Macro Economic Situation

1.1 Real Sector

Nepalese economy experienced growth rate of 2.5 percent in the year 2006/07 which is very low in comparison to the past five year's growth. Despite the dialogue and peace agreement between the major political parties which induce to anticipate higher growth rate in the year, the growth of economy remained less than satisfactory due to unfavorable weather condition and regional political tension throughout the year.

Real GDP growth (base year 2000/01) at producer prices in FY 2006/07 remained only 2.50 percent. The slow growth rate has been caused by lower agriculture production growth. In the FY 2006/07, the growth rate of agricultural products and non-agricultural products were 0.70 percent and 3.60 percent respectively.

In FY 2006/07, GDP at current prices rose by 11.29 percent to Rs. 719.50 billion where as in FY 2005/06 it has increased by 9.68 percent to Rs. 646.50 billion.

The contribution of agriculture and non-agriculture sectors in terms of constant price GDP in FY 2006/07 has been 36.1 percent and 63.9 percent respectively as compared to the respective contributions of 36.8 percent and 63.2 percent during the previous years, thereby reflecting a decline of 0.7 percentage-point in the contribution of agriculture and the same percentage-point rise in the contribution of non-agriculture during the current year.

In terms of GDP structure at constant price, the contributions of major sectors like agriculture are estimated at 36.1 percent, Wholesale and Retail Trade 13.1 percent, Transport, Communications and Storage 8.7 percent, Real estate and professional service 7.5 percent, Industry 7.8 percent, Construction 6.1 percent and Education 5.9 percent.

While analyzing the GDP performance by classifying economic activities into three major groups, namely, Primary (Agriculture and Forest, Fisheries, and Mining and Quarrying), Secondary (Industry, Electricity, Gas, Water and Construction), and Tertiary (rest of the services sectors), it is estimated that the primary sector increased by 0.72 percent, secondary sector by 2.06 percent and 4.09 percent increment is estimated in the Tertiary sector during the fiscal year 2006/07.

According to new series of accounting published by the Central Bureau of Statistics the per capita GDP at current price estimated to have increased by 8.85 percent to Rs. 27,209. Such rise last year was 7.28 percent to Rs. 24,996. In US dollar terms, per capita GDP at current price is estimated to be $383 this year, a rise of US$ 33 from last year's level.

From the demand side, consumption at constant price this year is estimated to have increased by 2.00 percent to Rs 482.35 billion. It had increased by 5.8 percent to Rs. 472.97 billion in last year. The ratio of total consumption to GDP is estimated to be 92.3 percent this year while such ratio was 92.8 percent last year.

Table 1: Real Sector Indicators

Indicators	Unit	Fiscal Years				
		2002/03	2003/04	2004/05	2005/06	2006/07*
Real GDP (at producer price)	Annual % Change	3.9	4.7	3.1	2.8	2.5
GDP (at constant price)	,,	3.4	5.1	3.0	3.3	2.5
Agriculture	,,	3.3	4.8	3.5	1.1	0.7
Non-Agriculture	,,	3.5	5.3	2.8	4.6	3.6
GDP (at current producer price)	,,	7.1	9.0	9.8	9.7	11.3
Ratio with GDP (at current producer price) :						
- Gross Domestic Saving	%	8.6	11.8	11.6	7.9	9.4
-Gross Investment	%	21.4	24.5	26.5	26.0	25.3
-Difference between Domestic Saving & Investment	%	-12.8	-12.8	-14.9	-18.1	-16.0
-Total Consumption	%	91.4	88.3	88.4	92.1	90.6

*Annual preliminary estimates (first 8 month)
Source: Economic Survey 2007

Out of the total consumption, government and private sectors' estimated contribution is 9.9 percent and 88.2 percent respectively whereas last year's corresponding shares were 10.0 percent and 88.2 percent. Private sector's consumption had increased by 6.4 percent last year and is estimated to have increased by 1.9 percent this year. Similarly the consumption of the government sector is estimated to increase by 0.46 percent this year over the growth of 0.80 percent last year.

National Disposable Income at current price is estimated to have increased by 10.3 percent to Rs 857.62 billion. Such income had increased by 12.9 percent to Rs 777.57 billion last year.

In the current fiscal year, Gross Domestic Saving at the constant price is estimated to go up by 9.1 percent to Rs 40.32 billion. It had fallen by a high rate of 24.7 percent to Rs 36.94 billion. The ratio of Gross Domestic Saving to GDP is estimated at 7.7 percent this year, which has stood at 7.2 percent in last year.

Gross Capital Formation at constant price is estimated to have decreased by 6.1 percent to total Rs 106.52 billion compared to the reduction of 0.8 percent last year. The ratio of Gross Capital Formation to GDP is estimated at 20.4 percent this year which stood at 22.3 percent last year.

1.2 Financial Sector

In terms of number and financial deepening, financial sector is growing remarkably after the introduction of financial sector reform program in the country. A total number of 16 new bank and financial institutions were established in 2006/07. These included 2 commercial banks, 9 development banks, 4 finance companies and a micro-finance institution. With these new institutions 20 commercial banks, 38 development banks, 12 micro-finance institutions, 74 finance companies, 17 cooperatives (licensed by NRB) actively have been operating in this sector. In addition, there are 47 financial non-government agencies operating under the license of NRB. There are many more savings and credit cooperatives operating in the field under the license of Cooperative Department. Total number of such cooperatives by mid-July, 2006 was 2912.

Deposit collection of commercial banks increased by 15.3 percent in the FY 2006/07 to Rs.334.45 billions. Similarly loans and advances (principal and interest) amounted to Rs. 340.35 billions which increased by 10.7 percentages over previous year.

By mid-January 2007, total assets/liabilities of 35 development banks amounted to Rs 17 billions. Total fund of the finance companies by mid-January 2007 amounted to Rs 45 billions with an increase of 11.3 percent in the first 6 months of FY 2005/06 followed by the increase of 15.8 percent during the similar period of FY 2006/07. Total resources of micro-finance companies amounted to Rs 9.42 billions in the first 6 months of FY 2006/07 with an increment of 15.0 percent.

Non-bank institutions include Employees' Provident Fund (EPF), Citizen Investment Trust (CIT) and Insurance Companies. Total loan distributed by the EPF reached Rs 3127.3 millions in the first eight months of FY 2006/07 compared to Rs 2957.4 millions in the same period last year. In the fiscal year 2006/07 total assets/ liabilities of the CIT is estimated to be increased by 16.2 percent to the total of Rs 8,420 millions.

There are 21 insurance companies in operation by mid-May 2007 which include 4 life, 16 non-life, and 1 life and non-life insurance companies. Investments of life-insurance companies are estimated to have increased by 15.0 percent this year to reach a total of Rs. 14.16 billions whereas the investment of non-life is estimated to be increased by 24.5 percent to give the total amount of Rs 40.7 millions in this year.

1.3 Inflation

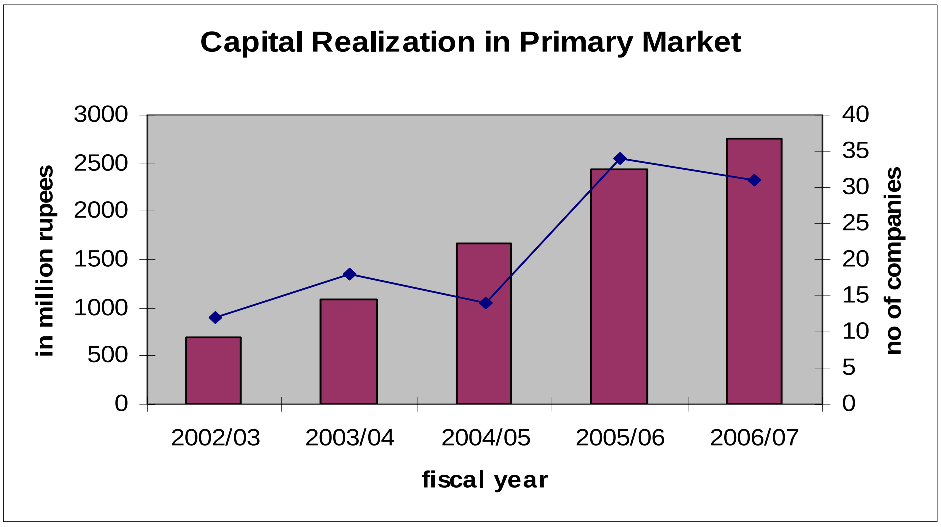
The average annual consumer inflation moderated to 6.4 percent in FY2006/07 from the level of 8.0 percent in 2005/06. The inflation year-on-year also moderated to 5.1 percent in mid-July 2007 from the level of 8.3 percent in the corresponding month of previous year.

According to Nepal Rastra Bank, the deceleration in the growth of non-food and services group index was largely on account of the base effect of the hike in prices of petroleum products in March 2006. The appreciation of the Nepalese currency against the US dollar also contributed to dampen the prices of imported goods.

Share Market

2.1 Primary Market

In FY 2006/07 Security Board of Nepal (SEBON) granted permission to 31 different companies for mobilization of Rs 2.75 billion as against Rs. 2.44 billion realized by 34 different companies during the preceding year. Although the number of capital mobilizing companies has decreased during the year, amount of capital mobilization has risen by 12.85 percent. Following chart shows the capital mobilization trend of 5 fiscal years in the primary market.



Source: Security Board of Nepal

2.2 Secondary Market

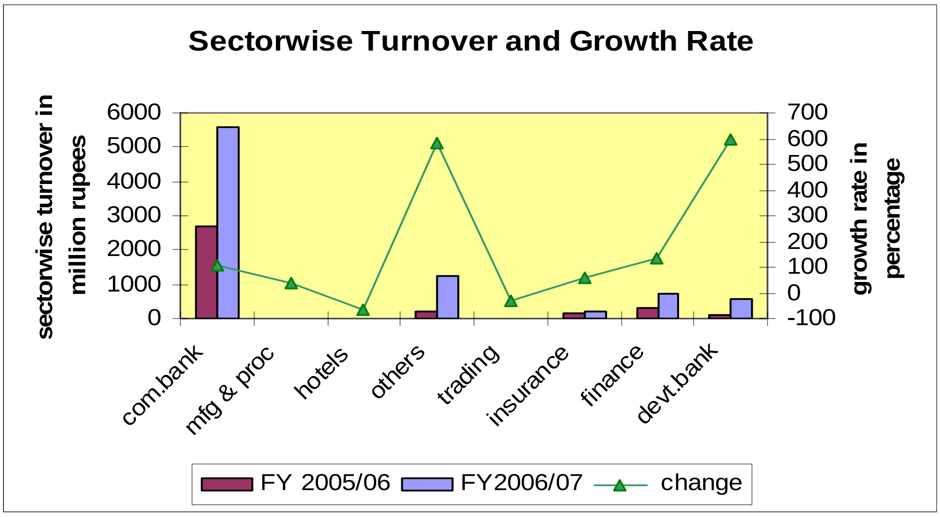
FY 2006/07 proved to be a remarkable year for share market. With the restoration of peace and subsequent boost of investor confidence major indicators of share market grew tremendously. It would be remembered as a boom year for Nepalese Stock Market. Almost all the previous records of the securities market have been shattered in the year.

Major indicators of secondary market like amount of share traded, number of listed share, number of transaction, annual turnover, total market capitalization of listed shares, market capitalization and the GDP ratio, turnover to market capitalization and the GDP ratios all increased in the review period.

2.2.1 Turnover

Compared to previous year's transaction of the shares on the basis of amount it increased by 142 percent to Rs. 8.36 billion in FY 2006/07 while the number of transactions increased by 23.76 percent to 12.05 million. It was 9.73 million in preceding year. The number of companies share traded during the year increased by 5.45 percent to 116 which was 110 a year before. Similarly, the number of ordinary shares traded during the review period was 181.47 m. which is 48.48 percent increment over previous year.

The daily average trade size recorded in the year was Rs. 36.03 million as the market floor opened 232 days for trading.

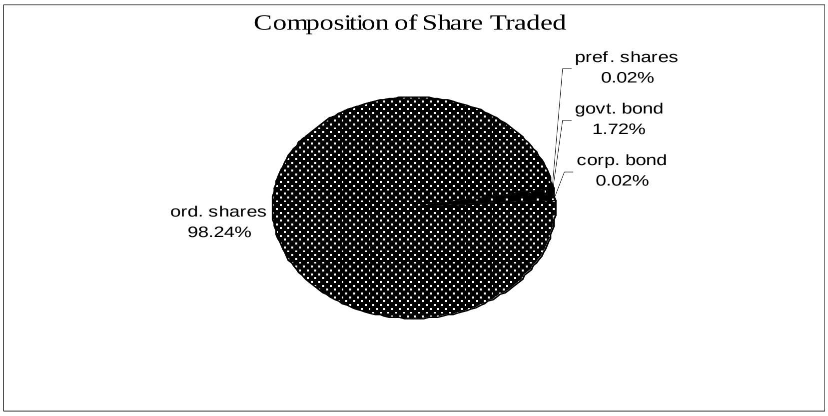


In the total turnover, the banking sector dominates others. In the review period total turnover of the banking sector was Rs. 5.56 billions which is 66.54 percent of total turnover. Other sector (mainly hydropower companies) came in second place on the basis of annual turnover. This sector's turnover was Rs. 1.25 billion which is accounted to 15.05 percent of the total transaction. In the same way, financial sector occupied 8.53 percent, development bank sector 6.90 percent, manufacturing and processing sector 0.29 percent, trading sector 0.12 and hotel sector 0.08 percent.

The turnover of the development banking sector and the other sector increased by approximately six fold compared to previous year. Similarly commercial bank, finance companies posted good rate of growth on the basis of turnover while insurance companies, manufacturing and processing companies posted relatively moderate rate of growth but hotel and trading companies' decline.

However, the composition of traded securities doesn't show the balanced figure. Buying and selling of securities other than ordinary shares rarely occurred in the secondary market during the review period. A total of 31,800 (1.72 percent of securities traded) government bond amounting Rs. 366.77 millions have been traded in 7 transactions during the year. Similarly, corporate bond occupies 0.02 percent in the composition of securities traded. In the review period 3570 corporate bond amounting Rs.3.57 millions have been traded in 11 transactions.

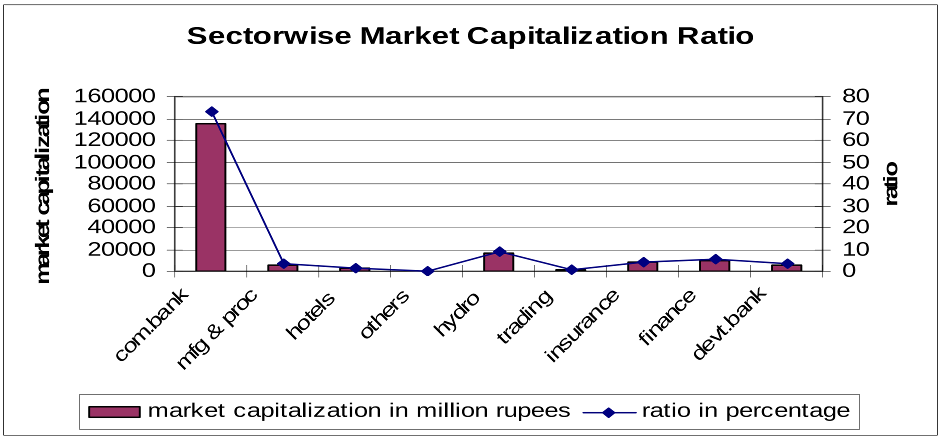
The number of Preferential Shares transaction was 6, quantity of traded share was 3300 and amount of traded shares was Rs. 330,300. By the number of shares traded it is 0.02 percent in the total. The quantity of ordinary shares traded was 18.14 million, which is 98.24 percent of the total share traded during FY 2006/07.



Looking at the turnover to market capitalization and to the GDP ratios it was 4.48 and 1.12 percent respectively. This is a slight improvement over to previous years', 3.57 and 0.6 percent.

2.2.2 Market Capitalization

Total market capitalization of listed shares increased by 92.53 percent to Rs.186.30 billion. The Central Banks' directives to increase capital base of banks and financial institutions have major impact on market value of listed shares. Most of the companies opted to issue bonus and right share to increase their capital base. It created buying pressure on market as investor attracted by the offering of bonus shares and right share.



The market capitalization to GDP ratio reached at 25.90 percent this year. It is a notable increment over previous years' 17.35 percent level. But, compared to other developed stock market the ratio is still meager.

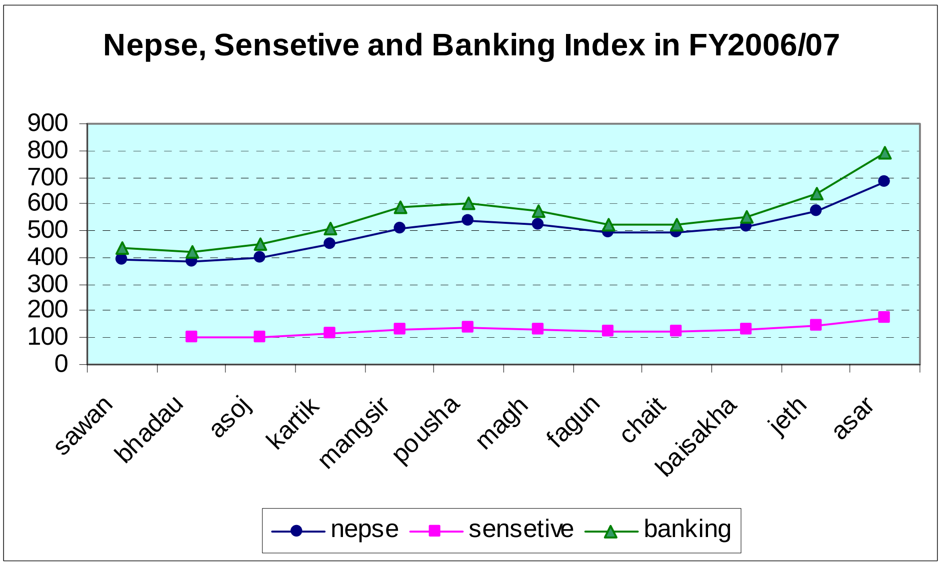
The commercial bank group again stood first at contribution to market capitalization. Market capitalization of the commercial bank group touched 135.58 billion rupees in FY 2006/07 which is 72.77 percent of the total market capitalization. Hydropower companies occupied 8.88 percent in the total market capitalization. Similarly, share of finance companies in the total market capitalization was 5.3 percent, insurance companies 4.32, development banks 3.22 , manufacturing and processing 3.32, hotels 1.7 percent, trading 0.42 and others 0.01 percent.

2.2.3 Indices

Due to whopping increment in the share prices of banks, financial institutions, hydropower companies and development banks, NEPSE index almost doubled over the year. Restoration of peace, improvement in listed companies' financial performance and most importantly the Central Bank's direction dated 26 March 2007, to double paid up capital for banks and financial institution, contributed to remarkable increment in share prices and subsequently the stock market indices.

The stock market opened with NEPSE index 386.83 points at the beginning of the FY 2006/07 and end with 683.95 points during the year. It was recorded high of 683.95 on 16 July, 2007, and low of 355.60 on 3 August, 2006. During the year it beat the record of 545.82 set in FY 2000/01.

The Sensitive index, unveiled from 1 January 2007 which shows the price movement of the companies categorized under Class A reached 175.08 point (which is also a highest point Sensitive index touched) at the end of year registering a rise of 75.08 points. It was recorded low to 98.21 on 14 September, 2006.

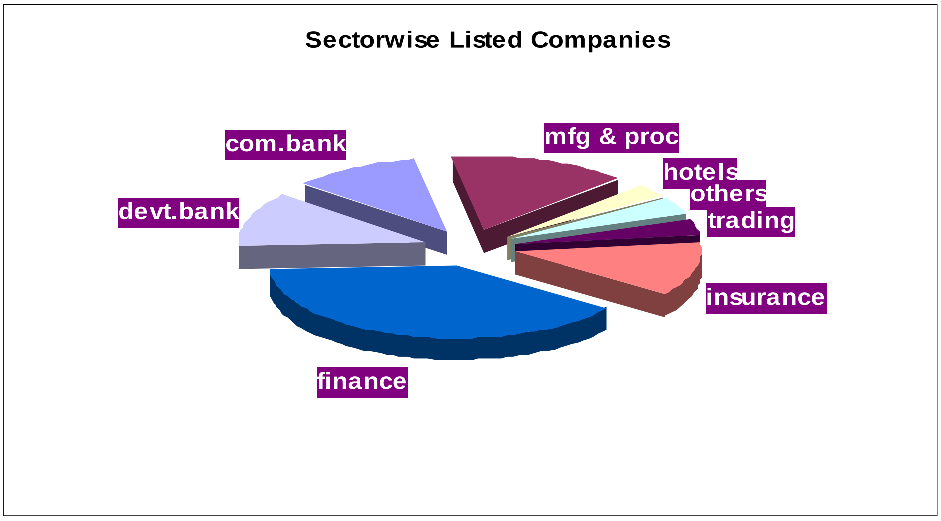


Banking Index went up by 344.22 points to reach at 789.21 during the year. Banking Index measures the transaction of companies listed under commercial bank group which occupied 66.45 percent of overall turnover in FY 2006/07. Banking Index touched the lowest point 387.37 on 3 August, 2006.

2.2.4 Listing and de-listing

The total number of listed companies in FY 2006/07 was 147 with listing of 12 new companies. However the number of listed companies at the end of fiscal year remain the same (135) as of previous years' with the delisting of 12 companies on 5 March 2007.. This is second time in NEPSE history while on 17 July 2002 it had de-listed 25 companies. De-listed companies have been either already closed, or have not held Annual General Meetings or have no audited results for more than two years. Altogether 3.64 million shares amounting Rs. 384.24 million have been de-listed.

At the end of FY 2006/07 there were 15 companies listed under commercial bank group. Similarly, there were 16 companies in development bank group, 16 companies in insurance group, 53 companies in finance group, 21 companies in manufacturing and processing group, 4 companies in hotel group, 5 each in trading and other group. Prices of listed share reached Rs. 21.74 billion during FY 2006/07, which rose 8.96 percent over the previous year.



The number of listed securities other than corporate and government bond upto FY 2006/07 reached to 243.50 million which was 226.54 million in previous year and the increment is 7.48 percent. During the year 10.71 million ordinary share amounting Rs. 1071.40 million, 9.14 million rights share amounting Rs. 914.39 million, 10.25 million bonus shares amounting Rs. 1025.73 million, 1.81 million corporate debenture amounting Rs. 1810.00 million and 330.00 million government bond amounting 3300.00 million listed for trading. As mentioned above, during the same period 3.64 million shares amounting Rs. 384.24 million have been de-listed.

2.2.5 Classification of Companies

NEPSE has classified 66 companies under the 'A' category on 12 February 2007 while there were 56 companies under this category last year. New 12 companies have been upgraded from category 'B' to ‘A’ and 2 companies owing to their poor performance have been degraded. Companies earning profit consecutively for three years with at least 1000 shareholders and paid up capital Rs. 20 million are listed under category 'A'.

2.2.6 Other Developments

With a view to initiate the reform in stock market as well as institution NEPSE has taken some important steps which have been underlined below:

A. Market Stabilizing Measures

Stock Exchange has initiated some important measures toward stabilizing share prices. Such measures include abolition of matching transaction, beginning of trading halt system through circuit breaker. In addition, it has also taken step towards managing blank transfer.

As a result of revising capital structure of commercial banks through the announcement of Monetary Policy for FY 2006/07 by Nepal Rastra Bank, the share price of such banks declined substantially, resulting volatility in the commercial banks-dominated stock market. Thus, with a view to stabilize the stock market, NEPSE introduced a system of trading halt through circuit breaker on banking group on the one hand and on the other, it abolished matching transaction of such banks to be effective from August 2, 2006. As this measure/provision helped to increase the stability of market, on September 17, 2006 Membership of Stock Exchange and Transaction Byelaws- 2055 has been amended along with abolishment of matching transaction so that such provision could be implemented at all sectors. In addition, blank transfer has also been made systematic. As per the amendment, NEPSE can halt the share trading of respective listed companies by imposing the circuit breaker whenever share prices of the companies move up or down over 10 percent in a single day transaction. As per the provision, a total of 50 circuit breakers were imposed on the share transactions of different companies during the current fiscal year..

Under the systematized blank transfer system popularly known as B.T., the investor who intends to resale the share purchase for market benefit can register it within T+ 5. If the investor changed the mind and decides to transfer it s/he can do. Previously there was no time limit for it and investors used to register it as and when they required. But now it is mandatory to decide about blank transfer or ownership transfer. These measures aim to create awareness among investors, and to avert possible panic at the stock market.

B. Trading Automation

To develop Computerized Trading System (CTS) NEPSE has made an agreement with the British Company Comdaq Limited in November, 2006 under the Asian Development Bank (ADB) loan assistance project- Corporate and Financial Governance (CFG) at the cost of 300,000 US dollar. The project is targeted to be completed by mid August 2007 which aims to substitute the present open out cry system by electronic system.

C. Trading of the Government Bonds Started

Stock Exchange has started secondary trading of the government bonds on 29 December 2006 through the formal inauguration by finance minister Dr. Ram Sharan Mahat. On the first day bonds worth Rs. 7 hundred thousands were traded. The objective of the secondary trading of the bond is to boost the liquidity and reduce the cost of borrowing of the government. However, investors' response to government bond was not encouraging. Low number of individual investors and differential income tax on interest for individual and corporate were the major reason for minimal transaction of the bond.

D. Sensitive Index

With the objective of providing real information of the 'A' graded companies share price movement Stock Exchange unveiled a sensitive share price index from 1 January 2007. The sensitive index is calculated with 16 July 2007 as base period includes all 'A' class listed companies. There are 66 companies categorized into 'A' class, while the total number of listed companies is 135. To fall into 'A' category, the listed company must have at least Rs 20 million as its paid-up capital, 1,000 share holders, market value higher than the paid-up value, and must record profits for three consecutive years.

E. Organizational reform

In order to make its core business more efficient and smooth NEPSE has started organizational reform. NEPSE introduced the new organizational chart, and it also introduced Voluntary Retirement Scheme (VRS) under which 45 percent staffs opted for the VRS, while process of recruiting fresh and competitive professional manpower have been started. Similarly it also started outsourcing of non–core business like security and cleaning services.