of 14.9 percent in the same period of the previous year. Sugar, Cement, and Iron and Steel industries witnessed a significant credit expansion under the production sector credit. Similarly, credit to agriculture sector increased by Rs. 1.5 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 26.4 percent (Rs.18.9 billion), 40.4 percent (Rs.15.7 billion), and 24.4 percent (Rs 5.7 billion) respectively. Credit to these sectors during the corresponding period in the previous year had increased by 15.7 percent, 44 percent, and 6 percent respectively. Credit to real estate sector increased to Rs.14.6 billion in the ten months of 2009/10 compared to Rs.11.9 billion in the same period a year ago.

Liquidity position of Commercial Banks

11. The liquid assets of the commercial banks stood at Rs. 170.4 billion as at mid-May 2010. Of the components of liquid assets, liquid fund declined by 8.2 percent. A decline in commercial banks' balance with the NRB as well as balance held abroad accounted for a contraction of liquid funds of commercial banks. In the review period, the balance held abroad declined by Rs. 1.6 billion amounting to Rs. 51.8 billion while the balance with NRB declined by Rs. 8.6 billion. Similarly, another

component of liquid assets, commercial banks' investments in government securities declined by 11.4 percent (Rs. 8.2 billion) in the review period.

12. On account of the higher credit disbursement relative to deposit mobilization, the credit-deposit ratio increased to 89.3 percent in mid-May 2010 from 81.2 percent in mid-July 2009. Similarly, the liquidity-deposit ratio declined to 29.4 percent in mid-May 2010 from 34.2 percent in mid-July 2009.

Liquidity Management

13. In the ten months of 2009/10, NRB injected net liquidity amounting to Rs.103.1 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. 107.1 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.9.7 billion was mopped up. Of the total liquidity mopped up, Rs.7.5 billion and Rs. 13.3 billion were mopped up through outright sale auction and reverse repo auction respectively, while Rs. 11 billion was injected through repo auction.
14. In the ten months of 2009/10, NRB injected net liquidity amounting to Rs. 84.5 billions through net purchase of USD 1.1 billion from commercial banks. A net liquidity of Rs. 121.5 billion was injected through the net purchase of USD 1.6 billion in the same period last year.
15. The NRB purchased Indian currency equal to 82.5 billion through the sale of USD 1.8 billion in the Indian money market during the review period. Indian currency equal to 59.9 billion was purchased through the sale of USD 1.2 billion 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. Banks and Financial Institutions used standing liquidity facility (SLF) amounting to Rs.91.9 billion in the review period. The use of the SLF by commercial banks had amounted to Rs.96.6 billion in the corresponding period of the previous year. Likewise, Inter-bank transactions of commercial banks stood at Rs.231.7 billion in the first ten months of 2009/10 compared to Rs.248.2 billion in the corresponding period of the previous year.

Interest Rates

17. The weighted average 91-day Treasury bill rate stood at 7.41 percent in the tenth month of 2009/10 compared to 6.73 percent in the corresponding month of the previous year. Similarly, the weighted average inter-bank rate stood at 7.13 percent in the tenth month of 2009/10 compared to 7.07 percent in the corresponding 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. The maximum interest rate of two-year and more than two years' fixed deposits increased from 9.5 percent as at

mid-July 2009 to 13 percent as at mid-May 2010. The shortfall of liquidity in the banking system contributed to increase the interest rates in the review period.

Securities Market

18. The year on year (y-o-y) NEPSE index declined by 30.79 percent to 457.81 points in the first ten months of 2009/10. This index stood at 660.96 in the same period last year. Likewise, NEPSE sensitive index (based on July 2006) stood at 113.01 point in mid May 2010, which was 174.13 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 42.02 in mid May 2010, a contraction of 34.23 percent compared to the same period last year.
19. The y-o-y market capitalization increased by 46.27 percent to Rs.356 billion in mid May 2010. The ratio of market capitalization to GDP stood at 30.11 percent in the review period. It was 24.57 percent in the same period last year. Of the total market capitalization, bank and financial institutions accounted for 71.9 percent followed by manufacturing and processing companies (2.2 percent), hotels (1.4 percent), business entities (0.5 percent), hydropower (4.2 percent) and other economic sectors (20 percent).
20. Total paid up capital of the listed companies stood at Rs. 75.34 billion in mid May 2010, an increment of 36.56 percent over the period of one year. This increase was largely due to the additional listing of securities at the NEPSE. As at the tenth month of 2009/10, additional securities worth Rs.22.73 billion (ordinary share of Rs.3.98 billion, bonus share of Rs. 3.44 billion, right share of Rs.8.04 billion and government securities of Rs.7.25 billion) were listed at the NEPSE.
21. Total number of companies listed at the NEPSE increased to 171 in mid May 2010 compared to 157 last year. Among them, 139 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

22. The year on year (y-o-y) inflation as measured by the consumer price index moderated to 10.0 percent in mid-May 2010 compared to 12.9 percent increase in the same period last year. In the review period, the price index of food and beverages group increased by 12.3 percent whereas the index of non-food and services group rose only by 7.2 percent. The index of food and beverages and non-food and services group had risen by 16.5 percent and 8.8 percent respectively in the same period last year.
23. Of the items in the food and beverage group, price indices of spices increased by 28.7 percent compared to an increase of 17.5 percent in the same period last year. Similarly, the price indices of sugar and sugar related products, restaurant meal,

pulses as well as meat, fish and eggs sub-groups increased in the review period by 22.6 percent, 18.1 percent, 16.2 percent and 15.9 percent respectively compared to their respective increase of 66.9 percent, 18.2 percent, 26.3 percent and 27.5 percent in the same period last year. The index of grains and cereal products subgroup also witnessed an increase of 12.5 percent compared to an increase of 6.3 percent in the corresponding period of the previous year.

24. Within non-food and services group, the index of education, reading and recreation, housing goods and services as well as tobacco and related products increased by 10.9 percent, 9.8 percent and 9.3 percent during the review period compared to their respective increase of 8.3 percent, 8.0 percent and 17.5 percent during the same period last year.
25. Region-wise, the price index of Hills rose by 12.0 percent followed by 9.8 percent in Terai and 9.1 percent in Kathmandu Valley in the review period. The respective rates were 11.8 percent, 12.4 percent and 14.3 percent during the same period last year.
26. In the review period, the y-o-y core inflation rose to 11.2 percent, a moderation from 12.7 percent a year ago.

Wholesale Price Inflation

27. During the review period, the y-o-y wholesale price inflation increased by 8.4 percent compared to a rise of 15.5 percent a year ago. The indices of agricultural commodities, domestic manufactured commodities and imported commodities increased by 10.6 percent, 8.9 percent and 4.1 percent respectively in the review period compared to their respective increase of 23.4 percent, 7.7 percent and 8.4 percent a year ago.
28. Within the agricultural commodities group, the price index of spices, livestock production, pulses and foodgrains respectively increased by 29.6 percent, 21.7 percent, 18.7 percent and 17.8 percent compared to an increase of 21.3 percent, 34.0 percent, 25.4 percent and 2.6 percent respectively during the same period last year.
29. Within the group of domestic manufactured commodities, the price index of food-related products increased by 16.5 percent compared to a rise of 4.1 percent a year ago. Within the imported commodities group, the price indices of petroleum products and coal increased by 11.4 percent in the review period compared to an increase of 1.5 percent in the corresponding period of the previous year.

National Salary and Wage Rate

30. The overall y-o-y salary and wage rate index rose by 13.0 percent in the review period compared to a rise of 21.1 percent a year ago. The increase in basic salary and allowances in mid-August 2009/10 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 and wage rate index. 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 wage rate index increased by 12.7 percent in the review period compared to an increase of 22.5 percent in the same period of the previous year. Wages of agricultural, industrial and construction laborers increased by 18.9 percent, 4.1 percent and 8.2 percent respectively in the review period. These wage rates had increased by 27.8 percent, 15.1 percent and 21.3 percent respectively in the same period last year.

Fiscal Situation [□]

Budget Deficit / Surplus

31. In the ten months of 2009/10, government budget surplus on cash basis stood at Rs.7.1 billion compared to a surplus of Rs 6.1 billion in the corresponding period of the previous year.

Government Expenditure

32. In the review period, total government spending increased by 25.1 percent to Rs.159.6 billion compared to an increase of 25.7 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.
33. In the review period, recurrent expenditure increased by 24.9 percent to Rs.102.3 billion. In the corresponding period of the previous year, the recurrent expenditure had increased by 26.5 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 accounted for such a rise in the recurrent expenditure.
34. In the review period, capital expenditure increased by 33.5 percent to Rs.34.75 billion as against a 11.4 percent increase in the corresponding period of the previous year. However, such amount of capital expenditure accounted for only 32.70 percent of the budget estimate. Delay in the budget approval, 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 performance of capital expenditure in the review period.

[□] Figure includes the reports from 7 NRB district offices, 35 RBB branches (out of 65 branches conducting govt. transaction), 21 NBL branches (out of 42 branches conducting govt. transaction), 5 Everest Bank branches, and 1 from Nepal Bangladesh Bank Ltd.

35. In the ten months of 2009/10, the expenditure on principal repayment declined by 11.6 percent to Rs.12.41 billion. In the corresponding period of the previous year, such expenditure had increased by 28.2 percent.

Government Revenue

36. In the ten months of 2009/10, revenue mobilization of the government grew by 25.4 percent to Rs.138.56 billion compared to an increase of 39.9 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.
37. Of the total revenue mobilization, Value Added Tax (VAT) grew by 37.5 percent to Rs.42.85 billion in mid May 2010. It had increased by 24.5 percent in the corresponding period of the previous year. Increase in the consumptions and reforms in VAT administration are attributed for such a growth in the VAT.
38. In the review period, custom revenue rose by 33.8 percent to Rs.27.9 billion compared to an increase of 29.2 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.
39. In the review period, excise revenue increased by 56.8 percent to Rs.18.91 billion compared to an increase of 45.0 percent to 12.1 billion 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.
40. Income tax revenue increased by 22.1 percent to Rs.24.73 billion in the review period. In the corresponding period last year, such revenue had risen by 46.0 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.
41. In the review period, non-tax revenue declined by 7.3 percent to Rs.17.6 billion, in contrast to a sharp growth of 62.1 percent in the same period last year. A decline in the receipts of the Nepal Government from royalty, principal and interest accounted for such decrease in the non-tax revenue in the review period.

Foreign Cash Loans and Grants

42. The government received foreign cash loans amounting to Rs.3.58 billion and foreign cash grants amounting to Rs.20.84 billion in the ten 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.3.21 billion and Rs.18.81 billion respectively.

External Sector Situation

Foreign Trade

43. Nepal's merchandise exports declined by 11.2 percent to Rs. 50.20 billion in the ten months of 2009/10. Such exports had grown by 19.5 percent to Rs. 56.54 billion in the same period last year. On a monthly basis, exports declined by 13.9 percent in April/May, 2009/10 compared to the value of the previous month.
44. In terms of destination, exports to India declined by 7.0 percent in the ten months of 2009/10 in contrast to a growth of 10.4 percent in the same period last year. Likewise, exports to other countries plummeted by 18.2 percent as against a growth of 38.2 percent in the same period last year. The decline in the exports to India was mainly ascribed to the decrease in the exports of readymade garments, zinc sheet, GI pipe, plastic utensils and pulses among others. Likewise, exports to other countries declined considerably due mainly to the decrease in the export of woolen carpet, pulses, readymade garments, herbs as well as silverware and jewelleryes among others.
45. The merchandise imports, on the other hand, grew by 35.6 percent to Rs. 309.88 billion in the ten months of 2009/10. Such imports had grown by 25.4 percent to Rs. 228.54 billion in the same period last year. On a monthly basis, the merchandise imports declined by 15.3 percent in April/May, 2009/10 compared to the value of the previous month.
46. Imports from India grew by 35.3 percent in the review period compared to a growth of 10.5 percent in the same period last year. Likewise, imports from other countries grew by 36.0 percent compared to a growth of 52.2 percent in the same period last year. The growth in the import of vehicles and spare parts, M.S. billet, petroleum products, M.S. wire and rods and hot rolled sheet in coil among others, from India and gold, telecommunication equipment and parts, polythene granules, steel rod and sheet and silver among others, from other countries contributed significantly in the rise of total imports in the review period. The imports of gold and vehicles, which had increased significantly in the earlier months, have however dropped substantially from Jan/Feb and Feb/March respectively.
47. Total trade deficit during the ten months of 2009/10 expanded by 51.0 percent to Rs. 259.68 billion. Trade deficit had risen by 27.4 percent to Rs. 172 billion in the same period last year. Trade deficit with India rose by 51.0 percent in the review period compared to a growth of 10.5 percent in the same period last year. Likewise, trade deficit with other countries expanded by 50.9 percent compared to a growth of 56.5 percent in the same period last year.
48. As a result of the slowdown in exports and accelerated import growth, the ratio of export to import dropped to 16.2 percent in the ten months of 2009/10 from 24.7 percent a year ago.

Balance of Payments

49. The overall BOP recorded a deficit of Rs. 17.36 billion in the ten months of 2009/10 as against a surplus of Rs. 43.06 billion in the same period last year. The current account also registered a deficit of Rs. 34.78 billion as against a surplus of Rs. 37.04 billion in the same period last year. The large trade deficit coupled with a decelerated remittances growth led to such a huge current account deficit.
50. The FOB-based merchandise trade deficit grew by 52.1 percent to Rs. 251.16 billion in the ten months of 2009/10. Such deficit had grown by 27.4 percent to Rs. 165.16 billion in the same period last year. The transfer account registered a surplus of Rs. 229.48 billion in the review period compared to Rs. 200.38 billion a year ago. Under the transfers subgroup, grants increased by 12.7 percent to Rs. 22.23 billion while pension receipts rose by 60.1 percent to Rs. 22.61 billion. Likewise, the workers' remittances increased only by 10.2 percent to Rs. 186.44 billion compared to its significant growth of 55.5 percent in the corresponding period of the previous year. On a monthly basis, the remittance inflows grew by 14.7 percent in April/May compared to a growth of 25.7 percent in the same month of the previous year.

Foreign Exchange Reserves

51. The gross foreign exchange reserves declined by 14.9 percent to Rs. 238.34 billion in mid-May 2010 from a level of Rs. 279.99 billion as at mid-July 2009. Such reserves had increased by 33.3 percent to Rs. 283.43 billion in the same period last year. NRB's reserves declined by 17.4 percent to Rs. 185.29 billion in the review period from a level of Rs. 224.19 billion as at mid-July 2009. The gross foreign exchange reserves in dollar terms declined by 7.5 percent to USD 3.32 billion in mid-May 2010 from a level of USD 3.59 billion as at mid-July 2009. Such reserves had increased by 15.4 percent to USD 3.58 billion in the same period last year. The widening of the current account deficit resulted in the depletion of foreign exchange reserves in the review period. Based on the trend of import in the ten months of the current fiscal year, the current level of reserves is sufficient for financing merchandise imports of 7.9 months and merchandise and service imports of 6.6 months.

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

52. The price of oil (Crude Oil Brent) in the international market went up by 36.3 percent to USD 76.51 per barrel in mid-May 2010 from USD 56.13 per barrel in mid-May 2009. Similarly, the price of gold also surged by 33.6 percent to USD 1236.50 per ounce in mid-May 2010 from USD 925.25 a year ago.
53. Nepalese currency vis-à-vis the US dollar appreciated by 8.69 percent in mid-May 2010 compared to mid-July 2009. It had depreciated by 13.46 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 71.81 in mid-May 2010 compared to Rs. 78.05 in mid-July 2009.