



Nepal Rastra Bank

Research Department

Current Macroeconomic and Financial Situation of Nepal (Based on Five Months' Data of 2016/17)

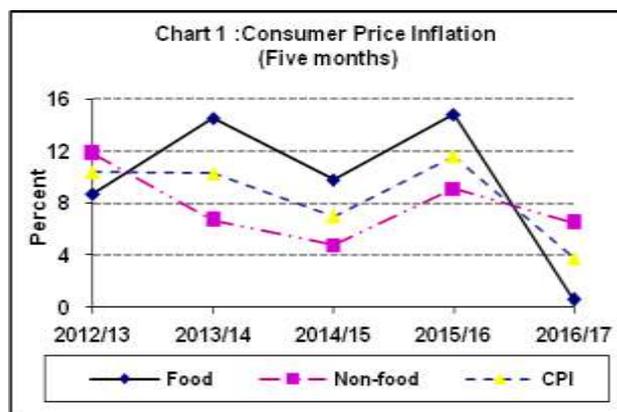
Macroeconomic Outlook

1. The real output is expected to rebound to the targeted level in 2016/17. Favorable monsoon, improved power supply, expected pickup in reconstruction works and steady remittances have the potential to improve the economic growth outlook going forward.
2. A better than expected growth in agriculture is slated to propel the economic growth to the targeted level in 2016/17. A significant increase in paddy output with 20.8 percent share in agricultural output is to underpin the accelerated growth of agriculture in 2016/17.
3. The consumer price inflation is expected to remain within the targeted level of 7.5 percent in 2016/17. A boost in summer crops, normalcy in supplies and decelerating Indian inflation are expected to contain inflation within the targeted level.
4. The far low level of non-performing assets (NPA) below 2 percent, especially of commercial banks, requiring the lower level of loan loss provisioning and resulting in potentially higher level of profitability attributes the financial sector stability. However, this very attribute poses a challenge in maintaining financial sector stability going forward. Acceleration in overall bank credit to private sector by 30.4 percent (y-o-y) including overdraft, hire purchase and real estate loans is a matter of concern. Credit excesses in risky areas could divert bank credit from productive sectors. Therefore, banks and financial institutions are required to exhibit prudent and cautious lending behavior going forward.
5. On external front, relatively higher rate of growth in imports is likely to exert pressure on country's balance of payments (BOP). However, a steady growth in remittances and an increased level of official development assistance (ODA) are likely to offset the pressure, resulting in a modest surplus in BOP going forward.

Inflation, Salary and Wage Rate

Consumer Price Inflation

6. The year-on-year (y-o-y) consumer price inflation has significantly decelerated to 3.8 percent in mid-December 2016 from 11.6 percent in mid-December 2015.
7. The y-o-y inflation is continuously decelerating since mid-June 2016. The base effect, improved supply situation and deceleration in Indian inflation are the underlying factors for a downward path of inflation in recent months.



Food Inflation

8. The food inflation dropped to 0.6 percent in mid-December 2016 from 14.8 percent in the corresponding month of 2015. A fall in prices of ghee and oil by 20.5 percent, pulses and legumes by 6.6 percent, fruit by 2.4 percent and cereal grain by 1.1 percent caused the deceleration in food inflation to 0.6 percent in mid-December 2016. Of food and beverage group, the prices of sugar and sugar products increased by 14.7 percent and alcoholic drinks by 11.6 percent.

Box 1: Y-O -Y Food Inflation (Five Months)		
Particulars	Inflation (Percent)	
	2072/73	2073/74
Food Inflation	14.8	0.6
1. Pulses and Legumes	48.9	(6.6)
2. Ghee and Oil	42.3	(20.5)
3. Spices	15.3	7.3
4. Fruit	14.3	(2.4)
5. Meat and Fish	13.9	2.1
6. Milk Products and Egg	11.9	3.5
7. Vegetable	11.6	4.5
8. Cereal Grains and their Products	11.3	(1.1)

Source: National Consumer Price Index, mid-December 2016

Non-food Inflation

9. The non-food inflation also moderated to 6.5 percent during the review period from 9.1 percent in the corresponding period of the previous year. The decline in prices of transportation and communication contributed to the moderation in non-food inflation in the review period.

Region-wise Consumer Price Inflation

10. The Hilly region witnessed a relatively higher rate of inflation of 5.6 percent followed by Terai and Mountain both at 3.7 percent and the Kathmandu Valley at 2.5 percent in the review period. In the corresponding period of the previous year, Hilly region, Terai region,

Mountain region and the Kathmandu Valley had seen the inflation rate of 12.4 percent, 10.2 percent, 10.3 percent and 13.2 percent respectively.

Inflation Differential between Nepal and India

11. The y-o-y consumer price inflation was slightly lower at 3.4 percent in India compared to 3.8 percent in Nepal in December 2016, showing an inflation wedge of 0.4 percent. Such inflation was 5.6 percent in India

Box 2: Commodity-Wise Inflation Wedge between Nepal and India			
Commodities	Inflation (Percent)		Wedge
	Nepal	India	
Overall Consumer Price Inflation	3.8	3.4	0.4
1. Sugar and Sugar Products	14.7	21.1	(6.4)
2. Alcoholic drinks	11.6	6.4	5.2
3. Education	10.0	5.5	4.5
<i>Source: Ministry of Statistics and Programme Implementation, India, December 2016</i>			

and 11.6 percent in Nepal reflecting a wider inflation differential of 6 percent in the corresponding period of the previous year. This indicates that the inflation wedge between Nepal and India has narrowed down significantly in recent months (Box 2).

Wholesale Price Inflation

12. The y-o-y wholesale price inflation dropped to 2.7 percent in the review period from 7.9 percent a year ago. The decline in the index of imported commodities by 0.6 percent and relatively lower growth in the wholesale price indices of agricultural commodities by 3.5 percent and domestic manufactured commodities by 4.7 percent accounted for the significant drop in wholesale price inflation in the review period.

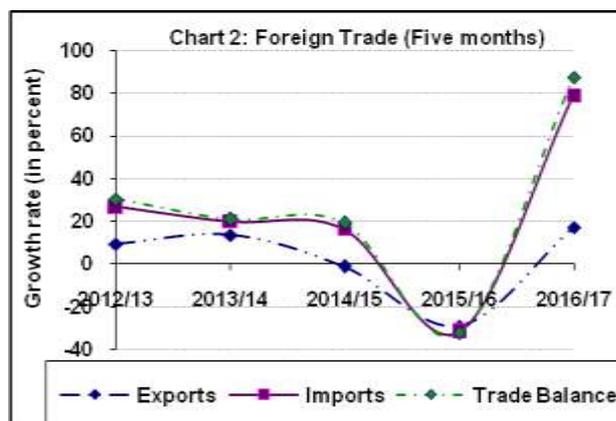
National Salary and Wage Rate

13. The y-o-y salary and wage rate index rose to 14.2 percent in the review period from 6.3 percent in the corresponding period of the previous year. In the review period, the salary index increased 18.5 percent, while the wage rate index grew 13.2 percent. The hike in pay scale of civil service drove up the salary and wage rate index in the review period. The salary indices of civil service, army and police forces and public corporation sub-groups increased 24.2 percent, 23.6 percent and 20.8 percent respectively in the review period. Likewise, wage rate indices of construction laborer, agricultural laborer and industrial laborer witnessed a growth of 13.8 percent, 13.5 percent and 12.2 percent respectively in the review period.

External Sector

Merchandise Trade

14. In the first five months of 2016/17, merchandise exports recovered by 17.1 percent to Rs. 30.63 billion from the base of the corresponding period of 2015/16. However, merchandise exports have remained far below the pre last year's level.
15. Destination-wise, the recovery of exports to China was significant at 55.3 percent from the negative growth of 66.3 percent last year. However, the export base to China is very low. Merchandise exports to India rose 22.6 percent in the review period as against the decline of 39.2 percent a year ago. Merchandise exports to other countries grew 8.9 percent in the review period as against the decline of 6.9 percent a year ago.
16. Commodity-wise, exports of juice, jute goods, rosin, among others increased whereas export of cardamom, readymade garments, woolen carpet, among others decreased in the review period.
17. Merchandise imports increased 78.9 percent to Rs. 382.64 billion in the review period as against a decline of 32 percent in the same period of the previous year.
18. Source-wise, imports from India increased significantly by 105.8 percent, followed by China by 43 percent and other countries by 43.8 percent.
19. Commodity-wise, imports of vehicles and spare parts, petroleum products, machinery & parts, construction materials among others increased whereas imports of coldrolled- sheet in coil, aircraft spare parts, among others decreased in the review period.
20. Based on customs points, the exports through Dry Port Customs Office, Biratnagar Customs Office and Bhairahawa Customs Office decreased whereas exports from other customs points increased in the review period. On the import side, imports through Kailali Customs Office and Mechi Customs Office decreased whereas imports through other customs points increased in the review period.
21. Total trade deficit in the review period widened 87.6 percent to Rs 352.01 billion as against the contraction of 32.4 percent in the same period of the previous year. The export-import ratio fell to 8 percent in the review period from 12.2 percent in the corresponding period of the previous year.



Export-Import Price Index

22. The y-o-y unit value export price index (based on customs data) increased by 12.3 percent whereas import price index decreased by 0.3 percent in the fifth month of 2016/17. Consequently, the TOT index improved 12.6 percent compared to an increment of 22 percent in the corresponding period of the previous year. There was an increase in price of export items such as yarsagumba, carpet, pashmina, jute goods and cardamom, whereas there was a decrease in price of import items such as vehicle tyres, CRT television and polyester yarn in the review period. This resulted in the increment of export price index and the decrement of import price index in the review period.

Services

23. The total services receipts and expenses increased 9.5 percent and 9 percent respectively in the review period. As a result, net services stood at a surplus of Rs. 3.59 billion in the review period compared to a surplus of 3.04 billion in the same period of the previous year. Under the services account, travel receipts increased 30.5 percent to Rs. 22.65 billion in the review period. Such receipts had decreased 15.3 percent in the same period of the previous year.

Workers' Remittances

24. The growth in workers' remittances slowed to 6 percent (Rs. 287.66 billion) in the review period from 19.4 percent in the corresponding period of the previous year. The fall in number of outgoing workers and the decline in remittances from India on account of recent demonetization of high value Indian currency notes resulted in the modest growth in workers' remittances in the review period.
25. The number of out-migrant workers based on final approval for foreign employment, decreased 8.9 percent in the first five months of 2016/17 compared to the decline of 22.6 percent in the same period of the previous year.

<i>Box 3: Number of Nepalese Workers Going Abroad for Foreign Employment *</i>			
Mid-Month/Year	2014/15	2015/16	2016/17
August	42309	37756	35485
September	51551	40275	34759
October	35550	35484	24949
November	43213	23061	30588
December	53354	38350	33650
January	45362	35389	
February	48941	34219	
March	44460	35701	
April	52210	31615	
May	31375	36778	
June	37962	37687	
July	26600	32398	
Total	512887	418713	159431
Percentage Change	-2.8	-18.4	-8.9**
* Based on final approval for foreign employment except re-approval. ** July/Dec. Source:- Foreign Employment Department			

Current Account and BOP

26. The current account surplus squeezed to Rs. 3.49 billion in the review period from Rs. 149.13 billion in the same period of the previous year on account of sharp increase in imports. The overall BOP recorded a surplus of Rs. 28.78 billion in the review period compared to a surplus of Rs. 128.11 billion in the same period of the previous year.
27. Capital transfer of Rs. 5.15 billion and Foreign Direct Investment (FDI) inflow of Rs. 6.84 billion were recorded in the review period. In the same period of the previous year, capital transfer and FDI inflows were Rs. 6.78 billion and Rs. 1.92 billion respectively.

Box 4: External Sector (USD)*							
Particulars	(USD Million)						
	2014-15		2015-16		2016-17	Percentage Change in Five months	
	Five Months	Annual	Five Months	Annual	Five Months	2015/16	2016/17
Goods Exports (FoB)	423.9	988.1	269.2	703.9	319.2	-36.5	18.6
Goods Imports (FoB)	3184.2	7657.6	2007.7	7092.5	3498.8	-36.9	74.3
Trade Balance	-2760.2	-6669.5	-1738.5	-6388.6	-3179.6	-37.0	82.9
Total Trade	3608.1	8645.6	2276.9	7796.3	3818.0	-36.9	67.7
Travel Receipts	209.0	536.7	165.2	392.7	210.9	-21.0	27.6
Workers' Remittances	2320.4	6192.0	2587.5	6253.4	2680.1	11.5	3.6
Current Account Balance	34.7	1067.3	1417.7	1338.8	32.6	-	-
BOP (-Surplus)	-236.2	-1437.0	-1214.1	-1779.8	-268.4	-	-

** Data from BOP Presentation*

1. In US dollar terms, total merchandise exports and imports increased 18.6 percent and 74.3 percent respectively in the first five months of 2016/17. Exports and imports had decreased 36.5 percent and 36.9 percent respectively in the corresponding period of the previous year.
2. In the review period, travel receipts increased 27.6 percent and worker's remittance rose 3.6 percent. Travel receipts had decreased 21 percent and remittances had increased 11.5 percent in the corresponding period of the previous year.
3. Current account recorded a surplus of USD 32.6 million in the review period. It was in surplus of USD 1417.7 million in the corresponding period of the previous year. Likewise, Balance of Payments (BOP) recorded a surplus of USD 268.4 million in the review period compared to the surplus of USD 1214.1 million in the corresponding period of the previous year.

Foreign Exchange Reserves

28. The gross foreign exchange reserves increased 3.6 percent to Rs. 1076.84 billion as at mid-December 2016 from Rs. 1039.21 billion in mid-July 2016. Of the total, reserves held by NRB increased 2.9 percent to Rs. 912.86 billion as at mid-December 2016 from Rs. 887.01 billion as at mid-July 2016. Similarly, the



reserves of banks and financial institutions (except NRB) increased 7.7 percent to Rs. 163.98 billion as at mid-December 2016 from Rs. 152.20 billion as at mid-July 2016. The share of Indian currency in total reserves stood at 21.9 percent as at mid-December 2016.

Foreign Exchange Adequacy Indicators

29. Based on the imports of the first five months of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 14.3 months, and merchandise and services imports of 12.4 months. The ratio of reserve-to-GDP, reserve-to-imports and reserve-to-M2 stood at 47.9 percent, 103.5 percent and 45.1 percent respectively as at mid-December 2016. Such ratios were 46.2 percent, 117.4 percent and 46.3 percent as at mid-July 2016.

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

30. The price of oil (Crude Oil Brent) in the international market increased 37.3 percent to USD 51.72 per barrel in mid-December 2016 from USD 37.66 per barrel a year ago. The price of gold increased 6.2 percent to USD 1126.95 per ounce in mid-December 2016 from USD 1061.50 per ounce a year ago.
31. Nepalese currency vis-à-vis the US dollar depreciated 0.9 percent in mid-December 2016 from mid-July 2016. It had depreciated 5.5 percent in the same period of the previous year. The buying exchange rate per US dollar stood at Rs. 107.70 in mid-December 2016 compared to Rs. 106.73 in mid-July 2016.

Fiscal Situation *

Budget Deficit / Surplus

32. In the first five months of 2016/17, the Government of Nepal (GoN) ran a surplus of Rs. 52.52 billion in its budget. Such surplus was Rs. 32.81 billion in the corresponding period of the previous year.

Government Expenditure

33. In the review period, total government expenditure on a cash basis increased 82.5 percent to Rs. 194.61 billion. Such expenditure had decreased 9 percent in the corresponding period of the previous year.

*

Based on the data reported by 8 NRB offices, 69 branches of Rastriya Banijya Bank Limited, 49 branches of Nepal Bank limited, 24 branches of Agriculture Development Bank limited, 9 branches of Everest Bank Limited, 4 branches of Global IME Bank Limited and, 1 branch each from Nepal Bangladesh Bank limited, NMB Bank Limited, and Bank of Kathmandu Limited conducting government transactions and released report from 79 DTCOs and payment centers.

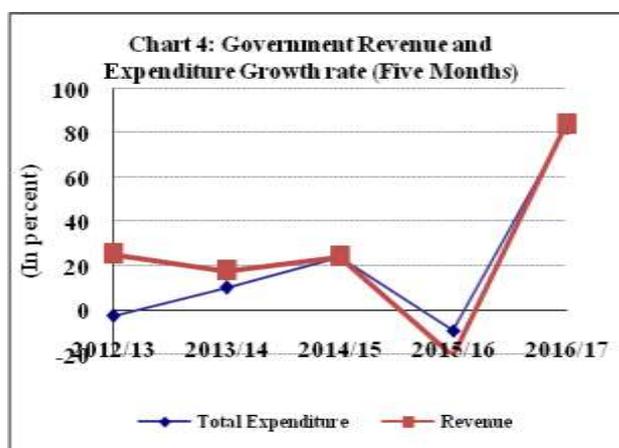
34. In the review period, recurrent expenditure increased 93.5 percent to Rs. 160.99 billion. Such expenditure decreased 12.7 percent in the corresponding period of the previous year. In the review period, capital

Box 5: The Budget Performance			
<i>Rs. In billion</i>			
	Budget Estimates	Outturns in Five Months	As percent of budget estimates
Total Expenditure	1048.92	194.61	18.55
Recurrent	617.16	160.99	26.09
Capital	311.95	20.67	6.63
Financial	119.81	12.95	10.81
Revenue	565.90	207.60	36.69

expenditure increased to Rs. 20.67 billion. Such expenditure was Rs. 8.52 billion in the corresponding period of the previous year. Government Budget announcement one and half months before the start of new fiscal year and timely approval of Appropriation Bill resulted in relatively higher growth in recurrent and capital expenditure. However, outturns in various heads of government expenditure have remained far below the annual targets.

Government Revenue

35. In the review period, the government revenue collection increased 84 percent to Rs. 207.60 billion. Such revenue had decreased 20.6 percent in the corresponding period of the previous year. Higher growth rate of major tax heads such as value added tax, income tax, customs, excise duty and others tax heads contributed to the rise in overall revenue collection in the review period.



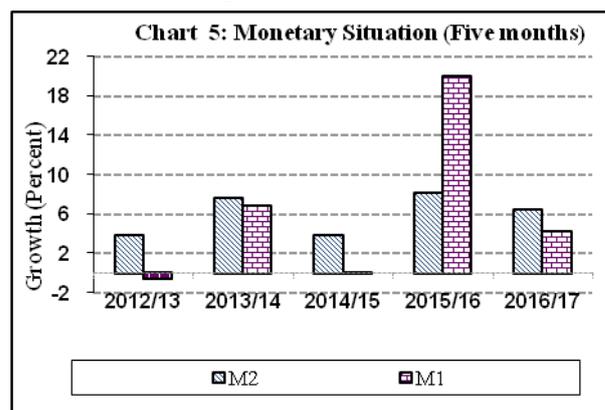
Cash Balance of the GoN

36. Because of a slow pace of government expenditure relative to resource mobilization, the GoN accumulated cash balance of Rs. 199.14 billion at Nepal Rastra Bank as of mid-December 2016.

Monetary Situation

Money Supply

37. Broad money (M2) increased 6.5 percent in the review period compared to an increase of 8.2 percent in the corresponding period of the previous year. On y-o-y basis, M2 expanded 17.6 percent in mid-December 2016.



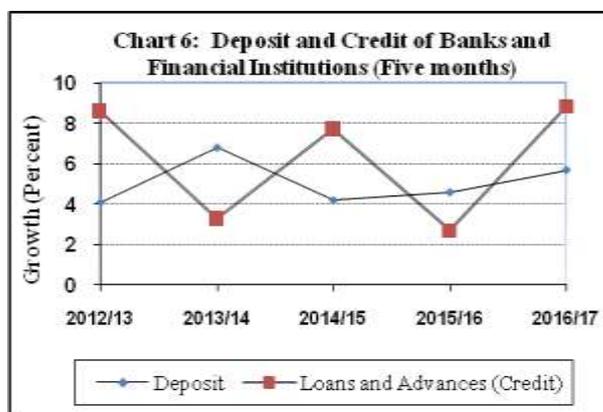
38. The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) increased Rs. 28.78 billion between mid-July and mid-December 2016 compared to an increase of Rs. 128.11 billion in the corresponding period of the previous year.
39. Reserve Money increased 2.8 percent in the review period compared to a growth of 0.7 percent in the corresponding period of the previous year. On y-o-y basis, reserve money increased 6.8 percent in mid-December 2016.

Domestic Credit

40. Domestic credit expanded 5.6 percent in the review period as against a decline of 0.3 percent in the same period of the previous year. On y-o-y basis, domestic credit increased 24.4 percent in mid-December 2016.
41. Claims of monetary sector on the private sector increased 10.3 percent in the review period compared to a growth of 4.2 percent in the previous year. On y-o-y basis, claims on the private sector increased 30.4 percent in mid-December 2016.

Deposit Collection

42. Deposits at Banks and Financial Institutions (BFIs) increased 5.7 percent in the review period compared to an increase of 4.6 percent in the corresponding period of the previous year. On y-o-y basis, deposits at BFIs expanded 20.6 percent in mid-December 2016. Of the total deposits at BFIs, the share of demand deposits, saving deposits and fixed deposits remained 8.1 percent, 42.9 percent and 31.8 percent respectively in mid-December 2016. Such shares were 9 percent, 43.4 percent and 29.3 percent respectively a year ago.



43. Credit to the private sector from BFIs increased 9.6 percent in the review period compared to an increase of 3.3 percent in the same period of the previous year. In the review period, private sector credit from commercial banks and development banks increased 9.8 percent and 12.1 percent respectively, while that of finance companies decreased 7.4 percent. On y-o-y basis, credit to the private sector from BFIs increased 31.3 percent in mid-December 2016.
44. Credit to the agriculture sector increased 7.9 percent, industrial production sector 7.1 percent, construction sector 9.7 percent, wholesale and retail trade sector 8 percent, service industries sector 10.1 percent and transport, communication and public sector 12.8 percent in the review period.

45. Of the total outstanding credit of BFIs, 60.9 percent is against the collateral of land and building and 14.6 percent against the collateral of current assets (such as agricultural and non-agricultural products). Such ratios were 60.1 percent and 12.5 percent respectively in the same period of the previous year.
46. The outstanding credit of BFIs in overdraft, margin nature, real estate and hire purchase increased significantly in mid-December 2016 from the level a year ago.

Box 6: Outstanding loan of BFIs in some areas				
<i>(Rs. in billion)</i>				
Headings	Mid-July		Mid-December	
	2015/16	2016/17	2015/16	2016/17
Overdraft	245.99	294.33	248.97	336.06
Margin Nature Loan	24.08	37.66	26.75	38.34
Residential Personal Home Loan (Up to Rs. 10 million)	118.86	142.82	123.68	159.25
Real Estate Loan	85.68	108.07	91.31	119
Hire Purchase	80.97	110.08	83.74	136.28

47. Of the total lending of commercial banks, credit to small and medium enterprises was only 2.5 percent (Rs. 38.54 billion) in mid-December 2016..
48. Trust Receipt (T.R.) loan extended by commercial banks increased 7.9 percent (Rs. 5.73 billion) in the review period as against a decline of 7.1 percent in the same period of the previous year.

Liquidity Management

49. In the first five months of 2016/17, the NRB mopped up Rs. 94.25 billion liquidity, on a turnover basis, through various instruments. These consist of Rs. 31.5 billion through deposit collection auction (including Rs. 26.45 billion through 14 days deposit collection auction under corridor system introduced in the current fiscal year) and Rs. 62.75 billion through reverse repo auction on a cumulative basis. In the corresponding period of the previous year, Rs. 183.40 billion was mopped up through deposit collection auction, Rs. 85.30 billion through reverse repo auction and Rs. 9.10 billion through outright sale auction.
50. In the review period, the NRB injected net liquidity of Rs. 175.77 billion through the net purchase of USD 1.64 billion from foreign exchange market (commercial banks) and Rs. 10.01 billion through repo auction (including Rs. 10 million through 14 days repo auction under corridor system introduced in the current fiscal year). Net liquidity of Rs. 196.83 billion was injected through the net purchase of USD 1.88 billion in the corresponding period of the previous year.

51. The NRB purchased Indian currency (INR) equivalent to Rs. 178.67 billion through the sale of USD 1.56 billion and Euro 95 million in the review period. INR equivalent to Rs. 111.16 billion was purchased through the sale of USD 1.06 billion in the corresponding period of the previous year.

Refinance, Productive Sector and Deprived Sector Lending

52. The NRB has been providing refinance facility aimed at expanding credit to the productive sector along with promoting export. In the review period, the use of such facility has increased. In the review period, a total refinance of Rs. 3.38 billion including general refinance Rs. 3.01 billion and export refinance Rs 0.37 billion was availed. In the corresponding period of the previous year, a total refinance of Rs. 1.70 billion including general refinance of Rs. 1.54 billion and export refinance of Rs. 0.16 billion was utilized.
53. A sum of Rs. 254.9 million housing loan at a concessional interest rate of 2 percent has been extended to 121 borrowers by the BFIs to the earthquake victims as of mid-December 2016. For this, NRB provides a refinance facility to BFIs at a zero percent interest.
54. In the "Rehabilitation Fund", to be operationalized by this Bank, the Government of Nepal has deposited Rs. 2.75 billion to "Interest Subsidy Account" and Rs. 2.25 billion to "Refinance Account".
55. As of mid-October 2016, a total number of 3996 farmers obtained Rs. 4.8 billion loan under the 6 percent interest subsidized lending scheme of GoN for selected agro-businesses. Under this provision, Rs. 97.5 million interest subsidies have been provided.
56. There is a policy-provision for commercial banks to disburse 20 percent of their total credit in the productive sector. Such credit of commercial banks was 16.21 percent in mid-December 2016.
57. There is a policy provision for commercial banks to disburse 5 percent of their total credit to the deprived sector including direct lending of 2 percent. Under this provision, commercial banks disbursed 5.6 percent of total credit to the deprived sector including direct lending of 1.2 percent as of mid-October 2016.

Inter-bank Transaction and Standing Liquidity Facility

58. In the review period, inter-bank transactions of commercial banks stood at Rs. 486.7 billion and those of other financial institutions (excluding transactions among commercial banks) amounted to Rs. 151.88 billion. Such transactions were Rs. 317.52 billion and Rs. 30.78 billion respectively in the corresponding period of the previous year. The BFIs used the standing liquidity facility (SLF) of Rs. 10.05 billion in the review period.

Interest Rates

59. The weighted average 91-day Treasury Bill rate increased to 2.34 percent in the fifth month of 2016/17 from 0.48 percent a year ago. The weighted average inter-bank transaction rate among commercial banks, which was 0.82 percent a year ago, increased to 2.67 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions increased to 5.22 percent from 1.50 percent a year ago.
60. The weighted average interest rate spread between deposit and lending rate of commercial banks decreased to 5.37 percent in the review month from 6.07 percent a year ago. The average base rate of commercial banks came down to 6.78 percent in the review month from 6.91 percent a year ago.

Merger/Acquisition

61. The number of BFIs involved in merger and acquisition has been increasing after the introduction of merger/acquisition policy aimed at strengthening financial stability. As of mid-December 2016, 120 BFIs (including 'D' class) were involved in merger and acquisition. Of which, the license of 79 BFIs was revoked thereby forming 41 BFIs.

Reinstatement of Branches

62. Of the total 318 branches of Nepal Bank Limited, Rastriya Banijya Bank and Agricultural Development Bank closed during the insurgency period, 149 branches have been reinstated as of mid-December 2016.

Capital Market

63. The NEPSE index which was 1,701.9 points in mid-November 2016 declined to 1,530.1 points in mid-December 2016. However, the index has increased by 36.5 percent from 1,121.0 points a year ago. The index increased due to the capital hike plan of BFIs and implementation of reform programs in the stock market.
64. The total turnover of the securities increased by 164.9 percent to Rs. 106.15 billion during the first five months of 2016/17. The increased liquidity of stocks due to the dematerialized transactions, extension in the share trading time from 2016/17 as well as the bullish trend of the NEPSE index itself, were the primary reasons of such upsurge in turnover.
65. During the first five months of 2016/17, Securities Board of Nepal (SEBON) has approved 34.97 million securities of 10 companies worth Rs. 7.66 billion for the initial public offerings (including further public offerings). Likewise, 10 companies are in pipeline to get the approval for initial public offerings of 5.09 million shares worth Rs. 480.55 million.