NEPAL RASTRA BANK

ECONOMIC REPORT

2001/02

Published By:
Nepal Rastra Bank
Central Office
Research Department
Statistics Division
Baluwatar, Kathmandu
NEPAL
Telephone: 4419804, 4419805, Ext. 357
Web Site: http://www.nrb.org.np

Contents

Acronyms

ACU	:	Asian Clearing Unit
ADB	:	Asian Development Bank
ADB/N	:	Agriculture Development Bank (of Nepal)
AIC	:	Agriculture Inputs Corporation
AMC	:	Assets Management Company
AMC	:	Assets Management Company
BOP	:	Balance of Payments
CIB	:	Credit Information Bureau
CIS	:	Cottage and Small Industries
CIT	:	Citizen Investment Fund
CPI	:	Consumer Price Index
CRR	:	Cash Reserve Ratio
CRRDB	:	Central Regional Rural Development Bank
DICGC	:	Deposit Insurance and Credit Guarantee Corporation (P.) Ltd.
EPF	:	Employees' Provident Fund
ERRDB	:	Eastern Regional Rural Development Bank
FCs	:	Financial Companies
FINCOOPS	:	Financial Cooperatives
FINGOs	:	Financial Non-governmental Organizations
FWRRDB	:	Far Western Regional Rural Development Bank
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
GDS	:	Gross Domestic Saving
GWH	:	Giga Watt Hours
ha	:	Hectares
HMG/N	:	His Majesty's Government of Nepal
ICO	:	International Labour Organization
IFAD	:	International Fund for Agricultural Development
IMF	:	International Monetary Fund
L/C	:	Letter of Credit
LPG	:	Liquid Petroleum Gas
M_1	:	Narrow Money
M_2	:	Broad Money
MT	:	Metric tonnes
MWRRDB	:	Mid Western Regional Rural Development Bank
NBFIs	:	Non Bank Financial Institutions
NBL	:	Nepal Bank Limited
NFA	:	Net Foreign Assets
NGO	:	Non-government Organization
NIDC	:	Nepal Industrial Development Corporation
NOC	:	Nepal Oil Corporation

NRB	:	Nepal Rastra Bank
NRB	:	Nepal Rastra Bank
NUCPI	:	National Urban Consumer Price Index
NWPI	:	National Wholesale Price Index
OBIs	:	Other Banking Institutions
OPEC	:	Organization of Petroleum Exporting Countries
PE	:	Public Enterprise
PSBs	:	Postal Saving Banks
RBB	:	Rastriya Banijya Bank
RDBs	:	Rural Development Banks
RM	:	Reserve Money
RMDC	:	Rural Micro-finance Development Center
RSRF	:	Rural Self Reliance Fund
SAF	:	Structural Adjustment Facility
SDR	:	Special Drawing Rights
SFDP	:	Small Farmers Development Programme
SITC	:	Standard International Trade Classification
TT	:	Telegraphic Transfer
TU	:	Tribhuvan University
VAT	:	Value Added Tax
VDC	:	Village Development Committee
WPI	:	Wholesale Price Index
WRRDB	:	Western Regional Rural Development Bank

Overview of the World Economy

(Annual percent change unless otherwise stated)

	1994	1995	1996	1997	1998	1999	2000	2001
World output	3.7	3.6	4.0	4.2	2.8	3.6	4.7	2.5
Advanced economies	3.4	2.7	3.0	3.4	2.7	3.3	3.9	1.2
Major advanced economies	3.1	2.3	2.8	3.2	2.8	2.9	3.5	1.1
United States	4.0	2.7	3.6	4.4	4.3	4.1	4.1	1.2
Japan	1.1	1.5	3.6	1.8	-1.0	0.7	2.2	-0.4
Germany	2.3	1.7	0.8	1.4	2.0	1.8	3.0	0.6
France	1.9	1.8	1.1	1.9	3.5	3.0	3.6	2.0
Italy	2.2	2.9	1.1	2.0	1.8	1.6	2.9	1.8
United Kingdom	4.7	2.9	2.6	3.4	3.0	2.1	3.0	2.2
Canada	4.7	2.8	1.6	4.3	3.9	5.1	4.4	1.5
Other advanced economies	4.6	4.3	3.8	4.3	2.2	5.0	5.3	1.6
Developing countries	6.7	6.1	6.5	5.8	3.5	3.9	5.7	4.0
Africa	2.3	3.0	5.6	3.1	3.4	2.6	3.0	3.7
Developing Asia	9.6	9.0	8.3	6.6	4.0	6.1	6.7	5.6
China	12.6	10.5	9.6	8.8	7.8	7.1	8.4	7.3
India	6.8	7.6	7.5	5.0	5.8	6.7	5.4	4.3
Asean-4[1]	7.6	8.1	7.3	3.4	-9.4	2.9	5.1	2.6
Middle East and Turkey[2]	0.5	4.2	4.8	5.6	3.9	1.0	5.8	2.1
Western Hemisphere	5.0	1.8	3.6	5.2	2.3	0.2	4.0	0.7
Brazil	5.9	4.2	2.6	3.3	0.2	0.8	4.4	1.5
Countries in transition	-8.5	-1.5	-0.5	1.6	-0.8	3.6	6.6	5.0
Central and eastern Europe	3.0	5.6	4.0	2.6	2.3	2.2	3.8	3.1
Russia	-13.5	-4.2	-3.4	0.9	-4.9	5.4	9.0	5.0
World trade volume	8.8	9.7	6.8	10.5	4.2	5.3	12.4	-0.2
Commodity Prices (US Dollar)								
Oil	-5.0	7.9	18.4	-5.4	-32.1	37.5	57.0	-14.0
Non-fuel	13.4	8.4	-1.3	-3.0	-14.7	-7.0	1.8	-5.5
Consumer prices								
Advanced economies	2.6	2.6	2.4	2.1	1.5	1.4	2.3	2.2
Developing countries	55.3	23.2	15.4	10.0	10.6	6.9	6.1	5.7
Countries in transition	252.5	133.8	42.5	27.3	21.8	44.1	20.2	15.9
Six month (LIBOR[3], percent)								
On US Dollar deposits		6.1	5.6	5.8	5.5	5.5	6.6	3.7
On Japanese Yen deposits	5.1	1.3	0.7	0.7	0.6	0.2	0.3	0.2
On Euro deposits	2.4	5.7	3.7	3.5	3.7	3.0	4.6	4.1
	4.7							

1. Indonesia, Malaysia, the Philippines, and Thailand
2. Includes Malta
3. London inter-bank offered rate

Source: IMF Annual Report 2002

World Economic and Financial Development

During the year 2001, the world economy experienced a synchronized, widespread slowdown after the unusually strong expansion of the previous year. This slowdown reflected a series of intertwined developments including the downward adjustment in equity prices (particularly in the information technology sector), a rise in energy prices, and the tightening of monetary policy in industrial countries in response to the evidence of rising demand pressures. The September 11 terrorist attacks in the United States further weakened the international economy, which had already started to weaken since the end of 2000. This September 11 incident had a substantial influence on macroeconomic conditions, though of temporary nature.

However, in the first few months of 2002, there were increasing signs of global slowdown bottoming out in most regions and that growth was turning up in some of them-most notably in North America and a number of East Asian countries. This reflected the significant easing of macroeconomic policies in the advanced countries in 2001, especially in the United States and in a number of emerging countries in Asia. Inflation remained extremely low almost everywhere, partly mirroring the weakening of growth in 2001. In the case of Japan, the ongoing deflation continued to worsen the already difficult economic conditions.

Financial flows to the emerging market economies were weak through much of 2001. This was basically because of the high concern of investors about risk, particularly in the wake of crisis in Turkey early in the year, the September 11 terrorist attacks, and mounting difficulties in Argentina. The impact of terrorist attacks, however, proved less durable than had been initially feared and the crisis in Argentina led to relatively little contagion to other countries in late 2001. As a result, flows to emerging markets strengthened and risk spreads in the first quarter of 2002. The following are highlights in the world economy during 2001 based on the *Annual Report 2002*, *International Financial Statistics December 2002* and *World Economic Outlook April 2002* of the International Monetary Fund (IMF).

Developments in *commodity markets* dominated because of a series of fluctuations in the price of oil. The oil prices declined by 14 percent in 2001. Such prices in the Organization of Petroleum Exporting Countries (OPEC) remained in the reference band of US$ 22-28 per barrel. The terrorists attacks in September led to a fall in actual and anticipated demand, bottoming out at around US$ 19 per barrel. However, this weakness was largely reversed in the early 2002 as demand revived while OPEC and some non-OPEC members made the further production cuts. During April 2002, prices remained highly volatile around US$ 25 a barrel when a series of largely non-economic factors including increased tensions in the Middle East and political developments in Venezuela raised concerns about supply disruptions. Non-oil commodity prices were generally depressed by 5.5 percent during 2001. Prices of semiconductors fell rapidly through 2001 as demand for information technology goods slumped.

The world *consumer prices* increased by 4.1 percent in 2001. Such increase was 4.3 percent in 2000. Consumer prices both in industrial countries and developing countries increased by a lower rate of 2.2 percent and 5.7 percent respectively. Such increase was 2.3 percent and 6.1 percent respectively in 2000. In contrast, consumer prices in Africa increased at a higher rate of 10.1 percent as against 8.4 percent in 2000. Asian region also experienced an upward trend, though very little, in consumer prices in 2001. Such increase was 2.7 percent against an increase of 1.8 percent in the previous year. The consumer prices increase in China was only 0.3 percent, as consistent to the previous year's level. The Newly Industrialized Asian economies experienced 1.9 percent increase in consumer prices, which was 1.1 percent in 2000. The South Asian region had an increase of 3.9 percent in consumer prices, which was 4 percent in 2000. Bangladesh, India and Pakistan experienced such increase of 1.8 percent, 3.8 percent and 3.8 percent respectively against such increase of 2.3 percent, 4 percent and 4.4 percent respectively in 2000.

The volume of the world trade declined by 0.2 percent in 2001 followed by a fall of 1.5 percent in imports and 1.3 percent in exports in advanced economies. Both imports and exports in developing economies increased marginally by 2.9 percent and 3 percent respectively. Such growths were 16 percent and 15 percent respectively in 2000. The present fall in global trade volume reflected the weakness in economic activity, particularly in manufacturing and, more specifically, information technology sectors that are relatively trade sensitive. Exports in all regions declined being marked in emerging Asia because of the importance of information technology production in the region. Both exports and imports in Newly industrialized Asian economies fell by 5.2 percent and 7 percent respectively.

Financial flows to emerging markets declined in 2001. Portfolio flows was specially affected by outflows from the crisis in Argentina and Turkey, deflation of the information technology bubble and the economic slowdown in the United States. These resulted in a generalized move of investors to higher quality assets with a major blow to the bond markets.

In *the stock market*, unfavorable economic indicators caused severe weaknesses in 2001. However, most major stock markets were returning to double digit growth rates following increased investor confidence on expectations of economic recovery. This increased confidence partly reflected the rapid monetary policy response in industrial countries. Equity prices were broadly unchanged in the United States and Europe owing to concerns over the quality of reported earnings in the wake of the unexpected collapse of Enron and other large corporations. However, emerging Asia performed best on the back of impressive gains by technology companies.

In *foreign exchange markets*, the US dollar remained remarkably strong in 2001. This strength continued in the first quarter of 2002 with an expectation that the US economy would be the first to rebound from the global slowdown. However, the Dollar softened in April 2002 against the background of increased uncertainty in the outlook for corporate earnings and Euro began to strengthen. The Japanese Yen remained strong in 2001/02.

Key Developments in Emerging Market and Industrial Countries

In *Latin American emerging market economies*, growth slowed through much 2001. This was reflected in the slowdown of industrial countries with difficult external financing conditions, which came to a head during the Argentine crisis in late 2001. After the onset of the Argentine crisis, economic developments diverged with extremely difficult conditions in Argentina. However, there were increasing signs of ending slowdown particularly in those countries with the closest trading ties with the United States, including those of the Central America and the Caribbean. The low inflation mirrored both weak activity and improved policy frameworks.

In *emerging Asia*, countries experienced sharp falls in growth in 2001 with exceptions of India and China. This low growth was largely attributed to the external environment including the downturn in the global information-technology industry and oil price movements. The economic and political uncertainties in some countries of Asia also put downward pressure on growth. However, both China and India remained relatively buoyant because of their less dependence on external trade than other economies in the region as well as their strong domestic demand.

In *central and eastern Europe*, economic performance remained well compared with other emerging market regions during the global slowdown. Though the exports weakened in 2001, it was largely offset by robust domestic demand, which was underpinned by lower inflation and interest rates, strong investment spending (often driven by foreign direct investment), and fiscal stimulus in several countries. This pattern of well held-up economic performance was, however, an exception to Turkey. Turkey suffered its worst recession in over fifty years in 2001, with the events of September 11 setting back the immediate signs of recovery.

Countries of the Commonwealth of Independent States remained resilient regarding the growth rates. The average growth rate of these states was 6.25%, the highest growth rate among the major developing and transition country regions. This robust growth was supported by improved macroeconomic stability and policy implementation as well as country specific factors.

Despite the weak external environment, growth in *Africa* was relatively well in comparison to other parts of the world in 2001/02. The growth of this region was the mixed result of: the interaction between commodity market developments, the conduct of economic policies, and the extent of the armed conflict and other form of civil tension. The oil price fluctuations also had varying effects, with higher oil prices supporting the activity of producers and having a harmful effect on the many other commodity exporters in the region.

Growth in *Middle East* slowed considerably in 2001/02 due to the various factors such as the global slowdown, lower oil production and the regional security situation after the September 11 terrorist attacks. Because of the curtailment in oil production, the real GDP of Petroleum Exporting countries depressed on one hand and the security situation dampened activity, including tourism affected the growth particularly in Egypt, Israel, Jordan and the Syrian Arab Republic.

The growth was weak in the *industrial countries*. Both the United States and Canada experienced slowdown in 2001. However, these both economies witnessed recovery in the early months of 2002-with positive growth in the last quarter of 2001 and a substantial acceleration in the first quarter of 2002. Europe also experienced deceleration in activity. Within Europe, activity was particularly weak in Germany and Italy, and relatively more robust in France and the United Kingdom. Activity in Australia and New Zealand remained relatively strong, largely reflecting buoyant domestic demand. In contrast, the Japanese economy suffered its third and most severe recession of the last decade. Though the external factors promoted the slowdown, weakness in domestic demand was also a contributing factor. However, by early 2002, there were signs that the economy was bottoming out.

International Reserve and Use of Reserves

Total reserves of all countries up to the end of 2001 increased by 8 percent and amounted to Special Drawing Rights (SDR) 1729.2 billion. Such reserves up to the end of 2000 was of SDR 1578.5 billion. Non-gold reserves increased by 19 percent and amounted to SDR 1896.3 billion at the end of 2001. Such reserves were of SDR 1545.3 billion at the end of 2000. For all countries, non-gold reserves accounted 98 percent of total reserves. The increase in foreign exchange reserve approximately by SDR 140 billion resulted an increase in non-gold reserves. The gold reserves valued at SDR 35 per ounce amounted to SDR 32.9 billion at the end of 2001. Such reserves were of SDR 33.2 billion at the end of the year 2000. However, the gold reserve valued at the market price of SDR 220.02 per ounce at the end of 2001 amounted to SDR 207 billion, which amounted to SDR 200 billion at the end of 2000 at the market price of SDR 210.64 per ounce.

Use of the IMF Resources

Total use of the Fund credit from the General Resources Account (GRA) amounted to SDR 53.5 billion in 2001, while the use of such credit was SDR 43 billion in 2000. Turkey and Argentina were the largest borrower of the Fund in 2001. These countries borrowed SDR 11.2 billion and SDR 11.1 billion respectively from the Fund.

Repayment in the GRA during the year 2001 totaled 13.3 billion, compared with SDR 15.2 billion in 2000. Korea, Russia and Indonesia made the significant repayments of SDR 4.5 billion, 2.3 billion and 1.4 billion respectively.

Examining the Fund account position up to October 31, 2002; total quota was SDR 212.7 billion of which SDR 130.6 billion (61 percent) was from the industrial countries and the remaining amount was from developing countries.

An Overview of Economic and Financial Performance

The overall performance of the economy did not remain satisfactory in FY 2001/02 due to external as well as internal factors. The gross domestic product (GDP) at 1994/95 prices was estimated to have declined by 0.5 percent both at factor cost and producer's prices. The real GDP growth was negative due to a sharp decline in trade, restaurant and hotel (-10.4 percent) and manufacturing (-10.0 percent) sub-sectors of non-agriculture sector. The growth rate of real GDP stood at 4.7 percent both at factor cost and producer's prices last year. The growth of nominal GDP at both producer price and factor cost increased by 2.7 percent during the review year, which was 8.1 percent and 7.5 percent respectively last year. This year, the ratio of consumption to GDP increased by 3.3 percentage points to 88.4 percent and the ratio of gross domestic saving (GDS) to GDP decreased proportionally to 11.6 percent. The real per capita GDP this year declined by 2.6 percent to Rs. 12,197 whereas nominal per capita GDP increased marginally by 0.4 percentage points to Rs. 17,755. The ratio of total investment to GDP increased marginally by 0.4 percentage points to 24.4 percent during the review year.

Sectorally, the real GDP of agriculture sector at the factor cost grew by 2.2 percent while that of non-agricultural sector declined by 2.1 percent during the review year. In the previous year, the comparable growth rates were at 5.5 percent and 4.3 percent respectively.

With regard to the agricultural sector, a growth of 1.9 percent was recorded in the combined production index of food grains and cash crops in the review year as compared to the growth of 3.9 percent in the previous year. Similarly, growths of 2.3 percent to 6.1 percent were recorded in the livestock products comprising of milk, meat and eggs during the review year. Like wise, the growth rates of other products and fishery were registered at 3.3 percent and 5.2 percent respectively during the review year.

On industrial front, overall scenario was not satisfactory during FY 2001/02 due to internal threat of industrial security and slackness in the world economy. The production index of 33 industrial goods (base year 1986/87=100) increased by 2.6 percent in the review year compared to 5.7 percent increase in the previous year. However, based on export data, the production of exportable goods like garment, carpet and Pashmina witnessed a sharp decline. The number of registered industries remained the same in the review year while the number of licensed industries declined. The total credit disbursement by Nepal Industrial Development Corporation (NIDC) during the review year declined by 8.9 percent mainly due to the lack of financial resources.

The performance of the tourism sector measured in terms of tourist arrivals, average duration of stay, hotel beds and per capita expenditure showed mixed results during the calendar year 2001. In the review year, tourists arrivals by air declined by 21.8 percent due to unfavorable internal as well as external situations. However, per capita expenditure of the tourists increased by 6.8 percent. In addition, the hotel beds capacity and average duration of stay of the tourist remained same as of the previous year's level.

National Urban Consumer Price Index (NUCPI) on annual average basis increased by 2.9 percent compared to an increase of 2.4 percent last year. The price indices of food and beverage, and non-food and services group increased by 3.7 percent and 2.1 percent respectively in the review year compared to a decline of 2.3 percent and a sharp rise of 8.1 percent respectively in the previous year. The annual average inflation in Terai, Hills and Kathmandu Valley recorded a rise of 3.4 percent, 2.5 percent and 2.0 percent respectively in the review year and these rates were 1.1 percent, 5.2 percent and 3.2 percent respectively in the previous year. Prices of food and beverages drove up the overall index in the review year.

In the external sector, the policies adopted during FY 2001/02 concentrated mainly on facilitation of foreign exchange and prevention of abuse of foreign exchange. During the review year, total exports declined by a higher rate than total imports. However, trade deficit widened slightly owing to the large volume of imports. During the review year, net service income declined sharply resulting into the marked deterioration of current account, despite a significant increase in net transfer receipts. As a consequence of deterioration in current account and lower surplus recorded in capital account, overall balance of payments (BOP) remained in deficit.

In the export front, total export declined by 15.6 percent to Rs 47.0 billion as against an increase of 11.7 percent during the previous year. Regionwise, export to India increased by 7.4 percent as against a heavy growth of 22.7 percent a year ago. On the other hand, export to other countries which had increased by 3.6 percent during the preceding year, registered a negative growth of 35.9 percent during the review year. Total imports also declined by 7.2 percent to Rs 107.4 billion during the review year as against an increase of 6.6 percent in the previous year.

In the review year, trade deficit expanded marginally by 0.7 percent and stood at Rs 60.4 billion as compared to an expansion of 2.3 percent during the preceding year. Current account deficit stood at Rs 20.8 billion in the review year compared to a much lower deficit of Rs 11.0 billion in the previous year. On the capital account, net foreign capital of Rs 17.5 billion was received during the review year. In this account, official capital net registered a decline of 57.5 percent and stood at Rs 3.0 billion. However, miscellaneous capital item net reflected an inflow of Rs 14.5 billion during the review year compared to an inflow of Rs 9.2 billion in the previous year. Consequently, net position of external payments resulted in a deficit of Rs 3.3 billion compared to a surplus of Rs 5.2 billion in the preceding year.

The net position of convertible foreign exchange resulted in a surplus of Rs 5.1 billion during the review year compared to a surplus of Rs 7.3 billion last year. Total income declined by 15.2 percent while total expenditure went down by 13.9 percent in the review year. In the preceding year, total income and expenditure had gone up by 39.8 percent and 55.6 percent, respectively.

Net foreign assets (NFA) of the banking system recorded an increase of 0.7 percent and reached to Rs 88.4 billion at the end of the review year compared to an increase of 9.1 percent in the preceding year. NFA of Nepal Rastra Bank (NRB) increased by 8.2 percent while that of commercial banks went down by 42.9 percent during the review year. In the preceding year, NFA of NRB had increased by 14.8 percent and that of commercial banks had declined by 15.5 percent.

In the fiscal front, the government budget for FY 200/02 was prepared in the backdrop of strong commitment of the government in improving the economy. FY 2000/01 witnessed an impressive growth of GDP, satisfactory revenue collection, rising regular and development expenditure and high fiscal imbalances. The revised estimate of the government budgetary operations in FY 2001/02 reflected a fiscal deficit of Rs.16.7 billion, 9.5 percent lower than that of the previous year. During the review year, total government expenditure and investment increased by 2.7 percent while total resources grew by 6.9 percent. As percent of GDP, total expenditure and total resources stood at 17.6 percent and 13.6 percent respectively resulting in the fiscal deficit of 4.0 percent.

In the review year, tax revenue increased by 3.9 percent reflecting an achievement of 85.6 percent of its target and non-tax revenue by 2.9 percent, with 62.7 percent realization of its target. On the expenditure side, regular expenditure increased 15.1 percent due to the increasing debt servicing of external loan and increasing obligation on social security whereas development expenditure during the review year, declined by 10.3 percent. Regarding the public debt, the stock of the total outstanding debt amounting to Rs.293.7 billion at mid-July 2002. The outstanding debt to GDP ratio was 65.8 percent in the review year compared to 63.5 percent last year.

National Wholesale Price Index (NWPI) comprising agriculture, commodities, domestic manufactured commodities and imported commodities with weights 49.6 percent, 20.4 percent and 30.0 percent respectively was developed and being published by the NRB since the beginning of FY 2001/02.

In NWPI (base year: 1999/00) on annual average basis increased by 4.9 percent during FY 2001/02 compared to a rise of 1.4 percent during the preceding year. WPI for agriculture, domestic, manufacture and imported commodities increased by 7.6 percent, 5.5 percent and 0.6 percent respectively in the review year.

Inflation remained within the limit, despite a reduction in bank rate and refinance rate at the beginning of the review year. The bank rate was cut by 100 basis points from 7.5 percent to 6.5 percent, and the refinance rates against foreign currency export loans and sick industry loans were fixed at 4.0 percent and 4.5 percent respectively. In continuation of flexible monetary policy stance, NRB further cut the bank rate and the refinance rate by 100 basis points to 5.5 percent and 6.5 percent in December 2001. Similarly, cash reserve ratio (CRR) on average was cut by 100 basis points from 10.0 percent to 9.0 percent. NRB, in accordance with the provision made in NRB Act, 2002, announced annual monetary policy and program for the first time on 16 July 2002. Reduction in CRR by one percentage point, removal of the ceiling on interest spread of 5 percent between lending and deposit rates, allocation of Rs 100.0 million from the NRB profit of 2001/02 to Rural Self Reliance Fund (RSRF), a refinance facility of Rs 1.5 billion for sick industry and gradual removal the priority sector lending program ware the major highlights of the monetary policy 2002/03. Structural reforms of Rastriya Banijya Bank (RBB) and NRB, establishment of Assets Management Company (AMC), prudential norms for commercial banks regarding equity investment in other banks and financial institutions sale and transfer of shares, minimum paid up capital were also announced on 16 July 2002.

Real Sector Development

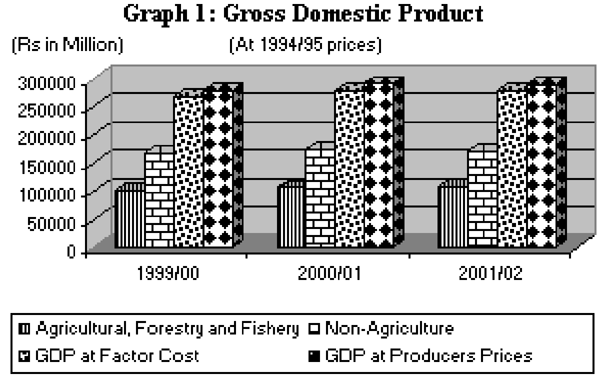
Overall GDP Growth

The performance of the Nepalese economy in terms of GDP remained unsatisfactory during FY 2001/02. The economic activities, in particular trade, tourism and manufacturing sub-sectors, slowed down due to both internal and external factors. As a result, the real GDP both at factor cost and producer's prices declined by 0.5 percent and reached Rs 278.5 billion and Rs 289.2 billion respectively compared to a higher growth of 4.7 percent in both measures of GDP during the previous year.

The real GDP of agriculture sector at factor cost grew by 2.2 percent while that of non-agricultural sector declined by 2.1 percent. In the preceding year, the comparable growth rates were 5.5 percent and 4.3 percent respectively. The negative growth of non-agriculture sector during the review year was attributed mainly to the negative growth rates in trade, restaurant and hotel (10.4 percent) and manufacturing (10.0 percent) sub-sectors. The finance and real estate sub-sector showed a relatively higher growth rate of 3.3 percent followed by transport, communication and storage (1.9 percent), electricity gas and water (1.7 percent), community and social service (1.7 percent), constructions (1.7 percent) and mining and quarrying (1.0 percent).

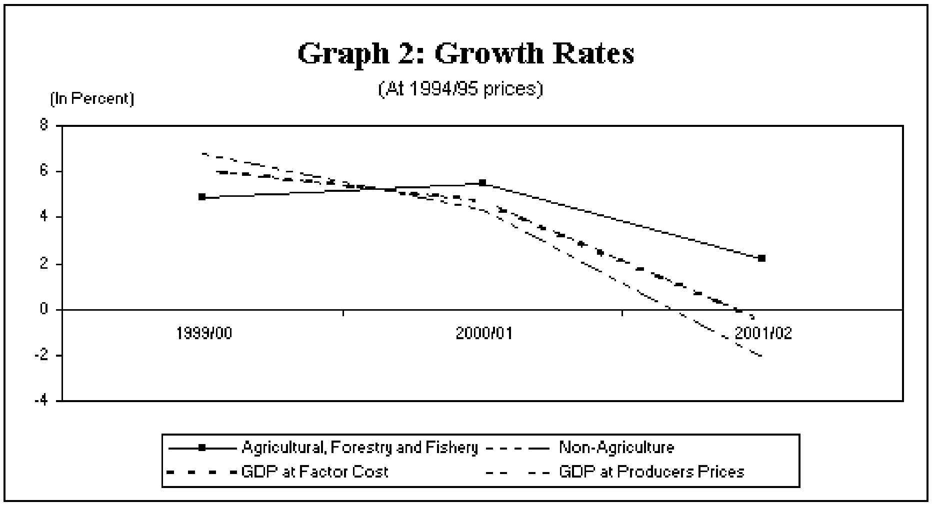
With regard to the composition of GDP, the share of agriculture sector to real GDP increased marginally to 39.0 percent while the share of non-agriculture sector declined correspondingly to 61.0 percent due to the negative growth of this sector during the review year.

Graph 1: Gross Domestic Product



During the review year, the nominal GDP at producer's prices increased by 2.7 percent and that at factor cost increased by 2.8 percent to Rs. 421.3 billion and Rs.

404.4 billion respectively. The nominal GDP at producer's prices and factor cost went up by 8.1 percent and 7.5 percent respectively in the previous year. Sector-wise, the nominal agriculture and non-agriculture sector GDP recorded a growth of 6.0 percent and 0.8 percent respectively. The respective growth rates in the previous year were 4.1 percent and 9.7 percent.



Consumption, Investment and Savings

During FY 2001/02, total consumption increased by 6.4 percent due to the increase in both public and private consumption. The ratio of private consumption to GDP went up by 2.9 percentage points during FY 2001/02. As a consequence, the ratio of total consumption to GDP increased by 3.1 percentage points to 88.2 percent while GDS to GDP ratio decreased correspondingly to 11.8 percent. The GDS declined by 18.4 percent to Rs. 49.8 billion compared to a growth of 6.0 percent during the previous year. The investment to GDP ratio increased marginally by 0.6 percentage point to 24.6 percent in the review year while the rate of investment decelerated by 1.1 percentage points to 5.4 percent due to the deteriorating internal security situation.

The real per capita GDP in FY 2001/2 registered a decline of 2.7 percent to Rs. 12,216 compared to an increase of 3.6 percent in the preceding last year. However, the nominal per capita GDP increased marginally by 0.4 percent to Rs. 17,800.0 (Table 1).

Agriculture Production

Agriculture production also remained less satisfactory in the review year despite the normal weather condition in most parts of the country. The overall production index of principal food grains and cash crops moved up just by 1.9 percent in the review year compared to 3.9 percent rise in the previous year.

The production of livestock and other crops remained normal during the review year whereas the production of fishery increased satisfactorily by 5.2 percent in the review year compared to an increment of 4.9 percent in the previous year.

Foodgrains

In FY 2001/02, weighted production index of principal foodgrains (consisting of paddy, wheat, maize, millet and barley and occupying one-third share in total agricultural production) rose marginally by 0.7 percent compared to 2.8 percent increase in the previous year. The total production of principal food grains stood at 7,247 thousand metric tones (MT). The production of paddy decreased by 1.2 percent to 4,165 thousand MT during the review year due to unfavorable weather condition in the eastern part of the country. In the previous year, the production of paddy had increased by 4.6 percent. The maize production in the review year, increased by 1.8 percent to 1,510.8 thousand MT compared to 2.7 percent rise in the previous year. In FY 2001/02, the wheat and barley production increased by 8.7 percent to 1,258 thousand MT and by 2.4 percent to 31 thousand MT respectively. However, the production of millet came down marginally by 0.1 percent to 283 thousand MT in the review year. In the previous year, wheat, millet and barley had shown negative growth rates.

Cash Crops

The weather condition favoured the cash crops and, as a result, the production of major cash crops increased in the review year from previous years' level. The production index of the principal cash crops comprising sugarcane, oil seeds, tobacco, jute and potato increased by 7.6 percent compared to a higher growth of 9.1 percent in the previous year.

The production of sugarcane and oilseeds increased by 1.6 percent to 2,448 thousand MT and by 2.0 percent to 135 thousand MT respectively while the production of potato surged up significantly by 12.1 percent to 1,473 thousand MT. The corresponding growth rates in the previous year were 5.2 percent, 7.8 percent and 11.1 percent respectively. The production of jute increased by 3.0 percent to 16.9 thousand MT.

However, the production of jute and tobacco recorded a negative growth of 2.4 percent to 16 thousand MT and 5.3 percent to 4.0 thousand MT respectively compared to the positive growth in the previous year.

Production of Other Agricultural Crops, Livestock and Fishery

The total production of other agricultural crops, viz., pulses, fruits and vegetables which contribute around 22 percent to the agricultural GDP, increased by 3.3 percent in the review year compared to 9.6 percent rise in the previous year. The production of vegetables increased by 5.1 percent to 1,738 thousand MT, while the production of pulses increased by 2.9 percent to 250 thousand MT. However, the production of fruits declined by 2.8 percent to 474 thousand MT.

The livestock sector, which contributes around 28 percent to the agricultural GDP, showed a positive growth during the review year. The production of milk, meat and eggs increased by 3.1 percent to 1,159 thousand MT, by 2.4 percent to 199 thousand MT and by 6.1 percent to 538 million. Similarly, the production of fishery increased by 5.2 percent to 35 thousand MT during the review year. During the previous year also, all these products had witnessed a positive growth.

Area Under Principal Crops

In FY 2001/02, the total area under cereal and cash crops decreased marginally by 0.4 percent in comparison to the previous year's level. Of the total cultivated area, the area under cereal crops decreased by 0.5 percent to 3296 thousand hectares (ha.) while the area under cash crops increased marginally by 0.3 percent to 393 thousand ha. in FY 2001/02. During the review year, the area under paddy and millet declined by 2.8 percent and 0.7 percent respectively. However, the area under wheat and maize increased by 4.1 percent and 0.2 percent respectively. But the area under barley remained constant at last year's level of 28 thousand ha.

Under the cash crops, the cultivated area under sugarcane remained constant while that of potato increased by 1.6 percent. The area under oilseeds, tobacco and jute declined by 0.3 percent, 9.8 percent and 7.5 percent respectively in FY 2001/02.

With regard to the composition of total cultivated area during the review year, 89.4 percent was under principal cereal crops and the remaining 10.6 percent was under cash crops. The area under paddy alone occupied 46 percent of the total cultivated area under principal cereal crops while the area under oil seeds occupied 48.0 percent of the total cultivated area under cash crops.

Productivity of Principal Crops

With regard to productivity, positive trend has been observed in both principal food grains and cash crops except for Jute in FY 2001/02. Crop wise, the productivity of paddy in the review year increased to 2.75 MT per hectare compared to the yield of 2.70 MT per ha. in the previous year. Likewise, the productivity of maize, wheat and barley also slightly improved to 1.83 MT 1.89 MT and 1.13 MT per ha. respectively. The corresponding yields per hectare in the previous year were 1.80 MT, 1.81 MT and 1.08 MT respectively. But the productivity of millet remained constant at 1.09 MT per ha. in the review year.

Among the cash crops, the per hectare productivity of sugarcane, oil seeds, tobacco and potato improved slightly during the review year to 37.80 MT, 0.72 MT, 0.99 MT and 11.23 MT respectively. However, the productivity of jute declined marginally to 1.44 MT per ha. during the review year. (Table 3 and 4)

Livestock Population

During the review year, total livestock population (in number) increased by 4.6 percent to 41 million compared to a rise of 3.7 percent in the previous year. The population of cattle, sheep and ducks declined by 0.1 percent to 7 million units, by 1.2 percent to 0.8 million units, and by 0.7 percent to 0.4 million units respectively. While the population of buffaloes, goats, pigs and fowls increased by 2.1 percent to 3.7 million units, by 2.0 percent to 6.6 million units, by 2.4 percent to 0.9 million and by 8.0 percent to 21.4 million units respectively (Table 3 (a)).

Irrigation and Agricultural Inputs

The area under irrigation facility expanded remarkably by 63.1 percent to about 18 thousand ha. in FY 2001/02. The total supply of chemical fertilizers through Agriculture Inputs Corporation (AIC) [private sector involvement not included] decreased by 7.0 percent to 21964 (nutrient) MT during FY 2001/02. However, the supply of nitrogen declined by 27.7 percent during the review year. The supply of phosphorous increased remarkably by 32.1 percent and the supply of potash increased significantly by 16 times during the review year. In the previous year, the supply of nitrogen, phosphorous and potash had declined by 34.5 percent, 40.2 percent and 81.1 percent respectively. The sale of improved seeds registered a remarkable increase of 45.5 percent to 2,756 MT against the decline of 26.7 percent in the previous year.

The disbursement of agricultural credit by the Agriculture Development Bank (ADB/N) increased by 9.3 percent to Rs. 8.8. billion in the review year. The credit disbursed to agro-business and agro-industry, marketing and warehouse construction increased by 16.5 percent and 20.2 percent respectively during the review year. However, credit to agricultural production, and farm mechanization and irrigation decreased by 1.8 percent and 7.3 percent respectively (Table 5a).

Manufacturing

The overall situation of industrial sector was not satisfactory during FY 2001/02 due to deterioration of internal security and slackness in global economy. The production index of 33 industrial goods (base year 1986/87 = 100) increased by 2.6 percent compared to 5.7 percent in the previous year. However, based on the export figure, the production of non-indexed items like readymade garment, woolen carpet and Pashmina declined sharply by 40.4 percent, 27.7 percent and 69.8 percent respectively during the review year due to low demand in the international market.

Among 15 manufacturing groups under the index, production of 11 groups increased at the rates ranging from 0.2 percent to 4.9 percent, while the production of other 4 groups declined at the rates ranging from 0.6 percent to 3.5 percent during the review year.

Similarly, among 15 manufacturing groups, foot wear manufacturing (4.9 percent), other non-metallic mineral products (4.9 percent), food manufacturing (4.1 percent), manufacturing of rubber products (4.0 percent), manufacturing of cutlery and equipment (3.6 percent), manufacturing of electrical appliances (3.3 percent) and iron and steel based industries (3.0 percent) witnessed relatively growth rates.

Likewise, wood and wood products (2.0 percent), manufacturing of plastic products (2.0 percent), manufacturing of other chemical products (1.2 percent) and manufacturing of textile (0.2 percent) were the groups with growth rates below 3 percent.

Productwise, 18 items registered a positive growth while 13 items showed a negative growth. The production of the remaining two items viz., straw board and agricultural tools registered constant growth rates. The production of the items such as noodles, cement, tea and sugar showed relatively higher growth rates ranging from 5.0 percent to 11.2 percent. The production of GI/HB wires, steel utensils, shoe, slipper, plywood, vegetable ghee, animal feeds, iron rod and angles, dry-cell battery, plastic goods, synthetic clothes, soap, matches and detergent powder registered a nominal growth rate ranging from 1.0 percent to 4.9 percent. While the production of bidi, cotton clothes, liquor, ACSR conductor/ PVC cable, jute goods, beer, squash, biscuits, soft drinks, cigarette, processed leather, paper and bricks and tiles declined by the rates ranging from 0.6 percent to 34.5 percent. The decline in the production of most of these industries is attributable to the growing competitive environment, imports of the competitive goods at a cheaper price from abroad, insecurity and low demand in local as well as external markets.

During the review year, the production of noodles, sugar, tea, cement, and wires increased due to the increase in the domestic demand as well as the increase in the export to the neighboring countries. The production of bidi, beer, liquor, cotton clothes, jute goods and squash declined due mainly to closure of some factories, cheaper import from abroad and insecurity.

During the review year, 111 new industries were registered with a total capital investment of Rs. 20.6 billion.

Industrial Credit

The credit disbursement of NIDC has been declining since FY 1996/97 due to lack of resources and poor recovery of the outstanding credit. The disbursement of industrial credit went down by 8.9 percent to Rs. 74.3 million in FY 2001/02. Credit disbursement to hotel, service and other industries declined by 34.8 percent, 14.1 percent and 28.3 percent respectively. However, credit disbursement to manufacturing sector increased by 58.1 percent in the review year.

Tourism

The performance of tourism sector measured in terms of tourist arrivals, average duration of stay, occupancy of hotel beds and per capita expenditure showed a mixed trend in the calendar year 2001. The number of tourist arrivals registered a decline of 21.8 percent (363 thousand persons) in comparison to 5.7 percent decline last year. The number of tourist arrival declined due to internal as well as external factors. The number of tourists by air from India and other countries declined by 31.9 percent and 19.2 percent respectively due to internal insecurity, September 11 attack in US, India-Pakistan tension, war against terrorism, etc. The share of Indian tourists in the total tourist arrivals declined to 18.0 percent from the previous year's level of 20.7 percent while the share of other countries in the total tourist arrivals increased to 82.0 percent from the previous year's level of 79.3 percent.

However, per capita expenditure of the tourist went up by 6.8 percent to Rs. 34,345. The hotel bed capacity (i.e. number of hotel beds) remained same as of previous year. With regard to the average duration of stay, there was no change during the review year from the last year's level of 12 days.

Petroleum Product

Nepal Oil Corporation (NOC) imported 63578 kilolitres of petrol, 287,657 kilolitres of diesel, 390,113 kilolitres of kerosene and 48,757 MT of liquefied petroleum gas (LPG) in the review year as compared to 60,653 kilolitres of petrol, 333,791 kilolitres of diesel, 325,198 kilolitres of kerosene and 40,102 MT of LPG in the previous year. The import of petrol, kerosene and LPG, in the review year, witnessed increments of 4.8 percent, 20.0 percent and 21.6 percent respectively as compared to the corresponding imports of the previous year. However, the import of diesel, in the review year, witnessed a decline of 13.8 percent as compared to that of the previous year.

Similarly, the corporation sold 63,271 kilolitres of petrol, 286,233 kilolitres of diesel, 386,593 kilolitres of kerosene and 48,757 MT of LPG in FY 2001/02. In the previous year, 59,245 kilolitres of petrol, 322,060 kilolitres of diesel, 316,381 kilolitres of kerosene and 40,102 MT of LPG was sold. The sale of petrol, kerosene and LPG, in the review year witnessed increments of 6.8 percent, 22.2 percent and 21.6 percent respectively as compared to the corresponding imports of previous year. However, the sale of diesel, in the review year witnessed a decline of 11.1 percent as compared to that of the previous year.

Electricity

The hydro-power generation (including import) increased by 11.73 percent to 2,087.61 Giga watt hours (GWH) during the review year as compared to 1,868.42 GWH last year. Nepal imported 237.78-gwh electricity registering an increase of 4.96 percent as against the import of 226.54 GWH during the previous year. Likewise, Nepal exported 142.9 GWH electricity to India in the review year. The total export in the previous year was 126.0 GWH.

Inflation

Consumer Price Index (CPI)

The rate of inflation during FY 2001/02, as measured by the NUCPI (1995/96 = 100) on annual average basis, registered a rise of 2.9 percent compared to an increase of 2.4 percent in the preceding year. On point-to-point basis, (Jun/Jul 2001 and Jun/Jul 2002), the rate of inflation increased by 3.5 percent compared to the 3.4 percent rise in the previous year.

During the review year, the index for food and beverages group increased by 3.7 percent compared to a decline of 2.3 percent in FY 2000/01 and the index for non-food and services group rose by 2.1 percent compared to a sharp rise of 8.1 percent in the preceding year. The main reasons for relatively a higher growth rate in the food and beverages group were : (i) negative growth rate (1.2 percent) of paddy production, (ii) higher growth rate of prices of beverages and oil related products due to additional tax imposed by the government and price rise in international markets, and (iii) continuous increase in the prices of pulses, meat, fish and eggs.

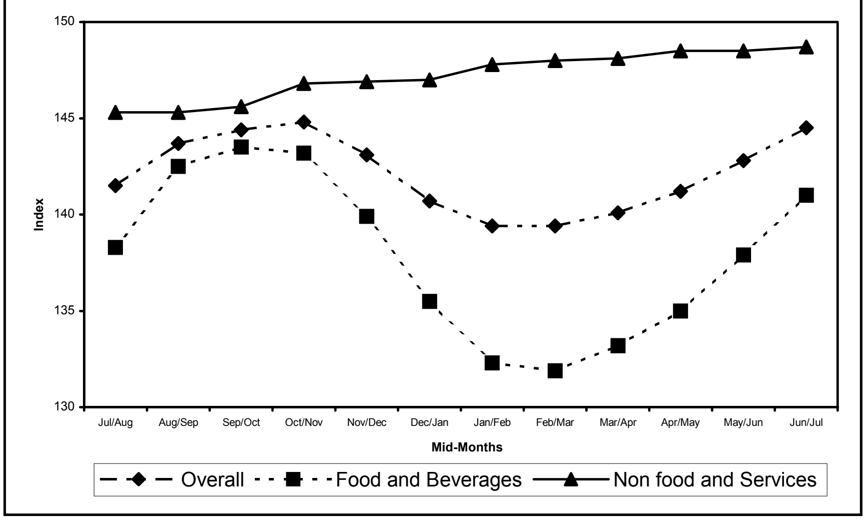
Regionwise, the annual average rates of inflation in Terai, Hills and Kathmandu Valley were 3.4 percent, 2.5 percent and 2.0 percent respectively. Whereas the rates were 1.1 percent, 5.2 percent and 3.2 percent respectively last year.

Seasonal Price Movement

According to monthly price movement of NUCPI for the review year, it could be divided into three phases of price.

As depicted in the chart below, the overall index shot up by 2.3 percent during July/August to October/November. In this period, the price indices for the food and beverages and non-food and services groups went up by 3.5 percent and 1.0 percent respectively. During the period Nov/Dec to Feb/Mar, the overall index decreased by 2.6 percent, of which food and beverages group index declined by 5.7 percent, while the non-food and services group index increased by 0.8 percent. For the period March/April to June/July, the price level increased by 3.1 percent. During the period, the food and beverages index rose by 5.9 percent and the non-food and services by 0.4 percent.

Graph 3: Seasonal Price Movement of FY 2001/02



Price Movement of Sub-groups of Commodities

All the sub-groups' indices under food and beverages group moved up. The increment was within the range of 1.2 percent to 8.3 percent. Notable increment was in the indices of oil and ghee (8.3 percent) and vegetables and fruits (7.5 percent). The indices for other sub-groups such as sugar and related products, beverages, meat, fish and eggs and restaurant meals increased by 5.9 percent, 5.0 percent, 4.1 percent and 3.3 percent respectively.

The index for grains and cereals products moved up by 2.1 percent in the review year whereas it had declined sharply by 13.7 percent in the preceding year. The negative growth rate (1.2 percent) of paddy production was the main reason for such pressure on prices of grain and cereal products.

The index for vegetables and fruits went up by 7.5 percent in the review year compared to 4.1 percent increase in the preceding year. In the review year, the production of fruits declined by 3.0 percent due to the unfavorable weather conditions, which was responsible for he increase in the prices of fruits. The Wholesale Price Index (WPI) of vegetables and fruits, in India also, recorded a rise of 18.1 percent in FY 2001/02.

A remarkable price rise was observed in oil and ghee sub groups. During the review year, the index of this group moved up by 8.3 percent, while such index had declined by 4.7 percent last year. Increase in the prices of edible oil, soybeans and oil seeds in the international markets as well as in India (Indian WPI of edible oil increased by 9.2 percent in the review year) and additional taxes were the major reason for such a price rise.

The index for non-food and services group rose by 2.1 percent as compared to 8.1 percent rise in the preceding year. Relatively higher price rise occurred under the sub-group of medical and personal care (6.2 percent) and tobacco and related products (4.6 percent). Similarly, the indices for cloth, clothing and sewing services, housing and transport/ communication increased by 2.5 percent 1.4 percent, and 2.5 percent respectively. The indices for education, reading and recreation and fuel, light and water observed a negative growth of 1.3 percent and 0.9 percent respectively.

A continuous increase in medical Doctor's fee and other medical services specially in private sector remained the main reason for such increase in the index of medical and personal care. Similarly the price index of tobacco and related products went up due mainly to increase in the excise duty on tobacco related products and as a result, the production of tobacco declined by 5.3 percent in the review year.

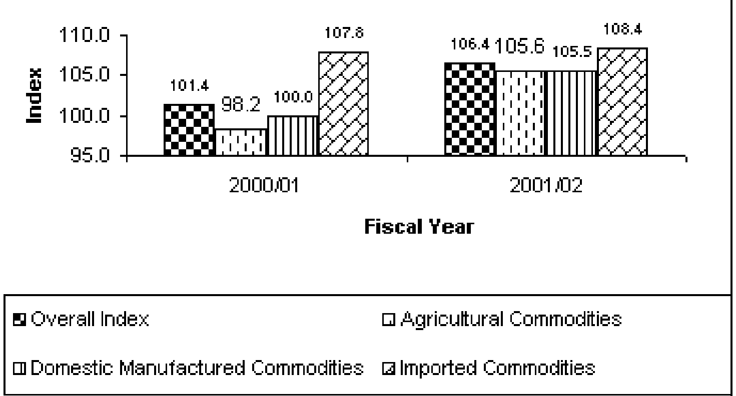
In FY 2001/02, private and government schools and colleges reduced their fees and other annul charges which contributed to scale down the index of education, reading and recreation by 1.3 percent in contrast to 14.0 percent rise in the preceding year.

NWPI

The NWPI was constructed in order to measure the directional movements of prices for a set of selected items in the primary and wholesale markets. There was only NUCPI prior to FY 2001/02 in measuring the overall price situation and inflation in the country. Since the beginning of FY 2001/02 the NRB started publishing NWPI (Base Year: 1999/00 = 100) on monthly basis regularly. The NWPI comprises of three major groups with their respective weight namely (i) agricultural commodities (49.6 percent), (ii) domestic manufactured commodities (20.4 percent) and (iii) imported commodities (30.0 percent). All together 415-price quotations of 71 commodities are collected from 20 different market centers. The annual average index constructed on the basis of Laspeyres' revised formula. The NWPIs for the FY 2000/01 and 2001/02 are presented in the following graph.

The NWPI (base year: 1999/00 = 100) on annual average basis, increased by 4.9 percent during FY 2001/02 compared to a rise of 1.4 percent in the preceding year. Groupwise indices for agricultural commodities, domestic manufactured commodities and imported commodities moved up by 7.6 percent, 5.5 percent and 0.6 percent respectively.

Graph 4: NWPI



Last year the index of imported commodities had increased by 7.8 percent whereas the index of agricultural commodities had declined by 1.8 percent and the index of domestic manufactured commodities had remained constant.

Under the agricultural commodities, on point-to-point annual basis, the index of cash crops increased remarkably by 27.5 percent due mainly to higher prices of potato (38.7 percent), oilseeds (11.7 percent), sugarcane (3.8 percent) and jute (2.3 percent). The indices of food grains, pulses, spices, livestock production and fruits/vegetables moved up by 6.2 percent, 6.1 percent, 5.0 percent, 4.4 percent and 1.6 percent respectively. The indices of all four sub-groups under domestic manufactured commodities increased by a range of 1.4 percent to 7.7 percent on yearly basis. Likewise, under the imported commodities out of seven sub-groups, four sub-groups (petroleum products and coal, transport vehicles and machinery goods, medicine and electric/electronic goods) indices declined by 0.1 percent to 2.3 percent whereas the indices of chemical fertilizers and chemical goods (11.3 percent), textile related products (1.2 percent) and others (0.7 percent) went up.

The annual growth rate of NWPI remained higher than the NUCPI. Some important common commodities' (rice, maize, pulses, vegetables, fruits, milk, buffalo meat, mustard oil, beverages, cigarette, vegetables ghee and petrol) weight in the NUCPI (33.0 percent) and NWPI (45.0 percent) is different. According to their respective price, the NUCPI increased by 1.3 percent while the NWPI increased by 3.3 percent. The difference of 2.0 percent, which is reflected on the NWPI.

Wholesale Price Indices of Some Important Commodities

Food grains

In FY 2001/02, the NWPI of food grains remained at 87.5 higher by 6.2 percent than that of last year and lower by 12.5 percent than that of the base year. The indices of rice, maize and wheat increased by 2.3 percent, 20.6 percent and 13.8 percent respectively in the review year. In contrast, such indices had decreased by 14.0 percent, 20.1 percent and 25.5 percent respectively the preceding year. The weak supply situation in the review period caused for an increase in the prices of food grains.

Construction Materials

The index of construction materials moved up by 5.0 percent in the review period compared to 3.8 percent increase last year. The indices of cement, bricks and iron rod went up by 7.1 percent, 5.6 percent and 4.5 percent respectively in the review year. Costlier petroleum products, additional tax on cement and environmental pressure on bricks factory resulted in an increase in the prices.

Petroleum Products

In the review year the NWPI of petroleum products decreased by 2.4 percent in contrast to a significant increase (25.9 percent) last year. In the FY 2000/01, government did increase and decrease the prices of petroleum products in different times leading to 2.4 percent decrease as a net result in the petroleum prices.

Chemical Fertilizers

The NWPI of chemical fertilizers increased by 11.8 percent in the review period compared to an increase of 8.4 percent last year. The price of chemical fertilizers sold by AIC are controlled by the government. Directly or indirectly the prices of the chemical fertilizers in the private sector is dominated by the government prices.

Wages

In the review period, the wage rate of different kind of labourer showed the increasing trend. The growth rate of agricultural labourer remained higher than the construction labourer. As such, the growth rate of agricultural labourer peaked up by 15.4 percent compared to 12.0 percent rise of construction labourer. The townwise wage rate is given below.

Townwise Wage Rate

(In Rs.)

S.No.	Groups & Sub-groups	Unit	FY 2000/01*				FY 2001/02			
			KTM	BRT	BRJ	BHR	KTM	BRT	BRJ	BHR
1.	**Agricultural Labourer:**									
1.1	Male	Daily	125.0	85.0	75.0	60.0	130.0	85.0	78.3	60.0
1.2	Female	Daily	70.0	50.0	65.0	60.0	75.0	50.0	75.0	60.0
2.	**Construction Labourer:**									
2.1	Mason									
2.2.1	Skilled	Daily	300.00	171.7	150.0	171.7	310.0	171.7	150.0	180.0
2.2.2	Semi Skilled	Daily	225.0	136.7	123.3	143.3	235.0	136.7	123.3	151.7
2.2	**Carpenter:**									
2.2.1	Skilled	Daily	300.0	173.3	155.0	178.3	310.0	173.3	170.0	186.7
2.2.2	Semi Skilled	Daily	225.0	140.0	120.0	143.3	235.0	140.0	130.0	151.7
3.0	**Labourer:**									
3.1	Male	Daily	140.0	100.0	83.3	81.7	145.0	100.0	93.3	85.0
3.2	Female	Daily	125.0	86.7	83.3	76.3	128.0	86.7	93.3	79.0

** Wage rate has been revised on the basis of survey conducted in FY 2001/02*

KTM = Kathmandu, BRT = Biratnagar, BRJ =Birganj, BHR = Bhairahawa

The wages of different types of labourers remained higher in Kathmandu. Bhairahawa recorded the lowest wage rate for agriculture labourers where as Birgunj recorded the same for construction labourers. Similarly, unskilled labourers were cheaper in Bhairahawa compared to other cities. The wage rates of all types of labourers recorded higher in Birgunj than that in other cities. The wage rates of agriculture labourers increased by 3.5 percent and construction labourers by 3.3 percent.

External Sector Developments

Policy Development in International Trade and Payments

Some policy measures were adopted during FY 2001/02 for the promotion of the external sector of the economy. Before involving in the import and export transactions in convertible foreign currencies through the letter of credit (L/C), commercial banks must acquire the business credibility information of the concerned foreign importers and exporters effective from December 19, 2001. This has been done for the prevention of abuse of foreign exchange in the transactions of convertible foreign currencies through L/C. Such credibility information is necessary for L/C worth 50 thousand US dollar or more. Commercial banks can acquire such information from any unit working in Nepal or from the representative of any reputed international organization which has a branch office in Nepal. Similarly, such information can also be acquired from the correspondent bank of the related commercial bank. In this regard, any transaction can not be done with the firm, company or other units that have been mentioned as Credit Risk, High Credit Risk or Rating Not Determined. Approval of one step upper level than that taken in the normal condition is must, if it is necessary to open L/C even in above mentioned conditions. Such credibility information will be valid for one year and that can be used by other commercial banks as well. However, for the L/C that are opened for the imports under global tender contract provided by the government or semi-government units, back to back L/C and usance L/C, such information is not required. Similarly, while negotiating or purchasing clean documents which fulfill all conditions of L/C that are obtained by Nepalese exporters, such information is not needed.

In the context of liberalization, it does not seem reasonable to take permission even for a small amount of foreign exchange. To avoid this practical difficulty, related commercial banks are authorized to provide foreign exchange up to US$ 500 on submission of necessary documents. If submitted invoice worth more than US$ 500, foreign exchange less than the amount mentioned in the invoice can not be provided. Such restriction has been imposed considering the possibility of abuse of foreign currencies by exchanging in small amount. Similarly, the pre-approval of NRB is compulsory for the cancellation of the draft/TT against the name of the education institutes (college, university, institute etc.).

Commercial banks that are authorized for transactions of convertible foreign exchange can arrange an interest rate swap contract under certain conditions.

A contract was signed between NRB and Central Bank of Peoples Republic of China to improve payments system and promote tourism. For the implementation of this contract, following provisions have been arranged.

(a) Daily determination of exchange rate of Yuan in Nepal.

(b) Nepalese commercial banks and other licensed institutions can purchase Yuan in prevailing exchange rate from Chinese tourists visiting Nepal.

(c) Commercial banks required to open account at Jhangmu branch of Banks of China in Khasa to deposit such Yuan.

(d) Commercial banks permitted to deposit the Yuan earnings of the Nepalese exporters at the same bank branch in Khasa.

(e) Such deposit of Yuan is to be used for the payment of imports from China.

(f) In case of inadequacy Yuan deposit, Nepalese commercial banks can purchase necessary Yuan by selling convertible foreign exchange and deposit at the above mentioned bank branch in Khasa.

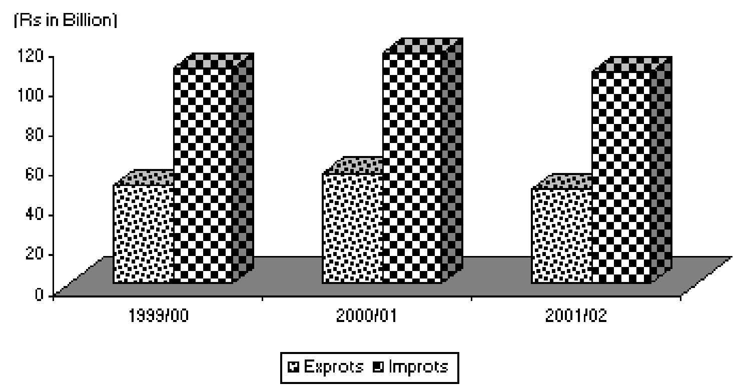
During the review year, NRB intervened in the foreign exchange market altogether 16 times, selling a total of US$ 102.40 million in seven times and purchasing a total of US$ 107.45 million in nine times to and from the commercial banks.

Performance of the external sector of the economy during the review year was not much encouraging. Total exports declined at a rate higher than the total imports. However, trade deficit contracted owing mainly to relatively larger volume of total imports. In the review year net of service income declined markedly. As a results current account deficit widened significantly despite encouraging growth in net current transfer. Similarly, overall BOP turned into deficit of Rs. 3.3 billion.

Merchandise Trade

During the review year, total trade in nominal value decreased by 9.9 percent to Rs. 154.3 billion as against an increase of 8.2 percent last year. Such a negative growth in total trade is attributed to the decline in both exports and imports during the review year compared to that in the preceding year. In proportion to GDP, total trade this year stood at 36.7 percent, which was 41.8 percent last year. Similarly, in terms of US dollar total trade registered a decline of 13.5 percent compared to a growth of 1.2 percent last year. The composition of total trade showed that trade with India occupied 46.7 percent and that with other countries covered 53.3 percent during the review year. The respective shares last year were 41.6 percent and 58.4 percent. The import sustainability of exports during the review year declined to 43.7 percent from 48.1 percent in the preceding year. Import sustainability of export to India improved to 63.4 percent while that to other countries declined to 30.0 percent. The corresponding figures for the previous year were 57.6 percent and 42.0 percent.

Graph 5: Foreign Trade



During FY 2001/02, total exports decreased by 15.6 percent and reached Rs. 46.5 billion. Last year, total exports had increased by 11.7 percent to Rs 55.7 billion. As percent of GDP, exports accounted for 11.2 percent during the review year compared to 13.6 percent in the previous year. Regionwise, exports to India increased by 7.4 percent compared to a much higher growth of 22.7 percent a year ago whereas that to other countries declined markedly by 35.9 percent compared to an increase of 3.6 percent in the preceding year. Major commodities that were responsible for the increase in exports to India included jute goods, pulses, catechu, ginger, oil cakes, skin, hajmola, cardamom, noodles, polyester yarn, vegetable ghee, copper wire rod, M.S.pipe, juice, writing and printing paper, plastic utensils, etc. Major commodities that contributed to the decrease of exports to other countries were woolen carpet, readymade garments, Pashmina, hide and skin , pulses and herbs.

In dollar terms, total exports decreased by 19.0 percent to US $ 610.6 million in FY 2001/02 in comparison to 4.5 percent rise amounting to US $ 753.8 million in the preceding year. In dollar terms, export to India recorded a growth of 3.1 percent compared to a growth of 14.8 percent a year ago, whereas that to other countries showed a decrease of 38.4 percent as compared to a decline of 3.1 percent in the previous year. Of the total, exports to India accounted for 59.6 percent whereas other countries occupied 40.4 percent. The respective shares a year ago were 46.8 percent and 53.2 percent.

Looking towards the composition of exports based on the Standard International Trade Classification (SITC), manufactured goods classified chiefly by materials (SITC-6) occupied the first position accounting for 37.1 percent of the total export despite a negative growth of 8.0 percent whereas with a negative growth of 44.4 percent miscellaneous manufactured articles (SITC-8) secured a second position with 26.8 percent share in total export. The share of manufactured goods classified chiefly by materials and miscellaneous manufactured articles were respectively 34.0 percent and 40.7 percent in the previous year. The Animal and vegetable oils and fats (SITC-4) remained in third position, accounting for 15.8 percent of total exports compared to 7.4 percent share in the previous year. Export of food and live animal (SITC-0) covered 10.9 percent of total exports this year as against 8.6 percent share in the previous year. Chemicals and drugs (SITC-5) recorded a 7.1 percent share compared to the preceding year's share of 7.3 percent. The relative share of exports of primary commodities (SITC 0-4) increased by 10.9 percent to 28.3 percent from 17.4 percent of the previous year, whereas that of manufactured and capital goods (SITC 5-8) decreased by 10.9 percent to 71.7 percent from 82.6 percent of the previous year. Sectorwise, decline in exports to third country contributed significantly to the decrease in total exports during the review year.

Total imports during the review year decreased by 7.2 percent to Rs. 107.4 billion as against a rise of 6.6 percent in the previous year. Such a decrease in total imports could largely be attributed to decrease in imports from other countries. During the review year, imports from other countries decreased by 10.2 percent to Rs. 63.3 billion compared to a growth of 2.4 percent a year ago. Import from India during the review year decreased marginally by 2.4 percent to Rs. 44.1 billion compared to a rise of 14.0 percent in the previous year. In dollar terms, total import declined by 10.9 percent during the review year as compared to a marginal decline of 0.3 percent in the previous year. Imports from India in dollar terms experienced a decrease of 6.3 percent during the review year compared to a growth of 6.6 percent in the preceding year and that from other countries declined by 13.8 percent compared to a decline of 4.2 percent a year ago.

The value of total imports in relation to GDP slipped to 25.6 percent in the review year from 28.2 percent a year ago. The relative share of imports from India in total imports went up to 41.1 percent from 39.1 percent while that from other countries decreased to 58.9 percent from 60.9 percent in the previous year.

During the review year, the shares of imports of primary commodities (categorized in SITC 0-4) and that of manufactured and capital goods (SITC 5-9) were 34.3 percent and 65.7 percent respectively. The respective shares last year were 27.1 percent and 72.9 percent. Commoditywise, imports from India revealed a significant decrease in thread by 53.6 percent, chemicals by 44.0 percent, other machinery and parts by 19.4 percent, textiles by 23.3 percent, vehicles and spare parts by 8.1 percent, books and magazines by 4.9 percent, agriculture equipment and parts by 53.2 percent and paper by 8.8 percent. Imports of commodities from India which went up were, electrical equipment (43.0 percent), medicine (10.8 percent), coal (26.5 percent), petroleum product (89.0 percent), cold-rolled sheet in coil (40.6 percent), hot rolled sheet in coil (18.9 percent) M.S. wire rod (15.9 percent) and M.S. billet (22.0 percent). Regarding imports from third countries, major items, which showed a marked decline during the review year were gold and silver (84.0 percent), raw wool (43.8 percent), raw silk (67.4 percent), aircraft and spare parts (36.7 percent), other machinery and parts (36.3 percent), thread (51.5

percent), copper wire, rod, scrapes and parts (49 percent), palm oil (83.8 percent), textile (40.1 percent) and transport equipment and parts (19.4 percent). However, during the review year, import of chemical fertilizer rose by 528.3 percent, electrical goods by 16.4 percent, petroleum products by 31.4 percent, medicine by 10.8 percent, medical equipment and parts by 12.9 percent, crude soyabean oil by 103.2 and crude palm oil by 237.2 percent.

Due to relatively large base of imports, trade deficit during the review year expanded marginally by 0.7 percent to Rs. 60.4 billion due to a higher rate of decline in total exports. In the previous year trade deficit rose by 2.3 percent to Rs. 60.0 billion. In dollar terms, such deficit decreased by 3.3 percent, which in the previous year also had decreased by 4.3 percent. As a proportion of GDP, the trade deficit stood at 14.4 percent in the review year compared to 14.6 percent in the preceding year. Regionwise, due to an increase in exports and a decrease in imports, trade deficit with India contracted by 15.7 percent as against an increase of 4.0 percent a year ago. Trade deficit with countries other than India increased by 8.4 percent compared to a marginal rise of 1.5 percent during the previous year. Of the total trade deficit, 26.7 percent was with India and 73.3 percent was with other countries. The corresponding shares in the previous year were 32.0 percent and 68.0 percent.

BOP

The overall BOP position of the country remained at a deficit during the review year. Total exports decreased at a rate higher than total imports resulting in an expansion of trade deficit this year. Together with this, deterioration in service account led to the current account deficit to widen further despite an increase in transfers net. The surplus in capital account was in adequate to offset such a large current account deficit and thus overall BOP remained in unfavourable during the review year.

Regarding the current account, trade deficit increased by 0.7 percent to Rs. 60.57 billion in the review year compared to an expansion of 2.3 percent in the preceding year. Total exports (at f.o.b. value) decreased by 15.6 percent to Rs. 47.0 billion compared to an increase of 11.7 percent a year ago. Similarly, total imports (at c.i.f. value) decreased by 7.1 percent to Rs. 107.5 billion which in the previous year had increased by 6.6 percent. Of the total imports, 5.2 percent (Rs. 5.5 billion) was under aid in kinds. The share of such imports in the previous year was 6.1 percent (Rs. 7.1 billion).

On the services side, gross receipts declined further sharply by 30.8 percent to Rs. 28.8 billion compared to a decrease of 3.4 percent in the preceding year. The decline in such receipts was attributed to the fall in the income under subheads - other transportation by 39.6 percent, travel by 26.1 percent, investment income by 21.5 percent and other services by 64.7 percent. However, receipts under government n.i.e. rose by 16.8 percent. On the payments side, payments on freight on merchandise decreased by 31.7 percent, government n.i.e. by 13.8 percent and other services by 12.8 percent. However, payments on investment incomes, travel and other transportation increased by 30.0 percent, 3.8 percent and 2.8 percent respectively. As a result, total payments increased by 1.0 percent to Rs. 19.6 billion compared to a rise of 16.4 percent last year. Consequently, net services income went down to Rs. 9.3 billion with a sharp decline of 58.4 percent compared to a decrease of 15.9 percent in the previous year.

On the transfers front, net receipts increased by 13.3 percent and reached Rs. 30.5 billion during the review year compared to a rise of 15.2 percent in the preceding year. Private gross transfer receipts, which had increased by 25.6 percent in the previous year, further rose by 31.7 percent in the review year. Similarly, private transfer payments increased by 37.6 percent as against a decline of 24.6 percent in the previous year. As a result, net private transfer, went up by 31.2 percent compared to an increase of 34.4 percent in the preceding year. Receipts of central government declined further by 7.4 percent compared to a negative growth of 1.2 percent in the preceding year owing to the decrease by 10.6 percent in grants to the government, which constituted 85.3 percent of total transfer receipts under central government. Indian excise refund during the review year increased by 16.8 percent compared to a rise of 10.4 percent a year ago. As a consequence of the above development, the current account became unfavorable by Rs. 19.5 billion this year compared to a deficit of Rs. 11.0 billion in the previous year. The current account imbalance in the review year was about 5.0 percent of the nominal GDP. Such imbalance was 2.7 percent of GDP a year ago.

On the capital account, a net foreign capital of Rs. 17.1 billion was received during the review year. Among the components of this account, official capital net (foreign loans Rs. 8.0 billion minus amortization Rs. 5.1 billion) was recorded at Rs. 3.0 billion registering a sharp decline of 57.5 percent compared to a decline of 17.8 percent in the previous year. Nonetheless, the other component, miscellaneous capital items net reflected an inflow of Rs 14.5 billion during the review year compared to an inflow of Rs. 9.2 billion in the previous year. Consequently, net position of external payments recorded a deficit of Rs. 3.3 billion compared to a surplus of Rs. 5.2 billion in the preceding year.

Income and Expenditure of Convertible Foreign Exchange

During FY 2000/01, transaction on convertible foreign exchange resulted in a surplus of Rs. 5.0 billion which was lower by 30.5 percent over the surplus of the previous year.

In the income side, total income declined by 15.2 percent to Rs. 76.2 billion mainly attributing to the decreased income under foreign aid, merchandise exports, interest receipts and tourist expenditures. In the expenditure front, total expenditure declined by 13.9 percent amounting Rs. 71.1 billion. Such a decrease in expenditure is mainly attributed to the decrease in expenditure under merchandise imports and diplomatic mission. In the previous year, total income had increased by 39.8 percent amounting Rs. 89.8 billion whereas total expenditure had gone up by 55.6 percent amounting Rs. 82.6 billion, and thus, resulting in a surplus of Rs. 7.3 billion.

Foreign Assets and Liabilities of the Banking System

NFA of the banking system in the review year recorded a marginal increase of 0.7 percent (Rs. 0.6 billion) to Rs. 88.4 billion as compared to a higher increase of 9.1 percent during the previous year. In US dollar terms, such assets decreased by 3.5 percent (US$ 41.0 million) to $ 1.1 billion compared to an increase of 2.9 percent in the previous year. Similarly, gross foreign assets, in the review year increased marginally by 0.8 percent (Rs. 0.8 billion) to Rs. 107.6 billion as against an increase of 11.9 percent (Rs. 11.3 billion) in the preceding year. However, in dollar terms, gross foreign assets decreased by 3.5 percent (US$ 49.0 million) to US$ 1.4 billion compared to a rise of 5.6 percent (US$ 75.1 million) a year ago. Regarding the overall foreign liabilities of the banking system, an increase of 1.0 percent (Rs. 0.2 billion) to Rs. 18.6 billion was registered compared to the previous year's growth of 27.8 percent (Rs. 4.0 billion). In dollar terms, a decrease of 3.2 percent (US$ 8 million) to US$ 23.7 million was recorded during the review year compared to a growth of 20.6 percent (US$ 42.0 million) a year ago.

Foreign exchange holding as at mid-July 2002 with the banking system stood at Rs. 105.9 billion, comprising 75.8 percent convertible currency and 24.2 percent inconvertible currency. Such foreign exchange holding in the previous year was recorded at Rs. 105.2 billion comprising 76.2 percent convertible currency and 23.8 percent in-convertible currency.

Agencywise, the NFA of the Monetary Authority grew by 8.2 percent (Rs. 6.2 billion) to Rs. 81.1 billion as against an increase of 14.8 percent (Rs. 9.7 billion) in the preceding year. Gross foreign assets of the Monetary Authority during the review year grew by 7.4 percent (Rs. 5.7 billion) to Rs. 81.8 billion compared to an increase of 14.2 percent (Rs. 9.5 billion) in the previous year.

In US dollar terms, the official gross foreign assets in the review year was equivalent to US dollar 1,044.6 million, which reflected a growth of 2.9 percent (US$ 29.8 million) as against a rise of 7.7 percent (US$ 73.3 million) in the previous year. The gross foreign assets of the Monetary Authority accounted for 76.5 percent of total gross foreign assets of the banking system for the review year compared to 71.7 percent in the previous year. Monthwise, such official foreign assets showed a mixed trend. On average, the gross official foreign assets of Monetary Authority amounted Rs. 80.6 billion showing a growth of 10.5 percent (Rs. 7.7 billion) over the average foreign assets in the previous year (Rs. 73.0 billion).

The growth of convertible currency of the NRB holding was recorded as of 7.0 percent (Rs. 3.73 billion). The growth of inconvertible currency was 8.3 percent (Rs. 1.9 billion) in the review year. In the previous year, growth of convertible currency was negative by 2.6 percent (Rs. 1.4 billion) and that of inconvertible currency was positive by 96.3 percent (Rs. 10.9 billion). Gold and IMF gold tranche, in terms of gross assets, grew in the review year whereas SDR account showed a marked decrease. During the review year, gold and IMF gold tranche recorded an increase of 4.5 percent and 10.8 percent respectively compared to a respective growth of 6.0 percent and 0.2 percent in the previous year, whereas SDRs decreased by 74.2 percent compared to a decline of 72.1 percent in the previous year. On the liabilities side of the NRB, foreign liabilities declined sharply 40.6 percent in the review year compared to a decline of 13.6 percent a year ago.

As at mid-July 2002 foreign assets held by commercial banks declined by 16.1 percent (Rs. 4.9 billion) to Rs. 25.2 billion. The growth of such assets was recorded at 6.5 percent (Rs. 1.8 billion) a year ago. Commercial banks' total liabilities increased by 3.8 percent (Rs. 0.7 billion) compared to a growth of 32.2 percent (Rs. 4.2 billion) in the previous year.

Foreign Loan Agreements

During FY 2001/02 eight loan agreements amounting to a total of Rs. 9.9 billion were signed with the donors. Out of these eight agreements, two were bilateral with Belgium and Sweden amounting to Rs. 0.2 billion and Rs. 1.0 billion respectively and six were multilateral with different agencies amounting to a total of Rs. 8.7 billion. Namely, multilateral donor agencies were Asian Development Bank (ADB) (two agreements), OPEC, the World Bank, International Fund for Agriculture Development (IFAD) and NDF.

During FY 2001/02 foreign grant agreements amounting to Rs. 23.3 billion were signed with thirteen countries and five donor agencies under bilateral and multilateral basis. This amount was 67.6 percent (Rs. 9.4 billion) higher than that of the previous year.

Among the donor countries USA, Japan, Norway and India were the premier donors to Nepal. In terms of amount, USA ranked the largest donor providing Rs. 5.9 billion (25.3 percent) Japan ranked second providing Rs. 5.3 billion (22.8 percent), Norway was in third position agreeing to provide Rs. 1.9 billion (8.2 percent). India agreed to provide Rs. 1.3 billion (5.7 percent) and ranked in fourth position. Other donors were China, Switzerland, Finland, Netherlands, U.K, Australia, Canada, Sweden and Denmark who signed the loan agreements amounting to altogether Rs. 2.8 billion (12.0 percent). Multilateral agreements were signed with five different donor agencies. Among these agencies UNICEF was the largest donor agreeing to provide Rs. 5.6 billion (24.1 percent of total grants). Other multilateral donors were the World Bank, International Labour Organization, IFAD and ADB who agreed to provide Rs. 0.4 million (1.8 percent).

Transaction with the IMF

During FY 2001/02, transaction with the IMF resulted into a net balance of SDR 25733 (payments to the IMF), indicating a net outflow with the total receipts of SDR 201680 and payments amounting to SDR 227413. The total receipts of SDR 201680 was an aggregate of purchase of SDR 130000, burden sharing SDR

70345 and interest on SDR holding SDR 1335, during the review year. Similarly, Nepal paid a total of SDR 227413, including cumulative charge SDR 226502 and Telex charge SDR 911.

IMF Liabilities

The total liabilities to the IMF amounted to Rs. 442.4 million (SDR 4.5 million), as at the end of the FY 2001/02. This amount is lower by Rs. 304.7 million (SDR 3.3 million) than the total liabilities at the end of the preceding year. No liabilities were on the account of Stand-by Credit, IMF Trust Fund and SAF account as in the previous year. Liability on ESAF declined by Rs. 304.7 million (SDR 3.3 million) to Rs. 442.4 million (SDR 4.5 million) during the review year.

Transaction under Asian Clearing Union (ACU)

The total transaction which was settled through ACU amounted to Rs. 4.2 million (ACU dollar 0.05 million) during the calendar year 2002 (January-December). The amount was lower by Rs. 828.5 million (ACU dollar 11.05 million) against that of the previous year. Total exports of goods settled under the ACU registered a decline of Rs. 12.5 million (ACU dollar 0.17 million) to Rs. 1.8 million (ACU dollar 0.02 million). Similarly, total imports decreased by Rs. 816.0 million. In ACU dollar terms, imports transactions were lower by 10.88 million. The overall balance of transaction showed a negative position as in the preceding year. It recorded a negative balance of Rs. 0.6 million (ACU dollar 0.01 million) in the review year compared to a negative balance of Rs. 803.3 million (ACU dollar 10.71 million) in the preceding year.

Fiscal Sector Development

During FY 2001/02, the revised estimates of the government budgetary operations reflected a fiscal deficit of Rs.16.7 billion (Table 35), which was 9.5 percent lower than that of the previous year[+]. During the review year, expenditure and investment increased by 2.7 percent over that of the previous year and it was lower by 4.2 percentage points than the growth rate of total resources (6.9 percent). The total expenditure and total resources as percent of GDP were 17.6 percent and 13.6 percent respectively. The fiscal deficit[*] was 4.0 percent of the GDP in the FY 2001/02 which was marginally lower (by 0.5 percentage points) than that of the previous year.

On July 9, 2001 the government presented the budget for FY 2001/02 to the Twentieth Session of the Parliament. FY 2000/01 had experienced the satisfactory revenue mobilization and normal growth in GDP but at the same time the government expenditure had sharply gone up resulting in the higher fiscal deficit. The principal objective of the budget was to address **"Poverty problem"** by strengthening the liberal and market oriented economic policy pursued earlier.

To achieve the above objective, the budget had taken, inter alia, following policy measures:

- Providing the means of production viz. high yielding variety of seeds, fertilizers, appropriate technology, irrigation facilities and agriculture loan in agricultural pocket areas and connecting these areas to the markets through additional provisions of agricultural roads and rural electrification.
- Lowering the interest rate by 1 percent to promote commercial farming of exportable as well as other cash crops.
- Strengthening the delivery system of agricultural technology and inputs in 21 districts having minimum or no road facilities and experiencing food deficits.
- Reducing the rate of interest by 2 percent to 10 percent on new loans channeled through ADB/N for expansion of areas under tea growing, quality improvement and productivity enhancement of tea estates as well as providing additional 50 percent subsidy on the interest rate for the next five years.
- Continuing the program of providing concessional loans for the increase in milk production, diversification of dairy business, production of high value dairy products and establishment of milk processing industries.

[+] The fiscal deficit is the difference between the total expenditure including net loan and investment and the resources (revenue and grants).

[*] Excluding principal payments of internal and external loan.

- Making more effective the programs under the **Karnali Zone Special Program of Agriculture Development** and providing the loans at 10 percent interest rate.
- Providing loan at a low interest rate of 7.5 percent for the re-habilitation of sick industries.
- Carrying out various promotional activities to rejuvenate the tourism sector with the joint partnership of the government and the private sector.
- Launching a special two-year program called **"Destination Nepal"** and implementing the public awareness program to promote and make it effective.
- Authorizing the Director General of Industry department to issue licenses for investment up to Rs.1000.0 million to expedite the process of foreign investment.
- Establishing a special industrial security force with the participation of the private sector.
- Providing the administrative, fiscal and other concessions and incentives to encourage the investment of the non-resident Nepalese.
- The existing industrial estates will be to convert them into **Special Industrial Zone** by providing additional services with the participation of the private sector.
- Making the provision for the commercial banks to invest up to Rs.1000.0 million in the hydropower projects.
- Improving the operational modalities of the existing duty draw back system under one window policy to facilitate the duty refund. Issuing the Pass Book to each eligible exporter for the purpose of duty draw back from the custom point at the time finished products are exported.
- Reviewing the financial efficiency and managerial capability of the NIDC and the ADB/N.
- Making the commercial bank manual fully operational on capital fund, credit, loan classification, reserves, single loan exposure limits, auditing and financial statement in the current FY.
- Formulating and bringing into effect the policies regarding the ceiling of capital applicable to the establishment of new commercial banks, development banks and other financial institutions.
- Permitting foreign investors of the currently operating joint venture commercial banks to enhance their share from 50 percent up to two third of total share.
- Reducing the number of projects to the desirable size in order to divert resources towards the projects of high rate of return.

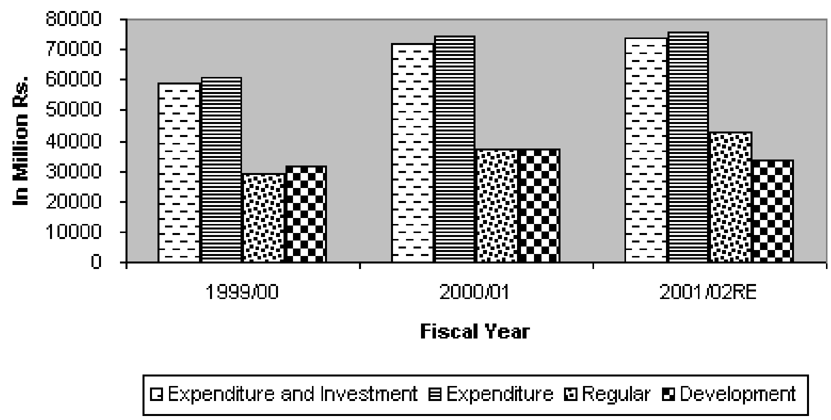
- Dissolving several unnecessary and ineffective committees, councils, commissions and centers, set up under several acts including Development Committee Act.
- Setting up a pension fund by deducting a portion of the remuneration and adding equal amount for the new entrants in the permanent post under all types of public services, including army, police, professionals, teachers etc.
- Eliminating the shortcomings of Value Added Tax (VAT) and developing VAT as a mainstay of internal revenue.
- Setting up of the Department of Inland Revenue by merging the Department of VAT with the Department of Taxation.
- Penalizing the executive chief and account officers of the public enterprises (PEs.) who had not done the final audit of the respective PEs. for the last two years.
- Encouraging private sector investment in those PEs in which the government involvement is unnecessary.
- Integrating the existing Grameen Vikas Bank, Bishweshwor with the Poor, Jagriti, Mahila Aaya Arjan Programs which targeted the poverty alleviation under the umbrella of **Poverty Alleviation Fund.**
- Expanding the programs under **Poverty Alleviation Fund** to all the Village Development Committees (VDCs.) within next 5 years.
- Reducing the rate of interest by 2 percent on the loans to be provided to the target groups through the **Rural Micro Credit Program** and channelizing Rs.1.5 billion by **Rural Microfinance Development Center** (RMDC) through Non-governmental Organizations (NGOs).
- Introducing reforms in the institutional and capital structures of Grameen Vikas Banks in order to preserve the credibility of these Banks and making arrangements of an additional investment of Rs.100.0 million through **Poverty Alleviation Fund**.
- Making arrangements to provide credit to youths intending to go abroad for employment against collateral and on guarantee of the employment agencies.

Although the government could not implement most of the measures mentioned in the budget, it tried to control the leakage of revenue and unnecessary government expenditure by reducing the number of projects and prioritizing them. The government established the Inland Revenue Department by merging the Department of VAT with Department of Taxation.

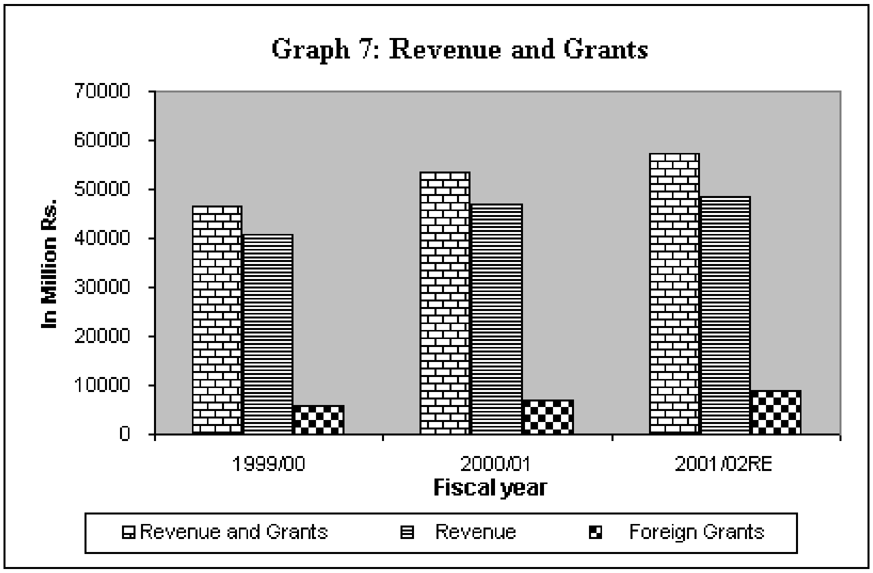
Budget Estimates for FY 2001/02

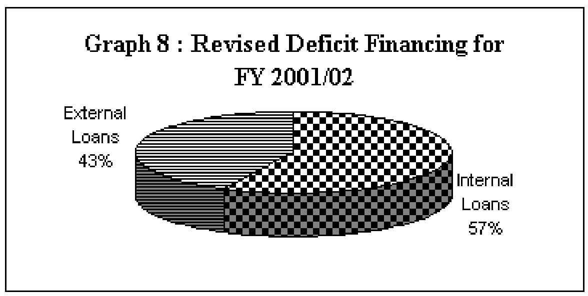
The budget estimated total expenditure, net of loans and investment, for FY 2001/02 at Rs.90.1 billion (Table 35). It was 25.0 percent higher than that of the previous year's actual (Graph 6). The total expenditure was estimated at Rs.92.2 billion. Of this, Rs.41.8 billion (45.3 percent) was allocated for regular and Rs.50.5 billion (54.7percent) for development. The regular expenditure was higher by 12.6 percent than that of the previous year, while development expenditure was higher by 36.2 percent over that of the proceeding year. The increase in internal security expenses, debt servicing of loan and social obligations were the major factors for the increase in the regular expenditure

Graph 6: Total Expenditure



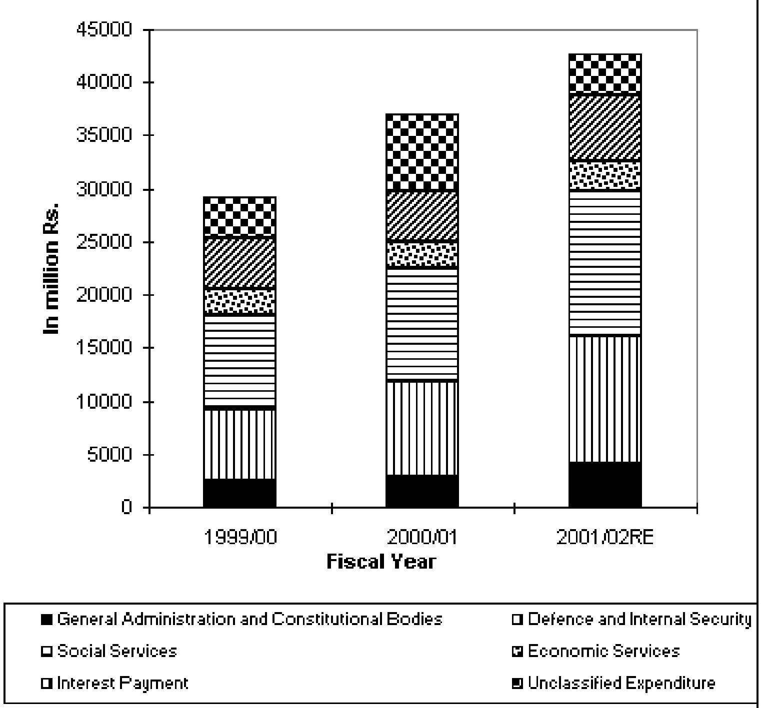
Total resources (revenue and grants), on the other hand, was projected to increase by 34.8 percent to Rs.72.2 billion. Of this, revenue receipt was estimated at Rs.58.1 billion which was 24.0 percent higher than that of the previous year and foreign grants was estimated at Rs.14.1 billion which was 109.1 percent higher than that of the previous year (Graph 7). As a result, fiscal deficit was estimated at Rs.17.9 billion, which was 3.2 percent lower than the previous year's actual deficit. Of the total fiscal deficit, 40.6 percent (Rs.7.3 billion) was proposed to be financed through internal loan and the rest 59.4 percent (Rs.10.6 billion) through external loan. External financing (grants and loans) of the development expenditure, therefore, stood at 49.0 percent in the review year.



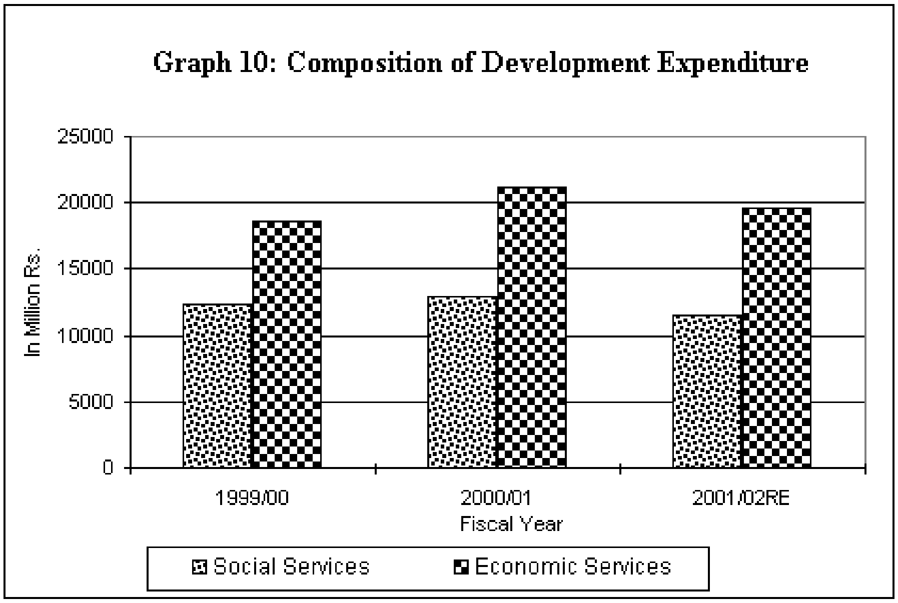


Of the total regular expenditure, Rs.13.5 billion (32.4 percent) was allocated for social services which was 26.6 percent higher than that of the previous year's level (Table 37). The growing need for the maintenance of law and order situation as well as increasing liabilities of interest payment to both internal and external loans forced the government to increase the budget allocation for defense and internal security by 14.7 percent to Rs.10.3 billion and for interest payment by 40.4 percent to Rs.6.6 billion constituting 24.7 percent and 15.8 percent of the total regular expenditure respectively. Of the total amount allocated for regular expenditure, 10.2 percent was allocated for general administration and constitutional bodies, 7.3 percent for economic services and 25.3 percent for miscellaneous heading (Graph 9).

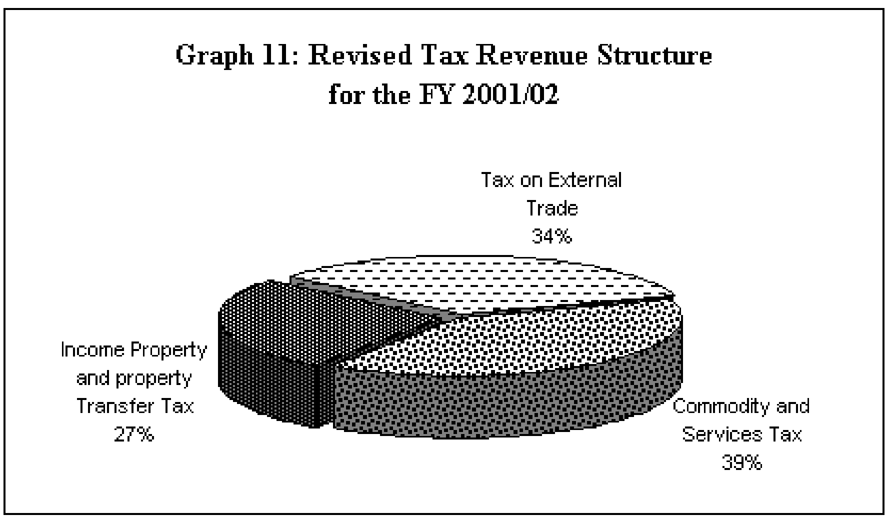
Graph 9: Composition of Regular Expenditure



The budget allocated for economic services such as development of some large projects like Nepal Irrigation Sector Project, Bagmati Irrigation Project, Sunsari-Morang Irrigation Project and other irrigation projects, Construction of Kali Gandaki -"A", Middle-Marsyangdi and other hydro electricity projects, B.P. Highway (Banepa-sindhuli-Bardibas), Rural Electrification and Distribution Projects and other development projects and programs constituted 60.0 percent of the total development expenditure which amounted to Rs.30.3 billion (Table 38). This amount was 43.5 percent higher than that of the previous year's level. Likewise, of the total development expenditure 37.2 percent (Rs.18.8 billion) was allocated for social services, 2.2 percent for economic administration and planning and 0.6 percent for unclassified expenditure. A great deal of emphasis was given to drinking water projects such as Melamchi Project, Rural and other Drinking Water Projects, the projects like basic education project, as well as community infrastructure development programmes. As a result, the social sector development budget went up by 45.7 percent in the review year (Graph 10).

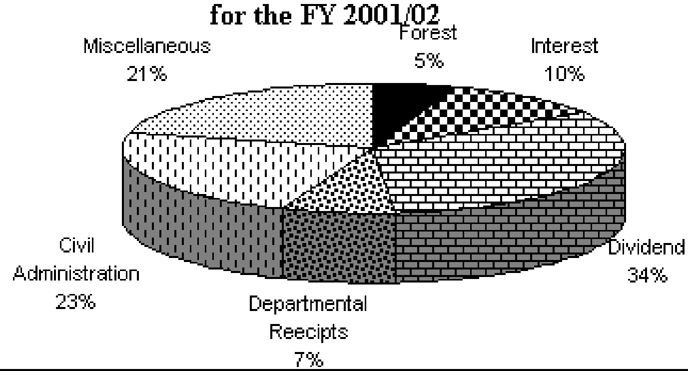


On the revenue side, the budget had targeted to mobilize revenue amounting to Rs.58.1 billion. Of this, 81.2 percent (Rs.47.2 billion) was estimated from taxes, and the remaining 18.8 percent (Rs.10.9 billion) from non-tax resources (Table 36).



Of the total tax revenue, the highest share of 41.8 percent (Rs.19.7 billion) was projected to be collected from commodity and services taxes. This was followed by tax on external trade which amounted to 30.6 percent (Rs.14.4 billion) and tax on income and property transfer amounted to 27.6 percent (Rs.13.0 billion). Of the total non-tax revenue, dividend was estimated to constitute a significant portion of 31.1 percent (Rs.3.4 billion). This was followed by miscellaneous sources, which includes royalty, sales of government property, donation and miscellaneous income 21.2 percent. Other sources of non-tax revenue included the administrative fees and fines (19.7 percent), interest receipts (15.0 percent), departmental receipts (6.7 percent) and income from forest (6.3 percent). The departmental receipts included public utilities like drinking water, irrigation, electricity, postal services, food and agriculture, education, transport and others.

Graph 12: Revised Non Tax Revenue Structure for the FY 2001/02



Revenue Policy and Major Changes in the Tax Rates

In order to achieve the above mentioned target of revenue mobilization, the budget for FY 2001/02 planed to develop Valued Added Tax (VAT) as the main base of the revenue mobilization and making customs and income tax supplementary to it. The budget also proposed to broaden the income tax base by bringing all the income sources into the tax net. Similarly, the budget also aimed at encouraging trade payments through organized banking sector. The budget also planed to systematize the customs valuation based on the transaction value and implementing effective measures to control revenue leakage. With these strategies, the following measures were taken.

Indirect Tax

- Bringing more taxable industries, traders and entrepreneurs under VAT net.
- Registering all the traders dealing with vehicles, motor-bikes, television, air-conditioner, electronic equipment, spare parts of vehicles, computers, color-lab telephone, cellular phone, tiles, marble, slabs, hardware under VAT regime to broaden the VAT base.
- Amalgamating existing district level VAT and Tax Offices into district Inland Revenue Office.
- Exchanging inter-customs information among customs offices, extending Automated System for Customs Data (ASYCUDA) in other customs points to

make customs valuation and checking system easier, transparent and effective and monitoring international transaction prices of imported goods.

- Linking the central monitoring unit at the Ministry of Finance with Information Management System of its departments and making the monitoring practices more manageable and effective.
- Levying only one percent customs duty on the importation of machinery and spare parts for rehabilitation of sick industries at the recommendation of the **Sick Industries Recommendation Committee.**
- Providing tariff concessions on capital goods imported by the film producers, companies dealing with hydropower generation, transmission and distribution, poultry business, tea industry, horticulture and floriculture industries.
- Providing 80 percent tariff rebate on raw wool imported by Pashmina industry to promote export of Pashmina.
- Raising the tariff rates on import of video parts, video camera, wristwatch, spectacles, marbles, granites, album and posters.
- Raising the export tariff rates on processed oil, vegetable ghee, plastic products and copper wire.
- Making the arrangement that **Inland Revenue Office** can buy the goods itself or make it buy in case of under invoicing and penalizing Rs.2000 or cent percent of evaded tax amount whichever is higher.
- Making it compulsory for the government offices to buy from the VAT registered sellers in case of goods and services costing more than Rs.25,000 at a time.
- Waiving additional charges, interest and late penalties for those tax payers who have not submitted tax return and have not paid tax until FY 1999/00 if they submit the tax return, pay tax, additional charge and interest by December 10, 2000.
- Increasing the due date of payment of VAT collected by hotels and travel agencies from one month to two months.
- Increasing the excise duties in health hazard products like cigarette, beer, wine and alcohol.
- Banning the production of plastic bags of less than 20 microns, considering its negative impact on environment.
- Levying excise duty of Rs.5 per sack on locally produced as well as imported cement.

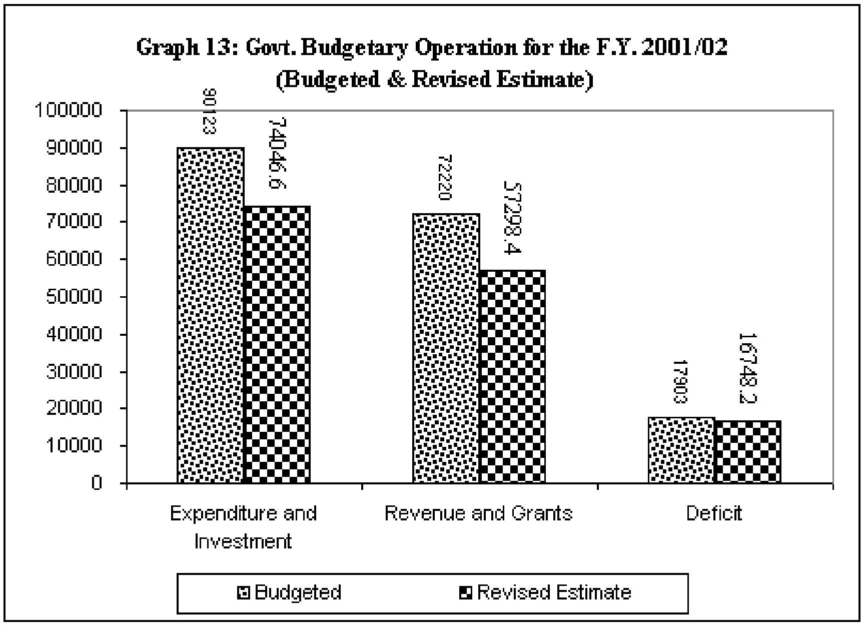
Direct Tax

- Making the importers not registered with income or VAT to pay advance income tax at the rate of 2.5 percent of customs price of such imports as an advance income tax at the customs point. And also the exporters of basic agriculture products are made to pay 2.5 percent advance income tax at customs point.

- Imposing 10 percent Capital Gain Tax on the sale of securities and shares on the basis of initial price of 1st day of FY 2001/02.
- Charging 5 percent advance tax instead of existing 15 percent to those temporary residues who are involved in satellite business.
- Maintenance of books of accounts are made mandatory for professionals viz. doctor, engineer, advocate, consultant, auditor and so on.
- Providing amnesty to tax defaulters who are liable to pay income tax in accordance with the Income Tax Act, 2031 provided they declare the value of their property at the price of July 11, 2001 and pay 10 percent tax on that value.
- Exempting registration fee to be levied on property transfer during family partition up to Rs.50000 and charging the progressive rate of registration fee beyond this amount.
- Imposing a special fee of one percent of import value at the customs points and one percent special tax on actual income of taxpayers in order to meet the increasing need of additional expenditure on internal security.
- Waiving the Telecommunication Services Charge to encourage paging service.

Revised Budget Estimates for FY 2001/02

The revised budget estimates for FY 2001/02 showed a decline in the total expenditure and investment by 17.7 percent compared to budget estimate. Similarly, the total resources (revenue and grants) also was made downward revision by 20.7 percent compared to the budget proposal (Table 35). The total expenditure and investment stood at Rs.74.0 billion and total resources at Rs.57.3 billion resulting in the decline in the revised fiscal deficit by 6.4 percent (Rs.16.7 billion). However, compared to the previous year's level, the revised figures of the total expenditure and investment as well as total resources were higher 2.7 percent and 6.9 percent respectively. Of the total revised expenditure and investment, regular expenditure stood at Rs.42.7 billion which was 2.2 percent higher than the budget estimate and 15.1 percent higher than that of the previous year. The expenditure incurred for the internal security and interest payments led to such an increase in the regular expenditure. The revised estimate of development expenditure stood at Rs.33.3 billion which was 34.1 percent below the budget estimate and 10.3 percent lower than the previous year's level. The pressing security needs led to a sharp decline in development expenditure.



Of the revised estimate of total resources, revenue alone contributed Rs.48.6 billion (84.8 percent). It was lower than the budget estimate by Rs.9.5 billion (16.4 percent). However, it remained 3.8 percent higher than the previous year's level (Table 35). Foreign grants, another component of total resources contributed Rs.8.7 billion and constituted 15.2 percent of the total resources. The revised estimate of the foreign grants was short of budget target by 38.4 percent due to government's weak implementation of development projects and deteriorating law and order situation.

Of the total fiscal deficit, amounting to Rs.16.7 billion, Rs.8.3 billion (49.7 percent) was financed through internal loans and Rs.6.2 billion (37.0 percent) was met through foreign loans. The remaining Rs.2.2 billion was met through the cash balance including overdraft.

Revenue

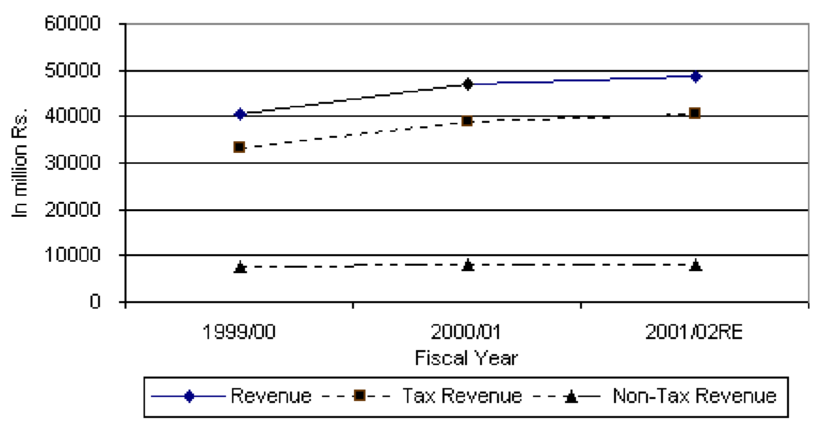
During the review year, Rs.40.4 billion (83.1 percent) of the total revised revenue was estimated to be realized from taxes and the remaining Rs.8.2 billion (16.9 percent) from non-tax sources. Compared to the previous year's level the revised figure of tax revenue was higher by 3.9 percent while that of non-tax revenue was higher by 2.9 percent. The revised estimate of the tax revenue depicted an achievement of 85.6 percent of its budget target while the revised estimates of non-tax revenue showed only 62.7 percent.

The revised estimate for almost all the taxes revealed a lower performance than that of the budget target excepting export duty, contract tax and house and land tax (Table 36). The revised revenue from external trade tax stood at Rs.13.6 billion which is a shortfall of 5.5 percent from the budget estimate but 8.7 percent higher than that of the previous year. Likewise, tax on commodity and services fell short of target by 18.8 percent

The composition of the tax revenue for the FY 2001/02 also depicted the usual scenario dominated by indirect tax in which customs duty and VAT played a major role. In the revised estimates of the total tax revenue, customs duty, as usual, contributed the highest share (33.8 percent) followed by VAT (29.4 percent) and excise duty (9.4 percent). The revised estimates of import duty increased by 5.3 percent compared to the previous year but fell short of the budget target by 8.4 percent. The revised estimate of VAT showed a decline of 1.3 percent compared to that of last year and remained short of the target by 19.4 percent. The revised estimate of excise duty observed a negligible growth of 0.4 percent over that of the preceding year.

Revenue from the house and land registration surged up by 52.6 percent compared to that of the previous year. The revised estimate of house and land tax registered a growth of 34.9 percent compared to that of the previous year and also exceeded the budget target by 10.2 percent. The revised estimate of vehicle tax increased impressively by 36.8 percent but remained slightly below the target by 2.1 percent.

Graph 14: Comperative Trend of Government Revenue



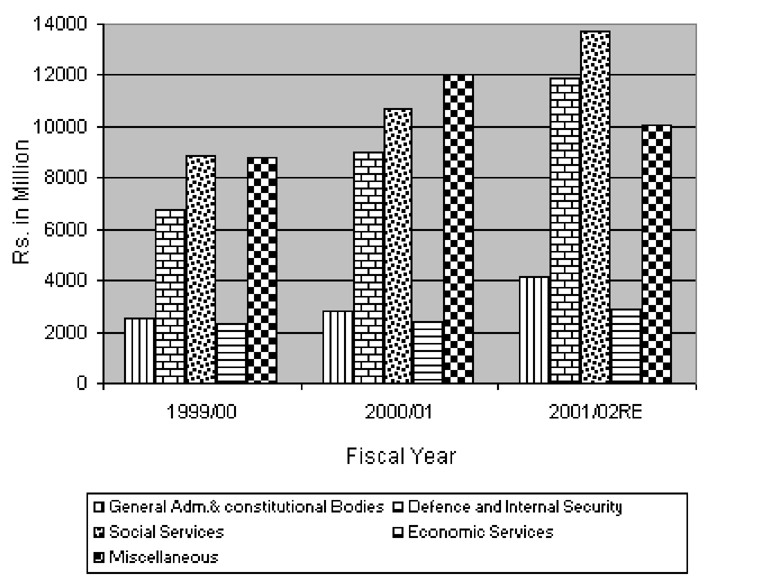
The revised estimate of interest tax declined by 3.3 percent compared to that of last year and remained short of target by 18.5 percent. The revised estimate of urban house and land tax declined sharply by 48.3 percent compared to that of the previous year. Income tax during the review year increased marginally by 0.7 percent compared to that of the previous year but fell short of target by 17.8 percent.

With regard to non-tax revenue, the revised estimates of the revenue receipts from dividend, departmental receipts and miscellaneous headings reflected a satisfactory achievement but the revenue receipts from forest, interest and administrative fees, fines etc. declined compared to the that of previous year. Revenue receipts from the each of the non-tax sources remained below the budget target.

Regular Expenditure

The revised regular expenditure during FY 2001/02 witnessed an increase of 15.1 percent to Rs.42.7 billion compared to a growth of 26.6 percent in the previous year. This expenditure exceeded the budget estimate by 2.2 percent. During the year the larger increase in regular expenditure was attributed to the jump in expenditure in internal security and general administration. During the review year, expenditure in economic services under regular expenditure increased

Graph 15: Comperative Trend of Regular Expenditure

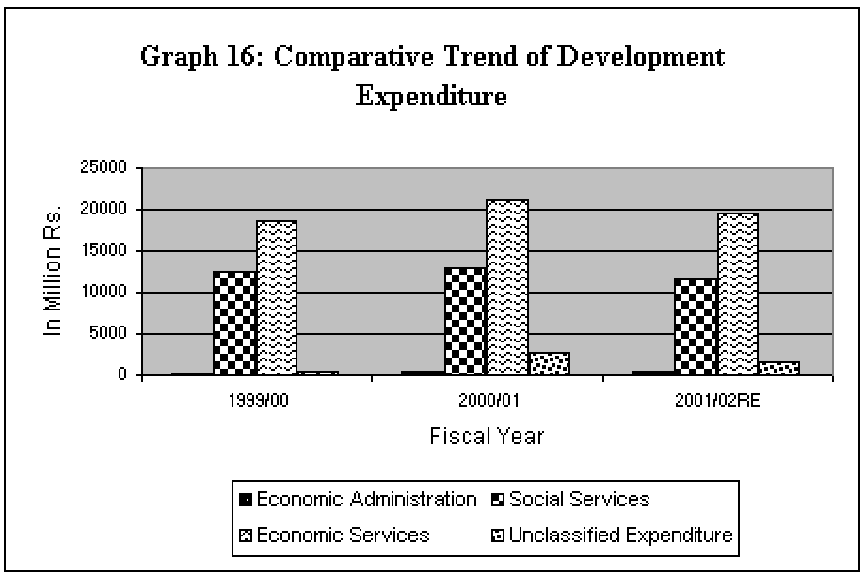


by 14.0 percent to Rs.2.9 billion compared to a slow growth of 6.9 percent in the previous year. Similarly, the revised expenditure in social services accelerated by 28.2 percent to Rs.13.7 billion compared to an increase of 20.4 percent in the preceding year. This was mainly due to the higher expenditure on education and health. Expenditure on defence and internal security as well as general administration and constitutional bodies surged up by 32.2 percent and 46.4 percent to Rs.11.9 billion and Rs.4.1 billion respectively. During the review year miscellaneous expenditure (interest payment and unclassified expenditure) under

regular expenditure declined by 16.5 percent to Rs.10.0 billion in contrast to a high growth of 37.1 percent in the previous year. Of the total regular expenditure miscellaneous expenditure absorbed 23.5 percent whereas interest payment alone constituted 14.5 percent of the total regular expenditure.

Development Expenditure

The revised estimate of the development expenditure stood at Rs.33.3 billion. This amount was lower than the budget estimate by 34.1 percent and lower than that of the previous year by 10.3 percent. (Table 38) The revised estimate on economic services stood at Rs.19.6 billion, which was only 64.7 percent of the corresponding budget estimate and 7.1 percent lower than that of the previous year. The revised figure for all the sub-headings of economic services revealed low compared with the budget estimate. On the other economic services (which include tourism, meteorology, commerce and labor) the figures appeared to be only 33.3 percent of the budget estimate followed by industry and mining (59.2 percent), transport (67.3 percent), irrigation (67.6 percent) and electricity (69.0 percent).



The revised estimate of the development expenditure on social sector stood at Rs.11.5 billion (Table 38) reflecting a decline of 10.3 percent from the previous year's level and fell short of the budget estimate by 38.4 percent. The revised estimate of all the sub-headings under social services showed lower performance compared to the budget estimate. However, the revised estimate of the expenditure on other social services (which includes women, children and social welfare, sports and housing) increased by 15.8 percent followed by health (13.3 percent). However, expenditure on education, local development and drinking water showed a decline of 26.4 percent, 17.9 percent and 8.1 percent respectively as compared to that of the previous year.

The revised estimate of the expenditure on economic administration and planning stood at Rs.396.3 million. This was lower than the target by 64.0 percent but was marginally higher than the previous year's level by 3.1 percent. Unclassified expenditures, the remaining components of the development expenditure also declined by 37.3 percent as compared to the actual expenditure of the previous year.

The revised share of economic services, social services, economic administration and planning and unclassified expenditure under the development expenditure were respectively 59.0 percent, 34.7 percent, 1.2 percent and 5.1 percent of the total development expenditure.

Public Debt

The total outstanding debt (both internal and external) amounted to Rs.293.7 billion at mid-July 2002. (Table 40) which was higher by12.8 percent as compared to that of the previous year. The share of the external debt in the total outstanding debt decreased to 74.9 percent in the review year from 76.9 percent in the previous year, while that of the internal debt increased to 25.1 percent from 23.1 percent. The outstanding debt to GDP ratio increased from 63.5 percent in the preceding year to 65.8 percent in the review year.

The outstanding external debt in the review year amounted to Rs.220.1 billion, an increase of 9.8 percent compared to that of the previous year. Similarly, the outstanding internal debt amounted to Rs.73.6 billion, an increase of 22.6 percent compared to that of the previous year.

Ownership Pattern of Internal Debt

NRB holdings of government bonds (excluding Treasury Bills) stood at 27.2 percent of the total bonds which was lower by 16.0 percentage points from that of the previous year level (Table 41). While the ownership of the individuals increased to 26.7 percent during the review year followed by commercial banks (19.5 percent), Provident Fund Corporation (10.5 percent), Financial Institutions (8.8 percent), Private Business Enterprises (1.1 percent) and Government Business Enterprises (2.2 percent). However, the ownership of non-profit organizations decreased to 3.9 percent compared to that of the previous year.

In the review year, total outstanding amount of Treasury Bills increased by 48.9 percent to Rs.41.1 billion compared to the previous year (Table 42). The ownership of NRB increased to 37.1 percent in the review year from 11.0 percent in the previous year while that of commercial banks and Financial Institutions decreased to 56.0 percent and 3.6 percent respectively during the review year compared to 80.6 percent and 7.1 percent last year. However, the ownership of other Institutions increased to 3.3 percent from 1.2 percent in the previous year.

Monetary and Credit Situation

Monetary Policy Developments

Monetary Policy Goals

The primary objectives of monetary policy are to (a) achieve domestic price stability, (b) secure a reasonable level of surplus in the BOP, and (c) maintain an adequate level of liquidity to support a high, sustained and broad-based economic growth. These are the core objectives of monetary policy stated in the NRB Act, 2002. Besides these objectives, NRB Act, 2002 also aims at maintaining financial sector stability and developing a secure, healthy and efficient payments system.

Monetary Policy Stance

Keeping these objectives in mind and taking the current macro-economic situation into account, the priority of monetary policy objectives was decided and accordingly, the monetary policy measures were chosen and implemented in FY 2001/02. The economy in terms of economic growth did not perform well from the very beginning of FY 2001/02 due to both external and internal factors. This was anticipated even before the beginning of the fiscal year. Accordingly, an accommodative monetary policy stance was adopted through the simplification and reduction of bank rate and refinance rates at the beginning of the fiscal year. During FY 2001/02, the BOP showed a deficit but the international reserves remained at the satisfactory level. Inflation remained within the desirable limit. Monetary aggregates showed the decelerating trend. Against this macroeconomic development, the monetary policy stance was further relaxed in the middle of the fiscal year.

Monetary Policy Measures

In line with relaxed monetary policy stance, the bank rate was cut by 100 basis points from 7.5 percent whereas the refinance rate against foreign currency export loans and refinance rate to rural development banks and export loans in local currency were revised downward to 5.5 percent from 6.5 percent in beginning of the fiscal year. Similarly, the refinance rates against foreign currency export loans and sick industry loans were also introduced and interest rates against such refinancing were fixed at 4.0 percent and 4.5 percent respectively. In order to relax monetary policy stance further, the NRB made the announcement of monetary policy changes on December 20, 2001. Of the two major monetary policy changes, the following changes were made in the bank rate and refinance rates.

Bank Rate and Refinance Rates

(in percent)

S.N.		Prior to Change	Effective from December 20, 2001	Change (in percentage point)
1.	Bank Rate	6.5	5.5	1.0
2.	Refinance against foreign currency export loans	4.0	2.0	2.0
3.	Refinance to financial institutions against their sick industry loans	4.5	3.0	1.5
4.	Refinance to Rural Development Banks and export loans in local currency	5.5	4.5	1.0

While the bank rate was cut by 100 basis points to 5.5 percent from 6.5 percent, the other refinance rates were lowered by 100 basis points to 200 basis points. The objective of the cut in the bank rate and refinance rates was to soften market interest rates, thereby help increase the bank credit to the private sector.

The other major monetary policy change was effected in CRR. The following changes were made in CRR with effect from December 20, 2001. The CRR, on average, was cut by 100 basis points from 10.0 percent. The reduction in CRR was effected with respect to domestic fixed deposits, lowering it by 150 basis points from 6.0 percent. The loanable funds of commercial banks amounting to about Rs. 2.0 billion were released through this reduction. The basic objectives of the CRR cut were to help commercial banks lower their lending rates through the reduced cost of funds and augment their loanable resources.

CRR

(in percent)

	Prior to Change	Effective from December 20, 2001	Change (in percentage point)
A. Balance with NRB	Average 7.0	Average 6.0	Average 1.0
(i) Of domestic current deposit liabilities	8.0	7.0	1.0
(ii) Of domestic saving deposit liabilities	8.0	7.0	1.0
(iii) Of domestic fixed deposit liabilities	6.0	4.5	1.5
B. Cash in Vault	3.0	3.0	0.0
C. Average CRR	10.0	9.0	1.0

During the review period, NRB also made refinancing of Rs. 1.11 billion to commercial banks against the sick industry loans. This was aimed at providing succor to sick industries and thereby help boost industrial activities in the country.

Outcome

The Nepalese economy registered a negative growth of 0.5 percent during FY 2001/02 due to both severe domestic and international shocks. Had the monetary policy not been accommodative, the economy would have slipped further down. In the context of declining government development expenditure, the relaxed monetary policy stance helped increase the private sector investment. Otherwise, in the absence of the accommodative monetary policy stance, the growth of bank credit to the private sector would have been marginal and insignificant.

In the face of slowdown in economic activities, both monetary aggregates posted lower growths than initially projected during the review year. For example, while broad money grew by 4.4 percent, narrow money (M1) increased by 9.3 percent. Lower growth of time deposit by 2.1 percent led to a higher growth of M1 vis-à-vis M2.

Analysis of Monetary and Banking Sector Development

Banking Survey

The total liquidity liabilities (L1) of the banking sector, comprising monetary authorities, commercial banks and other deposit taking institutions, increased by 4.7 percent (Rs. 10.8 billion) during FY 2001/02 and stood at Rs. 238.7 billion as at mid-July 2002. Such liabilities had gone up by 15.5 percent (Rs. 30.7 billion) in the previous year. Of the total liquidity liabilities of the banking sector, the share of time and saving deposits of other banking institutions (OBIs) (except for OBI's saving and time deposits held at commercial banks) stood at 6.9 percent at mid-July 2002 compared to 6.6 percent at mid-July 2001. The extended coverage and relatively higher deposit rates could be attributed for the increased share of deposits of OBIs during the review period.

Of the expansionary factors of liquidity liabilities, NFA of the banking sector increased by 1.1 percent (Rs. 887.8 million) during the review year and accumulated to Rs. 84.5 billion as at mid-July 2002. Such assets had gone up by 9.9 percent (Rs. 7.6 billion) in the previous year. While the shares of NFA of monetary sector dropped slightly to 104.6 percent in mid-July 2002 from 105.0 percent a year earlier, the shares of OBIs remained at negative levels of 4.6 percent and 5.0 percent, respectively, in mid-July 2002 and mid-July 2001. Because OBIs could not operate foreign asset transaction but could make use of foreign borrowings, the share of NFA of OBIs remained negative.

Banking Survey

(As at mid-July)

Rs. in million

	2000	2001	2002	Change			
				2000/01		2001/02	
	Jul	Jul	Jul	Amount	Percent	Amount	Percent
1. Foreign Assets, Net	**76065.1**	**83617.6**	**84505.4**	**7552.5**	**9.9**	**887.8**	**1.1**
NFA (MS)	80467.5	87798.1	88419.1	7330.6	9.1	621.0	0.7
Foreign Assets	94855.8	106190.7	106996.3	11334.9	11.9	805.6	0.8
Foreign Liabilities	14388.3	18392.6	18577.2	4004.3	27.8	184.6	1.0
NFA (OBI)	-4402.4	-4180.5	-3913.7	221.9	-5.0	266.8	-6.4
Foreign Assets	0.0	0.0	0.0				
Foreign Liabilities	4402.4	4180.5	3913.7	-221.9	-5.0	-266.8	-6.4
2. Net Domestic Assets	**121192.1**	**144289.7**	**154210.9**	23097.6	19.1	9921.2	**6.9**
A. Domestic Credit	178934.8	210463.1	231439.4	31528.3	17.6	20976.3	10.0
i. Claims on Government	42046.2	52076.5	62380.3	10030.3	23.9	10303.8	19.8
Claims on Govt(net) (MS)	38775.0	49191.1	59691.9	10416.1	26.9	10500.8	21.3
Claims on Govt (MS)	38775.0	49191.1	59691.9	10416.1	26.9	10500.8	21.3
Govt Deposits (MS)	0.0	0.0	0.0				-
Claims on Govt (OBI)	3271.2	2885.4	2688.4	-385.8	-11.8	-197.0	-6.8
ii. Claims on NBFI	47.2	49.7	132.4	2.5	5.3	82.7	166.4
Claims on NBFI (MS)	47.2	49.7	132.4	2.5	5.3	82.7	166.4
Claims on NBFI (OBI)							
iii. Claims on Non-financial Govt. Enter.	1808.1	2223.0	3076.0	414.9	22.9	853.0	38.4
Claims on Non-Fin. Govt. Enterprises (MS)	1808.1	2223.0	3076.0	414.9	22.9	853.0	38.4
Claims on Non-Fin. Govt. Enterprises (OBI)							
iv. Claims on Private Sector	135033.3	156113.9	165850.7	21080.6	15.6	9736.8	6.2
Claims on Private Sector (MS)	109447.6	126757.9	133315.3	17310.3	15.8	6557.4	5.2
Claims on Private Sector (OBI)	25585.7	29356.0	32535.4	0.0	0.0	3179.4	10.8
B. Capital and Other Items (net)	57742.7	66173.4	77228.5	8430.7	14.6	11055.1	16.7
Capital and Other Items(net) (MS)	52880.2	61199.4	68913.1	8319.2	15.7	7713.7	12.6
Less Claims on OBI (MS)	-8455.6	-9633.7	-8266.7	-1178.1	13.9	1367.0	-14.2
Time and Saving Deposits of OBI at MS	1017.3	1497.2	1800.0	479.9	47.2	302.8	20.2
Capital and Other Items (net) (OBI)	12300.8	13110.5	14782.1	809.7	6.6	1671.6	12.8
3. Liquid Liabilities (L1)	**197257.3**	**227907.3**	**238716.3**	30650.0	15.5	10809.0	**4.7**
A. Broad Money (M2)	186120.9	214454.1	223988.3	28333.2	15.2	9534.2	
Money Supply (M1)	60979.8	70576.9	77156.2	9597.1	15.7	6579.3	9.3
- Currency	42143.0	48295.1	55658.3	6152.1	14.6	7363.2	15.2
- Demand Deposits	18836.8	22281.8	21497.9	3445.0	18.3	-783.9	-3.5
Time Deposits (MS)	125141.1	143877.2	146832.1	18736.1	15.0	2954.9	2.1
B. Less Time and Saving Deposits of OBI (at MS)	1017.3	1497.2	1800.0	479.9	47.2	302.8	20.2
C. Time and Saving Deposits (OBI)	12153.7	14950.4	16528.0	2796.7	23.0	1577.6	10.6

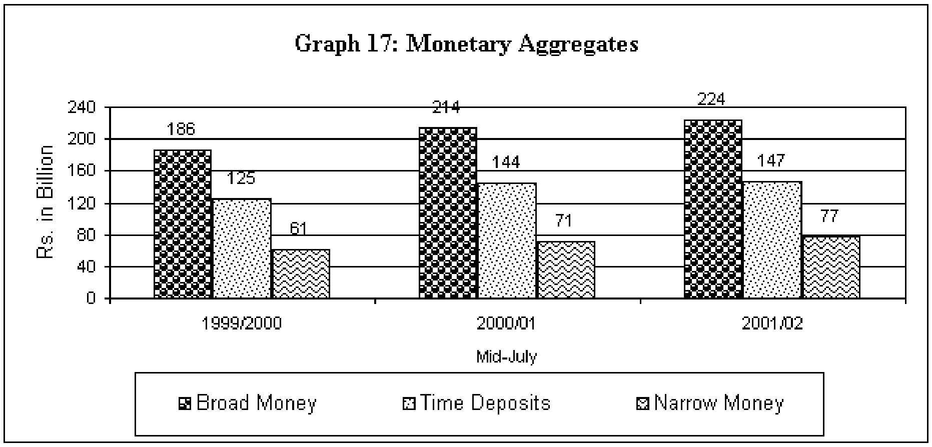
Note: In this table, MS refers to those items that are derived from the Monetary Survey and OBI refers to OBIs.

Domestic credit, the other expansionary factor of liquidity liabilities, increased by 10.0 percent (Rs. 21.0 billion) in the review year as compared to an increase of 17.6 percent (Rs. 31.5 billion) in the preceding year. The deceleration of domestic credit was primarily attributable to the lower growth of claims on private sector in the review year as compared to that of the previous year. The claims on private sector witnessed a growth of 6.2 percent (Rs. 9.7 billion) in the review year and stood at Rs. 165.9 billion at the end of the fiscal year. Such claims had risen by 15.6 percent (Rs. 21.1 billion) in the previous year. The share of claims on private sector on total domestic credit declined to 71.7 percent in the review year from 74.2 percent a year earlier. The other component of domestic credit, the claims on government, went up by 19.8 percent (Rs. 10.3 billion) in the review year in comparison to the previous year's growth of 23.9 percent (Rs. 10.0 billion). The share of claims on government on total domestic credit rose to 27.0 percent in the review year from 24.7 per cent in the previous year. The claims on non-bank financial institutions, on the other hand, which had gone up by 5.3 percent (Rs. 2.5 million) in the previous year, increased by 166.4 percent (Rs. 82. 7 million) in the review year. The claims on non-financial government enterprises went up by 38.4 percent (Rs. 853.0 million) in the review year and stood at Rs. 3.1 billion as at mid-July 2002. Such claims had increased by 22.9 percent (Rs. 414.9 million) in the previous year.

The contractionary factor of liquidity liabilities, capital and other items net, soared up by 16.7 percent (Rs. 11.1 billion) during the review year. In the previous year, such items had gone up by 14.6 percent (Rs. 8.4 billion). The deceleration in domestic credit coupled with the acceleration in capital and other items, net caused the high deceleration in net domestic assets, which had gone up by 19.1 percent (Rs. 23.1 billion) in the preceding year but increased by a lower rate of 6.9 percent (Rs. 9.9 billion) in the review year.

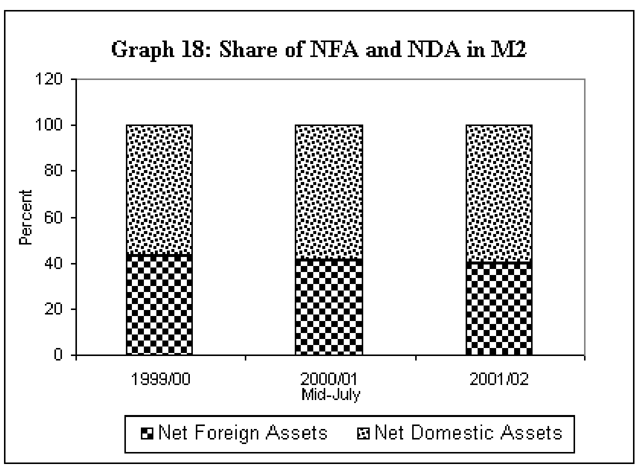
Monetary Survey

Monetary Aggregates: Both monetary aggregates, M1 and M2, grew at a slower pace during FY 2001/02, with a significant drop occurring towards the initial months of the fiscal year. M1 grew by 9.3 percent (Rs. 6.6 billion) in the review year as compared to 15.7 percent (Rs. 9.6 billion) growth in the previous year. Likewise, M2, which had gone up by 15.2 percent (Rs. 28.3 billion) in the previous year, registered relatively a lower growth of 4.4 percent (Rs. 9.5 billion) in the review year. The fall in NFA was responsible for the declining trend of M2 in the review year. Reserve money (RM) also registered a lower growth of 11.9 percent (Rs. 8.4 billion) in the review year as compared to a growth of 15.7 percent (Rs. 9.6 billion) in the preceding year. The lower growth of NFA of monetary authority was primarily responsible for the decelerated rate of growth of RM during the review period.

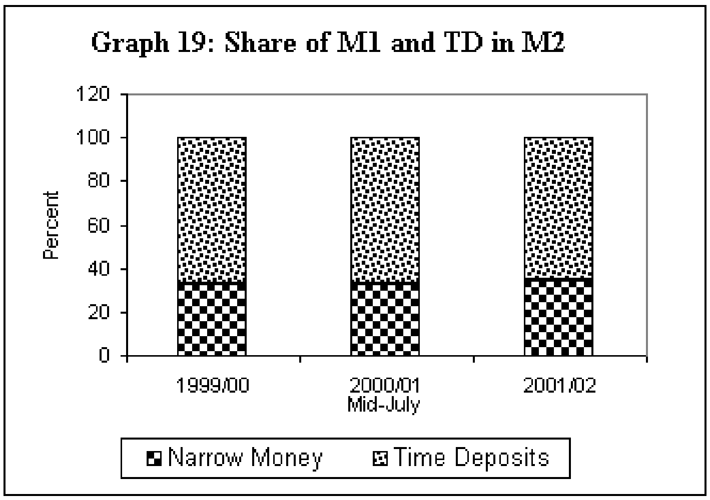


Components of M_1: With the significant fall in demand deposits, M1 supply maintained a lower growth of 9.3 percent (Rs. 6.6 billion) in the review year, as compared to 15.7 percent (Rs. 9.6 billion) in the previous year, and stood at Rs. 77.2 billion as at mid-July 2002. The demand deposits fell by 3.5 percent (Rs. 783.9 million) in the review year and amounted to Rs. 21.5 billion at the end of the fiscal year. The currency held by public, another component of M1, increased by 15.2 percent (Rs. 7.4 billion) from the preceding year and aggregated Rs. 55.7 billion at the end of review year.

Components of M_2: M_2, which is used as measure of overall liquidity in the monetary sector, registered a lower growth of 4.4 percent (Rs. 9.5 billion) in the review year compared to a relatively higher rate of 15.2 percent (Rs. 28.3 billion) in the preceding year. The deceleration in NFA was the contributory factor for the lower growth of M2 during the review year.

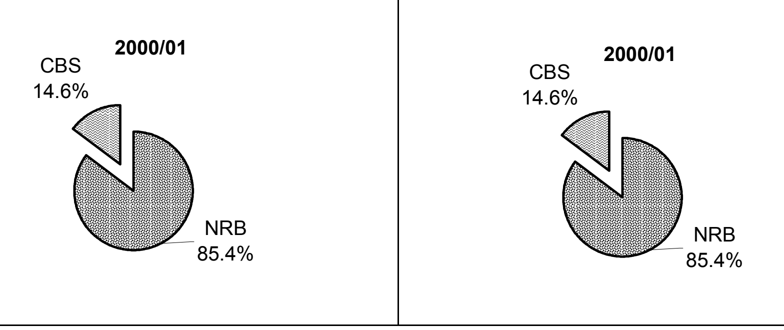


The share of NFA in M_2 has been declining over the years. It declined from 43.2 percent at mid-July 2000 to 40.9 percent at mid-July 2001 and further to 39.5 percent at mid-July 2002. Conversely, the share of net domestic assets (NDA) increased from 56.8 percent at mid-July 2000 to 59.1 percent in mid-July 2001 and further up to 60.5 percent in mid-July 2002. On the demand side of monetary liquidity, the share of M1 stood at 34.5 percent in FY 2001/02 as compared to 32.9 percent in the preceding year. Consequently, the share of time deposits fell to 65.6 percent in the review year from the previous year's level of 67.1 percent.



Expansionary Factors of Money Supply: NFA after adjusting the exchange valuation gain, declined by 3.8 percent (Rs. 3.3 billion) during the review period and stood at Rs. 88.4 billion as at mid-July 2002. Such assets had gone up by 6.5 percent (Rs. 5.2 billion) in the previous year. World economic recession, the September 11 incident in the US, and quantitative restrictions and value addition in some goods imposed by India in the revised trade treaty in 2002 were the major factors behind the decline in NFA during the review year. Of the total NFA, NRB's share went up to 91.7 percent in mid-July 2002 from 85.4 percent a year ago. Conversely, the share of the commercial banks declined to 8.3 percent in mid-July 2002 from 14.6 percent a year earlier.

Graph 20: NFA of Monetary Sector
(As of mid-July)



Domestic credit, the other expansionary factor of money supply, went up by 8.9 percent (Rs. 16.6 billion) in the review year and stood at Rs. 204.5 billion as at mid-July 2002. Such credit had witnessed a relatively higher growth of 18.5 percent (Rs. 29.3 billion) in the previous year. The decelerated growth of the claims on private sector was responsible for the lower growth of domestic credit.

Of the components of domestic credit, monetary sector's claims on government rose by 21.3 percent (Rs. 10.5 billion) in the review year and stood at Rs. 59.7 billion at the end of FY 2001/02. Such claims had risen by 26.9 percent (Rs. 10.4 billion) in the preceding year.

Another expansionary factor of money supply, the claims on government enterprises, declined by 3.6 percent (Rs. 431.3 million) in the review year and reached Rs. 11.5 billion as at mid-July 2002. In the preceding year such claims had gone up by 15.5 percent (Rs. 1.6 billion). Of the claims on government enterprises, the claims on financial enterprises dropped by 13.3 percent (Rs. 1.3 billion) while the claims on non-financial enterprises increased by 38.4 percent (Rs. 853.0 million) in the review year. In the preceding year, such claims on financial and non-financial enterprises had increased 13.9 percent (Rs. 1.2 billion) and 22.9 percent (Rs. 414.9 million), respectively.

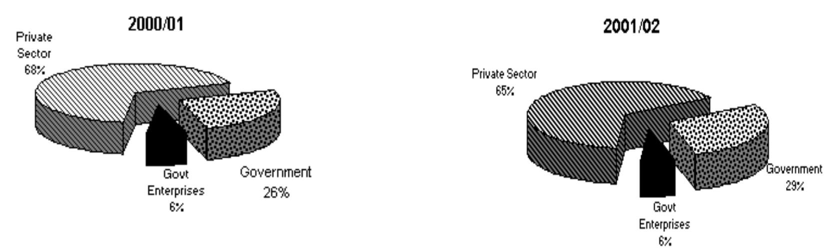
Of the total decline of Rs. 431.3 million in claims on government enterprises, commercial banks' claims stood at Rs. 404.9 million, the balance being that of NRB's claim. While the drop in commercial banks' claims was attributed primarily to the decline in the transfer made by commercial bank branches of ADB/N to their head office, the decline in NRB's claim was ascribed partly to the repayment of loans by the Rural Development Banks (RDBs) and partly to the reduction on NRB's investment in NIDC.

One of the important components of domestic credit, claims on private sector, registered a growth of 5.2 percent (Rs. 6.6 billion) during the review year, as compared to a relatively higher growth of 15.8 percent (Rs. 17.3 billion) in the preceding year. The recession in economic activities together with the worsening security condition were important factors behind the slower growth in claims on private sector during the review period.

The sectoral breakdown of the total domestic claims revealed that the share of claims on government increased from 26.2 percent at mid-July 2001 to 29.2 percent at mid-July 2002. As a consequence, the share of claims on government enterprises and the claims on private sector both declined to 5.6 percent and 65.2 percent, respectively, in the review year from 6.3 percent and 67.5 percent, respectively, in the previous year.

Graph 21: Sectoral Classification of Domestic Credit

(As at mid-July)



Contractionary Factors : One of the contractionary factors of money supply, net non-monetary liabilities, increased by 6.1 percent (Rs. 3.8 billion) in the review year and stood at Rs. 68.9 billion as at mid-July 2002. Such liabilities had gone up by 11.7 percent (Rs. 6.2 billion) in the preceding year.

Time deposits, the other contractionary factor of M1, decelerated to 2.1 percent (Rs. 3.0 billion) in the review year as compared to the previous year's growth of 15.0 percent (Rs. 18.7 billion).

RM

RM went up by 11.9 percent (Rs. 8.4 billion) during the review year and stood at Rs. 79.0 billion as at mid-July 2002. It had posted a comparatively higher growth of 15.7 percent (Rs. 9.6 billion) in the preceding year. Of the sources of RM, while the shares of NRB's NFA fell down to 102.7 percent in the review year from 106.2 percent in the previous year, the share of net domestic assets (NDA) were at negative levels of 2.7 percent and 6.2 percent, respectively, in the review year and the previous year.

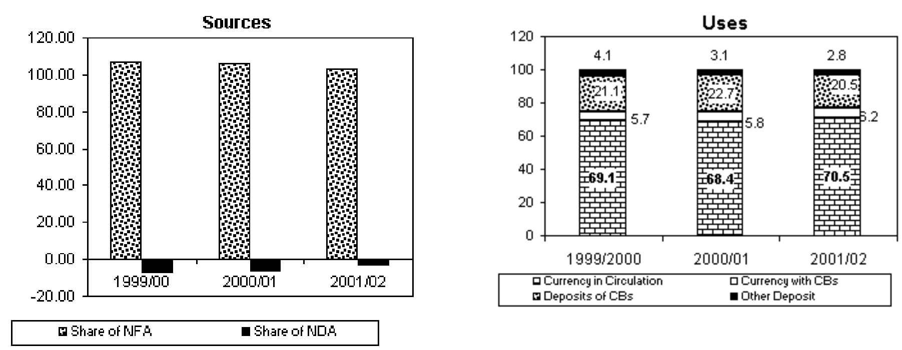
On the uses front of RM, currency in circulation posted a growth of 15.2 percent (Rs. 7.4 billion) during the review year in comparison to almost the same growth of 14.6 percent (Rs. 6.2 billion) in the previous year. Likewise, the currency held by commercial banks, which had increased by 17.4 percent (Rs. 609.9 million) in the previous year, expanded by 19.2 percent (Rs. 792.0 million) in the review year. The deposits of commercial banks posted a lower growth of 1.0 percent (Rs.

167.4 million) and stood at Rs. 16.2 billion at the end of FY 2001/02. Such deposits had risen by relatively a higher growth of 24.1 percent (Rs. 3.1 billion) in the previous year. The other deposits witnessed a growth of 3.7 percent (Rs. 80.5 million) in the review year, against the negative growth of 12.2 percent (Rs. 302.9 million) in the preceding year.

During the review year, the share of currency in circulation in RM rose to 70.5 percent from 68.4 percent in the preceding year. The share of currency held by commercial banks, which was 5.8 percent in FY 2000/01, increased by 0.4 percentage points and reached 6.2 percent at the end of FY 2001/02. However, with the drop of 2.2 percentage points, the share of deposits of commercial banks was maintained at 20.5 percent in the review year. The share of other deposits also dropped from 3.1 percent in mid-July 2001 to 2.8 percent at mid-July 2002.

Graph 22: Sources and Uses of RM

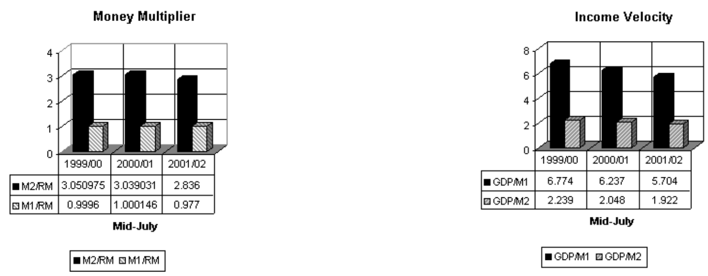
(Percentage Share)



Money Multiplier

During the review year, both narrow and broad money multipliers exhibited downward movements as compared to the previous year. Narrow money multiplier fell to 0.9770 as at mid-July 2002 from 1.0001 in the corresponding month of previous year. Likewise, broad money multiplier went down to 2.836 in the review year from 3.039 in the previous year. The increase in commercial banks' reserves relative to their domestic demand deposits caused the decline in the value of money multipliers during the review period.

Graph 23: Money Multiplier and Income Velocity of Money



Income Velocity

Income velocity of both M_1 and M_2 continued to display declining trends during the review period. Income velocity of M_1 plummeted to 5.704 in the review year from the previous year's level of 6.237. Similarly, the income velocity of M2 that was 2.048 in previous year fell to 1.922 in the review year. The downward movement in interest rates was attributable to the decline in income velocity of monetary aggregates.

Monetary Policy and Outlook for 2002/03 : The NRB, in accordance with the provision made in NRB Act, 2002 announced for the first time the annual monetary policy and programme for FY 2002/03 on July 16, 2002. Some of the salient features of the programme included the following: (a) reduction of the CRR by 1 percentage point effective from July 22, 2002 to inject liquidity into the economy so as to facilitate economic growth; (b) removal of the required interest spread of 5 percent between lending and deposit rates of commercial banks in order to bring about more competitiveness; (c) allocation of Rs. 100.0 million from the profit of FY 2001/02 by the NRB to RSRF for long-term credit flow to prescribed sectors and thereafter allocation of 5 percent of its net profit annually; (d) revitalizing sick industries by providing refinance facility of Rs.1.5 billion for these industries; and (e) gradual removal of the priority sector lending program in five years' time, thereby making commercial banks free from this role and, subsequently, expanding development banks and micro-credit institutions in rural areas.

Together with the announcement of the monetary policy and programme, the implicit monetary targets for 2002/03 were also announced. M2, M1 and RM were estimated to grow by 12.0 percent, 11.8 percent and 11.5 percent, respectively. These growths in monetary aggregates were estimated to provide adequate liquidity to attain a GDP growth of 4.0 percent with 4 percent inflation and surplus in the BOP amounting to Rs. 3.5-4.0 billion.

Financial Development

Financial Institutions

Commercial Banks

Total Assets/Liabilities

During the review period, total assets/liabilities of commercial banks went up slightly by 2.2 percent (Rs. 5.4 billion) and aggregated Rs. 250.9 billion as at mid-July 2002. Such assets and liabilities of commercial banks had soared up by 18.7 percent (Rs. 38.7 billion) in the preceding year. The total assets/liabilities of commercial banks to nominal GDP ratio fell only negligibly by 0.2 percentage point to 59.6 percent at mid-July 2002 from 59.8 percent at mid-July 2001. The decline in commercial banking activities during the review period was primarily due to insurgency problem.

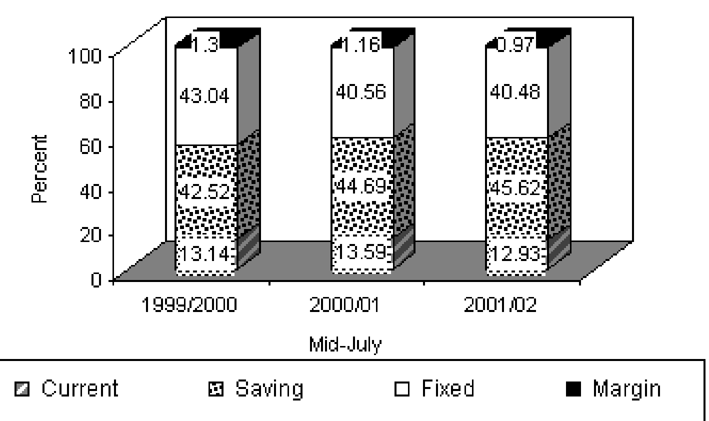
Liabilities Front

Deposits : Total deposits of commercial banks, which had gone up by 17.3 percent (Rs. 26.7 billion) last year, increased nominally by 1.4 percent (Rs. 2.5 billion) and stood at Rs. 183.7 billion at mid-July 2002.

Among the components of total deposits, savings deposits posted a growth rate of 3.5 percent (Rs. 2.8 billion) during the review period compared to an impressive increment of 23.3 percent (Rs. 15.3 billion) in the preceding year. Likewise, there was a lower growth of 1.2 percent (Rs. 884.9 million) registered by fixed deposits during the review period compared to the significant increase of 10.5 percent (Rs. 7.0 billion) in the previous year. On the other hand, demand deposits of commercial banks fell by 3.6 percent (Rs. 880.0 million) during the review period compared to a growth of 21.3 percent (Rs. 4.3 billion) a year earlier. Similarly, margin deposits also went down by 14.8 percent (Rs. 310.1 million) compared to a growth of 4.7 percent (Rs. 94.7 million) in the preceding year. The overriding factors for the decline in total deposits were the looting of banks by the Maoists, particularly in the rural areas, and the closure of some of the branches of RBB and NBL.

With respect to the share in total deposits, the share of savings deposits went up by 0.9 percentage points to 45.6 percent at mid-July 2002 compared to 44.7 percent in the previous year. Similarly, there was no noticeable change in the share of demand, fixed and margin deposit which stood at 12.9 percent, 40.5 percent, and 1.0 percent, respectively, at mid-July 2002 compared to a share of 13.6 percent, 40.6 percent and 1.2 percent, respectively, in the previous year.

Graph 24: Structure of Total Deposits
(Percentage Share)



Borrowings from NRB : Commercial banks' outstanding borrowings from the NRB went up from Rs. 5.5 million at mid-July 2001 to Rs. 1.04 billion at mid-July 2002. The increased borrowing of commercial banks was due to the refinancing policy of the NRB for sick industry loans.

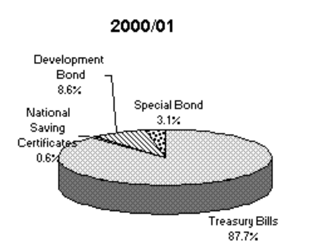
Other Liabilities : The other liabilities of commercial banks went up by 2.5 percent (Rs. 1.6 billion) during the review period and aggregated Rs. 65.9 billion compared to a notable growth of 23.0 percent (Rs. 12.1 billion) a year earlier. The lower level of profit of commercial banks was responsible for the decelerated rate of growth of other liabilities during the review period.

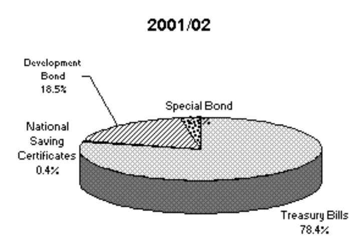
Assets Front

Liquid Funds: Total liquid funds of commercial banks which had risen by 12.1 percent (Rs. 5.5 billion) last year, fell by 7.3 percent (Rs. 3.7 billion) and stood at Rs. 46.9 billion as at mid-July 2002. This was ascribed to the combined effect of a negative growth of foreign currency in hand by 7.4 percent (Rs. 49.0 million), balance held abroad by 15.4 percent (Rs. 4.2 billion), and cash in transit by 15.3 percent (Rs. 363.0 million) as well as a lower growth in balance with NRB by 1.0 percent (Rs. 167.4 million). Cash in hand, however, had gone up by 19.2 percent (Rs. 792.0 million) in the review year. In the previous year, foreign currency in hand had soared up by 5.3 percent (Rs. 33.8 million), balance held abroad by 7.4 percent (Rs. 1.9 billion), balance with NRB by 24.1 percent (Rs. 3.1 billion) and cash in hand by 17.4 percent (Rs. 609.9 million). Cash in transit, however, had posted a negative growth of 6.6 percent (Rs. 167.0 million) in the previous year.

Loans and Advances : The total loans and advances of commercial banks rose by a relatively lower rate of 6.0 percent (Rs. 9.6 billion) during FY 2001/02, primarily due to a lower growth in claims on government and private sector as well as a negative growth of claims on government enterprises, and stood at Rs. 170.5 billion at mid-July, 2002. In the previous year, such loans and advances had increased by a much higher rate of 18.2 percent (Rs. 24.7 billion).

Graph 25: Structure of Government Securities Held by Commercial Banks (As at mid-July)





Out of the total loans and advances, claims on government, which had gone up by a higher rate of 39.7 percent (Rs. 7.2 billion) in the previous year, went up by a relatively lower rate of 15.2 percent (Rs. 3.9 billion) in the review year and aggregated Rs. 29.3 billion at mid-July 2002. Among the various government debt stocks held by the commercial banks, the share of treasury bills fell to 78.4 percent at mid-July 2002 from the previous year's level of 87.7 percent. Conversely, the share of development bonds, which was 8.6 percent in the previous year, went up to 18.5 percent in the review year. The shares of national saving certificates and special bonds both declined to 0.4 percent and 2.7 percent at mid-July 2002 from previous year's shares of 0.6 percent and 3.1 percent, respectively.

The commercial banks' claims on government enterprises declined by 4.0 percent (Rs. 404.9 million) and aggregated Rs. 9.8 billion at mid-July 2002, compared to an increase of Rs. 1.5 billion a year earlier. The decline in commercial banks' claim on government enterprises was attributed to the decline in the amount that commercial bank branches of ADB/N transferred to its head office. Among the claims on government enterprises, while the claims of financial enterprises recorded a decline of 15.7 percent (Rs. 1.3 billion) in the review year compared to an increase of 16.4 percent (Rs. 1.1 billion) a year earlier, the claims on non-financial enterprises registered a higher growth of 38.5 percent (Rs. 853.0 million) in the review year compared to a lower growth of 23.0 percent (Rs. 414.9 million) a year earlier.

The major contributory factor for the total decrease in claims on financial government enterprises was the decline in the transfer of ADB/N's of commercial bank branches to its head office totaling to Rs. 1.3 billion during the review year. The increase in claims on non-financial government enterprises, on the other hand, was mainly due to the increase in loans and advances availed by Birgunj Sugar Factory and National Trading Limited during the review year.

The principal component of loans and advances of commercial banks, claims on private sector, showed a lower growth of 5.4 percent (Rs. 6.7 billion) during the review period and amounted to Rs. 130.1 billion at mid-July 2002 compared to a higher growth of 15.0 percent (Rs. 16.1 billion) in the previous year. A fall in both exports and imports together with the recessionary trend in the tourism and industrial sector were the responsible factors for the lower growth of claims on private sector during the review period.

The **foreign bills purchased and discounted** of commercial banks declined by 29.6 percent (Rs. 557.1 million) during the review period as compared to a decline of 4.9 percent (Rs. 97.1 million) a year earlier and amounted to Rs. 1.3 billion at mid-July 2002.

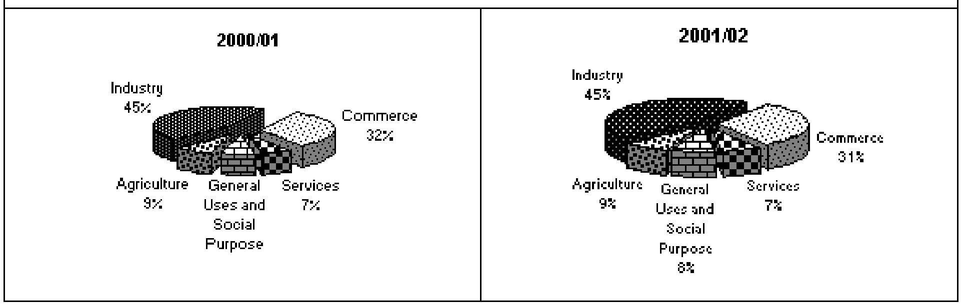
Other Assets : Other assets of commercial banks fell by 1.4 percent (Rs. 478.5 million) in the review period as against an increase of Rs. 8.5 billion in the previous year.

Commercial Banks' Credit by Purpose

The total purpose-wise credit decelerated during the review year. Such credit had gone up by 13.5 percent (Rs. 13.4 billion) in FY 2000/01 as against the lower growth of 4.6 percent (Rs. 5.2 billion) in FY 2001/02. While reviewing the sector-wise classification, the agriculture sector expanded by relatively a lower growth of 1.6 percent (Rs. 156.6 million) during the review year, as compared to the previous year's growth of 12.8 percent (Rs. 1.1 billion). Likewise, the industrial sector grew by 5.1 percent (Rs. 2.6 billion) in the review year as compared to previous year's higher rate of 13.6 percent (Rs. 6.1 billion) growth. The commercial and the general uses and social sectors also posted a lower growth of 2.0 percent (Rs. 728.4 million) and 13.2 percent (Rs. 1.1 billion) during the review year, in comparison with the growth of 10.5 percent (Rs. 3.5 billion) and 40.9 percent (Rs. 2.3 billion) a year ago. The services sector, however, accelerated by 8.4 percent (Rs. 635.0 million) in FY 2001/02 compared to 5.0 percent (Rs. 365.3 million) in FY 2001/02.

Of the total commercial bank credit, the share of industrial sector stood at a higher level of 45.4 percent during the review year followed by the share of commercial sector at 32.1 percent. The shares of the industrial sector and commercial sectors were 45.4 percent and 31.3 percent, respectively during the previous year. Similarly, the shares of agricultural, services and general uses and social sectors were 8.9 percent, 6.7 percent and 7.1 percent, respectively, during the review year compared to their shares of 8.6 percent, 7.0 percent and 7.7 percent, respectively, during the previous year.

Graph 26: Sectorwise Credit of Commercial Banks



Priority Sector Lending : In order to make bank credit available to small agricultural, industrial and services sector and generate income and employment opportunities, the NRB had directed the commercial banks to extend at least 9 percent of their total outstanding loans to the priority sector. Excluding Kumari Bank Ltd, all the commercial banks satisfied the required lending requirement to priority sector during FY 2001/02. In aggregate, the loan provided to the priority sector by all the commercial banks amounted to Rs. 16.34 billion at mid-July 2002. This figure formed 15.7 percent of their total outstanding loans of six months ago. Such lending of the commercial banks had amounted to Rs. 14.0 billion at mid-July 2001 and this was equivalent to about 14.4 percent of their outstanding loans of six months ago.

Deprived Sector Lending : The commercial banks have also been directed by the NRB to extend some part of their priority sector lending to the deprived sector. The deprived sector lending requirement is discriminatory with regard to the aging of commercial banks ranging from 0.56 percent to 2.25 percent of their six-month prior total outstanding loans. In terms of this provision, the loans provided by commercial banks stood at Rs. 3.48 billion at mid-July 2002. This figure formed about 3.3 percent of their six-month prior total outstanding loans. Deprived sector lending, which amounted to the same figure of Rs. 3.5 billion at mid-July 2001, formed about 3.6 percent of total outstanding loans of six months ago.

Commercial Banks' Deposit and Lending Rates

Commercial banks could themselves fix the interest rate on deposits and lending. Yet, they were directed by the NRB to maintain the weighted average interest rate spread at or below 5 percent. In the review period, the interest rate was affected by excess liquidity. As a result, interest rate on saving deposits declined to 2.5-6.25 percent at mid-July 2002 from 3.0-6.5 percent a year earlier. The interest rate on one year fixed deposit also declined to 3.5-7.0 percent at mid-July 2002 compared to 4.5-7.75 percent in the previous year.

Interest Rate Structure of Commercial Banks*

(As of Mid-July)

Particulars	Percent per annum		
	1999/00	2000/01	2001/02
1. Deposit Rates			
Saving Deposits	4.0-6.5	3.0-6.5	2.5-6.25
One Year Fixed Deposits	6.0-7.75	4.5-7.75	3.5-7.0
2. Lending Rates			
Industrial	10.5-15.5	7.0-15.0	7.0-14.5
Commercial	9.0-16.5	7.0-16.0	7.0-16.0
Priority Sector	12.0-14.5	12.5-14.5	12.0-14.0
Export	7.5-15.0	7.0-12.5	6.5-12.0
Overdrafts	10.0-18.0	10.0-18.0	11.0-17.00

* Unweighted

The lending rates of commercial banks also exhibited a mixed trend in the review year. Interest rate on export bills declined to 6.5-12.0 percent at mid-July 2002 from the range of 7.0-12.5 percent in the previous year. Lending rate for commercial loans remained at the same range of 7.0-16.0 at mid-July 2002, compared to the previous year. The industrial lending rate was stood at 7.0-14.5 percent at mid-July 2002, compared to the range of 7.0-15.0 percent a year ago. Thus, there was a decline of 0.5 percentage point in the higher limit of the industrial lending rate in the review year compared to the previous year. With regard to the interest rate on overdraft, on the other hand, while there was a decline in the higher limit by one percentage point, there was an increase by one percentage point on the lower limit. Consequently, the interest rate on overdraft was 11.0-17.0 percent at mid-July 2002, compared to 10.0-18.0 percent a year earlier.

Other Banking and Non-Banks Financial Institutions

OBIs include all deposit taking financial institutions other than commercial banks *viz.;* Development Banks, Rural Development Banks (RDBs), Finance Companies (FCs), Financial Cooperatives (FINCOOPs) and FINGOs. Similarly, Non-Bank Financial Institutions (NBFIs) include all other financial institutions not directly involved in accepting public deposits but occupying important place in the financial system in mobilizing financial resources collected in different forms such as premiums through insurance business, collection of employees' provident fund and voluntary savings of corporate employees. Altogether 18 insurance companies including Deposit Insurance and Credit Guarantee Corporation (DICGC), one Employees Provident Fund (EPF) and one Citizen Investment Trust (CIT) belong to this type of financial institutions. Apart from this, securities market too mobilizes financial resource from capital market through the selling and buying securities such as corporate shares, debentures and bonds.

OBIs

There are 16 development banks including ADB/N and NIDC established under the special Acts. Development Banks other than the above were established under Development Bank Act, 1995. In addition, the present financial system includes 5 RDBs, 54 FCs, 34 FINCOOPs, 33 FINGOs and 116 Postal Saving Banks (PSBs).

Total outstanding loans of OBIs[#] increased by 10.6 percent (Rs. 3.18 billion) in FY 2001/02 compared to the increase of 16.1 percent (Rs. 4.15 billion) in the preceding year. The total outstanding loans of OBIs at mid-July 2002 remained Rs. 33.1 billion. Of the total outstanding loan, ADB/N accounted for 50.3 percent, FCs 36.1 percent, NIDC 6.2 percent, co-operative societies (with limited banking transactions) 4.0 percent and RDBs 3.4 percent.

Sources and Uses of Funds of OBIs

The aggregate sources of funds of OBIs recorded a growth of 8.7 percent (Rs. 3.9 billion) to Rs. 48.1 billion during FY 2001/02 compared to an increase of 17.3 percent (Rs.6.5 billion) in the previous year. In the review year, paid up capital and reserves witnessed a growth of 9.8 percent (Rs. 351.1 million) to Rs. 4.0 billion and 27.3 percent (Rs. 417.8 million) to Rs. 2.0 billion respectively. During the year, deposits of OBIs went up by 10.5 percent (Rs. 1.6 billion) to Rs. 16.5 billion compared to an increase of 23.0 percent (Rs. 2.8 billion) last year. FCs hold the largest share of 80.9 percent (Rs. 13.5 billion) in the total deposit of OBIs as at mid-July 2002, followed by cooperative societies (with limited banking transactions) 9.4 percent (Rs. 1.6 billion), ADB/N 4.6 percent (Rs. 759.8 million), NIDC 2.4 percent (Rs. 402.5 million) and RDBs 2.1 percent (Rs. 341.1 million). During the review year, aggregate borrowing of these institutions declined by 6.6 percent (Rs. 518.5 million) to Rs. 7.3 billion against an increase of 9.4 percent (Rs. 673.4 million) in the previous year. Both domestic as well as foreign borrowing fell by 6.8 percent (Rs. 251.7 million) to Rs. 3.4 billion and 6.4 percent (Rs. 266.8 million) to Rs. 3.9 billion. In the previous year, whereas domestic borrowing had

---

[#] Include NIDC, FCs, Cooperative Societies (with limited banking transactions), RDBs and non-commercial banking transactions of ADB/N.

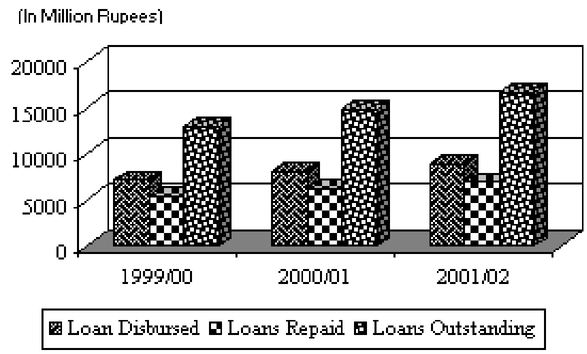
an increment of 32.1 percent (Rs. 895.3 million) to Rs. 3.7 billion, foreign borrowing had gone down by 5.0 percent (Rs. 221.9 million) to Rs. 4.2 billion. Other liabilities of OBIs went up by 12.5 percent (Rs. 2.0 billion) to Rs. 18.3 billion in the review year. This included Rs. 8.6 billion loanable fund of ADB/N against Rs. 6.7 billion in the previous year.

On the uses side, the aggregate cash and bank balance and investment of OBIs increased by 32.5 percent (Rs. 1.0 billion) to Rs. 4.3 billion and 4.8 percent (Rs. 218.0 million) to Rs. 4.7 billion respectively. Of the total investment of OBIs outstanding at mid-July 2002, Government securities accounted for 56.7 percent (Rs. 2.7 billion), fixed deposits and others accounted for 38.0 percent (Rs. 1.8 billion) and shares accounted for 5.3 percent (Rs. 252.8 million). During the review year, loans and advances of these financial institutions grew up by 10.8 percent (Rs. 3.2 billion) to Rs. 32.5 billion compared to an increase of 14.7 percent (Rs. 3.8 billion) in the preceding year. As at mid-July 2002, ADB/N had the largest share of 51.2 percent in total outstanding loans of these institutions followed by FCs (36.7 percent), NIDC (4.5 percent), cooperative societies (with limited banking transactions (4.0 percent) and RDBs (3.6 percent). Purpose-wise distribution of outstanding loans and advances of these institutions as at mid-July 2002 revealed that 51.2 percent (Rs. 16.7 billion) went for agricultural sector, 9.7 percent (Rs. 3.14 billion) for housing sector, 4.5 percent (Rs. 1.4 billion) for industrial sector and the remaining 34.6 percent (Rs. 11.3 billion) went for other sectors. Other assets of OBIs went down by 50.6 percent (Rs. 580.6 million) to Rs. 6.5 billion in the review year.

ADB/N

ADB/N was established in 1968 with an objective of improving the living standard of farmers by providing easy access to loans in order to increase production and productivity in agriculture sector. The bank has been lending to individual farmers and cooperative societies for agriculture production; farm improvement, irrigation and allied purposes like business and industrial projects based on agriculture. The bank is the largest vehicle providing agriculture credit and has a wide network all over the country. It collects public deposits through its commercial bank branches. It has adopted reform measures to speed up its loan repayment for the last few years.

Graph 27: Credit Operations of ADB/N



The total loan disbursement of ADB/N increased by 9.3 percent (Rs. 748.6 million) to Rs. 8.8 billion in FY 2001/02 compared to an increase of 13.3 percent (Rs. 952.1 million) in the previous year. Of the total loan disbursed during the year, 47.7 percent (Rs. 4.2 billion) went for agro-industry, marketing and warehouse construction, 21.2 percent (Rs. 1.9 billion) for agriculture production, 17.8 percent (Rs. 1.6 billion) for agro-business, 11.5 percent (Rs. 1.0 billion) for farm improvement and irrigation and the remaining 1.8 percent (Rs. 154.8 million) for miscellaneous purposes. Similarly, the total loan recovering of ADB/N went up by 12.1 percent (Rs. 752.8 million) to Rs. 6.95 billion this year compared to an increase of 16.0 percent (Rs. 856.9 million) in the previous year. Loan disbursement as well as loan recovery of ADB/N fell short of the target by 2.3 percent (Rs. 212.0 million) and 8.4 percent (Rs. 639.0 million) respectively of the annual target set for the year. The annual targets of ADB/N for loan disbursement and realization were Rs. 9.1 billion and Rs. 7.6 billion respectively. The total loan outstanding of ADB/N increased by 12.8 percent (Rs. 1.9 billion) to Rs. 16.7 billion in the review year compared to an increase of 14.7 percent (Rs. 1.9 billion) in the previous year.

Of the total loan of Rs. 16.7 billion outstanding as at mid-July 2002, agro-industry, marketing and warehouse construction accounted for 36.2 percent, agro-business 21.2 percent, agriculture production 20.6 percent, farm improvement and irrigation 17.6 percent and miscellaneous purposes 4.4 percent. Borrower-wise outstanding loan with individuals and cooperatives remained 94.9 percent and 5.1 percent respectively.

Maturity-wise, of the total loan outstanding as at mid-January 2002, 55.5 percent (Rs. 9.3 billion) consisted of medium term loan followed by 37.7 percent (Rs. 6.3 billion) short-term and 6.8 percent (Rs. 1.3 billion) long-term.

Of the total loan repayment of ADB/N during the review year, agro-industry, marketing and warehouse construction contributed 47.4 percent followed by agriculture production 23.1 percent, agro-business 16.7 percent, farm improvement and irrigation 11.8 percent and miscellaneous purposes 1.0 percent.

Sources and Uses of Fund of ADB/N

Sources of Fund : Total sources of fund of ADB/N increased by 8.8 percent (Rs. 2.8 billion) to Rs. 35.0 billion during FY 2001/2002 compared to an increase of 14.6 percent (Rs. 4.1 billion) in the previous year. The paid up capital of ADB/N increased by 1.8 percent (Rs. 26.6 million) to Rs. 1.5 billion during the review year. Reserve fund increased by 13.9 percent (Rs. 36.7 million) this year compared to a growth of 105.1 percent (Rs. 134.5 million) in the preceding year. Borrowing from the central bank went down by 1.8 percent (Rs. 4.6 million) to Rs. 250.8 million. Similarly borrowing from commercial banks fell significantly by 32.4 percent (Rs. 379.2 million) to Rs. 791.7 million during the review year. Foreign borrowing fell by 7.3 percent (Rs. 266.8 million) to Rs. 3.4 billion this year compared to a fall of 4.9 percent (Rs. 188.1 million) in the preceding year. Because of the growth in public deposit mobilization aggregate borrowing of ADB/N fell by 12.8 percent (Rs. 650.6 million) to Rs. 4.44 billion in 2001/2002 as against an increase of 8.0 percent (Rs. 376.2 million) in the previous year.

Overall deposit of ADB/N increased by 17.0 percent (Rs. 3.0 billion) to Rs. 20.8 billion during the review year compared to an increase of 17.8 percent (Rs. 2.7 billion) in the previous year. Current, saving, fixed and other deposit accounted for 5.2 percent, 53.3 percent and 37.1 percent 4.4 percent respectively.

Uses of Fund : Cash and Bank Balances of ADB/N decreased by 6.7 percent (Rs. 179.7 million) to Rs 2.52 billion in the review year as against an increase of 6.3 percent (Rs. 160.9 million) in the previous year. Cash and bank balances constituted 7.2 percent of the total fund available. In the FY 2001/02 the bank's total loan outflows in agricultural and commercial activities went up by 13.3 percent (Rs. 2.7 billion) to Rs. 23.1 billion compared to an increase of 17.2 percent (Rs. 3.0 billion) in the previous year.

Total investment of ADB/N declined by 9.7 percent (Rs. 250.2 million) to Rs. 2.3 billion during the review year compared to a fall of 7.8 percent (Rs. 219.2 million) in the preceding year. Of the total investment, the proportion of government securities, fixed deposits and shares consisted of 64.5 percent, 29.6 percent and 5.9 percent respectively.

Small Farmers Development Programme (SFDP)

The total number of SFDPs at the end of FY 2001/02 stood at 217 spreading all over 75 districts of the country. During the review year, total savings collected under the programme declined by 26.2 percent (Rs. 20.1 million) to Rs. 56.5 million compared to a fall of 16.6 percent (Rs. 15.2 million) in the preceding year. The number of farmers benefiting from the programme stood at 103792 as at mid-July 2002, showing a significant decline of 26.2 percent from the previous year's level.

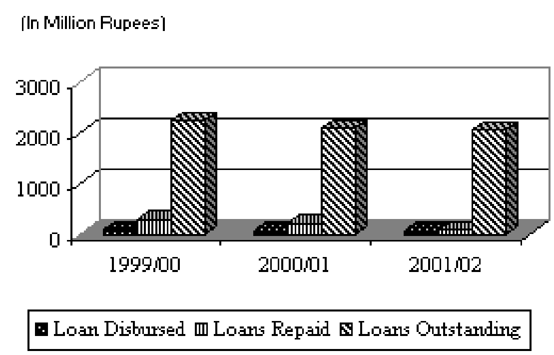
In the review year, total loan disbursement under this program fell by 16.1 percent (Rs. 79.4 million) to Rs. 413.3 million compared to a decline of 10.9 percent (Rs. 60.1 million) in the preceding year. Of the total loan disbursed, agriculture production accounted for 34.2 percent (Rs. 141.5 million), agro-business 31.7 percent (Rs. 131.1 million), agro-industry, marketing and warehouse construction 17.0 percent (Rs. 70.1 million), farm improvement and irrigation 15.8 percent (Rs. 65.3 million) and other purposes 1.3 percent (Rs. 5.3 million).

Loan repayment under this program fell moderately by 9.9 percent (Rs. 39.4 million) to Rs. 358.6 million compared to a decline of 12.8 percent (Rs. 58.3 million) last year. As a result, total outstanding loan marginally increased by 2.9 percent (Rs. 54.7 million) to Rs. 2,0 billion in the review year compared to an increase of 5.2 percent (Rs. 94.7 million) in the preceding year.

NIDC

NIDC was established in 1959 with a view to encouraging industries in private sector through financial and technical assistance. It extends loans against adequate collateral and also makes share participation in private sector industries for their establishment, improvement, expansion and modernization. The corporation has been facing solvency problem for the last few years because of slackness in loan repayment. Therefore, the Corporation has heavily curtailed its disbursements because of lack of fund. However, NRB has given approval to the Corporation to manage financial resource by accepting institutional deposits.

Graph 28: Credit Operations of NIDC



Loan disbursements of NIDC during FY 2001/02 totaled Rs. 74.3 million reflecting a further decline of 8.9 percent (Rs. 7.3 million) over the FY 2001/02. Of the total loan disbursed during the year 35.5 percent (Rs. 26.4 million) went for manufacturing sector, 17.2 percent (Rs. 12.8 million) for service sector, 10.1 percent (Rs. 7.5 million) for hotels and the remaining 37.2 percent (27.6 million) for other purposes. Similarly, the total loan realization of NIDC declined significantly by 57.4 percent (Rs. 137.7 million) to Rs. 102.3 million during the review year compared to a fall of 19.3 percent (Rs. 57.3 million) in the previous year. As a result, financial position of the Corporation heavily deteriorated and the lending activities almost went into doldrums. Outstanding loan of NIDC further went down by 1.3 percent (Rs. 28.0 million) to Rs. 2.1 billion in the review year compared to a decline of 7.1 percent (Rs. 158.4 million) last year.

Of the total outstanding loans of NIDC in FY 2001/02, 63.6 percent (Rs. 1.31 billion) went for manufacturing, 24.7 percent (Rs. 507.5 million) for hotels, 5.6 percent (Rs. 114.3 million) for services and the remaining 6.1 percent (Rs. 126.2 million) went for miscellaneous purposes.

Sources and Uses of Fund of NIDC

Sources of Fund : The total sources of fund of NIDC went down marginally by 1.5 percent (Rs. 39.3 million) to Rs. 2.66 billion in the review period as against an increase of 6.5 percent (Rs. 163.8 million) in the preceding year. In the review year, paid up capital and reserve fund of the Corporation remained constant

Fixed deposit liability of NIDC, compared with the preceding year, went down by 9.0 percent (Rs. 40.0 million) to Rs. 402.5 million during the review year. The Corporation made no refund of borrowing during the year due to liquidity problem and therefore, the outstanding balance of borrowing remained at par with that of last year. The respective shares of NRB, the government and external sector in the total outstanding borrowing in FY 2001/02 were 63.6 percent (Rs. 902.3 million), 16.5 percent (Rs. 234.6 million) and 19.9 percent (Rs. 281.3 million). Industrial development bonds worth of Rs. 30.0 million were matured and repaid during the year and to that extent the development bond liability of NIDC was reduced and stood at Rs. 55.0 million as at mid-July 2002. During the review year, other liabilities of NIDC increased by 19.1 percent (Rs. 30.7 million) to Rs. 191.2 million.

Uses of Fund : Aggregate investment of NIDC remained at Rs. 129.6 million consisting of 88.4 percent in company shares and the remaining 11.6 percent in NCM mutual fund. Cash and bank balances reduced by 25.6 percent (Rs. 60.2 million) to Rs. 174.8 million at mid-July 2002, as against an increase of 60.8 percent (Rs. 88.9 million) at the same time in the preceding year. Similarly, industrial loan went down by 2.3 percent (Rs. 34.1 million) to Rs 1.5 billion as at mid-July, compared to a decline of 26.5 percent (Rs 537.1 million) last year. Other assets of NIDC increased by 3.2 percent (Rs. 28.4 million) to 906.3 million this year compared to 2.5 times (Rs. 625.3 million) increase in the preceding year.

Other Development Banks

Development Banks established as public limited companies and came into operation under the Development Bank Act, 1996. The main objective for the establishment of these banks is to make financial resources and technology needed available for the establishment, development, expansion and increase in the capacity and productivity of specific sectors. These banks are allowed to collect deposits as prescribed by NRB and to advance loans for fixed and working capital need of agricultural, industrial, services, trade sectors and other commercially viable and productive enterprises. The number of such development banks till mid-July, 2002 reached 14.

Sources and Uses of Fund of Other Development Banks

The total sources of fund of other Development Banks significantly increased by 59.9 percent (Rs. 1.9 billion) to Rs. 4.9 billion at mid-July, 2002 compared to the previous year. The sources of fund in the review year consisted of capital fund 16.3 percent (Rs. 802.9 million), deposits 69.6 percent (Rs. 3.4 billion), borrowing 7.0 percent (Rs. 345.4 million) and other liabilities 7.1 percent (Rs. 350.2 million). On the uses side, Cash and Bank balances recorded 19.6 percent (Rs. 968.9 million), investments 9.8 percent (Rs. 483.3 million), loans and advances 66.6 percent (Rs. 3.3 billion) and other assets 4.0 percent (Rs. 196.0 million). Of the total investment Government Securities accounted for 41.4 percent (Rs. 200.0 million), share and debenture 11.9 percent (Rs. 57.3 million) and other investment for 46.8 percent (Rs. 226.0 million). During the review year, while deposits went up by 52.7 percent (Rs. 1.2 billion) loans and advances increased by 60.9 percent (Rs. 1.2 billion).

FCs

FCs came into operation under the Finance Companies Act, 1985. They are registered as limited liability companies with the office of the registrar of companies according to the provisions made in the Companies Act, 1965. They accept time deposits and advance loans to individuals, firms, companies or institutions for agriculture as well as non-agriculture purposes in order to increase economic activities. They also perform functions of merchant banking with prior approval of NRB. They have become popular among low-income and medium class people as they make loans available for hire purchase and for the purchase of vehicles, machinery, tools, equipment, durable household goods or other similar movable properties. Subsequent to the adoption of financial liberalization, many FCs came into operation especially in Kathmandu and other urban areas. In FY 2001/02 the number of FCs reached 54, of which only 18 companies were out of Kathmandu valley.

Sources and Uses of Fund of FCs

The aggregate sources of fund of FCs recorded a growth of 16.8 percent (Rs. 2.7 billion) to Rs. 18.4 billion during FY 2001/02 compared to an increase of 21.1 percent (Rs. 2.8 billion) in the previous fiscal year. As 6 more FCs came into operation during the review year, total number of FCs till the end of FY 2001/02 reached 54 as against 48 at the end of the previous fiscal year.

Public Deposit is the major source of fund of FCs, which consisted of 72.9 percent of the total sources in FY 2001/02. During the review year, capital fund went up by 29.4 percent (Rs. 665.4 million) to Rs. 2.9 billion compared to an increase of 30.6 percent (Rs. 530.4 million) last year. Deposit liability increased by 15.4 percent (Rs. 1.8 billion) to Rs. 13.5 billion compared to an increases of 19.5

percent (Rs. 1.9 billion) in the previous year. FCs borrowed fund from commercial banks only. Their aggregate borrowing increased by 13.9 percent (Rs. 29.8 million) to Rs.244.8 million in the review period compared to an increase of 22.2 percent (Rs. 39.1 million) in the previous year. Other liabilities also increased by 9.6 percent (Rs. 160.4 million) to Rs. 1.8 billion in FY 2001/02 compared to an increase of 19.6 percent (Rs. 272.6 million) in the preceding year.

On the uses side, aggregate liquid assets of FCs increased significantly by 39.7 percent (Rs. 813.9 million) to Rs. 2.9 billion in the review period compared to an increase of 18.5 percent (Rs. 319.9 million) in the preceding year. Aggregate investment went up by 28.0 percent (Rs. 355.4 million) to Rs. 1.6 billion in the review year compared to an increase of 12.3 percent (Rs. 138.8 million) in the preceding year. Of the total investment of FCs 93.3 percent consisted of government securities.

Loans and advances accounted for 64.8 percent of the total sources of fund of FCs. During the review period, loans and advances of FCs recorded a growth of 10.0 percent (Rs. 1.1 billion) to Rs. 12.0 billion compared to an increase of 19.9 percent (Rs. 1.8 billion) in the previous year. Of the total loans and advances, 44.3 percent (Rs. 5.3 billion) accounted for term loan, 26.3 percent (Rs. 3.1 billion) for housing, 20.4 percent (Rs. 2.4 billion) for hire purchases, 3.0 percent (Rs. 363.6 million) for leasing and the remaining 6.0 percent (Rs. 713.1 million) for other purposes. Other assets of FCs increased by 24.9 percent (Rs. 401.9 million) to Rs. 2.02 billion during the review year compared to an increase of 43.1 percent (Rs. 486.3 million) in the preceding year.

FINCOOPs

Cooperative societies are non-profit making organizations established for the mutual benefit of the members. They are registered under the Cooperative Act, 1992 at the respective District Cooperative Offices under the Department of Cooperatives, Ministry of Agriculture and Cooperative, and are allowed to accept deposits from and advance loans to members only. They are authorized to carry on limited banking transactions among their members with prior approval of NRB. Cooperatives dealing with deposits and credits are called FINCOOPs. Subsequent to the adoption of financial liberalization in the country the number of FINCOOPs has increased considerably. Total number of FINCOOPs under operation remained 34 in the FY 2001/02.

Sources and Uses of Fund of FINCOOPs

The aggregate source of fund of cooperative societies (with limited banking transaction) revealed a growth of 12.8 percent (Rs. 260.7 million) to Rs. 2.3 billion during FY 2001/02 compared to an increase of 39.3 percent (Rs. 573.6 million) in the previous fiscal year. Capital fund of these cooperatives witnessed a growth of 19.0 percent (Rs. 40.1 million) to Rs. 251.7 million and deposits increased by 10.2 percent (Rs. 145.5 million) to Rs. 1.6 billion during the review year. Of the total deposits outstanding as at mid-July 2002, saving deposit and fixed deposit constituted 46.5 percent (Rs. 730.3 million) and 44.4 percent (Rs. 697.2 million) respectively. Aggregate borrowing of these institutions declined by 12.1 percent (Rs. 8.1 million) to Rs. 58.7 million during the review year. The outstanding balance of borrowing is composed of the borrowings from NRB (0.7 percent), commercial banks (96.1 percent) and RDB & FCs (3.2 percent). The other liabilities of these cooperative societies increased by 25.2 percent (Rs. 83.2 million) to Rs. 413.5 million in the review year.

On the uses side, the aggregate liquid fund and investment of these societies went up by 26.6 percent (Rs. 94.1 million) to Rs. 448.5 million and 4.5 percent (Rs. 8.2 million) to Rs. 188.8 million respectively. Of the total investment outstanding as at mid-July 2002, Government Securities accounted for 29.9 percent (Rs. 56.5 million), NRB bond/fixed deposits accounted for 13.9 percent (Rs. 26.2 million) and other investment accounted for 56.2 percent (Rs. 106.1 million). Similarly, loans and advances of these societies increased by 7.6 percent (Rs. 92.3 million) to Rs. 1.31 billion as at mid-July 2002 compared to an increase of 39.5 percent (Rs. 346.1 million) in the previous year. Of the total loans and advances, 50.2 percent (Rs. 659.7 million) went for commercial purposes, 10.8 percent (Rs. 142.1 million) for production purposes, 4.0 percent (Rs. 52.0 million) for consumption purposes and the remaining 35.0 percent (Rs. 459.7 million) for other purposes. The other assets of these societies also increased by 23.8 percent (Rs. 66.1 million) to Rs. 343.8 million in the review year.

FINGOs

NGOs are non-profit making social institutions. NGOs involved in mobilizing financial resources with the prior approval of NRB are called FINGOs. They are also called financial intermediaries. Because of higher operating cost, commercial bank branches in rural areas are either closed down or merged with one another, FINCOOPs and FINGOs could become much popular in rural micro financing. These institutions borrow funds from and function as financial intermediary agencies of commercial banks. The number of FINGOs reached 25 as at mid-July, 2002.

Sources and Uses of Fund of FINGOs

Membership fees, grants, accumulated profits and borrowings are the major sources of fund of FINGOs. The aggregate sources of fund of FINGOs increased significantly by more than 2.5 times (Rs. 39.9 million) to Rs. 55.4 million in the FY 2001/02 compared to that in the previous year. Of the total sources, 7.1 percent (Rs. 3.9 million) constituted capital fund, 6.0 percent (Rs. 3.3 million) staff welfare fund, 1.4 percent (Rs. 789.0 thousand) risk bearing fund, 10.4 percent (Rs. 5.8 million) accumulated profit, 47.1 percent (Rs. 26.1 million) borrowings from domestic and foreign institutions and 28.0 percent (Rs. 15.5 million) constituted other sources.

FINGOs maintained 22.8 percent (Rs. 12.6 million) of their total sources in liquid fund as cash in hand and balances with domestic banks. A major share of

55.4 percent (Rs. 30.7 million) of the total sources of fund of FINGOs was utilized in micro financing and the remaining 21.8 percent (Rs. 12.1 million) in other loans. Micro financing activities of these institutions increased heavily by almost 3 folds (Rs. 22.8 million) to Rs. 30.7 million compared to that of last year.

PSBs

At mid-July 2002, total number of PSBs remained 116 throughout the 75 districts of the country. During FY 2001/02, deposit collection of PSBs went up by 13.6 percent (Rs. 1.9 million) to Rs. 16.2 million. Outstanding balance of deposit increased by 13.0 percent (Rs. 1.2 million) to Rs. 10.8 million. During the review period, while the number of PSBs remained the same as that in the previous year, the number of accounts reduced from 6000 to 5000. Because of the increase in the minimum balance to be maintained in savings account from Rs10.00 to Rs 100.00 many PSB accounts were further closed down during the review year.

Non-Bank Financial Institutions

Insurance Companies

Altogether 18 insurance companies including DICGC, are in operation in Nepal. They issue life, fire and marine policies against various types of risks and collect a large amount of fund in the form of premium, which is mobilized through the financial system. The aggregate premium collected by insurance companies during FY 2001/02 was estimated to have increased by 29.6 percent (Rs. 637.2 million) to Rs. 2.8 billion compared to an increase of 20.0 percent (Rs. 359.7 million) in the previous year. Of the total premium collected during the review year, 66.9 percent (Rs. 1.9 billion) constituted premium from non-life business and the remaining 33.1 percent (Rs. 925.0 million) was from life business. In addition, insurance companies earned an income of Rs. 784.0 million during the review year by investing their fund in HMG securities, shares and fixed deposits.

Sources and Uses of Fund of Insurance Companies

Aggregate sources of fund of insurance companies increased by 24.0 percent (Rs. 2.4 billion) to Rs. 12.2 billion in the FY 2001/02 compared to an increase of 21.0 percent (Rs. 1.7 billion) in the preceding year. Of the total source, 72.1 percent (Rs. 8.8 billion) constituted fund from life business and the remaining 27.9 percent (Rs. 3.40 billion) was from non-life business. Insurance fund as the major source of fund of insurance companies occupied 49.3 percent (Rs. 6.0 billion) share in the total sources. Other sources included paid up capital 8.6 percent (Rs. 1.1 billion), reserve fund 6.3 percent (Rs. 764.5 million) and other liabilities 35.8 percent (Rs. 4.4 billion).

On the uses side, investment occupied the highest rank with 80.4 percent (Rs. 9.8 billion) share in total uses. In the category under other uses cash and bank balances occupied 5.0 percent (Rs. 612.1 million), fixed assets 2.5 percent (Rs.304.5 million) and other assets 12.1 percent (Rs. 1.5 billion).

DICGC

Credit Guarantee Corporation was established in 1974 as a private limited company under the Company Act 1964. The main objective, among others, of the Corporation is to guarantee compensation on loss incurred by banks and financial institutions on their lending under the priority sectors viz., agriculture, industry and services. The Corporation envisages a plan to implement deposit insurance scheme and the formation of the relevant law is in the process. The main sources of income of the corporation are guarantee fee, interest on fixed deposits and return on government securities investment.

The amount of credit guaranteed by DICGC to the priority sector loans extended by commercial banks decreased by 13.0 percent (Rs. 518.9 million) during FY 2001/02 and stood at Rs. 3.5 billion as at mid-July, 2002. Of the total credit guaranteed by DICGC, RBB accounted for the highest share of 52.7 percent followed by NBL 23.0 percent, Nepal Investment Bank Ltd 5.5 percent, Nepal Arab Bank Ltd 4.9 percent, Bank of Kathmandu 4.8 percent, Himalayan Bank Ltd. 4.6 percent, and Lumbini Bank Ltd. 4.5 percent.

Purpose-wise, of the total credit guaranteed, services sector accounted for the highest share of 38.6 percent, followed by agricultural sector 33.0 percent and industrial sector 28.4 percent. Region-wise, of the total credit guaranteed, 55.5 percent share went to the Central Development Region, 18.9 percent to the Eastern Development Region, 14.0 percent to the Western Development Region, 6.0 percent to the Mid-Western Development Region and the remaining 5.6 percent to the Far-Western Development Region.

EPF

EPF is an autonomous body incorporated under the Employees Provident Fund Act, 1962 merging the earlier Army Provident Fund and Civil Servants Provident Fund. It mobilizes savings collected through compulsory provident fund contributions on the part of employers and employees, among others, in civil, army and police services. During FY 2001/02, total loan disbursement of the EPF surged up by 43.2 percent (Rs. 1.1 billion) to Rs. 3.6 billion compared to an increase of 52.9 percent (Rs. 873.6 million) in the preceding year. The total loan realization of EPF went down by 3.7 percent (Rs. 21.5 million) to Rs. 564.4 million this year against an increase of 99.7 percent (Rs. 292.5 million) in the previous year. During the review year, outstanding loan of EPF increased by 46.8 percent (Rs. 3.05 billion) to Rs. 9.57 billion compared to an increase of 42.3 percent (Rs. 1.94 billion) in the previous year.

Sources and Uses of Fund of EPF

Total sources of fund of EPF recorded a growth of 15.0 percent (Rs. 3.92 billion) during the review year and stood at Rs. 30.1 billion at mid-July, 2002 compared to an increase of 18.5 percent (Rs. 4.1 billion) in the previous year. During the review year, provident fund collected from the employees went up by

15.3 percent (Rs. 3.6 billion) to Rs. 27.4 billion compared to an increase of 18.4 percent (Rs. 3.7 billion) in the previous year. Similarly, reserves and other liabilities of EPF increased by 12.5 percent (Rs. 258.0 million) to Rs. 2.3 billion and 6.0 percent (Rs. 26.0 million) to Rs. 460 million respectively.

On the uses side, total loan increased significantly by 45.4 percent (Rs. 3.1 billion) to Rs. 9.8 billion in the review year compared to an increase of 47.5 percent (Rs. 2.2 million) in the preceding year. Of the total outstanding loan, the share of employees and institutions accounted for 63.1 percent (Rs. 6.2 billion) and 36.9 percent (Rs. 3.6 billion) respectively. Similarly, total investment of EPF increased by 3.7 percent (Rs. 671.0 million) to Rs. 18.6 billion in the review year compared to an increase of 9.6 percent (Rs.1.6 billion) in the previous year. Of the total investment of EPF outstanding as at mid-July, 2002 fixed deposits accounted for 80.0 percent (Rs. 14.9 billion), HMG securities accounted for 18.5 percent (Rs. 3.4 billion) and shares accounted for 1.5 percent (Rs. 274.0 million). During the review year, the cash and bank balances went up by 44.1 percent (Rs. 206.0 million) to Rs. 673.0 million compared to a significant increase of 111.3 percent (Rs. 246.0 million) last year. Fixed assets increased by 27.0 percent (Rs. 75.0 million) to Rs. 353.0 million and the other assets of EPF declined by 11.5 percent (Rs. 89.0 million) to Rs. 684 million in the review year.

CIT

CIT was established under the Citizen Investment Trust Act, 1991. The CIT accepts deposits through voluntary contributions of employees at 10 percent of the salary. It makes investment in government securities, company's shares and in the form of fixed deposit in banks and financial institutions to the benefit of the contributors. It also advances term loans to firm and institutions against adequate securities.

Sources and Uses of Fund of CIT

Total sources of fund of CIT increased by 37.5 percent (Rs. 426.1 million) to Rs. 1.6 billion during FY 2001/02 compared to an increase of 67.9 percent (Rs. 459.4 million) in the preceding year. The major sources of fund of CIT are paid up capital, reserve fund, fund from voluntary contributions and other liabilities. Fund from employees' voluntary contributions alone constituted 87.1 percent (Rs. 1.4 billion) of the total sources. Paid up capital accounted for 2.0 percent (Rs.31.2 million), reserve fund 1.2 percent (Rs. 18.7 million) and other liabilities 9.7 percent (Rs. 151.8 million) in the review year.

The CIT used 73.2 percent (Rs. 1.1 billion) of the total sources in making investment in government securities, fixed deposits, shares and debentures. Other uses consisted of cash and bank balances 4.8 percent (Rs. 75.6 million), loans and advances 20.6 percent (Rs. 322.0 million), fixed assets 0.2 percent (Rs. 2.2 million) and other assets 1.2 percent (Rs. 18.6 million).

Financial Sector Reforms and Regulations

Achieving the financial sector stability and maintaining a secure, healthy and efficient domestic payment system are the important functions enshrined in the new NRB Act, 2002. In pursuance of these functions, efforts are being initiated to widen, deepen and make the financial system resilient to shocks over time. In this process, a number of financial sector reform measures, regulatory measures including the licensing policy, prudential norms and actions against those not complying with the prudential norms initiated in FY 2001/02 are discussed below.

Reform Measures

Nepal began to introduce financial sector reforms as part of overall economic liberalization process in the second half of the 1980s. Since then, significant achievements have been made in the financial sector and appropriate reform measures are still being undertaken. Some of the major reform measures undertaken in FY 2001/02 are highlighted below.

Management Contract of RBB and Nepal Bank Limited (NBL)

As a first step in resolving the problems of the two largest commercial banks, RBB and NBL, it was necessary to undertake structural reforms by recruiting two international management teams. Deloitte Touche Tomatsu of the United States was initially selected for the management contract of RBB and an agreement was signed accordingly. However, this firm did not abide by the rules of the contract and declined to function. Consequently, an alternative to this firm was being worked out. With regard to NBL, a contract (agreement) was at the final stages of being signed with M/s ICC Consulting, Bank of Scotland (Ireland) Ltd.

Inspection and Supervision Manual

To upgrade the NRB's inspection and supervision capability, Ms. Fredricka P. Santos, on Inspection and Supervision Manual was prepared. In order to generate better understanding and build up capacity among the supervisors, 112 officers in five phases were imparted training on on-site/off-site inspection. Moreover, the supervisors undertook an on-site visit of some banks and financial institutions for supervision and inspection.

Establishment of AMC

An interaction programme was held relating to the outcome of a study on the establishment of the AMC. This was participated in by Chief Executive Officers (CEOs) of commercial banks and financial institutions, lawyers, economists and intellectuals of the country. His Majesty's Government of Nepal (HMG/N), in principle, agreed to the establishment of the AMC that would assist in remedying the problem of non-performing assets of the financial sector. Measures relating to the management of the required capital and the legal framework were underway.

Prudential Regulations

In the aftermath of the liberalization of the financial sector, the number of banking and non-banking financial institutions with different modes of operations has increased. This has made the task of ensuring adequate monitoring and control a challenging one for the NRB. As the prudential norms adopted help ensure a more smoother functioning of the overall financial system, the NRB has been developing these norms from time to time and has directed the commercial banks to comply with them. Hence, with effect from July 16, 2001, the NRB issued some directives, both revised and new, in order to assist commercial banks in maintaining a sound and healthy financial position. Of these 10 directives, 7 were released in the latter half of the previous year and hence were discussed in the *Economic Report* of the previous year. The remaining three directives issued were as follows:

Provision Relating to Investment in Share and Securities: According to this provision, banks may invest in shares and securities of any one corporation not exceeding 10 percent of the paid up capital of such institution. Similarly, the amount of investment in shares and securities of any one corporation in which the bank hold financial interest shall be limited to 10 percent of the paid up capital of such company and the cumulative amount of such investment in all the companies in which the bank hold financial interest shall be limited to 20 percent of the paid up capital of the bank. For investment in shares and securities like this, the total amount of investment shall be restricted to 30 percent of the paid up capital of the bank. This provision was introduced with a view to reducing the financial power in the hands of a few people and thus helps promote competition in the financial sector.

With respect to the above provision, banks can only invest in the shares and securities of corporations that are already listed in the stock exchange or where arrangement exists for listing within one year. Banks cannot invest in any shares, securities and hybrid capital instruments issued by any banks and financial institutions licensed by the NRB. This provision has primarily been created to safeguard the overall financial system from the chain effect of loss or insolvency and to allow the banking and financial institutions to diversify risks and operate in a competitive manner.

Provision Relating to Submission of Data to NRB*:* This provision has been undertaken as statistics of commercial banks play instrumental role for evaluating and analyzing the country's economic, monetary and financial activities. Moreover, an essential element of improving the quality and effectiveness of market discipline for financial institutions is ensuring the accuracy and availability of information on the operations of these institutions. Hence, it is mandatory for commercial banks to submit their statistics to the NRB within the stipulated time period. Such statistical data need to be submitted only after incorporating them on the basis as required in the NRB Act, 2002 and Commercial Bank Act, 1974. Furthermore, the data should also be incorporated in line with the directives issued by the NRB relating to account and other measures and the guidelines provided by the *Monetary and Financial Statistics Manual (MFSM) 2000* prepared by the IMF.

Provision Relating to Transfer or Sale of Shares of the Bank's Promoters: This provision is made to secure the long-term interest of the bank by checking the tendency of the promoters to take undue advantages in the short run and disregarding the interest of banks. According to this provision, the transfer or sale of the shares of the promoter can take place only after the prior approval from the NRB. As far as possible, such shares shall be transferred or sold to the promoter within the same group. Only in circumstances where such transfer or sale of shares to the promoter within the same group is not possible, the shares may be transferred or sold to individual or institution of another promoter group. The promoters are not permitted to transfer or sell their shares to the individual or institution under the following conditions:

(i) one who is included in the blacklist of Credit Information Bureau (CIB), and the removal from such list has not yet completed a minimum period of five years;

(ii) one who is appointed as an internal or external auditor, legal or other advisor, or partner in any kind of contract entered into with the concerned bank;

(iii) one who has not cleared the tax as per the prevailing law;

(iv) one who is convicted by court of law for committing fraud with any bank;

(v) one who is a stock broker or market maker;

(vi) one who has received loan from the bank and possessed shares of less than 1 percent of the bank's issued capital which, with the transfer or purchase of additional shares, results in increasing the share holding of more than one percent of the issued capital of the bank, has not repaid the total outstanding loan amount;

(vii) one who holds less than ten percent of the bank's issued share capital and with the transfer or purchase of additional shares, results in increasing the share holding of more than ten percent of the issued capital of the bank;

(viii) one who does not have minimum qualification and experience stipulated by the NRB for becoming the promoter of a bank; and

(ix) individuals or institutions who have obtained loan from the bank against which the concerned bank, because of default, has published public notice for repayment of loan and the loans are not paid.

New Licensing Policy for Commercial Banks: Until the mid-1980s, Nepal's financial sector was dominated by the two large government-owned commercial banks (RBB and NBL), and competition in the financial system was enhanced only after the entry of three joint-venture banks (Nepal-Arab Bank, Nepal-Indosuez

Bank, and Nepal-Grindlays Bank). As of mid-July 2002, 16 commercial banks existed in the country.

While framing its licensing policy, the NRB has given emphasis or policy issues rather than administrative control measures and has granted operating licenses to commercial banks that fulfill its policy criteria. A study undertaken in 1995 by the NRB, for instance, suggested that as there was growing concentration of commercial banks inside the Kathmandu Valley, incentives in the form of lower paid-up capital should be provided to those banks that set up their head offices outside the Kathmandu valley. The NRB has been emphasizing on such types of policy-oriented issues in the licensing of commercial banks with the primary objective of promoting efficient intermediation by financial institutions through increased competition. In this regard, a new licensing policy for opening a commercial bank was made effective from May 15, 2002. The main features of the policy are given below.

Paid-up Capital

(i) New commercial banks set up at the national level are required to have a minimum paid up capital of Rs. 1.0 billion.

(ii) Permission would be granted to set up a national level commercial bank with the head office in Kathmandu provided that it was a joint venture with foreign bank or foreign financial institution or it had a technical service agreement (TSA) with such a bank or financial institution for at least three years.

(iii) Generally, the promoters of the commercial banks could possess 70 percent of the total share capital and 30 percent was required to be sold to the several public. Foreign banks could invest a maximum of 67 percent of the total share of the commercial bank of the national level. Also, if the foreign bank agreed to acquire at least 50 percent of the total share capital of the commercial bank of the national level, then 20 percent of the total share was required to be sold to the general public. This scheme was aimed at granting an opportunity to Nepalese promoters to invest at an optimum level.

(iv) The banks under operation and the banks already possessing operating licenses were required to extend their paid up capital to Rs. 1.0 billion by mid-July 2009. The paid-up capital should be increased by 10 percent every year upto FY 2008/09. The banks to set up with participation of the foreign banks would be registered by fulfilling the legal formalities as per the Nepalese law.

(v) The commercial bank with their offices other than in the Kathmandu Valley should have the paid-up capital of Rs. 250 million. The promoters of such banks could hold 70 percent of the total share and the remaining 30 percent was required to be sold to the general public.

(vi) The banks established outside the Kathmandu valley would be permitted to operate in the Kathmandu valley and all over the Kingdom provided that they performed satisfactorily for at least three years, subsequently extended its paid-up capital to Rs. 1 billion, and complied with all the other prescribed terms and conditions. These banks will not be permitted to open any type of office in the Kathmandu valley unless they are allowed to function there.

(vii) A minimum of 20 percent of the total share capital committed by the promoters need to be deposited with the application and another 30 percent after receiving the letter of intent at the interest-free account of the NRB. The bank should start operations within a year of receiving the letter of intent. The remaining amount agreed upon by the promoters would be paid before the bank comes into operation. Generally, the NRB would decide within four months of the date of application whether to grant permission to set up the bank or not. If the decision is taken not to allow the establishment of the bank, the NRB would present a written clarification to the applicant specifying the reasons.

Promoters' Qualification

(i) The NRB would not proceed with further actions of the application if any of the promoters was legally charged in the past for not being able to repay the debt to the bank or finance company and his collateral was processed for auction, if he was recorded in the blacklist of CIB, and if the time period of five years had not elapsed since the removal of his name from the black list of CIB. The application would be immediately cancelled if such evidence was provided irrespective of the stage of its processing.

(ii) One third of the total promoters should have taken either economics as a major subject or taken accounts, finance, law, banking or statistics at the graduate level or a degree in chartered accountancy from Tribhuvan University (TU) or any university recognized by TU and at least 25 percent of the promoters should possess working experience in a bank or financial institution or similar professional experience.

(iii) The promoters of a bank or finance company shall not be promoters of another bank or finance company that has been granted license by the NRB.

(iv) Stockbrokers, market makers, and persons or institutions involved in auditing the accounts of the bank cannot be the directors of the bank or finance company.

Sale of Promoters' Shares

(i) The transfer or sale of the shares of the promoters group could take place only after three years of operations of the bank and notifying the Stock Exchange of the distribution of shares to the general public for sale. However, prior permission was required from the NRB to sell such shares.

(ii) The shares allocated for the general public shall be offered initially within three years from the date of operations of the bank. If this was not done, it was neither possible to give bonus share nor announce and distribute dividends.

(iii) The shareholders of the promoters' group and the members of the family of the promoters shall not get any loans or advances from the same organization. For this purpose, the family member implies a husband, wife, son, daughter, adopted son, adopted daughter, father, mother, stepmother and dependent brothers and sisters of the promoters.

Branch Expansion Policy

The bank with its head office in the Kathmandu valley would be permitted to open one main branch office in the Kathmandu valley and only after opening two branches outside Kathmandu it would then be permitted to open another branch in the Kathmandu valley.

License to Two Commercial Banks

Permission was given as per the decision made on August 25, 2001 to the proposed Siddharta Bank Limited, with authorized capital of Rs. 1 billion and issued and paid-up capital of Rs. 500 million, to open its head office in Kathmandu Metropolitan City and undertake transactions throughout the kingdom. Permission was also granted to the proposed Laxmi Bank Limited, with a share capital of Rs. 240 million, and issued and paid-up capital of Rs. 120 million to set up its head office in Birganj Sub-Metropolitan City and undertake transactions throughout the kingdom except the Kathmandu Valley. Laxmi Bank Limited was given license effective from March 21, 2002 to undertake banking operations.

Banking Inspections and Supervision

The NRB is both a regulator and supervisor responsible for safeguarding the soundness of banks and encouraging competition among them. To make the banking inspection and supervision more efficient and to mitigate the inefficiencies of the banking system, the following measures were undertaken by the NRB during FY 2001/02.

On-Site Inspection

As per this fiscal year's work plan to inspect 15 branches each of RBB and NBL, and 7 joint venture and private banks, inspection and supervision on a branchwise basis was undertaken of 11 branches each of RBB and NBL. Similarly, general inspection and supervision of a total number of 5 banks including 2 joint-venture banks (Himalayan Bank Limited and Standard Chartered Bank Nepal Limited) and 3 private sector banks (Machapuchhre Bank Limited, Lumbini Bank Limited and Kumari Bank Limited) were completed. Likewise, special inspection works were undertaken in 8 different commercial banks and an extraordinary inspection of ADB/N, Ramshahpath was jointly undertaken by the Bank Inspection and Supervision Department and Non-Bank Inspection and Supervision Department.

Off-site Supervision

Based on the financial details/reports of FY 2000/01, actions have been undertaken against the following banks.

(i) *Nepal Bank of Ceylon Limited*: Certain clarifications were sought by the NRB from this bank. Firstly, the NRB's directive was not followed as the bank had a capital of Rs. 249.8 million instead of Rs. 500 million as of mid-July 2001. Hence, the Bank was directed to submit a work plan in order to maintain the minimum capital requirement. Second, based on the credit provided to different lenders and loan loss provisioning for such credit, there was a shortfall of Rs. 169.9 million. The bank was thus required to arrange such loan loss provisioning before the end of FY 2001/02. Third, after adjusting the above shortfall of loan-loss provisioning, a net loss of Rs. 151.5 million was recorded during FY 2000/01. Thus, the bank was directed to write back the provision of staff bonus for that purpose. Finally, as the bank was not able to maintain the compulsory cash reserve, a fine of Rs. 26,785 was imposed.

(ii) *Nabil Bank Limited* : After assessing the details of loan classification, the bank was directed to provide an additional amount of Rs. 196

million for loan loss provisioning as some loans had to be classified at a lower category.

(iii) *Standard Chartered Bank Nepal Limited* : Due to fraud signature, cash shortage, fraud notes, etc. the bank bore a loss of Rs. 626,000; thus, the bank was directed to make its internal control more strict and take action against the concerned staff and recover the loss. The bank was also penalized Rs. 200 as it did not maintain the required compulsory cash reserve.

(iv) *Nepal Industrial and Commercial Bank Limited*: The NRB instructed this bank to furnish some details to rectify its shortcomings. One, a clarification was demanded as per the initial report relating to the expense of Rs. 127, 968 by the auditor and no response from the Board of Directors. Two, since the bank could not fulfill the directive of maintaining a minimum capital of Rs. 500 million it was restricted from announcing or distributing any kind of dividend or bonus share and directed to submit a work plan relating to the maintenance of minimum capital. And three, the bank was penalized Rs. 806,635 for the shortfall in the required deprived sector lending.

(v) *Nepal Investment Bank Limited*: Because the bank could not maintain a minimum capital of Rs. 500 million, it was directed not to announce any kind of dividend or bonus until then. Moreover, as the loans of the borrowers in the black list were not found to be classified as bad loans, a directive was given to the bank to classify these loans under the bad loan category from the next fiscal year as per new directive issued to commercial banks and to allocate a fund for 100 percent loan loss provisioning.

(vi) *Nepal Bangladesh Bank Limited* : Some clarifications were sought from this bank for not fulfilling some of the norms of the NRB. One, the bank was demanded to submit the details of the components of the fiscal year's income since it had showed an income though it had not received last quarterly interest income of a fiscal year by mid-October of another year despite being notified. A clear and concrete response was also demanded from the Board. Two, after assessing the bank's loan classification and loan loss provisioning, a shortfall equivalent to Rs. 25.4 million, additional loan loss provisioning was needed. The bank was directed to properly submit the details to the NRB after getting it certified by the auditor that this or more than this amount had been maintained as retained earnings. The bank was also directed to distribute dividend or bonus share only after receiving the permission from the NRB. Three, as the bank was not able to maintain compulsory cash reserve, it was penalized Rs. 74,063 for a total number of three times.

(vii) *Kumari Bank Limited*: As the bank was not able to provide bills/vouchers relating to the previous board expenses of Rs. 15 million, the process has been moving forward after questioning the directors. The bank was also penalized Rs. 25,099 for not being able to maintain the compulsory cash reserve.

(viii) *Machapuchhre Bank Limited*: Since the Chairman of the Board of Directors was placed in the black list, the bank was directed to dismiss him from his post as he was no longer qualified to hold such post as per the Commercial Bank Act 1974, Clause 8 (3).

(ix) *Lumbini Bank Limited* : The bank was imposed a fine of Rs. 375,634 for a total number of five times because it was not able to maintain the compulsory cash reserve.

(x) *Everest Bank Limited*: A penalty of Rs. 1,396, 899 was imposed since there was a shortfall in priority sector and deprived sector lending.

(xi) *Himalayan Bank Limited*: As the compulsory cash reserve was not maintained, a penalty of Rs. 99,880 was imposed. Moreover, the bank was penalized Rs. 3,385,563 as there was a shortfall in priority sector and deprived sector lending.

Dismissal of the Board of NBL and Lumbini Bank Limited

Effective March 14, 2002, the Board of Directors of NBL was dismissed as per the NRB Act, 2002, Clause 86, sub-clause (1) and a necessary arrangement was made. This was because the Board of Directors violated the directives of the NRB quite often and worked against the interest of the depositors. Moreover, the operations of the bank were not satisfactory, and the bank was not able to fulfill its commitments.

Similarly, Lumbini Bank Limited also violated the directives of the NRB, worked against the interest of the depositors, did not operate satisfactorily, and it seemed as if the bank was not able to fulfill its commitments. Thus, taking into consideration the interest of the investors and depositors, as per the NRB Act, 2002, Clause 86, sub-clause (1) the Bank's Board was dismissed effective March 20, 2002, and a necessary arrangement was made.

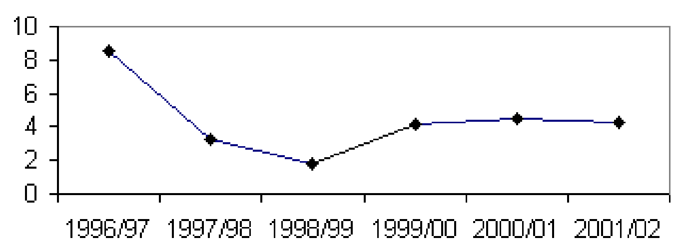
Financial Markets

Financial markets were quite stable during the review year. The liquidity position was quite comfortable and foreign exchange position was also stable during the review year.

Interbank Transaction

The commercial banks had an excess liquidity position throughout the review year, except for January when there was a deficit. The commercial banks utilized their excess liquidity in the interbank transaction market. The interbank transaction was Rs. 3.2 billion in the beginning of the FY 2001/02, touched its highest level amounting to Rs. 6.6 billion in mid-June 2002, but eventually declined to Rs. 945 million at the end of the fiscal year. As per the fluctuations in liquidity position, there were also fluctuations in the interbank transaction rate. The average annual interbank transaction rate was 4.2 percent at the end of the review year compared to 4.50 percent a year earlier. During the review year, the maximum interbank transaction rate was recorded at 6.3 percent in February, following the deficit in liquidity in January.

Graph 29: Weighted Interbank Rate



Foreign Exchange Intervention

During FY 2001/02, the NRB intervened in the foreign exchange market 17 times- purchase of 9 times amounting to Rs. 8.3 billion and sale of 8 times amounting to Rs. 7.8 billion. As a result, Rs. 0.50 billion liquidity was injected into the economy during the review year.

Foreign Exchange Reserve and Exchange Rate

The foreign exchange reserve position remained at a comfortable level during FY 2001/02. There was no significant fluctuation in such reserves during the review year as it aggregated Rs. 107.0 billion at the end of FY 2001/02 compared to Rs. 106.2 billion at the end of FY 2000/01.

Government Securities Transactions

Of the different government securities instruments, its weighted average rate treasury bill of 4.7 percent at the end of FY 2001/02. The weighted average treasury bill rate for the previous year was 5.0 percent. During the review year, treasury bill rate reached its maximum level of 5.4 percent in March, owing to the liquidity crisis in January and the subsequent low level in February.

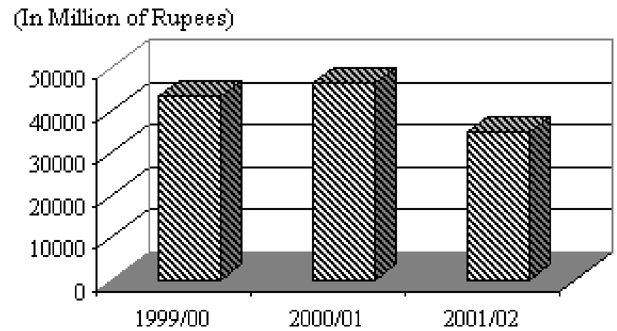
During the review year, the government mobilized Rs. 5.4 billion by issuing various bonds of different maturity periods and interest rates. Likewise, national saving certificates amounting to Rs. 499.8 million was also mobilized during FY 2001/02.

In the secondary market, the liquidity amounting to Rs. 27.5 billion in cumulative terms was mopped up during FY 2001/02. The repo transaction stood at Rs. 46.2 billion in cumulative terms in the review year compared to Rs. 53.2 billion in the previous year.

Stock Market

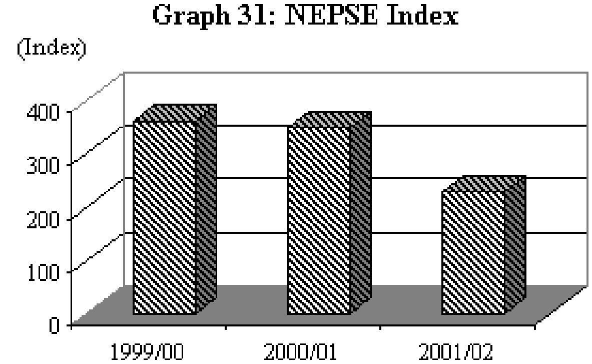
The number of companies listed in the Nepal Stock Exchange Ltd. decreased from 115 to 96 during FY 2001/02 because of the delisting of 25 companies. The NEPSE Index slipped down from 348.4 at mid-July 2001 to 227.5 at mid-July 2002. Market capitalization as well as turnover fell significantly during the review year. However, the paid up value of the listed shares increased by 9.3 percent (Rs. 741.2 million) to Rs. 8.7 billion during FY 2001/02 compared to an increase of 8.1 percent (Rs. 591.6 million) in the preceding fiscal year.

Graph 30: Market Capitalization



The average monthly turnover declined by 34.1 percent (Rs. 66.3 million) to Rs. 128.4 million in FY 2001/02 against an increase of 101.9 percent (Rs. 98.2 million) in the previous year. An average daily share turnover of Rs. 6.3 million was observed during the review year compared to an average daily turnover of Rs. 9.7 million in the previous year. Meanwhile, the volume of shares traded in the stock market went down significantly by 34.0 percent (Rs. 795.3 million) to Rs. 1.54 billion during the review year. The share prices showed a downward trend during the review year resulting in the fall of the share price index from 348.4 at mid-July 2001 to 227.5 at mid-July 2002. The market turnover during the review year fell significantly because of the uncertain business environment due to the deteriorating law and order situation of the country.

Graph 31: NEPSE Index



The Market capitalization of listed shares, which stood at Rs. 46.4 billion at mid-July 2001, slide down by 25.1 percent (Rs. 11.7 billion) to Rs. 34.7 billion at mid-July 2002. The Market Capitalization/GDP, Total Turnover/Paid up Value of listed shares and Total Turnover/Market Capitalization ratios remained at 8.1 percent, 17.7 percent and 4.4 percent respectively.

Microfinance Institutions and Refinances

Over the years, a number of micro-credit programmes and projects aimed at alleviating poverty and generating gainful employment opportunities are being launched and implemented. The progress of some of the micro-credit programmes during FY 2001/02 is briefly reviewed below.

Production Credit for Rural Women

This project was undertaken with the goal of uplifting the socio-economic conditions of rural women. Based on the Loan Agreement between HMG/N and IFAD, the total loan amounting to Rs. 234.6 million was obtained from time to time and disbursed to the participating banks, such as NBL, RBB and ADB/N. As of mid-July 2002, the disbursed loan amounting to Rs. 187.6 million was yet to be recovered from the participating banks. In line with the auxiliary loan agreement between HMG and the NRB as of mid-July 2002, the NRB paid the principal and the interest amounting to Rs. 47.0 million and Rs. 28.1 million, respectively, to HMG/N.

Micro-Credit Project For Women

This project came into operations with the signing of the loan agreement between HMG/N and the ADB/N on September 16, 1993. Under this project, women of rural and urban areas were provided loans to smoothly operate their agricultural and small enterprise businesses. As of mid-July 2000, this programme was underway in 10 municipalities of 15 districts. As per the agreement with the project by the participating 42 branches (16 from RBB and 26 from NBL), from 1994/95 to 1999/00, loan amounting to Rs. 195.2 million was disbursed. The NRB had paid Rs. 17.3 million as interest to HMG/N as of mid-July 2002.

The Third Livestock Development Project

The primary objective of this project was to raise livestock productivity and consequently raise the living standard of the people involved in this business. Under the loan assistance of the ADB/N, the area under operations of this project included Syangja, Rupandehi, Palpa, Kaski, Tanahu, Lamjung, Nawalparasi, Kapilvastu, Parbat, Argakhanchi, Baglung, Gulmi, Kailali, Kanchanpur, Banke, Bardiya, Surkhet, Dadeldhura, together in Kathmandu Valley of Central Development Region, Chitwan, Dhading, Nuwakot, Sindupalchowk, and Kavre districts. As per an auxiliary loan agreement with 19 banks and financial institutions in the project area as of mid-July 2002, credit programmes were implemented and loan amounting to Rs. 90.6 million had been disbursed.

Western Terai Poverty Alleviation Project

Under the loan agreement of HMG/N and IFAD, this project had been implemented primarily with a goal of alleviating poverty in 8 districts of Western Terai. Under this project, the NRB received an equivalent amount of US$ 3.45 million from HMG/N at 3 percent rate of interest and distributed this amount to the RDBs and other replicates at 4 percent rate of interest. As of mid-July 2002, the RDBs replicates received a loan of Rs. 131.4 million. About 20,000 borrowers benefited from this project.

The Community Groundwater Irrigation Project

The 20-year long-term Agricultural Perspective Plan lays emphasis on increasing agricultural productivity to raise the income of small and marginal farmers. Along with these lines, under the loan agreement between HMG/N and ADB, this project was operated in 12 Terai districts of Eastern and Central region of the Kingdom. Out of the credit provided to the farmers for installation of shallow tube-wells and crop production, about 657,000 individuals (of which 50 percent below the poverty line) from 110,000 families were expected to benefit. NBL, Sahara Savings and Loan Cooperative Ltd., Jhapa, Eastern Rural Development Bank and Deprosc Development Bank were selected to work as participating financial institutions. In FY 2001/02, 6 'Financial Service Training' programmes and 1 programme evaluation workshop were carried out for the benefit of the officers and staff of NRB involved in this project, the participating financial institutions and other farmers from the consumer group. To implement the project in a simple and fast way within a specified time framework, a target was set for selecting additional financial institutions for the successive years.

Rural Micro-finance Project

Under the loan assistance provided by the ADB/N for the operation of rural microfinance project, a loan agreement was signed between HMG/N and the ADB/N on February 21, 1999 through which the ADB/N agreed to provide a loan of US$ 2 million to HMG. From this amount and the grant assistance provided by HMG, the RMDC aimed at providing wholesale credit to RDBs, cooperative societies, and non-government organizations that obtained permission to function as financial intermediaries and also focused on supporting their institutional development. As of mid-June 2002, the RMDC provided loans and advances amounting to Rs. 104.9 million to Nirdhan Utthan Bank Limited, Self-Help Development Centre, Western Rural Development Bank (WRDB), Mid-Western Rural Development Bank (MWRDB) together with 6 development banks and comprising a total of 17 different non-government institutions and development banks. Out of the total loans and advances, Rs. 45.1 million was recovered and Rs. 59.8 million was yet to be recovered. From this project 270,000 households were expected to benefit. Moreover, the RMDC was targeting to disburse wholesale credit amounting to Rs. 1,817.4 million during the up coming Tenth Plan.

RSRF

RSRF started its operations after receiving a total capital of Rs. 20 million during FY 1990/91 and FY 1991/92. It has, as of mid-July 2002, disbursed loans equivalent to Rs. 52.3 million through 177 cooperatives and non-government organizations of 42 districts. The Trust had recovered the loan amounting to Rs. 36.8 million and the loan outstanding was Rs. 15.5 million. About 7,595 deprived households from the rural sector benefited.

RDBs

With the primary goal of uplifting the living standards of poor women of the rural areas, as of mid-July 2002, the RDBs operating in the five development regions disbursed the loan of Rs. 6.81 billion to 163,960 rural women members and recovered Rs. 5.63 billion. These banks provided micro-credit programs to 940 VDCs of 42 districts through 4,682 centres. As the RDBs provided services to the households of the rural areas, the operating costs have been more and, except for the Western Rural Development Bank, the other four rural development banks had posted a net loss. This net loss was borne by the NRB and HMG to the amount of Rs. 112.8 million and Rs. 50.0 million, respectively, and totaling Rs. 162.8 million. The NRB and HMG/N provided Rs. 4.5 million and Rs. 1.9 million, respectively, in order to render a better retirement scheme to the staff of the Far Western Rural Development Bank. Various measures have been initiated for productivity improvement and cost reduction to make these banks self-reliant in five years' time.

Regional Rural Development Banks

With an objective of providing micro-credit services to the rural poor under group guarantee basis, RDBs, have been established in each development region of the country. By mid-July 2002, these banks disbursed, in aggregate, loans amounting to Rs. 7.0 billion to 149549 members, of which Rs. 5.8 billion was realized and Rs. 1.2 billion remained outstanding. RDBs provided services through 4682 Centers in 42 districts of the country. They collected deposits to the tune of Rs. 433.0 million, of which 92.8 percent (Rs. 401.7 million) was from group savings and the remaining 7.2 percent (Rs. 31.3 million) from personal savings.

Eastern Region Rural Development Bank (ERRDB)

ERRDB with its Head Office at Biratnagar has been operating in 8 different districts of the region. By mid-July 2002, it disbursed a total loan of 3.1 billion to 47728 borrowers. It has altogether 1363 Centers and 51697 members, comprising of 10860 groups formed within 259 VDCs. Of the total loan disbursed, Rs. 2.7 billion was realized and Rs. 414.6 million remained as outstanding as at mid-July, 2002. During this period, total saving deposits of this bank reached Rs. 132.9 million. Of the total saving deposits, 91.8 percent (Rs. 122.0 million) accounted for group savings and the remaining 8.2 percent (Rs. 10.94 million) for Personal Savings.

Central Region Rural Development Bank (CRRDB)

CRRDB with its Head Office at Janakpur has been operating in 12 different districts of the region. By mid-July 2002, it disbursed a total loan of Rs. 932.1 million to 33992 borrowers. It has altogether 1112 Centers and 35105 members, comprising of 7062 groups formed within 247 VDCs. Of the total loan disbursed, Rs. 715.9 million was realized and Rs. 216.2 million was outstanding as at mid-July, 2002. During this period, total saving deposits of the bank reached Rs. 126.7 million. Of the total saving deposits, group savings accounted for 92.2 percent (Rs. 116.8 million) accounted for and the remaining 7.8 percent (Rs. 9.9 million) was accounted for by Personal Savings.

WRRDB

WRRDB with its Head Office at Butwal has been operating in 13 different districts of the region. By mid-July 2002, it disbursed a total loan of Rs. 1.6 billion to 39604 borrowers. It has altogether 1086 Centers and 39694 members, comprising of 7791 groups formed within 262 VDCs. Of the total loan disbursed, Rs. 1.2 billion was realized and Rs. 331.0 million remained outstanding as at mid-July, 2002. During this period, total saving deposits of this bank reached Rs. 83.9 million. Of the total saving deposits, group savings accounted for 92.1 percent (Rs. 77.0 million) and the remaining 7.9 percent (Rs. 6.9 million) was accounted for by Personal Savings.

Mid Western Region Rural Development Bank (MWRRDB)

MWRRDB with its Head Office at Nepalgunj has been operating in 4 different districts of the region. By mid-July 2002, it disbursed a total loan of Rs. 703.7 million to 16281 borrowers. It has altogether 538 Centers and 18770 members, comprising of 3754 groups formed within 102 VDCs. Of the total loan disbursed, Rs. 574.3 million was realized and Rs. 129.4 million was outstanding as at mid-July, 2002. During this period, total saving deposits of this bank reached Rs. 43.0 million. Of the total saving deposits, group savings accounted for 95.1 percent (Rs. 40.9 million) and the remaining 4.9 percent (Rs. 2.1 million) was accounted for by Personal Savings.

Far-western Region Rural Development Bank (FWRRDB)

FWRRDB with its Head Office at Dhangadhi has been operating in 5 different districts of the region. By mid-July 2002, it disbursed a total loan Rs. 751.5 million to 11944 borrowers. It has altogether 583 Centers and 18694 members, comprising of 3355 groups formed within 80 VDCs. Of the total loan disbursed, Rs. 634.4 million was realized and Rs. 117.1 million was outstanding as at mid-July, 2002. During this period, total saving deposits of this bank reached Rs. 46.4 million. Of the total saving deposits, group savings accounted for 96.9 percent (Rs. 45.0 million) and the remaining 3.1 percent (Rs. 1.4 million) was accounted for by Personal Savings.

Sources and Uses of Fund of RDBs

Aggregate sources of fund of five RDBs went up by 4.0 percent (Rs. 72.9 million) to Rs. 1.91 billion during FY 2001/02 compared to an increase of 29.7 percent (Rs. 419.4 million) in the preceding year. In the review year, whereas capital fund increased by 24.7 percent (Rs. 37.1 million), deposit and borrowing went up by 20.4 percent (Rs. 57.7 million) to Rs. 341.1 million and 10.3 percent (Rs. 110.4 million) to Rs. 1.18 billion respectively. Of the total borrowing outstanding of RDBs, 96.3 percent consisted of borrowing from domestic financial institutions, 2.7 percent from NRB and the remaining 1.0 percent from other sources as at mid-July 2002.

During the review period, the liquid fund of RDBs surged up by 36.9 percent (Rs. 45.0 million) to Rs. 166.8 million and investment increased by 20.1 percent (Rs. 78.0 million) to Rs. 466.1 million. Of the total investment, fixed deposits in banks and financial institutions accounted for 78.2 percent, Government Bonds 1.6 percent and the remaining 20.2 percent accounted for by other financial assets. Loans and advances of the RDBs went up by 14.6 percent (Rs. 145.6 million) to Rs. 1.2 billion this year compared to an increase of 36.4 percent (Rs. 267.1 million) in the previous year. Of the RDBs' total loans and advances outstanding at mid-July 2002, personal loans accounted for by 13.2 percent (Rs 150.7 million), group loan 82.0 percent (Rs 939.8 million) and the remaining 4.8 percent (Rs. 55.4 million) was accounted for by other loans.

NRB Refinances to Microcredit Institutions and Development Banks

Revolving Line of Credit Facility to RDBs

Under this facility, the NRB had been providing the refinance facility to banks and financial institutions in the form of revolving line of credit facility. The WRRDB could draw a deposit not exceeding Rs. 50 million from the NRB at a time or at different times at or before the FY 1990/00. Similarly, in FY 2001/02, a revolving line of credit of Rs. 20 million and Rs. 10 million was provided to ERRDB and Far FWRRDB, respectively.

Cottage and Small Industries (CSI) Refinance

Under the loan assistance of World Bank, the CSI project was set up for facilitating the industrial development in the country. Although the project was terminated in 1992, as of mid-July 2002, the NRB still had to pay back the loan amounting to Rs. 55.6 million to HMG.

Refinance to ADB/N and NIDC

In order to support commercial farming, refinance facility was provided to ADB/N from FY 1997/98 to mid-July 2002 for the commercial production of export-oriented agricultural products such as tea, apple, raw cotton, cardamom, dried ginger, herbs, cut flowers, tissue culture, etc,. However, Rs. 246.3 million was yet to be recovered out of the total refinancing facility of Rs. 250.6 million.

NRB provided a special refinance facility of Rs. 30 million to NIDC during FY 1998/99. Out of the total refinance facility provided to NIDC, Rs. 902.3 million was due as of mid-July 2002. Besides this, out of total NRB's investment in NIDC debenture, Rs. 50 million was yet to be recovered as of FY 2001/02. Further, investment in the shares of this Corporation amounted to Rs. 47.4 million as of mid-July 2002.