



NEPAL
ECONOMIC
FORUM

nefport

Docking Nepal's economic analysis





Why nefport?

In Nepal, economic analysis has not traditionally been a popular subject with readers or writers. There is an enormous readership for writing on politics, for example, so much so that even writers who start out focusing on the economy and business end up becoming political analysts. As a result, there is a vacuum in the field of independent research on economic issues. Such reports, as are available are produced by NGOs and bi- and multilaterals, and so when international investors are interested in Nepal, all the reports they have access to are from a development, rather than economics or business perspective. Further, while there are numerous private sector bodies working in different sectors, few generate widely useable research or information.

Nefport aims to fill this information gap by providing economic analysis that can meet the range of needs of business people, potential investors, development practitioners, management professionals, and students in and outside Nepal.

This issue focuses on the whole of fiscal 2008/2009 and presents the outlook for 2009/2010. We will also publish sectoral reports either as stand-alones or part of general nefport reports. It is envisaged that nefport will soon transition to being a quarterly and eventually a monthly. We look forward for support to enable us to make this change over one year.

We are also eager to receive your valuable feedback on how to make our product more useful and reader-friendly. Please email us at contact@nepaleconomicforum.org

Sujeev Shakya

Chairman

Nepal Economic Forum

FACT SHEET

GDP - official exchange rate (\$)	12.64 billion
GDP - purchasing power parity	31.09 billion
GDP per capita - PPP (\$)	1100
GDP - real growth rate (% of GDP)	5.6



Politics

On 10 April 2008, Nepal held elections to a Constituent Assembly. 60% of the 17.5 million eligible Nepalis voted in the election, which had twice been postponed from June and November 2007. The Communist Party of Nepal-Maoist (CPN-M) won 220 out of 575 elected seats, becoming the largest party in the Constituent Assembly. The Nepali Congress (NC) emerged as the second-largest, with 110 seats, and Communist Party of Nepal-Unified Marxist-Leninist (UML) third, with 103 seats.

On 28 May 2008, Nepal was declared a Federal Democratic Republic and the 239-year-old monarchy was abolished. In August, a coalition government was formed including the CPN-M, which was renamed the Unified Communist Party of Nepal-Maoist (UCPN-M) and the UML. The NC went into opposition. Ram Baran Yadav was appointed President, Paramanand Jha Vice President, and Pushpa Kamal Dahal 'Prachanda', Prime Minister of Nepal.

Under the direction of then Finance Minister Baburam Bhattarai, the Maoist-led government presented a Rs 236 billion budget 08/09 that featured public-private partnership and cooperatives as models for the economy in transition. The budget prioritized rural infrastructure, tourism and water resources, and the government hoped to increase Nepal's economic growth rate to 7 percent in 2010/11, with double-digit growth over three years.

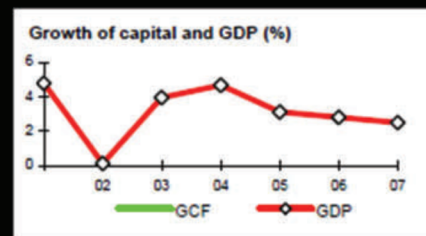
On 30 April, 2009, Min Bahadur Rayamajhi was chosen as the new Chief Justice of Nepal by a seven-member Council headed by PM Prachanda.

On 3 May 2009, PM Prachanda dismissed the Chief of Army Staff, Lt Gen Rookmangud Katawal, alleging that he was not cooperating with the government. A number of other parties, both in the ruling coalition and outside it, claimed that the decision had been made without their consent, and the same day President Yadav informed Gen. Katawal that he was reinstated. On 4 May, Prachanda resigned as Prime Minister, stating that the President's move had been unconstitutional and noting that his party would agitate for the principle of "civilian supremacy", or control of the security forces by the elected government.

FACT SHEET

GDP composition by sector (% of	Agriculture	32.5
	Industries	16.6
Labor force		14.6
Labor force by sector (% of GDP)	Agriculture	76
	Industries	6
Unemployment rate		4.1% - *
		22.3% +

* - unemployed
+ - underemployed



Nepal at a glance, ADB

On 23 May 2009, UML-leader Madhav Kumar Nepal was elected Prime Minister in a new coalition that included the NC and 21 other parties. Like Prachanda, Nepal faces a number of challenges, notably sustaining and moving forward the peace process including on the issue of integration of the two armies, ensuring the new constitution can be promulgated in May 2010 as planned, and consolidating the changes stemming from the process. From mid-2008 until he became PM, Nepal had been chairperson of the Constitutional Committee, which leads the constitution-drafting process. Nepal had resigned from his post as General Secretary of the UML in April 2008, taking responsibility for the party's poor showing in the election.

The new Finance Minister Surendra Pandey presented the budget for fiscal 09/10 in July, but this has not yet been passed, due to an ongoing blockade of the Legislature-Parliament by the UCPN-M. Also in July, the Indian Parliament passed the country's budget, prioritizing agriculture and irrigation. This has consequences for Nepal's agriculture sector, which will have to catch up with its Indian counterpart at a time when Nepali agricultural products have already been losing their competitive edge .

Seven temporary cantonment sites continue to house over 19,600 personnel of the Maoist army and just over 4,000 cadres disqualified as minors or late recruits in a verification process supervised the United Nations Mission in Nepal (UNMIN) in 2007. The Special Committee, with the mandate to supervise, integrate and rehabilitate Maoist combatants, was constituted in January 2009 along with a Technical Committee, but there has been little substantive progress on the issue. The provisions of the Interim Constitution include integration and rehabilitation of Maoist army personnel and democratization of the Nepal Army.

FACT SHEET

Population below poverty line (% of the population)	30.9
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Distribution of Family Income - Gini Index (0=perfect equality, 100= absolute inequality)	47.2
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Budget (\$)	Revenue	1.7
(In Billion)	Expenditure	2.3

International Relations

Nepal's international relations saw something of a shake-up following the CA election, when PM Prachanda broke with tradition and made his first state visit, in August, to China rather than India, in a move that was read as signaling a distancing from New Delhi. While in Beijing, Prachanda did not garner some expected commitments, such as on extending the Tibetan Autonomous Region's railway to the border with Nepal or assistance to build a road connecting Kimathanka on Nepal's northern border with China's Dingri for better connectivity and trade. However, China did pledge Rs 62.5 million in military aid.

PM Prachanda visited India the next month, with the primary aim of renegotiating the 1950 Treaty of Peace and Friendship, which provides an open border between India and Nepal permitting free and unrestricted travel of people and goods. Although initially supported enthusiastically by both sides, the treaty has over the decades become the target of increased resentment within Nepal, with many actors see it as encroaching upon the sovereignty of the country. India has signaled its willingness to review the treaty, but there has been little substantive preparation for doing so.

PM Prachanda's visit to China and his reported ignoring of a number of other suggestions from New Delhi, including on the dismissal of Gen. Katawal, are seen as having led to a cooling of relations between the UCPN-M and India, and increased Indian support for the other parties.

Shortly after he took office, PM Nepal visited India in August 2009. New Delhi pledged support worth over Rs 35 billion for a variety of infrastructure and development activities, as well as the construction of a National Police Academy.

In another development, Nepali Gurkha soliders who served in the British army will be allowed to settle in the UK and gain British citizenship following a review of UK policies spurred on by a campaign by the Nepali soldiers.

FACT SHEET

Inflation rate - consumer prices	7.75
Central bank discount rate	6.50%
Market value of publically traded shares (\$)	5.5 billion
Industrial production growth rate	1.80%

The International Economy

Financial Markets and Global Recession: The ongoing subprime mortgage crisis triggered by a dramatic rise in mortgage delinquencies and foreclosures in the United States has had severe negative consequences for banks and financial markets around the globe, as is well-documented. The crisis, which had been building up for close to a decade, has exposed extensive weaknesses in financial industry regulation and the global financial system. When US house prices began to decline in 2006-07, refinancing became more difficult and as adjustable-rate mortgages began to reset at higher rates, mortgage delinquencies soared. Securities backed with subprime mortgages, widely held by financial firms, lost most of their value. The result has been a large decline in the capital of many banks and US government sponsored enterprises, tightening credit around the world.

Impact of global financial crisis on Nepal: As Nepal's financial system has limited exposure to the global financial market and products, the impact of the ongoing global financial crisis on Nepal should be limited. However, in response to the effects on India and the Middle East, various indirect consequences are possible. For example, the depreciation of the Nepali Rupee against the US Dollar in response to the depreciation of the Indian Rupee could mean an adverse effect on Nepal's trade balance, inflation, and external debt servicing. Remittance inflows, the country's major foreign exchange earner and the lifeline of Nepal's economy, could also be affected. While growth in remittance inflow remains robust so far, Middle East countries, where the majority of Nepali migrant workers are located, are gradually starting to be affected by the global crisis through declining oil prices. If the crisis prolongs, these effects would intensify, the demand for foreign labor in Middle East countries could decline sharply, decreasing Nepal's remittance inflows. A slowdown in tourist inflows, another source of foreign exchange earning, and possible tightening of external aid flows are also likely, given the economic slowdown in the developed countries. While a major downturn is unlikely, the high growth Nepal has planned for, particularly in tourism and foreign aid, in the wake of improved domestic conditions, may not materialize in the short-term. Also, the Government may experience difficulty in securing financing (external credit or FDI) for a number of proposed large-scale infrastructure projects.

FACT SHEET

Electricity (kWh)	Production	2.703 bl.
(bl. - billion ml. - million)	Consumption	2.276 bl.
	Exports	165 ml.
	Imports	560 ml.
Oil (bbl/day)	Production	0
	Consumption	12,550
	Exports	0
	Imports	12,550
Current account balance (\$)		241 million



Foreign Exchange: The year 2008/09 saw the appreciation of the US dollar against the Nepali Rupee. On 15 June 2008, one US dollar was worth NPR 68.75, while on the 15 of June 2009, one dollar was Rs 76.15. In mid-May, Nepal Rastra Bank said the country's gross foreign exchange reserves stood at Rs 283.4 billion, a 33.3% increase compared with the figure for mid-July 2008.

Climate Change: Nepal ranks as the world's 126 largest carbon emitter, emitting 3214 thousand metric tons of carbon every year (which is less than 0.1% of total emissions). However, Nepal is a high risk country for the consequences of climate change, due to the danger posed by rapidly melting and receding glaciers, glacial lake outbursts, and major flooding in the plains. Seven years after the proposal of National Adaptation Programmes of Action (NAPA) for climate change, to identify priority activity areas to respond to immediate climate change-related needs concrete plans are yet to be drawn up. The Global Environment Facility (GEF) has agreed to provide \$200,000 to help draft the document and UNDP Nepal has sought further assistance from donors to prepare an "Extended NAPA" document.

FACT SHEET

Exports (\$, f.o.b.)	868 million
Major export partners	India 69.30% US 8.30% Germany 4.10%
Major export commodities	carpets, clothing, leather goods, jute goods, grain

Key Stories

Teliasonera acquires Spice Nepal

In September, 2008 Teliasonera entered the Nepali telecommunications market, acquiring 51% of the shares and votes in TeliaSonera Asia Holding B.V., which in turn owns 80% of the shares and votes in Spice Nepal. Spice Nepal is the second largest mobile operator in Nepal with around 1.6 million subscribers. Teliasonera is a public limited telecommunications service provider incorporated in Sweden. This is one of the most significant multinational purchases in Nepali corporate history, and a sign of the latent demand and market that remains untapped in Nepal. Mobile penetration in Nepal remains at 60% with only 30% geographic coverage. Since it was acquired, Spice Nepal intends to invest \$120 million in 2009 and \$130 million in 2010 to expand its coverage into rural areas with the objective of increasing its subscribers by an additional 1.2 million customers. At present, there are 4.65 million mobile users in Nepal, with Nepal Telecom having the largest subscriber base of 2.78 million.

Tourism

Although tourist arrivals by air increased by 4% in 2008 in the wake of the elections and the end of conflict, the instability and unstable security situation in Nepal has precipitated a 4% decline in tourist arrivals in the first half of 2009. Significantly, there was a 20% drop in the number of Indian tourists compared to the over 450,000 who came overland in 2008. In addition to the local political and security situation, the global recession has also had a role in the declining arrivals. However, the tourism sector is on the upswing regardless, in comparison with its prospects during the conflict years, and this has encouraged investments such as those that led to the opening of new trekking routes including rural routes through Gorkha, a "Guerrilla Trek" from Myagdi to Rukum, and the beginning of work on The Great Himalayan trail. Nepal's reputation as an adventure tourism destination continues to grow.

FACT SHEET

Imports (\$,	3.229
Major import partners	India 58.90%
	China 13.60%
Major import commodities	gold, machinery and equipment, petroleum products, fertilizers



Remittances

The number of Nepali workers going abroad has dropped by 13% in fiscal 08/09 compared to 07/08, 217,164 Nepali workers left the country for foreign employment. The fall in departures can largely be blamed on the impact of the global recession impact on Middle East countries and Malaysia. However, remittances grew by almost 50% during the first 11 months of 08/09, and Nepal Rastra Bank, the national bank, is on track to meet its Rs 200 billion remittance target. New destinations for Nepali workers are also opening up, including Cyprus, Mauritius, Romania, Qatar, Saudi Arabia, Japan and Korea. The inflow of remittances is critical in enabling Nepal to meet the trade deficit, maintain its foreign exchange reserve and its balance of payment. Remittances are also estimated to support over 30% of all households in Nepal.

Import/Export

Exports \$868 million note - does not include unrecorded border trade with India (2008)

Export goods Carpets, clothing, leather goods, jute goods, grain, herbs

Imports \$3.229 billion (2008)

Import goods Petroleum Products, Gold, Machinery

FACT SHEET

Debt - external (\$)		3.285 billion
Telephone	main lines in use	766,400
	mobile cellular	4.65 million
Radio broadcast stations	AM	6
	FM	80
	Shortwave	4

Enabling factors to private sector growth

The growth of the private sector is restricted by a number of major infrastructural, bureaucratic and governmental problems. Primary recommendations for tackling these problems is privatization of inefficient state-run entities and allowing competitive markets to develop with the government settling into a regulatory role. The major hurdles the private sector faced the past year are highlighted below.

Petroleum supplies

In the past year, Nepal experienced one of its worst fuel shortages ever. The rise in the price of crude oil, heavy government subsidies, and a politically-controlled oil monopoly exposed the grave shortcomings in Nepal's petroleum market. The Nepal Oil Corporation (NOC) estimates that at \$100 per barrel, petrol should retail at Rs 80 a liter, diesel at Rs 70 and kerosene at Rs 61. Government subsidies on petroleum products are intended to increase the access to fuel for the poor. However, subsidization without coordination with India has meant that a black market in fuel supplies flourishes along the border. Political unwillingness to remove or review the subsidies during the fuel crisis meant that NOC was forced to bear losses as high as Rs 2.7 billion a month. This forced it to limit imports to 40% of the actual monthly demand. The reduction in global demand as a result of the global recession, the fall in crude prices, and a much-delayed rise in the retail prices of fuel products in Nepal eventually lead to a normalization of supply. This chain of events, with its severe impact on a range of economic activity, highlighted the inflexibility and politicization of basic economic needs. This, and the energy crisis due to a shortfall in electricity production, remain issues of serious concern in the starting and operating of any business in Nepal. The crisis has not yet precipitated a change in NOC's monopoly or broken the cartel of retail pumps and transportation companies. As of June, NOC had outstanding liabilities of Rs 11.19 billion, most of which is loans from government institutions including the Citizen's Investment Trust and Employee Provident Fund.

FACT SHEET

Television broadcast stations	9
Internet hosts	42,219
Internet users	337,100
Share in world total merchandising export (% of world merchandising exports)	0.01



Water supply

Kathmandu Valley is increasingly facing the pressures of urbanization, particularly with water supplies inadequate to the growing demand. Faced with a demand of around 250 million liters of water per day, Kathmandu Upatyaka Khanepani Limited (KUKL), the Valley's water supply company, is able to supply barely 100 million liters a day. In addition, the Valley's antiquated water supply system, which is over 100 years old, is estimated to cause losses of up to 40% of supply due to leakages. The supply situation will only worsen until the completion of the Melamchi Water Supply Project, which is expected to bring 170 million liters of water per day to the capital. The Rs 17 billion project is expected to be completed by 2014 – 15 years since its conception – by the China Railway 15 Bureau Group Corporation. However, even this extra supply will not ensure that the Valley's daily demand for water, which will have risen further by then, will be met. In the meantime groundwater levels in and around the Valley continue to decline and the price of privately purchased tankers of water continues to increase.

Power supply

Also this past year, Nepal experienced some of its worst electricity shortfalls ever, with the capital having to bear up to 20 hours of power cuts a day. During the year, the 70 MW Mid-Marshyangdi Hydro Electric Project came online, bringing the country's total electricity supply to around 360 MW. However, peak hour demand for electricity has risen to over 800 MW, creating a significant deficit. Over 500 MW of power is expected to come online within the next five years through the 457 MW Upper Tamakoshi, 30 MW Chamelia and 60 MW Kulekhani III projects. However, until this happens, the supply-demand ratio will continue to be starkly inadequate, and by the time these projects do come online, the demand will have increased considerably. Although alternative sources of power, including renewable sources, are being explored, they cannot as yet provide a significant contribution to meet Nepal's power demands. In the short run, the government is faced with the option of either increasing supply through thermal plants or through importing power from India.

FACT SHEET

Share in world commercial services export (% of world commercial exports)	0.01
Inward FDI flows by host economy (\$)	5.742 million
Doing business (ranking by country on a basis of 181, the best is the first)	121



Militant labor

A militant labor force is a cross-cutting problem for all spheres of the private sector, as the primary means labor unions use to express any discontent is to shut down all production and service delivery. Such tactics deter investors from labor intensive industries, forces companies to shut down and leave, and makes it a near-impossible task for industrialists to draw foreign investment into Nepal.

FACT SHEET

Doing business ranking

Starting a business	73
Employing workers	150
Registering property	28
Getting credit	109
Protecting investors	70
Trading across border	157
(of 181 countries, best is first)	

Infrastructure

Railways

On 17 December 2008, Nepal and India signed letters of exchange to amend the Rail Service Agreement between the two countries. The Agreement was signed in May 2004 allowing rail traffic to and from the Inland Container Depot (ICD) in Birgunj. This agreement will not just open up the rail traffic for tank wagons for liquid cargo and flat wagons for bilateral break-bulk cargo, but will also create the potential for transportation of crude and edible oil, petroleum products, and similar other cargo to and from the ICD Birgunj. The amendments also seek to simplify the procedures for customs examination and clearance of bilateral as well as transit cargo.

The Katihar-Jogbani railway line was completed in 2008. The 108 km-long broad gauge line will provide regular passenger train service from Jogbani to Kolkata. Likewise, there will be train service once a week from Jogbani to New Delhi. Speaking at its inauguration in June 2008, India's then Minister for Railways Laloo Prasad Yadav announced that the Indian government was ready to extend the broad gauge railway line up to Biratnagar. The Morang Trade Association and Morang Chamber of Industries and Commerce have said that such services could help create an economic boom in Nepal.

The Ministry of Physical Planning and Works invited six consulting firms to submit a Request for Proposal (RFP) for a feasibility study for an electric railway line connecting Mechi to Mahakali as well as Kathmandu to Pokhara. All the firms, of which two are from the US and one each from Canada, South Korea, Australia and India, must have a tie-up up with a Nepali consulting firm in order to ensure technical transfer from foreign to Nepali companies. The government has allocated Rs 150 million for the building of an electric railway line in the Tarai from Mechi to Mahakali, the upgrading and widening of the Jaynagar-Janakpur-Bardibas rail line and the study for a Kathmandu-Pokhara railway.

FACT SHEET

Global Competitiveness Index	Business cost of terrorism	130
	Ethical behavior of firms	124
	Quality of overall infrastructure	130
	Local availability of research and training services	128



Petrol

In January 2009, the government endorsed a proposal to lay down a Raxaul-Amlekhgunj petrol pipeline tabled by the Ministry of Commerce and Supplies. The project, a joint-venture by the Nepal Oil corporation and Indian Oil Corporation, will cost around Rs 80 million according to 1996 estimates, since when it has been in the pipeline.

Koshi Petrochemicals of Hattimuda, Morang district started commercial refining of crude oil sourced from the Middle East in May 2009. The company started selling oil to industries in Morang, Sunsari, Birgunj, Butwal, Udayapur, Nepalgunj and Bhairahawa. The company produces 30,000 liters of diesel daily. Its production capacity is 20,000 tons annually and 60,000 liters daily. Koshi Petrochemicals' diesel retails for Rs 50.30 per liter, which is Rs 1 cheaper than Nepal Oil Corporations prices. The company will also begin producing furnace oil, turpentine and kerosene in the future. Koshi Petrochemicals began with a loan of Rs 270 million from Kumari Bank.

Privatization of drinking water

Nepal Water Supply Corporation has transferred some of its responsibilities in the capital to the Kathmandu Valley Water Management Board (KVVMB) and Kathmandu Upatyaka Khanepani Limited (KUKL). The privatization was to meet the prerequisites set by the Asian Development Bank for eligibility for grants and loans. The KVVMB will look after the policy matter while KUKL will manage the supply of water and infrastructure repair and maintenance. This ends the role of the Nepal Water Supply Corporation in Kathmandu Valley only; the corporation will continue to be responsible water supply management outside Kathmandu.

Energy

The Federation of Nepalese Chambers of Commerce and Industry (FNCCI) will start rural hydropower projects in 45 districts. The umbrella organization of Nepali private entrepreneurs is taking this step after Norway consented to provide technical expertise.

FACT SHEET

Global Competitiveness Index	Extent of staff training	133
	Extent of market dominance	130
	Prevalence of foreign ownership	129
	Co-operation in labour-employer relations	132



The Independent Power Producers' Association-Nepal (IPPAN) and Small Hydro Power Developers' Association Nepal (SHPDAN) has urged the government to re-adjust the new Power Purchase Agreement rates. Nepal Electricity Authority (NEA) in December 2008 fixed PPA rates for dry and monsoon seasons for projects generating up to 25 MW. As per the agreement with NEA, producers are supposed to sell to the NEA at least 80% of the energy generated. NEA purchases about 150 MW electricity from private power producers .

The FNCCI, the Association of District Development Committees of Nepal (ADDCN), the Municipal Association of Nepal and the National Association of Village Development Committees in Nepal have signed a memorandum of understanding to build small and medium hydropower projects to generate up to 5 MW of electricity in each district. The Rs 21 billion projects would generate 150 MW in 45 districts .

The Securities Board of Nepal (Sebon) has approved Chilime Hydropower Company's initial public offering (IPO) of 23,04,000 units. The board permitted Chilime to add a premium of Rs 223.70 to the face value of Rs 100 per unit, making each share unit worth Rs 323.70 and the total equal to its net worth. Chilime recently distributed 35% cash dividends to its shareholders from last year's profits .

The 6,000 MW Pancheswor Multipurpose Project agreed upon by India and Nepal in 1997, but hobbled by political tensions could soon move forward. Current Finance Minister Surendra Pandey said that the government would begin work on the construction of a ropeway and approach road to the proposed site. The revival of the project, the centerpiece of the 1996-97 Indo-Nepal Treaty, will now cost both governments more than Rs 30,000 crore, instead of the initially estimated Rs 17,000 crore .

The Supreme Court validated the government's decision to award the construction of the Arun III Hydropower Project to the Indian firm Sutlej Jal Vidyut Nigam (SJVN). Another rival Indian company, Jindal Steel and Power, had filed a writ petition at the Supreme Court questioning the government's motivation in awarding the project, to be completed within five years, to the SJVN in March 2008 .

FACT SHEET

Availability of latest technologies	128
Extent of market	129
Global competitiveness ranking	126
Economic freedom index (100=totally free 0=totally re-	53.17



Work on the Upper Karnali Hydroelectric Project is sporadically disrupted by local residents who say that they the Indian company contracted in mid-2008 by the government to build the project started work without adequate consultation with or consent from local communities. The residents are demanding jobs, a 50% share in the project, compensation for the acquisition of their land and an environmental impact assessment of the project. Staffers are demanding that the administration in Dailekh and Achham districts provide extra security to the project.

Local populations from eight Village Development Committees are also frequently causing strikes disrupting the construction of the 4.5MW Lower Indrawati Hydroelectric Project by the Sunkoshi Hydropower Co Ltd. Construction. The project is slated to be completed by 15 February 2011.

Prime Minister Nepal said on his August 2009 visit to India that the government planned to generate 25,000 MW of hydroelectricity in the next 20 years and sought India's active participation. The two sides agreed to facilitate increased Indian public and private sector involvement to harness Nepal's hydropower potential. Both sides agreed in particular to expedite progress on the Sapta Koshi High Dam, Sunkoshi Diversion Project and the 245 MW Nau Mure Project. Both sides also agreed to expedite the construction of the Dhalkebar-Muzaffarpur 400 KV cross border transmission line.

FACT SHEET

Total area (km ²)	147,18
Total population	25.76 million
Urban population as % of total	16%
Population median age	20.0 years
Population	2.00%
Investment in infrastructure with private participation (\$)	14 million

FY2009/2010 budget on hydropower development:

- Programs will be formulated to develop at least 25,000 MW of capacity within the next 20 years.
- Rs 14.69 billion is budgeted for the electricity sector. The electricity sector will be restructured to promote private sector involvement in production and transmission.
- In order to encourage domestic and foreign investment, appropriate policy will be formulated for long run energy development after making necessary reviews in the existing policies.
- Construction work on the 130 MW Upper Seti will be initiated by the government.
- Construction of Upper Tamakoshi Hydropower Project (456 MW) will be completed by FY 2012/13 through local investment.
- The construction of Kulekhani III (14 MW), Chameliya (30 MW), Upper Trisuli (60 MW), Rahughat (27 MW) and Lower Solu Hydroelectricity project will be expedited.
- Rs 1.57 billion proposed to be budgeted for community and rural electrification program.
- Construction of three main cross-country transmission lines of 400 KV will be initiated through an NEA-private sector joint venture.

FACT SHEET**Finance and Banking**

Government cash surplus or deficit	-10
Government of debt (% of GDP)	43
Deposit money bank's assests (% GDP)	57.4

Real State

QUICK FACTS:

- Investment: Rs 60-70 billion (Rs 50 billion in land development, Rs 20 billion in housing).
- Developers are constructing 6,000 residential units worth about Rs 60 billion annually.
- The population of Kathmandu growing by approximately 10% annually.
- Of the Rs 13 billion annual land revenue tax, 40% (about Rs 7 billion) comes from real estate.
- Outstanding loans of commercial banks to the sector grew to Rs 29.5 billion in March 2009 from Rs 6.6 billion the previous year.
- There are few investment outlets other than land or housing for the over \$1.5 billion Nepal receives in remittances annually.
- Nepal has the highest rate of urbanization among SAARC countries, with a 7% annual growth rate.

Benefits to the economy

Figures from the Department of Land Reforms and Management show that land transactions in the cities and urban centers almost doubled in the first seven months of 2008/09 compared to the same period last year. These transactions generated Rs 3.85 billion in revenue, a 150% increase on collections in the same period the previous year. Given the growing demand for housing in urban areas and commercial banks holding Rs 470 billion in deposits, this sector appears set to grow more. The government gave developers permission to build 3,385 units

According to the Nepal Land and Housing Developers' Association (NHLDA), over 20,000 people are employed by the 50-some housing projects underway in Kathmandu. Banks, insurance companies, and construction materials producers and traders all gain from this increase.

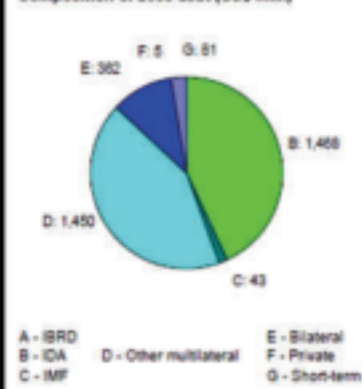
NLDHA organized a fair, Panchakanya Real Estate Expo, from 2-4 April 2009, that was attended by over 50,000 visitors and 40 exhibitors. The objective of the expo was to showcase the products and services that have been developed in the real estate sector.

FACT SHEET

Finance and Banking

Domestic credit to the private sector	36.3
Real interest rate (%)	0.3
Interest rate spread (% pts)	5.8

Composition of 2006 debt (US\$ mil.)



Nepal at a glance, ADB



Health

As of 2008, there were 40 pharmaceutical firms in Nepal. The Rs 10 billion pharmaceutical industry is growing at about 13% annually and meets about 40 percent of Nepal's total drug requirement. Investment in pharmaceuticals is estimated to be around Rs. 5 billion .

There are close to 4400 health-related institutions in Nepal, including 94 are hospitals, 5 health centers, 699 health posts, 293 Ayurvedic service centers and 201 primary health centers. There are about 7,000 hospital beds. Nepal Medical Council figures from January 2009 show 8,076 registered doctors in Nepal. Over 800 graduates each year have been licensed in recent years, compared with the previous high of 448 in 2003. Nepal has 11 medical colleges that produce at least 700 graduates each year and an estimated 500 graduates return home to Nepal having studied elsewhere. Over 300 doctors leave Nepal to work overseas every year.

The Nepal Health Entrepreneur's Council claims that over 50% of all medical and health institutions in Nepal are below minimum standard. Hospitals and doctors are also increasingly under threat and have on occasion been subject to violent reactions stemming from claims of negligence.

In response to cases of swine flu in India, the government has deployed 75 rapid response teams and has stockpiled 36,000 Tamiflu tablets, antibiotics and anti-viral medicines. It has also placed checkpoints at all key entry points into the country. A major outbreak of bird or swine flu would be a challenge for Nepal, as there are only 494 veterinarians in the country.

Traditional medicine continues to thrive. There is one Ayurveda hospital in Kathmandu with 100 beds, one regional hospital in Dang district with 30 beds, 14 zonal Ayurveda Ausadhalayas, 55 District Ayurveda Health Centers and 216 Ayurveda Ausadhalayas.

China Nepal Boda Hospital, a 50 bed hospital, opened in Nepal at a cost of nearly Rs. 80 million invested by the Chinese private sector.

FACT SHEET

Infrastructure

Paved roads (% of total roads)	50.9
Mobile cellular subscription (per 100 ppl)	11.6
Internet users (per 100 ppl)	1.4

FACT SHEET

Economic and social context

Inflation (annual % change in con- sumer price index)	6.1
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External debt flows

Disbursement	174
Long-term external debt	141 million



Manufacturing

During 1993-94, Nepali exported 3.326 million square meters of **carpets**. During this time, carpet-making was classified as a cottage industry, was income tax free and came under the Generalized System of Preference (GSP) from importing countries. (GSP is a system of exemption from the Most Favored Nation principle that obligates WTO member countries to treat the imports of all other WTO member countries the same as imports from their "most favored" trading partner). Many of these factors have changed unfavorably in the past 15 years – the government taxes earnings from export, there is competition with cheaper Indian carpets, there has been no effective economic diplomacy or market – with the result that in 2007-08 Nepal exported only 1.136 million square meters of carpets, a 65.8% drop. The industry still earns Rs 6 billion a year.

The **readymade garment industry** is continuing to lose its hold in the US, with exports to the world's largest apparel market plunging by another 49% in the first eight months of 2008. Statistics from the Garment Association of Nepal (GAN) show that Nepal's garment sales to the US from January to August 2008 totaled \$10.17 million, down from \$19.73 million during the same period the previous year. Deteriorating labor relations, eroding competitiveness and massive diversion of international orders are the primary reasons for this downturn.

An **increase in government salaries** has led to trade unions demanding a raise as well. The wages of government employees were increased in response to high inflation rates over the past 12 months – inflation remains at 10%. The salary of non-gazetted employees was increased by 6%, while that of gazetted employees was increased by 4%. The UCPN-M-affiliated trade union, All Nepal Trade Union Federation (ANTUF), have demanded a 100% increase in dearness allowance and a 40 percent increase in basic salary. Major companies have been affected by these. For example, Surya Nepal was forced shut down until the management gave in to the demands of the workers and increased basic salary and remuneration .

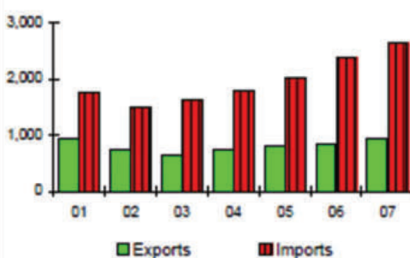
Over three decades since the first study was conducted on setting up special economic zones (SEZ) in 1983, and 18 years after plans were announced to develop such zones, the government has announced that it will set up SEZs in four different parts of the country , Birgunj, Bhairahawa, Panchkhal and Jiling. exports.

FACT SHEET

External debt flows

IMF purchases	33 million
Principal repayments	114 million
Long-term external debt	114 million

Export and import levels (US\$ mill.)



Nepal at a glance, ADB

The SEZ in Birgunj will focus on agro-based industries and manufacturing while the SEZ in Bhairahawa will focus on exports.

According to NRB, pashmina exports have increased by 622.8 % in the past year. This increase can be attributed to increase in demand for high value sweaters. Nepal receives low-volume offers in contrast to big volume producers like China .

The Indian government removed the import tax on crude oil used for making ghee. This has made the Indian ghee industries more competent compared to their Nepali counterparts. As result, of 22 vegetable ghee factories in Nepal, only 6 continue to be in operation. Nepal imported 329 million kg of crude palm oil in 2008/09, nearly 50 % less than in previous fiscal years.

According to the Chamber of Industries of Morang (CIM), **180 factories have closed down in the district**, citing increased insecurity, labor problems and bandhas as reasons for closure. The factories produced plastics, readymade garments, zinc oxide, oil and ghee.

Transporters in the Morang-Sunsari area have been facing huge losses due to the ongoing strikes and protests. The Nepal Transport Workers' Association complained that the losses have reach Rs 5 million. 500 transport workers have moved to other jobs, as strikes and bandhs make working in transport an untenable economic decision .

Udaypur Cement factory, Nepal's largest cement factory, incurred a loss of Rs. 5 million per day due to the power shortage in March this year .

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FACT SHEET

External debt flows

Net Flows	61 million
Long-term external debt	31 million
IMF purchases	0
Short-term external debt	0

Tourism

Trekking

19% of all tourists visit Nepal for trekking. The Annapurna region generated around Rs. 2 billion in government revenue and the Langtang region generated around Rs. 700 million. It is estimated that trekker numbers will increase despite the global recession.

A 25 km trekking route from Manakamana Temple to Gorkha Durbar was opened in an attempt to promote tourism in Gorkha district. The trekking route offers visitors an opportunity to experience the lifestyle and culture of the people of Gorkha.

A 13-day Guerilla trek that follows the trail of the Maoist militia from Beni to the Maoist heart land in Rolpa has been established. The trek allows visitors to see historic locations as well as some unique scenery while helping locals recover from a decade long insurgency.

Adventure tourism

Nepal has introduced a new adventure sport in the form of heli-skiing which allows adventure seekers the option of snowboarding or skiing down the slopes of the Himalayas after being flow up on a Helicopter. The season runs from late Febraury through early April.

Ilam picks up

Ilam is coming up as a tourist destination through the promotion of tea tourism and its scenic views of Everest and Kanchenjunga. Over 20,000 tourists, mostly traveling by land from India, visited Ilam the past year.

Resorts shut down

Seven resorts – Machan, Gaida Wildlife, Chitwan Jungle Lodge, Narayani Safari, Island Jungle Resort, Tiger Tops and Temple Tiger whose premises were within the Chitwan National Park have been shut down. Their 16 year loan contract with the government for their respective properties expired in July 2009. Controversies have sparked over whether or not the government should renew the license of these resorts .

FACT SHEET

External debt flows

Interest payments	35 million
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Visit Nepal Year 2011 launched

The Ministry of Tourism and Civil Aviation launched the Visit Nepal Year 2011 campaign with the objective of drawing over one million tourists into Nepal. The first Visit Nepal Year 1998 attracted 492,000 tourists. If the targeted one million tourists is reached, it is estimated that an additional 500,000 jobs in the tourism sector will be created. In line with the campaign the government is giving heavy discounts on royalties, fees and visas to attract more tourists. The budget has also allocated Rs. 250 million for upgrading airports and Rs. 100 million in extension of certain airports.

Aviation

China Eastern started flight services between Kathmandu-Kunming three times a week. This is the third Chinese airline to operate in Nepal with Air China operating seven weekly flights between Beijing-Kathmandu and China Southern Airlines operating three flights between Guangzhou-Kathmandu. 14,706 Chinese tourists flew into Nepal during 2008.

Yeti Airlines purchased 2 brand new Pilatus Porter aircrafts with the objective of extending its service routes to airfields which cannot take Twin Otters.

Buddha Air has added three new ATR-42 aircraft to its fleet in the past year with the objective of increasing the number of flights it offers to Biratnagar, Pokhara, Bhadrapur, Bhairahawa, Nepalgunj and Dhangadhi. The France-made 47-seaters were purchased with a load of US \$ 10 million from IMF and the flights were expected to get cheaper by 25% from the addition.

Bahrain Air entered the Nepali airline market and became the fifth Gulf based carrier to fly into Kathmandu. The Airline will fly into Kathmandu three times a week.

Pakistan International Airlines (PIA) has started flights between Islamabad-Kathmandu twice a week this will be in addition to the Karachi-Kathmandu route.

FACT SHEET

Other non-debt resource flows

FDI - net (\$)	6
Portfolio equity flows	0
FDI (\$)	54
Grants - expanding technical co-operation (\$)	434 million



Due to growing demand, Thai airways added three more flights a week to its Kathmandu-Bangkok route. This brings total Thai flights to 10 a week.

Nepal's first budget carrier, FlyYeti.com suspended operations in July 2008. The airlines remained in operations only for 6 months.

FACT SHEET

Other non-debt resource flows

Debt forgiveness (\$)	15 million
IDA Grants (\$)	43 million
Technical co-operation grants (\$)	97 million



Remittance

Remittance inflows grew by 51% in the first 11 months of fiscal year 08/09 with an estimated Rs. 200 billion inflow for the whole fiscal year expected. It has an 18% contribution to Nepal national GDP.

Major remittance sources:

Qatar – 1.3%

Malaysia – 19.2%

Saudi Arabia – 14.9%

India – 13.4%

UK – 2.2%

An estimated 30% of all Nepali households are dependent on remittances for daily household expenses.

With the British Government's decision to grant former British Gurkha's citizenship, a significant number of British Gurkha families are expected to move to Britain. This is expected to impact remittance flows from British Gurkhas leading to a decrease in remittances from the United Kingdom.

The number of **Nepali workers** leaving for work abroad has fallen by 13% in the last fiscal year. This is the first drop in Nepal's foreign employment history and is largely a product of the global recession. There are an estimated 2.5 million Nepali citizens working abroad.

FACT SHEET

GDP - official exchange rate (\$)	12.64 billion
GDP - purchasing power parity	31.09 billion
GDP per capita - PPP (\$)	1100
GDP composition by sector (% of total GDP)	Agriculture 32.5 Industries 16.6 Services 50.9

Worker numbers and change %:

1998/99	27,796	258.88%
1999/00	35,543	27.87%
2000/01	55,025	54.81%
2001/02	104,736	90.34%
2002/03	105,043	0.29%
2003/04	106,660	1.53%
2004/05	139,718	30.99%
2005/06	165,252	18.27%
2006/07	204,533	23.77%
2007/08	249,051	21.76%
2008/09	217,164	-12.80%

Breakdown by country:

Country	08/09	07/08
Qatar	76,175	85,442
Malaysia	35,070	50,554
UAE	31,688	45,342
Saudi Arabia	48,749	42,394

Under the **Employment Permit System (EPS)**, Nepali workers are being recruited to work in South Korea. To meet the surge in demand for flights from Nepali workers leaving the country for South Korea, Korean Air has added a direct flight between Seoul-Kathmandu. This is a result of cooperation between the Korean and Nepali government to provide Nepali blue collar workers in five industries – agriculture, manufacturing, service, fishery and construction.

FACT SHEET

Major economic aggregates

GNI	10.4 billion
Exports of goods, services and income	3.3 billion
Worker remittance and composition of employees	1.7 billion

Communications

There are 4.65 million mobile phone users in Nepal with 2.78 million subscribing to Nepal Telecom (NT) and 1.86 million subscribing to Mero Mobile. The telephone penetration rate in the country has also gone up with 20 out of every 100 people now having access to telephone services.

Nepal Telecom has a fixed line subscriber base of 441,416 lines, 74,805 dial-up accounts and 13,969 ADSL accounts. NT, the largest telephone company in Nepal, has expanded its telephone services to 3264 VDCs in the country through the usage of VSAT technology. During the last fiscal year, NT posted net profits of Rs. 7.94 billion, up from the 5.54 billion from the previous year.

A survey carried out by the Nepal Telecom Authority (NTA) has revealed that 75% of all mobile users are unhappy with the quality of service being provided by the mobile service providers in Nepal. Nepal Telecom has stated that unreliable power and load-shedding are hampering its connectivity. In response to the growing power shortages, NT is switching its base tower stations power supplies to solar powered batteries.

Spice Nepal, operators of Mero Mobile, United Telecom Limited (UTL), and Nepal Telecom have reduced their interconnection charges as per the directives of the Nepal Telecommunications Authority (NTA), the regulatory authority for telecommunication service providers.

The past year, Nepal Telecom introduced its Asymmetric Digital Subscriber Line (ADSL) internet service which provides high-speed internet access. The service provides speeds up to 2 Mbps with the potential of going up to 8 Mbps.

There are over 543 cable television service providers in Nepal, which have distributed over 1 million lines throughout the country covering over 9 million people. The government has a 100% investor tax on cable companies and earned Rs. 3 million in FY 07/08 from these companies.

There are over 10 TV channels and 158 FM stations that provide media services in Nepal, an additional 12 TV channels are expected to go on air. During FY 07/08, the government earned over Rs. 6 million in revenues from television channels alone. The number of FM stations is expected to double with 383 licenses issued. Due to an overcrowding of airwaves, the government stopped issuing licenses from February 2009

FACT SHEET

Major economic aggregates

Imports of goods and services	3.7 billion
Current account balance	6 million

Education

There are **45,000 schools in Nepal**. Of these 31,000 are government schools, 8,000 are private schools and 6,000 are community schools. The literacy rate for the total population in Nepal is 54.1% of which 65.5 % are male and 42.8 % are female . The literacy rate among the youth (between the ages of 15-24) is more encouraging, with 85% of all males and 73% of all females literate .

The number of students that have passed the **SLC exams** in 2009 has been at an all time high. 68.47% (4.74% higher than that of the last academic year) of the regular and exempted students, who appeared for the exams, have passed the exam. 72.03% of the boys and 64.34% of the girls have received their school leaving certificates .

Nepali students are increasingly looking to pursue their **education abroad**. Nepali students spend more than Rs 30 billion annually to study abroad. Between 1990 and 2005, the number of students going to countries other than India has doubled . The trend is ever increasing: Ministry of Education in Nepal receives 100 daily applications to study abroad in 2007/08; they received an average of only 50 applications per day in 2006/07. Currently, 24,000 students seek education outside Nepal.

With 7,700 students going to the USA in 2007 , Nepal ranks 13th by number of students studying in the USA, compared to 23rd in 2004. Nepal ranks 11th among countries sending students to Australia. This exodus of students going abroad has developed a **thriving market for educational consultancies**. There are around 200 consultancies that are registered with ECAN (Educational Consultancy Association of Nepal) and another 100 registered with Nepal Educational Consultancies' Association .

To meet the **growing demand for an international education**, many schools in Nepal offer international degrees, especially in the +2 category. There are currently 25 institutions that offer A Levels in Nepal. Of these 3 are located outside Kathmandu Valley. One school in Kathmandu has started offering IB (International Baccalaureate).

FACT SHEET

Ratios

External debt stocks to exports (%)	110.2
External debt stocks to GNI (%)	35
Debt Service to exports (%)	4.5

The private sector has shown interest in the education sector in Nepal. The **joint venture between Chaudhary Group and Manipal K-12** is an example of private sector investment in the educational sector in Nepal. This venture will offer service to existing and new schools under the brand name “CG-Manipal Schools”. A key component of this venture is the ability to offer ICT-based school learning solutions and tutorials as a result of Manipal’s partnership with TutorVista.com, an online tutoring company.

Major donor funded school education programs, namely Education for All, Secondary Education Support Program (SESP), Teacher Education Project (TEP) and Food for Education Program (FFEP) are set to end at the end of this fiscal year. In response, the Ministry of Education is planning to initiate a School Sector Reform (SSR) program for 2009-2015 with an estimated budget of US \$ 5.7 billion. The objective of the SSR is to integrate the education system, structurally and functionally and to create uniform policies to ensure quality and excellence in the education sector. A major undertaking of the program is creating two educational structures, elementary level from grades 1-8 and secondary level from grades 9-12 .

In the budget by the Maoist led government, it was announced that all private schools are to pay a **5% Education Service Tax (EST)**. The government claimed that this tax would be spent on educating students in remote parts of the country. Although some schools have paid the service tax, most of the private schools and the umbrella organization for private schools, PABSON, refuse to pay the EST.

FACT SHEET

Ratios

Short-term external debt stocks	2.2
Multilateral to external debt stocks	85.8

Agriculture

Unfavorable environmental conditions (climate change) such as winter drought and delayed monsoons, overflowing of the Koshi river, and Indian government's ban on exports of rice and wheat have created **food shortages** in Nepal. 41 out of 75 districts or 2 million people are in the danger of facing shortage of food. Food stockpiles are 20% lower than in 2008. .

In addition to shortage of food supply, **dramatic increase in food prices** has limited access to food. In 2007, food prices increased by more than 40%. Consumer Price Index (CPI) based inflation as of mid-November 2008 was 14.5%. Rising inflation, according to the NRB report, has been driven primarily by a significant rise in food and beverage prices (17.0%). Supply cartels were found to be hoarding food stocks to create artificial food shortages and increase prices to gain undue profits. Price rise is caused primarily by hoarding and black-marketeering (30%), wholesalers (20%), bandhs and strikes (10%) and the Indian market (40%).

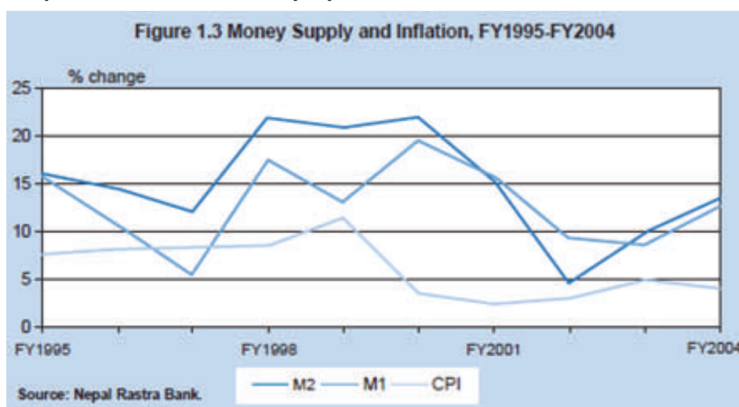
According to the WFP, in the rural areas, **8 out of 10 households do not have the money to buy food**; they are either borrowing money or buying food on credit. Additionally, half of all Nepalis are eating less .

Farmers have been hard hit by the never-ending bandhs. Because of the bandhs, many farmers have been unable to bring their produce to the market and supplies of essential items have also been affected. For example, the capital requires 140,000 litres of milk per day but only half that amount can be supplied during strikes and blockades. In protest to the week-long ban on cargo vehicles by the Maoists, 300 farmers in Chitwan dumped 500 quintals of fresh vegetables on the road.

Poverty Reduction Strategy (PRS), based on the Tenth Plan, believes that greater productivity in agriculture can bring about higher economic growth. ADB, IFAD, OPEC fund, UN agencies and the World Bank are the major multilateral agencies involved in PRS. Australia, Canada, Denmark, Finland, Germany, India, Japan, Kuwait Fund, Norway, Saudi Fund, Sweden, Switzerland, UK and USA are the bilateral agencies that invest in agriculture through the PRS .

GRAPHS

Nepal Economic Quarterly Updates, ADB



Foreign Aid

Nepal relies heavily on foreign aid. For the FY2008/09, 81 % of the capital expenditure of the government is expected to be met by foreign aid . In the first eight month of 2008/09, foreign aid commitment decreased by 11.4 % to \$573 million (Rs. 43 billion). Of the \$573 million, \$510 million (Rs. 38 billion or 89 %) has been committed in the form of grants while \$63 million (Rs. 5 billion or 11 %) has been committed in the form of loans. The trend of foreign aid commitment and disbursement in the past 5 years (graph below) shows that commitment has always been much higher than disbursement. Only 60% of the committed amount has been disbursed in 2007/08.

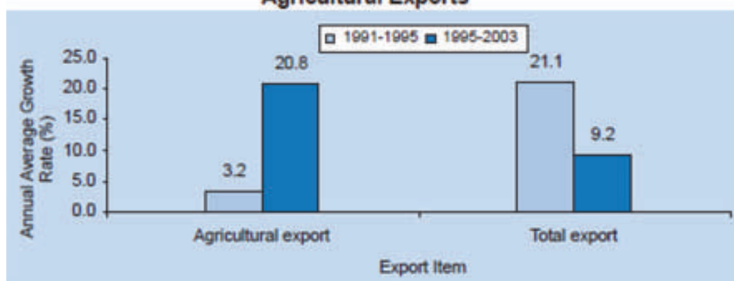
Foreign aid commitment is highest in the rural development sector; this sector constitutes 29% of total aid to Nepal. Other major sectors that receive aid are electricity (8.2%), health (8.1%), transport and communication (5.8%), drinking water and sewerage (4.4%), agriculture, irrigation and forestry (4.0%), education (3.0%) and other sectors (37.5%).

Nepal receives aid through bilateral and multilateral agencies. The key multilateral agencies that provide aid are ADB, DFID and World Bank. The current portfolio of ADB consists of 29 projects and a total aid package of \$882 million. Of the 29 projects, 20 projects (\$658 million or Rs. 49 billion) are aid in the form of loans while 9 projects (\$226 million or Rs. 17 billion) are investment grants. As of 2008, the World Bank's commitment to Nepal is worth \$849 million. Of the total commitment, \$589 million or 70% is not disbursed. World Bank's portfolio in Nepal consists of 17 active projects

DFID's current portfolio to Nepal is worth \$117 million (Rs. 9 billion). Of this amount, \$55 (Rs. 4 million) billion is used to give assistance to the Government of Nepal. DFID alone provides 52% of bilateral aid to the government. DFID provides assistance through three frameworks, namely the Bilateral Program Aid Framework (\$107 million or Rs. 8 billion), the Conflict Prevention Pool (\$6 million or Rs. 450 million) and the Multilateral Debt Relief Fund (\$3 million or Rs. 225 million). The highest spending has been in the health sector, accounting for 32% of the bilateral budget to Nepal.

Nepal Economic Quarterly Updates, ADB

Figure 4: Annual Average Growth Rate of Nepal's Agricultural Exports*



Bilateral aid **Bilateral aid** is also provided by India, China, GTZ, JICA and USAID. In 2007, JICA provided Nepal Rs. 118 million (USD 2 million) worth of technical assistance. Of this 118 million, Rs. 106 million (90%) was provided in the form of loans and Rs. 12 million (10%) in the form of grants . Government of India provides assistance to Nepal through India -Nepal Economic Cooperation Program and India's total aid portfolio, consisting of over 290 projects, is valued at Rs. 23 billion (USD 307 million) and the Chinese government's aid portfolio to Nepal is worth Rs. 1,646 million (USD 21.94 million).

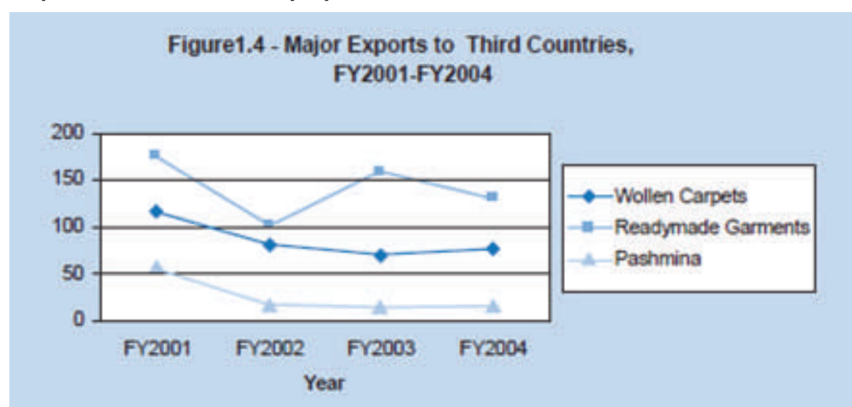
FDI: FDI contributes 1% of GDP. In FY2007/08, Nepal received the highest FDI to date: a commitment of US\$144 million (Rs.10 billion). This increase in FDI can be attributed to the recent housing boom and rising interest in hydro projects. Indian investors topped FDI in Nepal at \$67 million (Rs. 5 billion). South Korean investors committed \$43 million (Rs. 3 billion), Chinese investors committed \$7 million (Rs. 525 million) and United Arab Emirates investors committed \$6 million (450 million) .

Nepal received \$23 million (Rs. 2 billion) in investment in the **housing sector** alone. Indian investment in this sector is worth \$18 million (Rs. 1 billion), UK investment is worth \$3 million (Rs. 225 million) , Chinese investment is worth \$1 million (Rs. 75 million) and Spanish investment is worth \$0.5 million (Rs. 37 million).

Investment in hydropower is worth \$33 million (Rs. 2 billion). One of the biggest projects is to be undertaken by South Korean Hydropower Company; they have committed to invest \$29 million (Rs. 2 billion).

GRAPHS

Nepal Economic Quarterly Updates, ADB



Financial and Capital Markets

Nepal Rastra Bank (NRB)

Of the 235 **financial institutions** registered with NRB and in operation, there are 25 commercial Banks, 59 development banks, 78 finance companies, 12 micro-finance development banks, 16 Savings and Credit Co-operatives and 45 Financial Intermediaries (NGOs). As of July 2007, there are 9,362 cooperative institutions in operation. There are a few more commercial banks and other institutions waiting to commence operations.

In the last one year a few development banks and finance companies were upgraded in class, as shown in the following table:

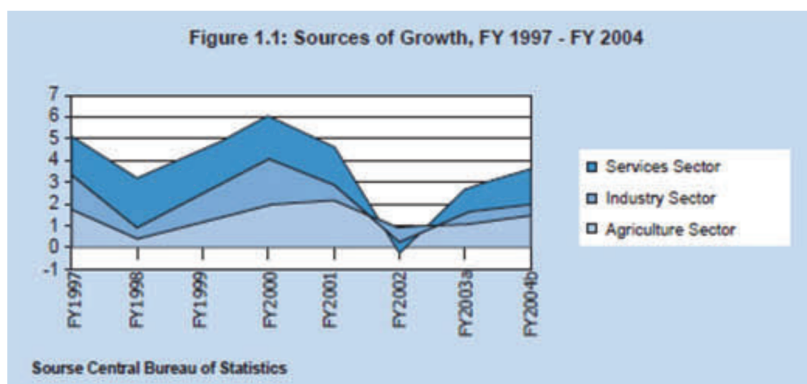
Company	Original Grade	New Grade
KIST	Finance Company	Commercial Bank
ACE	Finance Company	Development Bank
NMB	Finance Company	Commercial Bank
DCBL	Development Bank	Commercial Bank

The number of **commercial bank branches** operating in the country increased to 617 in mid Jan 2009 from 555 in mid July 2008. Among the total bank branches, 48.95% bank branches are concentrated in the central region alone. By the end of mid Jan 2009, total 302 branches are operating in this region. However, in the western, eastern, mid-western and far- western region are 19.45% (120), 19.29% (119), 7.78% (48) and 4.54% (28) respectively.

Commercial Banks held dominant shares on the major balance sheet components of financial system. Of the total deposits Rs.576,897.60 million in mid-Jan 2009, the commercial banks occupied 83.2 %. Similarly, finance companies held 9.5 %, development banks 6.4% and others 0.9%. Likewise, on the loans and advances, the share of commercial banks stood at 77.9%, development banks 7.4%, finance companies 12.2%, micro credit development banks 1.8% and others 0.7% in mid Jan 2009. In the same year the share of commercial banks in borrowings, liquid funds and investments constituted 59.0%, 74.8% and 92.2% respectively.

Nepal Economic Quarterly Updates, ADB

Figure 1.1: Sources of Growth, FY 1997 - FY 2004



NRB has intervened in a few **badly performing institutions** due to financial mismanagement on the part of the board of such institutions such as World Merchant Banking and Finance Company, United Bikas Bank, Nepal CSI Development Bank. NRB has handed over the management of the latter two institutions to their respective boards.

NRB also decided to **liquidate Nepal Development Bank** due to mismanagement by the board which led to a lot of bad loans and a cash crunch at the company. The liquidation process is ongoing.

NRB took over the management of **Bank of Kathmandu** due to disputes among its board members. The dispute among the board members arose after its CEO was asked to resign, but was resolved soon after. NRB decided to hand over the management of the bank to a new board of directors that was elected in an Emergency General Meeting.

NRB announced that it has **stopped issuing licenses** to new financial institutions. Licenses pending have also been stalled at the moment until further notice.

Banking Fine and Punishment Act was introduced to bolster corporate responsibility.

Securities Exchange Board of Nepal (SEBON)

The following new regulations were introduced by SBON in the past one year:

Securities Registration and Issue Regulation, 2065: This regulation was issued under the Securities Act and deals with the registration of companies with the Board and issue of shares and debentures of the registered company as well as listing of such shares.

Securities Issue Guide Lines, 2065: This guideline was issued to ensure fair, systematic and transparent issue of shares and also ensure the interests of the investors.

Securities Board Regulation, 2064: This regulation was introduced to regulate the workings of the Securities Exchange Board of Nepal.

Stock Exchange Licensing Regulation, 2064: This regulation deals with setting up of stock exchanges in the country and regulations relating to operations of such exchanges. Currently there is only one stock exchange in Nepal, Nepal Stock Exchange.

Securities Businessperson (Stock Broker, Dealer and Market Maker) Regulation, 2064: This regulation was introduced to regulate the licensing and operations of different individuals and institutions related to stock exchange like stock brokers, dealers and market makers. Presently there are no licensed dealers and market makers in operation.

Securities Businessperson (Merchant Banker) Regulation, 2064: This regulation relates to regulations of licensing and operations of merchant bankers. Merchant bankers are licensed to carry out issue management and portfolio management among other things.

SEBON granted the first portfolio management license to a non-financial company, which started operations from June 2009.

A new Mutual Fund act is in the offing from SEBON and policy papers are under review.

NEPSE introduced its online trading services to brokers through a WAN system in November 2007. The budget speech committed to introduce Central Depository System for stock trading from October 2009. This will mean paper shares will be obsolete leading to easier trading of shares and increase in trades per day. This will also mean the prices will better reflect the market and the different institutions.

Ministry of Finance

The government changed twice during the past one year. **Baburam Bhattarai** was the minister of finance in the Maoist government and presented the budget for 2008/09.

After the ousting of the Maoist government, **Surendra Pandey** was appointed the finance minister. He presented the budget for the fiscal year 2009/10.

As per the budget speech for the fiscal year 2009/10, economic **growth rate of 5.6 %** was achieved the past fiscal year, the highest over the past eight years. The agriculture sector registered a growth rate of 5.65 %, which is the highest since fiscal year 1993/94. Similarly, the growth rate of 5.57 % in non agriculture sector is also the highest achieved since fiscal year 1997/98.

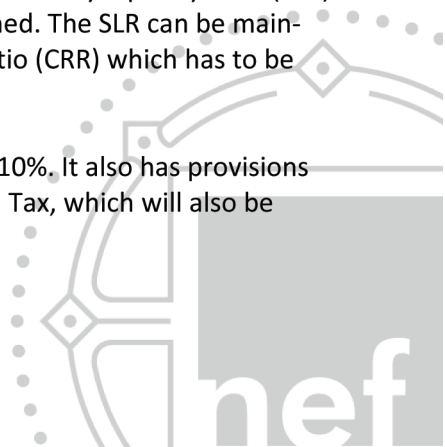
Record revenue collection reached record highs this past fiscal year, which could probably be due to Voluntary Disclosure of Income Scheme brought about by the Maoist government.

Revenue mobilization at the end of the current Fiscal Year was expected to have increased by 22 % with a collection of around Rs.107 billion against a target of Rs. 103.66 billion. The ratio of revenue to Gross Domestic Product thus reached 13 % with the revenue growth rate 22 % this year, making it one of the highest since fiscal year 1993/94.

The average annual **inflation rate** has reached 7.1 % in June 2008, compared to 7.8 % and 6.7 %, respectively, in June 2006 and June 2007. Taken on point-to-point basis, the annual increase in inflation has reached 11 % in June this year, compared to 4.5 % in June 2007 and 9.1 % in June 2006.

The new **Monetary Policy** for the upcoming fiscal year has some major changes, including statutory liquidity ratio (SLR) which was introduced for banks in addition to the cash reserve ratio (CRR) already maintained. The SLR can be maintained in the form of cash or near cash items like bonds and gold unlike the cash reserve ratio (CRR) which has to be maintained in the form of cash.

The **new monetary policy** has decreased the **Capital Gains Tax** for individuals from 15% to 10%. It also has provisions for **Capital Gains Tax** on real estate transactions over Rs. 50 lacs in addition to Value Added Tax, which will also be needed for all real estate transactions worth over Rs. 50 lacs.





Insurance

The **insurance industry** in Nepal suffers from a lack of diversification of insurance portfolios. Quite a few insurance companies are owned by business houses that prefer to insure their own business, for example, there are insurance companies which have majority insurance of aircrafts of airline companies owned by the same promoters.

The **number of insurance companies** has become quite high for the market and the products offered are similar in most cases. Nepal's induction to WTO means that there will be international insurance companies looking to enter the Nepali market. This means that there is a possibility of mergers and acquisition in the insurance sector.

With **regulations** stating that a single insurance company may not provide life and general insurance, National Life and General Insurance has split into National Life Insurance and NLG Insurance Company to carry out life and general insurance respectively.



Business Highlights

6.3 million Nepalis now have phones. Of the total number of telecom subscribers, 4.24 million subscribe to Nepal Telecom and 1.87 million subscribe to Spice Nepal (Mero Mobile). 19.73% of Nepalis use mobiles, 2.93% use landlines and 0.28% use other telecom services. There are currently, six telecom companies in operation, namely Nepal Telecom, Spice Nepal, UTL, STM Telecom, Nepal Satellite and Smart Telecom .

Groundwater crisis in Kathmandu. Groundwater level is decreasing at the rate of 2.5 meters annually. The rate of groundwater extraction is three times higher than the recharge rate .

Bad Loans on the Road to Recovery: The Wilful Defaulter Action Monitoring Committee has recovered bad loans worth Rs. 500 million since its inception in February 2009. Nine of the 238 defaulters, who owe more than Rs. 10 million each, have started paying back their loans to their banks .

Rastra Banijya Bank (RBB) was unable to sell its promoters share of NIBL at their premium price of Rs. 1068 per share. This price was deemed unjustifiable by SEBON .

Banks flock to Kavre: With 36 banks, Kavre has the highest number of banks after Kathmandu. Kavre has become the ideal location for commercial banks to open one branch outside Kathmandu, as per NRB's regulation. Banks in Kavre do daily transaction worth Rs. 150-200 million .

In the last Three years, more than **two dozen hotels shut down in Dharan** due to continuous strikes, bandhs and security problems .

Number of Indian tourists visiting Pokhara has decreased by 50% in the last year due to rumors of demonstrations, violence and mistreatment of Indian tourists, especially after the Maoists have left the government.

Investors in Biratnagar have turned to education and health sectors due to insecurity in the industrial sector and inability to compete with Indian and Chinese products. In the last two years, investors have invested Rs. 1 billion in these two sectors in Biratnagar. Leading business houses like the Golchha Organisation, Bishal Group, Devanara Group, Rathi Group and MC Group have all put money in health and education .

Profits of commercial banks increased by 33.2% in 2008/09. The accumulated net profit of 26 commercial banks has reached Rs. 14.16 billion. In the previous fiscal year, net profit of commercial banks was Rs. 10.63 billion .

Nepal Bangladesh Bank on the road to recovery. The bank is still under Nepal Rastra Bank's control and is focusing on reducing its non-performing loans. They have reduced their non-performing loans from 30% in the third quarter to 19% in the fourth quarter .

To meet increase in customer demand, **banks prepare to offer gold as an additional product.** NIC and Ace Development Bank are already attracting investment in gold while Nabil and Sunrise are also preparing to import gold for the same .



Standard Chartered (SCB) is the leader among commercial banks in forex reserves. SCB has foreign exchange worth US\$ 188.2 million, as of 23rd April, 2009. The combined forex reserves of commercial banks stands at US\$ 707 million. Nepal's total forex reserves stands at US\$ 3.14 billion and this amount is sufficient to pay for merchandise imports for 12.3 months .

Return of "hidden cash" eases liquidity crunch. Banking system was facing a liquidity crunch after Rs. 10 billion worth notes of Rs. 1000 and Rs. 500 disappeared. The main reason behind this disappearance may have been fear of government action under VDIS. With five-fold oversubscription of NRB bonds and treasury bills, Rs. 16.68 billion worth of application for Rs. 3 billion worth bonds, the liquidity crunch has been eased .

Construction cost soars by 30% in the last six months. Cost of construction has increased dramatically mainly due to the 75% rise in the price of cement and 200% rise in the price of bricks. These materials account for 29% and 12% of overall construction budget .

Mall Culture in Kathmandu: Malls have been sprouting all around Kathmandu to cater to the brand conscious Nepali consumers. Malls such as the recently opened City Center Mall have a stately presence through their multi-storied buildings and promise a "complete shopping experience". An average of 4,000-5,000 people visits these malls every day. This number is even higher during weekends when up to 25,000 people visit these malls. To cater to this market, by 2010, there will be at least eight malls around the city.

Double-Digit Inflation: According to NRB, inflation has reached 12.3 percent in the 11th month of the last fiscal year (2008/09). Inflation has been driven by the rise in food and beverage prices; food prices have increased by 19 %. The main food groups to show such a hike in price are sugar (62.3 %), vegetables and fruits (55.5 %). Kathmandu valley witnessed an inflation of 14.5 % .

Draft for new FDI policy: Minister for industry, Mahendra Yadav, was presented a draft for a new foreign investment and technology transfer policy. The policy is expected to widen the area of foreign investment and remove the existing hurdles.



Outlook 2009/2010

Perhaps unsurprisingly, given the dominance of political pre-occupations and agendas, the economic outlook in Nepal is rarely seen as positive. And yet there are always opportunities, and a fresh perspective is essential in order to have a clearer understanding of the immediate future.

The political impasse will continue with the constitution-drafting deadline of May 2010 perhaps not met. The tenure of government(s) will be unpredictable, and the parties will increasingly appeal to ethnic sentiments. This and future governments' short and uncertain span of power will inevitably result in more politically-motivated decisions, including frequent changes in political appointments and new areas identified for political influence. Political parties will continue to use their labor and student organizations to pressure for change from the streets and in shows of power. There will be no major improvement in the law and order situation, given that no government will be in a position to work on long-term solutions to tackle impunity and check crime. No major policy changes are envisaged, as successive governments will be more interested in their own survival rather than in delivering growth.

After insufficient rain this year, a good monsoon is needed next year for better growth in the agriculture sector as well as a better monsoon would mean more production in India, leading to stagnation or lowering of prices on food grains, which would lead in turn to lower inflation. The increase in the fair weather roads network will result in more production pockets linked to markets.

The water and energy crises will continue to create a sense of hopelessness for the general public, and could fuel a variety of disruptive acts. Global oil prices may rise, reviving memories of serpentine queues, given that the government and Nepal Oil Corporation have taken no steps to deregulate fuel prices. While a few hydropower projects may reach financial closing, they will be far from producing, and so there is unlikely to be a respite from the long power cuts. Generators, inverters and others forms of alternative energy sources will continue to boom and more players will enter this segment.

Given the fluid political situation, new manufacturing units or businesses that employ larger number of labor may still be on the back burner. Ahead of Visit Nepal 2011, there may be smaller investment parcels visible in the hospitality sector.

Real estate will continue to see transactions, though prices may not see major increases. A few real estate development projects will be likely to default, which will stem the exponential growth of apartment projects in particular in Kathmandu. With tighter regulations, banks will have fewer real estate projects to invest in.

The banking and financial services sector will see addition of a few banks and financial institutions, even as some existing institutions get into trouble as interest rates rise. International financial institutions will start showing interest in some institutions, which could lead to another dimension in the valuation of companies.

Capital markets will show improvement, as mutual funds are likely to get off the ground, and the pricing issue for securities is resolved. More people outside Kathmandu will have access to both primary and secondary capital markets. Innovative debt and other financial instruments will emerge, giving investors additional opportunities.



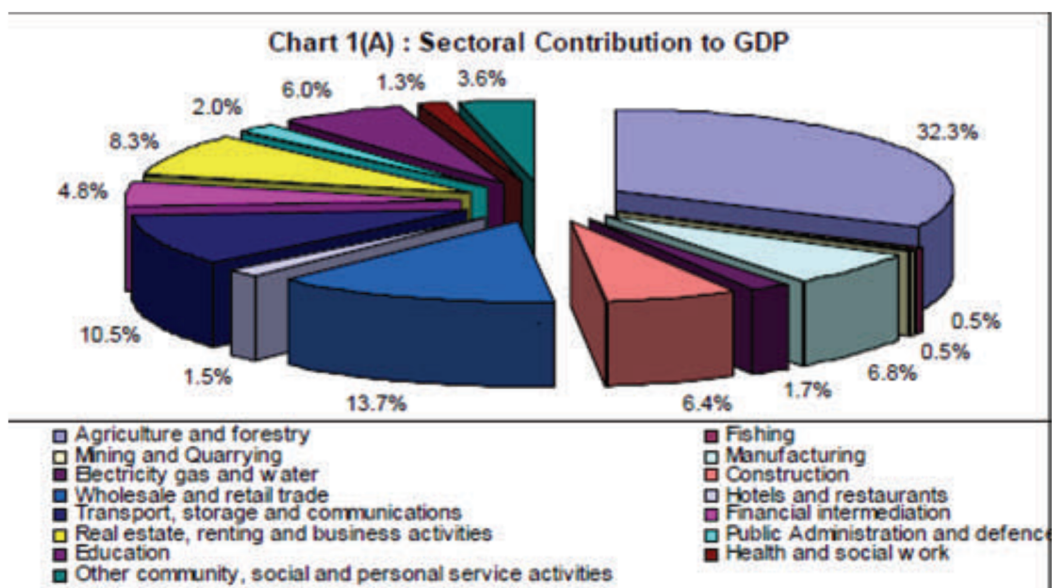


Remittances will continue along with migration, and that will continue to fuel liquidity in the economy. More people educated abroad returning to Nepal will continue to result in incremental changes in the working culture, as well as attitudes to innovation and change.

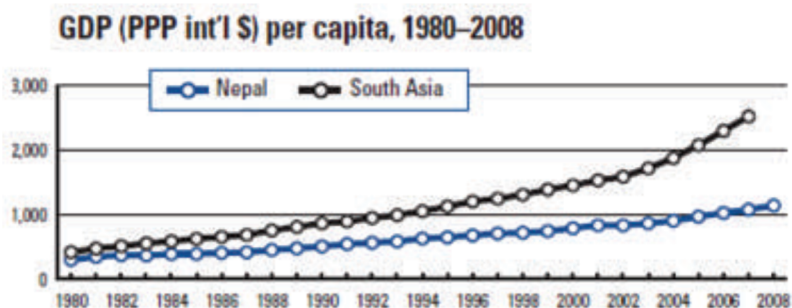
External assistance will not see any major changes, though commitments for funding will be made with disbursements pending. More dialogues will be held between bilateral/multilaterals and the private sector, leading to some headway in public-private dialogue as well as some joint projects undertaken, slowly leading to a policy transformation.



Graphs

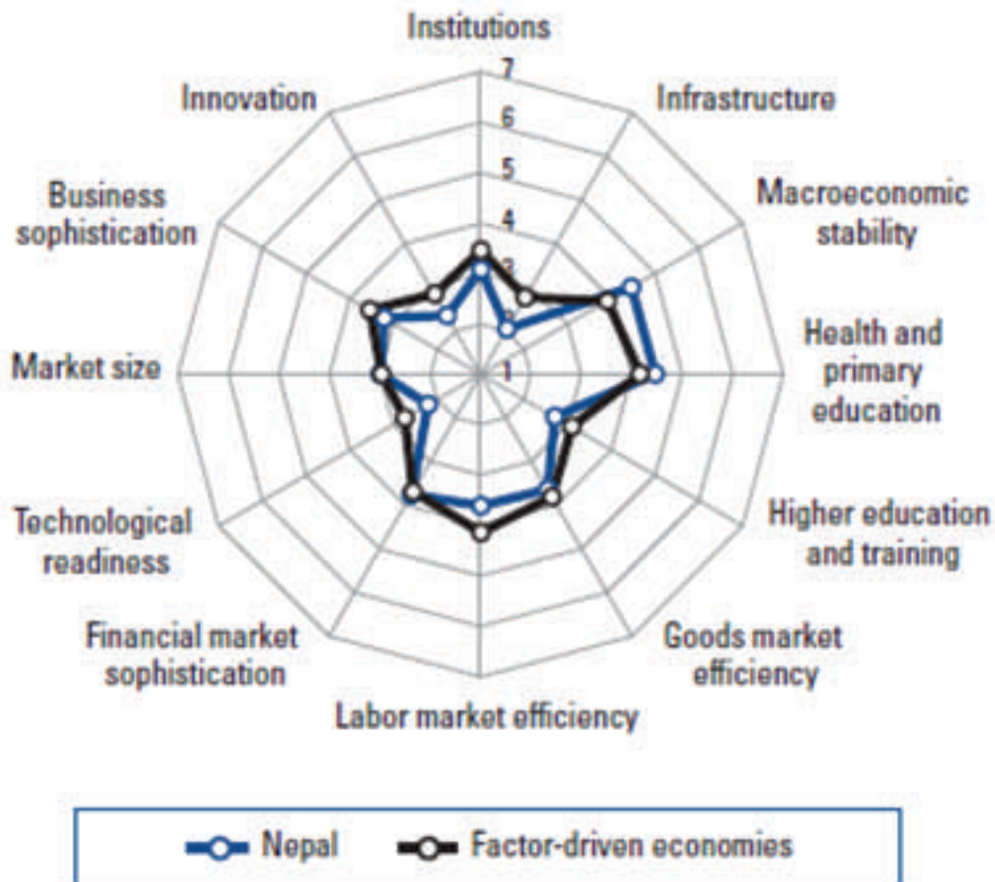


Economic Survey 2008/09



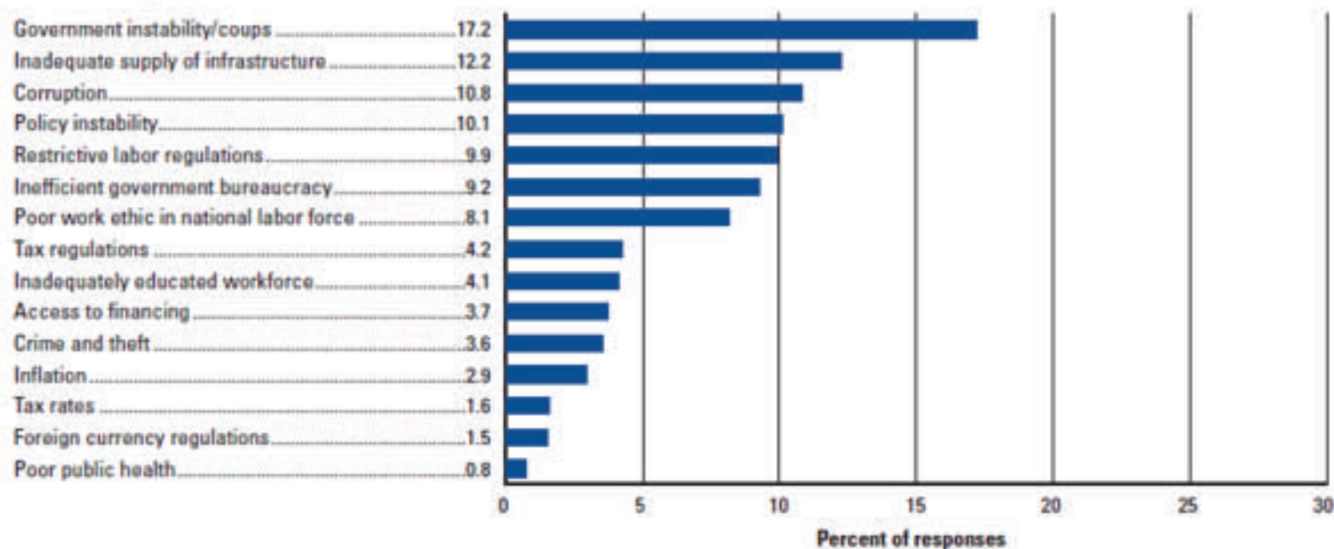
The Global Competitiveness Report, 2009/2010

Stage of development



The Global Competitiveness Report, 2009/2010

The most problematic factors for doing business



Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country/economy and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

The Global Competitiveness Report, 2009/2010



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