Current Macroeconomic Situation

(Based on the first eight months' data of 2007/08)

Money Situation

Overall Liquidity

1. In the first eight months of 2007/08, broad money (M_2) increased by 13.5 percent compared to a growth of 11.4 percent in the same period last year. Likewise, narrow money (M_1) increased by 11.5 percent in the review period compared to a growth of 5.7 percent in the previous year. An expansion in net foreign assets (NFA) as well as domestic credit contributed to such a higher growth in monetary aggregates in the review period.

2. Time deposits grew by 14.4 percent in the review period compared to a growth of 14.1 percent in the previous year. However, compared to a growth of 6.3 percent in the previous year, currency in circulation witnessed a substantial growth of 13.9 percent (Rs 11.65 billion) in the review period. A higher government expenditure for conflict management and remittance inflows led to such a substantial increase in currency in circulation in the review period.

3. NFA, after adjusting foreign exchange valuation gain/loss, increased by Rs 13.29 billion (10.1 percent) in the review period compared to an increase of Rs 12.28 billion (4.6 percent) in the previous year. A significant inflow of workers' remittances along with a receipt of foreign aid, particularly in the eighth month of 2007/08, accounted for such a noticeable increase in NFA in the review period.

4. Reserve money, which had increased by 5.5 percent in the previous year, grew by 11.5 percent in the review period. An increase in NFA of Nepal Rastra Bank contributed to the increase in reserve money in the review period.

Liquidity of Commercial Banks

5. The liquid funds of commercial banks increased by 6.8 percent amounting Rs 69.61 billion in the review period. Such funds had increased by 6.4 percent in the previous year. Of the liquid funds, the deposits of commercial banks with the NRB increased by 6.7 percent amounting Rs 24.39 billion in the review period compared to a growth of 5.9 percent last year.

6. Commercial banks have Rs 129.95 billion liquid assets as of mid-March 2008, including Rs. 60.34 billion holding of government securities.Liquidity-deposit ratio of commercial banks came down to 34.6 percent in the review period from 37.6 percent in the previous year on account of higher private sector credit off-take.

Liquidity Management

7. A net liquidity of Rs 54.99 billion was injected through foreign exchange intervention in the review period compared to Rs 44.43 billion in the previous year. A higher inflow of remittances in the review period increased the purchase of the US dollar in the foreign exchange market.

8. In the first eight months of 2007/08, the NRB purchased Indian currency equivalent to Rs 57.9 billion by selling 910 million US dollar. During the same period in the previous year, a total of Rs 35.44 billion equivalent Indian currencies were purchased by a sale of 490 million US dollar. A growing current account deficit with India including a higher payment by Nepal Oil Corporation (NOC) to Indian Oil Corporation (IOC) accounted for such an increase in purchase of IC in the review period. The sale of the US dollar to purchase IC remained higher than the purchase of the US dollar from commercial banks in the review period.

9. For managing liquidity of banking system, a total of Rs 9.27 billion has been absorbed in open market operation including Rs 5.57 billion through reverse repo auctions and Rs 3.7 billion through outright sale auctions in the review period. During the same period in the previous year, outright sale auctions had absorbed Rs 7.89 billion and reverse repo auctions Rs 14.06 billion. In the review period, repo auction injected Rs 9.0 billion to supplement liquidity shortage experienced by some commercial banks in the sixth and seventh months of 2007/08. A short-term liquidity shortfall was observed by some commercial banks in the review period on account of over subscription in initial public offering (IPO) of shares by ADB/N[*] and the issuance of electricity bond by Nepal Electricity Authority.

10. For managing liquidity, commercial banks increased the use of Standing Liquidity Facility (SLF) and Inter bank transactions in the review period. Inter bank transactions stood at Rs 190.82 billion in the review period compared to Rs 111.21 billion in the previous year. Moreover, commercial banks borrowed Rs 72.5 billion under SLF in the review period compared to Rs 8.49 billion last year.

Total Domestic Credit

11. Compared to a growth of 3.7 percent in the previous year, domestic credit increased by 13.2 percent in the review period. A substantial increase in private sector credit contributed to the increase in domestic credit in the review period.

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[*] Initial public offering of shares worth Rs 125.0 million by Agriculture Development Bank (ADB/N) for its borrowers was over-subscribed to Rs 5.79 billion, which was deposited in various branches of ADB/N in remote areas, causing shortage of liquidity in the banking system for a short time.

12. Net claims on government declined by 0.7 percent in the review period compared to a decline of 11.6 percent in the previous year. A higher budget deficit contributed to such a lower decline in net claims on government in the review period.

Commercial banks' Deposit mobilization and Credit flows

13. Commercial banks mobilized additional deposits of Rs 41.14 billion in the first eight months of 2007/08 compared to Rs 38.80 billion in the same period of the previous year. Out of the total deposits mobilized, saving deposits stood at the top, with Rs 21.23 billion (51.6 percent) followed by fixed deposits of Rs 16.53 billion (40.2 percent).

14. Out of total resource mobilized of Rs 64.07 billion in the review period, private sector credit remained at Rs 48.89 billion (78.5 percent). Commercial banks' claims to the private sector actually increased by 18.9 percent in the review period compared to an increase of Rs 10.3 percent in the previous year. As a result, the credit-deposit ratio increased to 87.0 percent in the review period from 82.1 percent last year.

15. Commercial banks provided credit of Rs 10.99 billion (22.5 percent) to production sector, Rs 7.35 billion (15.0 percent) to construction, Rs 6.51 billion (13.3 percent) to wholesale and retail business, Rs 4.84 billion (9.9 percent) to real estate, Rs 2.24 billion (4.6 percent) to tourism, education and health services and Rs 10.29 billion (21.0 percent) to miscellaneous sectors including margin lending.

Interest Rates

16. Short-term interest rates increased in the review period. The weighted average monthly 91-day treasury bill rate stood at 5.54 percent as in mid-March 2008 compared to 2.36 percent a year ago. Similarly, the weighted average monthly inter bank rate remained at 5.07 percent as in mid-March 2008 compared to 1.39 percent in mid-March 2006. A decline in excess liquidity of commercial banks pushed up short-term interest rates.

17. In spite of marginal hike in interest rates on deposits of more than a year by some commercial banks, there have been no noticeable changes in interest rates on the other deposits and lending in the review period. Interest rates on saving deposits still remained at 2 to 5.5 percent. Interest rates on fixed deposits ranged between 1.75 and 5.75 percent for more than one year, and between 2.75 and 6.75 percent for more than two years. Interest rates on industrial loan also vary among commercial banks from minimum of 7.0 percent to maximum of 13.0 percent, whereas interest rates for the commercial loans ranged from 8.0 percent to 13.5 percent.

Securities market

18. The year on year (y-o-y) NEPSE index increased by 44.7 percent to 714.76 points in mid-March 2008. This index was 494.06 a year ago.

19. The y-o-y market capitalization increased by 77.3 percent to Rs. 230.82 billion in mid-March 2008. Market capitalization to GDP ratio increased to 29.1 percent from 18.1 percent a year ago. Of the total market capitalization, bank and financial institutions hold the largest share.

20. Total paid up capital of the listed companies increased by 17.01 percent amounting to Rs.24.59 billion in mid-March 2008. This increase was due to the additional listing of securities.

21. Total number of companies listed at the NEPSE stood at 146 in mid-March 2008 compared to 131 a year ago. Among the currently listed companies, bank and financial institutions are 111. Production and processing industries, hotels, business entities, hydropower and companies in other groups are 21, 4, 5, 3 and 2 respectively.

22. Monthly turnover to market capitalization ratio stood at 0.81 percent in mid-March 2008 compared to 0.55 percent a year ago.

23. The twelve-month rolling standard deviation reflecting an increased volatility in the stock market stood at 172.4 in mid-March 2008 compared to 69.2 a year ago.

24. Securities Board of Nepal (SEBON) granted permission for primary issuance of Rs. 4.98 billion in the first eight months of 2007/08. These consist of ordinary shares of Rs.402.4 million to eight companies, right shares of Rs.3.08 billion to seventeen companies and debentures of Rs. 1.50 billion to Nepal Electricity Authority.

25. The Government of Nepal (GON) issued Treasury Bills of Rs. 6 billion, Development Bonds of Rs. 2.4 billion and Citizens Saving Certificate of Rs. 800 million in the first eight months of 2007/08.

Consumer Price Inflation

26. The y-o-y consumer inflation stood at 7.2 percent in mid-March 2008 compared to 6.2 percent in the corresponding period last year. The upward pressure on the index was due to rise in the prices of food articles like rice and rice products, and oil and ghee.

27. Group-wise, the index of food and beverages group rose up by 9.4 percent in the review period compared to a rise of 9.2 percent a year ago. The price indices of oil and ghee increased by 27.3 percent, grains and cereal products by 14.9 percent (among them, rice and rice products rose by 19.4 percent), and pulses by 13.7 percent, accounting for increase in the prices of food and beverage group. However, the price

indices of sugar and sugar-related products, vegetables and fruits and spices declined by 8.4 percent, 1.8 percent and 0.7 percent respectively during this period.

28. The index of non-food and services group rose by 4.9 percent compared to a rise of 3.2 percent last year. An increase in prices of tobacco and tobacco related products by 8.3 percent, housing goods and services by 6.1 percent, and medicine and personal care by 5.8 percent accounted for such a higher increase in the price index of non-food and service group.

29. Region-wise, the price indices of Kathmandu Valley, Terai and the Hills rose by 7.0 percent, 7.1 percent and 7.5 percent respectively in the review period. Last year, the respective rates were 6.4 percent, 6.5 percent and 5.2 percent.

30. In mid-March 2008, the y-o-y core inflation moderated to 6.1 percent from 6.8 percent a year ago.

Fiscal Situation

Budget Surplus/Deficit

31. In the first eight months of 2007/08, the government budget remained at the deficit of Rs 6.99 billion. In the same period of the previous year, the budget was at the surplus of Rs 1.18 billion. The budget deficit was on account of higher growth of government expenditure in the current year.

32. Of the sources of deficit financing, the government mobilized domestic borrowing of Rs 9.20 billion (excluding overdraft). In the review period, the GON's cash balance with the NRB amounted to Rs 4.34 billion. Including the cash balance of Rs 3.12 billion of the previous year, the cumulative cash balance of the GON amounted to Rs 7.46 billion.

33. In the review period, the net domestic borrowing of the government remained at a negative of Rs 433.14 million as the government repaid domestic borrowing worth Rs 5.29 billion.

34. The external financing of budget deficit amounted to Rs 2.52 billion, which is 15.9 percent higher than that of the same period last year. In the previous year, the government had received foreign debt amounting to Rs 2.18 billion.

Government Expenditure

35. In the first eight months of 2007/08, government expenditure, on a cash basis, increased by 32.5 percent to Rs 80.34 billion compared to an increase of 15.0 percent in the same period of the previous year. The increase in government expenditure was on account of the rise in all kinds of government expenditures i.e. recurrent, capital and principal repayments.

36. In the review period, recurrent expenditure rose by 19.2 percent to Rs 51.10 billion compared to an increase of 14.6 percent in the corresponding period of the previous year. A higher expenditure on conflict-related activities, the salary hike of government employees, and expenditure on CA election accounted for a rise in recurrent expenditure in the review period.

37. In the review period, the capital expenditure went up by 91 percent to Rs 17.42 billion compared to an increase of 12.6 percent in the same period last year. A pick up in capital spending was on account of loan investment of Rs 3.5 billion in NOC, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 520 million in the Nepal Electricity Authority, and the release of fund of Rs 1.2 billion to Poverty Alleviation Fund (PAF).

Government Revenue and Foreign Cash Grants

38. In the first eight months of 2007/08, revenue mobilization of the government rose by 26.2 percent amounting to Rs 60.61 billion compared to an increase of 16.4 percent in the corresponding period of the previous year. Such an impressive growth of revenue was due to higher growth of revenue from customs, Value Added Tax (VAT) and excise duties.

39. In the review period, VAT revenue grew by 25.8 percent to Rs 19.51 billion compared to an increase of 10.4 percent last year. The growth in VAT revenue was on account of the rise in remittances and reforms in VAT administration such as establishment of Large Taxpayers Unit, strengthening of billing system and non-filers management.

40. In the review period, customs revenue rose by 26.1 percent to Rs 12.85 billion compared to an increase of 13.5 percent in the same period of the previous year. Reforms in customs administration, the increase in imports of high tax yielding

vehicles and spare parts as well as a rise in the amount of Indian excise refund contributed to such a high growth of customs revenue.

41. In the review period, excise revenue increased by 27.8 percent to Rs 6.36 billion compared to an increase of 22.1 percent in the same period last year. Reforms in excise administration, identification of new excisable goods and increase in the imports of high tax yielding vehicles are some reasons for higher excise revenue in the review period.

42. In the first eight months of 2007/08, income tax increased by 33.7 percent to Rs 10.18 billion. The increase in the income of some public enterprise and private enterprises as well as the rise in investment income accounted for a higher growth of income tax. Last year, such revenue had grown by 36.5 percent.

43. In the review period, non-tax revenue increased by 15.9 percent to Rs 8.65 billion compared to an increase of 18.9 percent in the same period last year. Such an increase in non-tax revenue was on account of dividend paid by some public enterprises including the NRB. Of the total dividend of Rs 3.43 billion for 2006/07 appropriated by the NRB to the GON, the NRB has disbursed Rs 2.50 billion as of mid March 2008.

44. In the review period, the government received foreign cash grants of Rs 9.78 billion. The GON had received foreign cash grants of Rs 10.63 billion in the corresponding period of the previous year.

45. The outstanding domestic debt of the government stood at Rs 95.75 billion as in mid-March 2008. Such outstanding debt had stood at Rs 96.18 billion at the beginning of the current fiscal year.

External Sector Situation

Foreign Trade and Balance of Payments

46. In the first eight months of 2007/08, total exports went down by 2.6 percent compared to a decline by 6.6 percent in the corresponding period of the previous year. Of the total exports, export to India plummeted by 6.9 percent in 2007//08 compared to a decline by 6.4 percent in the same period of 2006/07. Exports to other countries, however, registered a growth of 7.2 percent in the review period compared to a decline of 7.0 percent in the same period of previous year.

47. The drop in the exports to India was largely due to the fall in the exports of vegetable ghee, textiles, chemicals, wire and thread. Similarly, exports to other countries rose primarily due to the increase in the exports of pulses and herbs, plants, packing materials of paper, stationery, and buttons.

48. In the first eight months of 2007/08, total imports increased by 12.5 percent in contrast to a decline of 1.1 percent in the corresponding period of the previous year. Of the total imports, imports from India increased by 15.0 percent in the review period compared to a growth of 2.3 percent in the corresponding period of 2006/07; similarly, imports from other countries went up by 8.2 percent in contrast to a decline of 6.4 percent in the previous year.

49. A rise in the import of M.S. billet, vehicles and spare parts, petroleum products, hot rolled sheet in coil, and medicine among others, from India and increase in the import of gold, telecommunication equipment & parts, transport equipment & parts, other machinery & parts, and electrical goods, among others, from other countries were responsible for the surge in total imports in the first eight months of 2007/08.

50. The overall BOP posted a surplus of Rs. 13.29 billion in the review period. The BOP had registered a surplus of Rs. 12.28 billion in the corresponding period of the previous year. In the review period, the current account posted a surplus of Rs. 10.41 billion as a result of the upsurge in travel receipts and workers' remittances by 76.3 percent and 28.1 percent respectively. In the corresponding period of the previous year, the current account had maintained a surplus of Rs. 10.67 billion.

Foreign Exchange Reserves

51. The gross foreign exchange reserves increased by 10.2 percent amounting to Rs. 181.98 billion in mid-March 2008 from Rs 165.11 billion in mid-July 2007. Such reserves had gone up by 7.3 percent in the corresponding period of the preceding year. In terms of US dollar, the gross foreign exchange reserves went up by 10.8 percent to US$ 2.82 billion in mid-March, 2008. In the same period of the previous year, such reserves had increased by 12.8 percent. On the basis of the import figures for the first eight months of 2007/08, the current level of reserves is adequate for financing

merchandise imports of 11.3 months, and merchandise and service imports of 8.9 months.

Price of Oil and Gold in International Market

52. The price of oil (Crude Oil Brent) in international market accelerated by 81.5 percent to US$ 110.75 per barrel in mid-March, 2008 from US$ 61.02 per barrel in mid-March, 2007. Likewise, the price of gold went up by 54.7 percent to US$ 995.00 per ounce in mid-February, 2008 from US$ 643.25 in the previous year.

Exchange Rate Movement

53. Compared to mid-July 2007, the Nepalese currency appreciated by 0.56 percent vis-à-vis the US dollar in mid-March 2008. It had appreciated by 5.11 percent in the corresponding period of the previous year. The exchange rate of one US dollar was Rs. 64.49 in mid-March 2008 compared to Rs. 70.50 in mid-March 2007.