

# **Current Macroeconomic Situation**

*(Based on the First Five Months' Data of 2007/08)*

## **Monetary Situation**

### **Money Supply**

1. Broad money ( $M_2$ ) registered a growth of 9.5 percent in the first five months of 2007/08 compared to a growth of 4.0 percent in the same period last year. Likewise, narrow money ( $M_1$ ) increased by 4.8 percent in the review period compared to a growth of 2.7 percent in the previous year. An increase in domestic credit on account of an increase in credit to the Government of Nepal (GON) and the private sector contributed to the acceleration in monetary aggregates in the review period.
2. Time deposits increased by 11.7 percent (Rs 31.55 billion) to Rs 300.18 billion in the review period compared to a growth of 4.6 percent in the previous year. Besides the elevated level of remittances, commencement of banking transactions by three new commercial banks and branch expansion by the existing commercial banks contributed to the significant rise in time deposits in the review period.
3. Net foreign assets (NFA), after adjusting foreign exchange valuation gain/loss, increased by Rs 24.1 million in the review period compared to a rise of Rs 5.78 billion (4.1 percent) in the previous year. Despite the elevated level of remittances and a boom in tourism, NFA remained almost stagnant on account of a deceleration in foreign assistance, a higher level of payment to Indian Oil Corporation (IOC) by Nepal Oil Corporation (NOC) and an unsatisfactory performance of export in the review period.

### **Domestic Credit**

4. Compared to a growth of 2.8 percent in the previous year, domestic credit increased by 10.4 percent in the review period. An acceleration in private sector credit including an increase in claims on government accounted for the rise the domestic credit.
5. Net claims on government increased by 4.8 percent in the review period as against a decline of 11.1 percent in the previous year. A higher growth of expenditure relative to resource mobilization accounted for the rise in claims on government in the review period.
6. Claims on financial institutions increased significantly by 100 percent in the review period. Such claims had grown by 29.5 percent in the previous year. Commercial banks' short-term placement at finance companies, development banks and other financial institutions resulted in the rise in the claims on financial institutions in the review period.
7. Compared to a growth of 5.6 percent last year, private sector credit showed a rise of 10.9 percent in the review period. A pick up in the growth of the private sector credit was on account of the commencement of three new commercial banks and

credit expansion in production, construction, transport and communication and service sector by commercial banks in the review period. In the review period, the areas such as production of iron rod, textiles, cement, transport equipments, real estate and residential construction absorbed an increased amount of bank credit.

### **Reserve Money**

8. Reserve money grew by 2.1 percent in the review period, which had declined by 1.2 percent in the previous year. Notwithstanding a decline in NFA of the Nepal Rastra Bank (NRB), a rise in net claims on government contributed to the increase in reserve money in the review period.

### **Purchase and Sale of Foreign Exchange**

9. The net purchase of US dollar 464.8 million from the commercial banks resulted in the injection of liquidity of Rs 29.76 billion in the review period. Last year, such net purchase was US dollar 394.5 million leading to the liquidity injection of Rs 28.9 billion.
10. The purchase of Indian currency by way of selling US dollar 550 million amounted to Rs 35.08 billion in the first five months of 2007/08. During the same period in the previous year, the purchase of Indian currency had amounted to US dollar 320 million, an equivalent of Rs 23.39 billion. A higher level of payment by NOC to IOC in the review period compared to the previous year and a widening current account deficit with India resulted in the rise of the purchase of IC in the review period.

### **Open Market Operations**

11. For managing short-term liquidity, net liquidity amounting to Rs 6.81 billion was absorbed through reverse repo auction of Rs 5.57 billion and outright sale auction of Rs 1.24 billion in the first five months of 2007/08. During the same period in the previous year, net liquidity of Rs 18.38 billion was absorbed through outright sale auction of Rs 5.89 billion and reverse repo auction of Rs 12.49 billion. Compared to the previous year, a higher private sector credit off-take and the increased purchase of IC through the sell of US dollar lowered the absorption of liquidity in the review period.

**Table 1: Secondary Market Operations  
(In the first five months)**

Heads	Rs in million	
	2006/07	2007/08
<b>Liquidity Absorption</b>	<b>18380.0</b>	<b>6810.0</b>
Sale Auction	5890.0	1240.0
Reverse Repo Auction	12490.0	5570.0
<b>Liquidity Injection</b>	<b>0.0</b>	<b>0.0</b>
Purchase Auction	0.0	0.0
Repo Auction	0.0	0.0
<b>Net Liquidity Absorption</b>	<b>18380.0</b>	<b>6810.0</b>

### Inter Bank Transactions

12. Inter bank transactions of commercial banks cumulated to Rs 143.76 billion in the review period compared to Rs 77.14 billion in the previous year. In addition, the use of standing liquidity facility (SLF) availed by the commercial banks from the NRB cumulated to Rs 36.19 billion in the review period compared to Rs 5.12 billion last year. Significant acceleration in the private sector credit off-take resulted in the rise of both inter-bank transaction and the use of SLF in the review period.

**Table 2: Status of Inter Bank Transaction and Standing Liquidity Facility  
(In the first five months)**

	Rs million	
	2006/07	2007/08
Standing Liquidity Facility	5121.0	36190.0
Inter Bank Transaction	77142.0	143760.0

### Short-term Interest Rates

13. The short-term interest rates increased in the review period. The weighted average monthly 91-day Treasury bill rate stood at 3.59 percent as in mid-December 2007 compared to 1.98 percent a year ago. Similarly, the weighted average monthly inter bank rate remained at 4.73 percent as in mid-December 2007 compared to 1.34 percent a year ago. Interest rates on the deposits of commercial banks remained constant in the review period. A decline in excess liquidity as a result of an increase in private sector credit drove up the short-term interest rates in the review period.

**Table 3: Weighted Average 91-day Treasury Bill and Inter bank Rate**

(Percent)

Mid-month	91-day Treasury Bill Rate		Weighted Average Inter Bank Rate	
	2006/07	2007/08	2006/07	2007/08
August	2.99	4.25	2.07	4.10
September	2.78	2.14	1.83	2.18
October	2.54	2.16	2.11	3.35
November	2.11	3.03	1.20	3.73
December	1.98	3.59	1.34	4.73

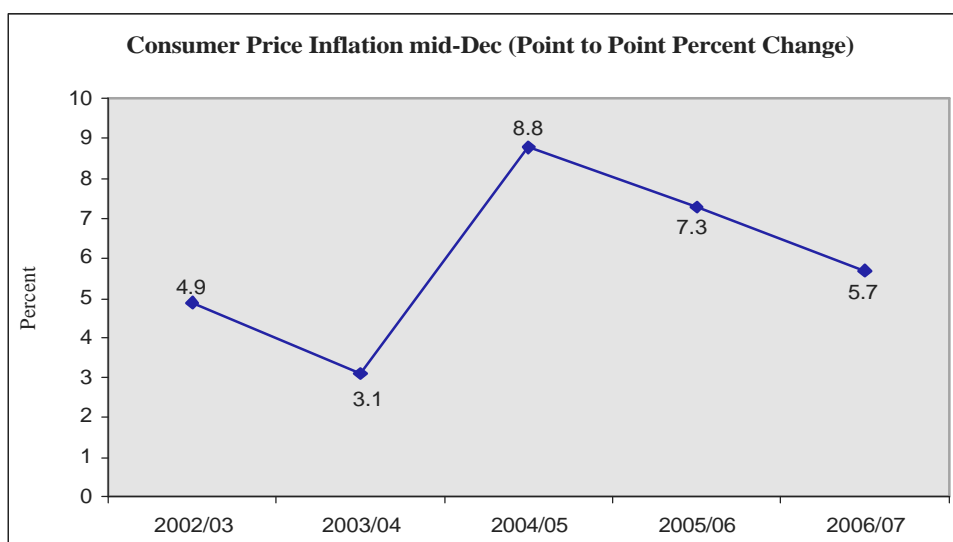
## **Securities Market**

14. The year on year (y-o-y) NEPSE index increased by 101.7 percent to 1025.91 points in mid-December 2007. This index was 508.58 a year ago.
15. The y-o-y market capitalization increased by 151 percent to Rs. 322.62 billion in mid-December 2007. Market capitalization to GDP ratio increased to 40.6 percent from 17.9 percent a year ago. Of the total market capitalization, bank and financial institutions held the largest share.
16. Total paid up capital of the listed companies stood at Rs. 23.85 billion in mid-December 2007, an increase of 16.3 percent over the period of one year. This increase was due to the additional listing of securities.
17. Total number of companies listed at the NEPSE reached 142 in mid-December 2007 compared to 141 a year ago. Of the listed companies, 107 were bank and financial institutions, 21 production and processing industries, 4 hotels, 5 business entities, 3 hydro power and 2 companies in other groups.
18. Monthly turnover to market capitalization ratio stood at 0.85 percent in mid-December 2007 compared to 0.73 percent a year ago.
19. The twelve-month rolling standard deviation stood at 185.4 in mid-December 2007 compared to 56.2 a year ago.
20. Nepal Securities Board (SEBON) granted permission to issue ordinary shares of Rs. 274.4 million to seven companies, and right shares of Rs. 2.21 billion to other ten companies in the first five months of 2007/08.
21. Government bonds of Rs. 3.1 billion were additionally listed at the NEPSE in the first five months of this year. As of mid-July 2007 such bonds amounting to Rs. 7.05 billion were listed at the NEPSE.

## **Inflation**

### **Consumer Price Inflation**

22. The y-o-y inflation moderated to 5.7 percent in mid-December 2007 from 7.3 percent a year ago. The moderation was on account of the base-effect of hike in prices of petroleum products in March 2006 and the nominal appreciation of the Nepalese currency against the US dollar.

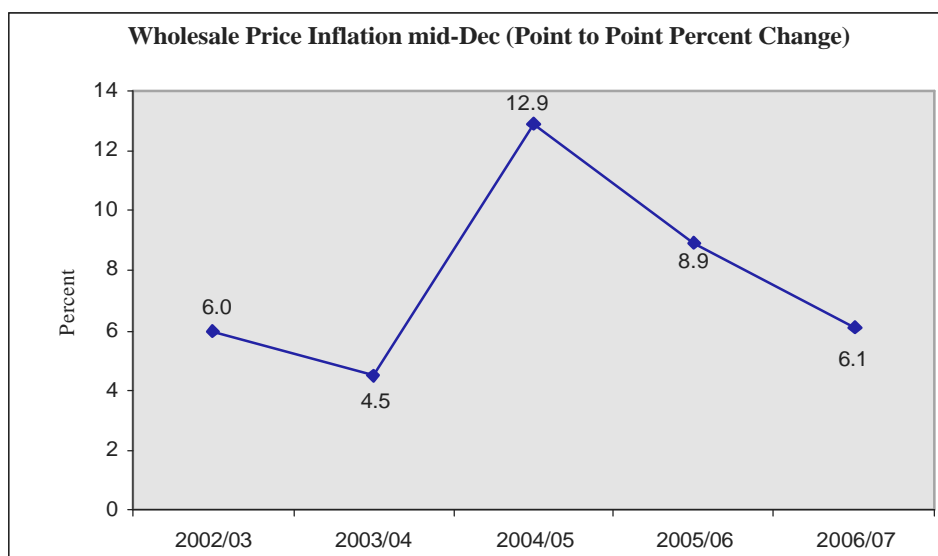


23. Group-wise, the index of food and beverages group rose by 7.1 percent compared to a rise of 7.3 percent a year ago. Within this sub-group, the prices of pulses rose by 14.4 percent, oil and ghee 12.5 percent, grains and cereal products 10.3 percent and milk and milk products 6.4 percent. However, the prices of sugar and sugar-related products declined by 17.0 percent during this period. The index of non-food and services group rose by 4.1 percent compared to a rise of 7.3 percent last year. The deceleration was on accounts of the lower level of rise in the prices of housing goods and services; fuel, light and water; and transport and communication sub-groups.
24. Region-wise, the price level in Kathmandu Valley, Terai and the Hills rose by 4.9 percent, 6.2 percent and 5.3 percent respectively in the review period. Last year, the respective rates were 6.8 percent, 7.4 percent and 7.6 percent. The frequent general strikes in the Terai region was the driving factor for a higher rate of the inflation in Terai, relative to other regions.
25. In mid-December, 2007, the y-o-y core inflation moderated to 4.7 percent from 6.7 percent a year ago.

### **Wholesale Price Inflation**

26. The y-o-y wholesale price inflation slowed to 6.1 percent in mid-December 2007 from the level of 8.9 percent a year ago. The moderation in the wholesale price inflation was on account of the slow growth in the prices of agricultural commodities group and domestic manufactured commodities group compared to last year. The price of agriculture commodities declined to 5.3 percent from 10.2 percent last year. In this group, the price of spices declined by 10.6 percent in the review period compared to a rise of 34.4 percent in the corresponding period last year. Likewise, the prices of food grains, pulses and livestock production group rose by 5.0 percent, 9.6 percent and 2.1 percent respectively compared to the respective rise of 16.5 percent, 23.7 percent and 9.6 percent last year. The prices of

cash crop as well as fruits and vegetable rose marginally in the review period compared to last year. The wholesale prices of domestic manufactured commodities group rose by 6.3 percent during the review period compared to a growth of 9.1 percent in the previous year. Within this group, the prices of construction material and food-related products rose by 11.1 percent and 5.2 percent respectively in the review period compared to last year's rise of 17.6 percent and 8.8 percent respectively. Likewise, the wholesale price index of imported commodities rose marginally to 7.1 percent in the review period from 7.0 percent a year ago.



### **National Salary and Wage Rate**

27. The y-o-y salary and wage rate index rose by 8.0 percent in mid-December 2007 compared to a rise of 10.2 percent a year ago. Such moderation was mainly on account of low pressure on wage rate index notwithstanding a 17 percent net increment in the salaries of civil servants, including security personnel, teachers and employees of public enterprises announced effective from mid-July 2007. The wage rate index rose by 6.9 percent in the review period compared to a rise of 11.7 percent last year. Within the wage rate index, the index of agriculture laborer rose by 3 percent compared to a high rate of 12.8 percent last year. In the review period, the index of industrial laborers and construction laborers increased by 12.4 percent and 9.8 percent respectively.

## **Fiscal Situation<sup>1</sup>**

28. In the first five months of 2007/08, the government budget remained at the deficit of Rs 9.81 billion. In the same period last year, the budget was at the surplus of Rs 4.95 billion. The budget deficit was on account of higher growth of government expenditure in the current year.
29. Of the sources of deficit financing, the government mobilized Rs 5.08 billion through the fresh issuance of securities, and Rs 2.57 billion from NRB in the form of overdraft. The amount raised through the issuance of securities is 24.8 percent of the budgeted ceiling of Rs 20.5 billion for 2007/08. The government can borrow up to Rs 4.33 billion (statutory limit of 5 percent of the previous year's net revenue collection) as overdraft from the NRB
30. In the review period, the net domestic borrowing of the government remained at Rs 4.14 billion. In this period, the government retired domestic securities worth Rs 3.51 billion and borrowed Rs 7.65 billion by way of fresh issuance and overdraft.
31. Of the total budget deficit, remaining Rs 2.24 billion was financed through external borrowing.

### **Government Expenditure**

32. In the first five months of 2007/08, the government expenditure on a cash basis, increased by 44.3 percent to Rs 47.26 billion compared to an increment of 7.0 percent in the same period last year. The increase in government expenditure was on account of rise in all forms of government expenditures i.e. recurrent, capital and principal repayments.
33. In the review period, the recurrent expenditure rose by 27.7 percent to Rs 30.95 billion compared to an increase of 6.7 percent in the corresponding period of the previous year. The higher growth of recurrent expenditure was on account of increased expenditure on relief-related activities, the salary hike of government employees, the rise in peace-related expenditure and additional expenditure relating to the preparation of constituent assembly elections.
34. In the review period, the capital expenditure went up by 120.3 percent to Rs 7.43 billion compared to an increase of 14.6 percent in the same period last year. The loan investment of Rs 500 million to the NOC, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 520 million in the Nepal Electricity Authority, the release of fund of Rs 1.2 billion to Poverty Alleviation Fund (PAF)

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<sup>1</sup> As of January 18, 2008, revenue mobilization increased by 26.5 percent to Rs. 48.75 billion compared to a growth of 19.0 percent a year ago. In this period, the government expenditure increased by 29.4 percent to Rs. 58.97 billion compared to a growth of 10.9 percent last year. Budget deficit stood at Rs. 2.74 billion during this period as against the budget surplus of Rs. 3.79 billion in the same period last year. As of January 18, 2008, the cash balance of the GON with the NRB amounted to Rs 7.64 billion. Including the previous years' cash balance of Rs 3.12 billion, the outstanding cash balance of the GON with NRB stood at Rs 10.77 billion as on January 18, 2008.

and the disbursement of funds to local authorities contributed to the significant rise in capital expenditure.

### **Government Revenue and Foreign Cash Grants**

35. In the first five months of 2007/08, the revenue mobilization of the government grew by 21.0 percent to Rs 32.36 billion compared to an increase of 13.0 percent in the corresponding period last year. The increase in customs revenue and excise revenue on account of administrative reforms, a rise in VAT revenue and income tax revenue, as well as growth rate in non-tax revenue accounted for such a healthy growth of government revenue.
36. In the review period, the government received foreign cash grants of Rs 3.42 billion. The GON had received foreign cash grants of Rs 7.23 billion in the corresponding period of the previous year.

### **External Sector Situation**

#### **Foreign Trade and Balance of Payments**

37. In the first five months of 2007/08, total exports fell by 6.9 percent as against a rise of 0.2 percent in the corresponding period of the previous year. Of the total exports, export to India plummeted by 9.3 percent in 2007//08 compared to a marginal growth of 0.9 percent in the same period of 2006/07. Exports to other countries also posted a decline of 1.4 percent in comparison to a decline of 1.2 percent in the comparable period of the previous year.
38. The decline in the exports to India was primarily attributed to the decrease in the exports of vegetable ghee, toothpaste, chemicals, textiles and wire. Similarly, exports to other countries also dropped arising from the lower exports of woollen carpet, pashmina, readymade garments, Nepalese paper & paper products and tanned skin.
39. In the first five months of 2007/08, total imports grew merely by 1.5 percent compared to a growth of 10.0 percent in the corresponding period of the previous year. While imports from India rose by 2.4 percent in the review period compared to its growth of 10.5 percent in the corresponding period of 2006/07, imports from other countries were at the same level of 9.2 percent as the comparable period in the previous year.
40. An upsurge in the import of vehicles and spare parts, M.S. billet, hot rolled sheet in coil, other machinery & parts and pipe & pipe fittings, among others, from India and an increase in the import of gold followed by telecommunication equipment & parts, electrical goods, transport equipment & parts and other machinery & parts, among others, from other countries led to the slight rise in total imports in the first five months of 2007/08.
41. Based on the monetary statistics, the overall balance of payments (BOP), which was at deficit for last couple of months, returned to a surplus of Rs. 24.1 million in the first five months of 2007/08. The BOP had registered a surplus of Rs. 5.78 billion in the corresponding period of the previous year.



### **Foreign Exchange Reserves**

42. The gross foreign exchange reserves stood at Rs. 165.37 billion in mid-December 2007, rising by merely 0.2 percent from the level of Rs 165.11 billion in mid-July 2007. Such reserves had increased by 3.8 percent in the corresponding period of the preceding year. In terms of US dollar, gross foreign exchange reserves rose by 2.7 percent to US\$ 2.61 billion in mid-December 2007. In the same period of the previous year, such reserves had risen by 7.6 percent. On the basis of the import figures for the first five months of 2007/08, the current level of reserves is sufficient for financing merchandise imports of 10.3 months and merchandise and service imports of 8.0 months.

### **Price of Oil and Gold in the International Market**

43. The price of oil (Crude Oil Brent) in the international market surged by 48.9 percent to US\$ 93.19 per barrel in mid-December 2007 from US\$ 62.58 per barrel in mid-December 2006. Likewise, the price of gold rose by 26.6 percent to US\$ 789.50 per ounce in mid-December 2007 from US\$ 623.75 in the previous year.

### **Exchange Rate Movement**

44. In comparison to mid-July 2007, the Nepalese currency appreciated by 2.53 percent vis-à-vis the US dollar in mid-December 2007. It had appreciated by 3.71 percent in the corresponding period of the previous year. The exchange rate of one US dollar remained at Rs. 63.25 in mid-December 2007 compared to Rs. 71.45 in mid-December 2006.