Nepal Rastra Bank

Research Department

Current Macroeconomic and Financial Situation of Nepal

(Based on Three Months' Data of 2015/16)

Growth Outlook

1. The economic growth outlook, which was getting weakened on account of strike in the Southern parts of the country since the first month of the current fiscal year, further deteriorated owing to unofficial economic blockade imposed by India. The blockade on the import of essential commodities such as medicines, food grains and petroleum products has made public life miserable. So is the case of developmental projects which remain stalled on account of shortage of fuel and necessary raw materials.

2. There has been a significant change in the structure of the Nepalese economy and lifestyle of Nepalese people since the political change of 1990. During the period, the uses of private vehicles and L.P. Gas for cooking have increased tremendously. Since then, there has been an increased dependency on foreign countries for essential commodities such as food grains and medicines.

3. Likewise, there has been gradual increase in uses of improved seeds, chemical fertilizers and modern agro-equipments in agricultural sectors. On the industrial front, there has been an increasing trend of importing raw materials from India. Because of the landlockedness and difficult terrain on the north of the country, the country has to rely on Indian routes for most of her imports and exports. Under these circumstances, ensuing fuel shortages due to strike and blockade have impacted overall agriculture and industry sectors adversely.

4. Of the services sector, tourism, hotels, transportation and educational activities have remained disrupted. Due to the low number of tourist arrival, the occupancy rate of the hotels has fallen below 30 percent even in the high tourist season. The public transports and Carrier Services are running in a very few number. On the whole, the supply and distribution system of the country has been badly affected by the strike and the unofficial Indian blockade.

5. The paddy with 21 percent share in the agricultural production has further been affected by the strike and the Indian unofficial blockade. It was already hit hard by deficient monsoon. On account of the insufficient supply of chemical fertilizer, insecticides and related agricultural equipments, the production of paddy is projected to decline by 5 percent.

6. In the review period, most of the industries in the major industrial corridors have been closed and the capacity utilization of the running industries is also very low. The construction work on Upper Tamakoshi project has not yet been resumed because of the

disruption in the road linking to the construction site of the project. Similarly, the construction works on important hydroelectric projects such as Rasuwagadhi and Sanjen have also been affected due to the fuel shortage.

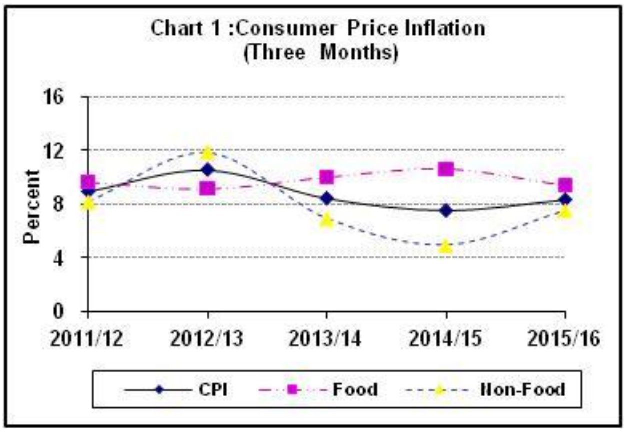
7. In the absence of timely legal arrangements of National Reconstruction Authority (NRA) established earlier by the ordinance could not start its work. Similarly, the process of disbursal of Rs. 2 hundred thousand promised to each household of the eartquake victims for the reconstruction of their houses has not yet taken place. Likewise, the reconstruction of historical heritages and private buildings has also not started yet.

8. Of the two major customs points in the north, Rasuwagadhi customs point has come into operation recently. However, Rasuwagadhi Customs point may get blocked at any time due to the perennial landslide at 7 km long Ramche segment road to Rasuwagadhi Customs point, and Betrawati -Mailung-Syaphrubeshi track is not completed yet. The road to Tatopani Customs point has still not come into operation due to the obstruction of landslide.

9. The reconstruction works after the devastating earthquake has not started yet. The industries with about 53 percent capacity utilization were being operated during the last fiscal year. In the aforesaid context and the prevailing difficult situation created by the blockade and strikes, the overall capacity utilization of industry, trade, and services sectors has been projected to fall further. As a result, the potential output of the economy is also projected to be gradually declining. In this context, compared to a targeted growth of 6 percent, the World Bank has recently revised the growth rate to 3.7 percent. If the adverse situation continues, the growth outlook is likely to deteriorate further.

Inflation, Salary and Wage Rate

10. The y-o-y consumer price inflation rose 8.3 percent in mid-October 2015 compared to 7.5 percent in the corresponding period of the previous year. While food and beverage group inflation was 9.4 percent, non-food and services group inflation was 7.5 percent in mid-October 2015. The food and beverage group inflation and non-food and services group inflation were 10.6 percent and 4.9 percent respectively in the corresponding period of the previous year. The shortage of essential commodities on account of strike and unofficial Indian blockade has exerted pressure on overall inflation in Nepal.



11. Under food and beverage group, the hard hit was the pulses and legumes sub-group whose prices overshooted to 34.6 percent during the review period compared to an increase of 10.5 percent in the corresponding period of the previous year. The price indices of ghee and oil sub-group which had decreased by 1.1 percent and milk products and eggs sub-

group which had increased by 10.5 percent in the corresponding period of the previous year, increased by 17.3 percent and 10.7 percent respectively during the review period. Likewise, the price indices of meat and fish sub-group and cereal grains and their products sub-group increased by 10.0 percent and 8.8 percent respectively during the review period compared to an increase of 7.0 percent and 10.6 percent respectively in the corresponding period of the previous year. The price indices of fruits sub-group and spices sub-group, which had increased by 14.3 percent and 5.8 percent respectively in the corresponding period of the previous year, increased both by 8.3 percent in the review period.

12. Under non-food and service group, the price index of education sub-group increased by the higher rate of 12.2 percent during the review period compared to an increase of 5.5 percent in the corresponding period of the previous year. The price indices of clothes and footwear sub-group and housing and utilities sub-group, which had increased by 7.6 percent and 2.2 percent in the corresponding period of the previous year, increased by 10.4 percent and 9.8 percent respectively during the review period. Likewise, the price indices of furnishing and household equipment sub-group and communication sub-group both increased by 3.8 percent during the review period compared to an incresase of 6.3 percent in the furniture and household equipment sub-group and a decrease of 0.2 percent in the communication sub-group in the corresponding period of the previous year. The price index of recreation and culture sub-group increased by 3.0 percent in the review period compared to an increase of 4.7 percent in the corresponding period of the previous year.

13. In terms of ecological regions, the price index in the Kathmandu Valley increased by 9.1 percent followed by 8.8 percent in Hilly region, 7.7 percent in Terai region and 7.2 percent in Mountain region during the review period. Such indices had increased by 7.7 percent in the Kathmandu Valley and 7.4 percent in both Hilly region and Terai region in the corresponding period of the previous year.

Consumer Price Inflation: Deviation between Nepal and India

14. The y-o-y CPI inflation of Nepal was relatively at a higher rate of 8.3 percent compared to 5.0 percent in India showing an inflation wedge of 3.3 percent during the review period. A year ago, inflation in Nepal was 7.5 percent compared to 5.5 percent in India reflecting a narrower inflation wedge of 2 percent. The rise in inflation wedge between Nepal and India was on account of lingering impact of April/May 2015 earthquakes and the recent unofficial Indian economic blockade on trade routes.

Wholesale Price Inflation

15. The y-o-y wholesale price index increased by 5.9 percent during the review period compared to a rise of 7.2 percent in the corresponding period of the previous year. The wholesale price indices of agricultural commodities and domestic manufactured commodities increased by 10.5 percent and 5.7 percent respectively, whereas such index of imported commodities decreased by 3.9 percent in the review period. The increments in agricultural commodities, domestic manufactured commodities and imported commodities were 9.5 percent, 6.2 percent and 3 percent respectively in the corresponding period of the previous year.

National Salary and Wage Rate

16. The y-o-y salary and wage rate index increased by 8.1 percent during the review period compared to an increase of 9.4 percent in the corresponding period of the previous year. Within the salary and wage rate index, while the salary index increased by 0.8 percent, the wage rate index rose by 10 percent compared to an increase of 7.6 percent and 9.9 percent respectively in the corresponding period of the previous year.

17. The salary indices of bank and financial institutions, education and public corporations sub-group increased by 2.3 percent, 1.5 percent and 0.7 percent respectively during the review period. Likewise, wage rate indices of agricultural labourer, construction labourer and industrial labourer witnessed the growth of 13.2 percent, 9.8 percent and 3.5 percent respectively in the review period.

Box 1: Effect of Past Blockades on Prices

The 1970 blockade

Even though the economic blockade of 1970 was for the short period of time, it had created a problem in smooth supply of some commodities like salt, spices products in the country as Nepal was dependent for these products on India. But, during that period, Nepal was self-sufficient in food production due to which there was no problem on supply of food products. At that time, the purchasing power of Nepalese people was low; shortage of petroleum products also didn't make much effect due to limited number of transportation vehicles. Because of these reasons, the Indian economic blockade had limited impact on prices at that time.

The 1989 blockade

The Indian blockade which started from April 1989 lasted for about 15 months had created shortages of essential commodities like food products, salt, oil, spices. including the supply of petroleum products. The government had brought the petroleum products and other essential commodities for daily uses by air transport from the third country. As per the data published by Nepal Rastra Bank, the CPI inflation during those 15 months of blockade period had ranged between 8.1 percent and 10.5 percent.

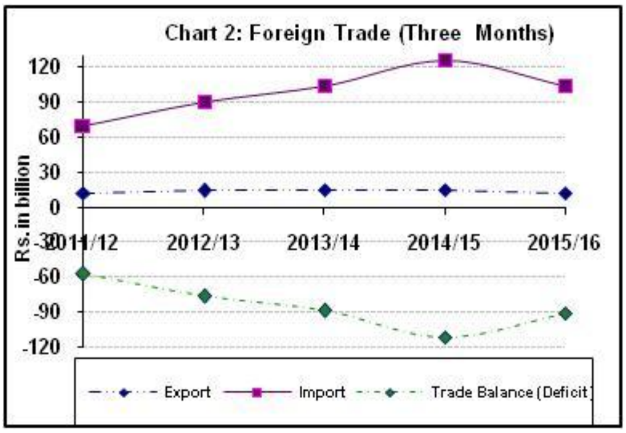
External Sector

External Sector

18. The foreign trade of Nepal is being adversely affected on account of obstruction on trade routes in the southern parts of the country in general and near closure of Birgunj customs point. International trade of Nepal has also been affected due to the difficulties on Nepal-China customs points on account of earthquake induced landslides. However, the balance of payments has remained favorable due to the contraction in imports and upsurge in transfer income.

Foreign Trade Situation

19. Merchandise exports decreased significantly by 25.4 percent to Rs. 16.81 billion in the first three months of 2015/16 compared to a drop of 2.3 percent to Rs. 22.53 billion in the same period of the previous year. The total exports decreased due to a fall in exports to India, China and other countries in the review period on account of current unfavorable circumstances.



20. Exports to India decreased by 35.9 percent during the review period compared to a drop of 6.4 percent in the same period of the previous year. The fall in exports to India is attributed mainly of the fall in the exports of zinc sheet, juice, textiles, polyester yarn, among others. The export had decreased by Rs. 46.7 million to Rs. 906 million in 1970/71 due to the Indian blockade in the form of quantitative restriction on exports. Similarly, the exports to India had decreased by Rs. 432 million to Rs. 603 million in 1988/89 on account of the Indian blockade.

21. Exports to China dropped by 66.5 percent in the review period contrary to an increase of 93.2 percent in the same period of the previous year. This fall is mainly attributed to the decrease in the exports of tanned skin, readymade garments, noodles, rudrakshya among others. Similarly, exports to other countries dropped by 3.3 percent in the review period compared to a decrease of 0.4 percent in the same period of the previous year. The fall in exports to other countries is attributed to a drop in the exports of pulses, tanned skin, tea, handicrafts, among others. In US dollar terms, exports to China decreased by 68.6 percent to USD 2.9 million during the review period as against an increase of 93.6 percent in the same period of the previous year. Similarly, exports to other countries decreased by 9.8 percent to USD 74.9 million in the review period as against an increase of 1.9 percent in the same period of the previous year.

22. During the review period, merchandise imports shrinked by 31.9 percent to Rs. 130.49 billion. Such imports had gone up by 24.4 percent to Rs. 191.72 billion in the same period of the previous year. The slowdown in imports is attributed mainly to a decrease in imports of petroleum products on account of unofficial economic blockade imposed by India on trade routes in the Southern parts of the country.

23. Imports from India fell by 35.4 percent in the review period as against an increase of 22.8 percent in the same period of the previous year. The import of petroleum product, vehicles and spare parts, M.S. billet, medicine, among others has decreased whereas the import of chemical fertilizer, M.S.wire rod, collrolled sheet in coil, vegetables has increased. Imports from China decreased by 13.3 percent in the review period compared to a growth of 40.1 percent in the same period of the previous year. Imports from China decreased on account of the fall in the imports of television, machinery parts, solar panel, and electrical equipments, among others. Similarly, imports from other countries decreased by 32.2 percent in the review period contrary to an increase of 21.5 percent in the same period of

the previous year. Imports from other countries decreased mainly due to a fall in the imports of silver, crude soybean oil, edible oil, among others. In US dollar terms, the imports from China decreased by 18.9 percent to USD 194.4 million in contrast to an increase of 43.2 percent in the same period of the previous year. The imports from other countries decreased by 36.6 percent to USD 289.6 million in contrast to an increase of 24 percent in the same period of the previous year.

24. Total trade deficit during the review period contracted by 32.8 percent to Rs. 113.68 billion compared to an expansion of 29.1 percent in the same period of the previous year. Trade deficit with India, China and other countries narrowed down by 35.3 percent, 11.2 percent, 38.6 percent respectively in the review period. Such deficits had widened by 27.8 percent, 38.6 percent and 27.8 percent respectively in the same period of the previous year. The FOB based trade deficit decreased by 32.7 percent to Rs. 109.81 billion in the review period. Such deficit had gone up by 29.6 percent in the same period of the previous year.

25. The exports-imports ratio reached 12.9 percent in the review period on account of a fall in imports. Such ratio had remained at 11.8 percent in the same period of the previous year.

Export-Import Price Index

26. The y-o-y unit value export price index based on customs data increased by 8.6 percent in the third month of 2015/16 compared to a rise of 12 percent in the same period of the previous year. Increase in price of major export items such as orthodox tea, yarsagumba, cardamom caused the export price index to rise in the review period.

27. The y-o-y unit value import price index based on customs data decreased by 7.1 percent in the third month of 2015/16. It had increased by 4 percent in the corresponding period of the previous year. Price of major import items such as petroleum products, metal, computer and spare parts and glasses etc. caused import price index to decrease in the review period.

28. Terms of Trade (TOT) index increased by 16.8 percent on y-o-y basis in the third month of 2015/16 compared to an increase of 7.6 percent in the corresponding period of the previous year.

Customs-wise Trade Situation

29. The foreign trade with India and other countries of Nepal is affected by the obstruction and unofficial blockade in the Southern parts of Nepal and the earthquake of April 25, 2015. Consequently, the exports and imports from southern customs points decreased and there is no trade through Tatopani customs point after the earthquake in the review period.

30. The imports from all customs points declined due to the protest and unofficial blockade imposed by India on southern trade customs points. The imports through Birgunj dry port declined to Rs. 9.22 billion in the review period compared to Rs. 21.25 billion in the corresponding period of previous year. Similarly, the imports through Birgunj customs point fell to Rs. 43.21 billion in the review period compared to 80.33 billion in the same period of the previous year and the imports through Biratnagar Customs point also dipped to Rs.18.85 billion compared to Rs. 23.99 billion in the same period of the previous year.

Similarly, the imports through Bhairahawa, Nepalgunj, Mechi and other customs points have decreased.

31. In the review period, the exports through customs points other than Tribhuvan International Airport have decreased. The exports through Birgunj customs point declined to Rs. 2.50 billion in the review period from Rs. 3.99 billion in the same period of the previous year and the export through Biratnagar customs point declined to Rs. 4.61 billion from Rs. 6.07 billion in the same period of the previous year. Similarly, the exports through Bhairahawa, Nepalgunj, Mechi, Birgunj dry port and other custom points have also decreased.

Box 2: Customs points-wise Trade in Three Months *(Rs. millions)*

Custom Points	Exports			Imports		
	2014/15	2015/16	Percent Change	2014/15	2015/16	Percent Change
Birgunj	3993.8	2495.3	-37.5	80329.5	43205.3	-46.2
Bhairahawa	2075.1	600.3	-71.1	26666.5	25459.2	-4.5
Biratnagar	6076.5	4612.1	-24.1	23993.5	18846.4	-21.5
Tribhuvan International Airport	5730.1	6724.8	17.4	22304.8	22011.7	-1.3
Dry Port	792.4	465.7	-41.2	21249.9	9224.2	-56.6
Nepalgunj	436.8	313.0	-28.3	7393.9	4329.5	-41.4
Mechi	2418.5	1416.7	-41.4	4607.1	3368.5	-26.9
Tatopani	636.4	0.0	-	0.0	2066.3	-
Others	374.9	181.2	-51.7	5169.8	1975.0	-61.8
Total	**22534.4**	**16809.1**	**-25.4**	**191715.1**	**130486.1**	**-31.9**

Services

32. The gross services receipts in the review period decreased by 0.7 percent to Rs. 32.39 billion in contrast to an increase of 19.9 percent in the same period of the previous year. The travel receipts and other receipts decreased by 12.1 percent and 17.7 percent respectively in the review period. On the other hand, the government receipts increased by 52.1 percent in the review period. The devastating earthquake of April 25, 2015 as well as the strike in the Terai-Madesh region adversely affected the tourism and other service sectors leading to a fall in services income.

33. The total services expenses increased by 8.3 percent in the review period compared to the 23.2 percent increase in the same period of the previous year. The travel, government and other service expenses increased by 8.8 percent, 42.1 percent and 21 percent respectively in the review period while transportation service expenses decreased by 1.4 percent due to fall in imports.

34. The net services receipts remained in deficit by Rs. 2.33 billion on account of a decrease in services receipts and increase in service expenses in the review period compared to Rs. 0.55 billion surpluses in the same period of the previous year.

Transfers

35. The net transfer receipts rose significantly in the review period due to upsurge in the grants and workers' remittances. The net transfer receipts increased by 27.3 percent to Rs. 191.67 billion in the review period. It had decreased by 3.8 percent in the same period of the previous year.

36. The gross transfer receipt increased by 27.2 percent to Rs. 192.31 billion in the review period as against a decrease of 3.9 percent in the same period of the previous year. The total foreign grants of Rs. 16.37 billion was received in the review period. Such grant was Rs. 6.96 billion in the same period of the previous year.

37. Workers' remittances increased by 24 percent to Rs. 166.42 billion in the review period in contrast to a decrease of 0.6 percent in the same period of the previous year. In US dollar terms, the remittances increased by 15.7 percent to USD 1.59 billion compared to an increase by 1.6 percent in the same period of the previous year.

Box 3: Number of Nepalese Workers going abroad for Foreign Employment *

Mid-Month/Year	2013/14	2014/15	2015/16
August	45937	42309	37756
September	24214	51551	39919
October	31959	35550	35484
November	31949	43213	-
December	41634	53354	-
January	50032	45362	-
February	37285	48941	-
March	48552	44460	-
April	45854	52210	-
May	54173	31375	-
June	54926	37962	-
July	61717	26600	-
Total	**528232**	**512887**	**113159**
Percentage Change	16.5	-2.9	-12.6**

* Based on final approval for foreign employment.
** July/Oct. 2014-July/Oct 2015
Source:- Foreign Employment Department

38. The number of workers going abroad for foreign employment, however, decreased in the recent months. The number of Nepalese workers seeking foreign employment, based on final approval for foreign employment, decreased by 12.6 percent in the first three months of 2015/16. It had increased by 26.7 percent in the same period of the previous year.

39. The pension income decreased by 4.8 percent to Rs. 9.52 billion in the review period compared to Rs. 10 billion in the same period a year ago.

Current Account

40. The current account surplus remained high in the review period due to decrease in imports and upsurge in remittances and grants. The current account registered a surplus of Rs. 85.88 billion during the review period in contrast to a deficit of Rs. 6.48 billion in the same period of the previous year. The current account surplus in US dollar terms was USD 818.2 million in the review period compared to the deficit of USD 67.1 million in the same period of the previous year.

Box 4: Dividend Payment to FDI Companies*

(Rs. in million)

S.N.	Sectors	2014/15 Annual	2015 October
1	Financial Sector	1794.43	0.00
2	Communication Sector	4.00	1416.2
3	Hydro Power Sector	2874.48	0.00
4	Industry Sector	2299.19	0.00
5	Services Sector	238.61	0.00
	Total	**7210.71**	**1416.2**

**Based on approval from NRB*

Capital and Financial Account

41. The capital transfer amounted to Rs. 3.95 billion in the review period

compared to Rs. 1.45 billion in the same period of the previous year.

42. Foreign Direct Investment (FDI) inflow amounted to Rs. 1.12 billion in the review period compared to Rs. 917.7 million in the same period of the previous year.

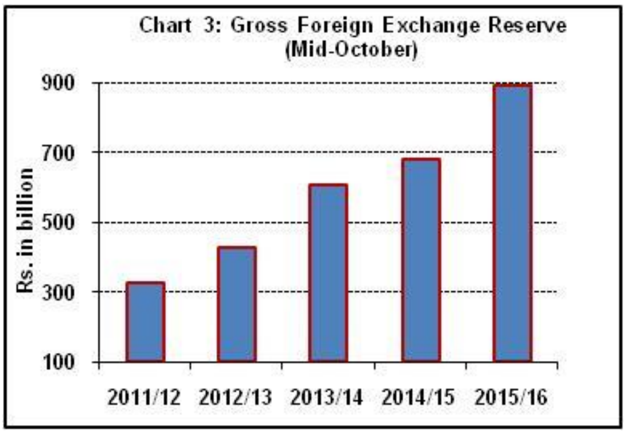
43. Dividend payment to FDI companies, based on approval from Nepal Rastra Bank, amounted to Rs. 1.42 billion in the review period. The dividend payment was Rs. 7.21 billion in 2014/15.

BOP Situation

44. The overall BOP recorded a significant level of surplus of Rs. 64.15 billion in the review period compared to a surplus of Rs. 2.96 billion in the same period of the previous year. In US dollar terms, the BOP recorded a surplus of USD 610.4 million compared to a surplus of USD 30.1 million in the same period of the previous year.

Foreign Exchange Reserves

45. The gross foreign exchange reserves increased by 8.3 percent to Rs. 892.07 billion as at mid-October 2015 from Rs. 823.87 billion as of mid-July 2015. Such reserves had increased by 2.1 percent in the same period of the previous year. The gross foreign exchange reserves in US dollar terms increased by 5.8 percent to USD 8.62 billion in mid-October 2015. Such reserves had decreased by 0.7 percent in the same period of the previous year.



46. The foreign exchange reserves held by NRB increased by 9.3 percent to Rs. 768.47 billion as at mid-October 2015 compared to Rs. 702.88 billion as of mid-July 2015. Such reserves had increased by 1.0 percent in the same period of the previous year. The share of NRB in total reserves stood at 86.1 percent as at mid-October 2015.

47. The foreign exchange reserves of banks and financial institutions (except NRB) increased by 2.2 percent to Rs. 123.60 billion as at mid-October 2015 compared to the level of mid-July 2015. Such reserves had increased by 9.1 percent in the same period of the previous year.

48. During the review period, the inconvertible foreign exchange reserves decreased by 0.9 percent to IRs 118.71 billion. Such reserves had increased by 1.4 percent in the same period of the previous year. The share of inconvertible foreign exchange reserves in total reserves stood at 21.3 percent as at mid-October 2015.

Foreign Exchange Adequacy Indicators

49. The reserve adequacy indicators remained satisfactory in the review period. Based on the imports of the three months of the current fiscal year, the foreign exchange holding of the banking sector is sufficient to cover prospective merchandise imports of 20.8 months, and merchandise and services imports of 16.4 months. The ratio of reserve-to-GDP, reserve-to-imports and reserve-to-M_2 increased to 42 percent, 136.6 percent and 45.5 percent respectively in mid-October 2015. Such ratios were 38.8 percent, 93.2 percent and 43.9 percent as at mid-July 2015.

Box 5: Reserve Adequacy Ratio (Percent)

Description	Mid-July		Mid-October	
	2014	**2015**	**2014**	**2015**
Reserve/GDP	34.3	38.8	35.0[a]	42.0[a]
Reserve/Imports*	83.1	93.2	77.1	136.6
Reserve/M2	42.5	43.9	42.1	45.5

* Goods and services import
a, GDP data of the previous year is used.

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

50. The price of oil (Crude Oil Brent) in the international market decreased sharply by 42.6 percent to USD 48.96 per barrel in mid-October 2015 from USD 85.23 per barrel a year ago. The decrease in the price of petroleum product is attributed to the decrease of demand for petroleum products in emerging and developing economies including China along with no reduction in production by the OPEC and USA. Similarly, the price of gold declined by 4.6 percent to USD 1180.85 per ounce in the mid-October 2015 from USD 1237.50 per ounce a year ago.

Box 6: The MoU between Nepal and China for Petroleum Import

The MoU has been signed on October 28, 2015between Nepal Oil corporation (NOC) and China National United oil corporation (Petro China) to import petroleum product in Nepal. This MOU has given the framework to import of petrol, diesel and other petroleum product from China. (Source: Press Release of NOC, October, 2015).

51. Nepalese currency vis-à-vis the US dollar depreciated by 2.3 percent in mid-October 2015 from mid-July 2015. It had depreciated by 2.8 percent in the same period of the previous year. The exchange rate per US dollar stood at Rs. 103.49 in mid-October 2015. It was Rs. 101.14 in mid-July 2015.

Policy Measures for Narrowing Down Trade Deficit

52. Nepal has undertaken some policy initiatives such as special refinance facility to export industries and cash subsidy to exporters aimed at promoting exports. With a view to promoting export, the GoN has made a provision of providing cash subsidy of 2 percent for export of specified 10 industrial goods, 1 percent for export of specified 15 industrial and 7 agricultural goods. Under this provision, cash subsidy of Rs 250.3 million was granted for exporters in 2014/15. In the first three months of the current fiscal year 2015/16, Rs 29.75 million was granted as cash subsidy.

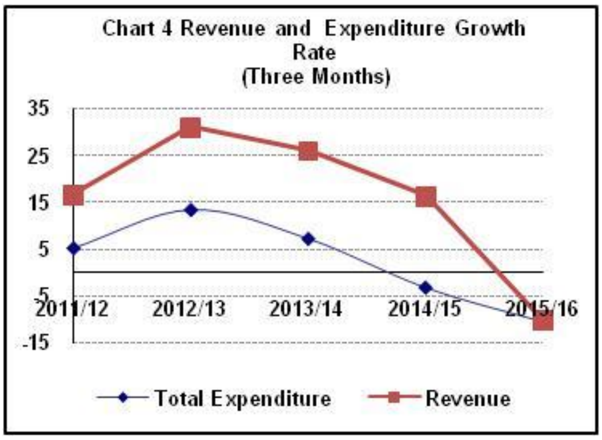
Fiscal Situation *

Budget Deficit / Surplus

53. During the three months of 2015/16, government budget on cash basis remained at a surplus of Rs. 40.68 billion. Despite the slowdown in resource mobilization, a significant fall in government expenditure led to accumulation of such a budget surplus. Budget surplus was Rs. 37.44 billion in the corresponding period of the previous year.

Government Expenditure

54. During the review period, total government expenditure on cash basis dropped by 10.6 percent to Rs. 49.40 billion compared to a decrease of 3.3 percent to Rs. 55.24 billion in the corresponding period of the previous year. Such decline in government expenditure in the review period can be attributed to the adverse impact of Terai agitation and the Indian blockade on both recurrent and capital expenditure.



55. During the review period, recurrent expenditures dropped by 22 percent to Rs. 41.07 billion. Such expenditures had declined by 3.3 percent in the corresponding period of the previous year.

56. Although, capital expenditures increased by 58.6 percent to Rs. 2.87 billion in the review period, this amount is only 1.4 percent of the budget estimate for fiscal year 2015/16. The annual target for capital expenditure, therefore, is less likely to be met in 2015/16. In the three months of the previous year, capital expenditures had shrinked by 16 percent.

57. During the review period, disturbances at customs points have disrupted the overall supply system including that of fuel. Important projects are stalled on account of fuel shortage, and post-earthquake reconstruction has not yet started owing to shortage of construction materials. Consequently, the capital expenditure of the GoN has been lower than expected.

Government Revenue

58. During the review period, the government revenue mobilization dropped by 10.2 percent to Rs. 75.66 billion. Such revenue had risen by 16.3 percent to Rs. 84.27 billion in the corresponding period of the previous year. Contraction in imports and slowdown in economic activities due to disturbances at southern customs points is responsible for the

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* Based on the data reported by 8 NRB offices, 67 branches of Rastriya Banijya Bank Limited, 44 out of 47 branches of Nepal Bank limited, 19 branches of Agriculture Development Bank limited, 9 branches of Everest Bank Limited, 4 branches each of Global IME Bank Limited and, 1/1 branch each of NMB Bank Limited, Nepal Bangladesh Bank limited and Bank of Kathmandu Limited conducting government transactions and release report from 79 DTCOs and payment centres.

decrease in revenue mobilization. If the existing Indian unofficial blockade continues, it may be difficult to mobilize the revenue as per the annual target in the current fiscal year.

59. Of the total revenue mobilization, VAT revenue dropped by 16.4 percent to Rs. 23.58 billion during the review period. It had increased by 19.4 percent in the corresponding period of the previous year.

60. During the review period, customs revenue dropped by 26.7 percent to Rs. 13.63 billion in contrast to an increase by 23.7 percent in the corresponding period of the previous year.

61. During the review period, excise revenue dropped by 21.6 percent to Rs. 10.22 billion as against an increase by 25.4 percent in the corresponding period of the previous year.

62. Income tax revenue increased by 42.6 percent to Rs. 14.86 billion during the review period. Such revenue had risen by 13.4 percent in the corresponding period of the previous year.

63. During the review period, non-tax revenue increased by 3.7 percent to Rs. 9.97 billion compared to an increase by 1.8 percent in the corresponding period of the previous year.

Box 7: Measures Adopted by the Government during Past Blockades

I. The 1970 Indian Economic Blockade

- Exemption of sales tax on all types of machinery including electrical motor and their parts, all types of cotton threads, iron billet and aluminum ingot.
- Imposition of Rs. 150 per hour operation of rope line.
- Imposition of vehicle tax of 13 paisa per kilometer on specified main highways.
- Imposition of excise duty of Rs. 3 per liter on beer production and an increase in export duty on leather shoes by 7 percent.
- Execution of government expenditure as per the target despite reduction in revenue collection.
- Increment in saving interest rate to increase savings for promoting investment.
- Reduction in lending interest rate to increase investment on sectors of national priority.

II. The 1989 Indian Economic Blockade

- Reduction of price and increase in supply of essential goods such as electricity and firewood.
- Reduction of additional import duty and implementation of Open General License (OGL) system on import of essential commodities including fuel.
- Issuance of economic work plan comprising short-term measures to regularize the supply and distribution of essential consumer goods and raw materials, medium term measures to mobilize resources and promotion of exports and long term measures to develop alternative source of energy and expansion of electricity-based public transport system.
- Increment of embarkation tax on international flight from Rs. 200 to Rs. 300, introduction of 100 percent entertainment tax on video shows, increase in customs duties on boulders, sand and timber to discourage export.
- Exemption of additional import duties on 72 items including stove, pressure cooker, coal.
- Exemption of additional customs duty on the import of raw materials used for the domestic production of goods whose additional customs duty were exempted.
- Exemption of import duty and sales tax on the equipment and spare parts used for solar system and biogas plants to encourage the development of alternative energy
- Imposition of import duties on agriculture products in order to protect the agriculture sector.
- Reduction of exports duty to 0.5 percent and provision of cash subsidy to promote export diversification.

Source: Budget Speeches of GoN 1970/71 and 1989/90

Public Debt [1]and Cash Balance of the GoN

64. Outstanding public debt of the GoN declined to Rs. 537.76 billion with domestic debt at Rs. 191.34 billion and external debt amounting to Rs. 346.42 billion as at mid-October 2015. In mid-October 2015, total public debt-to-GDP ratio declined to 25.31 percent.

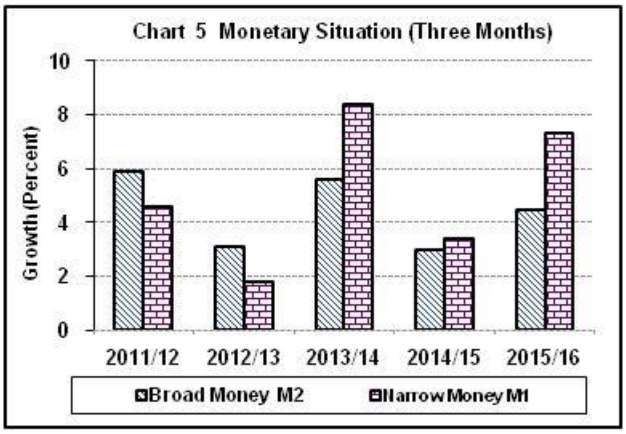
65. During the review period, the GoN made principal payment of Rs. 8.60 billion comprising Rs. 5.45 billion domestic debt and Rs.3.15 billion external debt.

66. Because of low government expenditure relative to resource mobilization, the cash balance of the GoN held at Nepal Rastra Bank surged to Rs. 84.62 billion as at mid-October 2015.

[1] Based on FCGO and Balance of Payment data.

Monetary Situation

Money Supply



67. Broad money supply (M2) increased by 4.5 percent in the first quarter of 2015/16 compared to an increase of 3 percent in the corresponding period of the previous year. Narrow money supply (M1) increased by 7.3 percent in the review period compared to an increase of 3.4 percent in the same period of the previous year. On y-o-y basis, M2 expanded by 21.6 percent and M1 expanded by 24.2 percent in mid-October 2015.

68. Net foreign assets (after adjusting foreign exchange valuation gain/loss) increased by Rs. 64.15 billion (8.6 percent) in the review period compared to an increase of Rs. 2.96 billion (0.5 percent) in the corresponding period of the previous year. Remarkable increase in remittance inflows along with the contraction in imports at a higher rate resulted in a large expansion of net foreign assets in the review period.

Domestic Credit

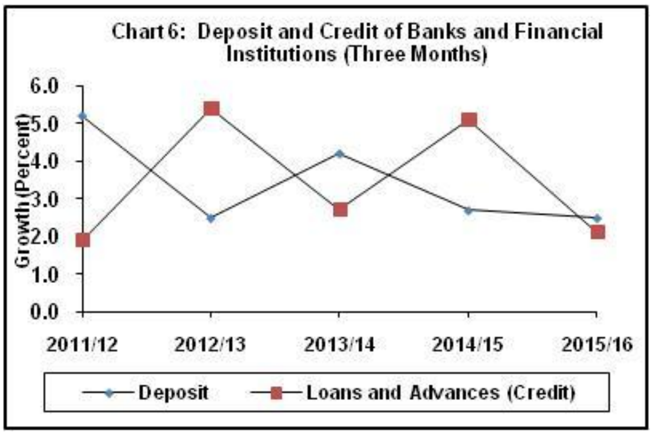
69. Domestic credit decreased by 0.9 percent in the review period compared to an increase of 2.1 percent in the same period of the previous year. On y-o-y basis, domestic credit increased by 12.2 percent in mid-October 2015. A rise in cash balances of the GoN with the NRB and the decelerated growth of claims on private sector resulted in a decline in domestic credit in the review period. Claims on the private sector increased by 2.9 percent in the review period compared to a growth of 5.4 percent in the corresponding period of the previous year. On y-o-y basis, claims on the private sector increased by 16.6 percent in mid-October 2015 compared to a growth of 19.8 percent a year ago.

Reserve Money

70. Reserve money increased by 5.8 percent in the review period compared to a decrease of 8.9 percent in the corresponding period of the previous year. On y-o-y basis, reserve money increased by 32.7 percent in mid-October 2015. Such growth of reserve money is attributed to the increase in the net foreign assets of this bank.

Deposit Mobilization

71. Deposits at banks and financial institutions (BFIs) increased by 2.5 percent (Rs. 42.19 billion) in the review period compared to a growth of 2.7 percent (Rs. 38.15 billion) in the corresponding period of the previous year. Deposits at commercial banks, development banks and finance companies increased by 2.2 percent, 3.5 percent and 3.8 percent respectively in the review period. In the same period of the previous year, deposits at commercial banks and finance companies had increased by 4.1 percent and 1.1 percent respectively. However, such deposits at development banks had decreased by 5.0 percent. On y-o-y basis, deposits at BFIs expanded by 19.8 percent in mid-October 2015.



Credit Disbursement

72. Loans and advances of BFIs increased by 2.1 percent (Rs. 32.75 billion) in the review period compared to a growth of 5.1 percent (Rs. 67.15 billion) in the corresponding period of the previous year. In the review period, loans and advances of commercial banks, development banks and finance companies increased by 1.7 percent, 2.9 percent and 6.1 percent respectively. Likewise, credit to the private sector from BFIs increased by 2.7 percent (Rs. 36.65 billion) in the review period compared to an increase of 5.3 percent (Rs. 59.53 billion) in the same period of the previous year. Private sector credit from commercial banks, development banks and finance companies increased by 2.6 percent, 3.3 percent and 2.5 percent respectively in the review period. On y-o-y basis, credit to the private sector from BFIs increased by 16.9 percent in mid-October 2015.

73. There has been a lower growth in credit disbursement in major areas such as industrial production, wholesale and retail trade, construction and agriculture. Credit to the industrial production sector increased by Rs. 4.39 billion (1.7 percent) in the review period compared to an increase of Rs. 19.95 billion (9 percent) in the same period of the previous year. In the review period, credit to the wholesale and retail trade sector, construction sector and transport, communication and public sector increased by Rs. 6.51 billion (2.2 percent), Rs. 3.27 billion (2.1 percent) and Rs. 5.29 billion (8.8 percent) respectively. The credit to the wholesale and retail trade sector, construction sector and transportation, communication and public service sector had increased by Rs. 22.75 billion (9.3 percent), Rs. 8.63 billion (7.2 percent) and Rs. 2.84 billion (6 percent) respectively in the same period of the previous year. In the review period, credit to the agriculture sector decreased by Rs. 862 million (1.3 percent) compared to an increase of Rs. 2.71 billion (5.3 percent) in the corresponding period of the previous year.

74. In the first quarter of 2015/16, the banks and financial institutions extended 59.2 percent of their total credit against the collateral of house and land, and 13 percent against the collateral of current assets (such as agricultural and non-agricultural products). Such ratios were 58.9 percent and 13.7 percent respectively in the same period of the previous year.

75. In the review period, commercial banks' credit to government enterprises decreased by 36.3 percent to Rs. 7.87 billion. Such credit had increased by 5.9 percent in the same period of the previous year.

76. Of the total lending of commercial banks, the credit to small and medium industries is only 2.4 percent (Rs. 27.17 billion) in the review period. Insufficient collateral has been one of the major constraints for SME finance in Nepal. The implementation of secured transaction registry will help to address this problem. Although the Secured Transaction Act, 2006 is already in place; the delay in establishment of secured transaction registry office has affected the registration process.

Liquidity Management

77. In the first quarter of 2015/16, the NRB mopped up Rs. 57.25 billion liquidity through deposit collection auctions, Rs. 56.30 billion through reverse repo auction and Rs. 9.10 billion through outright sale auction on cumulative basis. The outstanding deposit collection auction amounted to Rs. 57.25 billion as at mid-October 2015. In the corresponding period of the previous year, Rs. 40 billion was mopped up through deposit collection auction and Rs. 187 billion through reverse repo auction.

Box 8: The Cost of Liquidity Absorption (Rs. in million)

Liquidity Absorption Instruments	2014/15 (Annual)		2015/16 (Three Months)	
	Amount	Interest Expenses	Amount	Interest Expenses
Deposit Collection Auction	155000	170.5	57250	196.9
Reverse Repo Auction	315800	2.8	56300	5.3
Outright Sale Auction	6000	17.3	9100	29.0
Total	**476800**	**190.6**	**122650**	**231.2**

78. In the review period, the NRB injected net liquidity of Rs. 117.46 billion through the net purchase of USD 1.13 billion from foreign exchange market (commercial banks). Net liquidity of Rs. 72.01 billion was injected through the net purchase of USD 801.6 million in the corresponding period of the previous year.

79. The NRB purchased Indian currency (INR) equivalent to Rs. 62.40 billion through the sale of USD 600 million in the review period. INR equivalent to Rs. 83.68 billion was purchased through the sale of USD 860 million in the corresponding period of the previous year.

80. In the first quarter of 2015/16, total interest expenses incurred in mopping up liquidity of Rs. 122.65 billion through various instruments, on cumulative basis, reached Rs. 231.2 million. Such cost incurred in mopping up liquidity of Rs. 476.80 billion throughout 2014/15 was Rs. 190.6 million (Box 8). Slower growth of credit in relation to increased deposit mobilization accompanied by higher remittance inflows have resulted in excess amount of liquidity in the banking system, thereby increasing the costs of liquidity management. Unrest in southern plain as well as the unofficial economic blockade on Indo-Nepal transit points are attributable to lower credit growth.

Reinstatement of Bank Branches Closed during the Conflict Period

81. Of the total 284 closed during the conflict period, 54 branches of Agriculture Development Bank Limited, 47 branches of Rastriya Banijya Bank Limited and 26 branches of Nepal Bank Limited have been reinstated till mid-October 2015. Of the remaining, 13 of ADBL, 50 of RBB and 94 of NBL are in the process of reestablishment. Thus, of the total 284 public sector bank branches closed during the conflict period, 127 branches have been re-established and 157 branches are still in the process of re-establishment.

Box 9: Reinstatement of Bank Branches Closed during the Conflict Period

Particulars	Total	Nepal Bank Ltd.	Rastriya Banijya Bank Ltd.	Agriculture Development Bank Ltd.
Total closed branches	284	120	97	67
Reinstated branches	127	26	47	54
In the process of reinstatement	157	94	50	13

Financial Deepening Indicators

82. In the first quarter of 2015/16, the ratios of broad money, domestic credit, private sector credit and total deposits to GDP have increased compared to that of the previous years, indicating improvement in financial deepening (Box 10).

Box 10: Financial Deepening Indicators

(Percent)

Indicators	Mid-October		
	2013	**2014**	**2015***
M2/GDP	71.5	75.9	92.4
Domestic Credit/GDP	63.7	68.0	81.5
Private Sector Credit/GDP	60.3	63.1	70.8
Total Deposits/GDP	[illegible]	57.1	66.6

Financial Broadening

83. Expansion of branch network of BFIs has contributed to widen the access to finance. The branch network of BFIs reached 3,958 in mid-October 2015 from 3,617 a year ago. Likewise, the growth in the deposit and loan accounts has also contributed to broaden the financial access (Box 11).

Box 11: Financial Broadening Indicators

Headings	Mid-October	
	2014	**2015**
Number of BFIs	197	194
Branches of BFIs	3,617	3,958
Number of ATM/Debit Card *	41,29,711	45,31,787
Number of Credit Card	59,352	45,554
Number of Deposit Accounts *	1,31,12,881	1,49,34,618
Number of Loan Accounts *	9,37,873	10,33,384

* As of mid-September

Refinance and Productive Sector Lending

84. The NRB has been providing refinance facility to enhance productive sector lending. Utilization of such facility has decreased in the review period.

85. In the review period, a total refinance of about Rs. 1.39 billion including general refinance of Rs. 1.29 billion and export refinance of Rs. 0.10 billion has been provided. In the corresponding period of the previous year, a total refinance of Rs. 1.96 billion including general refinance of Rs. 1.32 billion and export refinance of Rs. 0.64 million was utilized.

86. This bank has issued necessary directive to provide refinance facility to banks and financial institutions aimed at promoting the housing loan at 2 percent concessional interest to the earthquake affected victims. It is expected that the demand for this loan will take place along with the commencement of the government led rehabilitation and reconstruction work.

87. 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 out of their total loans and advances stood at 15.8 percent in mid-October 2015.

Inter-bank Transaction and Standing Liquidity Facility

88. In the review period, inter-bank transactions of commercial banks stood at Rs. 185.59 billion and those of other financial institutions (excluding transactions among commercial banks) amounted to Rs. 18.31 billion. Such transactions had amounted to Rs. 80.12 billion and Rs. 40.04 billion respectively in the corresponding period of the previous year. The BFIs did not use standing liquidity facility (SLF) in the review period.

Interest Rates

89. Weighted average of 91-day Treasury Bill rate has increased while the inter-bank transaction rate has decreased in the third month of 2015/16 compared to a year ago. The weighted average 91-day Treasury Bill rate increased to 1.10 percent in the review month from 0.93 percent a year ago. On the contrary, the weighted average inter-bank transaction rate among commercial banks that was 1.03 percent a year ago declined to 0.64 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions decreased to 2.10 percent from 2.55 percent a year ago.

90. Weighted average interest rate spread between deposit and lending rate of commercial banks inched down to 4.34 percent from 4.83 percent a year ago and the average base rate came down to 7.22 percent from 7.73 percent a year ago.

Status of Non-performing Loans of BFIs

91. In the review period, the overall ratio of non-performing loans (NPL) to total loans of BFIs has slightly decreased. The ratio has inched down from 3.33 percent in mid-July 2015 to 3 percent in mid-September 2015. Such ratio was 3.63 percent a year ago.

Status of Merger and Acquisition of Banks and Financial Institutions

92. The number of BFIs opting for merger has been increasing after the introduction of merger policy that was aimed at strengthening financial stability. After the issuance of the "Bank and Financial Institutions Merger By-law, 2011", 83 BFIs have merged with each other resulting in the formation of 31 BFIs as of mid-October 2015. In the review period, 2 finance companies were acquired by a commercial bank and one development bank was acquired by another development bank.

Regulatory Measures

93. In the review period, the NRB has issued directives pertaining to branch acquisition of problematic bank by another under specified provisions, special refinance facility up to Rs. 0.5 million for extending credit to agriculture and small enterprises in the specified 10 districts of high poverty incidence and bordering VDCs and municipalities of specified districts in the Southern regions and opening branches in these areas without approval from the NRB. Further, additional directives relate to including the credit extended to the organized sector operating public city transport services under productive sector lending and replacing magnetic strip cards by chip-based card, among others. Likewise, the existing provision for submitting the net clearing position of BFIs through electronic channel by Nepal Clearing House Ltd. to Banking Office has been modified in five specified sessions from the existing ones. Similarly, BFIs are required to make their capital plan as per the monetary policy provision, public through their own websites.

Macro prudential Regulation

94. There is a provision to limit credit in real estate sector at 25 percent of total credit disbursement. Such credit flow of BFIs amounted to Rs. 210.89 billion (including Rs. 122.07 billion residential home loans less than Rs. 10 million each) as at mid-October, 2015. This is 15.1 percent of total credit exposure of BFIs. As at mid-October 2015, the BFIs' total margin lending extended against the collateral of shares stood at 1.8 percent (Rs. 25 billion) of their total credit exposure.

95. There are provisions to maintain Loan-to-Value (LTV) ratio at 60 percent while lending in real estate sector, single obligor limit not to exceed 40 percent of the total loans and advances, Statutory Liquidity Ratio (SLR) at 12 percent of total deposits for commercial banks and 9 percent and 8 percent for development banks and finance companies, which collect current and call deposits respectively.

96. Mandatory credit-deposit (local currency deposit and including core capital) ratio is 80 percent. Such ratios of commercial banks, development banks and finance companies stood at 71.97 percent, 70.05 percent and 75.21 percent respectively as at mid-September 2015. This shows that BFIs have additional room for credit disbursement.

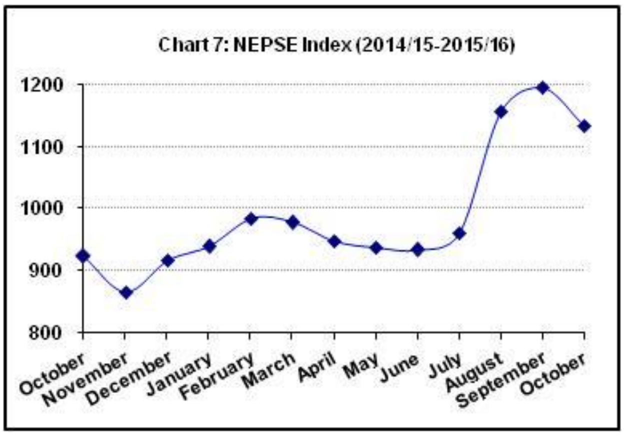
97. To manage the risk that occurs because of higher institutional deposits in the deposit structure of BFIs, there is a provision for commercial banks to limit institutional deposit at 60 percent of their total deposit. Share of such deposits at BFIs remained at 48 percent as at mid-October2015.

98. Commercial banks are required to maintain 10 percent capital fund ratio of the risk weighted assets and development banks and finance companies are required 11 percent each. Such ratios of commercial banks, development banks and finance companies were 11.94 percent, 16.14 percent and 21.58 percent respectively as at mid-September 2015. BFIs are required to maintain capital buffer of 1 percent or more in addition to capital adequacy ratio (CAR) before they distribute dividend.

99. While there is no limit for commercial banks in deposit collecition, development banks and finance companies can collect financial resources up to 20 times and 15 times of their core capital respectively. Accordingly, development banks' and finance companies' resources collection stood at 6.9 times and 5.1 times of their core capital respectively as at mid-October 2015.

Securities Market

100. NEPSE index increased by 22.8 percent to 1,134.5 points in mid-October 2015 on y-o-y basis. This index had increased by 61.6 percent to 923.6 points a year ago. The Index started to surge with the rise in investors' confidence due to the provision of monetary policy of 2015/16 relating to the hike in the paid-up capital of BFIs, and the speed-up in the constitution making process.



101. The stock market capitalization on y-o-y point basis increased by 23.4 percent to Rs. 1169.36 billion in mid-October 2015. The ratio of market capitalization to GDP of 2014/15 stood at 55.0 percent in mid-October 2015 compared to 48.8 percent a year ago.

102. Of the total market capitalization in mid-October 2015, the share of banks and financial institutions (including insurance companies) stood at 81.4 percent, hydropower 5.3 percent, manufacturing and processing companies 2.8 percent, hotels 2.1 percent, trading 0.1 percent, and others 8.3 percent respectively.

103. Total number of companies listed at the NEPSE decreased from 235 in mid-October 2014 to 232 in mid-October 2015 due to the merger of some BFIs. Of the total listed companies, the number of BFIs (including insurance companies) stood at 197 followed by manufacturing and processing industries (18), hydropower (7), hotels and trading (4 each) and other companies (2).

104. On y-o-y basis, total paid-up capital of the listed companies increased by 25.3 percent to Rs. 217.88 billion in mid-October 2015. Within the third month of 2015/16, the total securities worth of Rs.4.56 billion was listed in the NEPSE, in which the value of ordinary share was Rs. 633 million, right share was Rs. 380 million, bonus shares was Rs. 2.45 billion and the debenture was Rs. 1.1 billion.