



NEPAL  
ECONOMIC  
FORUM

# nefport

Docking Nepal's Economic Analysis

*October 2010 : Issue 3*



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## EDITORIAL

The nefport was conceived as an essential tool for those doing business in Nepal. To this objective, it offers a quarterly overview combined with an outlook for the Nepali economy. While media coverage on the economy has improved over the last year, the nefport provides a critical overview that is often lacking. Most importantly, the nefport provides a view of the economy strictly from the perspective of those who keep it moving - the private sector.

The response we received from the first two issues of the nefport was overwhelming and has encouraged us to come out with an even better issue. The critical feedback and input received from our readers has been an invaluable asset in helping us put together a publication that caters to the needs of business executives and development practitioners.

This issue features a special look into the new monetary policy, fourth quarter banking numbers, the growing capital markets, and the state of energy, infrastructure and real estate in Nepal. Aside from this, sector based overviews and outlooks are presented similar to other issues of the nefport.

At a macro level, it is starkly apparent that political stagnation is the biggest problem Nepal faces. This has precipitated in higher investment risks and an unstable business environment. This also means that there is a glaring lack of progress in developing the necessary infrastructure for creating a comfortable business environment. Basic fundamentals for comfortably doing business – electricity, telecommunication, water, sanitation and road networks – need immediate focus and improvement.

Nepal Economic Forum is a not for profit organization and a wing of beed management. Special thanks to beed invest and beed management for the detailed reviews on the monetary policy, banking, capital markets, energy and real estate. We thank all our readers who have encouraged us to continue and our sponsor, The Asia Foundation, for assisting us in coming out with this issue.

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

Sujeev Shakya  
Chairman  
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## FACT SHEET

### Gross Domestic Product

(At 2000/01 Prices)

NPR in billion

Products	2000/01	2008/09 <sup>R</sup>	2009/10 <sup>P</sup>
<b>Agriculture</b>	155.62	201.50	203.75
Agriculture and Forestry	153.78	198.28	200.36
Fishery	1.84	3.22	3.39
<b>Non-Agriculture</b>	269.83	366.11	384.78
<b>Industry</b>	73.56	88.09	91.51
Mining and Quarrying	1.82	2.53	2.64
Manufacturing	38.41	39.13	40.17
Electricity Gas and Water	7.75	13.08	13.15
Construction	25.59	33.34	35.55
<b>Service</b>	196.27	278.02	293.27
Wholesale and Retail Trade	69.93	70.91	74.89
Hotels and Restaurant	8.46	9.11	9.89
Transport, Storage and Communications	31.42	51.88	55.23
Financial Intermediation	11.46	24.50	24.89
Real Estate, Renting and Business	35.27	46.34	48.60
Public Administration and Defence	5.29	10.00	10.42
Education	17.37	36.40	38.76
Health and Social Work	4.18	8.31	8.77
Other Community, Social and Personal Service	12.90	20.57	21.82
<b>Total GVA including FISIM</b>	425.45	567.61	588.53
Financial intermediation indirectly measured	12.03	24.71	26.49
GDP at basic prices	413.43	542.90	562.04
=Taxes less subsidies on products	28.09	49.03	56.99
<b>GDP at producers price</b>	441.52	591.93	619.03

<sup>R</sup> Revised

<sup>P</sup> Provisional

Source: Central Bureau of Statistics, National Accounts Estimates, 2010

## POLITICAL SCENARIO

Political instability remains a major impediment towards economic growth in Nepal. The collective ability, motivation and dedication of the political class to collaboratively work towards developing Nepal has come under increasing scrutiny. Economic growth and wealth creation remain neglected areas of interest for all political parties. A lack of confidence in national leaders does not bode well for the economy. It increases risk and decreases the incentive for people to invest. Political stagnation is also indicative of a national economy that cannot respond and adapt to a changing environment. Feeble political leadership has meant that legislations and reforms, dependent on a proactive government, do not move at a pace that would allow Nepal to keep up with changes in the global economy.

### Highlights

**Eight day strike:** The Unified Communist Party of Nepal – Maoists (UCPN-M) held an eight day strike, from 1st to 7th May, 2010. The protest was held in opposition to the government of Prime Minister Madhav Kumar Nepal, whom the UCPN-Maoists accused of being incompetent and unable to lead the peace process to its conclusion.

**Deadline not met:** The Constituent Assembly (CA) was unable to meet its 28th May 2010 deadline for writing the new constitution. A subsequent constitutional crisis was averted when the three major parties agreed to extend the term of the Constituent Assembly by one year. The vote in the CA to amend the deadline for the CA was carried out on the night of 27th May 2010.

**Prime Minister resigns:** Prime Minister Nepal resigned from his post on 30th June 2010. His primary reasons for resigning were the deadlock in the CA, to make way for a consensus government, and an

informal agreement between the three major parties that promised his resignation in return for the extension of the CA deadline.

**No new government:** Till the publication of this issue of nefport, Prime Minister Nepal was still serving as the care taker Prime Minister. After eight rounds of elections, no party had been able to field a candidate capable of securing a majority in the CA and forming a new government.

**New president elected in the Nepali Congress Party:** Acting president, Sushil Koirala, was elected the new president of the Nepali Congress (NC) party during the 12th General Convention of the Nepali Congress on 20th September 2010.



## OUTLOOK

A new government will not be elected until either the UCPN-M or NC is able to form a coalition with the smaller parties. The United Marxist Leninists (UML) maintains a stance of neutrality unless a consensus is reached. Without support from the UML, the probability of an NC led government remains slim. Although the largest party in the CA, the CPN-M cannot form a coalition without the backing of the Madhesi Parties. The likelihood of a consensus government remains slim, unless the balance of power shifts. This would require a shift in stance from one of the three major parties: UCPN-M, UML, or NC. Meeting the constitution writing extended deadline of 28th May 2011 and resolving the Maoist combatant issue is contingent on a working agreement between the parties. This seems unlikely until the UCPN-M is involved and engaged in the government.



## INTERNATIONAL ECONOMY

Global integration of the Nepali economy is limited and restricted to only a few sectors. As a result, the global economic contraction in 2009, estimated at -0.6% by the IMF, had a limited impact upon the Nepali economy. Conversely, the projected 4.6% global economic growth in 2010 will also have limited bearing upon the economy. With its neighbors India and China expected to grow by 9.4% and 10.5% respectively in 2010, Nepal would benefit considerably from stronger integration with the two Asian giants.

### Highlights

**China Overtakes Japan as the Second Largest Economy:** As predicted by many analysts, during the second quarter of 2010, China overtook Japan as the second largest economy in the world on a nominal basis. China's second quarter GDP of USD 1.33 trillion exceeded Japan's GDP which stood at USD 1.28 trillion. The Chinese economy is expected to maintain double digit growth over the next few years. However, with a per capita income of USD 37,800 in 2009, Japan still remains one of the world's richest countries. China's per capita income in 2009 stood at USD 3,600.

**BP oil spill:** In mid-June, the petroleum company BP struck a deal with the Obama Administration to set aside USD 20 billion to cover the Gulf of Mexico oil spill claims since the accident on 20th April 2010. The company will pay USD 3 billion into an escrow account in the third quarter of this year and another USD 2 billion in the fourth quarter. This will be followed by payments of USD 1.25 billion a quarter until the USD 20 billion has been fully paid.

**G20 meeting:** The meeting of the G20 world leaders, held in Toronto Canada on 26-27th June 2010,

concluded with an outline for reducing budget deficits. Leaders postponed decisions on global banking regulations to the November session in Seoul, South Korea. The meeting's concluding statement expressed solidarity in terms of their desire to reduce debt, but did little to alter austerity plans and stimulus measures countries have already introduced.

**China Un-pegged:** On 19th June 2010, China announced that it will slowly and gradually make the Yuan "more flexible." The Yuan has been pegged to the US Dollar for the past two years. It remains to be seen how China will put the new system into practice and the composition of a basket of currencies that Beijing will use as a reference point for the Yuan.

**India deregulates fuel prices:** On 25th June 2010, the Government of India deregulated petroleum prices from government control. This means gasoline prices will move in response to global fuel prices rather than government fiat. The objective of the move was to reduce the government subsidy burden. India's fuel subsidies cost the government as much as USD 17.5 billion annually. The government's decision will help more private companies open fuel retailing outlets in India. Despite the deregulation, the government is retaining the right to intervene if global crude prices spike.

**Indian central bank increases interest rates:** In September, the Reserve Bank of India (RBI) again increased its interest rate to curb inflation. This is the fifth time within a year that interest rates have been hiked. RBI raised its repo rate (rate at which it lends to banks) from 5.75% to 6%. Simultaneously, its reverse repo rate was adjusted up from 4.5% to 5%, higher than what economists had predicted. The market was expecting an adjustment of 25 basis points rather than

the increase of 50 basis points. RBI is tightening its monetary policy and wants to bring the inflation rate down to 5-5.5%.

**Indian Currency Symbol:** The Indian Rupee got its symbol on 15th June 2010. The new symbol is designed to look like an amalgamation of the Hindi alphabet 'RA' (र) and part of the English alphabet 'R'. Indian currency has become the fifth currency to have its own graphical symbol. The new symbol is meant to differentiate the Indian Rupee from the rupee of Pakistan, Nepal, Sri Lanka and the Rupiah of Indonesia. The symbol will be adopted in India within six months and all over the world within a year. However, the symbol won't be printed in the currency notes.



## OUTLOOK

The global economy still stands upon uncertain grounds as sovereign risk in parts of the Euro area have materialized and spread to the financial sector. Market and liquidity risks have increased. Banks again have become reluctant to lend to one another, especially in the Euro zone. As a result, the value of safe haven investments like US bonds and gold has increased. Riskier assets such as European and emerging markets equity prices have shed its previous gains. Commodities prices in major economies are also declining as a result of the lack of improvement in the economic situation. However, Nepal's two neighbors India and China will continue to see robust growth as will most emerging and developing economies.

### Latest IMF projections

The world economy is recovering better than expected, but at varying speeds for different regions  
(percent change unless otherwise noted)

	Projections			
	2008	2009	2010	2011
<b>World Output</b>	3	-0.6	4.6	4.3
<b>Advanced Economies</b>	0.5	-3.2	2.6	2.4
United States	0.4	-2.4	3.3	2.9
Euro Area	0.6	-4.1	1	1.3
Japan	-1.2	-5.2	2.4	1.8
Newly Industrialised Asian Economies	1.8	-0.9	6.7	4.7
<b>Emerging and Developing Economies</b>	6.1	2.5	6.8	6.4
Central and Eastern Europe	3.1	-3.6	3.2	3.4
Developing Asia	7.7	6.9	9.2	8.5
China	9.6	9.1	10.5	9.6
India	6.4	5.7	9.4	8.4
ASEAN-5 <sup>1</sup>	4.7	1.7	6.4	5.5
Middle East and North America	5.3	2.4	4.5	4.9

Source: IMF World Economic Outlook, July 2010.  
<sup>1</sup>Indonesia, Malaysia, Philippines, Thailand and Vietnam



## MACROECONOMIC OVERVIEW

At the turn of the century, Nepal's GDP for the 2000/01 fiscal year stood at NPR 413 billion (USD 5.5 billion). Since then, Nepal's economy, as estimated for the 2009/10 fiscal year, has painstakingly grown to NPR 619 billion (USD 8.25 billion) at 2000/01 prices. The decade saw momentous change in Nepal's political spectrum through the removal of the monarchy and the end of the civil war. However, economic progress has at best trudged forward with socio-political issues consistently trumping the economy. During this time period, according to the Central Bureau of Statistics (CBS), Nepal's per capita Gross National Income (GNI) doubled from NPR 19,144 (USD 255) in 2000/01 to NPR 42,291 (USD 564). However, this still keeps Nepal close to the bottom of global income tables.

### Highlights

**GDP growth falls short:** Nepal's economic growth during the fiscal year 2009/10 is expected to fall well short of the government's target of 5.5%. The CBS estimates that the Nepali economy will grow by around 4.6% at producer prices and 3.5% at basic prices. A poor monsoon, which had an adverse impact upon agriculture, restricted growth in the sector to an estimated at 1.1%. Aside from this, political instability, shaky labor relations, frequent strikes, and incessant power shortages also contributed towards holding back economic growth.

**Nepal progressing towards Millennium Development Goals (MDGs):** The National Planning Commission (NPC) and the United Nations Development Program (UNDP) state that Nepal is on course to meet most of its MDG targets by 2015, except the more complex targets of full employment and climate change. Nepal's ability to meet most of these

targets during a time period of great political instability and mediocre economic growth is a testament to its resiliency and potential.

**Budget delay causes woes:** The prolonged delay in announcing the budget for the 2010/11 fiscal year has created uncertainty which is adversely affecting all sectors. Until the budget is passed, the private sector is less likely to invest and economic activities will further slow down. Political wrangling and the inability of political parties to form a new government are the main reasons for the delay. The special budget prepared by the Ministry of Finance (MoF) can only cover for one-third of the full year's budget. As a result, only development activities that were started in the past will continue to be financed. The special budget does not have enough resources to initiate new development activities and bring in new programs. Government expenditure have also been curtailed which will lead to difficulties in salary disbursements to those on the government's payroll including civil servants, police personnel and teachers.

### The International Monetary Fund (IMF) plans to move out of Nepal:

The IMF, which has had an office in the Nepal Rastra Bank since 1977, is closing down its office in Kathmandu on 31st October 2010. Its representative in New Delhi is set to oversee its Nepali operation. With over three decades of involvement in economic policy reforms in Nepal, the IMF has provided invaluable technical assistance. Given the country's precarious political situation combined with an economy afflicted by a budget deficit, balance of payment crisis and inflationary pressures, the IMF's decision comes as a surprise. The IMF's resident representative, Alexander Pitt, stated that the decision to oversee operations from New Delhi will have no impact on the IMF's relations with Nepal and on the work that it does in the country.

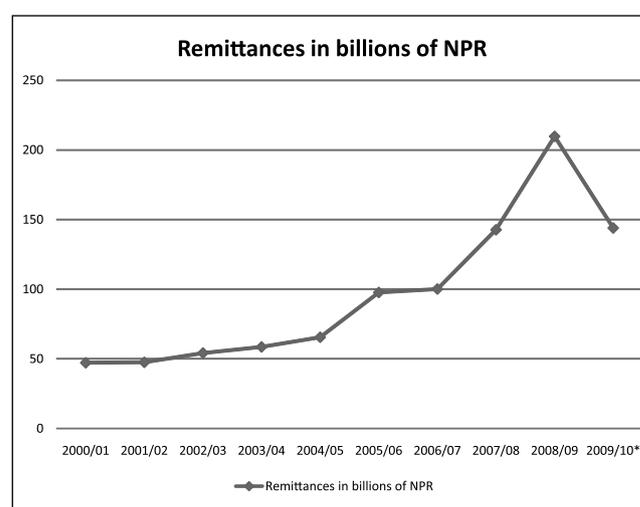
## Remittances

Remittances are a significant portion of Nepal's national GDP and a key factor in maintaining a positive Balance of Payment (BoP) in the national accounts. However, remittance contributions over the past fiscal year decreased by two percentage points to around 19% of GDP largely due to the global economic recession. This was reflected in a BoP deficit of around NPR 2.6 billion (USD 34.67 million) for the 2009/10 fiscal year. Given its huge contribution to the national economy, any changes in remittance will have a wide spread impact upon it. The remittance economy also provides employment opportunities to Nepal's largely unemployed or under-employed work force. Officially, there are slightly over 1.6 million Nepali workers working around the world. However, including undocumented illegal workers and seasonal workers in India, an estimated 3-4 million Nepali men and women are currently working abroad and remitting back around NPR 231.7 billion (USD 3.08 billion) to Nepal. Remittances have played a key factor in setting Nepal on its course to meet its MDG goals related to poverty, health and education.

**Global economic crisis has a limited impact on remittance:** The global economic crisis did not severely affect most of the destination countries of Nepali migrant worker. While remittance value did drop, the drop was not as drastic or prolonged as many had feared. Additionally, the flourishing industry of placement agencies have successfully expanded and diversified worker destinations with countries like Libya, Iraq, Israel and Korea being added to the roster.

**Workers numbers up, but remittance numbers lag:** During the 2009/10 fiscal year, the Department of Foreign Employment granted 294,094 permits

for foreign employment, a 35.4% increase from the 217,164 permits issued the previous fiscal year. However, during the same period, remittance numbers only increased by 10.5%. This has been attributed to an increase in the use of informal money transfer systems. These informal channels are estimated to hold as much as 35% of the total remittance sent back to Nepal.



\* First eight months

Source: Ministry of Finance, Economic Survey: Fiscal Year 2009/10, 2010

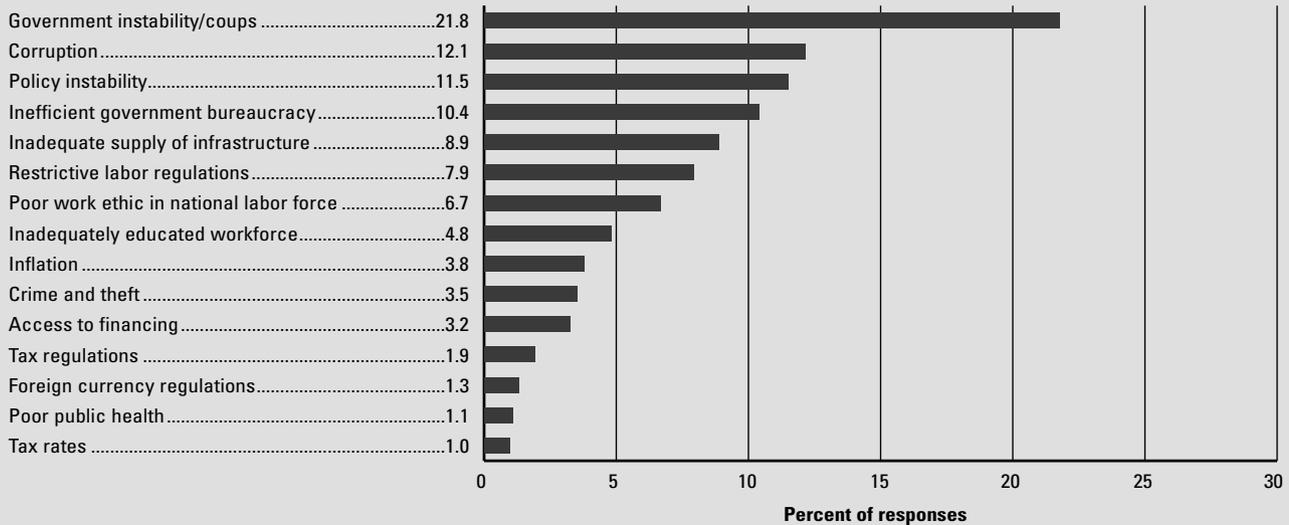
**Destination Malaysia:** Malaysia is a major working destination for Nepali workers. It is estimated that over 400,000 Nepali workers are currently working there. During the 2009/10 fiscal year, a total number of 113,933 people were granted permission to seek employment in Malaysia, a 240.7% rise in the number of workers going to Malaysia compared to the previous fiscal year. This dramatic rise is attributed to the Malaysian government's decision to ban Bangladeshi workers in favor of Nepali workers. During the last fiscal year, Malaysia absorbed 38.5% of all Nepali foreign employees. However, recent strikes by some 5000 Nepali workers in Malaysia have raised fears of a possible ban on the hiring of Nepali workers.



## Nepal slips 5 ranks in the Global Competitiveness rankings:

Nepal was ranked 130th out of 139 countries surveyed in the World Economic Forum’s annual Global Competitiveness Index for 2009/10. The report is a measure of the competitiveness of a country’s national economic environment upon the global stage. Nepal’s ranking shows a desperate need to improve in all of the twelve components that define a nation’s economic competitiveness. In addition to this, it reveals the biggest impediment to doing business in Nepal is a strong lack of confidence in government reflected through concerns of political instability, corruption and unreliable policies.

### 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 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 2010-2011 © 2010 World Economic Forum

**Iraq Opens:** With over 35,000 Nepali workers already illegally working in Iraq, the Nepali Government decided to lift its ban on sending Nepali workers there. The government placed the ban in response to the massacre of 12 Nepali workers by Iraqi militants in 2006.

**Korea calls for more workers:** The Korean government opened up an additional 4000 quotas for Nepali migrant workers in addition to the 6400 quota it made available in 2008. An estimated 42,000 Nepali workers turned up to sit for the Korean Language Test, a necessity for qualifying for a job in the country.

## Trade

The Nepali economy operates under a considerable trade deficit. This deficit is offset by the remittance economy through which Nepali workers send money back to Nepal. Limited industrial production in Nepal is the primary reason for high import numbers and low export numbers. Trade is the most vulnerable to political instability, labor relations, lack of security and power cuts. These factors will continue to dictate the growth of trade in Nepal. Nepal's trade ranking in the World Bank's Doing Business Report also fell from 159th in 2009 to 161th in 2010.

### Petroleum, vehicles and gold constitute biggest import categories:

Petroleum products alone accounts for close to 24% of all imports from India, amounting to NPR 51.5 billion (USD 686 million), an increase of 24.5% from the previous year. Driving up petroleum imports is the import of vehicles and their parts, which accounts for 11% or NPR 23.7 billion (USD 316 million) of total imports from India. Aside from this, gold remains the primary import from beyond India. Nepal imported more gold in the 2009/10 fiscal year than petroleum in the previous 2008/09 fiscal year, with a total of NPR 41.6 billion (USD 554 million) worth of gold coming into the country.

## Trading Across Borders in Nepal

	Doing Business 2008	Doing Business 2009	Doing Business 2010
Rank		159	161
Cost to export (USD per container)	1600	1764	1764
Cost to import (USD per container)	1725	1900	1825
Documents to export (number)	9	9	9
Documents to import (number)	10	10	10
Time to export (days)	43	41	41
Time to import (days)	35	35	35

Source: World Bank and IFC, *Doing Business in Nepal, 2010*

**Trade deficit over NPR 216 billion:** The past fiscal year 2009/10 saw total exports fall by 9.7% to slightly above NPR 67 billion (USD 902 million) while imports shot up by 33.2% to NPR 284 billion (USD 3.7 billion) during the same time period. India is Nepal's dominant trade partner and commands 57% of Nepal's total trade account.

**Exports:** Nepal's primary exports to India constitute jute goods, polyester yarns, textiles and threads. In total, these products account for 31% of all exports. Most export products constitute raw or semi processed materials. Beyond India, Nepali exports are dominated by three primary product categories – pulses, readymade garments and woolen carpets. These three products account for nearly 60% of Nepal's total



## World Bank and International Finance Corporation's Doing Business Report:

The World Bank and International Finance Corporation's annual Doing Business report ranked Nepal 123rd out of 183 countries surveyed. Nepal's position remains unchanged from the previous years. The report ranks countries based on the ease of doing business in a country and examines the hurdles that exist for small and medium size enterprises. Over the past year, the only reform undertaken by Nepal was to lower property transfer costs. As a result, its ranking in registering property moved up 3 notches to 26th, its highest ranking in all categories. However, without any policy reforms taking place in any other category, Nepal's rankings have dropped in seven of the ten categories the report basis its rankings on.

Ease of...	Doing Business 2010 rank	Doing Business 2009 rank	Change in rank
Doing Business	123	123	0
Starting a Business	87	75	-12
Dealing with Construction Permits	131	130	-1
Employing Workers	148	147	-1
Registering Property	26	29	+3
Getting Credit	113	109	-4
Protecting Investors	73	70	-3
Paying Taxes	124	111	-13
Trading Across Borders	161	159	-2
Enforcing Contracts	122	122	0
Closing a Business	105	105	0

Source: World Bank and IFC, Doing Business Report, 2010

exports beyond India, which has a total market value of NPR 11.9 billion (USD 158 million).

**Asian Development Bank (ADB) report identifies export opportunities:** An ADB study of 130 countries assessing the level of opportunity the country has in terms of product upgrading and growth ranked Nepal second in South Asia. The study stated that between

2001 to 2007, Nepal had a diversified export base with an export basket of around 100 products in which it had a comparative advantage. Coming in at 33 out of 130 countries, the report reaffirmed that the Nepali economy has considerable opportunities to tap into export driven growth.

## Agriculture

The importance of the agricultural sector to the Nepali economy cannot be exaggerated in terms of its contribution to GDP and employment absorption. The Nepal Labor Force Survey conducted in 2008 found that 73.9% of the population is engaged in the agriculture sector. For the 2009/10 fiscal year, agriculture and forestry had a combined contribution of 33.03% to the national GDP. However, given the sector's contribution to GDP and employment, it has not been able to see growth on par with the national economy. The last fiscal year saw the sector grow by a mere 0.93% points and since the 2000/01 fiscal year, the sector's contribution to the national economy has decreased by 3.1% points.

### Composition of GDP by ISIC Division in % (at current prices)

Industry	2000/01	2008/09	2009/10
Agriculture and Forestry	36.15	32.1	33.03

Source: Central Bureau of Statistics, National Accounts Estimate, 2010

**Exports of floral products increase:** Floriculture Association of Nepal (FAN) reported a growth in exports of floral products such as bulbs, tubers and live plants to US, Japan, European and Gulf countries. Exports of floral products have been increasing on an average of NPR 12 million (USD 0.2 million) per year. Incidentally, the sector is facing huge threats from Indian and Chinese traders leading to fierce price wars. Chinese traders have started leasing land plots in Nepal for floriculture while Indian traders are being accused of dumping state-subsidized floral products in Nepal.

### Improper distribution of chemical fertilizers:

The Agriculture Inputs Corporation (AIC) in Ilam is reporting huge quantity of fertilizers being unsold due to illegal import of cheap substandard fertilizers from India. However, farmers in the Terai and inner Madhes are complaining of not being able to obtain subsidized quality fertilizers even by the end of the paddy plantation season. Government officials and police administration are alleged to be encouraging smugglers to illegally import fertilizers from India.

**Monsoons effect agricultural yield:** Very low rainfall and a prolonged winter drought in 2009 reduced agricultural productivity as well as cultivatable land area. A poor monsoons in 2009 also lead to a sharp decline in the production of summer crops like paddy and maize causing food shortages that lead to double digit inflation. Agricultural production grew by a mere 1.05% during the last fiscal year as opposed to the 3.0% growth seen the previous fiscal year.

### Annual Growth Rate of GDP by Economic Activities in % (at current prices)

Industry	2000/01	2008/09	2009/10
Agriculture and Forestry	3.01	3	1.05

Source: Central Bureau of Statistics, National Accounts Estimate, 2010

## Manufacturing

The manufacturing in Nepal has failed to make any significant inroads. The primary reason for this debacle is due to the lack of access to proper infrastructure and modern technology. Moreover, labor issues along



with an unstable government are added domestic challenges. Given its limited scope and high risks, the manufacturing sector has effectively been neglected. For instance, till the last fiscal year, industrial policies formulated in the year 1992 were still being followed without any changes and adjustments to keep up with the times. In most industrialized nations, a strong manufacturing sector has always been the primary focus of a strong economy. In Nepal, manufacturing is yet to take on its role in the national economy.

**New Industrial policy:** The new industrial policy has finally replaced the previous 18 year old policy with the government's endorsement. Various reforms have been introduced in the new policy with primary focus being on women entrepreneurs, micro, small and cottage industries. The key policies are as follows:

- Allow sub-contracting of productions for the first time in the country which will create specialization in the manufacturing process and allow small scale industries to be incorporated into larger manufacturing process.
- 40% income tax waiver for industries employing more than 25 women and an investment board for making investments above NPR 10 billion (USD 133.33 million).
- To promote domestic manufacturing different tariff rates for imported raw material and finished goods will be placed. The protection rate will be at least 25%.
- Geographical regions in Nepal have been categorized into three groups of highly underdeveloped, undeveloped and underdeveloped industrial regions. Industries in rural areas will get tax holidays of 5, 7 and 10 years respectively.

- Government to focus on necessary industrial infrastructure development in various regions around the country to enhance the manufacturing sector.
- 25% income tax concessions to small, medium and large industries that directly employ 100, 300 and 600 persons respectively.
- Development of Agro-Export Promotion Zone where industries will be exempted of excise duty and VAT on raw and packaging materials.
- 5% income tax deduction on research and market promotion activities.
- Information technology (IT), cement, hydropower, vehicle and motor parts, chemical fertilizer, biotechnology and adventure tourism have been made high priority industries, while agriculture, forest-based, Ayurvedic, and homeopathic medicine manufacturing, minerals and handicrafts have been made priority industries.

## Tourism

Tourism plays a crucial role in Nepal's economy. It offers one of the greatest potentials for earning foreign currency and securing foreign direct investments (FDI). Given Nepal's historically exotic identity, its geographic diversity and rich cultural history and tradition, its potential as a tourist destination has not been fully tapped into. During FY 2009/10, tourism contributed NRS 16.76 billion (USD 223.56 million) to the national economy. This was equivalent to 40% of the total value of merchandise exports in FY2009/10 or 2.1% of Nepal's GDP. Contribution of tourism as percent of total foreign exchange earnings dropped to 6% in FY 2009/10 as compared to FY 2008/09 (6.5%).

### Tourist arrival by month, 2009-2010

Month	2009	2010	% change
January	21,944	26,071	18.8
February	25,181	33,492	33
March	33,005	44,431	34.6
April	37,819	38,694	2.3
May	25,129	26,634	6
June	23,222	26,997	16.3
July	23,266	29,338	26.1
Total	189,566	225,657	19

Source: Ministry of Tourism and Civil Aviation, Monthly Report 2010

**Tourist arrivals up:** The total visitor arrivals for the first seven months of this year stood at 225,657, which is 19% more than that of the same period, last year.

**2011 Nepal Tourism Year:** 2011 has been declared as Nepal Tourism Year (NTY) by the government of Nepal. The campaign aims to bring at least a million visitors – 700,000 by air and 300,000 over land. Given the present context, this goal looks almost impossible to achieve. The government's promotion and campaign efforts remain inadequate, but the private sector has been seriously involved in preparing for the influx of tourists.

### Targets and Achievements of Ministry of Tourism and Civil Aviation

Description	Status as of mid-Jan 2009	Target for mid-Jan 2010	Progress as of mid-Jan 2010
Tourist Stay (days)	11.78	13	11.6
Tourists Spending per Day (NRS)	3165.14	4906.44	2835.59
Tourists Spending per Day (USD)	46.68	63	36.88
Direct Employment ('000)	88	100	90

Source: Ministry of Tourism and Civil Aviation, Monthly Report, 2010

### Foreign Exchange Earnings from Tourism

Description	2000/01	2008/09	2009/10
Total Foreign Exchange Earnings from Tourism (Rs. In 10 million)	1171.7	2796	1676.7
As % of Total Value of Merchandise Exports	21	40	40
As % of Total Value of Foreign Exchange Earnings	7.4	6.5	6
As % of GDP	2.7	2.9	2.1

Source: Ministry of Finance, Economic Survey: Fiscal Year 2009/10



**Targeted tourist stay days still not met:** While the increase in tourists is an encouraging sign, careful analyses of the tourists coming to Nepal shows that an average visitor stays here for 11.78 days spending NRS 2835.59 (USD 36.88) per day. This is well below the targeted 13 day stay and average spending of NRS 4906.44 (USD 65.42) per day set by the Ministry of Tourism and Civil Aviation.

**Domestic airlines go international:** In mid-March, domestic carriers Buddha Air and Air Dynamic received permission to operate international flights. Buddha Air has already started its flights to Bhutan while those to Indian cities like Lucknow and Patna are expected to start later during the year. Air Dynamic is planning to connect cities like Karachi, Doha, Kuala Lumpur and few Indian cities to Kathmandu. Meanwhile Ministry of Tourism and Civil Aviation (MoTC) is processing applications of Shree and Unity to operate international flights.

**International air connectivity improving:** Due to the revised Air Service Agreement (ASA) signed between India and Nepal, the air seat capacity for these two countries has increased five folds. Two Indian private airlines, Kingfisher and SpiceJet, are adding flights to the Delhi-Kathmandu route. Incidentally, Air Arabia, Qatar Airways, Bahrain Air, Etihad Airways and Gulf Air have increased their weekly flight frequency. Dragon Air, the Hong Kong based airlines, has also recently announced to double its flights from Hong Kong to Kathmandu offering six flights per week.

**Land link to Lhasa:** In an effort to improve land connectivity, Nepal and China have recently signed a memorandum of understanding (MoU) to resume the Kathmandu-Lhasa direct bus service.

## Foreign Aid

Nepal has a long history of foreign aid and as such, it has become a staple part of Nepal's national economy both as an industry in itself and as a means to promote development. While the debate on utility of foreign aid remains, it continues to play a significant factor in Nepal's national economy.

**Foreign aid increases:** During the first eight months of the 2009/10 fiscal year, Nepal received foreign aid commitments of over NPR 76.7 billion (USD 1.02 billion) from bilateral and multilateral donors. The amount included NPR 58.3 billion (USD 777.9 million) in grants and the rest in the form of loans. This amounted to almost a 60% increase in aid commitment to what was made available the previous fiscal year.

**Aid utilization needs improvement:** The government had a NPR 2.1 billion (USD 28 million) deficit in the first eight months of the 2009/10 fiscal year. Part of the reason for this is its inability to fully utilize foreign aid committed to Nepal. Of the total aid committed, only 47% has been utilized, leaving some NPR 40.38 billion (USD 538.4 million) untapped.

**Government budget deficit a result of slow reimbursements:** At the end of the 2009/10 fiscal year, the government has spent over NPR 9 billion (USD 120 million) from the government treasury on various projects where donors have pledged reimbursement through grant assistance. The total reimbursements pending is estimated at around NPR 33.11 billion (USD 441 million) of which NPR 15.78 billion (USD 210 million) is to be reimbursed to the Ministry of Education alone.



## OUTLOOK

To a large extent, Nepal's economic future is dependent upon whether its political leaders can establish a working relation. The conclusion of the peace process and the writing of the new constitution are by far the most important hurdles to ensuring political stability in Nepal. That being said, the likely hood of any major legislative change remains highly improbable. Once the new budget is announced and government spending increases, the liquidity crunch will ease up. Without a new budget, reductions in government expenditure can trigger a liquidity crisis as banks are already reporting declining deposits. Following a liquidity crunch, banks cannot invest, thereby impeding growth in other sectors.

Although remittance growth decreased the last fiscal year, the numbers of people seeking to go abroad in search of work remains unabated. This trend is set to continue and should the global economy recover from its recession, the industry will continue to see impressive growth numbers. Nepal's trade deficit and its resulting strain on the Balance of Payment (BoP) remains a source of concern. Barring any major political changes, tourism should also have a good year with tourist number increasing along with the number of hotels and restaurants. This should also help to ease the pressure on the BoP through foreign currency earnings.

Given that the year 2011 has been declared Nepal Tourism Year, tourism is going to be one the main factors contributing to the service sector growth in the months to come. As 2011 nears, many challenges still remain to be addressed, particularly meeting the infrastructure deficit. By mid-March 2010, a total of 492 tourism industries with foreign and joint investments (as compared to 69 in FY 2008/09) were approved by the Nepali government. Fixed capital of those industries stands at NPR 17.9 billion (USD 238 million) with a total project cost of NPR 19 billion (USD 253 million). This is expected to generate employment for 22,699 people. A review of tourists' objectives to visit Nepal shows that recreation is highest on their list. Hence, the recreational sub-sector such as casinos, museums, nature reserves, hotels and restaurants are expected to do well in year 2011. Various political parties have committed to not hold any strikes and closures throughout the year 2011. This will not only positively impact the tourism industry but other sectors such as construction, manufacturing and industry as well.

While Nepal has a comparative advantage for the exporting of around 100 products, the investments to setup industries for these products is lacking. Investments into these products are negatively influenced by political instability, labor concerns and frequent closures. The lack of exports is a direct indication of a floundering manufacturing sector in Nepal. Although a new industrial policy has been introduced, the manufacturing sector's prospects remain a challenge. However, of the present industries in operation, industrial production, as such, will remain largely unchanged and will continue to move forward. In the longer run, Nepal will need to see robust growth in manufacturing.

Having experienced a good monsoon, the agricultural sector will have a good year. The price of agricultural goods is expected to increase and the sector overall can be expected to increase its contribution to GDP. The crop sub-sector accounts for nearly two-third of agricultural output. Except for some pocket areas in Eastern, Mid- and Far Western regions, production outlook of both the crop looks normal. Food prices in Nepal are influenced less by domestic production than overall imports. Though Government of India has not lifted its export ban of wheat and rice, expectations of a bumper harvest for FY 2010/11 may loosen the export restrictions to Nepal. This will have a downward pressure on food prices as well as increase food security. Assuming no disruptions to transportation of fertilizers and seeds, it is safe to assume that agriculture sector will recover and show a growth of more than the average 3% rate in FY 2010/11.

Finally, the availability of foreign aid will continue without any major changes in its opted ways of disbursement and usage. While the global recession has impacted aid, its economic impact on the development sector will be negligible. This is partly because of the vast aid basket that Nepal can tap into and also because of the cushioning gap between commitment and usage of aid in Nepal.



## HEALTH AND EDUCATION

Government spending on health and education is an important policy objective to increase human capital formation along with meeting political and social compulsions. Size and efficiency of these allocations are important for promoting growth and social justice.

### Health

Though there has been an increase in public spending on health over the years, Nepal ranks as one of the lowest spenders in health as a percent of GDP among developing nations. On the positive side, Nepal is showing progress in achieving health related Millennium Development Goal (MDG) targets such as reducing Infant Mortality Rate (IMR) and maternal mortality ratio. However, inequality in terms of access to and utilization of health care services persist. More urban than rural and more rich than poor have access to health centers or routinely scheduled health services. The Health Sector Reform Support Program (HSRSP) that concluded in July 2010 pointed out that 43% of the poorest could not get any health service.

### Government spending on health

As % of GDP

Actual 2005/06	Actual 2006/07	Actual 2007/08	Est. 2008/09	Budget 2009/10
0.93	1.07	1.25	1.45	1.68

Source: The World Bank, Nepal Economic Update, Kathmandu, April 2010

**Social Health Insurance to be expanded on a national scale:** The Ministry of Health and Population (MoHP) is selecting health issues to be included under the social health insurance scheme. Started through pilot projects in a few Primary Health Care Centers

(PHCCs) in Morang and Damauli, the scheme is meant to address high-cost and low frequency illnesses. The MoHP is undertaking initiatives to expand the insurance scheme countrywide. Such schemes are needed to supplement government spending on the health sector. Incidentally, it is equally important to think about ways to bridge the gap between premium collection and expenditures.

**Malnutrition and food insecurity causing deteriorating health problems:** Nepal has one of the highest malnutrition rates in the world according to a recent report published by World Food Program in Nepal. Low land productivity, poor public distribution system, political instability, corruption, weak governance and inadequate infrastructure are some of the reasons for such a poor food and nutrition status.

**Drug Production Regulation for Nepali pharmaceutical companies:** Ministry of Health and Population (MoHP) recently completed the final draft of the Drug Production Regulation as per the World Health Organization (WHO) guidelines on regulation, safety and quality assurance. This regulation will help Nepali pharmaceutical companies meet the Good Manufacturing Practice (GMP) deadline of mid-April 2011 set by WHO.

**Pharmaceutical Industry:** At present, Nepali pharmaceuticals cover 40% of the total demand for medicines in Nepal, 55% is met by Indian companies and 5% from other countries. The pharmaceutical industry is estimated to be around NPR 12 billion (USD 160 million). Nepal is already self-sufficient in producing drugs for fever and cough as well as pain killers, antibiotics and vitamins. There is plenty of scope to take the industry to the next level. However, with 28 of the 48 pharmaceutical companies based in the Terai,



they have been adversely affected by the frail political situation. Furthermore, production costs have increased due to power cuts, shortage of human resources and the inability of the government to control the import of drugs already being produced in the country.

## Education

There is no denying the fact that investment in human capital i.e., education and skills development, are enablers of growth and prosperity. Nepal has gradually been increasing the proportion of GDP allocated to education over the years.

### Government expenditure on education

As % of GDP

Actual 2005/06	Actual 2006/07	Actual 2007/08	Est. 2008/09	Budget 2009/10
2.94	2.95	3.29	3.74	4.18

Source: The World Bank, Nepal Economic Update, Kathmandu, April 2010

**Large portion of educational expenditures just to meet recurrent expenses:** An analysis of the government expenditure on education shows that a very high proportion of the educational budget, NPR 42.24 billion (USD 563 million), is actually for recurrent expenses such as salaries, leaving a negligible proportion for development expenditures.

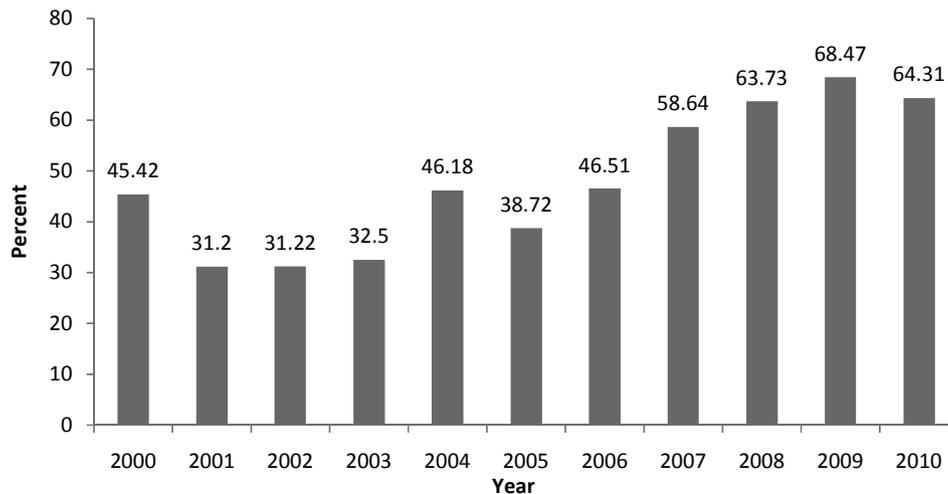
**Increasing criticisms against National Literacy Campaign:** The Informal Education Center (IEC) under the education ministry started the second phase of the National Literacy Campaign in February. This three-month campaign targets to make an additional 1.2 million persons aged 15 to 60 literate. During the first phase, NPR 2 billion (USD 27 million) was spent

without a proper recording of expenses. As a result of this and the limited results observed, the budget for the second phase was reduced from NPR 1.04 billion (USD 13.86 million) to NPR 750 million (USD 10 million). The campaign has also drawn criticism for having over ambitious goals, inefficient implementation, and lack of transparency along with nonexistent monitoring and evaluation. Moreover, the National Planning Commission (NPC) and IEC cannot even reach consensus on how to gather data on illiteracy.

**Shutdown of private schools over tuition fee hike:** The Maoist-aligned All Nepal National Independent Students' Union-Revolutionary (ANNISU-R) called a nationwide strike to protest against private school's decision to increase tuition fee by 25%. More than 8,000 private schools across the nation were shut down for a week. The strike was called off upon the condition that the Fee Determining and Monitoring Committee (FDMC) of the education ministry would review and readjust the fee structure.

**4% drop in School Leaving Certificate (SLC) pass percentage:** The SLC exam results were published in July 2010 and 64.31% of the 342,632 students who gave the exam passed. There was a drop of 4.16% in the number of students who passed compared to the previous year. Since 2000, when 205,539 students gave the SLC and 45.72% passed, the pass percentage had increased over the past five years to 68.47%. However, the pass percentage should not be the only criteria to evaluate the success of the education sector, as it does not provide a full picture of the quality of education. English, mathematics and science are the subjects that most SLC students fail. This is worrying since these are the subjects that build skills demanded by the labor market. An education sector reform is long overdue in order to build a better work force that can effectively participate in the global labor market

### SLC Pass Percent



Source: Department of Education, Education For All: Secondary Education Support Program & Community School Support Program Report, 2007 and Office of the Controller of Examinations (OCE), 2010



### OUTLOOK

Delay in announcement of a full-fledged budget will severely affect the health sector. As the special budget has sufficient funds only to meet recurrent expenses such as salaries, regular programs of the MoHP will be affected. In particular, programs such as family planning and administering vaccines are likely to face the brunt of resource shortage. In light of the news that non communicable diseases are on the rise and monsoon related epidemic, this will aggravate delivery of health services. Malnutrition among children and women is a serious public health issue in Nepal. Food insecurity in many districts of Nepal will further exacerbate the existing health problems.

The trend of Nepali students leaving the country in search of better education will continue. Banks, facing declining deposits are not in an aggressive lending mode. This will make it difficult for students to obtain loans to finance their studies. The recent hike in salaries of teachers and staffers working in the public education sector will require a larger education budget to meet the expenses. A higher public spending in education will be required to absorb the ex-combatants and former child soldier as they rejoin their civil life and start their education. Foreign donors have pledged increased support and hence higher development expenditure for health and education is anticipated. In terms of allocation for education as percent of GDP, Nepal is slightly better off than some of its neighbors like Bangladesh and Sri Lanka. Nevertheless, public spending is still behind the UNICEF standard of 6%.

## MEDIA AND COMMUNICATION

Innovation and Technology	Nepal	Region	All countries
% of Firms With Internationally-Recognized Quality Certification	3.14	9.5	15.81
% of Firms Using Technology Licensed from Foreign Companies *	0.55	5.01	14.89
% of Firms using its Own Website	23.27	35.47	33.58

Source: Enterprise Survey 2009, World Bank and IFC, 2010

Information and communication technology (ICT) can have significant direct and indirect economic and socioeconomic benefits. Conducive national policies, market regulation, liberalization, and private sector development can significantly impact the price of ICT. The mobile cellular market is the most competitive of the telecommunication services sectors due to liberalization and privatization. Nepal (reporting a drop by 64%) is one of the few countries where mobile cellular tariffs dropped dramatically between 2008 and 2009.

The recently published Economic Survey 2009 report by the World Bank Group provides a comparative regional study on the challenges businesses have to face. As the following table shows, Nepal lags in all the indicators of 'Innovation and Technology'. 23.27% of firms in Nepal use websites to communicate with their suppliers and customers as compared to 35.37% firms within the region. This shows the Nepali firms' inability to absorb and take advantage of the economic potential of the internet. This could be due to host of reasons such as lack of knowledge, poor computer literacy, affordability, missing supporting infrastructure such as electricity supply. Similarly only 0.55% of the Nepali firms use technology licensed from foreign companies, far below the regional average of 5.01%. More worrying is the fact that only 3.14% Nepali firms have internationally recognized quality certification.

**Teledensity and internet usage at a glance:** Even during the financial crisis, the mobile cellular market has been resilient, showing a steady growth in the number of mobile cellular subscriptions. Along with cellular subscriptions, internet penetration is also on the rise with an 11 times increase in the number of users. However, in actual numbers, the user base still remains relatively small.

### Teledensity at a glance:

Services	Penetration Rate%	
	2009	2010
Fixed	2.96	2.96
Mobile	18.84	25.75
Others (limited mobility, GMPCS, 3G)	0.27	1.53
Total	22.07	30.24

Source: Nepal Telecommunications Authority, Management Information System, Kathmandu, 2010

### Internet Usage:

Year	Users	Internet Penetration Rate%
2000	50,000	0.2
2005	175,000	0.7
2010	625,800	2.2

Source: International Telecommunication Union, 2010



### **Maoists plan to launch and expand their own media:**

The Unified CPN (Maoist) is planning to launch a new satellite TV and expand its radio channel Mirmire FM nationwide. It also has decided to recognize only Janadisha Daily, Janadesh Weekly, Red Star Weekly, Radio Mirmire and Sansleshan Mashik as its official publications. The party is also deliberating on whether to launch a new broadsheet or upgrade the existing daily Janadisha to a broadsheet.

**Ncell expansion:** In a move to increase Ncell mobile penetration outside Bagmati Zone, the company introduced cheap mobile handsets in the month of June. Ncell launched this campaign to target rural people with low income. Black and white handsets cost NPR 1130.90 (USD 15.00) while their colored counterparts cost NPR 1,356 (USD 18.08). Ncell also introduced BlackBerry services for its business market.

**Launch of Satellite Phone:** I4 Technologies launched its satellite phone ISatPhonePro in the month of June targeting mountaineers, the military, media persons and travelers. The phones cost USD 700 (excluding VAT) and can be used to make calls to anywhere in the world. Prepaid customers will have to pay 95 cents and post-paid service users will be charged 68 cents respectively per minute for a call.

**Nepal Telecom (NT) and its CDMA expansion plans:** Nepal's largest telecom operator, NT, got the green signal from the government to invite the largest tender ever called in the country worth NPR 15 billion (USD 200 million) for expanding its CDMA network across Nepal. NT currently has 700 towers for CDMA service across the country and plans to increase this number to 2,500.



## **OUTLOOK**

The telecommunication sector has been growing at a fast pace and will continue being a key contributor to Nepal's economic development. Teledensity during 2010 stood at 30.24% clearly showing that there is a large untapped market waiting to be explored. The country's largest telecommunication company, Nepal Telecom (NT), recently announced its target of increasing its subscriber base to 13 million in the next three years. The price war this will precipitate in between Ncell and NT in order to win a larger market share will benefit consumers. Additionally, both companies have aggressively started to invest in infrastructure to expand their coverage areas. Along with these two, the other four telecommunication companies of Nepal are also expected to continue with their investment plans.

The broadcasting sub-sector is expected to show growth as well. By mid-June, 81 different foreign TV channels had applied for downlink permission from the Ministry of Information and Communications (MoIC) to broadcast in Nepal. The recent start of direct-to-home (DTH) television service in Nepal is going to end the monopoly of cable operators in Nepal. The TV broadcasting sector will be seeing growth, both in terms of number of viewers and operators. Viewers will have more choices as cable- and DTH- operators compete against each other to increase their subscriber base. One can also hope that problems such as under-reporting of subscribers by cable operators and revenue loss incurred by the government through illegal imports of DTH in Nepal will be reduced.

As the number of Nepal's middle class rises, so will the demand for electric goods and other consumer durables. The market for mobile phones and television will show a positive growth in the months to come. During FY 2009/10, telecom equipments worth NPR 8.43 billion (USD 112.4 million) were imported, a record high change of 107.64%, indicative of the growing demand for such products.

## REVIEW: MONETARY POLICY

The Monetary Policy for the 2010/11 fiscal year was put forth by the Nepal Rastra Bank in the hope of being able to tackle various economic issues that have plagued the country's economy. The policy's has clearly focused on uplifting the rural areas by encouraging investments in these areas. For instance, it wants development banks and finance companies to follow commercial banks in extending cheaper loans to deprived sector through various incentives. In addition, the policy also targets to achieve a balance of payment (BOP) surplus of Rs. 9 billion. Furthermore, the policy has given importance to banking investments in agriculture, energy, small industries and tourism sectors.

### Policy Summary

#### Economy:

- Growth target of 5.5% for the economy
- Inflation targeted at 7%, in contrast to the existing 10.5%
- A targeted Balance of Payment (BoP) surplus of NPR 9 billion (USD 120 million)
- Establish a provision for keeping fund reserves that will last for seven months
- Note printing and issuing to be streamlined
- A clean note policy will be adopted

#### Banking/Financial Sector:

- Tighten monitoring and control mechanisms over financial institutions by imposing more financial ratios to be fulfilled, Know Your Customer (KYC), an early warning system, stress tests, and contingency plans.
- Disclosure requirements for financial institutions will also be adopted more stringently
- Try to channel money away from the informal sector, and discourage capital flight by aligning interest rates with those of neighboring countries
- Tackle the deposit-lending rate differential
- 15% growth in internal lending projected, 15% growth in deposits of commercial banks projected- expected Credit to Deposit (CD) ratio within 85%
- Bank rate increased from 6.5% to 7%
- Statutory Liquidity Ratio of 15% for Commercial Banks, 11% for Development Banks, 10% for Finance which includes Cash Reserve Ratio of 5.5%
- The lending rate for central bank's refinancing to financial institutions against their good loans has come down to 7% from 7.5%



- Encourage banks to come up with a detailed plan to double their investment in agriculture, energy, small industries and tourism within two years with the NRB monitoring to ensure implementation. The NRB will also encouraging loans towards these sectors by imposing minimum and maximum lending rates
- Extension of Trust Receipt Loan terms from 90 to 120 days
- A pledge to enforce strict regulations on the salaries and benefits of directors, CEOs, and high ranking staff of banks and other financial institutions by not only making payrolls transparent but also compatible with financial system

#### **Controlling Risk/Loan exposure:**

- Discouraging multi-banking transactions, i.e. restricting banks from depositing money in other financial institutions for interest income, as it increases risks to loans
- Encourage lending in diversified sectors, especially manufacturing
- Maximum 40% loan exposure in any sector, unless stipulated for any particular sector
- Relax credit flows to the housing sector which has a relatively higher value addition and tighten fresh loans on land transactions. Loan provisions for land plotting businesses limited to 10%, and if higher, to be brought down to 10% within the next 2 years
- Seize passports of those defaulting loans of over NRS 10 million (USD 133,333)

#### **Capital Market:**

- The policy has also checked ongoing practice of using promoters shares pledged as collateral to take loans from banks. It states that promoters with more than 1% holding will be allowed to pledge only 50% of the shares owned by them as collaterals
- Margin lending raised to 60% from 50% of lesser of 180 day average or Last Traded Price (LTP)
- Private sector banks and financial institutions are encouraged to participate in mutual funds

#### **Establishing new or upgrading BFIs:**

- The process of accepting applications for establishing a new commercial bank has been suspended for now until new provisions are put into place to control increasing number of banks. Also, professional capacity and experiences of promoters, qualifications of promoters and directors, public's access to financial services, among others, will be considered while granting licenses to new financial institutions
- Apart from the required capital, decisions regarding upgrades will now depend upon a feasibility study, institutional capacity and existing competition
- Banks and financial institutions are barred from opening new branches without NRB approval



- Infrastructure development banks are to be encouraged. Separate standards will be prepared for these financial institutions aiming for long term investments on infrastructure development
- Encourage the merger and acquisitions of the financial institutions. Introduction of incentives policy for those that take up bad financial institutions

### Foreign Exchange:

- Adopt a policy to channel remittance sent by the Nepali migrant workers from India through formal banking channels
- To promote exports, the new monetary policy has given let-ups in foreign exchange, allowing firms to export goods of more than worth USD 500,000, an increase from the existing USD 200,000 limit. The deposit amount, against the export amount that they must guarantee on the basis of a bank guarantee or Cash Against Document (CAD), has also been slashed to 1% from the existing 5%
- Nostro accounts in Indian banks to be allowed if found appropriate
- Reversing its existing policy on importing gold and silver, the NRB has allowed the import of gold and silver as per the recommendation of the Nepal Gold and Silver Dealers' Association

### Microfinance:

- Deprived sector lending is fixed at 3% of the total lending on commercial banks, 2.5% on development banks and 2% for financial institutions
- Financial institutions have been allowed to extend per family loans up to NPR 250,000 (USD 3333) through deprived sector lending in order to promote animal farming in rural areas, and under the same, extend loans up to NPR 300,000 (USD 4000) for small enterprises set up by women
- The policy has arranged collateral free loan up to NPR 200,000 (USD 2666.67) or those members of deprived families who have obtained technical education equivalent to higher secondary education
- Provision of providing a loan of up to NPR 10 million (USD 133,333.33) as the incentive for opening banks in the rural areas
- Aim to extend banking services in remote districts; opening door for D and C class financial institutions to go to districts with low financial access

Despite the positive intent of the monetary policy, it is still highly unlikely that most of its targets for the fiscal year 2010/11 will be achieved. For instance, a BOP surplus of NPR 9 billion (USD 120 million) does not look feasible with a clear-cut-strategy not being laid out along with the enormous trade deficit witnessed in the past year. In the context of banking policies, it is hard to imagine financial institutions going to rural sectors seeking investments despite incentives. However, all the positive steps that the monetary policy wants to take are welcomed despite doubts over whether the desired outcomes are attainable.

## REVIEW: BANKING

### Unaudited Financial Figures of Commercial Banks

as of fourth quarter for the fiscal year 2009/10.

(NPR in millions)

Banks	Paid Up Capital	Reserves and Surplus	Deposits	Loans and Advances	i) Real Estate Loan	ii) Home/Housing Loan	Net Profit	Non Performing Loans	Credit to Deposit (CD) Ratio	Earnings per Share (NRS)
Nepal Investment Bank	2,409	2,779	50,095	40,948	9,407	1,469	1,266	0.62%	81%	53
NABIL Bank	1,449	2,828	46,406	33,031	4,617	2,405	1,146	1.47%	71%	79
Standard Chartered Bank	1,398	2,740	35,183	16,177	438	4,094	1,086	0.61%	60%	78
Nepal Bangladesh Bank	1,860	269	10,052	9,119	424	589	1,017	4.06%	78%	55
Everest Bank	1,280	1,480	36,932	28,156	871	4,132	832	0.16%	71%	65
Himalayan Bank	1,600	2,043	37,666	29,124	2,945	975	523	3.52%	79%	33
Bank of Kathmandu	1,182	1,069	20,316	17,044	1,742	1,563	509	1.51%	81%	43
Nepal Credit & Commercial Bank	1,400	160	10,825	8,388	1,465	727	461	2.72%	69%	33
Nepal Industrial & Commercial Bank	1,312	801	15,969	12,732	1,470	1,026	453	0.72%	73%	35
State Bank of India	1,654	888	34,896	18,032	971	2,480	400	1.47%	71%	24
Laxmi Bank	1,614	509	18,083	14,736	3,346	858	327	0.12%	82%	20
Prime Commercial Bank	1,264	391	17,884	13,947	3,365	1,090	326	Nil	74%	26
Kumari Bank	1,306	637	17,432	14,766	3,600	1,139	317	0.50%	79%	24
Lumbini Bank	1,295	161	5,768	5,493	220	107	304	4.53%	77%	23
Siddharta Bank	1,310	422	20,197	16,654	3,309	703	238	0.53%	81%	18
Bank of Asia Nepal	1,500	243	12,481	11,107	2,345	802	208	0.27%	81%	14
Citizen Bank	1,207	101	14,214	10,925	2,550	753	194	0.31%	72%	16
Sunrise Bank	1,510	249	14,830	12,044	3,380	489	192	1.12%	77%	13
DCBL	1,746	299	8,065	7,546	2,920	339	162	1.44%	74%	9
NMB Bank	1,502	558	10,111	7,931	1,408	594	155	0.70%	70%	10
KIST Bank	2,000	186	15,963	12,486	3,362	1,048	141	0.19%	68%	7
Machhapuchchhre Bank	1,479	349	18,536	14,973	3,372	786	128	1.42%	73%	9
Global Bank	1,473	152	15,032	12,009	2,464	510	105	0.82%	74%	7
Nepal Bank	380	-4,878	42,406	24,935	1,480	2,056	357	4.98%	66%	94
Rastriya Baniya Bank	1,172	-11,127	68,623	35,693	1,780	3,111	2,011	9.81%	61%	172
JANATA Bank	1,400	46	855	608		39	10	0.00%	26%	1
Agricultural Development Bank	9,438	989	32,463	33,638	8	1,575	1,450	8.22%	92%	15
Total	631,283	462,242	63,262	35,459	14,317					



The banking sector is an integral part of and significant contributor to the national economy. The commercial banking sector has played a major role in strengthening the country's banking system and increasing its stature. Its performance during the last fiscal year is an indication of its ability to adapt to a changing business environment. Despite political instability, a liquidity crisis, and Nepal Rastra Bank's tight real estate and housing loan policies, the commercial banking sector performed fairly well in-terms of net profits. Moreover, its display of resilience during a difficult period indicates not only a strong banking system in the country but also a strong central bank which has been vigilant throughout the year.

Unlike fiscal year 2008/09 in which two commercial banks posted net profits over NPR 2 billion (USD 26 million), the fiscal year 2009/10 saw only Rastra Banijya Bank managing to post profits over NPR 2 billion. Five commercial banks managed to post profits higher than NPR 1 billion (USD 13 million). Of the private commercial banks, Nepal Investment Bank led the way with NPR 1.26 billion (USD 16.8 million) and Nabil Bank, Standard Chartered Bank and Nepal Bangladesh Bank followed closely behind.

Despite Nepal Bangladesh Bank's low net interest income, total operating income and operating profit, in comparison to the other top four commercial banks, its high write back of provisions for possible losses is the major contributing factor to its high net profit. On the other end of the spectrum, KIST bank, Machhapuchhre Bank, Global Bank and Janata Bank came in with net profits below NPR 150 million (USD 2 million). However, in the case of Janata Bank which started its banking operations only in April, 2010, its net profit as of now cannot be scrutinized.

With all commercial banks required to reach the paid up capital fund of NPR 2 billion (USD 26 million) or NPR 1.6 billion (USD 21 million) paid up capital with over NPR 400 million (USD 5.33 million) in reserves and surplus, most commercial banks have been increasing their paid up capital by issuing right shares and bonus shares. This has resulted in low earnings per share (EPS) for most banks in the fiscal year 2009/10 in comparison to the previous year, with net profits barely witnessing the same growth as their capital. Nabil Bank and Standard Chartered Bank, which hold the top two spots in-terms of EPS are prime examples. In the fiscal year 2009/10 both the banks increased their paid up capital by issuing 50% bonus shares. However, the net profits increased only by 11.18% and 5.92% respectively for Nabil and Standard Chartered Bank. Hence, EPS for Nabil and Standard Chartered were NPR 79 (USD 1.05) and NPR 78 (USD 1.04) which is far below what these banks had achieved the previous fiscal year with EPS over NPR 100 (USD 1.33). On the other hand, government controlled Rastriya Banijya Bank's EPS stood at NPR 172 (USD 2.29).

From an investor's perspective, a bank's reserves are vital to determining its ability to give out bonus and cash dividend. Moreover, positive reserves also contribute to the increment of the company's net worth when measuring the true value of any organization. As per the 4th quarter reports, only government controlled banks like Rastriya Banijya Bank and Nepal Bank had negative reserves. Nepal Credit and Commerce Bank, Nepal Bangladesh Bank and Lumbini Bank had negative reserves till fiscal year 2008/09 which these banks managed to wipe out in the fiscal year 2009/10.

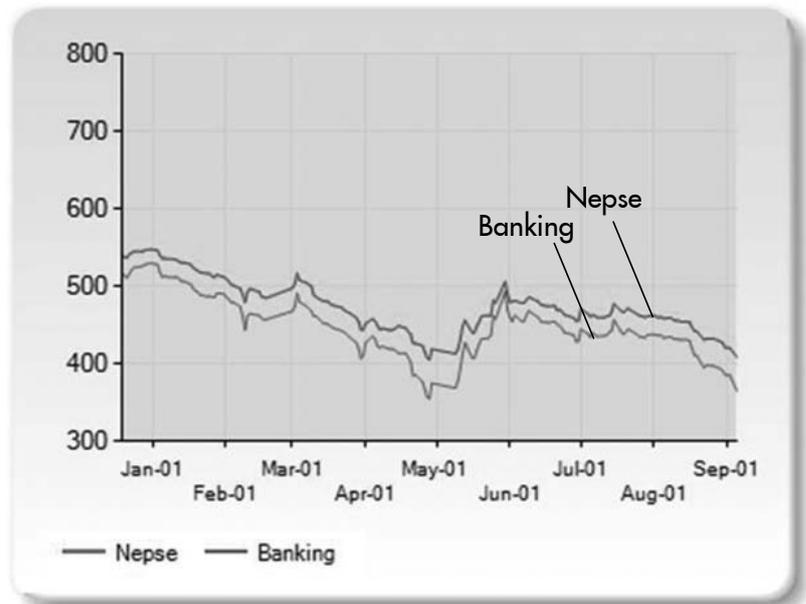
Luring depositors in a highly competitive market is a tough task for any banking institution. In the fiscal year

2009/10, commercial banks managed to acquire and maintain deposits worth NPR 631 billion (USD 8.41 billion) which is a 13.71% increase from the previous year; the compounded annual growth rate (CAGR) in total deposits for last three fiscal years in the commercial banking sector has been 14%. Amongst the non-government controlled commercial banks, Nepal Investment Bank topped the table for the second consecutive year with over NPR 50 billion (USD 667 million) in deposits with Nabil bank coming second with over NPR 46 billion (USD 613 million). As for government controlled banks, Rastriya Banijya Bank once again topped the list with over NPR 68 billion (USD 906 million).

Increments in total deposits also have an indirect positive impact on total loans and advances which led to a 16.85% increase in the 2009/10 fiscal year. This was higher than the last three years CAGR of 16%, despite banks being conservative on loans and advances due to the liquidity crisis. The issue of real estate and housing loan exposures of commercial banks have also been a matter of great concern with NRB stipulating that a bank's total real estate and housing loans should be less than 40% of its total loan portfolio. Out of the 40%, the maximum real estate loan exposure is set at 15%. As per the 4th quarter unaudited reports, the total real estate and housing loan constitutes

21.35% of the total commercial banks loans and advances. At the end of the 2009/10 fiscal year, 14 commercial banks had real estate loan exposures of more than 15%, with DCBL, Sunrise and KIST bank with the highest levels of exposure with 38.69%, 28.06% and 26.92% respectively in the real estate sector. Furthermore, almost all these banks with high real estate exposure have posted a lower net profit in comparison to other banks.

The industry average on Non Performing Loans (NPL) is 1.99% with government controlled banks like Rastriya Banijya Bank and Agriculture Development Bank having NPLs of over 8%. On the other hand, if government controlled banks are taken out of the picture, the average NPL is 1.31% with Lumbini Bank having the highest NPL at 4.53% and Laxmi Bank having the lowest, with only 0.12%. However, in the case of Lumbini Bank its present NPL is commendable because in fiscal year 2006/07, its NPL was a massive 20.37%. As for the Credit to Deposit (CD) ratio which measures the bank's ability to generate loans from deposits received, the industry average for the fiscal year 2009/10 was 73% which is slightly lower than the year before. Agriculture Development Bank and Laxmi Bank lead the way with CD ratios of 92% and 82% respectively while Standard Chartered Bank has one of the lowest CD ratios of 60%.





## OUTLOOK

Due to the government's spending through the special budget and continuous remittance inflow, funds are slowly flowing back into banks. Compared to the severe liquidity crisis six months ago when banks and financial institutions literally stopped lending and interbank lending rates had reached a weighted average of 11.1%, the liquidity crunch has considerably eased.

The regulation segregating the real estate market into plotting, commercial real estate and housing loans has been a logical and scientific step taken by NRB towards the management of a real estate bubble. Further, an acute shortage of gold, due to a ban on imports and delays in removing price disparity have now been addressed by the central bank through the supply from its own gold reserve and a gold auctioning modality has also been setup. These activities will attribute positively on the health of financial markets. However, interest rates are like to remain unchanged in the near future both in terms of lending as well as deposits. Most banks and financial institutions are on a wait and watch situation with no major decisions on pricing likely until the formation of a new government and the passing of a new budget. However, the situation will start to deteriorate if budget and government spending are not in place within the next three months.



## REVIEW: CAPITAL MARKETS

### Bond Market

Bonds constitute only a tiny portion of the overall capital market in Nepal. According to the Securities Board of Nepal (SEBON), bond issue holdings only constitute 13.8% of the total capital market issuances of which equity constitutes 84.5% and the rest is preferred stock. As of April, 2010 the Nepal Stock Exchange (NEPSE) stated the total paid up value of equities and bonds is NPR 74.26 billion (USD 990 million). Government-issued bonds take the form of Development bonds, Citizen Saving bonds, Special bonds, and Treasury bills (28 days t-bills, 91 days t-bills, 182 days t-bills, and 364 days t-bills).

Debentures are the only form of corporate bond issued in the Nepali capital market. Corporate debentures represent around 19% of the bond market. Debentures and bonds are quite similar, except that bonds are relatively more secured than debentures. In case of liquidation, debenture holders are paid after bond-holders have been paid.

Citizen Saving bonds can be subscribed to only by Nepali citizens and interest is paid semi-annually until the maturity date. Development bonds can be subscribed to by individual investors and institutional investors, and the interest is paid semi-annually. Both Citizen Saving bonds and Development bonds have relatively long terms or maturity periods. On the contrary, treasury-bills, which are primarily used by NRB as a monetary policy tool, have short time periods – ranging from 28 days to 364 days.

Not all the available bonds are listed on NEPSE. Only development bonds (among the government bonds) and corporate debentures are listed. Other forms of government bonds are not required to be listed on the NEPSE. The government only started listing Development bonds on the NEPSE in 2005. Other than a few exceptions, including bonds issued by Siddhartha Bank Ltd., corporate bonds are generally listed on the NEPSE. As of October 2008, SEBON reported that NPR 5.7 billion (USD 76 million) worth of corporate bonds had so far been issued in the market and NPR 5.3 billion (USD 70.6 million) worth of corporate bonds were listed.

#### Debentures issued in the fiscal year 2003/04:

Name	Issue date	Maturity date	Interest rate	Total Amount
NIBL Bond 2010	2003/11/24	2010/11/24	7.50%	NPR 300 mil

#### Debentures issued in the fiscal year 2005/06:

Name	Issue date	Maturity date	Interest rate	Total Amount
NIBL Bond 2013	2006/06/26	2006/06/25	6%	NPR 250 mil
NIC Bond 2013	2006/06/26	2006/06/25	6%	NPR 200 mil
Nepal SBI Bank Rinpatra 2013	2006/07/16	2006/07/15	6%	NPR 200 mil

#### Debentures issued in the fiscal year 2006/07:

Name	Issue date	Maturity date	Interest rate	Total Amount
NIBL Bond 2014	2007/06/26	2014/06/25	6.25%	NPR 250 mil

### Debentures issued in the fiscal year 2007/08:

Name	Issue date	Maturity date	Interest rate	Total Amount
Kumari Bank Ltd. Bond 2013	2008/06/09	2013/06/09	8%	NPR 400 mil
NIBL Bond 2015	2008/07/09	2015/07/09	8%	NPR 250 mil
Himalayan Bank Ltd. Bond 2015	June 2008	June 2015	8%	NPR 500 mil
Nabil Bond 2018	June 2008	June 2018	8.50%	NPR 300 mil

### Debentures issued in the fiscal year 2008/09:

Name	Issue date	Maturity date	Interest rate	Total Amount
BOK Rinpatra 2012	Sept 2008	Sept 2012	6%	NPR 300 mil
Laxmi Bank Debenture 2015	2008/11/25	2015/11/25	8.50%	NPR 350 mil

## Commodity Exchange

Commodity and Metal Exchange Nepal Limited (COMEN) in 2006 introduced commodity derivatives as a financial instrument in Nepal by facilitating the trade of commodities futures in goods such as lentils, wheat, flour, rice etc. in their trading pit. Commodities were then traded on the trading pit as stocks are currently traded. Online trading platforms were only introduced later on. Mercantile Exchange Nepal (MEX) and Nepal Derivative Exchange Limited (NDEX) followed soon after in introducing commodities futures. While about 18 more exchanges have been registered with the company registrar, only the 3 aforementioned exchanges are currently operational. Nepal Spot Exchange (NSE), a subsidiary of MEX, is planning to start their operation in the spot exchange market.

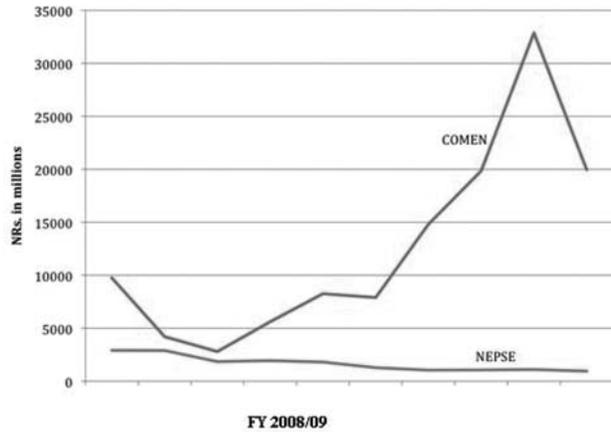
The current state of Nepal's commodity futures market is characterized by trading of cash-settled futures contracts on global-based commodities by speculative investors in a self-regulated environment. There are only a small number of physical deliveries of traded commodities, an infant spot market, a lack of true economic users, and no regulatory oversight whatsoever. Currently, speculative investors in Nepal's market are the only users accruing all the benefits of a bull market. Any temporary slump in the commodity futures market could damage its overall growth prospects.

Nevertheless, given the commodity market's 3 year history and success stories in other developing countries, the growth prospect of the market looks good. The present growth of trading in this market is overwhelming when compared to that of the stock exchange. The following graph shows the trade volume of COMEN and Nepal Stock Exchange (NEPSE) for the year 2008, by which we can see how commodity trades in COMEN alone are worth multiple times more than that in NEPSE; though one must keep in mind that in the commodities market, transactions are made using margins.

The challenge, however, is to maintain the momentum by creating a credible as well as sustainable spot market with deliveries aligned with the needs of domestic market participants along with an emphasis on local agro-

commodities. Moreover, due to the lack of regulation in Nepal, the procedure for opening an exchange is similar to opening a company. All interested parties have to do is register their exchange with the Company Registrar in Tripureshwor in compliance with the Company Act. Currently, there are no capital and technical requirements. Therefore, any party meeting the standard requirements for a company can register for an exchange. As mentioned before, currently there are about 18 exchanges registered with the Company Registrar (the exact number cannot be verified) and at present, only 3 exchanges are currently operational and they all trade in commodity futures.

Today, the noticeable progress in the Nepali commodity market is that all exchanges complete their trades on their online trading platform. The Automated Trading System (ATS) has replaced the traditional open trading floor. This computerized system is based on software that automatically controls trade order entry, execution and submits trades to the exchange.



Source: Beed Invest



## OUTLOOK

The capital markets recently witnessed some regulatory transformations. The long awaited Mutual Fund Regulation has been approved by the Ministry of Finance and is expected to be a key driver for the revival of the stock market. Mutual funds will be able to mobilize funds from small investors creating market stability and providing it with more depth. The stock market has been witnessing a constant bearish trend for the past one and half years due to a lack of institutional investment and other macro issues rather than fundamental issues of performance of the listed companies. Thus, the introduction of mutual funds is likely to create a different wave in the market calling back the “bulls.”

The Nepal Stock Exchange has signed an agreement with CMC Limited, India for the development of a Central Depository System (CDS) and Clearing and Settlement System with the technical assistance of NPR 80 million (USD 1.07 million) from the Indian government. The software and its implementation is expected to be completed by the end of January next year. The implementation of the CDS system in Nepal is expected to increase volume by at least 5 folds, following a similar trend to that of the Bombay Stock Exchange (BSE), where the effect was a 30 folds increase. Investors will also be free from the settlement time lag of over 20 days, a major deterrent for active investors. Additionally, the monopoly of the 23 brokers in the Nepal Stock Market is coming to an end. Nepal Stock Exchange has started the induction process of 27 new brokers, after the court go-ahead verdict on its suspension. New brokers will introduce new players in the market, boosting the market depth to a large extent.

Overall, capital markets will be experiencing a bullish market in about one year, largely because of the mutual funds that will start operations, the CDS system and additional brokers working on new investors’ acquisitions.

## REVIEW: ENERGY, INFRASTRUCTURE AND REAL ESTATE

While energy and infrastructure are industries in their own right, they both have a significant impact upon all other aspects of business. The better a country's infrastructure, the easier it is to do business in that country. Without access to power, there are very few industries that can flourish. The World Bank's Doing Business report highlights Nepal's weak infrastructure which leads to problems of access to the basic necessities of running a business.

Infrastructure	Nepal	South Asia	All countries
Number of Power Outages in a Typical Month	51.96	42.21	8.92
If there were outages, Duration of Power Outages (hours)	6.51	4.56	5.46
Value Lost Due to Power Outages (% of Sales)	26.95	10.81	4.9
If a generator is used, Electricity from Generator (%) *	24.58	25.94	19.9
Delay in Obtaining an Electrical Connection (days)	8.95	48.42	37.32
Average number of Incidents of Water Insufficiency in a Typical Month*	23.46	21.01	6.32
If there were shortages, Average Duration of the Water Shortage (hours)*	24.06	10.8	12.86
Delay in Obtaining a Water Connections (days)	10.5	64.15	34.96
Delay in Obtaining a Mainline Telephone Connection (days)	7.78	31.24	26.31

Source: World Bank and IFC, Enterprise Survey 2009, 2010

### Price listing since 2003

Year	Petrol (NPR/Lt)	Diesel (NPR/Lt)	Kerosene (NPR/Lt)
2003	56	33.50	27
2004	62	41	36
2005	67	46	39
2006	67	52.50	47.65
2007-Oct	73.50	56.25	51.20
2007-Dec	80	56.25	51.20
2008	100	70	65
2008-Dec	85.50	60.50	60.50
2009	77.50	57.50	57.50
2010-Feb	77.50	59	59
2010-Mar	80	61	61
2010-Apr	82	63	63
2010-July	85	65.50	65.50

Source: NOC

### Energy

Nepal has the potential to become energy independent through the utilization of alternative energy sources that include bio-fuels, hydropower, solar and wind. However, at present, the hydropower sector is unable to produce enough electricity to meet current demand and the country remains entirely dependent on imports for all its fuel and gas needs.

**Fuel Shortages:** The country continues to face periodic fuel shortage. The latest spat was a result of the Nepal Oil Corporation (NOC) decision to exert pressure on the government to adjust the fuel prices by adopting an import cut strategy. This strategy created mayhem as consumers had to queue at fuel stations for long hours. The NOC denied that shortages were due to its strategy, which would enable NOC to settle its past dues worth



NPR 640 million (USD 8.5 million) to the Indian Oil Corporation (IOC). While attempts have been made to open the petroleum market to the private sector, the bill is yet to be endorsed by the Legislature-Parliament.

**Private sector involvement in the hydro industry:** 17 hydro firms have applied for license at the Department of Electricity Development (DoED) to run hydroelectric power projects ranging from micro power projects of 1-25 MW to above 100 MW. According to the DoED, Nepali private companies see opportunities in smaller projects which constitute the bulk of the applications in comparison to Indian companies that continue to invest in larger hydroelectric projects. Some of projects have been listed below.

S.No	Hydro Firm/ Project Name	Capacity	Location
1.	Muktishree Energy Pvt Ltd	667 MW	Bheri-4 in Salyan
2	Water Creation Pvt. Ltd	420 MW	Humla Karnali Hydroelectric Project located in Simikot district
3.	Navyug Urja Pvt Ltd	105 MW	Dudhkoshi Hydroelectric Project located in Solukhumbu district
4.	Chandan Holding Pvt Ltd	30 MW	Bharbun Khola Hydroelectric Project in Dolpa district
5.	Hewa-Sewa Khola Hydroelectric Project	3 MW	Sankhuwasabha
6.	Kinja Marbu Hydroelectric Project	4.6 MW	Solukhumbu
7.	Middle Balephi Hydroelectric Project	7.5 MW	Sindupalchowk
8.	Upper Bharbun	20 MW	Dolpa
9.	Phakphok Khola	2.2 MW	Illam

**Price hikes in petrol and diesel:** The Indian Government's revised prices have created wide gaps in the prices of petrol and diesel by NPR 5 and NPR 2 per liter respectively. In response, NOC has intensified its pressure to hike prices. The price of petrol stands at NPR 85 (USD 1.13) per liter, diesel at NPR 65.50 (USD 0.87) and Liquefied Petroleum Gas (LPG) at NPR 50 (USD 0.67). The price hike is necessary to curtail rampant smuggling of petrol and diesel across the India-Nepal border.

**Subsidies on Liquefied petroleum gas (LPG):** The strategy of the NOC to continue to subsidize LPG prices remains a mystery. LPG subsidies account for some three quarters of the total losses NOC suffers. There is a NPR 130 (USD 1.73) subsidy on each LPG cylinder which costs NPR 1250 (USD 16.67) as opposed to the cost of kerosene which stands at NPR 65 (USD 0.86) per liter. The NOC is making a profit of NPR 8.50 (USD 0.11) per liter of kerosene. The corporation has attempted to subsidize the LPG prices and cover up the losses through the price hike in petrol, diesel and kerosene. This move has been strongly opposed as such strategy is burdening the lower income strata of the consumers as over 80% of LPG is consumed in urban centers.

**Main dam of the Sikta irrigation project completed:** Sino-Hydro Lumbini Company, a joint venture of China and Nepal, has completed the construction of the main dam of Sikta irrigation project in four years. The main dam is estimated to cost NPR 1.70 billion (USD 22.67 million) which is a major portion of the NPR 7.45 billion (USD 99.33 million) project. The project is ready to construct a 20 Km main canal this year for which the government has been requested to allocate a budget of NPR 2 billion (USD 26.67 million) for the tender process and for advance payment to the contractor. It is expected to take more than seven years to complete the construction of 50km main canal and around 233km long-branch canals.

## Infrastructure

**Road projects:** The World Bank has agreed to provide an additional assistance of NPR 3 billion (USD 40 million) to help improve the rural road networks of the country. The current Rural Access Improvement and Decentralization Project (RAIDP) is upgrading rural roads in 20 districts since 2005. With the new financial assistance, the operations will expand to 10 more districts - Bara, Parsa, Saptari, Tahahun, Gulmi, Arghakhanchi, Dang, Pyuthan, Surkhet and Kanchanpur – and help upgrade a further 550 km of rural roads to all-weather standard roads.

**Kathmandu-Terai Fast Track:** The Kathmandu-Terai fast track road estimated at NPR 67.72 billion (USD 903 million) and NPR 43.65 billion (USD 582 million) for four lane and two lane roads respectively in March 2008 has escalated to a NPR 75.45 billion (USD 1006 million) and NPR 48.75 (USD 650 million) for four lane and two lane roads respectively, as per the latest study on the Fast Track conducted by Asian Development Bank (ADB). The study also suggests that the estimated number of vehicles using the road is approximately 5000 a day, down from 8000 a day estimated in 2008. Hence, to secure the project, ADB is pressing the government for substantial investment in the four-lane project as the private sector is not ready to invest in the mega project under the built-operate-own-transfer model. The project was originally scheduled to be completed by 2014 but uncertainty in the implementation has not only delayed the project by a year but also pushed up the project cost.

**International Airport in Bara:** Land Mark Worldwide (LMW) Company of South Korea, a company known for developing, managing and financing big projects, has bagged the contract of conducting a Detailed Feasibility Study (DFS) of the much hyped second international airport at Nijgadh in Bara. As per the agreement, the company has to submit the DFS report within 10 months starting 1st April 2010. The cost for the feasibility study is estimated at NPR 266 million (USD 3,551,023). The government has decided to develop the airport under the Build Operate Own and Transfer (BOOT) model. The proposed airport is estimated to occupy an area of 80 sq. km out of which 40 sq. km will be for the airport and a town will be built on the remaining land. LMW has stipulated that a four lane track road to connect to Kathmandu is a prerequisite for development of the International Airport.

## Real Estate

Real estate, renting and business activities contributed 8.26% to Nepal's GDP during the 2009/10 fiscal year while the construction businesses contributed 6.64%. These contributions are calculated from the figures provided by the Nepal Land and Housing Developers Association (NLHDA), which stated that NPR 85 billion (USD 1.13 billion) has been invested in the real estate sector throughout the country which in turn has led to the creation of around 300,000 jobs opportunities.

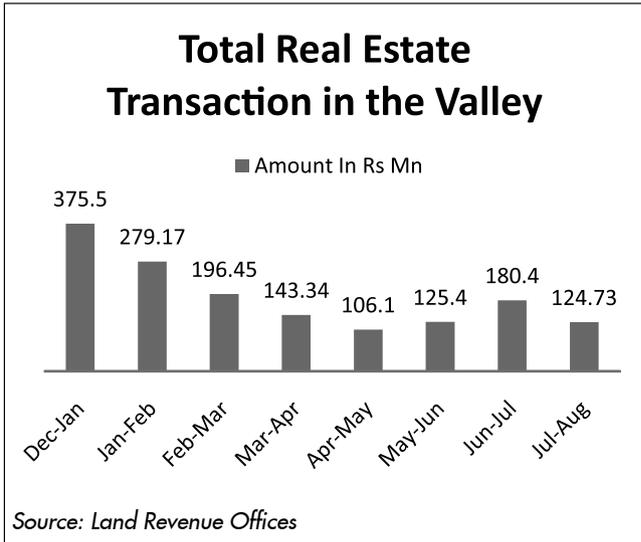
**Nepal Rastra Bank's (NRB) Directives:** As per the NRB's December 2009 directive, banks and financial institutions (BFIs) are required to reduce their lending to real estate and housing to 25% and 15% respectively.

The objective is to limit lending to the sector to 40% of total lending by the end of the current fiscal year. As a result, real estate loans went down from NPR 65.72 billion (USD 876.2 million) in the second quarter to NPR 63.64 billion (USD 848.53 million) in the third quarter this year. The NRB's directive was fuelled by the liquidity crisis during the last 8 months. It had a cascading effect on the sector with banks refusing to allow fresh loans to the sector.

**Drop in real estate transactions:** The real estate sector witnessed a 25% decline in transaction during the first 10 months of the fiscal year 2009/10 in the capital. All five Land Revenue Offices (LROs) across the capital accounted for declining revenue.

**NRB sets further regulations:** The NRB's December 2009 directive, led to a sharp rise in interest rates for home loan. To provide some respite to the BFIs, the central bank recently issued new directives wherein BFIs are allowed to reschedule the real estate loans provided the borrower repays 25% of principal along with all the accumulative interests. The Central Bank on 21st September, 2010, released a new directive which allows 25% lending to housing and 10% to the real estate sector. Banks are required to bring their total lending to the housing and real estate sector to 30% by the end of the fiscal year 2010/11 and further down to 25% by the end of fiscal year 2011/2012.

**The Kathmandu Valley Town Development Committee (KVTDC):** The KVTDC launched the Kuleshwor housing project and Golphutar housing project which cover around 65.48 acres and 26.76 acres of land respectively. KVTDC has so far completed around 12 such projects in the valley. Under the Land Pooling Project, it had launched Dallu Housing Project (49.77 acres), Naya Bazaar (105.59 acres), Gangabhu (35.43 acres),



Chabahil Gopikrishna (25.25 acres), Bagmatiphat Jwagal area (24.75 acres), Kirtipur (13.44 acres), Kamal Vinayak (18.22 acres), Libali Bhaktapur (84.19 acres), Lubu Lalitpur (33.80 acres), Sintitar Bhaktapur (65.97 acres), Saibhu Bhaishapati (69.36 acres) and Sinamangal (113.22 acres). The 12 projects have covered around 1256.58 acres of land.

**Non Resident Nepalis (NRNs) can now own land:** As per Ministry of Foreign Affairs NRN Regulation 2066 Section 11 (3), NRNs are allowed to own two Ropani (0.25 acre) of land and housing in Kathmandu valley. They can also buy up to 0.25 acre in the valley, 0.65 acres in the Terai municipalities, and 1.25 acres in municipalities other than in the valley and the Terai.

**Land Revenue Office adds transfer restrictions:** The Land Revenue Office (LRO) is set to bar multiple ownership transfers of the same land plots and houses on the same day. The directive requires LROs not to allow BFIs to accept the property as collateral on the day of transaction. This is a positive step taken by the government to stop over speculation and prevent artificial rises in prices. However, such restrictions are not applicable to the transfer and distribution of parental property among siblings. Likewise the ministry has granted permission for ownership transfer of property as gifts to spouses.



## OUTLOOK

Hydropower continues to be used as a political tool and reforms in the sector in the near future look unlikely. Recently, UCPN-Maoists have asked the caretaker government to review 14 hydropower deals made with the foreign investors, exacerbating the uncertain investment climate. Unless resolved immediately, this will scare away other potential investors.

The nation will not be getting any respite from the 16 hours of daily load shedding during the upcoming dry months. Maintenance works in Kulekhani Hydropower plants were completed by August but there is not going to be any change in the load shedding hours. Demand for energy has been growing steadily but no new energy projects will be adding electricity to the national grid. This is going to put pressure on alternative energy generation mechanisms. Individuals and enterprises will have little choice but to rely on expensive alternatives such as battery operated inverters and generators operating on diesel. With the recent hike in petrol and diesel, cost of producing a unit of electricity by such alternative methods is going to be an expensive affair. If the proposed tariff increase by Nepal Electricity Authority (NEA) gets approved by the Electricity Tariff Determining Commission, consumers then will have to pay NRS 9 (USD 0.12) per unit of electricity up from the current rate of NRS 6 (USD 0.08).

Infrastructure development in Nepal will remain largely unchanged as no major change in policy is yet to come about. Without the passing of the budget, no new projects will be started but ongoing projects will be able to continue through the special budget released by the Ministry of Finance. However, should a proper budget not be passed within the next three months, these projects will also come to a halt.

Fuelled by the liquidity crisis and the directive of Nepal Rastra Bank (NRB) the realty market has sustained a severe blow. Revenue collection during August-September in all five Land Revenue Office located in Kathmandu recorded a sharp decline of 58.82% this year as compared the same period last year. Despite the December regulation imposed by NRB towards realty lending, land and home prices have not corrected. Developers and land bankers are holding on to their assets but how long can they hold is yet to be seen, especially in the wake of the liquidity crunch, high interest rates and projects nearing completion. In Pokhara real estate developers have started selling land plots by lowering prices by up to 40% because of high interest rates on bank loans. The mortgage and high interest rates are slowing catching up with the developers and it is only a matter of time before they start liquidating their assets at cost to recover their investment. In the near future one will see consolidation and correction in this over hyped and over speculated sector. A fall in the price of land and housing will eventually see large developers acquiring projects of small scale developers.



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## ACRONYM LIST

ADB	Asian Development Bank	IMR	Infant Mortality Rate
AIC	Agriculture Inputs Corporation	IOC	Indian Oil Corporation
ANNISU-R	All Nepal National Independent Students' Union-Revolutionary	LRO	Land Revenue Office
ASA	Air Service Agreement	MDGs	Millennium Development Goals
BFI	Banks and Financial Institutions	MoF	Ministry of Finance
BoP	Balance of Payment	MoHP	Ministry of Health and Population
CA	Constituent Assembly	MoTC	Ministry of Tourism and Civil Aviation
CBS	Central Bureau of Statistics	MoU	Memorandum of Understanding
COMEN	Commodity and Metal Exchange Nepal Limited	NC	Nepali Congress
CPN-M	Unified Communist Party of Nepal – Maoists	NEPSE	Nepal Stock Exchange
DoED	Department of Electricity Development	NOC	Nepal Oil Corporation
EPS	Earnings per Share	NPC	National Planning Commission
FAN	Floriculture Association of Nepal	NPL	Non Performing Loans
FDMC	Fee Determining and Monitoring Committee	NPR	Nepali Rupees
GDP	Gross Domestic Product	PHCCs	Primary Health Care Centers
GMP	Good Manufacturing Practice	NRB	Nepal Rastra Bank
GNI	Gross National Income	RBI	Reserve Bank of India
HSRSP	Health Sector Reform Support Program	RAIDP	Rural Access Improvement and Decentralization Project
ICT	Information and communication technology	SEBON	Securities Board of Nepal
IEC	Informal Education Center	SLC	School Leaving Certificate
IMF	International Monetary Fund	UML	United Marxist Leninists
		UNDP	United Nations Development Program
		USD	US Dollars
		VAT	Value Added Tax
		WHO	World Health Organization





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