

NEPAL
ECONOMIC
FORUM

nefport

Docking Nepal's Economic Analysis

JUNE 2014 | ISSUE 17

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EDITORIAL

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

The internal strife between NC and UML has been a major bottleneck to both constitution writing and administrative functions in the current government. There have been, for instance, delays in adoption of the budget, leading to delays in making the planned budget expenditure, which in turn has resulted in a budget surplus. This will ultimately have a negative impact on Nepal's infrastructure development. Still, owing to a rise in agricultural production, continuous growth in the service sector, strong remittance flows and recovery of public investment, the Nepali economy is expected to grow at 4.5% at the end of FY 2013-14.

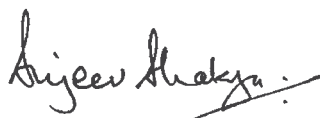
We have used USD conversation rate of NPR 97.63 to a dollar, the four month average, for this issue.

We continue to cover the sections in the manner readers are now used to: the first section provides a general overview of the macroeconomic state of Nepal's economy. It goes into some depth within each sector and provides an overview of the key stories that have developed over the last quarter. This section also provides an outlook for the next quarter of the Nepali economy.

Like in the previous issues, the second part of nefport presents an in-depth review of the financial and capital markets, where we provide a detailed analysis and assessment of the performance and figures of banks, financial institutions and capital markets. We have also included a Summary of the Nepal Economic Update, April 2014, published by The World Bank Group.

Nepal Economic Forum, a division of beed, is a not-for-profit organization that functions as Nepal's premier private sector led economic policy and research institution. We would like to thank beed invest and beed management for their support in making this issue possible.

We are eager to receive your valuable feedback on how to make future issues of nefport more useful and user friendly. Please email us your suggestions at info@nepaleconomicforum.org



Sujeev Shakya
Chairperson
Nepal Economic Forum

POLITICAL OVERVIEW

The internal disagreements between the two largest parties in the coalition government, Nepali Congress and the Communist Party of Nepal (Unified Marxist Leninist), have created delays in round two of the constitution writing process. These disagreements have also fueled the government's inability to smoothly conduct administrative affairs of the government.

Impact of the recent Indian election on Nepal: Nepal-India connection looks to be strengthened after the recent historic election where Bharatiya Janata Party (BJP) came out the clear winner. During his campaign, BJP leader Narendra Modi promoted his plan of economic prosperity, development and employment, which is going to have a positive impact on all of India's neighbors, including Nepal. The new government in India is expected to prioritize on maintaining peace and stability with its neighbors and investment-friendly policies. Although Nepal is a secular state, pro-Hindu organizations are eager to be an ally to Modi in hopes of reviving Nepal as a Hindu nation.¹

Factions in the UCPN (Maoist): The division of the Baburam faction and the Dahal faction has put a feud in the UCPN party. The scenario in the UCPN party took a turn for the worse during the first week of May when, during the party's convention in Biratnagar, senior leader Baburam Bhattarai accused the party leader Pushpa Kamal Dahal of being incompetent in handling the present political situation of the nation. Bhattarai had further mentioned that Dahal's leadership would come into question if there were to be any occasion of a revolt at a national level.²

However, the disputes between the party seems to have subsided as Bhattarai has made a comeback and Dahal has shown interest in addressing the issues put forward by Bhattarai. Bhattarai seems adamant in making the party free from its subjective and organizational viewpoints and feels UCPN-Maoist should focus on the needs of the national rather than the party's alone.³

TRC formed: On April 25, majority of the members in the Legislature Parliament voted on establishing the Truth and Reconciliation Committee (TRC).⁴ The Supreme Court had ordered the forming of the TRC to implement investigations on atrocities in relation to Nepal's armed conflict from 1996 to 2006.⁵ The TRC bill is based on the South African Model that recommends amnesty even for serious human rights violations. There has been a debate on whether or not to offer amnesty to heinous crimes, including murder in custody, torture, rape, etc., in Nepal. TRC's success now depends on how the committee amends past crimes without generating unfair treatment to all parties involved while consolidating both the victims and the perpetrators in harmony.⁶

Koirala Govt. moving at a tortoise pace: Prime Minister Sushil Koirala's

responsibilities as a prime minister is clear: completing the drafting of the constitution by February next year and the holding of local elections by April-May.⁷

Now that the Koirala government has passed the honeymoon period of 100 days, many criticisms have been thrown at Koirala with regard to the pace at which actions have been taken.⁸ The government's negligence in areas of governance is seen in its action towards service delivery, operation of developmental projects and stamping its authority to keep foreign and domestic investors at ease. Even though the government enjoys two-third of the majority in the legislature parliament, it has not been able to prepare and implement policies for development. Sushil Koirala himself has made public that he would quit as the prime minister if his government faces any more pressure from all sides.⁹

OUTLOOK

Given that Narendra Modi has a strong economic growth agenda for his government, he will be looking at facilitating regional cooperation, particularly with its growing Eastern neighbors. Nepal needs to have clear agendas on how it can participate in this region's growth.

INTERNATIONAL ECONOMY

As advanced economies tighten their monetary policies, emerging markets witnessed capital-flow reversals and sharp decline in domestic asset prices. In countries like India, Brazil, South Africa, and Indonesia, capital has become less accessible and more expensive.

ECB to impose a USD 20 million annual supervisory fees: The draft proposals from the European Central Bank (ECB) stated that the largest institutions that receive its supervision will be imposed with USD 20 million (NPR 2.65 billion) as supervisory fees per year. This will lead to ECB receiving between 700,000 Euros (USD 952,000; NPR 93 million)¹⁰ to 2 million Euros (USD 2.7 million; NPR 265.5 million) from its 130 lenders, and between 2,000 Euros (USD 2,700; NPR 265,000) and 200,000 Euros (USD 272,000; NPR 26.56 million) from 5,800 banks. The estimated fees will be charged starting from November 2014 when the bank becomes the European region's bank supervisor under the new Single Supervisory Mechanism. The bank estimates the expenditure for the supervisory fees to reach 260 million Euros (USD 353.73 million; NPR 33.41 billion) in 2015. The supervision is going to help the banks decrease their borrowing costs that would offset the supervision

costs and put the banks in a beneficial position.¹¹

BJP's historic win in the Indian Elections 2014: With half a billion people having participated in the elections, India's election became the biggest election any democracy has ever exercised. The election lasted for six long weeks to serve the 834 million registered voters. The results made Narendra Modi's Bharatiya Janata Party (BJP) victorious, coming close to outright majority of the 543 elected seats by defeating the once dominant Congress Party.¹²

The elections have brought about a positive outlook for both foreign and domestic investors which will have the biggest impact on the nation's economy.¹³ The markets have already soared high in light of the elections as the benchmark stock index has jumped to a record high of 6%. In the past six months, foreign investors have invested more than USD 16 billion

(NPR 1.5 trillion) on Indian stocks and bonds. Nonetheless, given that the nation's economy is going through its worst slowdown since the 1980s and also suffering from high inflation, it is not an easy task for Modi to live up to the hopes of the citizens in catalyzing India's economic growth.¹⁴

Indian Rupee on its 11-month high against the US Dollar: Capital Inflows and excitement over the succeeding government has stimulated the Indian rupee's escalation to its 11-month high and has made it the best performing currency in the Asia-Pacific region (against the US dollar) in 2014. The Indian Rupee stood at 58.52 per US Dollar, a 5.3% gain in the past one month. With the help of India's booming foreign fund inflows, the Indian Rupee has gained 327 paisa in less than six months.¹⁵ Furthermore, the sales of US Dollar by the banks have increased; there has been a firm session in the local equity market and the Euro has improved against the

dollar. These factors have helped the Indian Rupee to go strong against the US Dollar.¹⁶ However, the Indian Rupee is expected to depreciate against the US Dollar marginally after its rise over the last couple of months.

Regional tension between China and Vietnam:

Further regional tensions have been added between Vietnam and China as a large Chinese oil rig, HD-981, was placed in disputed waters near the Paracel Islands in the South China Sea, which Vietnam considers as the nation's exclusive economic zone. Vietnam took it as provocation from China's side as the China National Offshore Oil Corporation began setting up the rig worth USD 1 billion (NPR 93.78 billion) along with a fleet of vessels.¹⁷

This particular incident has acted as a barrier for regional peace and economic cooperation. Both the nations have had a history of clashes

with each other.¹⁸ At present, the Vietnamese government has been looking for numerous defense options, including legal actions. Vietnamese nationals have been protesting heavily and have gone to the extent of dangerous riots aimed at the Chinese people in Vietnam.¹⁹

Thailand's coup has taken a toll on its once booming economy:

While its neighboring developing countries are showing a forecasted growth of 5% this year, Thailand's Gross Domestic Product (GDP) has gone down by 2.1% in the first quarter, showing signs of an upcoming recession that would be a depressing contrast in comparison with its 6.5% growth in 2012. Analysts had forecasted the economy to rise by 0.2% this year but the economy has been clearly suffering due to the political instability.²⁰ This comes as no surprise to Thailand as the country has been amidst a political instability for the last seven months

which has now resulted in a coup. The tourism sector that recruits millions and accounts for 6% of the GDP has been hampered by the present scenario of the nation. In the first three months of this year, the number of tourists visiting Thailand dropped 6% to 6.6 million. The uncertainty level with regard to security has brought about tremendous change in both the domestic as well as the foreign investors. From 2012 onwards, Foreign Direct Investment has shown a steep fall. The coup has arrived at a time when Thailand's economy has been showing a drastic downfall and it further ascertains an uncertain future for the nation as a whole.²¹

“ OUTLOOK

The appreciation of the Nepali Rupees (as a result of the appreciation of the Indian Rupee) will have a favorable effect on Nepal's Balance of Payment.

macroECONOMIC

OVERVIEW

Growth is expected to stand at 4.5% in FY 2013-14, mostly on account of increased agriculture output and growth in the services sector, particularly education services and retail trade. Given the increases in remittance and slow credit growth, the banking system is still witnessing excess liquidity. Also, delays in budget expenditure are bottlenecks to infrastructure development in Nepal.

AGRICULTURE

The agriculture sector appears to be gaining pace in the third quarter of the fiscal year 2013-14. Despite the decrease in the export of NTIS (Nepal Trade Integration Strategy) products, the country's overall agro productivity seems to be on the rise.

Agro insurance gaining momentum:

A year after it was introduced, the idea of agro insurance seems to be warming up among the commercial farmers. Small time farmers, on the other hand, are still hesitant about the insurance. According to the insurance regulator's data, 12 non-life insurance companies have issued agro related insurance policies worth NPR 99.45 million (USD1 million) till mid-December 2013.²²

In order to encourage the agro insurance to commercial and small farmers, the government had announced 50% subsidy on the agro insurance premiums to be paid by the Ministry of Agricultural Development, which was approved in the annual budget of the current fiscal year. So far, 90% of the policy holders

are commercial farmers; the remaining are small time farmers.

Among the 12 non-life insurance companies, NLG Insurance has issued the highest amount of agro insurance worth NPR 36.12 million (USD 0.37 million), followed by Shikhar Insurance that has issued policies worth NPR 25.27 million (USD 0.25 million) during the review period.

Interest subsidy on agro insurance premium:

In an attempt to lure additional investment in agricultural sector, the Ministry of Agriculture Development (MoAD) has been planning to provide interest subsidy on agro and livestock loans acquired by farmers from all banks and financial institutions.

As suggested by the Ministry of Finance (MoF), MoAD is in the process of

Table 1: NTIS products with positive changes **NPR in '000**

S.N	NTIS Product	Q3, FY 2012/13	Q3, FY 2012/132	% change
1	Natural Honey	5	168	3079.7
2	Essential Oils	51,056	114,000	123.3
3	Cardamom	2,634,330	3,690,334	40.1
4	Noodles, pasta and like	425,708	587,809	38.1
5	Nepali paper and paper products	365,104	467,664	28.1
6	Woolen Products	323,154	351,995	8.9
7	Tea	1,356,241	1,405,342	3.6
8	Iron and Steel products	9,071,043	9,180,537	1.2

Source: TEPC, Foreign Trade Statistic of Nepal 2070/71

drafting a guideline based on which subsidy would be extended to the farmers. Though the cap for the interest subsidy has not been decided yet, MoF has instructed that the caps shall not exceed 3% of the total loan amount. This move made by the ministry is in line with the provision laid in the fiscal policy of this fiscal year.²³

Projects selected for PACT grant: The Project for Agriculture Commercialization and Trade (PACT), implemented by the Ministry of Agriculture Development with assistance of the World Bank, has selected 291 projects/firms out of 1400 proposals eligible for its grant of NPR 900 million.²⁴ PACT will provide NPR 3-5 million (USD 0.03 – 0.05 million) in the form of grant to the selected projects, enabling the farmers and agribusiness groups to engage in profitable market-oriented production.

Among the selected 291 projects are 55 vegetable production projects, 41 dairy production projects, 30 poultry groups, 23 dairy and dairy-related production groups, 22 coffee production projects, 20 seeds production projects,

12 floriculture groups and some animal husbandry projects.

Drop in NTIS export: A year-on-year comparison of the export of Nepal Trade Integration Strategy (NTIS) products has seen a marginal drop of 1.03%—from NPR 20.38 billion to NPR 20.17 billion—in the first nine months of this fiscal year.²⁵

Of the 13 NTIS products, eight have seen a positive change in export while the other five have witnessed a negative change (*see Table 1 & 2 for details on NTIS Products with Positive and Negative Changes*).

Iron and steel products saw the highest increase in earnings of NPR 109 million (USD 1.1 million). Registering a 40.1% increase in earnings—a whopping NPR 1.05 billion (USD 10.7 million), cardamom export also witnessed a significant growth.

Meanwhile, the export of silver jewelry had a massive decline of NPR 92 million (USD 0.9 million). The handicraft traders attribute this slump to a warning issued by the European

Union, which stated that unless the quality of Nepali silver jewelry was improved, it would bar its entry into the European market.

Agriculture sector expands: The Preliminary Estimate of Crops data released by the Ministry of Agriculture Development show that the country produced an extra 824,000 tons of food grain this fiscal year.²⁶

According to the data, production of cereal crops such as paddy, maize, and wheat increased by 12% (5.04 million tons), 14.2% (2.23 million tons), and 1% (1.88 million tons) respectively this fiscal year due to timely rainfall and adequate supply of chemical fertilizers (*see Figure 1: Production of Cereal Crops*).

Similarly, production of cash crop such as sugarcane and oilseed increased only marginally by 3.1% and 1.1% to 3 million and 0.18 million tons respectively.

The production of spice crops such as ginger and chilies increased by 14.3% and 7.5% to 2.6 million and 0.03 million tons respectively this fiscal year. On the other hand, production of cardamom, garlic, and turmeric decreased by 9.8%, 11.4%, and 14.8% to 0.006 million, 0.05 million and 0.042 million tons respectively (*see Figure 2: Production of Spice Crops*).

Cereal output jumped to 9.4%—9.56 million tons—during this fiscal year due to timely rains and an adequate supply of chemical fertilizers. The overall growth in cereal production has helped the agricultural sector to swell 4.72% this year. The growth rate of agricultural sector was 1.07% in the last fiscal year.

Table 2: NTIS products with negative changes NPR in '000

S.N	NTIS Product	Q3, FY 2012/13	Q3, 2012/132	FY	% change
9	Articles of silver jewelry	135,811	42,991		-68.3
10	Ginger	988,407	342,385		-65.4
11	Lentils	2,376,090	1,552,078		-34.7
12	Medicinal Herbs	1,077,342	866,230		-19.6
13	Woolen and Pashmina shawls	1,584,663	1,577,141		-0.5

Source: TEPC, Foreign Trade Statistic of Nepal 2070/71

EDUCATION

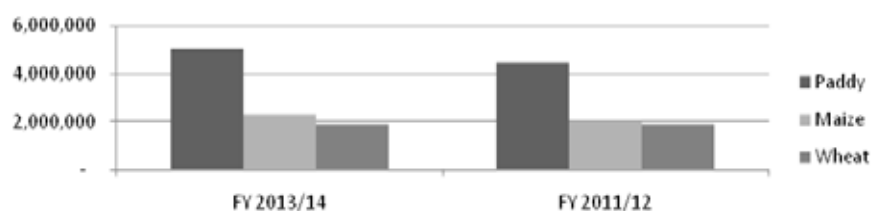
The education sector continues to be fraught with problems, particularly in the rural regions. While the government has been focusing on achieving 100% literacy throughout the country, with special emphasis on adult education, the longstanding problem of textbook shortages among school students, and rampant corruption prevalent both within the system and among private educational institutes threatens to undermine the government's efforts.

Tuition fee hike revoked: The decision to withdraw the hike in tuition fees across the country was taken by the government and institutional schools after protests by agitating students. A five-point agreement has been agreed upon, which includes adjusting the already deposited hiked fee amount of the previous month with the current month's fee, incorporation of representatives from the CPN-Maoist-aligned student union in the high level monitoring committee, holding talks with students and institutional school teachers to discuss various educational issues, and implementing the institutional school directives to change English names of schools.²⁷

Education Fair a success: Over 90 academic institutions from across the country participated in the Kantipur Hissan Education Fair 2014, drawing over 225,000 students. The annual fair aims at helping students make the right choices in shaping their future, as well as bringing the entire higher secondary colleges under one roof and curbing unhealthy competition.²⁸

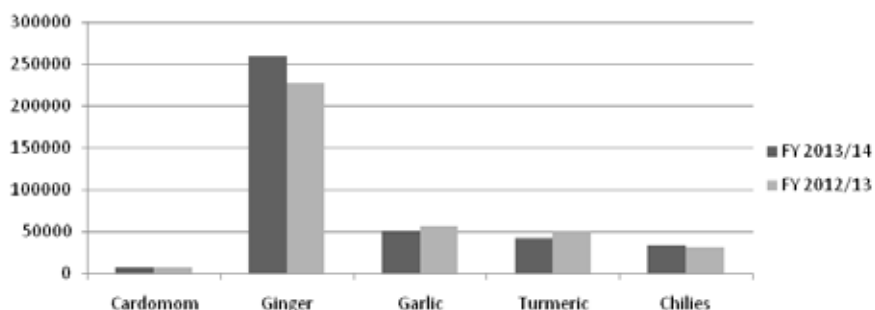
English medium classes increase student enrollment: The Ministry of

Figure 1: Production of cereal crops



Source: MoAD, Preliminary Estimate of Crops

Figure 2: Production of spice crops



Source: MoAD, Preliminary Estimate of Crops

Education's proposal to make English the primary medium of instruction in all government-run schools in a decade's time has made a positive impact. The number of students in a school in Baglung district increased from 12 to 120 after it started classes in English medium. The school has also been planning to introduce computer education, library, extra-curricular activities and other services parallel to that of private schools.²⁹

Government to enforce education regulations: Concerned government authorities have expressed commitment towards the Commission for Investigation of Abuse of Authority for the effective implementation of the Private and Institutional School Operation Directives 2013, in order

to ensure the regulation of fees, and to avoid malpractice in private schools as per the existing legal provisions. This move follows numerous complaints regarding the exorbitant fees charged by private schools. The directive fixes a maximum fee ceiling for private schools and restricts the collection of annual fees and admission fees. The Department of Education has fixed a monthly fee of NPR 1,100 (USD 11.27) for primary level, NPR 1,250 (USD 12.8) for lower secondary level, and NPR 1,700 (USD 17.41) for secondary level for 'C' grade schools. The directive, however, allows the 'A' grade schools to hike fees by 50% and 'B' grade schools by 25%. Likewise, 'D' grade schools mandatorily have to deduct 25% from the fee ceiling.³⁰

Government plan to promote literacy:

In a bid to meet the Millennium Development Goals in regard to education, the Government of Nepal is working towards ensuring the success of the 'Literate Nepal Mission' by 2015. The government has decided to award local bodies with a literacy rate of 100%. National Non-Formal Education Council has also decided to award NPR 0.5 million (USD 5,121), NPR 0.2 million (USD 2,048) and NPR 0.05 million (USD 512) to districts, municipalities and VDCs respectively which have achieved universal literacy. According to the council, local bodies can be declared fully literate if 95% of their population are literate. The Literate Nepal Mission aims at eradicating illiteracy from the country by 2015.³¹

Education and Disabilities:

The Department of Education, along with the National Campaign for Education Nepal, conducted a week long program to increase the enrollment of children with disabilities in schools. The campaign was conducted during the Global Action Week for Education with the theme of Equal Right, Equal Opportunity: Education and Disabilities. The aim of the program is to increase awareness among guardians and stakeholders to make school education accessible to disabled children.³²

Unauthorized classes in schools: Of the 27 private and boarding schools in the Okhaldhunga region, 18 were found to be running classes at levels higher than that allowed by their permits. The District Education Office has given a one week notice to these schools to stop these illegally run classes.³³

TEXTBOOK SHORTAGES

The Government of Nepal initiated its free textbook campaign for public schools across the country in 2009. Textbook scarcity, however, still looms large even today in the far western region. The scarcity, which has been attributed to delays in printing, has caused students to go without textbooks despite the start of the academic session. Often, the students are forced to appear for their annual examinations without textbooks.³⁶ The Central Textbook Management and Monitoring Committee has, therefore, decided to give private publishers the responsibility of printing and distributing textbooks for primary and secondary levels, after the government entity Janak Education Materials Center (JEMC) failed to do the job on time yet again. This move is aimed at ensuring timely distribution of textbooks.³⁷

However, claims have arisen in various districts regarding how unresolved commission bargains between schools and publication houses often lead to sub-standard textbooks. According to students and parents, private schools tend to pick publishers based on the amount of commission received unlike public schools where there is only one government authorized book distributor. Although regulation dictates that textbooks from a certain publisher should be used for a minimum of three years, private schools are reportedly in violation of this rule with textbooks and publishers being changed every year. The District Education Office, which acts as the monitoring body, continues to remain mute on these issues.

Literacy program benefits Chitwan:

The campaign to make Chitwan a literate district by 2015 is gaining ground with over 13,500 people being turned literate in the area within the past year. According to the District Education Office, some VDCs and nine wards of two municipalities were announced fully literate following the literacy program which was launched in 21 places with a budget of NPR 6.68 million (USD 0.06 million). In the current year, a total of 1,729 literacy classes have been conducted in 45 places with a budget of NPR 23.2 million (USD 0.24 million). Male and female literacy rates in the district have reached 86.48% and 89.76 % respectively.³⁴

CIAA summons officials: The Com-

mission for Investigation of Abuse of Authority (CIAA) has summoned District Education Officials of Rautahat for issuing licenses to community schools for financial gains. Investigation into the matter identified that these schools existed only on paper. The CIAA conducted its first phase hearing of the school operators at the district and the second phase at its regional office in Hetauda.³⁵

ENERGY

Both state monopolies, Nepal Oil Corporation (NOC) and Nepal Electricity Authority (NEA), continue to make losses, with NOC's losses slightly offset with the

price hike in the month of March. NOC had proposed that prices of petrol increase to NPR 140 (USD 1.43) per liter and that of diesel increase to NPR 109 (USD 1.12) per liter. However after protests, NOC rolled back the hike by 50% to petrol costing NPR 14.5 (USD 0.15) per liter and diesel costing NPR 105.5 (USD 1.08) per liter. Due to reduction in import prices fixed by the Indian Oil Corporation (IOC), NOC's losses have reduced to NPR 47.7 billion (USD 488.6 million) for the month of May (see Table 3: Projected Losses for NOC from March to May 2014).³⁹

NEA on the other hand, sought feedback from consumers on a proposed 20% tariff hike for electricity. In a public notice, the Electricity Tariff Fixation Committee (ETFC) asked consumers to provide suggestions and comments on the proposal by NEA's management committee. While NEA proposed a hike of 20%, the ETFC stated that a 10% to 15% hike would be more likely. NEA's cumulative losses reached NPR 14.31 billion (USD 146.57 million), even after the government wrote off a whopping NPR 27 billion (USD 276.55 million).⁴⁰

Panel formed to manage petroleum sector: In a bid to effectively manage imported petroleum products in

Nepal, the Legislative Parliament on March 29, formed an 11 member parliamentary panel. The formation of the panels comes nine days after an agreement between the government and the opposition parties.⁴¹ Additional objectives of the Panel would be to explore viability of alternatives sources of energy and also improving the efficiency of Nepal Oil Corporation criterion.

Fuel import exceeds total exports: Fuel imports constituted 19% of Nepal's total imports in the first nine months of FY 2013-14. According to Trade and Export Promotion Centre (TECP), Nepal imported petroleum products worth NPR 99.42 billion (USD 1.01 billion), an increase of 22% from NPR 81.52 billion (USD 835 million) during the same period last year. The total exports stood at NPR 68.2 billion (USD 698.6 million) for the same time period in FY 2013-14.⁴² This shows that export figures are not sufficient to finance the growing import of petroleum products. Trade expert Posh Raj Pandey stated that the increase in petroleum imports could be attributed towards the power crisis along with the depreciating Nepali Rupee against the US Dollar.

EPF and CIT to extend credit to NOC: Newly-appointed Finance Secretary Yuba Raj Bhusal, who joined office on April 17, decided to arrange a loan of NPR 2.5 billion (USD 25.6 million) to the ailing Nepal Oil Corporation (NOC). The decision comes as a result of shortage of petrol and diesel in the valley. Indian Oil Corporation (IOC) had slashed supply of petroleum products due to unpaid dues owed by NOC. NOC needs to pay NPR 5.18 billion (USD 53.06 million) to IOC.

As per the decision, Employees' Provident Fund (EPF) will be providing NPR 1.5 billion (USD 15.36 million) whilst Citizen Investment Trust will cover the remaining NPR 1 billion (USD 1.02 million). In the past, EPF has extended a total loan of NPR 10.85 billion (USD 111 million) to NOC whilst CIT has arranged credit of NPR 7.93 billion (USD 81.23 million). Furthermore, NOC owes NPR 12.64 billion (USD 129.47 million) to the government and an additional NPR 2.74 billion (USD 28.07 million) to commercial banks. With all these loans, NOC is under debt of NPR 34.16 billion (USD 349.89).⁴³

Govt. agencies' outstanding dues to NEA: The Ministry of Home Affairs tops the list of 21 government agencies, with outstanding dues of NPR 40 million (USD 0.41 million) to Nepal Electricity Authority (NEA). Health and Local Development ministries owe NPR 39 million (USD 0.4 million) and NPR 26 million (USD 0.27 million) respectively. The total amount owed to the NEA by different government agencies is more than NPR 195 million (USD 1.98 million) in electricity bills. Under the initiative of Gokarna Bista,

Table 3: Projected Losses for NOC from March to May 2014

Particulars	Loss as per Beginning of Month	Loss as per Middle of Month
March	169.7	105.5
April	72.3	64
May	69.9	47.7

Source: Nepal Oil Corporation

the then Minister for Energy, various ministries and government agencies had cleared outstanding dues worth NPR 700 million (USD 7.17 million) to NEA. The campaign started by Bista trimmed NEA's recoverable amount by NPR 610 million (USD 6.25 million) to NPR 7.28 billion (USD 74.57 million) in FY 2010-11. However, due to lack of continuity to the campaign, the total recoverable amount increased by NPR 660 million (USD 6.76 million) in FY 2012-13 to NPR 7.35 billion (USD 75.28 million).⁴⁴

8 hydro projects to add 170 MW in five years: Nepal Electricity Authority (NEA) has entered into Power Purchase Agreement (PPA) with eight hydro-electric project developers up until the current FY 2013-14. These projects are set to add 170.47 megawatts of electricity within five years, which is the estimated timeframe for completion of the projects from the date of PPA signing.⁴⁵ If the developers are successful in completing the projects within the stipulated timeframe, the country may start generating 2002 MW of electricity by FY 2018-18 as against the forecasted demand of 1906 MW as projected by NEA. Nonetheless, power cuts during the dry season will still continue since the projections on electricity generation have been made for the wet season. NEA's other concern is that the power generated through these run-of-the-river projects may not come to any fruition during off-peak hours when the country's power generation capacity is expected to hit 2,002 MW while demand would be less than that.

Upper Trishuli to finish in 26 months: The 60 MW Upper Trishuli 3 A Hydropower Project being constructed

in Nuwakot and Rasuwa districts is likely to complete within the next 26 months. After the completion of the project, it will be able to generate at full capacity of 69 MW after resolving the prolonging dispute on project capacity. So far, approximately 35% of the project works is completed, however, 45% of total payment was already released to the contractor. In addition, around 50% works on dam, 60% on tunnel and 30% on powerhouse construction have been completed.⁴⁶ Axiom Bank of China has provided a soft loan assistance of NPR 10.5 billion (USD 107.55 million) for the project. The expected completion period of the project was 35 months beginning from June 2011; however, the construction works stagnated due to capacity dispute and obstruction by locals.

Probe into Upper Tamakoshi construction: The Commission for Investigation of Abuse of Authority (CIAA) has started probe into quality of construction materials used in the 456 MW Upper Tamakoshi Hydropower Project. The project is the country's first large-scale hydel project being constructed with domestic resources. Reports of irregularities prompted CIAA to probe the materials used in the construction. The irregularities became apparent after 80 meters of tunnel's ceiling started developing cracks.⁴⁷ The anti graft body then sent the samples of the construction materials used in the project to India for further tests, as the materials used in the construction are believed to be sub-standard. The investigation is primarily focused on the construction companies involved in the project, China's Sino Hydro, suppliers of the construction materials, and German-based Lamier International, the project's consultant.

IBN allowed to hold negotiations on transmission lines: As per the Investment Board of Nepal (IBN) meeting, IBN has been authorized to hold negotiation with investors for the development of transmission lines for hydropower projects above 500 MW capacity. IBN had sought to incorporate generation and transmission line construction in one project. As IBN is currently holding negotiations with three foreign developers for Power Development Agreement (PDA), merging these projects into one would prove efficient for IBN. The meeting, chaired by Prime Minister Sushil Koirala, also agreed to waive off 100% income tax for a period of 10 years, in addition to 50% tax exemption for another 5 years for hydropower projects starting to generate electricity within 2018.⁴⁸

No significant progress on PTA between India and Nepal: While Nepal is looking to export electricity to India, slow progress of implementation of Power Trade Agreement (PTA) between India and Nepal, which was drafted in 2009, has not enabled Nepal to find a market for export of electricity. Although, Nepal has eight export-oriented projects under construction, it has faced difficulties in exporting electricity. No export-oriented hydropower projects can be implemented unless Nepal and India include electricity among 'traded commodities' in their bilateral 'trade and transit treaty'. In addition to India, Bangladesh has also shown interest in buying electricity from Nepal, providing an option for Nepal to look beyond India for export.

However, Indian Power Secretary Pradeep Kumar Sinha has pointed the finger at Nepal for not playing a

proactive role in signing the PTA. He called on the Nepali government to immediately take the initiative to create a joint mechanism, similar to that of which India has with Bangladesh.

Transmission lines to be set up at Kali Gandaki and Marsyangdi Corridor: A USD 440 million (USD 4.5 million) project commissioned by donors is set to help Nepal setup power lines at Kali Gandaki and Marsyangdi corridor. Potential local and foreign investors in the hydropower sector faced lack of transmission lines as a major hindrance, which prompted donors to help facilitate the construction of transmission lines. The construction of the new transmission lines is an initiative under the Asian Development Bank's (ADB) South Asia Sub-Regional Economic Cooperation (SASEC). The ADB has confirmed an investment of USD 180 million (NPR 17.57 billion), subject to approval from its board. In addition, the government will invest USD 60 million (NPR 5.86 billion) while donors will invest the rest of the required capital to complete the project.⁴⁹ As the government considers Central Region as a major consumer of power, the construction of the transmission lines, which will be erected in the Kali Gandaki and Marsyangdi corridors as well as the Marsyangdi-Kathmandu section, will be its main priority.

FOREIGN AID

According to Nepal Portfolio Performance Review for 2014, the fragmentation of donor agencies and assistance has acted as a hindrance in the implementation of projects. The utilization of foreign

assistance continues to remain inefficient due to weak performance, weak execution of the budget, and frequent transfers of key project staff and government officials, resulting in the loss of trust amongst donors. Additionally, in order to discourage aid fragmentation, the planned policy of fixing a minimum of foreign aid that will be received by the country has managed to further irk donors.

Government budgetary system overlooked: The Finance Ministry's Development Cooperation Report 2012-13 points out that in the last fiscal year, over 36% of foreign aid, i.e. of NPR 33.7 billion (USD 345 million) out of NPR 93.7 billion (USD 960 million), was distributed outside the country's national budgetary system. This indicates an increase by 13% as compared to the previous year. In regard to the assistance that comes through the budgetary system, only 46% was disbursed through the national treasury. This often results in a situation where the performance evaluation of such aid cannot be undertaken. While most agencies are found to comply with the regulations, a few multilateral and bilateral agencies are still found to be extending assistance through unofficial channels. *Table 4* shows the off budget aid provided by various bilateral and multilateral donors. The rise in off budgetary aid is said to result from the lack of faith in the government system, as well as the poor absorption capacity.⁵⁰

Assistance in customs modernization: The Government of Japan, in association with the Asian Development Bank, will provide NPR 146.45 million (USD 1.5 million) to the Government of Nepal as Capacity Development Technical Assistance

(CDTA) for the modernization of Nepal's customs services. The CDTA is expected to facilitate the integration of Nepal into the world trading system as well as reduce the time and costs of trading. It is also expected to be instrumental in the implementation of various trade facilitations programs, and custom reforms. The Government of Japan is funding this project—expected to be operational by 2015—through its Japan Fund for Poverty Reduction.⁵¹

Japan confirms assistance for tunnel roads: The Government of Japan has assured assistance for the development of a 2.2 km tunnel from Nagdhunga to Naubise. The construction of this tunnel will shorten the distance from Kathmandu valley to other parts of the country. While it is yet to be confirmed whether the assistance will be in the form of a grant or a loan, the Japanese government will be taking a team of Nepali officials to Japan to observe Japan's tunnel technology.⁵²

Kabeli-A Hydroelectric Project receives financing: The World Bank Group has approved financing worth NPR 8.26 billion (USD 84.6 million) for the Kabeli-A Hydroelectric Project. The run-of-river project, located in the Panchthar district, will have an installed capacity of 37.6 MW. The funding package includes a NPR 3.5 billion (USD 40 million) loan and a NPR 585.8 million (USD 6 million) grant from the International Development Association, a NPR 1.9 billion (USD 19.3 million) loan from International Finance Corporation, and a NPR 1.9 billion (USD 19.3 million) loan from Canada Climate Change Program. The project has three main com-

Table 4: Off Budget Aid from Multilaterals and Bilaterals

S.No.	Donor	Off Budget Aid
1	World Bank Group	2%
2	Asian Development Bank	7%
3	United Nations	79%
4	European Union	73%
5	Global Fund to Fight AIDS, Tuberculosis and Malaria	16%
1	Netherlands	100%
2	USAID	99%
3	Australia	80%
4	India	79%
5	United Kingdom	64%
6	Germany	57%
7	South Korea	56%
8	Norway	34%
9	China	29%
10	Denmark	21%
11	Japan	17%
12	Switzerland	12%
13	Finland	11%

Source: Development Cooperation Report 2012-13

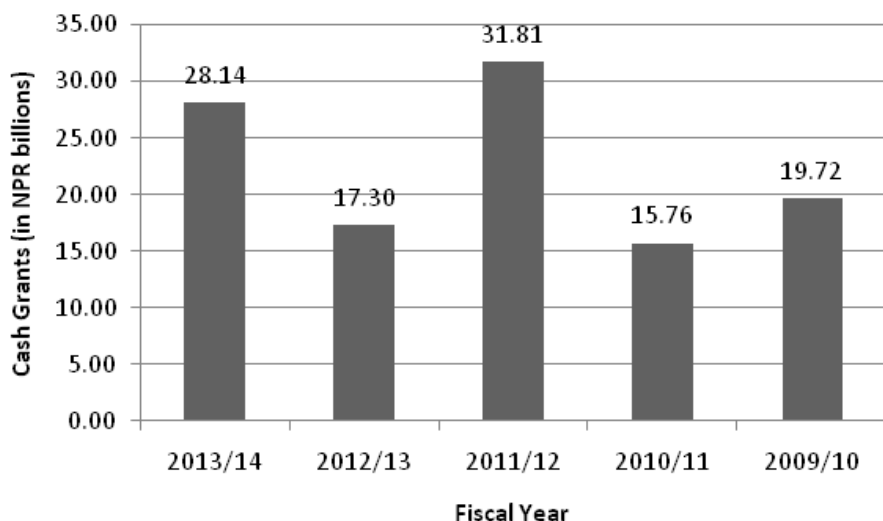
ponents, which includes building plant infrastructure, supporting Ministry of Energy in supervising implementation of the project, and supporting the Investment Board of Nepal in facilitating the development of large hydropower projects in accordance with international standards.⁵³

Japan supports Micro-Hydropower Improvement: The Government of Japan has extended a grant of around NPR 1.47 billion (USD 15.05 million) for the Micro-Hydropower Improvement Project in Bajhang, Bajura and Rukum Districts in Western Nepal. The total capacity of the three

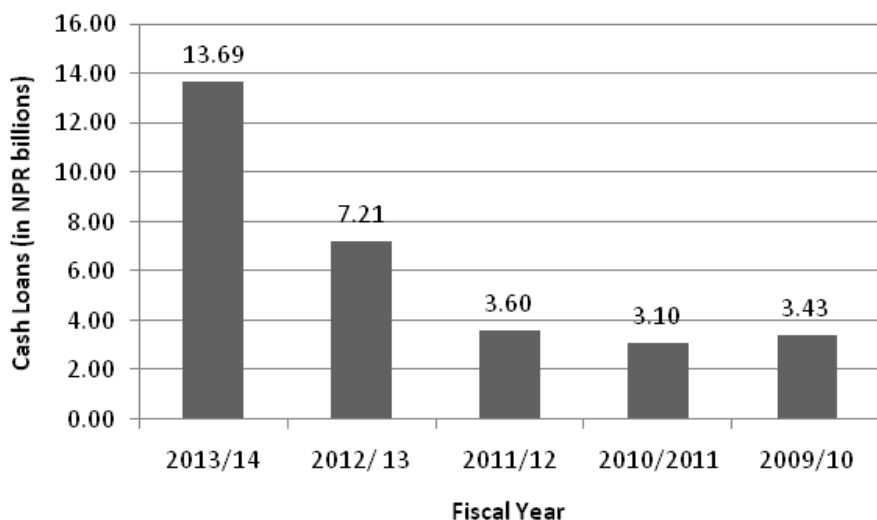
plants will be 698 KW (Bajhang 230 KW, Bajura 228 KW, and Syarpudaha and Rukum 240 KW).⁵⁴

Govt. under fire for non-transparency in TA spending: According to the 51st Annual Report of the Office of the Auditor General (OAG), while the government received technical assistance (TA) from donors worth NPR 84.48 billion (USD 0.86 billion), it is unknown as to where and through which agencies TA worth NPR 27.73 billion (USD 0.28 billion) has been spent. Questions regarding non-transparency of TA has therefore been raised, which is in conflict with the Financial Procedure Act and the directions of the Parliamentary Public Accounts Committee (PAC). While TA is generally provided by donors for detailed project reports and studies, audit reports for only 46 projects—out of 61 signed between government and donors—have been submitted to the OAG. Foreign assistance of NPR 3.33 billion (USD 34.1 million) received by eight ministries have also not been audited.⁵⁵

Swiss assistance for nutrition and road projects: A grant assistance of NPR 2.35 billion (USD 24.07 million) was pledged by the Swiss government for the implementation of two projects in Nepal. Of the total amount, NPR 337 million (USD 3.45 million) of the grant is to be spent on improving family nutrition through Home Garden Projects in 20 districts in Nepal, whereas NPR 2.12 billion (USD 21.71 million) will be spent on Local Roads Improvement Project. The former will be implemented by the Ministry of Agriculture Development/Vegetable Development Division and the latter by the Ministry

Figure 3: Comparison of Foreign Cash Grants in the 3rd quarter over past 5 years

Source: Nepal Rastra Bank

Figure 4: Comparison of Foreign Cash Loans in the 3rd quarter over past 5 years

Source: Nepal Rastra Bank

of Federal Affairs and Local Development through the Department of Local Infrastructures Development and Agricultural Roads.⁵⁶

ADB loan for Bhairahawa airport upgrade: The Asian Development Bank has pledged to assist the government with a loan of NPR 2.9 billion (USD

30 million) to upgrade the Gautam Buddha Airport in Bhairahawa into a regional international airport with high air safety systems. The support has been extended under its South Asia Tourism Infrastructure Development Project which focuses on tourism and infrastructure development in India, Bangladesh and Nepal. The airport project has also received NPR 1.7 billion (USD 17.7 million) from the Government of Nepal and NPR 292 million (USD 3 million) from the Asian Clean Energy Fund. The additional assistance is expected to assist in making the airport a full-fledged international one which can accommodate wide-body airplanes.⁵⁷

Cash loans highest in five years: A comparison of foreign aid during the third quarter over the past five years indicates that while total cash grants declined in FY 2012-13 to NPR 17.30 (USD 177.2 million), it has picked up again to reach NPR 28.14 billion (USD 288.2 million) in the current fiscal year as can be seen in *Figure 3*. Cash loans, on the other hand, stood at its highest at NPR 13.69 billion (USD 140.2 million) in comparison to the past five years as can be seen in *Figure 4*.

HEALTH

This quarter saw an end to Nepal's nearly three decade long battle against polio, thanks to the combined efforts of the international, national and communal stakeholders. The question that remains now is whether this success can be replicated to eradicate other endemic diseases such as tuberculosis, malaria and leprosy in the country.

Non communicable diseases on the rise: Research conducted by the Nepal Health Research Council indicates that a majority of the adults in the country are at risk of developing non communicable diseases. Hypertension, blood glucose, and cholesterol are becoming more prevalent as a result of increased alcohol and tobacco consumption amongst the population. While raised cholesterol level was found to be prevalent in more than a fifth of the adult population, high cholesterol and diabetes were greater among older age groups.⁵⁸

Nawalparasi health project delayed: The Equity and Access Programme in Nawalparasi that aimed at providing health and maternity services to underprivileged communities has been delayed by six months. The program was supposed to be implemented under the District Public Health Office over six months ago; however, inability to reach an understanding with partner organizations over bargains for commissions has resulted in the delay. The program had an initial budget of NPR 1.2 million (USD 12291), and was to be implemented in Bendimanipur, Ghurkot, Rakachuli, Hupsekot, Jauwari, Bharatipur, Naram and Arkhalafall.⁵⁹

Anemia widespread in western Tarai: According to Bheri Zonal Hospital in Nepalgunj, 300 people from the district were found to be suffering from anemia over the past year. Doctors, however, suspect that over 1000 people might be suffering from the disease. Health workers have warned that anemia is widespread in the districts of Banke, Bardiya, Dang, Kailali and Kanchanpur and the situation may worsen if efforts are not initiated to control it immediately.⁶⁰

NEPAL DECLARED POLIO-FREE

Having maintained its polio-free status for three years, Nepal has been declared polio-free by the World Health Organization (WHO). An independent panel of experts constituting the South East Asia Regional Certification Commission for Polio Eradication certified Nepal, Bangladesh, Bhutan, Democratic People's Republic of Korea, Indonesia, Maldives, Myanmar, Sri Lanka, Thailand and Timor-Leste—the countries constituting the WHO's South East Asia Region—as polio-free.

This certification identifies that 80% of the world's population is living in polio-free regions, which was an important step towards polio eradication. While no polio cases were reported from 2000–2004, the disease surfaced in 2005, with the last reported polio case being in 2010.⁶⁵

Table 5: Polio Cases in Nepal from 1999 to 2007

Year	No. of Polio Cases
1999	2
2000	4
2005	4
2006	5
2007	5
2008	6
2010	6

Source: Child Health Division

Continuous monitoring is now undertaken by the government through surveillance medical officers in 10 key districts in regard to vaccine safety and effectiveness, with special attention on Siraha, Mohattari and Rautahat where polio cases have been reported in the past.⁶⁷

The fight against polio in Nepal was initiated in 1988 alongside the worldwide campaign to eradicate polio; it was further bolstered with the government earmarking the National Immunization Day for Polio in 1996 after which immunization coverage doubled from 43% to 87%. Over 600,000 newborns are now administered anti-polio drops each year. According to the National Certification Committee of Polio, India's aggressive fight against polio has helped Nepal maintain its polio-free status.

Midwifery studies to be introduced: The Institute of Medicine under Tribhuvan University is working towards launching Midwifery Studies as a separate three year diploma course, with support from the United Nations Population Fund for

the upcoming academic year. According to the Ministry of Health and Population, plans are on to introduce an Act to promote midwifery services, amend existing policy, and introduce long-term policy on maternity workers.⁶¹

Rise in respiratory diseases: According to the Epidemiology and Disease Control Division, Nepal is highly susceptible to respiratory diseases due to a large proportion of the population working abroad in construction jobs, particularly in Middle Eastern and some European countries. The World Health Organization points out there have been a total of 250 laboratory confirmed cases of Middle East Respiratory Syndrome Coronavirus (MERS-CoV), including 93 deaths, from September 2012 to date. Weak surveillance mechanisms in Tribhuvan International Airport and border areas have exposed the country to the risk of influenza virus. Alarmed by the rise in respiratory diseases among the populace, the government is planning to conduct a test for MERS-CoV in the country.⁶²

Rolpa suffers from lack of medical services: Though a government hospital was established in the Rolpa district over three decades ago, the locals continue to be deprived of proper health facilities. According to the hospital staff, corruption and lack of proper management are the major reasons behind the inability of the hospital to provide services. Even the NPR 7.5 million (USD 77000) fund released by the government for the maintenance of the hospital has not been used for its purpose. Lack of qualified doctors in this district has forced the people of Rolpa to spend thousands of rupees while seeking medical services in Butwal or Nepalgunj even for minor health problems.⁶³

Kidney ailments on the rise: The doctors at Human Organ Transplant Centre state that around 10% of the

country's population is suffering from kidney related diseases, while some 3,000 people are living with failed kidneys. The government spends approximately NPR 5,60,000 (USD 5700) per person for the treatment of kidney failure, whereas Nepali citizens spend around NPR 6 billion (USD 61.5 million) for the treatment of kidney diseases abroad every year. Over 80% of kidney failures result from hypertension, diabetes, sedentary lifestyles, and obesity. Infection, heredity, and use of unnecessary medicines are among other causes.⁶⁴

INFRASTRUCTURE

Infrastructure investment requirement:

The World Bank report on 'Reducing Poverty by Closing South Asia's Infrastructure Gap' indicates that Nepal requires an investment of up to USD 18.5 billion (NPR 1.81 trillion) in infrastructure projects by 2020 to avoid constraint on its economic growth. In other words, Nepal's investment in infrastructure should be in the range of 8.24% to 11.75% of its Gross Domestic Product. The forecasted infrastructure investment requirement in the various sectors is depicted in *Table 6*.

Expansion of Birgunj dry port: Nepal Intermodal Transport Development Board (NITDB) has issued a notice to acquire 10 *bighas*⁶⁷ of land in Birgunj to enlarge the capacity of the Inland Container Depot (ICD). This will enable the board to accommodate various types of containers and reduce congestion. Currently, the dry port is spread over 38 hectares and can barely handle the 90 containers it receives every alternate

day. Last year, the Indian government had agreed in principle to allow additional railway tracks for the expanded ICD. USD 1.6 million (NPR 156.21 million) will be invested by the World Bank funded "Nepal-India Trade and Transport Project" for the construction of the extra railway tracks.⁶⁸

Upper Karnali Hydropower project:

Investment Board Nepal is slated to complete the Upper Karnali hydropower project development agreement (PDA) within two months with the developer, GMR Energy Limited. The company will manage funds within two years and complete the construction work within eight years. The project is estimated to cost NPR 139.5 billion (USD 1.43 billion). GMR will provide 108 mega watt of free electricity to Nepal once the project comes into operation and free equity of 27%.⁶⁹

New Transmission lines construction:

The Asian Development Bank (ADB), European Investment Bank (EIB), Norway, and Strategic Climate Fund are prepared to invest in a USD 440 million (NPR 42.96 billion) project to construct new transmission lines in Marsyangdi and Kali Gandaki corridors. The construction of transmission lines will occur under the ADB's South Asia Sub-Regional Economic Cooperation Power System Expansion Project.⁷⁰

Water and energy commission bill:

The Water and Energy Commission Secretariat (WECS) is preparing a law which, if endorsed, will require hydropower developers above 10 MW and irrigation projects of more than 500 hectares to go through WECS,

Table 6: Infrastructure Investment Requirement 2011-2020

Sector	USD 'In Billions'	NPR 'In Billions'
Transport	5.50	536.97
Electricity	7.00	683.41
Water supply and Sanitation	2.60	253.84
Solid Waste Management	0.50	48.82
Telecommunication	0.60	58.58
Irrigation	2.30	224.55

Source: *Reducing Poverty by Closing South Asia's Infrastructure Gap*, World Bank December 2013

besides the VDC, at local level and Ministry of Energy to acquire survey license.⁷¹

Investment in Terai roads: A proposed budget of NPR 794.5 million (USD 8.14 million) for road expansion in Terai has been announced by the Minister for Physical Infrastructure and Transport. The budget would be used for repairing postal road and for the construction of culverts and bridges in Dhanusha, Mahottari, and Sarlahi districts.⁷²

Investment in Kathmandu-Hetauda tunnel highway: TBi Holdings, a company promoted by non-resident Nepalis (NRNs), has signed a share purchase agreement worth NPR 1 billion (USD 10.24 million) with Nepal Purbhadhaar Bikas Company (NPBC) to develop the Kathmandu-Kulekhani-Hetauda tunnel highway. The total project cost is estimated at NPR 35 billion (USD 358.5 million) and is expected to be completed by the end of 2016.⁷³

MANUFACTURING AND TRADE

The first nine months of the fiscal year 2013-14 saw an improvement in the manufacturing and trade sector, with the total exports from the country increasing by 19.2%, a 3.5% increase compared to the same period in last FY 2012-13. The import growth rate also increased as compared to the last fiscal from 20.3% to 27.7%. This growth can be attributed to a massive surge in the imports resulting in a bloating trade deficit and also to the depreciation of the local currency against the US dollar.

Top exports, imports in the first nine months of the current fiscal: The total exports from the country was recorded at NPR 68.12 billion (USD 697.73 million) during the first nine months of the current fiscal year, according to the current macroeconomic situation published by Nepal Rastra Bank. Amongst the major exports, woolen carpets topped the exports list with total exports of NPR 5.5 billion (USD 56.33 million), an increase of 25.8% as compared to that of the same review

period last year. Similarly, zinc sheets exports to India were worth NPR 5.15 billion (USD 52.75 million), a growth of 35.9% from the corresponding period of last year. Likewise, textile and polyester exports were worth NPR 4.19 billion (USD 42.91 million) and NPR 3.83 billion (USD 39.22 million), increase of 1.7% and 9.4% respectively. Moreover, the export of pashmina took a leap of 13.5% to NPR 42.2 million (USD 0.43 million).

Likewise, the petroleum products topped the imports list during the first nine months of the current FY, where products worth NPR 97.9 billion (USD 1 billion) were imported. Also, vehicle and spare parts import from India was worth NPR 25.1 billion (USD 257.09 million). While gold imports saw a meager increase of 3.5% from NPR 19 billion (USD 194.61 million) to NPR 19.5 billion (USD 199.73 million), imports of MS wire rod fell significantly by 98.3% from NPR 1.3 billion (USD 13.31 million) to NPR 23 million (USD 0.23 million).⁷⁴

Trade deficit surges: In the first nine months of the current fiscal year, Nepal's total trade deficit has gone up by 29.1% to NPR 454.06 billion (USD 4.65 billion). The increase in deficit during the same period last fiscal was 23.6%. Trade deficit with India this FY 2013-14 increased by 30.4% to NPR 303 billion (USD 3.10 billion) in comparison to 16.5% increase in the same review period last year. Similarly, trade deficit with other countries increased by 26.6% to NPR 150 billion (USD 1.53 billion) in contrast to 16.5% during the same review period last year.

During the review period, the country's total exports amounted to

NPR 68.1 billion (USD 0.69 billion), whereas the total imports stood at NPR 522.18 billion (USD 5.34 billion). Imports from India increased from NPR 270.22 billion (USD 2.76 billion) to NPR 348.7 billion (USD 3.57 billion), an increase of 29%, whereas the total imports from other countries increased from NPR 138.6 billion (USD 1.41 million) to NPR 173.4 billion (USD 1.77 million), an increase of 25.2% as compared to the same period last year. (Refer to Table 7: Foreign Trade Statistics based on Nine Months data of 2013-14).⁷⁵

Nepal imported agro products worth USD 1.01 billion last FY: According to the statistics published by the Ministry of Agricultural Development, Nepal imported raw and processed agro products worth NPR 99.34 billion (USD 1.01 billion) in FY 2012-13, an increase of 30.63% as compared to the FY 2011-12.

Top agro imports of Nepal includes vegetable products, prepared foodstuff, oils and their cleavage products, cereals, edible vegetables, fruits and nuts, live animals, maize, betel nuts and dairy produce (see Table 8: Comparison of Import of Agro Products in FY 11-12 and FY 12-13).

Among the vegetable products, imports of edible vegetables, roots and tubers amounted to NPR 9.71 billion (USD 99.45 million). The country imported 225,229 tons of fresh and chilled potatoes worth NPR 3.07 billion (USD 31.44 million). Cereals, imports of semi-milled or wholly milled rice amounted to NPR 9.23 billion (USD 94.54 million). Imports of rice from India alone amounted to NPR 8.94 billion (USD 91.57

Table 7: Foreign Trade Statistics based on Nine Months data of 2013-14

NPR in millions	2011/12	2012/13 ^R	2013/14 ^P	Percent Change	
				2012/13	2013/14
TOTAL EXPORTS	55242.2	57159.0	68121.0	3.5	19.2
To India	37437.4	37580.7	45340.2	0.4	20.6
To Other Countries	17804.8	19578.3	22780.8	10.0	16.4
TOTAL IMPORTS	339844.0	408830.1	522185.1	20.3	27.7
From India	219829.1	270221.3	348704.7	22.9	29.0
From Other Countries	120014.9	138608.8	173480.4	15.5	25.2
TOTAL TRADE BALANCE	-284601.8	-351671.1	-454064.1	23.6	29.1
With India	-182391.7	-232640.6	-303364.5	27.6	30.4
With Other Countries	-102210.1	-119030.5	-150699.6	16.5	26.6
TOTAL FOREIGN TRADE	395086.2	465989.0	590306.1	17.9	26.7
With India	257266.5	307802.0	394044.9	19.6	28.0
With Other Countries	137819.7	158187.1	196261.2	14.8	24.1

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

Source: NRB Report - Recent Macroeconomic Situation (9 months), 2010/71

Table 8: Comparison of import of agro product in FY 11-12 and FY 12-13

(NPR in billions)

S.No.	Items	2011-12	2012-13
1	Vegetable products	35.3	50.9
2	Foodstuffs, beverages and tobacco	18.8	26.2
3	Animal or vegetable fats and oils	18.6	18.5
4	Live animals, animal products	3.4	3.7
	Total	76	99

Source: The Kathmandu Post, Agricultural Ministry

million). The country also imported maize worth NPR 4.85 billion (USD 49.6 million) from India. Imports of paddy amounted to NPR 4.75 billion (USD 48.65 million).

Meanwhile, Nepal imported 52,910 tons of fresh apples worth Rs 1.27 billion (USD 13 million), according to the ministry. Imports of coffee, tea and spices amounted to Rs 4.15 billion (USD 42.50 million) in the last fiscal.⁷⁶

BOP surplus increases to NPR 106 billion: During the first nine months of the FY 2013-14, the country's Balance of Payment (BOP) recorded a surplus of NPR 106.23 billion (USD 1.08 billion) compared to a surplus of NPR 30.77 billion (USD 315.16 million) during the same period the previous year. The substantial increase in the BoP has been attributed to rise in net services, grants, net income and workers' remittances.

Workers' remittance rose by 31.5% to NPR 397.80 billion (USD 4.07 billion) compared to the increase of 21.9% in the corresponding period last year. The current account posted a surplus of NPR 68.7 billion (USD 703.67 million) in the review period in contrast to a surplus of NPR 22.24 billion (USD 227.79 million) in the same period last year.⁷⁷

Government to revise NTIS: In order to adapt to the changing context, the government decided to revise the list of products and services in the Nepal Trade Integration Strategy (NTIS) 2010. The NTIS 2010 consists of 12 products and 7 services. The products include pashmina, honey, lentils, handmade paper, cardamom, tea, iron and steel, noodles, silver jewelry,

ginger, medicinal herbs/essential oils and woolen products, while the services include education, tourism, engineering, health, hydroelectricity, labor service, and information technology and business process outsourcing. Out of these, exports of iron and steel, tea and woolen products increased whereas honey, silver jewelry, lentils, ginger and herbal products decreased significantly.

As per the Trade and Export Promotion Centre, exports of NTIS products grew by 11% to NPR 26.85 billion (USD 275.01 million) during the last FY. The Ministry of Commerce and Supplies has shortlisted firms for assessing the performance of the existing products and services under the NTIS, recommendation of low-performing products and services and inclusion of new ones.⁷⁸

Policies to streamline domestic trade being formulated: The Government of Nepal is in the final stages of drafting four policies with the aim to create a competitive environment for businesses, increasing efficiency in internal trade, and protecting the rights of consumers and producers. The four policies are Internal or Domestic Trade, Price Monitoring, Consumer Protection, and a guideline to implement the Competition Promotion and Market Protection Act. These policies are being prepared to improve the business environment and expand the roles of the government and the private sector in trade and investment promotion.

The policy regarding internal or domestic trade will give recognition to domestic products and encourage the private sector in promoting trade and investment. The price monitoring policy will help the government in regulation of prices. The consumer protection

policy will discourage unfair market practices and protect consumer rights, and the guideline to implement the Competition Promotion and Market Protection Act will control black marketing and artificial price hikes.⁷⁹

REAL ESTATE

Government renting homes for VIPs:

The government is now proposing to rent properties for VIPs after its plan to buy houses and apartment units in Kathmandu for VVIPs and VIPs and other high ranking officials failed. The plan to buy properties was shelved after only one single property developer bid for the scheme. Currently, the Department of Urban Development and Building Construction is preparing to issue a tender notice to rent apartments and houses.⁸⁰

Increase in home loans: As per Nepal Rastra Bank (NRB), home loans increased from NPR 58 billion (USD 594.08 million) in February 2013 to NPR 77 billion (USD 788.70 million) in February 2014. On the other hand, real estate loans continued to decline, which came down by NPR 7 billion (USD 71.70 million) to NPR 82.8 billion (USD 848.10 million) during the same period. In February 2014, commercial banks' loan exposure stood at 7.8% while for development banks it was 8.36%, which is well below the 10% maximum limit set by the NRB.⁸¹

Third party criteria for constructing new buildings:

Besides the concerned owner and Kathmandu Metropolitan City (KMC), construction of all new buildings within the valley will have to be supervised by a third party. The

third party will provide consultations to owners regarding the existing legal and technical aspects of construction and the national building code.⁸²

Misappropriation of funds under housing schemes: A total of 468 complaints under the housing segment against 11 cooperatives have been received by the high level commission formed to probe troubled cooperatives. It is estimated that promoters have misappropriated NPR 1.33 billion (USD 13.62 million) in the name of housing projects.⁸³

Online Land records: The Department of Land Reforms and Management (DoLRM) is working to implement a new automation system—the Land Records Information Management System (LRIMS)—in 14 Land Revenue Offices within six months. Maintaining online database at Land Revenue Offices at Dilli Bazaar, Chabahil, Kalanki Bhaktapur, Lalitpur, Baglung, Morang, Chitwan, Dhading, Kaski, Kavre, Makwanpur and Parsa has begun under the LRIMS. LRIMS is devised to automate land transaction related functions of the Land Revenue Offices on different land transaction process requirements and to make the information easily accessible to landowners and related authorities.⁸⁴ The project has been funded by Asian Development Bank. An agreement worth USD 1.365 million (NPR 133.26 million) was signed between the DoLRM and RMSI India to implement the system.

REMITTANCE

Remittance inflows to Nepal reached NPR 397.8 billion (USD 4.07 billion) in the first

9 months of the fiscal year 2013-14, registering an increase of 31.5% as against an increase of 21.9% during the same period of the last fiscal year (see Figure 5: *Inflow of Worker's Remittance for First 8 Months of Past Two Fiscal Years*). In US dollar terms, remittance inflow went up by 15.6% to USD 4.02 billion (NPR 392.5 billion) compared to an increase of 8.8% in same period of the previous year.⁸⁵ On a monthly basis, remittances inflows declined by 8.3% in March/ April of the current fiscal year compared to the inflows in February/March.

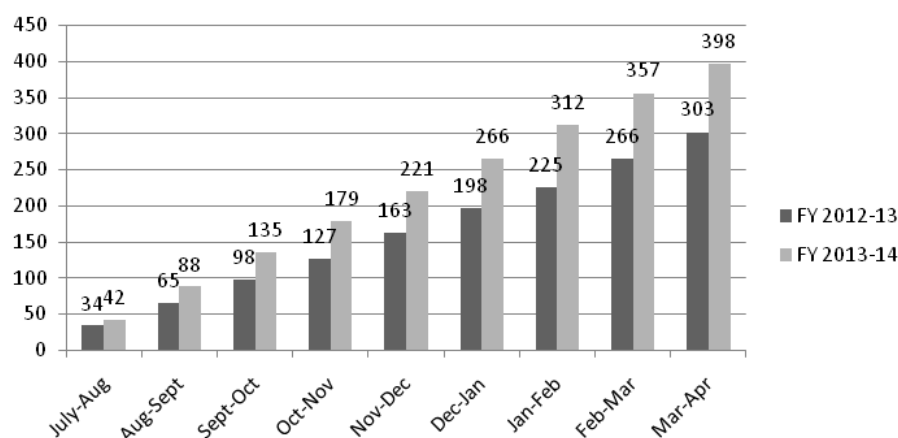
Increasing remittance has positively contributed to the Balance of Payments (BoP), recording a surplus of NPR 106.2 billion (USD 1.08 billion) by mid April, as against a mere NPR 30.7 billion (USD 314 million) during the same period of last fiscal year. The growing BoP surplus is an indication that Nepal is earning more than it is paying for the transactions done with the rest of the world.

Foreign employment attracts 700,000 Nepalis in nine months: A total of 686,532 migrant workers left the country for foreign employment in

the first nine months of FY 2013-14 (see Figure 6: *Monthly data of Nepali workers seeking foreign employment for the past five years*).⁸⁶ The highest number was recorded from mid February to mid April, with approximately 32% of the total migrant workers leaving in these two months. While Qatar was the top destination for Nepali workers, Malaysia, UAE, Saudi Arabia and Kuwait ranked second to fifth respectively.

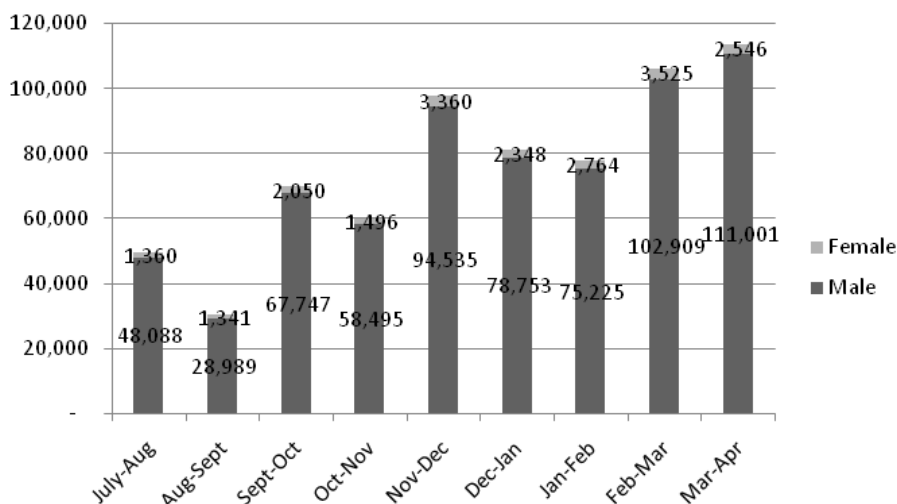
Second batch of Foreign Employment Bond 2075 issued: Nepal Rastra Bank issued the second batch of the five year NPR 1 billion (USD 10.2 million) Foreign Employment Bond from March 19 to April 8. The second batch also saw an issue worth NPR 250 million (USD 2.56 million) yielding 9% interest. While the first batch realized a subscription of 10%⁸⁷, the second batch was more popular fetching a subscription of 20%. Of the NPR 500 million (USD 5.12 million) issued, migrant workers have subscribed to a total of NPR 76.4 million (USD 783,000), as compared to NPR 42.8 million (USD 438,000) of the entire NPR 1 billion (USD

Figure 5: Inflow of Worker's Remittance for First 9 months of FY 2012-13 and FY 2013-14



Source: Current Macroeconomic Situation of Nepal (Based on Five Months' Data of 2013-14), Nepal Rastra Bank

Figure 6: Monthly Figures for Migrant Workers Seeking Foreign Employment for FY 2013-14



Source: Monthly Progress Report for Preapproval Details for Chaitra 2070, Department of Foreign Employment

10.2 million) bond last fiscal year.⁸⁸ However, the bond saw the most subscription from Papua New Guinea and least from countries with high migrant population such as Qatar and UAE. This suggested that only Nepalis with better paid jobs bought the bonds.

Death toll of migrant workers rises:

A total of 862 migrant workers lost their lives abroad in a span of a year from mid April 2013 to mid April 2014, as against 677 deaths of last year. The death toll rose by 21% from mid April 2012 to mid April 2013.⁸⁹ Additionally, 104 migrant workers returned with disabilities between mid April 2013 and mid 2014, as against 65 of the previous year. As per the Department of Foreign Employment, the primary cause was due to cardiac arrest, followed by natural causes, traffic accidents, suicide, heart attacks

and death at the workplace.

One stop shop for foreign employment services:

The government has initiated efforts to build a labor village to provide all foreign employment services from one location. The Ministry of Labor and Employment leased 22 *ropanis* of land at Soltimode from Nepal Trust for this purpose. The Village has begun providing services for Qatar and Malaysia, with plans of relocating various governmental and non-governmental offices, including the Foreign Employment Promotion Board, to the new location.⁹⁰ Additional plans for the Village include bringing private stakeholders, including recruiting agencies, pre-departure orientation, training and health centers, to the Village as well. The objective of setting up the Village is to speed up the process and ensure convenience.

TELECOMMUNICATION AND MEDIA

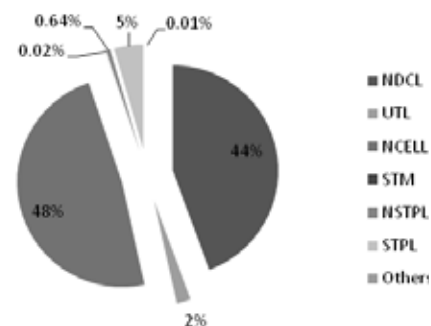
Nepal's teledensity has increased to 88.5% as of mid April 2014. During the same period, Ncell's customer base stood at 11.33 million subscribers, while Nepal Telecom (NT) had 10.41 million subscribers (including fixed line and mobile lines), an increase of 5% and 8% during the last six months. United Telecom Limited (UTL) witnessed a decrease of 31% during the same period. Ncell and NT market share currently stand at approximately 48% and 44% respectively.⁹¹ The market share of the telecom operators are shown in Figure 7.

The data/internet services penetration rate currently stands at 32%. NT leads in the data segment with 51% market share, followed by Ncell and UTL with a market share of 47% and 1 % respectively. The growth trend of voice telephone and data service penetration is depicted in Figure 8.

Nepal Telecom expands 3G Service:

As a part of its plan to add 10 million mobile lines, Nepal Telecom (NT) has expanded its third generation (3G) service to 20 districts in the Eastern, Mid-Western and Far Western regions.

Figure 7: Market Share of Telecom Operators



Source: MIS Report, Nepal Telecommunications Authority

Under the project, NT has erected 107 Base Transceiver Station (BTS) towers in these districts to expand its 3G service. The service is available in Sunsari and Morang districts in the Eastern Region; Banke, Bardia, Surkhet, Dailekh, Dang, Rolpa, Salyan, Pyuthan and Jumla districts in the Mid-Western Region; and all the nine districts in the Far Western Region. 3G network will be initially available to customers residing in the district headquarters, major business hubs and surrounding areas. This ambitious project was started two years ago.⁹²

Smart Telecom to bring international strategic partner: Smart Telecom, which bagged the unified licence last year, plans to sell certain percentage of its shares to an international partner once the Due Diligence Audit is complete. The company has 80% investment from Singapore based Lal Sahu Distribution and 20% from Square Network, a local firm.⁹³

Connecting Google Maps with BTS: In a bid to ease monitoring telecom services, Nepal Telecommunication Authority (NTA) plans to connect base transceiver stations (BTS) with Google Maps and convert BTS towers of all service providers into Geographical Information System (GIS). NTA intends to shortlist the consultant within this fiscal year and convert all BTS tower into GIS in the next fiscal year.⁹⁴

Revision of terms of permit for ISPs, NSPs: Nepal Telecommunication Authority (NTA) is reviewing licensing conditions for internet service providers (ISPs) and network service providers (NSPs) to make

GLOBAL ECOMMERCE MARKET

The ecommerce market has seen tremendous growth globally over the past decade. Total global online sales reached USD 1.22 trillion in 2013. In China alone, the figure stood at around USD 200 billion. There are around 200 million internet users in neighboring India alone, and this number could grow to 500 million by 2015, according to consulting firm McKinsey & Co.

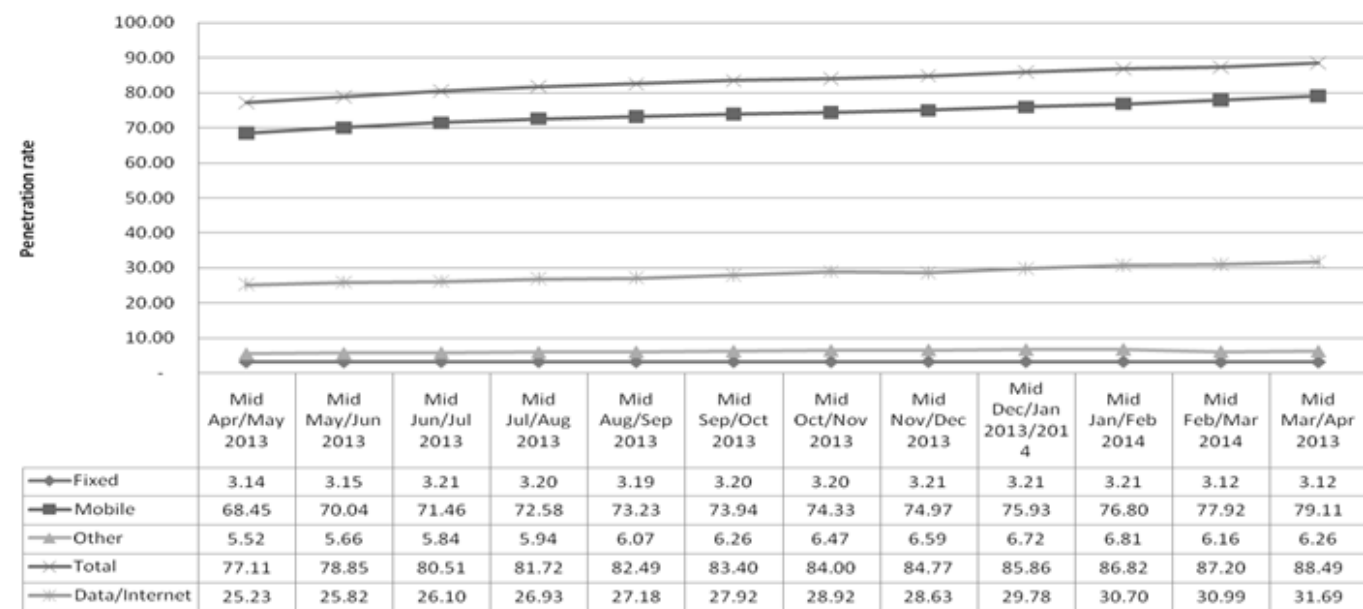
Nepal's e-Space: Nepal is also witnessing increased activity in the ecommerce market in recent times. Over the last few years, dozens of websites have been launched in Nepal to sell everything from books to clothes to flight tickets to second hand goods. Online payments are rising steadily. Internet penetration in Nepal currently stands at 31.69% (mid March-April).⁹⁷ With the telecom companies offering affordable Internet services coupled with a growing smart phone market, this number is expected to grow significantly in the next few years and help boost the ecommerce market.

Budding ecommerce industry: There is a common saying about the Nepali retail consumers' mentality – "can't touch, won't buy." However, the trend is gradually changing. A younger market with 22.6% of the population between 15-24 years and 34.9% between 25-54 years⁹⁸, along with higher incomes and better awareness is fueling this. As people are getting busier, they are realizing how the internet can make their life easy. While some companies are tapping into this and filling the gaps in the market, others are displacing the traditional brick and mortar stores. They have a huge advantage compared to brick and mortar stores, since operational costs are lower for online ventures; there is wider reach of products and services since there is no theoretical geographic limitation, which benefits them and the consumers.

Challenges faced: The ecommerce business is expected to develop further in the next few years on the back of a fast growing internet-connected population and improvement in related infrastructure such as payment and delivery systems. The latter is still posing the biggest hindrance to its growth, since there are no proper payment gateways in the market as a result of government restrictions and absence of strong lobbying for it. Development of a payment system, legalizing and securing payments and creating reliability from portals is a major issue at the moment. Also, since all houses and localities don't have proper addresses yet, delivery at times becomes a huge constraint as well.

Nonetheless, the ecommerce market is on the path to contributing significantly to the economy, going by past practices. Since the industry is still at a very nascent age with no proper data, it is hard to put an overall number or valuation to it. Though it is probably just a small percentage of the total revenues of traditional retail companies, the online market is definitely growing at a rapid pace. Overcoming the aforementioned challenges will help the industry unleash its full potential, as has been the case in other economies.

Figure 8: Growth trend of voice telephone and data service service penetration



Source: MIS Report, Nepal Telecommunications Authority

them compatible to latest technological advancements. The revision to license conditions is expected to make monitoring of services by ISPs and NSPs easy and effective for NTA.⁹⁵

Separate company to build telecom infrastructure: NTA is exploring the possibilities of establishing a new company to build telecommunication infrastructure. The sole aim behind this is to eliminate costly infrastructure duplication efforts of service providers and overcome disputes over sharing resources.⁹⁶

TOURISM

In an effort to create a sustainable tourism growth within the country, Nepal Tourism Board (NTB), Hotel Association

Nepal (HAN), along with various companies associated with tourism are jointly working together to promote several tourism related projects. NTB, after the ineffective one year tourism plan, is now planning to launch a five-year tourism plan for strategic development of the tourism industry, whereas HAN has unveiled its 10-points plan of attracting 2 million tourists by 2020.

Employment from tourism on the rise: In 2013, the Nepali travel and tourism industry directly supported 3.2% of the total employment of the country. This figure represents 504,000 direct jobs supported by tourism; the figure is expected to rise by 6.4% to 536,000 in 2014. Tourism creates various direct, indirect, and induced jobs in hotels, travel agencies, airlines and many other areas of the economy (*see Table 9: Economic contribution of Tourism*).

According to the Travel and Tourism Economic Impact 2013 report published by World Travel and Tourism Council, the total contribution of tourism to the country's Gross Domestic Product (GDP) was NPR 145.3 billion (USD 1.48 billion), which is 8.2% of the total GDP. The revenue generated from tourism sector is 21% of the total export. In terms of capital investment in the tourism sector, Nepal ranked 126th, which is far behind other South Asian countries such as India, Sri Lanka, and Bangladesh that rank 4th, 71st, and 83rd respectively.⁹⁹

Investments rise in hotel industry: The hospitality sector in the lake city of Pokhara is witnessing an expansion spree with the local entrepreneurs opening up new hotels and expanding their current capacity. This surge

in investment follows the positive signals—a rapidly increasing domestic and foreign tourist inflow and tourist spending—that the tourism industry in Pokhara has been receiving lately.

Investments of around NPR 1 billion (USD 10.24 million) are expected to be pumped into various hotel development projects. Some of these projects include the expansion of The Glacier Hotel at Lakeside and Bajra Inn at NPR 150 million (USD 1.53 million) and NPR 50 million (USD 0.51 million) respectively, and the construction of Batika Hotel with an investment of NPR 100 million (USD 1.02 million).¹⁰⁰

Tourist arrivals in controlled area increases: The number of foreign tourists visiting the controlled areas increased to 12,937 trekkers in 2013 as compared to 11,632 trekkers during 2012, an increase of 11.2%. The foreign tourists are required to avail of special permits from the Department of Immigration (DOI) to travel to these areas. Also, the DOI does not issue permits to individual trekkers. Only those travelling in a group through a government authorized trekking agency can apply for the permit. The permit fees charged to the trekkers range from USD 10 per week to USD 500 for 10 days.¹⁰¹

As per the data received for 2013 from the Ministry of Culture, Tourism and Civil Aviation, the Manaslu region in Western Nepal received the highest number of trekkers at 4,439, followed by Mustang, Humla, Tsum Valley, Narphu and Kanchenjunga receiving 2,862, 1603, 1179, 862, and 837 trekkers respectively. However, the trekkers to Upper and Lower Dolpa have decreased by 36.94% and 40.43%

Table 9: Economic contribution of tourism

COMPONENT	2013	2014 (FORECAST)
Tourist arrivals	796,000	861,000
Direct jobs	504,000	536,000
Income from tourists(NPR)	39.1 billion	43.8 billion
Domestic travel spending(NPR)	71.1 billion	77.3 billion
Total contribution to GDP (NPR)	145.3 billion	157.8 billion
Direct contribution to GDP (NPR)	68.8 billion	75.6 billion
Investment(NPR)	14.6 billion	15 billion

to 338 and 585 trekkers respectively. The government, during the 1970s, had declared most of the villages in districts bordering China's Tibet region as restricted and controlled areas. Trekking agencies and tour operators have been lobbying with the government to open up such areas that have an immense potential to contribute to the country's tourism as well as the local economy.

Sun Koshi rafting declared best in the world: Lonely Planet, the largest travel guide book publisher in the world, has named Sun Koshi River Rafting as the best rafting river in the world. The travel guide book, in its article Hold tight: the world's best rafting rivers, declared the Sun Koshi as the best in the world, followed by the Magpie River in Canada, Zambezi River in Zimbabwe/Zambia, Alsek River in USA/Canada, Middle Fork of the Salmon River in USA, Franklin River in Australia, Rio Futaleufú in Chile, Rio Cotahuasi in Peru, Colorado River in USA, and Noce River in Italy.¹⁰²

According to the Nepal Association of Rafting Agents, around 15% of the tourists visiting Nepal go rafting. The government has allowed rafting on only 14 of the 6,000 rivers flowing across the country. The Sun Koshi is commercially rafted between September and January, after which the river triples in volume and becomes un-raftable. It takes up to 10 days to run the river.

New trekking routes to promote tourism: New trekking routes are being constructed in different parts of the country to promote tourism. Six new routes in Myagdi will soon be launched with the view to make historical and religiously significant sites accessible, and an alternative route in the Annapurna circuit is being developed to increase the flow of tourists in the area. Likewise, ongoing construction of Galeswor, Piple, Begkhola, Chimkhola, to Dhaulagiri Aaisafal trail and Bhu-tatopani, Naryang will be completed this fiscal.¹⁰³

The trekking routes to be developed were introduced after the tourism budget comprising of NPR 5.9 million (USD 0.06 million), which had been blocked for the last three years, were released this FY. To promote mountains below 5,800 meters and to develop mountaineering activities, the Government of Nepal has also decided to open 104 new peaks for mountaineering.¹⁰⁴ Now with the addition of 104 peaks, 310 mountains are open for trekking in Nepal.

Avalanche kills guides and climbers:

Sixteen Sherpa guides were killed in one of the deadliest high altitude avalanche on Mount Everest on April 18. The avalanche took place in the Khumbu Ice Fall just above the base camp-I as the guides were setting the ropes and preparing camps along the routes.¹⁰⁵ The entire expedition was cancelled due to the tragic accident even though the mountain remains open for expedition. The spring climbing season is regarded as the busiest season of the year. About

334 foreign climbers had been given permission to climb Mount Everest and an estimated 400 Sherpa guides are helping the climbers. Similarly, on May 22, three climbers, two Nepali and one Indian, died on Kanchenjunga as an avalanche hit them at an altitude of 7500 meters while descending. A group of 13 members had scaled the world's third tallest mountain. However, their accomplishment was soon overturned by sorrow as they lost three of their members.¹⁰⁶

“ MACROECONOMIC OUTLOOK

The streamlining process of the agriculture sector by the government to commercialize and increase productivity seems to be heading in the right direction. Crop insurance, one of the most important risk management tools for farmers, has been getting ample attention from the government and now it is time for the small framers to realize its importance. A few other challenges, such as market development and market access, supply of agro inputs, etc., still exist in the agriculture sector that needs focus from the government.

While efforts are on for the development of education sector in Nepal, there are various loopholes which result in the quality of education suffering. While the government's decision to make English the medium of instruction in all government schools has resulted in increased enrolment of students, yet its failure to look into the problem of textbook shortages undermines its efforts to make quality education available for everyone. As such, a continued focus needs to be placed by the government on building a foundation for a reliable system that will help it achieve its goals.

With theft of petroleum products rampant, Nepal Oil Corporation's (NOC) problems regarding uninterrupted supply have been mounting. Approximately, 10,500 liters of petroleum products are stolen every day. This coupled with NOC owing Indian Oil Corporation, it is likely that shortages will continue unless a more permanent solution is drafted rather than provisioning for loans to clear outstanding dues. Nepal Electricity Authority (NEA), on the other hand, has not

been able to successfully complete transmission line because of which Power Purchase Agreements are coming to a halt. Unless, NEA finishes the construction of proposed transmission lines on time, electricity shortage will not be alleviated even in the long run. Nonetheless, with the onset of the monsoon season, loadshedding hours will reduce in the next quarter.

While Nepal continues to get ample amounts of foreign aid, its weak absorption capacity means that it has not been able to effectively utilize foreign aid. Considering the improvement of Nepal in the World Bank's annual rating of countries, and the increasing trend of aid, the weak absorption capacity needs to be particularly addressed and full utilization of aid ensured.

Nepal is still lagging behind in the health sector despite making certain progress. Concerted efforts are, therefore, still required in regard to public health, endemic diseases and immunization facilities, especially among the rural population, which faces a majority of the health problems due to lack of timely health care.

Despite the trade deficit ballooning year-on-year, the country's ability to import goods and services is quite good due to a massive inflow of remittance that has resulted in the foreign exchange reserve piling up. Although remittances have been increasing, the country needs to make investments into local industries and into the productive sectors of the economy, thereby minimizing imports. Industries need to

be set up; sectors that produce export-oriented goods and services and bring in foreign currency should be promoted.

The introduction of online land records is a welcome step that will ease the land transaction related difficulties currently faced by property owners. Besides allowing them to view information from their homes, the new automated Land Records Information Management System will enable the government to increase scrutiny on several issues, including deviation from rules by the government officials and the middle men.

Migration of Nepali workers to foreign countries is resulting in an acute shortage of labor in the housing sector. The demand and supply gap has widened over the years forcing employers to hire Indian workers. Due to the demand supply mismatch, wage rates have doubled as compared to the last two years. This has led to shortage, increasing cost and overall slowed down housing projects.

The physical progress of major infrastructure projects have seen little government spending in the first half of the current fiscal year 2013-14. Despite being listed as a national priority project, the fate of Kathmandu Fast Track remains undecided as developers walked away from the project. The government is yet to decide whether to re-invite foreign investors or spend its own money. Though NPR 500 million (USD 5.12 million) has been allocated, the money has remained unused. Similarly, the Mid-Hill Highway Track opening, which was expected to be completed some months ago, is still struggling to open 3.5 km of track in the western section. As far as the Postal Road is concerned, of the 20 bridges targeted, only two bridges have been completed so far.¹⁰⁷ These instances clearly indicate that the government will not be able to meet the targets set in the policy and program.

While the remittance inflows have been increasing to Nepal, most of it is spent on consumption. Despite efforts such as the introduction of Foreign Employment Bonds, the government has not been successful in utilizing such inflows towards productive sectors. On top of that, the negative consequences of foreign employment cannot be ignored. Each year around half a million youths enter the job market in Nepal and most do not find any work. Foreign employment is the only option for them. And given that the prospects of job creation in the immediate future look bleak, foreign labour migration will continue to be youth's choice for many years to come. Therefore, the

government should extend its necessary support and explore new lucrative markets for the Nepali workers.

Nepal Telecom and Ncell are currently engaged in a fierce competition for the top spot, with both telecom giants focusing on the expansion of their services. While Ncell may lead Nepal Telecom in terms of the number of mobile SIM lines distributed, Nepal Telecom still has high number of active subscribers. The number of active mobile phones for both the operators is more or less equal.

GSM is the most popular technology here in Nepal with almost 2 million users, with a significant number of new subscribers signing up for the service every month. On the other end of the spectrum, CDMA and landline subscribers are growing at a snail's pace. The internet penetration rose to 31.69% from 31% during mid March-April, mainly due to the expansion of GPRS and 3G across the country by Nepal Telecom and Ncell. While Nepal Telecom is more aggressive in expanding their network, Ncell is promoting their already existing network with various schemes and offers. With the current trend, the internet penetration is expected to reach 50% within this year.

Since tourism is defined as a priority sector, all the stakeholders involved should designate it as a national prior industry. The government needs to designate various parts of the country as Tourism Destination Development Zone where the private investors should be given special facilities in getting the state owned land, basic infrastructure support and encouraging tax benefits for several years.

Likewise, with the initiative of the Nepal Tourism Board (NTB) on developing a five-year tourism plan from the next fiscal year, the tourism sector will witness a planned and strategic development of the industry. The board has proposed to conduct global marketing of Nepali tourism, organize advertisement campaigns and establish international offices abroad.

NTB also plans to have strong promotional activities in BRICS (Brazil, Russia, India, China and South Africa) nations. Additionally, the plan also aims to promote tourism of the country culturally, religiously, agriculturally and geographically. NTB has laid prime emphasis on political stability. Similarly, it gives equal weight to the development of infrastructure, purchase of aircraft for the national flag carrier, investment in the hospitality sector, and tourist security, among others.

The background features a large, light gray, stylized letter 'R' on the left side. A trail of small, light gray dots starts from the top left and curves downwards and to the right, ending near the bottom right. The word 'REVIEW' is written in a simple, black, sans-serif font, positioned in the lower right quadrant of the page, overlapping the right side of the 'R' and the trail of dots.

REVIEW

REVIEW

Financial Markets

The deposit mobilization of Banks and Financial Institutions (BFIs) at the end of first nine months of the current FY 2013-14 depicts strong deposit growth rate as compared with the same period of the previous fiscal year.

As per the current macroeconomic situation report for the first nine months of FY 2013-14 published by Nepal Rastra Bank (NRB), the deposit mobilization of BFIs increased by 11.4%, i.e. NPR 135.28 billion (USD 1.38 billion), as compared to a 8.4%, i.e. NPR 85.44 billion (USD 875.14 million), during the same period last year. During the review period, deposit mobilization of commercial banks increased by 10.9%, development banks by 16.9% and finance companies by 10.7%. The deposit mobilization of commercial banks had increased by 7.5%, development banks by 10.9% and finance companies by 7.3% in the same period the previous year.

Likewise, loans and advances of BFIs increased by 10.9%—NPR 125.40 billion (USD 1.28 billion)—compared to a growth of 14.9%—NPR 143.94 billion (USD 1.47 billion)—in the same period the previous year. In the review period, loans and advances of commercial banks increased by 10.8%, development banks by 16.6%, and finance companies by 8.5%. In the corresponding period of the previous

year, such loans and advances had increased by 14.3%, 10.8% and 8.1% respectively.

In order to control the excess liquidity of the BFIs, NRB mopped up net liquidity of NPR 348 billion (USD 3.56 billion) through reverse repo auction and NPR 8.50 billion (USD 87.06 million) through outright sale auction in the corresponding period of the previous year. The NRB purchased Indian currency (INR) equivalent to NPR 225.70 billion (USD 2.31 billion) through the sale of USD 2.28 billion in the review period.

INTRODUCTION OF ACQUISITION BYLAW

Nepal Rastra Bank has introduced the Acquisition Bylaw by creating ways for BFIs to raise their net worth and expand their balance sheet size by acquiring similar organizations. The bylaw also includes a provision of forceful acquisition if the central bank deems it necessary. Under the forceful acquisition provision, if a single group has promoted more than one BFI, the central bank may force them to be

acquired by other BFIs. Similarly, BFIs failing to lower non-performing loans below 5% for three consecutive years or those facing prompt corrective action for at least three times, and those failing to pay liabilities may also be subject to forceful acquisition. Moreover, the central bank may also force BFIs to be acquired if they fail to raise paid-up capital to the required level, issue public shares timely, and if the issued shares are not subscribed.

According to the bylaw, commercial banks or Class 'A' financial institutions (FIs), development banks or Class 'B' FIs, and finance companies or Class 'C' FIs can acquire each other. However, these institutions are barred from acquiring microfinance banks or Class 'D' FIs. Microfinance institutions can only be acquired by other microfinance institutions.

Likewise, in order to ease the acquisition process, the latest bylaw has also offered concessions to institutions that complete takeover process. Under this facility, NRB will give additional time for institutions that have completed acquisition process to make

adjustments to the equity structure in case they exceed the regulator's limit.

Similarly, institutions that have completed the acquisition process will be given additional time to bring credit-deposit ratio within the limit of 80% in case they exceed the ceiling fixed by the regulator. Also, institutions that have completed takeover process will be given extra time to meet regulatory requirements on deprived sector lending and investment, says the bylaw, which gives priority to institutions that want to upgrade themselves or expand work area through the process of acquisition.

As per the bylaw, parties to the acquisition process must first get the approval from their respective general meetings and give authority to their boards of directors to take matters forward. Then a joint acquisition committee, under the coordination of the institution intending to make the acquisition, should be formed, following which an application should be filed at NRB. The application should also include a letter from Nepal Stock Exchange on suspension of trading of shares of the institution which is getting acquired. Then within the next 15 days, NRB will call the parties to the acquisition process for a meeting, following which due diligence audit of the institution that is getting acquired will be conducted. Therefore, based on evaluation of assets and liabilities, institutions make the acquisition by purchasing shares in cash or by offering stock option.¹⁰⁸

CITIZENS BANK INTERNATIONAL'S ACQUISITION OF NEPAL HOUSING AND MERCHANT FINANCE

The Nepali financial market is set to witness its first ever acquisition of a financial institution right after the issuance of the Acquisition Bylaw by Nepal Rastra Bank. Citizens Bank International, a class "A" financial institution, and Nepal Housing and Merchant Finance, a class "C" financial institution, have signed a Memorandum of Understanding (MoU) in regard to the acquisition of the latter financial institution. The commercial bank will be conducting a due diligence audit to assess the value of the finance company and will offer a price according to the report.

Although the Nepali financial market has already witnessed more than 50 sets of mergers in the past three years, this will be the first acquisition of a financial institution by another one. As per the officials from Citizens Bank, shareholders of Nepal Housing would receive payments in stock for selling the company.¹⁰⁹

However, the acquisition process has been delayed as the NRB has asked both the financial institutions to get an approval from their respective special general meetings; the acquisition bylaw states that parties to acquisition process must first get the approval from their respective general meetings and give authority to their boards of directors to take the matter forward.¹¹⁰

NRB ACT ENVISAGES TO HIKE PAID-UP CAPITAL

The proposed Nepal Rastra Bank (NRB) Act has envisaged to increase the paid-up capital of the Central Bank to NPR 5 billion (USD 51.21 million) from the current paid-up capital of NPR 3 billion (USD 30.72 million). The draft of the proposed act has been sent to the Finance Ministry for discussions. The proposed Act also features providing the central bank more power on liquidating the crisis ridden Banks and Financial Institutions (BFIs). Currently, the act allows the central bank to only recommend liquidation of such BFIs to the court; the final say or decision remains with the court. However, the proposed act states that the appellate court will declare BFIs' liquidation after the central bank completes clearing the assets and liabilities of the troubled BFIs. Similarly, the proposed act has cited in its preamble that the central bank's roles would be of controlling inflation, managing balance of payments, and maintaining financial stability.¹¹¹

FOREIGN COMPANIES DIRECTED TO DIVEST SHARES

According to the circular issued by the NRB, foreign companies in Nepal, other than Banks and Financial Institutions (BFIs), will have to divest their holdings in Nepali BFIs by mid July 2015. NRB has also stated that those companies failing to divest their shares within the deadline stipulated by the regulator would not be allowed

TABLE 10: THIRD QUARTER RESULTS OF COMMERCIAL BANKS-UNAUDITED FY 2013-14 (FIGURES IN NPR IN TEN MILLION)																																		
Bank	DEPOSIT			LOANS AND ADVANCES			OPERATING PROFIT			NET PROFIT			NPL (%)		COST OF FUND (LCY)		BASE RATE %																	
	Paid-up Capital	Reserve & Surplus	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	% Change	FY 12/13	FY 13/14	FY 12/13	FY 13/14	Change															
			3 QTR	3 QTR		3 QTR	3 QTR		3 QTR	3 QTR		3 QTR	3 QTR		3 QTR	3 QTR	3 QTR	3 QTR	Change															
Nabil Bank	304.71	528.49	5759.78	7390.43	28.31	4510.04	5351.25	18.65	209.22	225.03	7.56	153.36	164.19	7.06	3.40	2.96	4.59	3.45	-1.14	5.80														
Nepal Investment	414.67	426.78	5852.53	7132.41	21.87	4692.97	5356.72	14.14	174.04	191.97	10.30	134.65	139.20	3.38	2.53	1.63	4.84	4.19	-0.65	6.89														
Standard Chartered	204.16	356.27	3825.51	4295.01	12.27	2157.36	2701.62	25.23	129.51	143.02	10.43	84.80	99.94	17.85	0.88	0.52	2.10	1.78	-0.32	5.24														
Himalayan Bank	289.00	319.45	4791.62	6291.71	31.31	4018.09	4571.57	13.77	112.07	122.64	9.43	71.80	79.28	10.42	3.91	2.84	4.77	4.42	-0.35	7.78														
Nepal SBI Bank	265.02	182.34	5366.70	5143.68	-4.16	2855.04	3359.27	17.66	82.11	98.61	20.09	54.94	67.47	22.81	0.48	0.35	4.50	4.09	-0.41	8.02														
Nepal Bangladesh	221.03	176.48	1470.81	2352.44	59.94	1281.43	1760.59	37.39	22.59	38.09	68.61	31.08	40.17	29.25	3.50	1.80	6.05	5.56	-0.49	6.12														
Everest Bank	192.12	398.75	5129.34	6276.43	22.36	4185.44	5064.30	21.00	162.16	168.73	4.05	103.43	108.09	4.51	0.70	0.62	4.31	3.59	-0.72	6.39														
Bank of Kathmandu	192.21	173.94	2415.28	2967.97	22.88	2162.66	2610.53	20.71	62.17	52.48	-15.59	42.78	35.49	-17.04	1.86	1.52	5.03	5.01	-0.02	8.17														
NCC Bank	147.00	98.17	1853.50	2206.74	19.06	1591.53	1715.54	7.79	26.88	19.05	-29.13	23.88	17.20	-27.97	3.69	3.40	6.41	6.44	0.03	9.69														
NIC Asia Bank	231.15	270.39	2336.22	4056.99	73.66	1881.84	3329.21	76.91	60.34	85.10	41.03	38.51	62.73	62.89	1.10	2.77	6.78	6.18	-0.60	8.03														
Lumbini Bank	172.97	59.19	966.00	1340.11	38.73	898.22	1200.49	33.65	15.63	10.45	-33.14	11.68	14.54	24.49	1.37	1.53	6.61	6.20	-0.41	8.71														
Machhapuchhre	247.87	63.92	2474.09	3381.09	36.66	2006.95	2753.50	37.20	6.65	39.58	-495.19	9.83	31.79	223.40	2.73	2.20	6.58	5.99	-0.59	8.57														
Kumari Bank	160.38	125.83	2392.35	2742.41	14.63	1976.16	2233.12	13.00	26.37	26.24	-0.49	16.82	19.23	14.33	4.83	3.69	6.60	6.17	-0.43	8.50														
Laxmi Bank	169.41	126.02	2420.79	2955.89	22.10	1915.09	2298.21	20.01	40.83	34.71	-14.99	27.80	23.36	-15.97	1.41	2.21	5.97	5.92	-0.05	9.41														
Siddhartha Bank	181.35	105.23	2723.18	3248.15	19.28	2221.09	2531.89	13.99	45.89	55.63	21.22	28.41	36.36	27.98	2.46	3.14	6.40	5.57	-0.83	9.00														
Global IME Bank	410.68	225.25	3033.51	4939.94	62.85	2490.70	4128.47	65.76	44.48	71.36	60.43	36.10	72.88	101.88	2.30	2.82	6.74	4.68	-2.06	8.21														
Citizens Bank	210.18	58.19	2142.07	2504.42	16.92	1806.44	2177.04	20.52	31.54	39.91	26.54	22.85	30.40	33.04	2.45	2.39	6.38	5.32	-1.06	8.22														
Prime Commercial	263.86	87.48	2566.99	3015.44	17.47	2139.15	2538.80	18.68	52.24	54.77	4.84	38.80	42.37	9.20	2.92	2.01	6.92	6.02	-0.90	9.05														
Sunrise Bank	201.50	70.80	2217.05	2609.33	17.69	1779.02	2013.21	13.16	19.25	27.38	42.23	21.84	27.27	24.86	3.74	3.62	6.48	5.74	-0.74	8.72														
Grand Bank	200.00	26.86	1648.16	1900.73	15.32	1403.59	1543.91	10.00	21.18	9.00	-57.51	16.18	8.94	-44.75	1.45	4.55	7.55	7.24	-0.31	9.83														
NMB Bank	200.00	72.47	1964.08	2525.58	28.59	1589.42	1960.36	23.34	35.00	38.77	10.77	26.51	30.06	13.39	1.90	1.32	6.95	5.74	-1.21	8.33														
KIST Bank	200.00	-77.47	210.20	1967.97	836.24	1713.08	1451.99	-15.24	-6.69	-39.43	-489.39	-5.50	-21.36	-288.36	7.89	23.72	6.43	5.60	-0.83	9.80														
Janata Bank	200.00	10.84	1200.77	1641.29	36.69	1111.52	1434.50	29.06	19.76	7.07	-64.22	12.58	4.62	-63.28	0.97	1.39	7.05	6.50	-0.55	8.79														
Mega Bank	200.00	38.00	1284.22	1705.00	32.77	1161.97	1525.99	31.33	20.45	40.00	95.60	12.01	25.79	114.74	1.84	1.99	5.22	4.93	-0.29	8.34														
Civil Bank	200.00	11.40	1153.64	1843.21	59.77	1053.59	1553.92	47.49	13.26	11.91	-10.18	8.43	7.58	-10.08	0.61	1.57	7.86	7.87	0.01	10.14														
Century Bank	200.00	20.13	935.53	1670.60	78.57	821.44	1437.52	75.00	3.73	6.93	85.79	2.39	6.26	161.92	1.19	0.67	7.32	6.29	-1.03	9.88														
Sanima Bank	200.00	52.72	1617.82	2036.08	25.85	1420.17	1825.14	28.52	31.30	49.60	58.47	21.15	32.08	51.68	0.06	0.05	7.45	6.57	-0.88	8.40														
Public Sector Banks																																		
Nepal Bank	396.55	-345.08	5706.28	6590.15	15.49	3520.83	3860.77	9.66	2.07	29.27	-1314.01	24.88	38.40	54.34	5.19	5.33	4.80	4.15	-0.65	7.39														
Rastriya Banjiya Bank	858.90	-606.08	8588.69	9954.81	15.91	4509.69	5349.51	18.62	61.05	78.24	28.15	103.26	125.57	21.60	5.95	4.77	3.71	3.04	-0.67	5.95														
Agriculture Dev. Bank	963.68	538.66	4723.43	6634.78	40.47	4684.28	5450.47	16.36	85.82	67.30	85.70	94.53	80.05	-15.32	6.27	6.43	5.49	5.52	0.03	12.16														
Total	8298.40	3595.41	88770.14	113320.79	27.66	69558.79	85089.41	22.33	1610.90	1803.41	11.95	1269.77	1449.94	14.19	2.65	3.13	5.93	5.33	-0.60	8.32														

to receive bonus shares, cash dividends or buy right shares.

Amongst the companies, Chaudhary Group, through its Irish offshore company NB International, holds 50% in Nabil Bank, along with Yong Lian Realty, a Malaysian company, which has a 12.9% stake in NMB Bank.

As per the current Banking and Financial Institutions Act (BAFIA), Clause 4 (3) allows only foreign BFIs to invest in Nepali BFIs. Since the said foreign companies, NB International and Yong Lian Realty, had held stakes in the aforementioned banks before the introduction of the NRB Act and BAFIA, therefore they have been given time to come within the parameters of BAFIA. Likewise, the new circular has also directed BFIs, which had foreign ownership in the past but failed to increase the shareholdings of the public to at least 30%, to comply within July 2015.¹¹²

NRB DECIDES TO STICK WITH THE INTEREST SPREAD

The central bank has firmly refused to budge from its current policy of capping interest spread of the banks during the mid-term review of monetary policy. NRB had prescribed a 5% spread rate. Initially, the central bank had planned on imposing a 3% ceiling but didn't move ahead thinking of the state of the banks. NRB has asked the banks to maintain the 5% spread rate—the difference between the deposit and the lending rate by the current FY 2013-14.¹¹³

COMMERCIAL BANK PERFORMANCE ANALYSIS

As per the published unaudited data for the third quarter of the current fiscal year, of the 30 commercial banks, 22 banks saw their net profit increase while 11 banks saw their operating

profit decrease compared to the same quarter in the previous fiscal year. During the period, the operating profit margin of commercial banks grew by 11.95%, whereas the net profit margin grew by 14.19%. The banks have been able to increase their operating profits mainly due to the decrease in the overall cost of funds.

At the end of the third quarter, the average cost of fund of banks stood at 5.33%, which was 5.93% during the same period last fiscal year. However, the average Non Performing Loans (NPL) of commercial banks increased during the quarter to 3.13%, which was 2.65% during the same period of the previous FY. Likewise, the average base rate of commercial banks stood at 8.32%, the highest being 12.16% of Agriculture Development Bank and the lowest being 5.24% of Standard Chartered Bank.

“ OUTLOOK

As of the third quarter of current FY 2013-14, the banking system witnessed a slump of profit growth as the banks' net interest income and operating profit both failed to expand immensely. The weighted average 91-day Treasury Bill rate decreased to 0.06% in April 2014 from 3.49% a year ago. The weighted average inter-bank transaction rate among commercial banks went down to 0.19% in April 2014 from 3.78% in April 2013.

The average cost of funds of commercial banks at the end of third quarter of current fiscal year has dropped to 5.33% from 5.61% at the end of second quarter of the current fiscal year. The excess liquidity of BFIs has been mopped up through the open market operations (OMOs) as NRB mopped up net liquidity of NPR 348 billion (USD 3.56 billion) through reverse repo auction and NPR

8.50 billion (USD 87.06 million) through outright sale auction. A net liquidity of NPR 8.50 billion (USD 87.06 million) was mopped up through outright sale auction in the corresponding period of the previous year.

At the end of third quarter of current fiscal year, the government had NPR 86.91 billion (USD 890.19 million) deposits with the central bank. NRB had stressed on the need to raise the government's capital spending citing a large chunk of the money allocated for various development purposes has always remained unused. The government had allocated NPR 85.10 billion (USD 871.65 million) for capital spending this fiscal year. But in the first nine months of this fiscal, only NPR 26.26 billion (USD 268.97 million), or 30.86% was spent.

REVIEW

Capital Markets

SECONDARY MARKET PERFORMANCE

The first eleven months of the current fiscal year has been overwhelming for the overall capital market with the market witnessing a steady upward trend. The Nepal Stock Exchange (NEPSE) index (73.56%), rallied to close at 899.53 points during the review period (i.e. till June 11, 2014), an increase of 381.26 index points. The market has been on a bullish trend with the successful completion of the Constituent Assembly (CA) elections, the improving economic situation of the country and the investors' access to finance and the positive liquidity situation.

As shown in *Table 11*, during the review period, all the sub-indices has ended in the green zone. The Insurance sub-index (+275.06%) saw the biggest gain amongst the sub-indices, as it gained a whopping 2576.58 points. Similarly, the Hotels sub-index (+180.21%) continued to impress investors as it gained valuable 1184.83 points. The

hydropower sub-index (145.58%) showcased huge growth in the last few months of the review period as it gained 1572.55 points. Likewise, amongst the BFIs, the Development banking sub-index showed encouraging growth (+122.25 %) while the Finance index (75.46%) and Commercial banking sub-index (+59.68%) also posted positive development.

The Manufacturing & Processing sub-index (+33.02 %) also continued to impress investors with their anticipated attractive returns. However, the 'Others' sub-index (+9.90 %) could post only a marginal growth as the share price of Nepal Telecom failed to achieve desired momentum.

KEY DEVELOPMENTS

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

NEPSE reaches five year high: The Nepal Stock Exchange (NEPSE) index

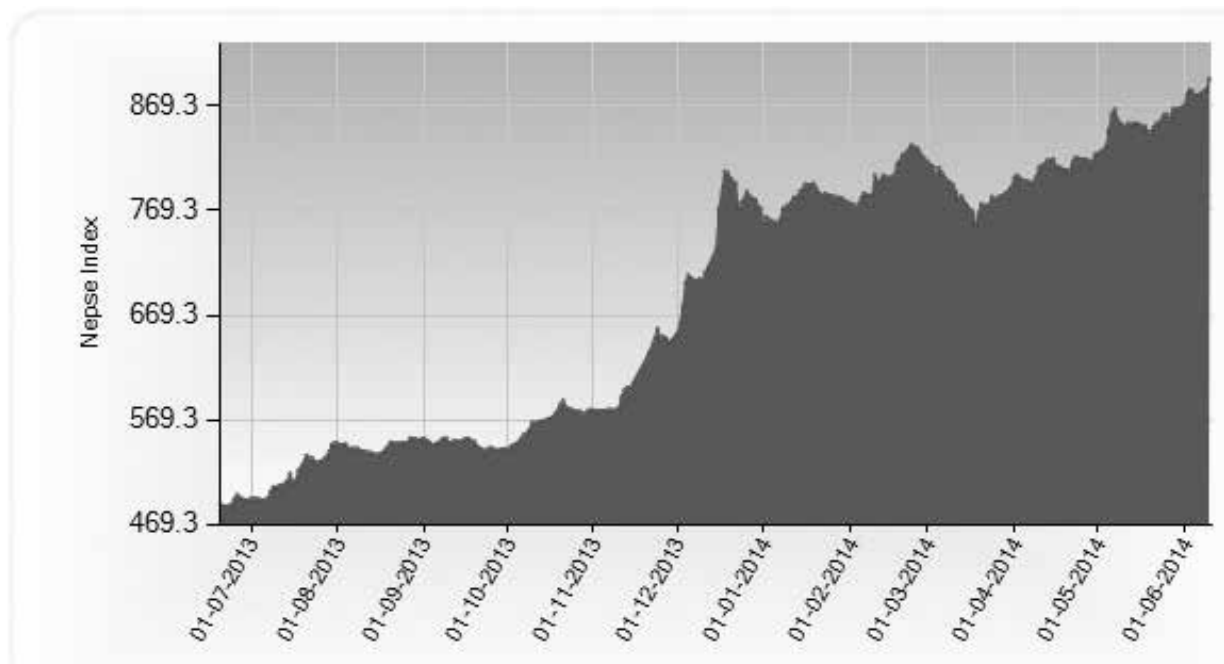
Table 11: Sector wise Performance of the sub-indices

Indicators	15-Jul-13	11-Jun-14	% Change
NEPSE Index	518.27	899.53	73.56%
Commercial Bank Index	505.48	807.15	59.68%
Development Bank Index	257.85	573.07	122.25%
Hydropower Index	1080.92	2653.47	145.48%
Finance Index	253.67	445.1	75.46%
Insurance Index	936.75	3513.33	275.06%
Others Index	700.22	769.51	9.90%
Hotels Index	657.49	1842.32	180.21%
Manufacturing & Processing	868.72	1155.56	33.02%

Source: NEPSE

hit a new five year high of 885.63 points on June 3, 2014. The index was 881.17 points on October 27, 2008 after which the index started to decline. The recent surge in the index can be attributed to the increasing investors' confidence following the

Figure 9: NEPSE Index performance



successful completion of the Constituent Assembly elections and the upcoming budget of the next fiscal year. Also the positive political development, the latest draft of foreign investment policy which allow foreign investment in stock market, and the improving economic situation of the country can be attributed to the bullish trend seen in the market. The market has also been witnessing huge transactions volume, which can be cited as the investors' understanding and maturity towards the market.¹¹⁴

SEBON to allow merchant bankers to widen services: Securities Board of Nepal (SEBON) has proposed to add a new set of activity for merchant bankers wherein they can provide consultancy services. The new field has been included in a proposed new regulation governing the merchant bankers.

According to the existing rules, merchant bankers can operate as sales and issue manager, underwriter, share registrar and investment manager.

Likewise, under the category of consultancy services, merchant bankers will be permitted to provide counsel on merger, asset valuation and business plan of corporate bodies, capital restructuring, loan syndication and working capital financing. Similarly, consultancy related to venture capital and wealth management of companies will also be provided by a merchant banker. Alongside adding consultancy to the list of services, the proposed regulation has also hiked their paid-up capital requirement from NPR 70 million (USD 0.71 million) to NPR 80 million (USD 0.81 million). While the paid up capital requirement will remain unchanged for merchant bankers conducting the existing four tasks, it will be hiked for those merchant bankers opting to add consultancy services to their portfolio.

The proposed regulation has also inserted a provision that any company failing to publish its audited report for the last two years cannot purchase promoter shares of merchant banks.

As per the current rule, this prohibition applies to companies not publishing their audited reports for the last three years. The proposed policy has also included a detailed provision regarding ownership transfer. The existing regulation only talks about handing over the ownership to firms that are recognized as qualified firms. The proposed regulation has added the procedures for doing so. As per the proposed regulation, a shareholder of a merchant bank first has to submit to SEBON the paperwork related to the shares to be sold or handed over.¹¹⁵

Schemes worth NPR 3.6 billion in the offing: The Nepali capital market will be witnessing additional fund offerings in the future as five mutual fund managers having filed applications for the approval of their proposed schemes. Amongst the existing fund managers, NIBL Capital, merchant banking arm of Nepal Investment Bank; NMB Capital, subsidiary of NMB Bank; and Laxmi Capital, subsidiary of Laxmi Bank, are the new

entrants to the mutual fund market wherein all the five fund managers, including Nabil Invest and Siddhartha Capital, have applied and are seeking approval from SEBON for their new mutual fund schemes.

Nabil Invest has already submitted the prospectus to SEBON where they have proposed NPR 1 billion (USD 10.24 million) equity oriented scheme. Likewise, NIBL Capital has also applied for approval for its NIBL Sambriddhi Fund worth NPR 800 million (USD 8.19 million). Other schemes waiting for approval are Siddhartha Capital who have already submitted the prospectus for their scheme worth NPR 800 million (USD 8.19 million), NMB Capital who have

been seeking the go-ahead from the regulator for its NPR 600 million (USD 6.14 million) NMB Sulabh Invest Fund, and Laxmi Capital who have also applied for approval of its Laxmi Value Fund worth NPR 400 million (USD 4.09 million). Likewise, Global IME Bank's Global Capital is also preparing the prospectus for a mutual fund scheme.¹¹⁶

Digitization of share certificates: CDS and Clearing Limited has requested companies listed at the Nepal Stock Exchange (NEPSE) to digitize and dematerialize their share certificates issued to the shareholders within this fiscal year, as they plan to go completely into electronic clearing within the coming six months. CDS Bylaws

2012 states that the concerned government bodies, including CDS and the SEBON, have to go fully digital within six months of the start of transactions of dematerialized shares.

Though the government had set up CDS four years ago to promote online clearance of stock trading, CDS had announced to start a full-fledged online clearing system by October, 2013. However, the online clearance system failed to materialize due to various reasons, including companies' reluctance to acquire licenses of clearing members (CMs) and depository participants (DPs). Till date, only 16 out of 235 listed companies have entered into an agreement with CDS to dematerialize their shares.¹¹⁷

“ OUTLOOK

The NEPSE index has been witnessing steady growth since the completion of the Constituent Assembly elections. Besides positive political developments, the surge in the index are mainly due to the growth in the third quarter results of key listed companies, a comfortable liquidity situation of the Banking and Financial Institutions, fall in interest rates, NEPSE's initiative to establish a fully automated online trading system, and CDS and Clearing's announcement to adopt a fully automated clearance. These factors have all made investors hopeful about benefitting from the rising prices.

Likewise, Nepal Rastra Bank has introduced the Acquisition Bylaw,

including a provision of forceful acquisition whereby commercial banks, development banks and finance companies can acquire any BFI, while 'D' class FIs (micro-finance institutions, non-government organisations and cooperatives) can acquire other 'D' class FIs only. After the successful introduction of the acquisition bylaw, Citizens Bank International is on the verge of acquiring Nepal Housing and Merchant Finance Ltd.

Moreover, looking at the current uptrend and the rise in the share prices, the fundamental analysis cannot be justified, since most of the scrips are way overpriced.

REVIEW

Nepal Economic Update, 2014

This edition of Nepal Economic Update (NEU), which has a special focus on Dealing with Excess Liquidity in the Banking System, discusses three major issues. First, NEU discusses the impact of strong inflationary pressures on the overall economy. The average rate of inflation, driven by rise in food prices as a result of low agricultural production, is expected to be 9.8% for FY 2013-14. This rate is higher than the target rate (8.5%) set by Nepal Rastra Bank. Various factors have been attributed to rise in food prices, particularly increments in food prices in India—which is tributary to that of Nepal—and hoarding of food supply by middlemen.

Second, the increase in remittance has raised the level of liquidity in the market. Moreover, this excess liquidity is not being utilized to its potential and as a result, it has put inflationary pressures on the economy. The rate of credit growth has also decreased substantially, i.e. 9% in the first half of this year compared to 12.3% at the same time in FY 2013. In addition, the declining credit to deposits ratio is an indicator that the banks are with-

holding credit and making it difficult for the borrowers to access it by maintaining high lending rates.

Finally, the challenges faced by government regarding the clarity of policy goals and priorities have led to a delay in adoption of budget. This has led to the following delays: spent only 37% of the budget allocated for recurrent expenditures and 13.5% for the budget allocated for capital projects; used only 13% of the NPR 21.8 billion (USD 223 million) allocated to the National Pride Projects by mid-year; budget for only two out of the 21 infrastructure projects have exceeded the 50% utilization mark. This delay in making the planned budget expenditure has led to Nepal being the only country in South Asia to post a budget surplus of 0.3% of GDP. Delay in adoption of budget caused by structural inefficiencies in the process of budget planning, formulation and execution is the major cause of the unutilized surplus.

Moreover, the increase in remittances has led to positive Balance of Payment. In addition to rise in remit-

tances (updated to stand at 30% of the GDP), increase in foreign grants has resulted in government surplus of more than NPR 56 billion (USD 574 million).

EXCESS LIQUIDITY: A "FORTUNATE" PROBLEM IF WELL MANAGED

One of the key bottlenecks to investment supported growth in Nepal is excess liquidity. Excess liquidity can be attributed to three issues, namely inefficient deposit mobilization, slowing of domestic credit, and inadequate coverage of financial services. This has led to declining loan to deposit ratios. First, despite excess liquidity, banks are reluctant to take corrective measures to effectively mobilize deposits. Instead, banks are voluntarily holding back cash by maintaining high lending rates. NRB's response so far has been to wait and watch till the situation stabilizes automatically. Given the magnitude of this problem however, it is unlikely to be corrected on its own. It is also equally difficult for NRB to balance maintaining loose monetary

policy to support credit and prevent the build-up of excess liquidity. Overcompensating for one can cause potential disturbances in other areas of the economy.

Second, credit slow down can be attributed to a combination of investors postponing investments, banks being risk averse. Issues such as dissolving of the first Constituent Assembly, run up to the elections, depreciation of the Rupee, and over exposure in the real estate sector may be some of the reasons for lack of demand for credit and/ or tight credit policies from banks. Given the contradictory nature of the issues behind the credit slow down (the demand for credit low in some cases and high, but risky in others), NRB can be said to be in a policy dilemma.

Although the above issues need to

be addressed in the short term, the financial sector in Nepal can only develop by addressing the gaps in the coverage of the financial services, both in terms of access and effectiveness of use. Some of the gaps are concentration in the urban areas, while rural areas are still deprived of these services; concentration on male and limited access for female; purpose of usage, where savings are intended for emergencies rather than investment of financial services; and frequency of usage.

Moreover, the inefficiency of financial sector is manifested by the fact that a large fraction of household borrowing occurs outside of formal sector (11% in Nepal, which is higher than the South Asian average of 9%), such as borrowing with friends, family, etc. The case of access to financing is even worse in case of enterprises. Nepal's Enterprise Survey, a survey done on

small enterprises of Nepal, showed that although 85% of the SMEs had a bank account, only 35% had loans from banks and financial institutions. This indicates that majority of enterprises still operate via informal borrowings. Similarly, innovations in methods of delivering financial services have improved though only a small proportion of the population has been able benefit from it.

Despite these challenges, the Nepali economy is expected to grow at a faster rate by the end of this fiscal year; economic growth is expected to be 4.5%, a rate higher than the previous fiscal year's modest growth of 3.6%. The reasons for the favorable growth rate can be attributed to rise in agricultural production, continuous growth in the service sector, strong remittance flows and recovery of public investment.¹¹⁸

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NEPAL ECONOMIC FORUM

Nepal Economic Forum (NEF) strives to be the premier private-sector led economic policy and research organization by redefining the economic development discourse in Nepal.

Established as a not-for-profit organization under the beed (www.beed.com.np) eco-system, NEF has benefited from extensive exposure, experience and network of beeds who contribute in the research and dialogue process. With Sujeev Shakya as Chair, NEF benefits from the leadership of one of the most respected economic analysts in Nepal, known for his bestseller *Unleashing Nepal - Past, Present and Future of the Economy* (Penguin 2009). NEF has worked in partnership with many Nepali and International institutions in its quest to mainstream the discourse on the Nepali economy, which has not received the necessary space it deserves.

NEF broadly works under three areas:

First, the **Business Policy Research Center (BPRC)**, which engages in research, dialogue and dissemination relating to pertinent economic policy issues. Through BPRC, NEF has been producing *nefport*, a quarterly economic publication docking economic analysis and research, **nefsearch**, a periodic research publication, conducting **neftalk**, a platform for policy discourse, and *nefcast*, an online dissemination platform. BPRC is in the process of starting **nefsource** a resource center, and holding a *nefclave*, a platform for discourse on economy and beyond, which is scheduled for September 2013.

Second, through the **Center for Public, Private and Community Partnerships (PPCP)**, the partnerships discourse is further elaborated through addition of the community dimension to the existing models of public private partnerships. The concept stems from the need to integrate the community dimension to economic development strategies especially as Nepal moves towards a federated structure. Apart from standalone interventions, the PPCP perspective is integrated in many of the work that NEF and beed initiate.

Thirdly, through **Development Consulting**, NEF engages with a plethora of multilateral, bilateral and International Non-Governmental Organizations in areas where a fresh pair of lenses are required to view the formulation and implementation of strategies. Hands on experience along with a wide 'cultural bandwidth' put NEF in a unique position to deliver Glocal solutions. With an international network and extensive Nepal experience, NEF uses solution-oriented approach to assignments.

Currently, NEF is helping to incubate the US based Accountability Lab's Nepal operations. With transparent financial systems, high standards of conflict of interest disclosures, strong support of beed back-end infrastructure, access to high quality global and local human resources and firms, NEF is poised to set high delivery and ethical standards for firms operating in Nepal.



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