



# Nepal Rastra Bank

## Research Department

# Current Macroeconomic and Financial Situation of Nepal

(Based on Three Months' Data of 2016/17)

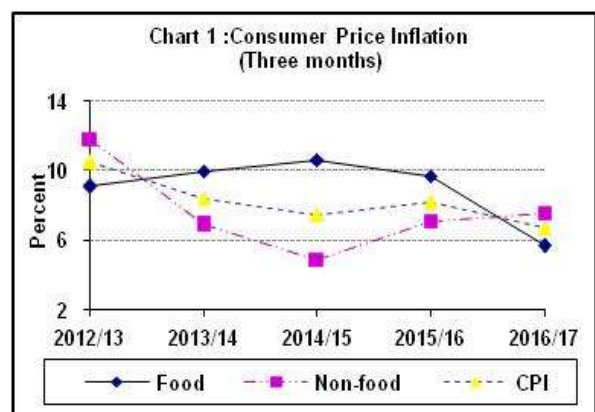
## Economic Outlook

1. The macroeconomic performance during the review period remained satisfactory with a deceleration in consumer price inflation and a return of the country's balance of payment position to a surplus.
2. The government expenditure has picked up relative to that of last year. However, there is a room for improvement in government expenditure especially capital spending as it has remained far short of annual target. The government revenue collection has exceeded the total government expenditure resulting in a significant level of cash accumulation of Rs. 196.62 billion with the NRB during the review period.
3. According to Hotel Association of Nepal, the bed occupancy rate in the hotels is estimated to have improved to 60 percent during the review period owing to the arrival of tourist season. This is expected to bring about positive impact on the hotels, restaurants and trekking businesses.
4. A boost in summer crops on the back of favorable monsoon, better than last year's industrial capacity utilization, an upsurge in services sector and a pickup in credit off-take have potentially improved the economic growth outlook. However, acceleration in capital spending and reconstruction related activities is the key to unlock the growth potential going forward.

## Inflation, Salary and Wage Rate

### Consumer Price Inflation

5. Consumer price inflation has been moderating since mid-July 2016. The rate of inflation has further moderated to 6.7 percent in mid-October 2016 from the level of 7.9 percent in mid-September 2016. Such



inflation was 10.4 percent in mid-July 2016 and 8.2 percent a year ago.

6. The pressure on overall consumer price inflation eased on account of remarkable decline in the food inflation in the review period compared to the corresponding period of the previous year.

### Food and Beverage Group

7. The food inflation fell to 5.7 percent in the review period from 9.7 percent in the corresponding period of the previous year. The food inflation moderated on the back of deceleration in prices of pulses and legumes, ghee and oil, milk products and egg, meat and fish compared to the corresponding period of the previous year. In the review period, the prices of sugar and sugar products and alcoholic drinks increased by 17.8 percent and 13.4 percent respectively.

### Non-food and Services Group

8. The non-food inflation rose to 7.6 percent during the review period from 7.1 percent in the corresponding period of the previous year. The rise in non-food inflation was on account of increase in price indices of clothes and footwear by 11.2 percent; education 9.6 percent and housing and utilities 9.4 percent.

### Region-wise Consumer Price Inflation

9. The Hilly region witnessed a relatively higher rate of inflation of 8.9 percent followed by Mountain region at 6.3 percent, Terai region at 6.2 percent and the Kathmandu Valley at 5.7 percent in the review period. In the corresponding period of the previous year, Hilly region, Mountain region, Terai region and the Kathmandu Valley had seen the inflation rate of 8.5 percent, 6.9 percent, 7.5 percent and 9.1 percent respectively.

### Inflation Differential between Nepal and India

10. The y-o-y consumer price inflation was lower at 4.2 percent in India compared to 6.7 percent in Nepal in October 2016 showing an inflation wedge of 2.5 percent. Such inflation was 5 percent in India and 8.2 percent in Nepal reflecting a wider inflation differential of 3.2 percent in the corresponding period of the previous year.

<b>Box 1: Commodity-Wise Inflation Wedge between Nepal and India</b>			
<b>Commodities</b>	<b>Inflation (Percent)</b>		<b>Wedge</b>
	<b>Nepal</b>	<b>India</b>	
<b>Overall Consumer Price Inflation</b>	<b>6.7</b>	<b>4.2</b>	<b>2.5</b>
1. Sugar and Sugar Products	17.8	23.6	(5.8)
2. Alcoholic Products	13.4	7.1	6.3
3. Clothes and Footwear	11.2	5.2	6
4. Fruits	10.0	4.4	5.6
5. Spices	10.0	7.4	2.6
<i>Source: Ministry of Statistics and Programme Implementation, India, November 2016</i>			

- Though the inflation wedge between Nepal and India is narrowing down gradually, it is still high on account of relatively higher prices of clothes and footwear, alcoholic products, among others (Box 1).

### Wholesale Price Inflation

- The y-o-y wholesale price inflation dropped to 5.0 percent in the review period from 5.9 percent a year ago. The wholesale price indices of agricultural commodities and domestic manufactured commodities showed a growth of 7.2 percent and 5.8 percent respectively, whereas such index of imported commodities declined 1.1 percent in the review period. In the corresponding period of the previous year, the increments in wholesale price indices of agricultural commodities and domestic manufactured commodities were 10.5 percent and 5.7 percent respectively, whereas the price index of imported commodities had seen a decline of 3.9 percent.

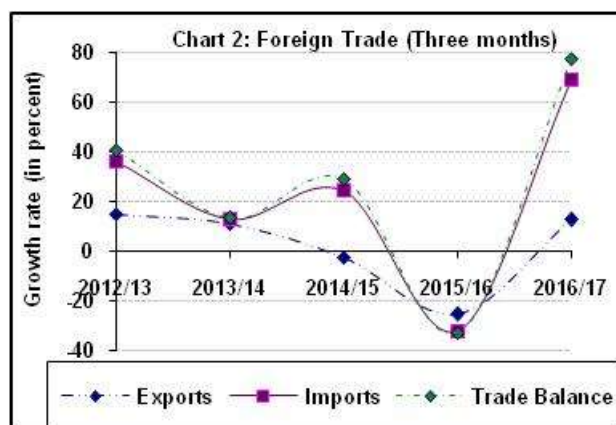
### National Salary and Wage Rate

- The y-o-y salary and wage rate index rose to 14.4 percent in the review period from 8.1 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 13.4 percent. The hike in pay scale of civil service drove up the salary index relatively higher than the wage rate index. 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 15.7 percent, 13.5 percent and 12.3 percent respectively in the review period.

## External Sector

### Merchandise Trade

- In the first three months of 2016/17, merchandise exports increased 12.6 percent to Rs. 18.93 billion in contrast to a drop of 25.4 percent in the same period of previous year. In the review period, exports to India, China and other countries increased 19.9 percent, 29.5 percent and 3.9 percent respectively. Commodity-wise, exports of juice, jute materials, rosin, shoes and sandals, among others, increased whereas export of zinc sheet, readymade garments, cardamom, vegetables, among others, decreased in the review period.



- Merchandise imports increased 69.1 percent to Rs. 220.68 billion in the review period as against a drop of 31.9 percent in the same period of the previous year. In review period, imports from India, China and Other countries increased 79 percent, 58.8 percent and 49.9 percent respectively. Commodity-wise, imports of vehicles and spare parts, construction materials, petroleum products and agriculture equipment, among others, increased whereas

imports of silver, cold rolled sheet in coil, gold, among others, decreased in the review period.

16. Based on customs points, the exports through Tribhuwan Airport Customs Office, Mechi Customs Office and Jaleshwar Customs decreased whereas exports from other customs points increased in the review period. On the import side, imports through Kailali Customs Office and Biratnagar Customs Office decreased whereas imports through other customs points increased in the review period.
17. Total trade deficit in the review period expanded 77.5 percent to Rs 201.75 billion compared to a contraction of 32.8 percent in the same period of the previous year. The export-import ratio fell to 8.6 percent in the review period from 12.9 percent in the corresponding period of the previous year.

### Export-Import Price Index

18. The y-o-y unit value export price index based on customs data increased 13.9 percent while import price index decreased 3.5 percent in the third month of 2016/17. Consequently, the Terms of Trade (TOT) index increased 18 percent compared to an increase of 16.8 percent in the corresponding period of the previous year. Increase in the price of export items such as carpet, cardamom, tea, pashmina caused the rise in export price index in the review period. Fall in the price of TMT bar, cloths, petroleum product resulted in a decline in import price index in the review period.

### Services

19. While the total services receipts increased 6.4 percent, expenses rose 6.2 percent in the review period. As a result, net services deficit increased to Rs. 2.40 billion in the review period in contrast to a deficit of Rs. 2.33 billion in the same period of the previous year. Under the services account, travel receipt increased 27.6 percent to Rs. 11.67 billion in the review period. Such receipt had decreased 12.1 percent in the same period of the previous year.

### Workers' Remittances

20. The workers' remittances increased 3.2 percent to Rs. 171.80 billion in the review period compared to a growth of 24 percent in the corresponding period of the previous year. Consequently, net transfer receipts increased 1.5 percent to Rs. 194.48 billion in the review period. Such receipts had increased 27.3 percent in the same period of the previous year.

21. The number of workers going abroad for foreign employment has been continuously falling in the recent months. The number of Nepalese workers seeking foreign employment, based on final approval for foreign

<b>Box 2: Number of Nepalese Workers Going Abroad for Foreign Employment *</b>			
<b>Mid-Month/Year</b>	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>
August	42309	37756	35485
September	51551	40275	34759
October	35550	35484	24949
November	43213	23061	
December	53354	38350	
January	45362	35389	
February	48941	34219	
March	44460	35701	
April	52210	31615	
May	31375	36778	
June	37962	37687	
July	<b>26600</b>	<b>32398</b>	
<b>Total</b>	<b>512887</b>	<b>418713</b>	<b>95193</b>
<b>Percentage Change</b>	-2.8	-18.4	-16.1**
* Based on final approval for foreign employment except re-approval. ** July/Oct. Source:- Foreign Employment Department			

employment, decreased by 16.1 percent in the first three months of 2016/17. It had decreased by 12.3 percent in the same period of the previous year.

### Current Account and BOP

22. On account of an increase in trade deficit, decrease in grants and slower growth of workers' remittances, the current account slipped into a deficit of Rs. 1.97 billion in the review period from a surplus of Rs. 85.88 billion in the same period of the previous year. However, the overall BOP recorded a surplus of Rs. 19.70 billion in the review period compared to a surplus of Rs. 63.96 billion in the same period of the previous year.
23. In the review period, Nepal received capital transfer amounting to Rs. 2.41 billion and Foreign Direct Investment (FDI) inflow of Rs. 5.02 billion. In the same period of the previous year, capital transfer and FDI inflows were Rs. 3.95 billion and Rs. 1.12 billion respectively.



### Foreign Exchange Reserves

24. The gross foreign exchange reserves increased 1.5 percent to Rs. 1054.61 billion as at mid-October 2016 from Rs. 1039.21 billion in mid-July 2016. Of the total foreign exchange, reserves held by NRB increased 0.8 percent to Rs. 894.42 billion as at mid-October 2016 from Rs. 887.01 billion as at mid-July 2016. Similarly, the reserves of banks and financial institutions (except NRB)

**Box 3: External Sector (USD)\***

Particulars	(USD Million)						
	2014-15		2015-16		2016-17	Percentage Change in Three months	
	Three months	Annual	Three months	Annual	Three months	2015/16	2016/17
Goods Exports (FoB)	258.8	988.1	179.9	703.9	193.0	-30.5	7.3
Goods Imports (FoB)	1933.9	7657.6	1236.2	7092.5	2021.8	-36.1	63.5
Trade Balance	-1675.1	-6669.5	-1056.3	-6388.6	-1828.7	-36.9	73.1
Total Trade	2192.7	8645.6	1416.1	7796.3	2214.8	-35.4	56.4
Travel Receipts	106.7	536.7	87.5	392.7	109.0	-18.0	24.7
Workers' Remittances	1378.1	6192.0	1594.3	6253.4	1605.9	15.7	0.7
Current Account Balance	-67.1	1067.3	818.2	1338.8	-18.2	-	-
BOP (-Surplus)	-30.1	-1437.0	-608.6	-1779.8	-184.6	-	-

\* Data from BOP Presentation

1. In the US dollar terms, total merchandise exports and imports increased 7.3 percent and 63.5 percent respectively in the first three months of 2016/17. Exports and imports had decreased 30.5 percent and 36.1 percent respectively in the corresponding period of the previous year.
2. In the review period, travel receipts increased 24.7 percent and worker's remittance rose marginally 0.7 percent. Travel receipts had decreased 18 percent and remittances had increased 15.7 percent in the corresponding period of the previous year.
3. Current account slipped into deficit by USD 18.2 million in the review period. It was in surplus of USD 818.2 million in the corresponding period of the previous year. Likewise, Balance of Payments (BOP) remained at surplus of USD 184.6 million in the review period compared to the surplus of USD 608.6 million in the corresponding period of the previous year.

increased 5.3 percent to Rs. 160.19 billion as at mid-October 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-October 2016.

### Foreign Exchange Adequacy Indicators

- Based on the imports of the first three months of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 14.6 months, and merchandise and services imports of 12.5 months. The ratio of reserve-to-GDP, reserve-to-imports and reserve-to-M2 stood at 46.9 percent, 104.1 percent and 44.6 percent respectively as at mid-October 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

- The price of oil (Crude Oil Brent) in the international market decreased 0.2 percent to USD 48.87 per barrel in mid-October 2016 from USD 48.96 per barrel a year ago. The price of gold increased 6 percent to USD 1251.80 per ounce in mid-October 2016 from USD 1180.85 per ounce a year ago.
- Nepalese currency vis-à-vis the US dollar appreciated 0.2 percent in mid-October 2016 from mid-July 2016. It had depreciated 2.3 percent in the same period of the previous year. The buying exchange rate per US dollar stood at Rs. 106.49 in mid-October 2016 compared to Rs. 106.73 in mid-July 2016.

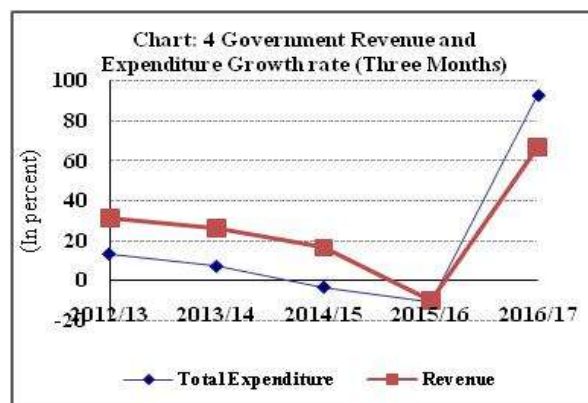
## Fiscal Situation \*

### Budget Deficit / Surplus

- In the first three months of 2016/17, the Government of Nepal (GoN) ran a surplus of Rs. 54.61 billion in its budget. Such surplus was Rs. 40.68 billion in the corresponding period of the previous year.

### Government Expenditure

- In the review period, total government expenditure on a cash basis increased 92.7 percent to Rs. 95.16 billion. Such expenditure had decreased 10.6 percent in the corresponding period of the previous year.
- In the review period, recurrent expenditure increased to Rs. 86.79 billion. Such expenditure was 41.07 billion 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.

In the review period, capital expenditure increased to Rs. 7.29 billion. Such expenditure was Rs. 2.87 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 of annual targets.

## Government Revenue

31. In the review period, the government revenue collection increased 66.7 percent to Rs. 126.12 billion. Such revenue had decreased 10.2 percent in the corresponding period of the previous year. Higher growth rate of major tax heads such as, value added tax, customs, excise duty and others tax heads contributed to the overall rise in revenue collection in the review period.

<b>Box: 4 The Budget Performance</b>			
<b>Heads</b>	<b>Budget Estimates (Rs. in millions)</b>	<b>Outturns in Three Months</b>	
		<b>Rs. in million</b>	<b>As percent of budget estimates</b>
<b>Total Expenditure</b>	<b>1048921.4</b>	<b>95161.7</b>	<b>9.07</b>
Recurrent	617164.13	86791.7	14.06
Capital	311946.33	7292.6	2.34
Financial	119810.9	1077.4	0.90
<b>Revenue</b>	<b>565896.5</b>	<b>126115.3</b>	<b>22.29</b>

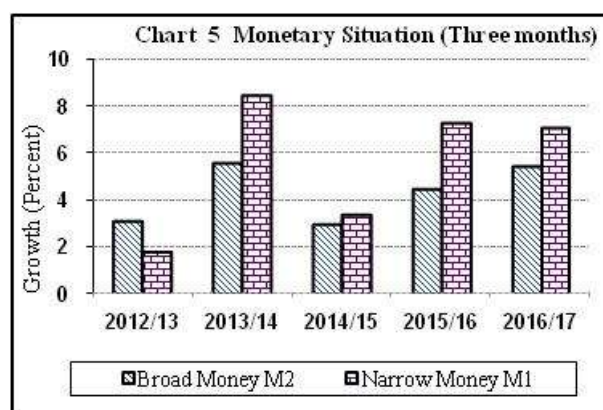
## Cash Balance of the GoN

32. Because of a slow pace of government expenditure relative to resource mobilization, the GoN accumulated cash balance of Rs. 196.62 billion at Nepal Rastra Bank as of mid-October 2016.

## Monetary Situation

### Money Supply

33. Broad money (M2) increased 5.4 percent in the review period compared to an increase of 4.5 percent in the corresponding period of the previous year. On y-o-y basis, M2 expanded 20.5 percent in mid-October 2016.
34. The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) increased Rs. 19.70 billion in the review period compared to an increase of Rs. 63.96 billion in the corresponding period of the previous year.



35. Reserve money decreased 0.3 percent in the review period against an increase of 1 percent in the corresponding period of the previous year. On y-o-y basis, reserve money increased 3.3 percent in mid-October 2016.

### Domestic Credit

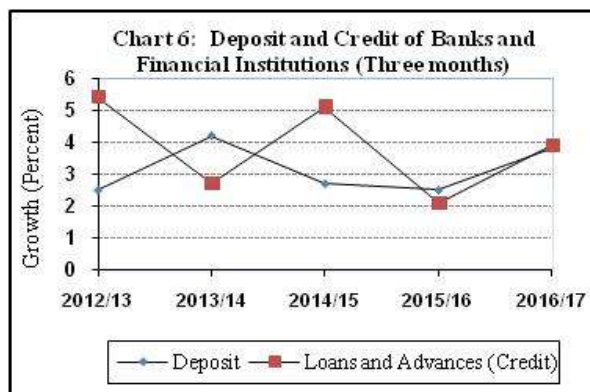
36. Domestic credit expanded 0.4 percent in the review period as against a decline of 1.5 percent in the same period of the previous year. On y-o-y basis, domestic credit increased 19.6 percent in mid-October 2016.
37. Claims of monetary sector on the private sector increased 4.3 percent in the review period compared to a growth of 2.9 percent in the previous year. On y-o-y basis, claims on the private sector increased 24.8 percent in mid-October 2016.

### Deposit Collection

38. Deposits at Banks and Financial Institutions (BFIs) increased 3.8 percent in the review period compared to an increase of 2.5 percent in the corresponding period of the previous year. Deposits at commercial banks and development banks increased 3.9 percent and 4.9 percent respectively, while that at finance companies decreased 11.9 percent in the review period. On y-o-y basis, deposits at BFIs expanded 21 percent in mid-October 2016.

### Credit Disbursement

39. Credit to the private sector from BFIs increased 4.2 percent in the review period compared to an increase of 2.7 percent in the same period of the previous year. In the review period, private sector credit from commercial banks and development banks increased 4.2 percent and 7.8 percent respectively, while that of finance companies decreased 8.5 percent. On y-o-y basis, credit to the private sector from BFIs increased 25.6 percent in mid-October 2016.



40. The increase in credit off-take is attributed to the credit expansion in agriculture by 6.7 percent, industrial production 4.5 percent, construction 5.9 percent, wholesale and retail trade 5.5 percent and service industries 6.6 percent in the review period.
41. Of the total outstanding credit of BFIs, 60.7 percent is against the collateral of land and building and 15.1 percent against the collateral of current assets (such as agricultural and non-agricultural products). Such ratios were 59.2 percent and 13 percent respectively in the same period of the previous year.
42. The outstanding credit of BFIs to real estate sector amounted to Rs. 265.85 billion (including Rs. 152.81 billion residential home loans less than Rs. 10 million each) in mid-October 2016. This is 14.9 percent of total credit exposure of BFIs. As at mid-October 2016, the BFIs' total margin lending extended against the collateral of shares stood at 2.2 percent



(Rs. 38.58 billion) of their total credit exposure. Of the total lending of commercial banks, credit to small and medium enterprises was only 2.5 percent (Rs. 36.81 billion) in the review period.

43. Trust Receipt (T.R.) loan extended by commercial banks increased 5.5 percent (Rs. 4.01 billion) in the review period as against the decline of 1.1 percent in the same period of the previous year.

### **Liquidity Management**

44. In the first three months of 2016/17, the NRB mopped up Rs 90.25 billion liquidity, on a turnover basis, through various instruments. These consisted of Rs. 31.5 billion through deposit collection auction (including Rs. 26.45 billion through 14 days deposit collection auction under the corridor system introduced in the current fiscal year) and Rs. 58.75 billion through reverse repo auction on a cumulative basis. In the corresponding period of the previous year, Rs. 57.25 billion was mopped up through deposit collection auction, Rs. 56.30 billion through reverse repo auction and Rs. 9.10 billion through outright sale auction.
45. In the review period, the NRB injected net liquidity of Rs. 108.95 billion through the net purchase of USD 925.9 million equivalent to Rs. 98.94 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 the corridor system introduced in the current fiscal year). Net liquidity of Rs. 117.46 billion was injected through the net purchase of USD 1125.9 million in the corresponding period of the previous year.
46. The NRB purchased Indian currency (INR) equivalent to Rs. 107.59 billion through the sale of USD 900 million and Euro 95 million in the review period. INR equivalent to Rs. 62.40 billion was purchased through the sale of USD 600 million in the corresponding period of the previous year.

### **Refinance and Productive Sector Lending**

47. 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. 2.54 billion including general refinance of Rs. 2.17 billion and export refinance of Rs 0.37 billion was made available to banks and financial institutions. In the corresponding period of the previous year, a total refinance of Rs. 1.39 billion including general refinance of Rs. 1.29 billion and export refinance of Rs. 0.10 billion was utilized. Moreover, a sum of Rs. 153.8 million housing loan has been extended by the BFIs to the earthquake victims as of mid-October 2016. This is under the zero percent interest refinance scheme introduced by this bank.
48. 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 stood at 16.33 percent in mid-October 2016.

### **Inter-bank Transaction and Standing Liquidity Facility**

49. In the review period, inter-bank transactions of commercial banks stood at Rs. 280.57 billion and those of other financial institutions (excluding transactions among commercial

banks) amounted to Rs. 88.37 billion. Such transactions were Rs. 185.59 billion and Rs. 18.31 billion respectively in the corresponding period of the previous year. The BFIs used the standing liquidity facility (SLF) of Rs. 7.75 billion in the review period.

### **Interest Rates**

50. The weighted average 91-day Treasury Bill rate increased to 2.12 percent in the review month from 1.10 percent a year ago. The weighted average inter-bank transaction rate among commercial banks, which was 0.64 percent a year ago, increased to 3.27 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions increased to 4.13 percent from 2.10 percent a year ago.
51. The weighted average interest rate spread between deposit and lending rate of commercial banks remained 4.45 percent in the review month compared to 4.34 percent a year ago. The average base rate of commercial banks came down to 6.43 percent in the review month from 7.22 percent a year ago.

### **Merger/Acquisition**

52. 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-October 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.

## **Capital Market**

53. The NEPSE index reached 1,803.7 points in mid-October 2016 from 1,718.2 points in mid-July 2016. The index, which was 1,134.5 points in mid-October 2015 upsurged by 59 percent on y-o-y basis. The bullish trend of stock market was primarily due to the capital hike plan of BFIs, the reforms implemented in stock market as well as the increased confidence among investors on account of relatively improved political situation.
54. The total turnover of the securities increased 144.8 percent to Rs. 74.85 billion during the first quarter of 2016/17. The increased liquidity of stocks was on account of dematerialized transactions, the increment in the share trading time from this fiscal year as well as the bullish trend of the NEPSE index itself.