

2nd International Conference on Economics and Finance

26-28 February 2015, Kathmandu, Nepal



Conference Paper and Proceedings



Nepal Rastra Bank

May 2015

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VOLUME 1



Nepal Rastra Bank

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Brochure Front



2nd International Conference on Economics and Finance

26-28 February 2015
Kathmandu, Nepal

Program Schedule

Organized by



Nepal Rastra Bank

Brochure Back

Administrative Notes

To maximize and enhance the benefits from the program, paper presenter and non-presenter participants are advised to observe the following notes:

1. Paper presenter and non-presenter participants should be punctual and arrive at the allocated venue at least 10 minutes prior to the start of scheduled events such as the inaugural program, business program, concluding program, and post conference sight seeing tour.
2. Participants are encouraged to contribute actively in the session to acquire maximum benefit.
3. Participants should inform the Secretariat if they have any problems (e.g. health) so that assistance can be rendered quickly.
4. The Secretariat will be available to assist participants during the program.

Dress Code

Participants are requested to be dressed appropriately as follows.
Inaugural program, business program, concluding program and presentation of certificate – Formal Attire
The post-conference sight seeing tour – Smart Casual

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About Nepal Rastra Bank

Nepal Rastra Bank (NRB) is the Central Bank of Nepal, established in 1956 to discharge the central banking responsibilities including guiding the development of financial sectors, and maintaining internal and external stabilities.

The NRB Act, 2002 has laid down the primary functions of the Bank as:

- to formulate necessary monetary and foreign exchange policies to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy in Nepal;
- to develop a secure, healthy and efficient payment system
- to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development ; and
- to further enhance the public confidence in Nepal's entire banking and financial system.

To discharge those responsibilities, the NRB has currently about 1,300 staffs working at the central office and 15 departments, one banking office, one bankers training center in Kathmandu and 7 offices outside Kathmandu in the major cities of Nepal.

Vision: To become a modern, dynamic, credible and effective Central Bank

Mission: Maintaining macro-economic stability through sound and effective monetary, foreign exchange and financial sector policies.

Conference Banner



2nd International Conference on Economics and Finance
26-28 February 2015, Kathmandu, Nepal
Venue: Hotel Yak and Yeti

Program Summary

Thursday, 26 February 2015

08:30 – 09.00	Registration
09.00 – 10.00	Inaugural Ceremony (Hall Regal 1)
10.00 – 10.30	Tea Reception (Regal 2 Hall)

Business Program

10.30-12.00	Parallel Sessions (3- Sessions)
12.00-13.00	Lunch Break (Garden)
13.00-14.30	Parallel Sessions (3- Sessions)
14.30-15.00	Tea Break
15.00-16.30	Parallel Sessions (3- Sessions)
18.00-20.00	Opening Dinner Hosted by Nepal Rastra Bank (Garden)

Friday, 27 February 2015

09.30-11.00	Parallel Sessions (3- Sessions)
11.00-11.15	Tea Break
11.15-12.45	Parallel Sessions (3- Sessions)
12.45-13.45	Lunch Break (Garden)
13.45-15.15	Parallel Sessions (3- Sessions)
15.15-15.30	Tea Break

Joint Session

15.30-16.30	Guest Speech by Governor, State Bank of Pakistan Mr. Ashraf Mahmood Wathra (Hall: Regal 1)
16.30 – 16.45	Break
16.45-17.45	Closing Ceremony (Hall: Regal 1)
18.00-20.00	Closing Dinner Hosted by Nepal Rastra Bank (Regal 2 and Regency)

Saturday, 28 February 2015

09.00 – 05.00	Post-Conference Program Sight Seeing Tour for International Participants Places: Bhaktapur and Dhulikhel
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Programme Schedule

Thursday, 26 February 2015

08:30 – 09.00 **Registration**

09.00 – 10.00 **Inaugural Program** (Hall Regal 1)

Welcome Remarks

by Mr. Gopal Prasad Kaphle

*Deputy Governor and Coordinator, Conference Organizing Committee,
Nepal Rastra Bank*

Inauguration and Remarks

by Chief Guest Honorable Minister of Finance

Dr. Ram Sharan Mahat

Keynote Speech

by Dr. Yuba Raj Khatiwada, Governor, Nepal Rastra Bank

Vote of Thanks

*by Dr. Min Bahadur Shrestha, Executive Director, Research Department,
Nepal Rastra Bank*

10.00 – 10.30 **Tea Reception**

Parallel Sessions

Session I

Time: 10.30 – 12.00,

Venue: Hall – Durbar

Theme: Financial Sector Development, Economic Growth, Poverty Alleviation -I

Session Chair: Prof. Dr. Sri Ram Poudyal

Export-Led Growth Hypothesis: An Empirical Study of Nepal

Mr. Shishir Shakya, Institute for Frontier Studies, Lalitpur, Nepal

On the Impact of Remittances on Central Bank Balance sheet, Inflation and Welfare in Nepal

Prof. Frank Westermann, Institute for International Policy Research, University of Osnabrueck, Germany

Linkages between Real Sector and Financial Sector in Nepal: A Vector Error Correction Model

Mr. Prem Prasad Acharya, Nepal Rastra Bank, Nepal

Time: 10.30 – 12.00,

Venue: Hall - Regency

Theme: Exchange Rate, International Trade and Capital Flows I

Session Chair: Mr. Deependra Bahadur Kshetry

A Review on Trends and Patterns of FDI Inflow and Its Impact on Indian Economy

Dr. Rama Krishna Chiruvolu, K. Changrakala PG College, Tenali, India

Equilibrium Exchange Rate Estimation for BD Taka- A Cointegration Analysis

Mrs. Luthfe Ara Begum, Bangladesh Bank, Bangladesh

The Impact of Exchange Rate Variation on Inflation in South Asian countries

Mr. Md Omor Faruq, Bangladesh Bank, Bangladesh

Time: 10.30 – 12.00,

Venue: Hall – Regal 2

Theme: Inclusive Finance and Financial Literacy I

Session Chair: Mr. Sushil Ram Mathema

Does Islamic Financial Services Industry improves Financial Inclusion in Developing Countries? Evidence from Muslim Countries

Mr. Md. Zulkhibri Abdul Majid, Islamic Development Bank, Jeddah, Saudi Arab

Financial Literacy for Increase Sustainable Access to Finance

Mr. Ramesh Prasad Chaulagain, Nepal Rastra Bank, Nepal

Microfinance and the Financial Inclusion - A Role of Government

Dr. Begur N. Channaveere Gowda. Vivekananda College, Bangalore, India

Session II

Time: 13.00 – 14.30,

Venue: Hall – Durbar

Theme: Financial Sector Development, Economic Growth, Poverty Alleviation II

Session Chair: Dr. Min Bahadur Shrestha

Capital Financing and Industrial Growth in Bangladesh: A Co-integration Analysis and Innovation

Mr. Md. Abdul Wahab and Mrs. Nurun Nahar Sultana, Bangladesh Bank, Bangladesh

Trend and Macro Economic Linkages of Inflation, Money Supply and Economic Growth in South Asia

Dr. Sudhakar Patra, PG Department of Economics, Ravenshaw University, India

Panel Data Analysis of Financial Development, Economic Growth and Rural-urban Income Inequality: Evidence from SAARC Countries

Prof. A.K. Giri and Madhu Sehrawat, Department of Economics and Finance, Birla Institute of Technology and Science, Pilani, India

Time: 13.00 – 14.30,

Venue: Hall - Regency

Theme: Exchange Rate, International Trade and Capital Flows II

Session Chair: Dr. Posh Raj Pandey

The Causal Relationship between Foreign Direct Investment and Tourism Development: Evidence from Sri Lanka

Dr. Champa Rupani Rajapakse, University of Sri Jayewardenepura, Nugegoda, Sri Lanka

Trend, Pattern and Determinants of Foreign Direct Investment in South Asian Countries

Dr. Kabita Kumari Sahu, PG Department of Economics, North Orissa University, India

Devaluation and Testing the J-Curve Hypothesis: A Case of Nepal

Dr. Mahesh Kumar Chaulagai, Nepal Rastra Bank, Nepal

Time: 13.00 – 14.30,

Venue: Hall – Regal 2

Theme: Inclusive Finance and Financial Literacy II

Session Chair: Mr. Tulasi Prasad Uprety

Financial Literacy among the College Students

Mr. Bharat Singh Thapa and Surendra Raj Nepal, Central Department of Management, Tribhuvan University Nepal

Financial Inclusion Index: A case of SAARC Countries

Dr. Vinayak Bhagwanrao Bhise and Dr. Someshwar Narayan Babar, Dr. Babasaheb Ambedkar Marathwada University, Aurangabad, India

Session III

Time: 15.00 – 16.30,

Venue: Hall – Durbar

Theme: Financial Sector Development, Economic Growth, Poverty Alleviation III

Session Chair: Mr. Keshav Prasad Acharya

Three Years Ahead Dynamic GDP Forecasting for Nepal

Mr. Mani Raj Shrestha, Nepal Rastra Bank, Nepal

Does Financial Development Spur Growth? Time Series Evidence from Bangladesh

Mr. Tarek Aziz, Bangladesh Bank, Bangladesh

Banks, Non-Bank Companies and Stock exchange: Do we know the Relationship?

Dr. Binam Ghimire, New Castle Business School, London, UK

Time: 15.00 – 16.30,

Venue: Hall – Regency

Theme: Credit and Capital Market

Session Chair: Dr. Ram Hari Aryal

Macroeconomic Risk and Equity Mutual Fund Returns

Mrs. Inderjit Kaur, National Institute of Financial Management, Faridabad, India

Possibilities of Foreign Employment Saving Bond for Sustainable Economic Development in Nepal

Dr. Rashmee Rajkarnikar, Central Department of Economics, Tribhuvan University, Kathmandu, Nepal

Re-investigation of Credit Risk and Performance Relationship: Panel Data Analysis of Islamic Banks in Pakistan

Mr. Azam Ali, State Bank of Pakistan, Pakistan

Time: 15.00 – 16.30,

Venue: Hall – Regal 2

Theme: Micro Finance, Empowerment and Entrepreneurship

Session Chair: Mr. Gopal Prasad Kaphle

Analysing the Determinants of Rural Poverty and Human Deprivation in Western Development Region of Nepal

Mr. Arjun Kumar Thapa, Pokhara University, Nepal

Impact of Microfinance and Microcredit facilities on Entrepreneurs' in Malaysia

Mr. Kiran Kumar Thoti, and Prof. Dr. Roselina Ahmad Saufi, Universiti Malaysia Kelantan, Kota Bharu Malaysia

Beyond Financial Access: Reassessing the Promise of Microfinance in Promoting Women's Empowerment

Mrs. Tara Bajracharya, Save the Children, Nepal Country Office, Nepal

Friday 27 February 2015

Session 1

Time: 9.30 – 11.00,

Venue: Hall – Regal 1

Theme: Monetary Policy and Inflation

Session Chair: Prof. Dr. Bishwambhar Pyakurel

Quantification of M2, RM and BOP for Monetary Programming of Bangladesh

Mr. Imam Abu Sayed, Bangladesh Bank, Bangladesh

Inflation Targeting' in the Indian Context: Issues and Challenges *Dr. Amaresh Samantaraya , Pondicherry University, India*

Optimal Level of Inflation in Nepal: An Empirical Investigation *Mr. Siddha Raj Bhatta, Nepal Rastra Bank, Nepal*

Time: 9.30 – 11.00,

Venue: Hall – Regency

Theme: Financial System, Financial Stability and Corporate Governance I

Session Chair: Dr. Rewat Bahadur Karki

Disproof for the Financial Markets Random Walk Theory. FX Evidence

Dr. Vladimir Prelov, Russian Academy of Sciences, Russia

Dividend Policy, Performance, and Stock Price in Nepal

Dr. Nabaraj Adhikari, Securities Board of Nepal (SEBON), Nepal

Institutional Investors and the Stock Market Behavior- Evidence from India

Prof. SSS Kumar Indian Institute of Management Kozhikode, Kerala, India

Time: 9.30 – 11.00,

Venue: Hall – Regal 2

Theme: Public Finance and Fiscal Policy

Session Chair: Prof. Dr. Madan Kumar Dahal

Counter-cyclical or Pro-cyclical in Fiscal Policy of Nepal

Dr. Tap Prasad Koirala, Nepal Rastra Bank, Nepal

The Composition of Public Expenditure and Economic Growth in India: Evidence from Auto-Regressive Distributed Lag Approach

Dr. Geetilaxmi Mohapatra and A K Giri, Department of Economics and Finance, Birla Institute of Technology and Science, Pilani, India

Is Public Debt the cause of Inflation for Nepal?

Ms. Sajana Silpakar, Nepal Rastra Bank, Nepal

Session II

Time: 11.15 – 12.45,

Venue: Hall – Regal 1

Theme: Money, Banking and Financial Policies I

Session Chair: Dr. Ravindra Prasad Pandey

Effect of Portfolio Diversification on Banks Performance: Evidence from Pakistan

Mr. Musarat Naveed, University of Central Punjab, Lahore, Pakistan

The Determinants of Non-Performing Loan in Nepalese Commercial Banks

Ms. Seema Bhattarai, Himalayan White House College, Kathmandu, Nepal

Trade-offs between Real Economic Activity and Bank Profitability for Implementing New Regulatory Standards: South Asian Perspective

Mr. Ripon Roy and Mrs. Rokeya Khatun, Bangladesh Bank, Governor's Secretariat, Bangladesh

Time: 11.15 – 12.45,

Venue: Hall – Regency

Theme: Financial System, Financial Stability and Corporate Governance II

Session Chair: Dr. Govinda Bahadur Thapa

The Relationship between Stock Market and Sector Returns, and Inflation: Evidence from Colombo Stock Exchange

Mr. Thuraisingam Udayaseelan, Central Bank of Sri Lanka, Sri Lanka

Exploring the Effects of Knowledge Management in the Banking Sector of Vietnam

Prof. Borwen Kreng, National Cheng Kung University and Hsingme Chen, National Taipei University of Education, Taiwan

Does Regulatory Arbitrage Induce Presence of Foreign Banks in India?

Ms. Anjali Prashad, Jawaharlal Nehru University, India

Time: 11.15 – 12.45,

Venue: Hall – Regal 2

Theme: Remittance and Labor Migration

Session Chair: Associate Prof. Dr. Shiva Raj Adhikari

**Revisiting the Gravity Model of Migration and Remittances:
Implications for South Asian Countries**

Mr. Md. Mahinur Alam, Chief Economist Unit, Bangladesh Bank, Bangladesh

**Temporary Migration, Remittance and Technological Adaptation in Nepalese
Agriculture**

Mr. Naveen Adhikari, Central Department of Economics, Tribhuvan University, Nepal

The Study of Minimum Wage Policy in Malaysia and India

*Prof. Balakrishnan Parasuraman and Kiran Kumar Thoti, Universiti Malaysia Kelantan, Kota Bharu
Malaysia*

Session III

Time: 13.45 – 15.15,

Venue: Hall – Regal 1

Theme: Money, Banking and Financial Policies II

Session Chair: Mr. Ganesh Bahadur Thapa

**Impacts of Foreign Exchange Intervention on the Parallel Exchange Rate in a
Developing Country: a case study of Myanmar**

Mr. Koji Kubo, Japan External Trade Organization (IDE-JETRO), Bangkok, Thailand

**Determinants of Lending Behavior of Nepalese Commercial Banks: An Empirical
Assessment**

Ms. Neelam Timsina, Nepal Rastra Bank, Nepal

Velocity of Money Function in Nepal

Prof. Gaurang Dattubhai Rami, Veer Narmad South Gujarat University Surat, India

Time: 13.45 – 15.15,

Venue: Hall – Regency

Theme: Financial System, Financial Stability and Corporate Governance III

Session Chair: Mr. Bal Krishna Man Singh

The Socio-Economic Impact of Mobile Banking on Rural Bangladesh

*Mr. Shudipta Sharma, University of Chittagong, Department of Communication and Journalism,
Bangladesh*

**An Empirical Relationship between Financial Development Indicators and Human
Capital in Some Selected Asian Countries**

*Ms. Madhu Sehrawat, Department of Economics and Finance, Birla Institute of Technology and
Science, India*

Time: 13.45 – 15.15,

Venue: Hall – Regal 2

Theme: Enterprises and Food Security

Session Chair: Dr. Ram Prasad Gyanwaly

Are Mergers and Acquisitions Necessarily Anti-Competitive? Empirical Evidence of Indian Manufacturing Sector

Dr. Pulak Mishra, Indian Institute of Technology, Kharagpur, India

Key Factors for Enterprise Development: Evidence from Solar Sector of Nepal

Mr. Maheshwor Prasad Yadav, Mewar University, Rajasthan

Food Security Situation in Nepal: A Study based on Nutrition Analysis

Mr. Rudra Mani Khatiwada, Green Nepal, Nepal

15.15-15.30

Tea Break

Joint Session

Time: 15.30 – 16.30,

Venue: Hall – Regal 1

Guest Speech : Mr. Ashraf Mahmood Wathra
Governor, State Bank of Pakistan

Title: Promoting Equitable Economic Growth through Inclusive Finance

Closing Ceremony

16.45-17.45	<p>Summary of Conference <i>Dr. Min Bahadur Shrestha, Executive Director and Member of Conference Organizing Committee, Nepal Rastra Bank</i></p> <p>Remarks <i>by Representative of Participants</i></p> <p>Presentation of Certificates <i>by Dr. Yuba Raj Khatiwada, Governor Nepal Rastra Bank</i></p> <p>Presentation of Souvenirs <i>by Mr. Gopal Prasad Kaphle, Deputy Governor Nepal Rastra Bank</i></p> <p>Closing Remarks <i>by Dr. Yuba Raj Khatiwada, Governor Nepal Rastra Bank</i></p> <p>Vote of Thanks <i>by Dr. Prakash Kumar Shrestha, Director and Member Secretary Conference Organizing Committee, Nepal Rastra Bank</i></p>
18.00-20.00	Closing Dinner Hosted by Nepal Rastra Bank

Saturday, 28 February 2015

09.00 – 05.00	<p>Post-Conference Program Sight Seeing Tour for International Participants Places: Bhaktapur and Dhulikhel</p>
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Seminar Organizing Committee

Mr. Gopal Prasad Kaphle

Deputy Governor, Nepal Rastra Bank

Coordinator

Dr . Min Bahadur Shrestha

Executive Director, Research Department
Nepal Rastra Bank

Member

Dr. Ram Prasad Gyanwaly

Head, Central Department of Economics
Tribhuvan University

Member

Dr. Shiva Raj Adhikari

Associate Professor, Department of Economics
Patan Multiple Campus

Member

Dr. Prakash Kumar Shrestha

Director, Siddharthanagar Office
Nepal Rastra Bank

Member- Secretary

Seminar Secretariat

Dr. Prakash Kumar Shrestha

Director, Siddharthanagar Office
Nepal Rastra Bank

Coordinator

Mr. Sunil Udhas

Director, Research Department
Nepal Rastra Bank

Member

Mr. Naresh Shakya

Director, Human Resource Department
Nepal Rastra Bank

Member

Dr. Dilli Ram Pokharel

Deputy Director, Research Department
Nepal Rastra Bank

Member

Mr. Guna Raj Bhatta

Assistant Director, Research Department
Nepal Rastra Bank

Member and Contact Person

Welcome Remarks

Mr. Gopal Prasad Kaphle
Deputy Governor, Nepal Rastra Bank

Honorable Finance Minister
Honorable Governor, Nepal Rastra Bank
Conference Participants
Distinguished Guests
Media Friends

Ladies and Gentlemen,

It gives me great pleasure to extend to you all a very warm welcome on behalf of organizing committee and Nepal Rastra Bank to this "2nd International Conference on Economics and Finance" organized by Nepal Rastra Bank (NRB). For many of you, this may be your first visit to Nepal and some of you have attended our earlier conference held in April 2012. It is an opportune time to discuss and share research findings and build network among us. I hope ideas and outcomes shared and exchanged here help us to understand economic issues and design appropriate policies.

I would also like to welcome Honorable Ministry of Finance and Vice Chairmen of Nepal Planning Commission for accepting our invitation to join this opening ceremony despite being in a busy schedule. This has definitely provided us encouragement.

Ladies and Gentlemen,

In recent years, there have been dramatic transformations in the theory and practice of central banking. Many central banks have applied unconventional approach to recover from the financial crisis of 2007. The Euro zone is still struggling to recover. This financial crisis has challenged the conventional thinking of the role of central banks to maintain only price stability. Maintaining financial stability has also emerged as an important challenge for central banks, being an apex financial institution in the economy. Financial stability is in fact, also necessary for sustained economic growth. Central banks should create sound and resilient financial system capable of mobilizing resources so as to promote economic growth.

Ladies and Gentlemen,

The role of central bank is vital in the country's overall financial sector development and economic growth in the economy. Central banks should be aware of theoretical development and empirical findings in the economic and financial issues. Knowledge does not have any national boundary. Hence, many central banks in the world regularly organize conference related to economics and finance. It provides us ideas to solve many economic issues and broaden the horizon of knowledge. In this conference, I know that a wide range of very interesting research papers are going to be presented from intellectuals coming from a dozen different countries. We are grateful to paper presenters and participants who have taken our "Call for Papers" positively, and come here after a long journey, giving us a precarious time to share own research findings and thoughts.

Ladies and Gentlemen,

Let me take this opportunity to briefly share about the current macroeconomic situation and a brief evolution of financial system in Nepal. With the adoption of economic liberalization measures since the early-1990s, Nepal has been making steady progress towards modernizing her economy and financial system. However, the agriculture sector still contributes more than one-third to GDP and the share of industry sector is only about 15 percent. The long-standing political transition and delay in promulgation of new constitution have affected the overall growth performance of Nepalese economy, resulting in a slower than potential growth of GDP, despite substantial expansion of financial sector in last two decades. The average GDP growth has been hovering around 4 percent and inflation at a higher single digit. The performance of external sector has remained weak with ever increasing trade deficits. Thanks to increasing remittance, however, which has been supporting to finance imports. But, it has been creating the consumption-based economy.

Nevertheless, Nepal has huge potentiality in hydropower, tourism, herbs and agriculture being rich in water resource, biodiversity, natural beauty and cultural diversity. It is pity to say that Nepal has not been able to utilize available resources and growth potentialities. As a result, Nepal still has low per capita income and is one of the Least Developed Countries in the world. Without further delay, Nepal should start harnessing its available natural resources and increase investment by creating amicable investment friendly environment with shortening political transition, giving due focus on economic issues.

The NRB, from its own part and from its establishment in 1956, has been active in promoting financial development, maintaining macroeconomic stability, and helping to promote economic activities in the economy. We know that maintaining financial stability, increasing financial access and allocating credit to the productive sectors are key challenges to us. To discharge our duties, we are giving due focus on enhancing our human capital, providing opportunities to attain international trainings, conferences and seminars. Going beyond, we have started organizing this type of international conference since 2012 at home also. I hope it will be continued in future as well.

Ladies and Gentlemen,

Following this inaugural session, it is no doubt that, today and tomorrow, a number of resource speakers will deliver their research studies on various themes such as financial sector development, economic growth, poverty alleviation, inclusive finance and financial literacy, exchange rate, international trade and capital flows, credit and capital market, remittances and labor migration, money, banking and financial policies among others. I hope this conference is important not only for presenting the research findings among the scholars and sharing views with the fellow participants but also a good platform for building network in the days ahead to get synergy on intellectual work. Moreover, I hope that you will also manage your time to enjoy the natural beauty and the flavor of Nepalese culture during your stay in Kathmandu.

Finally, I welcome you all once again and look forward to your active participation and sharing of ideas during the conference. I wish you every success in your deliberations and a very pleasant stay in Nepal.

Thank you very much!

Summary Speech of Honorable Finance Minister Dr. Ram Sharan Mahat

*Governor Dr. Yuba Raj Khatiwada
Conference Delegates
Ladies and gentlemen,*

Nepal accelerated the pace of financial liberalization in early 1990s realizing the importance of the sound financial system for overall economic development. The financial sector, thus, broadened and deepened as we witnessed more diversified banks and financial institutions (BFIs), strengthened regulation and supervision, among others. These developments, led to the introduction of a number of prudential norms.

Despite the weak performance of public sector banks until late 1990s, the introduction of financial sector reform measures brought significant changes in Nepal's financial sector in the subsequent years. Consequently, non-performing assets of both public and private banks, has come down to a much lower level and most of the banks are in a profitable position. Besides, loan and asset portfolio has been shifted substantially from public banks to private as only one-third of total loans and advances are now of the public banks. Hence, Nepal's banking system is perceived as healthy and competitive by the stakeholders.

However, there are still some areas to improve. To begin with, there is a challenge of enhancing access to finance and further deepening it into the rural sectors. The cooperatives are now being out of the purview of strong supervision and regulation. Also, we need to identify the risk takers and risk averters and regulate them accordingly.

Following financial liberalization, the economic and financial structure has also evolved significantly over the years. Most importantly, the dependence of external resources for financing has come down to twenty percent from about 40 percent in the initial stage of financial reform. We have attained a lot in the infrastructure, communication and social sectors in line with other economies in the region.

Nepal has also set a target to graduate from least developed country to the developing status by 2022 and two criteria have already been met except the per capita income. We are also in the process to revise our national account estimates to capture new activities, which are yet to be taken into account. As we are rich in natural resources, namely; hydro, bio-diversity and tourism among others, the country's prospect is very optimistic for investment. This will definitely help the overall economic development once the task of state restructuring completed. I hope that this forum would be meaningful to bring a richer discussion in the areas of economics and finance.

Thank you

Keynote Speech on Role of Central Bank in Supporting Economic Growth

Dr. Yuba Raj Khatiwada
Governor, Nepal Rastra Bank

Honorable Minister of Finance
Honorable Vice Chairman of the National Planning Commission
Honorable Members of the National Planning Commission
Board Members of Nepal Rastra Bank
Conference Participants
Distinguished Guests
Media Friends

Ladies and Gentlemen,

It is my privilege to get the opportunity to address this august gathering of intellectuals from Nepal and abroad. Today, I will briefly sketch the role of central banks in enhancing financial stability and supporting economic growth and through its policies and programs. It may be a bit of unconventional wisdom for many; but having financial stability in threat amid weak economic growth, it is evident that real economic growth must support the goal of financial stability. As I have spent my 30 years working at the Central Bank of Nepal and also have had an opportunity to work as a governor of that institution. My remarks are broadly based on the experience and knowledge I have gathered during my career in central bank. Today, I will highlight the theoretical insights, debate and ways the central banks can exercise in promoting economic growth in the economy. In addition, I will share what we have done in the past five years to contribute to economic growth along with maintaining financial stability, and increasing financial access in the Nepalese economy. I think this two-day conference will also discuss and debate around this theme.

It has been well-established fact that macro stability promotes economic growth through the process of reducing business uncertainty and strengthening credibility thus leading to increasing investment in the economy. Hence, existing dominant paradigm is that growth will come as a consequence of following stabilization and responsible monetary and fiscal policy. However, I would like to go beyond that to show the role of central bank in supporting economic growth, which will eventually help price stability and financial system stability in a developing country like Nepal.

Prevailing Theoretical Paradigm and Historical Evidence

In recent years, the dominant theoretical paradigm is that the main function of central bank is to formulate and implement monetary policy for macroeconomic stability, especially price stability. It has been considered that maintaining price stability could promote economic growth by providing stable environment for consumption and investment by anchoring price expectation. As a result, many advanced and emerging countries adopted inflation targeting monetary policy framework, giving sole focus on controlling inflation. Amidst stable and low inflation, however, the world witnessed the global financial crisis of 2007-08 originated in the US, the reason being that low consumer prices do not necessarily prevent the asset price bubble in the property and share markets.

On the assumption of full employment, the quantity theory of money provides the theoretical foundation that money stock directly relates to the price level. Proponents of neo-classical school go further and assert that economic agents are rational and they cannot be fooled. Moreover, real economic activities are determined by real factors, not by monetary factors, no money illusion, hence there is neutrality of money. So, monetary policy, through managing money supply, can only determine the price, not the output. "Rational Expectation" hypothesis of Robert Lucas (1972), and "Time Inconsistency" hypothesis of Kydland and Prescott (1977) advocate the ineffectiveness of monetary policy for promoting economic growth, since economic agents are foresighted and **labour market clears in the market. Time inconsistency" problem implies that the best** monetary policy choice prior to implementation is not necessarily consistent after implementation.

Based on such theoretical developments in the second half of the twentieth century, and experience of stagflation in the early 1970s, monetary policy and central bank started to focus just on inflation. This trend goes further with the adoption of inflation targeting framework since 1990. The focus on inflation means that the central bank should not be concerned with other goals such as promoting employment, supporting industrial policy for economic growth or allocating credit to sectors of special social need. The neoclassical tenets further prescribe that central banks should not also manage exchange rate and capital flows, and provide the credit to the government. All these arguments assume that central banks function independent of the economic environment and they are only technical institution, aloof of other economic issues. The recent financial crisis followed by economic and social crises have exposed these unrealistic assumptions.

A breakdown of Philip curve – inflation and unemployment trade off relation- in the post 1970s provides some empirical background to delineate monetary policy from employment creation. In the 1970s, belief in the effectiveness of monetary policy to fine-tune long-run inflation and unemployment levels began to unravel, both because academic economists changed their theories and because policymakers found that monetary policy was not working as expected (Maxfield, 1997).

However, throughout the early and recent history of central banking in the U.S., England, Europe, and elsewhere, financing governments, managing exchange rates, and supporting economic **sectors by using "direct methods" of intervention were the most important** tasks of central banking (Epstein, 2005). In the past, all central banks, *including* the Bank of England (BOE) and the U.S. Federal Reserve (the Fed) used direct means to support economic sectors (Epstein, 2005).

In addition to monetary policy, central banks have been more or less performing several functions **such as issuing the country's bank notes; acting as the bank of the government and commercial banks; serving as a lender of last resort to the banking and even the financial system as a whole; and allocating credit to promote national goals. Central banks' policies can, hence, have differential** impacts on different classes and groups: workers and capitalists, debtors and creditors, finance and industry, those operating in traded and non-traded goods (Epstein, 2005, 6). We can take examples of many newly industrialized countries where the central bank provided supports to the **government's policy for industrial development in the late 20th century (Amsden, 2000). Amsden** (2000) stresses the important role of finance in the success of these countries, and especially the mobilization and allocation of medium term and long-term finance for industrialization by keeping effective real interest rates low and extending the outreach to credit, for which central banks played the important role.

Ways of Influencing Economic Growth

Let me now elaborate some ways through which a central bank can affect the path of economic growth. As an important financial institution in the economy, central banks can influence economic growth through different channels if it wishes to do. Economic growth is in fact essential for emerging and developing countries to uplift the current state of living standard from acute poverty. Obviously there should be higher, sustainable and inclusive growth for balance development of the society. Central banks shape monetary policy, affect exchange rates, and guard financial stability (Maxfield, 1997), expand financial sector and increase financial access. Central banks can navigate economic variables crucial to national development and growth to high extent, although the roles of central banks alone are not enough. Central banks also play a role in determining the nature of international financial and monetary cooperation.

Some of the growth enhancing channels through which central banks can play the significant role in supporting economic growth in the economy are as follow.

(1) *Monetary and Credit Policy and Economic growth*

Formulating and implementing monetary policy is a prime function of central banks. Monetary policy, efforts to control the supply and price (interest rate) of money, can limit or aggravate economic fluctuations, inflation, unemployment, and growth (Maxfield, 1997). Each of these affects different groups in society differently. Investors are factoring macroeconomic variables into their investment decisions. A stable macroeconomic environment is also critical for a stable and sound development of the financial sector. A stable macroeconomic environment promotes savings necessary to **finance investments**. **The central bank's role in promoting a stable macroeconomic environment is reflected through the formulation and implementation of its monetary policy.**

As part of monetary policy, central bank can control credit growth in the economy. Central banks can use subsidized interest rates, legal restrictions, directed credit and moral suasion to promote credit allocation for particular sectors of national importance. Credit allocation function was even done by major central banks until the 1970s. In order to discourage the flow of resources into speculative borrowing and investment, the central bank can follow a policy of differentiated interest rates or work with government for interest subsidy to loans in certain targeted sectors or individuals. The selective credit controls are more appropriate for controlling and limiting credit facilitates for such unproductive purposes. The selective credit control measures may take the form of changing the margin requirements against certain types of collateral, the regulation of consumer credit and the rationing of credit.

(2) *Financial Sector Development and Economic Growth*

Nexus of between economic growth and financial development has been well-researched with several channels of inter-connections between them (Levine, 1997). The level of financial development is indeed associated with growth and there is very good evidence that the level of financial development affects growth. A famous paper by King and Levine (1993), based on analysis of 80 countries, has found a positive correlation between financial development and capital accumulation, per capita GDP and future growth. Theory and evidence imply that better developed financial systems ease external financing constraints facing firms for investment necessary for higher economic growth (Levine, 2005).

Financial instruments, markets, and institutions help lower the information and transaction costs in economic activities. By ameliorating market frictions, financial arrangements change the incentives and constraints facing economic agents. Thus, financial systems may influence saving rates, investment decisions, technological innovation, and hence long-run growth rates (Levine, 2005). Financial systems naturally influence the allocation of resources across both space and time,

done through financial intermediation, maturity transformation and risk management. Credit is necessary for entrepreneurship development and innovation (Schumpeter, 1934).

Central banks can play a vital role for the development financial system in any economy, especially in the developing country, where the banking system remains as a predominant source of financial services and products. The role of the central bank in promoting financial institutions lies in the design and implementation of policies, which encourage domestic savings to flow to the local financial institutions. Thus, more local resources can be mobilized to finance the investment required for economic growth. As we have seen in the newly industrialized countries, the **state's** main agent for financing investment has been the development bank; sometimes, the whole banking sector in these countries has been mobilized to direct provide long term credit to targeted industries. Many central banks have played a key role to develop such specialized financial institutions in the economy (Amsden, 2000).

(3) *Financial Stability and Economic Growth*

Recent experience of global financial crisis of 2007-08 has showed that stable macroeconomic environment may not be sufficient for financial stability. A stable macroeconomic environment is a necessary, but not sufficient condition for sustainable and higher economic growth.. It is the stable environment in which economic agents turns into speculative and Ponzi state from hedge situation as explained by Hyman Minsky (1992) in his famous "Financial Instability Hypothesis". While hedge state can fulfil all of their contractual payment obligations by their cash flows, speculative finance units cannot repay the principle out of income cash flows, but need to "roll over" their liabilities. It is the Ponzi units for which cash flows from operations are not sufficient to fulfil even interest payments. The greater the weight of speculative and Ponzi finance, the higher is the likelihood of financial instability in the economy (Minsky, 1992).

A stable financial system is a prerequisite for sustainable economic growth. We have seen from the examples of East Asian Financial Crisis of 1997 and the global financial crisis of 2007 how disruptive financial crises could be for economic growth. These crises provide evidence that financial markets are not necessarily efficient and central banks should also focus on financial stability through monetary policy as well as micro and macro-prudential policy. Not only price stability, stable financial system is equally necessary for smooth functioning for economy. Through contagion and cascading effect, any financial disruption can be growth retarding, as it is evident from Euro Zone stagnation.

In the extreme, financial instability involves a public rush to withdraw their deposits from banks which can paralyze the payment system. To prevent possible financial instability, central banks regulate banks and financial institutions with set of regulatory standards, and supervise them (Maxfield, 1997). Key factor for success in creating a stable climate conducive to higher growth is effective banking regulation and supervision. When supervision has failed to detect early warnings of failure in banking institutions, the central bank needs to serve as lender of last resort (Maxfield, 1997) and design appropriate mechanisms to resolve distressed financial institutions. Besides, fiscal authorities are often compelled to rescue the financial system from the crisis thereby creating a trade-off to public resource allocation for development. Hence, the role of central banks cannot be ignored for maintaining financial stability in the economy since our market- based financial system is prone to be unstable.

More importantly, financial stability is an issue that does not concern only the stability of individual institutions, but also has to be viewed from the macro perspective because it has a lot of

interactions and relationships with the conduct of monetary policy¹ Monetary policy is a first line of defense in case of any disruption in the financial system.

(4) *Financial Inclusion and Economic Growth*

Financial inclusion is typically understood as access to formal financial services such as credit, insurance and secure saving opportunities. Lack of financial inclusion is still a serious matter and a major concern for policymakers in developing countries. There could be five types of financial exclusion (Sarma and Pais, 2011) such as (1) access exclusion due to geography and "risk management of the financial system", (2) condition exclusion "due to conditions that are inappropriate for some people," (3) price exclusion due to non-affordability of financial services, (4) marketing exclusion due to the non-attractiveness of conducting business with certain groups within society (lending risk), and (5) self-exclusion, due to "fear of refusal or due to psychological barriers. Central bank should attempt to address all of these exclusions through expansion of financial institutions as well financial literacy.

Access to finance for low-income households can improve poor people's income and overall wellbeing, and in turn spur inclusive economic growth. We can find empirical evidence on positive impact of access to financial service on growth and poverty in a research work of Beck, Demirgüç-Kunt, and Levine (2006). Increasing access to finance requires intervention from government and central bank such as the establishment of special agricultural banks (development banks) and of requirements forcing commercial banks to lend a certain minimum percentage of their loan portfolio to targeted sectors (Gine, 2007) . Microfinance institutions, special vehicles for increasing financial access need support from central banks among others.

Many central banks in developing countries now aim to use financial inclusion to spur economic growth and address inequality. As a global network of 117 central banks and financial regulators working in ninety-four developing and emerging countries, has formed **the Alliance of Financial Inclusion** (AFI) to closely tackle the issue on financial inclusion².

(5) *Foreign exchange Management and Economic Growth*

The central bank manages and controls the foreign exchange and exchange rate policy of the country. It is the function of the central bank to avoid fluctuations in the foreign exchange rates and to maintain stability. Foreign exchange management is also essential for developing countries, because currencies of which are not reserve currencies. For most developing countries that need to import raw materials and spare parts for the purpose of economic development, for which they need foreign exchange, otherwise developing countries face the balance of payments constraint for economic growth as argued by Thirwall (1979). Moreover, maintaining real exchange rate undervalued by the central bank helps promoting economic growth in the economy. Eichengreen (2008), Rodrik (2008) and Berg and Miao (2010) provided empirical evidence on positive relationship between undervalued exchange rate and economic growth.

Nepal's Attempts

Since its establishment in 1956, Nepal Rastra Bank (NRB) has been performing both conventional and developmental role in Nepal. Since the beginning, NRB has been playing an important role on the expansion of financial institutions, and allocating credit to the productive sectors and deprived people. In this process, there has been a big expansion in financial institutions.

¹ http://www.bankofalbania.org/web/pub/M_BLEJER_TEMA_1325_1.pdf.

² <http://blogs.cfr.org/development-channel/2014/05/12/financial-inclusion-a-new-common-ground-for-central-banks/>

Since mid-1960s, NRB started using monetary policy to regulate credit and interest rate in the economy. Until late 1980s, NRB used to apply direct instruments for monetary management like interest rate setting and credit control. In recent years, NRB has been using indirect monetary policy instruments for twin objectives of price stability and external stability as per the new NRB Act 2002. However, along with due consideration on price and external stability, NRB has been paying attention to economic growth as well. We have provisions of refinancing at concessional rate for loans sanctioned for productive sectors. For example, 1 percent refinance rate for export credit and sick industry, and 4 percent for other productive sectors.

Considering the tendency of banks and financial institutions flowing loans to trading and commercial sectors for quick return, we have made the provision of flowing 20 percent of credit to the productive sectors like agriculture, tourism, industries and hydropower in 2011. Out of that, 12 percent of credit portfolio should be in agriculture and hydropower sector. As a result, banks and financial institutions have started providing credits to these productive sectors. Its impact on economic growth is yet to be realized because of protracted period of political instability and infrastructure deficit.

With substantial expansion of financial institutions and their branches after 1990, encouraged by the policy of financial liberalization, the maintaining financial stability has emerged as a challenge for NRB. With the occurrence of problems in some financial institutions amidst rising competition and weak economic growth, NRB has adopted the policy of financial sector consolidation by introducing merger policy in 2012. Since then, 65 banks and financial institutions have merged to become 25 financial institutions. Other several financial institutions are in the process of merging. We think that it will help us to maintain financial stability. In addition, we have introduced regulatory framework of international standards, prompt corrective actions, early warning signal, risk-based supervision and risk management guidelines. NRB also successfully completed the financial sector reform during the period of 2000-2011, in which state-owned banks like Nepal Bank Ltd and Rastriya Banijya Bank, which were in the verge of collapse technically, were restructured. As a result, these institutions are now modernized and their financial status has improved.

Despite the tremendous expansion of financial institution, we feel that financial access and outreach is still limited to urban areas. Hence, in recent years, NRB has been encouraging the establishment of micro-finance institutions and has been providing interest free short-term loans to establish such an institution or to open branches in remote rural and unbanked areas. As of January 2015, 36 micro-finance development banks are in operation. In addition, NRB has established Rural Self-Reliance Fund in 1991 in cooperation with the government to provide wholesale lending to micro-finance institutions at a concessional rate. In addition, since 1991, NRB has made the provision of providing deprived sector lending by mainstream financial institutions with a motive of increasing financial resources to the deprived sector as well as micro-finance institutions. As a result, resource flows to micro-finance has increased.

Concluding Remarks

Let me conclude by saying that central banks can play significant role in supporting economic growth although the dominant paradigm in neo-liberal era is just to support for the role of macroeconomic stability by central banks. Through several ways, as we have historical evidence, central banks can contribute to higher economic growth. However, the impact of central banks' actions depends on many complex factors such as the structure of the domestic economies, institutional development, political stability and governance system. Nobody doubts that along with macroeconomic stability, we need financial stability, access to finance, and sectoral credit allocation for higher economic growth in the economy, for which important roles of central banks

cannot be ignored. In other words, central banks should play effective role to achieve higher economic growth in the economy.

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Presentation Slides of Keynote Speech

*Presented by Dr. Yuba Raj Khatiwada
Governor, Nepal Rastra Bank*

 **Nepal Rastra Bank**

Role of Central Banks in Supporting Economic Growth



Dr. Yuba Raj Khatiwada, Governor, Nepal Rastra Bank

Keynote speech prepared for 2nd International Conference on Economics and Finance, Organized by Nepal Rastra Bank, 26-28 February, 2015, Kathmandu

 **Nepal Rastra Bank**

Outline of Presentation

- Theoretical Paradigm and Historical Evidence
- Channels of Influencing Economic Growth
 - Monetary and credit policy
 - Financial sector development
 - Financial stability
 - Financial Inclusion
 - Forex reserves and exchange rate management
- Nepal Rastra Bank's Initiatives
- Concluding Observations



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Theoretical Paradigm & Historical Evidence

- Dominant theoretical paradigm: main function of central bank to formulate and implement monetary policy for macroeconomic / price stability.
- Price stability to promote economic growth by providing stable environment for consumption and investment by anchoring price expectation.
- Many advanced and emerging economies adopted inflation targeting monetary policy framework, giving sole focus on controlling inflation.
- But..amidst stable and low inflation, the world witnessed the global financial crisis of 2007-08.



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Theoretical Paradigm & Historical Evidence (contd...)

- Quantity theory of money: money stock directly relates to the price level.
- Neo-classical school: economic agents are rational and they cannot be fooled; real economic activities are determined by real factors, not by monetary factors.
- "Rational Expectation" hypothesis and "Time Inconsistency" hypothesis advocate ineffectiveness of monetary policy for promoting economic growth, since economic agents are foresighted and labour market clears in the market.
- Breakdown of Philip curve – inflation and unemployment trade off - in the post 1970s provides empirical background to delineate monetary policy from employment creation.



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Theoretical Paradigm & Historical Evidence (contd...)

- Historically, in U.S.A., England, Europe, and elsewhere shows financing governments, managing exchange rates, and supporting economic sectors by using “direct methods” of intervention were most important tasks of central banking.
- Also central banks’ policies can have differential impacts on different classes and groups: workers and capitalists, debtors and creditors, finance and industry, those operating in traded and non-traded goods.
- Examples from many newly industrialized countries show that central banks provided supports to the government’s policy for industrial development in the late 20th century.



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Channels of Influencing Economic Growth

- **Monetary and Credit policy for economic growth:**
 - enabling stable macroeconomic environment.
 - ensuring credit allocation to productive sector through macro prudential measures
 - differentiated refinance rates, and other directed credit schemes.
 - changing margin requirements against certain types of collateral, regulation of consumer credit.
 - rationing of credit to particular areas.



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Channels of Influencing Economic Growth contd..

- **Financial Sector Development and Economic Growth**
 - Level of financial development associated with economic growth; there is very good evidence that the level of financial development affects growth.
 - Financial systems may influence saving rates, investment decisions, technological innovation, and hence long-run growth rates.
 - Central banks can play a vital role for the development financial system in any economy.



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Channels of Influencing Economic Growth contd..

- **Financial Stability and Economic Growth**
 - Evidence shows: a stable financial system is a prerequisite for sustainable economic growth.
 - But..financial markets are not necessarily efficient; central banks should also focus on financial stability through monetary as well as micro and macro-prudential policies.
 - Economic growth and financial stability are reinforcing: global financial crisis shows stable macro economic environment not sufficient for financial stability.
 - It is the stable economic growth in which financial system runs smoothly and the latter provides economic growth opportunities, at large.



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Channels of Influencing Economic Growth contd..

- **Financial Inclusion and Economic Growth**
 - Five types of financial exclusion such as (1) access exclusion (2) condition exclusion (3) price exclusion (4) marketing exclusion and (5) self-exclusion.
 - Central bank should attempt to address all of these exclusions for inclusive growth.
 - Access to finance ensures inclusive economic growth, and improves poor people's income and overall wellbeing.
 - Financial inclusion widens the base of financial services and ensures sustainability.



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Channels of Influencing Economic Growth contd..

- **Foreign Exchange Management and Economic Growth**
 - Developing countries face the balance of payments constraint for economic growth, particularly when economic growth is highly import intensive.
 - Reasonable forex reserves essential for high economic growth.
 - Exchange rate policy critical for macroeconomic stability and output growth driven by external demand.
 - Maintaining real exchange rate at the right level by central bank essential for promoting economic growth through external sector competitiveness.



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Nepal Rastra Bank's Initiatives

- **NRB Initiatives:** can be summarized into three works
 - **Credit Allocation:** example 20 % of bank credit has to go for specific productive sectors of which 12 % for agriculture and energy.
 - **Easy refinance:** example, refinance for exports at lowest possible rate (1 %). Other refinance rates for productive areas also low (4%)
 - **SME focus:** banks required to have SME desk, more focus on SME lending, women centric credit schemes.
 - **Financial inclusion:** encouraging expansion of micro-finance institutions and bank branch in rural areas,
 - **Other directed credit:** deprived sector lending (4.5% of total credit).



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Concluding Remarks

- Significant role of central banks in supporting economic growth
- Key channels through which central bank support economic growth:
 - Monetary and credit policy for reducing output gap
 - development of financial sector for better financial services
 - Financial stability for higher investment and output
 - Financial Inclusion for broad-based economic growth, and
 - maintaining adequate forex reserves and prudent exchange rate management
- However, the impact of central banks' actions depends on many complex factors such as the structure of the domestic economies, institutional development, political stability and governance system.

Vote of Thanks

Dr. Min Bahadur Shrestha
Executive Director
Research Department, Nepal Rastra Bank

Honorable Finance Minister Dr. Ram Sharan Mahat
Honorable Vice Chairman of the National Planning Commission, Prof. Dr. Govind Raj Pokhrel
Honorable Members of the National Planning Commission
Honorable Governor, Dr. Yuba Raj Khatiwada
Deputy Governor, Mr. Gopal Prasad Kaphle
Board Members of Nepal Rastra Bank
Distinguished Guests
Paper Presenters
Conference Participants from Various Organizations
Media Representatives and Friends

Ladies and Gentlemen,

It is a great pleasure and honor for me to express a vote of thanks to all participants and guests **at the opening session of this "2nd International Conference on Economics and Finance" organized by Nepal Rastra Bank in Kathmandu.**

After the great success of our previous international conference organized in 2012, we are organizing this second international conference on economics and finance. This is a great opportunity for us to present own research findings and get feedback from co-researchers and other participants, and building network for future research work. First of all, I would like to thank paper presenters for showing interest in our conference and giving time for us.

I believe that central banks should be aware of domestic and international economic issues, as well as development in economic theories and empirical findings, as an important financial institution in the economy. Central banks can support for sustainable economic growth by ensuring a stable macroeconomic environment, maintaining financial stability and allocating credit to the productive sectors as eloquently highlighted by Honorable Governor, Dr. Yuba Raj Khatiwada in his keynote address. I am confident that this conference will cover various pertinent economic and financial issues in two days, relevant and useful for policy makers and practitioners.

We do hope that you all interact and share your knowledge in the field of your research or areas you involved. This could be useful to us for broadening our vision in formulation of economic policies.

Ladies and Gentlemen,

On the behalf of Nepal Rastra Bank and the organizing committee of this conference, I would like to express my sincere gratitude to our Chief Guest Honorable Finance Minister Dr. Ram Sharan Mahat for inaugurating this conference and his inspiring remarks.

My heartfelt thanks go to our respected Governor Dr. Yuba Raj Khatiwada for his valuable keynote speech at this inaugural session.

Further, I like to express my indebtedness to Deputy Governor of Nepal Rastra Bank Mr. Gopal Prasad Kaphle and to all the Special Guests for your valuable time given to attend this opening session.

I would also like to express my thanks to all the other distinguished guests, paper presenters, participants and media friends for being here with us at this opening session.

Finally, once again thank you all for your gracious presence at this grand function. And, I would like to close this session and invite you all for hi-tea before the business session of this conference.

Thank you.

Promoting Equitable Economic Growth through Inclusive Finance

**Mr. Ashraf Mahmood Wathra,
Governor
State Bank of Pakistan,**

*Governor Nepal Rastra Bank, Dr. Yuba Raj Khatiwada,
Deputy Governor, Mr. Gopal Prasad Kaphle,
Executive Director, Dr. Min Bahadur Shrestha,
Distinguished Speakers, Ladies and Gentlemen!*

I am honoured and delighted to address this prestigious conference and I would like to express my gratitude to the Nepal Rastra Bank for inviting me to this event.

In my short remarks, I propose to share my thoughts on the need for promoting equitable economic growth among South Asian countries. Also, I would like to share SBP's vision on promoting inclusive economic growth in Pakistan through financial inclusion.

Ladies and Gentlemen!

In recent years, increasing globalization has enhanced the need for regional economic and financial cooperation among countries due to the cross boarder interdependencies and to take advantage of the emerging opportunities. The global financial crisis has pushed most of the emerging economies into most difficult economic challenges in recent history, in many ways;

First, the export-dependent emerging and developing economies were hit hardest as exports from the advanced economies dwindled due to the financial and economic meltdown causing loss of export revenues and reducing incomes in the South Asia and other emerging economies. Slower growth also translated into job loss, and lowering of wages, consumption, and welfare, therefore severely impacting poverty reduction and increasing social vulnerabilities.

Second, the dwindling export earnings and receding foreign capital inflows translated into foreign exchange market pressures, therefore, most of us were challenged while we endeavored to stabilize our foreign exchange markets due to weakening of exports earnings.

Third, the global crisis added to the volatility in international commodity prices thereby raising challenges for monetary management to curtail the inflationary pressures and expectations.

These common challenges must motivate us to strengthen our cooperation at regional level to help our nations sustain and contain future down side risks transmitting from advanced economies.

Ladies and Gentlemen!

The South Asian countries have strong fundamentals to their advantage. Let me highlight some of our strengths: South Asia is home to around 1.7 billion people, with the youth in majority, giving us positive population dynamics for both to grow fast and greater headroom in terms of debt carrying capacity to continue our economic expansion. The combined economy of South Asian region (SAARC) is 3rd largest in the world in the terms of GDP (PPP) after the United States and China and 8th largest in the terms of nominal GDP. Our financial sectors are still underdeveloped

and have a low level of financial leverage, yet these are stable and have shown remarkable resilience against the global crisis. Also, low level of financial sector development reflected in low public and private sector debt relative to GDP indicates potential for continued growth in the financial sector.

Ladies and Gentlemen!

Financial sector development is a pre-requisite for promotion of economic growth. Therefore, I would like to share **SBP's experience in promoting an inclusive financial sector in Pakistan**. Financial access helps the low income households and small businesses better manage their affairs; it spurs local economic activity; and, at a macro-level, the depth of financial intermediation is associated with faster economic growth and less inequality. In the past 15 years, financial access for the low income people has moved from a niche issue pursued by few social entrepreneurs to an important global development agenda. During this time, regional variations notwithstanding, a field focused initially on microcredit broadened first to microfinance, then to access to finance, and most recently to financial inclusion.

Although a late starter in microfinance, Pakistan has kept pace with the changing global trends in policy and practice, and the State Bank of

Pakistan's role has been pivotal in steering the sector with a strategic vision and pursuing a systemic approach in developing the microfinance sector on sound footings.

Pakistan was the first country in South Asia to have issued a Microfinance Law (Microfinance Institutions Ordinance 2001) which paved the way for creation of second tier banks catered to serve the low income segments of the society which were excluded from the mainstream commercial banks. This law widely contributed to the development of the sector and provided legislation for NGOs to transform into SBP supervised deposit taking to protect the depositors and to safeguard these institutions against political and other outside interferences.

As a regulator, SBP introduced specialized microfinance policy and regulatory framework pioneering global best practices. These regulations and supervisory mechanism strengthened the enabling environment to help MFBs develop viable business models to realize sustainable growth in microfinance. The success of microfinance regulations and market development in Pakistan is widely acknowledged by the international community. Our microfinance regulatory framework was ranked No. 1 in the world by the Economist Intelligence Unit (EIU) of the Economist Magazine in its reports in 2010 and 2011, and third best in its annual reports for 2012 and 2013.

In 2007, SBP developed a microfinance strategy to provide critical and long-term support to microfinance sector. The strategy implemented initiatives which led to a significant improvement in market infrastructure for microfinance. Today the sector has Microfinance specific CIB to address the problem of multiple borrowings and over indebtedness. A credit guarantee facility has been put in place which helped largely in building the confidence of commercial banks on the microfinance sector and has mobilized around Rs.13 billion from commercial bank and capital markets / retail investors for onward lending to around 650,000 micro borrowers. The facility has helped develop the market and introduced poor borrowers to mainstream financial institutions. This SBP facility changed the way donor funding was previously used to support microfinance institutions.

As the sector evolved, SBP strengthened the regulatory framework with enhanced focus on financial stability; State Bank revised the Minimum Capital Requirement (MCR) for Microfinance Banks (MFBs) in 2011 while allowing the existing MFBs to raise the prescribed minimum paid-up capital in a phased manner over the next three years. This step ensured that only such sponsors venture to establish MFBs which have adequate financial resources to meet the present and future

capital requirements in face of the growing demand for investments in technology, intensive infrastructure, and information systems. In another significant development, SBP introduced a microenterprise loan category in the year 2012 to promote enterprise lending and improve asset creation in the country. Under this category, Microfinance Banks were able to lend up to Rs.500,000/- to microenterprises.

To overcome geographical barriers in financial inclusion and reduce costs, SBP issued branchless banking (BB) regulations in the year 2008. This initiative catalyzed important branchless banking deployments in the country and resultantly the retail network of microfinance has arisen overwhelmingly through agents and mobile phone channels.

Now let me share the impact of the aforesaid initiatives, most of which have taken place since 2007.

Seven years down the road, the sector is today catering to more than 3.24 million borrowers (as of Sep 2014) out of which MFBs' share is 1.155 million. Depositors have grown to 5.734 million in Dec 2014, with average yearly growth of 69%. Now average loan size has increased from Rs. 10,000 in Dec 2007 to Rs 32,000 in Dec 2014 promising asset creation whereas previously some critics found the low average loan size meant for supporting consumption smoothening. This growth has led to improved ROE from negative 33.2% in Dec 2007 to positive 7.2% in Dec 2013, fetching both domestic and foreign equity injections in the industry.

In area of branchless banking, eight fully-functional models have emerged. Easypaisa is the third largest branchless banking model in the world. With innovative use of technology and partnerships, **these models have started changing the economics of 'banking with the poor'.** Pakistan is experiencing phenomenal growth in the number of branchless banking transactions which have been undertaken at thousands of small shops situated in the streets and local markets across the country to serve common people at convenient time. Average monthly volume of such transactions is estimated to be around 24 million. Average size of these transactions is only Rs.5000 which shows that technological solutions are helping to reach out the millions of previously financially excluded segments of our society.

With strong commitment of the Government, SBP's strategic vision, sound legal and regulatory foundations, robust market infrastructure, technological and institutional innovations, and private sector dynamism, the trajectory of microfinance is set for achieving the long term vision of "financial inclusion for all".

In closing, I would like to say that despite very strong economic reasons for enhancing financial cooperation among the South Asian countries, it will not be easy for the many of us to form a consensus on long-term visions requiring common understanding and efforts. This is because our countries differ in their development levels, their cultures and their languages, and suffering from presence of various historical and political conflicts among them. However, we may begin the process towards financial cooperation and integration, which is a longer term goal, by engaging more actively in research and discussions, in order to arrive at a long-term vision of regional financial cooperation that the South Asian countries can share, and to increase our understanding of that vision. I believe this conference is one such effort and we must continue the dialogue in our bilateral forums and similar events in future.

Thank you all!

Summary of the 2nd International Conference

**By Dr. Min Bahadur Shrestha
Executive Director
Nepal Rastra Bank**

*Honorable Governor Dr. Yuba Raj Khatiwada
His Excellency, Mr. Ashraf Mahmood Wathra, Governor, State Bank of Pakistan
Respected Deputy Governor Mr. Gopal Prasad Kaphle
Conference Chairs and Participants
My fellow colleagues from the Bank
Ladies and Gentlemen*

I am delighted to welcome all of you to this closing ceremony of the Second International Conference on Economics and Finance hosted by Nepal Rastra Bank.

With the major objective of bringing together current studies, research, analysis and thoughts in the area of economics, banking and finance which can be relevant for the policy implications, the call for paper was issued in September 2014. We received total 111 submissions. After the blind review process, the organizing committee selected 75 papers. Out of those, we had 53 full paper submissions. During this 2 day conference, 46 papers have been presented by 50 researchers.

The rich interaction among experts with diverse background and experience has been able to provide new insights and thoughts to the policy makers, particularly relevant for the South Asia region. I thus feel that the objective of the conference of fostering constructive discussion has been fully achieved.

During the parallel sessions, discussions ranged from the role of financial sector development in enhancing economic growth to the issues of financial literacy, corporate governance and external sector policies. I am going to summarize the common ideas and thoughts, which have gathered from the three parallel sessions.

There were four common thoughts, which were raised in a greater or lesser extent during the sessions. The first thought is the reaffirmation of the importance of the broadened and deepened financial sector for spurring economic growth. The participants presented empirical evidences and their country experiences in pointing out the relationship between financial sector policies and its relation to economic growth. The rich discussions suggested that developed financial sector is necessary but not sufficient for broad-based and sustainable economic growth.

The second observation is that the role of central bank, through monetary policy or credit and other financial sector policies, is heightened in the post-financial crisis period but . The role of central bank limits by fiscal and external sectors, coupled with the legacy of economic growth and maturity of the financial system. However, the role is relatively contrasting in developing countries, particularly to the South Asia region. The presentation from Bangladesh, Indian and Nepal was emphasized on the need of access to finance, financial literacy and inclusion for empowerment, entrepreneurship development and poverty alleviation.

The third issue commonly raised was the role and importance of corporate governance in the financial sector for financial and ultimately to economic stability. The discussion on the papers on financial markets, namely, stock market variables and emerging thoughts on innovative banking products suggested that the financial market's products and behaviors do affect the financial stability thereby overall economic development, innovative product and proper financial sector regulation is necessary to address the evolving financing needs and failure in the financial sector.

The last issue discussed on the external sector variables, especially, trade, remittance and foreign investments. Empirical observations and intense deliberations highlighted on the proper channeling of remittances, the importance of foreign investment to finance local projects in the growing globalization and also the causality of external sector and economic growth.

In his inaugural address, Honorable Finance Minister Dr. Ram Sharan Mahat highlighted the growth and development of Nepal's financial sector as well as the importance of deepened and broadened financial sector in economic growth. During the keynote presentation, Honorable Governor of Nepal Rastra Bank Dr. Yuba Raj Khatriwada emphasized on the role of central bank policies, especially, the monetary policy channels, in fostering economic growth. It was our great honor to have Governor of State Bank of Pakistan His Excellency Mr. Ashraf Mahmood Wathra as special guest speaker. During his speech, Governor Wathra highlighted the role of inclusive finance in enhancing economic growth and poverty alleviation.

I believe that the conference has provided new insights in aforementioned areas not only to the attendees of the conferences but also will provide a valuable input for the policy makers and future research works. In this context, I am pleased to announce that we will produce the conference proceedings soon and uploaded on our website. We have provided CD to all the paper presenters and participants which contain all the papers presented in this conference.

Ladies and Gentlemen,

Nepal Rastra Bank publishes NRB Economic Review twice a year. The most recent October issue has been distributed to all of you. The journal includes research papers that include Nepalese case. We would like to request all the paper presenters and participants to submit your research paper for the journal. The guidelines for the submission are available on the NRB website.

Lastly, I would like to thank you all, the session chairs, paper presenters, participants and the members of the secretariat for making this conference successful and fruitful. I also hope your active participation in the future conference to be hosted by Nepal Rastra Bank.

Thank you.

Vote of Thanks

**Director Dr. Prakash Kumar Shrestha
at the Closing Session of the NRB's 2nd International
Conference on Economics and Finance**

*Honorable Governor Dr. Yuba Raj Khatiwada,
Honorable Governor of State Bank of Pakistan, Mr. Ashraf Mahmood Wathra
Respected Deputy Governor and Chairperson of the Conference Organizing Committee,
Mr. Gopal Prasad Kaphle
Executive Director and Member of the Conference Organizing Committee,
Dr. Min Bahadur Shrestha
Other Members of Conference Organizing Committee,
Distinguished paper presenters and conference participants,
My seniors at Nepal Rastra Bank and my fellow colleagues,*

Ladies and Gentlemen,

The conference which started yesterday is ending today after having presentation and discussion of interesting papers in two days. Many persons have involved in making this event successful one. As the member-secretary of the Conference Organizing committee, I take this opportunity to acknowledge their contributions and extend heartfelt thanks to all of them.

I would like to thank Honorable of Finance Minister for inaugurating the conference and delivering a speech as a chief guest yesterday.

I would like to extend my special thanks to Honorable Governor Dr. Khatiwada for delivering insightful keynote speech and inspiring closing remarks. His keynote speech clearly highlighted the role of central banks in supporting economic growth, which is true for the developing countries like Nepal.

I am extremely grateful to the Honorable Governor of State Bank of Pakistan for accepting our invitation and addressing our conference.

I would acknowledge Deputy Governor Mr. Gopal Prasad Kaphle for delivering welcome remarks as the Chairman of the Conference Organizing Committee and providing guidance and leadership. I would also like to thank Dr. Ram Prasad Gyanwaly, Head of Central Department of Economics and Dr. Shiva Raj Adhikari, Associate Professor, Department of Economics, Patan Multiple Campus for providing valuable inputs and times as a member of organizing committee. While all the Members contributed equally, I would like to give heartfelt thanks to Executive Director and Member of the Committee Dr. Min Bahadur Shrestha who provided invaluable advice and feedback regularly.

All the esteemed session chairs also deserve heartiest thanks for sparing time for this conference despite their busy schedule. Without their firm handling of the session, I feel the conference sessions would not have been managed in a timely manner. I would also like to appreciate the contribution of all reviewers of the papers.

More importantly, I would like to give sincere thanks to all distinguished paper presenters and the participants in the conference. I would also like to thank Prof. A.K. Giri for delivering valedictory

remarks on behalf of all the participants. The presenters shared their important works and findings, and had fruitful discussion. The session participants gave their active attention and enriched the discussion. I feel that this event could not have been successful without all of your contributions.

Last but not least, I would acknowledge the contribution of my fellows at the Secretariat and support group who have worked tirelessly to ensure that the event did not have any serious lapses. While all contributed equally, I would highlight my colleagues Mr. Sunil Udash, Director at Research Department, and Mr. Naresh Shakya, Director at Human Resource Department. My special thanks go to both Deputy Director Dr. Dilli Ram Pokhrel and Assistant Director Mr. Guna Raj Bhatta who spent a lot of time since August 2014 for preparing this conference. I would also like to thank Hotel Yak & Yeti and contact person, Ms. Shital Baniya, for extending necessary cooperation for the event.

Let me thank you all once again for bringing this conference successfully to end.

Lastly, I wish all the paper presenters and participants' safe journey back home.

Thank you.

Nepal Rastra Bank
2nd International Conference on Economics and Finance
26- 28 February, 2015

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