



NEPAL  
ECONOMIC  
FORUM

# nefport

## KEY CONTRIBUTORS

BEED MANAGEMENT PVT. LTD.

BINOD ATREYA

CENTRE FOR FINANCIAL REGULATION AND INCLUSION

CHIRANJIBI NEPAL

JUDITH KARL

KAMNESHNEE NAIDOO

UJJWAL RAJ POKHREL

**DOCKING NEPAL'S ECONOMIC ANALYSIS**

ISSUE 26 | OCTOBER 2016



# CONTENTS

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## NEPAL FACTSHEET 4

## EDITORIAL 5

### 1 ACCESS TO FINANCE 7

- Financial inclusion scenario in nepal 8
- In conversation with Judith Karl 10
- Regulatory perspective of financial inclusion in Nepal 13
- Driving the agenda of financial inclusion in Nepal 16
- Where is financial inclusion going? 18
- Making access possible 21

### 2 GENERAL OVERVIEW 25

- Political Overview 26
- International economy 28

### 3 MACROECONOMIC OVERVIEW 31

### 4 SECTORAL REVIEW 37

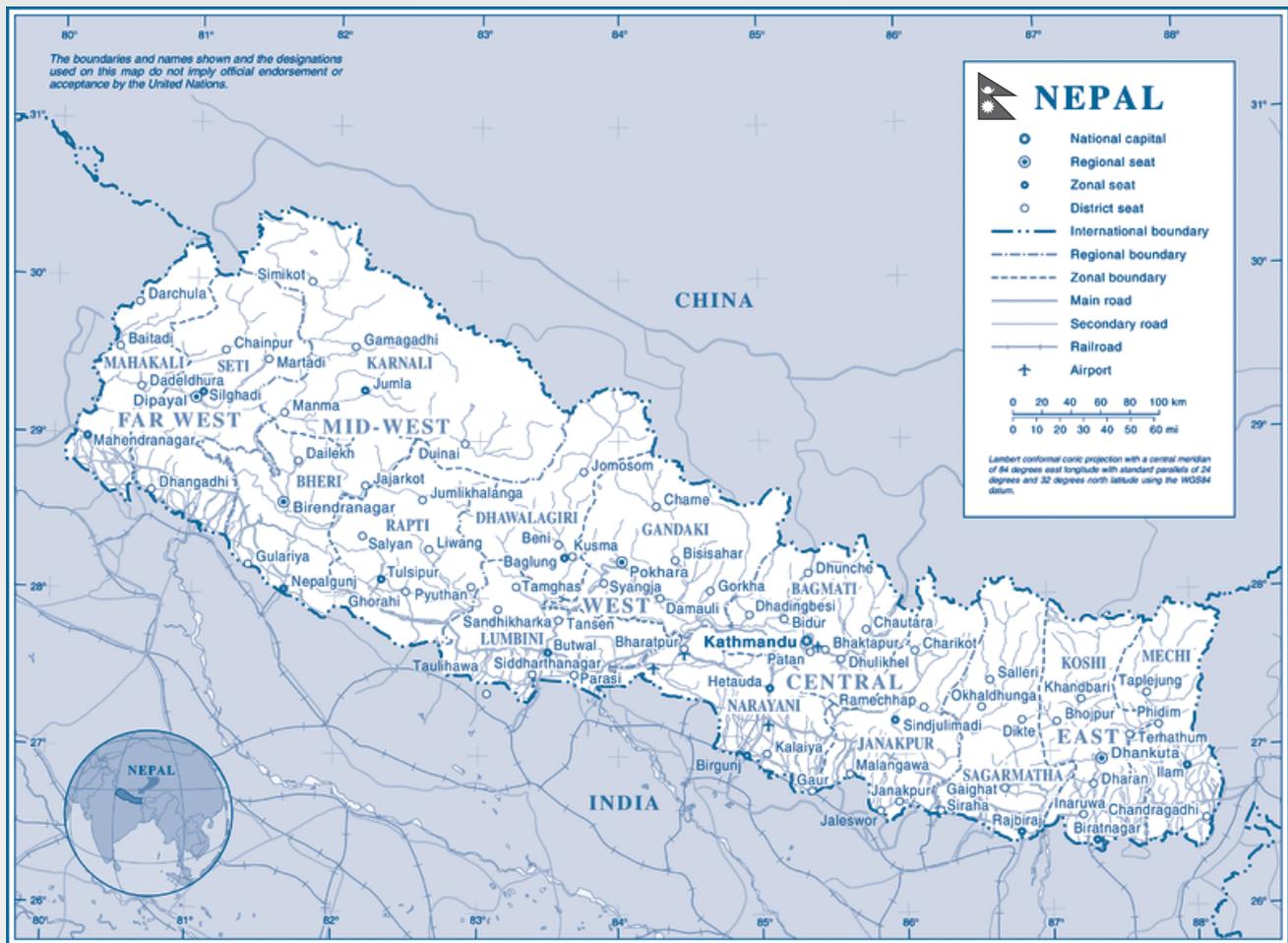
- Agriculture 38
- Energy 40
- Infrastructure 43
- Information and Communication Technology 45
- Real Estate 47
- Education 49
- Health 51
- Tourism 53
- Trade and Debt 55
- Foreign Aid 58
- Remittance 60

### 5 MARKET REVIEW 63

- Financial Market 64
- Capital Market 68

### 6 NEF Profile 75

# NEPAL FACTSHEET



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

## KEY ECONOMIC INDICATORS

GDP	USD 19.77 billion	GDP Growth rate (%)	0.77
Rank	109	Inflation (annual %)	10.2
GNI per capita (Atlas)	USD 730	Agricultural growth rate (annual %)	1.3
Rank	192	Industrial growth rate (annual %)	-6.3
GNI (PPP)	USD 2,410	Service Sector growth rate (annual %)	2.7
Rank	184		
Gross Capital Formation (% of GDP)	37%		
HDI	0.548		
Rank	145		

Sources:

Left Table - The World Bank; HDI figure from Human Development Reports of the UNDP, Right Table - Economic Survey Fiscal Year 2015-16 - Ministry of Finance, May 2016



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P.O Box 7025, Krishna Galli, Lalitpur – 3,  
Nepal

Phone: +977 1 554-8400

Email: [info@nepaleconomicforum.org](mailto:info@nepaleconomicforum.org)

**Contributors:**

Krinisha Shrestha  
Raju Tuladhar  
Rojesh Bhakta Shrestha  
Shayasta Tuladhar  
Shikshya Gyawali  
Sijan Thapa  
Sushan Shrestha  
Subrina Shrestha  
Tejaswee Shrestha  
Zubin Rajbhandary

**Design & Layout:**

Ultimate Marketing Pvt. Ltd.  
[info@marketingultimate.com](mailto:info@marketingultimate.com)

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# EDITORIAL

After the release of our 25th Anniversary Issue, we at Nepal Economic Forum are on a constant quest to recalibrate nefport. One good modality since our 20th issue has been to bring focus on a certain issue in each of our publications such as our special issues on agriculture, earthquake, the International Conference on Nepal's Reconstruction, and impact of the economic crisis.

In this issue we have partnered with the United Nations Capital Development Fund (UNCDF) to bring forward the issue of Access to Finance and Financial Inclusion in Nepal. This builds on the work that beed management undertook in Nepal on Making Access Possible (MAP). We are grateful to Judith Karl, Executive Secretary of UNCDF for her interview. We would also like to express our sincerest gratitude to Dr. Binod Atreya, Dr. Chiranjibi Nepal, Catherine Denoon-Stevens, Kamneshnee Naidoo and Ujjwal Pokhrel for their contributions to this special issue of nefport. We would also like to acknowledge and thank UNCDF Nepal for making this issue possible.

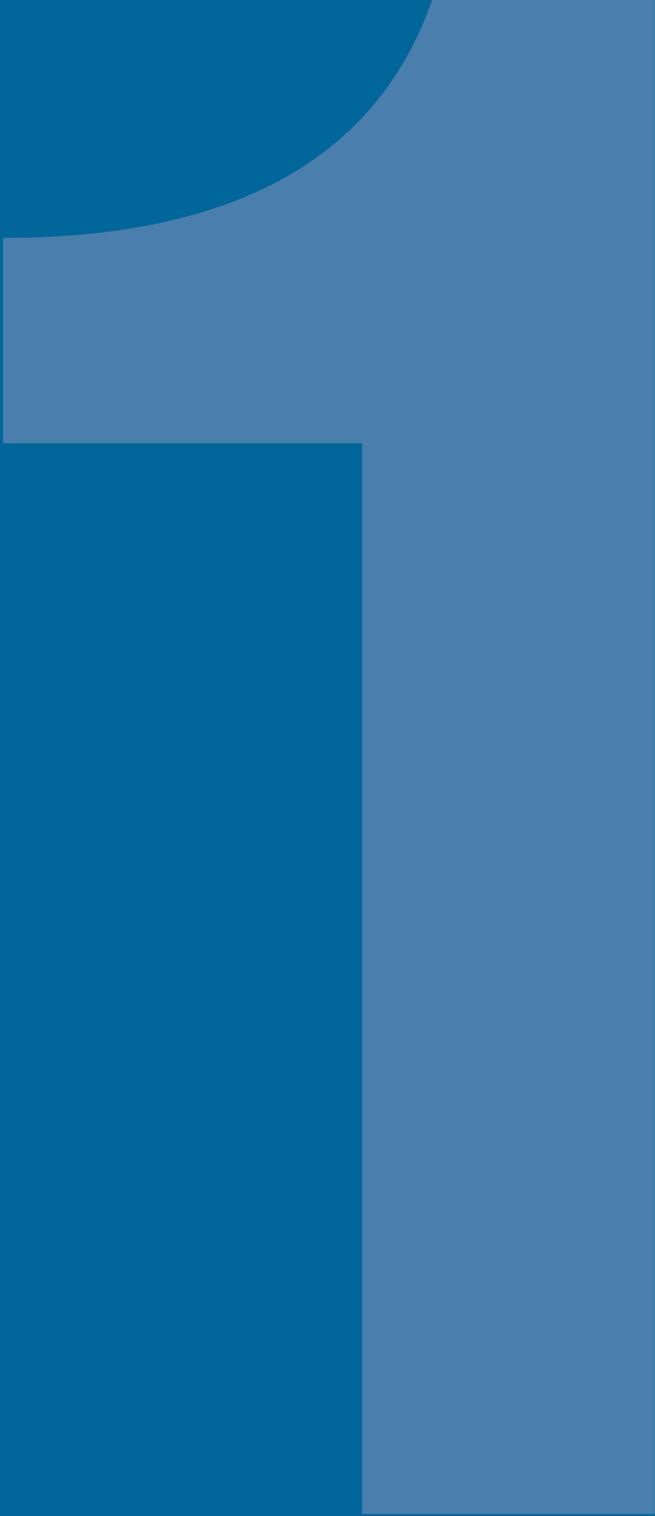
On the national front, we have seen yet another political transition, and with another government change scheduled for March 2017, it is unlikely that there will be major policy changes during this duration. As indicated by the economic survey, it is very clear that the Nepali economy has grown significantly, however failure to meet expense targets still remains a key issue, thereby keeping the whole economy insulated; as there is excess liquidity in the system.

The challenge for Nepal remains that it is not constraint on resources as indicated by the USD 6 billion of government revenues supplemented by assistance and loans, but planning and implementation that has deterred from pushing economic growth and development. NEF will continue to work in providing fresh perspectives to this discourse.

As always, we remain 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](mailto:info@nepaleconomicforum.org).

**Sujeev Shakya**  
Chair, Nepal Economic Forum





A SPECIAL ON  
**ACCESS TO FINANCE**

# FINANCIAL INCUSION SCENARIO IN NEPAL



**beed management pvt. ltd.**

## WHAT IS ACCESS TO FINANCE?

There has been increased emphasis on the improvement of Access to Finance (A2F) in the global scenario with countries adopting measures to improve the level of access for individuals and businesses alike. Access to Finance in basic terms means the ability of a person or an organization to obtain various financial services like deposit, credit, insurance, payment and several risk management services. Indicators such as having a bank account, using banks as primary financial institutions, usage of non-bank financial institutions, and ability to reach the financial institution by foot are used to gauge the level of access in a country. Multiple studies have been conducted on a global level to ascertain the impact of increased financial access on economic growth. The World Bank's study on access to finance and development, puts forward the view that improving access and building inclusive financial systems are crucial for economies at all levels of development; wherein better access to finance will help to facilitate equality of opportunity as well as realize the full potential of an economy.

However, it has been established that formal financial services such as commercial banks refrain from serving low income individuals and small and micro-enterprises because of the relatively higher cost of small transactions, lack of physical collateral and geographical constraints. It thereby becomes a challenge to ensure increased reach to

low cost and relevant risk management products such as savings, credit, payment and insurance.

## SCENARIO IN NEPAL

According to the Nepal Rastra Bank 61% of Nepali adults are formally financially included through the uptake of services offered by banks and cooperatives. Despite the rapid increment in the number of financial service providers and the resultant growth of the financial sector, 18% of the adult population do not access any form of formal or informal financial services. World Bank's Findex data shows that around 52% of the adult population of Nepal use bank accounts as a mailbox with only 1-2 interactions in a month, while only 18% actively use bank accounts with more than 3 interactions per month. However, having an account in itself does not truly reflect usage of financial services, thereby it is crucial to study the level of dormancy as well.

Furthermore, only 8.47% of the adult population exclusively use financial products and services from banks without availing services from informal or other formal channels. It is alarming that only such a small fraction of adult use banks as their prime channel for financial transactions. This exhibits both an unserved need of the customer and the inability of banks to tap into the existing demand.

The notion of increasing access to finance to uplift the living standard of individuals and ultimately strengthening

the economy has gained traction and accordingly the Government of Nepal has been adopting policies and strategic measures to facilitate access. Given that Nepal has been undergoing a prolonged phase of transition, revised acts and regulations of the financial sector though in the pipeline, have not undergone major reforms with consolidation and replacement of acts taking more than a decade.

fraud has time and again come to light, the end users still remain vulnerable.

## WAY FORWARD

The focus needs to be on improving existing institutions in the country as Nepal already has a large number of financial institutions and a well-established agent network which can be revived and made efficient. Efforts should be focused on

**Access to Finance in basic terms means the ability of a person or an organization to obtain various financial services like deposit, credit, insurance, payment and several risk management services. Indicators such as having a bank account, using banks as primary financial institutions, usage of non-bank financial institutions, and ability to reach the financial institution by foot are used to gauge the level of access in a country.**

Nepal Rastra Bank has taken various initiatives such as implementation of deprived sector lending by Microfinance Institutions (MFIs), requirement to open branches in rural areas prior to establishment of branches in urban areas, and provision of interest free/refinancing to Banks and Financial Institutions (BFIs) for opening branches in identified rural areas but with limited success.

A successful and laudable effort of the central bank has been the mandatory deprived sector lending provision wherein Class A, B and C institutions need to allocate 4.5%, 4.0% and 3.5% of their loan portfolio to deprived sectors. This criterion is generally fulfilled through wholesale lending to MFIs. However, while facilitating access to low income individuals, this practice often also results in lending at a high spread by MFI's; whereby access to finance eventually becomes costly to the end users and also questions the sustainability of MFIs that are heavily reliant on access to low cost funds. It is therefore crucial that the deprived sector lending directive take into account the MFI's lending capacity and avail funds accordingly.

At the field level, there is an increasing trend of inclination of low income groups to avail of financial services from cooperatives rather than MFIs. The preference for cooperatives arises mainly from the relationship forged with members and the perception of comparatively lower interest rates than those charged by MFIs. However, given that these cooperatives are loosely monitored and cases of

adopting technology such as mobile banking, internet banking, credit and debit cards, POS/POT machines, etc. This should be supported by the adoption of real-time gross settlement system and development of payment ecosystem in the economy. Regulatory impediments and usage barriers including stringent collateral requirements, high cost of usage (due to branches being in distant locations) and a generic product offering-consumer need mismatch among others should be addressed to facilitate provisions that support increased access to finance.

The current state of A2F in Nepal is still at a nascent stage. We have just come to realize where we currently stand and in order to achieve the goals set forth by Nepal Rastra Bank, we need to start and follow up on efforts towards tailored product development and technological embracement. Products and A2F models from countries can be incorporated, restructured and fitted in the Nepali context of A2F. Learnings from a) Mobile banking reach in Vietnam, Zimbabwe and Tanzania b) Agricultural Products such as Seasonal Loan Products for Char Farmers in Bangladesh c) Small holder agri lending of "Kilimo Biashara" in Kenya d) Parametric Banking – Correspondent banking by HDFC in India and e) "Kilimo Account Product by NMB, Tanzania, can be studied to develop products that best suit the Nepali consumer's need. Moreover, consumers must be empowered through the availability of a range of financial products they can choose from. In this sense, South-South learning is a key practice that needs to be explored and adopted.

# IN CONVERSATION WITH JUDITH KARL



## Judith Karl

*Judith is the Executive Secretary of United Nations Capital Development Fund (UNCDF) and has been associated with United Nations Development Program (UNDP) for about 24 years.*

*Nepal Rastra Bank together with UNCDF recently launched the financial inclusion roadmap for Nepal as part of the Making Access Possible (MAP) initiative. This study was conducted with the objective of escalating financial access in rural areas, to ultimately reduce poverty and increase the standard of living. MAP aims at encouraging the use of financial services among the poorer sections of Nepali society as financial inclusion is proven to create greater opportunities for income generating activities. During the launch, Sujeev Shakya, Chairperson of Nepal Economic Forum sat with Judith Karl, Executive Secretary of UNCDF to discuss some of the biggest road blocks to Nepal's financial inclusion scenario.*

**Sujeev:** *It has just been 24 hours since you arrived in Nepal, what is your initial impression of the country and how does it link with some of the larger roles you lead?*

**Judith:** Firstly, Nepal is one of the biggest programs UNCDF has in the world. We work with the Government on a lot of innovative and new approaches to drive local development. I find the Government to be very open to new types of development models which is important to achieve the localization of Sustainable Development Goals (SDG) and make the process inclusive and participatory. The Government has strong commitment towards financial inclusion and recognizes it as an important enabler for poverty reduction and eradication. There is great willingness

and spirit of commitment from Nepal Rastra Bank, Ministry of Finance and other parts of the Government to promote financial inclusion, which includes digital pathways to increase access to financial services for poor vulnerable households and communities. As for us at UNCDF, we know from years of experience and results from all around the world, access to finance can greatly impact household resilience to absorb shocks and their ability to manage finances securely all the while driving greater income dynamics at the local level. Nepal is a very interesting and dynamic place for us to work, and is also one of the countries that has great deal of support and commitment from the government.

**Sujeev:** *Talking about Nepal, what is your impression on how the country is faring in comparison to other countries that UNCDF works with on Financial Inclusion ?*

**Judith:** Nepal is facing many challenges and opportunities, similar to those countries in the same income category. There are tremendous opportunities in terms of financial access and usage through digital pathways. The government sees potential for digital pathways and some very important innovative initiatives are already underway, compared to some of the other countries, in terms of being able to leverage digital system for social protection payments, e-mapping exercises and being able to access excluded populations.

At the same time, it is facing similar challenges in terms of women's access to financial services. Women do tend to have lower levels of access and inclusion in most of these countries than men, and certainly in this case, Nepal follows similar patterns. Other similar challenges are how to get banking services and accessible pay points to remote populations. Bridging that gap is also a critical challenge

MAP exercise has shown that 65% of farmers are still using informal financial services, highlighting the constraints in their ability to increase productivity, access credit and avail other type of financial services, which would help to generate more income. There is strong evidence on the growth side, that financial inclusion is important contributor to growth.

Access to finance can greatly impact household resilience to absorb shocks and their ability to manage finances securely all the while driving greater income dynamics at the local level.

for the banking sector and financial service providers themselves. They require business models that go beyond brick and mortar banking systems subsequently providing poor people with access.

**Sujeev:** *We opened up with the issue of graduation from a LDC country; how do you see financial inclusion linking up with Nepal's graduation from LDC to a middle-income country ?*

**Judith:** Nepal has set 2022 as its aspirational date for graduation from a LDC country. There are multiple complex elements that go into meeting that aspiration. So I am talking about how financial inclusion can help address some of the key indicators in order to meet the aim of graduation. The three big indicators are Gross National Income, Human Assets Index and Vulnerability Index.

In terms of growth, our experiences show that financial services can boost economic activities for smallholder farmers, which is a major segment of the population in Nepal. It can boost small enterprise activities, improve the ability of individuals to engage in self-employment and other types of income generating activities. By increasing the overall income level, you also increase the fiscal space in local economy, making it possible to generate growth from within and not rely on external resources.

On the criteria of Human Assets Index, experience has shown that increased financial inclusion is directly correlated with maintaining children in school. This is mainly because, it provides greater financial stability and greater ability to manage household finances throughout the year. It also evens out the uneven income cycles over the course of the year which in turn helps them to pay for school, medical expenses and other emergency or unforeseen expenses. So it contributes significantly to household resilience and increases their ability to borrow during emergency. All these are the elements in building human assets and capital for more resilient households and also for healthier educated households.

Finally, for Vulnerability Index, we know that financial inclusion is a big contributor in reducing both individual and household vulnerability, as it increases their ability to deal with economic shocks. Having formal access to simple insurance services can also help people get through crisis situation, reducing the likelihood to resort to informal borrowing which can actually contribute to their vulnerability rather than their resilience. Introduction of new financial services and products like collective insurance and other type of micro insurance can also help deal with disasters and weather related shocks. In Nepal right now the MAP data shows only 11% of the population have access to insurance products, so increasing the range of insurance products that are available for poor households can be a tremendous contributor.

**Sujeev:** *Any final thoughts you have that you would like to share on Financial Inclusion in Nepal?*

**Judith:** The MAP exercise and introduction of road mapping exercise is a tremendous opportunity for the government to have a strong platform for convening and coordinating a wide range of actors around the financial inclusion agenda. It brings together both public and private sector actors, enabling them to see where the opportunities and challenges stand, so that they can allocate resource in

their programs by addressing the biggest gaps. It also shows tremendous potential of these markets by showcasing the demand side. In conclusion, financial inclusion is about recognizing that the poor also have resources. These resources with proper services can be a driver for their own resilience and development. The key to financial inclusion in our view is not a supply driven approach but a demand driven approach, which looks at how poor people live and work in their local communities as well as promote the design of financial services that addresses their needs.

# REGULATORY PERSPECTIVE OF FINANCIAL INCLUSION IN NEPAL



**Binod Atreya, PhD**

*Binod Atreya is the Former Executive Director at the Micro Finance Promotion and Supervision Department at Nepal Rastra Bank*

In the year 2015, Nepal had a per capita income of USD 762, making it one of the poorest countries in the world. The national average poverty line is at 25.2%, attributed to the fact that poverty is higher in rural areas; with more than 81% of the country's population living there. The geographical dispersion of the societies, lack of infrastructural development in the field of health, education, road and communication, the lack of economic opportunity, dependency of 66% of population on agriculture for livelihood and low awareness about the financial system in rural areas pose additional challenges for enhancing financial inclusion in Nepal.

Financial inclusion aims at ensuring access to appropriate financial products and services at an affordable cost and fair and transparent manner by regulated mainstream institutional players who also promote financial literacy and consumer protection. All sections of the society, including vulnerable groups and low income groups, should be able to access full range of financial services including credit, savings, insurance, pension, money transfers and remittance.

## GOVERNMENT INITIATIVES

Financial inclusion is a necessity for the economic development of the country as it creates opportunities for

people to be involved in income generating activities and also aids in improving well-being. The government in the recent budget for FY 2016/17, outlined the plan to expand banking and financial services in rural areas, promotion of mobile banking and branchless banking, continuation of government led programs such as Rural Self Reliance Fund (RSRF), Poverty Alleviation Fund (PAF), Youth and Small Entrepreneur Self-employment Fund. Moreover, recognizing the importance of financial inclusion the government has also emphasized the expansion of micro insurance, enforcement of subsidized agricultural lending program and implementation of the Financial Sector Development Strategy. The Financial Literacy Policy formulated with the intent of educating rural people is also in the process of approval from the government

Likewise, Nepal Rastra Bank (NRB) has also adopted policy measures to encourage the use of financial services in remote areas. Commercial Banks, Development Banks and Finance Companies are required to provide 5%, 4.5% and 4.0% respectively of their total credit portfolio to deprived sector, out of which Commercial Banks are required to lend 2% on their own. Moreover, Banks and Financial Institutions (BFIs) are required to establish rural branches before establishing branches in the urban areas. In order to assist BFIs to establish branch network in the

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pre-defined remote districts, interest free loan is provided. Special refinance facility is also provided to the BFIs for lending to small and cottage industries and enterprises that are run by women entrepreneurs.

In terms of regional comparison of financial inclusion, Nepal is in a better shape compared to other South Asian countries. In Nepal, while poverty level is decreasing, financial outreach has increased. Moreover, the understanding among rural people regarding the facilities offered by BFIs has increased and are much more empowered than before. Despite the achievement of the country, there is a long way ahead for Nepal to achieve the global target of universal financial access by 2020.

### **EMBRACING GLOBAL TRENDS**

Nepal needs to move along the global trend wherein

as per the World Bank Global Findex Data 2014, the number of unbanked adults dropped from 2.5 billion in 2011 to 2 billion in 2014. Currently, one of the global trends in financial inclusion is embracing technology and innovation that has transformed delivery mechanisms of financial services. Government initiative to encourage digital innovation to increase access of financial services to rural areas needs to be pushed towards materialization. Regulatory and supervisory framework needs to be robust to address the emerging challenges and risks. Financial Inclusion Index and monitoring framework needs to be developed and implemented to measure the outputs and outcomes. Global trends show that central banks have taken leadership in developing financial inclusion frameworks. In line with government policies, this calls for NRB to address many of these issues in order to create a financial system that is inclusive and serves the economy.

# FINANCIAL INCLUSION A POLICY PRIORITY FOR NEPAL



**Dr. Chiranjibi Nepal,**  
*Governor, Nepal Rastra Bank*

Financial inclusiveness is understood as providing and ensuring reliable and affordable financial services to all segments of society. Although access to finance is necessary for all members of society, it is particularly more important for disadvantaged and low income groups, as it provides opportunities for them to save and invest, and protect themselves from various risks such as natural disasters, illness, and loss of livelihoods.

Nepal Rastra Bank (NRB) understands that a literate economically active population would contribute to ensuring financial stability and economic development of the country. The access and use of appropriate financial services, such as credit, savings, insurance and payment, offers poor people an opportunity to undertake income generating activities. Opening of new bank branch in the unbanked areas allows people to use banking facilities and this could generate positive impacts on local households. As financial intermediation deepens, it helps in better distribution of capital and risks and decreases inequality levels.

Therefore, financial inclusion is a major policy priority for NRB which is also included in its Strategic Plan. It has been identified as an important pillar in the National Five-year Financial Sector Development Strategy, which is in the process of approval. NRB has continued deprived sector lending program with a view to expand financial services to rural poor. Banks and Financial Institutions (BFIs) are required to open branches in rural areas first in order to establish branches in urban centers. Interest free

loans are provided to BFIs for opening branches in the identified rural districts. Special refinancing policies and interest free loans are other facilities offered to encourage lending in the rural sector. Credit facility on subsidized interest rate is offered to members of cooperatives from Rural Self Reliance Fund. In line with the government's policies, NRB is introducing "one account in one household" campaign soon and is in the process of preparing regulatory directives to allow non-bank private institutions, such as telecom operators, to take part in delivering financial services. NRB has also developed Financial Sector Development Strategy for the next five years to address the priorities of the financial system in a comprehensive manner and that will be in operation from this fiscal year. Also, social security allowances from the government will be distributed through banking system from this fiscal year.

It is clear from global experience that digital financing services reduces cost of services and helps in enhancing the financial services in remote areas. Therefore, banks and financial institutions and other payment service providers are being encouraged to use digital products and channels, and to this effect NRB has recently released licensing policy applicable for all payment institutions. Unlocking the existing deposits and credit constraints, developing safety nets for rural borrowers, capacity enhancement, strengthening institutional mechanisms and ensuring sound corporate governance are other policy areas of importance, on which NRB will be focusing in the days to come.

# DRIVING THE AGENDA OF FINANCIAL INCLUSION IN NEPAL



**Ujjwal Raj Pokhrel**

*National Programme Coordinator, United National Capital Development Fund*

The recently launched Making Financial Access Possible (MAP) is a nationally representative diagnostic study undertaken by the Nepal Rastra Bank with support from UNCDF and UNDP. The study provides an overall picture of the financial inclusion situation in Nepal. The related FinScope survey (2015) – a demand side study that feeds the MAP findings – provides an overview of how people source their income and how they manage their financial lives.

The findings of the study reveal that, compared to other MAP countries<sup>i</sup>, the level of financial inclusion (in terms of access to formal and informal financial services) in Nepal is relatively high, with only 18% of the adult population being financially excluded. This percentage of people who are financially excluded is low compared to MAP countries globally and, in particular, to Asian MAP countries such as Pakistan (where 56% of adults are excluded), Myanmar (where 39% of adults are excluded) and Lao PDR (where 25% of adults are excluded). Thailand is an exception to this, with a mere 1% of the population are excluded from financial services.

Further analysing the FinScope findings, 40% of Nepali adults claim to be banked and 21% claim to have used financial services from a non-bank formally regulated financial institution. Totalling the usage of bank and non-bank formal institution, 61% of Nepali adults are being formally served. The informal channels serve 21% of the population, which means that 82% population are financially included. A total of 18% of Nepali adults are financially excluded and do not use services of any formal or informal financial service providers.

However, when studying the overlaps in the use of financial channels; as most of these channels are not used exclusively, informal channels emerge as the most predominant ones. According to the FinScope survey, 57% of the adult population report uptake of products through informal channels. Looking into the overlap between the uses of formal financial services (62% of the population) provided by banks and other formal institutions such as remittance providers, and cooperatives, the data reveals that 14% of Nepali use a combination of all financial service types. 22% of the population who are banked also overlap with

<sup>i</sup> These countries includes Mauritius 2014, South Africa 2014, Thailand 2013, Namibia 2011, Swaziland 2014, Botswana 2009, Lesotho 2009, Ghana 2010, Nigeria 2012, Zimbabwe 2014, Kenya 2013, Malawi 2014, Rwanda 2012, Uganda 2013, Myanmar 2013, Tanzania 2013, Zambia 2009, Democratic Republic of Congo 2014, Mozambique 2009, Pakistan 2008.

The level of financial inclusion (in terms of access to formal and informal financial services) in Nepal is relatively high, with only 18 of the adult population being financially excluded. This percentage of people who are financially excluded is low compared to MAP countries globally and, in particular, to Asian MAP countries such as Pakistan (where 56% of adults are excluded), Myanmar (where 39% of adults are excluded) and Lao PDR (where 25% of adults are excluded).

the population using informal financial services. Similarly overlaps could be detected between banks and cooperatives, and cooperatives and other informal channels.

Generally, banks are expected to be the drivers playing a key role in driving the agenda of financial inclusion. However, before addressing such expectations, one needs to carefully look into the findings from the MAP diagnostic study.

It emerges from the study that only 9% of the population exclusively transact with formal banks (A, B, C and D class banks) licenced by the Nepal Rastra Bank. This small percentages include both corporate as well as the non-corporate clients. The research also indicates that the average income of clients having a bank account is 1.7 times higher than of those without a bank account, 38% of those with a bank account have a regular monthly income whilst only 20% of those without an account claim to have regular monthly income. Likewise, 63% of adults with a bank account are aged between 25 and 54 years and only 19% are under the age of 25 years.

Hence, one of the key barriers to the uptake of formal financial services from banks seems to be income level and affordability. It is also evident from the study that the financial transactions of banks are driven by payments and savings products (out of those who have borrowed money, only 10% of adults are borrowing from banks). This is especially true given that majority of Nepali adults have irregular and unpredictable income flows. The survey also reveals that 71% of adults have irregular income, while 27% claim to earn a regular monthly income. Only 24% claim to earn NPR 10,000 or more a month while 42% of adults reportedly earn less than USD 2 per day.<sup>ii</sup>

The above scenario and findings pose an important question on whether banks in Nepal are best placed to promote the agenda of financial inclusion, especially to those unserved and underserved population in rural and remote areas where majority have no regular income sources and earn less than USD 2 per day.

ii MAP, FinScope Survey Findings, 2015

# WHERE IS FINANCIAL INCLUSION GOING?



## Centre for Financial Regulation and Inclusion (Cenfri)

*This article has been jointly authored by Barry Cooper, Catherine Denoon-Stevens and David Saunders.*

Developing countries and emerging markets around the world are taking up the call to use access to financial services as a tool to implement the UN Sustainable Development Goals (SDGs) set for 2030. Nepal is no exception. The government of Nepal plans to use financial inclusion (FI) as a way to ensure higher, sustainable and equitable growth, helping the country to graduate from least-developed country (LDC) status by 2022, and to achieve the SDGs and become a middle-income country by 2030.

The Central Bank of Nepal (Nepal Rastra Bank- NRB) is currently implementing a five-year strategic action plan (2012–2016) which includes financial inclusion as a priority. Building on this priority will help to drive the rest of the financial inclusion development in Nepal.

As priorities for financial inclusion are being rolled out and new ones are being adopted, it is important to take stock of the key global trends that will impact upon them and understand what they mean for Nepal going forward:

### FI is now mainstream

The 2014 Global Findex Survey shows that from 2011 to 2014, 721 million new accounts were opened. Over 90% were opened at financial institutions, the vast majority of which were banks. Further, the increasing role of mobile phone technology and more broadly fintech, particularly

in the payments and credit space, is creating new markets for financial services previously left to microfinance institutions (MFIs) or informal financial service providers. Financial service provision to new consumer segments is no longer on the periphery, it is now mainstream. But what does it mean?

In Nepal, whilst fintech has yet to shape the financial industry the same way it has in other emerging markets, banks play a critical role. Nearly half of adults in Nepal (40%) access at least one financial service from a bank. However, unlike with MFIs that struggle with scale and capability, banks struggle with providing valuable financial services, according to the end user. Findex found that only 18% of adults use their bank account more than three times a month. That means that most account-holding Nepalese citizens are merely using their accounts to deposit and withdraw money once a month (i.e. as a mailbox), or, not using them at all.

This is a major challenge for banks – as well as mobile money and fintech providers – that rely on usage fees to generate revenue in these markets.

### Access and ownership are no longer sufficient

The headline indicators in FI commonly measure the percentage of adults that have access to, or own, at least

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one financial service from a formal financial institution. However, this does not accurately reflect how adults live their financial lives and new measurement frameworks are offering new insights into how adults engage with the formal financial sector.

For one, FI requires adults to have access to a portfolio of financial services that meet their needs. However, this is rarely the reality in developing countries. For example, according to Nepal's FinScope consumer survey, 60% of adults have access to a financial service from a formal financial provider. However, just over half of those adults (38%) access more than one financial service from formal providers and, only 5%, access a full portfolio, i.e. savings, credit, insurance and payments.

Second, whilst access and ownership are often necessary conditions for FI, it does not guarantee use. As noted above, very few accounts at financial institutions are used regularly in Nepal. This should be a concern for policymakers and providers, as without usage business models are not viable for providers, and public policy objectives are unattainable as adults need to use services to get value from them.

Finally, informal financial services are often the largest category of financial service provision but are rarely considered when measuring FI. For example, in

Nepal 57% of adults report using informal financial services. Furthermore, of the 60% of adults using formal financial services from a bank or other type of formal provider, 37% use informal financial services in any case. This means that less than a quarter of adults (23%) are meeting their needs through formal financial services only. This phenomenon is not unique to Nepal and highlights the importance for policymakers and providers to understand these models and why, even when adults can access formal financial services, they still use informal alternatives.

Going forward it will be important to monitor and track these new indicators as a way to get deeper insight into the market for FI.

### **Business convergence becoming the norm**

Globally, financial service provision is seeing a convergence between different types of traditional financial services and non-financial services providers. The most common partnership to date has been between mobile network operators (MNOs) and banks. MNOs typically have a ubiquitous low-cost agent network, but no legal mandate for financial services beyond payments; and, while banks have the legal mandate, they often lack the low-cost distribution networks required to serve these emerging consumers.

Partnerships are also emerging between banks and traditional community-based financial service providers (e.g. cooperatives) who have similar distribution footprints to MNOs, but lack the capability and systems to scale up financial service provision.

For example, in Nepal, Savings and Credit Cooperative Societies (SACCOs) and MFIs play a key role in formal financial service provision whilst savings groups, hundis (informal payment brokers) and money-lenders do so in the informal space. The commonality amongst these types of providers is that they are local in nature, i.e. the service and decision-making for the service takes place at the community level. Whilst these types of providers are often difficult to scale, they offer a ready partner for other providers that do not have a local presence in the community.

This has been particularly evident in Nepal, with banks linking to MFIs to meet the government mandate of delivering 5% credit to deprived segments of the population. New business models, such as travel agents evolving into

remittance providers, in turn evolving into banks are also opening up new avenues for valuable financial services.

The challenge for Nepal, and most policymakers in the developing world, is how to enable these partnerships to deliver value to consumers, while delivering on their mandate for consumer protection, financial integrity and financial stability. In Nepal, updating regulatory frameworks to ensure that the best possible supportive foundation for financial inclusion is in place is a priority.

Going forward, Nepal will find itself faced with similar challenges that other developing countries are facing – how do we make financial services truly valuable for new consumer segments and viable for providers?

Whilst the trends above will lead us closer to the solution, it is not expected to be straightforward. Governments will need to make deliberate decisions to allow for innovation, but not undermine the potential of either side of this equation.

The challenge is set and Nepal is ready to step-up to the plate.

# MAKING ACCESS POSSIBLE



**Kamneshnee Naidoo**  
*One sentence Byline, MAP HUB*

Financial inclusion has been identified as a priority by many governments around the world, and internationally as the core of the Sustainable Development Goals (SDGs); as appropriate financial services can help improve household welfare and spur small enterprise activity. Financial inclusion is seen as a major contributor to the achievement of a number of SDGs. Macroeconomic evidence shows that economies with deeper financial intermediation tend to grow faster and reduce income inequality. At a national level financial inclusion complements critical national policies, notably on poverty eradication, reducing inequality, job creation and growth, as well as supporting education and health objectives.

UNCDF's Making Access Possible (MAP) Programme aims to help foster policy environments that enable sustainable financing for development and complementing key public policy initiatives through long-term data and measurement. By empowering poor households to take a long-term view of education and health, financial inclusion further complements government policy, positioning governments to reap the demographic dividend by ensuring healthier and educated young people, raising productivity and attracting further investments in the real economy.

MAP is a multi-country initiative to support financial inclusion through a process of evidence-based country

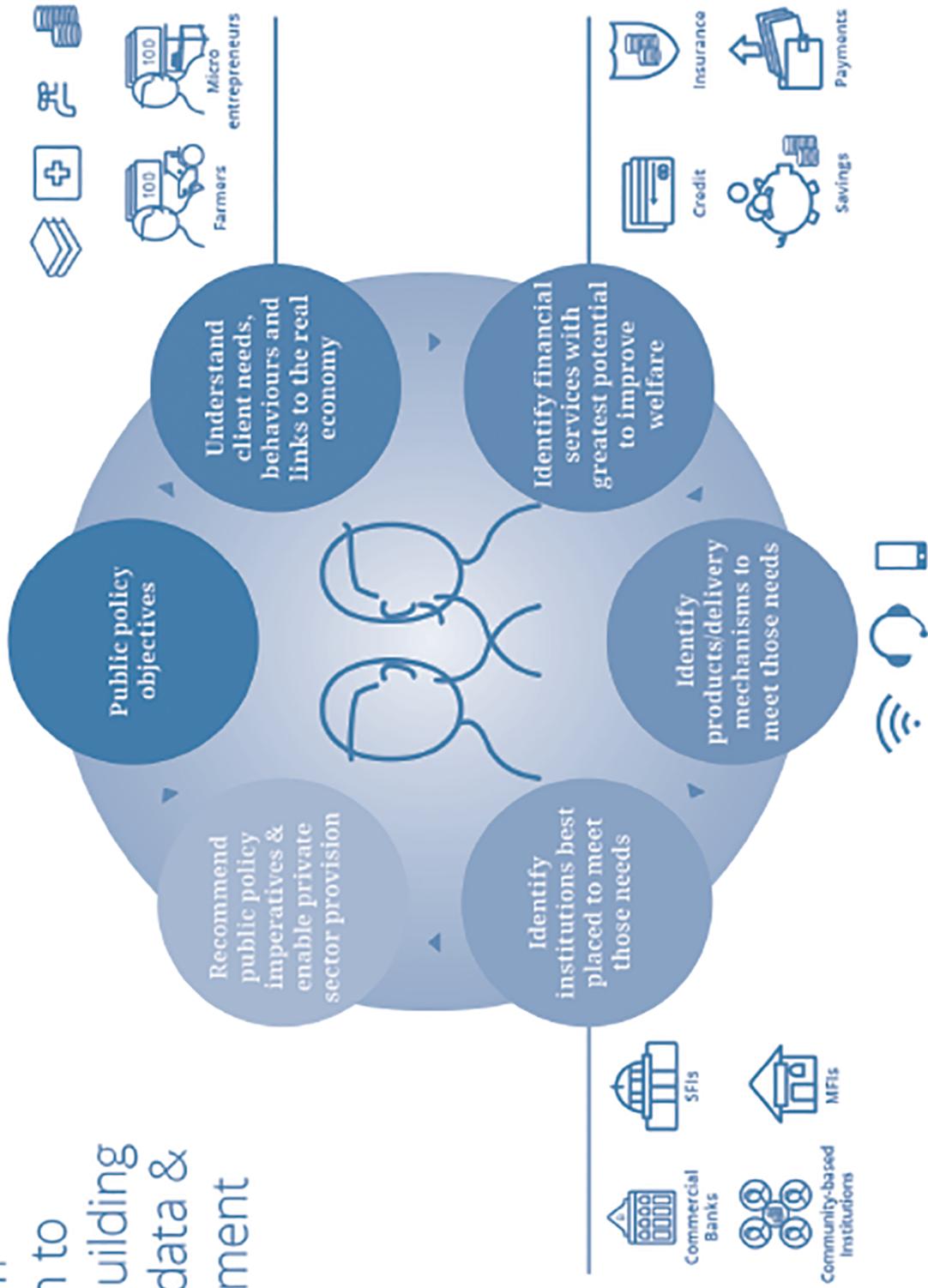
diagnostic and stakeholder dialogue, leading to the development of national financial inclusion roadmaps that identify key drivers of financial inclusion and recommended action. Through its design, MAP seeks to strengthen and focus the domestic development dialogue on financial inclusion. The MAP framework has been developed by UNCDF in partnership with FinMark Trust and Cenfri and is intended to become a public good that can advance the global financial inclusion agenda. The partnership leverages their experience in financial inclusion development, aligning their respective strengths in implementation, primary demand-side research and diagnostic composition.

A key component of the MAP diagnostic is to link financial inclusion to household demand for services. Financial transactions play an integral role in the daily lives of most people, especially those living in poverty.<sup>iii</sup> However, they are frequently compelled to use informal and often sub-optimal services. Research has shown that poor households utilize a range of informal methods to manage their daily needs, including “storing savings at home, with others, and with banking institutions; joining savings clubs, savings-and-loan clubs, and insurance clubs; and borrowing from neighbours, relatives, employers, moneylenders, or financial institutions.”<sup>iv</sup>

<sup>iii</sup> World Bank, 2011. Findex data.

<sup>iv</sup> Daryl Collins, Jonathan Morduch, Stuart Rutherford, Orlanda Ruthven. “Portfolios of the Poor.” Princeton, 2009.

# Long term approach to market building through data & measurement



By empowering poor households to take a long-term view of education and health, financial inclusion further complements government policy, positioning governments to reap the demographic dividend by ensuring healthier and educated young people, raising productivity and attracting further investments in the real economy.

These mechanisms are not ideal, particularly in protecting the poor from short-term and long-term household risks and shocks, but they are useful reference points for governments and the private sector in their efforts to make markets work for the poor. By understanding the needs and demands of poor households, policy, product, and service solutions can be developed that better serve their needs and reduce inequalities of access. With greater access to a range of financial services, poor and low-income households and businesses can generate income, build assets, smooth consumption and manage risks.

Thus, the MAP programme is based on detailed analytics to drive the understanding of implementation at country level in order to enable functioning market systems. A key challenge at country level is the existence of good data and analytics to inform policymaking and market development. The MAP programme aims to address this by making available good data that is nationally representative at country level, high quality analytics to inform decision-making around market development through the development of national roadmaps and sets a strong stakeholder process by expanding beyond the “traditional” government counterparts; by engaging with the private sector to drive investments around financial inclusion and MAP empowers them to “see” un-tapped markets and drive smart investment strategies on their part.

The MAP Global Hub established in Johannesburg, South Africa, provides leading global technical assistance to 16 countries in the programme as well as technical oversight, where necessary. In ensuring that countries can leverage and learn from each other, regional MAP forums have been set up with the key purpose to ensure focus on the implementation of the roadmap and gain feedback from Government and country coordinators on the programme so that it remains relevant and continues to be implemented at the country level. Additionally, a regional monitoring and evaluation framework was developed to ensure effective tracking of progress against a financial inclusion baseline.

It is increasingly recognised that a broader ecosystem of providers is necessary to deliver the diverse set of financial services that the poor require. Strategies that remain focused on only one of these providers – such as microfinance institutions, private sector, cooperatives or a single activity such as institution-building – miss the bigger picture and are also unlikely to enable the systemic change required to drive universal financial inclusion, especially for the poor.

This is based on the view that competitive markets are the key means through which innovation and competition will best occur, resulting in falling transaction costs together with the scale and sustainability required to overcome the significant levels of exclusion that remain.<sup>v</sup> The MAP programme aims to facilitate this market development agenda.

v Porteous, 2004, Honohan and Beck, 2007





GENERAL  
**OVERVIEW**

# GENERAL OVERVIEW

## POLITICAL OVERVIEW

In yet another repeat of history, another coalition government has failed to perform with a new coalition taking its place. Although the actors are different, the dynamics remain the same. Presence of a common agenda with buy in from key players of the coalition is crucial to ensure that the partnership succeeds. Industry experts are of the opinion that opportunistic politics without any consideration for ethical norms is the root for the current government's instability and this trend is bound to continue as corrective actions have not yet emerged.

**New prime minister elected:** Following the resignation of K.P Sharma Oli after nine months in the office, Pushpa Kamal Dahal has been elected as the new prime minister of Nepal. The resignation was resultant of the no-trust motion registered against Prime Minister Oli by the Communist

Party Nepal (Maoist Center), Nepali Congress and other fringe parties. The change of power comes at the hand of a power-sharing agreement between CPN (Maoist-Center) and Nepali Congress wherein Mr. Dahal will serve as prime minister for nine months after which Sher Bahadur Deuba of Nepali Congress will service as prime minister for the next nine months. The Oli government's failure to honor the power sharing agreement with CPN (Maoist-Center) and handover the position of Prime Minister to CPN (Maoist-Center) after nine months of holding office, resulted in the latter pulling out of the coalition with the UML and Oli government losing its majority support.<sup>5</sup> The CPN (Maoist-Center) and Nepali Congress under the new coalition government have agreed to assign leadership of 12 ministries to Nepali Congress including Ministry of Home Affairs and Foreign Affairs.<sup>6</sup>

**Special envoys visit China and India.** The newly appointed Deputy Prime Minister and Minister for Home Affairs Krishna Bahadur Mahara visited China as a special envoy of Prime Minister Pushpa Kamal Dahal. Mahara held meetings with Chinese Premier Li Keqiang and Minister for Foreign Affairs Wang Yi during his visit and updated the Chinese leadership about the new government's plan and policies along with an update on the latest political development in the country.<sup>7</sup> Despite the change in government, the Chinese government is committed to implementing all previous agreements signed with Nepal which include deals in areas of trade, cross border transport and energy cooperation along with the permission to use Chinese railways, roads and ports to trade with third parties.

On the other hand, Deputy Prime Minister and Minister for Home Affairs Bimalendra Nidhi visited India to deliver an update on the political scenario and priorities of the new government. During DPM Nidhi's visit, he met with the Indian Prime Minister Narendra Modi who communicated that India will fully support the priorities of the new government. Mr. Nidhi also extended an invitation on behalf of Nepal's president, Bidhya Devi Bhandari, to Indian President Pranab Mukherjee.<sup>8</sup> DPM Nidhi also met Vice

President of Indian National Congress, Rahul Gandhi who pledged support to the government.<sup>9</sup>

**New task force formed for negotiations:** Representatives from the Maoist Center and Congress alliance along with representatives from the agitating Madesh-based parties, jointly known as the Sanghiya Gathabandhan (Federal Alliance), have formed a new taskforce to start negotiations on disputed issues. A draft proposal for

the constitutional amendment will be prepared by the taskforce after which the government will register a constitution amendment proposal in the parliament by mid-October. The negotiations will mainly touch upon issues of restructuring of state, provincial representation in the Upper House and citizenship. The Madhesi parties have demanded a population based provincial representation in the Upper House along with changes in state restructuring such that at least two provinces are in the Terai region.<sup>10</sup>

## “ OUTLOOK

Given the very short tenure of each government, never-ending political transitions and each government prioritizing party politics over country politics, the public does not expect major outcomes from the change in power. The expectation is rather built around witnessing another change in government in a predictable framework of nine months. In the immediate run, the intent of the government will center primarily on discussing the demands of the Madhesi movement, as well as building a better bilateral relationship and working towards implementation of federalism. In terms of economic policies and legislative reforms, there is very little expectation as the government may not prioritize it given the pre-occupation with amendment and implementation of the constitution, as well as potentially holding local elections at the earliest.

# GENERAL OVERVIEW

## INTERNATIONAL ECONOMY

Last quarter marked some significant changes for the leading economies in the world like China and India. After much speculation on whether UK will exit or stay in the European Union (EU), people of UK voted to opt out of the EU. On the other hand, after the exit of Raghuram Rajan, Urjit Patel has taken on the role of the governor of the Reserve Bank of India (RBI). Other major happenings include the meeting of leaders in the G-20 summit and decrease in the prices of oil in the global market.

**UK votes for Brexit:** In the historic referendum conducted in the last week of June 2016, United Kingdom (UK) voted to leave the European Union (EU).<sup>11</sup> The referendum turnout was 71.8% where more than 30 million people voted. At the end of referendum, the percentage of people who voted to leave stood at 52%, while those who voted to remain stood at 48%. While England and Wales strongly voted to leave, Scotland and Northern Ireland voted to remain. After the referendum, Theresa May was chosen as the new prime minister while David Cameron resigned after losing the referendum.<sup>12</sup> For UK to exit the EU, Article 50 of the EU treaty needs to be invoked first, following which it will take at

least two years from that point for the UK to completely exit the EU.

**G20 summit held in China:** The 11th G20 (Group of 20) summit hosted by China in the city Hangzhou was held from 4-5 September this year. It was attended by world's most powerful leaders who represent around 85% of the world's economy. One of the major highlights of the summit was the joint US-Chinese ratification of the Paris agreement on climate change, a non-legally binding deal that requires each country to commit to curb greenhouse gas emissions.<sup>13</sup> On the other hand, the United States and Russia failed to reach an agreement over the Syrian Crisis.<sup>14</sup> UK initiated multiple bilateral trade deals with several countries including China and India as a separate entity post-Brexit. However, the United States denied trade deal with the UK citing that it prioritized trade negotiations with the EU bloc before considering a deal with UK.<sup>15</sup>

Additionally, during the summit, world leaders raised concerns over rising income inequality and exclusive growth around the world along with the growing populist backlash against globalization. On that front, 'Hangzhou Consensus',

the final communique of the summit, appealed to G20 for more inclusive economic growth through open trade and innovation, implementation of sustainable development goals and well-coordinated macroeconomic policies.<sup>16</sup>

### **Urjit Patel takes over as the new governor of Reserve Bank of India (RBI):**

Urjit Patel, deputy governor of the Central Bank of India- RBI has been appointed as the new governor.<sup>17</sup> The appointment ensued after Raghuram Rajan stepped down from the post following the end of his tenure without seeking a new term.

Rajan's most notable achievements during his reign include monetary policy reforms, wherein the central bank adopted Consumer Price Index (CPI)-targeting approach to curb high inflation plaguing the Indian Economy and Strategic Debt Restructuring (SDR) Scheme to tackle non-performing assets in the banking sector.<sup>18</sup> However, as Patel was one of the architects of previous policy changes, no such dramatic shift is expected during his tenure in terms of monetary policy stance. The major issue that the new governor will be facing in the immediate future is whether to cut the repo rate or not

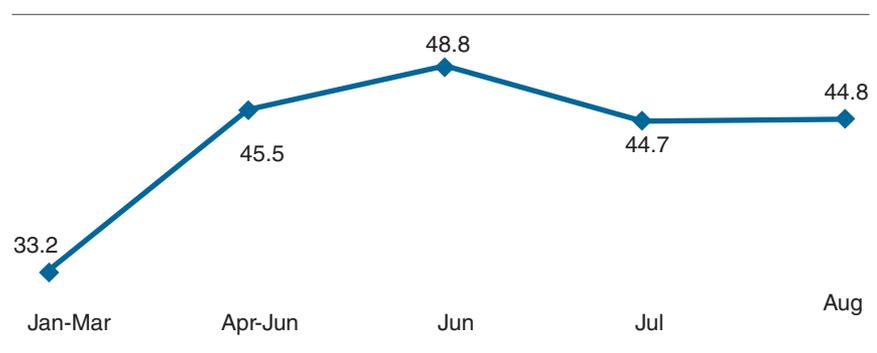
as the economy is in its 15-month low and could use a stimulus while inflation is out of its target 2-6% band at 6.02%.<sup>19</sup>

**Oil prices in free fall:** Crude oil prices in the global market, as measured through the WTI benchmark, has been experiencing a free fall over the past three months. It hit the lowest in January in several years at a monthly average of USD 29.78 per barrel (NPR 3,208) because of supply side disruptions, especially wildfires in Canada and terrorist attacks on Nigeria's oil infrastructure.<sup>20</sup> Subsequently, it showed a fairly inclining trend till June. It averaged at USD 48.8 per barrel (NPR 5,257) for the month of July and started declining again. By the end of August, it stood at USD 44.88 per barrel (NPR 5,265).

OPEC member countries held talks amongst themselves prior to the 15th International Energy Forum (IEF15) to be held in Algeria from 26-28 September. The oil cartel along with non-OPEC Russia was in talks to hold another oil freeze to keep prices artificially high. However, a

concrete agreement was yet to be reached as Iran said it would only cooperate after it had regained its market share following the lifting of Western-backed economic sanctions. If OPEC productions do freeze, there are speculations that oil prices could rise to USD 60 (NPR 6,463).<sup>21</sup>

**Figure 1: Monthly average prices of crude oil (WTI) – In USD**



Source: World Bank Commodity Price Data (The Pink Sheet)

## OUTLOOK

Following the events of the last quarter, it is clear that Brexit will reshape the map of Europe; however, the timeline for it remains uncertain as UK itself is unprepared and unsure of its decision. To make the exit smooth, EU and UK should start figuring out how to make the best of it by preparing its strategies and priorities. By the looks of it, UK is likely to suffer in the short and medium term as a lot of political energy is and will be devoted to Brexit. Furthermore, it would be interesting to see if appointment of Urjit Patel as the governor of RBI changes anything in the Indian economy. In regard to the US Presidential Elections, with Hilary Clinton and Donald Trump now accepting the nomination for the Democratic and Republican Parties respectively, it will be interesting to see the election results in November and the series of changes that it will bring in which will impact not only the economy of US but also other developing countries.





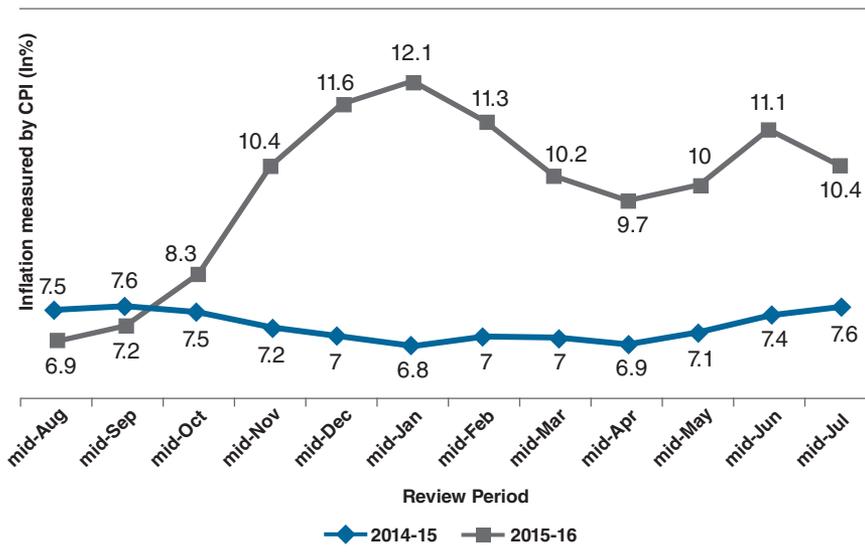
MACROECONOMIC  
**OVERVIEW**

The country is still recovering from the lingering effects of the April earthquake and the border blockade. As the economy showed signs of stabilizing, a major political upheaval with a new Prime Minister at the helm, has thrown a shadow of uncertainty over the future prospects of the country. As shown through past experiences political changes have not exactly been conducive to economic development with inflation levels jumping back to double-digit figures, casting doubts over the government's ability to control inflation. In addition, trade deficit has reached an all-time high while government spending has fallen short of the targeted expenditure at the end of FY 2015/16.

**Inflation:** After dropping down to single digits for the first time in mid-April, inflation measured by Consumer Price Index (CPI) returned to double digits in mid-May to stand at 10% and continued this trend as shown in Figure 2. For FY 2015/16, the annual average inflation measured by CPI increased to 9.9% compared to 7.2% last year. This increase can be retraced to the closing of border points for almost five months, which hampered the movement of goods. Inflation levels can be further expected to rise as the budget for FY 2016/17 is considered to be expansionary and distributive. Hikes in government salaries have raised concerns about further inflationary pressure being exerted on the economy due to the budget.

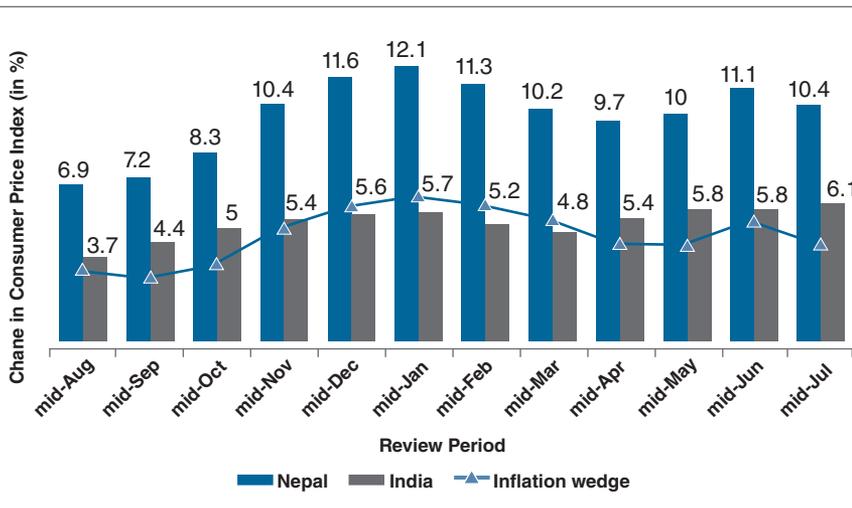
**Inflation wedge between Nepal and India:** Inflation wedge, measured as the year-on-year change in the CPI of India and Nepal, has been on the rise as shown in Figure 3. Over the same period last year, inflation wedge between India and Nepal was lower as shown in Figure 4. In June 2014/15,

**Figure 2: Year on Year inflation measured by Consumer Price Index (CPI) for twelve months of FY 2014-15 & 2015-16**



Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

**Figure 3 : Year-on-year percentage change in CPI in Nepal and India and the inflation wedge in the corresponding period for FY 2015-16**



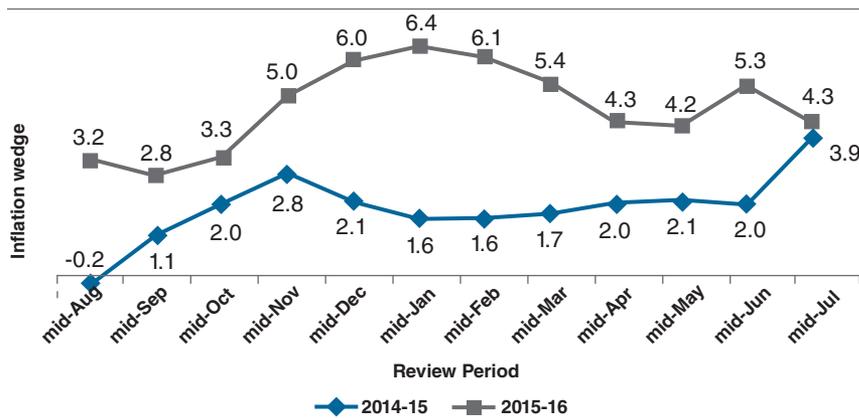
Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

the wedge stood at 2% but widened to 5.3% in FY 2015/16. This is an indicator that supply side constraints are having substantial effects in raising prices in Nepal. Constraints such as transportation hold ups and shortage of raw materials push prices up. Ineffective market monitoring has also led to fabricated price hike of many goods and has further increased

inflationary pressure.

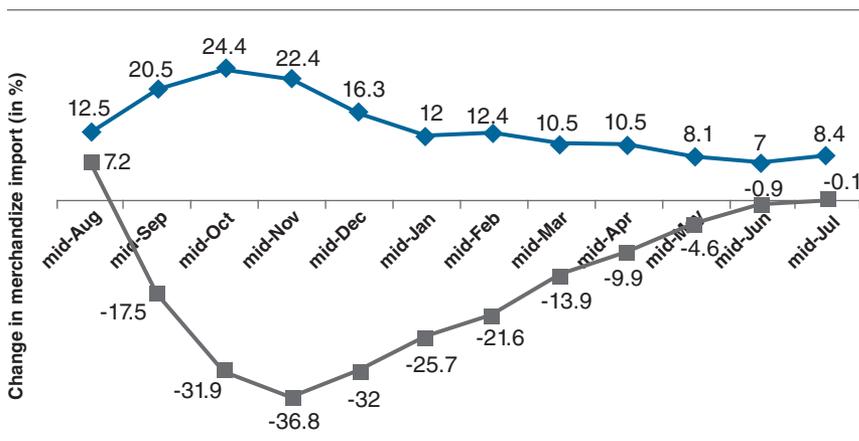
Over the same period last year, inflation wedge between India and Nepal was lower as shown in Figure 4. In June 2014/15, the wedge stood at 2% but widened to 5.3% in FY 2015/16. This is an indicator that supply side constraints are having substantial effects in raising

**Figure 4 : Year-on-year change in inflation wedge (based on CPI) between Nepal and India in FY 2014-15 and FY 2015-16**



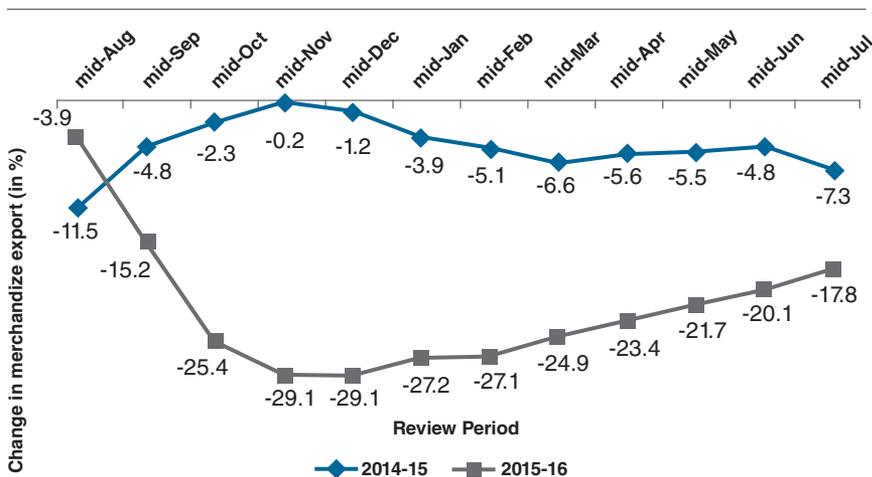
Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

**Figure 5: Year-on-year percentage change in merchandize imports in review periods in FYs 2014-15 and 2015-16**



Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

**Figure 6: Year-on-year percentage change in merchandize exports in review periods in FYs 2014-15 and 2015-16**



Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

prices in Nepal. Constraints such as transportation hold ups and shortage of raw materials push prices up.

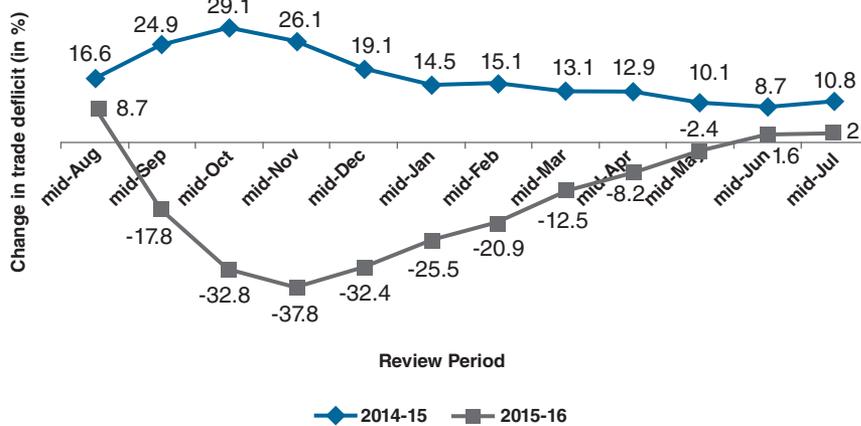
**Import-Export and trade deficit:**

Merchandise exports and imports had drastically deteriorated during the blockade with imports falling as low as -36.8% during the month of December as shown in Figure 5. Likewise, merchandise exports also faced drastic downturn with exports falling to -29.1% during December as shown in Figure 6. With the lifting of the blockade, both exports and imports have started recovering with imports improving to -0.1% at the end of FY 2015/16. The large fall in petroleum products and overall disruption of the supply chain over the course of the blockade has left imports struggling to reach pre blockade levels even though there are signs of improvement. Exports, which have struggled against imports since remittance flow into the country increased, have slowly improved to -17.8% as compared to -7.3% in the previous year.

Nepal’s ever-expanding trade deficit initially experienced substantial contractions during the blockade period, resultant of the severe restrictions on imports. However, as the blockade came to an end there was a rise in imports, resulting in a once again ballooning trade deficit to now stand at 2%, as shown in Figure 7. Political upheaval in the country and a lack of industrial development has severely hampered foreign trade in the country with trade deficit now at NPR 703.8 billion (USD 6.5 billion). Furthermore, the tendency of Nepali’s to import consumer goods from neighboring countries has led to a greater widening of the trade gap.

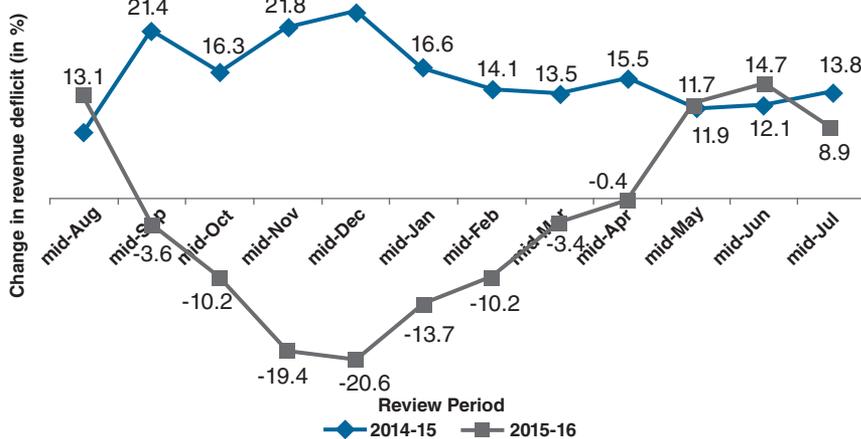
**Government Revenue:** The government revenue collection increased to NPR

**Figure 7: Year-on-year percentage change in trade deficit in the twelve months of FYs 2014-15 and 2015-16**



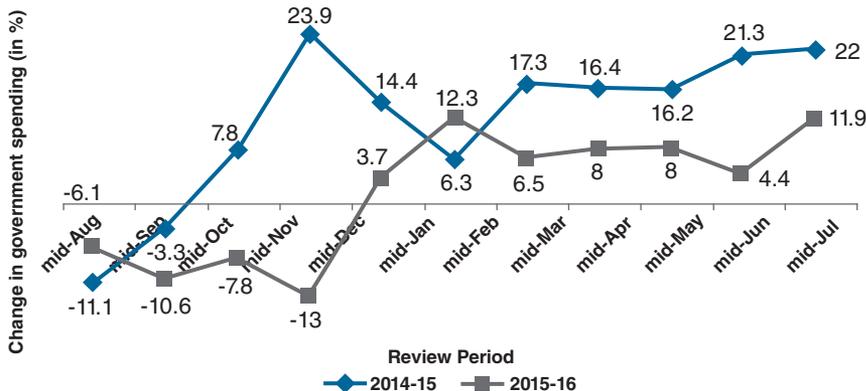
Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

**Figure 8: Year-on-Year percentage change in revenue collection during the review periods for FY 2014-15 and 2015-16**



Source: Current Macroeconomic Situation of Nepal (annual data for 2015-16), Nepal Rastra Bank

**Figure 9: Year-on-year percentage change in government expenditure during the review period for FY 2014-15 and 2015-16**



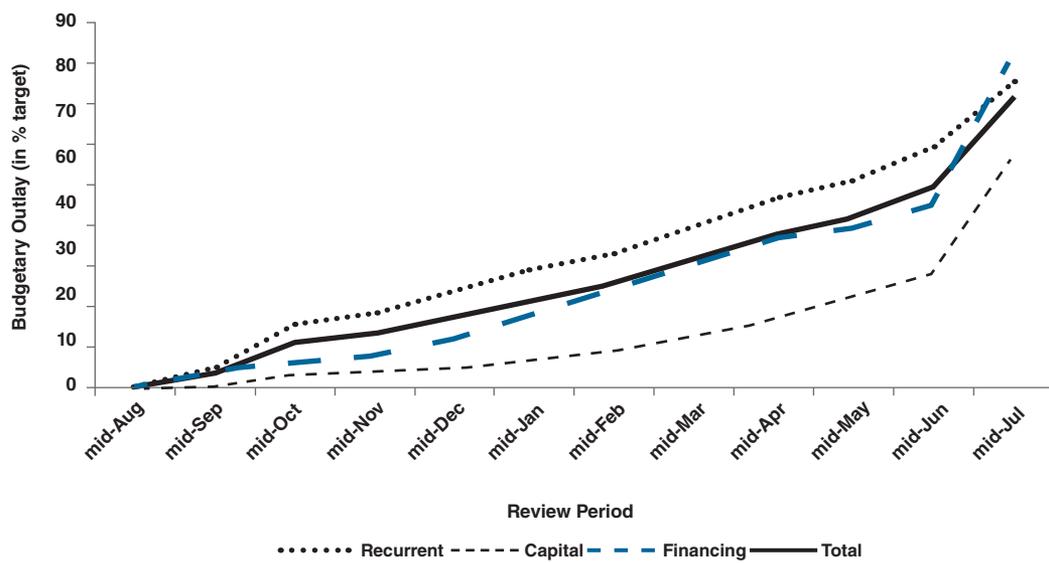
Source: Current Macroeconomic Situation of Nepal (Based on nine months' data of 2015-16), Nepal Rastra Bank

482.75 billion (USD 4.48 billion) at the end of FY 2015/16, which is 101.6% of the annual target of NPR 475 billion (USD 4.41 billion). Revenue collection had initially slowed down in the months of the blockade due to decrease in customs and VAT revenue, and it looked unlikely that the government would be able to achieve its collection goal.

Figure 8 shows the change in revenue collection for FY 2014/15 and FY 2015/16, from where it can be derived that while revenue collection had dropped significantly to -20.6% during the blockade, revenue collection gathered pace after re-routing of cargos and the ending of the blockade, culminating in the government exceeding its revenue collection target.

**Government Spending:** Government expenditure increased 11.9% to NPR 569.57 billion (USD 5.27 billion) in FY 2015/16, which constitutes 69.5% of the total targeted expenditure of NPR 819.4 billion (USD 7.64 billion). A failure to achieve the targeted expenditure can be narrowed down to the fuel crisis caused by the blockade, which severely hampered development activities.

Figure 9 shows that government spending started to pick up following the blockade and has reached post blockade levels. Capital spending, which amounted to 15.5% of total expenditure up till April 2016, increased to 37.9% by the end of the year. Recurrent expenditure and capital expenditure also experienced increase by 6.5% and 8.6% respectively. Figure 10 shows the monthly budgetary outlay in terms of percentage of the target achieved for government spending.

**Figure 10: Budgetary outlay trend over the nine months of FY 2015-16**

Source: Ministry Wise Budget Expenditure Status for various months, Financial Comptroller General Office

## “ OUTLOOK

Controlling the inflation rate to within 7.5% seems a tall task with food and cereal crop prices expected to grow in the country. The tabling of an expansionary budget for FY 2016/17 has further raised fears of higher inflation levels. Trade deficit will continue to expand until and unless steps are taken to mitigate it as imports will continue to outpace exports. As the country is still recuperating from the effects of the blockade and the April Earthquake, major political changes in the country at such a critical time paints a bleak future of the economy.



# 4

SECTORAL  
**REVIEW**

# AGRICULTURE

Growth of agriculture sector in 2015/16 stood at 0.8% against the estimated growth rate of 1.3%.<sup>22</sup> The prolonged disturbances in Terai, the key agricultural belt of the country, along with the shortage of chemical fertilizers and fuel adversely affected the sector. Apart from this, lack of modern agro-technology, misuse of agricultural land, lack of irrigation facility and poor food distribution channel have been persistent problems. Despite various measures being adopted, the country has not been able to be self-reliant in agriculture. As a result, threat of food insecurity is still looming in a few parts of the country.

**Agriculture Modernization project set to be implemented:** The Government of Nepal, with an objective to make the country self-reliant by modernizing and commercializing the agriculture sector, is set to start the implementation of 'Prime Minister Agriculture Modernization Project' as envisioned in fiscal budget 2016/17, by mid of September 2016. The working guidelines for implementation of the project has already been submitted to the Ministry of Finance for approval. In the first year of the 10-year scheme, Ministry of Agriculture Development (MoAD) plans to spend NPR 5.78 billion (USD 53.65 million). The aim of the project is to promote smallholder farmers by land-pooling to develop such land into pockets, blocks or zones. Accordingly, 2,100 pocket areas of 10 hectares each, 150 blocks of 100 hectares each, 30 zones of 500 hectares each and 7 super zones

of 1,000 hectares each will be created. The project will be implemented under private-cooperative-group-partnership model where farmers' cooperative will be involved in the production and private sector will be involved in processing, setting up warehouse facilities and agriculture input factories.

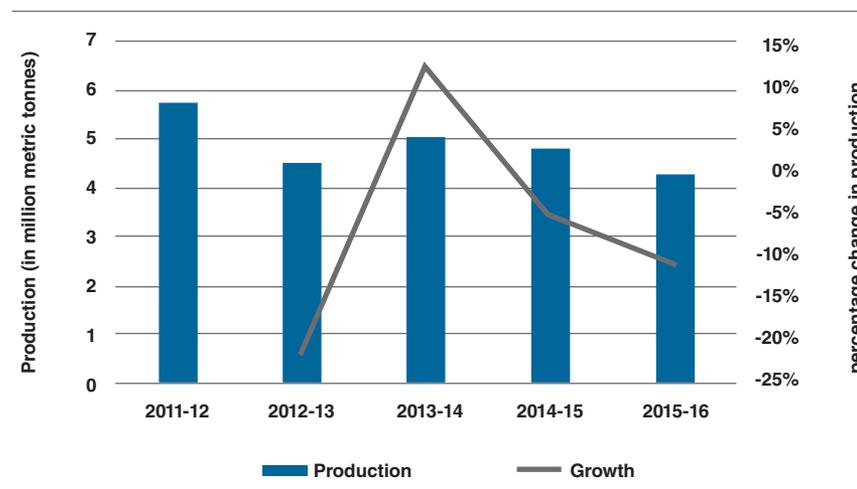
The government has aimed to be self-sufficient in wheat and vegetables by this fiscal year and paddy and potato in the next two years. By the end of the project, the government has envisaged to become self-sufficient in maize, fish and fruits like banana, papaya, litchi, kiwi, apple and orange.<sup>23</sup>

**Paddy plantation coverage enlarged:** The timely monsoon in Nepal has led to increment in paddy plantation. Out of 1.43 million hectares of paddy cultivation area, about 68% has already

been planted this monsoon compared to less than 50% plantation in the corresponding period of last year. The farmers depend widely on monsoon rain for irrigation as only 25% of the paddy fields have access to irrigation facilities.<sup>24</sup> However, production in the FY 2015-16 declined by 12% to 4.26 million metric tons which was 4.79 million metric tons in the previous year. The 'Paddy Mission Programme' that was launched last year with an objective of improving the productivity of paddy from the existing 3.1 metric tons per hectare to five metric tons per hectare was not successful as paddy production registered in decline during the same period.<sup>25</sup>

**Risk of Food insecurity in the country:** The report on food security of the country published by Ministry of Agriculture Development

**Figure 11: Paddy production volumes and percentage change in its production over five consecutive fiscal years**



Source: Ministry of Agriculture Development

(MoAD) highlights that a total of 212 Village Development Committees (VDCs) in 13 districts are under the threat of food insecurity. Minimal storage capacity is the key reason for such high risk of food insecurity as the production of winter crop last year was very low. Also natural calamities like floods, landslides and the resultant disruptions in supply channels also contribute to the threat of food insecurity. The country had a total food deficit of 71,000 tons in the last fiscal year due to decline in the production of major cereal crops. However, due to favorable monsoon this year, paddy production is expected to be improved which would also minimize the food insecurity situation.

**Mangoes and litchis harvest increased:** The harvest of mango and litchis in Parsa district this year was valued at NPR 135 million (USD 1.25 million) and NPR 20 million (USD 0.18 million) respectively registering a huge jump compared to the harvest of last year. The reason for such jump is the increase in the harvest area as well as favorable weather condition. Moreover, this year is the fruiting season of mango which fruits every alternate year. Mango was grown on 448 hectares of land in Parsa district that produced 2,610 tons this year. Similarly, 400 tons of Litchi was produced in 50 hectares of land.<sup>26</sup>

**Nepali tea improves its demand in international market:** The demand for Nepali tea was hit hard in the international market after a positive test of harmful chemical ‘anthraquinone’ (acque) on tea produced in Ilam district in the month of April. However, the popularity of organic tea of Ilam has rebounded and the demand has gradually increased. Although, in the first picking season of the year, the market was not encouraging; nevertheless, tea demand is showing significant improvement recently. Tea producers are now focusing more on quality organic tea as European countries are seeking standards such as eco-friendliness and bio-friendliness in tea production. As per Nepal Tea and Coffee Development Board the annual export of tea is 11.3 million kilograms with China, Netherland, Denmark, France, and the USA being the major export destination.<sup>27</sup>

**New bill drafted to regulate and improve agro markets:** The Ministry of Agriculture Development (MoAD) has drafted a new bill “Agro Market Development and Management Bill” to regulate and improve agriculture market by setting certain standards. As per the new provision of the draft bill, wholesale agriculture markets should compulsorily have stalls with shed, label pricing on products, parking, proper road access, water and

sanitation. Further, it also mandates provision for timely inspection on the weighing machines and pest control of agro products. The bill has also acknowledged the participant of farmers group in the committee by providing 25% of the stalls in wholesale markets to farmer groups. The draft bill also requires mandatory registration of wholesale market at Promotion and Marketing Development Directorate and also the registration of agro collection centers, local weekly markets and agro retail markets at District Development Committee. Currently, there are 22 government wholesale agro markets and 3 in private wholesale agro markets.<sup>28</sup>

**Sugarcane and cardamom with insurance policy:** Insurance Board (IB) is introducing insurance policies on sugarcane and cardamom to help farmers increase the production of these two cash crops. The sugarcane insurance policy has already been prepared and IB is conducting studies to draft cardamom insurance policy. The bill has proposed to fix a premium at 5% for both the crops. The policy will cover losses triggered by lightning, drought, landslide, fire, earthquake, flood, cyclonic storm, hailstorm, snow, sleet, pest and other diseases. The victim within various parameters will be able to compensate about 90% of the total damage from the insurance.<sup>29</sup>

## “ OUTLOOK

Various new measures of agriculture modernization, governance with control mechanism, and insurance are being considered to promote agricultural sector. Though two-third of the country’s population is engaged in agricultural sector, Nepal has been importing food grains and is also facing food insecurity in various districts. The government should set strict deadlines for implementation of various announcements made to take the country out of the looming situation and in the longer term guide the country towards being self-sufficient in agri-produce.

# ENERGY

Nepal is in the midst of an energy crisis with load shedding showing no signs of going down. Estimated installed capacity over the next 15 years show that the country needs to take strides in hydropower development if it is to become energy independent. While major hydropower projects constructed by Independent Power Producers (IPPs) are progressing and are expected to bring down the load shedding hours in the country, the financial health of NEA has been a topic of concern in the energy sector. Further, steps have also been taken to improve efficiency in the hydropower sector by amending the outdated Electricity Act 1993.

### Required installed capacity to increase to 10,092 MW by 2030:

A joint survey conducted by the National Planning Commission (NPC) and the Investment Board of Nepal (IBN) has shown that Nepal would need an installed electricity capacity of 10,092 MW by 2030 if the annual GDP growth rate remains at a constant 5%. Nepal Electricity Authority's (NEA) demand forecast for the same period (i.e. 2030) is less than half of the study's forecast. Sources in IBN claim their forecast to be more reliable as they have taken latent demand into consideration which others have missed out.

The study also provides different demand figures in relation to the growth in GDP. For example, if the GDP is to grow at a constant rate of 7% over the period then required installed energy capacity would be

11,560 MW in 2030. Similarly, an installed capacity of 14,702 MW would be required by 2030 if the economy grows at a constant annual rate of 10%.<sup>30</sup>

### Over two-dozen hydropower projects to be completed within this fiscal year:

NEA has stated that around 24 hydropower projects developed by Independent Power Producer's (IPP) are expected to be completed within this fiscal year. These projects will contribute around 175 MW of electricity to the national grid and is expected to reduce the current load shedding hours.<sup>31</sup>

Projects such as 50 MW Upper Marsyangdi A project and 25 MW Upper Madi hydropower project are expected to come into operation before the end of this year.<sup>32</sup> In addition, 100 MW is expected to be generated from an additional 21 hydropower projects, all of which are in their final stages of construction.

### India suggests increase in power tariff rates:

In the bilateral talks held between the neighboring countries in June 2016, India proposed an increase

in per unit electricity charge on the supply of electricity to Nepal from the Dhalkebar-Mizaffapur and Tanakpur-Mahendranagar transmission lines. At present, Nepal imports 80 MW of electricity at the rate of INR 3.44 (NPR 5.52) per unit through the Dhalkebar-Mizaffapur transmission line from NTPC Vidyut Vyapar Nigam. Nepal also imports 20-35 MW of electricity from PTC India at the rate of INR 6 (NPR 9.63) per unit from the Tanakpur-Mahendranagar transmission line. The Nepali delegation has agreed to discuss this proposal in a separate meeting between officials of the NEA and respective power trading companies of India. The Indian delegation also inquired about arrangements to import electricity from Nepal after 2019; however, a concrete agreement has not been made.

### Competitive bidding to be introduced for hydropower projects:

The government is devising an Energy Crisis Reduction Bill with a provision that hydropower projects with a capacity of more than 10 MW should be awarded only through competitive bidding. According to

**Table 1: Major projects coming into operation by the end of 2016**

Hydropower Project	Capacity
Upper Marsyangdi A	50 MW
Upper Madi	25 MW
Hewa Khola	14.9 MW
Madkyu Khola	13 MW
Thapa Khola	11.2 MW
Jog Mai Khola	7.6 MW
Tungun Tosne Khola	4.36 MW

Source: News articles

the Ministry of Energy (MoE), such a provision is essential to ensure that only companies or individuals with enthusiasm and capacity to develop a project are awarded the contract. Only developers who meet essential technical and financial prerequisites will be able to attain a license once the bill becomes a law. The proposed law is expected to get approved in the coming months.<sup>34</sup>

**DoED to issue license for mid-sized hydropower Projects:** In order to cut down the procedural hassles and time taken for issuing of licenses, Ministry of Energy (MoE) has amended the Electricity Rules 1993 to permit DoED to award survey, generation, transmission and distribution licenses to projects with a capacity up to 100MW.<sup>35</sup> Furthermore, DoED can now also change project capacities and cancel licenses. In the case of storage-type and multipurpose projects though, older provisions and procedures will still prevail.

**NOC storage facilities under scrutiny after another fuel shortage:** Kathmandu valley once again witnessed long queues at petrol stations as the Raxaul depot center was closed temporarily for maintenance. NOC had increased its imports from other depots but failed to curtail shortage efficiently in the capital. Such shortcomings have raised doubts regarding storage facilities run by the NOC.

NOC is yet to expand the storage capacity of its Thankot depot, which caters to demand in the Kathmandu Valley. As of now, the Thankot depot has a capacity of 1,870 kiloliter, which is deemed insufficient to meet the growing demand in the valley. Furthermore, NOC has been posting profits of NPR 31 billion (USD 287.75 million) over the past two fiscal years showing that they have the financial capability to undertake an overhaul of their storage facilities.<sup>36</sup> However, no steps have been taken to solve these issues at hand.

**SAARC Power Trade Agreement endorsed by the government:** The SAARC Power Trade Agreement (PTA) signed among the South Asian Countries has been endorsed by

the government. By doing so, it has opened up possibility for Nepal to sell its surplus energy to any member of SAARC at the market price. Till now the PTA has been signed by Bhutan and India with the remaining members yet to sanction the agreement.

The main purpose of the agreement is to allow cross-border trade of electricity within the member states. The agreement also says that the member states can contemplate over freeing export and import duties and other fees for cross-border trade and exchange of electricity between the buying and selling entities.<sup>37</sup> Furthermore, the agreement will be implemented according to the Electricity Act 1992 and will act as the law of energy trade.

**Table 2: Update on status of the project hydropower projects**

Project Name	Stage	Status	Status as of
<b>Budhi Gandaki</b>	Construction	Reconstruction work is taking place as damage occurred during the April earthquake. <sup>38</sup>	27th August 2016
<b>Kali Gandaki "A"</b>	In operation	Repair work is being conducted on a subsidiary dam that collapsed and the project has been temporarily closed. <sup>39 40</sup>	20th August 2016
<b>Upper Marsyangdi</b>	Construction	Turbine and tunnel testing currently being conducted with major construction on the dam already completed. <sup>41</sup>	3rd September 2016
<b>Upper Tamakoshi</b>	Construction	80% of the construction has been completed and is expected to come into operation by 2018. <sup>42</sup>	15th August 2016

*Source: Authors Own, through various sources*

### RELATION BETWEEN LOSSES OF NEPAL ELECTRICITY AUTHORITY (NEA) AND POWER PURCHASE COSTS

NEA's annual loss has more than doubled in the last fiscal year to reach a massive NPR 11.79 billion (USD 109.4 million). Increase in the power purchase costs is the primary reason for the hike in losses of NEA. Previously, in 2014/15, NEA's losses accumulated to NPR 5.13 billion (USD 47.62 million).

NEA spent NPR 24.24 billion (USD 225 million) to purchase electricity from IPP's and India in the fiscal year 2015/16; an increase from the NPR 19.21 billion (USD 178.3 million) spent in the previous fiscal year. This comes as a result of a wide gap in purchasing and selling price of electricity from India. This marks almost nine years of financial trouble for the country's single power off taker. As of now, NEA has requested the government to compensate for the losses accumulated.<sup>43</sup>

However, NEA has stated that its losses will be curtailed marginally in this fiscal year as a result of a hike in electricity tariffs by an average of 19%. This is expected to contribute roughly NPR 5 billion (USD 46.41 million) to NEA's revenue.

Furthermore, NEA has also witnessed an increase in net system losses, or "electricity leakages" in fiscal year 2015/16. The leakage increased to 25.78% as compared to 24.44% the year before. Continued effort to minimize such losses has so far been unsuccessful with low quality distribution systems, huge amount of unpaid dues and theft of electricity still rampant. NEA Managing Director, Mukesh Kafle, associated the rise in leakages to the inability to collect electricity tariffs from customers in central Terai due to the lengthy strike in the region. Economic activity was also hampered in the region due to the protests, which ultimately led to many customers defaulting on electricity tariffs.<sup>44</sup>

**Table 3: Power Purchase Costs and Losses incurred by the NEA**

Fiscal Year	Power Purchase Cost (NPR billion)	Loss (NPR billion)
2011/12	11.95	9.95
2012/13	13.57	3.41
2013/14	17.04	6.81
2014/15	19.21	5.13
2015/16	24.24	11.79

Source: *The Himalayan Times*

## “ OUTLOOK

Measures taken by government in the review period is set to strengthen the foundation to make the hydropower sector efficient. While the budget for the fiscal year 2016/17 made provisions for energy emergency issues, nothing substantial has resulted from it. Furthermore, with NEA facing more financial hardships, the plan to split the NEA into three separate entities will be a good step towards curbing the NEA's growing debts. With more hydropower projects on the road to completion, decrease in load shedding hours can also be expected.

# INFRASTRUCTURE

The major challenge faced by many of the developing countries is that of infrastructural needs. The lack of infrastructure such as ports, roads, irrigation and power supply is documented as one of the major hindrance for economic growth. For a country like Nepal infrastructure development efforts should make better use of private sector resources including a favorable climate for foreign investment in infrastructure development.

## Application for Infrastructure of AIIB

**Funding:** The government of Nepal submitted proposals for the funding of five infrastructure projects to the Asian Infrastructure Investment Bank (AIIB). The projects include Sharada-Babai Hydropower Project, Nepal Distribution System Upgrading and Extension Project, Pokhara-Beni Jomsom Road Upgrading, Samakushi-Tokha-Chhahare Road Upgrading and Extension and the Urban Infrastructure Improvement project aimed at developing infrastructure in 18 Terai districts.<sup>45</sup>

## Construction work of Gautam Buddha International airport unable to meet target:

The construction work of the NPR 6 billion (USD 55.7 million) Gautam Buddha International Airport has not been able to meet its target of completion of 23% of work by September 2016. Only 16% of the work has been completed so far. An agreement to build the airport was signed between Nepal Government and Asian Development Bank on May 25th 2010. As per the agreement ADB agreed to provide 40.5% loan and

18% grant to Nepal Government. The remaining capital of NPR 2.49 billion (USD 23.1 million) is to be covered by Nepal Civil Aviation Authority and the OPEC fund International Development of Organization of Petroleum Exporting Countries.<sup>46</sup> The contract to build the airport was awarded to China's Northwest Civil Aviation Airport Limited.

## Grant assistance from Japan to enhance air safety:

Japan granted NPR 1.5 billion (USD 13.9 million) assistance for improving air safety at eight airports across Nepal. The project -Improvement of Aviation safety Facilities includes the improvement of five short take-off and landing (STOL) airstrips, two regional airports and Tribhuvan International Airport (TIA).<sup>47</sup> The project is expected to begin in 2017 and aimed to be completed in three years.

High chances of contract termination: The USD 75 million (NPR 8.1 billion) Tribhuvan International Airport improvement project funded by Asian Development Bank (ADB) is in doldrums. Since tangible progress has not been achieved, the Civil Aviation Authority of Nepal (CAAN) is in the process of terminating its contract with Spanish contractor "Constructora Sanjose". The contractor to this effect has filed claims for NPR 2.21 billion (USD 20.5 million) which includes all future claims in compensation. However in case of breach of agreement, CAAN estimates the compensation to be around NPR 60-70 million (USD 557,000- 650,000).<sup>48</sup>

## Environmental and Social Impact assessment of second international airport:

CAAN has shortlisted four firms and has asked to submit request for proposal by September 5, 2016 to conduct an Environmental and Social Impact assessment of the second international airport planned at Nijgadh.<sup>49</sup> The four firms include a) CEOCE Consultants; b) ADMC Engineering and Desired Engineering Consultancy, c) Nepal Environmental and Scientific Services, d) BDA Nepal and Environment and Resource Management Consultant and Silt Consultant, Tech Studio of Engineering with Association of Raft Consultancy. The airport project is estimated to cost NPR 121 billion (USD 1.1 billion) with an annual capacity to handle 20 million passengers in the first phase. In the current fiscal year, the government has allocated NPR 2.5 billion (USD 23.2 million) for the project. It is estimated that NPR 1 billion (USD 9.3 million) will be used on land compensation while NPR 1.5 billion (USD 13.9 million) will be used for resettling people living on the project site.

## Next-Gen radar system installation complete:

The installation of MSSR (Mode S Monopulse Secondary Surveillance Radar), the next generation en-route surveillance system, at Bhatte Danda has been completed. The installation was originally planned to be completed by 2015. The newly installed radar system is expected to come into operation by November this year. The radar system can track flights up to 250 nautical miles.<sup>50</sup>

**Construction of Terai-Fast track under constant political turmoil:**

The Supreme Court has published an order against the awarding of the project to construct Terai-Fast Track to the Indian firm 'Infrastructure Leasing and Financial Services Transportation Networks'. Earlier the Sushil Koirala led government had awarded the construction contract to the Indian firm. Later the KP Sharma Oli led government decided that the fast track will be developed by local firms. Now with the return of the Maoist-Congress coalition government there is a division over who should construct the Fast track. The Deputy Prime Minister, a Nepali congress leader is pushing for awarding the contract to the Indian firm.<sup>51</sup>

**Japan to provide the first soft loan for road sector:**

Japan is expected to provide the first loan of NPR 18 billion (USD 167.1 million) at an interest of 0.01% for the Nagdhunga-

Naubise Tunnel Road project. The repayment has been fixed at 30 years including a grace period of 10 years.<sup>52</sup>

**Road expansion of Narayangadh-Mugling road section delayed:**

The deadline for expansion of Narayangadh-Mugling road section has been extended to mid-September 2017 from its initial deadline of April 2017. However with the current pace of work it is estimated that the remaining 75% of work will not be completed within the extended deadline. The expansion project aims at widening the road from Mugling to 16 kilo by nine meters and from 16 kilo to Aaptari by eleven meters.<sup>53</sup> The project is being implemented with the support of World Bank aid of NPR 2.9 billion<sup>54</sup> (USD 26.9 million).

**Sluggish progress rate on the construction of Pachthar-Tehrathum road:**

The Pachthar-Tehrathum

road expansion since its inception has witnessed slow progress. The construction of the road which is a link road between Chiwabhanjyang VDC, Chyangthampu in East Panchthar district to Baitadi, was slated to be completed three years ago. At the current rate of progress the deadline of 2018 appears to be difficult.<sup>55</sup>

**Land pooling and land development at outer ring road:**

Kathmandu Valley Development Authority (KVDA) has finally initiated the process of land pooling and land development for the outer ring road project which remained in limbo for the past 11 years. The administrative process has begun in Satungal and Chobar areas. The outer ring road is estimated to be 73 km with 6.1 km being included in the first phase which is expected to be completed in 2.5 years with NPR 50 million (USD 0.46 million) allocated in the current fiscal year.<sup>56</sup>

## OUTLOOK

There is an enormous need of investment to develop the much needed infrastructure of the country. There is no single option that is evidently sufficient to address the infrastructure and investment gaps. The current economic situation of the country does not allow for the required financial resources or any competent government institutions to kick start or monitor and regulate any large scale projects. Under such a scenario it is important to develop a favorable investment climate so as to facilitate private investment. Most of the infrastructure projects have recorded a delay with majority of the contractors attributing the delay of projects to the April 25th earthquake and the economic blockade. However if one compares the progress rate of projects before the natural and economic calamity, the projects delay would have been inevitable.

# INFORMATION AND COMMUNICATION TECHNOLOGY

The ICT sector of Nepal has witnessed tremendous growth in the past few years, in terms of quantity and quality both. While the number of mobile users in the country has outnumbered the population of the country by 2.11 million, the number of internet subscribers is also on the rise and has reached 13.53 million. 4G services is expected to be introduced within this fiscal year and telecom operators such as Nepal Telecom and Ncell is constantly working on widening its reach and service portfolio.

**Nepal one of APAC’s fourth malware prone nations:** In the Malware Infection Index 2016 published by Microsoft Asia, Nepal is ranked as Asia’s fourth most malware prone nation. Nepal also ranks fifth in the list of top five locations across the globe at the risk of infection. The index determines key malicious software threats and ranks markets based on how prone they are to malware threats. The report reflects that emerging countries in the APAC region are especially vulnerable to malware threats. Gamarue, Skeyeah and Peals are the three most encountered malware.<sup>57</sup>

**4G services to be introduced:** In order to allow the telecom operators to start 4G based services, Nepal Telecommunications Authority (NTA) has amended the Radio Frequency Policy and submitted the draft of the policy to the Ministry of Information and Communication (MOIC).<sup>58</sup> After being revised by the technical committee at the ministry, it will be forwarded to the

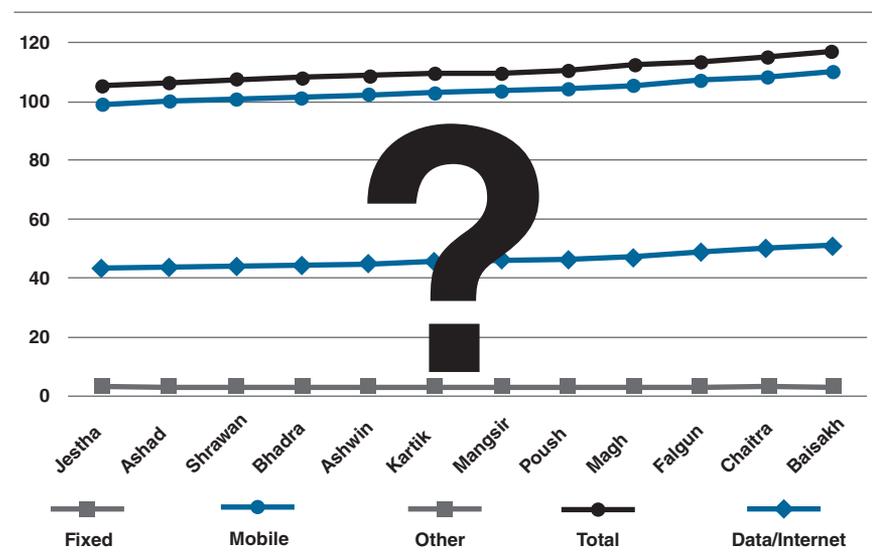
Radio Frequency Determination Committee for approval. After approval, telecom operators can use the existing frequency of 1,800 Mhz frequency band and start 4G services under the Technology Neutrality Policy. Only telecom operators who have the Unified Telecom License are eligible for the Technology Neutrality Policy. Nepal Telecom and Ncell have already applied for the launch of 4G services. If everything goes as planned, 4G services should start by the end of this fiscal year.<sup>59</sup>

**New firms not to get basic telephone service license:** MoIC has removed the clause regarding the provision to issue unified license for basic telephone services from the Radio Frequency Policy which was amended in the third week of July. New companies are now barred from obtaining unified license for basic telephone services.<sup>60</sup> The decision

to scrap the clause puts an end to the entry of potential competition. Previously, Radio Frequency Policy Determination Committee chaired by Minister for Information and Communications had endorsed the Radio Frequency Policy stating that NTA shall invite new service providers to submit a detailed service extension plan within a month of the date of the commencement of the policy, to obtain the unified license for the basic services.

**Mobile subscribers greater than population:** According to the Management Information Systems (MIS) Report published by the NTA, the number of mobile subscribers in Nepal stood at 29.05 million in April while the total population of the country stands at 26.49 million as per the Central Bureau of Statistics. With this, the mobile service penetration rate has hit 109.65% of the population.

**Figure 12: Growth Trend of Voice Telephone and Data Service Penetration**



Source: Nepal Telecommunications Authority (NTA)

Increase in mobile subscribers has also led to rise in the sales of mobile devices. According to the Department of Customs, Nepal has imported 4.16 million handsets as of mid-May in this fiscal year. With the rise in the number of mobile phone users, internet penetration has also increased to 51.10% of the total population as of mid-April 2016.<sup>61</sup> The graph below shows the trend of voice telephone and data service penetration in Nepal in the last 12 months.

**Ncell changes logo and pledges to invest additional NPR 70 billion:**

After being acquired by the Axiata group, Ncell has rebranded itself by unveiling its new logo in August which shows the Axiata ribbon on the right top of the name.<sup>62</sup> Following its acquisition Ncell has also pledged to invest NPR 70

billion (USD 0.65 billion) in capital and operating expenditure over the next two years, in addition to the commitment to invest NPR 12 billion (USD 112 million) as capital investment in 2016. This move of Ncell is expected to improve the network coverage and connectivity for its customers.

**Nepal Telecom expands microwave radio link to all districts:**

In order to improve connectivity in landline, GSM, CDMA, ADSL and EVDO internet services, Nepal Telecom (NT) has expanded its microwave radio link to all 75 districts in Nepal.<sup>63</sup> Previously, headquarters of Mugu, Humla and Dolpa were connected via the satellite services. This expansion will also allow NT to expand its 3G and WiMax services in the region.

**Landline phone to be migrated to IP technology:**

Nepal Telecom is planning to migrate its PSTN phone to IP technology in the next three years.<sup>64</sup> NT is the only operator to provide landline service to major areas of Nepal and most of its landline phone services is currently running through the Time Division Multiplexing (TDM) switch while only a small percentage is running through IP based on NGN technology. Currently, NT signed a contract with Huawei for the migration to IP technology from TDM switches. In the current phase, a total of four lakh from the total of seven lakh customers will be shifted to the IP technology. IP technology will also allow new services like messaging services, video services among others to the landline phone.

## “ OUTLOOK

The ICT sector of Nepal seems to be on a development path with the players in the sector working towards expansion its reach and services. With huge investments planned by the players in the next few years, the quality of services and ICT infrastructure is expected to improve. Introduction of 4G services will provide faster data access, enhanced roaming capabilities and broadband multimedia to the internet users in the country. 4G services is expected to be more affordable as well because the cost to deliver data will be much lower.

# REAL ESTATE

The real estate sector in Nepal is slowly gaining momentum after a six-year spell of recession. Growth in this sector is indicated by the increased number of land transactions and land revenue collection as well as the increase in demand for housing and land loans.

**Revenue collection in FY 2015/16 below targeted revenue:** The Department of Land Reform and Management (DOLRM) reported a 9% increase in revenue collection in FY 2015/16 as compared to the previous fiscal year. However, during FY 2015/16, the DOLRM was unable to meet its target of NPR 12.011 billion (USD 111.5 million) of revenue collection. It collected only

NPR 11.909 billion (USD 110.5 million) which is 0.85% below the targeted revenue.<sup>1</sup>

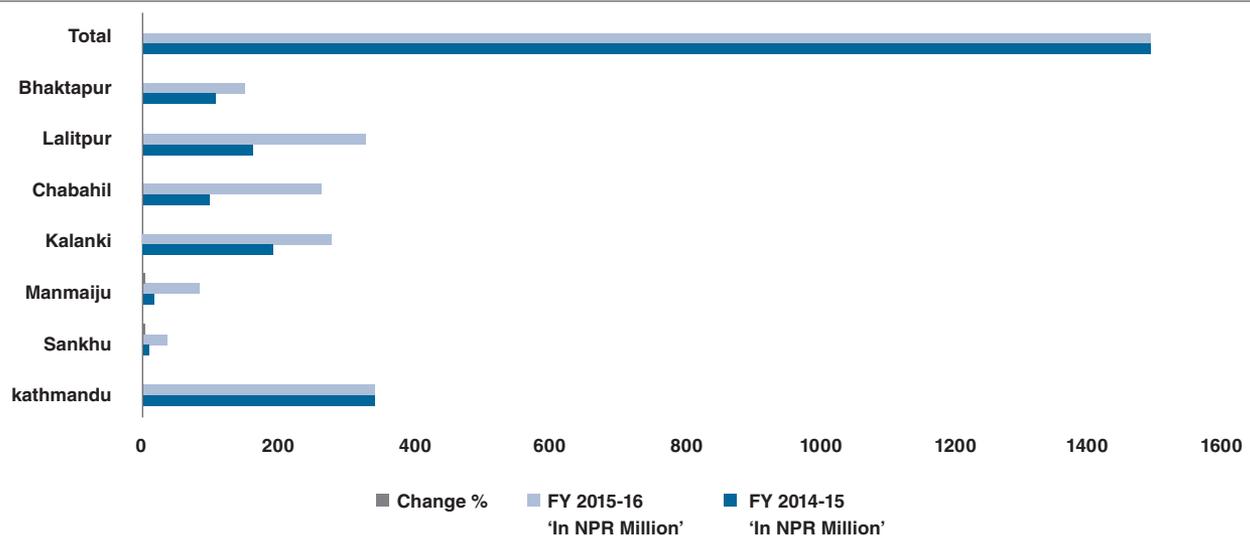
Compared to the previous quarters of FY 2015/16, the last quarter of the FY 2015/16 witnessed an overwhelming increase in the revenue collection. Revenue collection in Ashad 2015/16 (mid-June to mid-July) was NPR 1.965 billion (USD 18.2 million) as against the monthly target of NPR 646.78 million (USD 6 million) which is 204% higher.

**Increase in collection of capital gain tax from land transactions:** The capital gain tax collection within the Kathmandu valley increased by 59% in FY 2015/16 totaling NPR 1490.6

million (USD 13.8 million) as compared to FY 2014/15 which was at NPR 934.68 million (USD 8.7 million). Figure 13 below shows the collected capital gain tax in various areas.

**Lending by BFI's to Real Estate sector increases:** As showed in Table 4 below, total real estate lending by Banking and Financial Institutions (BFI) increased by NPR 46.34 billion (USD 430.2 million) i.e. an increase of 18% in FY 2015/16.<sup>66</sup> During the same period, personal home loans increased by 20% and real estate loans increased by 26%. However, with expanding real estate lending, Nepal Rastra Bank has directed BFI's to limit lending to, at the most 50% of the market value of land.<sup>67</sup>

**Figure 13: Capital Gain Tax from Land Transactions**



Source: Department of Land Reform and Management

**Table 4: Real Estate Lending by BFI's**

Loan Category	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16
	In 'NPR'	In 'NPR'	In 'NPR'	In 'NPR'
Personal Home Loan	66.21	89.48	118.86	142.81
Real Estate Loan	86.06	82.48	85.67	108.06

Source: Nepal Rastra Bank

#### Access to concessional home loans for quake survivors simplified:

The Nepal Rastra Bank has simplified the guideline on concessional home loans for earthquake survivors. Survivors applying for concessional home loans will now, not have to submit official documents to prove that the home they lost to the earthquake was the only home. The ceiling has been fixed at NPR 2.5 million (USD 23,206) within Kathmandu valley and NPR

1.5 million (USD 13,924) outside the valley.<sup>68</sup>

**Proposal of mandatory home insurance:** The Insurance Board is considering making home insurance mandatory against natural disasters, theft, fire and other mishaps for private residential buildings in metropolitan, sub-metropolitan and municipalities. The proposal submitted by the Insurance board suggests payment of a premium

of NPR 500 (USD 4.6) for property worth NPR 500,000<sup>69</sup> (USD 4,641). The Insurance Board plans to collaborate with the National Reconstruction Authority to implement the property insurance scheme.

#### Rise in land ownership title of females:

The district of Sindhuli has witnessed an increasing trend of land being registered under a female's name. The key driver for this is the existing provision that allows 25% registration fee waiver if a land is registered under the ownership title of a female. Statistics indicate that in FY 2015/16 out of the total 7,593 land transactions, 2,292 were registered in the name of female family members.<sup>70</sup>

## OUTLOOK

The DOLRM was unable to meet its revenue target in FY 2015/16 of NPR 12.011 billion (USD 111.5 million) due to the earthquake and economic blockade. However, the overwhelming increase in revenue collection during the last month of FY 2015/16 is attributed to:

- Increment of minimum land valuation in the new fiscal year.
- Increased momentum in the reconstruction process and transferring of properties.
- Increment in the number of municipalities i.e. conversion of VDCs to municipalities. (In VDCs only 2% registration tax is charged but with the conversion of VDCs into municipalities, the tax rate is 4%).

The increased demand for home loans in FY 2015/16 was mainly due to home loans being available at interest rates as low as 6%. The low interest rate can be attributed to excess liquidity within banking and financial intuitions.

The Insurance Board's decision to make home insurance mandatory is a much needed step to reduce losses arising from natural calamities. However, before making home insurance mandatory, the current household insurance coverage amount fixed at NPR 10 million (USD 92,825), will have to be revised. Furthermore, the Insurance board will also need to introduce measures that bar insurance companies from deducting certain amounts during claim settlement process.

# EDUCATION

The Education Act of 1971 has been amended for the eighth time and was passed by the Legislative Committee on June 4, 2016 in Rastrapati Bhawan, Nepal. It has been claimed that the new improvised act has addressed issues of provision of quality education and better management systems in public schools. Also, in this quarter private schools continued to be on the radar for not following the directives of Ministry of Education.

**Government schools without any management committee:** The new Education Act formed on June 4, 2016 revised the formation method of school management committee of government schools. The new provision now requires committee of two male and two female members to be elected among the guardian, supporter and the school's funding organizations. A chairperson must also be selected among the four individuals from the management committee. The Ministry of Education (MoE) has already given a green signal to form the committees but majority of the government school across the nation has not been able to do so.<sup>71</sup> Without a proper committee, schools, are likely to get into problems regarding decision and policy making, examination process, planning and even pay out to the staffs.

**Educational strike forces academic institutions to remain shut:** Strike called in by the All Nepal National Independent Students' Union-Revolutionary (ANNISU-R) caused all the educational institutions

to remain shut on August 15-16, 2016. They demanded the government to fulfil their 17 point charter. Their demands included minimizing the school fees in the private institutions, streamlining of educational institutes affiliated to foreign boards and universities, improving the quality of public school, and amending the Education Act among others.<sup>72</sup>

**10th ECAN Fair:** The 10th educational fair was organized by Education Consultancy Association (ECAN) from June 9-12, 2016 in Exhibition Hall, Bhrikuti Mandap. It showcased more than 70 international institutions and 225 stalls. There were 15 institution each from India and Australia and 10 each from Japan and New Zealand<sup>73</sup>. The fair was the largest so far in terms of the volume of participants and the number of stalls. This educational fair mostly targeted to students who have just finished their 12 grade and are planning to pursue their bachelor's degree abroad.

**Dolkha is declared a literate district:** National Literacy Campaign (NLC) established on 2009 has been working along with the government to ensure the right of education to every individual in the nation. The overall literacy rate of the country at 2015 was 63.9%<sup>74</sup>. On June 24, 2016, Dolkha was declared a literate district and it became the 29th district in the list of literate districts of Nepal<sup>75</sup>. The new constitution has promised right to education to all citizens. NLC has been working on it to eradicate illiteracy all over the nation.

**Reconstruction of school delayed by budget shortage:** Reconstruction of schools destroyed by the earthquake of 2015 has still not been completed on account of lack of budget. An estimate of NPR 186 billion (USD 1.7 billion) was prepared by the government to reconstruct more than 8,000 schools destroyed in the earthquake. However, as the government has not been able to manage the budget, it plans to reconstruct only about 20% of the damaged school this year. Till date, government has provided only NPR 5 billion (USD 46.41 million) to the National Reconstruction Authority<sup>76</sup>. Project Implementation Unit under the Ministry of Education (MoE) has also admitted that the reconstruction of school has been delayed.

**HSEB transformed to National Examination Board:** Higher Secondary Educational Board (HSEB), the autonomous body which managed Plus Two education system in Nepal, has been transformed to National Educational Board (NEB) as per the eight amendment of the Education Act, 1971. This transformation has also eliminated School Leaving Certificate (SLC) exams conducted in grade X. Instead a national level exam will now be held at grade XII. The existing 3,600 higher secondary school previously monitored by HSEB will now be run under the Department of Education. As per the amendment to the act, the chairperson of NEB is to be appointed by the Cabinet on recommendation of a committee led by the chairperson of Public Service Commission and consisting of at least a woman educationist and two

persons nominated by the Ministry of Education as members.<sup>77</sup>

#### New committee formed to review fee structure of schools:<sup>78</sup>

A five member task force has been formed under Department of Education (DoE) to review the fee structure of private schools. The committee has four members from guardians' associations, Private and Boarding Schools Organization Nepal (PABSON) and Boarding Schools Association Nepal and is headed by the director of DoE. Private schools in Nepal have been demanding to make amendments to some of the provisions and have been refusing to follow the directives. According to the DoE, two third of the parents need to endorse any hike in the school's structural fee.

#### Legislature-Parliament endorses Open University Bill<sup>79</sup>:

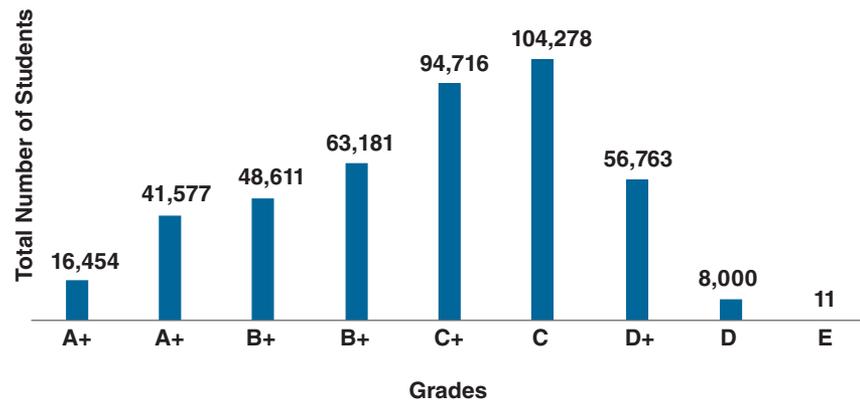
The Open University Bill has been approved by the Legislature-Parliament with majority after a decade of discussion. With this, access to higher education will be ensured to all via such modality. This concept aims to produce skilled manpower targeting those who are unable to attend regular classes. Law makers have also lobbied to develop the information and technology at remote areas so that such Open Universities can run smoothly.

### SLC RESULTS 2073

The new Education Act abolished the SLC (School Leaving Certificate) examinations of grade X. The last batch of SLC students managed to achieve pretty good results. In total, there were 615,553 candidates appearing for SLC this year. This year's results reflect that 97% of the students have passed the SLC examinations as these students have scored the necessary grade to qualify for grade XI. Before the letter grading system was introduced, the pass percentage stood at 47.43% in 2015<sup>80</sup>.

The massive increase in the percentage of students passing the SLC examinations does not reflect that the education system of Nepal has improved within a year. Instead, drastic change in this passing rate can be attributed to the shift to letter grading system and the eligible criteria set for enrolment in grade XI. The GPA allocated in the present context does not consider the student failing in an individual subject. If a student has failed to achieve certain marks in one subject but covers up in other subjects and the average GPA is 1.6 or more, they are considered to be pass.<sup>81</sup>

Figure 14: SLC Results of 2072 (2016)



Source: Office of the Controller of Examinations (OCE)

## OUTLOOK

The outlook for the education sector looks positive in the coming quarters. The government has been taking multiple steps to bring about changes in quality of education in both the private and public schools. However on the reconstruction front, with the ongoing pace of reconstruction of the earthquake affected schools, plans for reconstruction is not likely to be carried out as planned.

# HEALTH

Health related problems in and around the valley is on the rise. The number of cholera and cancer patients and people suffering from respiratory diseases is also multiplying. Shortage of drugs and medical facilities in the rural areas still remain a point of concern. Even though the government is taking some positive steps to improve the facilities across the nation, there has not been much change in the health scenario.

### **Cholera increases in capital:**

About 132 cases of cholera have been reported in Kathmandu since mid-April. The disease which is transmitted by drinking/eating water and food that is contaminated with *Vibrio Cholerae* Bacterium has affected people in Lalitpur the most. Since last year another strain, 'Inaba' has been seen in patients diagnosed with cholera, reflecting the fact that the disease is gradually becoming antibiotic resistant.<sup>82</sup>

### **Reconstruction of earthquake struck health facilities:**

A total of 724 health facilities used for providing day to day health services were destroyed by the earthquake of 2015. According to the Ministry of Health (MoH), only 90 out of 724 health facilities have been fully reconstructed by August 2016. Most of the re-constructed facilities are located in Bhaktapur, Dhading, Dolakha, Gorkha, Nuwakot and Sindhupalchowk. Reconstruction of these health facilities were facilitated with the support of bilateral donors and NGO/INGOs such as GIZ, MdM France and Nyaya Health

Nepal. The border blockade of 2015 has been cited as a reason for delayed reconstruction of facilities in other regions. Multiple bilateral donors, NGO/INGOs and the government have come to an agreement worth NPR 4 billion (USD 37 million), for the swift reconstruction of the damaged health facilities.<sup>83</sup>

### **Government and Dr. Govinda KC come to agreement:**

Dr Govinda KC, senior orthopedic surgeon of Tribhuvan University Teaching Hospital, began his eight hunger strike in June 26, 2016. He demanded that some reforms be made in Nepal's medical education.<sup>84</sup> On July 25th, Dr KC called off his hunger strike following the signing of the four point agreement with the government. Government has agreed to acquire the Manmohan Memorial Institute of Health Sciences (MMIHS) and make necessary changes to the Health Profession Education Commission Bill that call for free medical seats for students and establishment of a medical institution in each province.<sup>85</sup> However on August 21, Dr KC and his supporters staged a protest outside the Prime Minister's residence demanding swift implementation of the points that the government had previously agreed on.<sup>86</sup>

### **Down syndrome cases on the rise:**

The number of people suffering from Down syndrome, medical condition where a child suffers from poor physical and mental development, has been increasing in Nepal. A total of 350 cases have already been registered

with Down Syndrome Society Nepal (DSSN). Each month DSSN has been receiving 10-15 registrations of new children suffering from this condition. However, Nepal does not have an exact record of people suffering from Down syndrome as it is not recorded. World Health Organization states that the prevalence of Down syndrome is between 1 in 1,000 to 1 in 1,100 live births worldwide.<sup>87</sup>

### **Health insurance scheme widened; now in Ilam and Baglung<sup>88</sup>:**

Ministry of Health (MoH) has extended the health insurance scheme to Ilam and Baglung, following the budget announcement of 2015-16. The scheme will cover all households of Baglung and Ilam and will cover health costs up to NPR 10,000 (USD 92.8) per member. A household of five can pay premium of NPR 2,500 (USD 23.2) per annum or additional NPR 450 (USD 4.2) for each additional member under the scheme. This scheme would cover medical expenses up to NPR 50,000 (USD 464) for each household. The insurance scheme currently covers only government hospitals and medical centers. However, MoH is planning to tie-up with various private health institutions to widen the benefit of this insurance scheme.

### **36 doctors with fake credential nabbed:**

The Central Investigation Bureau (CIB) of Nepal arrested 36 doctors in three days on account of possessing fake credentials. According to the reports, 35 of these doctors had produced fake certificates of Bihar

Intermediate Education Council (BIEC), while one was practicing illegally without obtaining license from Nepal Medical Council (NMC). Prior to this CIB had arrested 17 doctors in February, after the program 'Operation Quack' was launched. Medical licenses of these doctors have been annulled by the NMC after an elaborate investigation.

#### **Doctors advise government to improve the facilities in villages:**

Scholarship doctors stationed in rural districts have called for improving the medical services in rural areas to maximize the potential benefit of the free medical education for prospective doctors' scheme introduced by the government. The free medical

education scheme grants scholarship to students from villages who pass the MBBS entrance examination. Upon completing their graduation, these scholarship doctors are required to return to villages and work for the next five years. On the other hand, the "One Village: One Doctor" programme which was envisaged in 2015 states that each VDC will have a doctor with a doctor for every 10,000 people. These doctors have claimed that if the basic facilities are provided at health institutes, they are ready to go to any part of the country to work. They claim that unavailability of certain drugs and diagnostic facilities such as X ray machines has made it difficult for them to practice medicine in rural areas.<sup>90</sup>

#### **Formulation of procedure relating to hiring doctors and health workers on contract:**

To make the process of hiring doctors or health workers on contract simple, transparent and systematic, MoH formulated the Procedures Relating to Appointment of Doctors or Health Workers of Nepal Health Service on Contract-2015 in June. The tenure of such appointees is one year which can be extended if necessary. Appointees need to be a Nepali citizen registered with Nepal Medical Council to qualify applying for the post. As per the procedures, Nepal Health Service will appoint candidates of the seventh and eighth level, while the fourth and fifth level of the central hospitals will be appointed by the ministry.<sup>91</sup>

## **“ OUTLOOK**

Development of health sector still looks questionable as the government has not been able to provide satisfactory proper health facilities across the nation. Despite the budget of NPR 40.56 billion (USD 376.5 million) allocated in the current fiscal year, the development process still seems dawdling. Health facilities in rural areas are still struggling with lack of drugs and equipment. Also, even after the signing of the deal with Dr. Govinda KC, the government has not taken any solid steps to act on it and this may lead to another series of protests.

# TOURISM

Nepal's Tourism sector received a major setback after last year's earthquake and subsequent India border blockade. Nepal Tourism board (NTB), in collaboration with travel associations are making efforts to market Nepal as a safe tourist destination, to attract tourist from all over the globe. In 2015, Nepal faced a sharp drop in tourist inflow by 31.78% compared to the figures in 2014. But now the international tourist arrivals has increased by 12.77% in the first six months of 2016, compared to last year's figures. This year Indian tourist arrivals have increased by 37.62% and tourist from USA by 47.40% but Chinese tourist arrivals has dropped by 28% in the first half of 2016. However, Tourist inflow is expected to grow further in autumn, which is peak tourist season in Nepal.<sup>92</sup>

#### **WTTC's forecast on tourism sector:**

As per Travel and Tourism Economic Impact 2016 report, published by the World Travel and Tourism Council (WTTC), Nepal's travel and tourism sector has contributed NPR 85.3 billion (USD 0.79 billion) to the Gross Domestic Product (GDP) in 2015 and is expected to increase by 7% in 2016. Nepal ranks third out of 184 countries, after India and China, in terms of making direct contribution to GDP by this sector. Nepal's tourism sector had generated 3.2% of total employment in 2015 and is estimated to grow by 6% this year. Employment opportunities are further expected to increase by 3.8% annually by 2026. The report also

predicts that international tourist arrivals to Nepal would reach 1.73 million and capital investment in tourism sector will rise by 4.4 % annually over the next 10 years.<sup>93</sup>

#### **Service rate increase by 10% in ABC region:**

The local Tourism Management Sub-Committee at Chhomrong has hiked the prices for food and accommodation along the Annapurna Base Camp route. The Hotel Entrepreneurs' Association of New Bridge, Jhinu, Kimrong Khola, Ghurjung, Chhomrong, Bhanuwa and ABC took a unanimous decision to increase the rate of services by 10%, which had remained unchanged since 2012. They have also made a new provision for making advance booking system for accommodation. However, this unilateral decision of the locals was criticized by the tourism stake holders such as the Union of Nepal Trekking, Travel, Rafting, Airlines workers, Trekking Agencies' Association of Nepal, and Western Regional Association Pokhara, as the decision was made without any consultation, and the new system of advance booking of rooms along the route, also did not seem feasible. This has created a rift between the Pokhara-based tourism entrepreneurs and the locals.<sup>94</sup>

#### **National Tourism Strategy 2016-2025:**

The Ministry of Culture, Tourism and Civil Aviation (MoCTCA) suggested to set aside a budget of NPR 6.44 billion (USD 59.8 million) to implement the new National Tourism Strategy 2016-

2025, which was developed with the technical assistance of Samarth-NMDP. The objective of the new strategy is to increase tourist inflow to 2.52 million annually by 2025, increasing stay and spending from tourist. However, to attain the targets set in the strategy, Nepal needs to focus on infrastructure development, rebranding and better quality of service. There are 11 special strategies set which includes branding target, marketing target, focused programmes and development target, tourism economy, improvement of business investment target, human resource development, infrastructure development, improvement of tourism quality, reforms in institutional and management, conservation of cultural heritage and zero carbon target, for the development of tourism sector. Similarly, the strategy also aims to increase jobs in the tourism industry, as this sector provides direct employment opportunities to the people.<sup>95</sup>

#### **Encouraging adventure tourism:**

In order to promote adventure tourism, Government of Nepal (GoN) has amended the Aviation Sports Regulation 2012 and enforced the Recreational Aviation Regulation 2016. Pokhara has become the main hub for adventure activities, so this new regulation is trying to encourage companies in other regions to invest in such activities. Currently the providers are being offered 50% off on license renewal fees, pilot registration fees and tax imposed on equipment. The regulation has also simplified

procedures for foreign amateur flyers in Nepal. Now the companies will have to quote a standardized fare for all the activities and it has created a code of conduct for pilots and operators.<sup>96</sup>

#### Decline in tourist arrivals concerns

**Sauraha entrepreneurs:** Even though tourist inflow has increase this year, visitors to Sauraha has remained dismal. The popular jungle safari destination has faced declined in tourist inflow by 50% in the first six months of 2016. This has made it difficult for the tourism sector in Sauraha to recover

from the deadly earthquake and the following trade blockade. The hotel sector has been affected the most, as decline of tourist has severely affected hotel occupancy rate. Many hotel entrepreneurs have taken loans from banks and are gravely worried that they will not be able to make payment on time, due to the slow pace of business growth.<sup>97</sup>

#### Nepal ranks third on National Geographic Traveler magazine:

Nepal took the third spot among 10 locations on National Geographic Traveler magazine's "Ten Places That Deserve More Travelers". This

internationally recognized ranking can be a thrust to promote Nepal's tourism industry and portray Nepal as a safe destination. Even though the earthquake had damaged many tourism infrastructure, heritage sites and trekking trails, it has announced that Nepal is an accessible location. It has highlighted that 33 out of 35 trails, that have been listed, are safe and accessible, only 2 trails have been rerouted. It also mentions that the famous Annapurna trail has already been tested for safety and suggests readers to visit the cultural centers, to learn the art of Himalayan singing bowls.<sup>98</sup>

### BUDGET SET FOR TOURISM PROMOTION

Nepal Tourism Board (NTB) is taking the initiatives to promote Nepal through digital marketing, to revive the tourism industry that was adversely affected by the devastating earthquake and the subsequent border blockade. It will be launching promos through popular international media like CNN International and BBC World as publicity campaign. These promotional campaigns aims to attract more tourist inflow by 2017 and provide impetus for the Visit Nepal Year campaign in 2018.

MoCTCA has also approved NPR 1.12 billion (USD 10.4 million) as tourism budget for the FY 2016/17 of which NPR 275 million (USD 2.6 million) will be allotted for international publicity and NPR 230 million (USD 2.1 million) for domestic tourism promotion. Similarly, NPR 223 million (USD 2.06 million) has been set aside for tourism marketing, NPR 30 million (USD 0.28 million) for promoting Pokhara as a tourist destination and NPR 30 million (USD 0.28 million) for tourism planning as well as research.

NTB will also be spending NPR 250 million (USD 2.3 million) to promote Nepal through the global travel site, Trip Advisor and has also earmarked NPR 8 million (USD 74, 259) to partner with international news agency Reuters. It has solely allocated a budget of NPR 125 million (USD 1.1 million) to promote tourism in the major markets of China and India. NTB also strives to tap markets like Australia, East Europe, Southeast Asia and the gulf countries and has allocated around NPR130 million (USD 1.2 million) for business to consumer marketing.<sup>99</sup>

## “ OUTLOOK

The tourism sector is gradually recovering after being hit by two major disasters in 2015. Nepal has also been recognized internationally to be an attractive destination and has high potential to be top destination in South Asia, if it can effectively implement the strategies set for tourism development. It also need to leverage on its current ranking provided by popular travel publication National Geographic Traveler magazine. Nepal is also situated between two most populated counties in the world, India and China. Hence, an aggressive promotional campaign should be carried out, as it has high potential to attract tourist from these countries.

# TRADE AND DEBT

Trade in the last quarter of FY 2015/16 was not able to fully normalize to pre trade embargo levels. While imports in Nepal had been witnessing an inclining trend over the past years, the economic blockade resulted in a decline in the volume of imports though it was only marginal. Exports, on the other hand, declined drastically as it was not able to rebound at the same pace as imports. This is set to further slow-down the growth of the economy and widen the trade deficit in the coming year.

**Foreign trade scenario:** Table 5 below shows the foreign trade scenario of Nepal for FY 2015/16. The cumulative effect of the decreasing export trends in the previous month is reflected in the substantial decline of exports which dipped by 17.8% amounting to NPR 70.12 billion (USD 654.53 million). During this time period, exports to major trade partner India declined by 29.3%, China by 24.6% and that to other countries by 6.3%. The trade blockade primarily led to the decline of the total exports figure. As the country's export was already on a declining trend, this further exacerbated the country's trade deficit.

Unlike exports, annual imports only declined by 0.1% i.e. by NPR 773.60 billion (USD 7.22 billion). While imports from India saw a decline of 2.9%, imports from China rose by 15.5% totaling NPR 115.69 billion (USD 1.07 billion). Despite the blockade, import figures did not register a substantial fall as imports picked up in the later months of FY 2015/16.

**Table 5: Foreign Trade Statistics for the FY 2015/16 (in billions)**

In NPR millions	2013-14	2014-15 <sup>R</sup>	2015-16 <sup>P</sup>	Percent Change	
				2014-15	2015-16
TOTAL EXPORTS	91.99	85.31	70.11	-7.3	-17.8
To India	59.61	55.86	39.49	-6.3	-29.3
To China	2.84	2.22	1.68	-21.5	-24.6
To Other Countries	29.53	27.22	28.94	-7.8	6.3
TOTAL IMPORTS	714.36	774.68	773.59	8.4	-0.1
From India	477.94	491.65	477.21	2.9	-2.9
From China	73.31	100.16	115.69	36.6	15.5
From Other Countries	163.10	182.86	180.69	12.1	-1.2
TOTAL TRADE BALANCE	-622.37	-689.36	-703.48	10.8	2.0
With India	-418.33	-435.79	-437.71	4.2	0.4
With China	-70.47	-97.93	-114.01	39.0	16.4
With Other Countries	-133.56	-155.63	-151.75	16.5	-2.5
TOTAL FOREIGN TRADE	806.35	860	843.71	6.7	-1.9
With India	537.56	547.52	516.70	1.9	-5.6
With China	76.15	102.39	117.37	34.5	14.6
With Other Countries	192.63	210.08	209.63	9.1	-0.2

Based on customs data R=Revised / P=Provisional

Source: NRB Report –Current Macroeconomic Situation, Based on six months data of 2015/16

**Top imports and exports:** The steep fall in oil import can be considered a key factor in the fall of overall value of imports. Import of petroleum products registered a decline of 40.4% compared to the last fiscal year when petroleum products worth NPR 65.60 billion (USD 612.34 million) was imported in FY 2015/16. Similarly, MS Billet worth NPR 22.65 billion (USD 211.43 million) was imported from India in FY 2015/16, this is a 14% compared

to FY 2014/15. However, the import of vehicle and spare parts from India registered a growth of 42.6% while import of gold from other countries registered a sharp increase of 151.6%.

In terms of export, cardamom registered an increment of 20% amounting to NPR 4.6 billion while the export of polyester yarn fell from NPR 5 billion (USD 46.67 million) to NPR 3.2 billion (USD 29.87 million). While export of

Iron and steel products has been restricted on the grounds of domestic need of construction material post-earthquake, the export of Zinc sheets fell by 55.9% amounting to NPR 1.9 billion (USD 17.74 million).

**Trade deficit:** During the FY 2015/16, the total trade deficit widened by 2% reaching NPR 703.48 billion (USD 6.56 billion). As the country's imports are growing at a relatively higher rate than exports, trade deficit is an expected phenomenon. However, due to trade disturbances during the FY 2015/16, the trade deficit is only 2% compared to the figure of 10.8% during the last fiscal year.

**BOP Surplus:** Continuing the trend of the previous fiscal year, FY 2015/16 also registered a rise in BOP surplus amounting to NPR 191.24 billion (USD 1.78 billion). The BOP has seen a surplus of NPR 140.42 billion (USD 1.31 billion) in the current account which had registered a surplus of NPR 108.32 billion (USD 1.01 billion) in FY 2014/15.

**Rise in government's domestic debt:** At the end of the third quarter of FY 2015/16, the Nepal government's total debt stood at NPR 589.69 billion, comprising of 64 % external debt and 36% internal debt. As in the previous quarters, the 10.9% increment of external debt is mainly attributed to the increase in dollar exchange rate. By the end of the third quarter of FY 2015/16, the government received internal debt of NPR 42.58 billion (USD 397.46 million) and external debt of NPR 25.62 billion (USD 239 million). Of the total external debt, 36% was received from multilateral sources, while 2% was received from bilateral sources. Similarly, the government repaid NPR 10.98 billion (USD 102.49 million) in

principal repayment of external creditors and NPR 26.26 billion to domestic creditors. The total interest paid by the third quarter was NPR 5.43 billion (USD 50.68 million).<sup>100</sup>

**Birgunj ports witness fall in traffic with Bhairahawa ousting Birgunj as the largest gateway:** The Birgunj-Raxaul port considered to be one of the major custom points of Nepal, witnessed a substantial fall in transactions. The six-month long blockade at the Nepal-India border was cited as the main reason for the drop in import and export.<sup>101</sup> Bhairahawa now stands as the largest import gateway as traders have diverted to Bhairahawa during the period of unrest at Birgunj. However, even after the blockade and the return of normalcy in Birgunj, the use of Bhairahawa port still remains high. Bhairahawa customs collected NPR 5 billion (USD 46.67 million) in customs duty, which is close to the NPR 7 billion (USD 65.34 million) collected at Birgunj Customs during the first month of the current fiscal year.<sup>102</sup>

**Tripartite agreement mandated for vehicle importers:** In a bid to minimize under-invoicing of vehicles, the budget speech for FY 2015/16 has enforced the provision of mandatory tripartite agreement between automobile manufacturers and its distributors on vehicles imported from third countries other than India-if the vehicle is imported through a third party. This provision is not applicable to domestic authorized distributors importing directly from the manufacturing countries. Currently, importers are believed to be under invoicing by using third parties wherein custom clearance is not based on the actual price. Nepal's trade data shows that the import of vehicles and its parts, are one of the highest value

import items and also the key source of custom revenues.<sup>103</sup>

**Traders seek easing of ban on Nepali basmati export:** Nepal government has restricted the export of all types of rice from Nepal as the country's production of cereal crop was low in the last fiscal year. This restriction has been imposed for the last two years. Rice traders are now requesting the government to ease out the restriction on the export of basmati rice as Nepal's Red Basmati rice is considered to be of superior quality and has good potential in the Indian markets. There is also high demand of Basmati rice in USA, Europe and the Middle East.<sup>104</sup>

**Visakhapatnam Port to be utilized:** The Visakhapatnam (Vizag) Port is Nepal's second transshipment point after Kolkata-Haldia port as per the agreement signed between Nepal and India. The agreement allows the transportation of cargo through the rail route connecting Visakhapatnam-Jogbani/Birgunj and four additional road routes. The Kolkata port is around 700 km from Nepal's border while Vizag port is 1,436 km from the Nepal border. However, Vizag port has a higher handling capacity of 350,000 TEUs (Twenty foot equivalent units) per year with waiting time of less than two hours. It costs USD 1.08 per kilometer including port charges and rail fare to transport 30 tons of cargo from Vizag Port to Nepal while it costs USD 1.46 per km from Kolkata Port.<sup>105</sup> The study done by Nepal Freight Forwarders Association (NEFFA) showed that the cost of third-country trade can be reduced by 15% while doing trade through Vizag port.<sup>106</sup> Currently the Kolkata port receives around 40,000 TEU of cargo. It is anticipated that the Vizag port will receive around 25,000-30,000 TEU of Nepali traders per year.

## “ OUTLOOK

Nepal's export has been continuously depleting while imports continue to soar. Industry experts have stressed on harmonizing production related policies and strategies to support the growth of production in the country by providing a favorable environment. In order to improve the country's trade scenario, the country needs to be able to produce good quality products at competitive prices.<sup>107</sup> The sharply declining export figures paints a worrisome picture of the country's economy and government actions should be directed toward rectifying this trend.

# FOREIGN AID

The Government of Nepal (GoN) is currently focusing on resolving problems related to low spending patterns of donor funded project. Capital expenditure was at its lowest at 56% in FY 2015/16 when compared with expenditure over the last five years. The Government of Nepal (GoN) is now concentrating on the completion of donor funded projects in order to mobilize foreign aid.<sup>108</sup>

**Pledge made by DFID:** The Government of Great Britain and Northern Ireland have pledged approximately NPR 10.10 billion (USD 93.7 million) to the GoN through Department for International Development (DFID). The amount was offered for the Post Earthquake Reconstruction Programme, which is being supported by DFID. The main objective of the project is to support 4 major earthquake affected districts - Dhading, Gorkha, Nuwakot and Rasuwa - by constructing roads and trails, improving water and sanitation for the people as well as reaching the most vulnerable with cash transfers.<sup>109</sup>

**Japan's aid for aviation safety:** The Government of Japan promised to extend NPR 15.1 billion (USD 140 million) to the GoN as grant assistance, for the Improvement of Aviation Safety Facilities in major airports. The main purpose of the project is to improve land safety measures and efficiency of air transport in 8 major airports

of Nepal- Tribhuvan International Airport, Chaurjahari, Dhangadhi, Jomsom, Jumla, Lukla, Simikot and Rara Airports. It will provide them with equipment for enhancing guidance and landing safety for aircraft, like landing system localizers to indicate the direction of approach of the aircraft, VHF omnidirectional range (VOR) equipment and distance measuring equipment (DME) to increase domestic flight operations.<sup>110</sup>

World Bank provides credit for road sector development: The GoN will receive a credit of NPR 5.93 billion (USD 55 million) from World Bank to accelerate implementation of the Road Sector Development Project (RSDP) and post-earthquake reconstruction work. This amount will also be used to strengthen Nepal's road and bridge networks that can withstand future seismic and climate vulnerabilities. RSDP was started in 2008 and initially included 10 beneficiary districts for improving road connectivity to economic centers and social services. The additional amount will now be used to maintain earthquake-affected bridges in a further 25 districts, which will provide connectivity along the Birgunj-Narayanghat-Mugling-Kathmandu corridor. The development of this corridor will contribute towards economic growth, as it carries a majority of the incoming and outgoing freight of Nepal.<sup>111</sup>

**Switzerland helps to reconstruct school in Jiri:** A Memorandum of Understanding (MoU) was signed between the Embassy of Switzerland and the Ministry of Education, where the Government of Switzerland will provide approximately NPR 105 million (USD 0.9 million) for the reconstruction of Jiri Technical School (JTS) in Dolakha district. The aid is aimed at accelerating academic operations at the school by building classrooms, girl's hostel and reconstruction of the school premises, which is expected to be completed by December 2018.<sup>112</sup>

**Korea support's WFP (World Food Programme) for Zero Hunger project in Nepal:** Korea International Cooperation Agency (KOICA) has contributed NPR 215.5 billion (USD 2 billion) for the Saemaul Zero Hunger Communities Project in Nepal. The project was launched in 2012 in two Village Development Committees: Ladagada and Pokhari in Doti District and is currently being implemented by the United Nations World Food Programme (UN WFP). The additional fund will help WFP in 'Saemaul Undong' plan initiated by the Republic of Korea for the development of rural community. It will also aid WFP's cash for assets program, where the community will be involved in building assets such as roads, irrigation systems, and other facilities used by community, and will receive payment for it.<sup>113</sup>

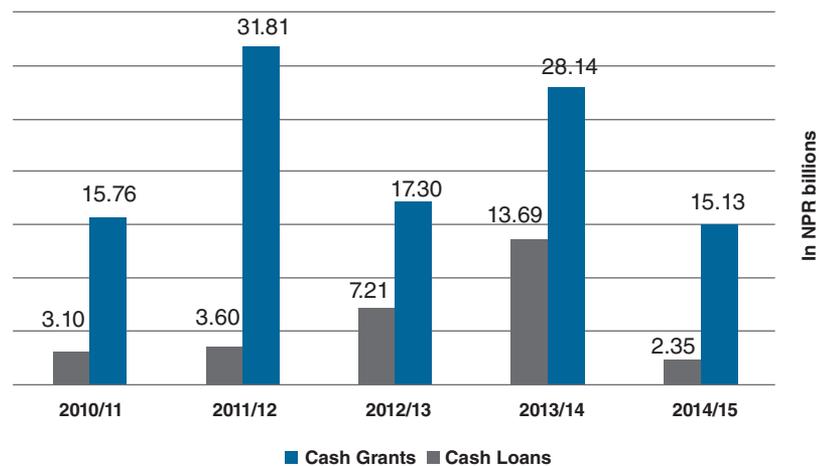
### EU contributes NPR 6 billion for reconstruction:

The Government of Nepal received NPR 6 billion (USD 55.7 million) as the first tranche of financial assistance out of NPR 12 billion (USD 0.11 billion), from the European Union (EU) for the Nepal-EU Action for Recovery and Reconstruction (NEARR) budget support program. The contribution was made to accelerate the rehabilitation of Nepal's earthquake affected communities, with the aim to reconstruct their houses better and safer. This amount is an important contribution in Nepal's treasury to initiate the implementation of Post Disaster Recovery Framework (PDRF) on the initial phase. The second tranche of NPR 6 billion (USD 55.7 million) will be provided on the later stage of the year that will help accelerate reconstruction through PDRF implementation.<sup>114</sup>

**Cash loans and grants risen:** Figure 15 shows that both cash loans and cash grants increased significantly in the FY 2015/16 as compared to the previous year. It is to be noted that while cash grants increased by 10.83%, the increase in cash loans was

an overwhelming 27.17%. The overall rise in both cash grants and loans can be ascribed to post-earthquake reconstruction programmes as a large share of aid inflows in the year 2015/16 was primarily allocated to reconstruction projects.

**Figure 15: Cash Grants and Cash Loans over the last five years**



Source: Current Macroeconomic Situation, Nepal Rastra Bank

## “ OUTLOOK

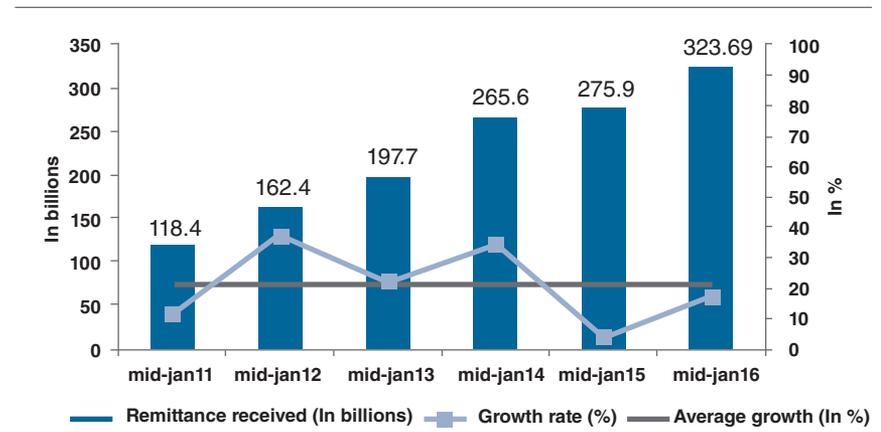
Nepal's export has been continuously depleting while imports continue to soar. Industry experts have stressed on harmonizing production related policies and strategies to support the growth of production in the country by providing a favorable environment. In order to improve the country's trade scenario, the country needs to be able to produce good quality products at competitive prices. The sharply declining export figures paints a worrisome picture of the country's economy and government actions should be directed toward rectifying this trend.

# REMITTANCE

With the blockade affecting usual sources of income for most families especially along the Terai belt, remittances have largely aided in making ends meet. However, concerns regarding sustainability of remittance driven economy are bound to surface given the instability in the international job market for migrants, namely the gulf countries and Malaysia, consequently leading to declines in number of workers going abroad. On top of this, the remittance inflow for the first six months has been low compared to the average rate of inflow during the same time-frame for the last six years.

**Pseudo-growth in Remittances:** In the first six months of the fiscal year 2015/16, the worker's remittance figured at NPR 323.69 billion (USD 2.99 billion) which was an increase of 17.3% compared to the same period of the previous year.<sup>115</sup> It should be noted that in the previous year the remittance collected in the same period grew by just 3.9%, which suggests that fiscal year 2014/15 was not particularly a good year in terms of remittances. In the current year, though the remittance growth appears to be of a considerable amount, in actuality it is not the case. The average growth in remittance for the first six months in the last six years stands at approximately 21%, whereas the current rate of growth is 17.3%. Therefore, the current pace at which remittance collection is moving is lower compared to the average, and is marked by a gap of nearly 4% or NPR 10.15 billion (USD 93.9 million).

**Figure 16: Growth in remittances along with six-monthly data on remittances received for the past six years**



Source: Nepal Rastra Bank

### Decrease in number of workers going abroad:

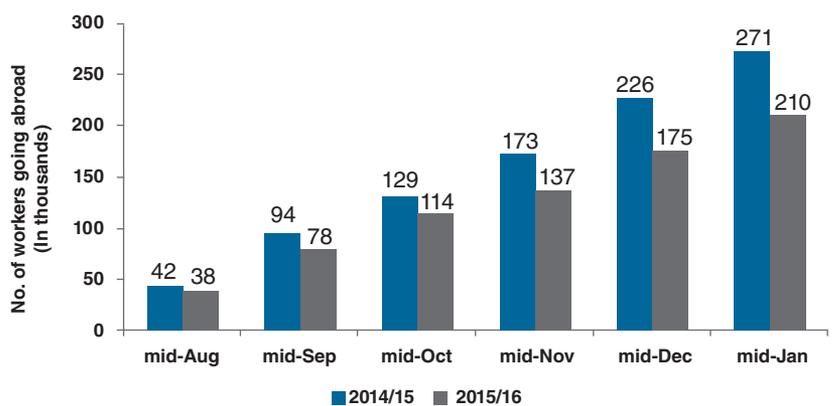
In the current fiscal year 2015/16 up until mid-January 2016, an estimated 210,315 number of people have gone abroad for foreign employment based on the final approval by the department of foreign employment. This figure is 22.5% lower compared to last year for the same time period.<sup>116</sup> In fact, the current fiscal year marked a decline in foreign employment throughout all the months till mid-January 2016 compared to the previous year (refer Figure 17). This decline has primarily been attributed to the slide in demand for workers in the gulf countries as a consequence of sharp falls in the international crude oil prices and the recent decision by the Malaysian government to halt work permits for the foreign workers; Malaysia alone accounted for almost 40% of the foreign workers in fiscal year 2014/15, while the gulf countries combined accounted for nearly 56%. Given

that remittance income to GDP is nearly 30%, the decline in workers going abroad has significant impact on the economy. For instance, a single worker on average sent NPR 1.2 million (USD 11,108) in 2014/15; therefore, for every fall in the number of workers, Nepal would on average lose that much money or more.

### Manpower agencies go on a protest:

Manpower agencies, who have been engaged in placing prospective seekers of foreign employment, have shut down their businesses as a form of protest. The agencies undertook protests against the decision of the police authorities to raid 17 manpower agencies following complaints of financially cheating and overcharging clients as well as other irresponsible acts such as sending the clients to a different destination than promised; the agencies also protested against Malaysia halting foreign employment.<sup>117</sup> Up-to 754 manpower

**Figure 17: Comparative pattern on Number of workers going abroad in the first six months of fiscal year 2014/15 and 2015/16**



Source: Nepal Rastra Bank

agencies ceased their operations which reportedly have reduced Nepali foreign job seekers going abroad by more than 50%. Prior to this conflict with the authorities, the manpower agencies also had voiced their discontent with the government's scheme of providing free tickets and free visas for the Nepali migrant workers going to the gulf countries and Malaysia. However, there have been allegations against the agencies of being involved in unlawful conduct, receiving commission from international companies for supplying workers illegally and evading tax.<sup>118</sup>

**Foreign workers keen on acquiring vocational skills:** More number of workers planning on going abroad has begun enrolling themselves at vocational and technical institutes in hopes of acquiring specialized skills. On average, a skilled worker is expected to earn at least 40% more than an unskilled worker.<sup>119</sup> However, though the number of skilled workers is increasing, the increase has occurred at a slow pace. For instance, in 2014, the Council for Technical Education and Vocational Training (CTEVT) reported 52% of the workers going abroad were unskilled, and 32% were semi-skilled; while, only 16% were

skilled. Yet these figures are slightly encouraging compared to a decade ago in 2004 where only 4% of the workers were skilled while nearly 70% were unskilled and the rest semi-skilled. With regards to the slow growth, there have been allegations that Nepal has been unable to tap into the full potential of migration economy due to poor governance; on one instance the Labor Minister nearly scrapped a Swiss-supported vocational training project claiming Nepali youths should be discouraged working abroad, when the current unemployment rate for youths (15-29) stands at 19.2%<sup>120</sup> i.e. 1.41 million or more than 1.5 times greater than the population of Lalitpur and Bhaktapur combined.

**NIBL's visa direct online service launched:** Nepal Investment Bank Limited (NIBL) has launched first of its kind online remittance service. Named NIBL Visa Direct, this digital financial service enables real time transfer of funds through NIBL to any Visa cardholder within Nepal. Regardless of the card sender uses, this service allows customers to transfer funds in Nepali currency to NIBL Visa credit, debit or prepaid card holders.<sup>121</sup> Prior to this, Prabhu Money Transfer

had also tied up with Eko, a mobile-based financial technology company, in providing Indo-Nepal real time online remittance service; with estimated benefit to 500,000 Nepali migrants working in India.<sup>122</sup> As per the FinScope survey of 2014, 36% of the remittance senders use banking channels to transfer funds while 63%, 22%, and 4% use other formal channels (like remittance agents), Family and Friends, and Informal channels (hundi) respectively.<sup>123</sup>

## OUTLOOK

With falls in the number of workers going abroad, the subsequent earnings from remittances is expected to decrease in the coming years. The absolute amounts perhaps may not reflect the full extent of the decrease but if one were to take into account the remittance that otherwise would have been coming in, the impact is likely to be substantial. This further would lead to decrease in aggregate demand, as much of the remittance money goes into consumption. If the trend continues, labor shortage especially in agriculture would be curbed but the costs of the lost job opportunities would likely far outweigh the benefits of additional labor; given earnings from remittances are a lot higher than agriculture. Similarly, as major international job markets are heavily reeling under their own problems along with the uncertainty of job sustainability for migrant workers, the conditions signal for the need to swiftly accommodate the impending unemployment and underemployment crisis. One of the avenues that potentially could lessen a portion of the unemployment could be the earthquake reconstruction works; which unfortunately has gotten entangled in the usual political squabbles.





MARKET  
**REVIEW**

# FINANCIAL MARKET

Despite all the odds, BFIs were able to post significant growth during the FY 2015/16. As per the un-audited fourth quarter results published by commercial banks, their net profit went up by 27% as compared with the previous fiscal year.

## Deposit and credit mobilization

The annual macroeconomic and financial situation report of FY 2015/16 published by the Nepal Rastra Bank (NRB) depicts that the deposit collection of Banks and Financial Institutions (BFIs) increased by 19.4%. The growth in the corresponding review period last fiscal was 20.1 %. The deposit

mobilization of commercial banks and development banks increased by 20.7% and 16.5% respectively, whereas finance companies deposit decreased by 12%.

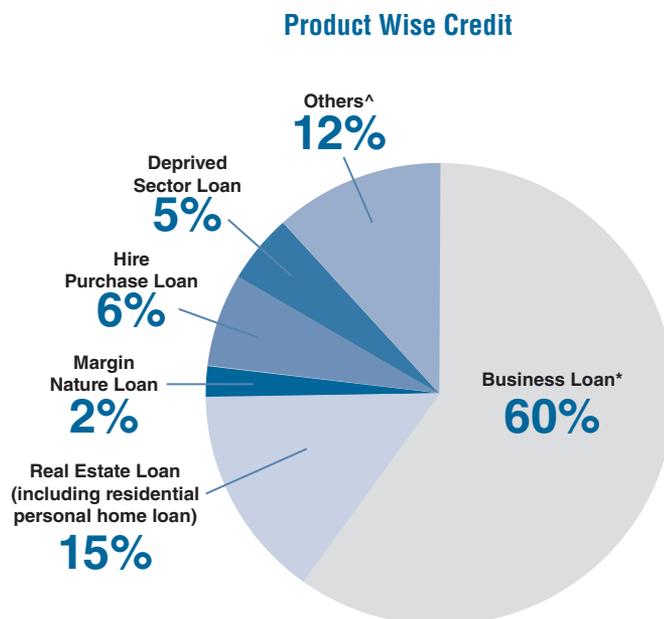
Credit to the private sector extended by BFIs increased by 23.7% compared to a growth of 19.8% during the same period last fiscal. Credit mobilization of commercial banks and development banks increased by 26.5% and 20.3% respectively while that of finance companies decreased by 12.5%. Of the total outstanding credit of BFIs, 60.8% is against the collateral of land and building while 15.2% is against the collateral of

current assets such as agricultural and non-agricultural products. In terms of product flow of credit issued by BFIs, out of total credit flow of NPR 1.68 trillion (USD 15.6 billion) as shown in Figure 18 Business Loans (60%), Real Estate Loans (15%) and Others Loans (12%) have the highest concentration.

## Liquidity management

In order to control excess liquidity in the banking system, NRB mopped up liquidity of NPR 591.63 billion (USD 5.4 billion) on turnover basis through various instruments. Liquidity absorption consisted of NPR 297.50 billion (USD 2.7 billion)

**Figure 18: Product wise credit flow by BFIs**



Note - Others^ includes bill purchased and other product loans. Business Loans\* includes Term Loan, Overdraft, Trust Receipt/Import Loan and Demand & Other Capital Loans.

Source: Nepal Rastra Bank

via deposit collection auctions, NPR 235.95 billion (USD 2.1 billion) through reverse repo auction, NPR 9.5 billion (USD 88 million) through outright sale auction on a cumulative basis, and NPR 49.08 billion (USD 454 million) through NRB bonds. NRB further injected net liquidity of NPR 471.35 billion through the net purchase of USD 4.45 billion from foreign exchange market (commercial banks), while net liquidity of NPR 396.72 billion was injected through the net purchase of USD 4.03 billion in the corresponding period of the previous year. Likewise, NRB purchased Indian currency equivalent to NPR 385.47 billion through the sale of USD 3.4 billion and Euro 0.21 billion in the review period.

### Foreign exchange

The gross foreign exchange reserves stood at NPR 1.03 trillion (USD 12 billion) in mid-July 2016, an increase of 26.1% as compared to NPR 824.06 billion (USD 7.6 billion) at the end of last fiscal year 2014/15. Based on imports, the foreign exchange holdings of the banking sector is sufficient to cover prospective merchandise imports for 16.5 months.

### Interest rates

The weighted average 91-day Treasury bill rate during the FY 2015/16 has decreased to 0.0456% from 0.1739% a year ago. Similarly, weighted average interbank transaction rate of commercial banks has declined to 0.699% from 1.01 % a year ago.

### Interest rate corridor introduced

The central bank has introduced an “interest rate corridor” with the objective to reduce interest rate volatility in the money market. The interest rate corridor is the range between which the interest rate moves

in the money market. As per the current arrangement, the Standing Liquidity Facility (SLF) rate; the rate at which the central bank provides loans to BFIs, is the upper bound rate of the corridor while the average interbank rate between commercial banks before two working days will be the lower bound of the corridor. The central bank, while lending money, will charge the upper bound rate and will offer lower bound rate while absorbing liquidity from the market.

### Deprived sector lending

In order to increase direct participation of ‘A’ class commercial banks in deprived sector lending, the central bank has instructed commercial banks to disburse at least 2% of their total loans to the deprived sector on their own. Commercial banks are required to float 5% of their total loan to deprived sector while development banks and finance companies are required to float 4.5% and 4% respectively. So far, BFIs have been disbursing deprived sector loans via Microfinance Institutions (MFIs). As per the fresh directive, the commercial banks have to make 1.25% of lending to deprived sector by mid-September, 1.5% by mid-December, 1.75% by mid-April, 2017 and 2% by mid-July 2017.

### Amendments in NRB Act, 2002

The parliament has endorsed a bill to make amendments to Nepal Rastra Bank (NRB) Act, 2002. The endorsed bill restricts officials of the central bank from joining BFIs for a certain period. As per the amendments, the governor of the central bank would not be able to take up any positions in BFIs. Similarly, the deputy governors and executive directors will not be allowed to join any BFIs up to three years of their retirement or leaving the central bank job. Likewise, the officer level staff of the central bank will have to wait for 2 years.<sup>124</sup>

### Insurance

The Insurance Board revises “Corporate Governance Related Directive for Insurers, 2016”

The Insurance Board has come up with revised directive on corporate governance to ensure more transparency and internal control in insurance companies as well as strengthen the internal governance system. The major highlights of the directives are as follows:

- **Fixed two term for Board of Directors**

The revised directive prohibits board of directors from retaining the post for more than two terms. Earlier, the directive only mentioned the term r to be capped at four years. Now as per the revised directive, a board director can have a maximum tenure of eight years i.e. two terms of four years each. The revised directive has retained the previous provision of fixing a maximum of two terms for the Chief Executive Officer (CEO).

- **Relaxation in the qualification, pay and perks of CEO**

According to the revised directive, an insurance company can now recruit an individual holding Master’s degree as CEO provided they have five years of work experience at the management level in the insurance sector, or eight years in BFIs, or seven years if it is in both BFIs and insurance sector with at least one year in insurance sector. Regarding the pay and perks, the insurance companies can pay their CEO up to 25 times higher than their junior-most staff based on the underwriting profits of the company after approval in the general body meeting of the

company. Earlier insurers had to maintain CEO remunerations at not more than 15 times the salary of the lowest paid.

- **Mandatory to appoint the compliance officer**

In order to ensure internal control in a company, all the insurance companies have to appoint a compliance officer mandatorily amongst the managerial level who would be responsible to ensure the compliance of directives, circulars, laws, rules as well as instructions issued by the regulators regarding monitoring, supervision or regulation. The compliance office should prepare quarterly reports detailing observations about the compliance, and will be responsible for the truth

and authenticity of the report, according to the directive.

- **Other limitations**

The new provision has barred board members from acquiring shares and debentures issued by the company during their tenure and up to one year after they leave their jobs. The Insurance Board (IB) chairman is barred from holding any position in insurance companies. Similarly, IB board members cannot work in insurance companies in any position for at least two years after leaving the IB.

### 4th Quarter Performance Analysis

As per the unaudited annual figures of FY 2015/16, the operating profit margin of commercial banks grew

by staggering 61.8% whereas the net profit margin grew by 27%. Out of 28 commercial banks, 19 banks were able to post net profit above NPR 1 billion (USD 9.2 million). The highest net profit earner amongst private sector bank was Nabil Bank posting an astounding net profit of NPR 282.2 billion (USD 2.6 billion).

The average Non Performing Loan (NPL) of banks have gone down to 1.6% from 2.2% during the fiscal year. Moreover, the overall cost of fund of commercial banks has decreased to 3.6% from 4.3% during the fiscal year. Likewise, the average base rate of commercial banks stood at 6.5% during the year, the highest being 11.5% of Agriculture Development Bank and the lowest being 4.2% of Nabil Bank.

## “ OUTLOOK

Since the issuance of 'Bank and Financial Institution Merger by-law, 2011' and 'Acquisition Bylaws 2014', 108 BFIs have merged with each other resulting in the formation of 43 BFIs as of mid-July 2016. Likewise, 4 finance companies were acquired by two commercial banks while one development bank was acquired by another development bank. Moreover, 11 institutions including 2 development banks and 9 finance companies are under the resolution process. The ongoing consolidation can expect to be expedited in the current fiscal year as BFIs are required to meet the new capital structure stipulated by the central bank by the end of the current fiscal year. The current consolidation process can expect to create larger banks with higher risk absorption and lending capacity. The total number of development banks and finance companies is expected to decrease significantly while the number of commercial banks is still expected to be above 25 as most of the commercial banks are in the process to meet capital requirements on their own by issuing bonus, rights shares and by acquiring other BFIs.

Despite the effects of the earthquake and economic blockade, BFIs have been able to post significant growth in the previous fiscal year. Some of the key reasons for growth are increments in non-operating income, foreign exchange gains, and decrease in its cost of fund and staff expenses amongst others. Going forward, BFIs will need to focus on operational efficiencies as a way to drive their financial performance. Moreover, with the increment in paid-up capital, BFIs face a stiff challenge to sustain the growth and earnings amidst unfavorable business and political environment in addition to increased competition which may restrain profitability growth over the period. In the days ahead, BFIs will have to become more intelligent, leverage technology and become more innovative in their product offering, pricing and target segment to get an edge over its competitors.

**TABLE 6: UNAUDITED 4TH QUARTER RESULTS OF COMMERCIAL BANKS-FY 2015-16 (FIGURES IN NPR TEN MILLION)**

Bank	Paid-up Capital	Reserve & Surplus	DEPOSIT			LOANS AND ADVANCES			OPERATING PROFIT			NET PROFIT			NPL (%)			COST OF FUND (LCY)			BASE RATE (%)
			FY 15/16	FY 14/15	% Change	FY 15/16	FY 14/15	% Change	FY 15/16	FY 14/15	% Change	FY 15/16	FY 14/15	% Change	FY 15/16	FY 14/15	% Change	FY 15/16	FY 14/15	% Change	
			4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR		4 QTR	4 QTR		
Nabil Bank	755.2	11,026.7	10,423.8	5.8	7,773.0	15.7	434.4	323.6	34.3	282.2	209.4	34.8	1.1	1.8	2.1	3.2	(1.1)	4.2	4.2		
Nepal Investment Bank	1,055.6	10,862.7	9,063.1	19.9	8,701.0	28.5	370.0	254.6	45.3	255.1	196.2	30.0	0.7	1.3	2.8	3.6	(0.9)	5.1	5.1		
Standard Chartered Bank	440.4	5,572.7	5,728.6	(2.7)	3,169.7	13.1	167.3	182.7	(8.4)	126.5	129.0	(1.9)	0.3	0.2	1.5	1.9	(0.4)	4.6	4.6		
Himalayan Bank	437.5	8,732.3	7,353.8	18.7	6,910.1	24.7	299.1	157.5	89.9	191.6	111.2	72.2	1.2	3.2	2.3	3.4	(1.1)	5.7	5.7		
Nepal SBI Bank	309.4	6,521.4	5,162.8	26.3	4,699.5	17.5	204.1	163.0	25.2	133.2	106.5	25.0	0.1	0.2	2.6	3.2	(0.6)	6.0	6.0		
Nepal SBI Bank	303.9	305.1	3,987.4	3,383.3	17.9	3,252.8	2,582.4	26.0	152.0	102.5	48.3	81.4	47.2	0.7	1.3	4.0	4.2	(0.3)	7.1	7.1	
Everest Bank	274.3	587.0	9,373.5	8,309.4	12.8	6,891.2	5,536.4	24.5	266.6	225.3	18.3	173.0	157.4	9.9	0.4	0.7	2.2	3.3	(1.0)	4.9	4.9
Bank of Kathmandu Lumbini	457.7	330.8	6,783.6	5,973.9	13.6	6,031.8	5,062.6	19.1	161.1	106.6	51.1	75.8	47.9	2.3	3.5	4.0	4.3	(0.2)	6.9	6.9	
NCC Bank	235.3	128.4	3,036.4	2,666.1	13.9	2,489.1	2,144.2	16.1	74.8	48.8	53.3	40.8	72.5	0.9	1.9	4.2	5.0	(0.7)	7.4	7.4	
NIC Asia Bank	457.5	287.0	6,948.8	5,347.7	29.9	5,844.6	4,214.4	38.7	166.6	86.8	91.9	106.6	56.7	0.9	2.1	4.4	5.1	(0.7)	6.4	6.4	
Machhapuchhre Bank	386.5	151.1	5,229.2	4,420.6	18.3	4,423.4	3,481.9	27.0	126.6	74.8	69.3	61.6	44.7	0.6	0.6	3.4	4.7	(1.2)	6.2	6.2	
Kumari Bank	269.9	138.8	3,795.1	3,342.2	13.5	3,011.1	2,707.0	11.2	78.3	40.1	95.4	74.0	39.5	1.1	2.5	4.4	5.0	(0.6)	7.2	7.2	
Laxmi Bank	303.9	260.7	4,815.4	3,999.2	20.4	4,036.0	3,097.1	30.3	96.2	60.8	58.1	67.4	41.6	0.8	1.3	4.1	4.6	(0.5)	6.8	6.8	
Siddhartha Bank	302.3	323.0	6,493.4	5,107.7	27.1	5,530.5	4,184.7	32.2	164.2	111.7	47.1	124.5	92.8	1.4	1.8	3.8	4.6	(0.8)	6.7	6.7	
Global IME Bank	616.4	254.6	7,468.3	6,017.6	24.1	6,084.1	5,022.7	21.1	186.9	124.0	50.6	138.7	96.1	1.9	2.2	3.1	4.2	(1.1)	6.0	6.0	
Citizens Bank International	365.1	172.2	4,739.4	3,578.2	32.5	4,056.7	2,920.0	38.9	112.9	79.3	42.4	109.0	72.0	1.3	1.5	4.3	5.0	(0.7)	6.1	6.1	
Prime Commercial Bank	370.5	175.6	4,835.3	4,100.6	17.9	4,028.9	3,261.7	23.5	150.5	101.1	48.9	112.8	74.6	1.2	1.8	4.3	4.7	(0.4)	7.0	7.0	
Sunrise Bank	397.6	216.9	5,165.0	3,969.7	30.1	4,286.5	3,182.2	34.7	95.2	64.9	46.7	95.2	65.4	1.2	2.9	4.5	5.2	(0.6)	6.9	6.9	
NMB Bank	448.7	246.4	6,478.1	5,460.8	18.6	5,308.2	4,168.1	27.4	112.3	100.9	11.3	115.0	76.4	1.7	0.4	4.0	4.6	(0.6)	6.7	6.7	
Prabhu Bank	588.1	36.6	6,094.1	5,034.9	21.0	4,821.3	3,927.1	22.8	87.6	(73.3)	(219.6)	114.8	70.5	8.4	7.4	3.3	4.1	(0.9)	6.3	6.3	
Janata Bank Nepal	206.0	62.3	2,406.8	2,292.0	5.0	2,047.3	1,851.7	10.6	45.8	17.5	160.9	32.5	15.0	1.2	1.9	4.5	5.3	(0.8)	8.0	8.0	
Mega Bank	324.1	96.7	3,100.0	2,490.0	24.5	2,735.9	2,056.4	33.0	72.0	63.5	13.4	55.2	41.6	0.8	1.8	4.0	4.3	(0.2)	6.6	6.6	
Civil Bank	308.3	53.4	3,156.4	2,665.6	18.4	2,570.4	2,253.4	14.1	25.5	19.0	33.7	33.1	23.0	2.7	3.2	5.4	5.9	(0.6)	7.9	7.9	
Century Commercial Bank	284.1	53.3	2,896.8	2,494.9	16.1	2,508.4	2,035.2	23.3	56.2	33.0	70.1	38.3	26.1	0.2	0.3	4.2	5.6	(1.4)	7.1	7.1	
Sanima Bank	402.2	141.6	4,642.3	3,404.5	36.4	4,044.2	2,826.4	43.1	147.1	92.6	58.9	104.6	62.4	0.0	0.1	3.8	5.0	(1.2)	5.6	5.6	
<b>Public Sector Banks</b>																					
Nepal Bank	646.5	38.5	8,941.0	7,800.7	14.6	6,352.7	5,337.5	19.0	221.2	45.6	385.4	301.9	52.6	2.7	4.0	2.0	2.3	(0.4)	6.1	6.1	
Rastriya Banijya Bank	858.9	73.4	14,620.8	12,422.2	17.7	8,547.0	7,583.6	12.7	207.1	147.2	40.6	264.8	464.4	4.0	5.4	1.8	2.2	(0.4)	6.4	6.4	
Agriculture Dev. Bank	1,037.4	838.5	8,726.3	7,692.1	13.4	7,975.2	6,660.1	19.7	268.1	58.4	359.3	257.7	360.3	3.9	5.4	5.3	5.5	10.6	11.5	11.5	
<b>Total</b>	<b>12,165.6</b>	<b>7,970.1</b>	<b>176,449.2</b>	<b>149,706.1</b>	<b>17.9</b>	<b>138,130.8</b>	<b>111,925.0</b>	<b>23.4</b>	<b>4,549.5</b>	<b>2,812.5</b>	<b>61.8</b>	<b>3,693.2</b>	<b>2,911.9</b>	<b>1.6</b>	<b>2.2</b>	<b>3.6</b>	<b>4.3</b>	<b>(0.7)</b>	<b>6.5</b>	<b>6.5</b>	

# CAPITAL MARKET

## Secondary Market Performance

After reaching its highest point 1881.49 on June, 2016, the NEPSE index went down by almost 11% to reach 1675.91 points however, after a brief correction the market has since been recovering as investors' confidence continue to strengthen further.

## NEPSE CROSSES 1800 MARK

The Nepal Stock Exchange (NEPSE)

benchmark index (+19.80 %) went up by a whopping 303.31 points during the review period (7 June to 6 September 2016) to close at 1834.8 points. At the end of review period, the total market capitalization had reached NPR 2.02 trillion (USD 18.77 billion).

As shown in Table 7 above, during the review period, all sub-indices except for the Hydropower sub-index (-1.90%) ended in the green zone. All the

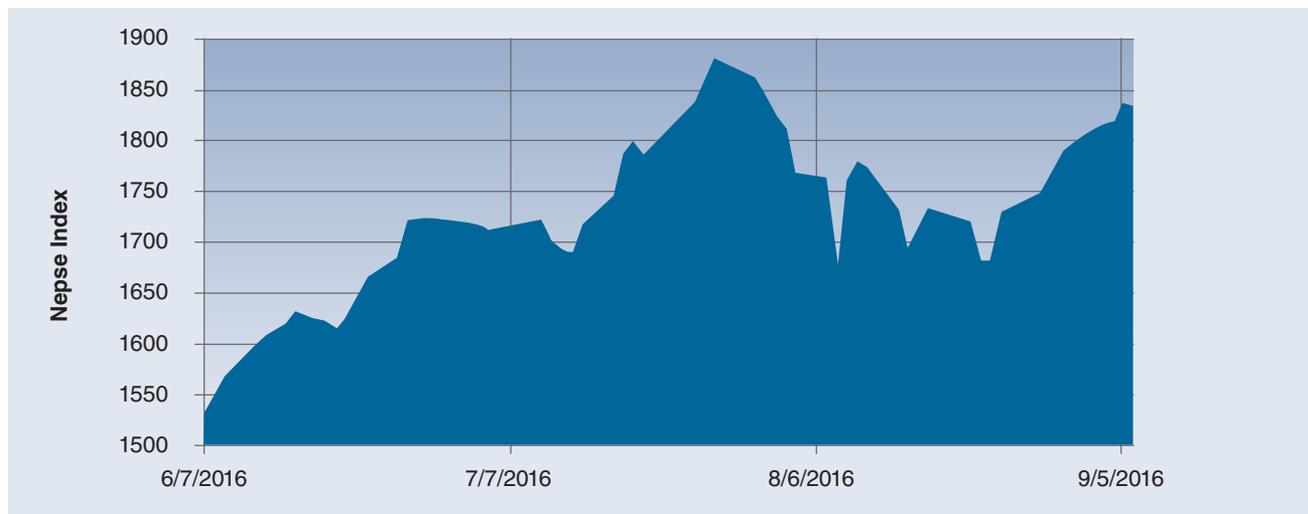
sub-sectors representing the banking sector; commercial banking (+25.21 %), development banking; which also includes micro-finance institutions (+25.90%) and finance (+17.81%) sub-sectors were amongst the highest gainers. The Insurance sub-index (+14.90%) followed suit as the share prices of both life and non-life insurance companies continue to go up. Likewise, Hotels (+8.71%) and the manufacturing and Processing sub-Index (+7.94%) witnessed a marginal growth.

**Table 7: Sector wise Performance of the sub-indices**

Indicators	7-Jun-16	6-Sep-16	% change
<b>Nepse Index</b>	<b>1,531.5</b>	<b>1834.8</b>	<b>19.80%</b>
Commercial Bank Index	1,416.6	1773.66	25.21%
Development Bank Index	1,507.6	1898.14	25.90%
Finance Index	726.8	856.26	17.81%
Insurance Index	7,671.7	8814.79	14.90%
Hydropower Index	2,439.4	2393.08	-1.90%
Manufacturing & Processing Index	2,313.9	2497.58	7.94%
Hotel Index	1,980.9	2153.55	8.71%
Others Index	781.3	792.44	1.43%

Source: NEPSE

**Figure 19: NEPSE Index performance**



Source: NEPSE

## Key Developments

Some of the key developments in the capital market during the review period are highlighted below:

### Regulation on public issues

Securities Board of Nepal (SEBON) has come up with a new pricing regulation for both Initial Public Offering (IPO) and Further Public Offering (FPO) to regulate the pricing by listed companies for public issue. For IPO pricing, SEBON has sought approval from the Ministry of Finance (MoF) to allow companies to float their primary shares on a free-pricing model. This would allow companies to issue primary shares at more than NPR 100 per share; subject to a cap on pricing by SEBON. Such pricing models would encourage more real sector companies to be listed on NEPSE.

Likewise, to control the trend of high premium in FPOs, SEBON has announced new standards for determining share price of FPOs where the average price of four specified criteria, i.e. Capitalized Earning, Net Worth Per Share / Book Value Per Share, 180 Days Average of Closing Market Price and Discounted Cash Flow (DCF), have to be considered. All the upcoming FPOs that are to be issued in premium have to calculate share price accordingly.

### Expedite dematerialization process

In order to expedite the process of dematerialization (from physical to electronic form) of shares, SEBON has directed depository participants and share registrars to open beneficiary accounts within three days and provide debit instruction slips. The depository participants are also directed to submit documents provided by the beneficiaries for dematerialization of share certificates to the share registrars within seven days. The share registrars should then

dematerialize the share certificates within three days after checking the documents. Similarly, the registrars should also ensure that bonus and right shares of investors are deposited in the beneficiary's account within three days from listing of those shares.

### Extension of trading hours and deduction in brokerage fees

Amidst growing participation of investors in the secondary market, NEPSE has extended the trading hour by an hour, with the market now remaining open for transaction from 11 am to 3 pm. Earlier the market used to be open between 12 am to 3 pm only.

SEBON has also revised the brokerage fee on share transactions that the stock broker charges to investors. The new brokerage fee structure for investors trading less than NPR 50,000 per transaction has gone down by almost 67%. Moreover, the new fee structure as shown in Table 8 has added an additional slab to further decrease the brokerage commission on share trading i.e. while purchasing or selling the shares in the stock market.

### New credit rating company

The Nepali capital market may witness another credit rating company soon as a Memorandum of Association (MOU)

has been signed between CARE Ratings India, Vishal Group Limited and Emerging Nepal Limited to start a credit rating company named CARE Ratings (Nepal) Limited. Currently ICRA Nepal is the sole credit rating agency operating in Nepal, which is a subsidiary of ICRA Limited of India and has been in operation since 2012. As per the initial MOU, CARE ratings India will hold 50% ownership, Vishal Group will own 19% and Emerging Nepal Limited will hold a 10% stake while the remaining 19% will be held by various BFIs, insurance companies and corporate bodies.<sup>125</sup>

### Regulation for issuing further public issues and rights for unregulated companies

SEBON has formed an expert committee to work on the formation of regulations for issuing FPO and right shares of listed companies having direct regulatory body. Currently hydropower companies and other companies such as manufacturing, trading does not have a direct regulatory body unlike banking and insurance companies which are regulated by the central bank and the Insurance Board respectively. SEBON has requested concern authorities to suggest required regulations regarding issuance of right shares and FPOs within a month to the formed committee.

**Table 8: Old and new brokerage fee structure**

Old Provision	
For Transaction	Brokerage Fee (%)
Up to NPR 50,000	1.00
Over NPR 50,000 to up to NPR 500,000	0.90
Over NPR 500,000 to up to NPR 1 million	0.80
Over 1 million	0.70
New Provision	
Up to NPR 50,000	0.60
Over NPR 50,000 to up to NPR 500,000	0.55
Over NPR 500,000 to up to NPR 2 million	0.50
Over NPR 2 million to up to NPR 10 million	0.45
Over NPR 10 million	0.40

Source: NEPSE

### Primary Market:

During the review period, the primary market witnessed the issuance of three Initial Public Offerings (IPO's). All the offerings received overwhelming response from the market as these offerings were oversubscribed by multiple folds.

- National Microfinance Bittyta Sanstha issued IPO worth NPR 30 million (USD 278 thousand) from July 31st to August 3rd

2016, which was oversubscribed by more than 400 times, with the total collection of NPR 11.30 billion (USD 104 million).

- Similarly, RSDC Laghubitta Bitiya Sanstha (RSDC) floated its primary share worth NPR 40 million (USD 371 thousand) from 21st to 28th of August 2016. RSDC is a wholesale microfinance lender licensed by Nepal Rastra Bank (NRB)

headquartered in Rupandehi. It has been assigned "IPO Grade 4" indicating below-average fundamentals by the credit rating company - ICRA Nepal.

- Suryodaya Lagubitta Bittyta Sanstha floated primary shares worth NPR 12 million (USD 111 thousand), the primary issue was oversubscribed by over 340 times as it collected a total of NPR 3.71 billion (USD 34.4 million).

## OUTLOOK

The oversubscription rate of primary issues and daily transactions volume at the stock exchange clearly signals increasing participation and confidence of investors. The total market transaction in the previous FY 2015/16 increased by staggering 147.47% to NPR 164.63 billion (USD 1.52 billion) from NPR 66.53 billion (USD 617 million) in the FY 2014/15.<sup>126</sup> The total transaction volume of the current fiscal year could expect to grow significantly as average market turnover has been over NPR 1.7 billion (USD 15.7 million) per day. The overwhelming participation of investors has been fuelled primarily due to lower-cost of margin arising from abundant liquidity in the banking system amidst limited avenues for investments.

With the rising trading volume, the risk of suspicious transactions and entry of black money into the market cannot be denied. The formation of a committee by SEBON to look after the possible illicit flow of funds; and its immediate closure afterwards, indicates the significance of sensitivity of information in the market. The regulator therefore needs to take proper initiative to ensure that genuine or general investors are not carried away by such initiatives or rumors in the market as the primary objective of such measures is to discourage illegal funds in the market. Likewise, the initiative taken up by the regulator to establish a committee to suggest required regulations regarding issuance of right shares and FPOs of companies with concerned regulators is a welcome step. The formalization of such regulations could minimize risk to general investors and provide operational clarity.

The tightening of margin lending by the central bank further indicates that the regulator is taking precautionary steps to minimize risk in the event of market downfall. As per NRB's annual figure for the FY 2015/16, BFIs total margin lending extended against the collateral of shares stood at 2.2% of their total loan exposure at NPR 37.66 billion (USD 349 million). Even though the market may showcase some volatility in the short run, demand for the Bank and Financial Institutions (BFI's) scrips is likely to go up in anticipation of impressive stock dividends as BFIs have posted good growth in the FY 2015/16. The capital requirement as stipulated by the central bank has to be met by BFIs by the end of the current FY 2016/17.

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# NEF PROFILE

Nepal Economic Forum (NEF) is a premier private-sector led economic policy and research organization that seeks to re-define the economic development discourse in Nepal. Established in 2009 as a not-for-profit organization under the beed (www.beed.com.np) umbrella, NEF is a thought center that is working to create positive transformations in policy reforms. NEF stands out in being able to make significant strides to bring the private sector perspective and engage with both the public and private sectors in the development discourse. NEF is currently a recipient of the Open Society Foundations' Think Tank Fund.



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

NEF has partnered with the Himalayan Consensus Institute (HCI) to facilitate the development of alternative development paradigms and successfully held the first Himalayan Consensus Summit 2016 in March 2016.

## NEF BROADLY WORKS UNDER THREE AREAS:

### BPRC

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

### PPCP

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



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



We are striving to ensure financial sustainability for NEF to complement the support it currently gets from beed management. If you are interested to support NEF, please do get in touch with [sujeev.shakya@beed.com.np](mailto:sujeev.shakya@beed.com.np) or [shayasta.tuladhar@beed.com.np](mailto:shayasta.tuladhar@beed.com.np)



P.O.Box 7025, Krishna Galli, Lalitpur - 3, Nepal  
Phone: +977 1 5548400  
[info@nepaleconomicforum.org](mailto:info@nepaleconomicforum.org)  
[www.nepaleconomicforum.org](http://www.nepaleconomicforum.org)

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