



NEPAL
ECONOMIC
FORUM

nefport

Docking Nepal's Economic Analysis

JANUARY 2013 | ISSUE 11

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EDITORIAL

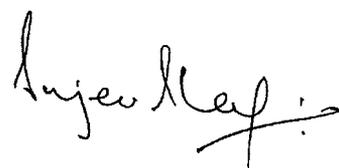
With our eleventh issue of nefport, we bring to you an overview of the past four months of the Nepali economy, covering events from August 15, 2012 to December 15, 2012. This issue builds upon the general structure established in previous issues and is divided into two sections. The fifth issue of nefsearch, which covers Foreign Direct Investment in Nepal, accompanies this issue. The first section provides a general overview of the overall macroeconomic state of Nepal's economy. It goes into some depth within each sector and provides an overview of key stories that have developed over the last quarter. It also provides an outlook for the next quarter of the Nepali economy.

Like 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 the Nepal Stock Exchange. We hope that this analysis will be of interest for those invested in the general economic well being of the country.

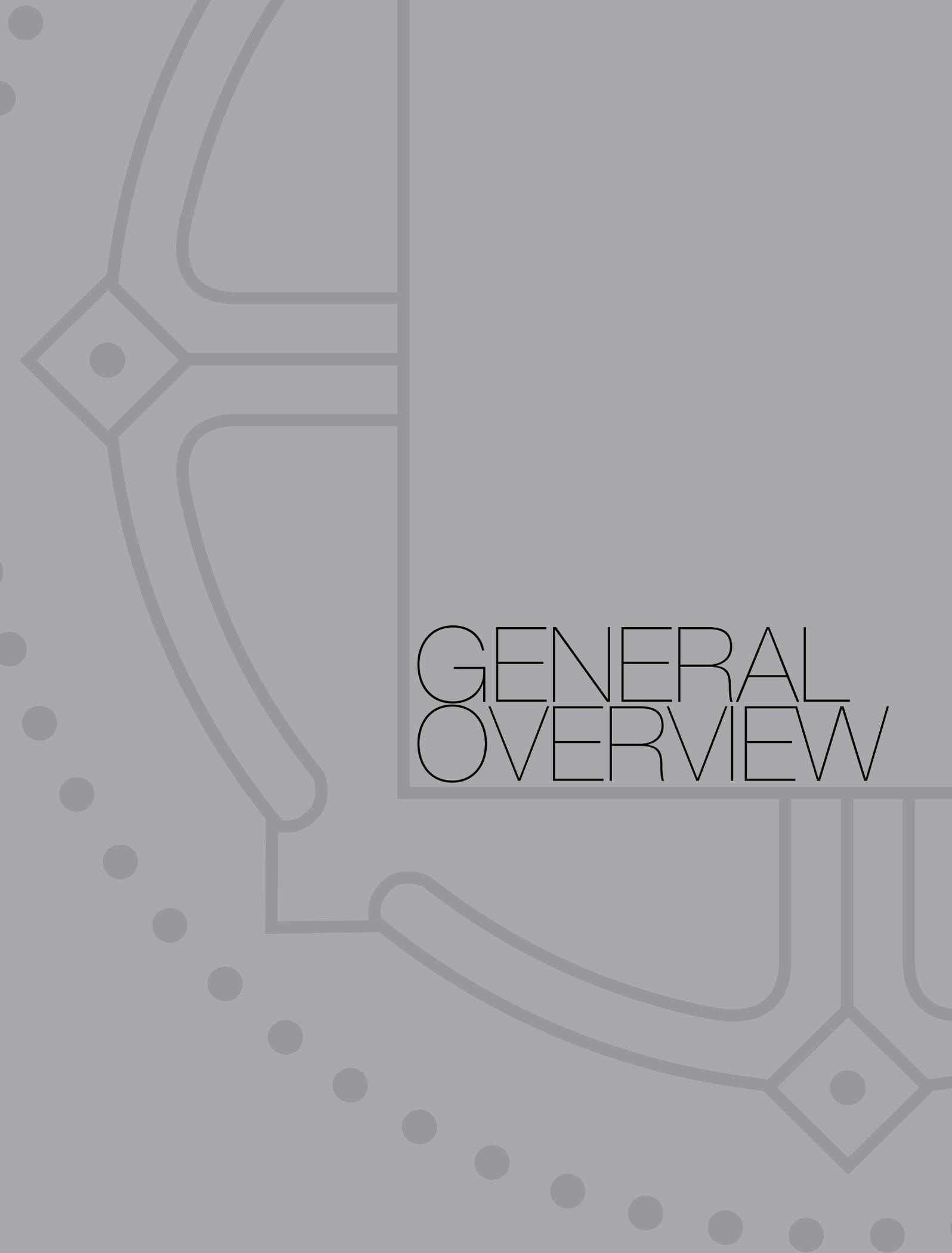
While the US dollar has appreciated in value considerably during the course of the last quarter, we have used a USD conversion rate of NPR 86 to a dollar, the quarterly average to the dollar amount.

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 would also like to thank all our readers for their invaluable feedback. Your input helps us develop this publication and better cater to your needs. We appreciate your encouragement.

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
Chairman
Nepal Economic Forum

The background features a light gray abstract design. On the left, there are several overlapping semi-circular and circular shapes, some containing smaller circles. A vertical line runs down the left side of the page. On the right, there are vertical lines and a diamond shape at the bottom. The text 'GENERAL OVERVIEW' is centered in the middle-right area.

GENERAL OVERVIEW

POLITICAL OVERVIEW

Political instability continues to remain a major impediment to growth in Nepal, increasing risks and decreasing incentives for investment in the country and further slowing down long-term growth prospects for the Nepali economy. The fresh round of elections for a new Constituent Assembly, which was to be held on November 22, 2012, has been delayed and postponed to April-May 2013. Absence of a workable constitution due to which there are no legal provisions for holding polls is being cited as the main reason behind this delay, therefore highlighting the need to build on legal infrastructures to hold elections.

HIGHLIGHTS

CPN Maoist to hold General Convention:

A CPN Maoist General Convention has been scheduled from 9-13 January 2013. This is the first convention after the split in the party. The convention will be expected to have over 100 representatives from India, Europe, America and other parts of Asia.¹

Resignation by Supreme Court Judge:

Supreme Court Judge, Justice Bharat Upreti, resigned two weeks prior to the end of his four-year term on November 29, 2012, citing an interest to work in the private sector. The apex court currently has only six temporary Justices, which affects speedy administration of justice. A parliamentary hearing is required for appointment of Supreme Court judges. However, a petition is under judicial consideration in the Supreme Court for retaining the justices who have undergone parliamentary hearing once, since there is

currently no Parliament in the country.² As the decision to appoint justices to the Apex Court is currently split, it is expected that at least five ad hoc judges will retire at the end of their terms.³

Budget through ordinance (again- so check for this quarter):

President Dr. Ram Baran Yadav has approved the budget through an ordinance forwarded by the Maoist-led caretaker government, authorizing the use of cash from the consolidated fund and appropriating it for services and works to be carried out in FY 2012/13.⁴ The certification of the ordinance has been made as per Article 88 (1) of the Interim Constitution of Nepal 2063 (2006), to give continuity to day-to-day administration, development work for the year and meet the expenditures of the government for the remaining eight months. The budget through ordinance, amounting

to USD 3.5 billion (NPR 300 billion) is based on the previous year's expenditure allocation, and includes allocations for elections, army integration, national development, formation of a general directorate of security, peace and security and daily administration.⁵

“ OUTLOOK

The political quagmire will persist as holding of elections in April/ May looks more and more difficult. Political parties will continue to find coming to a consensus elusive. The political uncertainty will prolong the appointment of officials at key positions in the government. The uncertainty will prove to be a hurdle in obtaining approvals on controversial decisions by the government such that the government may face financial implications.

INTERNATIONAL ECONOMY

There are positive signs for the global economy in 2013. Although United States and Japan, key drivers of the economy, face major challenges, there are significant developments in emerging markets. From Asia to Latin America to the Middle East and Sub-Saharan African, the emerging markets are creating new frontiers of growth.

HIGHLIGHTS

British banks fined by US regulators:

Following Barclays Bank, which was fined in June 2012 for manipulating London interbank offered rate (Libor), Standard Chartered Bank has been fined USD 667 million (NPR 58 billion)⁶ for helping Iranian customers evade U.S. sanctions, and HSBC has been fined a record-breaking USD 1.9 billion (NPR 165.3 billion) for breaking U.S. anti money-laundering rules. The Royal Bank of Scotland is also settling allegations for attempting to manipulate the Libor. It is expected that fines for Libor-rigging and compensation for customers 'mis-selling' (deliberate sale of products or services in circumstances where the contract is either misrepresented, or the product/service is unsuitable for the customer's needs) in the form of Payment Protection Insurance alone could cost the U.K. banking industry USD 32.2 billion.

India to liberalize FDI in multi-brand retail: With India now having opened

its doors to foreign investment in a broad range of sectors including multi-brand retail, which could allow foreign supermarkets such as Walmart into the country, the country seems to be taking slow but determined steps towards reviving its slowing economy.⁷

US Federal Reserve to keep key short-term rate near zero until the unemployment rate, which is currently at 7.7%,⁸ is at 6.5% or lower. The short-term rate is also said to stay unchanged at 0.25 until the current 2.2% inflation pace hits 2.5%. The Federal Reserve's current attempts to control unemployment and inflation targets are unprecedented and seek to facilitate economic growth and lower long-term borrowing costs.

China forms new Central Committee:

On November 14, 2012, with the conclusion of the 18th National Congress of the Communist Party of China, China elected its new Central Committee and a new Central Commission

for Discipline Inspection for the next five years.⁹ The Central Committee then elected the Politburo Standing Committee (China's leading cadres), which has been brought down to seven from the earlier nine members.

OUTLOOK

The American and European economies are still facing problems. The American economy is moving towards recovery, through promising developments such as recovery of the housing market, but is faced with the problem of drafting an effective budget. The European economies are still on the fence about where the European Monetary Union is headed. Similarly, BRIC (Brazil, Russia, India and China) countries are faced with the challenges of spurring growth as their economies are slowing down. The ripple effects of uncertainty will be faced by Nepal as exports and remittances are affected by a shaky global outlook.

macroECONOMIC

OVERVIEW

The Nepali economy has shown encouraging growth rates in the last few years. The economy is growing steadily in the past 2 years and has recorded a year on year growth of 4.56 % in FY 2011/12. Increased agricultural production accompanied by growth in service sector is the major reasons behind the increase in growth rates. Although Nepal has been facing Balance of Payment problems because of high imports and relatively lower exports, significant contribution of remittances, which stands at almost 23% of GDP, Nepal has recorded the highest ever Balance of Payment surplus of USD 1.46 billion (NPR 127.70 billion) in FY 2011/12.

AGRICULTURE

Since 2011, The Ministry of Agriculture and Commerce (MOAC) has been working on the Agriculture Development Strategy (ADS) - a 20-year vision document for the agriculture sector. The draft strategy, which seeks to encourage commercialization of agriculture and increase agricultural productivity, has been vehemently opposed by farmers' groups. The ASD team has sought recommendations from stakeholders, including the government and farmers' rights groups, the deadline for which expired on November 15.

Agriculture Development Strategy (ADS) envisages 5% growth

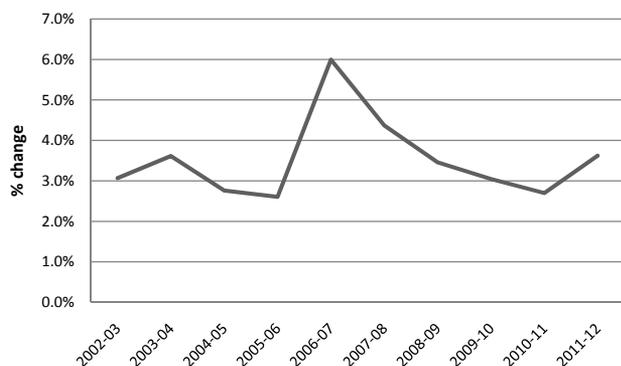
The proposed Agriculture Development Strategy recommends intensifying commercialization and increasing arable land so as to ensure farm production is increased and the agriculture sector grows at 5% by 2035.¹⁰

The government, with technical assistance from development partners - Asian Development Bank (ADB), World Bank, and United State Agency for International Development (USAID) International Fund for Agricultural Development (IFAD), European Union, Food and Agriculture Organization (FAO), Swiss Agency for Development and Cooperation (SDC), Japan International Cooperation Agency (JICA) Denmark Agency for International Development (DANIDA) - has formed a technical team comprising officials of the Ministry of Agriculture Development (MoAD) and Ministry of Finance (MoF), experts and stakeholders to prepare the draft ADS.¹¹ The draft ADS has identified frequent changes in government policies and leaderships and weak implementation as the major impediments to agriculture development.

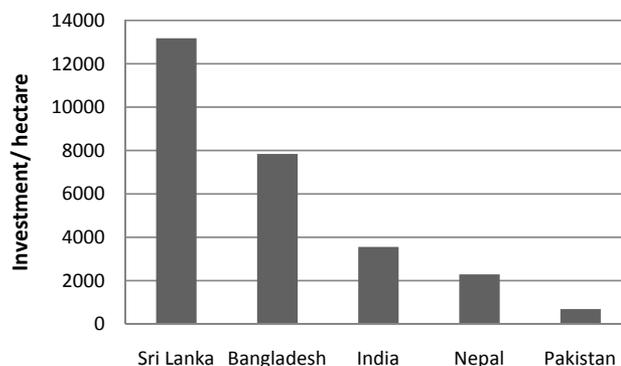
The National Farmers' Coalition has recommended that smallholder agriculture, revolutionary land reform and higher productivity through commercialization should also be included in the ADS.¹²

FAO predicts decline in Paddy production in 2012

According to the Rice Market Monitor Report, 2012, published by Food and Agriculture Organization (FAO), Nepal is likely to witness a decrease in paddy production by 5.3%,¹³ from 5.1 million tons in 2011 to 4.8 million tons. Shortage of fertilizers and inadequate rain fall are believed to be the major causes behind the projected decline. As a result of the expected production shortfall, Nepal is likely to import 200,000 tons of rice in 2013. The report predicted that along with Nepal, Cambodia, North Korea and Turkey's paddy production will also see a decline in 2012.

Figure 1: Agriculture Lending by Commercial Banks

Source: Ministry of Finance, Economic Survey (FY2011-12) and Nepal Rastra Bank, Banking & Financial Statistics Monthly (mid July 2012)

Figure 2: Investment in Agriculture in South Asia

Coffee production increases by 4.2%

In FY 2011-12, coffee production increased to 418 tons¹⁴ and was worth NPR 138 million (USD 1.6 million). Of the 418 tons, 215 tons of coffee worth NPR 43 million (USD 0.5 million) was exported. According to Nepal Tea and Coffee Development Board (NTCDB), coffee production is expected to reach 1000 tons by 2017¹⁵. Nepal's major coffee exporting countries are Japan, South Korea, US, Germany, UK and Australia.

This increase can be attributed to the expansion of the coffee plantation area. Coffee is currently planted on 1760 hectares of land in 40 districts in Nepal and commercial farming is conducted in 22 districts. Over 27,000 farmers are engaged in coffee production. The major coffee producing districts are Lalitpur, Kavrepalanchok, Sindhu-palchok, Arghakhachi, Kaski, Syangja, Palpa, Ramechhap and Gulmi. Lately, Baglung, Ilam, Parvat, Gorkha, Lamjung, Tanahu, Rasuwa, Nuwakot and Okhaldhunga have also been successfully producing coffee.

Despite the rise in coffee production, farmers are earning only around USD 59 (NPR 5100)¹⁵ annually through

coffee farming since it is a relatively new crop in Nepal and there is little commercialization.¹⁶

Agriculture lending increases by 64.9%

Commercial banks have responded well to Nepal Rastra Bank's directive to increase their lending to the agriculture and energy sector to 10% of their total lending by mid-2014. Agriculture lending has increased from NPR 14 billion (USD 162 million) in FY2010-11 to NPR 23.4 billion (USD 272 million), in FY2011-12. The major areas in agriculture that received credit were farming services, tea, animal farming, forestry and fishery.

Various commercial banks are adopting new ways to lend to the agriculture sector. Everest Bank, whose current lending to the agriculture sector stands at 3.2%, has even opened a separate branch to concentrate on such lending. The recently introduced branch - Krishi Udhyan Bikas Sakha (Agriculture Sector Development Branch) in Rajbiraj – is a separate branch that concentrates on agriculture lending. Himalayan Bank, whose agro lending amounts to 4% of its total lending, is seeking help from International Finance Corporation to

guarantee 50 percent of total lending, which will double their lending capacity by improving our capital adequacy ratio. Nepal Rastra Bank has placed agro loans in the 100 percent risk weight category. Kist Bank, whose agriculture lending portfolio accounts for 5% of its total lending, is a front runner in extending agro lending and is more inclined towards micro agro projects operated by women.

The farming sector received the highest percentage of commercial bank loans in FY1992-93. According to the graph below, the percentage of commercial bank portfolio dedicated to the agriculture sector spiked in 2006-07 but has been decreasing since FY2007-08. It is encouraging to see that following the NRB directive, the lending in the agriculture sector is increasing. It stood at 3.6% in FY2011-12 as opposed to 2.7% in FY2010-11.

Government to provide up to 50% subsidy on seed

As per the government's policy to subsidize the purchase of high-yield, the Ministry of Agriculture Development assists farmers who purchase certain given seeds¹⁷. Farmers will get subsidy ranging from 25% to 50% on the purchase of seeds of rice, wheat, maize,

millet, pea, mustard, lentil, pigeon pea, gram and moong. The ministry has made it clear that priority will be given to the purchase of domestic rather than imported seeds. The total subsidy will amount to NPR 80 million (USD 0.9 million) and is expected to increase agriculture productivity by 40%.

Nepal ranks second lowest in investment in agriculture in South Asia

Nepal has 4.21 million hectares of arable land and saw an investment of about NPR 9.34 billion (USD 108 million), in FY 2010-11.¹⁸ Nepal's agriculture budget was about 3.22% of the national budget of FY 2011-12 and Prime Minister Baburam Bhattarai is committed to increase the budget to 5% of the national budget in the next year. Low investment in agriculture has dampened the productivity of agriculture in Nepal. The graph below compares Nepal's investment in agriculture to other countries in South Asia.

Sri Lanka ranks the highest, with NPR 35 billion for 2.64 million hectares of land and Pakistan ranks the lowest in terms of investment in agriculture in South Asia.

EDUCATION

Increased awareness about the importance of education has improved access to public educational services across the country. This has also led to a series of changes in the educational sector, from closure of publicly run institutions in Kathmandu with sub-standard education to the launch of the Literate Nepal Mission and the ban on advertisements in the academic sector as well as use of English names.

Incentive for school enrolment

An incentive of USD 2.3 (NPR 200) is being provided to parents who send their children to school in the Gitanagar VDC of Chitwan district as of 24 November 2012. This initiative has been undertaken by the Village Education Committee (VEC) of the VDC and is aimed towards attracting children between the age groups of 5-12 who do not attend school. Local representatives and the VEC are also working towards implementing the government's 'Free and Compulsory Basic Education Programme', which aims to bring all children across the country to school by 2015. The Programme has been launched in 12 VDCs and one municipality in the district.¹⁹

1600 Dalit kids out of school in Baglung

Despite the Government of Nepal's ambitious goals of eradicating illiteracy within the next three years through its Education For All (EFA) campaign, surveys conducted by Dalit Class Uplift Coordination Committee (DCUCC), Baglung, indicate that as many as 1600 Dalit children aged 6-17 are currently out of school in the district. According to the District Education Office (DEO), a total of 7000 students within the district do not have access to education, of which 23.42% are said to comprise of Dalits, most of whom are suffering from abject poverty. The DCUCC is working towards providing access to education to these children; however, lack of awareness among families and their poor economic condition has resulted in children dropping out of school to earn a living.²⁰

Standardized size of classrooms and school buildings

The Department of Education (DEO), in a bid to improve education con-

ditions, has proposed the Institutional School Standard and Management Directives, 2012, which will determine the standard size of institutional school buildings and classrooms. According to the directives, new schools need to have two doors (3.6ft in width) and 3X4 ft windows for adequate ventilation and light. Similarly, classroom sizes should be one square feet per student at the basic level and 1.2 square feet per student at the secondary level, with the total number of students in each classroom not exceeding 33. The classroom height needs to be eight feet in Hilly and Mountainous regions, nine feet in Kathmandu Valley and ten feet in Terai. There should be separate rooms for principals, teaching staff, administration, the account section, library, to conduct practical trainings. In addition, the blueprint of school buildings needs to be passed by the Department of Urban Development and Building Construction to ensure safety and earthquake resistance.²¹

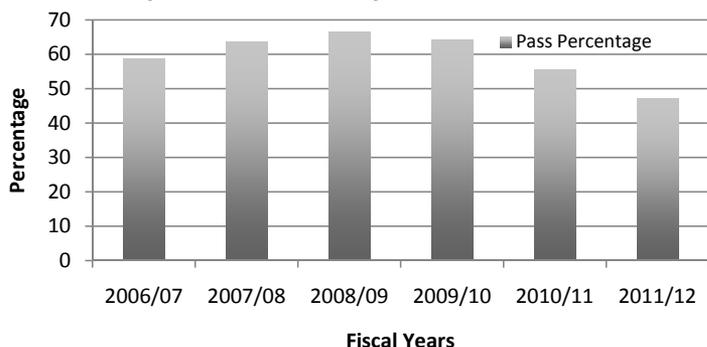
School pass mark goes up to 40

The Curriculum Development and Evaluation Council (CDEC) has increased the pass mark from 33 to 40 for students at the basic (Grade I to VIII) and secondary (Grade IX to XII) level schools. According to the CDEC, the pass mark has been increased to improve the standard of education, with the new provision to be implemented from the next academic session. The move is expected to improve student as well as teacher performance. Other changes that are scheduled to follow are the increase in percentage from 45 to 50 as criteria to achieve second division.²²

33 Public schools shut down in Kathmandu Valley

Thirty three public schools in

Figure 3: Pass Percentage of Students in Consecutive Years



Source: Ministry of Education

limits on the weight of school bags, provision for toilets, open land for school assembly and playground, etc. The MoE has also announced a no advertisements policy for the education sector. This move is aimed at controlling commercialization and commoditization of the academic sector.²⁷

Schools banned from using western names

After a series of student protests over use of western names for schools and colleges, the Department of Education (DoE), in its Private and Boarding Schools Guideline 2012, has proposed replacing western names of secondary schools with Nepali names within the next six months. There are currently over 250 higher secondary schools with foreign names in the Kathmandu Valley alone, although Education Regulations (Rule 154 of the Education Rules 2059) clearly state that name of academic institutions should reflect national identity, such as national and religious figures

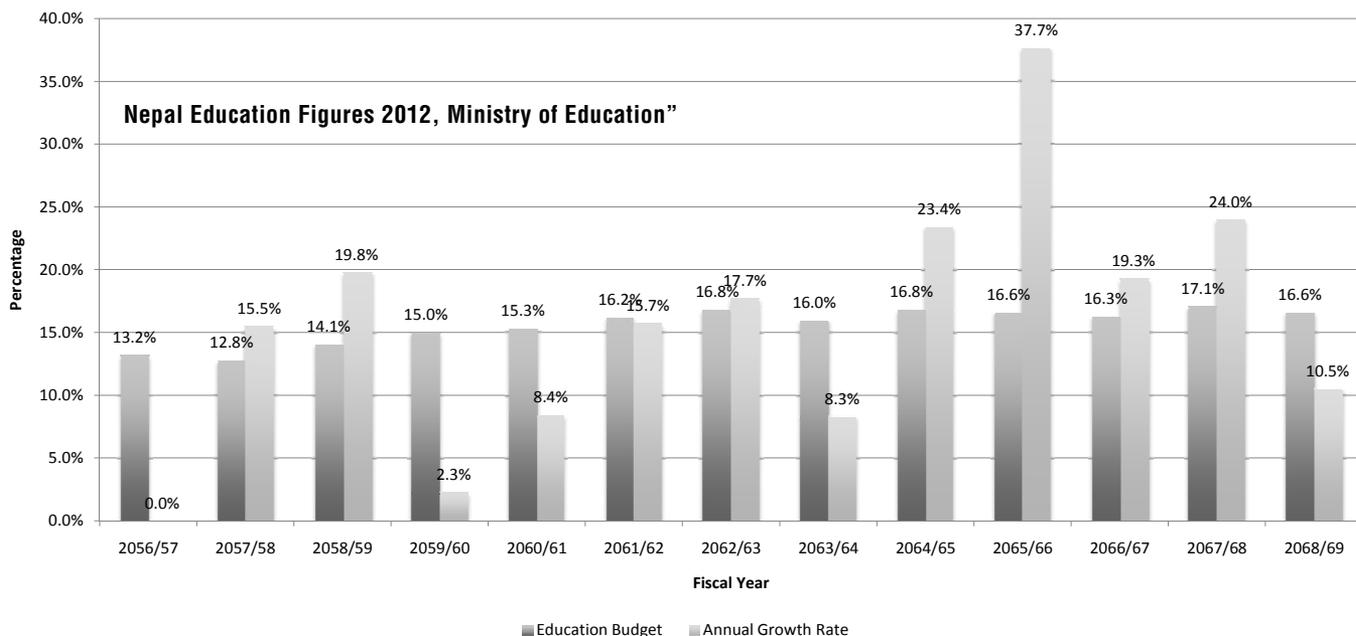
Kathmandu Valley - 10 in Kathmandu, 14 in Bhaktapur and nine in Lalitpur-have closed down over the past two years after the student-teacher ratio dropped below 1:1. In addition, enrollment rates continue to decrease, which means many more public schools might have to close down. One of the main reasons behind this is said to be the sub-standard quality of education provided by public schools in comparison to the more standardized

quality of education in private schools. Quality of education in public schools, therefore, needs to be standardized to deal with the increasing closures of public schools.²⁶

New guidelines for the education sector

The Ministry of Education (MoE) has unveiled the Private and Boarding Schools Guideline, 2012, which includes fixed fees for private schools,

Figure 4: Budget Vs Growth in Consecutive Years



Source: Ministry of Education

LITERATE NEPAL MISSION

The Non Formal Education Centre (NFEC) recently launched the 'Literate Nepal Mission' (LNM) with the objective of dropping illiteracy rates of the country to zero within 2015. The government's previous National Literacy Campaign in 2008 was able to literate only 3.8 million out of a population of 7.8 million, i.e. 51%, by 2010. Subsequent literacy campaigns have also been unable to completely eradicate illiteracy. The National Living Standard Survey, 2010-11, shows that the adult literacy rate, for ages 15 years and above, stands at 57% of the entire population.

The Literate Nepali Mission will, therefore, attempt to cover this gap by completely eradicating illiteracy by 2015. A National Literacy Fund is to be established to manage literacy certification to allow individuals to be eligible for employment.²³ A total of USD 46.5 million (NPR 4 billion) has been

allocated to the campaign, which aims at setting up 36,000 centers to conduct literacy classes. The progress of the campaign will be monitored by the Ministry of Local Development (MoFALD) and the Ministry of Education (MoE).²⁴

In order to qualify to be a part of public agencies like school management committees and consumer organizations, the government is making it mandatory for people to be literate. This is being done to ensure the success of the campaign. Similarly, the MoE has included students in the campaign whereby each student will be given the task of teaching one illiterate person as part of their practical classes. The criteria for someone to be deemed illiterate has also been revised by the MoE and according to the new criteria, a person will be considered literate if he/she has basic knowledge of operating a mobile phone and a calculator, is able to count up to 100, can express personal views in public and fill up bank vouchers and cheques.²⁵

and natural resources. However, the DoE, District Education Offices (DEO) and the Higher Secondary Education Board (HSEB) have been granting affiliations to academic institutions with western names despite these regulations. According to the guidelines, only institutions that are registered and receive support from trusts can be named after saints, litterateurs, scientists and educationists. Similarly, the term international cannot be used in school names, unless they fulfill certain criteria such as having an ISO certification, or at least one percent of foreign students. However these guidelines have constantly been disregarded.²⁸

ENERGY

Nepal Oil Corporation (NOC), the state owned oil monopoly, yet again increased the prices of petroleum products in September. As per the revised prices, petrol costs NPR 125 (USD 1.45) per liter, diesel and kerosene cost NPR 97 (USD 1.13) per liter and liquefied petroleum gas (LPG) costs NPR 1475 (USD 17.15)

per cylinder. The hike in price for the aforementioned products was NPR 5 (USD 0.06), NPR 4 (USD 0.05), and NPR 55 (USD 0.64) respectively.²⁹ The price hike reduced the losses for NOC for the month of September from the predicted NPR 1.17 billion (USD 13.6 million) to NPR 732.9 million (USD 13.6 million). For the month of November, losses are further expected to go down to NPR 204 million (USD 2.3 million). This reduction in losses is a result of decrease in crude oil prices

by almost USD 7 (NPR 602) per barrel, thereby reducing losses on diesel and increasing profits on petrol.³⁰ Based on the latest rates, the following table provides a summary of per unit profit or loss made by the petroleum products.

With the winter season on, electricity shortage is on the rise, leading to longer load shedding hours. Investments in hydropower project are being made; however, there will be a gestation period

Table 1: Per unit Profit and Loss of Petroleum Products

Item	Unit	Price (In USD)	Profit/(Loss) (In NPR)	Profit/(Loss) (In USD)	Unit
Petrol	125	1.45	13.69	0.16	per liter
Diesel	97	1.13	(1.91)	(0.02)	per liter
Kerosene	97	1.13	10.77	0.13	per liter
Aviation Turbine Fuel(Duty Paid)	120	1.39	23.91	0.28	per liter
Aviation Turbine Fuel(Bonded)	125	1.45	26.15	0.30	per liter
LP Gas	1475	17.15	(508.93)	(5.9)	per cylinder
Estimated Total loss of this month November 2012			(204.2 million)	(2.37 million)	

Source: www.nepaloil.com.np

for these projects to be operational, and until then there is no certainty about adequate availability of electricity.

LPG subsidy guidelines soon

After various failed attempts at bringing the dual pricing system for LPG, NOC is now working on finalizing the guidelines on Distribution of Subsidy on Liquefied Petroleum Gas so that the dual pricing system for LPG can be enforced as soon as possible.³¹ Upon completion, the guidelines will be forwarded to the Ministry of Commerce and Supplies for review. Sources at the NOC stated that the subsidy will be limited to household consumers and the quantity of subsidy to a cylinder (14.2 kg) per month will also be limited. Given that 40% of LPG import is consumed by commercial users, the dual pricing system will cut losses of NOC to the amount of NPR 366 million (USD 4.25 million) per month. Current losses per month through sale of LPG amount to NPR 610.7 million (USD 7.1 million). The guidelines also proposed differentiation of cylinders to be sold to consumers and commercial users; red colored cylinders to be distributed to consumers and blue ones to commercial users. LPG bottlers continue to protest against such a move, claiming that the coloring process will cost NPR 500 million (USD 5.8 million). Their protests have only led to delay in implementation since August, 2012.

Kathmandu's consumption nearly one third

As per the survey report - 'The Share of Kathmandu Valley in the National Economy' - published by Nepal Rastra Bank, Kathmandu consumes 30.7% of the total petroleum products and 29.2% of the total electricity consumed in Nepal. The use of LPG topped the

Table 2: Share of Kathmandu Valley Consumption of Electricity and Petroleum Products for FY 2010-11 (Amount in Millions)

Particulars	Consumption Amount (In NPR)	Consumption Amount (In USD)	As a % of National Total
Consumption of Electricity	5,261.6	61.2	29.20%
Consumption of Petroleum Products	24,075.7	314.8	30.7%
LPG	8,412.7	97.8	60.0%
Petrol	7,510.6	87.3	45.5%
Diesel	6,888.2	80.1	15.5%
Kerosene	1,264.2	14.7	37.6%

Source: Survey Report on 'The Share of Kathmandu in the National Economy', Nepal Rastra Bank, Research Department, Economic Development Division

list of consumption with a percentage share of 60%, the reason being the practice of using LPG for cooking in most houses. The reason behind a 45.5% share of petrol consumption was the large number of small vehicles such as motorcycles and taxis plying on the roads. The report stated that economic activities are mostly concentrated in urban areas due to high population density, infrastructure facilities and government service outlets. An official of NOC stated that due to changing lifestyles, Kathmandu valley will need more fuel in future. Needless to say, the country will have to manage its resources well if urbanization continues at this pace.

Exploration of petroleum

The BBB Champion Oil and Gas of the United States of America and the EABG multi-national company of Dubai, UAE, received approval in August-end to begin exploration of petroleum products in Nepal.³⁴ Exploration work was to be started in a month's time and would take place in 10 locations in Biratnagar, Rabilraj and Janakpur. The cost of the exploration work is estimated to be USD

30 million (NPR 2.5 billion). All human resources needed for research and exploration of the sites, excluding technical manpower, are supposed to involve locals.

EU's renewable energy project

The European Union (EU) handed over the renewable energy project -infrastructure development for renewal electricity generation – to the government in October. The project was carried out at a cost of USD 20.3 million (NPR 1.7 billion), where the contribution of EU was USD 19.3 million (NPR 1.7 billion); while the Government of Nepal had invested USD 1 million (NPR 86 million) through its Alternative Energy Promotion Centre (AEPCC). The project has benefitted one million rural populations from 21 districts of the country.³³ The project has provided solar systems to over 206 health posts, 378 schools, 29 community computer literacy programs, 59 community entertainment centers and 124 community telecommunication centers. It has also put in place renewable energy infrastructure in remote rural areas to facilitate income generation, sustainable growth and

delivery of social services for poverty alleviation through the installation of 933 photovoltaic and 38 thermal systems.

Eighty MW thermal plants in the offing

The Nepal Electricity Authority (NEA) has decided to install thermal plants with a capacity of 80 MW, which is in line with the Load-shedding Minimization Work Plan. As per NEA sources, a 36 MW plant will be installed within three months, and another 44 MW plant will be installed in nine months.³⁴ Digambar Jha, former managing director of Nepal Oil Corporation, has been appointed consultant for the purpose of installing the plants. The installation works depends on the budget allocated by the government. The government aims to generate 200 MW through thermal plants. Currently, there are two thermal plants in the country that generate 40 MW of electricity.

Neighboring giants land hydro projects

Beijing's CWE Investment Corporation (CWEI), a subsidiary of the China Three Gorges Corporation, is to develop the 750 MW West Seti hydropower project, and has started a preliminary study of the site. For the purpose of the study, a preliminary visit has been conducted to gain information and assess the technical and financial feasibility of the project.³⁵ The field visit is being done as part of an agreed work plan that the Investment Board of Nepal and CWEI jointly developed following the signing of the memorandum of minutes (MoM) in Beijing in August. The government of Nepal and CWEI will jointly develop the project with equity investment in the ratio of 1:3 respectively. The West Seti

project aims to supply up to 150 MW of electricity to the western industrial corridor, while the remaining power would go towards fulfilling domestic power demand.

Meanwhile, the Investment Board of Nepal awarded the 900 MW Arun III Hydropower Project to the Sutlej Jal Vidyut Nigam Ltd (SJVN) - India's state-owned power producer.³⁶ The company displayed financial ability to bring NPR 82.5 billion (USD 959 million) for the development of the project. Arun III is a run-of-the-river project based in Sankhuwasabha district; the final approval means that construction on the project can be started.

Baglung district: An example of micro-hydro success

A total of 84 micro hydropower projects producing 2408 KW of electricity have illuminated 22,769 projects in Baglung.³⁷ The projects were constructed with financial and technical assistance of the Alternative Energy Promotion Centre under the Ministry of Environment, Science and Technology, Nepal government. Baglung has immense potential for micro-hydro projects as it has many rivers viable for electricity production. Rural electrification provides round the clock electricity and has helped boost the lifestyle of the local people. In addition, six hydro projects are under construction in the district. Micro hydro projects in other districts are also slowly picking up. Ramechhap recently constructed a 5 KW micro hydro project in Bhujju VDC.³⁸ Dhading and Myagdi are two other districts where micro hydro projects have made their presence felt. Myagdi has two more projects in the offing, which will generate 48 MW of electricity.³⁹

FOREIGN AID

Uncertainty over the budget continues, and further delays in reaching an agreement over the budget seriously undermines the absorptive capacity of the country towards foreign aid. Additionally, this reduces the scope for commitment on future foreign assistance to Nepal. The government's implementation bottlenecks in aid projects in the power sector have led to multilateral agencies such as the World Bank holding back on substantial investments.⁴⁰ Foreign cash grants continue to increase, with the country receiving its highest amount in foreign aid - USD 541 million (NPR 46.57 billion) in the fiscal year 2011-12 - exceeding the previous year by USD 27.4 million (NPR 20.36 billion). The last fiscal year 2011-12 witnessed a total commitment of USD 542 million (NPR 46.57 billion) in cash grants and USD 50 million (NPR 4.26 billion) in cash loans amounting to the country's highest received foreign aid, and exceeding previous year's by almost double the amount.

Anti-corruption measure to address misuse of foreign aid

A ten-point proposal has been forwarded to the Ministry of Federal Affairs and Local Development after consultation among donors regarding misuse of development funds in the form of massive corruption, bad governance, and lack of transparency and monitoring and evaluation systems. These funds have been allocated to local bodies for development and social security by 14 donor agencies that have collectively contributed USD 200 million (NPR 17.2 billion) for the first phase of the Local Governance and Community Development Programme (LGCDP). The government

has contributed USD 500 million (NPR 43 billion) for LGCDP. The anti corruption measure seeks clear policies and rules on corruption from the ministry, as inspection has indicated that USD 3.5 million (NPR 300 million) of the allocated budget for FY 2011-12 has been misused. Similarly USD 4.4 million (NPR 380 million) of the budget distributed for development projects in Saptari are yet to be provided.⁴¹

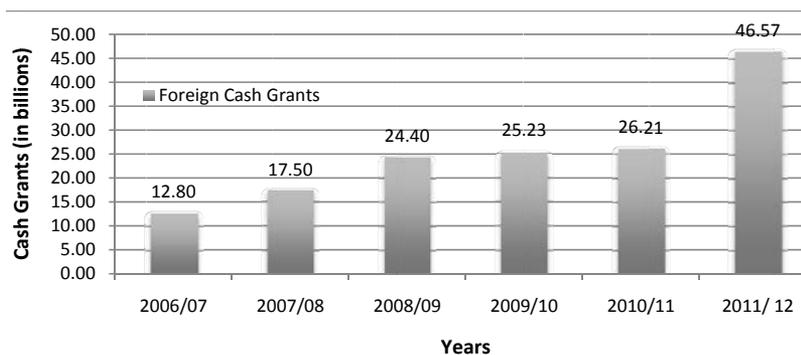
Mega Bank and Helvetas to help agro-based enterprises

Mega Bank Nepal in cooperation with the Helvetas Swiss Inter-cooperation will implement a financing program jointly whereby Mega Bank will provide micro credit to individuals involved in agriculture in eight districts of Nepal and Helvetas will provide technical services and vocational training to the targeted groups. This initiative has been undertaken to ensure sustainable growth in agro-based enterprises and creation of self-employment opportunities. This joint initiative is expected to be a model through which sustainable development in the country can be achieved. The scheme will be implemented in the districts of Rautahat, Sarlahi, Bara, Parsa, Banke, Bardia, Kailali and Kanchanpur.⁴²

U.S provides grant assistance for cultural preservation

The Embassy of the United States has provided two grants to the Patan Dubar Square in Kathmandu valley to support cultural preservation and tourism promotion. This is a part of the Ambassadors Fund for Cultural Preservation (AFCP) in Nepal, and is being provided to the Kathmandu Valley Preservation Trust (KVPT) and the Alliance for Ecotourism. The AFCP, which is administered by the US Department of State,

Figure 5: Foreign Cash Grants to the Government of Nepal over the last six years



Source: Recent Macroeconomic Situation, Nepal Rastra Bank

Figure 6: Comparison of Foreign Aid receipt in the first three months in consecutive years

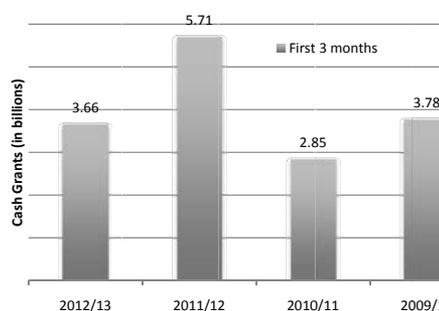
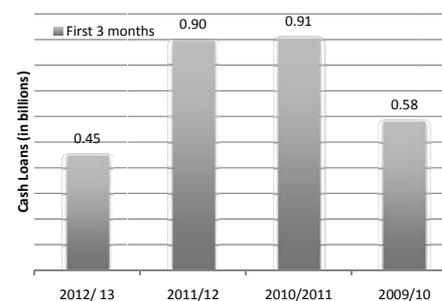


Figure 7: Comparison of Cash Loans undertaken in the first three months in consecutive years



Source: Recent Macroeconomic Situation, Nepal Rastra Bank

provides support for the preservation of cultural sites, objects, collection and form of traditional cultural expression around the world.⁴³

The KVPT will receive USD 205,000 (NPR 17.6 million) for the ongoing restoration and conservation of the Patan Durbar Square. The Alliance for Ecotourism, on the other hand, will receive USD 75,300 (NPR 6.5 million) to preserve the Kartik Nach tradition - a unique form of 17th century story telling through dance that has been on the decline.

IFC helping small poultry farmers

The International Finance Corporation is providing technical assistance to small poultry farmers of Nepal by providing training on better farm

management practices to help increase productivity, reduce costs and improve poultry quality as well as boost sustainable agribusiness. The project aims at strengthening the technical skills of 3,000 poultry farmers and directly impacting 40% of the industry through the country's leading poultry firms - Avinash Hatchery and Pro Biotech Industries. This initiative will be led by the South Asia Enterprise Development Facility in partnership with the UK Government and the Norwegian Agency for Development Cooperation. The poultry sector has been selected for assistance as it contributes around 3% to the GDP of Nepal with an investment of USD 334.26 million (NPR 28.7 billion). The poultry industry continues to suffer from low productivity.⁴⁴

HEALTH

MoFA acceptance made mandatory for foreign aid and loans

The government has mandated that all parties need to seek prior acceptance or suggestions from the Ministry of Foreign Affairs (MoFA) while agreeing on any form of foreign aid or loans, to ensure that it is in line with the foreign policy and priority. Terms and conditions put forward by both sides should also be provided to the MoFA, whereby the loan or aid can be rejected if they are not in alliance with foreign policy parameters. The MoFA has already begun regulating the INGOs in Nepal through the requirement to register with the Aid Management Platform at the Ministry of Finance.⁴⁵

Australia increases annual aid to USD 38 million (NPR 3.29 billion)

The Government of Australia has raised its annual aid by USD 5.3 million (NPR 455.8 million), to USD 38 million (NPR 3.29 billion) from USD 32 million (NPR 2.7 billion) per annum. The aid will be provided through AusAID, the development agency of the Government of Australia in Nepal in areas of education, health, rural livelihoods and governance reforms in order to improve the quality of life of the Nepali people

As per the latest data published by the Nepal Rastra Bank, Foreign Cash Grants for the first three months of the current Fiscal Year (FY) 2012-13 is USD 42.6 million (NPR 3.66 billion) which was at USD 66.4 million (NPR 5.71 billion) during the same period in FY 2011-12. Similarly, cash loans have dropped to USD 5.2 million (NPR 0.45 billion) from USD 10.5 million (NPR 0.90 billion) during the same period.

The private and public health sector continues to remain vulnerable due to increasing cases of medical negligence in the form of malpractices, medical errors and misconduct. The Australian National Health and Hospital Reform Commission states that hospital errors kill 4,550 people each year, which is equivalent to 13 jumbo jet crashes that kill all on board. The Canadian Medical Association says 24,000 people die annually due to medical errors in Canada. In Nepal, widespread unaccountability and low-key prosecution of clinical negligence are key reasons behind medical negligence.⁴⁶

Blood shortage in eastern Nepal

The eastern districts of Nepal have been facing an acute blood shortage, despite the launch of blood donation programs to deal with this crisis. Hospitals in these regions have been hit hard after blood banks in the region ran out of blood. The hilly regions have been most affected by this crisis as they have access to fewer organizations supplying blood. The shortage in blood supply has been attributed to a lack of blood donation campaigns during the festival season of Dashain and Tihar.⁴⁷

Pneumonia, a public health issue

Pneumonia still remains one of the leading causes of death in children under the age of five in Nepal. According to Paropkar Medical Hospital, one in every 22 children is said to die before reaching the age of one, whereas one among every 19 die before the age of five. The Nepal Demographic Health Survey (NDHS)-2011 indicates that 5% of children under the age of five display symptoms of acute respiratory infections (ARI). Of the 35,000 deaths of children under the age of five every year, 5,600 have been due to pneumonia, out of

which only 30% have had access to the required medicine.⁴⁸

Non Communicable Diseases, a major health threat

Non Communicable Diseases (NCDs) such as diabetes and cancer have become major health threats in Nepal. They account for 36.5% of diseases and half of total deaths in the country. A survey conducted by Merlin Nepal and Solid Nepal, however, indicates that only one in five health workers are trained to treat NCDs. There is, therefore, a need for an increase in trained and skilled health workers to meet the growing needs of the population. NCDs account for almost 63% of deaths and 43% of global burden of diseases; however, health policies in Nepal have no mention of NCD treatments.⁴⁹

Most health institutions illegal: DHO

According to The District Health Office of Siraha, over 90% of private health institutions in the district are operating illegally, with only eight health-related organizations possessing a valid license. Despite it being necessary for hospitals or clinics to be registered with the Company Registered Office before operations, this regulation has not been complied with: more than 48 health related institutions are running without adequate government permission. The increase in unregistered and illegal health institutions is attributed to negligence by monitoring bodies, despite increasing pressure demanding legal action against those involved.⁵⁰

Blindness rate reduces

The blindness rate in Nepal has seen a considerable reduction over the past two years with rates dropping by half, from 82% to 39%. This decrease in blindness throughout the country can be attributed to the development of

small incision cataract surgery, which uses an inexpensive intraocular lens. This development has enabled thousands of cataract patients to correct/regain their sight. According to the Nepal Netra Jyoti Sangh, over 10,000 cataract surgeries are conducted every year, with 60% of them being from India.⁵¹

INFRASTRUCTURE

Government provides soft loan for Ankhukhola hydro-power project

Under the Load Shedding Reduction Action Plan, the Ministry of Finance has approved provided soft loans amounting to NPR 160 million (USD 1.86 million) to Ankhokhola Hydro-power project.⁵² The Dhading based 7MW hydro-power project is the only hydro-power project being developed by the private sector currently. As per the action plan, soft loans worth NPR 20 million per megawatt (MW) at an interest rate of 10% shall be extended only to projects that are finding it difficult to obtain financing from the existing banks. Seven projects had received the Finance Ministry's approval for Rastriya Banijya Bank (RBB) loan under the scheme but only Akhukhola has received the loan till date.

Modikhola project comes into operation

The 10 MW lower Modikhola Hydro project, developed with an investment of NPR 1.92 billion (USD 22.32 million), came into operation in October this year and has been connected to the central electric transmission line. The project has signed a 30-year power purchase agreement with Nepal Electricity Authority (NEA). The project is expected to generate profits

after three years of operation and the investment is expected to be recovered within 14 years.

Kulekhani hydro starts generating electricity

The Kulekhani Hydroelectricity project I&II have started generating electricity in full capacity. Kulekhani I, located at Jhosing, has a capacity of 60 MW while Kulekhani II - located at Bhainse - can generate a maximum of 35 MW.⁵³

Nepal asks China for soft loan to build Upper Arun and Tamakoshi projects

As per the recommendation of NEA, the government has requested the Chinese government to provide a soft loan of USD 633 million (NPR 54.43 billion) to develop 335MW Upper Arun and 87MW Tamakoshi. The Upper Arun Hydropower project has a firm capacity of 250MW, which is about 75% of the installed capacity. The total cost of the projects is estimated to be USD 500.79 million (NPR 43.06 billion). The Tamakoshi V project is estimated to cost USD 131.99 million (NPR 11.35 billion) and will generate 428.26 GWh per year.

Kathmandu-Tarai Fast Track project

Reliance Infrastructure, Infrastructure Leasing and Financial Services, Larsen and Turbo and Gammon India have submitted Expression of Interest for the construction of Kathmandu-Tarai Fast Track road. The project is estimated at NPR 80 billion (USD 930.23 million) which shall be executed under the public private partnership on build-operate-transfers model.

Nepal seeks assistance for East-West High hill road

The Nepali Government formally requested the Chinese government for assistance for the ambitious project.

The 1,776 km East-West High Hill Highway is estimated to cost NPR 43 billion (USD 500 million). The highway will pass through 12 zones, 24 districts and 215 villages and service nearly seven million people.

MANUFACTURING AND TRADE

The first quarter of fiscal year 2012-13 was encouraging for the Nepali manufacturing sector as the total exports increased by 14.9%, compared to the same period last year; however, the exports of Nepal's major products like pashmina, tea and readymade garments saw a plunge in the first quarter. The trade deficit also continued to widen further as the imports increased by 36.1% during the same period.

Exports of garments and carpets decline

During the first three months of FY 2012-13, exports of the country's major items i.e. readymade garments, carpets and pashmina plunged as compared to the same period last year. During the review period of this year, Nepal exported readymade garments worth NPR 1.04 billion (USD 12.09 million) as against NPR 1.50 billion (USD 17.44 million) last year; a decrease of 30.7%. Similarly, exports of woolen carpets declined to NPR 1.29 billion (USD 15 million) from NPR 1.71 billion (USD 19.88 million); a decline of 24.8%. The earnings from pashmina exports went down to NPR 519.35 million (USD 6.03 million) from NPR 629.25 million (USD 7.31 million); a drop of 17.5% over the review period, mainly attributing to the decline in the dollar fluctuation.

Meanwhile, Nepal's total export earnings during the review period

have increased by 7.1% to NPR 19.68 billion (USD 228.83 million). The major items being exported were ginger, lentil, meat items, tubes and pipes, iron and steel.⁵⁴

Rice import soars

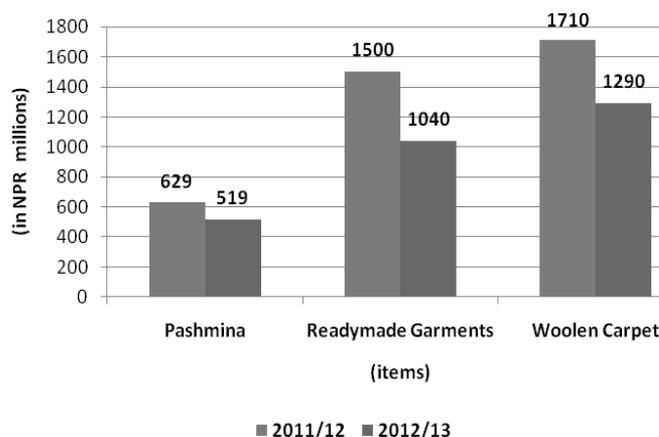
The first three months of the current fiscal year saw imports of rice surge as compared to last year. The country imported rice worth NPR 1.63 billion (USD 18.95 million) during the first three months of FY 2012-13 as compared to NPR 325.4 million (USD 3.78 million); a whopping increase of 401%. The rise in imports can be attributed to the increase in the prices of rice by 20% this year. The rise in import can also be attributed to the recent lifting of the ban on export of non-basmati rice by India after a gap of more than three years. Also, the rise in import could be due to the decision of the government to open rice exports to China. The government during the last FY allowed traders to export 10,000 tons of rice to China, looking at the growing demand for rice in Tibet.⁵⁵

Balance of Payment depicts surplus in Q1

In the first three months of FY 2012-13, Nepal's Balance of Payments (BOP) recorded a surplus of NPR 347.3 million (USD 4.03 million) as compared to a surplus of NPR 33.66 billion (USD 391.39 million) during the same period last fiscal; Remittance inflows into the country recorded an increase by 28.8%, to NPR 97.72 billion (USD 1136.27 million) from NPR 75.88 billion (USD 822.32 million) last year, as compared to an increase by 28.3% during the same period the previous year.

The current account posted a deficit of NPR 2.94 billion (USD 34.18 million) as compared to a surplus of NPR 13.82

Figure 8: Exports of Pashmina, Readymade Garments and Woolen Carpets for the 1st Quarter of FY 2011/12 and 2012/13



Source: "Exports of garment, carpets, pashmina decline in Q1", The Kathmandu Post, November 27, 2012.

Table 3: Foreign Trade Indicators for first 3 months (in NPR millions)

	2010-11	2011-12 R	2012-13 P	Percent Change	
				2011-12	2012-13
TOTAL EXPORTS	16,679.3	18,037.4	20,732.4	8.1	14.9
To India	10,249.9	11,572.4	12,265.2	12.9	6.0
To Other Countries	6,429.4	6,465.0	8,467.2	0.6	31.0
TOTAL IMPORTS	93,074.2	100,264.3	136,479.5	7.7	36.1
From India	63,236.6	63,905.8	86,921.1	1.1	36.0
From Other Countries	29,837.6	36,358.5	49,558.4	21.9	36.3
TOTAL TRADE BALANCE	-76,394.9	-82,226.9	-115,747.1	7.6	40.8
With India	-52,986.7	-52,333.4	-74,655.9	-1.2	42.7
With Other Countries	-23,408.2	-29,893.5	-41,091.2	27.7	37.5
TOTAL FOREIGN TRADE	109,753.5	118,301.7	157,211.8	7.8	32.9
With India	73,486.5	75,478.2	99,186.3	2.7	31.4
With Other Countries	36,267.0	42,823.5	58,025.6	18.1	35.5

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

Source: NRB Report - Recent Macroeconomic Situation (3months) 2069/70

billion (USD 160.69 million) same period last year. The deficit can be attributed to the significant rise in the imports of merchandise and services⁵⁶

Both imports and exports on the rise

Nepal's export to India during the first three months of FY 2012-13 witnessed a rise of 6% to NPR 12.26 billion (USD 142.55 million) as compared to NPR 11.57 billion (USD 134.53 million) during the same period last year. Exports of Nepali products during the first three months of the previous year had increased by 12.9%. The export of G.I pipe, jute sacks, polyester yarn, textiles and juice to India has also increased. There has been a significant increase in imports (from India) - 36% to NPR 86.92 billion (USD 1010.69 million) as compared to the increase of a mere 1.1% the previous year. The major imports from India were petroleum products, M.S Billet, chemical fertilizer, cement and rice.⁵⁷

Further, exports to other countries have increased by 31 percent to NPR 8.46 billion (USD 98.37 million) this fiscal year as compared to only 0.6 percent during the same period in the previous fiscal year. Exports to other countries rose primarily due to the increase in exports of pulses, tanned skin and readymade leather goods. Imports from other countries increased by 36.3% to NPR 49.58 billion (USD 576.51 million) compared to 21.9% in the corresponding period of previous year; edible oil, dry cell batteries, flash lights, shoes and sandals constituted the major imports.

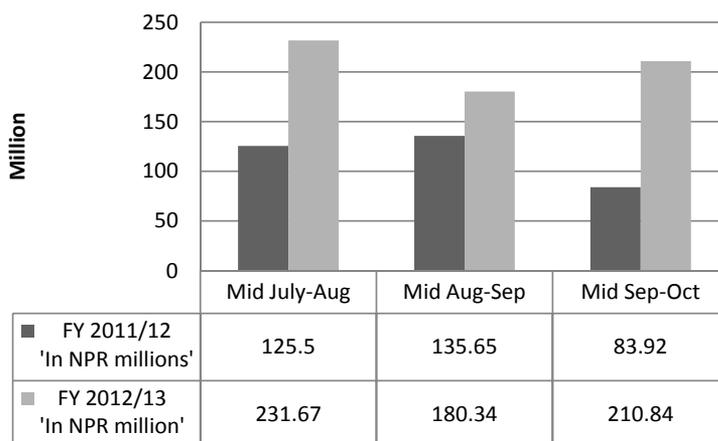
Foreign Direct Investment (FDI) in manufacturing sector falls

FY 2011-12 recorded a drastic fall in the FDI commitment to the manufacturing sector by a whopping 83%, compared to

the previous year. The government in partnership with the Confederation of Nepalese Industries (CNI) has earmarked eight potential sectors ideal for foreign investments, among which manufacturing is one of the main.

FDI commitment to the manufacturing sector, despite it being one of the most lucrative sectors for foreign investors, fell owing to factors like power crisis, increasing labor costs, frequent labor disputes, eroding competitiveness of Nepali products in the international market and political instability in the country. The FDI commitment towards the sector added up to only NPR 988 million (USD 11.48 million) during FY 2011-12 while it had received NPR 6.13 billion (USD 71.27 million) FDI commitment in FY 2010-11.⁵⁸ This has resulted in the loss of 1,541 jobs in the domestic market. The manufacturing sector, which comprises mainly of industries such as food, beverage and tobacco, textiles and readymade garment, chemical and plastic products, mining products had received a total of NPR 6.13 billion (USD 71.27 million) of FDI commitment in the FY 2010/11.

Figure 9: Land/Property Registration Fee Collection (Kathmandu Valley)



Source: Department of Land Reforms and Management

REAL ESTATE

The property registration fees within the Kathmandu Valley in the first quarter (mid July to mid October) of this fiscal year 2012-13 increased by 80.5%. The revenue collection from five land revenue offices in the valley stood at NPR 622.86 million (USD 7.24 million). During the same period last fiscal year, revenue collection stood at NPR 345.07 million.

Land and housing transaction increased in major cities and districts outside the Valley. Land revenue offices based in 42 districts outside the valley collected a total revenue of NPR 273.4 million (USD 3.17 million) in mid October to mid November, which is 25% higher compared to the same period last year.

Dilemma over foreigners purchasing property

The government in FY2011-12 budget had proposed allowing foreign nationals and companies to purchase houses or apartments costing USD 200,000 (NPR 17.2 million) and above to address the woes of the realty

sector. However, the Home Ministry raised concerns on whether foreigners should be allowed to stay in the country indefinitely on grounds on them having purchased an apartment. Currently, foreigners are not allowed to own land in Nepal⁵⁹.

Assistance in earthquake resilience

The British government has pledged a technical cooperation grant of NPR 2.5 billion (USD 29.06 million) to Nepal⁶⁰. The grant is meant to assist in building earthquake resilience here and its objective is to strengthen the government's disaster risk management policy, scale up community based disaster resilience activities and improve preparedness for a national and international emergency response.

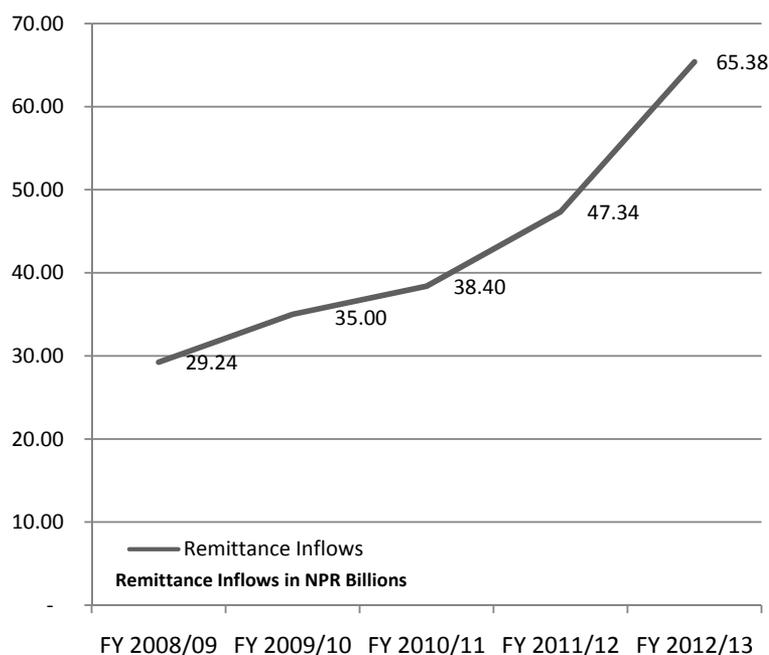
Loss of rental tax

A study conducted by the Nepal Rastra Bank (NRB) shows that the government is losing approximately NPR 7 billion (USD 81.39 million) in rental tax from Kathmandu Valley alone. Currently, rental tax has been fixed at 10% of rentals charged. The study shows that people and firms within the valley pay NPR 85.44 billion (USD 993.48 million) in rent each year. However, rental tax collected by the Inland Revenue Department (IRD) hardly crosses NPR 1 billion (USD 11.62 million). This is because the rental contracts are drafted and registered at a lower rental value than what is actually paid and many lessors have verbal agreements with lessees thereby evading rental tax.

Declining home loan interest rates

The interest rates charged by banks for home loans offered have declined in recent months. This is mainly attributed to the declining cost of fund for the banks. Previously, many banks

Figure 10: Five Year Remittance Inflows for the first two months of every Fiscal Year



Source: Current Macroeconomic Situation, Nepal Rastra Bank

were paying high rates on fixed deposits and were forced to charge high rates on home loans. Currently, most of the fixed deposits in banks have matured, which gives banks space to bring down their rates. Himalayan bank introduced a home loan scheme at a fixed interest rate of 10.90% for three initial years as against the rate of 12.75%-16% it was charging earlier. Similarly, Nepal Investment Bank slashed its home loan interest rate by 30% which currently stands at 10.50%⁶¹.

REMITTANCE

Remittance inflows in the first two months of FY 2012/13 stood at NPR 65.38 billion (USD 760.2 million), a 38.1% percent growth from the same period last fiscal. Table 4 below

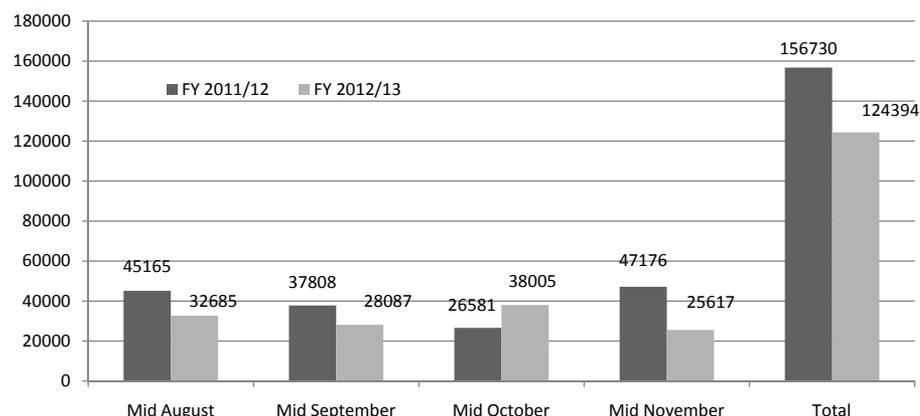
provides remittance inflows for the first two months of the fiscal year over past five years.

Increasing import and consumption, by virtue of higher remittance inflows, was one of the reasons attributed to the government revenue mobilization growing by 27.2% to NPR 36.95 billion (USD 429.6 million) during the first two months of FY 2012/13. However, in US dollar terms, remittance inflows increased by only 13.2% to USD 736.4 million (NPR 63.3 billion), compared to an increase of 28.1% in the same period of the previous year. This was a result of the appreciating US Dollar as against the Nepali Rupee. The average USD exchange rate for first four months of FY 2012/-12 stood at NPR 87.49, while this rate was NPR 75.79 for the same period last year.

Despite Remittance boost, outgoing migrant workers number declines

As per data available from the Department of Foreign Employment, the total number of migrant workers seeking foreign employment declined to 124,394 during the first four months of FY 2012/-13 from 156,730 during the same time period last year⁶² as shown in Figure 11. The decline in percentage for the first two months stood at 27%, due to the coinciding of paddy seasons and the festival of Dashain and Tihar. Most youths were working in fields and others were waiting for the festivities to end to leave for foreign employment.⁶³ However, despite the expectation of this number increasing thereafter, the decline for the first four months still stood at 20.63%. Reasons for the decline as cited by manpower companies were stricter policy by the government to give work permits, increasing number of workers leaving unrecorded via India and termination of fresh approval by the Saudi government for new workers.⁶⁴ While this was the case regarding migrant workers, remittance inflows, as stated above, grew at a rate of 38.1%, which

Figure 11: Migrant Worker Seeking Foreign Employment during the First Four Months of Past Two Years



Source: Department of Foreign Employment

points to the fact that remittance per worker is on the rise.

Women migration increases

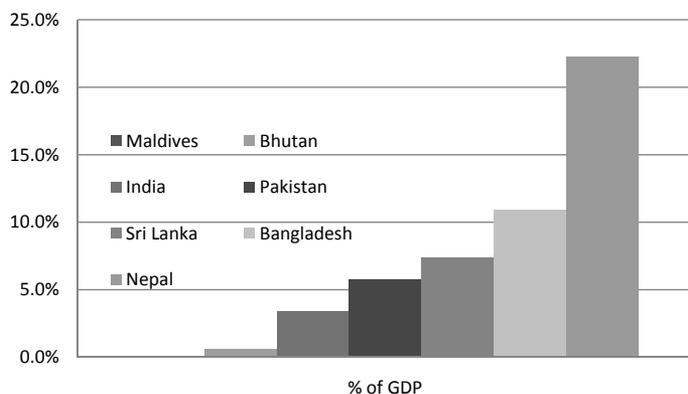
While the total number of migrant workers has declined in the current fiscal year, the number of women migrant workers has increased, despite the minimum age limit of 30 years⁶⁵. For the first three months of FY 2012/-13, 6,184 women left for foreign employment as against 2,264

during the same time period last year. The age limit was implemented in order to reduce abuse and exploitation of women. However, under-age women are still seeking foreign employment through illegal channels through India, thereby bloating this figure.

One fourth of remittance utilized to seek foreign jobs

Due to exorbitant service fees charged by manpower agencies, migrant

Figure 12: Remittance as a Share of GDP in FY 2010/12 for South Asian Countries



Source: Migration and Development Brief 19, Migration and Remittances Unit, Development Prospects Group, World Bank

Table 4: Worker's Remittance Inflows to South Asian Countries for the past five years (in USD Millions)

Country	2008	2009	2010	2011	2012e
Bangladesh	8,941	10,521	10,850	12,068	13,736
Bhutan	4	5	8	10	10
India	49,977	49,468	54,035	63,011	69,797
Maldives	6	5	3	3	3
Nepal	2,727	2,986	3,469	5,115	5,115
Pakistan	7,039	8,717	9,690	13,933	13,933
Sri Lanka	2,947	3,363	4,155	6,312	6,312

Source: Migration and Development Brief 19, Migration and Remittances Unit, Development Prospects Group, World Bank

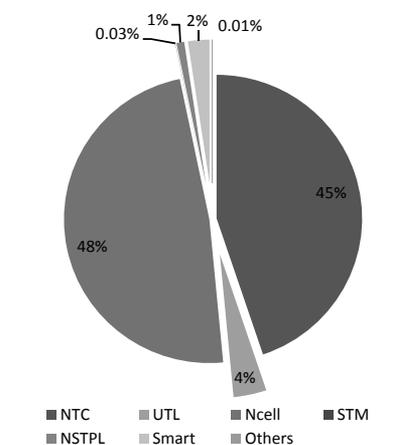
workers spend approximately one fourth of yearly remittance earnings to seek foreign employment. During fiscal year 2011/-12, out of a total amount of NPR 359.55 billion (USD 4.2 billion) received as remittance inflows, NPR 59.93 billion (USD 696.8 million) was spent on service fees charged by outsourcing agencies for employment in Malaysia, Qatar, Saudi Arabia, United Arab Emirates, Kuwait and Bahrain and other countries.⁶⁶ These agencies are charging more than the rates prescribed by the Department of Foreign Employment; however such practices are going unchecked due to weak regulation. For instance, the Department of Foreign Employment has set NPR 70,000 (USD 814) as service fee for Gulf countries and Rs 80,000 (USD 930) for Malaysia, but the current market price is NPR 110,000 (USD

1279) and NPR 130,000 (USD 1512) for Gulf countries and Malaysia respectively

Nepal sixth highest receiver of worker's remittance in 2011

As a percentage of GDP, Nepal was the sixth highest recipient of worker's remittance among developing countries in 2011. The figure for Nepal was 22.3 % of GDP.⁶⁷ In developing economies, remittance inflows are on an average three times the official development assistance (ODA). In the case of Nepal, this figure is five times. Increased remittance inflows to Nepal have led to increased consumption, and a ballooning trade deficit. Officially recorded remittance flows to developing countries are estimated to reach USD 406 billion (NPR 34.9 trillion) in 2012, a growth of 6.5% over the previous year. These flows are

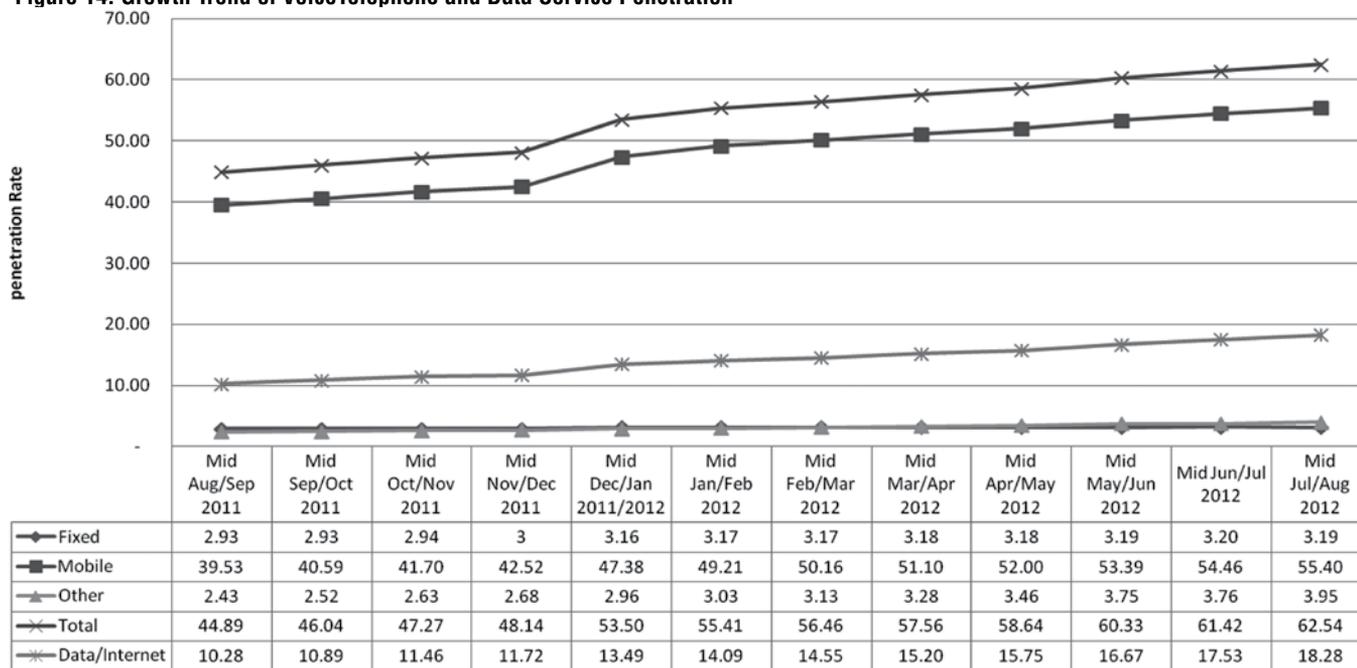
Figure 13: Market Share of Telecommunication operators in Nepal



Source: Nepal Telecommunication Authority "MIS report dated September 2012"

expected to rise by 8% in 2013 and 10% in 2014 to reach USD 534 billion (NPR 45.9 trillion) in 2015.

Figure 14: Growth Trend of Voice Telephone and Data Service Penetration



Source: Nepal Telecommunication Authority "MIS report dated Jun, 2012.

TELECOMMUNICATION AND MEDIA

The government's decision in December 1995 paved the way for active participation of the private sector in the development of telecommunication services in Nepal. Since then, the sector has witnessed significant growth and change. The Nepal Telecommunication Authority (NTA) recorded 4,093,688 new telecom subscribers during mid Aug 2011 to mid Aug 2012. The tele-density of the country currently stands at 66.14%⁶⁸, which was 47.27% during the same period last year. Despite the growth in tele-density, the country's fixed line user base continued to fall from 850,000 in mid April to 839,000 in mid August this year. In the cellular segment, market leader Ncell recorded a total of 8.49 million GSM subscribers, while Nepal Telecom had 7.13 million (GSM & CDMA) subscribers as shown in Figure 13.

Similarly, the growth in data/internet users increased from 3.28 million in Aug 2011 to 5.15 million in Aug 2012, a growth of 57.02%. The internet penetration rate stands at 19.32% as shown in Figure 14.

New Spectrum Policy

The government has brought out the Telecommunication Radio Frequency Distribution and Pricing Policy, 2012, which is aimed at bringing in four more operators for third generation (3G) service. The policy sets the price and frequency distribution for new services including 3G, 4G and basic telephone. Previously, the price of spectrum was based on the Telecommunication Act, and the Radio Communications License Regulation was

used for other services. As per the new policy, there will be reframing of the frequency to make 40 MHz spectrum available for 3G services in the 2100 MHz band and four operators will get 10 MHz bandwidth each. However, the telecom operators will have to acquire unified license before taking part in a 3G spectrum auction⁶⁹.

The new policy clearly states that NTA will be able to assign the frequency required to operate under the unified licensing system. An operator will also have to acquire unified license if it wants to operate 4G in addition to 3G. Further, under the new policy, operators will be able to pay unified license renewal fee of NPR 20.13 billion (USD 234.06 million) in installments over a period of 10 years. The operator will have to pay a license fee of NPR 50 million (USD 581,000) in the first year of operation. After the third year, the installment amount will increase every year. The operator will have to pay NPR 2 billion (USD 23.25 million) to the government in the tenth year to renew its license².

According to NTA, Nepal Telecom and Ncell are liable to pay NPR 1.68 billion (USD 19.53 million) and NPR 1.44 billion (USD 16.74 million) respectively.

WiMAX launched in Kathmandu

Nepal Telecom (NT) launched the much hyped WiMAX (Worldwide Interoperability for Microwave Access) service in Kathmandu on November 12, 2012. Currently, the high speed internet service is limited to only corporate clients. NT currently deploys WiMax infrastructure in 46 locations in Kathmandu Valley. In the second phase, NT plans to extend WiMAX services to Pokhara, Bhairahawa and surrounding regions. Under phase one, NT is

planning to cover 1,923 Village Development Committees (VDCs) in 24 regions in western Nepal and the second phase will cover 2,098 VDCs and 34 regions in east Nepal. In order to use the facility, users will need to purchase Customer Premises Equipment (CPE). CPEs are devices that enable consumers to access Communications Service Provider's services and distribute them around their house via a local access network. CPE is available in three formats - Outdoor (range 15 km), Indoor (range 5 Km) and USB Dongle. NT plans to make the WiMAX service available across the country within a year and plans to distribute 200,000 lines capable of delivering minimum WiMAX speed of 256kbps⁷⁰.

District Optical Fiber Project

The Ministry of Information and Communication announced plans to utilize the NPR 63 billion (USD 732.55 million) from the state's Rural Telecommunication Development Fund to expand the provision of fiber optic services to remote parts of the country. A committee has been assigned to oversee the 'District Optical Fiber Project' targeted at improvements in the quality of voice and data services in rural areas. The project aims to construct a 256kbps bandwidth high speed data service in 38 districts by 2014.⁷¹

TOURISM

During the first ten months of 2012, a total of 656,500 tourists visited Nepal (by air and land); an increase of 10.61% as compared to the figures of last year. The country witnessed a negative growth in monthly tourist arrivals for the first time since June 2009. The arrivals by air in October saw a drop

of 7.3% as shown in Figure 15 as compared to the October figures of last year. The unexpected drop in arrivals has been attributed to a substantial decline in the number of visitors from European and South Asian market segments due to the sluggishness in their economies.

Tourists from India and China account for 30% in the last 3 months

During the period from August to October 2012, Indians and Chinese accounted for 30% of the tourists who travelled to Nepal by air. Though 32,000 visitors from India and 15,000 visitors from China visited during the period, there was a slump of 5.04% in visitors from India and a mere 3.51% increase in tourists from China as compared to the figures of the same period last year. Amongst other nations, American tourists were the highest with a total of 12,000 visitors; an increase of 12.19% as compared to last year.⁷²

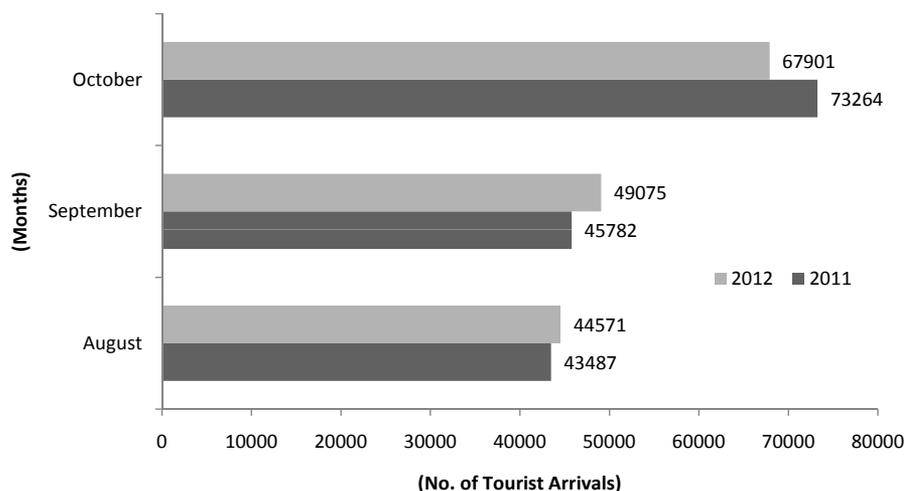
NRN pledges investment in hospitality industry

Nepal is expected to see an influx of foreign investment into the hospitality industry soon from a Non Resident Nepali (NRN). Shesh Ghale, a 54-year-old millionaire based in Australia who owns the Melbourne Institute of Technology, has formally announced his decision to make an investment of NPR 6.41 billion (USD 74.53 million) in Nepal to build a five-star hotel in Kathmandu. The construction of the hotel will commence from 2013 and would be completed within the next three-four years.⁷³

Bahrain Air resumes operations in Nepal

Bahrain Air, the second flag carrier of Kingdom of Bahrain has resumed its operations to Kathmandu from Sep-

Figure 15: Comparison of tourist arrivals by air for the period between August to October 2011 and 2012

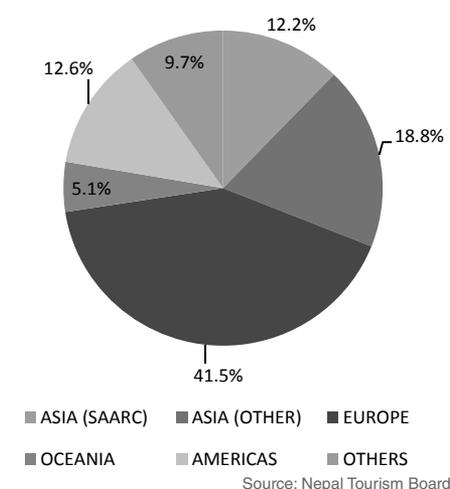


tember 14, 2012. The airlines had received huge requests from the passengers in their networks to re-start operations on the Kathmandu-Bahrain route. Kathmandu is an essential part of Bahrain Air's network. Currently, they will be flying with two flights a week. The airlines said it was positive about increasing the number of flights in the near future. They were earlier operating up to seven flights a week.⁷⁴

Guerilla Trek trial launched

Guerilla Trek, a new tourist trekking trial which stretches across the Central and Western Nepal through Myadi, Rukum and Rolpa districts, was launched jointly by Nepal Tourism Board (NTB) and Trekking Agencies Association of Nepal (TAAN) along with local organizations on October 2. The Guerilla Trek offers a remarkable journey through the heartland of the Maoist conflict-affected territory. It also consists of the Yarsagumba trial. The trek has a potential to be promoted world wide as a "war tourism product",

Figure 16: Region-wise % share for the month of October, 2012



similar to those seen in Vietnam, Russia and China.⁷⁵

Visit Lumbini Year (VLY) 2012 campaign fails to attract visitors

Though the inflow of tourist in Lumbini has increased by 20% to 524,000 visitors, including Nepalis, in the first nine months of 2012 as

Table 5: Total tourist arrivals by air, October 2012

Country of Nationality	October		% Change	% Share '12 Oct	Total (Jan-Oct)		% Change	% Share '12 Jan-Oct
	2011	2012			2011	2012		
ASIA (SAARC)	11,622	8,312	-28.5%	12.2%	141,935	164,319	15.8%	33.3%
ASIA (OTHER)	12,168	12,765	4.9%	18.8%	84,670	97,274	14.9%	19.7%
EUROPE	34,166	28,198	-17.5%	41.5%	127,305	133,429	4.8%	27.0%
OCEANIA	2,870	3,488	21.5%	5.1%	14,537	16,221	11.6%	3.3%
AMERICAS	7,301	8,561	17.3%	12.6%	39,122	43,561	11.3%	8.8%
OTHERS	5,137	6,577	28.0%	9.7%	35,539	39,215	10.3%	7.9%
Total	73,264	67,901	-7.3%	100.0%	443,108	494,019	11.5%	100.0%

Source: Immigration Office, TIA compiled by Nepal Tourism board

compared to the figures of the previous year, it seems difficult to meet the government's target of attracting one million tourists to Lumbini during 2012. The failure to attract the desired number of tourists in Lumbini can be attributed to the procedural delays in promotional activities from the government. A total of 524,000 tourists, including domestic tourists, have visited Lumbini during the first nine months of 2012, while 585,000 visited Lumbini in 2011. Domestic tourists account for more than 50% of the total inflow of visitors in Lumbini. As per the statistics of Lumbini Development Trust, Indian tourists visiting Lumbini have doubled over the last eight months to 94,000 compared to the same period last year.⁷⁶

Tourism entrepreneurs press for more budget for international promotion

Representatives of Trekking Agencies Association Nepal (TAAN), Nepal

Association of Tour and Travel Agents (NATTA) and Hotel Association Nepal (HAN) have demanded Nepal Tourism Board (NTB) raise its current budget of NPR 599.42 million (USD 6.97 million) for promoting Nepal in the international and domestic market by 60% in the FY2012-13. NTB has currently allocated around 30% of its current budget for promotional and marketing activities. As per the financial statements of the board, a total of NPR 346 million (USD 4.02 million) was spent in FY 2010-11, but only NPR 893.62 million (USD 1.08 million) was spent for promotional and marketing activities.

In a bid to increase tourists arrivals from new market segment, NTB has decided to focus promotional campaigns on the CIS (Commonwealth Independent States) and Scandinavian regions from next year, although promotions in existing regions would be

continued.⁷⁷ The committee has also suggested NTB include new programs focusing on international promotions.

Mustang named one of the top 10 destinations for 2013

Mustang has been named as one of the world's top 10 regions in "Best in Travel 2013" published by Lonely Planet, the largest travel guide book and digital media publisher in the world. It has described Mustang as being best for trekking activities, off the beaten track and culture. The book also states that though Mustang is politically a part of Nepal, their language, culture, climate and geographical is similar to Tibet.

The region was opened to tourism in 1992, with limited number of visitors. Last year, the region welcomed about 3,000 foreign trekkers; an increase of 36.4% as compared to the previous year. In the first six months of 2012, over 1,000 have already visited the place.⁷⁸

MACROECONOMIC OUTLOOK

The Nepali economy continues to face hurdles because of the political instability plaguing the country. The government has been investing immense time and energy on the agricultural sector, realizing that commercialization of the sector is of utmost importance. It is not just the draft Agriculture Development Strategy that proposes commercialization, but the National Farmers' Coalition also recommends it. The recent push by Nepal Rastra Bank to increase agriculture lending by Commercial Banks is a positive step in this direction. Another important step is the focus on government investment in infrastructure like irrigation systems and market access.

Meanwhile, in the education sector, the government has unveiled the Private and Boarding School Guidelines, 2012 in order to regulate the commercialization of education; these guidelines by the Ministry of Education propose changes in the education sector. However, Nepal is yet to see any quality changes that positively impact this sector. Although many of these changes are in the right direction, some seem haphazard.

While the Nepal government has always stressed on the fact that Nepal has immense potential for hydropower, the development of hydropower needs huge investment, which the government lacks. In addition, with the two state owned monopolies - NEA and NOC - running at losses, the country seems to be moving towards an energy crisis. Industrial growth is hampered because of inadequate energy availability, leading to fewer jobs, thereby fuelling migration. In order to break this vicious cycle, the government needs to make special arrangements with the neighboring countries to promote investment in hydropower projects. The government itself should invest in alternative energy, which is a far less expensive option.

Nepal has also been witnessing hurdles in the manufacturing sector due to the continuous energy crisis, labor problems and decreasing foreign investments resulting in a decrease in the export potential of the country. This has led to widening of the trade deficit due to the increase in consumption propelled by huge inflow of remittances, amidst sluggish industrial production.

Nepal's economy relies heavily on foreign aid and remittance. Since FY 2009/10, Nepal has witnessed a continuous increment in foreign aid commitments; however, there continues to be a gap between commitments and disbursements, primarily due to the low absorptive capacity of the country due to imple-

mentation bottlenecks. There has been a tendency to eulogize the remittance-dependency of Nepal's economy, and to a certain extent this is understandable. The increasing remittances have been crucial in maintaining overall current account and balance of payments surplus. Contributing 23% to the GDP, remittance has benefitted numerous households.

However, to the contrary, no significant contributions have been made towards the country's development as investments from remittances have mostly been in unproductive sectors such as real estate. Import-based consumption again leads to outflow of money from Nepal. The plight of migrant workers abroad also gives us the unfortunate side of remittances. Further, a huge chunk of remittance is lost in paying service fees to agencies. The government cannot merely benefit from remittance inflows, but it also needs to safeguard the interests of those migrant workers bringing in this money. Migrant rights experts and activists have asked the government to build a social security net for migrant workers and provide benefit, medical insurance and pension. The government must also reduce the cost for acquiring foreign jobs; it should also aim at enhancing the capacity of Nepali workers. With trained manpower, remittance can be doubled, thereby positively impacting the economy.

Another area that can contribute positively to the Nepali economy is the tourism sector. Keeping in mind the need to diversify tourist markets, Nepal Tourism Board (NTB) has been earmarking new destinations to promote Nepal as a popular tourist destination. NTB is planning to set up a marketing and promotion office in New Delhi, India. Additionally, NTB is planning to focus on promotional campaigns in 2013 in Norway, Sweden, Finland, Denmark and others and Commonwealth of Independent States (CIS) including countries like Armenia, Russia, Belarus and Ukraine. Even though these two regions are considered as emerging markets for Nepal, the contribution from them has been minimal so far. Thus, promotional and marketing activities would help boost tourist arrivals from these new market segments.

Uncertainty in the realty sector had led to a spiraling effect in the economy. However, after three years of a downturn, the realty sector is slowly regaining some vibrancy. Revenue collection data shows a positive picture for the first quarter of FY 2012/13. The increase in land/property transactions can be attributed to price cuts as high as 30%.

REVIEW

Financial Markets

Despite several negative factors - including the economic slowdown, limited avenues for productive investment and higher default rates in real estate loans - a majority of commercial banks have performed better than expected during the first quarter of the current fiscal year 2012-13. However, the performance of development banks and finance companies on an average does not seem promising.

TRENDS IN DEPOSIT, CREDIT AND LIQUIDITY

The banking sector, the largest financial intermediary, saw a slowdown in deposit growth in the first three months of FY 2012-13. As per the latest macroeconomic situation published by Nepal Rastra Bank (NRB), deposit mobilization of Banks and Financial Institutions (BFIs) increased by merely 2.5%, i.e. NPR 25 billion (USD 290 million), as compared to a growth of 5.2% - NPR 43.14 billion (USD 502 million) during the same period last fiscal. During the review period, deposit mobilization of commercial banks, development banks and finance companies increased by 1.7%, 4.8% and 3.4% respectively.

With the ease in liquidity situation, banking credit grew by 5.4% or NPR 52 billion (USD 602 million) as compared to a mere growth of 1.9% or NPR 16 billion (USD 186 million) during the same period in the previous fiscal year. Amongst the BFIs, commercial banks saw the highest growth of

credit mobilization by 5.1%, followed by 3.8% in development banks and 1.9% in finance companies.

During the review period, the Central Bank mopped up net liquidity equivalent to NPR 8.5 billion (USD 99 million) via open market operations, while it injected net liquidity of NPR 46.86 billion (USD 544.88 million) through the net purchase of USD from the foreign exchange market (commercial banks).

BASE RATE IMPLEMENTATION

In tune with the promise to introduce a 'base rate' in the monetary policy for the current fiscal year, NRB is now implementing the base rate. Directives have been circulated to commercial banks to implement the base rate from the beginning of the third quarter of the current fiscal year.

With this, commercial banks will have to determine a base rate and publish

it on a monthly and quarterly basis, through which banks should base their interest rate to disburse loans. The base rate is calculated by taking into consideration cost of fund, mandatory cash reserve ratio (CRR), statutory liquidity ratio (SLR), operating cost and minimum predetermined return on investment.

Even though the Central Bank had initially planned to make it mandatory for banks to charge a rate higher than the base rate for lending, it later decided to back down after concerns were raised by new commercial banks. Since new commercial banks have a higher cost of fund, their base rate would also be higher, hence directly hampering their capacity to lend to good projects. As per the current provision, banks can decide whether to keep the interest rate for lending above or below the base rate; however, the central bank plans to make it mandatory to charge interest rates higher than the base rate in the future. The Central Bank has

TABLE 6: FIRST QUARTER RESULTS OF COMMERCIAL BANKS-UNAUDITED FY 2012-13 (NPR IN TEN MILLIONS)

Bank	Paid up Capital	Reserve & Surplus	DEPOSIT			LOANS AND ADVANCES			OPERATING PROFIT			NET PROFIT			NPL (%)			"COST OF FUND (%)			
			FY 11/12		FY 12/13	FY 11/12		FY 12/13	FY 11/12		FY 12/13	FY 11/12		FY 12/13	FY 11/12		FY 12/13	FY 11/12		FY 12/13	
			4 QTR	1 QTR	Change	4QTR	1QTR	Change	1QTR	1QTR	% Change	1QTR	1QTR	% Change	1QTR	1QTR	1QTR	1QTR	1QTR	1QTR	1QTR
Nabil Bank	243.5	360.5	5,502.4	5,948.8	8.1	4,286.8	4,241.7	-1.1	47.1	64.1	36.07	30.5	58.8	93.1	2.83	2.99	2.83	2.99	6.10	4.31	-1.79
Nepal Investment	301.2	366.8	5,701.6	5,443.4	-4.5	4,291.2	4,440.7	3.5	44.9	58.5	30.29	29.4	47.7	62.2	1.03	2.27	1.03	2.27	8.60	5.70	-2.90
Standard Chartered	185.1	260.2	3,596.5	3,499.3	-2.7	1,982.8	1,929.0	-2.7	46.8	49.8	6.41	33.1	33.1	0.0	0.75	0.82	0.75	0.82	3.51	2.59	-0.92
Himalayan Bank	240.0	273.3	4,773.0	4,815.3	0.9	3,596.8	3,721.5	3.5	26.0	30.7	18.12	16.4	20.0	22.0	4.74	2.76	4.74	2.76	7.82	5.12	-2.70
Nepal SBI Bank	209.3	137.0	5,333.7	5,169.7	-3.1	2,614.2	2,797.6	7.0	14.6	24.6	68.49	9.5	16.2	70.5	1.59	0.49	1.59	0.49	5.42	4.82	-0.60
Nepal Bangladesh	200.9	100.5	1,695.2	1,576.3	-7.0	1,093.3	1,150.3	5.2	2.5	1.3	-48.00	3.1	6.1	96.8	18.62	3.95	18.62	3.95	7.88	6.74	-1.14
Everest Bank	176.1	274.3	5,000.6	5,005.0	0.1	3,661.6	3,780.9	3.3	38.3	51.4	34.20	24.4	32.7	34.0	0.37	0.71	0.37	0.71	7.36	4.94	-2.42
Bank of Kathmandu	168.4	116.9	2,499.1	2,459.2	-1.6	1,931.9	1,902.8	-1.5	20.2	20.4	0.99	13.4	15.2	13.4	1.94	2.44	1.94	2.44	7.80	5.40	-2.40
NCC Bank	140.0	58.9	1,648.5	1,769.9	7.4	1,290.0	1,465.2	13.6	2.6	0.9	-65.77	2.1	4.6	119.0	4.11	3.13	4.11	3.13	9.28	6.84	-2.44
NIC Bank	131.1	87.5	2,211.1	2,060.6	-6.8	1,724.2	1,544.9	-10.4	9.8	19.5	98.98	6.2	12.4	100.0	1.42	1.19	1.42	1.19	9.57	6.99	-2.58
Lumbini Bank	160.1	45.6	766.8	859.4	12.1	697.9	810.4	16.1	2.4	2.9	20.83	2.3	2.4	4.3	1.87	1.17	1.87	1.17	9.97	7.95	-2.02
Machhapuchhre	247.7	14.9	2,154.5	2,185.8	1.5	1,610.5	1,699.7	5.5	1.1	-0.2	-116.36	7.3	6.7	-8.2	4.10	2.80	4.10	2.80	9.30	7.40	-2.02
Kumari Bank	160.3	90.5	2,198.5	2,254.2	2.5	1,787.7	1,901.5	6.4	5.8	0.9	-84.31	4.2	1.9	-54.8	2.2	4.4	2.2	4.4	8.8	7	-1.90
Laxmi Bank	169.4	86.7	2,271.5	2,256.8	-0.6	1,670.1	1,818.9	8.9	14.4	13.1	-9.03	9.3	8.6	-7.5	1.01	1.20	1.01	1.20	8.40	6.70	-1.70
Siddhartha Bank	161.9	72.1	2,594.8	2,531.8	-2.4	2,021.7	2,087.6	3.3	4.1	3.8	-7.32	2.6	2.1	-19.2	1.50	1.90	1.50	1.90	9.90	6.70	-3.20
Global IME Bank	218.4	88.4	2,693.3	2,810.3	4.3	2,076.4	2,296.8	10.6	8.9	10.8	21.35	5.7	8.3	45.6	2.70	2.20	2.70	2.20	9.10	6.80	-2.30
Citizens Bank	210.1	24.6	1,795.4	1,759.8	1.4	1,441.5	1,559.7	8.2	8.1	10.2	25.93	5.2	6.7	28.8	3.00	2.40	3.00	2.40	9.56	6.44	-3.12
Prime Commercial	224.5	60.0	2,399.0	2,320.6	-3.3	1,890.2	2,020.8	6.9	90.3	54.5	-39.65	5.7	8.9	56.1	0.77	3.29	0.77	3.29	10.56	7.59	-2.97
Bank of Asia Nepal	200.0	24.7	1,535.1	1,526.4	-0.6	1,216.5	1,306.7	7.4	6.6	9.7	46.97	4.3	6.5	51.2	1.24	3.70	1.24	3.70	10.60	8.08	-2.52
Sunrise Bank	201.5	18.8	1,875.9	2,058.2	9.7	1,437.9	1,695.5	17.9	5.1	3.6	-29.27	3.4	4.4	29.4	3.80	2.10	3.80	2.10	9.90	7.16	-2.74
Grand Bank	200.0	45.0	1,502.3	1,488.9	-0.9	1,142.6	1,225.1	7.2	6.6	4.2	-36.36	5.5	4.3	-21.8	1.50	1.07	1.50	1.07	9.52	8.61	-0.91
NMB Bank	200.0	39.0	1,598.2	1,596.2	-0.13	1,246.8	1,429.5	14.7	5.0	11.8	136.00	4.2	9.0	114.3	0.71	2.19	0.71	2.19	10.79	6.80	-3.99
KIST Bank	200.0	25.4	2,017.3	2,013.0	-0.2	1,496.6	1,668.7	11.5	1.1	0.7	-36.36	0.7	1.1	57.1	1.62	3.98	1.62	3.98	9.50	6.72	-2.78
Janata Bank	200.0	8.7	772.2	920.4	19.2	746.1	906.8	21.5	2.0	4.2	110.00	1.3	2.7	107.7	0.00	0.40	0.00	0.40	10.11	7.70	-2.41
Mega Bank	163.1	17.9	919.2	1,092.5	18.9	793.3	1,022.6	28.9	0.3	4.0	1,076.47	0.2	2.6	1,138.1	0.88	0.97	0.88	0.97	9.69	5.87	-3.82
Commerz & Trust	140.0	5.8	633.2	738.1	16.6	564.9	699.5	23.8	0.3	3.1	1,007.14	0.2	2.0	1,076.5	0.00	0.00	0.00	0.00	10.33	7.53	-2.80
Civil Bank	120.0	5.4	880.7	1,033.6	17.4	775.1	914.9	18.0	1.0	3.5	257.14	0.6	2.2	254.8	0.00	0.00	0.00	0.00	10.80	8.51	-2.29
Century Bank	108.0	7.9	446.0	699.8	56.9	420.2	650.6	54.8	0.9	0.3	-71.11	0.6	0.2	-68.4	0.00	0.00	0.00	0.00	11.13	7.85	-3.28
Sanima Bank	201.6	16.7	1,117.8	1,274.6	14.0	953.1	1,163.6	22.1	4.7	7.7	63.83	3.0	5.4	80.0	0.97	0.47	0.97	0.47	10.80	7.88	-2.92
Public Sector Banks																					
Nepal Bank	177.2	-442.2	5,604.2	5,611.3	0.1	2,969.8	2,981.9	0.4	2.6	-6.9	-365.38	2.0	2.8	39.5	5.29	5.85	5.29	5.85	4.43	4.11	-0.32
Rastriya Banijya	549.7	-809.4	8,777.5	8,766.3	-0.1	4,044.8	4,125.0	2.0	0.1	8.50	10,525.00	10.7	20.0	86.9	11.46	6.95	11.46	6.95	5.03	4.79	-0.24
Agriculture Dev.	947.4	515.6	4,323.8	4,598.2	6.3	3,939.3	3,977.9	1.0	7.1	11.3	59.15	28.5	30.7	7.7	10.03	5.88	10.03	5.88	5.86	6.28	0.42
Total	7,156.5	1,998.0	86,778.9	8,143.7	1.57	61,415.8	4,938.3	5.7	431.2	482.8	11.97	275.5	386.3	40.2	2.88	2.30	2.88	2.30	8.67	6.50	-2.17

also instructed banks to maintain the interest rate while renewing or restructuring the loan.⁷⁹

The base rate is expected to keep the interest rate regime transparent to allow borrowers to make wise decisions as they can compare the base rate of various banks. Moreover, it will also push banks to be efficient in order to keep the base rate competitive.

COMMERCIAL BANKS: PERFORMANCE ANALYSIS

As per the published unaudited data for the first quarter of the current fiscal year, of the 32 commercial banks, 26 banks saw their net profit increase; however, 11 banks saw their operating profit decrease as compared to the same quarter in the previous fiscal year. During the period, the operating profit margin of commercial banks grew by 11.97%, whereas the net profit margin grew by 40.2%. These banks have been able to increase operating profit primarily due to a decrease in the overall cost of fund. At the end of the first quarter, the average cost of fund of banks stood at 6.5%, which was at 8.67% during the same period last year. Moreover, banks were able to book handsome net profits from the write back of provisions for possible loss, i.e., banks were able to pull back a substantial amount of bad debt. Likewise, the average Non Performing Loans (NPL) of commercial banks remained on the lower side at 2.3%, which was at 2.88% during the same period of the previous FY.

“ OUTLOOK

The net liquidity and Credit to Deposit (CD) ratio of the commercial banking sector at the end of FY 2011-12 stood at 34.87% and 70.01% respectively, which was 30.01% and 83.25% at the end of FY 2010-11. With the ease in liquidity in the banking system, the interest rate offered by BFIs on deposits is expected to tumble further in the days ahead. The International Monetary Fund (IMF) has advised the Central Bank to implement measures to absorb excess liquidity from the banking system, since excess liquidity in the market poses a challenge in maintaining interest rates at a level close to those in India and to ensure monetary and exchange rate stability with India.⁸⁰

As money supply increases, yield on bank deposits will continue to tumble, especially among commercial banks. Due to low yields on bank deposits, the probability of a large chunk of deposits being diverted towards consumption increases, thereby escalating inflation. As shown above, during the first quarter, the deposit mobilization of BFIs increased marginally by 2.5%, as compared to a growth of 5.2% during the same period in the previous FY. It can, therefore, be expected for funds to be diverted towards financial cooperatives which offer higher

interest rates or unproductive sectors such as real estate, which can lead to deterioration of the current liquidity situation and financial stability.

Moreover, in the absence of a full budget for the FY 2012-13, investment growth is expected to dampen further, which may worsen the current liquidity position. Also, the Balance of Payment (BOP) recorded a surplus of merely NPR 347.3 million (USD 4.03 million) at the end of the first quarter of the current FY as compared to a surplus of NPR 33.66 billion (USD 391.39 million) during the same period last year, largely due to current account deficit aided by huge trade deficit. The narrow BOP surplus during the period indicates decreasing supply of money into the banking system.

Commercial banks have managed to perform better than expected during the first quarter, primarily due to a higher spread rate –the difference between deposit rates and lending rates offered by banks. Such a spread has helped banks minimize their interest expenses, as there has been no substantial drop in lending rates. With the implementation of base rate policy from the third quarter of the current fiscal year, it will be interesting to see how it impacts the profitability of commercial banks.

REVIEW Capital Markets

The Nepal Stock Exchange (NEPSE) Index continued with its upward steam at the end of the first four months of FY 2012-13. The Index gained 111.79 points to reach 501.51 points, the highest point in the last 30 months.

During the review period, the total market turnover amounted to NPR 5,406 million (USD 62.86 million), an 80 % growth as compared to the same period in FY 2011-12. During FY 2011-12, the Index had shown some resilience by gaining valuable 27.2 points to close at 389.72 points after three years of a continuous downward spiral.

As shown in Table 7, during the review period, the hydropower sub-index (+56.94%) saw the biggest gain amongst the sub-indices, as it gained a whopping 389.25 points. The insurance sector (+50.50%) followed suit as it gained over 251.41 points. Similarly, the 'others' sub-index (+33.19%) appreciated by over 196.16 points largely due to the movement in the share price of Nepal Telecom (NTC). Likewise, amongst the BFIs, only the commercial banking sub-index demonstrated encouraging growth (+30.81%), aided by its benefit announcement for the FY 2011-12. However, the development banking sub-index (+4.20%) and finance sub-index (-0.50%) failed to appeal to investors as selling pressure mounted over them. Further, the hotels sub-index (+18.52%) witnessed an encouraging march, boosted by its improving financials.

Dissecting the long-term performance of the NEPSE index, the market interestingly completed a circle from 300 points (January 2006) to 300 points

(January 2012) in seven years. During the period, the highest ever index was at 1,175 points at the end of August 2008, exactly mid-way through as shown in figure 17. Moreover, after reaching the highest point in August 2008, the market plunged rapidly by 480 points in just over four months to close at 695 points in 2008. Such a movement indicates the level of high volatility in the market. Most common and stable markets don't come back to their original index.

After reaching a low of 298.89 points during March in 2012, the market since April was climbing up steadily until August. However, the market gained a sudden rapid momentum from September, to cross the psychological benchmark of 500 points in November. The environment and the fundamentals of the listed companies do not support the current rapid climb, and our Index lacks both depth and breadth; therefore, the current barometer may not be a true indicator to gauge the true performance of the market.

KEY REASONS FOR THE SURGE

- Due to sluggish economic activity, the demand for credit has nosedived, because of which banks have limited avenues to invest and are sitting with excess cash amidst ample liquidity in the banking system. Therefore, lending against shares by banks has increased drastically. By the end of the first

quarter of the current FY, commercial banks had lent NPR 6.17 billion (USD 71.74 billion) against the collateral of shares. The amount stood at around NP 4.97 billion (USD 57.79 million) at the end of last fiscal year.⁸¹

- Both the Securities Board of Nepal (SEBON) and the Nepal Rastra Bank (NRB) have agreed to allow margin lending based on a stockbrokers guarantee. Stock brokers can now function as an enabler between financial institutions and share investors who want to have a share purchase loan (margin loan) against share purchase invoices. According to the new provisions, financial institutions provide 60% of the amount required to buy shares, while 40% has to be furnished by the investors. Currently, around 15 financial institutions are actively providing such loans, however none of the commercial banks are involved in this yet.⁸²

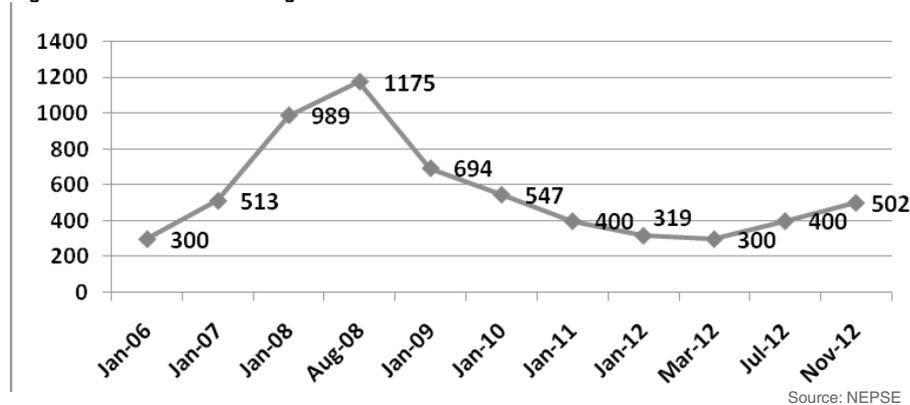
- With Interbank and Treasury Bill (TB) rates below 1%, development banks and finance companies are attracted to

Table 7: Sector wise Performance of the sub-indices

Indicators	July 15, 2012	Nov 20, 2012	% Change
NEPSE Index	389.72	501.51	28.68%
Commercial Bank Index	358.57	469.04	30.81%
Development Bank Index	245.43	255.75	4.20%
Hydropower Index	683.56	1072.81	56.94%
Finance Index	265.66	264.32	-0.50%
Insurance Index	497.86	749.27	50.50%
Others Index	590.98	787.14	33.19%
Hotels Index	489.04	632.04	29.24%

Source: NEPSE

Figure 17: NEPSE Index Long Term Performance



shares of Nepal Telecom (NTC) and hydropower companies. The annual yield from these investments is over 4-5% and they will stay invested till liquidity is adequate. This is a good sign for the market where institutional investors are finally attracted towards real returns.

- There has been ample news and dis-

cussion about transparency issues in the commodity market in September this year. Though it may well be a coincidence, it seems like the timing of the growth matches with the entrance of commodity traders in the stock market. The present growth shows that the market is full of speculators looking for short-term gains.

- With excess liquidity in the banking system, the yield on bank deposits has plunged drastically. The current yield offered by BFIs on deposits is unattractive; hence many investors have been drawn towards the secondary market.

- Dividend declaration of key listed companies, especially commercial banks, and expectations of bonus shares from life and non-life insurance companies since they have to meet their capital requirement has also enticed investors to enter the market as they can reap quick benefits through dividend income.

- Finally, Siddhartha Capital a subsidiary of Siddhartha Bank has floated the most awaited instrument of the stock market — mutual funds. The entry of mutual funds is expected to bring much-needed institutional investors into the market.

OUTLOOK

The current surge witnessed in the market exhibits improving investor confidence towards the capital market with an expectation of political consensus in the near future. However, the rapid unnatural rally towards 500 points raises questions about its sustainability and signals investors to be cautious while making investment decisions, and not to base their decisions on herd mentality and group behavior, since the current rapid climb is not supported by basic fundamentals.

Sadly, the market is again headed towards another mountain shaped graph and people tend to forget it has two troughs and one peak. We are at the first trough and should not hurry into creating a peak. We need steady growth aligned with scrip's fundamentals and environment changes.

The first quarterly result of listed companies, which is mostly dominated by BFIs scrip's, is mixed. Majority of commercial banks' performances are encouraging compared to the same quarter of the previous FY; however the performance of development banks and finance companies on an average is unattractive, as higher interest expenses and provision for bad loans have absorbed their profitability. Meanwhile, the benefit announcements made by listed companies for FY 2011-12 has also been below expectations and hasn't managed to attract genuine investors.

The under subscription of Lotus Finance's Initial Public Offering (IPO) clearly signals increasing investor awareness and selection criteria. Of the NPR 80 million (USD 0.93 million) worth of IPO, only NPR 11 million (USD 0.12 million) worth of shares were subscribed to. In the near future, the secondary market is going to see few large IPO's of commercial banks; and therefore, both share issuing companies and issue managers should be aware of the need to be cautious in the future.

On a positive note, the much awaited mutual fund has rolled out, and its subscription signals a positive message across the market. A matter of caution, however, is that its size of NPR 400 million (USD 4.6 million) is a drop in the ocean for market stability and hence, we will need more of these mutual funds to create market depth and hope banks like Nabil, NIBL, NMB, and Laxmi will come out with such funds soon. Likewise, the CDS and clearing limited has taken over the task of settlement and clearing related to share trading, which used to be carried out at NEPSE. After the takeover, the clearing and settlement is expected to be expedited, and be performed within three days following the trading day (T+3). Similarly, SEBON has granted a license to ICRA Nepal, which is the first credit rating company in Nepal. The credit rating company is expected to help investors make sound investment decisions based on their ratings.

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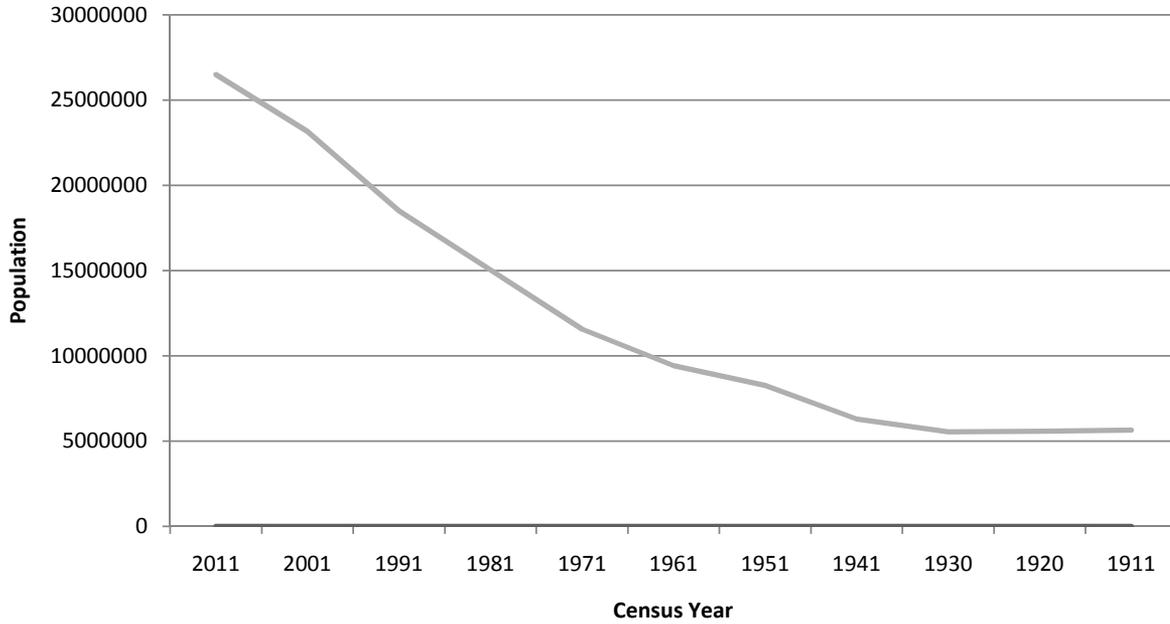
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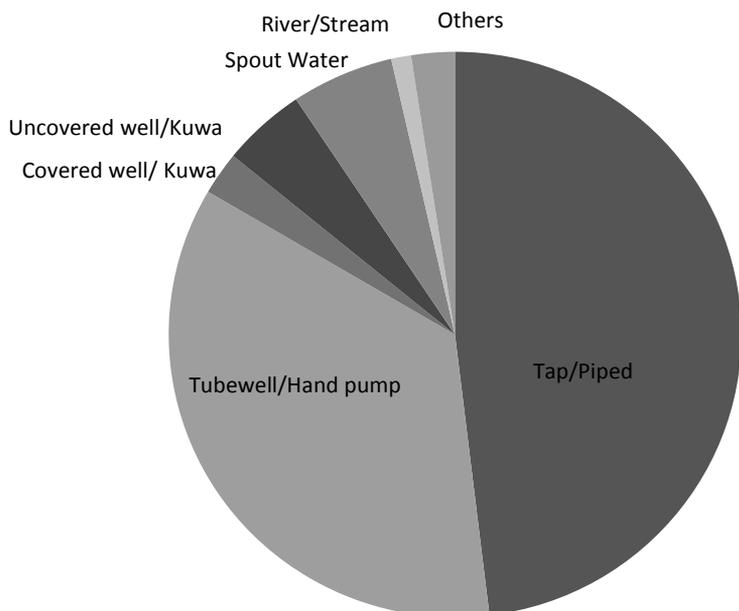
NATIONAL POPULATION AND HOUSING CENSUS 2011 STATISTICS

Source: Central Bureau of Statistics

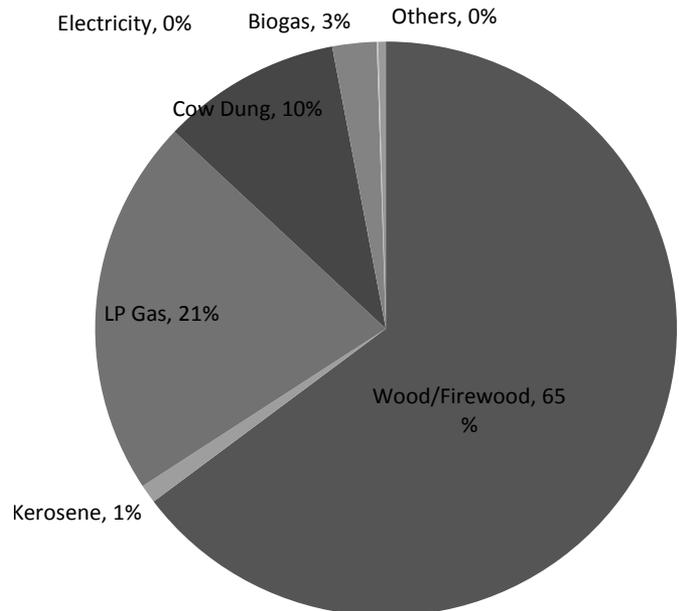
INTER CENSAL POPULATION CHANGES



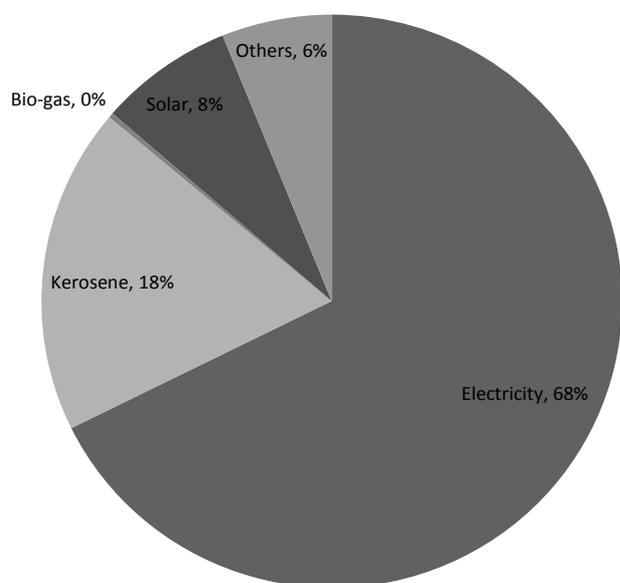
SOURCE OF DRINKING WATER IN NEPAL



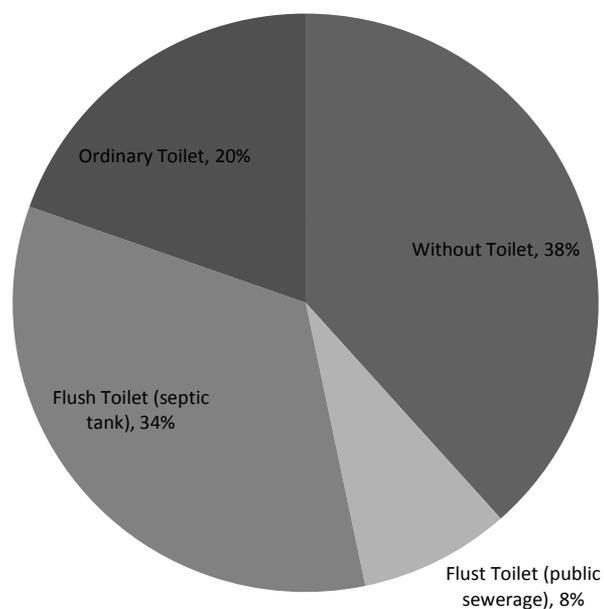
TYPE OF FUEL USED FOR COOKING IN NEPAL



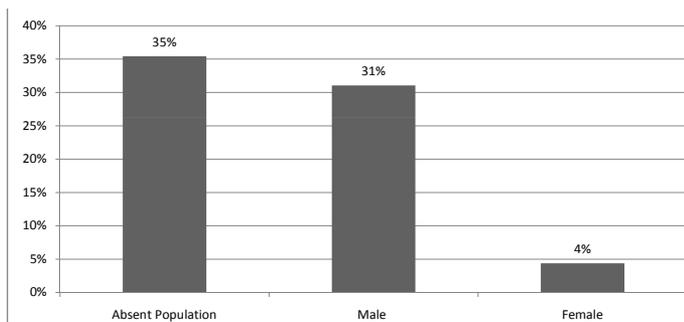
USUAL SOURCE OF LIGHTING IN NEPALI HOUSEHOLDS



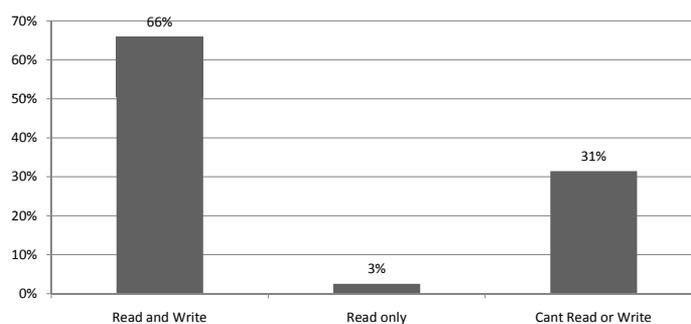
TYPES OF TOILETS IN THE HOUSEHOLDS OF NEPAL



ABSENT POPULATION IN THE HOUSEHOLDS OF NEPAL



LITERACY STATUS IN NEPAL FOR POPULATION AGED 5 YEARS AND ABOVE





NEPAL ECONOMIC FORUM

By re-defining the economic development discourse in Nepal, Nepal Economic Forum (NEF) strives to be the premier private sector led economic policy and research organization. Established as a not-for-profit organization under the beed (www.beed.com.np) umbrella, NEF is benefited from the 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 known for his best-seller *Unleashing Nepal - Past, Present and Future of the Economy* (Penguin 2009) and the “Economic Sense” column he wrote under the pseudonym Arthabeed for more than ten years in Nepal Times. NEF has worked in partnership with many Nepali and International institutions in its quest to mainstream the discourse on the Nepali economy that has not got the necessary space that it deserves.

NEF broadly works under three areas:

First, the **Business Policy Research Center (BPRC)** engages in research, dialogue and dissemination relating to pertinent economic policy issues. For three years, the BPRC has been producing **nefport**, a quarterly economic analysis publication and conducting **neftalk**, a platform for policy discourse. From 2011, a periodic research publication **nefsearch** was started and from 2012, **nefcast**, a video series began. BPRC is in the process of starting **nefsource**, a resource center.

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 the areas where a fresh pair of lenses are required to view the formulation and implementation of strategies. Hands on experience along a wide ‘cultural bandwidth’ puts NEF in a unique position to deliver Glocal solutions. With an international network and extensive Nepal experience NEF uses solution-oriented and actionable goals to complete its 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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