1. Economic Activities

World Economy

Economic Growth

1.1 The global economy is encountering the first ever post World War II era big economic crisis. As a result, the world economy is expected to face dual problems of negative impact on domestic demand and economic growth on the one hand, and contraction of global exports and imports on the other. The consequence of reduced employment opportunities caused by the slowed down economic activities reflected in income vulnerability of the people will make them face severe livelihood problems. As compared to expansion in global economy by 5.1 percent, 5.2 percent and 3.2 percent in the years 2005, 2006, and 2007 respectively, it is estimated to turn negative by 1.3 percent in 2009. The global economy, however, is estimated to grow by 1.9 percent in 2010 if economic stimulus packages could be successfully adopted and executed. The estimated growth, as compared to growth rates achieved between 2006 and 2008, would still be quite low making outcome of troubled global financial and economic crisis clearly being felt. The following table provides clear picture how gradual slowdown appeared in aggregate global economic growth in 2008 as compared to years 2006 and 2007 expected to witnessing negative growth in 2009 among some groups of economies including advanced and newly industrialized Asian economies and slow down in economic growth rates in other groups namely, Newly Emerged and Developing Economies , African countries and Middle- East Countries.

Table 1 (a) : World Economic Growth rate

(Annual Percentage Change)

	2006	2007	2008	Forecast	
				2009	2010
World Output	5.1	5.2	3.2	-1.3	1.9
Advanced Economies	3.0	2.7	0.9	-3.8	0.0
Newly Emerged and developing	8.0	8.3	6.1	1.6	4.0
Developing Asia	9.8	10.6	7.7	4.8	6.1
African Countries	*6.1*	6.2	5.2	2.0	3.9
Middle-East Countries	5.7	6.3	5.9	2.5	3.5
Newly industrialized Asian	5.6	5.7	1.5	-5.6	0.8

Source: International Monetary Fund (World Economic Outlook), 2009

Consumer Price

1.2 Consumer Price Index (CPI) based inflation does not seem to come down in proportion to slowdown observed in economic growth. For instance, while economic growth rate of developed countries recorded 2.7 percent in 2007, the rate of inflation in those countries remained at 2.2 percent, which rose to 3.4 percent with downslide in growth rate to 0.9 percent in 2008. Similarly, with 3.8 percent negative growth forecast for economies of the same group of countries, corresponding inflation rate is estimated to be negative by 0.2 percent only. The characteristic of economic growth rate and inflation seem to be similar in case of newly emerged and developing countries as well. The following table clarifies such a trend:

Table 1 (b) : CPI Based Rate of Inflation

(Annual Percentage Change)

	2006	*2007*	*2008*	*Forecast*	
				2009	*2010*
Advanced Economies	*2.4*	*2.2*	*3.4*	*-0.2*	*0.3*
Newly Emerged and developing Economies	*5.4*	*6.4*	*9.3*	*5.7*	*4.7*
Developing Asia	*4.2*	*5.4*	*7.4*	*2.8*	*2.4*
African Countries	*6.3*	*6.3*	*10.1*	*9.0*	*6.3*
Middle-East Countries	*6.8*	*10.5*	*15.6*	*11.0*	*8.5*

Source: International Monetary Fund (World Economic Outlook), 2009

Net Aggregate Domestic Demand

1.3 The effect of present financial and economic crisis in the global economy on economic growth and inflation will be reflected in aggregate domestic demand. As there will be a reduction of employment opportunities with adverse impact on income of the people, demand for domestic and external goods and services for consumption and investment will also decrease thereby causing decline in aggregate demand, and ultimately stagnating the growth of the economy. The following table makes clear the status of demand forecast made for some developed and emerging Asian economies. It is clear that decline in demand of developed and newly emerging industrialized economies will have notable effect on the world economy.

Table 1(c) : Net Domestic (Household) Demand

(Annual Percentage Change)

	2006	***2007***	***2008***	***Forecast***	
				2009	2010
Advanced Economies	*2.8*	2.3	0.4	-3.3	0.0
United States of America	2.6	1.4	-0.3	-3.3	0.2
EU Countries	2.8	2.4	0.9	-2.9	-0.6
United Kingdom	*2.6*	3.5	0.6	-4.8	-1.0
Canada	*4.7*	4.3	2.4	-3.2	1.3
Newly Industrialized l Asian Economies	4.2	4.5	1.7	-5.4	0.7

Source: International Monetary Fund (World Economic Outlook), 2009

1.4 It can be concluded that reduction in domestic investments in the above-mentioned economies will hamper the vitality of economic activities thereby resulting in reduction in employment. Because of overall fall in demand, demand for labors from developing countries employed in those countries could also be curtailed. Possibility of aggregate fiscal imbalance looming large with decline in the flow of remittance, which occupies a major place among the sources of income for some countries, is going to be a matter of their concern. In addition, there is the possibility of decline in exports from developing countries to developed and Newly industrialized economies of Asia, following their decreased demand for consumer goods. Further, scenario forecast made for the year 2009 is very scary. Situation could improve a little if programs to be developed (to cope with the situation) by economically and financially affected countries, and the World Bank, IMF, Asian Development Bank and other international institutions, are successfully implemented. The IMF Global Economic Scenario, 2009 foresees some improvement in aggregate demand of some major economies for 2010, but (the report) sees it difficult even to restore the situation to 2006 and 2007 level.

Table 1(d) : World Trade

(Annual Percentage Change)

Volume of World Trade in Summary

	2006	2007	2008	Forecast 2009	Forecast 2010
Volume of World Trade (Goods and Services	9.2	7.2	3.3	-11.0	0.6
Exports					
Advanced Economies	8.5	6.1	1.8	-13.5	0.5
Newly Emerged and Developing Economies	10.9	9.5	6.0	-6.4	1.2
Imports					
Advanced Economies	7.6	4.7	0.4	-12.1	0.4
Newly Emerged and Developing Economies	13.2	14.0	10.9	-8.8	0.6

Source: International Monetary Fund (World Economic Outlook), 2009

1.5 The effect of financial and economic crises in the world economy is clearly mirrored on the world trade. The Table 1 (d) above clearly shows that decline in world trade volume, which began with rise in the price of petroleum products followed by significant price rise in food grains in some countries owing to various reasons, has been exacerbated by the recent economic recession. Exports from developed, newly emerged and developing economies grew by 8.5 and 10.9 percent respectively in 2006, which started declining for both groups thereafter. As per the estimates of IMF 2009, exports of developed, and newly emerged and developing economies will decline by 13.5 and 6.4 percent respectively. Imports for these economies seem to follow similar trend. Imports of Advanced Economies recorded gradual decline during the period with marginal increase of 0.4 percent in 2008, while imports of newly emerged and developing economies showed notable increase in 2007 and 2008. According to IMF estimates, these economies will record a negative grown in their imports in 2009. Despite positive estimates in exports and imports for both groups of countries in 2010, it will again be difficult to maintain the growth recorded in 2006 and 2007.

Economic Growth Rates of Neighbors

1.6 From economic growth aspect, the years 2006 and 2007 have been encouraging for Nepal's two neighbors. China successfully achieved growth rates of 11.6 and 13.0 percent growth rates in those two years while growth rate that of India during these years stood at 9.8 and 9.3 percents respectively. Likewise, during the same period rates of economic growth of other SAARC countries except Nepal remained very encouraging. Growth rates afterwards have been normal in all countries.

Table 1 (e) : Economic Growth Rates of Nepal and Neighboring (SAARC) Countries

(Annual Percentage Change)

	2006	***2007***	***2008***	***Forecast***	
				2009	2010
China	11.6	13.0	9.0	6.5	7.5
Afghanistan	8.2	12.1	*3.4*	9.0	7.0
Bangladesh	6.5	6.3	*5.6*	5.0	5.4
Bhutan	8.8	17.9	6.6	5.7	6.6
India	9.8	9.3	7.3	4.5	5.6
Maldives	18.0	7.2	5.7	-1.3	2.9
Pakistan	6.2	6.0	6.0	2.5	3.5
Srilanka	7.7	6.8	6.0	2.2	3.6
Nepal	3.7	3.2	4.7	3.6	3.3

Source: International Monetary Fund (World Economic Outlook), 2009

National Economic Activities

1.7 Gross Domestic Product is estimated to grow this year by 4.7 percent at producers' price against the targeted 7.0 percent meaning that GDP will grow at the lower rate as compared to the target due to influence of external and internal factors. Of three major internal causes identified, major one is low (unsatisfactory) yield of winter crops due to lack of timely rainfall, second is contraction in non-agricultural sector industrial production due to energy load shedding and absence of any significant expansion in production of the services sector. In addition, factors like closures (*Bandhs*), strikes in different forms - *chakka jams for instance,* and labor conflicts etc. also played critical roles in negatively affecting the expansion of overall economic activities. GDP in FY 2007/08 recorded a growth rate of 5.3 percent.

Agriculture Sector

1.8 Aggregate production of agriculture sector comprising of Agriculture, Forestry and Fishery is estimated to increase by 2.2 percent (at constant prices of FY 2000/01). Growth of this sector in the previous fiscal year was 4.7 percent. Contribution of this sector to GDP in the current fiscal year is estimated at 32.3 percent against previous year's 32.1 percent.

Non-agriculture Sector

1.9 Growth rate of non-agriculture sector in FY 2008/09 is estimated at 4.8 percent. This growth rate is less as compared to 5.7 percent growth recorded in the previous fiscal year. Major reason for this decline is the shortage of energy supply. Sub-sector that recorded negligible or negative growth is electricity, gas and water. This sub-sector is estimated to record a negative growth of 1.1 percent, which had recorded 3.7 percent growth in the previous fiscal year. In the previous fiscal year, Marshyangdi Hydropower Project completed under the German government assistance contributed to record growth in the sector. On the contrary, disruption in energy production of Kulekhani and flood in Sapta Koshi this year made energy supply situation uneasy thereby negatively affecting a number of economic activities.

Manufacturing Industry

1.10 Manufacturing as a sub-sector of non-agriculture sector recorded negligible progress. According to an estimate, this sub-sector's progress has been negative by 0.5 percent in this year. Despite low growth, progress made by the sub-sector was positive in the previous year.

Construction Industry

1.11 This sub-sector has recorded 5.7 percent growth rate, which is notable as compared to other sub-sectors. This sub-sector's growth rate was only 3.1 percent in the previous year. Satisfactory progress in overall construction sub-sector is attributable mainly to public and private sector initiated rapid growth in offices and residential construction activities in Kathmandu valley and other urban areas.

Wholesale and Retail Trade

1.12 This sub-sector's growth has been relatively satisfactory. As compared to 7.0 percent growth in domestic production of this sub-sector in the previous year, estimate is that growth will hover around 4.7 percent this year.

According to estimates, slump in demand of sales goods could be the reason for decline in growth rate of this sub-sector.

Hotel and Restaurant

1.13 In the previous year, this sub-sector had achieved a growth rate of 8.5 percent, which is estimated to remain at 5.1 percent this year. Worldwide economic growth affected by global financial crisis could be one of the causes for decline in growth of this sub-sector. Decrease in number of tourist arrivals and corresponding decrease in their spending caused by imbalances in various aspects of economic domain could be a factor for decline in growth of this sub-sector.

Transport, Communication and Warehousing

1.14 Growth rate of this sub-sector during the current fiscal year 2008/09 is estimated at 7.8 percent. This sub-sector had recorded 7.1 percent growth in the previous fiscal year. The sector could achieve such satisfactory growth especially due to gradual expansion of the communications sector. The sector would have achieved higher growth rate than present estimates if it were not affected by frequent closures (*bandhs*) and load shedding.

Financial Intermediation

1.15 Growth rate of this sub-sector is estimated to be only 3.3 percent in this fiscal year. The sub-sector had achieved 13.8 percent growth in the previous year. Reason for slowdown of the pace of financial intermediation has been mainly due to energy crisis and other obstructions being faced by various branches of financial activities.

Real estate and Commercial Services

1.16 According to estimates, this sector achieved growth rate of 4.5 percent this year as compared to 4.4 percent growth in the previous fiscal year. Expansion of this sector in the face of retarded growth in other sectors for investments has had positive effect on real estate and commercial services.

Public Administration and Defense

1.17 Estimates prepared based on public expenditure on public administration and defense, this sub-sector is expected to achieve 3.3 percent growth this year, which was limited to 0.4 percent in the previous fiscal year.

Education

1.18 Education sub-sector is expected to achieve a growth of 9.9 percent this year because of expansion of public expenditure on education with the objective of developing social infrastructure and quality human resource. The sub-sector had achieved growth of 3.3 percent in the previous fiscal year.

Health and Social Work

1.19 Growth of this sub-sector in FY 2008/09 remained at 6.5 percent as compared to 13.6 percent growth achieved in the previous fiscal year. This growth has been possible with the government commitment of gradually availing health services to the people and the private sector participation in this sub-sector. The progress, however, has been less than in the previous fiscal year.

Other Community, Social and Personal Services

1.20 This sector has achieved a growth of 6.1 percent, which was 11.1 percent in the previous year. This sub-sector comprises community services, other social and professional services provided by the government.

Sector Details

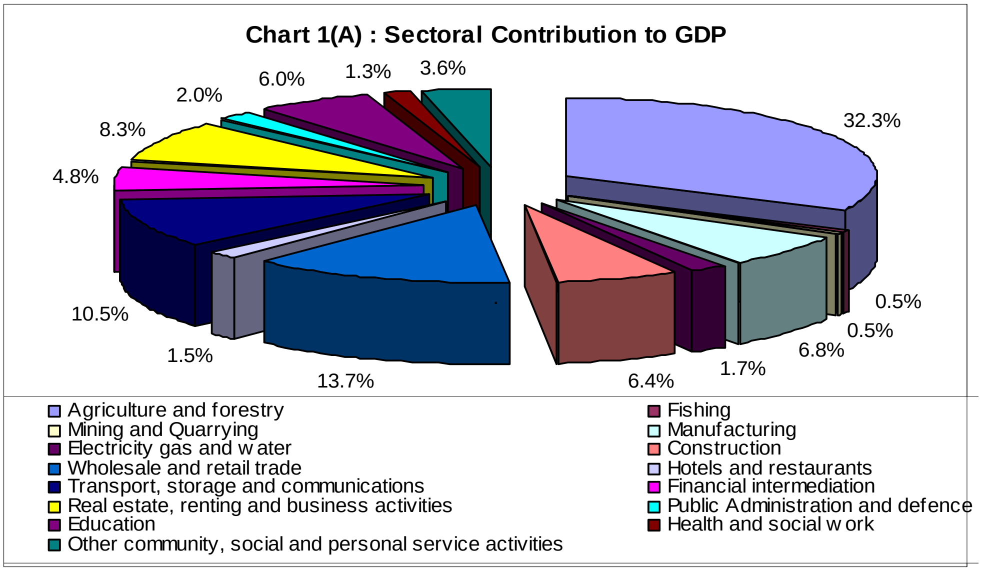
1.21 Primary sector comprise of Agriculture, Forestry, and Aquaculture. Domestic production of this sector in FY 2008/09 is estimated to grow by 2.2 percent, which had grown by 4.7 percent in the previous fiscal year. Secondary sector includes industrial production, electricity, gas, water, and construction. Growth of this sector is estimated to remain constant at 1.8 percent as in the previous fiscal year. Tertiary sector comprises service areas. This sector is estimated to grow by 5.9 percent as compared to 7.0 percent growth recorded in the previous fiscal year.

Structure of GDP

1.22 As per the ISIC classified structure of GDP, agriculture sector occupied 32.3 percent at consumer prices, with 67.7 percent occupied by the non-agriculture sector. There has been no notable change in the overall GDP structure between the current fiscal year (2008/09) and previous fiscal year with 32.6 and 67.4 percent shares of these two sectors respectively. A nominal change of percentage point, however, is noticed in the industry sub-sector under the non-agriculture sector. In the previous year, this sub-sector occupied 7.2 percent, which slightly decreased to 6.8 percent in the current fiscal year. Electricity, gas and water, which occupied 2.0 percent share of GDP in the previous fiscal year, is estimated to remain at 1.7 percent in the current fiscal year. Likewise, ratio of construction in GDP was 6.5 percent in the previous fiscal year while it is estimated to remain 6.4 percent this year. The following chart explains contribution of each sector to GDP in the current fiscal year.

Consumption

1.23 The gross consumption in FY 2008/09 at constant prices totaled Rs. 531.72 billion which is 6.0 percent higher than that of the previous year. This amount is 90.7 percent of GDP, which was 89.6 percent in the preceding year.



Out of the gross consumption in FY 2008/09, the government is estimated to consume 10.9 percent as compared to 10.5 percent in FY 2007/08. Observation of existing gross consumption structure between the government and private sector in FY 2008/09 shows that food, non-food, and services will occupy 60.1 percent, 27.9 percent, and 12 percent shares respectively. In FY 2007/08, shares of food, non-food, and services in gross consumption of the government and private sector put together were 59.8 percent, 27.8 percent, and 12.4 percent respectively. Observation of consumption pattern of the government and the private sector during the past two years shows no noticeable change in the consumption pattern in the private sector with food items still heavily weighing on gross consumption. Observation of consumption dynamics in FY 2008/09 shows that of total estimated increase of 6 percent in aggregate consumption, private sector consumption will rise by 5.7 percent, while that in government sector by 10.1 percent. In FY 2007/08, consumption of the private sector and the government sector had increased by 3.3 percent and 3.6 percent.

Savings

1.24 In FY 2008/09, Gross Domestic Savings is estimated to have declined by 6.9 percent at constant prices. In FY 2007/08, such savings had gone up by 26.9 percent. Because of consumption rising rapidly with negative growth in savings, savings in FY 2008/09 is estimated to have contained at 8.0percent which was11.2 percent in FY 2007/08.

Capital Formation

1.25 Gross Capital Formation in FY 2008/09 is estimated to be around Rs. 150.42 billion at constant prices. It is 25.7 percent in proportion to GDP. As compared to the previous fiscal year, Gross Capital Formation is estimated to grow at 0.4 percent this year. Growth of 21.8 percent Gross Capital formed in the previous year was 26.7 percent in proportion to GDP. In FY 2008/09, the share of fixed capital formation out of Gross Capital Formation has been 77.3 percent with 22.7 percent share of change in stock. Such shares in FY2007/08 were 73.3 percent and 26.7 percent respectively. Out of Gross Capital Formation, the share of the government in 2008/09 is estimated at 19.5 percent while that of the private sector remained at 80.5 percent. In FY 2007/08, share of the government was 14.8 percent with the rest (85.2 percent) been shared by the private sector. The change shows that in FY 2008/09 share of the government has gone up on fixed capital formation with relative decrease in the participation of the private sector.

Net Export of Goods and Services

1.26 According estimates, imports, and exports of goods and services totaled Rs. 201.23 billion and Rs. 105.32 billion respectively in FY 2008/09 with a trade deficit totaling Rs. 95.91 billion. This deficit equals to 16.4 percent in proportion to GDP in comparison to 16.3 percent in FY 2007/08. In this fiscal year, exports of goods and services will be able to sustain 52.3 percent of total imports of goods and services. Such capacity in FY 2007/08 was 45.5 percent only. This is due to 64.9 percent growth recorded on the income from service sector with a very nominal growth in expenditure in that sector. In comparison to 7.4 percent growth in income from export of services, expenditure on imports of services had increased by 23.6 percent in the preceding year, which has comparatively helped improve the situation this year.