NEPAL ECONOMIC FORUM

# nefport

A SPECIAL ISSUE ON

## NEPALI CAPITAL MARKET: OPPORTUNITIES AND CHALLENGES

**DOCKING NEPAL'S ECONOMIC ANALYSIS**

ISSUE 29 | JUNE 2017

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# NEPAL FACTSHEET


Map Source: https://en.wikipedia.org/wiki/File:Un-nepal.png

## KEY ECONOMIC INDICATORS

| | | | |
|---|---|---|---|
| GDP | USD 25.05 billion | GDP Growth rate (%) | 6.9 |
| Rank | 105 | | |
| GNI per capita (Atlas) | USD 730 | Inflation (annual %) | 3.2 |
| Rank | 196 | | |
| GNI (PPP) | USD 2,500 | Agricultural growth rate (annual %) | 5.3 |
| Rank | 187 | | |
| Gross Capital Formation (% of GDP | 28% | Industrial growth rate (annual %) | 11 |
| HDI | 0.55 | Service Sector growth rate (annual %) | 6.9 |
| Rank | 144 | | |

*Sources:*
*Left Table — Nepal Economic Survey report 2016; Statistics time; The World Bank; HDI figure from Human Development Reports of the UNDP,*
*Right Table — Budget 2017/18- Ministry of Finance, May 2017*

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# EDITORIAL

One of the main highlights for Nepal Economic Forum (NEF) this quarter was the successful completion of Second edition of Himalayan Consensus Summit (HCS). HCS 2017 was a three-day event where people from around the world came together to explore new opportunities to scale up sustainable, environment-friendly and social businesses. NEF has also been selected as a partner to the study on BBIN MVA. The project aims to develop economic corridors by linking Bangladesh, Bhutan, India, Nepal and Myanmar.

We are very thankful for the support from different stakeholders as well as members of our distinguished advisory board, which has been crucial in NEF's growth.

This quarter was eventful for Nepali politics and economy. The Government of Nepal successfully conducted the first round of local elections after twenty years. With regard to economic development, reports from different governmental and non-governmental agencies like IMF and World Bank confirmed the encouraging growth of 7%.

The quarter was also marked with the announcement of budget amounting NPR 1279 billion (USD 12.32 billion). The criticism on unspent capital expenditure has made the government rethink its approach toward budget implementation and will provide the impetus for better administering of the budget. This will be the first budget that will work under the fiscal devolution model. The successful completion of local level elections also provides an opportunity for economic growth, and a move towards local levels with more accountability and transparency. Meanwhile, the relief from power cuts after a decade is also showing a positive impact on economic activities.

This edition is a Capital Market special, with focus on highlighting the existing opportunities and challenges in the Nepali Capital Market. We would like to thank especially the Chairman and Executive Directors of SEBON along with the other key contributors for helping us making this issue an enriching one.

We continue to look forward to your valuable comments and suggestions.

**Sujeev Shakya**
**Chair, Nepal Economic Forum**

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GENERAL

# OVERVIEW

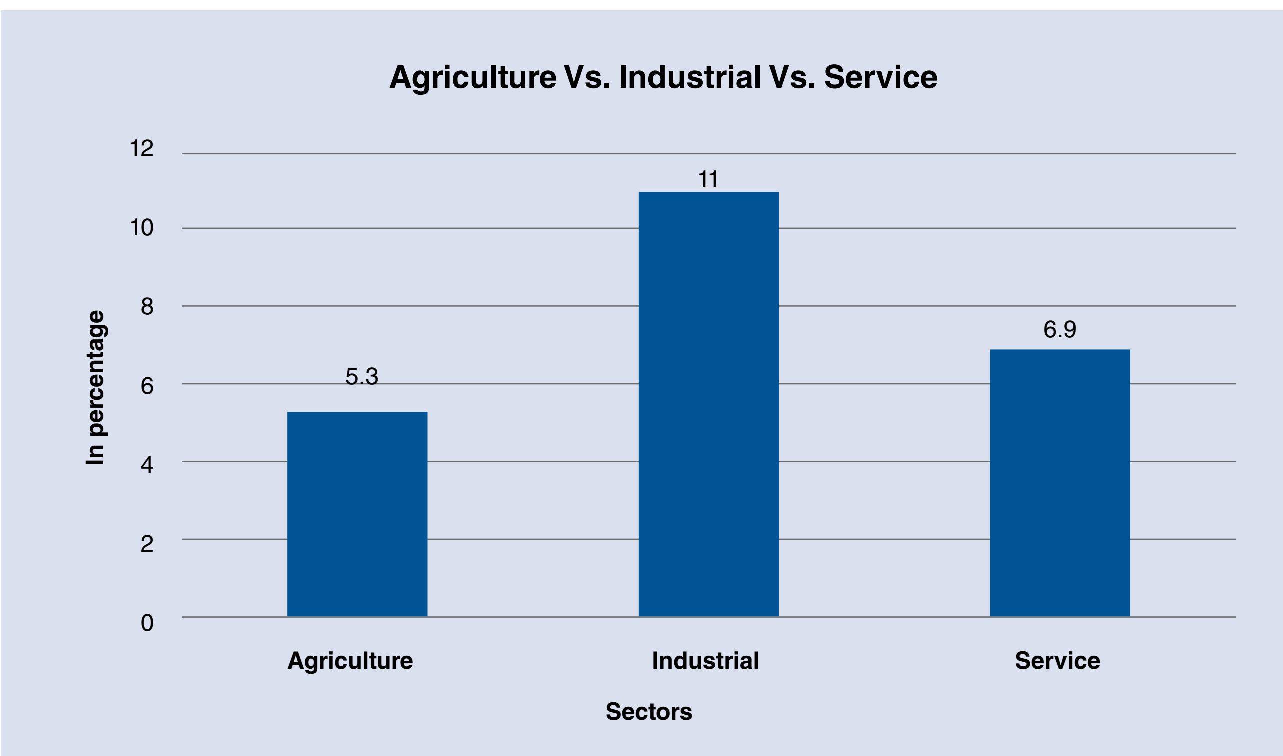
# BUDGET REVIEW

The budget for the new fiscal year 2017/18 was presented by Finance Minister Krishna Bahadur Mahara on May 29. The budget, which was proposed right after the successful completion of first round of local elections, addresses various issues related to the federal structure as envisioned by the constitution.

## Overview of Nepali Economy

Projected economic growth: 6.9%

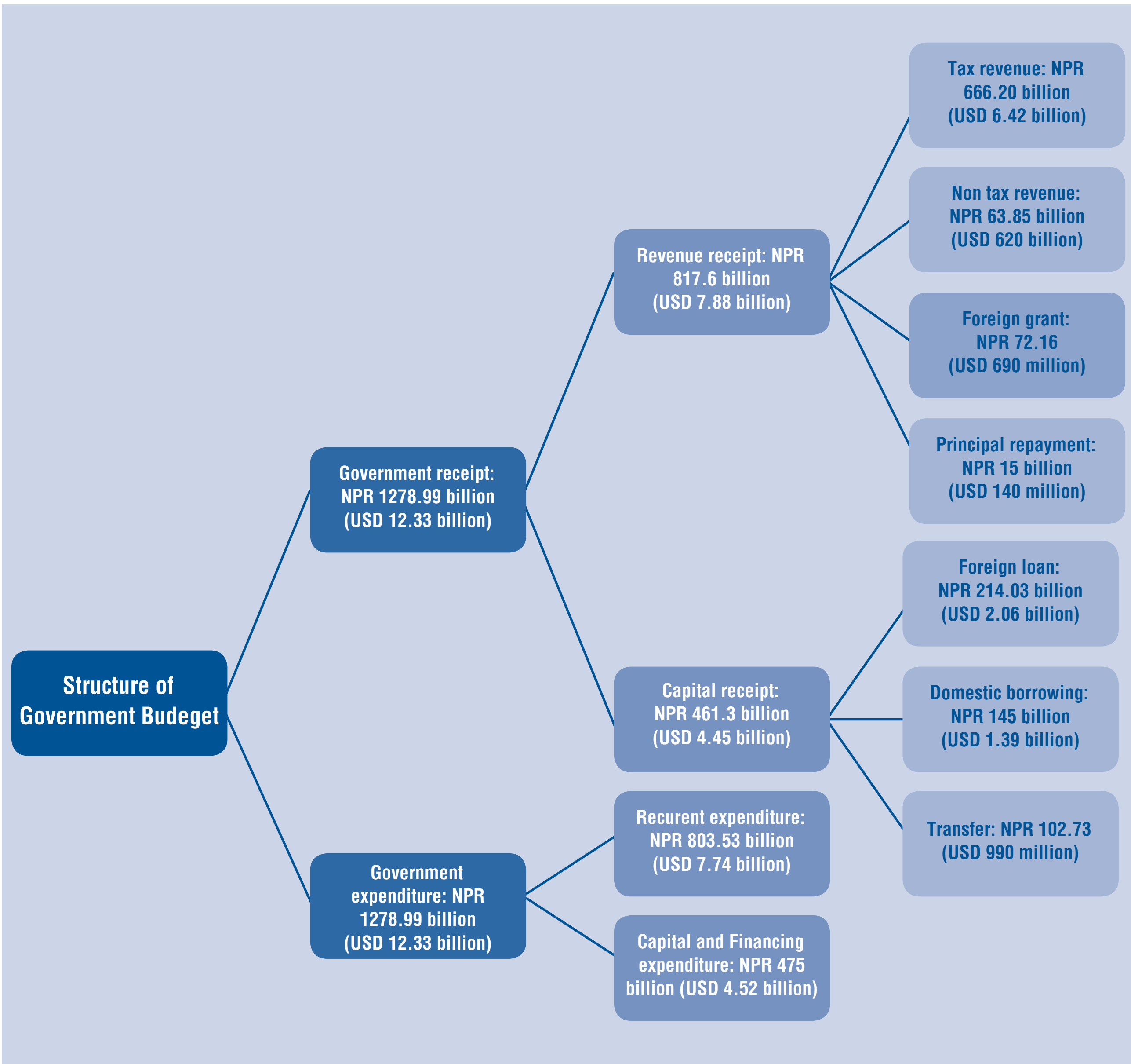
**Figure 1: Sector wise growth**




*Source: Ministry of Finance, Budget FY 2017/18*

As per the budget of FY 2017/18, agriculture sector grew by 5.3% as compared to the previous fiscal year. Likewise, industrial and service sector observed growth of 11% and 6.9% respectively.

**Figure 2: Overview of current budget**

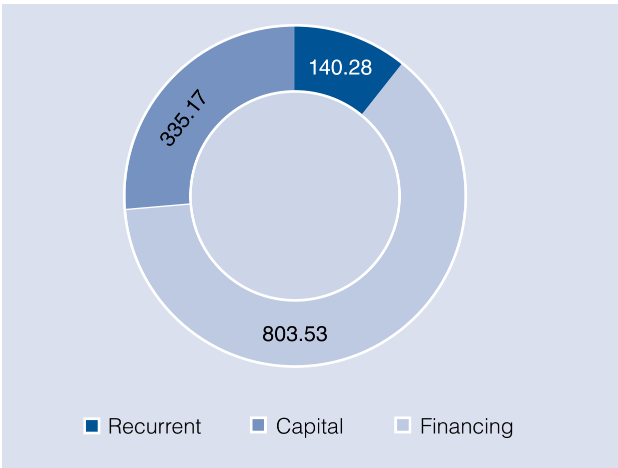



*Source: Ministry of Finance, Budget FY 2074/75*

The size of the current budget is NPR 1278.99 billion (USD 12.33 billion). Of the total budget, NPR 803.53 billion (USD 7.74 billion) has been allocated to recurrent expenditure and NPR 475 billion (USD 4.58 billion) to capital expenditure. With regard to sources of fund, NPR 730.5 billion (USD 7.04 billiin) will be collected as a revenue; NPR 15 billion (USD 140 million) will be principal repayment and NPR 72.16 billion (USD 690 million) will be foreign grant. The deficit financing of NPR 461 billion (USD 4.44 billion) will be done as follows: NPR 214.03 million (USD 2.06 billion) as a foreign loan; NPR 145 billion (USD 1.39 billion) as domestic borrowing and NPR 102.73 (USD 990 million) as a transfer.

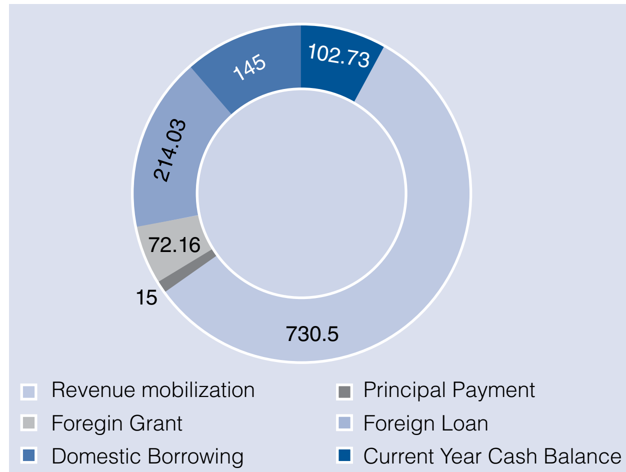
NEPAL ECONOMIC FORUM

**Figure 3: Allocation of Budget (Amount in billion)**



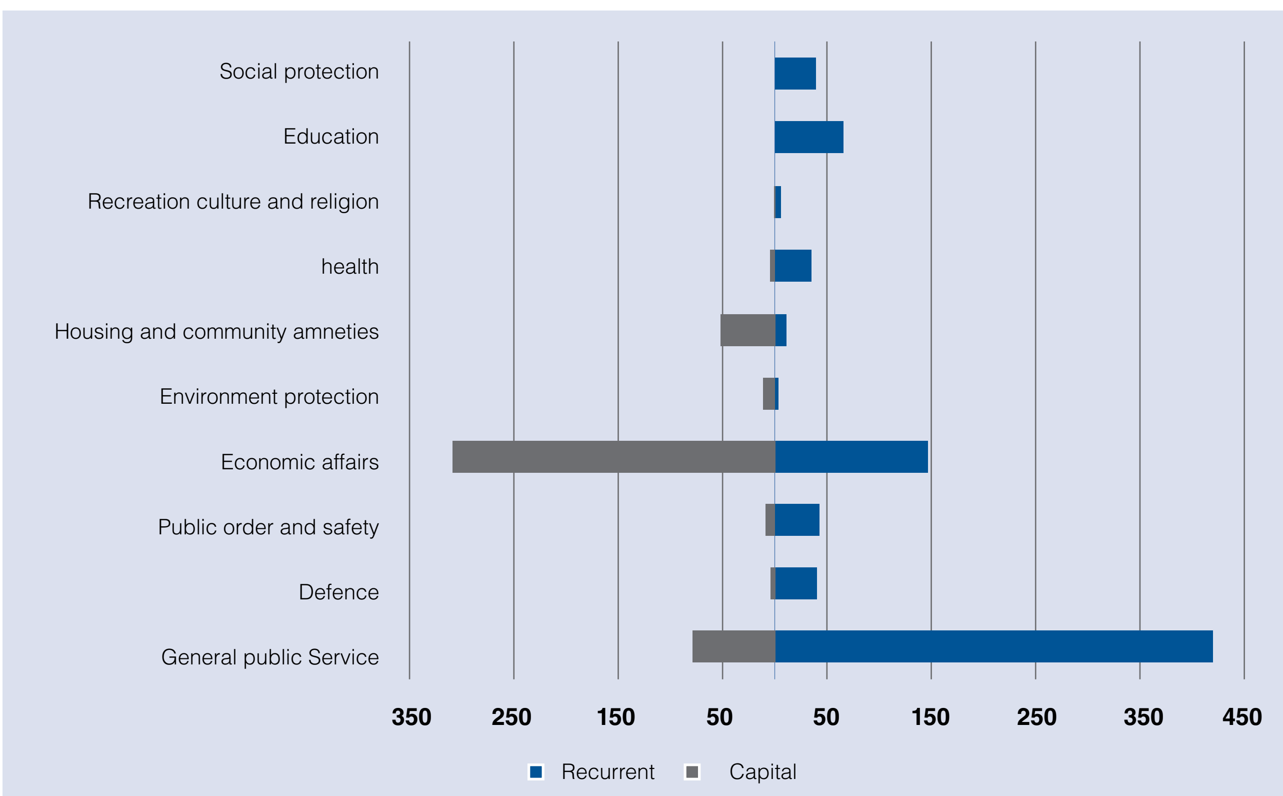

*Source: Ministry of Finance, Budget 2074/75*

**Figure 4: Sources of fund (Amount in billion)**




*Source: Ministry of Finance, Budget 2074/75*

**Figure 5: Recurrent vs Capital expenditure**




*Source: Ministry of Finance, Budget FY 2074/75*

### Five key highlights of the budget:

- Post-earthquake reconstruction work will be given continuity. As such budget of NPR 146.18 billion (USD 1.41 billion) has been allocated for the purpose.

- Budget has assumed the federal structure as 17.2% of the budget has been allocated to local governance. Following modality will be assumed while distributing the budget.

### Table 1: Fiscal modality of current budget

| Area | Amount (in NPR) |
|---|---|
| Rural | 100 million-390 million (USD 0.96 million- 3.75 million) |
| Municipalities | 150 million -430 million (USD 1.44 million — 4.14 million) |
| Sub-metro | 400 million -630 million (USD 3.85 million- 6.07 million) |
| Metro | 560 million -1.24 billion (USD 5.39 million 11.95 million) |

*Source: Ministry of Finance, Budget FY 2017/18*

- The work of national pride projects will be expedited.

### Table 2: Status of national pride projects

<table>
<tr><th>Projects</th><th>Tentative completion date</th><th>Amount (in NPR)</th></tr>
<tr><td>Upper Tamakoshi Hydro (500 MW)</td><td>Current fiscal year</td><td>500 million (USD 4.82 million)</td></tr>
<tr><td>Construction work of Gautam Buddha Regional International Airport</td><td>Mid-April 2018</td><td rowspan="2">13.72 billion (USD 132.2 million )</td></tr>
<tr><td>Construction work of Pokhara International Airport</td><td>2022</td></tr>
<tr><td>Fast track</td><td>2022</td><td>10.14 billion (USD 97.7 million) for this fiscal year</td></tr>
<tr><td>Melamchi Khanepani</td><td>Mid-October 2017</td><td>6.75 billion (USD 65.1 million)</td></tr>
</table>

*Source: Ministry of Finance, Budget FY 2074/75*

- Tax base will be broadened (rather than increasing tax rate) by facilitating e-tax payment.
- Economic growth of 7.2% will be achieved with the implementation of the budget. Likewise, 400,000 employments will be generated.

GENERAL OVERVIEW

# POLITICAL OVERVIEW

The successful completion of the first phase of local elections, after almost 20 years, is a major achievement for Nepal. Given that there were doubts over the preparations made by the government and Election Commission (EC) to hold the elections, it is commendable that the polls were conducted without any major incident. Although this has given hope for the successful completion of the second phase of elections, the unresolved issues with the Madhes-based political parties is likely to make the second round of elections a challenge.

**Local elections held after two decades:** Nepal successfully held its first phase of the local elections in three provinces—3, 4 and 6—with around 50,000 candidates filling their nominations for 13,500 posts. The local elections that were held after 20 years witnessed a voter turnout of an estimated 71%. The winning candidates will serve a term of five years.[1] The Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML) have won a majority of positions with 125 seats in the Mayor/Chair position and 136 seats in the Deputy Mayor/Deputy Chair position. The Nepali Congress (NC) came second by securing 104 seats in Mayor/Chair position and 84 seats in the Deputy Mayor/Deputy Chair position, while the Communist Party of Nepal, CPN (Maoist Centre), ranked third with 46 seats in Mayor/Chair position and 49 seats in Deputy Mayor/Deputy Chair position.

**Merger of six Madhes-based political parties:** Six out of the seven parties under the United Democratic Madhesi Front (UDMF)—Tarai Madhes Democratic Party, Sadbhawana Party, Tarai Madhes Sadbhawana Party, National Madhes Socialist Party, Madhesi Jannadhikar Forum-Republican and Sadbhawana Party—have merged to form a new party, Rastriya Janata Party-Nepal (RJP-N). While the Federal Socialist Forum-Nepal, the only remaining Madhesi party from the UDMF that s not part of the RJP-N, is likely to join the Naya Shakti Party Nepal.[2] The merger consolidates the strength of the Madhes-based parties to push for constitution amendment and revision of local units in Tarai districts. However, the RJP-N has declared that they will not participate in the second round of polls until their demands are met.

**Bill to amend Local Level Election Act registered:** With the aim of bringing the agitating RJP-N on board for the second round of elections, the government has registered a bill at the Parliament Secretariat to amend the Local Level Election Act. The amendment was tabled as the RJP-N was not able to register the nomination of their candidates 15 days ahead of the due date, thus not permitting the EC to recognize the candidates as the party's official nominees according to the Act. However, even with the amendment to the Act to qualify the RJP-N's participation in the election, the EC has made it clear that the party will not get 'umbrella' as their election symbol and will have to use one of the symbols assigned to the parties before the merger. This is mainly because the ballot papers have already been printed and reprinting the same with a new party symbol is not feasible.[3]

**Second phase of local election faces turmoil:** The second phase of local election for provinces 1, 2, 5 and 7 was scheduled for June 14, 2017. The EC has made preparation for the second phase of polls to be held in 461 local units.[4] However, the ruling parties recently proposed the postponement of the second phase of elections by 8 to 10 days. On the other hand, the RJP-N has been demanding that the government fulfill its previous commitment to amend the constitution and the Election Act to enable them to register with the EC.[5] The RJP-N is also demanding the Supreme Court to take back its stay order on the government's decision to increase the number of local units in Terai. Earlier the government had increased 22 units in Terai to address the concerns of the Madhesi parties.[6] Under the new constitution, the completion of the local elections will be followed by provincial elections and then national level elections. All the elections are to be completed by January 2018.

In order to ensure the inclusion of the agitating Madhes-based parties for the second phase of election, the government has decided to postpone the election to June 23, 2017.[7] However, a day after rescheduling, the government again rescheduled the polls to June 28, 2017, since the earlier date of June 23 falls on the last Friday of Ramadan, a religious day for the Muslim community.

**Supreme Court stays decision to increase the number of local units:** The government created 22 additional local units in Tarai, right before the second phase of local level elections. The Cabinet decided to increase the number of local units and upgrade Birgunj and Biratnagar to metropolitan cities. Previously the government had agreed to conduct local level elections in 744 local units.[8] The EC has, however, turned down the government's request to increase the number of local units before the second round of elections, since it will be difficult to re-print the ballot papers, voter IDs and voter roll for the new local units.[9] In this regard, the Supreme Court issued an interim order against the government's decision to increase the number of local units saying that the move is against the Local Level Election Act 2017.[10]

**Prime Minister Dahal steps down, Deuba sworn in as new PM:** In line with the power-sharing agreement with the NC, Prime Minister Pushpa Kamal Dahal resigned after nine months in office. Dahal's resignation comes at a time when the second phase of local election is yet to be carried out.[11] The President of Nepali Congress Sher Bahadur Deuba has been sworn as the 40th Prime Minister of Nepal.This is the fourth time that Sher Bahadur Deuba held the position of PM of Nepal.

The new government is being formed under the leadership of NC and will be joined by the current coalition partner, CPN (Maoist Centre). The newly elected Prime Minister Deuba formed his Cabinet by administering oath to seven new ministers comprising of three from Nepali Congress, three from CPN (Maoist Centre) and one from Nepal Loktantrik Forum. Out of the seven ministers, three have been given the title of Deputy Prime Minister.

## Budget Highlights:

- Legal and policy arrangements will be made to implement the fundamental rights as envisioned by the constitution. For this propose constitutional commissions will be established as per the constitution.
- Capacity of constitutional bodies will be enhanced in accordance with the federal structure and necessary resources have been provisioned for their smooth operation.
- Budget has been allocated for the elections of Federal Parliament and State assembly.
- The capacity of Truth and Reconciliation Commission and Commission of Investigation on Enforced Disappeared Persons will be enhanced to conclude the conflict-era cases.
- Resources have been allocated to Rural Municipality/Municipality to strengthen local level bodies for service delivery and implementation of development activities.

## OUTLOOK

Once again Nepal witnessed the change in government under the gentlemen's agreement between major political parties. Functioning under yet another transition government would entail the slow-down of processes in the government. Given that news of dispute over ministerial portfolio has started to surface, it will be a challenge for the newly elected PM to complete his Cabinet. The key challenge for the new government will be the successful implementation of the second phase of election by bringing in the agitating Madhes based parties.

GENERAL OVERVIEW

# INTERNATIONAL ECONOMY

Last quarter marked some significant changes for economies in South Asia. Nepal has signed Memorandum of Understanding (MoU) with China on the framework of the much-anticipated One Belt One Road (OBOR) initiative. Meanwhile, Bhutan has opted out of the Bangladesh, Bhutan, India, Nepal (BBIN) Motor Vehicles Agreement (MVA), leaving the three members of the regional sub-grouping in a limbo. Additionally, credit rating agency, Moody's, has downgraded China's sovereign credit rating for the first time in almost thirty years.

**Nepal signs MoU with China on OBOR:** Nepal signed a MoU with China on the framework of OBOR on May 12.[12] The signing of the MoU came just days ahead of the Belt and Road Forum for International Cooperation summit in Beijing on May 14-15.

OBOR is an ambitious project initiated by China to revive the old Silk Route which aims to link 65 countries across 3 continents: Asia, Africa and Western Europe. The cumulative GDP of the connected countries amounts to about 40% of the global GDP. The initiative seeks to promote economic cooperation and connectivity of China with countries in the Eurasian region through a network of land and sea routes. The incentives for Nepal to join OBOR are increasing connectivity, financial integration and related infrastructure development such as railway, road, civil aviation, power grid, information and communication.

**Bhutan opts out from MVA agreement under BBIN:** Bhutan has backed out from the Motor Vehicles Agreement (MVA), under the sub-regional cooperation of Bangladesh, Bhutan, Indian, Nepal (BBIN), for the time being due to its inability to ratify the pact.[13] The MVA agreement envisions allowing passengers, personal and cargo vehicles of the member states seamless travel access to another country without transit hassles and difficulties.[14] It aims to enhance connectivity and promote trade cooperation between the member states.

Bhutan, however, has given a green signal to other three members to go ahead with the road connectivity project, which is in line with Indian Prime Minister Narendra Modi's 'Neighbourhood first' policy. In such a scenario, India is now examining the possibility of working with only Bangladesh and Nepal to implement the BBIN. But with Bhutan out of the picture, the initially planned routes for vehicular movement need to be amended before implementation.[15]

**Moody's downgrades China's credit ratings:** The US-based credit rating agency, Moody's, has downgraded China's sovereign credit ratings by one notch from Aa3 to A3, placing it in the same category with countries like Japan and Israel.[16] Soaring debt and slowing growth that is bound to erode China's financial strength have been cited as the reasons for the downgrade. The growth via stimulus measures that China has adopted in recent years has led to massive debt levels in the Chinese economy. In fact, Moody's expects the government debt to rise to 40% of GDP by the end of 2018 and to 45% by 2020. The economic growth of China, the second largest economy, is also expected to slow down to 5% over the next five years.

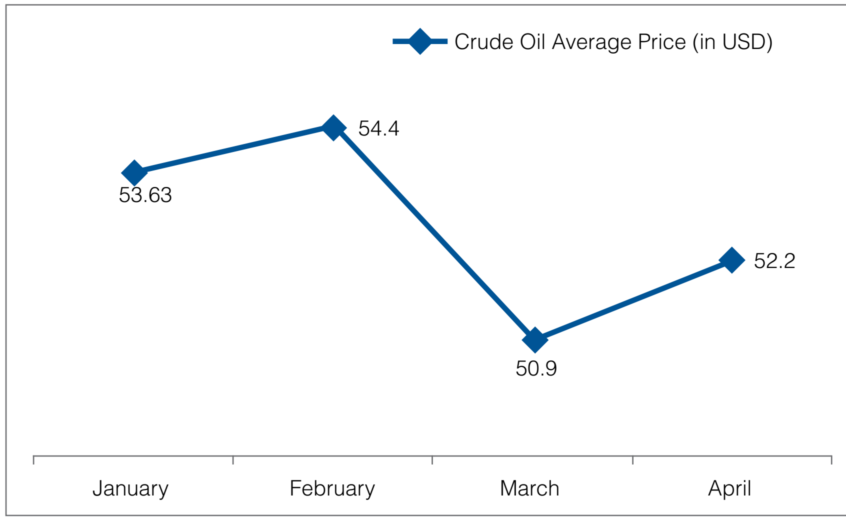
The downgrade of ratings will most likely increase the cost of borrowing for state owned enterprises, though only by a small margin. China's Ministry of Finance has released a statement saying that the rating agency has overestimated the difficulties facing the Chinese economy and underestimated the Chinese government's ability to deepen supply-side structural reform and appropriately expand aggregate demand.

**Oil Prices fairly stable:** Crude oil prices in the global market have remained fairly stable despite the agreement amongst the oil-producing nations under the Organization of the Petroleum Exporting Countries (OPEC) to cut down oil production to increase prices. The prices have hovered around the range USD 50-54 (NPR 5,158-5570) per barrel in the first five months of 2017 as shown in Figure 6.

The OPEC members have renewed an agreement with ten other non-OPEC oil producing countries to curb outputs till March 2018.[17] The agreement had first taken place in December 2016 wherein the member and non-member OPEC nations agreed to output reductions of almost 1.8 million barrels per day equivalent to 2% of global oil reduction. It was expected that the OPEC will cut down productions further, but they simply extended the existing ceiling of 1.8 million barrels.

The existing low oil prices have been attributed to weak global demands and increasing shale-oil growth in the United States (US).

**Figure 6 Monthly average prices of crude oil (Brent, WTI and Dubai)**




**Venezuela's economic crisis deepens:** Venezuela is experiencing the worst economic crisis in its history. According to the International Monetary Fund (IMF), the Latin American country had a negative economic growth rate of -8% in 2016 and that it is worsening. It suffers from hyperinflation—the inflation rate in Venezuela is already over 400% and soaring.[18] The country is mired in heavy debt, which amounts to an estimated sum of NPR 743 billion (USD 7.2 billion), while the unemployment rate is expected to reach 20% in 2017. It is facing severe food crisis, making it difficult for the Venezuelan people to make their ends meet. Moreover, since the government controls the price of basic goods, this has led to proliferation of black market. The government cannot import food to meet the required demand as foreign reserves have dwindled. The prevailing scenario has led to massive protests and outbreaks inside the country.[19]

## OUTLOOK

Nepal is a part of many agreements like OBOR and BBIN; their implementation however, is far from ideal. If it wants graduate to a middle income nation by FY 2013, it cannot continue this trend. Assuming right economic vision and implementation of such projects will help the country mobilise its major economic resources, including financial and human resources, and achieve the desired economic growth. Moreover, apart from increment in trade and commercial activities, implementation of BBIN will reduce the probability of Nepal facing another economic sanction in the future.

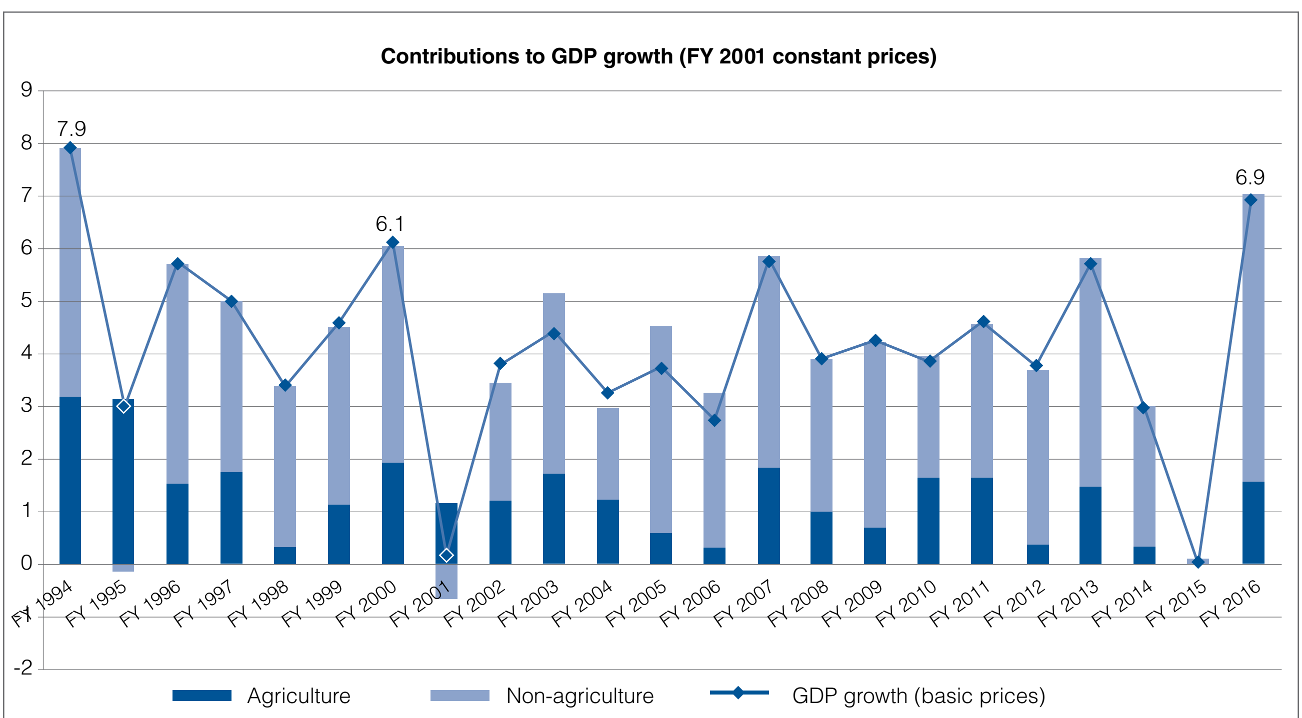
# 2

MACROECONOMIC
# OVERVIEW

# MACROECONOMIC OVERVIEW

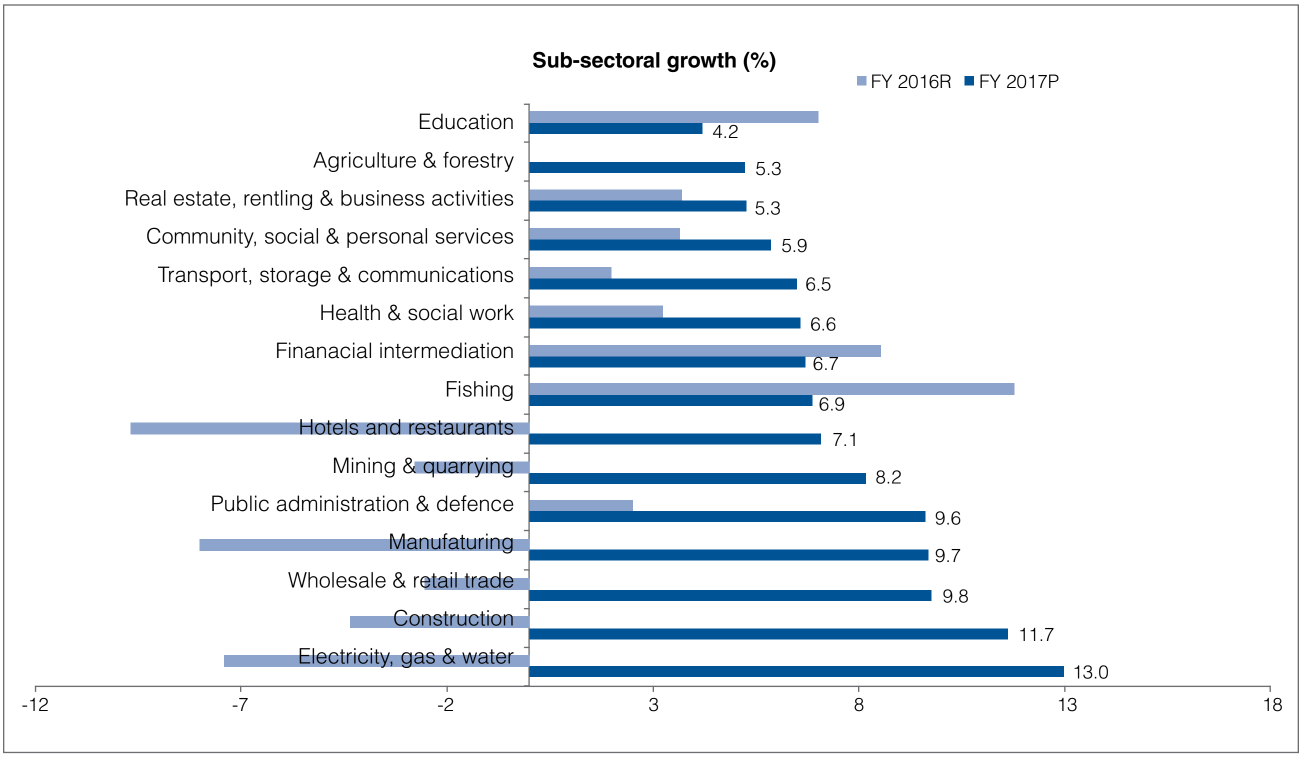
A bit of luck and some government efforts have led to a remarkable recovery of economic activities in fiscal year 2016/17 (FY 2017). The Central Bureau of Statistics (CBS), the official government agency responsible for national accounts, estimates that Nepal's gross domestic product (GDP) will likely grow by 6.9% in FY 2017-a sharp rise from 0.01% in FY 2016 and 3% in FY 2015. This is the highest GDP growth rate (at basic prices, FY 2001 constant prices) since FY 1994 when GDP grew by 7.9% and is higher than the government's target of 6.5%. It is a result of a combination of base effect, favorable monsoon rains, pick up in reconstruction works, improved electricity supply and a normalization of supplies following the 2015 earthquakes and trade embargo in 2016.

**Figure 7: Contribution to GDP growth**




*Source: Central Bureau of Statistics; Authors' computation*

**Figure 8: Sub-sectoral growth**




*Source: Central Bureau of Statistics*

The CBS projected agricultural, industrial and services growth at 5.3%, 10.9% and 6.9% respectively. Consequently, the agriculture sector contributed 1.7 percentage points, industrial sector 1.6 percentage points and services sector 3.6 percentage points to the overall projected GDP growth of 6.9%. Notably, electricity, gas and water sub-sector will likely grow at a faster rate (a whopping 13%) compared to a negative 7.4% growth in FY 2016. Similarly, construction activities are likely to grow at 11.7%, up from a negative 4.4% in FY 2016. Wholesale and retail trade and manufacturing are projected to grow by 9.8% and 9.7% respectively, up from negative growth rates in FY 2016.

**Base effect and government effort:** First, considering a large base effect at play here, even a slight improvement in the usual drivers of growth, mostly favorable monsoon rains and remittance-backed consumption, would have resulted in a significantly higher growth compared to previous years. Indeed, seven sub-sectors that grew by over 5% this year had negative growth rates last year. Base effect refers to the tendency of achieving an arithmetically high growth rate when starting from a very low base.

Second, favorable monsoon rains led to record paddy harvest and consequently an impressive agricultural growth. Paddy output is projected to grow by 21.7% this year—paddy alone contributes 20.7% to agricultural gross value added. Wheat and maize outputs are projected to grow by 2% and 1.3% respectively. Meanwhile, the government's efforts in supplying agricultural inputs, including chemical fertilizers and seeds, have also helped.

Third, the industrial sector pretty much got a facelift, thanks to sound management and supply of electricity, improved confidence of investors, and pick up in post-earthquake reconstruction (both private and public). All the four economic activities—mining and quarrying; manufacturing; electricity and water;

and construction—that constitute the industrial sector registered close to a double-digit growth. These positive developments are reflected in the high growth rate of public and private fixed capital investment, 16.1% and 30.7% respectively.

Fourth, dampening effects on demand due to the deceleration of remittances and temporary disruptions caused by demonetization of higher denomination currency notes in India, were more than offset by the surge in demand following the normalization of supplies, first tranche of housing grants, and increase in tourist arrivals, ensuring a robust services growth. Local election-related expenses are also going to boost services activities.

## OUTLOOK

Sustaining such a high growth rate would necessitate structural reforms and reasonable degree of political stability, which will increase public and private investment. Else, exogenous factors such as monsoon rains and transactions based on remittance-backed demand of imported goods in services sectors will continue to dictate the trajectory of growth, whose medium term equilibrium state is around 4%. Subject to above average monsoon rains; the nature of fiscal budget—decentralized spending versus old-fashioned centralized spending; faster pace of reconstruction works; completion of large-scale infrastructure projects and election related expenses, GDP is likely to grow by 4.5% to 5.5% in FY 2018.

3

SECTORAL

# REVIEW

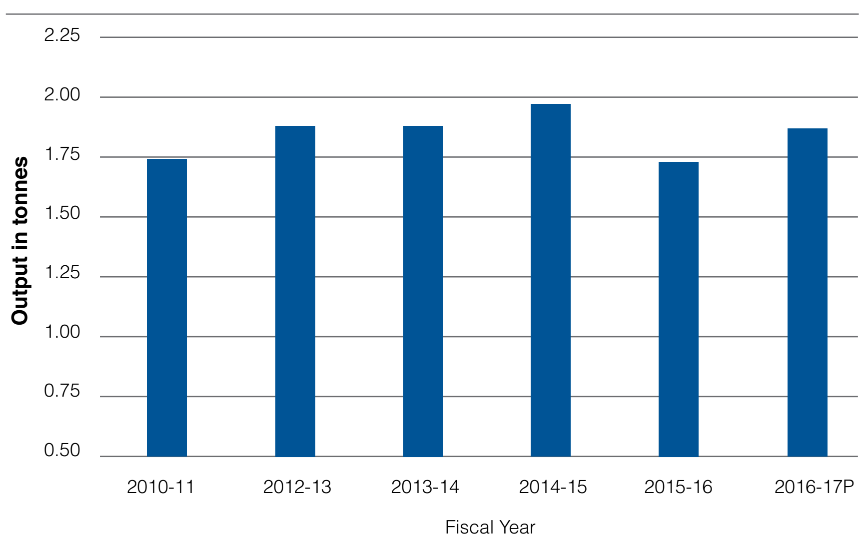
# AGRICULTURE

**The Government of Nepal along with the International Monetary Fund and Asian Development Bank have made upward revision and estimate the Gross Domestic Product (GDP) to grow at an average of 6.27 % this fiscal year. The prospective growth is mainly attributed to a bumper agricultural output due to above average monsoon rains and timely availability of chemical fertilizers. Record high paddy and wheat harvest have already been witnessed in the FY 2016/17. However, to make the country self-reliant in agricultural products, as envisioned by the budget of FY 2016/17, the government needs to expedite its programs to enhance agricultural productivity.**

**Wheat harvest to jump:** The government's preliminary estimate predicts winter wheat harvest to increase by 8% to reach 1.87 million tonnes in FY 2016/17. This growth has been projected after considering hailstorms in Eastern, Central and Western regions that damage at least 4% of the standing wheat crops. The harvest is worth nearly NPR 40 billion (USD 385.5 million), based on the average price of wheat of NPR 21 per kg. Favourable weather during the planting season, improved varieties of seeds and increased use of machines in farms has led to such growth. According to the Ministry of Agriculture, the productivity in FY 2016/17 has been recorded at 2.5 tonnes per hectare, up from 2.3 tonnes per hectare last year. Out of 743,000 wheat acreage, 45%, which is 33, 4350 hectares, is now covered by improved wheat. Meanwhile, paddy harvest is projected to jump by 21.66% to 5.23 million tonnes in FY 2016/17, which is expected to bring down the country's rice import bill.[20]

**Tea exports:** The country's tea export increased by 19% to reach record high of 13,289 tonnes in FY 2015/16. As per the statistics of the National Tea and Coffee Development Board, the tea shipments were worth NPR 2.4 billion (USD 23.1 million ) in FY 2015/16, up from NPR 2 billion (USD 19.3 million) compared to the previous year. The growth has been mainly attributed to the product publicity campaigns launched through Nepal's embassies in Pakistan, China and UK, along with promotion of Nepali tea in global trade fairs and exhibitions. Tea production has also increased in the country by 4.65% to 24,263 tonnes in the FY 2015/16, while the total area under tea plantation also increased from 26,165 hectares to 27,688 hectares during the same review period. Jhapa is the main tea producing district and it alone produces around 74% of the country's total production.[21]

**Figure 9: Wheat production volumes over six consecutive fiscal years**




*Source: Ministry of Agriculture Development*

**Agribusiness Innovative Centre launched:** With a view to enhance competitiveness and promote local agro-processing companies, a business hub named Nepal Agribusiness Innovation Centre has been recently launched in Kathmandu by the World Bank Group with the support of Finland, Norway and Sweden. The Centre aims to support over 150 small and medium enterprises in next 18 months by providing customized services such as coaching, training, market linkages and investment facilitation. This initiative has been taken considering the rise in demand for ready-to-consume food products due to rapid urbanisation and a growing middle class in the country.[22]

**Countervailing duty on Nepali jute scrapped:** The Government of India has finally issued a notification to customs to remove additional custom duty on Jute products, which means that from now on no Countervailing Duty (CVD) shall be imposed on Nepali jute products imported into India. The Government of Nepal had been repeatedly requesting India to waive CVD on Nepali jute exports so as to enhance jute exports from Nepal to India and revive the ailing jute industry. Nepali jute producers import 70% of their raw materials from India and export 95% of the finished products back to India.

**NFC to buy 4,000 tonnes of wheat:** The Nepal Food Corporation (NFC), the official government agency to manage food market and import in Nepal, has decided to buy 4, 000 tonnes of wheat, worth NPR 125 million (USD 1.20 million), directly from farmers. The decision was taken in a bid to ensure that the farmer get a fair price for their harvest and protect them from possible exploitation by middlemen. Accordingly, the Corporation will be buying 3,000 tonnes of wheat from farmers in the Mid-Western and Far-Western Region and remaining 1,000 tonnes from Central and Eastern Region. The NFC has fixed prices at NPR 26,750 (USD 257.83) and NPR 26,300 (USD 253.49) per tonne for farmers in the districts. The bought wheat will be sold in Kathmandu and Pokhara through the NFC outlets.[23]

## Budget Highlights:

The fiscal budget 2017-18 allocated around NPR 30.41 billion (USD 293.1 million) to the agriculture sector and the Ministry of Agriculture Development has received NPR 24.26 billion (USD 233.8 million) for central level expenditure, while NPR 5 billion (USD 48.2 million) has been transferred to local units. No new programs have been announced for the sector as previous programs announced under the budget for FY 2016/17 will be continued. A few other highlights are as follows:

- Priority will be given to farm modernization, commercialization and mechanisation to attain self-sufficiency on food as envisioned in the budget for FY 2016/17.
- The development programs envisioned in the previous budget such as Pocket and Block program, special crops development and production program, fishery development program, one-ward-one- technician program and small irrigation projects will be handed over to the local units.
- The government has also planned to establish a dairy industry to promote the livestock sector.
- The government has also announced to table “Land Use Bill” in the Parliament to stop haphazard plotting and encourage optimal use of land for agriculture
- The government will prepare a policy for contract and community farming for the implementation of the same.

## OUTLOOK

The sector is showing positive signs with the government making continuous efforts to increase agricultural production. With developmental programs being handed over to the local level, concentrated efforts on delivery of programs regarding irrigation and agriculture mechanization, among others, could be expected, provided the new local bodies prioritise their implementation.

# ENERGY

Energy scenario in Nepal looked highly optimistic over the past months. Nepal has been able to boost its electricity production due to good spring rains and is now considering to decreasing the energy imports from India. Higher tariff rates for hydropower projects have also been approved with the view of enticing more private and foreign investment. Meanwhile, LPG prices have soared across the country due to prevailing high prices in India.

**Nepal cuts down on energy imports:** The Nepal Electricity Authority (NEA), the state-owned power utility, has started cutting down on energy imports from India with domestic producers boosting output helped by rising water levels in the rivers. The state-owned power utility has decreased imports over the Dhalkebar-Muzaffarpur cross-border transmission line to 80 MW from 135 MW. As of May 2017, hydropower projects in Nepal were producing 600MW of electricity, an increase of 35 MW from the previous month. The state-owned projects are generating 393MW of electricity, while independent power producers have contributed 207MW. The NEA has further stated that power generation is expected to grow as snow-fed rivers will swell with rising temperatures. With such optimistic outlook on energy production, the NEA is planning to reduce imports from other cross-border transmission lines as well in the coming months.

**NEA to renew PPA with India:** NEA is planning to renew its power purchase agreement (PPA) with the NTPC Vidyut Vyapar Nigam (NVVM), the Indian state owned nodal agency, in regards to energy imports from Dhalkebar-Muzzaffarpur cross border transmission line as the current PPA in place is expiring at the end of May 2017. The meeting between the NEA and NVVM officials is expected to take place in Kathmandu soon. The NEA decided to renew the PPA with the NVVM to meet the current energy demand of the country, but has stated that energy imports will be reduced due to higher electricity generation in the future.

**NEA approves new tariff rates for hydropower projects:** The NEA has announced that contractors of peaking run-of-the-river (PRoR) and reservoir projects will be able to get new tariff rates in grid connection agreements.[27] The Ministry of Energy had previously set the tariff rates but it was only approved by the NEA recently. The NEA also approved these new tariff rates to attract private sector and foreign investment in hydropower generation. Further, the NEA has also endorsed the proposal of paying foreign investment projects in US dollars for the first 10 years of power commissioning or until the payback period of the foreign loan, whichever is earlier.[28] Under the new tariff rates, generators of reservoir projects can sell per unit of electricity at NPR 12.40 (USD 0.12) during dry season and at NPR 7.10 (USD 0.06) during wet season. For PRoR projects, the rates have been set at NPR 10.55 (USD 0.10) and NPR 4.80 (USD 0.05) per unit for dry and wet seasons, respectively.

**Kulekhani III to miss completion deadline again:** The Kulekhani III hydropower project is expected to miss its completion deadline again, after contractors claimed that payment delays from the NEA have hampered the construction process. The project had been under construction since 2008, and has extended its completion deadline four times previously. The NEA, however, stated that the 14MW power plant will start generating electricity from July 2017. As per their agreement, contractors Sino Hydro and Jheijian Jialin Company have not completed their work on the project due to payment dispute.[29] As a result the contractors are working at a slower pace, casting doubts over whether the project will meets its July

2017 deadline. With major aspects of the projects still pending, meeting this deadline looks highly doubtful. Furthermore, the cost of the project has swelled to NPR 4.22 billion (USD 40.67 million), an increase of almost 10% from the initial estimated cost due to delays.

**Upper Tamakoshi to come into operation by July 2018:** The Upper Tamakoshi Hydropower project is expected to come into operation by July 2018 as 87% of the construction has already been completed. Construction has been further accelerated in order to meet the deadline. The construction process was hampered by the 2015 earthquakes and the four-month blockade, but now the project is on track. The 456MW national pride project will begin its first phase of production in July 2018, with the second phase of production expected to start in December 2018. Delays have caused cost overruns, with the expected cost of the project now standing at NPR 42 billion (USD 404.5 million compared to the initial cost stood of NPR 35.29 billion (USD 340.1 million).[30]

**Tamakoshi III to be built using PPP model:** The Investment Board Nepal (IBN) has prepared a structure for the construction of the stalled Tamakoshi III Hydropower Project, whose fate has been in uncertain since the potential developer Statkraft backed out in January 2016. The IBN is now planning to develop the hydropower project under the public-private partnership (PPP) model with a combination of domestic and international investments. The contract for the project will be conferred through international competitive bidding. Domestic investors and locals affected by the project will have a 25% stake in the scheme as well. Initially, the Norwegian company Statkraft had signed a project negotiation agreement with IBN to build Tamakoshi III, but it backed out just before talks were to be held to sign a project development agreement (PDA). Reasons cited for their departure include concerns about finding buyers for the electricity produced by the project. The IBN has also stated that more than a dozen of foreign companies are already showing interest in the 650 MW hydropower project.[31]

**NOC hikes LPG prices:** The Nepal Oil Corporation (NOC) has hiked the price of LPG by NPR 25 (USD 0.24) to NPR 1,375 (USD 13.25) from March 10, 2017. The NOC stated that the price hike was a result of the Indian Oil Corporation increasing the price, the sole supplier of LPG to Nepal.[32] With this new adjustment, NOC will now have to accept a loss of NPR 333 (USD 3.20) on the sale of each LPG cylinder.[33] The NOC has not increased prices of other petroleum products however. The NOC has stated that it is maintaining the loss in sales of LPG through profit which it has been making from other petroleum products. Currently, the NOC makes a profit of NPR 1.23 (USD 0.01) per liter of petrol, NPR 13.05 (USD 0.13) per liter of kerosene and NPR 13.01 (USD 0.12) per liter of aviation fuel.

## Budget Highlights:

The budget for FY 2017/18 has allocated NPR 62.47 billion (USD 602 million) to implement and develop various hydropower projects and transmission lines across the country. Buddhigandaki Hydropower project was the highest recipient of allocated funds—the 1200MW project is to receive NPR 10.17 billion (USD 98 million). The 456MW Upper Tamakoshi Hydropower project was allocated NPR 500 million (USD 4.8 million), to further accelerate its construction and have it connected to the national grid by the end of FY 2017/18. Under the budget, the government also documented plans to conduct feasibility studies for the construction of pumped storage hydropower projects to increase revenues during peak demand hours and to further meet domestic demands. Transmission lines such as the Dhalkebar-Muzaffarpur cross border transmission lines are also in line for upgrades, with the Dhalkebar substation being upgraded to 400kVA. The budget has also outlined plans to begin construction of the 400kV Butwal-Gorakhpur cross border transmission line in FY 2017/18.

## OUTLOOK

With the onset of monsoon, electricity generation is expected to increase, which should further decrease energy imports from India. Moreover, major hydropower projects like Upper Tamakoshi and Tamakoshi III have made significant progress and should further ease the country's electricity supply in near future. Kulekhani III, however, continues to face delays and its date of completion is still uncertain. Price of LPG in the country will continue to be dictated by price trends in India.

# INFRASTRUCTURE

Nepal has one of the poorest infrastructures in South Asia. Unlike other countries, most of the infrastructure projects are still being undertaken by the government, with a handful projects under the Private Public Partnership (PPP) model or the Build Own Operate and Transfer (BOOT) model. The government-led projects are prone to delays, while the quality of completed infrastructure is usually sub-standard. Furthermore, political instability coupled with weak governance structures has hindered infrastructure development in Nepal.

**Government set to buy land to ease Birgunj port operations:** The Integrated Check Post (ICD) currently being constructed by India is expected to increase the load on the already overburdened Sirsiya dry port. Hence, the government passed a mandate on January 1, 2017, to acquire 41 hectares of land in order to ease the burden from the ICP and dry port. The Ministry of Finance (MoF) has appointed the head of Sirsiya dry port to begin the land acquisition process and the first phase of the procedure has already begun. A committee has also been formed under the coordination of the Chief District Officer (CDO) in order to determine the compensation for affected individuals.[34]

**Delay in petroleum pipeline project:** The Raxual-Amlekhgunj petroleum pipeline, being built with an investment of NPR 4.4 billion (USD 42.4 million), is expected to be delayed after the Ministry of Forest and Soil Conservation (MoFSC) refused the fast-track proposal of the Nepal Oil Corporation (NOC) to chop down 13,000 trees in the project's right-of-way. The MoFSC has recommended the NOC to undertake the Environmental Impact Assessment (EIA) first.[35] As it takes about one and a half years to complete the EIA study, the MoFSC's refusal to cut down trees will definitely delay the project.

**Government initiates bigger fuel storage plants:** The government is considering private finance initiatives to build petroleum storage plants in all the seven provinces, which will cost around NPR 117 billion (USD 1.127 billion). The storage plants are expected to be eight times bigger than the current storage plants with each plant having a storage capacity of 530,000 tons of petroleum and 70,000 tons of cooking gas. The land acquisition process for building the storage plants has been initiated by the NOC.[36]

**Houses for disadvantaged communities:** Under the People's Housing Program, The Ministry of Urban Development has decided to build over 25,000 housing units in FY 2017/18 for disadvantaged communities in 72 districts, other than Kathmandu Valley. The cost of each housing unit will not be more than NPR 300,000 (USD 2891.56). The program will be implemented in places where there are at least 10 beneficiary families living on the basis of their identification. This condition is not applicable in case of Dom and highly marginalized and endangered ethnic groups.[37]

Nepal-China cross border rail link: With Nepal signing the Belt and Road Initiative, the government is expecting financial assistance from China to build the cross boarder rail link, costing NPR 830 billion (USD 8 billion), between the countries. The proposed 550 km rail link will connect Kathmandu to China's western Tibet region. The rail link will run 400 Km in China and 150 Km from Nepal boarder to Kathmandu.[38]

**Construction of road section of postal highway:** The construction of 60 km Birgunj-Thori road section, a part of the Postal highway that stretches 975 km from Bhadrapur (east) to Dudhaura (west), is likely to commence soon with the Postal Highway Directorate issuing a tender for the construction. The construction of the Birgunj-Thori road section is estimated to cost around NPR 2.75 billion (USD 26.5 million) to 3 billion (USD 28.9 million). Earlier NPR 60 million (USD 578,000) allocated for the project was frozen due to lack of progress in building the highway.[39]

**Slow progress in Mid-Hill Highway:** Less than 50 percent of blacktopping has been completed in the 34.43 km Diktel-Halesi road in the Mid-hill highway even though the contract period expired in March. The upgradation of the road section began at the start of FY 2014/15 with an estimated cost of USD 12.5 million under the financial assistance of the Asian Development Bank (ADB).[40]

**Nepal Army to build Fast track road:** The government has awarded the construction of the 76 km Kathmandu-Nijgadh Fast-Track project to the Nepal Army. The expressway project links Kathmandu with Nijgadh in the southern plains of Nepal in less than 2 hours. The controversies and delay in the commencement of the project has escalated its cost from NPR 56 billion (USD 539.8 million) to NPR 112 billion (USD 1.08 million).[41]

**DPR of Nagdhunga tunnel project awarded to Japanese company:** The Department of Roads has hired Nippon Koei, a Japanese company, to prepare the Detailed Project Report (DPR) of Nagdhunga Tunnel Project and supervise the construction of the project. The company will work with ITECO Nepal to complete the DPR within a year at an estimated cost of NPR 990 million (USD 9.54 million). The total cost of the project is estimated at NPR 20.2 billion (USD 194.7 million ), for which NPR 15.2 billion (USD 146.5 million) will be provided by the Japanese government through the assistance loan agreement. As per the agreement, the interest rate is fixed at 0.01 percent per annum with repayment period of 40 years and grace period of 10 years.[42]

**Melamchi to miss deadline again:** The first phase of the Melamchi Water Supply Project is set to miss its third deadline of October 2017. The sluggish excavation works of 16 to 22 meters per day has been mainly attributed for the delay. The first phase of the project is expected to supply 70 million liters of water to Kathmandu Valley every day. However, the preparation of the DPR for the second phase of the project has begun at an estimated cost of NPR 250 million (USD 2.41 million). The second phase of the project is expected to cost NPR 20 billion (USD 192.8 million) in total. The valley will receive 510 million liters of water per day once the project is completed.[43]

**Payment dispute in Bhairahawa airport:** Payment dispute between the Chinese contractor and Nepali subcontractor has halted the work of the Gautam Buddha Airport project in Bhairahawa. The project began facing problem after the Chinese company illegally appointed a sub-contractor without informing the project executing agency. So far, although the Chinese contractor has received NPR 1.3 billion (USD 12.5 million), work amounting to only NPR 650 million (USD 6.26 million) has been completed.[44]

## Budget Highlights:

There has been moderate increment in capital budget this fiscal year. Capital expenditure for the FY 2017/18 increased from NPR 311.95 billion (USD 3 billion) to NPR 335.17 billion (USD 3.23 billion) as compared to an increase of 7.4% the previous fiscal year. Funds allocated for national pride projects are as follows:

| S.N | Key Infrastructure Highlights | Budget allocation 'In NPR' |
|---|---|---|
| 1 | Nijgadh International Airport, Gautam Buddha Regional International Airport and Pokhara Regional international Airport | 13.72 billion |
| 2 | Kathmandu Terai-Madhesh Fast Track | 10.14 billion |
| 3 | Postal Highway-Hulaki Rajmarg | 4.27 billion |
| 4 | North South Public road Karnali, Kali Gandaki and Koshi | 2.3 billion |
| 5 | Khulali-Laifu-Kalikot-Simikot Road | 300 million |
| 6 | Upper Tamakoshi Hydro Power Project | 500 million |
| 7 | Budhi Gandaki Hydro Power Project | 10.17 billion |
| 8 | Rani-Jamara-Kulariya Irrigation Project; Bheri Babai Diversion & Western part of Babai Irrigation project; Sikta Irrigation project | 5.16 billion |
| 9 | Melamchi Drinking Water Project 2nd Phase | 6.57 billion |
| 10 | Pashupati area and Lumbini area 2nd phase Masterplan | 1.16 billion |

## OUTLOOK

The government has failed to learn the lessons in project planning despite knowing the causes of project delays and cost escalations. Lack of coordination among government ministries and individual institutions working in isolation are some of the main drivers behind project cost escalation as well as delay in project completion. The current standoff between the Ministry of Supplies and the Ministry of Forest and Soil Conservation for laying the petroleum pipeline is a classic example of poor coordination and ego problems that exist in our bureaucracy. Similarly, the standoff between Department of Archeology and the Kathmandu Metropolitan City stands proof of poor coordination between government institutions.[45] Likewise, the constant delays in majority of the infrastructure projects indicate the government's inability to implement the penalty clause mentioned in the agreement with contractors.

Sadly the government continues to have a monopolistic approach towards infrastructure development and still adheres to models that have failed in other countries. Therefore, it is crucial for the government to identify the prerequisites required for infrastructure development under public-private partnership model and develop policy frameworks accordingly.

# INFORMATION AND COMMUNICATION TECHNOLOGY

The telecommunications sector has witnessed significant improvements in recent years. The Nepal Telecommunications Authority (NTA) has made commendable efforts to build necessary infrastructure to improve internet access, connection quality and reduce telecommunication costs across the country. However, the 4G services introduced by the Nepal Telecom (NT) in Kathmandu and Pokhara is far from ideal as subscribers have been facing connectivity problems. As more telecommunication service providers are expected to be given 4G license in the coming years, the 4G services are likely to improve as well as expand the user base.

**MoIC clueless on implementing clean feed system:** Though the budget for FY 2017/18 lays down provisions for the implementation of clean feed system which will require the foreign broadcasters to remove commercials from their programs within the territory of Nepal; Ministry of Information and Communications (MoIC) is doubtful over its implementation. Nepali advertising agencies had been demanding to implement the system since foreign channels are being broadcasted without any restrictions, impeding the progress of domestic media and advertising industry. Meanwhile, cable service operators have argued that broadcasting Indian and other foreign channels are their main source of income and obtaining clean feed would make their purchase of rights expensive.[46]

**NTA to launch 15 broadband projects:** The NTA has decided to launch 15 broadband projects in 61 districts under the Rural Telecommunication Development Fund (RTDF) once the local elections are over. The project aims to increase internet penetration. Meanwhile, broadband projects have been awarded to three internet service providers, Nepal Telecom, WorldLink and Subisu, to expand internet services in earthquake-affected districts. The three service providers need to complete the project within a year.[47]

**Increased internet penetration:** According to a report of the Management Information System (MIS), published by the NTA, internet penetration in the country has surged by 18.22% over the year ending mid-February. It has been reported that out of the total national population of 26.49 million, 56% of them are internet subscribers—suggesting that one in two Nepalis use the internet. In the data segment, Nepal Telecom has the highest number of subscribers with 7.85 million subscribers followed by Ncell with 6.21 million subscribers, while Smart Telecom is the third largest player with 118,772 subscribers. The growth in web connectivity has been mainly attributed to mobiles with more and more people using social media platforms like Facebook and Twitter.[48]

**Delay in acquiring internet bandwidth:** In light of growing internet demand, the Nepal Telecom (NT) in December 2016 had signed an agreement with China Telecom to acquire internet bandwidth. The plan was to be completed by mid-February 2017. However, the plan is behind schedule due to delay in the completion of infrastructure on the Chinese side. With the purchase of bandwidth from China, the NT will no longer have to solely depend on the Indian telecom service providers, whereas this will also help other Nepali service providers to establish connection with other countries via China.[49]

**Disappointing 4G service:** 4G network subscribers have been voicing dissatisfaction due to slow internet speed, poor internet connection and limited coverage area of the service. The users complain that they do not feel any difference between the 4G and 3G services. According to the Nepal Telecom officials, the reasons behind the problems that people are facing could be due to many users being concentrated in one area or the BTS (Base Transceiver Station) tower being far from the users.[50]

**NT to connect 11 hill districts:** Since mid-March the Nepal Telecom has begun work to extend its 1,000-km fibre network to 11 hill districts. According to the state-owned telecom service provider, the work will be completed within a year after which 11 hill districts will be connected to its optical fibre network. As of now, out of the 75 district headquarters within the network connection route, 55 of them have already been connected to the network. In addition to improving the telecommunication services, the project will also be connecting exchanges, BTS (Base Transceiver Station) and repeater towers that fall on the network route.[51]

**Quality guidelines to be implemented by NTA:** To keep domestic telecom operators in check, the NTA is planning to implement a new Quality Guideline from July 16. It is believed that the domestic telecom providers have been compromising on their quality of service in the absence of stringent regulatory provision for the sector. The new guideline will include provisions such as compensation to customers by the telecom operators if the service quality is not met; however, the nature of compensation is yet to be decided. In addition, the guideline has also set the quality standards for data and voice services.[52]

**NTA's new directive on pulse duration:** The NTA has come up with a new directive that requires phone companies to bring down their pulse duration from 20 to 10 seconds for domestic mobile calls and from 60 to 30 seconds for international calls. This initiative will lower call prices, easing the financial burden on mobile phone users. Those service providers that do not abide by the new directive will be penalised. So far, only the Nepal Telecom has implemented this directive, while Ncell has failed to abide by the regulator's instructions.[53]

## Budget Highlights:

Following are the highlights for the ICT sector from the recently released budget:

- NPR 4.98 billion (USD 48 million) has been allocated for the information and communication sector.
- All the government related documents will be compiled and made available through electronic medium by establishing an information bank in the Department of Information. Clean feed policy will be in force from July 16, 2017.
- In order to increase the usage of information technology, Tele-Centres and Community Information Centres will be established under the Ministry of Information and Communications with the support of the NTA through local postal offices.
- All district headquarters, municipalities and rural municipalities will be connected through optical fibre lines within two years.
- In order to make the telecommunication service more systematic and competitive, mergers amongst telecommunication service providers will be encouraged.
- Registration of International Mobile Equipment Identity (IMEI) numbers will be made compulsory to ensure that all mobile sets sold in the market are registered.
- Postal Savings Banks will be expanded in all local levels to develop them as a payment centre for collecting remittance and social security allowances, and to pay electricity, drinking water and telephone charge.
- Various targeted programs will be implemented to increase the representation of women, Dalit, differently abled people, Madhesi, marginalized community and people from deprived sectors, class and communities to the mass communication media.

## OUTLOOK

In the review period, the telecommunication sector has witnessed many positive developments. With the launch of broadband projects the user base is expected to increase all over the country, with people even in the rural areas getting access to internet service. Meanwhile, various provisions have been laid down in the ICT sector prioritizing communication such as establishing an information bank and operating tele-centres and community information centres. The successful implementation of these provisions is expected to facilitate the ICT sector to become more effective.

REAL ESTATE

# REAL ESTATE

Housing and real estate represents a significant portion of most people's wealth and this is especially true for many people in Nepal. It is estimated that many Nepalis have their net worth tied up in real estate. The size and scale of the real estate market within the Kathmandu Valley makes it an attractive and lucrative sector for many investors in Nepal.

**Houses for disadvantaged communities:** Under the People's Housing Program, The Ministry of Urban Development has decided to build over 25,000 housing units for disadvantaged communities in 72 districts other than Kathmandu Valley, in fiscal year 2017/18. The cost of the each housing unit will not be more than NPR 300,000 (USD 2,892). The program will be implemented in places where there are at least 10 beneficiary families living on the basis of their identification. The rule is not applicable in case of Dom and highly marginalized and endangered ethnic groups sparsely settled in the country.[54]

**Increased flow of credit:** In the first nine months of the current fiscal year 2016/17, Banks and Financial Institutions (BFIs) have disbursed credit amounting to NPR 214.9 billion (USD 2 billion), an increase of 17.5% as compared to the same period of the previous fiscal year.[55] Table 3 shows the increase in credit disbursement in the construction sector.

**Table 3: BFI's Credit Disbursement during first nine months**

| S.N | Details | FY 2016/17 'In billion NPR' | FY 2015/2016 'In billion NPR' | % Change |
|---|---|---|---|---|
| 1 | Heavy Construction Projects | 24.85 (USD 239.5 million) | 19.6 (USD 188.9 million) | 27% |
| 2 | Residential Construction | 175 (USD 1.7 billion) | 149.5 (USD 1.4 billion) | 17% |
| 3 | Non-residential Construction | 14.8 (USD 142.7 million) | 13.8 (USD 133 million) | 7% |

*Source: Nepal Rastra Bank*

**Online building permit:** The Kathmandu Metropolitan City office (KMC) is in the process of setting up a new system to approve building blueprints online. Once the system is in place, people need not visit the office to get a permit to construct buildings and houses. A policy level decision to this effect has already been taken by the KMC.[56]

**Apartment buildings declared safe:** The KMC has declared 18 out of 51 high rise apartment buildings in the Kathmandu Valley as safe. However, decision has not been made on the remaining 33 apartments. Currently the KMC has sought Non-Destructive Test report from 19 apartment buildings and Detailed Damage Evaluation report from 5 apartment buildings. Similarly, the KMC has asked for various reports from 6 apartment buildings while 3 apartment buildings have not responded to KMC's request.[57]

## Budget Highlights:

- The budget provides continuity to the People's Housing Program for which NPR 2.44 billion (USD 23.5 million) has been allocated.
- Personal housing grant to earthquake victims has been increased to NPR 300,000 (USD 2,892)

## OUTLOOK

The demand for individual housing and plot has increased significantly with exception of apartments. The increase in demand has resulted in increase of price of both land as well as houses. Market research indicates that the price of land has increased by almost 70 to 80% after the earthquake and economic blockade.

The increase in credit flow to the construction sector is due to the provision of refinancing at zero percent interest to a large extent . Besides the demand for credit in the construction sector is also on the rise due to the growing pace of large projects and reconstruction of physical structures. It is also expected that with rapid reconstruction and infrastructural development, credit extension will exponentially increase in the near future.

# EDUCATION

The education sector has been rocked by the recent protests launched by student unions against school fee hikes, which exposed the rampant fee hikes practiced by schools in the Kathmandu Valley. Student unions have further pushed for better school fee regulations. Meanwhile, textbooks for the upcoming academic year are yet to be fully published.

**Growth in private sector education:** In the past two decades, there has been an unprecedented growth in the education sector. According to the Advertising Association of Nepal (AAN), education sector comprises of around 10% of Nepal's advertising market contributing NPR 60 million (USD 0.58 million) annually. This sector is seen very lucrative from business point of view. Since the government and community education institutions have become incompetent, there has been a growth in investment in private sector education. With the private investors coming in, the education sector has not only become competitive but the education cost has also increased. Meanwhile, the sector has created employment opportunities for many people in the country. In addition, the increase in remittance inflow has also pushed people, even in the rural areas, to spend on quality education.[58]

**Schools padlocked over excessive fee hikes:** Student unions affiliated to various political parties padlocked about 175 private schools across the country as a symbolic protest against the unilateral and unlawful fee hike by schools for the new academic session that started on April 14. The padlocked schools include notable institutions like Rato Bangla, Ullens, GEMS, KIST and KMC. The unions were forced to resort to this move as they felt that the schools continued to charge excessive fees in violation of the standard fee determined by the government and failed to return the excess amount to the guardians.[59] On April 28, an agreement was reached between the unions and the Ministry of Education (MoE) to reduce the illegal fee hikes within 15 days. This has yet to be implemented, but the MoE have stated that work has started and will be accelerated once the local elections are concluded.[60]

**Better regulations for school fee:** The Department of Education (DoE) and the district education offices have been directed by the MoE to monitor private schools and take stern action against the violators who have increased fees against the rules set by the government. The directive was issued after the student unions including Nepal Students Union, Tarai Madhes Students Front and Naya Shakti Students Union submitted a three-day ultimatum to Education Minister Dhani Ram Paudel to bring down the hiked fees in private schools. Some private schools were reported to have violated the existing laws by charging exorbitant amount for re-admission and admission forms along with increasing the fees every year, which is against the rule.[61] Moreover, according to the Guardians Association Nepal (GAN), these schools have also been forcing students to buy books and stationaries from particular shops in order to get kickbacks while leaving little room for the students to get any discounts on stationaries. The new fee structure of private schools requires it to be approved by two-thirds of the majority of guardians. Before increasing fees, the schools must also seek permission from the Fee Restructuring Committee and the District Education Office. The existing rules states that private schools violating the law can be fined up to 25,000 and have their license revoked. However, the government has been criticized for not fulfilling its commitments as it has hardly taken any strict action against the violators. [62]

**4.4 million textbooks yet to be printed:** While the textbooks should have been distributed to the schools before the start of the new academic session, nearly 4.4 million textbooks are yet to be printed. It is not the first time that school students have faced the shortage of textbooks, which affects the teaching and learning process in many districts of Nepal year after year.[63] According of the DoE, a total of 37,251,955 are required for 5,757,744 students from Grade 1-10 in the current academic year. Janak Education Materials Center (JEMC), the state-funded publication house, had been assigned by the government to print 20,001,840 copies of textbooks for grades 6-10, while the private sector had been assigned to print 17,250,115 copies of textbooks for grades 1-5.[64]

**SEE concludes, results within 90 days:** The nationwide Secondary Education Examination (SEE) of Grade 10, which replaced the previous School Leaving Certificate (SLC), concluded on March 27. The exams were administered in 1,923 examination centers across the nation from 8 am to 11 am for eleven days. With 278,450 female students taking the SEE this year, female examinees outnumbered their male counterparts who stood at 259,732. The SEE will use grading system to evaluate students' performance and aims to publish the results within 90 days of the completion of the exams.[65]

Following the restructuring in the school level education after the implementation of the eighth amendment to the Education Act, this is the first exams of Grade 10 at the regional level. It has been decentralized at the five development regions with five different question sets. The Act has also provisioned SLC exams as the School Leaving Certification Exams (SLCE) for grade 12 students in place of the earlier Higher Secondary Education Examination. The National Board will hold this exam, while the district boards will hold the Grade 8 exams.

**New education set up concern donors:** Representatives of more than a dozen donor agencies and countries attended the four-day Budget Review Meeting of the School Sector Development Plan (SSDP), where concerns were raised over how the education sector would function in the new local set-up. The SSDP is a government initiative for the education sector, which aims to increase number of educated teachers and enhance equitable participation and learning outcomes. It is estimated to cost NPR 124.50 trillion (USD 1.20 trillion), 20% of which is expected to come from donors. The donors were uncertain about the implications of the roll-out of the federal structure and the management of education up to the secondary level by the local government. The meeting also noted a resource gap for the reconstruction of the school buildings. In response to such concerns, Dhaniram Poudel, Minister of Education, stated that a technical committee was formed to direct the federal restructuring and minimizing any gap in capacity at the local level.[66]

## Budget Highlights:

The budget for FY 2017/18 has allocated only 10.25% of the total budget for the education sector. Of the total budget of NPR 1,278 billion (USD 12.32 billion), the education sector has been allocated NPR 131 billion (USD 1.26 billion) for the coming fiscal year. The budget states that local levels will now have the responsibility to pay the salary of school teachers from grade 1 till 10. In addition to this, local levels will also be tasked with distribution of education materials, textbooks and scholarships. With the handing over of a large part of control of the sector to the local level, a lot now rests on the hands of elected representatives and the execution of the allocated resources.

## OUTLOOK

The protests against school fee hikes are expected to continue as the MoE is yet to come up with anything concrete regarding the issue. With imminent protests, there are high chances for the upcoming academic year to get affected. While the private education sector experienced growth over the past year, the continued protest will cast a shadow over any sort of potential growth. With a large proportion of textbooks yet to be published, many students will have to start their new academic year without them.

# HEALTH

Various health-related policies and programs were endorsed by the government in the review period. The effective implementation of the policies is, however, going to be a challenge in the absence of stringent rules and regulations required for their enforcement. Unless the government strictly implements the health policies, they will not yield the desired result for the health sector.

**Health-related policies:** According to the Ministry of Health (MoH), the Cabinet recently endorsed three health-related policies—the National Eye Health Policy-2017, National Ayurveda and Complementary Medicine Policy-2017 and a concept paper to amend the reproductive health bill. While the 'National Eye Health Policy-2017' seeks to provide basic eye health services free of cost, the 'National Ayurveda and Complementary Medicine Policy-2017' envisions providing free basic Ayurveda medical services and conducting research on the Ayurvedic treatment system.[67]

**Extracted kidneys:** The Human Organ Transplant Centre of Bhaktapur was recently successful in transplanting extracted kidneys of a brain dead person into two beneficiaries. This transplantation, permitted under the Human Organ Transplantation (Regulation and Prohibition) Act, was the first of its kind in the country. The Human Organ Transplantation (Regulation and Prohibition) Act allows extraction of 8 organs including kidneys, lungs, pancreas, small intestine and pupils from a brain dead person for transplant purposes.[68]

**Cancer protocol enforced:** The government has enforced the cancer protocol in an attempt to bring uniformity in cancer treatments and make effective use of government's aid to cancer patients. The protocol provides the guidelines for the type and the amount that can charged for treatment, duration of medication use along with different fee structures for 17 types of cancer.[69]

**Endorsement of health insurance bill:** To ensure all Nepali citizens with basic healthcare services, the government has recently endorsed the draft of Health Insurance Act prepared by the Ministry of Health. Once the bill is enacted into law, various services such as yoga, immunization, family planning, safe motherhood, out-patient care, in-patient care, surgery, medicines and emergency care, among others, will be provided free of cost. Meanwhile, patients whose treatment is not available in health posts and primary healthcare centers can be referred to hospitals where they shall receive free services. The bill also states that people working in private institutions, civil servants and migrant workers have to enroll their family members in the health insurance policy system.[70]

**New mental health policy:** According to the Health Minister, a new 'National Mental Health Policy' has been drafted to provide free treatment and care for mental health patients. The Policy will be tabled in the Cabinet for approval soon. The Ministry of Health (MoH) has also directed the Department of Public Health Services to design programs to implement the policy. The program will be implemented with public-private partnership at the local levels and provinces along with adequate resources allocated from the central and provincial governments.[71] According to the data, around 20% of the people are suffering from mental illnesses in Nepal.[72]

**Growing suicide rate:** In last five years, Nepal has witnessed a rise in suicide rates mainly due to depression and other mental health problems. According to Nepal police, total number of people committing suicide stood at 3,997 in 2011/12, which grew to 4,667 by 2015/16. The six month data of Nepal Police for the current fiscal year shows that 2,262 people have committed suicide in the country so far. As per the statistical model of the World Health Organization (WHO) in 2012, Nepal ranked seventh in the world with suicide rates at 25 per 100,000 heads.[73]

**Slaughter houses to be monitored:** The Kathmandu Metropolitan City (KMC) is planning intensive monitoring of slaughter houses and meat supplying shops around Kathmandu Valley. Out of the estimated 2,500 meat shops and 1,000 fish shops in the valley, 60% of them do not meet hygiene standards. Due to lack of proper dumping area for the slaughter wastes, KMC has also announced that the slaughter houses will be shifted outside the valley and packaged meat will be imported from those places.[74]

**Strengthening health facilities:** In order to ease the pressure on hospitals during disasters, the MoH has positioned emergency supplies in warehouses of six major hospitals around Kathmandu Valley. Such supplies will contain health kits including surgical equipment that can serve over 200 patients for up to 10 days. In addition to prepositioning of emergency supplies including drugs and equipment, the Ministry has also begun establishing Regional Health Emergency Operation Centers that will coordinate and deploy resources when required.[75]

**Swine flu in Kathmandu:** As per the health experts, 20 cases of swine flu have been recently detected in Kathmandu Valley. According to the National Public Health Laboratory (NPHL), out of the 10 samples tested from various hospitals, 1 to 2 cases of H1N1 were detected. The symptoms of H1N1 flu include coughing, difficulty in inhaling and high fever. The flu severely affects children, elderly people, asthma patients, people with lung problems along with HIV and Hepatitis-infected persons.[76]

**Rising cases of tuberculosis:** While the WHO aims to end tuberculosis (TB) worldwide by 2050; Nepal has only been able to provide treatment to 93% of the TB patients in the country. According to the data, almost 8,000 TB patients have been left out. Though the government does target to end the TB epidemic in the country by 2035, 120 cases of TB are reported on an average in Nepal on a daily basis. As per the National Tuberculosis Centre (NTC), under the Department of Health Services, more than 15 million people are infected with TB—almost half the total population of the country. On an average, 20 people die of TB every day, while 25 cases are missed in Nepal.

In an effort to identify and provide treatment for TB patients, the government is planning to establish sophisticated and reliable technology to detect the disease in 45 districts within a year and eventually in all the 75 districts by 2021.[77] Meanwhile, 4,344 health care centers including hospitals, primary health care centers, health posts and private health care centers are already providing free treatment for TB.[78]

**Non-communicable disease interventions:** The essential non-communicable disease interventions for primary health care program, which was started with the help of WHO, will now be operational in eight more districts—Palpa, Baglung, Myagdi, Achham, Bardiya, Surkhet, Makawanpur and Rautahat. The program was already in effect in districts of Illam and Kailali. The program package includes minimizing the risks associated with non-communicable diseases and treatment for such diseases.[79]

**Regulating medical labs:** In view of complaints from various sectors regarding ill-equipped medical laboratories along with lack of human resource and quality assurance, the MoH has issued a directive to regulate medical labs. The directive, which has already been approved by the Cabinet, has categorized medical laboratories into five levels—A, B, C, D and E. In addition, laboratories have been classified as public health laboratories, hospital-based laboratories, standalone laboratories, research laboratories, referral laboratories and reference laboratories. All clinical laboratories will be required to have qualified human resource, necessary equipment and reliable test reports.[80]

## Budget Highlights:

The budget for FY 2017/18 has allocated NPR 41.09 billion (USD 396 million) for the health sector. Key provisions in the health sector have been highlighted as follows:

- NPR 31.78 billion (USD 306 million) has been allocated for the implementation of health related services. However, as per the constitution, these services do not include primary health services to be provided from local level.
- National Health Insurance Scheme will be offered to all citizens with an aim of providing health insurance to all Nepalis within 3 years.
- In the coming fiscal year, a plan will be developed and construction will be initiated to upgrade Bir Hospital to international standards.
- Free of cost treatment of cancer, kidney, liver and heart related diseases in all the government hospitals of Nepal for people below the poverty line will be continued. Kidney dialysis will be provided free of cost. Health services will

be expanded to identify and cure sickle cell anaemia disease prevalent in the Tharu community of Tarai region.

- With the view of improving the quality of Ayurvedic medicine, adoption of Good Manufacturing Practice (GMP) in Singhadurbar Vaidhyakhana will be continued. Industries that manufacture medicines using Nepali medicinal herbs will be encouraged.
- Medicine Act, 2035, will be revised to provide quality medicines and equipments. All the government hospitals will have their own pharmacies to provide medicines at a reasonable rate.
- In partnership with government and non-governmental organizations, health awareness campaign entitled 'Healthy Me, Healthy My Country' will be expanded by mobilizing the students of public and private schools.
- All the students who have passed M.D. and MBBS under government scholarships must work in remote areas for specified period.
- Various population planning and management related orientation and awareness programs will be conducted.

## OUTLOOK

The budget for FY 2017/18 has various provisions for the development of the health sector and attempts to make health services more affordable and accessible in the country. Though health has always remained a priority for the government, budgets allocated in previous years have not been spent adequately. Health related provisions such as implementation of National Health Insurance Scheme and free of cost kidney dialysis are very encouraging. However, development in the health sector largely depends on how effectively these provisions are implemented by the government.

# TOURISM

Nepal's tourism sector is finally rebounding after hitting a low owing to the 2015 earthquake and subsequent India-imposed blockade. Nepal is now once again gaining recognition in the global arena as a famous tourist destination. The Ministry of Culture, Tourism and Civil Association (MOTCA) and Nepal Tourism Board (NTB) have launched various projects under the National Tourism Strategy 2016-2025 in a bid to attract two million tourists annually by the year 2025. International Finance Corporation (IFC) has also offered to invest in the tourism sector.

**Pokhara on 'World's Best Spring Trips':** The National Geographic travel magazine has put Pokhara on its list of 'World's Best Spring Trips 2017'.[81] Pokhara made it to the list along with other destinations like Cape Town of South Africa, Philadelphia of the USA, Great Barrier Reef of Australia and Suzhou of China.[82] The magazine commended the city, which is a getaway to Nepal's Annapurna region, for its scenic Himalayan views, lakes and snow-covered peaks. It also described Pokhara as a hidden gem for adventure travellers as the city offers adrenaline-filled adventure sports like paragliding and acrobatic flight, among others.

**IFC to investment in tourism sector:** The International Finance Corporation (IFC) has offered to invest NPR 10.3 billion (USD 100 million) in the tourism sector of Nepal. The offer is part of the government-launched National Tourism Strategy 2016-25 and aims to augment job creation by bringing the private sector and government together. The strategy has envisaged arrival of 2.53 million tourists and foreign exchange earnings of NRP 340 billion (USD 3.27 billion) annually as well 633,000 job creations.[83]

Under the strategy, the IFC has studied three locations for destinations promotion—Arun Valley to Koshi Tappu in the Eastern Region, Rarato Bardia in the Midwestern Region and greater Pokhara in the Western Region—along with a few more areas to develop hotels, resorts and other facilities. The government's responsibility will be to facilitate infrastructure like roads and electricity. However, this is not the first time the IFC has provided a loan to Nepal. In the past, IFC provided NPR 1 billion (USD 10 million) to help finance the Buddha Air expansion and NPR 309 million (USD 3 million) to Nepal Hospitality and Hotel Limited to build the Fairfield Kathmandu Hotel.[84]

**Tourism injected NPR 177 billion (USD 1.7 billion) in Nepal's Economy:** According to the Economic Impact Research report of the World Travel and Tourism Council (WTTC), the travel and tourism sector of Nepal injected NPR 177 billion (USD 1.7 billion) in the economy in 2016 and supported more than 427,000 jobs. The tourism sector accounted for 3.6% of Nepal's GDP and is forecasted to rise by 6.8% in 2017. The direct impact of tourism to GDP reflects the economic activities generated by related industries such as hotels, travels agencies, airlines, passenger transportation services and other restaurant and leisure industries. Moreover, the London based council also made predictions for the year 2027 as shown in Figure 10. In South Asia, Nepal is behind

**Figure 10: Economic Contributions of the Tourism Sector**

| Year | Jobs | GDP (direct contribution) | Foreign tourists arrival |
|---|---|---|---|
| 2016 | 427,000 | 3.6 | 753,002 |
| 2017 | 452,500* | 6.8* | 801,000* |
| 2027 | 604,000* | - | 1,384,000* |

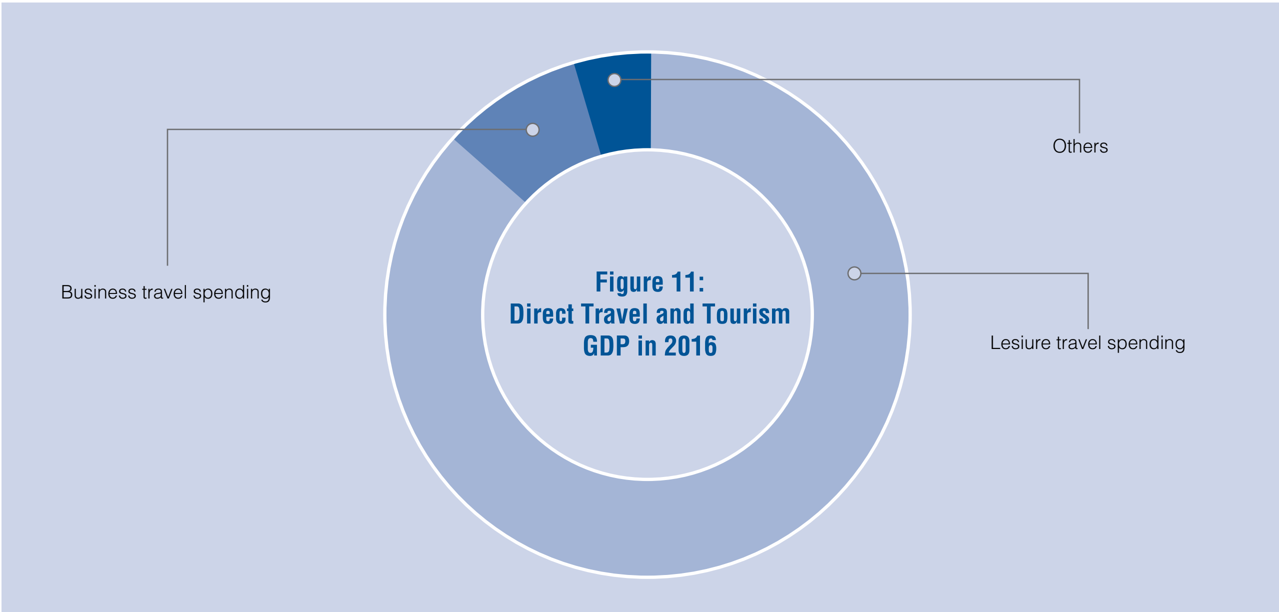



**Figure 11: Direct Travel and Tourism GDP in 2016**

*Source: World Travel and Tourism Council (WTTC)*

India and Bangladesh and ahead of Sri Lanka in terms of direct contribution of tourism sector to the economy.

**Hoteliers urge government to expedite infrastructure development:** Even though Nepal has witnessed a large inflow of tourists this fiscal year compared to the last, lack of infrastructure continues to be a major setback for the tourism industry. According to the Hotel Association Nepal (HAN), the private sector is vehemently preparing itself to accommodate the 2020 target of two million tourists annually. However, they have criticized the government for not being serious about public infrastructure to achieve the target.

If the government expedites infrastructure facility development like airports and develops numerous training programs for human resources to enhance the quality of service, there will be an increased flow of tourists. Therefore, hoteliers have urged the government to fasten the pace of infrastructure development. However, many projects still remain stalled. For instance, the expansion of Tribhuwan International Airport, which was expected to have been completed by 2018, has been extended to 2021 due to the re-tender process.[85]

**NTB announces its biggest media campaign:** The Nepal Tourism Board (NTB) has announced the launching of its biggest media campaign to publicize Nepal to global audiences and bring significant impact on Nepal's tourism. The campaign is to be conducted in partnership with international news agencies—Reuters, BBC and the American travel site app Trip Advisor. The NTB has signed a NPR 70 million (USD 674,699) worth of contract for six months with BBC under which the news agency will broadcast 30 minute video clip on Nepal in Europe and Asia. The NTB has also signed a one-year deal worth NPR 25.79 million (USD 248,578) with Trip Advisor and a three-month deal worth NPR 7.73 million (USD 74,506) with Reuters. This campaign is the first ever consumer media campaign to draw attention of the foreign travellers.[86]

**Rise in the travel expenses of Nepali outbound travellers:** The expenses of Nepali outbound travellers increased by 43.09% in the first eight months of the fiscal year 2016/17, according to the Macroeconomic Outlook unveiled by the Nepal Rastra Bank (NRB). In fact, the travel expenses have been increasing every year for Nepali travellers as per the data. The rising trend of Nepali people going abroad for vacation or business purposes, notwithstanding for foreign jobs, has also resulted in the increase of travel expenses. It has been reported that he amount the country receives from tourists visiting Nepal is substantially lower than the amount Nepali people spend to travel outside.[87] Some of the popular destinations for Nepalis travelling abroad for vacation and corporate incentive packages include Thailand, Indonesia, Malaysia, Singapore, United Arab Emirates and Cambodia as visas are easily available in these countries.

## Budget Highlights:

The budget for 2017/18 announced on May 29 puts emphasis on developing tourism infrastructure and building of trekking rails to increase the number of tourists in the next fiscal year. This includes upgradation of Tribhuvan International Airport as per international standard. Under this expansion project, runway and parking way will be extended with Koteshore section of Koteshor Suryabinayak road by converting it into tunnel road.

## OUTLOOK

Given the growing recognition of Nepal in the global market and various government projects, the number of tourists coming to Nepal is bound to increase in foreseeable future. To accommodate the growing number of foreign visitors, however, both the private sector and the government should work together; the government especially needs to invest more on developing infrastructure.

# TRADE AND DEBT

**Owing to the normalization of trade in the first nine months, trade activities have considerably picked up in the country. Investments made for trade promotion is expected to increase exports from the country. However, trade deficit continues to escalate with significant increase in imports. Unless the local industries are promoted and are able to grow in tandem with the growing domestic demand, the current trade deficit can be expected to continue.**

**Foreign trade scenario:** Table 4 summarizes the foreign trade scenario in Nepal for the first nine months of FY 2016/17. The normalization of Nepal's foreign trade has led to an increase in total exports figure. In the current review period, merchandise exports increased by 12.1% amounting to NPR 55.2 billion (USD 532 million)—a sharp increase compared to the decline of 23.4% during the same review period last fiscal year. Nepal's export to both of its southern and northern neighbor, India and China, has increased by 15.7% and 8.5% respectively. However, the growth in exports still lags behind the growth of imports in terms of both value and growth rate.

Nepal imported merchandise worth NPR 726.4 billion (USD 7 billion), almost thirteen times the value of total exports during the first nine months of the current FY 2016/17. Contrary to the situation of declined imports in the previous fiscal year, total imports registered an increase of 39.7%. Imports from India, the key trading partner of Nepal, increased by a staggering 51.2% amounting to NPR 472.7 billion (USD 4.56 billion). While the dependency on Indian imports continues to increase, imports from China and other countries have also increased by 12.6% and 28.9% respectively.

**Table 4: Foreign Trade Statistics for the first nine months of FY 2016/17 (in billions)**

| In NPR Billion | 2014/15 | 2015/16$^{R}$ | 2016/17$^{P}$ | Percent Change | |
|---|---|---|---|---|---|
| | | | | 2015-16$^{R}$ | 2016-17$^{P}$ |
| TOTAL EXPORTS | 64.3 | 49.2 | 55.2 | -23.4 | 12.1 |
| To India | 41.6 | 27.7 | 32.1 | -33.4 | 15.7 |
| To China | 2.0 | 1.2 | 1.3 | -41.3 | 8.5 |
| To Other Countries | 20.6 | 20.3 | 21.9 | -1.5 | 7.5 |
| TOTAL IMPORTS | 577.1 | 520.0 | 726.4 | -9.9 | 39.7 |
| From India | 364.8 | 312.7 | 472.7 | -14.3 | 51.2 |
| From China | 80.2 | 82.4 | 92.7 | 2.8 | 12.6 |
| From Other Countries | 132.2 | 124.9 | 161.0 | -5.5 | 28.9 |
| TOTAL TRADE BALANCE | -512.8 | -470.7 | -671.2 | -8.2 | 42.6 |
| With India | -323.2 | -285.0 | -440.7 | -11.8 | 54.6 |
| With China | -78.1 | -81.2 | -91.4 | 3.9 | 12.6 |
| With Other Countries | -111.5 | -104.5 | -139.1 | -6.3 | 33.0 |
| TOTAL FOREIGN TRADE | 641.4 | 569.2 | 781.6 | -11.3 | 37.3 |
| With India | 406.4 | 340.4 | 504.8 | -16.2 | 48.3 |
| With China | 82.2 | 83.6 | 94.0 | 1.7 | 12.5 |
| With Other Countries | 152.84 | 145.20 | 182.82 | -5.0 | 25.9 |

*Source: NRB Report- Current Macroeconomic Situation (based on nine month data of 2016-17)*

**Top imports and exports:** The top three commodities exported in the first nine months of the current FY 2016/17 were woolen carpet, juice and jute goods. In terms of value, woolen carpets amounting to NPR 5.49 billion (USD 52.91 million) and NPR 159 million (USD 1.53 billion) was exported to other countries and China respectively; juice worth NPR 3.9 billion (USD 37.59 million) and jute goods, mainly comprising of sackings, worth NPR 3.4 billion (USD 32.77 million) was exported to India.[88] While the data published by the Trade and Export Promotion Centre (TEPC) shows that yarns (polyester, cotton and others) worth NPR 4.81 billion (USD 46.36 million) was exported, iron and steel products worth NPR 4.27 billion (USD 41.16 million) was also exported during the same review period, making these the top exported products.

Petroleum products continue to top the charts of import with the country importing petroleum worth NPR 85.96 billion (USD 828.5 million) in the first nine months of the current FY 2016/17. This is a staggering increase of 119.9% compared to same review period last fiscal year; however, in last year the total import declined due to the trade embargo. Still this is a 4% increase in the import of petroleum products compared to the FY 2014/15. Vehicles and spare parts is the second most imported product which in turn again increases the demand of petroleum products. In the review period, vehicles and spare parts worth NPR 62.14 billion (USD 595.94 million) was imported, an increase of a staggering 71.4% compared to the same review period last fiscal year.[89]

**Export of NTIS products not as anticipated:** Despite revising the Nepal Trade Integrated Strategy (NTIS) in 2016 and short listing the high potential export products, the performance of the products is still not encouraging. Out of the identified priority products for export, ginger, medicinal herbs, cardamom, pashmina, carpets and footwear registered a decline in export. A most encouraging trend is seen in the export of textiles which saw a 59.3% growth amounting to NPR 3.85 billion (USD 37.1 million) in the first nine months of the current fiscal year.[90]

**Trade Deficit:** In the first nine months of the current FY 2016/17, Nepal's total trade deficit widened by 42.6% amounting to NPR 671.20 billion (USD 6.5 billion). During the same period last fiscal year, the trade deficit had contracted by 8.2%. The normalization of trade and the momentum gained by reconstruction activities in the country is bound to put pressure on demand for goods and services, thereby resulting in increased imports. This will widen the trade deficit further, but will facilitate economic growth through increased capital investment in the country.

**BOP surplus:** The substantial increase in imports has resulted in an account deficit of NPR 10.34 billion (USD 99.66 million) in the first nine months of the current FY 2016/17. The current account was in surplus of NPR 133.19 billion (USD 1.28 billion) during the same review period last year as the trade embargo and slow pace of post-earthquake reconstruction lowered the imports. Continuing with the previous trend, the country recorded a Balance of Payment (BOP) surplus of NPR 50.64 billion (USD 488 million) in the first nine months of the current FY 2016/17. However, the current BOP surplus is significantly lower compared to surplus of the same period last fiscal year, which stood at NPR 163.81 billion (USD 1.58 billion).

**Rise in domestic debt:** In the third quarter of the FY 2016/17, the government of Nepal's total debt stood at NPR 635 billion (USD 6.1 billion) and the Debt to GDP Ratio slightly increased to 28.26% from 27.91% during the same period last fiscal year. Meanwhile, external debt decreased by 1.2% amounting to NPR 384 billion (USD 3.7 billion) and domestic debt increased by 5.1% amounting to NPR 251 billion (USD 2.42 billion). During this period NPR 10.82 billion (USD 104.3 million) has been repaid to external creditors as principal repayment and NPR 17.97 billion (USD 173.20 million) has been repaid to domestic creditors.[91]

**Government to hike subsidy on selected export items:** The Ministry of Commerce is planning to hike the incentives on major exportable goods to 15% in the coming FY 2017/18. This incentive is targeted towards promoting the local export-based industries by reducing the cost of production in order to increase the competitiveness of domestic products in the international market. The Ministry also intends to monitor the domestic industries and traders to ensure effective usage of the incentive.[92]

**Quality marks for imported goods:** The Nepal Bureau of Standards and Metrology (NBSM) has declared that twelve imported goods—dry cell, LPG regulator and valve, gas cylinder, PVC cable, GI wire, GI sheet iron rod and cement—now require Nepal Standards (NS) certifications to qualify for selling in the domestic market. The NS certification, which covers 15 physical and chemical standards, has been mandatory for such goods produced domestically. The NS certification for imported goods will also ease custom clearance processes as it will shorten the quality assurance checks at the border points.[93]

**Cargo tracking system:** To enable the authorities to follow shipments, the Government of Nepal is implementing an electronic cargo tracking system for Nepal-bound shipments at Indian ports from June. The government will be signing a Memorandum of Understanding with the Indian authorities to implement the system. Under this system the containers will be tagged with electronic chip that will be attached to containers at Kolkata Port or Vishakhapatnam Port and will be retrieved once the containers reach Birgunj Dry Port. The government intends to charge NPR 3000-NPR 3500 (USD 29- 34) per container for the tracking service.[94]

**Nepal's trade with the US:** The council meeting of the Trade and Investment Framework Agreement (TIFA)—a bilateral pact aimed at promoting trade and investment between Nepal and the US—was recently held in Nepal. The discussions focused on customs and trade facilitation, sanitary and phytosanitary measures, food safety, labeling requirements, standards and conformity assessment and labor. The Trade Facilitation and Trade Enforcement Act 2015 has established country-specific preference program which grants duty free treatment to Nepali products exported to the US market.[95] Since the enforcement of TIFA which is expected to span over 10 years, Nepal's export to the US has witnessed an increasing trend—exports to the US increased by 20% in FY 2015/16 amounting to NPR 9.34 billion (USD 90 million).[96]

**TEPC to be upgraded:** As per the plan under Trade Policy 2015, the Ministry of Commerce (MoC) is planning to upgrade the Trade and Export Promotion Centre (TEPC) into Trade Promotion Institution (TPI). The government has formed a committee to look into the legal, economic and organizational aspects to facilitate the transformation. This new institution will be an autonomous body with increased responsibility in regard to trade related issues.[97]

**Larcha dry port construction to gain momentum:** The construction of the only dry port on Nepal-China border, Larcha dry port, near Tatopani had halted after the Bhotekoshi flood swept away the bridge in 2014. China's Beijing Real Estate Group Company was awarded the contract for the construction of Larcha dry port in 2012. The Chinese government has agreed to restart the second-phase construction after monsoon. The dry port covers an area of 27.5 million square feet, which will provide space for parking up to 200 trucks and accommodate 159 big containers and 33 cars. The Chinese government has provided the necessary funding and technical assistance for the project. Out of which Nepal government has so far spent NPR 2 billion (NPR 19.28 million). The construction is to be carried out in three phases—rescue, protection and resume. The rescue work will incorporate protecting the area from possible landslides during monsoon. For protection, Nepal government will construct retention wall encircling the project area. Thereafter, the construction of the dry port will resume.[98]

## Budget Highlights:

- NPR 10.96 billion (USD 0.1056 billion) has been allocated for Industry, Commerce and Supply Sector.
- Priority will be given to the effective implementation of Commerce Policy 2015 and Nepal Integrated Trade Strategy 2016. In addition to this, market diversification and expansion of exportable goods with comparative advantage and competitiveness will be emphasized along with the production and promotion of exportable goods.
- The budget also promotes the production, development and capacity enhancement related activities for high-value, low-volume and high export potential goods such as Pashmina, coffee, tea, ginger, honey, cardamom and herbs.
- The budget prioritizes the establishment of well-equipped laboratories to facilitate the certification of quality of exportable goods.
- The ongoing construction of integrated check posts will be expedited in Biratnagar, Bhairahawa and Nepalgunj. Moreover, the integrated check post currently being constructed in Birgunj will be brought into operation within this fiscal year.
- World Customs Organization Goods Classification and Codification 2017 will be implemented from this fiscal year.
- Custom Automation System will be extended to all custom office to make the system web-based.

## OUTLOOK

For a developing country like Nepal, an account deficit is perceived in a positive light assuming that the imported goods and services will boost the country's productive capacity in the long run. However, the increased growth in import of consumption goods remains a matter of concern for Nepal. The Budget for FY 2017/18 has focused on facilitating trade activities in the country. The implementation of procedural upgradation including establishment of web-based custom automation, implementation of import export code and establishment of laboratories to certify exportable goods will ease the process of exporting and importing goods while also cutting down on time and cost. These efforts are expected to improve export figures of the country.

# FOREIGN AID

Foreign aid plays an ambiguous role in shaping our economy given that significant portion of Nepal's budget is still reliant on it. Therefore, role of foreign aid in Nepal has emerged as an interesting topic for future study.

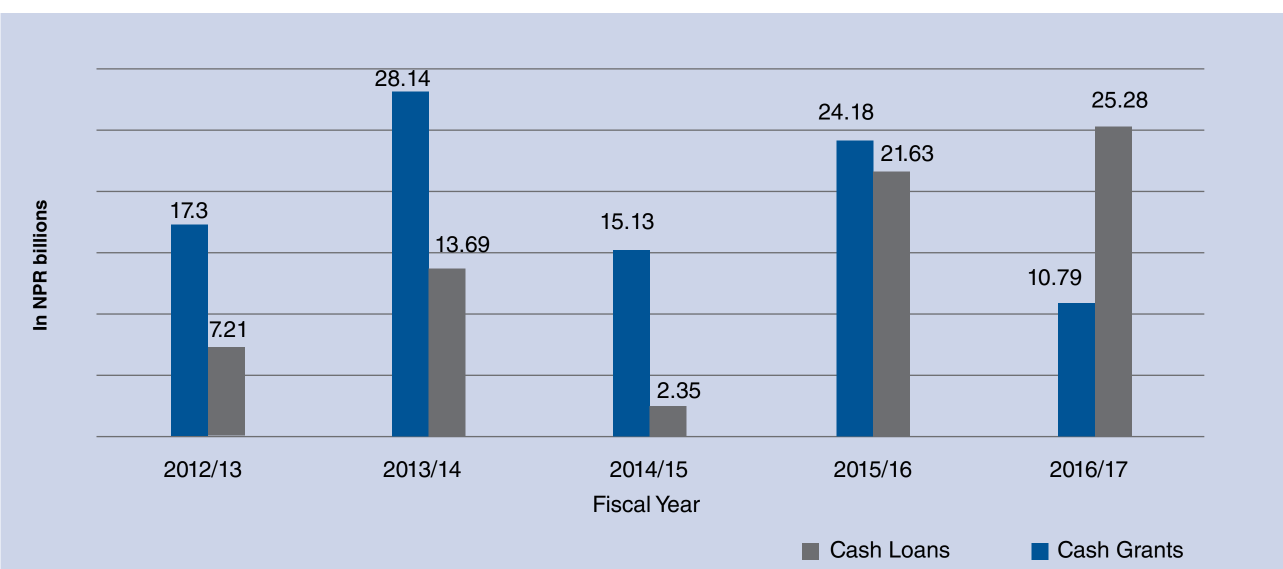
**Donors agree to extend the committed fund:** Donor agencies have entered into an agreement with the Ministry of Finance (MoF) to release 75 percent of the committed fund for post-earthquake reconstruction. The total committed amount was USD 4.1 billion and the agreement to release NPR 321.63 billion (USD 3.1 billion) was reached recently to expedite reconstruction. Of this amount NPR 166 billion (USD 1.6 billion) will be disbursed as grants and NPR 155.63 billion (USD 1.5 billion) as soft loans. However, any delay in utilization of the released fund could again derail the sanctioning of the committed fund.[99]

**World Bank to extend USD 100 million for financial sector stability:** The World Bank has committed to provide NPR 10.37 billion (USD 100 million) to the Government of Nepal for launching programs related to financial stability. The main objective of the assistance is to help Nepal achieve its medium-term reform program to ensure stability in the financial sector by reducing vulnerabilities of the banking system and increasing its transparency. In this regard, the proposed credit will be used to support following four main policy areas:

- Enhancing financial sector development
- Restructuring and consolidating the financial system
- Strengthening the legal and regulatory framework
- Enhancing the governance and transparency of the banking sector[100]

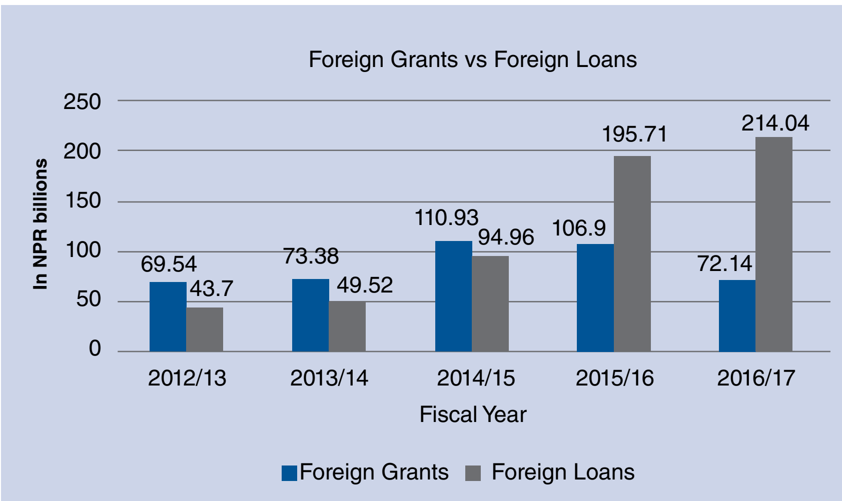
**European Union pledges USD 6.75 million for improving education:** The European Union (EU) has agreed to provide financial assistance of NPR 700 million (USD 6.75 million) to the government for improving the education sector. The fund will be used to strengthen the School Sector Reform Program in order to ensure

**Figure 12: Comparison of Foreign Cash Loan and Foreign Cash Grants in the first nine months over the past five years**




*Source: Current Macroeconomic Situation, Nepal Rastra Bank*

**Figure 13: Comparison of Foreign Cash Grants and Foreign Cash Loans over a period of five fiscal years**




*Source: Ministry of Finance, Budget Speech of Fiscal Year 2017/18*

quality education in the country. Similarly, the aim of the project is to increase the school enrolment rate and decrease disparity in access across gender, ethnicity and income level. Likewise, the partial amount of the fund will be utilized to reconstruct the schools affected by the 2015 earthquake.[101]

As shown in the above Figure 12, foreign aid has had an increasing trend expect for FY 2014/15. In fact, foreign cash loans in 2016/17 have increased approximately by 4 times as compared to 2012/13 with an annual average growth rate of 211.08% over a period of five years. In contrary, foreign cash grants have maintained a random trend with an annual average growth rate of 5.22% over the period of 2012/13 to 2016/17. Meanwhile, foreign cash grants have decreased by 38% in 2016/17 as compared to 2012/13.

**Donors commit to spend the allocated budget:** To expedite the fund mobilization, donors and developing partners themselves have spent 37% of the foreign aid that Nepal had received in FY 2015/16 via off-budget channel. The corresponding number was 35% in FY 2014/15. Out of NPR 111.42 billion foreign aid Nepal had received (USD 1.074 billion), approximately NPR 396 million (USD 3.82 million) was disbursed through off-budget channel. Most of the funds were utilized for post-quake reconstruction.[102]

## Budget Highlights:

The Government of Nepal recently published the budget amounting NPR 1,279 billion (USD 12.33 billion) for the FY 2017/18. Of the total fund, contributions of foreign cash grants and foreign cash loans have been estimated to be NPR 72.17 billion (USD 700 million) and NPR 214.04 billion (USD 2.06 billion) respectively.

As shown in the Figure 13, contribution of foreign cash loans has increased with an annual average growth rate of 55.13% over a period of five years. Likewise, contribution of foreign cash grants has shown a random trend. Moreover, contribution of foreign cash grants as a source of funds in FY 2017/18 has decreased substantially as compared to last fiscal year.

## OUTLOOK

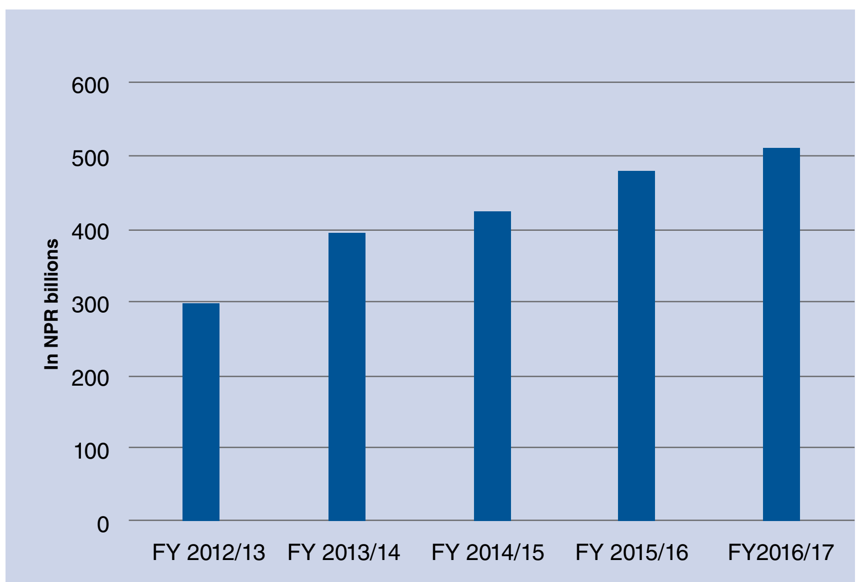
Even though foreign aid is a crucial financial source for Nepal's budget, excessive dependency on it could have adverse effects on the country's economy. For instance, corruption and growing dependence on foreign capital are the embedded costs of foreign aid. As Nepal is now almost over with its political transition, foreign projects like the Belt and Road Initiative should be prioritised instead of aid. The focus should be on industrializing the economy rather than relying on comprehensive packages from donor countries.

# REMITTANCE

On the backdrop of ever widening trade deficits with meagre exports, the continuous decline in remittance has put pressure on the country's balance of payments and domestic liquidity. Though the government is making regulatory changes to ensure the security of the migrant workers going abroad, further conscious efforts to create local job opportunities for the potential outbound migrant is necessary considering the ongoing economic crisis of host countries.

**Ban on women domestic workers from going to Gulf:** The International Relations and Labour Committee of Parliament has issued a circular to all concerned ministries including Ministry of Labour and Employment (MoLE), Ministry of Foreign Affairs (MoFA), and Ministry of Home Affairs (MoHA) instructing them to effectively implement a ban on Nepali women from travelling to Gulf countries for employment as domestic workers. Despite a travel restriction in place that bars Nepali women from going to Gulf countries and Malaysia and work as housemaids, the MoLE is found to have issued work permits to around 500 women in the last one year. Further, hundreds of Nepali women have been leaving the country every month through illegal channels. The circular issued by Parliamentary Committee stressed on the need for developing required legal framework and safety nets to protect the rights of domestic workers before allowing them to go abroad.[103]

**Figure 14: Comparison of remittance inflow of first nine months of the fiscal year**




*Source: Current Macroeconomic Situation, Nepal Rastra Bank*

**Decline in remittance growth rate:** Remittance inflow rose by 6.3% to NPR 511.93 billion (USD 4.93 billion) in the first nine months of FY 2016/17 compared to a growth of 13% in the corresponding period of the previous year (refer Figure 14).[104] The fall has been attributed to a slower growth in the number of outbound workers seeking foreign employment due to economic slowdown in gulf countries thereby resulting in fewer job opportunities. Moreover, after the government made regulations stricter to safeguard migrant workers, including enforcement of 'Free Visa, Free Ticket', manpower companies have become more cautious about sending workers for employment haphazardly, resulting in decline in the number of outbound migrants.

**Remittances delivers gains along with compounded long-term problem:** Releasing 'Nepal Country Economic Memorandum', the World Bank has said that the large-scale outbound migration and remittance inflow contributed to the steady loss of competitiveness, through appreciation of real exchange rate, and have enabled the growth of the low-productivity services. However the report mentions that large scale migration is not a sign of strength, but a symptom of deep, chronic problems. Though inflow of remittance is acting as a safety net for people and helping them stay to out of poverty, in many cases the country's stock of human capital has tremendously reduced due to outbound migration. Consequently, this has led to a low economic growth in the country. Hence, comprehensive approaches such as restructuring public investment program, unleashing large investments, revitalizing existing sources of growth, and investing in people has been recommended to boost investment and accelerate productivity.

## Budget Highlights:

In order to route remittance inflow through formal channel and utilize the same in the productive sector, the budget for FY 2016/17 mandates that all Nepali outgoing labours must open a bank account and remit money to that account. Further, remitters will be motivated to invest in productive sectors including Remit Hydro.

## OUTLOOK

The number of outbound migrants may further decline due to cost cutting measures adopted by the host county on the backdrop of ongoing lurch in the global oil prices. This may hit the macro-economic situation of the county involving balance of payment and domestic liquidity. The government has to come up with right strategies for utilization of remittance in productive sector, and accelerate the thought process to check the economy's excessive dependence on remittances.

# 4

MARKET

# REVIEW

# FINANCIAL MARKET

At the end of third quarter (Mid-April) of the current fiscal year 2016/17, net profit of the commercial banks has surged by 33.7% as compared to the same period of the corresponding fiscal year.

## Key Indicators

Some of the key macroeconomic indicators as per the macroeconomic and financial situation report based on nine months data of FY 2016/17 published by Nepal Rastra Bank (NRB) are highlighted below.

**Deposit and credit mobilization:** Deposits at Banks and Financial Institutions (BFIs) increased by 8.9% compared to an increase of 12.1% in the same period of the previous year. Of the total deposits at BFIs, the share of demand deposits and saving deposits fell to 7.5 % and 36.6% respectively while the share of fixed deposits increased to 40.6% from 28.6% a year ago.

In the review period, credit extended to the private sector by BFIs increased by 15.6% compared to an increase of 14.4% in the corresponding period of the previous fiscal year. Credit mobilization of commercial banks increased by 19.1% while that of development banks and finance companies decreased by 0.1% and 2.8% respectively. Of the total outstanding credit of BFIs, 60.8% is against the collateral of land and building and 14% against the collateral of current assets such as agricultural and non-agricultural products.

Likewise, in terms of credit exposure, the outstanding credit of BFIs to real estate and personal residential home loan increased by 26.5% while Hire Purchase loan increased by 60.4% as compared to same period of last fiscal year. Similarly, commercial banks total credit to Small and Medium Enterprises (SME's) was only 2.6% i.e. NPR 2.32 billion (USD 22.36 million) of the total credit exposure as on Mid-April 2017.

**Table 5: Loan portfolio of BFIs in some key areas (In NPR billions)**

| Type of loan | Mid-Apr 2016 | Mid-Apr 2017 | % change |
|---|---|---|---|
| Overdraft | 278.6 | 346.5 | 24.4 % |
| Real Estate and Personal Residential Home Loan | 231.1 | 292.4 | 26.5 % |
| Hire Purchase | 92.9 | 149 | 60.4 % |
| Margin Nature Loan | 35 | 39.2 | 12 % |

*Source: Nepal Rastra Bank*

**Liquidity Management:** In the review period, NRB injected liquidity of NPR 61 billion (USD 587.95 million) in the banking system through various open market operations such as repo auction worth NPR 33.21 billion (USD 320.1 million) and outright sale auction worth NPR 27.79 billion (USD 267.85 Million). Likewise, BFIs used Standing Liquidity Facility (SLF) worth NPR 61.74 billion (USD 595.08 million) during the review period. NRB injected net liquidity of NPR 324.56 billion (USD 3.13 billion) through the net purchase of USD 3.03 billion from foreign exchange market (commercial banks). Likewise, in terms of absorption, NRB mopped up NRP 101.10 billion (USD 974.45 million) through open market operations. Under this system, NPR 29.80 billion (USD 287.23 million) was mopped up through 14 days deposit collection auction under corridor system, NPR 7.05 billion (USD 67.95 million) under 90 days deposit collection auction and NPR 64.25 billion (USD 619.28 million) through reverse repo auction on a cumulative basis. Similarly, NRB also purchased Indian currency (INR) equivalent to NPR 354.04 billion (USD 3.41 billion) through the sale of USD 3.22 billion and Euro 95 million during the review period. INR equivalent to NPR 268.39 billion (USD 2.59 billion) was purchased through the sale of USD 2.48 billion in the corresponding period of the previous fiscal year

**Foreign Exchange Reserves and Adequacy:** The gross foreign reserves stood at NPR 1057.38 billion (USD 10.2 billion) at the end of third quarter of FY 2016/17, an increase of 1.7% compared to NPR 1,039.21 billion (USD 10 billion) in mid-July 2016. Out of the total foreign exchanges, reserves held by NRB increased by 0.8 % to NPR 894.16 billion (USD 8.62 billion) while the reserves held BFIs increased by 7.8% to NPR 163.22 billion (USD 1.57 billion). The share of INR in total reserves stood at 23.9% as at mid-April 2017.

Based on the imports of the first nine months of current fiscal year, the foreign exchange holdings of the banking sector is sufficient to cover the prospective merchandise imports of 13.3 months, and merchandise and services imports of 11.5 months. The ratio of foreign currency reserve-to-GDP, reserve-to-imports and reserve-to-M2 stood at 40.7 %, 95.4 % and 42.9 % respectively as at mid-April 2017.

**Interest Rates:** The weighted average 91-day Treasury bill rate decreased to 0.93 % in the review period from 1.1 % a year ago. Likewise, the weighted average inter-bank transaction rate among commercial banks also decreased to 0.75% from 1.59 % a year ago. Also, the weighted average inter-bank rate among other financial institutions increased to 7.27% from 1.21% a year ago.

**Balance of Payments (BOP):** In terms of BOP, the current account fell into a deficit by NPR 10.34 billion (USD 99.66 million) compared to a surplus of NPR 133.19 billion (USD 1.28 billion) in the same period of the previous fiscal year. Nonetheless, the overall BOP posted a surplus of NPR 50.64 billion (USD 488.1 million) in the review period compared to a surplus of NPR 163.81 billion (USD 1.58 billion) in the same period of the previous year.

In the review period, Nepal received Capital transfer of NPR 10.41 billion (USD 100.34 million) and Foreign Direct Investment (FDI) inflow of NPR 11.07 billion (USD 106.7 million) compared to transfer of NPR 10.82 billion (USD 104.29 million) and NPR 4.19 billion (USD 40.38 million) respectively in the same period of the previous year.

**Third Quarter Performance Analysis of Commercial Banks:** As per the unaudited third quarter financial results of commercial banks as shown in Table 6, the operating profit margin of commercial banks grew by staggering 43.1% while the net profit margin grew by 33.7 % compared to the same quarter of the corresponding fiscal year. Amongst all the commercial banks, Nabil Bank was able to post the highest net profit of NPR 2.68 billion (USD 25.83 million) followed by Nepal bank at NPR 2.51 billion (USD 24.19 million) and Nepal Investment Bank at NPR 2.37 billion (USD 22.84 million ) at the end of this quarter. During the period, the deposit mobilization increased by 21.3% while credit mobilization by the commercial banks increased by 32%.

At the end of third quarter, the average Non-Performing Loan (NPL) of banks has gone down to 1.6% from 2% as compared to the corresponding period while the average cost of fund of the commercial banks has increased to 4.5% from 3.6%. Similarly, the average base rate of commercial banks stood at 8.7% during the end of this quarter, the highest being 11.4% of Mega bank and the lowest being 5.7 % of Nabil Bank Limited.

## Key Developments

**Enactment of Bank and Financial Institutions Act (BAFIA) 2017:** The President has recently certified the Banks and Financial Institutions Act (BAFIA) 2017 endorsed by the Parliament. Some of the key highlights of the Act which is already implemented are as follows:

- The Chief Executive Officer (CEO) of BFIs will only be able to serve two terms of four years each, similar provision, however, is not in place for Chairperson or Board of Directors (BOD).
- Promoter of BFIs will not be able to hold any position in management.
- BFIs will be able to allocate only 0.5% of shares to their employees during the Initial Public Offering (IPO). Earlier, BFIs could allocate 5% of shares to their employees.
- BFIs which have completed ten years of operation would be allowed to convert all promoter shares into ordinary shares (general shares) upon approval of the central bank if such changes do not disrupt the capital market, the banking sector and the entire financial sector.
- The Act bars the individuals serving in Constitutional posts from becoming a member of board of any BFIs.

**License granted to ten new Life Insurance companies:** The government has granted operating license to 10 new life insurance companies as per the recommendation made by the Insurance Board (IB), the regulator of Insurance companies in Nepal. Currently, there are 9 life-insurance companies already operating in Nepal, the new entrants are: Citizen Life, Star Life, Sun Nepal Life, Sanima Life, Reliance Life, IME Life, Mahalaxmi Life, Jyoti Life and Union Life Insurance.[105] However, the application of two other aspiring companies, Standard Life and Uni Life were rejected as these companies failed to produce documents required

## TABLE 6 THIRD QUARTER RESULTS OF COMMERCIAL BANKS-UNAUDITED-AS ON FY 2016-17 (FIGURES IN NPR TEN MILLION)

| | | | DEPOSIT | | | LOANS AND ADVANCES | | | OPERATING PROFIT | | | NET PROFIT | | | NPL (%) | | COST OF FUND (LCY) | | | BASE RATE (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank | Paid-up Capital | Reserve & Surplus | FY 16/17 | FY 15/16 | % Change | FY 16/17 | FY 15/16 | % Change | FY 16/17 | FY 15/16 | % Change | FY 16/17 | FY 15/16 | % Change | FY 16/17 | FY 15/16 | FY 16/17 | FY 15/16 | % Change | FY 16/17 |
| | | | 3 QTR | 3 QTR | | 3 QTR | 3 QTR | | 3 QTR | 3 QTR | | 3 QTR | 3 QTR | | 3 QTR | 3 QTR | 3 QTR | 3 QTR | | 3QTR |
| Nabil Bank | 618.5 | 809.3 | 11,705.9 | 11,331.6 | 3.3 | 9,055.4 | 7,073.8 | 28.0 | 410.0 | 303.2 | 35.2 | 268.3 | 205.2 | 30.8 | 1.0 | 1.5 | 2.3 | 2.2 | 0.1 | 5.7 |
| Nepal Investment Bank | 874.6 | 995.8 | 11,981.1 | 11,263.7 | 6.4 | 10,194.6 | 8,437.4 | 20.8 | 345.7 | 243.5 | 42.0 | 237.7 | 183.2 | 29.7 | 0.6 | 0.8 | 4.6 | 2.3 | 2.3 | 6.9 |
| Standard Chartered Bank | 374.9 | 483.8 | 6,956.7 | 5,812.4 | 19.7 | 3,735.5 | 2,969.6 | 25.8 | 161.3 | 131.9 | 22.3 | 106.4 | 90.7 | 17.3 | 0.2 | 0.2 | 2.6 | 1.5 | 1.1 | 6.0 |
| Himalayan Bank | 661.4 | 451.0 | 9,289.0 | 8,087.8 | 14.9 | 7,808.3 | 6,528.8 | 19.6 | 239.7 | 205.6 | 16.6 | 153.5 | 131.9 | 16.4 | 0.9 | 3.0 | 3.3 | 2.3 | 1.0 | 7.9 |
| Nepal SBI Bank | 497.9 | 311.0 | 8,546.7 | 6,341.7 | 34.8 | 6,171.5 | 4,620.5 | 33.6 | 175.0 | 143.2 | 22.2 | 110.4 | 95.0 | 16.2 | 0.1 | 0.1 | 3.0 | 2.6 | 0.4 | 8.2 |
| Nepal Bangladesh Bank | 551.4 | 285.5 | 3,853.5 | 3,582.0 | 7.6 | 3,724.8 | 3,138.8 | 18.7 | 110.4 | 76.6 | 44.1 | 82.7 | 70.0 | 18.1 | 1.0 | 1.6 | 4.9 | 4.3 | 0.6 | 7.8 |
| Everest Bank | 460.6 | 543.3 | 9,281.1 | 7,918.8 | 17.2 | 7,355.0 | 5,918.3 | 24.3 | 235.5 | 118.1 | 99.4 | 152.5 | 120.9 | 26.1 | 0.7 | 0.6 | 4.2 | 2.0 | 2.2 | 7.0 |
| Bank of Kathmandu Lumbini | 562.9 | 303.6 | 7,067.5 | 4,072.0 | 73.6 | 6,274.0 | 3,485.5 | 80.0 | 124.9 | 74.3 | 68.1 | 88.6 | 48.4 | 83.1 | 1.8 | 3.8 | 4.7 | 4.0 | 0.7 | 9.4 |
| NCC Bank | 467.9 | 239.3 | 5,526.4 | 2,741.7 | 101.6 | 4,870.2 | 2,319.6 | 110.0 | 8.6 | 35.5 | (75.8) | 16.7 | 37.4 | (55.3) | 4.7 | 1.6 | 5.8 | 4.3 | 1.5 | 8.8 |
| NIC Asia Bank | 635.7 | 306.4 | 7,906.1 | 6,414.6 | 23.3 | 6,725.4 | 5,249.8 | 28.1 | 132.1 | 92.7 | 42.5 | 113.8 | 76.0 | 49.7 | 0.5 | 1.1 | 5.3 | 4.6 | 0.7 | 10.0 |
| Machhapuchchhre Bank | 659.8 | 175.8 | 5,804.8 | 4,843.9 | 19.8 | 5,305.8 | 4,081.7 | 30.0 | 133.1 | 86.7 | 53.5 | 100.6 | 62.4 | 61.2 | 0.4 | 0.6 | 4.3 | 3.9 | 0.4 | 8.3 |
| Kumari Bank | 326.5 | 114.3 | 3,903.5 | 3,482.2 | 12.1 | 3,448.6 | 2,869.6 | 20.2 | 50.8 | 43.8 | 16.0 | 37.5 | 35.5 | 5.6 | 1.3 | 2.0 | 5.3 | 4.5 | 0.8 | 10.3 |
| Laxmi Bank | 315.9 | 432.9 | 5,780.1 | 4,371.1 | 32.2 | 5,021.7 | 3,668.0 | 36.9 | 73.6 | 61.6 | 19.5 | 58.9 | 44.0 | 33.9 | 1.8 | 1.3 | 6.8 | 3.9 | 2.9 | 9.9 |
| Siddhartha Bank | 525.0 | 282.3 | 7,527.5 | 5,335.4 | 41.1 | 6,626.0 | 4,466.5 | 48.3 | 118.4 | 95.5 | 24.0 | 95.7 | 78.6 | 21.8 | 1.7 | 1.2 | 4.8 | 3.9 | 0.9 | 7.7 |
| Global IME Bank | 724.2 | 312.0 | 8,581.1 | 6,740.6 | 27.3 | 7,313.5 | 5,734.2 | 27.5 | 196.3 | 135.4 | 45.0 | 147.6 | 103.2 | 43.0 | 1.5 | 1.9 | 5.4 | 2.9 | 2.5 | 8.6 |
| Citizens Bank International | 587.6 | 217.6 | 5,556.0 | 4,437.4 | 25.2 | 4,780.0 | 3,784.3 | 26.3 | 88.7 | 75.9 | 16.9 | 88.2 | 72.5 | 21.7 | 1.6 | 1.8 | 7.1 | 4.0 | 3.1 | 10.3 |
| Prime Commercial Bank | 579.2 | 191.0 | 5,610.7 | 4,627.9 | 21.2 | 4,861.1 | 3,704.1 | 31.2 | 125.3 | 86.5 | 44.9 | 88.2 | 71.0 | 24.2 | 1.4 | 1.6 | 5.0 | 4.2 | 0.8 | 8.0 |
| Sunrise Bank | 545.3 | 200.8 | 5,806.2 | 4,128.3 | 40.6 | 5,086.6 | 3,377.4 | 50.6 | 119.4 | 64.7 | 84.5 | 85.7 | 58.8 | 45.7 | 1.5 | 2.3 | 5.2 | 4.7 | 0.5 | 9.5 |
| NMB Bank | 646.1 | 395.5 | 7,115.0 | 5,745.4 | 23.8 | 6,024.2 | 4,845.5 | 24.3 | 116.9 | 86.7 | 34.8 | 114.3 | 77.1 | 48.2 | 1.7 | 1.7 | 4.6 | 4.1 | 0.5 | 9.0 |
| Prabhu Bank | 588.1 | 189.2 | 7,160.2 | 5,454.2 | 31.3 | 5,959.4 | 4,435.7 | 34.4 | 117.2 | 52.6 | 122.8 | 144.5 | 75.8 | 90.6 | 4.3 | 10.0 | - | 3.6 | (3.6) | 8.3 |
| Janata Bank Nepal | 464.6 | 84.0 | 3,546.5 | 2,290.0 | 54.9 | 3,324.0 | 1,961.3 | 69.5 | 45.8 | 30.2 | 51.7 | 38.1 | 22.7 | 67.8 | 2.0 | 1.2 | 5.1 | 4.6 | 0.5 | 10.4 |
| Mega Bank | 458.2 | 102.8 | 3,844.3 | 2,606.5 | 47.5 | 3,493.6 | 2,190.6 | 59.5 | 80.2 | 46.0 | 74.3 | 54.2 | 32.3 | 67.8 | 0.9 | 1.3 | 5.5 | 3.8 | 1.7 | 11.4 |
| Civil Bank | 458.3 | 131.2 | 3,381.1 | 2,822.1 | 19.8 | 2,980.7 | 2,408.7 | 23.7 | 3.00 | 21.10 | (85.8) | 15.4 | 20.0 | (23.0) | 4.7 | 2.2 | 6.3 | 5.5 | 0.8 | 11.0 |
| Century Commercial Bank | 368.9 | 93.2 | 3,314.4 | 2,600.6 | 27.4 | 3,006.8 | 2,282.7 | 31.7 | 47.1 | 34.5 | 36.5 | 31.0 | 23.2 | 33.6 | 0.5 | 0.9 | 7.4 | 3.8 | 3.6 | 10.6 |
| Sanima Bank | 530.5 | 174.0 | 5,343.2 | 4,344.2 | 23.0 | 4,859.6 | 3,647.0 | 33.2 | 143.6 | 102.8 | 39.7 | 94.6 | 67.0 | 41.2 | 0.0 | 0.1 | 4.6 | 3.9 | 0.7 | 9.1 |
| **Public Sector Banks** | | | | | | | | | | | | | | | | | | | | |
| Nepal Bank | 745.9 | 276.4 | 8,395.4 | 8,263.1 | 1.6 | 7,420.9 | 5,982.0 | 24.1 | 220.0 | 122.2 | 80.0 | 251.5 | 164.3 | 53.1 | 2.9 | 3.7 | 1.9 | 2.1 | (0.2) | 5.9 |
| Rastriya Banijiya Bank | 858.8 | 209.1 | 13,536.4 | 13,007.7 | 4.1 | 10,136.4 | 7,929.0 | 27.8 | 181.1 | 146.1 | 24.0 | 207.4 | 162.0 | 28.0 | 2.7 | 3.5 | 1.3 | 1.9 | (0.6) | 5.8 |
| Agriculture Dev. Bank | 1,252.0 | 708.7 | 8,953.0 | 8,351.4 | 7.2 | 8,868.8 | 7,427.6 | 19.4 | 181.5 | 68.5 | 165.0 | 157.4 | 121.3 | 29.8 | 3.3 | 4.9 | 5.6 | 4.7 | 0.9 | 11.2 |
| **Total** | **16,340.7** | **9,019.8** | **195,273.4** | **161,018.3** | **21.3** | **164,432.4** | **124,538.0** | **32.0** | **3,985.2** | **2,785.4** | **43.1** | **3,141.4** | **2,350.4** | **33.7** | **1.6** | **2.0** | **4.5** | **3.6** | **0.9** | **8.7** |

by the Insurance Board. Recently, the Insurance Board has increased the paid-up capital requirement of Life Insurance companies to NPR 2 billion (USD 19.28 million) from NPR 500 million (USD 4.82 million) while Non-Life Insurance companies has to increase their capital to NPR 1 billion (USD 9.63 million) from NPR 250 million (USD 2.41 million). These companies have to increase their paid-up capital by the end of coming fiscal year 2017/18.

## Provision in the Budget for FY 2017-18

### Banking

- Financial Sector Development Strategy will be implemented to improve financial sector reform programs.
- BFIs will be encouraged to provide technology based financial services, such as branchless banking, internet banking, and mobile wallet services.
- The campaign 'bank account for all Nepalis' will be effectively implemented during the fiscal year.
- To increase private and foreign investments in infrastructure development, with participation of both domestic and international banks, an Infrastructure Development Bank will be established within upcoming FY 2017/18.
- Financial literacy programs will be implemented.
- Arrangements will be made to ensure that all the government payments, such as social security, salary/allowance and other payments made from national treasury, would be made only in the bank account of the concerned person or institution.
- Similarly, the government plans to make arrangements to collect revenue or taxes from e-payments.
- An arrangement will be made for e-payment of the international trade by obtaining e-gate way for international transactions.
- The government will make necessary arrangement for opening branch office of at least one commercial bank in each local unit, such as rural municipalities and municipalities, and obtain the electronic data of such fund in the Financial Comptroller's Office.
- A study will be carried out to establish a strong and effective institution by merging the funds like Youth Self Employment Fund, Rural Self Reliance Fund and Economic Revival Fund.

### Insurance

- Insurance companies will be motivated to expand their services nationwide and increase public awareness about it.
- Considering the fact that Nepali insurance companies are remitting a large chunk of money annually to reinsurance companies for the purpose of paying premiums for reinsuring their business abroad, a mandatory arrangement will be made for Nepali life and non-life insurance companies to reinsure major share of their insurance policies to Nepal Reinsurance Company.

## OUTLOOK

With successful completion of first round of local elections and the government accelerating spending during the last quarter of the fiscal year, the liquidity in the banking sector is expected to ease in coming days. However, the banks are less likely to expedite lending during the last quarter of the current fiscal year. On the flip side, with significant decline in the number of outbound migrant workers this fiscal year coupled with rising imports, it would be interesting to monitor the growth of deposits in the banking sector.

The much awaited Bank and Financial Institution Act (BAFIA) 2017 has been finally enacted by the President, after a long exercise in the Parliament. The Act is expected to strengthen good governance, accountability and transparency in the banking sector. As the FY 2016/17 comes to an end, many BFIs are yet to meet the new capital requirement stimulated by the central bank. It is most likely that many BFIs would further consolidate with other BFIs, while some BFIs might have to face regulatory actions for not meeting the stipulated capital. Further, as the government has outlined the fiscal policy, the upcoming monetary policy for the FY 2017/18 will play a significant role in carrying out the plans and actions outlined by the government.

# CAPITAL MARKET

The secondary market was able to recover by 22.48% to close above 1,600 points during the review period—February 26 to May 31, 2017—as demand for scrip's of Insurance and micro-finance institutions mounted in the market.

## Secondary market

During the review period, the Nepal Stock Exchange (NEPSE) benchmark index increased by 22.48% (295.10 points) to close above 1,600 points. At the end of the review period, the total market capitalization had reached NPR 1.88 trillion (USD 18.12 billion) while the total floated market capitalization was NPR 647 billion (USD 6.23 billion).

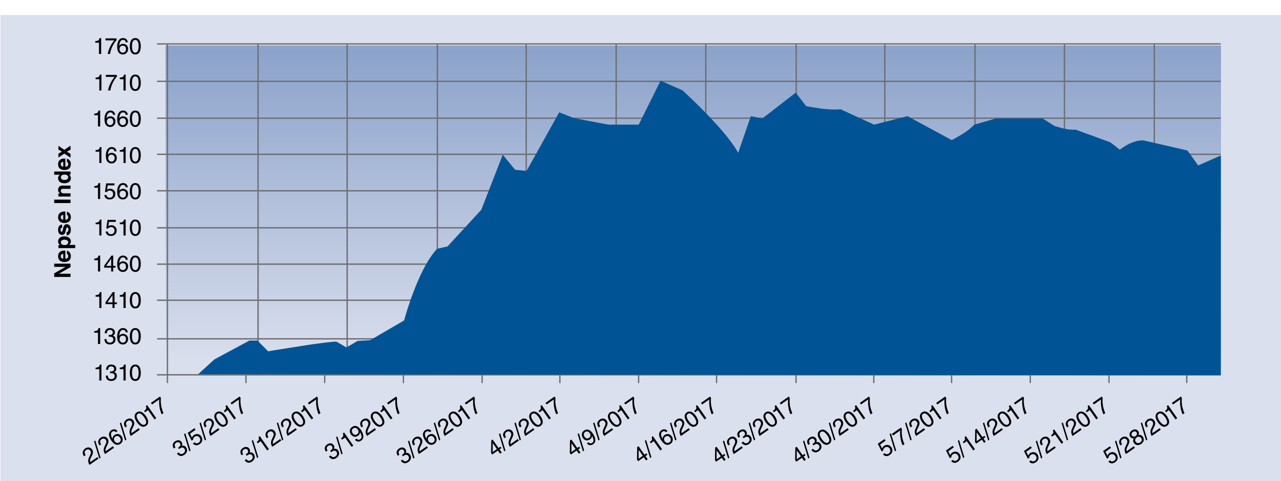
As shown in Table 8 below, during the review period, all the sub-indices ended in green zone led by the Insurance sub-index which went up by 51.68%. The sub-index surged with the Insurance Board increasing the paid-up capital requirement for the all insurance companies. The Development banking (+35.99%) and the Hotels sub-index (35.19%) followed suit as investors were attracted to the scrip of these sectors.

### Table 7: Key Indicators

| Indicators | 26-Feb-17 | 31-May-17 | % change |
|---|---|---|---|
| **NEPSE Index** | **1313.01** | **1608.11** | **22.48%** |
| Commercial Bank Index | 1255.57 | 1431.21 | 13.99% |
| Development Bank Index | 1439.41 | 1957.54 | 35.99% |
| Finance Index | 607.45 | 776.21 | 27.78% |
| Insurance Index | 5686.49 | 8625.36 | 51.68% |
| Hydropower Index | 1531.61 | 2045.95 | 33.58% |
| Manufacturing & Processing Index | 2137.93 | 2428.09 | 13.57% |
| Hotel Index | 1676.69 | 2266.8 | 35.19% |
| Others Index | 658.84 | 698.46 | 6.01% |

*Source: NEPSE*

### Figure 15: NEPSE Index performance




*Source: NEPSE*

## Primary Market

In the public issue front, market witnessed four Initial Public Offerings (IPOs) including one mutual fund scheme during the review period.

- Swadeshi Microfinance issued 300,000 unit shares worth NPR 30 million (USD 290,000). After the allotment, the paid capital will reach NPR 100 million (USD 960,000) from its current capital of NPR 70 million (USD 670,000).
- Mahuli Samudayik Microfinance floated 120,000 unit shares worth NPR 12 million (USD 120,000). After the public offering, its paid up capital will increase from NPR 28 million (USD 270,000) to NPR 40 million (USD 390,000).
- Laxmi Equity Fund, a close ended seven-year equity oriented scheme managed by Laxmi Capital Market had issued 100 million units worth NPR 1 billion (USD 9.6 million), with a face value of NPR 10 per unit. The mutual fund issue was assigned AMC Quality 3 by ICRA Nepal, indicating adequate assurance and management quality.
- Chhyangdi Hydropower Company Limited floated 540,000 unit shares worth NPR 5.4 million (USD 52,000) to the general public, the issue was assigned IPO grade 4 by ICRA Nepal, indicating below average fundamentals.

## Key Developments

Fresh Regulations from SEBON: Securities Board of Nepal (SEBON) has enacted 'Securitas Issue and Allotment Directive 2017'.The new directive provides operational guidelines on premium pricing for IPOs, pricing mechanism for Further Public Offering (FPO) and new allotment model, amongst others. As per the new allotment rules, each investor should be allotted a minimum of ten units whenever possible, while the shares have to be allotted within 20 days from the date of offer closure. Similarly, SEBON has amended 'Securities Businessperson (stock brokers, security dealers and market maker) regulation 2008', and according to amended regulation stock brokers will have to increase their paid-up capital to NPR 20 million (USD 0.19 million) from existing NPR 2 million (USD 0.019 million ), amongst others.

**Full implementation of ASBA:** SEBON has made Applications Supported by Blocked Amount (ASBA) process mandatory for all the public issues—i.e. Initial Public offering (IPO), Further Public Offering (FPO) and mutual fund schemes—from Shrawan 1, 2074 (July 16, 2017) , after which the timeframe for the allotment of share will be reduced to 20 days. Meanwhile, many Banks and Financial Institutions (BFIs) have reduced ASBA fees while a few of them have been providing the service free of cost. Further, to make this ASBA process more effective and organized, SEBON has directed representatives of CDS and Clearing (CDSC) and Nepal Merchant Banker Association (NMBA) to make the system online. The board has also given recommendations such as modifying the ASBA charges as well as simplifying the application forms and online data transfer from ASBA bank members to the merchant bankers.

**Telecom Companies need to go public:** As per the amended Companies Act 2007, telecom companies with a capital investment above NPR 50 million (USD 480,000) will now be required to issue shares to the general public. Currently there are six telecom companies operating in Nepal, namely Nepal Telecom, Ncell, United Telecom, STM Telecom, Smart Telecom and Nepal Satellite. However, so far, only Nepal Telecom has issued shares to the general public.[106]

## Provision in the Budget for FY 2017/18

- Policy and institutional arrangements will be made for development and stability of capital markets.
- Manufacturing companies will be encouraged to enter the capital market.
- Stock exchange market will be made transparent and fully automated.
- Membership of the international regulatory institution on securities market will be obtained.

## OUTLOOK

Even though a series of positive events have unfolded in third quarter, such as good financial results of listed companies, mainly Banking and Financial Institutions (BFIs); upward revision on economic growth by the government and multilateral bodies; timely announcement of fiscal budget for the FY 2017/18; and successful completion of first phase of local level election; the secondary market has remained volatile with low market volumes. The sluggish movement of the secondary market clearly indicates low confidence of investors on account of political uncertainty. The market is likely to be dicey in the coming days as investors seem to have adopted 'wait and watch' approach until the second phase of local elections are over. Moreover, the fiscal policy for the FY 2017/18 has failed to excite investors as there are not any encouraging announcements specific to development of capital markets in Nepal.

On a positive note, Securities Board of Nepal (SEBON)—apex regulator of capital markets in Nepal—has been continuously coming out with new and updated regulations one after another to accommodate and facilitate new changes in the securities market. The new 'Securities Issue and Allotment Directive 2017' is likely to attract larger participation of investors in the primary market as it ensures every applicant a minimum of 10 units whenever possible. Likewise, the directive also provides operational clarity for real sector companies to issue initial offering to the general public at premium. The directive is likely to attract real sector companies interested to collect long-term capital from the primary market. Further, the increment of stock brokers' presence outside Kathmandu is expected to increase market size and demand for scrip in the coming days.

5

NEPALI CAPITAL MARKET:
# OPPORTUNITIES AND CHALLENGES

# FOREWORD

**Dr. Rewat Bahadur Karki, Chairman,**
Securities Board of Nepal (SEBON)

The Nepali capital market has come a long way since the inception of Securities Board of Nepal (SEBON) 25 years ago. However, we have to admit that we have not been ableto attain the desired growth owing to various internal and external constraints. Political instability leading to frequent changes in the government, weak institutional capacity of stock exchange and CDSC including the SEBON, lack of institutional investor and poor financial literacy regarding capital markets are some of the key bottlenecks to name a few.

The history of securities market in Nepal commenced in 1937 with the floatation of shares by Biratnagar Jute Mills Limited and Nepal Bank Limited. Since then the securities market in the country is increasing both in terms of depth (volume) and width (kinds of instrument) along with growing awareness and interest amongst the general public. Still, we believe that in comparison to the growth of Nepali financial market, sufficient financial infrastructure has not been established to sustain and support the growth.

Although the market is still in its evolutionary stage, the role it can play inthe economic development of the country as a key mobilizer of financial resources has also been felt lately. And we believe that we have added responsibility and challenges as a primary regulator of capital markets. Since our establishment, we have been operating with three objectives: to protect the interest of the investors, develop the securities market and to regulate and supervise the market.

Despite various challenges, we have been working rigorously towards capital markets modernization in Nepal with support from the government in recent years. Some of the key breakthroughs we have achieved lately, which we believe are going to be a game-changer for development of capital markets in the country, are: fully automatedtrading of securities at Nepal Stock Exchange (NEPSE) from beginning of 2016; enactment of the Securities Registration and Issuance Regulation 2016 to attract real sector companies; introduction of Securities Issue and Allotment Guidelines 2017 and amendment of Securities Businessperson (stock broker, securities dealer, and market maker) Regulation 2008;launch of Application Supported by Block Amount (ASBA) system for initial offering (IPO/FPO) in the primary market via 2,300 branches of banks and financial institutions across all 75 districts; Policy shift from fixed pricing system to open pricing system with some cap in IPO; expansion of stock brokers' offices outside Kathmandu Valley; decision in principle to allow to set up one additional stock exchange from the private sector along with the structural reform i.e. corporatization of NEPSE and CDSC; and opening doors to issue local currency bonds via international financial institutions.

We are currently working on various reforms to further modernize and develop our market. We have currently halted the issuance of new licenses for merchant bankers as we are working on amending the existing Securities Businessperson (Merchant Banker) Regulation 2008 to enhance their scope of work and capital requirement. Likewise, we are trying to improve and expand investors' awareness and education programs to both accessible and remote districts of Nepal. Similarly, the Commodities Act is pendingfor approval at the Parliament which will further develop commodities market in Nepal, which also comes under SEBON jurisdiction as mandated by new commodities bill. Similarly, we have taken the responsibility to develop regulations for Venture Capital (VC) and Private Equities (PE) funds and are also working on allowing Non-Resident Nepali's (NRNs) and Foreign Institutional investors (FIIs) in our secondary market. Further, we have been requesting the government to provide tax deduction on income tax for individuals making investments in mutual funds schemes and establish a training institute to facilitate investor's education.

Of late, we have also been focusing on strengthening our institutional capacity for prompt supervision, monitoring and prudent regulation. It gives me immense pleasure to announce that we have been able to receive associate membership of the International Organization of Securities Commission (IOSCO).We believe that such partnership will help us to further develop and regulate our market as per international standards, educate investors and facilitate foreign investments. Finally, I would like to take this opportunity to thank Nepal Economic Forum for their commendable effort in bringing out this special issue on Nepali capital market and also the key stakeholders for providing their valuable insights and inputs for this issue.

# UNDERSTANDING NEPALI CAPITAL MARKET

## Understanding capital markets?

The capital market comprises of the equity (stock) market and debt (bond and debentures) market where the buyers and sellers engage in the trade of equity and debt instruments. Further the market is divided into primary market and secondary market. The primary market deals with issuance of new stocks and other securities such as bonds and mutual funds, whereas secondary market deals with the trade of existent securities.

Capital market are a key part of the overall financial system as it facilitates the process of channeling savings and investments between suppliers of capital such as retail investors and institutional investors, and users of capital such as business, government and individuals. Capital market is essential in providing an alternative medium to mobilize long term financial resources and helps the economy to generate savings and encourages investment activities. The growth and deepening of capital markets can have a significant positive effect on national growth and development.

## Overview of Nepali Capital Market

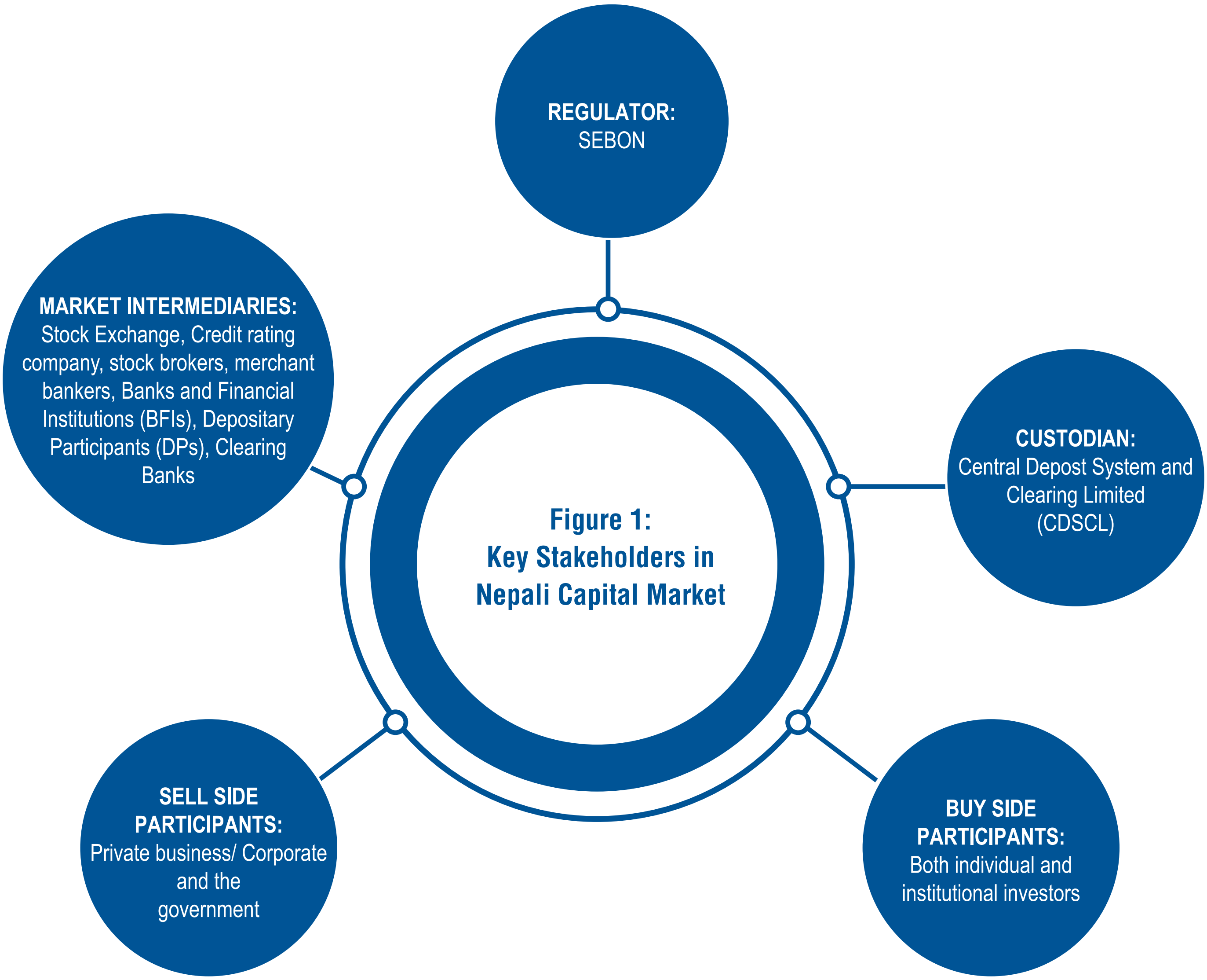
The securities market of Nepal started in the year 1973 with the flotation of shares by Biratnagar Jute Mills Ltd. However, a more systematic trading of securities began with the establishment of Nepal Stock Exchange (NEPSE) and Securities Board of Nepal (SEBON) in 1993 under the capital market reform program initiated by the government. SEBON is the regulator of the capital market in Nepal while Nepal Stock Exchange, owned by the government, is the only stock market in Nepal. Since the establishment of these Institutions, Nepali capital market has come a long way, as the market has increased both in

### Table 1: Key Developments in the Nepali capital market

| Year | Key Developments |
|---|---|
| 1937 | Primary flotation of shares by Biratnagar Jute Mills and Nepal Bank Limited |
| 1964 | Introduction of Government Bond |
| 1976 | Establishment of Securities Exchange Center Limited (SECL) |
| 1993 | Converted SECL into Nepal Stock Exchange Limited (NEPSE)<br>Establishment of Securities Board of Nepal (SEBON) as an apex regulator of securities market |
| 2007 | Introduced fully automated screen based trading replacing the open-cry-out system at NEPSE |
| 2011 | Establishment of Central Securities Depository System (CDS and Clearing Limited) to provide centralized depositary, clearing and settlement services |
| 2016 | Beginning of dematerialize form of share trading at NEPSE replacing paper based clearing and settlement system |
| 2017 | Introduction of Applications Supported by Blocked Amount (ASBA) system |

### Table 2 Key stakeholders in Nepali Capital Market

| | |
|---|---|
| Securities Board of Nepal (SEBON) | Apex regulator of capital market |
| Nepal Stock Exchange (NEPSE) | Sole secondary market |
| Central Deposit System and Clearing Limited (CDSCL) | Subsidiary of Nepal Stock Exchange (NEPSE) |
| No. of Credit Rating Company | 1 |
| No. of Depositary Participants (DP's) | 68 |
| No. of Stock Brokers | 50 |
| No. of Merchant Bankers | 23 |
| No. of Mutual Funds | 9 |
| No. of ASBA affiliated Banks and Financial Institutions (BFIs) | 52 |
| No. of Clearing Banks | 4 |
| No. of Listed Companies | 212 |




terms of depth (volume) and width (kinds of instruments). However, in comparison to growth of Nepali financial market, sufficient financial infrastructure has not been setup to sustain and support the growth.

Lately people's interest toward capital market has been increasing, indicated by overwhelming participation in both primary offerings of securities and increased volume in the secondary market.

### Primary Market

In the primary market front, the market has seen an increasing number of primary offers mostly in the form of equities, right shares, Initial Public Offer (IPO) or Further Public Offer (FPO) of ordinary shares. Besides these ordinary shares, the presence of corporate and government bonds along with mutual fund schemes have also been felt in the primary market. Due to attractive returns and increased awareness about capital markets, these have been receiving overwhelming response and the primary offerings have been oversubscribed by multiple folds. As per the latest data, the number of Depositary Participants (DP)—Account Holders with Central Depositary and Clearing Limited (CDSL)—was 831,880, indicating increasing number of investors in the Nepali capital market. Moreover, with changes in Securities Issuance and allotment guidelines, the primary market is likely to witness entry of real sector companies and higher number of investors.

### Table 3: Primary Market Statistics (In NPR ten millions)

| Details | Fiscal Year | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 07/08 | 08/09 | 09/10 | 10/11 | 11/12 | 12/13 | 13/14 | 14/15 | 15/16 | 16/17* |
| Ordinary Shares (IPO) | 92.5 | 181.6 | 264.9 | 172.9 | 129.9 | 318.7 | 157.4 | 697.7 | 276 | 103 |
| Rights Shares | 609.3 | 1,426.3 | 817.3 | 507.5 | 45.2 | 393.5 | 424.3 | 230.8 | 940 | 2,301 |
| Bonds & Debentures | 295 | 75 | 0 | 5 | 120 | 355 | 145 | 290 | 0 | 0 |
| Further Public Offering (FPO) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 583 | 778 |
| Mutual Funds | 0 | 0 | 0 | 0 | 0 | 0 | 80 | 225 | 100 | 285 |
| Total Capital Mobilization | 996.8 | 1,682.9 | 1,082.2 | 685.4 | 295 | 1,067.2 | 806.7 | 1,443.5 | 1,899 | 3,467 |

*Source: Economic Survey FY 2015/16 and FY 2016/17, *Based on first 8 months' data of 2016/17*

Total primary issue amounting to NPR 1.8 billion (USD 17.3 million) were made in FY 2015/16 while issues amounting to NPR 1.4 billion (USD 13.5 million) was made in FY 2014/15. In the first eight months of current fiscal year 2016/17, the primary market has already mobilized issues amounting to NPR 3.4 billion (USD 32.8 million), out of which right shares worth NPR 2.3 billion (USD 22.2 million) was issued.

### Secondary Market

All the secondary market trading is conducted through NEPSE. As of mid-May 2017, there were 212 listed companies on NEPSE. The sole secondary market has seen a steady growth in terms of volume and market capitalization over the years.

mid-March 2017. Likewise, at the end of mid-March 2017, the total market capitalization has now reached NPR 1.5 trillion (USD 14.5 billion). This amounts to 59.13% of GDP, but the amount of stock that is free floating is much less than this, because promoters shares are not frequently traded in the secondary market. The total floated market capitalization as of mid-May 2017 is NPR 515.9 billion (USD 5 billion) which amount to 25.7% of GDP.

The secondary market of Nepal is mostly dominated by financial institutions, out of 212 listed companies, 80% of listed companies are from the financial sector. However, the recently introduced 'Securities Issue and Allotment Directive 2017' has laid down guidelines to ease the entry of real sector companies through various provisions.

### Table 4: Secondary Market Statistics

| Details | Fiscal Year | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 07/08 | 08/09 | 09/10 | 10/11 | 11/12 | 12/13 | 13/14 | 14/15 | 15/16 | 16/17* |
| NEPSE Index | 963.4 | 749.1 | 477.7 | 362.9 | 389.7 | 518.3 | 1,036.1 | 961.2 | 1,718.2 | 1,355.2 |
| No. of Listed companies | 142 | 159 | 176 | 209 | 216 | 230 | 233 | 232 | 229 | 212 |
| Total Turnover (In NPR billions) | 22.8 | 21.7 | 11.9 | 6.7 | 10.3 | 22 | 77.3 | 65.3 | 164 | 132.3 |
| Total Market Capitalization (In NPR billions) | 366.2 | 512.9 | 376.9 | 323.5 | 368.3 | 514.5 | 1,057.2 | 989.4 | 1,890.1 | 1,536.9 |

*Source: Economic Survey FY 2015/16, 2016/17, *Based on first 8 months' data of 2016/17*

The sole benchmark index has been in a bullish trend for the past few fiscal years after it reach to a lowest point in the FY 2010/11, the market closed at 1622.54 points as on June 7, 2017. The total yearly market turnover has increased from NPR 22.82 billion (USD 220 million) in the year 2007/08 to NPR 132.34 billion (USD 1.27 billion) at the end of

Meanwhile, online trading is expected to be available by the end of second quarter of FY 2017/18. With the entry of real sector players and possible availability of online trading, the secondary market is expected to be more dynamic and the number of market participants is expected to increase substantially in the coming years.

**Figure 2: NEPSE benchmark index's long term performance (April 2005 to 12th June 2017)**

# LEARNING FROM REGIONAL MARKETS

Capital Markets in South Asia have made considerable progress in the last two decades. Many countries in the region now have a functioning capital markets with regulations and structures based on international practices.[107] While there are substantial differences in the size and level of development among different capital markets, South Asia is experiencing a rapid growth in primary and secondary markets. The rapid growth in economy and financial sector of India, the inclusive growth approach of Bangladesh, the peace dividend in Sri Lanka and the prospects of growth in Nepal holds prospect for the international investing community.[108]

The Indian capital market is by far the largest in the region with 5,820 listed domestic companies and a market capitalization of about 72.586% of GDP at the end of 2015. The total trading of the Indian capital market is split approximately by 80/20 between the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE), the two main stock exchanges that operate nationwide.

## India's embark on a comprehensive reform

The securities market in India began in the late 18th century with the trading in the securities of East India Company in Mumbai and Calcutta.[109] In July 1875, the first stock exchange, Bombay Stock Exchange (BSE), was formed following a period of brisk trading and speculation in securities.

The real transformation of India's financial market began in the early 1990's with economic liberalization and market oriented reforms. India's capital markets began to stage extensive changes with the establishment of the Securities and Exchange Board of India (SEBI) in 1992 as an independent market regulator that helped to enhance investor protection and corporate disclosure.[110] The repeal of Controller of Capital Issues (CCI) in the same year put administrative controls over the pricing of new equity issues. Then the inception of National Stock Exchange (NSE) in 1994 led to a significant rise in volume of transactions and instruments in financial intermediation.[111] The introduction of the modern Open Electronic Limit Order Book (ELOB), which replaced the open outcry system of trading, paved a way for an integrated national market. The technological development in India has made investing safer and hassle free, encouraging more people to join the capital market. The opening up of the Indian economy has also increased the flow of Foreign Direct Investment (FDI) and put India on a global map as a new force to reckon with.

The development of a derivative market in 2000 with trading in stock index future has significantly enhanced the maturity of the market through greater variety of innovative products for investment. A number of measures have also been taken to manage the risks in the market and protect its integrity. By the fourth quarter of 2001, each of India's two largest exchanges—BSE and NSE—had four equity-derivative products: futures and options for single stocks, and their respective stock indices.[112] NSE ranked fourth globally in trading index futures, a sign of an evolving and maturing market.

Today, India's stock markets rank among the most expensive in the world. There are 21 stock exchanges in India along with NSE and BSE. According to the World Federation of Exchanges, the NSE has become the leading stock exchange in the country and the fourth largest in the world by equity trading volume in 2015.

**Table 5 Key figures of regional countires**

| | GDP per capita (current US $) | | Market Cap of listed domestic companies % of GDP | | Turnover ratio of domestic shares (%) | | Listed domestic companies | |
|---|---|---|---|---|---|---|---|---|
| Countries | 2005 | 2015 | 2005 | 2015 | 2005 | 2015 | 2005 | 2015 |
| India | 729.0 | 1,593.1 | 66.3 | 72.6 | 83.9 | 50.9 | 4,763.0 | 5,820.0 |
| Bangladesh | 485.9 | 1,211.7 | 4.8 | 37.1* | 6.2 | 4.7* | 195.0 | 543.0 |
| Srilanka | 1,259.8 | 3,926.2 | 23.4 | 25.3 | 18.9 | 8.6 | 239.0 | 294.0 |
| Pakistan | 714.0 | 1,434.7 | 41.4 | 15.2* | 307.7 | 29.6* | 639.0 | 557^ |

*Source: World Bank Data, *2011 figures, ^2014 figures*

**Table 6 Annual Average of Major Indices and their Market Capitalization**

| Year/Month | S&P SE Sensex | NIFTY 50 index | Market Capitalization (In INR ten millions) | |
|---|---|---|---|---|
| | | | BSE | NSE |
| 2010-2011 | 18,605 | 5,584 | 68,39,084 | 67,02,616 |
| 2011-2012 | 17,423 | 5,243 | 62,14,941 | 60,96,518 |
| 2012-2013 | 18,202 | 5,257 | 53,48,645 | 52,32,273 |
| 2013-2014 | 20,120* | 6,010 | 74,15,296 | 72,77,720 |
| 2014-2015 | 26,557 | 7,967 | 1,01,49,290 | 99,30,122 |
| 2015-2016 | 26,322 | 7,984 | 94,75,328 | 93,10,471 |
| Apr 15-Dec15 | 26,948 | 8,167 | 100,37,734 | 98,31,658 |
| April 16-Dec 16 | 27,036 | 8,311 | 106,23,347 | 104,39,621 |

*Source: SEBI Handbook of Statistics 2016; Note: Market Capitalization is as on last trading day of the respective year.*

## Key Game changers that helped to develop Indian Capital Markets

- Economic liberalization and the opening up the economy to market forces
- Regulatory environment with the emergence of SEBI
- Establishment of National Stock Exchange (NSE) which helped to widen the market
- Modern Open Electronic Limit Order Book (ELOB) and consequent countrywide integration of market
- Application of technology in the payment and settlement systems
- Development of the Derivative Market
- Economic Growth

In last couple of years, Indian financial market recorded a phenomenal growth as stock market capitalization reached a trillion USD.[113] Driven by robust economic demand, consumption and savings rate, the capital markets continues to exhibit a growth. Historically, Indian BSE Sensex reached an all-time high of 30,602.34 in May, 2017.[114]

Boston Consulting Group has predicted Indian consumer market to be the third largest in the world by 2025.[115] These evolving spending patterns will have substantial impact on India's growing capital market.

### Lessons from Indian Capital market

The Indian capital market has undergone a lot of innovation coupled with many reforms and development over the years. With a structured regulatory mechanism and a robust market infrastructure as well as growing market capitalization and liquidity, it is now in par with International capital markets.

In a country like Nepal, whose capital market is still at an early stage of development, we can enhance market efficiency and transparency by developing a sophisticated and competitive environment for financial intermediation.[116] Like in India, a strong regulatory and legal framework is fundamental for providing market participants with the confidence to enter the market. Initiatives must be taken to improve corporate governance and protect investors, particularly minority shareholders who have little knowledge of the risk and return considerations. The investor base must be broadened through reforms which in turn will encourage both domestic and foreign investments.

# KEY STAKEHOLDER'S PERSPECTIVE

## PERSPECTIVE: REGULATORS

**Niraj Giri**
Executive Director
Regulation and Management
Department, SEBON

**Paristha Nath Poudyal**
Executive Director
Supervision and Research
Department, SEBON

Securities Board of Nepal (SEBON) was established by the government in June 1993 as an apex regulator of securities market, and it has been regulating the market as per the Securities Act 2006. Some of the key duties of SEBON according to the Act are issuing necessary securities regulations and directives, supervision, issuance of license and registration of securities.

As the Nepali capital market continues to evolve, we have greater challenges and responsibilities in terms of creating prudent regulations, monitoring & supervision and protecting investors. Currently, SEBON is supervising more than 450 entities participating in the capital market such as stock exchange, merchant bankers, stock brokers, listed companies, clearing and settlement member, credit rating companies, mutual fund schemes, Bank and Financial Institutions (BFIs) participating in Applications Supported by Blocked Amount (ASBA) system, and Depositary Participants (DPs), among others.

With the growing number of market participants offering various services, supervision has become a challenge for us. We have already recruited 27 additional staff and are in the process of hiring additional 14 staffs. This has helped us to become proactive and take prompt actions to some extent. Moreover, as the market size increases, there is a need to establish regional offices outside Kathmandu with an active enforcement team under the supervision department that has the capacity to dig out issues and take actions. Recently we received associate membership of International Organization of Securities Commission (IOSCO); however we need to work on information sharing system and develop co-ordination amongst regulators to achieve full membership, which we believe is vital to develop our institutional capacity and network. Moreover, SEBON now has the responsibility to outline strategies as environed in the Financial Sector Development Strategy 2016/17-2020/21 to develop the overall capital market.

Realizing the need to create adequate infrastructure to support the robust growth, we have been rigorously working on amending and bringing out new regulations, directives, guidelines and circulars. Some of the key regulatory changes we are currently working on are as follows:

- **Creating legal grounds to attract real sector companies:** The government has already amended the 'Securities Registration and Issuance Regulation 2016' and the recently introduced 'Securities Issue and Allotment Directive 2017' provide further operating guidelines and clarity to ease the entry of real sector companies. The directive allows the real sector companies to sell shares at a premium and provides them the liberty to sell only 10% to 15% of shares to the general public.

- **New allotment module to encourage wider participation of individual investors:** New allotment module is another important provision in the recently released 'Securities Issue and Allotment Directive 2017'. As ASBA system provides access to participate in primary offering from across 75 districts, only natural persons would be allowed to take part in the primary offering of securities to ensure higher allotment. Only in case of under subscription it will be open to other institutional investors via auction. This provision is expected to make the market vibrant as it will increase market base, participation and trading volume in the secondary market. Moreover, as per the new directive the public offering should be allotted within 20 days and get listed in the secondary market within 2 months.
- **Enhancing institutional capacity of stock brokers:** The Securities Businessperson (stock brokers, security dealers and market maker) regulation 2008 has been recently amended with the objective to enhance the capacity of stock brokers and minimize market risk. Some of the new requirements under the amended regulation are: increment of paid-up capital by 10 times to NPR 20 million (approx. USD 200,000); permission is required from SEBON to open up new branches; arrangement of adequate human resource with required education.
- **Opening up new areas to merchant bankers and strengthen their capital base:** The existing 'Securities Businessperson (merchant bankers) regulation 2008' is being amended to open new areas of services and increment of their minimum capital requirement. Some of the new areas that are going to open up are advisory for Private Equity and Venture Capitals, investment advisory services and loan syndication and retirement fund management, amongst others.
- **Commodities Act:** Regulations governing the commodities market have already been formulated and is waiting for approval from the Parliament.

Likewise, we have also started the groundwork on the following rules and regulations:

- **To introduce a consolidated code of conduct:** Corporate governance has become a major issue for the sectors that do not have a direct regulatory body. The hydropower sector is a case in point. Meanwhile, lack of such regulatory body is one of the main deterrents for the entry of real sector companies. There are already sector specific corporate governance codes of conduct issued by Central bank and Insurance Board for the companies under their regulation. However, to provide uniformity, we are working on a consolidated fundamental code of corporate governance applicable to all listed companies.
- **Opening up legal grounds for Private Equity (PE) and Venture Capital (VC) funds:** As pre-IPO market is important for the growth of businesses, creating legal infrastructure for PEs and VC's are essential. Hence, we are initiating work on developing a separate regulation for these firms to operate in Nepal. The work is still in the preliminary phase and will take some time for it to be completed.
- **Amendment of Securities Act 2007:** A few changes have to be made in the existing Securities Act 2007 so that it can accommodate the new changes in the securities market. The market has changed drastically in last ten years. SEBON today requires greater autonomy with the ability to approve market issues on our own to ensure that issues are resolved on a timely manner and capital market plans are timely developed and implemented. The existing approval system often takes a lot of time and energy. The Financial Sector Development Strategy (FSDS) has clearly outlined to provide autonomy to SEBON as per international practice.

Apart from these regulatory and supervisory changes, we have been lobbying with the government to provide various incentives and support for the overall development of the securities market. Few of the key recommendation are:

- Establishment of a dedicated Capital Market Training Institute which could provide adequate training and certification programs. It will help to educate both investors and develop human capital required for the market participants.
- To levy Transaction Tax Instead of Capital Gain Tax (CGT) on secondary market transactions.
- To consider merchant bankers and stock brokers as participants of financial sector service providers. Financial sector service providers do not have to pay Value Added Taxes (VAT) to the government.
- To provide tax deduction on personal income tax for investments made in mutual funds.

# PERSPECTIVE: STOCK EXCHANGE

**Sitaram Thapaliya**
Chief Executive Officer,
Nepal Stock Exchange Limited

Nepal Stock Exchange (NEPSE), the only secondary market of Nepal, is co-owned by the government, Nepal Rastra Bank andNIDC Development Bank including its member'si.e. stock brokers and market makers. It is established under the Company Act and is operated under Securities Exchange Act, 1983, to facilitate transactions of various securities.

With the view of facilitating and promoting the growth of capital markets, Securities ExchangeCenter Limited (SECL) was established in 2033 BS (1976) and Securities Act was endorsedon 2040 BS (1983). The SecuritiesAct was brought into specializationand established as an Act on 2050 BS (1993) after which SECL was converted into NEPSE. NEPSE then started trading through open-out-cry system with only 62 listed companies from Poush 29, 2050 BS (January 13, 1994) by giving license to 25 brokers. Later, in the year 2064 BS, the open-out-cry system was converted to an automated trading computerized system.

The transaction volume, number of investors as well as number of stock brokers (50) have substantially increased over the years. Meanwhile, trading activities have been expanded beyond the Kathmandu Valley—currently there are 42 branch offices (Remote Work Stations) of stock brokers outside the valley. In the present context, with changes in the market dynamics, following issues need to be considered and pondered upon.

1) **Implementing the bylaws:** A number of key bylaws such as trading bylaws, listing bylaws, auction market procedures, trade guarantee fund procedures and trade cancellation procedures are currently under review with the regulatory body. The services provided by the exchange in coming days could enhance and improve with the approval of these bylaws and are essential for the overall development of the secondary market. Likewise, the bylaws formulated by stock exchange for Rights renouncement provisionin 2063 are still pending for approval.
2) **Privatization of the stock exchange:** Various exercises have been carried out to privatize the stock exchange in the past.However, due to various limitations we have failed to materialize the issue so far. In the year 2064 we had initially launched NEPSE's privatization model such that the shares of the stock exchange will be sold to listed companies with good governance. But later getting a strategic partner from abroad was considered beneficial since they will be bringing in the technological know-how and capital. Bringing in international stock exchange will also help in conducting cross-border transactions initially within the South Asiancountries. Still, though Memorandum of Understanding (MOU) has been signed, provision of getting a strategic partner is still pending at the Ministry. A detail study report has been submitted to Ministry of Finance (MoF) in September10, 2015. Likewise, the MoU with National Stock Exchange (NSE) India has given us the opportunity to train NEPSE's employees, product development and bring efficiency in other necessary functions. Thegovernments as well as other concerned bodies need to take initiative to materialize the process as it isessential for providing value added services to investors.
3) **Increment in the tradable products:** The tradable products in the stock market have been defined by the Securities Act. Currently, shares, bonds, debenturesand convertiblepreferred stock are allowed to be traded in the stock exchange. However, there is a need of increment in the tradable products along with the growth of the capital market. The stakeholders of the capital market need to work together to expand the number of tradable products so that investors have a choice amongst various trading instruments.
4) **Sufficiency of one stock exchange:** Currently, worldwide, stock exchanges have started to integrate.

For instance, in Pakistan, three stock exchanges have merged to become one. Similarly, there has been consolidation of stock exchanges in India. Since Nepal is a relatively small market, a single stock exchange can efficiently cater to the market demand provided that the current stock exchange is developed and diversified. Meanwhile, if internet based transactions beginin the near future, the access to the stock market and consequently the user base will increase substantially.

5) **Develop debtmarket:** The government bonds are currently nottraded in the stock exchange mainly due to the presence of parallel market. Various market makers as well as the brokers are given license to trade these bonds. However, these bonds are only being traded via the market maker since the process of trading through the brokers is lengthy and time consuming. Meanwhile, corporate bonds are rarely traded; the reason being good companies issuing bonds at a relatively higher rate than the current bank rate. As a result, the investors do not have the incentive to sell those bonds in the secondary market. Therefore, the governments as well as the regulatory bodies need to look into these issues to develop the debt market.

6) **Fully automated trading, clearing and settlement:** Post full operation of Central Depositary and Clearing Limited (CDSL)—a subsidiary of NEPSE—the trading volume and client base in the secondary market has increased by multiple folds as it provided quick clearing and settlement (electronic) of shares being traded in the market. Likewise, we are currently in the process to replace our existing trading software with fully automated online trading facilities, which will allow investors from across Nepal to participate in the market. If the development happens as per our plan, we will be able to launch online trading within second quarter of FY 2017/18.

Over the years, NEPSE has put in numerous efforts for the development of the securities market, from investors education and awareness programs to various measures to modernize our market. As the market evolves we would require greater support and guidance from the government, regulators and other key stakeholders. As we are moving towards fully automated online trading in near future, the new system is going to change the dynamics of our secondary markets from number of marketparticipants totrading volume and market outreach, amongst others. Moreover, we are also working on bringing additional tradable instruments and services soon to provide additional investment opportunities. Nonetheless, despite numerous challenges we are moving forward and are dedicated towards overall development of capital market in Nepal, and are confident that we will provide better services in the coming days.

# PERSPECTIVE: MERCHANT BANKERS

**Pravin Raman Parajuli**
Chief Executive Officer
Nabil Investment Banking Ltd.

Merchant bankers are licensed and regulated by SEBON as per the securities Businessperson (Merchant Banker) Regulations, 2008. There are currently 22 merchant banks operating in Nepal providing four major services such as Issue management, underwriting, registrar to shares and Portfolio Management Services which majority of subsidiary of Banks & Financial Institutions (BFIs) are also rendering Fund Management & Depository Services under Mutual Funds and Depository Participant (DP) related services under Central Depository System (CDS) . Out of these merchant bankers, seven are promoted by private entities, 14 of them are subsidiaries of BFIs while one is promoted by Citizens Investment Trust (CIT).

According to the Securities Businessperson (Merchant Banker) Regulations 2008, merchant bankers in Nepal are allowed to carry out the following operations:

1) Issue Management: All the functions related to issue and sales management of securities including drafting of prospectus, offer documents and other related documents.
2) Underwriting: by entering into agreement with body corporate and undertake to purchase the unsubscribed portion of securities offered by body corporate.
3) Registrar to Shares: provide share registration related services such as maintaining register of ownership of securities and execute name transfer on behalf of the body corporate.
4) Portfolio Management: provide portfolio management services to the clients by entering into an agreement.

Besides these, subsidiary Merchant Bankers of BFIs are allowed to render the following services.

1. Fund Management: provide fund management services to the schemes of mutual funds registered with SEBON in line with the Offer Document approved by SEBON.

2. Depository: provide transaction facilitation services once the units of mutual funds are listed with stock exchange & starts to get traded.

In addition, Merchant Bankers are also allowed to render the services of DP under CDS once they are registered for the same with SEBON & obtains membership of CDSC & Clearing Ltd. (CDSC).

Merchant banking services in Nepal was earlier provided by Banks and Financial institutions themselves (BFIs). However, since the enactment of Securities Businessperson (Merchant Banker) Regulations 2008, merchant banking services can only be carried out by those institutions that have obtained merchant banking license from SEBON. Since the establishment of this regulation, the number and scope of work of merchant bankers have gradually increased over the years.

In Nepal, most of the merchant banking institution started as subsidiaries of BFIs. Therefore, it was easy for these institutions to move forward within a short period of time because of the brand value and recognition of the parent company. For instance, Nabil Invest has the brand of parent organization and many processes have already been standardized through that brand. However, other private sector merchant banking participants face more challenges as there are limitations in their scope and they have the pressure to develop their brand. Meanwhile, since merchant bankers need to build resources, infrastructure and create market, the entry of these institutions in the market depends on its feasibility of entry.

In recent years, the securities market of Nepal has witnessed many positive changes. SEBON has been taking initiatives in various issues such as cutting down on the stock brokers' commission and attracting subsidiaries of BFIs towards merchant banking business. They have also tried to ease certain regulations to facilitate real sector companies that want to enter capital market by looking into areas such as flexibility in premium pricing issue, and other tax benefits to real sector companies through changes in the fiscal policy. However, one of the major reasons behind the real sector companies not being encouraged to participate in the capital market is because promoters do not get adequate benefit by going public and having to share the benefits with all the shareholders. Therefore, conditional offers and incentives such as having tax rebates on dividend payouts amongst others are required to motivate companies to get that benefit and in turn investors are rewarded for it.

With the capital market moving in a positive direction, a lot of development is expected in the merchant banking regulations. Mutual fund has already opened up and the scope of merchant banker is expected to be enhanced in terms of advisory services to Private Equity (PE) and Venture Capital (VC) firms, retirement fund management, loan syndication, Merger and Acquisition (M&A) advisory amongst other services. Besides bringing changes in the regulations of the capital market, the following changes are essential to develop overall eco-system required for a robust growth of the overall market:

**Institutionalization of SEBON, NEPSE & CDSC:** Building SEBON as a strong independent regulator is for the betterment of all stakeholders as this further builds confidence of investors towards the apex regulator and helps to build the market. NEPSE & CDSC's stakes need to be privatized to bring in institutional investors which improves their capacity further & also improves their service delivery, a much needed impetus for the development of the market.

**Efficient stock exchange offering innovative products:** In order to ensure efficiency of the secondary market, there needs to be competition so that participants have an incentive to improve and innovate. The stock exchanges can come up with various products such as stock derivatives, stock options and intraday trading services to make the stock market more dynamic by providing additional investment options to the investors. Meanwhile, additional stock exchange will also benefit the listed companies since they will have an option to choose amongst the stock exchanges rather than going for one stock exchange by default. In addition, the best way forward would be privatization of existing stock exchange & CDSC so that they are run more efficiently. These institutions need to be governed by self-discipline and professionalism.

**Adaptation of efficient and reliable technology:** If international investors enter in the future, market develops and regional companies get listed, these investors will look into internationally competent software and system standards. Such internationally accredited software is based on tested technology, and thus is more reliable and efficient. Such software also supports regional integration required to support online trading in the near future. Therefore, adopting internationally accredited systems, software and technology is essential for long-term development of the market.

**Additional credit rating agencies:** Currently, there is only one credit rating agency operating in Nepal. As a result, the institutions do not have other options and are unable to renegotiate the fees charged by the sole rating agency. A platform should be developed to bring multiple credit rating agencies in operation—there are already two credit rating agencies that have intended to start operations. With new credit rating agencies, institutions providing debt instruments and coupon rate fixing for the same are likely to benefit in the future.

**Requirement of one window solution:** Development of capital markets can be beneficial for raising funds for various infrastructure and national government projects. With many such projects coming up in the near future, the institutions can come with instruments such as municipal bonds and government bonds to make the projects feasible. In addition, such initiatives will in turn support the overall development of the market & will also provide an investment opportunity to the masses to participate in projects of national importance.

**Changes in the NEPSE index:** The existing benchmark NEPSE index needs to be updated as it does not reflect the true movement of the market as the index involves all the shares including non-traded promoters' shares. Moreover, movement of share prices of a few large cap companies has significant impact on the overall index. In the meantime, the existing development bank sub-index includes around 30 to 40 micro finance companies, which is misleading. Therefore, the methodology to calculate benchmark NEPSE index needs to be changed and a separate sub-index needs to be developed for the development banks as well as the micro finance companies. Moreover, the index has to be updated in a timely manner as per the various corporate actions taken by listed companies such as rights shares, bonus shares, and other actions relative to capital changes.

**Over The Counter (OTC) Markets:** OTC market which provides the platform for trading of shares of public limited companies registered with the Office of Registrar of Companies (OCR) which has not been listed, delisted or which have not met the criteria of stock exchange to be listed. For this, the companies now need to register themselves at OTC market, get transacted at its floor and formalize the same later at OCR. However, though it has gained momentum off late, a lot still needs to be done.

**Establishment of a capital market training institute:** As an initiative for the capital market development, we as merchant bankers have been lobbying SEBON to come with a dedicated training institute for capital market. In Nepal, as of now, certified courses are not available for a fund manager or a portfolio manager. Setting up a training institute will lead to quality human resource in the capital market which is one of the important criteria for capital market development. Such institutions can initially be set up by linking with regional counterparts and then run independently after certain level once operational efficiency is reached.

All the key stakeholders including the Ministry of Finance (MoF), SEBON, NEPSE, CDS and merchant bankers need to push each other as well as themselves for the betterment of the capital market. The new guidelines have tried to encourage real sector companies to enter the capital market, however, the institutional capacity of these companies has to improve and regulator's need to ensure that adequate arrangements are made to protect the interest of investors.

# PERSPECTIVE:STOCK BROKERS

**Nitesh Kumar Sanghai**
Managing Director, ABC Securities Pvt. Ltd.
(Stock broker no.17)

There are currently 50 stock brokers operating in Nepal licensed by SEBON and NEPSE, and these stock brokers are governed under Securities Businessperson (stock broker, security dealers and market maker) Regulation 2007 issued by SEBON.

Stock Brokerage in Nepal started with individuals being granted brokerage licenses by the Nepal Stock Exchange (NEPSE). During the initial days, the brokerage business was a part time activity. Meanwhile, licensed professionals such as Chartered Accountants (CA) were preferred over others. However, after a few years, all individual broker licenses were converted into operating licenses for companies as a reform to develop the secondary market. During the initial years, the size of the market was quite small with a very few listed companies, investors and trading volumes. As the securities market evolved over the years due to various reforms, more and more companies started to go public, mostly due to regulatory requirements which increased market capitalization along with the trading volume in the secondary market. The addition of 27 new stock brokers a few years back has helped to improve the service quality in the broking industry due to increased competition, while the expansion of stock brokers' branches outside Kathmandu Valley has helped to increase the size of the market.

Open-out-cry system of trading and settlement of transactions in physical form (share certificates) were the two biggest bottlenecks in the development of Nepal's secondary market. The introduction of an Automated Trading System named NEPSECTS (NEPSE Computerized Trading System) back in 2007, which replaced the Open-out-cry system, changed the way stock brokers operated. With the new system in place, we were able to place multiple orders online and multiple transactions could be executed at the same time that helped to increase both market volume and the overall market index. Similarly, the introduction of Central Depositary and Clearing along with full fledge trading of dematerialize (electronic) shares since the beginning of 2016 has changed the landscape of our stock brokerage industry. It has made it easier for both investors and stock brokers to keep track of their holdings and transactions as well as eased the settlement system tremendously.

Stock brokerage business has come a long way over the years, and today we are in the institutionalization phase. The recently amended 'Securities Businessperson (stock broker, securities dealer, and market maker) Regulation 2008' requires us to increase our capital requirements by 10 times to NPR 20 million (USD 193,000) from previous requirement of NPR 2 million (USD 20,000) by second quarter of next fiscal year 2017/18. As the Nepali capital market is evolving, stock brokers are positive about their future investments. In this scenario, the increase in capital requirement for stock brokers has raised the issue of increasing the scope of business for stock brokers as well. At present, stock brokers are only allowed to place buy/sell orders on behalf of their customers and are not permitted to invest themselves as broker dealers, provide advisory services or increase liquidity in the market by providing margin trading services. Hence, it seems essential that the scope of work of the brokerage companies need to be re-engineered to accommodate a policy where investors get a 'one window access' to the whole range of value added financial services from us. If need be, we, stock brokers, are willing to invest capital, hire knowledgeable human resource and invest in better technology to provide better services to investors.

On an operational side, due to lack of legal structure and clarity, stock brokers often fall victim to frauds committed by investors. We are the ultimate target for any wrong doings—even if it is the investor's fault—and as a result our brokerage services are suspended. Hence, stock brokers in Nepal are declared guilty within an instance, and we have to prove our innocence time and again. Likewise, amongst all the stakeholders in the capital market, brokers are looked down upon the most. Stock brokers are perceived as businessmen who are only concerned with brokerage commission and not service quality. However, I believe as stock brokers are gradually institutionalizing their business amid increased capital requirement, they will have a greater role to play in the development of capital markets. Also, once stock brokers are allowed to provide advisory services, brokers will have to invest in an in-house research department with adequate resources which will assist in providing scientific reasoning for investments.

At present, the services offered by stock brokers are highly personalized as customers are gained through personal contacts. However, as we expect the online trading to kick-start soon, the personal touch will start to diminish in the industry and the competition is likely to swing towards better technology, customer support and transaction charges. Moreover, as our market matures further, it is likely that new financial instruments and products will be introduced in the market. The initiatives taken by SEBON and NEPSE in recent years have been very progressive and good for the overall development of the market. Amidst the new reforms and regulatory changes, the securities market in Nepal is likely to grow both in terms of depth and width providing greater investment opportunities and returns to the investors.

# PERSPECTIVE:VENTURE CAPITALIST

**Williem Grimminck**
Director, One to Watch

In the last few years, in addition to the rapid expansion of traditional financing options, Nepal has seen a growing presence of alternative financing institutions in the form of Venture Capitals, Private Equity, and Impact Funds, among others. These alternative mechanisms, besides providing finances, add value through the provision of technical support in the form of management and offer legal and financial advisory services to the recipient. However, despite the immense potential to grow, these institutions are currently not functioning to their full capacity mainly due to the lack of legal framework. Thus, in the absence of a favorable legal environment, alternative financing mechanisms are yet to fully take off in Nepal.

Some of the companies providing capital required for expansion of business in Nepal are Dolma Impact Fund and Business Oxygen. Likewise, some of the venture funds are One to Watch and True North Associates. And some of the firms providing seed capital are Biruwa Ventures and Avant Ventures.

Institutions providing alternative means of financing mainly seek to bridge the finance gap for Small and Medium Enterprises (SMEs) who are either too small or highly risky for banks and other financial institutions to finance. One to Watch, as a Venture Capitalist working in Nepal for the last four years, is investing in companies that offer innovative solutions and scalable business models for high potential markets such as agriculture & food, renewable energy, infrastructure and healthcare. Venture Capitalists mainly inject funds when the recipient companies are in their growth stage, their business model is tested and they have already gained some traction in the market. At this stage, these companies do not have a convincing combination between collateral and positive cash flow, while they also lack a track record. Venture Capital tolerates more risk than banks, in return for a higher upside than interest rates. So far, One to Watch has interviewed over 200 entrepreneurs, accelerated 40 companies and invested in 15 companies.

Raising capital from the stock market, which is designed to attract capital from the public, can probably be the largest source of capital for SMEs. However, it is important to understand that companies that are listed in the stock market are mostly mature companies with multimillion dollar investment appetite. In case of SMEs, it is a big leap to go from unbankable investments to getting listed in the stock market. Still, in the current scenario, SMEs are considering Initial Public Offerings (IPOs) as a viable option. This ambition of SMEs mainly stems from the lack of alternative exit options for investors to dilute their investments. But whether IPO is the ideal option or not is the main question that needs to be pondered upon.

The growth of SMEs with IPO investment will take some years to materialize. Investments in SMEs should come in phases. At the early stage, a first round of investment, say series A investment is required to improve the business model for long term revenues. Thereafter, the companies need to raise series B investment to expand the company. The next step would be series C investment mainly for perfecting the company and to scale-up further. The company at this stage would have adopted millions of dollars from national and international investors and these investors would want to cash out already.

However, there are many constraints for the companies to go public via IPO as there are cap on valuations, lock-in period, limited listed industries, lack of transparency and exclusion of foreign investors are some of the other challenges. If some of these issues are resolved, investors would be more willing to finance SMEs which would ultimately lead to more job creation and stronger economy. This might be a good enough reason to initiate change.

# WAY FORWARD

Nepal's capital market is still at a nascent stage and requires a number of transformative reforms for it to develop as an alternative platform to raise long-term capital required for the economic growth of the country. In recent times, the government has been making efforts to further develop the capital market. The government's recently endorsed five year Financial Sector Development Strategy (2016/17-2020/21) is a case in point. To ensure that the Nepali capital market has an organic and sustainable growth, it is important for the policymakers, regulators and market participants to engage and contribute in the growth. Some of the areas to consider are as follows:

1. **Develop primary market:** Due to mandatory requirement to go public, almost 85% of listed companies in the secondary market are from the financial sector. Since the market is heavily skewed towards BFIs, our capital market does not reflect the real picture of our economy—the supply of securities in the primary market is minimal compared to the size of our economy. Regulatory restrictions on pricing, low attractiveness due to poor incentives coupled with negative attitude of companies towards going public are some of the key bottlenecks restricting real sector companies from entering the capital market. The capital market can only be deemed successful when private companies start considering capital markets as a viable option to raise capital rather than borrowing from financial institutions.

   SEBON has already created a platform for investors to participate in the primary market from across 75 districts of the country via ASBA and has amended key regulations to ease the entry of real sector companies. In order to increase participation, the government can nudge private firms to go public, not only to guarantee transparency and accountability but also to provide critical mass for domestic debt and equity markets. Nonetheless, it is not advisable for companies to go public through compulsion or excessive incentives, since this can distort the free choices made by the companies, which could also have an adverse effect on the markets. The bottom line is that companies should decide to enter the market on their own rather than being forced to. Nonetheless, as the primary market develops further, book building practices should be allowed to sell primary offering at different prices to different investors.

2. **Governance a key challenge:** International experiences suggest that timely and credible disclosure of company information tends to promote investor confidence. In Nepal, besides the companies which are regulated by institutions such as Nepal Rastra Bank and the Insurance Board, other companies listed in the NEPSE have comparatively weak governance structure and are highly vulnerable.

   Past experiences suggest that governance has been a key challenge for private companies in Nepal as they have failed to disclose information to general investors and comply with accounting standards and regulatory requirements. The regulator should strictly supervise and enforce listed companies to abide with regulatory requirements, necessary corporate governance directives and guidelines. To ensure this, a corporate governance code should be developed for strict monitoring and corrective action procedures, which will also facilitate the establishment of an effective enforcement regime. Such a regime will also address the concerns regarding manipulation of share prices in the secondary market.

3. **Attract institutional investors:** The secondary market is dominated by retail investors with the presence of a handful of institutional investors. Due to the dominance of retail investors the market is highly volatile and illiquid at times. Entry of a few mutual fund schemes has helped to bring in institutional investment but their fund size is not large enough to have a significant impact.

   Large Institutional investors such as pension funds, insurance companies and BFIs prefer to invest in fixed-income securities and bank deposits over investing in the secondary market as the market is perceived to be highly risky due to weak regulatory regime. Moreover, there is lack of incentives for these institutions to invest in the capital markets such as waiver on taxes on income and capital gained earned. There are a few investment companies in the market, but due to lack of legal provisions their role is ambiguous so far. Institutional investors should be encouraged to invest in the capital market by conducting awareness programs, providing training to the investment managers, or lobbying to make necessary changes in their respective regulations restricting or putting cap on investment in the capital markets.

4. **Open market for foreign investors and firms:** Opening up the market for foreign investors is an important step towards developing our markets. The government has recently approved the long-awaited Foreign Investment and Technology Transfer Act (FITTA). The new Act has open doors for Non-Resident Nepalis (NRNs) and Foreign Institutional Investors (FIIs) to participate in the secondary market and repatriate profits upon approval from the central bank. With this development, the regulators should come up with necessary regulations and guidelines to attract such investors in our securities market. Moreover, as the capital markets deepen, foreign merchant banks/international firms should also be allowed to enter under certain conditions. The entry of such firms will help to bring in adequate capital, technology, know-how and human skill development.

5. **Autonomous regulatory body:** The existing legal structure does not provide operational autonomy to ensure regulatory changes in a timely manner. As the capital market has grown over the years, it now requires the structure to take prompt actions. Further, the regulator has to ensure that its operations or actions does not hinder or constraint the performance of its market participants.

   The existing Securities Act 2007 needs to be amended to accommodate the aspiration of the changing market dynamics. Given that the market size is growing, the need to further enhance the capacity of SEBON in terms of its governance and management as well as in its capacity to regulate, supervise and enforce regulations is required. SEBON has also been initiating various measures lately to enhance its capacity. The government should provide optimum support for establishing SEBON's autonomy, improve its governance and enhance its capacity.

6. **Develop ecosystem with adequate capacity:** Sound trading and settlement infrastructure, presence of effective market intermediaries, prudent regulations, effective regulatory body and a well-informed investor community are some of the key conditions required to develop an overall ecosystem for the sustainable development of the capital market. Sound co-ordination amongst these stakeholders is a key for success, as misunderstanding and mistrust between them will obstruct the overall development of the market.

   To promote innovation and expand market development, the scope of key market intermediaries such as merchant bankers and stock brokers should be broadened to expand their role. For instance, stock brokers should be allowed to provide advisory and margin lending services amidst their increased capital requirement while merchant banks should be able to provide valuation, advisory, book building and other services. Likewise, in order to support organic growth, the security dealers as envisioned in trading bylaws should be introduced at the earliest. Such a provision will help to minimize price fluctuation in the secondary market. Besides educating the investors, educating the market intermediaries is also essential to increase the level of understanding of the market. Likewise, the organizational capacity of sole stock exchange should be improved while additional credit rating company should be introduced to enhance market completion.

7. **Develop market for new financial instruments and services:** Our market is currently limited to trading of a few financial instruments, such as equity shares, convertible preference shares, government bonds, mutual fund units and corporate bonds. Moreover, the trading of government bonds is very slim while trading of corporate bonds is almost nonexistent. Issues such as differential tax rates between corporate & individual investors, and nonexistent of government bond yield curve are some of the major impediments for the development of debt market.

   As the market continues to grow, key market participants should work with the regulators to develop and introduce new products and services which will increase investment opportunities and support diversification of our market. Proper regulation for commodities exchange, Private Equity and Venture Capital is a must while financial securities such as

Real Estate Investment Trusts (REIT) and Exchange Traded Funds (ETFs) should be developed.

8. **Enhance Investors' education and protection:** As our market is primarily dominated by retail investors, basic education about the market is essential for developing investors' base, minimize market volatility and risk management. The regulator along with market intermediaries should continue with its investor education program across the country through various platforms such as print, television or social media. As visualized by SEBON, a dedicated capital market training institute providing training and certification program to both investors and market intermediaries should be establish at the earliest. This will go a long way in developing human capital for market intermediaries while will help to increase educated investors base. Moreover, compensation fund to protect investors against possible loss or damage as envisioned in Securities Act should be initiated at the earliest as such a provision will further improve the confidence of investors.

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# NEF PROFILE

Nepal Economic Forum (NEF) is a premier private-sector led economic policy and research organization that seeks to re-define the economic development discourse in Nepal. Established in 2009 as a not-for-profit organization under the beed (www.beed.com.np) umbrella, NEF is a thought center that is working to create positive transformations in policy reforms. One of the big updates for NEF this year was its feature in the list of Top Think Tanks in Southeast Asia and the Pacific in the 2016 Global Go To Think Tank Index. The report was released by the Think Tanks and Civil Societies Program under University of Pennsylvania. NEF stands out in being able to make significant strides to bring the private sector perspective and engage with both the public and private sectors in the development discourse. NEF is currently a recipient of the Open Society Foundations' Think Tank Fund.

NEPAL ECONOMIC FORUM

NEF works in partnership with many Nepali and international institutions in its quest to mainstream the discourse on the Nepali economy, which has not been given the necessary space it deserves.

NEF has partnered with the Himalayan Consensus Institute (HCI) to facilitate the development of alternative development paradigms and successfully held the second Himalayan Consensus Summit 2017 in March 2017.

## NEF BROADLY WORKS UNDER THREE AREAS:

**BPRC**

The Business Policy Research Center (BPRC) engages in research, dialogue and dissemination relating to pertinent economic policy issues. BPRC has been producing nefport, a quarterly economic analysis publication, nefsearch, a periodic research publication and conducting neftalk, a platform for policy discourse.

**PPCP**

Through the Center for Public, Private and Community Partnerships (PPCP), the partnerships discourse is further elaborated through addition of the community dimension to existing models of public private partnerships. Apart from standalone interventions, the PPCP perspective is integrated in the work that NEF and beed initiate.

beed devCon

NEF operates in the domain of Development Consulting through its devCon division in conjunction with beed management.. It works with a variety of bilateral, multilateral, national and international NGOs in the areas of policy research, economic analysis, value chain analysis, enterprise development, sectoral studies and public private dialogue.

We are striving to ensure financial sustainability for NEF to complement the support it currently receives from beed management and the Open Society Foundations. If you are interested to support NEF, please do get in touch with sujeev.shakya@beed.com.np or niraj.kc@beed.com.np

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