

Current Macroeconomic Situation

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

Monetary Situation

Money Supply

1. In the first ten months of 2007/08, broad money (M_2) grew by 18.5 percent and narrow money (M_1) increased by 15.7 percent. In the same period of the previous year, M_2 and M_1 had grown by 9.5 percent and 4.7 percent respectively. An increase in both net foreign assets (NFA) and net domestic assets (NDA) contributed to such a monetary expansion in the review period.
2. Time deposit went up by 19.9 percent in the review period compared to a growth of 11.8 percent in the previous year on account of significant increment of remittances. Likewise, currency in circulation increased by 17.8 percent in the review period compared to a rise of 5.2 percent last year. An increased flow of remittances to rural areas, a rise in government relief related expenditure and expenses incurred on constituent assembly (CA) elections accounted for the growth in currency in circulation in the review period.

Net Foreign Assets (NFA)

3. NFA, after adjusting exchange valuation gain/loss, increased by Rs. 19.88 billion (15.1 percent) in the review period. In the same period last year, NFA had increased by Rs. 6.97 billion (5.0 percent). An elevated level of remittances and an increase in foreign assistance contributed to such a rise in NFA in the review period.

Domestic Credit

4. Compared to a growth of 11.2 percent in the previous year, domestic credit increased by 16.6 percent in the review period. An increase in bank credit to the private sector contributed to the acceleration in domestic credit in the review period. Claims on private sector increased by 19.5 percent in the review period compared to an increase of 16.7 percent last year. In the review period, credit flows towards residential and non-residential construction, wholesale and retail trade and real estate increased. Likewise, bank credit to iron and steel production and to food processing also increased.
5. Commercial banks significantly expanded short-term loan to development banks and finance companies in the review period. Significant cash balance of the Government of Nepal (GON) with the Nepal Rastra Bank (NRB) accounted for the decline in net claims on government as in the previous year.

Liquidity of Commercial Banks

6. Liquid assets of commercial banks increased by 3.5 percent amounting to Rs. 135.37 billion in the review period as against a decline of 2.4 percent in the previous year. Out of total liquid assets, liquid fund was of Rs. 73.22 billion whereas investment in government securities amounted to Rs. 62.15 billion. In the review period commercial banks' total liquid assets stood at 34.3 percent of the total deposit.

Liquidity Management

7. In the review period, the NRB injected net liquidity of Rs. 76.61 billion by purchasing 1.19 billion US dollar from commercial banks. In the previous year, the NRB had injected Rs.

52.46 billion by purchasing 731.7 million US dollar. An elevated level of remittances accounted for such a higher purchase of US dollar in the review period.

8. The NRB purchased Rs. 77.27 billion equivalent Indian Currency (IC) by selling 1.21 billion US dollar in the review period compared to a purchase of Rs. 48.89 billion equivalent IC by selling 690 million US dollar in the previous year. A widening current account deficit with India and a higher payment by Nepal Oil Corporation (NOC) to Indian Oil Corporation (IOC) contributed to the increase in IC purchase in the review period.
9. In the review period, the NRB mopped up Rs. 13.04 billion liquidity including Rs. 6.57 billion from reverse repo auction and Rs. 6.47 billion from outright sale auction. The NRB injected Rs. 9 billion through repo auction in the sixth and seventh month of 2007/08 on account of liquidity shortage faced by some commercial banks. In the same period of previous year, the NRB had absorbed Rs. 24.26 billion through reverse repo auction of Rs. 14.06 billion and outright sale auction of Rs. 10.20 billion, and injected Rs. 2.0 billion through repo auction.
10. In the first ten month of 2007/08, commercial banks' the standing liquidity facility (SLF) borrowing from the NRB cumulated to Rs. 97.6 billion. In the corresponding period of the previous year, commercial banks' SLF borrowing had cumulated to Rs. 30.94 billion.

Inter-bank Transactions and Short-term Interest Rate

11. Inter bank transactions cumulated to Rs. 224.97 billion in the first ten months of 2007/08 compared to Rs. 138.81 billion in the corresponding period of the previous year. The relatively better cash management by commercial banks and the expansion in the bank credit to equity market contributed to such a growth in the inter-bank transactions.
12. The weighted average monthly 91-day Treasury Bill rate increased to 5.32 percent in mid-May 2008 from 2.43 percent a year ago. Similarly the weighted average monthly inter bank rate increased to 6.48 percent in mid-May 2008 from 3.35 percent in mid-May 2007.

Securities market

13. The year on year (y-o-y) NEPSE index increased by 57 percent to 806.26 points in mid-May 2008. This index was 513.45 a year ago.
14. The y-o-y market capitalization increased by 97.9 percent to Rs. 274.10 billion in mid-May 2008. Market capitalization to GDP ratio increased to 33.4 percent from 19 percent a year ago. Of the total market capitalization, bank and financial institutions held the largest share.
15. Total paid up capital of the listed companies reached Rs.25.54 billion in mid-May 2008 with an increase of 19.6 percent over the period of one year. This increase was due to the additional listing of securities.
16. Total number of companies listed at the NEPSE reached 148 in mid-May 2008 compared to 131 a year ago. Of the listed companies, 113 were bank and financial institutions. Production and processing industries, hotels, business entities, hydro- power and companies in other groups were 21, 4, 5, 3 and 2 respectively.
17. Monthly turnover to market capitalization ratio increased to 0.70 percent in mid-May 2008 from 0.38 percent a year ago.
18. The twelve-month rolling standard deviation stood at 126.8 in mid-May 2008 compared to 64.4 a year ago. This reflected an increased volatility in the stock market.

19. Nepal Securities Board granted permission for primary issuance of 7.34 billion in the first ten months of 2007/08. These consisted of ordinary shares of Rs.402.4 million to eight companies, right shares of Rs.5.04 billion to 31 companies and debentures of Rs.1.90 billion to two companies including Nepal Electricity Authority.
20. The GON issued Treasury Bills of Rs. 8.12 billion, Development Bonds of Rs. 3.90 billion, and Citizens Saving Certificates of Rs. 1.30 billion in the first ten months of 2007/8.

Inflation and Wage Rate

Consumer Price Inflation

21. The y-o-y consumer inflation rose to 9.2 percent in mid-May 2008 from 4.6 percent in the previous year. The inflation was mainly driven by the significant rise of 13.0 percent in prices of food and beverages in the review period. The price rise of food and beverages was 6.1 percent a year ago.
22. Of the items showing price rise, price indices of oil and ghee sub-group increased by a whopping rate of 27.6 percent on a y-o-y basis in May 2008 compared to an increase of 9.9 percent a year ago. The sub-group of grains and cereal products witnessed a y-o-y price rise of 21.0 percent in mid-May 2008 compared to an increase of 6.4 percent in May 2007. Prices of rice and rice products of this sub-group increased by 25.2 percent (y-o-y) compared to an increase of 3.8 percent a year ago. The price rise of pulses, milk and milk products and meat, fish and eggs stood at 12.1 percent, 10.5 percent and 10.2 percent respectively on a y-o-y basis in mid-May 2008 compared to a rise of 11.2 percent, 6.3 percent and 5.9 percent respectively in mid-May 2007.
23. The index of non-food and services group rose by 5.3 percent in mid-May 2008 compared to a rise of 3.0 percent last year.
24. Region-wise, the price rise in Terai region was 10 percent followed by 8.6 percent in the hills and 8.5 percent in the Kathmandu Valley. Last year, the respective rates were 5.0 percent, 4.0 percent and 4.4 percent.
25. In mid-May 2008, the y-o-y core inflation rose to 7.5 percent from 6.8 percent a year ago.

Wholesale Price Inflation

26. The y-o-y wholesale price inflation increased to 10.1 percent in mid-May 2008 compared to 6.2 percent a year ago. Of the items showing double digit price rise, the price of food grains increased by 21.1 percent compared to a rise of 2.3 percent a year ago. Likewise, the prices of both sub-groups chemical fertilizer and chemicals as well as construction materials increased by 17.6 percent on a y-o-y basis compared to a rise of 4.4 percent and 14.2 percent respectively in the previous year.
27. Of the other sub-groups with rise in prices, domestic manufactured food related commodities, pulses and transport vehicles and machinery goods saw a y-o-y price rise of 13.9 percent, 12.1 percent and 11.7 percent respectively in mid-May 2008 compared to an increase of 8.9 percent, 11.9 percent and 2.3 percent respectively a year ago.

National Salary and Wage Rate

28. The y-o-y salary and wage rate index rose by 7.0 percent in mid-May 2008 compared to a rise of 11.9 percent a year ago. Of the salary and wage rate indices the y-o-y salary index increased by 10.9 percent compared to a rise of 6.2 percent in the corresponding period of the previous year. Despite the pressure on salary index on account of hike in salary of civil servants including security personnel, teachers and employees of public enterprise by 17

percent in July 2007, the pressure on wage rate index with a higher weight remained modest, resulting in a rise of national salary and wage index in the review period at the same rate as in the previous year. The y-o-y wage rate index increased by 5.9 percent in the review period compared to an increase of 13.8 percent in the same period of the previous year. Wages of agriculture, industrial and construction labour increased by 6.3 percent, 4.6 percent and 7.1 percent respectively in mid-May 2008. Last year, these wages had increased by 10.9 percent, 19.2 percent and 11.5 percent respectively.

Fiscal Situation

Budget Surplus/Deficit

29. The government budget deficit amounted to Rs 6.4 billion in the first ten months of 2007/08. The budget was at a surplus of Rs 2.86 billion in the corresponding period of the previous year. The relatively higher growth of government expenditure resulted in the budget deficit in the review period.
30. The domestic financing of the budget deficit through the issuance of securities (excluding overdraft) amounted to Rs 13.33 billion in the review period. The GON's cash balance with the NRB amounted to Rs 9.87 billion in mid-May 2008. Including the cash balance of Rs 3.12 billion for the previous year, the cumulative cash balance of the GON reached Rs 12.99 billion in mid-May 2008.
31. However, the net domestic borrowing of the government remained at a negative of Rs 1.94 billion on account of repayment of Rs 5.40 billion domestic debt and cash balances with the NRB in the review period.
32. The outstanding domestic debt (including cash balance with NRB) of the government stood at Rs 94.24 billion as in mid-May 2008. Such outstanding debt was at Rs 96.18 billion in mid-July 2007.
33. The external financing of budget deficit amounted to Rs 3.12 billion, showing a 26.1 percent growth from the level of a year ago. In the previous year, the government had received foreign debt amounting to Rs 2.47 billion.

Government Revenue and Foreign Cash Grants

34. In the first ten months of 2007/08, revenue mobilization of the government soared by 24.0 percent amounting to Rs 78.99 billion compared to an increase of 22.5 percent in the corresponding period of the previous year. Such an impressive growth of revenue was on account of substantial increase in the import of merchandise goods.
35. Of the total revenue mobilization, VAT revenue grew by 21.8 percent to Rs 25.3 billion in mid-May 2008. The growth in VAT revenue was on account of growing imports and consumption induced by the rise in remittances and reforms in VAT administration such as establishment of Large Taxpayers Unit, strengthening of billing system and non-filers management.
36. In the review period, customs revenue rose by 21.5 percent to Rs 16.16 billion compared to an increase of 13.1 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.
37. In the review period, excise revenue increased by 23.9 percent to Rs 8.32 billion compared to an increase of 36.3 percent in the same period of the previous year. Reforms in excise

administration, identification of new excisable goods and increase in the imports of high tax yielding vehicles accounted for such a higher excise revenue in the review period.

38. Income tax revenue increased by 34.4 percent to Rs 13.87 billion in the first ten months of 2007/08. The evolution of the corporate culture on account of the growth in banks and financial institutions contributed to such a higher growth of income tax collection. Last year such revenue had risen by 32.1 percent.
39. In the review period, non-tax revenue grew by 16.9 percent to Rs 11.73 billion compared to an increase of 33.3 percent in the same period of the preceding year. Such an increase in non-tax revenue was on account of the increase in dividend paid by some public enterprises including the NRB.
40. In the review period, the government received foreign cash grants of Rs 13.68 billion. The GON had received foreign cash grants of Rs 12.62 billion in the corresponding period of the previous year.

Box 1: Budgetary Situation as of June 20, 2008

- *The government revenue increased by 26.3 percent to Rs 91.82 billion as of June 20, 2008. The government revenue had increased by 20.7 percent in the same period of the previous year.*
- *As of June 20, 2008, the government expenditure rose by 18.4 percent to Rs 121.29 billion. Such expenditure had increased by 21.2 percent in the comparable period of the preceding year. The budget deficit amounted to Rs 10.38 billion in the review period compared to the budget deficit of Rs 9.20 billion in the same period of the previous year. The government's cash surplus with the NRB stood at Rs 5.63 billion as of June 20, 2008. Including previous year's cash balance of Rs 3.12 billion, the total cash balance of the government with the NRB cumulated to Rs 8.75 billion.*
- *As of June 20, 2008, the capital expenditure reached Rs 29.63 billion. In the corresponding period of previous year, capital expenditure had increased to 21.69 billion.*

Government Expenditure

41. The government expenditure, on a cash basis, increased by 28.2 percent to Rs 101.46 billion in mid-May 2008 compared to an increase of 12.6 percent in the same period of the previous year. The increase in government expenditure was on account of the rise in all three heads of government expenditure i.e. recurrent, capital and principal repayments.
42. In the review period, recurrent expenditure rose by 21.9 percent to Rs 64.77 billion compared to an increase of 13.6 percent in the corresponding period of the previous year. The rise in peace related expenditure, the salary hike of government employees, non-budgetary expenses on different items and expenditure on CA election exerted a pressure in recurrent expenditure in the review period.
43. In the review period, the capital expenditure went up by 55.6 percent to Rs 23.36 billion compared to an increase of 35.0 percent in the same period last year. A pick up in capital spending was on account of the investment in public enterprises amounting to Rs 7.24 billion including the loan investment of Rs 4 billion in NOC for the clearance of arrears, share investment of Rs 1.75 billion in Agriculture Development Bank and Rs 1.05 billion

in the Nepal Electricity Authority and the release of Rs 1.2 billion to Poverty Alleviation Fund (PAF).

External Sector Situation

Foreign Trade and Balance of Payments

44. In the first ten months of 2007/08, total exports declined whereas total imports increased significantly. Total exports fell by 1.2 percent compared to a decline of 0.3 percent in the corresponding period of the previous year. Of the total exports, export to India declined by 7.5 percent in the review period compared to a decline of 1.0 percent in the same period of 2006/07. Exports to other countries, on the other hand, grew by 13.0 percent compared to a decline of 3.1 percent in the comparable period of the previous year.
45. The decline in the exports to India was on account of the fall in the exports of vegetable ghee, textiles, chemicals, rosin and toothpaste. Likewise, exports to other countries went up largely due to the increase in the exports of pulses, Nepalese paper and paper products, herbs, wheat, packing materials of paper, cigarettes, electric wire and stationary.
46. In the first ten months of 2007/08, total imports surged by 21.0 percent compared to a rise of 10.5 percent in the corresponding period of the previous year. While imports from India soared by 25.4 percent in the review period compared to a growth of 11.4 percent in the corresponding period of 2006/07, imports from other countries rose by 13.8 percent compared to a rise of 9.0 percent in the previous year. Consequently, the total trade deficit expanded by 31.6 percent in the review period compared to a growth of 16.5 percent a year earlier.
47. A rise in the import of petroleum products, M.S. billet, vehicles and spare parts, cold rolled sheet in coil and hot rolled sheet in coil, among others, from India and an increase in the import of gold, telecommunication equipment & parts, other machinery & parts, transport equipment & parts and video television & parts from other countries were responsible for the surge in total imports in the review period.
48. In the first ten months of 2007/08, the remittances sent by the Nepalese working abroad increased by 35.3 percent to Rs. 108.64 billion compared to an increase of 3.1 percent in the previous year.
49. The overall BOP posted a surplus of Rs. 19.88 billion in the first ten months of 2007/08 compared to a surplus of Rs. 6.97 billion in the corresponding period of the previous year mainly because of the upsurge in travel receipts, remittances and capital transfer. The current account posted a surplus of Rs. 4.63 billion in the review period compared to a surplus of Rs. 5.04 billion in the corresponding period of the previous year.

Foreign Exchange Reserves

50. The gross foreign exchange reserves aggregated Rs. 197.03 billion in mid-May 2008, an increment by 19.3 percent from the level of Rs 165.13 billion in mid-July 2007. Such reserves had fallen by 0.3 percent in the corresponding period of the preceding year. On the basis of US dollar, gross foreign exchange reserves expanded by 15.5 percent to US\$ 2.94 billion in mid-May, 2008. Such reserves had risen by 12.5 percent in the same period of the previous year. On the basis of the import figures for the first ten months of 2007/08, the current level of reserves is adequate for financing merchandise imports of 10.6 months and merchandise and service imports of 8.6 months.

Price of Oil and Gold in the International Market

51. The price of oil (Crude Oil Brent) in the international market surged by 86.2 percent to US\$ 123.83 per barrel in mid-May 2008 from US\$ 66.51 in mid-May 2007. In the same way, the price of gold soared by 29.4 percent to US\$ 865.00 per ounce in mid-May 2008 from US\$ 668.25 in the previous year.

Exchange Rate Movement

52. In comparison to mid-July 2007, the Nepalese currency depreciated by 3.2 percent vis-à-vis the US dollar in mid-May 2008. It had appreciated by 12.8 percent in the corresponding period of the previous year. The exchange rate of one US dollar was Rs. 67.00 in mid-May 2008 compared to Rs. 65.70 in mid-May 2007.