Current Macroeconomic Situation

(Based on the Eight Months' Data of the FY 2010/11)

Monetary Situation

Money Supply

1. According to the preliminary figures, broad money (M2) has increased by 1.9 percent during the eight months of the FY 2010/11 compared to a growth of 7.2 percent in the corresponding period of the previous year. Broad money has expanded at lower rate in the review period on account of decline in net foreign assets of the banking system and a slower growth in net domestic assets. However, narrow money (M1) declined by 2.1 percent in the review period.

2. Net foreign assets (after adjusting foreign exchange valuation gain/loss) declined by Rs. 11.30 billion (5.3 percent) during the review period compared to Rs. 19.12 billion (8.5 percent) in the corresponding period of the previous year. The improvement in merchandise export and workers' remittances as well as marginal increase in import were the factors responsible for the relatively lower deficit in balance of payments (BoP) leading to the lower decline in net foreign assets of the monetary sector during the review period relative to that of the corresponding period of the previous year.

Domestic Credit

3. Domestic credit increased by 5.0 percent during the review period. It had expanded by 10.4 percent in the corresponding period of the previous year. During the review period, claims on private sector increased by 10.6 percent compared to a growth of 16.6 percent in the corresponding period of the previous year. The policy measures initiated to curb the excessive credit flow to unproductive sector and a decline in import growth contributed to slower growth in credit to the private sector during the review period.

Deposit Mobilization and Credit Flow of Commercial Banks

4. The imbalance between deposit mobilization and lending by commercial banks has continued during the eight months of the FY 2010/11. The deposit mobilization of commercial banks increased by Rs. 12.14 billion while the loan and advances increased by Rs. 54.24 billion in the review period. The deposit mobilization had increased by Rs. 21.77 billion and loan and advances had increased by Rs. 61.95 billion in the corresponding period of the previous year. Contrary to the lower

growth rate in deposit mobilization, credit to private sector increased by Rs. 46.64 billion during the review period.

5. Of the total bank credit to private sector, the credit to production sector increased by Rs. 19.21 billion during the review period compared to Rs. 9.87 billion in the corresponding period of the previous year. Similarly, banks' credit to wholesale and retail trade, construction and agriculture sectors increased by Rs. 11.48 billion, Rs. 2.40 billion and Rs. 0.88 billion respectively during the review period. On the contrary, credit to transportation, communication and public services declined by Rs. 1.63 billion.

Liquidity Management

6. The NRB injected net liquidity of Rs. 20.80 billion through secondary market operation during the review period. Liquidity of Rs. 21.0 billion was mopped up through outright sale auction of Rs. 2.0 billion and reverse repo auction of Rs. 19.0 billion during the review period. On the other hand, liquidity of Rs. 41.80 billion was injected through repo auction during the review period. Liquidity of Rs. 8.44 billion was mopped up through outright sale auction and reverse repo auction while Rs. 77.57 billion was injected through repo auction in the corresponding period of the previous year.

7. The NRB injected net liquidity of Rs. 108.93 billion through the purchase of USD 1.50 billion from foreign exchange market (commercial banks) during the review period. A net liquidity of Rs. 55.17 billion was injected through the purchase of USD 733.1 million from foreign exchange market in the corresponding period of the previous year.

8. The NRB purchased Indian currency equivalent to Rs. 117.97 billion through the sale of USD 1.62 billion in the Indian money market during the review period. INR equivalent to Rs. 101.80 billion was purchased through the sale of USD 1.35 billion in the corresponding period of the previous year.

Inter Bank Transaction and Standing Liquidity Facility

9. Inter-bank transaction of commercial banks reached Rs. 252.70 billion during the first eight months of the FY 2010/11 compared to Rs. 188.54 billion in the corresponding period of the previous year. Liquidity injection through the standing liquidity facility (SLF) amounted to Rs. 156.11 billion during the review period. Of the total SLF used during the review period, the outstanding amount was Rs. 1.08 billion as at mid-March 2011. Liquidity injected through the SLF had amounted to Rs. 85.17 billion in the corresponding period of the previous year. The outstanding amount of SLF was Rs. 2.4 million as at mid-March 2010.

Short-term Interest Rates

10. The short-term interest rates remained slightly higher in mid-March 2011 compared to mid-March 2010. For example, the weighted monthly average 91-day Treasury bill rate stood at 8.09 percent in mid-March 2011 compared to 7.79 percent in mid-March 2010. The weighted average inter-bank rate remained at 10.18 percent in mid-March 2011 compared to 8.85 percent in mid-March 2010.

Securities Market

11. The year on year (y-o-y) NEPSE index declined by 21.0 percent to 384.17 points in mid-March 2011. This index had stood at 486.25 in the same period last year. The decline in share prices was on account of the significant increase in the supply of securities.

12. The y-o-y stock market capitalization decreased by 10.2 percent to Rs. 337 billion in mid-March 2011. The ratio of market capitalization to GDP stood at 27.7 percent in mid- March 2011. This ratio was 35.4 percent a year ago. Of the total market capitalization, the share of bank and financial institutions stood at 70.1 percent followed by manufacturing and processing companies (2.8 percent), hotels (1.8 percent), business entities (0.5 percent), hydropower (4.6 percent) and other sectors (20.2 percent).

13. Total paid-up capital of the listed companies stood at Rs. 96.75 billion in mid-March 2011, registering an increase of 31.7 percent over the period of one year. This increase was largely due to the additional listing of securities at the NEPSE. As at mid-March 2011, additional securities worth Rs. 21.20 billion (ordinary share of Rs. 7.63 billion, bonus share of Rs.2.56 billion, right share of Rs. 6.03 billion and government securities of Rs. 4.99 billion) were listed at the NEPSE.

14. Total number of companies listed at the NEPSE increased to 202 in mid- March 2011 from 168 last year. Among them, 170 were 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

15. The y-o-y inflation as measured by the consumer price index (2005/06=100) increased to 10.7 percent in mid-March 2011 from 9.9 percent in the corresponding period of the previous year. During the review period, the index of food and beverage group increased by 17.3 percent and the index of non-food and services group increased by 5.3 percent. The indices of these groups had increased by 14.8

percent and 6.0 percent respectively in the corresponding period of the previous year.

16. During the review period, of the items under food and beverage group, price index of vegetables sub groups increased by the highest rate of 73.1 percent compared to an increase of 2.3 percent in the corresponding period of the previous year. The price indices of fruits and spices, which had increased by 21.3 percent and 34.0 percent respectively in the same period of the previous year, increased by 33.4 percent and 22.1 percent respectively during the review period. During the review period, the price indices of tobacco products, restaurant and hotel and cereals grains increased by 17.1 percent, 15.5 percent and 13.4 percent respectively compared to the increase of 11.4 percent, 20.9 percent and 12.1 percent respectively during the corresponding period of the previous year. Similarly, the price indices of milk products and egg and meat and fish increased by 10.5 percent and 7.7 percent respectively during the review period compared to their respective increase of 13.4 percent and 24.5 percent in the corresponding period of the previous year. The index of legume varieties, which had increased by 30.0 percent in the corresponding period of the previous year, decreased by 8.1 percent during the review period.

17. Within the group of non-food and services, the price index of clothing and footwear increased by 13.7 percent which had increased by 6.8 percent in the corresponding period of the previous year. The price index of transport, which had decreased by 0.7 percent in the corresponding period of the previous year, increased by 11.3 percent in the review period. Similarly, the price index of housing and utilities, which had increased by 6.7 percent in the corresponding period of the previous year increased by 6.4 percent in the review period. The price index of communication, which had remained unchanged in the same period of the previous year declined by 10.4 percent in the review period.

18. Region-wise, the price index in Kathmandu Valley increased by 13.9 percent followed by 11.6 percent in Hills and 7.9 percent in Terai during the review period. The respective growth rates were 9.0 percent, 11.1 percent and 9.8 percent in the corresponding period of the previous year.

Wholesale Price Inflation

19. During the review period, the y-o-y wholesale price index increased by 12.4 percent compared to a rise of 12.2 percent in the corresponding period of the previous year. The wholesale price indices of agricultural commodities, domestic manufactured commodities and imported commodities increased by 15.4 percent, 8.2 percent and 9.7 percent respectively during the review period compared to the increase of 19.2 percent, 12.1 percent and 1.2 percent in the corresponding period of the previous year.

20. During the review period, within the group of agricultural commodities, the wholesale price index of spices sharply increased by 52.2 percent compared to an increase of 36.4 percent in the corresponding period of the previous year. Likewise, the wholesale price indices of food grains, livestock production and cash crops increased by 9.9 percent, 11.8 percent and 22.7 percent respectively compared to an increase of 22.2 percent, 35.5 percent and 7.2 percent in the corresponding period of the previous year. The wholesale price index of pulses declined by 0.5 percent during the review period, as against the increase of 33.7 percent in the corresponding period of the previous year. The wholesale price index of fruits and vegetables increased by 29.0 percent during the review period, which had decreased by 5.3 percent in the corresponding period of the previous year.

21. Within the group of domestic manufactured commodities, the wholesale price index of beverages and tobacco and construction materials increased by 15.5 percent and 5.2 percent compared to the increase of 13.2 percent and 11.3 percent respectively during the same period of the previous year. The wholesale price index of food related products declined by 0.9 percent during the review period, as against the increase of 18.5 percent in the corresponding period of the previous year.

22. During the review period, within the imported commodities group, the wholesale price index of drugs and medicine and petroleum products and coal increased by 5.5 percent and 17.9 percent during the review period which had increased by 6.6 percent and 2.9 percent in the same period of the previous year. The price indices of chemical fertilizer and chemical goods and textile related products, which had decreased by 11.9 percent and 1.3 percent respectively in the corresponding period of the previous year increased by 6.1 percent and 6.9 percent respectively during the review period.

National Salary and Wage Rate

23. The y-o-y salary and wage rate index increased by 19.1 percent during the review period compared to an increase of 13.7 percent in the corresponding period of the previous year. In the salary and wage rate indices, the salary index remained unchanged in the review period as against the increase of 13.8 percent in the corresponding period of the previous year. However, during the review period, the overall salary and wage rate index increased mainly due to the increase in wage rate index. During the review period, the wage rate index increased by 25.5 percent compared to an increase of 13.6 percent in the corresponding period of the previous year.

24. The indices of wages of agricultural, industrial and construction laborers increased by 34.6 percent, 10.4 percent and 20.4 percent respectively during the review

period. These rates had increased by 17.0 percent, 8.8 percent and 10.6 percent respectively in the corresponding period of the previous year.

Fiscal Situation *

Budget Deficit / Surplus

25. During the eight months of the FY 2010/11, government budget remained at a surplus of Rs. 6.29 billion. A high growth in the resource mobilization relative to total government expenditure accounted for such a surplus during the review period. In the corresponding period of the previous year, budget surplus had stood at Rs. 4.94 billion.

Government Expenditure

26. During the review period, total government spending increased by 9.2 percent to Rs. 132.59 billion compared to an increase of 32.4 percent in the corresponding period of the previous year. During the review period, the low growth rates on both recurrent and capital expenditures were attributed for such a low growth rate in the government expenditure.

27. During the review period, recurrent expenditure increased by 13.4 percent to Rs. 89.97 billion. In the corresponding period of the previous year, such expenditure had increased by 29.3 percent. Delay in the announcement of the annual budget was responsible for such a low growth rate of recurrent expenditure.

28. During the review period, capital expenditure increased by 10.8 percent to Rs. 24.87 billion compared to an increase of 53.3 percent in the corresponding period of the previous year. Delay in the announcement of the annual budget, delay in approval of program and procurement process and slow process of infrastructure development were attributed for such a low growth rate of capital expenditures.

29. During the review period, principal repayment expenditure increased by 18.7 percent to Rs. 11.20 billion in contrast to a decline by 6.9 percent in the corresponding period of the previous year.

Revenue

30. During the review period, revenue mobilization of the Government of Nepal (GoN) grew by 16.5 percent to Rs. 123.04 billion compared to an increase of 25.6 percent to Rs. 105.58 billion in the corresponding period of the previous year. The impact of the delay in the announcement of the government budget, revenue mobilization

* Based on the data reported by 8 offices of NRB, 53 out of total 65 branches of Rastriya Banijya Bank Limited, 30 out of total 42 branches of Nepal Bank Limited, 5 branches of Everest Bank Limited and 1 branch each of Nepal Bangladesh Bank Limited and Global Bank Limited conducting government transactions.

based on previous year's Finance Act during the first four months and slow growth in the capital expenditure attributed for such a low growth of revenue mobilization. Likewise, decline in the import also affected the growth rate of revenue of the government during the review period.

31. Of the total revenue mobilization, VAT revenue grew by 18.9 percent to Rs. 39.97 billion in mid-March 2011. It had increased by 43.5 percent in the corresponding period of the previous year. Lack of expansion of industrial products, ineffective billing system, use of fake bills and low invoicing practice attributed for such a low growth rate in VAT.

32. During the review period, custom revenue rose by 7.0 percent to Rs. 23.46 billion compared to an increase of 43.0 percent in the corresponding period of the previous year. The growth rate of custom revenue declined mainly due to the low growth rate of import compared to that of the corresponding period of the previous year.

33. During the review period, excise revenue increased by 16.4 percent to Rs. 17.27 billion compared to an increase of 65.0 percent in the corresponding period of the previous year. The growth rate of excise revenue declined due mainly to the decline in imports of high excise tax yielding vehicles.

34. Income tax revenue increased by 29.0 percent to Rs.22.60 billion during the review period. Such revenue had risen by 20.7 percent in the corresponding period of the previous year.

35. During the review period, non-tax revenue increased by 28.5 percent to Rs. 15.42 billion compared to a decrease of 29.2 percent in the same period of the previous year.

Foreign Cash Loans and Grants

36. During the first eight months of the FY 2010/11, the Government of Nepal received foreign cash loans amounting to Rs. 2.44 billion and foreign cash grants amounting to Rs. 14.70 billion. Such receipts were respectively Rs. 2.53 billion and Rs. 15.74 billion in the corresponding period of the previous year.

External Sector Situation

Foreign Trade

37. Merchandise exports increased by 6.6 percent to Rs. 42.84 billion during the eight months of the FY 2010/11. Such exports had declined by 8.5 percent to Rs. 40.18 billion in the same period last year. On a monthly basis, exports decreased by 6.9 percent in February/March of the current fiscal year compared to the value of the previous month.

38. Exports to India increased by 10.8 percent during the eight months of the FY 2010/11 in contrast to a drop of 3.3 percent in the same period last year. Exports to other

countries decreased by 1.0 percent in contrast to a plunge of 16.8 percent in the same period last year. The increase in the exports to India was mainly ascribed to the increase in the exports of zinc sheet, jute goods, thread, M.S. pipe and plastic utensils among others. Exports to other countries declined due mainly to the decline in the export of readymade garments, handicraft goods, Nepalese paper & paper products, herbs and silverware & jewelleries among others.

39. Merchandise imports also increased by 1.4 percent to Rs. 253.50 billion during the eight months of the FY 2010/11. Such imports had grown by 41.8 percent to Rs. 250.06 billion in the same period last year. On a monthly basis, the merchandise imports increased by 6.5 percent in February/March of the current fiscal year compared to the value of the previous month.

40. Imports from India grew by 25.1 percent during the review period compared to a growth of 38.0 percent in the same period last year. Likewise, imports from other countries declined by 27.3 percent in contrast to a growth of 46.8 percent in the same period last year. The import of petroleum product, M.S. billet, cold rolled sheet in coil, other machinery and parts, chemical fertilizers and medicine among others increased from India whereas import of gold, readymade garments, steel rod & sheet, other machinery & parts, threads and betelnuts declined from other countries in the review period.

41. Total trade deficit during the eight months of FY 2010/11 increased by 0.4 percent to Rs. 210.66 billion. Trade deficit had risen by 58.6 percent in the same period last year. Trade deficit with India rose by 28.4 percent during the review period compared to a growth of 53.3 percent in the same period last year. On the contrary, trade deficit with other countries declined by 31.1 percent compared to a growth of 65.0 percent in the same period a year ago.

42. The improvement in exports coupled with deceleration in import contributed to an increase in the ratio of export to import to 16.9 percent in the review period from the ratio of 16.1 percent a year ago.

Balance of Payments Situation

43. The overall BOP recorded a deficit of Rs. 11.30 billion during the eight months of FY 2010/11 compared to a deficit of Rs. 19.12 billion in the same period last year. The current account also registered a deficit of Rs. 8.87 billion compared to a deficit of Rs. 30.50 billion in the same period last year. The decline in trade deficit along with improvement in current transfer attributed to such a decline in the current account deficit.

44. The FOB-based merchandise trade deficit increased marginally by 0.2 percent to Rs. 203.35 billion during the eight months of FY 2010/11. Such deficit had grown by 60.5 percent in the same period last year. The service account deficit declined significantly by 22.2 percent to Rs. 7.54 billion during the review period. Service

account deficit had increased by 4.2 percent to Rs. 9.70 billion in the same period last year. The net transfer account registered a growth of 12.8 percent to Rs. 198.03 billion in the review period compared to that of a year ago. Under the transfers sub-group, grants increased by 11.0 percent to Rs. 17.22 billion while pension receipts rose marginally by 9.4 percent to Rs. 19.43 billion. Likewise, workers' remittances increased by 12.3 percent to Rs. 161.62 billion compared to its growth of 9.9 percent in the same period last year. On a monthly basis, the remittance inflows increased by 11.0 percent in February/March compared to the value of the previous month of this fiscal year. Likewise, under the financial account foreign direct investment of Rs 5.47 billion was recorded in the review period compared to the level of Rs 1.61 billion in the same period a year ago.

Foreign Exchange Reserves

45. The gross foreign exchange reserves declined by 4.4 percent to Rs. 257.05 billion in mid-March 2011 from a level of Rs. 268.91 billion as at mid July 2010. Such reserves had decreased by 14.7 percent to Rs. 244.29 billion in the same period last year. On a monthly basis, foreign exchange reserve of Rs 761.6 million declined in the month of February/March from the level of the previous month of this year. Out of total reserve, NRB's reserves declined marginally by 2.7 percent to Rs. 199.86 billion in the review period from a level of Rs. 205.37 billion as at mid-July 2010. The gross foreign exchange reserves in USD terms also declined by 1.3 percent to USD 3.57 billion in mid-March 2011. Such reserves had decreased by 8.1 percent in the same period last year. Based on the trend of import during the eight months of the current fiscal year, the current level of reserves is sufficient for financing merchandise imports of 8.3 months and merchandise and service imports of 7.1 months.

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

46. The price of oil (Crude Oil Brent) in the international market went up by 38.8 percent to USD 110.25 per barrel in mid- March 2011 from USD 79.43 per barrel in mid-March 2010. Similarly, the price of gold also surged by 26.6 percent to USD 1400.50 per ounce in mid- March 2011 from the level a year ago.

47. Nepalese currency vis-à-vis the US dollar appreciated by 3.25 percent in mid- March 2011 from the level of mid July 2010. It had appreciated by 7.80 percent in the corresponding period of the previous year. The exchange rate of one US dollar stood at Rs. 72.10 in mid- March 2011 compared to Rs. 74.44 in mid July 2010.