

NEPAL
ECONOMIC
FORUM

nefport

Docking Nepal's Economic Analysis

JANUARY 2015 | ISSUE 19

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Issue 19 | January 2015

Publisher: Nepal Economic Forum
Website: www.nepaleconomicforum.org

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EDITORIAL

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

Since the Indian Prime Minister Narendra Modi's visit in August 2014, various reform agendas have been taken up by the Nepali government. Although reforms such as the signing of the Power Trade Agreement between Nepal and India and the Power Development Agreement for Upper Karnali Hydropower Project gives hope for Nepal's economic development, the major question is on the implementation of these reforms. With successful implementation of reforms, we can hope to see improvement of economic activity in Nepal in 2015.

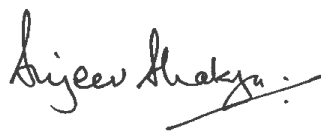
We have used USD conversation rate of NPR 98.14 to a dollar, the three month average, for this issue.

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



Sujeev Shakya
Chair
Nepal Economic Forum

POLITICAL OVERVIEW

“The Constituent Assembly has hit road blocks in forging consensus on certain key issues of the Constitution. On the other hand, cooperation between SAARC member nations is gaining momentum.

SAARC Summit concluded: A 36 point Kathmandu Declaration, focused on enhancing connectivity and combating terrorism in the region, was adopted during the 18th South Asian Association for Regional Cooperation (SAARC) Summit held in Kathmandu on November 26-27, 2014. The regional event was attended by the heads of state from seven SAARC member states including India, Pakistan, Afghanistan, Bhutan, Bangladesh, Maldives and Sri Lanka and their respective country delegations.¹

The SAARC Summit facilitated connectivity by supporting regional tourism and cooperation in the generation of electricity. One of the decisions taken was to make the South Asia region an attractive common tourism destination by ensuring that the fees to archaeological and heritage sites for tourists from SAARC countries are the same as that of national visitors. Similarly, in order to facilitate energy cooperation, the Framework Agreement for Energy Cooperation was ratified by ministers of the member nations. The members agreed to develop transmission inter-connectivity within the region and facilitate power supply from surplus countries to deficit countries in the

region. The Summit also declared 2016 as the SAARC year of cultural heritage.

Constituent Assembly unable to forge consensus: One year after the election of the second Constituent Assembly (CA), the CA is still unable to agree on issues of federalism. As a result, the CA is unlikely to meet the earlier announced deadline of drafting the Constitution by January 22, 2015.

The CA definitely has accomplished some significant tasks: owning the work done by the previous CA, formulating and endorsing its regulations and forming the thematic and procedural committees. However, it still needs to settle the key disputed issues of federalism (name and number of federal states), system of governance, electoral model and judiciary. Further, the CA also needs to prepare a draft constitution; seek public feedback; and endorse the draft statute.² The likelihoods of accomplishing these tasks are slim, given the serious disputes between the major parties.

Concerns over CIAA's jurisdiction: The Commission for the Investigation of Abuse of Authority (CIAA) has been criticized for overstepping

its jurisdiction and discouraging foreign investment after it directed the Ministry of Energy to cancel the license of 11 hydropower projects.³ The Finance Committee of the legislature-parliament has termed the CIAA's move as questionable. The CIAA defended its decision by stating that the project developers had failed to prepare detailed survey reports of projects, conclude power purchase agreements or reach financial closure within the deadline.⁴ The Finance Committee questioned the validity of the CIAA's directive given that the financial closure is subject to signing of Power Purchase Agreements and building of transmission lines, both beyond the control of the hydropower projects.

“ OUTLOOK

Post Indian Prime Minister Modi's visit and cooperation on hydropower, Nepal-India relations has undergone positive transformation, from one of mistrust to one of cooperation. Nepal's initiative in this regard has been a welcome change and if it remains consistent, it will support in the economic development of both nations.

INTERNATIONAL ECONOMY

In the last few months, crude oil price has decreased substantially. Generally, the impact of the decrease in oil prices can have a severe negative impact on certain countries that rely heavily on export of petroleum products and a moderate impact on countries that have a reserve or additional source of income. Its impact on global growth is negligible, effecting merely the redistribution of global wealth.

Oil price dropping down: Global oil prices continued to plummet and touched USD 94 (NPR 9225) a barrel on September 30, 2014. The price of Brent crude oil went further down by an additional USD 4 (NPR393) to a four-year low of about USD 73 (NPR 7164) whereas the American crude dropped below USD 70 (NPR6870).⁵ The lethargic economic growth in the economic giant China, together with the recent surge in oil production by non OPEC countries, especially China and USA, has further helped in this price drop. The oil cartel, Organization of the Petroleum Exporting Countries (OPEC), has decided not to cut petroleum production, despite the plunge in prices in recent times. This move of OPEC indicates its diminishing influence.

Five big banks fined: Global regulators announced NPR 314.048 billion (USD 3.2 billion) in fines against five major US and European banks for attempting to

manipulate foreign exchange markets. The banks penalized are Citigroup C, which was fined a total of NPR 65.56 billion (USD 668 million), JP Morgan Chase Inc. was fined NPR 64.97 billion (USD 662 million), Switzerland's UBS AG was fined NPR 78.51 billion (USD 800 million), Royal Bank of Scotland was fined NPR 62.22 billion (USD 634 million) and HSBC Holdings was fined NPR 60.65 billion (USD 618 million). The UK's Financial Conduct Authority and the Commodities and Futures Trading Commission disclosed that some of the banks had continued to manipulate the forex market even while they were under investigation for rigging Libor.⁶

Sluggish economic growth in China: The recent analysis of the third quarter of China's economy has revealed that it grew at its slowest pace in more than four years. The result disclosed by the National Bureau of Statistics of China showed a growth of 7.3% in the

third-quarter.⁷ Various reasons like the sluggish demand conditions, higher farm yields, along with the globally declining oil price can be attributed to the current sluggish growth in China. In addition to these issues, China seems to be combating its collapsing real-estate market and industrial production all of which have contributed to the slowing down of the Chinese economy, which may fall short of the government's target of 7.5%.

Alibaba becomes world's largest IPO: Alibaba Group Holding Ltd, a Chinese e-commerce company, became the world's largest e-commerce company after it raised an astounding sum of NPR 2.14 trillion (USD 21.8 billion) in an initial public offering in its US trading debut. The company's share increased by 38% to NPR 9214.36 (USD 93.89) in the New York Stock Exchange after the IPO was priced at NPR 6673.52 (USD 68). Jack Ma founded Alibaba in 1999 with an investment of NPR

5.88 million (USD 60,000) which is now valued at NPR 22.71 trillion (USD 231.4 billion). Alibaba has been dominating the e-commerce industry in China and profiting from its rapidly growing consumers. Alibaba is now larger than Amazon.com Inc. and EBay Inc. combined and also more valuable than ten companies in the Standard & Poor's 500 Index.⁸

G20 leaders target trillions in economic growth: In the G20 summit held on November 15–16, 2014, in Brisbane, Australia, the G20 leaders—who represent a substantial portion of the world's economy—committed to reform measures to boost their col-

lective economic growth by additional 2.1% by the year 2018. They also agreed to a global initiative to help address the gap of NPR 6869.8 trillion (USD 70 trillion) in infrastructure needed by the year 2030. Even with the evidence of an economic slowdown in some nations, their strategy in achieving the target is to improve productivity by matching private investment with capital projects.⁹ The summit concluded with the release of the final communiqué known as the “Brisbane Action Plan” that contains more than 800 reforms to generate jobs, to reinforce financial institutions and to stimulate the sluggish global economic growth.

“ OUTLOOK

As an oil importing country whose major import, by far, are petroleum products, Nepal stands to gain from the current decrease in oil prices. Also, since Nepal has adopted the auto fuel pricing mechanism, end consumers will also see a good drop in transportation cost. Moreover, the change in prices can have a downward impact on Nepal's inflation rate.

macroECONOMIC

OVERVIEW

The overall macroeconomic situation of Nepal in the current review period looks bleaker than before. High Inflation, inability to carry out budgeted expenditure as planned, and trade deficit have shown no signs of improvement in the current review period. The consumer price index and wholesale price index increased by 7.5% and 7.2% respectively in the review period. Government budget showed a surplus of NPR 37.44 billion (USD 381.49 million) compared to NPR 32.62 billion (USD 332.38 million) last year. Growth rate of exports has decreased while that of imports has increased leading to a higher export import ratio compared to the same period last year. Poor performance of foreign trade sector, accompanied by decline in remittance has resulted in a current account deficit of NPR 37.49 billion (USD 382 million). The growth rate of foreign exchange reserves has declined to a mere 2.1% compared to 13.8% last year.

AGRICULTURE

The agriculture sector has always been at the mercy of factors that are beyond its control, whether it is the impact of natural disasters, or its dependence on timely and sufficient rainfall. The bottom line is, the sector's productivity—which is directly linked to the country's economic growth—will continue to remain unstable unless major changes are made to the existing farming method.

Natural disaster hits paddy production: Following landslides and floods in different parts of the country, the Ministry of Agriculture Development has predicted a drop in agriculture output this year. As a result, the targeted economic growth of 6% might not be likely this FY 2014-15.

Paddy output is expected to drop at least 18% as a result of 35,040 hectares of paddy field being destroyed in 17 paddy production districts. Sindupalchowk, Rautahat, Sarlahi, and Ramechhap in the Mid-Western Region have been the worst hit with almost 17,365 hectares of cultivated land being destroyed. Similarly, 16,032 hectares have been damaged in Banke, Bardia, and Surkhet in Mid-Western Region. The total loss is estimated to be approximately NPR 1.91 billion (USD 19.4 million).¹⁰

Statistics from the Ministry of Agricultural Development indicate that paddy transplantation has been completed on less than 90% of the 1.52

million hectares of land available for paddy production; transplantation was completed on 98% of the paddy field in the same period last year.

Ministry contemplating on extending agro loan: In an attempt to increase the involvement of youth in agriculture sector to help the country become self-sustaining in production of agro products, and to discourage youth seeking employment opportunities overseas, the government is mulling over extending loans up to NPR 10 million (USD 0.1 million) to farmers at a subsidized interest rate. Ministry of Agricultural Development has prepared a guideline which, if approved, will make the loan available to farmers at a sub-

sized interest rate lower than 6% with a loan period of 5 years.¹¹

According to the guideline, people aged 21 - 45 that are interested in commercial farming in areas beyond metropolitan and sub-metropolitan cities would be eligible for the interest subsidy loan. Farmers involved in vegetable, fruit, medicinal herbs, sugarcane, dairy, mushroom, black cardamom, ginger, floriculture, livestock, and slaughterhouse operation will be eligible for the interest subsidy. The guideline has been prepared in line with the announcement made through the budget speech earlier this FY 2014-15 and has been forwarded to the cabinet for approval.

Vegetable pesticide usage down: Triggered by public concern over the high rate of pesticide usage in vegetables sold at Kalimati Fruits and Vegetable Market, the Plant Protection Department (PPD) initiated a campaign to build a testing lab to test the level of chemicals and monitor its use in vegetables earlier this year. Nearly 14% of the vegetables supplied to the market contained high level of pesticide residue back in June/July. However, after 4-5 months of monitoring, pesticide residue in vegetable has seen a significant decrease of approximately 95%. According to PPD, out of 187 samples tested, 26 were found contaminated with harmful chemicals in June/July. The test done in October/November revealed that none of the 109 samples of farm produce tested positive for containing harmful pesticides.¹²

One-door policy for foreign investment in agriculture: The Ministry of Agriculture Development is preparing a

draft of agriculture strategy that incorporates one-door policy for inviting and managing foreign investment in agriculture sector. Members of Agriculture and Water Resources Committee had urged the government to introduce a one-door policy in order to increase investment in the sector.¹³ The agriculture sector, despite being the highest contributor to the nation's economy, has poor growth rate due to low investment from the government and the private sector.

Agro insurance lacking awareness: There has been a slow growth in adopting crop and livestock insurance due to lack of awareness among farmers regarding the provisions for insuring crop and livestock through cooperatives. As a result, the Ministry of Agriculture Department has only spent NPR 60 million (USD 0.6 million) of the total NPR 120 million (USD 1.2 million) earmarked for insurance premium subsidy last FY 2013-14. As such, the government budget this FY 2014-15 has also reduced the subsidy amount by 50% compared to last fiscal.¹⁴

Under the scheme, the government bears 75% of the insurance premium amount and farmers are only liable for 25%. If farmers get insurance for crop and cattle through cooperatives, the liable percentage goes down to 10% because farmers will get an additional 15% discount on premium on top of the 75% subsidy.

EDUCATION

The education sector's performance in the past quarter has been dismal. The

less than expected outcome of the School Sector Reform Program, increase in the school dropout rate, and a very low pass percentage in the School Leaving Certificate examination raises questions on the effectiveness of the government's existing educational policies.

School sector reform program: The highly anticipated education reform program that was expected to overhaul the education system of Nepal and bring it in par with international education has failed miserably. The five-year, NPR 255 billion (USD 2.6 billion) School Sector Reform Program, which was to be implemented between 2009 and 2014, has not even taken its first step towards effective implementation. The project envisioned the implementation of a two-tier schooling system; primary schooling from grades 1-7 and secondary schooling from grades 8-12, and recruitment of new teachers as per the needs of the changed format of schooling.¹⁵

The government and donor agencies have agreed to extend the program's deadline by two years to 2017. Donors involved in the project are Asian Development Bank, European Union, World Bank, UNICEF, Norway, Australia, and Finland, along with the Government of Nepal.¹⁶

Free and compulsory education bill finalized: The Ministry of Education has finalized the Free and Compulsory Education Bill to achieve the government's goal of free basic education for all. The bill is in line with one of the components of the Millennium Development Goal that seeks to ensure free and compulsory education for students

enrolled from grade 1 to 8 by providing free stationary and admission.

The program has been implemented in 13 districts, viz. Saptari, Manang, Dolpa, Kapilvastu, Parsa, Dhankuta, Mustang, Bardia, Dadeldhura, Kanchanpur and Rupandehi by the Department of Education. The program is expected to cover the remaining districts next year.¹⁷ However, lack of legal provisions for its supervision has been hindering its effective implementation.

School dropout rate rise in far-west:

The number of higher secondary school dropouts in the far-western region of Nepal has been increasing in comparison to primary, lower, and secondary levels. One of the reasons behind the high rate of dropouts is the mid-season employment opportunities in India. Child marriage poses another barrier to the continuation of education.¹⁸

License revoking and merger of schools:

District Education Office (DEO) of Bhaktapur has revoked the license of private schools that have not been in operation for long after acquiring a license. Similarly, the DEO is in its final stage of merging more than two dozen public schools that lacked enrollment of new students in the last few years. The DEO has already selected the names of schools whose licenses will be revoked and those to be merged.¹⁹

Due to the popularity and quality of education that private schools offer in comparison to public schools, enrollment in public schools are declining every year. According to a report prepared by the Department of

Education, “7.44 million students were enrolled into the school system in 2011. This number declined by 166,202 to 7.27 million in the next academic session. During the last academic session, the number went further down by 150,882 to 7.12 million, while the number of schools and class promotion rate went up significantly”.²⁰

Education sector struggling to meet expectations:

According to the Education Minister Chitrlekha Yadav, the government has not been able to achieve the expected outcome in public school education. Despite a huge allocation of budget—NPR 86.03 billion (USD 876 million)—for the overall development of the education sector, better results were not produced. Only 28% of students passed the School Leaving Certificate (SLC) examination from public schools, in comparison to 93% of students from private schools. Private schools have been achieving greater academic success with little investments. Of the total students in Nepal, 22% of the students currently study in private schools while the remaining 78% study in public schools.²¹ As per the Ministry, one of the reasons for underperformance in the public education sector is political

pressure that bars education officers from effectively executing education laws, policies and directives.

ENERGY

The state owned entity Nepal Oil Corporation (NOC) swung back to profit during months of October and November after consecutive months of losses. The automatic pricing mechanism, which is expected to eliminate costly fuel subsidies, came into effect on September 30. NOC slashed NPR 1.44 on a liter of petrol and NPR 0.27 on a liter of diesel and kerosene.²² After the decrease in fuel prices, the NOC registered a loss of NPR 261.4 million (USD 2.66 million) during the beginning of October.²³ The profit earned was largely due to the fall in crude oil prices in the international market. NOC enjoyed profit on almost all the petroleum products with a decrease in Brent crude oil (USD 90 a barrel).²⁴

The petroleum prices will be reviewed every 15 days and prices will be adjusted accordingly. Prices of the petroleum products were revised after the Indian Oil Corporation forwarded the new rates to NOC. After the adjustments, petrol will cost NPR 128 per liter (USD 1.30) while

Table 1: Profit/Loss for Nepal Oil Corporation for the first quarter of FY 2014/15

Particulars	Profit/Loss as per Beginning of Month (NPR)	Profit/Loss as per Middle of Month (NPR)
September	-33.5 million	-2.8 million
October	261.4 million	217.9 million
November	171.5 million	183.7 million

Source: Nepal Oil Corporation

kerosene and diesels will cost NPR 101.5 (USD 1.03) per liter each.²⁵

Master plan for development of cross border agreed: Neighbors Nepal and India have agreed to prepare a master plan for the development of a cross-border transmission line until 2034, and an action plan until 2025 on power trade.²⁶ The meeting of Joint Steering Committee and Joint Working Group held in New Delhi formed a six-member Joint Technical Team, which includes three members each from both countries, to prepare the master plan. The two countries have also agreed to complete the Detailed Project Report of the Pancheswar Multipurpose Project, which has been in abeyance for the last two decades. The project situated on the bank of the Mahakali River is expected to generate 6,720MW electricity and will also irrigate 93,000 hectares of land in Nepal and 1.6 million hectares in India.

World Bank to invest USD 130m in solar plants: The World Bank is looking to finance the development of 25MW solar power plants in order to curb leakages faced by Nepal Electricity Authority. The World Bank will provide NPR 12.75 billion (USD130 million) in loans, while NPR785 million (USD8 million) will be financed domestically for the 'Grid Solar and Energy Efficiency Programme'. While NPR 5.3 billion (USD54 million) will be used in developing the solar plants, the rest will be used to reduce power leakage and transmission losses. The solar plants are expected to provide electricity at NPR 12 per unit. The project aims to reduce power leakages to 10% from the current 24.79% by 2020. The solar plants will

PDA OF ARUN III SIGNED

Investment Board Nepal (IBN) finalized the Project Development Agreement (PDA) negotiations with Satluj Jal Vidyut Nigam Limited, a power developer from India on the 900 MW Arun III Hydropower Project.³⁰ With the project cost estimated at NPR 104 billion (USD 1.05 billion), Arun III is an export oriented project with a 25 year build-own-operate-transfer model.³¹ According to IBN officials, Satluj has agreed to offer 6% shares to locals and provide 20 units of energy free for a month to households in the six Village Development Committees that will be affected by the project. Similarly, Nepal will receive 21.9% free energy, which is equivalent to 197 MW, from the project. Satluj will undertake a study on whether the project will affect any development projects upstream and downstream around the Arun III project site, within six months of the signing the PDA.

Following are the project highlights:

- Completion of the project and energy generation by 2020
- Nepal to receive NPR 348 billion (USD 3.55 billion) in 25 years
- Nepal to receive 21.9% energy free of cost
- SJVNL to enjoy income tax holiday for first 10 years of power generation and 50% tax waiver for another five years
- SJVNL to build 56 km transmission line free of cost to link power generated by the project to a substation of Nepal Electricity Authority (NEA)
- SJVNL to provide 30 units electricity free of cost to affected households
- Affected household will get opportunity to buy shares worth NPR 800 million (USD 8.15 million) at the rate of NPR 100 (USD 1) per unit

be installed in Pharping, Debighat, Trishuli and Kulekhani.²⁸

Upper Marsyangdi-II PDA soon: Investment Board Nepal is preparing to sign the Project Development Agreement (PDA) with India's GMR Energy Limited on the 600 MW Upper Marsyangdi-II Hydro Project, located along the Lamjung-Manang border, within three months.²⁹ PDA of Upper Marsyangdi-II and 650MW Tamakoshi-III are yet to be signed. According to a GMR survey, more than NPR100 billion (USD 1.02 billion) will be invested in the project

by GMR, International Finance Corporation (IFC) and Nepali agents. The estimated completion time for the project is approximately five years.

Ngadi hydro project ready for PPA: Nepal Electricity Authority (NEA) has initiated preparations to sign a Power Purchase Agreement (PPA) with the construction of 30MW Ngadi Hydro Power Project located at Bahundanda, Lamjung.³² The eco-friendly project, which is estimated to be completed in four years, was left unattended after authorities did not take initiative to sign the agreement. This project is

promoted by Lamjung Electricity Development Company, and Butwal Power Company (BPC). It is reported that BPC has spent NPR 250 million (USD 2.55 million) in constructing a Bailey bridge over the Marsyangdi River and is building an 8 km long road as part of infrastructure development. It has also constructed a motorable bridge, roadway and purchased land among others.

12 hydropower projects under construction: The Department of Electricity Development has announced that altogether 12 hydropower projects are under construction in the Trishuli river system.³³ Upon completion, these projects will generate a total of 1,500 MW, where projects on Trishuli River will generate 827 MW, while those on Bhotekoshi will produce 324 MW. Similarly, Nuwakot and Rasuwa districts are attracting huge investments in hydropower sector with a total of 55 hydropower projects that have acquired licenses in that area. Work on about a dozen projects are currently under construction while others are being constructed after acquiring a generation license.

FOREIGN AID

Nepal has one of the highest Foreign Aid to GDP ratios among South Asian nations. Though the country has been receiving foreign aid since the 1980s, little has been achieved relative to the total inflow. While there are many donor agencies working across a broad range of activities within the country, these agencies are often caught up in pursuing their own objectives due to which there is often limited impact.

Norway pledges grant for expansion of power sector: Norway has pledged a grant of NPR 5.9 billion (USD 55 million) to be spent under the Sub-Regional Economic Cooperation (SASEC) Power Expansion Project, and to be administered by the Asian Development Bank (ADB), the lead donor for the project. The project aims at increasing access to electricity, helping overcome power shortages in Nepal, and exporting surplus power to neighboring India by strengthening and increasing the power transmission capacity and network in the country. The project will leverage private sector investment and extend access to energy services in Nepal in line with the Norwegian development policy on energy.³⁵ The grant from Norway will complement a NPR 17.7 billion (USD 180 million) loan from the ADB's concessional resources (the Asian Development Fund), a loan of NPR 11.8 billion (USD 120 million) from the European Investment Bank, and a NPR 1.9 billion (USD 11.2 million) grant from the ADB-administered Strategic Climate Fund.³⁶

Foreign aid commitment in first quarter tops NPR 84.34 billion: The country has received grant assistance commitments worth NPR 84.34 billion (USD 860 million) in the first quarter of the current fiscal year. This commitment exceeds the total aid received in the whole of the previous fiscal by NPR 10.96 billion (USD 111.6 million). The largest component of the assistance is a commitment of NPR 44.8 billion (USD 456.5 million) from the European Union, followed by NPR 38.6 billion (USD 393.3 million) from the US Agency for International Development (USAID).³⁷

EU announces threefold increase in development support: The European Union (EU) announced a threefold increase in its development support in its new seven year EU-Nepal Development Cooperation Strategy for 2014 with a commitment of NPR 44.8 billion (USD 456.5 million). The three major areas of interventions will be sustainable rural development, education, and strengthening democracy and decentralization. The program will aim at fostering quality education and strengthening democratic governance.³⁸

ADB, UK provide support for women and children: The Asian Development Bank (ADB) will administer NPR 343.5 million (USD 3.5 million) in grants from the UK government and ADB's Gender and Development Cooperation Fund to expand Women and Children Service Centers to 15 additional districts. To expand the project, the UK government is contributing NPR 314 million (USD 3.2 million) in grants, while ADB's Gender and Development Cooperation Fund is contributing NPR 29.5 million (USD 300,000). The Government of Nepal will also be contributing NPR 37.3 million (USD 380,000).³⁹

USAID pledges support of USD 402 million: The US Agency for International Development (USAID) has pledged to provide NPR 39.4 billion (USD 402 million) over a period of five years to improve governance, expand proven health interventions in maternal and child health, improve literacy, increase economic growth, and address the challenges of food insecurity and climate change.⁴⁰

Increasing loans, decreasing grants: The review of the first quarter of FY

2014-15 indicates a shift in trend relating to the proportion of cash loans and cash grants in total aid. The total amount of foreign cash grants has decreased from NPR 13.9 billion (USD 141.6 million) in the first quarter to just NPR 3.34 billion (USD 34 million) in the current fiscal year, a decline of 75% from the previous year. In comparison, the total amount of foreign cash loans has increased from NPR 1.19 billion (USD 12 million) in the first quarter of the previous year to NPR 1.99 billion (USD 20.2 million) in the current fiscal year, a rise of 67.22%.

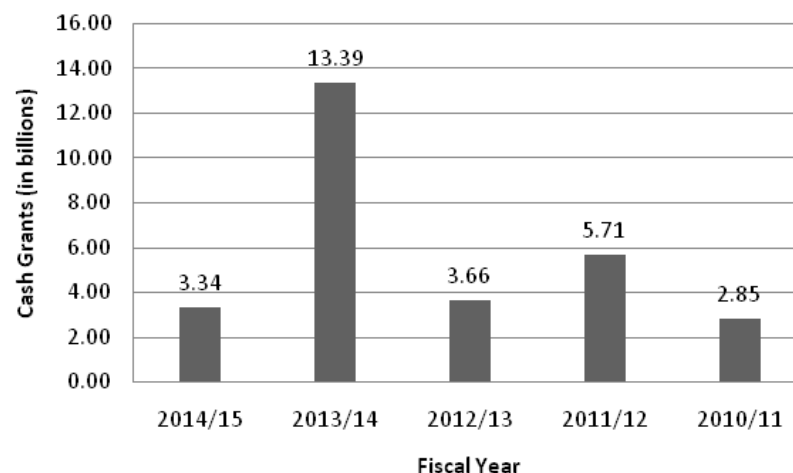
HEALTH

The health sector may witness a change now that the government has decided to formulate the national health policy. The policy is deemed necessary to be implemented as various diseases, from malnutrition to cancer, affect a majority of the population of Nepal. Similarly, the lifestyle adopted by the citizens is seen as the main reason for increase in health problems. The policy should be effectively implemented in order for the health sector to see any tangible changes.

National health policy to be formulated:

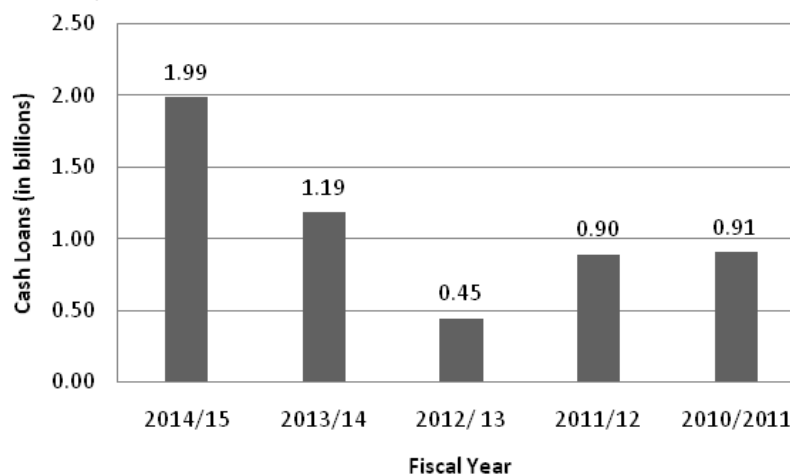
The Ministry of Education has decided to form a seven member special committee to formulate a national health policy in response to Dr. Govinda KC's demands.⁴¹ Dr. KC is a senior professor at the Institute of Medicine. The committee comprises of experts from medical sector to formulate national medical education policy. KC's other demands include immediate formation of a central medical university and passage of a bill proposed by the medical university feasibility study committee, and no new medical college to be

Figure 1: Comparison of Foreign Cash Grants in the first quarter over the past five years



Source: Current Macroeconomic Situation, Nepal Rastra Bank

Figure 2: Comparison of Foreign Cash Loans in the first quarter over the past five years



Source: Current Macroeconomic Situation, Nepal Rastra Bank

granted licenses until the bill on medical university is passed by parliament.

100,000 locals exposed to health risk: Approximately 100,000 people living

around the Tribhuvan International Airport area are at a high health risk as air traffic volume has increased significantly over the years.⁴² An estimated 25,000 households currently reside

within close proximity of the runway. Although the noise caused by aircrafts has caused disturbances to over 100 schools, a dozen hospitals and polyclinics in the area, the government has yet to implement the International Civil Aviation Organization's request to adopt measures to reduce the number of people affected by aircraft noise.

Increase in cataract patients in Eastern Region: The eastern part of the country has witnessed an increase in people losing their eyesight due to cataract.⁴³ This is seen as a serious setback to health institutions working to eradicate blindness by the end of 2020. Sagarmatha Chaudhary Eye Hospital carried out a total of 53,979 eye surgeries in 2013, of which, 44,245 were cataract patients. The number increased to 155,000 in 2014. Although there are 15 eye treatment centers in the eastern region, it has been unable to effectively address the issue.

Increase in cancer patients: The number of cancer patients has increased by approximately 30% compared to last year in the Bhaktapur Cancer Hospital.⁴⁴ In 2012, more than 7000 cancer patients visited the hospital while this number increased to around 9000 in 2013. The main cause in the increase in this number is attributed to lack of awareness about cancer, poor lifestyle and eating habits. However, resource is a major hindrance to providing speedy health services to patients. The hospital currently has 82 beds, and an additional 50 beds are required to handle the flow of patients.

Urban population in hypertension risk: A research conducted by Dr. Om Murti Anil, a cardiologist at the Cardiothoracic Vascular and Transplant

Centre of Institute of Medicines, reveals that one fourth of the urban population inside the Kathmandu Valley are at serious risk of hypertension.⁴⁵ The survey revealed that of the 5000 people who took part in the survey, 28%—most of them males—had hypertension while 44% had pre-hypertension which could lead to hypertension. In addition, the research shows that 59% of the people had high cholesterol. The main cause for the increase in hypertension is lack of physical exercise.

INFRASTRUCTURE

Soft loan for Pokhara airport: Following the cabinet's decision of October 27 to construct the Pokhara regional airport with Chinese funding, the Ministry of Finance has sought soft loans amounting to USD 215.96 million (NPR 21.19 billion) from China Exim bank. The project is to be constructed under the Engineering Procurement and Construction (EPC) model. Under the EPC contract, the contractor is required to deliver the project at the stipulated time at the agreed price irrespective of cost overruns. Initially, the project cost was estimated at USD 166 million (NPR 16.29 billion). The project hit the rocks when short listed bidder China CAMC Engineering Co quoted USD 305 million (NPR 29.93 billion). An independent cost evaluation has estimated the project cost at USD 215.96 million (NPR 21.19 billion).⁴⁶

Upgradation of Bhairahawa Airport: The contract for upgradation of Bhairahawa airport into a regional international airport has been awarded

to China's Northwest Civil Aviation Airport Construction Group for NPR 6.22 billion (USD 63.39 million). Civil Aviation Authority of Nepal had estimated the project cost at NPR 6.3 billion (USD 64.19 million). The contract includes construction of a new runway, exit and parallel taxiways with flexible pavements, rehabilitation of the existing runway for conversion into parallel taxiway, drainage system parallel to the runway, taxiway and diversion of the Ghaghara river and airport boundary. To fund the project, Asian Development Bank will provide USD 58.50 million (NPR 5.74 billion), i.e. USD 42.75 million in loans and USD 15.75 million in grants, OPEC Fund for International Development will give a USD 15 million (NPR 1.47 billion) loan, while the remaining deficit amount will be borne by the Civil Aviation Authority of Nepal.⁴⁷

Repair works at Bhojpur airport: After 35 years of its establishment, the Bhojpur airport is finally undergoing repair and expansion works. The airport is scheduled to remain closed for seven months.

Kabeli hydro project: A USD 40 million (NPR 3.92 billion) loan agreement and USD 6 million (NPR 588.84 million) grant agreement has been signed between the Government of Nepal and the World Bank for developing the 37.6 MW hydro project located on the Taplejung-Panchthar border. The grant portion will be used for developing the institutional capacity of the Department of Energy Development, strengthening the capacity of Investment Board and negotiating power development agreement with large project investors.

Earlier, the Commission for the Investigation of Abuse of Authority had ordered termination of license over non-completion of the project's financial closure.⁵⁰

Mid-Modi hydro project: The construction of 15.1 MW Modi Hydro Project at Kaski-Parbat kicked off on November 23. The run-of-the-river hydro project is developed by Himal Hydro & General Construction Ltd, a joint venture of Chaudhary Group and India's Coastal Projects Limited. The project is scheduled to be completed within three years with an estimated total cost of NPR 2.8 billion (USD 28.53 million).⁵¹

Upper Karnali PDA: A Power Development Agreement has been signed between Investment Board Nepal and India's GMR-ITD for the 900 MW Upper Karnali Hydropower project. As per the agreement, the project, which is being built under the build-own-operate-transfer model, must be completed within five years. This means the project, which will generate electricity by 2021, will be handed over to the government free of cost after 25 years of electricity generation. The project is expected to continue generating electricity for another 50-75 years from the handover date. As a part of the agreement, the developer will hand over 400 Kv (100 km) transmission line free of cost to the government at the end of the 25 year term.

The project will provide 12% electricity free of cost to Nepal with the Government of Nepal holding the right to purchase up to 50% of the power, 27% free equity worth NPR

9.45 billion (USD 96.29 million) to Nepal Electricity Authority and extend NPR 118 billion (USD 1.2 billion) in royalties, NPR 1 billion (USD 10.19 million) in customs duties, and NPR 10 billion (USD 101.9 million) in value added tax. In addition, the project developer will construct a 2 MW project to supply electricity year round to households affected by the project.⁵³

Upper Tamakoshi reaches another milestone: With the construction of the tailrace tunnel, 69% of the overall work of the project is complete. The project is expected to be completed by July 2016.⁵⁴

Panchthar Mid-Hill track open: The 200 km mid hill highway linking Chiyo bhanjyang near the Nepal-India border in Panchthar with the Mahakali river in Baitadi has been completed. It includes the 60 km Chiyo bhanjyang-Ganesh chowk, 40 km Ganeshchowk-Jorsal and 99 km Jorsal-Myanglung road section.⁵⁵

BP Highway near completion: After 20 years of construction, the BP highway connecting Banepa-Sindhuli-Bardibas is expected to officially come into operation from May 2015. The construction of the highway began in 1996 through finance from Japanese International Cooperation Agency.⁵⁶

MANUFACTURING AND TRADE

In the first three months of FY 2014-15, manufacturing and trade sector has seen a slight downfall wherein exports have fallen by 2.3% amounting to NPR 22.54 billion (USD 229.67 million). Imports are climbing further with the country importing 24.7%

more than the imports during the same review period of last FY. Imports stood at NPR 192.25 billion (USD 1.96 billion), with majority of imports coming from India. Nepal has been spending almost all of its remittance inflow and foreign exchange earnings on import of goods. Nepal's weak supply capacity has been pointed out as the major reason for the country's massive trade deficit. The government's poor policies have failed to channelize remittance into investments whereby exports have not been able to pick up.⁵⁷

Foreign trade scenario: Nepal's export to India has fallen by 6.4% amounting to NPR 13.56 billion (USD 138 million). Interestingly, export to China has increased by 93.2% although the amount of export is a mere NPR 889 million (USD 9 million), which is only a fraction of the country export to India. In terms of imports, Nepal imported goods worth NPR 124.45 billion (USD 1.27 billion) from India, which is an increment of 23.4% in the first three months of the current FY. Imports from China registered a growth of 39.3 % amounting to NPR 23.22 billion (USD 236.6 million) while imports from other countries amounted to NPR 44.58 billion (USD 454 million) as shown in *Table 2*.

Similarly, Nepal's total trade deficit in the first quarter of the FY 2014-15 stood at 169.72 billion (USD 1.73 billion), which is an increment of 29.5% from previous year's review period. Trade deficit with India has increased by 28.4%. Trade deficit with other countries also paint a familiar picture with deficit increasing by 37.8% this fiscal. Although the country's trade deficit with China decreased by 10.9% in

the review period of last fiscal, the same has increased by 37.8% this fiscal, amounting to NPR 22.34 billion (USD 227.63 million)

Top exports, imports: Woolen carpets has topped the exports list once again with the country exporting products worth NPR 7.38 billion (USD 75.2 million) in the first three months of the current fiscal year. This is an increment of 30.5% in comparison to the review period of the last fiscal. Polyester, cotton and other yarns come second with export amounting to NPR 6.43 billion (USD 65.5 million), followed by textiles which has registered a growth of 4.7% amounting to NPR 5.65 billion (USD 57.57 million).

Similarly, petroleum products continued to be the top imported products, registering a growth of 21% amounting to NPR 134.4 billion (USD 1.37 billion). Iron and steel products come second with transaction of NPR 65.44 billion (USD 666.8 million). This was followed by machinery and parts which contributed NPR 41.43 billion (USD 422 million) to Nepal's total import for the FY 2013-14. India and USA are the top two trading partners while Germany and Bangladesh come close for the third spot.⁵⁸

BOP surplus: Balance of Payment (BOP) surplus for the first three months of FY 2014-15 amounted to NPR 2.96 billion (USD 30.16 million) compared to the surplus of NPR 52.74 billion (USD 537.39 million) during the same period previous year. The increase in imports of merchandise and services combined with the decrease in grants and workers' remittances has resulted in the current account deficit of NPR

Table 2. Export Statistics for the first quarter of FY 2014-15 (in billions)

NPR in billions	2012/13	2013/14R	2014/15P	Percent Change	
				2013/14	2014/15
TOTAL EXPORTS	20.73	23.07	22.53	11.3	-2.3
To India	49616.3	50999.8	59417.3	2.8	16.5
To China	0.68	0.46	0.88	-32.6	93.2
To Other Countries	24644.7	25917.3	30875.0	5.2	19.1

Based on customs data R=Revised / P=Provisional
Source: NRB Report - Recent Macroeconomic Situation, 2070-71

Table 3. Import Statistics for the first quarter of FY 2014-15

NPR in billions	2012/13	2013/14R	2014/15P	Percent Change	
				2013/14	2014/15
TOTAL IMPORTS	136.47	154.12	192.25	12.9	24.7
From India	86.92	100.85	124.45	16	23.4
From China	18.87	16.66	23.22	-11.7	39.3
From Other Countries	30.68	36.59	44.57	19.3	21.8

7.59 billion (USD 77.33 million) in contrast to the surplus of NPR 37.49 billion (USD 382 million) in the same review period last year.⁵⁹

Trade with South Asia grows at snail's pace: Nepal's trade with South Asian countries, excluding India, has barely grown despite the launch of South Asia Free Trade Area in 2006. India still accounts for a majority of the country's export and import. According to the Trade and Export Promotion Centre, Nepal's exports to South Asian countries, excluding India, range from 0-3.4% of total exports while imports range from 0-0.4%. Afghanistan is the third largest export destination

for Nepali goods after India and Bangladesh. Nepal has failed to export goods to other South Asian countries as a majority of Nepal's export goods are in the sensitive list. Since this constricts the prospects for growth of regional trade, SAARC member countries have promised to shorten the list by 95% by 2020.⁶⁰

Inter-ministerial cooperation to reduce trade deficit: The Ministry of Commerce and Supplies is preparing a white paper on foreign trade status with the aim of garnering inter-ministerial cooperation to reduce the ever widening trade deficit through explanation of the role of stakeholder ministries to control

the trade deficit. The increase in the ratio of import shows that the country is bringing in non-tradable goods. The white paper has stressed on the need to reduce the increasing trade dependency on India. A number of required interventions and remedies sought has been mentioned in the paper. However, experts are of the view that there is no possibility of curbing imports in the current situation as Nepal's imports are essential items with low demand elasticity.⁶²

Nepali herbs to be exported to Europe:

Himalayan Bio Trade Private Limited, French company NATEVA and GIZ have agreed to export semi-processed herbs of Nepal as an ingredient for cosmetic products in Europe. The partnership aims to scale up the value chain of new natural ingredients from Nepal and promote the export of personal care and cosmetics products to Europe. This is expected to improve rural incomes of small farmers and act as an example of linking international business with socially balanced economic development.⁶³

Amended trade policy to boost exports:

Ministry of Commerce and Supplies is preparing to amend the current trade policy to boost exports and to make it more private-sector friendly. The current trade policy has now become inadequate to address the ballooning trade deficit and does not encourage the private sector. The trade policy draft will focus on developing industrial zones for export promotion, trade-related infrastructures and institution development. The government has also proposed a Product Development Fund, with participation of the private sector, to boost production and productivity of products

EXPORT OF NTIS PRODUCTS RISES

The export of products listed under Nepal Trade Integration Strategy (NTIS) has shown a marginal growth of 2.08%. Despite the government's effort to boost the export of niche products, their export performance has remained very weak.

In the FY 2013-14, Nepal exported goods worth NPR 91.36 billion (USD 930.9 million) out of which NTIS products contributed only NPR 27.41 billion (USD 279.29 million). The government had introduced NTIS in 2010 to boost the export of Nepali products that have competitive and comparative advantages.

Among the NTIS products, iron and steel products top the export list but there is very less value addition on the iron and steel products. On the positive side, the export value of natural honey has increased eight folds in 2013-14, followed by essential oils which increased by 85%. However, the export volume of these products are still low.⁶¹

Table 4. Trade Balance Statistics for the first quarter of FY 2014-15

NPR in billions	2012/13	2013/14R	2014/15P	Percent Change	
				2013/14	2014/15
TOTAL TRADE BALANCE	-115.74	-131.05	-169.71	13.2	29.5
With India	-74.65	-86.36	-110.88	15.7	28.4
With China	-18.18	-16.20	-22.33	-10.9	37.8
With Other Countries	-22.90	-28.48	-36.49	24.4	28.1

Table 5. Foreign Trade Statistics for the first quarter of FY 2014-15

NPR in billions	2012/13	2013/14R	2014/15P	Percent Change	
				2013/14	2014/15
TOTAL FOREIGN TRADE	157.21	177.19	214.78	12.7	21.2
With India	99.18	115.35	138.01	16.3	19.6
With China	19.55	17.12	24.11	-12.4	40.8
With Other Countries	38.47	44.70	52.66	16.2	17.8

Based on customs data R=Revised / P=Provisional
Source: NRB Report - Recent Macroeconomic Situation, 2070-71

with export potential. The draft has also stressed on bringing new legislations and amendment of legislations related to service trade so as to reap benefits from export services.⁶⁴

Nepal needs an additional investment of NPR 400-500 billion (USD 4.1–5.1 billion) for achieving 10% economic growth rate.⁶⁵

Suspicious surge in garlic imports:

Biratnagar Customs Office has registered an import of 1,797 tonnes of garlic worth NPR 59.84 million (USD 60,974) in the first quarter of the current FY. This raises suspicion that garlic imports from China have surged mainly for re-export to India. In the whole of last fiscal year, Nepal had only imported 2,135 tonnes of garlic. Police are of the view that betel nut smugglers have shifted to exporting Chinese garlic after the government hiked the import duty on betel nuts sharply to discourage its re-export. Previously, no garlic used to be exported through Biratnagar Customs; this is the first time that garlic is being shipped to India.⁶⁶

Rice worth NPR 2.66 billion imported:

In the first two months of the current FY, Nepal imported rice worth NPR 2.66 billion (USD 27.14 million) from India which is an increment of 12.7%. Despite a 12% rise in paddy production, rice imports have not fallen. Paddy production has not increased in line with the rise in population and moreover farmers are shifting to the production of cash crops. Nepali rice faces stiff competition from Indian rice, as they have low production cost due to government subsidies while Nepali farmers are facing issues related

to irrigation, labor and load-shedding. The country had imported cereal products worth NPR 28.62 billion (USD 291.62 million) during the last fiscal. The increased dependence on imported products has ballooned the country's trade deficit.⁶⁷

Betel nut exports stops:

The Indian authorities have announced that they will conduct lab tests to determine if the betel nuts being exported are of Nepali origin. Since this announcement, no shipments have been dispatched to India. Smuggling of betel nut to India has been rife due to the wide difference in prices in India and Nepal; it fetches NPR 100 (USD 1.01) more per kilogram in India. Nepal's import of betel nuts surpasses its domestic requirement as most of the shipments are re-exported to India after being labeled as Nepali products. The country imported 3,802 tonnes of betel nuts in FY 2011-12; this number soared to 7,930 tonnes in FY 2012-13.⁶⁸

Collective trademark for ginger:

The Trade and Export Promotion Center will be branding Nepali ginger as Himalayan Ginger in the international market with the registering of collective trademark of ginger at the Department of Industry. Nepal Ginger Producers and Traders Association—the national level traders association—had been lobbying for the trademark registration for the last three years. Seventy per cent of the registration cost will be borne by the government while the association will pitch in the remainder.⁶⁹

Disclosure of MRP of six more imported products:

The Department of Customs is looking to enforce the

disclosure of Maximum Retail Price (MRP) on biscuits, soft drinks, chocolates/candies, all kinds of fast food, carpets and paints. The department is also mulling over expanding the MRP requirement on the import of 14 goods of daily use during the current fiscal. MRP is seen as a tool to maintain price uniformity in the domestic market and is intended to facilitate consumers as the system will dissuade traders from fixing arbitrary prices. This system will also prevent the under invoicing of imported goods.⁷⁰

REAL ESTATE

Opening of new Land revenue office:

The government is all set to open 21 new Land Revenue Offices (LRO) in 20 districts this fiscal year. The opening of these new offices is aimed at easing land and housing transactions as well as increasing the revenue of the government. At present, there are 83 such offices in all 75 districts. The addition of 21 new LROs will take their number to 103.⁷¹

On the path to recovery:

Revenue from property transaction increased by 62% in the first two months of the current fiscal year as compared to the same period last fiscal. The revenue collection stood at NPR 1.67 billion (USD 17.02 million) as of mid-September 2014. As per the Department of Land Reforms and Management, Kathmandu Valley alone contributes to more than 35% of overall land revenue collections of the country.⁷²

Grand condominium conundrum:

Based on a request made by Citizens Bank International, Nepal Rastra Bank

has sought the Finance Ministry's permission to release 36 condominium at Grand Apartment at Dhumbarahi, initiating the process to transfer ownership to their buyers. The central bank had earlier frozen the asset following violation of banking rules by the project developer, Oriental Builders and Developers. Citizens Bank International has partially financed the Grand Apartment project by securing the same property as collateral. The bank needs to recover NPR 115.90 million (USD 1.18 million), including NPR 75.30 million (USD 767,271) in interests, from the project developer. The buyers have agreed to deposit NPR 40 million (USD 407,581) for the transfer of the apartment units as per the condition laid down by Citizens Bank, and a tripartite agreement has also been signed between the bank, the buyers and the project developer.⁷⁴

Amendment to Land Acquisition Act: The Ministry of Land Reforms and Management has been directed by the National Development Action Committee to prepare and endorse Land Acquisition Act amendment bill in the parliament within three months. The Act is aimed at addressing the problems in land acquisition, which have hindered the progress of major development projects.⁷⁵

REMITTANCE

That remittance plays a very important role in Nepal's economy is a fact that can never be overemphasized. More than 500,000 people went abroad to find work in FY 2013-14. About the same number of people enter the workforce every year, which makes it clear that remittance has been

HANDLING CREDIT & LIQUIDITY SHOCK COMMERCIAL BANKS VS. DEVELOPMENT BANKS

The Nepal Rastra Bank (NRB) stress test result indicates development banks, in terms of Capital Adequacy Ratio (CAR), are in a better position to handle standard credit shock as compared to commercial banks. CAR indicates a banking institution's capacity to absorb shocks and its ability to extend loans.

In its latest Financial Stability Report, NRB warns that 22 commercial banks would find themselves in a very difficult position if 15% or more of their deposits are withdrawn. Similarly, 16 commercial banks may be in trouble if 2%, 5% and 10% of their deposits are withdrawn in first, second and third day. This is because a major chunk of bank loans fall under housing and real estate loans. The stress test result also shows that if exposed to a standard credit shock, 28 commercial banks—which is roughly 90% of the class A financial institutions—would find their CAR fall below the 10% level.

Meanwhile, development banks fared far better in handling credit and liquidity shocks. The stress test of 18 out of 20 national level development banks shows that CAR of one bank is expected to fall below the 10% CAR mark if 10% of the deposit is withdrawn. Five banks would drop below the 10% CAR mark if 15% of the deposit is withdrawn, and 67% of the development banks would see their CAR fall below the 10% level if 20% of their deposit is withdrawn.⁷³

playing a significant role in averting unemployment crisis. Interestingly, remittance is, so far, spent mostly on the import of consumer goods. The lack of policies aimed towards increasing productive use of remittance in capital formation continues to be a problem for the Nepali economy.

Decline in Remittance: The review of the first three months of FY 2014-15 shows a slightly dismal performance of this sector. Worker's remittance during the review period amounted to NPR 134.189 billion (USD 1.36 billion) as against NPR 135.03 billion (USD 1.37 billion) that was registered last year

during the same review period, indicating a decline of 0.6%. Compared to the worker's remittance growth of 38.2% during the same period last year, the decline of 0.6% this quarter is quite small. Whether this decline is something that is indicative of a long run trend or just a short-term fluctuation can only be ascertained through a review of the performance of remittance in the next quarter.

Remittance decline raises concern: Decline in remittance has raised concerns as there is no corresponding decline in either the number of people

going abroad for work or in the wage rate. The decline is unprecedented as increasing growth in remittance from period to period has been a constant feature of the economy for many years.

One of the reasons is the strengthening of the Nepali rupees against the US dollar. This year, the exchange rate per dollar was NPR 97.31 in August and NPR 97.24 in September as compared to the previous year's exchange rate where the dollar stood at NPR 96.61 in August and NPR 103.85 in September. However, a decline in remittance cannot be attributed to a change in exchange rate alone as there has been a decline in remittance in dollar terms as well. Nepal Rastra Bank, which has attributed the decline to a rise in the use of informal channels, is currently conducting a study on why this has happened.⁷⁶

Nepal urged to reduce reliance on remittance: The Government has been called on by various multilateral organizations to focus on building a more resilient economy and reduce the country's reliance on remittance. During an event jointly organized by the Ministry of Finance, Asian Development Bank, and United Nations Development Program, the representatives of the donor agencies pointed out that although remittance may aid in short term poverty reduction, it will not help the country in long term resilience building. They emphasized on the need to promote domestic entrepreneurship.⁷⁷

Returning foreign workers create jobs in Nepal: Remittance hasn't just contributed to keeping the economy afloat; it has also made some contribution to creating jobs in Nepal. Workers often return with important skills that help

Table 6: Changes in remittance (in NPR billions)

Particulars	2012/13		2013/14		2014/15	Percent Change in 3 months	
	3 months	Annual	3 months	Annual	3 months	2013/14	2014/15
Grants	5.27	34.18	13.078	48.52	6.96	148.1%	-46.8%
Worker's remittance	97.72	434.58	135.03	543.29	134.19	38.2%	-0.6%
Pension	8.94	35.33	9.17	41.37	10.00	2.5%	9.1%

Source: Current Macroeconomic Situation, based on three months data, NRB

them generate income for themselves and create jobs for others. A worker from Hetauda, who worked in a vegetable nursery for several years in Israel, returned to start his own firm, Shalom Agriculture, which has worked with 400 Nepali farmers in 33 districts. Likewise, another worker used his experience working in a coffee farm in Ethiopia to start an organic coffee farm in his village, and is now exporting coffee abroad.⁷⁸

Others have used their experiences of working in restaurants and hotels abroad to start their own business after returning to Nepal.⁷⁹ Most of the people going abroad are employed in low skilled and semi-skilled work. With appropriate policies from the government, the skills that the workers bring back can be used to promote the growth of small and medium enterprises.

Remittance through informal channels: Worker's remittance continues to find its way through informal channels. Informal channels include inflow of fund that enters through channels other than the official channel approved by Nepal Rastra Bank, such as informal money transfer network like *Hundis*, as well as the money which the workers themselves carry back home or

send back through friends and relatives. Studies indicate that about 50% of the total remittance, excluding remittance inflow from India, flows through informal channels.⁸⁰ Due to geographical and cultural proximity and open border with India, most of the remittance inflow from India goes unrecorded. Lack of accurate data about remittance flowing through informal channels severely limits policy prescriptions.

TELECOMMUNICATION AND MEDIA

The fast track growth of the Nepal telecom industry has made it a key contributor to Nepal's economic development. Nepal Telecom Authority reported a total of 25,247,720 telecom subscribers during mid-September 2014. The teledensity of the country stood at 95.28% as on mid-September, while the internet penetration rate stood at 34.09% with 9,033,239 users (see *Figure 3* for the growth trend of voice telephone and data service penetration).⁸¹

Nepal Telecom and NCell are the two largest operators in telecommunication sector of Nepal. Though private players, such as Smart Telecom, United Telecom

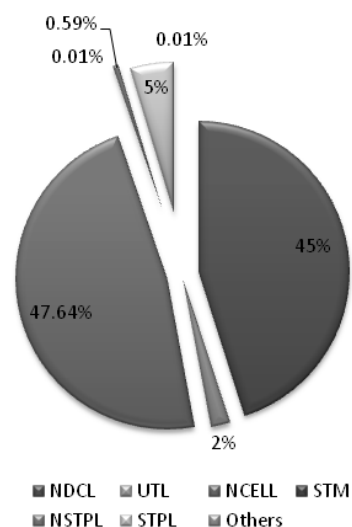
and STM Telecom, have registered growth, the privately owned NCell and publically owned Nepal Telecom dominate the telecommunication sector with a market share of approximately 45% and 48% respectively (see Figure 4).

Rural Telecommunication Development Fund: The Rural Telecommunication Development Fund (RTDF) was created for the development of telecommunication in rural areas. The Telecommunication Act 1997 makes it mandatory for telecom operators to

contribute 2% of their annual income to the fund. During the FY 2012-13, the government received NPR 1.73 billion (USD 17.63 million). The size of the RTDF stands at NPR 9.52 billion (USD 97 million).⁸²

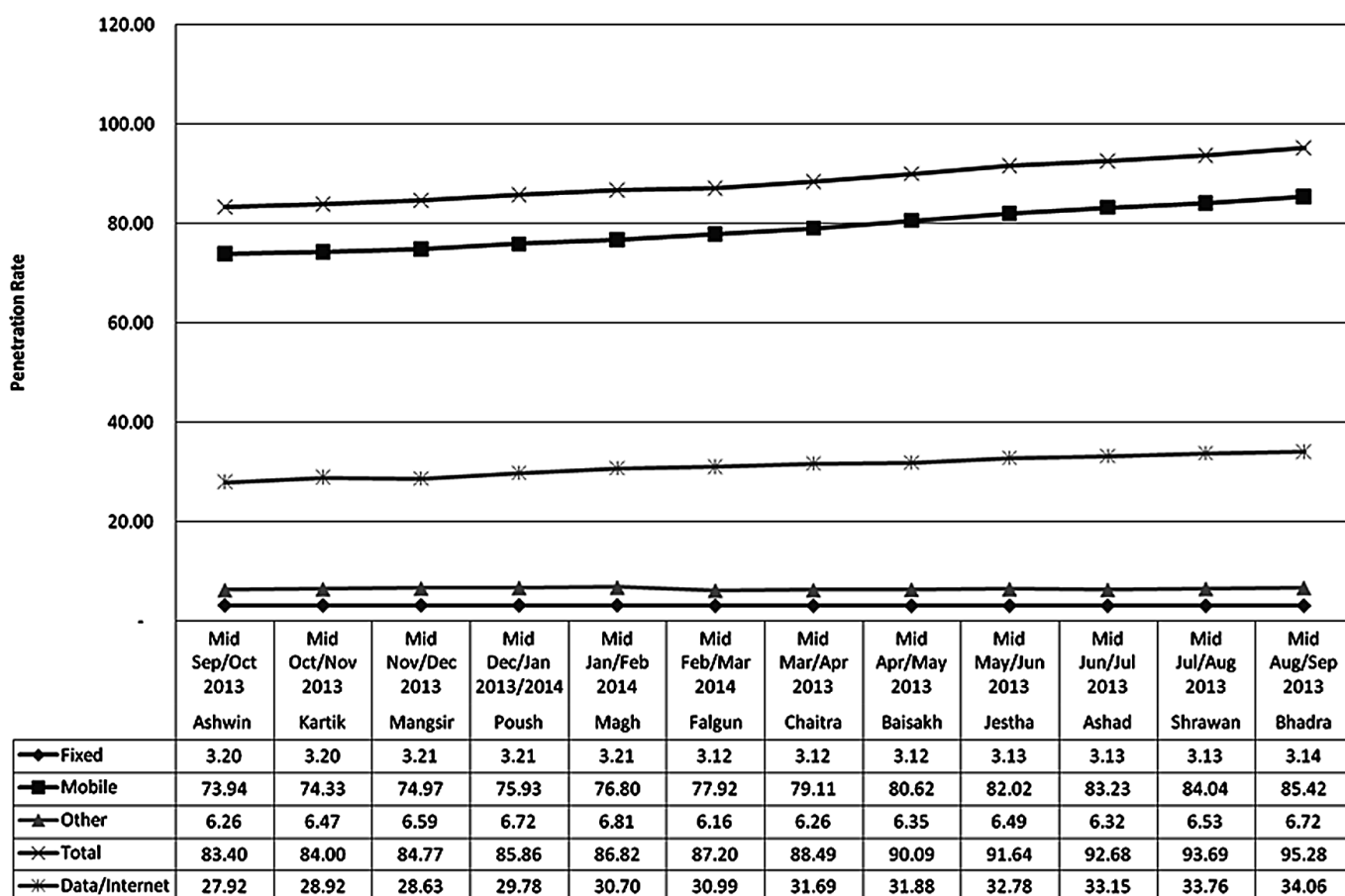
Smart Telecom to launch mobile service: Smart Telecom has approached Nepal Telecommunication Authority for spot frequency and permission to import telecommunication equipment worth over NPR 1 billion (USD 10.19 million). This is a move to expand

Figure 4: Market share of Telecom Operators



Source: Nepal Telecommunication Authority

Figure 3: Growth Trend of Voice Telephone and Data Service Penetration



the company's mobile service in the Kathmandu Valley. The company had procured telecom equipment worth NPR 7.86 million (USD 80,000) during the last fiscal year.⁸³

TOURISM

The Tourism Employment Survey 2014, conducted by the Tourism Ministry, has shown that one job was generated from every six tourist visits over a year's period. The survey, which is the first of its kind to be conducted in Nepal, is expected to give a real picture of the industry. Although UN World Tourism Organization estimates that the entry of one tourist in a particular country provides employment to 12 people, the estimates for Nepal is comparatively very low. The survey result is also lower than the estimates provided by the Economic Survey 2013 which states that the tourism industry has generated 178,000 direct jobs. The survey, however, does not take into account the informal sector and is purely linked with the total arrivals and their outcome in the industry.⁸⁴

CPN-M campaigns against trekking operators: Tourism workers affiliated to Mohan Baidya-led CPN Maoist have written to embassies of the United Kingdom, USA, China, India, Denmark and Germany among others, asking them to advise their respective citizens against using the services of Himalaya Expeditions Inc, Explore Himalaya Travel & Adventure, Peak Promotion, and Himalayan Guides Nepal. All Nepal Revolutionary Tourism Workers Union had sent letters to 14 different companies urging them to release pending salary and benefits to workers at the earliest and not to

adopt 'hire and fire' policy. Meanwhile, the entrepreneurs have argued that they cannot hire staff on a permanent basis as trekking is a seasonal business.⁸⁵

Chinese tourist arrivals at all-time high: Chinese arrival to Nepal has reached an all-time high of 113,173, registering a jump of 55.3% in air arrivals and 44.7% in overland travelers. Around 93% of the Chinese tourists were first time visitors to Nepal. The increase in Chinese tourists has been attributed to the improved air connectivity between Nepal and China. The recently revised air service agreement between Nepal and China permits Chinese carriers to operate 56 flights weekly with any type of aircraft.⁸⁶

According to Nepal Tourism Statistics 2013, Chinese tourists rank sixth in terms of visitor's length of stay which stands at 9.48 days while the longest stay are for tourists from Norway who spend an average of 23.74 days in Nepal.⁸⁷

Tourist Police Post in Bhaktapur: The first Tourist Police Post (TPP) will be opened in Bhaktapur to cater to the problems and complaints of the tourists. Bhaktapur Municipality has already provided two rooms and other pre-requisites to set up the TPP at its premises, where seven police personnel will be working. This is expected to make the environment more convenient for tourist. The TPP is a combined initiative of Metropolitan Police Range Bhaktapur, Bhaktapur Municipality and Bhaktapur Tourism Development Committee.⁸⁸

National Tourism Strategy Plan in the offing: The government is all set to introduce a 10-year National Tourism Strategy Plan (NTSP). The core aim

of the plan is to diversify the country's tourism attractions and services by ensuring improved quality of products and human resources. The draft plan has prioritized four tourism development areas, which includes Pokhara in central/western, Kailali in far-western, Illam in eastern and Karnali in mid-western development regions.

NTSP has also highlighted the need to improve areas such as aviation infrastructure, power shortages, regulative and administrative procedures, etc., to develop the investment and business environment. NTSP has also noted that the Ministry of Culture, Tourism and Civil Aviation lacks knowledge on tourism sector. Moreover, the plan stresses on the need to establish a system to coordinate the management of tourism sector and the destination areas, along with a transition plan from central to federal structures.⁸⁹

Department of Tourism revived: After 15 years, the government has revived the Department of Tourism by dissolving the existing Tourism Industry Division. The department has been authorized to regulate the country's tourism industry under the Ministry of Culture, Tourism and Civil Aviation. Under this, the department will regulate four sectors—expedition, trekking, hotel and restaurant, and adventure tourism. Furthermore, it will assist the Ministry in providing tourism services, products and infrastructure development. The department will also act as a single-window system for the issuance of licenses and permits for new hospitality businesses.⁹⁰

NTB controversy continues: The investigation into the alleged financial irregu-

larities at Nepal Tourism Board (NTB) has shown that NTB head and its board members were involved in the misuse of millions of rupees of tax money. The seven-member fact finding panel led by Purna Chandra Bhattarai, joint secretary at the Ministry of Federal Affairs and Local Development, had done a 48-day study during which they uncovered mismatches between vouchers and payments.

Additionally, NTB officials had submitted hefty amounts of new restaurant bills to artificially inflate the payments figure. The top government officials have been charged with abusing authority to amend the Board's Financial Bylaws. A committee under joint secretary Bhattarai had prepared a draft of the new Financial Bylaws for NTB and was told to implement it without changes. However, more than 90% content of the Bylaws was later modified. The amended Financial Bylaws, which was kept hidden for more than six months, had only come to light after pressure from the private sector.⁹¹

Following orders from the parliamentary Public Accounts Committee to the Tourism Ministry to suspend the NTB chief Subash Niroula, he has been removed from the post as per the NTB Regulation 2055 and NTB Act.⁹² There are over 13 cases related to NTB under consideration by the Supreme Court.⁹³

Pokhara air space getting congested: The number of paragliding flights has reached a saturation point in Pokhara, making the airspace congested and unsafe. There are around 19 paragliding companies operating in the area, with an additional 35 having applied for the operating permits. The Tourism Ministry has decided

not to issue new operating permits in Sarangkot, Toripani and Mandredhunga, including areas covered by the air traffic service route of Pokhara airport and its control zone with effect from September 17. The decision has been undertaken after consultation with pilots, officials at Pokhara airport and the aviation regulatory body.⁹⁴

MOU signed with Thai Hotels Association: Hotel Association Nepal has signed a Memorandum of Understanding with Thai Hotels Association. The hotel associations of both the nations will be working together to facilitate the liaison between member hotels and will also be sharing experiences regarding tourism sector. The two associations will also partner in providing required training to produce and manage skilled human resources.⁹⁵

Locals block Beni-Jomsom road: The locals residing along the Beni-Jomsom road, leading to Muktinath Temple in Mustang, blocked the road to protest against the transport entrepreneurs' monopoly. The locals claim that the jeep entrepreneurs' notorious transport syndicate in the region has ignored their needs and turned down their proposal to operate their vehicles on the route. A total of 53 jeeps are affiliated to the syndicate that operate on the 21-kilometer long Jomsom-Muktinath road on a daily basis. As per the Jeep Entrepreneurs' Committee regulations, new jeeps are added on the route once every three years. While the locals have been demanding the addition of new jeeps, the committee is insistent that new vehicles will be permitted on the route only after a year.⁹⁶

Rara witnesses increase in tourists: The number of tourists visiting Rara

Lake has increased significantly. An estimated 30-40 domestic and international tourists visit the lake daily. Arrivals of domestic and international tourists overland has increased after the opening of Karnali Highway. Hotels that used to be deserted during Dashain, is now packed. The increase in the flow of tourist has motivated the locals to operate hotels and build concrete houses.⁹⁷

Sheraton's foundation stone laid: Work has started for the construction of Sheraton Kathmandu Hotel, a five star hotel with an estimated investment of NPR 8 billion (USD 81.51 million). The 17-storey luxury property spread over 14 *ropanis* (7122.08 sq m) of land, is due to be opened in February 2018.⁹⁸ The Sheraton Kathmandu Hotel marks the re-entry of Sheraton brand in Nepal. Earlier, the brand had managed Hotel Everest Sheraton and Gokarna Forest Resort under the Le Méridien brand.⁹⁹

Private sector's support for Tourism Vision 2020: A pact to pursue the Tourism Vision 2020 campaign jointly has been recently forged between the Hotel Association Nepal, Trekking Agencies Association of Nepal, Nepal Association of Tour and Travel Agents, Pacific Asia Travel Association, Nepal Association of Tour Operators, and Nepal Mountaineering Association. Vision 2020 was launched by the government in 2012 with the view to increase tourist arrivals to 2 million by 2020. The vision also aims to increase employment in tourism by NPR 1 million (USD 10,189).¹⁰⁰

KGH reinvents itself: Kathmandu Guest House has rebranded itself for catering to all tourist types—budget to boutique travelers. The hotel was

renovated and has expanded with the completion of its deluxe wing—the Siddhi Annex. The hotel is offering basic rooms for budget travelers, the standard and garden facing rooms for medium range travelers, and the deluxe and suite for the high-end travelers. Guests from all nationalities are appreciating the variety in room choices as the hotel offers contemporary and traditional services.¹⁰¹

Chitwan jungle resort controversy:

The writ petition against the renewal of the lease agreements of the six jungle resorts located inside Chitwan National Park (CNP) has been quashed by the Supreme Court. The Apex Court had earlier issued an interim order to put on hold the renewal of the lease agreements and operations and demolition of the properties until a final verdict was issued. Seven hotels and resorts are currently operating in CNP: Tiger Tops Jungle Lodge, Machan Wildlife Camp, Chitwan Jungle Lodge, Gaida Wildlife Camp, Island Jungle Resort, Hotel Narayani Safari and Temple Tiger Hotel. However, the Supreme Court decision does not mean that the lease agreements of the jungle resorts will be renewed as the renewal decision is under the jurisdiction of the Forest Ministry.¹⁰²

Info centers, shelters planned for Annapurna Circuit:

Annapurna Conservation Area Project (ACAP) has started the process to establish information centers and shelters in the Annapurna Circuit following off season avalanches and blizzards that hit the region recently, claiming 43 lives and leaving 500 trekkers stranded. The information centers will have weather information, situation of trekking

routes, information regarding trekking routes and internet connection.¹⁰³

Khumbu among 10 best regions in Lonely Planet:

Nepal's Khumbu region has been listed among the 10 best regions to explore in 2015 by Lonely Planet. The guide book has placed Nepal in the sixth spot after Gallipoli in Turkey, Rocky Mountain National Park in the US, Toledo in Belize, Tasmania in Australia and Norway Arctic in Norway. Khumbu is also known as the Everest region and receives around 36,000 trekkers and mountaineers annually.¹⁰⁴

Safari elephants lack proper care:

Two safari elephants owned by local hotels in Sauraha in Chitwan National Park have died with a week's span. The animals were suffering from malnutrition, tuberculosis and a host of other physical ailments due to improper diet and care. The elephants are forced to make up to seven trips a day, even during the hot season. Lack of medical treatment, care, food and the culture of chaining the elephants have made the situation very difficult for the animals.¹⁰⁵

NTB targets NPR 951 million revenue:

Nepal Tourism Board (NTB), in its preparation to finalize its annual budget, has said that they expect to collect NPR 951 million (USD 9.69 million) from tourist service fees and Trekkers Information Management System in FY 2014-15. NTB has also proposed a significant fund to organize Himalayan Travel Mart in Kathmandu and to promote Nepal internationally. Moreover, NTB has proposed a budget of NPR 278.6 million (USD 2.84 million) for the promotion of Nepali tourism products and services in the international market and a budget of

NPR 279 million (USD 2.84 million) to open offices in India and China.¹⁰⁶

New hotels in Myagdi: Entrepreneurs in Myagdi have started to increase investment in the hospitality sector with the increase in the number of visitors to Jomsom, Upper Mustang and Dhaulagiri Base Camp. Over half a dozen hotels have come into operation in a single year. The existing hotels have increased their capacity and added new facilities. Currently, there are 42 hotels in Beni Bazaar, the district headquarters of Myagdi, which lies 82 km away from tourist town of Pokhara. With more hotels coming into operation, Myagdi now has a capacity to accommodate around 1000 guests at a time.¹⁰⁷

No information on tourist arrival since July:

Neither the Immigration Office at Tribhuvan International Airport (TIA) nor Nepal Tourism Board (NTB) has maintained the records of tourists visiting Nepal after July. TIA's contract with NTB, which is responsible for compiling tourist arrival data, ended last fiscal. The delay in renewing the contract has affected the compilation of data. With its contract renewal pending and a delayed release of the budget, NTB has been unable to pay the outsourced data collection staff at TIA, leading to non-maintenance of the record of tourists visiting Nepal.¹⁰⁸

Luxury resort in Bharatpur: A luxury resort has been opened with an investment of NPR 170 million (USD 1.73 million) in Bharatpur of Chitwan district. The Bharatpur Garden Resort, spread over 22 *kathbas* (7449.86 sq. m), has 40 rooms and a conference hall along with a swimming pool and a well maintained garden.¹⁰⁹

“ MACROECONOMIC OUTLOOK

Despite the agriculture sector being the highest contributor to the nation's economy, there has been no significant improvement in this sector. This is because agriculture has not been modernized, with most farmers continuing to rely on outdated farming methods. While Nepal used to be a net food exporter until a couple of decades ago, today it depends largely on the import of food items to meet the country's growing demands, mostly due to its failure to raise agricultural productivity.

While the government has been injecting more funds into the public education sector, the performance of this sector has fallen far behind in comparison with the private education sector that is producing greater academic success with little investments. For instance, only 28% of the students studying in public schools made it through the last School Leaving Certificate examination as compared to the 93% students from private schools who passed the examination. Lack of proper supervision and ineffective implementation of different national education programs, coupled with political interference during the execution of education laws, policies and directives are the reasons for the underperformance of this sector. The government needs to look into these areas for the public education sector to perform better.

In the energy sector, the introduction of an automatic fuel mechanism pricing method adopted by the Nepal Oil Corporation (NOC), has enabled the corporation to cut down fuel prices, which were attributed to fluctuation of international oil markets. In addition, the profit generated by NOC demonstrates the state owned entity has the ability to perform effectively. Furthermore, Nepal-India relations in terms of energy cooperation have accelerated after Narendra Modi was elected the Prime Minister of India. The much-anticipated PDA on the 900MW Upper Karnali was finally signed after lack of progress in recent years. This agreement will provide opportunities to one of the least developed regions of Nepal.

Effective utilization of foreign aid remains an issue for the country with the government unable to make use of 51% of grants and 76% of loans received in FY 2013-14. Aid absorption capacity of the country must therefore be improved, with the development of comprehensive and long-term strategic policies and plans to effectively channel funds in alignment with the nation's development goals. A decline in foreign cash grants can be seen in the first quarter of the current

fiscal year which could potentially be a deliberate strategy of donor agencies to cut off grants and increase the proportion of loans. The increase in the debt paying capacity of the country has been cited as the reason for this shift. While decreasing dependence on foreign aid and increasing reliance on loans to carry out developmental activities is a good sign for the economy, increasing loans may also divert limited resources away from developmental activities as the interest and principal payment obligations also increase.

Although the government has been able to create and strengthen a successful health network, including primary health services, the National Health Policy still faces various challenges, which are yet to be addressed. Despite the update in the policy and countable improvements in people's health status, people from all regions and social structure are yet to access the health services. The state has been attempting to address issues such as malnutrition and obesity but to no avail. Malnutrition is observed in over half of the total population of children under five years. Hence, the government must ensure the new health policy is effectively implemented in order to improve the country's health sector.

In terms of trade and manufacturing, with the country's ever widening trade deficit, Nepal's remittance fueled economy has become highly vulnerable to policy issues in the Middle East and Malaysia from where the country receives majority of its remittance income. Nepal had been traditionally dependent on the imports of manufactured goods like machinery and electronics but the country is now increasingly importing agricultural products as well. Political instability, lack of proper industrial environment coupled with policy paralysis has greatly marred the growth of the country's export sector wherein the productive capacity has diminished. One measure of reducing Nepal's trade deficit is the development of hydropower sector that will aid in cutting down the import of petroleum products and battery inverters, which are some of the major cash consuming import items. With the availability of energy, domestic industry will also flourish as energy is a vital necessity for industrial production.¹¹⁰

The real estate sector continues to show an upward trend with significant property transactions in the major cities. The revenue collection amounting to NPR 7.81 billion (USD 79.58 million) in the fiscal year FY 2013-14—as compared to NPR 5.2 billion (USD 53 million) in FY 2012-13 and NPR 4.79 billion (USD 48.81 million) in FY 2011-12—is a

sign of revival of the sector. The revenue collection has been largely driven by growing land transactions and easy access to loans from banks and financial institutions. However, transaction of houses and apartments is yet to gain momentum.

Under the aviation sector, the proposed USD 600 million (NPR 58.88 billion) Nijgadh-Bara second international airport has become a dream project. Lack of coordination between the Ministry of Tourism, the National Planning Commission and the Investment Board Nepal has stalled the project. Though the project has been allocated NPR 5 million (USD 51,000) for fencing, it is necessary that stakeholders set prudent deadlines for national priority projects.

In terms of infrastructure, the World Bank supported pre-feasibility study shows the Upper Karnali River is capable of generating 4180 MW hydropower. The report mentions the 4180 MW Karnali Storage project and the 300 MW Upper Karnali Diversion Project to be mutually exclusive. This raises the question as to what impact the 900MW Upper Karnali project will have on the larger project and are we compromising on optimum development for the sake of a quick deal.

The contribution of remittance to Gross Domestic Product (GDP) in FY 2013-14 was 29%. From 2.1% of GDP in 2001, remittance has registered an annual compound growth rate of 35%. The large contribution of remittance to GDP indicates the importance of remittance in supporting macroeconomic stability through Balance of Payments (BOP) surplus. The review of the first three months of the fiscal year

indicates a decline in remittance, accompanied by decline in export-import ratio. The result of this can be seen in BOP which registered a deficit in contrast to a surplus in the previous year. Although the review of performance of three months is not an indicative of a trend, the performance of remittance in the coming period must be closely watched. Continued BOP deficit over successive periods will adversely affect the country's ability to import foreign goods.

Stiff competition persists between Ncell and Nepal Telecom in terms of increasing their subscriber base. However, Smart Telecom's entry into the Kathmandu Valley will further intensify the competition. Telecom operators now must provide attractive schemes and promotions to retain their customers. With increased teledensity, the government must bring in provisions for infrastructure sharing among telecom operators to reduce investments and make services economical.

Nepal's tourism sector is witnessing a surge in investment activity, representing a positive market sentiment and growth outlook. Although the recent accidents in Annapurna and Dhaulagiri mountain regions have been deemed as the worst trekking disasters, the positive trend in international tourist arrival and higher disposable income of the middle class aiding the growth of domestic travelers has been fueling the expectations of the sector. Nepal will be injecting more than NPR 150 billion (USD 1.53 billion) into the development of tourism and airport infrastructure in the next five years. With regional airports and star hotels coming up in the very near future, the prospects for the tourism industry looks very good.



NEPAL
ECONOMIC
FORUM

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

The deposit mobilization of Banks and Financial Institutions at the end of first three months of the current FY 2014-15 depicts a strong deposit growth rate as compared to the same period in the previous fiscal year.

As per the current macroeconomic situation report for the first quarter of FY 2014-15 published by Nepal Rastra Bank (NRB), the deposit mobilization of Banks and Financial Institutions (BFIs) increased by 2.7%, i.e. NPR 38.15 billion (USD 388.73 million), as compared to a 4.2%, i.e. NPR 49.64 billion (USD 505.80 million), during the same period last year. During the review period, deposit mobilization of commercial banks increased by 4.1%, development banks by 5%, and finance companies by 1.1%. The deposit mobilization of commercial banks had increased by 3.9%, development banks by 4.8%, and finance companies by 3.3% in the same period the previous year.

Likewise, loans and advances of BFIs increased by 5.1%—NPR 67.15 billion (USD 684.22 million)—compared to a growth of 2.7%—NPR 31.11 billion (USD 316.99 million)—in the same period the previous year. In the review period, loans and advances of commercial banks increased by 7%, development banks by 4%, and finance com-

panies by 2.7%. In the corresponding period of the previous year, such loans and advances had increased by 7.7%, 5.2% and 0.6% respectively.

In order to control the excess liquidity of the BFIs, NRB injected net liquidity of NPR 72.01 billion (USD 733.74 million) through the net purchase of USD 801.63 million from foreign exchange market (commercial banks), while net liquidity of NPR 88.93 billion (USD 906.15 million) was injected through the net purchase of USD 882.30 million in the corresponding period of the previous year. The NRB purchased Indian currency (INR) equivalent to NPR 83.68 billion (USD 852.65 million) through the sale of USD 860 million in the review period.

CITIZENS BANK INTERNATIONAL TO ACQUIRE PEOPLE'S FINANCE

Citizens Bank International has signed a Memorandum of Understanding with People's Finance Limited to

acquire the troubled finance company. The commercial bank has been focusing on acquisitions to increase its capital base rather than the current trend of mergers being adopted by the banks and financial institutions.

The commercial bank had signed a similar agreement with Nepal Housing and Merchant Finance a few months back. The acquisition of the troubled finance company would benefit both the depositors and the shareholders of the troubled finance company. The bank will be conducting a Due Diligence Audit of the finance company, based on which the swap ratio would be determined. The recent Annual General Meeting of the commercial bank has approved the proposed acquisition of both People's Finance and Nepal Housing and Merchant Finance.¹¹¹

NRB HANDS BACK MANAGEMENT OF H&B DEVELOPMENT BANK

Nepal Rastra Bank (NRB) has handed back the management of H&B Devel-

opment Bank to a new team of promoters. The central bank had taken over the reins of the development bank a few months back following the deterioration of the financial health of the latter due to its good for payment cheques scam worth NPR 801 million (USD 8.16 million).

The central bank had deputed a three member team at H&B Development Bank. Since the bank's position had improved immensely after the takeover, the central bank decided to handover the responsibility to the new set of promoters. The new board directors of the bank are Madhav Prasad Acharya, Sushil Raj Parajuli, Gopal Prasad Bastola, Kedarmann Karmacharya and Mekh Bahadur Gurung. The new team has submitted a plan to NRB, wherein the current board of directors (BoD) will appoint a CEO and handover the responsibility to the BoD that will be elected during the annual general meeting scheduled to be held next year.¹¹²

NEPAL BECOMES AIIB MEMBER

Nepal signed a Memorandum of Understanding (MoU) along with 20 other Asian nations to establish the Asian Infrastructure Investment Bank (AIIB). The AIIB, which is expected to come into operations by 2015, will be an avenue to acquire credit at lower interest rates to finance infrastructure projects. The AIIB will make available financial resources required to develop infrastructure in the Asian region in a hassle-free manner. The authorized capital of the bank is expected to be USD 100 billion, and the initial subscribed capital of around USD 50 billion. The paid-in ratio will be 20%. Although the proposed bank has been considered as a direct competitor to multilateral

BASEL III IMPLEMENTATION POSTPONED

Nepal Rastra Bank (NRB) has decided to postpone the phase-wise implementation of the international regulatory framework aimed at strengthening the shock absorbing capacity of the banks. The central bank had earlier decided to introduce Basel III regulatory frameworks at Class 'A' financial institutions from the beginning of 2015, but is now mulling over launching from mid July 2015.

Basel III frameworks were introduced by the Switzerland-based Basel Committee on Banking Supervision in December 2010 as a measure to improve the shock absorbing capacity of the banking sector, which had been badly hit by the global financial crisis of 2007-2009. Basel III frameworks have focused on enhancing the resilience of banks through improved risk management techniques, such as creation of additional capital buffers and disclosure of off-balance sheet assets, like letters of credit and forward exchange contracts.

The central bank has prepared a timetable for transition from Basel II to Basel III between 2015 and 2019. As per the Basel III accord, banks will have to maintain Tier 1 capital of 6% of risk weighted assets in 2015, which will eventually be raised to 7% by 2019. Tier 1 capital incorporates paid-up capital, retained earnings, irredeemable non-cumulative preference shares and share premium, among others, while risk weighted assets include assets such as government securities, which carry zero per cent risk weight, and investment in private equity, which carry 150% risk weight.

Since NRB has made it mandatory for commercial banks to maintain Tier 1 capital at 6% of risk weighted assets, class 'A' financial institutions, excluding state-owned Rastriya Banijya Bank and Nepal Bank Ltd, will have no problem in meeting this requirement. Similarly, another provision in Basel III is the capital conservation buffer, where the buffer should be maintained at 1% of the risk weighted assets and gradually be raised to 2.5% by 2019. Currently, the commercial banks in Nepal are already maintaining capital conservation buffer of 1% as mandated by Basel III.¹¹³

institutions like the World Bank and the Asian Development Bank, the MoU states the new bank will work as a complementary institution, not competitor to the multilateral institutions. The other countries to sign the MoU

are Bangladesh, Bhutan, China, India, Kazakhstan, Kuwait, Lao People's Democratic Republic, Malaysia, Mongolia, Myanmar, Oman, Pakistan, Qatar, Singapore, Sri Lanka, the Philippines, Uzbekistan and Vietnam.¹¹⁴

TABLE 9: FIRST QUARTER RESULTS OF COMMERCIAL BANKS-UNAUDITED FY 2014-15 (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 13/14	FY 14/15	% Change	FY 13/14	FY 14/15	% Change	FY 13/14	FY 14/15	% Change	FY 13/14	FY 14/15	% Change	FY 13/14	FY 14/15	% Change	FY 13/14	FY 14/15	% Change	
			1 QTR	1 QTR		1 QTR	1 QTR		1 QTR	1 QTR		1 QTR	1 QTR		1 QTR	1 QTR		1 QTR	1 QTR		
Nabil Bank	365.66	586.05	7192.89	8060.82	12.07	4882.04	6179.78	26.58	57.17	78.39	37.12	45.78	50.48	10.27	3.31	2.10	3.82	2.76	-1.06	5.81	
Nepal Investment Bank	476.87	364.80	7114.60	7494.12	5.33	5021.97	5981.81	19.11	58.82	53.87	-8.42	46.26	49.13	6.20	1.70	1.55	4.67	3.69	-0.98	6.49	
Standard Chartered Bank	203.92	224.58	4001.71	5216.11	30.35	2280.20	2955.36	29.61	49.63	48.66	-1.95	33.42	34.97	4.64	0.83	0.25	1.93	2.10	0.17	5.28	
Himalayan Bank	289.80	364.48	5936.14	6891.24	16.09	4172.58	5054.86	21.14	27.16	41.50	52.80	17.35	26.86	54.81	2.65	2.18	5.13	3.63	-1.50	7.33	
Nepal SBI Bank	265.02	232.79	5637.30	5506.66	-2.32	3005.26	3721.11	23.82	32.10	38.82	20.93	22.27	25.62	15.04	0.35	0.23	4.40	3.42	-0.98	8.17	
Nepal Bangladesh Bank	243.13	172.55	2086.77	2696.31	29.21	1360.21	2106.95	54.90	13.06	5.05	-61.33	14.15	4.66	-67.07	1.40	1.94	6.33	4.67	-1.66	8.24	
Everest Bank	213.73	371.08	5869.32	6616.47	12.73	4511.64	5355.31	18.70	55.02	61.19	11.21	35.10	39.11	11.42	0.60	0.63	4.13	3.08	-1.05	6.07	
Bank of Kathmandu	212.02	159.42	2777.52	3437.50	23.76	2406.76	2890.95	20.12	16.71	25.37	51.83	12.22	16.58	35.68	1.43	1.16	5.58	4.10	-1.48	7.09	
NCC Bank	147.00*	128.90	2263.84	2237.57	-1.16	1684.10	1808.91	7.41	33.37	91.88	175.34	3.25	10.27	216.00	2.82	2.70	6.92	5.52	-1.40	8.80	
NIC Asia Bank	265.82	236.90	3785.57	4688.49	23.85	3180.31	3746.47	17.80	22.77	22.07	-3.07	14.49	15.42	6.42	2.90	2.62	6.54	5.03	-1.51	7.35	
Lumbini Bank	200.00	62.73	1201.96	17105.43	41.89	1039.46	1478.33	42.22	2.43	6.14	152.67	2.48	8.06	225.00	1.67	1.04	6.89	5.38	-1.51	8.16	
Machhapuchhre Bank	277.62	64.97	2889.75	3737.12	29.32	2349.26	3044.89	29.61	3.03	19.68	549.50	6.74	19.03	182.34	2.60	2.04	6.77	4.98	-1.79	7.89	
Kumari Bank	243.16	56.77	2589.94	2964.05	14.44	2086.41	2384.61	14.29	6.61	4.24	-35.85	4.64	3.28	-29.31	3.59	4.38	6.55	5.03	-1.52	8.33	
Laxmi Bank	233.79	88.83	2659.34	3148.30	18.39	2246.48	2644.64	17.72	0.79	6.78	758.23	0.51	5.23	925.49	2.04	1.69	6.43	4.83	-1.60	8.07	
Siddhartha Bank	203.11	111.38	2916.95	3647.08	25.03	2348.39	2901.91	23.57	15.75	20.27	28.70	10.56	14.41	36.46	3.06	2.74	5.89	4.68	-1.21	7.85	
Global IME Bank	501.16	157.40	3535.52	5389.47	52.44	2859.59	4553.47	59.24	15.31	33.05	115.87	27.14	22.27	-17.94	2.59	2.88	6.31	4.13	-2.18	7.55	
Citizens Bank International	237.95	48.80	2327.63	2960.90	27.21	1933.53	2497.20	29.15	13.20	16.58	25.61	10.37	11.03	6.36	2.66	2.35	6.44	4.58	-1.86	7.59	
Prime Commercial Bank	263.86	116.62	2625.79	3433.24	30.75	2187.96	2831.78	29.43	9.20	20.62	124.13	12.37	16.16	30.64	2.27	2.62	6.87	4.81	-2.06	7.85	
Sunrise Bank	234.94	81.75	2601.05	2772.44	6.59	2056.97	2152.23	4.63	8.69	14.07	61.91	9.32	9.50	1.93	3.11	4.25	6.47	4.82	-1.65	8.30	
Grand Bank	200.00	-170.42	1985.54	1554.80	-21.69	1571.72	1406.06	-10.54	3.96	-33.64	-949.49	5.74	-28.06	-588.85	2.92	25.49	7.04	7.06	0.02	8.76	
NMB Bank	200.00	120.88	2020.38	2735.06	35.37	1618.73	2111.65	30.45	11.74	19.45	65.67	9.08	14.27	57.16	1.83	0.53	6.10	4.34	-1.76	7.78	
Prabhu Bank	320.88	-41.97	2056.52	3167.64	54.03	1659.72	2397.85	44.47	-8.98	-32.31	-259.80	-2.74	-11.68	-326.28	7.52	15.65	6.41	4.23	-2.18	8.22	
Janata Bank Nepal	206.00	16.85	1359.60	1983.63	45.90	1198.49	1725.15	43.94	-6.03	-2.10	65.17	-5.98	2.13	135.62	1.50	1.08	6.92	5.24	-1.68	8.35	
Mega Bank	233.00	51.30	1392.18	1897.53	36.30	1299.58	1674.18	28.82	15.54	12.69	-18.84	10.18	8.09	-20.53	1.68	2.15	5.69	4.46	-1.23	7.77	
Civil Bank	269.89	51.91	1570.35	2398.54	52.74	1374.81	2050.97	49.18	1.84	-9.60	-621.74	1.24	-9.60	-874.19	1.50	2.22	8.11	5.99	-2.12	8.89	
Century Commercial Bank	200.00	27.36	1292.65	2211.94	71.12	992.28	1898.42	91.32	3.50	5.25	50.00	2.39	3.55	48.54	0.63	0.46	7.10	5.24	-1.86	8.49	
Sanima Bank	255.02	41.40	1810.26	2659.00	46.88	1545.84	2283.39	47.71	13.43	20.32	51.30	8.63	13.09	51.68	0.09	0.05	7.06	5.20	-1.86	7.85	
Public Sector Banks																					
Nepal Bank	646.50	-232.97	6303.47	7082.47	12.36	3712.99	4213.79	13.49	-4.75	4.03	184.84	2.11	2.69	27.49	4.72	4.78	4.39	3.49	-0.90	7.27	
Rastriya Banijya Bank	858.89	-490.93	1278.15	1050.17	-17.84	4865.60	6086.53	25.09	18.43	18.17	-1.41	25.92	67.38	159.95	5.55	3.95	3.11	2.50	-0.61	4.88	
Agriculture Dev. Bank	963.68	631.06	6068.61	6547.71	7.89	5072.48	5812.21	14.58	9.97	13.61	36.51	23.70	21.50	-9.28	5.57	5.62	5.29	4.99	-0.30	9.43	
Total	9285.42	3635.27	97151.30	115891.81	19.29	76525.36	95950.77	25.38	499.47	624.10	24.95	408.69	465.43	13.88	2.50	3.38	5.84	4.47	-1.38	7.66	
*NCCB: The paid up capital of the bank has reached Rs.2.02 billion as at Ashad 32, 2071 after the declaration of Bonus Shares.																					

HIMALAYA FINANCE AND CRYSTAL FINANCE SENT INTO LIQUIDATION

Nepal Rastra Bank has decided to initiate the process of liquidating two crisis-ridden finance companies, Himalaya Finance and Crystal Finance, as both the financial institutions are not in a position to come into operations.

The promoters of both the finance companies have been found of embezzling funds from their respective companies. Himalaya Finance has a huge loan exposure into

the real estate sector as well as huge amount of deposits to be returned to the depositors, while Crystal Finance does not have much liability towards its depositors. Since Crystal Finance has insured individual deposits up to NPR 200,000 with the Deposit and Credit Guarantee Corporation, the depositors are likely to get back their deposits.

The central bank will be applying to the Patan Appellate Court for the liquidation. The central bank had declared Himalaya Finance crisis ridden in January 2013 and Crystal Finance in September 2012.¹¹⁵

OUTLOOK

As of the first quarter of current FY 2014-15, the banking system witnessed a growth in its profits as the banks' net interest income and profits both exceeded the earnings as compared to the same quarter of the previous year. The aggregated net profit of commercial banks rose to NPR 4.65 billion (USD 47.38 million) from NPR 4.08 billion (USD 41.57 million), as compared to the same quarter in the previous year.

The weighted average 91 day Treasury bill rate increased to 0.93% from 0.07% a year ago. The weighted average inter-bank transaction rate among commercial banks remained at 1.03% during the first quarter of this FY from 0.25% a year ago. The average cost of funds of commercial banks has dropped to 4.47% from 5.84% at the end of first quarter of current fiscal year.

REVIEW

Capital Markets

Following the positive increase in the previous quarter, the NEPSE index saw a dip back to 862.5 points from its six year high of 1083 points achieved in the last quarter.

**SECONDARY MARKET
PERFORMANCE**

The Nepal Stock Exchange (NEPSE) index plunged from its 1000 mark index during the review month, witnessing a down trend to close at 862.5 points on November 20, 2014. The index had reached 1083.55 points on July 21, 2014, the highest since August 2008.

During the review period (August 18 to November 20, 2014), the NEPSE index (-14.88%) plunged from its rally witnessed earlier to close at 862.5 points. The review period witnessed a slump and huge fluctuations in the NEPSE index due to panic in the market as investors feared the new central bank directive would prompt banks and financial institutions (BFIs)

to offload their stocks. The Nepal Rastra Bank (NRB) had asked BFIs to bring down their share investment to 1% of their core capital by Mid-July 2015. Later, the NRB issued a clarification that its 1% limit for BFIs to make investment was only for the 'held-for-trading' while 30% total investment has remained intact.

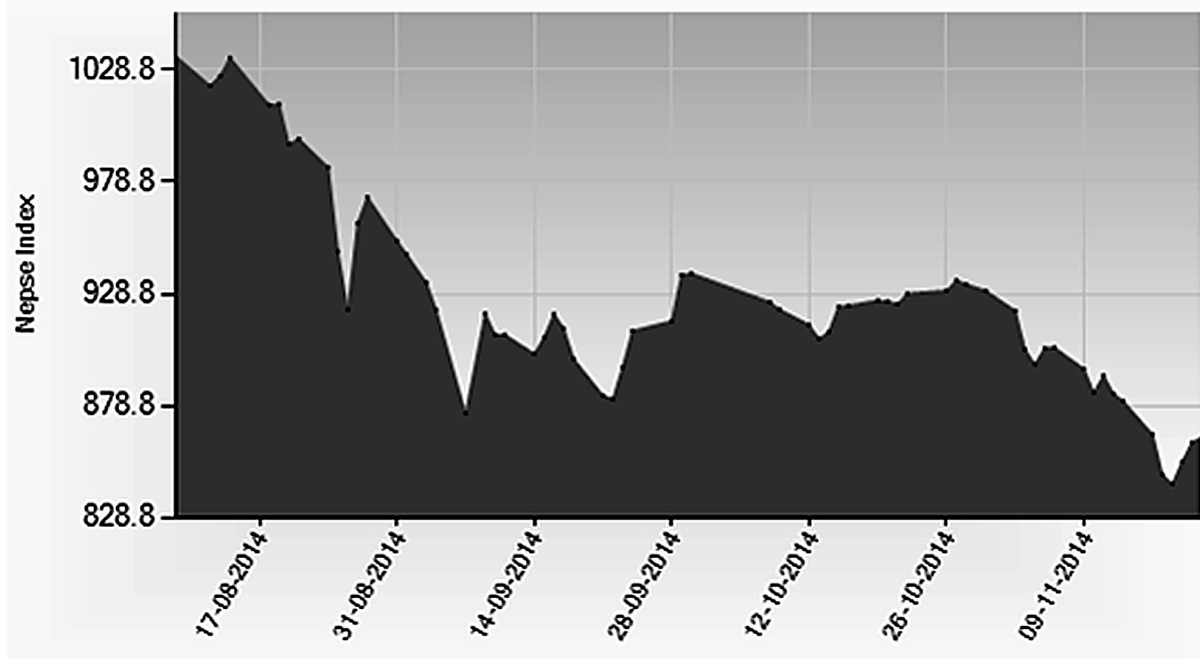
As shown in *Table 8*, during the review period, all the sub-indices closed in the red zone. The Hydropower index (-23.92%) was the biggest loser among all the sub-indices with a staggering loss of 661.6 points. The Commercial Bank sub-index (-18.56%) also could not withstand to its earlier gain as the index lost 169.85 sub points. Likewise, the Insurance sub-index (-11.41%) failed to impress the investors' confidence and lost a whopping 488.6 points.

Table 8: Sector wise Performance of the sub-indices

Indicators	18 Aug, 14	20 Nov, 14	% Change
NEPSE Index	1013.25	862.5	-14.88%
Commercial Bank Index	915.32	745.47	-18.56%
Development Bank Index	730.81	656.84	-10.12%
Hydropower Index	2765.4	2103.8	-23.92%
Finance Index	520.34	478.18	-8.10%
Insurance Index	4281.72	3793.12	-11.41%
Others Index	753.07	704.91	-6.40%
Hotels Index	1917.62	1884.87	-1.71%
Manufacturing & Processing	1190.62	1233.59	3.61%

Source: NEPSE

Figure 9: NEPSE Index performance



The Development Bank sub-index (-10.12%) also followed suit in the downtrend of the market as it lost 73.97 points to close at 656.84 points during the reviewed period. The Finance sub-index (-8.10%) too was in a losing streak as it lost 42.16 points. The 'Others' sub-index (-6.40%) continued to lose points as the index closed 48.16 points lower than the last month's index of 753.07 points. The share prices of the Hotels sub-index (-1.71%) also could not sustain and lost points during the reviewed period. However, the Manufacturing & Processing sub-indices (+3.61%) was the only sub index to close positively with a gain of 42.97 points.

KEY DEVELOPMENTS

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

SEBON AMEND SECURITIES REGULATION

Securities Board of Nepal (SEBON), the market regulator, has amended the Securities Registration and Issue Regulation to pave way for international financial institutions to float local currency bonds in Nepal. Once the amendments to the regulation are approved by the Ministry of Finance, international financial institutions like the Asian Development Bank (ADB) and the International Finance Corporation (IFC) of the World Bank Group will be able to issue securities and list them on the domestic stock market. Since the current regulation did not have a provision on local currency bonds issuance by international institutions, SEBON was asked to amend the regulation after the government permitted ADB and IFC to issue such bonds.

The amended regulation will make it

mandatory for the issuer of securities to take necessary permission from the government prior to floating the bonds on the market. It also makes it mandatory for the bond issuer to prepare prospectus mentioning the yield on bonds, maturity period, areas of investment and other related information.¹¹⁶

NEPSE SELECTS THREE FOREIGN FIRMS FOR ONLINE TRADING PLATFORM

The Nepal Stock Exchange (NEPSE) has shortlisted three foreign firms among 10 companies to implement the online trading system and recommend NEPSE on the business requirement specifications. The selected firms are South Korea's Korea Exchange, Japan's Daiwa Institute of Research and Hong Kong's The International Securities Consulting. NEPSE had called for an Expression of Interest (EoI) on April 3 for foreign companies for the second time, after

its first EoI called on February failed to attract competitive domestic companies.

The companies selected were based on their annual turnover, number of employees, goodwill in countries of operation, and their working status in various under developed countries. Once the company is selected, the selected consultant will advise NEPSE to either upgrade or replace the existing software.¹¹⁷

NIBL SAMRIDDI FUND-I IN THE OFFING

Nepal Investment Bank's subsidiary NIBL Capital is all set to debut their much awaited mutual fund scheme 'NIBL Samriddhi Fund-I'. 'NIBL Samriddhi Fund-I' is a closed ended fund with an initial corpus of NPR 800 million (USD 8.15 million) which may exceed up to NPR 1 billion (USD 10.18 million). The scheme has received

Fund Management Quality Rating of AMC Quality 3 from ICRA Nepal. As per NIBL Capital, a total of 15% of the total scheme will be allocated to the staffs of Nepal Investment Bank and NIBL Capital and the remaining 85% will be offered to the general public.¹¹⁸

NEPSE COMMENCES PAPERLESS TRADING

The Nepal Stock Exchange (NEPSE) formally conducted the trading of the dematerialized shares of commercial banks. With the introduction of paperless trading, CDS and Clearing Ltd. has allowed investors to own paperless certificates of banking groups in the first phase. Currently, both paperless and physical form of share certificates can be traded through the system, while the purchasers will receive the ownership certificates in an electronic format. Similarly, CDSCL

has come up with a guideline for the settlement of physical shares currently in possession of the investors. As per the guideline, the payment should be settled within T+3 (within 3 days of the trading). The Depository Participant (DP) needs to submit the ownership transfer and demat request forms within T+7 days at the CDSC.

Following the submission, the CDSC will make buyers receive the paperless form within T+9 days. The DP will be providing a 'Beneficiary owned Identification Number' to the owners of the paperless stocks. Similarly, investors can place orders using 'delivery instruction slip' through the DP or the clearing members (stocks brokers) at the time of selling. Likewise, both the DPs and clearing members will directly be linked to CDS through a software which will help settle the stock transaction instantly.¹¹⁹

OUTLOOK

The NEPSE index witnessed a series of downward spirals along with heavy fluctuations in the market. The benchmark index lost a staggering 150 points as consensus on constitution writing eludes political parties. The widening rift in the Constituent Assembly (CA) has weakened the confidence of investors, and the fall in the benchmark index is a reflection of the political polarization in the CA. Investors are also

facing problems in availing loans by pledging their dematerialized shares as collateral due to legal ambiguity which has affected the stock market as a whole.

Moreover, although the market is approaching an over sell situation with the recent fall in the political situation, the market may be sluggish until some positive developments occur in the political front.

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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 re-defining the economic development discourse in Nepal.

Established as a not-for-profit organization under the beed (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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