NEPAL ECONOMIC FORUM

nefport

MACROECONOMIC SPECIAL

INSIGHTS AND OUTLOOK

DOCKING NEPAL'S ECONOMIC ANALYSIS

ISSUE 30 | SEPTEMBER 2017

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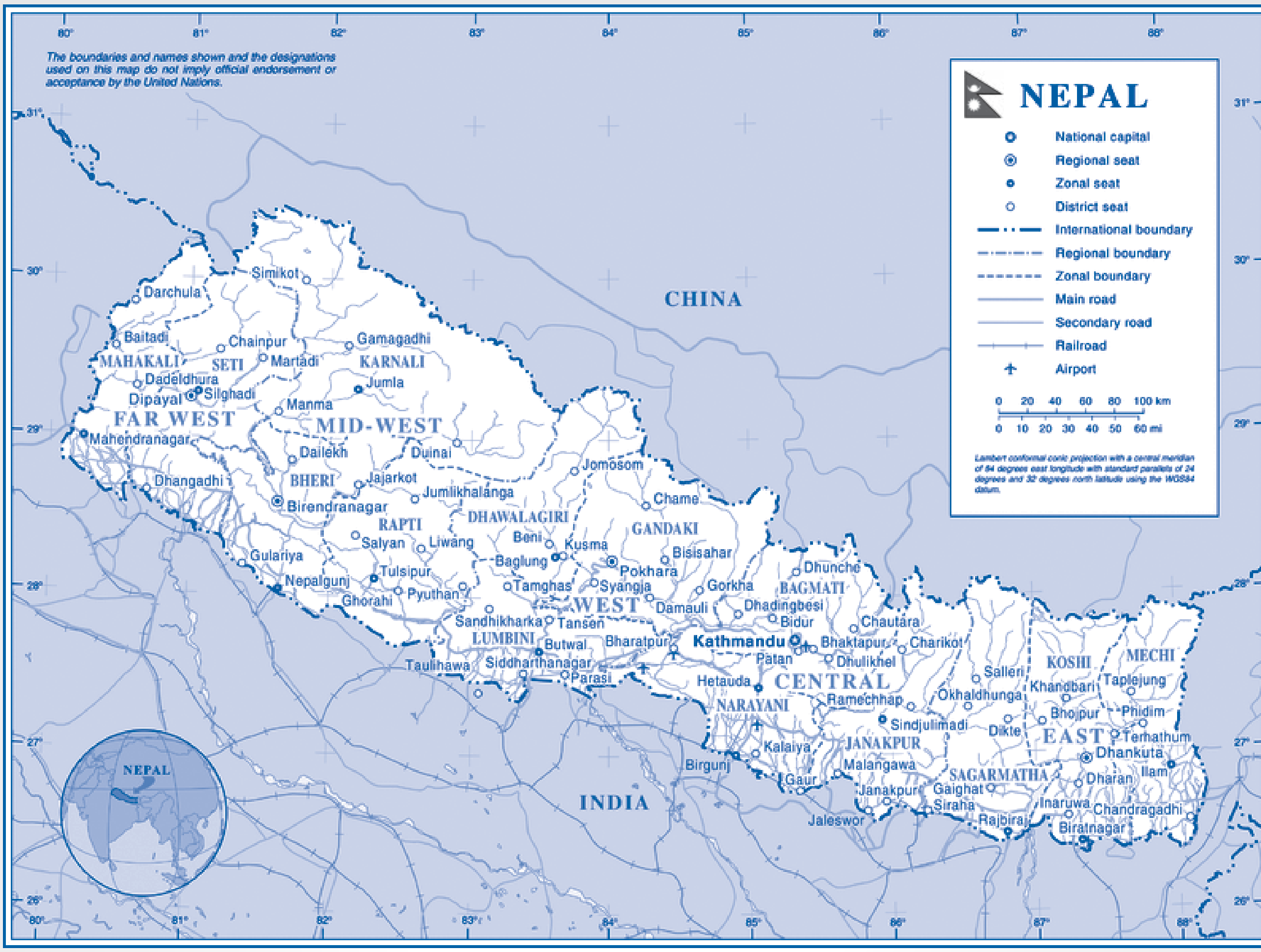
September 2017 | ISSUE 30

NEPAL FACTSHEET



Map Source: https://en.wikipedia.org/wiki/File:Un-nepal.png

KEY ECONOMIC INDICATORS

GDP	USD 23.31 billion	GDP Growth rate (%)	6.9%
Rank	105		
GNI per capita (Atlas)	USD 730	Inflation (annual %)	4.8%
Rank	196		
GNI (PPP)	USD 2,500	Agricultural growth rate (annual %)	5.3%
Rank	187		
Gross Capital Formation (% of GDP	34%	Industrial growth rate (annual %)	11%
HDI	0.558	Service Sector growth rate (annual %)	6.9%
Rank	144		

Sources:
Left Table — Statistics time; The World Bank; HDI figure from Human Development Reports of the UNDP,
Right Table — Budget 2017/18- Ministry of Finance, May 2017, Annual Report: Nepal Rastra Bank

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EDITORIAL

The successful completion of Linkfest was one of the main highlights for Nepal Economic Forum (NEF) this quarter. Linkfest was a one-day event where people from various fields came together to share their experiences on the issue of connectivity and landlockedness in South Asia. We are also pleased to announce that NEF has been selected as a partner to conduct a study on BBIN MVA. The project, initiated by India, aims to develop economic corridors linking Bangaldesh, Bhutan, India, Nepal and Myanmar. Currently, feasibility study of the economic corridors is in progress.

We are very thankful for the support from different stakeholders as well as members of our distinguished advisory board, which has been crucial in NEF's growth.

This quarter was eventful for Nepali politics and economy. The Nepal government successfully conducted the second phase of local elections after a hiatus of 20 years. While on the economic front, reports from different governmental and non-governmental agencies like IMF and World Bank confirm the encouraging growth of 7%.

Another milestone this quarter was the announcement of the monetary policy by Nepal Rastra bank, which aims to stimulate the Nepali economy. The completion of local level elections also provides an opportunity for economic growth, and is a move towards the implementation of federalism with which will make the government more responsive and accountable. In the meantime, relief from power cuts after a decade is having a positive impact on economic activities.

This edition is a macroeconomic special, highlighting the fundamental macroeconomic issues of the country. We would like to thank all the key contributors especially Mr. Shankar Sharma (former vice-chairman of National Planning Commission), Mr. Nara Bahadur Thapa (Executive Director, Nepal Rastra Bank), Mr. Andrea Bauer (Senior Resident Representative of International Monetary Fund, Nepal) and Senior Fellow Mr. Chandan Sapkota for helping us make this issue an enriching one.

We continue to look forward to your valuable comments and suggestions.

Sujeev Shakya
Chair, Nepal Economic Forum

1

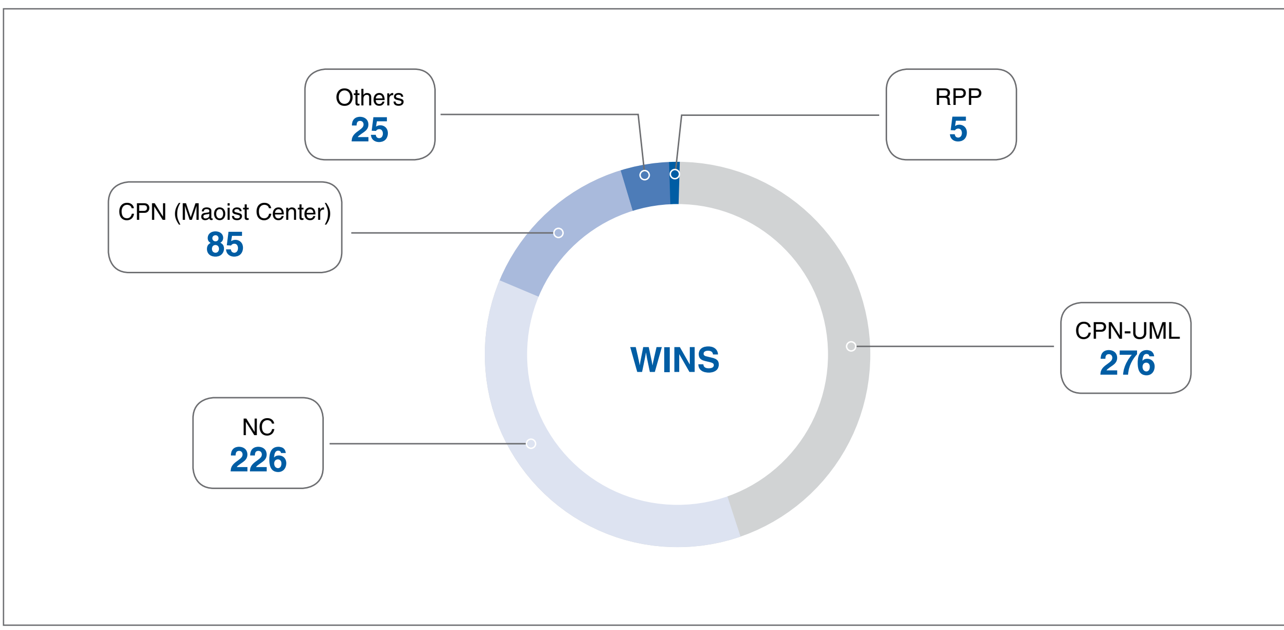
GENERAL
OVERVIEW

GENERAL OVERVIEW

POLITICAL OVERVIEW

The second phase of local level elections was held on June 28 in districts of Provinces 1, 5 and 7, while elections in Province 2 are scheduled for September 18. The Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML) secured the most number of wins in the local elections. According to the data compiled by the Information Technology Management Department of the Election Commission (EC), a total of 51,482,433 votes were casted in the two phases of local elections, out of which the CPN-UML secured 36.82%. Chart below summarises the total wins of respective political parties in the two phases of local polls:

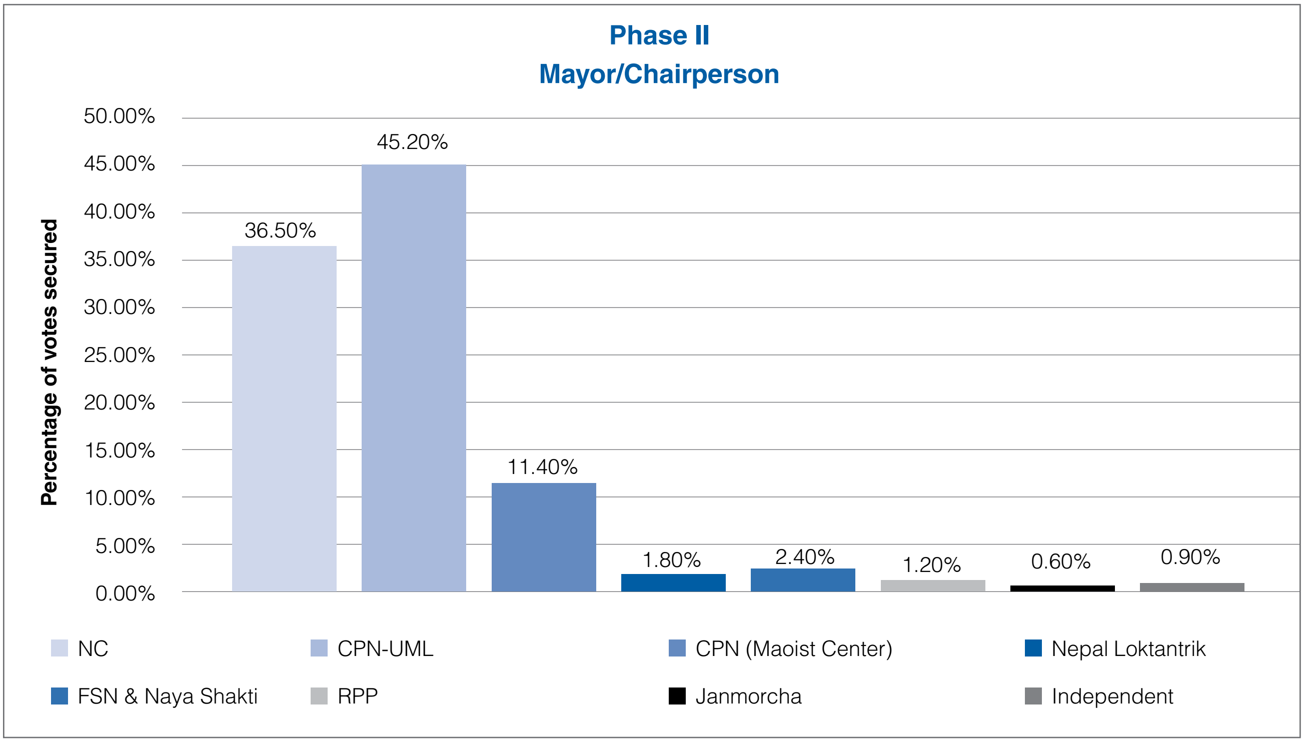
Figure 1: Local election overview



Source: The Kathmandu Post

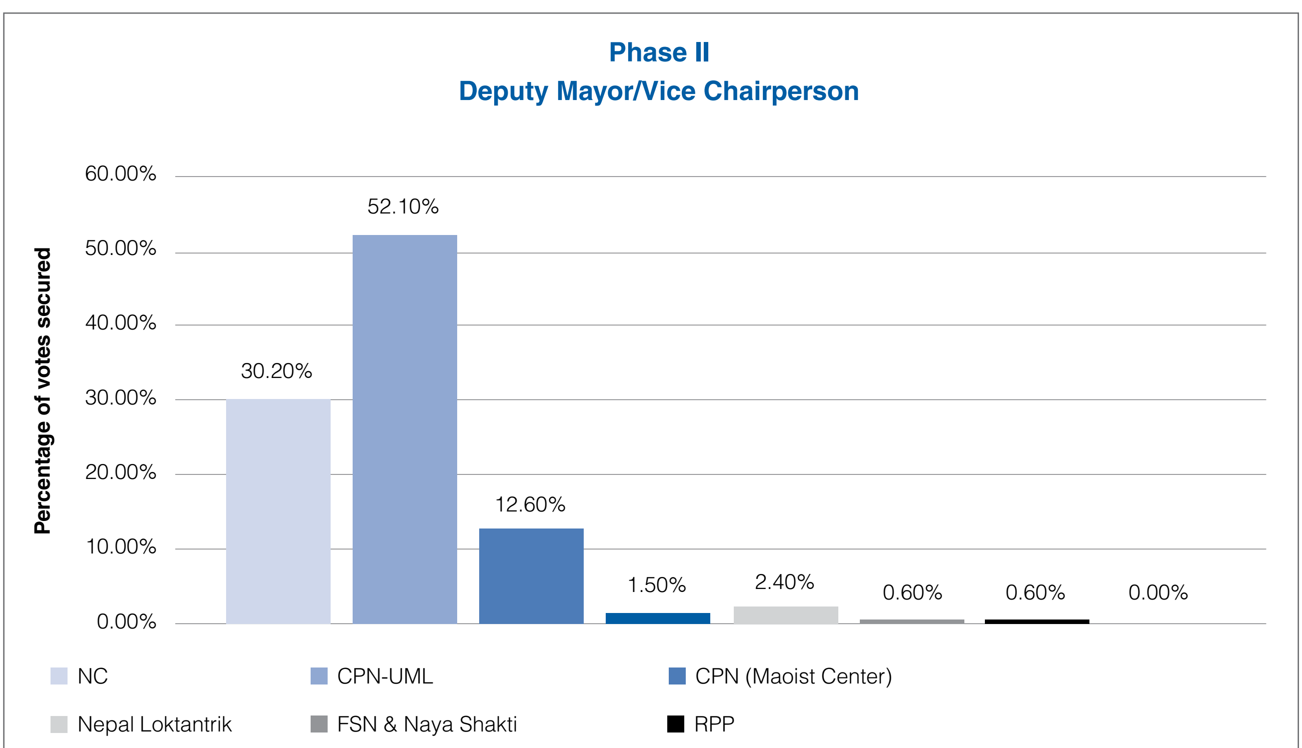
Second phase of local polls concludes: Despite some minor incidents, the EC was successful in concluding the second phase of local elections peacefully. In total, 6,432,765 voters casted their vote in 35 districts and approximately 62,000 candidates stood for the elections from different political parties. However, 11,000 voters that were added after 2015 were found without their voter identity card this election. Charts below summarise the key highlights of the elections.

Figure 2: Second phase elections for mayor/chairperson



Source: Election Commission

Figure 3: Second phase elections for deputy mayor/vice chairperson



Source: Election Commission

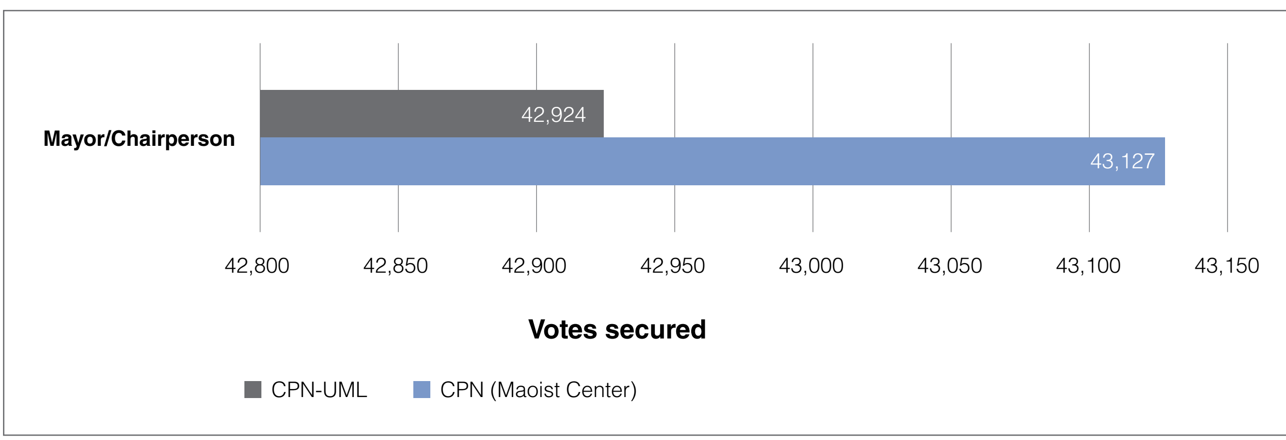
The CPN-UML secured 45.2% of the total votes for the position of mayor/ chairperson and 52.1% for the position of deputy mayor/vice chairperson. Likewise, the Nepali Congress (NC) secured 36.5% of total votes for mayor/ chairperson positions and 30.2% for deputy mayor/vice chairperson positions. Similarly, coalition partner, the CPN (Maoist Centre) secured 11.4% of total votes for mayor/ chairperson positions and 12.6% for deputy mayor/vice chairperson positions. The big three parties won 95% of the seats.[1]

Bharatpur re-election: The mayoral candidate of the CPN (Maoist Centre), Renu Dahal, won the election in Bharatpur with 43,127 votes against her counterpart who secured 42,924 votes. Likewise, Parbati Shah of NC got elected as deputy mayor securing 47,197 votes whereas her CPN-UML counterpart got 39,535 votes.

Internal dispute affects the Rastriya Janata Party-Nepal (RJP-N): An internal dispute has made it difficult for the RJP-N to take decisions on whether or not to participate in the third phase of local level elections in Province 2. The meetings of the party's office bearers failed to reach any concrete decision about joining the polls. Some of the office bearers claimed that the party cannot contest in the elections in province 2 as it boycotted the elections in other six provinces. But majority of the members urged the party to put the constitution amendment proposal to a vote in Parliament and go to the polls.

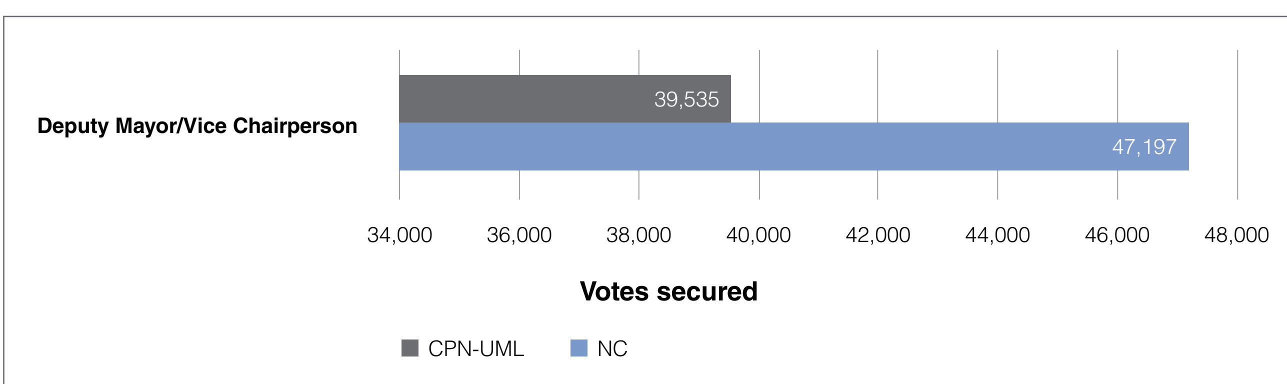
The NC, the CPN (Maoist Centre) and the RJP-N have agreed to present the constitution amendment proposal for a floor test in Parliament. The prime minister has claimed that the RJP-N, to retain its public support, will take part in the third phase of local level elections and that the government is sincerely trying to address their demands. Also the PM hinted at the possibility of forming electoral alliances with the CPN (Maoist Centre) and the RJP-N for the upcoming local level polls.[2]

Figure 4: Re-election in Bharatpur for mayor/chairperson



Source: Election Commission

Figure 5: Re-election in Bharatpur for deputy mayor/vice chairperson



Source: Election Commission

Rastriya Prajatantra Party (RPP) seeks grace time to prove 40% share: The faction wanting to break away from the RPP has registered an application seeking 10 more days to collect and verify the signatures to register a new party. As per the clause 33 (2) of the Act on Political Parties, a faction willing to split and form a new party must secure the support of 40% members of the central committee and the parliamentary party. The main reason behind the split of the RPP was a dispute over whether or not to join the government. After nine months since the merger between the RPP-Nepal and the RPP, the unified party split lately.[3]

RPP supports government without cabinet share: Two days after dissolving a committee formed to negotiate with the government, the RPP formally refused to join the coalition government citing reservations over the number of ministerial portfolios allocated to the party. The dialogue committee was dissolved immediately after prime minister appointed 19 new ministers without consulting the RPP. Though some office bearers suggested withdrawing support to the government, RPP did not take a decision to this effect. The party will be holding assemblies in all the rural municipalities and provinces by mid-September to revive its agenda of Hindu nation and also plans to hold its conventions in all the six provinces where local level elections have been held.[4]

Government forms Constitution Delineation Commission (CDC): The government has formed a five-member Constitution Delineation Commission (CDC) to carve out constituencies for the upcoming provincial and national elections. The CDC has been mandated to delineate 165 electoral constituencies for federal parliament and 330 for state parliament within 21 days. The perks and remuneration of the CDC chief and its members are similar to those of chief election commissioner and election commissioners. The committee itself decides its terms and reference and the delineation takes place on the basis of geography and population. As per constitutional provision, any decisions taken by the CDC cannot be raised in any court. The CDC's report will be sent to Parliament and then be forwarded to the EC. As per the constitutional deadline, elections for federal and state parliaments must be held by January 21, 2018, when the term of the incumbent Parliament expires.[5]

Bibeksheel Nepali and Sajha Party merge: Sajha Party and Bibeksheel Nepali have inked a unification deal, becoming Bibeksheel Sajha Party (BSP). The unified party has opted for Sajha Party's election symbol and has vowed to establish a capable alternative force to lead the nation. The unified party will have 17 members from each party as central committee members. The 34-member central committee will eventually be expanded to 51 members with seven leaders being appointed as coordinators of the seven provinces. Leaders from both sides have agreed to pursue inclusive democracy, welfare state and economic development as the new party's socio-political agendas. The party is to adopt a centre-left political ideology and follow the collective leadership formula. The unified party plans to contest in the third phase of local elections in Province 2.[6]

OUTLOOK

The local level elections demonstrated a change from the 2013 elections with the CPN-UML emerging as the strongest party, while the NC emerged as the second strongest party, but far in front of its coalition partner, the CPN-MC. Meanwhile, the RPP, which stands for reinstating the monarchy, Hindu state and rejects the federal structure, has sunk into insignificance. The merger of Bibeksheel Nepali and Sajha Party can be seen as a credible political alternative if the unified party practices inclusive democracy. At present, the key challenge for the government is to address the demands of the Madhes-based parties.

GENERAL OVERVIEW

INTERNATIONAL ECONOMY

Although the global economic growth is slowly becoming more stable, some uncertainties still remain prevalent. In the case of Nepal, its growth rate looks positive and the country is expected to benefit from the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) in the coming days. In the meantime, India is planning to accelerate its economy with the implementation of Goods and Service Tax (GST), while the diplomatic crisis over Qatar has sent shockwaves across the Middle East. The US President Donald Trump's stance on climate change at the G20 summit surprised world leaders and was termed 'regrettable'.

Nepal third fastest growing economy in 2017: The World Bank's latest edition of Global Economic Prospects has ranked Nepal third in the list of world's fastest growing economies in 2017. According to the report, the global growth rate is estimated to be 2.7%, with Ethiopia and Uzbekistan ranking as the fastest and second-fastest-growing economy with projected growth of 8.3% and 7.6% respectively.[7] Nepal has been ranked third with projected growth of 7.5%. India and China are the 4th and 16th fastest growing economies with the growth rate of 7.2% and 6.5% respectively. Emerging-market and developing economies are projected to grow at 4.1%, whereas growth in advanced economies is estimated to accelerate to 1.9% in 2017.

BIMSTEC Ministerial Meeting: Kathmandu hosted the senior office level meeting of the BIMSTEC and the 15th BIMSTEC Ministerial Meeting (MM) from August 10-11. Delegates from all the BIMSTEC member states—Nepal, India, Bhutan, Bangladesh, Myanmar, Sri Lanka and Thailand—were present in the meeting. It was announced in the meeting that the BIMSTEC free trade area agreement will be signed soon and a grid interconnection between the member states will be set up. Similarly, according to the declaration, trade and economic cooperation among the member states will be enhanced. However, the much-expected date for hosting the fourth BIMSTEC summit in Nepal was not announced as the Nepali side failed to propose a specific date.[8]

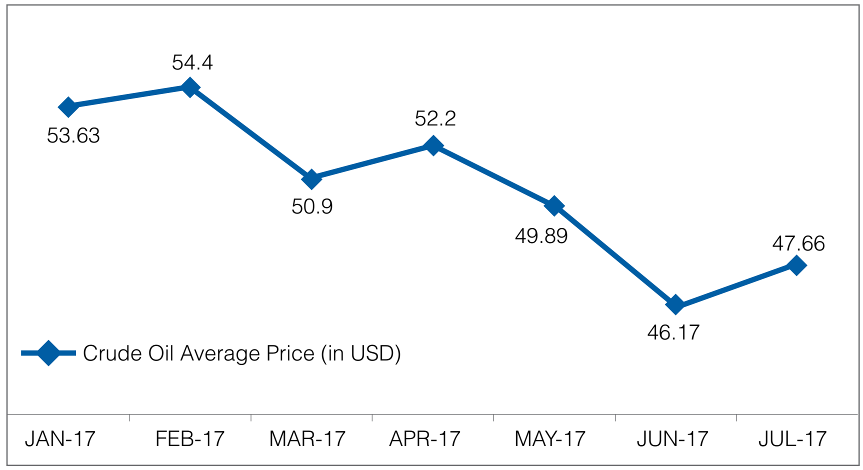
G20 summit held in Germany: The 12th G20 Summit was held in Hamburg, Germany, from July 7-8. The Group of Twenty (G20), a forum that brings together the world's 20 major economies, held discussions on major issues such as climate change, free trade, migrants and refugees. Surprisingly, 19 of the 20 leaders present in the Summit agreed on all points made in the joint declaration, known as the communiqué, with the exception of Donald Trump who did not agree on climate change.[9] Although the US withdrew from the Paris Agreement, which falls within the United Nations Framework Convention on Climate Change, the country affirmed its strong commitment to lower down emissions. The G20 chairmanship rotates annually between nations divided into regional groupings. Argentina will hold the presidency in 2018 to set the agenda and lead discussions.

India introduces GST: To unify the country into a single market, India has replaced its numerous federal and state taxes with Goods and Service Tax (GST) from July 1. This move is considered as the biggest economic reform India has adopted since independence and under the new system goods and services will be taxed under four basic rates—5%, 12% 18% and 28% respectively.[10] The structure of GST is Central

Goods and Services Tax (CGST), State Goods and Services Tax (SGST), Union Territory Goods and Services Tax(UT-GST) and Integrated Goods and Services Tax (IGST). GST is predicted to simplify and rationalise the current indirect tax regime and eliminate tax cascading effect in order to foster transparency and stability in the Indian economy.

Gulf Crisis: On the first week of June, four Arab nations, Saudi Arabia, United Arab Emirates, Bahrain and Egypt, abruptly cut off diplomatic ties with Qatar and imposed a land, sea and air blockade on the country. The Arab nations have cited two main reasons for breaking ties with Qatar: Qatar's support for Islamist groups linked to al-Qaeda and its relations with Iran, with whom it shares the world's largest gas field. This crisis has adversely affected constructing companies in Qatar as the tiny oil- and gas-rich state prepares to host the Football World Cup in 2022. Kuwait and Oman are the only two states from the six-member Gulf Co-operation Council (GCC) that have not cut ties with Qatar.[11]

Figure 6: Average price of crude oil



Source: World Bank Commodities Prices (The Pink Sheet)

Fluctuating Oil Prices: The crude oil prices continue to fluctuate in the global market. The crude oil quarterly average price saw increasing and decreasing trend in the first-two quarters respectively. Oil prices fell last quarter, with energy markets focused on comments from Organisation of the Petroleum Exporting Countries (OPEC) and non-OPEC officials meeting in Abu Dhabi to discuss ways to boost agreement with a deal to cut output.[12] As of July 2017, average crude oil prices stood at NPR 4,922 (USD 47.66) per barrel up from NPR 5,539 (USD 53.63) per barrel in January as shown in Figure 6. OPEC output hit a 2017 high in July and so did its exports. On a monthly average basis, the crude oil prices declined sharply in June for the second month in a row. Despite ongoing high conformity by OPEC and non-OPEC oil producers, the oil market witnessed significant bearish sentiment in June mainly due to excess oil supply and on-going high oil inventories.

OUTLOOK

Despite a fragile recovery in the world economy, countries must carry out institutional and market reforms to attract private investment. Moreover, challenges facing the global economy, such as trade restrictions, financial instability and climate change cannot be addressed by a single nation, so all the countries should make efforts to solve these issues collectively. Stability in the oil market will be a key determinant of global economic growth in the coming year.

At present, Nepal's growth rate might look positive but graduating into a middle-income country by 2030 is still a tall order. Nepal should strive to get as much as benefit from BIMSTEC in developing core areas like trade, investment, connectivity, energy and tourism.

2

MACROECONOMIC OVERVIEW

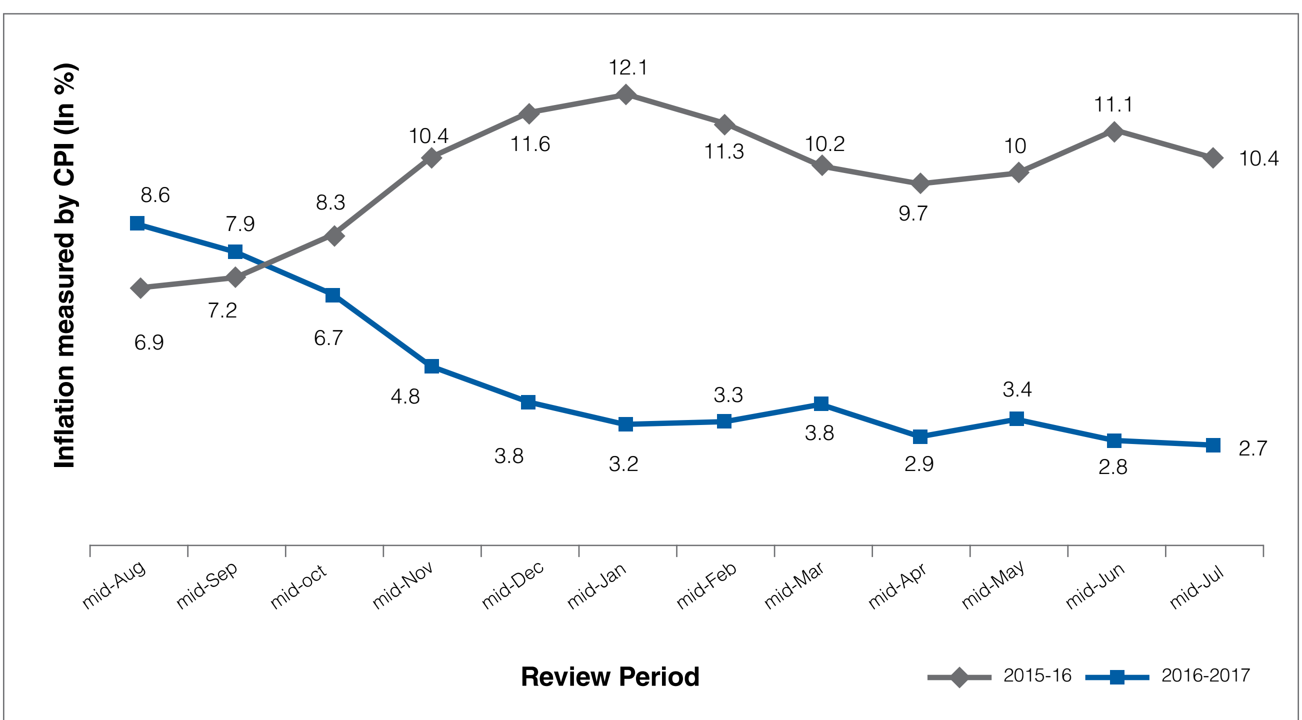
MACROECONOMIC OVERVIEW

Year-on-year (YoY) inflation level has receded to record low at 2.7% over the past twelve months of FY 2016/17, thus taming the inflation within the targeted level of 7.5%. On the other hand, Nepal's trade deficit continues to widen as merchandise import increased to NPR 990.11 (USD 9.59 billion).

Inflation: Inflation rate, measured by Consumer Price Index (CPI), dropped to its lowest level in 12 years at 2.7% as of mid-July 2017 (see Figure 7). It stood at a peak of 10.4% over the same period the previous year. Food inflation shrank to 1.9%, which was caused by a decline in prices of vegetables, meat and cereals. Non-food inflation also moderated to 6.5% on the back of declining prices of clothes, housing and communication.

The massive drop in inflation rates can be mainly attributed to an improved supply situation and a deceleration in the Indian inflation rate. Prices in Nepal have moderated after the end of the border blockade owing to smooth supply. During the blockade, disruptions to supply caused domestic prices to rise rapidly as Nepal depends on India for more than 60% of its total imports.

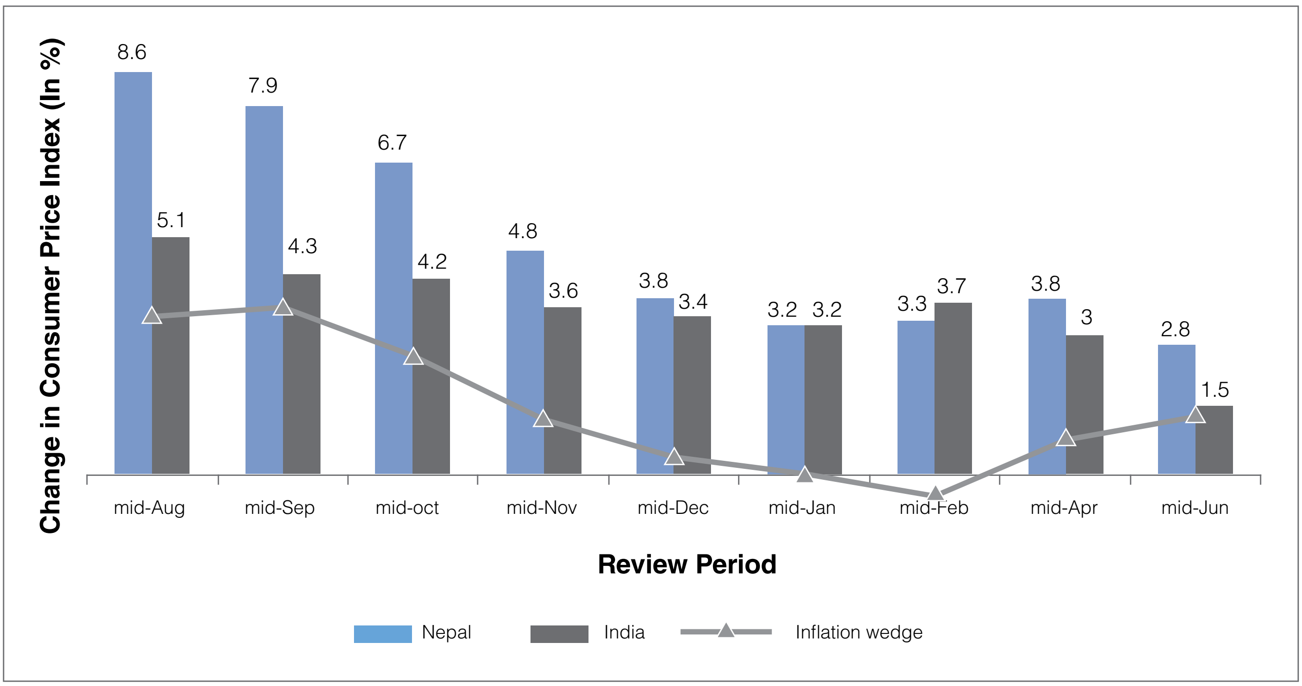
Figure 7: Year on Year inflation measured by Consumer Price Index (CPI) for twelve months of FY 2015-16 & 2016-17



Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

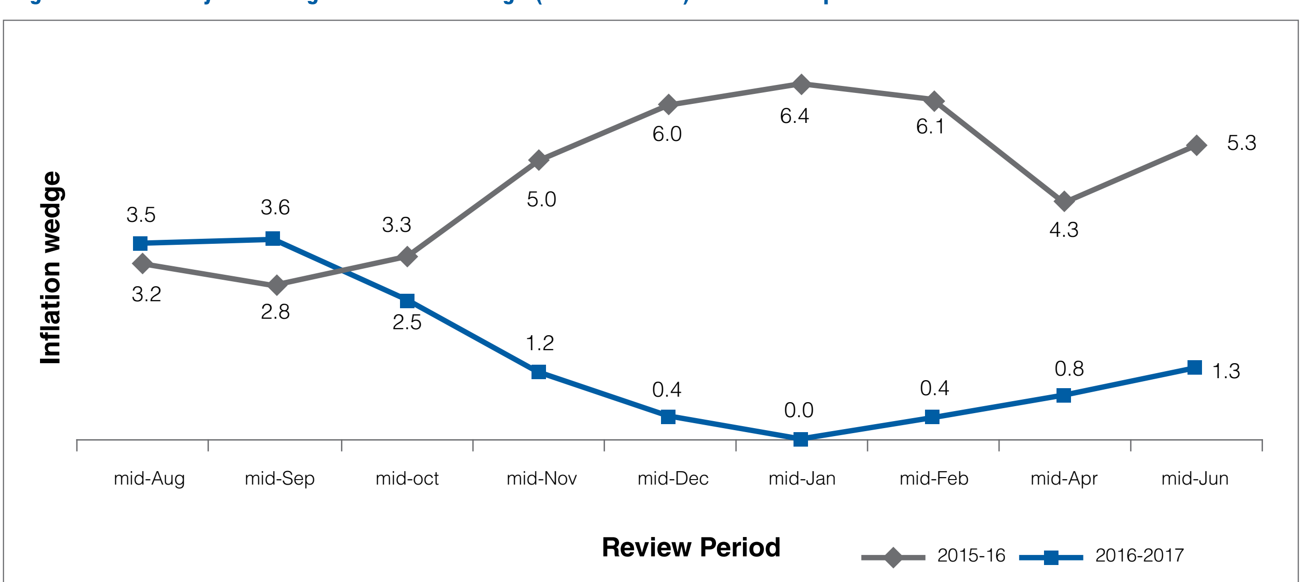
Inflation wedge between Nepal and India: Inflation wedge, measured as the YoY change in CPI of India and Nepal has fallen to 1.3%, as shown in Figure 9: Year-on-year percentage change in CPI in Nepal and India and the inflation wedge in the corresponding period for FY 2016/17. Over the same period last year, the inflation wedge between India and Nepal stood at 5.3% as shown in Figure 9 . Inflation wedge between the two countries moderately increased from 0% in January to 0.4% in February. The wedge increased further to 0.8% in April to 1.3% in June. An improved supply situation between the two countries and a deceleration in the Indian inflation rate can be cited as the main reasons for the subtle inflation wedge. The average inflation wedge for FY 2016/17 has stood to 1.1%.

Figure 8: Year-on-year percentage change in CPI in Nepal and India and the inflation wedge in the corresponding period for FY 2016-17



Source: Current Macroeconomic Situation of Nepal (Based on the eleven month data of 2016/17), Nepal Rastra Bank

Figure 9: Year-on-year change in inflation wedge (based on CPI) between Nepal and India in FY 2015-16 and 2016-17



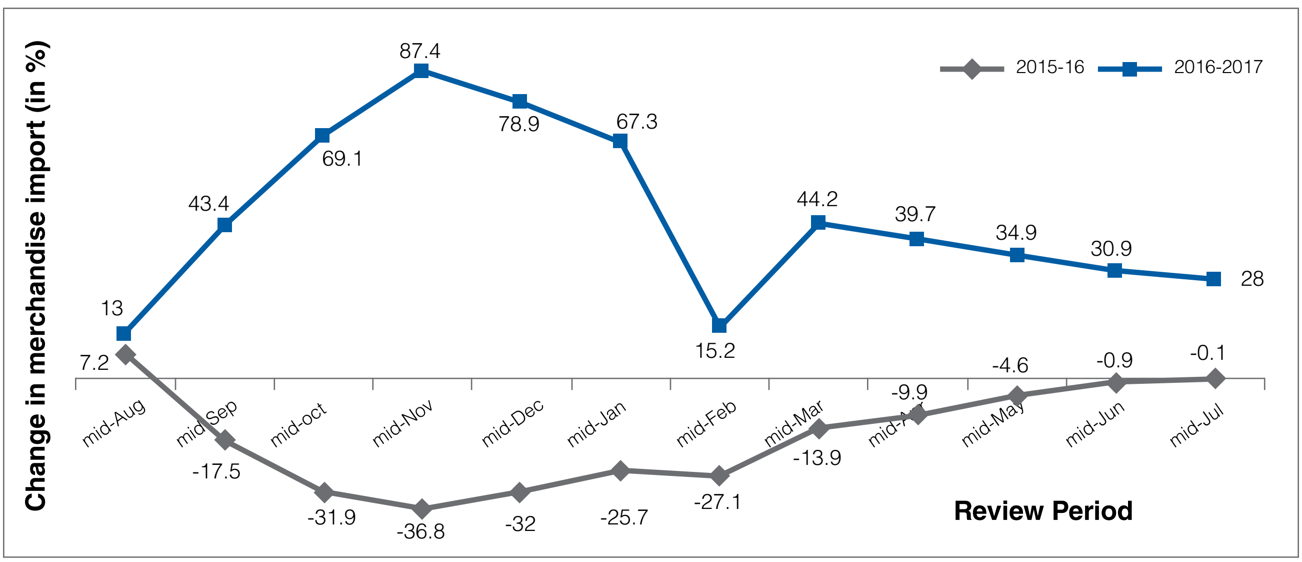
Source: Current Macroeconomic Situation of Nepal (Based on the eleven month data of 2016/17), Nepal Rastra Bank

Import-export and trade deficit: Merchandise imports have increased by 28% to NPR 990.11 billion (USD 8.68 billion) in the first twelve months of FY 2016/17, as shown in Figure 10. During the same period in the previous year, Merchandise imports had deteriorated to -0.1% due to the border blockade. Imports have been increased due to an increase in import of vehicles, petroleum products and machinery. In comparison to the same period last year, Nepal's import from India increased by 32.8%, showing a greater dependency on its neighbour.

Merchandise exports have grown at a sluggish pace in comparison to a drastic increment in Merchandise imports. Merchandise exports increased by only 4.2% to NPR 73.05 billion (USD 707 million) in the first twelve months of FY 2016/17. The corresponding figure was—17.8% in FY 2015/16. A lack of growth in the industrial sector can be attributed to the lack of any substantial growth in exports. Similarly, annual average wholesale price indices (WPI) eased to 2.7% in FY 2016/17. The corresponding figure was 6.7% in the previous year.

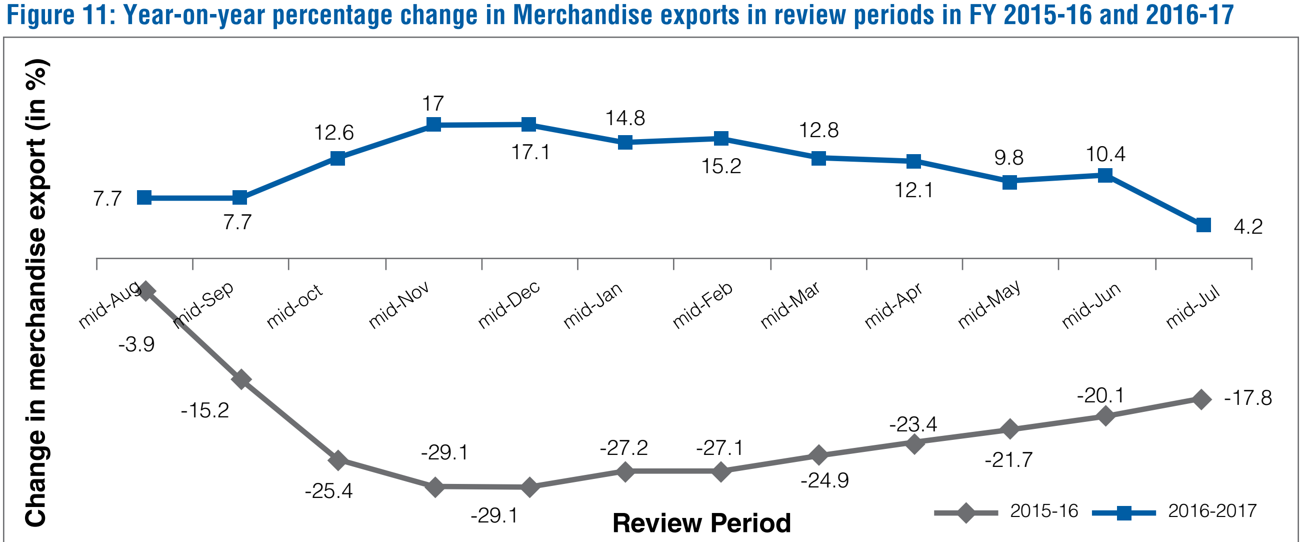
As a result of the widening gap between imports and exports, Nepal's trade deficit increased to 30.4%, compared to 2% in the same period the previous year, as shown in Figure 12. Nepal's trade deficit now stands at NPR 917.6 billion (USD 8.88 billion). Nepal's propensity to import goods from India and the lack of growth in domestic producers can be attributed to the widening trade gap. With the government unable to boost exports and support the development of the domestic industrial sector, the trade deficit will continue to worsen with imports growing at a substantial rate.

Figure 10: Year-on-year percentage change in Merchandise imports in review periods in FY 2015-16 and 2016-17



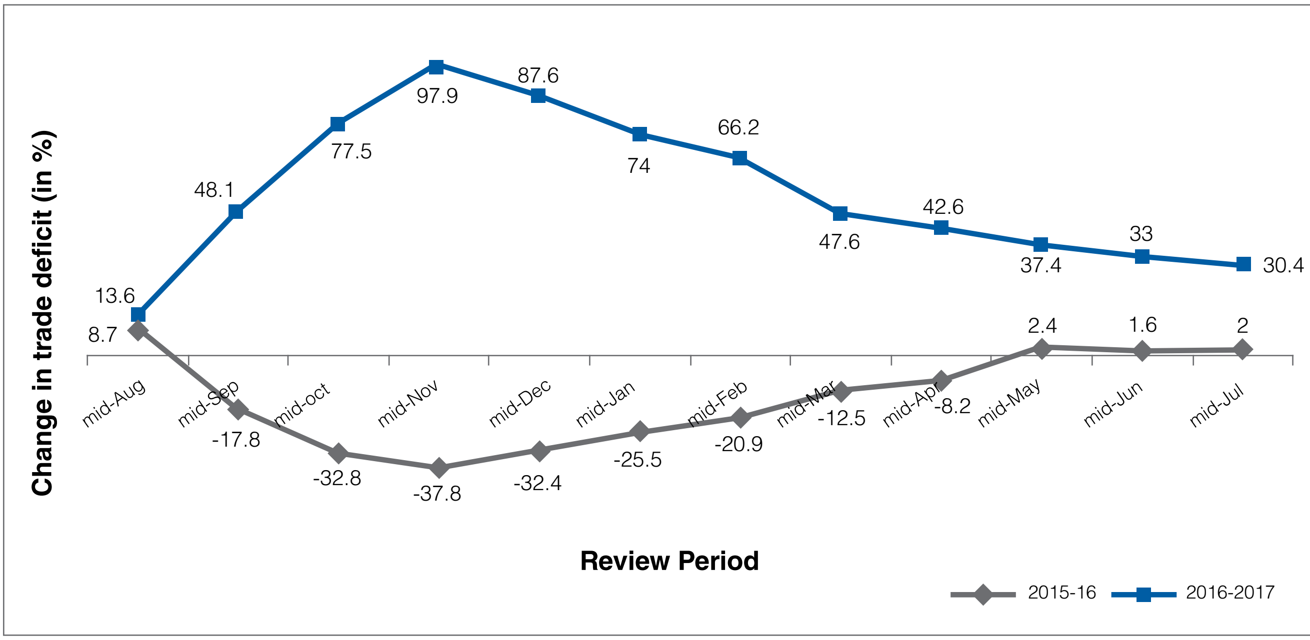
Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

Figure 11: Year-on-year percentage change in Merchandise exports in review periods in FY 2015-16 and 2016-17



Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

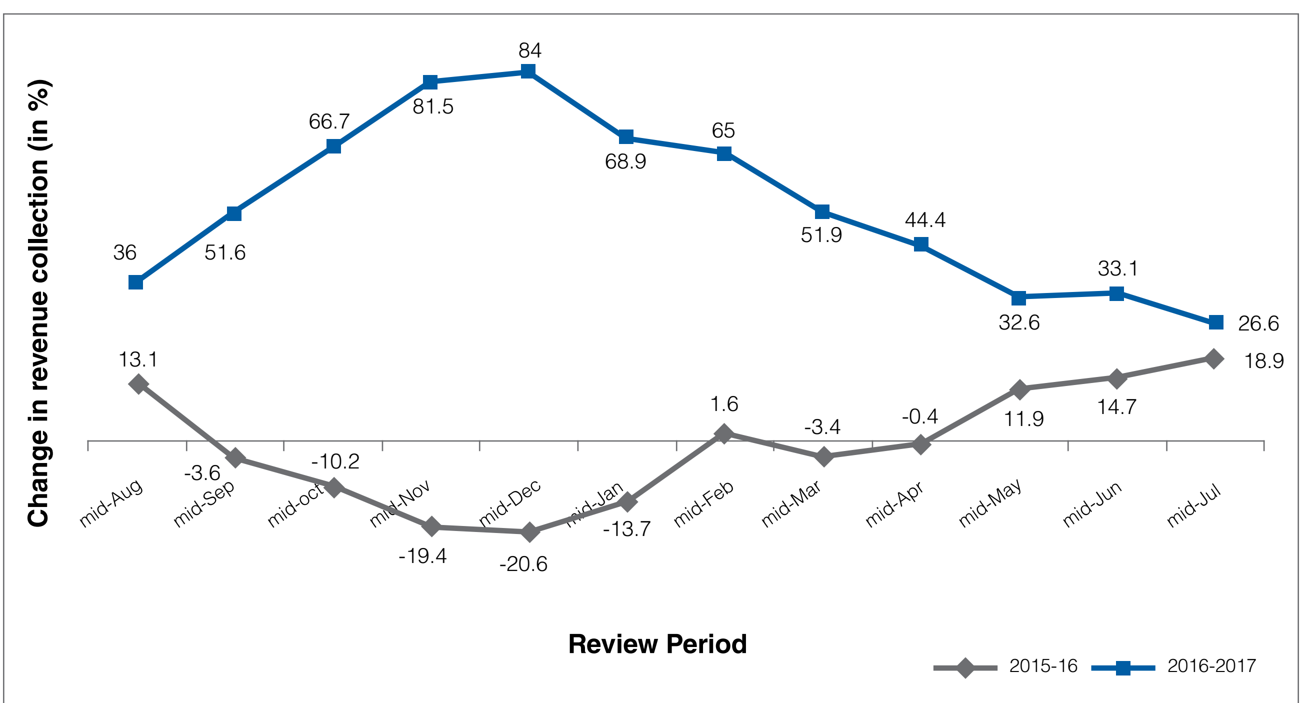
Figure 12: Year-on-year percentage change in trade deficit in review periods in FY 2015-16 and 2016-17



Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

Government revenue: Government revenue collection increased by 26.4% amounting to NPR 609.17 billion (USD 5.89 billion). The revenue collection had increased by 18.8% to NPR 481.98 billion (USD 4.66 billion) compared to the corresponding period of the previous year as shown in Figure 13. Increase in government revenue can be accredited to higher growth rate of value added tax, income tax and customs.

Figure 13: Year-on-Year percentage change in revenue collection during the review periods for FY 2015-16 and 2016-17

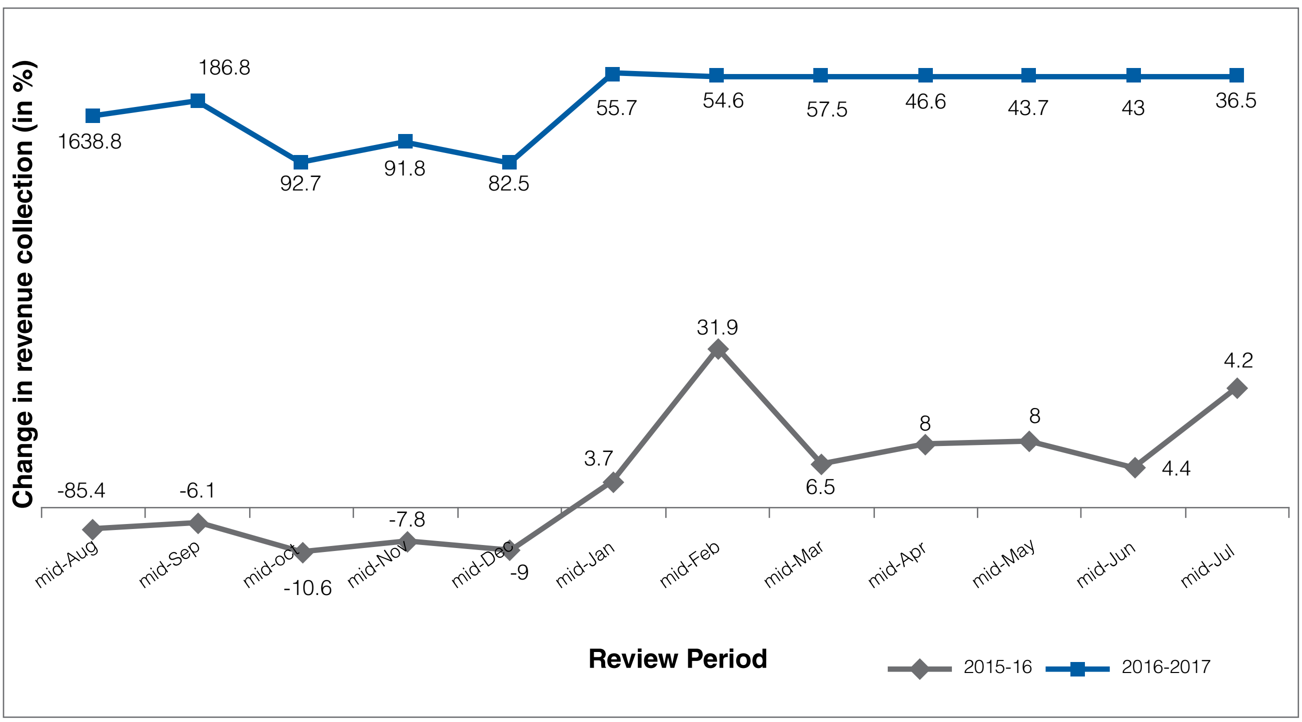


Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

Government expenditure: Total government expenditure increased by 36.5% to NPR 763.91 billion (USD 5.37 billion), compared to an increase of 14.2% in the corresponding period of the previous year, as shown in Figure 14. This was on account of both recurrent and capital expenditure rising to NPR 501.62 billion (USD 4.85 billion) and NPR 189.46 billion (USD 1.83 billion) respectively. Recurrent and capital expenditure stood at NPR 356.50 billion (USD 3.45 billion) and NPR 111.70 billion (USD 1.08 billion) respectively in the corresponding period of the previous year.

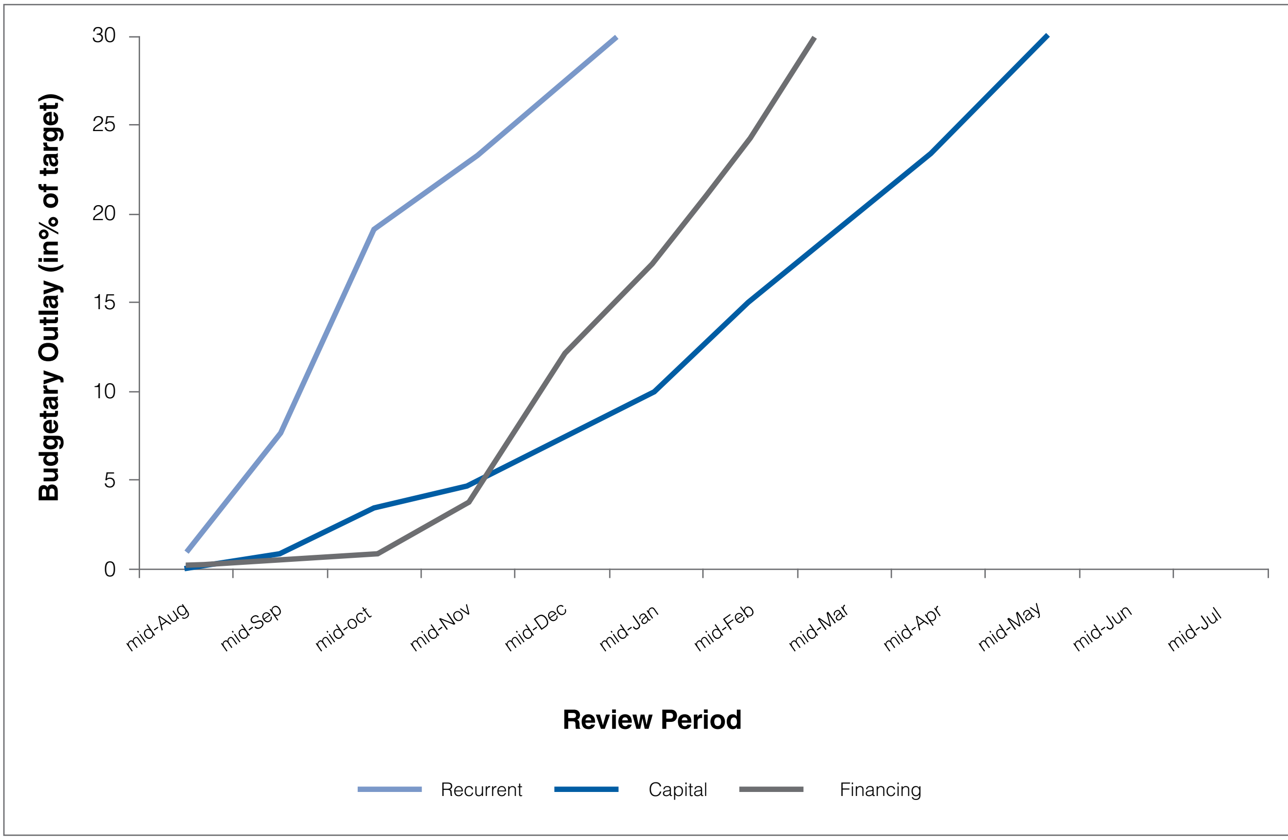
Although the recurrent and capital expenditure have increased in comparison to the corresponding period of the previous year, the outturn in twelve months is still not satisfactory. The utilisation of capital and recurrent budget has been approximately 60% and 81% respectively. Figure 15 shows the monthly outlay in terms of percentage of the target achieved for government spending.[13]

Figure 14: Year-on-year percentage change in government expenditure during the review period for FY 2015-16 and 2016-17



Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

Figure 15: Budgetary outlay trend over the twelve months of FY 2016-17



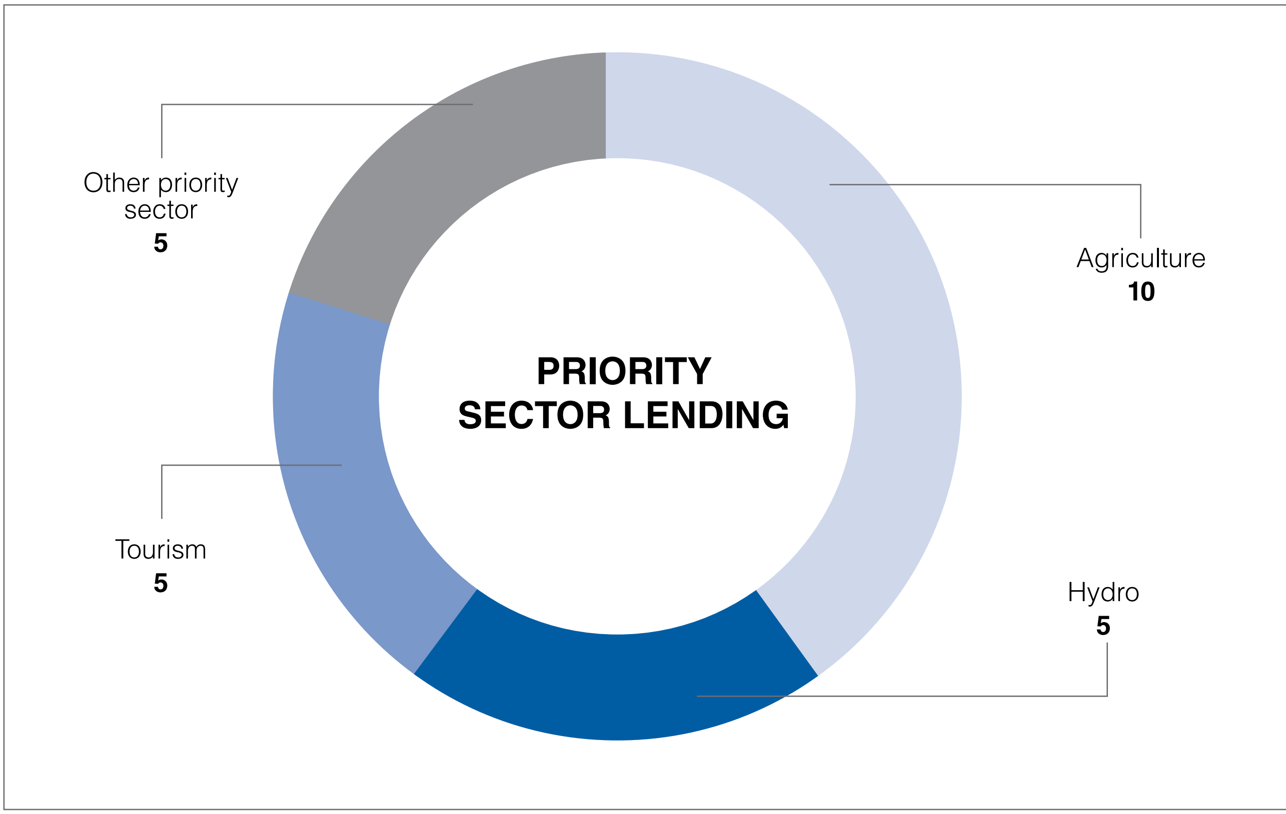
Source: Current Macroeconomic Situation of Nepal (Based on the annual data of 2016/17), Nepal Rastra Bank

5 Key points of Monetary Policy 2017/18

- The targeted economic growth of 7.2% will be achieved through effective liquidity management.
- Cash Reserve Ratio (CRR) and Statutory Liquidity Fund (SLF) have been fixed to 6% and 12% respectively.
- The inflation level for the coming fiscal year 2074/75 has been targeted at 7%.
- Interest rate corridor has the following features:

Particular	Rate (in %)
Standing Liquidity Facility (Ceiling rate)	7%
Repo (policy rate)	5%
Term Deposit (floor rate)	3%

- Priority sector lending for 'A' class commercial banks has been fixed to 25%.



OUTLOOK

Inflation levels are expected to remain relatively low in the country; however, changes in global oil prices threaten to increase inflation. Nepal's trade deficit will continue to widen, increasing the need to strengthen domestic industries in order to make Nepali exports more competitive in the global market. Since the current account deficit is a product of consumption binge, the government should use deficit financing for investment purposes. If the borrowed foreign funds are not utilised in investments with higher return than the interest rate, repaying the debts will be a challenge in the future.

Additionally, the macroeconomic outlook of Nepal needs to be revamped. Besides focusing on current economic stances, Nepal needs to prepare a vision to achieve the economic growth required to graduate from its status as a least developed nation to a middle-income nation by FY 2030. The overarching dynamics of the economy must be carefully scrutinised to take stock of possible opportunities and risks. If Nepal wants to leapfrog from the current age of slump to the era of economic prosperity, it needs to focus on promoting its manufacturing industries. Nepal needs to abandon the bourgeois form of economic model, where the majority of resources are controlled by few plutocrats, and focus primarily on manufacturing commodities. Doing so will help mobilise working class labourers—the most important economic actors—and thereby achieve the desired socio-economic evolution.

3

SECTORAL REVIEW

NEPAL ECONOMIC FORUM

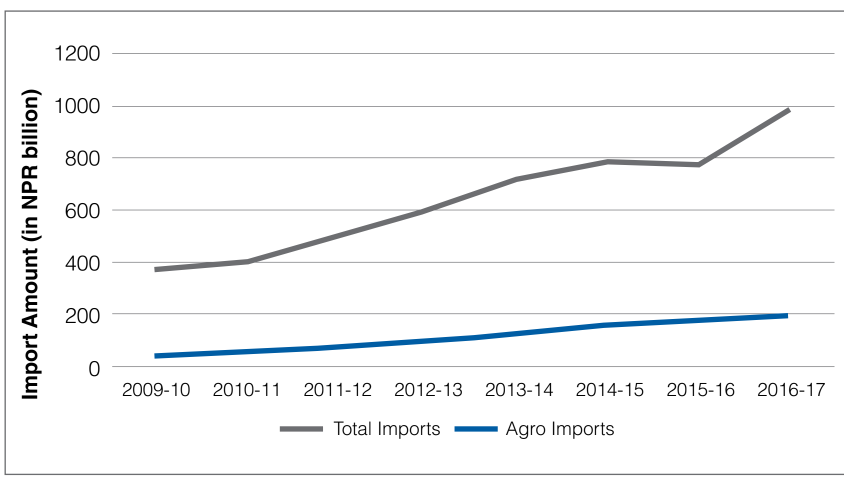
AGRICULTURE

Though efforts have been taken by the government to upgrade the agro products and agricultural sector, various impediments such as untimely monsoon, flood and landslides, dependency on rainfall for irrigation and lack of availability of chemical fertilisers continue to plague the sector.

Paddy plantation affected due to weak monsoon: Due to weak monsoon in various districts during June/July, paddy plantation has been carried out only on 77.03% of total 1,552,469 hectares of arable land. During the month of July last year, paddy plantation was completed in more than 80% of arable land. As per the Ministry of Agriculture Development (MoAD), large volume of paddy plantation is yet to be carried out in many districts including key rice producing districts like Jhapa and Morang. In Jhapa, paddy plantation has been completed on only 72% of 87,500 hectares of arable land, while only 55% of 88,000 hectares of land in Morang has been planted with paddy. The government had projected paddy plantation for 2017/18 to be carried out on almost 94% of arable land that would surge the production to an all-time high of 5.4 million metric tonnes against earlier record-setting production of 5.23 metric tonnes in 2016/17. However, the MoAD considers the current figure for this year to be satisfactory as volume of arable land of paddy has increased as compared to last year.[14]

Agro import close to hitting NPR 200 billion mark: According to the Department of Customs, the country's raw and processed agriculture import bill is worth NPR 196 billion (USD 1.90 billion) in the FY 2016/17, with year-on-year growth of 11.36%. The country's total import bill amounted to NPR 984.06 billion (USD 9.52 billion) in FY 2016/17 out of which the share of agro products is 20%, much higher than what the country spent on oil imports. The food import bill has surged up by four folds in the last eight years—in FY 2009/10 the import bill stood at NPR 44.43 billion (USD 0.43 billion). The key factors leading to such increase in imports have been attributed to increase in food consumption, stagnant local agricultural production, growing food processing industry and expanding live-stock industry.[15]

Figure 16: Imports of Agricultural products



Source: Department of Customs

Table 1: Paddy plantation completed in arable land

Development Region	Paddy Plantation in arable land (in %)
Eastern	65.19%
Central	73.52%
Western	88.90%
Mid-western	73.01%
Far-western	98.66%

Source: Ministry of Agriculture Development

DDC doubles the capacity for powder production: Dairy Development Corporation's (DDC) powder production plant at Biratnagar has doubled its capacity and plans to produce four types of milk products from September 2017. The two-decade old powder plant has been producing three tonnes of milk annually. With the increased capacity, the plant now can produce six tonnes annually and plans to diversify its product lines into condensed milk, skimmed milk powder, tea milk and milk whitener. The increased production capacity is expected to eliminate the requirement of declaring the milk holidays during the flush season, from September to March, when DDC stops buying milk from farmers due to excessive supply.[16]

Nepali tea to be trademarked soon: The National Tea and Coffee Development Board in association with Trade and Export Promotion Centre has planned to register 'Nepal Tea' as a collective trademark in FY 2017/18. This will be registered in the US, Germany and Canada. Nepali orthodox tea has been gaining popularity in the international market because of its improved quality, aroma, taste and aftertaste. Nepali teas have even bagged awards at global and North American tea championships. However, due to lack of branding, Darjeeling tea has overshadowed Nepali tea. After the collective trademark, Nepali tea is expected to expand its presence in the global orthodox tea market.[17]

Investment in climate adaptation: A joint study on impact of climate change finance conducted by the MoAD, National Disaster Risk Reduction Centre, Freedom Forum and United Nations Development Programme (UNDP) has revealed that investment made by the government on climate-related programmes in agricultural sector has had positive impact on the income level of farmers. The study has reviewed the outcome of climate-related government expenditure on agricultural sector and its socio-economic benefits among farmers in Bardiya and Magyadi. With the increase in climate finance investment, household income has increased by 20%, especially among the poorest, while some farmers reported five-fold increase in income over a three-year period. Further, it has also been established that despite remarkable impacts of such programmes, there is a lack of gender and climate specific projects at the local level. Such findings are expected to help the climate-related ministries in decision-making.[18]

Government's fish farming project in lurch: The government's plan to develop a fishery block in Chitwan district under the Prime Minister Agriculture Modernisation Project envisioned in fiscal budget 2016/17 does not seem to be going as intended. Owing to farmers' lack of interest to dig ponds for fish rearing, the allocated budget for the fishery block has remained unspent. The project aims to prepare fish pond in 99 hectares of land, monitor the fish farms and provide trainings to the farmers. The total budget allocated for the development of the fishery was NPR 30 million (USD 0.29 million), of which NPR 29.9 million (USD 0.28 million) was for the construction of new ponds. However, the grant spent so far is only NPR 6.2 million (USD 0.06 million). Apart from the monetary support, in order to encourage farmers to undertake fish farming, the government is also providing equipment required to dig ponds at a discounted rate and free technological support. But even this provision does not seem to attract farmers. As per Jogendra Mahato, general secretary of the Nepal Fish Entrepreneurs Association, the government introduced the project very late and without consulting the farmers; moreover, the grant provided by the government is far less than the actual cost required to construct a fish pond, therefore failing to attract the farmers to dig ponds.[19]

Floods and landslides to impact agri-output: Heavy downpour, floods and landslides in mid-August have damaged cereal crops, vegetables and legumes planted on thousands of hectares of land in the southern Tarai belt. As per the MoAD, the heavily affected districts are Jhapa, Morang, Sunsari, Saptari, Siraha, Sarlahi, Dhanusha, Mahottari, Chitwan, Rasuwa, Ramechhap, Bara, Parsa, Rasuwa, Myagdi, Rupandehi, Bhajhang and Baitadi. Accordingly, in Bara 55,800 hectares of paddy fields are sub-merged in flood water, while in Dhanusha 21,305 hectares are submerged. Similarly, in Parsa and Rupandehi 20,000 hectares and 1,430 hectares of paddy field are submerged respectively. Though the actual data is yet to come, it is estimated that in the eastern region vegetables worth around NPR 140 million (USD 1.35 million), stored foods worth around NPR 120 million (USD 1.25 million) and fishes worth around 30 million (USD 0.29 million) have been destroyed.[20]

OUTLOOK

Weak monsoon during rice planting season and heavy rainfall followed by flood and landslide during mid-August, that have damaged crops heavily, will have an adverse impact on the agricultural output. As a result the food prices are expected sore in the coming days. Further, the prevailing scenario indicates that the growth target of 5.3% in the agricultural sector as projected by the government for the FY 2017/18 is not likely to be achieved.

ENERGY

In the review period, Nepal has been able to boost its electricity production due to good monsoon, but not enough to meet the higher demand of the dry season. The state owned power utility, the Nepal Electricity Authority (NEA), is focusing on completing the construction of hydropower plants to increase electricity production and has proposed higher tariff rates to minimise the loss being incurred by the utility. Meanwhile, Nepal Electricity Regulatory Commission Bill has been passed to form a regulatory body that will oversee the operating procedure of the associated companies in the power sector.

India reduces electricity export prices: With an agreement to reduce the export price of electricity, per unit price of electricity exported from different Indian states through 132 KV, 33 KV and 11 KV cross-border transmission lines have decreased by NPR 0.112 (USD 0.001), NPR 0.128 (USD 0.0012) and NPR 0.144 (USD 0.0014) respectively. The unit cost of electricity imported from 132 KV transmission line is NPR 8.88 (USD 0.086) and those imported from 33 KV and 11 KV lines are NPR 9.6 (USD 0.093) and NPR 10.464 (USD 0.101) respectively. The Central Electricity Authority (CEA) of India agreed to reduce the electricity export price at the request of the NEA. Currently, Nepal imports around 300 MW of electricity from India through various cross-border transmission lines, out of which 50% is imported through the Dhalkebar-Muzaffarpur and Tanakpur-Mahendranagar transmission lines, at NPR 5.76 (USD 0.056) per unit. However, purchase made through other cross-border lines from different Indian state-owned authorities used to cost NPR 8.992 (USD 0.087) to NPR 10.464 (USD 0.101) per unit before the reduction.[21]

NEA proposes to hike electricity tariff: The NEA has proposed the Electricity Tariff Fixation Commission (ETFC) to hike electricity tariff to minimise the loss being incurred by the power utility. Since the NEA was facing losses due to purchase rates being higher than its selling rates, the board of the NEA approved the proposal to adjust the tariff and forwarded it to the Commission. The power utility has proposed to hike the tariff by 10% to 20% in industrial sector as per its Financial Restructuring Plan. The authority has proposed to hike the tariff on demand (load quantum approved by the NEA) by 10% for the industrial sector. Industries have to pay a minimum charge for the load quantum approved by the NEA whether they fully utilise the approved load amount or not. Likewise, the NEA has proposed 20% hike in tariff for electricity consumed on top of the approved load quantum. However, the power utility has proposed different tariffs for rural cottage industries, small industries, trading, irrigation, community drinking water and entertainment businesses. Moreover, the NEA has proposed to review the slab set for the household users and minimise it to 20 units from 10 units at present.[22]

NEA reduces losses by 88%: The NEA has significantly reduced its losses by controlling power leakages and hiking the tariff. It posted a net loss of NPR 970 million (USD 9.39 million) last fiscal, an 88% drop from the previous fiscal of NPR 8 billion (USD 77.45 million). The NEA had projected a net loss of NPR 7.6 billion (USD 73.58 million) at the beginning of the last fiscal year, but its expectations got outperformed. Meanwhile, revenues of the NEA increased significantly from NPR 34 billion (USD 329.17 million) to NPR 40 billion (USD 387.26 million) in the last fiscal year.

The NEA was also successful in cutting down electricity leakages, resulting in savings of at least NPR 2 billion (USD 19.363 million). The NEA's Janakpur distribution centre cut down leakage to 32.61% from 52.33% within a year. Likewise, the Biratnagar distribution centre's losses came down to 16.7% from 19.78% in the same period. Although the NEA's administrative costs were expected to total NPR 7 billion (USD 67.77 million), they stood at NPR 6 billion (USD 58.09 million). However, the cumulative loss of the NEA is still high at NPR 35.6 billion (USD 344.66 million).[23]

Dhalkebar substation project to meet October deadline: The Chinese contractor, Central Power Grid International Economic and Trade Corporation, which is working on 220 kV Substation Project at Dhalkebar has agreed to meet the completion deadline of October 2017. The contractor had stopped working at the construction site without formally informing the NEA, the owner of the substation. The contractor has agreed to resume work and meet the deadline at the request of a team consisting members from the Ministry of Energy and the NEA. The representative of Power Grid Corporation of India, the consultant of the project, has also agreed to provide the final drawing of the cable trench required by the contractor to speed up the construction.

Nepal's electricity demand is expected to increase by around 200 MW during the upcoming dry season. Even though the country's installed capacity of hydroelectricity by then is expected to go up by additional 130 MW, generation of electricity is expected to drop by a third around that time due to the decrease in water level in most of the river basins. It will be difficult for the NEA to keep the country free from power shortage if the substation at Dhalkebar is not completed immediately. The current import capacity of Dhalkebar-Muzaffarpur transmission line is 160 MW, but with the completion of the 220 kV substations, the country can import another 100 MW of electricity.[24]

Upper Trishuli 3A project works resume after a hiatus: The Contractor for Upper Trishuli 3A Hydroelectric Project, China Gezhouba Group Company (CGGC) has resumed construction of the project which was halted after the devastating earthquake in April 2015. CGGC resumed work after clearing the debris of the earthquake and is reconstructing the power house of the 60MW hydropower plant. However, the project construction will go smoothly only if the Export-Import (Exim) Bank of China extends the grace period to pay back the loan it has granted Nepal for the project construction. Although the bank agreed to extend the grace period, no official letter has arrived yet. The Chinese bank has extended a concessional loan worth NPR 11.847 billion (USD 114.7 million) at an annual interest rate of 1.75% for 25 years. The grace period of five years expired in August 2016.[25]

Nepal Electricity Regulatory Commission (NERC) Bill passed: Parliament has endorsed the NERC Bill which will come into force within 91 days after the President approves it. This endorsement has helped towards forming a regulatory body to oversee the companies involved in electricity generation, distribution, transmission and trading. The regulatory body will frame rules to regulate the players in the power sector. In addition, the body will develop the grid code; operating procedure of electricity service and its maintenance; and fix standards for the quality and safety of the national grid, among others. Moreover, the body will also work to settle the disputes among the license holders of the electricity generation, distribution, transmission and trade. Though the government has allowed private investment in the power sector, it has been limited to power generation only. Private investors seem disinclined to invest in distribution, transmission and trading. To lower the cost of electricity, the government has prioritised developing a transmission line through state or state-controlled administrations.[26]

OUTLOOK

With the increased budget allocation to the energy sector, around 10,000 MW of electricity is expected to get produced within 10 years.[27] Budget of FY 2017/18 has allocated NPR 62.47 billion (USD 604.8 million) to the energy sector. Additionally, budget has also given priority to the completion of Upper Tamakoshi Hydro Project which is expected to generate 500 MW of hydro energy by FY 2018/19. As the energy supply is going to surge over time, the NEA should install adequate transmission grids to channel timely and proper distribution. Moreover, in order to utilise the surplus energy, Nepal needs to focus on other aspects of the economy as well. For instance, promoting manufacturing industries could be a boon in utilising surplus energy. In the long run, it could help create sustainable employment opportunities, eventually contributing to the growth of GDP.

INFRASTRUCTURE

Infrastructure development is essential for Nepal to move from a least developed country to a developing country by 2020. Infrastructure, transport and energy systems connect people and create the means for growth in market opportunities. The Upper Karnali Hydropower project, the Tarai-Kathmandu Fast tract or the Nijgadh International Airport are some of the infrastructure projects the government needs to prioritise to propel the country's economic growth.

Land acquisition of Korala port complete: The government has completed land acquisition for the construction of a dry port in Korala, Manang. The establishment of a port in Korala is of strategic importance to enhance bilateral trade with China. Korala lies 273 km from Pokhara and 75 km from the nearest Chinese market at Dhunga Basin. The opening of the Korala port is expected to boost tourism between Pokhara and Mansarovar which is only 400 km away from Dhunga Basin.[28]

Delay in construction works of the GBIA: The Gautam Buddha International Airport (GBIA) project, estimated to cost NPR 6 billion (USD 58.1 million), is facing delays as a result of payment dispute between the Chinese Contractor Northwest Civil Aviation Airport Company (NCAAC) and different local contractors and workers hired by the Chinese Company. It is estimated that hardly 30% of the physical work has been completed so far despite the contractual requirement to complete at least 5% of the physical work every month. The government has warned the NCAAC that it would terminate its license if the latter does not speed up construction works by the end of October.[29]

Construction of Pokhara International Airport finally kicks off: The construction of the NPR 22.3 billion (USD 215.96 million) Pokhara Regional International Airport project began from August 2, 2017—16 months after the foundation stone of the project was laid. A Chinese contractor China CAMC Engineering Co. Ltd. has been selected for the construction of the airport. The project is expected to be completed by July 2021. The airport will be constructed with Chinese funding with the China EXIM Bank providing the loan of NPR 22.3 billion (USD 215.96 million) at 2% per annum.[3]

Expected delay in construction of Katahari-Bathana railway: The NPR 4.48 billion (INR 2.8 billion, USD 43.4 million) Katahari-Bathnaha cross border broad gauge railway project is expected to get delayed due to land owners moving to the Supreme Court on grounds of inadequate compensation for land acquisition. The 18.1 km railway project stretches from Kalahari in Nepal to Bathana in India. Till date 119 bigha (19 hectares) of land has been acquired by the government for the project, for which NPR 530 million (USD 5.1 million) has been distributed as compensation. The government envisions linking the railway project to the East-West railway project via Itahari.[32]

DPR of East-West Railway commenced: The Department of Railway (DORW) began the process of Detailed Project Work (DPR) for Butwal-Gaddhachauki section of East-West electric railway project. The government aims to complete the DPR in 15 months.[33] The DPR

Table 2: East-West Electrified Railway Project features

Total Length (Mechi to Mahakali)	945.244 km
Geographical locations	24 Districts (Mechi to Mahakali)
Project Land required	2247 ha of forest (Mechi to Mahakali)
No of Bridges	334
Longest Bridge	1171 m (Saptakoshi river)
No of tunnels	10 (26.7 km)
Longest Tunnel	17.742 km
Form of Investment	Public Private Partnership

Source: Office of The Investment Board of Nepal, Ministry of Physical Infrastructure & Transport of Kakadvitta-Bardibas section of the project is expected to be completed by this September. The total project cost of the East-West Electrified Railway Project is estimated at NPR 309.8 billion (USD 3 billion). The salient features of the project are as per Table 2 above.

Contracting for road projects under Indian Line of credit: India's Ministry of External Affairs has announced[34] that the process to award road contracts as per the Indian Line of credit III worth NPR 31 billion (USD 300 million) will be held in Kathmandu. The contracting process was delayed for three months after Nepal denied the Indian proposal of selecting contractors from New Delhi. The proposed road and irrigation projects under the Indian Line of Credit is shown in Table 3 below.

Table 3: Line of Credit proposed Investment

Road Project	District	Length	Cost in USD
Ranke-Rabi-Bhedetar Road	Ilam, Dhankuta and Panchthar	90 km	31.5 million
Charikot Jiri section of Lamonsanghu Tamakoshi Jiri Road	Dolakha	55 km	22 million
Seleghat-Ramechap-Sangutar Road	Ramechhap, Okhaldhunga	55 km	22 million
Gandkot-Rampur Ramdi (Pipaldanda)	Palpa and Nawalparasi	130 km	45.5 million
Lamahi Ghorahi Tulsipur Road	Dang	47 km	16.5 million
Bhalubang-Bagdula-Bhimgittee	Pyuthan and Baglung	70 km	24.5 million
Sahajpur Boktan- Dipayal Road	Doti	50 km	17.5 million
Tarai Roads	Mahottari, Bara, Parsa, Kapilvastu, Siraha, Saptari, Banke, Dhanusha, Sarlahi, Bardiya	243 km	60.75 million
Bardibas Jaleshwar			
Gandak-Canal Road			
Chanauta-Krishna nagar			
Basantapur Katahariya Kawahigoth – Paparadi Padam Road			
Urban Terai Road in Rajbiraj-Malangwa –Shiraha			
Nepalgunj-Gulariya			
Total		**740km**	**330 million**

Irrigation Project	Projected Cost in USD
Mahakali Irrigation Project III	165 million
Rehabilitation of Koshi Pump canal and distribution system	35 million

Source: Nepal Energy Forum

OUTLOOK

Lack of proper infrastructure continues to be is one of the key reasons behind low economic growth of Nepal. The country is still poorly connected to its neighbouring economic giants. Though many projects have been envisioned, its implementation still remains a major concern. Poor infrastructure hinders Nepal from taking advantage of global value chains and developing the manufacturing sector. Further, there is a dire need for the government to increase capital spending to bolster construction of infrastructure projects.

INFORMATION AND COMMUNICATION TECHNOLOGY

In the review period, numerous positive developments have taken place in the ICT sector. Various telecommunication companies have submitted their applications to expand broadband internet network in different parts of the country. Meanwhile, Nepali consumers will now have access to online trading via selected payment gateways. Likewise, Nepal is gradually moving towards e-governance with initiatives such as expansion of online registration of personal events.

Government websites highly vulnerable: A group of hackers that go by the name of Paradox Cyber Ghost (PCG) reportedly hacked 58 government websites, including the Ministry of Defence, Office of the Auditor General and Nepal Law Commission. This was a testimony to how vulnerable government websites are to such breaches. In order to look into the incident, the Ministry of Science and Technology formed a three-member committee which has recommended the government websites to obtain clearance from the department before its operation and to be annually audited. The committee has also recommended recruiting a dedicated system administrator in all government offices to monitor cyberspace minutely and report it to senior officials on a daily basis.[35]

Nepal to get Chinese internet bandwidth from August: With China Telecom re-locating its optical fibre along 20-kilometre stretch around Lhasa, Nepal will be receiving Chinese internet bandwidth from August. The cross-border internet link project had been delayed due to a halt in the maintenance work of the damaged cables owing to unfavourable weather conditions and frequent avalanches. To link with China Telecom, the optical fibre from Kathmandu to Rasuwagadi has already been laid by Nepal Telecom (NT).[36]

Online trading to start soon: First-of-a-kind service that allows debit and credit card holders to purchase goods and services from Nepal-based online stores is being launched in the country. Nabil bank and Himalayan bank have installed systems to support online trading all over the country. In order to ensure secure online transactions, renowned payment technology companies like Visa and Mastercard have certified these systems. Electronic cardholders of any other bank will also be able to engage in online trading as long as online shoppers using Nabil bank payment gateway use electronic cards that are products of Visa, Mastercard or Union Pay International, while online shoppers using Himalayan bank payment gateway use electronic cards that are products of Visa, Mastercard, Union Pay International, American Express or JCB.[37]

IT park finally resumes its operations: After being stalled for years, Nepal's only Information Technology (IT) park in Banepa has finally come into operation. The park was established in 2013 with the view of promoting IT in Nepal. On April, 2016, Memorandum of Understanding (MOU) had been signed separately by three parties: Kathmandu University (KU), Cloud Himalaya and Soft Tech foundation with the Department of Information Technology to occupy the area for 10 years. However, after the agreement was signed the government pulled back from the deal. Nevertheless, work at the park has now started after the government gave its green signal.[38]

Expansion of online registration of personal events: In view of modernising the civil registration system, the Department of Civil Registration (DoCR) has expanded online registration of personal events like birth, death, marriage, divorce and migration in 131 local units of 48 districts. The online registration was launched on March 25, 2015. According to DoCR, 32% of the total population will now be able to use the online registration service. They have been installing the system in various areas where there is adequate infrastructure to support such online service. As per the Economic Survey 2016/17, a total of 759,926 incidents both through online and manual process were registered as of mid-March, up from 180,163 in the first week of April.[39]

Mechanism to check internet speed of ISPs: Due to constant complaints from the public that the Internet Service Providers (ISPs) have not been providing the agreed internet speed, the Nepal Telecommunications Authority (NTA), the sole telecom regulator of the country, has decided to introduce a system to check the internet speed and rates being charged by ISPs. To implement this mechanism, a "probe device" will be placed in the residence or office of those who have filed a complaint. The device will automatically read the internet speed once it gets connected to the server of the NTA.[40]

Free internet service to bus passengers: Nepal Telecom (NT) has collaborated with Cybernetics Pvt Ltd in a bid to provide free internet service to bus passengers. Permission from NT is required if the service is to be operated by buses travelling to different parts of the country. R-UIM card with 10GB data is to be provided to each bus free of cost. However, the bus owners will need to pay a certain amount to NT for the data consumed on a monthly basis. In the first phase, NT Bus Internet Service has been subscribed by seven vehicles travelling different routes.[41]

Slow growth in 4G subscription: Currently, NT has more than 4 million pre-paid SIM users and 350,000 post-paid SIM users in Kathmandu Valley and Pokhara. However, amongst them only 7,729 post-paid SIM and 508,500 pre-paid SIM subscribers have switched to 4G service. This slow growth in 4G service is due to limitation of frequency spectrum to telecom companies. These companies have only been able to provide 30 mbps internet speed on 4G service, while such service should have around 90 mbps internet speed. However, also the fact that all the subscribers do not have 4G compatible mobile sets has led to slower growth in 4G subscription in the country.[42]

Increase in internet access: Since smart phones are now available at affordable prices, around 58% of Nepal's population has access to internet service—up from 16% compared to five years ago. According to the Management Information System (MIS) report of the NTA, in the past five years data subscription and voice segment has surged by 42.33% and 65.24% respectively. Likewise, data penetration stood at 58.08% in March 2017 compared to 15.75% in March 2012. Similarly, the report also states that NT has 7.92 million data subscribers and Ncell has 6.73 million subscribers. It is believed that there has been a steady rise in the data segment due to the increase in popularity of social media and communication platforms.[43]

NTA received proposal from Worldlink and Mercantile: Worldlink and Mercantile Communications Pvt Ltd have submitted their applications to the NTA to lay broadband internet network in districts of Province 6. These proposals are currently under the review of a technical committee of the NTA. The Internet Service Provider (ISP) awarded with the broadband project need to complete the project within one year. Likewise, they will be required to provide free internet service in the region for a minimum of two years. Meanwhile, the party winning the contract is required to expand broadband internet service in every district headquarter, municipality, village development committee, education institution, health institution and public area, among others. United Telecom Ltd (UTL) has already been awarded to lay optical fibre in various areas of Provinces 4 and 5.[44]

OUTLOOK

Despite a number of positive developments in the ICT sector, lack of proper infrastructure still poses a concern. As Nepal is gradually moving towards e-governance, the government needs to invest in security packages to minimise the vulnerability of cyber-attacks. If the government fails to look into the issue of cyber security then the benefits of e-governance cannot be completely achieved. Meanwhile, though IT Park in Banepa has now come into operation, its utility will depend on the availability of proper infrastructure and supporting facilities. Likewise, efforts from the telecom regulator such as checking the internet speed and rates charged by the ISPs is expected to boost the efficiency of the ISPs of the country.

REAL ESTATE

The level of urbanisation in Nepal is mostly concentrated within the Kathmandu Valley. However, in recent years the pace of urbanisation has been rapid in other cities as well which has pushed up the real estate and housing prices in many parts of the country.

Low uptake of subsidised quake loan: The Nepal Rastra Bank (NRB) through its circular 26/071/72 dated May 27, 2015[45] had directed Banking and Financial Institutions (BFIs) to provide loans at 2% per annum for quake-hit families. As per the circular, BFIs were directed to provide loan up to NPR 2.5 million (USD 24,200) within the Kathmandu Valley and up to NPR 1.5 million (USD 14,523) in other quake-affected districts. However, the uptake of concessional loan facility provided by the NRB under refinancing facility through BFIs has been dismal. It is estimated that banks have issued only NPR 816.5 (USD 7.90 million) to 382 customers.[46]

Increase in personal home loan limit: The Monetary Policy 2017/18 has raised the ceiling for personal home loan from NPR 10 million (USD 96,814 million) to NPR 15 million (USD 0.14 million).[2] The NRB through the new monetary policy has reduced the Loan to Value ratio (LTV) on real estate lending from existing 50% to 40% within the Kathmandu Valley. However, the LTV outside the Valley remains unchanged at 50%. Similarly, the LTV ratio on home loan has been fixed at 50% within the Kathmandu Valley and 60% outside the Valley.[2] The LTV ratio indicates how much an individual can borrow against an appraised value of the property/collateral.

Land pooling projects within the valley: As per the Ministry of Urban Development there are as many as 12 land pooling project spanning over 260 hectares being implemented within the Kathmandu Valley and 11 projects with 405 hectares are in the pipeline. The government has adopted the land pooling system to develop four new satellite cities including the construction of the proposed 71.93 km outer ring road.[47]

OUTLOOK

The low uptake of subsidised loan is largely driven by BFIs disbursing loans to individuals who have a satisfactory income to service the loan and those who can provide adequate collateral. Similarly, the scheme was introduced at a time when the government had postponed the approval of designs for houses which meant that the earthquake victims had to wait till the government began the approval process. Further, the BFI's reluctance to provide loan under this scheme as the NRB circular is silent on levying penal interest on an overdue loan as well as BFIs not being able to charge over 2% interest on the loan and that interest cannot be revised throughout the loan period has resulted in the dismal level of loan disbursement.

The increase in home loan cap is expected to increase the demand for housing. However, the demand for apartment in high rise buildings is not expected to increase anytime soon as a result of the earthquake. Similarly, the NRB's directive to increase capital of the BFIs, the quantum of funds available for housing and real estate is also expected to increase. As a result, the real estate and housing market will continue an upward trend. However, the reduced LTV ratio within the Kathmandu Valley may dissuade investors in investing in real estate within the Valley. It is expected that real estate investors may venture outside of the Valley to take advantage of the unchanged LTV ratio as well as the growing demand for real estate in emerging cities such as Biratnagar, Itahari, Bhairahawa, Butwal, Nepalgunj.

EDUCATION

The last quarter was a mixed bag for the education sector, with the government making tall promises on the one hand and displaying inadequacies on the other. While there are reasons to be optimistic—the momentum gained in the reconstruction of schools in Kavre and the handing over of control to local levels by the Ministry of Education (MoE)—there are also reasons to be cynical. The sudden suspension of school funds in Udayapur, for instance, throws lights on the MoE's ineptitude in implementing its plans.

SEE results reveal disparity in education: The Office of Controller of Examinations (2017) released the results of Secondary Education Examination (SEE), formerly known as School Leaving Certificate (SLC), on June 16. Out of 462,136 examinees, only 12,284 (i.e. 2.66%) obtained a GPA of 3.65 or above. The highest percentage of students that appeared for the exam—23.47% (108,464 students)—obtained a GPA of 1.65-2.[48]

The results reveal a large disparity in educational attainment across different regions of Nepal. Province 6 (the Karnali region) and Province 7 (the Far Western region) had the worst average performance with only 7.06% and 9.42% of examinees obtaining a score of 2.80 or above respectively. In contrast, Province 3, which contains the Kathmandu Valley and the Chitwan district, had the best average performance with 40.51% of examinees receiving a GPA of 2.80 or above.

Overall performance also deteriorated from last year, with outstanding performers (those with a GPA of 3.65 or above) dropping from 3.76% to 2.76% in the regular category. Meanwhile, the percentage of students obtaining a GPA of less than 2.00 jumped from 55% to 68% in the same period.[49]

18-point directive issued by MoE: Following the completion of the second phase of local level elections, the MoE issued an 18-point directive instructing all local level education bodies to act in accordance with local government's educational plans and policies. A MoE spokesperson revealed that local governments will now have a greater say in education governance; for instance, resource allocation and expenditure, opening of new schools, keeping of student records, and appointment of teachers will be overseen by local level education offices. Moreover, the directive also states that the holding of school level examinations, provision of scholarships and educational counselling services, and establishment of libraries will fall under the jurisdiction of local level authorities.[50]

Lawmakers seek more budget for education sector: Participating in the budget discussion session in Parliament, lawmakers blamed the lackadaisical government policies toward community schools for the sorry state of the education sector. Lawmakers opined that the education sector should be the top most priority for the government and that it should receive the highest budget allocation. In reality, only 10.25% of Nepal's total budget for FY 2017/18 has been allocated to the education sector. Lawmakers demanded concrete policies to improve the quality of education throughout the country. Key issues highlighted were: lack of teachers in rural areas, the need for universities in every province and the need for administrative units in rural municipalities.[51]

"One school one library" campaign: Education Minister, Gopalman Shrestha, revealed that the government plans to immediately implement the "One school one library" campaign that aims to restore or establish libraries in earthquake-damaged schools, providing access to books to Nepali children in general and earthquake-affected children in particular. Shrestha further commented that the government has made arrangements to ensure that conflict victims from marginalised communities do not get deprived of education. Moreover, he remarked that community schools illegally collecting fees would face repercussions and that the reconstruction of 9,333 schools affected by the 2015 earthquakes had begun.[52]

School reconstruction gains momentum in Kavre: Reconstruction of community schools damaged in the 2015 earthquakes has picked up pace in the Kavre district. According to local authorities, 24 out of 71 schools under reconstruction are in the final stage of being completed. Reconstruction of school buildings with two to four rooms were supposed to be completed by the end of last year, but due to local level elections the target could not be met. For the district, the government has allocated NPR 270 million (USD 2.61 million) for the reconstruction of schools destroyed by the earthquake, while an additional NPR 260 million (USD 2.52 million) has been allocated for repairs of schools damaged by the earthquake. According to local authorities, some 365 schools are being repaired using the available funds.[53]

Schools in Udayapur left to fend for themselves: 170 community schools in the Udayapur district have been left to fend for themselves after the government cut off their funding with effect from mid-July.[54] These schools had previously been operating with teachers from per capita funding (PCF) quota. According to the District Education Officer, they did not receive any warning or clarification from the MoE in this regard. Although the MoE claims that it had created 12,000 teaching posts under the PCF quota last fiscal year, it has not been able to implement the scheme.

Sajha Prakashan to be investigated: The MoE has formed a three-member panel to investigate irregularities at Sajha Prakashan—the state-owned publishing house. The chairman and general manager of Sajha, Dolendra Prasad Sharma, has been accused of rampant corruption and embezzlement, reportedly pocketing millions every year. Sajha Prakashan publishes three textbooks for compulsory subjects in grades 11 and 12. While the number of students in these grades has been rising every year, the number of books published by Sajha has been on the decline since Sharma's appointment in 2015. Sharma's original tenure expired on January 2017 but he was immediately reappointed for a four-year period.[55]

OUTLOOK

With its 18-point directive, the MoE has assigned greater responsibility of the education sector to the local bodies. Therefore, the role of locally elected representatives will be increasingly important in the sector. While the MoE has made hefty assertions regarding the implementation of projects such as the "One school one library" campaign, it will be important to keep officials accountable to their claims. The Sajha Prakashan probe is a step in the right direction to curb rampant corruption in the sector.

HEALTH

Many health related cases including diarrhoea and viral infections has been on the rise during the review period. Such cases have resulted due to lack of availability of clean drinking water and absence of heath related awareness programmes relating to flu vaccinations and personal hygiene. Lack of adequate awareness building has been a major drawback in the development of the health sector in the country.

Swine flu in Nepal: Flu cases have been on the rise throughout the country. In a period of two weeks, 12 people have died and more than 100 patients have been diagnosed with swine flu. The symptoms of swine flu are high fever, dry cough, weakness, chills, sore throat, runny nose, fatigue, diarrhoea in children, and headache. Such outbreak of swine flu has raised concerns as it seems to be the same strain of flu that had led to an epidemic in 2009 and a major outbreak in Jajarkot in 2015.[56] In Nepal, the flu was first detected in Waling, Syangja this season.[57]

Health alert issued to flood victims: Doctors have alerted flood victims across the country to be cautious against water borne and vector borne diseases. There is increased risk of water borne diseases such as diarrhoea, cholera, Hepatitis A, Hepatitis E, typhoid and other gastrointestinal diseases post flooding. In addition, there are high risk of malaria, dengue, chikungunya and leptospirosis as well.[58]

Health Insurance Bill-2017: Health Insurance Bill-2017 was presented by the Health Ministry for parliamentary approval. The bill proposes universal health insurance for all Nepalis. Clause 21 of the bill requires all family members to sign up to the health insurance scheme. The health security programme has been launched by the government in Ilam, Baglung, Kailali, Baitadi, Achham, Kaski, Myagdi and Palpa districts. However, a strong legal basis is required for the programme to be expanded all over the country. As outlined in the Social Health Security Program (Operating) Regulations-2015, the legislation will waive insurance premium for the poor and marginalised communities.[59]

11th hunger strike: Dr Govinda KC, a senior orthopaedic surgeon at Tribhuvan University Teaching Hospital, launched his 11th hunger strike on July 24, 2017, demanding an end to the anomalies in medical education and endorsement of the Health Profession Education (HPE) bill.[60] One of the provisions of the bill aims to prohibit establishment of new medical colleges in the Kathmandu Valley for 10 years. If the bill is passed and amended, affiliation will not be granted for those medical colleges that have already taken the letter of intent. However, the HPE bill has been revised with the note that MBBS and post-graduate programmes will be allowed to run by medical schools that have already got the letter of intent. This allows the CPN-UML promoted Manmohan Memorial Institute of Health Sciences (MMIHS) in Kathmandu and CPN (Maoist Centre) backed B&C Medical College Teaching Hospital and Research Centre in Birtamod, Jhapa to get affiliation. This completely goes against the demands of Dr KC.[61] The bill has not yet been sent to Parliament for endorsement as enough preparations have not been made.[62] However, Dr KC has decided to suspend his hunger strike on the 23rd day in the view of ongoing crisis due to floods and landslides in various parts of the country.[63]

Government to add two vaccines: The government is planning to introduce two vaccines, Fractional-Dose Inactivated Poliovirus Vaccine (fIPV) and Rotavirus vaccine from coming January. fIPV will be introduced as a substitute for a previously used vaccine named Israeli acute paralysis virus (IAPV). The monetary aid for the introduction of these new vaccines will be provided by the Global Alliance for Vaccination and Immunisation (GAVI).[64]

Rising cases of ENT in the Valley: With the change of season, there has been a rise in Ear, Nose and Throat (ENT) problems as well as viral infections in the Kathmandu Valley. Environmental pollution, consumption of contaminated food and drinking water are the major reasons behind such problems. According to a chief consultant ENT and surgeon at Bir Hospital, more than 50% people visiting Bir Hospital for treatment have suffered from ear infection and around 20% to 30% have problems related to throat and nose.[65]

High failure rate in MD/MS license test: Out of 235 candidates who appeared for the MD/MS licensing examination conducted by the Nepal Medical Council (NMC), only 71 have passed—70% of the doctors failed the exam. According to the NMC Registrar, the people who have failed the examination have appeared for the exams multiple times. Meanwhile, out of the 164 doctors who failed the license test, 111, 21 and 10 of them got their masters from China, Philippines and the Russian Federation respectively.[66]

Health Ministry to expand mHealth and eHealth services: Formal efforts have been initiated by the Health Ministry to expand the use of mobile phones and electronic tools, popularly known as mHealth and eHealth services, by its health facilities. In the first phase, a mobile application and SMS service is being used to track the pregnant women for regular antenatal visits in Baglung and Ilam districts. The Ministry has signed a Memorandum of Understanding with an international company called Medic Mobile to scale up the programme in various districts. According to the Ministry officials, this agreement will leverage mHealth technologies to promote health services. In order to effectively leverage eHealth and mHealth solutions in Nepal, Medic will be providing advice and technical support to the Ministry. The programme will cover 59 VDCs in Baglung, 24 VDCs in Ilam and few VDCs in Gorkha and Dhading.[67]

Rising cases of diarrhoea in the valley: With the onset of monsoon, diarrhoea cases are on the rise in the Kathmandu Valley. According to the statistics of Sukraraj Tropical and Infectious Disease Hospital, Teku, 65 cases of gastrointestinal diseases were recorded in the month of June. According to the District Public Health Office, Lalitpur, 75 to 80% of the drinking water consumed in the Valley contains diarrhoea causing bacteria.[68]

Unsafe blood transfusions: According to the World Health Organisation (WHO), blood transfusion to patients should take place only after it gets irradiated (exposed to radiation) to make it safe from diseases. However, it has been discovered that this practice has not been adopted in Nepal. Although there are more than 250 hospitals across the country, only the Civil Service Hospital has a blood irradiator machine. Besides this, all the other hospitals, including cancer hospitals, have been transfusing blood without irradiating it.[69] According to National Centre for AIDS and STD Control (NCASC), since July 2016, 116 people comprising of 78 males, 35 females and three transgenders have contracted HIV due to blood transfusion, which is 4% of the total 28,865 HIV cases in Nepal. Such cases were mostly reported from Kathmandu, Palpa, Sunsari and Jhapa districts.[70]

OUTLOOK

Despite the government's efforts to strengthen the health sector of the country, lack of adequate health infrastructure still remains to be a major concern. The cases of blood transfusion without irradiating show gross negligence within the health sector. Meanwhile, flood triggered by heavy rainfall is expected to increase water borne diseases in the Tarai region. Also, with the government not addressing Dr Govinda KC's demands, another series of protests can be expected in the coming days.

TOURISM

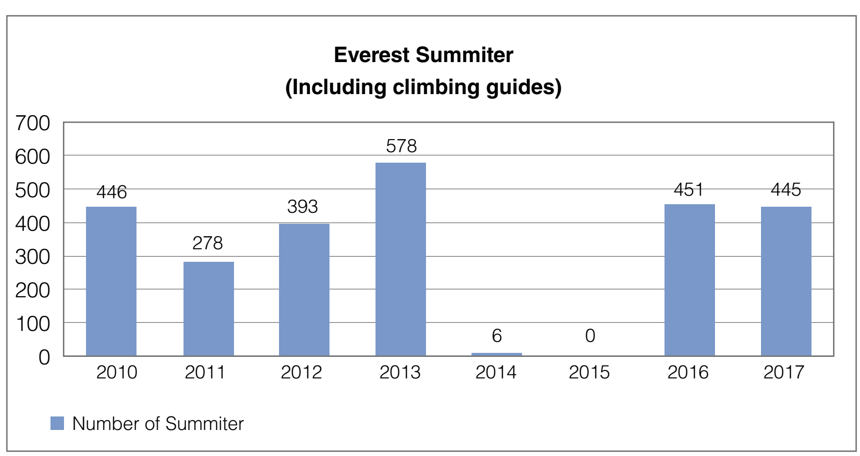
The tourism sector saw a robust growth in the first half of 2017 and is expected to contribute up to 6.8% to GDP in 2017, almost the double the amount compared to the figure of last year which stood at 3.6%. The number of Everest climbers increased massively this year and there has been a significant growth in the number of paragliders as well.

Tourist arrivals rise: Foreign tourist arrivals in Nepal recorded a healthy growth of 28% in the first half of 2017. According to the Department of Immigration, Nepal welcomed a total of 460,304 foreign tourists via air in the first six months of 2017, compared to 359,672 in the first half of 2016.[71] India was the largest tourism market for Nepal in the review period with 93,049 tourists coming from the southern neighbour compared to 64,842 in the first six months of 2017. Similarly, arrivals from China improved to 54,090 in the first half of 2017, compared to 39,609 in the same period of 2016. Tourists arriving from the USA, Sri Lanka, United Kingdom, Thailand, Myanmar, Republic of Korea and Australia also improved in the first half of 2017. It has been noted that although the growth rate in the first half of 2017 is positive, it is still not sufficient to bring two million tourists by 2020.

Everest saw a record number of climbers this spring season: This spring season marked the fourth highest number of successes with 445 climbers making it to the Mount Everest. Everest saw a record number of climbers this season due to a backlog resulting from the 2014 and 2015 avalanches.[72] There were 190 foreigners, 32 fee-paying Nepalis and 223 high-altitude climbing guides if we breakdown the list of summiteers this year. The government issued 375 climbing permits this season. It costs around NPR 1,136,190 (USD 11,000) for foreigners and NPR 75,000 (USD 726) for Nepalis to climb the Everest. Five people have died on the Nepal side of the mountain this season. Given the short window of good weather this year, the success rate should be considered satisfactory.

Government statistics show that 451 people climbed Everest last year as shown in the Figure 17. Among them, 197 were foreigners.

Figure 17: Everest Summiter



Source: Tourism Department

Number of paragliders soaring high: Nepal has tremendous potential in adventure tourism with paragliding being one of the fastest growing segments. The number of paragliders jumped more than double to 19,341 last year. Among the total paragliders, 14,666 were foreigners.[73] There are currently 70 paragliding companies operating in the country. Among them, 95% are based in Pokhara. Nepali paragliders are charged NPR 8,000 (USD 77) for a flight lasting 20-25 minutes, while the price for foreigners is NPR 12,000 (USD 1160). A flight lasting nearly an hour will cost NPR 15,000 (USD 145) for a foreigner and NPR 10,500 (USD 101) for a Nepali.

Tourist spending jumps: Spending of foreign tourists who visited Nepal in the first 11 months of the current fiscal year 2017/18 has increased by 41.9%.

According to the latest report of the Nepal Rastra Bank (NRB), foreigners travelling to Nepal spent NPR 55.2 billion (USD 532.7 million) in the 11-month period between mid-July and mid-June, as against NPR 38.9 billion (USD 368.8 million) in the same period a year ago.[74] The rise in the inflow of foreign tourists has gradually increased Nepal's tourism income. Nepal is expected to attract around 800,000 foreign tourists in 2017.

At the same time, Nepalis visiting foreign countries spent NPR 72.9 billion (USD 698 million) in the first 11 months of the current fiscal year, up by 44% in the same period a year ago, shows the NRB report. Of the total money spent by Nepalis abroad, NPR 31.2 billion (USD 300 million) was spent by students.

ICAO removes Nepal from Significant Safety Concern (SSC) list: The aviation regulator of the country, Civil Aviation Authority of Nepal (CAAN), has recently announced that Nepal has passed a safety audit conducted by International Civil Aviation Organisation (ICAO).[75] From July 4 to 11, a two-member team of ICAO had conducted the audit of Nepal's aviation sector in four areas of aviation safety, after which it was established that the country meets the ICAO's safety standards—Nepal's compliance rate was 66.08%, higher than ICAO's mandatory compliance rate of 60%. In the wake of audit report, the ICAO has removed Nepal from its Significant Safety Concern (SSC) list which was imposed since July 2013.This further opens the door for Nepal's international airlines including the state-owned Nepal Airlines Corporation and privately-owned Himalaya Airlines to expand their flights to new foreign destinations.

Although the global aviation watchdog has removed Nepal from SSC list; the country is still in the blacklist of the European Commission (EC). However, CAAN believes that the removal of the SSC tag will help Nepal to get its name removed from the EC blacklist as well.

Construction of Pokhara Int'l Airport kicks off: The Culture, Tourism and Civil Aviation Minister recently commenced the construction of Pokhara International Airport, located at the country's premier tourist destination, Pokhara, Kaski. This is one of the three new international airports planned in the country. The project is scheduled to be completed by July 10, 2021, as per the contract signed between the project office and the Chinese contractor, China CAMC Engineering Co. Ltd, which bagged the contract in May 2014.

According to the project office, once the airport is ready for operation it will have 2,500 meters long and 45 meters wide runway which can handle medium category jets such as Boeing 757 and Airbus 320.[76]

Himalayan Travel Mart to get continuity in 2018: Himalayan Travel Mart 2017 was held in Kathmandu from June 1 to 4 with the theme 'Nepal: Gateway to the Himalayas'. It was the biggest international event hosted by the Nepal government since the Nepal Tourism Year 2011 campaign. Pacific Asia Travel Association (PATA) Nepal Chapter, the organiser of the event, stated that the event was immensely successful and saw the participation of 107 media and bloggers, 74 buyers, 14 sellers, 21 speakers and nine renowned international personalities from 53 countries. In a bid to attract more tourists, the Nepal Tourism Board has announced that Himalayan Travel Mart will get continuity in the coming years.[77] It is reported that it will be organised in the month of May or June next year.

Nepal Airlines launched online ticketing: The NAC has launched online ticketing services from July and now people wanting to travel via NAC can book tickets from anywhere in the world using their foreign exchange-based international travel cards.[78] Similarly, domestic passengers can book their tickets using debit or credit card from the NAC website. The NAC has been conducting international flights from Kathmandu to New Delhi, Bengaluru, Mumbai, Doha, Hong Kong, Bangkok and Kuala Lumpur. As the airline has been outsourcing the ticketing jobs to travel agencies so far, the online ticket service will immensely benefit foreign tourists visiting Nepal because they no longer have to rely on travel agents or travel all the way to the airline's office to book air tickets. The online booking system is expected to reduce the cost of tickets for travellers as well.

OUTLOOK

The sharp rise in tourist spending gives a glimpse of how tourism industry has bounced back after the 2015 earthquakes. Moreover, given that Nepal is no longer in the safety concern list of the ICAO and NAC has started an online ticketing system, travellers coming to Nepal is bound to increase in foreseeable future, especially with the peak season just around the corner. The government should prioritise improving poor air connectivity, developing infrastructure and safeguarding safety issues in order to create congenial environment in the country.

TRADE AND DEBT

TRADE AND DEBT

Trade activities are rebounding after hitting the lowest point in the aftermath of 2015 earthquakes and India-imposed economic blockade. Imports have been increasing at an alarming rate, while export still has not normalised to the level prior to the slump. This has worsened the trade deficit and can be expected to increase further in the foreseeable future. Moreover, exports of the priority products under National Trade Integration Strategy (NTIS) have also taken a hit. In such a scenario, it is pertinent that local industries are promoted and given the opportunity to grow in tandem with the growing domestic demand.

Foreign trade scenario: Table 4 shows the foreign trade scenario of Nepal for the FY 2016/17. The normalisation of Nepal's foreign trade has led to an increase in the total exports figure. In the current review period, merchandise exports improved by 4.2%, with total exports amounting to NPR 73.05 billion (USD 707 million) as compared to the drop of 17.8% during the same period last fiscal year. Exports to Nepal's southern and northern neighbour, India and China, increased by 5% and 1.2% respectively, while exports to other countries witnessed a rise of 3.3%. However, the growth in exports still lags behind the growth of imports in terms of both value and rate.

Nepal imported merchandise worth NPR 990.11 billion (USD 9.59 billion) during last fiscal year. In contrast to the situation of declined imports by 0.1% in the previous fiscal year, total imports registered an increase of 28%. While imports from India increased by a staggering 32.8%, imports from China and other countries have also increased by 10% and 26.8% respectively.

Table 4 Foreign Trade Statistics for the first eleven months of FY 2016/17 (in billions)

In NPR Billion	2014/15	2015/16[R]	2016/17[P]	Percent Change	
				2015-16	2016-17
TOTAL EXPORTS	85.3	70.1	73.0	-17.8	4.2
To India	55.9	39.4	41.4	-29.3	5.0
To China	2.2	1.7	1.7	-24.6	1.2
To Other Countries	27.2	28.9	29.9	6.3	3.3
TOTAL IMPORTS	774.7	773.6	990.1	-0.1	28.0
From India	491.7	477.2	633.7	-2.9	32.8
From China	100.1	115.7	127.2	15.5	10.0
From Other Countries	182.9	180.7	229.2	-1.2	26.8
TOTAL TRADE BALANCE	-689.4	-703.5	-917.1	2.0	30.4
With India	-435.8	-437.7	-592.2	0.4	35.3
With China	-97.9	-114.0	-125.5	16.4	10.1
With Other Countries	-155.6	-151.8	-199.3	-2.5	31.3
TOTAL FOREIGN TRADE	860.0	843.7	1063.2	-1.9	26.0
With India	547.5	516.7	675.1	-5.6	30.7
With China	102.4	117.4	128.9	14.6	9.9
With Other Countries	210.1	209.6	259.1	-0.2	23.6

Source: NRB Report: Current Macroeconomic Situation (based on annual month data of 2016-17)

Top imports and exports: The top three commodities exported in the FY 2016/17 were woollen carpet, juice and jute goods. In terms of value, woollen carpets amounting to NPR 7.3 billion (USD 70.7 million) were exported to China and other countries; juice worth NPR 5.1 billion (USD 49.4 million) and jute goods, mainly comprising of sackings, worth NPR

4.5 billion (USD 43.6 million) was exported to India. Other top exported products include Cardamom, textile, readymade garments and polyester yarn.

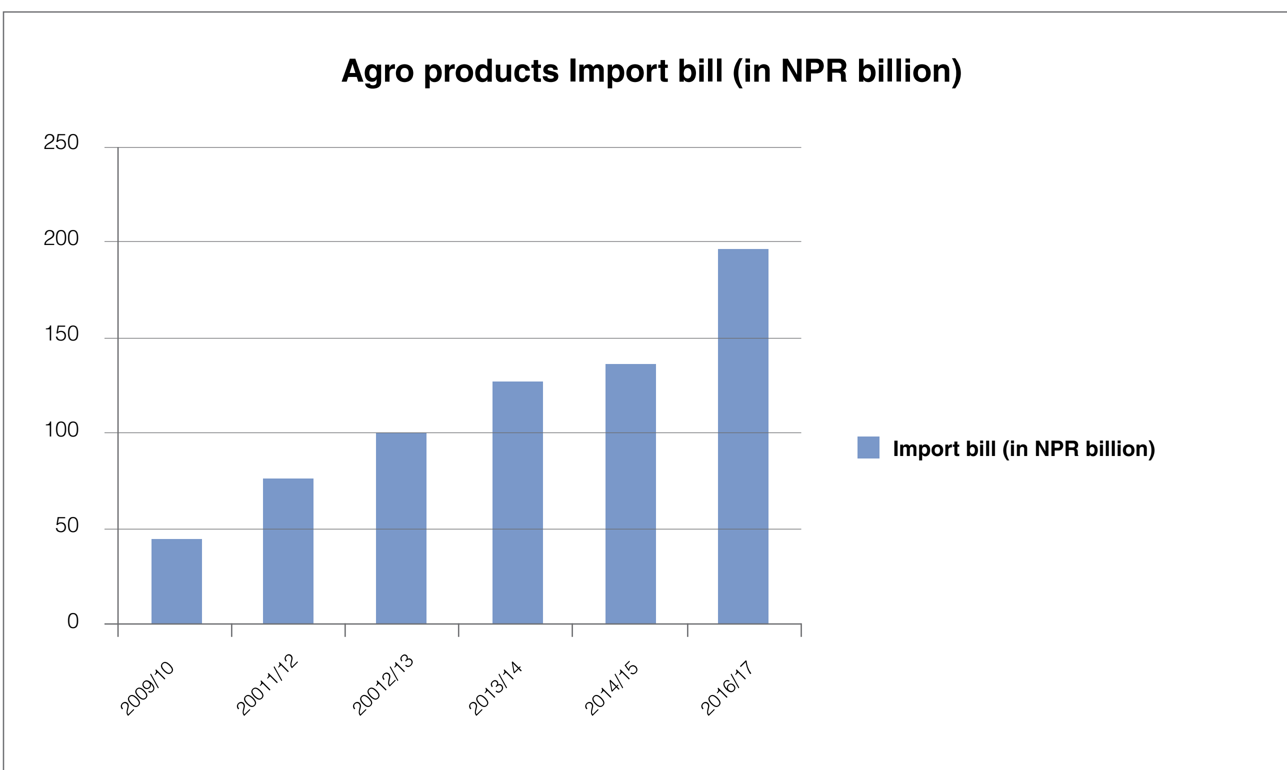
Petroleum products continue to top the charts of import with the country importing petroleum worth NPR 121.4 billion (USD 1.17 billion) in the FY 2016/17—a staggering increase of 76.7% compared to the same review period last fiscal year. However, last year the total import declined due to the trade embargo. Still compared to the FY 2014/15 this is an increase of 8.3% in the import of petroleum products. Vehicles and spare parts is the second most imported product which in turn increases the demand of petroleum products. In the review period, vehicles and spare parts worth NPR 77.8 billion (USD 753 million) was imported, an increase of a staggering 23.7% compared to the same review period last fiscal year.

Trade deficit: In the FY 2016/17, Nepal's total trade deficit widened by 30.4% amounting to NPR 917.06 billion (USD 8.88 billion); the export import ratio declined to 7.4% in the review period as compared to 9.1% in the last fiscal year. Moreover, trade deficit as a percentage of GDP jumped to 35.3% in the review period from 31.3% in the previous year. The normalisation of trade put pressure on demand for goods and services, thereby resulting in increased imports.

BOP surplus: The substantial increase in imports has resulted in a current account deficit of NPR 10.13 billion (USD 98.1 million) in the FY 2016/17. The current account was in surplus of NPR 140.42 billion (USD 1.36 billion) during the same review period last year as the trade embargo lowered the imports. Continuing with the previous trend, the country recorded a Balance of Payments (BOP) surplus of NPR 82.15 billion (USD 795 million) last fiscal year. However, the current BOP surplus is significantly lower compared to surplus of the same period last fiscal year, which stood at NPR 188.95 billion (USD 1.83 billion).

Nepal's agricultural import bill balloons: Nepal has been witnessing a surge in agricultural import bill over the past few years which reached its highest during the last FY 2016/17. Nepal imported raw and processed agro products worth NPR 196 billion (USD 1.90 billion) in the previous fiscal year surpassing the expenditure on oil imports for which it is completely dependent.[79] Figure 18 summarises Nepal's ballooning food imports over the years.

Figure 18: Agro products Import bill over the years



Source: Department of Customs

Growing middle class, burgeoning population and stagnant domestic agricultural production are supposed to have driven up imports manifold. Changes in food habits due to increasing remittances are also inducing more imports.

Unusually tighter security checks dampen Nepal-India trade: Heightened security checks by Indian border security personnel at the Nepal-India border point at Bhairahawa severely hit imports and exports between the two countries.[80]

Citing the reason to keep tabs on activities of "anti-India" elements, India's Sashastra Seema Bal increased surveillance along the borders of Nepal and Bhutan, and the Bhairahawa border point was especially affected by the move. Heightened security checks ended up in traffic congestion stretching kilometres along the border point. As a result, only around 100 cargo vehicles entered Nepal from India per day while normally the daily figure stood at 300 to 350 cargo vehicles. Moreover, the revenue collection was also severely dampened; it fell from around NPR 230 million (USD 2.23 million) to NPR 120-130 million (USD 1.16-1.26 million).

Export of priority products under NTIS drops: Export of priority products listed under the Nepal Trade Integration Strategy (NTIS) declined in the FY 2016/17 as compared to the previous fiscal year. This is set to have a negative impact on the government's target of expanding the export of merchandise goods listed under the NTIS to 4% of GDP by 2020 from 2% in FY 2015/16. NTIS products accounted for 41% of the total exports in the first eleven months of the FY 2016/17 amounting to NPR 27.88 billion (USD 0.27 billion), which is around 1% of the country's GDP.[81]

NTIS is a programme launched by the government to promote products and services with high export potential.

OUTLOOK

The increasing growth of import of consumption goods remains a grave concern for the Nepali Economy. As the spending capacity of people in the country increases, Nepal's dependency on imports to fulfil their consumption needs will also increase. Therefore, it is of paramount importance that Nepal concentrates and focuses on low-volume, high-value products and services to compensate for the ever-burgeoning imports.

FOREIGN AID

Nepal relies heavily on foreign aid, from infrastructure building to human resource development to post-disaster reconstruction programmes. Every year, close to a billion dollars gets poured into the Nepali Economy. Last quarter too, Nepal received some major grants, most noteworthy being the grant assistance from Millennium Challenge Corporation (MCC); at the same time, there are prospects of investment from the rising multilateral financial institution, the Asian Infrastructure Investment Bank (AIIB). However, there are several challenges to effective aid delivery in Nepal which consequently precludes the objectives of foreign aid from being met. Slow progress of projects funded by the Asian Development Bank (ADB), one of the largest donors in Nepal, exemplifies this.

USD 500 million grant assistance from MCC: Nepal has bagged grant assistance worth NPR 51.6 billion (USD 500 million) from the Millennium Challenge Corporation (MCC), an independent US government agency working to reduce global poverty through economic development.[82] Nepal was selected for the grant under the 'compact programme' of MCC for having made progress in upholding democratic rights, rule of law, economic freedom and curbing corruption. As Nepal scored well in the MCC policy indicator scorecard in 2014, it was deemed fit to develop a compact, larger grant-based investment.

The Electricity Transmission Project and the Road Maintenance Project are the two projects identified by the office of the Millennium Challenge Nepal—the Nepal government office which coordinates development of the MCC programme—to be implemented under the MCC grant. Under the Electricity Transmission Project, 300 km of 400kV transmission lines will be built from eastern to western parts of the country along with three power substations.[83] Similarly, under the Road Maintenance Project, the grant will be utilised to maintain 305 km of road segments. Funds from the MCC however comes with a condition—if the projects under the grant are not completed exactly after five years of their implementation date then they will be rolled back.

INGOs to spend foreign aid worth NPR 23 billion (USD 223 million) off-budget: For the current FY 2017/18, International Non-Governmental Organisations (INGOs) operating in Nepal have reached an agreement with the government to spend nearly NPR 23 billion (USD 223 million) in technical and other assistance. A total of 135 INGOs, that have received funds from 23 countries including the UK, Australia, Japan and USA, among others, will be spending the amount across 75 districts and the money will be spent off-budget, i.e. it will not be part of the government's annual budget.[84] Of the allocated money, INGOs plan to spend around NPR 13 billion (USD 126 million) in 39 hill districts, more than what the districts in both mountains and Tarai will be receiving. An average of approximately NPR 334.41 million (USD 3.24 million) will be spent in each hill district. Similarly, a total of around NPR 5.80 billion (USD 56.2 million) will be spent in various Tarai districts, while an average of approximately NPR 290.41 million (USD 2.81 million) has been allocated to each Tarai district. For the 16 mountain districts, NPR 4.10 billion (USD 39.7 million) has been allocated with around NPR 256.48 million (USD 2.48 million) being allocated for each district on average.

AIIB to invest in Nepal's infrastructure development: The Asian Infrastructure Investment Bank (AIIB) has promised to invest hugely in infrastructure development in Nepal. The investment will be made in two mega projects, each consisting of NPR 10 billion (USD 96.8 million) through soft loans with annual interest rate of 2%.[85] One project under the AIIB investment would be power distribution system improvement in the Kathmandu Valley considering the Vallley's poor power distribution system, and technical leakage, among others. Another project will include settlement development and systematic urbanisation in some Tarai districts.[86] Nepal has proposed to AIIB to invest in other projects as well, including construction of a new tunnel from Tokha of Kathmandu to Chhahare of Nuwakot and development of satellite city at Chhahare.

MoF declines agreement extension of India's Small Development Project deal: The Ministry of Finance (MoF) has declined to extend India's Small Development Project terms of agreement between the two countries post its expiration.[87] Reasons behind the refusal have been cited as lack of institutional arrangements in the face of changing constitutional provisions and formation of the local federal units. The ministry has said that once the required institutional arrangements are in place, both the sides can move ahead with the agreement.

Under the agreement, various local bodies are allowed to reach out directly to the Indian Embassy with proposals to receive up to NPR 50 million (USD 484 thousand) in grants for small and local development projects including for schools, colleges and hospitals. The Small Development Project was launched in November 2003 and is popularly known as the "umbrella agreement". The project comes under the broader Nepal-India Economic Cooperation programme wherein there are more than 529 large and small level projects either in implementation or already completed in all districts of Nepal with a total outlay of over NPR 76 billion (USD 736 million). The projects with an outlay of less than NPR 50 million are termed as Small Development Projects (SDPs).

Japan provides NPR 257 million grant for human resource development: The government of Japan is extending a grant of worth NPR 257 million (USD 26.5 million) for Nepal's human resource development.[88] The grant will be used in the form of scholarship wherein government officials will be selected to pursue master degree programmes in various universities in Japan. The grant aims to enhance capacity and skill development of government officials who are expected to engage in formulation and implementation of socio-economic development plans and programmes in Nepal.

ADB-funded projects make sluggish progress: Projects funded by the ADB, one of the biggest multilateral lending institutions in Nepal, have shown dismal performance with low fund disbursement and fewer contract awards. Despite the targeted award contracts worth NPR 55 billion (USD 533 million) for 2017, only contracts worth NPR 6.2 billion (USD 61 million) was awarded, which is only 11% of the annual target.[89] If the current trend continues, it will be difficult for the ADB to achieve even 50% of the target by the end of the year. Poor performances by projects like Melamchi Water Supply Project, Gautam Buddha International Airport, Supporting School Sector Development Plan, South Asia Subregional Economic Cooperation (SASEC) Power System Expansion, Earthquake Emergency Assistance Project and Kathmandu Valley Water Supply Improvement Project have been considered the major reason behind the low disbursement. In 2016, ADB aid disbursement was a record breaking 89% of the target.

OUTLOOK

Foreign Aid is an integral part of the Nepali Economy and is being used in all sectors from infrastructure and energy to health and education. In such a scenario, it is crucial that foreign grants are utilised effectively. However, there are several obstacles to it including corruption and incompetence of the government. As Nepal transitions to a federal structure, there is an opportunity to recalibrate the aid delivery mechanisms and make it more localised for transparency and effectiveness.

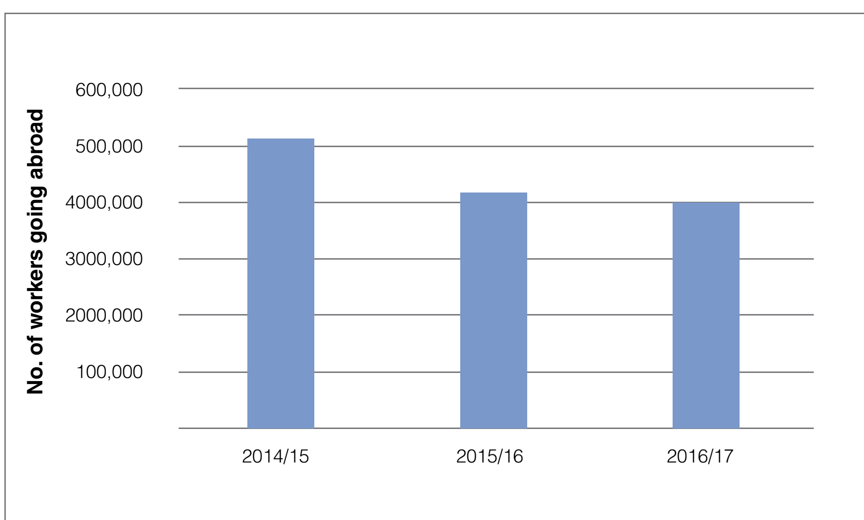
REMITTANCE

The exogenous factors such as slow economic growth in the gulf countries, diplomatic row in Qatar—one of the preferred labour destination of Nepali migrant workers—and the internal impediments such as remittance coming through informal channels and the failure of the government to implement the "Free Visa Free Ticket" scheme have adversely affected the migrants going abroad, consequently hitting the remittance inflow.

Remittance coming through informal channels: As per the Nepal Rastra Bank (NRB) statistics, the country received remittance totalling to NPR 695.45 billion (USD 6.73 billion) in the last FY 2016/17. However, Chandra Dhakal, vice-chairperson of Federation of Nepalese Chamber of Commerce and Industry (FNCCI), has informed that as per a study, 30% of the total remittance is entering Nepal via informal mediums. If all the remittance were to come from formal channels, the total remittance received by the country would be around NPR 900 billion (USD 8.71 billion).[90] Though the informal channels are less secure, migrant workers still prefer to use them as the fee charged through illegal mediums is comparatively less. Further due to poor banking access, many migrant workers are obliged to rely on informal channels. Nevertheless, in a bid to bring remittance through formal channels, the fiscal budget of 2017/18 has mandated all migrant workers leaving for foreign employment to open bank accounts. This is also expected to ensure that inflow of remittance is invested in the productive sectors of the economy. Furthermore, lawmakers have also urged the government to launch schemes to encourage migrant workers to send remittance through formal channels.[91]

Continuous decline in remittance growth rate: Remittance inflow rose only by 4.6% to NPR 695.45 billion (6.73 USD billion) in the FY 2016/17 compared to the growth rate of 7.7% in the corresponding period of the previous year. The decline in remittance inflow has been observed since the second half of the FY 2015/16 and is mainly attributed to slowdown in gulf countries due to rampant fall in oil prices, thereby resulting in fewer job opportunities and decreasing the number of foreign migrant (Refer Figure 19). According to the Department of Foreign Employment, decline in remittance can also be a result of many Nepali migrant workers choosing to stay back in the country after the earthquakes of 2015 in order to help their family rebuild their homes. Moreover, the deprecation in the value of US dollar in the recent months, that depleted by nearly 4% in the last one year, has affected the remittance growth adversely.

Figure 19: Outmigration for Foreign Employment



Source: Department of Foreign Employment

Failure of 'Free visa fee ticket' scheme: As per the study report prepared by a sub-committee of the parliamentary International Relations and Labour Committee, none of the migrant workers have benefitted from the "Free Visa Free Ticket" scheme in the last two years. The "Free Visa, Free Ticket" scheme was imposed by the government on June 2015, under which employer bears the cost of tickets and visa of the migrant workers. Despite the provision, migrant workers have been found paying NPR 50,000 (USD 484.07) to NPR 900,000 (USD 8,713.33) for visa, ticket and processing, which reveals the government's failure in strictly implementing the scheme. The scheme had received severe pushback from recruitment agencies as well as Nepal Association of Foreign Employment Agencies since the very beginning. After the imposition of the scheme, recruiting agencies have started to issue the receipt of NPR 10,000 (USD 96.81) as a processing fee, even though in reality migrant workers may have been paying far more. It has been noted that only if the foreign employment sector is well managed and the recruiting agencies are held accountable, the scheme can be fully implemented.[92]

Amendment in Foreign Employment Regulation: The Nepal government has recently amended the Foreign Employment Regulation for the welfare of the migrant workers. As per the amendment, the government has more than doubled the compensation given to the families of migrant workers who pass away, suffer serious injuries or become critically ill while working abroad from NPR 0.3 million (USD 2,904) to NPR 0.7 million (USD 6,777). Accordingly, a new clause has been added which allows the migrant workers to claim compensation up to NPR 0.7 million (USD 6,777) who become critically ill. Earlier, only families of those who suffered serious injuries or those who lost their lives while working overseas were eligible for compensation under the welfare scheme. The government has also changed the earlier rule that did not cover migrant workers to get benefit under this scheme whose contracts were still valid but had returned home for vacation or emergency. Further, a new provision has been added whereby the welfare scheme would be applicable for additional one year in case the initial contract of the migrant worker expires and s/he renews the work agreement in the host country. Meanwhile, the contribution of migrant workers to the Foreign Employment Welfare Fund has also been increased whereby migrant workers who leave for Gulf countries and Malaysia with a maximum three-year work permit have to contribute NPR 1,500 (USD 14.50) per person which earlier was only NPR 1,000 (USD 9.68). Similarly, workers planning to leave for South Korea and Israel with over three-year contract have to pay NPR 2,500 (USD 24.20) each to the fund.[93]

OUTLOOK

The country has been immensely benefiting from remittance inflow in the form of increased foreign exchange and stability in the balance of payments. With the ongoing plunge in crude oil prices that has impacted job-opportunities and diplomatic row in Qatar—a work place for more than 400,000 Nepalis—remittance inflow is likely to decline in the future.[94] The government should be proactive to implement right strategies to address the economy's excessive dependence on remittance and adopt measures to bring remittance through formal channels.

4

MARKET

REVIEW

FINANCIAL MARKET

Despite mismatch between deposit and credit growth, commercial banks were able to increase its operating profit by 28.7% and net profit by 26.6% during the FY 2016/17.

Key Indicators

Some of the key macroeconomic indicators as per the macroeconomic and financial situation report based on annual data of FY 2016/17 published by the Nepal Rastra Bank (NRB) are highlighted below.

Deposit and Credit Mobilisation

Deposits at Banks and Financial Institutions (BFIs) increased by 14% in the review year compared to an increase of 19.4% previous year. Of the total deposits at BFIs, the share of demand deposits and saving deposits fell to 8.7% and 35.4% respectively while the share of fixed deposits increased to 43.2% from 30.5% a year ago.

Likewise, credit extended to the private sector by BFIs increased by 18.2% in the review year as compared to an increase of 23.7% in the previous fiscal year. Credit mobilisation of commercial banks increased by 25% while that of development banks and finance companies decreased by 13.7% and 13.3% respectively. Of the total outstanding credit of BFIs, 60.9% is against the collateral of land and building and 13.9% against the collateral of current assets such as agricultural and non-agricultural products.

In terms of credit exposure, the outstanding credit of BFIs to real estate loan increased by 16.5% and personal residential home loan increased by 17.5% during the year. Similarly, Hire Purchase loan increased by 35.6% while overdraft loan increased by 22.1%.

Liquidity Management

In the review year, the NRB injected liquidity of NPR 61 billion (USD 590.57 million) in the banking system through various open market operations such as repo auction worth NPR 33.21 billion (USD 311.84 million) and outright purchase auction worth NPR 27.79 billion (USD 269.05 Million). Likewise, BFIs used Standing Liquidity Facility (SLF) worth NPR 62.39 billion (USD 604.03 million) during the review period. Moreover, the NRB injected net liquidity of NPR 435.86 billion (USD 4.22 billion) through the net purchase of USD 4.11 billion from foreign exchange market (commercial banks).

Likewise, in terms of absorption, the NRB mopped up NRP 124.45 billion (USD 1.20 billion) through open market operations. Under this system, NPR 43.75 billion (USD 0.423 billion) was mopped up through 14 days deposit collection auction under corridor system, NPR 16.45 billion (USD 159.3 million) under 90 days deposit collection auction and NPR 64.25 billion (USD 0.622 billion) through reverse repo auction on a cumulative basis. Similarly, the NRB also purchased Indian currency (INR) equivalent to NPR 451.89 billion (USD 4.37 billion) through the sale of USD 4.12 billion and Euro 120 million during the review year. INR equivalent to NPR 385.47 billion (USD 3.73 billion) was purchased through the sale of USD 3.40 billion and Euro 210 million in the previous year.

Foreign Exchange Reserves and Adequacy

The gross foreign reserves stood at NPR 1079.52 billion (USD 10.45 billion) at the end of mid-July 2017, an increase of 3.9% compared to NPR 1,039.21 billion (USD 10 billion) in mid-July 2016. Out of the total foreign exchanges, reserves held by the NRB increased by 4.5 % to NPR 927.27 billion (USD 8.98 billion) at mid-July 2017 from NPR 887.01 billion (USD 8.59 billion) a year ago. The share of INR in total reserves stood at 23.3% as at mid-July 2017.

Based on the imports of FY 2016/17, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 13.2 months, and merchandise and services imports of 11.4 months. The ratio of foreign currency reserve-to-GDP, reserve-to-imports and reserve-to-M2 stood at 41.5 %, 95.3 % and 41.7 % respectively as at mid-July 2017.

Interest Rates
The weighted average 91-day Treasury Bill rate decreased to 0.71 % in the review period from 0.05% a year ago. Likewise, the weighted average inter-bank transaction rate among commercial banks also decreased to 0.64% from 0.69 % a year ago. Also, the weighted average inter-bank rate among other financial institutions increased to 4.47% from 3.35% a year ago.

Balance of Payments (BOP)
In terms of BOP, the current account fell into a deficit by NPR 10.13 billion (USD 98.07 million) In FY 2016/17 compared to a surplus of NPR 140.42 billion (USD 1.36 billion) during FY 2015/16. Nonetheless, the overall BOP posted a surplus of NPR 82.15 billion (USD 795.33 million) in the review year compared to a surplus of NPR 188.95 billion (USD 1.83 billion) in the previous year.

In the review period, Nepal received Capital transfer of NPR 13.36 billion (USD 129.34 million) and Foreign Direct Investment (FDI) inflow of NPR 13.50 billion (USD 130.7 million) compared to transfer of NPR 16.99 billion (USD 164.49 million) and NPR 5.92 billion (USD 57.31 million) respectively in the same period of the previous year.

Fourth Quarter (Annual) Performance Analysis of Commercial Banks
As per the unaudited fourth quarter (annual) financial results of commercial banks for FY 2016/17 as shown in Table 5, the operating profit of commercial banks grew by 28.7% while the net profit grew by 26.6 % compared to the annual figure of previous fiscal year. Nabil Bank was able to post the highest net profit of NPR 3.62 billion (USD 35.04 million) followed by Nepal bank at NPR 3.21 billion (USD 31.07 million) and Nepal Investment Bank at NPR 3.16 billion (USD 30.59 million) at the end of this quarter. During the review year, the deposit mobilisation increased by 18.5% while credit mobilisation by the commercial banks increased by 24.8%.

At the end of fourth quarter, the average Non-Performing Loan (NPL) of banks has gone down to 1.5% from 1.7% as compared to the corresponding period while the average cost of fund of the commercial banks has increased to 5.3% from 3.5%. Similarly, the average base rate of commercial banks stood at 9.8% during the end of this quarter, the highest being 11.9% of Janata bank and the lowest being 6.0% of Rastriya Banijya Bank.

Key Developments
Monetary Policy for FY 2017/18
The central bank has rolled out the monetary policy for current fiscal year 2017/18 with the objective to support the government's target to meet the economic growth rate of 7.2% during the fiscal year. The policy aims to increase domestic credit, private sector lending and money supply by 27.8%, 20% and 18% respectively this fiscal year, while the central bank plans to contain inflation within 7.5%. Some of the key provisions in the policy are highlighted below; moreover, the central bank has already issued relevant circulars to implement key provisions.

- The policy has raised the lending requirement for the commercial banks towards productive sector by 5% to 25% of their total lending portfolio by mid-July 2018. Out of 25% portfolio, 10% of credit should go to agriculture sector, 5% to hydropower sector, 5% to tourism and remaining 5% to other productive sectors as prescribed by the central bank. Moreover, the central bank has included pharmaceuticals, cement and garment industries under the productive sector basket which also includes small and cottage industries and export oriented companies. Likewise, development banks and finance companies would have to lend 15% and 10% of their total lending to the productive sector as well.
- The policy has not changed the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) at 6% and 12% respectively.
- The policy has directed BFIs to restrict organisational deposit within 45% from earlier 50% by mid-July 2018.
- Similarly, the central has given BFIs till mid-October to bring their Core-Capital-Cum-Deposit (CCD) ratio requirement to the regulatory limit of 80% to avoid penalty for not meeting the requirement.
- The central bank has given some respite to the automobile sector as BFIs will now be able to extend up to 65% of the value of the vehicle from existing 50%, moreover, in case of electric vehicles only 20% down payment would be required.
- The ceiling for personal housing loan has been increased to NPR 15 million (USD 145,222) from NPR 10 million (USD 96,814).
- The policy intends to allow dividends up to NPR 100 million (USD 968 147) to be repatriated directly via commercial banks upon submission of certain documents.
- The policy has reduced loan-to-value ratio for credit sought to build or purchase residential houses inside Kathmandu Valley, now onwards borrowers

TABLE 5 FOURTH QUARTER RESULTS OF COMMERCIAL BANKS-UNAUDITED-AS ON FY 2016/17 (FIGURES IN NPR TEN MILLION)

			DEPOSIT			LOANS AND ADVANCES			OPERATING PROFIT			NET PROFIT			NPL (%)		COST OF FUND (LCY)			BASE RATE (%)
Bank	Paid-up Capital	Reserve & Surplus	FY 16/17	FY 15/16	% Change	FY 16/17	FY 15/16	% Change	FY 16/17	FY 15/16	% Change	FY 16/17	FY 15/16	% Change	FY 16/17	FY 15/16	FY 16/17	FY 15/16	% Change	FY 16/17
			4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR	4 QTR	4 QTR		4QTR
Nabil Bank	618.5	903.0	11,889.6	11,026.7	7.8	9,149.1	7,773.0	17.7	546.4	434.4	25.8	362.0	281.9	28.4	0.8	1.1	2.7	2.1	0.6	6.6
Nepal Investment Bank	924.0	1,178.0	12,566.9	10,862.6	15.7	10,668.3	8,700.9	22.6	480.1	369.9	29.8	316.0	255.0	23.9	0.8	0.7	5.8	2.7	3.2	8.4
Standard Chartered Bank	400.5	815.8	6,387.2	5,572.7	14.6	3,920.3	3,169.7	23.7	192.3	170.1	13.1	138.1	129.2	6.9	0.2	0.3	3.1	1.3	1.8	6.5
Himalayan Bank	649.1	527.4	9,288.1	8,733.5	6.4	7,765.4	6,774.5	14.6	249.1	229.7	8.4	217.6	193.5	12.5	0.9	1.2	4.0	2.3	1.7	9.6
Nepal SBI Bank	692.4	350.9	8,166.4	6,521.3	25.2	6,302.5	4,697.5	34.2	234.0	205.9	13.6	152.3	133.1	14.4	0.1	0.1	3.5	2.6	1.0	9.0
Nepal Bangladesh Bank	721.9	349.3	4,371.3	3,984.7	9.7	3,746.0	3,252.8	15.2	177.1	151.9	16.6	120.0	119.8	0.2	0.8	0.7	5.1	4.0	1.2	10.3
Everest Bank	574.1	588.3	9,509.4	9,373.5	1.4	7,828.4	6,891.1	13.6	318.2	283.4	12.3	198.1	173.0	14.5	0.5	0.4	4.8	2.2	2.6	7.7
Bank of Kathmandu Lumbini	562.9	332.0	7,213.6	6,783.6	6.3	6,254.9	6,031.7	3.7	162.8	99.2	64.1	123.9	65.5	89.2	1.5	2.5	5.4	4.0	1.3	10.6
NCC Bank	467.9	256.0	5,879.5	3,036.3	93.6	4,816.8	2,489.1	93.5	40.6	74.7	(45.6)	132.5	70.7	87.4	4.8	0.9	6.0	3.7	2.3	9.3
NIC Asia Bank	669.2	349.0	8,669.7	6,948.7	24.8	7,158.3	5,845.1	22.5	169.4	136.9	23.7	146.9	106.6	37.8	0.4	0.8	6.1	4.4	1.7	11.3
Machhapuchchhre Bank	659.8	251.6	5,862.9	5,229.1	12.1	5,186.6	4,423.4	17.3	178.0	125.8	41.5	130.1	89.8	44.9	0.4	0.6	4.8	3.4	1.4	10.3
Kumari Bank	596.9	211.2	5,207.1	3,795.0	37.2	4,519.5	3,011.1	50.1	80.1	75.4	6.2	70.0	71.6	(2.2)	1.9	1.2	5.9	4.4	1.5	11.3
Laxmi Bank	747.2	218.2	5,932.0	4,815.4	23.2	5,273.3	4,035.9	30.7	135.8	96.1	41.3	100.2	67.7	48.0	0.9	0.8	7.4	4.1	3.3	10.3
Siddhartha Bank	662.8	328.4	7,731.7	6,493.4	19.1	6,606.3	5,535.0	19.4	185.0	165.3	11.9	141.8	125.4	13.1	1.2	1.5	5.4	3.8	1.6	10.4
Global IME Bank	808.0	409.9	10,191.0	7,468.2	36.5	8,081.9	6,084.1	32.8	271.5	185.0	46.8	203.8	138.2	47.5	1.6	1.9	7.1	3.1	4.0	10.4
Citizens Bank International	692.1	252.7	5,271.8	4,739.3	11.2	4,807.7	4,056.5	18.5	124.9	110.9	12.6	121.0	108.0	12.0	1.3	1.4	8.0	4.4	3.6	11.2
Prime Commercial Bank	632.5	312.6	6,586.3	4,834.2	36.2	5,771.0	4,027.2	43.3	201.2	143.5	40.2	148.2	111.5	32.9	0.8	1.2	8.2	4.3	3.8	10.6
Sunrise Bank	701.7	231.5	6,101.3	5,165.0	18.1	5,173.0	4,374.9	18.2	159.3	95.5	66.8	116.8	95.1	22.8	1.4	1.2	6.0	4.5	1.5	11.2
NMB Bank	646.1	426.9	7,322.4	6,478.1	13.0	6,121.9	5,302.1	15.5	198.4	124.1	59.9	151.1	111.5	35.5	1.7	1.8	5.1	4.0	1.1	10.1
Prabhu Bank	588.1	205.1	8,134.9	6,094.0	33.5	6,197.9	4,821.2	28.6	136.9	87.6	56.3	175.1	114.7	52.7	4.3	8.4	-	3.3		10.5
Janata Bank Nepal	699.3	182.1	4,857.4	2,406.7	101.8	4,565.3	2,047.2	123.0	59.1	16.1	267.1	64.1	13.3	382.0	2.1	2.4	8.0	4.5	3.5	11.9
Mega Bank	458.2	377.2	3,893.6	3,075.0	26.6	3,459.7	2,735.8	26.5	118.7	72.0	64.9	79.1	55.1	43.6	1.4	0.8	6.0	4.0	2.0	11.0
Civil Bank	518.5	149.3	3,411.0	3,156.4	8.1	2,949.0	2,570.4	14.7	11.00	25.40	(56.7)	33.8	33.1	2.1	4.1	2.7	6.8	5.4	1.5	11.6
Century Commercial Bank	546.0	118.7	4,259.3	2,896.7	47.0	3,950.7	2,508.4	57.5	68.4	58.5	16.9	44.7	41.3	8.2	1.2	0.2	8.1	4.2	3.9	11.2
Sanima Bank	689.7	216.0	5,822.8	4,642.3	25.4	5,126.5	4,045.5	26.7	199.9	147.8	35.3	130.0	99.6	30.5	0.0	0.0	5.4	3.8	1.5	10.2
Public Sector Banks																				
Nepal Bank	804.2	351.0	9,394.4	8,941.0	5.1	7,437.2	6,352.7	17.1	320.9	194.7	64.8	321.9	288.2	11.7	3.2	3.1	2.0	2.0	(0.0)	6.3
Rastriya Banijya Bank	858.8	311.3	15,357.5	14,620.7	5.0	10,643.1	8,547.0	24.5	266.4	173.4	53.6	308.2	235.5	30.9	2.4	4.3	1.3	1.4	(0.1)	6.0
Agriculture Dev. Bank	1,252.0	708.7	12,684.6	11,178.6	13.5	8,829.7	7,945.9	11.1	118.9	145.6	(18.3)	277.6	246.4	12.7	3.0	4.4	5.7	4.3	1.5	11.3
Total	**18,842.4**	**10,912.1**	**211,963.7**	**178,872.7**	**18.5**	**172,310.3**	**138,049.7**	**24.8**	**5,404.4**	**4,198.8**	**28.7**	**4,524.9**	**3,574.3**	**26.6**	**1.5**	**1.7**	**5.3**	**3.5**	**1.8**	**9.8**

will not get credit excess of 40% of fair market value of the property. Nonetheless the ratios remains unchanged i.e. 50% for transactions outside the Valley.

Central Bank open license for Infrastructure Development Bank

To pave the way for the establishment of an Infrastructure Development Bank, the central bank has issued 'licensing policy for Infrastructure Development Bank 2017'. As per the new policy, initial capital of NPR 20 billion (USD 193.6 million) is required for such establishment.

If the bank is established with foreign investment, a foreign investor can invest a maximum of 85% or a minimum of 20% shareholding moreover, only foreign banks and financial institutions are permitted to be its shareholders. As per the policy, domestic investors could not invest in the proposed shares of the company by taking out loan from any Bank and Financial Institutions (BFIs) while Non-Resident Nepalis (NRNs) would be allowed to make investments through remittance.

Financial Institutions to be established in all local level bodies

As per the new federal setup, 744 local bodies have been established including metropolises, sub-metropolises, municipal councils and village councils. The central bank has urged commercial banks to establish branches in all local level units lacking banking services as envisaged by the government to have at least one commercial bank branch in each local unit. The government intends to distribute budget allocated to local bodies directly to the bank account maintained at a commercial bank.

Nepal Bankers Association (NBA), the umbrella organisation of commercial banks, has shown willingness to open bank branches in 250 local units out of 411 which are unserved by commercial banks. Meanwhile, the Ministry of Finance (MoF) and the central bank have agreed to allow local bodies to open operational account in a national level development bank, in the absence of a commercial bank in the area.[95] Moreover, to motivate financial institutions to open branches in local bodies, the central bank would allow commercial or development bank to open a branch in Kathmandu Valley after opening five branch offices in unserved local units.

License for Microfinance companies halted

The central bank has stopped accepting applications for the establishment of new 'D' class micro-insurance company. Earlier the central bank was accepting applications for establishment of microfinance companies in districts with low financial access namely, Manang, Humla, Jumla, Dolpa, Kalikot, Mugu, Jajarkot, Bajhang, Bajura and Darchula. Currently there are 48 microfinance companies operating in Nepal.

New Life Insurance Company begins operation

Out of the six new life insurance companies receiving operating license from the Insurance Board (IB), IME Life Insurance has started its operations from August 17, 2017. There are currently 9 life insurance companies operating in Nepal.

OUTLOOK

As the banking sector is recovering from a liquidity crunch, the availability of liquid funds to support the projected growth of the government is going to be a challenge amidst weak capital expenditure structure, sluggish growth of remittance and whopping trade deficit. The liquidity in the banking system has eased in recent days primarily due to sudden rise of capital expenditure by the government during the last month of previous fiscal year 2016/17; however, the availability of loanable funds is still limited due to tight Core-Capital-Cum-Deposit (CCD) ratio of BFIs owing to mismatch between credit and deposit growth. Moreover, the central has given BFIs till mid-October to bring their Core-Capital-Cum-Deposit (CCD) ratio requirement to the regulatory limit of 80%, to avoid penalty for not meeting the requirement.

Timely approval of yearly budget and dissemination of financial resources to locally elected local bodies can expect to ease liquidity in the banking system further, however it will be a challenge to maintain healthy liquidity post festive season when lending demand soars up. Despite ease in liquidity the interest rates on credit products are unlikely to go down as banks with higher institutional deposits would have to compete for individual deposits, thus exhausting additional pressure on deposit rates.

The intention of the central bank to expedite lending towards productive sector is a welcome step, which is key for supporting the government's expected growth. Since commercial banks have not been able to meet the existing requirement of 20% as well, it will be a challenge for the banks to meet the new requirement within the stipulated timeframe. Nonetheless, introduction of some incentives as recommended by the International Monetary Fund (IMF) to encourage BFIs to lend towards productive sectors could be a key for its success.[96]

Despite increased capital, most of the commercial banks have been able to book handsome profits courtesy of increased interest earnings. Going forward, banks would have to become more innovative in order to maintain the earnings amidst increased competition which may restrain profitability growth over the period.

CAPITAL MARKET

The secondary market went up by 1.34% to close at 1629.75 points during the review period (May 31 to August 17, 2017). The market started with a brief uptrend, however the trend could not sustain as supply pressure mounted in the market amidst new listing of rights shares of Banks and Financial Institutions (BFIs).

Secondary market

During the review period, the Nepal Stock Exchange (NEPSE) benchmark index increased by 1.34% (21.64 points) to close above 1,629.75 points. At the end of the review period, the total market capitalisation had reached NPR 1.91 trillion (USD 18.49 billion) while the total floated market capitalisation was NPR 654 billion (USD 6.33 billion).

As shown in the table 6 below, during the review period, all the sub-indices except for the commercial bank (-1.02%) and the Hydropower (-8.80%) ended in the green zone. The sub-sectors representing the hotel (+8.34%) and manufacturing & processing (+8.26%) were the highest gainers during the review period. While the subsectors, development bank (+3.68 %), finance (+6.11%), insurance (+7.15 %) and other (2.15%) continue to move upwards. The total market

Table 6: Key Indicators

Indicators	31-May-17	17 Aug-17	% change
NEPSE Index	**1608.11**	**1629.75**	**1.34%**
Commercial Bank Index	1431.21	1416.60	-1.02%
Development Bank Index	1957.54	2029.51	3.68%
Finance Index	776.21	823.60	6.11%
Insurance Index	8625.36	9241.98	7.15%
Hydropower Index	2045.95	1865.90	-8.80%
Manufacturing & Processing Index	2428.09	2628.71	8.26%
Hotel Index	2266.8	2455.85	8.34%
Others Index	698.46	713.50	2.15%

Source: NEPSE

Figure 20: NEPSE Index performance

Source: NEPSE

during the review period was NPR 37.80 billion (USD 366.02 million)

Primary Market

In the public issue front, market witnessed two Initial Public Offerings (IPOs) and one Further Public Offering (FPO) during the review period.

- Nepal Hydro Power issued IPO of 390,000 units at NPR 100 per share. The current paid up capital of the company stands at NPR 221 million (USD 2.13 million). After the IPO, the paid up capital will reach NPR 260 million (USD 2.51 million). The credit rating agency, ICRA Nepal, has assigned grade 4 rating to this issue, indicating below average fundamentals of the company.
- Himalayan Power Partner Limited floated 3,196,251 unit equity shares worth NPR 319.62 million (USD 3 million). The credit rating agency, ICRA Nepal, has assigned grade 4 rating to this issue, indicating below average fundamentals of the company.
- Pokhara Finance has issued FPO of 983,682 units shares worth NPR 216.4 million (USD 2.09 million) at NPR 220 per unit to maintain its promoter-public share structure at 51:49. After the FPO, its paid up capital will reach NPR 655.7 million (USD 6.34 million) and the reserve of the company will grow by NPR 118 million (USD 1.14 million). ICRA Nepal has assigned grade 4 rating to this issue, indicating below average fundamentals.

Key Developments

Merchant Bankers Regulation Amended

After amending the 'Securities Businessperson (stock brokers, security dealers and market maker) regulation 2008', SEBON has also amended the 'Merchant Banker Regulation, 2074'. The amended regulation has increased the scope of work of merchant bankers along with increase in their paid up capital by three folds. The board has increased the minimum paid up capital of Issue and Sales Manager from NPR 30 million (USD 290,444) to NPR 50 million (USD 484,074) and the paid up capital of Securities underwriter from NPR 40 million (USD 387, 59) to NPR 70 million (USD 677,704). Likewise, the paid up capital requirement of Share Registrar and Investment manager has increased to NPR 30 million (USD 290,444) and NPR 50 million (USD 484,074) respectively. Merchant bankers are now allowed to provide advisory services related to corporate restructuring, valuation, corporate plan, loan syndication, working capital financing, venture capital, private equity, hedge fund and asset management. Meanwhile, in order to provide cushion against losses, the amended regulation restricts the Securities Underwriter and Investment Manager to perform their underwriting and portfolio management services up-to five times and ten times their net worth respectively.

SEBON implements Code of Conduct

With the view of maintaining good governance in the capital market, SEBON has implemented "Nepal Securities Board Members Code of Conduct, 2074" for the member of its board. Some of the key provisions are;

- Board members will not be allowed to invest in shares of listed stocks and trade in secondary market.
- Board members can no longer join the board of any brokerage company, or any company either listed or is in the process of being listed in the secondary market.
- Further, the board members are also barred from working as a full-time employee of the fore mentioned organisations.
- Similarly, any decisions and discussions made while performing duties by board members should not be disclosed to any individuals or media.

OUTLOOK

Despite impressive fourth quarterly financials published by the listed companies and announcement of capital plan by listed insurance companies to increase their paid-up capital, the investors have not shown adequate confidence. Low liquidity in the banking system has been one of the key deteriorating factors as fresh margin loans are currently restricted along with high interest rates. Moreover, investors have shown mixed reactions to provisions for margin lending in the monetary policy for FY 2017/18. As per the new policy, BFIs could only lend up to 40% of its core capital as margin type loans moreover, BFIs would be able to extend only up to 10% margin on a single listed company of its core capital.

As the festive season is around the corner, selling pressure may mount in the market as indicated by past trends; however, with ease in banking liquidity, market can revive in coming days. Moreover, trading volume of securities is expected to multi-fold in near future as fully automated online trading system is scheduled to be implemented from November, 2017.

5

MACRO-ECONOMIC SPECIAL

BUILDING STRONGER MACROECONOMIC POLICY FRAMEWORKS AND INSTITUTIONS

Section 1: Andreas Bauer, Senior Resident Representative of IMF Nepal

From a macroeconomic perspective, Nepal hit a sweet spot in 2016/17. Real GDP growth rebounded strongly, inflation declined to the lowest level in many years, the current account was roughly in balance, and international reserves rose further. Fiscal spending increased substantially but the overall balance remained within manageable limits. Risks from brisk credit growth were of concern but other economic outcomes were generally encouraging.

Can Nepal continue to deliver high growth with low inflation and external stability going forward? While policymakers deserve much credit, last year's outcomes were also helped by favourable conditions such as low capacity utilisation following the earthquake and trade disruptions, good rains, improved power supply, and low imported inflation. As these conditions dissipate, macroeconomic trade-offs will get starker and will need to be managed cautiously. For instance, as production approaches potential, strong demand for consumption and reconstruction will tend to push up prices, imports, and the current account deficit. Against this backdrop, achieving sustained high growth with stability will require both an acceleration of structural reforms and, importantly, a strengthening of macroeconomic policy frameworks and institutions.[1]

Without a pick-up in private investment and productivity, growth will remain constrained. Creating a more conducive business environment will therefore be essential, including opening product and services markets to meaningful competition, streamlining regulations and bureaucratic processes, making labour and land markets more flexible, and stepping up investments in infrastructure. Ongoing deliberations on new labour, social security, and foreign investment and technology transfer bills provide immediate opportunities to move such reforms to the top of the policy agenda.

Nepal's exchange rate peg to the Indian rupee provides an important anchor for the economy. Still, monetary policy retains influence on activity, price stability, and the external balance given capital controls. Efforts by the Nepal Rastra Bank (NRB) to make the monetary policy framework more transparent and forward-looking are therefore welcome. Measures announced in the 2017/18 monetary policy statement include establishing a floor for the interest rate corridor and identifying an explicit policy rate (two-week repos) and target level (initially 5%). Properly implemented, these steps should help stabilise interbank interest rates, providing banks with greater certainty on funding costs and guiding market expectations. Key priorities are now to strengthen liquidity forecasting and use deposit collection auctions proactively to keep interbank rates within the targeted corridor. Over time, these steps could be followed by a narrowing of the interest rate corridor and, ultimately, the announcement of a medium-term inflation target.

Macroprudential instruments such as ceilings for the credit-to-capital-cum-deposit (C-CD) ratio, or loan-to-value ratios for risky loan categories should remain a

1. By Andreas Bauer, Senior Resident Representative of the International Monetary Fund for Nepal. This article draws from the IMF's 2017 assessment (Article IV Consultation) of Nepal's economy, which can be found at www.imf.org.

part of the NRB's policy toolkit. There is also a need to continue strengthening financial sector supervision. Strict enforcement of the existing regulation remains important given rapid credit growth in recent years, which carries risks of excessive asset-price inflation and risk-taking by financial institutions.

In the fiscal area, Nepal faces at least two major institutional challenges. At the central government level, strengthening public financial management (PFM) and budget implementation remains key to allow a gradual scaling up of high-quality spending. Some progress was made in 2016/17 but the continued bunching of spending in the last few weeks of the fiscal year remains a problem from a macroeconomic perspective and raises concerns about waste. Addressing these issues will require moving to more realistic budget envelopes that effectively prioritise spending, strengthening project and programme preparation and implementation capacity, and integrating disparate PFM systems across ministries.

The process of fiscal decentralisation that has been initiated following successful local elections holds the potential for major improvements in the delivery and quality of public services across the country. However, cross-country experience suggests that such outcomes require autonomy and strong accountability of subnational governments and decentralised expenditure responsibilities with appropriate resources (vertical balance).[2] The establishment of a robust and sustainable framework for intergovernmental fiscal arrangements is therefore both urgent and essential for the success of federalism in Nepal, along with a major effort to build implementation capacity at the subnational level.

Admittedly, the outlined policy agenda is extensive and demanding, requiring consensus-building, persistence, and strong ownership for implementation. At the same time, the likely rewards in terms of growth and stability dividends are sizeable. Can policymakers step up to the challenge?

2. See Sow/Razafimahefa (2015), Fiscal Decentralization and the Efficiency of Public Service Delivery, IMF Working Paper 15/59

MEDIUM-TERM MACROECONOMIC CHALLENGES

Section 2: Chandan Sapkota, Senior Fellow, Nepal Economic Forum

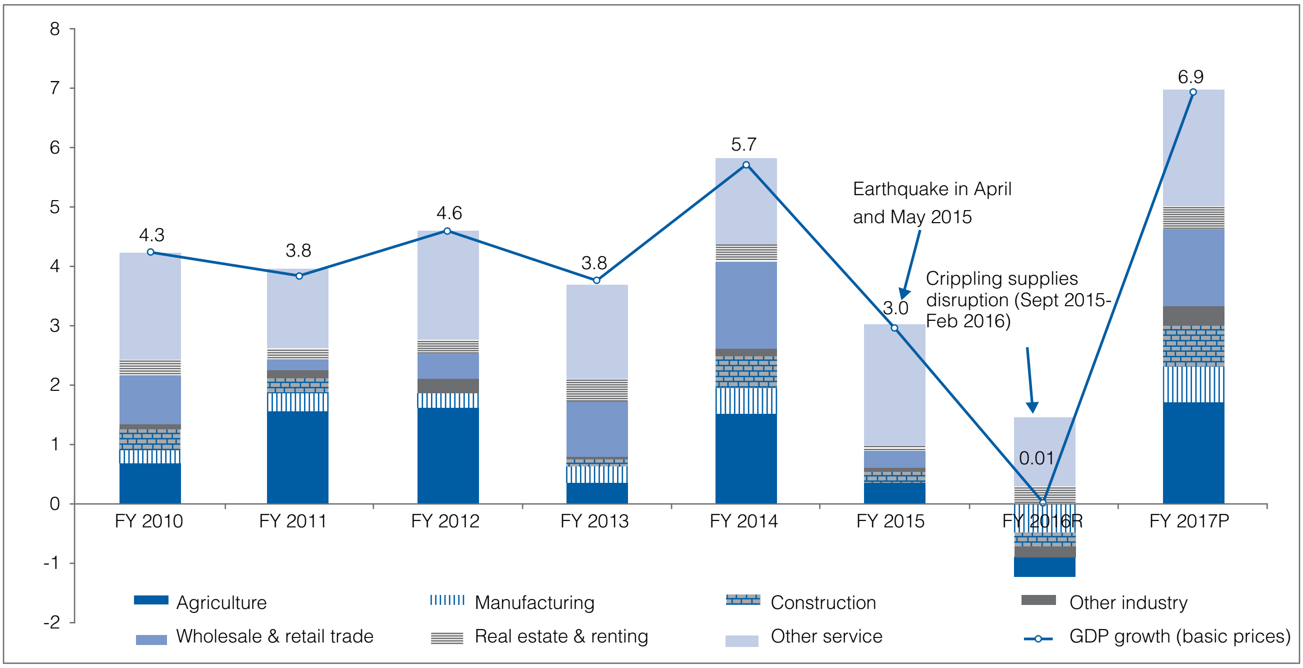
Except for a few episodes of growth spurts, economic growth has largely been low yet volatile in Nepal, mostly stagnating below 5%. Similarly, inflation has been stubbornly high, mostly settling in between 6% and 12%. Public expenditure absorption capacity is receding but revenue mobilisation is robust on the back of taxes on remittance-financed imports and domestic consumption. Outstanding public debt is only about a quarter of gross domestic product (GDP). External sector is largely stable, but is vulnerable to fluctuation in remittance inflows. Financial sector is relatively stable, but remains exposed to asset-liability mismatches arising from recurring sources, including reckless lending growth amid slowdown in deposit growth, evergreening of troubled assets and mismanagement. Meanwhile, unemployment rate remains high.

The prevailing scenario does not portray an economy that is macroeconomically sound with robust fundamentals to support high, sustainable and inclusive economic growth. Instead, it resembles an economy that is susceptible to macroeconomic imbalance triggered by a few exogenous factors, including fluctuation in remittance income, monsoon rains, trade and supplies disruptions, and political instability. These challenges need to be properly diagnosed and addressed (to exploit low hanging fruits) as the country marches towards its overarching goal to become a middle-income country by 2030. Specifically, medium-term macroeconomic challenges emerge from low capital formation, fiscal mismanagement, stubbornly high inflation, and financial and external sectors vulnerabilities.

Base effect blessing: Some analysts quickly point to the impressive growth and inflation numbers in FY 2017 and argue that the economy may have reached an inflexion point from where the trajectory will be upward and stable. GDP growth (at basic prices) increased to an estimated 6.9% and annual average inflation moderated to 4.5% in FY 2017.[3] These numbers largely reflects a 'base effect' blessing and to some extent the government's efforts to improve electricity supply and accelerate reconstruction works. In FY 2018, the base effect will quickly dissipate. Hence, it will be difficult to attain FY 2018 growth and inflation targets of 7.2% and 7.5%, respectively, unless the factors supporting growth and inflation are much stronger than in FY 2017. This is unlikely to be the case.

3. Full year FY 2017 monetary and external sector data were not released when this article was written.

Figure 1: Contributions to GDP growth (percentage points)



Source: Central Bureau of Statistics

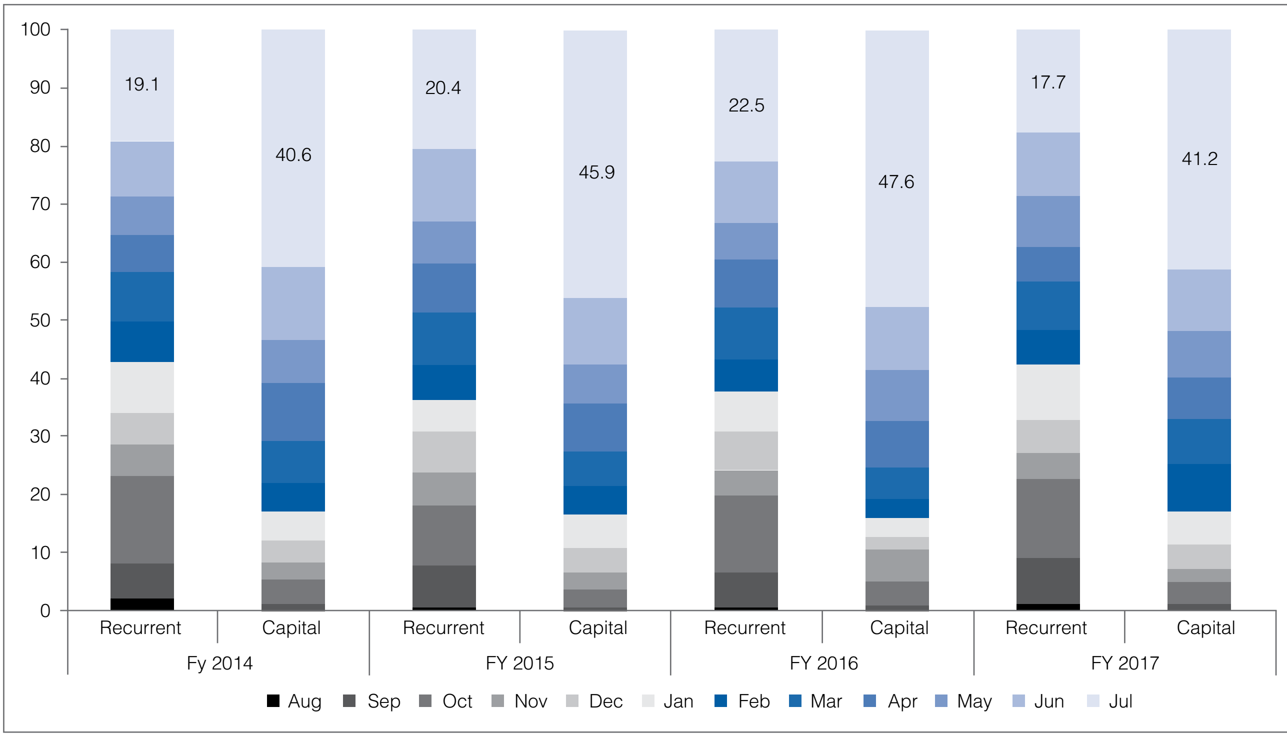
Overall, the economy has not reached an inflexion point and the performance of key macroeconomic variables will continue to be underpinned by the same exogenous factors such as monsoon and remittance. The gradual deindustrialisation beginning FY 1997, coinciding with the Maoist insurgency, has not stopped as this sector barely constitutes 14% of GDP now, down from a high of 22.3% of GDP in FY 1996—the outcome of liberalisation and structural reforms initiated in the early 1990s.

Macroeconomic challenges: The current state of macroeconomics will not support a rapid structural transformation, whereby the pace and pattern of economic growth and development is supported by a vibrant industrial sector, higher absorption of unemployed workforce in productive sectors, and production of high-valued, high-productivity goods and services across all sectors. Five key macroeconomic challenges will dictate the nature of structural transformation Nepal's economy will be undergoing in the medium term.

First, sources of growth have to be reliable, i.e. less reliance on monsoon rains for agricultural output growth and remittance-backed demand for services output growth. A substantial proportion of the variability of GDP growth is caused by volatility of agricultural output growth, which is dictated largely by monsoon rains as irrigation network is too limited to substitute for water shortfall during weak monsoon. For a more dependable source of growth, capital formation must increase so that the most binding constraint to economic growth—inadequate supply of infrastructure, mainly energy, transport, and irrigation—is addressed head-on. Hence, a major macroeconomic challenge in the medium-term would be to enhance quantity as well as quality of public and private investment.

Public gross fixed capital formation averaged just 5.8% of GDP in the last five years. This needs to increase to about 8-12% of GDP annually. The public sector has to lead the way by accelerating capital spending, which has been affected by structural weaknesses in project preparation and implementation; low project readiness; bureaucratic hassle in project approval and sanctioning of spending authority; weak project and contract management; and political interference at planning, management and operational stages. Public capital spending averaged just 4.8% of GDP in the last five years. Furthermore, almost 60% of the actual capital spending occurred in the last quarter and 41.2% in the last month, raising doubts over the quality of spending. Low quality of capital investment tends to increase operation and maintenance budget, which is a part of recurrent spending, for the next few years.

Figure 2: Monthly share of actual annual spending (percent)



Source: Financial Comptroller General Office (FCGO)

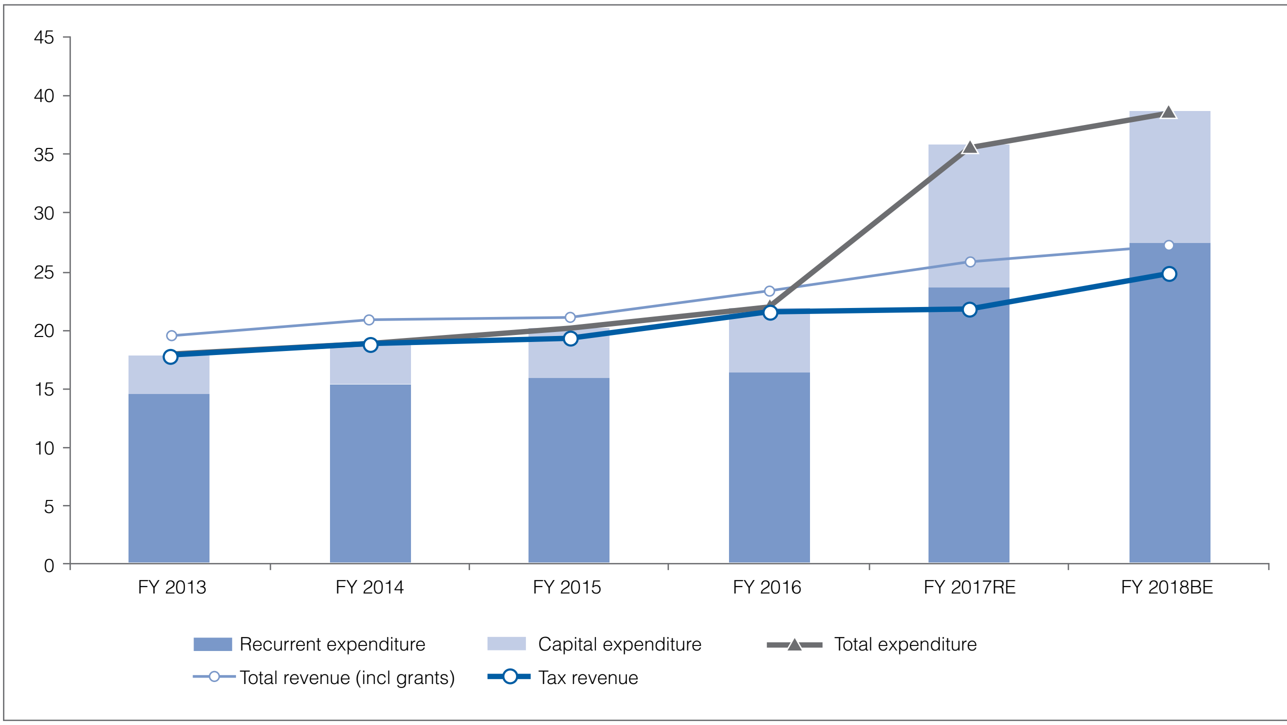
Furthermore, private gross fixed investment, which averaged 21.6% of GDP in the last five years, also needs to increase so that total gross fixed investment is at least above 30% of GDP. Currently, total gross fixed investment is below the average for low-income countries. In addition to enhancing capital spending absorption capacity, private sector investment needs to be facilitated by implementing laws, policies and regulations that are already in place, and by amending those that are deemed deficient. The current state of policy implementation paralysis is deterring both domestic as well as foreign investment. Net FDI inflows are barely one percent of GDP.

Second, while there is a need to increase quality and quantity of capital spending, containing the growth of recurrent spending, which is almost equivalent to tax revenue, is also required. This calls for a bit of fiscal discipline although public debt is only a quarter of GDP. Just because there is ample fiscal space does not imply that recurrent spending can be indefinitely increased to satisfy politician's voter base and supporters, including local contractors, by doling out incoherent pet projects and cash handouts. Better fiscal management is particularly important in the federal setup.

Additionally, revenue leakages, through under-invoicing of imported goods and tax waivers, need to be plugged in and tax sources diversified in order to mobilise enough revenue to cover rising recurrent spending and to maintain sound fiscal balance.

Third, stubbornly high inflation has to be lowered by primarily addressing supply-side constraints as monetary policy does not have much traction to contain it due to pegged exchange rate between Nepali and Indian currency and the fact that almost 60% of imports, including fuel and cooking gas, are sourced from India. Average annual inflation of around 8.7% in the last ten years is too high, and discourages investments and savings. Supply-side issues such as shortage of electricity and fuel, high transport and wage costs, low productivity, and excessive labour unionising for political reasons pose threat to lowering inflation and accelerating industrialisation. Ideally, inflation in Nepal should not deviate much from that prevalent in India. The central bank and the government need to pay special attention to transitory and structural factors driving inflation.

Figure 3: Expenditure and revenue overview (share of GDP)

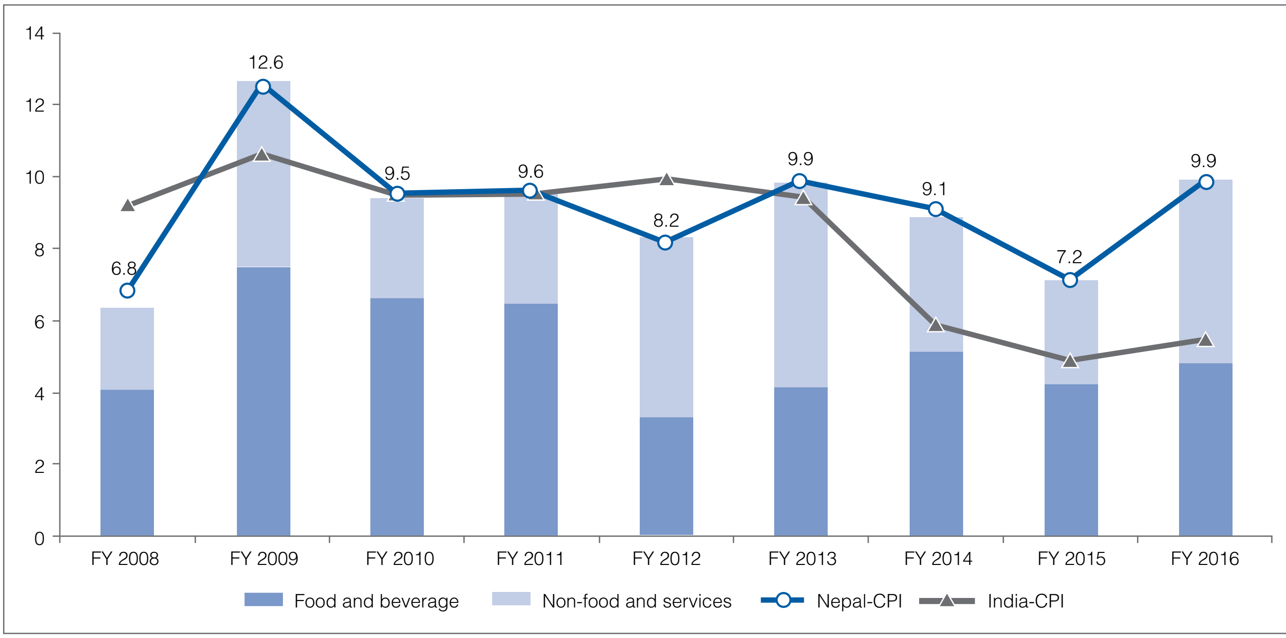


Source: Budget speech, Ministry of Finance

Fourth, financial sector stability is another macroeconomic challenge over the medium-term. Financial sector troubles are recurring, typically caused by accumulation of unbalanced portfolio, lax monitoring and supervision, and asset-liability mismatch. As experienced in the past, a sudden credit squeeze arising from such factors leads to erosion of confidence on and efficacy of the regulator. The central bank needs to enhance its capacity to enforce monetary rules and regulations, and intensify monitoring and evaluation of banks and financial institutions. Consolidation of financial sector; better quality and diversification of portfolio; and expansion of traditional as well as new financial services throughout the country are some of the unfinished tasks for the central bank. Furthermore, the central bank needs to think beyond just buying and selling of government bills and bonds as a core monetary policy instrument. As such, back-loading of budgetary spending in the last month of fiscal year drastically increases liquidity in the first quarter of next fiscal year and then it begins to get tighter in the next two quarters, heightening interest rate volatility.

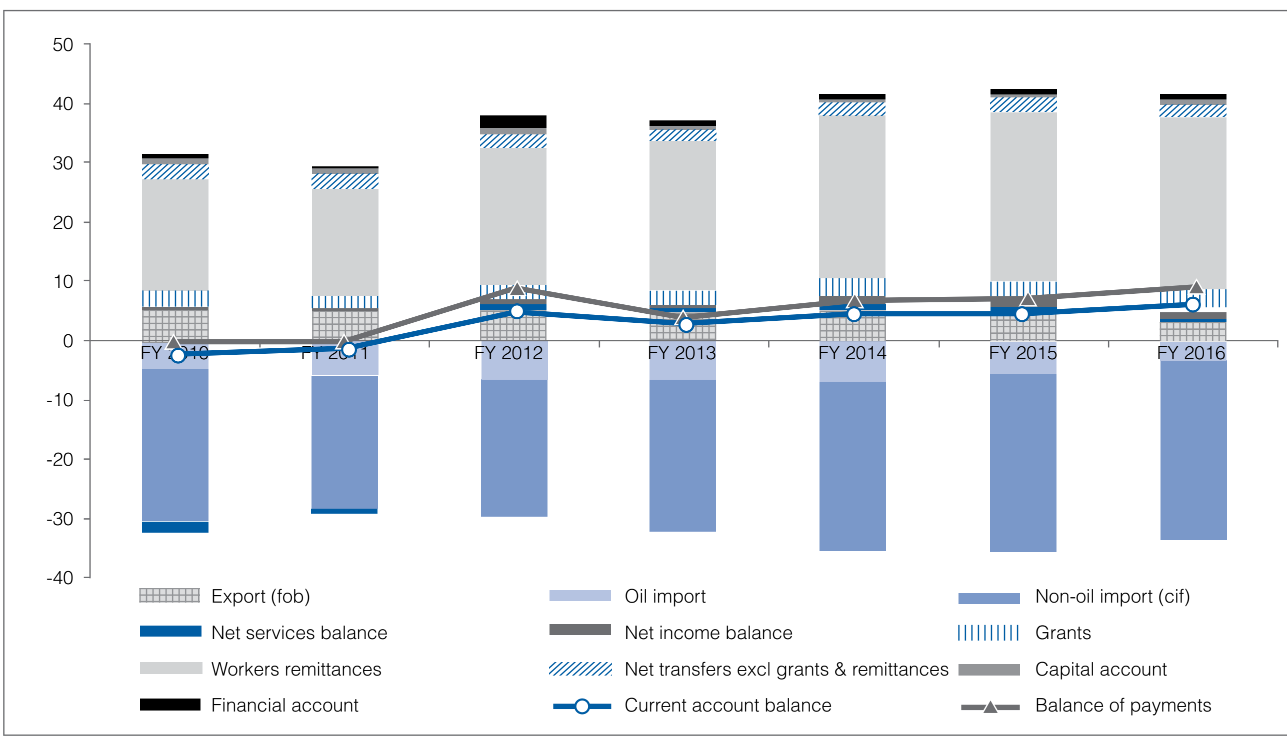
Fifth, the gap between demand for and supply of materials needed for post-earthquake reconstruction and the inelastic nature of import demand means that import growth is likely to remain high in the next few years. Meanwhile, without much improvement in supply-side constraints and implementation of investment-friendly laws and policies, export growth may be at most moderate. Given the forecast of low fuel prices globally due to supplies glut as well as subdued demand, investment in the major fuel and commodity exporting countries is likely to continue to slow down, some of which employ a large number of Nepali migrant workers. This could either mean continued deceleration or tepid growth of remittance inflows, potentially resulting in current account deficit. As such widening trade deficit coupled with decelerating remittance resulted in a current account deficit of 0.4% of GDP in FY 2017, the first deficit since FY 2011.Note that Nepal's low per capita income and the need to import materials for reconstruction necessitate tolerance to moderate level of current account deficit in the medium term. However, the government and the central bank need to keep an eye on the level of balance of payments and foreign exchange reserves so that it is enough to sustain at least 7 months of import of goods and services.

Figure 4: Contributions to inflation (percentage points)[4]



Source: Nepal Rastra Bank; Reserve Bank of India

Figure 5: External sector (share of GDP)



Source: Nepal Rastra Bank

4. Note: For Nepal FY 2015 (mid-July to mid-July)=100; for india, FY 2012=100 (April-March)

THE ROLE OF MONETARY POLICY IN MACRO–FINANCIAL STABILITY OF NEPAL

Section 3: Nara Bahadur Thapa, Executive Director at Research Department, Nepal Rastra Bank

Introduction

1. The Nepal Rastra Bank (NRB), established in 1956 under the NRB Act 1955, is currently operating under the NRB Act 2002. The major responsibilities of the NRB are to maintaining monetary stability and issuing bank notes on behalf of the government.
2. The NRB is the banker to the Nepal government. It manages the treasury of the government and provides the overdraft facility should the need arise. It also acts as an economic advisor to the government. The major functions of the Bank are to link monetary policy with fiscal policy, underscore the need for fiscal-monetary policy coordination to facilitate economic growth and maintain macroeconomic stability.
3. The NRB is also the banker to the financial institutions in Nepal and provides the safety net in the form of lender of last resort (LOLR). This facility empowers the NRB to regulate and supervise banks and other financial institutions under its domain. The ultimate goal of regulation and supervision is to maintain financial stability so that banks and financial institutions do not face solvency or liquidity problems.
4. Nepal is an open economy and has adopted the fixed exchange rate regime. Nepal's exchange rate regime is fixed but adjustable. Given the peg, the country's balance of payment position will be contingent upon the kind of external shocks it faces. Needless to say, the exchange rate will not absorb shocks, but the country's balance of payments will. In the event of a negative shock, the peg comes under pressure as international reserves deplete. In the event of a positive shock, the country accumulates international reserves, posing a challenge for liquidity management. Both of these shocks have implications for financial stability and economic growth.

Legislative mandates

5. In Nepal, price stability is the primary legislative mandate of the monetary policy, but not the sole mandate. Price stability is a part of monetary stability but the other important aspect of it is the stability in the external value of the Nepali rupee. As Nepal has the currency peg with the Indian rupee, the objective of external sector stability boils down to securing a reasonable level of surplus in country's balance of payments. The peg being the nominal anchor of monetary policy, caution needs to be taken so that pressure does not build on it due to monetary and financial excesses.
6. The NRB Act 2002 has granted the legislative mandate of financial stability to the NRB. Commercial banks, development banks, financial companies and microfinance institutions are under NRB's regulatory perimeter. However, savings and credit cooperatives, which do indulge in deposit-taking activities, are not under the NRB's regulatory perimeter. While capital market institutions are under the Securities Board of Nepal (SEBON), insurance companies are under

the Insurance Board. At this juncture, the NRB faces challenges in securing the legislative mandate of financial stability.

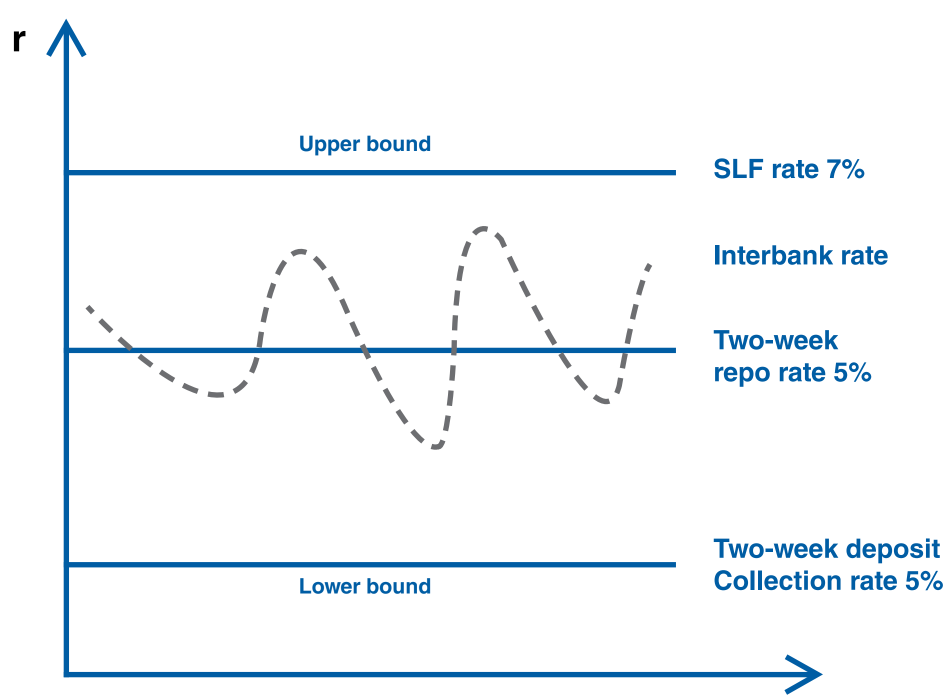
7. Price, external sector and financial stability creates a congenial environment for sustainable economic growth. Once stability is achieved on these fronts, the focus of monetary policy is on facilitating inclusive and broad-based economic growth through the adequate provision for liquidity and credit facilities.

Tools

8. Interest rate is one of the conventional monetary policy tools aimed at macroeconomic stability. Under this tool, the process of causation starts from the level of money supply to the level of interest rates, to the level of investment and ultimately to economic growth and the level of prices. However, at times, abrupt changes in the level of interest rates have the potential to destabilise the macroeconomic situation. To address this issue, the NRB in its recent monetary policy has introduced the concept of fixed interest rate corridor with the floor at 3.0%, the ceiling at 7.0% and the repo or the policy rate at 5.0%. The policy rate is the central rate around which short-term market interest rates are expected to hover.

9. To complement the monetary policy, macro-prudential tools were introduced in the wake of the global financial crisis of 2008. Interest rate as the traditional monetary policy tool has certain limitations: it is weak on controlling the quality and the composition of bank credit. The composition of credit rather the level of bank credit matters for growth and, at times, financial stability.

10. Since 2010, credit-to-core capital and deposit (C-CD) ratio has been the most important macro-prudential tool in place in Nepal. It acts as the nominal anchor for financial stability in the country. It curbs the excessive risk-taking behaviour of banks. However, there are arguments that C-CD ratio only exists in Nepal. But we must not forget that C-CD ratio is the mirror image of liquidity ratio. India has the statutory liquidity ratio (SLR) as high as 20% of net demand and time deposit liabilities. The mirror image of SLR is the C-D ratio. The implied C-D ratio is 80% in India. Until liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) are in place, we need to continue with the C-CD ratio as the nominal anchor of financial stability in Nepal. The removal of C-CD ratio in the absence of alternatives will be at the peril of financial stability. If the C-CD ratio is removed there



are high chances of financial crisis occurring within the medium term of three years. Hence, the NRB is firm on its continuation.

11. In addition to C-CD ratio, the NRB has introduced the concept of differentiated loan-to-value (LTV) ratio for real estate and home loans. The objective is to reorient the composition of bank credit in favour of priority sectors. One study conducted by the NRB shows that 69% of bank deposit is collected and 53% of bank loans is disbursed in the Kathmandu Valley—indicating high concentration of financial resources in the Valley. In light of this, the NRB has reduced the real estate LTV ratio for the Valley from 50% to 40%. But it is still 50% for outside the Valley. Likewise, the home loan LTV ratio for the Kathmandu Valley is reduced from 60% to 50% whereas the home loan LTV for outside Valley is 60%. The objective is to help decentralise the use of financial resources outside the Valley especially in the wake of the new federal set up the country envisions to adopt.
12. A larger allocation of bank credit to priority sectors such as agriculture, hydropower, tourism and manufacturing is crucial for achieving inclusive and sustainable economic growth. Precisely for this reason, the NRB has intervened in the loan portfolio of banks. The NRB has directed banks to increase the allocation of their loans to 25% to designated priority sectors. The priority sector lending requirement is also broken down to 10% for agriculture, 5% for energy, 5% for tourism and 5% for other priority sectors. This requirement is considered important to link the financial sector with the national economy and to reorient financial resources towards relatively under-banked sectors of the economy.
13. The deprived sector lending requirement of 5% for commercial banks, 4.5% for development banks and 4% for finance companies has contributed to channelize the substantial amount of financial resources for the weaker section of society. This provision has helped divert financial resources as large as NRS 111.5 billion from urban to rural areas, especially for rural women. These measures of credit allocation have the potential to create an environment for inclusive and broad-based economic growth.

Conclusion

14. The NRB is playing an important role for the macro-financial stability of Nepal. It has multiple legislative mandates and has corresponding instruments in place to achieve them. The traditional tool of interest rate is for monetary stability, macro-prudential tools are for financial stability and priority and deprived sector lending requirements are for inclusive and broad-based economic growth. The currency peg is used as the nominal anchor for monetary policy, C-CD ratio acts as the nominal anchor for financial sector stability, and priority and deprived sector lending requirements link the financial sector with the national economy. These measures are serving Nepal well for balancing the country's multiple aspirations of inclusive growth and macro-financial stability, among others.

MACROECONOMIC SITUATION:
SATISFACTORY BUT WEAK FOUNDATION FOR GROWTH

Section 4: Dr. Shankar Sharma, Former Vice Chairman, National Planning Commission.

Favourable indicators but no growth

Macroeconomic situation of Nepal is satisfactory, but the foundation of growth is weak due to structural impediments and institutional challenges. The government's present target to graduate to middle-income country by 2030 is difficult to achieve.

Nepal has made remarkable progress in reducing poverty and improving social indicators in the last two and half decades. The incidence of poverty has declined from 38% in 2000 to 21.6% in 2015. Similarly, infant mortality rate (per 1,000 live births) and maternal mortality rate (per 100,000 live births) declined from 64, and 415 to 33 and 258 during the same period. Gender equality and empowerment of women related indicators and universal primary education achievements have shown excellent progress.

Total outstanding public debt-GDP ratio has declined from 46.1% to 24.1% during the last decade and average budget deficit as a percentage of GDP declined by 3.5% in the last decade compared to above 7% in the early 1990s. Inflation has also remained in the modest level and the financial sector remained stable. Revenue growth has been remarkable. Balance of payment situation has also remained favourable mainly because of high level of remittance.

However, there are challenges. Nepal is one of the slowest growing economies in Asia. Its average growth rate of about 4% during the last decade, low productivity, large scale migration, high dependence on remittance, and skyrocketing trade-deficit are making the economy highly vulnerable. The government has to undertake significant reforms to move towards higher trajectory of sustained and inclusive growth.

Drivers of growth revisited

The current favourable position—reduction in poverty, improvement in social indicators, good macroeconomic indicators, cushion of foreign exchange and comfortable fiscal space—provides promising opportunities to reinvigorate Nepal's economy and develop strong foundation for economic development. Sustained higher growth, improved export performance, job creation and reduced dependence on remittance can be achieved by changing the growth drivers and improving institutions.

Agriculture is a critical component of the Nepali economy. The share of agriculture is about 32% in GDP and close to 75% of the population depends on it for their livelihood; but it is growing only by about 3% per annum and the productivity growth is one of the lowest in the region. The gap between actual and potential yields can be narrowed by increasing irrigation facilities, as only about 21% arable land has year-round irrigation. Rapid diversification from cereal crops to high value crops like, fruits, vegetables, herbs, medicinal plants and similar crops along with commercialisation of production provides enormous opportunity to improve productivity growth and farmers' income.

Nepal has not been able to tap benefits from vastly available water resources and opportunities provided by its two giant neighbours—world's second largest economy, China and the ninth largest economy, India. Investment in hydropower resources—potential of which is huge—could help significantly in improving productivity, increasing the competitiveness of the economy, creating jobs, and reducing trade deficit, by exporting power to India and other parts of the region.

Nepal has the potential to enlarge the market especially as it is in the proximity of vast north Indian market, which is a home to about 500 million people. The country has not been able to participate in regional and global value chains, which is vital in this globalised and interdependent world. In addition, Nepal is losing comparative advantages (revealed comparative advantages) in many products, but has developed its capability in producing goods in higher complexity sectors (which is not less than some of the Northern Stares of India) and is generating product opportunities in a number of manufacturing products.

Nepali exporters have not been able to utilise the trade preferences provided by different countries and regions. India provides market access to almost all manufacturing products produced in Nepal. Generalised System of Preferences provided by the European Union, and preferential market provided by the US in 66 products and preferences provided by Australia, Canada, China and other countries have been grossly underutilised. So Nepal, among others, should take advantage these favourable provisions to improve the economy of the country.

In addition, tourism and ICT are some of the service sector which has a great potential to support growth and reduce trade deficit. Nepal has a strong comparative advantage in tourism and ICT has the highest potential of value addition and is growing at an exponential rate.

Higher level of public investment including in the tourism areas, simplified procedures for investment including FDI, improvement of transportation and transit system in maximising the benefits from neighbouring economic powerhouses, could help in achieving higher and sustained growth in Nepal.

NEPAL ECONOMIC FORUM

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NEF PROFILE

Nepal Economic Forum (NEF) is a premier private-sector led economic policy and research organisation that seeks to re-define the economic development discourse in Nepal. Established in 2009 as a not-for-profit organisation under the beed (www.beed.com.np) umbrella, NEF is a thought center that is working to create positive transformations in policy reforms. One of the big updates for NEF this year was its feature in the list of Top Think Tanks in Southeast Asia and the Pacific in the 2016 Global Go To Think Tank Index. The report was released by the Think Tanks and Civil Societies Program under University of Pennsylvania. NEF stands out in being able to make significant strides to bring the private sector perspective and engage with both the public and private sectors in the development discourse. NEF is currently a recipient of the Open Society Foundations' Think Tank Fund.

NEPAL ECONOMIC FORUM

NEF works in partnership with many Nepali and international institutions in its quest to mainstream the discourse on the Nepali economy, which has not been given the necessary space it deserves.

NEF has partnered with the Himalayan Consensus Institute (HCI) to facilitate the development of alternative development paradigms and successfully held the second Himalayan Consensus Summit 2017 in March 2017.

NEF BROADLY WORKS UNDER THREE AREAS:

BPRC

The Business Policy Research Center (BPRC) engages in research, dialogue and dissemination relating to pertinent economic policy issues. BPRC has been producing nefport, a quarterly economic analysis publication, nefsearch, a periodic research publication and conducting neftalk, a platform for policy discourse.

PPCP

Through the Center for Public, Private and Community Partnerships (PPCP), the partnerships discourse is further elaborated through addition of the community dimension to existing models of public private partnerships. Apart from standalone interventions, the PPCP perspective is integrated in the work that NEF and beed initiate.

beed devCon

NEF operates in the domain of Development Consulting through its devCon division in conjunction with beed management.. It works with a variety of bilateral, multilateral, national and international NGOs in the areas of policy research, economic analysis, value chain analysis, enterprise development, sectoral studies and public private dialogue.

We are striving to ensure financial sustainability for NEF to complement the support it currently receives from beed management and the Open Society Foundations. If you are interested to support NEF, please do get in touch with sujeev.shakya@beed.com.np or niraj.kc@beed.com.np

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