

NEPAL  
ECONOMIC  
FORUM

# nefport

**Docking Nepal's Economic Analysis**

MARCH 2014 | ISSUE 16



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## EDITORIAL

**W**e are happy to present you the sixteenth issue of nefport, which provides an overview of the events of the past three months that had an impact on the Nepali economy.

There has been a positive step in the political front: the Constituent Assembly has broken the two month long deadlock and chosen Sushil Koirala, the president of the Nepali Congress, as the new Prime Minister. A cabinet has also been sworn in.

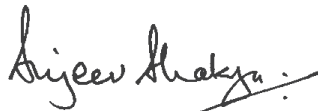
We have used USD conversation rate of NPR 99.82 to a dollar, the three month average, for this issue.

We continue to cover the sections in the manner readers are now used to: the first section provides a general overview of the macroeconomic state of Nepal's economy. It goes into some depth within each sector and provides an overview of the key stories that have developed over the last quarter. This section also provides an outlook for the next quarter of the Nepali economy.

Like in the previous issues, the second part of nefport presents an in depth review of the financial and capital markets, where we provide a detailed analysis and assessment of the performance and figures of banks, financial institutions and capital markets.

Nepal Economic Forum, a division of beed, is a not-for-profit organization that functions as Nepal's premier private sector led economic policy and research institution. We would like to thank beed invest and beed management for their support in making this issue possible.

We are eager to receive your valuable feedback on how to make future issues of nefport more useful and user friendly. Please email us your suggestions at [info@nepaleconomicforum.org](mailto:info@nepaleconomicforum.org)



Sujeev Shakya  
Chairperson  
Nepal Economic Forum

# POLITICAL OVERVIEW

Over two months after the elections in November, the elected Constituent Assembly members were able to forge a consensus to identify the next Prime Minister for Nepal. Although there are disagreements, positive steps are being taken to form a government and constitution writing.

**Nepal sees its 37<sup>th</sup> prime minister in Sushil Koirala:** Nepali Congress president and parliamentary party leader, Sushil Koirala, 74, was elected as the 37<sup>th</sup> Prime Minister on February 10, 2014. Koirala secured more than two-thirds votes in the parliament, nearly three months after the elections were held in November.<sup>1</sup> Of the 553 members present in the Legislature Parliament, 405 voted for Koirala. Only 148 votes were cast against him.

Lawmakers from 17 parties, including NC, CPN-UML, CPN-ML, Rastriya Prajatantra Party, Rastriya Janamorcha, Dalit Janajati Party and Nepali Janata Dal and two independent lawmakers voted in support of Koirala whereas the UCPN-M, Madhesi Janaadhikar Forum- Nepal, MJF-Democratic, Terai Madhes Democratic Party and Sadbhawana Party, Rastriya Prajatantra Party-Nepal and some fringe parties voted against Koirala's candidacy.<sup>2</sup>

Koirala's election as the prime minister has ended nearly a year of government by a non-political technocratic council of ministers led by the former Chief Justice Khil Raj Regmi and restored the country to a multi-party political course. This is the first time since 2008 that the two largest parties in par-

liament, which at present are NC and CPN UML, have come to an understanding to form a new government. Koirala has committed to deliver a new constitution within a year and implement the past agreements of the peace process.<sup>3</sup> Koirala plans to focus on achieving high economic growth and economic progress by utilizing Nepal's natural resources and attracting domestic and foreign investment in economic sectors.

**Regmi resigns as Chief Justice:** Chairman of the Interim Election Government, Khil Raj Regmi, has offered his resignation formally from his post of Chief Justice on February 11, 2014. Regmi announced his resignation during his address to the nation. The resignation has come in the wake of the formation of the new government that took place a day earlier. Regmi, during his address, expressed that he and his cabinet members are proud to hand over the responsibility to the newly elected government, the Nepali Congress. Regmi's resignation also comes amid the protests by the Nepal Bar Association (NBA) against Regmi's return to the apex court.<sup>4</sup>

**CPN-UML back out from the coalition:** At the very beginning of his regime as

the prime minister, Sushil Koirala has suffered a hitch at the eleventh hour when his significant coalition partner, CPN-UML, decided to stay out of the government after being denied the home ministry. The relations between the two major parties has become more difficult as senior UML leaders have declared that they will not join the NC-led government and have blamed the NC for breaching a two-party agreement under which the UML was to head the home ministry.<sup>5</sup> Koirala himself dismissed UML's claims, expressing that the NC leaders never granted the home ministry to UML's candidate. UML is firm in its decision to not join the government unless they can head the home ministry.<sup>6</sup>

## OUTLOOK

Although it took over two months, it looks positive that the government will be formed soon. As a result, local elections will most likely be held and the constitution writing will be taken seriously. With the possibility of anti incumbency voting, politicians should take their responsibilities seriously. On the international front, the result of the upcoming parliamentary election in India is expected to impact its engagement with its neighbors, including Nepal.

# INTERNATIONAL ECONOMY

The world economy grew at approximately 2.9% in 2013. As the developed economies recover in 2014, which will push the growth in the emerging markets, the world economy can be expected to grow at close to 3.5% in 2014.

**European banks loan over USD 3 trillion to emerging markets:** European banks, such as Erste Bank, HSBC, Santander, Standard Chartered and UniCredit, have loaned over USD 3 trillion (NPR 298.68 trillion) to emerging markets, more than four times the amount lent to emerging markets by US banks. The six most exposed banks had more than USD 1.7 trillion (NPR 168.88 trillion) of exposure in the developing markets. Estimations show that the investment banking units of HSBC and Standard Chartered each generated around USD 2.1 billion (NPR 208.61 billion) to USD 2.2 billion (NPR 218.54 billion) from emerging markets.

**Emerging Markets shocks a concern for 2014:** When currency combines with revenue slowdown and rising bad debts, there are threats to the exposed banks. As such, the following would be affected by problems in emerging markets: Barclays in South Africa; Standard Chartered and HSBC in India and Indonesia; British banks,

with an exposure of USD 518 billion (NPR 51.45 trillion) in the Asia-Pacific region; Spanish banks, with an exposure of USD 475 billion (NPR 47.19 trillion), in Latin America; and French and Italian banks, each with an exposure of USD 200 billion in the region, in developing economies in Europe. On the brighter side, European banks have some 12% of their assets in emerging markets and about a quarter of their earnings are generated from the region. Standard Chartered derives more than 90% of its earnings from Asia, Africa and the Middle East.<sup>7</sup>

**Chinese firms continue to go global in 2014:** Chinese companies continue to diversify as the Chinese overseas investment, which totaled USD 61.6 billion (NPR 6.12 trillion) by September 2013, a 17.4% year on year increase. The nation's overseas investment is all set to grow at double-digit rates in 2014 and the companies are already involved in newer and broader mergers and acquisitions.

Lenovo, a multinational technological firm, is pushing itself beyond Personal Computers and moving aggressively into the mobile market; Lenovo bought Google's Motorola handset business at USD 2.91 billion (NPR 289.07 billion) in the beginning of 2014.<sup>8</sup> Similarly, led by China's wealthiest man Wang Jianlin, Dalian Wanda, a property conglomerate, purchased a controlling stake in UK based yacht maker, Sunseeker International. The purchase came after the firm's record-breaking USD 2.6 billion (NPR 258.28 billion) acquisition of AMC Entertainment, an American movie theater chain. Huawei, a multinational networking and telecommunications equipment and services company, continues to have one of the largest global business footprints among the Chinese firms.<sup>9</sup> The firm generates about 70% of its group revenue abroad. Its biggest overseas markets for its wireless network business are in Western Europe and Asian emerging markets such as Indonesia.<sup>10</sup>

### **MINT Economies the Next BRIC?**

Economist Jim O'Neill has coined the term MINT, namely Mexico, Indonesia, Nigeria and Turkey, to denote them as emerging economic giants. They have been identified based on their favorable demographics and economic prospects for the next 20 years.<sup>11</sup> MINTs may have more in common with each other than the BRICs (Brazil, Russia, Indonesia and China). Mexico, Indonesia and Turkey all share very multi-dimensional trade patterns which goes on to show that there is more natural affinity between the MINTs than the BRICs.<sup>12</sup> In 2012, the GDP of Mexico was USD 1,178 billion (NPR 117.02 trillion), Indonesia was USD 878 billion (NPR 87.22 trillion), Nigeria was USD 263 billion (NPR 26.13 trillion) and Turkey was USD 789 billion (NPR 78.38 trillion). It is estimated that in 2050 the MINT nations will see a steep growth; Mexico's GDP is estimated to be USD 6,950 billion (NPR 690.41 trillion); Indonesia's USD 6,040 billion (NPR 600.01 trillion); Nigeria's USD 4,910 billion (NPR 487.76 trillion)

and Turkey's USD 4,450 billion (NPR 442.06 trillion).<sup>13</sup>

### **Global shift discussed in World Economic Forum 2014:**

The World Economic Forum held its Annual Meeting for 2014 in Davos, Switzerland, from January 22-25. One important issue that the meeting focused on was the marked shift in the balance of the world's main growth engines as the United States and other developed economies; it was expected that the developing economies would be contributing more and emerging markets somewhat less than before to the international economy. Although they are still determined to tap into the growing middle classes of the new mega-cities of Asia, Latin America and Africa, major companies are becoming more selective as they may face ups and downs while conducting businesses in emerging markets. The global economy is on the cusp of a slowdown in emerging markets. There is a higher proportion of developed market growth that will drive the global economy.<sup>14</sup>

### **USA hopes to bounce back to the global economy in 2014:**

In his State of the Union Address, US President Barack Obama discussed the future of the nation, most importantly its plans to bounce back to the global economy. The President claims that there are many factors that show that 2014 shall have positive impacts to the US economy: the lowest unemployment rate in over 5 years, a rebounding housing market, a manufacturing sector that is adding jobs for the first time since the 1990s; the amount of oil production in the nation itself has exceeded the oil imports for the first time in nearly 20 years and the nation's deficits are cut by more than half.<sup>15</sup>

### **OUTLOOK**

With some stability in the political sphere, coupled with modest improvements in the international economy, Nepal can expect to see some positive impact to its economy.



# macroECONOMIC

OVERVIEW

The first half of FY 2013-14 witnessed low capital spending; the Ministry of Finance spent only 13.5% of the allocated amount for capital budget for this fiscal year. If the government is to meet its lofty target of 5.5% economic growth in this fiscal year, it needs to expedite its capital and recurrent expenditure. Also, in spite of favorable political developments, the private sector is cautious about investing in the economy. This has led to excessive liquidity in the banking system.

## AGRICULTURE

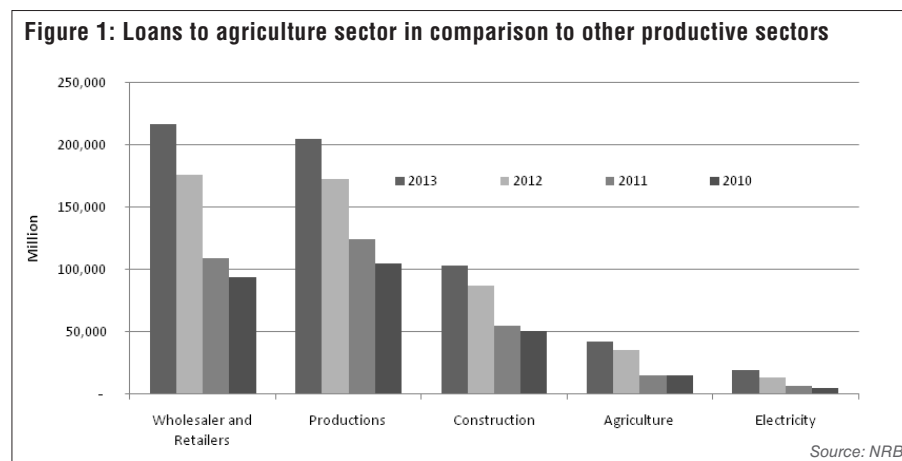
The Government of Nepal has been taking sufficient measures to remove the financial constraints and to revitalize the agriculture sector, which accounts for over 60% of the GDP, in order to increase the output. In spite of these efforts, credit towards the sector is still lagging behind in comparison to other productive sectors.

**Agro lending of BFIs doubles:** The agriculture sector lending has doubled in the last two years. However, reaching the regulator's prescribed mark of 10% lending still seems to be a far off target. The sector has received loans worth NPR 41.2 billion (USD 412 million) until mid-November 2013, which accounts only for a meager 4.1% of the total lending of Banks and Financial Institutions (BFIs).<sup>16</sup>

BFIs' credit exposure to agro sector stood at NPR 20 billion (USD 200 million) in November 2011, which increased to NPR 40 billion (USD 400 million) by November 2013 due to the

mandatory lending policy introduced by Nepal Rastra Bank (NRB). Since the beginning of the current fiscal year, loans to the agriculture sector has increased by 3.8%, which had gone up by 18% in the corresponding period last fiscal year, according to NRB statistics (*see Figure 1: Loans to agriculture sector in comparison to other productive sector*).

Furthermore, NRB has also asked BFIs to provide collateral free loans of up to NPR 1 million (USD 10,000) to agriculture business projects /activities like coffee, orange, tea, and livestock and dairy products based on the business plan's viability. In addition, NRB has offered the banks refinancing facility against agro loans at 5% interest to promote the sector.



**Lukewarm response to Agro insurance:** The crop and livestock insurance scheme introduced by the government in 2013 has received a lukewarm response from the farmers. Of the NPR 130 million (USD 1.3 million) allocated for the purpose in the FY 2013-14, only NPR 2.59 million (USD 26,000) has been spent so far.<sup>17</sup>

The scheme was introduced to encourage farmers as well as to bring new investments in the agriculture sector. As per the scheme, the government provides 50% subsidy on insurance premium for crops and livestock. The officials at the Ministry of Agricultural Development cite lack of awareness as the reason behind the crop insurance policy not gaining popularity among farmers.

**Subsidy in wheat:** The Ministry of Agriculture Development has introduced wheat seed subsidy scheme promoting the use of improved seeds in an effort to boost production. The scheme, introduced in the country for the first time, will enable farmers to get 35% subsidy on the purchase of improved variety of wheat seeds through the National Seed Company Limited and its dealers across the country.<sup>18</sup>

According to the ministry, using improved varieties of seeds could potentially boost wheat yields by about 30% in irrigated areas. The national wheat seed requirement stands at around 8,000 tons annually. Low productivity in the country is a result of farmers not being able to afford improved seeds.

The government has earmarked around NPR 105 million (USD 1 million)

for the scheme and aims to distribute 5,400 tons of improved variety of wheat seeds for this winter plantation. The national seed vision 2013-2025 has envisaged increasing wheat production to 2.36 million tons in 2025 from 1.88 million tons in 2013 and estimates requirement of 20,570 tons of seeds by the time.

**No Monsanto:** The Supreme Court, on January 26, continued the stay order that banned the import of genetically modified (GM) seeds, including those supplied by Monsanto, a US-based chemical and agricultural biotechnology company. The controversy and campaign against Monsanto heated up after CG Seeds decided to tie up with Monsanto to sell GM seeds in Nepal.<sup>19</sup> Monsanto GM seeds are known for not producing promised output and affecting biodiversity.

Earlier in 2011, a pilot project on maize production was initiated by USAID in partnership with the Ministry of Agriculture, Department of Agriculture, and Monsanto to improve food security and to increase overall production in the country. However, the outrage against this decision from agriculturist, environmentalist, and experts compelled USAID to withdraw the project. Using Monsanto GM seeds have resulted in devastating impact in different countries around the globe.

**Department of Agriculture spending falls:** In the first quarter of the FY 2013-14, the Department of Agriculture was able to spend only around 61% of the total allocated budget. Out of a NPR 1.34 billion (USD 13 million) budget, the department's spending stood only at NPR 822

million (USD 8.2 million).<sup>20</sup>

The amount spent in the first quarter is 26% less compared to the spending of NPR 649.86 million (USD 6.4 million)—around 87% of the allocated budget of NPR 748.4 million (USD 7.5 million)—in the corresponding period last year. The department attributed this huge drop in spending to the Constituent Assembly election and lack of proper dissemination of budget information.

## EDUCATION

The education sector is all set to undergo some major changes that will have far reaching effects in the education system. The government is already forging ahead on its plans to overhaul the existing system in an effort to create a good learning environment for the children, youth, and adults by reducing barriers and providing better facilities.

**Government schools to opt for English medium:** The government has put forth its ten year plan to run classes in English medium in all government schools across the country.<sup>21</sup> According to the plan, priority will be given to mother tongue as medium of teaching up to Grade 3 and English for the teaching of Science, Mathematics, and English up to Grade 8. English language as the mode of teaching has been proposed from Grade 9 to the university level. The proposal of this plan has been developed with the objective to bridge the gap between private and government schools, and considering the recognition of English language in the international market.

**Private schools asked to cancel send up exams:** The Department of Education has directed private schools to cancel the preparation/SLC send-up exam to allow all the 10<sup>th</sup> graders to appear in the SLC examination. As per the Education Regulation 2011, it is illegal to conduct a test of this nature wherein the failed students are restricted from appearing in the SLC examination. Though the department had taken its decision to scrap the practice three years ago, it still continues under the pretext of preparing students for the SLC examination.<sup>22</sup>

Likewise, the central fee determination and monitoring committee has also expressed its concern over the examination fee imposed by private schools, and urged the department to take strong and immediate action against those schools charging exam fee and holding the exam unlawfully.

The government is in the process of implementing School Sector Reform Plan. After its full implementation, the SLC examination will be scrapped and replaced by a board examination taken at the 12<sup>th</sup> grade level.

**Remote VDCs attain complete literacy:** With a remarkable achievement made by its residents in reading and writing, along with the ability to use mobile phones and open their own bank accounts, Tansen, Kaski, Kavre, and Palpa have been declared completely literate village development committees (VDCs).<sup>23</sup>

The National Literacy Campaign, a government mission with the fundamental goal to promote universal access to basic education, eradicate

illiteracy, improve adult literacy skills, improve state supported community learning centers, and to improve the living standard of its people across the country within two years, was initiated four years ago in 55 VDCs.

Although the campaign has already passed its stipulated time of completion, the results of the campaign remain positive in VDCs where the campaign has been efficient. On the other hand, in as many as 14 VDCs of the districts—out of the 55 VDCs where this campaign was launched—the program failed to grab the attention of the public and, thus, have failed to show positive results.

**School Integration Directive in place:** The government has endorsed the “School Integration Directives 2013” to effectively implement its school merger plan, which will allow it to merge any two or more schools or set up a new school if the schools in question lack the minimum enrollment of students. The directive will also allow the government to shut down a school if there are no merger options. The directive was prepared by the Department of Education after the enrolment rate of the students fell noticeably in hundreds of public schools across the country.<sup>24</sup>

Records at the Department of Education show a gradual decrease in the number of students, mainly in the urban areas that have a large numbers of private schools. According to District Education Offices in Kathmandu Valley, over 12 dozens schools from Kathmandu, Lalitpur, and Bhaktapur were closed after the teacher-student ratio went below 1:5. The Education Regulation 1999 stipulates the teacher-

student ratio to be 1:50 in the Tarai, 1:45 in the Hills and 1:40 in the Mountain region. The standard ratio envisioned in the School Sector Reform Program is 1:30.

**Education sector receives multi-billion rupee aid:** The Government of Nepal has received an additional aid of NPR 4.28 billion (USD 42.8 million) from the European Union (EU) for the implementation of School Sector Reform Program. Previously, in 2010, the EU had provided a USD 26 million grant for the same program.<sup>25</sup> The primary objective of the program is to improve the schooling outcomes at primary levels by increasing access to and improving equity and quality of primary education.

## ENERGY

While there were no price increments for petroleum products in this quarter of the FY 2013-14, the losses of Nepal Oil Corporation (NOC) have only been mounting, with NOC recording a loss of NPR 1.77 billion (USD 17.7 million) for the month of February (see *Table 1 for breakdown of monthly losses for NOC*). Of the petroleum products sold, NOC made profit from sale of kerosene and aviation turbine fuel, while recording losses from the sale of petrol, diesel and Liquefied Petroleum Gas (LPG). As per IOC prices effective from January 16, NOC suffered a loss of NPR 1143.1 (USD 11.45) per cylinder, which contributes approximately NPR 1.6 billion (USD 62.4 million) towards monthly losses.<sup>26</sup>

On the other hand, on account of Nepal Electricity Authority (NEA) being loss ridden, the Electricity Development Department

(EDD) has failed to pay royalties to District Development Committees hosting hydropower project. The EDD Director General, Dilli Bahadur Singh, speaking at the inauguration of the embankment construction of the 50 MW Upper Marsyangdi A Hydro power project, stated that since NEA has incurred a loss of NPR 40 million (USD 400,700) until December 2013, royalty payments will be delayed.<sup>27</sup> Upon completion of any hydro power project, the concerned region and district get 38% and 12% royalty respectively.

**Demand supply gap widens:** Despite an increasing demand for energy, a total of only 30 MW generated by six small hydropower projects was added to the national grid in 2013. Among the projects that Nepal Electricity Authority is overseeing, development of Chameliya, Kulekhani III, Upper Trishuli 3A and Rahughat are behind schedule, registering only satisfactory progress in 2013. In addition, the decision and subsequent withdrawal to upgrade the capacity of the Upper Trishuli 3A project from 60 MW to 90 MW slowed development. While the Upper Tamakoshi (456 MW) Project is said to reduce the strain on supply, it is also six months behind schedule, and is now expected to be completed by July 2016. Currently, hydropower projects with a total installed capacity of 2,000 MW are in different stages of development.<sup>28</sup>

**Petroleum products top import list:** Import of petroleum products reached NPR 37.86 billion (USD 379.2 million) in the first four months of the fiscal year 2013-14, registering an increase of 27% as against the same period of the last fiscal year (*see Table 2*).<sup>29</sup> As a percentage of total

**Table 1: Per Unit Profit/ (Loss) on Petroleum Products as per Current Rates for the Month of November**

Petroleum Product	Profit/ (Loss) in NPR	Profit/ (Loss) in USD
Petrol	4.4 per liter	0.04 per liter
Diesel	(8.6) per liter	(0.09) per liter
Kerosene	4.2 per liter	0.04 per liter
Aviation Turbine Fuel (Duty Paid)	26.6 per liter	0.26 per liter
Aviation Turbine Fuel (Bonded)	29.7 per liter	0.3 per liter
LP Gas	(1143.1) per cylinder	(11.45) per cylinder
Estimated Total Loss for August 2013	(1.77 billion)	(17.7 million)

Source: Nepal Oil Corporation

**Table 2: Import of Petroleum Products for First Four Months of FY 2012-13 and FY 2013-14**

Particulars	FY 2012-13	FY 2013-14
Import of Petroleum Products	33.08	37.86
% of Total Imports	17.0%	18.0%
Growth per annum		27%

Source: Trade and Export Promotion Center

imports, petroleum products now constitute 18% of total imports in FY 2013-14. The increase in imports can be attributed to the increased demand coupled with increased prices in the international market.

**NOC demands subsidy equivalent to losses:** In the midst of heavy losses incurred by Nepal Oil Corporation (NOC), mainly due to under pricing of LPG, NOC has urged the government to provide subsidy equivalent to its losses from trade of petroleum products.<sup>30</sup> NOC spokesperson Mukunda Ghimire stated that despite making losses, NOC has been paying

more than NPR 2 billion (USD 20.03 million) in the form of taxes to the government, and therefore in return, should be provided subsidies. He also stated that NOC now does not have the capacity to incur more losses by providing petroleum products at reasonable prices.

NOC also requested the government to implement the automatic price adjustment mechanism. Since NOC cannot align selling price of the petroleum products with prevailing purchase prices, it has been unable to check its mounting losses.<sup>31</sup> NOC has demanded that the government

## Energy Efficiency to Reduce Load Shedding

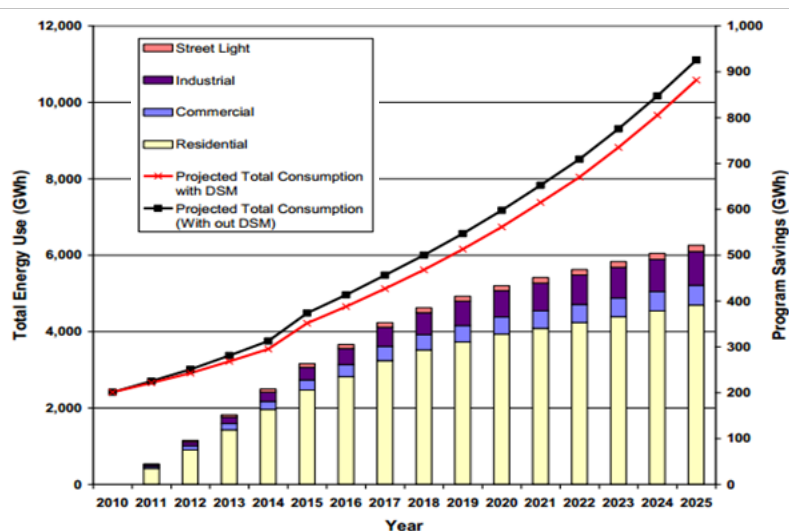
An average of 10 hours of daily power outage is a common occurrence during the dry season in Nepal. Due to a huge supply-demand mismatch, Nepal Electricity Authority (NEA) has not been able to ensure reliable and continuous electricity supply for several years. While construction of new hydro power plants takes many years, other renewable sources like solar power might be faster but more expensive. Therefore, the most cost-effective option is proper Demand Side Management (DSM) and Energy Efficiency (EE). Unlike approaches that simply expand energy supply, DSM and EE prioritize actions that focus on the efficient use of energy.

The implementation of DMS/EE options could reduce energy demand by 430 Gigawatt hours per year by 2020 and bring down peak demand by 260 MW<sup>38</sup> which is nearly equivalent to the total capacity of Kaligandaki (144 MW), Middle Marsyangdi (70 MW) and Kulekhani I (60 MW) hydropower projects. Most options such as energy efficient lighting for residential and commercial sector and high efficiency street lighting are highly cost-effective for the end user and NEA.

Introduction of an Energy Standard and Labeling Program for home appliances, complemented by a public awareness campaign, can lead to peak demand reduction of up to 80 MW.<sup>39</sup> Proper energy management and regular energy audit in industries and other big commercial consumers are effective tools to tap these saving opportunities. Therefore, EE measures in energy-intensive industries<sup>40</sup> could reduce demand by 160 Gigawatt hours annually<sup>41</sup>.

The benefits of energy efficiency for the national economy have been demonstrated through projects such as Nepal

Figure 2: Projected electricity-savings through DSM/EE options in various sectors in Nepal



Energy Efficiency Program<sup>42</sup> or NEA DSM/EE Project. Although potentials are large, Energy Efficiency is still a mostly untapped resource in Nepal. Barriers like lack of awareness and information, institutional support for DSM/EE and access to investment capital have to be addressed by the government, NEA and other sector stakeholders. Through a comprehensive EE policy framework and establishment of support agencies, combined with instruments that provide financial incentives, EE technologies can become the standard in the country.

Further awareness campaigns are needed to make it mainstream. The government and NEA should take the lead and develop a proper framework that provides incentives for all who are willing to use energy efficiently and, thereby, help in dealing with the energy deficit scenario.

Author: Susanne Bodach, Energy & Environment Expert at FNCCI-EEC

look into establishing a price stabilizing fund to ensure regular supply of petroleum products.

**Policy to buy electricity from export oriented projects approved:** As per the policy approved by the Nepal Electricity Authority (NEA) Board, NEA can procure electricity from export oriented hydro power projects at up to NPR 10.6 (USD 0.11) per unit during the dry season. NEA will seek proposals from export-oriented projects for procurement of electricity.<sup>32</sup> As per NEA officials, the rate has been fixed in order to send a positive message to investors, which will in turn help fulfill the demand of electricity during the dry season. As per this decision, GMR Energy Limited, Sutlej Hydro Power Corporation and Bhilwara Energy of India, and Statkraft International of Norway will be able to sell electricity in Nepal.

**Industrial firms to get dedicated feeders:** After 145 enterprises submitted a letter of intent to the Nepal Electricity Authority (NEA) for dedicated feeders supplying electricity round the clock, NEA finally approved the policy to do so for factories and non industrial firms. As per the policy, industrialists will have to bear the expenses regarding installation. However, the rate for electricity supplied through the dedicated feeders is yet to be fixed, although NEA has stated that the rate will double. The rate will be implemented upon approval from the Electricity Tariff Commission.<sup>33</sup>

**Small hydropower companies unable to repay loans:** As a result of rise in operating costs, 15 hydropower projects with a combined capacity of 73 MW are unable to pay back loans.<sup>34</sup> The rise

in operating costs can be attributed to rise in interest rate on loans at the time of construction, appreciation of US dollar and hike in remunerations of staffers. A total of NPR 11 billion (USD 110.2 million) has been invested by promoters in these projects.

**Private sector involvement in construction of transmission lines delayed:** Even after the decision to allow the private sector to construct transmission lines, implementation has not followed through due to the inability of the Nepal Electricity Authority to decide on the model of investment. A Recommendation Task Force led by Energy Ministry Joint Secretary, Keshav Dhvaj Adhikari, prepared a report regarding investment model and sent it to NEA Board for its approval.<sup>35</sup> As a result, various projects have been affected due to lack of transmission lines.

**Marsyangdi and Upper Karnali hydro project developments:** GMR Energy Limited, the energy arm of GMR Group of India and International Corporation (IFC), signed a joint development agreement to develop the 600MW Upper Marsyangdi-2 hydropower project. The project, located in Manang and Lamjung and already in an advance stage of development, has completed all survey and investigation works, finalized the feasibility studies, and received a majority of the clearances from the government.<sup>36</sup> The project is being undertaken by Himtal Hydropower Company, a Nepali subsidiary of GMR Energy.

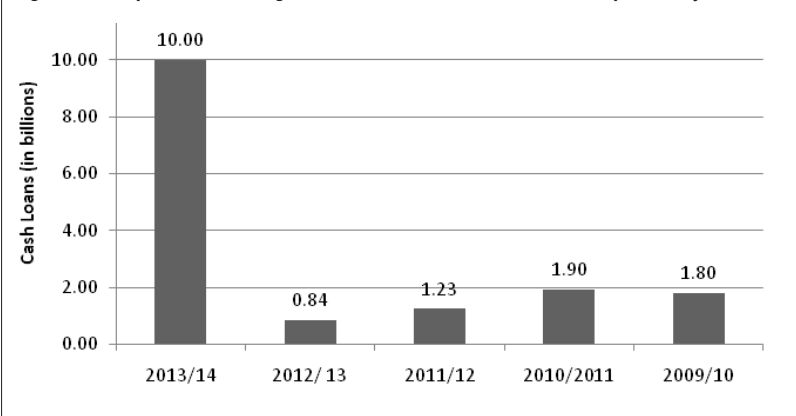
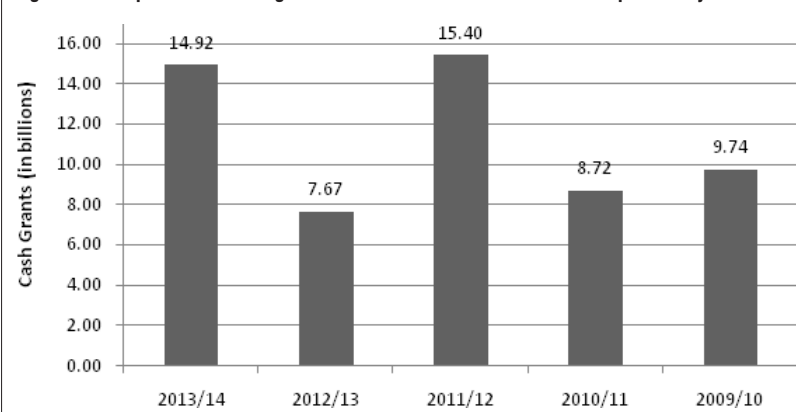
With regards to the 900 MW Upper Karnali hydropower project, negotiations on the Project Development Agreement (PDA) are close to com-

pletion with deals on financial and local benefit packages remaining to be decided. As per the Joint Secretary of Investment Board, Nepal, Mukunda Prasad Poudel, the PDA will be signed within a few months.<sup>37</sup>

## FOREIGN AID

The frequent transfer of officials within the government continues to be the bane hindering the implementation of numerous projects. What the country urgently needs is strengthening of the public finance management system and expediting reforms relating to it. As per Nepal Portfolio Performance Review for 2013, issues of low allocation of capital budget, delays in its spending, failure to adhere to budget ceilings, lack of linkages between budget financing and programs, and weak structure and performance of the internal audit system continue to remain an issue.

**World Bank support for rural transport and agriculture:** The World Bank has approved NPR 14.97 billion (USD 150 million) to finance the improvement of transport infrastructure, and raising agricultural productivity to spur economic growth and reduce poverty in rural Nepal. NPR 9.98 billion (USD 100 million) will be provided to the Project for Strengthening the Nation Rural Transport Program, which aims to enhance the availability and reliability of transport connectivity for communities in 33 districts. NPR 4.99 billion (USD 50 million), on the other hand, will be provided to the Irrigation and Water Resources Management Project, which will be used to rehabilitate 80 additional Farmer Managed Irrigation Schemes in 40 districts of mid and Far Western Nepal.<sup>43</sup>

**Figure 3: Comparison of Foreign Cash Loans in five months over the past five years****Figure 4: Comparison of Foreign Cash Grants in five months over the past five years**

billion (USD 112.20 million) in aid for improving local governance and service delivery over the next four years under Phase II of the Local Governance and Community Development Programme. The Government of Nepal will be contributing NPR 111.79 billion (USD 1.12 billion) with other development partners contributing NPR 22.55 billion (USD 226 million). Support from the UK government is expected to contribute towards improving on the delivery of services by local government for over two million families, and reduce the number of people below the poverty line from 25% of the population to 15% by 2017, meanwhile also ensuring that 1.7 million people are better prepared for extreme weather condition and natural disasters.<sup>45</sup>

#### **Swiss grant assistance for LGCDP phase II:**

The Government of Switzerland is providing a grant assistance of NPR 1.1 billion (USD 11.01 million) for Phase II of the Local Governance and Community Development Programme (LGCDP) to run from July 2013 to July 2017. The assistance is complementary to that provided by various other development partners. The second phase of the LGCDP project will continue to strengthen the local governance structures and expand the initiatives introduced in the first phase. The project contributes towards poverty reduction through inclusive, participatory planning approaches and ensuring accountability and transparency of local bodies by enhancing their service delivery capacities. The project will cover all the 75 districts, 58 municipalities and 3,915 Village Development Committees of Nepal.<sup>46</sup>

#### **Danish grant assistance for peace:**

A grant assistance of NPR 10.8 billion (USD 108.19 million) has been provided by the Government of Denmark for the implementation of the Peace Rights and Governance Project (PRGP), and Inclusive Growth Programmes (UNNATI). The objective of the UNNATI program is to promote sustainable, inclusive growth that reduces poverty and raises living standards; the program will cooperate with the private sector to achieve this. The commercialization of agriculture through selected products,

emphasis on rural transport infrastructure, and public private dialogue and advocacy for responsible business, including rights and good corporate governance, are the three components of the five year project. Meanwhile, the objectives of the PRGP project are strengthening of peace, responsive and accountable local governance for effective service deliver, and citizen empowerment.<sup>44</sup>

**UK aid for improving local governance:** The Government of United Kingdom has pledged NPR 11.2

**NPR 269 million project for improving food security:** The European Union, Dan Church Aid and DANIDA have jointly launched the “Improving Food Security Governance in South and South East Asia through Strengthened Participation of Organization of Marginalized Farmers” project, wherein NPR 269 million (USD 2.69 million) will be provided in assistance. The five year project, aimed at ending hunger and malnutrition by improving food security governance, is expected to benefit 97,000 households in Bangladesh, India, Myanmar and Nepal. In Nepal alone, it is expected to benefit 24,000 households. The overall objective is to strengthen capacities of local farmers, develop critical understanding of food and nutrition issues, address loopholes in related policies, protect farmer rights enabling them for better production, procurement and distribution systems, and facilitate the involvement of local farmers in decision making processes.<sup>47</sup>

**Australia provides NPR 13 million in aid to NGOs:** The Australian Embassy has provided NPR 13.94 million (USD 0.14 million) in aid to nine organizations in Nepal as part of Australia’s Direct Aid Programme. The aid is expected to support projects in the areas of health and sanitation, education and media development, as well as assist communities and projects with a clear humanitarian and development theme.<sup>48</sup>

**Foreign aid at its highest in five years:** Comparatives drawn on foreign cash loans received by Nepal in the first five months of the fiscal year over the past five years indicates that the country received NPR 10 billion (USD 100.18 million) in the current

fiscal year 2013-14, the highest in the past five years, as can be seen in *Figure 1*. Last fiscal, the figure stood at NPR 835.3 million (USD 8.36 million), a tenfold increase as compared to the previous year. Similarly, foreign cash grants received in the first five months doubled to NPR 14.92 billion (USD 149.46 million) this fiscal as compared to NPR 7.67 billion (USD 76.83 million) in the previous fiscal year, as shown in *Figure 4*.

## HEALTH

In the past quarter, the health sector in the Valley faced bottlenecks in terms of smooth operations with hospitals going into lockdown over politicization of government health institutions. However, smooth operations ensued following the focus on seniority and competence rather than political allegiance.

**Crowd funding for health care:** Keeping in mind the limited access to surgery for common operations like cesarean sections, burns or vehicular accidents in rural Nepal, often resulting in deaths, Nyaya Health tied up with a hospital in Achham in western Nepal to build an innovative crowd funding model. According to this model, patients who require complex care are given the opportunity to tell their stories online, wherein people from around the world can directly fund a portion of their costs starting from NPR 1000 (USD 10). These funders are given regular updates on the patient’s health status. In 2013 alone, the website helped raise money for 86 urgent operations.<sup>49</sup>

**President of Nepal Medical Council**

**resigns:** The president of the Nepal Medical Council, Dr. Damodar Gajurel, has resigned citing his inability to work with newly elected members of the council. In his resignation letter, he alleged the council members of not attending meetings wherein important decisions needed to be undertaken. He further alleged that despite the mounting pressure from medical students graduating from China to pursue internship opportunities in Nepal, the members chose to ignore this issue.<sup>50</sup>

**Nepal on the juncture of eradicating polio:** The country has faced zero cases of polio in the past three years with the last reported case being filed in August 2010. Regular vaccination campaigns and surveillance programs on the progress of containing polio is said to be the reason behind this.<sup>51</sup>

**Health awareness on the rise among Rautes:** As per Raute Upliftment Institution Nepal, who organized a free health camp at Doila in Satikhani, health awareness in the Raute community has increased. The community is said to have actively cooperated and communicated with health workers, and requested for medicines. The primary problems prevalent amongst the community are gastritis, anemia and malnutrition caused by food shortages.<sup>52</sup>

**Indian ambulances operating unchecked:** Sources indicate that over two dozen ambulances bearing Indian number plates are operating unchecked in the district of Parsa, as a result of the failure of concerned authorities—the Traffic Police Office and the Department of Transport Management—to stop such ambulances from operating in Nepal. These



ambulances are said to acquire passes from Birgunj customs and operate even in Kathmandu. Employees and health workers at hospitals have been found to be involved in assisting these ambulances and taking commission.<sup>53</sup>

**Contribution based health insurance plan on the cards:** The Employees Provident Fund is planning to launch a contribution based health insurance plan for its members in the next fiscal year. The insurance plan is expected to operate under four schemes, namely sickness and treatment, accidental death or disability, delivery and dependant facilities. The plan has been designed to support the government's efforts to provide social security to a majority of the people.<sup>54</sup>

## INFRASTRUCTURE

The provision of quality and efficient infrastructure services is essential to realize the full potential of the growth impulses surging through the Nepali economy. One of the most dominant challenges of Nepal is to develop the basic infrastructure to accelerate the pace of development.

**Upper Tamakoshi Hydropower project:** The 456 mega watt (MW) upper Tamakoshi Hydropower Project, with an estimated total project cost of NPR 35.29 billion (USD 353.5 million), has completed 57% of the total construction works. Till date, NPR 16.29 billion (USD 163.2 million) has been spent on the project. The developers of the project have been called upon by the government to expedite construction so as to bring the project into operation within its mid-July 2016 deadline.

**IFC, GMR to jointly develop 600 MW project:** The International Finance Corporation (IFC) and GMR Energy Limited of India signed a Joint Development Agreement (JDA) to develop the 600 MW Upper Marshyangdi II hydropower project. As per the agreement, IFC shall hold 10% equity in the project and lend 15% of the total project cost of USD 1 billion (NPR 99.82 billion) to the company. The Detailed Project Report and Environment Impact Assessment report has been submitted to the Ministry of Energy. The Project Development Agreement is under discussion at the Investment Board of Nepal.

**Troubled Upper Marshyangdi Project:** Construction works at the 50 MW Upper Marshyangdi hydropower run-of-the-river project has once again come to a halt due to agitating workers. The workers have demanded hike in allowances and that the project provide employment to locals as per their qualification. It is estimated that the project incurs a loss of NPR 400,000 (USD 4000) when work is halted for one day. So far, only a 2 km stretch of tunnel has been constructed as a result of frequent strikes by workers. The total project cost is estimated at NPR 10 billion (USD 100.2 million) and the project was initially expected to come into operation by the end of 2016.

**Sunkoshi to be developed as pumped storage:** The Asian Development Bank (ADB) signed a NPR 600 million (USD 6 million) loan agreement with Department of Electricity Development (DoED) for funding the Detailed Project Report (DPR). The DOED has plans to develop Sunkoshi-II (1,110 MW) and Sunkoshi-III (536

MW) as pumped-storage projects. The preparation of a DPR is aimed at suggesting feasible and appropriate modality for project development. As per the study conducted by Japan International Cooperation Agency, the project is considered among the 10 best reservoir projects. The estimated cost of the project currently stands NPR 100 billion (USD 1 billion).

**Land Acquisition for Middle Bhotekoshi Project:** The middle Bhotekoshi hydropower project has completed 67% of the land acquisition work. The project has paid over NPR 170 million (USD 1.7 million) as compensation to the landowners. The 102 MW run-of-the-river project is promoted by Chilime Hydropower Company with an estimated cost of NPR 14 billion (USD 140.25 million). The construction is expected to begin this year and start power generation by 2016.

**Upper Karnali Hydro project and PDA negotiations:** Almost 80% of negotiations on Project Development Agreement is complete between the government and developers of the Upper Karnali Hydropower project. The export oriented project is being developed by a consortium of GMR Energy, GMR Infrastructure and Italian-Thai Development Project. The consortium is building the project under the build, own, operate and transfer (BOOT) model and giving away 12% of power generated by the project and 27% stake in the company free of cost to the government. Under the BOOT model, the project will be handed over to the government for free within 30 years of the date of commencement of power generation. The PDA has not gone ahead due to the

project developer demanding income tax concession.

**Kathmandu-Terai Fast Track:** The much hyped NPR 100 billion (USD 1 billion) four lane 76 km expressway is facing uncertainty after all three shortlisted international developers (Reliance Infrastructure, Infrastructure Leasing & Financial Services, and Larsen and Turbo) did not submit their Request for Proposal (RFP) for the project within the deadline set for September 21 last year. A technical committee formed to study ways to implement the project declared Public Private Partnership (PPP) model infeasible to construct the expressway. Instead the committee has suggested building the expressway through donor assistance and government resources. The World Bank has shown interest to lend the required funds for the construction of the project under the

International Bank for Reconstruction and Development (IBRD).

**KTM-Hetauda tunnel road:** Nepal Purbadhar Bikas Company Limited (NPBCL) has begun the construction of the 58 km Kathmandu-Hetauda Tunnel Road with a total investment of NPR 35 billion (USD 350.6 million). NPBCL has a target to complete the road project by end of 2016.

**Nagdhunga-Naubise tunnel:** Japan International Corporation Agency (JICA) is carrying out a new feasibility study to construct a tunnel on the Nagdhunga-Naubise section of Tribhuvan Highway which links the capital with the outside world. Earlier consultants GEOCE and Tech Studio Engineering had conducted the feasibility study for the Department of Roads. The earlier feasibility recommended building an 8 meter and 2.3 km tunnel. The tunnel,

including the access road, was estimated to cost NPR 5 billion (USD 50 million).

**Department of Roads under spending:** The Department of Road spent only 12.23% of the NPR 32 billion (USD 320.6 million) funds allocated till December 2013. The physical progress stood at 19.68% (*see Table 3: Progress in road projects during the first trimester*).

Jajarkot-Dunai road, which connects Dolpa, has the highest physical progress of 98%. Syabrubesi-Rasuwegadhi has the highest budget spending of 41.84% of the allocated fund of NPR 178 million (USD 1.8 million). Mid-Hill spent 14.38% of the budget while achieving 42.98% of physical progress. Four kilometers of the targeted 24 km of the road has been graveled. The Postal Highway project spent NPR 85.1 million (USD 852,535) of the allocated NPR 2.21 billion (USD 22.1 million). The North-South corridor project spent NPR 80 million (USD 801,443) of the allocated NPR 510 million (USD 5.1 million).

**Table 3: Progress in road projects during the first trimester**

Project	Budget 'In NPR'	Financial Progress	Physical Progress
Kathmandu Valley Road Improvement Project	1.8 billion	21.35%	32.15%
Kathmandu-Bhaktapur Road Improvement Project	80 million	9.17%	7.45%
Road Sector Development Project	2.78 billion	10.26%	7.62%
B.P. Highway	1.23 billion	6.72%	21%
Mid-Hill Highway	1.90 billion	14.68%	42.98%
Jajarkot – Dunai Road	90 million	45.37%	98%
North – South Roads	500 million	8.02%	34.46%
Kanti Highway	120 million	5.02%	13.53%
Saljhandi – Dhorpatan	160 million	4.44%	89.74%
Regional Roads	830 million	19.08%	10.16%

Source: Department of Roads

**Melamchi water project:** The construction of a water treatment plant, which is one of the two major components of Melamchi Drinking Water and Supply Project (MDWSP), is being built with an estimated cost of NPR 4.2 billion (USD 42.1 million) under the financial assistance of the Government of Japan. The contract for building the water treatment plant has been awarded to VA-Tech Wagag Company. The Government of Japan has agreed to provide approximately NPR 5.34 billion (USD 53.6 million) in loans. The plant will have a capacity of 850 million liters and supply 170 million liters of water per day to the Kathmandu valley by April 2016 .

## MANUFACTURING AND TRADE

The first five months of the fiscal year (FY) 2013-14 saw an improvement for the manufacturing and trade sector, with the total exports from the country increasing by 13.7%, a 9.4% increase compared to the same period in last fiscal. The import growth rate has also tapered as compared to last FY with the total imports growing by 19.9% as compared to a 26.8% increase during the same period in FY 2012-13. This can be attributed to the weakening of the local currency in contrast to the appreciation in the dollar.

**Imports of betel nuts on the rise:** The government's effort to discourage the imports of betel nuts failed to yield any positive results as the country imported betel nuts worth NPR 600 million (USD 6.01 million) in the first six months of the FY 2013-14. The country imported a total of over 9,000 tons of betel nut during the first six months of the FY, up from 7,930 tons during FY 2012-13.

The government, in order to curb the imports, has increased the custom valuation from USD 450 per ton to USD 750 per ton and the custom duty from 20% to 30%. The custom duty office in Mechi collects NPR 200-300 million (USD 2-3 million) annually from imports of betel nuts alone. Since its consumption in Nepal is low, mostly all the imported betel nuts are re-exported to India labeled as original Nepali products.<sup>66</sup>

**Pharmaceuticals companies demand removal of export barriers:** The Association of Pharmaceutical Producers of Nepal (APPON) and pharmaceutical entrepreneurs have urged the gov-

**Table 4: Foreign Trade Statistics based on Five Months data of 2013-14 (NPR in millions)**

	2011/12	2012/13 <sup>R</sup>	2013/14 <sup>P</sup>	Percent Change	
				2012/13	2013/14
<b>TOTAL EXPORTS</b>	<b>30058.0</b>	<b>32875.7</b>	<b>37366.5</b>	<b>9.4</b>	<b>13.7</b>
To India	19779.9	20617.7	24212.8	4.2	17.4
To Other Countries	10278.1	12258.0	13153.7	19.3	7.3
<b>TOTAL IMPORTS</b>	<b>177785.4</b>	<b>225392.3</b>	<b>270354.1</b>	<b>26.8</b>	<b>19.9</b>
From India	112395.7	144487.6	178003.2	28.6	23.2
From Other Countries	65389.7	80904.7	92350.9	23.7	14.1
<b>TOTAL TRADE BALANCE</b>	<b>-147727.4</b>	<b>-192516.6</b>	<b>-232987.6</b>	<b>30.3</b>	<b>21.0</b>
With India	-92615.8	-123869.9	-153790.4	33.7	24.2
With Other Countries	-55111.6	-68646.7	-79197.2	24.6	15.4
<b>TOTAL FOREIGN TRADE</b>	<b>207843.4</b>	<b>258267.9</b>	<b>307720.6</b>	<b>24.3</b>	<b>19.1</b>
With India	132175.6	165105.3	202216.0	24.9	22.5
With Other Countries	75667.8	93162.7	105504.6	23.1	13.2

\*based on customs data R=Revised / P= Provisional

Source: NRB Report - Recent Macroeconomic Situation (5 months), 2010/71

ernment to remove non tariff barriers to export their products to India. Though Nepal's medicinal products are of high quality and competitively priced, trade barriers are hindering the exports. Additional duty and lengthy paperwork have been a hindrance to export allopathic medicines and herbal products to India.

As per APPON, exporters have to pay an additional duty, besides going

through lengthy procedures for registration of products and getting it certified by Indian authorities, thus curbing the growth of the local industries. Also, Indian products are granted trouble free entry into India while the Nepali products are not provided that privilege.<sup>67</sup>

**Balance of Payment records surplus:** During the first five months of the fiscal

## Macroeconomic Overview

year 2013-14, the country's Balance of Payments (BOP) recorded a surplus of NPR 68.02 billion (USD 681.42 million), compared to a surplus of NPR 3.3 billion (USD 33.05 million) during the same period the previous year. The workers' remittances inflow into the country recorded a growth of 35.28% with the figure rising to NPR 221.17 billion (USD 2.21 billion) from that of NPR 163.48 billion (USD 1.63 billion) the previous year.<sup>68</sup>

The current account posted a surplus of NPR 50.35 billion (USD 504.40 million) in the review period in contrast to a surplus of NPR 1.64 billion (USD 16.42 million) in the same period the previous year.

**Trade deficit surge further:** During the first five months of fiscal year 2013-14, the country's trade deficit increased by 21% to NPR 232.99 billion (USD 2.33 billion), compared to an increase of 30.3% during the same period last year. The trade deficit with India has increased by 24.2% during the review period as compared to the growth of 33.7% in the same period last fiscal. Similarly, the trade deficit with other countries also saw a rise by 15.4% as compared to the figures during the same corresponding period (see Table 4: Foreign Trade Statistics based on Five Months data of 2013-14). During the review period, the total exports were to the tune of NPR. 37.36 billion (USD 374.27 million), whereas the total imports stood at NPR. 270.35 billion (USD 2.70 billion). Imports from India increased from NPR 144.48 billion (USD 1.44 billion) to NPR 178 billion (USD 1.78 billion), an increase of 23.2%, whereas the total imports from other countries

increased from NPR 80.90 billion (USD 810.45 million) to NPR 92.35 billion (USD 925.16 million), an increase of 14.1 % as compared to the same period last year.

A significant increase in the import of petroleum products, cold rolled sheet in coil, threads, fruits, and other machinery and parts increased the import figures from India. Likewise, imports from other countries rose mainly on account of an increase in the imports of GI wires, other stationeries, raw silk, copper wire rod, scrapes and sheets, and silver.<sup>69</sup>

**Rise in exports of woolen carpets, pashmina, readymade garments:** During the first five months of the current fiscal year, the exports of woolen carpets, pashmina and readymade garments witnessed a growth as compared to the corresponding period last year. Nepal exported a total of NPR 1.05 billion (USD 10.51 million) worth of pashmina products, an increase of 34.2% compared to the figures last year; similarly, the exports of readymade garments also saw a rise of 32%, as the total exports reached NPR. 1.82 billion (USD 18.23 million). Likewise, exports of woolen carpets also witnessed a growth of 19.3%, with the export figures totaling NPR. 3.12 billion (USD 31.25 million).<sup>70</sup>

## REAL ESTATE

**Increase in land revenue:** During the first half of the current fiscal year, the land revenue collection by Department of Land Reform and Management (DOLRM) increased by 26.43%. Land

Revenue offices across the country collected NPR 2.87 billion (USD 28.8 million) in registration fees as compared to NPR 2.27 billion (USD 22.7 million) collected during the first six months last year. The land revenue offices have surpassed its revenue collection target of NPR 2.14 billion (USD 21.4 million) by 34% during the review period. The current revenue collection represents 63.77% of the current fiscal year's target. The increasing land revenue collection is attributed to the decreasing interest rates from a peak of 16% to rates on home loans below 10%.<sup>71</sup>

**Lower interest on home loans:** Interest rates for home loan have come down to as low as 8%. Five months earlier, the interest on home loan stood at approximately 10%. The low interest rate can be attributed to the excess liquidity with commercial banks and low demand for corporate loan. It is estimated that commercial banks are sitting on NPR 70 billion (USD 701.3 million).<sup>72</sup>

**e-Building permit:** The Kathmandu Metropolitan City (KMC) office is set to introduce the e-building permit system from January. In the trial phase, KMC office will provide username and password to authorized engineers and designers of private firms in seven wards. In this context, first phase software training has been provided to 40 engineers and designers.<sup>73</sup>

**Tax default:** The Kathmandu Metropolitan City (KMC) office has directed its ward authorities to step up its drive to collect land tax from houses and commercial complexes residing within the area of 10,000 square feet.

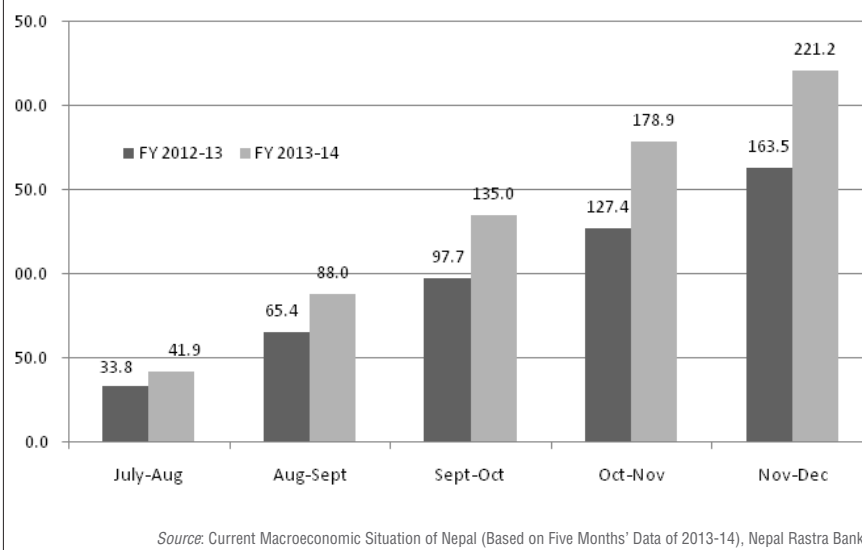
The Accrued tax from 2004 to 2010 amounts to NPR 1-1.5 billion (USD 10 -15 million). KMC plans to penalize 10% fine to the pending dues if taxes are not paid by January 14, 2014.<sup>74</sup>

**Legal complication for NRNs and foreigners to buy homes:** The 2011-2012 fiscal budget had announced allowing NRNs and foreigners to buy houses and apartments by introducing a guideline by mid-October 2011. As per the budgetary provision, foreign individuals and companies will be permitted to buy flats and apartments costing USD 200,000 (NPR 20 million) or more and foreign buyers of such units would not be allowed to sell them for five year. However, even after two years, there have been no such guidelines. In order to introduce a guideline, the NRN Act 2008 has to be amended as the act states that NRNs can purchase land up to 2 ropanis but does not mention anything about apartments, the quantity and price.<sup>75</sup>

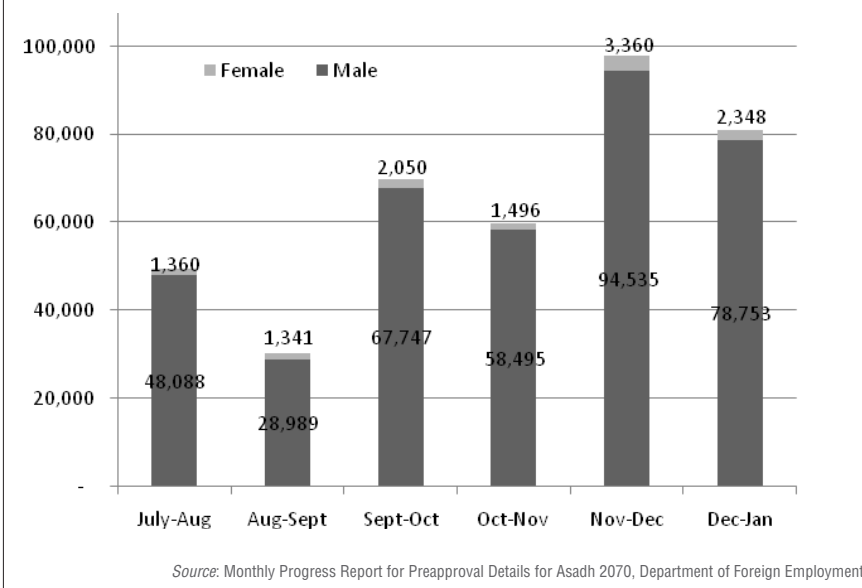
## REMITTANCE

Remittance inflows to Nepal reached NPR 221.18 billion (USD 2.21 billion) in the first 5 months of the fiscal year 2013-14, registering an increase of 35.2% as against an increase of 22.7% during the same period of the last fiscal year (see *Figure 5: Inflow of Worker's Remittance for First 5 Months of Past Two Fiscal Years*). In US dollar terms, remittance inflow went up by 18.7% to USD 2.22 billion (NPR 221.6 billion) compared to an increase of 8.8% in same period of the previous year.<sup>76</sup> The strong dollar as against the Nepali Rupee has been the major reason for the rise in remittance.

**Figure 5: Inflow of Worker's Remittance for First 5 months of FY 2012-13 and FY 2013-14 (Amount in NPR Million)**



**Figure 6: Monthly Figures for Migrant Workers Seeking Foreign Employment for FY 2013-14**



On a monthly basis, remittances inflows declined by 3.6% in November/December of the current fiscal year compared to that of the previous month. .

**Foreign employment attracts 400,000 Nepalis in six months:** A total of 388,562 migrant workers left the country for foreign employment in the first half of FY 2013-14 (see Figure 6 for monthly data of Nepali workers seeking foreign employment in FY 2013-14).<sup>77</sup> The highest number was recorded between mid November and mid December, while the lowest numbers were recorded during mid August to mid September due to the festive season. While Qatar was the top destination for Nepali workers, Malaysia, Saudi Arabia, UAE and Kuwait ranked second to fifth respectively.

**Foreign Employment Bond 2075 issued in batches:** In another attempt to regulate the flow of remittance through formalized channels, Nepal Rastra Bank issued a batch of the five year Foreign Employment Bond early on in the middle of FY 2013-14 from December 16 to January 6. The first saw an issue worth NPR 250 million (USD 2.5 million) yielding 9% interest.<sup>78</sup> After the previous practice of issuing the entire amount of bond towards the end of the fiscal year failed to attract significant subscriptions, issuing in the mid year is hoped to provide NRB with enough time to undertake promotional activities properly.

**Most remittance from South Korea through illegal channels:** A total of NPR 3.86 billion (USD 38.6 million) worth of remittance was sent to Nepal from South Korea during fiscal year 2012-2013, as per reports made available by Korean banks. This, despite the total remuneration of

approximately 20,000 Nepalis through the Employment Permission System alone standing at NPR 19.2 billion (USD 192.3 million).<sup>79</sup> While there is a significant number of Nepalis going independently or even before the EPS started, the actual figure of remittance will be higher than NPR 19.2 billion (USD 192.3 million).

Experts of the remittance sector point out this is mainly due to higher USD exchange rate and cheaper fees through the Hawala system, and also due to lack of easy access to remittance companies. In addition, the banks in Nepal are closed on Sundays when migrant workers would be free. CEO of IME, Suman Pokharel stated that the government must take initiatives to create an environment for easy transfer of remittance from such countries in order to discourage illegal activities.

**ILO launches project to protect migrant worker rights:** The International Labor Organization and European Union collectively launched a three year project to manage labor migration from Nepal, India and Pakistan to countries in the Gulf. The project called 'Promoting Effective Governance of Labor Migration from South Asia' will focus on protection of migrant worker rights, impact of labor migration in development, and minimizing unregulated migration. The project will conduct pre-departure orientation programs and track the condition of migrant workers in destination countries through various tools such as workplace inspection. Foreign employment agencies will also be monitored to stop them from duping foreign job aspirants.<sup>80</sup> The Ministry of Labor and Employment is also a major part of the project, which hopes to benefit more than 20,000 migrant workers

through services during recruitment, employment and return.

**Mobile banking for remittance must, say experts:** In order to channel inward remittance inflow through formal routes, experts state the need for remittance agencies and financial institutions to utilize mobile banking technology. Mayumi Ozaki, Asian Development Bank's rural finance/micro finance specialist, stated that in a country such as Nepal where more than two million people are working abroad and with 70% of the population without access to finance, monetary transaction through mobile technology should be given priority.<sup>81</sup> She stated examples of Kenya's mPesa and Bangladesh's bKash that successfully provide mobile payment service for remittance payments. Nonetheless, to guarantee success, good telecom infrastructure and supportive regulation will be required along with financial literacy.

## TELECOMMUNICATION AND MEDIA

The total number of fixed line telephone subscribers during mid-November 2012 stood at 834,352, which increased to 849,096 during mid-November 2013, registering a nominal growth of 1.8%. The tele-density for fixed lines has increased from 3.14% in Mid-November 2012 to 3.20% during Mid-November 2013. Similarly, in terms of total number of mobile phone subscribers, the figure of 16,379,056 during November 2012 increased to 19,695,627 in November 2013, showing a growth of 20.25%. The combined (fixed, mobile and others) tele-density as of mid November 2013 stood at 84%.

Data and internet service penetration

rates during November this fiscal year (2013-2014) stood at 28.92% as compared to 20.86% during November 2012. The growth trend of voice telephone and data service penetration is depicted in *Figure 7*.

#### Market share of telecom operators:

The market share of Ncell and Nepal Telecom stands approximately at 49% and 43% respectively. While UTL and Smart Telecom command around 3% and 4% market share respectively, Nepal Satellite controls only 0.67% (*see Figure 8: Market Share of Telecom Operators*).

**NPR 1.2 billion collected in frequency fees:** The government, through the introduction of “Telecommunication Service Radio Frequency (Distribution and Pricing) Policy 2012”, collected

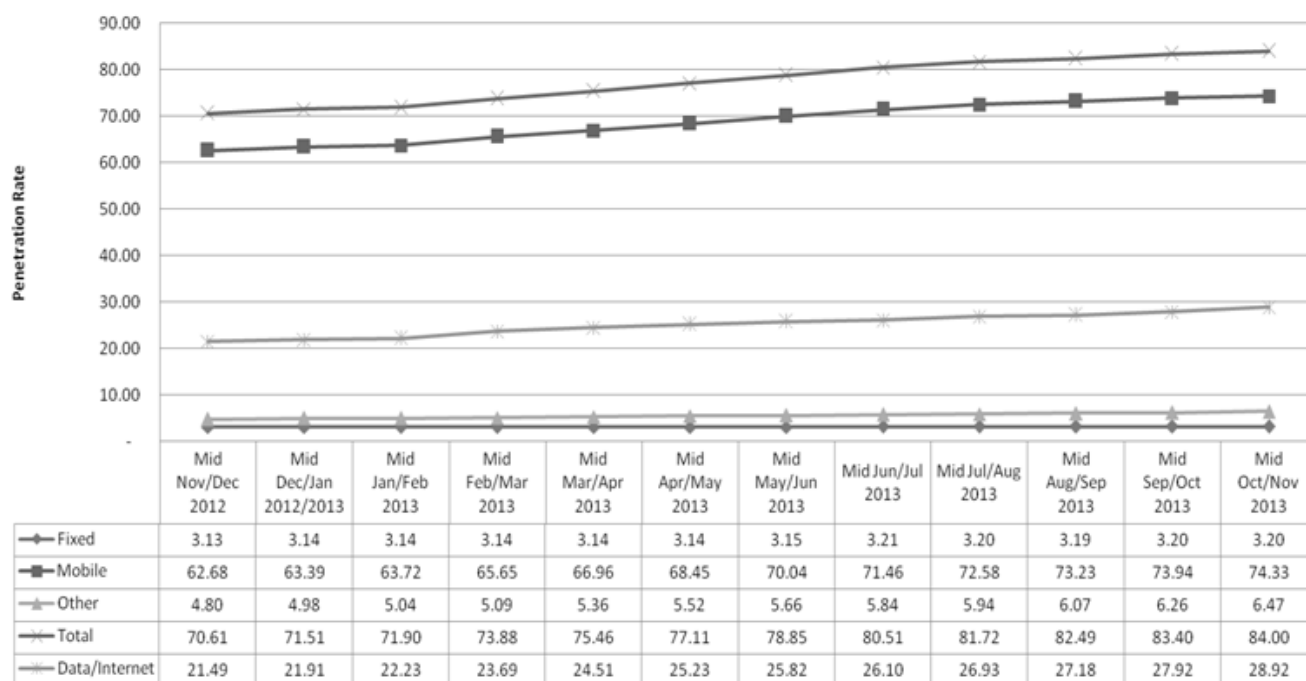
NPR 1.2 billion (USD 12 million) in frequency fees from telecom companies during fiscal year 2012-2013. The collection of spectrum fees before the implementation of this policy amounted to NPR 790 million (USD 7.9 million) during fiscal year 2011-2012.

During fiscal year 2012-2013, Ncell paid NPR 1.44 billion (USD 14.4 million) in 3G (3rd Generation) fees for the period 2007-2013 while Nepal Telecom had paid NPR 488 million (USD 4.8 million) of the total NPR 1.64 billion (USD 16.4 million) owed for 3G service use during 2006-2013. Similarly, CG Communication (formerly STM Telecom Sanchar) paid only NPR 2 million (USD 20,000) out of the total spectrum fee of NPR 28.8 million (USD 288,520).<sup>82</sup>

**NTA to protect consumer rights:** In a bid to protect consumer rights, Nepal Telecommunication Authority (NTA) will start preparing a guideline within this fiscal year (2013-2014) that will allow it to check the fees consumers are being charged. Currently there is no legal framework to address consumer complaints regarding telecom companies disregarding the rates approved by the NTA and overcharging consumers.<sup>83</sup>

**Service quality test for telecom:** The NTA has shortlisted three consultants to carry out Quality of Service (QoS) tests of wireless telecom services in 11 districts during this fiscal year. The NTA is currently waiting for the go ahead from the Ministry of Information and Communications as this program is carried over from the last

**Figure 7: Growth Trend of Voice Telephone and Data Service Penetration**



Source: Nepal Telecommunications Authority "MIS report dated February 2013"

fiscal year (2012-2013). The last QoS was conducted in 2011 in four major cities, namely Kathmandu, Pokhara, Biratnagar and Nepalgunj, which indicated that the service quality had not improved compared to the findings of the QoS test done in 2007. NTA expects to complete the QoS test within three months after finalizing the consultant from the shortlist.<sup>84</sup>

**Nepal Telecom looks for a strategic partner:** The Nepal Telecom (NT) technical sub-committee submitted its report to the NT board, making way for the invitation of Expression of Interest (EoI) for hiring an international consultant. The consultant will help NT to find a strategic partner through a Due Diligence Audit (DDA) report of NT and documents for calling in tenders. It is expected that the prospective partner will have to invest NPR 30-40 billion (USD 301-401 million) to buy shares. Nepal Telecom had been planning for the last four years to bring in a partner by off-loading 30% of the stake.<sup>85</sup>

**Ncell's growth in net sales:** Ncell's net sales increased from NPR 41.4 billion (USD 414.7 million) in 2012 to NPR 46.16 billion (USD 462.4 million) in 2013. The growth of 11.5% can be attributed to the 10.9 million subscribers, including 1.8 million new subscribers during 2013.

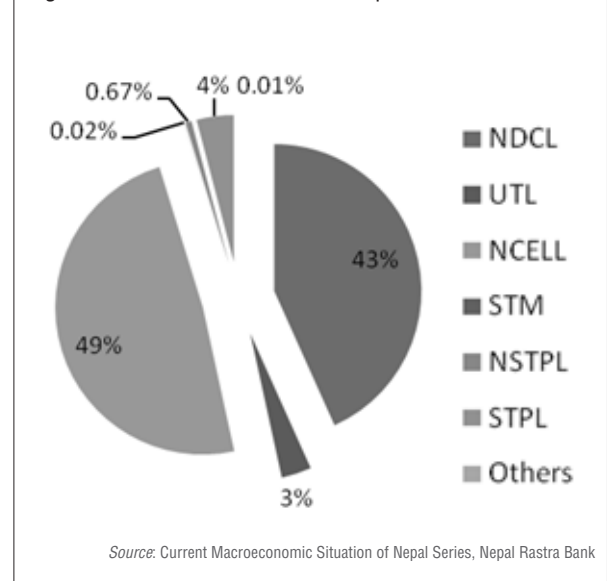
## TOURISM

The tourism industry witnessed a series of unfortunate issues in 2013. The European Commission's ban on Nepali airlines on poor safety records, the Constituent Assembly elections followed by continuous strikes by the political parties,

and lack of tourism marketing hampered the sector's growth. Despite these issues, the tourism sector is optimistic that the industry will gain momentum and post positive growth in 2014. The industry will see a revival with massive investments pouring in, backed by the belief of the formation of a stable government. Likewise, a high level committee has given recommendations on various issues, including tax break to incentives for vehicle imports, easy access to land leased hotel construction, and plans for the overall development of the tourism industry.

**Surge in hotel industry investments:** The hotel industry in Nepal is witnessing an inflow of investments with the entry of new star rated hotels and deluxe resorts that are being planned to be built in various parts of the country. As per the data provided by the Ministry of Culture, Tourism and Civil Aviation (MoCTCA), eight star rated hotels and deluxe resorts have filed application to conduct Initial Environmental Examination (IEE) and Environmental Impact Assessment (EIA). Hotel Nilgiri (three-star) in Jhapa, Hotel Galaxy (two-star) in Budhanilkantha, Sheraton Hotel (deluxe five-star) in Kesharmahal, Rara Hotel and Recreation Center (deluxe resort) in Mugu, Nepal Hospitality in Thamel, Star Hospitality in Baneshwor, Himalayan Shangri-la Village Resort in Dhulikhel, and a deluxe resort in Chitwan area are amongst the companies that have applied at MoCTCA

Figure 8: Market Share of Telecom Operators



to conduct IEE and EIA.

The development of tourism infrastructures, increase in flow of domestic tourists and positive political development have encouraged investors to invest in the hospitality sector which will subsequently help the tourism industry flourish.<sup>86</sup>

**Number of trekkers increase in Annapurna region:** Annapurna Conservation Area (ACA) saw a rise in the arrival of trekkers by 6.56%, with 113,495 trekkers visiting the region in 2013. Though the trekking trials have been shortened due to construction of new roads, the number of trekkers has been on an upswing. The number of arrivals could have increased given the stability of political situation in the country. Earlier, a large number of tourists had cancelled their Nepal trip owing to the political instability due to the Constituent Assembly polls.<sup>87</sup>

**Nepal on New York Times must visit destination list:** The New York Times



has placed Nepal in the 45<sup>th</sup> position in the list of “52 Places to go in 2014”. Nepal features in the list along with destinations like Cape Town in South Africa, Christchurch in New Zealand, North Coast California, Namibia, Ecuador, Vietnam, Australia, and Netherlands among others. The publication describes Nepal as “the mother lode of alpinism, home to eight of the world’s 10 highest summits (including Everest)”.<sup>88</sup>

A committee at the Ministry of Culture, Tourism and Civil Aviation (MoCTCA) had recommended last September that the government allow access to 165 new peaks this year, out of which 13 fall above 23,000 feet.

**Growth in tourist arrivals in Lumbini:** Lumbini, the birthplace of Lord Buddha, saw a steady increase in the domestic and Indian tourists in 2013, though the tourist arrivals from other countries have not been encouraging. The domestic tourist arrivals to Lumbini in 2013 were 573,529, up from 539,210 in 2012, an increase of 6.36%. The total number of Indian tourists visiting the Buddhist pilgrimage spot rose from 120,583 in 2012 to 150,252 in 2013. The Lumbini Development Fund were of the opinion that lack of marketing and publicity campaigns were the major reasons for the downfall of tourist arrivals from the third world countries.<sup>89</sup>

**CAAN’s five star airport hotel plan gets nod:** The Finance Ministry has approved the proposal of the Civil Aviation Authority of Nepal (CAAN) to build a five star airport hotel in Sinamangal under the build-own-operate-transfer (BOOT) modality. The tourism ministry has said that the proposal would be sent to the

Cabinet for its final approval. As per the plan, CAAN will lease the 116 ropani of land for at least 30 years. The land has been underutilized and CAAN intends to use the property for commercial use. With the tourism sector expanding at a steady pace, the demand for accommodation has been increasing with a number of global hotel chains planning to enter Nepal. The proposed luxury hotel could create more value for Nepal’s fast-growing tourism industry, and could become a big source of revenue for the government. The plan aims at facilitating tourism and offering accommodation to travelers passing through Tribhuvan International Airport (TIA).<sup>90</sup>

**Nepal can accommodate 7.44 million tourists annually:** The “Economic Activities Report 2013-14”, a study conducted by Nepal Rastra Bank (NRB) research department, has concluded that the tourist standard hotels in Nepal have increased by 15.4% to 1,224 hotels as compared to the last fiscal year. As per the study, a total of 20,408 rooms are available per day in the country, which means that the country can accommodate 7.44 million tourists annually with the existing infrastructure. The survey was conducted in eight major cities in 47 districts, i.e. Kathmandu, Pokhara, Biratnagar, Janakpur, Birgunj, Bhairahawa, Nepalgunj and Dhangadhi.

The report also focused on Nepal’s hospitality sector which had been growing gradually in terms of service and facilities. However, the report pointed out the sector’s inability to shift its focus from traditional tourism to other products. As per the report, the tourism sector has been lacking in promoting mountaineering, enter-

tainment, pilgrimage and medical tourism to increase the tourist length of stay.<sup>91</sup>

**License made mandatory for operators:** The government has introduced mandatory license for all adventure tourism operators and recreational tourism activities. This provision, which comes as an amendment to the Tourism Act 1997, has been introduced under the Tourism Industry Service Delivery Directive 2013 by the Ministry of Culture, Tourism and Civil Aviation. The Ministry has issued working guidelines to make the services provided by the tourism industry division more organized and transparent, and to regulate the adventure and recreational tourism activities.

As per the directive, the companies applying for the license need to submit feasibility study report, details and map of the place where the business is to be operated, including land ownership or agreement certificate, citizenship and bio-data of shareholders, copies of company registration and industry registration certificate and prospectus, report of Initial Environmental Examination (IEE) and Environmental Impact Assessment (EIA), and documents related to insurance, among others. The license and renewal fees for fun parks with cable cars are fixed at NPR 75,000 (USD 750) and NPR 35,000 (USD 350), while for a bungee jumping the fees are NPR 40,000 (USD 400) and NPR 20,000 (USD 200), and for canyoning the fees are fixed at NPR 30,000 (USD 300) and NPR 20,000 (USD 200). Similarly, the license fees for amusement parks, cable car and fun parks are NPR 50,000 (USD 500) and NPR 25,000 (USD 250) respectively.<sup>92</sup>

## MACROECONOMIC OUTLOOK

Despite being an agriculture-based economy, Nepal's agricultural development has not been satisfactory in terms of financing and producing. Despite being accorded much importance in almost all plan periods, the sector has lagged far behind in generating momentum for the much-needed economic growth. Additionally, the government's agricultural development endeavors in the past (in the Five-year plans and the 20-year Agriculture Prospective Plan) focused mainly on the production aspect of agriculture and was found lacking in managing the farmers' marketing needs.

For over two decades, Nepal has been working to uplift its educational standard by providing quality higher education to its citizens. The formulation and implementation of various strategies have made a number of positive impacts in the sector: A case in point being the rise of literacy rate from 54.1% in 2001 to 65.9% in 2011. Despite this, there are still a number of stumbling blocks that have prevented this sector from making a significant improvement. These challenges need to be addressed in the best manner possible if the country is to witness any positive changes in its education system.

Electricity is one of the cheapest sources of energy as compared to diesel, kerosene and LPG. With the onset of heavy load shedding, consumption of petroleum products through generators has increased which puts pressure on Nepal Oil Corporation, as well as our trade deficit. Therefore, there is need for development of alternate sources of electricity such as hydropower, wind, solar and even waste. The government must take initiatives to conduct studies and develop these options. There is also need to strengthen the regulatory mechanism in order to increase transparency, increase efficiency and reduce wastages in the market.

Foreign aid continues to see a steady incline in comparison to previous years. The increase of flow in foreign aid to the country is said to be a result of the timely announcement of the budget and the gradual improvement in the political situation.

In the last two decades, Nepal has been able to expedite its infrastructure development, making it possible to link all the district headquarters. Funding has always remained a key issue for infrastructure development. Haphazard and non-engineered construction has raised serious concerns towards sustainability of opened track roads.

Likewise, hydropower has remained in the clutches of a select exclusive group and often been conducted in a non-transparent manner. Constructions have been disrupted by locals backed by political parties. Further, market mechanism for power trade and power purchase is not in place to attract private and foreign investment in mega projects.

With the country's trade deficit widening further, Nepal needs to focus on finding solutions and plough in investments in the productive sectors of the economy. Similarly, with the exports seeing a rise in the recent months, the government needs to speed up custom clearance procedures to simplify trade. Also, the government needs to focus on the long ongoing issues of the exporters, i.e. continuous power shortages, labor problems, expensive finance, and absence of proper infrastructure, which add up to the internal challenges for Nepali products since the exporters have to compete with products from countries that are able to supply similar products at lower rates.

The growth of realty sector indicated by the increase in land revenue is mainly attributed to the sale and purchase of land. The sale of apartments and houses has been stagnant and developers are finding it difficult to complete projects on time. Besides there has been a double digit increment in the price of major construction materials as well as labor cost, which has increased the construction cost.

With the strengthening of the dollar against the Nepali Rupee, along with increasing number of Nepalis seeking foreign employment, remittance in the following quarter is likely to register an increase. Nonetheless, remittance inflow through illegal channels is also on the rise. The government and financial sector needs to ease the process of sending back money in order to channelize remittance through legal channels. On a positive note, the issuance of the Foreign Employment Bond in parts can be taken as an improvement which will help increase subscription, thereby utilizing more remittance money towards capital formation.

The mobile penetration in Nepal, previously considered relatively low by world standards, has quickly increased by fourfold in the last four years. The growth of fixed-line telephone has flattened out and there are very few signs that this segment of the communication sector would pick up again in the short to medium term. With growth of mobile services and economical cellular phones, expansion of fixed lines into the underserved rural areas also seems sluggish.

Since the tourism sector failed to give continuity to its promotional campaign carried out in the past years, the impact was visible in the total tourist arrivals in 2012-13. The arrivals saw a dip by 1.4% as compared to last year. Also, the prolonged political transition, absence of required infrastructures in the tourism sector are attributed for the failure to attract more tourists to Nepal. Moreover, the policies and programs have not been able to deal with challenges like diversifying tourism products and holding promotional campaigns beyond traditional areas to create employment, alleviate poverty and make tourism a major foreign exchange earning sector.

The background features a large, light gray, stylized letter 'R' on the left side. A series of small, light gray dots forms a curved path along the left and bottom edges of the page. The word 'REVIEW' is printed in a thin, black, sans-serif font in the center-right area.

REVIEW

**REVIEW**

# Financial Markets

## Trends in deposit, credit and liquidity

The deposit mobilization of Banks and Financial Institutions (BFIs) at the end of first six months of the current FY 2013-14 demonstrates strong deposit growth rate as compared with the same period of the previous fiscal year.

As per the report published by Nepal Rastra Bank (NRB), the deposit mobilization of BFIs increased by 8%, i.e. NPR 95.41 billion (USD 955.82million), as compared to a growth of 5.3%—NPR 54.13 billion (USD 542.27 million)—during the same period last fiscal year. During the review period, deposit mobilization of commercial banks, development banks and finance companies increased by 7.2%, 13.9% and 8.4% respectively as compared to a growth of 4.6%, 7.4% and 5.8% respectively during the same period last fiscal year. The deposit mobilization of development banks and finance companies has improved during the review period as interest rate offered by commercial banks on deposits continued to be on the downward spiral.

Similarly, during the review period, the banking credit grew only by 7.3%—NPR 83.66 billion (USD 838.10 million)—as compared to a growth of 11.2%—NPR 108.17 billion (USD 1.08billion)—during the same period

in the previous fiscal year. Amongst the BFIs, development banks saw the highest growth of credit mobilization by 12.1%, followed by 7% in commercial banks and 6.5% in finance companies.

To control money supply in the market, the central bank mopped up net liquidity equivalent to NPR 118.50 billion (USD 1.18 billion) via open market operations during the review period. The central bank purchased Indian Currency (IC) equivalent to NPR 143.06 billion by selling USD 1.44 billion in the Indian money market.

### KEY DEVELOPMENTS

#### Stress testing

In line with the provision in the current fiscal year's Monetary Policy, Nepal Rastra Bank (NRB) has made it mandatory for National level 'B' class development banks and 'C' class finance companies to conduct stress testing

on a quarterly basis from now on. 'A' class commercial banks have been conducting such tests for the past one year. Stress testing is an analysis tool which helps banks to determine whether a bank will be able to withstand the impact of adverse economic scenarios. Stress tests focus on three key risks: credit risk, market risk and liquidity risk. Stress tests help to detect weak spots in advance, so that preventive measures can be taken by both the banks and the regulator.

#### Acquisition by laws

Realizing the need for a separate guideline for acquisition to expedite and smoothen the current merger drive for the consolidation of the banking industry, NRB is planning to introduce acquisition policy within the current fiscal in the current year's monetary policy. Currently, merger bylaw introduced in 2011 is facilitating BFIs for merger. However, in the absence of acquisition policy, many BFIs, especially the commercial banks with high

net worth and assets size, are awaiting such policy as it will allow BFIs to buy up or acquire other BFIs instead of merging with other BFIs.

### BASEL III

NRB has carried out a study on 'Basel III and Nepalese Banking' which will act as a consultative document for Basel III implementation in Nepali banking industry in the future. The central bank plans to begin implementation of Basel III by 2015 in its five year strategic plan for the period 2012-2016. Basel III framework was introduced in 2010 by the Basel committee on banking supervision with an objective to improve the shock absorbing capacity of banks as the first order of defence.

Currently, only the commercial banks are reporting their capital adequacy requirement in accordance with the new capital adequacy framework under Basel II while the other BFIs such as 'B', 'C' and 'D' class institutions are reporting their capital adequacy under Basel I. Since the existing capital adequacy requirement for the commercial banks are already higher than the global standard for capital adequacy prescribed by Basel II, it will not be necessary for the majority of Nepali commercial banks to have any change in total capital requirements (tier I, i.e. 6% or under Basel III). However, it seems that improvements have to be made on credit

rating practices, corporate governance, countercyclical buffer and liquidity ratios for the implementation of Basel III in Nepal.

Nepalese banking system has not yet achieved the level of development and advancement of international standard. There are a number of shortcomings and limitations in the system, such as the absence of credit rating practices, absence of internal rating of credit by banks, weak corporate governance, absence of strong macro-prudential measures and regulatory compliance. There will be a need of increased level of capital and liquidity after implementation of the Basel III.

The conclusion of the study were as follows:

- Tier 1 capital ratio and total capital ratios of the Nepalese banks found to be higher than the minimum capital determined by the Basel III taking in to consideration the inherent risk in Nepalese banking sector
- The risk exposure of the Nepalese banks is likely to be affected very insignificantly by the measures prescribed by the Basel III. Nepalese banks are not yet exposed to complex financial instruments like derivatives and securitized assets. However, as the market gains maturity, these measures would be more relevant.

- The leverage position of our commercial banks complied on the basis of offsite data is higher than the minimum prescribed limit (i.e. 3%).

- There will be need of additional capital for buffers like capital conservation buffer (2.5%) and countercyclical buffer. There is a transition arrangement for the implementation. Data shows that the banks are in buffer since we already have higher level of capital requirements.

- Implementation of liquidity monitoring framework is necessary for the development and implementation of the liquidity requirements under Basel III.

The study has concluded that implementing new capital and liquidity requirements as prescribed under Basel III will not be a very complex issue in the context of Nepal. Moreover, sufficient period of transition arrangement has been given. But there is a need of a timely development and issuance of regulation for the effective implementation of Basel III capital regulations in Nepal.

### Call account period extended

The central bank has extended the call account period till the end of current fiscal year to allow development banks and finance companies to maintain interest bearing

call accounts at commercial banks or with other development banks or finance companies.

### Spread rate

Nepal Bankers Association (NBA) has urged the central bank to revise its provision to bring the average spread rate between credit and deposit of BFIs to 5%. As per the existing provision, BFIs with spread rate above 5% will have to bring its spread rate below the stipulated requirement by the end of current FY 2013-14. Spread rate is the difference between average interest rate of deposit and credit.

The new provision for spread rate is expected to affect profitability of BFIs who are less efficient. Moreover, such a provision can be expected to slash both deposit and lending rates in the near future. Further, the provision aims to protect both depositors and borrowers. Meanwhile, 'B' class development banks and 'C' class financial institutions have urged the central bank to widen the spread rate for them due to their limitations in conducting business as compared to the 'A' class commercial banks.

### Financial consumer protection and financial literacy

In a bid to make banking services more friendly and increase the banking services to wider population, the central bank has prepared a draft guideline regarding 'consumer protection and financial literacy' to provide operational clarity to BFIs and provide further protection to depositors and borrowers. The guideline is expected to materialize soon after incorporating feedback from the stakeholders.

Some of the key highlights of the proposed guideline are as follows:

- BFIs need to be transparent regarding the clauses of the services offered to the customers.
- BFIs will also have to inform customers in writing regarding the details of different types of accounts and its features, fees or charges, process of banking and account closure, method of interest rate calculation, advance repayment charges for loans, actions to be taken against borrowers who fail to repay loans in time, late fee, fines and penalties, policies regarding electronic cards usage, and laws and penalties regarding any banking offence.
- Usage of simple and clear language to correspond with clients in Nepali language has been prescribed.
- BFIs will not be able to charge any additional fee from depositors while opening or closing a bank account or to maintain the account. Similarly, BFIs have to provide services such as Any Branch Banking Services (ABBS), certification of bank statement, issuance of bank statement and activating an inactive account free of cost.
- BFIs can impose renewal charges on the cards provided to customers only when the validity of the card expires and a new card has to be issued. However, for any liable additional charge, the BFIs have to inform the customer in advance.
- The average difference on interest rate offered in various savings accounts should not be more than 2%.

- Borrowers can make advance repayment on loan without any advance payment fee; moreover, BFIs need to make a clear policy regarding the matter.
- BFIs will not be able to charge borrowers more than the actual expenses for services sought with third entities such as Credit Information Bureau, valuers and insurance companies.
- BFIs should ensure confidentiality and protection of customer's information. However, it can share the information to concerned authorized institutions if required.

### Commercial Bank Performance Analysis

As per the published unaudited data for the second quarter of the current fiscal year, of the 31 commercial banks, 25 banks saw their net profit increase while 8 banks saw their operating profit decrease as compared to the same quarter in the previous fiscal year. During the period, the operating profit margin of commercial banks grew by 17.1 %, whereas the net profit margin grew by 19.9%. These banks have been able to increase operating profit primarily due to a decrease in the overall cost of fund. At the end of the second quarter, the average cost of fund of banks stood at 5.61%, which was at 6% during the same period last fiscal year. However, the average Non Performing Loans (NPL) of commercial banks increased during the quarter to 2.96% which was at 2.61% during the same period of the previous FY. Likewise, the average base rate of commercial banks stood at 8.74%, the highest being 10.61% of Civil Bank and the lowest being 6.28% of Rastriya Banjiya Bank.

## “ OUTLOOK

The banking system continues to witness acute liquidity aided by increasing deposit growth and lower demand for credit. The yield on short term rates have fallen to an all time low; the weighted average Treasury bill (T-bill) rate for 28 days has fallen to 0.0879% while 364 days T-bill rate stands at 1.004%. Meanwhile, the inflation rate has surged to 9.7% indicating higher inflationary pressure due to higher money supply. Likewise, the weighted average interbank rate has fallen to 0.2250%. As the liquidity ratio of BFIs is broadening, BFIs have been slashing interest rate offered to its deposit accounts. The average cost of funds of commercial banks at the end of second quarter of current fiscal year has dropped to 5.61% from 6% at the end of first quarter of the current fiscal year. To cope with excessive money supply in the banking system, the central bank has been continuously using various instruments. The central bank recently offered reverse repo (maturity - 7 days) worth NPR 19.5 billion (USD 195.35 million) which was oversubscribed by 2.21 times indicating the level of liquidity in the banking channel; the weighted average interest on such instrument, which was based on bidding, was 0.3541%. The central bank has so far issued reverse repo worth NPR 177 billion (USD 1.77 billion).

The BFIs were optimistic about the growth of credit post Constituent Assembly (CA) election. However, the demand for credit has not been encouraging or as expected. Likewise, the government's expenditure has been disappointing. At the end of second quarter of current fiscal year, the government had NPR 77.84 billion (USD 779.80 million) deposit with the central bank. The finance minister has blamed ministries responsible for development work for low capital spending despite timely budget. At the end of second quarter, only 13%—i.e. NPR 11.47 billion (USD 114.90 million)—of the total capital budget allocated has been spent.

Positive indicators such as; higher investors' confidence in the capital market, increasing trend in land registration, establishment of a new government, government's improved optimism towards expending capital expenditure in the second half of the fiscal year, and improving investors' confidence towards the economy can increase the demand for credit during the coming quarters of the current fiscal year, thereby providing the much needed spark for achieving the desired economic growth for the fiscal year.

**TABLE 5: SECOND QUARTER RESULTS OF COMMERCIAL BANKS-UNAUDITED FY 2013-14 (FIGURES IN NPR IN TEN MILLION)**

Bank	Paid-up Capital	Reserve & Surplus	DEPOSIT			LOANS AND ADVANCES			OPERATING PROFIT			NET PROFIT			NPL (%)			COST OF FUND (LCY)			BASE RATE %	
			FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change		
			2 QTR	2 QTR		2 QTR	2 QTR		2 QTR	2 QTR		2 QTR	2 QTR		2 QTR	2 QTR		2 QTR	2 QTR			
Nabil Bank	304.7	469.8	5,899.6	6,909.7	17.1	4,545.5	5,139.7	13.1	144.9	139.3	-3.9	111.2	105.5	-5.1	2.68	3.05	4.79	3.61	4.79	3.61	-1.18	6.07
Nepal Investment	414.4	381.5	5,513.7	7,199.6	30.6	4,644.9	5,225.1	12.5	117.6	126.2	7.4	89.1	93.9	5.3	3.17	1.76	4.84	4.41	4.84	4.41	-0.43	7.07
Standard Chartered	204.2	321.2	3,705.0	4,002.6	8.0	1,982.4	2,511.6	26.7	83.9	94.4	12.6	55.9	63.3	13.3	0.75	0.63	2.14	1.73	2.14	1.73	-0.41	5.15
Himalayan Bank	276.0	332.1	4,753.7	5,976.7	25.7	3,896.3	4,395.7	12.8	77.9	85.4	9.6	50.0	54.4	8.8	3.20	3.46	4.87	4.67	4.87	4.67	-0.20	7.87
Nepal SBI Bank	265.0	160.8	5,410.0	5,644.6	4.3	2,809.6	3,232.6	15.1	56.8	65.2	14.8	38.2	45.9	20.2	0.43	0.32	4.60	4.25	4.60	4.25	-0.35	8.31
Nepal Bangladesh	221.0	163.4	2,370.0	1,510.5	-36.3	1,239.4	1,598.2	29.0	8.2	28.3	245.4	17.2	27.1	57.9	3.57	1.50	5.34	5.81	5.34	5.81	0.47	8.22
Everest Bank	192.1	358.6	4,922.3	5,992.2	21.7	4,219.3	4,796.5	13.7	100.7	106.3	5.6	64.2	67.9	5.7	0.70	0.60	4.33	3.89	4.33	3.89	-0.44	6.77
Bank of Kathmandu	192.0	163.5	2,397.4	2,931.8	22.3	2,116.0	2,483.4	17.4	44.0	36.1	-17.9	30.3	25.0	-17.3	2.02	1.33	5.04	5.27	5.04	5.27	0.23	8.25
NCC Bank	147.0	97.2	1,858.6	2,201.7	18.5	1,562.2	1,760.8	12.7	15.5	20.9	34.6	15.6	16.0	2.8	2.98	2.46	6.48	6.60	6.48	6.60	0.12	9.96
MIC Asia Bank	231.2	328.1	2,213.8	3,844.1	73.6	1,784.1	3,183.9	78.5	36.7	52.3	42.7	23.3	38.5	65.1	1.20	2.96	6.89	6.40	6.89	6.40	-0.49	8.69
Lumbini Bank	173.0	51.5	920.1	1,254.3	36.3	836.9	1,104.5	32.0	8.2	8.9	8.3	6.3	6.9	9.1	1.52	2.18	6.72	6.59	6.72	6.59	-0.13	9.42
Machhapuchhre	247.9	63.8	2,255.2	3,111.4	38.0	1,816.1	2,527.0	39.1	3.77	25.3	-571.1	3.3	20.4	520.1	3.07	2.67	6.96	6.28	6.96	6.28	-0.68	8.84
Kumari Bank	160.4	112.8	2,342.3	2,740.2	17.0	1,917.5	2,151.1	12.2	11.1	8.7	-21.9	9.7	6.2	-36.5	4.38	4.26	6.76	6.33	6.76	6.33	-0.43	9.01
Laxmi Bank	169.4	116.4	2,371.7	2,819.0	18.9	1,822.2	2,190.7	20.2	23.6	20.6	-12.7	16.2	14.6	-10.1	1.30	2.14	5.85	6.25	5.85	6.25	0.40	9.32
Siddhartha Bank	181.4	93.1	2,671.4	3,142.0	17.6	2,157.2	2,472.0	14.6	19.5	37.2	90.5	11.6	24.3	108.9	3.10	3.52	6.57	5.74	6.57	5.74	-0.83	9.14
Global IME Bank	278.1	98.3	2,936.6	3,697.6	25.9	2,391.7	3,011.6	25.9	33.6	43.9	30.5	24.5	53.3	117.6	2.10	3.22	6.41	5.05	6.41	5.05	-1.36	8.46
Citizens Bank	210.2	51.4	1,922.7	2,359.1	22.7	1,689.5	2,041.7	20.8	11.9	30.9	160.6	10.1	23.6	134.3	3.60	2.46	6.21	5.64	6.21	5.64	-0.57	7.88
Prime Commercial	257.4	68.7	2,439.6	2,694.7	10.5	2,039.3	2,332.4	14.4	16.7	36.4	117.9	16.2	31.0	91.7	3.51	2.21	7.08	6.31	7.08	6.31	-0.77	9.26
Sunrise Bank	201.5	66.1	2,215.8	2,533.0	14.3	1,725.7	2,013.0	16.6	10.2	18.8	84.3	12.6	20.6	63.1	2.94	2.91	6.68	6.03	6.68	6.03	-0.65	8.98
Grand Bank	200.0	36.9	1,630.0	1,993.9	22.3	1,367.4	1,539.0	12.5	10.1	9.9	-2.7	8.8	9.4	7.4	1.70	4.29	7.96	7.24	7.96	7.24	-0.72	9.92
MMB Bank	200.0	62.2	1,705.2	2,319.2	36.0	1,477.1	1,741.3	17.9	23.4	24.5	4.5	16.6	19.8	19.5	1.82	1.58	6.44	6.00	6.44	6.00	-0.44	9.11
KIST Bank	200.0	-32.7	2,098.4	1,940.4	-7.5	1,758.7	1,587.5	-9.7	-8.2	-40.0	-388.4	-7.0	-19.9	-186.0	7.15	17.54	6.44	6.38	6.44	6.38	-0.06	10.56
Janata Bank	206.0	7.5	1,042.5	1,490.2	43.0	1,000.4	1,295.0	29.4	11.1	1.9	-82.8	7.1	1.3	-82.2	1.22	1.10	7.35	6.76	7.35	6.76	-0.59	9.63
Mega Bank	233.0	28.8	1,182.7	1,509.2	27.6	1,089.0	1,372.3	26.0	13.2	25.6	94.6	8.4	16.6	98.4	1.83	1.93	5.16	5.24	5.16	5.24	0.08	8.98
Commerz & Trust	200.0	10.9	839.7	1,068.5	27.2	786.0	1,024.8	30.4	6.5	2.3	-64.9	4.1	1.5	-64.9	0.32	2.41	6.77	7.57	6.77	7.57	0.80	10.51
Civil Bank	200.0	7.2	1,100.2	1,848.6	68.0	978.2	1,529.3	56.3	5.3	5.3	1.3	3.4	3.4	1.2	1.48	1.45	7.98	7.98	7.98	7.98	0.00	10.61
Century Bank	112.6	17.8	816.1	1,428.6	75.0	720.9	1,233.7	71.1	3.9	5.9	51.2	2.5	4.0	57.4	0.45	0.91	7.39	6.44	7.39	6.44	-0.95	10.20
Sanima Bank	221.8	40.1	1,447.1	1,989.0	37.4	1,299.3	1,717.1	32.1	18.4	29.9	62.3	13.1	19.4	48.9	0.19	0.10	7.67	6.91	7.67	6.91	-0.76	9.54
Public Sector Banks																						
Nepal Bank	396.5	-357.3	5,701.4	6,432.6	12.8	3,241.7	3,890.3	20.0	-8.7	10.7	223.4	3.9	26.2	572.3	5.40	5.83	4.80	4.23	4.80	4.23	-0.57	8.55
Rastriya Banijya Bank	858.9	-659.8	8,616.7	9,700.7	12.6	4,320.5	5,217.8	20.8	41.0	44.5	8.5	61.0	71.8	17.7	6.53	4.92	3.84	3.08	3.84	3.08	-0.76	6.28
Agriculture Dev. Bank	963.7	627.2	4,497.2	6,496.6	44.5	4,317.2	5,269.9	22.1	29.9	31.1	85.7	54.6	46.0	-15.8	6.64	6.05	5.57	5.30	5.57	5.30	-0.27	10.52
Total	8,319.2	3,287.0	89,796.5	108,781.9	21.1	67,552.0	81,589.4	20.8	970.7	1,136.7	17.1	781.9	937.9	19.9	2.61	2.96	6.00	5.61	6.00	5.61	-0.39	8.74



## REVIEW

# Capital Markets

## SECONDARY MARKET PERFORMANCE

The first seven months of the current fiscal year has been rewarding to the secondary market as investors' confidence continues to grow stronger. The sole secondary market, Nepal Stock Exchange (NEPSE) index (54.96), went up by 284.83 points during the review period to close at 803.1 points. The market has already gained 202.68 points post the Constituent Assembly (CA) election held on November 19 and has also seen a whopping rise on daily market turnover. Post-election the market has already witness transactions worth NPR 20.55 billion (USD 205.87 million) averaging NPR 373.65 million (USD 3.74 million) of daily transaction.

As shown in *Table 6*, during the review period, all the sub-indices has ended in the green zone. The Insurance sub-index (+165.58%) saw the biggest gain amongst the sub-indices, as it gained a whopping

1551.06 points. Similarly, the hotels sub-index (+117.18%) continued to impress investors as it gained valuable 772.42 points. Likewise, amongst the BFIs, the Development banking sub-index demonstrated encouraging growth (+97.03%) while the Commercial banking sub-index (+51.01%) and Finance sub-index (+47.32%) also posted healthy growth.

The Hydropower sub-index (+87.27%) continued to impress investors as hydropower scrip's continued to provide attractive returns to investors. Also, the 'Others' sub-index (+13.25%) posted a marginal growth as the share price of Nepal Telecom failed to achieve desired momentum.

## KEY DEVELOPMENTS

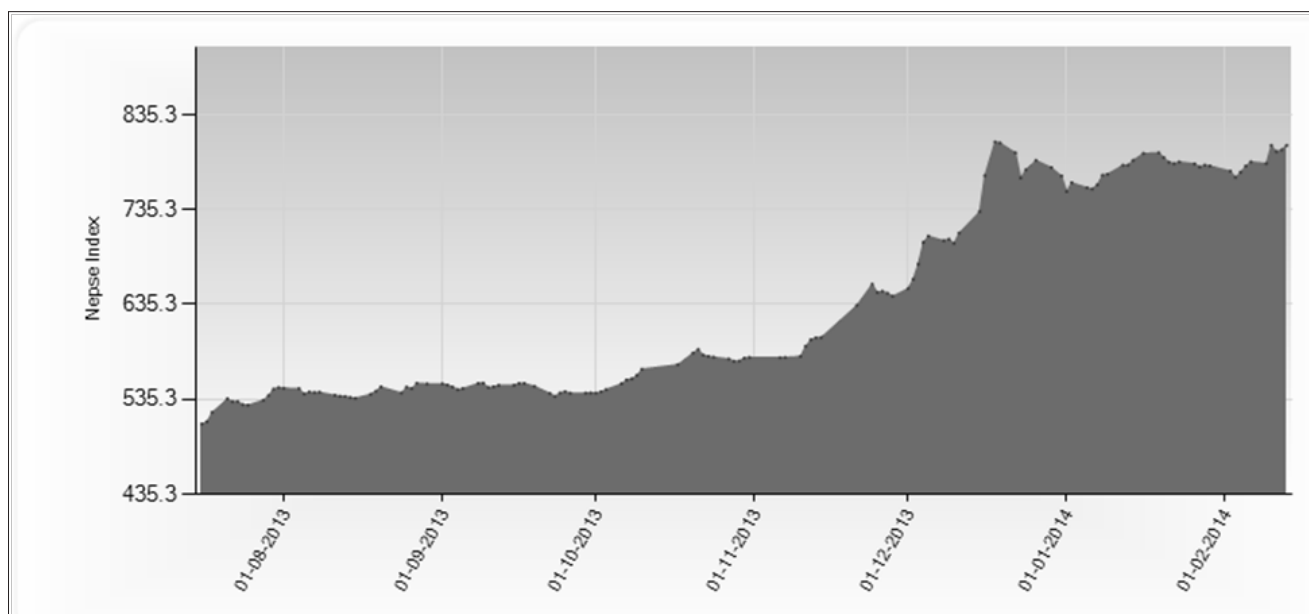
Some of the key developments in the capital market during the review period are as follows:

**Table 6:** Sector wise Performance of the sub-indices

Indicators	15-Jul-13	15-Feb-14	% Change
NEPSE Index	518.27	803.1	54.96%
Commercial Bank Index	505.48	763.35	51.01%
Development Bank Index	257.85	508.04	97.03%
Hydropower Index	1080.92	2024.23	87.27%
Finance Index	253.67	373.7	47.32%
Insurance Index	936.75	2487.81	165.58%
Others Index	700.22	793.02	13.25%
Hotels Index	657.49	1427.91	117.18%
Manufacturing & Processing	868.72	931.27	7.20%

Source: NEPSE

**Share offering on premium:** In a bid to attract real sector companies into the capital market, the Securities

**Figure 9: NEPSE Index performance**


Board of Nepal (SEBON) is currently conducting an internal homework to remove the existing provision which cap the price of premium shares while offering shares in the primary market. As per the existing provision, the companies can only issue shares in premium on par with its net worth. SEBON has kept the draft Securities Registration and Issue Regulation 2008 with amendments in its website to gather feedback from potential stakeholders on the matter. As per the proposed amendment, companies will be allowed to issue shares at a premium rate up to two and half times the company's net worth. The proposed amendment is expected to motivate companies to collect equity funds from the local market and will also help Nepali capital market to mature further.

**List of Group "A" companies published:** Out of 230 companies listed at NEPSE, 130 companies have managed to end up in the list of group 'A' companies published by

NEPSE for the current FY 2013-14. Last FY, 120 companies were listed in this group. This year, 25 commercial banks, 1 manufacturing, 1 telecom, 3 hydropower, 1 hotel, 14 insurance companies, 27 finance companies, and 58 development banks made up the category of group 'A' companies.

NEPSE enrolls companies in this category if the companies are able to meet established standards, such as having paid-up capital of at least NPR 20 million (USD 200.36 thousand), possess at least 1,000 general shareholders, generate profits for three consecutive years, maintain book value of shares at higher level than paid-up value, and submit financial reports within six months of conclusion of every financial year. In the absence of lack of adequate information and ratings of listed companies at the NEPSE, this list is expected to help investors as a tool to make wise investment decisions. However, the criteria for selecting companies need to be revised and made more scientific.

**Local Currency Bonds:** The Nepali capital market may witness the issuance of local currency bonds in near future as the Ministry of Finance has given a green signal to issue such bonds in the local market by introducing guidelines in October 2013 for such issue. Local currency bonds are long term debt instruments denominated in local currency and issued by international financial institutions to raise funds locally to finance various long term development projects within the country.

The International Finance Corporation has already applied to Ministry of Finance and has proposed to issue local currency bonds worth USD 500 million, i.e. approx. NPR 50 billion, in the country. Meanwhile, the government has asked for further information on various modalities of the funds, such as interest rate to be offered to bond subscribers, lending rate, spread rate and the projects in which the funds would be invested.<sup>95</sup>

## “ OUTLOOK

The bullish trend in the secondary market signals improved investors' confidence especially after the Constituent Assembly (CA) election held on November 19, 2014. Besides positive political development, easy access to credit and lower borrowing rates has been one of the primary factor behind the current surge. On one hand, Banks and Financial Institutions (BFIs) have been expediting its lending via margin lending or loans against shares as the overall demand for credit has not been encouraging and there's excess liquidity in the banking system. On the other hand, due to lower returns in bank deposits, investors are diversifying their investments into the capital markets as the return from capital markets is significantly higher than returns in the bank deposits, which easily beats the current inflation rates that is close to 10%. Understanding the complexity of the situation, the central bank has requested to provide latest status on margin lending with BFIs. However, it is less likely that the central bank would be able to enforce any limits on such lending as BFIs seems to have extended credit within the prescribed limits.

Up to some extent, better than expected benefit announcements made by the key listed companies, largely the financial institutions, from their earnings from the FY 2012-13 and impressive second quarter earnings reports of these listed companies have also pushed the market upwards. However, fundamental analysis cannot rationalize the current uptrend, except for few scrips, the share prices of most of the key listed companies can be deemed overpriced. Meanwhile, the key ingredient for the current surge has been the volume of transactions at the market. Looking at the level of volume at the market along with improved earnings reports of listed companies, positive political development, improving investors' confidence, and easy access to margin lending, the market is likely to remain bullish in the coming days. Yet, at the same time, the investors need to be cautious while making investment decisions as manipulation of shares prices is a common phenomena in Nepali capital markets.

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## NEPAL ECONOMIC FORUM

**Nepal Economic Forum (NEF)** strives to be the premier private-sector led economic policy and research organization by redefining the economic development discourse in Nepal.

Established as a not-for-profit organization under the beed ([www.beed.com.np](http://www.beed.com.np)) eco-system, NEF has benefited from extensive exposure, experience and network of beeds who contribute in the research and dialogue process. With Sujeev Shakya as Chair, NEF benefits from the leadership of one of the most respected economic analysts in Nepal, known for his bestseller *Unleashing Nepal - Past, Present and Future of the Economy* (Penguin 2009). NEF has worked in partnership with many Nepali and International institutions in its quest to mainstream the discourse on the Nepali economy, which has not received the necessary space it deserves.

*NEF broadly works under three areas:*

First, the **Business Policy Research Center (BPRC)**, which engages in research, dialogue and dissemination relating to pertinent economic policy issues. Through BPRC, NEF has been producing *nefport*, a quarterly economic publication docking economic analysis and research, **nefsearch**, a periodic research publication, conducting **neftalk**, a platform for policy discourse, and *nefcast*, an online dissemination platform. BPRC is in the process of starting **nefsource** a resource center, and holding a *nefclave*, a platform for discourse on economy and beyond, which is scheduled for September 2013.

Second, through the **Center for Public, Private and Community Partnerships (PPCP)**, the partnerships discourse is further elaborated through addition of the community dimension to the existing models of public private partnerships. The concept stems from the need to integrate the community dimension to economic development strategies especially as Nepal moves towards a federated structure. Apart from standalone interventions, the PPCP perspective is integrated in many of the work that NEF and beed initiate.

Thirdly, through **Development Consulting**, NEF engages with a plethora of multilateral, bilateral and International Non-Governmental Organizations in areas where a fresh pair of lenses are required to view the formulation and implementation of strategies. Hands on experience along with a wide 'cultural bandwidth' put NEF in a unique position to deliver Glocal solutions. With an international network and extensive Nepal experience, NEF uses solution-oriented approach to assignments.

Currently, NEF is helping to incubate the US based Accountability Lab's Nepal operations. With transparent financial systems, high standards of conflict of interest disclosures, strong support of beed back-end infrastructure, access to high quality global and local human resources and firms, NEF is poised to set high delivery and ethical standards for firms operating in Nepal.



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